# Prabhudas Lilladher

# Gujarat State Fertilisers & Chemicals

## Weak quarter; maintain 'Accumulate' on attractive valuations

Q4FY13 Result Update

**May 17, 2013**

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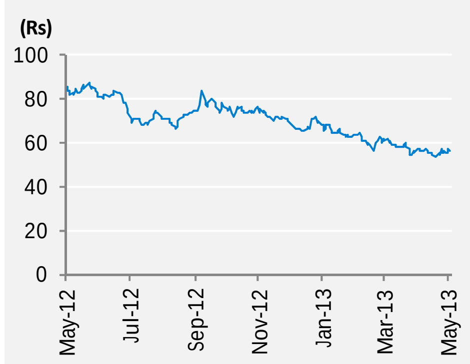
| | |
|---|---|
| Rating | **Accumulate** |
| Price | Rs57 |
| Target Price | Rs66 |
| Implied Upside | 15.8% |
| Sensex | 20,286 |
| Nifty | 6,187 |

***(Prices as on May 17, 2013)***

| **Trading data** | | | |
|---|---|---|---|
| Market Cap. (Rs bn) | | | 22.5 |
| Shares o/s (m) | | | 398.5 |
| 3M Avg. Daily value (Rs m) | | | 22.7 |
| **Major shareholders** | | | |
| Promoters | | | 37.84% |
| Foreign | | | 12.44% |
| Domestic Inst. | | | 26.03% |
| Public & Other | | | 23.69% |
| **Stock Performance** | | | |
| **(%)** | **1M** | **6M** | **12M** |
| Absolute | (1.2) | (25.1) | (32.4) |
| Relative | (9.5) | (35.9) | (58.6) |
| **How we differ from Consensus** | | | |
| **EPS (Rs)** | **PL** | **Cons.** | ***% Diff.*** |
| 2014 | 13.9 | 15.6 | *-11.1* |
| 2015 | 15.7 | 16.8 | *-6.6* |

**Price Performance (RIC: GSFC.BO, BB: GSFC IN)**




*Source: Bloomberg*

***GSFC's Q4FY13 result disappointed on the margin front. Adjusted EBITDA margins stood at 9.9% (-930bps YoY/-50bps QoQ) primarily due to pressure in the chemicals segment. However, capro-benzene spreads have bottomed out and we expect subsequent quarters to witness gradual improvement in chemicals margins. Commencement of TIFERT is likely to boost manufactured fertiliser volumes and margins in FY14E. We have downgraded estimates by 7%/2% to Rs 13.9/15.7 in FY14E/15E due to lower fertiliser prices and volumes combined with slow recovery in capro-benzene spreads. However, we maintain 'Accumulate' (revised target price Rs 66) due to attractive valuations. Union Ministry's directive to recover subsidy on ammonium sulphate is likely to remain a major overhang on the stock (though management clarified that they have approached the Delhi High Court and are confident of the outcome in GSFC's favour).***

- **Q4FY13 results disappointed due to lower margins**: GSFC reported PAT of Rs584m, -75% YoY which included employee provisioning of Rs520m related to wage revision of employees at its polymer and fibre units. This employee provisioning included Rs400m of one-off items related to gratuity, pension liabilities and was non-recurring in nature. After adjusting for the one-offs of Rs400m, adjusted PAT stood at Rs984m, -47% YoY and significantly below est. of Rs1.4bn. Though revenues at Rs 17.0bn, 11% YoY were slightly lower than est. of Rs17.7bn, the primary disappointment was at the margins front. Adjusted EBITDA margins stood at 9.9% (est. of 13.3%) due to lower margins in the chemicals segment.

- **Adjusted chemicals margins stood at 11.5% (est. of 16.0%); fertiliser margins stood at 8.6% (est. of 10.0%)**: Adjusted chemicals margins stood at 11.5% (est. of 16.0%) due to pressure on caprolactam-benzene spreads. Spreads remained weak due to lower caprolactam prices (US$2400/mt), while benzene (US$1400/mt) remained at elevated levels. Fertiliser margins also witnessed pressure due to huge inventory in the system.

*Contd...2*

| **Key financials (Y/e March)** | **2012** | **2013** | **2014E** | **2015E** |
|---|---|---|---|---|
| Revenues (Rs m) | 53,018 | 61,967 | 58,031 | 61,509 |
| *Growth (%)* | *12.6* | *16.9* | *(6.4)* | *6.0* |
| EBITDA (Rs m) | 11,291 | 7,813 | 8,474 | 9,498 |
| PAT (Rs m) | 7,664 | 5,187 | 5,526 | 6,250 |
| EPS (Rs) | 19.2 | 13.0 | 13.9 | 15.7 |
| *Growth (%)* | *7.5* | *(32.3)* | *6.5* | *13.1* |
| Net DPS (Rs) | 1.5 | 2.0 | 2.0 | 2.0 |

| **Profitability & Valuation** | **2012** | **2013** | **2014E** | **2015E** |
|---|---|---|---|---|
| *EBITDA margin (%)* | *21.3* | *12.6* | *14.6* | *15.4* |
| *RoE (%)* | *24.2* | *13.9* | *13.2* | *13.4* |
| *RoCE (%)* | *21.1* | *11.3* | *10.4* | *11.4* |
| EV / sales (x) | 0.4 | 0.6 | 0.5 | 0.4 |
| EV / EBITDA (x) | 1.7 | 4.6 | 3.1 | 2.5 |
| PE (x) | 2.9 | 4.3 | 4.1 | 3.6 |
| P / BV (x) | 0.6 | 0.6 | 0.5 | 0.5 |
| *Net dividend yield (%)* | *2.7* | *3.5* | *3.5* | *3.5* |

*Source: Company Data; PL Research*

- **Maintain 'Accumulate', with target price of Rs66:** We expect subsequent quarters to witness gradual improvement in chemicals margins (stabilization in caprolactam prices coupled with softening in benzene prices, reduction in benzene consumption by 4% and strong downstream demand). Fertiliser demand is expected to pick-up with the onset of monsoons. GSFC continues to trade at attractive valuations of 4.1x FY14E earnings and 50% discount to book value. We maintain '**Accumulate**' with revised target price of Rs66.

**Exhibit 1: Q4FY13 Result Overview (Rs m)**

| Y/e March | Q4FY13 | Q4FY12 | YoY gr (%) | Q3FY13 | FY13 | FY12 | YoY gr (%) |
|---|---|---|---|---|---|---|---|
| **Net Sales** | **16,960** | **15,300** | ***10.9*** | **16,728** | **61,967** | **53,018** | ***16.9*** |
| **Expenditure** | | | | | | | |
| Raw Materials | 11,599 | 8,870 | *30.8* | 11,431 | 40,515 | 29,438 | *37.6* |
| *% of Net sales* | *68.4* | *58.0* | | *68.3* | *65.4* | *55.5* | |
| Personnel | 1,066 | 1,189 | *(10.3)* | 1,019 | 3,951 | 3,936 | *0.4* |
| *% of Net sales* | *6.3* | *7.8* | | *6.1* | *6.4* | *7.4* | |
| Other Expenditure | 2,623 | 2,301 | *14.0* | 2,537 | 9,688 | 8,355 | *16.0* |
| *% of Net sales* | *15.5* | *15.0* | | *15.2* | *15.6* | *15.8* | |
| Total Expenditure | 15,289 | 12,359 | *23.7* | 14,986 | 54,154 | 41,728 | *29.8* |
| **EBITDA** | **1,671** | **2,941** | ***(43.2)*** | **1,742** | **7,813** | **11,290** | ***(30.8)*** |
| *Margin (%)* | *9.9* | *19.2* | | *10.4* | *12.6* | *21.3* | |
| Depreciation | 340 | 343 | *(0.9)* | 348 | 1,321 | 1,292 | *2.2* |
| **EBIT** | **1,331** | **2,598** | ***(48.8)*** | **1,394** | **6,493** | **9,998** | ***(35.1)*** |
| Interest | 127 | 54 | *135.3* | 108 | 363 | 144 | *151.0* |
| Other Income | 180 | 409 | *(56.0)* | 194 | 1,381 | 1,366 | *1.1* |
| **PBT** | **1,384** | **2,953** | ***(53.1)*** | **1,479** | **7,511** | **11,219** | ***(33.1)*** |
| Tax | 400 | 1,090 | *(63.3)* | 681 | 2,496 | 3,558 | *(29.8)* |
| *Tax Rate (%)* | *28.9* | *36.9* | | *46.0* | *33.2* | *31.7* | |
| **Adjusted PAT** | **984** | **1,863** | ***(47.2)*** | **991** | **5,207** | **7,488** | ***(30.5)*** |
| Extraordinary Income | (400) | 441 | *(190.8)* | 379 | (21) | 88 | *(123.6)* |
| **Reported PAT** | **584** | **2,304** | ***(74.6)*** | **1,370** | **5,187** | **7,576** | ***(31.5)*** |
| **Adjusted EPS** | **2.5** | **4.7** | ***(47.2)*** | **2.5** | **13.1** | **18.8** | ***(30.5)*** |

*Source: Company Data, PL Research*

## Revision in estimates

We have revised our earnings estimates downwards by 7% to Rs 13.9 in FY14E. While revenues have been revised downwards by 4% due to lower fertiliser prices and volumes, EBITDA has been revised downwards by 8% YoY in FY14E due to near-term pressure on margins. FY15E earnings estimates have been revised downwards by 2% to Rs 15.7.

**Exhibit 2: Revision in estimates**

| | FY14E | | | FY15E | | |
|---|---|---|---|---|---|---|
| | Old Estimates | New Estimates | % Change | Old Estimates | New Estimates | % Change |
| Net sales (Rs m) | 60,192 | 58,031 | -3.6% | 63,892 | 61,509 | -3.7% |
| EBITDA (Rs m) | 9,163 | 8,474 | -7.5% | 9,969 | 9,498 | -4.7% |
| *Margin* | *15.2%* | *14.6%* | *(62) bps* | *15.6%* | *15.4%* | *(16) bps* |
| PAT (Rs m) | 5,938 | 5,526 | -6.9% | 6,384 | 6,250 | -2.1% |
| EPS (Rs) | 14.9 | 13.9 | -6.9% | 16.0 | 15.7 | -2.0% |

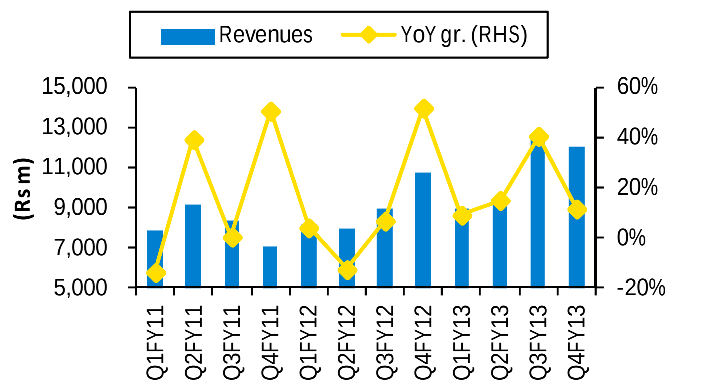
*Source: Company Data, PL Research*

# Segmental Performance

## Fertilisers

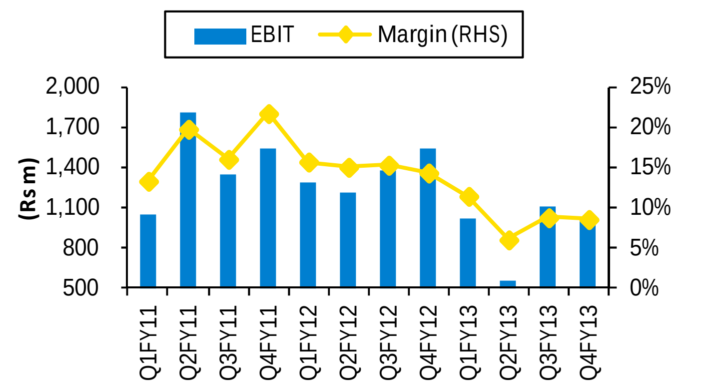
Fertiliser segment reported revenues of Rs12.0bn, 11.7% YoY (est. of Rs12.5bn). Fertiliser EBIT for the quarter stood at Rs1bn, -33% YoY lower than est. of Rs1.2bn due to lower margins. EBIT margins stood at 8.6% lower than est. of 10.0%. Margins have witnessed pressure over the last few quarters due to huge inventory in the system which has necessitated higher discounts and promotional offers to push sales. GSFC has undertaken Rs410m of provisioning in Q4FY13 related to higher marketing costs and rebates on fertilizers for FY13. Company has already undertaken portion of the farmgate price reduction on inventory in the current quarters' results. However, some more provisioning might be undertaken in the subsequent quarters.

**Exhibit 3: Fertiliser revenues & growth % YoY**




*Source: Company Data, PL Research*

**Exhibit 4: Fertiliser EBIT & Margins**

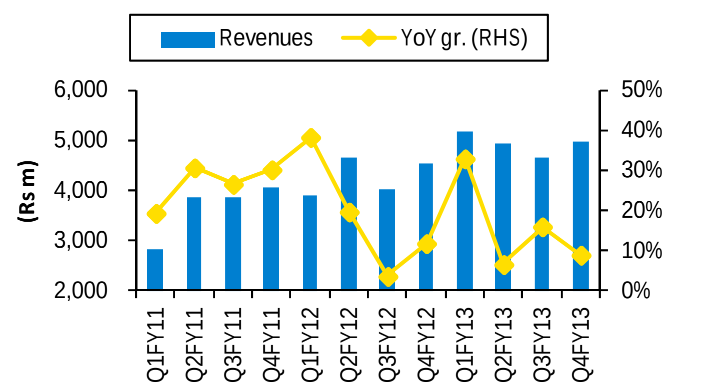



*Source: Company Data, PL Research*

## Chemicals

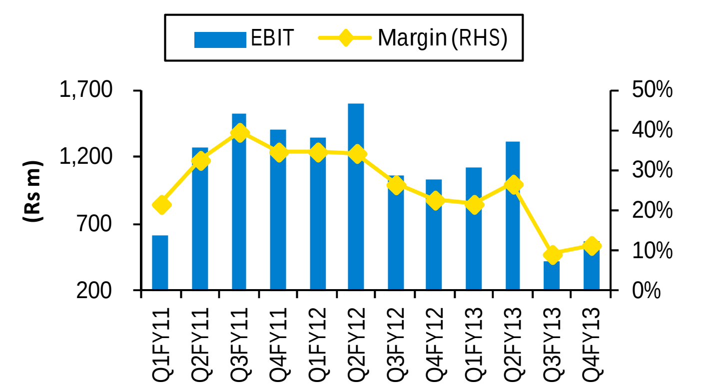
Chemicals segment reported revenues of Rs5.0bn, 9% YoY (est. of Rs5.2bn). Adjusted chemicals EBIT for the quarter stood at Rs571m, -45% YoY lower than est. of Rs843m due to lower margins. Adjusted EBIT margins stood at 11.5%, lower than est. of 16.0%. Chemicals margins continue to remain under pressure due to pressure on caprolactam-benzene spreads. However, we expect margins to improve slightly from the current levels due to improvement in spreads, reduction in benzene consumption by 4% and strong downstream demand. We have modelled for chemicals margins of 16.0% in FY14E.

**Exhibit 5: Chemicals revenues & growth % YoY**




*Source: Company Data, PL Research*

**Exhibit 6: Chemicals EBIT & Margins**




*Source: Company Data, PL Research*

## Key Takeaways of the Conference Call

- **FY13 performance impacted by multiple issues:** Management highlighted that FY13 was impacted by multiple issues: a) Severe drought in core areas of Gujarat, Rajasthan and Maharashtra b) Increase in raw materials costs by 11% YoY c) Higher rebates extended to push fertilizer sales d) Decline in caprolactam prices, while benzene prices remained elevated e) Low availability of phos acid (which led to DAP (at Sikka) capacity utilization of 45%) and f) Delay in subsidy receivables.

- **Q4FY13 performance impacted by wage provisioning, lower ammonia sales & rebates in fertilizers:** Q4FY13 performance was impacted by higher wage provisioning of Rs520m (one-off items of Rs400m related to gratuity & pension liabilities), lower ammonia sales of 8,000mt and higher rebates on fertilizers to push sales. ***Excluding the wage provisioning impact and lower ammonia sales, chemicals margins would have been 13%.***

- **TIFERT to start shipments soon; GSFC expects capacity utilization of 50% in FY14:** TIFERT's trial runs are being done and phos acid is now being produced. GSFC expects shipment to commence soon. However, capacity utilization in FY14 is likely to be at 50%.

- **Outlook - chemicals margins to improve from current levels, fertilizer demand expected to pick up:** Chemicals margins are likely to improve from current levels due to improvement in caprolactam-benzene spreads. Capro-benzene spreads have started witnessing improvement due to softening in benzene prices and stabilization of caprolactam prices. Global caprolactam prices have bottomed out (Europe gradually improving, America witnessing improved traction, no further downside expected in India). Reduction in benzene consumption by 4% would also help to improve margins. On the fertilizer side, demand is expected to pick up with the onset of monsoons. Subsidy and farmgate prices reduction on complex fertilizers are in line with the decline in global raw materials prices.

- **Capro-benzene spreads are at US$1000/mt:** Current capro-benzene spreads are US$1000/mt and have improved from the lows of US$763/mt witnessed in Q3FY13.

- **Delhi High Court has stayed the order on recovery of ammonium sulphate subsidy:** Management pointed out that they have approached the Delhi High Court on the ammonium sulphate subsidy issue and the court has put a stay on the order of the Union Ministry for withdrawal of the subsidy on ammonium sulphate. The matter is expected to be heard in September 2013 and management remains confident of the matter turning out to be favorable in GSFC's favor. Total amount under litigation is Rs6bn (of which Rs2bn has not yet been received by GSFC).

- **GSFC's ammonium sulphate is the lowest priced in the market place-** GSFC's ammonium sulphate is sold in the marketplace at Rs7,500/mt, while subsidy is Rs4,900/mt (total realization is Rs12,400/mt). GSFC's competitor sells ammonium sulphate at Rs11,000/mt in the marketplace. Hence, if the decision does not work out in GSFC's favor, GSFC can sell the product in the market at higher price or even export it.

- **GSFC to reduce prices on complex fertilizers:** GSFC is likely to reduce prices on DAP by Rs1,000/mt. The company was already selling at reduced prices in the marketplace since the last few months. Hence, it is likely to undertake limited price cuts.

- **GSFC undertook Rs410m of provisioning in fertilizers in Q4FY13 related to higher marketing costs, rebates:** GSFC has undertaken Rs410m of provisioning in Q4FY13 related to higher marketing costs and rebates on fertilizers for FY13. The company has already undertaken portion of the farmgate price reduction on inventory in the current quarters' results. However, some more provisioning might be undertaken in the subsequent quarters.

- **Subsidy outstanding at the end of Q4FY13 was Rs17bn:** Of the total debtors of Rs29bn, subsidy is outstanding to the tune of Rs17bn.

- **DAP capacity utilization at Sikka likely to be 70% in FY14:** GSFC indicated that capacity utilization in Sikka's DAP plant is likely to inch upto 70% in FY14 (in FY13, it stood at 45-50% due to low availability of phos acid).

## Income Statement (Rs m)

| Y/e March | 2012 | 2013 | 2014E | 2015E |
|---|---|---|---|---|
| **Net Revenue** | **53,018** | **61,967** | **58,031** | **61,509** |
| Raw Material Expenses | 29,514 | 40,515 | 38,056 | 38,645 |
| Gross Profit | 23,504 | 21,452 | 19,975 | 22,864 |
| Employee Cost | 3,936 | 3,951 | 4,346 | 4,780 |
| Other Expenses | 8,278 | 9,688 | 7,155 | 8,586 |
| **EBITDA** | **11,291** | **7,813** | **8,474** | **9,498** |
| Depr. & Amortization | 1,292 | 1,321 | 1,560 | 1,600 |
| Net Interest | (1,221) | (1,018) | (980) | (1,160) |
| Other Income | 1,366 | 1,381 | 1,300 | 1,400 |
| **Profit before Tax** | **11,220** | **7,511** | **7,894** | **9,058** |
| Total Tax | 3,731 | 2,304 | 2,368 | 2,808 |
| **Profit after Tax** | **7,488** | **5,207** | **5,526** | **6,250** |
| Ex-Od items / Min. Int. | — | (21) | — | — |
| **Adj. PAT** | **7,664** | **5,187** | **5,526** | **6,250** |
| **Avg. Shares O/S (m)** | **398.5** | **398.5** | **398.5** | **398.5** |
| **EPS (Rs.)** | **19.2** | **13.0** | **13.9** | **15.7** |

## Balance Sheet Abstract (Rs m)

| Y/e March | 2012 | 2013 | 2014E | 2015E |
|---|---|---|---|---|
| Shareholder's Funds | 35,168 | 39,416 | 44,016 | 49,340 |
| Total Debt | 6,170 | 15,051 | 11,551 | 8,051 |
| Other Liabilities | 2,474 | 2,392 | 2,392 | 2,392 |
| **Total Liabilities** | **43,811** | **56,859** | **57,959** | **59,783** |
| Net Fixed Assets | 18,114 | 20,842 | 24,282 | 27,682 |
| Goodwill | — | — | — | — |
| Investments | 4,327 | 6,724 | 6,724 | 6,724 |
| Net Current Assets | 21,370 | 29,292 | 26,952 | 25,376 |
| *Cash & Equivalents* | *8,976* | *1,631* | *7,655* | *7,088* |
| *Other Current Assets* | *24,247* | *39,978* | *31,006* | *30,283* |
| *Current Liabilities* | *11,853* | *12,318* | *11,710* | *11,995* |
| Other Assets | — | — | — | — |
| **Total Assets** | **43,811** | **56,859** | **57,959** | **59,783** |

## Cash Flow Abstract (Rs m)

| Y/e March | 2012 | 2013 | 2014E | 2015E |
|---|---|---|---|---|
| C/F from Operations | 5,405 | (8,405) | 15,771 | 9,099 |
| C/F from Investing | (3,958) | (6,532) | (5,000) | (5,000) |
| C/F from Financing | 1,402 | 7,592 | (4,746) | (4,666) |
| Inc. / Dec. in Cash | 2,849 | (7,344) | 6,024 | (568) |
| Opening Cash | 6,127 | 8,976 | 1,631 | 7,655 |
| Closing Cash | 8,976 | 1,631 | 7,655 | 7,088 |
| FCFF | 1,723 | (12,894) | 13,451 | 6,859 |
| FCFE | 3,970 | (4,013) | 9,951 | 3,359 |

## Quarterly Financials (Rs m)

| Y/e March | Q1FY13 | Q2FY13 | Q3FY13 | Q4FY13 |
|---|---|---|---|---|
| **Net Revenue** | **14,118** | **14,160** | **16,728** | **16,960** |
| **EBITDA** | **2,372** | **2,028** | **1,742** | **1,671** |
| *% of revenue* | *16.8* | *14.3* | *10.4* | *9.9* |
| Depr. & Amortization | 292 | 340 | 348 | 340 |
| Net Interest | (452) | (428) | (85) | (53) |
| Other Income | 548 | 460 | 194 | 180 |
| **Profit before Tax** | **2,532** | **2,115** | **1,479** | **1,384** |
| Total Tax | 805 | 611 | 488 | 400 |
| **Profit after Tax** | **1,727** | **1,505** | **1,370** | **584** |
| **Adj. PAT** | **1,727** | **1,505** | **991** | **984** |

## Key Financial Metrics

| Y/e March | 2012 | 2013 | 2014E | 2015E |
|---|---|---|---|---|
| **Growth** | | | | |
| Revenue (%) | 12.6 | 16.9 | (6.4) | 6.0 |
| EBITDA (%) | 0.3 | (30.8) | 8.5 | 12.1 |
| PAT (%) | 7.5 | (32.3) | 6.5 | 13.1 |
| EPS (%) | 7.5 | (32.3) | 6.5 | 13.1 |
| **Profitability** | | | | |
| EBITDA Margin (%) | 21.3 | 12.6 | 14.6 | 15.4 |
| PAT Margin (%) | 14.5 | 8.4 | 9.5 | 10.2 |
| RoCE (%) | 21.1 | 11.3 | 10.4 | 11.4 |
| RoE (%) | 24.2 | 13.9 | 13.2 | 13.4 |
| **Balance Sheet** | | | | |
| Net Debt : Equity | (0.1) | 0.3 | 0.1 | — |
| Net Wrkng Cap. (days) | 117 | 185 | 138 | 119 |
| **Valuation** | | | | |
| PER (x) | 2.9 | 4.3 | 4.1 | 3.6 |
| P / B (x) | 0.6 | 0.6 | 0.5 | 0.5 |
| EV / EBITDA (x) | 1.7 | 4.6 | 3.1 | 2.5 |
| EV / Sales (x) | 0.4 | 0.6 | 0.5 | 0.4 |
| **Earnings Quality** | | | | |
| Eff. Tax Rate | 33.3 | 30.7 | 30.0 | 31.0 |
| Other Inc / PBT | 12.2 | 18.4 | 16.5 | 15.5 |
| Eff. Depr. Rate (%) | 3.4 | 3.1 | 3.5 | 3.4 |
| FCFE / PAT | 51.8 | (77.4) | 180.1 | 53.7 |

*Source: Company Data, PL Research.*

## Key Operating Metrics

| Y/e March | 2012 | 2013 | 2014E | 2015E |
|---|---|---|---|---|
| **Revenues- (Rs m)** | | | | |
| Fertiliser | 35,919 | 42,791 | 35,316 | 36,977 |
| Chemicals | 17,099 | 19,752 | 22,715 | 24,532 |
| **EBIT Margin (%)** | | | | |
| Fertiliser | 15.1 | 8.7 | 10.4 | 10.5 |
| Chemicals | 29.5 | 17.5 | 16.0 | 18.0 |

*Source: Company Data, PL Research.*

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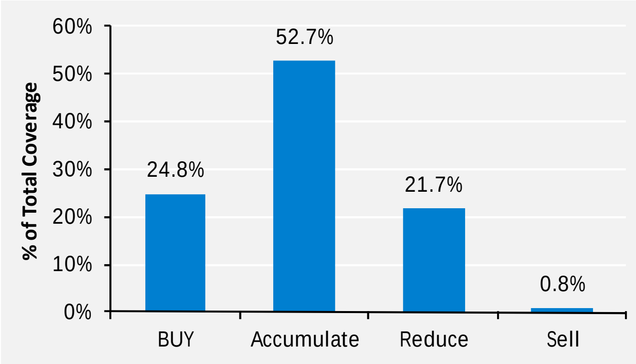
**Rating Distribution of Research Coverage**




**PL's Recommendation Nomenclature**

| | | | | | |
|---|---|---|---|---|---|
| **BUY** | : | Over 15% Outperformance to Sensex over 12-months | **Accumulate** | : | Outperformance to Sensex over 12-months |
| **Reduce** | : | Underperformance to Sensex over 12-months | **Sell** | : | Over 15% underperformance to Sensex over 12-months |
| **Trading Buy** | : | Over 10% absolute upside in 1-month | **Trading Sell** | : | Over 10% absolute decline in 1-month |
| **Not Rated (NR)** | : | No specific call on the stock | **Under Review (UR)** | : | Rating likely to change shortly |