Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Atul Ltd

Weak margin performance; Capex to drive growth

Speciality Chem	Sharekhan code: ATUL
Reco/View: Buy ⇔	CMP: **Rs. 9,343** / Price Target: **Rs. 11,000** ⇔

↑ Upgrade ⇔ Maintain ↓ Downgrade

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		⇔	

ESG Disclosure Score NEW

ESG RISK RATING 40.23
Updated Apr 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

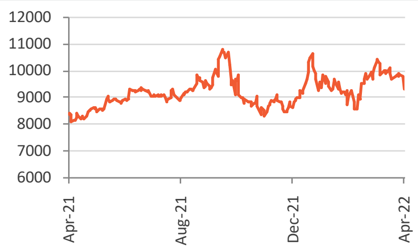
Company details

Market cap:	Rs. 27,643 cr
52-week high/low:	Rs. 10,975/7,901
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	10
Others	22

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-9.8	-0.6	-3.3	11.8
Relative to Sensex	-9.4	-0.8	2.9	-5.4

Sharekhan Research, Bloomberg

Summary

- Atul Limited's (Atul) Q4FY2022 PAT of Rs. 126 crore sharply missed our estimates due to weaker-than-expected OPM and lower other income, offsetting strong revenue growth of 23% y-o-y.
- Revenue grew strongly by 29%/18% y-o-y from POC/LSC segments; however, EBIT margin disappointed with a steep decline of 1,030 bps/240 bps y-o-y to 12.1%/14.1% due to contraction in gross margin and higher operating cost.
- Atul has done cumulative capex of Rs. 913 crore over FY2021-FY2022 to augment capacities of key products (like sulphur black dyes, para-cresol, para-cresidine). Ramp-up of capacities, price hikes, and likely normalisation of energy/logistics cost should drive strong earnings growth (expect 31% PAT CAGR over FY22-24E) on a low base of FY22 (PAT de-growth of 8% y-o-y).
- Atul is expected to be a key beneficiary of structural growth tailwinds (China plus One strategy) for Indian specialty chemicals space and sustained capex to augment capacities would result in long runway for earnings growth. Hence, we maintain a Buy on Atul Ltd with an unchanged PT of Rs. 11,000.

Atul Limited's (Atul) Q4FY2022 performance was marred by weak OPM of 15% (down 782 bps; down 324 bps q-o-q and below our estimate of 16.8%) as input and power and fuel cost remained at elevated level, offsetting strong revenue growth of 22.8% to Rs. 1,370 crore (broadly in-line with our estimates). Revenue growth reflects decent demand traction with 28.8%/17.8% y-o-y rise in revenue from performance and other chemical (POC)/Life Science Chemical (LSC) segments to Rs. 1,053 crore/Rs. 367 crore. However, PoC/LSC EBIT margin declined by 1030 bps/211 bps y-o-y to 12.1%/14.1%. Consequently, operating profit/adjusted PAT of Rs. 205 crore/Rs. 126 crore, down 19.3%/27.3% y-o-y, missed our estimate due to weak margin performance and lower-than-expected other income (adjusted for Rs. 10 crore of foreign exchange gain).

Key positives

- Strong revenue growth of 29% y-o-y for the POC segment.

Key negatives

- Gross/EBITDA margin fell by 533 bps/782 bps y-o-y to 47.5%/15% on high input and power and fuel cost.
- PoC/LSC EBIT margin declined sharply by 1,030 bps/240 bps y-o-y to 12.1%/14.1%.

Revision in estimates – We have lowered our FY2023 earnings estimates to factor in lower margin assumption and have fine-tuned our FY2024 earnings estimates.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 11,000: We believe continued high capex intensity (to augment capacities), market share gains (China plus one strategy by global peers), and focus on process efficiencies (to improve product yields and support margins) would drive a 31% PAT CAGR over FY2022-FY2024E with healthy RoE of 18%. Hence, we maintain our Buy rating on Atul with an unchanged price target (PT) of Rs. 11,000. At the CMP, the stock trades at 32.7x/26.5x its FY2023E/FY2024E EPS.

Key Risks

1) Revenue growth could be hit by weak demand and delay in commissioning of capex project and new products and 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	FY21	FY22	FY23E	FY24E
Revenue	3,731	5,081	5,851	6,729
OPM (%)	24.6	17.9	20.5	21.6
Adjusted PAT	656	604	845	1,044
% y-o-y growth	(1.6)	(7.9)	39.9	23.5
Adjusted EPS (Rs.)	221.5	204.1	285.5	352.6
P/E (x)	42.2	45.8	32.7	26.5
P/BV (x)	7.2	6.2	5.3	4.4
EV/EBITDA (x)	29.1	29.8	22.2	17.9
RoCE (%)	23.4	18.2	21.8	23.0
RoE (%)	18.8	14.6	17.5	18.2

Source: Company; Sharekhan estimates

PAT missed estimates due to weaker-than-expected margin

Atul's Q4FY2022 consolidated revenue stood at Rs. 1,370 crore (up 22.8% y-o-y; down 0.7% q-o-q), broadly in-line with our estimate of Rs. 1,384 crore. The y-o-y revenue growth was driven by robust 28.8%/17.8% y-o-y rise in revenue from the performance and other chemical/life science chemical segments to Rs. 1,053 crore/ Rs. 367 crore. OPM at 15% (down 782 bps y-o-y; down 324 bps q-o-q) was below our estimate of 16.8% due to lower gross margin (down 533 bps y-o-y to 47.5% and against estimate of 49.5%) and higher operating cost on account of rise in power and fuel cost, employee cost, and other expenses. Consequently, operating profit declined by 19.3% y-o-y to Rs. 205 crore, below our estimate of Rs. 232 crore. PAT (adjusted for Rs. 10 crore of forex gain) at Rs. 126 crore (down 27.3% y-o-y; down 17.1% q-o-q) was also 27% below our estimate of Rs. 173 crore on account of lower-than-expected margin.

Results (Consolidated) Rs cr

Particulars	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)
Revenue	**1,370**	**1,116**	**22.8**	**1,380**	**(0.7)**
Total expenditure	1,165	862	35.2	1,129	3.2
Operating profit	**205**	**254**	**(19.3)**	**251**	**(18.4)**
Other Income	22	19	19.3	3	623.8
Depreciation	44	37	20.4	45	(3.0)
Interest	3	2	44.5	2	78.5
PBT	**182**	**236**	**(23.0)**	**210**	**(13.4)**
Tax	45	59	(23.9)	53	(14.7)
Reported PAT	**136**	**175**	**(22.2)**	**155**	**(12.3)**
Adjusted PAT	**126**	**174**	**(27.3)**	**152**	**(17.1)**
Reported EPS (Rs.)	46.1	59.2	(22.2)	52.5	(12.3)
Adjusted EPS (Rs)	42.6	58.7	(27.3)	51.4	(17.1)
Margin (%)			**YoY (bps)**		**QoQ (bps)**
OPM	15.0	22.8	(782)	18.2	(324)
Tax rate	24.9	25.2	(30)	25.3	(38)
NPM	9.2	15.6	(635)	11.0	(182)

Source: Company, Sharekhan Research

Segmental performance (Consolidated) Rs cr

Particulars	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)
Revenue					
LSC	367	312	17.8	398	-7.6
POC	1,053	817	28.8	1,026	2.6
others	15	15	-2.1	21	-30.2
Gross revenue	**1,435**	**1,144**	**25.4**	**1,445**	**-0.7**
Less: Inter segment	**64**	**28**	**128.7**	**65**	**-0.7**
Net revenue	**1,370**	**1,116**	**22.8**	**1,380**	**-0.7**
EBIT					
LSC	52	51	2.5	45	15.8
POC	128	183	-30.3	149	-14.4
Others	4	5	-10.0	10	-60.4
Total EBIT	**184**	**238**	**-23.0**	**204**	**-10.1**
Margin (%)			**bps**		**Bps**
LSC	14.1	16.2	-211	11.3	286
POC	12.1	22.4	-1,030	14.5	-240
Others	27.9	30.3	-242	49.1	-2,124
Overall EBIT margin	**13.4**	**21.4**	**-796**	**14.8**	**-139**

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 the 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 are 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 PLI schemes 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 ongoing expansion plans in a calibrated manner, be it in expanding capacities through new projects or de-bottlenecking 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 with an unchanged PT of Rs. 11,000

We believe continued high capex intensity (to augment capacities), market share gains (China plus one strategy by global peers), and focus on process efficiencies (to improve product yields and support margins) would drive a 31% PAT CAGR over FY2022-FY2024E with healthy RoE of 18%. Hence, we maintain our Buy rating on Atul with an unchanged price target (PT) of Rs. 11,000. At the CMP, the stock trades at 32.7x/26.5x its FY2023E/ FY2024E 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 (UK) 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 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 due 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 and 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	DSP Investment Managers Pvt Ltd	4.1
2	HDFC Asset Management Co Ltd	2.6
3	Aditya Birla Sun Life Asset Manage	2.4
4	Vanguard Group Inc/The	2.0
5	TRIVEDI SHIVANI TEJAS	1.8
6	Kotak Mahindra Asset Management Co	1.7
7	Mirae Asset Global Investments Co	1.5
8	TRIVEDI TEJAS B	1.4
9	Norges Bank	1.3
10	Government Pension Fund	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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;