Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Atul Ltd

Strong Q1; near-term challenges persist for chemical industry

Speciality Chem	Sharekhan code: ATUL
Reco/View: Hold ↔	CMP: Rs. 7,013 / Price Target: Rs. 7,550 ↑

↑ 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 35.84

Updated Jun 08, 2023

High Risk

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

Source: Morningstar

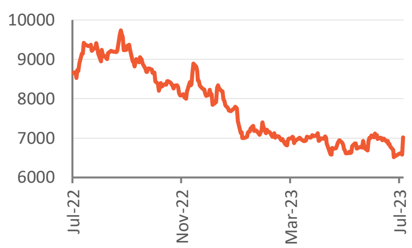
Company details

Market cap:	Rs. 20,749 cr
52-week high/low:	Rs. 9,805 / 6,470
NSE volume: (No of shares)	0.5 lakh
BSE code:	500027
NSE code:	ATUL
Free float: (No of shares)	1.6 cr

Shareholding (%)

Promoters	45
FII	8
DII	26
Others	21

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.8	0.2	-5.7	-19.0
Relative to Sensex	-6.2	-11.5	-15.7	-37.9

Sharekhan Research, Bloomberg

Summary

- Q1FY24 was a positive surprise with a 18%/11% beat in EBITDA/PAT at Rs. 182 crore/ Rs. 102 crore, up 22%/13% q-o-q led by sharp margin recovery in performance and other chemicals (POC) despite challenging demand/pricing environment for chemicals industry especially for companies focused on discretionary end-user industries.
- POC revenues/EBIT was up 5%/5.7x q-o-q to Rs. 874 crore/Rs. 89 crore. A key positive surprise was a sharp 828 bps q-o-q rise in EBIT margin to 10.2%. Life Science Chemical (LSC) segment's performance was soft with 14%/42% q-o-q decline in revenue/EBIT to Rs. 350 crore/Rs. 52 crore with steep 726 bps q-o-q decline in EBIT margin to 14.9%.
- Despite outperformance in POC segment, challenges like sharp price erosion led by rise in supply from China, reduction in inventory by customers and weak global demand persist for chemical industry. This makes us cautious about near term outlook for Atul Limited.
- Current valuation of 36/29x its FY2024E/FY2025E EPS seems rich given volatile earnings due to the commodity nature of the business. Hence, we maintain Hold rating on Atul Ltd. with a revised PT of Rs. 7,550.

Q1FY24 performance was strong with an 18% beat in consolidated EBITDA at Rs. 182 crore (up 22% q-o-q) supported by robust margin recovery of 292 bps q-o-q to 15.4% (286 bps above our estimate), while revenues were subdued at Rs. 1182 crore (down 1% q-o-q and 3.6% below our estimates). Robust operating performance was driven by a beat in POC segment which posted 5% q-o-q revenue growth and a steep 828 bps q-o-q improvement in EBIT margins to 10.2% which was surprising given it caters to discretionary end-user industries and current challenges in the chemicals industry because of higher supply from China. LSC performance was soft with 14%/42% q-o-q decline in revenue/EBIT to Rs. 350 crore/Rs. 52 crore with a steep 726 bps q-o-q decline in EBIT margin to 14.9%. Consolidated PAT at Rs. 102 crore (down 37% y-o-y; up 13% q-o-q) was also 11% above our estimate of Rs. 92 crore on account of strong EBIT margin improvement in POC segment.

Key positives

- POC revenue/EBIT margin was up 5%/828 bps q-o-q.

Key negatives

- LSC revenue/EBIT margin declined 14%/726 bps q-o-q.

Revision in estimates – We maintain our FY2024-FY2025 earnings estimates.

Our Call

Valuation – Retain Hold with a revised PT of Rs. 7,550: Despite a strong recovery in POC segment, we remain cautious on near-term outlook for Atul as demand/pricing challenges persist for chemical industry. Valuation of 36/29x its FY2024E/FY2025E EPS seems rich, given volatile earnings due to the commodity nature of the business, hence we maintain Hold rating on Atul Ltd with a revised PT of Rs. 7,550.

Key Risks

Faster ramp-up of new projects/products and proactive price hike to pass on higher raw-material/logistics/energy costs are key upside risks, while weak revenue growth amid likely delay in commissioning of capex and inadequate price hikes are downside risks to our earnings estimate and rating.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	5,081	5,428	5,680	6,359
OPM (%)	17.9	14.3	16.2	17.7
Adjusted PAT	604	518	576	721
% y-o-y growth	(7.9)	(14.2)	11.2	25.1
Adjusted EPS (Rs.)	204.1	175.1	194.6	243.4
P/E (x)	34.4	40.1	36.0	28.8
P/BV (x)	4.7	4.4	4.0	3.5
EV/EBITDA (x)	22.3	26.6	21.6	17.1
RoCE (%)	18.2	14.2	14.8	16.6
RoE (%)	14.6	11.4	11.7	13.0

Source: Company; Sharekhan estimates

Strong Q1 led by margin beat

Consolidated revenues of Rs. 1,182 crore (down 20% y-o-y; down 1% q-o-q) was 4% below our estimate of Rs. 1,226 crore. Life Science Chemical (LSC) revenue declined sharply by 14% q-o-q to Rs. 350 crore while that from Performance and Other Chemical (POC) grew by 5.4% q-o-q at Rs. 875 crore. LSC revenue declined both on y-o-y and q-o-q basis due to subdued global demand and lower price realization. POC segment revenue recovered on q-o-q basis but declined on y-o-y basis due to higher inventory and lower capacity utilization by customers. OPM at 15.4% (down 35 bps y-o-y; up 292 bps q-o-q) was above our estimate of 12.6% due to higher gross margin at 46.5% (down 201 bps y-o-y; up 67 bps q-o-q). Consequently, operating profit of Rs. 182 crore (down 22% y-o-y; up 22% q-o-q) was 18% above our estimate of Rs. 154 crore. LSC EBIT declined by 42% q-o-q to Rs. 52 crore. POC EBIT grew sharply by 466% q-o-q to Rs. 89 crore. Adjusted PAT at Rs. 102 crore (down 37% y-o-y; up 13% q-o-q) was 11% above our estimate of Rs. 92 crore on account of strong EBIT margin improvement (growth of 466% q-o-q) in POC segment.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Revenue	**1,182**	**1,477**	**(20.0)**	**1,195**	**(1.1)**
Total expenditure	1,000	1,244	(19.6)	1,046	(4.4)
Operating profit	**182**	**233**	**(21.8)**	**149**	**22.0**
Other Income	8	36	(77.2)	24	(66.1)
Depreciation	52	47	9.8	51	1.7
Interest	2	2	29.3	2	(7.3)
PBT	**138**	**220**	**(37.1)**	**120**	**15.1**
Tax	36	58	(36.9)	30	22.5
Reported PAT	**102**	**163**	**(37.5)**	**92**	**11.0**
Reported EPS	34.6	55.4	(37.5)	31.2	11.0
Adjusted EPS (Rs.)	34.6	55.0	(37.1)	30.7	12.7
Margin (%)	**Q1FY24**	**Q1FY23**	**YoY (%)**	**Q4FY23**	**QoQ (%)**
OPM	15.4	15.8	(35)	12.5	292
Tax rate	26.3	26.2	8	24.7	159
Adjusted NPM	8.6	11.0	(236)	7.6	105

Source: Company; Sharekhan Research

Segmental performance (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Revenue					
LSC	350	485	-27.7	409	-14.3
POC	874	1,057	-17.3	830	5.4
others	12	11	4.0	13	-9.9
Total	**1,236**	**1,553**	**-20.4**	**1,251**	**-1.2**
Inter segment	**54**	**76**	**-28.5**	**56**	**-3.4**
Net	**1,182**	**1,477**	**-20.0**	**1,195**	**-1.1**
EBIT					
LSC	52	80	-34.3	91	-42.3
POC	89	130	-31.6	16	465.9
Others	2	0	NA	1	71.7
Total	**143**	**210**	**-31.8**	**107.4**	**33.2**
EBIT Margin (%)			**bps**		**bps**
LSC	14.9	16.4	-149	22.2	-726
POC	10.2	12.3	-214	1.9	828
Others	15.5	-0.3	1,581	8.2	739
Overall EBIT margin	**12.1**	**14.2**	**-210**	**9.0**	**312**

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 chemicals sector, given a massive revenue opportunity from the perspective of import substitution (India's total specialty chemical imports are estimated at $56 billion), the 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 opportunities, and low input prices would help the sector witness a high double-digit earnings growth trajectory on sustained basis over the next 2-3 years.

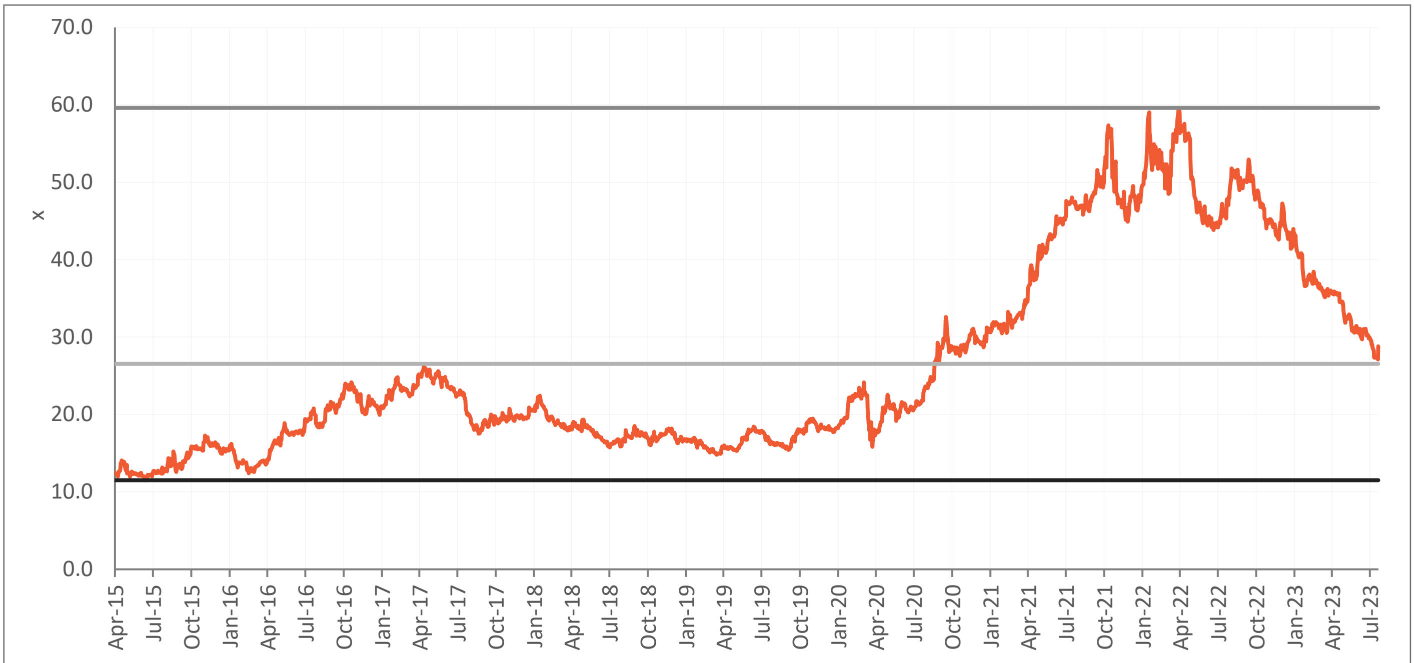
■ **Company Outlook – Near-term outlook challenging**

The chemicals industry is facing challenges like sharp price erosion led by rise in supply from China, reduction in inventory by customers and weak global demand. This makes us cautious about near-term outlook for Atul Limited. Having said that, China plus one strategy by global players provides long term growth opportunities for companies like Atul as it 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 de-bottlenecking capacities through internal accruals.

■ **Valuation – Retain Hold with a revised PT of Rs. 7,550**

Despite a strong recovery in POC segment, we remain cautious on near-term outlook for Atul as demand/pricing challenges persist for chemical industry. Valuation of 36/29x its FY2024E/FY2025E EPS seems rich, given volatile earnings due to the commodity nature of the business, hence we maintain Hold rating on Atul Ltd with a revised PT of Rs. 7,550.

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. However, weak global demand and pricing pressure in the chemical industry is a concern for the company.

Key Risks

- Faster ramp-up of new projects/products and proactive price hike to pass on higher raw-material/logistics/energy costs are key upside risks to our earnings estimate and valuation.
- Weak revenue growth amid likely delay in commissioning of capex and inadequate price hikes are downside risks to our earnings estimate and rating.

Additional Data

Key management personnel

Sunil Lalbhai	Executive Director and Promoter
Samveg Lalbhai	Executive Director and Promoter
Bharathy Mohanan	President, Utilities and Services and Whole-Time Director
Gopi Kannan Thirukonda	Chief Financial Officer and Whole-Time Director
Lalit Patni	Company Secretary and Compliance officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	DSP Investment Managers Pvt Ltd	4.73
2	Life Insurance Corp of India	3.76
3	Kotak Mahindra Asset Management Co	3.67
4	Canara Robeco Asset Management Co	2.28
5	HDFC Asset Management Co Ltd	2.27
6	Aditya Birla Sun Life Asset Manage	2.21
7	SBI Life Insurance Co Ltd	1.87
8	Vanguard Group Inc/The	1.84
9	Mirae Asset Global Investments Co	1.7
10	Akshita Holdings Pvt Ltd	1.57

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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