Zuari Agro Chemicals Ltd

January 16, 2017

DALAL & BROACHA
STOCK BROKING PVT. LTD.

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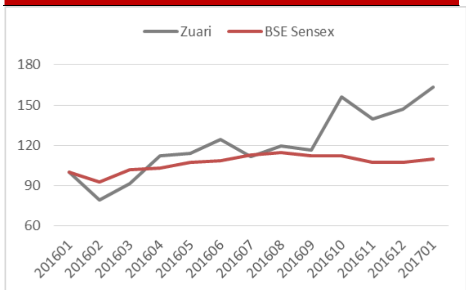
Initiating Coverage @ Dalal & Broacha

BUY	
Current Price	254
Target Price	382
Upside/Downside	50%
52 Week Range	Rs118/263

Key Share Data	
Market Cap (Rs.bn)	10.5
Market Cap (US$ mn)	155
No of o/s shares (mn)	42.06
Face Value	10
Monthly Avg.vol (BSE+NSE) Nos'000	97.7
BSE Code	534742
NSE Code	ZUARI
Bloomberg	ZUAC IN Equity

Price performance



% Shareholding	**Dec-16**	**Sep-16**
Promoters	65.7	73.8
Institutions	10.4	11.5
Non-Institution	23.9	14.7
Total	**100.0**	**100.0**

We are positive on Fertiliser sector as we believe companies in the sector are likely to improve their financials driven by lower working capital to sales which can lead to re-rating of the sector. Our underlying assumption is that Government will have to repay subsidy dues before the implementation of the DBT scheme. We like Zuari Agro and Chemicals Ltd as company is likely to benefit the most.

A Turnaround Story

For NPK fertiliser manufacturing companies, subsidy per ton of the fertiliser has been declining since the introduction of Nutrient Based Subsidy (NBS). However, trade receivables continued to pile up to significant levels due to delays by the Government with regard to payment of subsidy on account of inadequate provision in the Union Budget for subsidy, which every year has to be subsequently revised upwards with a time lag. Consequently, companies have to borrow heavily to fund high level working capital. Within the sector, Zuari has significantly higher net working capital to sales ratio compared to peers, reflected in bleeding ROEs of the company over the years. We expect ROEs of the company to turnaround from negative 1.5% in FY16 to 9.4% in FY18E and 15.9% in FY19E.

Raw Material Access – Key Competitive Advantage

Raw material cost constitute 75-80% of the revenue for phosphatic and complex fertiliser industry. Zuari has following tie-ups with global partners to ensure the certainty of the availability of the raw materials. With falling trend in raw materials gross margins are expected to remain stable in the near term.

Strong Marketing Reach of Group

Adventz Agri Business Group comprises of three leading fertiliser companies – Zuari Agro Chemicals Ltd, Paradeep Phosphates Ltd, Mangalore Chemicals &Fertilisers Ltd. The group has a pan-India presence through the three well-established brands – Jai Kissan Navratna and Mangala. Company plans to leverage the consumer connect of the three brands.

Outlook & Valuation

With normalized inventory level and better utilisation, volume growth for the company is expected to improve. Over next two years, company is going to focus on two key strategies to improve future financial performance one, by reduction in debt levels with better working capital management and second by higher focus on complexes and non-subsidy business revenue growth over next 3 years. Company's products offerings are similar to Coromandel Intl. With strong management team in place, optimization of product mix (more in favour of non-subsidy and complex fertilisers) over next 3 years, we expect the profitability and return ratios of the company to turnaround on a sustainable basis. In our opinion, company is well-placed to turn positive free cash flow (FCF) in FY17 from negative FCF in FY16. We recommend a buy with a target price of Rs 382. At our target price, stock should trade at a P/E multiple of 10x and 6x on FY18E and FY19E consolidated EPS, respectively.

Key Financials (Rs mn) – Standalone

Year	Net Sales	% Growth	EBIDTA	OPM %	Adj. PAT	% Growth	EPS	P/E (x)	ROE %	RoCE %
FY16	52,537.6	-460.9	1,674.3	3.2	(114.5)	NA	(2.7)	NA	-1.5%	3.4%
FY17E	42,192.9	-19.7	2,231.5	5.3	642.2	NA	15.3	16.6	8.4%	5.4%
FY18E	49,226.5	16.7	2,586.6	5.3	775.1	20.7	18.4	13.8	9.4%	6.4%
FY19E	55,146.5	12.0	3,195.8	5.8	1,484.8	91.6	35.3	7.2	15.9%	8.3%

Investment Arguments

A Turnaround Story

For NPK manufacturing companies, subsidy per ton of the fertiliser has been declining since the introduction of NBS.

Per kg NBS rates for nutrients (in Rs per kg)

Nutrient	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	% change
N	23.2	27.2	24.0	20.9	20.9	20.9	15.9	-24%
P	26.3	32.3	21.8	18.7	18.7	18.7	13.2	-29%
K	24.5	26.8	24.0	18.8	15.5	15.5	15.5	0%
S	1.8	1.7	1.7	1.7	1.7	1.7	2.0	22%

Source: Company, Industry, Dalal & Broacha Research

However, trade receivables continued to pile up to significant levels due to delays by the GoI with regard to payment of subsidy on account of inadequate provision in the Union Budget for subsidy, which every year has to be subsequently revised upwards with a time lag. Consequently, companies have to borrow heavily to fund high level working capital.

Within the sector, Zuari has significantly higher net working capital to sales ratio compared to peers.

% Net Working Capital/ Net Sales

Company	FY13	FY14	FY15	FY16
Coromandel Inter	31%	20%	24%	25%
G S F C	43%	34%	38%	44%
R C F	36%	38%	40%	47%
Chambal Fert.	48%	40%	33%	38%
Nagarjuna Fert.	42%	24%	8%	16%
Zuari Agro Chem.	63%	53%	43%	54%

Source: Company, Industry, Dalal & Broacha Research

Peer Comparison

(Rs mn, Standalone)	CMP	MCAP	Sales	OP. Margin	PAT Margin	D/E	Subsidy Outstanding	Subsidy Outstanding / Revenue	Subsidy / Mcap
Coro. Intl.	328	95,658	115,002	7.5%	3.1%	0.95	20,170	18%	21%
G N F C	265	41,132	45,483	14.5%	5.0%	1.16	10,838	24%	26%
R C F	57	31,446	86,494	6.7%	2.2%	1.06	39,280	45%	125%
Chambal Fert.	84	34,771	95,363	5.7%	0.9%	2.07	30,936	32%	88%
Zuari Agro.	254	10,683	52,538	5.6%	-0.3%	4.26	17,110	33%	160%

Source: Company, Industry, Dalal & Broacha Research

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DBT – Implementation to lead to Turnaround the sector

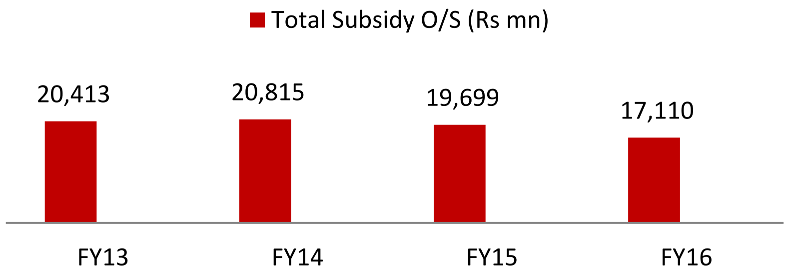
National Informatics Centre (NIC) and fertilizers department have been proactive in implementation of Direct Benefit Transfer (DBT) in fertilizers. Pilot run has started in 2 districts. Post the success of the pilot run, government is expected to implement it across the country.

We believe that with DBT implementation over the period of next 2-3 years, the gradual shift in subsidy payment mechanism are expected to significantly provide working capital relief to the fertiliser companies.

Key changes expected	Current Subsidy Regime	DBT	Impact on the companies
Time Period of subsidy payment	3 to 4 months for 85% of the subsidy, while balance **15% remains outstanding for 3-5 years**	100% on 2 weeks after the sale	Lower Working Capital Requirement
Process	Complex process requiring a lot of time	Simplified and quick online system	Subsidy is received faster
Point of release	Released when the product reaches the district	Released when the actual sales is done	Helps to create a standard payment system
Need for verification	After the bill is generated the government needs to verify the sale with the farmer	Need of verification doesn't exist as it is aadhar linked	Helps to lower the subsidy payment time lag
Subsidy payment break up	85% when the product enters the district	100% on sales	Lower working capital requirement
	15% on verification after sale has taken place		

Source: Company, Industry, Dalal & Broacha Research

Zuari Agro Chemical Ltd – Subsidy Outstanding



15% outstanding subsidy accumulated over the years represents 90% of the total subsidy outstanding in the balance sheet.

Source: Company, Dalal & Broacha Research

Borrowings and Receivables details (Rs mn)

	ZACL			PPL (100%)			MCFL			Total	
	Sep'16	Mar'16	Sep'16	Sep'16	Mar'16	Sep'16	Sep'16	Mar'16	Sep'16	Sep'16	Mar'16
Borrowings											
Short Term	21320	35100	27170	20280	23450	19800	5510	11960	7590	47110	70510
Long Term	3500	2500	0	4570	5080	3990	1790	2010	1790	9860	9590
Total	**24820**	**37600**	**27170**	**24850**	**28530**	**23790**	**7300**	**13970**	**9380**	**56970**	**80100**
Subsidy Receivables	10410	17110	10380	9050	12250	9070	6210	10430	7430	25670	10430
Trade Receivables	11560	13990	11070	10160	11090	7160	5610	4860	3450	27330	4860
Inventories	4710	4250	11070	7220	7150	9790	2720	2400	4620	14650	2400

Source: Company, Dalal & Broacha Research, ZACL – Standalone business, PPL – Joint Venture, MCFL - Subsidiary

During H1FY17, with sharp fall in the gas prices, Zuari has registered improvement in working capital situation. Subsidy outstanding as on Q2FY17, stood at Rs 10,400mn versus Rs 10,380mn on Q1FY17, and Rs 17,110mn on FY16. Company received Rs 670mn till Q2FY17. Going forward, management believes subsidy is likely to be lower on effective implementation of gas price pooling. Consequently, it will help cut debt on a YoY basis.

Targeting Lower Debt Levels in FY17

Targeting Lower Debt Levels in FY17 (Rs mn)	FY16	FY17E
Standalone	37600	27000
PPL	28530	20000
MCFL	13970	10000

Source: Company, Dalal & Broacha Research

COMMON SIZE	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E
Revenue from operation (Net)	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Operating Cost	-83.9%	-80.0%	-77.6%	-77.7%	-79.6%	-75.9%	-76.3%	-76.4%
Gross Profit	16.1%	20.0%	22.4%	22.3%	20.4%	24.1%	23.7%	23.6%
Employee Benefit Expenses	-0.9%	-1.4%	-1.5%	-1.5%	-1.6%	-1.9%	-1.9%	-1.9%
Other expenses	-11.5%	-14.6%	-17.5%	-16.7%	-15.5%	-17.1%	-16.6%	-16.1%
EBITDA Excl OI	3.7%	3.9%	3.4%	4.0%	3.2%	5.1%	5.1%	5.6%
Other Income	0.9%	1.1%	0.8%	0.9%	2.5%	3.0%	2.6%	2.3%
EBITDA	4.6%	5.1%	4.3%	4.9%	5.7%	8.1%	7.7%	7.9%
Depriciation Expenses	-0.3%	-0.5%	-0.4%	-0.3%	-0.5%	-0.8%	-0.7%	-0.6%
EBIT	4.3%	4.6%	3.9%	4.6%	5.2%	7.3%	7.0%	7.3%
Intrest Cost	-1.9%	-4.0%	-5.0%	-4.2%	-5.7%	-6.7%	-4.7%	-3.4%
PBT	2.4%	0.6%	-1.2%	0.4%	-0.6%	0.7%	2.3%	3.9%
Total Tax Expenses	-0.8%	-0.1%	0.1%	-0.2%	0.3%	-0.2%	-0.7%	-1.3%
PAT	1.7%	0.5%	0.5%	0.2%	-0.3%	-0.6%	1.5%	2.6%

Source: Company, Dalal & Broacha Research

Impact of DBT Implementation on Zuari's Financials - Scenario

	FY15	FY16	Post DBT	
% of Subsidy Outstanding Paid by Government			100%	
Sales	55,076	52,538	52,538	Assuming Same level of Sales
Total Receivables in B/S	26,516	27,067	9,982	
Of which Subsidy Receivalbes	19,699	17,110	-	Assuming Govt pays enitre subsidy dues
As % of Sales	35.8%	32.6%	0.0%	
Normal Business Receivables	6,817	9,957	9,982	
As % of Sales	12%	19%	19%	
Borrowings	23,820	33,343	13,740	
Of which Short Term	23,820	31,056	11,453	
Long Term	-	2,288	2,287	
Interest Cost	2,328	3,005	1,170	
Cost of Debt	9.32%	10.52%	8.5%	Factoring lower cost of debt by 200 bps
EBIT (Rs mn)	2,535	2,710	2,710	
% Margins	4.6%	5.2%	5.2%	Assuming same level of efficiency.
PBT	207	(323)	1,540	
Tax	84	(159)	462	
Tax Rate	40%	49%		
PAT	124	(164)	1,078	
EPS	2.9	(3.9)	25.6	Indicates Turnaround at same level of efficiency.

Source: Company, Dalal & Broacha Research

However, two critical requirements for success of the DBT are:

1. Government must pay off entire subsidy outstanding (Rs 430bn, as per industry information) due over the years before starting new DBT mechanism
2. Building necessary technology infrastructure for effective execution of DBT scheme

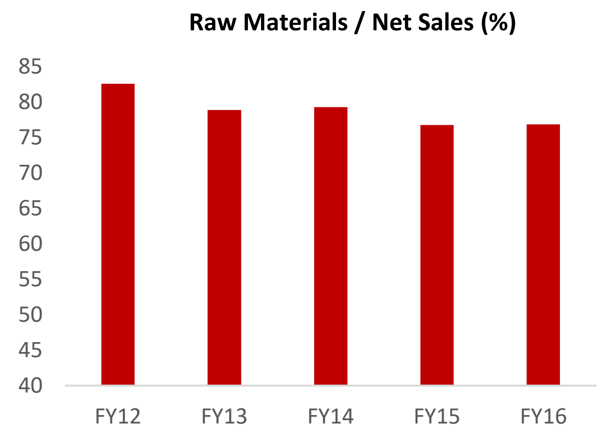
There exists a risk in terms of higher requirement of working capital in first year of initial implementation of the DBT scheme, as companies will have to wait for 100% of the subsidy receivable amount till final sale is made to the farmer. However, in our opinion, once the payment cycle normalises, overall time taken for payment of subsidy can come down sharply as proposed weekly subsidy payment cycle is implemented under DBT. We have assumed gradual decline in debtor days during FY17-19E.

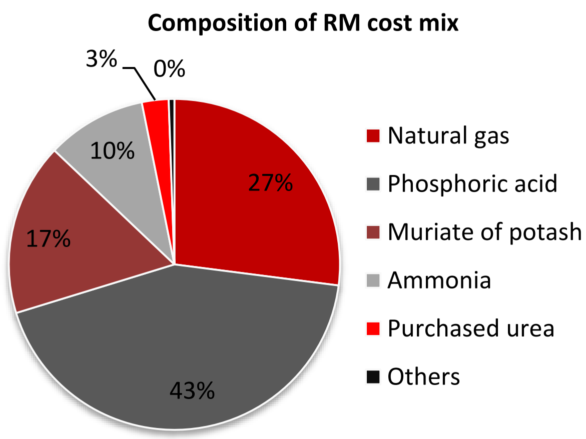
We believe going forward over next 3-5 years, we are likely to see major reforms in Fertiliser sector and following are the key indications:

1. No better time for Government to implement the DBT when Gas prices have declined sharply
2. Government will demonstrate Pro-farmer reforms such as Direct Benefit Transfer (DBT) of fertiliser subsidy before next General Elections in 2019
3. Government emphasis on Online Payments Systems
4. DBT experiment in 16 districts in this year to evaluate the problems
5. Certainty that Government wants to reduce on subsidy burden in budget, long term solution to this problem is one-time pain of paying off old subsidies outstanding and start with new DBT for fertiliser subsidy.

Raw Material Access – Key Competitive Advantage

Raw material cost constitute 75-80% of the revenue for phosphatic and complex fertiliser industry.



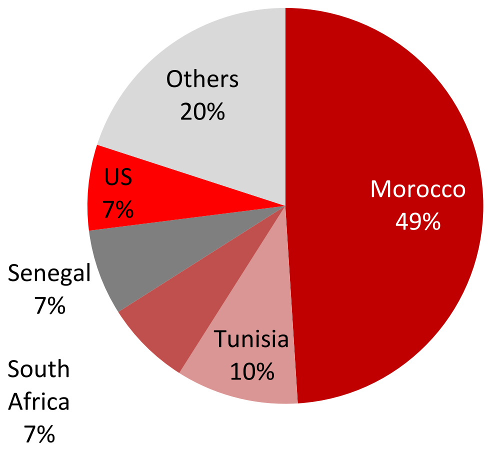


Source: Company, Dalal & Broacha Research

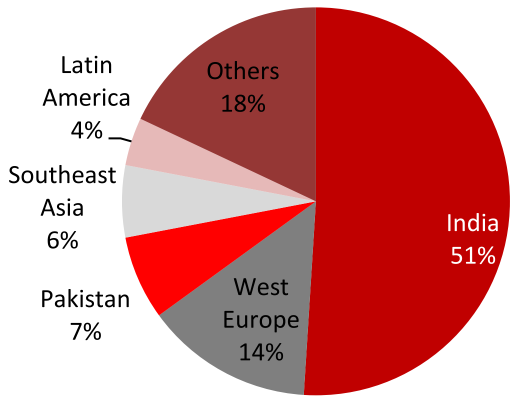
Import Dependence for Raw Materials

Import dependence is high because of the lack of sufficient availability of cost effective raw materials in India. Key raw materials / intermediates imported include ammonia, phosphoric acid, rock phosphate, sulphur and MOP. Phosphoric acid and rock phosphate are in short supply in the global market and hence durable tie-ups with producers in overseas countries is a source of competitive advantage for the domestic players. Ultimately, the ability to control the overall cost of production remains a key source of strength for the players. The cost of production is influenced by import prices, exchange rate fluctuations and conversion efficiency. Adequate handling systems and storage facilities, given the high import dependence, also impart competitive advantage.

World Acid Exports 2013

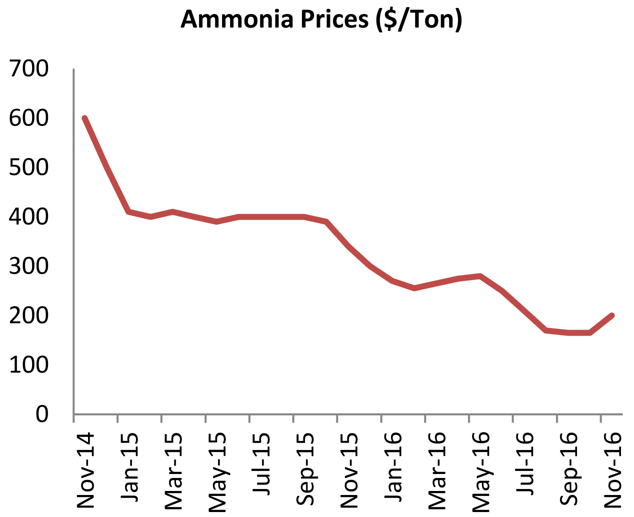


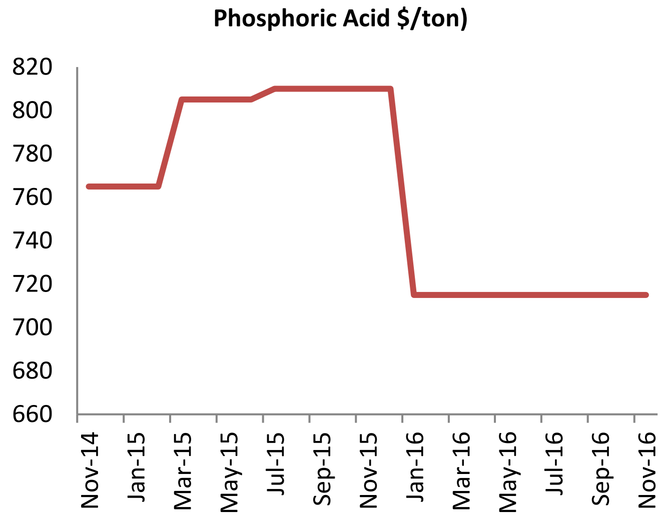
World Acid Imports 2013

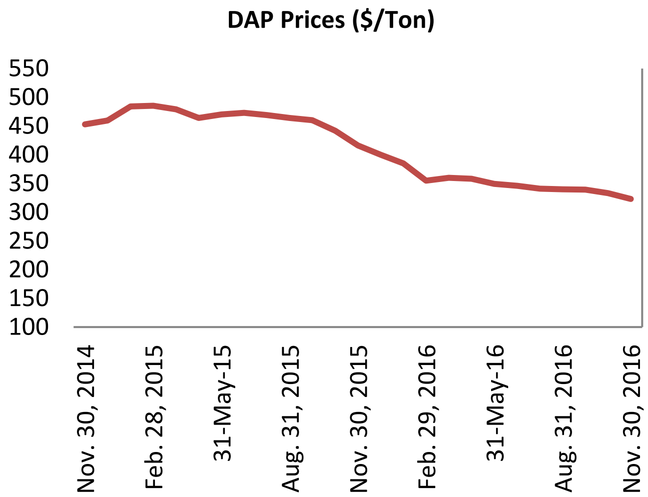


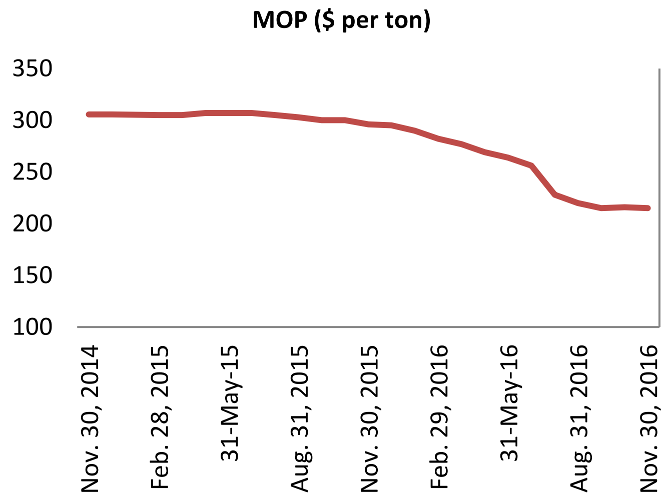
Source: Company, Industry, Dalal & Broacha Research

Favourable Trends in Raw Materials









Source: Bloomberg, Dalal & Broacha Research

Zuari has following tie-ups with global partners to ensure the certainty of the availability of the raw materials.

Raw Material	Partner	Remarks
Phosphoric Acid/ Rock	OCP, Morocco	OCP has 33% market share of Rock and 47% market share of Phos Acid.
Ammonia	Muntajat, Qatar	
Muriate of Potash	APC(Jordan),Canpotex (Canada), BPC(Belarus), Uralkali (Russia)	

Source: Company, OCP, Dalal & Broacha Research

Update on key Subsidiaries and Joint Ventures

(I) Paradeep Phosphates Ltd (Joint Venture)

Zuari has entered into 50:50 joint venture with O.C.P. Morocco, to create a holding company. This holding company holds 80% in stake in Paradeep Phosphates and balance 20% is held by Government of India. Paradeep Phosphates is located in Paradeep Orissa, was acquired through Government's divestment plan. Its DAP capacity is 0.72mmt, sulphuric acid 0.66mt, and phosphoric acid 0.225mmt. This strategic partnership with OCP makes it a significant player in the P&K industry. PPL has recently augmented its phosphoric acid and sulphuric acid capacities, which could drive profits from FY17. Company has shown improvement in profitability in Q2FY17 and outlook remains positive.

Key financial Summary:

Particulars Rs in mn	FY-2014	FY-2015	FY-2016	Q1FY2017	Q2FY2017
Revenue	**42893**	**42128**	**48388**	**7041**	**10853**
EBITDA (Before exceptional)	895	2045	2618	155	1021
margin (%)	2.1%	4.9%	5.5%	2.2%	9.4%
PAT	-1259	433	679	-761	302
margin (%)	-2.9%	105.0%	1.4%	-15.4%	5.8%
Net Debt	**21729**	**18519**	**27173**	**26403**	**24687**

Source: Company, Dalal & Broacha Research

(II) MCA Phosphates Pte (Joint Venture)

Zuari also has 30% stake in MCA Phosphate Pte, with Mitsubishi Corp, registered in Singapore. The JV holds 30% stake in FOSPAC (a company in exploration and production of rock phosphate in Peru). The JV will purchase the entire production of rock for exports for minimum 20 years.

(III) Mangalore Chemicals & Fertilisers (Subsidiary)

- Zuari has a 53% stake in Mangalore Chemicals and Fertilisers.
- Mangalore Chemicals and Fertilizers Limited ("MCFL") is engaged in the manufacture and sale of urea, diammonium phosphate and complex fertilisers, ammonium bicarbonate, sulphonated naphthalene formaldehyde, plant nutrition products and plant protection chemicals.
- Also engaged in the sales of Crop Care, ABC, SNF. Currently operating on Naptha. Facility converted for dual use of Naptha & Gas
- Company has advantage of Port connectivity & infrastructure in place at Mangalore port.
- MCFL has one manufacturing facility located at Penambur, Mangalore in Karnataka

Particulars Rs in mn	FY-2014	FY-2015	FY-2016	Q1FY2017	Q2FY2017
Revenue	**33148**	**25903**	**30065**	**5594**	**8485**
EBITDA (Before exceptional)	2247	1706	1068	372	613
margin (%)	6.8%	6.6%	3.5%	6.6%	7.2%
PAT	709	375	-2401	-84	153
margin (%)	2.1%	1.4%	-8.0%	1.5%	1.8%
Net Debt	**14930**	**10220**	**13859**	**10032**	**7297**

Source: Company, Dalal & Broacha Research

(IV) Zuari Fertiliser & Chemicals Ltd (Subsidiary, SSP Business)

Company's subsidiary – Zuari Fertiliser & Chemicals Ltd operates India's largest SSP manufacturing plant at Mahad, Maharashtra with capacity of 200000 MTPA. Sugarcane, Onion and Banana are the crops where SSP is applied. Company has strong reach and brand in the regions, it operates.

Particulars Rs in mn	FY-2016	Q1FY2017	Q2FY2017
Prodution Qty (MTs)	**49081**	**10100**	**12830**
Sales Qty (MTs)	53000	5018	16896
Total Revenue	**524.2**	**50.8**	**158.6**

Source: Company, Dalal & Broacha Research

Non-Fertiliser Products Revenue to increase contribution to Consolidated Revenue

Apart from fertilisers (Subsidy dependent business), company operates in non-fertiliser products through its 100% subsidiaries such as:

Particulars	Business Description	Current Revenue	Potential Revenue
Crop Care (Zuari Agri Sciences Ltd)	Zuari has a presence in all the geographies across India	Rs 2300mn	Rs 5000mn (Over 3 years)
	Tie ups with MNCs in India for marketing.		
Seeds Business (Zuari Agri Sciences Ltd)	The Company has a current product offering of hybrids across its crop segments that include cotton, maize, paddy, pearl millet, tomato, Okra, hot pepper, mustard	Rs 450mn	Rs 4000mn (Over 5 years)
	Invested in collection of Germplasm lines		
	Expected to launch new products in the next 2-3 years		
	The Company has built a strong pan-India sales / distribution network with offices in 12 cities and tie-ups with 1,600+ distributors and 25,000 dealers / sub-dealers		
Speciality Plant Nutrients Business (Zuari Speciality Fertilisers Ltd)	Specialty Fertilizers are broadly categorized as, 1) Water Soluble Fertilizers-Market Leader in WSF (24% market share) 2) Micronutrients 3) Fortified Organic Manures & Biofertilizers 4) Soil Amendment Formulations 5) Specialty Agri Fluids	Rs 3356mn	NA

Source: Company, Dalal & Broacha Research

Currently these contribute very insignificantly to the consolidated revenue (5% of FY16 revenue). Through Jai Kisan Junctions, (currently, 100 stores operational), company plans to push for non-fertiliser products sales. Management expects this business to fare well going forward leading to increasing contribution from this non-subsidy dependent revenue stream. This should help the company to build a long term sustainable revenue model with better profitability (similar to Coromandel International Ltd) than the traditional business. Management aims to increase revenue contribution to 20% of revenue over 3-5 years.

The key to success in this segment of business is the distribution strength which Adventz already has – needs to be exploited.

Strong Marketing Reach of Group

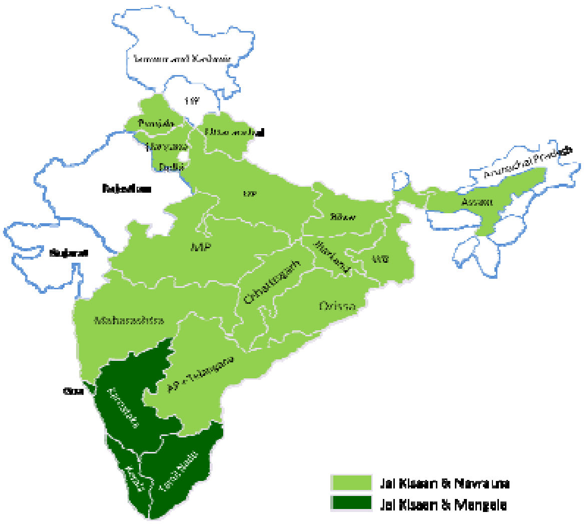
Adventz Agri Business Group comprises of three leading fertiliser companies – Zuari Agro Chemicals Ltd, Paradeep Phosphates Ltd, Mangalore Chemicals &Fertilisers Ltd. The group has a pan-India presence through the three well-established brands – Jai Kissan Navratna and Mangala. Company plans to leverage the consumer connect of the three brands.

Adventz Agri Business Group – Market Share Details

Product	Market Share in India
Urea	3.3%
DAP	13.3%
NPK	14.9%
MOP	11.2%

Source: Company, Dalal & Broacha Research

Geographical Brand Presence



Jai Kissan Junctions (100 centers / H1FY17 Revenue of Rs 410mn)

Positioning	Key Value Proposition: Convenience, Reliability and experience
	Assurance of Right Quality and Quantity
	High level of Service & Knowledge
	Enhanced buying experience due to better interiors and good ambience at stores
Business Model	Location: Identified based on potential Sales, mostly Taluka place.
	Showroom space: 500-750 sq mt.
	Audio-visual and internet supported aids
	One Permanent and one outsourced Agronomist available in store
Synergies	Synergies with existing Channel Partners
	Extension of knowledge of scientific farming to the farmers which will help in strengthening the brand

Source: Company, Dalal & Broacha Research

Industry - Current Situation - Excess Inventory Levels leading to muted Volumes Growth

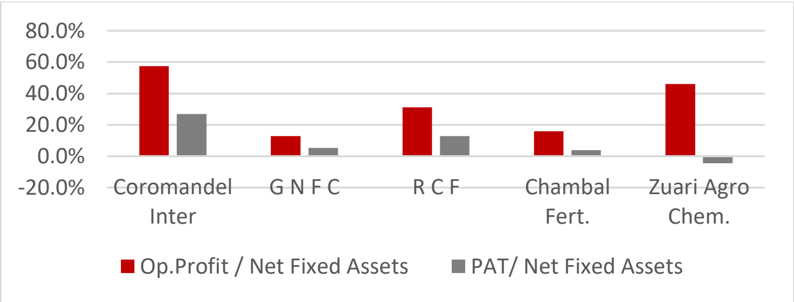
- Normally April to Aug and Nov to Jan is the demand pick up season for fertilisers however, production has to be conducted throughout the year due to higher cost of plant shutdowns.
- Due to 2 bad monsoons, Industry-wide inventory level is high at ~40% of annual consumption vs. normal level of ~15-20% (2 months)
- Gas Prices are down by 15-20% YoY which leads to lower Gas Subsidy Per ton – leading to lower realization on Urea.

ROE Analysis

(FY16)	Coro. Intl.	G N F C	R C F	Chambal Fert.	Zuari Agro Chem.
NP / PBT	0.68	1.00	0.66	0.29	0.61
PBT / EBIT	0.71	0.48	0.67	0.77	-0.15
EBIT / Sales	0.07	0.10	0.05	0.06	0.05
Sales / Assets	2.51	0.63	1.57	1.42	1.4
Assets / Equity	2.02	2.82	1.99	2.89	4.7
ROE (%)	**17.1%**	**8.5%**	**6.9%**	**5.5%**	**-3.0%**

Source: Company, Dalal & Broacha Research

Zuari Agro - Return on Fixed Asset Parameters



Source: Company, Dalal & Broacha Research

Peer - Valuations

	CMP	P/E (x)		EPS	
	(Rs)	FY18E	FY19E	FY18E	FY19E
Coro. Intl.	335	16.7	14.6	18.8	21.5
Chambal Fert.	84	7.8	7.4	10.3	10.8
Zuari Agro.	254	6.6	4.0	38.7	63.3

Source: Company, Dalal & Broacha Research

Note:

1. Zuari Agro – Dalal & Broacha Research- Consol estimates, Coromandel and Chambal – Bloomberg Consensus – Consol. Estimates
2. PPL – will be treated as an associate hence consol revenue of Zuari are likely to be reduced to that extent as per IND-AS accounting.

Key Assumptions – P&L Account (Standalone)

	FY14	FY15	FY16	FY17E	FY18E	FY19E
Total Volumes (MT) (ie Own Mfg+ Traded)	**1.4141**	**1.4387**	**1.5434**	**1.4952**	**1.6329**	**1.7701**
% Growth		1.7%	7.3%	-3.1%	9.2%	8.4%
Realization	*36,602*	*38,281*	*34,040*	*28,219*	*30,146*	*31,154*
% Growth		4.6%	-11.1%	-17.1%	6.8%	3.3%
Maufactured (MT)	**0.8937**	**1.0051**	**1.0438**	**0.9876**	**1.0492**	**1.1280**
% Growth		12.5%	3.9%	-5.4%	6.2%	7.5%
Realization	*38,061*	*37,115*	*32,111*	*27,958*	*30,329*	*31,503*
% Growth		-2.5%	-13.5%	-12.9%	8.5%	3.9%
Traded (MT)	**0.5203**	**0.4337**	**0.4997**	**0.5076**	**0.5838**	**0.6422**
% Growth		-16.7%	15.2%	1.6%	15.0%	10.0%
Realization	*34,308*	*41,305*	*38,348*	*29,643*	*29,778*	*30,500*
% Growth		20.4%	-7.2%	-22.7%	0.5%	2.4%
Gross Margins	22.4%	22.3%	20.4%	24.4%	23.9%	23.9%
Manufactured	30.7%	26.5%	26.9%	28.7%	26.0%	26.0%
Traded	7.2%	13.9%	9.5%	11.0%	12.0%	12.0%
EBIDTA (Rs mn)	1,761	2,227	1,674	2,231	2,587	3,196
EBIDTA (Rs per ton)	1,246	1,548	1,085	1,492	1,584	1,805

Key Assumptions – Balance Sheet (Standalone)

	FY14	FY15	FY16	FY17E	FY18E	FY19E
Trade Payble Days	41	62	36	30	35	40
Debtor Days	202	176	188	175	150	130
Inventory Days	39	37	31	40	35	35
Working Capital days	191	142	191	191	158	135
Turnover ratios (x)						
Net sales to total assets	16.5	15.1	11.5	9.1	10.5	12.7
Net sales to working capital	1.9	2.6	1.9	1.9	2.3	2.7
Debt equity ratio	3.2	3.0	4.2	3.5	3.2	2.6

Outlook & Valuation

Going forward, over next 2 years, with normalized inventory level, expected pick up in volume growth with better operating efficiency gives revenue growth visibility with better profitability.

Company's ongoing capex of Rs 1400mn on the sulphuric acid plant, gypsum pond and debottlenecking of detrain of complexes which will get commissioned in April or May 2017. This can help in improving the operating efficiency which we have not factored in our estimates. Further, management is also evaluating plans to revamp the Goa plant and Mangalore chemicals and fertilizers plant which will lead to increase in capacity and energy savings in future. However, certain clarifications are awaited from the Government, post which capex plan will be finalized.

Over next two years, company is going to focus on two key strategies to improve future financial performance:

1. Reduction in debt levels with better working capital management which we believe is a certainty in the light of DBT scheme implementation for fertilisers.

2. Higher focus on complexes (better margins) and non-subsidy business revenue growth.

Company's products offerings are similar to Coromandel International. With strong management team in place, we see optimization of product mix to be executed over next 3-5 years.

Consequently, we expect the profitability and return ratios of the company to turnaround on a sustainable basis. In our opinion, company is well-placed to turn positive free cash flow (FCF) in FY17 from negative FCF in FY16. We recommend a buy with a target price of Rs 382. At our target price, stock should trade at a P/E multiple of 10x and 6x on FY18E and FY19E consolidated EPS, respectively.

SOTP-based target price valuation based on FY18 estimates	Methodology		Per Share
Standalone Business (ZACL)	P/E Multiple	8x FY19E EPS	282
Paradeep Phosphates Ltd (40% Equity)	EV/EBIDTA	10x FY18E EBIDTA	58
Managalore Chemicals (53% Equity)	Market Capitalisation	50% Hold. Co Disc.	35
Seed Business (Zuari Agri Sciences)	Book Value	1x FY16 Book Value	7
Value of the firm			**382**

DCF Based Valuation Method

Particulars	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27
EBIT Standalone	2,535	2,710	3,202	3,557	4,166	4,416	4,681	4,962	5,260	5,575	5,910	6,264	6,640
EBIT (I-T)	2452	2869	3102	3175	3435	2959	3136	3324	3524	3735	3960	4197	4449
Dep	179	278	343	343	343	361	379	398	417	438	460	483	507
	2630	3147	3445	3519	3778	3319	3515	3722	3941	4174	4420	4680	4956
Capex	-1413	-2040	-1400	-1400	-1000	-500	-500	-500	-500	-500	-500	-500	-500
Change in WC	5677	-6106	5514	709	780	858	944	1038	1142	1256	1381	1520	1672
FCFF	6,894	(4,999)	7,559	2,827	3,558	3,677	3,958	4,260	4,583	4,929	5,301	5,700	6,128
FCFF Growth Rate		-173%	-251%	-63%	26%	3%	8%	8%	8%	8%	8%	8%	8%
Weights			1	2	3	4	5	6	7	8	9	10	11
Cost of Capital %	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%
	1	1	0.89	0.80	0.71	0.64	0.57	0.51	0.46	0.41	0.36	0.32	0.29
PV FCFF	6,894	(4,999)	6,755	2,258	2,539	2,345	2,256	2,169	2,086	2,005	1,926	1,851	1,778

Sum of PV of FCF	26,189
Calculation of Terminal Value	
Terminal Growth Rate	6%
	6,042
Terminal Value	61,967
PV of Terminal Value	14,353
Enterprise Value	40,542
Add: Cash & Investments	100
Less: Debt	(27,066)
Market Capitalisation	13,577
No. of shares	42
Value per share	**323**

Source: Company, Dalal & Broacha Research

Company Background

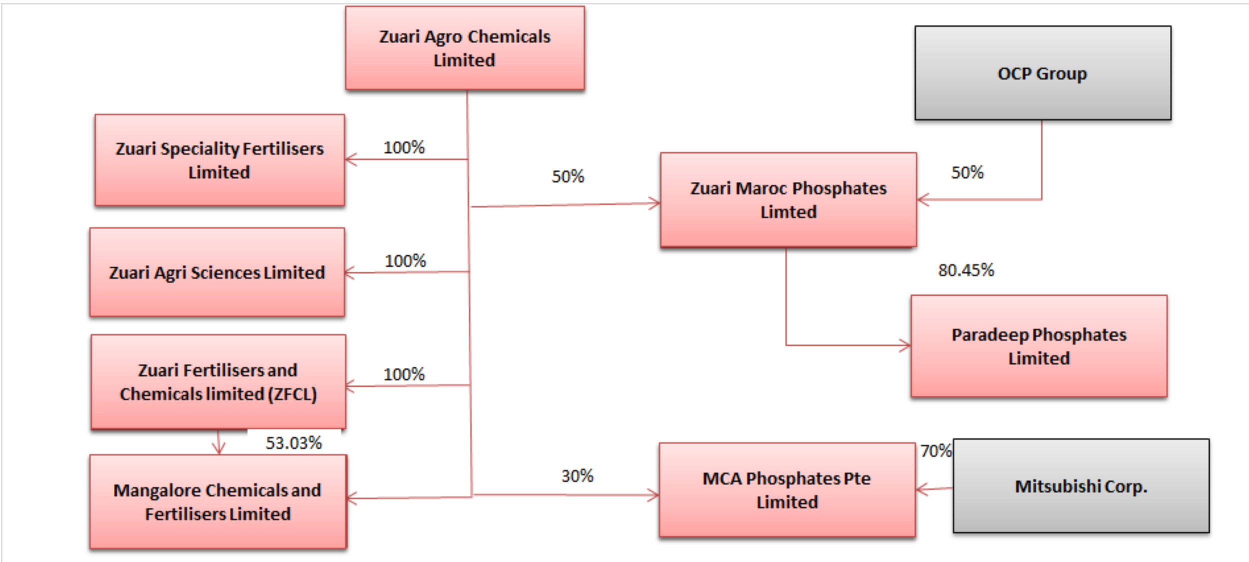
Zuari Agro Chemicals Ltd established in Zuari is a single-window agricultural solution provider with presence in businesses across four major verticals Agribusiness, Engineering and Infrastructure, Emerging Lifestyle and Services.

Key business area of the company include:

- Nutrients: Urea, DAP, MOP, Complex Fertilizers, SSP
- Crop Protection: Insecticides, Fungicides and Herbicides
- Seeds: Cotton, Maize, Paddy, Mustard
- Speciality Fertilisers: SOP and Water Soluble Fertilisers
- Micro-nutrients: Zinc Sulphate, Sulphur, Boron

Company's focus is on Complex fertilisers and non-fertiliser products for driving growth going forward.

Corporate Structure



Source: Company, Dalal & Broacha Research

Manufacturing Plants – Geographically well-placed

Zuari's operations are spread across five key marketing areas – Goa, Maharashtra, AP, Karnataka and Tamil Nadu. The company has a manufacturing facility at Goa, with four plants, dedicated to manufacturing urea, DAP and NPK based fertilizers. Company has manufacturing presence in South India through its subsidiary company – Mangalore Chemical & Fertilisers Ltd has plant located Panambur, Mangalore. Paradeep Phosphates Ltd (in which Zuari holds 40% stake) has plant located in Paradeep, Orissa.)

Plant locations

Particulars	Location	Urea	DAP/NPK	SNF	SSP	Water Solubles	Total
Zuari Agro Chemicals	Goa	399300	860000				1259300
Paradeep Phosphates	Paradeep, Orissa		1200000				1200000
Mangalore Chemicals Fertilizers	Mangalore	379500	255500	21500			656500
Zuari Fertilizers & Chemicals	Mahad, Maharashtra				200000		200000
Zuari Speciality Fertilizers	Baramati, Maharashtra					12000	12000
Total		**778800**	**1835500**	**30000**	**200000**	**12000**	**3327800**

Source: Company, Dalal & Broacha Research

Key Management Team

Kapil Mehan, Managing Director

Zuari Agro Chemicals Ltd and Paradeep Phosphates Ltd

Mr. Mehan is a graduate in Veterinary Science and Animal Health from the Punjab Agricultural University, Ludhiana and holds a Postgraduate Diploma in Management (PGDM) with specialization in Agriculture from the Indian Institute of Management, Ahmedabad (1981). Armed with an extensive experience, he has held several prominent leadership positions and strategic roles in prestigious companies such as Rallis India, Tata Chemicals and Coromandel International.

Suresh Krishnan, Managing Director

Mangalore Chemicals & Fertilizers Ltd

Mr. Krishnan is an alumnus of BITS Pilani and has 25 years of corporate experience in fertiliser, energy and cement sectors. He has been associated with the Adventz Group for over two decades and has been widely acknowledged for his dynamic leadership, vision and commitment. His functional experience spans corporate finance, corporate strategy, projects planning, operations and business development.

Zuari Agro Chemicals Financials

Profit & Loss (Rs Mn)	FY15	FY16	FY17E	FY18E	FY19E
Net Sales	55,076	52,538	42,193	49,226	55,146
Total Cost of goods sold	(42,818)	(41,845)	(31,907)	(37,460)	(41,972)
Gross Profit	**12,258**	**10,693**	**10,286**	**11,766**	**13,175**
Employee Benefit expense	(825)	(863)	(821)	(956)	(1,072)
Other expenses	(9,206)	(8,156)	(7,233)	(8,224)	(8,907)
Operating Profit	**2,227**	**1,674**	**2,231**	**2,587**	**3,196**
Depreciation	(179)	(278)	(343)	(343)	(343)
Other Income	487	1,314	1,314	1,314	1,314
Finance costs	(2,328)	(3,005)	(2,898)	(2,400)	(1,950)
PBT	**207**	**(295)**	**304**	**1,157**	**2,216**
Tax expense	(84)	159	(100)	(382)	(731)
PAT	**124**	**(137)**	**203**	**775**	**1,485**
Exceptional Items*	0	(22)	(439)	0	0
Reported PAT	**124**	**(159)**	**(235)**	**775**	**1,485**
Adjusted PAT	**123.6**	**(114.5)**	**642.2**	**775.1**	**1,484.8**

Balance Sheet (Rs Mn)	FY15	FY16	FY17E	FY18E	FY19E
Equity Capital	421	421	421	421	421
Reserves	7,613	7,454	7,219	7,808	8,935
Net Worth	**8,034**	**7,875**	**7,640**	**8,228**	**9,356**
Total Debt	23,820	33,343	26,488	26,563	24,767
Trade payables	9,400	5,123	3,468	4,720	6,043
Other current liabilities	2,430	2,793	2,645	2,746	2,831
Short term provisions	364	271	218	254	285
Deferred tax liabilities	251	92	92	92	92
Total Liabilities	**44,299**	**49,497**	**40,549**	**42,603**	**43,373**
Gross Block	5,819	6,888	7,288	7,688	7,688
Accumulated Depreciation	3,159	3,303	3,646	3,990	4,333
Net Block	2,660	3,585	3,642	3,698	3,355
Intangible assets	13	19	19	19	19
Capital WIP	978	970	1,000	1,000	1,000
Total Fixed Assets	**3,638**	**4,555**	**4,642**	**4,698**	**4,355**
Investments	3,293	3,693	3,693	3,693	3,693
Long term loans & advance	3,730	5,512	4,426	5,164	5,785
Sundry debtors	26,516	27,067	20,229	20,230	19,641
Cash & bank	**10**	**26**	**100**	**115**	**150**
Short term loans & advanc	478	2,910	2,337	2,726	3,054
Inventories	5,579	4,395	4,046	4,720	5,288
Other current assets	1,056	1,340	1,076	1,255	1,406
Total Assets	**44,299**	**49,497**	**40,549**	**42,603**	**43,373**

*Note: Price reduction claims estimating to Rs 438.6mn have been included under exceptional item.

Cash Flow Statement (Rs Mn)	FY15	FY16	FY17E	FY18E	FY19E
Cash Profit	**302**	**142**	**547**	**1,119**	**1,828**
(Inc) / Dec in					
Sundry Debtors	2,110	-551	6,837	-1	589
Inventories	11	1,184	350	-674	-568
Loans & Advances	1,326	-2,432	573	-390	-328
O. Current Assets	-573	-284	264	-179	-151
Sundry Creditors	3559	-4277	-1655	1252	1323
Other Current Liabilites	-786	321	0	0	0
Other Current Liabilites	89	42	-149	101	85
Provisions	-68	-93	-53	36	31
Change in Working Capital	5668	-6090	6167	146	981
CF from Operating Activities	**5971**	**-5948**	**6714**	**1264**	**2809**
CF from Investing Activities	(3,601.9)	(3,378.0)	655.6	(1,137.9)	(621.1)
CF from Financing Activities	(2,377.6)	9,342.4	(7,294.5)	(111.5)	(2,153.2)
Cash Generated (Utilised)	(8.7)	16.1	74.7	15.0	34.9
Cash at the start of year	18.3	9.6	25.7	100.4	115.4
Cash at the end of year	9.6	25.7	100.4	115.4	150.3

Ratios	FY15	FY16	FY17E	FY18E	FY19E
OPM	4.0	3.2	5.3	5.3	5.8
NPM	0.2	(0.3)	(0.6)	1.6	2.7
Tax Rate (in %)	40.3	53.7	33.0	33.0	33.0
Growth Ratio					
Net Sales	6.4	(4.6)	(19.7)	16.7	12.0
Operating Profit	26.4	(24.8)	33.3	15.9	23.6
PAT	(53.2)	(228.6)	48.0	(429.5)	91.6
Per Share					
Adj. Earning Per Share (EPS)	2.9	(2.7)	15.3	18.4	35.3
Cash Earnings (CPS)	7.2	2.8	2.6	26.6	43.5
Dividend	2.4	0.0	0.0	4.4	8.5
Book Value	191.0	187.2	181.6	195.6	222.4
Free Cash flow	56.3	(221.7)	175.2	3.0	52.0
Valuation Ratios					
P/E (x)	86.4	-93.3	16.6	13.8	7.2
P/B (x)	1.3	1.4	1.4	1.3	1.1
EV / Sales	0.6	0.8	0.9	0.8	0.6
EV / EBIDTA	15.5	22.1	16.6	14.3	11.6
Div. Yield (%)	0.9	0.0%	0.0%	1.7%	3.3%
FCF Yield (%)	22.2	-87.3%	69.0%	1.2%	20.5%
Return Ratios (%)					
ROE	1.5%	-1.5%	8.4%	9.4%	15.9%
ROCE	6.4%	3.4%	5.5%	6.4%	8.3%

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