Sharekhan by BNP PARIBAS

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# Vinati Organics Limited

## Recovery in ATBS and expansion to drive growth

| Speciality Chemcials | Sharekhan code: VINATIORGA | Result Update |
|---|---|---|

**3R MATRIX**

| | + | = | - |
|---|---|---|---|
| Right Sector (RS) | ✓ | | |
| Right Quality (RQ) | ✓ | | |
| Right Valuation (RV) | | ✓ | |

+ Positive = Neutral - Negative

**What has changed in 3R MATRIX**

| | Old | | New |
|---|---|---|---|
| RS | | ↔ | |
| RQ | | ↔ | |
| RV | | ↔ | |

| Reco/View | Change |
|---|---|
| Reco: **Buy** | ↔ |
| CMP: **Rs. 1,244** | |
| Price Target: **Rs. 1,550** | ↔ |

↑ Upgrade ↔ Maintain ↓ Downgrade

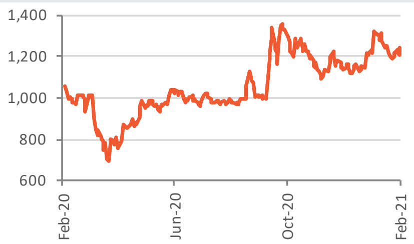
**Company details**

| | |
|---|---|
| Market cap: | Rs. 12,787 cr |
| 52-week high/low: | Rs. 1,418 / 651 |
| NSE volume: (No of shares) | 1.8 lakh |
| BSE code: | 524200 |
| NSE code: | VINATIORGA |
| Free float: (No of shares) | 2.7 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 74 |
| FII | 7 |
| DII | 4 |
| Others | 16 |

**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 2.0 | 6.0 | 27.4 | 18.2 |
| Relative to Sensex | -4.1 | -13.9 | -5.2 | 2.0 |

*Sharekhan Research, Bloomberg*


**Summary**

- Q3FY2021 results were weak with 6% miss in operating profit at Rs. 72 crore (down 13.1% y-o-y) due to higher cost (given commissioning of Butyl Phenol plant) and weak revenue mix (ATBS share at 38% versus 56% in Q3FY2020 and specialty products at 6% versus 17% in Q3FY2020).
- Management has guided for strong revenue growth of 20% each in FY2022 and FY2023 as its key ATBS segment has recovered to pre-COVID level and likely ramp-up of utilisation at Butyl Phenol plant. Thus, we expect a strong 29% PAT CAGR over FY2021E-FY2023E.
- Amalgamation of Veeral Additives Private Limited (subject to NCLT approval) seems in right direction as it provides entry into antioxidants (AO – forward integration for Vinati Organics) with incremental revenue opportunity of Rs. 300 crore.
- We like Vinati Organics' business (global market share of 65% each in IBB and ATBS), debt-free status, and solid return profile (RoE/RoCE of 23%/30%). Hence, we maintain our Buy rating on Vinati Organics with an unchanged PT of Rs. 1,550.


**Vinati Organics Limited's (Vinati Organics) Q3FY2021 operational performance was weak with 6.3%/13.1% y-o-y decline in revenue/operating profit to Rs. 223 crore/Rs. 72 crore. The decline in revenue can be is attributed to weakness in the ATBS segment, given softness in demand from the global oil industry because of low oil prices. Operating profit margin (OPM) missed our estimates by 314 bps to 32.3% (down 254 bps y-o-y; down 607 bps q-o-q) due to adverse revenue mix and higher-than-expected operating cost (staff cost up 7.7% y-o-y and other expenses up 30% y-o-y) on account of recent commissioning of Butyl Phenol plant. The revenue mix deteriorated due to the decline in the share of ATBS segment, which was at ~38% (versus 56% in Q3FY2020), lower contribution from high-margin customised products at 6% compared to 17% in Q3FY2020, and start of revenue contribution from low-margin Butyl Phenol. Consequently, operating profit was also 6% below our estimate of Rs. 77 crore. However, PAT at Rs. 64 crore (down 4% y-o-y; up 3.4% q-o-q) was 18.7% above our estimate of Rs. 54 crore due to lower effective tax rate at 9.2% (versus assumption of 25%) and higher other income, which offset the weak margin performance. Management has guided for strong 20% annual revenue growth for FY2022 and FY2023, as its key ATBS segment has recovered sharply in December 2020 and reached pre-COVID-19 level. Moreover, amalgamation of Veeral Additives Private Limited (VAPL, subject to NCLT approval) seems in right direction, as it provides entry into antioxidants (AO – forward integration for Vinati Organics) with incremental revenue opportunity of Rs. 300 crore. A potential recovery in ATBS margins and ramp-up of Butyl Phenol (peak revenue potential of Rs. 400 crore- 500 crore) would lead to a 29% PAT CAGR over FY2021E-FY2023E. We like Vinati Organics' business (global market share of 65% each in IBB and ATBS), debt-free status, and solid return profile (RoE/RoCE of 23%/30%). Hence, we maintain our Buy rating on Vinati Organics with an unchanged PT of Rs. 1,550. At the CMP, the stock trades at 33.6x its FY2022E EPS and 28.3x its FY2023E EPS.**

**Key positives**

- Gross margin remains largely stable at 55% (up 38 bps y-o-y) despite weak revenue mix.
- Management has guided for robust revenue growth of 20% each in FY2022 and FY2023.

**Key negatives**

- Sharp contraction in OPM by 254 bps y-o-y and 607 bps q-o-q to 32.3% (314 bps below our estimate) on account of higher opex.

**Our Call**

**Valuation – Maintain Buy on Vinati Organics with an unchanged PT of Rs. 1,550:** We have fine-tuned our FY2021 earnings estimate and largely maintained our FY2022-FY2023 earnings estimates, as we expect sharp earnings recovery in the ATBS segment. Vinati Organics' dominant global market share in ATBS/IBB segments, a pipeline of 12 new products in the R&D phase, and massive export opportunities in the specialty chemical sector (amid China Plus One strategy by global customers) would drive sustained long-term high double-digit earnings growth. Moreover, concerns on ATBS demand and margins are expected to recede as strong global economic recovery has led to a sharp rise in oil price. Hence, we maintain our Buy rating on Vinati Organics with an unchanged PT of Rs. 1,550. At the CMP, the stock trades at 33.6x its FY2022E EPS and 28.3x its FY2023E EPS.

**Key Risks**

- Lower demand due to economic slowdown and delay in the completion of expansion projects might affect revenue growth.
- Higher raw-material prices and delay in the ability to pass on price hikes adequately and adverse forex fluctuations might affect margins.

**Valuation** Rs cr

| Particulars | FY19 | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|
| Net Sales | 1,128 | 1,029 | 945 | 1,354 | 1,601 |
| OPM (%) | 37.5 | 40.2 | 34.9 | 36.9 | 37.5 |
| Adjusted PAT | 283 | 334 | 271 | 380 | 452 |
| y-o-y growth (%) | 107.2 | 18.0 | (19.0) | 40.5 | 19.0 |
| Adjusted EPS (Rs.) | 27.5 | 32.5 | 26.3 | 37.0 | 44.0 |
| P/E (x) | 45.3 | 38.3 | 47.3 | 33.6 | 28.3 |
| P/BV (x) | 12.2 | 10.0 | 8.7 | 7.3 | 6.0 |
| EV/EBITDA (x) | 30.0 | 30.2 | 37.8 | 24.5 | 20.0 |
| RoCE (%) | 41.8 | 34.1 | 22.9 | 30.2 | 30.0 |
| RoE (%) | 30.6 | 28.6 | 19.7 | 23.6 | 23.3 |

*Source: Company; Sharekhan estimates*

**Q3 margin impacted by weakness in ATBS segment & higher cost, PAT lifted by higher other income & lower tax rate**

Vinati Organics' Q3FY2021 operational performance was weak. The company's revenue declined by 6.3% y-o-y to Rs. 223 crore due to sluggish ATBS demand from the oil and gas sector. OPM missed our estimates by 314 bps to 32.3% (down 254 bps y-o-y; down 607 bps q-o-q) due to adverse revenue mix and higher-than-expected operating cost (staff cost up 7.7% y-o-y and other expenses up 30% y-o-y) on account of recent commissioning of Butyl Phenol plant. Consequently, operating profit at Rs. 72 crore (down 13.1% y-o-y; down 14.3% q-o-q) was also 6% below our estimate of Rs. 77 crore. However, PAT at Rs. 64 crore (down 4% y-o-y; up 3.4% q-o-q) was 18.7% above our estimate of Rs. 54 crore due to lower effective tax rate at 9.2% (versus assumption of 25%) and higher other income, which offset weak margin performance.

**Amalgamation of VAPL provides forward integration; Incremental revenue potential of Rs. 300 crore**

Vinati Organics' board has approved a scheme of amalgamation of VAPL into Vinati Organics. VAPL manufactures three types of antioxidants (AO 1010, AO 1076, AO 168) with primary application in the polymer industry. There is demand potential of 10,000 mt in India; and global demand is estimated at ~3,00,000 mt. VAPL has capacity of 24,000 mt and the amalgamation of VAPL provides forward integration for Vinati Organics. This acquisition will add new revenue stream of specialty chemicals with strong demand, given rising consumption of various plastics such as LDPE, LLDPE, and PP. After the acquisition, Vinati Organics will be the largest and the only integrated manufacturer of these AO's in India. Management said that there would be no cash outgo to acquire VAPL as its promoters would get equity shares of Vinati Organics. VAPL is 100% owned by the promoters of Vinati Organics; and thus, post the amalgamation, promoter holding in Vinati Organics would increase to 74.32% versus 74.1% currently. The amalgamation is expected to get completed in the next 8-10 months and VAPL provides incremental revenue potential of Rs. 300 crore at peak level.

**Results** Rs cr

| Particulars | Q3FY21 | Q3FY20 | YoY % | Q2FY21 | QoQ % |
|---|---|---|---|---|---|
| **Revenue** | **223.5** | **238.5** | **(6.3)** | **219.4** | **1.8** |
| **Operating profit** | **72.1** | **83.0** | **(13.1)** | **84.1** | **(14.3)** |
| Other Income | 9.3 | 15.4 | (39.7) | 1.4 | 562.9 |
| Depreciation | 10.8 | 9.3 | 16.0 | 10.8 | 0.1 |
| Finance Cost | 0.0 | 0.3 | (96.1) | 0.0 | (79.4) |
| PBT | 70.6 | 88.9 | (20.5) | 74.7 | (5.5) |
| Tax Expenses | 6.5 | 22.0 | (70.7) | 12.7 | (49.0) |
| **PAT** | **64.1** | **66.8** | **(4.0)** | **62.0** | **3.4** |
| EPS (Rs.) | 12.5 | 13.0 | (4.0) | 12.1 | 3.4 |
| **Margin (%)** | | | **BPS** | | **BPS** |
| Gross margin | 55.0 | 54.6 | 38 | 59.9 | (497) |
| OPM | 32.3 | 34.8 | (254) | 38.3 | (607) |
| PAT Margin | 28.7 | 28.0 | 68 | 28.3 | 43 |

*Source: Company; Sharekhan Research*

## Outlook and Valuation

■ **Sector view - Structural growth drivers to propel sustained growth for the specialty chemicals sector in the medium to long term**

We remain bullish on the medium to long-term growth prospects of the specialty chemicals sector, given a massive revenue opportunity from the perspective of import substitution (India's total specialty chemical imports is estimated at $56 billion), potential increase in exports given China Plus One strategy by global customers, and favourable government policies (such as tax incentive and production-linked incentive scheme). In our view, conducive government policies, product innovation, a massive export opportunity, and low input prices would help the sector witness a sustained high double-digit earnings growth trajectory in the next 2-3 years.

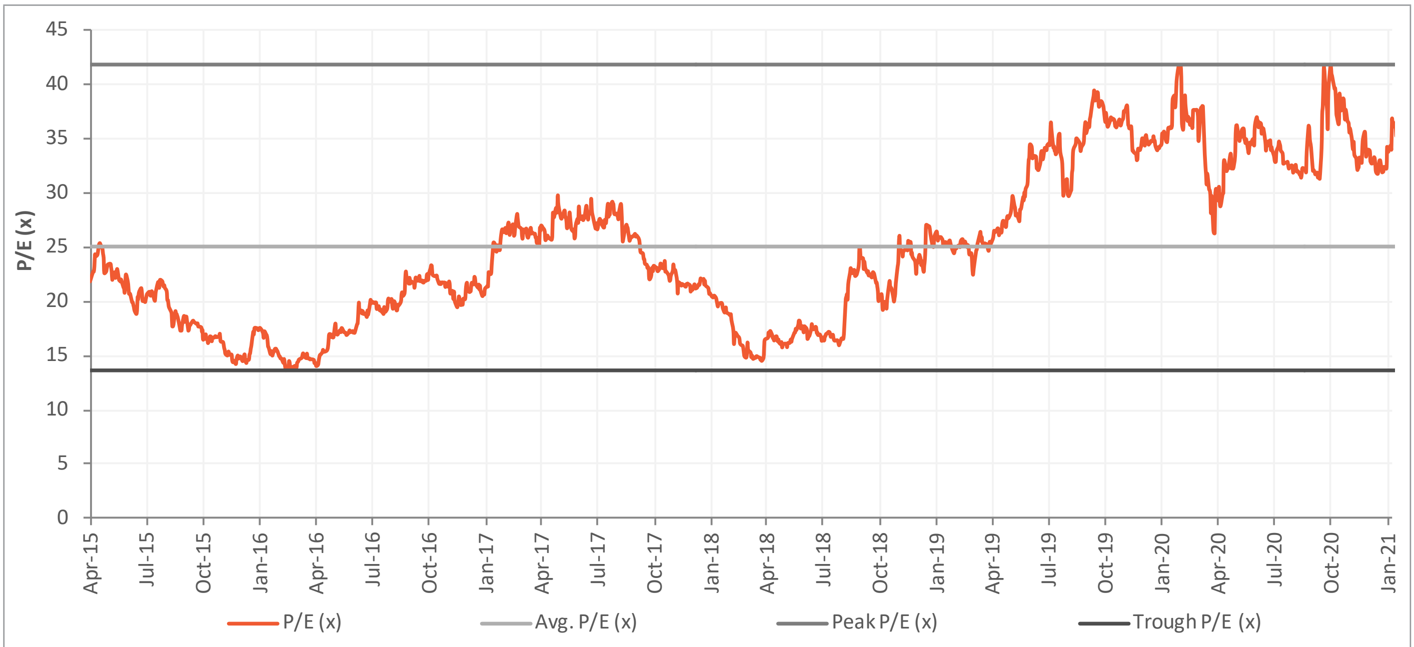
■ **Company outlook – Niche business with significant market share, improvement in ATBS demand bodes well for earnings recovery:**

Vinati Organics operates in niche segments and has an exceptional product basket that holds a significant market share globally. Hence, the company is able to generate significantly higher margins. This coupled with a debt-free balance sheet helps Vinati Organics generate superior return ratios. Potential recovery in ATBS margins and demand and ramp-up of Butyl Phenol (peak revenue potential of Rs. 400 crore-500 crore) would lead to a 31% PAT CAGR over FY2021E-FY2023E.

■ **Valuation - Maintain Buy on Vinati Organics with an unchanged PT of Rs. 1,550:**

We have fine-tuned our FY2021 earnings estimate and largely maintained our FY2022-FY2023 earnings estimates, as we expect sharp earnings recovery in the ATBS segment. Vinati Organics' dominant global market share in ATBS/IBB segments, a pipeline of 12 new products in the R&D phase, and massive export opportunities in the specialty chemical sector (amid China Plus One strategy by global customers) would drive sustained long-term high double-digit earnings growth. Moreover, concerns on ATBS demand and margins are expected to recede as strong global economic recovery has led to a sharp rise in oil price. Hence, we maintain our Buy rating on Vinati Organics with an unchanged PT of Rs. 1,550. At the CMP, the stock trades at 33.6x its FY2022E EPS and 28.3x its FY2023E EPS.

**One-year forward P/E (x) band**




*Source: Sharekhan Research*

## About company

Incorporated in 1989, Vinati Organics is one of India's leading manufacturers and exporters of specialty organic intermediaries, monomers, and polymers. Vinati Organics is the world's largest manufacturer and seller of Isobutyl Benzene (IBB) and 2-Acrylamido 2- Methylpropane Sulfonic Acid (ATBS) having a significant market share in both the product categories. The company currently has a capacity of 25,000 TPA for IBB and 26,000 TPA for ATBS. Vinati Organics is an export-oriented company, as 70%-75% of its overall revenue are derived from export markets.

## Investment theme

Vinati Organics operates in niche segments and have an exceptional product basket with a significant market share in its products globally. Hence, the company is able to generate significantly higher margin profile. This coupled with a lean balance sheet (debt-free company) helps Vinati Organics to generate superior return ratios. Vinati Organics is expected to see increased volumes in ATBS (2-Acrylamido 2 Methylpropane Sulfonic Acid) due to a capacity expansion, while IB (Isobutylene) volumes are expected to rise due to enhancement of capacity utilisation and a gradual ramp-up in utilisation levels for butyl phenol.

## Key Risks

Lower demand due to economic slowdown and delay in completion of expansion projects might impact revenue growth. Adverse raw-material prices and delay in the ability to pass on price hikes adequately and forex fluctuations might affect margins.

## Additional Data

**Key management personnel**

| | |
|---|---|
| Vinod Saraf | Chairman |
| Vinati Saraf Mutreja | Managing Director &CEO |
| Viral Saraf Mittal | Director-CSR & Corporate Strategy |
| Sunil Saraf | Non-Independent Director |
| N. K. Goyal | Chief Financial Officer |
| Milind A. Wagh | Company Secretary and Compliance Officer |

*Source: Company Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Mirae Asset Global Investments Co | 3.0 |
| 2 | Invesco Asset Management India Pvt | 1.3 |
| 3 | INVESTOR EDUCATION & PROTECTN FD | 1.1 |
| | Canara Robeco Asset Management Company | 0.9 |
| 4 | Vanguard Group Inc/The | 0.8 |
| 5 | Goldman Sachs Group Inc/The | 0.6 |
| 7 | L&T Mutual Fund Trustee Ltd/India | 0.5 |
| 8 | Dimensional Fund Advisors LP | 0.4 |
| 9 | BlackRock Inc | 0.3 |
| 10 | LIC Nomura Mutual Fund Asset Management | 0.3 |

*Source: Bloomberg*

## Understanding the Sharekhan 3R Matrix

| | |
|---|---|
| **Right Sector** | |
| Positive | Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies |
| Neutral | Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies |
| Negative | Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability. |
| **Right Quality** | |
| Positive | Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance. |
| Neutral | Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable |
| Negative | Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet |
| **Right Valuation** | |
| Positive | Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment. |
| Neutral | Trading at par to historical valuations and having limited scope of expansion in valuation multiples. |
| Negative | Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple. |

*Source: Sharekhan Research*

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