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Stock Update

Sudarshan Chemical Industries Limited

Robust Q3; new launches & capex to drive growth

Speciality Chemicals | Sharekhan code: SUDARSCHEM | Result Update

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

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 506**	
Price Target: **Rs. 615**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

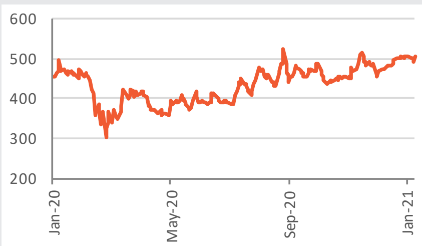
Company details

Market cap:	Rs. 3,505 cr
52-week high/low:	Rs. 538 / 286
NSE volume: (No of shares)	3.1 lakh
BSE code:	506655
NSE code:	SUDARSCHEM
Free float: (No of shares)	4.2 cr

Shareholding (%)

Promoters	40.0
FII	6.8
DII	9.3
Others	43.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.7	15.2	31.2	11.7
Relative to Sensex	8.8	-1.7	8.6	-1.5

Sharekhan Research, Bloomberg

Summary

- Q3FY21 numbers were strong with better-than-expected revenue growth of 19.6% y-o-y to Rs. 506 crore led by double-digit volume growth while OPM at 15.2% was resilient and in line with estimate.
- Management hinted at strong demand traction for its product portfolio - coatings, plastics, and inks in domestic and exports market, which would help sustain volume growth in coming quarters.
- Capex of Rs. 585 crore, new launches (including yellow high-performance pigment) and a likely price hike to pass on raw material costs would drive strong growth in coming years. EBITDA/PAT set to register a CAGR of 20%/25% over FY2021E-FY2023E.
- We maintain a Buy on Sudarshan Chemical with a revised PT of Rs. 615, given its dominant position in pigments market, double-digit earnings growth outlook and strong RoE of 23%. At CMP, stock trades at 17.3x FY2023E EPS.

Sudarshan Chemical Industries Limited (SCIL) clocked a strong double-digit revenue growth of 19.6% y-o-y (up 18.1% q-o-q) to Rs. 506 crore in Q3FY21, 9% higher than of our estimates of Rs. 465 crore. Better-than-expected revenue growth indicates that business has recovered above pre-COVID-19 levels (solid 22.1% y-o-y growth in revenues of pigment segment) with 21%/24% y-o-y volume growth for specialty/non-specialty products. OPM of 15.2% (down only 6 bps y-o-y; down 19 bps q-o-q) was in line with estimates as miss in gross margin at 42.8% (down 140 bps q-o-q) was offset by the benefit of operating leverage (reflected in strong revenue growth). Consequently, adjusted operating profit of Rs. 77 crore (up 19.1% y-o-y; up 16.6% q-o-q), was 8.1% above our estimate of Rs. 71 crore. Gross margin was impacted by higher raw material costs and impact of Rs. 2.4 crore on export incentives in the pigment segment. Adjusted PAT at Rs41 crore (up 29% y-o-y; up 42.4% q-o-q) was also 23% ahead of our estimate of Rs. 33 crore led by better-than-expected revenue growth, higher other income (up 83.5% y-o-y) and a lower-than-expected effective tax rate at 22.3% (adjusted for tax provision of Rs. 4.3 crore for FY2020). The management has indicated for strong demand across its product portfolio comprising coatings, plastics, and inks in the domestic and export markets, which would help sustain volume growth momentum in coming quarters. A likely price hike to pass on raw material cost increase would result in better margins going forward. The long-term growth outlook remains intact supported by capex plan of Rs. 585 crore over FY2020-FY2022E to augment capacities to tap growth in the domestic and export markets. The launch of 4-5 products in FY2022E including potential launch of yellow high-performance pigment would improve gross/EBITDA margin over next few years. Hence, we expect SCIL's revenue, EBITDA, and PAT to register CAGR of 19%, 20%, and 25%, respectively, over FY2021E-FY2023E along with a high RoE of 23%. Hence, we maintain our Buy rating on SCIL with a revised PT of Rs. 615 (reflects upward revision in earnings estimate). At CMP, the stock is trading at 20.5x its FY2022E EPS and 17.3x its FY2023E EPS.

Key positives

- Strong 21%/24% y-o-y volume growth for specialty/non-specialty products helped revenue growth beat estimates.
- Largely stable margin at 15.3% despite rise in raw material cost as company benefited from operating leverage and cost rationalisation.

Key negatives

- Net debt-to-equity ratio rose marginally to 0.9x as of December 2020 versus 0.8x as of September 2020

Our Call

Valuation – Maintain Buy on SCIL with a revised PT of Rs. 615: We increased our FY2021-FY2023 earnings estimates to factor in better-than-expected revenue growth (reflecting normalcy of demand) and slightly higher margin. SCIL's dominant market share (35% share in Indian pigment market and fourth-largest player globally), exit of global players from the space, SCIL's consistent focus to augment capacity (capex plan of Rs. 585 crore over FY2020-FY20222E), and a likely increase in share of high-margin products (new capex to focus on specialty chemicals) would help SCIL grow well above the industry's growth rates on a sustained basis. Hence, we model revenue, EBITDA, and PAT CAGR of 19%, 20%, and 25%, respectively, over FY2021E-FY2023E along with high RoE of 23%. Hence, we maintain our Buy on SCIL with a revised PT of Rs. 615 (reflects increase in earnings estimate). At the CMP, the stock is trading at 20.5x its FY2022E EPS and 17.3x its FY2023E EPS.

Key Risks

- Lower demand amid economic slowdown, delay in completion of expansion projects and intense competition (China has introduced 13% export rebate for chemicals) could impact revenue growth.
- Higher raw material prices and delay in the ability to pass on price hikes adequately, adverse forex fluctuations, and interest rate movements might affect margins.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	1,593	1,708	1,794	2,206	2,548
OPM (%)	12.8	14.4	15.3	15.7	15.7
Adjusted PAT	83	131	129	171	202
% y-o-y growth	*(1.8)*	*57.6*	*(1.6)*	*32.5*	*18.4*
Adjusted EPS (Rs.)	12.0	18.9	18.6	24.7	29.2
P/E (x)	42.1	26.7	27.2	20.5	17.3
EV/EBITDA (x)	18.6	16.0	15.0	12.1	10.4
P/BV (x)	6.2	5.8	5.2	4.4	3.7
RoCE (%)	16.0	17.2	15.5	16.8	17.1
RoE (%)	16.5	22.4	20.2	23.1	23.1

Source: Company; Sharekhan estimates

Sharp beat in revenues led by strong demand recovery; In-line EBITDA margin at 15.2%

Q3FY21 results were strong with a 9% beat in revenues at Rs506 crore (up 19.6% y-o-y and 18.1% q-o-q) and resilient OPM at 15.2% (largely flat y-o-y and in-line with expectations). Consequently, operating profit (adjusted for forex gain) also increased by 19.1% y-o-y to Rs. 77 crore (8.1% above our estimate). Better-than-expected performance was driven by strong revenue growth, reflecting that business operations are above pre-COVID-19 levels. Revenue growth from pigment segment was solid, rising 22.1% y-o-y (18.7% q-o-q) to Rs477 crore with 168bps y-o-y improvement in EBIT margin to 12.4%. Adjusted PAT at Rs. 41 crore (up 29% y-o-y; up 42.4% q-o-q) was also 23% ahead of our estimate of Rs33 crore led by better-than-expected revenue growth, higher other income (up 83.5% y-o-y) and lower-than-expected effective tax rate at 22.3% (adjusted for tax provision of Rs. 4.3 crore for FY2020).

Q3FY2021 results conference call highlights

- **Business update –** Strong demand traction with 21%/24% y-o-y volume growth for specialty/non-specialty products: The management indicated that demand have recovered to normalized level in domestic market and it is witness growth in exports market. Production has returned to pre-COVID levels. Exports are also healthy with share of exports in revenue at 44% in Q3FY2021 and the domestic share at 56%.
- **Demand and margin outlook –** Strong volume growth momentum is expected to sustain given strong demand traction for coatings, plastics and inks in domestic and export markets. The company will take price hike to pass on the rise in raw material cost and focus to improve product mix would keep margin resilient in Q4FY2021. Potential launch of a yellow high-performance pigment would improve gross margins in the coming years. The management expects EBITDA margins to gradually improve in the next couple of years as new capex would increase the share of specialty chemical products and would have a higher asset turnover ratio of ~2.5x.
- **Capex guidance –** The company has guided for capex spending of Rs. 150 crore for FY2021 and Rs. 220 crore for FY2022. The management reiterated an overall capex plan of Rs. 585 crore over FY2020-FY2022E, which would be largely focused on growth capex for new product development and ramp-up of existing products. Out of the total capex, 70% would be cater to growth capex.
- **New product launches –** The management has said that there are 20-25 new products in the pipeline and it plans to launch 4-5 products in FY2022. New product sales would arise from the US, Europe, South East Asia, and Japan and is expected to account of 15-20% of overall revenues.

Results Rs cr

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Revenue	**506**	**424**	**19.6**	**429**	**18.1**
Operating profit	80	63	26.5	68	17.7
Adjusted operating profit	**77**	**65**	**19.1**	**66**	**16.6**
Other Income	3	1	83.5	2	40.7
Depreciation	21.7	18	21.8	22	(1.0)
Interest	5	4	22.0	5	(10.7)
PBT	56	43	30.8	42	31.7
Tax	17	13	31.1	12	38.2
Exceptional Item	-	(2)	-	-	-
PAT from Continuing Operation	39	28	38.3	30	29.1
PAT from Discontinuing Operation	-	-	NA	-	NA
Reported PAT	39	28	38.3	30	29.1
Adjusted PAT	**41**	**32**	**29.0**	**29**	**42.4**
Reported EPS (Rs)	5.7	4.1	38.3	4.4	29.1
Margin (%)			**BPS**		**BPS**
OPM (%)	15.7	14.9	87	15.8	(5)
Adjusted OPM (%)	15.2	15.3	(6)	15.4	(19)
Reported PAT margin (%)	7.7	6.7	105	7.1	66
Adjusted PAT margin (%)	8.1	7.5	59	6.7	138

Source: Company; Sharekhan Research

Segmental performance Rs cr

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Revenue					
Pigments	477	391	22.1	402	18.7
Others	29	33	(10.2)	27	8.8
Total Revenues	**506**	**424**	**19.6**	**429**	**18.1**
EBIT					
Pigments	59	42	41.2	44	32.6
Others	2	5	(67.9)	3	(51.0)
Total EBIT	**61**	**47**	**30.1**	**48**	**27.1**
EBIT margin					
Pigments	12.4	10.7	168	11.1	130
Others	5.2	14.5	(933)	11.6	(637)
Total EBIT margin	**12.0**	**11.0**	**96**	**11.1**	**85**

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector View – De-focus of global players and rising demand to help Indian dyes and pigment to post a 10% CAGR over FY2019-FY2025**

The dyes and pigments segment is the second largest sub-segment with 22% share in the Indian specialty chemicals industry. The segment grew by 7.3% CAGR growth over FY2014-FY2019, with a market size of ~$7 billion in FY2019. The dyes and pigments segment is expected to register a 10% CAGR over FY2019-FY2025 and reach $12.5 billion by FY2025. De-focus of global players and increased demand for textiles, paints, and plastic would drive strong growth for dyes and pigments in India. Large domestic players are expected to further consolidate their position supported by reliable raw material sourcing, strong R&D capabilities, right product portfolio, strong marketing capabilities, and strong adherence to global environmental compliance standards (given polluting nature of manufacturing process of dyes and pigments).

■ **Company Outlook – Robust capex plan to increase capacities to further consolidate position in domestic and help tap exports markets:** Significant growth opportunities are available for players in Southeast Asia, as innovators seek a reliable partner for assured sourcing, as the situation in China remains largely unaltered due to the ongoing government clampdown because of environment and compliance issues coupled with US-China trade war and the recent COVID-19 outbreak across the world. With significant expansion plans of Rs. 585 crore over FY2020-FY2022E and exit of two global peers from the space, the company is scaling up its position in both domestic and global markets. SCIL is investing in the right areas for building capabilities and richer client engagements, which is expected to create a long-term moat in a higher growth pigment industry.

■ **Valuation - Maintain Buy on with a revised PT of Rs. 615:** We increased our FY2021-FY2023 earnings estimates to factor in better-than-expected revenue growth (reflecting normalcy of demand) and slightly higher margin. SCIL's dominant market share (35% share in Indian pigment market and fourth-largest player globally), exit of global players from the space, SCIL's consistent focus to augment capacity (capex plan of Rs. 585 crore over FY2020-FY20222E), and a likely increase in share of high-margin products (new capex to focus on specialty chemicals) would help SCIL grow well above the industry's growth rates on a sustained basis. Hence, we model revenue, EBITDA, and PAT CAGR of 19%, 20%, and 25%, respectively, over FY2021E-FY2023E along with high RoE of 23%. Hence, we maintain our Buy on SCIL with a revised PT of Rs. 615 (reflects increase in earnings estimate). At the CMP, the stock is trading at 20.5x its FY2022E EPS and 17.3x its FY2023E EPS.

One-year forward P/E (x) band

Source: Sharekhan Research

About company

Established in 1952 and headquartered in Pune, SCIL is India's largest and the world's fourth largest manufacturer of colour pigments. The company has a domestic market share of ~35% and global market share of ~3% in organic pigments. The company's product portfolio comprises organic, inorganic, and effect pigments, serving four main end-uses: coatings, plastics, inks, and cosmetics. SCIL has two manufacturing units – at Roha (established 1973) and Mahad (1993), both of which are located in Raigad district (Maharashtra) with combined capacity of 37,000 tonne per annum (tpa).

Investment theme

SCIL is a leading world-class colour solutions provider focusing on exceptional and sustainable results, which helps in customer retention. Significant growth opportunities are available for players in Southeast Asia as innovators seek a reliable partner for assured sourcing, as the situation in China has not changed much due to the ongoing government clampdown because of environment and compliance issues coupled with US China trade war and the recent COVID-19 crisis. With significant expansion plan over FY2020-FY2022E and exit of two global peers from the space, the company is scaling up its global rankings. SCIL is investing in the right areas for building capabilities and richer client engagements, which is expected to create a long-term moat in a booming industry.

Key Risks

Lower demand offtake due to the economic slowdown and delay in completion of expansion projects coupled with increased competitive intensity might affect revenue growth momentum. Higher raw-material prices and delay in the ability to pass on price hikes adequately, adverse forex fluctuations, and interest rate movement might affect margins.

Additional Data

Key management personnel

Pradeep Ramwilas Rathi	Chairman
Rajesh Balkrishna Rathi	Managing Director
AshishV. Vij	Whole Time Director/Chief Operating Officer
Nilkanth Natu	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	BHANSHALI AKASH	6.4
2	RATHI ROHIT K	4.4
3	Amansa Capital Pvt Ltd	3.2
4	RATHI VIJAYKUMAR R	3.1
5	Norges Bank	2.5
6	GOVERNMENT PENSION FUND - GLOBAL	2.4
7	ICICI Prudential Asset Management	2.3
8	Axis Asset Management Co Ltd/India	1.9
9	KEDIA VIJAY KISHANLAL	1.6
10	Profitex Shares and Securities	1.4

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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