

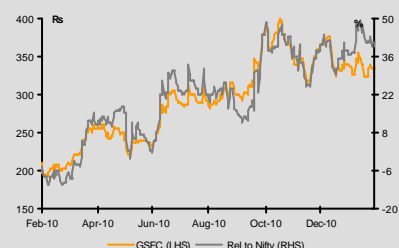
February 21, 2011

Reco	Previous Reco
Buy	Buy
CMP	Target Price
Rs 335	Rs 530
EPS change FY11E/12E (%)	NA
Target Price change (%)	NA
Nifty	5,519
Sensex	18,438

Price Performance (%)	1M	3M	6M	12M
Absolute	(2)	(8)	15	57
Rel. to Nifty	1	(2)	15	37

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Agri-input & Chemicals
Bloomberg	GSFC@IN
Equity Capital (Rs mn)	798
Face Value(Rs)	10
No of shares o/s (mn)	80
52 Week H/L	413/192
Market Cap (Rs bn/USD mn)	27/599
Daily Avg Volume (No of sh)	200157
Daily Avg Turnover (US\$m)	1.5

Shareholding Pattern (%)

	D'10	S'10	J'10
Promoters	37.8	37.8	37.8
FII/NRI	8.6	6.9	6.5
Institutions	26.8	28.2	27.9
Private Corp	10.9	10.8	10.6
Public	15.9	16.3	17.1

Source: Capitaline

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Short term supply pressure to keep margins intact

- **Caprolactam prices increased further by 25% to US\$ 3,480 / mt by Feb'2011 over Q3FY11 average prices of US\$ 2,790 / mt**
- **Spread increased to US\$ 2,330 / mt (FY10 / 9MFY11 average of US\$ 1,200 / mt / US\$ 1,720 / mt). Earnings may outperform our FY12 estimates by 25% if margins sustain at current level**
- **Supply side issues due to maintenance shut down of various plants and stocking in China - along with rising input costs are driving caprolactam prices**
- **We reiterate BUY on compelling valuations of FY12 P/BV of 0.9x, EV/EBITDA 2x and P/E 5x with investment value of Rs120 / share to support downside risk**

Caprolactam prices increased by 25% over Q3FY11 average

As mentioned in our note (*All time high Caprolactam spread to drive earnings*) caprolactam prices have been firming up since Jan'10 and increased by 32% to US\$ 2,850 / mt till Dec'10. On the other hand, the prices of its key raw material, Benzene, have gone up only by 5% to US\$ 1,000 / mt. As a result, spread (contribution margin) increased from US\$ 1,260 / mt in Jan'10 to US\$ 1,850 / mt by Dec'10. Caprolactam prices increased further by 25% to US\$ 3,480 / mt till Feb'11 (over Q3FY11 average price at US\$ 2,790 / mt). With benzene prices up by 20% to US\$ 1,150 / mt (over Q3FY11 average of US\$ 960 / mt), this spread has further increased to US\$ 2,330 / mt against Q3FY11 average of US\$ 1,830 / mt Feb'2011.

Supply side issues and rising input cost are driving caprolactam prices

We believe that the current all time high caprolactam prices are unlikely to sustain at their current level and likely to come down by H1FY12. Caprolactam prices have been driven by:

- Industry capacity utilization at > 90%,
- Short term supply side constraints as various plants globally have undergone maintenance shut down in the last 6 months,
- Increased demand from China due to stocking by Chinese players – on account of Chinese spring festival days / new year and
- Rising raw material prices since caprolactam's key raw material – Benzene is a crude derivative and prices of which have been continuously rising

Global caprolactam consumption stood at 4.3 mn mt against capacity of 4.7 mn mt in 2009 (capacity utilization at 91%). Strong demand growth for caprolactam (driven by firm demand from user industry) has kept the utilization rates on higher side. Key user industries for caprolactam include Nylon – 6 polymers for fiber and plastics / film manufacturers.

Compelling valuations to support downside risk, reiterate BUY

We reiterate our BUY recommendation on the stock with price target of Rs 530, implying 51% upside on our recommendation. The stock trades at compelling valuations of FY12E P/E of 5x and EV/EBITDA of 2x. Further P/BV of 0.9x (FY12E estimated book value of Rs 390 / share) and per share investment value of Rs 120 protects downside risk.

Financial Snapshot

Rs Mn

YE-Mar	Net Sales	EBITDA (Core)	EBITDA (%)	PAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
FY09	58,808	8,509	14.5	4,994	62.7	114.2	29.3	5.3	2.8	1.4
FY10	40,192	4,477	11.1	2,545	31.9	(49.0)	12.5	10.5	6.4	1.2
FY11E	45,336	10,460	23.1	6,417	81.9	156.6	27.3	4.1	1.9	1.0
FY12E	49,220	8,928	18.1	5,285	66.3	(19.1)	18.4	5.0	2.0	0.9

Prices for Caprolactam, Benzene, Nylon-6

In US\$ / mt	Benzene	% yoy	Caprolactam	% yoy	Nylon-6	% yoy	Caprolactam – Benzene spread	% yoy
Jan-10	1,040	201%	2,300	92%	2,625	74%	1,260	48%
Feb-10	930	127%	2,350	88%	2,660	73%	1,420	69%
Mar-10	935	105%	2,440	88%	2,700	72%	1,505	79%
Apr-10	995	62%	2,615	75%	2,805	55%	1,620	84%
May-10	915	48%	2,700	64%	2,930	48%	1,785	73%
Jun-10	805	8%	2,505	43%	2,800	36%	1,700	68%
Jul-10	795	-5%	2,295	14%	2,615	14%	1,500	28%
Aug-10	855	1%	2,550	20%	2,795	12%	1,695	33%
Sep-10	860	12%	2,595	29%	2,840	17%	1,735	40%
Oct-10	945	24%	2,700	38%	2,905	25%	1,755	47%
Nov-10	940	10%	2,810	36%	3,080	29%	1,870	55%
Dec-10	1,000	5%	2,855	32%	3,125	27%	1,855	52%
Q3FY11	962	12%	2,788	35%	3,037	27%	1,827	52%
Jan-11	1,095	5%	3,120	36%	3,425	30%	2,025	61%
Feb'11 - 1st week	1,135		3,380		3,575		2,245	
Feb'11 - 2nd week	1,150		3,480		3,625		2,330	

Source: Fibre2Fashion, Emkay Research

Short term supply side issues driving caprolactam prices

News	Affected plant capacity (mt)	Impact on quarter
Japanese firm Toray shut its CPL manufacturing facility for planned maintenance. The plant is located at Aichi, which has capacity to produce 1,00,000 tonnes of CPL every year	100,000	Q4CY10
Japan's Ube planned to restart its CPL production line at Yamaguchi Prefecture in the early November, which was closed in late September for planned outage	NA	NA
Taiwanese firm CPDC announced to undergo expansion at its plant located at Hsiaokang. This plant has annual production capacity of 1,75,000 tonne / year. But after expansion, Hsiaokang plant will be able to produce around 1,90,000 - 200,000 tonnes / year of caprolactam	NA	NA
Chinese firm Shandong Haili announced to commence operation in December 2010. The plant is fifth biggest caprolactam plant in China with annual production capacity of 1,00,000 tonne/year	NA	NA
U.S.A based Honeywell restarted its CPL production line with capacity of 3,75,000 tonne / year. The plant was shut in November due to technical error	NA	NA
Sinopec announced for regular plant outage at its Taiwan based CPL production capacity. The plant may shut in late February and outage can last for 35 days	NA	NA
Japanese firm UBE also plan to shut its Osaka Sakai, based in the first quarter of 2011, for regular maintenance purpose which has annual production capacity 95,000 tonnes	95,000	Q1CY11
Buyers were in hurry to make sufficient stockpiles to run plant during the Chinese Spring Festival holidays	NA	NA
Chinese government announced anti-dumping duties on CPL imported from Europe and U.S.A.	NA	NA
Chinese firm CPDC announced for plant outage at its Toufen, Taiwan based CPL production plant. The plant has annual production capacity of 1,00,000 tonnes and it's expected to remain shut for approximately one month starting from beginning of second quarter of 2011	1,00,000	Q2CY11
Japanese firm UBE announced for planned outage for its plant based in Yamaguchi Prefecture in the last quarter of 2011. The CPL plant has annual production capacity of 90,000 tonnes and is expected to remain shut for 45 days	90,000	Q4CY11

Source: Fibre2Fashion, Emkay Research

Global Demand supply – Region wise

	2002	2003	2004	2005	2006	2009	2012
North America	927	927	927	927	927	927	927
South America	88	91	91	91	91	106	106
West Europe	1,151	1,058	1,031	1,031	1,031	1,031	1,031
East Europe	737	714	714	714	754	754	754
South & Southeast Asia	202	217	222	222	222	222	222
East Asia	555	555	615	781	843	1,164	1,176
Japan	587	617	595	542	542	542	542
World Capacity	4,247	4,179	4,195	4,308	4,410	4,746	4,758
World Consumption	3,575	3,702	3,846	3,927	4,032	4,347	4,652

Source: Fibre2Fashion, Emkay Research

Our estimates do not factor such aggressive margins in FY12...

Though current spread between caprolactam and benzene remains at all time high (US\$ 2,330 / mt by Feb'2011 against FY10 / 9MFY11 average of US\$ 1,200 / mt / US\$ 1,720 / mt) and EBIT margins in chemical segment stood at 40% in Q3FY11 (against FY10 / 9MFY11 at 19.4% / 32.4%), we do not factor such high margins in our estimates for FY12. We expect the current spread to come down in H1FY12 and have modeled for 24% margins in chemical segment for FY12.

...However we expect the benefit of high chemical prices may continue till H1FY12

As discussed, we believe that higher caprolactam spread is driven by short term supply side concerns and higher demand on account of inventory pile up in China. We expect these short term distortions in raw material (benzene) and finished products (caprolactam) to correct, leading to decline in margins. However, we believe that companies may continue to benefit in short term (by H2FY12) as industry dynamics remain intact.

Higher than expected margins may spur FY12 earnings estimate by ~25%

We estimate FY11E / FY12E APAT of Rs 6.5 bn / Rs 5.3 bn and AEPS of Rs 81.9 / Rs 66.3. Decline in FY12 over FY11 is on account of drop in chemicals margins from 33% to 24%. We have modeled for chemical segment margins at 24% for FY12 as against FY10 average of 19% and historical five year average of 21%. We would like to highlight that company's earnings may outperform our estimates by approximately 25% if chemical margins sustain at current levels of ~40%.

Key Financials

Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Net Sales	58,808	40,191.90	45,336.42	49,219.77
Growth (%)	65.4	(31.7)	12.8	8.6
Expenditure	50,299	35,715	34,876	40,292
Materials Consumed	38,193	25,422	27,973	30,565
Power & Fuel	3,069	3,019	3,174	3,199
Employee Cost	3,890	2,902	3,174	3,445
Other Exp	5,148	4,372	557	3,082
EBITDA	8,509	4,477	10,460	8,928
Growth (%)	79.4	(47.4)	133.7	(14.7)
EBITDA margin (%)	14.5	11.1	23.1	18.1
Depreciation	1,430	1,409	1,450	1,600
EBIT	7,078	3,067	9,010	7,328
EBIT margin (%)	12.0	7.6	19.9	14.9
Other Income	713	1,130	914	800
Interest expenses	392	306	206	240
PBT	7,400	3,891	9,718	7,888
Tax	2,406	1,346	3,188	2,603
Effective tax rate (%)	32.5	34.6	32.8	33.0
Adjusted PAT	4,994	2,545	6,530	5,285
Growth (%)	114.1	(49.0)	156.6	(19.1)
Net Margin (%)	8.5	6.3	14.4	10.7
(Profit)/loss from JVs/Ass/MI	-	-	-	-
Adj. PAT After JVs/Ass/MI	4,994	2,545	6,530	5,285
E/O items	-	-	265	-
Reported PAT	4,994	2,545	6,796	5,285
PAT after MI	4,994	2,545	6,530	5,285
Growth (%)	114.1	(49.0)	156.6	(19.1)

Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
PBT (Ex-Other income)	6,687	2,761	8,804	7,088
Depreciation	1,430	1,409	1,450	1,600
Interest Provided	392	306	206	240
Other Non-Cash items	688	(692)	(1,100)	(95)
Chg in working cap	241	(6,658)	5,071	(955)
Tax paid	-2,406	-1,346	-3,302	-2,603
Operating Cashflow	7,032	-4,220	11,129	5,275
Capital expenditure	(1,230)	(1,472)	(3,000)	(3,000)
Free Cash Flow	5,802	-5,692	8,129	2,275
Other income	713	1,130	914	800
Investments	(3,847)	1,811	-	-
Investing Cashflow	-3,134	2,941	914	800
Equity Capital Raised	-	-	-	-
Loans Taken / (Repaid)	(2,355)	3,636	-	-
Interest Paid	(392)	(306)	(206)	(240)
Dividend paid (incl tax)	(359)	(359)	(359)	(558)
Income from investments	0	0	0	0
Others	0	0	0	0
Financing Cashflow	-3,105	2,971	-565	-798
Net chg in cash	-438	220	8,479	2,277
Opening cash position	819	381	601	9,080
Closing cash position	381	601	9,080	11,357

Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Equity share capital	797	797	797	797
Reserves & surplus	18,518	20,644	25,602	30,234
Net worth	19,315	21,441	26,399	31,031
Minority Interest	0	0	0	0
Secured Loans	1,548	1,748	1,748	1,748
Unsecured Loans	1,692	5,128	5,128	5,128
Loan Funds	3,240	6,876	6,876	6,876
Net deferred liabilities	1,716	1,497	1,497	1,497
Total Liabilities	24,271	29,814	34,772	39,404
Gross Block	32,153	32,316	34,135	37,135
Less: Depreciation	20,130	21,501	22,951	24,551
Net block	12,023	10,815	11,184	12,584
Capital work in progress	509	1,819	3,000	3,000
Investments	6,061	4,250	4,250	4,250
Current Assets	14,631	21,037	27,680	31,551
Inventories	7,456	6,111	6,832	7,417
Sundry debtors	4,807	6,216	4,968	5,394
Cash & bank balance	381	601	9,080	11,357
Loans & advances	1,987	8,109	6,800	7,383
Other current assets	-	-	-	-
Current lia & Prov	8,954	8,107	11,342	11,980
Current liabilities	4,690	4,217	7,453	8,091
Provisions	4,264	3,889	3,889	3,889
Net current assets	5,677	12,930	16,339	19,571
Misc. exp	-	-	-	-
Total Assets	24,271	29,814	34,772	39,404

Key Ratios

Y/E, Mar	FY09	FY10	FY11E	FY12E
Profitability (%)				
EBITDA Margin	14.5	11.1	20.0	18.1
Net Margin	8.5	6.3	12.2	10.7
ROCE	33.0	15.5	30.7	21.9
ROE	29.3	12.5	27.3	18.4
RoIC	38.1	15.2	43.3	37.3
Per Share Data (Rs)				
EPS	62.7	31.9	81.9	66.3
CEPS	80.6	49.6	88.2	86.4
BVPS	242.4	269.0	331.3	389.4
DPS	4.5	4.5	7.0	7.0
Valuations (x)				
PER	5.3	10.5	4.1	5.0
P/CEPS	4.2	6.7	3.8	3.9
P/BV	1.4	1.2	1.0	0.9
EV / Sales	0.4	0.7	0.4	0.4
EV / EBITDA	2.8	6.4	1.9	2.0
Dividend Yield (%)	1.3	1.3	2.1	2.1
Gearing Ratio (x)				
Net Debt/ Equity	-0.2	0.1	-0.2	-0.3
Net Debt/EBITDA	-0.4	0.5	-0.6	-1.0
Working Cap Cycle (days)	47.0	73.6	35.0	35.0

Recommendation History: Gujarat Sate Fertilisers – GSFC IN

Date	Reports	Reco	CMP	Target
31/01/2011	<u>Gujarat Sate Fertilisers Q3FY11 Result Update</u>	Buy	327	530
16/12/2010	<u>Gujarat Sate Fertilisers Company Update</u>	Buy	349	530
22/10/2010	<u>Gujarat Sate Fertilisers Q2FY11 Result Update</u>	Buy	370	530
03/08/2010	<u>Gujarat Sate Fertilisers Q1FY11 Result Update</u>	Accumulate	312	368

Recent Research Reports

Date	Reports	Reco	CMP	Target
16/02/2011	<u>Fertiliser Policy Update Increase in subsidies</u>			
31/01/2011	<u>GNFC Q3FY11 Result Update</u>	Buy	112	157
28/01/2011	<u>Tata Chemicals Q3FY11 Result Update</u>	Accumulate	345	393
27/01/2011	<u>Deepak Fertilisers Q3FY11 Result Update</u>	Buy	157	250

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