Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Sumitomo Chemical India Ltd

Mixed Q1; growth outlook intact

Agri Chem		Sharekhan code: SUMICHEM	
Reco/View: Buy	↔	CMP: **Rs. 477**	Price Target: **Rs. 540** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 34.41

Updated July 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

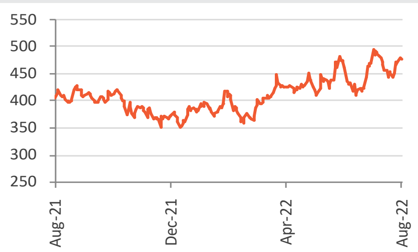
Company details

Market cap:	Rs. 23,809 cr
52-week high/low:	Rs. 512/341
NSE volume: (No of shares)	4.3 lakh
BSE code:	542920
NSE code:	SUMICHEM
Free float: (No of shares)	12.5 cr

Shareholding (%)

Promoters	75.0
FII	1.9
DII	6.7
Others	16.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.7	15.7	18.5	18.0
Relative to Sensex	-11.8	7.0	17.4	10.1

Sharekhan Research, Bloomberg

Summary

- Q1FY23 was mixed as stronger-than-expected revenue growth of 26% y-o-y to Rs. 986 crore was offset by a miss of 188 bps in OPM at 19% and thus operating profit of Rs. 188 crore (up 25% q-o-q) was in-line with expectations. PAT of Rs. 138 crore (up 31% y-o-y) was slightly above our estimate on lower tax rate.
- Domestic revenue growth of 16% y-o-y was better than peers, despite delayed rainfalls led to spillover of sales to Q2FY23. Export revenue growth of 94% y-o-y was led by phenomenal growth across regions. Revenue growth was led by both volume growth/price hikes. Gross margin of 35.1% (down 96 bps y-o-y) missed estimate on product mix change.
- High exports growth is expected to sustain, led by ramp-up of new product registrations in Latin America and strong growth traction in Africa. Margins are expected to sustain led by proactive pricing; capex for five proprietary products for parent is on track to get commercialised by Q2FY2023/Q1FY2024.
- We maintain a Buy on SCIL with an unchanged PT of Rs. 540, given superior earnings growth outlook (expect 24% PAT CAGR over FY22-24E) by leveraging technological capabilities of the parent and a massive opportunity in the CRAMS space. We expect SCIL to enjoy a premium valuation over domestic peers.

Sumitomo Chemical India Limited (SCIL) reported mixed Q1FY23 performance with sharp 10% beat in revenues at Rs. 986 crore, up 26% y-o-y but the stronger-than-expected revenue growth was offset by a 188 bps miss in OPM at 19% (marginally down 12 bps y-o-y. Consequently, operating profit of Rs. 188 crore (up 25.2% y-o-y) matched our estimate of Rs. 188 crore. Strong revenue growth was driven by volume growth (except for Glyphosate) and price hikes across product categories as the company passed on raw material price increase to end-customers. This led to sustained high growth of 94%/16% y-o-y in export/domestic revenue to Rs.197 crore/Rs.788 crore in Q1FY23. Export revenue share increased by 700 bps y-o-y to 20% led by super strong growth across regions (South America/North America/ Africa/Europe/Asia (ex-India) revenue grew by 121%/26%/58%/278%/89% y-o-y). OPM missed our estimate as gross margin of 35.1% (down 96 bps y-o-y) was 186 bps below our estimate due to change in product mix. PAT of Rs. 138 crore (up 30.6% y-o-y) was 2.8% above our estimate led by lower-than-expected tax rate of 23.1% (versus our estimate of 26.5%).

Key positives

- Stronger-than-expected revenue growth of 26% y-o-y led by a strong growth in domestic/ export markets.
- Export revenue grew by 94% y-o-y to Rs. 197 crore.

Key negatives

- Miss of 188 bps in OPM at 19% (largely flat y-o-y) due to lower-than-expected gross margin on product mix change.

Revision in estimates – We maintain our FY2023-FY2024 earnings estimates.

Our Call

Valuation – Maintain Buy on SCIL with an unchanged PT of Rs.540: We believe SCIL would continue to enjoy premium valuations versus domestic peers, given its superior earnings growth outlook (could accelerate future growth, given amassive revenue opportunity from contract manufacturing), its strong parental advantage (robust R&D capabilities, global distribution, and financial strength), and a robust balance sheet (Rs. 643 crore of cash and cash equivalents as onJune 30, 2022). Hence, we maintain our Buy rating on SCIL with an unchanged PT of Rs.540. At the CMP, SCIL is trading at 44.8x its FY2023E EPS and 36.4x its FY2024E EPS.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	2,645	3,065	3,474	4,035
OPM (%)	18.4	19.6	21.2	22.5
Adjusted PAT	345	424	531	655
% YoY growth	46.6	22.6	25.4	23.3
Adjusted EPS (Rs.)	6.9	8.5	10.6	13.1
P/E (x)	68.9	56.2	44.8	36.4
P/B (x)	15.4	12.4	10.1	8.2
EV/EBITDA (x)	48.4	39.6	31.5	25.0
RoNW (%)	25.0	24.4	24.8	24.9
RoCE (%)	32.7	33.0	32.7	32.9

Source: Company; Sharekhan estimates

In-line operating profit as revenue beat offset by margin miss

Q1FY23 performance was mixed with sharp 10% beat in revenues at Rs. 986 crore, up 26% y-o-y bur the stronger-than-expected revenue growth was offset by a 188 bps miss in OPM at 19% (marginally down 12 bps y-o-y. Consequently, operating profit of Rs. 188 crore (up 25.2% y-o-y) matched our estimate of Rs. 188 crore. Strong revenue growth was driven by volume growth (except for Glyphosate) and price hikes across product categories as the company passed on raw material price increase to end-customers. This led to sustained high growth of 94%/16% y-o-y in export/domestic revenue to Rs. 197 crore/Rs. 788 crore in Q1FY23. Export revenue share increased by 700 bps y-o-y to 20% led by super strong growth across regions (South America/ North America/Africa/Europe/Asia (ex-India) revenue grew by 121%/26%/58%/278%/89% y-o-y). OPM missed our estimate as gross margin of 35.1% (down 96 bps y-o-y) was 186 bps below our estimate due to change in product mix. PAT of Rs. 138 crore, up 30.6% y-o-y and 2.8% above our estimate of Rs. 134 crore was led by lower-than-expected tax rate of 23.1% (versus our estimate of 26.5%).

Results (Consolidated) Rs cr

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Revenue	**986**	**782**	**26.0**	**665**	**48.2**
Total Expenditure	798	632	26.2	556	43.5
Operating profit	**188**	**150**	**25.2**	**109**	**72.2**
Other Income	5	5	-14.2	7	-36.7
Interest	1	2	-28.1	1	81.4
Depreciation	11	11	1.8	11	-1.8
PBT	180	142	26.2	104	72.5
Tax	42	37	13.5	29	40.9
Reported PAT	**138**	**106**	**30.6**	**75**	**85.0**
Equity Cap (cr)	50	50		50	
Reported EPS (Rs.)	2.8	2.1	30.6	1.5	85.0
Margins(%)			**BPS**		**BPS**
OPM	19.0	19.2	-12.3	16.4	265.0
NPM	14.0	13.5	49.3	11.2	279.1
Tax rate	23.1	25.7	-259.4	28.3	-519.6

Source: Company, Sharekhan Research

Product/geographical revenue break-up Rs cr

Product wise revenues	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Insecticides	384	289	32.8	286	34.4
Herbicides	315	282	12.0	116	172.7
PGR	59	47	26.0	36	64.9
Metal Phosphides	79	55	44.0	84	-6.0
Fungicides	79	55	44.0	97	-18.8
AND & EHD	69	55	26.0	47	48.2
Total	**986**	**782**	**26.0**	**665**	**48.2**
Geography wise revenues					
Domestic	788	680	15.9	447	76.5
Exports	197	102	93.9	218	-9.7
Total	**986**	**782**	**26.0**	**665**	**48.2**

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 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-inputs 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 in 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.

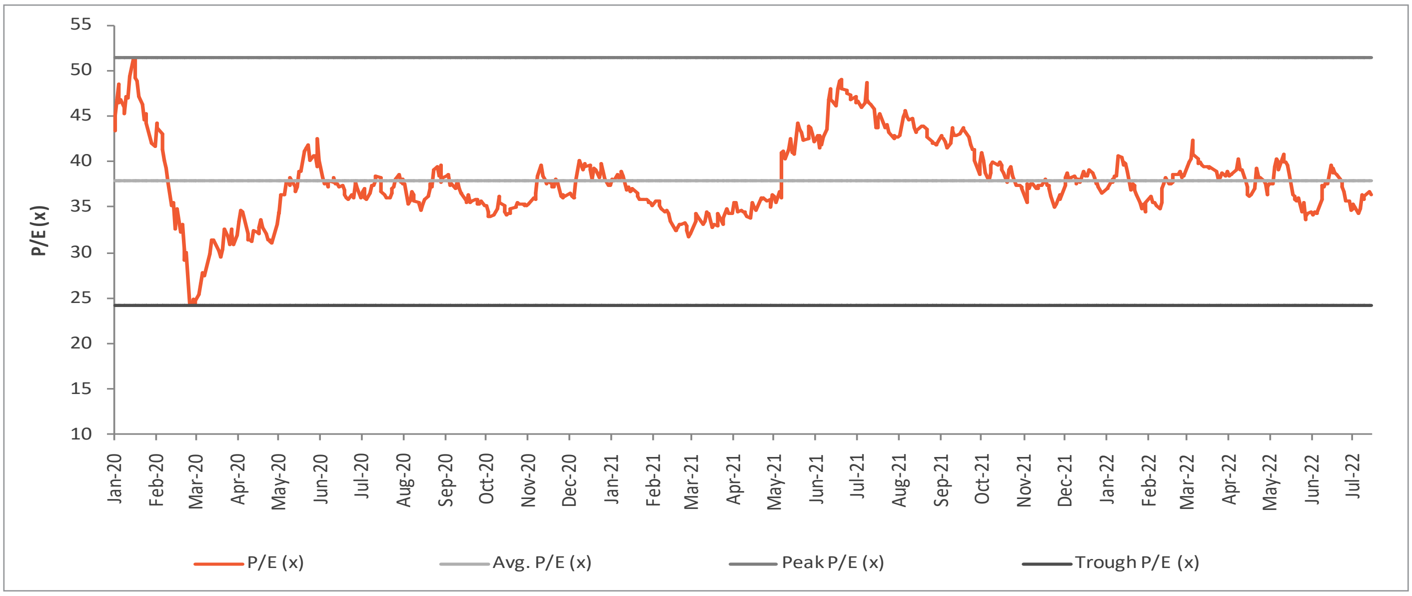
■ Company outlook - Strong earnings growth prospects ahead

After the merger of ECCL, SCIL has become India's third-largest agrochemical company with revenue of Rs. 3,065 crore in FY2022. The acquisition provides strong revenue growth opportunities as both ECCL and SCIL are present in different crop-protection product portfolio and operate in different geographical areas (both in domestic and exports markets). Hence, we expect SCIL's revenues to post a 15% CAGR over FY2022-FY2024E. Moreover, margins are expected to expand by 290 bps and reach 22.5% by FY2024E, supported by synergies from ECCL's merger and ramp-up of existing/new capacities. Thus, we expect SCIL's earnings to report a 24% CAGR over FY2022-FY2024E. The revenue opportunity from CRAMS could further aid SCIL's revenue and earnings growth.

■ Valuation - Maintain Buy on SCIL with an unchanged PT of Rs. 540

We believe SCIL would continue to enjoy premium valuations versus domestic peers, given its superior earnings growth outlook (growth could accelerate future growth, given a 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. 643 crore of cash and cash equivalents as onJune 30, 2022). Hence, we maintain our Buy rating on SCIL with an unchanged PT of Rs. 540. At the CMP, SCIL is trading at 44.8x its FY2023E EPS and 36.4x its FY2024E 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 the coming years, thus genetic crop-protection chemicals should grow in double digits. Hence, the merger of ECCL (has 100% generic portfolio in the 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 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 raw-material supply from China could lead to lower margins.
- Adverse weather conditions could affect demand of agri inputs and impact earnings outlook

Additional Data

Key management personnel

Mukul Govindji Asher	Chairman and Independent Director
Chetan Shantilal Shah	Managing Director
Sushil Champaklal Marfatia	Executive Director
Hiroyoshi Mukai	Non-executive Director

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corporation of India	3.60
2	Axis Asset Management Company Ltd	0.90
3	Vanguard Group Inc	0.70
4	L&T Mutual Fund Trustee Ltd	0.40
5	Invesco Asset Management India Private Limited	0.30
6	Union Mutual Fund	0.20
7	Norges Bank	0.20
8	BlackRock Inc	0.10
9	Quant Money Managers	0.04
10	Exide Life Insurance	0.04

Source: Bloomberg (old data)

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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 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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