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FERTILIZERS: *"THE DARK DAYS ARE OVER"*

On 16/1/2017 we initiated sector coverage on Fertilizer Sector. You might be thinking Why fertilizer, it doesn't match our investment philosophy of growth at a reasonable price, it's a sector which is burden by subsidies, too much government interference, the industry doesn't have pricing power, there is absolutely no long term competitive advantage, so why on earth are we buying this sector?

Let's be very clear that Fertilizer is a tactical investment rather than a core holding. Majority of Investors have written this sector off because they haven't made money in this sector for the last 12-13 years. This is a sector where there has been no new capacity addition from last 1.5 decade but there are big changes happening in the Sector. The government has been delaying subsidy payments to these companies for last many years which have caused stretched working capital cycle to about 200 days. There are structural changes happening in the sector, because of which both private and public companies have decided to increase capacity, which makes us bullish on this sector. All these companies are trading at 20-25% of their replacement value; a small shift in perception of the sector can give us mega gains. We expect a 30-40% Fall in working capital days and 25% decrease in Interest cost in FY 2018, which will makes the balance sheet look a lot better.

We Have Initiated Coverage on 5 stocks, 3 of them are private companies whereas GSFC and RCF are state-owned.

Stocks under Coverage:

1. **Chambal Fertilizers**
2. **Coromandel International**
3. **Deepak Fertilizers**
4. **RCF**
5. **GSFC**

This Investment is not a No-Brainer investment and has many moving objects like Government Policy, Gas Prices, Subsidy Realization time, monsoon etc. But we believe the pain of tracking the sector closely is worth the gain.

Our Thesis is based on 6 Important Changes that have happened in this sector which can be Games changers, but Dalal Street needs Results for confirmation. The Next 4 Quarters will be exciting for Fertilizer companies as working capital cycle improves, Interest burden decreases, operating margin improve due to fall in raw material prices, volumes improve due to good monsoon.

Fertilizer Industry in India

India is the second largest fertilizer consumer in the world after China and world's third largest producer. Total subsidy allocated by the govt. for fertilizers in the year 2015-16 was 72,969 cr. (50,500 cr. for Urea and rest for partially decontrolled NPK fertilizers). Total market size of the Indian fertilizer industry is 1.2 lakh crore. At present, Urea prices are highly subsidized (75% Subsidy) and administered under New Urea policy-2015 whereas NPK Fertilizers are partially decontrolled and subsidy is disbursed based on the nutrient content available in the particular fertilizer under Nutrient Based Subsidy (which was introduced in 2010).

Fertilizers in India

Non- Urea Fertilizers

Urea

DAP
Market size:280 bn
Production: 38.22 lakh MT
Sales: 97.65 lakh MT
Imports: 56.03 lakh MT

NPK Fertilizers
Production: 83.76 lakh MT
Sales: 88.79 lakh MT
Imports: 6.29 lakh MT

SSP
Market Size: 30 bn

MOP
Market Size:
60 bn

Market Size: Rs. 600 bn
Production: 244.65 lakh MT
Sales: 319.74 lakh MT
Imports: 84.74 lakh MT

Urea

Urea is the most widely used plant nutrient in Indian Agriculture. Import of urea for the year 2015-16 stood at 8.47 million MT (26.5% of the total urea demand). Urea production in the country during FY2015-2016 was 24.47 million MT. Urea is a very important fertilizer and due to lack of affordability, this product is highly subsidized (Subsidy is 70% of the MRP).

NPK Fertilizers

NPK fertilizer is primarily composed of three main elements: Nitrogen (N), Phosphorus (P), and Potassium (K), each of these being essential in plant nutrition. NPK fertilizers can be of various types depending on the proportion of various nutrients in the fertilizers.

Nitrogen ('N' of NPK)

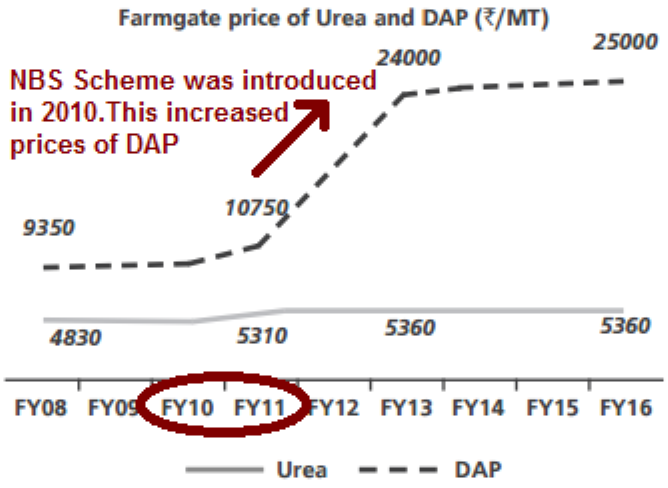
Urea is made of Nitrogen hence most farmers' buys fertilizers with a lot of Nitrogen content as it's cheaper because of large subsidies given by the government.

MOP (Muriate of Potash) ('K' of NPK)

The demand of MOP in the country is entirely met by imports. MOP Imports for the country in 2016 was 3.24 million MT as compared to 4.2 million MT during previous year.

DAP (Di-ammonium Phosphate) ('P' of NPK)

Last year around 57% of the total DAP consumption (9.76 million) of the country was imported.



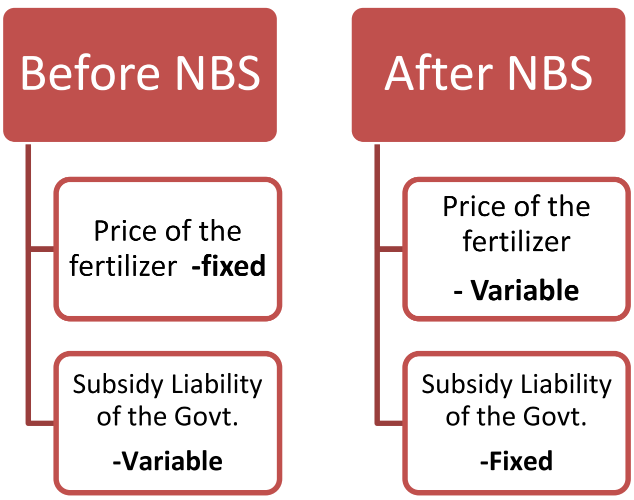
In India due to excessive subsidy being given to urea as against phosphatics, the urea price is only 20-25% of DAP price. This is the main cause for excessive usage of urea which is perceived as a cheaper fertiliser but in reality distorts the balanced nutrition and affects farm level productivity.

The balance nutrition is 4.2:2:1 for NPK, whereas due to a lot of Subsidies in India on Urea, farmers distort this ratio to 7.7:3:1.

Nutrient Based Subsidy (NBS) scheme Went Wrong

NBS(Nutrient Balance Subsidy) Policy was introduced on 1st April, 2010 for fertilizers other than urea. This subsidy given to the companies is fixed annually on the basis of its nutrients content (i.e. Nitrogen, Phosphate, Potash and Sulphur).22 grades of different de-controlled fertilizers and 15 complex fertilizers were included in the scheme.

This lead to increase in consumption of Urea and the partially decontrolled Fertilizers showed a sudden spurt in prices. The overall consumption of fertilizers reduced and companies were discouraged to introduce new products. Government was a key beneficiary of the scheme as they have managed to save subsidy of 4500 Crores (approx) by fixing the subsidy and keeping the MRP open for the manufactures/suppliers to decide a reasonable level.



Change in Fertilizer Industry:

1. **Petronet RasGas Deal- Saves Subsidy of 6,000 Crores**
2. **Gas Pooling Policy – Saves Subsidy of 4,800 Crores**
3. **Neem Coating Policy – Saves Subsidy of 6,000-7,000 Crores**
4. **New Urea Policy 2015 – Saves Subsidy of 1,200 Crores**
5. **Lower P&K Subsidy - Saves Subsidy of 5,000 Crores**
6. **Drop in Urea Prices- Saves Subsidy of 2,500 Crores**
7. **China Slashes Export Duty – Saves Subsidy of 1000 Crores**

1) PetroNet RasGas Deal

India produced 31.14 billion cubic meters of gas for the financial year 2016. Of the total gas consumption, more than 40% is met through imports. RaGas of Qatar and Petronet signed an agreement to revise the price of LNG at $ 6-7 per million British Thermal Unit (MBTU) as against the older rate of $12-13/MBTU, since natural gas is 95% of the raw material cost of making Urea, this would mean large savings in Subsidy. This reduction in the gas prices have reduce the subsidy burden of the Government by 6000 Cr. Approx.

2) Gas Pooling Policy:

Earlier, Fertilier Plants based on location paid different amounts for Gas depending on weight of Domestic Gas v/s International and Location. This was disadvantageous for the plants which had no access to cheap domestic gas. By pooling domestic gas with the imported gas cost for all the players will be uniform and everyone will benefit from reduction in natural gas prices resulting in a fair playing field.

Domestic gas prices reduced from $4.66/MMBTU for April- September 2015 period to $ 2.50 /MMBTU for the October1st –March2017. Every $1/ MMBTU fall in gas prices reduces the price of urea by Rs. 1800-2000/ MT. Lower raw material prices will lead to lower working capital borrowings, lower finance cost and hence improved profitability. The implementation of Gas Pooling Policy with effect from 1st July, 2015 has been an important step in favour of the fertilizer companies. According to this policy domestic gas will be pooled with R-LNG to provide natural gas at uniform price to all for the purpose of manufacturing of Urea. India Imports 40% of Gas of its total Gas Requirement for its fertilizer use; the government sets the price for Domestic Gas once in 6 months while imported gas comes at international price agreements.

3) Neem Coating Policy

In January 2015, the Govt. made it mandatory for the urea manufacturers to Neem coat a 75% of the subsidized urea manufactured from its earlier cap of 35%. Neem coated urea releases nitrogen slowly into the soil thus helps in reducing underground water contamination due to leaching of urea. It ensures lesser usage of urea in the same area with higher crop yields. It is estimated that this will help reduce consumption of urea for 10-15% as Urea (without Neem Coating) for fertilizer was smuggled to other Industries, but after neem coating the Urea cannot be used anywhere except in Farms. Due to lower Consumption of Urea, it is estimated that the government will save 6000-7000Cr.

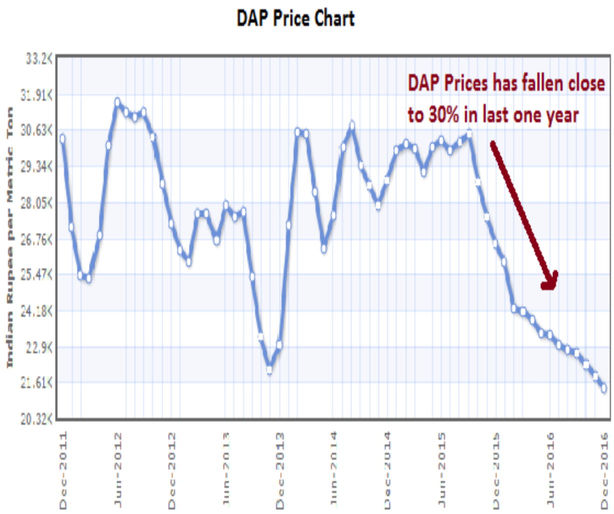
4) New Urea Policy

The urea consumption in India has always been higher than the supply. The govt. aims to make India a net exporter hence it has started to incentivise local production of Urea under Its Make In India Programme. New Urea Policy was introduced by the govt in 2015 with effect from 1st June, 2015 which mainly aims at higher urea production and conserving energy. Chambal has committed 6000 Cr. for 1.34 million Tonnes of Capacity addition; whereas RCF is also investing 5530 Cr. in Capacity addition of Urea. This is expected to save 4800 Crores of Subsidy over a 4 year period i.e. 1200 an Annual.

5) Lowered P&K Subsidy

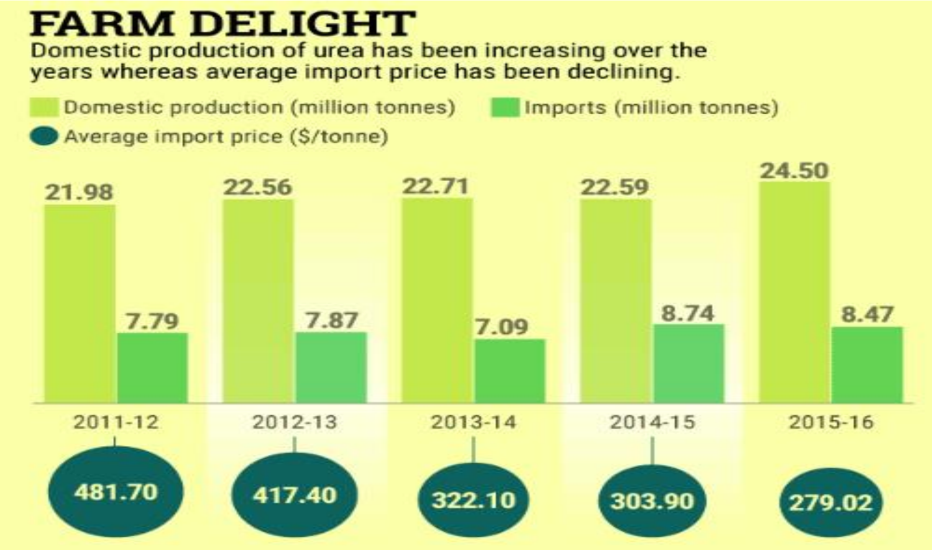
Fall in International Prices of MOP/DAP

As against total consumption of 9.76 Million MT during the year, around 5.60 million MT of DAP was **imported constituting about 57% of total consumption in the country.** There was downward trend in the prices of DAP in international market. The demand of MOP in the country **is entirely met out of imports.** MOP imports in the country during the year were 3.24 million MT as against 4.20 million MT during the previous year. MOP Prices have fallen 26% this year and are showing sign of weakness



6) Drop in Imported Urea Prices

Urea Prices have fallen in International Market, which decreases subsidy paid on Urea. India Imports 27% of its Urea needs. This will help save subsidy of 2,500 Cr. India Signed a Deal with China for import of urea at $219/MT, a 30.48% decrease from its previous year’s number of $315/MT.



In Year 2016-2017, India has signed deal with China to Import Urea at 219$ against average import price of 279$ last year. There has been a Steep Drop of 55% in Imported Urea prices from 482$ IN 2012 to about 219$ in 2016-2017 has decreased subsidy burden. There will be further savings of 2500 Crores of Subsidy for the Government.

7) China Slashes Export Duty -

China has released tariff regulation for 2016, wherein export tariff on industrial grade Phosphoric Acid has been cut from USD 47/tn to zero. This helps save about 1000 Crores of Subsidy for the government.

	Urea	NPK Fertilizers	Total Subsidy Disbursed	Carryover Liability
FY11	24,337	41500	65837	9324
FY12	37,683	36108	73791	22201
FY13	40,016	30576	70592	26417
FY14	41,824	29427	71251	40341
FY15	47,400	24670	72070	31831
FY16	50,500	22469	72969	35000*

The biggest problem with fertilizer companies was their working capital cycle. With savings of about 30,000 Crores expected from the above factor, we believe working capital cycle of Fertilizer companies will get in a better Shape in coming quarters.

Other Important Factors that may be game changer for the Industry –

Direct Benefit Transfer - The government in its last year's budget announced the implementation of the Direct Benefit Transfer (DBT) scheme on a pilot basis. This scheme will enable the fertilizer subsidy to be directly transferred to the farmer's bank account, thereby reducing the working capital requirement of the fertilizer industry, apart from plugging leakages. This project is initially implemented for 16 districts started this rabi season in October 2016. These districts will be selected where penetration of Aadhar, Jan Dhan and banking through ATM is more. The long term roll out of the DBT in urea project largely depends on the success of DBT in LPG.

Soil Health Card - Due to extra excessive use of fertilizer, the soil health has deteriorated, hence Prime Minister Modi came up with Soil health card, where the farmer will exactly be informed what fertilizer to use, in how much quantity depending upon the unique characteristic of his soil.

Crop Insurance - PM Modi has launched Crop Insurance scheme, where farmers can insure their crop for a small payoff. This scheme is expected to increase risk appetite of farmers.

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Comparative Analysis

Company Name	Sales (Rs. In Cr.)	5 year CAGR Sales Growth (%)	5 year CAGR Profit Growth (%)	OPM (%)	ROE (%)	ROCE (%)	Total Debt/Equity	Working Capital Days	EV/EBITDA
Chambal	10527	13	16	10	21	8	2.12	175	13.93
Coromandel	11522	9	-8	9	21	14	0.93	206	12.7
Deepak	4353	22	-13	9	6	6	1.29	157	9.75
RCF	8659	9	-3	5	7	5	1.08	220	11.95
GSFC	6163	5	-11	11	9	8	0.27	210	9.75

Sales Growth: Sales growth for the fertilizer companies has been sluggish on the long term basis with single digit CAGR growth in the last 5 years. The Growth is expected to be stable due to good monsoon season after two consecutive droughts in the country. We believe that the sales growth of these companies will remain in high single digit for the medium term.

Profit Growth: Fertilizer Companies have taken a hit on profitability front due to overdependence on subsidy paid by the government. Urea is subsidized product i.e. MRP is fixed 5350. NPK fertilizers, DAP, MOP are partially decontrolled by the govt which means that the subsidy is fixed and the MRP of the fertilizer is not fixed by the government. Coromandel, Deepak have more exposure to non-urea fertilizers and trading and thus have higher scope of margin expansion. RCF, Chambal are pure Urea manufactures, though Chambal trades NPK, MOP, DAP fertilizers as well. Urea has 6-8% margins whereas non-urea fertilizers have double digit margins.

Working Capital Days: Rising Trade receivables due to delayed payment of subsidy by the government and increase in short term working capital debt due to lower inventory turnover has resulted in higher working capital days. Longer the cash conversion cycle, higher the uncertainty of cash flows.

Usually Government Owned companies have higher working capital days. RCF and GSFC are government run companies and have working capital days of 220 and 210 respectively which are higher than the industry average.

Outstanding Subsidy Receivables

Company Name	FY16	FY15	Total Debt (FY 2016)
Chambal Fertilizers	3093	2672	4629
Coromandel International	2017	1789	2223
Deepak Fertilizers	795	335	1898
RCF	3927	3000	2797
GSFC*	844	655	1190

*Ammonium Phosphate Subsidy

Majority of Debt of Fertilizer Companies is because of delayed Subsidies. Once these companies start getting their subsidies on time we believe there will substantial improvement in working capital cycle. There will be large savings in Interest cost and We believe that there is a large possibility of working capital cycle to come down from 200 days to about 100-120 days in 2017-2018 which will decrease interest burden, make balance sheet better.

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CHAMBAL FERTILIZERS

CMP : 83.5 Weight : 4%	
Company Name	**Chambal Fertilizers**
Market Cap(Rs. Cr)	3474
Debt	4629
Cash	189
Enterprise Value	7914
Promoters Holding	37.84%
52 week high/low	87/50.85
Shares outstanding (In Cr.)	41.60

About the company

The Company's segments include Fertilisers and other Agri-inputs segment, Own Manufactured Phosphoric Acid segment, Shipping segment .Fertilizers include manufacture and marketing of Urea, Single Super Phosphate and other fertilizers. It imports and supplies DAP, MOP and NPK Fertilizers leveraging its dealer network. Shipping segment include equipment's which are used for transportation of crude oil and other liquid Products.

Chambal Fertilizers	2016	2015	2014	2013	2012
Sales	10527	9738	8911	8202	7539
Sales Growth (%)	8%	9%	9%	9%	33%
Profit	479	331	314	298	209
Profit Growth (%)	45%	5%	5.37%	42.58%	-8.33%
Total Debt	4629	3800	4456	5004	3474
ROCE (%)	8%	7%	7%	6%	6%
Working Capital Days	175	170	205	189	115
Trade Receivable	3914	3171	3559	3586	2219
Dividend Payout (%)	92	33	26	26	32

Chambal's fertilizer business mainly includes manufacturing of Urea and trading of DAP and other complex fertilizers. Company's 58% revenue is contributed from traded products which enjoys higher Operating Margins in the Industry. Natural Gas forms the most important raw material for the company (95%) since the company manufactures Urea. Due to fall in raw material prices, and various policies introduced by the government in this sector, we believe that debt scenario for these companies will change going forward as more subsidy repayments are expected from the government this fiscal year.

Manufactured Goods:

Particulars	2015-16	2014-15
Urea Production (MT in Lac)	21.25	18.52
SSP* Production (MT in Lac)	1.65	1.38

***Single Super Phosphate**

Traded Goods:

Particulars	2015-16	2014-15
DAP	8.98	6.39
MOP	1.87	1.99
SSP	0.20	0.22
Other Fertilizers	0.91	0.42

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Capacity Expansion will boost sales growth

Chambal is expanding in Kota, Rajastan by setting up a 6,000 crore Urea plant with capacity of 1.34 million Tonnes, this will help it increase its capacity by 63%. They have till date has spent approx 1000 cr and in the second half of the year they will spend more 400 cr. The commercial production of this capacity will start from Jan 2019. Chambal's Existing capacity is 2.13 Million Tonnes, using replacement value approach chambal's old capacity will be valued at Approximately 9000 crores whereas its enterprise value is about 3800 Crores only.(Only long term debt is taken for calculation of Enterprise value as short term debt Is against subsidy receivable. We have reduced 1,000 crores which is debt taken for new capacity). No businessman will do fresh investment in a project where IRR is less than a minimum of 12%, i.e. Chambal management believes they can make atleast 720 Crores/Year of the Investment they have made. Chambal has 2.13 million Urea capacity now, and if we extrapolate the above analysis, Chambal should do about 2000Cr. of EBIT is what management is expecting from manufacturing business alone. (Please note we have no intention of holding fertilizer for next 3 years, use this for information purpose only)

Rising Outstanding Subsidy

Rs. In Cr	Sept 16	Sept 15
Urea	1448	1128
P&K	639	533
SSP	30	84

Outstanding Subsidy has risen for the first half of the year mainly because of decrease in receipt of urea subsidy from 2800 cr to 2100 cr over same period last year. According to the management in the concall, things have now normalised as they have received 600 crores in the month of October.

Loan Outstanding

	Sept 16	Sept 15
Long term loan (new project)	703	100
Long term loan (Shipping)	582	869
Working Capital Loan	3297	2801

Majority of the debt of the company is the working capital debt. Since the company doesn't receive subsidy payment from the government on time, they are compelled to borrow more debt to meet their raw material requirements. Last year, sudden rise in inventory levels has affected the operating cash flows of the company.

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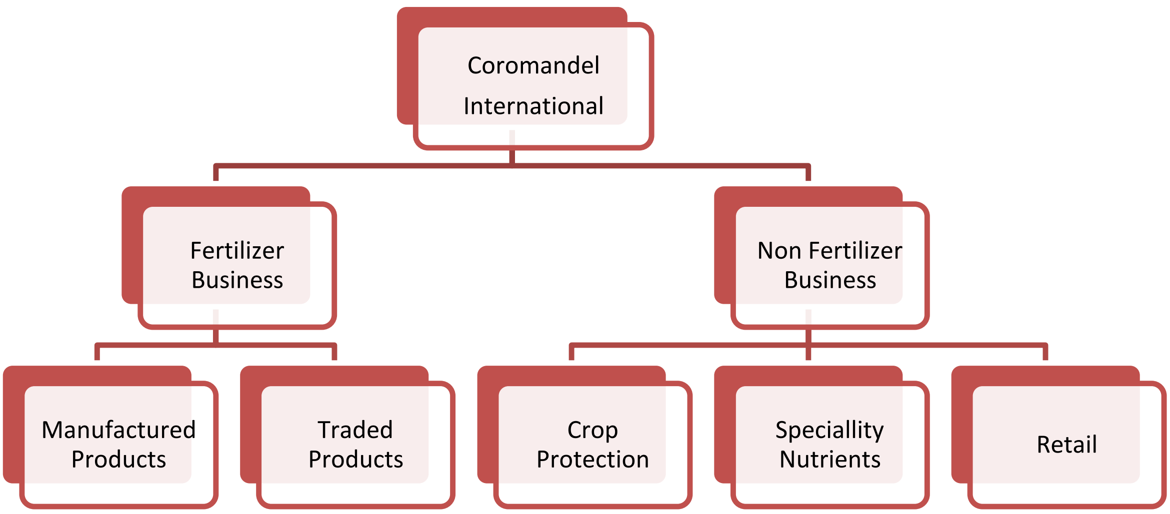
COROMANDEL INTERNATIONAL

CMP : 328 Weight : 4%	
Company Name	**Coromandel International**
Market Cap(Rs. Cr)	9555
Debt	2223
Cash	203
Enterprise Value	11575
Promoters Holding	62.04%
52 week high/low	341.95/145.50
Shares outstanding (In Cr.)	29.13

About the company

Coromandel is a flagship company of the Murugappa Group and is a subsidiary of E.I.D. Parry (India) Limited (EIDP) which holds 62.04% of the equity share capital in the Company. The Company is present in entire agri-value chain comprising of Fertilisers, Crop protection, Specialty Nutrients and Organic compost. The Company also operates a network of around 800 rural retail outlets under its retail business across Andhra Pradesh, Telangana and Karnataka.

Coromandel International	2016	2015	2014	2013	2012
Sales (Rs. In Cr)	11522	11306	10053	9034	9902
Sales Growth (%)	2%	12%	11%	-9%	30%
Profit (Rs. In Cr)	490	529	547	577	809
Profit Growth (%)	-7%	-3%	-5%	-29%	6%
Total Debt (Rs. In Cr)	2223	2106	1671	2867	2876
ROCE (%)	14%	16%	15%	14%	20%
Working Capital Days	152	208	186	179	206
Trade Receivable (Rs. In Cr)	1809	1446	1483	1820	958
Dividend Payout (%)	32	33	36	30	31



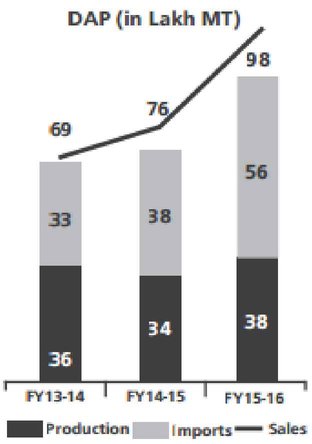
Fertilizer Business

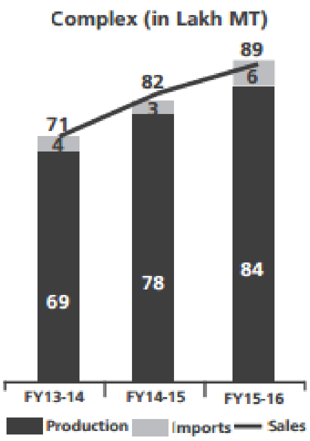
Fertilizer business contributes 85% of the revenue and 64% of the EBITDA.
Coromandel International has phosphatic capicity to 3.6 million tons. It is the largest private sector Phosphatic fertilizer company in India. It manufactured 2.4 million tons of Phosphatic fertilizers (DAP and complex) in FY16.Products like DAP are partially traded and Urea is totally traded by the company. The Raw materials of DAP are imported and then made here in India.
Manufactured Sales of the company for FY16 was 6363 crores. (65% of total sales)

Products manufactured	Sales (FY16) – in Cr.	(%)
Di-Ammonium Phosphate (DAP)	619	10%
Ammonium Phosphatic Fertilizers	4045	64%
Single Super Phosphate (SSP)	353	6%
Plant Protection Chemicals	1177	18%
Others	169	2%
Total	6363	100%

Non-Fertilizer Business

Non-Fertilizer Business includes higher margin business like crop protection, speciality nutrients and Retail. It contributes 15% of the revenue and 36% to the total EBITDA of the company.
Under Crop Protection, company manufactures pesticides, herbicides, fungicides in India and exports it. 45% of the Non fertilizer revenue comes from exports. (67% of the non- fertilizer sales comes from pesticides).
Speciality Nutrients include G-Sulphur, Water Soluble fertilizer and Organic manure.
Retail Business – The Company entered into the retail business in the year 2007 and now has around 800 stores. It is a one stop solution for all farmer needs. They are present in southern states of the country.





Source: FAI

On Complex fertilizer side, on the back of rising imports and lower sales growth, the inventory of complex fertilizers company has started piling up.
Industry's DAP volumes by 28% and complex fertilizers by 8%.In the last fiscal year, imports of DAP went up by 45% to 56 lakh MT.

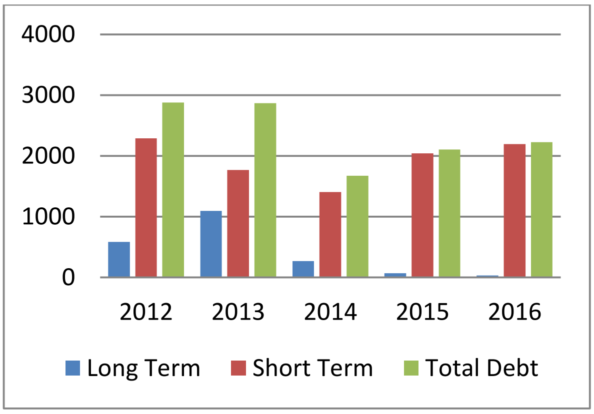
Investment Rationale

- **Increased Contribution of EBITDA from non-subsidy business (EBITDA Margin – 15%) than subsidy business (EBITDA Margin – 5%) will improve the overall operating margins of the company.**
  Following table shows that % age contribution of Non-subsidy business has increased in the last quarter over same quarter last year. **We believe this trend will continue as company's focus is to increase its non-fertilizer business.**

	Q2 FY17	Q2 FY16
Non- Subsidy Revenue	36%	30%
Subsidy Revenue	64%	70%

- **Coromandel has a competitive advantage as it is present in the entire agri-chain and has branded itself well under the brand name "GorMor".**

- **Company's focus on increasing non-fertilizer business's share to revenue will fuel profitability. Crop protection business has shown a healthy volume growth. (Organic manure grew at 20% last quarter.)**



Most of the debt of the company is short term debt raised for working capital loans.

The long term debt of the company is negligible and has reduced from around 550 Cr. in FY 2012 to 30 Cr. in FY16.

We believe that the volumes of DAP, MOP and Phosphatic fertilizers will pick up this season which will help to lower the working capital debt.

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DEEPAK FERTILIZERS

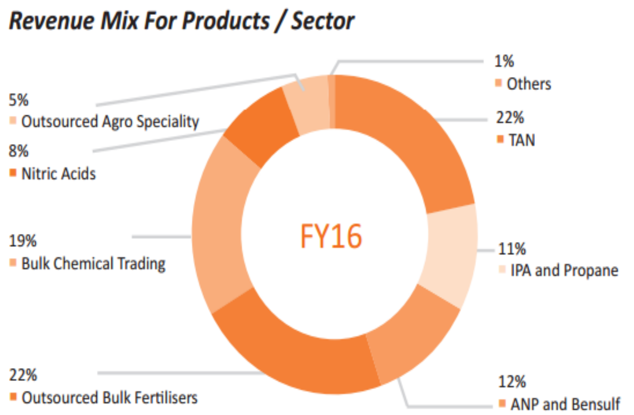
CMP : 243 Weight : 4%	
Company Name	**Deepak Fertilizers**
Market Cap(Rs. cr)	2143
Debt	1898
Cash	234
Enterprise Value	3807
Promoters Holding	51.07%
52 week high/low	284/128.15
Shares outstanding (In Cr.)	8.82

About the Company

Deepak fertilizers broadly operate in two segments i.e. Fertilizers and Chemicals. Company's 60% revenue comes from Chemical Business. It is the largest player in TAN. Along with fertilizers it also deals in Speciality Fertilizers like Bensulf and water soluble fertilizers. Its flagship brand name is "Mahadhan".

Deepak Fertilizers	2016	2015	2014	2013	2012
Sales	10527	9738	8911	8202	7539
Sales Growth (%)	8%	9%	9%	9%	33%
Profit	479	331	314	298	209
Profit Growth (%)	45%	5%	5.37%	42.58%	-8.33%
Total Debt	4629	3800	4456	5004	3367
ROCE (%)	8%	7%	7%	6%	6%
Working Capital Days	175	170	205	189	115
Trade Receivable	3853	3049	3440	3434	2022
Dividend Payout (%)	92	33	26	26	32

Product Mix



60% of total revenue- chemicals (outsourced – 29% and manufactured-71%)

40% - fertilizers (69% is outsourced fertilizers)

Margins: 12.4% for chemicals and 2.2% for fertilizers business.

Raw Material

The major raw materials for the Company's manufacturing unit at Taloja are Natural Gas, Ammonia, Phosphoric Acid and Propylene while the manufacturing facility at Srikakulam operates on bought out Ammonia.

Raw Material Consumed		%
Ammonia	50903	33.80
Natural Gas	46021	30.56
Proplyene	28696	19.05
Phosphoric acid	21666	14.38
Sulphur	1599	1.06

In May 2014, the Company's ANP fertilizer production under flagship brand (Mahadhan) had stopped as their supplier (GAIL) had stopped the supply of natural gas. In July 2015 gas supply resumed, the production has resumed which will boost the revenues of the company.

Chemical Business

TAN : Technical Ammonium Nitrate

- Deepak Fertilizers is India's Largest and world's 5th largest manufacturer of TAN (Technical Ammonium Nitrate). **Approx 40% market share of TAN in the country.**
- Technical Ammonium Nitrate (TAN) is a preferred blasting chemical for the mining of Coal, Iron ore, metals, etc., as well as for many infra projects due to its low cost. In 2016, TAN in India has grown by 14% to 0.8 MT.
- China is the largest consumer of commodities and the slowdown in China has affected the mining companies significantly.
- **Opportunity: (Coal India in FY16 has achieved a total production of 536 million MT. Production grew by 8%).** The Central Government has targeted coal production of 1 Billion MT for Coal India and total target of 1.4 billion for the country by 2020.
- **Competitive Advantage:** Only producer of explosive grade low density Prilled Ammonium Nitrate in India. It also manufactures AN Melt, high density AN and low density AN.
- **Capacity and Plants:** Manufacturing of TAN is done in two plants i.e. One in Taloja in Maharashtra (75% capacity utilization) and another under a wholly owned subsidiary Smartchem Technologies Limited (SML).
- Platinum Blasting Services Pvt. Ltd. (JV in Australia) is a wholly owned subsidiary of the company and during the year it bagged 3 blasting service contracts in Mining industry in Australia.
- **Risks: Increase in imports of Fertilizer Grade Ammonium Nitrate which is used as a cheaper substitute in India.**
- Potential growth opportunities outside India will be tapped by the company; exports grew 64% mainly due to increase exports to African and south east Asian countries.

Industrial Chemicals

- Industrial Chemicals is broadly divided into 2 segments namely Solvents and Acids.
- In its manufacturing facility in Taloja, company manufactures products like Iso Propyl Alcohol, various grades of Nitric Acid and liquid Carbon Di-oxide and trades various solvents for the pharmaceutical industry.
- **Competitive Advantage: Largest Manufacturer of Nitric Acid in India**
- The current capacity of all the three types of acids is close to 840000 MTPA, most of which is used for captive consumption with only 160000 MTPA available for merchant sale. With the increased capacity, the company will be able to provide an incremental 148000 MTPA.

- The capacity addition is done with CAPEX of 550 Cr and the commercial production will start in H2 FY18.

	Industry	Capacity utilization	Comment
Iso Propyl Alcohol (IPA)	125000 MT	102%(70000)	• IPA prices are connected to crude prices • Deepak is the largest manufacturer • 80% of the industry production is consumed by Pharma industry

Fertilizer Business

- Company is mainly into chemicals business and majority of their fertilizer business is outsourced. They have added capacity for their complex fertilizers and 32,000 mpta for bensulf plant and more than doubled their NPK (complex fertilizers) plant to 11,00,000 mtpa.
- The Company manufactures prilled nitro phosphate fertiliser under the brand name “Mahadhan Mahapower” and trades in a number of NPK and bulk fertilisers under the brand “Mahadhan”. It also manufactures speciality nutrients like Bentonite Sulphur (Bensulf) and distributes many other water soluble and organic nutrients.
- **Bulk Fertilizers has grown to sales of 4, 94,661 MT in FY16.**
- **Speciality Fertilizers include Bensulf and water soluble fertilizers.** In last 5 years the speciality fertilisers grew from Rs. 140.25 crore to Rs.211.76 crore.

Production Pattern (in MT)

Production	FY16	FY15	Capacity (MTPA)	Capacity Utilization (%)
Ammonia	107535	50143	128700	84
Iso Propyl Alcohol	71,177	74,983	70000	102
Diluted Nitric Acid	5,13,185	4,28,662	702900	73
Concentrated Nitric Acid	1,05,064	87,783	138600	76
TAN	3,38,483	3,03,721	469000	72
Nitro Phosphate Fertiliser	1,59,573	38,989	229500	70
Liquid Carbon Dioxide	33,452	11,730	33000	101
Bentonite Sulphur	14543	18525	25000	58
Methanol	-	8578	100000	-

Total Debt

Company’s long term debt has fallen marginally in the first half of FY16.The short term debt of the company which is the working capital debt has increased by 80% from FY 15.

(Rs. In Cr.)	H1 2016	2016	2015	2014	2013	2012
Long term	449	489	339	592	714	510
Short Term	1474	1409	785	232	304	269
Total Debt	1924	1898	1124	824	1018	779

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RASHTRIYA CHEMICALS AND FERTILIZERS LIMITED

CMP : 58.2 Weight: 4%	
Company Name	**RCF**
Market Cap(Rs. cr)	3211
Debt	2797
Cash	4
Enterprise Value	6004
Promoters Holding	80%
52 week high/low	59.35/35.25
Shares outstanding	55.17

About the Company

Rashtriya Chemicals and Fertilizers Limited is a Government owned fertilizer and chemical manufacturing company. The Company majorly operates in manufacturing of Urea and other products include Complex Fertilizers, Bio-fertilizers, Micro-nutrients, water soluble fertilizers, soil conditioners and a range of Industrial Chemicals. The Company operates through the segments, including TROMBAY, THAL and TRADING.

RCF	**2016**	**2015**	**2014**	**2013**	**2012**
Sales	8659	7716	6588	6774	6434
Sales Growth (%)	12%	17%	-3%	5%	17%
Profit	191	322	250	281	249
Profit Growth (%)	-41%	29%	-11.00%	13.00%	2.00%
Total Debt	2797	1926	1708	1716	1215
ROCE (%)	5%	10%	9%	10%	10%
Working Capital Days	220	195	213	196	150
Trade Receivable	4315	3297	2769	2579	1978
Dividend Payout (%)	38	37	39	34	36

Rashtriya Chemicals and Fertilizers is a government owned Fertilizer Company which is a pure urea player with 90% revenue coming from sale of fertilizers (manufacturing and trading combined) and the rest comes from Industrial products.

	2015-2016	**2014-15**
Thal Unit – (Ammonia &Urea)	20.97 lakh MT	21.78 lakh MT
Trombay Unit - Urea	1.49 lakh MT – Urea 4.62 lakh MT – Sulphala 15:15:15 1.75 lakh MT of Suphala 20:20:0	4.23 lakh MT of Urea 3.97 lakh MT of Suphala 15:15:15 2.61 lakh MT of Suphala 20:20:0
Industrial Products	0.69 lakh MT	1.52 lakh MT

Company has appointed Mr. Manoj Mishra as chairman and Managing Director of the company this year (June 2016).He is the managing director of NFL as well and has experience of many years in the fertilizer sector.

According to management the outstanding subsidy of the RCF will reduce to half by the end of FY17.They will reduce their working capital debt burden and hence finance cost will reduce. Reduction in Finance cost and increase in demand of fertilizers due to good monsoon this year will improve their profits.

GUJARAT STATE FERTILIZERS AND CHEMICALS

CMP: Rs.115 Weight: 4%	
Company Name	**GSFC**
Market Cap(Rs. cr)	4582
Debt	1190
Cash	42
Enterprise Value	5730
Promoters Holding	38%
52 week high/low	117.9/57.50
Shares outstanding	39.84

About the Company

GSFC is a Gujarat Government promoted company. Company operates in fertilizers (70%) and Chemicals-Industrial Product (30%) business. Gujarat has been their primary market as total fertilizers sales in this state stood at 47%.88% of the revenues come from manufacturing business. Trading Products include DAP, Methanol and Melamine.

GSFC	2016	2015	2014	2013	2012
Sales (Rs. In Cr)	6163	5325	5412	6253	5302
Sales Growth (%)	16%	-2%	-13%	18%	12%
Profit (Rs. In Cr)	412	423	387	560	786
Profit Growth (%)	-3%	9%	-31%	-29%	5%
Total Debt (Rs. In Cr)	1086	965	749	703	1190
ROCE (%)	8%	9%	8%	12%	22%
Working Capital Days	210	201	229	182	141
Trade Receivable (Rs. In Cr)	3308	1972	1984	779	904
Dividend Payout (%)	23	21	23	11	11

GSFC operates in two segments:

1. **Fertilizers (70% revenue share) :**

Fertilizers portfolio includes Urea, Water Soluble fertilizers, liquid bio fertilizers, seeds and tissue cultures. DAP, Urea, Ammonium Sulphate and Ammonium Phosphate Sulphate forms 25%,16%, 11% and 16% of the manufacture sales of the company respectively.

Product	Production	GSFC Market Share
Di-ammonium phosphate (DAP)	370200	5%
Ammonium Sulphate Phosphate	328430	9%
Ammonium Sulphate	334030	77%
Urea	411431	2%

2. **Chemicals (30% Revenue share):**

Product	Market Share	Total Demand	Use
Caprolactam	56%	150000	Tyre Cord & Nylon Yarn
Melamine	33%	55000	Laminates & Plywood
Nylon 6	47%	57000	Extrusion for filaments, Packaging, Moulding for Automobiles

Subsidy: Company has been receiving subsidy on a regular basis during H1FY17.Subsidy payments from the Government has improved in H1FY17 as compared to H2FY16.**The current outstanding subsidy of Ammonium Sulphate stood at Rs 915 Cr in H1FY17 out which the company is confident of receiving a majority portion during H2FY17 itself**.

Due to the various policies introduced by the government, the dependence on subsidy as a percentage of sales has gone down for the company. This reduced dependence will improve the working capital cycle of the company.

Q2 Results showed a 6% increase in production and 9% increase in volumes. Imports of Traded goods like DAP, complex fertilizers is on a rise but due to inability to sell, the inventory levels for the company has risen to 1172 cr. We believe inventory levels will come down this Rabi reason and things will return to normal from next season.

Capacity Expansion plans to boost the volume growth

1. Company in the 2nd Quarter of FY17 has commissioned:

- Nylon 6 – 15000 MTPA
- Water Soluble Fertilizers – 20000 MTPA

GSFC is expecting 250 crores of revenue from these capacities at 100% utilization levels.

2. Company has also planned capacity of 40000 MT for Melamine Plant by March 18. This capacity is expected to add 400 crores to the topline.
3. Company is also enhancing its Caprolactam Plant with the capacity of 50000 MT and capex incurred for the same is 75 cr which is likely to be completed by March 2017.
4. Company has undertaken debottlenecking at Sikka Complex – to be completed by March 2017.

Rise in Caprolactom Prices Will Boost the Industrial chemicals margins

- GSFC's Caprolactom business is 11% of its total consolidated revenue. GSFC'S industrial business was under pressure as Caprolactom Prices had fallen drastically and this segment had started incurring losses in the second half of the fiscal year 2015
- Caprolactam Price has now reached $ 1830 per MT from $600 per MT in September16. The caprolactam- benzene spreads have reached $1000 per MT. **The spread or the price difference is used to gauge profitability in the caprolactam business.**

Conclusion –

The thesis is that balance sheet will improve dramatically in FY 2018, there are moving factor that we need to watch out for, but there is considerable margin of safety. We have taken a Contrarian Call by entering fertilizer, we do totally understand all the risks attached with it, as Warren Buffett says "Risk is not knowing what you are doing", we do understand what we are doing. There is a big probability that the payoff in coming months will be large if our thesis goes right. There is considerable margin of safety in Fertilizers at these levels. Fall in raw material prices OF MOP and DAP will benefit Deepak, Coromandel a lot, whereas working capital cycle reduction will have a larger impact on RCF. Chambal will benefit from both raw material price fall as 58% of its revenue is from traded goods (MOP, DAP and NPK) and reducing in working capital cycle in Urea unit. GSFC is well place in both its fertilizer unit as well as industrial chemicals.

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Disclosure - Amit Jeswani & Family have no positions.

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