

INITIATING COVERAGE

VO IN EQUITY

January 05, 2017

A 'vin vin' situation

Vinati is amongst the best Indian specialty chemicals companies and is rapidly gaining scale by building large capacities for new products over FY17-20 alongside generating ~25% RoCE. It targets both import substitution and global clients looking for greener/purer but cheaper processes/products. A technocrat promoter, backed by marketing-savvy gen-next and stable team, has driven flawless execution. One of its most unappreciated strengths is the promoter's R&D approach through tie-ups with leading national institutes and perseverance therein; this has not only expanded the target market but also made Vinati unbeatable on costs/processes and, hence, the leader in most launches. Near-term multiples are futile as business/opportunity/cash-generation scales change in FY21E. Target P/E of 19x FY19E EPS (peers at 16-18x) won't be the limit for this fast evolving (products to knowledge) chemical company.

Competitive position: **STRONG**

Changes to this position: **POSITIVE**

An unbeatable business model...

Vinati's strategy has been to identify niche products and develop new processes patiently until it gets a substantially greener, cheaper and high-purity product than existing ones. This, combined with backward/forward integration, has imparted scale-driven moats, making it market leader in all its core products - ATBS (45% global share), IBB (65% global share) and IB (70% India share). Vinati's unique R&D model also helps in approaching products across multiple application areas whilst keeping the costs also low for a growing company.

...and patient, experienced promoters have driven growth

Technocrat promoter Vinod Saraf founded Vinati in 1989 after a successful stint with Birla (last role, Jt MD, MRPL). He forged technical partnerships and displaced MNCs like Chevron/Lubrizol with key clients to gain leadership in core products. This drove sales/PAT CAGR of 27%/51% with ~25% RoCE in the last decade.

Aggressive launch pipeline to drive the next leg of growth

Growth acceleration is certain as new products PTBT/PTBBA and custom synthesis opportunities come on-stream contributing ₹1.5bn revenues by FY18 (vs overall revenues of ₹6.3bn; FY16). Core products such ATBS and IBB will grow at 15% and 4% sales CAGR. Growth beyond FY18 would be driven by PAP and butylated phenols (₹6bn/₹3bn revenues) reaching peak potential by FY22. Growing cash flow stream and client base will further accelerate new product launches.

Valuations – 20x in 2020; still not much

Vinati is still in its infancy despite leadership in its products. Results of promoter's focus on product and organisation development will only become credibly visible post new launches and scale expansion. Skillset development implies Vinati will have an equal or larger chance of becoming a much larger chemicals player in the next decade, providing clients a partner with unbeatable propositions. Given visible growth and capital efficiency, Vinati is better bet than SRF/PI.

Key financials

Year to March (₹ mn)	FY14	FY15	FY16	FY17E	FY18E	FY19E
Net Sales	6,961	7,717	6,309	6,920	8,370	10,553
Operating Profit	1,621	2,009	2,129	2,267	2,872	3,753
Net Profits	862	1,158	1,315	1,381	1,712	2,154
Diluted EPS (₹)	17.5	22.4	25.5	26.8	33.2	41.7
RoE	31.3%	31.1%	27.0%	22.6%	22.4%	22.5%
P/E (x)	34.0	26.4	23.3	22.2	17.9	14.2
P/BV (x)	9.4	7.0	5.7	4.5	3.6	2.9

Source: Company, Ambit Capital research

Specialty Chemicals

Recommendation

Mcap (bn):	₹309/US\$0.5
6M ADV (mn):	₹32/US\$0.5
CMP:	₹594
TP (12 mths):	₹800
Upside (%):	35

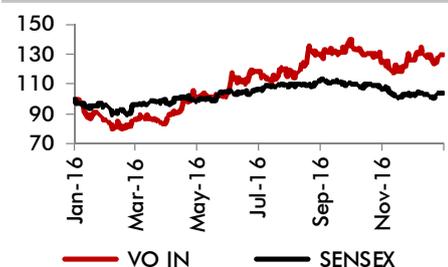
Flags

Accounting:	GREEN
Predictability:	AMBER
Earnings Momentum:	GREEN

Catalysts

- Commissioning of PAP and butylated phenol projects in FY19E, which will drive sharp earnings growth over FY19-21E
- Positive contribution to margins from IBAP project from FY19E
- 15% volume growth in FY18/FY19 from ATBS

Performance (%)



Source: Bloomberg, Ambit Capital Research

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Snapshot of Company Financials

Profit and Loss

Year to Mar (₹ mn)	FY17E	FY18E	FY19E
Net revenues	6,920	8,370	10,553
EBITDA	2,199	2,794	3,664
Depreciation	274	304	554
Interest expense	20	122	122
Adjusted PBT	1,973	2,446	3,077
Tax	592	734	923
Adjusted net profit	1,381	1,712	2,154
Reported net profit	1,381	1,712	2,154
Profit and Loss Ratios			
EBITDA Margin (%)	32%	33%	35%
Net profit margin (%)	20%	20%	20%
EV/ EBITDA (x)	13.9	11.8	9.2
P/E (x)	22.2	17.9	14.2
EV/Sales (x)	4.4	3.9	3.2

Company Background

Vinati Organics is a mid-sized Indian specialty chemicals player with global market leadership in two products – ATBS (used in water treatment chemicals/ shale oil recovery) and IBB (intermediate for ibuprofen). The company was founded by Mr. Vinod Saraf (former joint MD of MRPL) in 1989. Vinati has plants in Lote and Mahad and headquarters in Mumbai (all in Maharashtra). Global leadership in these products was achieved through development of greener and cost efficient process through 4-8 years of effort on developing a credible alternative to existing manufacturing process. Vinati is embarking on a big capex cycle (₹9bn over FY17-FY20) for PAP (intermediate for paracetamol) and new IB derivatives (butylated phenols), both substituting expensive and more polluting imports. The company had revenues of ₹6bn and profits of ₹1.3bn in FY16. It has a debt-free balance sheet and generates RoCE of ~25%.

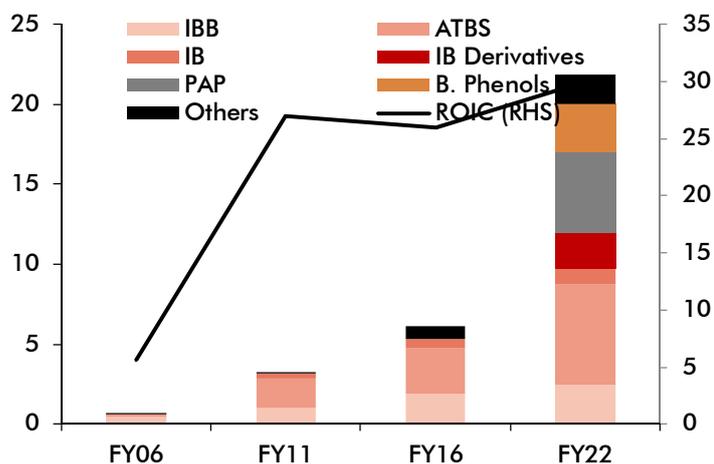
Balance sheet

Year to Mar (₹ mn)	FY17E	FY18E	FY19E
Total Assets	7,280	11,993	15,147
Fixed Assets	5,545	9,241	11,687
Current Assets	2,300	3,368	4,154
Investments	27	27	27
Total Liabilities	7,281	11,993	15,147
Total networth	6,789	8,501	10,655
Total debt	-	3,000	4,000
Current liabilities	860	912	989
Deferred tax liability	492	492	492
Balance Sheet ratios			
RoCE	21%	19%	17%
RoE	23%	22%	22%
Gross Debt/Equity (x)	0.0	-	0.4
Net debt (cash)/ Eq (x)	(0.1)	(0.0)	0.3
P/B (x)	4.5	3.6	2.9

Cash flow

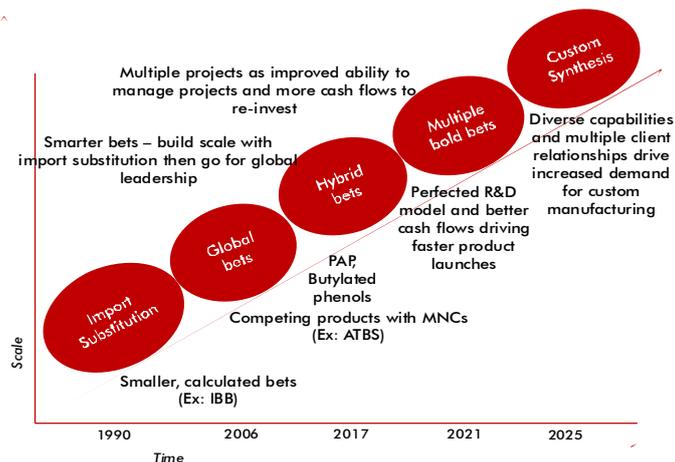
Year to March (₹ mn)	FY17E	FY18E	FY19E
PBT	1,973	2,446	3,077
Depreciation	274	304	554
Tax	(592)	(734)	(923)
Net Working Capital	(199)	(335)	(506)
CFO	1,408	1,726	2,235
Capital Expenditure	(2,000)	(4,000)	(3,000)
Investment	-	-	-
CFI	(1,932)	(3,922)	(2,910)
Issuance of Equity	-	-	-
Inc/Dec in Borrowings	(133)	3,000	1,000
Net Dividends	-	-	-
Interest paid	(20)	(122)	(122)
CFF	(153)	2,878	878
Net change in cash	(677)	681	202
Closing cash balance	45	727	929

Revenue diversification and ROIC have strengthened



Source: Company, Ambit Capital research. LHS -Revenues in ₹ bn. RHS is in %.

...driven by natural evolution in business model



Source: Company, Ambit Capital research

Company background

Vinati Organics is a specialty chemicals manufacturer established in 1989 by Vinod Saraf. Vinati is known globally for Iso Butyl Benzene (IBB) and 2-Acrylamido 2-methylpropanesulfonic Acid (ATBS). Using the best technologies and process, Vinati has become the world's largest manufacturer with a share of 65% in IBB and 45% in ATBS. IBB is primarily used in pharmaceuticals as a raw material for the manufacture of ibuprofen and ATBS is a specialty monomer used as co-monomer in numerous polymerization processes. IBB and ATBS (and their variants) together contribute 77% of Vinati's revenues. IB now contributes 12% of revenues.

Vinati had sourced from Institut Francais du Petrole (IFP), France, technology for making IBB and National Chemical Laboratories (NCL), Pune for ATBS. Vinati has started de-risking its product portfolio by adding products like IB derivatives (PTBT/PTBBA) which are used in agrochemicals/fragrances, HPMTBE (used as solvent). The company is based out of Mumbai and has over 600 employees. The promoters hold ~74% stake in the company.

Exhibit 1: Plant profiles

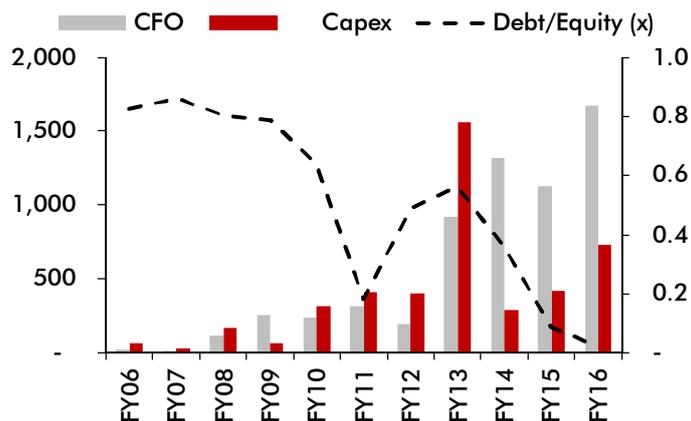
	Plant 1	Plant 2
Location	Mahad–Raigad, Maharashtra	Lote-Ratnagiri, Maharashtra
Established	1992	2002
Gross Block		
Certifications	ISO 9001:2008; ISO 14001:2004 and OHSAS 18001:2007	ISO 9001:2008; ISO 14001:2004 and OHSAS 18001:2007
Products manufactured	IBB, NBB	ATBS, NaATBS, TBA, IB, HPMTBE, DAAM, Butyl Phenol Project
Technical knowhow	Institut Francais du Petrole (IFP) France	National Chemical Laboratories (NCL), Pune (for ATBS)

Source: Company, Ambit Capital research

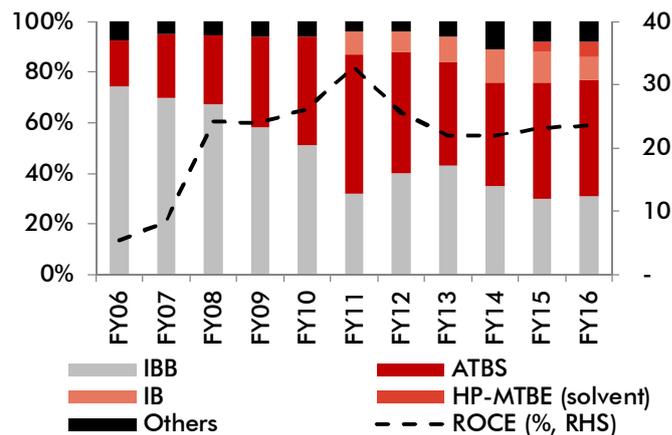
Exhibit 2: ATBS and IB are Vinati's key growth products

Product	Salience	Applications	Mfg Location	Clients	Market Share	Exports	R&D Partner	Capacity	Commence	Characteristics
ATBS	46%	Water treatment chemicals Emulsions for paint and paper coatings Oil field and mining chemicals Construction chemicals	Mahad	Clariant, BASF, Dow, Nalco	45% global share	95%	National Chemical Laboratories (NCL), Pune	26,000	2002	0.5% variation vs. 3% tolerance levels
IBB	31%	Core intermediate for Ibuprofen Perfume industry	Lote	Shasun, BASF	65% global share	74%	Institut Francais du Petrole (IFP) in France	16,000	1992	99.8% purity
IB	9%	Antioxidants Fragrances and perfumes Insecticides and pesticides, Personal care, Monomers	Mahad		70% domestic share	0%	Saipem, Italy	12,000	2010	Gaseous
HP-MTBE	6%	Specialty solvent for organic synthesis and pharmaceuticals synthesis	Lote		India leader	21%	Own			Colourless liquid; 99.9% purity level
Others	8%		Lote, Mahad			16%				

Source: Company, Ambit Capital

Exhibit 3: Cash flow trends (₹ mn) and leverage ratio (X)


Source: Company, Ambit Capital research

Exhibit 4: Revenue break-up and RoCE trends


Source: Company, Ambit Capital research

Promoters and key management

Mr. Vinod Saraf founded the company in 1989 after spending most of his working career with Birla Group. Mr. Saraf had a long experience in dealing with organic chemicals during his long stint with Birla Group (last role was Joint MD of MRPL, then a Birla JV with HPCL) and as VP of Grasim's chemicals division. He also had established textile and sponge iron plant for Birla along with MRPL, giving him good experience in operational execution. Over the years, Mr. Saraf proved himself as a sound technocrat as well as a businessman and took some right bets on products. He always played on his chemical process prowess rather than getting into asset-heavy tolling businesses. Some of the successes were purely due to right product selection (e.g. IBB) or choosing the right partners (e.g. IFP, NCL and IICT); some can be attributed to perseverance like in the cases of ATBS and PAP, where he took more than a decade to get the product right. Some of these long-gestation products were supported by strategic product launches that helped keep growth steady.

Induction of well-educated daughters into the management team balances the technical/manufacturing execution strengths of Mr. Saraf with marketing capabilities/new age aggression of the newer generation. Eldest daughter Ms. Vinati Saraf has spent a decade in the company and handles the key responsibilities of marketing and finance and is the public face of the company. Meanwhile, Mr. Vinod Saraf spends most of his time finding the next generation of products/processes.

Most of his executive team has stayed with him through these years. The company's empowered culture has helped it retain employees despite compensations being in line with the industry at best. Vinati has separate, well-experienced hands taking care of various critical functions, manufacturing facilities, and overall execution.

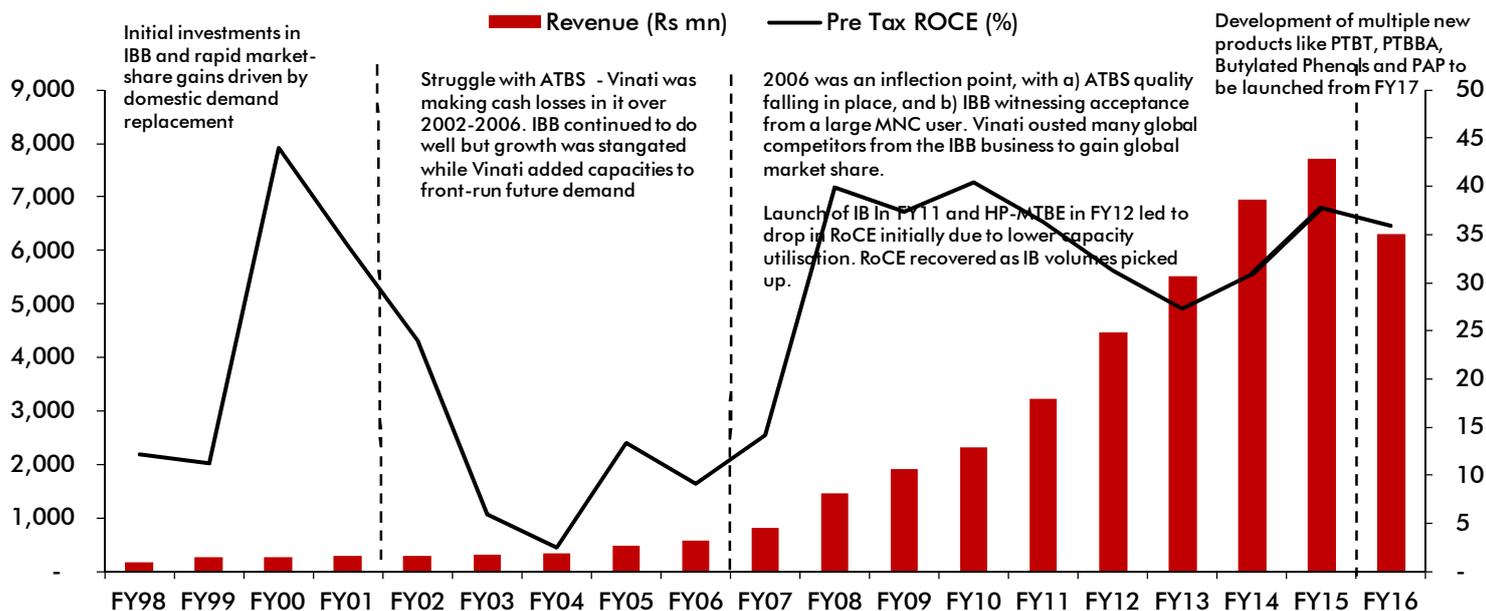
Exhibit 5: Management profiles

Name	Description	Experience with Vinati	Designation
Promoters			
Mr. Vinod Saraf	Mr. Vinod Saraf is the founder of Vinati Organics Ltd. He is a management graduate from BITS, Pilani with 19 years of previous industrial experience with Bhilwara Group, Modern Syntex (I) Ltd and Grasim Industries Ltd. As Vice President of a chemical division of Grasim industries, he was responsible for the identification of chemical/petrochemical projects, technical tie-ups and feasibility studies among others. During this period, he was involved in the implementation of the gas-based sponge iron project of Grasim. Subsequently, he was nominated as "Managing Director (Finance and Administration)" on the Board of Directors of Mangalore Refinery & Petrochemical Ltd.	Since Inception	Managing Director
Ms. Vinati Saraf Mutreja	Ms. Vinati Saraf Mutreja joined Vinati Organics Ltd in 2006. She worked as a consultant for Mercer Oliver Wyman, a New York-based consulting firm. She received Bachelors in Economics and in Applied Science, Biotech and Pharmaceutical Development from University of Pennsylvania.	10+ Years	Executive Director
Viral Saraf Mittal	She has earlier worked with Citi Bank and Ernst and Young. She became a part of Vinati in 2009. She holds a Bachelors of Science degree in Economics (Finance and Management) from The Wharton School, University of Pennsylvania.	8 Years	Director, Strategy
Professionals			
Mr. Nand Kishore Goyal	He is a Chartered Accountant degree with 24 years of experience in Finance & Accountancy including seven years of previous experience with M/s. Modern Treads (India) Ltd and GSL (India) Ltd.	15+ Years	Chief Financial Officer (CFO)
Mr. Jayesh Ashar	He is a chemical engineer with post-graduation in management. He has more than 23 years of experience in chemicals and plastics industry. He has been associated with the company in all projects from initial stages and contributed to their successful commercialisation.	15+ Years	Chief Operating Officer (COO)
Mr. Mahendra Churiwala	He is a B.Com graduate from Calcutta University in 1973 with 30 years of experience in marketing.	15+ Years	Sr. Vice President (Marketing)
Mr. B. S. Lathi	He is having a degree in Master of Management Studies from BITS, Pilani with 30 years of industrial experience, including 14 years of experience in the manufacturing sector.	15+ Years	Executive President - Mahad Plant
Mr. Amit Thanawala	He is a graduate in Polymer Engineering from Pune University and Masters in Marketing Management from Mumbai University with 18 years of experience in selling and marketing of chemical and polymers.	15 Years	Vice President - Marketing

Source: Company, Ambit Capital

Evolution: Slow and steady but impactful

Exhibit 6: Vinati – evolution of revenues and RoCE



Source: Company

1989-98: Initial IBB set up

For his entrepreneurial journey, Mr. Vinod Saraf first identified IBB (an ibuprofen Intermediate) which was being imported into the country at that point in time. He was able to persuade the Institut Francais du Petrol (IFP) in Paris to give Vinati the manufacturing technology for IBB. In something novel for a startup, he also signed up Technip to put up a plant for him to cover his technological risks. This helped Vinati to begin with a world class plant right at the onset. The first IBB plant of 1,000 MT was commissioned in 1992.

The promoter took a large risk in hindsight with most of the project (₹145mn) being funded through a mix of debt, sale of equity stake to primary shareholders through an IPO and other funding agencies like MPCL.

One key differentiation in the process was that Vinati used a self-manufactured catalyst (technology provided by IFP). Mr. Saraf attributes the product's success to the process given to them by IFP, which made execution much easier. The company enjoyed good profitability, led by large import substitution demand from domestic ibuprofen manufacturers. Boots India, Hyderabad Chemicals and Shasun were some of the key ibuprofen manufacturers in India which started buying IBB from Vinati.

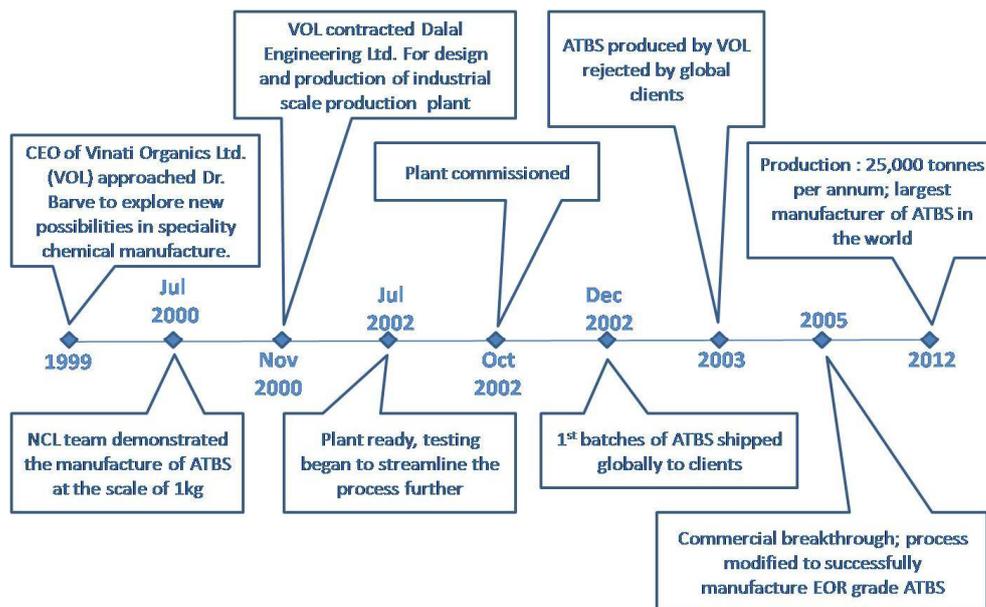
So, we had the technological risk well-covered. The demand was already there as India was importing IBB at about \$6 (landed cost) when it cost about \$3 otherwise. So if we could manufacture the same in India, we realised that we could sell it for almost 30-40% less price and still make money. So, market demand was not a risk,"

Mr. Vinod Saraf in an Interview to Business Outlook – May'2014

1999-05: Unsuccessful journey of ATBS; IBB posts moderate growth

Vinati started its journey with ATBS in 1999 with Mr. Vinod Saraf asking NCL, a leading chemical research institute in India, to take up process R&D for developing the product. NCL responded quickly with a lab stage process in as early as 2000. Vinati set up a small commercial plant (1200MT) for ATBS manufacturing in 2002 later on facing rejections from the clients as the product didn't meet the required specification of clients. Given the product is a performance chemical (used as additive in some other large volume chemicals to import specific properties), even small slip-ups in the product made it unusable for the client. Consequently, the company made cash losses on ATBS from 2002-2006.

Exhibit 7: ATBS – the journey from failure to success



<http://casehistory.nclinnovations.org/>

Source: NCL Pune

The inflection point in 2006

The company persisted and finally got a breakthrough in 2006 with acceptable improvements in the quality of the product (ATBS). Since then, the company emerged as a global leader in ATBS by 2012 with manufacturing capacity reaching 26000 MT by the year-end. The low-cost proposition and greener process helped Vinati scale up the product.

There was another inflection point in Vinati’s journey in 2006. It won its biggest client for IBB after many years of perusal. The buyer now contributes over 40% of Vinati’s current IBB volumes. Chevron and Shell were two large sellers of the product at that time and gradually ceded share to Vinati Organics in IBB. After a journey of two decades, Vinati has become the lowest-cost producer of IBB in the world (as of 2016). In another key event in 2006, Vinati Saraf, the elder daughter of Mr. Vinod Saraf, also joined the business and was instrumental in these two big events.

2007-2015: Backward integration and diversification

When it saw that the ATBS segment will grow significantly, Vinati began to backward-integrate itself by manufacturing IB and brought on-stream a plant of 12,000 MT (commissioned in 2010). Vinati began to save 10-15% in raw material cost by manufacturing IB. The company sourced a ready-to-use technology from Saipem, Italy. Of the total IB capacity, around 50% was planned for captive consumption and the rest for domestic sales. By FY13, the market for IB in India (which was earlier imported minimally) was a third of the installed capacity, of which Vinati had a 70% share. Vinati’s local manufacturing actually created a new market for IB through new applications which were never envisaged when it was imported at 15% additional charges. Increased domestic availability also boosted demand for IB. Vinati also increased the scale of MTBE sourcing (key raw material for IB), by launching a forward-integration product HP-MTBE, which further improved the cost-effectiveness of IB and ATBS. In IBB and ATBS, Vinati continued to gain market share by expanding capacity.

While Vinati succeed in gaining global market leadership in both ATBS and IBB and boosted margins by entering products such as IB and HP-MTBE, it didn’t launch any major product from 2005-2015. However, it did a lot of work on PAP, which it was not able to commercialise due to issues with the cost of the product while trying to develop a more environment friendly process. NCL (the R&D partner for Vinati) was able to develop a unique process by 2009; however, the process didn’t give the desired quality/cost for long. Vinati continued to focus on process improvement. It also

“That year was a real turnaround for us. In that sense, the growth we have shown has really taken place over the past eight years,” “They came to our plant before inking the deal and they liked what they saw.” It now buys over 6,000 tonne of IBB (nearly 40% Vinati’s IBB sales).

Mr. Vinod Saraf in an Interview to Business Outlook – May’2014

“We have very good operational efficiencies, which comes with the experience of two decades”

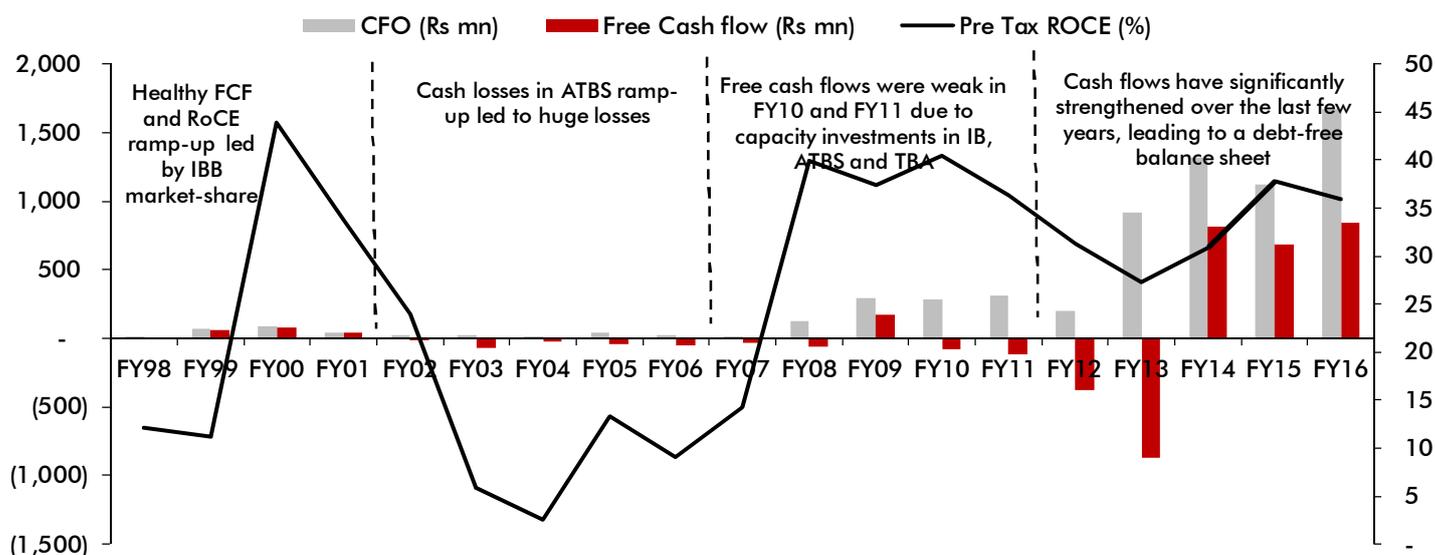
Mr. Vinod Saraf in an Interview to Business Outlook – May’2014

worked on many IB derivatives in tie-up with IICT which will get launched subsequently.

2015 onwards – diversification into PAP, IBAP, and Butyl Phenols

Vinati has been able to develop the desired quality levels for PAP which is more cost effective as imports as of now after almost 15 years of efforts. The company has finally announced a 30000 TPA scale facility for PAP (ingredient in paracetamol), of which 22000 TPA caters to domestic demand. The company has also accelerated its journey into IB derivatives with two large waves of product launches, with PTBT, PTBBA and TB Amine getting commercialised in FY17 and butylated phenols getting commercialised in FY19. On the IBB front, too, Vinati is looking to launch forward-integration products such as IBAP which will boost margins. Vinati has also made a beginning in customised products with its first product order in custom synthesis in FY16 and commercialising it in FY17.

Exhibit 8: Cash flows have significantly strengthened over the past 4 years



Source: Ambit Capital

Exhibit 9: SWOT analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> ▪ Institutionalised process of product development leads to higher success levels of new product launches ▪ Low cost R&D tie-ups/technology sourcing with global research laboratories such as NCL Pune, IICT Hyderabad, Saipem, Italy, IFP France, etc. ▪ Strong track record in product marketing leading to rapid market share gains in ATBS, IBB, IB ▪ Focused on green product development which creates a strong differentiation when catering to global MNCs ▪ Relationships with global pharma and chemical majors such as BASF, Clariant ▪ Healthy capital allocation track record with ROCEs of ~24% 	<ul style="list-style-type: none"> ▪ Long gestation in launching new products due to core process R&D being done in tie-ups with research laboratories ▪ Nearly 90% of the raw material is linked to crude prices which created volatility on sales value front ▪ Relatively longer working capital cycle of 80 days as raw material is sourced from large local suppliers such as Reliance or PSU OMCs leading to payable days of 12-13 days while finished product is supplied to large MNCs where receivable tend to be ~60-70 days.
Opportunities	Threats
<ul style="list-style-type: none"> ▪ Potential customised product development opportunities given wide presence across key chemical segments such as pharma, oil-field recovery, water treatment, acrylic fibres, adhesives, personal care products, mining and coatings etc. ▪ Expansion projects in IB derivatives and PAP will drive substantial diversification of product portfolio ▪ Recovery in ATBS volumes with potential uptick in crude prices ▪ Margin expansion opportunity in IBB by launching advanced intermediate IBAP for Ibuprofen manufacturing 	<ul style="list-style-type: none"> ▪ USFDA ban on Ibuprofen ▪ Risk of competition due to development of product substitute for IBB or ATBS ▪ Execution delays in PAP and Butylated Phenols ▪ Stricter environmental regulations/ imposition of blanket environment taxes in India ▪ Import duties or unfavourable taxation for imported goods in US and Europe

Source: Company, Ambit Capital research

Focus on process drives high success rate

Vinati's product philosophy has three major pillars: (i) developing a greener, cost-efficient manufacturing process for an existing product, (ii) backward and forward integrating that product to further build scale benefits on raw materials and capture a higher share of the value chain, and (iii) developing commercially useful products from waste generated in chemical reactions conducted for (i) and (ii) to boost margins and reduce waste footprint. Over a period of time while (i) drives higher product revenues, (ii) and (iii) strengthen the moats around the core products and improve EBITDA margins. This interplay of (i), (ii) and (iii) forms the core competitive advantage of Vinati and continues to drive scale and client relationship and strengthens process-related moats. Competitors would find it difficult to replicate all these attributes in a short period of time.

Unique strategy for product development

Unlike many of its specialty chemicals peers that focus on applications, products and clients, Vinati focuses on inventing better chemical processes which are greener, have higher purity levels and are cost-efficient. The downsides of this business model are slower product launches and a concentrated product portfolio. Vinati has overcome those issues by being focused on developing materially better products such as ATBS, IBB and IB, which dominate market shares.

Exhibit 10: Vinati focuses on standalone products not specific chemistries to derive process advantages, thereby driving better purity, greener products and lower costs

	Chemistry specialisation	Industry specialisation
SRF	Fluorine	Agrochemicals, Pharmaceuticals
Navin Fluorine	Fluorine	Agrochemicals, Pharmaceuticals
PI Industries	Multiple	Agrochemicals
Aarti Industries	Benzene/Toluene Nitration, Hydrogenation	Agrochemicals, Pharmaceuticals, Others
Atul	Multiple	Multiple
Vinati	Multiple	Multiple

Source: Company, Ambit Capital research

Environmentally a responsible company

Vinati is one of the greenest chemicals companies in the country. Management has consistently articulated that the environmental impact of the new products, raw material, manufacturing process and applications is a major factor in product selection. The annual report clearly mentions this:

Mr. Vinod Saraf, Founder – Vinati Organics

"At Vinati, our business is driven by 4 important philosophies:

- Enter into niche products with technological entry barriers.
- The technology should be clean and green.
- Be globally competitive for all our products in quality and cost.
- Benefit all stakeholders, foremost being the environment.

Purity levels of Vinati's products are among the best globally

- 99.8% - The purity levels of IBB are among the highest in the world
- 99.97% - The purity levels of HP-MTBE are among the highest in the world
- 0.5%- The variation level in purity standards of ATBS compared to 3% of global tolerance levels

Source: Company

Being green is a financial choice. Greener the process is less is the cost of treating effluent. Building an efficient process creates lesser wastes which is not only green but also saves significant raw material costs

Mr Vinod Saraf

Investment by IFC indicates best environment safeguard practices

IFC invested \$16mn (\$11mn ECB and \$5mn by FCCB) in Vinati in 2011 by subscribing to FCCBs. We note that IFC only invests after a thorough due diligence of the company's processes and policies w.r.t. the environment. The IFC's investment objective clearly states that Vinati's processes and policies are aimed at minimising effluent discharge and looks forward to set an example for Indian mid-sized chemicals companies.

"The Project is expected to have the following development impact:

- *Supporting a global-scale and competitive manufacturing operation which is environment friendly as it is committed to minimizing effluent discharge;*
- *Demonstration effect of good Environmental and Social practices among the mid-sized Indian pharmaceutical and specialty chemicals producers, where such practices are limited and*

GOLD rating by EcoVadis for CSR

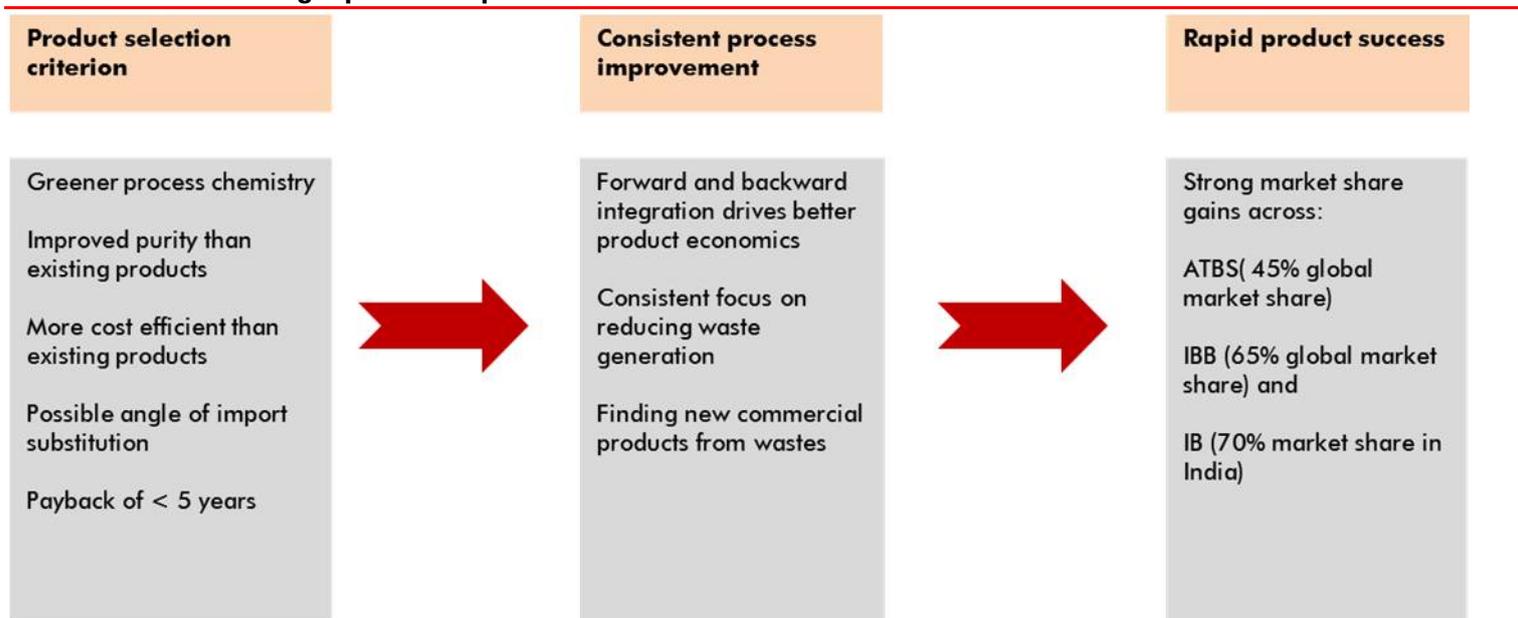
We note that Vinati is rated Gold by the reputed CSR rating firm EcoVadis. EcoVadis is a collaborative platform that enables companies to monitor the sustainability performance of suppliers across 150 sectors and 110 countries.

Companies with an overall score approximately in the top 5% are recognised as the gold level. The assessment is done on the parameters of environment-friendliness, social responsibility, ethics and supply chain. These scores are being used by a wide range of MNCs to screen their suppliers. The list can be viewed here <http://www.ecovadis.com/customer-stories/>. Most Indian players either don't subscribe to these ratings or don't have a place in these ratings.

Striving to minimise effluents

Vinati has continuously strived to minimise emissions from its manufacturing. Both of Vinati's plants have zero waste production. Management's focus has been to develop processes in such a way that it doesn't need any excess raw material reducing the core source of any waste generation. The company has demonstrated its commitment towards the environment by innovating new ways to utilise the residuals created by the plants. For example, the co-products created by production of ATBS were used to manufacture TBA. Furthermore, TBA residuals were used in the manufacture of industrial polymers.

Exhibit 11: Vinati's thought process on product evolution



Source: Ambit Capital research

Utilisation of waste products and integration into related products drive margins and asset turns

We note that apart from core products like ATBS and IBB, Vinati has created many other products to improve scale and sourcing efficiency. Vinati is now forward-integrating IBB into IBAP, a molecule that is between IB and ibuprofen in the value chain. The key salient features of Vinati’s product strategy are: (a) controlling waste products generated during the core product synthesis and converting them into commercially useful products; b) continuously backward and forward integrating into new related products to reduce costs; and c) developing new products with the same RM to improve scale for raw material sourcing. A well-designed and integrated product portfolio, combined with rapid market share and gain of scale, aids overall profitability of the business.

Exhibit 12: Vinati’s product integration

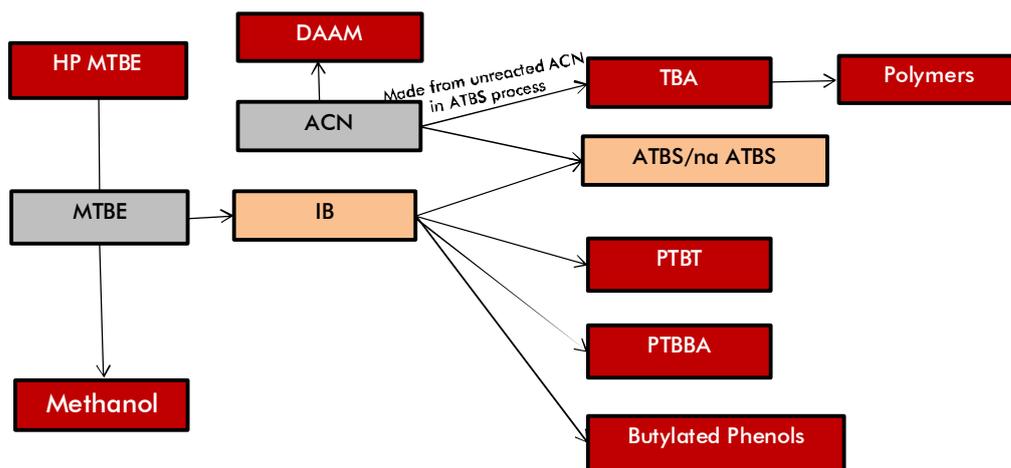
Raw Material	CAN	MTBE	Toulene, Propylene
Core Product	ATBS*	IB	IBB
Forward Integration		ATBS, PTBT, PTBBA, Butylated Phenols	IBAP
Product generated from usage of Waste Raw Material	TBA, TBA is also forward integrated to multiple polymers	Methanol	Hexenes, C10 Aromatics
New Products from to aiding to RM procurement scale	DAAM	HP MTBE	

Source: Company, Ambit Capital research. ATBS is manufactured from ACN and IB.

ATBS value chain is a very good example of “waste to wealth” philosophy

When Vinati started manufacturing ATBS, it used to manufacture it from Acrylo Nitrile (ACN) and Isobutylene (see chart below). It later backward integrated into IB, which it manufactures from MTBE, saving on the logistics costs of IB imports. It also developed another process for synthesising high-purity MTBE, driving integration benefits. Methanol synthesised as a byproduct is also sold commercially. It also used to have some waste untreated ACN from the ATBS process. It developed TBA from the unreacted ACN and converted it to polymers. Similarly, another product called DAAM was developed from ACN. Vinati has also been forward integrating into IB derivatives, which should support growth.

Exhibit 13: MTBE-Acrylonitrile value chain – multiple products aiding to cost synergies



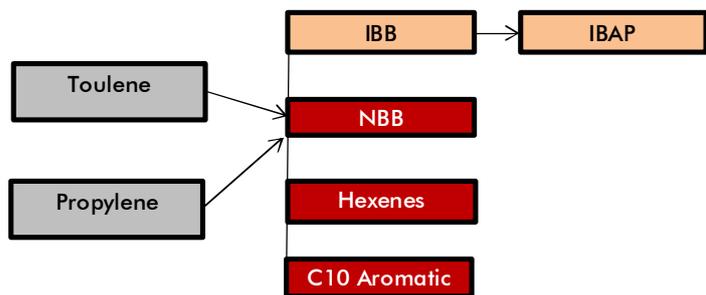
Source: Company, Ambit Capital research

Environmentally responsible process development drives sustainability

Being clean and green hasn’t been a requirement for us by law as such – it was something that we had typically engaged into as a part of our DNA. Even when environment regulations were not so strict, that point of time we had invested more than ₹100mn on our effluent treatment plant.

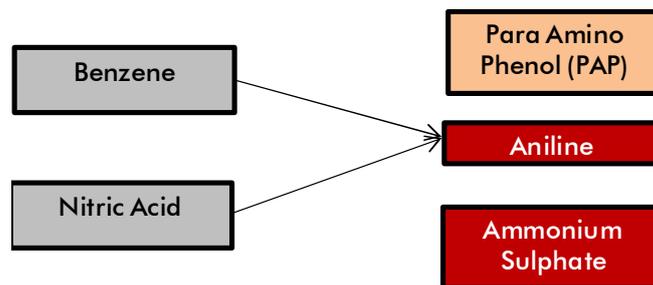
Vinati Management

Exhibit 14: IBB value chain – Vinati is now forward integrating into IBAP, which will improve margins



Source: Company, Ambit Capital research

Exhibit 15: PAP value chain will be a completely new block for Vinati Organics – it will help open multiple opportunities for new product development



Source: Company, Ambit Capital research

Unique R&D model drives better process development

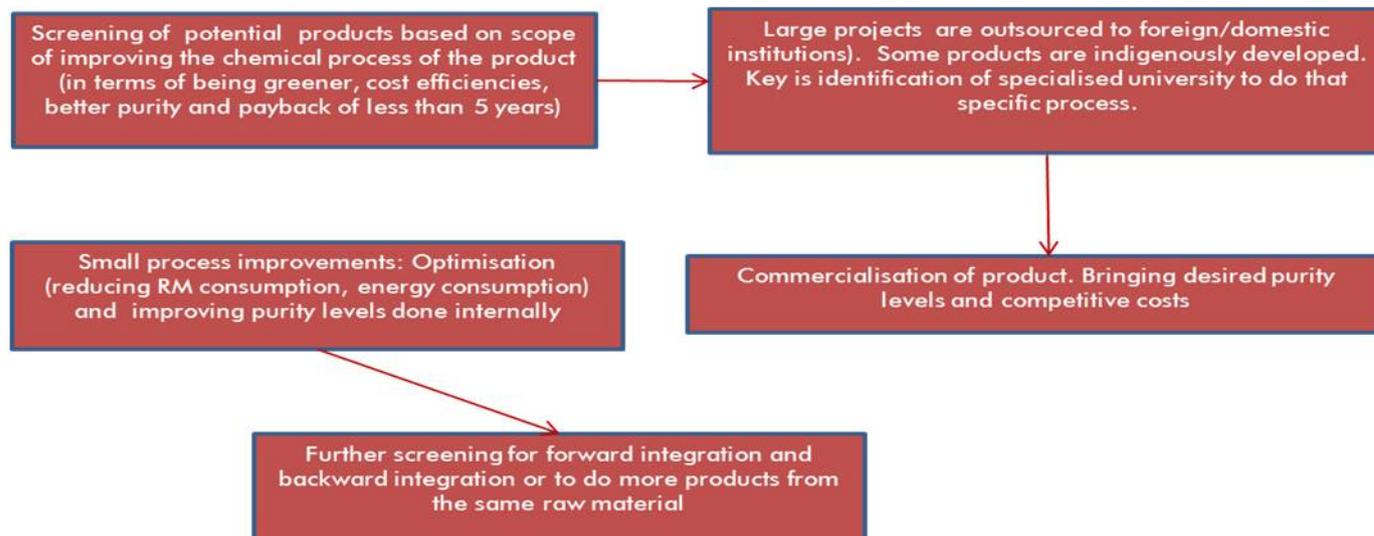
Vinati follows a hybrid model, wherein it gets a large part of its process research done from external research institutes which have much better infrastructure to undertake such work. It also has its own R&D/plant team working on improving product synthesis (purity, costs, etc.) to desired quality levels on a commercial basis.

Exhibit 16: Vinati gets technical knowhow through tie-ups with global R&D institutes

Product	Source	Technology Acquisition	Plant commissioned	Initial success	Comments
IBB	IFP, France	1989	1992	1995	Vinati successfully displaced Chevron and a Shell group company to gain market leadership here. Now Vinati is the lowest cost producer with the largest scale globally
ATBS	NCL, Pune	2000	2002	2006	The product initially made cash losses; however, Vinati turned it around with the help of an external consultant. ATBS is now the highest margin contributor for Vinati
IB	Saipem SpA, Italy	2009	2010	2010	IB was developed more to gain cost leadership in ATBS. However, Vinati also started to sell it in India and now has 70% market share in India
PTBT, PTBBA	IICT, Hyderabad	2016	2017E	2017E	These products are IB derivatives
IBAP	NCL, Pune	NA	TBD	TBD	The product will witness a ready market from IBB customers as it is an advanced intermediate in Ibuprofen manufacturing process
PAP	NCL, Pune	NA	2019E	2020E	Company started working on this product in 1998.
Butylated Phenols	Not Disclosed	NA	2019E	2019E	These products are IB derivatives with substantial import substitution demand

Source: Company, Ambit Capital research

Exhibit 17: Unique R&D outsourcing model



Source: Company, Ambit Capital research

ATBS and IB derivatives: Key organic growth engines

After a hiatus in FY16 due to a fall in ATBS volumes, Vinati is back on track to clock 7-8% volume growth. IBB (31% of sales) will witness a marginal 3-4% volume growth given ibuprofen is growing only at 3-4% globally. IBB volumes may remain stagnant but forward integration to IBAP will drive better realisations on a per unit volume basis (15-20%). Volume growth of ATBS (46% of sales) is likely to recover to 14-15% as: a) usage in water treatment and construction chemicals is witnessing traction, b) recovery in shale oil application-related volumes, which formed ~20% of ATBS demand in FY15.

ATBS – likely to sustain 10-15% volume growth

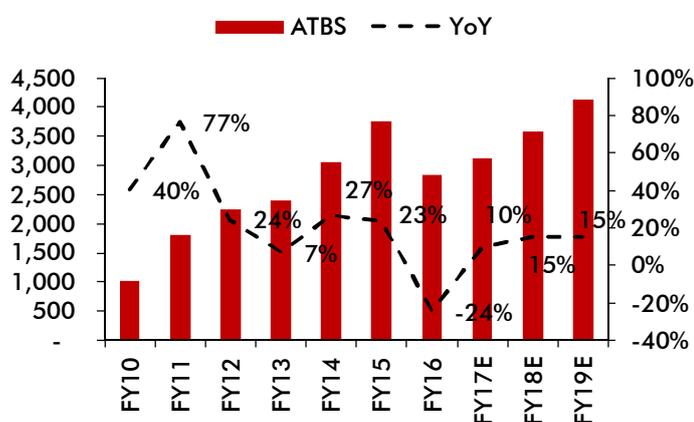
Vinati licensed ATBS technology from National Chemical Laboratories (NCL), Pune. The company established its first plant (1,200 TPA) in 2002. Vinati was the third company globally to enter ATBS (after Lubrizol and Toagosei). However, with its better process it rapidly gained market share. It has over the years, increased capacity ~20x to 26000 TPA. Lubrizol (14,000 TPA) sells most of its volumes in the market with very limited captive consumption. Toagosei (6,000 TPA) uses ATBS for largely captive consumption and sell the polymers which are produced.

ATBS finds wide application in emulsions for paints and paper coatings, water treatment chemicals, adhesives, hydrogels and super absorbents, textile auxiliaries, detergents and cleaners, acrylic fibre, construction polymers, and oil field polymers.

ATBS growth is likely to remain strong

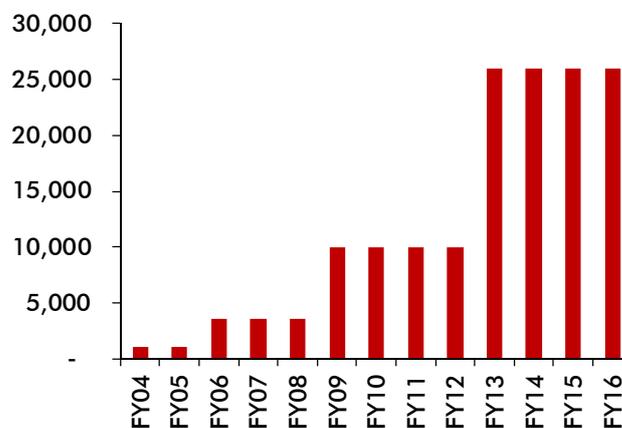
Vinati had 20-25% volume contribution (in FY15) from shale oil drilling, which had come to a standstill after a sharp fall in crude prices over FY15/16. Now, with OPEC cuts, growth is likely to revive. In addition, over the last two years, Vinati has worked a lot on growing usage in water treatment chemicals and construction chemicals, which should aid volume growth recovery. Even without shale recovery volumes, we believe Vinati can post ~14% volume growth.

Exhibit 18: ATBS revenue growth (₹ mn)



Source: Company, Ambit Capital research

Exhibit 19: ATBS capacity expansion (MT)



Source: Company, Ambit Capital research

Process strength in ATBS should continue to push volume growth

Vinati's ATBS process is better than that of its peers because of continuous refinement by the company over years. The following features (based on claims made by NCL – a leading Indian research institute on chemical technologies and licensors of technology for ATBS to Vinati) make Vinati's ATBS process better than peers and would continue to drive market share gains for the company in the product:

- higher yield per kilogram of isobutylene used;
- higher purity of the final product with little or no discoloration;
- the ability to recover the unreacted raw material acrylonitrile from the mixture; in comparison, Lubrizol's process recovers only 85%;

Vinati's key clients are BASF, Dow Chemicals, Nalco Company (USA), AkzoNobel, SNF Floerger, Ciba, and Clariant Chemicals, among many others.

- absence of sub-zero temperature requirement;
- reduction in the reaction duration by at least 50%;
- enhanced ease of stirring, drying and filtration.

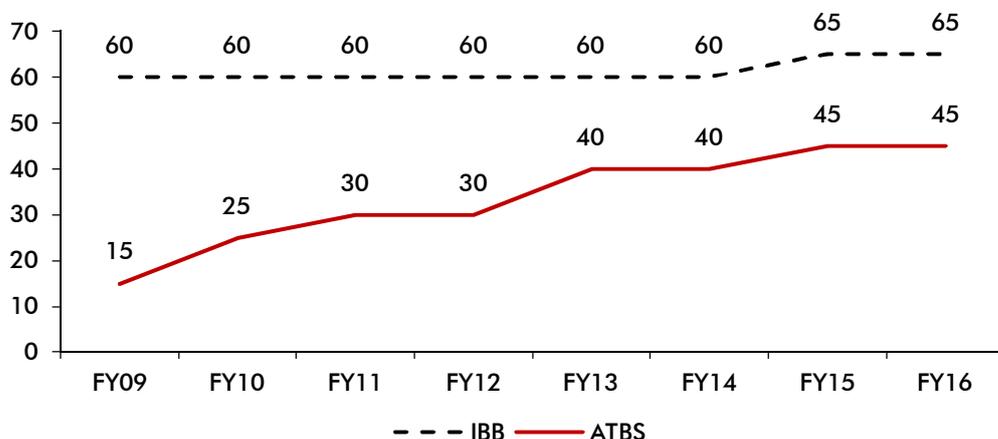
The chemical process used by Vinati is able to recover effluents and polymerise them, adding to Vinati’s product portfolio. Vinati’s process (licensed from NCL) is also able to reduce the variation in metal content (which can interfere with the process in final usage of ATBS) and increase the polymer weight to match international quality requirements.

Through the backward integration of ATBS provided by the IB plant, Vinati saves 15% in terms of logistics and excise costs in IB. Earlier, IB was imported from Europe or China.

Competitive threats from new/existing players are limited

A process refined over the last decade and scale benefits accumulated on a gradual basis will prevent any new competition. We believe players in the organised ATBS market do not plan to undertake capacity expansion soon, because Toagosei does not see ATBS as a major product; ATBS is just one of the products of its 4 segments consisting of 65 products and is not marketed for oil, adhesive, detergent and construction applications (some of the key segments for Vinati’s sales). Lubrizol’s ATBS too is much expensive than Vinati’s product costs.

Exhibit 20: Vinati has gained share in ATBS (volumes up 10-12% CAGR) and IBB (volumes growing at 4-5% CAGR) over the last few years (market share in %)

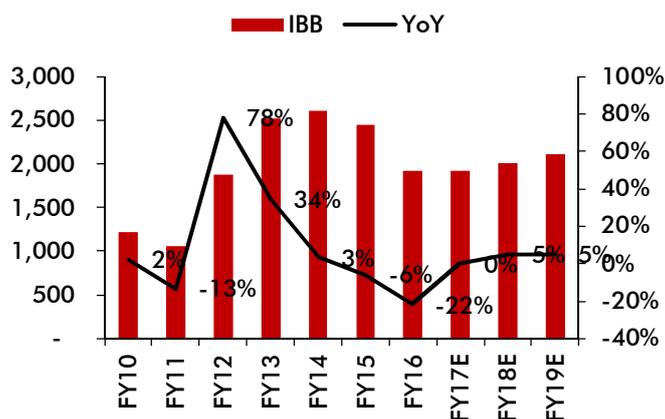


Source: Company, Ambit Capital research

IBB – a mature product; IBAP expansion will be the next kicker

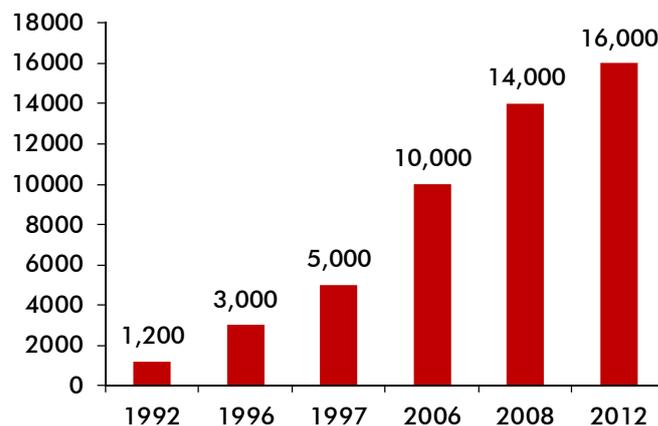
IBB is used as an intermediate in ibuprofen (used as anti-inflammatory, analgesic medicine) manufacturing. Vinati has ~65% market share. IBB is a 20,000 TPA volume market globally and is growing at 4-5%. Vinati has capacities of ~16000 TPA. We don't anticipate much capacity expansion. We expect Vinati to be able to protect its market share and grow in-line with the market hereon.

Exhibit 21: IBB volumes have grown at a CAGR of 7%, which we expect to moderate to 5% over next three years



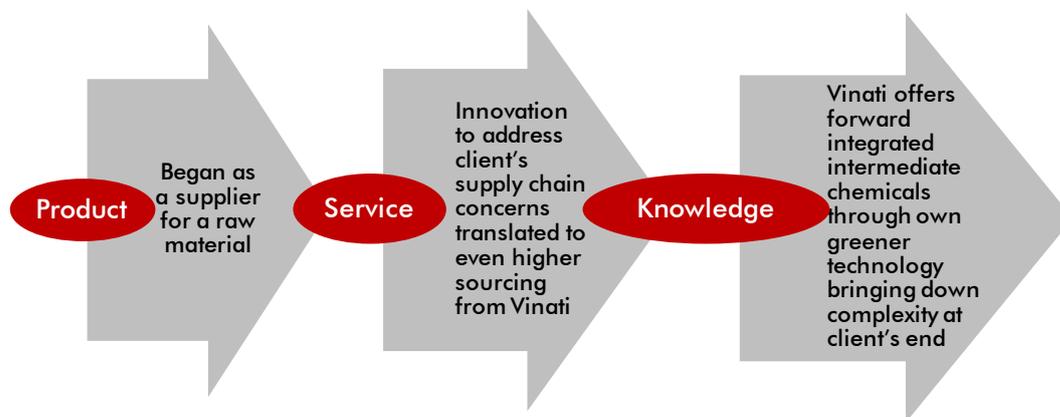
Source: Company, Ambit Capital research. LHS is revenues in ₹ mn.

Exhibit 22: No recent capacity expansion in IBB for Vinati after 2012 (MT)



Source: Company, Ambit Capital research

Exhibit 23: Vinati's journey with MNC clients - significant advancement of target product market and margins by being knowledge/service partner than just supplier



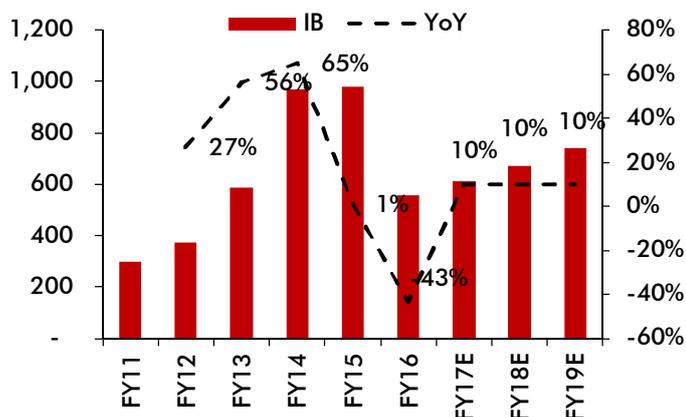
Source: Company, Ambit Capital research

IB derivatives are the next growth driver

Vinati is the domestic market leader in IB with over 70% market share and capacity of 12,000 MT. It uses ~50% of total production for captive purposes and sells the rest in the domestic market, largely to agri-based firms. Exports are negligible. Vinati is working on tripling capacity as new IB derivatives such as PTBT, PTBBA and butylated phenols are being launched over the next two years. IB derivatives are being used predominantly as import substitution.

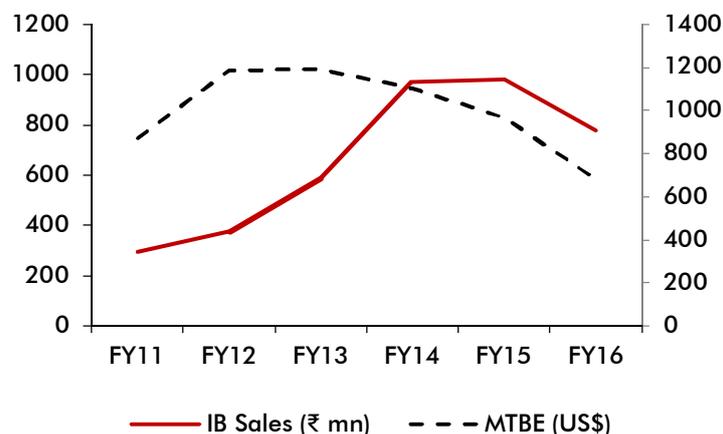
- Vinati has been able to drive growth of the domestic IB industry with its large capacity. Previously, IB was imported and was not freely available. Increasing availability produced new uses for IB, which in turn grew demand. In essence, Vinati has expanded the domestic IB market.
- Through backward integration of ATBS provided by the IB plant, Vinati saves 15% in logistics and excise costs in IB. IB was earlier imported from Europe or China.
- Vinati manufactures IB from MTBE, which is also purified and sold as HPMTBE. This provides synergy in all its products. MTBE is derived from crude oil and, hence, witnesses raw material volatility.

Exhibit 24: IB gross sales are moderating due to linkage to crude-related raw material; but volumes are growing at ~10%, which is likely to sustain (₹ mn)



Source: Company, Ambit Capital research

Exhibit 25: IB sales have linkages to MTBE prices, which are linked with crude



Source: Company, Ambit Capital research

Flurry of new products ahead; product risks diversifying

In 27 years of its journey, Vinati has launched three key products – ATBS, IBB and IB – and all of them have garnered dominant market shares in their respective markets. After a hiatus of six years, Vinati recently announced capex for two major products which can double its revenues by FY21: a) butylated phenols (an import substitution used in fragrances, agrochemicals, etc.) for which production will begin by FY19; b) PAP (used in paracetamol manufacturing) which is likely to be available by late FY19 or early FY20; and c) forward integration to IBAP. Vinati has a much superior technology in PAP, which will replace imports and also help gain global market share. Together these projects can contribute about half of Vinati’s sales by FY21 while contributing incrementally to its current RoCE of ~25%.

An array of projects will support strong topline growth

Vinati has been undertaking three major capex projects: a) IB derivatives PTBT, PTBBA, TB Amine and another custom synthesis project which will add revenues of ₹2bn by FY18; b) PAP project (entirely new process block), which will add revenue of ~₹6bn over FY19-21; and c) IB derivatives expansion project 2 for butyl phenols, which will add revenue of ~₹3bn over FY19-FY21. In totality, the new projects can add ~₹11bn sales over FY17-FY21 vs current sales of ₹6bn. Vinati is also building a 8MW power plant, which will save ₹80mn in power cost. IBB forward integration to IBAP/IHAP will add other ₹1.5bn to Vinati’s sales. The power plant and the upgrade project will boost margins by 100-150bps over two three years.

Vinati Management on PAP

We have been working on a breakthrough technology for a long time and finally we can say that all our results have been positive, we are getting the yields that we wanted.

Major Product launches after a hiatus

IBB – 1993

ATBS – 2003

IB – 2010

PTBT/PTBBA - 2017

Butylated Phenols – 2018

PAP - 2019

Exhibit 26: Vinati – key new projects

Project	Capex	Project Commencement	Revenue Commencement	Revenue	Key Products	Target market
IB Derivatives/ Custom Synthesis	₹1.5bn	FY16	FY17	2bn	<ul style="list-style-type: none"> PTBT/PTBBA: PTBT and PTBAA are IB-based derivatives, which are currently imported into India with applications in perfumery, personal care and polymer additives. Sales of these two products commenced in FY17. TB-Amine: TB Amine, or tertiary butyl amine, is used in the rubber and pharmaceuticals industries. Sales commenced in FY17; we expect to see the full effect of this project on revenues in FY18. Custom synthesis: A niche customised product was launched in FY17 for an American and Japanese client on a contract basis. We expect that his product will fetch Vinati ₹450mn revenues on a full year basis from FY18. 	PTBT/PTBBA - Import substitution Custom Synthesis – Global demand
PAP	5bn	FY17	FY20	6bn	<ul style="list-style-type: none"> PAP (para amino phenol) is the raw material for paracetamol. Vinati has a very environment friendly and cost efficient technology (20% cheaper) than current imports. It has also brought land for the project in Mahad, Maharashtra. The PAP project has a revenue potential of about ₹6bn. 	Import substitution + Global demand
Butylated Phenols	2bn	FY17	FY20	3.5bn	<ul style="list-style-type: none"> Butyl Phenols are intermediates which find applications as raw materials for products that go into a wide variety of 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. Around 35-40% of the total quantity finds application in the perfumery industry. Around 15% is used for plastic additives and the remaining butyl phenols are used for inks/resins and lubricants. 	Import substitution + Global demand

Source: Company, Ambit Capital research. In timelines – 1st year of the range is project commencement date and the end year of the range is the starting year for revenues.

PAP largely finds application as paracetamol intermediate

Para amino phenol or 4-aminophenol (PAP) is one of the most widely used intermediates in the pharmaceutical industry. Primarily, PAP is used in the manufacture of paracetamol, a widely used over-the-counter analgesic (pain reliever) and antipyretic (fever reducer). More than 80% of para amino phenol worldwide is used for manufacturing paracetamol (in pharmaceuticals) while 7 % is used as rubber antioxidant and 5% in dyes and miscellaneous purposes.

Vinati has a unique process for PAP

The conventional manufacturing route is a multi-step process involving iron/acid reduction, which poses a serious environmental problem. The proposed route involves catalytic hydrogenation of nitrobenzene to directly give p-aminophenol. Having a greener process and at the same time being competitive to Chinese in terms of cost give us a fair degree of comfort on Vinati gaining rapid market share in PAP by displacing players using polluting process. Given PAP is predominantly imported, Vinati should get good market share as its product is meaningfully cheaper.

PAP will largely be an import substitution

Vinati is setting up a capacity of 30,000 TPA. India currently imports close to 21000 TPA of PAP. All the imports of PAP are from China and are comparatively more expensive. The global demand for PAP (excluding India) is 110-130 MTPA. We believe Vinati can get 30-40% market share over next few years as it has a greener process than Chinese suppliers. Two large MNC players (Malinkrodt and Novacyl) manufacturing paracetamol have a requirement of 44TPA, which could be a key target for Vinati.

Butyl phenols is also a well-thought project for import substitution

Vinati is setting up capacity of 39000 MTPA for butyl phenols, which will come on stream by FY19. Butyl phenols are intermediates which find application as raw materials for products that go into a wide variety of 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. Around 35-40% of the total quantity finds application in the perfumery industry. Around 15% is used for plastic additives and the remaining for inks/resins and lubricants.

Vinati intends to make four kinds of butyl phenols:

- Para-Tertiary Butyl Phenol (PTBP)
- Ortho-Tertiary Butyl Phenol (OTBP)
- 2,4-Di Tertiary Butyl Phenol (2,4-DTBP)
- 2,6-Di Tertiary Butyl Phenol (2,6-DTBP)

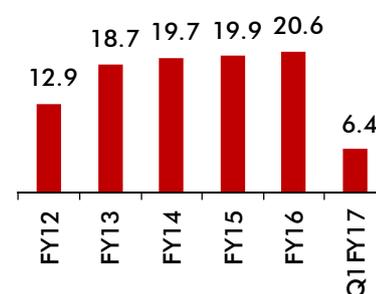
India imports ~20500 MTPA butyl phenols, which can be substituted by Vinati's integration with IB

India is a net importer of butyl phenols. The total demand in India is 20,500 MTPA. There are no manufacturers in India for butyl phenols. Previously, Herdillia (now SI Group), Balmer Lawrie, and Naik Naware Chemical tried to manufacture these products. However, due to lack of scale and IB supply constraints, they couldn't manufacture them economically. Vinati, with its backward integration of IB, can easily replace this import demand.

Exports are also a good opportunity

Globally, di-tertiary butyl phenols are widely used in lubricants, plastic additives and fuel additives. The use of 2,6-DTBP as a jet fuel additive is a large volume application. PTBP is also used in poly carbonate manufacturing. It will be possible to export some of these products. Some of the target customers for di-tertiary butyl phenols are Cytec (acquired by Solvay recently), Everspring (Taiwan based polymer additives player), Omnova (US based functional chemicals player), and Adeka (Japanese plastic additives company).

Value of imported Butyl Phenols in India (in '000 MT per annum)



Source: Company, Ambit Capital

Exhibit 27: Vinati's organic revenue model – products launched from FY16 will contribute ~47% of sales by FY21

₹ mn	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E	FY20E	FY21E
Net revenue												
IBB	1,217	1,055	1,878	2,523	2,607	2,454	1,915	1,915	2,010	2,111	2,216	2,327
YoY	2%	-13%	78%	34%	3%	-6%	-22%	0%	5%	5%	5%	5%
Saliency	51%	32%	40%	43%	35%	30%	31%	27%	23%	19%	15%	13%
ATBS	1,026	1,813	2,253	2,405	3,054	3,762	2,841	3,125	3,594	4,133	4,753	5,466
YoY	40%	77%	24%	7%	27%	23%	-24%	10%	15%	15%	15%	15%
Saliency	43%	55%	48%	41%	41%	46%	46%	44%	42%	38%	31%	30%
IB		297	376	587	968	982	556	611	673	740	814	895
YoY			27%	56%	65%	1%	-43%	10%	10%	10%	10%	10%
Saliency		9%	8%	10%	13%	12%	9%	9%	8%	7%	5%	5%
HP-MTBE (solvent)						327	371	389	447	514	566	623
YoY							13%	5%	15%	15%	10%	10%
Saliency						4%	6%	5%	5%	5%	4%	3%
PTBT, PTBBA								100	300	600	1,119	1,231
YoY									85%	10%	10%	10%
Saliency								7%	11%	8%	7%	7%
TB Amine								100	250	350	508	559
YoY									40%	10%	10%	10%
Saliency								4%	5%	4%	3%	3%
Custom Products								300	700	925	435.5	375.625
YoY									40%	10%	10%	10%
Saliency								4%	5%	4%	3%	3%
Para Amino Phenol											2,000	3,500
Saliency											13%	19%
Butylated Phenols										800	2,000	2,500
Saliency										7%	13%	14%
Others	143	132	188	352	819	654	494	568	653	751	864	994
YoY		-8%	42%	87%	133%	-20%	-25%	15%	15%	15%	15%	15%
Saliency	6%	4%	4%	6%	11%	8%	8%	8%	8%	7%	6%	5%
Total	2,386	3,296	4,695	5,867	7,449	8,179	6,176	7,108	8,628	10,925	15,276	18,470
YoY	17%	38%	42%	25%	27%	10%	-24%	15%	21%	27%	40%	21%
Saliency	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Company, Ambit Capital research

Good track record of capital allocation

Vinati's capital allocation has been flawless with controlled capacity expansion and no forays beyond those related to the business. The company has refrained from committing capacities for any new product before strong signs emerge that it is well-differentiated in terms of costs and purity. This strategy has led to rapid growth in sales and capacity utilisation post launch of a product, which in turn has provided sustained, healthy RoCE. Thereby, ROCE has sustained at ~25% over the last decade despite rapid capacity expansion across key products while staying well ahead of Indian emission standards. Subsequently, the balance sheet is debt-free. Vinati has only done one equity dilution in the last 2.5 decades after the IPO and most capex has been funded internally. Vinati has focused on organic growth given lack of acquisition targets that meet environment and process excellence standards.

Patience is at the core of Vinati's capital allocation practice

Management has refrained from adding ambitious capacities without perfecting the technology (purity, environment friendliness, cost-efficiencies). Before commissioning large capacities, it has worked for many years perfecting the products.

Exhibit 28: Extended time between technology acquisition and plant commissioning to launch a fully differentiated product

Product	Source	Technology acquisition	Plant commissioned	Initial success
IBB	IFP, France	1989	1992	1995
ATBS	NCL, Pune	2000	2002*	2006
IB	Saipem SpA, Italy	2009	2009	2010
PAP	NCL, Pune	2010	2019	2019

Source: Company, Ambit Capital. * The capacity was very small.

Exhibit 29: Capacity expansion has been gradual, avoiding any major drag on RoCE

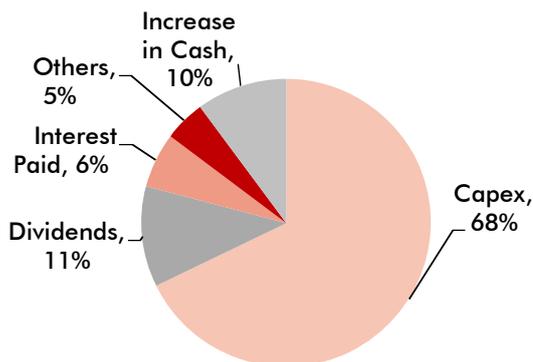
	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
ATBS	1,000	1,000	3,600	3,600	3,600	12,000	10,000	10,000	10,000	26,000	26,000	26,000
IBB	5,000	5,000	10,000	10,000	14,000	14,000	14,000	14,000	14,000	16,000	16,000	16,000
IB							12,000	12,000	12,000	12,000	12,000	12,000
TBA				300	300	500	500	500	1,000	1,000	1,000	1,000
HPMTBE									6,000	6,000	6,000	6,000
DAAM										1,000	1,000	1,000

Source: Company, Ambit Capital research

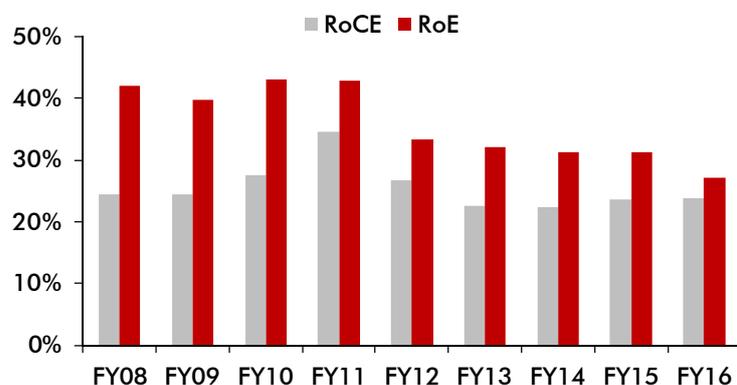
Balance sheet is debt-free; growth driven organically through internal accruals with just one small equity dilution since IPO

We note that Vinati has judiciously used capital by investing in plants and machinery through a mix of debt and operating cash flows. The company also paid back shareholders through dividends at ~11% of its cumulative cash flows. Over FY06-FY16, Vinati sourced ~90% of its capital requirements from internal accruals.

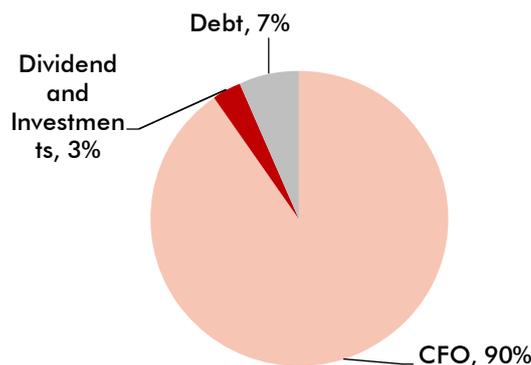
Management has been successful in deleveraging its exposure to IBB by entering ATBS. Strategy of entering new products only if it has an edge over existing players helped Vinati become a global leader in ATBS and IBB. Management's decision of backward integration into IB has given Vinati significant cost advantages in ATBS. Management has also not shied of using debt for expansion. Whilst overall debt sourcing through FY06-16 was 7%, most of it was repaid in FY14 and FY15.

Exhibit 30: Application of capital - FY06-16


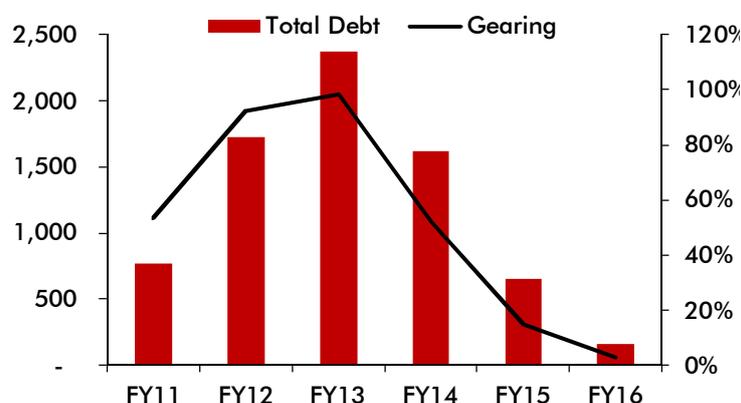
Source: Company, Ambit Capital research

Exhibit 32: RoCE and RoE are healthy; recent fall has been attributed to decline in leverage and reduced ATBS sales due to decline in shale-oil-related demand


Source: Company, Ambit Capital research

Exhibit 31: Sources of capital - FY06-16


Source: Company, Ambit Capital research

Exhibit 33: Balance sheet is virtually debt free (₹ mn)


Source: Company, Ambit Capital research

RoE moderating with reduction in leverage but ROCE remains healthy

Vinati has consistently generated RoE of 30%+ over FY12-FY15. This has been driven by PAT margins that are higher than the peer median. Decline in commodity prices in FY16 explains the significant rise in PAT margins and fall in asset turns. We expect RoE to increase to 30% beyond FY17. The company had raised significant debt to facilitate expansion in ATBS and backward integration into manufacturing isobutylene. With the use of internal accruals to repay debt, financial leverage improved from 1.8x in FY12 to 1.1x in FY16.

Exhibit 34: DuPont analysis

Company/ metric	RoE					PAT Margin					Asset Turnover (x)					Financial Leverage (x)				
	FY12	FY13	FY14	FY15	FY16	FY12	FY13	FY14	FY15	FY16	FY12	FY13	FY14	FY15	FY16	FY12	FY13	FY14	FY15	FY16
Vinati	33.1%	32.1%	31.3%	31.1%	27.0%	12.2%	12.4%	12.4%	15.0%	20.9%	1.5	1.3	1.4	1.5	1.2	1.8	2.1	1.8	1.4	1.1
Camlin FS	7.6%	25.5%	36.2%	48.2%	23.0%	1.1%	4.0%	5.6%	9.9%	7.3%	2.3	2.0	2.3	2.1	1.5	2.9	3.1	2.7	2.4	2.1
PI Industries	38.4%	22.7%	30.7%	30.9%	30.5%	10.8%	7.8%	10.7%	11.7%	15.0%	3.4	2.8	2.8	2.6	1.9	1.1	1.0	1.0	1.0	1.1
Aarti	18.8%	20.0%	20.0%	21.5%	25.2%	6.2%	6.4%	6.2%	7.0%	9.6%	1.4	1.4	1.4	1.3	1.2	2.1	2.2	2.3	2.3	2.2
Atul	14.9%	17.0%	25.7%	24.2%	23.3%	5.1%	5.9%	8.9%	9.1%	10.4%	1.8	1.8	1.9	1.9	1.7	1.6	1.6	1.5	1.4	1.3
Peer Median (ex Vinati)	16.8%	21.3%	28.2%	27.6%	24.2%	5.6%	6.1%	7.5%	9.5%	10.0%	2.0	1.9	2.1	2.0	1.6	1.9	1.9	1.9	1.9	1.7
Divergence	16%	11%	3%	4%	3%	7%	6%	5%	6%	11%	-0.6	-0.7	-0.8	-0.5	-0.5	0.0	0.2	0.0	-0.5	-0.5

Source: Company, Ambit Capital research.

Financial Assumptions

Exhibit 35: Financial Assumptions

Particulars (₹ in mn unless mentioned)	FY14	FY15E	FY16E	FY17E	FY18E	Change (%)			Comments
						FY16E	FY17E	FY18E	
Growth Rate									
IBB	2,607	2,454	1,915	1,915	2,010	-22%	0%	5%	IBB growth is likely to be in line with the industry growth; new applications into perfumery will add 100bps to growth ATBS is likely to recovery back to 14% growth as oil volumes are out of the base in FY16 IB is likely to continue witness
ATBS	3,054	3,762	2,841	3,125	3,594	-24%	10%	15%	
IB	968	982	556	611	673	-43%	10%	10%	
HP-MTBE (solvent)	-	327	371	389	447	13%	5%	15%	
New products (FY17+) : Custom blend, PTBT, PTBBA, TB Amine	-	-	-	500	1,250			150%	
Others	819	654	494	568	653	-25%	15%	15%	PTBT and PTBBA are new products introduced in FY17
Financials									
Net Sales	6,961	7,717	6,309	6,920	8,370	-18%	10%	21%	Sales growth decline in FY16 was due to crude price decline while volume growth rates were healthy. We expect Vinati to register early double-digit volume growth rates. EBITDA growth will be marginally faster led by higher revenue share from ATBS and new products. Depreciation charges will materially increase with commissioning of new plants PAT growth in FY18 will marginally moderate due to higher interest costs High interest costs will bring down PAT margins
Reported EBITDA	1,529	1,918	2,067	2,199	2,794	8%	6%	27%	
Reported EBITDA margin (%)	22.0	24.8	32.8	31.8	33.4	790 bps	-100 bps	160 bps	
Adjusted EBITDA	1,529	3,751	4,349	5,554	6,954	16%	28%	25%	
Adjusted EBITDA margin (%)	22.0	24.8	32.8	31.8	33.4	790 bps	-100 bps	160 bps	
Depreciation	153	177	185	274	304	5%	48%	11%	
Interest	181	98	79	20	122	-19%	-74%	508%	
PAT	862	1,158	1,315	1,381	1,712	14%	5%	24%	
Pat margin (%)	12.4	15.0	20.8	20.0	20.5	580 bps	-90 bps	50 bps	
Cash Flow Parameters									
CFO	1,315	1,126	1,675	1,408	1,726	49%	-16%	23%	CFO had one-time exports benefits in FY16 Capex of a) ₹2bn for PTBT/PTBBA/TB Amine and a 8MW power plant; b) ₹5bn for PAP; c) ₹2bn for butylated phenols; d) rest is maintenance capex FY17-FY19 will be heavy-capex years
Capex	(294)	(422)	(732)	(2,000)	(4,000)	74%	173%	100%	
FCF	1,021	704	942	(592)	(2,274)	34%	-163%	284%	
Turnover Ratios									
Cash Conversion Cycle	79	73	87	78	76	18%	-10%	-2%	IBB has longer working capital cycle GB turnover will decline due to high CWIP Capital Employed Turnover too will decline due to high CWIP
Gross Block Turnover	2.0	2.0	1.4	1.2	0.9	-29%	-16%	-20%	
Capital Employed Turnover	1.6	0.5	0.6	0.6	0.6	16%	4%	-3%	
Profitability Ratios									
RoCE	22.5	23.7	23.7	21.0	18.7	0 bps	-280 bps	-230 bps	RoCE is likely to remain healthy RoE will come back to 27-28% once capex expenses translated into sales and profits
RoE	31.3	31.1	27.0	22.6	22.4	-410 bps	-430 bps	-20 bps	
RoIC	24.1	25.0	25.7	22.2	19.4	80 bps	-350 bps	-280 bps	

Source: Company, Ambit Capital

Exhibit 36: Ambit vs. Consensus

	Ambit	Consensus	Deviation	Comments
Sales				
FY17E	6,920	6,853	1%	
FY18E	8,370	8,039	4%	
FY19E	10,553	8,669	22%	
Reported EBITDA				
FY17E	2,199	2,261	-3%	Consensus estimates are limited and do not factor in projects such as PAP and Butylated Phenols in FY19.
FY18E	2,794	2,741	2%	
FY19E	3,664	3,094	18%	
Reported PAT				
FY17E	1,381	1,429	-3%	We also build in higher interest costs due to execution of PAP project resulting in broadly in-line PAT as consensus in FY19 despite having much higher EBITDA
FY18E	1,712	1,718	0%	
FY19E	2,154	1,955	10%	

Source: Bloomberg, Ambit Capital

What is the ideal multiple for a leader in its infancy?

Vinati's leadership in its few products launched in the last two-and-a-half decades is built on an unbeatable proposition for clients (low cost, better product, less polluting). Such a combination, if repeated in the next two big launches, can lead to a sharp re-rating in valuations as seen over Mar-13 to Mar-15, though the starting point was low then. Whilst the market will await the commercialisation of these projects, we take comfort from the steps and processes ahead of the launches and suggest investors should buy this stock with a holding period of 2-3 years. We initiate with a BUY and DCF-based TP of ₹800 (33% upside), implying 20x FY19E EPS; though the real earnings jump (doubling) will happen over FY19-21 as new projects come on stream fully by FY19-end. Long-term RoCE after these projects should jump to 30% before softening. This scale change to nearly 3-4x its present scale will make it another successful and sustainable (even stronger) specialty chemicals story akin to SRF and PI, which investors are ready to value at 20x or more for the chemicals business. Key risk remains process innovation/substitution related competitive threats for existing/new products and key man risk.

We like Vinati's steady execution and focus on green chemistries, which should drive a premium over peers. We note that Vinati has a much more scalable business model than peers because is not centered on a specific chemistry or application but based on astute product selection backed by use of quality R&D organisations nationally and globally. Flawless accounting scores and strong capital allocation history provide comfort on promoters.

DCF methodology

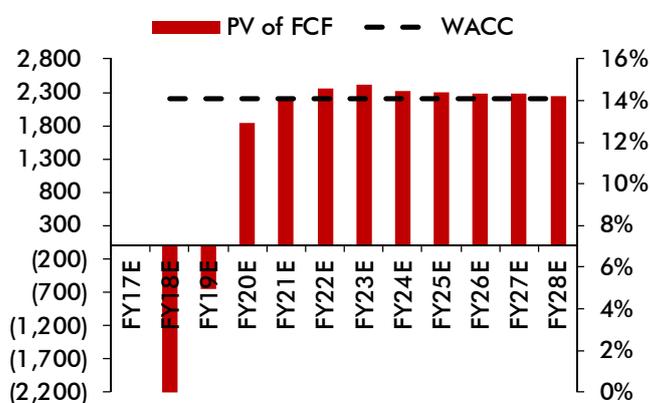
DCF is the right metric for valuing Vinati as some of the new projects will start contributing to revenues only from FY19 even as the projects will be funded by cash flows generated over FY18-19. We derive a DCF-based valuation of ₹800 (~33% upside) using a WACC of 14.2% (target debt/market value of capital employed of 0.1x) and terminal growth of 5%.

Exhibit 37: WACC assumptions

Cost of Equity	15.0%
Debt Equity	0.1
Cost of Debt	10%
WACC	14.1%

Source: Ambit Capital research

Exhibit 38: FCF profile of Vinati (₹ mn)

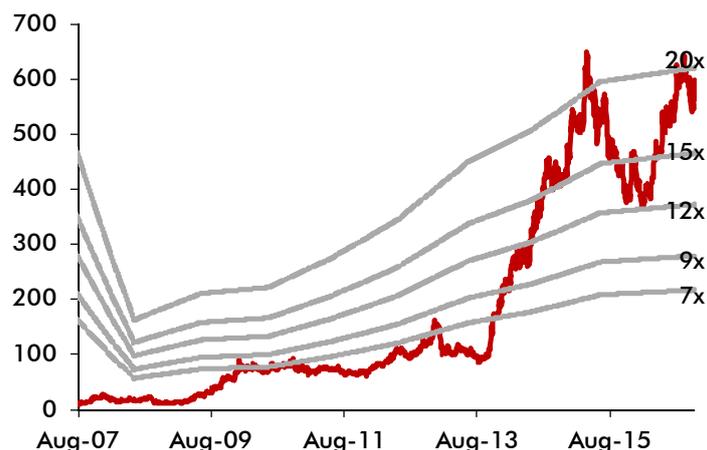


Source: Ambit Capital research

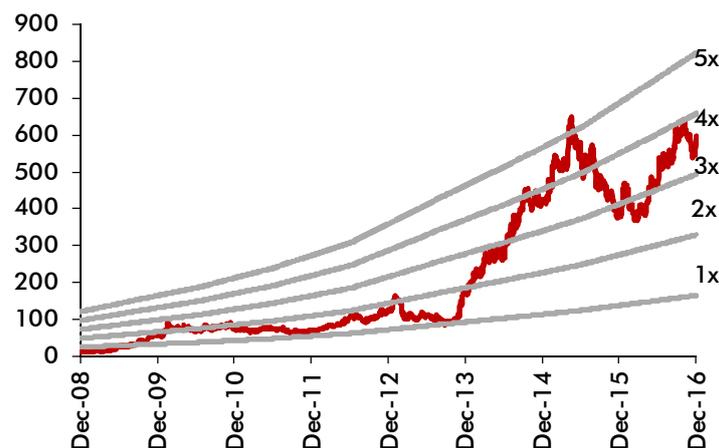
Exhibit 39: Vinati's 12-month forward DCF summary

	₹ mn
Total PV of FCF	17,204
PV of terminal value	23,589
EV	40,793
Net debt FY17	(96)
Equity Value	40,889
Number of shares (mn)	52
Implied share price (₹)	800
Current share price (₹)	592
Upside	35%

Source: Ambit Capital research

Exhibit 40: Vinati's P/E band chart


Source: Ambit Capital research

Exhibit 41: Vinati's P/B band chart


Source: Ambit Capital research

Sharp capex cycle over FY17-19; FCF to strengthen from FY20 as capex cycle subsides

Vinati has been undertaking three major expansion projects:

- ₹2bn (over FY16-FY18) for i) IB derivatives PTBT/PTBBA/TB Amine, ii) custom synthesis opportunity for a Japanese/American client, iii) upgrade of IBB to IBAP (advanced intermediate for ibuprofen manufacturing), iv) 8MW cogeneration plant, which will drive annual power savings of ₹70mn-80mn.
- ₹5bn (over FY17-FY20) for PAP derivatives, which would support sales of ₹6bn at better margins than overall blended margins from FY20.
- ₹2bn (over FY17-FY19) for additional IB derivatives. Butylated phenols should start contributing sales of ₹4bn-5bn from FY19. These products are unlikely to be margin-accretive but their margins will be broadly in range with blended margins.

Project (1) will add ~₹2bn of sales over FY17-FY19 (vs ₹6bn overall sales in FY16). Projects (2) and (3) are likely to start contributing only from FY19/FY20. However, debt servicing for these will start hitting the P&L in FY18/FY19 while the profits will come from FY20. This means FY17-19 earnings growth will be ~20% despite EBITDA growing by ~26%. However, earnings will spike from FY20/FY21 as projects (2) and (3) come on stream, doubling earnings over FY19-21.

Exhibit 42: Vinati's cash flow statement

₹ mn	FY17E	FY18E	FY19E	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E
CFO	1,408	1,726	2,235	2,967	3,908	4,608	5,331	5,971	6,687	7,490	8,388
CFO growth	-16%	23%	30%	33%	32%	18%	16%	12%	12%	12%	12%
Capex	(2,000)	(4,000)	(3,000)	(500)	(500)	(500)	(500)	(700)	(700)	(700)	(700)
FCF	(592)	(2,274)	(765)	2,467	3,408	4,108	4,831	5,271	5,987	6,790	7,688

Source: Ambit Capital research

These new projects will also reduce the product concentration of the top 3 products from 88% to 48%. Product concentration risk has been a key concern for Vinati.

Exhibit 43: Product concentration risks are easing – new products will account for ~40% of sales for Vinati

	FY14	FY15	FY16	FY17E	FY18E	FY19E	FY20E
Saliency							
IBB	35%	30%	31%	27%	23%	19%	15%
ATBS	41%	46%	46%	44%	42%	38%	31%
IB	13%	12%	9%	9%	8%	7%	5%
HP-MTBE (solvent)		4%	6%	5%	5%	5%	4%
PTBT/PTBBA/TB Amine/Custom Synthesis				7%	14%	17%	14%
Para Amino Phenol							13%
Butylated Phenols						7%	13%
Others	11%	8%	8%	8%	8%	7%	6%

Source: Company, Ambit Capital research

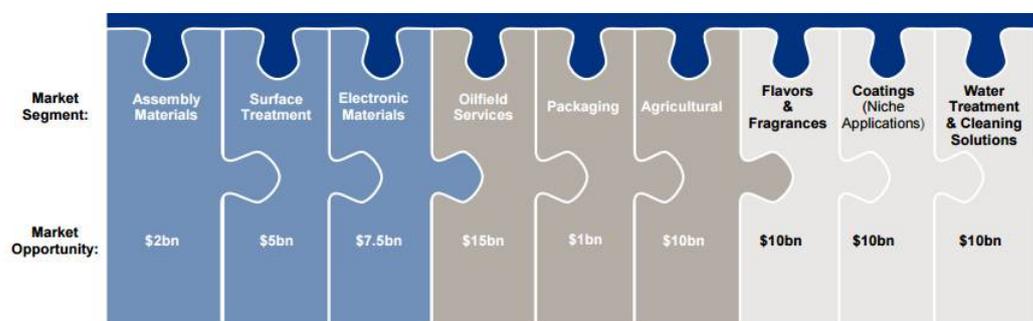
Relative valuations – differentiated business model not captured in valuations
Unique product philosophy provides larger addressable market for Vinati

The unique aspect in which Vinati differentiates itself from its specialty chemicals peers is its strong DNA of product development. Unlike peers, which focus on specific chemistries and application areas, Vinati focuses on a defined product selection criterion. It focuses on developing cost-effective, superior processes for existing products wherein it takes help from external R&D institutes to develop the core process and then builds scale by growing volumes and backward/forward integrating into allied products which limits competition. Cheapest (in cost), greenest (in process), largest (in scale), purest (in terms of chemical purity) are keywords associated with Vinati's products.

Vinati's differentiation lies in its uniqueness to form a network of research which is not only cheaper but also can have multiple projects running and access to more talent than the promoters can have in his firm.

Two other key differentiators which Vinati has over others are: a) accessing low-cost R&D from other research institutes for core product development, and b) focus on being green by not only spending money on plants but developing new chemical processes for converting waste into useful products.

These differentiators provide Vinati a much bigger target market size than that of its peers. This should give growth a much longer tail for Vinati than for peers.

Exhibit 44: Market size of non-pharma and non-agrochem customised product manufacturing is also fairly large


Source: Platform Chemicals

Exhibit 45: Presence across multiple chemical application segments could drive substantial opportunities (custom synthesis) in the future

	IBB	ATBS	IB	HP MTBE	PAP	Butylated Phenols	PTBT/ PTBBA
Pharma	Yes			Yes	Yes		
Agri			Yes				
Water Treatment		Yes					
Aroma/ Perfumery	Yes					Yes	Yes
Adhesives		Yes					
Personal Care							
Oil Exploration		Yes					
Plastic Additives						Yes	
Others			Yes (anti-oxidants)	Yes	Yes (Rubber antioxidants)	Yes (lubricants, inks, resins)	Yes

Source: Ambit Capital research

Differentiated R&D model also helps expand the target market size

Vinati's differentiation lies in its uniqueness to form a network of research which is not only cheaper but also can have multiple projects running and access to more talent than the promoters can have in his firm. This clearly opens Vinati to much bigger target market size unlike a PI, which has a defined focus on agrochemicals.

Unlike competitors, Vinati has tie-ups with global R&D institutes for product development and has proven/perfected this model over the past three decades. Executing projects with R&D help from multiple research institutes gives Vinati the ability to focus on products that cut across different chemical applications. Once Vinati's product numbers reach a critical mass, width of client relationships will become much more pronounced than peers, resulting in a much bigger target market. This advantage to clients becomes much more pronounced as we believe outsourcing of chemical manufacturing globally to India will get much more prominence.

Attractive financials and growth vs peers

While peers too have attractive investment arguments, Vinati scores well on parameters such as dominance in core products, return ratios, consistency of earnings growth and cash conversion. Unlike peers, Vinati focuses on fewer products but develops very strong competitive advantages based on continuous improvement in process used for product and significant scale powered by a unique process which is greener and cost efficient. Vinati has demonstrated superior RoE of 25-30% consistently while delivering 52% EPS growth over the last decade. Its focus on clean products and heightened focus on global EHS compliance provide it much better sustainability score than peers.

Growth spurt ahead led by aggressive product launches

Since 2010, after the IB launch there has been a hiatus of new launches. Interestingly, FY17-19 will have a significant number of new launches with a) IBB forward integration to IBAP, b) launch of IB derivatives such as PTBT/PTBBA/butylated phenols and c) PAP. Successful launch of these projects would treble the gross block from ₹5bn in FY16 to ₹15bn in FY19, which should drive similar growth in sales alongside modest margin accretion led by better product mix and operating leverage. Potential market size for PAP and butylated phenols is ~₹10bn and ₹4bn respectively, of which Vinati can get a 50-70% share going by the past record and process prowess.

Current multiples don't capture the inherent strength of the business model

Vinati's current FY19E EPS multiple of 14x is in line with peer multiples of 12x-16x and reflects the company's healthy return ratios, environmental focus, and flawless track record of gaining global leadership in key products. We believe these multiples will re-rate as: a) revenue growth driven by new projects becomes more visible and return ratios recover from the sharp capex cycle, and b) investors become more appreciative of a much bigger target opportunity ahead. We note that post commissioning of PAP and butylated phenols, Vinati's earnings can easily double over FY19-21.

Valuations can inch closer to PI Industries

Vinati currently trades at a 20% discount to PI Industries on PE multiples. Both have similar RoCE, strong track records of corporate governance, and traits which can lead to multifold growth over next decade. One key difference between PI and Vinati is product diversification, which is higher for PI. As Vinati's PAP and butylated phenols projects meet with success, some of those concerns will abate. Also, Vinati should post ~35% EPS CAGR over FY17-21 vs PI's 25%, which should take of any other minor imperfections in comparing with PI.

Exhibit 46: Vinati may be the cheapest bet amongst PI, SRF and Vinati in the growth, ROCE and target multiple matrix

Net Profits (₹ mn)	FY17E	FY18E	FY19E	FY20E	FY21E	Ambit Target Price (₹)	Target Market Cap (₹ mn)
SRF	5,003	6,168	7,576	8,481	9,387	1,750	100,485
PI	3,989	4,976	6,228	7,560	9,227	1,100	151,349
Vinati	1,381	1,712	2,154	2,971	3,893	800	41,272

PE at target price	FY17E	FY18E	FY19E	FY20E	FY21E	ROCE	Growth
SRF	20.1	16.3	13.3	11.8	10.7	12%	17%
PI	37.9	30.4	24.3	20.0	16.4	25%	23%
Vinati	29.9	24.1	19.2	13.9	10.6	24%	30%

Source: Ambit Capital

Exhibit 47: Relative benchmarking of peers – Vinati is the third-best specialty chemicals company in our framework

	Capital Efficiency	Margins	Product/Process Capabilities	Global orientation	Cash Conversion	Scalability	Total score
PI Industries	●	●	●	●	●	●	●
SRF Ltd.	●	●	●	●	●	●	●
Vinati Organics Ltd.	●	●	●	●	●	●	●
Atul Ltd.	●	●	●	●	●	●	●
Aarti Industries Ltd.	●	●	●	●	●	●	●
Navin Fluorine International Ltd.	●	●	●	●	●	●	●
Oriental Carbon & Chemicals Ltd.	●	●	●	●	●	●	●
Camlin Fine Sciences Ltd.	●	●	●	●	●	●	●
Sudarshan Chem.	●	●	●	●	●	●	●
Adi Finechem Ltd.	●	●	●	●	●	●	●
Omkar Speciality Chemicals Ltd.	●	●	●	●	●	●	●
Gujarat Fluorochemicals Ltd.	●	●	●	●	●	●	●

Source: Ambit Capital Note: ● - Strong; ● - Relatively Strong; ● - Average; ● - Relatively weak.

Exhibit 48: Underlying data – Vinati has much superior financials than peers

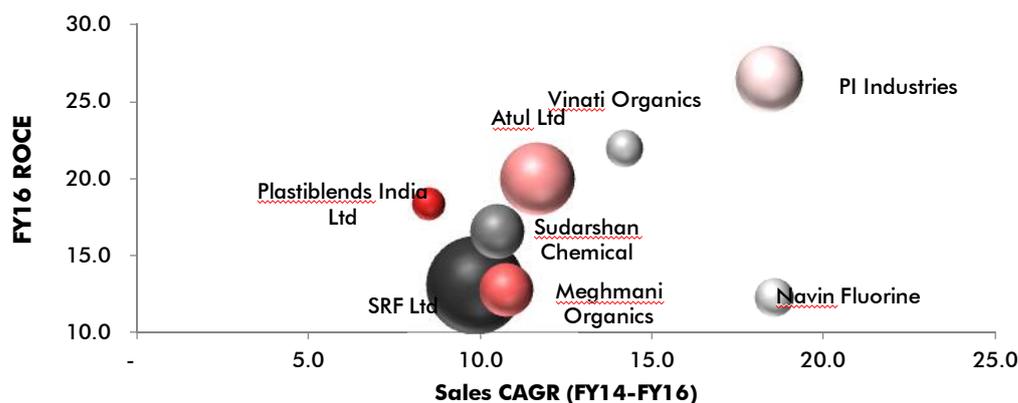
	Growth (CAGR 5 year)			Median RoCE	Capital Turnover	EBITDA margin	Dividend payout	Export Share	Export CAGR	CFO/ EBITDA
	Rev	EBITDA	PAT							
Atul Ltd.	17%	29%	34%	15.5	2.00	14.8	14%	46%	19%	78%
SRF Ltd.	26%	48%	16%	9.8	0.57	16.2	19%	27%	11%	90%
Oriental Carbon & Chemicals Ltd.	23%	12%	9%	19.4	1.02	19.7	23%	64%	19%	98%
Sudarshan Chem.	16%	11%	6%	12.9	1.73	10.0	45%	42%	23%	55%
Gujarat Fluorochemicals Ltd.	47%	NM	NM	13.7	0.39	21.3	12%	38%	-5%	79%
Vinati Organics Ltd.	27%	29%	24%	24.7	1.59	24.9	19%	66%	24%	79%
Aarti Industries Ltd.	17%	18%	23%	18.3	1.38	16.1	25%	47%	22%	81%
PI Industries	41%	34%	43%	26.3	2.03	19.6	14%	55%	42%	85%
Adi Finechem Ltd.	31%	59%	NM	27.4	1.86	16.5	30%	25%	31%	60%
Navin Fluorine International Ltd.	18%	NM	NM	12.1	0.94	12.4	32%	31%	-7%	85%
Camlin Fine Sciences Ltd.	32%	43%	120%	25.2	2.08	14.4	9%	77%	28%	42%
Omkar Speciality Chemicals Ltd.	31%	32%	36%	17.0	0.77	19.7	25%	DNA	N/A	18%
Narmada Gellatin	10%	11%	14%	17.3	1.35	15.9	14%	4%	1%	73%
Balaji Amines	19%	17%	10%	16.3	1.31	16.4	14%	6%	31%	90%

Source; Company, Ambit Capital

Exhibit 49: Comparative valuations of India's specialty chemicals players

Company Name	Market Cap (USD mn)	ADVT - 6m (USD mn)	P/E			P/B			EV/EBITDA		ROE			CAGR (FY16-FY19)		
			FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY18E	FY19E	FY17E	FY18E	FY19E	Sales	EBITDA	EPS
Global Majors																
DU PONT (E.I.) DE NEMOURS	64,375	2.8	22.7	20.0	17.6	6.8	6.0	3.7	11.8	10.8	30.6	32.5	32.1	3.2	13.1	24.7
SOLVAY SA	12,316	0.3	13.9	12.8	12.1	1.3	1.3	1.2	6.4	6.1	7.7	9.3	9.7	5.9	14.6	23.8
PI INDUSTRIES LTD	1,676	1.3	28.4	23.9	20.5	7.5	6.0	4.9	17.5	15.1	29.7	27.6	25.3	17.9	20.4	20.6
VINATI ORGANICS LTD	451	0.4	21.5	17.9	15.7	4.7	3.8	3.2	10.8	9.6	22.7	22.6	21.7	11.2	14.4	14.2
AARTI INDUSTRIES LIMITED	842	0.6	17.7	14.9	12.7	4.3	3.4	NA	9.2	8.0	26.4	25.3	24.7	13.1	15.6	21.1
BASF INDIA LTD	731	0.4	-1,914.5	43.0	NA	NA	NA	NA	17.2	NA	-0.2	9.8	NA	NA	NA	NA
GUJARAT FLUOROCHEMICALS LTD	762	0.6	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
ADI FINECHEM LTD	105	0.2	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
ATUL LTD	893	1.7	19.6	16.7	14.0	3.9	3.2	NA	10.5	9.1	21.1	20.4	21.0	11.6	14.2	17.3
SRF LTD	1,307	6.5	17.8	15.0	12.4	2.9	2.5	2.1	8.7	7.4	17.1	17.5	18.3	12.8	14.2	19.2
LONZA GROUP AG-REG	9,353	0.4	22.3	18.6	17.0	4.2	3.6	3.2	10.8	10.7	18.4	18.1	18.8	5.3	12.6	26.2
KONINKLIJKE DSM NV	10,919	0.6	18.7	16.1	14.4	1.8	1.7	1.6	9.2	8.7	10.4	10.6	11.4	3.5	17.7	107.2
LANXESS AG	6,165	0.3	26.0	21.1	15.7	2.7	2.3	2.1	6.5	5.7	9.3	11.6	15.0	5.7	15.4	31.8
BASF SE	84,353	2.6	18.6	17.4	16.1	2.7	2.6	2.5	8.6	8.1	14.1	15.0	15.8	-4.1	2.6	7.9

Source; Company, Ambit Capital research

Exhibit 50: Vinati's RoCE is much superior to that of other players


Source: Company

Cross-cycle valuations

Vinati saw a sharp re-rating similar to most peers such as PI Industries, Aarti Industries and Atul Ltd since FY14. However, Vinati's multiples took a beating as the steep fall in crude prices led to concerns over ATBS volumes used in enhanced oil recovery (a key product of the company). Multiples re-rated again as visibility over earnings growth beyond FY17 emerged and the promoters announced share purchase in individual capacity at ₹500 or below.

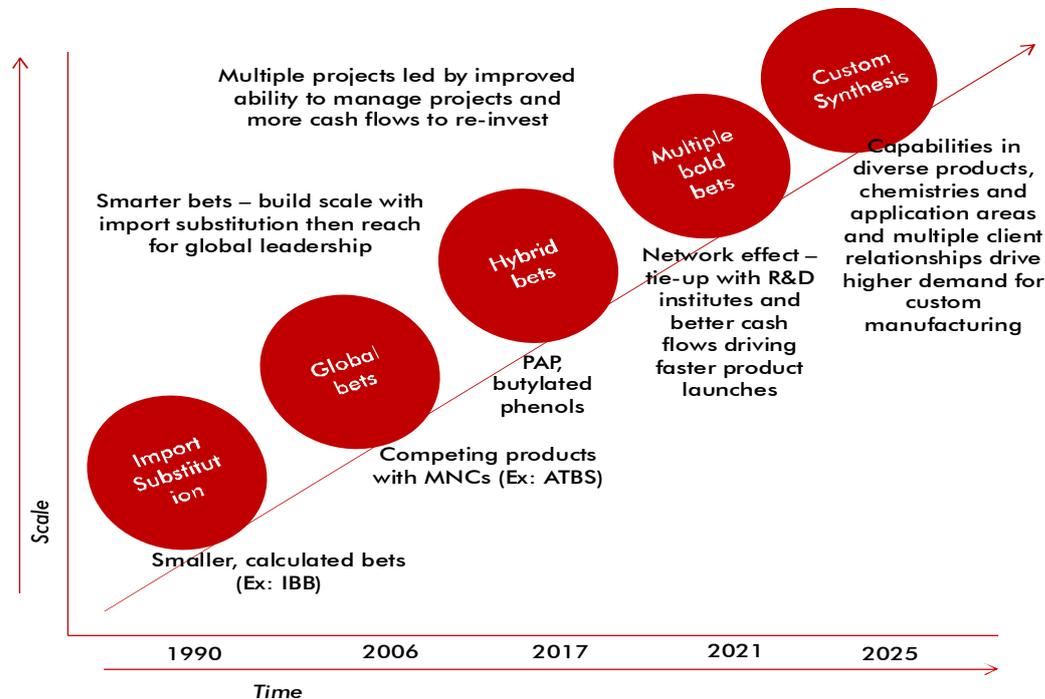
Vinati is currently trading at 18x one-year forward estimates, which is in-line with last two-year average. On P/B, Vinati is trading at 3.5x one-year forward book value, which is also in-line with the last two-year average.

Comparison with historical average is not correct given specialty chemicals as a sector started getting investor attention only over last two years. Growth opportunities for Indian specialty chemicals players has been expanding, driven by: a) growing pollution problems in China, and b) increasingly stringent norms for putting up new chemical manufacturing units in the US and Europe alongside growing labour costs. This implies

ample growth opportunities for Vinati, which has presence in multiple application areas and have access to a much wider client base.

Growing cash flows will also provide much bigger reinvestment opportunities; Vinati's business model can take up multiple projects given there are no process development bottlenecks as seen in other chemicals players in India.

Exhibit 51: We expect Vinati's business model to evolve into a much stronger one



Source: Ambit Capital research

Exhibit 52: Vinati has successfully expanded its target market by cost effectiveness and product differentiation led by process innovation and successful use of scale

		Exports	Import substitution
Cost Effectiveness	Scale	<ul style="list-style-type: none"> World's largest IBB and ATBS facility 	<ul style="list-style-type: none"> Materially lower IBB and ATBS cost vs. cost of imported products
	Process Innovation	<ul style="list-style-type: none"> Commercial product development from ATBS waste Backward integration into IB from ATBS 	<ul style="list-style-type: none"> One-step process drives cost competitiveness in PAP Sourcing of new process from Saipem, Italy for indigenous IB manufacturing
Product Differentiation	Scale	<ul style="list-style-type: none"> Using scale, market creation for multiple co-products generated from waste Constant process improvisation 	<ul style="list-style-type: none"> Good scale of domestic IB supply drove invention of new applications Scale of cash flows driving more investments in new import substitution projects
	Process Innovation	<ul style="list-style-type: none"> Greener process for PAP and IBAP would make clients choose Vinati over others Ranked in top 5 percentile by ecoVadis for green processes 	<ul style="list-style-type: none"> Tie-up with domestic R&D institutes to develop indigenous technologies Multi chemistry/application chemicals launches through asset-light R&D model

Source: Ambit Capital research

Catalysts and risks

Key risks

Regulatory risks over Ibuprofen

IBB, which is used for manufacturing of Ibuprofen, is a key product for Vinati Organics, contributing one-third of sales. Globally, ibuprofen is a preferred OTC medicine for pain relief. USFDA recently issued warnings of increased risk of heart attack w.r.t. usage of Ibuprofen. While USFDA continues to keep this drug OTC, India has removed the drug from the OTC list. However, implementation of this ban has so far been weak in India. Most of Vinati's IBB sales come from exports anyways. An interesting point to be noted here is that such concerns have been talked about for ibuprofen for many years; but, nothing has impacted the popularity of ibuprofen as an analgesic so far.

NSAIDs (Ibuprofen is a product of the same family) are effective treatments for pain, inflammation and fever. Consumers can still take them but should be aware of this increased risk of heart attack or stroke, especially at higher doses.

- USFDA statement

Execution risks for PAP

We expect PAP to be the next big product for Vinati apart from IBB, ATBS and IB. This project entails a capex similar to Vinati's current gross block. Vinati had delayed the project in FY12 due to lack of desired purity levels. The commercialisation of the project has now been announced only after additional trials over last few years, which gives us confidence that this time Vinati would achieve success in the product.

Key man risk

A key differentiator for Vinati has been Mr. Vinod Saraf's technical and manufacturing capabilities. While he has built a good execution team alongside nurturing the second generation of the promoter family, Mr. Vinod Saraf's product ideation is the secret sauce of the company's success. Due to some unforeseen reasons, if Mr. Vinod Saraf is not able to lead the ideation part of the business this could be a key risk to our thesis.

Catalysts

ATBS volume recovery

We are building in 10% volume growth for ATBS over FY17/18 after a weak FY16 wherein all the oil-related demand for ATBS (nearly 15% of ATBS volumes) was wiped out. Demand hereon would be led by water treatment chemicals.

Commercialisation of butylated phenol plant in FY19 and PAP plant in FY20

Management has indicated timelines of 12 months and 24 months for the butylated phenols and PAP plants, respectively. We build in full year of revenues from butylated phenols in FY19 and PAP in FY20. Commissioning of these plants in FY18-end and FY19-end would be key catalysts for the stock price.

Commissioning of IBAP and power plant

We expect the IBAP plant to be commissioned in FY20 and the power plant in FY18. Both will act as key margin drivers as upgrade to IBAP (forward integration of IBB) will help boost IBB margins. The power plant will save ₹80mn in terms of power cost in FY19. We haven't explicitly built these benefits into our estimates.

Appendix

Exhibit 53: Break-up of RM costs – high exposure to crude derivatives

Raw material	FY10	FY11	FY12	FY13	FY14	FY15	FY16
Toluene	442	418	679	918	999	956	645
As % of total RM cost	32%	22%	25%	27%	24%	21%	22%
Propylene	336	343	504	664	754	737	458
As % of total RM cost	24%	18%	18%	20%	18%	16%	16%
Acrylonitrile	232	542	642	553	690	892	544
As % of total RM cost	17%	29%	23%	16%	17%	20%	18%
IB	194	73					
As % of total RM cost	14%	4%					0%
MTBE		342	723	998	1,426	1,613	1,006
As % of total RM cost		18%	26%	29%	34%	35%	34%
Others	176	158	191	265	305	356	302
As % of total RM cost	13%	8%	7%	8%	7%	8%	10%
Total	1,379	1,876	2,738	3,399	4,174	4,554	2,955

Source: Company, Ambit Capital research

Exhibit 54: Explanation for the flags used on the first page

Segment	Score	Comments
Accounting	GREEN	Vinati scores well on most of accounting parameters such as earnings to cash flow conversion, CWIP/sales, volatility in depreciation rates, etc. It is in the top decile on our accounting framework.
Predictability	AMBER	Given multiple drivers for volumes of different products, volume growth over short periods of time is difficult to track.
Earnings momentum	GREEN	Earnings momentum is positive. While consensus estimates are limited, growth outlook has improved post 2QFY17.

Source: Company, Bloomberg, Ambit Capital research

Appendix

Market for PAP is well-supported by import substitution opportunity

Para amino phenol or 4-aminophenol (PAP) is one of the most widely used intermediate in the pharmaceutical industry. Primarily, PAP is used in the manufacture of paracetamol, a widely used over-the-counter analgesic (pain reliever) and antipyretic (fever reducer). More than 80% of para amino phenol worldwide is used for manufacturing paracetamol (in pharmaceuticals) while 7 % is used as rubber antioxidant and 5% is used in dyes and miscellaneous purposes.

Global demand scenario

Covidien Ltd is the world's largest paracetamol maker with an estimated capacity of 30,000 TPA. It is the only Western manufacturer remaining in the game. India and China accounted for about 100k TPA of paracetamol production in 2013, more than 70% of global capacity. Out of the 100k, 65k paracetamol manufacturing happens in China.

The demand of PAP in India based on paracetamol capacity that exists is close to 38,500 TPA. India currently imports close to 21000 TPA of PAP. All the imports of PAP happen from China.

Domestic demand scenario

India is one of the major users of p-amino phenol and is the second-largest market for this product after China. The demand for PAP in India based on paracetamol capacity is close to 38,500 TPA. However, the PAP and paracetamol capacity is not being fully utilised. Easy availability of competitive PAP from China, pollution and credit terms are the major reasons for the imports. India currently imports close to 21000 TPA of PAP. All the imports of PAP happen from China.

Vinati is establishing 30,000 TPA capacities

Total demand for PAP globally is 130,000- 150,000 TPA

Vinati's right to win is its cleaner process and 20% cost difference vs Chinese imports

The conventional manufacturing route is a multistep process involving iron/acid reduction, which poses a serious environmental problem. The proposed route involves catalytic hydrogenation of nitrobenzene to give p-aminophenol directly. Having a greener process and at the same time being competitive to the Chinese in terms of cost gives us a fair degree of comfort in Vinati gaining rapid market share in PAP and displacing players using polluting processes. In India, given PAP is predominantly imported, Vinati should get a good market share given its product is 20% cheaper than imports.

Chinese players use polluting process

China has a lot of manufacturers of PAP and paracetamol. However, all the notable ones which are large and established use a polluting process which leads to production of metal sludge.

Butyl Phenol to is a well thought out project for import substitution

Butyl phenols are intermediates which find application as raw materials for products that go into a wide variety of 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. Around 35-40% of the total quantity finds application in the perfumery industry. Around 15% is used for plastic additives and the remaining butyl phenols are used for inks/resins and lubricants.

Vinati is planning to manufacture the following for butyl phenols:

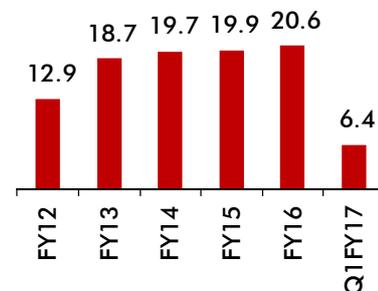
- Para-Tertiary Butyl Phenol (PTBP)
- Ortho-Tertiary Butyl Phenol (OTBP)
- 2,4-Di Tertiary Butyl Phenol (2,4-DTBP)
- 2,6-Di Tertiary Butyl Phenol (2,6-DTBP)

Indian imports ~20500 MTPA, which can be substituted by Vinati’s integration with IB

India is a net importer of butyl phenols. The total demand of these butyl phenols in India is currently 20,500 MTPA. In India, currently, there are no manufacturers for butyl phenols. Previously, companies like Herdillia (Now SI Group), Balmer Lawrie, Naik Naware Chemical Pvt Ltd tried to manufacture these products. However, due to lack of scale and IB supply constraints, they couldn’t manufacture products economically. Vinati, with its backward integration of IB, can easily replace this import demand.

- By volume, PTBP is the largest product amongst the four butyl phenols. It is mostly imported from Korea, Taiwan, Singapore and Russia. There are 2 grades of PTBP imported into India – technical grade used for perfumery application and standard grade that is used in resin/ink application.
- OTBP comes second by volume amongst the four butyl phenols. It goes entirely into manufacturing perfumery products. All leading Indian perfume manufacturing companies use OTBP. This product is imported from Switzerland and Taiwan.
- The use of 2,4-DTBP and 2,6-DTBP is currently smaller. These two products are used for manufacturing antioxidants, which are used as additives for plastics. With increasing use of plastics and composites in India, the use of these butyl phenol based antioxidants is expected to grow rapidly. 2,4-DTBP and 2,6-DTBP are imported into India from Switzerland, Taiwan, Singapore and China.

Value of imported Butyl Phenols in India (in ‘000 MT per annum)



Source: Company, Ambit Capital

Domestic market size for butyl phenols is ~21000 MT

The value of imported butyl phenols in India is ~₹3bn. We believe this is a low hanging fruit for Vinati as the company would be cost competitive due to backward integration with IB. In addition to this, because of availability of raw materials like 2,4-DTBP and 2,6-DTBP, there will be an increase in the manufacturing of antioxidants and UV stabilisers in India.

Global butyl phenol market could add another 10000-15000 TPA

Globally, butyl phenols are well-known compounds that are widely used in numerous applications. While, in India, PTBP and OTBP are large volume products, globally, 2,6-DTBP and 2,4-DTBP are the large volume products. Globally, these di-tertiary butyl phenols are widely used in lubricants, plastic additives and fuel additives. The use of 2,6-DTBP as a jet fuel additive is 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, Kaoching, Tasco and DIC. Almost all these butyl phenol manufacturers are forward integrated and also manufacture antioxidants for plastics and lubricants from di-tertiary butyl phenols. The estimated capacity of butyl phenols globally is close to 400000 TPA.

Promoter made open market purchases until ₹ 515/share levels

Insider trading

The promoters filed an intention to increase their stake in Dec 2016 by giving a trading plan to the stock exchange for increasing their stake to 75% provided the share price is lower than ₹500. Management said it is a binding statement and promoters would start buying shares after the completion of the 6-month cooling period which ends in June 2016. The promoters recently bought ~150k shares.

SEBI requires promoters to submit their trading plans 6 months before the actual period of trading. We note that the promoters have followed the trading norms.

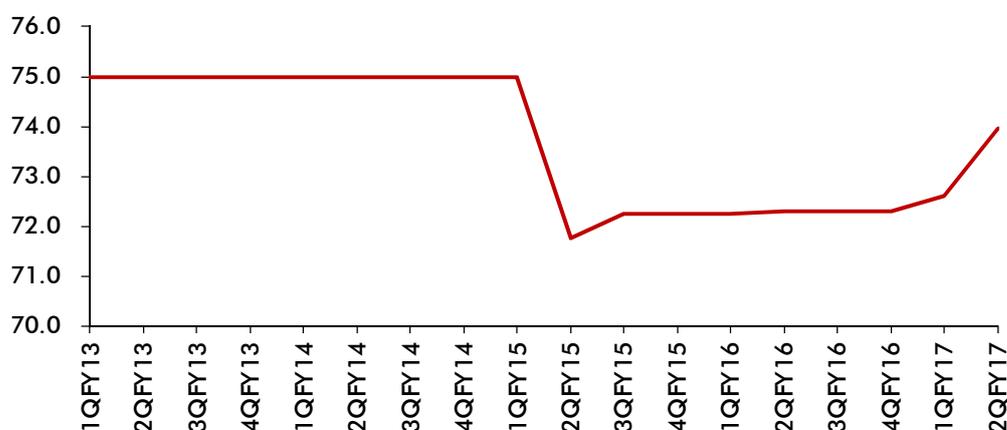
Exhibit 55: Recent insider trades

Date	Name	Net buy	Close Price
1-Apr-12	Abha Sharma	10,000	83.45
30-Apr-12	Abha Sharma	1,500	92.95
21-Feb-13	Viral Saraf Mittal	3,750	106.15
31-Jul-13	Viral Saraf Mittal	3,883	102.3
6-Aug-13	Viral Saraf Mittal	1,117	96.55
4-Jul-14	Suchir Chemicals	1mn	341.45
3-Nov-14	Suchir Chemicals	25,000	426.55
11-Nov-14	Vinod B Saraf	36,300	410.85
21-Nov-14	Suchir Chemicals	23,100	421.05
24-Nov-14	Suchir Chemicals	24,500	425.05
1-Dec-14	Suchir Chemicals	24,000	422.3
2-Dec-14	Suchir Chemicals	23,500	422.35
4-Dec-14	Suchir Chemicals	24,000	421.55
10-Dec-14	Suchir Chemicals	25,000	417.25
16-Dec-14	Suchir Chemicals	17,500	419
21-Sep-15	Suchir Chemicals	31,000	468.1
7-Jun-16	Suchir Chemicals	117,500	492.85
8-Jun-16	Suchir Chemicals	40,000	514.65

Source: Bloomberg

Promoter holding came down to 72% as IFC exercised the FCCB option. Promoters are looking to raise their stake to 75% again.

Exhibit 56: Promoter shareholding declined as IFC converted its FCCBs in Vinati by acquiring 4.4% stake; promoters gradually picked up stake from the open market



Source: Company, Ambit Capital research

Managerial remuneration still below 2% of PBT

Vinati's managerial remuneration as a percentage of PBT is significantly lower than that of the peer set. The increase in managerial remuneration (26% CAGR) has been broadly in line with the increase in PBT (24% CAGR) over FY11-16.

Exhibit 57: Managerial remuneration as a percentage of PBT

Company	Managerial Remuneration/PBT						CAGR (FY11-16)	
	FY11	FY12	FY13	FY14	FY15	FY16	MR	PBT
Vinati	1.8%	1.7%	1.2%	1.5%	1.2%	1.9%	26%	24%
Camlin	6.6%	9.1%	8.0%	6.7%	6.3%	7.0%	42%	40%
PI Industries	0.2%	0.1%	0.1%	0.1%	0.1%	0.1%	17%	35%
Aarti	16.3%	6.8%	4.8%	2.3%	2.5%	2.9%	-8%	30%
Atul	2.3%	3.1%	2.6%	2.6%	3.0%	3.2%	32%	24%
Peer group median (ex Vinati)	4.4%	5.0%	3.7%	2.5%	2.8%	3.1%	30%	32%
Divergence with median	260	330	250	100	160	114	364	799

Source: Company, Ambit Capital research

Earnings to cash flow conversion

Vinati's average cash conversion of 84% over FY11-16 is substantially higher than the peer median of 77%. The company's cash conversion cycle has increased marginally from 79 days in FY11 to 87 days in FY16. The increase in debtor days in FY16 was primarily due to increased domestic sales which have a credit period of 90-100 days vs export credit period of 55-60 days.

Exhibit 58: Cash conversion analysis

	FY11	FY12	FY13	FY14	FY15	FY16
Vinati	62%	41%	95%	111%	86%	103%
Camlin FS	39%	-92%	135%	61%	68%	91%
PI Industries	33%	77%	77%	101%	81%	106%
Aarti	46%	66%	80%	92%	85%	117%
Atul	61%	69%	97%	62%	98%	109%
Peer group median (ex Vinati)	43%	68%	89%	77%	83%	107%

Source: Company, Ambit Capital research

Vinati Organics' P&L statement

Year to March (₹ mn)	FY14	FY15	FY16E	FY17E	FY18E	FY19E
Net Sales	6,961	7,717	6,309	6,920	8,370	10,553
% growth	26%	11%	-18%	16%	21%	26%
Operating expenditure	5,432	5,800	4,242	4,721	5,576	6,889
EBITDA	1,529	1,918	2,067	2,199	2,794	3,664
% growth	27%	25%	8%	6%	27%	31%
Depreciation	153	177	185	274	304	554
EBIT	1,467	1,833	1,944	1,993	2,569	3,199
Interest expenditure	181	98	79	20	122	122
Non-operating income	92	91	62	68	78	90
Adjusted PBT	1,286	1,735	1,865	1,973	2,446	3,077
Tax	424	577	550	592	734	923
Adjusted PAT	862	1,158	1,315	1,381	1,712	2,154
% growth	12%	15%	21%	5%	24%	26%

Source: Company, Ambit Capital

Vinati Organics' Balance Sheet

Year to March (₹ mn)	FY14	FY15	FY16E	FY17E	FY18E	FY19E
Shareholders' equity	99	103	103	103	103	103
Reserves and surpluses	3,002	4,237	5,305	6,685	8,398	10,552
Total net worth	3,101	4,340	5,408	6,789	8,501	10,655
Debt	1,100	372	133	-	3,000	4,000
Deferred tax liability	331	390	492	492	492	492
Total liabilities	4,532	5,103	6,033	7,281	11,993	15,147
Gross block	3,711	4,123	4,851	6,851	10,851	13,851
Net block	3,042	3,273	3,819	5,545	9,241	11,687
CWIP	101	200	248	248	248	248
Investments (non-current)	27	27	27	27	27	27
Cash & cash equivalents	338	182	722	45	727	929
Debtors	1,151	1,291	1,148	1,324	1,607	2,035
Inventory	466	545	447	493	596	752
Loans & advances	620	840	423	423	423	423
Total current assets	2,582	2,887	2,755	2,300	3,368	4,154
Current liabilities	783	634	720	743	795	873
Provisions	206	256	117	117	117	117
Total current liabilities	989	889	837	860	912	989
Net current assets	1,593	1,998	1,918	1,440	2,456	3,164
Net Long term Assets	33	29	20	20	20	20
Total assets	4,796	5,528	6,033	7,280	11,993	15,147

Source: Company, Ambit Capital research

Vinati Organics' Cash Flow Statement

Year to March (₹ mn)	FY14	FY15	FY16E	FY17E	FY18E	FY19E
Net profit before tax	1,286	1,735	1,865	1,973	2,446	3,077
Depreciation	153	177	185	274	304	554
Others	-	-	-	-	-	-
Tax	(365)	(520)	(447)	(592)	(734)	(923)
(Incr)/decr in net working capital	98	(233)	73	(199)	(335)	(506)
Cash flow from operations	1,315	1,126	1,675	1,408	1,726	2,235
Capex (net)	(294)	(422)	(732)	(2,000)	(4,000)	(3,000)
(Incr)/decr in investments	167	(146)	(33)	-	-	-
Other income (expenditure)	-	-	-	-	-	-
Cash flow from investments	(90)	(535)	(722)	(1,932)	(3,922)	(2,910)
Net borrowings	(256)	(419)	(240)	(133)	3,000	1,000
Issuance/buyback of equity	-	-	-	-	-	-
Interest paid	(71)	(49)	(33)	(20)	(122)	(122)
Dividend paid	(121)	(120)	(181)	-	-	-
Cash flow from financing	(1,135)	(746)	(502)	(153)	2,878	878
Net change in cash	89	(156)	451	(677)	681	202
Free cash flow	1,021	704	942	(592)	(2,274)	(765)

Source: Company, Ambit Capital

Vinati Organics – Key Ratios

Year to March	FY2014	FY2015	FY2016	FY2017E	FY2018E	FY2019E
PBT margin (%)	18.5%	22.5%	29.6%	28.5%	29.2%	29.2%
Net profit margin (%)	12.4%	15.0%	20.8%	20.0%	20.5%	20.4%
Dividend payout ratio (%)	20.1%	18.8%	18.9%	0.0%	0.0%	0.0%
RoCE (post-tax) (%)	22.5%	23.7%	23.7%	21.0%	18.7%	16.5%
RoIC (%)	24.1%	25.0%	25.7%	22.2%	19.4%	17.6%
RoE (%)	31.3%	31.1%	27.0%	22.6%	22.4%	22.5%
Working Capital Turnover	6.8	7.1	6.0	6.9	6.6	6.3
Gross Block Turnover	2.0	2.0	1.4	1.2	0.9	0.9

Source: Company, Ambit Capital

Valuation Summary

Year to March	FY2014	FY2015	FY2016	FY2017E	FY2018E	FY2019E
EPS (₹)	17.5	22.4	25.5	26.8	33.2	41.7
Diluted EPS (₹)	17.5	22.4	25.5	26.8	33.2	41.7
BVPS (₹)	62.8	84.1	104.8	131.6	164.7	206.5
Dividend per share (₹)	3.5	4.2	4.8	-	-	-
P/E (x)	34.0	26.4	23.3	22.2	17.9	14.2
P/BV (x)	9.4	7.0	5.7	4.5	3.6	2.9
EV/EBITDA (x)	19.6	16.0	14.5	13.9	11.8	9.2
EV/EBIT (x)	20.5	16.8	15.4	15.3	12.8	10.5
EV/Sales (x)	4.3	4.0	4.8	4.4	3.9	3.2

Source: Company, Ambit Capital

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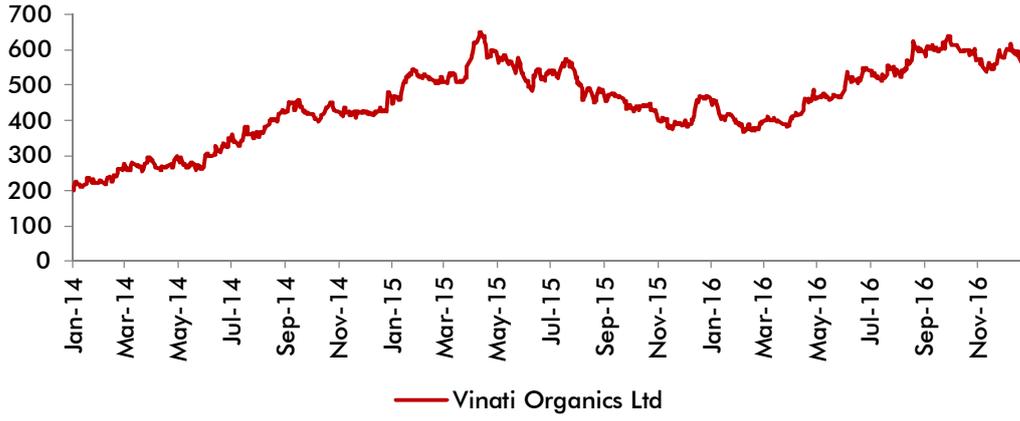
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Vinati Organics Ltd (VO IN, BUY)



Source: Bloomberg, Ambit Capital research

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month)
BUY	> 10%
SELL	≤ 10%
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