Sharekhan by BNP PARIBAS

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Sumitomo Chemical India Limited

Massive CRAMS opportunity improves growth prospects

Agri Chem	Sharekhan code: SUMICHEM	Company 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. 378**	
Price Target: **Rs. 448**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

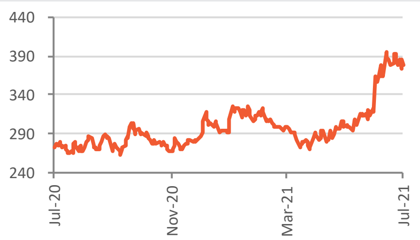
Company details

Market cap:	Rs. 18,845 cr
52-week high/low:	Rs. 403 / 258
NSE volume: (No of shares)	7.6 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	4	34	16	39
Relative to Sensex	3	27	7	-7

Sharekhan Research, Bloomberg

Summary

- Robust export growth prospects led by 1) CRAMS opportunity from parent SCC (to supply five products worth Rs. 200-250 crore), 2) higher sales to LatAm (SCC acquired Nufram's distribution business in LatAm) and 3) doubled capacity of tebuconazole. We expect a 13% revenue CAGR over FY21-24E.
- Focus on high margin PGRs/herbicides, rising share of specialty chemicals, further synergies from Excel Crop Care to drive 346 bps expansion in margins and take EBITDA margins to ~22% in FY24.
- Promising H1FY22 outlook in volume terms, price hikes and margin given good agronomics in India (above normal monsoon and higher crop prices in India) and adequate inventories to supply products in the upcoming Kharif season.
- We maintain our Buy rating on SCIL with a revised PT of Rs. 448 as massive contract manufacturing opportunity from parent provides superior growth prospects and expect SCIL to enjoy premium valuation over domestic peers.

Sumitomo Chemical India Limited (SCIL) is on firm footing to tap contract manufacturing opportunities from its parent Sumitomo Chemical Company (SCC Japan, leading global chemical company). SCIL has taken first step in this direction for supply of five proprietary molecules to its parent with one molecule expected to be commercialized by Q2FY22 and remaining four by FY2022-end. The company has indicated a total revenue potential of Rs. 200-250 crore (asset turnover of 2-2.5x) from these five products with overall opportunity size much higher as one molecule, which will have capacity of 350 TPA would fulfil only one-third of the requirement of SCC Japan. In our view, this is just the beginning for SCIL in terms of contract manufacturing and opportunity seems to be in excess of $3 billion and provides a long runway for growth in the exports market. Our optimism stems from the fact that SCC Japan's revenues from Health & Crop Sciences Sector stands at ~$3.1 bn and has strong product pipeline in agri-solutions/environmental health products with revenue potential of ~US$1.4 -$1.8 billion. In addition, SCIL is looking to expand in exports markets like Latin America (share of revenue increased to 4% in FY2021 versus only 2% in FY2020) as acquisition of Nufram's distribution business in Latin America by SCC Japan provides huge revenue growth opportunity (SCIL can supply 8-10 technical with overall opportunity size of $1 billion). We see potential for many-fold increase in revenue from Latin America supported by doubling of Tebuconazole (1350 TPA versus 750 TPA earlier and plan for additional capacity of 1500 TPA) and supply of other molecules. The company's focus on high margin PGRs/Herbicides, rising share of specialty chemicals, further synergies from Excel Crop Care (ECCL) to drive 346bps margin expansion and take EBITDA margin to ~22% in FY24. Strong CRAMS opportunity from parent and dominant position in India market makes SCIL well-positioned to grow its revenues/EBITDA/PAT at 13%/20%/19% CAGR over FY2021-FY2024E along high RoE of ~23%. A massive revenue opportunity from contract manufacturing from parent, strong balance sheet (Rs. 532 crore of cash & cash equivalents) and asset light business model likely to keep valuation at a premium to domestic peers. Hence, we maintain a Buy rating on SCIL with a revised price target (PT) of Rs. 448.

Our Call

Valuation – Maintain Buy on SCIL with a revised PT of Rs. 448: We have largely maintained our FY2022-FY2023 earnings estimates and have also introduced our FY2024 earnings estimate in this report. We believe that SCIL would continue enjoy premium valuations versus domestic peers given its superior earnings growth outlook (growth could accelerate future given the 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 & cash equivalents). Hence, we maintain a Buy rating on SCIL with a revised price target (PT) of Rs. 448. At CMP, SCIL is trading at 37.9x FY2023E EPS and 32.1x FY2024E EPS.

Key Risks

Ban on products like glyphosate (that fetch 15% of revenues) could impact earnings outlook. Delay in supply of raw material from China could affect margins. Adverse weather conditions could affect demand of agri-inputs and affect earnings outlook.

Valuation (Consolidated) Rs cr

Particulars	FY20	FY21	FY22E	FY23E	FY24E
Revenue	2,425	2,645	2,995	3,357	3,801
OPM (%)	13.7	18.4	19.7	21.1	21.9
Adjusted PAT	236	345	414	498	587
% YoY growth	*36.4*	*46.6*	*19.8*	*20.3*	*17.9*
Adjusted EPS (Rs.)	4.7	6.9	8.3	10.0	11.8
P/E (x)	80.0	54.6	45.5	37.9	32.1
P/B (x)	15.4	12.2	10.0	8.2	6.8
EV/EBITDA (x)	56.3	38.2	30.9	25.3	20.9
RoNW (%)	20.8	25.0	24.2	23.9	23.2
RoCE (%)	26.1	32.7	32.1	31.7	30.8

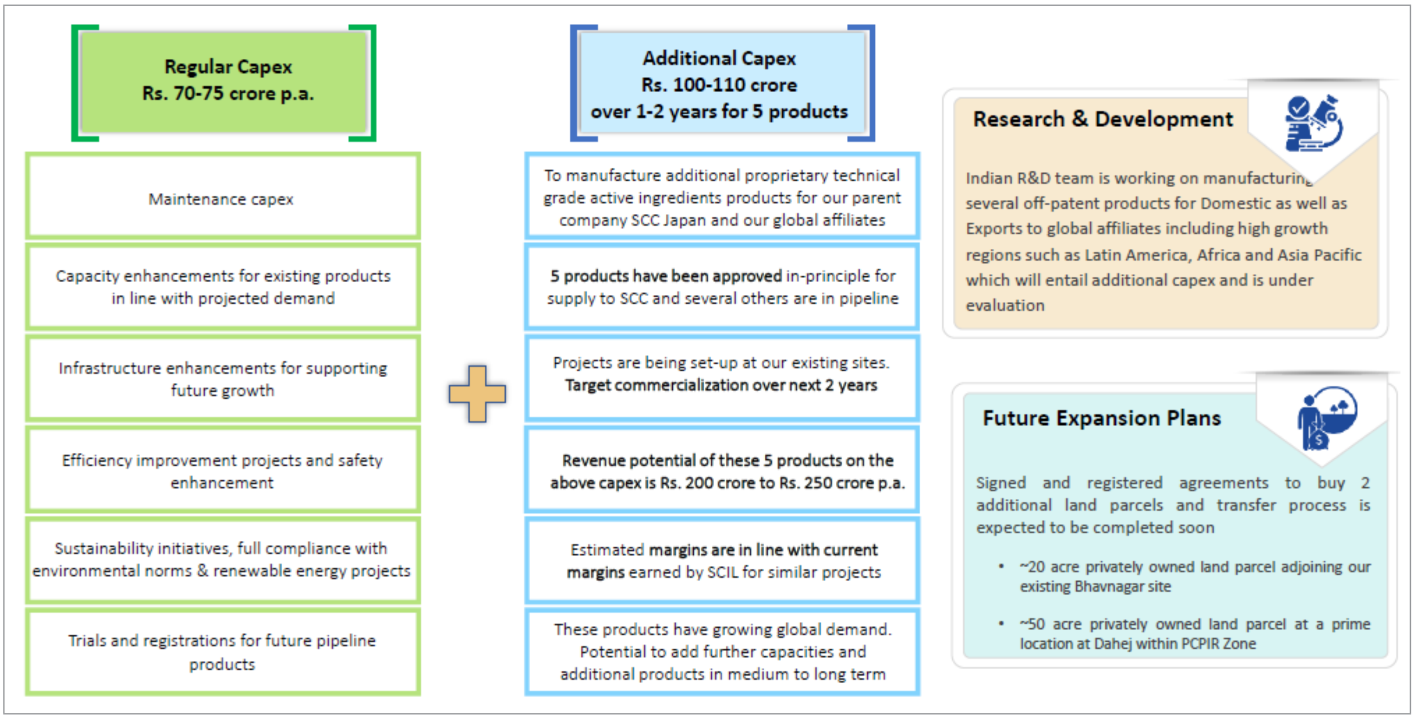
Source: Company; Sharekhan estimates

Massive CRAMs opportunity from parent SCC Japan to aid revenue growth – Initial supply of 5 proprietary molecules with revenue target of Rs200-250 crore

SCIL has recently announced a capex plan of Rs. 100-110 crore for 5 proprietary molecules products which it will manufacture and supply to its parent SCC Japan. One molecule is expected to be commercialised by Q2FY22 and remaining by end FY2022. The initial revenue potential from these five products is at Rs. 200-250 crore (implies asset turnover ratio of 2-2.5x) with gross margin in-line with current level of 37-38%.

The single molecule will have a capacity of 350 tonnes per year initially and it is just 33% of overall requirement of SCC Japan. This hints at massive CRAMS opportunity from the parent and potential further capex (in process to acquire two land parcels – 20 acre near its existing Bhavnagar site and 50 acres at Dahej within PCPIR Zone) to fulfill requirement of SCC Japan. The company has acquired land to set up more manufacturing units post FY2022. Exports accounts for 17-18% of SCIL's revenues and giving CRAMS opportunity, we are optimistic of high growth phase in exports and taking share to 25% over next 3-5 years. Overall, we expect SCIL's revenues to grow at a 13% CAGR over FY2021-FY2024E.

Capex plan and revenue potential from contract manufacturing from parent

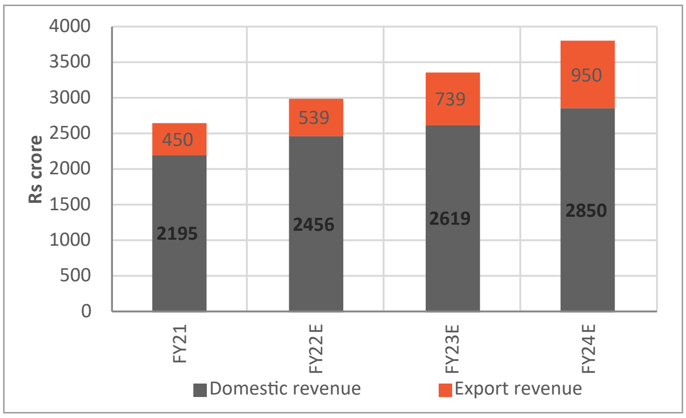


Source: Sharekhan Research

Latin America market – Potential to grow many-fold and drive long term growth

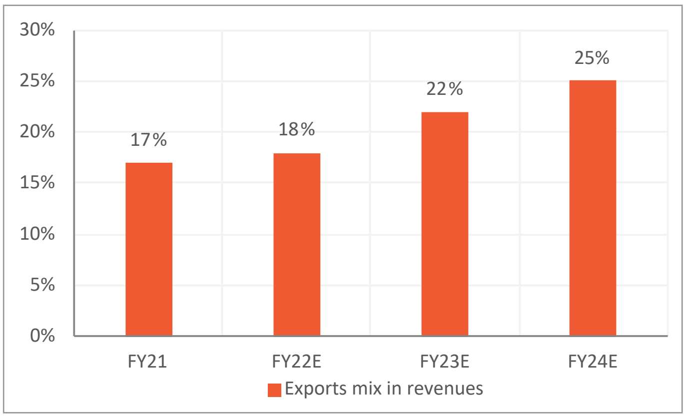
SCIL is looking to expand in exports markets like Latin America (share of revenue increased to 4% in FY2021 versus only 2% in FY2020) and as acquisition of Nufram's distribution in Latin America by SCC Japan provides a huge revenue growth opportunity (SCIL can supply 8-10 technical with overall opportunity size of $1 billion). We see a potential for a manifold increase in revenue from Latin America supported by doubling of Tebuconazole (1350 TPA versus 750 TPA earlier and plan for additional capacity of 1500 TPA) and supply of other molecules.

Revenues to grow at 13% CAGR over FY21-24E



Source: Company, Sharekhan Research

Share of exports to rise on CRAMS opportunity

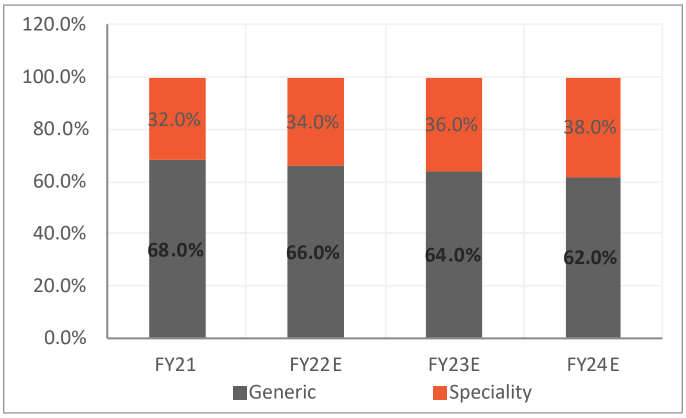


Source: Company, Sharekhan Research

EBITDA margin to expand led by focus on high margin PGR/herbicides and higher share of specialty chemicals

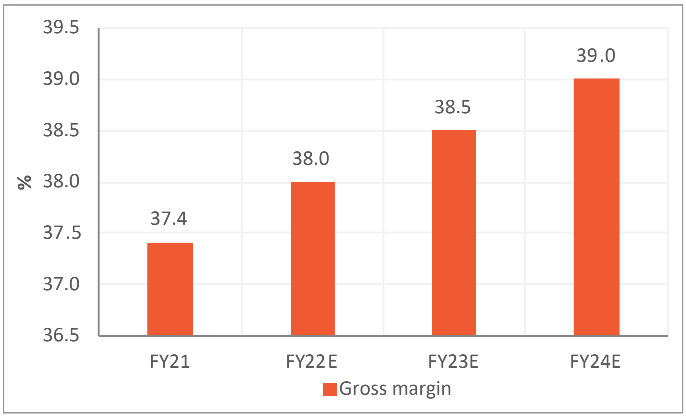
We expect gross margins to expand by 160 bps over FY2021-FY2024E to 39% as SCIL's dependence on imports of molecules would reduce (given ECCL's expertise in active manufacturing) and a likely rise in share of specialty chemical in revenues (expected to reach 38% by FY2024E from 32% in FY2021). This coupled with a larger scale of operations would result in a 346 bps improvement in EBITDA margin over FY2020-FY2024E to 22%.

Rising share of specialty chemicals



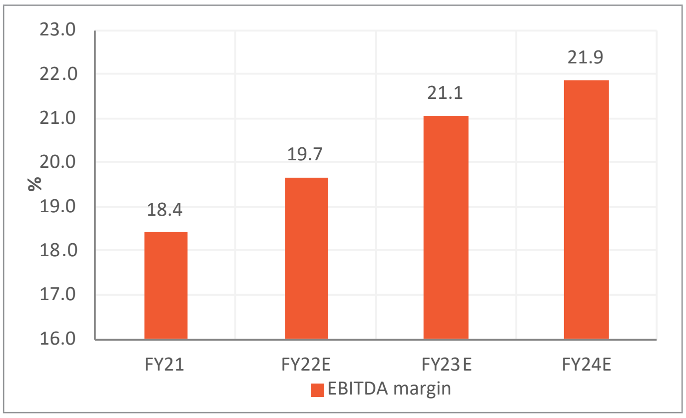
Source: Company, Sharekhan Research

Gross margin to improve over FY21-24E



Source: Company, Sharekhan Research

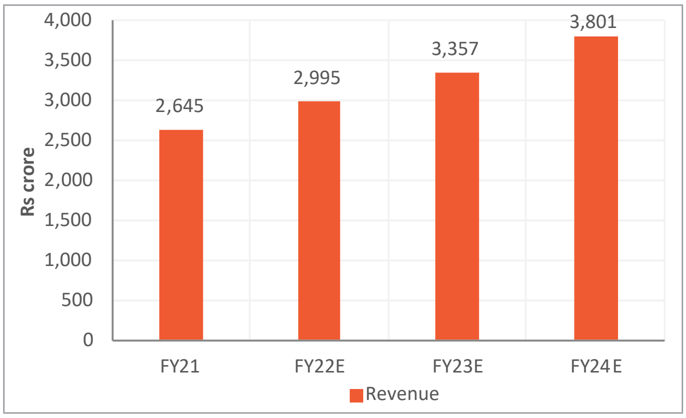
Expect sharp 346bps expansion in EBITDA margin



Source: Company, Sharekhan Research

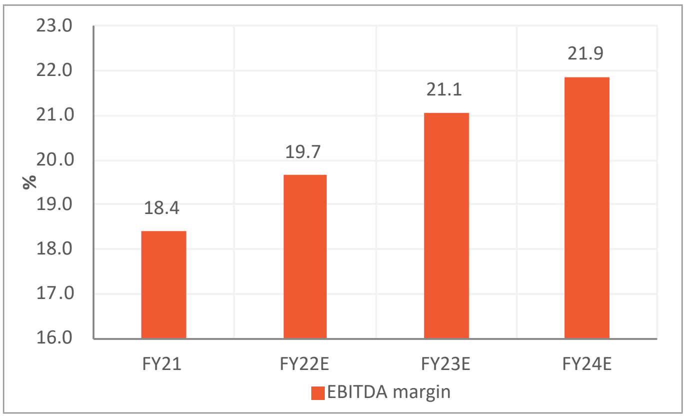
Financials in charts

Strong revenue growth outlook



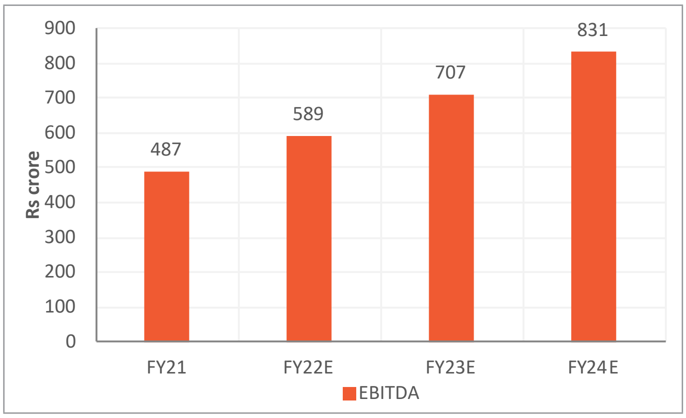
Source: Company, Sharekhan Research

Margins to expand led by cost rationalization



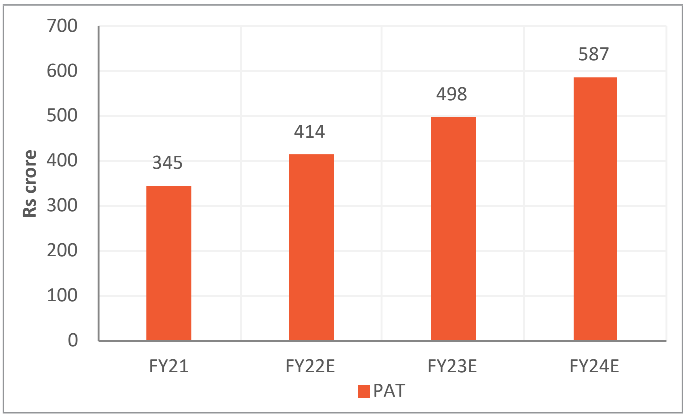
Source: Company, Sharekhan Research

EBITDA CAGR of 20% over FY2021E-FY2023E



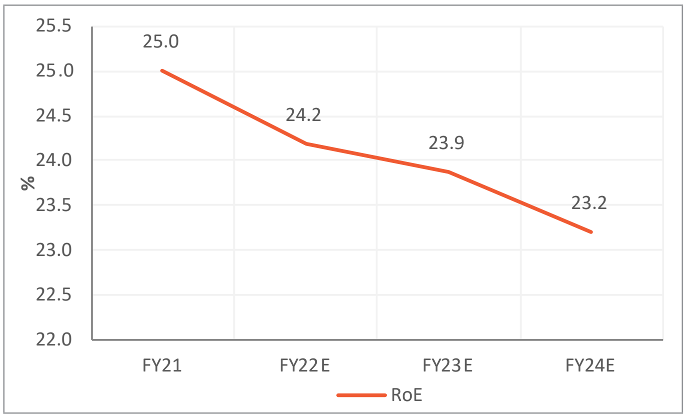
Source: Company, Sharekhan Research

Robust PAT growth outlook



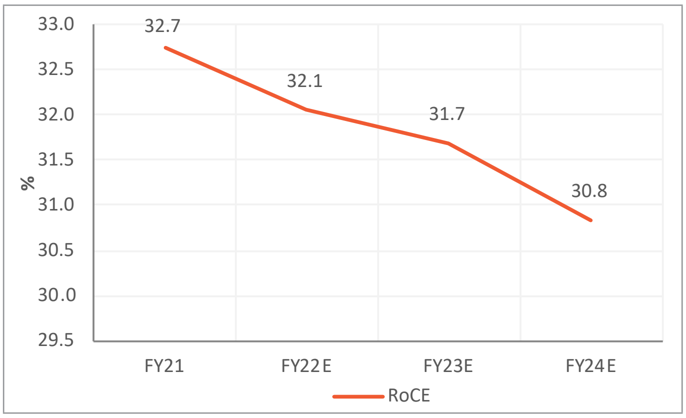
Source: Company, Sharekhan Research

RoE 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 – the 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-inputs in India. We also expect exports from India to grow strongly as the country 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.

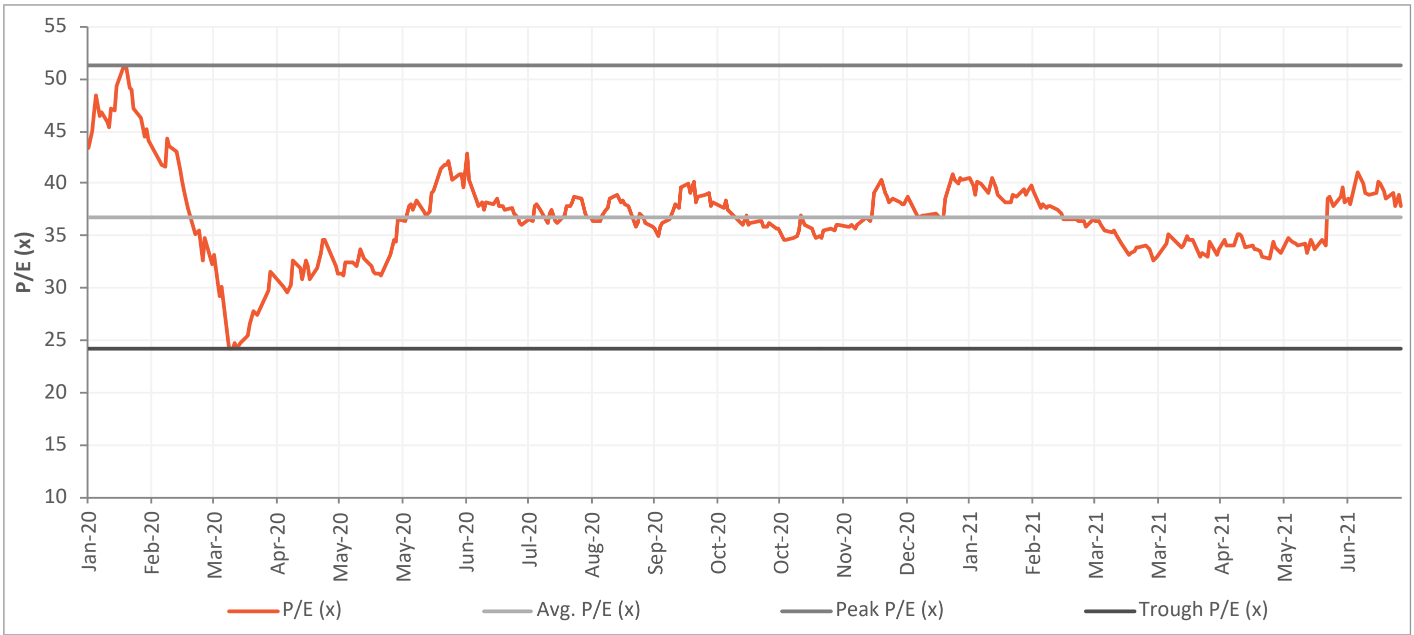
■ Company outlook - Strong earnings growth outlook

After the merger of ECCL, SCIL has become third-largest agrochemical company in India with revenues 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 presence (both in domestic and exports markets). Hence, we expect SCIL's revenue to grow at 13% CAGR over FY2021-FY2023E. Moreover, margins are expected to expand by 345 bps and reach 22% by FY2024E supported synergies from ECCL merger and ramp-up of existing/new capacities. Thus, we expect SCIL's earnings to clock a 19% CAGR over FY2021-FY2024E. With a limited capex, the company would generate decent cumulative FCF of Rs. 1412 crore over FY2022E-FY2024E. The revenue opportunity from CRAMS could further aid SCIL's revenue and earnings growth.

■ Valuation - Maintain Buy on SCIL with a revised PT of Rs. 448

We have largely maintained our FY2022-FY2023 earnings estimates and have also introduced our FY2024 earnings estimate in this report. We believe that SCIL would continue enjoy premium valuations versus domestic peers given its superior earnings growth outlook (growth could accelerate future given the 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 & cash equivalents). Hence, we maintain a Buy rating on SCIL with a revised price target (PT) of Rs. 448. At CMP, SCIL is trading at 37.9x FY2023E EPS and 32.1x FY2024E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

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

- Ban on products like 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	0.68
3	Invesco Asset Management India Pvt Ltd	0.35
4	L&T Mutual Fund Trustee Ltd	0.35
5	Union Mutual Fund	0.16
6	Norges Bank	0.15
7	BlackRock Inc.	0.05
8	Dimensional Fund Advisors LP	0.04
9	LIC Mutual Fund Asset Management Ltd.	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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