



**NIRMAL BANG**  
a relationship beyond broking

# Vinati Organics Ltd.

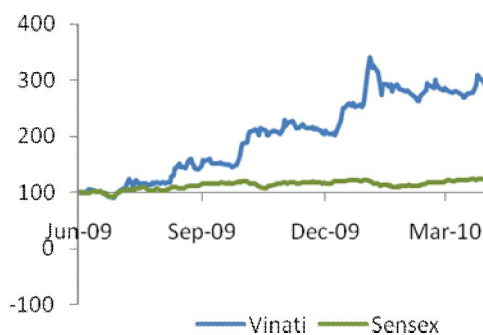


**Initiating Coverage**
**Vinati Organics Ltd**

Recommendation	BUY
CMP – 17 <sup>th</sup> June 2010	Rs. 70
Sector	Specialty Chemicals

<b>Stock Details</b>	
BSE Code	524200
NSE Code	VINATIOGA
Bloomberg Code	VO IN
Market Cap (Rs. cr)	345
Free Float (%)	25.1
52- wk HI/Lo	97/17
Avg. volume BSE (1 Mth)	20481
Face Value (Rs)	2.0
Dividend (FY 10)	50%
Shares o/s (Nos. in crore)	4.9

<b>Relative Performance</b>	<b>1 Mth</b>	<b>3 Mth</b>	<b>1 Yr</b>
VOL	1.8	8.5	161.7
Sensex	-3.6	0.2	20.2



<b>Shareholding Pattern as of 31/3/2010</b>	
Promoters Holding	74.88%
FII, Banks & Institutions	0.04%
Corporate Bodies	2.01%
Public & others	23.01%

**Company Background**

Incorporated in 1989, Vinati Organics Limited (VOL) has been operating in the chemical manufacturing industry since 1992. To remain different from the herd, it has chosen the specialty chemicals space and focused on niche products like Iso Butyl Benzene (IBB) and Acrylamido Tertiary Butyl Sulfonic Acid (ATBS). Vinati Organics is world's largest producer of IBB and N-Butylbenzene (NBB). It is also second largest company in the world to produce ATBS. Its manufacturing facilities are situated at Mahad and Lote Parshuram for IBB and ATBs respectively. The company exports these products to USA, Europe, Asia, Middle East and China.

**Investment Rationale**

Leader in the segments present:

VOL is a market leader in IBB with over 65% of global market share with manufacturing capacity of 14,000 mtpa at Mahad. It is also the 2nd largest in terms of capacity of ATBS with 10000 mtpa. Oligopoly in ATBS segment enables it to pass on incremental cost and maintain margins.

Backward integration will increase margins

IB is used to manufacture ATBS. VOL is setting up a 12,000 mtpa plant for manufacturing IB which is expected to be operational by June 2010. With backward integration into IB ATBS margins are expected to improve. The cost savings based only on freight and captive consumption of IB could be to the tune of Rs. 8 cr.

**Technology**

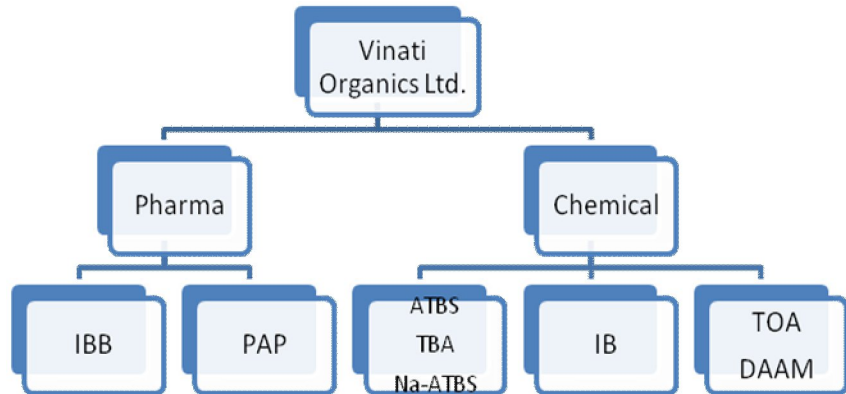
The company is into niche products those offer technological edge and cost competitiveness and gives it a strategic advantage. The IBB plant at Mahad is installed in technical collaboration with IFP, France. The ATBS plant at Lote is installed with the aid of NCL, Pune. Being at the advantageous position technologically, the company has created high entry barriers for competitors.

**Valuation and Recommendation**

We believe strong revenue growth, niche segment approach, leadership in the segments present, earnings visibility makes VOL attractive at current valuations. At CMP of Rs 70 the stock is trading at P/E of 6.9x and 5.8x of FY11E and FY12E EPS respectively. We initiate coverage with "BUY" rating and price target of Rs 100 (10x FY11E), potential upside of 43% from current levels.

Year	Net Sales (Rs Cr)	Growth %	EBITDA (Rs Cr)	EBIDTA (Margins%)	PAT (Rs Cr)	PAT (Margins)	Adj EPS (Rs)	P/E (x)	P/BV (x)
FY09	190.5	30.2	33.1	17.4	25.1	13.2	5.1	13.7	1.1
FY10	231.8	21.7	54.4	23.5	40.2	17.4	8.2	8.5	0.7
FY11e	342.8	47.9	76.8	22.4	49.5	14.4	10.0	6.9	0.5
FY12e	409.8	19.5	94.7	23.1	59.3	14.5	12.0	5.8	0.4

VOL's product portfolio in different business verticals:



**Products Portfolio:**

VOL is positioning itself as a niche product company with products like IBB and ATBS. The technology for manufacturing these products is being licensed by the company.

**Iso Butyl Benzene (IBB)**

IBB is used as a basic raw material for manufacturing Ibuprofen which is an anti-inflammatory analgesic bulk drug. IBB is also used in perfumery industries. VOL is a market leader in IBB with over 65% of global market share. It has the largest IBB manufacturing capacity in the world at 14,000 mtpa at Mahad, Maharashtra. VOL has acquired the technology to produce IBB from Institut Francais du Petrole (IFP), France.

IBB is a mature product with demand of 20,000 mtpa globally, growing at 3-5% pa. It is a cash cow for the company. We expect that IBB to contribute 38% of FY11E revenues at Rs 142 cr which is expected to go down to 32% of FY12E revenues. Being a mature product and almost flat market we are not expecting any price hike which hover around Rs 110/kg.

**2-Acrylamido 2 Methylpropanesulfonic Acid or Acrylamido Tertiary Butyl Sulfonic Acid (ATBS)**

Currently, there are 3 manufacturers of ATBS in the world. VOL is the only Indian company and second largest company in terms of capacity. VOL has taken the technology from National Chemical Laboratories, Pune.

Applications: This specialty monomer is widely used in

- Oil-field recovery,
- Acrylic fiber manufacturing,
- Adhesives, personal care products,
- Mining industry,
- Paper coatings,
- As dispersing and flocculating agents,
- Water treatment chemicals,
- Emulsions for paints, textile auxiliaries etc

Being a new product, more and more usages are being discovered through further R&D which enhances the potential markets for the product.

It has increased the capacity of ATBS from 5,000 mtpa to 10,000 mtpa in FY10 and is increasing it further to 12,000 mtpa by FY11. The plant with enhanced capacity will be operational by Oct-Nov 2010 and will add revenues in Q4FY11. VOL also manufactures sodium salt of ATBS (NaATBS) which is in liquid form. A major portion of the production is exported to Europe, America and other Asian countries, as demand for ATBS in India at present is limited. ATBS is a high margin product. Hence as its percentage to revenues increases in future, the overall margins of the company are expected to improve.

We expect ATBS and NaATBS (sodium salt of ATBS which is in liquid form) to contribute to 52% to FY11E revenues with Rs 192 cr but would decline as % to sales to 44% in FY12E as revenues from other products like IB, TOA, TBA etc would start contributing meaningfully from FY12E.

#### Isobutylene (IB)

The Company is setting up a 12000 mtpa backward integration project of making Isobutylene (IB), which is a key input in making ATBS. Currently IB is imported from Europe & Taiwan in pressurized tanks for which companies have to incur huge logistics cost. The project will cost around Rs. 35- 38 Cr. and will save significant transportation costs. Of the 12000 mtpa capacity being set up, 4000 mtpa will be for captive consumption and balance will be for sale to manufacturers of agro-chemicals, antioxidants, etc. in India. The project will become operational by June 2010 and is expected to contribute to growth in FY12E. We expect IB to contribute Rs 20 cr in FY11E. As major production of FY11 would go in captive consumption, we expect savings in the cost. Major push from IB would be reflected in FY12E where it is expected to contribute around Rs 51 cr to total revenues i.e. 12% to total revenues.

#### Other Products:

Following are few key derivative products of ATBS which the company is planning to monetize. These are low volume - high margins products.

#### N-Tertiary Butyl Acrylamide (TBA)

TBA is used in Personal care industry. It is also used as thickener, metal working fluid and as polymer in paper industry. VOL is expanding its 300 mtpa capacity to 700 mtpa which is expected to be operational by Sept 2010.

#### N-Tertiary Octyl Acrylamide (n-TOA)

TOA is used in enhanced oil recovery, antiscalants, adhesives and personal care like hair spray, mousses and styling products.

#### Diacetone Acrylamide (DAAM)

DAAM is used in Coatings industry for Elastomeric coating, wood coating and paint binding. It is also widely used in personal care industry for hair styling gel and in manufacturing of Epoxy Resin and Light sensitive Resin additive. VOL is putting up a 1000 mtpa capacity for DAAM which is expected to be operational by Dec 2010.

We expect total revenues from TOA, TBA and DAAM to be around Rs 11.8 cr for FY11E which is expected to increase to Rs 47.9 cr in FY12E after factoring in all the expansion exercises.

#### Acralymide

Acralymide is a new addition to VOL's product portfolio. The company is going to incur capital expenditure of around Rs. 26 Cr for its plant which is expected to be operational by Oct-Nov 2011. Although it would start contributing from Q4FY12 but full impact would only be visible in FY13. Hence we have not included any numbers from Acralymide in our projections.

#### PAP (Para Amino Phenol):

PAP is a key constituent in the manufacturing of Paracetamol. Currently, India imports PAP from China to meet its requirement. VOL is planning to set up a 30000 MT facility for PAP with the capex of Rs. 250-300 Cr.

Conventional process of manufacturing PAP is a cumbersome multistep process that involves iron and iron oxide sludge removal, making the products water soluble and recovering PAP. Disposal of effluent is also cumbersome.

VOL has adopted new technology developed by CSIR laboratory to recover pure PAP. This new PAP manufacturing technology removes the cumbersome step of effluent removal and eases out the process of recovery of pure PAP. In VOL's process fewer raw materials are used, lowering overall manufacturing cost. Also, because of no effluent, this is environment friendly process.

VOL's PAP plant is expected to be operational by Q4FY12. Currently, it is running trial batches to manufacture PAP using a highly environment friendly and cost-effective technology. We have not included any sales from it nor included any debt required for the project.

#### Power cogeneration

VOL is planning to install a cogeneration plant with capacity of 5 MW at Lote facility. It will use coal as a fuel. It will be used mainly for captive purpose. The required investment is around Rs 30 cr. As details of the project have not been finalized we have not incorporated any cost savings from the project in our projections.

### Investment Rationale

#### Niche product segment

VOL has positioned itself as a niche product company. The company operates in the product segments which provide technological edge or cost competitiveness and thus give a strategic advantage. VOL is a market leader in IBB with over 65% of global market share with a current capacity of 14,000 mtpa. It is also 2nd largest player worldwide in terms of capacity of ATBS. Oligopoly in ATBS has enabled the company to pass on incremental cost and maintain margins.

#### Backward integration – increase margins: IB

VOL is continuously aiming to be an efficient producer of specialty chemicals. IB, a key raw material for ATBS, comes in the form of gas and hence required to be imported via pressurized tankers. The freight cost of IB is about Rs. 20/kg. VOL is setting up a plant of 12,000 mtpa which will be operational by June 10. One kg of ATBS requires about 0.35 kg of IB. By FY11, VOL's captive demand for IB would be around 4,000 mtpa. With the backward integration into IB, the company will save on the logistics cost and will improve overall ATBS margins. Thus, the cost savings based only on freight cost on captive consumption would be in the range of Rs. 7-8 cr. Also, the remaining IB (about 8000 MTPA) can be sold in Indian market. Hence, we believe that VOL can recover its investment relatively faster.

#### Monetize by-products of ATBS

With the aim to be a zero-effluent company, VOL is focusing to monetizing by-products of ATBS like TOA, TBA, and DAAM. These by-products will add to revenues from FY11E and will constitute around 3.4% in FY11E and expected to increase to 14% of gross revenues in FY12E. These are high margins products, hence enhancing the margins of the overall company.

#### ATBS capacity expansion

With the surging demand for ATBS globally, VOL has increased its capacity from 5000 MTPA to 10000 MTPA in FY10 and further increasing it to 12000 mtpa in FY11. The full capacity will be operational by Nov- Dec 10. The effect of which could be seen in Q4FY11. ATBS is a high margin product than IBB. As its % to revenues increase, the overall margin of the company will also inch up.

#### No direct competitor

VOL is making their presence into specialty chemicals where there is less competition globally, technology is not easily available and large players would keep away from such products due to small global size of the products. It is the Indian player in these segments and have made impressive progress also.

#### Quality

VOL has achieved a purity level of 99.8% for IBB against the international standards of 99.5% by adopting the latest and most sophisticated technology and backed up by well equipped in-house R&D center.

As Isobutylbenzene is mainly consumed by Pharmaceutical industry the Company's main thrust is on production under hygienic and safe conditions. VOL is the preferred source for some of the largest chemical manufacturing companies which use ATBS. The technology used, enables the Company to recover, purify and resell the waste generated from the manufacturing process of ATBS.

#### Risks

##### Volatility in crude oil prices

Crude oil derivatives such as toluene are used as raw materials for manufacturing IBB and ATBS. So volatile oil prices affect the business adversely. Due to time lag in passing on the increased cost to customers and fixed price orders, bottom-line might get affected.

##### Saturated demand for IBB

IBB is mainly used for manufacturing Ibuprofen. Ibuprofen being a matured product impacts the expansion of IBB, whose growth is subdued. The demand for IBB is 20,000 mtpa globally growing at 3-5% pa.

##### Foreign Currency Risk

Key markets of VOL are USA, China, Middle East and European countries. 70-75% of the revenue comes from exports. Given the nature of business, a large proportion of the costs are denominated in Indian rupees (INR) leading to currency exposure. This gets partially offset as company imports its raw materials in the same currency.

### Quarterly Analysis

Vinati reported strong quarterly and yearly results

- Q4FY10 revenues grew by 37% over Q4FY09 at Rs 62 cr. FY10 revenues grew by 21.7% at Rs 231.8 cr
- FY10 EBITDA showed an impressive growth of 64.2% at Rs 54.4 with margins 23.5% on back of decline in cost of materials. VOL had beneficial year in terms of raw materials pricing for their IBB product, although which is not expected to remain in future.
- Company doubled its ATBS capacity during the year from 5,000 mtpa to 10,000 mtpa, which has also helped it in improving the margins as ATBS is a higher margin product than IBB. After expansion, VOL has become the second largest player of ATBS worldwide.
- VOL reported 17.3% PAT margins for FY10 which are highest in the history of the company. EPS for the year was Rs 8.2 as against Rs 5.1 for FY09, a growth of 60%.

Particulars (Rs Cr)	Q4FY10	Q4FY09	yoy	Q3FY10	qoq	FY10	FY09	yoy
Net Sales	62.0	45.3	37.0	57.8	7.2	231.8	190.5	21.7
Cost of materials	35.3	23.8	48.0	34.5	2.4	132.8	134.5	(1.2)
Employees Cost	2.7	2.2	26.3	3.1	(12.5)	11.5	8.8	30.0
Admin and other exps	9.4	5.1	83.7	7.7	21.6	33.0	14.1	134.8
EBITDA	14.5	14.1	2.9	12.5	16.5	54.4	33.1	64.2
<b>margins</b>	<b>23.4</b>	<b>31.2</b>		<b>21.6</b>		<b>23.5</b>	<b>17.4</b>	
Other income	1.5	2.0	(26.1)	1.3	14.2	5.9	5.3	10.3
Operating profit	16.0	16.1	(0.7)	13.8	16.3	60.3	38.5	56.8
Interest	0.7	0.8	(16.2)	0.8	(12.9)	3.4	3.3	2.1
Depreciation	1.3	0.8	52.1	1.1	13.2	4.9	3.3	50.6
PBT	14.1	14.5	(2.9)	11.9	18.5	52.0	31.9	63.1
Tax	2.4	2.3	5.5	2.6	(7.2)	11.8	6.8	73.9
<b>Tax rate</b>	<b>17.2</b>	<b>15.8</b>		<b>22.0</b>		<b>22.6</b>	<b>21.2</b>	
EO items	0.0	0.0		0.0		0.0	0.0	
PAT reported	11.6	12.2	(4.4)	9.3	25.8	40.2	25.1	60.2
Equity Capital	9.9	9.9		9.9		9.9	9.9	
FV	2.0	2.0		2.0		2.0	2.0	
EPS	2.4	2.47		1.9		8.2	5.1	

## Peer Comparison

Although there is no direct competitor for AVOI, we have still tried to take few same sector players and have compared them with VOL.

Particulars (Rs Cr)	Vinati Organics	Avon Organics	Chembond Chemicals	Alkyl Amin Chemicals
Sales	231.8	150.5	114.6	206.2
EBITDA	54.4	26.4	9.5	33.7
margin	23.5%	17.6%	8.3%	16.4%
PAT	40.2	8.9	5.1	9.2
margin	17.3%	5.9%	4.5%	4.5%
EPS	8.2	3.9	16.2	9.0
Book Value	20.1	21.3	126.8	64.6
RoNW	40.6%	18.5%	12.7%	13.9%
CMP	69.6	39.6	140.0	83.3
P/E	8.5	10.0	8.7	9.2

Vinati has highest EBITDA and PAT margins among the group still trades at same P/E. We believe that with all the expansion and growth, VOL should be re-rated and get better P/E now.

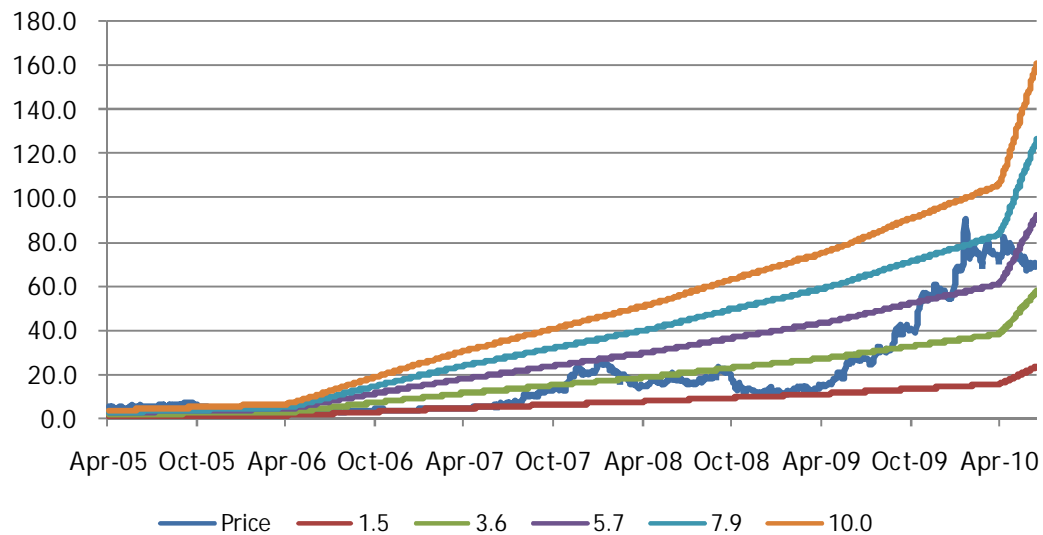
### Valuation and Recommendation

We believe that VOL's net sales will grow at a CAGR of 33% over a next two years with net profit CAGR of 21.7% during the same period. VOL had its all time high pat margins in FY10 on account of better raw materials pricing of IBB. Being the largest player in the world it enjoys the privilege of not passing over the whole benefits of lower raw materials cost. We expect PAT margins would come down to 14.4% in FY11E which are still high considering the nature of the industry and peer group comparison. We expect the company to have EPS of Rs. 10.0 in FY11E and Rs. 12.1 in FY12E.

At CMP of Rs 70 the stock is trading at P/E of 6.9x and 5.8x of FY11E and FY12E EPS respectively which looks attractive. We believe that this is the right time when VOL should get re-rated and enjoy better P/E multiple than its peers considering its leadership position in the present segments and its margins. We believe strong revenue growth, niche segment approach, leadership in the segments present, earnings visibility makes VOL attractive at current valuations. Based on our EPS of Rs. 10.0 for FY11E and a target multiple of 10x we arrive at target price of Rs. 100. We initiate coverage with "BUY" rating and price target of Rs 100 (10x FY11E), potential upside of 43% from current levels.



P/E Chart



Income Statement					
Particulars (Rs cr)	FY08	FY09	FY10	FY11E	FY12E
Net Sales	146.3	190.5	231.8	342.8	409.8
Cost of materials	103.4	134.5	132.8	226.3	268.4
Employees Cost	6.6	8.8	11.5	15.8	18.4
Admin and other exps	11.0	14.1	33.0	24.0	28.3
EBITDA	25.3	33.1	54.4	76.8	94.7
margins %	17.3	17.4	23.5	22.4	23.1
Depreciation	3.0	3.3	4.9	7.7	8.9
Interest	3.3	3.3	3.4	4.6	4.6
Other Income	4.0	5.3	5.9	5.1	6.1
Profit Before Tax	23.1	31.9	52.0	69.7	87.2
Taxes	7.9	6.8	11.8	20.2	27.9
Profit After Tax	15.2	25.1	40.2	49.5	59.3
Extra Ordinary Items	0.0	0.0	0.0	0.0	0.0
Adjusted PAT	15.2	25.1	40.2	49.5	59.3
margins %	10.4	13.2	17.4	14.4	14.5
Adj Earnings Per Share	3.1	5.1	8.2	10.0	12.0

Balance Sheet					
Particulars (Rs cr)	FY08	FY09	FY10	FY11E	FY12E
<b>Sources of Funds</b>					
Equity Share Capital	9.9	9.9	9.9	9.9	9.9
Reserves & Surplus	32.8	55.0	89.3	133.0	185.4
Shareholder's Funds	42.7	64.9	99.2	142.9	195.3
Secured Loans	28.2	44.8	57.0	59.8	59.8
Unsecured Loans	6.1	6.1	6.1	6.1	6.1
Total Debt	34.3	51.0	63.1	66.0	66.0
Net Deferred Tax	5.3	5.9	8.7	8.7	8.7
<b>Total Capital Employed</b>	<b>82.2</b>	<b>121.7</b>	<b>171.0</b>	<b>217.6</b>	<b>269.9</b>
<b>Application of Funds</b>					
Gross Fixed Assets	64.0	71.1	110.9	153.3	178.7
Less: Depreciation	23.2	26.4	31.4	39.0	48.0
Net Fixed Assets	40.8	44.7	79.6	114.3	130.8
Capital WIP	10.9	43.4	38.4	41.0	30.6
<b>Current Assets</b>					
Inventories	12.1	12.1	18.9	20.1	23.1
Sundry Debtors	22.1	27.9	35.9	48.6	56.9
Cash and Bank Balances	1.4	1.9	1.8	1.7	41.4
Loans and Advances	10.7	7.5	10.6	17.1	16.4
Current Liabilities	15.8	15.7	14.1	25.3	29.3
Current Liabilities	12.9	11.7	9.8	19.5	22.4
Provisions	2.9	4.0	4.3	5.8	6.9
Net Current Assets	30.5	33.6	53.0	62.2	108.6
<b>Total Capital Deployed</b>	<b>82.2</b>	<b>121.7</b>	<b>171.0</b>	<b>217.6</b>	<b>269.9</b>

Cash Flow Statement					
Particulars (Rs cr)	FY08	FY09	FY10	FY11E	FY12E
Profit Before Tax	23.1	31.9	52.0	69.7	87.2
Add: Interest	3.3	3.3	3.4	4.6	4.6
Add: Depreciation	3.0	3.3	4.9	7.7	8.9
Less: Operating Income	(4.0)	(5.3)	(5.9)	(5.1)	(6.1)
Less: Extra-Ordinary Inc	(0.1)	0.0	0.0	0.0	0.0
Operating Profit Before	25.2	33.1	54.4	76.8	94.7
Changes in WC	(7.2)	(2.6)	(19.5)	(9.3)	(6.6)
Les: Tax (Including FBT)	(7.5)	(6.2)	(8.9)	(20.2)	(27.9)
Cash Flow from Operat	10.5	24.3	26.0	47.3	60.2
Changes in Fixed Assets	(17.0)	(39.6)	(34.8)	(45.0)	(15.0)
Other Income	4.0	5.3	5.9	5.1	6.1
Cash Flow from Investir	(13.0)	(34.3)	(28.9)	(39.9)	(8.9)
Change in Equity Capita	0.0	0.0	(0.0)	0.0	0.0
Change in Borrowings	8.6	16.7	12.2	2.8	0.0
Dividends Paid (Incl Tax)	(2.3)	(2.9)	(5.9)	(5.8)	(6.9)
Interest Paid	(3.3)	(3.3)	(3.4)	(4.6)	(4.6)
Others	(0.0)	(0.0)	(0.0)	0.0	0.0
Cash Flow from Financi	3.0	10.5	2.8	(7.5)	(11.6)
Net Cash Flow	0.5	0.5	(0.1)	(0.1)	39.8
Opening Cash Balance	0.9	1.4	1.9	1.8	1.7
Closing Cash Balance	1.4	1.9	1.8	1.7	41.4

Ratio Analysis					
Profitability Ratios	FY08	FY09	FY10	FY11E	FY12E
EBITDA Margins	17.3	17.4	23.5	22.4	23.1
Adj PAT Margins	10.4	13.2	17.4	14.4	14.5
RoCE	47.8	51.5	52.2	43.6	36.9
RoNW	21.3	24.6	27.5	25.5	24.3
Growth Ratios					
Sales	78.3	30.2	21.7	47.9	19.5
EBITDA	203.7	30.8	64.2	41.1	23.3
Adj PAT	332.5	65.3	60.2	22.9	20.0
Valuation Ratios					
PE	22.6	13.7	8.5	6.9	5.8
P/BV	1.6	1.1	0.7	0.5	0.4
EV/EBITDA	14.9	11.8	7.4	5.3	3.9
Mcap/Sales	2.3	1.8	1.5	1.0	0.8
Per Share Data					
BV	8.6	13.1	20.1	28.9	39.6
EPS	3.1	5.1	8.2	10.0	12.0
CEPS	3.7	5.8	9.2	11.6	13.8
DPS	0.4	0.5	1.0	1.0	1.2

NOTE

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