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Street bullish on specialty chemicals

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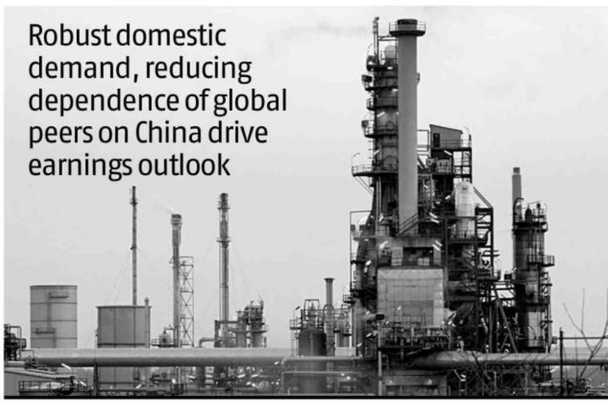

DECENT UPSIDE

	Price (₹)	Change in % YTD	Change in % 1-Yr	Target price (₹)	Upside (%)	FY22 E PE (x)
Aarti Industries	1,212	-1.6	24.8	1,298	7.1	29.9
Atul	6,855	6.6	38.1	6,914	0.9	27.6
Deepak Nitrite	1,110	17.8	159.4	1,225	10.4	20.7
Fine Organic Industries	2,421	-4.1	7.8	2,493	3.0	36.7
Galaxy Surfactants	2,175	8.8	29.6	2,363	8.7	24.5
Navin Fluorine International	2,630	0.7	129.5	2,820	7.2	45.3
PI Industries	2,225	1.2	43.8	2,442	9.8	37.5
SRF	5,619	0.9	35.4	6,047	7.6	25.5
Sudarshan Chemical Industries	510	6.4	11.4	614	20.4	22.7
Vinati Organics	1,479	22.5	48.3	1,361	-8.0	63.5

Data as on Feb 12; E: estimate; YTD: year-to-date; Source: Bloomberg, exchange Compiled by *BS* Research Bureau

With demand in India improving as businesses return to pre-Covid-19 levels, favourable government policies, and a huge export opportunity, experts say the Indian specialty chemicals industry is in a sweet spot to grow at a healthy double-digit rate over the medium term.

"We expect the industry to grow at a compound annual rate of 12 per cent and reach $65 billion by FY25, from the current $32 billion," said Mitesh Shah, research analyst, ICICI Securities. Despite good gains in the past year, there is room for upside in specialty chemicals stocks.

For several years, China dominated global chemicals supply with its continuously improving technology, better infrastructure, and low-cost labour. However, over the past decade, environmental crackdown, trade wars, and the more recent Covid outbreak have prompted firms to seek alternative sourcing venues, making India an attractive option.

"The structure of China's chemical industry is changing due to stricter environment norms, trade conflicts with the US, etc. While these shifts spell uncertainty, they can create opportunities for Indian chemical companies in certain value chains and segments, especially in the short term," McKinsey & Company said in a report. India is the sixth-largest chemicals producer with estimated market size of $180 billion in 2018. A 10 per cent shift of China's chemicals business to India will see India's global market share double from the current 3 per cent, said Nilesh Ghuge, analyst, HDFC Securities.

Notably, the performance of speciality chemicals is largely dependent on demand from user industries. Chemical companies catering for personal care, pharma and agrochemicals have witnessed strong growth, led by a faster-than-expected pick-up in demand.

Demand from automobile, construction, and textile firms is also catching up, as the economy recovers from the pandemic. With a significant portion of domestic demand still met by imports, firms have invested heavily in capacity expansion over the past few years, offering much headroom growth, said Ghuge. Additionally, government measures, such as the 'Make in India' initiative and the production-linked incentive (PLI) scheme for the sector, have increased investor optimism.

Although the view is bullish on the sector, experts expect leading players with large capacities in niche segments to reward shareholders disproportionately.

Aarti Industries reported strong growth in the Q3, driven by higher volumes and increased contribution from high-margin value-added products. Its management expects India to emerge as a significant operator in the global chemicals supply-chain and is looking to invest ₹1,000-1,200 crore annually over the next four-five years. The company remains confident of delivering 15-20 per cent annual growth in coming years aided by increased demand, project commissioning and business from new chemistries.

SRF reported operationally strong results in Q3, primarily on account of robust growth in its specialty chemicals business. The management sees significant growth opportunities in this segment aided by robust demand in the agrochemicals and active pharmaceutical ingredients (API) space and new product launches. Subsequently, it is investing aggressively in building the necessary capacity (60 per cent of the overall capex) and expects to sustain at 40-50 per cent over the next 3 to 4 years in speciality chemicals. Other businesses like technical textiles is also seeing recovery, while packaging and films, which had seen very high growth, is expected to grow at a healthy pace on the high-base.

PI Industries' revenue from exports — 2/3rd of the topline — grew 30 per cent in Q3, Despite challenges on the supply-chain front. Consequently, PI expects to end 2020-21 with overall growth of over 20 per cent. Moreover, even on a high base, it remains confident of clocking 20 per cent growth in 2021-22, aided by strategic acquisitions, strong product pipeline, and broad-based demand. With PI's superior return ratios and robust outlook, Edelweiss has upped its EPS estimate by 5 per cent each for FY21, FY22 and FY23.

Navin Fluorine's Q3 results were in-line with estimates as continued traction in specialty and the CRAMS (Contract research and manufacturing services) vertical was offset by weakness in its legacy business (refrigerant gas). But, the management is confident about the future and guided for 20 per cent revenue growth in speciality chemicals and $10 million revenue per quarter from CRAMS starting FY22. Emkay Global has increased its EPS estimate by 1.2 per cent for 12 months ending December 2022 and raised the target price to ₹2,834 (8 per cent upside).

Continued weakness in ATBS (Acrylamido Methylpropane Sulfonic acid) hurt **Vinati Organics'** top line, while adverse product mix hurt margins in Q3. However, revenue and profitability are expected to see an upward trajectory in FY22 led by the contribution from new product Butyl phenols, improved off-take from IBB (Isobutyl Benzene), and gradual revival in ATBS, said analysts at Geojit. Vinati is the world's largest producer of IBB and ATBS, which are used in the pharmaceuticals, and water treatment, paints, textiles, oil and mining sectors. Also, potential synergies from the planned amalgamation of Veeral Additives with itself — making it the largest and only integrated manufacturer for certain antioxidants in India — is positive, say analysts.