

Mangalore Chemicals and Fertilizers Ltd.

10th December 2024

Special situation: Merger arbitrage

Mangalore Chemicals and Fertilizers Ltd. (MCFL), a subsidiary of Zuari Agro Chemicals Ltd. (ZACL) and part of the Adventz Group, is a prominent fertilizer manufacturer based in Karnataka, India. The Company produces Urea, Di-Ammonium Phosphate (DAP), complex fertilizers and other specialty products under the brand name 'Mangala.'

MCFL primarily operates in southern India and has an annual production capacity of ~0.4 Mn MTPA for Urea and ~0.3 Mn MTPA for DAP and other complex fertilizers. Its manufacturing facility is strategically located in Panambur, Karnataka, near the New Mangalore Port, enabling efficient logistics and strong regional presence.

The merger ratio of MCFL with Paradeep Phosphates Ltd. (PPL) presents a potential upside opportunity of ~27.3%.

Merger with PPL

On February 7, 2024, MCFL announced its merger with PPL, a prominent private-sector producer of phosphatic fertilizers in India and part of the Adventz Group. PPL operates under Zuari Maroc Phosphates Pvt Ltd (ZMPPL), a joint venture between ZACL and Morocco's OCP Group. With manufacturing facilities in Paradeep, Odisha, and Zuarinagar, Goa, PPL has a total production capacity of ~3 Mn MTPA, including ~2.6 Mn MTPA for phosphatic fertilizers such as DAP and multiple NPK grades (N-10 to N-28), and ~0.4 Mn MTPA for Urea.

This merger will establish one of India's largest integrated private-sector fertilizer company, with a combined production capacity of ~3.7 Mn MTPA and a strong pan-India presence. MCFL's strong foothold in southern India complements PPL's significant market share across northern, central and eastern regions, creating a synergistic market reach. The integration is expected to enhance product portfolio diversification, introduce innovative offerings and improve raw material sourcing through increased procurement volumes. Furthermore, strategic support from the OCP Group will provide a competitive advantage in securing raw materials. The merger also sets the foundation for growth through capacity expansion in NPK production and backward integration with a phosphoric acid facility, further strengthening operational efficiency and profitability.

View & Valuation

Upon the scheme of arrangement becoming effective, MCFL shareholders will receive 187 PPL shares for every 100 MCFL shares held. The newly issued PPL shares will be listed on both the NSE and BSE. As of December 9, 2024, MCFL is trading at Rs. 162.1 per share, while PPL is trading at Rs. 110.4 per share. This implies that 100 MCFL shares, valued at Rs. 16,210, will entitle shareholders to 187 PPL shares worth Rs. 20,635. This arrangement offers an upside of ~27.3%, presenting an opportunity to capitalize on transactional arbitrage. However, the gain is contingent upon minimal regulatory delays, stable market conditions, and the absence of significant price fluctuations. Nonetheless, we believe PPL is well-positioned to benefit from merger synergies through enhanced sourcing efficiency, an optimized product mix and expanded market reach.

Arbitrage

CMP Rs. 162.1
(+27.3%)

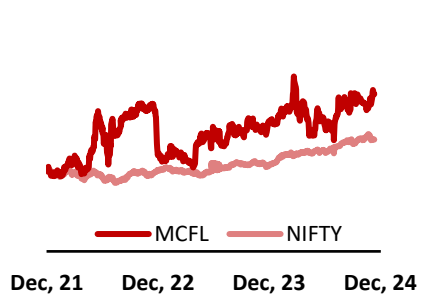
Company Data

Bloomberg Code	MCF IN
MCAP (Rs. Mn)	19,674
O/S Shares (Mn)	119
52w High/Low	171/94
Face Value (Rs.)	10
Liquidity (3M) (Rs. Mn)	60

Shareholding Pattern %

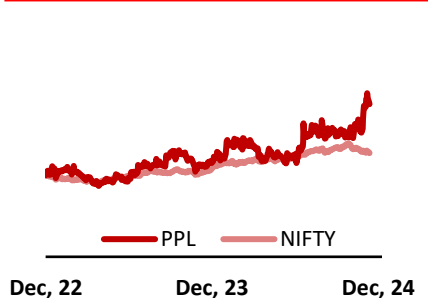
	Sep 24	Jun 24	Mar 24
Promoters	60.63	60.63	60.63
FIIs	1.66	1.45	1.84
DIIIs	6.52	5.55	2.89
Non-Institutional	31.2	32.37	34.64

MCFL vs Nifty



Source: Keynote Capitals Ltd.

PPL vs Nifty



Source: Keynote Capitals Ltd.

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About MCFL

Mangalore Chemicals and Fertilizers Ltd (MCFL) is a leading manufacturer of chemical fertilizers based in Karnataka, India. The Company produces a wide range of fertilizers, including Urea and non-Urea-based products such as Di-Ammonium Phosphate (DAP), Nitrogen Phosphorus (NP), Muriate of Potash (MoP), granulated fertilizers, micronutrients, soil conditioners and specialty fertilizers. Additionally, MCFL engages in trading of complex fertilizers by capitalizing on market opportunities and business feasibility.

MCFL operates primarily in southern India under the brand name 'Mangala', with ~82% of its sales volume originating from Karnataka in H1FY25. Its manufacturing facility is strategically located in Panambur, Karnataka, directly opposite the New Mangalore Port Trust, ensuring efficient logistics.

The Company has an annual production capacity of ~0.4 Mn MTPA for Urea and ~0.3 Mn MTPA for DAP and other complex fertilizers.

MCFL is a subsidiary of Zuari Agro Chemicals Ltd (ZACL) and is part of the Adventz Group, an Indian conglomerate with a significant presence in agriculture, engineering and infrastructure, real estate, consumer durables and the services industry.

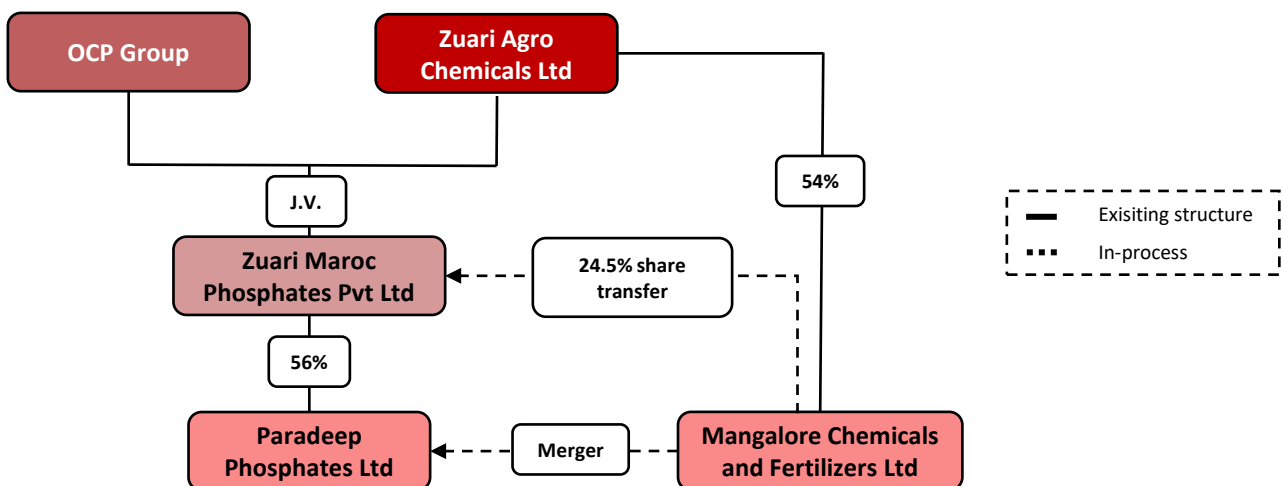
About PPL

PPL is India's second-largest private-sector phosphatic fertilizer company, promoted by ZACL and Morocco's OCP Group through their joint venture, Zuari Maroc Phosphates Pvt Ltd (ZMPPL).

PPL produces a wide range of fertilizers, including DAP, multiple NPK grades (N-10 to N-28), and Urea. The Company is also a key supplier of industrial products such as Gypsum, HFSA (Hydrofluorosilicic Acid), Sulphuric Acid and Ammonia.

With two manufacturing units located in Paradeep, Odisha, and Zuarinagar, Goa, PPL has a combined production capacity of ~3 Mn MTPA, comprising ~2.6 Mn MTPA for Phosphates and ~0.4 Mn MTPA for Urea. The Company secures its raw materials through long-term global contracts and markets its products under the established brands "Jai Kisaan" and "Navratna," serving 16 states across India with strong presence in North and East India.

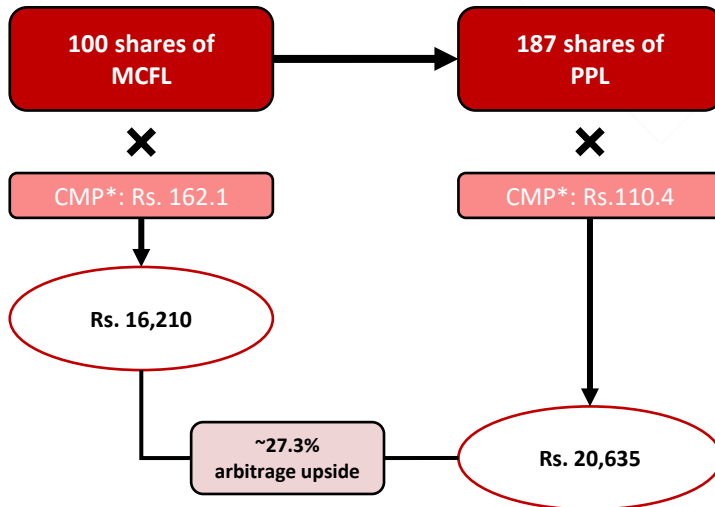
MCFL merger with PPL



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On February 7, 2024, MCFL announced its merger with PPL to create one of India's largest integrated private-sector fertilizer companies. As part of the merger scheme, ZACL will transfer a 24.5% stake in MCFL to ZMPPL, the current promoter of PPL. This ensures compliance with lender requirements, which mandate that PPL's promoter retains control and holds over 50% of the merged entity's share capital post-merger.

Transactional arbitrage



(*) CMP as on December 9, 2024
Source: Company, Keynote Capitals Ltd.

The arbitrage opportunity arises from this price disparity, allowing investors to profit from transactional arbitrage. Investors can capitalize on this gain by purchasing MCFL at its current price and holding it until the scheme's completion, assuming minimal regulatory delays, stable market conditions and the absence of significant price fluctuations.

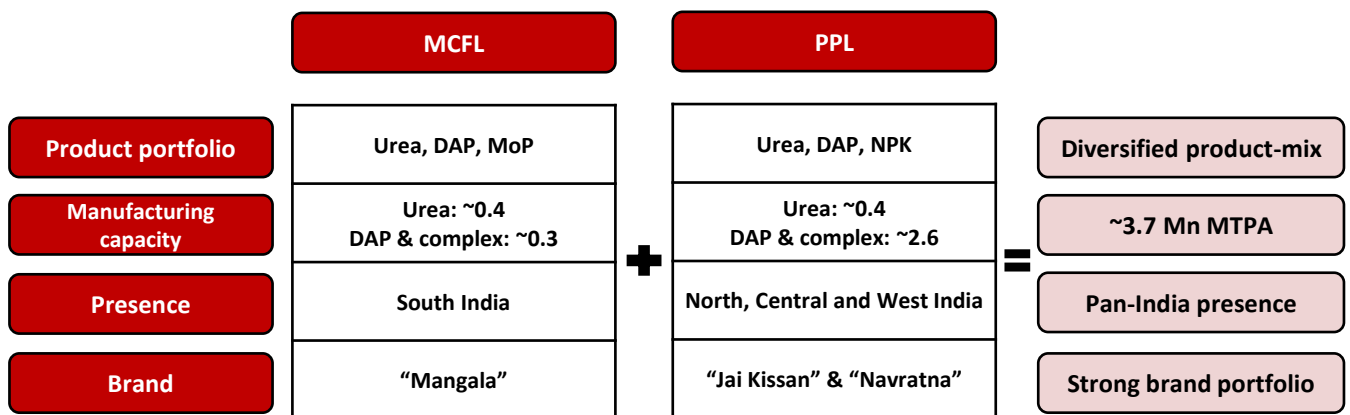
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Rationale behind the merger

By streamlining supply chain operations and improving procurement practices, the merger aims to reduce costs, enhance distribution capabilities and strengthen the retail network by introducing new products, thereby enhancing market presence and diversification.

Key benefits of the merger:

- Geographic expansion:** With MCFL's strong presence in Southern India and PPL's significant market share across Northern, Central, and Eastern India, the merger will establish the combined entity with an enhanced geographical reach and an extensive distribution network.
- Synergies in raw material sourcing:** The combined entity will benefit from leveraging higher procurement volumes to secure more favorable terms with suppliers. Additionally, MCFL will benefit from the strategic support of the OCP Group, the world's largest phosphate producer and PPL's promoter, further strengthening its raw material sourcing capabilities.
- Capacity expansion and backward Integration:** The merger unlocks opportunities for expansion and backward integration by utilizing surplus land at MCFL's Mangalore plant to increase NPK production capacity and establish a phosphoric acid facility. This facility will supply phosphoric acid to PPL's Goa plant, enabling it to qualify as a backward-integrated unit. As a result, PPL's western operations could qualify as an integrated manufacturer under regulatory requirements, with the government capping profit margins for fertilizer companies. Integrated manufacturers are eligible for a 12% profit margin, compared to 10% for standalone manufacturers and 8% for importers.



Source: Company, Keynote Capitals Ltd.

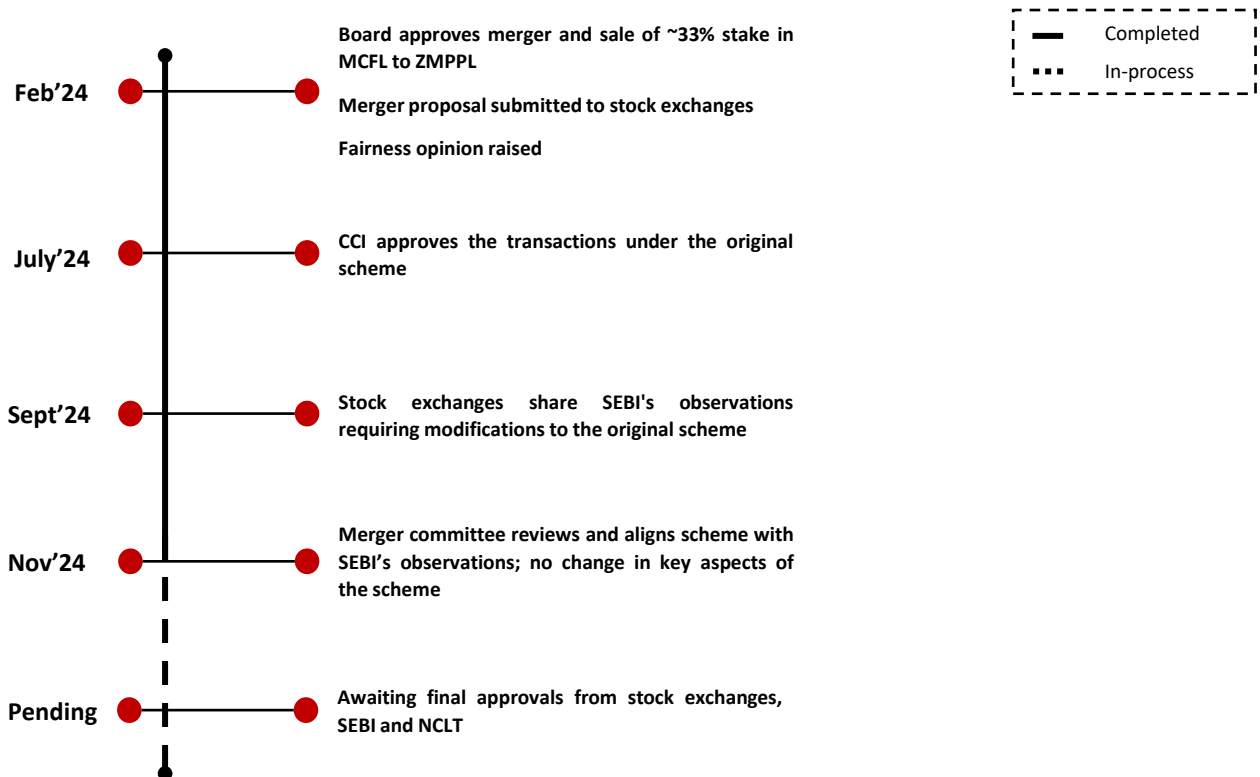
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Update on progress

The board of MCFL approved a scheme of arrangement with PPL on February 7, 2024, involving the sale of ~33.1% stake in the company to PPL. This move aligns with the lender's requirement for the existing promoter (ZMPPL) to retain more than 50% ownership in the Company. However, concerns were raised by shareholders regarding the fairness of the transaction between MCFL and ZMPPL. Despite these concerns, the Competition Commission of India (CCI) approved the original scheme on July 30, 2024.

Following SEBI's observations, communicated through BSE and NSE in September 2024, modifications to the scheme were required. A committee, guided by SEBI's feedback and a fairness opinion on the share exchange ratio, revised the stake transferred from MCFL to ZMPPL from ~33.1% to 24.5% while preserving the scheme's key features, such as business synergies and shareholder impact.

Timeline



Source: Company, Keynote Capitals Ltd.

Shareholding Pattern

	MCFL		PPL		PPL (Post-merger)	
	Share o/s (Mn)	%	Share o/s (Mn)	%	Share o/s (Mn)	%
Promoter & Promoter Group	71.9	60.6%	456.9	56.1%	608.0	58.6%
Public	46.7	39.4%	358.3	43.9%	428.9	41.4%
Total	118.6	100%	815.2	100%	1,036.9	100%

Source: Company, Keynote Capitals Ltd.

Similar precedents in the past

The merger between MCFL and PPL reflects the Adventz Group's strategic initiative to simplify its corporate structure, enhance operational efficiency and deleverage, aimed at creating value for shareholders. Similar past efforts reflecting this approach include the merger of Zuari Sugar & Power Ltd with Zuari Industries Ltd, the demerger of Zuari Industries Ltd and Zuari Holdings Ltd, and the transfer of operations from Zuari Investments Ltd to Zuari Finserv Ltd, all of which streamlined operations, improved organizational focus and enhanced efficiency.

Financial Statement Analysis of MCFL

Income Statement

Y/E Mar, Rs. Mn	FY22	FY23	FY24	H1FY25
Net Sales	28,956	36,415	37,954	15,904
Growth %	35%	26%	4%	
Raw Material Expenses	18,023	23,728	23,602	8,928
Employee Expenses	696	692	678	370
Other Expense	8,133	8,901	9,914	4,791
EBITDA	2,104	3,094	3,759	1,816
Growth %	5%	47%	21%	
Margin%	7%	8%	10%	11%
Depreciation	506	597	716	383
EBIT	1,598	2,498	3,043	1,433
Growth %	7%	56%	22%	
Margin%	6%	7%	8%	9%
Interest Paid	494	1,044	1,049	457
Other Income & exceptional	243	306	413	118
PBT	1,347	1,760	2,407	1,094
Tax	468	414	859	391
PAT	879	1,347	1,548	703
Growth %	31%	53%	15%	
Shares (Mn)	118.5	118.5	118.5	118.5
EPS	7.41	11.36	13.06	5.93

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24	H1FY25
Cash, Cash equivalents & Bank	5,572	3,659	3,283	3,408
Debtors	6,650	7,572	6,043	2,899
Inventory	4,298	2,411	1,686	2,403
Short Term Loans & Advances	852	1,159	1,325	1,639
Other Current Assets	726	743	713	570
Total Current Assets	18,099	15,544	13,049	10,920
Net Block & CWIP	8,900	10,911	10,935	10,653
Other Non-current Assets	209	137	321	623
Total Assets	27,208	26,591	24,304	22,196
Creditors	4,048	2,426	1,492	1,251
Provision	103	112	109	126
Short Term Borrowings	11,201	10,010	7,206	5,046
Other Current Liabilities	2,011	1,524	1,759	1,828
Total Current Liabilities	17,363	14,071	10,566	8,251
Long Term Debt	2,182	3,567	2,988	2,607
Deferred Tax Liabilities	511	615	1,040	1,118
Other Long Term Liabilities	322	307	313	302
Total Non Current Liabilities	3,014	4,488	4,341	4,027
Paid-up Capital	1,185	1,185	1,185	1,185
Reserves & Surplus	5,645	6,846	8,211	8,732
Shareholders' Equity	6,831	8,032	9,397	9,918
Total Equity & Liabilities	27,208	26,591	24,304	22,196

Cash Flow

Y/E Mar, Rs. Mn	FY22	FY23	FY24	H1FY25
Pre-tax profit	1,347	1,760	2,407	1,094
Adjustments	842	1,368	1,545	788
Change in Working Capital	-2,879	-856	1,406	1,981
Total Tax Paid	-181	-351	-395	-300
Cash flow from operating Activities	-872	1,921	4,963	3,563
Net Capital Expenditure	-1,695	-3,030	-962	-514
Change in investments	-256	391	-126	108
Other investing activities	82	209	263	76
Cash flow from investing activities	-1,869	-2,430	-824	-330
Equity raised / (repaid)	0	0	0	0
Debt raised / (repaid)	4,707	161	-3,386	-2,542
Dividend (incl. tax)	-119	-142	-178	0
Other financing activities	-550	-1,032	-1,078	-458
Cash flow from financing activities	4,038	-1,014	-4,642	-3,000
Net Change in cash	1,297	-1,523	-504	233

Valuation Ratios

	FY22	FY23	FY24	H1FY25
Per Share Data				
EPS	7	11	13	9
Growth %	31%	53%	15%	
Book Value Per Share	58	68	79	104
Return Ratios				
Return on Assets (%)	4%	5%	6%	6%
Return on Equity (%)	14%	18%	18%	18%
Return on Capital Employed (%)	9%	12%	15%	17%
Turnover Ratios				
Asset Turnover (x)	1.2	1.4	1.5	1.5
Sales / Gross Block (x)	3.5	3.3	2.7	2.8
Working Capital / Sales (%)	18%	30%	52%	13%
Receivable Days	74	71	65	75
Inventory Days	62	52	32	24
Payable Days	65	54	31	24
Working Capital Days	71	69	66	76
Liquidity Ratios				
Current Ratio (x)	1.0	1.1	1.2	1.3
Interest Coverage Ratio (x)	3.7	2.7	3.3	2.8
Total Debt to Equity	2.0	1.6	1.0	0.8
Net Debt to Equity	1.1	1.1	0.7	0.4
Valuation				
PE (x)	11.7	8.6	8.2	15
Earnings Yield (%)	9%	12%	12%	
Price to Sales (x)	0.4	0.3	0.3	0.5
Price to Book (x)	1.5	1.4	1.3	1.6
EV/EBITDA (x)	8.6	7.0	5.2	3.6
EV/Sales (x)	0.6	0.6	0.5	0.4

Source: Company, Keynote Capitals Ltd.

Financial Statement Analysis of PPL

Income Statement

Y/E Mar, Rs. Mn	FY22	FY23	FY24	H1FY25
Net Sales	78,587	1,33,407	1,15,751	62,213
Growth %	52%	70%	-13%	
Raw Material Expenses	62,813	1,06,132	89,984	45,474
Employee Expenses	1,385	2,132	2,298	1,195
Other Expense	7,678	17,134	16,989	9,819
EBITDA	6,711	8,010	6,480	5,725
Growth %	24%	19%	-19%	
Margin%	9%	6%	6%	9%
Depreciation	905	1,752	2,107	1,239
EBIT	5,807	6,258	4,374	4,486
Growth %	27%	8%	-30%	
Margin%	7%	5%	4%	7%
Interest Paid	855	2,912	3,660	1,728
Other Income & exceptional	393	911	688	341
PBT	5,344	4,257	1,402	3,100
Tax	1,365	1,220	409	762
PAT	3,978	3,037	992	2,338
Growth %	78%	-24%	-67%	
Shares (Mn)	0.0	814.5	814.7	814.7
EPS	6.92	3.73	1.23	2.86

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24	H1FY25
Cash, Cash equivalents & Bank	5,977	1,099	1,180	5,419
Current Investments	5,504	0	0	6,966
Debtors	9,025	36,897	27,205	24,352
Inventory	22,932	22,377	18,308	24,929
2.Short Term Loans & Advances	4,204	5,893	5,051	3,225
Other Current Assets	3,691	3,886	5,824	6,662
Total Current Assets	51,333	70,152	57,569	71,552
Net Block & CWIP	15,969	35,686	38,032	38,005
Other Non-current Assets	29	32	32	33
Other Non-current Assets	11,951	701	978	978
Total Assets	79,282	1,06,570	96,611	1,10,568
Creditors	22,734	19,125	14,881	22,416
Provision	752	900	728	778
Short Term Borrowings	24,261	40,192	33,179	36,839
Other Current Liabilities	2,786	3,693	3,471	4,415
Total Current Liabilities	50,534	63,910	52,259	64,448
Long Term Debt	5,282	6,119	6,765	6,438
Deferred Tax Liabilities	922	1,078	1,509	1,680
Other Long Term Liabilities	294	416	434	410
Total Non Current Liabilities	6,498	7,613	8,708	8,527
Paid-up Capital	5,755	8,145	8,148	8,148
Reserves & Surplus	16,495	26,902	27,496	29,445
Shareholders' Equity	22,250	35,047	35,644	37,592
Total Equity & Liabilities	79,282	1,06,570	96,611	1,10,568

Cash Flow

Y/E Mar, Rs. Mn	FY22	FY23	FY24	H1FY25
Pre-tax profit	5,344	4,257	1,402	3,100
Adjustments	1,975	4,006	5,198	2,771
Change in Working Capital	-6,909	-30,661	8,344	5,156
Total Tax Paid	-855	-1,374	-584	-212
Cash flow from operating Activities	-445	-23,772	14,361	10,815
Net Capital Expenditure	-6,198	-4,358	-4,111	-1,209
Change in investments	-4,822	82	405	-10,037
Other investing activities	33	89	37	21
Cash flow from investing activities	-10,988	-4,187	-3,669	-11,225
Equity raised / (repaid)	0	9750.679	30.353	19.4
Debt raised / (repaid)	16,289	15,428	-6,521	3,138
Dividend (incl. tax)	0	0	-407	0
Other financing activities	-399	-2,173	-3,325	-1,602
Cash flow from financing activities	15,890	23,006	-10,222	1,555
Net Change in cash	4,457	-4,953	470	1,145

Valuation Ratios

	FY22	FY23	FY24	H1FY25
Per Share Data				
EPS	7	4	1	3
Growth %	78%	-46%	-67%	
Book Value Per Share		43	44	40
Return Ratios				
Return on Assets (%)	6%	3%	1%	3%
Return on Equity (%)	20%	11%	3%	8%
Return on Capital Employed (%)	13%	9%	6%	8%
Turnover Ratios				
Asset Turnover (x)	1.3	1.4	1.1	1.0
Sales / Gross Block (x)	4.8	5.1	3.0	2.9
Working Capital / Sales (%)	41%	26%	50%	24%
Receivable Days	48	63	101	80
Inventory Days	93	78	83	113
Payable Days	76	72	72	101
Working Capital Days	64	68	111	92
Liquidity Ratios				
Current Ratio (x)	1.0	1.1	1.1	1.1
Interest Coverage Ratio (x)	7.2	2.5	1.4	2.8
Total Debt to Equity	1.3	1.3	1.1	1.2
Net Debt to Equity	1.1	1.3	1.1	1.0
Valuation				
PE (x)		13.5	57.0	21.2
Earnings Yield (%)		7%	2%	
Price to Sales (x)		0.3	0.5	0.7
Price to Book (x)		1.2	1.6	2.1
EV/EBITDA (x)		10.8	14.8	10.9
EV/Sales (x)		0.6	0.8	1.0

Source: Company, Keynote Capitals Ltd.

Rating Methodology

Rating	Criteria
BUY	Expected positive return of > 10% over 1-year horizon
NEUTRAL	Expected positive return of > 0% to < 10% over 1-year horizon
REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
NOT RATED (NR)/UNDER REVIEW (UR)/COVERAGE SUSPENDED (CS)	Not covered by Keynote Capitals Ltd/Rating & Fair value under Review/Keynote Capitals Ltd has suspended coverage

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