Tata Chemicals

Industry	CMP	Recommendation	Buying Range	Target	Time Horizon
Chemicals	Rs. 605	BUY at CMP and add on Declines	Rs. 550-605	Rs. 780	12 Months

HDFC Scrip Code	TATCHE
BSE Code	500770
NSE Code	TATACHEM
Bloomberg	TTCH
CMP as on 30 Jun - 17	332
Equity Capital (Rs Cr)	254.8
Face Value (Rs)	10
Equity O/S (Cr)	25.48
Market Cap (Rs cr)	15422
Book Value (Rs)	311
Avg. 52 Week Volumes	199013
52 Week High	665
52 Week Low	425

Shareholding Pattern (%)	
Promoters	30.98
Institutions	42.80
Non Institutions	26.22

PCG Risk Rating*	Yellow

* Refer to Rating explanation

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Company Profile

Incorporated in 1939, Tata Chemicals operates principally in industrial, agricultural and consumer chemicals. The company is the world's second-largest manufacturer of soda ash with annual production capacity in excess of 4.3mn MT spread across four continents (~6% global capacity share – ~70% capacity based on natural soda ash). The Company is a manufacturer of soda ash and sodium bicarbonate for diverse industries, such as glass, detergents, silicates, textiles, food, pharmaceuticals, animal feed, mining and chemical processing. More than 60% of Tata Chemicals' soda ash capacity is based on low-cost natural sources, giving the company a sustainable competitive advantage relative to synthetic soda ash manufacturers. In addition, the company is also an important player in India's agricultural inputs industry by virtue of its production of fertilizers as well as its majority ownership stake in Rallis India, which manufactures agrochemicals and seeds. Tata Chemicals is the market leader (~61% share) in India's branded salt segment. The Company operates through four segments: Inorganic Chemicals, which includes soda ash, salt, sodium bicarbonate, marine chemicals, caustic soda and cement; Fertilisers, which includes fertilizers and other traded products; Other Agri-Inputs, including Rallis India operations, and others, which includes pulses, spices, water purifier and nutritional solutions.

Investment Rationale

The divestment of the Urea Business by Tata Chemicals to Yara Fertilisers India for Rs. 2670cr will strengthen its Balance Sheet and will help to pursue growth potentials and opportunities in line with its strategic directions.

Its Europe business has witnessed turnaround in FY17 and posted ~Rs 100cr PAT. The operating performance has seen improvement due to lower fixed costs in Europe, absence of gas hedge losses and refinance costs. The deal has helped in retiring part of its net debt, which amounted to ~Rs.7900cr as on March 2016 to Rs 5500cr as on Mar 2017.

Tata Chemicals' subsidiary Rallis continues to post higher operating profits on account of improved operating margins. Management's outlook is optimistic led by above normal monsoon forecast in Kharif and expected recovery in global agrochem demand. Margin expansion in seed business and enhanced capacity utilisation at Dahej will spur growth.

Company is likely to witness increase in sales mainly in Soda ash and Bicarbonate with better margins due to lower fuel cost. Company will continue to focus on expanding its portfolio of value added offerings for high-end applications.

Tata Chemicals sells products including Pulses, Salt and Besan - has launched a new umbrella brand 'Sampann' for its foods portfolio which aims to out space market growth and would contribute significantly in the next five years by entering new product categories. The company also announced the launch of Tata Sampann Spices (75% of the spices market is unbranded, but the branded segment is growing at a 26% Cagr in terms of value). More than 90% market remains unorganized in Pulses and Spices, as consumer business (B2C) it has higher margins in comparison with other segments. In FY16, consumer was at ~11%. The contribution (FY17) of ~13% would increase to ~21% in FY19 which would help drive in profitability.

Consumer business is coming in limelight as it is growing rapidly. Revenue from branded salt (Tata Salt + iShakti) had grown 17% in FY16 and continues to almost double every five years. Sales volumes of branded salt grew 9%, and its market share in India's overall salt market increased by 230 bps to 24.7% (~61% in the national branded market).

Sales of Tata Sampann pulses and Besan grew 72% to Rs 410cr in FY16, and their distribution reach increased 34% to 1,22,000 outlets. As stated in its FY16 annual report, the company aims to reach 1 bn consumers by 2020 from 650 million currently. It also plans to increase its distribution reach to ~2.5 mn retail outlets by 2020 from ~1.7mn outlets currently.

Tata Kisan Sansar (TKS) is a dedicated franchisee retail network model for distribution of agri inputs which provides a trustworthy, "One-stop agri inputs and services" offering to farmers. TKS has 800+centres in 20000+ villages serving ~1.5mn farmers. Its rural reach (including that of Rallis) is unparalleled and may be used in future to exploit opportunities in rural / semi urban areas.

View & Valuations

We expect Tata Chemicals to post 8.3% revenue cagr along with 130bps margin expansion over FY17-19E. Consumer Business (incl. Agri Inputs) and Inorganic chemicals would drive revenues for the company. As Consumer Business revenue contribution would rise it would lead to margin expansion for the company. Overall Debt has been reduced by ~Rs 3000cr on the back of sale of Urea Business. Company has continuously maintained dividend payout 25-30% over the past few years and we expect the trend to continue for the next two-three years. In FY17, company has declared Rs 11 per share as dividend and record date has been fixed Jul 31 - 2017. Currently, Tata Chemicals trades at ~6.5x FY19E EV/EBITDA, we expect multiple to rerate further, based upon ~9x EV/EBITDA, we arrive to target price of Rs 780. We recommend investors' to BUY Tata Chemicals at CMP of Rs 605 and add on dips to Rs 550 with TP of Rs 780 over the next 12 months.

Tata Chemicals has sold off urea business to Yara for Rs 2,670 cr

Tata Chemicals has agreed to sell its urea plant in Babrala, Uttar Pradesh, to the Indian unit of Norway-based Yara International ASA for Rs 2,670cr, as it seeks to position itself as a maker of consumer products rather than fertilizers.

The transaction, the first cross-border deal in the fertilizer industry, doesn't include specialty products and complex fertilizers. Tata Chemicals will continue to own the brands Paras, TKS and Daksha.

This marks a decisive move on the part of the company to move forward on its strategy to build consumer business, while maintaining leadership in inorganic chemicals business and focusing on the farm business through its subsidiary Rallis India and Metahelix Life Sciences.

Tata Chemicals, the maker of Tata Salt, has been trying to exit the fertilizer business for at least two years as part of that strategy, aimed at moving away from segment driven by government regulation.

Tata Chemicals will reinvest proceeds from the sale of the Babrala plant in the consumer and inorganic chemicals business. Management said that there are exciting growth plans for speciality chemical business and consumer business. Company will continue to invest in these businesses. This deal will bring a lot more focus on these two verticals.

Tata Chemicals entered the spices market last year with an initial roll-out in Punjab and other parts of north India. It is evaluating diversifying into staples such as rice and atta and value-added products.

The divestment of the urea business by Tata Chemicals will unlock value for the company, strengthen its balance sheet and help it pursue growth in line with its strategy. The deal has helped in retiring part of its net debt, which amounted to ~Rs.7900cr as on March 2016 to Rs 5500cr as on Mar 2017.

The urea business, along with the assets, liabilities, contracts and deeds, will be transferred to Yara Fertilizers India on so called slump sale basis. Slump sale entails the transfer of one or more businesses for a lump-sum consideration without values being assigned to individual assets and liabilities. For Tata Chemicals, the valuation was attractive at ~8 times its FY16 operating profit. For Yara India, it is an entry into the world's second largest fertilizer market.

Yara India's parent Yara International was founded in 1905 to meet an emerging famine in Europe. Today, Yara has a worldwide presence, with close to 13,000 employees and sales to more than 150 countries. Yara has operated in India since the 1990s, focusing in recent years on premium product sales in the west and south of the country, delivering strong volume growth and margins well above Yara's average for the region.

Tata Chemicals operates under four segments i.e. (1) Inorganic Chemicals comprising Soda Ash, Salt, Sodium Bicarbonate, Marine Chemicals, Caustic Soda and Cement, (2) Fertilisers and other traded products,

(3) Other Agri-inputs (Rallis India operations) and (4) Others - comprising Pulses, Spices, Water Purifier, Nutritional Solutions.

Tata Chemicals is the world's second largest producer of soda ash, reaches over 650 million consumers through its Tata Salt brand and touches 85 percent of India's arable land through its agri business, together with its subsidiaries Rallis India and Metahelix Life Sciences.

Consumer business contribution to rise significantly over the next five years

Contribution of consumer business in consolidated revenues is likely to increase to ~21% in FY19E, from ~13% in FY17, led by (1) strong expected growth in the consumer piece and (2) exit from the Urea business. Salt business commands much higher margins and return ratios versus Tata Chemicals' overall business, on account of its strong brand positioning, which enables high margins and negligible working capital requirements.

The sourcing and processing of the pulses, spices and other products are also completely outsourced, enabling Tata Chemicals to grow without heavy investments. Growing share of consumer business in Tata Chemicals' overall revenues, hence, should enable gradual improvement in overall margins and return ratios.

Steady Transformation

Company's management, in various earlier calls and meets had shared its long-term vision of meaningfully increasing the share of FMCG business in the overall company revenues. In order to achieve this, it aims to leverage its superior brand strength in other FMCG products like Besan, Spices, Pulses etc. Additionally, demand for its 'premium salt variants' has also started picking up. A large proportion (95%) of the overall Pulses market is remains unbranded, which opens up big opportunity players like Tata Chemicals.

Tata Chemicals' consumer business commands growth profile, margins and return ratios similar to the leading FMCG companies in India. Thus, we believe company to command higher valuations on growing share of high-margin and asset-light consumer piece and sharp net-debt reduction seen in FY17 and we expect it to gradually reduced which should enable multiples to rerate further.

Tata Chemicals management aims to more than double the consumer business in the next 4-5 years, through (1) increasing distribution reach of the salt business, (2) growing presence of the recently launched product categories in the current network of salt business. Company has grown its salt business revenues at healthy CAGR of ~12% in the past seven years, capitalizing on (1) shift in market demand to national branded segment and (2) absence of strong brand in the category, enabling gradual market share gain for the company.

The recently added categories of Pulses, Spices and Besan (gram flour) are currently in the scale-up mode; Pulses and Spices have still long way to go which will drive consumer business. We see management's strong focus on growing its consumer business would drive performance in the years' to come.

Tata Chemicals holds investment in Tata Group companies

The non-current investments include both listed and unlisted entities which in the balance sheet have been shown as per Book Value. At current prices, its holdings works out to be ~Rs 1800cr (~12% of its market cap). The details of the holdings have been mentioned in a table. Moreover, Tata Chemicals is the promoter of listed Agrochemical Company Rallis India (holds ~ 50% stake).

FY17 Business Highlights

Chemicals Portfolio

Tata Chemicals is the key supplier to all major manufacturers of glass, detergents and other industrial products. Company possesses the World's 3rd largest producer of sodium bicarbonate, with application range from food to pharmaceuticals to air pollution control. In FY17, 65% revenues were derived from Inorganic Chemicals, 17% from fertilisers, ~16% Agri Inputs and ~3% from others. Outstanding gross subsidy receivables as on March 2017 was Rs 1,684 cr (Rs 1,902 cr for FY16).

Consumer Portfolio

Tata Chemicals is the pioneer & market leader in India's branded Iodised salt segment. Tata Salt is rated as one of the top 10 brands in Business and Consumer brands category in India by Super brands. Tata Salt reaches more than 130 mn households, with a market share of ~61% in the national branded salt category segment.

Tata Sampann range of Dals, pulses and spices bring natural, unpolished protein-based nutrition to Indian households. Tata Chemicals offers a complete suite of solutions for the Indian farmer & touches over 85 percent of India's arable land, supporting ~1.5 million farmers & serving over 20,000+ villages.

Pulses segment witnessed de growth; in fact, the food business sales fell on the back of management decision to stay away from the pulse business for some time due to government capping prices, which had impacted the business. However, we see a lot of potential in this space and company's focus has shifted to selling plain Dals only, which will continue to be where in price premium can be obtained, to also add more value-added portfolio in terms of besan and various mixes.

Spice business continues to chuggle on and continued to gain market share year-on-year. Company has covered three regions and towards the end of the year, they will enter the southern region. As far as the crop nutrition business is concerned, company has signed an agreement for transfer of ownership rights.

Tata Chemicals is in the process of acquiring land and a pilot plant in Gujarat where this business is to be sited. In addition, nutraceutical business in Chennai, the pilot plant has performed in line with managements' expectations, and in line with that the Board has approved an investment of Rs 250cr and the land for building this greenfield plant for nutraceutical has been assigned with Government of Andhra Pradesh in Nellore district. Both of these business leverage the capabilities of Tata Chemicals in the specialty chemicals area and especially in the area of food and nutrition.

Valuation and recommendation

We expect Tata Chemicals to post 8.3% revenue cagr along with 130bps margin expansion over FY17-19E. Consumer Business (Incl. Agri Inputs) and Inorganic Chemicals would drive revenues for the company. As Consumer Business revenue contribution would rise it would lead to margin expansion for the company. Currently, Tata Chemicals trades at ~6.5x FY19E EV/EBITDA, we expect multiple to rerate further, based upon ~9x EV/EBITDA, we arrive to target price of Rs 780. We recommend investors' to BUY Tata Chemicals at CMP of Rs 605 and add on dips to Rs 550 with TP of Rs 780 over the next 12 months.

Key Risks and Concerns

- Tata Chemicals operates in multiple countries; so any unfavourable changes in polices of other countries will be cause of concern for company

- Company is exposed to foreign exchange risks on its imports of raw materials / trading goods / capital item purchases and borrowings denominated in foreign exchange. Unfavourable Fluctuation in foreign currency may lead to higher outgo and lesser inflow and may increase the debt in absolute terms.

- For the last two-three years many parts of India had witnessed lower rains and which had resulted in lower agricultural activity leading to a drop in traction domestically for fertilizers and other agro products.

Financial Summary

(Rs Cr)	FY15	FY16	FY17*	FY18E^	FY19E
Sales	17203	14873	12942	13965	15178
EBITDA	2157	2091	2223	2447	2738
Net Profit	689	932	1099	1167	1382
EPS (Rs)	23.4	36.6	43.1	45.8	54.2
P/E	25.9	16.5	14.0	13.2	11.2
EV/EBITDA	8.3	8.6	8.1	7.3	6.5

Source: Company, HDFC sec Research,
* includes discontinuing Ops, ^ Does not include one off gain

Investments held by Tata Chemicals

Company	Price (Rs)	Shares Held (Cr)	Value (Rs cr)
Indian Hotels	134	0.9	**119**
Oriental Hotels	39	0.3	**10**
Tata Invst	740	0.1	**37**
Tata Steel	540	0.3	**135**
Tata Motors	433	0.2	**87**
Tata Global	151	4.3	**652**
Titan	520	1.4	**730**
Total			**1770**

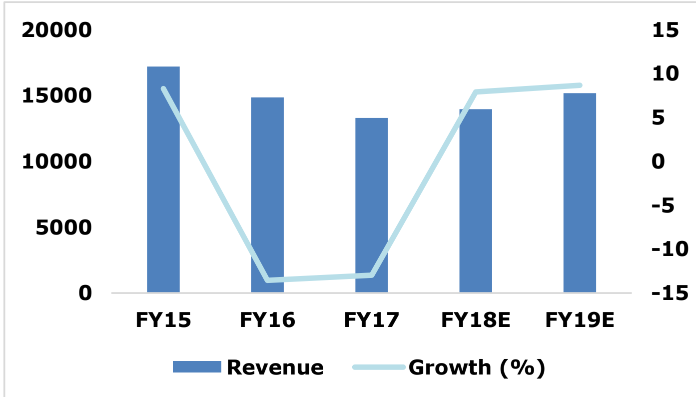
Source: Company, HDFC sec Research

Financial Snapshot

	FY17	FY16	Growth (%)
Revenues	12,942	14,873	-13.0
Operating Profit	2,223	2,091	6.7
OPM	21.1	14.6	
PAT	1,099	932	17.9
Revenues	**FY17**	**FY16**	
Inorganic Chemicals	8,634	8,820	-2.1
Fertilisers	2,289	4,113	-44.3
Other Agri Inputs	2,063	1,985	3.9
Segment EBIT			
Inorganic Chemicals	1,565	1,530	2.3
Fertilisers	119	15	693.3
Other Agri Inputs	265	220	20.5
Others	-86	-48	79.2

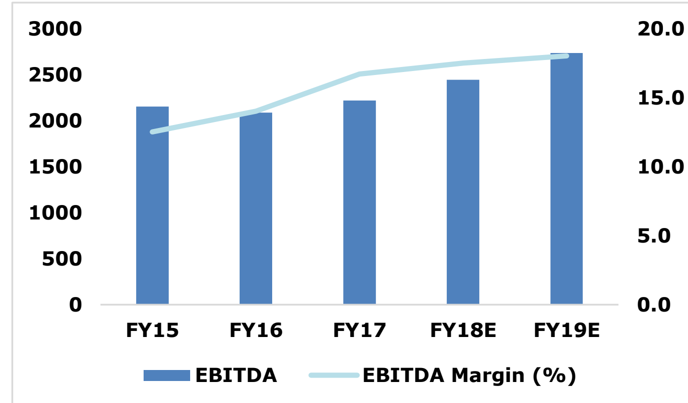
Source: Company, HDFC sec Research

Revenues to grow at ~8.3% over FY17-19E



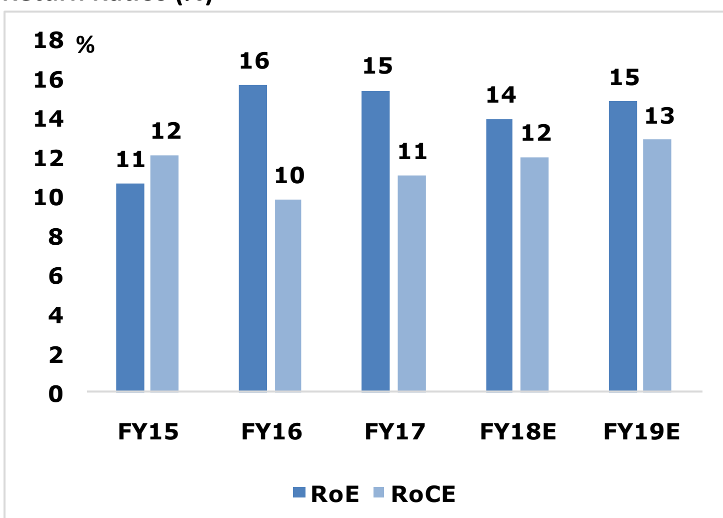
Source: Company, HDFC sec Research

EBITDA and EBITDA Margin Trend



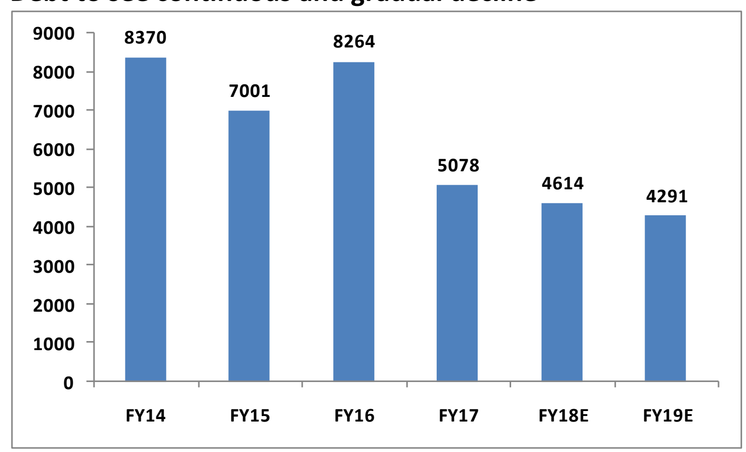
Source: Company, HDFC sec Research

Return Ratios (%)



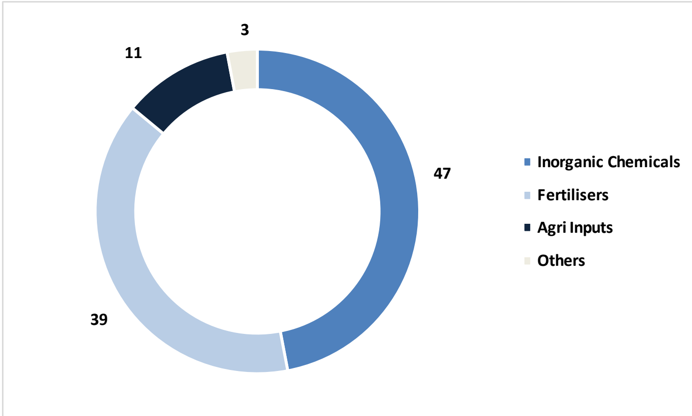
Source: Company, HDFC sec Research

Debt to see continuous and gradual decline



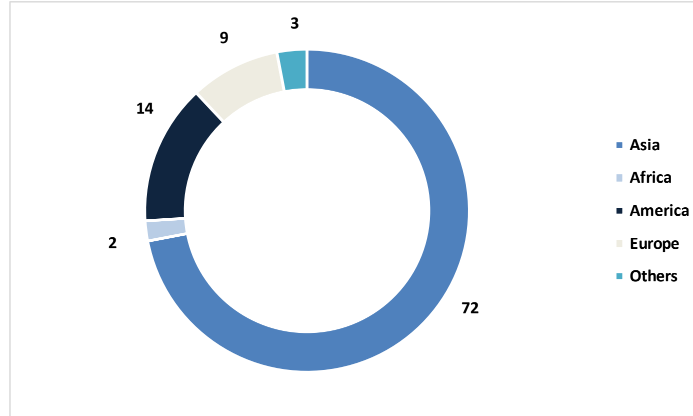
Source: Company, HDFC sec Research

FY16 Revenue Mix



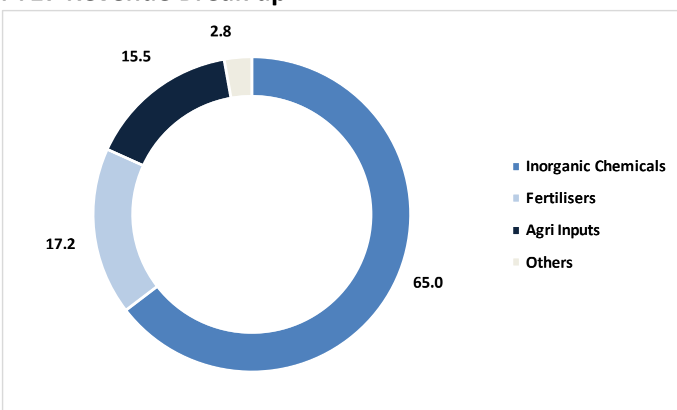
Source: Company, HDFC sec Research

FY16 Geographic Split



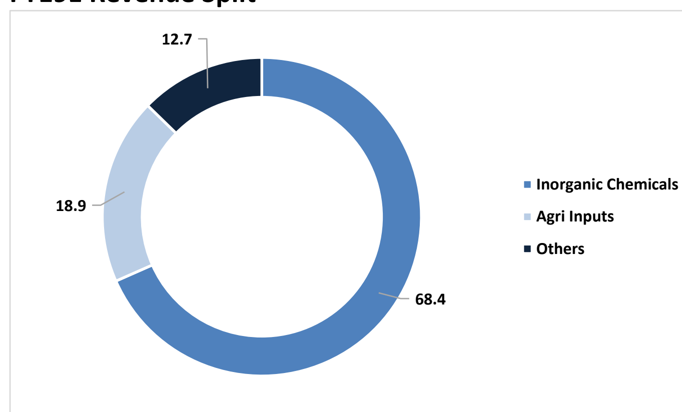
Source: Company, HDFC sec Research

FY17 Revenue Break up



Source: Company, HDFC sec Research

FY19E Revenue Split



Source: Company, HDFC sec Research

Income Statement (Consolidated)

(Rs Cr)	FY15	FY16	FY17*	FY18E^	FY19E
Net Revenue	**17203**	**14873**	**12942**	**13965**	**15178**
Growth (%)	8.3	-13.5	-13.0	7.9	8.7
Operating Expenses	15046	12782	10719	11518	12442
EBITDA	**2157**	**2091**	**2223**	**2447**	**2738**
Growth (%)	**19.2**	**-3.1**	**6.3**	**10.1**	**11.9**
EBITDA Margin (%)	**12.5**	**14.1**	**16.7**	**17.5**	**18.0**
Depreciation	463	526	534	539	566
EBIT	**1694**	**1565**	**1689**	**1908**	**2172**
Other Income	118	125	166	259	311
Interest	454	525	411	349	322
Exceptionals	-200	0	0	0	0
PBT	**1040**	**1040**	**1278**	**1559**	**1815**
Tax	351	248	357	527	617
RPAT	**689**	**792**	**921**	**1032**	**1199**
MI/Ass. Share	-205	15	13	-121	-128
PAT	**596**	**932**	**1099**	**1167**	**1382**
Growth (%)	-157.8	56.4	18.0	6.1	18.4
EPS	23.4	36.6	43.1	45.8	54.2

Source: Company, HDFC sec Research

* includes discontinuing Ops, ^ Does not include one off gain

Balance Sheet (Consolidated)

As at March	FY15	FY16	FY17*	FY18E^	FY19E
SOURCE OF FUNDS					
Share Capital	**254.8**	**254.8**	**254.8**	**254.8**	**254.8**
Reserves	5297	6034	7653	8496	9541
Shareholders' Funds	**5552**	**6289**	**7908**	**8751**	**9796**
Long Term Debt	5708	6744	4357	3965	3687
Net Deferred Taxes	227	205	202	200	197
Long Term Provisions & Others	1760	1808	1814	1935	2058
Minority Interest	**674**	**747**	**880**	**957**	**1040**
Total Source of Funds	**14032**	**16029**	**15145**	**15814**	**16704**
APPLICATION OF FUNDS					
Net Block	4372	4582	3917	4622	4586
CWIP	170	258	305	380	251
Deferred Tax Assets (net)	21	63	144	129	119
Long Term Loans & Advances Incl. Goodwill	8036	8469	8215	8284	8358
Total Non Current Assets	**12599**	**13372**	**12581**	**13415**	**13314**
Current Investments	5	9	221	571	751
Inventories	2627	2002	1381	1837	2037
Trade Receivables	3427	3484	2088	2219	2411
Short term Loans & Advances	473	654	690	635	616
Cash & Equivalents	1464	1371	1665	1428	1795
Other Current Assets	178	149	290	334	367
Total Current Assets	**8174**	**7669**	**6335**	**7023**	**7977**
Short-Term Borrowings	1293	1520	721	649	603
Trade Payables	2638	1677	1338	1458	1550
Other Current Liab & Provisions	2241	1435	2388	2197	2087
Short-Term Provisions	730	670	274	321	365
Total Current Liabilities	**6902**	**5302**	**4721**	**4624**	**4606**
Net Current Assets	1272	2367	1614	2399	3371
Total Application of Funds	**14032**	**16029**	**15145**	**15814**	**16704**

Source: Company, HDFC sec Research

Cash Flow Statement (Consolidated)

(Rs Cr)	FY15	FY16	FY17*	FY18E^	FY19E
Reported PBT	1,158	1,165	1,444	1,818	2,126
Non-operating & EO items	-118	-242	-166	-259	-311
Interest Expenses	454	525	411	349	322
Depreciation	463	526	534	539	566
Working Capital Change	656	-1,188	1,047	-1,022	-605
Tax Paid	-351	-248	-357	-527	-617
OPERATING CASH FLOW (a)	**2,262**	**538**	**2,913**	**898**	**1,481**
Capex	-438	-639	-639	-380	-530
Free Cash Flow	1,824	-101	2,274	518	951
Investments	16	-475	173	-54	-64
Non-operating income	118	125	166	259	311
INVESTING CASH FLOW (b)	**-304**	**-989**	**-300**	**-175**	**-283**
Debt Issuance / (Repaid)	-1,126	1,062	-2,384	-273	-158
Interest Expenses	-454	-525	-411	-349	-322
FCFE	244	436	-521	-104	472
Share Capital Issuance	19	73	133	77	83
Dividend	-368	-295	-323	-444	-465
FINANCING CASH FLOW (c)	**-1,928**	**315**	**-2,985**	**-989**	**-861**
NET CASH FLOW (a+b+c)	**29**	**-136**	**-372**	**-266**	**337**

Source: Company, HDFC sec Research

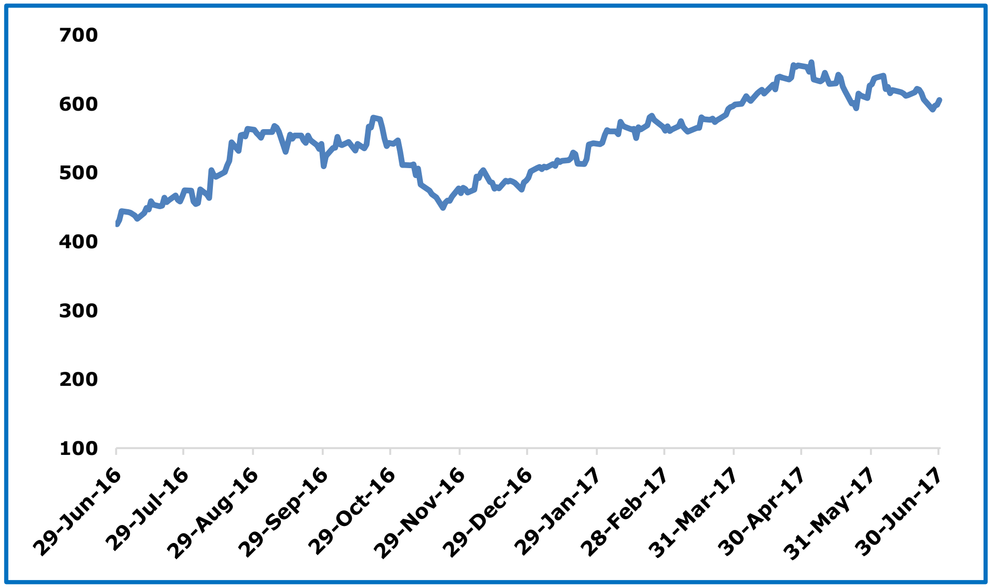
* includes discontinuing Ops, ^ Does not include one off gain

Key Ratio (Consolidated)

(Rs Cr)	FY15	FY16	FY17*	FY18E^	FY19E
EBITDA Margin	12.5	14.1	16.7	17.5	18.0
EBIT Margin	9.8	10.5	12.7	13.7	14.3
APAT Margin	4.7	6.2	8.2	9.2	9.9
RoE	10.7	15.7	15.5	14.0	14.9
RoCE	12.2	9.9	11.1	12.1	12.9
Solvency Ratio					
Net Debt/EBITDA (x)	2.6	3.3	1.4	1.1	0.6
D/E	1.3	1.3	0.6	0.5	0.4
Net D/E	1.0	1.1	0.4	0.3	0.2
PER SHARE DATA					
EPS	23.4	36.6	43.1	45.8	54.2
CEPS	41.6	57.2	64.1	66.9	76.4
BV	217.9	246.8	310.7	343.6	384.8
Dividend	12.5	10.0	11.0	15.0	15.5
Turnover Ratios (days)					
Debtor days	73	86	57	58	58
Inventory days	45	57	46	48	49
Creditors days	65	77	78	79	78
VALUATION					
P/E	25.9	16.5	14.0	13.2	11.2
P/BV	2.8	2.5	1.9	1.8	1.6
EV/EBITDA	8.3	8.6	8.1	7.3	6.5
EV / Revenues	1.0	1.2	1.3	1.3	1.2
Dividend Yield (%)	2.1	1.7	1.8	2.5	2.6
Dividend Payout	53.4	27.3	25.5	32.8	28.6

Source: Company, HDFC sec Research

Price Chart



Rating Definition:

Buy: Stock is expected to gain by 10% or more in the next 1 Year.

Sell: Stock is expected to decline by 10% or more in the next 1 Year.

Rating Chart

R E T U R N	HIGH			
	MEDIUM			
	LOW			
		LOW	MEDIUM	HIGH
		RISK		

Ratings Explanation:

RATING	Risk - Return	BEAR CASE	BASE CASE	BULL CASE
BLUE	LOW RISK - LOW RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 20% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 15% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 15%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 20% OR MORE
YELLOW	MEDIUM RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 35% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 20% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 35% OR MORE
RED	HIGH RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 50% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 30% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 50% OR MORE

Disclosure:

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