Management Meet Note | Madras Fertilizers Ltd

CMP (07/03/2011): Rs 21	52- wk HI/Low: Rs 31/13	Avg. Volume NSE (Qrtly): 149,522
Sector: Fertilizers	Market Cap: Rs 340.5 cr	Free Float: 14.73%

We met management on Thursday, 24 February 2011 to understand the future prospects of Madras Fertilizers Ltd.

Why we chose MFL?

In FY10, the company reported first time profits (although marginal) after six years. In addition we saw restructuring process shaping up which caught our attention. To reconfirm our belief MFL reported strong Q3FY11 results.

Company Overview

Madras Fertilizers Limited (MFL) incorporated in the year 1966 as a PSU under the administrative control of the department of Fertilizers (DOF), Ministry of Chemicals and Fertilizers and Government of India. MFL is engaged in the manufacturing of Ammonia, Urea and Complex Fertilizers (N:P & N:P:K), at Manali, Chennai. MFL is also engaged in manufacturing of Bio-fertilizers. It markets its products under the brand name “Vijay”.

What Went Wrong

- The company faced capex overrun during 1993-1999. As a practice, Govt didn’t recognize this cost while calculating subsidy hence the company suffered huge losses.
- As a result of mounting losses and unfavorable policies for complex subsidy the company had to stop the production of NPK
- In 2009-10 the company was declared a “sick unit”
- The accumulated loss as on date is Rs 790 cr

Steps Taken So Far…

- The Govt eventually recognized the problem and granted higher subsidy to the company. As a result the company has started earning profit on Urea which amounts to around Rs 100 cr yearly (Urea capacity of 4,80,000). Fixed cost of NPK is around Rs 30-35 cr reducing the overall profit to Rs 65-70 cr p.a.
- Apart from Govt there are four major lenders. The total amount due to them (including interest) is Rs 231 cr. against this Madras Fertilizers has settled with them to pay Rs 106.31 cr as full and final payment deriving Rs 124.69 cr one time benefit. This settlement would help the company in reducing its interest burden by half and lighten the balance sheet.
- MFL has proposed waiver of full government dues amounting to Rs 542.6 cr. We feel the possibility of granting waiver is quite high considering the enhanced interest from Govt to revamp the company. In latest Economic Review also, Govt has categorically mentioned MFL’s case for revamping which shows Govt’s commitment towards the company.
- Madras Fertilizers has large capacity of NPK 17:17:17. MFL is the only player in India to manufacture the combination. The business of complex fertilizers became unviable after the unfavorable policies announced by the Govt in past. Recent policy amendments like Nutrient Based Subsidy have again made the business of complex fertilizers attractive for the companies. Hence the company is mulling the prospects to re-start the facility. As a test

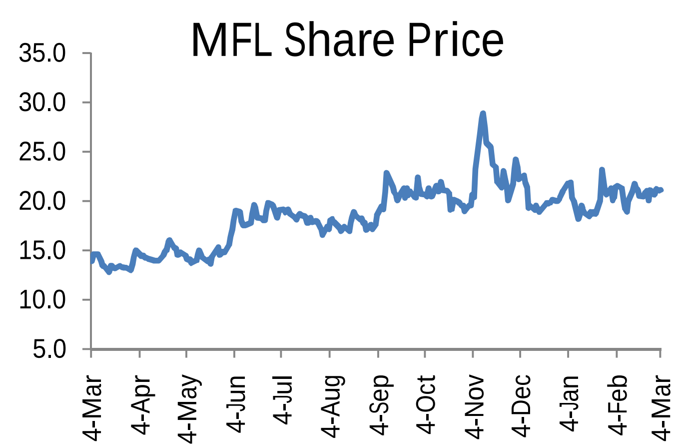
exercise and to know the productivity of the plants the company is manufacturing NPK 20:20:0 for Indian Potash Limited on tolling basis.

What Lies Ahead…

- With leaner balance sheet and reduced financial cost the company is committed to achieve higher profitability in coming years.
- From 1 April 2011, the company is mulling starting its NPK plant. It has three units of capacity of 2,80,000 each p.a. Currently only one unit is operational (for Indian Potash). Second unit is expected to commence operations from 1st April, 2011. Third unit would take time in commencing operations as it needs extensive restructuring. Management is confident of at least recovering fixed costs from the operations. Therefore, FY12 MFL would be able to report full profit of Urea in its books i.e. Rs 100 cr in FY12.
- To reduce the enormous subsidy burden, Govt is encouraging the fertilizer companies to use Natural Gas a feedstock in place of Naptha which is currently in use. For the purpose Govt is giving Rs 365 cr of loans to MFL out of which Rs 97 cr has already been disbursed in FY 10 and Rs 74 cr in FY11. For FY12 and FY13 expected funding is Rs 88 cr and Rs 106 cr respectively. In addition the Govt is devoted to shift the MFL's plant from Naptha based to Gas based. With the help of these funds MFL is revamping its plants to gas compatible and would be ready in next 18 months.
- We are not expecting any further dilution in the equity of the company.
- The company is expected to report Rs 65-70 cr of net profit in FY11 and Rs 100 cr in FY12 (4,80,000 X 2300). On current base of equity the EPS works out to be Rs 4.0 – Rs 4.3 for FY11 and Rs 6.2 for FY12E.
- At CMP of Rs 21, the company is available at P/E of 5.2x and 3.4x of FY11 and FY12 EPS respectively which is quite low considering its peers.

Conclusion

We believe the company is progressing well on the restructuring path. Q3FY11 results restore our belief. We expect company to report robust growth in FY12.



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