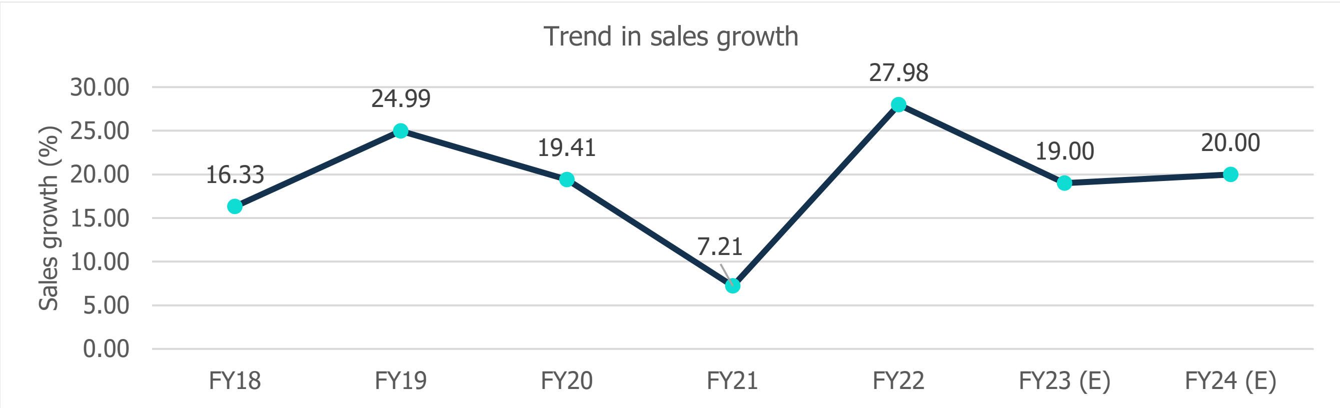
Speciality Chemicals: Growth Set to Continue Despite Margin Blip

March 02, 2023 | Ratings

Synopsis

- The Indian speciality chemicals sector has experienced significant growth, expanding by more than 17% in the last two fiscal years, ending FY22. According to CareEdge Ratings, this growth is expected to continue, with sales projected to increase by more than 19% until FY25. This growth is primarily driven by strong domestic demand and increased demand for exports, which has been bolstered by major global economies adopting the China +1 policy.
- The operating profitability margins of this sector saw significant improvements in FY21 and FY22, largely due to supply chain disruptions caused by the spread of Covid-pandemic. However, these margins have moderated in 9MFY23. CareEdge Ratings predicts that there may be some pressure on operating profitability in the near future due to the recessionary conditions in major global economies. Despite this, the operating profitability margins are expected to remain healthy, hovering around 18%.
- All sub-segments of the speciality chemicals sector have undertaken significant capex in the past three fiscal years, ended FY22, and a similar size of capex is currently underway and expected to be completed by the end of FY24. The next phase of growth is expected to occur post-completion and stabilization of this capex.
- Despite the large size of capex, the capital structure of the majority of sub-segments in the speciality chemicals sector remains comfortable. This is due to healthy internal accruals, which are expected to enable them to pursue substantial capex in the future.

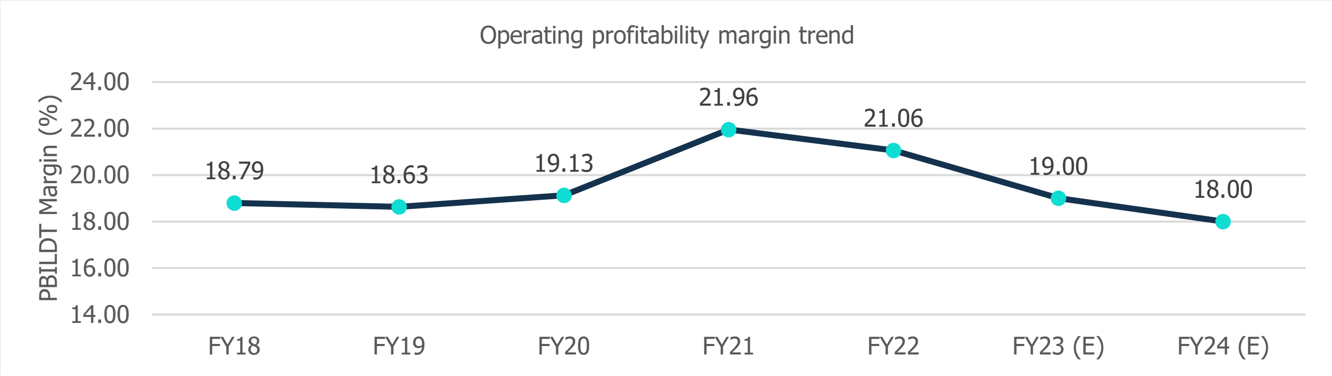
Healthy sales growth to sustain



Source: CareEdge Ratings, Annual reports of top 36 listed companies in the speciality chemical sector

The speciality chemicals sector began gaining traction even before FY18, and while sales growth was only marginally impacted in FY20 due to Covid-related disruptions in the latter part of the year, it was substantially affected in FY21 due to the outbreak of Covid. However, sales growth in FY22 was abnormally high due to pent-up demand and the low base of FY21. Looking ahead, we anticipate sales growth of nearly 20% to continue in FY23 and FY24, driven by both volume and value growth due to robust domestic demand and exports, thanks to the China + 1 policy adopted by major global economies. The major sub-segments of the speciality chemicals sector that contribute to this sales growth are fluorochemicals, amines, agrochemicals, pigments, surfactants, and fragrances.

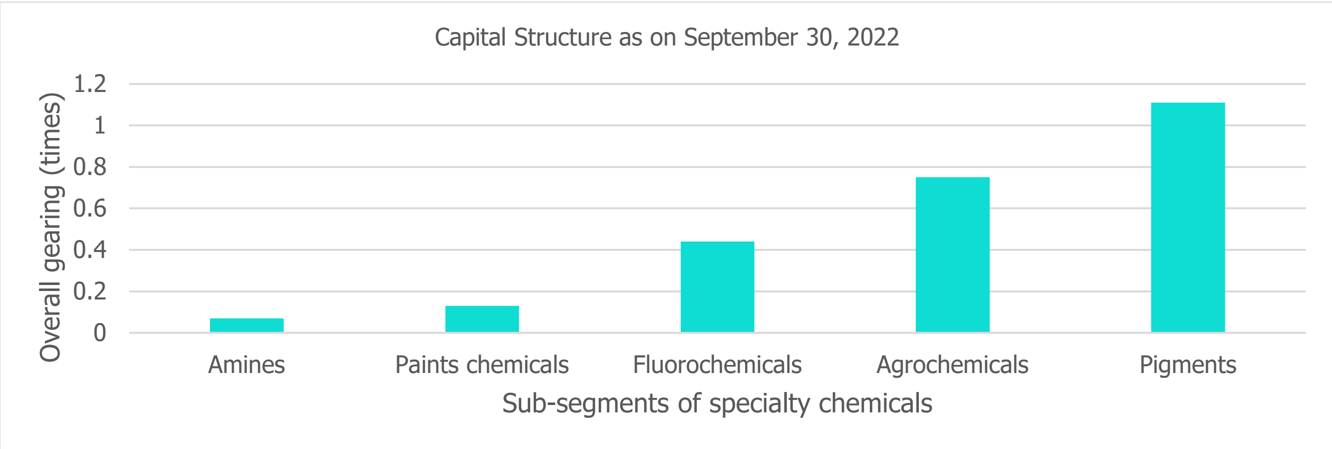
Operating profitability to remain healthy even after some dip in near term



Source: CareEdge Ratings, Annual reports of top 36 listed companies in the speciality chemical sector

The operating profitability margin for specialty chemical companies remained healthy at around 18% to 19%. It increased in FY21 and FY22 due to supply chain disruptions caused by Covid, which restricted imports and lowered raw material prices. However, with the normalization of supply chains, reduction in freight costs, and higher raw material prices, margins are expected to return to their earlier levels in the short to medium term. Operating profitability margins for fluorochemicals, amines, and agrochemicals remained strong even in 9MFY23 despite cost pressures, while margins for paint-related chemicals and pigments were impacted due to a slowdown in paint demand and the imposition of anti-dumping duty by China on imported pigments, respectively.

Comfortable capital structure for majority sub-segments of speciality chemicals



Source: CareEdge Ratings, published results of top 36 listed companies in the speciality chemical sector

The capital structure of the majority of sub-segments in the speciality chemicals sector remains comfortable. The capital structure of amines is extremely comfortable due to its high operating profitability, leading to healthy net worth accumulation. The capital structure of paint-related chemicals is equally comfortable, as it is a relatively small segment with no major capex undertaken in recent years. The capital structure of fluorochemicals remains comfortable despite undertaking nearly Rs.10,000 crore capex in the last three years ended FY22. Agrochemicals, one of the major sub-segments of the speciality chemicals sector, is highly capital-intensive, resulting in moderate leverage. However, the overall gearing of pigments is high due to the large capex undertaken in recent years, while the operating profitability was impacted in FY22 and 9MFY23.

CareEdge Ratings' View

"Despite the significant expected growth in the coming years, India's share in the global speciality chemical sector is only expected to increase from less than 3% in 2015 to around 6% by 2025, indicating significant long-term growth potential. Demand growth is expected to be driven by import substitution and increased export demand due to the China + 1 policy adopted by global economies. Operating profitability margins for the speciality chemicals sector have been consistently high and further improved in FY21 and FY22 due to supply chain disruptions.

However, normalization of supply chains, increased raw material costs, and reduced freight costs may result in margins returning to previous levels in the short to medium term. Indian companies in the speciality chemicals sector have completed significant capex in recent years and have ongoing capex for the next two to three years, with strong balance sheets expected to allow for even higher capex going forward. While a slowdown in demand from foreign countries due to near-term recessionary conditions in major global economies could temporarily pressure profitability margins, the sector is well-positioned for decent double-digit growth until FY30," said Hardik Shah, Director at CareEdge Ratings.

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