



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. 662	
Price Target: Rs. 815	↑

↑ Upgrade
↔ Maintain
↓ Downgrade

Company details

Market cap:	Rs. 4,581 cr
52-week high/low:	Rs. 792/422
NSE volume: (No of shares)	5.4 lakh
BSE code:	506655
NSE code:	SUDARSCHEM
Free float: (No of shares)	4.2 cr

Shareholding (%)

Promoters	39.6
FII	8.8
DII	9.3
Others	42.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-12.8	-5.6	16.4	47.1
Relative to Sensex	-19.7	-17.2	2.0	-4.5

Sharekhan Research, Bloomberg

Summary

- Recent anti-dumping duty on natural mica-based pearl industrial pigments would drive up FY22-FY23 earnings estimates by 9% on existing volumes of 1500 mt and 23% in case of market share gains (assuming mica pigment volume of 4000 mt).
- The Indian dyes, pigment and coating industry is expected to grow at 10% CAGR over CY19-25E and consolidation in global pigment industry would help SCIL beat industry growth rates.
- Capex of Rs. 600 crore is nearing completion and thus we expect SCIL to clock industry-beating revenue CAGR of 18% and margin expansion of 154 bps over FY21-24E. This would drive strong 24% PAT CAGR over FY21-24E along with high RoE of 24% in FY24E.
- We maintain a Buy on the stock with a revised PT of Rs. 815 as we expect sustained high earnings growth led by ramp-up of capacities and potential market share gain. At CMP, the stock is trading at 22x its FY23E EPS and 17x FY24E EPS.

Sudarshan Chemical Industries Limited (SCIL) is leader in Indian pigment market with 35% market share and fourth-largest player globally. India's dyes, pigments and coatings market to clock a 10% CAGR over CY19-25E and consolidation in global pigment industry provides strong growth tailwinds for SCIL. The company is well-placed to capture the opportunities as its capex is nearing completion.

- Anti-dumping duty on mica pigment to aid earnings by 9-23%:** Recently the Finance Ministry has imposed anti-dumping duty (ADD) on natural mica-based pearl industrial pigments for next five years in the range of Rs. 150-210/kg (\$2-2.8/kg) over the imported price of Rs. 380/kg. This is expected to increase FY22E/FY23E PAT by ~9% on current sales volume of 1500 mt (based on our calculation). Market share gain (mica pigment imports of ~2,181 mt) could have much higher incremental PAT of Rs48 crore (23% of FY23E PAT of Rs. 210 crore).
- Capex nearing completion – to drive industry beating revenue growth:** SCIL is on track to complete Rs120 crore of capex by September 2021 and another Rs. 180-200 crore capex by Q3FY21. Overall, the company's capex of Rs600 crore (initiated in FY20) is nearing completion in FY22. This has the potential to generate incremental revenue of Rs. 1,000-1,200 crore (asset turnover of 1.7-2x) and drive sustainable double-digit revenue growth. We expect SCIL's revenue to grow at 18% CAGR over FY21-24E.
- Margin to improve by 154 bps over FY21-24E:** Government's new RoDTEP scheme (which would replace the export incentive scheme MEIS) includes some pigment categories and this bodes well for improvement in margins from Q4FY21 level of 15.1%. Additionally, ramp-up of new capacities would drive operating leverage and rise in share of VAP to help margin expansion. Although Q2 margin to remain muted on temporarily elevated freight cost but overall, we expect SCIL's margin to improve by 154 bps over FY21-FY24E and reach ~17% in FY24E.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 815: We expect SCIL's PAT to grow at 24% CAGR over FY21-24E led by ramp-up of new capacities and margin expansion with potential for earnings upgrade given margin benefit from ADD on mica pigment and potential market share gain. Hence, we maintain a Buy on SCIL with a revised PT of Rs815. At CMP, the stock is trading at 22x its FY23E EPS and 17x FY24E EPS.

Key Risks

Lower demand amid economic slowdown, delay in completion of expansion projects, intense competition from countries like China and higher raw-material prices, adverse forex fluctuations might affect earnings.

Valuation (consolidated)

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	1,864	2,200	2,596	3,063
OPM (%)	15.4	15.4	16.5	17.0
Adjusted PAT	141	159	210	269
% y-o-y growth	7.6	12.6	31.9	28.2
Adjusted EPS (Rs.)	20.4	22.9	30.3	38.8
P/E (x)	32.5	28.8	21.9	17.1
EV/EBITDA (x)	17.5	16.0	12.8	10.5
P/BV (x)	6.2	5.4	4.5	3.7
RoCE (%)	17.1	15.9	16.6	17.9
RoE (%)	21.0	19.9	22.5	24.0

Source: Company; Sharekhan estimates

ADD on mica pigment – could increase FY23E PAT by 9-23%

Recently government has imposed anti-dumping duty (ADD) on natural mica-based pearl industrial pigments (excluding cosmetic-grade products) in the range of \$2-2.8/kg for a period of five years. We highlight here that India is importing ~2,181 MT of mica-based pigments at a price of Rs. 380/kg.

Mica-based pigment accounts for low single-digit percentage share in Sudarshan Chemical's FY2021 revenue of Rs1,864 crore and our rough cut calculation hints at Mica-based pigment sales volume of ~1,500 mt. We believe that ADD on mica-based pigments opens volume opportunity for Sudarshan Chemical apart from the benefit of pricing/margin on existing sales volume. In our base case scenario (assuming no market share gains), we expect an incremental PAT of ~Rs. 18 crore (potential earnings benefit of ~9% in FY2023E) and bull case (assuming market share gain) we see an incremental PAT contribution of ~Rs. 48 crore (potential earnings benefit of ~23% in FY2023E) from mica-based pigment.

Impact analysis of ADD on mica pigment – incremental PAT of Rs. 18-48 crore in FY23E

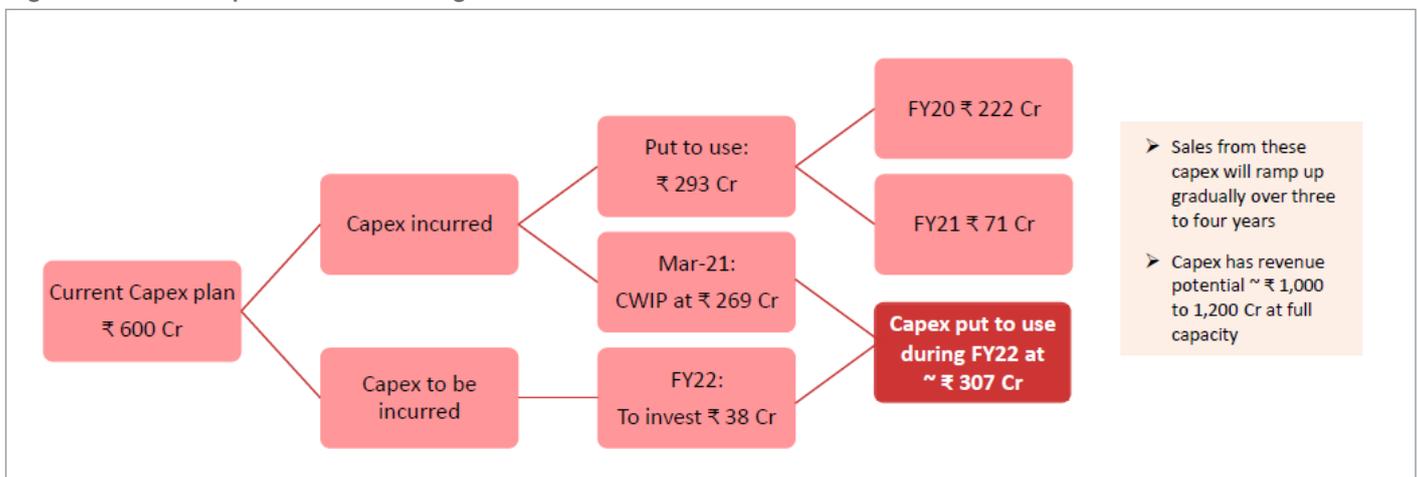
Particulars	Base case (no market share gain)	Bull base (Market share gain)
Mica pigment sales volume	1,500	4,000
Price benefit from ADD (Rs/kg)	160	160
Incremental PBT (Rs crore)	24	64
Tax rate	25%	25%
Likely incremental PAT	18	48
FY23E PAT	210	210
Upside to PAT	9%	23%

Source: Sharekhan Research; Note: Mica pigment sales volume is based on our calculation and SCIL does not provide any break of the same

Capex nearing completion – to drive 18% revenue CAGR over FY21-24E

The company's capex plan of Rs. 600 crore, (of which Rs. 293 crore has already been capitalised and Rs. 269 crore is in the capital work in progress stage as of March 2021) is nearing completion. The company is on track to complete Rs. 120 crore of capex by September 2021 and another Rs. 180-200 crore in Q3FY2022 and aims to launch three new product lines (each with 10-15 products) in FY2022. The management expects an incremental revenue potential of Rs. 1,000-1,200 crore (implies asset turnover ratio of 1.7-2x) over the next three years from capex of Rs600 crore. Moreover, the share of specialty chemical revenue in incremental revenue is expected to higher in the coming years, which would aid margin expansion. We thus expect SCIL's revenues to grow at an 18% CAGR and margin improve of 154 bps over FY21-24E.

Pigment business capex and revenue targets



Source: Company

Sudarshan Chemical product portfolio and applications

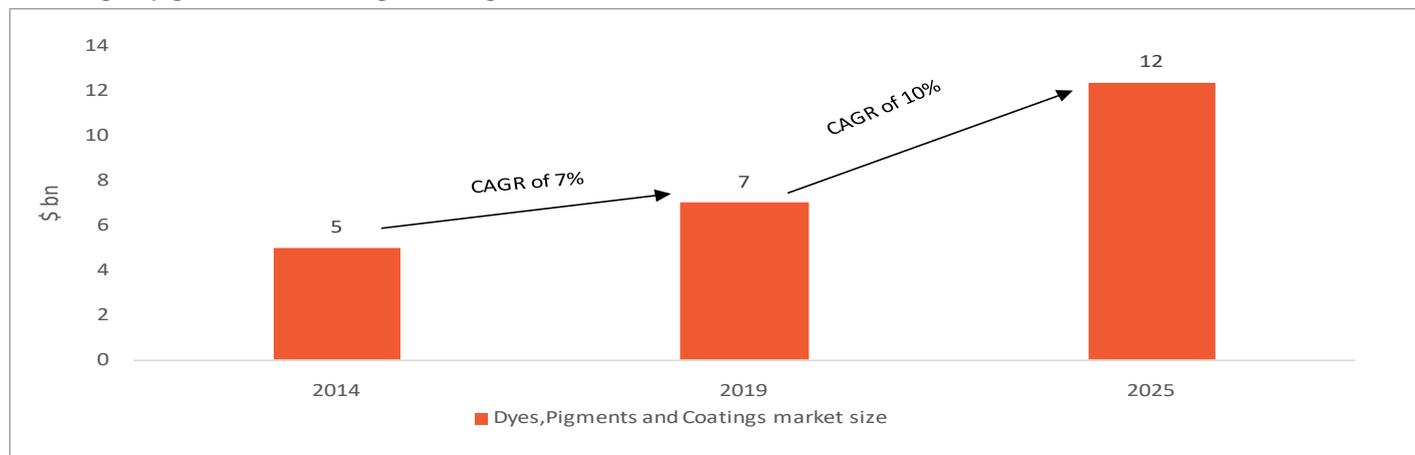
Organic Pigments	Azo Phthalos HPPs Dispersions	Coloured material made of organic compound with pigment properties. Commonly used for Coatings, plastics, Inks & Textile applications
Inorganic Pigments	Chromes Cadmiums Iron Oxides	Made up of mineral compounds. Are mainly oxides, sulphides of one or more than one metals. Used for plastics and industrial coatings
Effect Pigments	Mica base for industrial and cosmetics	Pigments with mica base and coated with oxides to give shimmer and glow. Mainly used in plastics, automotive coatings, cosmetics applications

Source: Company

Indian dyes, pigments and coatings industry – expected to grow at 10% CAGR over CY19-25E

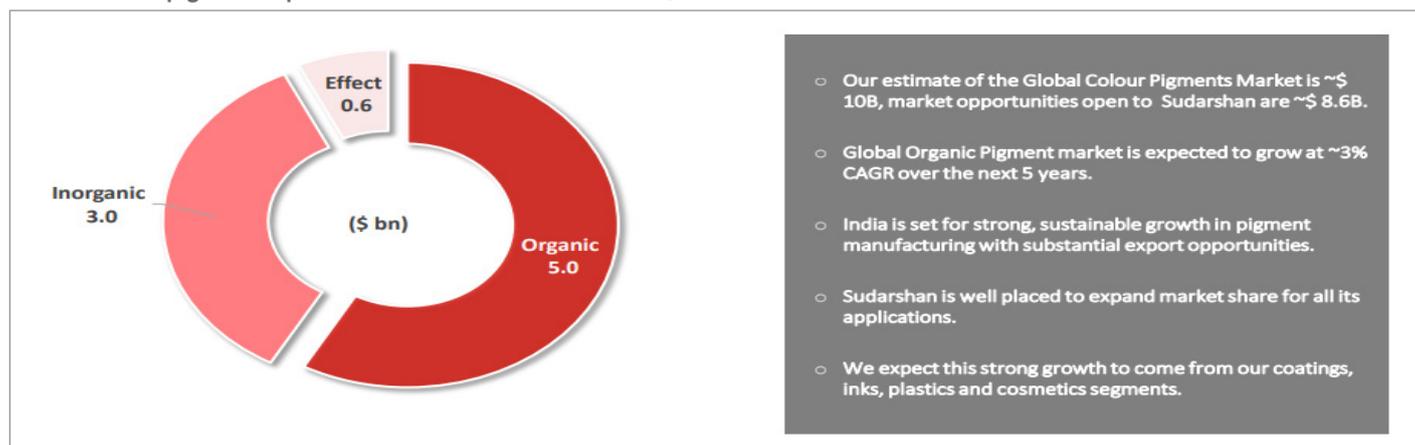
The Indian specialty chemical Industry has clocked a CAGR of ~12% over CY15-20 and is valued at ~\$32 billion. It serves various Industries including dyes, pigment and the coating industry, which contributes ~22% to the total demand of this Industry. Dyes, pigment and coatings industry have grown at a CAGR of 7% over CY14-19 and is expected to register 10% CAGR over CY19-25 to reach a market size of \$12.4 billion by FY25. Increased demand for pigments in industries like textiles and plastics would help in achieving strong growth in this sector.

Indian dyes, pigments and coatings industry market size to reach \$12 billion



Source: Industry reports

Global colour pigments space - addressable market size of \$8.6 billion for Sudarshan Chemical

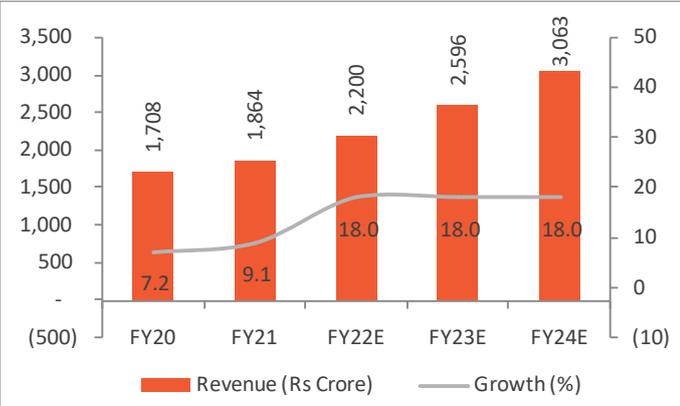


- Our estimate of the Global Colour Pigments Market is ~\$ 10B, market opportunities open to Sudarshan are ~\$ 8.6B.
- Global Organic Pigment market is expected to grow at ~3% CAGR over the next 5 years.
- India is set for strong, sustainable growth in pigment manufacturing with substantial export opportunities.
- Sudarshan is well placed to expand market share for all its applications.
- We expect this strong growth to come from our coatings, inks, plastics and cosmetics segments.

Source: Company

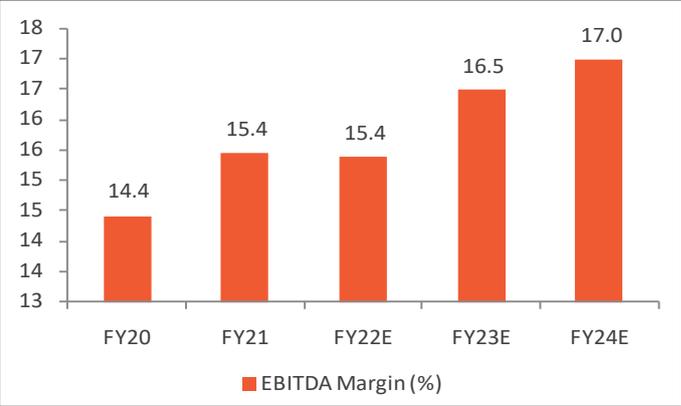
Financials in charts

Capex to drive 18% revenue CAGR over FY21-24E



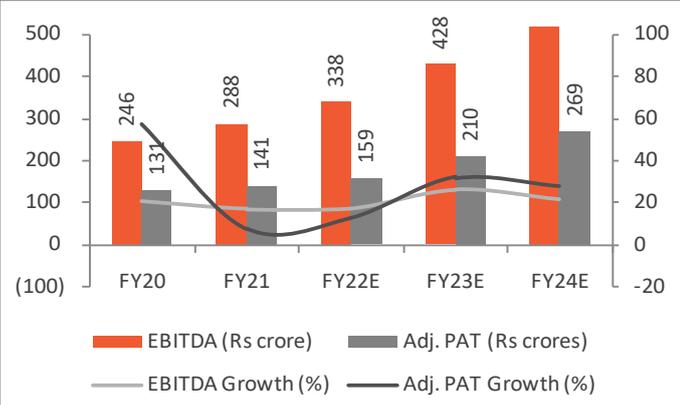
Source: Company, Sharekhan Research

Margin to improve led by ramp-up of capacities



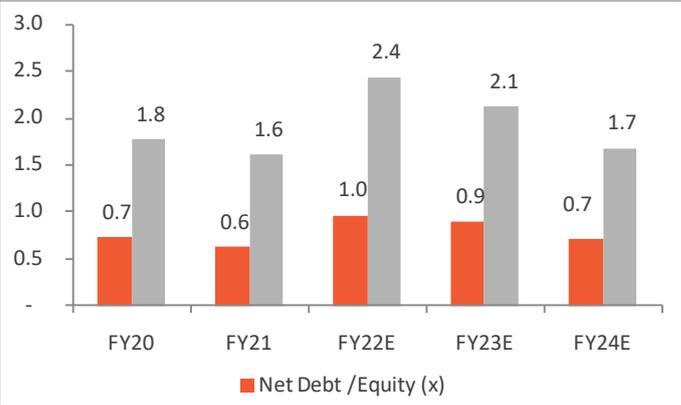
Source: Company, Sharekhan Research

EBITDA/PAT CAGR of 22%/24% over FY21-FY24E



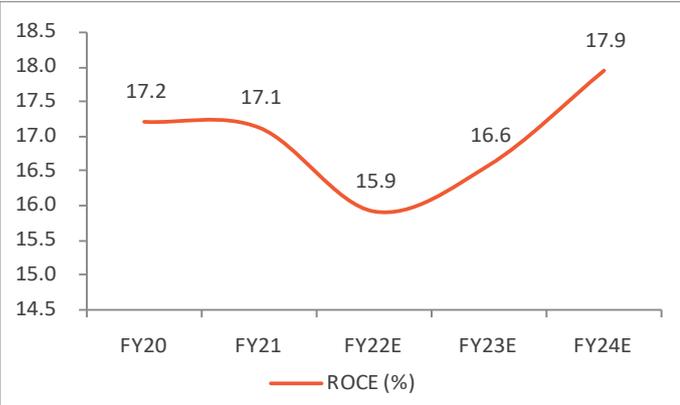
Source: Company, Sharekhan Research

Balance sheet to improve over to FY23-24



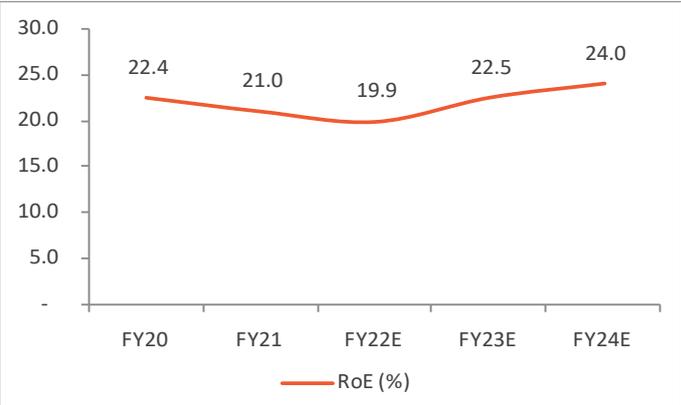
Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

RoE trend



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 CY2019-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 CY2014-FY2019, with a market size of ~\$7 billion in CY2019. 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).

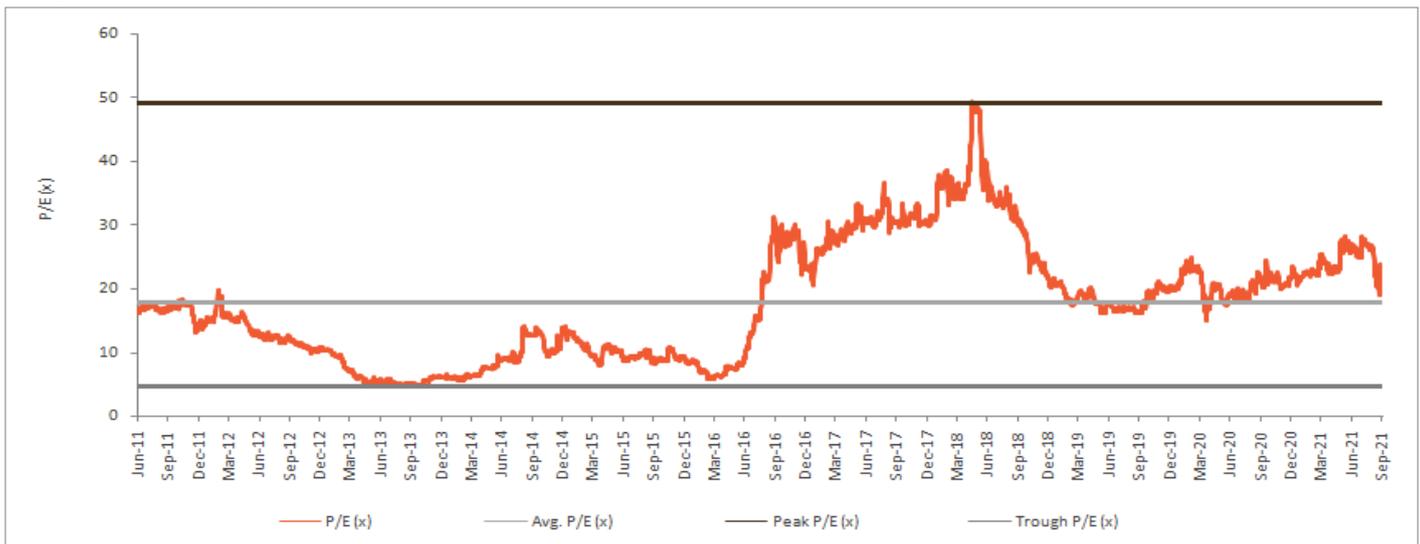
■ Company outlook - Robust capex to increase capacities and help SCIL further consolidate position in domestic and help tap exports markets

Significant growth opportunities are available for players in South-East 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 and the US-China trade war and the recent COVID-19 outbreak across the world. With significant expansion plans of Rs. 600 crore (largely completed) over FY2020-FY2022E and exit of two global peers from the space, SCIL 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. 815

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 and near-completion of capex plans to expand capacity. Thus, we model revenue, EBITDA and PAT CAGRs of 18%, 22%, and 24%, respectively, over FY2021-FY2024E along with high RoE of ~24% in FY2024E. Hence, we maintain our Buy rating on SCIL with a revised PT of Rs. 815 (upward revision reflects higher PE multiple to reflect potential market share gain and favourable government policies). At CMP, the stock is trading at 22x its FY23E EPS and 17x FY24E 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
Ashish V. Vij	Whole Time Director/Chief Operating Officer
Nilkanth Natu	Chief Financial Officer

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	BHANSHALI AKASH	6.2
2	Amansa Capital Pvt. Ltd.	3.2
3	GOVERNMENT PENSION FUND - GLOBAL	2.4
4	Norges Bank	2.4
5	ICICI Prudential Asset Management	2.3
6	Axis Asset Management Co. Ltd./India	1.9
7	Profitex Shares and Securities	1.7
8	Mirae Asset Global Investment Co. Ltd	1.5
9	Kedia Vijay Kishanlal	1.4
10	ICICI Lombard General Insurance Co. Ltd	1.4

Source: Bloomberg

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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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