Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Sumitomo Chemical India Limited

Strong Q4; Well positioned to leverage the parent

Agri-chemical	Sharekhan code: SUMICHEM	Result Update

Stock 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. 319**	
Price Target: **Rs. 370**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

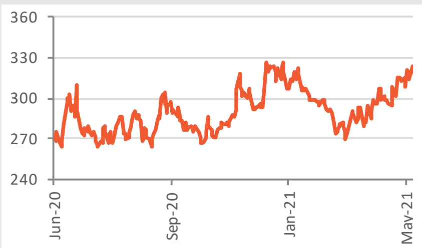
Company details

Market cap:	Rs. 15,923 cr
52-week high/low:	Rs. 338 / 255
NSE volume: (No of shares)	6.2 lakh
BSE code:	542920
NSE code:	SUMICHEM
Free float: (No of shares)	12.5 cr

Shareholding (%)

Promoters	75.0
FII	1.1
DII	6.3
Others	17.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6	7	11	18
Relative to Sensex	-1	3	-5	-35

Sharekhan Research, Bloomberg

Summary

- Robust Q4FY2021 results with better-than-expected revenue growth of 19.6% y-o-y to Rs. 534 crore and 81 bps beat in OPM at 13.4% (up 408 bps y-o-y). Operating profit/PAT at Rs. 71 crore/Rs. 54 crore, up 72%/128% y-o-y and beat of 20%/40% versus our estimate.
- Strong revenue growth was led by growth across product categories (excluding herbicides). Revenue from insecticides/PGR/metal phosphides/fungicides/AND & EHD up 15%/52%/82%/20%/15% y-o-y.
- Capex in existing products and new capex of Rs. 100 crore -110 crore for five proprietary products (revenue potential of Rs. 200 crore - 250 crore) for supply to the parent would drive industry-leading revenue growth.
- We expect Sumitomo Chemical India Limited (SCIL) to continue to enjoy premium valuation over domestic peers, given massive contract manufacturing opportunity from the parent and robust balance sheet. Hence, we maintain Buy on SCIL with a revised PT of Rs. 370.

Sumitomo Chemical India Limited (SCIL) reported robust revenue growth of 19.6% y-o-y to Rs. 534 crore in Q4FY2021, which was significantly above our estimate of Rs. 474 crore. Strong revenue performance was backed by 15%/52%/82%/20%/15% y-o-y revenue growth from insecticides/PGR/metal phosphides/fungicides/AND & EHD. However, revenue from herbicides was flat y-o-y. OPM expanded sharply by 408 bps y-o-y to 13.4%, which was a beat of 81 bps versus our estimate of 12.5%. Margin expansion was supported by benefit of operating leverage (volume growth across products), improved price for some products (gross margin up by 106 bps q-o-q), and synergies from the merger of Excel Crop Care Limited (ECCL). Adjusted PAT at Rs. 54 crore (up 128% y-o-y) was 40% above our estimate of Rs. 39 crore, led by better-than-expected revenue growth/margin and lower-than-expected effective income tax at 11.9% (versus 26.5% in Q4FY2020). The company plans to spend Rs. 70 crore -75 crore on capex for existing products and additional capex of Rs. 100 crore - 110 crore over the next 1-2 years for five proprietary products for the supply to parent SCC Japan. The five new products would be commercialised over the next two years and have combined revenue potential of Rs. 200 crore - 250 crore (9% of FY2021 revenue) and are expected to have gross margin of 37%-38% (in-line with SCIL's exiting gross margin). On the margin front, management indicated that the recent sharp improvement in margin is expected to sustain and the endeavor is to further expand margins with ramp-up of existing/new capacities. Massive revenue opportunity from contract manufacturing for the parent, strong balance sheet (Rs. 532 crore of cash and cash equivalents), and asset-light business model are likely to keep valuation at a premium to domestic peers. Hence, we maintain our Buy rating on SCIL with a revised price target (PT) of Rs. 370.

Key positives

- Higher-than-expected revenue growth of 19.6% y-o-y, led by strong growth across products (excluding herbicides).
- Better-than-expected OPM at 13.4% (up 408 bps y-o-y), led by benefit of operating leverage, better realisation, and merger synergies with ECCL.

Key negatives

- Revenue from herbicides remained flat y-o-y in Q4FY2021.

Our Call

Valuation - Maintain Buy on SCIL with a revised PT of Rs. 370: We have largely maintained our FY2022-FY2023 earnings estimate and expect strong EBITDA/PAT CAGR of 21%/20% over FY2021-FY2023E, led by robust product pipeline. We believe SCIL would continue to enjoy premium valuation versus domestic peers given its superior earnings growth outlook (growth could accelerate future given massive revenue opportunity from contract manufacturing), its strong parental advantage (robust R&D capabilities, global distribution, and financial strength), and a robust balance sheet (Rs. 532 crore of cash and cash equivalents). Hence, we maintain our Buy rating on SCIL with a revised PT of Rs. 370. At the CMP, SCIL is trading at 38.5x its FY2022E EPS and 32x its FY2023E EPS.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21	FY22E	FY23E
Revenues	2,228	2,425	2,645	2,995	3,357
OPM (%)	13.0	13.7	18.4	19.7	21.1
Adjusted PAT	173	236	345	414	498
% YoY growth	*19.0*	*36.4*	*46.6*	*19.8*	*20.3*
Adjusted EPS (Rs.)	3.5	4.7	6.9	8.3	10.0
P/E (x)	92.2	67.6	46.1	38.5	32.0
P/B (x)	15.2	13.0	10.3	8.5	7.0
EV/EBITDA (x)	54.7	47.5	32.2	25.9	21.1
RoNW (%)	17.3	20.8	25.0	24.2	23.9
RoCE (%)	26.2	26.1	32.7	32.1	31.7

Source: Company; Sharekhan estimates

Strong Q4FY2021 results led by better-than-expected revenue growth of 19.6% y-o-y and 81 bps beat in OPM at 13.4% (up 408bps y-o-y)

The company reported robust revenue growth of 19.6% y-o-y to Rs. 534 crore, which was significantly above our estimate of Rs. 474 crore. Strong revenue performance was backed by 15%/52%/82%/20%/15% y-o-y growth in revenue from insecticides/PGR/metal phosphides/fungicides/AND and EHD. OPM also expanded sharply by 408 bps y-o-y to 13.4%, which was a beat of 81 bps versus our estimate of 12.5%. Margin expansion was supported by benefit of operating leverage (volume growth across products), improved price for some products (gross margin up by 106 bps q-o-q), and synergies from the merger of Excel Crop Care Limited. Adjusted PAT at Rs. 54 crore (up 128% y-o-y) was 40% above our estimate of Rs. 39 crore, led by better-than-expected revenue growth/margin and lower-than-expected effective income tax at 11.9% (versus 26.5% in Q4FY2020).

For FY2021, revenue/operating profit/PAT grew strongly by 9%/46%47% to Rs. 2645 crore/Rs. 487 crore/Rs. 345 crore. OPM improved sharply by 467 bps y-o-y to 18.4% in FY2021, led by benefit of operating leverage, higher share of specialty 32% (from 29% in FY2020), and synergies from the merger of Excel Crop Care Limited. Free cash flow (FCF) increased by 2.1x y-o-y to Rs. 383 crore in FY2021 and working capital cycle lowered to 103 days from 115 days in FY2020.

Q4FY2021 results conference call highlights

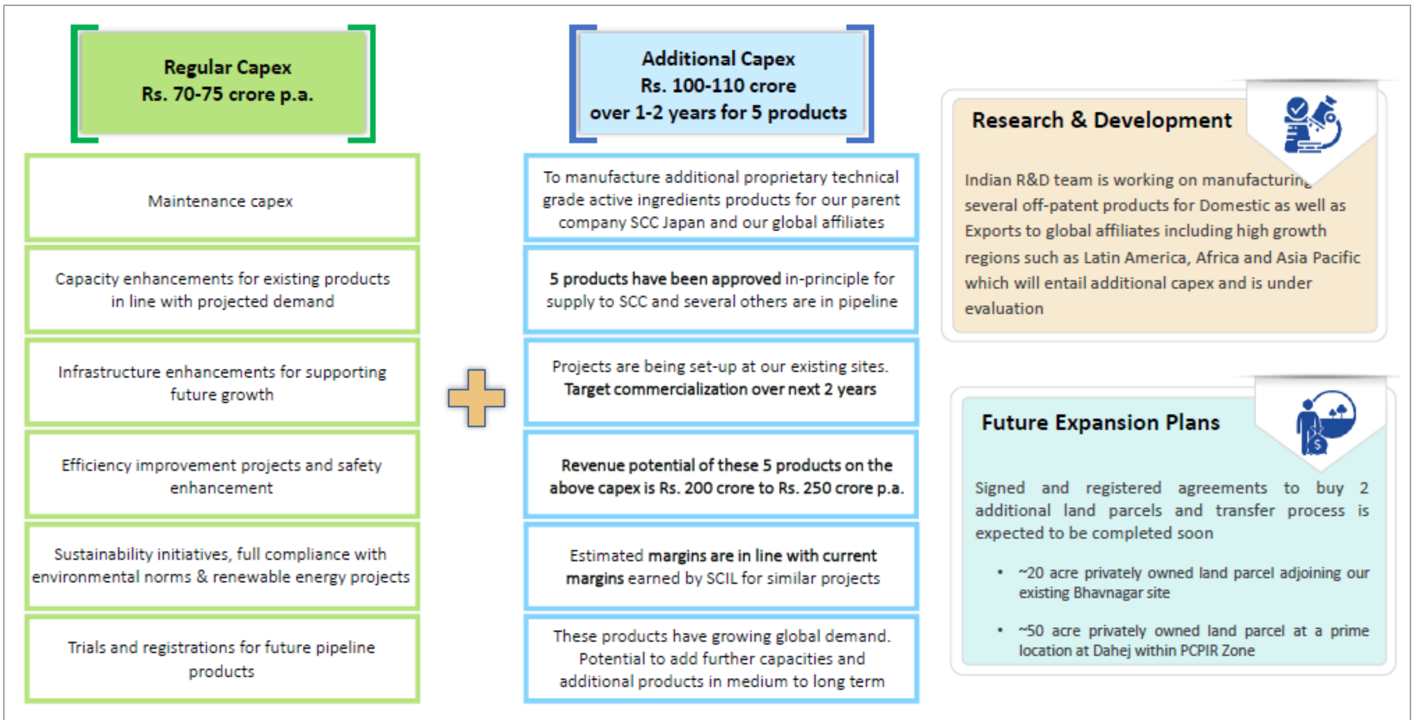
- **Capex guidance and revenue potential:** The company has received approval for manufacturing and exporting five proprietary molecules of the parent company, SCC Japan, for which it is doing additional capex of Rs. 100 crore-110 crore over the next 1-2 years. All five products will be manufactured at two of its existing facilities and would be commercialised over the next two years. It has a revenue potential of Rs. 200 crore-250 crore per annum with gross margins in line with current gross margin of 37%-38%. Asset turnover ratio on this new project would be more than 2x. Apart from this, the company will spend Rs. 70 crore-75 crore capex per annum for capacity enhancements of existing products and infrastructure development.
- **High demand potential of the five new products:** The five new products that the company is planning to supply to its parent have huge demand potential and depending upon the requirement and sourcing of the parent company, the company would further expand its capacity going forward. One out of the five products would be launched by Q1/Q2 of 2022 and the remaining products would be launched by the end of 2022. Volume wise, they would be producing 350 tonne of one of the proprietary products that would fulfill only one-third of their requirement of SCC Japan. Thus, there is an opportunity to double the capacity in Phase-2.
- **Capacity expansion:** Tebuconazole product is also in high demand and the company would set up an additional capacity of 1,500 tonne for the product. The company has also increased capacity for producing cypendazole (from 750 tonne to 1,350 tonne) and is planning to increase it further in its new production sites.
- **Strong R&D focus:** The company has a strong focus on R&D and the Indian R&D team is working on several off-patent products to meet domestic as well as global demand coming from regions such as Latin America, Africa, and The Asia Pacific. Three products are already in the pilot stage and would be commercialised soon.
- **New products launched:** The company has launched seven new products in FY2021, including three insecticides, two PGR, and two herbicides and has a similar product pipeline to be launched in FY2022.
- **Working capital reduction:** The company has reduced its net working capital days from 115 in FY2020 to 103 in FY2021. The company is also putting efforts to reduce it further and, thus, focusing on improving overall working capital. Collection during FY2021 has increased by 13% y-o-y. The company has strong cash and cash equivalents of Rs. 532 crore as of March 31, 2021.
- **Strong demand from Latin America:** The company is getting huge demand from Latin America as its parent has acquired Nufram's distribution in Latin America, thereby gaining a leadership position in the Latin America generics market segment. Revenue contribution from Latin America has also doubled from 2% in FY2020 to 4% in FY2021, led by ramp-up of exiting products and new product registrations.

Results Rs cr

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Net Sales	**534**	**447**	**19.6**	**561**	**-4.7**
Total Expenditure	463	405	14.2	483	-4.1
Reported operating profit	71	41	72.2	78	-8.6
Adjusted operating profit	**71**	**41**	**72.2**	**78**	**-8.6**
Other Income	5	6	-16.8	5	-14.3
EBITDA	76	47	61.6	83	-8.9
Interest	1	1	-15.3	1	-26.4
Depreciation	13	13	4.2	11	22.0
Exceptional income/(expense)	0	-1	NA	0	NA
Reported PBT	61	32	94.3	71	-13.4
Adjusted PBT	**61**	**33**	**87.2**	**71**	**-13.4**
Tax	7	9	-16.0	17	-56.4
Reported PAT	54	23	136.2	54	-0.1
Adjusted PAT	**54**	**24**	**127.6**	**54**	**-0.1**
Equity Cap (cr)	50	50		50	
Reported EPS (Rs)	1.1	0.5	136.2	1.1	-0.1
Adjusted EPS (Rs)	1.1	0.5	127.6	1.1	-0.1
Margins (%)			**BPS**		**BPS**
Gross margin	36.2	35.1	106.5	37.6	-143.9
Adjusted OPM	13.4	9.3	407.6	13.9	-55.8
Adjusted NPM	10.1	5.3	480.4	9.7	47.2

Source: Company; Sharekhan Research

Capex plan and revenue potential from contract manufacturing from parent



Source: Company

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, and Farmers (empowerment and protection) Agreement of Price Assurance and 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 7%-8% 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.

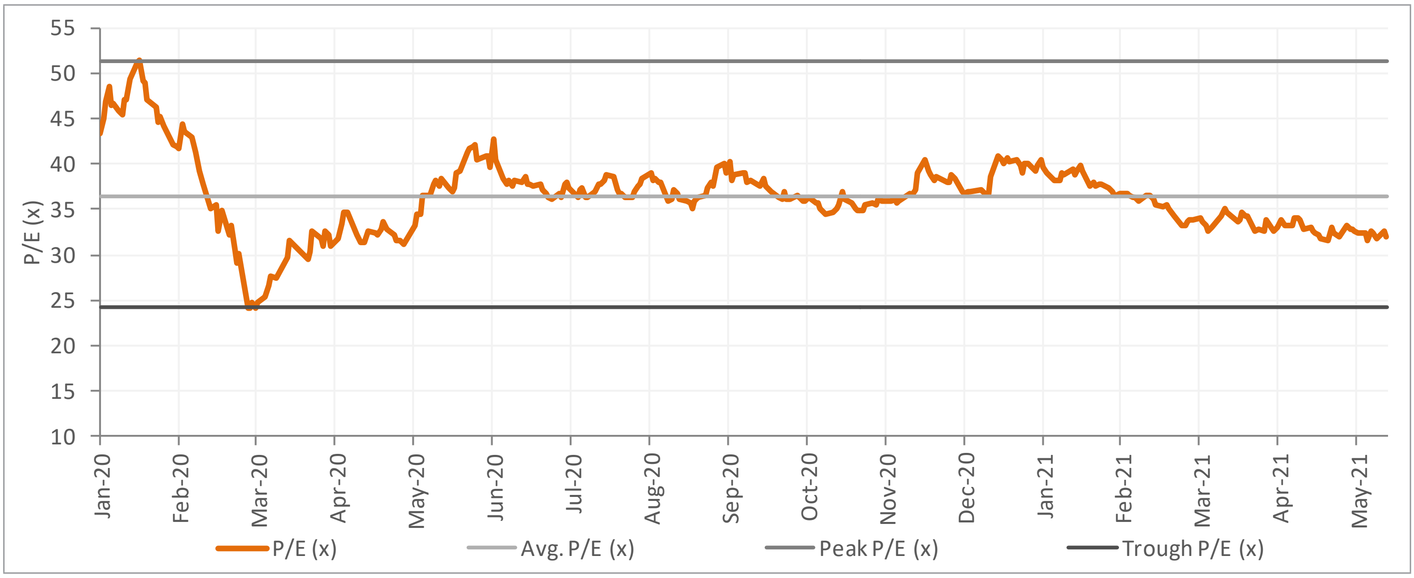
■ Company outlook - Strong earnings growth outlook

Post the merger of ECCL, SCIL has become the third largest agrochemical company in India with revenue of Rs. 2,645 crore in FY2021. 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 areas (both in domestic and exports markets). Hence, we expect SCIL's revenue to post a 13% CAGR over FY2021-FY2023E. Moreover, margins are expected to expand by 267 bps and reach 21.1% by FY2023E, supported synergies from ECCL's merger and ramp-up of existing/new capacities. Thus, we expect SCIL's earnings to report a 20% CAGR over FY2021-FY2023E. With limited capex, the company would generate decent cumulative FCF of Rs. 841 crore over FY2022E-FY2023. Revenue opportunity from CRAMs could further aid revenue and earnings growth of SCIL.

■ Valuation - Maintain Buy on SCIL with a revised PT of Rs. 370

We have largely maintained our FY2022-FY2023 earnings estimates and expect strong EBITDA/PAT CAGR of 21%/20% over FY2021-FY2023E led by a robust product pipeline. We believe SCIL would continue to enjoy premium valuation versus domestic peers, given its superior earnings growth outlook (growth could accelerate future given massive revenue opportunity from contract manufacturing), its strong parental advantage (robust R&D capabilities, global distribution and financial strength), and a robust balance sheet (Rs. 532 crore of cash and cash equivalents). Hence, we maintain our Buy rating on SCIL with a revised PT of Rs. 370. At the CMP, SCIL is trading at 38.5x its FY2022E EPS and 32x its FY2023E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

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 conventional chemistry sourced from its parent company, Sumitomo Chemical Company, and biological products sourced from US-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 produces many technical grade pesticides at its state-of-the-art manufacturing units with indigenous R&D facility.

Investment theme

Few crop protection chemicals are expected to be off patent in years, thus genetic crop-protection chemicals should grow in double digits. Hence, the 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 of SCIL. Cost synergies in terms of reduction in imported of raw material (post ECCL merger) would drive strong margin expansion. Additionally, SCIL derives multiple benefits from its parent's R&D capabilities and global presence.

Key Risks

- 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management Co. Ltd	0.80
2	Vanguard Group Inc	0.62
3	Invesco Asset Management India Pvt. Ltd.	0.35
4	L&T Mutual Fund Trustee Ltd	0.35
5	Norges Bank	0.15
6	Union Mutual Fund	0.13
7	BlackRock Inc	0.05
8	Dimensional Fund Advisors LP	0.04
9	LIC Mutual Fund Asset Management	0.04
10	BOI AXA Investment Managers Pvt. 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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