

Mixed numbers; margin recovery key to watch...

About the stock: Established in 1951, Sudarshan Chemical is a leading player in the Indian colour pigment industry with ~35% market share and is also among the top four players globally.

- It has a wide portfolio of 4,000+ varieties of products of Azos, blue, green, high performance pigments (HPPs), effects, pigment preparations and inorganics
- Among end users, coatings industries contribute highest followed by plastics, inks, cosmetics and other applications

Q1FY23 Results: Sudarshan Chemical's topline surpassed our estimates while bottomline remained below our estimates.

- Reported revenue grew 16.9% YoY to ₹ 554.2 crore, led by higher growth from engineering (up 35.1% YoY) & pigments (up 16.1% YoY)
- Gross margins fell 600 bps YoY to ~40.4% while EBITDA margins contracted 560 bps YoY to 7.5% due to higher COGS (+30% YoY)
- EBITDA declined 33.2% YoY to ₹ 41.4 crore. The decline was led by elevated level of Input costs across multiple intermediates
- PAT was down 72.9% YoY to ₹ 7.1 crore. The lower growth in bottomline was on account of higher taxes (31.9% vs. 22.4% in Q4FY22)

What should investors do? The stock appreciated at 11.8% CAGR in the last three years.

- We maintain **HOLD** as we believe margin recovery is key besides sustained revenues traction

Target Price and Valuation: We value Sudarshan Chemicals at 18x P/E FY24E EPS to arrive at a revised target price of ₹ 515/share (earlier ₹ 565/share).

Key triggers for future price performance:

- Upcoming capex bodes well for speciality pigments revenue growth
- Higher share of value added business portfolio expected to improve margin profile of the business
- Allocation of incremental FCF towards organic/inorganic growth likely to expand return ratios further

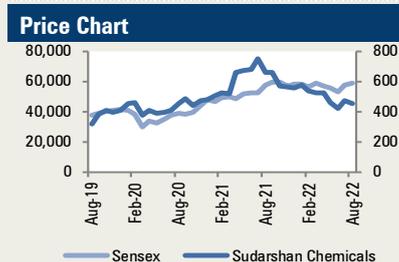
Alternate Stock Idea: Apart from Sudarshan Chemical, in our chemical coverage we also like Neogen Chemical.

- For Neogen Chemical, future revenue growth is expected to be driven by increasing custom synthesis opportunity
- BUY with a target price of ₹1645



Particulars	
Particular	Amount
Market Capitalisation	₹ 3153 crore
Debt (FY22)	₹ 819 crore
Cash (FY22)	₹ 35 crore
EV	₹ 3937 crore
52 week H/L	735/402
Equity capital	₹ 13.8 crore
Face value	₹ 2

Shareholding pattern				
in %	Sept-21	Dec-21	Mar-22	Jun-22
Promoter	35.7	35.7	35.8	35.8
DII	9.8	10.9	11.5	13.0
FII	9.4	8.5	7.9	6.0
Others	45.1	44.9	44.7	45.1



Recent event & key risks

- Input price inflation to be passed on during subsequent quarters
- Key Risk:** (i) Higher RMAT prices and inability to pass on to impact gross margins (ii) Ability to pass on energy, logistics cost can lead to better EBITDA margins

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Revenue	1,593.1	1,708.2	1,864.1	2,200.8	11.4%	2,594.5	2,970.2	16.2%
EBITDA	204.1	246.3	287.8	274.8	7.8%	298.9	386.5	18.6%
EBITDA Margins (%)	12.8%	14.4%	15.4%	12.5%		11.5%	13.0%	
Adj.PAT	132.8	145.1	141.1	130.0	5.2%	133.6	197.2	23.2%
Adj. EPS (₹)	8.7	18.5	20.4	18.8		19.3	28.5	
EV/EBITDA	18.2x	14.6x	12.9x	14.2x		12.8x	9.6x	
P/E	65.3x	21.5x	22.1x	24.0x		23.3x	15.8x	
ROE (%)	10.7	21.3	19.0	15.6		14.3	18.3	
ROCE (%)	14.4	15.2	14.4	10.9		11.3	15.4	

Key takeaways of recent quarter & conference call highlight

Q1FY23 Results: EBITDA margins impacted by escalation hike in RMAT, energy and logistics cost

- **Pigment business:** Revenues were up 16.1% YoY to ₹ 526 crore of which domestic and export revenues were up 33% YoY to ₹ 268 crore and 3% YoY to ₹ 258 crore, respectively. Revenue from the speciality pigment increased 11% YoY to ₹ 352 crore while the same from non-speciality pigment was up 29% YoY to ₹ 174 crore
- **Gross margins remain soft:** Although the management sounded confident of passing on higher input cost, there has been a fall in the GPM by 600 bps YoY. Intermediates price increase pass through continued through Q1FY23. We expect part of this to be on account of a lag in passing on input price inflation. Moreover, higher energy and logistic cost also remains a key challenge for a subdued margin performance. OPM contracted 560 bps YoY to 7.5%

Q1FY23 Earnings Conference Call highlights

Management commentary on Q1FY23 financial results

- Gross profit per kg is not much affected, which means the company is able to pass on the raw material hike to customers
- Escalation due to coal and logistics continues to impact EBITDA margins. Here, the company is unable to pass on the price hike of coal and logistics to its European customers
- Lower Inventory at sales end is impacting the pricing volatility
- Demand slowing down for pigments from plastics industry leading to lower growth. Significant revenues from domestic market were derived from plastic industry. Demand was worst in last quarter
- Management failed in anticipating the cost of RMAT and energy

Market outlook for Sudarshan

- Volume growth expectations in Q2
 - Export demands looks subdued
 - Domestic demand will start recovering from Q2. Largely the company expects growth to come from Q3. Good demand for red/yellow pigments can be expected in Q3
- The management believes there will be no more margins contraction from this level as raw materials have started to decline, which will help the company to maintained its margins

Capex update

- Total capex plan is ~₹ 750 crore of which total capex incurred is ₹ 730 crore
- overall revenue potential of capex is estimated at ~₹ 1500 crore out of which ~₹ 600 crore is from new products. Fundamentals on new project are strong

Pigment industry view

- Global colour pigments markets is ~\$10 billion (bn) and it is expected to grow at ~3% CAGR over the next five years
- Input costs continue at an elevated level across multiple intermediates
- Impact due to coal and logistics cost escalation continuing
- Subdued demand across geographies and segments resulting in pricing pressure
- Geopolitical risk for potential cost inflation and demand side impacts

Demand outlook for new product

- New products were targeted. New plants to be commissioned between Q2 and Q3
- Ramp up will be faster on new products. There will be no large growth on existing products

Speciality revenue performance

- Printing - Normal
- Coatings - Normal
- Plastic – Subdued. Demand was worst in last quarter
- Cosmetic – Performing well

Geographical Performance

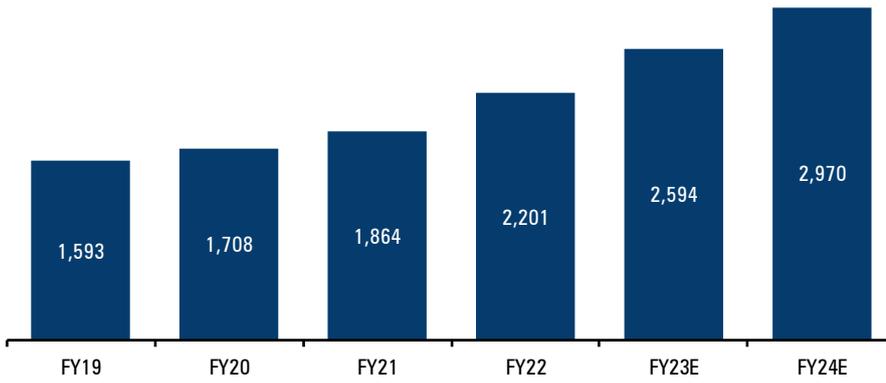
- Europe – Subdued
- US – Normal
- China – Closed
- Ukraine – Closed
- Russia – Closed

Others

- Total 30-35% of raw materials have been imported from China
- Engineering Business – It is not seasonal. It is a project business. No such demand issue has been addressed as such
- Cost of debt for new products capex is ~4-4.5%
- Cash conversion cycle has increased from 96 days to 114 days led by reduction in creditors' time cycle by 15 days

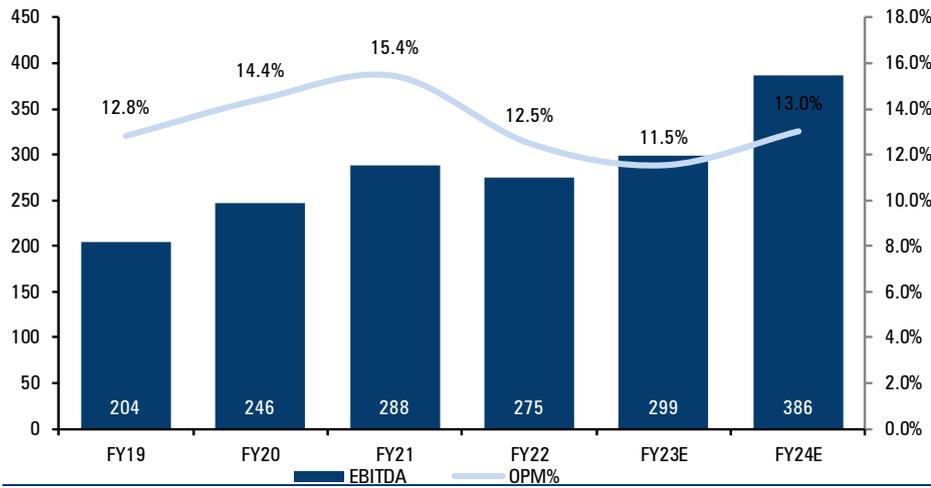
Financial story in charts....

Exhibit 1: Revenue trend (₹ crore)



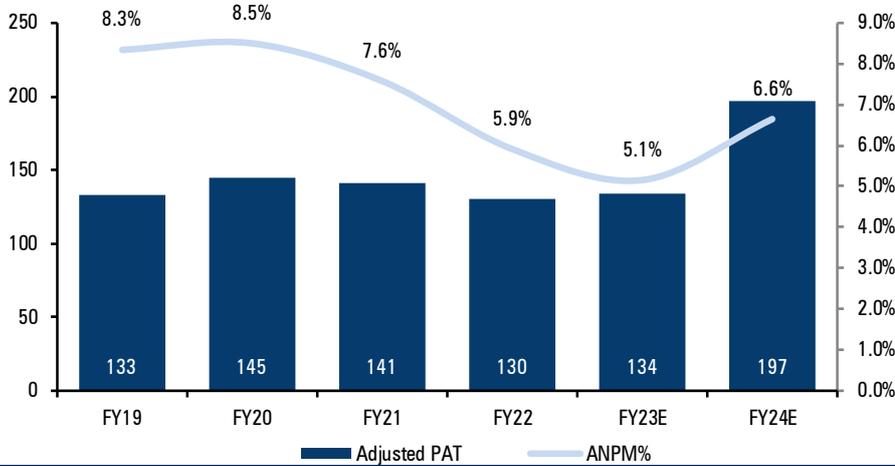
Source: Company, ICICI Direct Research

Exhibit 2: EBITDA (₹ crore) and OPM (%) trend



Source: Company, ICICI Direct Research

Exhibit 3: PAT growth trend (₹ crore)



Source: Company, ICICI Direct Research

Financial summary

Exhibit 4: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Total Operating Income	1,864.1	2,200.8	2,594.5	2,970.2
Growth (%)	9.1	18.1	17.9	14.5
Raw Material Expenses	1,060.5	1,270.4	1,531.0	1,725.4
Gross Profit	803.7	930.4	1,063.5	1,244.8
Gross Profit Margins (%)	43.1	42.3	41.0	41.9
Employee Expenses	155.7	184.0	217.0	249.5
Other Expenditure	360.2	471.6	547.6	608.9
Total Operating Expenditure	1,576.4	1,926.0	2,295.5	2,583.8
EBITDA	287.8	274.8	298.9	386.5
Growth (%)	16.8	-4.5	8.8	29.3
Interest	17.9	19.4	22.3	18.4
Depreciation	86.5	89.3	108.7	120.0
Other Income	7.0	5.0	11.0	14.9
PBT before Exceptional Item	190.4	171.1	179.0	262.9
Less: Exceptional Items	0.0	0.0	0.0	0.0
PBT after Exceptional Items	190.4	171.1	179.0	262.9
Total Tax	49.3	41.2	45.5	65.7
PAT before MI	141.1	130.0	133.6	197.2
PAT	141.1	130.0	133.6	197.2
Growth (%)	-2.7	-7.9	2.8	47.6
EPS (Adjusted)	20.4	18.8	19.3	28.5

Source: Company, ICICI Direct Research

Exhibit 5: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit/(Loss) after taxation	151.6	171.1	133.6	197.2
Add: Depreciation & Amortization	86.5	89.3	108.7	120.0
Net Increase in Current Assets	-176.1	-143.1	-192.9	-184.2
Net Increase in Current Liabilities	85.4	82.8	95.2	90.9
Others	17.8	-22.0	22.3	18.4
CF from Operating activities:	165.2	178.1	166.8	242.3
Investments	0.0	0.0	0.0	0.0
(Purchase)/Sale of Fixed Assets	-269.6	-310.2	-50.0	-50.0
Others	4.2	3.6	1.2	1.2
CF from Investing activities	-265.4	-306.6	-48.8	-48.8
(inc)/Dec in Loan	126.3	198.3	-80.0	-100.0
Dividend & Dividend tax	-0.4	-41.1	-34.4	-50.8
Other	-17.4	-19.4	-22.3	-18.4
CF from Financing activities	108.5	137.8	-136.7	-169.2
Net Cash Flow	8.2	9.3	-18.7	24.3
Cash and Cash Equivalent	15.6	23.8	35.3	16.6
Cash	23.8	33.2	16.6	40.9
Free Cash Flow	-104.4	-132.1	116.8	192.3

Source: Company, ICICI Direct Research

Exhibit 6: Balance sheet				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Equity Capital	13.8	13.8	13.8	13.8
Reserve and Surplus	729.7	819.3	918.5	1,064.9
Total Shareholders funds	743.6	833.2	932.3	1,078.7
Total Debt	614.6	819.3	739.3	639.3
Deferred Tax Liability	52.9	59.5	60.7	61.9
Long-Term Provisions	23.9	26.4	26.9	27.4
Other Non Current Liabilities	15.5	17.5	17.8	18.2
Source of Funds	1,450.5	1,755.8	1,777.0	1,825.5
Gross Block - Fixed Assets	939.9	1,177.6	1,437.6	1,562.3
Accumulated Depreciation	331.8	352.9	461.6	581.6
Net Block	608.0	824.8	976.1	980.8
Capital WIP	278.3	284.7	74.7	0.0
Goodwill	6.8	6.8	6.8	6.8
Fixed Assets	893.2	1,116.3	1,057.6	987.6
Investments	1.3	1.7	1.7	1.7
Other non-Current Assets	77.3	45.6	46.5	47.5
Inventory	411.6	566.0	667.2	763.9
Debtors	484.7	500.7	590.2	675.7
Other Current Assets	111.5	103.2	105.3	107.4
Cash	23.8	35.3	16.6	40.9
Total Current Assets	1,031.6	1,205.1	1,379.3	1,587.8
Creditors	441.1	521.8	615.1	704.2
Provisions	2.3	2.5	2.5	2.6
Other Current Liabilities	109.4	88.7	90.5	92.3
Total Current Liabilities	552.9	612.9	708.1	799.0
Net Current Assets	478.7	592.2	671.2	788.8
Application of Funds	1,450.5	1,755.8	1,777.0	1,825.5

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
Reported EPS	20.4	18.8	19.3	28.5
Cash EPS	15.1	13.9	14.3	21.1
BV per share	107.4	120.4	134.7	155.8
Cash per Share	3.4	5.1	2.4	5.9
Dividend per share	5.3	4.8	5.0	7.3
Operating Ratios (%)				
Gross Profit Margins	43.1	42.3	41.0	41.9
EBITDA margins	15.4	12.5	11.5	13.0
PAT Margins	7.6	5.9	5.1	6.6
Cash Conversion Cycle	89.1	90.4	90.4	90.4
Asset Turnover	2.0	1.9	1.8	1.9
EBITDA conversion Rate	57.4	64.8	55.8	62.7
Return Ratios (%)				
RoE	19.0	15.6	14.3	18.3
RoCE	14.4	10.9	11.3	15.4
RoIC	17.5	12.9	11.3	14.9
Valuation Ratios (x)				
P/E	22.1	24.0	23.3	15.8
EV / EBITDA	12.9	14.2	12.8	9.6
EV / Net Sales	2.0	1.8	1.5	1.3
Market Cap / Sales	1.7	1.4	1.2	1.0
Price to Book Value	4.2	3.7	3.3	2.9
Solvency Ratios				
Debt / EBITDA	2.1	3.0	2.5	1.7
Debt / Equity	0.8	1.0	0.8	0.6
Current Ratio	1.8	1.9	1.9	1.9

Source: Company, ICICI Direct Research

Exhibit 8: ICICI Direct coverage universe (Chemicals)

Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
SRF	2340	2,735	Buy	69,466	63.5	68.9	82.7	36.1	33.2	27.7	22.4	20.6	17.0	23.8	21.6	22.5	22.1	20.3	20.4
PI Industries	3200	3,710	Buy	48,550	55.5	67.2	82.4	57.6	47.6	38.8	40.8	34.2	27.8	16.3	17.1	18.2	13.8	14.5	15.2
Aarti Industries	712	860	Hold	25,812	21.7	24.4	30.7	32.8	29.2	23.2	22.6	18.9	15.4	12.0	12.6	13.6	13.3	13.2	14.4
Tata Chemical	825	1,155	Buy	21,009	47.5	63.6	73.0	17.4	13.0	11.3	12.4	9.1	6.8	6.6	8.4	9.0	6.6	8.3	8.8
Vinati Organics	2238	2,320	Hold	23,000	33.7	40.1	51.5	56.0	47.1	36.7	44.7	37.0	28.3	24.3	23.2	23.9	19.0	19.1	20.5
Sumitomo Chemical	474	520	Buy	23,679	8.5	10.2	11.5	55.9	46.7	41.1	35.9	30.1	26.0	30.2	28.6	26.7	22.0	21.3	19.9
Navin Fluorine	4200	4,450	Hold	20,812	52.3	67.4	89.0	80.3	62.3	47.2	58.4	41.8	30.6	17.8	18.7	19.6	14.0	15.8	17.9
Rallis India	208	200	Hold	3,987	8.4	8.9	12.4	24.3	23.1	16.6	13.9	14.1	10.1	12.7	11.6	15.3	9.7	9.5	12.1
Sudarshan chemical	455	515	Hold	3,153	18.8	19.3	28.5	24.0	23.3	15.8	14.2	12.8	9.6	10.9	11.3	15.4	15.6	14.3	18.3
Neogen Chemicals	1422	1,645	Buy	3,545	17.9	27.2	32.9	79.5	52.2	43.2	41.8	30.2	25.0	12.0	15.0	16.2	10.2	13.6	14.3
Astec Lifesciences	1791	2,215	Buy	3,509	45.1	54.8	69.3	39.7	32.7	25.9	24.6	20.7	16.5	19.3	17.7	19.4	22.3	21.3	21.2

Source: Bloomberg, ICICI Direct Research

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Sell: <-15%



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