Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Atul Limited

Strong margin performance continues; growth outlook intact

Speciality Chem	Sharekhan code: ATUL	Result Update

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. 6,374**	
Price Target: **Rs. 7,540**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 18,906 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	9
Others	23

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-1.4	6.1	25.3	29.2
Relative to Sensex	1.6	-10.7	2.6	16.1

Sharekhan Research, Bloomberg

Summary

- Atul Limited's (Atul) Q3FY2021 operating profit/adjusted PAT at Rs. 243 crore/Rs. 191 was above our estimate due to sharp 160 bps beat in OPM at 25.5% and substantially higher other income. Strong margin performance was led by 304 bps y-o-y improvement in gross margin to 55.3%.
- Revenue declined by 8.5% y-o-y, due to lower revenue from performance and other chemicals (POC) and life science chemicals (LSC) segments. POC's EBIT margin was up 180 bps y-o-y to 23.9% and that of LSC was largely stable y-o-y at 17.7%.
- High capex intensity and favourable dynamics of specialty chemicals to drive sustained growth. We expect EBITDA/PAT CAGR of 16%/13% over FY2021E-FY2023E. Share buyback program is small at Rs. 50 crore with buyback price of Rs. 7,250/share (13.7% premium to CMP).
- We maintain Buy on Atul with an unchanged PT of Rs. 7,540, given strong growth tailwinds for the specialty chemical space and robust balance sheet with RoE of ~17.5%. At the CMP, the stock trades at 23.9x FY2022E EPS and 21.9x FY2023E EPS.

Atul Limited's (Atul) consolidated revenue declined by 8.5% y-o-y and 4.9% q-o-q to Rs. 953 crore in Q3FY2021. Revenue from performance and other chemicals (POC) segment declined by 8.6% y-o-y (up 0.7% q-o-q) to Rs. 695 crore and that from the lifescience chemicals (LSC) segment stood at Rs. 286 crore (down 9.9% y-o-y; down 17.7% q-o-q). However, performance on the margin front was sharply better than expected, with 156 bps y-o-y jump in OPM to 25.5% (160 bps ahead of our expectation of 23.9%), led by sustained strong gross margin at 55.3% (up 304 bps y-o-y; up 111 bps q-o-q), given benefit of lower raw-material cost (down 14.3% y-o-y; down 7.2% q-o-q). EBIT margin of the POC segment improved by 180 bps y-o-y and 79 bps q-o-q to 23.9% and that of LSC segment was largely stable at 17.7% (down only 12 bps y-o-y). Consequently, operating profit stood at Rs. 243 crore (down 2.5% y-o-y; down 7% q-o-q) and above our estimate of Rs. 220 crore. Adjusted PAT at Rs. 191 crore (up 14.1% y-o-y; up 5.4% q-o-q) was also above our estimate of Rs. 155 crore on account of higher-than-expected operating profit and sharp jump in other income (up 3.2x y-o-y). Atul's strong presence in multiple chemistries and tie-up with large multinational companies make it well positioned to benefit from structural tailwinds in the Indian specialty chemical sector such as higher domestic demand, rising exports, and import substitution. High capital intensity for capacity expansion, market share gain, and rising share of high-margin products would ensure 16%/13% EBITDA/PAT CAGR over FY2021E-FY2023E along with RoE/RoCE of 17.5%/22%. Hence, we maintain our Buy rating on Atul with an unchanged PT of Rs. 7,540. At the CMP, the stock trades at 23.9x FY2022E EPS and 21.9x FY2023E EPS.

Key positives

- Continuous improvement in gross margin at 55.3% (up 304 bps y-o-y) led by lower input cost.
- POC segment witnessed 180 bps y-o-y and 79 bps q-o-q improvement in EBIT margin to 23.9%.

Key negatives

- Revenue declined by 8.6% y-o-y for POC segment and 9.9% y-o-y for LSC.

Our Call

Valuation – Maintain Buy on Atul with an unchanged PT of Rs. 7,540: We have increased our FY2021 earnings estimates to factor strong margin performance in Q3FY2021 and higher other income partially offset by marginally lower revenue. We have fine-tuned our FY2022-FY2023 earnings estimates. Atul has strong management and efficient capital allocation, which is reflected in 7.4x rise in PAT and RoCE expansion to 26.5% over FY2011-FY2020. High capex intensity (supported by strong balance sheet with net cash position of ~Rs. 590 crore) and favourable dynamics of specialty chemical (higher domestic demand, rising exports, and import substitution) would support sustained growth for Atul (expect revenue/EBITDA/PAT to register 17%/16%/13% CAGR over FY2021E-FY2023E). Hence, we maintain our Buy rating on Atul with an unchanged PT of Rs. 7,540. At the CMP, the stock is trading at 23.9x its FY2022E EPS and 21.9x its FY2023E EPS.

Key Risks

Revenue growth momentum might be affected due to - i) slower demand offtake, 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) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	4,038	4,093	3,726	4,563	5,075
OPM (%)	19.0	22.0	25.0	24.3	24.7
Adjusted PAT	432	666	672	792	862
% y-o-y growth	53.7	54.2	0.8	17.9	8.9
Adjusted EPS (Rs.)	145.6	224.5	226.3	266.7	290.4
P/E (x)	43.8	28.4	28.2	23.9	21.9
P/BV (x)	7.0	6.0	5.0	4.2	3.5
EV/EBITDA (x)	24.4	20.3	19.3	15.8	13.0
RoCE (%)	25.1	26.5	24.0	23.9	22.0
RoE (%)	17.5	22.7	19.4	19.0	17.5

Source: Company; Sharekhan estimates

Strong beat in PAT led by better-than-expected OPM and higher other income: Atul reported consolidated revenue of Rs. 953 crore (down 8.5%; down 4.9% q-o-q). Revenue from LSC declined by 9.9% y-o-y and 17.7% q-o-q to Rs. 286, while revenue from the POC segment stood at Rs. 695 crore (down 8.6% y-o-y; up 0.7% q-o-q). Operating profit margin (OPM) at 25.5% (up 156 bps y-o-y) was above our estimate of 23.9% due to improvement in gross margin at 55.3% (up 304 bps y-o-y; up 111 bps q-o-q) on account of lower input cost (down 14.3% y-o-y). Consequently, operating profit stood at Rs. 243 crore (down 2.5% y-o-y; down 7% q-o-q) and above our estimate of Rs. 220 crore. Adjusted PAT at Rs. 191 crore (up 14.1% y-o-y; up 5.4% q-o-q) was also above our estimate of Rs. 155 crore on account of higher-than-expected operating profit and sharp jump in other income (up 3.2x y-o-y).

POC segment's EBIT margin improves by 180 bps y-o-y, while LSC's EBIT margin remained largely stable y-o-y: EBIT margin of POC segment improved by 180 bps y-o-y and 79 bps q-o-q to 23.9% and that of LSC was at 17.7% (down only 12 bps y-o-y). Despite the sharp decline in revenue, EBIT for POC was down by only 1.1% y-o-y (up 4.2% q-o-q) to Rs. 166 crore. However, life science chemicals' EBIT declined by 10.6% y-o-y (down 24.4% q-o-q) largely reflecting weakness in revenue (down 9.9% y-o-y) as margin was largely stable y-o-y.

Share buyback program – Small size of Rs. 50 crore at maximum buyback price of Rs. 7,250/share: The board of directors of the company has approved buyback of fully paid-up equity shares not exceeding Rs. 50 crore at maximum buyback price of Rs. 7,250/share (13.7% premium to last closing price) from open market. Maximum equity shares to be bought back at maximum buyback size and price would be 0.69 lakh equity shares (only 0.23% of total outstanding share). Thus, size of the buyback is very small.

Results (Consolidated) Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Revenue	**953**	**1,041**	**(8.5)**	**1,002**	**(4.9)**
Material Cost	425	497	(14.3)	459	(7.2)
Gross Profit	**527**	**545**	**(3.2)**	**544**	**(3.0)**
Employee Expenses	79	75	5.2	77	3.4
Power and Fuel Expenses	81	95	(14.9)	85	(4.6)
Other Expenses	124	125	(0.6)	121	2.8
Operating profit	**243**	**249**	**(2.5)**	**261**	**(7.0)**
Other Income	37	12	224.0	6	477.7
Depreciation	33	32	3.1	33	0.6
Interest	2	3	(31.2)	2	-
PBT	**247**	**227**	**8.9**	**235**	**5.3**
Tax	57	57	(0.9)	60	(4.9)
PAT	**189**	**169**	**11.6**	**174**	**8.2**
Adjusted PAT	**191**	**167**	**14.1**	**181**	**5.4**
Reported EPS (Rs.)	63.6	56.9	11.6	58.8	8.2
Margin (%)			**YoY (bps)**		**QoQ (bps)**
Gross Profit Margin	55.3	52.3	304	54.2	111
Operating profit Margin	25.5	23.9	156	26.1	(57)
Net Profit Margin	20.0	16.1	396	18.1	197

Source: Company; Sharekhan Research

Segmental performance (Consolidated) **Rs cr**

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Revenue					
Life science chemicals	286	318	-9.9	348	-17.7
Performance and other chemicals	695	760	-8.6	690	0.7
others	14	9	52.8	11	30.4
Total	**995**	**1,087**	**-8.4**	**1,048**	**-5.1**
Inter segment	**42**	**45**	**-7.3**	**46**	**-8.6**
Net Revenues	**953**	**1,041**	**-8.5**	**1,002**	**-4.9**
EBIT					
Life science chemicals	51	57	-10.6	67	-24.4
Performance and other chemicals	166	168	-1.1	159	4.2
Others	2	4	-33.3	5	-48.5
Total EBIT	**219**	**228**	**-4.0**	**231**	**-5.2**
EBIT Margin (%)			**BPS (YoY)**		**BPS (QoQ)**
Life science chemicals	17.7	17.9	-12	19.3	-157
Performance and other chemicals	23.9	22.1	180	23.1	79
Others	17.6	40.4	-2,280	44.7	-2,707
Overall EBIT margin	**23.0**	**21.9**	**108**	**23.1**	**-7**

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.

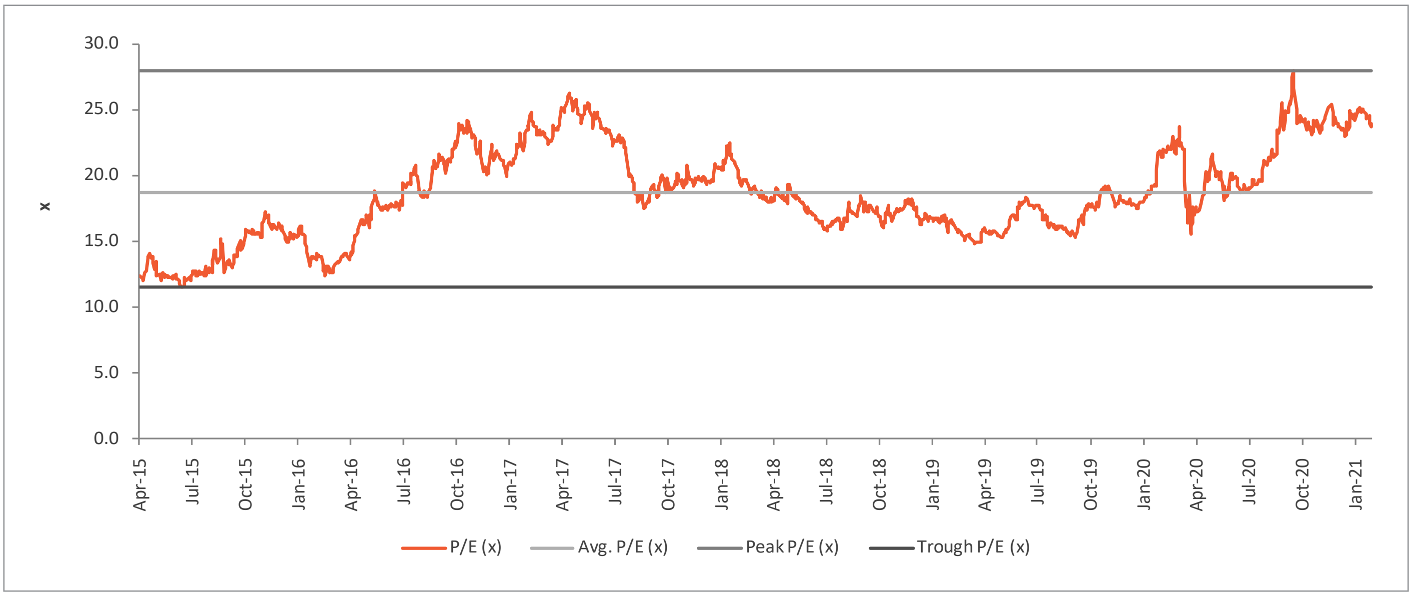
■ Company outlook - Significant export opportunities underway as global players shift base outside China

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 - Maintain Buy on Atul with an unchanged PT of Rs. 7,540

We have increased our FY2021 earnings estimates to factor strong margin performance in Q3FY2021 and higher other income partially offset by marginally lower revenue. We have fine-tuned our FY2022-FY2023 earnings estimates. Atul has strong management and efficient capital allocation, which is reflected in 7.4x rise in PAT and RoCE expansion to 26.5% over FY2011-FY2020. High capex intensity (supported by strong balance sheet with net cash position of ~Rs. 590 crore) and favourable dynamics of specialty chemical (higher domestic demand, rising exports, and import substitution) would support sustained growth for Atul (expect revenue/EBITDA/PAT to register 17%/16%/13% CAGR over FY2021E-FY2023E). Hence, we maintain our Buy rating on Atul with an unchanged PT of Rs. 7,540. At the CMP, the stock is trading at 23.9x its FY2022E EPS and 21.9x 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 companyis 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	Joint Managing Director
Bharathy Mohanan	President, Utilities & Services
Gopi Kannan Thirukonda	Chief Financial Officer
Lalit Patni	Company Secretary and Compliance office

Source: Bloomberg

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

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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