

# Alchemy of fast growth

The sector has attracted attention from chemical manufacturers due to impressive margins and profitability. Changes and improved consumption standards in client industries have also quickened growth



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**T**HE specialty chemicals sector is among the most isolated counters where analyst coverage is least. But those who cover the sector, believe that there are huge investment opportunities.

Analysts say more and more chemical companies are now focusing on the specialty segment these days due to low volumes and high price realisations. They believe that demand may continue to surge for the sector despite a slowdown in the economy.

"There are some concerns related to high raw material costs due to poor quality of feed stock, rising interest rates, inadequate infrastructure, labour and environmental issues. However, despite these issues, companies are not just expanding but the promising growth outlook of the sector is alluring other businesses to diversify into this segment," said Vivek Gupta, head of research at CapitalVia Global Research.

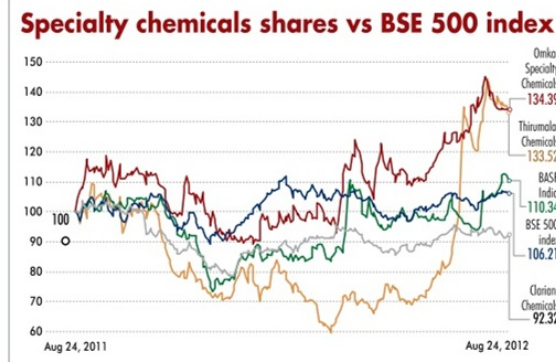
Gupta pointed out that the sector has witnessed attention from other chemical manufacturers, especially from the commodity chemical firms, due to the impressive margins and profitability. In addition to this, the changes and improved consumption standards in client industries have revived growth of the sector.

## Small is big

Most of the sector's entities that are listed on the exchanges are either mid caps or small caps. Parents of many of these firms are large foreign companies. Some of the major companies in the sector include BASF India, Atul, Clariant Chemicals, Thirumalai Chemicals, Akzo Nobel, DIC India and Omkar Specialty Chemicals.

"Unlike commodity chemicals, specialty chemicals are not vulnerable to profit volatility. The complexities of the business with specialised assets and applications make the products niche, and thereby, yield higher and stable margins. Competition in specialty sector is not on price, but on, technology and innovation," Gupta said.

Atul, which is a Gujarat-based colourants and agrochemicals company, has employed world's biggest plant to manufacture a particular chemical used



in fragrance and personal care products. Thirumalai Chemicals, which entered into the segment by producing food acids, is now among the world's top four producers of malic acid.

Camlin Fine, a major player in food antioxidants, is adding new products in its portfolio. Omkar Specialty is investing Rs 100 crore over the next two years. In addition, the sector fetched one of the highest FDI inflows in FY12.

According to a recent report by Ficci and department of chemicals and petrochemicals, while the global chemicals industry is valued at \$3.4 trillion, the specialty chemicals segment is estimated to be worth \$740 billion. Out of this, the domestic specialty chemical industry is believed to account for \$21.5 billion.

The domestic specialty chemicals market is expected to grow at the rate of 15-17 per cent per annum to hit \$80-100 billion mark by 2020.

## Surging topline

The penetration and adoption level of specialty chemicals used as homecare surfactants has been 100 per cent, while it is used to the extent of 75 per cent as rubber chemicals and just 25 per cent each as paints and coatings, dyes and pigments and specialty polymers, to name a few.

"End-use industries like automotive, electronics, packaged food and textiles are all driving the Indian specialty chemicals industry. Strong domestic demand, cou-

pled with huge investments, from domestic and foreign players, is making the industry scale new heights. Many international companies have pledged substantial investments in potential Indian markets because of availability of vast pool of skilled and cheap labour and resources," said Brokerage First Call in a recent note available on Bloomberg.

Top line of industrial chemical companies remained firm in the June quarter, but some companies saw pressure on bottom lines. BASF India, which is a subsidiary of a German company BASF, has reported a healthy 36.11 per cent year-on-year (YoY) rise in its profit after tax (PAT) to Rs 71.68 crore for the June quarter on 71.68 per cent rise in net sales to Rs 1,288.84 crore. The company is merging its unlisted entities with the listed company since 2010. Experts believe that upside in the stock will depend on how quick company commences mass local production, which is otherwise, caters to clients by importing from the parent company.

Top line of Thirumalai Chemicals jumped 111.23 per cent YoY to Rs 297.51 crore. Bottom line of the company surged 983.22 per cent to Rs 16.79 crore in the June quarter, compared with Rs 1.55 crore in the year-ago quarter.

For Atul, net sales were up 22.75 per cent YoY, while PAT climbed 102 per cent. Clariant Chemicals reported 8.45 per cent YoY rise in sales. However, its PAT growth YoY was muted at 1.08 per cent.

Chembond, Fineotex Chemicals, DIC

India and Akzo Nobel India remained the exceptions, with net profit declining 44.96 per cent, 28.08 per cent, 19.33 per cent and 10.42 per cent, respectively, on YoY basis. Akzo Nobel meanwhile posted a strong 62.38 per cent growth YoY sales growth.

The comparison though cannot be made between the companies as each caters to different end-user industries.

On Akzo Nobel, Anand Shah of Elara Securities in a recent note expressed several concerns over its businesses acquired and said the difficulty in projecting future performance will keep the stock range bound in the medium term. The brokerage maintained a 'reduce' on the stock, "Given high dilution, significant deterioration in margins and rising contribution of industrial business (nearly 40 per cent of revenues)."

However, it believes there is an upside chances if there is a possibility of delisting by the parent company. Also higher-than-expected growth and margin improvements in amalgamated entities and clarity over the growth of the amalgamated entities may also bring about an upside to the stock.

Meanwhile, Omkar Specialty Chemicals has been waiting for approval from the Maharashtra Pollution Control Board (MPCB) to begin production, which is expected to begin production by the end of September.

"We believe that commencement of the Urdhwa plant will give a boost for overall growth and profitability in the second half because it will enable the company to ramp up its production of high value-added products. For capacity expansion at Lasa Labs, the company has applied for approvals to MIDC and the USFDA," said Crisil Ratings in a note.

## Stock performance

Shares of Omkar Specialty Chemicals, DIC India, Indo Amines and Foscoso India have gained 41.79 per cent, 21.90 per cent, 21.08 per cent and 12.09 per cent, respectively. Akzo Nobel, Clariant Chemicals, NOCIL and Chembond gained 10.42 per cent, 9.01 per cent, 6.31 per cent and 5.35 per cent, respectively. BASF India and Thirumalai Chemicals are down 1.84 per cent and 1.40 per cent, respectively. ■

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