National Fertilizers Limited (BOM – 523630) (NSE – NFL)

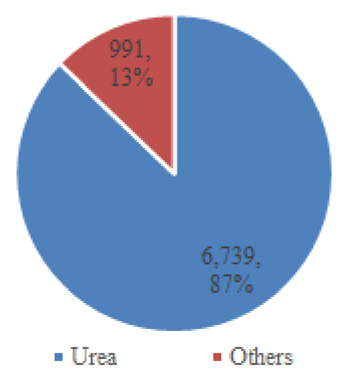
Last Price (28/4)	Market Cap	Industry	Dividend Yield (%)	Return on Equity	Price Target (FY18)
78.5 INR	3,856 INR Crore	Fertilizers	1.5	12.3%	Rs. 111 (41%)

Relative Valuations

	NFL	Sector	Country
Adjusted P/E	27x	18x	18x
Forward P/E	11x	13x	17x
EV/ EBITDA	15x	13x	12x
P/CF	14x	12x	10x

Source: Imperative Estimates, Bloomberg

NFL's Revenue (FY17E, Rs. Crores)



Buy-side:

Government policy initiatives – neem coated, low power cost, direct subsidy transfer, incentives for expanding production

NFL's target to expanding production, reducing leverage, improving efficiency

Rise in international prices of Urea in the current year

Sell-side:

Sensitivity towards availability as well as prices of natural gas

Any major decline in Urea prices

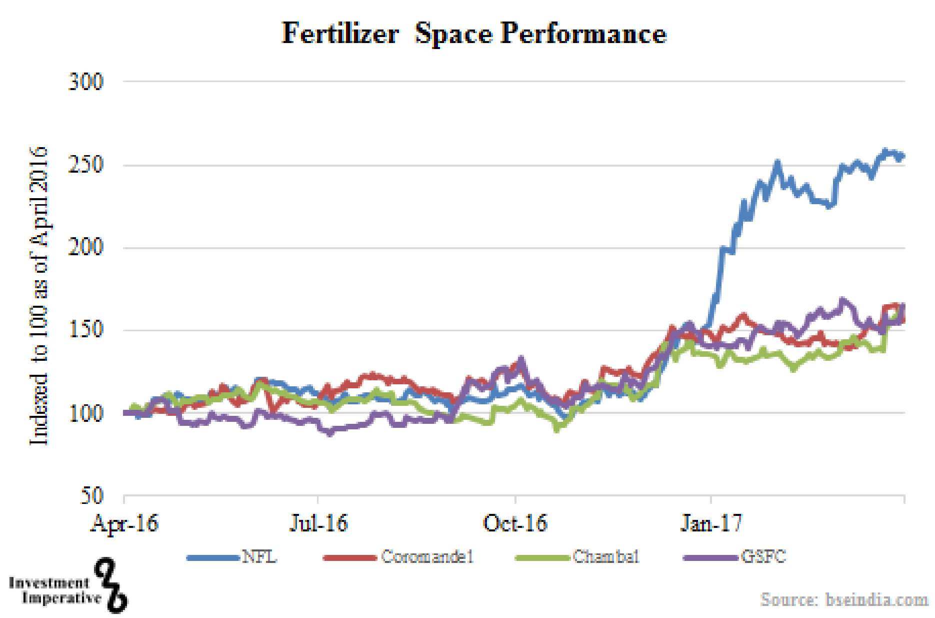
Operating inefficiencies on revival of sick units

NFL Revival on Capacity Expansions, Widening Margins, Direct Subsidy Transfer, Lower Leverage

Augmenting capacities, Margins

National Fertilizers Limited (NFL), India's second largest Urea manufacturer, saw a strong rebound in its operating performance in FY15-16 on record Urea production, increased turnover of other industrial products, imported goods, lower power consumption on lower gas prices, government policies on neem coated Urea and domestic production. The company operates through its five plants with an annual installed capacity of 35.7 Lakh Metric Tonne (LMT).

In 9MFY17, NFL posted earnings per share of Rs.2.31 as compared to Rs.3.47 in the prior year period. The subdued performance has been mainly due to lower revenues of Urea by 14% (forming 86% of the total revenues) partially offset by increased revenues of other products including DAP, Bentonite Sulphur and Bio Fertilizers. Revenues of Urea have been impacted by lower Urea prices in 9MFY17.



In 2017, Urea prices have increased by 22% in line with December 2015 levels which can augment NFL's subsidy revenues in the fourth quarter as well as FY17-18. Government's initiatives through Urea policy 2015 including pooling of gas, production of neem coated Urea, incentivizing the additional production beyond re-assessed capacities has helped in the expansion of production as well as a reduction in production costs.

NFL is targeting aggressive expansion of capacities through joint ventures, product lines, operating efficiencies across its plants. For the full year FY17-18, we are estimating NFL's revenues at Rs.9,537 crores and EBITDA at Rs.795 crores. The company's net is expected to grow by 57% to Rs. 295 Crore.

Capacity Augmentation Key for Adding Market Share, Substituting Imports

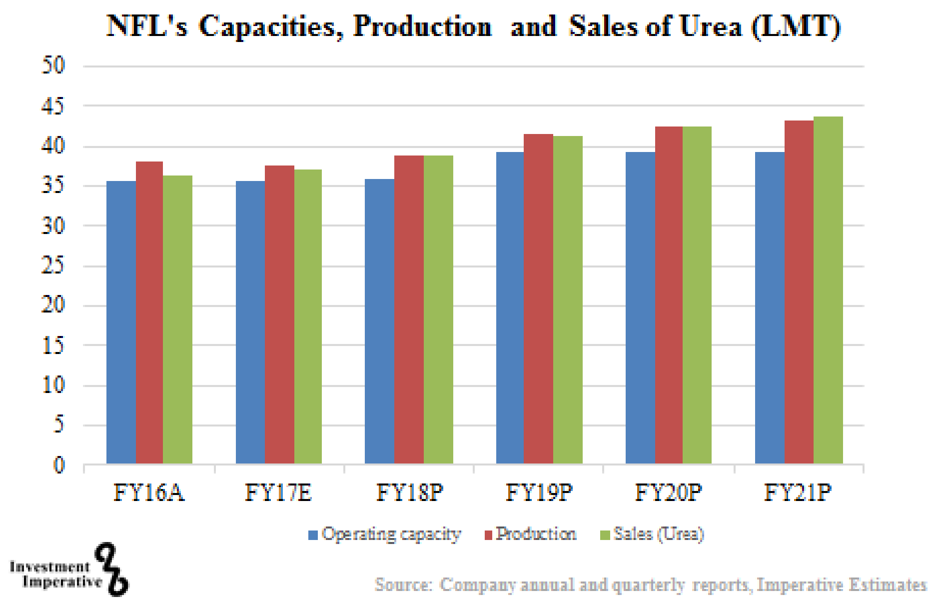
Joint ventures

The total Urea demand in India stood at ~34 million MT, with domestic production contribution almost 3/4th of the total requirement and remaining contributed through imports. The government is pushing for a revival of closed units in a bid to reduce reliance on imports. NFL has entered into a joint venture with Engineers India Ltd. (NSE: ENGINERSIN) and Fertilizer Corporation of India Ltd. (FCIL) for a revival of FCIL's Ramagundam plant with an annual installed capacity of 12.7 LMT with a project cost of Rs.5,260 crores.

Reviving of sick units to augment production, sales of Urea

Adding capacities for Bentonite Sulphur, industrial products

NFL and EIL will have 26% stake in joint venture entity, Ramagundam Fertilizers & Chemicals Limit, FCIL and Government of Telangana will have 11% stake, whereas for the remaining stake SBI capital is mandated to find partners. The company can expect the beginning of operations towards the second half of FY17-18.



Bentonite Sulphur, Other traded goods

NFL has seen increased contribution of other traded goods in the total revenues backed by offtake of industrial products like Nitric acid, Sodium nitrate and Sodium nitrite as well as DAP, Bentonite Sulphur, bio fertilizers.

NFL has begun manufacturing of Bentonite Sulphur plant with an installed capacity of 25000 MT per annum. The plant is expected to be operational by August 2018. The product is used in addressing the issues of Sulphur deficiency in soil across the plantation of paddy, wheat, sugarcane, pulses and oil seeds.

NPL is also considering to set up a plant for Murate of Potash (MoP), extraction of potash from salt, in a bid to further diversify its product line.

Government initiatives, Direct Subsidy Transfer to Revive the Space

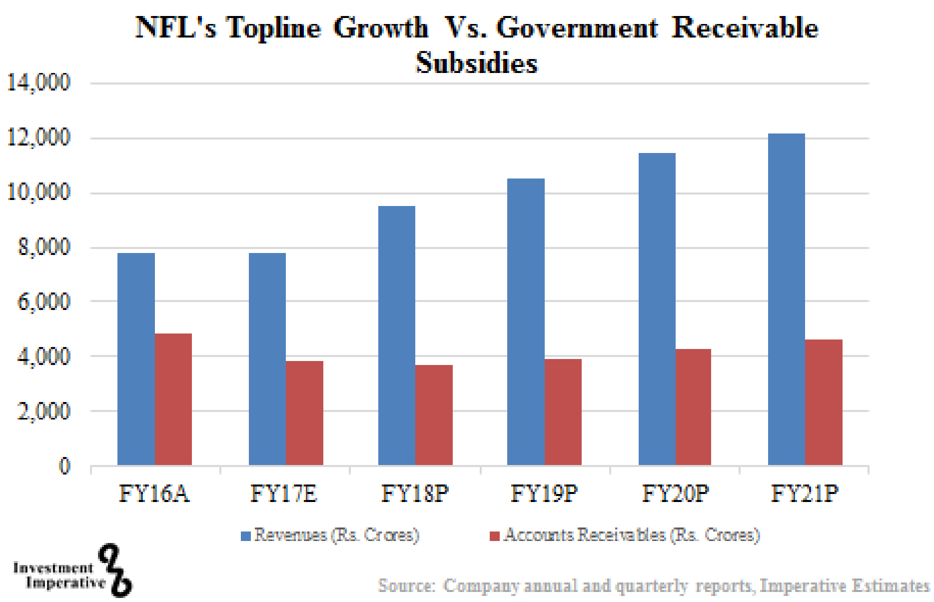
Urea Policy

The government of India is targeting a doubling of farmer's income by 2022 on the back of strong agricultural growth, developing of technology backed markets, direct subsidy transfers and reforms in fertilizer space. Currently, Government is meeting an excess demand of Urea by importing through three canalizing agencies, MMTC, STC and IPL. However, the economic survey on reforms in the fertilizer sector has suggested de-canalization of Urea import, a revival of closed plants, the compulsory production of neem coated Urea and bringing of Urea under nutrient based subsidy program currently applicable to phosphatic and potassic fertilizer.

Adding massive capacities on estimated demand in additives and compounds

Set up of facilities at SEZs to help in augmentation of margins, efficiency, leverage benefits

Multiple production facilities to help in reduction of cost as well as concentration risks



Direct subsidy transfer – A major revamp

Fertilizer sector has faced major liquidity issues on account of delayed outlays of subsidies and under provisioning by the government. This has resulted in higher leverage for the companies and hence a major debt on profitability. For the current financial year, the government has earmarked Rs.70,000 crores as against subsidy requirement of Rs.1.15 lakh crore including arrears of Rs.45000 crores from the previous financial year.

GoI is planning to directly transfer the fertilizer subsidy to farmers in order to target judicious use of Urea, encouraging ploughing back of subsidies into agricultural activities. The department of fertilizer (DoF) is running an experimental project in select districts and capturing details of the farmers in a bid to directly transfer subsidies to their bank accounts. The move can substantially reduce leakages, bring prudence in a usage of fertilizer, ease liquidity for Fertilizer companies and hence raise the productivity of overall agriculture output in the country.

How NFL is Targeting Improved Operating Margins

Partnered dealings with clients enabling long term relationship and growth

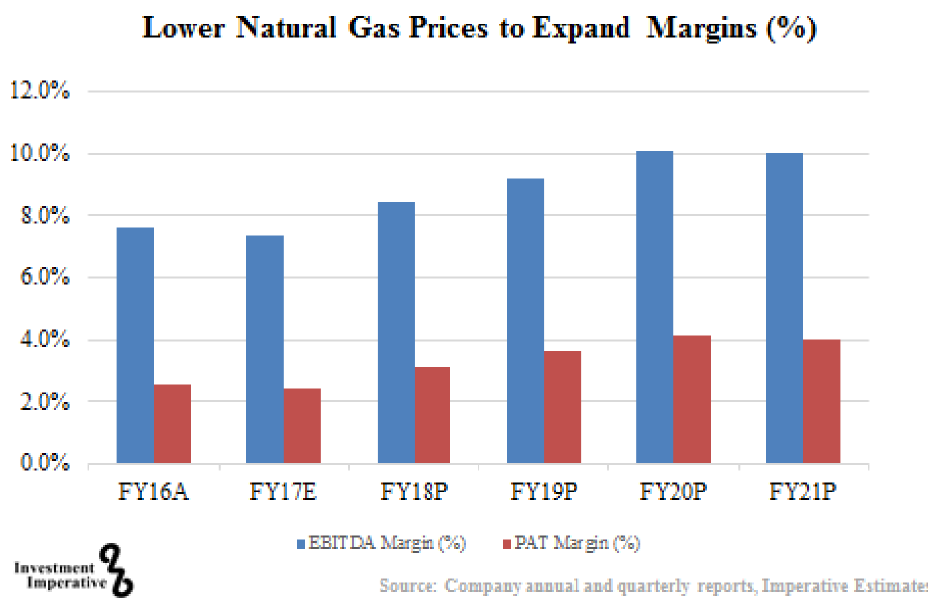
Recycled materials research and approach resulting in global technology tie ups

Technology sharing from Nafigate Corporation, based out of Czech Republic

Declining power costs

Fertilizer companies have seen a decline in their power consumption costs mainly due to the introduction of pooling of gas mechanism which has facilitated delivery of gas at similar prices to all manufacturers. The lower cost and adequate availability of natural gas have also allowed the companies to produce beyond reassessed capacities resulting in higher production and revenues. The government is providing gas to Fertilizer companies at a uniform and lower prices. In 9MFY17, NFL saw the raw material, power and fuel costs of Rs. 2,176 crore and Rs.1,609 crores as compared to Rs.2,837 crore and Rs.1,867 crore, respectively, in the prior year period.

NFL has installed Purge Gas Recovery plant at one of its manufacturing facilities in Vijaipur at a cost of Rs.29 crores. The plant, commissioned in July 2016, helps in lower energy consumption and enhancement of Ammonia production.



NFL can target further reduction of the gas prices by increasing capacity utilization at its operating facilities as well as add capacities by reviving closed units. In FY15-16, NFL managed gas prices of $9.96 per mmbtu as compared to $12.43 in the prior year. The number is expected to decline further in the current year considering higher capacity utilization and lower energy prices. NFL's other major heads including employee benefit expenses, other manufacturing expenses have increased on repairs, increased wages.

The outlook for natural gas prices remains subdued globally due to an availability of gas from North America, Russian fields. The supplies along with subdued prices of oil should help energy consuming companies', like NFL, in augmenting their operating margins by reducing a cost of production.

NFL's Deleveraging Imperative for High Sustainable Capital Expenditure

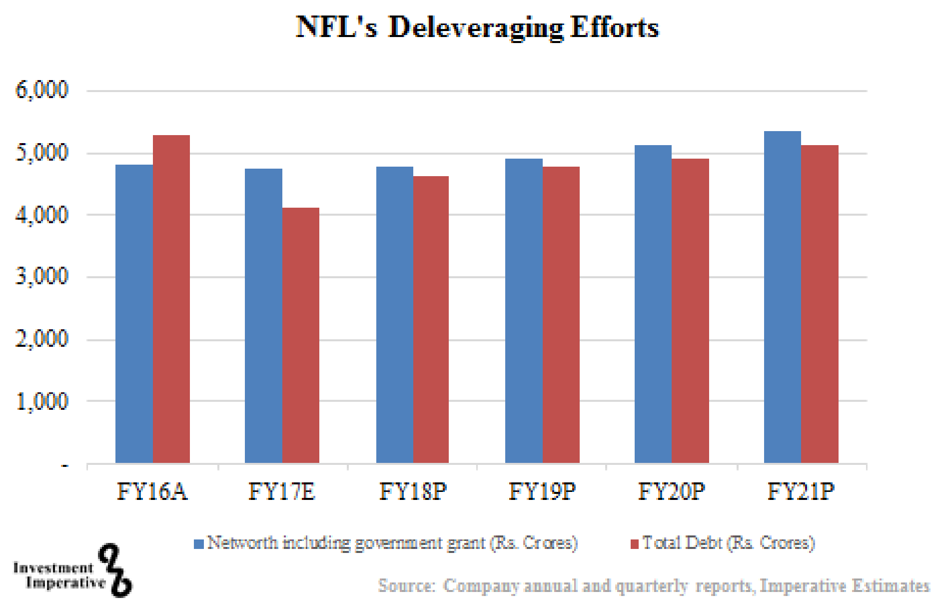
Reducing leverage

Substantial repayments in the recent years to lay foundation for next capex planning

Expected improvement in current ratings (ICRA AA/A1+), reduction of rates to help in net margins

NFL's total debt as on March 31, 2016, stood at Rs.5,277 crores as compared to Rs.6,787 crores in the prior year, reflecting substantial repayments of Rs.800 crores towards rupee term loan and external commercial borrowing. The company also reduced its working capital requirement by Rs.710 crores mainly due to lower energy prices, input cost. The company can further reduce its leverage in the current and next financial year to bring it down at around Rs.3,500-4,000 crores considering strong cash flow generation, improving operating margins partially offset by an increased capital expenditure.

The requirement of working capital can decline substantially if the government implements direct subsidy transfer to farmers for purchase of fertilizer. Reduction in leverage has resulted in lower interest cost for the company. In FY16-17, NFL's finance costs stood at Rs.228 crores as compared to Rs.301 crore, in 9MFY17 the number has declined further to Rs.153 crore as compared to Rs.155 crore in the prior year period.



Prudent capital position can enable NFL to go for higher capital expenditure in order to develop sick units via joint venture route.

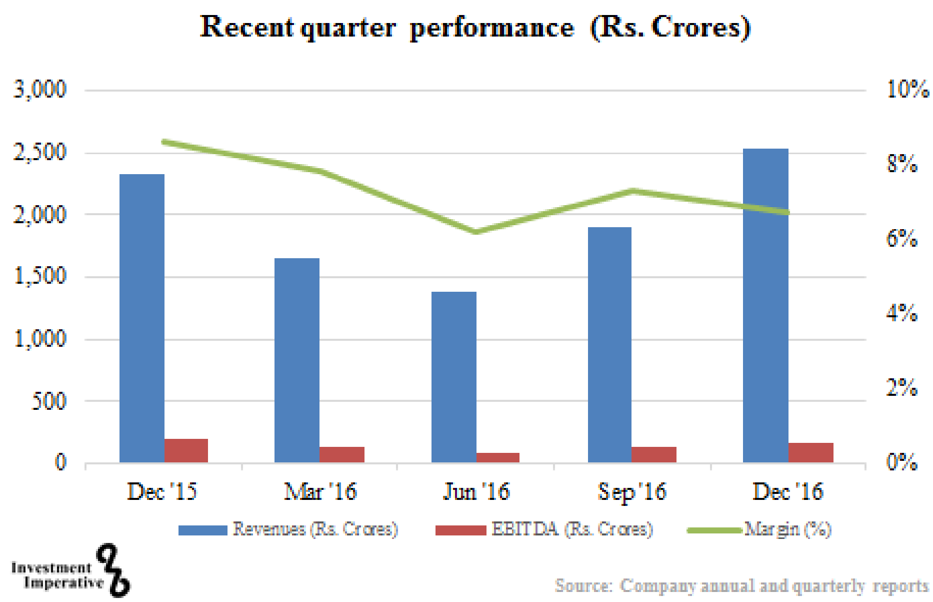
Working Capital Diligence

NFL's trade receivables, government subsidies, have declined in the recent past mainly due to an improvement in early repayment of subsidies by the government, decline in Urea prices. However, the company's spending towards employee payouts, repairs and maintenance and other manufacturing expenses has increased in the recent quarters considering rising wages, fresh employment, marginal inflation. The working capital requirement is expected to rise to Rs.4,425 crores in FY18 as compared to Rs.4,292 crores in FY16 reflecting marginal growth amidst expanding turnover, product line, operating capacities.

How NFL Has Been Performing in the Recent Quarters

Lower Urea prices impacting topline

NFL saw a rebound in its subdued topline of June quarter in September and December quarter mainly due to strong demand of Rabi crop. The company managed a topline of Rs.2,527 crores and EBITDA of Rs.170 crore reflecting a y-o-y growth of 8.4% and a decline of 15.6% respectively. Topline growth came in mainly from other good including industrial products, DAP, Bentonite Sulphur. However, lower Urea prices, higher employee expenses, other manufacturing including freight maintenance impacted its operating margins partially offset by lower natural gas prices.



NFL saw EPS of Rs.1.43 in the December quarter as compared to Rs.2.64 in the prior year quarter. In 9MFY17, NFL posted revenues of Rs.5,804 crores and a net profit of Rs.119 crore as compared to Rs.6,154 crores and Rs.171 crore, respectively, in the prior year period. Out of the total revenue, Urea contributed Rs.4,979 crores and other products Rs.857 crores as compared to Rs.5,811 crore and Rs.353 crore, respectively in the prior year period.

Performance drivers in the upcoming quarters

NFL has achieved higher production and sale of Urea over the last couple of years supported by New Urea Policy, a revival of sick units through joint ventures, catering to the local demand by substituting imported products. In the last quarter and FY18, the company can garner benefit of improved Urea prices and see a higher turnover backed by volume and prices gains. The lower natural gas prices and availability have helped in improved operating margins when compared with the FY13-15 period.

In the other product category, NFL's Bentonite Sulphur 25,000 tonnes plant alongside import of DAP, other industrial products will help in diversifying its revenues and hence strengthen its portfolio.

Global Fertilizer Demand and Prices Expected to Rebound in 2017

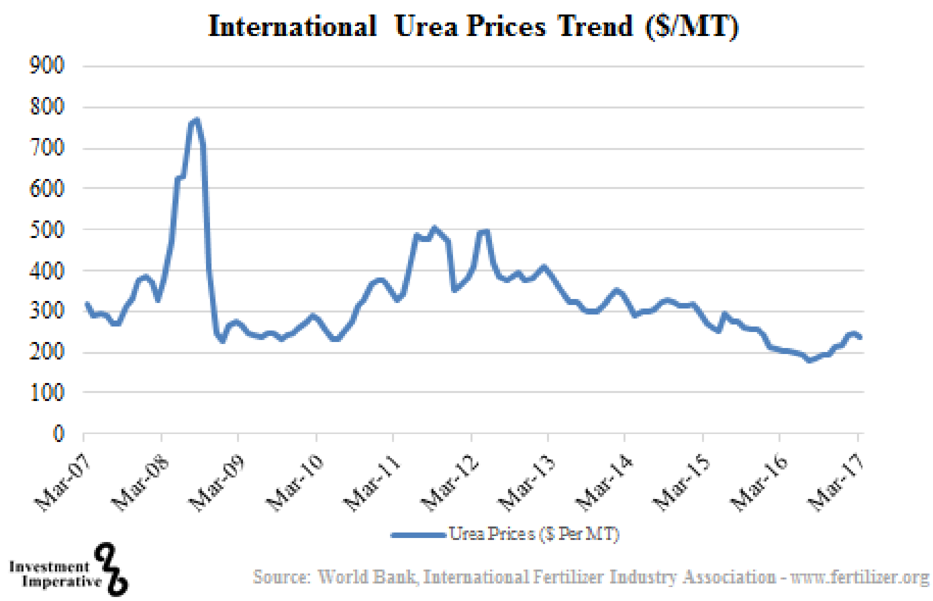
Relatively strong outlook for FY17 on conditions in Latin America, Asia

Urea prices recovery to help augment operating margins of the industry

Global capacity expansions in line with the demand expectations

Weak growth for FY15-16

The global fertilizer industry has seen a 1% decline in total production to 181 million tonnes nutrients in FY16, valued at ~$200 billion, mainly due to dry conditions, lower agri commodity prices in Latin America, Africa and South Asia. Out of the total production, Nitrogen contributed 108 million tonnes, phosphorous contributed 41 million tonnes and potassium contributed 32 million tonnes. The major decline in demand was seen from Latin American, Brazil and Argentina, mainly due to uncertain economic, political situation combined with unfavourable weather. The subdued demand alongside strong supply leads to weaker prices of the commodity and hence impacted industry-wide profitability.



Rebound in FY17-18

In 2017, the outlook is expected to be relatively better on account of improved market conditions, favorable weather, higher grain exports on weaker regional currencies, with an expected growth of 2.9% to 186 million tonnes. South Asia including India, Brazil and Argentina are expected to see a strong rebound in demand for fertilizer on economic and weather conditions. By 2021, the fertilizer industry is expected to see the demand of ~200 million tonnes. The demand outlook has helped in a rise of Urea prices in 1Q17 which is expected to remain at around $240-$250 per MT as compared to ~$200 MT in FY16.

Capacity expansions in 2016-2020

By 2020, the global fertilizer industry is expected invested ~$130 billion in expanding capacity by over 150 million tonnes. The capacity expansion is in line with the expectation of global demand which should prevent any run-offs in the international Urea prices. Declining consumption, scaling back of ammonia capacities in China has resulted in lower demand for input materials, natural gas. This should help the existing players with lower input, energy costs.

Valuations

Valuation premium to continue on an expected growth, capacity augmentation

One year forward valuations reflecting a strong growth in topline and bottomline

GoI's Urea policy and initiatives for higher domestic production, pilot projects towards targeting of direct subsidy transfer, favourable gas prices and availability have revived the sector with a strong growth potential in the upcoming years.

NFL is currently trading at 15x on enterprise value to earnings before income tax on FY17 estimates as compared to global industry estimates of 13.5x reflecting market premium. On one year forward price to earning basis, the company is trading at 13x, in line with the industry peers reflecting a strong growth on higher revenues, operating margin efficiencies.

Considering NFL's targeting of new product lines, target expansion of production capacities, and favorable Urea prices, we are giving a price target of Rs.111 in FY17-18 and Rs.146 in FY18-19. Any major appreciation in the international Urea prices can trigger further upside across the industry.

Exit Valuation on Current Multiples

On the basis of EV/ EBITDA

Sl. No.	Parameter	Multiple (x)	EBITDA (Rs. Crore)	EV (Rs. Crore)	Equity Value (Rs. Crore)	Price Per share
A	Exit in 2018	12.4x	795	9,884	5,199	106
B	Exit in 2019	12.4x	961	11,943	7,154	146
C	Exit in 2020	12.4x	1,145	14,229	9,313	190

On the basis of Price / Earnings

Sl. No.	Parameter	Multiple (x)	PAT (Rs. Crore)	Equity Value (Rs. Crore)	Price Per share (Rs.)
A	Exit in 2018	19.3x	295	5,676	116
B	Exit in 2019	19.3x	376	7,242	148
C	Exit in 2020	19.3x	472	9,097	185

Source: Imperative Estimates, Reuters, Bloomberg

Projected Financials

NFL's Income Statement

(All figures in INR Crores unless stated otherwise)	FY13A	FY14A	FY15A	FY16A	FY17E	FY18P	FY19P	FY20P	FY21P
Revenue from operations	6,720	8,017	8,520	7,766	7,730	9,470	10,437	11,359	12,061
Other income	37	45	37	46	58	67	77	88	101
Total Revenues	**6,757**	**8,062**	**8,557**	**7,812**	**7,788**	**9,537**	**10,514**	**11,447**	**12,163**
Operating Expenses									
Raw Material Consumed	4,275	4,457	4,447	3,649	**3,672**	**4,451**	**4,885**	**5,305**	**5,633**
Direct Operating Costs									
Power & Fuel	1,468	2,424	2,593	2,424	2,181	2,718	2,997	3,274	3,479
Employee benefit expenses	418	417	475	466	489	524	568	613	663
Freight Handling	306	378	392	436	584	715	757	744	791
Repairs	90	67	74	86	109	124	137	137	146
Manufacturing and Other Direct Expenses	125	147	156	160	187	210	210	229	243
[-] Total Operating Expenses	**6,682**	**7,890**	**8,138**	**7,221**	**7,222**	**8,741**	**9,553**	**10,303**	**10,954**
EBITDA	**75**	**172**	**419**	**591**	**566**	**795**	**961**	**1,145**	**1,209**
[-] Depreciation	118	129	73	80	91	162	193	227	263
EBIT	**(43)**	**43**	**346**	**511**	**475**	**633**	**768**	**918**	**946**
[-] Interest	130	204	301	228	206	209	227	238	250
PBT Before exceptional items	**(173)**	**(161)**	**45**	**283**	**269**	**424**	**541**	**679**	**696**
[-] Exceptional item	57								
PBT	**(231)**	**(161)**	**45**	**283**	**269**	**424**	**541**	**679**	**696**
[-] Taxes	(60)	(72)	18	86	**82**	**129**	**165**	**207**	**212**
PAT	**(171)**	**(90)**	**26**	**197**	**187**	**295**	**376**	**472**	**484**
Shares in issue (Lakhs)	49.06	49.06	49.06	49.06	49.06	49.06	49.06	49.06	49.06
Earnings per share (Rs.)	(3.48)	(1.83)	0.53	4.02	3.82	6.01	7.66	9.63	9.86

NFL's Balance Sheet

(All figures in INR Crores unless stated otherwise)	FY13A	FY14A	FY15A	FY16A	FY17E	FY18P	FY19P	FY20P	FY21P
Liabilities & Equity									
Current Liabilities & Provisions									
Cash Credit / Overdraft Utilization	1,703	4,040	5,002	4,292	3,954	4,425	4,647	4,879	5,123
[+] Accounts payable	337	363	174	312	289	314	324	353	374
[+] Other Current Liabilities	1,646	1,424	1,324	1,311	1,337	664	677	691	705
[+] Short Term Provisions	43	49	87	166	178	183	189	194	200
Total Current Liab. & Prov.	**3,730**	**5,875**	**6,588**	**6,081**	**5,757**	**5,587**	**5,836**	**6,116**	**6,402**
Non Current Liabilities									
Long term borrowings	3,092	2,632	1,785	985	176	199	119	40	20
Deferred tax liabilities	11	(60)	(68)	28	30	33	33	34	35
Other liabilities and Long term provisions	224	215	228	230	253	304	365	437	525
[+] Total Non Current Liabilities	**3,327**	**2,786**	**1,945**	**1,243**	**458**	**535**	**517**	**511**	**580**
Deferred Government Grant	2,445	3,537	3,373	3,194	**3,007**	**2,820**	**2,633**	**2,446**	**2,259**
Networth									
Share Capital	491	491	491	491	491	491	491	491	491
Reserves and surplus	1,093	1,003	990	1,116	1,241	1,470	1,778	2,178	2,586
[+] Total Networth	**1,584**	**1,494**	**1,481**	**1,607**	**1,732**	**1,961**	**2,268**	**2,668**	**3,076**
Total Liabilities & Equity	**11,085**	**13,692**	**13,387**	**12,124**	**10,954**	**10,902**	**11,255**	**11,742**	**12,317**
Assets									
Current Assets									
Cash & Cash Equivalent	6	4	5	8	9	16	56	82	172
[+] Inventory	418	418	285	503	390	392	476	522	567
[+] Account Receivables	3,146	4,629	5,029	4,828	3,830	3,706	3,892	4,289	4,668
[+] Loans & Advances	127	130	152	380	388	395	403	411	420
[+] Other Current Assets	532	1,515	1,809	1,211	1,150	1,093	1,147	1,205	1,265
Total Current Assets	**4,229**	**6,697**	**7,280**	**6,930**	**5,766**	**5,603**	**5,974**	**6,509**	**7,091**
[+] Net Fixed Assets	3,490	4,648	4,417	4,236	**4,326**	**4,545**	**4,479**	**4,405**	**4,317**
[+] Intangible assets	10	34	27	19	**12**	**4**	**0**	**0**	**0**
[+] WIP	1,358	14	39	61	-	-	-	-	-
[+] Non-current investments	0	0	2	-	-	-	-	-	-
[+] Long term loans and advances	56	47	31	34	32	30	31	33	35
[+] Other non current assets	1,942	2,252	1,592	844	819	720	771	794	873
Total Assets	**11,085**	**13,692**	**13,387**	**12,124**	**10,954**	**10,902**	**11,255**	**11,742**	**12,317**

NFL's Key Ratios

(All figures are dimensionless unless stated otherwise)	FY13A	FY14A	FY15A	FY16A	FY17E	FY18P	FY19P	FY20P	FY21P
Profit Margins									
EBITDA Margin	1.1%	2.1%	4.9%	7.6%	7.3%	8.4%	9.2%	10.1%	10.0%
EBIT Margin	-0.6%	0.5%	4.1%	6.6%	6.2%	6.7%	7.4%	8.1%	7.8%
PBT and extraordinary Margin	-2.6%	-2.0%	0.5%	3.7%	3.5%	4.5%	5.2%	6.0%	5.8%
PAT Margin	-2.5%	-1.1%	0.3%	2.5%	2.4%	3.1%	3.6%	4.2%	4.0%
Growth Rates									
Revenue		19.3%	6.3%	-8.8%	-0.5%	22.5%	10.2%	8.8%	6.2%
EBITDA		129.6%	143.5%	41.3%	-4.2%	40.4%	20.8%	19.1%	5.6%
EBIT		-199.9%	709.9%	47.8%	-7.0%	33.2%	21.2%	19.5%	3.1%
PBT		-30.1%	-127.7%	533.9%	-5.0%	57.4%	27.6%	25.6%	2.4%
PAT		-47.5%	-129.3%	651.1%	-5.0%	57.4%	27.6%	25.6%	2.4%
As a % of Sales									
Raw Material Consumed	63.6%	55.6%	52.2%	47.0%	47.5%	47.0%	46.8%	46.7%	46.7%
Power & Fuel	21.8%	30.2%	30.4%	31.2%	28.2%	28.7%	28.7%	28.8%	28.8%
Employee benefit expenses	6.2%	5.2%	5.6%	6.0%	6.3%	5.5%	5.4%	5.4%	5.5%
Freight Handling	4.5%	4.7%	4.6%	5.6%	7.6%	7.6%	7.3%	6.6%	6.6%
Repairs	1.3%	0.8%	0.9%	1.1%	1.4%	1.3%	1.3%	1.2%	1.2%
Manufacturing and Other Direct Expenses	1.9%	1.8%	1.8%	2.1%	2.4%	2.2%	2.0%	2.0%	2.0%
Liquidity Ratio									
Current Ratio	1.13x	1.14x	1.11x	1.14x	1.00x	1.00x	1.02x	1.06x	1.11x
Quick Ratio	1.02x	1.07x	1.06x	1.06x	0.93x	0.93x	0.94x	0.98x	1.02x
Return Ratio									
ROAE	-21.6%	-5.8%	1.8%	12.8%	11.2%	16.0%	17.8%	19.1%	16.8%
Pre Tax ROACE	-1.3%	0.6%	4.1%	6.6%	7.2%	9.7%	10.7%	11.8%	11.2%
Post Tax ROACE	-1.2%	0.7%	6.3%	11.4%	13.2%	18.9%	20.4%	21.5%	19.4%
ROAA	-3.1%	-0.7%	0.2%	1.5%	1.6%	2.7%	3.4%	4.1%	4.0%
Leverage Ratio									
Total Debt/ Equity	5.5x	6.1x	5.0x	3.9x	3.4x	2.8x	2.5x	2.2x	0.2x
Debt/ EBITDA	117.2x	52.7x	17.7x	10.6x	10.5x	6.9x	5.9x	5.1x	0.6x
Interest Coverage	-0.3x	0.2x	1.1x	2.2x	2.3x	3.0x	3.4x	3.9x	3.8x

NFL's Peers and Valuation Metrics

Sl. No.	Company	Mkt Cap (Rs. Crores)	EV/ EBITDA (x)		P/ E (x)		Dividend Yield (%)	Forward Revenue Growth Estimate (%)	Forward EPS Growth Estimate (%)	Return on Equity (%)	Total Debt (Rs. Crore)	Debt / Equity (x)	Debt / EBITDA (x)
	(As on April 28, 2017)		TTM	FY1	TTM	FY1							
1	Coromandel International	10,209	12.43	11.94	21.30	17.61	1.8%	7.4%	14.6%		2,982	1.1	3.5
2	Chambal Fertilisers	4,177	10.42	9.69	8.65	9.96	2.3%	2.5%	1.4%	21.4%	4,966	2.1	5.7
3	GSFC	5,124	14.25	8.75	19.26	10.87	1.9%	17.9%	6.7%	8.3%	1,288	0.3	1.9
4	Rashtriya Chemicals	4,666	19.98		28.43						3,042	1.1	6.0
5	GNFC	4,705	9.69		12.31			11.0%			3,108	1.1	5.0
	Mean		**13.4x**	**10.1x**	**18.0x**	**12.8x**							
	Median		**12.4x**	**9.7x**	**19.3x**	**10.9x**							

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