

India
ADD (Initiating coverage)

Consensus ratings*: Buy 7 Hold 3 Sell 3

Current price:	Rs1,439
Target price: ▲	Rs1,603
Previous target:	NA
Up/downside:	11.4%
EIP Research / Consensus:	20.9%
Reuters:	VNTI.NS
Bloomberg:	VO IN
Market cap:	US\$2,031m Rs1,47,945m
Average daily turnover:	US\$3.2m Rs236.3m
Current shares o/s:	102.8m
Free float:	25.9%

*Source: Bloomberg



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	10.6	31.8	43.3
Relative (%)	5.8	11.5	14.6

Major shareholders	% held
Promoter & Promoter Group	74.1
Mirae Asset	3.0
Invesco Asset Management	1.3

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Vinati Organics

Growth is back, initiate with Add

- With demand revival and capacity commissioning, VOL's main product ATBS is back on the growth path. We expect volume c.15% CAGR for FY21-23F.
- Lower gross margins of phenol will be compensated by overall revenue growth of 25% CAGR, resulting in EPS growth of 25.6% CAGR over FY21F-23F.
- We initiate coverage on VOL with an Add rating and 12-month TP of Rs1,603. At our TP, the stock will trade at 37.6x FY23F EPS.

Market leader in multiple molecules and expanding capacity

VOL is the market leader in ATBS (2-Acrylamido 2 Methylpropane Sulfonic Acid), HP-MTBE (High Purity-Methyl Tertiary Butyl Ether), IBB (Isobutyl benzene), and IB (Isobutylene). VOL has commissioned new 14kt of ATBS capacity and 39kt of butyl phenol. It plans to merge the 100% promoter entity Veeral Additives (Rs1.25bn totally paid for by shares of VOL) with itself to venture into the phenolic antioxidants (AO) market. AO uses butyl phenol as an input material and, hence, provides a market for a newly-commissioned butyl phenol. ATBS demand is reviving and IBB is doing well (because of demand from Ibuprofen API). From FY19, VOL was able to raise the price spreads of ATBS by 30% and IBB by 15% over key raw materials. We expect it to sustain, with margin dilution, because of phenols, to be compensated by volume growth. We expect 25.6% EPS CAGR over FY21-23F. We value VOL at 37.6x FY23F EPS (+1.5 SD of last three-year mean) to arrive at a TP of Rs1,603, and initiate coverage on VOL with Add.

Lower phenol margin to be compensated by volume growth

We expect ATBS and IBB gross margins to remain firm as VOL dominates both categories. Phenols are lower gross margin products and, hence, blended gross margins will likely trend lower. We build in gross margins of 55.7% for FY22F and 54% for FY23F (FY21F: 59%). However, the decline in gross margins is counterbalanced by volume growth from phenols.

Butyl phenols present import substitution opportunity

India imports ~21k tonnes of butyl phenol; hence, the bulk of VOL's 39k tonnes capacity can be utilised to replace imports. Forward integration through the merger with Veeral Additives (if approved by shareholders) will be positive in our view (as it will provide a captive market for phenols).

Risks

Sales are concentrated on ATBS and IBB. The top three molecules contribute 86% of sales (company annual reports of 2018-19). Any weakness in demand for any of these molecules will negatively impact EPS, in our view. 2) We have built in a graded rise in ATBS volume sales with the belief that VOL will not dilute gross margins. Any pricing discount to grab market share will impact our EPS disproportionately. 3) Phenol is a new product for Vinati. While management is confident of grabbing the import market of phenols in India, the actual execution and customer acquisition presents a risk.

Financial Summary

	Mar-19A	Mar-20A	Mar-21F	Mar-22F	Mar-23F
Revenue (Rsm)	11,081	10,289	9,259	12,448	14,413
Operating EBITDA (Rsm)	4,036	4,139	3,499	4,770	5,516
Net Profit (Rsm)	2,825	3,346	2,783	3,795	4,383
Core EPS (Rs)	27.5	32.6	27.1	36.9	42.6
Core EPS Growth	96.2%	18.5%	(16.8%)	36.4%	15.5%
FD Core P/E (x)	52.42	44.21	53.16	38.98	33.75
DPS (Rs)	7.0	8.3	6.9	9.4	10.9
Dividend Yield	0.49%	0.57%	0.48%	0.65%	0.75%
EV/EBITDA (x)	36.42	35.06	40.94	29.71	25.27
P/FCFE (x)	(274.87)	68.77	57.79	58.84	42.89
Net Gearing	(9.2%)	(21.9%)	(31.4%)	(35.1%)	(40.8%)
P/BV (x)	14.07	11.56	9.95	8.36	7.06
ROE	30.6%	28.7%	20.1%	23.3%	22.7%
% Change In Core EPS Estimates					
EIP Research/Consensus EPS (x)			1.02	1.07	1.01

SOURCES: EIP RESEARCH ESTIMATES, COMPANY REPORTS. PRICED AS AT 11 FEB 2021

Company overview

A niche organic compound manufacturer ➤

A niche organic compound manufacturer, VOL has been able to synthesise ATBS and since then has made good progress, in our view.

Figure 1: Overview of Vinati Organics

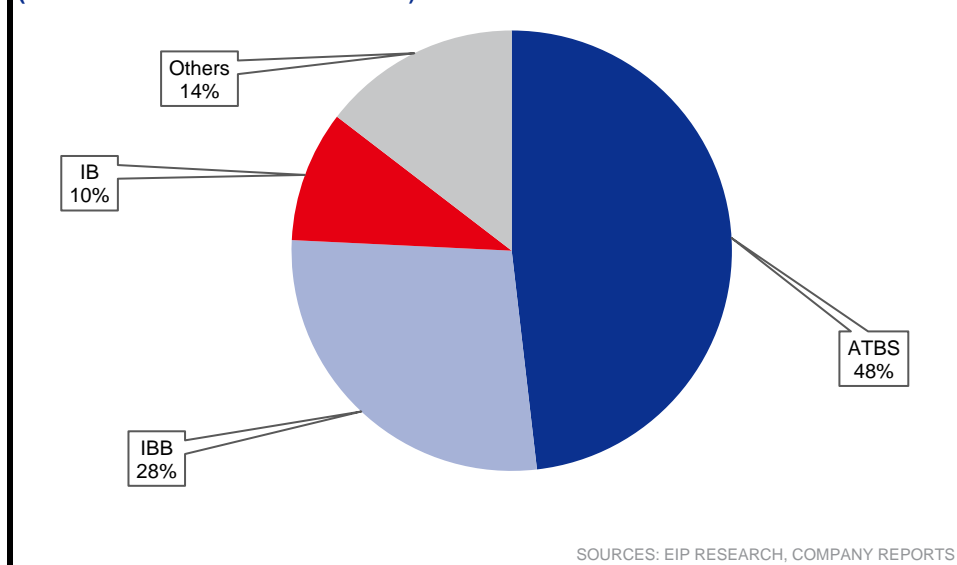
Product	VOL's position	Usage	Relevance
Isobutyl benzene (IBB)	Largest manufacturer in the world, with the largest market share	Pharmaceuticals	It is the primary raw material for Ibuprofen. This is a widely used painkiller across US, Europe, and Asia
2-Acrylamido 2 Methylpropane Sulfonic Acid (ATBS)	Largest manufacturer in the world and the only manufacturer in the country	Water-treatment chemicals, emulsions for paint and paper coatings, adhesives, textile auxiliaries and acrylic fibre, detergents and cleaners, oil field, mining chemicals and construction chemicals	It acts as an important ingredient to manufacture polymers for enhanced oil recovery (EOR). It makes acrylic fibres receptive to dye
Isobutylene (IB)	Largest manufacturer in the country	Agro-based chemicals, food additives and antioxidants	It is used as an intermediate
High Purity-Methyl Tertiary Butyl Ether (HPMTBE)	Largest manufacturer in the country	Pharmaceuticals and organometallic compounds	It is used as a specialty solvent
N-Tertiary Butyl Acrylamide (TBA)	Only manufacturer in the country	Thickeners, personal care, water treatment and metal working fluid	It increases the viscosity of coatings and solutions
N-Tertiary Octyl Acrylamide (TOA)	Only manufacturer in the country	Personal care, adhesives and enhanced oil recovery	It is an important ingredient in personal care products like hair gels and creams

SOURCES: EIP RESEARCH, COMPANY ANNUAL REPORTS

ATBS, IBB and IB contribute c86% of sales ➤

ATBS, IBB and IB contributed c.86% of sales over the last seven years (FY13-20). The company is establishing new capacity for phenols which will take 9-12 months to have a material impact on revenue and profitability.

Figure 2: ATBS is VOL's key molecule. VOL is now raising capacity by 54% to 40,000t (the chart shows VOL's revenue mix)

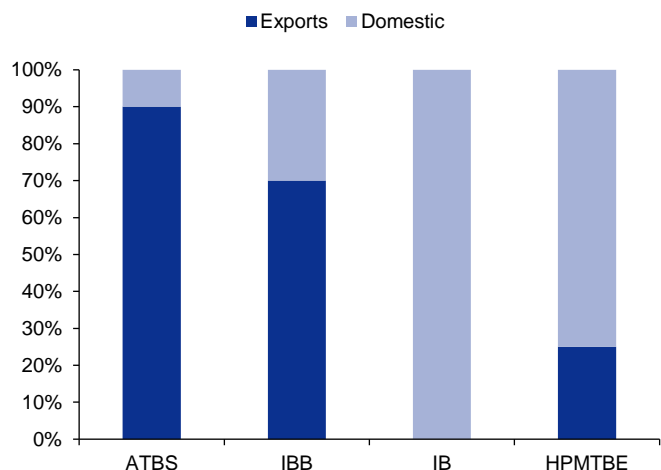


SOURCES: EIP RESEARCH, COMPANY REPORTS

ATBS, IBB is primarily meant for exports, while IB is sold in domestic markets ➤

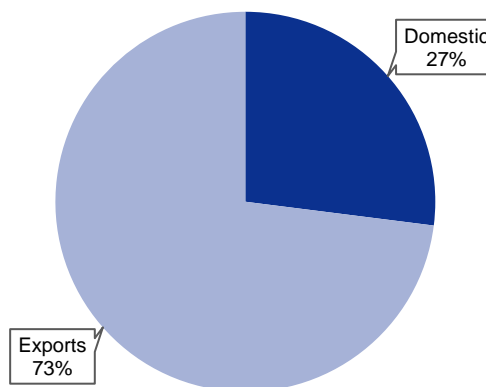
Vinati Organics exports about 90% of its ATBS production and ~70% of IBB (FY19). IB is used entirely for domestic consumption. Vinati Organics has 6,000t capacity of high purity-methyl tertiary butyl ether (HPMTBE). Almost 25% of VOL's HPMTBE production is exported (company's FY19 annual reports). VOL's overall exports formed 73% of its overall sales in FY19 and the rest is sold in domestic markets.

Figure 3: VOL exports 90% of ATBS and 75% of IBB. IB and HPMTBE were mainly sold in India in FY19



SOURCES: EIP RESEARCH, COMPANY REPORTS

Figure 4: On an overall basis, exports were 73% of FY20 sales



SOURCES: EIP RESEARCH, COMPANY REPORTS

Vinati Organics is setting up phenol production capacities ➤

Vinati Organics will be manufacturing molecules listed below (Source: company presentations and earnings call). These molecules are being manufactured primarily for domestic market consumption.

- 2,6-Di tertiary butyl phenol (2,6-DTBP)
- 2,4-Di tertiary butyl phenol (2,4-DTBP)
- Ortho tertiary Butyl Phenol (OTBP)
- Para tertiary butyl phenol (PTBP)

Business segment analysis

Vinati's revenue and profits are driven by sales of four individual molecules in the Indian and exports markets. They are ATBS, IBB, IB and HPMTBE. Vinati is setting up new phenol manufacturing capabilities to capture import markets. The business segment analysis of Vinati Organics is best done in the form of individual molecules analysis.

Critical molecules – ATBS

VOL is world's largest ATBS maker with 65% market share ►

Vinati Organics was the largest manufacturer in world with 65% market share in FY20 (Source: Company's FY20 annual report).

Market share gains likely as new plant comes online ►

Lubrizol's (Not Rated) exit from the ATBS business in 2018 was a shot in the arm for VOL. With 26kt of capacity in FY20, VOL was able to garner 65% of the global market share. It is further expanding capacity, which would likely take incremental market share from other players.

ATBS is a versatile chemical with multiple usages ►

ATBS is a versatile substance that possesses thermal stability, a hydrolytic nature, hydrophilicity, polarity, and reactivity ratio. It can easily be co-polymerised with acrylonitrile, acrylic acid, acrylic esters, and acrylamides, as it is highly polymerisable.

- ATBS is available in different forms such as powder (kg paper sacks or drums), pellets (kg drums) and in aqueous solution (kg cans).
- We expect the global market demand for ATBS to rise because of its applications in textiles, medical, personal care, water treatment, coatings, and chemical industries.
- ATBS's most important primary application is in the enhanced oil recovery industry, where ATBS is used in its highest purity grade.
- The powder/granular segment accounts for a major share of the total acrylamide tertiary butyl sulfonic acid (ATBS) market. In our view, the segment will expand at a rapid pace soon due to the expansion of water treatment and enhanced oil industries where ATBS is used extensively.

Usage of ATBS increased across spectrum, but crude price decline hit it badly ►

The global ATBS market expanded at a significant rate in 2016 due to its increased usage in the personal care, textiles and water treatment segments. During 1995-2005, there were few manufacturers across the globe; however, increased demand from textiles, personal care and other industries created new opportunities for ATBS manufacturers in the last decade. This led to greater production, which helped cater to ATBS demand from different industries worldwide. Concurrently, demand from suppliers also increased.

In North America and Western Europe, most industries see applications of Acrylamide Tertiary Butyl Sulfonic Acid. Therefore, these regions have high demand for ATBS. Many producers are emerging in China and India, making Asia-Pacific a prominent ATBS-producing region. The US, Canada, France, Germany, Norway, Sweden and others (Denmark, Belgium, etc) saw huge demand in personal care products and paint & coating agents in FY20, which aided the ATBS market.

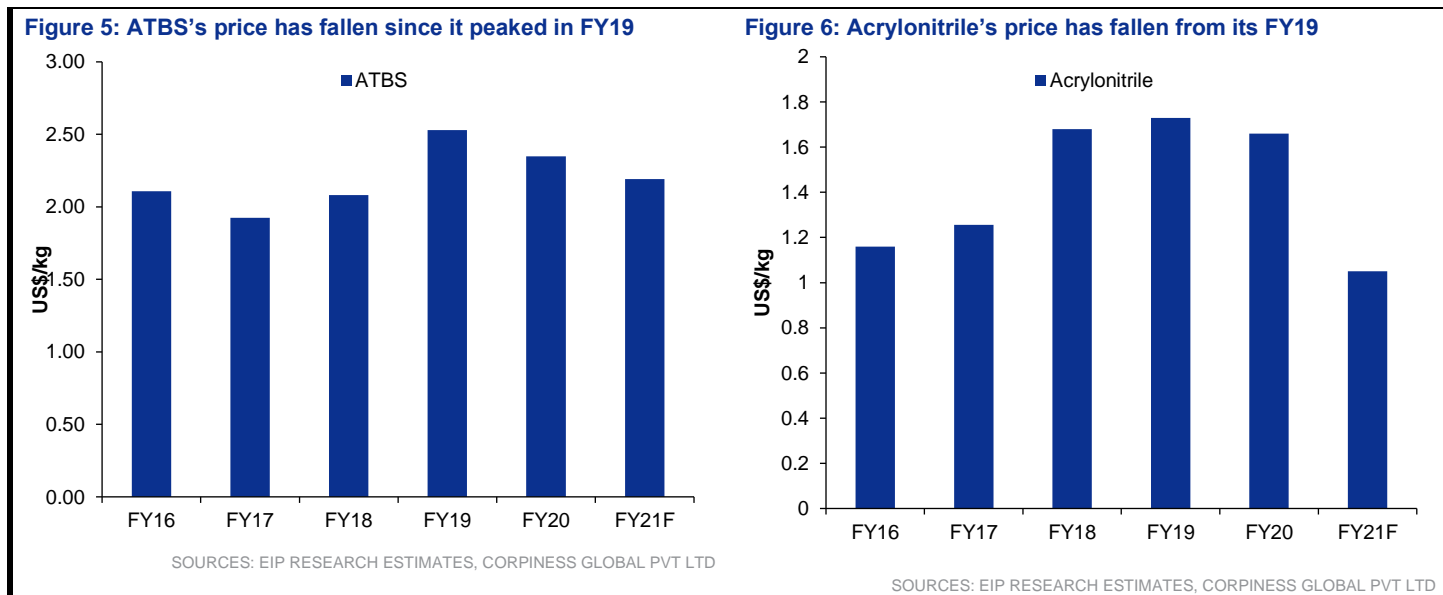
Competition primarily from Chinese companies ►

After the Lubrizol's exit, VOL turned into the world's largest manufacturer. Other players include Shandong Taihe Water Treatment Technologies, Toagosei, ALL Plus Chemical Company and Zeal Product. Several manufacturers are entering the market due to an increase in ATBS demand; these include Shandong

Lianmeng Chemical Group, China Chemical Group (Qingdao) and Xiamen Changtian Enterprise.

ATBS realisations depend on acrylonitrile price, the principal input material ➤

Apart from other inputs, one kg of ATBS production needs around 0.45 kg of acrylonitrile.



A measured ramp-up needed for ATBS margins ➤

ATBS is VOL's primary product, and was instrumental in turning around the company's business prospects once Lubrizol, the main competitor, exited the market. The main feedstock for ATBS is acrylonitrile, which is in short supply in India. Reliance Industries (Reduce, RIL IS, Rs2,061, TP Rs1,405) is the sole manufacturer with a 41k-tonne capacity. Given the demand-supply mismatch, the demand for acrylonitrile is mostly catered to via imports. Our analysis indicates that post Lubrizol's exit, ATBS's pricing drove Vinati Organics' margins. If the company follows a calibrated approach to ramping up ATBS capacity, margins may not fall at all, in our view.

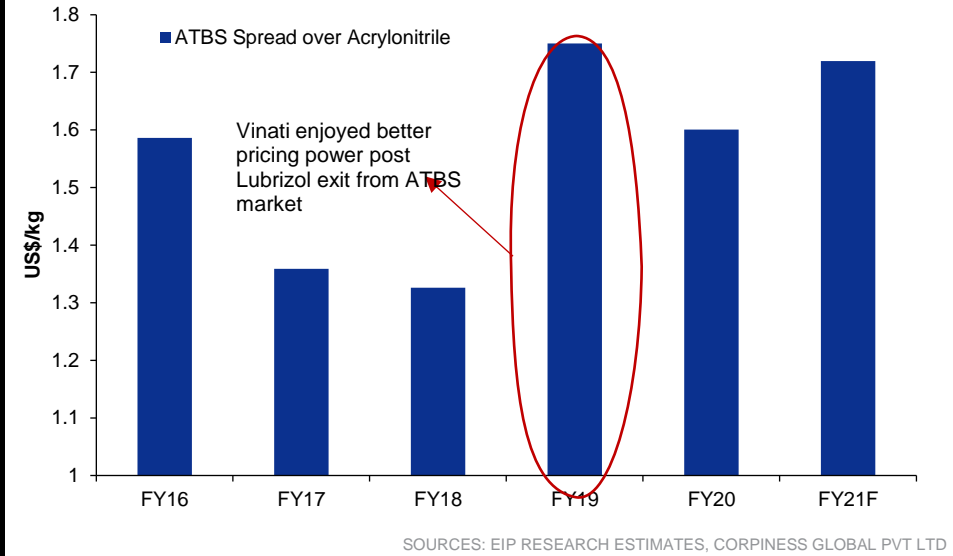
High price volatility in acrylonitrile – ATBS's main feedstock ➤

ATBS is manufactured from acrylonitrile, which in turn is manufactured from propylene. Given that propylene is a crude derivative, its prices are highly volatile. However, VOL's ATBS export prices have more-or-less tracked acrylonitrile prices.

Marked increase in ATBS's spreads from acrylonitrile ➤

With Lubrizol's exit from the business Vinati Organics acrylonitrile spread increased by 32% during FY19. As crude prices were soft in FY20, ATBS's acrylonitrile spread declined.

Figure 7: Lubrizol's exit from ATBS market boosts VOL's market share



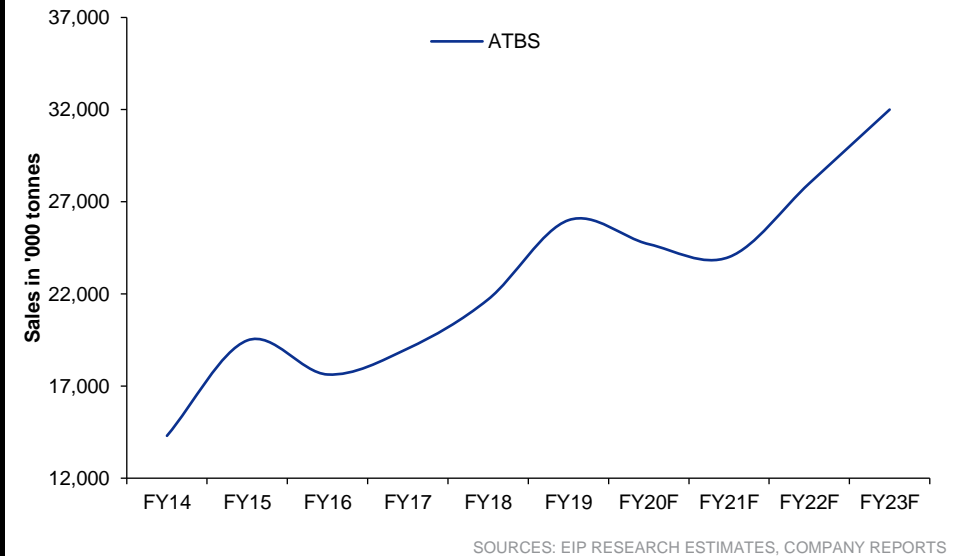
VOL likely to maintain current ATBS spreads at higher volumes ➤

- VOL is increasing its volumes, which is 30-35% of existing demand; hence, we are worried that prices may correct.
- However, the key is the slow ramp up of the ATBS business.
- We think it is unlikely VOL will ramp up capacity quickly and flood the market with ATBS.

We build in slow ramp-up in new ATBS plant capacity ➤

From FY20 Vinati Organics stopped disclosing sales volume numbers. However, management commentary and our market research indicate that sales volumes likely declined in FY20 and FY21F . We expect sales to pick up from FY22F.

Figure 8: As the global economy and crude prices revive, we expect ATBS sales to pick up. Commercial production from its new plant has already started



Critical molecules: IBB

IBB is another bellwether chemical >

IBB (Isobutyl benzene) is used to manufacture Ibuprofen, an analgesic, anti-inflammatory drug. Commercial isobutyl benzene has a broad range of impurities depending on the purity of propylene used to react with toluene to form isobutyl benzene, the starting material of ibuprofen. Hence, there can be multiple suppliers of IBB. However, getting a steady supply of the required purity might not be possible.

Global demand for Ibuprofen is ~35kt p.a.; IBB is an input >

Ibuprofen API's demand internationally is around 35,000t p.a. (tpa), according to the company. With global consolidation, manufacturing is concentrated in the hands of a few.

- Normally, 1kg of IBB yields 1.47kg of Ibuprofen.
- Hence, to meet global demand for Ibuprofen, 24kt of IBB (pure and free of impurities) is needed.
- Globally, there is ~30kt worth of IBB capacity (Source: Company) and VOL is the lead manufacturer.

IBB mostly used by Ibuprofen API manufacturers >

API manufacturers and Ibuprofen product producers use IBB. In the recent past, API has been scarce, leading to a price rise by as high as 30%. Ibuprofen is a generics drug and, hence, has thin margins; therefore, the steep hike made the medicine unviable, forcing many end producers to stop buying the API. Such events present a risk and an opportunity for VOL, in our view.

VOL uses Toluene as a raw material for IBB >

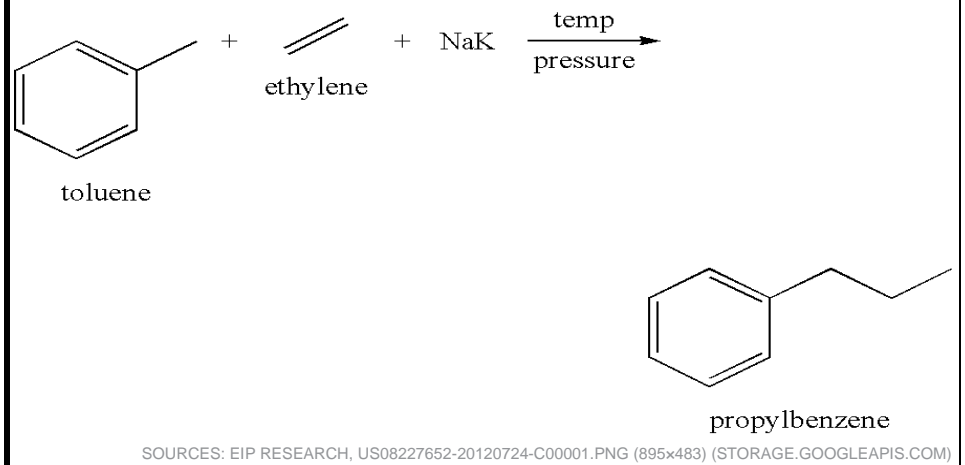
Toluene is used as the raw material for IBB and made from benzene, which is the basic raw material for many aromatic compounds.

Figure 9: Toluene's price is determined by Benzene to some extent as Toluene is manufactured from benzene. Benzene prices are derivative of crude oil prices



IBB is produced by combining Toluene with about 100 ppm to about 350 ppm of water and alkali metal catalyst, activating the catalyst at about 180-220°C, adding the ethylene and conducting the synthesis reaction at about 130-150°C.

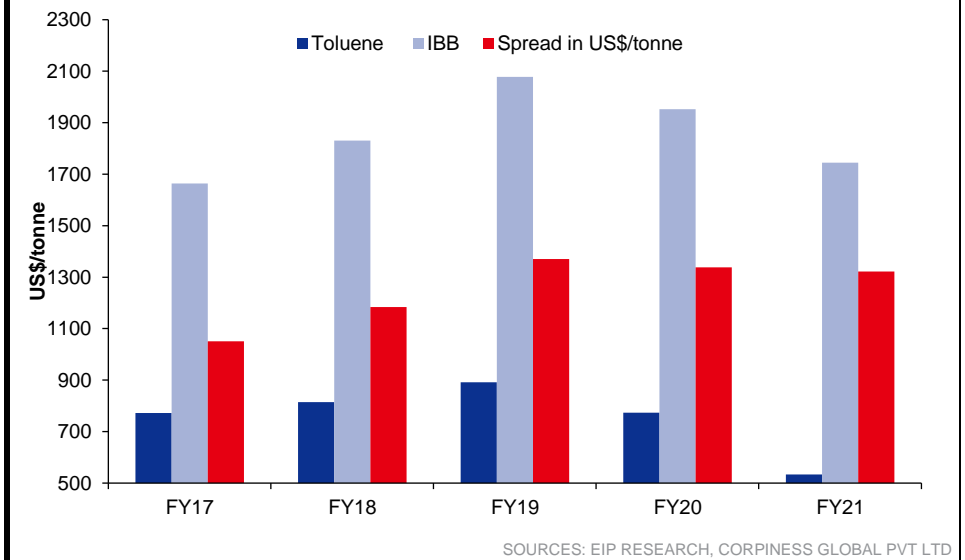
Figure 10: IBB is manufactured using Toluene in a very standardised process



Like ATBS, VOL has been able to garner higher margins on IBB from FY19, driven by the pharma API boom ➤

IBB is used to manufacture API (active pharmaceutical ingredient) for Ibuprofen. There has been a structural rise in its prices for the last three years. Apart from Vinati Organics, IBB is manufactured by Indian Organics Limited (IOL; Not Rated). On a combined basis these two companies account for more than 90% of the global IBB market share in FY20 (Sources: Annual reports of IOL and VOL).

Figure 11: IBB spread over Toluene increased in FY19. The increase was driven mainly by the boom in API prices of Ibuprofen in global markets



We expect IBB margins to remain strong over next few years ➤

Despite the high Toluene prices currently, we expect IBB margins to remain strong over coming years as it continues to have 65% market share in the global markets.

Critical molecules: Butyl phenols

VOL is undertaking fresh capital expenditure for its butyl phenols project, which it commissioned in 3QFY21. Butyl phenols are intermediates that find applications as raw materials in industries such as perfumery, inks & resins, plastics and lubricants. Butyl phenols are not directly used for these applications, but act as building blocks for making useful products. According to the company, VOL will manufacture four molecules in this range:

- 2,6-Di tertiary butyl phenol (2,6-DTBP)
- 2,4-Di tertiary butyl phenol (2,4-DTBP)
- Ortho tertiary Butyl Phenol (OTBP)
- Para tertiary butyl phenol (PTBP)

India imports ~20kt butyl phenols; global capacity is ~400kt >

India imports about 21kt of butyl phenols and the global capacity is ~400kt. In many cases, butyl phenols are captively consumed; hence, estimating the correct production number is difficult.

By volume, PTBP is the largest of the four butyl phenols. It is mostly imported from Korea, Taiwan, Singapore and Russia. The grades of PTBP most imported into India are the technical grade used in perfumery applications and the standard grade used in resin/ink applications.

OTBP, second by volume among the four butyl phenols, goes entirely into manufacturing perfumery products. All leading Indian perfume manufacturing companies are users of OTBP. This product is imported from Switzerland and Taiwan.

The use of 2,4-DTBP and 2,6-DTBP is currently smaller by volume. These two products are inputs in the manufacture of antioxidants which are used as additives for plastics. With the increasing use of plastics and composites in India, the use of these butyl phenol-based antioxidants is expected to grow rapidly, in our view. 2,4-DTBP and 2,6-DTBP are imported into India from Switzerland, Taiwan, Singapore and China.

PTBP and OTBP are principal products in India; globally most butyl phenol manufacturers are forward integrated >

- PTBP and OTBP are large-volume products in India and sold as 2,6-DTBP and 2,4-DTBP globally.
- Globally, these di-tertiary butyl phenols are widely used in lubricants, plastic additives and fuel additives. 2,6-DTBP is used as a jet fuel additive and has a large volume application globally.
- Globally, PTBP is also used in poly carbonate manufacturing.
- Some companies that are large volume manufacturers of butyl phenols are SI Group, BASF, Songwon, Oxiris, Chemtura/ Addivant, Eutec, Coaching, Tasco and DIC.
- Almost all butyl phenol manufacturers are forward integrated, and also manufacture antioxidants for plastics and lubricants from di tertiary butyl phenols.

Potential revenue from phenol butyl can be US\$80m >

It is difficult to ascertain the exact potential of butyl phenol revenues. However, using FY15 and FY16 Indian imports as guidance, we estimate overall revenue potential for butyl phenol project is ~US\$80m.

VOL has started its phenol manufacturing plant >

The capex is now complete, and VOL began producing phenols in 2HFY21.

Critical molecules: Polyphenol antioxidants (AO)

VOL proposes to merge 100% promoter-owned entity Veeral Additives with itself for a consideration of Rs1.25bn to be paid through equity shares of VOL.

Polyphenol antioxidant has wide applications >

Polyphenol antioxidants are in demand to manufacture food and beverages. Polyphenol antioxidants have anti-inflammatory properties which are now a key feature in the majority of cosmetics. There has been an upsurge in demand of animal feed possessing polyphenol antioxidant as well.

Global demand 300kt, Indian demand is more than 10kt >

According to VOL's management, global demand of phenolic antioxidants is c.300kt and Indian annual demand is over 10kt for FY20.

Butyl phenol is the input material for phenolic antioxidants >

Butyl phenol is the input material for phenolic antioxidants and will constitute forward integration for VOL.

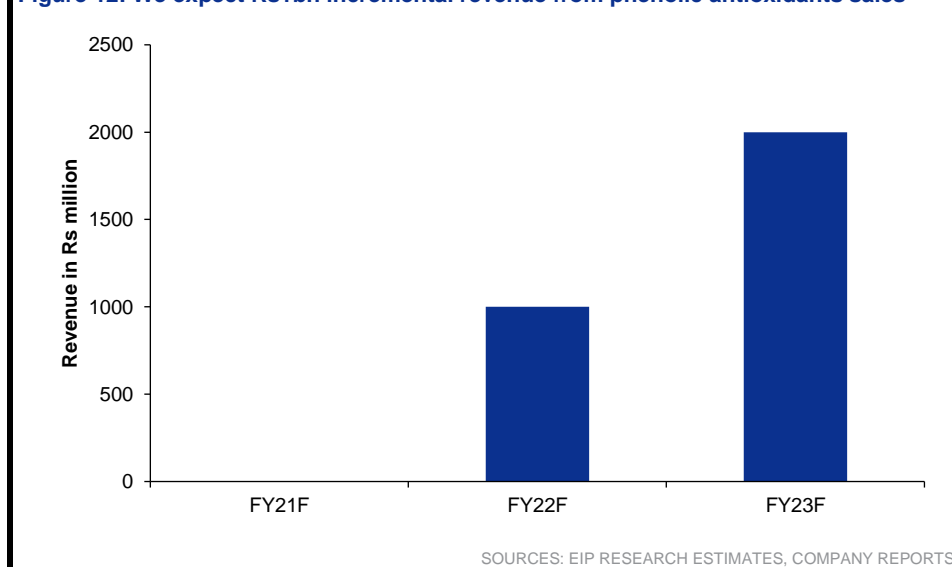
Revenue potential of AO is significant >

As of now India imports antioxidants. Veeral Additives was supposed to fill this gap by producing c.10,000t of antioxidants. According to VOL's management, AO's peak revenue potential is c.Rs5bn.

We have built in a slow ramp-up in revenue (assuming shareholders will approve the merger proposal) >

We have built in peak incremental revenue of Rs3bn from phenolic antioxidants.

Figure 12: We expect Rs1bn incremental revenue from phenolic antioxidants sales



Critical molecules: Methyl tertiary butyl ether

Methyl tertiary butyl ether (MTBE) is a crude derivative >

Methyl tertiary butyl ether (MTBE) is an organic compound typically produced by the reaction between isobutene and methanol in the presence of a catalyst. Hence, its prices depend directly on crude prices. MTBE is a flammable, volatile and colourless liquid with a mild odour.

Methyl tertiary butyl ether (MTBE) is primarily used as a fuel additive >

MTBE is used to increase the oxygen content of fuel, ensuring complete combustion. Compared to other oxygenates, Methyl Tertiary Butyl Ether exhibits

relatively low solubility in water without phase separation, lower blending density, vapour pressure and has no corrosion problems. All these attributes and properties render it advantageous over some other agents. Based on the application, global Methyl Tertiary Butyl Ether market is segmented into:

- fuel additives
- chemical intermediate
- others

Increased usage of ethanol is a risk to MTBE ➤

Other oxygenates are available as additives for gasoline, including ethanol and ethers such as Ethyl tertiary butyl ether (ETBE). Ethanol has been advertised as a safe alternative by agricultural and other interest groups in the US and Europe. In 2003, California was the first US state to start replacing MTBE with ethanol.

An alternative to ethanol is ETBE, manufactured from ethanol and isobutene. Its performance as an additive is similar to MTBE, but due to the higher price of ethanol, compared to methanol, it is more expensive. Higher quality gasoline is an alternative, so that additives such as MTBE are unnecessary.

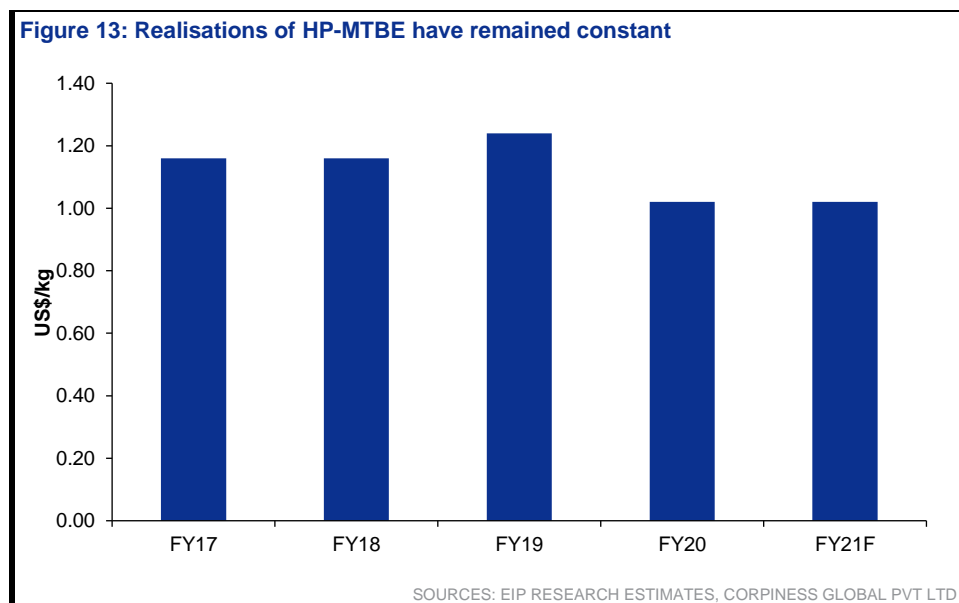
VOL makes high-purity MTBE, which is unlikely to be replaced by other additives ➤

There are multiple producers of MTBE like Huntsman Corporation, Avantor Performance Materials, China Petroleum & Chemical Corporation (Sinopec), Saudi Basic Industries Corporation (SABIC), LyondellBasell Industries N.V., Evonik Industries, Panjin Heyun Industrial Group, Petroliam Nasional Berhad (Petronas) and Reliance Industries, among others.

However, there are only a handful of global suppliers who can make high purity MTBE and VOL is on this list.

High-purity MTBE has specialised usage ➤

It is used in reaction, extraction and recrystallisation solvent in agricultural, pharmaceutical and chemical manufacturing. To put the exclusivity of HP-MTBE in perspective: while global capacity of MTBE is 33m tonnes as at FY20 (Source: EIP Research), VOL makes only 1,000t of HP-MTBE p.a.



Critical molecules: PAP, development of alternate synthesis not successful till date

VOL plans to start manufacturing of PAP (Para Amino Phenol), the intermediary molecule to manufacture paracetamol (Source: public disclosures by VOL). PAP is not a new molecule to the Indian market; it was manufactured by multiple companies previously. However, Chinese players have overcome competition in the last decade. In the recent past, multiple manufacturers have forayed into PAP manufacturing, including:

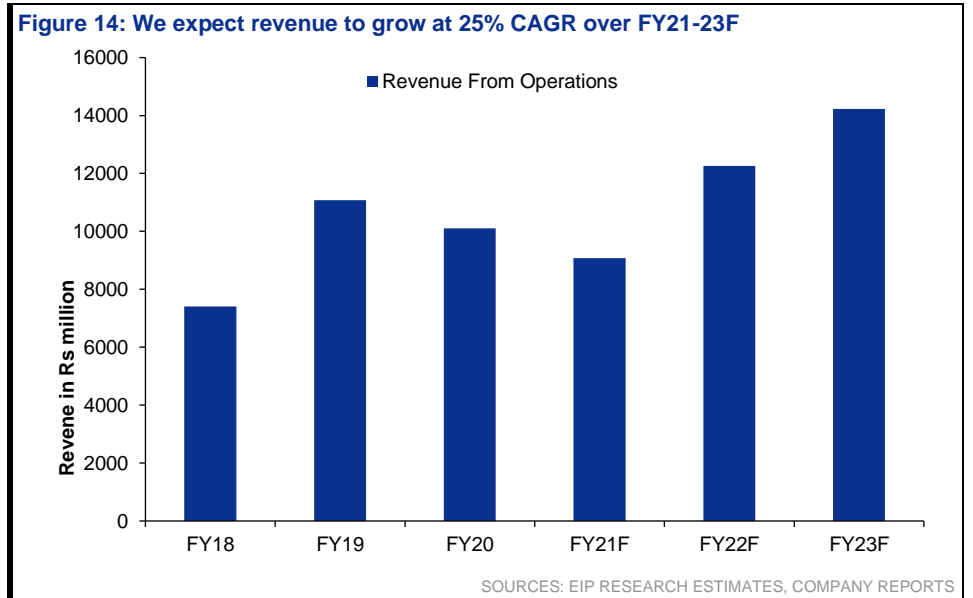
- Jay Organics (<https://jayorganics.com/products/para-amino-phenol/>)
- Bharat Chemicals (<http://www.bharatchemicals.net/>)

Manufacturing PAP through the alternate route can help VOL reduce production costs vis-à-vis competition by as much as 40%. However, till now it hasn't been successful in its attempts.

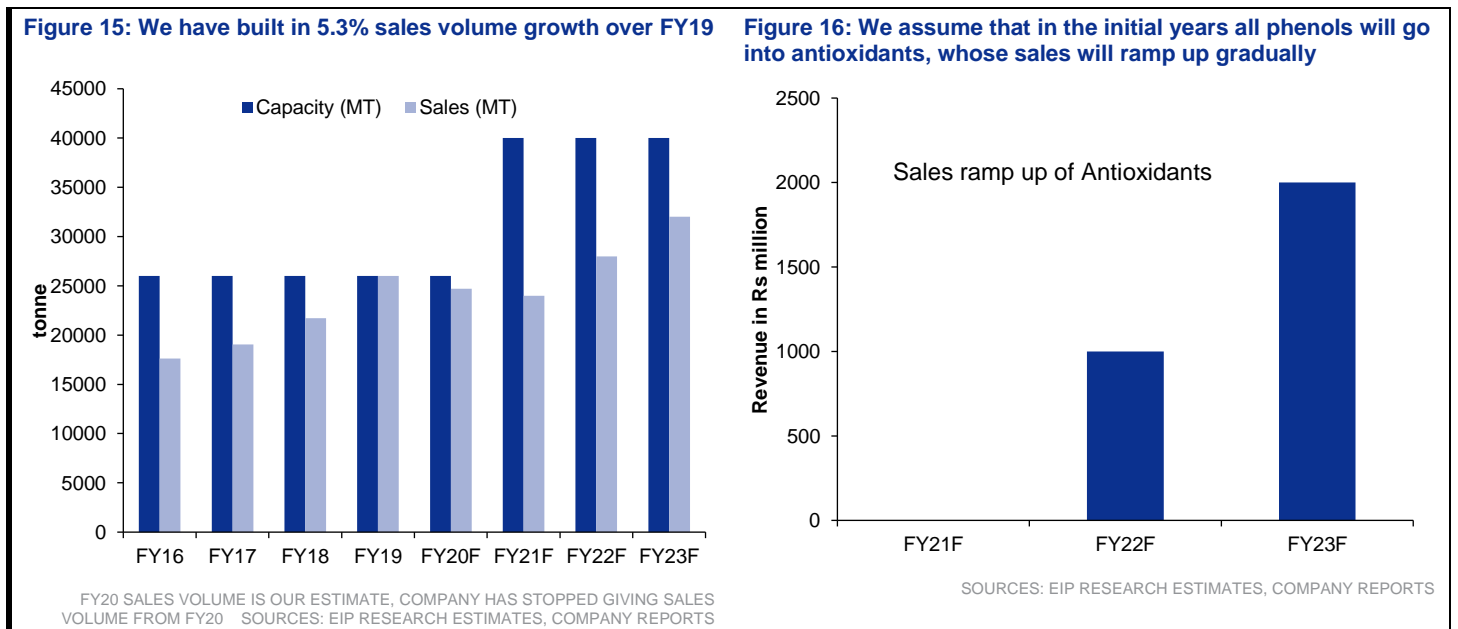
Earnings and valuation

We forecast c.25% revenue CAGR over FY21-23F ➤

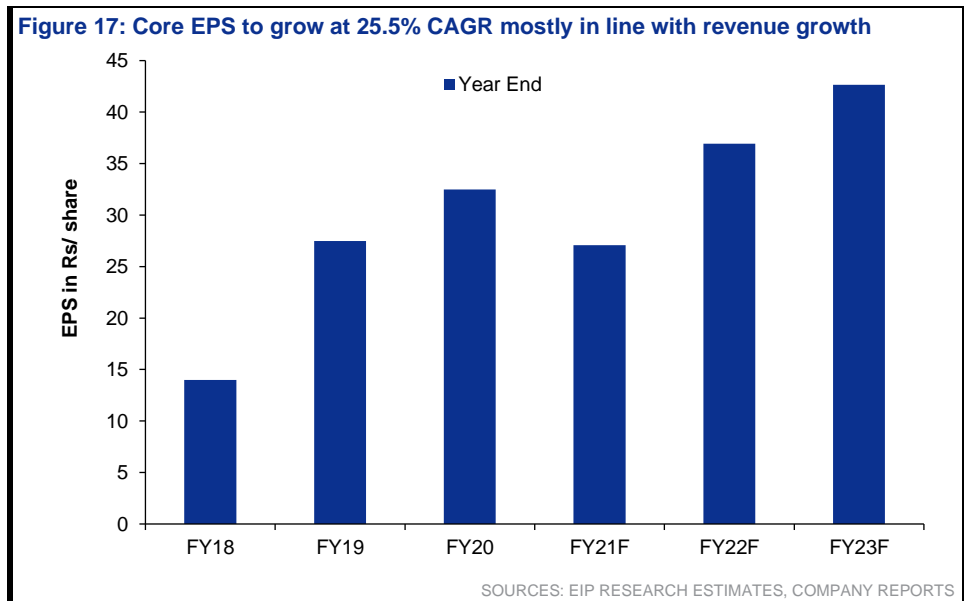
Given the number of new launches and capacity expansion, we expect VOL to clock 25% revenue CAGR over FY21-23F, despite the decline of about 10% in FY21F.



We factor in a graded ramp-up in ATBS and phenol capacity utilisation ➤

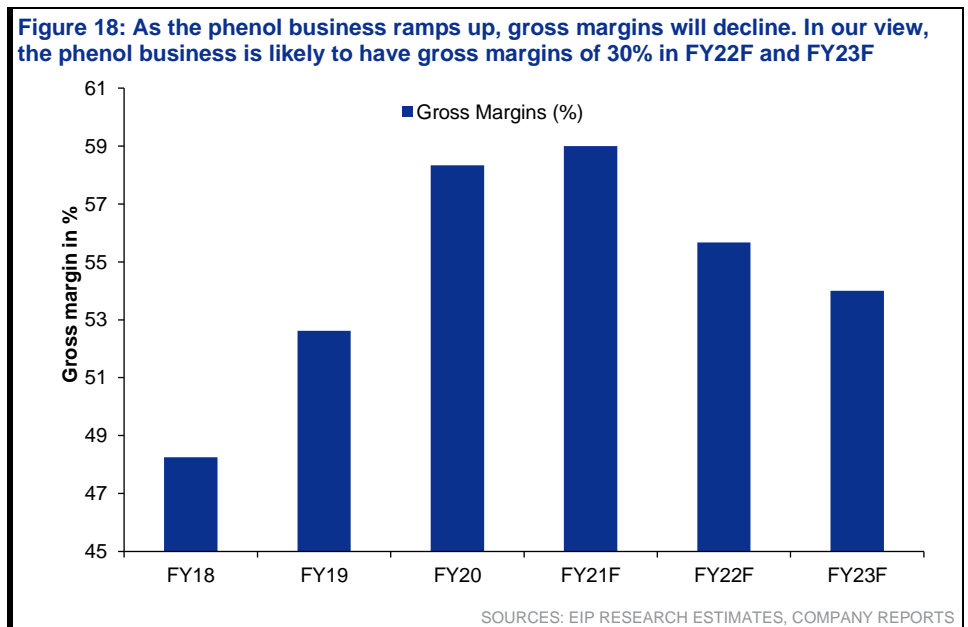


Core EPS to grow by 25.5% CAGR in FY21-23F ➤



We expect gross margins to decline as VOL ramps up phenol capacity ➤

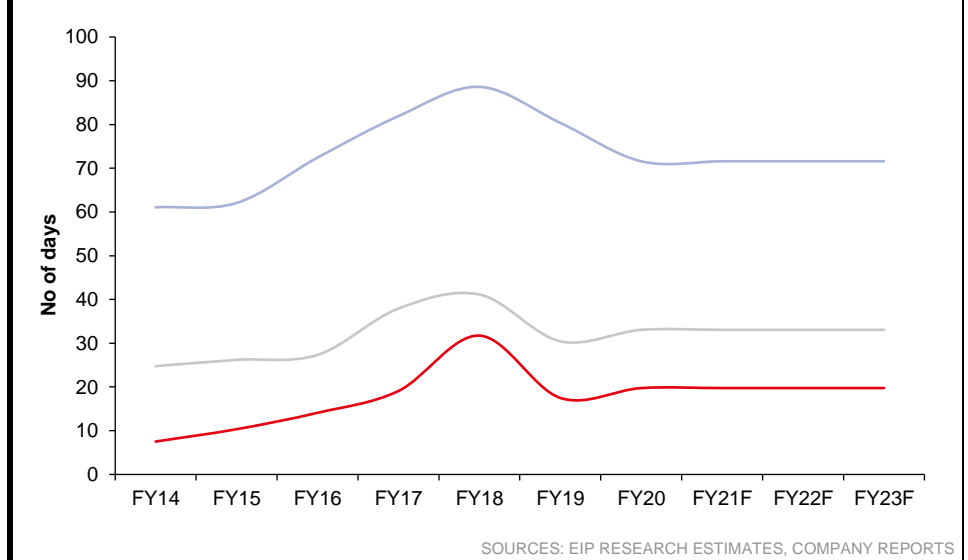
Phenol is likely to be a lower gross margin business for Vinati Organics. Therefore, we build in 55.6% gross margins in FY22F and 54% gross margin in FY23F. We expect phenol will be a 30% gross margin business against the current product portfolio gross margin of 58%. We expect FY21F gross margins to be 59% for base products, but it will likely taper to 58% in FY22F and FY23F.



Working capital will likely remain within normal range ➤

Despite seeing the worst demand so far for its main chemical ATBS, Vinati Organics maintained debt in the normal range. Given that demand for ATBS is improving (as crude oil prices are rising), we believe Vinati will be able to maintain the normal working capital range (i.e., creditor, debtor and working capital days will be around historical average).

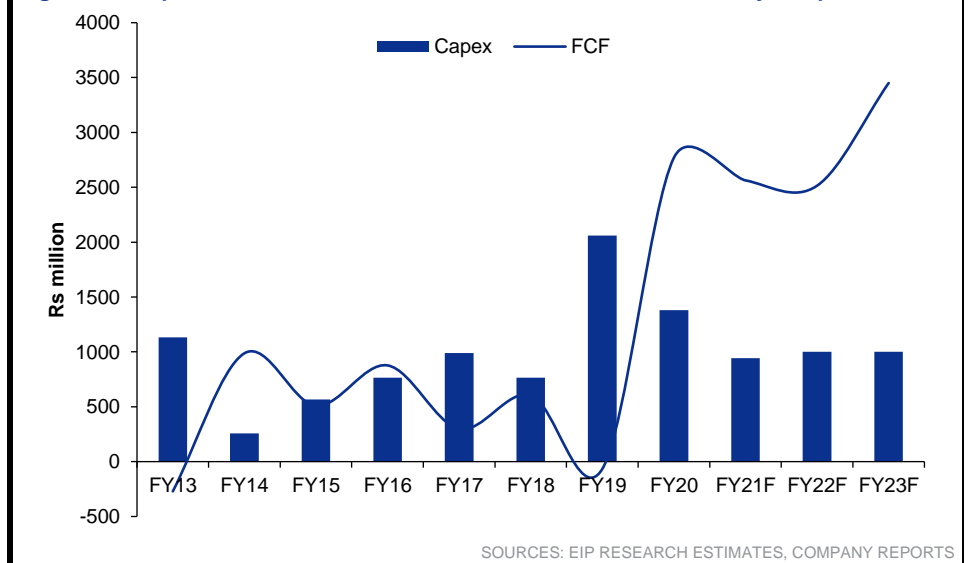
Figure 19: Working capital to be in historical range



Capex to taper off and free cash flow to increase ➤

With the commissioning of the ATBS and phenol capacities, most of Vinati Organics' capex is over. Going forward we expect VOL to incur maintenance capex of about Rs1 bn p.a.

Figure 20: Capex to trend down and free cash flow to increase as major capex is over



RoE to improve as company ramps up capacity in coming years ➤

Figure 21: VOL's RoE will improve as it ramps-up recently commissioned ATBS and phenol plants. We have built in a 330bp margin decline in FY22F from FY21F and 170bp gross margin decline in FY23F from FY22F

DuPont Analysis	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21F	FY22F	FY23F
Profitability (%)	12.53	15.25	22.73	22.40	19.72	25.49	32.45	30.06	30.49	30.41
Asset turnover (x)	1.25	1.27	0.85	0.76	0.74	0.90	0.71	0.56	0.64	0.63
Financial leverage (x)	1.78	1.38	1.25	1.21	1.23	1.17	1.13	1.11	1.10	1.09
ROE (%)	27.8	26.7	24.2	20.6	18.1	26.9	26.1	18.7	21.4	20.9

SOURCES: EIP RESEARCH ESTIMATES, COMPANY REPORTS

Valuation and recommendation

Prefer P/E (to DCF & EV/EBITDA) for valuation of chemical companies ➤

We value VOL on a P/E basis as we consider it a more appropriate valuation method for chemical companies over DCF or EV/EBITDA. In our view, DCF is not a suitable valuation method as the earnings of chemical companies are highly cyclical and forecasting long-term earnings is practically impossible. We think a balance sheet-based valuation is also inappropriate as short-term debt may rise because of inventory cycles, distorting the balance sheet for a short period (in many cases, only for one quarter).

Figure 22: Last 3-year average trading multiple has been 27x. But VOL rerated after Lubrizol's (Not Rated) exit from the ATBS business



Initiate coverage with Add ➤

We initiate coverage on VOL with an Add rating and TP of Rs1,603 as we expect:

- the volume ramp-up in ATBS and phenols to drive revenue CAGR of 25% and EPS CAGR of 25.5% over FY21-23F (the market is small and VOL's global market share was 65% in ATBS and IBB in FY20);
- ROIC to expand from 27% in FY21F to 37% in FY23F, which will prevent the derating of the stock;
- competition will be unable to replicate VOL's niche product portfolio; and
- entry into the AO market (if the merger is approved by shareholders) will be another positive for the company as it will provide forward integration to the phenol business.

Figure 23: We value VOL at 37.6x one-year forward EPS to arrive at TP of Rs1,603

Target Price Methodology		
FY22F EPS	Rs/Share	36.9
FY23F EPS	Rs/Share	42.6
P/E Multiple on FY23F EPS	x	37.6
Target Price	Rs/Share	1,603

SOURCES: EIP RESEARCH ESTIMATES, COMPANY REPORTS

We value the company at 37.6x FY23F EPS which is +1.5SD of long-term mean because

- VOL became the global leader in the ATBS market after Lubrizol's (Not Rated) exit in 2018. The price spreads of ATBS (ATBS's price is 0.45* Acrylonitrile price) improved by 30% and have stayed around that level from FY19.
- IBB spreads (IBB price - 0.80* Toluene price) improved in FY19 as there has been a structural rise in Ibuprofen prices. IBB is a principal raw material of Ibuprofen API.

Peer comparison

Figure 24: Peer Comparison

Company	Bloomberg Ticker	Closing Price (LC)	Target Price* (LC)	% Upside	Rating	Market cap (US\$ m)	EV/EBITDA (x)		P/BV (x)		RoE (%)		P/E (x)	
							CY21F	CY22F	CY21F	CY22F	CY21F	CY22F	CY21F	CY22F
UPL Ltd	UPLL IN	544	578	6%	HOLD	5,668	9.5	8.6	2.0	1.8	14.4	13.9	18.9	15.6
Rallis India Ltd	RALI IN	265	355	34%	ADD	733	13.3	12.0	3.3	2.9	16.5	15.7	21.4	19.8
SRF Limited	SRF IN	5,677	6,227	10%	ADD	4,559	18.9	16.3	4.9	4.2	18.8	17.6	29.8	25.8
PI Industries Limited	PI IN	2,228	2,505	12%	ADD	4,649	30.6	23.2	6.2	5.7	17.90	15.60	45.2	38.0
Vinati Organics Ltd	VO IN	1,439	1,603	11%	ADD	2,031	40.9	29.7	10.0	8.4	20.10	23.30	53.2	39.0
Bayer	BAYN GR	54	NR	NR	NR	66,673	6.9	6.3	1.1	1.0	2.85	2.85	8.3	7.4
BASF	BAS GR	67	NR	NR	NR	73,818	8.7	8.0	1.3	1.3	0.12	0.12	17.3	14.8
Corteva	CTVA US	43	NR	NR	NR	32,638	12.9	11.6	1.2	1.2	3.66	3.66	22.6	19.7

NR COMPANY ESTIMATES ARE FROM BLOOMBERG CONSENSUS
SOURCES: EIP RESEARCH ESTIMATES, COMPANY REPORTS, BLOOMBERG. PRICED AS AT 11 FEB 2021

Vinati Organics is trading at a higher multiple than its peers (PI trades near Vinati valuation) as:

- Vinati operates in a very niche space which faces minimal competition. It has a 65% market share in ATBS where it is expanding capacity by 54%, thus becoming even larger. Vinati has gained higher pricing power in this space after Lubrizol's exit in 2018.
- Even in IBB, Vinati controls 65% of the market share. The only competitor for Vinati is IOL (Not Rated). IOL uses the bulk of this molecule for internal consumption.
- Producing Butyl phenol domestically will stem India's reliance on imports. India imports 20kt of butyl phenol, while VOL's production capacity is 39kt.
- VOL's acquisition of Veeral Additives will aid forward integration in the manufacture of phenol. It will help the company to venture into another niche segment – that of AO. Indian demand for AO is 10kt (Source: Company) and the bulk of it is imported. The global market for AO is 300kt. Veeral Additives' peak capacity is 25kt. At peak capacity, Veeral Additives will consume 50% of VOL's phenol capacity, in our view.

SWOT Analysis

Figure 25: Vinati Organics

Strengths	Weaknesses
The company has a 65% market share in key chemicals like ATBS and IBB	Sales are concentrated on two molecules ATBS and IBB. The top three molecules contribute 86% of sales (FY13-20)
Vinati Organics has pricing power in ATBS and IBB. This is seen in rising gross margins over key raw materials like Acrylonitrile and Toluene	Vinati Organics has no control over input prices. Acrylonitrile and Toluene prices depend on crude oil prices
Opportunities	Threats
ATBS has many new usages (identified in the ATBS section). With new capacity commissioned Vinati Organics is in a unique position to get more market share	While ATBS and IBB don't have much competition, Phenols have significant competition from imports. We have built in much lower gross margins for phenols but competition can lead to further downside
Phenols have big opportunity for Vinati Organics as they can replace c10kt of AO and 10kt of phenol imports into the country	

SOURCES: EIP RESEARCH ESTIMATES, COMPANY REPORTS

Risks

- Sales are highly concentrated on the ATBS and IBB molecules. In fact, the top three molecules contribute 86% of sales (FY13-20). Any weakness in demand for either of these molecules will negatively impact EPS, in our view.
- We have built in a graded rise in ATBS volume sales with the belief that VOL will not dilute gross margins. Any pricing discount to grab market share will impact our EPS estimates disproportionately.
- Phenol is a new product for Vinati. While management is confident of grabbing a larger share of the import market of Phenols in India, the actual execution and customer acquisition presents a risk – there could be a delay in production ramp-up and customers may not switch to VOL-manufactured AO.

- Like phenol, Phenolic Antioxidants (AO) are an untested market for VOL. The company proposes to merge Veeral Additives (100% promoter entity, makes AO) with itself to launch VOL in the AO market. We believe the opportunity is significant as India imports 10kt of AO but execution and lack of experience presents a risk.

Appendix

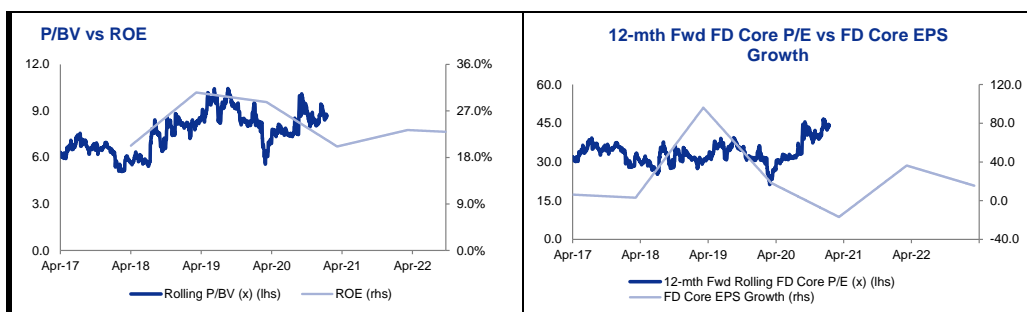
Vinati Organics Limited is a specialty chemical company, focusing on manufacturing specialty chemicals and organic intermediaries. It combines innovation with chemistry to deliver value-added products to customers.

VOL has two plants in Maharashtra, in Mahad (Raigad) and Lote Parashuram (Ratnagiri). The plants are ISO 9001: 2008, ISO 14001: 2004 and ISO 18001:2007 certified for following quality control, environment, and health and safety standards. VOL is a world leader in two products – Isobutyl Benzene (IBB) and 2-Acrylamido 2 Methylpropane Sulfonic Acid (ATBS). It is present in over 22 countries, and exports products to customers across the US, Europe and Asia.

Figure 26: Key management profiles

<p>Vinati Saraf Mutreja, Managing Director & CEO</p>	<p>Ms. Vinati Saraf Mutreja is the Managing Director & CEO of VOL. She joined VOL in 2006. She holds a Bachelor of Science in Economics (Finance) from The Wharton School and Bachelor of Applied Science from the School of Engineering (University of Pennsylvania) and has completed the Owner/President Management programme from Harvard Business School.</p> <p>She has been on Vinati Organics management team since 2006 and balances technical/manufacturing execution and marketing abilities with new age aggression. Ms. Mutreja has been featured in Forbes Asia's Businesswomen 2020 list. The World Economic Forum named Ms. Mutreja a Young Global Leader for 2020. Ms. Mutreja was also listed in The Economic Times annual India's Top 40 under 40 business leader for 2019. She was declared the Outstanding Woman Business Leader of the Year at The Economic Times Family Business Awards 2019.</p>
<p>Mr. Vinod Saraf Executive Chairman</p>	<p>Mr. Vinod Saraf is the founder and Executive Chairman of Vinati Organics Limited. Mr. Saraf has over 50 years of experience in the Indian manufacturing industry. Prior to VOL, he was associated with the Bhilwara Group, Modern Syntex (I) Ltd. and Grasim Industries and was nominated the MD of Mangalore Refinery & Petrochemicals Ltd. (MRPL). Mr. Saraf's emphasis on clean and green technologies and its assimilation into the business model of the company has allowed VOL to create a distinctive place for itself. He was recently awarded the Business Leader of the Year (Innovation) by CHEMTECH CEW Leadership & Excellence Awards. He was recently awarded the 2019 HURUN India Selfmade Entrepreneur of the year. Under his leadership, the company received various recognitions and accolades over the years. VOL was named the Most Promising Company of the Year by CNBC-TV18 IBLA 2020. VOL was adjudged Company of the Year in Chemicals by FICCI Chemicals and Petrochemicals Awards 2019.</p>

SOURCE: COMPANY WEBSITE

BY THE NUMBERS

Profit & Loss

(Rs mn)	Mar-19A	Mar-20A	Mar-21F	Mar-22F	Mar-23F
Total Net Revenues	11,081	10,289	9,259	12,448	14,413
Gross Profit	11,081	10,289	9,259	12,448	14,413
Operating EBITDA	4,036	4,139	3,499	4,770	5,516
Depreciation And Amortisation	(274)	(332)	(454)	(486)	(538)
Operating EBIT	3,762	3,808	3,046	4,284	4,977
Financial Income/(Expense)	(9)	(11)			
Pretax Income/(Loss) from Assoc.		8			
Non-Operating Income/(Expense)	500	450	495	544	599
Profit Before Tax (pre-EI)	4,252	4,255	3,541	4,828	5,576
Exceptional Items					
Pre-tax Profit	4,252	4,255	3,541	4,828	5,576
Taxation	(1,428)	(908)	(757)	(1,033)	(1,193)
Exceptional Income - post-tax					
Profit After Tax	2,825	3,346	2,783	3,795	4,383
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	2,825	3,346	2,783	3,795	4,383
Recurring Net Profit	2,825	3,346	2,783	3,795	4,383
Fully Diluted Recurring Net Profit	2,825	3,346	2,783	3,795	4,383

Cash Flow

(Rs mn)	Mar-19A	Mar-20A	Mar-21F	Mar-22F	Mar-23F
EBITDA	4,036	4,139	3,499	4,770	5,516
Cash Flow from Invt. & Assoc.					
Change In Working Capital	(1,138)	811	253	(765)	(472)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	(132)	(333)	16	(2)	
Other Operating Cashflow	(2,015)	(1,356)	(1,020)	(1,521)	(1,787)
Net Interest (Paid)/Received	(9)	(11)			
Tax Paid	1,262	908	757	1,033	1,193
Cashflow From Operations	2,004	4,159	3,506	3,514	4,450
Capex	(2,060)	(1,372)	(943)	(1,000)	(1,000)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(367)	(602)			
Cash Flow From Investing	(2,427)	(1,975)	(943)	(1,000)	(1,000)
Debt Raised/(repaid)	(115)	(33)	(3)		
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	(278)	(1,046)	(709)	(967)	(1,116)
Preferred Dividends					
Other Financing Cashflow	(10)	(11)			
Cash Flow From Financing	(403)	(1,091)	(712)	(967)	(1,116)
Total Cash Generated	(826)	1,094	1,851	1,548	2,333
Free Cashflow To Equity	(539)	2,151	2,560	2,514	3,450
Free Cashflow To Firm	(414)	2,196	2,563	2,514	3,450

SOURCES: EIP RESEARCH ESTIMATES, COMPANY REPORTS

BY THE NUMBERS...cont'd

Balance Sheet					
(Rs mn)	Mar-19A	Mar-20A	Mar-21F	Mar-22F	Mar-23F
Total Cash And Equivalents	1,003	2,811	4,662	6,210	8,543
Total Debtors	2,440	2,018	1,816	2,441	2,827
Inventories	924	932	838	1,127	1,305
Total Other Current Assets	944	665	655	687	706
Total Current Assets	5,311	6,426	7,971	10,465	13,381
Fixed Assets	6,657	7,817	8,307	8,820	9,282
Total Investments					
Intangible Assets					
Total Other Non-Current Assets	308	187	170	173	173
Total Non-current Assets	6,965	8,004	8,477	8,993	9,455
Short-term Debt	37	3			
Current Portion of Long-Term Debt					
Total Creditors	531	557	501	673	780
Other Current Liabilities	320	330	334	342	346
Total Current Liabilities	888	890	835	1,015	1,126
Total Long-term Debt					
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	29	41	41	41	41
Total Non-current Liabilities	29	41	41	41	41
Total Provisions	846	705	705	705	705
Total Liabilities	1,763	1,636	1,580	1,761	1,872
Shareholders Equity	10,513	12,794	14,868	17,697	20,964
Minority Interests					
Total Equity	10,513	12,794	14,868	17,697	20,964

Key Ratios					
	Mar-19A	Mar-20A	Mar-21F	Mar-22F	Mar-23F
Revenue Growth	51.9%	(7.2%)	(10.0%)	34.4%	15.8%
Operating EBITDA Growth	102.7%	2.6%	(15.5%)	36.3%	15.6%
Operating EBITDA Margin	36.4%	40.2%	37.8%	38.3%	38.3%
Net Cash Per Share (Rs)	9.40	27.31	45.36	60.41	83.12
BVPS (Rs)	102.28	124.48	144.66	172.18	203.96
Gross Interest Cover	398.55	348.63	17,585.48		
Effective Tax Rate	33.6%	21.4%	21.4%	21.4%	21.4%
Net Dividend Payout Ratio	25.5%	25.4%	25.5%	25.5%	25.5%
Accounts Receivables Days	69.35	79.07	75.56	62.41	66.70
Inventory Days	nm	nm	nm	nm	nm
Accounts Payables Days	nm	nm	nm	nm	nm
ROIC (%)	36.1%	35.5%	27.8%	35.0%	37.8%
ROCE (%)	37.0%	30.6%	21.0%	25.2%	24.8%
Return On Average Assets	25.7%	25.1%	18.0%	21.1%	20.7%

SOURCES: EIP RESEARCH ESTIMATES, COMPANY REPORTS

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Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2019, Anti-Corruption 2019

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1 CG Score 2019 from Thai Institute of Directors Association (IOD)

2 AGM Level 2018 from Thai Investors Association

3 Companies participating in Thailand's Private Sector Collective Action Coalition Against Corruption programme (Thai CAC) under Thai Institute of Directors (as of November 30, 2018) are categorised into:

companies that have declared their intention to join CAC, and companies certified by CAC.

4 The Stock Exchange of Thailand : the record of listed companies with corporate sustainable development "Thai sustainability Investment 2018" included:

SET and mai listed companies passed the assessment conducted by the Stock Exchange of Thailand: THSI (SET) and THSI (mai)

SET listed companies passed the assessment conducted by the Dow Jones Sustainability Indices (DJSI)

Recommendation Framework

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Definition:

Add The stock's total return is expected to exceed 10% over the next 12 months.

Hold The stock's total return is expected to be between 0% and positive 10% over the next 12 months.

Reduce The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

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Neutral A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.

Underweight An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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Definition:

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