April 28, 2021 | PICK OF THE MONTH | VOL-7, NO-03

Industry: Specialty Chemicals

Oriental Aromatics Limited

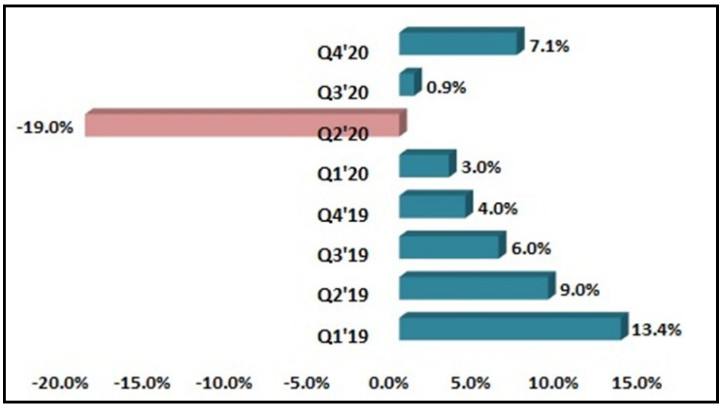
BUY

CMP: Rs.864 | **TARGET PRICE: Rs.1200** | **TIME : 12 months**

OVERVIEW: Industry:

The FMCG market in India is estimated to be around Rs4.3tn and is anticipated to revive in this calendar year according to market researcher NielsenIQ. This growth or trend is very much in line with the visible movement across Asia. Needless to mention, 2020 was a challenging year for most of the Asian markets which experienced a decline or lower growth in the FMCG market; however, the same is projected to pick up and normalise this year. Though many still argue, the discretionary segments will continue to take a hit as the consumers will continue to focus only on essential goods (rather than non-essentials), personal care categories may be hit hard, but Nielsen believes there will be opportunity and growth this year. In addition to this, the report also speaks about growth in the right stores, right categories, right segments, right occasions, and right price tiers. Though the market dynamics continue to be uncertain this year as well, aggressive players who will focus on trends including convenience, homebound, alternative, natural and blends will emerge as big winners in 2021.

Exhibit 01: Overall FMCG Scenario



Source: business-standard.com/article/companies/nielsen-predicts-revival-of-fmcg-growth-some-differ-as-covid-19-cases-rise-121032600016_1.html, Progressive Research

Global Chemical Industry: Anticipated to grow at a CAGR of ~4.8% (revenue wise), the global market for specialty chemicals is expected to reach a value of ~USD301bn by 2026. Specialty chemicals have been gaining a lot of traction in the international chemical industry due to their inherent properties and high-performance ability. These have common applications in a number of industries like food, animal feed, agriculture, textiles, household products, industrial products, telecommunications, oil & gas etc. Some of the key factors which have led to exponential growth in demand include need for safe chemicals to mitigate the environmental concerns, increased use of end-use products, increasing demand etc. Many key players in the industry have started looking at inorganic growth to supplement their portfolios with regional players as well as product additions to the already existing profiles via mergers and acquisitions.

Indian Chemical Industry: While employing nearly 2 million people, the Indian chemical industry on a global level is the sixth largest chemical producer, ranking 14th in exports and 8th in imports (excluding pharma products). Many analysts are estimating the domestic demand for chemical products to grow at approximately 9% per annum over the next 4-5 years where specialty chemicals accounts for nearly 22% of total chemicals and petrochemicals market. Due to geographical demand, shift in production and increasing consumption patterns of many Asian and Southeast Asian countries, strategic shift by many chemical players (trying to reduce their dependence on any one major supplier), the demand for specialty chemicals is expected to grow at 12% CAGR from FY2019-22 leading to growth of the Indian chemical industry. Despite facing many global headwinds, the chemical industry has been maintaining healthy returns.

SNAPSHOT

52 week H / L	Mcap (INR mn)
864 / 133	29076
Face value: 5	
BSE Code	NSE CODE
500078	OAL

Annual Performance

(Rs mn)	FY19	FY20	FY21E	FY22E
Total Revenue	7,547	7,599	6,082	6,992
EBITDA	1,150	1,265	1,457	1,566
EBITDA (%)	15.2	16.6	24.0	22.4
Other Income	13	74	54	54
Interest	130	119	54	58
Depreciation	178	190	184	239
PBT	855	1,029	1,273	1,323
PAT	571	862	948	989
Equity (Rs mn)	168	168	168	168
EPS (INR)	17.0	25.6	28.2	29.4

Quarterly Performance

Parameters (Rs mn)	Mar-20	Jun-20	Sept-20	Dec-20
Sales (Net)	1,697	1,133	1,838	1,907
EBITDA	355	183	491	534
EBITDA (%)	20.9	16.2	26.7	28.0
Other Income	39	4	5	7
Interest	36	8	3	2
Depreciation	51	46	46	42
PAT	236	97	331	360
Equity (Rs mn)	168	168	168	168

Ratio Analysis

Parameters (Rs mn)	FY19	FY20	FY21E	FY22E
EV/EBITDA (x)	26.8	23.2	20.1	18.7
EV/Net Sales (x)	4.1	3.9	4.8	4.2
M Cap/Sales (x)	3.9	3.8	4.8	18.6
M Cap/EBITDA (x)	25.3	23.0	20.2	18.6
Debt/Equity (x)	0.57	0.18	0.14	0.13
ROCE (%)	24	25	24	22
Price/Book Value (x)	7.4	6.3	5.2	4.4
P/E (x)	18.1	28.9	30.74	29.4

Shareholding Pattern as on 31st Mar, 2021

Parameters	No of Shares	%
Promoters	24960000	74.17
Institutions	31767	0.09
Public	8661809	25.74
TOTAL	33653576	100

Source: Annual Report

Note: All the data is calculated as per Market Price on 27th Apr, 2021

Industry: Specialty Chemicals | **Oriental Aromatics Limited** | BUY

CMP: Rs.864 | TARGET PRICE: Rs.1200 | TIME : 12 months

OVERVIEW: Industry (contd.)

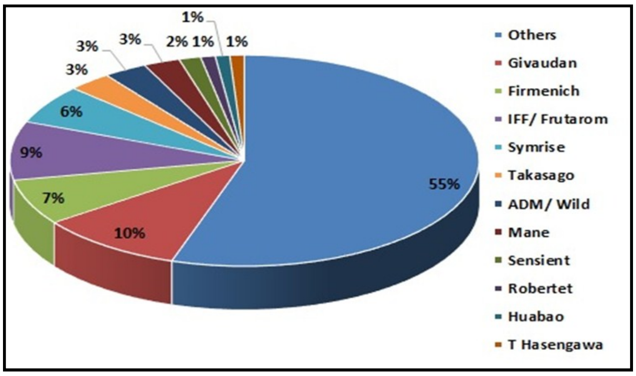
Global Flavour & Fragrance (F&F) Industry: was valued at USD29.8bn in 2019 and in times to come, IMARC expects the market to grow at a CAGR of around 5.1% during 2020-2025 to reach a value of approximately USD40.6bn by 2025. Some of the key end users of the flavours industry include those from the beverages, dairy, confectionary, meat, snacks, healthcare, bakery, etc.; while on the other hand, some of the key end users of the fragrances industry include industrial players from cosmetics, toiletries, soap, detergents, household cleaners, air fresheners, etc. Asia Pacific (APAC) has been playing a dominating role in terms of revenue in the global F&F market with nearly USD7.35bn in 2019 of revenues. Rising demand is anticipated from emerging economies like India, Japan and China where the latter is the largest F&F market in APAC, accounting for over nearly 40% of the regional market. Many analysts are of the view that in the coming years India and China will witness faster growth than mature markets like Japan. Growth will be driven by factors like growing population, rising middle class, increasing urbanization, rising incomes, changing lifestyles evolving consumption patterns & preference, growing awareness towards hygiene and increasing investment in these regions by major global players. APAC is also the fastest growing beauty market with higher penetration of fine fragrance and deodorants which also augurs well for propelling the growth of the fragrance sector. The F&F industry constantly keeps innovating and one of the recent processes in vogue is encapsulation which is a method of containing flavours and fragrances by using a coating material to isolate the coated material from the external environment. Many players are already experimenting and adding these products to their portfolio. According to the Facts and Factors research analysis, the global market for encapsulated fragrance is projected to reach around USD4,600mn by 2026 while growing at a CAGR of 4.5%.

Exhibit 02: Zone-wise Anticipated Growth

Country	2017 USD bn	2022 USD bn	% growth per annum
Africa & Middle East	1.5	1.9	5.0
Asia	11.6	15.8	6.4
Central & North America	6.7	7.9	3.4
Central & Eastern Europe	1.7	2.1	4.6
South America	2.1	2.6	4.5
Western Europe	4.6	5.5	3.5
Global Total	28.2	35.8	4.9

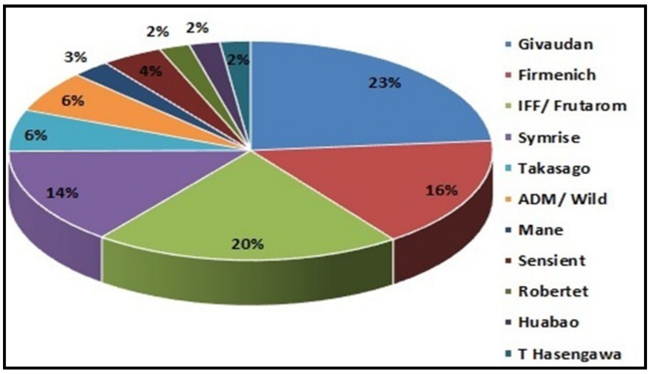
Source: OAL AR2020, Progressive Research

Exhibit 03: Global Sales F&F Inds (2020) +USD55bn



Source: biofuelsdigest.com/bdigest/2020/06/14/a-55b-global-industry-the-digests-2020-multi-slide-guide-to-fragrances-and-flavors/4/, Progressive Research

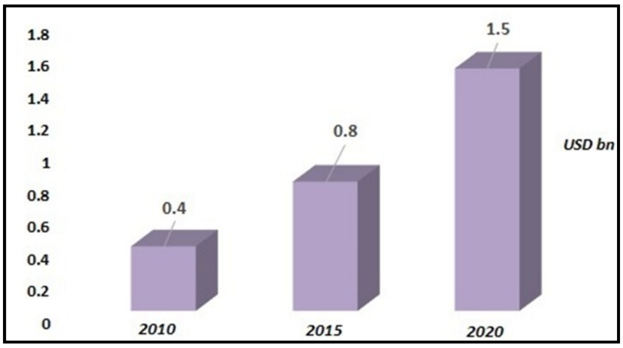
Exhibit 04: : Global Sales (est.) Top 11 F&F



Source: biofuelsdigest.com/bdigest/2020/06/14/a-55b-global-industry-the-digests-2020-multi-slide-guide-to-fragrances-and-flavors/4/, Progressive Research

Indian F&F Industry: India has been an inspiration to the global perfume industry while supplying raw materials as well as new ideas. The richness of natural resources and love for natural fragrances augurs well for domestic consumption as well as for exporting products. India is an important exporter of raw material for fine fragrances related to jasmine and sandalwood, florals perfumery like geranium, spices like pepper, woods including agar and grasses like vetiver. The Indian F&F market is dominated by global MNC's players while the local players are fragmented, smaller in size and cater to the unorganized market. In India, the top 6 F&F players contribute nearly 72% of the total market while the rest 28% is held by smaller players. On the other hand, the fragrance segment is more consolidated than the flavours market, where the top 5 players in the fragrance segment constitute ~85% of the fragrance market, while flavours market constitutes 58% for the organized market which is growing at 11-12% CAGR. India has been making an impact on the global fragrance oil markets while producing essential oils of menthol mint, sandal wood, jasmine, tuberose, spices etc. The Indian market is also dominated by MNCs where the top 4 global players (Givaudan, IFF, Firmenich and Symrise) constitute over 50% of the market share. As per a leading Indian newspaper in India, the ministry of micro, small and medium enterprises estimate the size of Indian F&F industry at around USD500mn which is growing at 11% per annum while the global F&F industry is valued at USD24bn.

Exhibit 05: Indian F&F Market



Source: OAL AR2020, Progressive Research

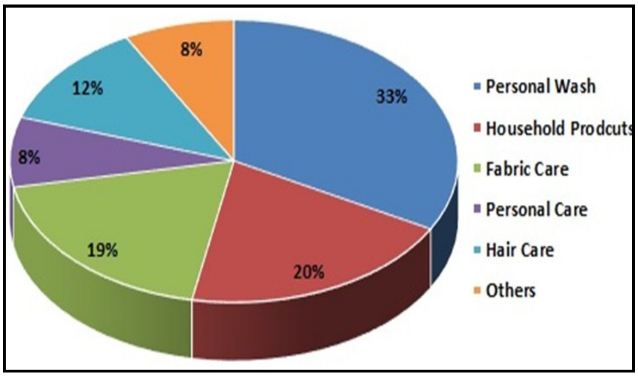
Industry: Specialty Chemicals | **Oriental Aromatics Limited** | **BUY**

CMP: Rs.864 | **TARGET PRICE: Rs.1200** | **TIME : 12 months**

OVERVIEW: Industry (contd.)

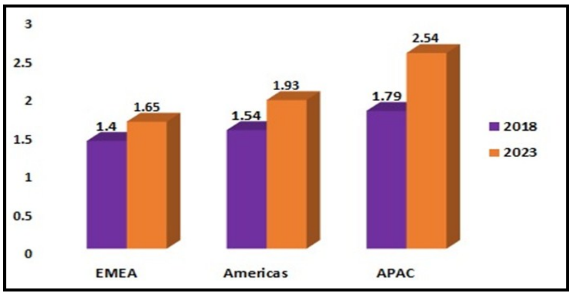
The Indian F&F industry is anticipated to grow exponentially due to rising disposable incomes, increasing demand for personal care products, increased market penetration, brand awareness and availability of products at affordable prices. Many of the Indian consumers in the urban, Tier I and Tier II cities are also moving towards using high end personal care products like hair gels, lotions, skin creams, products related to air care etc. which use a higher quality of F&F molecules than the regular soaps and detergents. Thus, the premiumization of FMCG products will be a big booster for the market to growth at a high CAGR rate. F&F blends are mainly dominated industries related to food and beverage (F&B) and FMCG, where the penetration of FMCG giants like HUL, P&G etc. has been growing consistently in the rural markets. While at the same time many major F&F houses who have manufacturing in India are exploring export opportunities and are fetching higher margins for the same.

Exhibit 06: Indian Fragrance Market End-use (2018-19)



Source: fairchem.in/investor-relations/Annual-Reports/Annual-Report-FY-18-19.pdf, Progressive Research

Exhibit 07: Global Market- Aroma Chemicals in (USD bn)



Source: OAL Feb 2021 Analyst PPT, Progressive Research

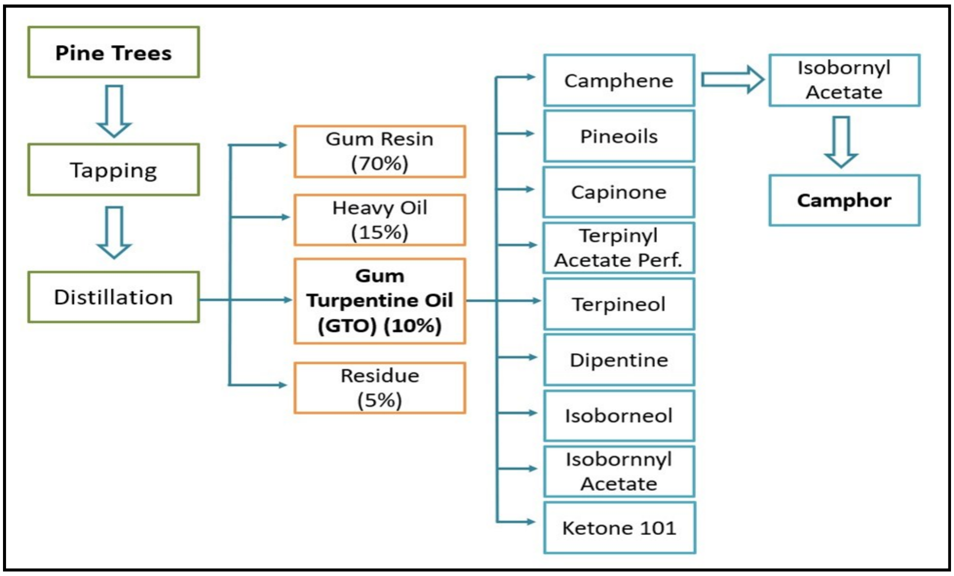
Aroma Chemicals Industry: The global market size for aroma chemicals surpassed USD5.10bn in 2019 and is estimated to grow at 6.0% CAGR between 2020 and 2026. The market is highly consolidated with the top four players accounting for ~55% market share. Some of the major types of aroma chemical products which find applications in F&B, fine fragrances, cosmetics & toiletries, soaps & detergents etc, include benzenoids, terpenoids, musk chemicals etc. In addition to this, many of these aroma chemicals are used in cosmetics & toiletries like aftershave, gels, lipstick, foundation, moisturizer, nail polish, shampoo, body wash, hand wash, mascara, sunscreen, toner etc. Soaps and detergents segments are daily necessity consumer goods and hold the largest market share. In addition to this, the escalating penetration of washing machines in the developing nations is another element which can fetch significant market growth.

Terpenoids represents the largest product category with a share of nearly 31%, followed by **Benzenoids** with a share of approximately 29%. Terpenoids has been gaining popularity as they find applications in perfumery, alternative medicines (such as aromatherapy), fragrant ingredient in F&B, essential oils etc. **Musk chemicals** are widely used in production of soaps & detergents and accounted for a market revenue of USD234.6mn in 2019. Rising demand for soaps and detergents products due to increasing consumer awareness towards sanitation can propel market growth. The upsurge in demand for natural aroma chemicals, advances in technology and other emerging applications add to the upcoming opportunities in the market. Growing demand from cosmetics & personal care industry and increasing R&D investments are the factors for the growth of this market. As per some estimates, USA accounts for nearly 33% of the market while Europe and Japan represent about 30% and 12% of the world market. The rest of the market includes the developing countries which also portray high growth rates and potential. Analyst anticipate the global market for aroma chemicals to grow significantly in Asia and South America, where APAC regions are expected to be the fastest growing regional markets. In addition to this, the increasing consumption of aroma chemicals in India is also expected to provide an uptick to the growth of this market. Some of the key manufacturers operating in this market include: BASF, Solvay, Kao, Takasago, Bell Flavors and Fragrances, Sensient Technologies, Symrise, Vigon International, Givaudan, Robertet, T.Hasegawa, Treatt, YingYang Aroma Chemical Group, Silverline Chemicals Ltd, PFW Aroma Chemicals B.V etc

Camphor Tablets Market: Camphor tablets are witnessing high demand from various end-users in the global market owing to medicinal benefits like pain relief, swelling reduction, relief from congestion, relief from worn out muscles, sprains, soothing burns, curing acne, strengthen hair root and other applications for usages as an insecticide, applications as antioxidant and many uses in aromatherapy etc. Camphor exhibits a number of medicinal properties which explains the high demand for manufacturing different types of medicines and a wide range of ayurvedic medicines. The shifting trend from conventional medicines to traditional medicines and growing production capacity of manufacturers across the globe, can help witness robust growth of the global herbal medicinal and ayurvedic products market where one of the sub segments i.e. pharma-grade synthetic camphor market is anticipated to grow at a faster rate. One more factor which stimulates market growth for camphor tablets is high consumption of camphor tablets for religious rituals. Camphor tablets are also used as an abuser to keep reptiles, insects, moth etc. away in agriculture and household activities. Camphor is a versatile repellent which drives mosquitoes away. The global camphor market size is estimated to reach USD500mn by 2025, growing at a CAGR of 5.5% during 2020-2025; the technical grade of synthetic camphor is predicted to generate a revenue of USD76.9mn by the end of 2027 and the camphor tablet segment is projected to witness the highest CAGR of 6.5%. In the porter five force model, the bargaining power of suppliers and competitive rivalry remain high while the bargaining power of buyer, threat of new entrants and the threat of substitutes remain moderate.

INVESTMENT RATIONALE:

Exhibit 08: Pine Based Aroma Chemicals Manufacturing

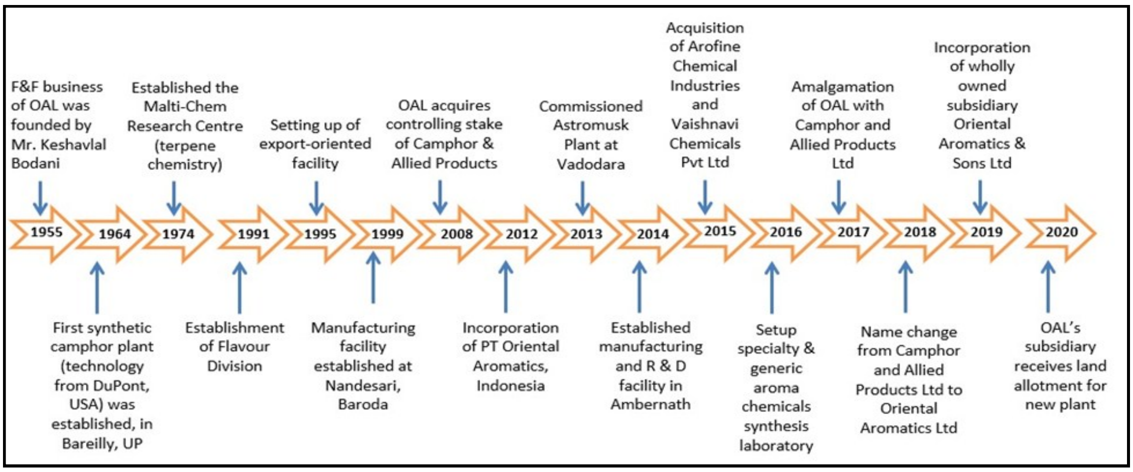


Source: OAL Feb 2021 Analyst PPT

About the Company:

Formerly known as Camphor and Allied Products, 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 and other chemicals used in industries related to flavours and fragrances, pharmaceuticals, soaps and cosmetics, rubber and tyre, paints and varnishes, fast-moving consumer goods (in fine fragrances, personal hygiene, home care, beauty & cosmetics industries) 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. The company has one overseas subsidiary and one domestic subsidiary. PT Oriental Aromatics (Indonesia) where OAL holds 99% of shares is engaged in the business of F&F while Oriental Aromatics & Sons Limited which is 100% wholly owned subsidiary is engaged in the business of speciality aroma chemicals and F&F. Over a period nearly 6 decades, today OAL has become an integrated business entity in flavours, fragrances, speciality aroma chemicals and camphor products. Established in 1955 by Mr. Keshavlal Bodani, the company has been constantly evolving, innovating and nurtured by three generations of the Bodani family.

Exhibit 09: Milestones Achieved



Source: OAL Feb 2021 Analyst PPT

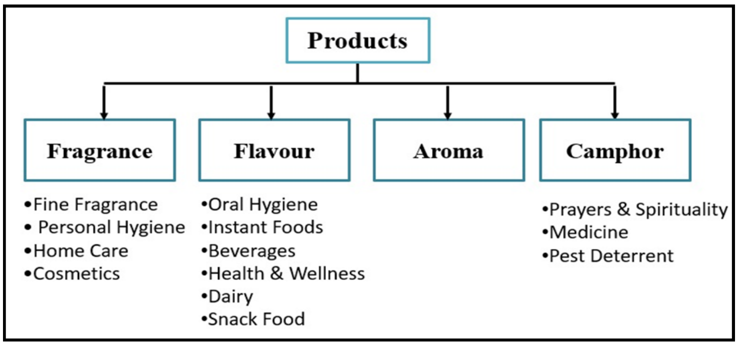
About the Company (contd.):

The industry as a whole has a lot of entry barriers since the business is a specialized one and good quality F&F formulations require quality aroma ingredients. OAL is backed by the ability to develop a diverse basket of creative aroma ingredients which are used to manufacture high-quality F&F. A combination of innovation with science has made OAL one of the few integrated players in the industry. OAL delivers quality aroma chemicals to clients across the world with a wide range of aroma chemicals and camphor products derived from pinene, petrochemical, musk and sandalwood derivatives. In addition to this, the company also delivers innovative F&F raw materials to marquee FMCG companies. The business segment can be divided into F&F, aroma chemicals and camphor & allied products. In FY20, these businesses constituted ~30%, ~35% and ~35% respectively with exports accounting for ~29% of total revenues. The company has a wide spread geographical presence with exports to Asia (Bangladesh, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Myanmar, Oman, Pakistan, Singapore, Sri Lanka, Thailand, UAE, Vietnam, Yemen); Africa (Egypt and Nigeria); South America (Argentina, Brazil, Colombia); North America (Mexico, USA); Europe (France, Geneva, Germany, Netherlands, Portugal, Spain, Switzerland, Turkey, UK, Ukraine). Currently the company aspires to develop into a global player in the specialty aroma chemicals segment and OAL intends to largely focus on generic specialty aroma chemicals where major overlap with its competitors is lesser.

Investment Rationale:

(A) Product Portfolio: Companies in the F&F segment play a vital role in the value chain of consumer goods like food, beverages, household-care products etc., and are directly dependent on the consumer's purchasing decision and preferences. Broadly speaking (in FY2020), the segment of perfumery chemicals accounted for nearly 53.47% of the total turnover, while camphor & isoborneol products occupied nearly 29.45% of the total turnover. As mentioned earlier as well, the four broad segments of OAL include F&F (blend) contributing 30%, camphor contributing 30-35%, specialty aroma contributing 25-30% and the rest coming from bulk chemicals. Management believes specialty aroma will be a key growth driver in near future.

Exhibit 10: OAL Product Portfolio



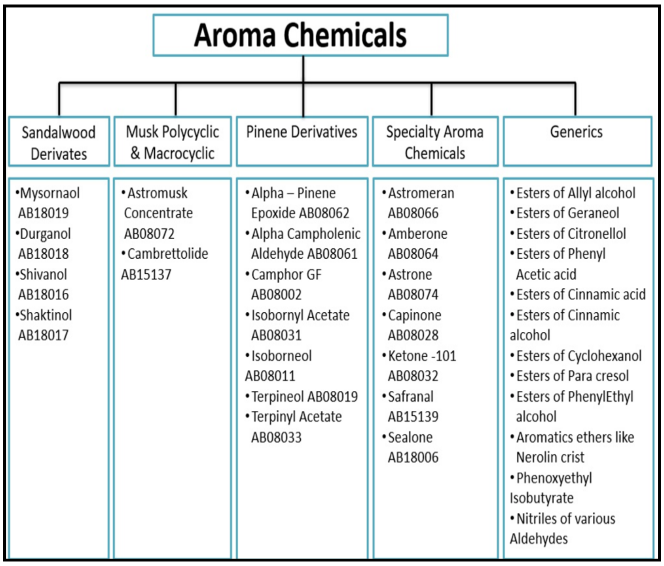
Source: OAL Website, AR2020, Progressive Research

(i) Fragrance: OAL delivers innovative fragrance formulations with the highest quality standards, highest levels of creativity, acceptability and the best performance final product. The company also has the ability to deliver custom designed fragrances for its customers. These products find applications in fine fragrances, soap and detergent, fragrances for cosmetics and toiletries, fragrances for incense sticks etc.

(ii) Flavour: A flavourant is a substance that imparts flavour to another substance by altering the characteristics of the solute which may cause it to become sweet, sour, tangy, etc. Flavourant essentially find applications as food flavours, fine pharma flavours, final food flavours, solid flavours, liquid flavours etc. OAL manufactures/ formulates many of these mixtures which impart the unique flavour to the food products. OAL specialises in custom flavour manufacturing and has been constantly delivering quality flavours used in oral hygiene, instant foods, beverages, health and wellness, dairy, snack foods, ready to eat food etc.

(iii) Aroma Chemicals: are the building blocks for any F&F formulations and OAL is one of the top aroma chemicals manufacturers in India. OAL can manufacture many synthetic aroma ingredients right from bulk to specialty grade at its manufacturing facility in Bareilly and Vadodara. The company has a long-term relationship to supply aroma chemicals to global majors like IFF, Givaudan, Symrise etc. OAL is one of the established names in the domestic as well as global aroma chemicals industry. The company also manufactures high value low volume specialty aroma chemicals where the industry has many high barriers to entry. OAL uses more than 28 different chemistries for a basket of over 200 aroma chemicals it manufactures which are supplied to the top 10 players in the global F&F industry. Currently the company is involved in 52 different ingredients and intends to scale it to 60 ingredients by end of FY22. Since many global players are looking for alternate suppliers with efforts to reduce reliance on China, OAL which is already supplying aroma chemicals to a number of major markets stands to benefit a lot. Rising demand for FMCG product categories can lead to a higher demand for aroma chemicals and OAL is well positioned to capture the upcoming opportunities with existing capacities as well the planned capital expenditures for future.

Exhibit 11: Aroma Chemicals Profile



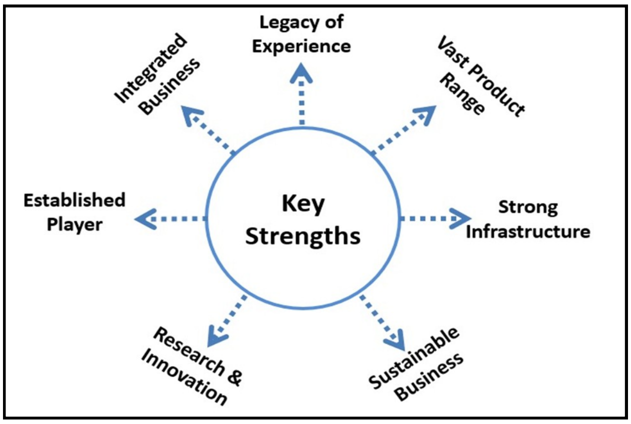
Source: OAL Feb 2021 Analyst PPT

INVESTMENT RATIONALE (contd.):

(iv) Camphor: has many applications in medicine and in making various other products due to antibacterial, antifungal, and anti-inflammatory properties to treat skin conditions, improve respiratory function, and relieve pain. OAL is one of the pioneers in manufacturing synthetic camphor in India. The company currently has a market share of nearly 33% and intends to scale up the same to 35-40%. The company is also looking at exploring opportunities for manufacturing medical grade camphor which is supplied to pharma players.

(B) Significant Strengths: OAL has gradually evolved as an integrated F&F player over the decades which is due to key parameters like experienced management, recognition, good infrastructure, strong research and innovative ability, sustainable production of good quality products etc.

Exhibit 12: Key Strengths



Source: OAL AR2020, Progressive Research

(a) Experienced Management: The Bodani family have extensive experience in the chemical industry which has resulted in OAL establishing a strong market position as a leading player in the Indian market of aroma chemical and camphor. The company caters to a basket of diverse products while enjoying a strong relationship with reputed clients.

(b) Recognized Player: OAL has a rich legacy with nearly 6 decades of experience in the segment of aroma chemicals and nearly 7 decades of experience in the F&F segment. OAL is one of the few global companies who are fully integrated in the space of F&F; the company is a pioneer in the field of terpene chemistry in India. With all the developments and operational progress, OAL is becoming a one-stop solution provider for the F&F industry. The company directly or indirectly caters to more than 2000 customers across 33 countries.

(c) Infrastructure: The company had set up the first synthetic Camphor plant in India backed by technology from DuPont and since then OAL has been gradually adopting excellence via R&D and innovation. OAL has an integrated and fully automated DCS controlled chemical manufacturing facility. The robust infrastructure created over the years has the capability of producing fragrances, flavours as well as specialty chemicals .

(d) Research and Innovation: continues to be the crux of the robust offering from OAL which are unique and distinguished solutions. The R&D centres help create unique combinations of aroma chemicals along with F&F. OAL is passionate and focused on R&D and nearly 4-7% of the revenue is spent on R&D.

(e) Product Range: The company has a vast product range which find applications in a number of industries ranging from F&F, pharmaceuticals, soaps & cosmetics, rubber & tyre, paints & varnishes, etc.

(f) Sustainability: is one of the key fundamental factors for the company's strategic and business growth. In pursuit of the same, the company has created a sustainable sourcing policy for key raw material like turpentine oil and alpha-pinene which safeguards consistent and value driven growth. OAL stands as one of the few manufacturers in the world who can use turpentine oil for manufacturing further enhanced products. The company has good and sustainable processes which ensure production of high-quality products. OAL has been constantly working on developing new products related to turpentine chemistry. Turpentine oil is derived from the resin of coniferous trees like Pine which is also sourced from a range of diverse geographies. The manufacturing plant of OAL is designed in such a way, that the processing operations can use turpentine oil derived from anywhere in the world. This helps reduce the dependence on any one region or any source for procurement and further use for manufacturing.

(C) Robust Operation Units: OAL has immense experience in the F&F industry which adds to the good understanding of the tastes and preferences of the customers' requirements in the domestic as well as the international markets. The company has a huge land bank in Vadodara and Bareilly, of which, ~60% is utilized by the existing plants. This indicates and shows enough room for brownfield/ greenfield expansions, going forward, if any. While giving highest importance to ensure that the environment remains relatively pollution free, all the plants of OAL are designed with suitable waste management systems and pollution control facilities as per guidelines of the authorities. The company is propelled by sustainable and robust manufacturing facilities located at different parts of the country.

(i) Plant 1- Bareilly (Uttar Pradesh): This was the first synthetic camphor plant established in India where technology was sourced from DuPont of USA in 1964. Accredited as pharma grade with WHO-GMP and USFDA certifications, this plant mainly manufactures camphor and specialty aroma ingredients (based on alpha-pinene) and currently has the capability of producing ~7,200 MTPA of pine-based chemicals and other end products. This plant can handle chemical operations such as fractionation, esterification, saponification, hydrogenation, dehydrogenation, oxidation, peroxidation, pyrolysis, etc.

(ii) Plant 2- Vadodara (Gujarat): This aroma chemicals manufacturing plant was set up in 1999 and is a new multipurpose plant facility with an end product capacity of ~6,200 MTPA added in 2018. A wide range of generic specialty aroma ingredients (from pinene, petrochem and other raw material sources) are manufactured at this plant. The products manufactured at this plant are of international standards and nearly 75% of the annual production from here is exported. This plant can handle chemical operations related to epoxidation, peroxidation, hydrogenation, aldol condensation, cyclization, esterification, bromination, etc.

(iii) Plant 3 Ambernath (Maharashtra): Set up in 2014, with a manufacturing capacity of ~6,000 MTPA of F&F related products, this plant also has a state of the art and modern R&D / QA infrastructure.

INVESTMENT RATIONALE (contd.):

(D) R&D Setup:

Unit1: OAL has always been focused on in-house R&D with initial works on terpene chemistry and developing many more interesting products since then. Established in 1974, the company has a process re-engineering lab at Vadodara (Nandesari) which is also a DSIR approved lab. The facility is well equipped to carry out high pressure reactions coupled with lab scale fractionating systems/ columns for separation. In this well-equipped pilot plant, OAL and its team has successfully developed several new products related to turpentine chemistry (having 47 patents). Many of the specialty chemicals developed by the company cater to diverse industries like soaps & detergents, cosmetics, F&F, paints & varnishes, pharmaceuticals etc.

Unit 2: Set up in 2016, centre for innovation at Mumbai is a state-of-the-art synthesis lab approved by DSIR focusing on research related to generic specialty aroma and new product development. This is a well-equipped lab to carry out various organic reactions in grams to kilograms scale as well as carry out high pressure reactions for various scales. The team here is powered by 20-25 research associates who carry out various organic reactions like aldol condensation, oxidation, reduction, hydrogenation, hydration, acetylation, esterification, isomerization etc.

The R&D centres have been constantly working and developing a number of molecules related to aroma chemicals and is also looking at scaling them to commercialization. In FY19-20 the R&D team successfully developed new encapsulation technology in perfume delivery system. In addition to this, the team is regularly working for new product development for personal & home care. The aim of the R&D centres is also at improving the yields of existing and new products via newer technologies, optimizing reaction and reengineering parameters to reduce costs, decreasing effluent costs by working on the effluent treatment plant (ETP), improving batch time cycles and using green chemistry. All these collective efforts are gradually resulting in improved quality of products while reducing their manufacturing cost and energy consumption. Some of the recent developments done by OAL (with the help of R&D team) in the recent past of 12-15 months include installation of new manufacturing facility for continuous process for alpha campholenic aldehyde which is the key raw materials for sandal products; successful implementation of process optimization to increase yields of rose nitrile products; increasing the capacity of sandal alcohol plant and constant work on a wide range of specialty aroma chemicals. Different aroma ingredients need different aroma chemistries and OAL is commercially producing aroma ingredients by using more than 28 chemistries in the factory. The company will be looking at rolling out high and mid-range molecules in the near future.

(E) Capex Plans: The APAC market for F&F continues to be one of the fastest growing markets in the world where China is a major market for the aroma chemicals industry. Many players are trying to diversify and reduce their reliance on China for materials, and making the Indian aroma chemicals industry stand at a gainful position. Along with other industry players, OAL continues to capitalize and enhance its backward and forward integration plans. The industry currently is seeing technological augmentation by many cash rich players trying to build sustainable capacity in the aroma-based business. The scale at which the Indian players operate has a huge potential to grow. As per the latest commentary by the Management, all the plants are running at almost full capacity, which invites the need for further capacity addition to cater to the increasing demand from the customers. Thus, the Management has planned a capex of approximately Rs3500mn- 4000mn for the next 3-5 years. As per Crisil rating report, the capex is proposed to be funded with a debt-equity mix of 70:30. The capex comprises of approximately Rs1500mn-1800mn towards the existing facility at Vadodara and Rs2000mn-2500mn for setting up a new plant at Mahad, Maharashtra. The capex at Vadodara plant involves setting up of hydrogenation facilities, expanding the capacity for its multipurpose plant (MPP) as well as creating a new dedicated block for a high-value, low-volume specialty chemicals. The capex at Mahad comprises of Rs1500mn spends towards setting up of a camphor plant and the balance for setting up an aroma chemical plant. The demand for camphor continues to be healthy and with the new facility addition, the company would able to meet the incremental demand and cater newer geographies. As per the Management, the payback period for the project is nearly 4 years. In addition to this, the Management also anticipates limited marketing risk from these projects as the products manufactured would cater to the existing clients. Management on conservative basis has projected 1.7x asset turn from these projects. As far as the capex for the aroma chemicals is concerned, the company is looking at enhancing the capacities for one of its existing products which is witnessing a robust demand. The new product proposed to be launched is anticipated to have limited marketing risk (for the generic molecule), currently facing limited competition and the company is expected to reap the benefits of the first movers' advantage.

Exhibit 13: Capex Details (Estimated Time Lines)

Capex Details	Location	Product	Anticipated Investment	Year of Commissioning
Brownfield Expansion of the MPP	Vadodara	Aroma Chemicals	~Rs100mn	Completed in December 2020
Dedicated Aroma Chemical Plant	Vadodara	Aroma Chemicals	~Rs200-250mn	H2-FY22
Hydrogenation Plant	Vadodara	Aroma Chemicals	~Rs1500mn	H2-FY22
Mahad	Mahad	Aroma Chemicals & Camphor	~Rs1500-2000mn	First Phase- H2FY23

Source: OAL Feb 2021 Analyst PPT

April 28, 2021 | PICK OF THE MONTH | VOL-7, NO-03

Industry: Specialty Chemicals | **Oriental Aromatics Limited** | BUY

CMP: Rs.864 | TARGET PRICE: Rs.1200 | TIME : 12 months

Financials: OAL intends to focus on operational efficiencies via process improvements, continue to increase its profitability and contribute to stakeholders and shareholders wealth. The company has been constantly following the path to sustainable growth while reporting decent return ratios. Liquidity position of OAL is adequately supported by healthy cash accumulations and modest cash balances. The company is more or less debt free with strong future growth prospects. The company caters to several different verticals which differentiates the business from other players. As per Management commentary, they have a vision of achieving 15% growth rate over the coming years and maintaining EBITDA margins in the range of 15-18%. Margin expectation is clearly a function of lot of factors like new product launches, an uptick in the value chain, de-bottlenecking, understanding the demand-supply parameters, better product mix etc. and OAL is already working towards it. Management has indicated that top 3-4 aroma chemical players in India can grow at ~20% CAGR over the next 3-4 years.

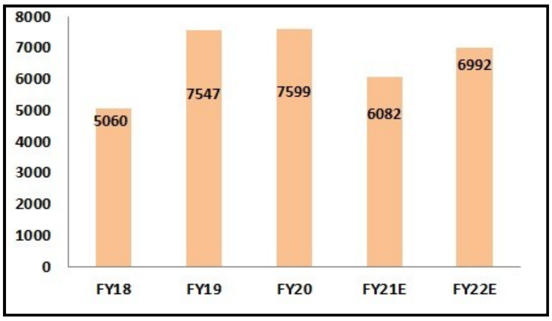
One needs to understand that the F&F business is inventory driven and many players need to keep long term inventory for long term contracts and thus sometimes many players become insulated with such long-term contracts. While at the same time, short term contracts are generally seen in the ingredients business wherein the inventory or raw materials price fluctuations essentially becomes a pass through for most of the players. The only challenge which the companies face here is at the margin level which needs to be maintained cautiously. Due to long withstanding relationships with the transporters and others, OAL is capable of sourcing approximately 70% to 75% of the inputs sustainably. In FY20 F&F, aroma chemicals and camphor and allied products constituted ~30%, ~35% and ~35% of the revenues while the company exported ~29% of its produce.

The company has a well-diversified raw material base coupled with a strong, sustainable, global de-risking RM strategy which is followed since 2015-2016 for e.g. earlier nearly more than 90-95% alpha-pinene was purchased from China, which is now reduced to mid-single digit in 2019-2020. The current processes and operations make sure that the entire juice of alpha-pinine which is imported is extracted and utilized.

Currently approximately 60% of RM is imported while the remaining 40% is procured locally. OAL has been successful in establishing a sustainable sourcing policy for raw materials with focus on geographical diversification. The company has a robust distribution network which helps deliver quality products across business verticals.

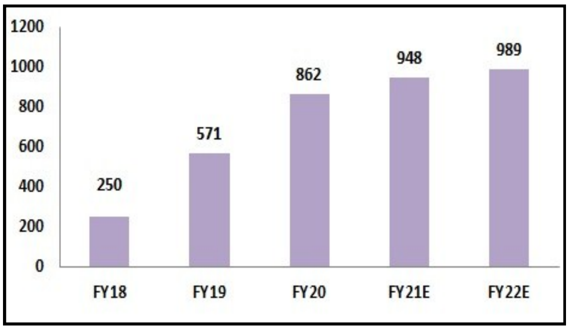
OAL is gradually reducing its debt while at the same time rewarding the shareholders and also doing a capex which only indicates the strong financial stability of the company. OAL also has a stable order book and demand continues to exist. OAL is looking at manufacturing high value, low volume products via the new MPP (multipurpose plant) as well as multipurpose products while adding new customers. EBITDA margins of the company have been improving considerably from 12.4% in FY17 to ~17% in FY20, which is due to new products launched in the aroma chemicals business and higher operational efficiencies. While the RoE and RoCE stand at ~17% and ~22%, respectively, Management expects return ratios to remain healthy at 20%+ levels over the next 2-3 years, supported by margin expansion and working capital improvement.

Exhibit 14: Sales Trend (Rs mn)



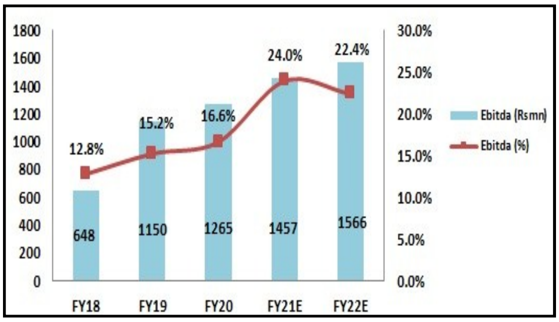
Source: Annual Reports, Progressive Research

Exhibit 15: PAT (Rs mn)



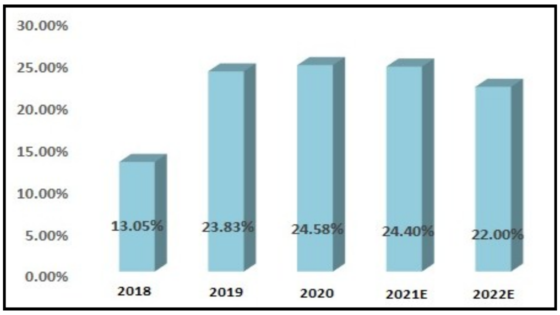
Source: Annual Reports, Progressive Research

Exhibit 16: Ebitda v/s Ebitda Margins



Source: Annual Reports, Progressive Research

Exhibit 17: ROCE Growth



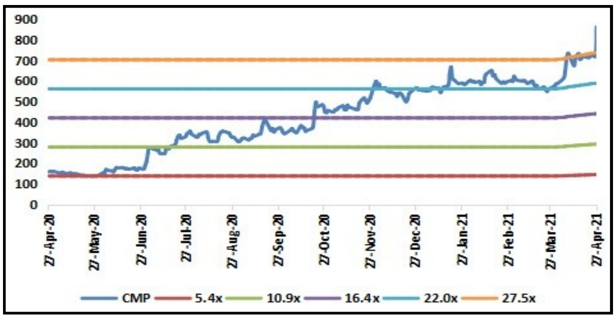
Source: Annual Reports, Progressive Research

Risks and Concerns: The company is more or less a proxy to the FMCG sector; any **slowdown in the growth rate** of the F&F industry can directly or indirectly impact the revenue as well as the profitability of the company. The F&F industry has many big and small players, thus making the same **highly competitive**. In addition to this, the industry is highly concentrated with large **MNC's dominating** majority of the market/industry. As and when these players strengthen their position in the Indian market creating dominance in niche products, maintaining the quality of output will remain the key to lucrative financial performance. In addition to this, OAL's business operations faces the risk of **high working capital requirements** along with high inventory holding period and debtor days. The camphor business has many domestic players as well as there are imports from China, and thus the company faces **intense competition** in this segment. In addition to this, the F&F segment faces intense competition from large international and domestic players. **Raw material** consumption accounts for approximately 64%-68% of the total sales, which invites **price fluctuation risks** impacting the profitability. Raw material price volatility, fluctuations to availability is a threat to the financial performance of all the players in the industry. However, many of the contracts for OAL have a clause of pass-through of prices to the customers. The company has entered into a **capex mode** (though in a phased form). With the huge capex plan coming in, the company is exposed to project execution risks and the **successful completion** of these projects in a timely manner within the budgeted cost will be something that will have to be monitored vigilantly. Moreover, the company's ability to secure **debt funding** in a timely manner will also be a crucial factor for maintaining adequate liquidity in the company. Nearly 29%-30% of the revenues are fetched from exports while at the same time the company also imports some key raw materials (for manufacturing aroma chemicals) and thus it is exposed to the risk of **foreign exchange rates** fluctuations. A large part of growth for the company comes from the customers who in turn sell FMCG products; so, the success of the business depends on the **success of the customers**. The stock is **highly illiquid** and number of shares outstanding is meager as Management holds 74.17% of the total shareholding.

Outlook and Recommendations: F&F is an integral and unavoidable part of FMCG sector and thus the industry will continue to grow. OAL has gradually evolved as an integrated F&F player (which is showing robust demand scenario) with time due to forward integration of the businesses along with strong presence in aroma chemicals market. OAL is favored with established market position in the Indian camphor and aroma chemical industry with a reputed client base and a diversified product mix. The extensive experience of the promoter's cushions the company's healthy operational performance coupled with good margins, comfortable financial risk profile and comfortable capital structure. With the help of sustainable chemistry and being environmentally compliant manufacturing company, Management of OAL is committed to be a global player in the specialty aroma chemical space with increased focus on high value and low volume products. With focus on one of its kind automated MPP in India for specialty aroma chemicals, laying more emphasis on innovation and capitalizing on enhancing the backward & forward integration, debottlenecking etc, the company aims at growing consistently via stickiness to its existing and new customers. OAL has been reporting good numbers which is a culmination of factors like hard work, tweaks in the operations, staying ahead of the curve, good raw material procurements strategies, China+1 and blue-sky strategy which has helped the company. China +1 strategy is here to stay for some more quarters and OAL is looking at a basket of 10-12 products to be launched in times to come which can add nearly Rs20-30mn each. Management intends to look at specialty chemicals going forward and will put lesser efforts on bulk chemicals. For a company which is the size of OAL, it is difficult to reach out to big players like Henkel, HUL etc., therefore the company uses the backdoor entry via ingredients business from players like IFF etc.

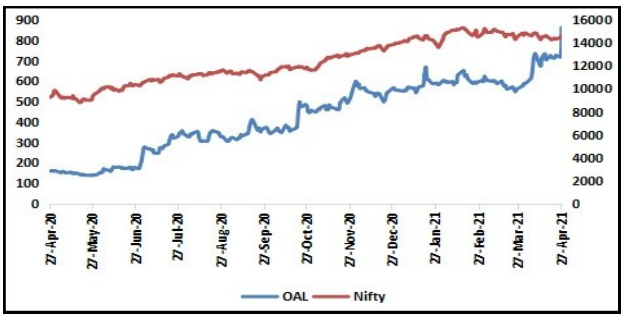
The industry currently is seeing technological augmentation by many cash rich players looking at building sustainable capacity in the aroma-based business. The scale at which the Indian players operate has a huge potential to grow. OAL aspires to develop into a global player in the specialty aroma chemicals segment. The capex of ~Rs4000-4500mn spread over FY2021-FY2024 which will majorly focus on expansion of capacities at existing Vadodara unit and setting up of new capacities at Mahad, (Maharashtra) will add-on as major triggers for growth of the top as well as the bottom-line of the company. OAL is very conservatively projecting an asset turn of 1.7x of the investment. The company clearly has a legacy of experienced Management with decades of understanding of niche F&F industry; focus on financial strengthening of the operations while trying to fetch profitable growth and return on assets with a long-term view; powered by an efficient team; expansion plan in place for the next 1000 days; aiming to further strengthening the aroma chemicals base with concentration on generic specialty aroma chemicals; increase supplies to the global giants in the F&F industry; deliver quality products at more competitive prices; value maximization via economies of scale and cash flow management. Since the company is a proxy to the FMCG sector, the same has its own pros and cons depending on the demand and supply; OAL can be a slow compounder with a long-term perspective, thus we initiate a BUY on the stock with a target of Rs1200 over a period of 12 months.

Exhibit 18: One Year Forward P/E



Source: Ace Equity, Progressive Research

Exhibit 19: Price v/s Nifty



Source: Ace Equity, Progressive Research

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