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Dyes and Pigments Sector: Overview

The purpose of this paper is to provide an overview of the listed companies in the Dyes and Pigments sector, their performance over time, and different approaches to value creation adopted by each of the key players in their respective segments.

This sector comprises companies engaged in the manufacturing of

1. **Bulk chemicals** - which are also known as upstream or basic chemicals. They are essentially like commodities with little or no differentiation in the products manufactured by different entities. Hence, customers often purchase from suppliers with the lowest cost. These are low-margin products with little or no pricing power for the producers. Companies with large production capacity and better economies of scale typically would perform better in this segment.
2. **Specialty chemicals**- these are niche chemical products manufactured through specialized processes. Companies develop speciality chemicals through investment in Research & Development (R&D). Downstream usage of specialty chemicals entails several quality control checks and approvals on the part of the customers. Since these are tailored to meet certain specific requirements, customers don't change the suppliers too often to maintain high-quality standards for their products. Hence, companies in this segment enjoy long-standing relationships with their customers and are also able to pass on some of the price hikes to their customers.

However, it is to be noted that chemicals that are classified as specialty chemicals during the initial phase of their development and sale, may later become a commodity/bulk chemical as more players start manufacturing the same product. Hence, the classification of a product into specialty and bulk chemicals may change during the various stages of a product life cycle.

There are 30+ listed companies in the Dyes and Pigment sector in India. The total market capitalization of all listed entities put together is ~INR 37k crores whereas total sales of all listed entities for FY23 was ~INR 15k crores. Atul Limited leads the pack with a market capitalisation of INR 21,158 crores and sales of INR 5133 crores (~1/3rd of the total sales of all companies put together).

Below is a summary of the product portfolio and growth strategy of the top 15 companies in the segment.

Company	Product portfolio	Growth strategy
Atul	Lifescience chemicals, evolution over time to transform from a bulk chemicals producer to specialty chemicals and expansion of product portfolio in the area of crop protection, polymers, and pharma intermediaries. It has created 140 brands	Investment of INR 1900 crores in capacity expansion, growth by expanding product portfolio, Growth by geographical expansion- currently 50% sales - domestic, 50%- exports.
Sudarshan Chem.	Product mix comprises: Speciality -69%, non-specialty-31%, development of new pigments with downstream usage in coatings, plastics, cosmetics, ink	Expansion of manufacturing capacity- INR 750 crore investment, growth by deepening geographical presence.
Vidhi Specialty	Synthetic and food grade colors- Asia's second-largest manufacturer with a diverse clientele in various sectors such as beverages, confectionary, pet foods, cosmetics, inkjet inks, home care, etc.	Growth through geographical expansion -66% exports, 34% domestic. Capex of INR 60 crores incurred for capacity expansion
Sadhana Nitro	Producer of chemical intermediaries	Growth through geographical expansion: sales mix has 60% -exports, 40%- domestic. The strategy is to create backward integration to expand the product portfolio. The company has also acquired Spidigo and diversified to the Wi-Fi business
Kiri Industries	Dyes, Dye intermediaries, and basic chemicals	Inorganic growth strategy through the acquisition of
Ultramarine Pig.	Pigments-32%, surfactants-66%, detergent manufacturing, BPO-9%. capacity expansion- 80 cr.	The company has followed a strategy of focusing on a single product: Ultramarine Blue. Growth through capacity expansion and increase in exports
Bodal Chemicals	Dyes, Dye intermediaries, and basic chemicals	INR 400 crore capex for Benzene downstream specialty product, INR 152 cr- Siel Chemical complex, caustic soda plant- capacity expansion
Bhageria Indust.	Dyes, Dye intermediaries, and solar power generation	Diversification to Solar Power Generation business
Sh.Pushkar Chem.	Chemcials, dyes & dye intermediaries- 45%,Fertilisers -47%, cattle feeds-8%.	Capacity expansion
Dynemic Products	Food color-81%, dye intermediaries- 14%, Others-5%. One of the world's largest manufacturers.	

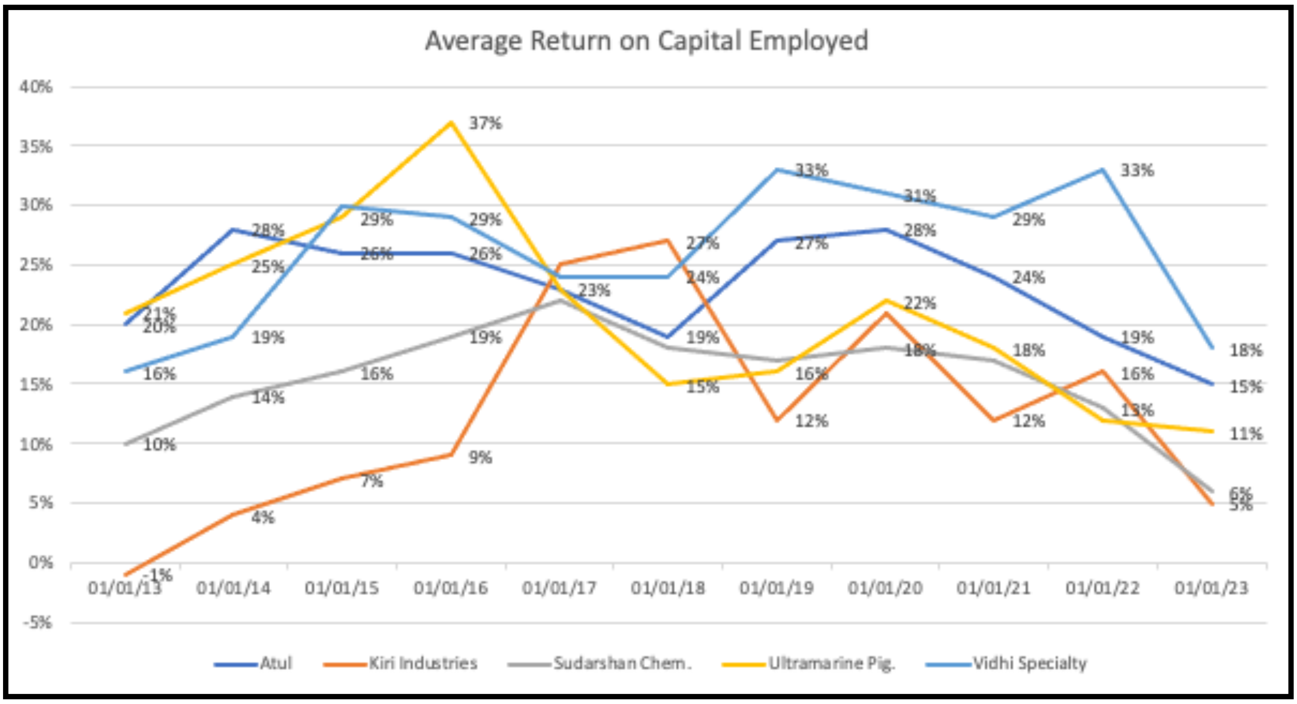
Poddar Pigments	Masterbatches- used to impart colour to polymers and textiles
Amal	Sold by Piramal to Atul. Backward integration for Atul, bulk chemicals
Indian Toners	Toners for photocopiers, laser printers, digital machines, and multifunction printers, and caters to the replacement market, under the Supremo brand.
Asahi Songwon	The product portfolio includes CPC Blue Crude, Pigment Alfa Blue 15:0 and 15:1, Pigment Beta Blue 15:3 &15.4 which serves Industries like Ink, Coating and paints, Plastic Textiles, Rubber, Paper and Pharmaceuticals. Long-standing relations with clients

Some of the top players in the market with a market capitalization of >INR 1000 crores are as below:

Name	BSE Code	Current Price	Market Capitalization
Atul	500027	7,169	21,158
Sudarshan Chem.	506655	471	3,258
Vidhi Specialty	531717	422	2,106
Sadhana Nitro	506642	81	1,933
Kiri Industries	532967	272	1,408
Ultramarine Pig.	506685	405	1,181

Average returns during different stages of the life cycle

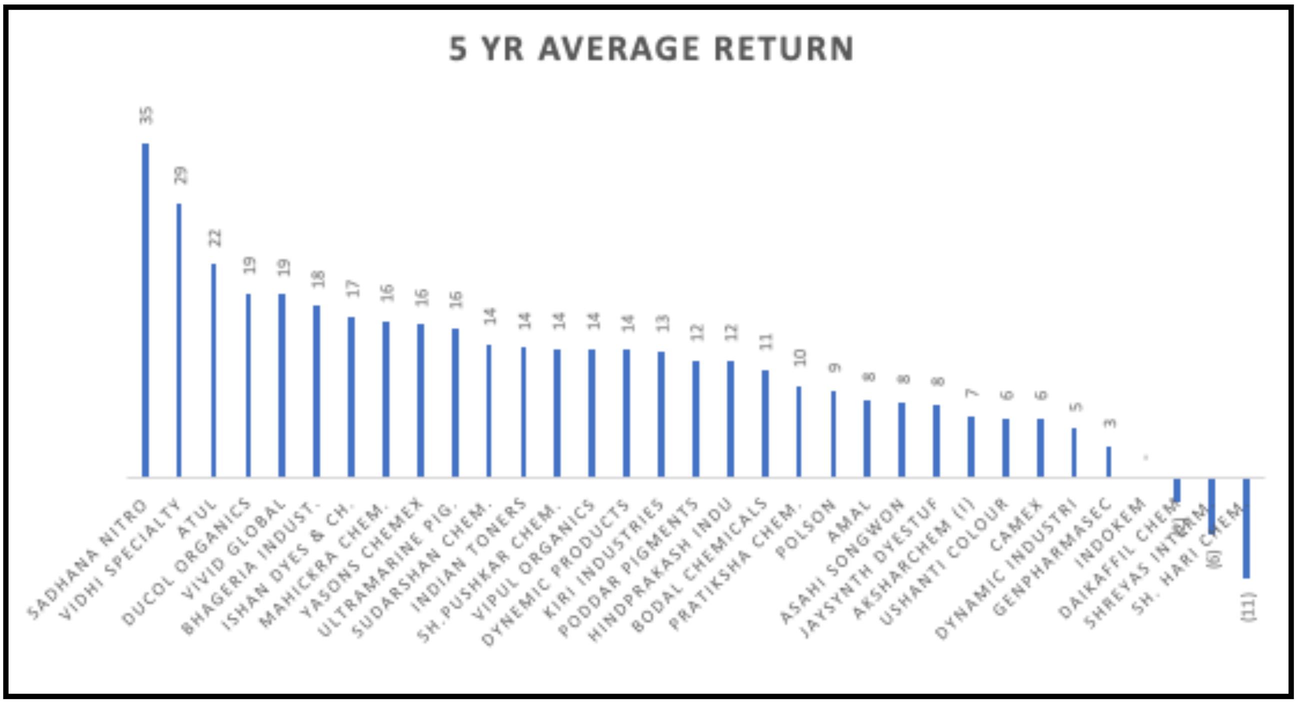
The average Return on Capital Employed (ROCE) for the select top companies is as below:



As we see in the chart above, all the top companies are currently experiencing a downward trend in terms of ROCE. While most companies experienced the high-returns phase during the 2013 to 2017 period, the returns are slowly tapering off and reducing to lifetime lows in certain cases. In terms of stability of returns, Atul Ltd. has experienced the most stable returns whereas Kiri Industries has experienced the highest volatility of annual returns during the trailing 10-year period.

Company Name	Std deviation of 10 yr returns
Atul	4.4%
Kiri Industries	9.0%
Sudarshan Chem.	4.5%
Ultramarine Pig.	7.7%
Vidhi Specialty	6.1%

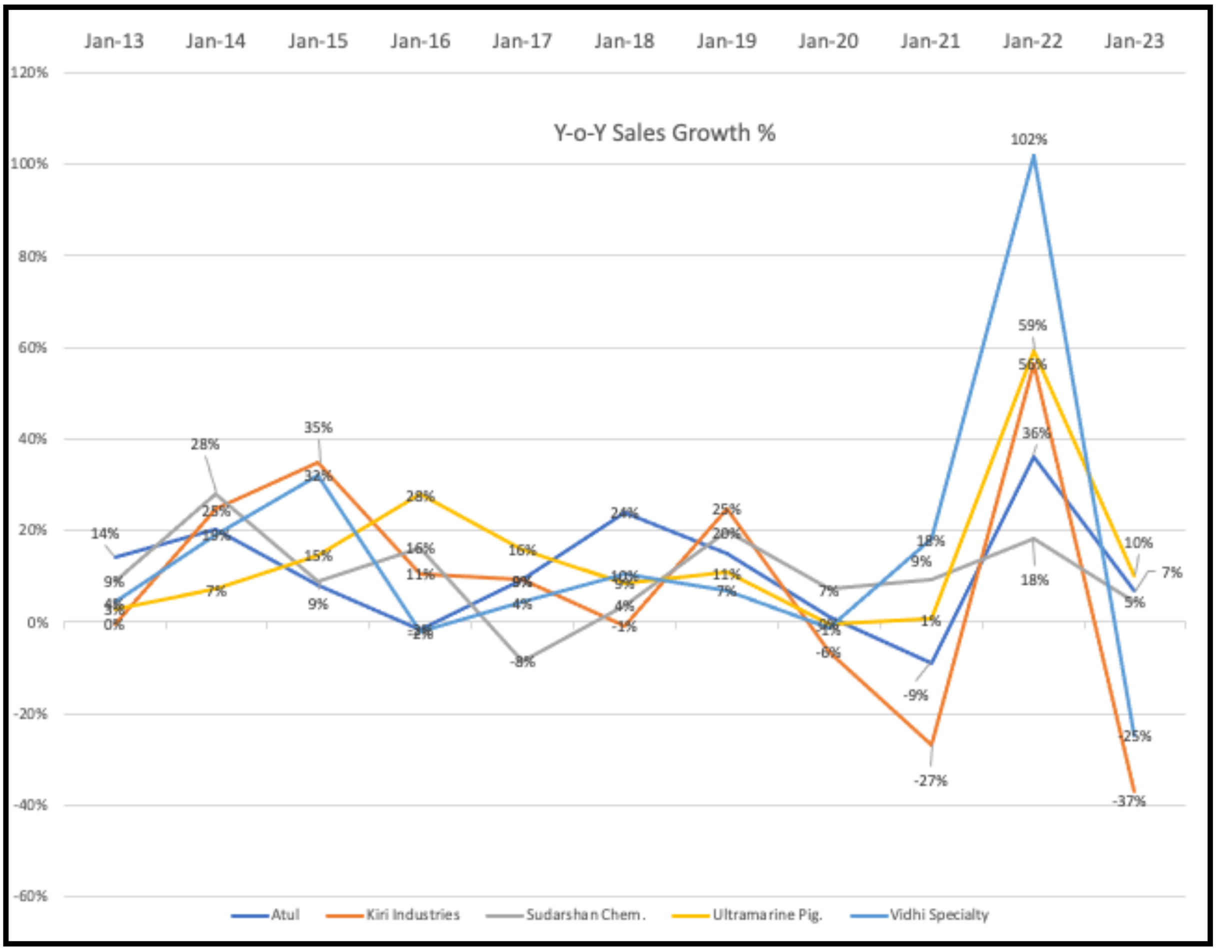
Barring a few, most of the entities have successfully created value by generating positive returns on the capital invested. The top 3 companies have a 5-year average return greater than 20% whereas the next 6 entities generate between 15-20% returns. The remaining companies have ROCE < 15%.



Hence, the segment offers a significant opportunity for value creation to the incumbents. This might be viewed as a potential opportunity by new participants aspiring to enter and explore the market. While each player has at some point in the life cycle enjoyed peak returns, none of them have been able to successfully sustain abnormal returns over a very long period. A detailed study of the competitive landscape can throw more light on the reasons for the lack of sustainability in returns.

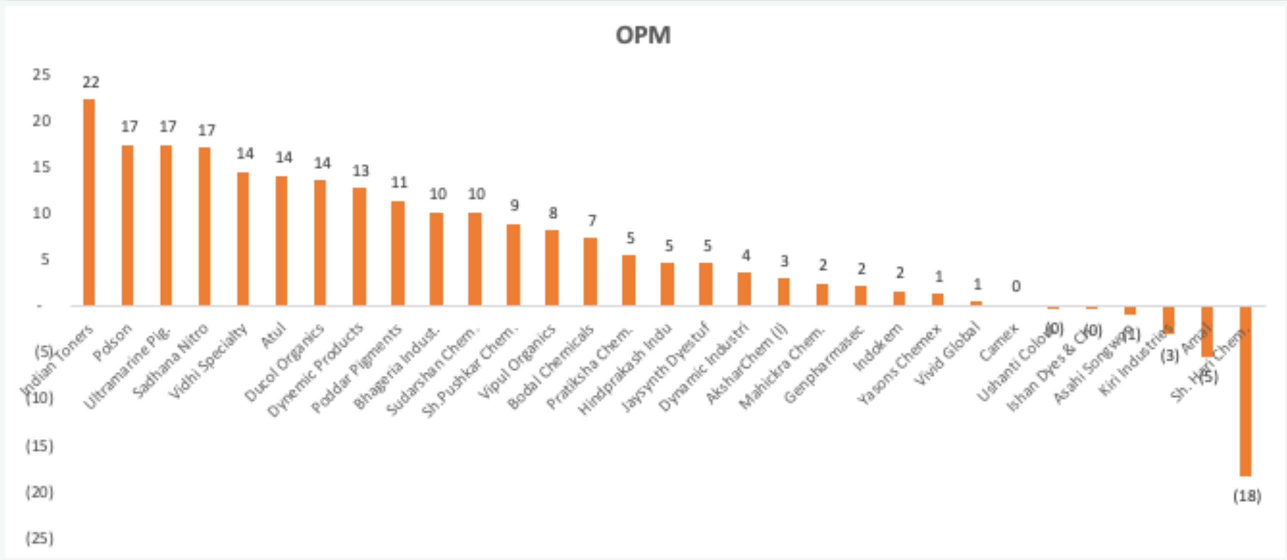
Y-o-Y Sales Growth Trend

Several Indian companies experienced unprecedented growth last year owing to a lack of imports from China, which is amongst the largest producers in the world. However, in FY24, revenue seems to be normalizing back to its original levels. Encouraged by high demand last year, several companies have embarked upon increasing their production capacities. It would be interesting to see how this additional production will be absorbed by the domestic and foreign markets in the coming period.



Operating Margins (%)

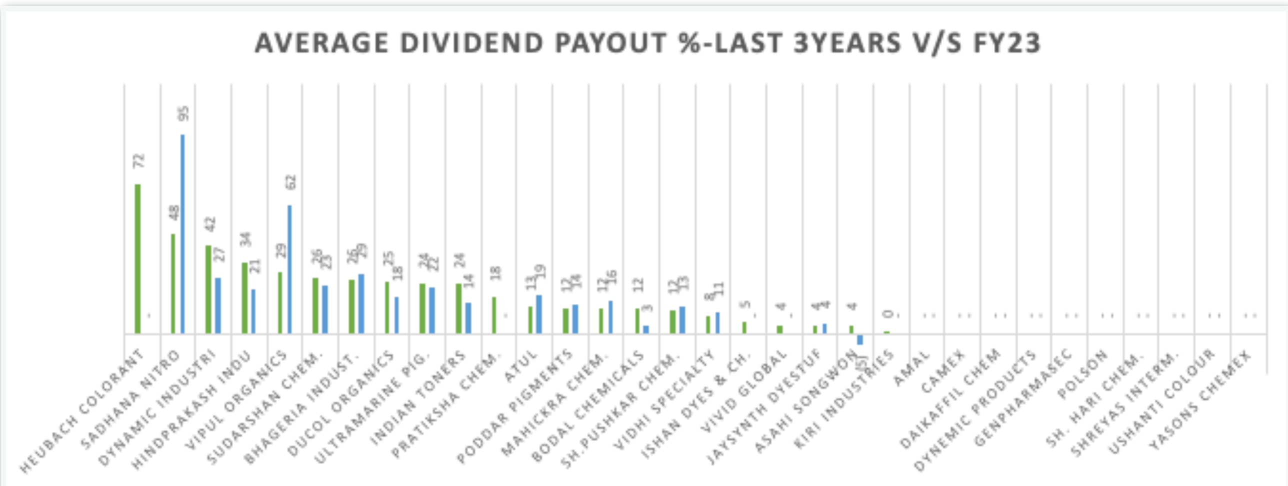
Below is a snapshot of FY23 Operating Margins for the various companies in the segment
Source: www.screener.in



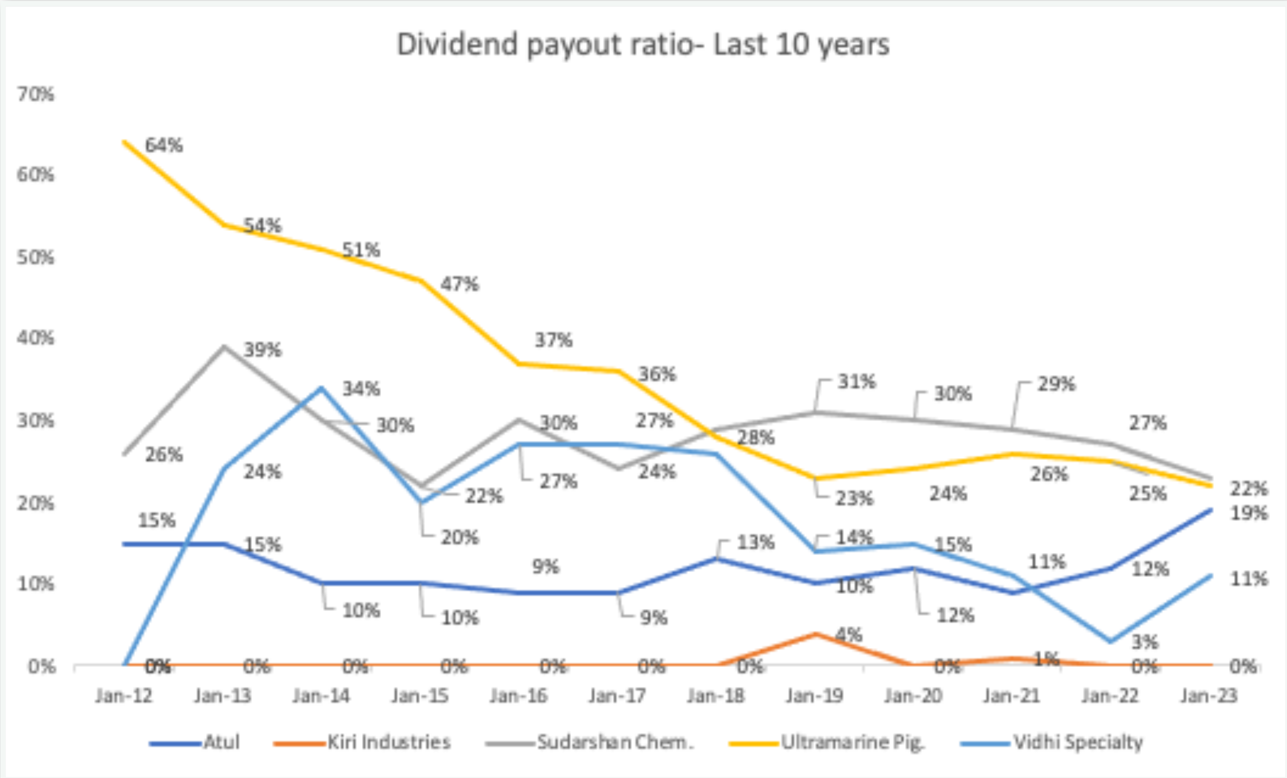
Indian Toners is a niche player in the segment, manufacturing toners for photocopiers, laser printers, digital machines, and multifunction printers, and caters to the replacement market, under the Supremo brand. It enjoys 18-22% Operating Margins owing to its unique products and brand value. Polson Ltd is a leading exporter of Tannin extracts and eco-friendly leather chemicals and earns OPM in the range of 15-17%. Companies with a specialty chemical-heavy portfolio such as Ultramarine Pigments, Vidhi Speciality, and Atul Limited enjoy higher Operating Margins whereas bulk chemical manufacturers have OPM in the range of 10-15% or even lower.

Dividend Payout Ratio

There are significant variations in the average dividend payout ratio across companies and years. Almost 1/3rd of the total # of companies in the sector have had close to zero dividend payout ratio in the last three years.

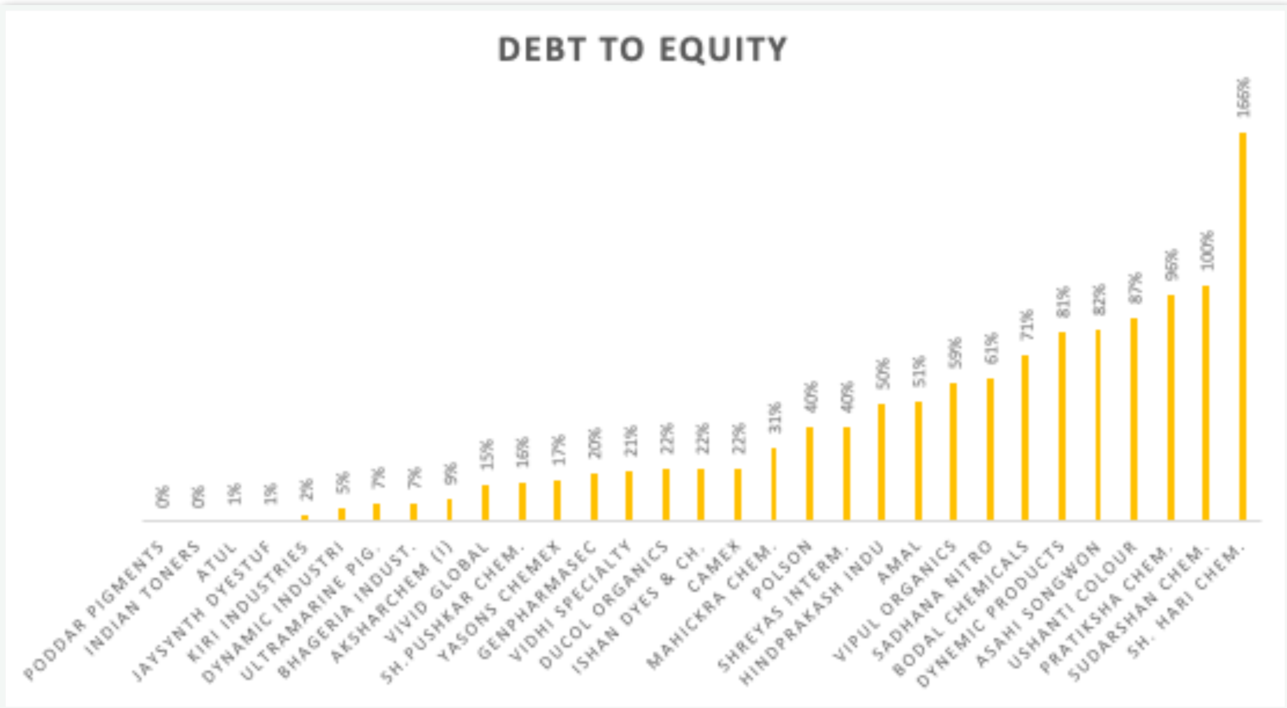


Despite record-high earnings in recent years, the dividend payout ratio has not increased significantly for the top companies. Kiri Industries has paid negligible dividends despite repeated profits. The company is sitting on an idle cash balance of INR 98 crores as of the end of FY23 against equity capital of INR 51 crores. For Ultramarine Pigments, the dividend payout ratio has been stable at ~22% in the past few years.



Debt to Equity

Barring a few companies, most of the players are operating at low leverage, using internal accruals to incur capex.



Key Takeaways

- Most of the leading companies in the sector are experiencing slower growth and downward trending returns on capital. Growth is primarily driven by geographical expansion and product innovation/differentiation.
- Companies with niche products (e.g. Indian Toners, Polson Ltd) and those into specialty chemicals (e.g. Ultramarine Pigments, Atul Ltd.) enjoy comparatively higher operating margins (~ in the range of 15-22%) and stable financial position/growth rates as compared to their peers selling bulk chemicals.
- There are very few companies with consistently stable dividend payouts in the sector. Almost 1/3rd of the companies use all their internal accruals to fund growth, thereby, providing negligible dividends to the shareholders.
- Given the unprecedented growth witnessed by the sector in FY23, several companies have planned capital expenditure for capacity expansion. If met by adequate demand, it can lead to a revival in growth rates/ ROCE for the companies.