Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Vinati Organics Limited

Improved earnings outlook; upgrade to Buy

Speciality Chemcials	Sharekhan code: VINATIORGA	Company 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. 1,316**	
Price Target: **Rs. 1,550**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 13,521 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
DII	7
FII	4
Others	15

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	13.4	8.2	29.3	34.5
Relative to Sensex	7.6	(12.2)	(3.4)	16.8

Sharekhan Research, Bloomberg

Summary

- We upgrade Vinati Organics to Buy (from Hold) with a revised PT of Rs. 1,550 as a likely volume/margin recovery in key ATBS segment and ramp-up of Butyl Phenol to drive sustained high earnings growth (expect 31% PAT CAGR over FY2021E-FY2023E).
- ATBS segment's realisation would also improve as price of key input acrylonitrile rose 20% in November 2020, which in turn could help margin recover in Q4FY2021. Moreover, the demand from pharma, plastic additives, agrochemicals, water treatment chemicals would remain strong.
- Dominant global market share of 65% in ATBS/IBB, ~12 new products in R&D phase and massive export opportunities in specialty chemical space would drive sustained high double-digit earnings growth even beyond FY2023.
- Company aims to double revenues over next 3-4 years with long-term sustainable EBITDA margins of 30-35%.

The recent sharp surge in Brent crude oil price to ~$55/bbl bodes well for recovery in demand for ATBS from oil & gas space and the same would remove big earnings concern for Vinati Organics given high exposure to oil & gas sector (accounts for 15-20% of overall revenues). Additionally, ATBS realisation is also expected to improve as price of its key input acrylonitrile is up by 20% m-o-m in November 2020 and the same could result into margin recovery in Q4FY2021. The management of Vinati Organics has also indicated that revenue and earnings are expected to normalise in Q4FY2021 as the company saw significant improvement in ATBS demand from oil & gas sector. The company aims to double its revenues over next 3-4 years with long-term sustainable EBITDA margins expected in the range of 30-35%. Demand from pharma, plastic additives, agrochemicals, water treatment chemicals remains strong besides good demand for IBB the led by Ibuprofen. A potential recovery in ATBS margins and ramp-up of Butyl Phenol (peak revenue potential of Rs. 400-500 crore) would lead to a 31% 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 24%/30%). We thus upgrade our rating on Vinati Organics to Buy (from Hold) with a revised PT of Rs. 1,550 (valued at 35x FY2023E EPS). The stock trades at 35.6x FY2022E EPS and 29.9x FY2023E EPS.

Our Call

Valuation - Upgrade Vinati Organics to Buy with a revised PT of Rs. 1,550: Vinati Organics' dominant global market share in ATBS/IBB segments, a pipeline of 12 new products in R&D phase and massive export opportunities in 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 also expected to recede as strong global economic recovery has led to sharp rise in oil price. Hence, we upgrade our rating on Vinati Organics to Buy (from Hold) with a revised PT of Rs. 1,550. The stock is trading at 35.6x FY2022E EPS and 29.9x FY2023E EPS.

Key risk

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

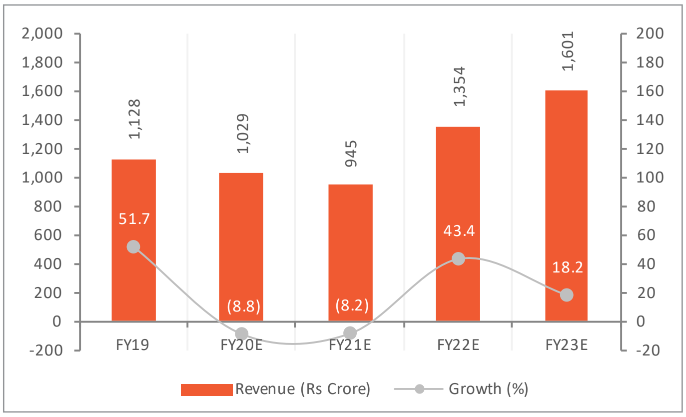
Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	1,128	1,029	945	1,354	1,601
OPM (%)	37.5	40.2	36.4	36.9	37.5
Adjusted PAT	283	334	263	380	452
y-o-y growth (%)	107.2	18.0	(21.1)	44.4	19.0
Adjusted EPS (Rs.)	27.5	32.5	25.6	37.0	44.0
P/E (x)	47.9	40.5	51.4	35.6	29.9
P/BV (x)	12.9	10.6	9.3	7.7	6.4
EV/EBITDA (x)	31.7	32.0	38.5	26.0	21.2
RoCE (%)	41.8	34.1	24.4	30.3	30.1
RoE (%)	30.6	28.6	19.2	23.7	23.4

Source: Company; Sharekhan estimates

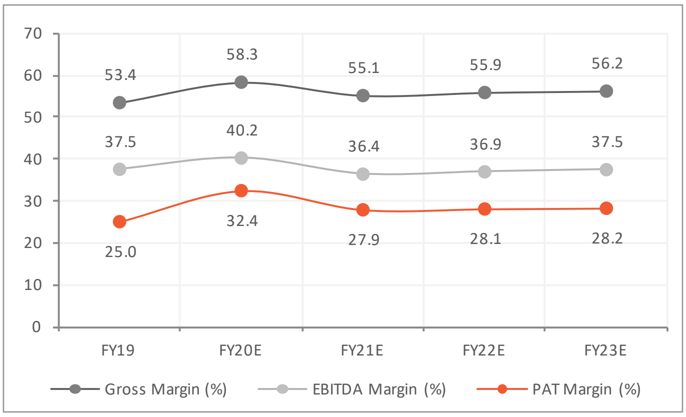
Financials in charts

Revenue growth to recover over FY22E-FY23E



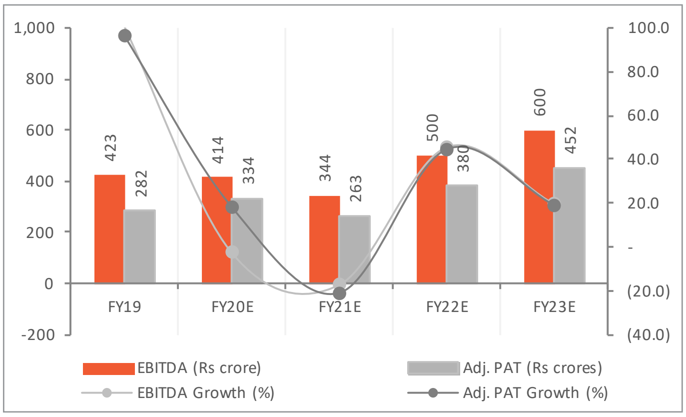
Source: Company, Sharekhan Research

Operates at a significantly higher margin profile



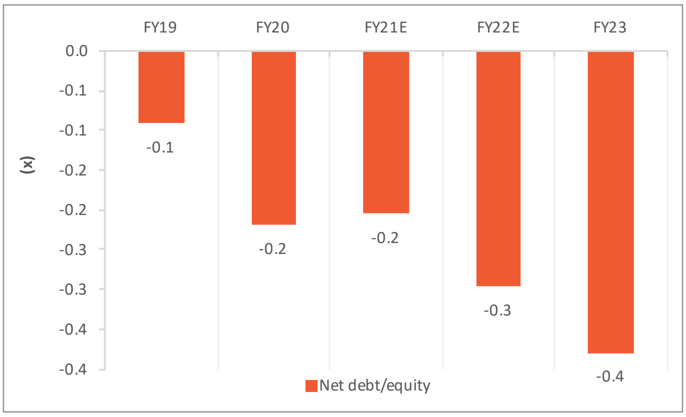
Source: Company, Sharekhan Research

EBITDA/PAT CAGR of 32%/31% over FY21E-FY23E



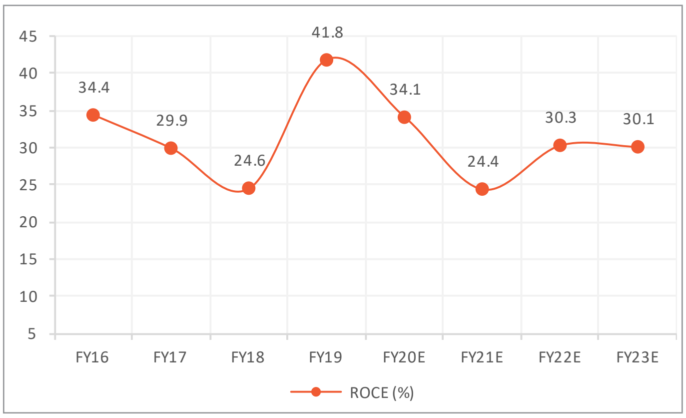
Source: Company, Sharekhan Research

Debt free company, balance sheet to get strong further



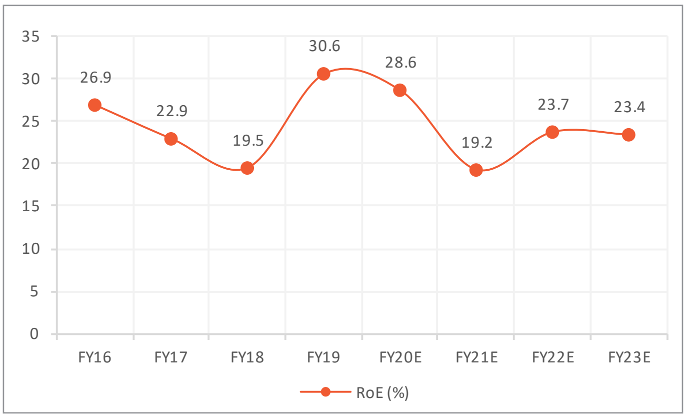
Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Structural growth drivers to propel sustained growth for the specialty chemicals sector in medium to long term

We remain bullish on 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.

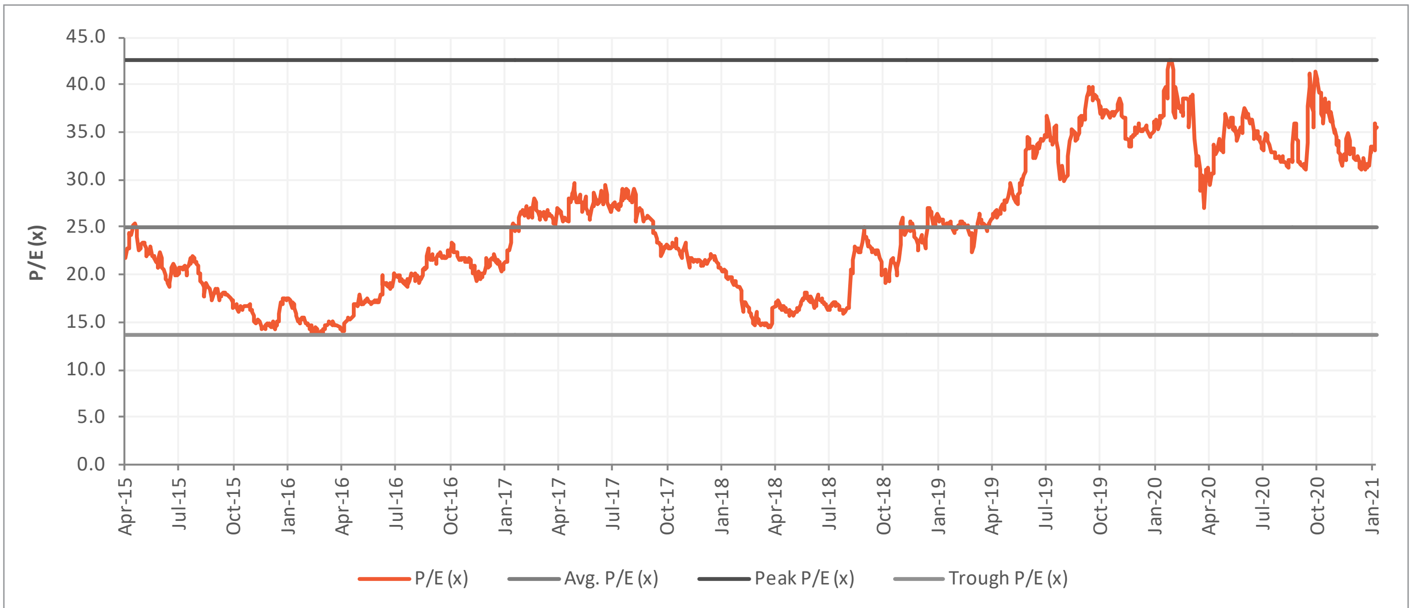
■ Company Outlook – Niche business with significant market share, improvement in ATBS demand bodes well for earnings recovery

Vinati 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 generate superior return ratios. Potential recovery in ATBS margins & demand and ramp-up of Butyl Phenol (peak revenue potential of Rs. 400-500 crore) would lead to 31% PAT CAGR over FY2021E-FY2023E.

■ Valuation – Upgrade Vinati Organics to Buy with a revised PT of Rs. 1,550

Vinati Organics' dominant global market share in ATBS/IBB segments, a pipeline of 12 new products in R&D phase and massive export opportunities in 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 also expected to recede as strong global economic recovery has led to sharp rise in oil price. Hence, we upgrade our rating on Vinati Organics to Buy (from Hold) with a revised PT of Rs. 1,550. The stock is trading at 35.6x FY2022E EPS and 29.9x FY2023E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Incorporated in 1989, Vinati Organics (Vinati) is one of India's leading manufacturers and exporters of specialty organic intermediaries, monomers, and polymers. Vinati is world's largest manufacturers and sellers 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 26000 TPA for ATBS. Vinati is an export oriented company, as ~70-75% of its overall revenues are derived from export markets.

Investment theme

Vinati Organics (Vinati) operates in a niche segments and have an exceptional product basket with 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 to generate superior return ratios. Vinati 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 an economic slowdown and a delay in completion of expansion projects might impact revenue growth.Adverse raw material prices and a 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	1.2
3	INVESTOR EDUCATION & PROTECTN FD	1.1
4	Vanguard Group Inc/The	0.8
5	Goldman Sachs Group Inc/The	0.7
6	Canara Robeco Asset Management Co	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	Tata Asset Management Ltd	0.3

Source: Bloomberg; Note: Shareholding as on November 09, 2020

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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