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YEARS

Demerger Opportunity

GHCL Ltd.

30-Aug-2021

RETAIL RESEARCH

GHCL Ltd.

Industry	LTP	Recommendation	Fair Value	Time Horizon
Commodity Chemicals	Rs. 352.1	Buy at LTP & add more on dips to Rs 300-304 band	Rs. 499	1 year

HDFC Scrip Code	GUJHEA
BSE Code	500171
NSE Code	GHCL
Bloomberg	GHCL IN
CMP Aug 27, 2021	352.1
Equity Capital (Rs cr)	95.0
Face Value (Rs)	10.0
Equity Share O/S (cr)	9.5
Market Cap (Rs cr)	3358.0
Book Value (Rs)	261.5
Avg. 52 Wk Volumes	122790
52 Week High	401.8
52 Week Low	141.2

Share holding Pattern % (June, 2021)	
Promoters	19.2
Institutions	38.1
Non Institutions	42.7
Total	100.0

Retail Research Risk Rating:

	Blue	

*** Refer at the end for explanation on Risk Ratings**

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Demerger:

GHCL approved a proposal to demerge its textile business into a separate entity in March 2020, whereby GHCL's shareholders will get shares in 1:1 ratio in the new textile entity, and both businesses will be listed as separate business entity. The textile business will cease to be the company's subsidiary after the restructuring. Textiles constitutes 35.1% of its total revenue, as on FY21.

In Sept-2020, the Competition Commission of India (CCI) approved the demerger of the Textiles Business of GHCL Ltd. into its wholly owned subsidiary GHCL Textiles Ltd ("GHCL Textiles"). In Apr-2021, shareholders and unsecured creditors had already approved the scheme of demerger and secured creditors have approved the scheme of demerger of GHCL's Inorganic Chemicals and Textile businesses in July-2021. With this the company will now approach the honorable NCLT for their approval. Overall, demerger process is likely to over by the end of 2021. The listing of Textile business as a GHCL Textiles Ltd may happen after a few months of record date for demerger.

Our Take

The company expects this demerger to deliver various operational and strategic benefits to each Business segment such as focused growth, concentrated approach, business synergies and increased operational and customer focus. Besides, it will address independent business opportunities with efficient capital allocation and attract different set of investors, strategic partners, lenders and other stakeholders, thus the demerger is expected to result in enhanced value creation for stakeholders.

GHCL continues to derive strength from its integrated position in the domestic soda-ash industry. It has a healthy operating performance in its soda-ash division, led by strong clientele, cost competencies (mainly on the back of its captive mines of lignite and limestone along with availability of salt), and favorable demand-supply dynamics of domestic soda ash industry in the medium term.

In the Home textiles segment, yarn has witnessed robust domestic demand, especially from low/medium value garments. There has also been growth in profitability on account of reduction in employee costs, third-party work allowing higher plant utilization levels, and yarn prices increasing more than cotton prices, thereby improving the spread. Though the benefit of lower cotton prices will no longer be available in the next quarter, we don't see a big impact on the margins as long as the higher costs are being passed over.

On 10 March, 2021, we had initiated coverage on GHCL Ltd and recommended to buy at LTP of Rs 234 & add on dips to Rs 217-219 band for base case target of Rs 272 and bull case target of Rs 292. Given healthy growth outlook and strong set of numbers in Q1FY22, we have now revised earnings.

Valuations & Recommendation:

GHCL has an established position in the domestic soda ash industry, and has captive source of raw material for lignite, limestone and salt, leading to cost competencies. Further, its soda-ash division meets most of the power requirement through captive sources. Thus, given its consistent ability to generate cash and sustainable demand across sectors, we are positive on the soda ash business. The outlook for Home Textile business has also enhanced substantially, given the stable margin profile, led by firm pricing and cost initiatives.

This restructuring will maximize value for all stakeholders, leading to a better focus on the demerged business. This demerger is intended to deliver various operational and strategic benefits to each business segment such as focused growth, concentrated approach, business synergies, and increased operational and customer focus.

The demerger of the Textiles division could result in value unlocking and give each segment the valuations they deserve. The process of demerger could get over in the next few months. We think once the record date for the demerger is announced, the stock price could begin to perform anticipating value unlocking.

Fair Value

Amount In Rs.Cr.	TTM June 2021 Total	TTM June 2021 Chemicals	TTM June 2021 Textiles
Sales	3302.1	2063.3	1238.9
EBITDA *	745.6	512.4	232.7
Interest*	79.3	48.5	30.8
Depreciation*	134.5	85.9	48.6
Other income*	27.3	18	9.3
PBT	559.1	396	162.6
Tax*	143.3	101.5	41.8
PAT	415.8	294.5	120.8
EBIT after OI	638.4	445.9	192.6
*= Derived figures			

Equity Capital	95.01	95.01	19.0
FV Rs.	10	10	2
EPS Rs.	43.8	31.0	12.7
P/E attributed		12	10
Fair Value Rs.		372	127
Total Fair value Rs.			**499**

Comparing its Soda ash business with Tata Chemical, the stock is trading at a big discount. On TTM basis, Tata Chemical is trading at 39.8x EPS. We value the stock at 70% discount to the valuations attracted by Tata Chemicals. Therefore, fair value of this business is Rs 372. On Textile business, we are comparing with Welspun India which is trading at 17.8x TTM EPS. We value Textiles business at 10x TTM EPS. Thus, fair value is Rs 127. **Therefore fair value of both business is Rs 499.** If these discount to the listed peers narrows, the stock price has a potential to move even higher.

Investors can buy the shares at the LTP and add on dips to Rs.300-304 band. At the LTP of Rs 348.1, the stock is trading at 5.8x FY23E EPS.

Financial Summary (Consolidated)

Particulars (Rs Cr)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	FY20	FY21	FY22E	FY23E
Total Operating Income	854	452	88.9	826	3.4	3305	2900	3295	3714
EBITDA	186	76	143.9	195	-4.8	823	686	804	912
Depreciation	34	33	3.2	33	2.8	131	133	134	142
Other Income	5	4	5.9	7	-37.7	18	27	23	24
Interest Cost	17	28	-41.7	19	-11.8	120	91	63	56
Tax	37	6	505.4	39	-5.7	98	112	135	163
APAT	103	13	692.3	111	-7.7	491	376	495	574
Diluted EPS (Rs)	10.8	1.4	692.3	11.7	-7.7	51.7	39.6	52.1	60.4
RoE-%						24.1	16.2	18.8	19.2
P/E (x)						6.8	8.9	6.8	5.8
EV/EBITDA						5.3	5.7	4.8	4.0

(Source: Company, HDFC sec)

GHCL Q1FY22 results key takeaway

- GHCL Ltd reported above expected numbers in Q1FY22, and reported healthy volume growth with positive realization gains supported by consistent demand in the key end user categories. This positive trend could continue going forward as demand has been stabilizing. Consolidated revenue grew by 88.9% YoY to Rs 854 crore, led by healthy volume growth in soda ash based on strong demand recovery and healthy growth in textile business.
- EBITDA grew to Rs 186 crore in Q1FY22 vs. Rs 76 crore in Q1FY21. EBITDA margin stood at 21.7% in Q1FY22 vs 16.8% in Q1FY21. Net profit stood at Rs 103 crore vs. Rs 13 crore. PAT margin was at 12% in Q1FY22.
- On Segmental front, Inorganics Chemicals division's revenue stood at Rs 526 crore in Q1FY22 vs. Rs 345 crore in Q1FY21. Home Textiles business revenue stood at Rs 328 crore in Q1FY22 vs. Rs 107 crore in Q1FY21.

Investment rationale

Soda ash Division

- GHCL is 2nd the largest manufacturer of soda ash in India with 25% market share, with an installed production capacity of 1.1 million ton per annum (mtpa). The company is the second largest manufacturer of soda ash in India, with 25% market share.
- It also has captive sources of raw material lignite, limestone and salt, leading to cost competencies. Furthermore, its soda ash division also meets most of its power requirement through captive sources, which makes it one of India's most cost-efficient player in this industry.
- Demand for flat glass continues to remain strong due to demand from construction and solar glass segment, the recovery in container glass is slow due to subdued activities in the hospitality and tourism sector. The detergent industry was impacted in April and May, but is now operating at pre-COVID level. To offset Increase in raw material and energy prices, GHCL has taken a price increase effective from June and another price increase in the month of July.
- GHCL's brownfield expansions could support its overall margins and returns. Earlier, GHCL had planned to take up capacity expansion project to increase the installed capacity at its existing location from 11 lakh MTPA to 12 lakh MTPA; however, due to COVID-19 pandemic and subsequent lower demand from glass makers, it has restricted this capacity expansion to 11.50 lakh MTPA. It is also planning to expand sodium bicarbonate capacity.
- GHCL has proposed to set up a greenfield project of 0.5mtpa in the next 4-5 years at a cost of Rs.3000 cr, for which the company submitted the application to the Government of Gujarat for getting these lands to registered in the company's name and also filed the

application for the Greenfield environmental clearances. GHCL will undertake a staggered phase-wise capex with a conservative debt/equity mix to ensure healthy credit metrics during the construction phase.

- The company expects to double the Refined sodium bi-carbonate (RSC) or baking soda capacity to 120,000MT from current 60,000 MT which is expected to commission by Sept’22 at a cost of Rs.200 cr. Also, 50,000MT of soda ash de-bottlenecking should be operational by Q4FY22E. The Greenfield soda ash expansion (500,000MT) may take another ~3-5 years. Post this expansion it aims to become India’s largest Soda Ash company.
- GHCL has appointed a dedicated team of 4-5 experienced people, along with hiring a consultant, to improve the overall product basket with higher value-added products in the chemical segment.

<u>Home textile Division</u>

- GHCL is India’s one of the leading integrated textile manufacturers and exporters and is recognized for its premium product development capabilities. Its total spinning capacity stands at 1.85lk spindles while its processing capacity is 45 Mn MTPA. It has unique bedding brands focused on sustainability. These are – REKOOP, CIRKULARITY, MEDITASI and REKOOP 2.0.
- The company primarily exports home textile products worldwide, to its marquee clients including Kohl’s, Bed, Bath & Beyond, QVC, Dillard’s, Revman International, Sunham, Amazon.com, Walmart.com, Sainsbury’s, Canningvale, etc.
- GHCL’s home textiles business current processing capacity stands at 45mn meters of wide width processing, 12 mn meters of weaving capacity and 30 mn meters of cut and sew. It has spinning facility with a capacity of 27000 tonnes (1.85 lac spindles).
- It has seen unexpected headwinds in the past five years, due to increased competitive intensity, overcapacity and structural issues with US retailers. The segment has reported 3.1% revenue CAGR over the past five years.
- The textile industry due to the geopolitical situation is witnessing shift from China mainly to India, Vietnam and Bangladesh.
- On 14 July, 2021, Government of India approved extension of Rebate of State and Central Taxes and Levies (RoSCTL) scheme till March 2024 and the garment exporters will continue to get a rebate on Central and State taxes on their outward shipment. Under this scheme, exporters are issued a Duty Credit Scrip for the value of embedded taxes and levies contained in the exported product. Exporters can use this scrip to pay basic customs duty for the import of equipment, machinery or any other input.
- GHCL’s spinning business witnessed robust domestic demand, mainly led by low and medium value garments. Keeping the growth pace steady over the long run, the company could see incremental capital allocation due to its decent run rate.

- Spinning continues to witness strong growth, with yarn and cotton prices at historic highs. The home textile business saw a sharp 25-30% jump, led by strong direct sales in the export market. Management remains focused on adding value-added products to this segment, which should boost the margin trajectory to 18-20% from previous ~15%.
- GHCL has planned capex to add 40,000 spindles in its yarn division along-with 10 MW solar power capacity at a total cost of Rs.230 crore in FY22.

Others

- GHCL's debt coverage indicators continued to remain comfortable, marked by total debt to equity ratio of 0.2 times, and interest coverage of 6.1 times in FY21. GHCL debt equity ratio went down from 3.6x in FY12. Debt reduction would help boost margins and improve return ratios, going forward.
- GHCL management is confident of generating strong cash flows and it will help the company improve leveraging, despite its near-term requirement of capex.
- The company is likely to invest around Rs 400-500 crore in the ongoing financial year 2021-22 mainly from the internal accruals.
- Dividend payout is 16% as on 31 March, 2021 and dividend yield is ~1.5% at current price.

Key Risks and Concerns

Soda ash Division

- China is the largest producer and consumer of soda ash. Due to slowdown in its domestic market, the country has started dumping its excess production in the global market. Weak domestic consumption in China may push exports to various nearby countries like the Middle East and some other Asian countries, which will add stress on global pricing. At the same time, rejection of antidumping duty on soda ash could bring pricing pressure in near to medium term.
- Soda ash is a raw material-based business. It takes about 5 tons of raw material to produce 1 tonne of soda ash. Thus, due to importance of logistics cost in the soda ash business, 96% of capacities in India are located in Gujarat, where raw material is easily available. Transporting soda ash over long distances is costly since it is a cheap commodity. This restricts GHCL's capability to sell it in far-off places. Once coastal shipping gains prominence, this cost could come down.

- GHCL is looking to add a large-sized greenfield soda ash project, going forward. Any delay in that or significant deviation in the size of its planned greenfield soda ash project and departure from the stated implementation timeline could adversely impact leverage and debt coverage indicators.
- Volatility in prices of key inputs such as salt and imported coal along with higher freight costs, moderation in soda ash demand from glass segment are some other concerns.

Home textile Division

- GHCL's exports to the US account for ~65% of the company's total home textiles sales. Retailers in the US continue to face business headwinds on account of a shift from traditional retail to e-commerce as well as COVID-led demand decline. Apart from this, the textile industry is facing challenges, given intense global competition, volatile cotton prices, and forex rates, which may affect the competitiveness of Indian players.

Others

- Despite good profit, the dividend payout by the company has been poor than other peers; the average payout ratio has been ~15% over the past five years. Management has promised to review dividend payout policy to make it more liberal.
- GHCL promoters own 19.2% holding in the company, as of 30 June, 2021 and they are not adding further stake aggressively. Lower stake holding by promoters could impact investors' confidence in the company and its promoters.

Segment wise Performance

Rs in Cr	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Segment Revenue										
Inorganic Chemicals	1151.1	1215.5	1230.6	1416.4	1650.6	1745.2	1910.9	2175.7	2188.1	1882.0
Home Textiles	823.6	1059.4	1017.0	957.2	1056.8	1227.9	1059.2	1165.6	1117.0	1018.1
Segment Revenue	1974.6	2275.0	2247.6	2373.6	2707.3	2973.1	2970.1	3341.3	3305.1	2900.1
PBIT										
Inorganic Chemicals	238.1	302.4	276.3	398.3	456.6	518.7	554.5	620.2	629.4	431.5
Home Textiles	11.4	44.8	82.9	68.1	113.1	131.6	-3.6	55.8	7.2	123.7

(Source: Company, HDFC sec)

GHCL Ltd.

Financials (Consolidated)

Income Statement

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
Net Revenues	**3341**	**3305**	**2900**	**3295**	**3714**
Growth (%)	**14.5**	**-1.1**	**-12.3**	**13.6**	**12.7**
Operating Expenses	2539	2483	2214	2491	2802
EBITDA	**802**	**823**	**686**	**804**	**912**
Growth (%)	**52.5**	**2.6**	**-16.6**	**17.2**	**13.4**
EBITDA Margin (%)	**24.0**	**24.9**	**23.6**	**24.4**	**24.6**
Depreciation	117	131	133	134	142
EBIT	685	691	552	670	769
Other Income	16	18	27	23	24
Interest expenses	127	120	91	63	56
PBT	573	589	488	630	737
Tax	180	98	112	135	163
RPAT	**393**	**491**	**376**	**495**	**574**
Minority Interest & Share of JVs	0	0	0	0	0
Exceptional Item	0	0	0	0	0
APAT	**393**	**491**	**376**	**495**	**574**
Growth (%)	**42.4**	**25.0**	**-23.5**	**31.7**	**16.0**
EPS	41.4	51.7	39.6	52.1	60.4

Balance Sheet

As at March	FY19	FY20	FY21	FY22E	FY23E
SOURCE OF FUNDS					
Share Capital	98	95	95	95	95
Reserves	1827	2054	2389	2677	3100
Shareholders' Funds	**1926**	**2149**	**2484**	**2772**	**3195**
Long Term Debt	702	822	577	502	407
Net Deferred Taxes	253	253	260	273	287
Long Term Provisions & Others	6	7	4	4	4
Minority Interest	**0**	**0**	**0**	**0**	**0**
Total Source of Funds	**2887**	**3231**	**3325**	**3551**	**3893**
APPLICATION OF FUNDS					
Net Block & Goodwill	2595	2665	2661	2832	2979
CWIP	114	120	105	75	111
Other Non-Current Assets	48	92	107	110	115
Total Non Current Assets	2756	2878	2874	3018	3205
Current Investments	0	0	0	0	0
Inventories	769	791	764	785	885
Trade Receivables	291	274	228	271	305
Cash & Equivalents	36	116	49	126	219
Other Current Assets	144	111	64	73	84
Total Current Assets	1239	1292	1104	1255	1494
Short-Term Borrowings	409	270	42	103	143
Trade Payables	409	408	377	406	458
Other Current Liab & Provisions	290	261	234	213	204
Total Current Liabilities	**1108**	**938**	**653**	**722**	**805**
Net Current Assets	131	353	452	533	689
Total Application of Funds	**2887**	**3231**	**3325**	**3551**	**3893**

RETAIL RESEARCH

GHCL Ltd.

Cash Flow Statement

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
Reported PBT	531	495	439	541	654
Non-operating & EO items	5	13	5	-40	10
Interest Expenses	126	120	91	63	56
Depreciation	117	131	133	134	142
Working Capital Change	-156	-18	61	-45	-94
Tax Paid	-93	-116	-107	-135	-163
OPERATING CASH FLOW (a)	**530**	**624**	**622**	**518**	**605**
Capex	-273	-206	-110	-275	-325
Free Cash Flow	257	418	512	243	280
Investments	1	0	1	-1	-2
Non-operating income	1	1	1	-3	1
INVESTING CASH FLOW (b)	**-271**	**-206**	**-108**	**-278**	**-325**
Debt Issuance / (Repaid)	-72	-63	-474	-15	-55
Interest Expenses	-126	-120	-91	-63	-56
FCFE	59	235	-53	166	168
Share Capital Issuance	6	-67	0	0	0
Dividend	-67	-90	-4	-73	-75
FINANCING CASH FLOW (c)	**-258**	**-339**	**-569**	**-150**	**-186**
NET CASH FLOW (a+b+c)	**1**	**80**	**-55**	**89**	**93**
Closing Cash & Equivalents	**12**	**92**	**36**	**126**	**219**

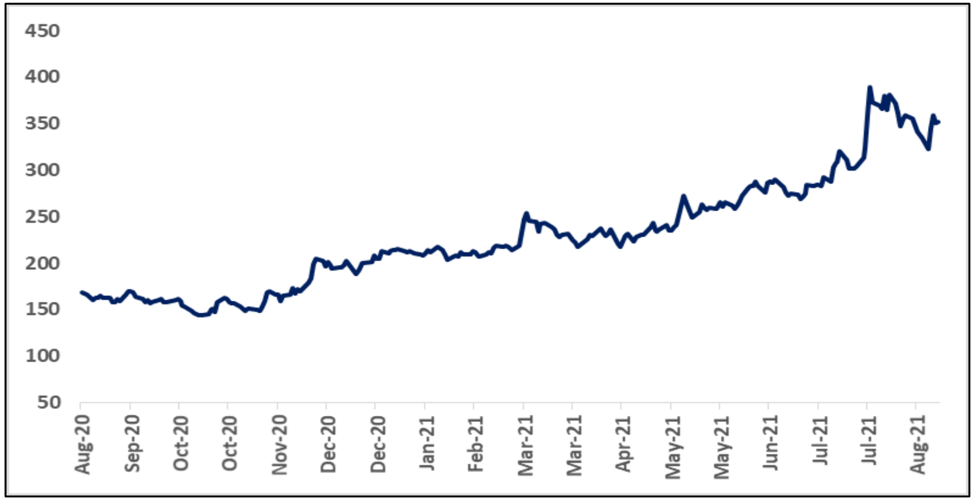
Key Ratios

Particulars	FY19	FY20	FY21	FY22E	FY23E
EBITDA Margin (%)	24.0	24.9	23.6	24.4	24.6
EBIT Margin (%)	20.5	20.9	19.0	20.3	20.7
APAT Margin (%)	11.8	14.9	13.0	15.0	15.5
RoE(%)	22.2	24.1	16.2	18.8	19.2
RoCE (%)	15.2	20.1	12.5	14.8	15.0
Solvency Ratio (x)					
Net Debt/EBITDA	1.4	1.3	0.9	0.8	0.6
Net D/E	0.6	0.5	0.2	0.2	0.2
PER SHARE DATA (Rs)					
EPS	41.4	51.7	39.6	52.1	60.4
CEPS	53.7	65.5	53.6	66.2	75.4
Dividend	5.0	3.0	5.5	6.0	7.0
BVPS	202.7	226.2	261.5	291.7	336.3
Turnover Ratios (days)					
Debtor days	32	30	29	30	30
Inventory days	84	87	96	87	87
Creditors days	45	45	47	45	45
VALUATION (x)					
P/E	8.5	6.8	8.9	6.8	5.8
P/BV	1.7	1.6	1.3	1.2	1.0
EV/EBITDA	5.5	5.3	5.7	4.8	4.0
EV / Revenues	1.3	1.3	1.4	1.2	1.0
Dividend Yield (%)	1.4	0.9	1.6	1.7	2.0
Dividend Payout (%)	16.3	8.6	16.0	14.0	13.6

(Source: Company, HDFC sec)

GHCL Ltd.

One Year Stock Price Chart



(Source: Company, HDFC sec)

HDFC Sec Retail Research Rating description

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This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Blue Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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