



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	✓	↔	✓

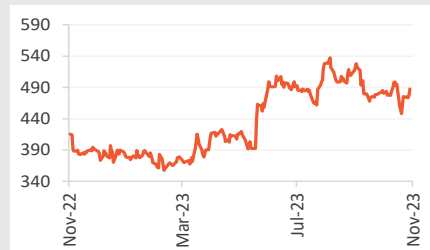
Company details

Market cap:	Rs. 3,292 cr
52-week high/low:	Rs. 566/345
NSE volume: (No of shares)	2.4 lakh
BSE code:	506655
NSE code:	SUDARSCHEM
Free float: (No of shares)	4.4 cr

Shareholding (%)

Promoters	35.8
FII	4.7
DII	13.7
Others	46.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.7	-10.1	13.3	14.4
Relative to Sensex	-0.8	-8.6	8.1	8.3

Sharekhan Research, Bloomberg

Sudarshan Chemical Industries Ltd

Decent Q2; Capacity ramp to drive growth

Speciality Chemicals

Sharekhan code: SUDARSCHEM

Reco/View: Buy



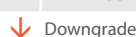
Upgrade



CMP: Rs. 476

Maintain

Price Target: Rs. 600



Downgrade

Summary

- SCIL continue to show improved financial performance on y-o-y basis. Revenue/OPM at Rs. 601 crore/11.3% rose 3%/down 51 bps y-o-y, in line with our estimates. PAT of Rs. 18 crore was 11% below our estimate.
- Pigment division grew by 10% y-o-y rise led by growth in domestic revenues to Rs. 272 crore owing to higher volume, while export revenue growth was muted at 3%.
- Ramping up of new capacity will to drive future growth with improvement in OPM as higher revenue is expected to be generated by higher margin speciality products.
- Improvement in domestic demand in H2FY24 and ramp-up of new projects would revive growth in FY24. Consolidation in global pigment industry bodes well for long-term earnings growth. We maintain a Buy with an unchanged PT of Rs. 600.

Consolidated revenues grew by 14% y-o-y to Rs. 601 crore, which was 3% above our estimate of Rs. 581 crore. Pigment division's revenues grew by 10% y-o-y to Rs. 522 crore mostly driven by volume growth. OPM at 11.3% (up 240 bps y-o-y; down 56 bps q-o-q) was 51 bps below our estimate of 11.8% as a large beat in gross margin was offset by higher employee and other expense. Consequently, operating profit at Rs. 68 crore (up 53% y-o-y; down 6% q-o-q) was inline with our estimate of Rs. 69 crore. EBIT from pigment business fell by 10% q-o-q to Rs. 38 crore mainly due to lower price raw material prices and change in the product mix. PAT of Rs. 18 crore (up 293% y-o-y) was 11% below our estimate of Rs. 20 crore as higher other income was offset by higher depreciation and tax expense.

Key positives

- Large beat of 438 bps in gross margin at 44.7%, up 597 bps y-o-y.

Key negatives

- Miss of 11% in PAT mainly due higher depreciation and tax expenses.

Management Commentary

- Pigment export sales was affected q-o-q on weak demand resulting from inflationary pressure in the EU & US. Gross margins on pigment business has gone up on q-o-q basis mainly due to lower price raw material prices and change in the product mix.
- Ink segment has seen improvement in demand in Q2FY24. Management expects demand to continue improve in coming quarters too.
- Coating segment is witnessing the subdued demand scenario as customers are differing buying decisions owing through falling price and also due to the late festival season. Management expects demand to pick-up in H2FY24.
- Business mix is expected to continue to change on expansion of product portfolio and deeper penetration in select international geographies. Product mix to tilt in favour of the speciality revenue which will lead to improvement in EBITDA and Gross margin.

Revision in estimates – We have tweaked our estimates for FY2024-FY2025E. We have introduced our FY2026 earnings estimates in this report.

Our Call

Valuation – Maintain buy on SCIL with unchanged PT of Rs. 600: After a dismal FY23, recent numbers give hopes of a strong revenue and margin recovery over FY24-25E with tailwinds for demand recovery in pigments, benefit of consolidation in top players in the global pigment market and softening of input costs. Moreover, ramp-up of new capacities would help absorb depreciation/interest cost and drive robust earnings growth and thus we expect SCIL's EBITDA/PAT to clock solid CAGR of 30%/68% on low base of FY23. Hence, we maintain a Buy on SCIL with an unchanged PT of Rs. 600. At CMP, the stock trades at 19.9x/16.5x FY25E/FY26E EPS.

Key Risks

- Lower demand amid an economic slowdown, delay in completion of expansion projects, and intense competition from Chinese products could impact revenue/earnings growth.
- Higher raw material prices and delay in the ability to pass on price hikes adequately, adverse forex fluctuations, and interest rate movements might affect margins.

Valuation (Consolidated)

Particulars	FY23	FY24E	FY25E	FY26E
Revenue	2,302	2,629	3,011	3,420
OPM (%)	9.2	11.0	13.0	13.5
Adjusted PAT	45	92	165	213
% y-o-y growth	(65.6)	104.5	80.6	28.6
Adjusted EPS (Rs.)	6.5	13.2	23.9	30.7
P/E (x)	73.5	35.9	19.9	15.5
EV/EBITDA (x)	19.4	13.8	10.2	8.6
P/BV (x)	4.0	3.8	3.3	2.9
RoCE (%)	5.8	9.1	15.5	17.8
RoE (%)	5.4	10.8	17.8	19.9

Source: Company; Sharekhan estimates

Q2FY24 conference call highlights

- ♦ **Outlook:** Management remains cautious due to the evolving geopolitical situation and global macroeconomic situation. The company has started cost improvement (utilisation of waste steam) and value-chain integration. This along with ramping up of new capacity will to drive future growth and lead to improvement in EBITDA margins. Company's business mix is expected to continue to change due to expansion of product portfolio and deeper penetration in select international geographies. The product mix is expected to tilt in favour of the speciality revenue which will lead to improvement in EBITDA and Gross margin.
- ♦ **Pigment business:** India sales is marginally higher by 3% q-o-q, while export was lower by 8% q-o-q. Export sales was lower mainly due to weak demand resulting from inflationary pressure in EU & US. Gross margin on pigment business has gone up on q-o-q basis mainly due to lower price raw material prices and change in the product mix.
- ♦ **Ink segment:** This segment saw demand recover in Q2FY24. Management expects demand to improve in coming quarters too.
- ♦ **Coating segment:** Coating segment is witnessing the subdued demand scenario as customers are differing buying decisions owing through falling price and also due to the late festival season. Management expects demand to pick up in H2FY24.
- ♦ **New capacity ramp-up:** The management believes that it can ramp-up the new facility in next 4 years and this gradual sales ramp-up of new Capex is expected to drive future growth.
- ♦ **Net debt:** This has reduced substantially to Rs 445 crore in Q2FY24 from Rs 926 crore in Q2FY23.
- ♦ **Raw material prices:** The management continue to see softer raw materials costs and the coal prices on y-o-y basis, while logistics costs have remained stable. Management believe that evolving geopolitical environment can result in uncertainty, which may have impact crude and other intermediary prices.

Results (Consolidated)

Particulars	Q2FY24	Q2FY23	YoY(%)	Q1FY24	QoQ (%)
Revenue	601	528	13.7	608	(1.2)
Total expenditure	535	486	10.2	538	(0.6)
Operating profit	66	43	53.0	70	(6.2)
Other Income	6	1	299.2	4	37.5
Depreciation	35	27	31.4	35	2.4
Interest	10	9	3.1	10	(6.5)
PBT	26	8	227.7	29	(10.0)
Tax	8	3	141.3	77	(89.2)
Adjusted PAT	18	5	293.6	24	(26.2)
EPS (Rs)	2.6	0.7	293.6	38.6	(93.3)
Adjusted EPS (Rs)	3.2	1.3	149.8	3.5	(26.2)
Margin (%)					
EBITDA margin (%)	11.3	8.9	240	11.9	(56)
Adj PAT margin (%)	3.7	1.7	200	4.0	(31)

Source: Company, Sharekhan Research

Segmental performance

					Rs cr
Particulars	Q2FY24	Q2FY23	YoY(%)	Q1FY24	QoQ (%)
Revenue					
Pigments	522	476	9.5	536	(2.7)
Others	79	52	52.2	72	10.5
Total Revenue	601	528	13.8	608	(1.2)
Inter Segment	0	0		0	
Net Revenue	601	528	13.7	608	(1.2)
EBIT					
Pigments	38	14	171.5	35	9.9
Others	-2	3	(164.9)	5	(145.0)
Total	35.9	17.3	106.9	39.4	(9.0)
EBIT margin					
Pigments	7.3	2.9	435	6.5	84
Others	(2.7)	6.4	NA	6.7	NA
Total	6.0	3.3	269	6.5	(51)

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - De-focus of global players, rising demand to help Indian dyes and pigments segment to report a 10% CAGR over FY2019-FY2025

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 FY2014-FY2019, with a market size of ~\$7 billion in FY2019 and is expected to register a 10% CAGR over FY2019-FY2025 and reach \$12.5 billion by FY2025. De-focus on global players and increased demand for textiles, paints, and plastic would drive substantial growth for dyes and pigments in India. Prominent domestic players are expected to further consolidate their position, supported by reliable raw-material sourcing, strong research and development (R&D) capabilities, the right product portfolio, strong marketing capabilities, and robust adherence to global environmental compliance standards (given the polluting nature of the manufacturing process of dyes and pigments).

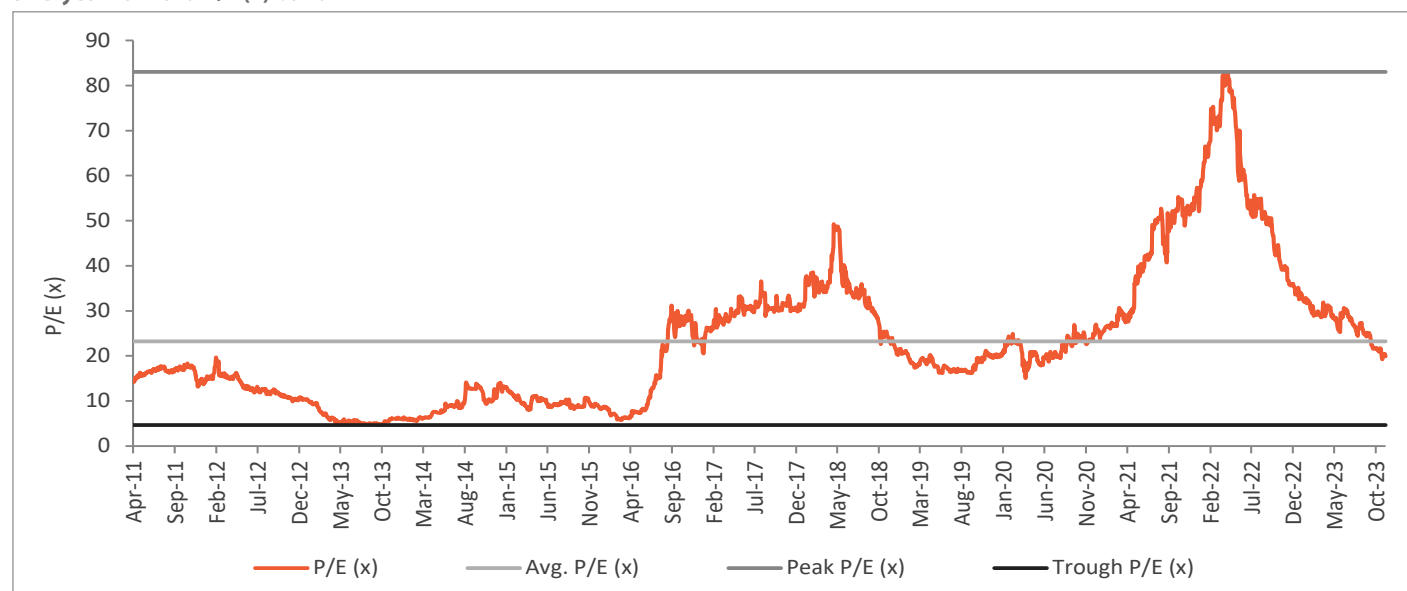
■ Company outlook - Demand recovery; ramp-up of new capacities to drive earnings recovery

Recent recovery in pigment demand and softening of input costs along with lower freight cost bodes well for revenue and a margin recovery over FY24-25. SCIL has completed its Rs. 750 crore capex plan and the ramp-up of new capacities/products would drive medium to long-term growth and would scale up SCIL's position in both domestic and global markets and is expected to benefit from the exit of two global peers from the space.

■ Valuation - Maintain buy on SCIL with a unchanged PT of Rs. 600

After a dismal FY23, recent numbers give hopes of a strong revenue and margin recovery over FY24-25E with tailwinds for demand recovery in pigments, benefit of consolidation in top players in the global pigment market and softening of input costs. Moreover, ramp-up of new capacities would help absorb depreciation/interest cost and drive robust earnings growth and thus we expect SCIL's EBITDA/PAT to clock solid CAGR of 30%/68% on low base of FY23. Hence, we maintain a Buy on SCIL with an unchanged PT of Rs. 600. At CMP, the stock trades at 19.9x/16.5x FY25E/FY26E 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 help in customer retention. Significant growth opportunities are available for players in Southeast Asia as innovators seek a reliable partner for assured sourcing. The situation in China has not changed much due to the ongoing government clampdown because of environmental and compliance issues. SCIL has completed its Rs. 750 crore capex plan and the ramp-of new capacities/products would drive medium to long-term growth and would scale up SCIL's position in both domestic and global markets and is expected to benefit from the exit of two global peers from the space.

Key Risks

- ♦ Lower demand amid economic slowdown, delay in completion of expansion projects, and intense competition from Chinese products could impact revenue/earnings growth.
- ♦ Higher raw-material prices and delay in the ability to pass on price hikes adequately, adverse forex fluctuations, and interest rate movements might affect margins.

Additional Data

Key management personnel

Rajesh Rathi	Chairman
Rajesh Balkrishna Rathi	Managing Director
Nilkanth Natu	Chief Operating Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Bhanshali Akash	8.1
2	Axis Asset Management Co Ltd/India	3.9
3	Mirae Asset Global Investments Co	2.97
4	ICICI Prudential Asset Management	2.46
5	ICICI Lombard General Insurance Co	1.71
6	Kedia Vijay Kishanlal	1.44
7	FIL Ltd	1.22
8	Rhodium Pvt Ltd	1.01
9	Dimensional Fund Advisors LP	0.69
10	State Street Corp	0.14

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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