PhillipCapital

Specialty Chemical Investors' Day

Key takeaways: Entering enhanced value-growth phase

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We organised a **'Specialty Chemical Investors' Day'** on 3rd December 2015 in Mumbai. In a day-long event, we hosted the following eminent dignitaries from the Indian specialty chemicals' sector in a panel discussion followed by board-room meetings with participating companies.

Panel participants

- **Samir Biswas,** *Joint Secretary, Ministry of C&PC*
- **Manish Panchal,** *Head of Chemicals, Tata Strategic Management*
- **Rajendra Gogri, MD,** *Aarti Industries ltd*
- **Belur Krishnamurthy Sethuram,** *MD, Celanese Chemicals India*
- **Dr. Dileep M. Wakankar,** *Head Product Stewardship, Archroma India*

Board-room meeting participants

- *Joint Secretary, Ministry of C&PC*
- *Aarti Industries*
- *Camlin Fine Sciences*
- *Meghmani Organics*
- *Fineotex Chemicals*
- *Shree Pushkar Chemicals*
- *Omkar Specialty Chemicals*

Takeaways from the panel discussion

Indian specialty chemicals – Well-set for accelerated value growth

- As per Tata Strategic Management (TSMG), the Indian specialty chemicals sector was valued at about US$ 25bn in 2014 and delivered 13% CAGR over the last decade. It expects continued growth in the sector; sees it crossing US$ 100bn by 2024, driven by improvement in domestic consumption.
- TSMG expects rapid progress (~20%) in the Indian packaging industry (currently valued at € 13.6bn), which will drive growth for specialised polymers. Additionally, it expects healthy growth in domestic construction chemicals (current market size of US$ 0.7bn), water-treatment chemicals (US$ 0.7bn), and surfactant segment (US$ 1.7bn) over the next five years.
- The Make-in-India initiative has already resulted in a 52% yoy jump in capex in Indian chemicals – touched US$ 2.5bn in 2014 – and a 49% yoy rise in FDI flow into the sector at US$ 4bn in FY15. Government sees enhanced investment interest by domestic and MNC players, which would strengthen the domestic specialty chemicals industry.
- Softening of Chinese exports (due to stricter environmental laws) should boost Indian exports of specialty chemicals – a scenario that is sustainable.
- With operational costs rising in China due to stricter environmental laws and with China losing its labour cost advantage over India, global peers are looking at India as an alternate source for specialty chemicals. This enhances growth visibility of the domestic industry (largely been dependent on domestic consumption).
- The panel discussion painted a picture of accelerated value-growth phase for the Indian specialty-chemicals industry over the next few years; this will be led by faster growth in the domestic consumption, multiplying exports (with China softening), and likely consolidation led by the increased interest of MNCs (leading to improvement in efficiency).

Shri Samir Biswas, Joint Secretary, Ministry of C&PC

Private sector needs to step up reforms

Key takeaways from the conference:

- To promote investment in this sector and make India an important international hub, the government has decided to attract major investment (domestic and foreign) by providing a transparent and investment-friendly policy and by setting up common infrastructure such as integrated Petroleum, Chemicals & Petrochemical Investment Regions (PCPIRs).

- Approved PCPIRs include — Dahej in Gujarat, Vishakhapatnam-Kakinada in Andhra Pradesh, Paradip in Odisha, and Cuddalore-Nagapattinam Tamil Nadu. The PCPIR at Dahej has already helped specialty chemicals companies to network and improved their efficiency through the use of common infrastructure and support services. The ministry expects three other PCPIRs to become operational in near future.

- The government is working on the development of clusters in different regions of India and focusing on the concept of cluster within cluster (such as having common effluent treatment plants).

- There are more than 40,000 unorganised chemicals players in India; consolidation of small players will help growth.

- National Chemical Inventory policy is expected to be finalised – this will bring proper registration number, provide unique code to each chemical, and production/ export/import data will be captured.

- New government is focused on the chemicals industry. The government has started chemicals policies under which different initiatives have begun such as education on chemicals-industry related R&D to encourage development of differentiated product/process, industry feedback on regular basis for improvement, and infrastructure development.

- The government is worried about the ignorance of the private sector on developing cracker plants. Currently, only 1-2 cracker plants are available in India, but to match domestic demand and substitute imports, it will need 4-5 more cracker plants. Each cracker costs around Rs 300bn and the government cannot invest directly. Hence, it expects the private sector to step up investments.

- India is currently facing feedstock availability issues – to resolve this, it has started its "reverse SEZ" development in Iran, Mozambique, and Magnolia. The government has also started work on development of a port in Iran to smoothen feedstock supply.

Aarti Industries

Growth will be driven by differentiated products and capex

About the company: Aarti Industries manufactures specialty chemicals and pharmaceuticals. Its units are in Gujarat, Maharashtra, Madhya Pradesh, and Silvassa. Aarti operates under three segments – specialty chemicals (85% of sales), bulk pharmaceuticals (10%), and personal care (5%). Key target industries for its specialty chemicals business are polymers (composite materials), agro chemicals, and pigments/dyes – all have almost equal revenue share. Aarti has a large basket of >155 products under specialty chemicals and about 45 products in the pharmaceuticals space. Agro chemicals are a leading target industry for Aarti's specialty chemicals business with 30% share followed by polymers 27%, pigments 19%, dyes 5%, etc. BASF is the largest customer with 8% of Aarti's sales.

Key takeaways from the conference:

- Aarti believes rising scale, customised product delivery, and balancing of co-products is the key to successful growth in specialty chemicals.
- In order to achieve scale, it has added processes such as hydrogenation and ethylenation. Simultaneously, it has generated demand for customised products in various target industries in order to balance co-products (isomers) which is important for a scale-up.
- Aarti is currently on track with capex worth about Rs 6bn over FY16-17, which can strengthen its operating performance from FY18.
- It generates over 50% of its revenue from exports and expects the ongoing softening of Chinese exports due to environmental issues to supplement its exports.
- Expects relatively stronger 10-12% growth in demand from polymers and agro chemicals. In addition, capacity expansion should boost Aarti's overall growth. Expects 15% annual volume growth, but sees revenue remaining muted (due to lower product prices with lower crude prices). Expects margin expansion of about 200bps over next two years.
- Currency fluctuations in the emerging markets will have no implication on Aarti, as 95% of its exports are dollar denominated.

Camlin Fine Sciences

Growth to sustain on value-added product offerings

About the company: Camlin is a global player in manufacturing preservatives for packaged food and industrial products. It is the world's largest manufacturer of food-grade antioxidants – TBHQ and BHA. It has wholly owned subsidiaries in Brazil, North America, and Spain to facilitate better customised products and services for its American and European clients. It is in the process of setting up distribution hubs across key geographies to attain faster growth and garner larger market share. Presently, around 75% of standalone revenue comes from its food division.

Products

Hydroquinone (HQ): HQ prices depend on demand supply rather than crude oil prices. Camlin, Italy, manufactures HQ and catechol from di-phenol and supplies it to Camlin, India. It uses ~50% of the total production for captive consumption and sells the remaining to a third party in Europe.

Catechol and other industrial products: There are only two manufacturers in the world for catechol – Rhodia (now Slovay) and Camlin, Italy. Catechol and HQ are similar in terms of cost per/kg but realisation for HQ is higher.

TBHQ and BHA: Camlin is the market leader with ~40% market share in TBHQ and ~65% in BHA. It has an in-house manufacturing facility for both, which gives it a cost advantage.

MEHQ: Market size is around 5000 MT (US$ 9-10/kg) and the only other major player is Rhodia.

Vanillin: China is a bigger market for Vanillin with 60% share. Vanillin prices have fallen to US$ 13/kg from US$ 20/kg – oversupply and stringent norms in China, increased costs for Chinese players, resulting in shut downs.

Key takeaways from the conference:

- New facility to be set up at Dahej SEZ for manufacturing 9000 MTPA of hydroquinone and 6000 MTPA of vanillin. Expected commissioning is by September 2017 at a capex of Rs 2.3-2.4bn.
- Camlin started downstream value-added products and reducing loose sale of catechol to improve overall realisation. Contribution from industrial segment in this product has grown to ~35% of the Indian business from negligible around three years back.
- It is increasing TBHQ capacity to 3600 MT from 2400 MT and BHA capacity to 2400 MT from 2000 MT by FY16.
- Camlin recently started selling MEHQ with a capacity of 100MT and the management expects to increase this to 1200 MT.
- In vanillin, Camlin has a better quality product (than Chinese players) at the same price (US$ 13/kg). It has also taken on lease one of the shutdown facilities in China for this product.
- Planning to enter into high-value products like 4-MAP, ODEB, veratrics acid, heliotropin, OTBCHA, PTBCHA.
- Management expects 15-17% revenue CAGR over FY16-18 with a margin improvement of 200bps to 17%.

Meghmani Organics

Focus is on improving utilisation, efficiently managing working capital and paying-down debt

About the company: Meghmani Organics is a Phthalocyanine-based pigment manufacturer. It has three business segments: Pigments, Agrochemicals and Basic Chemicals. Its Pigments segment manufactures and distributes Phthalocynine Green 7, Copper Phthalocynine Blue (CPC), Alpha Blue and Beta Blue. The Company's Agrochemicals segment manufactures and sells technical, intermediates and formulations of insecticides.

The Company's Basic Chemicals segment undergo processing in many stages before being converted into downstream chemicals, which are used by the agriculture sector, industry and also directly by the consumers.

The Company has three manufacturing facilities to manufacture pigment products located at GIDC Vatva, Ahmedabad (2,940 MTPA), GIDC Panoli, near Ankleshwar (17,400 MTPA) and Dahej SEZ Limited (10,800 MTPA).

Key takeaways from the conference:

- Guides at revenues of Rs 20bn over the next three years (Rs 14bn in FY16). Growth to be equally led by basic chemicals, agrochemical, and pigments, which account roughly for a third each currently.

- Invested Rs 6.5bn in capex in the past 3-5 years; focus from here is to improve utilisation, efficiently manage working capital, and pay down debt (debt is Rs 6.5bn, expects to retire Rs 1bn annually for next three years).
- With improved utilisation, expects OPM margins to improve steadily by 100bps each year to 20% by FY18.
- Meghmani has 170 acres of land in Dahej (market value Rs 2bn) – it didn't talk about the possibility of monetising this.
- Basic chemicals: This segment makes essential chemicals such as caustic soda, chlorine, and hydrogen. Its highly capital intensive, but all its products get sold in a 100km radius, resulting in higher EBITDA margin. This business' revenue is Rs 4.5bn and it earns an OPM margin of ~31%. The company expects to sweat its assets further leading to 20% revenue growth over the next three years. It has a negative working-capital cycle.
- Pigments: This business suffers from relatively low utilisation of 60%; but management feels that at the current run-rate, 12.0-12.5% OPM is sustainable. Almost 85% of the business' revenues are earmarked for exports to customers in paint, ink, textile, paper chemicals, and FMCG companies. Expects utilisation to gradually improve and drive 15-20% revenue CAGR.
- Agrochemicals: Impacted in the past led by intervention of Pollution Control Board – had to relocate plant from Chharodi to Dahej (both in Gujarat). Is largely into bulk sale of technicals; formulations accounts for just Rs 800mn of overall Rs 4bn segment revenues. Almost 60% of the revenues are led by exports. The company expects 3x jump in branded formulations sales over the next three years to Rs 2.4bn – to achieve this, it has also inducted a senior industry veteran as an independent director on its board.

Fineotex Chemicals

Focus is on specialisation and Chinese products replacement

About the company: FCL manufactures a range of textile auxiliaries and speciality chemicals for construction, water treatment, leather and paper industries. It has diversified into synthetic adhesives for wood and paper and acquired a 60% stake in Biotex in Malaysia in 2011 producing speciality chemicals for various industries. FCL has a production capacity of 22,000 tonnes per year, out of which its Indian plant located in Navi Mumbai has a production capacity of 15,500tpa (currently operates at 60% utilisation) account of 70% of total capacity.

FCL's range comprises 400+ specialty products and it is present in 33 countries with a reach in Asia, Africa, and South America. It has in-house R&D labs in Andheri and Navi Mumbai.

Customers include Vardhman, Chenab, Reliance Industries, RCF, Indorama, IFFCO, Raymond, Siyaram's, Grasm, Zuari, Pidilite, Archroma, Durian, and Clariant. FCL's products are used in pre-treatment, printing, dyeing, and finishing processes. Fertiliser additives are used in DAP/MOP.

Key takeaways from the conference:

- Main focus is on further specialisation, replacement of Chinese products, and overhead savings.
- Competitors include BASF, Atul Industries, and Archroma. Textile segment has a revenue share of 85-90%.
- The fertiliser segment is contractual in nature.
- Growth of the market has been 10% and FCL expects it to pick up. Its capex in FY16 would be Rs 50mn.
- Working capital includes 90days in debtors and 30-45days in inventory.
- Gross margin is at Rs 39/kg. FCL is a zero-debt company.

Shree Pushkar Chemcials & Fertilisers

Forward integration and alliance with global player to drive value

About the company:
Recently, SPCFL concluded an IPO worth Rs 700mn for setting up of a plant for manufacturing reactive dyes along with plants for manufacturing of h-acid and vinyl sulphone ester on a new plot of land near its existing works at MIDC Lote Parshuram, district Ratnagiri. Its capacity expansion includes – 750tpa of h-acid, 1,000tpa of vinyl sulphone, and 10,000tpa of sulphate of potash (SOP) for fertiliser. Capex on these three projects would be Rs 480mn.

SPCFL manufacturers dye intermediates with a capacity of 7,836TPA. Product line comprises of dye intermediates (gamma-acid, k-acid, vinyl sulphone, h-acid), acids (sulphuric acid, oleums), cattle feed supplement (di calcium phosphate-DCP), and fertilisers (single super phosphate-SSP, soil conditioner). 3,000tpa capacity is for dyes, 750tpa for h-acid, and 1,000tpa for vinyl sulphone.

Domestic clients include Vinati Organics, Atul, DCM Shriram, Megmani Dyes, and Amul; Huntsman among international. It has an exclusive marketing arrangement with Shriram Chemical & Fertilizers for SSP in Maharashtra and Karnataka and has tied up with Shivam Chemicals for marketing of DCP in Karnataka. It has also launched its own soil conditioner brand named Dharti Ratna. It has 125 dealers.

Key takeaways from the conference:
- Dye intermediates have a 78% share, fertiliser 15% and DCP/sulphuric acid 7% in terms of both value and volumes.
- The dye business results in acid production along with significant waste but the company created demand for its by-products and converted its wastes into commercially viable products, which made it a zero-waste player thereby improving its operating efficiency.
- Its backward integration started from 2010 at the acid division followed by SSP (sulphuric acid with rock phosphate), soil conditioner, and DCP (acid waste with rock phosphate) production.
- Set up a 500kw power plant in 2011 which takes care of 40% of power requirements.
- Gypsum (calcium sulphate), which is a waste product, has a realisation of Rs 300-400/tonne. However, conversion to soil conditioner (in combination with magnesium) as a secondary nutrient gives a realisation of Rs 8,000/tonne.
- By 2013, SPCFL became a zero effluent company.
- The forward integration initiatives of the company to manufacture dye stuffs (black, red, yellow) and colorants from current dye intermediates are complemented by its long-term manufacturing and supplying arrangement to the tune of 1,000TPA with Huntsman (a US-based company and a global player in dyes and petrochemicals with a turnover of approximately US$ 14.5bn).
- After new projects, it expects EBITDA margin to rise to 18-20% from 14.6% in H1FY16. It guides for revenues worth Rs 3-4bn for FY16/17 from Rs 2.69bn in FY15.

Omkar Speciality Chemicals

Change in business mix to lead growth

About the company: OSCL manufactures and sells specialty chemicals and intermediates for chemicals and allied industries. It makes a range of organic, inorganic and organo-inorganic intermediates. Product segments include iodine compounds, selenium compounds, intermediates, resolving agents and others (molybdenum, cobalt, and bismuth) and APIs which comprises of more than 200 products. OSCL exports to about 38 countries, including regulated markets such as Europe, North America, South America, China and other Asian countries. It has nine units in Maharashtra – five units in Badlapur (Thane), three units in Chiplun (Ratnagiri), and one unit in Mahad (Raigad) – with in-house capacity of 5,250 MTPA.

Key takeaways from the conference:

- OSCL has a specialised catalyst-driven process that leads to higher yields and better profitability.
- It is in the process of changing its business mix by reducing its dependency on iodine and focusing more on veterinary APIs, which is the highest contributor to the company's revenue mix with high margins.
- Backward integrated for most of its products to avoid dependency on suppliers and improve profitability for its finished products.
- It has a well-developed DSIR-recognised R&D centre – has 18 process patents and 15 European DMFs.
- Believes expansion of API business and utilisation of additional capacity will aid growth – expects considerable growth in revenues in the next 3-4 years.
- Has a wide and diversified customer base including Cipla, Lupin, Amul, Sun Pharma, Evonik, DSM, Samsung, and BASF. Top-30 customers account for less than 40% of sales with largest customers contributing 10%. More than 40% of customers are repeat ones.
- FY15 sales: Rs 2.65bn – expects FY17/18/20 sales to be Rs 4.1/8.4/12.5bn by 2020. Current blended EBITDA margins are 19.9% and it expects margins to expand by 300-350bps to 23-24% by FY18.
- WIP is Rs 1.10bn – this will get commissioned in coming quarters. Thereafter, it does not need capex until FY18. Future capex will be brownfield only, as the company has 40 acres of land.

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