Sharekhan
by BNP PARIBAS

Agri Inputs and Speciality Chemical

High demand and low base to drive growth

Q4FY2021 Results Preview

Sector: Agri Inputs and Speciality Chemicals

Sector View: Positive

We expect a strong 13% y-o-y rise in earnings for agri-input companies in our coverage supported by a 6.1% y-o-y revenue growth, given robust demand for agrochemicals from export market as higher crop prices improve farmer's purchasing power while domestic demand to remain lean on seasonality factor and margin to improve as large players would be able to hike product prices (to pass on a rise in raw material costs). We expect large players such as UPL and PI Industries to witness strong revenue growth of 8% y-o-y and 34% y-o-y, respectively given high exposure to international markets and strong demand for herbicides and fungicides. Agri-input players would also see working capital levels improve given better cash collection and receipt of fertiliser subsidy from the government. Specialty chemical players are likely to post a strong recovery given low base of Q4FY2020 and strong demand from key user industries like automobile and consumer durables. Overall, we expect an earnings growth of 25% y-o-y for specialty chemical companies under our coverage especially led by SRF and Aarti Industries. Outlook for the agri-input space is positive and we expect strong 7-8% growth annually supported by expectations of a normal monsoon for 2021, rising farmer incomes and global players' preference in sourcing from India. Potential high domestic demand, import substitution and export opportunities are also likely to present massive revenue opportunity for the Indian specialty chemical sector (expected to clock a 9% CAGR over 2019-2025). High double-digit earnings outlook and favourable government policies could aid further re-rating of quality players in the space. Preferred picks – Coromandel International, PI Industries, SRF, Atul Limited, Sumitomo Chemical India and Sudarshan Chemical.

Agri Inputs: We expect agri-Input companies under our coverage universe to post decent 6.1% y-o-y growth in revenues backed by: 1) strong demand from international markets (US, Europe and Latin America), 2) higher domestic demand for agro-chemicals given higher plantation for the Rabi season 3) low base of Q4FY2020 due to COVID-19 led lockdown. We highlight here that Q4 normally sees higher agrochemical demand in the US and Europe due to seasonality factor and Latin America is likely to see strong demand as Q3FY21 purchases by farmers was pushed to Q4FY2021. Companies like PI Industries and UPL are likely to do well given high exposure to international markets, likely market share gains in domestic markets, product launches and price hikes (due to rally in raw material prices in Q4FY2021). We still expect margins for companies under our coverage to improve by 155bps y-o-y as most of these companies are likely to pass on higher input costs to the customers. Also, better product mix and positive operating leverage also auger well for margin. A key thing to watch for in management commentaries would be quantum of price hike taken to mitigate the rise in raw material costs.

Speciality chemicals: Companies in this space are expected to witness a strong revival in revenue growth supported by rising demand from key user industries like automobile, consumer durables and other allied sectors. The growth will also be supported by favourable base impact of Q4FY2020 as the business operations was impacted due to lockdown in last few days of March 2020. High demand would lead be better pricing (which would help offset higher raw material cost) and benefit of operating leverage bodes for margin improvement y-o-y (although sequentially lower as 3FY2021 margins had an element low-cost inventories). Overall, we expect business environment to remain strong led by global pent-up demand and rising reliance on India (given the China plus one policy adopted by global companies). The recent winter storm in US has led to supply disruptions and as a result some of the key products such as phenol, benzene, acrylonitrile, acetic acid, aniline and styrene saw rise in prices. Overall, we expect specialty chemical companies under our coverage to report revenue growth of 11.7% y-o-y and margin expansion of 280 bps on a y-o-y basis.

Outlook

An early indication of normal monsoon in 2021 bodes well for the continued strong domestic growth for Indian agri-input players while favourable policies of global companies (China Plus One factor) for sourcing would drive market share gains in export market. The above factors and the vast opportunity from products going off-patent are expected to drive a 7-8% growth annually for Indian agrochemical industry. Hence, we expect high double-digit earnings growth for agri input companies over the next couple of years. We remain bullish on medium to long-term growth prospects for the Indian specialty chemical sector (set to clock a 9% CAGR over 2019-2025 and reach $304 billion by 2025), given the massive revenue opportunity both from the perspective of import substitution (India's total specialty chemical imports is estimated at $56 billion), potential increase in exports given China Plus One strategy by global customers, and favourable government policies (such as tax incentive and production-linked incentive scheme similar to that of the pharmaceutical sector).

Valuation

Conducive government policies, product innovation and massive export opportunity would help the sector witness a high double-digit growth trajectory on a sustained basis over the next 2-3 years. Structural revenue growth drivers (higher domestic demand, rising exports and import substitution) and potential for margin expansion (rise in share of high-margin value-added products) provide scope for further valuation re-rating of quality companies in the sector. Moreover, companies have raised money through QIP, which would be utilised for capacity expansion and inorganic opportunities, thus boosting growth prospects. Hence, we retain a positive stance on the sector.

Key Risks

Lower demand offtake for products as a result of slowdown in economic activity for specialty chemicals and a likely rise in price of key raw materials could affect earnings.

Leaders in Q4FY21: PI Industries, UPL, SRF and Aarti industries

Laggards in Q4FY21: Coromandel International, Insecticides (India) and Vinati Organics

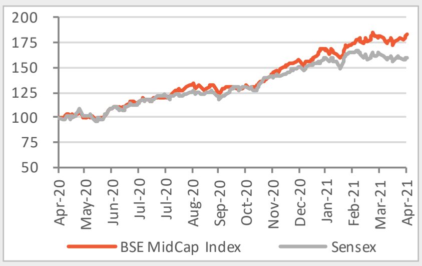
Preferred Picks: Coromandel International, PI Industries, SRF, Atul Limited, Sumitomo Chemical India and Sudarshan Chemical

Our coverage universe

Companies	CMP (Rs)	Reco.	PT (Rs)
Agri Inputs			
Coromandel International	758	Buy	1,000
Insecticides (India)	468	Buy	590
PI Industries	2,517	Buy	2,740
UPL	652	Buy	720
Sumitomo Chemical	291	Buy	350
Speciality Chemicals			
Aarti Industries	1,420	Buy	UR
Atul	7,984	Buy	9,600
SRF	6,215	Buy	6,760
Sudarshan Chemicals	541	Buy	615
Vinati Organics	1,545	Buy	1,750

Source: Sharekhan Research

Price chart



Source: BSE; Sharekhan Research

Q4FY21 Result Estimates

Companies	Revenue (Rs. cr)				OPM (%)				Net profit (Rs. cr)			
	Q4 FY21E	Q4 FY20	YoY (%)	QoQ (%)	Q4 FY21E	Q4 FY20	YoY (bps)	QoQ (bps)	Q4 FY21E	Q4 FY20	YoY (%)	QoQ (%)
Agri Inputs												
Coromandel International	2,622	2,869	-8.6	-25.8	13.1	13.6	-53	-106	199	234	-14.9	-40.2
Insecticides (India)	243	239	2.0	-18.6	7.1	-1.0	NA	206	8	-7	NA	25.0
PI Industries	1,147	855	34.1	-1.3	23.6	21.8	182	-11	191	110	73.8	-2.2
UPL	12,019	11,141	7.9	31.7	21.0	19.5	151	-315	972	886	9.7	-4.5
Sumitomo Chemicals	474	446	6.2	-15.6	12.5	9.4	312	-137	39	24	62.5	-28.7
Agri Inputs Total	**16,505**	**15,550**	**6.1**	**16.9**	**19.5**	**17.9**	**155**	**-173**	**1,408**	**1,246**	**13.0**	**-9.3**
Speciality Chemicals												
Aarti Industries	1,210	1,076	12.5	2.0	23.3	21.1	224	-71	160	127	26.4	3.4
Atul	964	965	-0.2	1.2	23.6	19.5	412	-190	159	124	28.7	-16.7
SRF	2,223	1,858	19.6	3.6	24.9	20.9	394	-52	307	221	38.7	1.4
Sudarshan Chemicals	494	449	9.9	-2.5	14.8	13.4	143	-88	37	34	9.6	-9.9
Vinati Organics*	239	245	-2.5	7.0	36.0	41.4	-544	374	63	75	-15.9	-2.1
Speciality Chemicals Total	**5,130**	**4,594**	**11.7**	**2.3**	**23.8**	**21.0**	**280**	**-60**	**726**	**580**	**25.2**	**-3.7**

*Source: Company; Sharekhan Research, * standalone*

Valuation

Companies	CMP (Rs)	EPS (Rs.)				CAGR over FY20-23E (%)	P/E (x)				Reco.	PT (Rs)
		FY20	FY21E	FY22E	FY23E		FY20	FY21E	FY22E	FY23E		
Agri Inputs												
Coromandel International	758	36.3	48.1	52.3	59.2	17.6	20.9	15.8	14.5	12.8	Buy	1,000
Insecticides (India)	468	42.1	39.1	65.4	74.2	20.8	11.1	12.0	7.1	6.3	Buy	590
PI Industries	2,517	33.1	43.8	55.3	70.6	28.8	76.1	57.5	45.5	35.7	Buy	2,740
UPL	652	31.4	41.2	48.4	55.0	20.6	20.8	15.8	13.5	11.8	Buy	720
Sumitomo Chemicals	291	4.7	6.9	8.3	10.0	28.6	61.9	42.2	35.1	29.1	Buy	350
Speciality Chemicals												
Aarti Industries	1,420	30.8	32.8	43.0	58.9	24.1	46.2	43.3	33.0	24.1	Buy	UR
Atul	7,984	224.5	226.3	266.7	300.3	10.2	35.6	35.3	29.9	26.6	Buy	9,600
SRF	6,215	138.8	173.9	216.5	265.0	24.1	44.8	35.7	28.7	23.5	Buy	6,760
Sudarshan Chemicals	541	18.9	18.6	24.7	29.2	15.6	28.5	29.0	21.9	18.5	Buy	615
Vinati Organics*	1,545	32.5	26.3	37.0	46.1	12.4	47.6	58.7	41.8	33.5	Buy	1,750

*Source: Company; Sharekhan Research, * standalone*

Q4FY2021E results: Company-wise key comments

Companies	Comments
Agri Inputs	
Coromandel International	We expect revenue to grow by 8.6% y-o-y due to lower phosphatic fertilisers sales volume and increase in raw material cost to impact margin (expect to decline by 53 bps y-o-y and 106 bps q-o-q to 13.1%.
PI Industries	Strong traction in the exports and domestic market to drive up revenue by 34.1% y-o-y, while EBITDA margin is likely to expand by 182 bps y-o-y to 23.6%, given benefit of operating leverage.
UPL	Strong demand environment in Latin America, North America, and Europe to drive 7.9% y-o-y revenue growth. We expect margins to decline by 151 bps y-o-y to 21% supported by higher contribution from high margin international geographies and benefit of operating leverage.
Insecticides (India)	We expect revenue to grow by only 2% y-o-y due to continued lower use of pesticides and ban on certain molecules in Punjab. Margins likely at 7.1% versus a negative margin of 1% in Q4FY2020.
Sumitomo Chemical India	We expect revenue growth of 6.2% y-o-y led by decent growth in export business as domestic demand is normally lean in Q4. Margin is expected to improve by 312 bps y-o-y to 12.5% led by a better mix of specialty chemical business in revenues.
Speciality Chemicals	
Aarti Industries	We expect revenues to grow by 12.5% y-o-y as domestic demand is anticipated to have reached above pre-COVID-19 levels, export business would witness gradual pick-up and low base of Q4FY2020. Margin also expected to improve y-o-y led by better plant operating rates.
Atul Industries	We expect revenue to reach pre-COVID level and thus expect flat y-o-y revenues while expected to improve by 412bps y-o-y given benefit of operating leverage and price hikes.
SRF Limited	Robust performance in specialty chemicals and packaging segments to drive 19.6% y-o-y revenue growth. Margins are likely to improve by 394 bps y-o-y to 24.9%, aided by healthy spread for packing films and price hike for specialty chemicals.
Sudarshan Chemical	We expect revenue to witness 9.9% y-o-y growth, while margins are likely to remain strong at 14.8% (likely to expand by 143 bps y-o-y) supported by adequate price hikes to offset rise in raw material cost.
Vinati Organics	Sequential recovery in ATBS demand is likely, while IBB volume growth would remain strong. Thus, we expect revenues to grow by 7% q-o-q (decline 2.5% y-o-y) and margins to expand by 374 bps q-o-q led by better profitability in ATBS segment given improved pricing.

Source: Company, Sharekhan Research

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

Atul Limited

Building capabilities for sustained high growth

Speciality Chem	Sharekhan code: ATUL	Company Update

Summary

- The Indian specialty chemicals sector is expected to witness high growth (a 9% CAGR over 2019-2025) led by factors like the China Plus One strategy by global players and import substitution and favourable policies.
- We believe that Atul Limited's is best placed to ride on chemical space growth given its high capex of Rs. 400-500 crore to expand capacities, vast product portfolio and strong relation with MNC companies.
- Focus to build product/technology capabilities, market share gain and sustained high margin (rising share of VAP) would ensure 18%/15% EBITDA/PAT CAGR over FY21E-FY23E along with RoE/RoCE of 18%/23%.
- Sustained high growth, competent management and efficient capital management would drive re-rating of the stock. Hence, we maintain a Buy rating on Atul Limited with a revised PT of Rs. 9,600.

We believe that Atul Limited is one of best bets on structural high growth cycle for Indian specialty chemicals sector (expect a 9% CAGR over 2019-2025). Our optimism stems from Atul Limited's vast product portfolio (~900 products across its business segments – Aromatics, Polymers, Crop Protection, Colours, Pharma and Bulk Chemicals), strong distribution reach (2,250 distributors and 38,000 retailers) and tie-up with large multinational companies. Most importantly, the company is undertaking a capex of Rs. 400-500 crore (post investment of Rs1,314 crore over FY2016-FY2020) to augment product capacities, which would drive next phase of earnings growth for Atul Limited. High capital intensity for capacity expansion, market share gain and rising share of high margin products would ensure strong PAT to register a 15% CAGR over FY2021E-FY2023E along with RoE/RoCE of 18%/23%.

Our Call

Valuation – Maintain Buy on Atul with a revised PT of Rs. 9,600: We expect Atul Limited to benefit immensely from favourable dynamics of Indian specialty chemicals sector (supported by the China Plus One strategy by global companies) and expectation of a CAGR of 9% over 2019-2025. Strong growth would drive high capex intensity (to augment capacities) and support sustained high double-digit earnings growth for quality players such as Atul Limited. We thus expect EBITDA/PAT to register 18%/15% CAGR over FY2021E-FY2023E and good return ratios (RoE/RoCE of 18%/23%) as well. Strong growth outlook and efficient capital management would drive re-rating of the stock. Hence, we maintain our Buy on Atul with a revised PT of Rs. 9,600 (valued at 32x FY2023E EPS). At the CMP, the stock is trading at 29.9x its FY2022E EPS and 26.6x its FY2023E EPS.

Key Risks

1) Revenue growth could be hit by weak demand and a delay in commissioning of capex project and new products. 2) Adverse raw-material prices and delay in the ability to pass on price hikes adequately in time and forex fluctuation might affect margins.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	4,038	4,093	3,726	4,563	5,247
OPM (%)	19.0	22.0	25.0	24.3	24.6
Adjusted PAT	432	666	672	792	891
% y-o-y growth	*53.7*	*54.2*	*0.8*	*17.9*	*12.6*
Adjusted EPS (Rs.)	145.6	224.5	226.3	266.7	300.3
P/E (x)	54.8	35.6	35.3	29.9	26.6
P/BV (x)	8.8	7.5	6.3	5.2	4.4
EV/EBITDA (x)	30.7	25.6	24.4	20.1	16.3
RoCE (%)	25.1	26.5	24.0	23.9	22.7
RoE (%)	17.5	22.7	19.4	19.0	18.0

Source: Company; Sharekhan estimates

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 7,984**	
Price Target: **Rs. 9,600**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

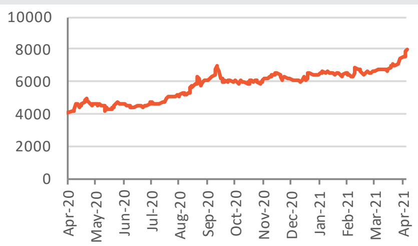
Company details

Market cap:	Rs. 23,623 cr
52-week high/low:	Rs. 8,130 / 3,922
NSE volume: (No of shares)	0.3 lakh
BSE code:	500027
NSE code:	ATUL
Free float: (No of shares)	1.6 cr

Shareholding (%)

Promoters	45
FII	23
DII	9
Others	23

Price chart



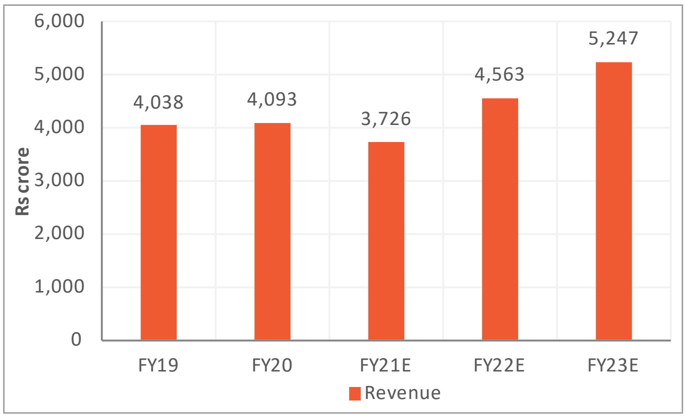
Price performance

(%)	1m	3m	6m	12m
Absolute	18.5	22.2	35.1	97.5
Relative to Sensex	21.0	21.2	12.3	37.9

Sharekhan Research, Bloomberg

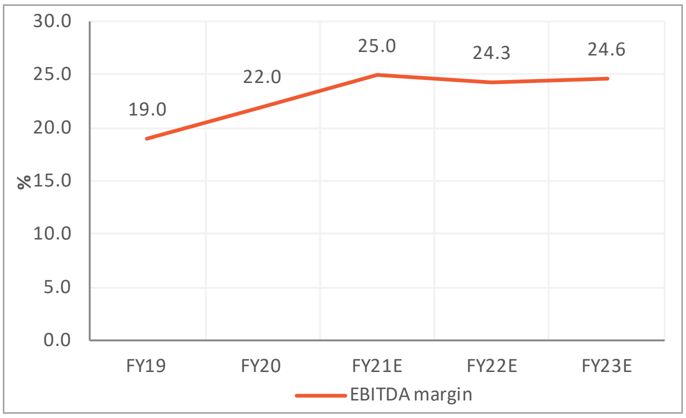
Financials in charts

Strong revenue growth outlook



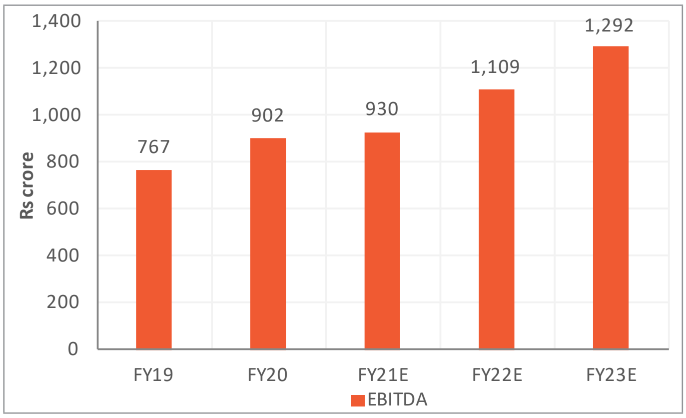
Source: Company, Sharekhan Research

Strong margin to sustain over FY22E-FY23E



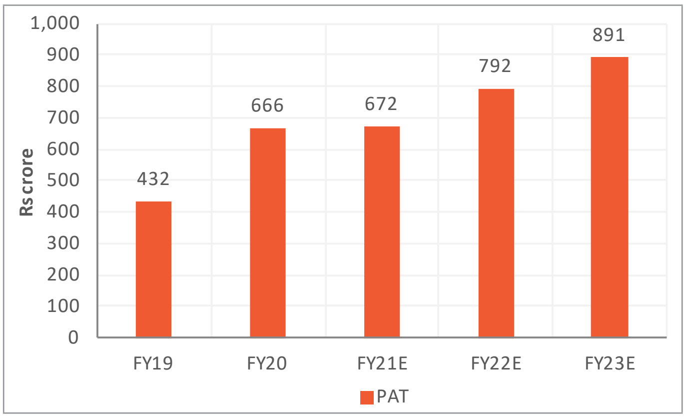
Source: Company, Sharekhan Research

EBITDA to post 18% CAGR over FY21E-FY23E



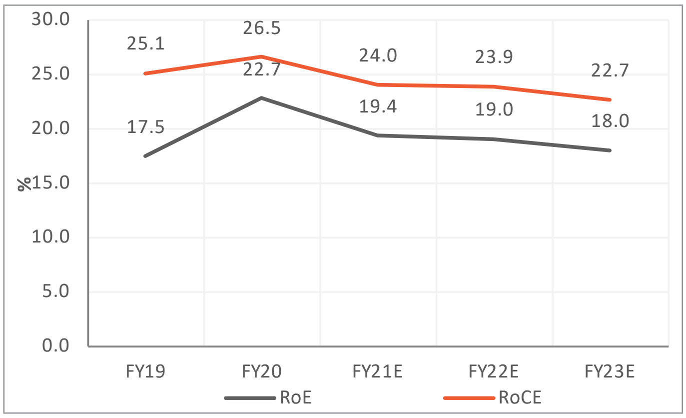
Source: Company, Sharekhan Research

PAT to post 15% CAGR over FY21E-FY23E



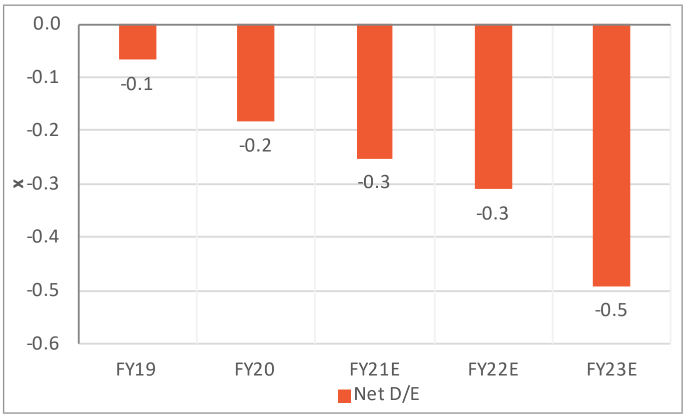
Source: Company, Sharekhan Research

RoE/RoCE Trend



Source: Company, Sharekhan Research

Strong B/S with net cash position



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector View – Structural growth drivers to propel sustained growth for the specialty chemical sector over the medium to long term:**

We remain bullish on medium to long-term growth prospects of the specialty chemical sector, given a massive revenue opportunity from the perspective of import substitution (India's total specialty chemical imports is estimated at $56 billion), potential increase in exports given the China Plus One strategy of global customers, and favourable government policies (such as tax incentives and production-linked incentive scheme similar to that of the pharmaceutical sector). In our view, conducive government policies, product innovation, massive export opportunity, and low input prices would help the sector witness high double-digit earnings growth trajectory on sustained basis over the next 2-3 years.

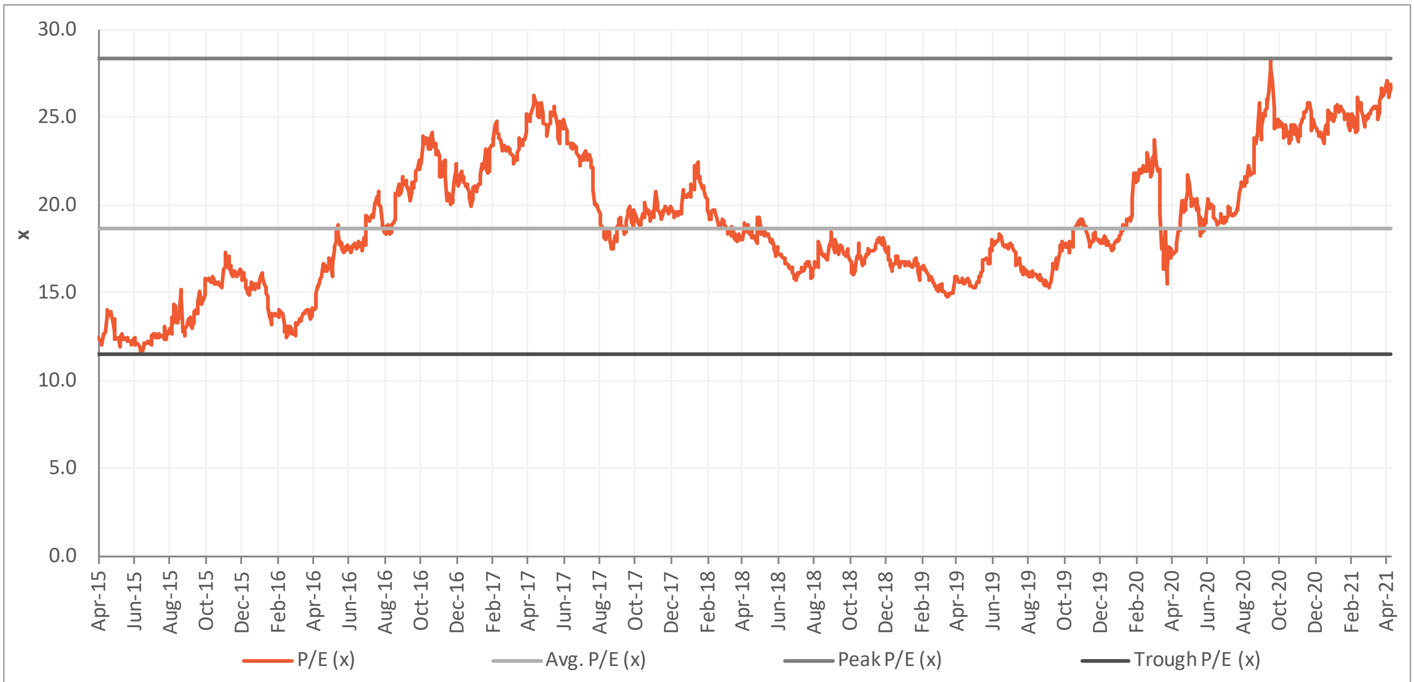
■ **Company outlook - Significant export opportunities underway as global players shift base outside China:**

The company has a healthy balance sheet and intends to continue its ongoing expansion plans in a calibrated manner, be it in expanding capacities through new projects or debottlenecking capacities through internal accruals. Growth is likely to be driven by improved utilisation of enhanced capacities. Moreover, significant opportunities are expected to arise in the medium to long term, as global players shift their manufacturing and vendor bases outside China.

■ **Valuation - Maintain Buy on Atul with a revised PT of Rs. 9,600:**

We expect Atul Limited to benefit immensely from favourable dynamics of Indian specialty chemicals sector (supported by the China Plus One strategy by global companies) and expectation of a CAGR of 9% over 2019-2025. Strong growth would drive high capex intensity (to augment capacities) and support sustained high double-digit earnings growth for quality players such as Atul Limited. We thus expect EBITDA/PAT to register 18%/15% CAGR over FY2021E-FY2023E and good return ratios (RoE/RoCE of 18%/23%) as well. Strong growth outlook and efficient capital management would drive re-rating of the stock. Hence, we maintain our Buy on Atul with a revised PT of Rs. 9,600 (valued at 32x FY2023E EPS). At the CMP, the stock is trading at 29.9x its FY2022E EPS and 26.6x its FY2023E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Incorporated in 1947 and headquartered in Gujarat, Atul is a member of the Lalbhai Group. The company is an integrated chemical company and has a diverse product portfolio. The company's businesses are broadly classified into two segments, i.e. lifescience chemicals and performance and other chemicals. Crop protection and pharmaceuticals are sub-segments of the lifescience chemicals segment, while aromatics, bulk chemicals and intermediates, colours, floras, and polymers are sub-segments of the performance and other chemicals segment. The company owns 114 brands and manufactures ~900 products and~450 formulations in its production facilities situated at Ankleshwar, Atul, Panoli, and Tarapur and through facilities situated at Ambernath, Ankleshwar, Atul, and Bristol (U.K.) in various subsidiaries. The company operates a network of over 38,000 retail outlets in India and serves more than 6,000 customers across 92 countries.

Investment theme

Atul intends to expand capacities in a calibrated manner without relying on external borrowings. Moreover, significant opportunities are expected to arise from a medium to long-term perspective, as global players shift their manufacturing base and vendor base outside China. Future growth is expected to be driven by improved utilisation levels backed by a strong demand outlook along with positive pricing tailwinds and operating leverage. The company achieved debt-free status in FY2018 and return ratios are expected to see a northward trend (after a gap of four years) on account of improved profitability (largely due to ease in input cost pressure) and strong free cash-flow generation. This gives the company ample scope to explore organic and inorganic growth opportunities further.

Key Risks

- Revenue growth momentum might be affected owing to i) slower demand offtake (post lifting of the lockdown), ii) delay in commissioning of capex project, and iii) delay in launch of new products.
- Adverse raw-material prices and delay in the ability to pass on price hikes adequately in time along with forex fluctuation might affect margins.

Additional Data

Key management personnel

Sunil Lalbhai	Chairman and Joint Managing Director
Samveg Lalbhai	JointManaging Director
Bharathy Mohanan	President, Utilities & Services
Gopi Kannan Thirukonda	Chief Financial Officer
Lalit Patni	Company Secretary and Compliance office

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	6.5
2	DSP Investment Managers Pvt Ltd	5.2
3	Aditya Birla Sun Life Trustee Company Pvt Ltd	3.1
4	Aditya Birla Sun Life Asset Management	2.9
5	Vangaurd Group Inc/The	1.9
6	TRIVEDI TEJAS B	1.9
7	TRIVEDI SHIVANI TEJAS	1.9
8	Goldman Sachs Group Inc/The	1.4
9	L&T Mutual Fund Trustee Ltd/India	1.4
10	Kotak Mahindra Asset Management Company	1.3

Source: Bloomberg; Note: Shareholding as on January 29, 2021

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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