Stock Idea

Sector: Agri-chemical

March 17, 2021

Sumitomo Chemical India Limited

Cream of the Crop

Sharekhan
by BNP PARIBAS

Powered by Sharekhan's 3R Research Philosophy

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Sumitomo Chemical India Limited

Cream of the crop

Agri-chemical	Sharekhan code: SUMICHEM	Initiating Coverage

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral - Negative

Reco/View	
Reco:	**Buy**
CMP:	**Rs. 275**
Price Target:	**Rs. 350**

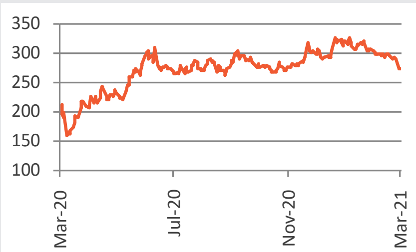
Company details

Market cap:	Rs. 13,709 cr
52-week high/low:	Rs. 338/153
NSE volume: (No of shares)	6.8 lakh
BSE code:	542920
NSE code:	SUMICHEM
Free float: (No of shares)	12.5 cr

Shareholding (%)

Promoters	75.0
FII	1.2
DII	6.6
Others	17.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-8	-10	-4	29
Relative to Sensex	-5	-18	-33	-36

Sharekhan Research, Bloomberg

Summary

- We initiate coverage on Sumitomo Chemical India Ltd. with a Buy and PT of Rs. 350; SCIL is part of Sumitomo Chemical Company (Japan) and a leading player with an 11% share in domestic agri-input market.
- Strong parentage offers competitive edge in terms of technical capabilities, strong distribution and R&D support would drive 12% CAGR in revenue and a 291 bps rise in margins over FY21E-FY23E.
- Merger with Excel Crop Care (ECCL) has strengthened generic product portfolio and geographical reach. Leveraging on parent and merger synergies would aid a 21% CAGR in PAT over FY21E-FY23E.
- Robust balance sheet with net cash (including liquid investment) of Rs. 680 crore and high asset turnover ratio would keep RoE/RoCE high at 24%/32%. We expect SCIL to continue enjoying premium valuation over domestic peers.

Sumitomo Chemical India Limited (SCIL) has multiple advantages from its Japanese parent Sumitomo Chemical Company (SCC, leading global chemical company) in terms of technical capabilities (great R&D capabilities and a large potential for introducing innovative molecules), distribution reach and financial support. Moreover, the merger with Excel Crop Care Limited (ECCL) has strengthened SCIL's generic product portfolio and geographical reach (pan-India presence) with a 13,700-strong distribution network. Robust parentage and synergies from ECCL merger would drive a 12% CAGR in revenues over FY2021E-FY2023E. Moreover, margins are expected to expand by 291 bps and reach 21% by FY2023E as SCIL's dependence on molecule imports would reduce (given ECCL's expertise in active manufacturing) and rising share of specialty chemicals in revenues (expected to reach 37-38% FY2023E from 29% in FY2020). Moreover, SCIL has lowered its net working capital cycle (to 74 days from 116 days in FY2020) and has cash & liquid investment worth Rs. 680 crore as of December 2020. The company's asset light model (asset turnover ratio of 6.6x) would help to generate strong RoE/RoCE of 24%/32% in FY2023E. Hence, we initiate stock idea coverage on SCIL with Buy rating and price target of Rs. 350.

Our Call

Initiate coverage with Buy and PT of Rs. 350: A strong parental advantage, revenue & cost synergies from ECCL merger and robust product pipeline would help it register strong EBITDA/PAT CAGR of 20%/21% over FY2021E-FY2023E along with a robust RoE of 24%. A superior earnings growth outlook, massive revenue opportunity from CRAMS (not factored in our earnings estimates) and a robust balance sheet (high asset turnover ratio of 6.6x and net cash of Rs. 680 crore) is likely to keep SCIL's valuations at a premium to domestic peers. We initiate coverage on SCIL with a Buy rating and PT of Rs. 350 (valued at 35x FY2023E EPS of Rs10). At CMP, SCIL is trading at 33x FY2022E EPS and 27.4x FY2023E EPS.

Key risk

Likely ban on products such as Glyphosate (that fetch 15% of revenues) could impact earnings outlook. Delay in supply of raw material from China could impact margins. Adverse weather conditions could affect demand of agri inputs and affect earnings outlook.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	2,228	2,425	2,688	2,996	3,348
OPM (%)	13.0	13.7	18.1	19.6	21.0
Adjusted PAT	173	236	344	416	501
% YoY growth	19.0	36.4	46.0	20.9	20.4
Adjusted EPS (Rs.)	3.5	4.7	6.9	8.3	10.0
P/E (x)	79.4	58.2	39.9	33.0	27.4
P/B (x)	13.1	11.2	9.1	7.4	6.1
EV/EBITDA (x)	47.1	40.9	27.0	22.0	17.8
RoNW (%)	17.3	20.8	25.2	24.8	24.4
RoCE (%)	26.2	26.1	33.4	32.9	32.4

Source: Company; Sharekhan estimates

Executive Summary

3R Research Positioning Summary

- **Right Sector:**
  Government's initiatives to boost farm output would drive demand for agri-inputs and crop protection products.
- **Right Quality:**
  Leading presence of SCC in global crop protection sector provides a strong growth opportunity in domestic and exports markets. SCIL holds market share of 11% in domestic agri-input market based on revenues.
- **Right Valuation:**
  SCIL to continue enjoy premium valuation to domestic peers given a strong parentage, superior earnings growth outlook and robust balance sheet.

Valuation and return potential

- We expect revenue/EBITDA/PAT CAGR of 12%/20%/21% over FY2021E-FY2023E.
- SCIL is trading at 33x FY2022E EPS and 27.4x FY2023E EPS.
- We value SCIL at 35x FY2023E and arrive at a PT of Rs. 350; Initiate coverage with Buy rating.

Catalysts

Long-term triggers

- Revenue and cost synergies from ECCL merger.
- Leverage SCC's network to boost generic exports.
- Focus to increase share of specialty chemicals.

Medium Term Triggers

- Favourable agronomics in domestic market (80% of revenues).
- Rise in farm income to boost demand for agri-inputs in India.

Key Risks:

- Weak monsoons could impact short term demand.
- Regulatory risks, adverse currency movement, geopolitical risk and volatile input prices.

Earnings and Balance sheet highlights

- **Strong earnings growth track-record:** Revenue/EBITDA/PAT clocked a CAGR of 13%/24%/27% over FY2018-FY2020.
- **Consistent margin improvement:** SCIL's margins has improved consistently to 13.7% in FY2020 versus 11.3% in FY2018.
- **Strong Balance sheet with net cash position:** The company's balance sheet is strong with net cash of Rs680 crore as of December, 2020.
- **Strong return ratios:** RoE/RoCE has consistently improved and stood at 21%/26% in FY2020.

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Why we like agri chemical space - Strong growth potential in domestic and exports market

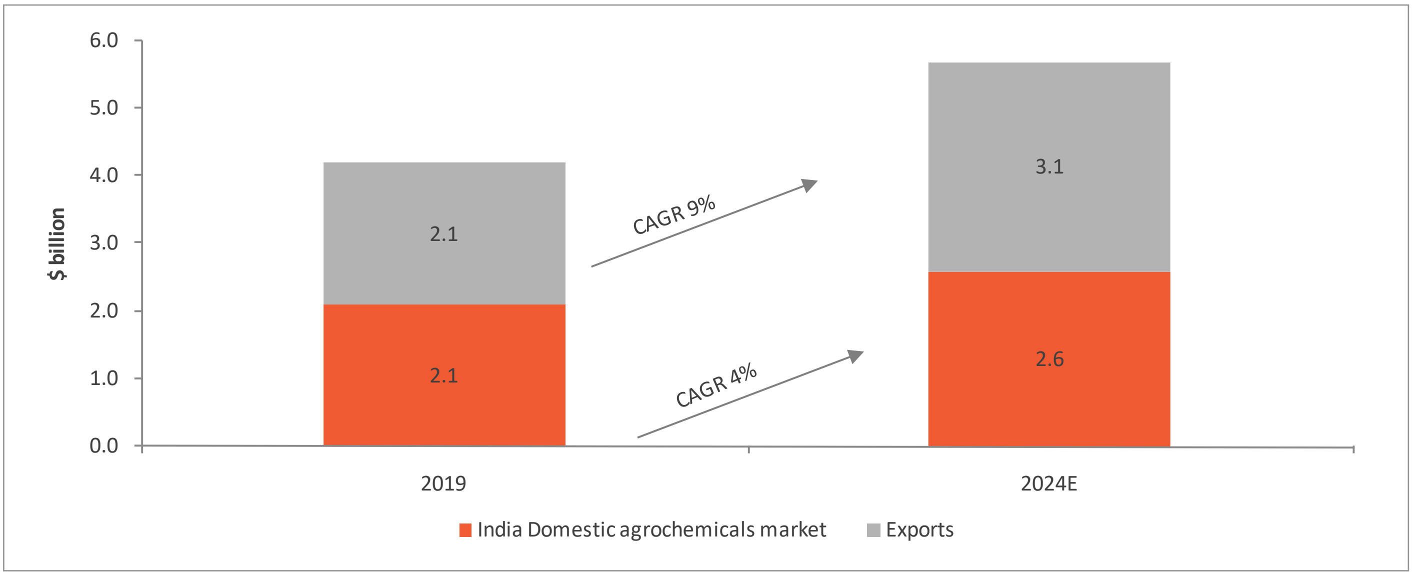
The Indian agrochemical industry is valued at ~$4.2 billion (equal share of domestic and exports) in 2019 and is expected to grow at ~9% during 2019-2024. As per industry estimates, India's agrochemical exports are expected to record an 8.6% CAGR over 2019-2024 and reach $3.1 billion by 2024 led by lower research and manufacturing costs, rise in technically skilled manpower and expiry of patents on certain products. India's agrochemical industry is expected to reach $5.7 billion by 2024. The share of exports would rise to 55% from 50% in 2019. Robust domestic demand supported by favourable government policies and rising exports offer strong growth opportunities in the agri-input landscape. We expect companies with global presence and strong branding to outpace industry growth rate.

Indian agrochemical market – expected to grow at 9% CAGR over 2019-2024

India has approximately 125 technical grade manufacturers in the agrochemical sector producing more than 60 technical grade pesticides and 800 pesticide formulators. Nearly all multi-national crop protection companies have a presence in India, with Sygenta, Bayer Crop Science and BASF ranking among the top 5 players in the country. The top 3 players control 57% of the market share.

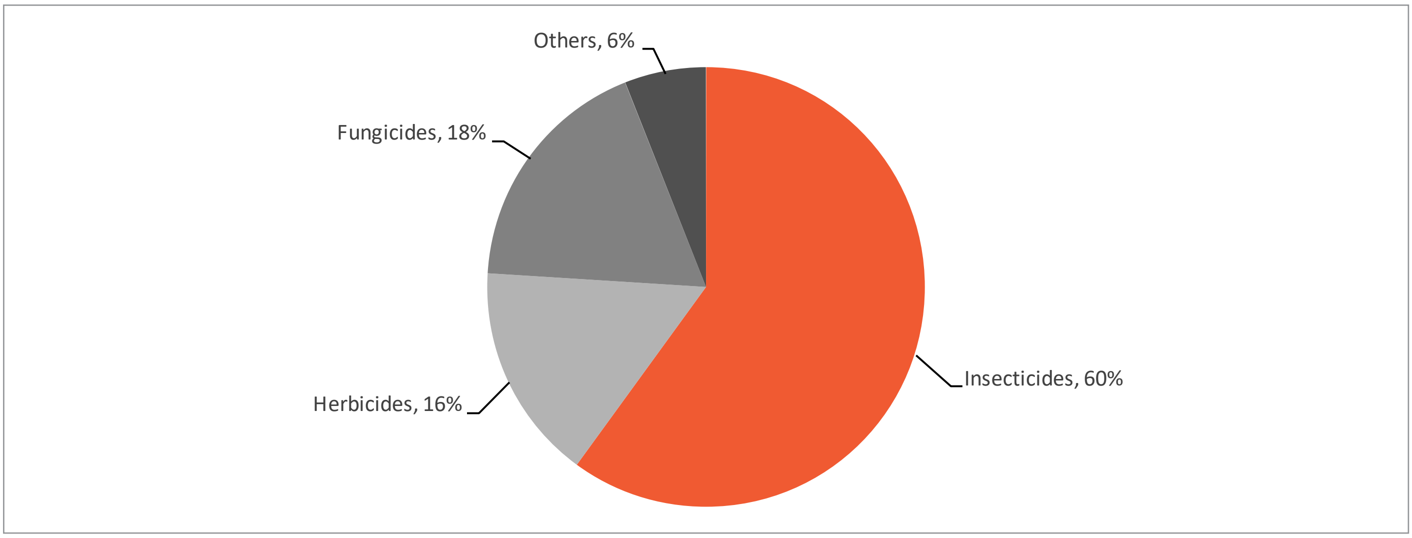
Indian agro-chemical industry is estimated to grow at 9% CAGR during 2019-24 and was worth approximately $4.2 billion in 2019. Exports contribute approximately 50% of the overall agrochemical industry revenue and are expected to continue its growth at 9% per annum due to lower research and manufacturing costs, rise in technically skilled manpower and expiry of patents on certain products. India is the fourth largest producer of pesticides after USA, Japan and China. In the Indian crop protection industry, 80% of molecules are non-patented, indicating the dominance of generic products. In the domestic market, insecticide production forms 60% of all pesticide products but a new emerging category, bio-pesticides, has immense growth potential due to its non-toxic nature. Currently only 3% of the crop protection market is held by bio-pesticides signifying the leading role of chemical pesticides especially for rice and cotton cultivation. However, bio-pesticides have the potential to increase their market share due to government's support in their promotion and increasing awareness about the toxic nature of chemical fertilisers.

Indian agrochemical market to clock 9% CAGR over 2019-2024E



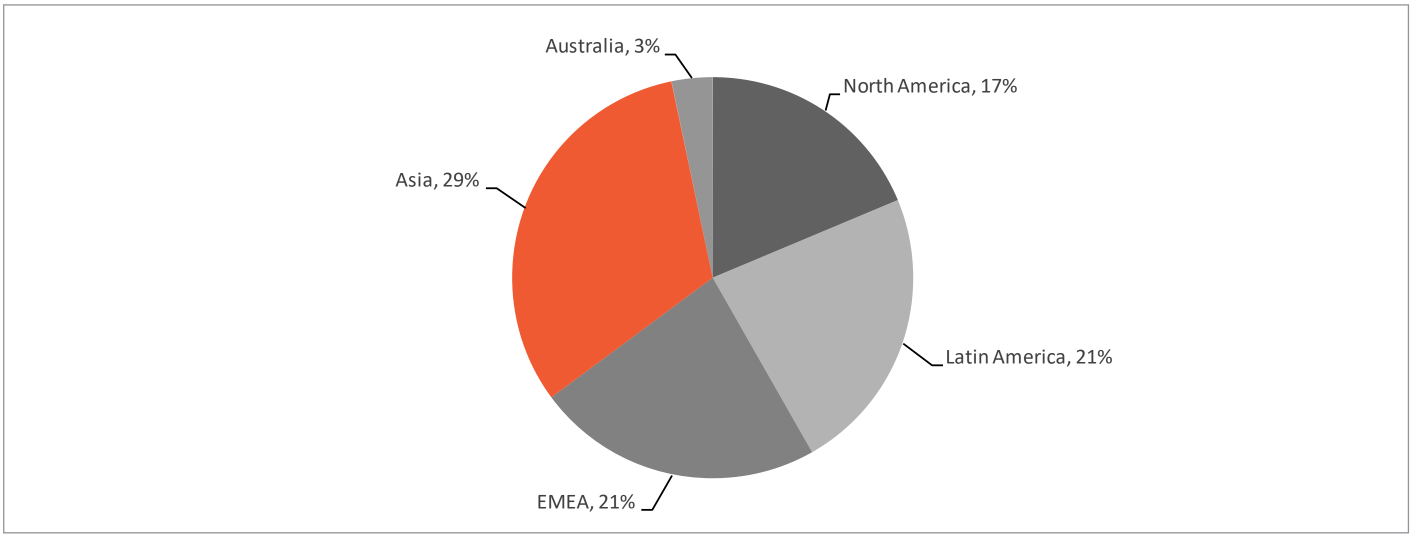
Source: Frost & Sullivan Research & Analysis, PI Industries' annual report

India pesticides market share by key segments



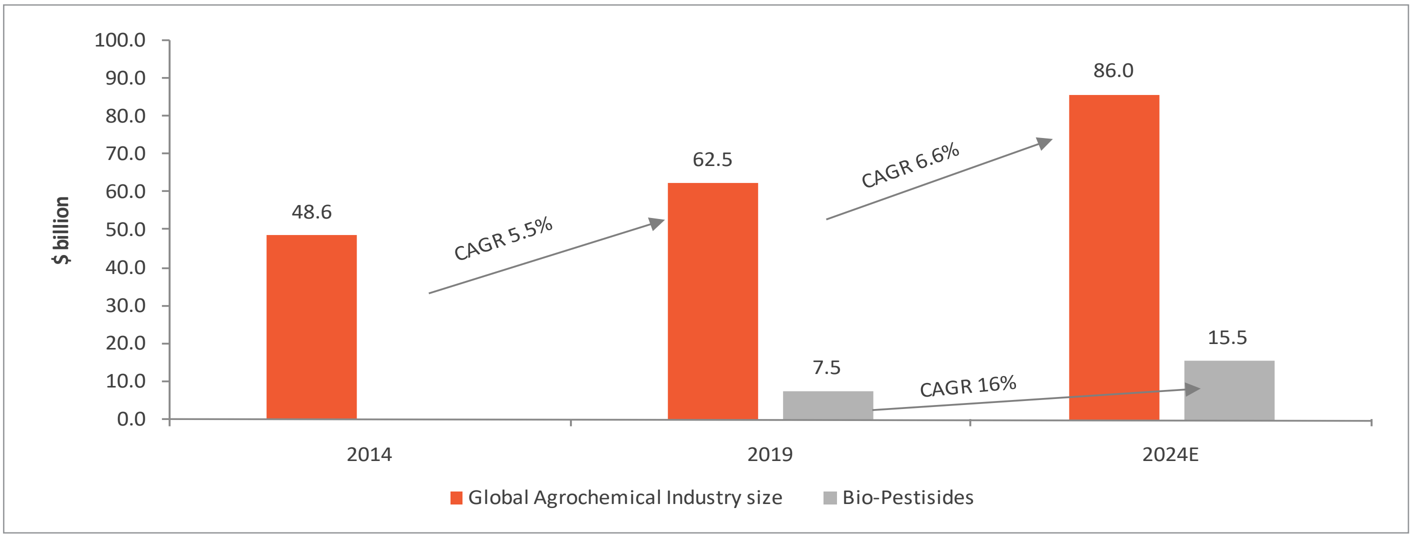
Source: Industry

Indian agrochemical market by export destination



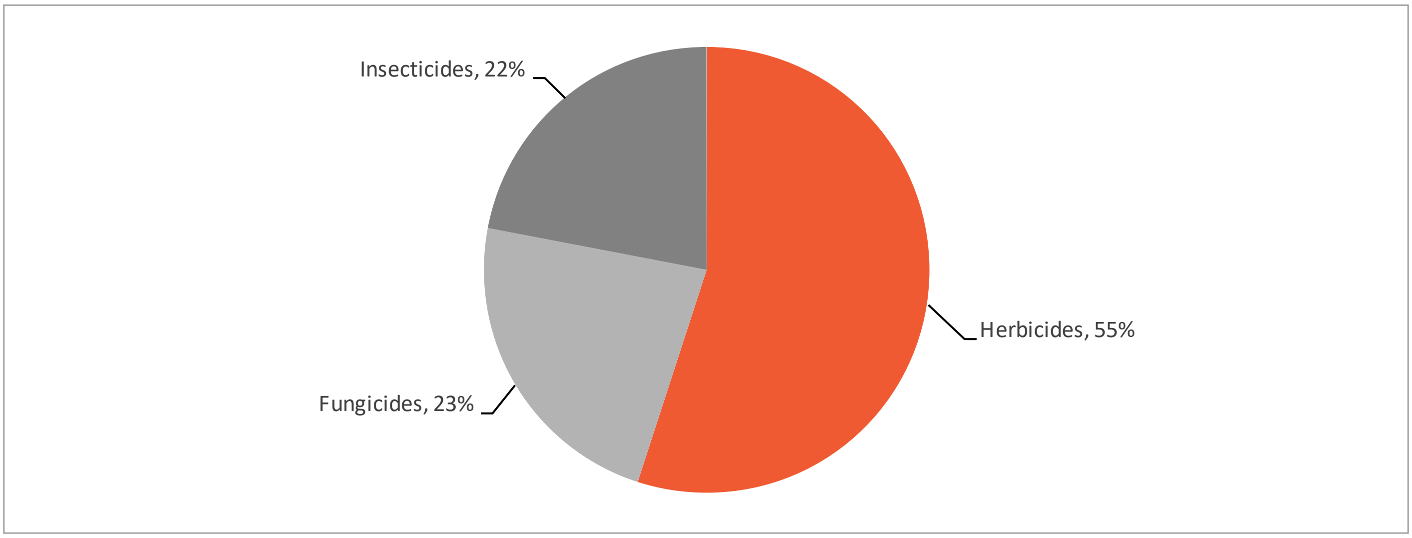
Source: Frost & Sullivan Research & Analysis, PI Industries' annual report

Global agrochemical market expected to grow at 6.6% CAGR over 2019-2024E



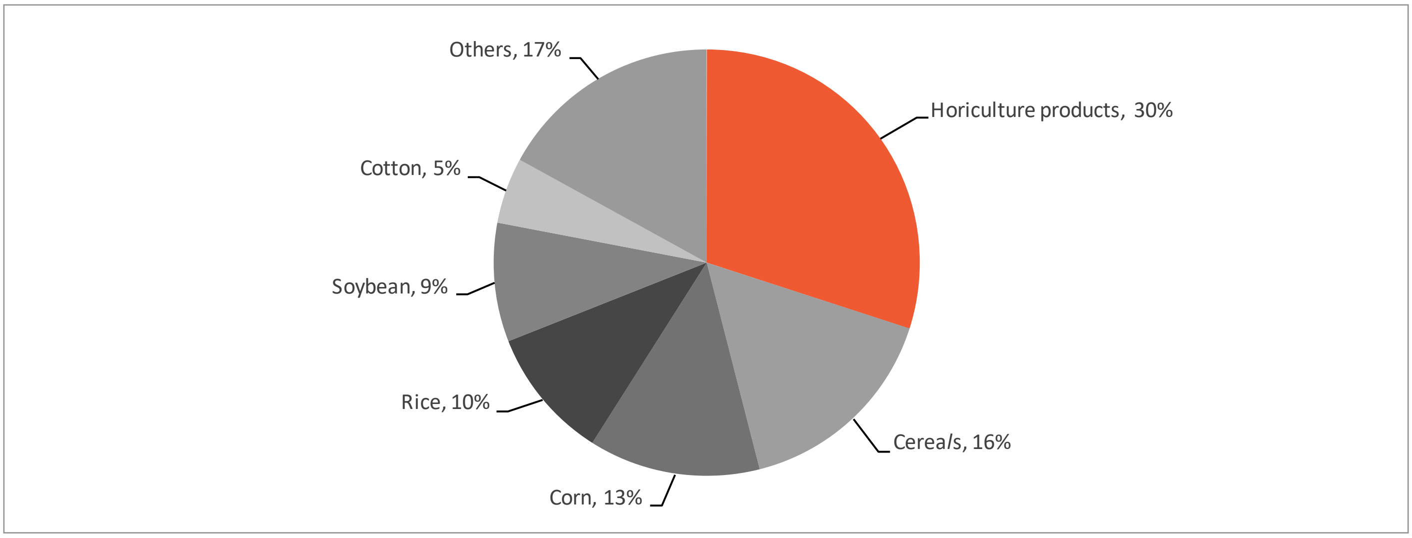
Source: Frost & Sullivan Research & Analysis, PI Industries' annual report

Region-wise global agrochemical market share



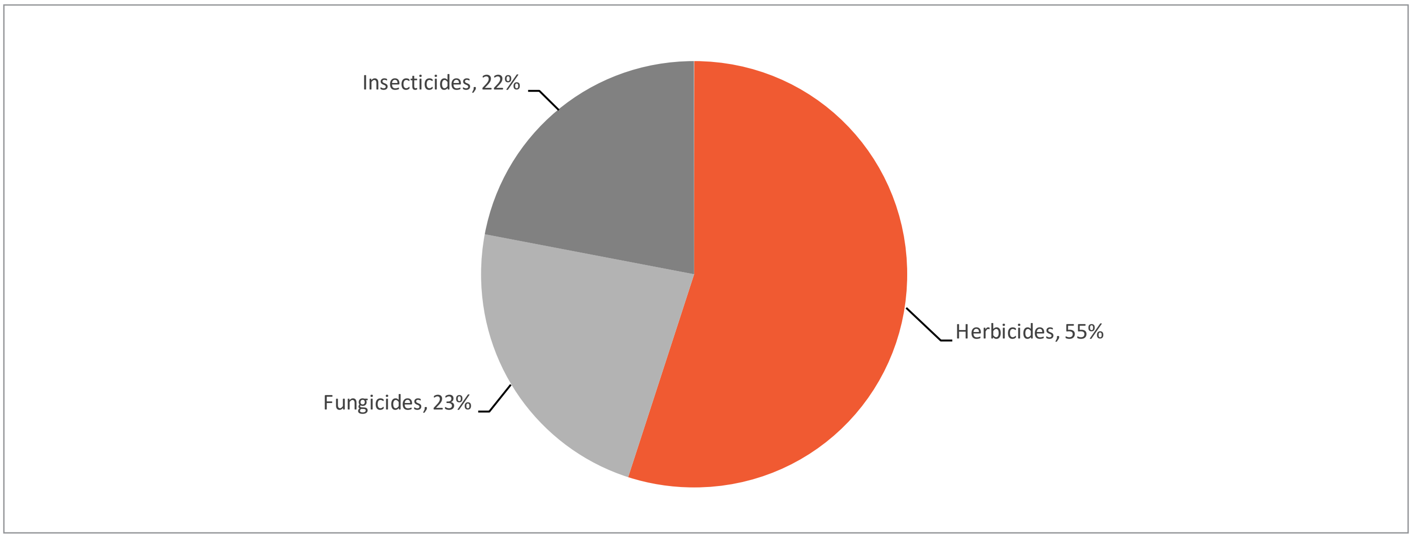
Source: Frost & Sullivan Research & Analysis, PI Industries' annual report

Global agro-chemical market mix by crops



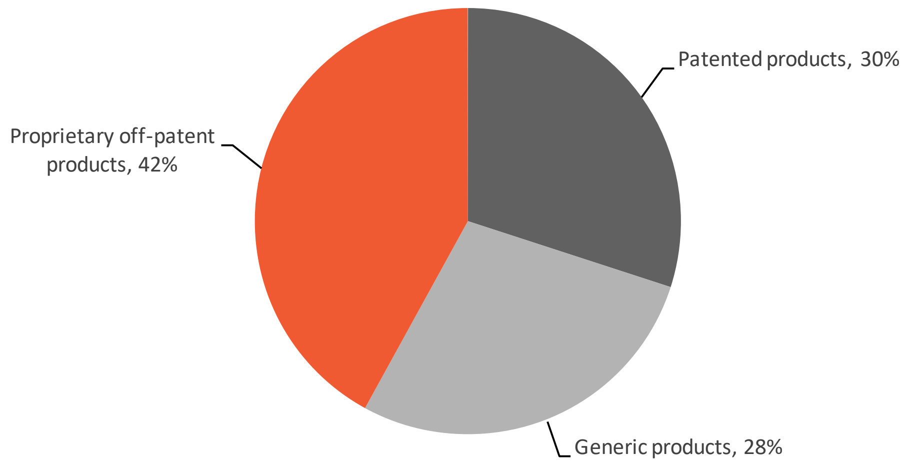
Source: Frost & Sullivan Research & Analysis, PI Industries' annual report

Global agrochemical market segment-wise break-up



Source: Frost & Sullivan Research & Analysis, PI Industries' annual report

Global agrochemical patented/ Off-patented market mix



Source: Frost & Sullivan Research & Analysis, PI Industries' annual report

In total 26 agrochemicals are going off-patent globally by CY22

Active Ingredient	Inventor Company	Category
Aminopyralid	Dow AgroSciences	herbicide
Amisulbrom	Nissan Chemical Industries	fungicide
Chlorantraniliprole	DuPont	insecticide
Cyprosulfamide	Bayer CropScience	safener
Fenpyrazamine	Sumitomo Chemical	fungicide
Flubendiamide	Nihon Nohyaku	insecticide
Flucetosulfuron	LG Chem Investment	herbicide
Fluopicolide	Bayer CropScience	fungicide
Isotianil	Bayer CropScience	fungicide
Mandipropamid	Syngenta	fungicide
Metamifop	Dongbu Hannong Chemicals	herbicide
Metofluthrin	Sumitomo Chemical	insecticide
Metrafenone	BASF	fungicide
Orthosulfamuron	Isagro	herbicide
Penflufen	Bayer CropScience	fungicide
Pinoxaden	Syngenta	herbicide
Pyrasulfotole	Bayer CropScience	herbicide
Pyrifluquinazon	Nihon Nohyaku	insecticide
Pyrimsulfan	Ihara Chemical Industry	herbicide
Pyroxasulfone	Kumiai Chemical Industry	herbicide
Pyroxsulam	Dow AgroSciences	herbicide
Saflufenacil	BASF	herbicide
Tembotrione	Bayer CropScience	herbicide
Thiencarbazone	Bayer CropScience	herbicide
Topramezone	BASF	herbicide
Valifenalate	Isagro	fungicide

Source: Agropage

Other key growth drivers for Indian agrochemical industry

(a) **Bio-pesticides:** The bio-pesticide sector is seeing strong growth due to increasing awareness about the toxicity of chemical fertilisers, environment-friendly nature of bio pesticides and the government's support in promoting bio-pesticides.

(b) **Animal feed:** The Indian animal feed market was worth Rs. 400.5 billion in 2018. The market is further projected to reach Rs. 898.5 billion by 2024, at a compounded annual growth rate of 14.3% during 2018 to 2024. According to estimates by leading industry sources, the demand for animal protein and dairy products in India will increase the compound feed consumption volumes to 40 million tonnes by 2020 from current consumption of 28 million tonnes. India is the sixth-largest producer of feed in the world market, amounting to 34.2 million tonnes in 2017 across ~1,201 feed mills.

(i) **Poultry:** India is the fourth largest producer of broiler and third largest producer of egg in the world. The Indian poultry market, consisting of broilers and eggs was worth Rs. 1,750 billion in 2018. The market is further projected to reach Rs. 4,340 billion by 2024, growing at a CAGR of 16.2% during 2019-2024, which is one of the fastest growing poultry industries in the world.

(ii) **Cattle:** India has one of the world's largest populations of cattle is its top milk producer, with a 20% share. The milk production in India was around 176.3 million tonnes in FY 2017-18. While the all India per capita availability of milk is 375 grams per day, there exists wide inter-state variability.

(iii) **Aquaculture:** Fisheries is a fast-growing sector in India and fish and fish product exports emerged as the largest group in agricultural exports. India is the second largest fish producer in the world with a total production of 13.7 million metric tonnes in FY 2018-19. World demand exceeds production and the per capita consumption is steadily increasing. This means that India has great scope in expanding further its aqua-culture industry.

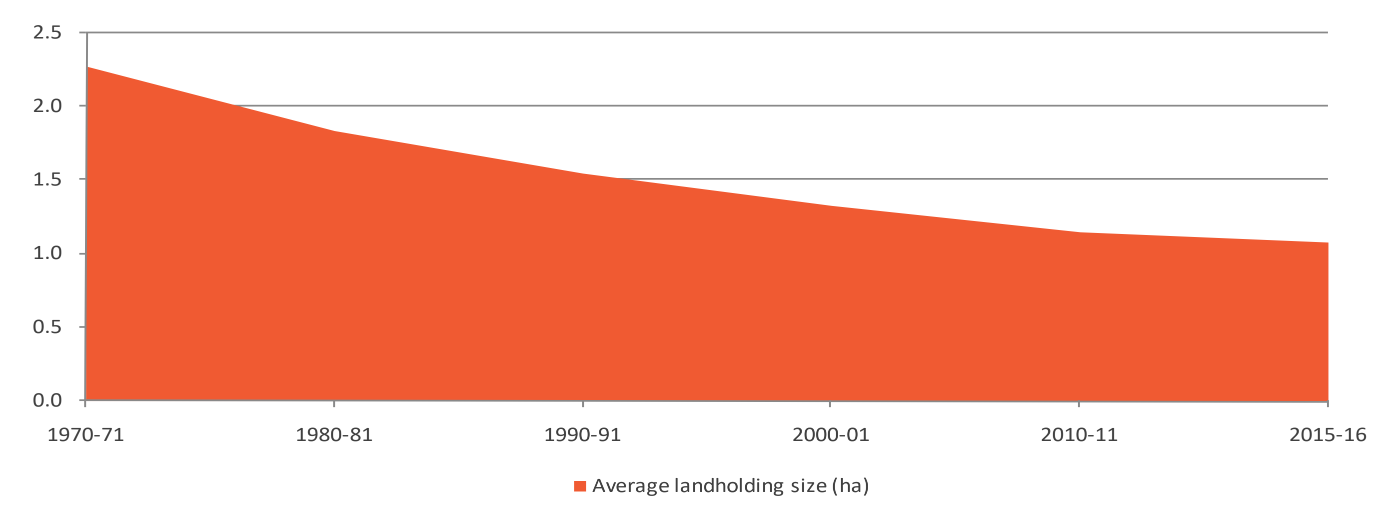
Strong sector tailwinds; likely rise in pesticides usage to benefit domestic players

The government's thrust to double farm incomes by FY2022 and incentives/subsidies from state governments would put more money in farmers' hands in the coming years. Moreover, reforms in agri space and continued government support for the sector would provide incentives for modern farming (which would increase penetration of pesticides from only 0.6kg/ha currently). With global players adopting the China plus one strategy, the Indian agrochemical industry is set to grow robustly.

Consumption of pesticides is lowest in India 0.6 (kg/ha) compared to other developed countries like China (13 kg/ha), Japan (12 kg/ha), USA (7 kg/ha), France (5 kg/ha) and UK (5 kg/ha). Paddy cultivation uses up the maximum amount of pesticides in India with a 26-28% share, followed by cotton with a share of 18-20%. Andhra Pradesh, Maharashtra, Punjab, Madhya Pradesh, Chhattisgarh, Gujarat, Tamil Nadu and Haryana contribute 70% of the consumption of Agrichemicals in India.

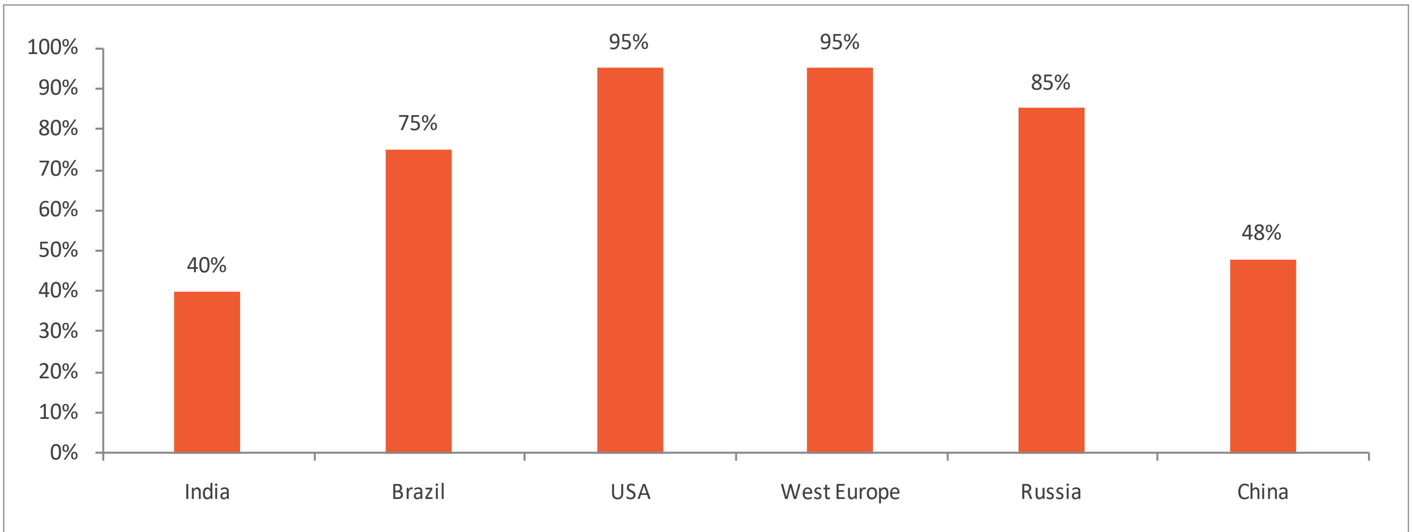
India' agriculture sector faces multiple challenges such as (1) small land holdings, (2) degrading soil quality, (3) limited access to quality seeds, fertilizers and pesticides, (4) low mechanization, (5) underdeveloped supporting infrastructure, and (6) imbalanced nutrient usage. We believe Agrochemical companies will be in the forefront to bridge the productivity gap in India and drive up consumption of agri-input in the country.

Falling per capita land holding (ha)



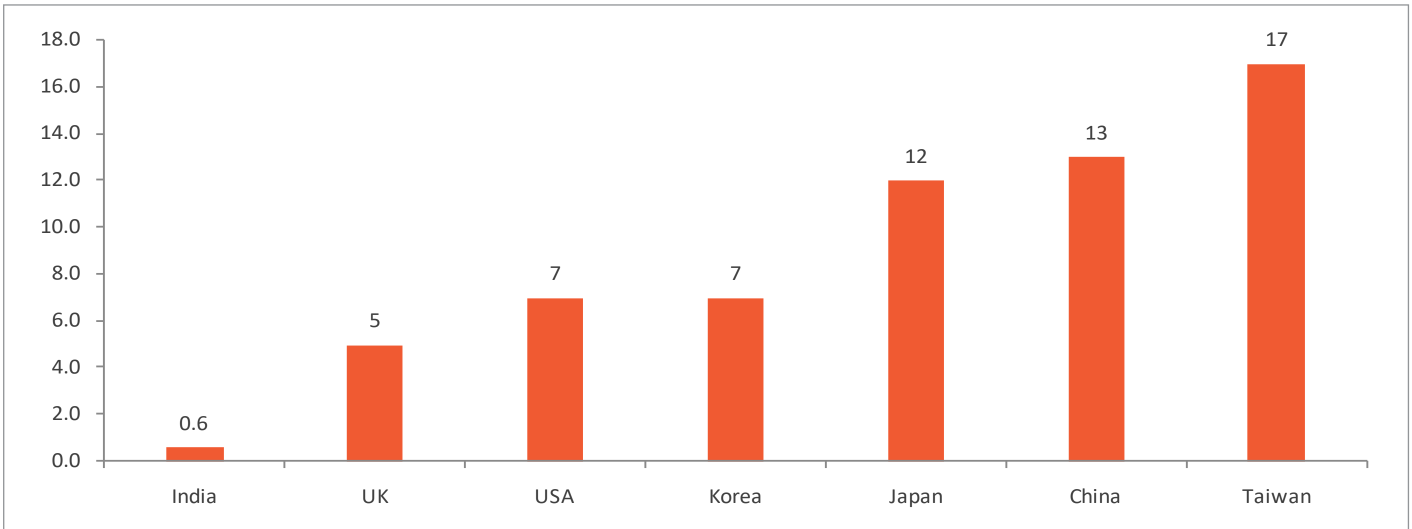
Source: Ministry of Agri; Sharekhan Research

Low Mechanization in Agriculture



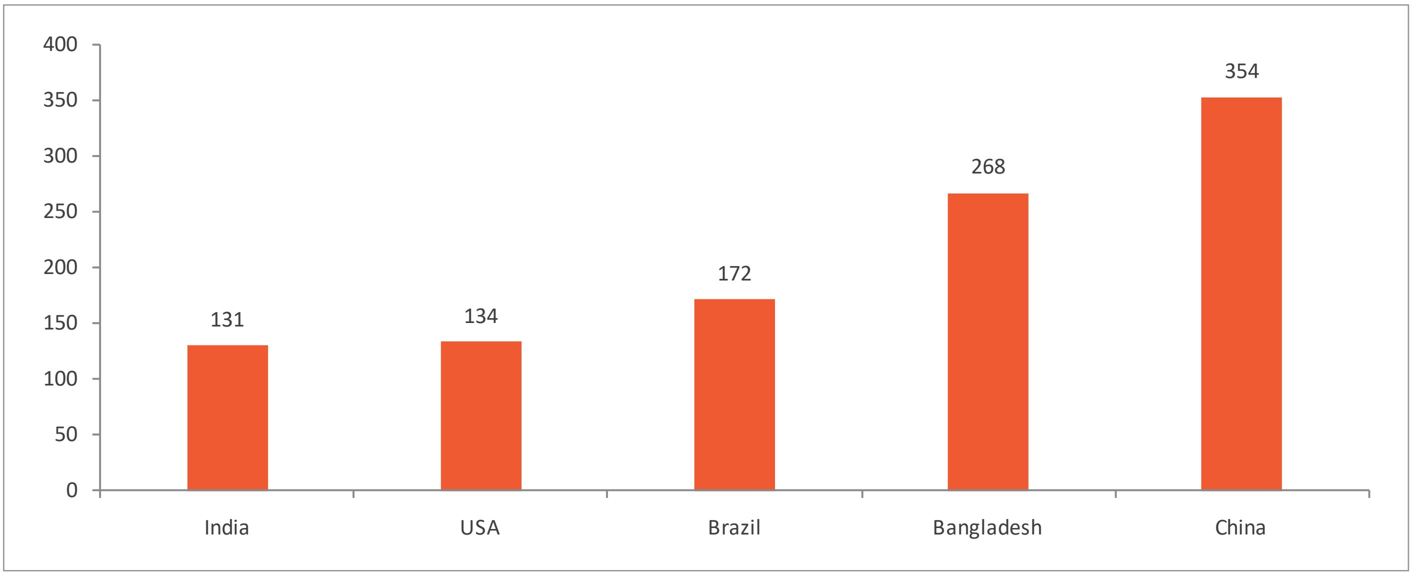
Source: World Bank; Sharekhan Research

Low Crop Protection Consumption (Kg/ha)



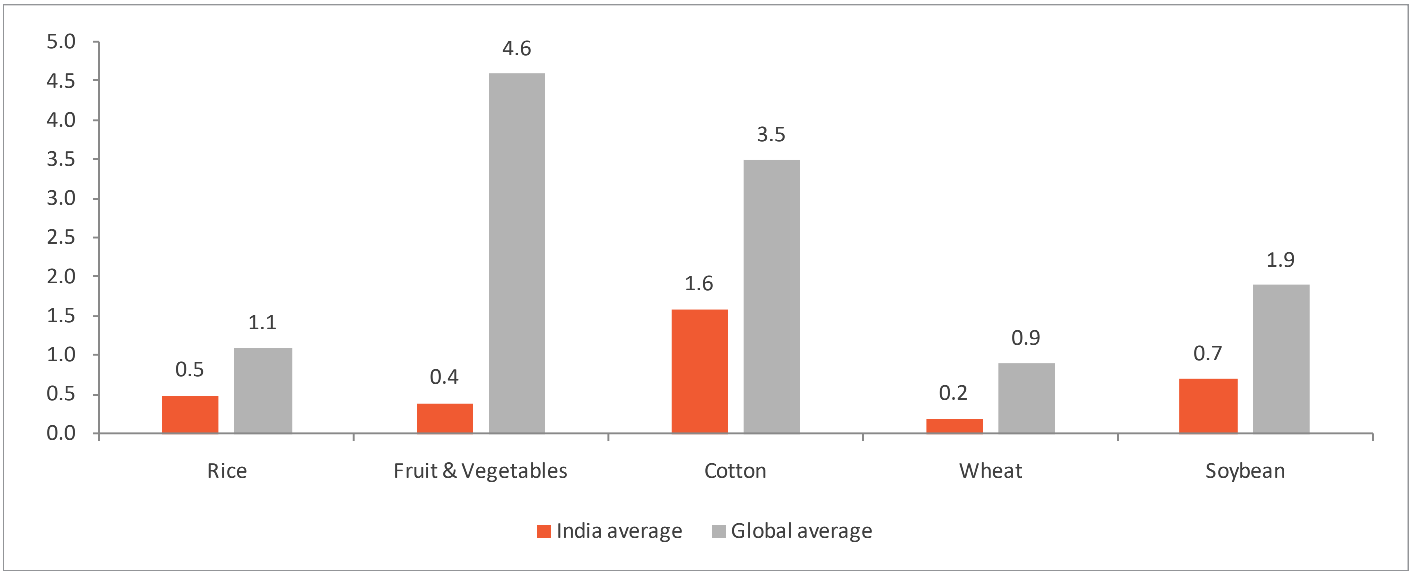
Source: FICCI; Sharekhan Research

Low Nutrient Usage (Kg/ha)



Source: FICCI; Sharekhan Research

Consumption of Pesticides across crops significantly lower (Kg/ha)



Source: Ken Analysis, Ministry of Commerce, BCG Analysis

Positive changes in the agri sector – MSP; government focus to double farm income

Increase in minimum support price for major crops

The Union Cabinet had approved a minimum support price (MSP) for 14 kharif crops, wherein farmers would get 50-83% more than their cost of produce for crop year 2020-21. The MSP for paddy has been raised by Rs. 52/ quintal to Rs 1828/quintal, while for jowar and Bajra, the MSP is at Rs 2620/ quintal and Rs 2150/quintal, respectively. The MSP for cotton has been raised by 50% or Rs. 260 to Rs. 5,515/ quintal and MSP for ragi, moong and groundnut have also been raised by 50%.

Government focus on agriculture to drive domestic consumption

The government is continuously focusing on means to double farm income such as i) increasing output by enhancing crop productivity and knowing the cropping intensity, ii) improving realisation of produce through price discovery, remunerative pricing and crop diversification, iii) reducing cost by balanced application of agri-inputs and effectively utilising available resources and iv) by providing risk coverage for crop, livestock & non-farm income.

Expectation of normal monsoon increases demand off-take for agri inputs

The India Meteorological Department (IMD) has predicted normal monsoon for 2020 at 100% of the long period average with an error if +/-5%. Sowing of kharif crops gathered pace as the monsoons reached fresh parts of the country with total acreage under different crops rising by ~39% y-o-y. The agriculture ministry's data reveals that kharif crops have been sown on ~13.13 million ha, which is 39% more than the same period last year. The southwest monsoon during the same period stood at 114.7 millimeters, or 30% more than normal. Further, the Prime Minister of India launched a Rs-50,000 crore 'Garib Kalyan Rojgar Yojna' covering 116 districts with more than 25,000 migrant workers in six states. Good and timely rainfall is expected to boost food output in India, one of the world's top producers and consumers of a range of agricultural commodities. This is expected to enhance demand for agri-inputs, including fertilisers in India.

Direct Benefit Transfer 2.0 to help in improve soil health

The government has launched the Direct Benefit Transfer (DBT) 2.0 wherein Soil Health Cards will be linked to fertiliser purchases. This will help -

- Digitise land records and improve rural connectivity,
- Improve soil health, which in turn will help the famers to make informed purchases, iii) help prevent fertiliser leakages and diversions and iv) help manufacturers receive subsidy payments periodically. This is expected to improve nutrient usage & promote balanced application along with enhancement of transparency level in subsidy disbursements.

A double booster in long term- Passage of Farm Bills in 2020

The Parliament has passed two key bills namely Farmers Produce Trade and Commerce (Promotion & Facilitation) Ordinance 2020 and Farmers (Empowerment & Protection) Agreement of Price Assurance & Farm Services Bill) which is primarily focused to address issues faced by farmers.

- The Bill allows farmers for barrier-free trade of their agricultural produce outside APMC boundaries. This aim is to offer farmers better prices for their products driven by increased competition among buyers and limiting the monopoly of APMC mandis (which would lower fees charged by APMC and commission of agents). The bill would also help lower other cess imposed by the state governments on APMC markets and result into development of common market for agri-produce in India.
- APMC mandis would continue to operate but farmers will have choice of director marketing of their farm produce or opt for APMC mandi route to sale their produce.
- Additionally, contract farming would provide assured prices (even before sowing) and access to organized markets for its agri produce and sourcing of better quality agri-inputs. The participation of corporates/private sector would result into development of supply chain and warehousing infrastructure and farmers would get access to advanced technologies. A focus on direct marketing of farm produce (without intermediaries) would help farmers get better prices.
- In a nutshell, the farm reforms are structurally positive and would play be critical in boosting farmers' incomes. Better rural incomes are likely to be beneficial for the agrochemical/fertilizer sectors and indirectly benefit rural centric companies in the consumer goods and auto sector.

Agriculture - A key driver of Indian economy

Agriculture is a significant part of India's economy and the largest employer as well. It contributes 18% of GDP, 8% of exports and generates 44% of jobs. Globally, in terms of agricultural production, India is first in pulses production (21% market share), second in seed cotton (22% market share) and also second in fruits, vegetables and sugarcane with a share of 11% and 18%, respectively. In cereals India is third with a market share of 10%. In terms of yield per hectare, India lags far behind the world. We believe optimum and judicious use of agri-inputs would help India improve its yield per hectare.

Area, production, and yield trend for foodgrains and horticulture

Year	Foodgrains			Horticulture			Area under irrigation (%)
	Area (mn ha)	Production (mn MT)	Yield kg/ha)	Area (mn ha)	Production (mn MT)	Yield kg/ha)	
1990–91	127.8	176.4	1,380	12.8	96.6	7.6	35.1
1995–96	121.0	180.4	1,491	15.0	140.1	9.3	40.1
2000–01	121.1	196.8	1,626	16.6	145.8	8.8	43.4
2005–06	121.6	208.6	1,715	18.7	182.8	9.8	45.5
2010–11	126.7	244.5	1,930	21.8	240.5	11.0	47.8
2011–12	124.8	259.3	2,078	23.2	257.2	11.1	49.8
2012–13	120.8	257.1	2,129	23.6	268.8	11.4	51.2
2013–14	125.0	265.0	2,120	24.2	277.3	11.5	51.9
2014–15	124.3	252.0	2,028	23.4	280.9	12.0	53.1
2015–16	122.7	252.2	2,056	24.4	286.1	11.7	-
2016-17	129.2	275.1	2,129	24.8	300.6	12.1	
2017-18	127.6	284.8	2,233	25.4	311.7	12.3	
2018-19	124.2	283.4	2,281	25.6	314.9	12.3	

Source: GoI, Sharekhan Research

Compared to China, Brazil and the US, India's productivity levels are lower. The reasons for the same are i) falling per capital land holdings, ii) low mechanization in farm lands, iii) imbalanced usage of nutrients and iv) lower consumption of crop protection products, hence improvement in productivity levels remains a key challenge.

Huge scope of yield improvement by using agri-inputs

Crop	India						China			World	
	Area (mn ha)	Produc-tion (mn MT)	Produc-tion Rank	Yield (Kg/ha)	Yield (% of World)	Yield (% of China)	Produc-tion	Yield	Produc-tion Rank	Produc-tion	Yield
Paddy	43.2	163.7	2	3,790	82.8	55.2	211	6,866	1	756.1	4,577
Wheat	30.4	92.3	2	3,034	89.2	56.2	133.2	5,396	1	749	3,401
Maize	9.9	25.9	7	2,616	46.4	43.8	263.6	5,967	2	1,100	5,632
Pulses	30.8	18.15	1	588	61.4	33.9	4.5	1,732	4	83.5	958
Sugarcane	4.95	348.4	2	70,394	100.4	110.1	140	63,948	3	1,861	70,134
Groundnut	5.8	7.46	2	1,287	80.1	35	16.36	3,678	1	44.9	1,606

Source: GoI, Sharekhan Research

Increasing yield though use of agrichemical is the way ahead

Tonnes/Hectare	Soyabean	Pulses	Cereal
World	2.3	0.9	3.7
India	1.4	0.6	2.9
China	1.9	1.7	5.7
Brazil	2.6	0.9	4.0
USA	2.7	1.8	6.8

Source: Sharekhan Research

Why We Like Sumitomo – Strong parentage and synergies from ECCL merger to drive growth

SCIL has multiple advantages from its Japanese parent Sumitomo Chemical Company (SCC) in terms of technical capabilities (great R&D capabilities and a large potential for introducing innovative molecules), distribution reach and financial support. Moreover, the merger with Excel Crop Care Limited (ECCL) has strengthened SCIL's generic product portfolio and geographical reach (pan-India presence) with a 13,700-strong distribution network. Robust parentage and synergies from ECCL merger would drive a 12% CAGR in revenues over FY2021E-FY2023E. Moreover, margins are expected to expand by 291 bps and reach 21% by FY2023E as SCIL's dependence on molecule imports would reduce (given ECCL's expertise in active manufacturing) and rising share of specialty chemicals in revenues (expected to reach 37-38% FY2023E from 29% in FY2020).

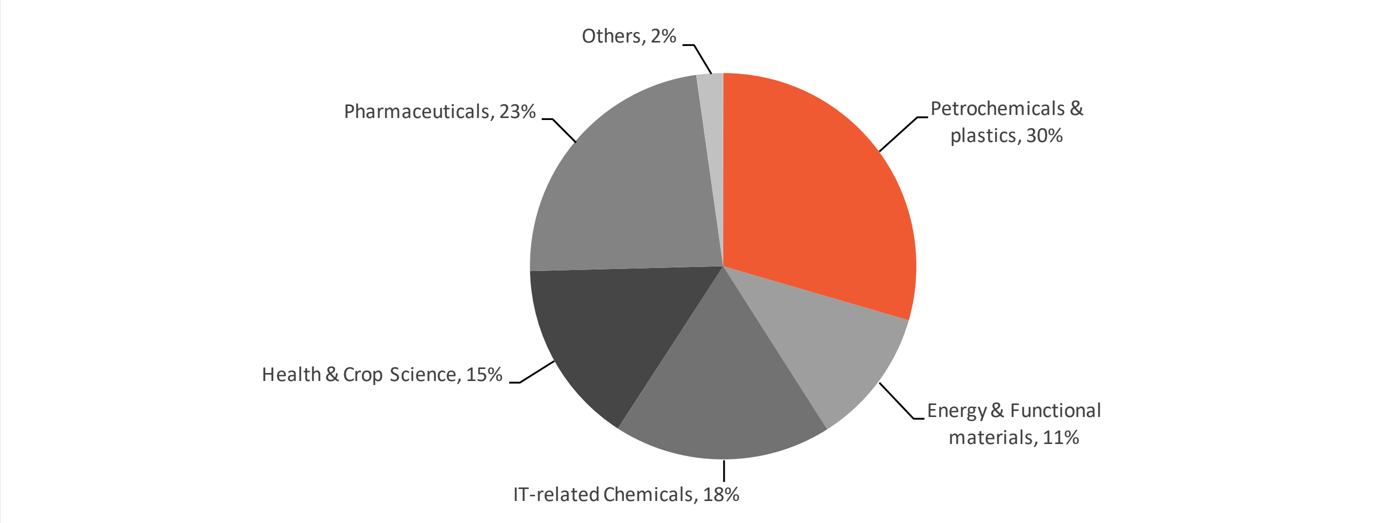
- Sumitomo Chemical India Ltd has a strong presence in the domestic market with 80% revenue contribution from India. SCIL revenue CAGR has been at 11% from FY2011–FY2020, which is much ahead of industry growth rate of mid-single digit.
- ECCL and SCIL merger in 2019 has increased the production capacity of the merged identity. It has also increased the distribution network to ~40,000 dealers across India and marketing capability. The merged identity will benefit from economies of scale and synergy effects which will decrease the cost and increase margins.
- SCIL has a fairly diversified product portfolio, which protects it from cyclicality of Indian agriculture. Post merger SCIL has presence in both technical grade and formulations and also manufacturing capability in generic and specialty chemicals. It also has a presence in bio-pesticides and Animal nutrition sector, 2 high growth sectors in the future.
- Sumitomo Chemical Company (SCC), Japan is SCIL's parent, which allows the latter to leverage SCC's global supply chain to expand its exports and SCC's R&D capabilities which gives it an advantage in developing new molecules and patents.
- SCIL has posted strong returns with ROCE of 23-26% and ROE of 15-21% during FY2018-2020. Post-merger with ECCL, we expect SCIL's margins to improve and return ratios to remain strong.

Strong parentage provides competitive edge and robust revenue growth potential

SCIL's parent company- Sumitomo Chemical Company is global chemical company with revenues of ~3.1 billion coming from Health & Crop Sciences segment. SCIL could benefit from its parent on multiple front including: 1) the parent's strong product pipeline in agri-input/solutions and environment health products, which provides robust market opportunity of $1.4-1.8 billion and 2) export opportunity given SCC's --presence in more than 40 countries and strong distribution network, 3) access to parent's R&D (SCC spends 7-8% of annual revenues on R&D) for developing a patented product portfolio (12,600 patented products) and 4) opportunity to expand specialty chemical business. With an aim to expand Health & Crop Sciences in India, SCC has set a target to increase SCIL's revenues to $500 million by FY2025 from $275 million in FY2018.

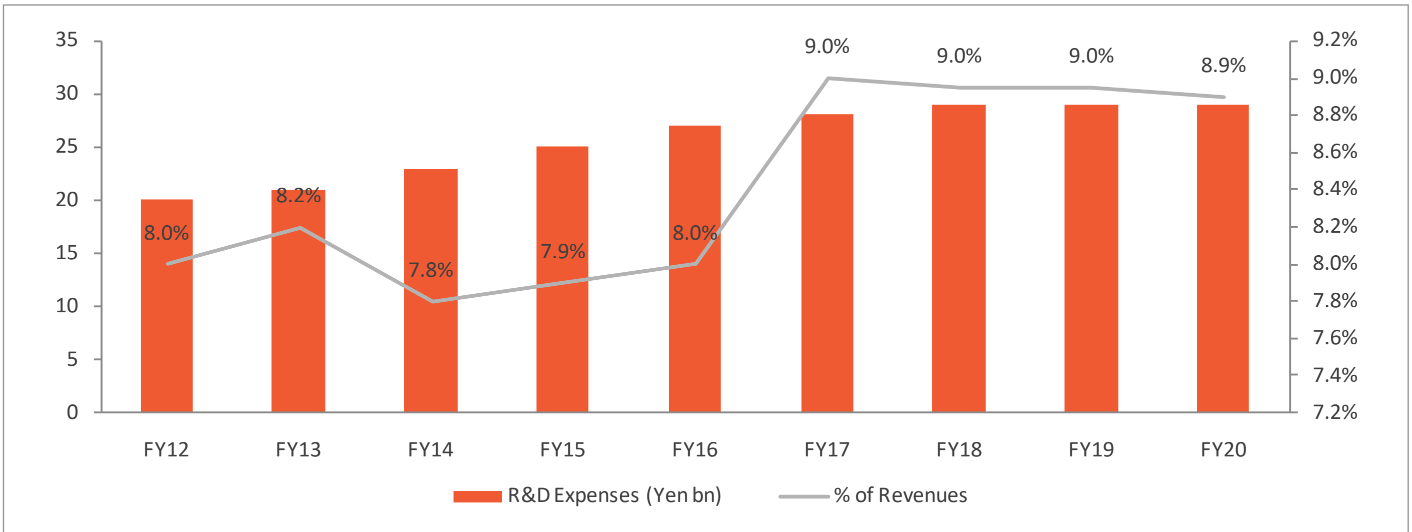
SCC is planning to launch new fungicide crop protection products such as Indiflin and Pavecto and also targets to enter next generation herbicide and increase the revenue from plant growth regulators (PGR). This provides a revenue potential of ~$1.4-1.8 billion over next couple of years. SCC also plans to introduce rice, biorational rhizosphere, botanical insecticides, which provides additional revenue opportunity of $750 million. R&D focus at parent level provides SCIL an access to launch formulations in the Indian market. Moreover, SCC is also focused on development of new molecule for the plant growth regulators (PGR) segment and should also benefit SCIL as it has exposure to rice portfolio and penetration in PGR through Excel Crop Care (ECC). PGR accounts for only 12% of SCIL's revenues in FY2020 and its share is expected to reach 15-16% over the next few years.

SCC revenue mix – Crop science accounts for 15%



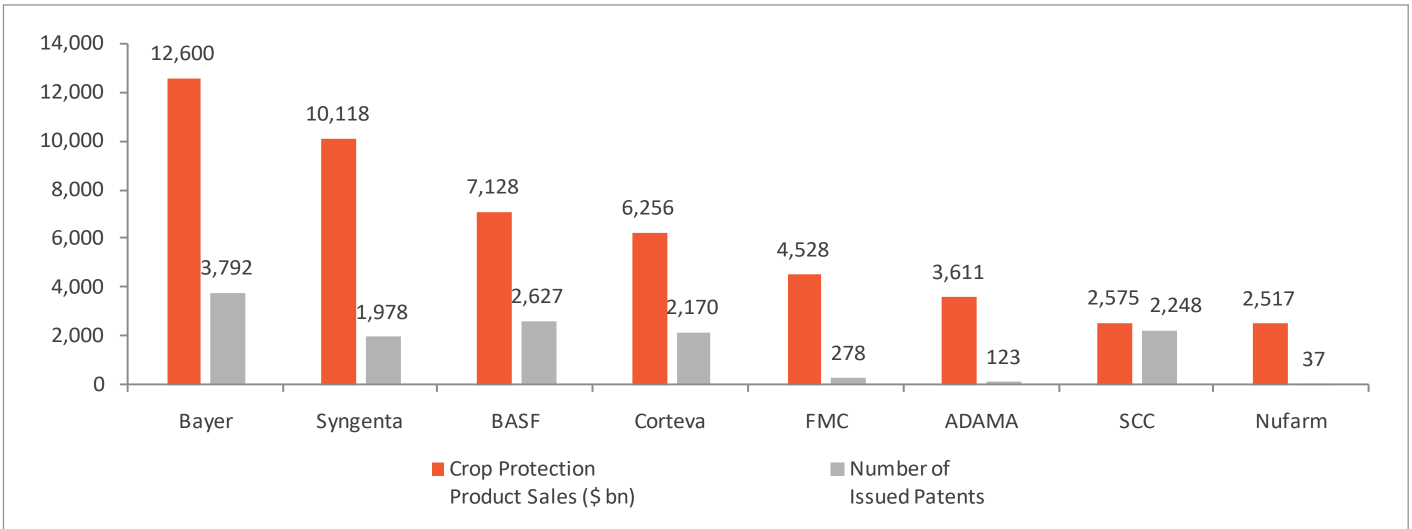
Source: SCC

R&D spent consistently at 8-9% of revenues



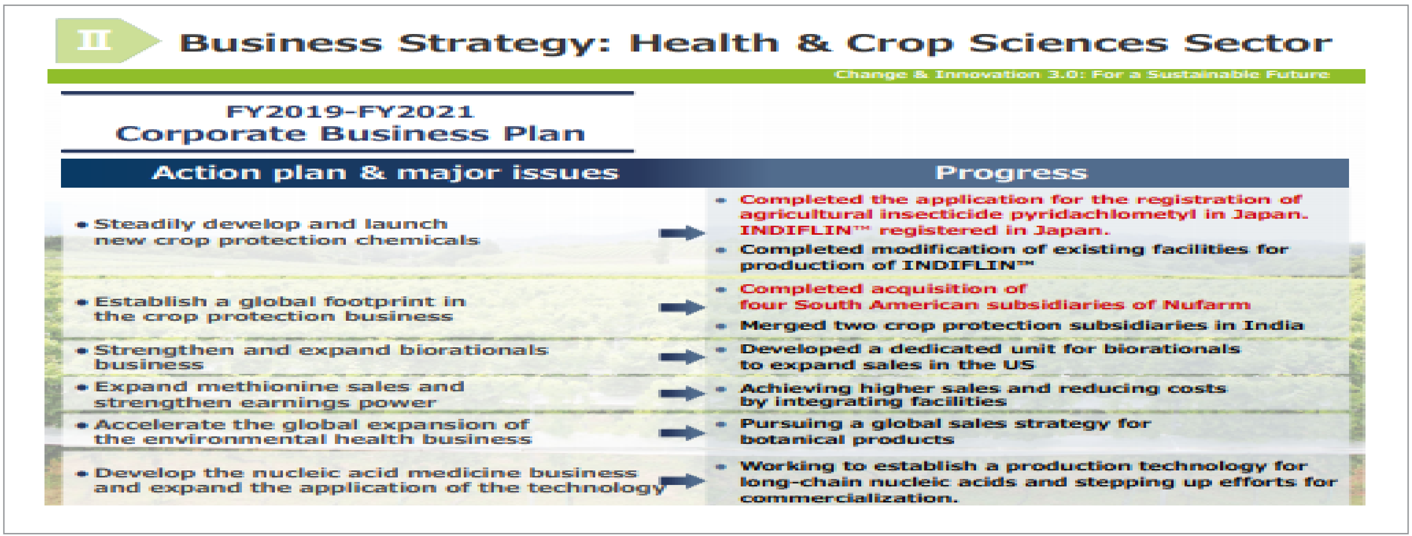
Source: SCC

SCL crop protection revenues and patents versus global players



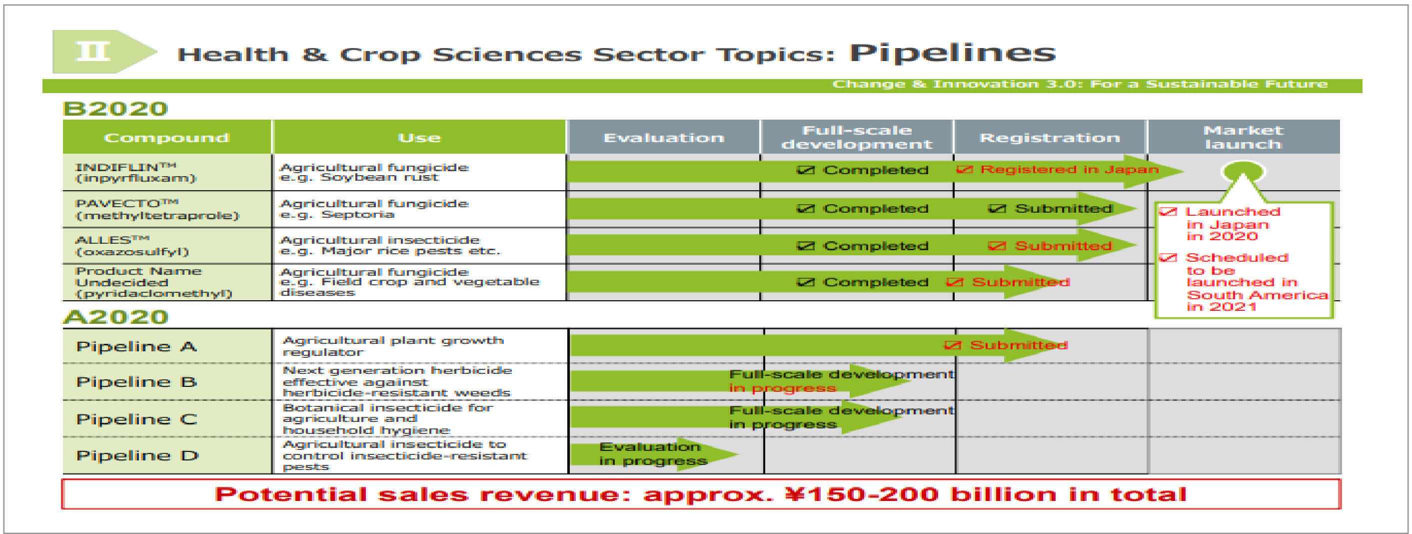
Source: SCC

SCC focus to develop new crop protection products



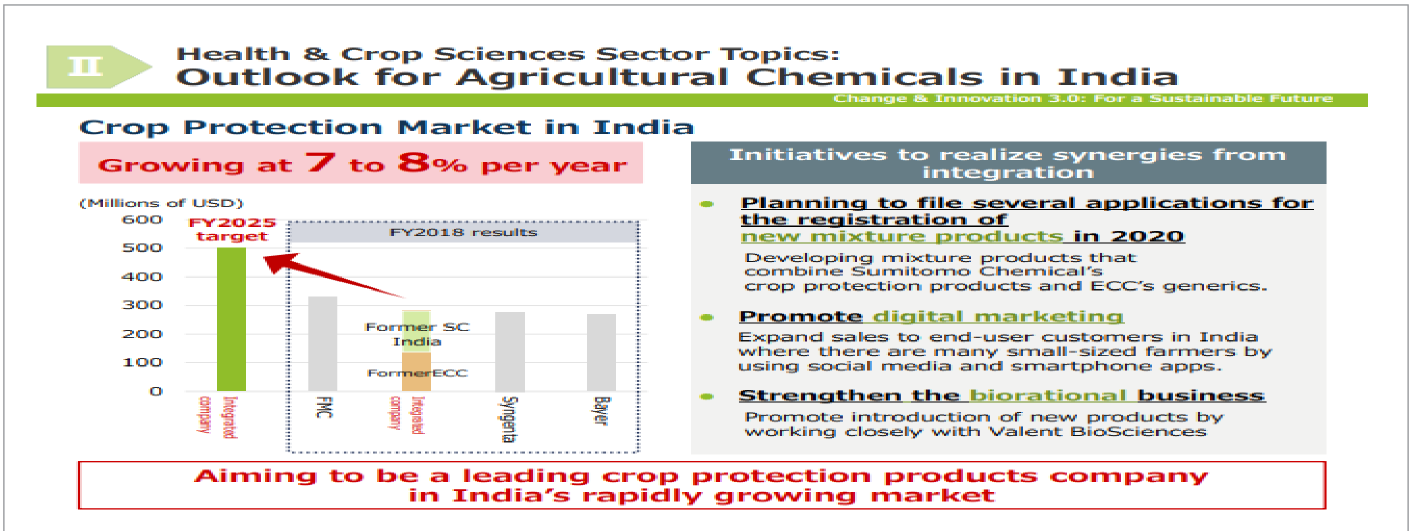
Source: SCC

SCC health & crop science product pipelines



Source: SCC

SCC has revenue target of $500mn for SCIL by 2025



Source: SCC

Strong domestic presence with market share of 11% in Indian agrochemical sector

The revenues of combined entity (SCIL + ECCL) has grown at 11% CAGR over FY2011-FY2020 (versus domestic industry average growth rate of mid single digit) and reached Rs2,425 crore in FY2020, making SCIL third largest agri-input company in India in terms of revenues (94% of revenues being derived from Agricultural Chemical business). In fact SCIL's revenue grew at much higher CAGR of 20% over FY2011-FY2019. We expect the strong growth momentum to continue led by 1) healthy product pipeline (9 new combination products under development) and capacity expansion (15-20% of EBITDA spent on capacity upgrade and expansion), 2) focus to increase share of exports (could reach 30% in next few years from 20% of agri-chemical revenues currently) and 3) rising specialty chemical product portfolio.

Leveraging parent SCC's R&D to development of new products and focus on capacity expansion

SCIL is under the process to develop and launch nine new combination products with five products for insecticides, 2 for fungicides and 2 for PGRs for production in India. The company is also developing for 2 technical grade products (1 each for insecticide and herbicides). The company has spent 11-20% (Rs. 38-43 crore) of its EBITDA on capital expenditure over FY2018-FY2020 to upgrade and expand its manufacturing capacities. SCIL has guided to spend 15-20% of EBITDA annually to augment capacities to cater growing India demand and tap export market.

Diversified Portfolio and strong distribution reach

In SCIL's portfolio, the top 10 products account for less than 50% of total revenue. None of the products/ molecules contribute more than 15% of total revenue. Product offerings are diversified across key crops and deep focus on Fruit &Vegetables, paddy and other high growth segments. SCIL has a dual-brand portfolio which offers products at well diversified prices and serves multiple customer sub-segments. Post-merger with ECCL, SCIL has further de-risked its portfolio by commanding manufacturing capability in both technical grade and formulations. Moreover, SCIL now has a presence in both generic and specialty chemicals and has product range covering both Kharif and Rabi crops which gives SCIL less dependency on seasonal cycle. Through its acquisition of Excel Crop Care, SCIL has built one of India's strongest distribution networks, comprising over 13,700 distributors.

SCIL: Key Products offerings

Product Name	Product Category	Indicative Use
Glyphosate	Herbicide	Tea Gardens, non-cropped
Profenophos	Insecticide	Cotton, Soya bean
Dantotsu	Insecticide	Vegetables
Tebuconazole	Fungicide	Wheat, Soya bean, Chilli
Progibb	Plant Growth Regulator	Citrus Fruits
Aluminum Phosphide	Fumigant	Warehousing of Food Grain
Chlorpyriphos	Insecticide	Paddy, Beans, Gram
DL-Methionine	Animal Nutrition	Poultry

Source: Company

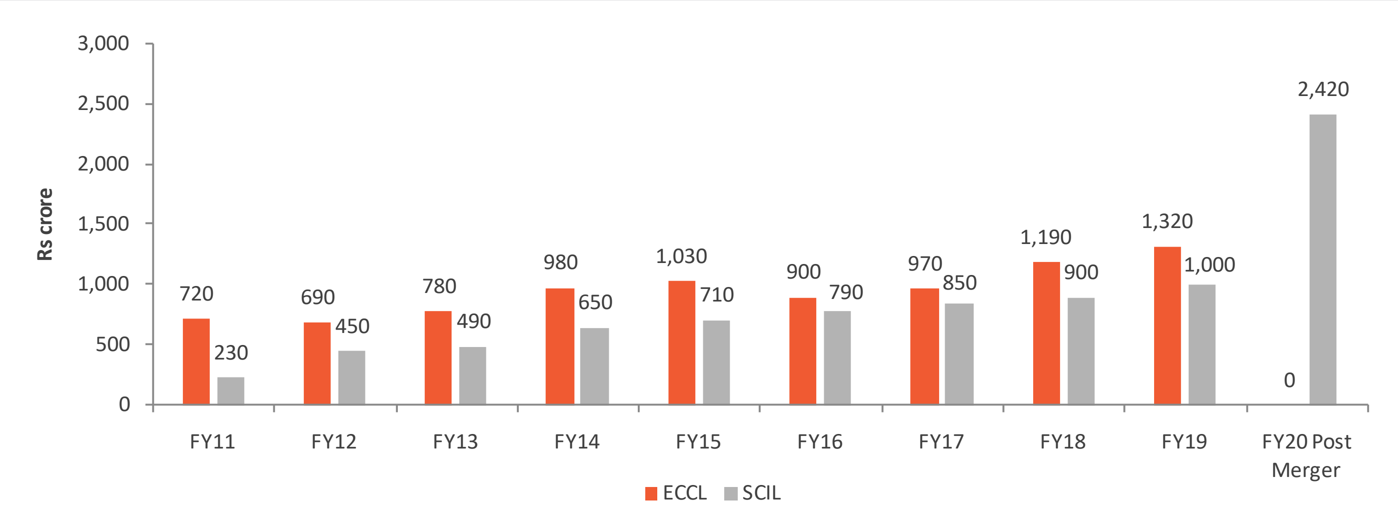
Keen focus to increase share of exports

Historically, exports have accounted for nearly 20-21% of SCIL's agro-chemical revenues. SCIL is focused on increasing exports to Africa and Europe given the support from SCC's global distribution network. With this, we expect share of exports in overall revenues to reach 28-30% by FY2023E. Contract manufacturing (CRAMS) for agri-chemical products is another growth area to increase exports revenues. SCIL is currently manufacturing only one molecule under contract manufacturing for parent company and reviewing 4-5 products for CRAMS going forward.

Specialty chemical segment provides massive growth opportunity

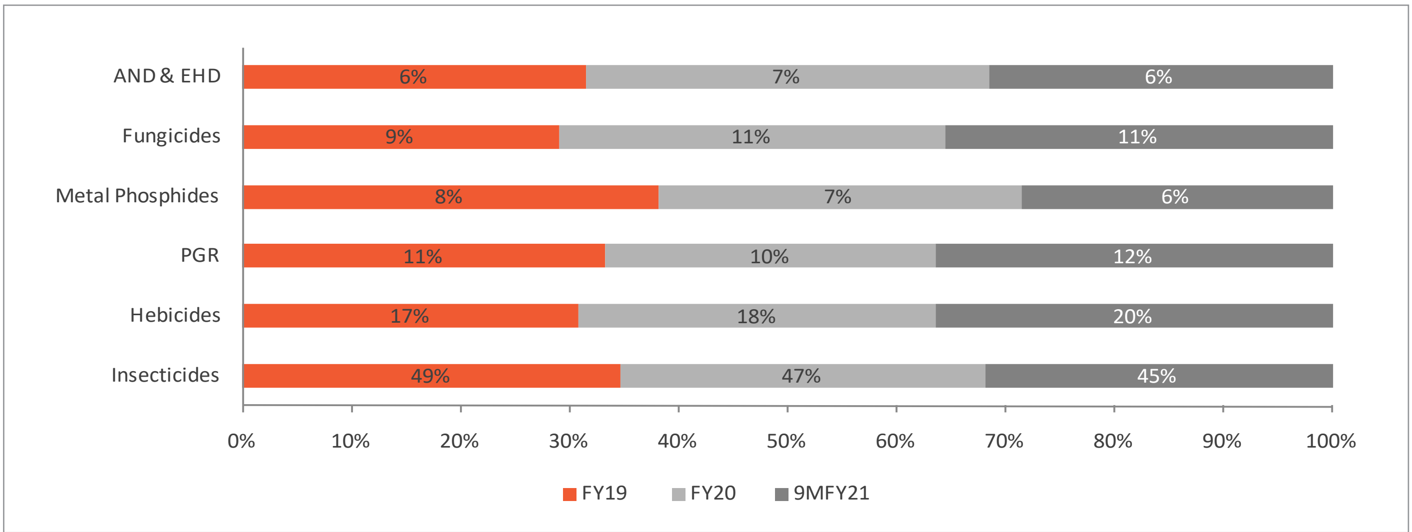
We expect share of specialty chemical to increase to 37-38% by FY2023E versus 29% in FY2020 given SCIL strong focus to increase product offering in specialty segment from portfolio of 15-20 products. The company targets to launch one new product each under specialty chemicals and generic every year, which would gradually expand share of specialty chemical in overall revenues.

Consistent track-record of revenue growth (merged entity) – 11% CAGR over FY2011-FY2020



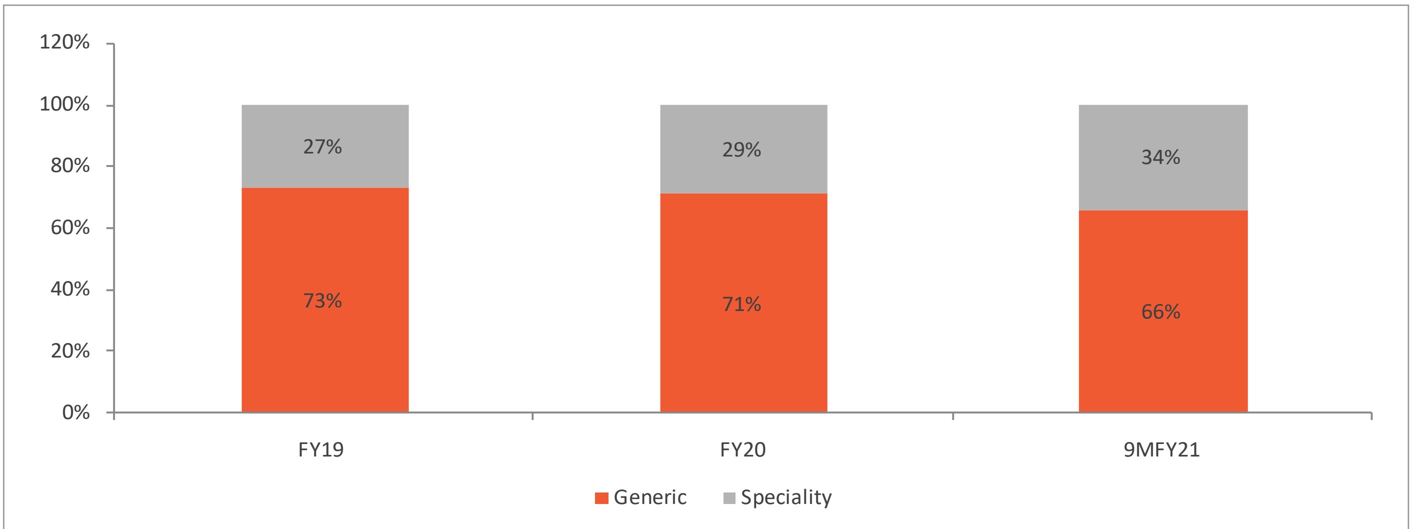
Source: Company

Product wise revenue mix of agri-chemical business



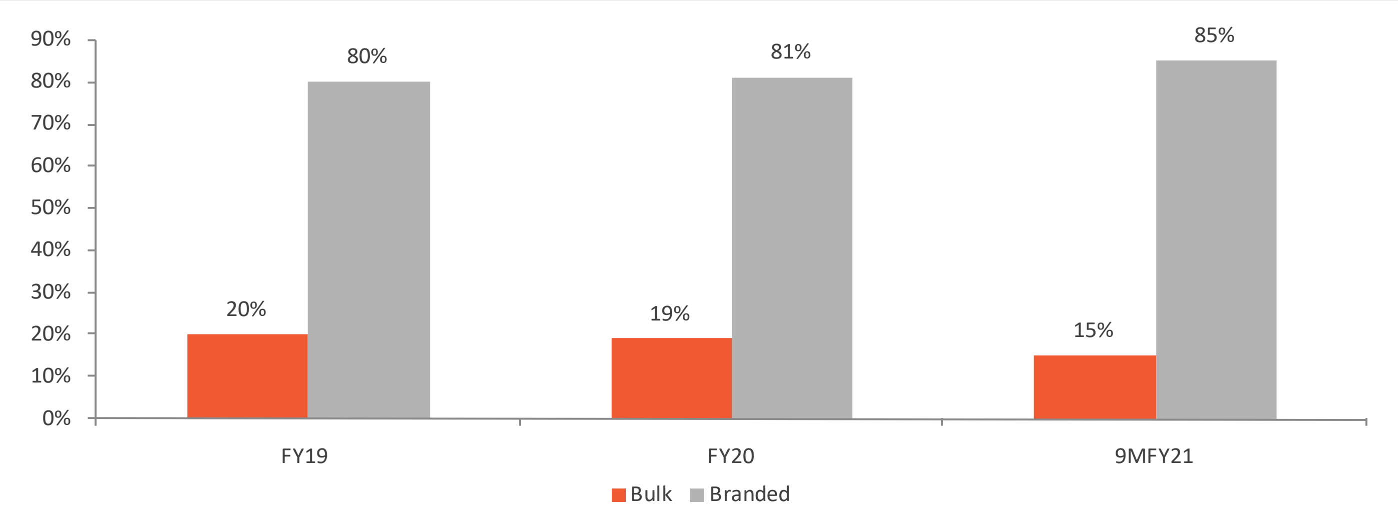
Source: Company

Revenue split between generic and specialty chemicals



Source: Company

Domestic revenue - bulk and branded mix



Source: Company

SCIL growth strategy

Levers	Growth Strategy
Continued Investment in R&D and Pipeline	• Investment in seamless integration of R&D between SCIL and SCC will lead to increased patented and specialty products • Introduce new products
Capacity Expansion	• Investment of ~15% EBITDA every year for upgradation of manufacturing facilities and capacity expansion
Brand Development	• Investment in marketing, on-field demonstrations and continued engagement with farmers • Focus on high-margin brands
Combination Products	• Introduction of 9 new combination products (5 insecticides, 2 fungicides and 2 PGR) and 3 technical products (1 insecticide and 1 herbicide) • Introduction of new molecules in specialty segment leveraging SCC's support
Expansion of Export Business	• Increasing exports to regions such as Africa and Europe leveraging SCC's presence in those countries which will increase export revenues • Contract Manufacturing for Sumitomo Chemical Company. • Currently manufacturing of 1 molecule but 4-5 molecules under review. • Using the parent company's Global supply chain and marketing network to enhance exports

Source: Company; Sharekhan Research

SCIL-ECCL Merger – provides well diversified product portfolio and large synergies

SCIL completed a reverse merger with ECIL with effect from 31 Aug 2019, by offering 51 shares of SCIL for every two shares in ECIL by all shareholders except held by SCIL pre-merger. Post-merger of ECCL and SCIL the new entity Sumitomo Chemical India Ltd will benefit from the Operational synergies in manufacturing and working capital management. The EBITDA margin improvement of 5% since the merger and reduction of net working capital days from 116 days in FY2020 to 74 days in 9MFY2021 days is the step in the right direction. Post merger, SCIL has a well-diversified portfolio of Technical grade and formulations and also generic and specialty chemicals. The manufacturing capability has also increased to five plants, which will lead to efficient capacity utilisation.

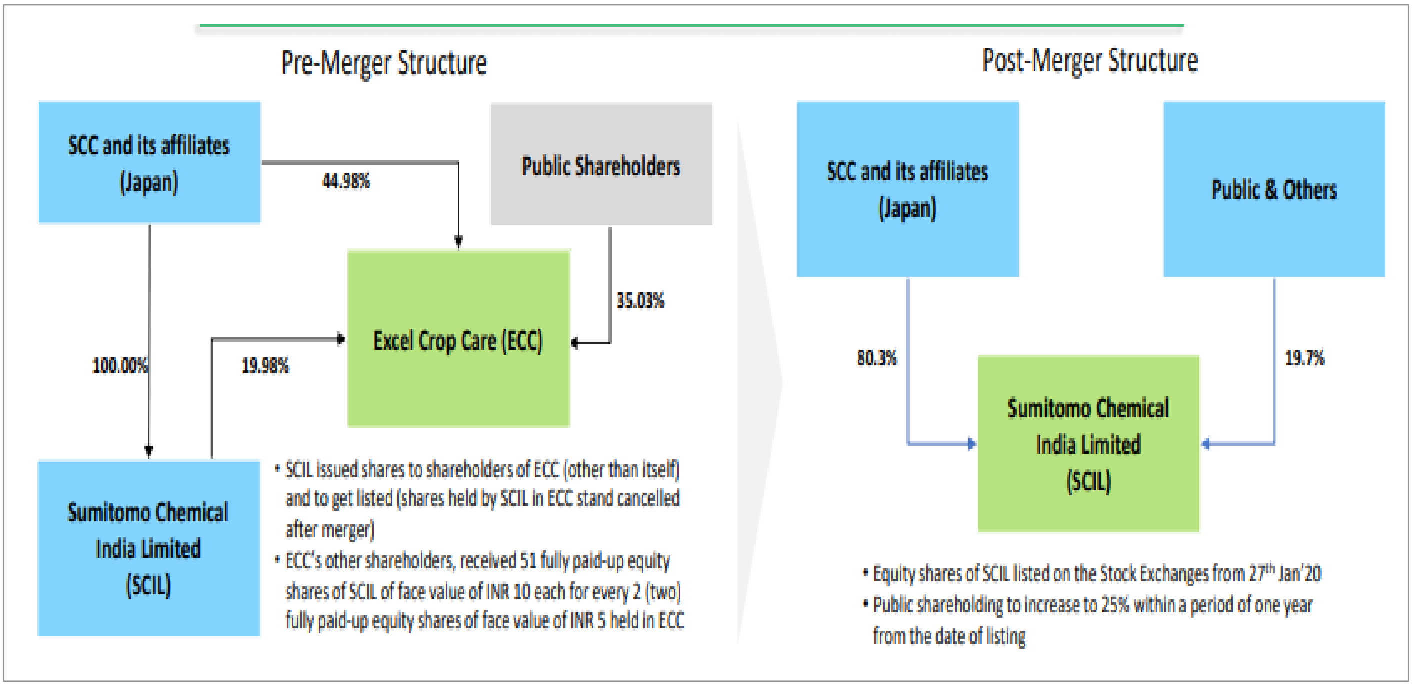
The merger with ECCL has significantly enhanced the product portfolio of SCIL and now the company is able to provide end-to-end solution across crops in India with ECCL product portfolio is focused towards rice, soybean, and cotton while SCIL offers crop protection products especially for wheat, sugarcane and fruits and vegetables. Also, SCIL has a pan-India presence now with SCIL strong presence in south and east and ECCL's presence in the North and West market with total distributor reach of ~13,700. Improved product offerings and better distribution reach provides strong revenue growth synergies for SCIL. Also geographical presence in export market has also increased with ECCL exports revenues coming Africa and Europe while SCI's exports market is focused towards North America and Latin America. In terms of cost synergies ECCL merger would reduce dependency upon imported raw material and thus could improve gross margin of SCIL in medium to long term.

Synergies from SCIL - ECCL merger

Parameter	ECCL	SCIL (Pre Merger)	SCIL (Post Merger)
Manufacturing Facilities	Plants in Gujarat(2) and Dadar & Nagar Haveli (1)	Plant in Maharashtra (1) and Gujarat (1)	5 plants in West India
Manufacturing Capability	Predominantly formulation company with facilities for both formulation & Technical	Manufacturing of Formulations	Both Technical & Formulation Manufacturing
Distribution Capability	4700+ Distributors across India	9000+ distributors concentrated in few regions	Improved depth and breadth of the distributors to 13,700
R&D Capability	3 fully equipped facilities	Outsources R&D	Creating new combinations using SCIL's chemistries
Industry Sub-segments	Insecticides (44%), Herbicides (27%), Fungicides (11%), Metal Phosphides (13%), Others (5%)	Insecticides (63%), Herbicides (7%), Fungicides (8%), Others (22%)	Insecticides (52%), Herbicides (19%), Fungicides (9%), Metal Phosphides (8%), Others (12%)
Product Capability	Major focus in Generics: nascent presence in Biopesticides	Major focus on Specialty Products	Presence across complete range of products
Business Segments	Presence only in Agrochemical segment	Presence in ASD, AND & EHD segments	ASD focused with presence in AND & EHD
Range of Crops Served	Staple crops with major presence in Kharif season	Fruits and vegetable crops covering both Kharif & Rabi season	Well diversified product range covering Kharif & Rabi crops
Customer Concentration	Top 5 customers contributes to ~12% of sales	Top 5 customers contributes to ~15% of sales	Top 5 customers contribute ~12% of sales
S&M Capability	Strong wide-spread presence with the distributors/retailers	High degree of engagement with farmers	Strong presence with both the retailers and farmers

Source: Company

SCIL company structure post and pre-merger with ECCL

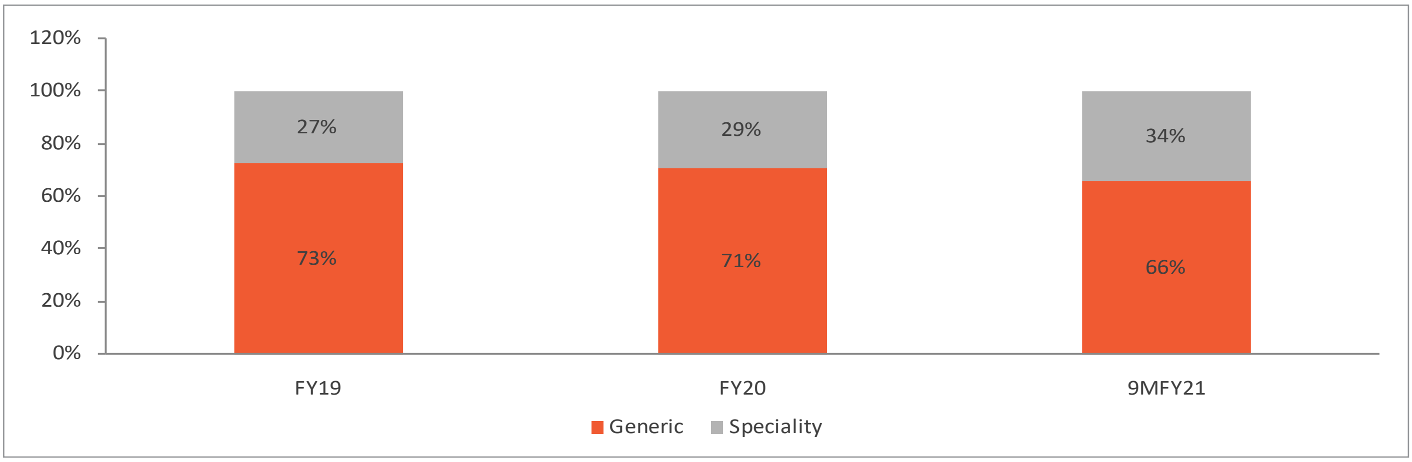


Source: Company

EBITDA margin to expand - cost synergies and higher share of specialty chemicals

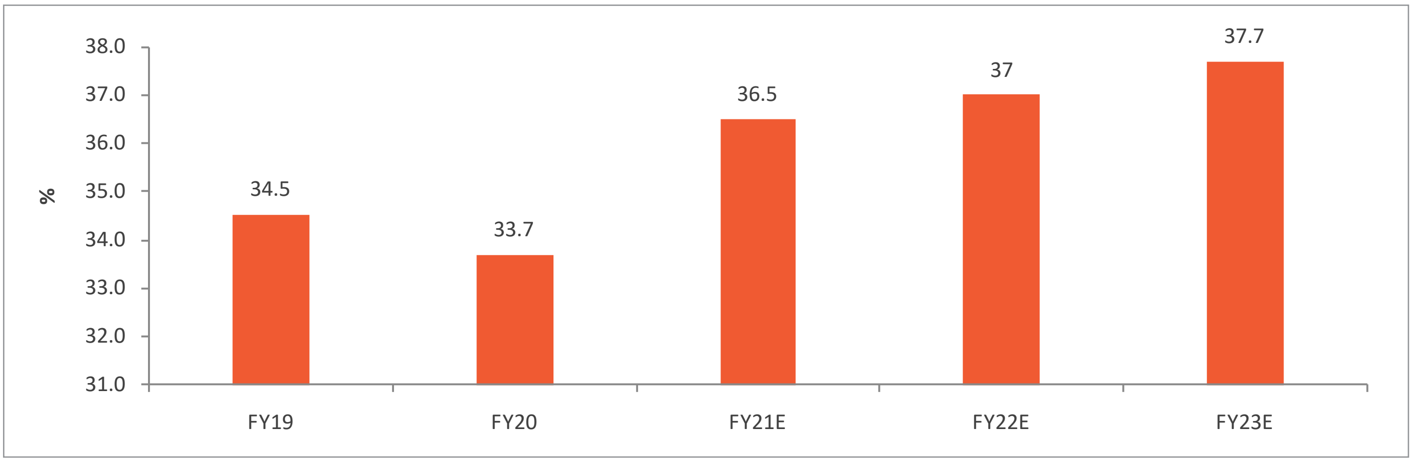
We expect gross margins to expand by 120 bps over FY2021E-FY2023E to 37.7% as SCIL's dependence on imports of molecules would reduce (given ECCL's expertise in active manufacturing) and likely rise in share of specialty chemical in revenues (expected to reach 37-38% by FY2023E from 29% in FY2020). Consequently, we expect EBITDA margin to improve significantly by 291bps over FY2020-FY2023E to 21% on account of higher gross margins, improvement in operating leverage and cost synergies from the merger with ECCL.

Rising share of specialty chemicals



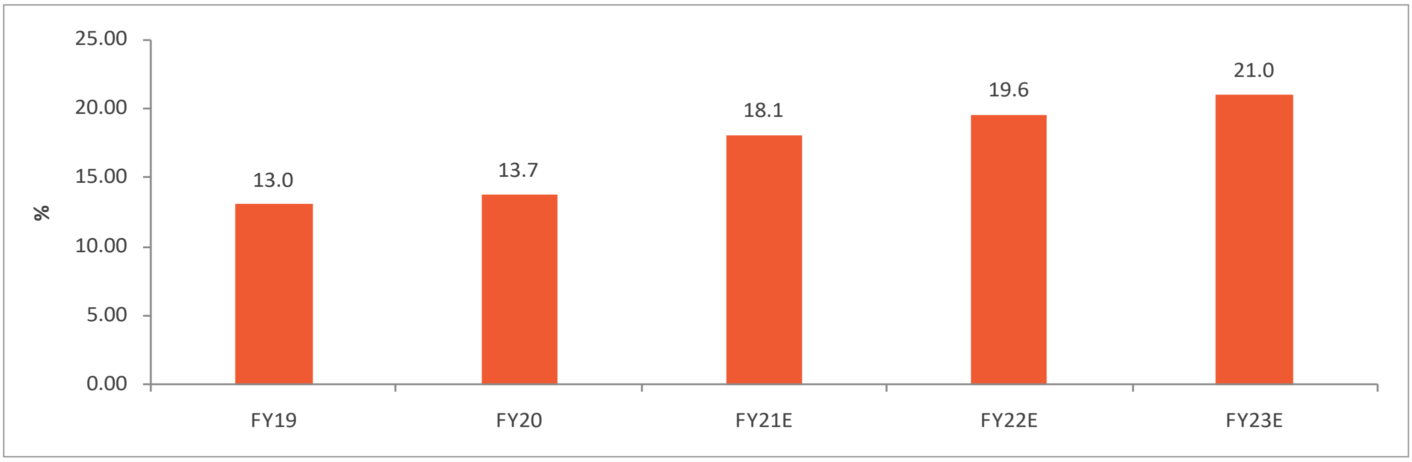
Source: Company data

Improving gross margin expectation over FY2021E-FY2023E



Source: Company data; Sharekhan estimates

EBITDA margin to follow gross margins - rise 291 bps over FY2021E-FY2023E



Source: Company data; Sharekhan estimates

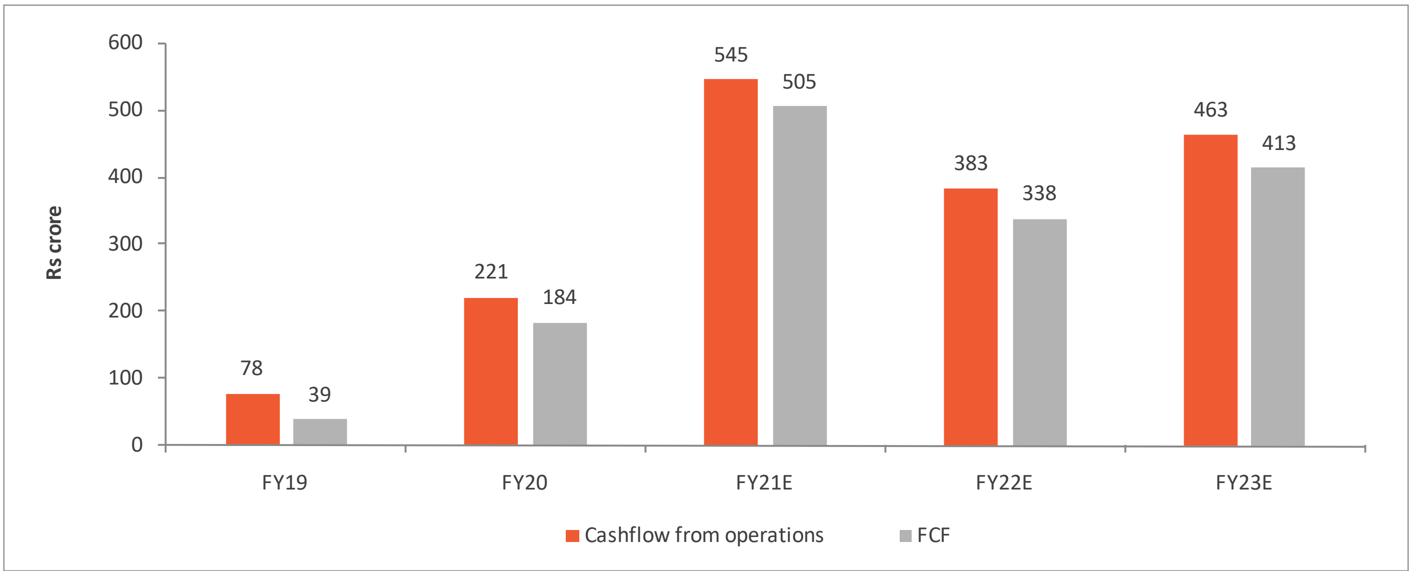
Strong Balance sheet with net cash, high asset turnover and robust return ratios

SCIL has a strong balance sheet with nil debt on books and cash and liquid investments at Rs680 crore as of December 2020 as compared to Rs. 180 crore as on March 2020. The sharp improvement in cash and liquid investments was due to sharp improvement in net working capital cycle to 74 days in Q3FY2021 versus 116 days in FY2020 and 131 days in FY2019. A sharp reduction in working capital cycle is attributable to conscious efforts by the management to reduce inventory and debtors days and increase payable days.

The company asset turnover ratio is also consistently high with average of 6.5x over FY2018-FY2020 given low capital requirement in the business and hence RoE/ROCE is upwards of 21%/26% in FY2020.

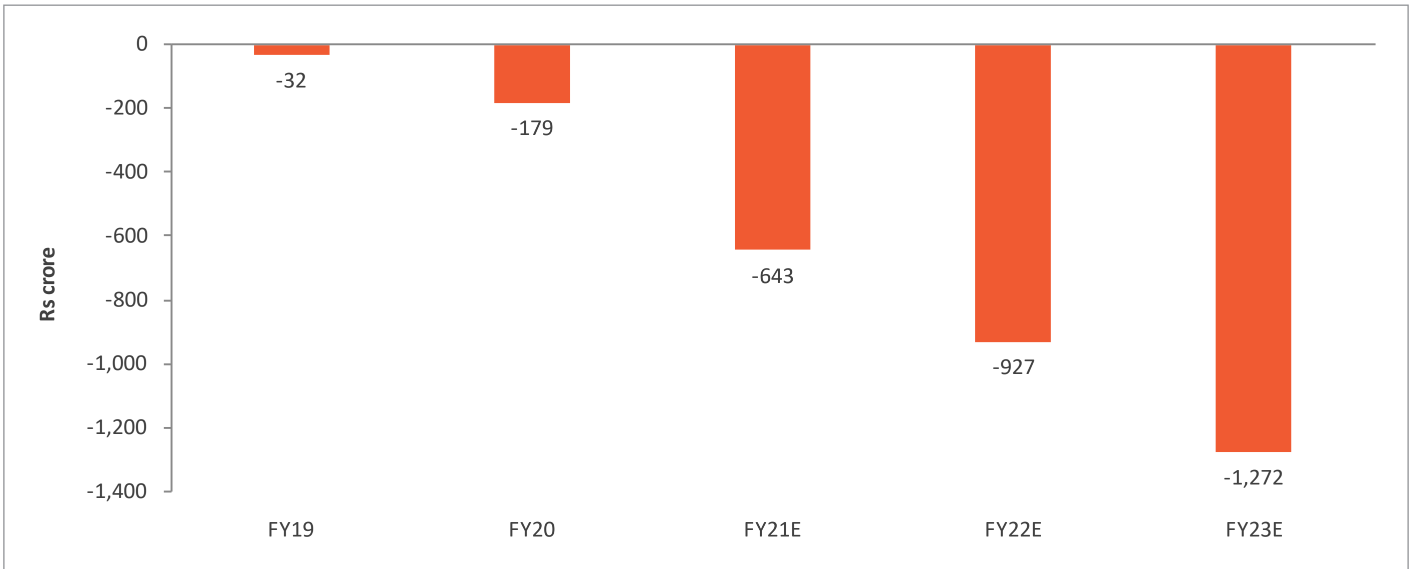
With sharp reduction in the working capital, robust EBITDA growth outlook and limited capex requirement, we expect SCIL's cash from operations and free cash flow to increase significantly over FY2021E-FY2023E.

Strong FCF generation



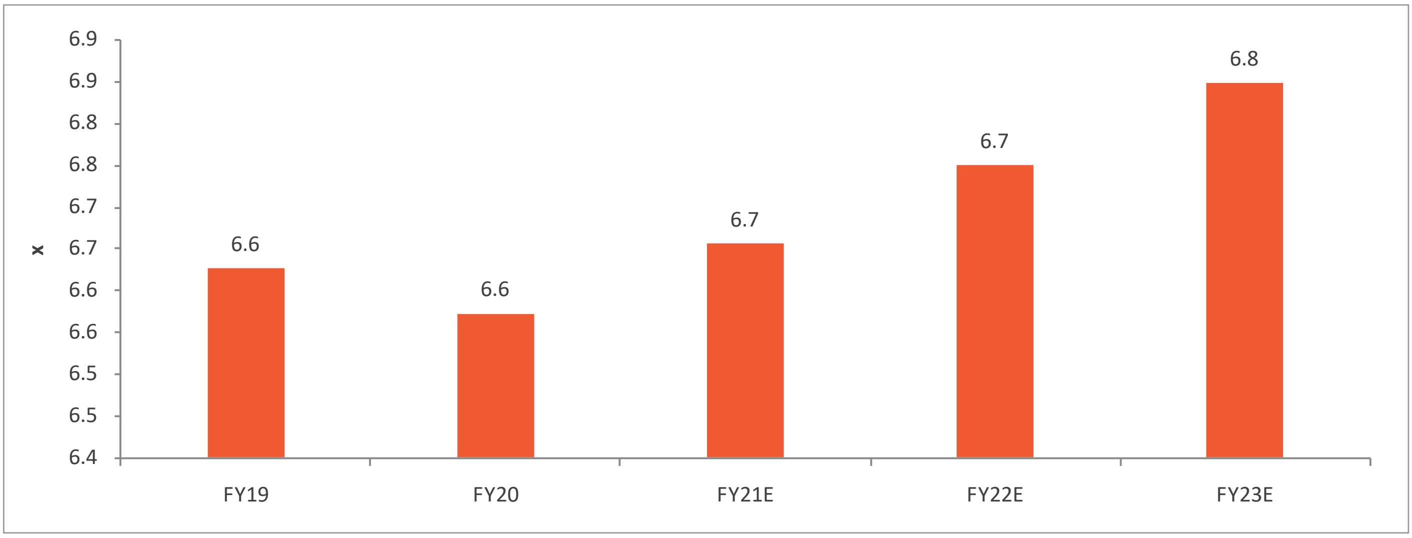
Source: Company; Sharekhan estimates

Net cash position (including liquid investment)



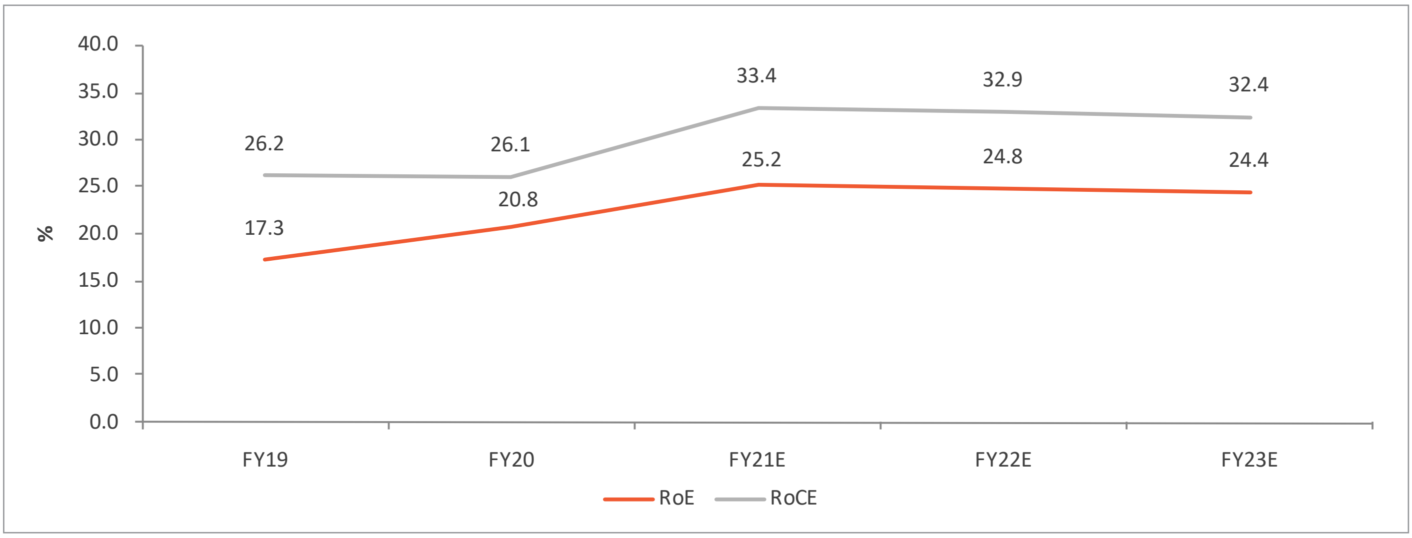
Source: Company; Sharekhan estimates

Higher asset turnover ratio



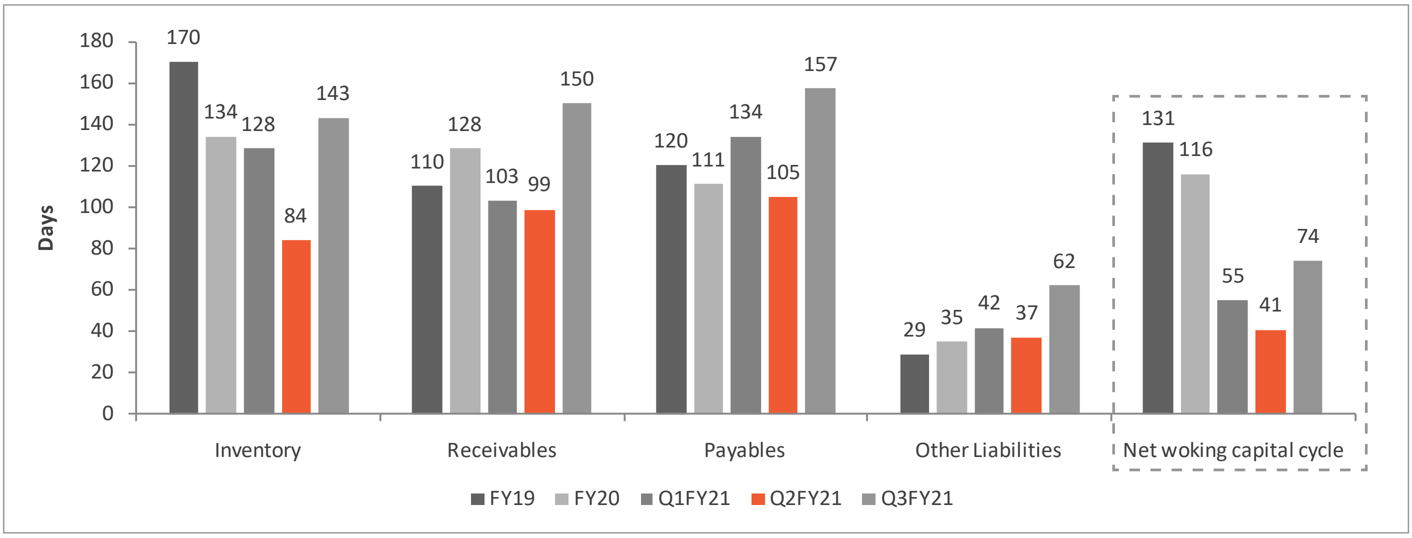
Source: Company; Sharekhan estimates

Strong return ratios



Source: Company; Sharekhan estimates

Working capital cycle improve significantly



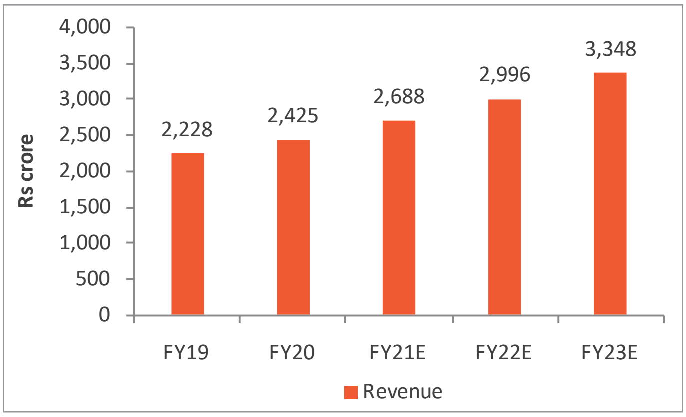
Source: Company

Minimal effect of Pesticides management bill: Recently the government of India released a draft notification for public comments regarding proposed ban of some agro-chemical products. The list of the products proposed to be banned includes some of SCIL's products. Management has advised the investors that the matter may not likely to affect the company's operations.

- Chloropyriphos and Quinalphos are the 2 technical grade products manufactured by SCIL. The company exports these products in a large quantity which would be outside the purview of GOI's proposal
- Some other technical-grade products are purchased by the company to manufacture formulations and for distribution purposes.
- The company also has large exports of Glyphosate, which would be outside the purview of proposal.

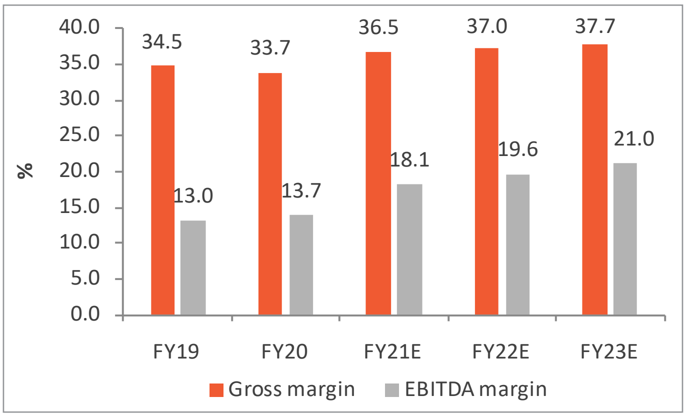
Financials in charts

Strong revenue growth outlook



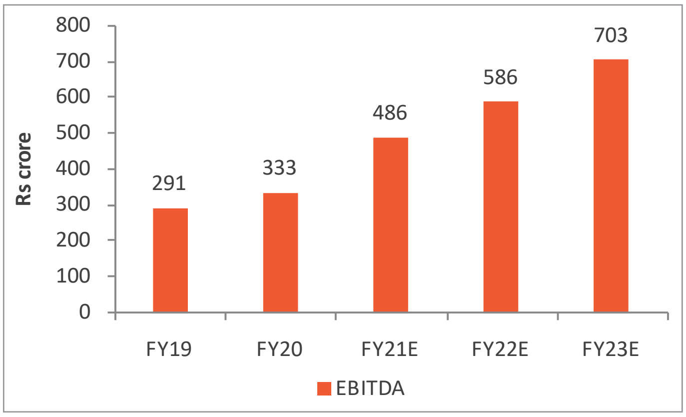
Source: Company, Sharekhan Research

Margins to expand led by cost rationalization



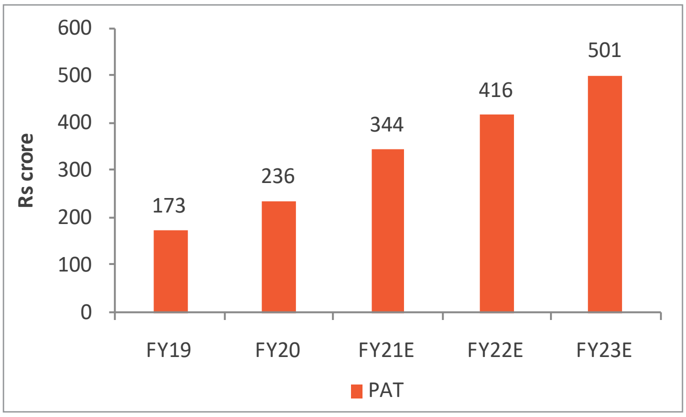
Source: Company, Sharekhan Research

EBITDA CAGR of 20% over FY2021E-FY2023E



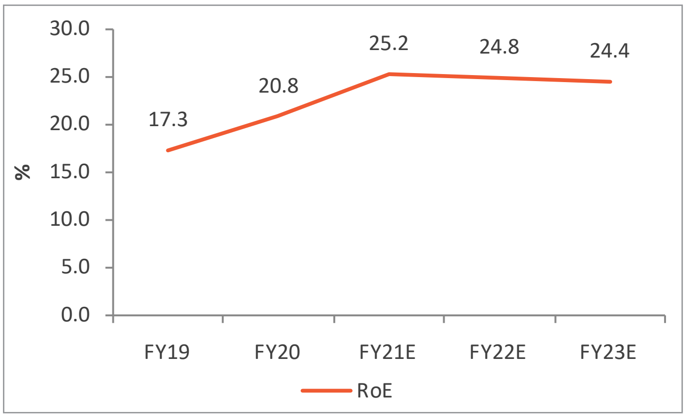
Source: Company, Sharekhan Research

Robust PAT growth outlook



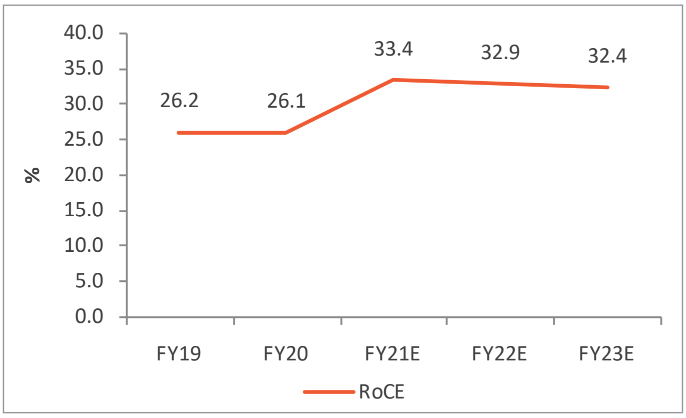
Source: Company, Sharekhan Research

RoE on improving trend



Source: Company, Sharekhan Research

Robust RoCE track record



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Rising food demand provides ample growth opportunities for agri-input players

The outlook for the Indian agrochemical industry is encouraging, primarily driven by rising foodgrain production and domestic demand, favourable regulatory reforms for farmers (government passed key agri-sector reforms namely Farmers Produce Trade and Commerce Bill, 2020 & Farmers (empowerment & protection) Agreement of Price Assurance & Farm Services Bill) and the vast opportunity from products going off-patent. The government's focus is to double farmers' income (higher MSPs for crops). A near-normal monsoon and higher reservoir levels would augment demand for agri-input in India. We also expect exports from India to grow at a strong pace as India is being looked upon as the preferred supplier for agri-input products given supply disruption from China. Thus, we expect India's agrochemical industry to witness high single digit growth annually on a sustained basis over the next few years. Moreover, international markets such as Latin America (grew by 7.6% in CY2019) would continue to grow at a robust pace supported by higher demand for crop protection and farm solutions mitigating slower growth in the US and Europe.

■ Company outlook - Strong earnings growth outlook

Post the merger of ECCL, SCIL has become third-largest agrochemical company in India with revenues of Rs. 2,425 crore in FY2020. The acquisition provides strong revenue growth opportunities as both ECCL and SCIL have a presence in different crop protection product portfolio and operates in different geographical presence (both in domestic and exports markets). Hence, we expect SCIL's revenue to grow at 12% CAGR over FY2021E-FY2023E. Moreover, margins are expected to expand by 291bps and reach 21% by FY2023E as SCIL's dependence on imports of molecules would reduce (given ECCL's expertise in active manufacturing) and aid gross margins. Thus, we expect SCIL's earnings to clock a 21% CAGR over FY2021E-FY2023E. With limited capex, the company would generate decent cumulative FCF of Rs. 1,257 crore over FY2021E-FY2023E. The revenue opportunity from crams could further aid revenue and earnings growth of SCIL.

■ Valuation - Initiate stock idea coverage on SCIL with a Buy rating and price target of Rs. 350

A strong parental advantage, revenue & cost synergies from ECCL merger and robust product pipeline would help it register strong EBITDA/PAT CAGR of 20%/21% over FY2021E-FY2023E along with a robust RoE of 24%. A superior earnings growth outlook, massive revenue opportunity from CRAMS (not factored in our earnings estimates) and a robust balance sheet (high asset turnover ratio of 6.6x and net cash of Rs. 680 crore) is likely to keep SCIL's valuations at a premium to domestic peers. We initiate coverage on SCIL with a Buy rating and PT of Rs. 350 (valued at 35x FY2023E EPS of Rs10). At CMP, SCIL is trading at 33x FY2022E EPS and 27.4x FY2023E EPS.

Peer valuation

Particulars	PE (x)			EV/EBITDA (x)			P/BV (x)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Domestic peers									
Sumitomo Chemical India Limited#	39.9	33.0	27.4	27.0	22.0	17.8	9.1	7.4	6.1
UPL Limited#	15.0	14.0	12.6	8.5	7.7	6.7	2.5	2.2	1.9
PI Industries#	51.3	40.6	31.8	35.2	27.9	21.9	6.6	5.7	5.0
Rallis India	24.1	19.6	16.5	14.6	12.3	10.4	3.3	2.9	2.6
BASF India	28.9	27.2	23.6	15.4	14.7	13.2	4.5	3.9	3.4
Global peers									
Bayer AG	9.1	8.2	8.0	7.6	7.1	6.6	1.4	1.3	1.4
BASF SE	16.8	15.4	13.6	9.2	8.6	8.0	1.8	1.8	1.7
FMC Corp	15.8	14.0	12.5	12.6	11.6	10.9	4.4	4.1	3.7

Source: Bloomberg; Sharekhan estimates#

Financials

Income Statement Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net sales	**2,228**	**2,425**	**2,688**	**2,996**	**3,348**
Raw material cost	1,459	1,608	1,707	1,888	2,086
Employee cost	158	179	190	200	213
Other expenditure	320	305	305	323	346
Total expenditure	1,938	2,092	2,202	2,410	2,645
Operating profit	**291**	**333**	**486**	**586**	**703**
Other income	8	11	20	21	22
Depreciation	28	41	45	49	54
EBIT	270	303	462	558	671
Interest	4	6	2	2	2
Exceptional (income)/expense	-7.0	-30.9	0.0	0.0	0.0
PBT	260	267	460	556	669
Tax	94	62	116	140	168
Reported PAT	166	205	344	416	501
Adjusted PAT	**173**	**236**	**344**	**416**	**501**

Source: Company, Sharekhan estimates

Balance Sheet Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Sources of Fund					
Equity capital	275	499	499	499	499
Reserves & surplus	774	723	1,005	1,346	1,756
Net-worth	1,048	1,222	1,504	1,845	2,255
Deferred tax liabilities	15	0	0	0	0
Other long-term liabilities	0	19	19	19	19
Total loans	20	0	0	0	0
Capital employed	**1,083**	**1,241**	**1,523**	**1,864**	**2,275**
Application of Funds					
Net block	279	285	275	265	256
CWIP	3	6	11	16	21
Investments	0	86	86	86	86
Other non-current assets	28	64	64	64	64
Current Assets					
Inventory	681	588	672	749	837
Sundry Debtors	671	850	821	874	977
Cash & Bank Balances	51	94	557	841	1,186
Other Current Assets	146	134	155	173	193
Total Current Assets	**1,549**	**1,665**	**2,205**	**2,637**	**3,193**
Less: Current Liabilities & Provisions					
Trade Payables	481	491	747	791	884
Other Current Liabilities & Provisions	296	374	372	414	463
Total Current Liabilities & Provisions	**777**	**865**	**1,118**	**1,205**	**1,346**
Net current Assets excluding cash	**721**	**706**	**530**	**591**	**660**
Total Assets	**1,083**	**1,241**	**1,523**	**1,864**	**2,275**

Source: Company, Sharekhan estimates

Cash Flow Statement

Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Cash flow from operating activities	78	221	545	383	463
Cash flow from investing activities	-35	-118	-20	-24	-28
Cash flow from financing activities	-65	-61	-62	-75	-90
Net change in cash and cash equivalents	-23	42	463	285	345
Opening cash balance	74	51	94	557	841
Closing cash & bank balance	51	94	557	841	1,186
Free Cash Flows (FCF)	**39**	**184**	**505**	**338**	**413**

Source: Company, Sharekhan estimates

Key Ratios

Margins (%)	FY19	FY20	FY21E	FY22E	FY23E
Margins (%)					
Gross Profit Margin	34.5	33.7	36.5	37.0	37.7
OPM	13.0	13.7	18.1	19.6	21.0
EBIT Margin	12.1	12.5	17.2	18.6	20.0
Tax Rate	36.2	23.2	25.2	25.2	25.2
Net Profit Margin	7.8	9.7	12.8	13.9	15.0
Financial Ratios					
Gross Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0
Interest Coverage (x)	74.1	54.9	230.8	278.9	335.5
Average Cost of Debt (%)	NA	NA	NA	NA	NA
Inventory Days (number)	104	94	90	90	90
Debtors Days (number)	99	113	110	105	105
Creditors Days (number)	81	72	100	95	95
Net Working Capital Days (number)	122	135	100	100	100
Fixed Assets Turnover Ratio (x)	6.6	6.6	6.7	6.7	6.8
Adjusted EPS (Rs)	3.5	4.7	6.9	8.3	10.0
Cash EPS (Rs)	4.0	5.5	7.8	9.3	11.1
DPS (Rs)	1.2	0.4	1.0	1.2	1.5
Dividend Payout (%)	34.2	9.1	15.0	15.0	15.0
BVPS (Rs)	21	24	30	37	45
RoNW (%)	17.3	20.8	25.2	24.8	24.4
RoCE (%)	26.2	26.1	33.4	32.9	32.4
Valuation (x)					
CMP (Rs/share)	275	275	275	275	275
Mcap (Rs crore)	13,709	13,709	13,709	13,709	13,709
EV (Rs crore)	13,677	13,616	13,152	12,868	12,523
P/E (x)	79.4	58.2	39.9	33.0	27.4
P/BV (x)	13.1	11.2	9.1	7.4	6.1
EV/EBITDA (x)	47.1	40.9	27.0	22.0	17.8
EV/Sales (x)	6.1	5.6	4.9	4.3	3.7
Dividend Yield (%)	0.4	0.2	0.4	0.5	0.5
Growth rates (%)					
Revenue	16.5	8.8	10.9	11.5	11.7
EBITDA	33.9	14.6	46.0	20.5	20.0
EBIT	20.8	12.0	52.4	20.9	20.3
PBT	17.6	2.6	72.4	20.9	20.4
Adjusted PAT	19.0	36.4	46.0	20.9	20.4
AEPS	19.0	36.4	46.0	20.9	20.4

Source: Company, Sharekhan estimates

About company

Sumitomo Chemical India Limited (SCIL) manufactures, imports and markets products for Crop Protection, Grain Fumigation, Rodent Control, Bio Pesticides, Environmental Health, Professional Pest control and Feed Additives for use in India. SCIL has also marked its presence in Africa and several other geographies of the world. The company's product range comprises of conventional chemistry sourced from our parent company, Sumitomo Chemical Company and biological products sourced from USA based subsidiary, Valent Biosciences LLC, a leader in producing a range of naturally occurring, environmentally compatible pesticides and plant growth regulators, for over 40 years. The company also produce many technical grade pesticides at its state-of-the-art manufacturing units with indigenous R&D facility.

Investment theme

With few crop protection chemicals are expected to be off patent in years, the genetic crop protection chemicals should grow in double digits. Hence, merger of ECCL (has 100% generic portfolio in crop protection market along with backward integration of a few technical) bodes well for industry leading revenue growth for SCIL. Cost synergies in term of reduction in imported of raw material (post ECCL merger) would drive strong margin expansion. Additionally, SCIL derives multiple benefits from parent's R&D capabilities and global presence.

Key Risks

- Likely ban on products such as Glyphosate (15% of revenues) could impact earnings outlook.
- Delay in supply of raw material from china could impact margins lower.
- Adverse weather conditions could affect demand of agri inputs and impact earnings outlook.

Additional Data

Key management personnel

Mukul Govindji Asher	Chairman & Independent Director
Chetan Shantilal Shah	Managing Director
Sushil Champaklal Marfatia	Executive Director
Hiroyoshi Mukai	Non-executive Director

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management Company Ltd/India	0.80
2	Vanguard Group Inc/The	0.69
3	Invesco Asset Managment India Pvt Ltd	0.35
4	L&T Mutual Fund Trustee Ltd/India	0.35
5	Tata Asset Management Ltd	0.30
6	Norges Bank	0.15
7	BOI AXA Investment Managers Pvt Ltd/India	0.06
8	Dimentional Fund Advisors LP	0.04
9	Essel Funds Management Company Ltd	0.03
10	LIC Mutual Fund Asset Management Company Ltd	0.02

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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