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Top Sector Ideas: Chemical

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Chemical Sector: Q2FY24 Review

Multiple Headwinds Troubling Most of the Chemical Pack; Guidance Turning Cautiously Positive!

- **Most companies missing our and street estimates:** The chemical pack for H1FY24 posted weak results overall, with most companies missing our and street estimates. The agrochemical pack continues to expect inventory destocking to continue in the coming quarters. This and weaker domestic demand in China, which is leading to higher Chinese exports at reduced prices, continue to affect realisations in some segments. High interest rates have led to inventory rationalization and global geopolitical turmoil has impacted demand in Western economies and put pressure on the export market. However, most of the companies in our coverage are confident that demand for Indian chemical companies will remain strong in the medium to long term.
- **Chemistry Plays – Fluorine Players saw low volume and weaker prices for Ref gases**, affecting margins drastically. Fluorine-based specialty chemicals continued to suffer from a slowdown in agro end-user markets and overall inventory destocking globally. Rubber Chemicals, Dyes & Pigments players were affected the most as Chinese oversupply and weak demand affected the realisation drastically. Benzene players started to see a certain amount of price recovery and expect the momentum to continue in H2FY24. Agrochemicals have reported mixed set of results with few players getting drastically affected by dry spell and irregular rainfall, impacting insecticide and herbicide sales in certain geographies
- **Outlook and Guidance:** Inventory pain from the export market may start to subdue for certain chemistries from Q3FY24 onwards. With H2FY24 being slightly better than the first half, we expect the broader demand scenario to normalize from FY25 onwards considering the current pace of recovery. Chemical players are witnessing that high-cost inventories were exhausted and stabilizing RM & operational costs will start reflecting in the financial performance moving ahead.

Chemical Sector: Q2FY24 Review

Sequential Performance Lower Than Expected

Financial Performance Chemicals

- **Dhanuka Agritech Ltd:** Dhanuka Agritech posted its strongest numbers in Q2FY24. The company beat our and industry estimates on all fronts despite the macro headwinds. Revenues from Operations stood at Rs 618 Cr in Q2FY24, up 14%/67% YoY/QoQ. EBITDA Margins elevated due to better operating performance to 23% against 18%/12% YoY/QoQ. This led to overall growth in the company's PAT which came in at Rs 102 Cr, up 39%/208% YoY/QoQ, beating our estimates by 86%.
- **PI Industries Ltd:** PI Industries' Q2FY24 numbers were largely in line with our estimates. Consolidated Revenue came in line with our estimates, up 20%/11% YoY/QoQ. EBITDA beat our estimates by 3.5% as gross margins improved by 135bps YoY on account of better mix. This resulted in an EBITDA margin of 26% v/s 24%/25% in Q2FY23/Q1FY24. The company's PAT stood at Rs 481 Cr, up 44%/23% YoY/QoQ, beating our estimate by 11.5% on account of lower tax expenses.
- **Navin Fluorine International Ltd:** NFIL numbers for Q2FY24 missed our estimates on all fronts as HPP and the shutdown of the specialty chemical plant affected production. The company reported revenue of 472 Cr against our estimate of 520 Cr and was up 12.5%/-3.9% YoY/QoQ. EBITDA halved from the last quarter due to negative operating leverage (up 4.8% but down 13.9% QoQ). EBITDA Margin fell to 20.84% (from 23%/22% in Q1FY24/Q2FY23). The company's PAT stood at Rs 61Cr, up 4.8%/(1.5)% YoY/QoQ, led by higher depreciation and interest expense from the recent Capex.

Financial Performance Chemicals

- **Camlin Fine Science Ltd:** Consolidated revenue was up 2.2% from our estimates (down 16%/3.3% YoY/QoQ). EBITDA declined significantly by 35% QoQ and missed our estimate by 46.5%. EBITDA Margin declined to 6.2% (from 11.4%/9.2% in Q2FY23/Q1FY24). The company's PAT stood at Rs (20.8) Cr due to lacklustre overall performance. CFS numbers for Q2FY24 were a major miss (except revenue) with our estimates on an adjusted basis (forex).
- **Aarti Industries Ltd:** Consolidated revenue beat our estimates by 6% (-14%/3% YoY/QoQ). EBITDA stood higher QoQ (-12%/16% YoY/QoQ) on account of volume expansion with stable-to-better realization for some products. It also beat our estimates by 33% as we expected lower gross margins. EBITDA margins increased to 16.1%, up 24/180bps YoY/QoQ. The company's PAT stood at Rs 91 Cr, posting growth of -26%/30% YoY/QoQ.
- **Apcotex Industries Ltd:** Falling prices and lower realizations continued to affect the numbers. However, volumes have increased. Consolidated Revenue was down 1.4% YoY but up 0.5% QoQ. EBITDA beat our estimate, up 33% YoY as gross margins hardened in the current quarter. The company's PAT declined by 50% YoY but was up 26% QoQ due to higher depreciation and interest expense of newly incurred capital expenditures.
- **NOCIL Ltd:** NOCIL's Q2FY24 topline declined with our expectations but there was a beat on gross margins which were higher by 218bps. Consolidated Revenue missed our estimates by 9% (down 10% YoY and 12% QoQ). EBITDA also shrunk by 18% QoQ on account of lower realisation and missed our estimate by 6%. EBITDA Margin came in at 12.9% (from 16%/14% in Q2FY23/Q1FY24). Its PAT stood at Rs 27 Cr, reporting a de-growth of 24% YoY and 21% QoQ.

Chemical Sector: Outlook

Most Chemical companies expect situation to improve from H2FY24 onward as inventory levels normalize from FY25

FY23 has been a tough period for entire most of the chemical space with multiple headwinds resulting into excess supply and bleak demand marked by several external issues, but the structural story of Indian Chemical industry remains strong with strategic portfolio composition to gain export market share, and strong domestic demand we expect revenue growth to gain momentum from FY25 onward. Given the changing landscape and growing reliance on India by international customers, we expect rapid growth in this sector over the coming period as conditions stabilize.

- **Agrochemicals**: The short-term outlook is weak as sluggish demand in the B2B sector, as distributors are preferring to keep a low inventory because of volatile international commodity prices and higher interest rates. However, the consumption of crop protection products in the key markets of North America and Latin America is robust, thereby indicating good health of the industry in the medium to long term.
- **Chemicals** companies to continue their focus on growth with their strong financial framework, including management of working capital and cash flows. Intensified focus on enhancing customer interactions and forging stronger partnerships: These initiatives are expected to yield positive results. Robust and Diverse business pipeline to drive sustainable growth and success in future. Witnessing gradual demand recovery QoQ. It will take a few more quarters for normalized demand across various end segments/product lines. Green shoots are visible in select sectors like dyes/pigments, polymers, etc., but discretionary demand pick-up may take a few quarters; broad-based recovery is expected in FY25. B2C agri demand has been healthy, but B2B demand recovery is weak on EL Nino conditions and erratic rains, which may impact the rabi season as well

Short and Medium-term Outlook

Short term

Margins to stay under pressure

Export slowdown continues as demand remains subdued

Aggressive dumping from China will impact sales volumes and realization

Demand-supply mismatch

Few Product-specific Chemicals will take a few more quarters to normalize.

Medium to Long Term

China/Euro +1 Outlook

Introduction of new products with further integration in product lines

Strategic Capex into new Chemistries

Efficient Inventory Management, and operational performance to survive the down phase

Strong Domestic Demand

Key Monitorables- Weak Demand/Over-Supply Scenario; Impact of high Capex Plans; New Products in Pipeline; Demand Trends across Key End-user Industries

Top sector Ideas: Chemical

Stock	Reco.	TP*	Recommendation Rationale
Navin Fluorine International Ltd	BUY	Rs 3,880	✓ In Q2FY24, the R32 plant faced stabilization issues. As a result, NFIL expects to sell 50% of volumes in the domestic market and remain in the export markets. The firm has initiated negotiations with two potential customers and expects at least one of them to lock up volumes by the next quarter. In the export market, demand for R-22 emissive applications is expected to pick up in CY24. ✓ NFIL witnessed a halt due to a stabilization issue at the HPP plant and the company has resolved the issue with the help of a partner and expects higher turnover in the coming quarters. NFIL is also in discussion with Honeywell for improving productivity and reliability of the plant. A possible expansion of HFO capacity might be on cards. ✓ NFIL's dedicated plant for Agrochemical Intermediate is running at full capacity and the company expects the MPP plant to achieve full capacity in the next year. Dedicated Agri-chem plant to contribute from FY25 onwards, with 50% of its capacity already booked. Newer molecules are seeing good traction in demand.

** Note: Target Price is based on our Q2FY24 Result Update Report*

Top sector Ideas: Chemical

Stock	Reco.	TP*	Recommendation Rationale
PI Industries Ltd	BUY	Rs 4,090	✓ PI has a robust pipeline of biological and bio-stimulant products at various stages of development. It is working to develop new technologies and building blocks for future growth. Discussions on the development partnership of promising R&D leaders are ongoing with global innovators with ongoing discussions across multiple strategic areas for organic growth. ✓ It is witnessing continued scale-up in demand of the existing and newly commercialised products and has a solid R&D pipeline of a diversified portfolio. Capacity expansion is going in accordance with the plan. The momentum of new enquiries and conversion is expected to remain high. PI plans to launch 4-5 new molecules every year which will have better margins than the traditional portfolio. ✓ **Pharma Business:** The Management aims to increase the revenue from the Pharma segment in H2FY24 and stated that margins would be positive. The company considers it possible to achieve a margin of 15% in the short term and targets margins to remain at +20% once the integration is complete. PI is also open to further inorganic growth opportunities in the segment.

** Note: Target Price is based on our Q2FY24 Result Update Report*

Top sector Ideas: Chemical

Stock	Reco.	TP*	Recommendation Rationale
Dhanuka Agritech Ltd	BUY	Rs 960	✓ During the quarter, Dhanuka commissioned its greenfield Dahej plant which started contributing from Q3FY24E. The company is currently negotiating with multinational enterprises and some of its existing partners for the new facility, but so far, no agreements have been concluded. ✓ The volumes have increased due to Dhanuka's low inventory channels and a growing contribution from newly launched products. Its ITI has been at an all time high. The management remains confident about its forecast of double-digit revenue growth and Gross margin-led EBITDA expansion. ✓ The management believes that the ITI number to cross about 20% in H2FY24 and much higher in FY25. Gross Margins remain higher given the higher ITI, favourable product mix, and easing out impact of the high-cost inventory.

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