

2 August 2021

Vinati Organics

Margins under pressure, valuation high; lowering to a Hold

Rating: **Hold**

Target Price: Rs.2,050

Share Price: Rs.1,925

A steep price hike in acrylonitrile (key RM for ATBS) in Q4 FY21, high phenol prices and delay in passing on prices hurt Vinati's gross/EBITDA margins 19%/16% y/y to 45%/26%. Further, higher freight cost compressed margins. We like the company and expect the strong growth momentum to continue on a pick-up in ATBS demand with a strong outlook, greater utilisation of butyl phenol and the Veeral amalgamation. We lower our rating to a Hold due to the recent jump in the stock price, valuing the stock at 44x FY23e, at a Rs2,050 target.

Highest revenue in Q1. Pent-up demand for ATBS (low base), greater demand and more utilisation in butyl phenol supported Vinati's Q1 revenue; up 66.8% y/y, 38.1% q/q, to Rs3.8bn. Profit was up 11.9% y/y, 14.2% q/q, to Rs809m, supported by a strong topline and higher other income.

EBITDA margin to return to normal. In Q1 FY22, the EBITDA margin contracted to 26.3% due to higher raw-material prices and operating expenses. Over FY19-21, on better pricing and demand, Vinati reported EBITDA margin between 37% - 40%. Management aims at ~33% EBITDA margin in FY22.

Outlook. The company guided to clock Rs20bn revenue in the next three years, of which 25% would come from antioxidants. The amalgamation with Veeral is expected to be complete by Jan'22, with revenue from Q1 FY23. The company guided to ~45%+ revenue growth in FY22 on the pick-up in ATBS demand and a rise in butyl phenol utilisation.

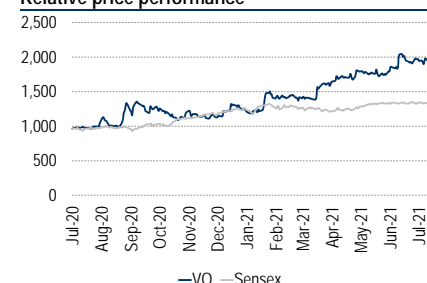
Valuation. Due to the recent rise in stock price, we lower our rating to a Hold, with a target of Rs2,050, at multiples of 44x FY23e EPS and 32x FY23e EV/EBITDA. **Risks:** Delay in expansion and scaling up from laboratory to commercial scale; slowdown in R&D.

Key data	VO IN/ VNTI.BO
52-week high / low	Rs.2132 / 963
Sensex / Nifty	52951 / 15885
3-m average volume	\$3.7m
Market cap	Rs.198bn / \$2662.9m
Shares outstanding	103m

Shareholding pattern (%)	Jun'21	Mar'21	Dec'20
Promoters	74.1	74.1	74.1
- of which, Pledged	-	-	-
Free float	25.9	25.9	25.9
- Foreign institutions	4.4	3.5	3.7
- Domestic institutions	6.8	7.3	6.7
- Public	14.7	15.2	15.6

Estimates revision (%)	FY22e	FY23e
Revenue	11.7	9.2
EBITDA	(1.3)	(3.4)
PAT	(2.1)	(4.8)

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY19	FY20	FY21	FY22e	FY23e
Sales (Rs m)	11,279	10,289	9,543	14,778	18,716
Net profit (Rsm)	2,825	3,338	2,693	3,670	4,810
EPS (Rs)	27.5	32.5	26.2	35.7	46.8
P/E (x)	70.0	59.3	73.5	53.9	41.1
EV / EBITDA (x)	46.5	47.1	55.3	38.8	29.9
P/BV (x)	18.8	15.5	12.8	10.8	8.9
RoE (%)	30.6	28.6	19.1	21.7	23.7
RoCE (%)	27.9	26.9	18.1	20.8	22.8
Dividend yield (%)	0.4	0.3	0.3	0.4	0.5
Net debt / equity (x)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)

Source: Company, Anand Rathi Research

Nav Bhardwaj
Research Analyst

Bhawana Israni
Research Associate

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rsm)

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
Net revenues (Rs m)	11,279	10,289	9,543	14,778	18,716
Growth (%)	51.7	(8.8)	(7.3)	54.9	26.7
Direct costs	5,251	4,287	3,877	7,093	8,890
SG&A	1,794	1,862	2,141	2,660	3,369
EBITDA	4,234	4,139	3,525	5,024	6,457
EBITDA margins (%)	37.5	40.2	36.9	34.0	34.5
- Depreciation	274	332	429	470	536
Other income	302	450	258	351	504
Interest expenses	9	11	2	12	12
PBT	4,252	4,247	3,352	4,894	6,413
Effective tax rate (%)	33.6	21.4	19.7	25.0	25.0
+ Associates / (Minorities)	0	0	0	0	0
Net income	2,825	3,338	2,693	3,670	4,810
Adjusted income	2,825	3,338	2,693	3,670	4,810
WANS	103	103	103	103	103
FDEPS (Rs / sh)	27.5	32.5	26.2	35.7	46.8
FDEPS growth (%)	96.3	18.2	-19.3	36.3	31.1
Gross margins (%)	53.4	58.3	59.4	52.0	52.5

Fig 3 – Cash-flow statement (Rsm)

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
PBT before OI and Interest	3,960	3,808	3,096	4,555	5,921
+ Non-cash items	274	332	429	470	536
Oper. prof. before WC	4,234	4,139	3,525	5,024	6,457
- Incr. / (decr.) in WC	1,096	(862)	2,278	1,834	1,512
Others incl. taxes	1,390	1,049	585	1,223	1,603
Operating cash-flow	1,748	3,952	662	1,967	3,342
- Capex (tang.+ intang.)	2,013	1,492	738	1,500	1,000
Free cash-flow	(265)	2,460	(76)	467	2,342
Acquisitions					
- Div. (incl. buyback & taxes)	866	681	617	734	962
+ Equity raised	-	-	-	-	0
+ Debt raised	(115)	(33)	17	-	-
- Fin investments	(353)	1,309	613	-	1,500
- Misc. (CFI+CFF) (adj OI & int)	(880)	(63)	(820)	(339)	-492
Net cash-flow	(14)	499	(468)	72	372

Source: Company, AnandRathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 2 – Balance sheet (Rsm)

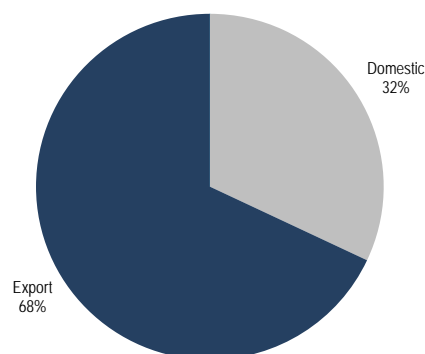
Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
Share capital	103	103	103	103	103
Net worth	10,513	12,794	15,434	18,370	22,218
Debt	37	3	20	20	20
Minority interest	-	-	-	-	-
DTL / (Assets)	846	705	779	779	779
Capital employed	11,395	13,502	16,234	19,170	23,018
Net tangible assets	4,719	7,491	7,557	8,528	9,209
Net intangible assets	26	17	12	12	12
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	1,912	310	558	617	400
Investments (strategic)	-	-	-	-	0
Investments (financial)	965	2,274	2,887	2,887	4,387
Current assets (ex cash)	4,616	3,802	6,257	8,837	10,818
Cash	38	537	69	141	513
Current liabilities	880	928	1,105	1,851	2,320
Working capital	3,736	2,874	5,152	6,986	8,498
Capital deployed	11,395	13,502	16,234	19,170	23,018
Contingent liabilities	233	-	-	-	-

Fig 4 – Ratio analysis

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
P/E (x)	70.0	59.3	73.5	53.9	41.1
EV / EBITDA (x)	46.5	47.1	55.3	38.8	29.9
EV / Sales (x)	17.5	19.0	20.4	13.2	10.3
P/B (x)	18.8	15.5	12.8	10.8	8.9
RoE (%)	30.6	28.6	19.1	21.7	23.7
RoCE (%) - after tax	27.9	26.9	18.1	20.8	22.8
RoIC	31.5	31.7	21.5	23.3	26.5
DPS (Rs / sh)	7.0	5.5	6.0	7.1	9.4
Dividend yield (%)	0.4	0.3	0.3	0.4	0.5
Dividend payout (%) - incl. DDT	25.5	16.9	22.9	20.0	20.0
Net debt / equity (x)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)
Receivables (days)	79.0	71.6	106.0	91.3	84.0
Inventory (days)	64.2	79.3	114.8	91.3	92.2
Payables (days)	36.9	47.4	62.7	58.4	58.4
CFO : PAT %	61.9	118.4	24.6	53.6	69.5

Source: Company, AnandRathi Research

Fig 6 – Revenue break-up, FY21



Source: Company

Company Update

Financial highlights

- Vinati's Q1 revenue grew 67% y/y, 38% q/q, to Rs.3.8bn due to strong demand for ATBS. The company has had the highest revenue in Q1. Realisations in and demand for ATBS has picked up from Dec'20 and have been returning to pre-Covid levels from Jan'21.
- The gross margin was 45%, down a sharp 1,874bps y/y, 1,458bps q/q, due to higher acrylonitrile, phenol and other raw material prices. The EBITDA margin contracted 1,569bps y/y, 916bps q/q, to 26.3%, the lowest since Q3FY15 due to a lower gross margin and higher operating expenses.
- Despite strong revenue growth in Q1, the EBITDA improved just 4.5% y/y, 2.4% q/q, to Rs1bn, due to the lower gross margin.
- Supported by higher other income, PAT growth was higher than EBITDA. PAT increased 11.9% y/y, 14.2% q/q, to Rs809m, because of the higher other income. In Q1, Vinati received Rs23.7m interest income on loan advanced to Veeral Additives Pvt Ltd. Post-receipt of all approvals for amalgamation and the scheme becoming effective, the loan advanced by the company to Veeral Additives will be cancelled and, consequently, the interest accrued would be eliminated from the revised financial statements of Vinati Organics; profit for Q1 would accordingly be corrected after approval.

Update on amalgamation

- To forward integrate, Vinati's Board approved the amalgamation of Veeral Additives Pvt. Ltd. with Vinati Organics. On this acquisition, butyl phenols will be the key raw materials to manufacture antioxidants. Vinati will be the largest and only integrated manufacturer of such antioxidants in India.
- With the acquisition, Vinati will be adding a new revenue stream, specialty chemicals, which have good growth potential domestically and globally. Growth would be driven by greater consumption of various plastics such as LDPE, LLDPE and PP, etc.
- Of the available 40,000 tonnes of butyl phenol capacity, ~45% will be used to manufacture antioxidants. The scheme of amalgamation is subject to approval by shareholders and the NCLT
- The company expects to receive all approvals by Jan'22 and revenue contribution would start from Q1FY23.

About Veeral Additives

Veeral Additives Pvt. Ltd. manufactures specialty chemicals. It has yet to start production, and this is the first project to manufacture antioxidants.

Fig 7 – Manufacturing capacity (Veeral)

Product	Capacity (tpa)
Anti-oxidants -- AO-1010 and AO-1076	16,000
Anti-oxidants -- AO-168	8,000
Intermediates for anti-oxidants (Metilox)	16,000
By-Products	
Methanol	1,600
32% HCl	6,000

Source: Anand Rathi Research

Key takeaways:Concall highlights

Operating highlights

- Q1 FY22 revenue up on strong demand pick-up in ATBS and rising share of butyl phenols. IBB and other products doing well
- Segment-wise revenue:
 - ATBS ~50%
 - IBB ~15%
 - Others ~35%
- Higher freight and power & fuel costs pushed up other expenses. The company expects higher costs to continue and will pass them on to customers
- It expects no material impact of the Mahad plant shutdown due to floods in Q2 as the company has maintained enough stocks. It expects ~20-25 days production loss in Q2 due to plant closure.

ATBS

- The company has a ~70% market share in global ATBS and expects to maintain or increase it as no additional capacity is coming up. Of the ATBS it manufactures, ~95% is exported.
- It has experienced a strong upswing in ATBS demand due to a soft FY21, contributing 50% to revenue. In FY21, the market was in surplus; today it is shortage.
- ATBS revenue growth was supported by ~20-25% volume growth.
- ATBS plant is running at 70-75% capacity.
- Prices of acrylonitrile peaked in Q4FY21 and delay in passing them on cut Q1 FY22 margins. Management says prices have started to come down, declining ~25-30% from the peak. This would help to better margins in coming quarters. Phenol prices are higher.

IBB

- The company has held to a 70% market share in IBB. It clocked the highest IBB sales in FY21 due to the low base. Its IBB revenue was down in FY20 as the plant of one of its largest customers was shut.
- In Q4 FY21, management talked of double-digit growth in IBB revenue in FY22 and FY23, revised to single digits at the Q1 FY22 concall. The growth would be supported by strong demand for Ibuprofen. Such growth is expected following new manufacturers and capacity expansions by existing ones.

Butyl Phenol

- The greenfield plant was operationalised last year. It is now running at ~50-60% capacity. The company expects Rs2.5bn revenue from these four butyl phenol products. Management says all butyl phenol products have been well received at home and abroad.
- The backward integration into IBB helped the company gain market share in a short time.
- Vinati has generated Rs400m in Q1 FY22 and expects Rs1.6bn-Rs2bn in FY22.

- At present, it manufactures four types of butyl phenol
 - Para-tertiary butyl phenol (PTBP)
 - Ortho-tertiary butyl phenol (OTBP)
 - 2,4-di tertiary butyl phenol (2,4-DTBP)
 - 2,6-di tertiary butyl phenol (2,6-DTBP)
- PTBP and OTBP are used mainly in the fragrance and resins. The global market is vast and the company has only 35,000 tons manufacturing capacity.
- Management says 2,4-DTBP and 2,6-DTBP will be used to manufacture antioxidants. The global market for antioxidants is more than 300,000 tons; the domestic market, 25,000 tons. The company is coming up with 25,000 tons of antioxidant capacity, and expects to sell 50% in the home market and export 50%.
- Key manufacturers: BASF, SI, Songwon. The company expects ~80% share domestically and to be one of the top-5 globally in 4-5 years.

PAP project

- This project is in a pilot stage and the company does not expect revenue generation in the next three years.

New products and expansion

- The company is working on new products. Management says that these products will have some synergies with existing products.
- The major growth contributor would be antioxidants, the direct forward integration of butyl phenol.
- Further, the company is working on other butyl phenol downstream products; O-sec-Butylphenol (OSBP), Di-sec-Butylphenol (DSBP) and T-butyl-o-cresol (TBOC). This would be horizontal integration (similar processes but different applications).

Capex

- The company has guided to ~Rs3bn capex in the next 2-3 years.
 - ~Rs2bn for new products
 - ~Rs0.5bn-0.7bn on Veeral additives
 - Further capex to expand ATBS or other capacity
- The company has enough land (~25 acres) for expansions.

Guidance

- Management guided to ~45%+ revenue growth in FY22 with EBITDA margin of ~33% in FY22
- It is focusing on R&D and has some products in the pipeline.
- It aims at Rs20bn revenue in the next three years, of which, ~Rs5bn would be from antioxidants.

Fig 8 – Quarterly trend

Particulars(Rs m)	Q4FY19	Q1FY20	Q2FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4FY21	Q1 FY22	% Y/Y	% Q/Q	FY20	FY21	% Y/Y
Income	3,019	2,907	2,491	2,385	2,453	2,316	2,194	2,235	2,798	3,864	66.8	38.1	10,237	9,543	(6.8)
RM costs	1,328	1,230	984	1,083	990	849	880	1,007	1,142	2,140	152.2	87.5	4,287	3,877	(9.6)
Employee exp	130	153	160	171	159	184	181	184	177	209	13.1	18.0	643	726	13.0
Other expenses	310	323	309	300	288	311	293	323	488	500	60.8	2.5	1,220	1,414	16.0
EBITDA	1,251	1,202	1,039	830	1,017	972	841	721	991	1,015	4.5	2.4	4,087	3,525	(13.8)
Depreciation	68	70	72	93	97	106	108	108	107	110	3.4	2.6	332	429	29.4
Interest	2	3	3	3	3	0	0	0	1	0	(70.9)	(88.6)	11	2	(80.6)
Other income	50	114	71	154	162	86	14	93	66	176	104.4	167.6	502	259	(48.5)
PBT	1,230	1,243	1,036	889	1,079	951	747	706	949	1,081	13.7	13.9	4,246	3,353	(21.1)
Tax	405	419	(64)	220	333	228	127	65	240	272	19.2	13.2	908	659	(27.4)
Reported PAT	825	824	1,100	668	746	723	620	641	709	809	11.9	14.2	3,338	2,693	(19.3)
EPS(Rs)	8.0	8.0	10.7	6.5	7.3	7.0	6.0	6.2	6.9	7.9	11.9	14.2	32.5	26.2	(19.3)

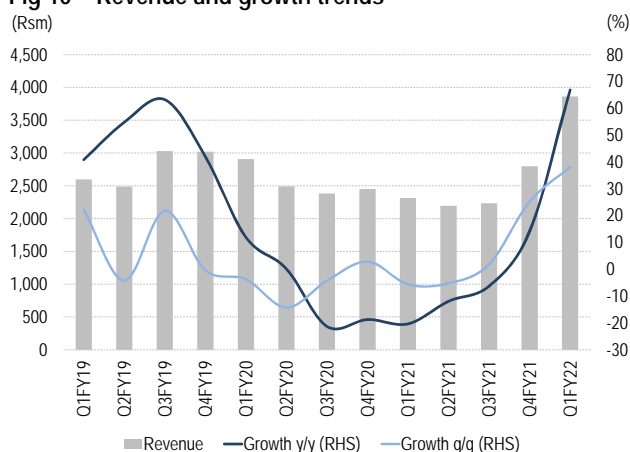
Source: Company

Fig 9 – Quarterly trend, as percent of sales

Particulars	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	bps Y/Y	bps Q/Q	FY20	FY21	bps Y/Y
Gross margins	56.0	57.7	60.5	54.6	59.7	63.4	59.9	55.0	59.2	44.6	(1,874)	(1,458)	58.1	59.4	126
Employee costs	4.3	5.2	6.4	7.2	6.5	8.0	8.2	8.3	6.3	5.4	(256)	(92)	6.3	7.6	133
Other expenses	10.3	11.1	12.4	12.6	11.7	13.4	13.3	14.4	17.4	12.9	(49)	(450)	11.9	14.8	291
EBITDA margins	41.4	41.3	41.7	34.8	41.4	42.0	38.3	32.3	35.4	26.3	(1,569)	(916)	39.9	36.9	(298)
Depreciation	2.3	2.4	2.9	3.9	4.0	4.6	4.9	4.8	3.8	2.8	(175)	(99)	3.2	4.5	126
Interest	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	(2)	(4)	0.1	0.0	(8)
Other income	1.6	3.9	2.9	6.5	6.6	3.7	0.6	4.2	2.3	4.5	84	220	4.9	2.7	(219)
PBT margins	40.7	42.8	41.6	37.3	44.0	41.1	34.0	31.6	33.9	28.0	(1,309)	(593)	41.5	35.1	(635)
Effective tax rate	32.9	33.7	(6.2)	24.8	30.8	24.0	17.0	9.2	25.3	25.1	116	(17)	21.4	19.7	(173)
PAT margins	27.3	28.3	44.1	28.0	30.4	31.2	28.3	28.7	25.3	20.9	(1,028)	(438)	32.6	28.2	(438)

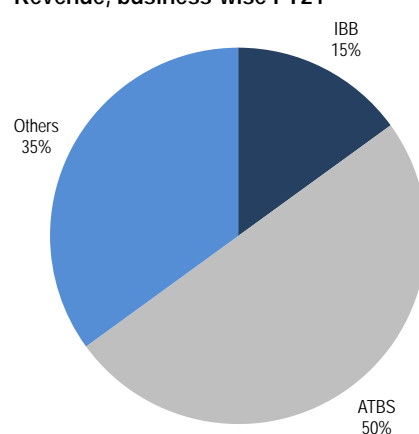
Source: Company

Fig 10 – Revenue and growth trends



Source: Company

Fig 11 – Revenue, business-wise FY21



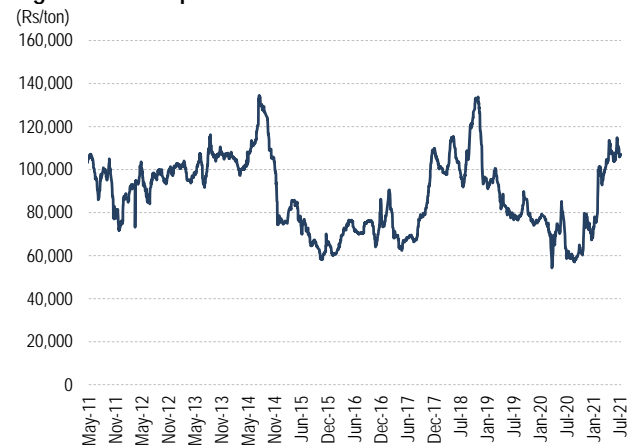
Source: Company, Anand Rathi Research

Fig 12 – Acrylonitrile price movement



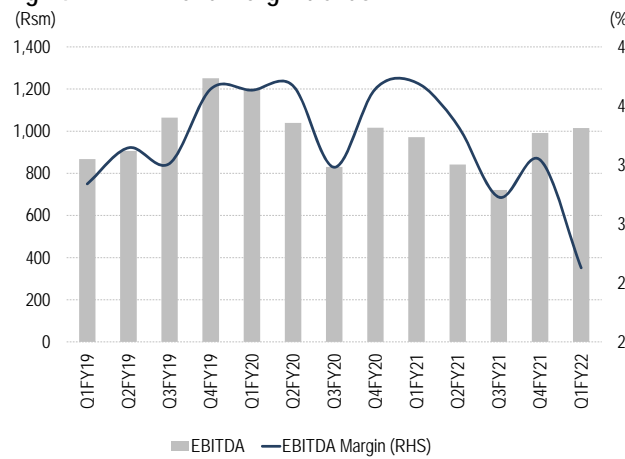
Source: Bloomberg

Fig 13 – Phenol price movement



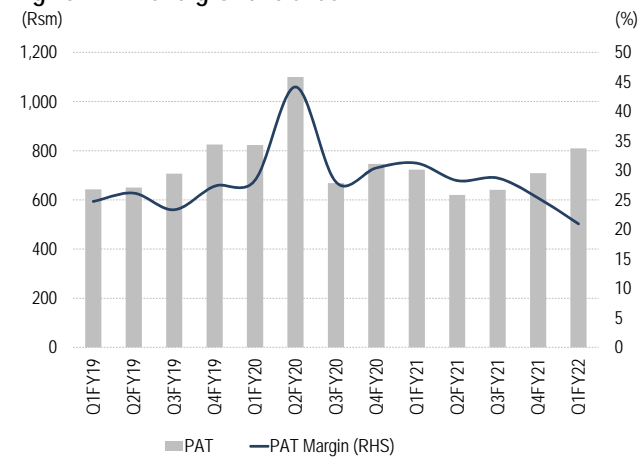
Source: Bloomberg

Fig 14 – EBITDA and margin trends



Source: Company

Fig 15 – PAT and growth trends



Source: Company

Revenue growth prospects

Butyl phenol. The ~39,000tpa butyl phenol plant was commissioned in Q2FY20. Being the leading manufacturer of IB, it will be easy for Vinati to forward integrate. The revenue potential is ~Rs4bn-4.5bn. FY21 plant utilisation was low due to the Covid-19 outbreak and the challenging business environment. Utilisation is expected to improve and Rs2.5bn revenue attained in FY23.

PTBBA expansion The company announced Rs1.5bn capex in Oct'20 to manufacture four specialty chemical products from the PTBBA plant. These will be used mainly in agrochemicals, dyes and plastic additives. The company can generate Rs2.4bn revenue from this expansion. Further, in Nov'20 it announced additional capex of Rs600m for new products and expansions. Expected revenue potential would be Rs3bn from capex of Rs2.1bn.

ATBS expansion. In FY20 the company expanded its ATBS capacity by 14,000 tons to 40,000 tons at Rs1.1bn capex. It expects to generate additional revenue of Rs2.5bn-3bn from this expansion. Margins are expected to be strong in Q1 due to the added contribution from high-margin ATBS. The company has guided to ~80-85% volume growth in ATBS in FY22.

The Veeral acquisition. The Board approved the Veeral Additives amalgamation with Vinati. The former manufactures antioxidants (24,000 tpa). This acquisition is a forward integration for Vinati as its butyl phenol products will be used to manufacture antioxidants. After the acquisition, Vinati will become the largest and only integrated manufacturer of such antioxidants in India. Veeral can generate Rs.3bn revenue.

Strong cash position. We estimate that after the Rs4.7bn capex (as indicated by management) from FY20 to FY23, the company will have cash and investments of Rs4.9bn in FY23. This will be 42% of its gross block. We believe that management will continue to find avenues to invest this accumulated cash at similar RoICs of 25%+, thus paving the way for further growth.

Valuation

Change in estimates

Based on management guidance for revenue and EBITDA, we are trimming our FY22e and FY23e.

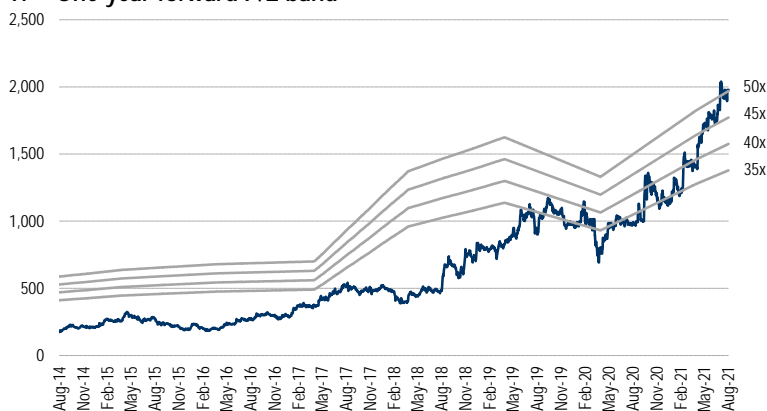
Fig 16 – Change in estimates

(Rs m)	Old estimates		New estimates		% change	
	FY22e	FY23e	FY22e	FY23e	FY22e	FY23e
Revenue	13,225	17,147	14,778	18,716	11.7	9.2
EBITDA	5,092	6,687	5,024	6,457	(1.3)	(3.4)
PAT	3,749	5,051	3,670	4,810	(2.1)	(4.8)

Source: Anand Rathi Research

We lower our rating to a Hold, with a higher target of Rs2,050. At this, the stock is valued at PEs of 58x FY22e and 44x FY23e. On an EV/EBITDA multiple, it is valued at 42x FY22e and 32x FY23e.

Fig 17 – One-year-forward P/E band



Source: Anand Rathi Research

Risks

- Shutdown of key clients’ manufacturing plants.
- Delay in scaling up from laboratory stage to commercial scale.
- Slowdown in R&D and new product pipeline.
- Unfavourable forex movements.
- Global slowdown, leading to a deceleration in key consumer sectors.

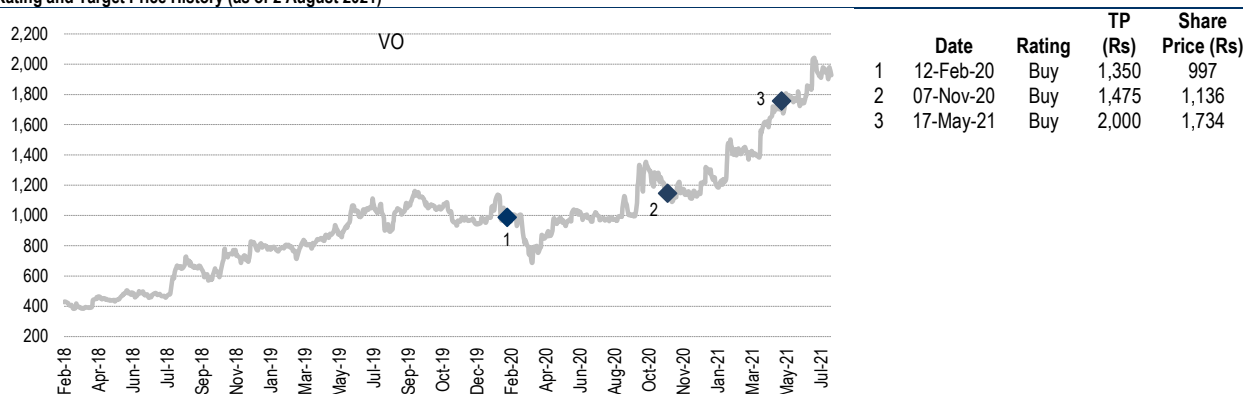
Appendix

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Rating and Target Price History (as of 2 August 2021)



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Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US\$1bn) and Mid/Small Caps (<US\$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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ARSSBL registered address: Express Zone, A Wing, 9th Floor, Western Express Highway, Diagonally Opposite Oberoi Mall, Malad (E), Mumbai – 400097.
Tel No: +91 22 6281 7000 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.