

ZUARI AGRO CHEMICALS

Rerating continues

India Equity Research | Fertilisers

Zuari Agrochemicals (ZAC) reported strong Q2FY18 numbers led by margin improvement and higher volume growth (25% YoY) in standalone business. Improvement in Paradeep Phosphate's (PPL) margin also boosted profitability; Mangalore Chemicals (MCFL) reported in-line numbers. While ZAC's standalone profit beat our estimate by 22%, est. consolidated PAT stood at INR1bn in Q2FY18 vs INR528mn in Q2FY17. We believe, margin expansion and subsidy reduction will help the company improve return ratios and trigger rerating. Also, structural changes like DBT along with working capital reduction will spur the sector's rerating and ZAC, being a leading player, is envisaged to reap the benefit. We therefore raise our target multiple to 15x FY19E EPS (from 12x), at 25% discount to industry leader Coromandel International, and revise up target price to INR758 (from INR524). Maintain 'BUY'.

ZAC Standalone turns around performance this quarter

ZAC's (standalone) performance benefited from robust volume spurt of 25% YoY versus industry's ~5% driven by the company's strategy of cleaning up surplus inventory in trade. Despite revenue jumping 25% to INR13bn (above estimate), EBITDA/mt improved by ~INR300 YoY to INR3,065 due to: 1) lower input cost; 2) currency appreciation; and 3) operating leverage, which boosted EBITDA 51% to INR1.3bn versus INR966mn estimate, while PAT jumped 3x YoY to INR535mn, surpassing our INR439mn estimate.

Paradip boosts profitability; MCFL's performance in line

PPL (40% JV) reported strong numbers despite tepid revenue growth (down 9%) with sharp improvement in EBITDA / mt to INR3,680 versus INR2,255 in Q2FY17 driven by lower input cost. This led to PAT catapulting 144% to INR660mn. MCFL's performance was broadly in line with estimate with revenue declining 5% and EBITDA and PAT jumping 3% and 40% to INR620mn and INR210mn, respectively.

Outlook and valuations: Rerating prospects intact; maintain 'BUY'

ZAC offers strong rerating potential driven by margin improvement, lower interest driven by reduction in working capital and better return ratios. Structural changes like DBT followed by ZAC's dominant position are likely to trigger rerating. Hence, we raise target multiple to 15x FY19E EPS and raise TP to INR758 and maintain 'BUY'.

Financials (standalone)

(INR mn)

Year to March	Q2FY18	Q2FY17	% change	Q1FY18	% change	FY17	FY18E	FY19E
Net rev.	13,148	10,518	25.0	7,038	86.8	63,855	69,497	71,816
EBITDA	1,275	842	51.4	331	284.8	4,657	5,278	5,406
Adj. profit	535	270	98.1	3	19,725.9	113	1,981	2,126
Dil. EPS (INR)	12.7	6.4	98.1	0.1	19,725.9	2.7	47.1	50.6
Dil. P/E (x)						226.3	13.0	12.1
EV/EBITDA (x)						15.4	12.8	12.3
ROAE (%)						1.2	12.7	12.8

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

MARKET DATA (R: ZUAR.BO, B: ZUAC IN)

CMP	: INR 614
Target Price	: INR 758
52-week range (INR)	: 690 / 178
Share in issue (mn)	: 42.1
M cap (INR bn/USD mn)	: 26 / 397
Avg. Daily Vol. BSE/NSE ('000)	: 162.1

SHARE HOLDING PATTERN (%)

	Current	Q1FY18	Q4FY17
Promoters *	66.1	66.1	66.1
MF's, FI's & BKs	10.0	10.4	10.1
FII's	0.5	0.3	0.4
Others	23.4	23.2	23.5
* Promoters pledged shares (% of share in issue)	:	NIL	

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	7.8	38.1	30.2
3 months	7.4	59.6	52.3
12 months	23.3	165.3	142.0

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October 27, 2017

Table 1: ZAC consolidated performance

INR mn	Zuari Agrochemical (Standalone)				PPL (100%)				MCFL				Consolidated	
	Q2FY18	Q2FY17	% YoY	FY17	Q2FY18	Q2FY17	% YoY	FY17	Q2FY18	Q2FY17	% YoY	FY17	H1FY18	FY18E
Volumes (MT)	522,545	416,069	25.6	1,465,000	337,013	399,170	(15.6)	1,337,000	324,450	321,162	1.0	943,000		
Sales	13,148	10,518	25.0	39,590	9,986	10,950	(8.8)	36,970	8,061	8,489	(5.0)	25,020	34,177	69,497
EBITDA	1,602	1,138	40.7	3,550	1,240	900	37.8	4,920	620	600	3.3	1,840	3,189	5,278
PAT	535	270	98.1		660	270	144.4		210	150	40.0		705	1,233
Share of associate													444	748
Reported PAT													1,149	1,981
Gross debt	30,776			31,053	30,776			24,610	10,367			11,760		
Subsidies o/s	12,600			14,850	12,600			12,920	6,540			6,790		

Note: EBITDA includes other income; consolidated numbers only consider ZAC and MCFL

Source: Company, Edelweiss research

Q2FY18 conference call: Key highlights

Industry:

- In AP and TN rainfall was above normal.
- The company primarily operates in Maharashtra and Karnataka.
- Overall, sowing area for sugarcane and cotton was higher by 9%/11%, respectively

Q2FY18:

- ZAC got higher prices driven by raw material benefits. The company had very high cost inventory in Q1FY18.
- Total group capacity is 3.3mn MT with utilization at 90%.
- Last year ZAC and PPL had taken a INR500-600mn hit on channel inventory, which was absent this year. This will help margin.
- PPL's main quarter is Rabi.

Q2FY18 (Zuari standalone):

- There has been far more discipline by ZAC and this has been because of not having any channel inventory.
- The company has also been able to save on logistics costs because of lower channel inventory.

Raw material:

- The company has got phos acid contracted upto December.
- For ammonia, prices started from USD375/tonne which have now corrected to around USD280/tonne.
- Prices of MOP are around USD227/tonne. Revised agreements have been signed at USD240/tonne.
- The company is planning to increase prices and also trying to control costs.
- AT Kearney is working on a business transformation plan for ZAC.

Subsidy:

- ZACL: INR12.6bn (INR14.9bn in March'17).
- MCFL: INR6.5bn (INR6.8bn in March'17).
- PPL: INR10bn (INR12.9bn in March'17).

- Debt had fallen in Q1FY18, due to flow of subsidy repayment. ZAC in Q2FY18 repaid INR3bn of excess urea subsidy.

Direct Benefit Transfer scheme (DBT):

- There is a misconception of working capital rising significantly post DBT.
- Under DBT, maximum subsidy will come during Kharif or Rabi season. There will be a mismatch of months and not years.
- All India DBT roll out will be by Jan 2018.

Stores/Retail

- 40 are in the pipeline and ZAC expects to end the year with 250.

Capex

- ZAC has planned new line for NPK for 0.8mn MT and plans to spend INR6bn for the NPK line.
- The company is looking at completing the line by FY20-21. This will be financed by a mix of loans and equity.

Financial snapshot

(INR mn)

Year to March	Q2FY18	Q2FY17	% change	Q1FY18	% change	YTD18	FY18E	FY19E
Net revenues	13,148	10,518	25.0	7,038	86.8	20,186	69,497	71,816
Raw material	9,620	7,820	23.0	4,825	99.4	14,445	51,528	53,351
Staff costs	206	210	(1.9)	221	(6.7)	428	1,426	1,487
Other expenses	2,047	1,646	24.4	1,660	23.3	3,707	11,265	11,572
Total expenditure	11,872	9,675	22.7	6,707	77.0	18,579	64,219	66,410
EBITDA	1,275	842	51.4	331	284.8	1,607	5,278	5,406
Depreciation	94	86	9.2	87	7.2	181	772	850
EBIT	1,182	757	56.2	244	384.1	1,426	4,505	4,556
Other income	327	296	10.5	356	(8.0)	682	881	897
Interest	689	707	(2.5)	594	15.9	1,284	3,256	3,111
Add: Prior period items								
Profit before tax	819	209	291.3	5	15,657.7	825	2,130	2,341
Provision for taxes	284	76	276.3	3	11,264.0	287	703	773
Minority interest	-	-	-	-	-	-	194	232
Associate profit share	-	-	-	-	-	-	748	790
Profit- Discontinued Ops								
Exceptional Items								
Reported net profit	535	134	299.8	3	19,725.9	538	1,981	2,126
Adjusted Profit	535	270	98.1	3	19,725.9	538	1,981	2,126
Diluted shares (mn)	42	42	-	42	-	42	42	42
Adjusted Diluted EPS	12.7	6.4	98.1	0.1	19,725.9	12.8	47.1	50.6
Diluted P/E (x)	-	-	-	-	-	-	13.0	12.1
EV/EBITDA (x)	-	-	-	-	-	-	12.8	12.3
ROAE (%)	-	-	-	-	-	-	12.7	12.8

As % of net revenues

Raw material	73.2	74.3	-	68.6	-	71.6	74.1	74.3
Employee cost	1.6	2.0	-	3.1	-	2.1	2.1	2.1
Other expenses	15.6	15.6	-	23.6	-	18.4	16.2	16.1
EBITDA	9.7	8.0	-	4.7	-	8.0	7.6	7.5
Reported net profit	4.1	2.6	-	-	-	2.7	2.9	3.0

* Annual numbers are on consolidated basis

Change in Estimates

	New	FY18E Old	% change	New	FY19E Old	% change	Comments
Net Revenue	69,497	82,757	-16.0	71,816	85,689	-16.2	Change in consolidation method for PPL
EBITDA	5,278	6,275	-15.9	5,406	6,459	-16.3	Change in consolidation method for PPL and higher margins in ZAC and MCFL
EBITDA Margin	7.6	7.6	-	7.5	7.5	-	
Adjusted PAT	1,981	1,504	31.7	2,126	1,837	15.7	Better profitability in PPL
Net Profit Margin	3.1	1.9	-	3.3	2.2	-	
Capex	10,727	10,960	(233)	2,410	2,565	(155)	

Note: We have adjusted our FY18/19 estimates to reflect changes under IND-AS and subsidiary accounting

Company Description

Incorporated in 1967 as Zuari Agro Chemicals, a joint venture between the K K Birla Group and the US Steel Corporation, it was renamed Zuari Industries (Zuari) in 1998. The company has a fertiliser manufacturing facility at Goa with four plants dedicated to manufacture urea, DAP, SSP and NPK-based fertilisers. Jai kisan (urea), Samraat, Sampurna are amongst Zuari's popular brands. The company also deals in agricultural inputs such as seeds and specialty fertilisers. It has diversified into several related and unrelated sectors through subsidiaries and has presence in seeds, cement, furniture, pesticides, etc. Zuari has marketing offices spread over Goa, Maharashtra, Karnataka, Andhra Pradesh, and Tamil Nadu. In 2012, post demerger, the entire fertiliser business is demerged into a separate entity Zuari Holdings (ZHL) which has again renamed as Zuari Agro Chemicals.

Investment Theme

With a capex outlay of ~INR900mn, ZAC is expanding its complex fertiliser capacity by ~300,000 MT in FY15. With implementation of NBS, ZAC's complex fertiliser segment is expected to benefit due to margin expansion and lower subsidy receivables. Zuari has converted the urea feedstock from naphtha to natural gas in Q4FY13 and will benefit from: (a) production of additional 40,000 MT urea p.a. from the existing plant (b) lower subsidy receivable, resulting in better working capital cycle. Further, company is setting up 1m MT DAP facility in UAE with the capex of USD800m and expected to start commercial production by H1CY16. To backward integrating this facility, ZAC has already acquired stake in rock phosphate mine in Peru. With the demerger of the fertiliser business from the non-fertiliser businesses, thus subsiding the investors concerns of possibility of investing fertiliser profits into non-synergic businesses, we believe that ZAC stands to gain from multiple rerating.

Key Risks

Any execution delay in expansion project could lead to postponement of ZAC's earnings.

Indian agriculture is largely dependent on monsoon. Poor monsoon could, therefore, be a demand dampener.

Possible delay in payment of fertiliser subsidies by government.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.9	6.6	6.8	7.4
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.5	67.1	65.0	66.0
Company				
Urea sales (mn MT)	406,294	466,000	400,000	400,000
Std nonurea sale vol(MT)	690,000	631,000	700,000	720,000
PPL nonurea sale vol(MT)	1,244,415	1,057,753	1,110,640	1,166,172
Non urea real(INR/MT)	31,531	27,125	27,125	27,125
Cost assumptions				
Phosp acid price(US\$/MT)	784	666	666	666
Ammonia (US\$/MT)	433	381	381	381
Materials costs (%)	77.2	70.7	74.1	74.3
Staff costs (%)	2.0	2.5	2.1	2.1
Other exp (% net rev)	17.2	19.5	16.2	16.1
Net borrowings (INR mn)	50,282	42,245	38,232	36,799
Tax rate as % of PBT	22.8	220.4	33.0	33.0
Capex (INR mn)	1,504	1,448	10,727	2,410
Debtor days	162	216	146	103
Inventory days	41	58	47	44
Payable days	57	79	77	77
Cash conversion cycle	146	195	116	70
Interest Exp (% of Debt)	8.3	10.6	8.3	8.1
Dep. (% gross block)	3.8	4.3	2.7	2.7

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Net revenue	76,114	63,855	69,497	71,816
Materials costs	58,748	45,134	51,528	53,351
Gross profit	17,366	18,720	17,969	18,465
Employee costs	1,515	1,605	1,426	1,487
Other Expenses	13,118	12,458	11,265	11,572
Operating expenses	14,633	14,063	12,691	13,059
Total operating expenses	73,382	59,198	64,219	66,410
EBITDA	2,732	4,657	5,278	5,406
Depreciation	655	776	772	850
EBIT	2,077	3,881	4,505	4,556
Add: Other income	621.33	760.8	881.04	896.66
Less: Interest Expense	4,190	4,541	3,256	3,111
Add: Exceptional items	(261)	(643)	-	-
Profit Before Tax	(1,492)	100	2,130	2,341
Less: Provision for Tax	(339)	221	703	773
Less: Minority Interest	(78)	91	194	232
Associate profit share	183	325	748	790
Reported Profit	(1,152)	(530)	1,981	2,126
Exceptional Items	(261)	(643)	-	-
Adjusted Profit	(891)	113	1,981	2,126
Shares o/s (mn)	42	42	42	42
Basic EPS (INR)	(21.2)	2.7	47.1	50.6
Diluted shares o/s (mn)	42	42	42	42
Adj. Diluted EPS (INR)	(21.2)	2.7	47.1	50.6
Adjusted Cash EPS	(13.7)	26.2	65.5	70.8
Dividend per share (DPS)	-	-	3.5	3.5
Dividend Payout Ratio(%)	-	-	8.7	8.1

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	19.2	22.0	18.3	18.2
Cost of goods sold	77.2	70.7	74.1	74.3
Depreciation	0.9	1.2	1.1	1.2
Interest Expense	5.5	7.1	4.7	4.3
EBITDA margins	3.6	7.3	7.6	7.5
Net Profit margins	(1.3)	0.3	3.1	3.3

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	(0.3)	(16.1)	8.8	3.3
EBITDA	(9.0)	70.4	13.3	2.4
PBT	(745.4)	(106.7)	2,028.0	9.9
Adjusted Profit	(1,093.5)	(112.7)	1,646.6	7.3
EPS	(1,093.5)	(112.7)	1,646.6	7.3

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	421	421	421	421	
Reserves & Surplus	13,053	12,644	13,298	14,690	
Shareholders' funds	13,473	13,065	13,719	15,111	
Minority Interest	3,553	3,644	3,839	4,071	
Short term borrowings	45,064	38,038	34,283	33,283	
Long term borrowings	5,408	4,930	4,996	4,996	
Total Borrowings	50,472	42,968	39,278	38,278	
Long Term Liabilities	147	186	186	186	
Def. Tax Liability (net)	(28)	60	60	60	
Sources of funds	67,618	59,923	57,082	57,706	
Gross Block	17,361	17,908	28,924	31,333	
Net Block	16,763	16,593	19,600	21,160	
Capital work in progress	1,020	1,428	811	811	
Intangible Assets	1,527	1,491	1,474	1,474	
Total Fixed Assets	19,310	19,512	21,885	23,444	
Non current investments	7,706	8,777	3,874	3,874	
Cash and Equivalents	191	723	1,046	1,479	
Inventories	7,278	7,085	6,168	6,727	
Sundry Debtors	41,004	34,627	20,963	19,575	
Loans & Advances	1,711	2,376	13,370	13,370	
Other Current Assets	2,849	2,164	3,722	3,722	
Current Assets (ex cash)	52,842	46,253	44,222	43,393	
Trade payable	8,735	10,870	10,874	11,647	
Other Current Liab	175	178	5,621	5,621	
Total Current Liab	8,910	11,048	16,495	17,268	
Net Curr Assets-ex cash	43,931	35,205	27,727	26,126	
Uses of funds	67,618	59,923	57,082	57,706	
BVPS (INR)	320.3	310.6	326.2	359.3	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	(1,152)	(530)	1,981	2,126	
Add: Depreciation	655	776	772	850	
Interest (Net of Tax)	2,807	3,043	2,182	2,085	
Others	(1,017)	(717)	388	362	
Less: Changes in WC	9,984	(9,075)	(3,148)	(1,601)	
Operating cash flow	(8,691)	11,647	8,471	7,025	
Less: Capex	1,504	1,448	10,727	2,410	
Free Cash Flow	(10,195)	10,199	(2,256)	4,615	

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow	(8,691)	11,647	8,471	7,025	
Investing cash flow	(4,981)	(405)	(4,597)	(1,513)	
Financing cash flow	13,634	(10,703)	(7,121)	(4,287)	
Net cash Flow	(38)	539	(3,247)	1,225	
Capex	(1,504)	(1,448)	(10,727)	(2,410)	
Dividend paid	-	-	(172)	(172)	

Profitability and efficiency ratios		FY16	FY17	FY18E	FY19E
Year to March					
ROAE (%)	(6.5)	1.2	12.7	12.8	
ROACE (%)	5.2	7.3	9.2	9.5	
ROA	(1.7)	0.2	3.4	3.7	
Inventory Days	41	58	47	44	
Debtors Days	162	216	146	103	
Payable Days	57	79	77	77	
Cash Conversion Cycle	146	195	116	70	
Current Ratio	6.0	4.3	2.7	2.6	
Gross Debt/EBITDA	18.5	9.2	7.4	7.1	
Gross Debt/Equity	3.0	2.6	2.2	2.0	
Adjusted Debt/Equity	3.0	2.6	2.2	2.0	
Net Debt/Equity	3.0	2.5	2.2	1.9	

Operating ratios		FY16	FY17	FY18E	FY19E
Year to March					
Total Asset Turnover	1.5	1.0	1.2	1.3	
Fixed Asset Turnover	7.1	3.5	3.5	3.3	
Equity Turnover	5.1	3.8	4.1	3.9	

Valuation parameters		FY16	FY17	FY18E	FY19E
Year to March					
Adj. Diluted EPS (INR)	(21.2)	2.7	47.1	50.6	
Y-o-Y growth (%)	(1,093.5)	(112.7)	1,646.6	7.3	
Adjusted Cash EPS (INR)	(13.7)	26.2	65.5	70.8	
Diluted P/E (x)	(28.9)	227.5	13.0	12.1	
P/B (x)	1.9	2.0	1.9	1.7	
EV / Sales (x)	1.0	1.1	1.0	0.9	
EV / EBITDA (x)	29.1	15.4	12.9	12.3	
Dividend Yield (%)	-	-	0.6	0.6	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Zuari Agro Chemicals	244	10.4	8.5	8.7	8.2	8.2	8.7
Coromandel International	2,035	22.1	18.2	13.2	10.6	19.1	20.1
Deepak Fertilizer Ltd	501	11.9	10.6	7.9	5.2	15.4	15.3
Median	-	11.9	10.6	8.7	8.2	15.4	15.3
AVERAGE	-	14.8	12.4	9.9	8.0	14.2	14.7

Source: Edelweiss research

Additional Data

Directors Data

S.K. Poddar	Chairman	N. Suresh Krishnan	Non Executive Director
Akshay Poddar	Non Executive Director	J.N. Godbole	Non Executive Director
Marco Wadia	Non Executive Director	Kapil Mehan	Managing Director
Gopal Krishna Pillai	Non Executive Director	Kiran Dhingra	Non Executive Director

Auditors - M/s. S. R. Batliboi & Co.

**as per last available data*

Holding – Top10

	Perc. Holding		Perc. Holding
Life Insurance Corporation of India	3.21	HDFC Asset Management	
L & T Investment Managment Ltd	2.91	Dimensional Fund Advisor	
General Insurance Corporation of India	1.35	ManU Life Fin Corp	
Kotak Mahindra	0.88	Coltrane Corporation	
L & T Mutual Fund	0.56		

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
23 Dec 2016	Coltrane Corporation Ltd	Sell	479750	226.50
23 Dec 2016	Globalware Trading & Holdings Ltd	Buy	479750	226.50

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
05 May 2017	SIL INVESTMENTS LTDS	Sell	15000.00
07 Apr 2017	SIL INVESTMENTS LTD	Sell	60000.00
07 Apr 2017	SIL INVESTMENTS LTD	Sell	30000.00
06 Apr 2017	SIL INVESTMENTS LTD	Sell	60000.00
05 Apr 2017	SIL INVESTMENTS LTD	Sell	60000.00

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Fertilisers

Chambal Fertilisers and Chemicals, Coromandel International, Deepak Fertilizer Ltd, Zuari Agro Chemicals

Recent Research

Date	Company	Title	Price (INR)	Recos
26-Oct-17	Coromandel International	Fertiliser segment margins shine; <i>Result Update</i>	488	Buy
16-Aug-17	Jain Irrigation Systems	GST dampener; guidance maintained; <i>Result Update</i>	95	Buy
16-Aug-17	Deepak Fertiliser	Fertiliser rebounds; <i>Result Update</i>	368	Buy

Distribution of Ratings / Market Cap

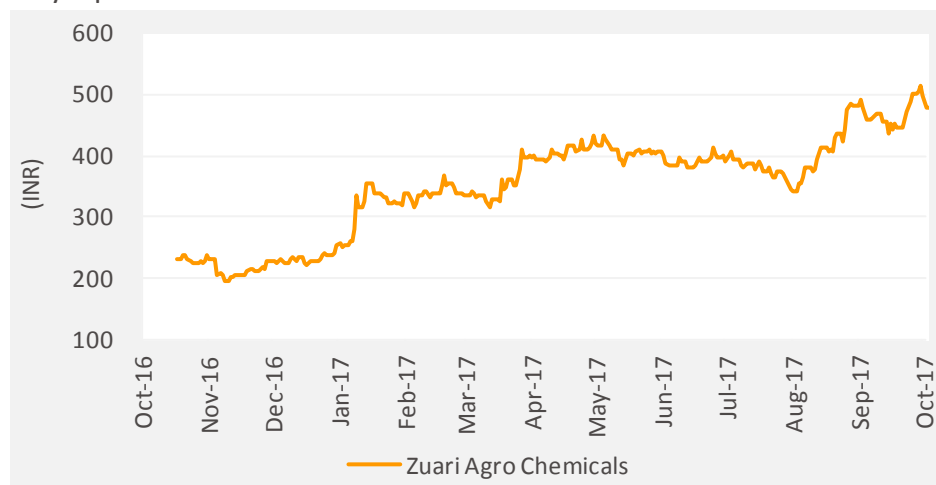
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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