

Input inflation, stiff competition to weigh in near term

About the stock: Established in 1951, Sudarshan Chemical is a leading player in the Indian colour pigment industry with ~35% market share and is also among the top four players globally.

- It has a wide portfolio of 4,000+ varieties of products of Azos, blue and green, high performance pigments (HPPs), effects, pigment preparations and inorganics
- Among end users, coatings industries contribute highest followed by plastics, inks, cosmetics and other applications

Q3FY22 Results: The topline came in above estimates due to better volume growth while bottomline remains almost in line due to margin pressure

- Reported revenue growth of 18.8% YoY to ₹ 601.8 crore, led by higher growth from pigments (up 17.4% YoY) & engineering (up 85% YoY)
- Gross margins fell 230 bps YoY to ~40.5% while EBITDA margin contracted 340 bps YoY to 12.3%, due to higher operating cost like other (+30.2% YoY)
- EBITDA declined 7.2% YoY to ₹ 73.9 crore
- PAT was down 7.1% YoY to ₹ 36.4 crore

What should investors do? The stock appreciated at 19% CAGR in last three years.

- We maintain our rating to **BUY** on the back of better growth outlook from speciality pigments

Target Price and Valuation: We value Sudarshan Chemical at 27x P/E FY23E EPS to arrive at a revised target price of ₹ 695/share (earlier ₹ 735/share).

Key triggers for future price performance:

- Upcoming capex bodes well for speciality pigments revenue growth
- Higher share of value added business portfolio expected to improve margin profile of the business
- Allocation of incremental FCF towards organic/inorganic growth likely to expand return ratios further

Alternate Stock Idea: Apart from Sudarshan Chemical, in our chemical coverage we also like Neogen Chemical.

- For Neogen Chemical, future revenue growth is expected to be driven by increasing custom synthesis opportunity
- BUY with a target price of ₹ 2160

SUDARSHAN

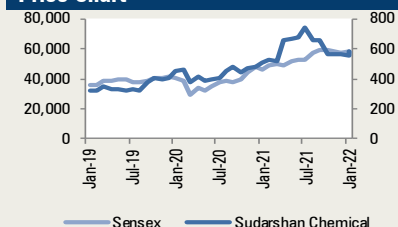
Particulars

Particular	Amount
Market cap (₹ Crore)	4,011
FY21 Total Debt (₹ Crore)	618
FY21 Cash & Inv (₹ Crore)	24
EV (₹ Crore)	4,605
52 Week H/L	794/486
Equity Capital (₹ Crore)	13.8
Face Value (₹)	2

Shareholding pattern

in %	Mar-21	Jun-21	Sept-21	Dec-21
Promoter	40.0	39.6	35.7	35.7
DII	9.0	9.3	9.8	10.9
FII	9.4	8.8	9.4	8.5
Others	41.6	42.4	45.1	44.9

Price Chart



Recent event & key risks

- Input price inflation will be passed on during subsequent quarters
- Key Risk:** (i) Higher RMAT prices and inability to pass on to impact gross margins (ii) Slowdown in end user demand

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	2 year CAGR (FY21-23E)
Net Revenue	1,593.1	1,708.2	1,864.1	5.9%	2,267.1	2,660.0	19.5%
EBITDA	204.1	246.3	287.8	11.1%	282.3	351.5	10.5%
EBITDA Margins (%)	12.8%	14.4%	15.4%		12.5%	13.2%	
Adj. PAT	132.8	145.1	141.1	15.1%	136.3	177.6	12.2%
Adj. EPS (₹)	8.7	18.5	20.4		19.7	25.7	
EV/EBITDA	22.1x	18.2x	15.7x		15.9x	12.7x	
P/E	65.3x	27.6x	28.4x		29.4x	22.6x	
ROE (%)	10.7	21.3	19.0		16.1	18.2	
ROCE (%)	14.4	15.2	15.2		13.6	16.2	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlight

Q3FY22 Results: Higher growth from both domestic, export businesses lead overall growth

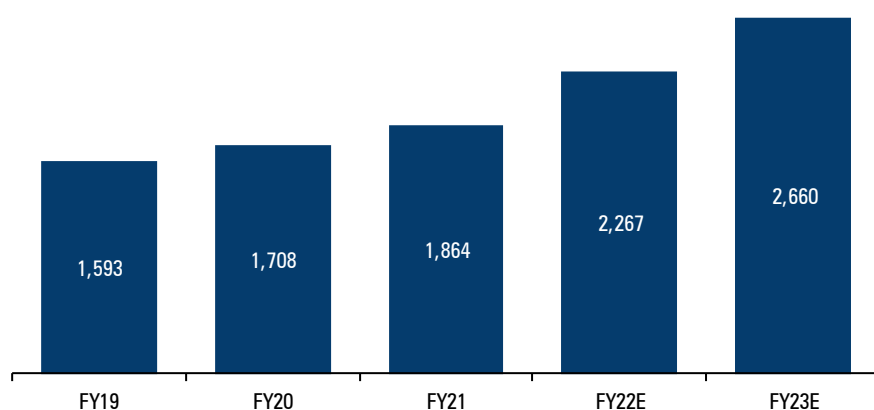
- **Pigment business:** Revenues were up 17.4% YoY to ₹ 560 crore, led by better growth from both domestic & export businesses. Pigment revenue from the domestic market was up 17.2% YoY to ₹ 306 crore while exports were up 17.6% YoY to ₹ 254 crore. Revenue from the speciality pigment increased 14% YoY to ₹ 375 crore while the same from non-speciality pigment was up 25% YoY to ₹ 185 crore
- **Gross margins remain soft:** Although the management sounds confident of passing on higher input cost this quarter, there has been a fall in the GPM by 180 bps QoQ to 40.5%. We expect part of this to be on account of a lag in passing on input price inflation. Moreover, higher energy and logistic cost also remains a key challenge for a subdued operational performance. The company is able to pass on only 70% of those inflated cost, which led to pressure on operating profit. OPM contracted 340 bps YoY to 12.3%

Q3FY22 Earnings Conference Call highlights

- Coating continues to witness decent demand, while better demand from ink has fuelled part of the growth for Q3FY22, which remained soft in Q2FY22. There has been an improvement in the demand outlook for plastics as well, which is supporting better volume growth for pigments, to some extent
- The company witnessed input cost escalation across multiple intermediates for pigments. Moreover, a sharp increase in energy cost impacted margins
- Higher freight and power cost impacted other expenses, which, in turn, led to a subdued operational performance. The inflation in power and freight cost is expected to be passed on with one quarter lag impact
- **Capex:** It is on track to complete capex this fiscal. The company has been on a capex spree since FY20. Total capex was envisaged at ₹ 750 crore with an expected asset turn of 2x. The company has commissioned ₹ 160 crore worth of capex by 9MFY22, while it is committed to incur ₹ 300 crore worth of capex in this fiscal
- The company expects to increase its presence in HPP. The capex for HPP is likely to commission during Q4FY22
- Capacity utilisation during Q3FY22 was ~ 80%

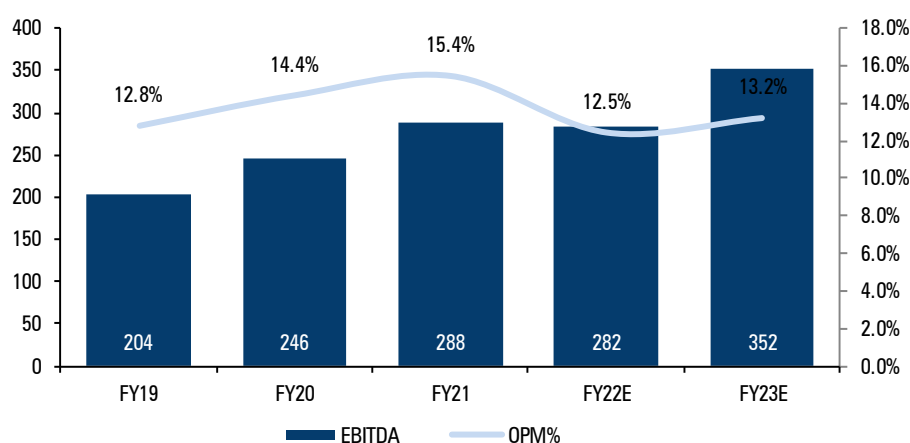
Financial story in charts....

Exhibit 1: Revenue trend (₹ crore)



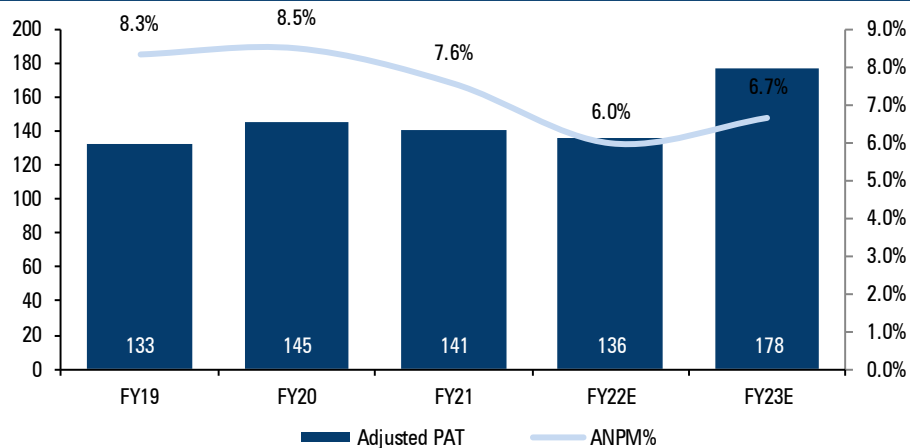
Source: Company, ICICI Direct Research

Exhibit 2: EBITDA (₹ crore) and OPM (%) trend



Source: Company, ICICI Direct Research

Exhibit 3: PAT growth trend (₹ crore)



Source: Company, ICICI Direct Research

Financial summary

Exhibit 4: Profit and loss statement ₹ crore				
(Year-end March)	FY20	FY21	FY22E	FY23E
Total Operating Income	1,708.2	1,864.1	2,267.1	2,660.0
Growth (%)	7.2	9.1	21.6	17.3
Raw Material Expenses	976.2	1,060.5	1,308.5	1,542.8
Gross Profit	732.0	803.7	958.6	1,117.2
Gross Profit Margins (%)	42.9	43.1	42.3	42.0
Employee Expenses	145.8	155.7	190.6	216.6
Other Expenditure	340.0	360.2	485.7	549.1
Total Operating Expenditure	1,461.9	1,576.4	1,984.7	2,308.4
EBITDA	246.3	287.8	282.3	351.5
Growth (%)	20.7	16.8	-1.9	24.5
Interest	14.2	17.9	19.0	24.0
Depreciation	73.5	86.5	86.5	103.8
Other Income	4.7	7.0	5.1	13.3
PBT before Exceptional Items	163.2	190.4	182.0	237.0
Less: Exceptional Items	-17.2	0.0	0.0	0.0
PBT after Exceptional Items	180.4	190.4	182.0	237.0
Total Tax	35.4	49.3	45.7	59.5
PAT before MI	145.1	141.1	136.3	177.6
PAT	145.1	141.1	136.3	177.6
Growth (%)	9.3	-2.7	-3.4	30.2
EPS (Adjusted)	18.5	20.4	19.7	25.7

Source: Company, ICICI Direct Research

Exhibit 5: Cash flow statement ₹ crore				
(Year-end March)	FY20	FY21	FY22E	FY23E
Profit/(Loss) after taxation	101.7	151.6	136.3	177.6
Add: Depreciation & Amortiza	73.5	86.5	86.5	103.8
Net Increase in Current Asset	-51.0	-176.1	-95.5	-173.8
Net Increase in Current Liabili	101.8	85.4	99.2	96.9
Others	36.6	17.8	19.0	24.0
CF from Operating activities	262.6	165.2	245.5	228.5
Investments	0.0	0.0	0.0	0.0
(Purchase)/Sale of Fixed Ass	-253.8	-269.6	-159.5	-150.0
Others	41.4	4.2	0.3	0.3
CF from Investing activities	-212.4	-265.4	-159.2	-149.7
(inc)/Dec in Loan	75.1	126.3	0.0	0.0
Dividend & Dividend tax	-100.2	-0.4	-35.1	-45.8
Other	-14.2	-17.4	-19.0	-24.0
CF from Financing activities	-39.4	108.5	-54.1	-69.8
Net Cash Flow	10.9	8.2	32.2	9.1
Cash and Cash Equivalent	4.8	15.6	23.8	56.1
Cash	15.6	23.8	56.1	65.1
Free Cash Flow	8.8	-104.4	86.0	78.5

Source: Company, ICICI Direct Research

Exhibit 6: Balance sheet ₹ crore				
(Year-end March)	FY20	FY21	FY22E	FY23E
Equity Capital	13.9	13.8	13.8	13.8
Reserve and Surplus	586.9	729.7	830.9	962.8
Total Shareholders funds	600.8	743.6	844.8	976.6
Total Debt	498.6	535.0	535.0	535.0
Deferred Tax Liability	50.1	52.9	53.9	55.0
Long-Term Provisions	15.7	23.9	24.4	24.9
Other Non Current Liabilities	3.6	15.5	15.9	16.2
Source of Funds	1,168.8	1,370.9	1,474.0	1,607.7
Gross Block - Fixed Assets	870.2	939.9	1,368.4	1,518.4
Accumulated Depreciation	245.3	331.8	418.3	522.1
Net Block	624.9	608.0	950.0	996.2
Capital WIP	48.0	278.3	9.3	9.3
Goodwill	0.0	6.8	6.8	6.8
Fixed Assets	672.8	893.2	966.2	1,012.4
Investments	0.9	1.3	1.3	1.3
Other non-Current Assets	92.2	77.3	78.9	80.5
Inventory	410.7	411.6	496.9	583.0
Debtors	364.1	484.7	492.6	578.0
Other Current Assets	73.3	111.5	113.7	116.0
Cash	15.6	23.8	56.1	65.1
Total Current Assets	863.7	1,031.6	1,159.3	1,342.1
Creditors	371.7	441.1	536.5	629.5
Provisions	7.1	2.3	2.3	2.4
Other Current Liabilities	82.1	189.0	192.8	196.7
Total Current Liabilities	460.8	632.5	731.7	828.6
Net Current Assets	402.8	399.1	427.6	513.5
Application of Funds	1,168.8	1,370.9	1,474.0	1,607.7

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios				
(Year-end March)	FY20	FY21	FY22E	FY23E
Per share data (₹)				
Reported EPS	21.0	20.4	19.7	25.7
Cash EPS	10.9	15.1	14.6	19.0
BV per share	86.8	107.4	122.0	141.1
Cash per Share	2.3	3.4	8.1	9.4
Dividend per share	7.6	5.3	5.1	6.6
Operating Ratios (%)				
Gross Profit Margins	42.9	43.1	42.3	42.0
EBITDA margins	14.4	15.4	12.5	13.2
PAT Margins	7.5	7.6	6.0	6.7
Cash Conversion Cycle	86.1	89.1	72.9	72.9
Asset Turnover	2.0	2.0	1.7	1.8
EBITDA conversion Rate	106.6	57.4	87.0	65.0
Return Ratios (%)				
RoE	21.3	19.0	16.1	18.2
RoCE	15.2	15.2	13.6	16.2
RoIC	15.6	18.8	13.9	16.2
Valuation Ratios (x)				
P/E	27.6	28.4	29.4	22.6
EV / EBITDA	18.2	15.7	15.9	12.7
EV / Net Sales	2.6	2.4	2.0	1.7
Market Cap / Sales	2.3	2.2	1.8	1.5
Price to Book Value	6.7	5.4	4.7	4.1
Solvency Ratios				
Debt / EBITDA	2.0	1.9	1.9	1.5
Debt / Equity	0.8	0.7	0.6	0.5
Current Ratio	1.8	1.6	1.5	1.5

Source: Company, ICICI Direct Research

Exhibit 8: ICICI Direct coverage universe (Chemicals)

Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
PI Industries	2428	3,340	Buy	36,836	48.6	53.8	66.8	56.4	50.9	41.0	39.1	34.5	28.6	17.2	17.2	18.3	13.8	13.4	14.5
Aarti Industries	982	1,120	Buy	35,591	14.5	18.8	32.0	66.5	51.3	30.1	38.3	29.0	19.2	10.7	11.0	16.1	15.0	12.8	18.3
Tata Chemical	919	1,035	Buy	23,419	10.1	39.9	49.3	88.5	22.3	18.0	16.9	11.2	8.9	4.1	6.6	7.7	1.8	6.8	7.9
Vinati Organics	1964	2,270	Buy	20,188	26.2	33.0	45.4	75.5	60.0	43.6	57.2	46.6	33.0	21.7	24.9	28.4	17.4	18.7	21.3
Sumitomo Chemical	376	505	Buy	18,793	6.9	8.5	10.1	54.6	44.4	37.4	37.7	30.6	25.3	29.8	29.3	28.1	22.4	22.1	21.2
Navin Fluorine	3824	3,710	Hold	18,946	45.0	53.0	73.1	77.8	66.0	47.9	54.0	46.7	31.9	21.0	19.0	22.6	13.6	14.2	17.0
Rallis India	277	305	Hold	5,388	11.4	9.7	13.8	24.3	28.7	20.1	15.9	18.5	12.8	18.0	13.9	18.2	13.9	10.9	13.9
Sudarshan chemical	579	695	Buy	4,011	20.4	19.7	25.7	28.4	29.4	22.6	15.7	15.9	12.7	19.0	16.1	18.2	15.2	13.6	16.2
Neogen Chemicals	1652	2,160	Buy	4,120	13.4	17.9	32.3	128.2	96.1	53.3	65.5	49.4	36.1	15.1	11.3	15.7	17.1	10.0	15.4
Astec Lifesciences	1730	2,120	Buy	3,389	33.2	43.1	55.0	52.1	40.2	31.5	32.0	23.9	19.3	18.9	21.6	22.4	21.0	21.6	21.9

Source: Bloomberg, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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