Sharekhan by BNP PARIBAS

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Sumitomo Chemical India Ltd

Weak Q1; Downgrade to Hold on earnings concern & high valuation

Agri Chem	Sharekhan code: SUMICHEM
Reco/View: Hold ↓	CMP: Rs. 407 / Price Target: Rs. 430 ↓

↑ 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 Jun 08, 2023

High Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 20,300 cr
52-week high/low:	Rs. 541/383
NSE volume: (No of shares)	3.8 lakh
BSE code:	542920
NSE code:	SUMICHEM
Free float: (No of shares)	12.5 cr

Shareholding (%)

Promoters	75.0
FII	2.5
DII	5.5
Others	17.0

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-6.9	-2.6	-9.4	-13.8
Relative to Sensex	-7.8	-10.1	-17.5	-26.6

Sharekhan Research, Bloomberg

Summary

- Q1 numbers were weak with a 25%/392 bps/43% miss in consolidated revenues to Rs. 724 crore/11%/Rs. 62 crore, down 27%/789 bps/55% y-o-y due to the pressure on domestic/export business amid challenging environment of higher channel inventory and pricing pressure for key products like Glyphosate.
- Domestic revenues fell by 21% y-o-y to Rs. 623 crore due to delayed monsoons, high channel inventories, and deferred purchasing decisions by trade partners. Export revenues fell 49% y-o-y to Rs. 101 crore given a decline from Africa/ Europe /South America; but the share of Japan revenue in exports was up sharply to 14% (vs. 5% in Q1FY23).
- High channel inventory remains a concern on demand for agri-inputs and pressure on glyphosate prices (as cited by global agrochem players) makes near-term earnings uncertain. We thus sharply cut our FY24/FY25 earnings estimate by 26%/13%.
- We downgrade SCIL to Hold (from Buy) with a revised PT of Rs. 430 given near-term earnings concern due to challenging demand environment and high valuation of 33x FY25E EPS limits upside from CMP.

Sumitomo Chemical India Limited (SCIL) reported weak Q1FY2024 performance with 25% and 392 bps miss in consolidated revenue at Rs. 724 crore (down 26.5% y-o-y) and OPM at 11.1% (down 789 bps y-o-y), respectively, due to weakness in both domestic and export business. Consequently, consolidated operating profit declined sharply by 57% y-o-y to Rs. 81 crore (45% below estimate). Domestic revenues slumped by 21% y-o-y to Rs. 623 crore due to impact on volume/margin in the domestic market, given delayed and erratic monsoons, delayed sowing, pricing pressures, surplus channel inventory, and deferred purchasing decisions by trade partners. Export revenue declined also by 49% y-o-y to Rs. 101 crore, led by a decline from Africa/ Europe /South America; but the share of Japan revenue in exports expanded sharply to 14% (from 5% in Q4FY2022) to Rs. 14 crore (up 57% y-o-y). Revenue across product categories were weak – herbicides/insecticides/PGR/metal phosphides/AND and EHD revenues fell by 24%/27%/14%/27%/63%/6% y-o-y. OPM of 11.1% (down 789 bps y-o-y) missed our estimate of 15.1% due a steep 405 bps y-o-y decline in gross margin to 31.1% as well as lower absorption of fixed cost. Consolidated PAT of Rs. 62 crore was down 55% y-o-y and 43% below our estimate of Rs. 107 crore, as miss in revenue/margin was partially offset by higher other income (up 276% y-o-y).

Key positives

- Revenues from the Japan market rose 57% y-o-y.

Key negatives

- Steep 21%/49% y-o-y decline in domestic/export revenue.
- Miss of 392 bps in OPM at 11.1%, down 789 bps y-o-y due to pressure on gross margin and lower absorption of fixed cost.

Revision in estimates: We have lowered our FY24 earnings estimates to factor slower revenue growth and lower margin assumption, given challenges in global agrochemical industry.

Our Call

Valuation – Downgrade to Hold with a revised PT of Rs. 430: Although SCIL's strong parental advantage (robust R&D capabilities, global distribution, and financial strength) provides CRAMs opportunity from parent, but near-term challenges may persist due to delayed sowing, pricing pressure and high channel inventory in both domestic/export markets. Weak demand and subdued agrochemical prices (amid higher supplies from China) makes earnings environment uncertain and SCIL's valuation of 45x/33x FY24E/FY25E EPS seem high to us. Hence, we downgrade SCIL to Hold (from Buy) with a revised PT of Rs. 430 as we limited upside from CMP.

Key Risks

Recovery in agrochemical product demand, better product price and potential more CRAMs opportunity from parent would improve earnings outlook and is key upside risk. Ban/restriction on the use of products such as Glyphosate (that fetch 15-18% of revenue), a delay in raw-material supply from China and adverse weather conditions are key downside risk.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	3,065	3,511	3,630	4,161
Operating profit	600	667	610	824
OPM (%)	19.6	19.0	16.8	19.8
Adjusted PAT	424	502	447	611
% YoY growth	22.6	18.6	-11.0	36.7
Adjusted EPS (Rs.)	8.5	10.1	9.0	12.2
P/E (x)	47.9	40.4	45.4	33.2
P/B (x)	10.5	8.5	7.4	6.2
EV/EBITDA (x)	33.7	30.0	32.0	23.3
RoNW (%)	24.4	23.3	17.4	20.4
RoCE (%)	33.0	30.1	23.2	27.1

Source: Company; Sharekhan estimates

Weak Q1; miss on all fronts

Q1FY2024 performance was weak with 25% and 392 bps miss in consolidated revenue at Rs. 724 crore (down 26.5% y-o-y) and OPM at 11.1% (down 789 bps y-o-y), respectively, due to weakness in both domestic and export business. Consequently, consolidated operating profit declined sharply by 57% y-o-y to Rs. 81 crore (45% below estimate). Domestic revenues slumped by 21% y-o-y to Rs. 623 crore due to impact on volume/ margin in the domestic market, given delayed and erratic monsoons, delayed sowing, pricing pressures, surplus channel inventory, and deferred purchasing decisions by trade partners. Export revenue declined also by 49% y-o-y to Rs. 101 crore, led by a decline from Africa/ Europe /South America; but the share of Japan revenue in exports expanded sharply to 14% (from 5% in Q4FY2022) to Rs. 14 crore (up 57% y-o-y). Revenue across product categories were weak – herbicides/insecticides/PGR/metal phosphides/ and EHD revenues fell by 24%/27%/14%/27%/63%/6% y-o-y. OPM of 11.1% (down 789 bps y-o-y) missed our estimate of 15.1% due a steep 405 bps y-o-y decline in gross margin to 31.1% as well as lower absorption of fixed cost. Consolidated PAT of Rs. 62 crore was down 55% y-o-y and 43% below our estimate of Rs. 107 crore, as miss in revenue/ margin was partially offset by higher other income (up 276% y-o-y).

Results (Consolidated) — Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Revenue	**724**	**986**	**-26.5**	**652**	**11.2**
Total Expenditure	644	798	-19.4	571	12.7
Operating profit	**81**	**188**	**-57.0**	**81**	**0.1**
Other Income	17.5	4.7	276.4	16	6.4
Interest	1.3	1.3	1.8	1	-4.1
Depreciation	13.5	11.2	20.3	14	-3.6
PBT	**83**	**180**	**-53.6**	**82**	**2.1**
Tax	21.6	41.5	-47.9	9	127.8
PAT	**62**	**138**	**-55.3**	**72**	**-14.5**
Equity Cap (cr)	50	50		50	
Reported EPS (Rs)	1.2	2.8	-55.3	1.4	-14.5
Margins (%)			**BPS**		**BPS**
OPM	11.1	19.0	-789.2	12.4	-123.2
NPM	8.5	14.0	-549.6	11.1	-255.4
Tax rate	26.0	23.1	284.5	11.6	1,432.7

Source: Company, Sharekhan Research

Product/geographical revenue break-up — Rs cr

Product wise revenues	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Insecticides	282	384	-26.5	280	1.0
Herbicides	239	315	-24.2	127	87.6
PGR	51	59	-14.3	30	69.5
Metal Phosphides	58	79	-26.5	81	-28.1
Fungicides	29	79	-63.3	87	-66.7
AND & EHD	65	69	-5.5	46	43.2
Total	**724**	**986**	**-26.5**	**650**	**11.4**
Geography wise revenues					
Domestic	623	788	-21.0	316	97.1
Exports	101	197	-48.6	334	-69.7
Total	**724**	**986**	**-26.5**	**650**	**11.4**

Source: Company, Sharekhan Research

SCIL's capex plan remains intact

Regular Capex
Rs. 70-75 crore p.a.

- Maintenance capex
- Capacity enhancements for existing products in line with projected demand
- Infrastructure enhancements for supporting future growth
- Efficiency improvement projects and safety enhancement
- Sustainability initiatives, full compliance with environmental norms & renewable energy projects
- Trials and registrations for future pipeline products

Additional Capex
Rs. 120 crore
over 2 years for 5 products*

- To manufacture additional proprietary technical grade active ingredients products for our parent company SCC Japan and our global affiliates
- **5 products have been approved** in-principle for supply to SCC and several others are in pipeline
- Projects are being set-up at our existing sites. **Target commercialization over next 1 year**
- **Revenue potential of these 5 products on the above capex is Rs. 200 crore to Rs. 250 crore p.a.**
- Estimated **margins are in line with current margins** earned by SCIL for similar projects
- These products have growing global demand. Potential to add further capacities and additional products in medium to long term

Research & Development

Indian R&D team is working on manufacturing several off-patent products for Domestic as well as Exports to global affiliates including high growth regions such as Latin America, Africa and Asia Pacific which will entail additional capex and is under evaluation

Future Expansion Plans

Signed and registered agreements to buy 2 additional land parcels and transfer process is expected to be completed soon

- ~20 acre privately owned land parcel adjoining our existing Bhavnagar site
- ~50 acre privately owned land parcel at a prime location at Dahej within PCPIR Zone

*Both the projects have started commercial production recently and are expected to generate some revenue in current fiscal year of FY24

Source: Company

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 MSP 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 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 U.S. and Europe.

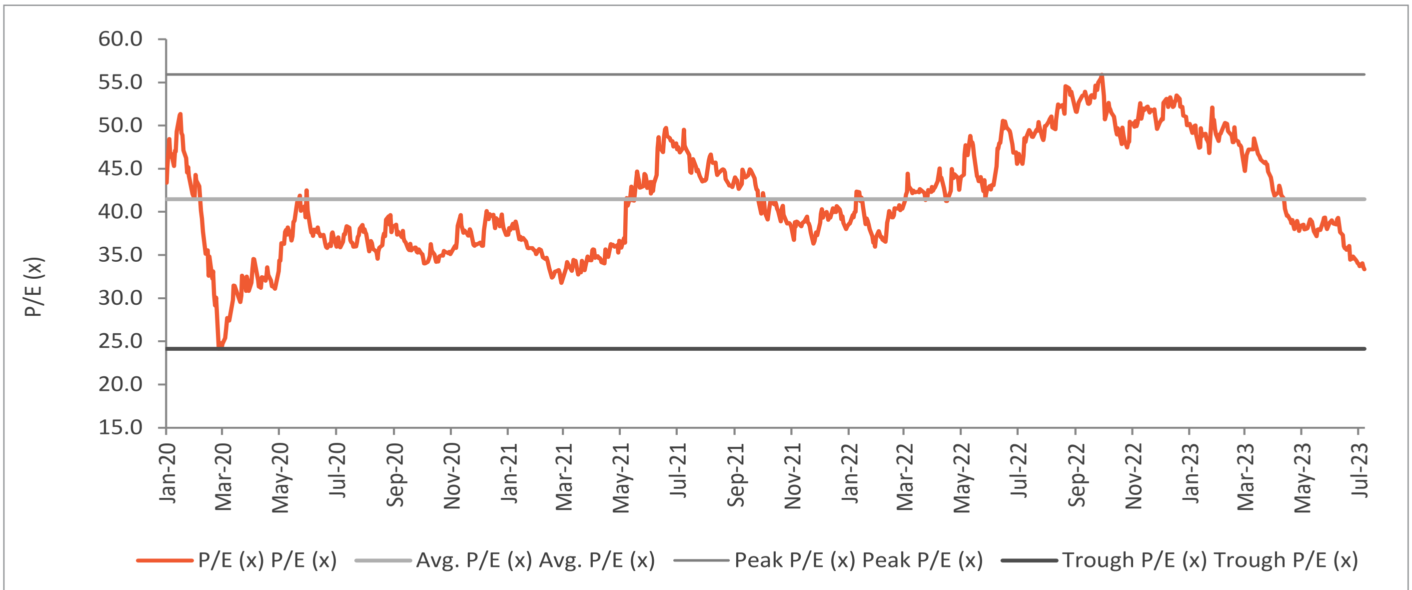
■ Company outlook - Near-term concerns; long term intact given massive CRAMs opportunity

High channel inventory and pricing pressure given rising Chinese supplies would make growth challenging for global as well as domestic agrochemical companies. Having said that, SCIL's long term growth outlook remain intact as new product launces would drive market share in domestic market and exports have large growth potential supported by massive CRAMs opportunity from the parent. We expect FY24 PAT to decline by 11% y-o-y to Rs447 crore due subdued growth from domestic/export market and margin contraction on pricing pressure.

■ Valuation - Downgrade to Hold with a revised PT of Rs. 430

Although SCIL's strong parental advantage (robust R&D capabilities, global distribution, and financial strength) provides CRAMs opportunity from parent, but near-term challenges may persist due to delayed sowing, pricing pressure and high channel inventory in both domestic/export markets. Weak demand and subdued agrochemical prices (amid higher supplies from China) makes earnings environment uncertain and SCIL's valuation of 45x/33x FY24E/FY25E EPS seem high to us. Hence, we downgrade SCIL to Hold (from Buy) with a revised PT of Rs. 430 as we limited upside from CMP.

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 U.S.-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. CRAMS from the parent would support medium to long-term growth for SCIL.

Key Risks

- Ban on products such as glyphosate (18% 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 Corp of India	1.42
2	Axis Asset Management Co Ltd/India	1.02
3	Vanguard Group Inc/The	0.78
4	360 ONE Asset Management Ltd	0.44
5	L&T Mutual Fund Trustee Ltd/India	0.42
6	BlackRock Inc	0.36
7	PGIM India Asset Management Pvt Lt	0.31
8	ICICI Prudential Asset Management	0.25
9	Union Mutual Fund/India	0.22
10	Norges Bank	0.15

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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