

Vinati Organics (14 Jul 07): Rs.125

Positioned strongly in its business: Poised to be a multi-bagger

Vinati Organics is in the business of specialty organic chemicals & pharmaceutical intermediates and had revenues of over Rs.200 crores in FY09. It has global oligopoly in two products (IBB & ATBS) that contributes virtually the whole of its revenues and profits. It exports bulk of its production to US, Europe, and China. Focused on niche products with technological entry barriers, the company is currently running a pilot for another such product. We understand this product holds significantly greater potential than its existing products.

We estimate revenues to grow over 30% each in FY10 & FY11 and PAT to grow 60% and 35% respectively in FY10 & FY11. At market capitalization of Rs.123 crores, it currently trades at 3.1x FY10 earnings and 2.3x FY1 earnings. Debt/Equity is 0.8x at the end of Mar-09.

Daily Line Chart from 01-Jan-08 to 14-Jul-09



On the chart, the stock was in a downtrend since Jan-08. The downtrend was broken in May-09 with rise in volumes and went on to overcome Jan-08 high. Currently the stock is near the support of Sep-08 intermediate high after a minor correction. The last intermediate high of a downtrend usually provides strong support.

Key Products

- *Isobutyl Benzene (IBB)*
- *2 Acrylamido 2 Methylpropane Sulfonic Acid & its sodium salt (ATBS & Na-ATBS)*

Isobutyl Benzene (IBB)

IBB is key ingredient of Ibuprofen, an anti-inflammatory analgesic bulk drug. It's also used in perfumes and as a specialty solvent. Vinati Organics is global market leader in IBB with over 60% global market-share. Its IBB production capacity is 14000 TPA and FY09 production was around 11,500 ton. IBB global market is growing at around 5% annually, as Ibuprofen is at a mature stage of product lifecycle. However, the company has been growing at a little faster rate due to gain in market share. It is expected to gain further market share this year, as production in China is going down (China IBB capacity is less than 2000 TPA). The company's competitive and significantly low cost of manufacturing and scale economies are the key success factors here. It supplies directly to ibuprofen manufacturers. India is a net exporter of Ibuprofen. BASF is the largest manufacturer of Ibuprofen in the world. Biocause (China) and Shasun Chemicals (India) are amongst the largest ibuprofen manufacturers. SI group Inc (Schenectady International) is the 2nd largest producer of IBB globally. In India, SI group has capacity of 3-4000 TPA.

ATBS

ATBS find applications in a wide range of areas including water treatment, oil recovery/drilling, mining, construction chemicals, personal care products etc. ATBS global demand continues to be strong. ATBS, Na-ATBS and other derivatives that the company makes are monomers and are supplied to polymer manufacturers who then sell the polymers to users through their distribution channels. Direct sales are only to acrylic fiber industry. Applications like Enhanced Oil Recovery & Water Treatment hold substantial potential for growth of ATBS. ATBS technology was developed by Pune-based National Chemicals Laboratory and was exclusively licensed to the company. The company has 15-20% global market share in ATBS. There are only three other manufacturers of ATBS globally viz. Lubrizol-USA, Toyo GOSSEI-Japan and a small Chinese company with less than 1000 TPA capacity. It is very difficult to get the right technology to make ATBS. With limited number of suppliers, customers are keen to support a new supply source. Vinati Organics has been able to improvise the technology and customize the products to suit varying applications. ATBS sales normally take place through long term or annual contracts. Vinati Organics has a few long term contracts with provisions to fully pass on changes in input costs and partly pass on currency fluctuations.

Investment Arguments

Oligopolistic position in both the products

Vinati Organics' global oligopolistic position in both of its key products positions it on a very strong footing. Cost leadership & scale economies in IBB and technological entry barrier in ATBS are great strategic advantages. Going forward, the company wants to get into only niche products that offer technological edge or cost competitiveness and this augurs well for its continued strategic edge.

ATBS capacity doubled effective May-09: Growth driver for FY10 & FY11

ATBS (including Na-ATBS) capacity was modernized and expanded at the cost of Rs.40 crores from 5000 TPA to 10,000 TPA. The expanded capacity is available effective 16th May 2009. The company has a long term (2-3 years) supply agreement for 5000 TPA. The high margin high growth product's contribution to sales is likely to go up from 43% in FY09 to 50% in FY10.

Backward integration into Isobutylene (IB), a key input for ATBS: Growth driver for FY11

The company is currently in the process of setting up backward integration project for making Isobutylene (IB), which is a key input in the making of ATBS. Currently IB is imported from Europe & Taiwan in pressurized tanks. The project will cost Rs.40 crores and save significantly in logistics costs. The project is expected to commence towards the end of FY10 and hence will contribute to growth in FY11. At present, there is only one manufacturer of IB in India with 6000 TPA capacity. India imported about 6000 ton of IB last year. Of the 8000+ TPA capacity being set up, about 4000 ton will be captive consumption and balance will be for sale to manufacturers of agro-chemicals, anti-oxidants, etc.

A new breakthrough product may drive growth beyond FY11

For growth beyond FY11, the company is currently working on a pilot project for another technology breakthrough drug intermediate. Like ATBS, technology for this product is also developed by Pune-based National Chemical Laboratory. We understand that this product has significantly higher market potential than the company's existing products.

Risks / Concerns

Capacity expansion in IBB

Large capacity expansion may lead to oversupply in IBB and may impact margins, as currently demand-supply is evenly balanced with demand growing at 1000 TPA. IOL Chemicals & Pharmaceuticals (IOLCP), a large producer of ibuprofen, recently expanded ibuprofen capacity and is shortly going to commence a 6000 TPA IBB capacity. IOLCP is not a major customer of Vinati Organics for IBB. However, if IOLCP could gain market share in ibuprofen with its enhanced capacity (3600 TPA to 6000 TPA), ibuprofen sales of its competitors could fall leading to lower demand of IBB for other IBB manufacturers. This may make them lower their prices to keep capacity utilization high. This can lead to margin compression in IBB.

Delay in launch of the new product for which pilot plant is being set up

Delay in launch of the new product, for which a pilot plant is currently being set up, may lead to lack of growth drivers beyond FY11 unless any other growth driver emerge in the meanwhile.

Forex fluctuations

As over 70% of the company's revenues come from exports and even the domestic sales track import parity price, INR appreciation is a risk. Though the risk is limited to the contribution margin, as even locally sourced raw material track import parity price. Even the contribution margin is not fully exposed as long term contracts have provisions to share forex risk. In addition, there is forex loan (Rs.36 crores as on 31-03-09) that acts as a partial hedge. [For our current view on INR/USD, please refer www.impetusadvisors.com/research.htm](http://www.impetusadvisors.com/research.htm)

Teething troubles in scaling up expanded capacity of ATBS

ATBS capacity was doubled recently in mid May09. As the process is new, there can be teething troubles. This may lead to lower earnings growth in the interim. There could also be delay in tying up customers for the enhanced capacity.

Ownership & Management

As at the end of Jun-09, the company is 75% owned by promoters (Saraf family led by MD Vinod Saraf & ED Vinati Saraf). Institutional holding is negligible. The company was formed in 1989 by Mr. Vinod Saraf, a first-generation entrepreneur jointly with Maharashtra Petrochemical Corporation Ltd, a government of Maharashtra undertaking.

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Office:

A-604 Oberoi Woods, Oberoi Garden City, Off Western Express Highway, Goregaon East, Mumbai 63
Telefax 91 22 28405766 Email research@impetusadvisors.com
