Sector: Specialty Chemicals **RESULT REVIEW Q3FY22** **Declared On: 21 Jan 2022**

Oriental Aromatics Limited

RECOMMENDATION SNAPSHOT					
*CMP	Initiation Price	Target	Potential Upside	Recommendation	MCap (Rsbn)
Rs702	Rs864	Rs900	28%	Buy	23.6

**as on 25th Jan, 2022*

About the Company:

Oriental Aromatics Ltd (OAL) is one of India's largest manufacturers of a variety of aroma chemicals, camphor products, fragrances and flavors and is one of the ten integrated manufacturers of F&F and aroma chemicals on a global level. The company manufactures a variety of terpene-based chemicals, speciality aroma chemicals with a product range including synthetic camphor, terpineol, pine oil, resins, astromusk, perfumery chemicals etc. The company has three manufacturing plants located at Nandesari (Gujarat), Bareilly (Uttar Pradesh) and Ambernath (Maharashtra). It is currently working towards setting up a new unit at Mahad, (Maharashtra) under its wholly owned subsidiary, Oriental Aromatics and Sons Limited. OAL is powered by its two dedicated R&D centers located in Mumbai and Ambernath. The facility at Mumbai focuses on aroma chemicals while that in Ambernath focuses on F&F. Established in 1955 by Mr. Keshavlal Bodani, the company has been constantly evolving, innovating and nurtured by three generations of the Bodani family.

Results: Quick Glance

- The company has reported net sales of Rs2058mn as compared to Rs1907mn in the same quarter last year, growth of 7.9%
- The Ebitda margins for the quarter under review stood at 7.8% as compared to 28.0% in the corresponding quarter last year
- The net profit came in at Rs80mn as against Rs364mn in the same quarter last year
- EPS for the quarter under review stood at Rs2.37 as compared to Rs10.8 in the corresponding quarter last year

Conference Call Highlights:

- During the quarter under review, the company has seen strong demand across all product categories, resulting in a better top line growth on a y-o-y basis. This is despite slightly lower volumes due to the planned shutdown undertaken at the Bareilly site for 20 days. The production and sales numbers at all plants have crossed the pre-Covid levels (9M period i.e. April-December, 2021). The average kg sold has also increased in this quarter as compared to pre-Covid levels
- The company entered Q3 with higher costs, and is in the process of passing it to the customers in Q4. Price hikes have been taken wherever and whenever possible; pass through has successfully happened across all the divisions. OAL has been able to successfully pass-on these price increases to most of their customers and is anticipating margin recovery in quarters to come
- OAL has seen margin and profitability pressure due to significant increases in all **input costs**. Management has indicated the same showing some signs of stabilization and in some cases downward correction too is seen. The company has inventory at higher cost. While the RM prices have stabilized and the higher prices are re-negotiated with the customers for these higher prices, OAL is micro-managing the RM and is quite vigilant in this regard. The PAT margins for Q3FY22 stood at ~3.89% v/s ~19.09% in Q3FY21 whereas for 9M, PAT margins stood at 6.43% in 9MFY22 v/s 16.30% in 9MFY21
- While at the same time, the realizations of finished products are also seen increasing which clearly indicates the successful transition of OAL from being a bulk commodity aroma ingredients manufacturer to a specialty aroma ingredients manufacturer
- The quarter under review saw the successful commissioning of the dedicated specialty aroma ingredient plant at **Vadodara.** The validation process is continuing as per schedule. The commercial batches from this validation process are successfully sold to the customers and the quality has been accepted by the global players
- The capex processes at **Mahad** are awaiting environmental clearance from the authorities; OAL has already done all the basic planning and is looking at commissioning the first phase in Q3 or Q4 FY23-24E. The Management is not disclosing the product mix not for certain reasons, but in the long run, camphor will be a part of it. The current draw down for Mahad capex includes Rs300mn (term loan); Rs180mn is invested from internal accruals; total is ~Rs480mn or so. The total estimated investment is Rs1500-2000mn in the next 3-4 quarters for this plant

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Conference Call Highlights (contd.):

- OAL has also successfully completed the capex project in **Bareilly** plant for increasing capacity of one of the products by almost 70% through process re-engineering. Validation process for this expansion is in progress and Management is anticipating the top-line contribution in FY23E. The recent strategic shutdown which was to update the boilers systems (producing steam at much more efficiency than before) has had an impact of ~Rs270-300mn to the topline. This plant is primarily driven by terpene-based chemicals and camphor is one of the major blocks. The recent upgrades were basically process re-engineering expansion along with brownfield project insight
- The current capacity of Camphor at Bareilly has been sold out and the additional capacity which will come in Mahad in times to come, the Management is confident of being able to sell it
- The projected capex for the **hydrogenation plant** estimated at ~Rs1400-1500mn which was anticipated to be on stream by June 2022 for commissioning is seeing a delay, where OAL is looking at end of Q2FY23 to Q3FY23 for the commissioning
- The demand for all the product categories served by the company remains strong and the Management is hoping to have better gross margins going forward; however still continue with the long-term guidance of 15-17%
- Camphor in the off-season are slightly lower and on the subdued side. While the Management looks at business margins in totality, all sectors which OAL caters to has similar margins expectation
- Post the capex plans, Management is projecting the aroma chemicals, specialty chemicals and camphor segments to have much larger share than F&F in the next 2 years or so, this will be a wait and watch for the plans to pan-out
- The Management is trying to target to get ~36% gross margins (with some product acquisition cost) and all expansions are anticipated to come in phase wise forms with phase wise inclusion to the products list which will give the opportunity to stabilize one product, contribute to the topline and bottom-line and then move to the next one
- F&F players grow with the FMCG players; in the current scenario, Indian FMCG players are under pressure and the F&F growth is coming from the Middle and far East which are playing a significant role as far as F&F is concerned for OAL

Financials:

Performance (Q3FY22)									
Q3FY22 Result (Rs mn)	**Dec-21**	**Dec-20**	**y-o-y**	**Sept-21**	**q-o-q**	**9MFY22**	**9MFY21**	**y-o-y**	**FY22E**
Total Revenue	2058	1907	7.9%	2305	(10.7%)	6659	4878	36.5%	8290
EBITDA	161	534	(69.8%)	198	(18.6%)	704	1211	(41.9%)	1103
Other Income	0.4	7	(94.8%)	20	(98.2%)	31	12	-	36
Interest	7	2	-	10	(32.4%)	23	13	82.9%	32
Depreciation	43	42	2.1%	41	5.8%	124	135	(8.0%)	190
Exceptional Items	0	0	-	0	-	0	0	-	0
Tax	32	133	(75.7%)	46	(29.8%)	160	281	(43.2%)	232
Net Profit	**80**	**364**	**(78.1%)**	**122**	**(34.5%)**	**428**	**795**	**(46.2%)**	**686**

Outlook and Recommendations:

OAL is one of the few integrated manufacturers of aroma chemicals and F&F on a global level. The company is more or a less a proxy to the FMCG sector, which has its own pros and cons depending on the demand-supply. The company seems to have been hit due to a combination of factors which has impacted the margins for the quarter under review. With a minor delay, the company continues to follow its expansion plan for the next 3 years i.e. the 1000 Day Program to augment the capacities in camphor, terpene chemicals and specialty aroma ingredients.

Please Turn Over

Outlook and Recommendations:

This capex plan is intended to further strengthen the specialty aroma chemicals base, increase supplies to the global giants in the F&F industry, deliver quality products at competitive prices and maximize value (via economies of scale). The single product expansion in Vadodara has been done, the hydrogenation plant is expected to commence operations by Q3 next year, and Mahad phase-1 by Q4 next year. Some of the key factors which will enable OAL grow in times to come include, (a) penetration of the FMCG segment and the requirement for the same across the board being high, (b) China plus one strategy staying in place and (c) relatively less capacity additions in aroma chemical, and OAL is one amongst the few who are working in multiple aroma chemistries and products. Management continues to maintain their conservative guidance of 15-17% margin level and one must look at performance of the company with a longer horizon. Looking at the margins pressure which is basically related to the raw material prices and inventory at higher costs, it appears, it is difficult for the company to pass on the price hikes in the same momentum as the raw material prices are moving. While the company tried to cope up with the price rises in Q2, there were price rises in Q3 which were higher than H1FY22, as a result of this, the exercise of pass-through was hit once again due to increased prices which further extended the lag phase for a pass-through. Despite the price increases which have taken place recently, steady demand, the stage of a stable pricing regime is something that has to be watched carefully in order to fetch stable margins; thus, we are a bit cautious and reduce our target price to Rs900.

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