



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

Reco: Buy	↔
CMP: Rs. 671	
Price Target: Rs. 780	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

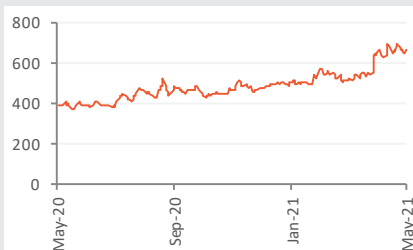
Company details

Market cap:	Rs. 4,643 cr
52-week high/low:	Rs. 729/364
NSE volume: (No of shares)	3.3 lakh
BSE code:	506655
NSE code:	SUDARSCHM
Free float: (No of shares)	4.2 cr

Shareholding (%)

Promoters	40.0
DII	9.0
FII	9.4
Others	41.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	(0.2)	17.5	41.6	72.6
Relative to Sensex	(6.8)	13.4	25.3	16.7

Sharekhan Research, Bloomberg

Summary

- Sudarshan Chemical Industries Limited (SCIL) reported solid Q4FY2021 results with stronger-than-expected revenue growth of 19.8% y-o-y and resilient margin at 15.1% (up 169 bps y-o-y). Sharp 19%/44% beat in operating profit/PAT at Rs. 87 crore/Rs. 53 crore, up 44%/58% y-o-y.
- Strong revenue growth was driven by 32.4% y-o-y revenue growth for the pigment segment to Rs. 533 crore, supported by volume growth of 27%/42% y-o-y for specialty/non-specialty products.
- Capex plan of Rs. 600 crore is nearing completion in FY2022 with incremental revenue potential of Rs. 1,000 crore-1,200 crore over the next 3-4 years. Rise in share of specialty chemical in revenue (versus 69% in FY2022) to improve margins.
- We expect SCIL to sustain high double-digit earnings growth over FY2022E-FY2023E with RoE of ~24%, led by its dominant position in the pigments market and capacity augmentation plan. Hence, we retain Buy on SCIL with a revised PT of Rs. 780.

Sudarshan Chemical Industries Limited (SCIL) posted robust Q4FY2021 results with stronger-than-expected revenue growth of 28.4% (up 13.9% q-o-q and versus expectation of 10% y-o-y growth) to Rs. 577 crore. Strong revenue growth was driven by solid 32.4% y-o-y revenue growth for the pigment segment to Rs. 533 crore, supported by volume growth of 27%/42% y-o-y for specialty/non-specialty products. OPM of 15.1% (up 169 bps y-o-y; flat q-o-q) was also resilient despite 1% impact of withdrawal of export incentive scheme (MEIS), higher raw-material cost (although taken price hike for some products) and increased freight cost. Gross margin declined by 205 bps y-o-y to 42% due to higher raw-material costs and removal of export incentive. Consequently, adjusted operating profit of Rs. 87 crore (up 44% y-o-y) was 19% above our estimate of Rs. 73 crore. The pigment segment's EBIT margin improved by 536 bps y-o-y to 12.2%. Adjusted PAT at Rs. 53 crore (up 58% y-o-y; up 30.6% q-o-q) was 44% ahead of our estimate of Rs. 37 crore, led by beat in operating performance and lower-than-expected expected effective tax rate at 16.8% (versus our assumption of 25%). Management has indicated that capex programme of Rs. 600 crore (Rs. 293 crore capitalised and Rs. 269 crore as CWIP as of March 2021) would get completed in FY2022 and has guided for incremental revenue of Rs. 1,000 crore-1,200 crore (on base of FY2020) over the next 3-4 years. Moreover, the share of specialty chemical revenue in incremental revenue will be higher compared to 69% share in FY2022 and, thus, would aid margin expansion going forward. Hence, we expect SCIL's revenue, EBITDA, and PAT to register a CAGR of 22%, 26%, and 26%, respectively, over FY2021-FY2023E along with high RoE of ~24% in FY2023E. Hence, we maintain our Buy rating on SCIL with a revised PT of Rs. 780. At the CMP, the stock is trading at 27x its FY2022E EPS and 20.7x its FY2023E EPS.

Key positives

- Large revenue beat led by strong 27%/42% y-o-y volume growth for specialty/non-specialty products.
- Resilient OPM at 15.1% (up 169 bps y-o-y and slightly above our estimate of 14.8%).

Key negatives

- Gross margin declined by 205 bps y-o-y to 42% due to higher raw-material costs and removal of export incentive.

Our Call

**Valuation – Maintain Buy on SCIL with a revised PT of Rs. 780:** We have increased our FY2022-FY2023 earnings estimates to factor in better-than-expected revenue growth and higher margin as we expect share of specialty products to increase over the next two years. We like SCIL as it is well placed to grow above industry rates supported by its dominant market share (35% share in the Indian pigment market and fourth-largest player globally), exit of global players from the space, nearing of capex plan to expand capacity, and a likely increase in share of high-margin specialty chemical products. Thus, we model revenue, EBITDA, and PAT CAGR of 22%, 26%, and 26%, respectively, over FY2021-FY2023E along with high RoE of ~24% in FY2023E. Hence, we maintain our Buy on SCIL with a revised PT of Rs. 780 (reflects upward revision in earnings estimate and higher valuation multiple of 24x its FY2023E EPS). At the CMP, the stock is trading at 27x its FY2022E EPS and 20.7x its FY2023E EPS.

Key risk

- 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

Particulars	FY19	FY20	FY21	FY22E	FY23E
Revenue	1,593	1,708	1,864	2,293	2,797
OPM (%)	12.8	14.4	15.4	16.3	17.0
Adjusted PAT	83	131	141	172	225
% y-o-y growth	(1.8)	57.6	7.6	22.0	30.5
Adjusted EPS (Rs.)	12.0	18.9	20.4	24.9	32.5
P/E (x)	55.8	35.4	32.9	27.0	20.7
EV/EBITDA (x)	24.2	20.6	17.7	14.6	11.7
P/BV (x)	8.2	7.7	6.2	5.4	4.5
RoCE (%)	16.0	17.2	17.1	17.0	17.3
RoE (%)	16.5	22.4	21.0	21.4	23.6

Source: Company; Sharekhan estimates

**Strong performance led by sharp 17% beat in revenue at Rs. 577 crore (up 28.4% y-o-y) and resilient margin at 15.2%:** The company reported robust Q4FY2021 results with a sharp beat of 16.8% in revenue to Rs. 577 crore (up 28.4% y-o-y; up 13.9% q-o-q), led by outperformance in the pigment segment (revenue up by 32.4% y-o-y and 11.6% q-o-q to Rs. 533 crore). OPM was resilient at 15.1% (up 169 bps y-o-y; largely flat q-o-q) was marginally ahead of our estimate of 14.8%. Consequently, operating profit of Rs. 87 crore (up 44.5% y-o-y; up 13% q-o-q) was also 18.8% above our estimate of Rs. 73 crore. EBIT margin in the pigment segment improved by 536 bps y-o-y to 12.2%. Adjusted PAT at Rs. 53 crore (up 58% y-o-y; up 30.6% q-o-q) was 44% ahead of our estimate of Rs. 37 crore, led by beat in operating performance and lower-than-expected effective tax rate at 16.8% (versus our assumption of 25%).

### Key Conference call takeaways

- ◆ **Capex and revenue guidance:** The company has a capex plan of Rs. 600 crore, of which Rs. 293 crore (Rs. 222 crore in FY2020 and Rs. 71 crore in FY2021) has already been capitalised and Rs. 269 crore is in CWIP as of March 2021. In FY2022, the company plans to invest another Rs. 38 crore. Thus, total addition capex that would be capitalised in the current financial year would be Rs. 307 crore. This would generate additional revenue of Rs. 1,000 crore - Rs. 1,200 crore (on the revenue base of FY2020) over the next 3-4 years with a higher share of specialty pigments as compared to 69% in FY2021. Incremental revenue implies asset turnover of 2.5x on growth capex of Rs. 400 crore (out of the total capex of Rs. 600 crore). Recently, the board has also approved another Rs. 135 crore capex for infrastructure development of upcoming projects. The company has also guided for Rs. 30 crore - 35 crore of maintenance capex every year.
- ◆ **Demand remains strong and there is a large addressable market size:** In Q4FY2021, specialty chemicals volume grew by 27% y-o-y and non-specialty volumes grew by 42% y-o-y. The company is currently operating at capacity utilization of 86% and targets 90% post capex. The total addressable market size of the business is \$8.6 billion, which includes paints and coatings, inks, plastic, and cosmetics. With the top two players trying to divest their business owing to environmental concerns, SCIL would further strengthen its position and would lead to long-term revenue growth.
- ◆ **Margin outlook:** Management has not given any guidance on margins; however, management is quite optimistic about increasing EBITDA margin post ramp-up of capex. Moreover, the potential increase in the share of specialty products would aid margin expansion going forward.
- ◆ **Pricing environment:** Management has increased prices of some of its products in Q4FY2021 due to increased raw-material cost and would increase for some of their products in Q1FY2022. Overall, raw-material prices have increased by 2-2.5 percentage points and management endeavours to pass on most costs increases to customers. In Q4FY2021, almost 1% margin was impacted due to withdrawal of export incentive scheme (MEIS).
- ◆ **Product launches:** Management has said that major product launched would happen in Q2FY2022 and most of the recently launched products have got good response from customers.
- ◆ **Debt:** The company's net debt stood at Rs. 614 crore as of March 2021 as compared to Rs. 499 crore as of March 2020. Debt/equity ratio stood at 0.8x in FY2021 and management has guided the ratio would improve going forward.
- ◆ **Better transparency in financial disclosure:** Management has improved the disclosure of financials and has now started providing split between domestic and export and specialty and non-specialty segment.

Results

Particulars	Rs cr				
	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)
<b>Revenue</b>	<b>577</b>	<b>449</b>	<b>28.4</b>	<b>506</b>	<b>13.9</b>
EBITDA	87	54	62.0	80	9.8
<b>Adjusted operating profit</b>	<b>87</b>	<b>60</b>	<b>44.5</b>	<b>77</b>	<b>13.0</b>
Other Income	2	1	136.7	3	(8.3)
Depreciation	21	22	(1.1)	22	(1.4)
Interest	4	3	39.8	5	(7.8)
PBT	64	30	111.6	56	14.8
Tax	11	3	254.6	17	(35.7)
Exceptional Item	-	-	NA	-	NA
PAT from Continuing Operation	53	27	95.6	39	36.4
PAT from Discontinuing Operation	-	-	NA	-	NA
Reported PAT	53	27	95.6	39	36.4
<b>Adjusted PAT</b>	<b>53</b>	<b>34</b>	<b>58.0</b>	<b>41</b>	<b>30.6</b>
Reported EPS (Rs.)	7.7	3.9	95.6	5.7	36.4
Adjusted EPS (Rs.)	7.7	4.8	58.0	5.9	30.6
<b>Margin (%)</b>	<b>Q4FY21</b>	<b>Q4FY20</b>	<b>YoY (%)</b>	<b>Q3FY21</b>	<b>QoQ (%)</b>
Reported OPM (%)	15.2	12.0	315	15.7	(56)
Adjusted OPM (%)	15.1	13.4	169	15.2	(11)
Reported PAT margin (%)	9.3	6.1	319	7.7	153
Adjusted PAT margin (%)	9.2	7.5	172	8.0	118

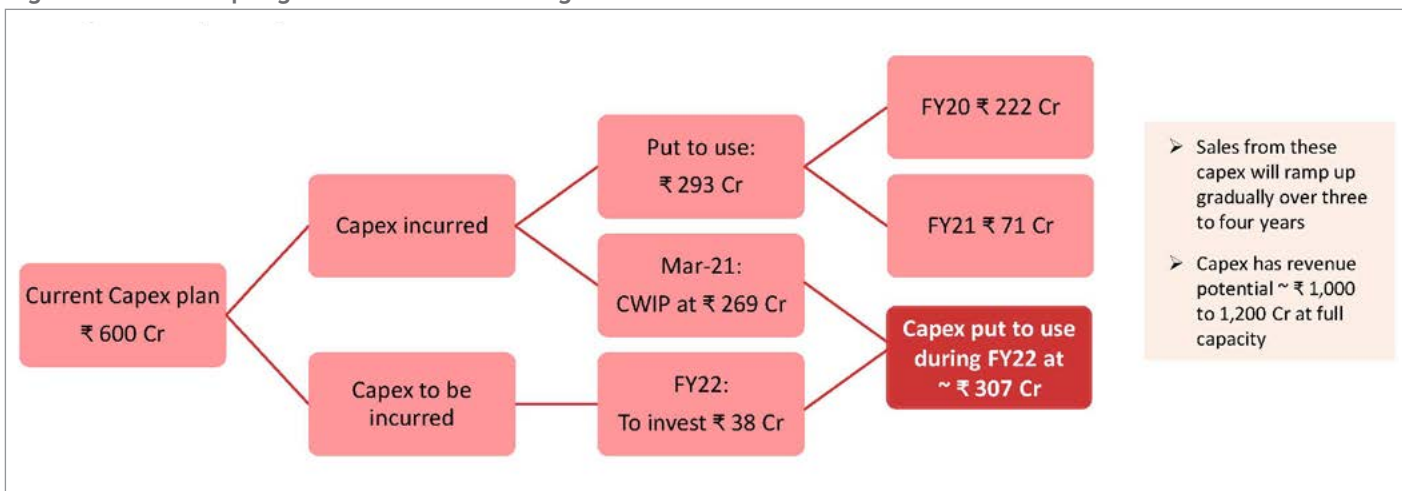
Source: Company; Sharekhan Research

Segmental performance

Particulars	Rs cr				
	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
<b>Revenue</b>					
Pigments	533	402	32.4	477	11.6
Others	44	47	-6.3	29	50.1
<b>Total Revenue</b>	<b>577</b>	<b>449</b>	<b>28.4</b>	<b>506</b>	<b>13.9</b>
<b>EBIT</b>					
Pigments	65	28	136.0	59	10.2
Others	3	6	-41.1	2	125.1
<b>Total EBIT</b>	<b>68</b>	<b>33</b>	<b>105.0</b>	<b>61</b>	<b>13.1</b>
<b>EBIT margin (%)</b>			<b>BPS</b>		<b>BPS</b>
Pigments	12.2	6.8	536	12.4	-16
Others	7.8	12.4	-461	5.2	260
<b>Overall EBIT margin</b>	<b>11.9</b>	<b>7.4</b>	<b>444</b>	<b>12.0</b>	<b>-8</b>

Source: Company; Sharekhan Research

Pigment business capex guidance and revenue targets



Source: Company

## 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 posted a 7.3% CAGR 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 robust adherence to global environmental compliance standards (given polluting nature of the manufacturing process of dyes and pigments).

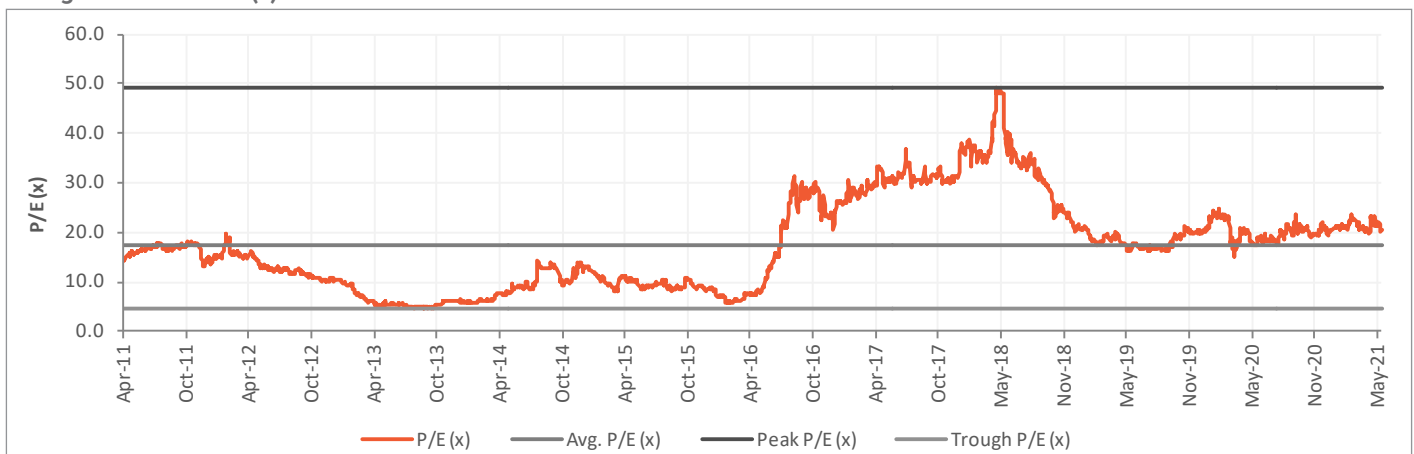
### ■ Company Outlook – Robust capex plan to increase capacities to further consolidate position in domestic and help tap exports markets

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. 600 crore (largely competed) 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 with a revised PT of Rs. 780

We have increased our FY2022-FY2023 earnings estimates to factor in better-than-expected revenue growth and higher margin as we expect share of specialty products to increase over the next two years. We like SCIL as it is well placed to grow above industry rates supported by its dominant market share (35% share in the Indian pigment market and fourth-largest player globally), exit of global players from the space, nearing of capex plan to expand capacity, and a likely increase in share of high-margin specialty chemical products. Thus, we model revenue, EBITDA, and PAT CAGR of 22%, 26%, and 26%, respectively, over FY2021-FY2023E along with high RoE of ~24% in FY2023E. Hence, we maintain our Buy on SCIL with a revised PT of Rs. 780 (reflects upward revision in earnings estimate and higher valuation multiple of 24x its FY2023E EPS). At the CMP, the stock is trading at 27x its FY2022E EPS and 20.7x 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 nearing completion of 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; Note: Shareholding as of January 29, 2021

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## 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 deteriorating 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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by BNP PARIBAS

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