Ajcon's Xpress idea: Thirumalai Chemicals Ltd. - "BUY", 9th September, 2014

About the Company

Thirumalai Chemicals Limited (TCL), started production of Phthalic Anhydride in 1976 in Ranipet, in South India. Since then, it has grown into a diverse and respected enterprise, rapidly expanding into the manufacture of many other critical Industrial Chemicals: Maleic Anhydride, Fumaric Acid and Malic Acid and various Fine Chemicals and Derivatives. Today TCL ranks among the largest producers in the world in all its core products. It has a strong manufacturing base capable of delivering quality products, with excellent logistics and technical support, at competitive prices.

Key strengths

a) Long experience in chemical segment
b) Technical and managerial competence to build world class Chemical manufacturing and Distribution
c) Ability to absorb technology, develop processes for new products and commercialize them
d) Excellent reputation in the industry at National and International level
e) Proven history of successful European/US partnerships with Customers, Licensors and Partners
f) Wide distribution network in India, Asia, North America and Europe

About its Business

Phthalic Anhydride (PA)

The PA business was badly impacted by low volumes and margins, since the main customer segments viz., Construction, Plastics, Auto, and Paints suffered deeply which would now turnaround owing to revival in economic cycle. The situation was further affected by the Government's Trade and Commerce policies, resulting in a flood of low priced import from around the world – which increased by 100% in the last 6 - 8 months. These resulted in capacity utilization falling sharply in the second half. Unit costs are very dependent on capacity utilization; these two factors lead to losses in the PA business. The senior management team is actively working toward correcting the unfair trade situation at a policy level, and management is now hopeful of correction.

PA Derivatives

PA Derivatives business performed reasonably well; but demand was stagnant. Both in its PA and Derivatives businesses, the company's Business & Manufacturing teams are working on internal cost reduction projects aimed at reducing manufacturing and sales cost in various areas -- in energy, packing and logistics, finance and improving business efficiencies.

The Food Ingredients Businesses

These businesses were positive contributors; this despite the slowdown in the Indian market and in the export market in Europe. These businesses continued to be profitable and to some extent mitigated the loss from the PA business.

Overseas Subsidiary: Optimistic Organic Sdn. Bhd., (OOSB), Malaysia

Maleic Anhydride (MA) is a very versatile intermediate that goes into many dozens of Speciality Applications in Foods, Polymers, Coatings, Pharma and Speciality Chemicals. Its overseas subsidiary M/s. OOSB registered a turnover of USD 45.25 million, (prev year USD 51.22 million), a decrease of 11.66 % over the previous year, and a profit before tax of USD 2.46 million (prev year USD 3.61 million).

The profit was impacted by the shut downs, especially for plant refurbishments which are critical for the planned expansion. The Subsidiary has witnessed a complete turnaround in the 2 years since the

Company acquired it fully: the Subsidiary has not only become profitable, but has repaid a good part of its debt. The subsidiary has undertaken a 30% capacity expansion largely funded by internal cash flows.

Outlook

In the Phthalic Anhydride business, large volumes of imports have affected sales in the domestic market. The market situation continues to be challenging but the company is gearing itself to rise above these. The International markets present a difficult trade situation given the volatility in prices of Raw material and in the finished product. The Management and Operating teams are working to address these. Continuous improvement in cost and efficiency will continue to be a focus in the coming year. In the Food Ingredients Business, the margins have improved, while reducing costs. Active efforts are being taken to expand the market.

Focus for FY15

The management team has set itself the following key tasks:

a) Work towards early correction of the Inverted Duty; caused by various trade agreements
b) Improve gross margin on all products
c) Improve raw material supply chain and costs, to derive significant cost efficiencies
d) Drive down total cost -- manufacturing and post manufacturing, by eliminating activities, improved reliability and better management of working capital.

We believe TCL is strong player in the specialty chemicals segment. Turnaround in business post revival in economic cycle would lead to growth in Phthalic Anhydride (PA) segment which would augur well for the Company. Recent decline in crude oil prices would lead to TCL's better margin performance in the near future. We recommend a "BUY" on the stock with a price target of Rs. 130 an upside of 20%, over a period of 3 to 6 months.

Stock Holding Disclosure under SEBI regulations:

- **a) Analyst holding: No**
- **b) Company holding: No**
- **c) Directors holding: No**
- **d) Group/Associates Position: No**
- e) **Relationship with management: No**

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