

ZUARI AGROCHEMICALS

Dearer input prices dent performance

India Equity Research | Fertilisers

Zuari Agrochemicals (ZAC) reported below expectation Q4FY18 performance impacted by higher raw material (RM) costs. Standalone EBITDA fell 21% YoY to INR610mn, similarly, EBITDA of Paradeep Phosphate (PPL – 40% joint venture) contracted ~50% to INR960mn. However, EBITDA of Mangalore Chemicals & Fertilizers (MCFL) nearly doubled. With management guiding for sustainable but lower EBITDA/MT of INR2,000 for ZAC (INR2,500 earlier estimate), we trim FY20E EBITDA by 7%. Factoring in further delays in subsidy receipts, we expect debt to remain high thereby exerting pressure on interest. Given high financial leverage, despite the marginal cut in EBITDA, we cut FY20E PAT by 32%. Subsidy receipts and company's ability to fund its ongoing capex remain key monitorables. We value the stock at 15x FY20E EPS and arrive at a revised TP of INR579 (INR847 earlier). Maintain 'BUY'.

Standalone impacted by rising phos acid prices

ZAC (standalone) reported 16% YoY growth in revenue to INR11.2bn (4% above estimate) with sales volume declining 1% YoY to 0.38mn MT. Impacted by higher RM prices (mainly phos acid), gross margin contracted ~200bps YoY to 27% and EBITDA margin dropped to 5.5%, down by 250bps YoY. While ZAC did not have any channel inventory, it was unable to pass on the increase in prices due to industry channel inventory being high. EBITDA/MT slipped 20% YoY to ~INR1,600.

PPL also reels under higher RM cost; MCFL posts strong quarter

While PPL reported 6% YoY growth in revenue, it was impacted by higher RM cost due to which EBITDA contracted ~50% to INR960mn. As a result, it reported loss of INR50mn versus PAT of INR780mn in Q4FY17. Meanwhile, MCFL reported excellent results with revenue/EBITDA increasing 18%/90% YoY and PAT coming in at INR210mn.

Outlook and valuations: Margin guidance lowered; maintain 'BUY'

With management guiding for sustainable but lower EBITDA/MT of INR2,000 for ZAC, we trim FY20E EBITDA by 7%. Factoring in further delays in subsidy receipts, we expect debt to remain high thereby exerting pressure on interest. Given high financial leverage, despite the marginal cut in EBITDA, we cut FY20E PAT by 32%. We value the stock at 15x FY20E EPS and arrive at a revised TP of INR579. Maintain 'BUY'.

Financials (standalone)

Year to March	Q4FY18	Q4FY17	% change	Q3FY18	% change	FY18	FY19E	FY20E
Net rev.	11,176	9,664	15.7	14,343	(22.1)	72,648	81,285	84,179
EBITDA	610	770	(20.7)	1,257	(51.4)	5,352	5,248	5,383
Adj. profit	(11)	71	(115.1)	480	(102.2)	1,430	1,586	1,622
Dil. EPS (INR)	(0.3)	1.7	(115.1)	11.4	(102.2)	34.0	37.7	38.6
Dil. P/E (x)						15.7	14.2	13.8
EV/EBITDA (x)						12.8	13.1	12.9
ROAE (%)						9.5	9.6	9.1

* Annual numbers are on consolidated basis

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

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

CMP	: INR 375
Target Price	: INR 579
52-week range (INR)	: 690 / 335
Share in issue (mn)	: 42.1
M cap (INR bn/USD mn)	: 16 / 250
Avg. Daily Vol.BSE/NSE('000)	: 167.5

SHARE HOLDING PATTERN (%)

	Current	Q3FY18	Q2FY18
Promoters *	66.1	66.1	66.1
MF's, FI's & BK's	9.2	9.2	10.0
FII's	1.0	1.0	0.5
Others	23.7	23.7	23.4
* Promoters pledged shares (% of share in issue)			NIL

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	0.6	(23.8)	(24.4)
3 months	1.4	(28.7)	(30.1)
12 months	12.6	(7.1)	(19.7)

Rohan Gupta

+91 22 4040 7416
rohan.gupta@edelweissfin.com

Nihal Mahesh Jham

+91 22 6623 3352
nihal.jham@edelweissfin.com

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Table 1: ZAC consolidated performance

INR mn	Zuari Agrochemical (Standalone)			PPL (100%)				MCFL				
	Q4FY18	Q4FY17	% YoY	FY18	Q4FY18	Q4FY17	% YoY	FY18	Q4FY18	Q4FY17	% YoY	FY18
Volumes (MT)	379,000	384,000	-1.3	1,741,000	316,000	306,000	3.3	1,291,000	214,000	205,000	4.4	1,017,000
Sales	11,176	9,664	15.7	46,476	9,520	8,970	6.1	37,970	6,340	5,360	18.3	26,930
EBITDA	610	770	-20.7	3,418	960	1,850	(48.1)	4,780	400	210	90.5	1,900
PAT	-11	71	NM	419	-50	780	NM	1,510	210	50	320.0	610

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

Source: Company, Edelweiss research

Q4FY18 Concall highlights:

Industry:

- In March'18, rainfall was 95% of LPA

Company:

- New energy norms have been extended till FY20 and thereon
- All three plants are near full production
- Government will charge 2% of the difference between actual and mandated energy norms
- In October'18, the company will take a shut down in the urea plant

MCFL:

- Certainly expects completion of the GAIL pipeline by this fiscal

Q4FY18/FY18:

- ZAC has cleared its inventory lying in the channel
- While the company's channel inventory was cleared and it could hike prices, but as the channel inventory of other players was full, it could not take a price increase
- Company could not pass on the increase in prices which impacted gross margin
- However, as of now, it has passed on the increase in prices
 - DAP MRP - INR25,000/MT.
 - Increased by INR1,500-2,000/MT to incorporate the increase in raw material prices
- Given the exchange situation, ZAC is further increasing prices this quarter
 - Last MRP was INR25,100 and company is taking a further INR700 price increase to mitigate this
- For FY18 EBITDA/MT:
 - ZACL: INR1,950 (FY17: INR2,000)
 - PPL: INR3,700
 - MCFL: INR1,900
- Qualified opinion of Auditors:
 - While the joint venture (JV) partner, Mitsubishi, has impaired assets of the JV, the main operating company in Peru has not taken any impairment.

- This led to the conflict between Mitsubishi and ZAC on this amount

- Other income:

- Company received an escalation claim

- **Raw material:**

- Phos acid price increased from USD580/MT to USD678/MT

- **Debt:**

- Company has ~IN2.5bn stuck in GST receivables in ZAC
- Also, the benefit of Special Banking Arrangement came later in the quarter

- **Capex:**

- Zuari (Standalone)
 - Financial closure of urea and ammonia plant has still not happened
 - Company is looking at closure in the next two-three months
 - Capex will be INR3-4bn in FY19. Main capex for ZAC will be in FY20
- PPL:
 - Putting up a new line. Company is doing an in-depth study on the investments
 - In 2-2.5 years, company will upgrade all four trains which will increase capacity by ~0.4mn MT
- MCFL:
 - Going in for energy reduction and right after that company will consider another line
 - Will be ~INR1bn in FY19. Total capex for that is INR3.5bn
 - MCFL is revamping ammonia which will take two years

- **Others:**

- While DBT led to a lot of teething problems initially, the problems are now much lesser
- The current store count is ~250

- **Guidance:**

- FY19 EBITDA/MT guidance:
 - ZAC – Standalone: INR2,000-2,200
 - PPL: INR3,500-4,500
 - MCFL: INR2,000-2,200

Fertilisers

Financial snapshot

(INR mn)

Year to March	Q4FY18	Q4FY17	% change	Q3FY18	% change	FY18	FY19E	FY20E
Net revenues	11,176	9,664	15.7	14,343	(22.1)	72,648	81,285	84,179
Raw material	8,152	6,859	18.9	10,587	(23.0)	51,869	60,762	63,100
Staff costs	217	213	1.7	237	(8.4)	1,631	1,758	1,919
Other expenses	2,198	1,822	20.6	2,262	(2.9)	13,796	13,517	13,778
Total expenditure	10,566	8,894	18.8	13,086	(19.3)	67,297	76,037	78,797
EBITDA	610	770	(20.7)	1,257	(51.4)	5,352	5,248	5,383
Depreciation	113	99	13.8	108	4.8	825	818	838
EBIT	497	671	(25.8)	1,150	(56.7)	4,526	4,430	4,545
Interest	901	750	20.1	798	12.9	4,036	3,545	3,612
Other income	331	168	96.8	178	86.4	871	900	901
Add: Prior period items								
Profit before tax	(212)	74	NA	529	NA	1,362	1,785	1,833
Provision for taxes	(62)	18	NA	49	NA	233	589	605
Minority interest	-	-	-	-	-	285	277	321
Associate profit share	-	-	-	-	-	585	668	714
Profit- Discontinued Ops								
Exceptional Items (139)								
Reported net profit	(150)	56	NA	480	NA	1,290	1,586	1,622
Adjusted Profit	(11)	71	NA	480	NA	1,430	1,586	1,622
Diluted shares (mn)	42	42	-	42	-	42	42	42
Adjusted Diluted EPS	(0.3)	1.7	NA	11.4	NA	34.0	37.7	38.6
Diluted P/E (x)	-	-	-	-	-	15.7	14.2	13.8
EV/EBITDA (x)	-	-	-	-	-	12.8	13.1	12.9
ROAE (%)	-	-	-	-	-	9.5	9.6	9.1
As % of net revenues								
Raw material	72.9	71.0	-	73.8	-	71.4	74.8	75.0
Employee cost	1.9	2.2	-	1.6	-	2.2	2.2	2.3
Other expenses	19.7	18.9	-	15.8	-	19.0	16.6	16.4
EBITDA	5.5	8.0	-	8.8	-	7.4	6.5	6.4
Reported net profit	(0.1)	0.7	-	3.3	-	2.0	2.0	1.9

Change in Estimates

	FY19E			FY20E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	81,285	74,546	9.0	84,179	76,650	9.8	Higher end product prices
EBITDA	5,383	5,784	(7.3)	5,284	5,664	(7.0)	Lower EBITDA/MT estimate
EBITDA Margin	6.5	7.6	-	6.4	7.5	-	
Adjusted PAT	1,586	2,268	(30.1)	1,622	2,376	(31.7)	Higher interest cost expectation due to lower subsidies received
Net Profit Margin	2.3	3.4	-	2.3	3.5	-	
Capex	12,656	7,204	75.7	5,241	5,208	0.6	

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	FY17	FY18	FY19E	FY20E
Macro				
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.6	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
USD/INR (Avg)	67.1	64.5	66.0	66.0
Company				
Urea sales (mn MT)	466,000	465,000	400,000	400,000
Std nonurea sale vol(MT)	631,000	681,000	800,000	800,000
PPL nonurea sale vol(MT)	1,057,753	1,110,640	1,166,172	1,224,481
Non urea real(INR/MT)	27,125	27,125	27,125	27,125
Cost assumptions	-	-	-	1
Other exp (% net rev)	18.4	19.0	16.6	16.4
Net borrowings (INR mn)	40,681	41,911	42,264	42,408
Phosp acid price(US\$/MT)	666	666	666	666
Ammonia (US\$/MT)	381	381	381	381
Materials costs (%)	71.7	71.4	74.8	75.0
Staff costs (%)	2.5	2.2	2.2	2.3
Tax rate as % of PBT	(84.3)	17.1	33.0	33.0
Debtor days	216	174	140	117
Inventory days	57	62	57	51
Payable days	76	90	89	86
Cash conversion cycle	197	146	108	82
Capex (INR mn)	1,448	914	12,656	5,241
Interest Exp (% of Debt)	10.6	9.3	8.0	8.3
Dep. (% gross block)	4.3	4.4	4.4	3.9

Income statement

(INR mn)

Year to March	FY17	FY18	FY19E	FY20E
Net revenue	63,768	72,648	81,285	84,179
Materials costs	45,746	51,869	60,762	63,100
Gross profit	18,023	20,779	20,523	21,080
Employee costs	1,605	1,631	1,758	1,919
Other Expenses	11,710	13,796	13,517	13,778
Operating expenses	13,315	15,427	15,275	15,697
Total operating expenses	59,060	67,297	76,037	78,797
EBITDA	4,708	5,352	5,248	5,383
Depreciation	773	825	818	838
EBIT	3,935	4,526	4,430	4,545
Less: Interest Expense	4,395	4,036	3,545	3,612
Add: Other income	563.5	871.4	900.00	901.00
Profit Before Tax	103	1,362	1,785	1,833
Less: Provision for Tax	(87)	233	589	605
Less: Minority Interest	91	285	277	321
Add: Exceptional items	(643)	(139)	-	-
Associate profit share	325	585	668	714
Reported Profit	(220)	1,290	1,586	1,622
Exceptional Items	(643)	(139)	-	-
Adjusted Profit	424	1,430	1,586	1,622
Shares o /s (mn)	42	42	42	42
Basic EPS (INR)	10.1	34.0	37.7	38.6
Diluted shares o/s (mn)	42	42	42	42
Adj. Diluted EPS (INR)	10.1	34.0	37.7	38.6
Adjusted Cash EPS	26.4	54.9	57.2	58.5
Dividend per share (DPS)	-	3.5	3.5	3.5
Dividend Payout Ratio(%)	-	13.4	10.9	10.6

Common size metrics

Year to March	FY17	FY18	FY19E	FY20E
Cost of goods sold	71.7	71.4	74.8	75.0
Operating expenses	20.9	21.2	18.8	18.6
Depreciation	1.2	1.1	1.0	1.0
EBITDA margins	7.4	7.4	6.5	6.4
Interest Expense	6.9	5.6	4.4	4.3
Net Profit margins	0.8	2.4	2.3	2.3

Growth ratios (%)

Year to March	FY17	FY18	FY19E	FY20E
Revenues	(16.2)	13.9	11.9	3.6
EBITDA	72.3	13.7	(1.9)	2.6
PBT	(106.9)	1,222.5	31.1	2.7
Adjusted Profit	(147.5)	237.4	11.0	2.3
EPS	(147.5)	237.4	11.0	2.3

Balance sheet		(INR mn)			
As on 31st March	FY17	FY18	FY19E	FY20E	
Share capital	421	421	421	421	
Reserves & Surplus	13,249	14,343	15,757	17,207	
Shareholders' funds	13,670	14,764	16,178	17,627	
Minority Interest	3,644	3,900	4,177	4,498	
Long term borrowings	5,105	5,257	5,969	5,969	
Short term borrowings	36,299	38,341	38,326	37,326	
Total Borrowings	41,404	43,598	44,294	43,294	
Long Term Liabilities	167	164	164	164	
Def. Tax Liability (net)	(664)	(787)	(787)	(787)	
Sources of funds	58,221	61,639	64,026	64,797	
Gross Block	17,944	18,844	18,736	21,736	
Net Block	16,630	16,704	15,777	17,940	
Capital work in progress	1,425	1,466	14,061	16,301	
Intangible Assets	1,301	1,275	1,290	1,290	
Total Fixed Assets	19,356	19,444	31,128	35,531	
Non current investments	8,900	9,525	9,000	9,000	
Cash and Equivalents	723	1,687	2,031	886	
Inventories	7,072	10,511	8,447	9,347	
Sundry Debtors	34,614	34,481	27,926	26,021	
Loans & Advances	237	85	90	90	
Other Current Assets	4,236	6,527	4,941	4,941	
Current Assets (ex cash)	46,159	51,604	41,404	40,399	
Trade payable	10,419	15,103	14,423	15,406	
Other Current Liab	6,498	5,519	6,440	6,940	
Total Current Liab	16,917	20,621	20,862	22,346	
Net Curr Assets-ex cash	29,242	30,983	20,541	18,053	
Uses of funds	58,221	61,639	64,026	64,797	
BVPS (INR)	325.0	351.0	384.6	419.1	

Free cash flow		(INR mn)			
Year to March	FY17	FY18	FY19E	FY20E	
Reported Profit	(220)	1,290	1,586	1,622	
Add: Depreciation	773	825	818	838	
Interest (Net of Tax)	2,945	2,704	2,375	2,420	
Others	(926)	745	547	612	
Less: Changes in WC	(9,075)	2,179	(9,115)	(2,488)	
Operating cash flow	11,647	3,385	14,442	7,980	
Less: Capex	1,448	914	12,656	5,241	
Free Cash Flow	10,199	2,471	1,786	2,739	

Cash flow metrics				
Year to March	FY17	FY18	FY19E	FY20E
Operating cash flow	11,647	3,385	14,442	7,980
Financing cash flow	(10,703)	(2,013)	(3,021)	(4,785)
Investing cash flow	(405)	(667)	(11,077)	(4,340)
Net cash Flow	539	705	344	(1,145)
Capex	(1,448)	(914)	(12,656)	(5,241)
Dividend paid	-	(172)	(172)	(172)

Profitability and efficiency ratios				
Year to March	FY17	FY18	FY19E	FY20E
ROACE (%)	7.1	8.9	8.4	8.4
ROAE (%)	3.0	9.5	9.6	9.1
Inventory Days	57	62	57	51
ROA	0.7	2.4	2.5	2.5
Debtors Days	216	174	140	117
Payable Days	76	90	89	86
Cash Conversion Cycle	197	146	108	82
Current Ratio	2.8	2.6	2.1	1.8
Gross Debt/EBITDA	8.8	8.1	8.4	8.0
Gross Debt/Equity	2.4	2.3	2.2	2.0
Adjusted Debt/Equity	2.4	2.3	2.2	2.0
Net Debt/Equity	2.3	2.2	2.1	1.9

Operating ratios				
Year to March	FY17	FY18	FY19E	FY20E
Total Asset Turnover	1.0	1.2	1.3	1.3
Fixed Asset Turnover	3.5	4.0	4.6	4.6
Equity Turnover	3.7	4.0	4.2	4.0

Valuation parameters				
Year to March	FY17	FY18	FY19E	FY20E
Adj. Diluted EPS (INR)	10.1	34.0	37.7	38.6
Y-o-Y growth (%)	(147.5)	237.4	11.0	2.3
Adjusted Cash EPS (INR)	26.4	54.9	57.2	58.5
Diluted P/E (x)	37.2	11.0	9.9	9.7
P/B (x)	1.2	1.1	1.0	0.9
EV / Sales (x)	1.0	0.9	0.8	0.8
EV / EBITDA (x)	12.8	11.5	11.9	11.6
Dividend Yield (%)	-	0.9	0.9	0.9

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Zuari Agro Chemicals	250	9.9	9.7	-	-	9.6	9.1
Coromandel International	1,831	16.4	13.5	10.4	8.3	23.1	23.5
Deepak Fertilizer Ltd	415	9.6	8.2	6.6	6.0	15.8	16.3
Median	-	9.9	9.7	6.6	6.0	15.8	16.3
AVERAGE	-	12.0	10.5	5.6	4.8	16.1	16.3

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 annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
SIL Investments Ltd	6.06	New Eros Tradecom Ltd	2.85
L&T Mutual Fund	3.48	General Insurance Corp Of India	1.35
Adventz Finance Pvt Ltd	3.39	Pilani Investment & Industries	1.03
Life Insurance Corp Of India	3.21	Jeewan Jyoti Medical Society	0.33
L&T Investment Management Ltd	2.91	Duke Commerce Ltd	0.26

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
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No Data Available

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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No Data Available

**in last one year*

Edelweiss Securities Limited, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.

Board: (91-22) 4009 4400, Email: research@edelweissfin.com

Aditya Narain

Head of Research

aditya.narain@edelweissfin.com

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

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

Recent Research

Date	Company	Title	Price (INR)	Recos
25-Apr-18	Coromandel International	Margin miss drags performance; <i>Result Update</i>	482	Buy
18-Apr-18	Coromandel International	Moderation in earnings growth; <i>Visit Note</i>	520	Buy
15-Feb-18	Zuari Agrochemicals	Strong show continues; <i>Result Update</i>	536	Buy

Distribution of Ratings / Market Cap

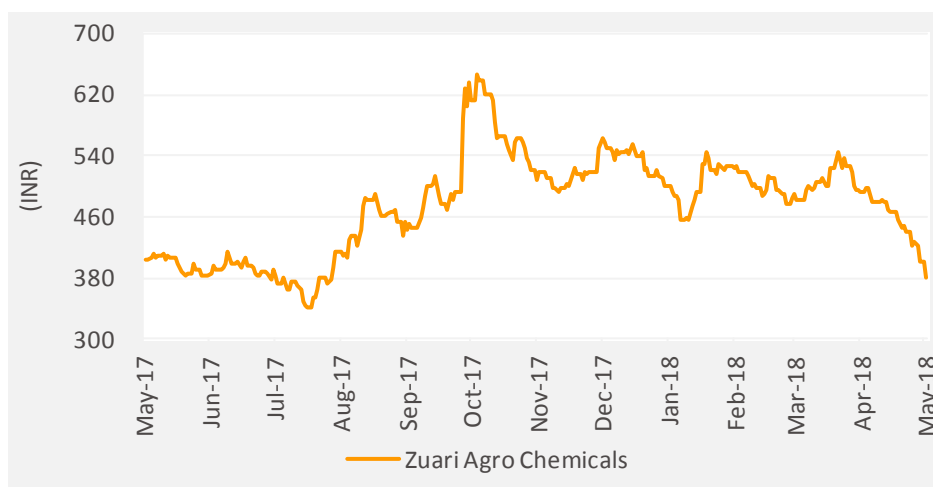
Edelweiss Research Coverage Universe

	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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