

28<sup>th</sup> December 2020

CMP ₹469.7/-

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## Company Background

Incorporated in 1952, Sudarshan chemicals established itself as largest pigment producer in India (~35% market share) and the fourth-largest producer in the world. At the beginning it manufactured only inorganic pigments however gradually, expanded its product basket to organic, inorganic and "effect" pigments, which cover classical azo pigments, specialized azo pigments, high-performance pigments, pearlescent pigments, phthalos and pigment dispersions. Company's products offered under the brands - Sudaperm, Sudafast, Sudacolor, Sumica and Sumicos are sold to more than 85 countries (with 50+ sales team and 60+ channel partners).

Sudarshan Chemicals Ltd has two manufacturing units – Roha (est. 1973) and Mahad (est. 1993) both of which are located in Raigad district with combined capacity of 37,000MTPA.

## Important Statistics

CMP(₹)	469.7
Market Cap (₹ mn)	32,516
52W High/Low	538/286
Shares o/s (mn)	69.2

## Product Profile

	Types	Application
<b>Organic Pigments</b>	Azo, Phthalocyanine, Alizarin, Arylide and others	Printing Ink, paints, plastics, rubber, optoelectronics, cosmetic, textiles.
<b>Inorganic Pigments</b>	Titanium Dioxide, Iron Oxide, Cadmiums, Chromes	Building & construction, automotive, packaging, paper & printing, textiles, etc.
<b>Effect Pigments</b>	Mica flake, Mica based for industrial and cosmetics	Automotive Industry, coatings, paintings and personal care industry

## Key Investment Thesis

- **Leading position with long established track record** – One of the largest pigment manufacturers in its India (with a 35% market share) and the fourth-largest globally, Sudarshan's strong brand equity, leading position, regular capacity additions and focus on high-margin products have been its key strengths.

Beginning with manufacturing a few inorganic pigments, Sudarshan has now become the largest manufacturer of pigments in India. In the last seven decades, it has added a range of products, comprising not only organic and inorganic pigments but also HPP, "effect" and high-margin pigments.

- **Capacity expansion and plan to grab global opportunity to further improve market share** – Sudarshan Chemicals invested ₹4500mn over FY17-20 (with plans to invest ₹2500-3500mn in FY21E) to achieve its target of ₹10,000mn capex in a few years. Global pigment manufacturers (BASF, Clariant) are quitting by Dec'20 due to intense competition from India and China. We believe that this capex would help the company strengthen its market position and expand its geographic reach.

- **High entry barriers restrict new entrant and intense competition** – Earlier, the pigment industry was commoditized in nature due to lack of product differentiation. Today, it has been transformed into a specialized industry due to changing customer needs for specialty and high-performance pigments. This requires strong R&D capabilities, technical knowhow, long gestation periods (6-24 months) and good customer relations. All these factors become high entry barriers and restrict new entrants thus lowering competition. The approval time for pigment sales varies according to products and the company is well placed in this regard.

## Financials

(₹ mn)			
Particulars	FY18	FY19	FY20
Revenues	13,294	15,930	17,082
EBITDA	1,873	2,040	2,463
EBITDA Margin (%)	14.1%	12.8%	14.4%
Net Profit	847	1,351	1,445
EPS (₹)	12.2	19.5	20.9
RoE (%)	19.3%	23.8%	24.1%
RoCE (%)	16.5%	16.1%	16.7%
P/E (x)	38.4	24.1	22.5
EV/EBITDA (x)	19.2	17.4	14.9
P/BV (x)	7.4	5.7	5.4

## Shareholding pattern (%)

	Sep'20
Promoter	42.7
FII	8.3
DII	3.2
Public & Others	45.8

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- **Divestment from other businesses to focus only on pigments** – Aiming to become the third-largest globally, the company decided to focus on pigments and thus divested several businesses in FY18-19. As it sold Prescent color business to Americhem, USA in FY19, Industrial mixing solutions to GMM Pfadler in FY20 at ₹300mn etc.

Further, it is continuously seeking to divest its holdings in its wholly-owned subsidiary, RIECO Industries (engaged in size-reduction equipment and pneumatic conveyance and air pollution control systems) on a going-concern basis.

- **Strong manufacturing and R&D capability with focus on innovation provides an edge over peers** – The company has two manufacturing sites – one at Roha (built in 1973) and another in Mahad (built in 1993) with total installed capacity of 37,000MTPA. Both the manufacturing facilities are located in Maharashtra and are equipped with modern water treatment facility. The Roha facility manufactures products such as Azos, HPPs, effect pigments and dispersions, while Mahad facility manufactures products such as blue and green pigment, HPPs, and effect pigments. The company employs 100+ scientists and has a dedicated R&D site with investments of \$10 million. On an average, the company spends nearly \$4 million on research, development and technical services, while \$2 million and \$3.4 million are spent on environmental compliance and effluent plant respectively.
- **Significant opportunity in its end use industries provides top-line visibility** – The three key end-user industries for the pigment business are coatings, plastics, ink and cosmetics; each contributing one-third to Sudarshan's top-line. Each of these industries, with the exception of ink used in publications (slower growth due to digitization of content), is likely to post 5-8% global and about 13-14% domestic growth. This presents a significant opportunity for the company to enhance its topline.
- **Diversified product basket and significant global presence balances risk** – Company diversified its products basket from being an inorganic pigment manufacturer to now manufacturing organic pigments and effect pigments over the years. Also over the years, it expanded its geographical presence (exports to 85+ countries) and operates in Mexico, North America, Europe and China through its wholly owned subsidiaries. Further the company intends to expand its global footprint to newer geographies and gain market share in the US, EU and China. We believe diversified product profile and significant global presence minimizes risk.
- **Robust Financials and healthy balance sheet provides comfort** – Company reported 13% and 9% topline CAGR over FY18-FY20 and FY13-20 respectively driven by the rising proportion of high-margin products, capacity expansion, launching of three large products and expanding geographical reach while EBITDA margin improved from 8.9% in FY13 to ~14.4% in FY20. Company reported PAT CAGR growth of 24% over FY18-20 and 25% over FY13-20 on account of healthy sales growth, expansion of operating margins and lower tax expenses.

Company's debt-equity ratio has improved from 1.5x in FY13 to 0.7x in FY20 due to greater profits and better leveraging. We expect D/E to return to 0.5-0.6x going ahead due to operating leverage and increasing profits.

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- **Performance improving QoQ basis and is expected to continue –** Company reported 1% YoY and 22% QoQ top-line growth on the back of improved sales volume in Q2FY21. EBITDA for the quarter stood at ₹677mn showcasing 2% YoY and 28% QoQ growth while EBITDA Margins improved by 18bps to 15.8%. Profit after tax for the quarter dropped by 34% YoY to ₹303mn while PAT margins reduced by 380bps to 7%.

Management expects EBITDA margin to gradually improve over next couple of years as capex would increase share of high margin specialty pigments. Also with completion of backward integration company's competitive edge is expected to improve as raw material dependency on China would reduce.

#### Key Concerns

- Lower demand offtake due to economic slowdown
- Sharp surge in raw material prices and inability to pass it on customers
- Adverse forex fluctuations and interest rate movements can affect margins

#### Outlook

Sudarshan Chemicals Ltd, being the market leader in India and fourth largest globally has reported 13% and 9% top-line CAGR over FY18-FY20 and FY13-20 respectively and improved EBITDA margins from 8.9% in FY13 to ~14.4% in FY20 driven by the rising proportion of high-margin products, launching of three large products and expanding geographical reach. Company's capex plan of ₹10,000mn over (FY17-FY22E) is expected to add another ₹35,000- 40,000mn to top-line in the next 3-5 years, which is almost 3x its current revenue size. Given humongous opportunity in its user industry, increasing share of high value products, healthy balance sheet and return ratios, we believe company's long term story remains intact. **At the CMP of ₹469.7, the stock is trading at ~22x FY20 EPS which is at discount to peers (from midcap space) and thus we recommend investors to *Accumulate* the stock on dips.**

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## Consolidated Financial Performance

(₹ mn)

Particulars	FY15	FY16	FY17	FY18	FY19	FY20
Net Sales	12,182	14,093	15,226	13,294	15,930	17,082
YoY Growth	8.9%	15.7%	8.0%	-12.7%	19.8%	7.2%
<b>EBITDA</b>	<b>1286</b>	<b>1674</b>	<b>1990</b>	<b>1873</b>	<b>2040</b>	<b>2463</b>
<b>EBITDA Margin</b>	<b>10.6%</b>	<b>11.9%</b>	<b>13.1%</b>	<b>14.1%</b>	<b>12.8%</b>	<b>14.4%</b>
Depreciation	419	481	546	577	656	735
<b>EBIT</b>	<b>867</b>	<b>1193</b>	<b>1445</b>	<b>1295</b>	<b>1385</b>	<b>1728</b>
<b>EBIT Margins</b>	<b>7.1%</b>	<b>8.5%</b>	<b>9.5%</b>	<b>9.7%</b>	<b>8.7%</b>	<b>10.1%</b>
Interest	370	343	306	234	170	142
Other income	218	140	224	92	70	47
Exceptional item	-	-	-	78	23	-6
PBT(after exceptional item)	716	990	1362	1153	2007	1804
Total sTax	172	291	328	384	680	353
<b>PAT (incl discontinued opr)</b>	<b>544</b>	<b>699</b>	<b>1034</b>	<b>847</b>	<b>1351</b>	<b>1445</b>
<b>PAT Margin</b>	<b>4.5%</b>	<b>5.0%</b>	<b>6.8%</b>	<b>5.8%</b>	<b>8.3%</b>	<b>8.5%</b>
EPS (₹)	7.85	10.10	14.94	12.24	19.52	20.88

Source: Company Filing, Way2wealth Research

(₹ mn)

Particulars	Q2FY21	Q1FY21	Q2FY20	YoY	QoQ
<b>Net Sales</b>	<b>4,289</b>	<b>3,523</b>	<b>4,249</b>	<b>1.0%</b>	<b>21.7%</b>
Total Expenditure	3,612	2,993	3,586	0.7%	20.7%
<b>EBITDA</b>	<b>677</b>	<b>530</b>	<b>663</b>	<b>2.1%</b>	<b>27.8%</b>
<b>EBITDA Margins</b>	<b>15.8%</b>	<b>15.0%</b>	<b>15.6%</b>	<b>17.84</b>	<b>74.76</b>
Depreciation	218.92	215.78	170.74	28.2%	1.5%
<b>EBIT</b>	<b>458</b>	<b>314</b>	<b>492</b>	<b>-7.0%</b>	<b>45.9%</b>
<b>EBIT Margins</b>	<b>10.7%</b>	<b>8.9%</b>	<b>11.6%</b>	<b>-90.70</b>	<b>176.85</b>
Other Income	18.15	3.05	14.58	24.5%	495.1%
Interest	51.47	38.96	37.03	39.0%	32.1%
PBT	424.65	277.95	469.73	-9.6%	52.8%
Tax	121.33	95.96	7.63	1490.2%	26.4%
<b>PAT</b>	<b>303.32</b>	<b>181.99</b>	<b>462.1</b>	<b>-34.4%</b>	<b>66.7%</b>
<b>PAT Margins</b>	<b>7.1%</b>	<b>5.2%</b>	<b>10.9%</b>	<b>-380.47</b>	<b>190.60</b>
EPS (₹)	4.38	2.63	6.68	-34.4%	66.7%

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Name of the Security	Sudarshan Chemical Industries Ltd.
Name of the analyst	Yogita Desai
Analysts' ownership of any stock related to the information contained	NIL
Financial Interest	
Analyst :	No
Analyst's Relative : Yes / No	No
Analyst's Associate/Firm : Yes/No	No
Conflict of Interest	No
Receipt of Compensation	No
Way2Wealth ownership of any stock related to the information contained	NIL
Broking relationship with company covered	NIL
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