Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Vinati Organics Ltd

Subdued Q1; Weak near-term outlook amid inventory destocking

Speciality Chemcials	Sharekhan code: VINATIORGA
Reco/View: Hold ↔	CMP: Rs. 1,816	Price Target: Rs. 1,900 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 28.98

Updated Aug 08, 2023

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

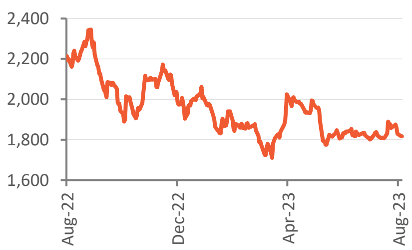
Company details

Market cap:	Rs. 18,669 cr
52-week high/low:	Rs. 2,373 / 1,693
NSE volume: (No of shares)	0.5 lakh
BSE code:	524200
NSE code:	VINATIORGA
Free float: (No of shares)	2.7 cr

Shareholding (%)

Promoters	74
FII	4
DII	8
Others	13

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.5	-7.3	-3.3	-17.9
Relative to Sensex	1.1	-13.8	-10.7	-26.7

Sharekhan Research, Bloomberg

Summary

- Q1 results were weak and reflected volume pressure primarily due to destocking of ATBS inventory and a fall in margin amid a favourable revenue mix and impact on operating leverage. Thus, consolidated PAT of Rs. 83 crore (down 28% q-o-q) was 10% below our estimates.
- H2FY23 saw high ATBS offtake given supply chain concern which led to overstocking of ATBS with the customers. The company expects normalisation in H2FY24 and ATBS capacity expansion by 20000 TPA would get delayed to Q4FY24 or early next fiscal as compared to earlier commissioning target of Q3FY24. We cut our FY24/FY25 earnings estimate by 18%/15%.
- Management's FY24 revenue/margin guidance of Rs. 2,000 crore/28% implies steep earnings de-growth in current fiscal. FY25 revenue growth guidance of 20-25% led by pick-up in antioxidants and recovery in ATBS. Investment of Rs. 280 crore on niche like MEHQ & Guaiacol and Iso Amylene would also get delayed by 6 months to March 2024. Also, VAPL merger is still pending with NCLT.
- We maintain a Hold rating on Vinati Organics Ltd with a revised PT of Rs. 1,900 given muted earnings outlook amid a challenging environment and rich valuation of 46x/33x its FY2023E/FY2024E EPS limits any meaningful upside from CMP.

Vinati Organics Limited (Vinati Organics) reported yet another subdued quarter with a miss of 2%/10%/10% in its consolidated revenues/operating profit/PAT at Rs. 431 crore/Rs. 109 crore/Rs. 83 crore, down 14/28%/28% q-o-q and 15%/17%/18% y-o-y. The weakness in revenue is attributed to lower volumes due to inventory destocking in ATBS while the pricing impact was not much and OPM contraction of 497 bps q-o-q was on the account of unfavourable revenue mix (ATBS/IBB/Butyl Phenol/Others at 40%/20%/17%/23%) and impact on operating leverage amid a decline in volumes.

Key positives

- IBB witnessed y-o-y revenue growth with revenue share of 20% versus 13% in Q1FY23.

Key negatives

- Lower revenue share of ATBS at 40% versus 44% in Q1FY23.
- Miss of 132/217 bps in gross/EBITDA margin at 47.6%/25.3%, down 267/497 bps q-o-q.

Management Commentary

- Weak revenue guidance of Rs. 2000 crore for FY24 due to volume impact on ATBS given inventory destocking by customers. For FY25, management expects a 20-25% revenue growth led by antioxidants and recovery in ATBS (expected from Q3FY24).
- EBITDA margin guidance of 28% as share of non-ATBS business to grow over the coming years.
- Expansion projects see 3-6 months delays – 1) ATBS expansion delayed by a quarter to Q4FY24 or early next fiscal, 2) investment in niche products (MEHQ & Guaiacol and Iso-Amylene) delayed by six months to March 2024.
- Veeral Additives Private Limited has started commercial production of new antioxidants and is expected to generate revenues of around Rs. 150 crore in FY24. The approval of merger of VAPL is pending with NCLT. Addressable market size for antioxidants is Rs. 10,000 crore.

Revision in estimates – We have sharply cut our FY24/FY25 earnings estimate by 18%/15% to factor lower ATBS volume and delay in expansion projects.

Our Call

Valuation – Maintain Hold with a revised PT of Rs. 1,900: Destocking of ATBS by clients and a delay in commissioning of new products has dampened the near-term earnings outlook for Vinati Organics. Even earnings quality would also be impacted by a high revenue mix from low margin non-ATBS revenues in the coming years. Subdued earnings outlook and high valuation of 46x/33x its FY2023E/FY2024E EPS limits any meaningful upside from CMP. Hence, we maintain a Hold rating on Vinati Organics Ltd with a revised PT of Rs. 1,900. We believe that potential merger of Veeral Additives (VAPL) with Vinati remains the only key long tern catalyst given opportunity to play on high-growth antioxidants.

Key Risks

- Faster-than-expected recovery in ATBS demand and commissioning of new products is key upside risk.
- Further delay in the completion of expansion projects and continued subdued ATBS demand remain downside risk.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	1,616	2,085	1,984	2,562
OPM (%)	26.9	28.6	27.1	29.7
Adjusted PAT	347	458	406	574
y-o-y growth (%)	28.7	32.1	(11.3)	41.3
Adjusted EPS (Rs.)	33.7	44.6	39.5	55.9
P/E (x)	53.8	40.8	45.9	32.5
P/BV (x)	10.2	8.4	7.4	6.2
EV/EBITDA (x)	43.0	31.0	33.1	23.0
RoCE (%)	25.2	28.9	21.9	26.6
RoE (%)	20.6	22.6	17.1	20.6

Source: Company; Sharekhan estimates

Weak Q1 on subdued performance by ATBS business

Consolidated revenue declined by 15%/14% y-o-y/q-o-q to Rs. 431 crore, which was 2% below our estimate of Rs. 440 crore. The weakness in revenue is attributed to lower volumes due to inventory destocking in ATBS, while the pricing impact was not much and OPM contraction of 497 bps q-o-q was on the account of unfavourable revenue mix (ATBS/IBB/Butyl Phenol/Others at 40%/20%/17%/23%) and impact on operating leverage amid volume decline. Resultantly, operating profit of Rs. 109 crore (down 17% y-o-y; down 28% q-o-q) was 10% below our estimate. Consolidated PAT of Rs. 83 crore (down 18% y-o-y; down 28% q-o-q) was also 10% below our estimate on account of revenue decline and margin pressure.

Q1FY2024 key earnings conference call highlights

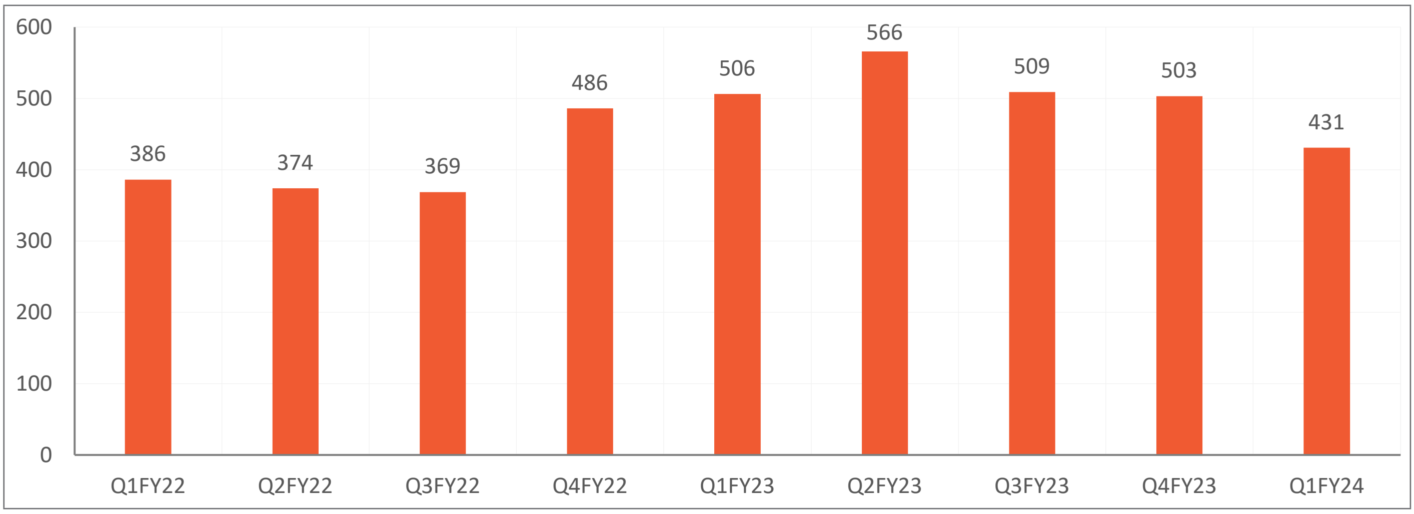
- **Volume decline –** Due to high freight cost and COVID-related issues, the company experienced high offtake by its customers of ATBS in H2FY23. This led to the buildup of customers' inventory. This inventory build-up is now being normalized through destocking by its major customer and led to lower volume in Q1FY24. Management expects ATBS demand to normalize in H2FY24. The company has not seen any material impact on ATBS prices.
- **Revenue and margin guidance –** Management expects Q2FY24 to be similar to Q1FY24. For FY24, the management expects to generate revenue of Rs. 2000 Crore and EBITDA margin of 28%. For FY25, the company expects to see a revenue growth of 20-25% with a slightly lower margin due to higher growth in lower margin business.
- **Veeral Additives Private Limited merger update –** VAPL has started commercial production of new antioxidants products and expected to generate revenues of around Rs. 150 crore in FY24. The company is targeting both domestic as well as export markets with an addressable market for VAPL being more than Rs. 10,000 crore. The approval of merger of VAPL with Vinati Oragnics is pending with NCLT.
- **New ATBS capacity delayed –** Work on a new line for ATBS is expected to now come online by the end of FY24 or early next fiscal versus earlier target to complete expansion by Q3FY24. Post expansion, ATBS capacity would increase to 60,000 TPA as compared to 40,000 TPA currently. The capacity expansion is led by customers' commitment.
- **Butyl phenol and antioxidants revenue potential –** The total combined revenue potential of butyl phenol and antioxidants is in the range of Rs. 900-1000 crore, with margins to remain within the range of 15-20%.
- **Other updates –** 1) Q1FY24 revenue mix was at 40%/20%/17%/23% from ATBS/IBB/butyl phenol respectively, 2) Any new investment management expects to generate at least 20% of ROCE.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	Y-o-Y %	Q4FY23	Q-o-Q %
Revenue	**431.0**	**506.3**	**(14.9)**	**503.4**	**(14.4)**
Total expenditure	322.0	375.4	(14.2)	351.1	(8.3)
Operating profit	**109.0**	**130.9**	**(16.7)**	**152.3**	**(28.4)**
Other Income	15.3	18.7	(18.0)	17.0	(9.6)
Depreciation	13.2	76.5	(82.8)	13.0	1.3
Finance Cost	0.3	12.8	(97.9)	0.1	102.4
PBT	110.9	136.3	(18.6)	156.1	(29.0)
Tax	27.6	35.1	(21.3)	40.7	(32.2)
PAT	**83.2**	**101.2**	**(17.7)**	**115.4**	**(27.9)**
EPS (Rs.)	8.1	9.8	(17.7)	11.2	(27.9)
Margin (%)			**BPS**		**BPS**
OPM	25.3	25.8	(56)	30.3	(497)
NPM	19.3	20.0	(67)	22.9	(361)
Tax rate	24.9	25.7	(83)	26.1	(118)

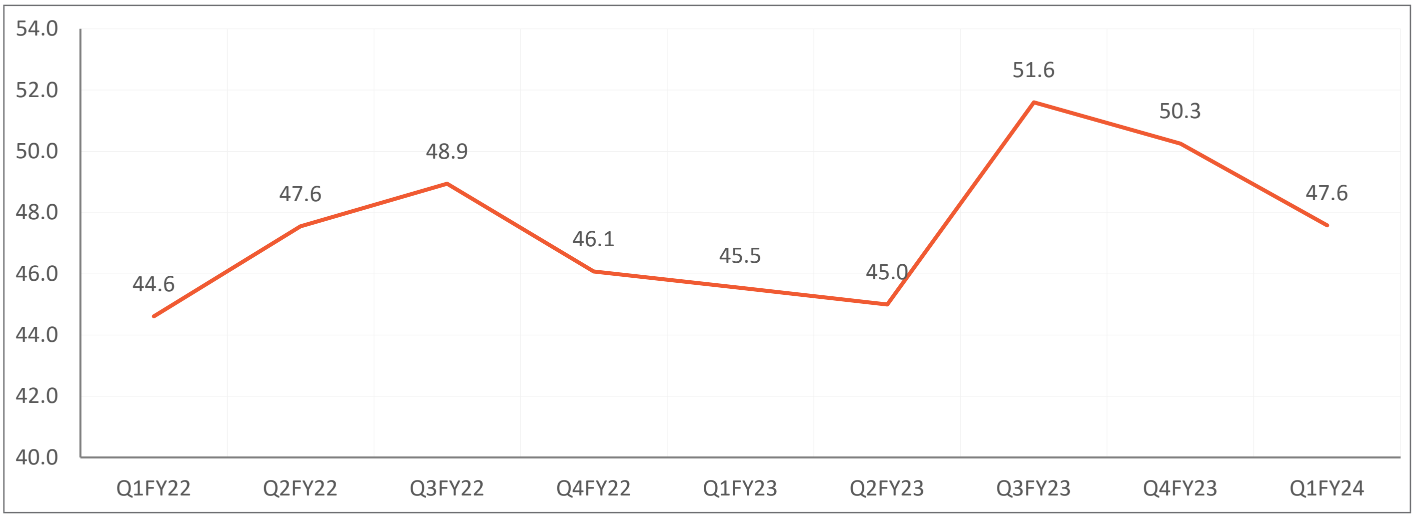
Source: Company; Sharekhan Research

Downward trend in Q1FY24 revenue



Source: Company; Sharekhan Research

Gross margin/OPM missed estimate



Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View - Structural drivers to propel sustained growth for specialty chemicals sector

We remain bullish on the medium to long-term growth prospects of specialty chemicals sector, given a massive revenue opportunity from the perspective of import substitution (India's total specialty chemical imports are estimated at $56 billion), potential increase in exports given the China Plus One strategy by global customers, and favourable government policies (such as tax incentives 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.

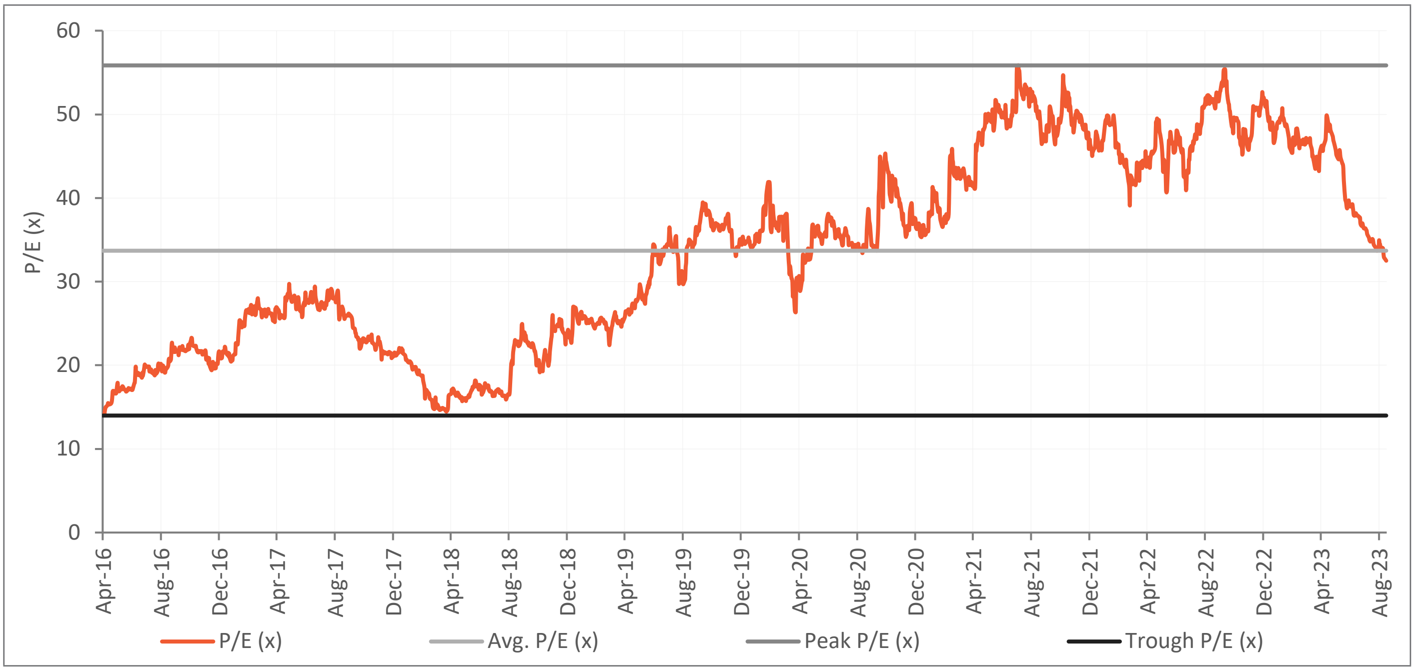
■ Company Outlook – Niche business with significant market share key products, weak ATBS a near-term concern

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. High channel inventory in chemical sector is now visible for ATBS as well and thus Vinati's clients are focused on destocking ATBS and the same would impact earnings of the company in FY24 (expect PAT to decline by 11% y-o-y).

■ Valuation – Maintain Hold with a revised PT of Rs. 1,900

Destocking of ATBS by clients and delay in commissioning of new products has dampened the near-term earnings outlook for Vinati Organics. Even earnings quality would also be impacted by a high revenue mix from low margin non-ATBS revenues in the coming years. Subdued earnings outlook and high valuation of 46x/33x its FY2023E/FY2024E EPS limits any meaningful upside from CMP. Hence, we maintain a Hold rating on Vinati Organics Ltd with a revised PT of Rs. 1,900. We believe that potential merger of Veeral Additives (VAPL) with Vinati remains the only key long tern catalyst given opportunity to play on high-growth antioxidants.

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. 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 can generate significantly higher margin profile. This coupled with a lean balance sheet 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 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. However, destocking of ATBS by clients and delay in commissioning of new products (MEHQ, guaiacol and isoamylene) has dampened near term earnings outlook for Vinati Organics.

Key Risks

- Faster-than-expected recovery in ATBS demand and commissioning of new products is key upside risk.
- Further delay in the completion of expansion projects and continued subdued ATBS demand remain downside risk.

Additional Data

Key management personnel

Vinod Saraf	Chairman
Vinati Saraf Mutreja	Managing Director and CEO
Viral Saraf Mittal	Director-CSR and Corporate Strategy
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	3.38
2	Canara Robeco Asset Management Co	2.08
3	INVESTOR EDUCATION & PROTECTN FD	1.14
4	Capital Group Cos Inc/The	0.92
5	Vanguard Group Inc/The	0.84
6	Goldman Sachs Group Inc/The	0.63
7	PGIM India Asset Management Pvt Lt	0.6
8	Axis Asset Management Co Ltd/India	0.51
9	Invesco Asset Management India Pvt	0.5
10	BlackRock Inc	0.45

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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