



3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✓	✗

+ Positive = Neutral - Negative

Reco/View

Reco: Buy	↔
CMP: Rs. 6,118	
Price Target: 6,725	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 18,146 cr
52-week high/low:	Rs. 7,021/3,257
NSE volume: (No of shares)	0.4 lakh
BSE code:	500027
NSE code:	ATUL
Free float: (No of shares)	1.6 cr

Shareholding (%)

Promoters	45
DII	23
FII	8
Others	24

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.6	24.2	33.0	41.9
Relative to Sensex	(9.8)	17.5	3.1	37.7

Sharekhan Research, Bloomberg

Atul Limited

Better-than-expected recovery in Q2; promising growth outlook

Speciality Chem

Sharekhan code: ATUL

Result Update

Summary

- Atul Limited's (Atul) Q2FY2021 performance was impressive with 7.9% and 106 bps beat in revenue and EBITDA margin, respectively, at Rs. 1,002 crore (down 4.2% y-o-y but much lower than our expectation of 8.3% y-o-y decline) and 26.1% (up 460 bps y-o-y; up 204 bps q-o-q).
- Revenue beat was driven by better-than-expected revenue from life science chemicals at Rs. 348 crore (up 5.3% y-o-y) due to recovery in domestic revenue; margin beat was led by better margin for performance and other chemicals segment (EBIT margin up 411bps y-o-y to 23.1%).
- Atul is well placed to benefit from structural revenue growth drivers such as higher domestic demand, rising exports, and import substitution for specialty chemical. Hence, we expect revenue/EBITDA/PAT CAGR of 14%/17%/16% over FY2021E-FY2023E.
- We recommend Buy on Atul with a PT of Rs. 6,725, given robust earnings growth outlook and strong balance sheet (nil debt) with RoE of ~18%. The stock trades at 23.8x its FY2022E EPS and 21.4x its FY2023E EPS.

Atul Limited (Atul) reported consolidated revenue of Rs. 1,002 crore (down 4.2%; up 51.7% q-o-q), which was 7.9% above our estimate of Rs. 929 crore. Revenue beat was on the account of better-than-expected revenue from life science chemicals segment at Rs. 348 crore (up 5.3% y-o-y; up 28.3% q-o-q), while revenue from performance and other chemicals segment was largely in-line at Rs. 690 crore (down 7.7% y-o-y; up 64% q-o-q). The sharp sequential improvement in revenue can be attributed to higher demand from key user industries in the domestic market as economic activities recovered sharply post unlockdown by the government. EBITDA margin came in at 26.1% (up 460 bps y-o-y; up 204 bps q-o-q), which was also above our estimate of 25% due to higher-than-expected margin in the performance and other chemicals segment (EBIT margin up 411 bps y-o-y to 23.1%). The improvement in EBITDA margin was on account of better operating leverage (51.7% q-o-q jump in revenue), improvement in gross margin by 276 bps y-o-y to 54.2%, and cost rationalisation (other expenses declined by 14% y-o-y). Consequently, operating profit increased by 16.4% y-o-y and 64.6% q-o-q to Rs. 261 crore, above our estimate of Rs. 232 crore. Adjusted PAT at Rs. 181 crore (down 11.9% y-o-y; up 52.8% q-o-q) was also above our estimate of Rs. 158 crore on account of higher-than-expected operating profit. We have increased our FY2021 and FY2022 earnings estimates to factor in faster-than-anticipated recovery in revenue and better-than-expected EBITDA margin. We have also introduced our FY2023 earnings estimates in this report. Revenue recovery in Q2FY2021 has been better than expected, with domestic revenue now largely close to pre-COVID-19 level and recovery is expected to gain momentum as the economy is expected to further recover in H2FY2021. We believe Atul is well placed to benefit in the medium to long term from structural revenue growth drivers such as higher domestic demand, rising exports, and import substitution for specialty chemical. Thus, we expect revenue/EBITDA/PAT to register a 14%/17%/16% CAGR over FY2021E-FY2023E. We recommend Buy on Atul with a PT of Rs. 6,725, given robust earnings growth outlook and strong balance sheet with RoE of ~18%. At the CMP, the stock is trading at 23.8x its FY2022E EPS and 21.4x its FY2023E EPS.

Key positives

- Improvement in gross margin by 276 bps y-o-y to 54.2% on account of lower input cost.
- Performance and other chemicals segment witnessed sharp 411 bps y-o-y improvement in EBIT margin to 23.1%.

Key negatives

- Revenue in performance and other chemicals segment declined by 7.7% y-o-y.

Our Call

Valuation - Recommend Buy on Atul with a PT of Rs. 6,725: We have increased our FY2021 and FY2022 earnings estimates to factor in faster-than-anticipated recovery in revenue in the domestic business and better-than-expected EBITDA margin. We have also introduced our FY2023 earnings estimates in this report. We believe Atul is well placed to benefit in the medium to long term from structural revenue growth drivers such as higher domestic demand, rising exports, and import substitution for specialty chemicals. Moreover, lower input cost and higher operating leverage would aid in margin expansion. Thus, we expect revenue/EBITDA/PAT to register 14%/17%/16% CAGR over FY2021E-FY2023E. Hence, we recommend Buy on Atul with a PT of Rs. 6,725. At the CMP, the stock is trading at 23.8x its FY2022E EPS and 21.4x its FY2023E EPS.

Key risk

- Revenue growth momentum might be affected owing to - i) slower demand off-take, 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.

Valuation (Consolidated)

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	4,038	4,093	3,876	4,527	5,029
OPM (%)	19.0	22.0	23.5	23.8	24.7
Adjusted PAT	432	666	629	763	849
% y-o-y growth	53.7	54.2	(5.6)	21.4	11.2
Adjusted EPS (Rs.)	145.6	224.5	211.9	257.2	286.1
P/E (x)	42.0	27.2	28.9	23.8	21.4
P/BV (x)	6.7	5.8	4.9	4.1	3.5
EV/EBITDA (x)	23.4	19.5	18.9	15.5	12.4
RoCE (%)	25.1	26.5	22.7	23.4	22.2
RoE (%)	17.5	22.7	18.2	18.6	17.5

Source: Company Data; Sharekhan Research

Note: We now convert Atul Limited into a Stock update; it was earlier a 'Viewpoint' under our coverage

Sharp beat in revenue and EBITDA margin: For Q2FY2021, Atul reported a revenue decline of 4.2% y-o-y (up 51.7% q-o-q) to Rs. 1,002 crore (7.9% above our expectation of Rs. 929 crore). The sharp sequential improvement in revenue can be attributed to higher demand from key user industries in the domestic markets as economic activities recovered sharply post unlockdown by the government. EBITDA margin came in at 26.1% (up 460 bps y-o-y; up 204 bps q-o-q), which was also above our estimate of 25%. The improvement in EBITDA margin was on account of better operating leverage (51.7% q-o-q jump in revenue), improvement in gross margin by 276 bps y-o-y to 54.2%, and cost rationalisation (other expenses declined by 14% y-o-y). Consequently, operating profit increased by 16.4% y-o-y and 64.6% q-o-q to Rs. 261 crore, above our estimate of Rs. 232 crore. Adjusted PAT at Rs. 181 crore (down 11.9% y-o-y; up 52.8% q-o-q) was also above our estimate of Rs. 158 crore on account of higher-than-expected operating profit.

Margin at EBIT level improves in the performance and other chemicals segment: Revenue from the life-science chemicals segment increased by 5.3% y-o-y to Rs. 348 crore; while in the performance and other chemicals segment, revenue was down by 7.7% y-o-y to Rs. 690 crore. EBIT margin of performance and other chemicals improved by 411 bps y-o-y and 276 bps q-o-q to 23.1% and that of life science chemicals was up by 43 bps y-o-y and 47 bps q-o-q to 19.3%.

Anaven JV receives environmental clearance: Anaven JV has received the environmental clearance for its 32,000 metric tonne monochloroacetic acid (MCA) plant in Gujarat, India. MCA is primarily used in Indian agricultural, personal care, and pharmaceutical markets. The JV expects the construction work on the plant to be completed this year and expects to reach full plant utilisation in the first half of 2021 and there are plans to further expand the capacity to 60,000 mt in the future.

Capex declined by 30% y-o-y; FCF up 19% y-o-y in H1FY2021: The company's cash flow from operating activities declined by 5% y-o-y to Rs. 394 crore, but capex was lower by 30% y-o-y to Rs. 146 crore in H1FY2021. Resultantly, the company's free cash flow (FCF) increased by 19% y-o-y to Rs. 248 crore in H1FY2021.

Results (Consolidated)

					Rs cr
Particulars	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Revenue	1,002	1,046	(4.2)	661	51.7
Material Cost	459	507	(9.6)	284	61.3
Gross Profit	544	538	1.0	376	44.4
Employee Expenses	77	77	(0.5)	74	3.7
Power & Fuel Expenses	85	96	(12.1)	53	58.7
Other Expenses	121	140	(13.9)	90	34.0
EBITDA	261	224	16.4	159	64.6
Other Income	6	21	(69.3)	41	(84.1)
Depreciation	33	32	2.8	33	0.3
Interest	2	2	6.4	3	(19.1)
PBT	235	212	10.5	164	43.3
Tax	60	2	2,405.5	46	30.1
Reported PAT	174	209	(16.6)	118	48.0
Adjusted PAT	181	205	(11.9)	119	52.8
Reported EPS (Rs.)	58.8	70.5	(16.6)	39.7	48.0
Adjusted EPS (Rs.)	61.1	69.3	(11.9)	40.0	52.8
Margin (%)	Q2FY21	Q2FY20	YoY(bps)	Q1FY21	QoQ(bps)
Gross Profit Margin	54.2	51.5	276	57.0	(273)
Operating Margin	26.1	21.5	460	24.0	204
Net Profit margin	18.1	19.7	(158)	17.9	13

Source: Company; Sharekhan Research

Segmental performance (Consolidated)

					Rs cr
Particulars	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Revenue					
Life science chemicals	348	330	5.3	271	28.3
Performance and other chemicals	690	747	-7.7	420	64.0
Others	11	13	-16.5	9	23.8
Total	1,048	1,090	-3.9	700	49.7
Inter segment	46	45	2.4	40	16.0
Net revenue	1,002	1,046	-4.2	661	51.7
EBIT					
Life science chemicals	67	62	7.7	51	31.5
Performance and other chemicals	159	142	12.2	86	86.3
Others	5	5	-3.8	-1	-1,026.9
Total	231	209	10.5	136	70.0
Margin (%)			BPS		BPS
Life science chemicals	19.3	18.9	43	18.8	47
Performance and other chemicals	23.1	19.0	411	20.3	276
Others	44.7	38.8	591	-6.0	5,068
Overall	23.1	20.0	306	20.6	248

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 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 China Plus One strategy by global customers, and favourable government policies (such as tax incentive and production-linked incentive scheme similar to the pharma 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.

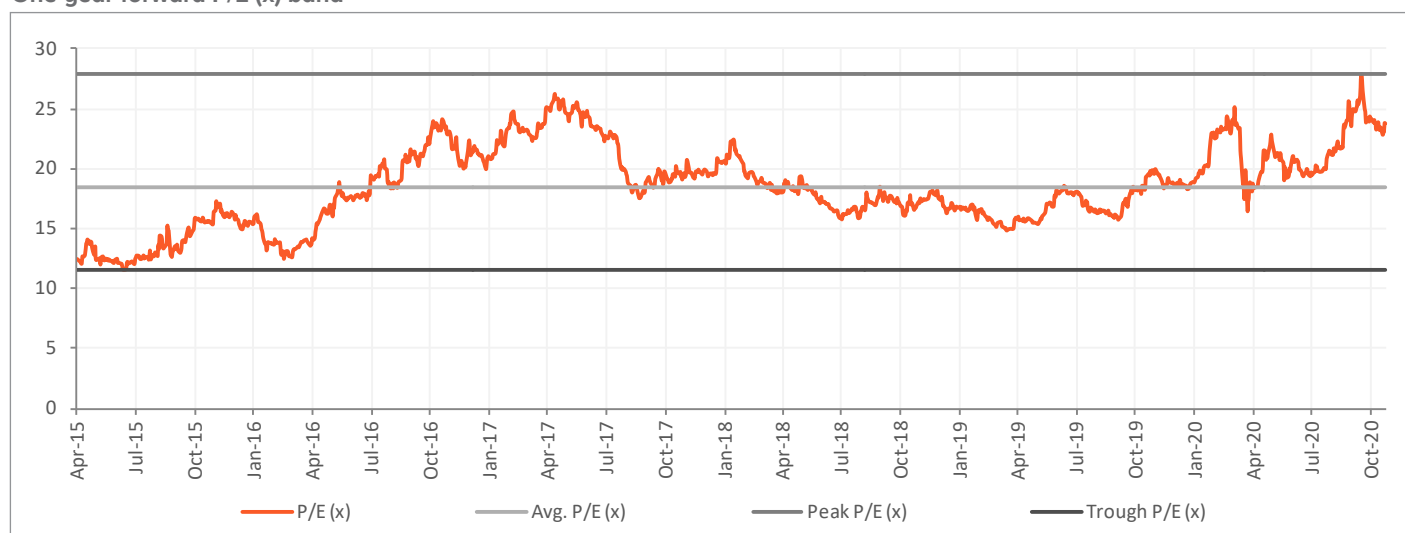
■ Company Outlook – Significant export opportunities underway as global players shift base outside China

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 over the medium to long term, as global players shift their manufacturing and vendor bases outside China.

■ Valuation – Recommend Buy on Atul with a PT of Rs. 6,725

We have increased our FY2021 and FY2022 earnings estimates to factor its faster-than-anticipated recovery in revenue in the domestic business and better-than-expected EBITDA margin. We have also introduced our FY2023 earnings estimates in this report. We believe Atul is well placed to benefit in the medium to long term from structural revenue growth drivers such as higher domestic demand, rising exports, and import substitution for specialty chemicals. Moreover, lower input cost and higher operating leverage would aid in margin expansion. Thus, we expect revenue/EBITDA/PAT to register 14%/17%/16% CAGR over FY2021E-FY2023E. Hence, we recommend Buy on Atul with a PT of Rs. 6,725. At the CMP, the stock is trading at 23.8x its FY2022E EPS and 21.4x 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, florals, 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 off-take (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	Joint Managing Director
Bharathy Mohanan	President, Utilities & Services
Gopi Kannan Thirukonda	Chief Financial Officer
Lalit Patni	Company Secretary and Compliance officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	7.0
2	DSP Investment Managers Pvt Ltd	5.2
3	Aditya Birla Sun Life Trustee Co P	3.4
4	Aditya Birla Sun Life Asset Manage	3.0
5	TRIVEDI TEJAS B	1.9
6	TRIVEDI SHIVANI TEJAS	1.9
7	CANARA ROBECO MUTUAL FUND	1.8
8	Akshita Holdings Pvt Ltd	1.6
9	L&T Mutual Fund Trustee Ltd/India	1.5
10	Goldman Sachs Group Inc/The	1.5

Source: Bloomberg

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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 deteriorating 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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