Stock Note

Gujarat Narmada Valley Fertilizers and Chemicals Ltd. (GNFC)

May 12, 2023

RETAILRESEARCH

HDFC securities
Click. Invest. Grow.
20 YEARS

Gujarat Narmada Valley Fertilizers and Chemicals Ltd. (GNFC)

Industry	LTP	Recommendation	Fair Value	Time Horizon
Fertilizer and Chemicals	Rs. 623	Buy in Rs. 619-626 band and add more on dips in Rs. 565-575 band	Rs. 690	2 quarters

HDFC Scrip Code	GNFCEREQNR
BSE Code	500670
NSE Code	GNFC
Bloomberg	GNFC IN
CMP (May 11, 2023)	623
Equity Capital (RsCr)	155.42
Face Value (Rs)	10
Equity Share O/S (Cr)	15.54
Market Cap (RsCr)	9682
Book Value (Rs)	569
Avg. 52 Wk Volumes (in '000s)	1768
52 Week High	837
52 Week Low	484

Share holding Pattern % (March, 2023)	
Promoters	41.18
Institutions	24.39
Non Institutions	34.43
Total	100.0

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
Harsh Sheth
Harsh.Sheth@hdfcsec.com

Our Take:

Promoted jointly by the Government of Gujarat (GoG) and Gujarat State Fertilizers and Chemicals Limited (GSFC), Gujarat Narmada Valley Fertilizers and Chemicals Ltd. (GNFC) was incorporated as a public limited company in 1976, with the two promoters cumulatively holding a 41.18% equity stake in it. Subsequently however, the entire shareholding of the GoG was transferred to Gujarat State Investments Limited (GSIL), a GoG undertaking. Based in Bharuch (Gujarat), GNFC is engaged mainly in the manufacture of fertilizers such as urea, Ammonium Nitro Phosphate (ANP) and Calcium Ammonium Nitrate (CAN), and industrial chemicals such as methanol, acetic acid, aniline, Toluene Di Isocyanate (TDI), formic acid, and nitric acid. The company also trades in a few fertilizers and chemicals.

Fertilizers

GNFC started fertilizer manufacturing and marketing operations by setting up in 1982, one of the world's largest single-stream ammonia-urea fertilizer complexes. It is one of the leaders in fertilizer industry. The company is engaged in manufacturing and selling fertilizers such as Urea, Ammonium Nitro Phosphate and Calcium Ammonium Nitrate under the umbrella NARMADA. GNFC has to its credit one of the largest Ammonia plant along with the world's largest single stream Urea plant.

Chemicals

Even as the company was implementing its fertilizer complex, plans were underway for expansion and diversification in related areas. This resulted in the setting up of core chemical and petrochemical plants such as Methanol, Formic Acid, Nitric Acid and Acetic Acid. These industrial chemicals are used by a wide range of manufacturers, processors and chemical operators in India and even abroad. While Methanol finds applications in chemicals, resins etc.

IT Services

GNFC diversified into IT services in 1989 by setting up (n)Code Solutions which offers Digital Certificates that can integrate with applications such as emails, workflow, enterprise wide applications, or secure VPNs. The Digital Certificates can be used by individuals, corporates and governments to secure online B2B/B2C applications and other online transactions. Although it's a small portion of company's revenues it has strong potential to grow. Margins in IT business are significantly higher than fertilizer and chemical segments and with increasing digitalization in the country we may see strong increase from this segment.

Valuation & Recommendation:

GNFC has established market position in fertilizers business (with its fertilizer brand Narmada being well entrenched within the farmer community especially in Gujarat), market leadership in chemicals business for products including Methanol, Acetic acid, Aniline and TDI, diverse chemicals product portfolio with high level of vertical integration across its fertilisers and chemical divisions allowing higher value addition and diversification. The company's strength lies in its product diversity and ability to switch among product streams in tune with the market conditions.

Post blockbuster FY22, 9MFY23 had been lacklustre due to unreasonably higher input costs and unfavourable demand conditions for certain products leading to lower realisations. In recent past, gas prices among other input costs have been coming off which shall drive the improvement in profitability going ahead.

The company is undertaking steps to improve its profitability and market share of its diversified product basket while most of its plants are running at more than 100% capacity utilization. It has, from time to time undertook debottlenecking and revamping activities to enhance the capacity and improve efficiencies.

The valuation expansion in GNFC over the past year or so has been much slower than other large chemical players that now quote at valuation of 2-2.5x of that of GNFC. While GNFC may find it difficult to grow fast over the large base of FY22 at the net level, we expect steady valuation expansion in the stock.

Gujarat Govt. has recently mandated a minimum of 30% of net profit, or 5% of net worth, whichever is higher, to be a minimum level of dividend declared for shareholders by companies where the Gujarat Govt. holds stake. Recently Gujarat Gas announced dividend of Rs. 6.65 (~30% payout) for FY23 vs Rs. 2 (~11% payout) in FY22. GNFC had paid Rs 123 Cr in dividend in FY22 (100% dividend, 7.2% payout) and will have to pay ~3.5x the amount in FY23 to meet the new regulations as per our estimates. In 9MFY22, it has reported 35.5% growth in topline and 6.5% growth in bottomline. A probable dividend of Rs.34.5 could mean 5.5% dividend yield.

We think the fair value of the stock is Rs 690 (6X TTMDec'22 EPS). Investors can buy the stock in Rs 619-626 band (5.5X TTMDec'22 EPS) and add more on dips in Rs 565-575 (5X TTMDec'22 EPS) band.

Financial Summary

Particulars (Rs cr)	9MFY23	9MFY22	YoY -%	FY19	FY20	FY21	FY22
Operating Income	7956	5870	*36%*	5,896	5,162	5,129	8,642
EBITDA	1510	1498	*1%*	868	542	1,003	2,384
APAT	1136	1067	*6%*	750	508	697	1,710
Diluted EPS (Rs)	73.3	68.9	*6%*	48.2	32.7	44.8	110.1
RoE-%				15.6	9.8	12.3	24.3
P/E (x)				12.9	19.1	13.9	5.7
EV/EBITDA (x)				11.1	19.1	8.1	3.5

(Source: Company, HDFC sec)

Key Triggers:

Lower input costs to aid growth in profitability in fertilizer segment

Sales in the fertiliser sector grew 15% yoy during April 2022-February 2023, led by higher availability of funds with farmers due to various policy measures, and the stable farm gate prices maintained by fertiliser companies as a response to the higher subsidy allocation during FY23 to counter the increase in raw material prices. Moreover, the sector saw a supplementary budget allocation of Rs 363.3 billion in March 2023, over and above the revised estimates of Rs 2,150 billion, leading to possibility of a lower-than-expected subsidy outstanding.

For nutrient-based fertilisers, the average prices for input raw material such as phosphoric acid, rock phosphate and sulphur have started to decline from Q4FY23, declining to USD1,000/t, USD250/t and USD150/t, respectively (6MFY23 average: USD1,600/t, USD380/t, USD335/t). Led by the decline in natural gas price, India Ratings estimates the subsidy requirement for the sector to come down from the FY23 levels.

GNFC had reported improved profitability in its fertilizer segment in Q3FY23 and we expect the company to report higher profit margins here given i) a decline in the working capital requirements, led by the moderation in the raw material prices; ii) timely GoI intervention towards revision in the NBS rates for nitrogen, phosphorous and potassium players to maintain the per tonne EBITDA margins; and iii) continued timely subsidy disbursements.

TDI expected to report a turn around

GNFC is 100% sole producer of Toluene Di–Isocyanate (TDI) with a capacity of 64,000 MTPA in India. TDI has wide application in foam, furniture cushion, industrial gaskets, protective pad for sports and medical use, automobile seats, packaging etc. India has imposed an anti-dumping duty on TDI on the imports from China, Japan and Korea. GNFC has the flexibility – it can sell CAN (Calcium ammonia nitrate) directly or convert CAN into TDI and sell it depending upon the market conditions.

In a major development, BASF Ludwigshafen (Germany) has recently decided to close down its TDI plant with an installed capacity of 300,000 tpa. Citing a high cost environment (utility and power costs) coupled with poor capacity utilisation, operating the TDI plant had become economically unviable. Demand for TDI was weak in Europe, Middle East and Africa. Covestro also had to shut down its TDI operations in Germany due to subsequent technical failures in its Caustic-Chlorine plant. All put together, ~17% of global nameplate capacity would be non-operation at this point in time. China has capacity to meet this shortfall, but these shutdowns could exert upward pressure on TDI prices.

GNFC has been running the TDI-2 plant at an EBITDA loss for 9MFY23, while it has seen some positive contribution from TDI-1 plant. The management of GNFC cited high power and utility costs, along with production outages due to maintenance shutdowns that led to a negative contribution margin in its TDI operations. As per Covestro – demand growth will be outstripping supply between 2021 to 2026. Demand is expected to grow at 5% CAGR, while supply addition is only 2% in CAGR terms between 2021 to 2026. With TDI prices expected to move upwards coupled with lower gas prices, we expect TDI to contribute higher to company’s EBITDA in Q4FY23 and beyond.

TDI prices have risen smartly in Feb and Apr 2023 and this could get reflected in the Q4FY23 numbers and beyond.

Capex to drive the growth

GNFC has continuously looking for the growth opportunities and achieving higher operational efficiencies. In FY22, it has completed debottlenecking of its TDI-II plant (increase in 10,000 MTPA) and formic acid (6800 MTPA) at Dahej and Bharuch facility respectively. Besides, with an increased captive consumption of CNA for TDI, the company’s market share in TDI has been falling which has led to setting up of 50,000 MTPA of CNA (potential to generate revenues of ~Rs 300 Cr). It is also setting up 4MW Solar Power Plant which will reduce its power cost going ahead. According to the management, CNA capacity expansion of 50 KTPA and solar power capacity of 4 MW with outlay of around Rs 140 Crores are expected to be completed by June, 2023 and May, 2023 respectively. It has started working on projects like that of enhancing ammonia capacity by 50,000 MTPA, Weak Nitric Acid capacity by 2,00,000 MTPA and Ammonium Nitrate Melt by around 1,50,000 MTPA. The total capex size is estimated to be around Rs 1,350 Cr. These plants are expected to be commercialized by FY25-26. Besides, work has already started in respect of coal based captive Steam & Power Plant at Dahej which is expected to bring cost competitiveness to TDI-Dahej operations.

Policy change for Gujarat State PSUs

Gujarat Govt. has recently mandated a minimum of 30% of net profit, or 5% of net worth, whichever is higher, to be a minimum level of dividend declared for shareholders by companies where the Gujarat Govt holds stake. However, only the minimum level and maximum permissible level of dividend should be declared. For share buyback, every state PSU with a net worth of at least Rs 2,000 crore and cash and bank balance of Rs 1,000 crore have been mandated to exercise the option to buy back their own shares. In the case of bonus shares, state PSUs that have defined reserve and surplus equal to or more than 10 times their paid-up equity share capital are required to issue bonus shares to their shareholders.

GNFC had paid Rs 123 Cr in dividend in FY22 (7.2% payout) and may have to pay ~3.5x the amount in FY23 to meet the new regulations as per our estimates.

Key Concerns

Volatility in raw material prices: Power and fuel are the key cost components for GNFC. Natural gas being an international commodity is subject to price fluctuation. The company is not affected by the price volatility of the natural gas to the extent consumed for Urea as under the Urea pricing formula the cost of natural gas is pass through if the consumption of natural gas is within the permissible norm for manufacturing of Urea. GNFC also deals in purchase of other feed stock materials (i.e Rock phosphate, and Denatured Ethyl Alcohol) which are imported by the company and used in the manufacturing of Ammonium Nitro Phosphate and Ethyl Acetate which are subject to a price and material availability risk. Raw materials and fuel used for chemicals are subject to price volatility and forex fluctuations to the extent these are imported. However, GNFC has so far been able to pass over the increased cost to the consumers though with a lag.

Competition in chemicals business: GNFC faces competition from large Indian and foreign players. Changes in capacities, production schedules and demand conditions can impact the capacity utilisation and margin trends. Also import/export policies in India and exporting countries/importing countries could impact the competitiveness of GNFC.

Timely payment of subsidies: Government subsidy accounts for more than 75% of revenue of the Urea suppliers and about 35% in case of P&K fertilizers. Therefore, its timely payment is very important for sustaining financial health of the company. GNFC is exposed to the fertilizer policy of the Government which at times results in delayed payments due to cumbersome procedures. Such inordinate delays in subsidy payments lead to liquidity problems and higher interest costs.

Erratic weather: The Indian agriculture sector remains vulnerable to the vagaries of monsoon as the area under irrigation remains low, resulting in volatility in sales and profitability of the fertilizer sector. The threat of El Nino this year remains alive which can result in deficient rainfall and lower consumption of fertilisers.

Promoter background: GNFC is majorly owned by the Govt of Gujarat enterprises, and hence, suffers from relatively poor perception attributable to PSUs. However Gujarat based PSUs are run quite professionally which could lead to improvement in the perception over time.

About the company

Promoted jointly by the Government of Gujarat (GoG) and Gujarat State Fertilizers and Chemicals Limited (GSFC), GNFC was incorporated as a public limited company in 1976, with the two promoters cumulatively holding a 41.18% equity stake in it. Subsequently, however, the GoG's entire shareholding was transferred to Gujarat State Investments Limited (GSIL), a GoG undertaking. Based in Bharuch, GNFC mainly manufactures fertilisers such as urea, ANP and calcium ammonium nitrate (CAN), and industrial chemicals such as methanol, acetic acid, aniline, TDI, formic acid and nitric acid. The company also trades in few fertilisers and chemicals. It further provides IT services and solutions covering digital signature certificates (DSCs), e-procurement, e-governance projects, data centres, CCTV surveillance systems etc under the brand name of (n)Code solutions.

Financials

Income Statement

Particulars (in Rs Cr)	FY19	FY20	FY21	FY22
Net Revenues	**5896**	**5162**	**5129**	**8642**
Growth (%)	***1.0***	***-12.4***	***-0.7***	***68.5***
Operating Expenses	5028	4621	4125	6259
EBITDA	**868**	**542**	**1003**	**2384**
Growth (%)	***-37.6***	***-37.6***	***85.2***	***137.6***
EBITDA Margin (%)	***14.7***	***10.5***	***19.6***	***27.6***
Depreciation	263	264	272	292
Other Income	221	153	237	209
EBIT	**826**	**430**	**968**	**2302**
Interest expenses	6	5	20	3
PBT	**819**	**425**	**948**	**2298**
Tax	78	-74	259	594
PAT	**741**	**499**	**689**	**1704**
Share of Asso./Minority Int.	9	9	8	7
Adj. PAT	**750**	**508**	**697**	**1710**
Growth (%)	***-5.7***	***-32.2***	***37.2***	***145.4***
EPS	48.2	32.7	44.8	110.1

Balance Sheet

Particulars (in Rs Cr) - As at March	FY19	FY20	FY21	FY22
SOURCE OF FUNDS				
Share Capital	155	155	155	155
Reserves	4909	5144	5913	7835
Shareholders' Funds	**5065**	**5299**	**6068**	**7990**
Minority Interest	0	0	0	0
Total Debt	208	860	4	2
Net Deferred Taxes	467	316	391	422
Total Sources of Funds	**5739**	**6476**	**6463**	**8414**
APPLICATION OF FUNDS				
Net Block & Goodwill	3940	3791	3701	3578
CWIP	25	82	161	138
Investments	799	673	938	1313
Other Non-Curr. Assets	338	205	206	876
Total Non Current Assets	**5103**	**4751**	**5005**	**5905**
Inventories	829	932	813	977
Debtors	1240	1413	510	625
Cash & Equivalents	235	189	1451	1182
Other Current Assets	184	1113	586	2029
Total Current Assets	**2488**	**3648**	**3360**	**4813**
Creditors	395	513	399	631
Other Current Liab & Provisions	1475	1429	1522	1673
Total Current Liabilities	**1870**	**1943**	**1922**	**2304**
Net Current Assets	618	1705	1438	2509
Total Application of Funds	**5739**	**6476**	**6463**	**8414**

Cash Flow Statement

Particulars (in Rs Cr)	FY19	FY20	FY21	FY22
Reported PBT	819	425	948	2,298
Non-operating & EO items	32	-58	-87	13
Interest Expenses	-46	-44	-61	-118
Depreciation	263	264	272	292
Working Capital Change	-258	-253	1,029	109
Tax Paid	-109	-48	-218	-628
OPERATING CASH FLOW (a)	**701**	**286**	**1,884**	**1,967**
Capex	-98	-130	-215	-137
Free Cash Flow	603	155	1,669	1,829
Investments	-12	-759	696	29
Non-operating income	-201	-12	-1,337	-1,791
INVESTING CASH FLOW (b)	**-310**	**-901**	**-856**	**-1,899**
Debt Issuance / (Repaid)	-42	680	-833	0
Interest Expenses	-3	-3	-19	-2
FCFE	345	62	177	66
Share Capital Issuance	0	0	0	0
Dividend	-139	-131	-78	-123
FINANCING CASH FLOW (c)	**-184**	**546**	**-929**	**-125**
NET CASH FLOW (a+b+c)	**207**	**-69**	**99**	**-57**

One-year Share Price Chart

Key Ratios

Particulars	FY19	FY20	FY21	FY22
Profitability Ratios (%)				
EBITDA Margin	14.7	10.5	19.6	27.6
EBIT Margin	14.0	8.3	18.9	26.6
APAT Margin	12.7	9.8	13.6	19.8
RoE	15.6	9.8	12.3	24.3
RoCE	16.4	7.5	15.8	32.7
Solvency Ratio (x)				
Net Debt/EBITDA	0.0	1.2	-1.4	-0.5
Net D/E	0.0	0.1	-0.2	-0.1
PER SHARE DATA (Rs)				
EPS	48.2	32.7	44.8	110.1
CEPS	65.2	49.7	62.4	128.8
BV	325.9	341.0	390.4	514.1
Dividend	7.0	5.0	6.0	10.0
Turnover Ratios (days)				
Debtor days	73	94	68	24
Inventory days	47	62	62	38
Creditors days	26	32	32	22
VALUATION				
P/E	12.9	19.1	13.9	5.7
P/BV	1.9	1.8	1.6	1.2
EV/EBITDA	11.1	19.1	8.1	3.5
EV / Revenues	1.6	2.0	1.6	1.0
Dividend Yield (%)	1.1	0.8	1.0	1.6
Dividend Payout	14.5	15.3	13.4	9.1

(Source: Company, HDFC sec)

HARSH RAJENDRA SHETH

Digitally signed by HARSH RAJENDRA SHETH
Date: 2023.05.12 08:46:58 +05'30'

HDFC Sec Retail Research Rating description

Green Rating stocks

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.

Yellow 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.