

Feb 2, 2012

GUJARAT STATE FERTILIZERS AND CHEMICALS LTD STRONG BUY

Gujarat State Fertilizers and Chemicals Ltd (GSFC) is premier fertilizer & chemical manufacturing company incorporated on February 15, 1962. It operates in two business segments: Fertilizers and Industrial Chemicals. The fertilizer segment includes urea, ammonium sulphate, di-ammonium phosphate (DAP) and ammonium phosphate sulphate and NPK traded fertilizer products. Its chemical division produces Caprolactam, which is a raw material of nylon 6 and is used in carpets, threads, ropes, plastics, tires, wire and cable.

- GSFC derives ~70 % of its revenues from fertilizer segment, which will be the key to sustained growth in coming quarters. Controlling food inflation is on top of the agenda on policy makers list and one of the ways to achieve this is increasing farm yields. This will lead to higher demand of complex fertilizer; we believe GSFC would be prime beneficiary due to strong brand and distribution network.
- GSFC's Tunisian JV, TIFERT is likely to get operational in FY13. Commencement of methanol production with 175,000tpa capacity is also expected in the same period, which will drive volumes in FY13.
- GSFC is trading at an attractive valuations as the market value of its investments plus cash on the books comes to around Rs. 215/share, more than 50% of its current market price.
- As per ASSOCHAM report, Gujarat achieved highest decadal agriculture growth rate in the country at a CAGR of 10.97% between FY00-10. GSFC has strong presence in the state and has very strong distribution network which in our opinion will be key growth driver as farmers opt for high yield supported by positive policy framework adopted by the state govt.
- The NBS (Nutrient Based Subsidy) introduced by the govt will help the fertilizer business of the company as it derives ~70% revenue from the fertilizer.

Based on a standalone FY13 P/E multiple of 6, the fair value for the company works out to Rs 579/share.

Financial Snapshot

| Projections (Rs Mn) | FY09A | FY10A | FY11A | FY12E | FY13E |
|-----------------------|--------|--------|--------|--------|--------|
| Net Sales | 58,847 | 40,192 | 47,551 | 49,077 | 57,155 |
| Y-o-Y Growth % | | -32% | 18% | 3% | 16% |
| Operating Expenditure | 51,051 | 34,090 | 35,328 | 39,022 | 45,825 |
| EBIDTA | 7,796 | 6,102 | 12,223 | 10,056 | 11,330 |
| Y-o-Y Growth % | | -22% | 100% | -18% | 13% |
| Adjusted PAT | 4,207 | 4,103 | 7,949 | 6,753 | 7,690 |
| Y-o-Y Growth % | | -2% | 94% | -15% | 14% |
| EPS Rs | 53 | 51 | 100 | 84.7 | 96.5 |
| BVPS Rs | 242 | 269 | 355 | 433 | 522 |
| EBIDTA % | 13% | 15% | 26% | 20% | 20% |
| NPM % | 7% | 10% | 17% | 14% | 13% |
| ROE % | 22% | 19% | 28% | 20% | 18% |
| PER x | | | | 4.0 | 3.5 |
| P/B Ratio | | | | 0.8 | 0.6 |

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| Recommendations | <= 1 year | 1 - 2 yrs | 2 - 5 yrs |
|-----------------|-----------|-----------|-----------|
| Strong Buy | | | |
| Buy | | | |
| Hold | | | |
| Reduce | | | |
| Sell | | | |

Strong Buy – Expected Returns > 20% p.a.
Buy – Expected Returns from 10 to 20% p.a.
Hold – Expected Returns from 0 % to 10% p.a.
Reduce – Expected Returns from 0 % to 10% p.a. with possible downside risk
Sell – Returns < 0 %



STOCK DATA

| | |
|--------------------|----------------|
| BSE / NSE Code | 500690 / GSFC |
| Bloomberg Code | GSFC IN Equity |
| No. of Shares (Mn) | 80 |
| Sensex / Nifty | 17300/ 5235 |

PRICE DATA

| | |
|----------------------|---------------|
| CMP Rs (1st Feb' 12) | 377 |
| Beta | 0.5 |
| Market Cap (Rs mn) | 30,063 |
| 52 Week High-low | 504.1 / 316.6 |
| Average Daily Volume | 29,512 |

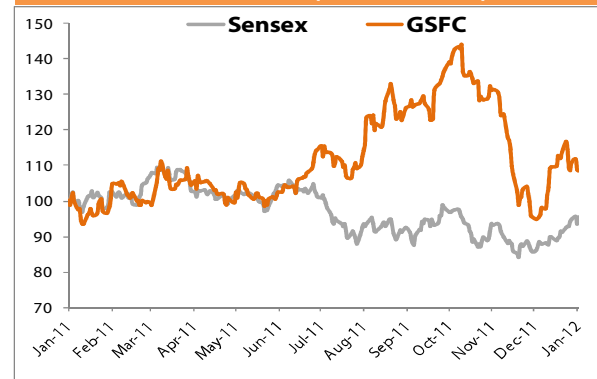
STOCK RETURN (%)

| | 30D | 3M | 6M |
|--------|--------|--------|-----|
| GSFC | -16.11 | -15.35 | -12 |
| Sensex | -1.03 | -5.54 | -4 |
| Nifty | -0.42 | -5.1 | -3 |

SHARE HOLDING PATTERN (%)

| | |
|-------------------|--------------|
| Promoter | 37.8 |
| Institutional | 38.5 |
| Non Institutional | 23.6 |
| Total | 100.0 |

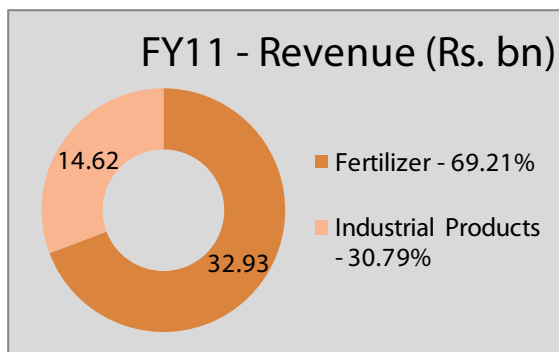
1 Year Price Performance (Rel. to Sensex)



BUSINESS PROFILE

GSFC is a premier fertilizer & chemical manufacturing company incorporated on February 15, 1962 and headquartered in Vadodara, Gujarat. It operates two business segments viz. fertilizers and industrial chemicals. The fertilizer segment includes urea, ammonium sulphate, di-ammonium phosphate, ammonium phosphate sulphate and NPK traded fertilizer products. GSFC's main chemical product Caprolactam is a raw material of nylon 6, whose application includes carpets, threads, ropes, plastics, tires, wire and cable. The company derives ~70% revenue from fertilizer segment and rest from industrial chemical segment.

GSFC derives ~70% revenue from fertilizer segment and rest from industrial chemical segment



Segment Wise Market Share in the Country

| Fertilizer | India DD (MTPA) | GSFC share | Product | India DD (MTPA) | GSFC share |
|------------|-----------------|------------|-------------|-----------------|------------|
| DAP | 11.10 | 8% | Caprolactam | 1,22,500 | 60% |
| Urea | 28.2 | 1% | Melamine | 40,000 | 40% |
| APS | 3.5 | 3% | MEK Oxime | 550 | 90% |
| AS | 0.5 | 70% | Nylon - 6 | 40,000 | 40% |

GSFC has very strong brand (Sardar), distribution network and agro extension activity in Gujarat

Out of total amount of DAP sold in Gujarat, GSFC had market share of 50%, well ahead of IFFCO which had the market share of 25%. In case of Ammonium Phosphate Sulphate (APS), the company attained the highest market share of 51% in Gujarat, followed by Gujarat Narmada Valley Fertilizers Company Ltd's (GNFC) share of 46%, which is promoted by GSFC. The company also carries out wide range of agro extension activities such as -

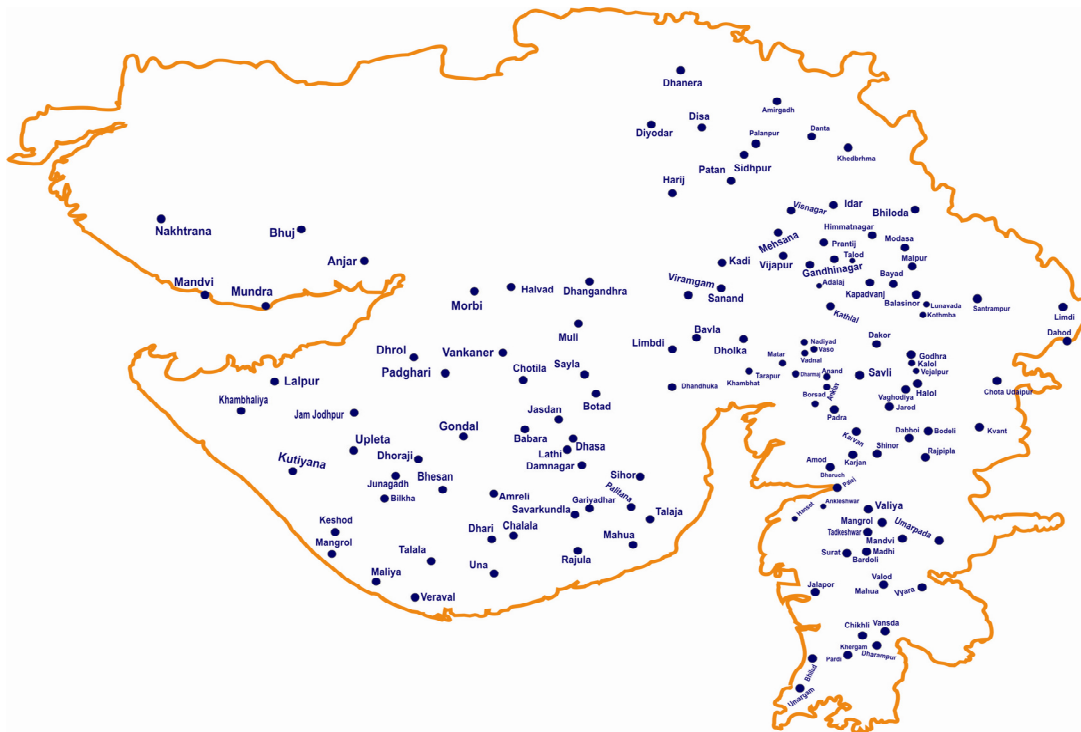
GSFC has very strong brand, network and agro extension activity in Gujarat

- It publishes Krishijvan – Agricultural magazine for farming community which has 65,000 subscribers in Gujarati (monthly) edition and 8000 subscribers in Hindi (quarterly) edition
- Farm youth training programs
- Field demonstrations, night meetings, seminars and exhibitions
- Promoting micro irrigation systems
- Soil and water testing facilities through well equipped laboratory besides Mobile Van Lab



BUSINESS PROFILE

Farm Information Centre cum Depots in Gujarat



GSFC has entered into strategic Joint Venture with Tunisian Indian Fertilizer (TIFERT) in Tunisia to ensure the consistent supply of Phosphoric Acid for its DAP manufacturing facility at Sikka plant. The project was delayed due to political turmoil in the country arising out of Arab Spring but it is expected to be functional by FY13. Capacity expansion plan at Vadodara for Nylon-6 by another 15,000MTPA is well on track. The company is also contemplating setting up of larger capacity plant at Dahej, replicating its Vadodara plant.

GSFC has commissioned its first 10MW Wind Mill Power Project at Kutch in March 2008 and added another 12MW capacity in January 2009; subsequently it has added 18MW capacity in Porbandar district and 33MW in Kutch district. The company completed the commissioning of further 50.4MW capacity at Rajkot and Surendranagar district in December 2011, which will take the total wind power capacity to 123.4MW. In the management call after the Q3FY12 results, the company mentioned that they are evaluating further 20MW of capacity addition.

As per ASSOCHAM report, Gujarat has achieved highest agriculture growth rate of 10.97% CAGR in the last decade with the help of

- Investment in agricultural infrastructure to improve irrigation system
- Latest technologies and dedicated power grid to ensure regular power supply
- Innovative and efficient management of state's groundwater resources

These factors has converted around 1.5mn hectare additional lands in largely semi-arid Gujarat, fit for farming thereby establishing the state on the top in systematic and scientific development of farm sector. We believe there is strong foundation for the agriculture sector in the state and it can maintain its growth rate in the upcoming years. GSFC will reap the benefit as it has strong presence in the market coupled with formidable brand and balance sheet strength for future expansion.

BUSINESS PROFILE

GSFC is trading at very attractive valuation as it has cash on books of ~ Rs. 9,500mn and investments in associate companies at present market value of around ~ Rs. 7,600mn. Cash plus value of investments comes to around Rs. 215/share which is more than 50% of the current market price. We believe that GSFC is trading at a very cheap valuation and this discount in the valuation is not justified given the return ratios, cash plus investments and earnings visibility in the sector, in which the company operates. It is trading at cash and investments adjusted PE of 1.9x based on estimated FY13 EPS, making it the top pick in fertilizer sector in India.

Cash and Investment Per Share

| Name of the Co. | Market Value (mn) |
|---|-------------------|
| Gujarat Narmada Valley Fertilizer Company | 2585 |
| Gujarat Industrial Power Company Ltd | 1565 |
| Gujarat Alkalies | 222 |
| Gruh Finance | 60 |
| IDBI | 55 |
| Mangalore Chemicals | 24 |
| Gujarat State Financial Corp | 3 |
| Unquoted Investments | 3167 |
| Investments Value Per Share (Rs) | 96 |
| Cash and Bank Balance | 9500 |
| Cash Per Share | 119 |
| Cash + Investments Per Share | 215 |

Cash plus value of investments comes to around Rs. 215/share which is more than 50% of the current market price

Trading at cash and investments adjusted PE of 1.9x based on estimated FY13 EPS

SWOT Analysis

| Strengths | Weaknesses |
|--|-------------------------------|
| Strong balance Sheet - High Cash + Zero Debt | High dependency on subsidy |
| Strong Brand and Distribution network | Volatile nature of industrial |
| Backward Integration (TIFERT) | Volatile raw material prices |

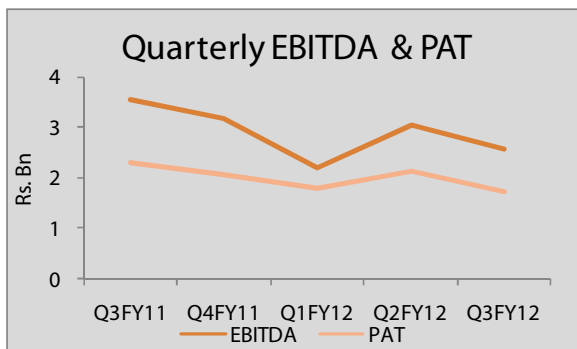
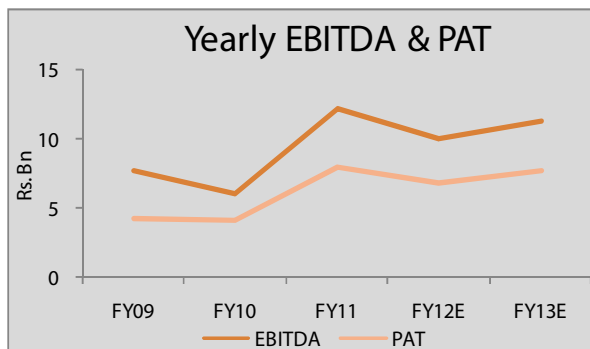
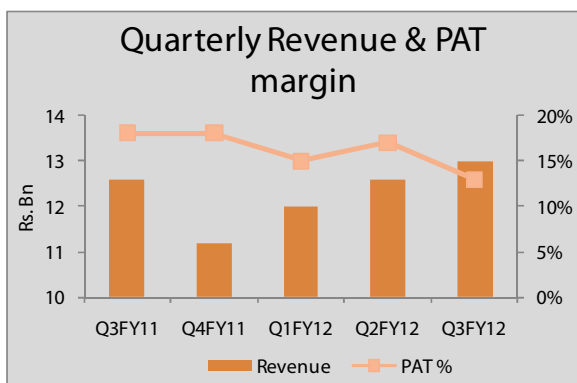
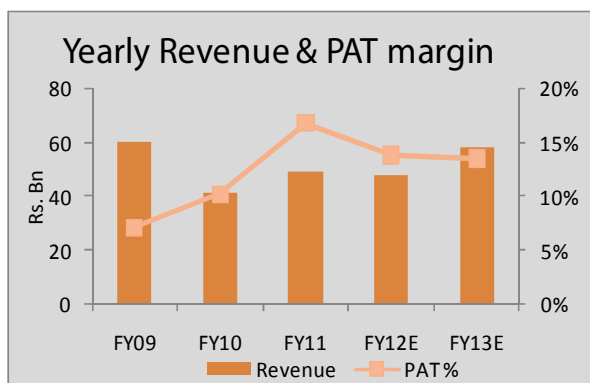
| Opportunities | Threats |
|---|-------------------------------------|
| Strong presence in Gujarat | Govt policies - decrease in subsidy |
| Strong balance sheet to fuel capacity expansion | Non availability of raw material |
| Agro products consolidation | Global competition |



BUSINESS PERFORMANCE

In Q3FY12, consolidated revenue grew 3% on Y-o-Y basis from Rs. 12.6bn to Rs. 13bn and EBIDTA margins contracted to 20% from 28% Y-o-Y basis mainly on account of declining margins in chemical segment. PAT also declined to Rs. 1.7bn from Rs 2.3bn a year ago period due to poor performance from chemical segment, declining caprolactum prices to a low of USD 2,500mt. This was on account of uncertain macroeconomic environment and jump in employee cost. Employee cost rose by 75% to Rs. 1.18bn on a Y-o-Y basis due to higher provisioning on account of wage revision at Vadodara plant. We believe that the revenue will be boosted from commissioning of TIFERT JV and Methenol plant in FY13.

Revenue will be boosted from commissioning of TIFERT JV and Methenol plant in FY13



Peer Comparison

Going by almost all the parameters, GSFC is an attractive buy compared to its nearest peers. It has the highest EBIDTA and PAT margin of 26% and 17% respectively in FY11. The company has a strong presence in the state of Gujarat and the largest producer of copralactum in India. Even though GSFC has similar profitability as Coromandel International, it trades at less than half market capitalization, largely due to higher dependence on fertilizer and better dividend payout by the Coromandel International.

Highest EBIDTA and PAT margin of 26% and 17% respectively in FY11, compared to its peers

Peer Group Comparison

| Companies | Revenue (Rs. mn) | EBIDTA Margin (%) | PAT Margin (%) | ROE % | P/E (x) | P/B (x) | CMP (Rs.) | FV (Rs.) |
|--------------------------|------------------|-------------------|----------------|-------|---------|---------|-----------|----------|
| GSFC | 47,550 | 26% | 17% | 28% | 3.8 | 1.1 | 377 | 10 |
| Coromandel International | 76,002 | 15% | 9% | 42% | 11.5 | 4.0 | 270 | 1 |
| Zuari Industries | 55,228 | 5% | 3% | 15% | 8.1 | 1.1 | 455 | 10 |
| Deepak Fertilizer | 16,279 | 24% | 11% | 19% | 6.8 | 1.2 | 140 | 10 |

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VALUATION

We expect GSFC's revenue to grow at a CAGR of 10% from FY11 to FY13E to Rs. 57bn and further estimate that PAT would be around Rs. 7.7bn in FY13. PAT and EBITDA margins would be under pressure due to higher raw material prices. We believe that the revenue will be boosted from commissioning of TIFERT JV and Methenol plant in FY13 and will be the main driver for improving the top line. The company has plans to enter water soluble and liquid fertilizer space which we have not considered in our estimates.

At current market price GSFC is trading at cash and investments adjusted PE of 1.9x based on estimated FY13 EPS of Rs. 96.5, making it the top pick in fertilizer sector in India. Further at the current market price, GSFC is trading at 4.4x and 3.9x based on estimated EPS for Rs 84.7 and Rs. 96.5 in FY12E and FY13E.

Based on a standalone FY13 P/E multiple of 6, the fair value for the company works out to Rs 579/share.

We recommend a **"STRONG BUY"** rating on the stock.

Profit & Loss Statement

| Particulars (Rs Mn) | FY09A | FY10A | FY11A | FY12E | FY13E |
|-----------------------------|--------|--------|--------|--------------|--------------|
| Net Sales | 58,847 | 40,192 | 47,551 | 49,077 | 57,155 |
| Operating Expenditure | 51,051 | 34,090 | 35,328 | 39,022 | 45,825 |
| Depreciation | 1,430 | 1,409 | 1,464 | 1,557 | 1,790 |
| EBIT | 6,366 | 4,693 | 10,759 | 8,499 | 9,541 |
| EBIT Margin (%) | 11% | 12% | 23% | 17% | 17% |
| Interest Expenses | 473 | 375 | 192 | 118 | 115 |
| Other Income | 721 | 1,130 | 1,012 | 1,472 | 1,715 |
| Profit Before Tax | 6,613 | 5,449 | 11,579 | 9,853 | 11,140 |
| Less: Tax | 2,405 | 1,345 | 3,630 | 3,100 | 3,450 |
| Adjusted PAT | 4,207 | 4,103 | 7,949 | 6,753 | 7,690 |
| PAT Margin (%) | 7% | 10% | 17% | 14% | 13% |
| ROE (%) | 22% | 19% | 28% | 20% | 18% |
| EPS (Rs) | 53 | 51 | 100 | 85 | 96 |
| BVPS (Rs) | 242 | 269 | 355 | 433 | 522 |
| Valuation Ratios (x) | | | | FY12E | FY13E |
| PER x | | | | 4.0 | 3.5 |
| P/B Ratio | | | | 0.8 | 0.6 |

Ratio Analysis

| Particulars (Rs Mn) | FY09A | FY10A | FY11A | FY12E | FY13E |
|-------------------------|-------|-------|-------|-------|-------|
| Current Ratio | 1.6 | 2.6 | 2.7 | 3.2 | 3.6 |
| Cash Ratio | 0.0 | 0.1 | 0.7 | 1.4 | 1.8 |
| Interest Coverage Ratio | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 |
| Debt Equity Ratio | 0.2 | 0.3 | 0.1 | 0.1 | 0.2 |
| ROCE | 18% | 12% | 23% | 15% | 13% |



Balance Sheet

| Particulars (Rs Mn) | FY09A | FY10A | FY11A | FY12E | FY13E |
|-----------------------------------|---------------|---------------|---------------|---------------|---------------|
| Application of Funds | | | | | |
| Fixed Asset (Net) | 12,023 | 10,815 | 12,613 | 14,406 | 18,436 |
| CWIP | 510 | 1,819 | 3,212 | 3,212 | 3,212 |
| Investments | 6,061 | 4,250 | 4,250 | 4,250 | 4,250 |
| Inventories | 7,456 | 6,111 | 5,648 | 6,628 | 7,522 |
| Sundry Debtors | 4,807 | 6,216 | 8,881 | 6,922 | 9,192 |
| Cash & Bank Balance | 381 | 601 | 6,127 | 11,569 | 19,370 |
| Loans & Advances | 1,987 | 8,109 | 1,862 | 1,862 | 1,862 |
| Miscellaneous Expenditure not W/O | 0 | 0 | 0 | 0 | 0 |
| Total | 33,225 | 37,921 | 42,593 | 48,848 | 63,845 |

Sources of Funds

| | | | | | |
|---------------------|---------------|---------------|---------------|---------------|---------------|
| Share Capital | 797 | 797 | 797 | 797 | 797 |
| Reserves & Surplus | 18,518 | 20,644 | 27,490 | 33,696 | 40,775 |
| Minority Interest | 0 | 0 | 0 | 0 | 0 |
| Total Debt | 3,240 | 6,876 | 3,923 | 3,840 | 9,660 |
| Net Deferred Tax | 1,716 | 1,497 | 2,043 | 2,043 | 2,043 |
| Current Liabilities | 4,690 | 4,217 | 5,384 | 4,748 | 6,179 |
| Provisions | 4,264 | 3,889 | 2,956 | 3,723 | 4,390 |
| Total | 33,225 | 37,921 | 42,593 | 48,848 | 63,845 |

Cash Flow Statement

| Particulars (Rs Mn) | FY09A | FY10A | FY11A | FY12E | FY13E |
|---|----------------|----------------|----------------|----------------|----------------|
| Profit Before Tax | 7,400 | 3,891 | 11,125 | 9,853 | 11,140 |
| Total Adjustments | 2,288 | 1,636 | 1,251 | 1,675 | 1,905 |
| Change in Working Capital | 1,035 | (1,284) | 4,074 | 1,111 | (1,067) |
| Direct Taxes Paid | (2,442) | (1,751) | (2,943) | (3,100) | (3,450) |
| Others | 0 | 0 | 0 | 0 | 0 |
| Cash Flow from Operations | 8,280 | 2,492 | 13,506 | 9,539 | 8,528 |
| Net Investment in GFA | (1,291) | (1,533) | (4,681) | (3,350) | (5,820) |
| Sale of Fixed Assets | 0 | 21 | 0 | 0 | 0 |
| Change in Investments | (4,435) | 1,575 | 0 | 0 | 0 |
| Others | 199 | (5,239) | 215 | 0 | 0 |
| Cash Flow from Investment | (5,527) | (5,175) | (4,466) | (3,350) | (5,820) |
| Proceed from LT Borrowings | 0 | 3,636 | 0 | 3,350 | 5,820 |
| Proceed from ST Borrowings | 0 | 0 | 0 | 0 | 0 |
| Repayment of f the Long Tem Borrowings | (2,348) | 0 | (2,953) | (3,433) | 0 |
| Repayment of f the Short Tem Borrowings | 0 | 0 | 0 | 0 | 0 |
| Dividend Paid | (356) | (356) | (356) | (547) | (611) |
| Interest Paid | (428) | (317) | (147) | (118) | (115) |
| Cash Flow from Financing | (3,192) | 2,902 | (3,515) | (747) | 5,093 |
| Net Cash Flows | (439) | 220 | 5,526 | 5,442 | 7,801 |
| Op bal of cash | 820 | 381 | 601 | 6,127 | 11,569 |
| Transferred to B/S | 381 | 601 | 6,127 | 11,569 | 19,370 |



Board Of Directors

| Director Name | Current Position | Description |
|---------------------|---|---|
| A. Joti | Non-Executive Non-Independent Chairman of the Board | Shri. A. K. Joti, IAS, is Non-Executive Non-Independent Chairman of the Board of Gujarat State Fertilizers & Chemicals Ltd. He is a Senior IAS Officer having experience in Policy Making, Public Administration, Management of Corporate Finance & Strategic Planning. During his career, he held various key positions at the State Government and Central Government levels. Presently, he is the Chief Secretary to the Govt. of Gujarat. |
| Atanu Chakraborty | Managing Director, Executive Director | Shri. Atanu Chakraborty, IAS, Managing Director, Executive Director of Gujarat State Fertilizers & Chemicals Ltd. He is an IAS Officer of the 1985 batch having experience of more than two decades in Finance, Administration, Economics, etc. He worked in various State as well as Central Government Departments and Public Sector Undertakings. He was Principal Secretary (Economic Affairs), Finance Department, Govt. of Gujarat, prior to his appointment as MD-GSFC. He is a voracious reader and areas of his interest include subjects such as Finance, Economics and Infrastructure, etc. He has done B.E. (Electronics & Communication), Post Graduate Diploma in Business Finance, M.B.A. (Business Administration) from U.K. & IAS. |
| B. Bhorania | General Manager - Finance | Shri. B.M. Bhorania is General Manager - Finance of Gujarat State Fertilizers & Chemicals Ltd. |
| Divyabhash Anjaria | Independent Non-Executive Director | Shri. Divyabhash Chandrakant Anjaria is Independent Non-Executive Director of Gujarat State Fertilizers & Chemicals Ltd. He is MBA (Finance), from Indian Institute of Management, Ahmedabad has experience in the financial sector viz. Capital Markets, Banking in India and Overseas, Corporate Finance & Management and Commodity Markets. He is a Member of the Personnel Committee and Chairman of Finance-cum-Audit Committee of Gujarat State Fertilizers & Chemicals. |
| P. N. Roy Chowdhury | Non-Executive Independent Director | Shri. P. N. Roy Chowdhury, IAS, is Non-Executive Independent Director of Gujarat State Fertilizers & Chemicals Ltd. He holds the B.A.(Maths);M.A.(Applied Maths);M.S.(Fin),UK; M.B.A.(Buss.Admn.),USA; IAS.He is a senior IAS Officer having experience in the field of Management & Administration. He held distinguished positions in the Government of Gujarat. Presently, he is Principal Secretary to Government of Gujarat, Agriculture & Co-operation Department. He has the directorship in Gujarat State Land Development Corporation Ltd., Gujarat State Seeds Corporation Ltd., Gujarat Agro Industries Corporation Ltd., Gujarat State Agri Marketing Board, Gujarat Narmada Valley Fertilizers Co. Ltd., Mahindra Gujarat Tractors Ltd |
| Ajay Shah | Independent Non-Executive Director | Shri. Ajay N. Shah, Ph.D. Independent Non-Executive Director of Gujarat State Fertilizers & Chemicals. Mr. Shah is Ph.D. in Economics from University of Southern California, Los Angeles; B.Tech in Aeronautical Engineering from I.I.T., Bombay. He has the consultancy experience of varied nature in the field of Finance and won many prestigious awards relating to Risk Management, Certified Financial Planning etc. during his career. He has the directorship in Centre for Monitoring Indian Economy, National Securities Clearing Corporation, Clearing Corporation of India Ltd., and J S W Steel Limited. |
| Vasant Gandhi | Non-Executive Independent Director | Prof. Vasant P. Gandhi, Ph.D. is Non-Executive Independent Director of Gujarat State Fertilizers & Chemicals. Prof. Vasant P Gandhi is Ph.D from Stanford; PGP, IIM, Ahmedabad and MA, MS (Stanford) having experience of Management, Consultancy & Research activities in agri business & agro industry. |