Dec 21, 2020 | PICK OF THE MONTH | VOL-6, NO-22

Industry: Specialty Chemicals

Ultramarine & Pigments Limited

BUY

CMP: Rs241 | TARGET PRICE: Rs325 | TIME : 12 months

OVERVIEW:

Industry– Chemicals:

The chemical industry, in some or the other way provides input to almost all downstream industries and thus is essential part of any economy. According to PWC, global chemical production is anticipated to grow by 2% in 2020 as compared to 1.2% growth in 2019, however one must also consider the uncertainties due to the pandemic which are difficult to assess. The entire gamut of chemicals (on the basis of value addition) can be broadly classified into 2 segments, i.e. Basic and Specialty chemicals. Basic Chemicals: are low value and high-volume products used as a starting material for production, processing and synthesis which is later formulated by many end user industries. Specialty Chemicals: are high value and low volume products which are sold on the basis of utility and quality; primarily used as additives or catalysts to provide a specific attribute to the end product.

Globally there are multiple changes across the value chain due to the on-going trade conflicts between US/ Europe and China. The idea is not to be dependent on a single country and thus the concept of **China +1 or +2 strategy** has emerged. This shift has presented India and many other Asian countries with opportunities to fill the new gaps. Additionally, the focus on ESG and environmental damage due to prospering chemical industry, stringent environmental laws in China have resulted in shutting down of many plants in China or relocation of the same which bolsters well for the Indian chemical industry. Chemical industry is an important part of India's trade as it ranks 3rd in exports in terms of most exported and 4th in imports. In recent years, India has been on a quest for becoming a manufacturing hub and the Indian chemical industry has outperformed all other industries. However, self-reliance is an important factor as India procures raw material from China and thus the need for backward integration arises while trying to reduce imports and increase exports of certain value-added chemicals. The Indian chemical council has set a target of doubling the current turnover from USD150bn to USD300bn by 2025 which will require the support from GOI, enhanced infrastructure and changes in certain current policies. Amid the challenging outlook surrounding the pandemic, Indian players in the chemical industry have started de-bottlenecking plants to increase capacity and efficiency, leveraging supply chains and improving pricing strategy while having a customer centric approach.

Specialty Chemicals: are used for their function and specific performances and have a number of applications in end user industries such as construction, oil and gas, cosmetics, textile etc. In addition to this, they find extensive applications in agrochemicals, pharmaceutical ingredients, flavour and fragrance ingredients, dyes and pigments, personal care, water treatment chemicals, construction chemicals etc. According to prnewswire, global specialty chemical was valued at USD711bn in 2019 and is expected to growth at 5% CAGR during 2020-2027 to USD953.9bn in 2027. The demand for specialty chemicals has been growing due to rapid industrialization, growth of end user industries and the market is dominated by Asia Pacific region which holds 36% market share. Within Asia, China leads the market share with 38.9% followed by India occupying 23.1% of the overall market. Geo-political change, need for de-risking global supply chains, low cost of labour coupled with higher capacities are some of the reasons why the Indian specialty chemical industry is gaining traction.
According to ICRA a positive demand outlook is seen for the segments involving surfactants and agrochemicals. As per a report by Mckinsey, the exports of specialty chemicals (in terms of value in 2018) stood at 55% of the total exports of the Indian chemicals; however, in terms of total exports they are only at 3% as compared to China's 13%. India's top 3 export sub-segments are agrochemicals (27%), dyes and pigments (19%) and API intermediates (18%). There is a possibility for India to further penetrate these markets as China's total value of exports across these three sub-segments is 2.7x higher than India's. India could penetrate deeper in these segments and further also serve newer or lesser explored segments such as plastic additives, rubber chemicals, flavours and fragrances etc.

SNAPSHOT	
52 week H / L	Mcap (INR mn)
299/103	7,037
Face value: 2	
BSE Code	NSE CODE
506685	NA

Annual Performance

(Rs mn)	FY18	FY19	FY20	FY21E
Total Revenue	2,774	3,069	3,062	2,933
EBITDA	602	702	758	741
EBITDA (%)	21.7	22.9	24.8	25.3
Other Income	87	102	115	115
Interest	6	1	11	15
Depreciation	48	58	86	90
PBT	634	745	776	750
PAT	436	565	620	555
Equity (Rs mn)	58	58	58	58
EPS (INR)	15	19	21	19

Quarterly Performance

Parameters (Rs mn)	Dec-19	Mar-20	Jun-20	Sep-20
Sales (Net)	820	735	607	767
EBITDA	219	174	131	220
EBITDA (%)	26.7	23.6	21.6	28.7
Other Income	17	22	26	34
Interest	2	1	2	2
Depreciation	22	21	21	21
PAT	158	130	100	172
Equity (Rs mn)	58	58	58	58

Ratio Analysis

Parameters (Rs mn)	FY18	FY19	FY20	FY21E
EV/EBITDA (x)	11.5	9.6	9.3	9.6
EV/Net Sales (x)	2.5	2.2	2.3	2.4
M Cap/Sales (x)	2.5	2.3	2.3	2.4
M Cap/EBITDA (x)	11.7	10.0	9.3	9.5
Debt/Equity (x)	0.04	0.05	0.12	0.13
ROCE (%)	15	16	21	21
Price/Book Value (x)	1.4	1.8	2.3	2.1
P/E (x) (TTM)	21.3	19.2	9.2	12.6

Shareholding Pattern as on 30th Sept, 2020

Parameters	No of Shares	%
Promoters	1,51,21,369	51.79
Institutions	3,97,048	1.36
Public	1,36,81,583	46.85
TOTAL	2,92,00,000	100

Source: Annual Report

Note: All the data is calculated as per Market Price on 18 Dec,2020

Please Turn Over

Dec 21, 2020 | PICK OF THE MONTH | VOL-6, NO-22

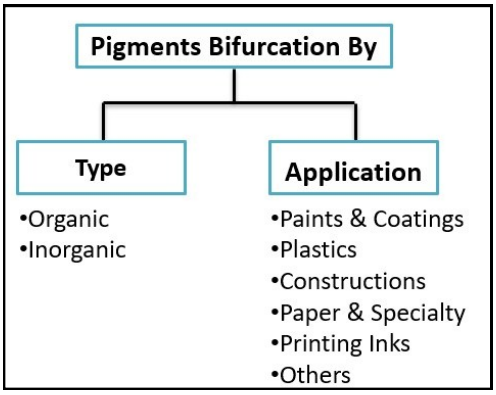
Industry: Specialty Chemicals | **Ultramarine & Pigments Limited** | **BUY**

CMP: Rs241 | **TARGET PRICE: Rs325** | **TIME : 12 months**

OVERVIEW: Industry– Chemicals (contd.)

Pigment and Dyes: Pigment is a colour material that is completely or nearly insoluble in water, imparts a range of colours to paints, coatings, plastics, inks, etc. and also improves their aesthetic properties. The growth in the pigment industry is attributable to growth in end user industries. Indian pigment manufacturers are looking at various opportunities and are expanding capacities, focusing on backward integration, focusing on high performance pigments and specialized pigments. Demand for aluminium based pigments/ metallic shades has also promoted development of superior quality coating solutions. Increasing demand for personal care products aided with high disposable income are also providing fillip to the pigment and dyes industry. The advent of 3D printing has also aided growth of pigments and dyes (at a small scale currently). Technological advancement in nano-particles is also expected to create opportunities for the pigments market. Nano-pigments due to their inherent properties of durability, hardness and toughness, improved transparency etc. have found a number of applications in industries like cosmetics, ceramic etc.

Exhibit 01: Pigments Bifurcation



Source: Progressive Research

Exhibit 02: Organic vs Inorganic Pigments

Organic	Inorganic
• Derived from plants • Smaller particles as compared to Inorganic particles • Brighter • Fewer colour options • Expensive as compared to Inorganic	• Based on chemical formulation • Larger particles • Long lasting colour • Larger variety of colours • Economical and cost effective

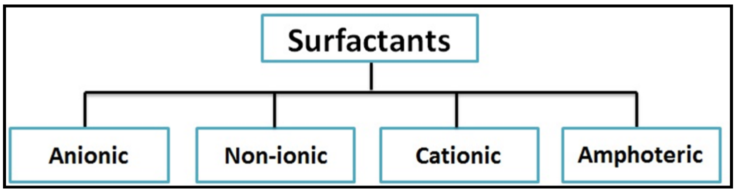
Source: koelcolours.com, Progressive Research

Pigments can be bifurcated as organic and inorganic pigments. **Organic Pigments:** are based on carbon chains and carbon rings while having metallic properties. Organic pigments are expensive when compared to inorganic pigments but organic pigments are brighter. The growth in organic pigment is due to need for aesthetics in packaging products, growing demand of paint & coatings in the automotive, building & construction industries etc. According to MarketsandMarkets, the organic pigments industry is expected to grow at a CAGR of 4.8% from USD3.55bn in 2017 to USD4.67bn in 2023. **In-organic Pigments:** consists of dry ground minerals like metals and metallic salts; made by relatively simple chemical reactions or rather chemical formulations. Inorganic pigments are cost effective, resistant to other chemicals and long lasting (can withstand bad climatic conditions and are heat resistant) and hence preferred over organic pigments. APAC is the largest market for inorganic pigments while the demand for paints and coating in India, China and Saudi Arabia is anticipated to drive growth. According to MarketsandMarkets global inorganic pigment industry is expected to grow at a CAGR of 5.1% from USD22bn in 2019 to USD28bn in 2024. Some of the key triggers for growth of inorganic pigments include requirement of improved quality industrial products, application as colorants in construction material, rise in production of plastic products, applications in production of polymers etc.

Ultramarine Pigment: is a blue pigment originally made by grinding *lapis lazuli*. It is used in detergents (for its corrective properties to remove yellowish tinge), and is often used on/with products meant to be white, such as linen, paper, etc. Additionally, its properties such as sun light resistance and non-irritability extends its application to industries including paints and coating, cosmetics, paper, inks etc. According to prnewswire, the global market for ultramarine pigments is estimated to grow at 4% CAGR from USD190mn in 2020 to USD249.3mn in 2027. The laundry grade segment is anticipated to grow at CAGR 3.1% and industrial grade is anticipated to grow at 3% CAGR during 2020-2027, while the cosmetic grade is expected to grow at 8.9% CAGR.

Surfactants: are one of the compounds that make up detergents and personal care products; they allow oil molecules to dissolve in water by breaking down the interface between water and oil/ dirt. The on-going Covid-19 pandemic has bolstered the growth of surfactants. There is increased awareness about hygiene and thus the use of hand sanitizers. Additionally, even before the outbreak of Covid-19 the demand of surfactants was on a rise due to increased inclination towards self-grooming, home care, and general awareness about cleanliness. According to MarketsandMarkets, surfactants market size is anticipated to grow at 4.5% CAGR from USD42.1bn in 2020 to 52.4bn in 2025. **Types of surfactants include:**

Exhibit 03: Types of Surfactants

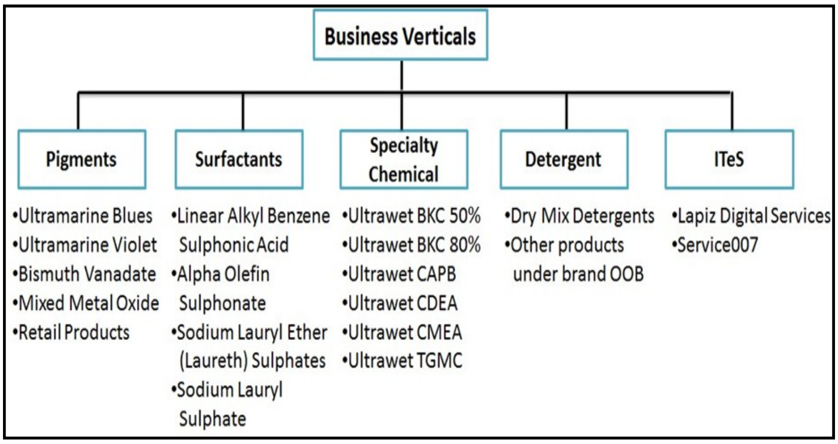


Source: airedalechemical.com, Progressive Research

Non-ionic: have no ionization when dissolved in water, are highly stable (barely react with acids), possess better emulsifying qualities and thus work better for removing oily and organic dirt. **Anionic:** carry a net negative charge due to anionic functional groups (like sulfonate, phosphate, carboxylates), mostly used in manufacturing detergents, cleaning products as well as in textile, mainly for dyeing, bleaching, fuel addictive etc. **Cationic:** carry a net positive charge, the surfactant is mainly used in production of fabric softeners. **Amphoteric:** possess the properties of anionic and cationic surfactants, which are new in the market and still under development phase; beneficial as they are biodegradable and resistant to water; mainly used in the manufacturing of shampoos, dyes, pharmaceuticals etc.

About the Company:

Exhibit 04: Business Verticals



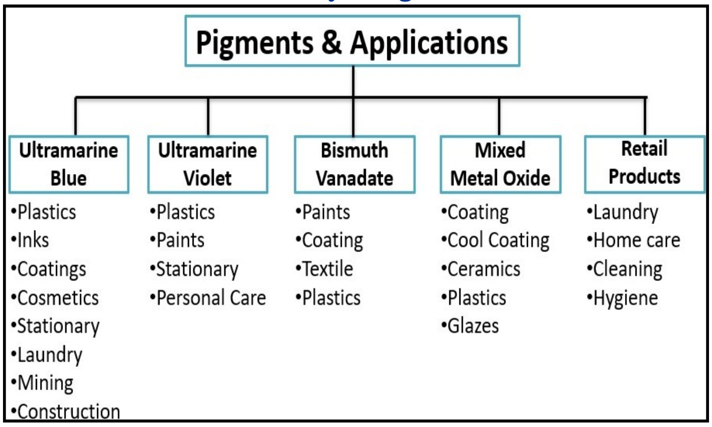
Source: Company Website, Progressive Research

Incorporated in 1960, Ultramarine & Pigments Limited (UPL), part of Thirumalai group, is one of the leading manufacturers of ultramarine blue pigments and the company specialises in manufacturing inorganic pigments, surfactants and detergents which match global standards, with consistent quality products and technological expertise. The company also retails its own line of products under the brand name 'OOB'. The company has 2 best in class manufacturing facilities in Ranipet and Ambattur, Chennai and an upcoming greenfield project in Naidupet. In addition to the business of speciality chemical, the company has also diversified and forayed into IT enabled services and is also engaged in wind energy generation (via turbine generators installed in TamilNadu). UPL manufactures non-toxic (food safe), environment friendly inorganic pigments that have a variety of end users. The pigment products manufactured by the company include ultramarine blue and ultramarine violet, which are used as colorants in industries including plastic, fabric, printing ink, paint, cosmetic, paper, etc.; and bismuth vanadate yellow (inorganic lead-free pigment) is used in alkyl & acrylic paints, water-based paints, nitro cellulose paints, etc. The surfactants product line comprises of linear alkyl benzene sulphonic acid (LABSA) and alpha olefin sulphonate (AOS) among others. LABSA is an anionic surfactant which is used for applications (in formulations) for domestic detergents, dish wash liquids, manufacturing detergent powders and cakes etc. AOS is used as active detergent in cake, powder or liquid detergent formulations; ingredient in shampoos; a wetting agent in fat liquors; a micro bubbling agent in concrete mixtures and emulsifiers for polymer processing. UPL manufactures and sells these pigments and surfactants in India as well as internationally. UPL is also involved in contract manufacturing & processing for leading FMCG clients. UPL is ISO 9001:2015, ISO 14001:2015 and OHSAS 18001:2007 certified. The company has Mr. R. Sampath as its Chairman.

INVESTMENT RATIONALE:

(A) Robust Segments:

Exhibit 05: End-user Industry of Pigments



Source: Company Website, Progressive Research

(i) Pigments: UPL is one of the largest manufacturers of ultramarine blue pigment (more than 50 grades). It manufactures various inorganic pigments such as ultramarine blues (pigment blue 29) and violets (pigment violet 15), bismuth vanadate (pigment yellow 184) and various mixed metal oxides. These pigments manufactured by UPL are certified non-toxic (food safe), environmentally friendly inorganic pigments. Ultramarine pigment is heat and light stable, can tolerate harsh weather conditions, is non-toxic (food safe) and helps brighten products. Attributable to its extensive properties, UPL's ultramarine pigment is utilised in the plastic industry, cosmetics, paints, construction etc. (high grade) and laundry products (low grade). UPL can also manufacture specialized blue pigments as per clients specifications; these customizations of products have resulted in increase of exports of high value added products resulting in better margins. Pigments account for more than 30% of the total revenue of the company.

(ii) Surfactants: UPL has been manufacturing anionic surfactants since 1975 and today this segment contributes more than 50% of the total revenue. Initially, the company would only manufacture a common surfactant used in detergents known as LABSA but now it also produces various surfactants including AOS, lauryl and lauryl ether sulphate (in various forms and concentrations) and also manufacturers speckles (both surfactant and soda ash). UPL has expertise in manufacturing high yield and prime quality surfactants of LABSA in concentrations of 90% and 96%. It is one of the few manufacturers in India to use falling film reactor process for manufacturing the same. Another surfactant, AOS possess high foaming and cleaning properties which can also be used in hard water (which is abundant in India). UPL manufactures variety of formulations of AOS including ready-to-use liquid, paste, powder, noodle etc. and in multiple concentrations (38%, 70%, 89% and 96%). The company is consciously diversifying its products range and adding value added products while keeping personal & home care industries in mind. The company continues on its strategy of long-term relationships and stickiness to its customers.

Please Turn Over

INVESTMENT RATIONALE (contd.)

(iii) Specialty Chemicals: The company is constantly looking at newer horizons and chemistries related to their domain in the speciality chemicals division. Currently, UPL is exploring opportunities for manufacturing Ultrawet BKC (50% and 80%), Ultrawet TGMC, Ultrawet CAPB and Ultrawet CMEA, among others. These specialty chemical products find extensive application in shampoos, cosmetics, sanitizers, hand wash, toothpaste, antiseptics etc. The company's move to venture into personal care segment is laudable due to increasing awareness of hygiene. According to financial express, Indian personal hygiene market is anticipated ti cross USD15bn by 2023, and the hand sanitizers segment alone will be worth more than Rs20bn by 2025. Some of the recent product developments include:

Ultrawet BKC: obtained from a reaction of benzyl chloride and dimethyl alkyl amine in the presence of water, Ultrawet BKC is used as softeners for textile, deodorants and hair products with extensive applications in aftershave, mouthwash, sanitizers etc. UPL manufactures the same in concentrations of 50% and 80%.

Ultrawet TGMC: are medium chained triglycerides of ultramarine used as carriers in flavour and pharmaceutical products, energy source in nutraceuticals applications and emulsifiers in cosmetics.

Ultrawet CAPB: used in cosmetics formulations like shampoos, bubble bath & bath gels, hand wash, toothpaste, makeup removers, skin care products, cleansers, antiseptics, hygiene products etc.

Ultrawet CDEA: is used as a wetting agent & dispersion in cosmetics and also used as a thickener.

Ultrawet CMEA: is used as a foam booster, stabilizer in cosmetics & shampoos, used for stabilizing foam in the presence of hard water and used as a viscosity modifier, conditioner, emulsifier, wetting agent in cosmetics, dye dispersant etc.

(iv) Detergents: UPL manufactures a variety of detergents and also undertakes toll manufacturing projects for FMCG clients for manufacturing and processing services. The company also provides onsite packing and labelling facility for all kinds of dry mixes. UPL manufactures high quality, highly effective and customer centric products (home and laundry care) under the brand name of 'OOB'. The company manufactures products such as dishwashing liquid and bars, detergents (power and liquid), scouring power etc. and these products are mainly sold in southern regions of India. UPL constantly tries to innovate and improve existing products, so as to increase revenues and expand to newer geographies. Rise in need for hygiene and awareness can increase demand for detergents and the company is aptly placed to benefit from the same.

Exhibit 06: Example of Detergents by UPL

Source: Company Website

(v) ITeS: The company provides IT enabled services through, Lapiz Digital. In addition, this wholly owned division provides services such as publishing, e-learning and healthcare and solutions for e-commerce etc. Lapiz addresses client's financial, operational, and strategic issues and enables them improve the same while also helping clients discover newer opportunities. UPL also provides BPO services through, Service007, which offers fully integrated 24/7 call centre services (inbound and outbound) along with customer relation management (CRM) software and also provides virtual assistant for administrative guidance to the management team, focussing on lead management, sales and distribution management, dealer management etc.

(B) Industry Tailwinds: The industry of manufacturing ultramarine blue pigments has many entry barriers due to tedious and difficult manufacturing processes which simply imply that it is not easy to set up a new manufacturing unit. UPL continues to be one of the global market leaders and has been constantly trying to expand its export spread. In addition to the pigments segment, UPL is also an established player in surfactants business as it provides a complete manufacturing solution to clients with well established relationships with customers (over the decades). As the manufacturing facilities are situated in South India, the company is a preferred supplier to factories situated in this region; the retail products are well accepted and now are a well-known preferred brand. This is also favoured with stickiness to the customers. Due to the industrial tailwinds, the company has been pushed to launch a new specialty chemical division. **The company has been able to establish its niche in the sectors mentioned below:**

(i) Paint Industry: in India had been witnessing a rise in demand (pre-Covid) and was in an upward trajectory. In the current scenario, once the market accepts the new normal, demand is anticipated to show an uptick. In terms of volume, India is the 3rd largest consumer of paint. The rise in disposable income and the shift from traditional whitewash to higher quality paints coupled with the increasing urbanisation and shortening of the repainting cycle can provide a fillip to the growth of the industry. According to businesswire, the paint industry in India is expected to grow at a CAGR of 12% during FY19-22. UPL's pigments can play a critical role here, since ultramarine pigments are environment friendly, heat resistance and help in tinting unwanted yellowness. In the recent festive season, the Indian paint industry has already witnessed revival of demand.

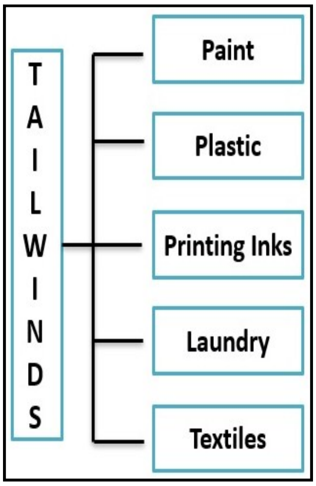
INVESTMENT RATIONALE (contd.)

(ii) Plastic Industry: has been capable to stimulate growth of ultramarine pigments. Owing to its traits like non-toxic, non-irritant and heat resistance, these pigments have become an imperative plastic colorant. Ultramarine pigments are leak-proof and are suitable to combine with metallic and other pigments for desired colour production. Ultramarine pigment has no adverse effect on the dimensional stability of polyolefins and other polymers. Plastics are one of the major contributors to the pigment segment of UPL as well as total revenue, and UPL's pigments are well acknowledged in the plastic industry.

(iii) Printing (ink): Ultramarine pigments are used in a variety of ink like solvent based inks, water based, flexographic, polyamide, packaging inks etc. They are also preferred in food contact applications as ultramarine pigments are non-toxic, easily dispersed, insoluble in all solvents. Moreover, the same is also approved from various international regulators for use in packaging and plastics. Increased demand for printing with the expected changes in the packaging industry can drive growth for this industry on a global level.

(iv) Laundry and Allied Products: There has been an uptick witnessed in the demand for detergents and soaps buoyed by the outbreak of Covid-19. Consumer behaviour has undergone a change due to growing awareness regarding sanitization and hygiene. Laundry products used for industrial application have also witnessed an uptick in industrial activity. As ultramarine pigments are non-toxic and non-irritant, they are widely used in laundry products. Surfactants find application in detergents where FMCG companies in India are witnessing robust sales from rural and semi-urban markets. UPL has more than 4 decades of experience in manufacturing high yield and quality surfactants and is a preferred vendor to many FMCG companies.

Exhibit 07: Inds Tailwinds



Source: Progressive Research

(v) Textile Industry: Ultramarine is prominently used in textile industry to brighten white clothes as well as in other applications to dye the clothes blue in color. Indian textile industry is the second biggest employment generator after agriculture. In FY19, Indian textile contributed 2% to GDP and accounts 15% of total exports. The outbreak of the pandemic has had severe impact on the industry coupled with the already existing legacy issues. Off late, Vietnam and Bangladesh have been better performers in the textile space; however, the pandemic has opened quite a many doors for revival of textile industry in India. China +1 or +2 strategy can benefit India as well and augment the demand for ultramarine pigments, surfactants and detergents.

(C) Capex: Board of Directors of UPL on 10th April, 2018, approved an investment of Rs700mn (funded through mix of internal accrual and term loan) for setting up a new manufacturing facility for surfactants/ specialty chemical in an Industrial Park in Naidupet. UPL's surfactants vertical was at a capacity utilization of around 90-100% (excluding Covid-19 impact). This project will lead to an addition of 32,000MT, however, the project is expected to be delayed by 2-3 quarters from the earlier expected completion of Q1FY21. UPL had also undertaken a product mix change project. The proposed project is aimed at catering the need of clients located in the southern parts of India. The main aim of the project is to be able to contribute towards need of industries which use these products as raw materials. The facility under question is situated in Ranipet and caters to the needs of Chennai. Demand from industries in this region and other parts of the country has been growing gradually and the issues related to timely delivery will be addressed once the capacities are up and running. Therefore, to meet the growing demands of the market, the proposed expansion augurs well for the company. UPL intends to expand some of its product capacity while simultaneously reducing capacities of other products. UPL has already increased its product offering from previous 4 to 10 products. Some of these products will also position as import substitutes and thus favour the Make in India theme. Some of the critical raw material like lauryl alcohol and lauryl ethoxylates will be imported from other countries as there is no supply from India. There exists a demand-supply gap in the segment of specialty surfactants & pigments in India. The requirements for mixed metal oxide and bismuth vanadate in India are completely dependent on 100% import and to capture this opportunity, UPL has proposed change in product mix and quantity.

Exhibit 08: Product-mix Change Project (in MT)

Products	Existing	Proposed	Total
Ultramarine Blue	200	100	300
LABSA	1350	-350	1000
AOS	1000	NIL	1000
Synthetic Detergents	4000	-2000	2000
Mixed Metal Oxide Pigments	-	50	50
Bismuth Vanadate Pigments	-	50	50
SLES or SLS	-	1500	1500
Specialty Surfactants	-	500	500
Total	**6550**	**-150**	**6400**

Source: environmentclearance.nic.in/writereaddata/Online/TOR/26_Mar_ 2019 _180912543KBZCJ1PFExecutiveSummary.pdf, Progressive Research

Sodium Lauryl Sulphate (SLS), known for its degreasing properties, finds application in floor and engine cleaners. SLS lowers surface tension of water and helps in lathering of products. UPL is also looking at increasing the capacity of sodium lauryl ether sulphates which find extensive application in personal care products including shampoos, hand and body washes etc. It is also used in printing, textile, and is used as a dyeing, cleansing or degreasing agent. Bismuth Vanadate pigment is mainly used in plastics due to its low warping, heat and light fastness properties. Mixed metal oxides are second generation pigments possessing UV durability, chemical resistance and heat resistance . They are used in plastics, paints, ceramic products, building material etc.

UPL also undertook pigment expansion project wherein Board of Directors on 6th February, 2020 approved incorporation of the wholly owned subsidiary, Ultramarine Specialty Chemicals Limited to implement its greenfield project for pigment division, the capacity of which will be expanded by 1500MT. Capacity will be added in a phased manner starting from FY21 till FY22 and the company expects expenditure to be around Rs512mn.

Please Turn Over

Industry: Specialty Chemicals | **Ultramarine & Pigments Limited** | BUY

CMP: Rs241 | TARGET PRICE: Rs325 | TIME : 12 months

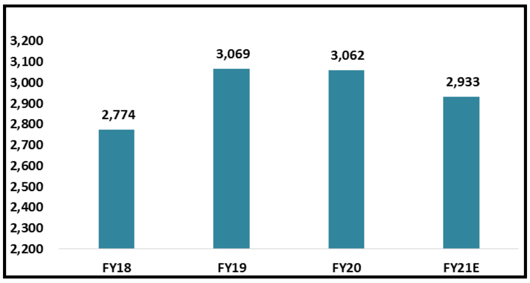
INVESTMENT RATIONALE (contd.)

(D) Diligently Strategic: UPL has constantly been adopting strategies to enhance revenue and profits, with high quality and customer centric products. Revenue has increased in the pigment division due to increased focus on selling value added products and investments made in technology over the past two years while the company is diligently putting in efforts to move out of the low end laundry grades. As far as the margin protection of the surfactant business is concerned, the company is using a product mix strategy. The current focus of the Management is on improving yield of high value grades of pigments and investments in R&D in all stages of the production process i.e raw material procurement to processing the final stage of value addition are in process of implementation. UPL plans to use its R&D capabilities to capitalize the demand of highly specialized, non-toxic, natural and high quality products. The company is involved in R&D and is improving its technology while it is also involved in researching complex processes with the vision to move up the ladder of value chain and scale. Water and energy are two major inputs in the manufacturing processes and the company is focussed on consuming them diligently. As all the manufacturing processes are highly water intensive and the company operates from inland facilities with high level of water scarcity; managing water supplies is one of the greatest challenges faced. Through various initiatives, UPL is constantly trying to reduce the requirement of water for downstream processes. Furthermore, the company is constantly putting in efforts to reduce the power consumption in both the segments of pigments and surfactants.

Financials:

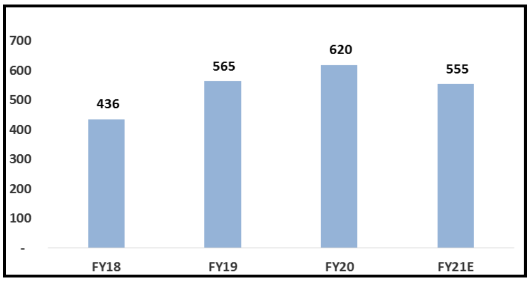
The company has a strong balance sheet coupled with cash and cash equivalents to the tune Rs441.7mn as on 30th September, 2020 as compared to Rs197mn as on 31st March, 2020. Besides this, UPL also has huge non-current investment to the tune of Rs1,591.9mn (holds 20.45 lakh shares in Thirumalai Chemicals Ltd) as on 30th September, 2020 as compared to 763.6mn as on 31st March, 2020. The company has robust return ratios with ROE of ~20% in FY20 (consolidated) and a 3-year average ROCE of 17.5%. UPL also has been rewarding its shareholders with constant dividend payments over the decades. Growth in exports for the pigments and surfactants division as well as introduction of new products continues to boost the top line. Exports have been nearly Rs940mn annually over the past 2 years (little less than one-third of total sales). In FY20, owing to global pressures, the company witnessed 10% volume drop in the pigments segment, however through change in product mix and addition of high value products, value drop was limited to 2% i.e. Rs980mn in FY20 as compared to Rs1,000mn in FY19. In FY20, surfactant segments reported revenue to the tune of Rs1,640mn as compared to Rs1,670mn in FY19. Surfactants contributed around 56.71% to total revenues while pigments contribute 31.7% and ITeS contributed 14.37% in FY20. Until FY19, UPL was debt-free, however for its recent capacity expansion at Naidupet, the company has borrowed Rs202.5mn in FY20. The company's borrowing further increased to Rs310mn as on 30th September, 2020. However, looking at the track record of the conservative Management, they will try to repay at the earliest. The company in H1FY21 reported tepid performance owing to plant shut down (pandemic effect), but was able to maintain Ebitda margins of 20% (consistent since FY18).

Exhibit 09: Revenue Trend (Rs mn)



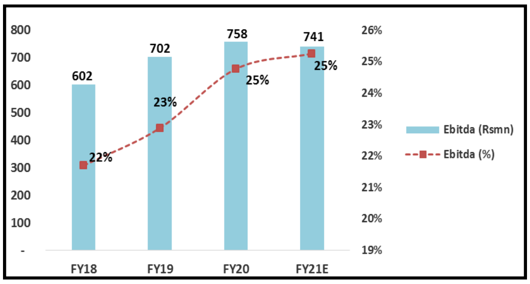
Source: Annual Report, Progressive Research

Exhibit 10: PAT Trend (Rs mn)



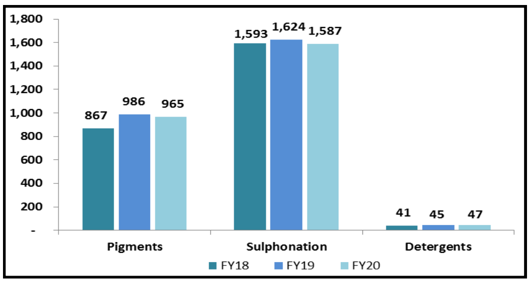
Source: Annual Report, Progressive Research

Exhibit 11: Ebitda v/s Ebitda Margins



Source: Annual Report, Progressive Research

Exhibit 12: Major Segments Revenue (Rs mn)



Source: Annual Report, Progressive Research

Risks and Concerns:

Raw Material Risk: Alpha Olefin which a key raw material for sulphonation is dependent on crude oil fluctuations and thus also exhibits an erratic behaviour in terms of availability and supply; moreover, this is a completely imported raw material as there are no players in India, who provide this

Capex Risk: The company has undertaken significant capex for capacity expansion/ change in product mix, any further delay in these projects will adversely impact the growth story

Forex Risk: As the company exports its products to a number of global players and at the same time imports certain raw materials, the company is exposed to forex fluctuation risks

Concentration Risk: The company is exposed to concentration risk as within the pigments segment, it predominantly deals with a single line of product i.e. ultramarine blue

Shrinking Demand: of the laundry products, white washing applications and slowdown in manufacturing sector itself can be a matter of concern

Competition: The domestic market for pigments continues to pose competitive challenges both from few organised and unorganised players

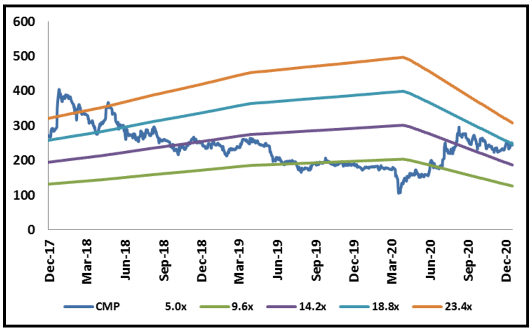
Receivable Risk: Any increase in sales volume which is via traders can impact the collection cycle and debtors outstanding

Stock Illiquidity: The stock is highly illiquid and traded on BSE only

Outlook and Recommendations:

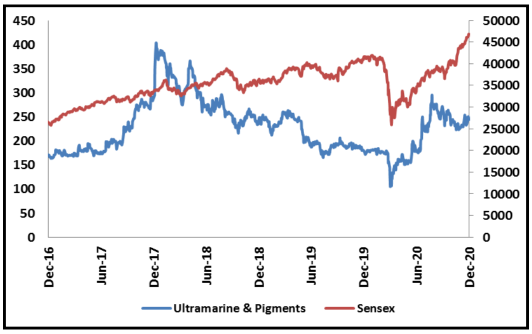
The company has been growing slowly and consistently via sustainable operational efficiencies, margins and profitability. UPL is the market leader in manufacturing ultramarine pigments and already has significant presence and customer base both in the domestic as well as the global market. Going forward, UPL intends to focus on value added products across segments. In FY20, the company increased manufacturing of higher value grades of pigments by 30% as compared to FY19 and more than 150% as compared to FY17. The company is constantly looking to add new products to its portfolio and some of them are expected to be commercially launched in the upcoming year. The management is focused on growth through its highly capable R&D department, high value-added products and further expansion in the export markets. The company has a healthy balance sheet, aims to provide import substitute products via change in product mix (as products like mixed metal oxide and bismuth vanadate are majorly imported in India), renewing focus on improving the operational efficiency, broadening the customer base, enhancing the revenues of the domestic division which adds to our conviction. The company has been following a beautiful strategy to meets its capex requirements from cash flows generated from its operations, and reinvestment / regeneration of free cash flows via the capex and finally distributing the surplus funds to its stakeholders. This cycle of reinvestment of free cashflow and re-distribution has been continuing for quite some time now and we anticipate the same to be continued and thus we initiate a BUY on the stock with a target price of Rs325 with a horizon of 12 months.

Exhibit 13: One Year Forward P/E



Source: Ace Equity

Exhibit 14: Price v/s Sensex



Source: Ace Equity

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