# Atul Ltd. (Atul) (CMP: Rs 81.10)

HDFC securities

## Stock Note

September 30, 2009

We feel that Atul could be bought at the current price and added on dips to the price band of Rs.65 to 70 for sequential targets of Rs.98 (5 x FY10E EPS) and Rs.117 (6 x FY10E EPS) in 2-3 quarters.

### Company Background

Atul Ltd (Atul) is a member of the US$ 1 bn Lalbhai Group, one of the oldest business houses of India, with interests mainly in textiles and chemicals. The promoters hold 39.4% stake in the company. Over the years, Atul joined hands with American Cyanamid Corp (1952), Imperial Chemical Industries plc (1955) and Ciba-Geigy (1960) to form 3 joint venture companies, namely, Cyanamid India, Atic Industries and Cibatul respectively.

Consequent to worldwide divestment of dyes and polymers business by Zeneca plc (formerly a part of ICI plc) and Ciba respectively, Atic Industries and Cibatul were merged into Atul in 1995 and 1998 respectively. Cyanamid India was merged with Wyeth India Ltd in 1997.

Atul operates through seven business divisions, namely, Aromatics, Bulk Chemicals & Intermediates, Crop Protection, Colors, Pharmaceuticals & Intermediates, Polymers and Floras.

Atul is present in China, Germany, UK and US through trading/marketing 100% subsidiary companies. It has manufacturing facilities at Atul and Ankleshwar in Gujarat and Tarapur in Maharashtra.

Over the last few years, it has initiated efforts to debottleneck capacities, cut time cycles, enhance yields, batch size; thereby cutting costs and improving profitability.

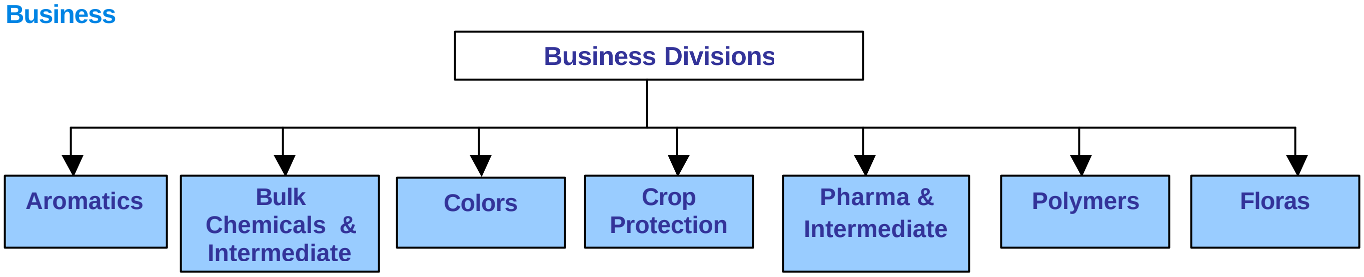
In FY09, Atul did capacity expansions across its key products:

- Crop protection product by 1500 MT or 14%
- Fragrance intermediate by 2400 MT or 40%
- Chemical intermediate by 1000 MT or 71%
- Composite intermediate by 540 MT or 68%

In FY09, Atul earned export revenues of Rs.560 cr out of the total revenues of Rs.1,159 cr. It made imports of Rs.190 cr.

Atul has forayed into date palm cultivation to bring the fruit in both fresh and processed forms in the Indian market. It has entered into contract farming with farmers in India for producing date palm fruits and had imported thousands of tissue cultured date palm plants from the UAE for plantation in India. It has established a subsidiary company Atul Rajasthan Date Palms Ltd, alongwith the Government of Rajasthan to promote date palms in India.

### Business




| Division | Contribution to FY09 Sales (%) | Contribution to FY08 Sales (%) | Exports % of FY09 Segmental Sales | Exports % of FY08 Segmental Sales |
|---|---|---|---|---|
| Aromatics | 26.1% | 21.0% | 66.2% | 64.1% |
| Bulk Chemicals & Intermediates | 10.7% | 11.0% | 22.2% | 16.9% |
| Colors | 22.3% | 25.0% | 45.0% | 53.5% |
| Crop Protection | 20.4% | 18.3% | 58.0% | 52.2% |
| Pharmaceutical & Intermediates | 6.3% | 6.5% | 79.7% | 79.1% |
| Polymers | 16.9% | 18.9% | 18.0% | 15.1% |

(Source: Company )

**Aromatics Division:**
The Aromatics Division operates in the fine chemical sector of the Chemical Industry and markets its products to four key user industries. It has about 325 customers in this division across 4 products. It is the largest manufacturer of para Anisic aldehyde and para Anisyl alcohol in the world.

User Industries
Personal Care
Pharma
Flavours & Fragrance
Dyestuff
Paper

| Product | Domestic Market Share (FY09) | Competition |
|---|---|---|
| p-Cresol | 35% | China (6) |
| p-AA | 65% | Europe (1), India (1) |
| p-AAI | 40% | India (2) |
| p-Cd | 30% | China (1) |

Thrust going forward – Value added products and explore related opportunities in Personal care and Flavours and Fragrance. In FY09, this division improved its PBT by 295%.

**Bulk Chemicals and Intermediates Division:**
The Bulk Chemicals and Intermediates division manufactures a variety of bulk chemicals and semi-speciality intermediates. Bulk Chemicals are used in chemical, paper and textile industries. Chemicals such as Resorcinol are used by rubber and tyre industry. Atul's customer base in this division is 227.

| Product | Market Share (FY09) | Competition |
|---|---|---|
| Resorcinol | 36% domestic | Japan (2), USA (1), China (8), Russia (1) |
| | 2% global | |
| CSA | 16% domestic | India (3) |
| Oleum 65%, $SO_3$, Caustic Soda | Captive Consumption | |

**Colors Division:**
The Colors division is the largest and oldest business division of Atul, manufacturing a wide range of dyestuffs for the textile, leather, paper, wool and silk industries. The division is the largest supplier of dyestuffs in India and exports nearly 40% of its production to more than 40 countries worldwide. The division's manufacturing operations started with sulphur dyes in 1952. In Colors business, the company has introduced new range in Vat and reactive dyes, new business segments such as high performance colorants. However, over time due to slowdown in its user industries like textile, paper, etc this division's contribution to the total turnover of Atul has gone below 25%. Atul is widening its range in the Colors Division, expecting to launch six new products with global potential.

| Product Group | User Industries |
|---|---|
| Textile Dyes | Textile |
| Paper Dyes | Paper |
| HP Pigments | Coatings |

| Product | Market Share (FY09) | Competition from players based in |
|---|---|---|
| Vat dyes | 11% | Europe (1), China (4), India (1) |
| Reactive dyes | 1% | Europe (2), India (8-10) |
| Sulphur Black | 8% | Europe (1), China (3) |
| HP Pigments | 2% | Europe (3) |

In FY09, Bulk Chemicals and intermediates and Colours division pulled down the PBT to the extent of Rs.27 cr.

**Crop Protection Division:**
The division manufactures herbicides, insecticides, fungicides and other intermediates. It is one of the only three Indian companies licensed to manufacture Phosgene-based products. It is a major producer of selected herbicides in India. It has 60 products under this division. It exports to 150 customers, has 950 customers for its branded customers and has 65 customers under the bulk category. Exports comprise 50% of the revenue pie and the products are accepted across 35 countries. In India crop protection products are available at 15,000 retail outlets.

User Industry – Agriculture

| Product | Market Share (FY09) | Competition |
|---|---|---|
| 2, 4 D group | 8% | USA (1), Australia (1), South America (1), Europe (1), China (1) |
| Indoxacarb | 3% | USA (1), India (1) |

Thrust going forward – Expand herbicide capacity by 50%, expand brand business, increase contract manufacturing through strategic alliances and introduce new products coming off patent. In fy09, this division came out of the red and registered a PBT of Rs.40 cr.

**Pharmaceuticals and Intermediates Division:**
The pharmaceuticals and intermediates division operates in three business areas – Sulfones, APIs and Phosgene based intermediates and chemicals. Sulfones are used in Aerospace and Paper Industries and powder coatings. It is used as curing agents in carbon fiber-based composites that are used in new generation aircrafts. In Phosgene based pharma intermediates, some of the products are used in new generation cephalosporins, anti HIV drugs and patented APIs. With the closure of a few Phosgene based intermediates manufacturers in Europe, US and China, Indian companies have started buying some of these intermediates from the division. The division has finalized a long-term contract with a European MNC for a specialty / performance chemical with application in the Polymer Industry. It has 25 products and 75 customers under this division.

| Product Group | User Industries |
|---|---|
| Pharma Intermediate & APIs | Pharma |
| Phosgenated Chemicals | Pharma, Polymers, Crop Protection |
| Sulfones | Pharma, Aerospace, Electronics, Polymers, Paper |

| Product | Market Share (FY09) | Competition |
|---|---|---|
| Pharma Intermediates & APIs | <1% | USA, Japan, Europe, India, China |
| Phogenated Intermediates | <1% | China (5), Europe (4), Japan (3), USA (2), India (1) |
| Sulfones | 45% | China (5), India (3), Europe (1), Japan (1) |

Thrust going forward – Grow business through custom synthesis and improve productivity through novel technologies.

**Polymers:**
Lapox Epoxy Resins and Hardener systems are manufactured and marketed by Polymers division of Atul. The manufacture of Epoxy systems began in 1968 in a company established as a joint venture between Atul and Ciba, Switzerland. In 1999, on the merger of the JV with the parent company, the Epoxy operations became a part of Atul. Polymers business caters to basic building blocks of infrastructure. This division expanded its capacity 3-fold to 23,000 tpa in FY08 and introduced new products for paints, coatings, composites and marine-coating applications which widened its customer base. Atul has commenced branded sales in this business.

User Industries
Handicrafts
Civil
Jewellery
Furniture
Engineering
Art and Craft

| Product | Market Share (FY09) | Competition |
|---|---|---|
| Epoxy | 21% | USA (1), China (2), Fareast (3), India (1) |
| Brands | 12% | India (3) |

**Floras:**
Floras was started with a view of productive utilizing of large land holdings of Atul Ltd. Its objective is to give genuine herbal extracts, which are obtained from scientifically grown crops. Floras has ensured that its products meet the perfumery and cosmetic industry's needs for genuine natural essential oils.

Products
Geraniol ex-palmarosa with 95% - 99% purity
Patchouli Oil
Safed Musli (Chlorophytum borivilianum)
Henna (Law sonia inermis)
Basil (Ocimum spp.)

* Tables – Source: Company Presentation

## Investment Rationale

Diversified user industries → largely insulated against slowdown:
Atul is a diversified chemical company engaged in the businesses of agrochemicals, bulk chemicals, intermediates, colors, pharmaceutical intermediates and polymers. It possesses the ability to manage complex processes in line with global standards of safety, quality and efficiency. It manufactures a wide variety of complex chemicals used in diverse sectors.

Atul has recently begun introducing value added down-stream products used by companies engaged mainly in the business of Flavours and Fragrances, FMCG and Pharmaceutical Industries. It caters to variety of industries right from pharma to paper to textile to agriculture to aerospace, electronics, polymers, etc.

This indicates non-dependence on any single customer segment, which insulates the company from the cyclicality of the businesses. This diversified customer base gives it the freedom to make changes to its product mix in order to improve volumes. It is not affected by slowdown in any one industry as it caters to nearly 10-12 industries. The introduction of new products in its various divisions has further widened its customer spread. Going forward too, the company is confident of increasing its customer base across the globe by securing long-term supply contracts.

Strong customer relations across the globe:

Atul has become the world's

- Fourth largest manufacturer of 2,4-D – Crop Protection
- Third largest manufacturer of Indoxacarb insecticide – Crop protection
- Largest manufacturer of *para* Cresol - Aromatics
- Largest manufacturer of *para* Anisic aldehyde within six years of its launch
- Largest manufacturer of *para* Anisyl alcohol
- Second largest manufacturer of a high-performance colorant
- Second largest manufacturer of Vat dyes - Colors
- Largest manufacturer of a curing agent

These various credits to Atul prove the strong customer base and good relationship it shares with them. Atul has a strong brand presence across the globe, which has made it a market leader in many of its products. It plans to increase its brand building programmes, which could further lead to an extensive growth in volume footprint and customers.

Further to strengthen its market presence, Atul plans to establish 3 more 100% overseas subsidiary companies apart from the existing 5 subsidiary companies it has in Europe, US, China and India.

Through its new initiatives like consumer packs in the Polymers division, it has reinforced its presence in the domestic market and has become one of the major players in this segment in India. Going forward, through various brand building and marketing exercises, it plans to expand its customer base and increase repeat orders from its existing customers.

Expansion plans and new launches and technologies to stimulate growth:

Atul has planned a capex of Rs.72 cr in FY10. It plans to increase in Resorcinal capacity from 2,500 tonnes p.a. to 5,000 tons p.a. over the next 2 years and also plans to introduce new value added downstream products through this expanded capacity. It plans to expand the herbicide capacity by 50% and introduce new products going off patent through this expansion. The company indicated that all its pharmaceutical plants have saturated and hence they plan to go for expansion of capacity for the pharmaceutical and phosgenated intermediates and APIs. Atul plans to launch 5-10 intermediates and APIs every year. They are ready for the launch of 2 APIs in FY10, which have recently gone off patent. Atul is improving its productivity through new technologies like ultrasonic crystallization and milling and has filed the patent for the technology recently. It also plans to introduce more value added products, which comprise brands and non-brand products by leveraging its current product portfolio and strengths. Its brand sales increased from Rs.47 cr in FY08 to Rs.82 cr in FY09. All these initiatives could help Atul improve its productivity and profitability.

Debt equity under control ensures smooth future expansion:

Atul has its debt equity ratio under control. In FY09, its debt equity fell to 0.77:1 from 0.95:1 in FY08. Atul could try to unlock value of one or two of its businesses by demerger or outright sale and deploy the excess cash. Atul could fulfill any new tie-ups, expansions or acquisitions without too many problems through its internal accruals.

Decent Book value shows hidden assets:

Atul has a book value of Rs.153.9 as of FY09, which can provide a buffer in case of market downturns. Atul is a market leader in many of its products, which indicates a strong brand position across the globe. High brand value could payoff in terms of higher repeat sales and more loyal customers.

Shift from commodity player to value added player:

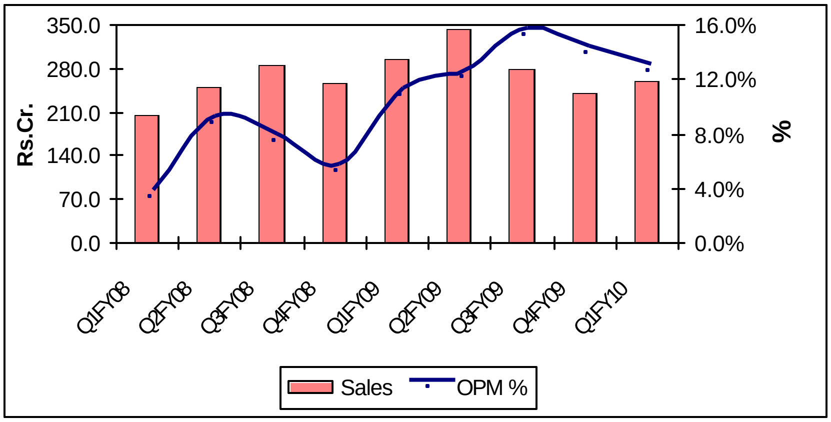
Atul is consciously skewing its business model away from industrial consumers and has drawn ambitious plans to participate in the stable and more profitable consumer pack business. Products like herbicides and epoxy resins, which were earlier sold to Industrial customers are now being sold directly to the consumers. It has introduced epoxy in packs from 6gms to 9kgs so as to cater to all sizes of customers. it plans to introduce downstream value added products across all its segments. It plans to introduce new products based on hydrogen in the bulk chemicals segments and new HP Pigments, which could be used in producing new vat dyes products. Atul is shifting its focus to branded products so as to earn high margins. For this, it is carrying out a lot of expansion activities and is coming out with new drugs and crop protection products that are going off patent. Branded products constituted 24% of crop protection sales in FY08.

Contract manufacturing – tie-up with MNCs to give an edge:

Atul has signed a long-term contract with Stamicarbon B.V, of the Netherlands for exclusive manufacture and supply of a polymer performance additive based on Phosgene Chemistry. Stamicarbon has patented the application of this specialty/performance chemical for use in polyamides. Atul has established the manufacturing process based on initial guidelines given by Stamicarbon. Phosgene chemistry being a core competency of Atul's Pharmaceuticals & Intermediates division could enable it to manufacture this specialty chemical with high quality standards. DSM will market this product worldwide under their brand. The sale of these phosgene-based derivatives is expected to grow steadily over next few years. Atul has also forged multiple alliances with MNCs in the area of contract manufacture and custom synthesis of Phosgene based products. It would also be manufacturing Phosgene based non-pharma intermediates and specialty chemicals for use in Agrochemical and Polymer Industries and is currently developing the business for these two products. In order to achieve the expanded volumes, Atul is debottlenecking its capacity for phosgene-based products.

Improving product mix and margins:

Over the last few quarters, through its constant changing product mix, Atul has been able to improve its sales and margins. However, after the sales peaked in Q2FY09, due to slowdown in demand in some of its segments, Atul witnessed fall in its sales in Q3FY09 and Q4FY09. However, with the demand situation improving across the globe, the company is hopeful of improving sales and margins further. Atul is coming out with new brands, products based on new technologies so as to improve its profitability and presence in the domestic and international market.




(Source: Company)

Fixed Cost/Repair and maintenance cost write offs not a recurring expense:

Atul saw fixed cost write offs in Q4FY09, which resulted in a decline in profits. Also the repair and maintenance cost during the quarter increased due to overhauling at 2 plants. These two additional costs impacted the profitability of Atul in Q4FY09. However, these two items are non-recurring in nature and may not impact the company's profitability in future.

## Industry Outlook

**Indian Chemical Industry**

- 13% of the total exports of the country is from chemicals
- Chemicals account of 13% of the total industrial output and 7% of the GDP
- Has observed 10% - 12% growth p.a. over the last few years
- Indian chemical industry accounts for 2% of global chemical industry

Indian chemical industry has a strong and diversified base consisting of many areas such as organic and inorganic chemicals, plastics, fibres, dyestuffs, paints, pesticides, insecticides, specialty chemicals, drugs and pharmaceuticals. Chemical sector has been consistently outperforming the average Industrial growth in India, due to increased domestic consumption, improving global competitiveness, etc.

This industry is moving up the value chain on the back of demand for newer applications in the domestic market as well as increased outsourcing by the western countries. Due to increasing environment concerns in China, many small and medium players have closed / trimmed their unviable operations. As a result, the dumping of chemicals at very low prices has partly come down, which has helped domestic players in domestic markets too. In the next few years, India's gas production is set to surge, which can also facilitate improved global competitiveness of select chemicals like Methanol, acetic acid, etc.

The sector is of late getting the benefit of increasing compliance costs in China, which is improving the level playing field for domestic players, both in the domestic and global markets, on a fair play note. Further, the appreciation of Chinese Yuan and deprecation of Indian Rupee against US dollar only adds further cream to India's improving global competitiveness.

**Indian Agrochemicals Industry:**

- Domestic market size – US$88 million
- Domestic market growth rate – 10% annually
- 2.5% of the global market.
- In India, insecticide commands major share 76%.
- Globally, herbicides commands major share 48% & insecticide only 29%.
- India is largest manufacture of basic pesticide chemicals among South Asia & Africa, next only to Japan.

**Indian Dyestuff & Pigments Industry:**

- Market size – US$110 million.
- Growth rate – 12%
- Indian market is 6% of the global market
- Major used in Paints, inks, textiles, polymers.
- Highly fragmented market
- 25 large & medium players holding 50% of the market.
- Remaining 50% is with another small 2000 un-organized players

The Indian dyestuff industry is an old industry, which grew rapidly through the 1970s and 1980s. In last 52 years, the dyestuff industry has grown many folds. From an industry that was considered mainly of importers and distributors in the 1950's, it has emerged as an important foreign exchange earner in the 1990's. Presently, the domestic demand for colorants is estimated at 50000 tons p.a., which is easily met by the domestic industry due to existing huge over-capacity. The dyestuff industry is estimated at Rs.100 bn accounting for less than 10% of the global market at Rs.1012 bn.

However, in the past few years, the performance of dyestuff industry has been dull. The increasing awareness about the environmental effects of chemical dyes has led to increased constraints on the dyestuff industry. Besides, the industry is continuously under stress due to the competition with China in the international market. Cheap imports and recession in textile sector further compounded the problems of the industry. Due to rising raw material and energy costs and inability to pass it on to the customers, margins of the industry have eroded. Lastly, the industry has not been able to keep pace with the developments in the West.

Currently, the Indian dyestuff industry is in the midst of a major restructuring and consolidation phase. With the shift in its emphasis on product innovation, brand building and environmental friendliness, the industry is increasingly moving towards greater customer orientation. Even though India enjoys an abundant supply of the basic raw materials, it will have to build up on technical services and marketing capabilities to face global competition and to increase its share of exports.

**Pharmaceuticals Industry:**

- India ranks 4 th in terms of volume & 13th in terms of value.
- Domestic market size – US$450 million
- Indian market is 1.6% of the global market
- Domestic market growth rate – 8 to 9%
- Strong player in generic market--several of the world’s leading drug companies are based in India
- Significant export led growth

## Financial Performance

Rs.Cr

| Particulars | Q1FY10 | Q1FY09 | % Chg | Q4FY09 | % Chg | Q3FY09 | % Chg |
|---|---|---|---|---|---|---|---|
| Net Sales | 261.0 | 294.7 | -11.4% | 240.3 | 8.6% | 279.73 | -14.1% |
| Other operating income | 3.0 | 4.0 | -24.1% | 7.1 | -57.9% | 3.62 | 96.7% |
| Total Operating Income | 264.0 | 298.7 | -11.6% | 247.5 | 6.7% | 283.4 | -12.7% |
| **Expenditure** | | | | | | | |
| Raw Materials | 146.0 | 174.2 | -16.2% | 104.2 | 40.1% | 150.17 | -30.6% |
| Employees Cost | 22.0 | 19.8 | 11.3% | 22.8 | -3.6% | 23.69 | -3.6% |
| Power & Fuel | 26.0 | 29.9 | -13.2% | 24.5 | 6.0% | 23.93 | 2.5% |
| Mfg Expenses | 16.0 | 20.0 | -20.1% | 25.5 | -37.3% | 20.93 | 21.9% |
| Other Expenditure | 21.0 | 23.2 | -9.4% | 36.8 | -43.0% | 21.85 | 68.5% |
| Total Operating Expenditure | 231.0 | 267.1 | -13.5% | 213.9 | 8.0% | 240.6 | -11.1% |
| **Operating Profit** | **33.0** | **31.6** | 4.6% | **33.5** | -1.6% | **42.8** | -21.6% |
| *OPM %* | *12.6%* | *10.7%* | | *14.0%* | | *15.3%* | |
| Other Income | 0.0 | 0.6 | -100.0% | 1.6 | -100.0% | 3.5 | -54.4% |
| Interest Expenses | 8.0 | 9.3 | -13.9% | 9.1 | -12.2% | 11.9 | -23.4% |
| Depreciation | 10.0 | 8.0 | 25.0% | 9.2 | 8.7% | 7.9 | 17.0% |
| Profit before tax & exceptional items | 15.0 | 14.8 | 1.2% | 16.8 | -10.9% | 26.6 | -36.6% |
| Exchange rate difference - Expenses (income) | 0.0 | -15.6 | -100.0% | -10.4 | -100.0% | -8.8 | 18.5% |
| Exceptional Items | 0.0 | 0.0 | - | 0.0 | - | 0.0 | - |
| PBT | 15.0 | -0.7 | -2127.0% | 6.4 | 134.4% | 17.8 | -63.9% |
| *PBTM %* | *5.7%* | *-0.3%* | | *2.7%* | | *6.3%* | |
| Tax | 3.0 | 0.0 | - | 2.3 | 29.9% | 2.0 | 13.8% |
| *Effective Tax Rate %* | *20.0%* | *0.0%* | | *13.7%* | | *7.6%* | |
| PAT | 12.0 | -0.7 | -1721.6% | 4.1 | 193.4% | 15.7 | -74.0% |
| *NPM %* | *4.6%* | *-0.3%* | | *1.7%* | | *5.6%* | |
| Equity Capital | 29.7 | 29.7 | 0.0% | 29.7 | 0.0% | 29.7 | 0.0% |
| **EPS** | **4.0** | **-0.2** | -1721.6% | **1.4** | 193.4% | **5.3** | -74.0% |

(Source: Company)

## Segmental

Rs.Cr

| Particulars | Q1FY10 | Q1FY09 | % Chg | Q4FY09 | % Chg | Q3FY09 | % Chg |
|---|---|---|---|---|---|---|---|
| **Segment Revenue** | | | | | | | |
| Colors | 80.0 | 120.0 | -33.3% | 68.6 | 16.7% | 60.3 | 13.7% |
| Specialty & Other Chemicals | 195.0 | 200.0 | -2.5% | 185.1 | 5.4% | 248.4 | -25.5% |
| Total | 275.0 | 320.0 | -14.1% | 253.6 | 8.4% | 308.8 | -17.9% |
| Less: Inter Segment Revenue | 2.0 | 5.0 | -60.0% | 2.2 | -8.7% | 12.6 | -82.6% |
| **Net Revenue** | **273.0** | **315.0** | -13.3% | **251.4** | 8.6% | **296.2** | -15.1% |
| | | | | | | | |
| **Segment Results** | | | | | | | |
| Colors | -1.0 | 5.0 | -120.0% | 0.4 | -363.2% | 1.2 | -68.1% |
| Specialty & Other Chemicals | 28.0 | 30.0 | -6.7% | 28.0 | 0.0% | 40.9 | -31.5% |
| Total | 27.0 | 35.0 | -22.9% | 28.4 | -4.8% | 42.1 | -32.5% |
| Less: Interest | 8.0 | 9.0 | -11.1% | 9.1 | -12.2% | 11.9 | -23.4% |
| Other unallocable exp | 5.0 | 11.0 | -54.5% | 6.6 | -24.0% | 6.9 | -5.1% |
| Add: Exchange rate gain/loss | 0.0 | -16.0 | -100.0% | -10.4 | -100.0% | -8.8 | 18.5% |
| Unallocable income | 1.0 | 1.0 | 0.0% | 4.2 | -76.0% | 3.3 | 24.9% |
| **PBT** | **15.0** | **0.0** | - | **6.4** | 134.4% | **17.8** | -63.9% |
| | | | | | | | |
| **Capital Employed** | | | | | | | |
| Colors | 145.0 | 177.0 | -18.1% | 158.9 | -8.7% | 187.2 | -15.1% |
| Specialty & Other Chemicals | 488.0 | 450.0 | 8.4% | 485.6 | 0.5% | 533.6 | -9.0% |
| Unallocable | 139.0 | 242.0 | -42.6% | 137.8 | 0.9% | 203.2 | -32.2% |
| **Total** | **772.0** | **869.0** | -11.2% | **782.2** | -1.3% | **924.0** | -15.3% |

(Source: Company)

### Q1FY10 Performance:

Atul's net sales dipped by 11.4% to Rs.261 cr in Q1FY10. This was led by the continuing degrowth in Bulk Chemicals & Intermediates and Colors. Colors division saw degrowth of 33.3% to Rs.80 cr in Q1FY10. Sales were also lower on account of lower exports particularly to the countries affected by recession and because of lower price realizations. The sales dropped also on account of general slackness in demand and lower realisations.

The operating expenses fell by 13.5% Y-o-Y from Rs.267.1 cr to Rs.231 cr in Q1FY10. All operating costs except employee cost as a percentage of sales dipped in Q1FY10. Employee costs increased by 80 bps Y-o-Y to 8.4%. Control in operating expenditure resulted in OPMs expanding by 190 bps from 10.7% in Q1FY09 to 12.6% in Q1FY10. This was despite Bulk Chemicals and Intermediates and Colours division continuing to report losses.

Interest costs fell by 13.9% to Rs.8 cr in Q1FY10. On the other hand, depreciation cost rose by 25% to Rs.10 cr. Tax outflow was Rs.3 cr in Q1FY10. Lower interest costs, better operating efficiencies and absence of negative impact of forex fluctuations led to PAT margins turning to positive in Q1FY10 to 4.6% vis-à-vis loss suffered in Q1FY09.

Atul earned an EPS of Rs.4 in Q1FY10 vis-à-vis loss in Q1FY09.

## Risks and concerns

- More than 50% of the Atul's revenues are derived from exports and therefore its profitability is impacted by rupee-dollar fluctuations. However it also imports some its key raw material and has a limited natural hedge against dollar. It has about Rs.150 cr worth of foreign currency loans (out of total loans of Rs.369 cr) on its books as on FY09.

- Atul did not have a prudent hedging practice in the past. In FY08, it took forward cover expecting rupee dollar rate to rise to 35, which resulted in a loss of Rs.44 cr for the company in FY09 results. In order to protect itself from such adverse losses, Atul's management has decided to take cover only for a period of 3-6 months in future. As of Mar 2009, it had outstanding currency option contracts worth $51.5 mn. Atul has unrealized MTM loss of Rs.54.8 cr as of March 31, 2009 which has not been accounted in the books.

- Atul has nearly 7 divisions, which makes it difficult for the company to focus its attention on any one core business. This could lead to the stock getting lower valuations in the eyes of the investor. While the downcycle in one business could be offset by an upcycle in another, investors looking to participate in any one segment may not find it Atul attractive to invest.

- While Atul has a lot of hidden reserves in terms of real estate, investments, etc., there has been no serious effort so far from the management to unlock these (except getting out of non core investments a couple of years back).

- Raw material price fluctuation could affect Atul's profitability. However, value addition and fixed rate supply contracts help it to mitigate this risk to some extent.

- Inability to utilise the existing and new capacities coming on stream could impact profitability.

- Atul has given Rs.21.3 cr as a loan to a sick associate company, Amal Ltd and is hopeful of recovery of the same.

- Of the total debtors of Rs.211.2 cr in FY09, debtors more than 6 months stood at Rs.32.7 cr (15.5%). This compares with Rs.15.8 cr worth debtors – more than 6 months – in FY08 out of total debtors of Rs.257.3 cr (6.1%).

## Financial Projections
### Profit & Loss A/c

Rs.Cr.

| Particulars | FY07 | FY08 | FY09 | FY10E |
|---|---|---|---|---|
| Net Sales | 936.0 | 1044.2 | 1223.9 | 1316.1 |
| Raw materials consumed | 523.5 | 602.4 | 659.1 | 718.4 |
| Mfg Expenses | 173.8 | 190.1 | 203.7 | 211.8 |
| Employee Cost | 70.8 | 79.3 | 94.7 | 100.8 |
| Others | 86.6 | 100.8 | 112.8 | 119.6 |
| Total Operating Expenses | 854.6 | 972.5 | 1070.2 | 1150.6 |
| EBITDA | 81.3 | 71.7 | 153.7 | 165.5 |
| Other Income | 15.5 | 28.7 | 14.8 | 24.0 |
| Forex expense/(income) | 12.4 | 6.8 | 44.0 | 16.5 |
| Interest | 28.3 | 30.9 | 41.4 | 45.0 |
| Depreciation | 30.7 | 29.7 | 31.9 | 43.0 |
| Profit Before Tax | 20.3 | 31.5 | 51.2 | 75.0 |
| Tax (including FBT & DT) | 0.8 | 2.8 | 10.2 | 17.0 |
| **Profit After Tax** | **19.5** | **28.7** | **41.0** | **58.0** |
| Equity Capital | 29.7 | 29.7 | 29.7 | 29.7 |

(Source: Company, HDFC Sec Estimates)

### Key Ratios

| Particulars | FY07 | FY08 | FY09 | FY10E |
|---|---|---|---|---|
| EPS (Rs.) | 6.6 | 9.7 | 13.8 | 19.5 |
| PE (x) | 12.4 | 8.4 | 5.9 | 4.2 |
| FD Book Value (Rs.) * | 100.8 | 143.8 | 153.9 | 173.0 |
| P/BV (x) * | 0.80 | 0.56 | 0.53 | 0.47 |
| EBIDTA (%) | 8.7% | 6.9% | 12.6% | 12.6% |
| PBT (%) | 2.7% | 3.2% | 4.2% | 6.5% |
| NPM (%) | 2.1% | 2.7% | 3.3% | 4.4% |
| ROCE (%) | 7.4 | 4.8 | 14.7 | 14.6 |
| RONW (%) | 6.7 | 7.9 | 9.3 | 12.0 |
| Debt-Equity | 1.2 | 1.0 | 0.8 | 0.6 |
| Current Ratio | 2.5 | 2.5 | 2.4 | 2.3 |
| Mcap/Sales (x) | 0.26 | 0.23 | 0.20 | 0.18 |
| EV/EBITDA | 2.4 | 3.0 | 1.3 | 1.5 |

(Source: Company, HDFC Sec Estimates)

* = Book value excluding revaluation reserve will fall by Rs.38.65 for FY08, Rs.37.98 for FY09 and Rs.37.29 for FY10(E). This will have an impact on P/BV.

## Conclusion

Atul operates through seven businesses and has diversified customer base that insulates it from non-performance of any one user industry. Atul over the years has moved from being a dyestuff company to a company, which manufactures agrochemicals, aromatics, pharmaceuticals and bulk chemicals. The company is undertaking expansion plans so as to improve its productivity and introduce new products based on new technologies.

Despite the continuing slowdown in the major economies, Atul expects to record similar or slightly higher sales in FY10 and a higher PAT. Lower volatility in forex could result in a much better bottomline performance on a reported basis.

Atul normally performs well during the second and third quarter and hence we expect it to perform well over the next 2 quarters. We believe, that the series of expansions, new launches and the seasonality factor could help garner more revenues over the next 2 quarters and could help in maintaining its OPM at 12.6% in FY10. Its PAT could grow at a CAGR of 26.4% over FY08-10 to Rs.58 cr. At the CMP of Rs.81.1, the stock is trading at 4.2x FY10(E) EPS.

We feel that Atul could be bought at the current price and added on dips to the price band of Rs.65 to 70 for sequential targets of Rs.98 (5 x FY10E EPS) and Rs.117 (6 x FY10E EPS) in 2-3 quarters.

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