Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Sumitomo Chemical India Ltd

Robust Q2; management addresses Glyphosate concerns

Stock Update | Result Update

Agri Chem	Sharekhan code: SUMICHEM
Reco/View: Buy ↔	CMP: **Rs. 492**	Price Target: **Rs. 570** ↑

↑ 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 Oct 08, 2022

High Risk

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

Source: Morningstar

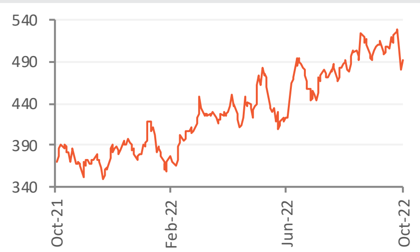
Company details

Market cap:	Rs. 24,536 cr
52-week high/low:	Rs. 541/341
NSE volume: (No of shares)	5.0 lakh
BSE code:	542920
NSE code:	SUMICHEM
Free float: (No of shares)	12.5 cr

Shareholding (%)

Promoters	75.0
FII	2.1
DII	6.4
Others	16.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.3	10.9	14.6	33.1
Relative to Sensex	-8.0	6.3	8.1	32.1

Sharekhan Research, Bloomberg

Summary

- Q2FY23 PAT of Rs. 201 crore (up 31% y-o-y) was 11% above our estimate led by superior revenue growth of 23%, a 157-bps margin beat and higher other income.
- Strong revenue growth was driven by volume growth (except for glyphosate) and price hikes. Domestic/export revenue saw a 21%/34% y-o-y to Rs. 918 crore/Rs. 203 crore. Although, LatAm revenue growth slowed to 8% y-o-y but has received two registrations for formulation products in Brazil which would support exports in FY24.
- Management addressed concerns on government notification on Glyphosate use through PCO and indicated some impact but the company has time to build infrastructure as domestic Glyphosate sales is in Kharif season, while H2 is period of exports.
- We maintain a Buy on SCIL with a revised PT of Rs. 570, given superior earnings growth outlook (expect 22% PAT CAGR over FY22-25E) 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. Any strict domestic/foreign regulation on usage of key products could impact growth and valuation.

Sumitomo Chemical India Limited (SCIL)reported Q2FY23 performance was good with higher-than-expected revenue growth of 23.2% y-o-y (versus estimate of 18% y-o-y growth) and beat of 157 bps in OPM at 24.8% (up 121 bps y-o-y). As a result, operating profit of Rs. 278 crore (up 29.5% y-o-y) was 11% above our estimate of Rs. 249 crore. Strong revenue growth was driven by volume growth (except for glyphosate volumes which declined sharply y-o-y) and price hikes as SCIL was able to pass input increase to end-customers. Domestic revenue grew by 21% y-o-y to Rs. 918 crore despite erratic rainfall during the Kharif season, while export revenue sustained strong growth momentum rising 33.6% y-o-y to Rs. 203 crore led by 80%/85%/38 y-oy revenue growth from Africa/Asia ex-India/Europe; however LatAm revenue growth slowed to 8% y-o-y. OPM expanded by 121 bps y-o-y to 24.8% (above our estimate of 23.2%) reflecting benefit of operating leverage (opex as percentage of revenue declined by 230 bps), which offsets 110 bps y-o-y contraction in gross margin at 37.9% (versus estimate of 38.3%). Consequently, PAT of Rs. 201 crore (up 31% y-o-y) was 12% above our estimate of Rs. 180 crore led by beat in revenues/margins, higher other income (up 34% y-o-y) partially offset by high depreciation (up 39% y-o-y).

Key positives

- Stronger-than-expected revenue growth of 23% y-o-y led by a robust growth in domestic/export markets.
- Beat of 157 bps in OPM at 24.8%, up 121 bps y-o-y.

Key negatives

- Slower revenue growth of 8% y-o-y from Africa.

Management Commentary

- The management indicated that India has not banned glyphosate but only restricted the way it can be used (only through PCOs) by farmers. This would have some impact on glyphosate, but SCIL has time of 3-6 months to develop PCO infrastructure as glyphosate is mostly used in Kharif season and H2FY23 is a period of exports. In addition, management stated that there is no substitute product which can match glyphosate's effectiveness and pricing.
- Five proprietary products for the parent are as per schedule with commercial production for one product at Bhavnagar plant started recently while other project (multiple products) at Tarapur site is expected to start commercial production in Q1FY24. SCIL has the potential to expand capacities for these products.
- Received two registrations for formulation products in Brazil and SCIL would be supplier. This is expected to support formulations export and commercial exports expected by Q1FY24.
- Other updates – 1) SCIL market share (Rs. 1,200 crore) of glyphosate at 35-40% in India, 2) Management expect to gain market share from unorganized players, 3) launched 8 new products (3 insecticide, 1 fungicide, 1 metal phosphide and 3 PGR products) and 3 unique proprietary 9(3) products (Sumi Blue Diamond, Pyclome and Danitol NXT) 4) Falling raw material prices could affect margins, given high-cost inventory and 5) plan to expand Tebuconazole capacity, 6) FY24 capex could be Rs. 250-300 crore over and above normal capex. 7) Net working capital days increased to 94 versus 72 in H1FY22 due to lower trade payable days.

Revision in estimates – We maintain our FY2023-FY2024 earnings estimates as we wait exact impact of government decision to restrict use of Glyphosate through only pest control operators. We have also introduced our FY25 earnings estimates.

Our Call

Valuation – Maintain Buy on SCIL with a revised PT of Rs. 570: We believe SCIL would continue to enjoy premium valuations versus domestic peers, given a 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. 800 crore of cash & cash equivalents as on September 30, 2022). Hence, we maintain our Buy rating on SCIL with a revised PT of Rs. 570. At the CMP, SCIL is trading at 46.2x its FY2023E EPS and 37.5x its FY2024E EPS.

Key Risks

Ban/restriction on use of 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 earnings outlook.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	3,065	3,474	4,035	4,583
OPM (%)	19.6	21.2	22.5	23.3
Adjusted PAT	424	531	655	773
% YoY growth	22.6	25.4	23.3	18.1
Adjusted EPS (Rs.)	8.5	10.6	13.1	15.5
P/E (x)	57.9	46.2	37.5	31.7
P/B (x)	12.7	10.4	8.5	6.9
EV/EBITDA (x)	40.8	32.5	25.9	21.6
RoNW (%)	24.4	24.8	24.9	24.0
RoCE (%)	33.0	32.7	32.9	31.9

Source: Company; Sharekhan estimates

Strong Q2 performance; Better-than-expected revenue growth of 23% y-o-y and 157 bps margin beat

Q2FY23 performance good with higher-than-expected revenue growth of 23.2% y-o-y (versus estimate 18% y-o-y growth) and beat of 157 bps in OPM at 24.8% (up 121 bps y-o-y). As a result, operating profit of Rs. 278 crore (up 29.5% y-o-y) was 11% above our estimate of Rs. 249 crore. Strong revenue growth was driven by volume growth (except for Glyphosate volume which declined sharply y-o-y) and price hikes as SCIL was able to pass input increase to end-customers. Domestic revenue grew by 21% y-o-y to Rs. 918 crore, despite erratic rainfall during Kharif season while export sustained strong growth momentum with 33.6% y-o-y growth in revenue to Rs. 203 crore led by 80%/85%/38 y-oy revenue growth from Africa/Asia ex-India/Europe; however LatAm revenue growth moderated to 8% y-o-y. OPM expanded by 121 bps y-o-y to 24.8% (above our estimate of 23.2%) reflecting benefit of operating leverage (opex as percentage of revenue declined by 230 bps), which offsets 110 bps y-o-y contraction in gross margin at 37.9% (versus estimate of 38.3%). Consequently, PAT of Rs. 201 crore (up 31% y-o-y) was 12% above our estimate of Rs. 180 crore led by beat in revenue/margin, higher other income (up 34% y-o-y) partially offset by high depreciation (up 39% y-o-y).

Q2FY23 earnings call takeaways

- **Update on Glyphosate order:** SCIL clarified that the government order on October 25, 2022 has not banned glyphosate but has only restricted the way it can be used by farmers i.e. through the Pest Control Operators (PCO). The management said the order is not a major hurdle and the company is confident of long-term growth. The spraying cost is ~Rs. 300-500 per acre for farmers and SCIL are looking at providing value-added services (spraying of glyphosate) to the farmer. The management said they haven't come across any report of health hazards caused due to glyphosate and at present there is no direct product in the market to replace it. SCIL has time of 3-6 months to develop PCO infrastructure as Glyphosate is mostly used in Kharif season in domestic market and H2 is period of exports.
- **Glyphosate performance in H1FY23:** Domestic glyphosate sale volumes in H1FY23 were down 40% y-o-y due adverse climatic conditions. However aggregate revenues have stayed flat y-o-y in H1FY23 as the company has taken price hikes. In the same period the export sales volume were up 451% y-o-y and management said H2 has always been a better period for the export of glyphosate. The company has ~35-40% market share of the domestic glyphosate industry and glyphosate gross margins at ~25%-27% are below the aggregate gross margins of the company.
- **Capex update:** The company said its Rs. 120 crore-capex plan for five proprietary products for parent is on track. First project got commercialised recently and the second project will get commercialized (multiple products) in Q1FY2024. The estimated margins are in line with current margins earned by SCIL for similar projects. Company signed agreements to buy 2 new land parcels at Bhavanagar and Dahej and said capex for additional products for FY24 will be ~Rs. 250-300 crores with an asset turnover of at least 2x.
- **Margins to be under pressure:** Raw material prices started falling off since July 2022 but the carry forward of high-cost inventories will keep the Gross and EBITDA margins under pressure going forward. Company said they will price their products in accordance with the raw material costs to maintain their margins.
- **LatAm update:** Received two registrations for formulation products in Brazil and SCIL would be supplier. This is expected to support formulations export and commercial exports expected by Q1FY24.
- **Other updates –** 1) SCIL market share (Rs. 1200 crore) of Glyphosate at 35-40% in India, 2) Management expect to gain market share from unorganized players, 3) launched 8 new products (3 insecticide, 1 fungicide, 1 metal phosphide and three PGR products) and 3 unique proprietary 9(3) products (Sumi Blue Diamond, Pyclome and Danitol NXT) 4) Falling RM price could impact margin given high-cost inventory

and 5) Plan to expand Tebuconazole capacity, 6) FY24 capex could be Rs. 250-300 crore over and above normal capex. 7) Net working capital days increased to 94 versus 72 in H1FY22 due to lower trade payable days. The company has started decreasing inventory levels to pre-Covid period, given the smoothening of supply chain and lower input costs.

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Net Sales	**1,122**	**910**	**23.2**	**986**	**13.8**
Total Expenditure	844	696	21.3	798	5.7
Reported operating profit	**278**	**215**	**29.5**	**188**	**48.2**
Other Income	11	8	34.2	5	126.2
Interest	1	2	-31.4	1	4.8
Depreciation	15	11	39.2	11	35.3
Exceptional income/(expense)	0	0	NA	0	NA
Reported PBT	**272**	**210**	**29.8**	**180**	**51.4**
Tax	71	55	27.3	42	69.8
Reported PAT	**201**	**154**	**30.6**	**138**	**45.8**
Equity Cap (cr)	50	50		50	
Reported EPS (Rs.)	4.0	3.1	30.6	2.8	45.8
Margins (%)			**BPS**		**BPS**
OPM	24.8	23.6	120.7	19.0	575.6
NPM	18.0	16.9	102.1	14.0	394.5
Tax rate	25.9	26.4	-49.4	23.1	281.3

Source: Company, Sharekhan Research

Product/geographical revenue break-up Rs cr

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Insecticides	480	421	13.8	384	24.8
Herbicides	254	125	103.4	315	-19.6
PGR	152	139	8.9	59	156.4
Metal Phosphides	69	64	7.7	79	-12.9
Fungicides	111	114	-3.2	79	40.5
AND & EHD	57	47	22.7	69	-16.7
Total Revenue	**1122**	**910**	**23.2**	**986**	**13.8**
Geography wise revenues	**Q1FY23**	**Q1FY22**	**YoY (%)**	**Q1FY23**	**QoQ (%)**
Domestic	918	758	21.1	788	16.5
Exports	203	152	33.6	197	3.1
Total Revenue	**1122**	**910**	**23.2**	**986**	**13.8**

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.

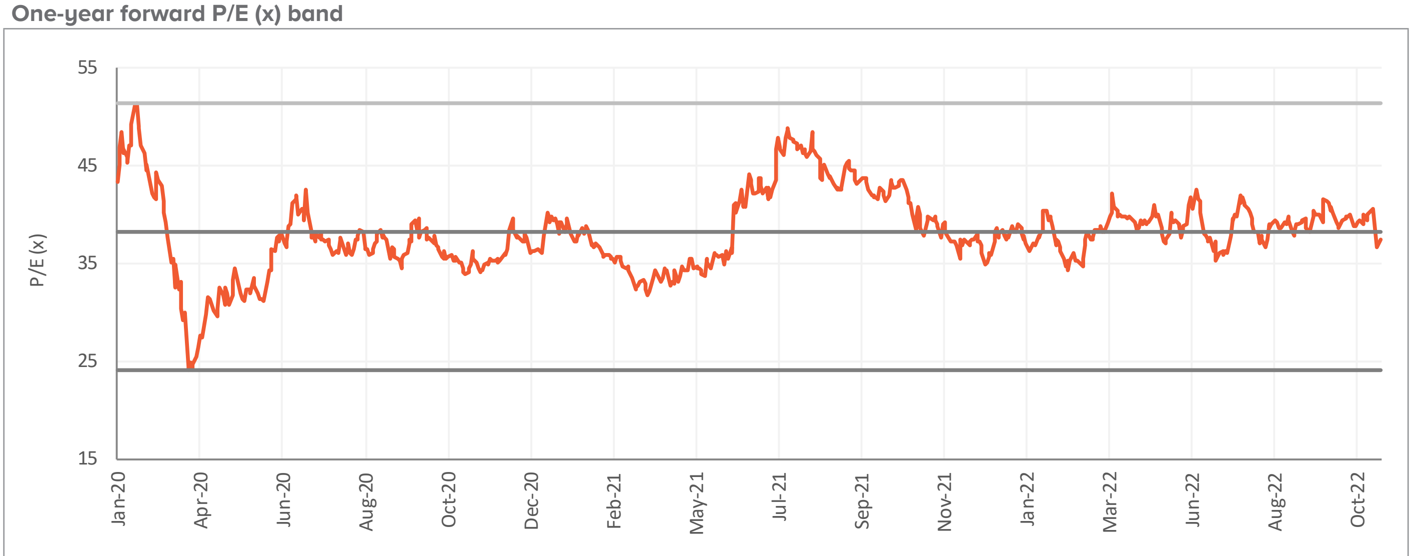
■ Company Outlook – Strong earnings growth prospects ahead

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 14% CAGR over FY2022-FY2025E. Moreover, margins are expected to expand by 373 bps and reach 23.2% by FY2025E, supported by synergies from ECCL's merger and ramp-up of existing/new capacities. Thus, we expect SCIL's earnings to report a 22% CAGR over FY2022-FY2025E. 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. 570

We believe SCIL would continue to enjoy premium valuations versus domestic peers, given a 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. 800 crore of cash & cash equivalents as on September 30, 2022). Hence, we maintain our Buy rating on SCIL with a revised PT of Rs. 570. At the CMP, SCIL is trading at 46.2x its FY2023E EPS and 37.5x 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: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corporation of India	3.6
2	Axis Asset Management Company Ltd	0.9
3	Vanguard Group Inc	0.7
4	L&T Mutual Fund Trustee Ltd	0.4
5	Invesco Asset Management India Private Limited	0.3
6	Union Mutual Fund	0.2
7	Norges Bank	0.2
8	BlackRock Inc	0.1
9	Quant Money Managers	0.04
10	Exide Life Insurance	0.04

Source: Bloomberg (old data)

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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