

4 February 2021

Vinati Organics

Subdued Q3, forward integration of butyl phenol; Buy

Lower demand for ATBS (mainly from the oil & gas industry) impacted Vinati's Q3 performance, while utilization of butyl phenol improved. The company expects to end FY21 on the lower side and expects strong demand recovery from Q4 following rising demand for its products (IBB, isobutyl), greater utilisation of butyl phenol and a pickup in demand for ATBS. Further, amalgamation with Veeral will add to revenue in coming years. We maintain our Buy rating, with the same target of Rs.1,475, valuing the stock at 30x FY23e EPS.

Subdued Q3. Revenue declined 6.3% y/y, though q/q up 1.8%, to Rs.2.2bn backed by continuous soft demand for ATBS. The EBITDA margin contracted 254bps y/y, 607bps q/q, to 32.3%, the lowest in the last 11 quarters, on the lower contribution of the high-margin ATBS and on higher operating expenses. Employee expenses rose due to hiring for the butyl phenol plant; other expenses jumped due to lower absorption of fixed costs on lower production.

Amalgamation of Veeral additives. Vinati's board approved the Veeral Additives amalgamation with Vinati. The latter manufactures antioxidants (annual capacity: 24,000 tonnes). This acquisition is a forward integration for Vinati as its butyl phenols products will be used to manufacture antioxidants. After the acquisition, Vinati will become the largest and the only integrated manufacturer of such antioxidants in India. Veeral can generate Rs.3bn revenue and an additional Rs.2bn by using butyl phenol from Vinati.

Outlook, valuation. ATBS demand picked up from Dec'20 and returned to pre-Covid levels in Jan'21. The company expects strong recovery from Q4. We maintain a Buy, with the same target of Rs.1,475, at implied multiples of 30x FY23e EPS and 21x FY23e EV/EBITDA. **Risks:** Delay in expansion and scaling up from laboratory to commercial scale; slowdown in R&D.

Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Sales (Rs m)	11,279	10,289	9,420	13,225	17,147
Net profit (Rs m)	2,825	3,338	2,734	3,749	5,051
EPS (Rs)	27.5	32.5	26.6	36.5	49.1
PE (x)	45.3	38.3	46.8	34.1	25.3
EV / EBITDA (x)	30.0	30.2	34.9	24.0	17.9
PBV (x)	12.2	10.0	8.5	7.0	5.7
RoE (%)	30.6	28.6	19.6	22.4	24.7
RoCE (%)	27.9	26.9	18.7	21.5	23.9
Dividend yield (%)	0.6	0.4	0.3	0.4	0.6
Net debt / equity (x)	(0.1)	(0.2)	(0.3)	(0.3)	(0.4)

Source: Company, Anand Rathi Research

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Rating: **Buy**

Target Price: Rs.1,475

Share Price: Rs.1,244

Key data	VO IN/ VNTI .BO
52-week high / low	Rs.1419 / 651
Sensex / Nifty	49998 / 14735
3-m average volume	\$2.3m
Market cap	Rs.128bn / \$1753m
Shares outstanding	103m

Shareholding pattern (%)	Dec'20	Sep'20	Jun'20
Promoters	74.1	74.1	74.1
- of which, Pledged	-	-	-
Free float	25.9	25.9	26.0
- Foreign institutions	3.7	3.9	5.1
- Domestic institutions	6.7	6.6	6.1
- Public	15.6	15.4	14.8

Estimates revision (%)	FY21e	FY22e	FY23e
Sales	(10.3)	(1.8)	(10.4)
EBITDA	(13.9)	(0.8)	(8.4)
EPS	(12.3)	(3.5)	(9.9)

Relative price performance



Source: Bloomberg

Nav Bhardwaj
Research Analyst

Bhawana Israni
Research Associate

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

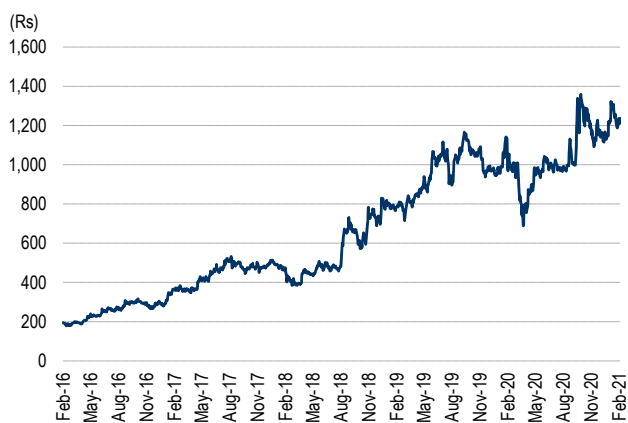
Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Net revenues (Rs m)	11,279	10,289	9,420	13,225	17,147
Growth (%)	51.7	(8.8)	(8.4)	40.4	29.7
Direct costs	5,251	4,287	3,815	5,621	7,202
SG&A	1,794	1,862	2,064	2,513	3,258
EBITDA	4,234	4,139	3,541	5,092	6,687
EBITDA margins (%)	37.5	40.2	37.6	38.5	39.0
- Depreciation	274	332	460	528	572
Other income	302	450	339	437	622
Interest expenses	9	11	2	2	2
PBT	4,252	4,247	3,418	4,999	6,734
Effective tax rate (%)	33.6	21.4	20.0	25.0	25.0
+ Associates / (Minorities)	0	0	0	0	0
Net income	2,825	3,338	2,734	3,749	5,051
Adjusted income	2,825	3,338	2,734	3,749	5,051
WANS	103	103	103	103	103
FDEPS (Rs / sh)	27.5	32.5	26.6	36.5	49.1
FDEPS growth (%)	96.3	18.2	-18.1	37.1	34.7
Gross margins (%)	53.4	58.3	59.5	57.5	58.0

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
PBT before OI and Interest	3,960	3,808	3,081	4,564	6,115
+ Non-cash items	274	332	460	528	572
Oper. prof. before WC	4,234	4,139	3,541	5,092	6,687
- Incr. / (decr.) in WC	1,096	(862)	(183)	1,030	1,122
Others incl. taxes	1,390	1,049	684	1,250	1,684
Operating cash-flow	1,748	3,952	3,041	2,812	3,882
- Capex (tang.+ intang.)	2,013	1,492	1,500	1,500	1,000
Free cash-flow	(265)	2,460	1,541	1,312	2,882
Acquisitions					
- Div. (incl. buyback & taxes)	866	681	410	562	758
+ Equity raised	-	-	-	-	0
+ Debt raised	(115)	(33)	-	-	-
- Fin investments	(353)	1,309	1,800	1,000	1,000
- Misc. (CFI+CFF) (adj OI & int)	(880)	(63)	(337)	(435)	-620
Net cash-flow	(14)	499	(333)	185	1,744

Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 2 – Balance sheet (Rs m)

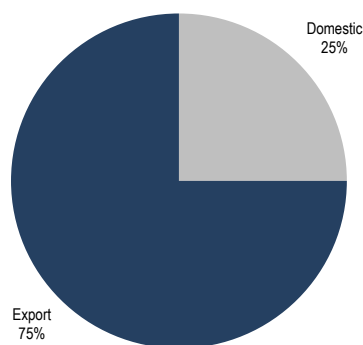
Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	103	103	103	103	103
Net worth	10,513	12,794	15,118	18,305	22,598
Debt	37	3	3	3	3
Minority interest	0	0	0	0	-
DTL / (Assets)	846	705	705	705	705
Capital employed	11,395	13,502	15,826	19,013	23,306
Net tangible assets	4,719	7,491	8,298	9,213	9,591
Net intangible assets	26	17	17	17	17
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	1,912	310	543	600	650
Investments (strategic)	-	-	-	-	0
Investments (financial)	965	2,274	4,074	5,074	6,074
Current assets (ex cash)	4,616	3,802	3,515	4,934	6,398
Cash	38	537	204	389	2,133
Current liabilities	880	928	824	1,214	1,556
Working capital	3,736	2,874	2,691	3,720	4,842
Capital deployed	11,395	13,502	15,826	19,013	23,306
Contingent liabilities	233	-	-	-	-

Fig 4 – Ratio analysis

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
P/E (x)	45.3	38.3	46.8	34.1	25.3
EV / EBITDA (x)	30.0	30.2	34.9	24.0	17.9
EV / Sales (x)	11.3	12.2	13.1	9.3	7.0
P/B (x)	12.2	10.0	8.5	7.0	5.7
RoE (%)	30.6	28.6	19.6	22.4	24.7
RoCE (%) - after tax	27.9	26.9	18.7	21.5	23.9
RoIC	28.0	27.5	19.1	21.9	25.4
DPS (Rs / sh)	7.0	5.5	4.0	5.5	7.4
Dividend yield (%)	0.6	0.4	0.3	0.4	0.6
Dividend payout (%) - incl. DDT	25.5	16.9	15.0	15.0	15.0
Net debt / equity (x)	(0.1)	(0.2)	(0.3)	(0.3)	(0.4)
Receivables (days)	79.0	71.6	73.0	73.0	73.0
Inventory (days)	64.2	79.3	90.1	85.9	86.9
Payables (days)	36.9	47.4	47.5	47.5	47.5
CFO : PAT %	61.9	118.4	111.2	75.0	76.9

Source: Company, Anand Rathi Research

Fig 6 – Revenue break-up



Source: Company

Company Update

Financial highlights

- Vinati's Q3 revenue declined 6.3% y/y, though q/q up 1.8%, to Rs.2.2bn due to lower realisations and volumes. Revenue from ATBS declined due to shrinking demand from the oil and gas industry.
- Due to the lower gross margin and higher operating expenses, the EBITDA margin contracted a sharp 254bps y/y, 607bps q/q, to 32.3%, the lowest in the last 11 quarters.
- Employee expenses were up 107bps y/y, though flat q/q, to 8.3%, due to hiring for the butyl phenol plant. Other expenses were up 185bps y/y, 109bps q/q, to 14.4%, due to lower absorption of fixed costs.
- Absolute EBITDA declined 13.1% y/y, 14.3% q/q, to Rs.721m due to lower gross profit, higher employee and other expenses.
- PAT declined 4% y/y, though q/q up 3.4%, to Rs.641m, due to the subdued operating performance compounded by higher depreciation and lower other income, but partially supported by lower tax expenses.
- The effective tax rate in Q3 was 9%, against 24.8% a year ago and 17% a quarter prior, due to earlier years' income-tax adjustments. Based on judicial pronouncements, the company received accrued tax benefits of Rs.110m in Q3 and Rs.173m in 9M FY21.

Update on amalgamation

- To forward integrate its business value chain, Vinati's Board approved the amalgamation of Veeral Additives Pvt. Ltd. with Vinati Organics.
- The acquisition is forward integration for Vinati as 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 after this acquisition.
- The acquisition will allow Vinati to add a new revenue stream of specialty chemicals, which have good growth potential both globally and domestically. Growth is driven by greater consumption of various plastics such as LDPE, LLDPE and PP, etc.
- Of the total available 40,000 tonnes of butyl phenol capacity, ~45% is used to manufacture antioxidants.
- The Scheme of amalgamation is subject to receipt of approvals from the requisite majority of shareholders and the NCLT

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

Product	Capacity (tpa)
Anti-oxidants AO-1010 & 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: Pre-Feasibility Report by Veeral Additives, Anand Rathi Research

Fig 8 – Quarterly trend

Particulars (Rs m)	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	% Y/Y	% Q/Q	9M FY20	9M FY21	% Y/Y
Income	2,487	3,031	3,019	2,907	2,491	2,385	2,453	2,316	2,194	2,235	(6.3)	1.8	7,784	6,745	(13.3)
RM costs	1,135	1,479	1,328	1,230	984	1,083	990	849	880	1,007	(7.1)	14.4	3,298	2,735	(17.1)
Employee exp	135	140	130	153	160	171	159	184	181	184	7.7	2.0	484	550	13.6
Other expenses	312	347	310	323	309	300	288	311	293	323	7.5	10.2	931	926	(0.5)
EBITDA	907	1,064	1,251	1,202	1,039	830	1,017	972	841	721	(13.1)	(14.3)	3,071	2,534	(17.5)
Depreciation	69	69	68	70	72	93	97	106	108	108	16.0	0.1	235	322	37.2
Interest	2	3	2	3	3	3	3	0	0	0	(96.1)	(79.4)	8	1	(87.9)
Other income	153	73	50	114	71	154	162	86	14	93	(39.7)	562.9	339	193	(43.2)
PBT	988	1,065	1,230	1,243	1,036	889	1,079	951	747	706	(20.5)	(5.5)	3,167	2,404	(24.1)
Tax	338	358	405	419	(64)	220	333	228	127	65	(70.7)	(49.0)	576	419	(27.2)
Reported PAT	650	707	825	824	1,100	668	746	723	620	641	(4.0)	3.4	2,592	1,985	(23.4)
EPS (Rs)	6.3	6.9	8.0	8.0	10.7	6.5	7.3	7.0	6.0	6.2	(4.0)	3.4	25.2	19.3	(23.4)

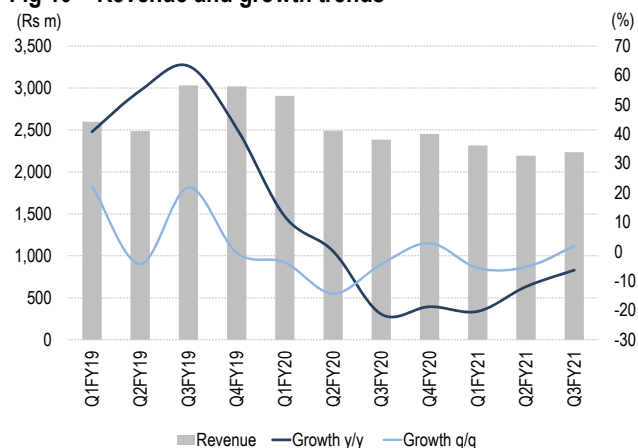
Source: Company

Fig 9 – Quarterly trend, as percent of sales

Particulars	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	bps Y/Y	bps Q/Q	9M FY20	9M FY21	bps Y/Y
Gross margins	54.4	51.2	56.0	57.7	60.5	54.6	59.7	63.4	59.9	55.0	38	(497)	57.6	59.5	182
Employee costs	5.4	4.6	4.3	5.2	6.4	7.2	6.5	8.0	8.2	8.3	107	2	6.2	8.1	193
Other expenses	12.5	11.4	10.3	11.1	12.4	12.6	11.7	13.4	13.3	14.4	185	109	12.0	13.7	177
EBITDA margins	36.5	35.1	41.4	41.3	41.7	34.8	41.4	42.0	38.3	32.3	(254)	(607)	39.5	37.6	(188)
Depreciation	2.8	2.3	2.3	2.4	2.9	3.9	4.0	4.6	4.9	4.8	93	(8)	3.0	4.8	176
Interest	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	(10)	(2)	0.1	0.0	(9)
Other income	6.1	2.4	1.6	3.9	2.9	6.5	6.6	3.7	0.6	4.2	(230)	352	4.4	2.9	(150)
PBT margins	39.7	35.1	40.7	42.8	41.6	37.3	44.0	41.1	34.0	31.6	(567)	(245)	40.7	35.6	(505)
Effective tax rate	34.2	33.6	32.9	33.7	(6.2)	24.8	30.8	24.0	17.0	9.2	(1,564)	(781)	18.2	17.4	(73)
PAT margins	26.1	23.3	27.3	28.3	44.1	28.0	30.4	31.2	28.3	28.7	68	43	33.3	29.4	(387)

Source: Company

Fig 10 – Revenue and growth trends



Source: Company

Fig 11 – Revenue, business-wise

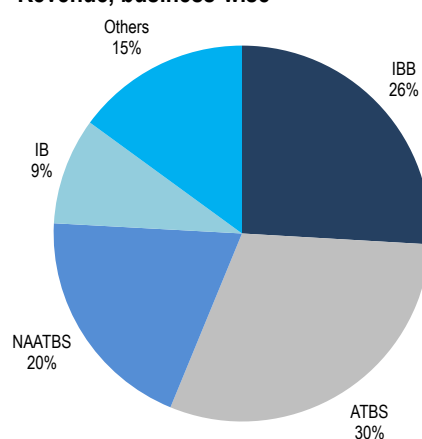
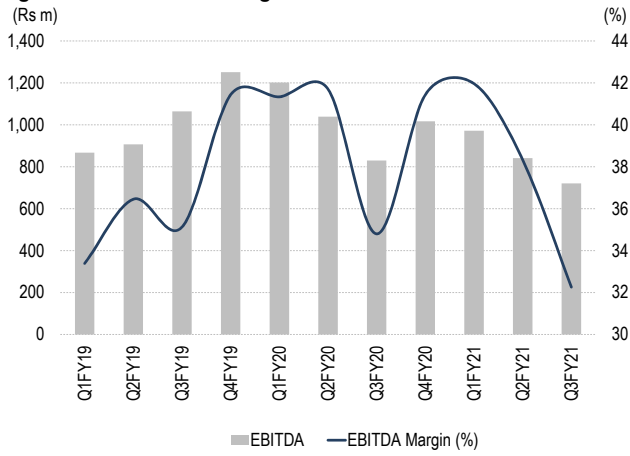
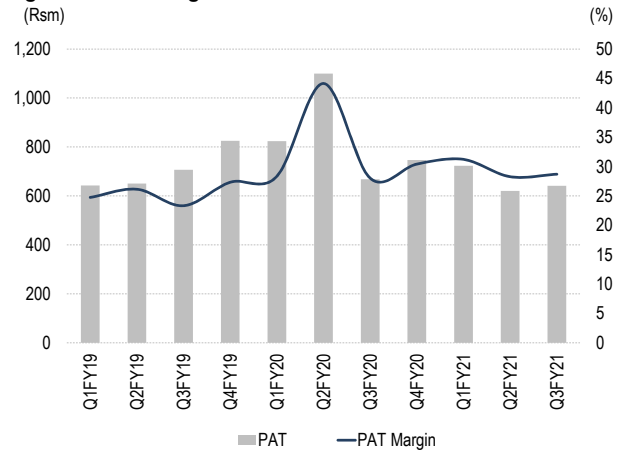


Fig 12 – EBITDA and margin trends



Source: Company

Fig 13 – PAT and growth trends



Source: Company

Valuation

Change in estimates

Fig 14 – Change in estimates

(Rs m)	Old estimates			New estimates			Change (%)		
	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e
Revenue	10,506	13,467	19,144	9,420	13,225	17,147	(10.3)	(1.8)	(10.4)
EBITDA	4,112	5,135	7,300	3,541	5,092	6,687	(13.9)	(0.8)	(8.4)
PAT	3,119	3,884	5,604	2,734	3,749	5,051	(12.3)	(3.5)	(9.9)

Source: Anand Rathi Research

To arrive at the potential value of Vinati, we use the DCF method. The 11% WACC used has been arrived at as follows.

Fig 15 – WACC

Equity (FY20) (Rs m)	12,794
Cost of equity (%)	11
Debt (FY20) (Rs m)	3
Cost of debt (%)	8
Weighted average cost of capital (%)	11

Source: Anand Rathi Research

To arrive at future cash-flows, we assume a 5% terminal growth rate.

Fig 16 – Present value of FCFF

(Rs m)	FY21e	FY22e	FY23e	FY24e	FY25e	FY26e	FY27e	FY28e	FY29e	FY30e	FY31e
EBIT	3,420	5,001	6,737	9,687	11,624	13,949	16,739	20,086	24,104	28,924	34,709
EBIT (1-t)	2,736	3,750	5,052	7,265	9,299	11,159	13,391	16,069	19,283	23,139	27,767
Depreciation	460	528	572	622	659	699	741	786	833	883	936
WC changes	183	(1,030)	(1,122)	(2,231)	(2,677)	(3,213)	(3,855)	(4,627)	(5,552)	(6,662)	(7,995)
Capex	(1,500)	(1,500)	(1,000)	(1,060)	(1,124)	(1,192)	(1,264)	(1,340)	(1,421)	(1,506)	(1,597)
FCFF	1,879	1,749	3,503	4,595	6,157	7,453	9,013	10,888	13,144	15,854	19,112
PV of FCFF	1,693	1,419	2,561	3,026	3,652	3,982	4,337	4,720	5,133	5,577	6,056

Source: Anand Rathi Research

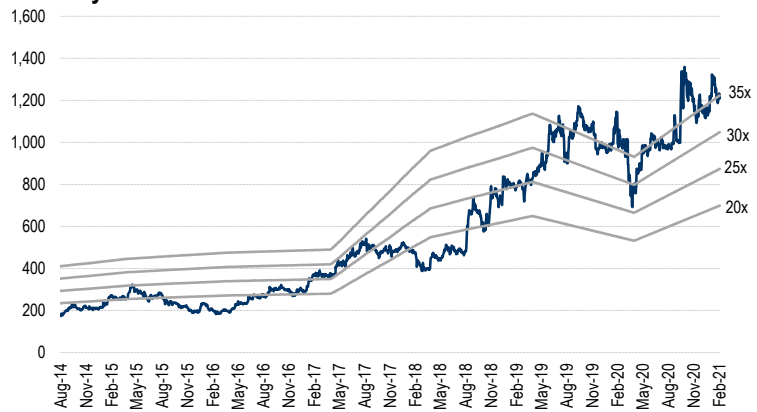
DCF-based valuation

Fig 17 – Target price (Rs m)

Present value	42,155
Terminal value	108,915
Debt	(3)
Cash	537
Total value	151,603
No. of shares (m)	103
Target price (Rs)	1,475

Source: Anand Rathi Research

We maintain a Buy, with the same target of Rs.1,475. At this, the stock is valued at PEs of 40x FY22e and 30x FY23e. On an EV/EBITDA multiple, it is valued at 29x FY22e and 21x FY23e.

Fig 18 – 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.

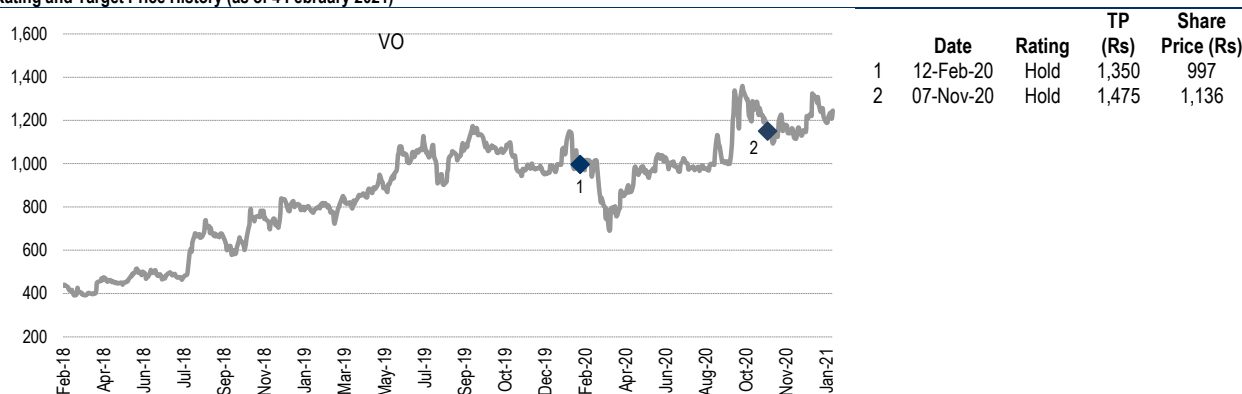
Appendix

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