

17<sup>th</sup> September, 2018

CMP – ₹836

View – Positive

**Company Background and Business Model**

Gujarat Fluorochemicals Limited (GFL) is part of the INOX Group, a conglomerate business house that holds leadership positions in diversified sectors such as industrial gases, renewable energy, entertainment, speciality chemicals, engineering plastics, refrigerants and cryogenic engineering. The standalone entity at GFL began its journey in 1987 at Ranjitnagar, Gujarat as India's largest producer of CFC and HCFC gases. Post the Montreal Protocol in 2007 that called for the gradual phasing out of CFC and HCFC gases the company forward integrated into Poly Tetra Fluoro Ethylene (PTFE) and other value added fluoropolymers at Dahej, Gujarat.

**Important Statistics**

M.Cap (₹Cr)	9,187
52 Week H/L (₹)	959/670
NSE Code	GUJFLUORO
BSE Code	500173

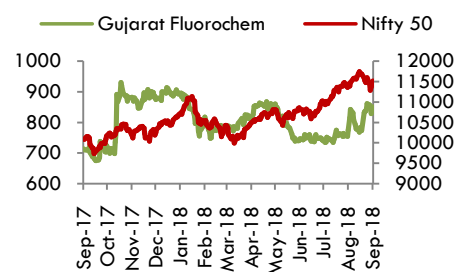
**Investment Rationale**

- **Fully integrated business model** – GFL is the largest fully integrated, technologically advanced and most cost-efficient producers of Chloromethanes, refrigerant gases and PTFE in India. As of 2018, its annual capacities in caustic soda, chloromethanes, refrigerant gases and PTFE (4th largest player globally) stood at 134,750 tonne (MT), 108,500 MT, 65,000 MT and 16,500 MT (~11% of global capacity) respectively. Furthermore, GFL has emerged into a credible global supplier of PTFE and value added products given its superior product quality and ability to scale with exports contributing 43% to the overall top line in 2018.
- **Three exciting expansions uplift prospects** – After three decades of expertise in fluorine chemistry, GFL through indigenous research has efficiently tapped into its rich experience by venturing into three exciting revenue streams in value added downstream products. Firstly, they plan to debottleneck their PTFE capacities by ~30% to ~21,000 MT from 16,500 MT in FY18. This expanded capacity is expected to be on stream in Q3FY19 and should provide them with incremental revenues to the tune of ~₹300-350 crore. Secondly, they have developed a host of new fluoropolymers (135,000 MT global demand) in house such as FKM, FEP, PFA and PVDF. These new fluoropolymers have also been qualified and approved by the customers over the last two years. Therefore, with commercial orders now coming in, the company expects to fully ramp up its 6,500 MT annual capacity by Q4FY20 thereby providing them with incremental revenues to the tune of ~₹600 crore. Lastly, with organic fluorine molecules gaining prominence in the new crop protection and pharmaceutical products, the company through its R&D has commercialized 2 molecules while 9 other molecules are at various stages in the pipeline. The company has set up a multi purpose plant that is expected to receive all the required clearances in FY19. GFL expects revenues from these fluoro specialty products to start flowing in from Q1FY20 with a peak revenue potential of ~₹450 crore. They have allocated a capex of ~₹450 crore (~₹300 crore already incurred as of FY18) for all three expansions that provides them with incremental revenues of ~₹1300 crore, thereby implying asset turnover in the range of 2.5-3x. Furthermore, with expansion being in VAP's they offer impressive EBITDA margins of 25%+ and RoCE in excess of 30%.

**Financials (Standalone)**

(₹cr)		
Particulars	FY18	FY17
Net Sales	2,056	1,428
EBITDA	579	300
EBITDA Margin	28.2%	21.0%
NormalizedPAT	333	141
PAT Margin	16.2%	9.9%
EPS (₹)	30.3	12.8
RoCE	13.1%	8.2%

Source: Annual Report



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- **Double boost from receding global supplies and anti dumping duty (ADD) protection** – Caustic soda prices have escalated since December 2017 on the back of strong demand pick up and receding global supplies due to three major setbacks. 1.) Lower supplies from US due to extreme weather conditions. 2.) ~25% of European supplies i.e. ~1 million tonne went out of production from 11 December 2017 post its decision to discontinue mercury process chlor alkali plants making it a net importer of the product from being a net exporter. It is unviable for European chlor alkali producers to shift to membrane cell technology as it entails high capital requirements and operational costs (high power costs) thereby limiting the scope for new capacities in Europe over the medium term. 3.) Chinese caustic soda supplies also receded due reduced production levels due to suppressed chlorine prices (lower PVC demand) apart from multiple plant closures as a consequence to its fight against pollution. This has resulted in a domino effect as the realisations of various downstream products viz. refrigerants, PTFE and their value added derivatives witnessed a 20-30% YoY rise. GFL, being a fully integrated player benefited largely from the firming realisation across all its product segments in FY18. Furthermore, the strong product demand led to rise in utilisation levels at GFL, resulting in higher operational efficiency with standalone EBITDA margins swelling to 28.2% in FY18 from 21.0% in FY17. GFL received another boost as the Finance Ministry imposed a definitive ADD of \$ 2637/MT on PTFE imports from China that are valid for a period of five years till July 2022.
- **Stellar Q1FY19 instills confidence** – Sales in Q1FY19 stood at ₹694.8 crore, up 46.7% YoY. EBITDA for the quarter came in at ₹212.6 crore, up 103.4% YoY with corresponding EBITDA margins at 30.6% vs. 22.1% in Q1FY18. Consequently, PAT in Q1FY19 was at ₹115.3 crore, up 82.1% YoY. The robust performance has been aptly supported by healthy volume growth in the PTFE and VAP segments that are instrumental in driving the company's operational performance going forward.

Segmental Analysis	PTFE	Caustic soda	Chloromethane	Refrigerant Gas (HCFC 22)	Others & VAP
Q1FY19 Sales Volume (MT)	3745	30281	16019	4841	
Q1FY18 Sales Volume (MT)	3420	27413	15445	4712	
YoY Growth (%)	9.5	10.5	3.7	2.7	
Q1FY19 Sales Value (₹ Cr)	280	114	70	111	121
Q1FY18 Sales Value (₹ Cr)	181	89	51	90	63
YoY Growth (%)	54.5	27.4	36.7	23.8	92.7
Q1FY19 Realisation (₹/MT)	7,46,595	37,482	43,448	2,29,705	
Q1FY18 Realisation (₹/MT)	5,29,240	32,503	32,956	1,90,577	
YoY Growth (%)	41.1	15.3	31.8	20.5	

### Valuation

At the current market cap of ₹9,187 crore, the implied cumulative value of GFL's long term holdings in Inox Wind (57.0%), Inox Leisure (48.1%) and other investments after applying a 45% holding company discount stood at ~₹1,455. As a result, the standalone entity is trading at 20.1x P/E valuations on a TTM basis. Operational performance at GFL has improved robustly with EBITDA margins at 28.2% in FY18 (21.0% in FY17) resulting in RoCE rising to 13.1% in FY18 (8.2% in FY17). **Therefore, we are POSITIVE on the stock as it depicts all the qualities of a turnaround candidate such as its advent into VAP streams, improving return ratios profile, low debt levels, ADD protection on its core product & further amplified by favourable global demand supply scenario.**

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**Disclosure of Interest Statement in Gujarat Fluorochemicals Limited as on September 17<sup>th</sup>, 2018**

Name of the Security	Gujarat Fluorochemicals Limited
Name of the analyst	Srinath Sridhar
Analysts' ownership of any stock related to the information contained	NIL
Financial Interest	
Analyst :	No
Analyst's Relative : Yes / No	No
Analyst's Associate/Firm : Yes/No	No
Conflict of Interest	No
Receipt of Compensation	No
Way2Wealth ownership of any stock related to the information contained	NIL
Broking relationship with company covered	NIL
Investment Banking relationship with company covered	NIL

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