

Sudarshan Chemical

Leaping into the league of giants

For the period over August-16 to November-20, the stock of Sudarshan Chemical Industries Ltd (SCIL) was merely up by 10%, despite EBITDA expanding at a 10% CAGR, and PAT doubling at a 19% CAGR. This is after considering the 48% stock rally from its March-20 lows until November. SCIL plans to become the third-largest pigment manufacturer globally by developing R&D capabilities, operational efficacy, and expanding to new geographies. Global scale is the key to success in the pigment business.

Two major global players shifting away from the pigment business could act as a tailwind for Indian pigment manufacturers. We believe SCIL is in a sweet spot to seize this opportunity by offering products similar to those of global players. We initiate coverage on the stock with a BUY recommendation. Our DCF-based target price of INR 550/sh (WACC of 10% and terminal growth rate of 3%) implies an upside of 21.5% from the current level (implied PE of 24x).

On the path to becoming the third-largest pigment manufacturer globally

In India, SCIL is the largest pigment manufacturer (with >35% market share) while globally, it is the fourth-largest. We believe it is positioned well to achieve the top-3 status by focusing on its core business, developing R&D, expanding to new markets, and improving manufacturing and operations. We also believe that having this global scale is essential to success in pigments as it leads to sustainable growth, cheaper feedstock, and access to cutting-edge technologies.

Capex to focus on high-value products and new product launches

SCIL's current Capex cycle was started in FY17. It has incurred INR 5.5bn over FY17-20 and planned for INR 3.5bn over FY21-FY22E. While a significant portion of Capex targets growth, some part of it is targeting margin expansion. We expect asset-turnover to be ~2.3-2.5x at peak utilisation.

Further, SCIL is enhancing its product mix towards higher-margin and higher-realisation speciality products such as azo pigments, cosmetics and pigment dispersions vs. non-speciality ones. It plans to launch ~25 products globally.

Earnings to grow at a 20% CAGR, and return ratios to improve over FY21-24E

We expect revenue to grow at a 14.8% CAGR over FY21-24E given SCIL's plans for geographical expansion and new product offerings, while, APAT CAGR would be ahead of revenue growth at 20%. SCIL will generate OCF/FCF yield of 7.5/4.2% in FY24E. RoE and RoIC to expand from 19.0/11.5% in FY21E to 23.9/15.3% in FY24E. Valuations are contextually moderate at 22.8/17.9x FY22/23E EPS.

Financial Summary (Consolidated)

Year Ending March (INR mn)	2Q FY21	1Q FY21	QoQ (%)	2Q FY20	YoY (%)	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	4,289	3,523	21.7	4,249	1.0	15,930	17,082	16,708	19,332	21,982
EBITDA	677	530	27.8	663	2.1	2,040	2,463	2,496	2,888	3,429
APAT	303	182	66.7	462	(34.4)	1,011	1,311	1,198	1,374	1,753
Diluted EPS (Rs)	4.4	2.6	66.7	6.7	(34.4)	14.6	18.9	17.3	19.9	25.3
P/E (x)						31.0	23.9	26.2	22.8	17.9
EV / EBITDA (x)						17.1	14.7	14.7	12.8	10.8
RoE (%)						20.1	22.4	19.0	19.7	22.6

Source: Company, HSIE Research

BUY

CMP (as on 19 Nov 2020)	INR 453
Target Price	INR 550
NIFTY	12,772

KEY CHANGES	OLD	NEW
Rating	-	BUY
Price Target	-	INR 550
EPS %	FY21E	FY22E
	-	-

KEY STOCK DATA

Bloomberg code	SCHI IN
No. of Shares (mn)	69
MCap (Rs bn) / (\$ mn)	31/422
6m avg traded value (Rs mn)	138
52 Week high / low	Rs 538/286

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	3.7	26.9	14.1
Relative (%)	(9.2)	(17.5)	6.3

SHAREHOLDING PATTERN (%)

	Jun-20	Sept-20
Promoters	42.66	42.66
FIs & Local MFs	3.21	4.25
FPIs	8.33	8.13
Public & Others	45.80	44.96
Pledged Shares	0.00	0.00

Source : BSE

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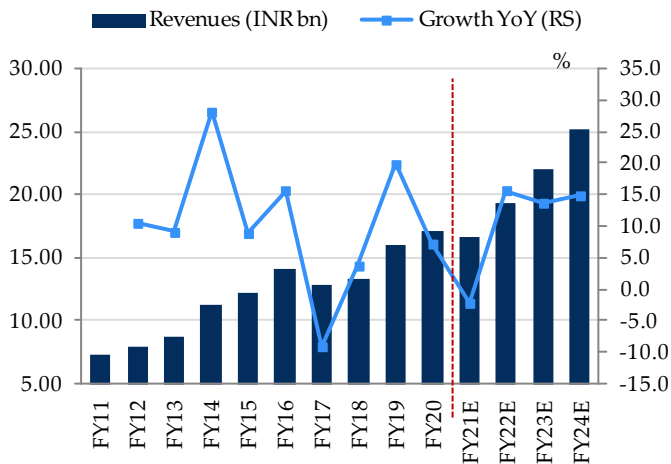
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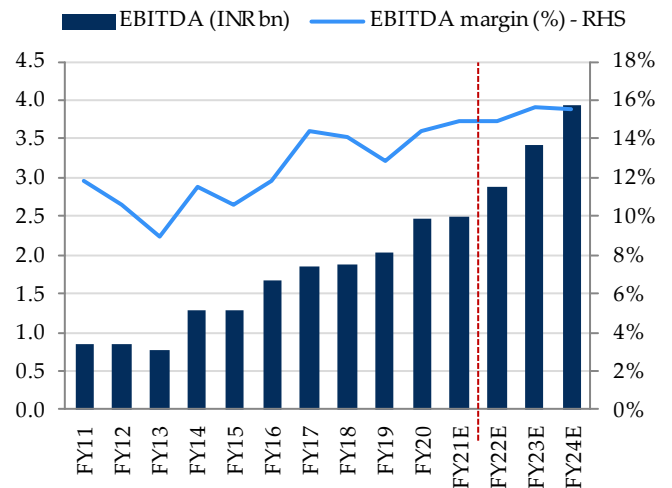
Story in charts

Exhibit 1: SCIL's revenue growth over the years



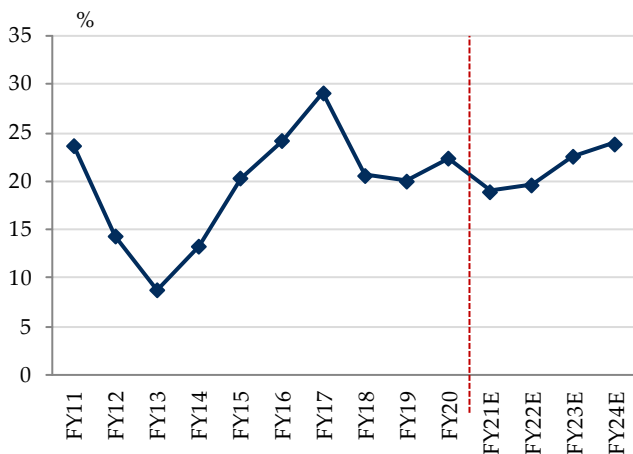
Source: Company, HSIE Research

Exhibit 2: SCIL's EBITDA and EBITDA margin trend



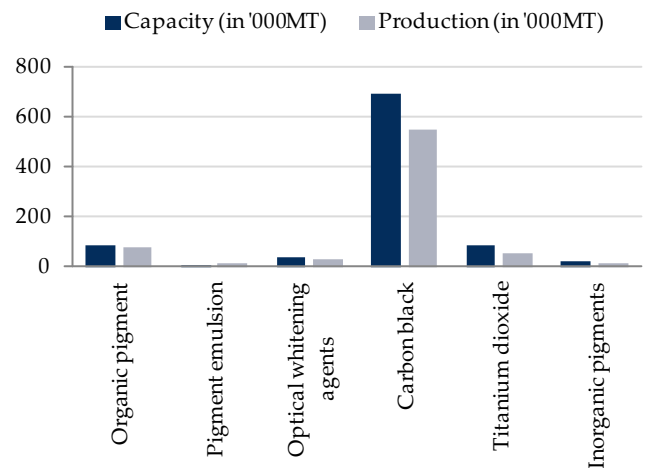
Source: Company, HSIE Research

Exhibit 3: SCIL's RoE (%)



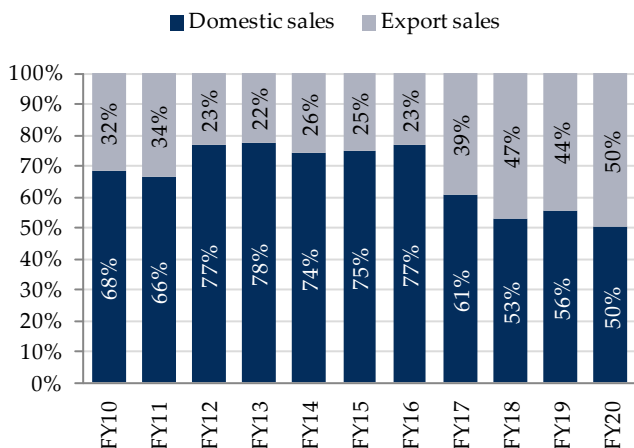
Source: Company, HSIE Research

Exhibit 4: Domestic pigments market in FY19



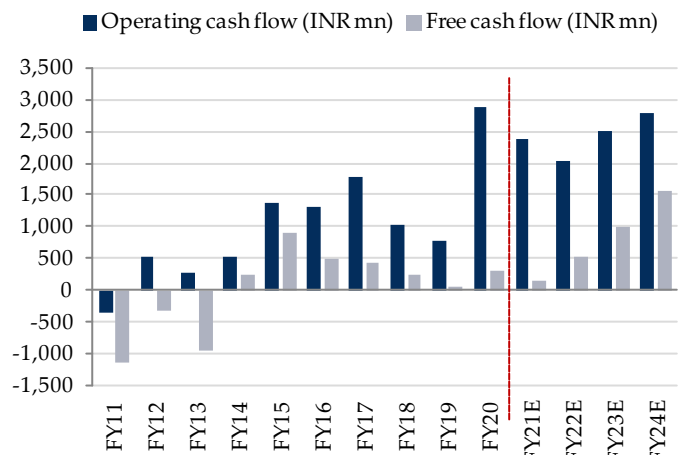
Source: Company, HSIE Research; Ministry of Chemicals and Fertilizers

Exhibit 5: Geographical revenue split of SCIL



Source: Company, HSIE Research

Exhibit 6: SCIL's OCF and FCF trend



Source: Company, HSIE Research

Aims to become the third-largest pigment manufacturer

SCIL is the largest pigment manufacturer in India (with >35% market share) and the fourth-largest globally. It is well-positioned to achieve the top-3 manufacturers status by focusing on core business, developing R&D capabilities, expanding to new markets, and improving manufacturing and operations.

It aims to take the No.3 spot in pigments. Having a global scale is essential for success in the pigment business; a case in point is the surfactants industry. It ensures sustainable growth, cheaper feedstock and, more importantly, exposure to cutting-edge technologies. The current industry consolidation is proof of the increasing importance of scale.

Management aims to feature in the top-3 in the global pigment market. To achieve this, it is focusing on strengthening products, R&D capabilities, and branding pigments across geographies for sustainable results. The company's strategy to achieve top-3 status is based on (1) developing R&D for sustainable growth, (2) excelling in manufacturing and operations, (3) strengthening global presence, and (4) focusing on core business.

Developing R&D capabilities; the launch of yellow pigment

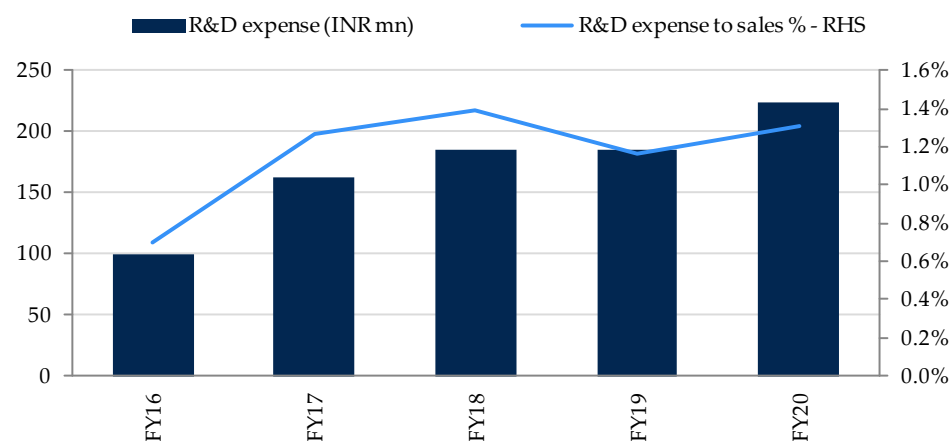
To be able to break into the top-3 spot of the global pigment market, management realises it needs to focus on (1) emulating the product portfolio of the top-2 players and (2) technical marketing of speciality products. To this end, it is improving research capabilities and infrastructure. R&D enhances efficiency, integrity and helps provide customers with innovative and sustainable solutions.

Its R&D would drive technical innovation and continually improve product development. Last year, the company launched high-performance yellow pigment, which is strategically a crucial molecule for the company. It developed the entire technology in-house and launched it within eighteen months of inception. This is an example of its strong R&D capabilities.

With more than 100 scientists, SCIL develops innovative pigments to cater to demand from the end-user industry. Sustainable growth is not just a buzz word for the company. Its R&D team finds ways to improve the efficiency of colours and materials with minimal risk to human health and the environment.

R&D expenses have escalated in the past five years from INR 99mn in FY16 to INR 224mn in FY20. It increased from merely 0.7% of sales to 1.3% of sales in FY20. The company has three National Accreditation Board (NABL) accredited and DSIR approved labs. Last year, it started a laboratory in Germany to stay abreast with global trends.

Exhibit 7: R&D spending on the rise



Source: Company, HSIE Research

Excelling at manufacturing and operations

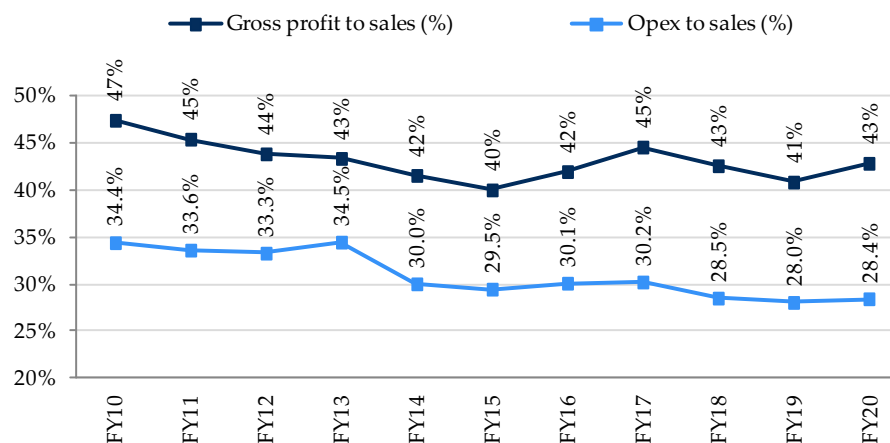
The prices of basic chemicals (raw material) used in manufacturing pigments are volatile. SCIL imports ~30% of its raw material from China, where environmental restrictions have led the prices to rise recently.

SCIL is present in the high-value speciality chemicals value chain, under which manufacturers are able to pass on increases in input costs, although typically with a one-quarter lag. This timing difference in passing on costs causes fluctuations in the margin. SCIL, with a strong brand value and scale of operation, has been able to pass on the fluctuations and maintain gross profit margin at ~43% with a standard deviation of 2.1% over FY10-20.

Also, pigment manufacturing is labour-intensive. It involves unit operation such as drying which demands energy. Power, fuel and labour expenses form the bulk of total operating expenses. With consistent efforts, SCIL has reduced these (as a percentage of sales) by ~600bps to 28% in FY20 (from 34% in FY10).

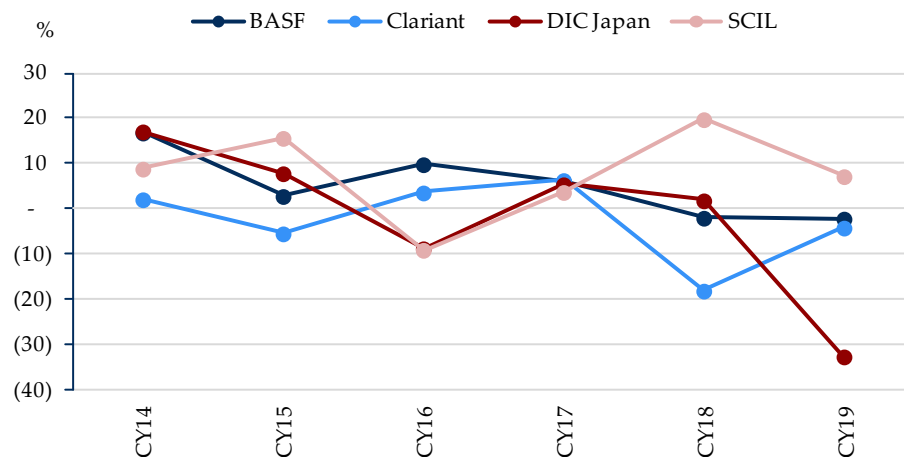
Given the strict control of operating expenses and efficiency, SCIL's operating margins are better than global players', thus giving it a competitive advantage over them. (Refer Exhibit 10)

Exhibit 8: SCIL's gross margins and opex to sales (%)



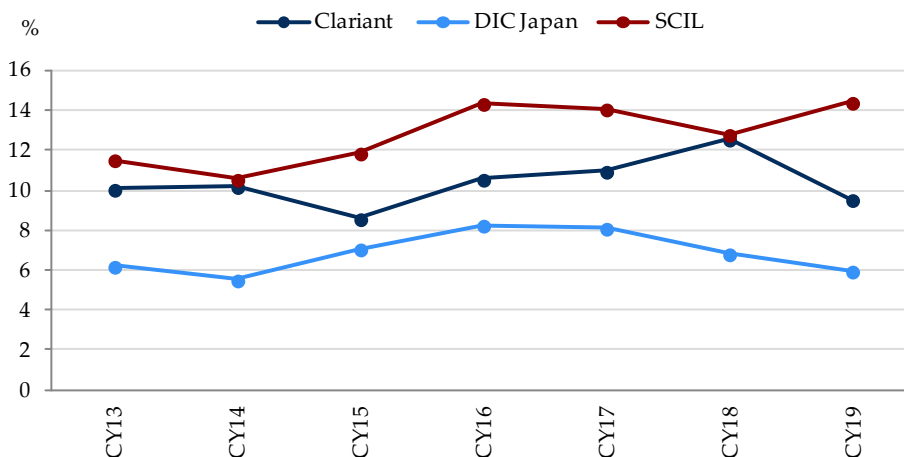
Source: Company, HSIE Research

Exhibit 9: YoY sales growth of global peers



Source: Company, HSIE Research | Since SCIL follows financial year for accounting, CY14/15/16/17/18/19 is FY15/16/17/18/19/20 for SCIL.

Exhibit 10: Operational performance of global peers



Source: Company, HSIE Research | Since SCIL follows financial year for accounting, CY13/14/15/16/17/18/19 is FY14/15/16/17/18/19/20 for SCIL.

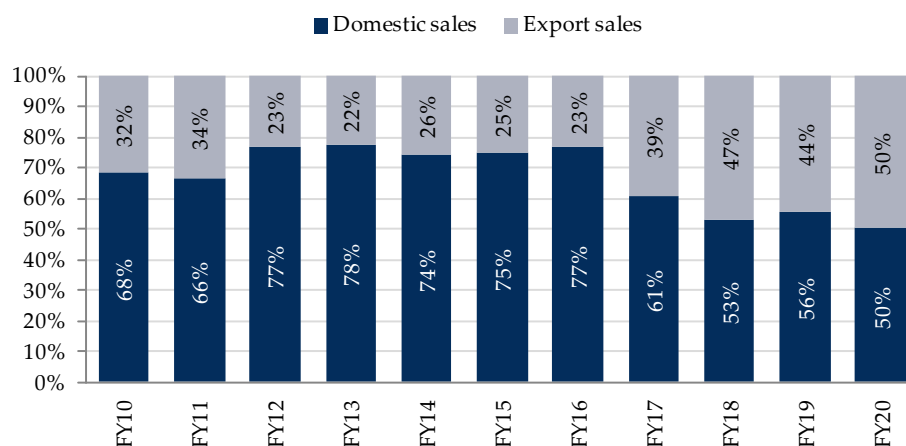
Global presence becoming stronger

SCIL has a global distribution network, with eight sales offices, around 60 channel partners, and sales in over 85 countries. Management, to cater to the developed markets of Europe, North America and Mexico, has set up marketing subsidiaries in these regions, which would support revenue growth in the coming years. Its wholly-owned Chinese subsidiary is engaged in distributing pigments in local markets and improving sourcing efficiencies. As mentioned, SCIL sources ~30% of its raw material from China.

Following its strategy to become the third-largest pigment manufacturer globally, it is now taking its attention to the untapped geographies. Last year, it opened a subsidiary, Sudarshan Japan Limited, in Japan to serve the Japanese market. It also plans to expand in South East Asia and South Korea.

Pigment exports of the company constituted 50% of total sales in FY20, up from 32% in FY10. Export contribution to revenue is expected to go up with rising production of high-performance and effect pigments and global expansion.

Exhibit 11: Geographical revenue mix (%)



Source: Company, HSIE Research

Focusing on the core business

SCIL has divested its stake in other businesses to achieve its aim of becoming third-largest pigment firm globally. In the past two years, it sold its stake in businesses other than pigment to focus on the latter.

Exhibit 12: Divestment from other businesses to focus on pigment business

Division/ Entity divested	Business	Date of divestment completion	Transferee company	Consideration (INR bn)
Prescient Color Limited	Manufacturing of plastic masterbatch	31-05-2018	Americhem Inc., U.S.A.	1.17
Agro-Chemical Division	Insecticides, fungicides, herbicides and plant growth regulators	20-09-2018	KIE Crop Solutions (I) Private Limited	0.07
Industrial Mixing Solutions Division	Industrial mixers manufacturing	26-04-2019	GMM Pfaudler Limited	0.29

Source: Company, HSIE Research

Capex to focus on high-value products

The current phase of the Capex cycle, which started in FY17, aims at the strategy of taking SCIL to the third spot in global pigment manufacturing. The company has incurred INR 5.5bn over FY17-20 and outlaid INR 3.5bn for FY21-FY22E.

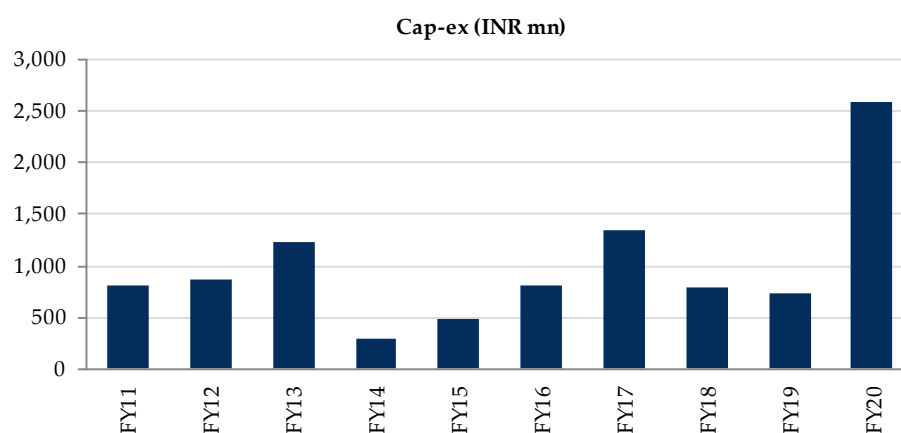
Capex is being spent on the development of two new molecules in high-performance pigment, backward integration, infrastructural investments and debottlenecking at Roha and Mahad facilities. SCIL is enhancing its product mix to higher-margin and higher-realisation speciality products like high-performance azo pigments, cosmetics and pigment dispersions vs. the non-speciality portfolio.

The growth Capex includes both the expansion of existing products and new products. A significant portion of Capex is being spent on growth Capex while a small portion is being spent on margin expansion projects.

In FY22, the company plans to undertake backward integration projects to improve margin. This plan should finalise by FY21 end.

The Capex would partly be funded through internal accruals and partly external debt. The company plans to raise INR 2bn of debt in FY21 for the same.

Exhibit 13: Capex spends rise



Source: Company, HSIE Research

New product launch to drive growth

The broad strategy of SCIL is to diversify its product portfolio to match with innovators' and to stay out of overly competitive areas. It launched the high-performance 'yellow pigment' in 2HFY20, becoming the second company globally to have it in its product portfolio. This pigment has an application in coatings and plastics industry. Its main application is for digital inks. The market for it is ~ INR 2.5bn, which is growing at 3-4% per annum. SCIL is targeting to achieve a ~20% market share in this pigment. It plans to gain share through cost leadership and advantage, which the new process of manufacturing the molecule will give it.

Based on the feedback received from customers, the company is modifying this yellow pigment, following which it would be relaunched in December. The contribution from the yellow pigment will start from 4QFY21, but significant contribution from this product is expected to come only by FY22 end.

The company plans to launch an organic pigment and a large molecule in 1HFY22. These pigments have an application in plastics and coatings industry. These new pigments will start contributing in FY23, as approval from end-user industry takes about 6-12 months. The high-performance product will drive near-term growth and help in improving operating margins.

Global players shift away from pigments

The pigment industry is seeing another round of restructuring. The two largest global pigment manufacturers Clariant AG and BASF SE are divesting their pigment businesses. Divestment decisions by these large manufacturers are attributed to either their long-term strategy to focus on their core businesses, or their inability to compete with Asian manufacturers owing to higher cost of production.

This shift of global players away from pigment business would be a tailwind for the Indian pigment market. The decision of the top two players to exit the pigments segment would strengthen SCIL's global market position.

SCIL is enhancing its product portfolio to bring it at par with global players'. It is in a sweet spot to capitalise on this opportunity by offering products comparable to these players' at a lower cost.

Exhibit 14: Pigment market structure

Producers	Inorganic pigments	Organic pigments	Specialities
Clariant		High presence	Medium presence
BASF	Medium presence	High presence	High presence
DIC (incl Sun Chemical)	Low presence		Medium presence
Heubach	Medium presence		Medium presence
Ferro	High presence	Low presence	Medium presence
Venator (ex Huntsman)	High presence		Medium presence
Lanxess		Low presence	Low presence
Altana (Eckart)	Low presence		High presence
Sudarshan (India)	Low presence	Medium presence	Low presence
Meghmani Organics (India)		Low presence	
Changzhou North American Chemical Group (China)		Medium presence	
Lily Group (Hangzhou Baihe Chemical) (China)		Medium presence	

Key

High presence
Medium presence
Low presence
No presence

Source: Companies, HSIE Research

Exhibit 15: Growth of pigment in end-user industry

Pigment type	Main applications						Other (specified)
	Architectural paints	Industrial coatings	Automotive coatings	Plastics	Inks		
Inorganics							
TiO ₂	▲▲▲	▲	▲	▲▲	▲	▲	Personal care
Carbon black	▲	▲	▲	▲	▲	▲▲▲	Rubber tyres
Iron oxides	▲▲	▲▲	▲	▲	▲	▲▲▲	Concrete
Zinc oxides	▲	▲	▲	▲	▲	▲	Personal care
Ultramarine	▲	▲		▲	▲	▲	Cosmetics
Mixed metal oxides	▲	▲▲	▲	▲▲		▲▲▲	Ceramics
Organics							
Azo pigments	▲▲	▲	▲	▲▲	▲▲▲	▲	
Polycyclic pigments	▲▲	▲▲	▲▲	▲▲	▲▲	▲	
Special effect pigments							
Effect pigments	▲	▲▲	▲▲▲	▲▲	▲	▲▲▲	Cosmetics
Functional pigments	▲	▲▲▲	▲	▲	▲	▲	Electronics

Key

	No application
▲	Low application
▲▲	Medium application
▲▲▲	High application

Source: Companies, HSIE Research

Why Clariant AG and BASF are selling their pigment business?

In 2015, Clariant AG had announced that it would continue focusing on its high-value speciality portfolio and divest from one-third of its activities. It decided to focus more on its core business units of care chemicals, catalysts and natural resources.

Following its long-term plan to align its businesses and become a pure-play speciality chemicals company, it successfully divested its Healthcare Packaging and Masterbatches businesses in 2019 and continues to divest from the pigments business. The proceeds from the divestments will be used to invest in innovation and technological applications within its core business areas.

Consequent to the divestment plan for the pigments business globally, Clariant Plastics & Coatings AG demerged the business into an entity named Colorants International AG. The management is confident of completing the sale in CY20.

BASF and DIC have reached an agreement on the acquisition of the former's global pigments business, which should complete in CY20. BASF has an extensive portfolio of organic and speciality pigments with particular strength in automotive coatings. However, it is struggling with rising raw material prices due to the softening of demand from the automotive industry. Thus, operating margins are under pressure, and competing with Asian manufacturers has become difficult.

Exhibit 16: Deal Details

Date	Transferor	Business	Transferee	Consideration
Dec-19	Clariant AG	Masterbatches	PolyOne	USD 1.56bn
Jul-19	Clariant AG	Healthcare Packaging	Arsenal Capital Partners	CHF 0.31bn
Aug-19	BASF	Global pigments	DIC	EUR 1.15bn

Source: Company, HSIE Research

What is the rationale behind DIC buying pigment business of BASF?

DIC is working on expanding its 'functional pigments business' to drive growth as a leading global manufacturer of high-growth, high-value speciality pigments, including those for displays, cosmetics and automobiles. The company is a leader in organic pigments and a valued manufacturer of Aluminium effect pigments, while BASF's business is a prominent player in effect pigment for pearl pigments and speciality inorganic pigments.

DIC has its presence mainly in commodity pigment, while BASF has a portfolio of high-performance organic pigments and special inorganic pigments. The product portfolios of DIC and BASF are highly complementary.

Exhibit 17: Global pigment market



Source: DIC, Japan, HSIE Research

Domestic pigment industry

The total installed capacity for manufacturing pigment (organic and inorganic) is 930ktpa. The capacity utilisation of pigment manufacturing is 80%. The capacity utilisation of organic pigments stood at 85% in FY19 while that of inorganic pigments (carbon black and titanium oxide) stood at 78%, the latter dominating the Indian pigment market with 85% of total volume.

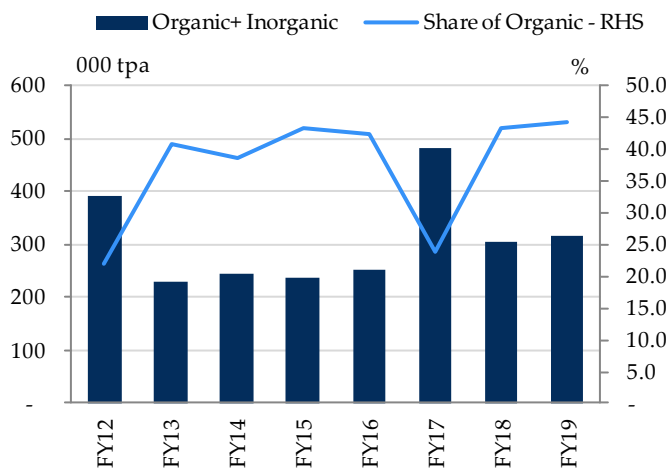
The domestic organic pigment production grew to 113ktpa in FY19 from 71ktpa in FY12 at a CAGR of 6.8%. The incremental production of 54ktpa was entirely exported during this period. The demand for organic pigment comes from the packaging, automotive, and construction industries. The increasing need for enhanced aesthetics in the packaging of a product for better marketing is increasing demand for organic pigments.

Currently, domestic demand for organic pigment is flat due to its higher cost compared to inorganic pigment's. If the purchasing power of Indians goes up, demand for organic pigment, too, will rise.

In exports, the share of high margin organic pigment has risen from 22% in FY12 to 44% in FY19.

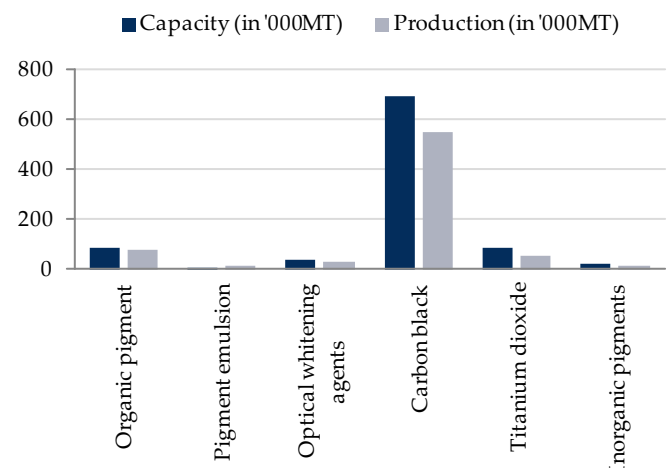
"The India growth story based on rising consumer spend and infrastructure growth is expected to drive increased demand for organic colourants in Packaging inks, Plastics and Paints & Coatings. The per capita consumption of colourants estimated at 50-60 grams is far below the Europe consumption of 400 grams. Though the local demand for organic pigments is expected to grow at GDP growth rate, India is expected to outperform and register a higher growth rate due to exports." (Source Clariant Chemicals AR FY20)

Exhibit 18: Total exports and rising share of organic pigment



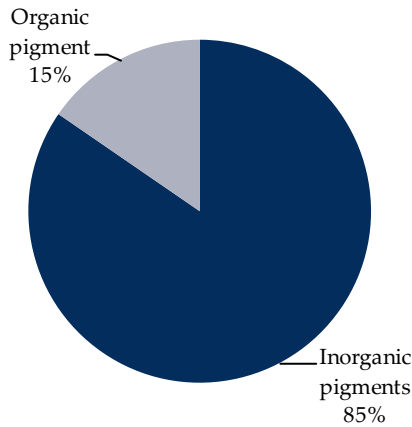
Source: Company, HSIE Research; Ministry of Chemicals and Fertilizers

Exhibit 19: Capacity vs production of pigments in FY19 of India



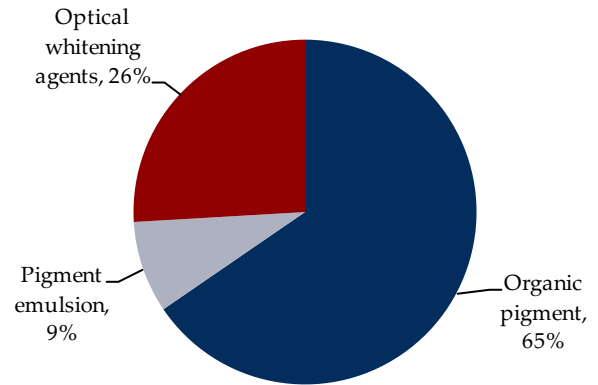
Source: Company, HSIE Research; Ministry of Chemicals and Fertilizers

Exhibit 20: Indian Organic and Inorganic Pigment



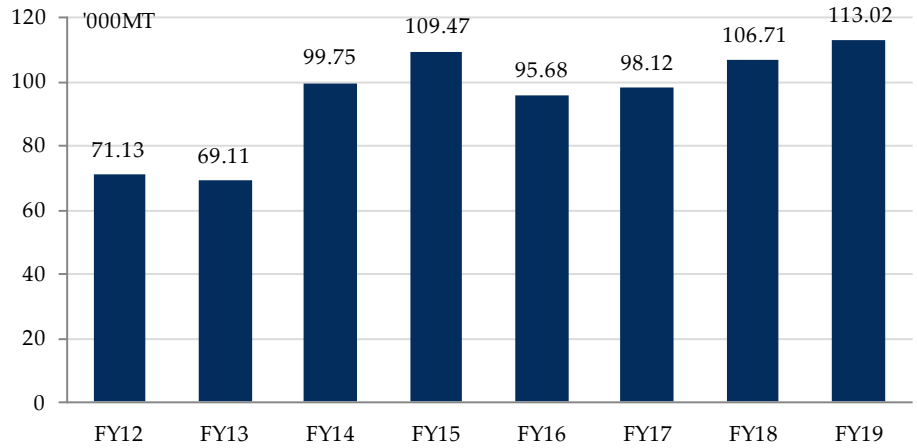
Source: HSIE Research; Ministry of Chemicals and Fertilizers

Exhibit 21: Organic pigments production mix in FY19 (Domestic)



Source: Company, HSIE Research; Ministry of Chemicals and Fertilizers

Exhibit 22: Domestic production of Organic pigment grew at a 7% CAGR over FY12-19



Source: Company, HSIE Research; Ministry of Chemicals and Fertilizers

Financials

In our view, SCIL's revenue would grow at 14.8% CAGR over FY21-24E to INR 25bn vs 11.2% CAGR over FY10-20, given its plans for geographical expansion and new product offerings. At the same time, EBITDA CAGR would be ahead of revenue growth at 16.3%, due to (1) the shift of product mix towards High-Performance Pigment (HPP) for automotive coatings and engineering plastics and (2) operating leverage. By FY24E, we believe EBITDA would reach INR 3.9bn from INR 2.5bn in FY21E, while margin would expand by 62bps to 15.6%.

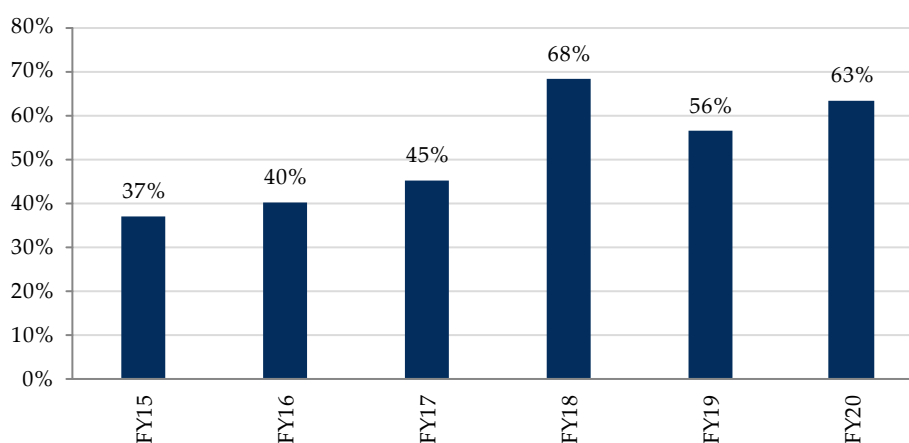
The credit rating of SCIL has always been healthy. Therefore, the company can raise foreign loans with ease. The share of foreign debt in total debt has risen steadily from 37% in FY15 to 63% in FY20, which has continually declined interest costs. This has led to the expansion of the PAT margin by 321 bps.

Exhibit 23: Consistent healthy credit rating

Date	Rating	Outlook
06-04-2020	IND A+	Positive
25-03-2019	IND A+	Stable
30-10-2018	IND A+	Stable
01-02-2018	IND A+	Stable
25-09-2017	IND A+	Stable
13-06-2017	IND A+	Stable
23-12-2016	IND A+	Stable
20-11-2015	IND A	Positive
26-05-2015	IND A	Stable

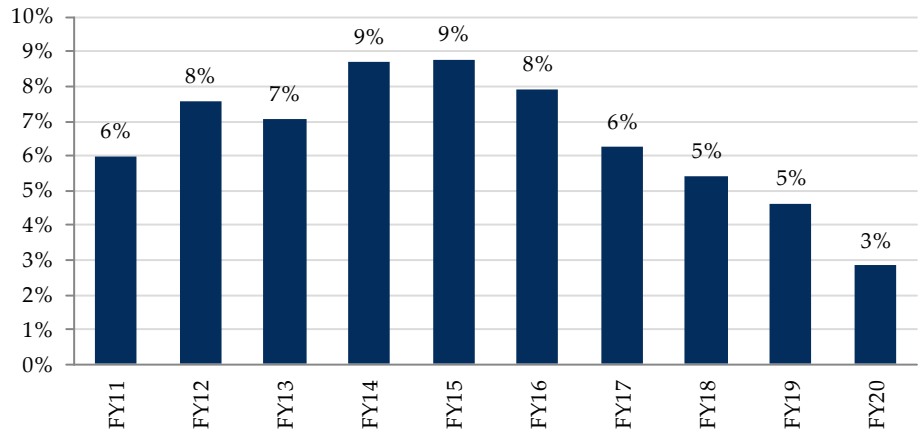
Source: Company, HSIE Research | Credit rating score and outlook is given by India Ratings & Research

Exhibit 24: Foreign debt's share in total debt



Source: Company, HSIE Research | Debt here includes both long term and short-term debt

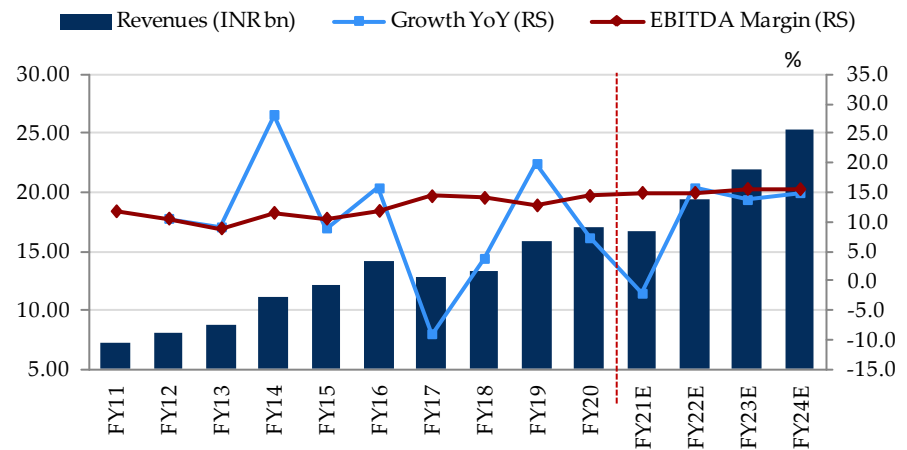
Exhibit 25: Interest cost as a % of total debt



Source: Company, HSIE Research | Debt here includes both long term and short-term debt

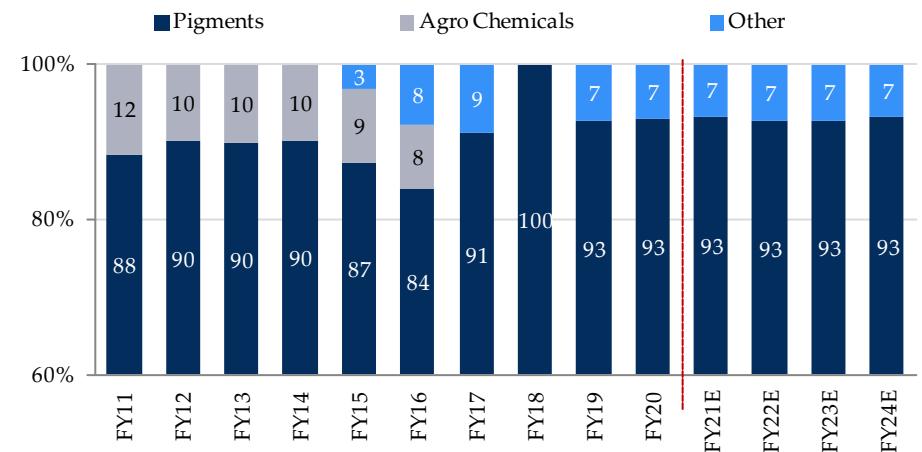
APAT will grow from INR 1.2bn in FY21E to INR 2.1bn in FY24E at CAGR of 20% over FY21-24E. APAT margin will expand by 99bps from 7.2% in FY21E to 8.2% in FY24E, in line with EBITDA expansion, offset by an increase in interest cost.

Exhibit 26: Revenue, growth and EBITDA margin



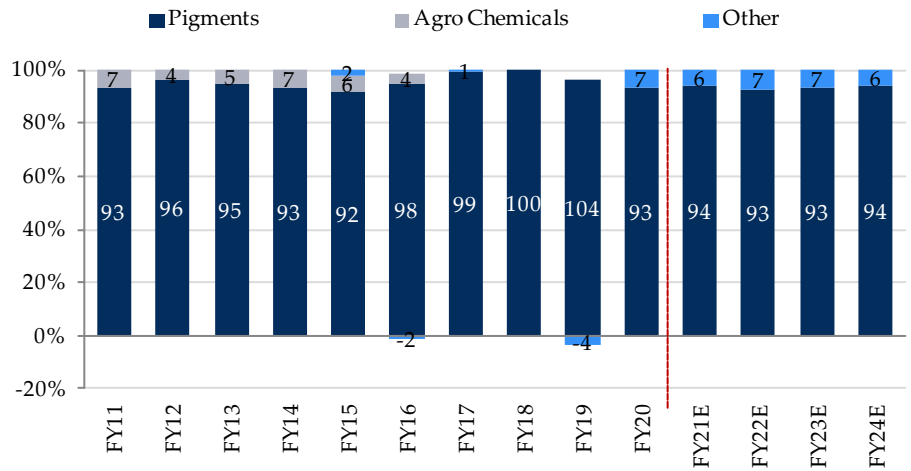
Source: Company, HSIE Research

Exhibit 27: Segmental revenue mix (%)



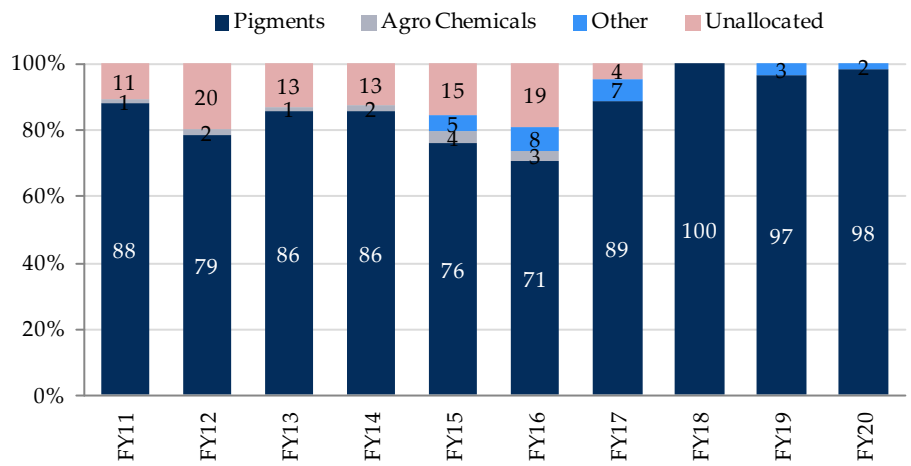
Source: Company, HSIE Research

Exhibit 28: Segmental EBIT mix (%)



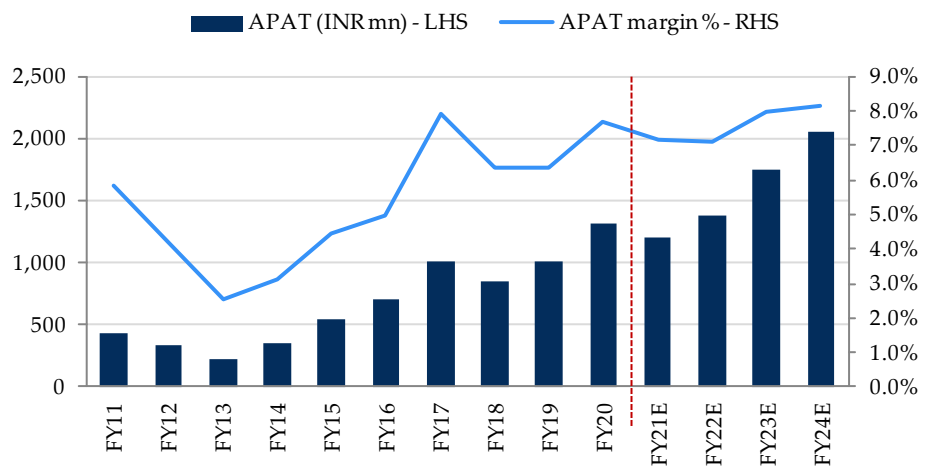
Source: Company, HSIE Research

Exhibit 29: Capital employed mix (%)



Source: Company, HSIE Research

Exhibit 30: APAT and APAT margin %

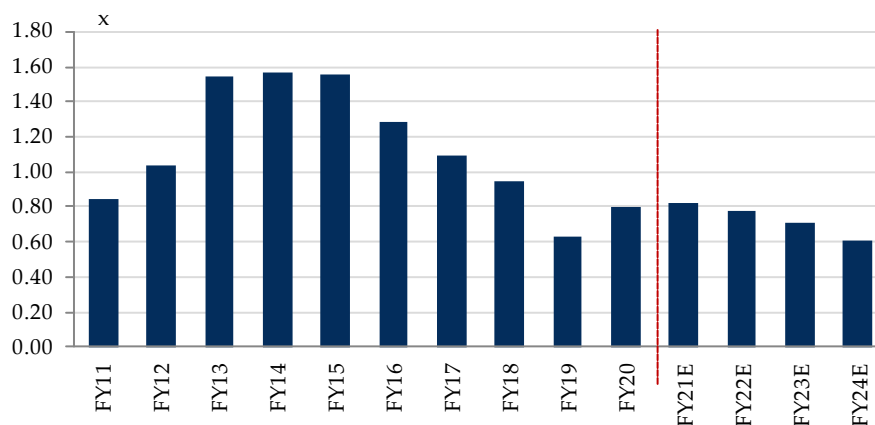


Source: Company, HSIE Research

Net debt-equity ratio to increase to 0.82x in FY21E, net debt-EBITDA to 2.2x

To finance the ongoing capital expansion, the company has planned to raise INR 2bn in FY21E. The total debt will increase from INR 5bn in FY20 to INR 7bn in FY21E. We expect the company to raise debt at competitive costs comfortably. Net debt to equity ratio will increase to 0.82x in FY21E from 0.80x in FY20, but it will fall to 0.61x in FY24E. Net debt/ EBITDA ratio will increase to 2.2x in FY21E from 2.0x in FY20, but it will fall to 1.4x in FY24E.

Exhibit 31: Net debt to equity ratio (x)



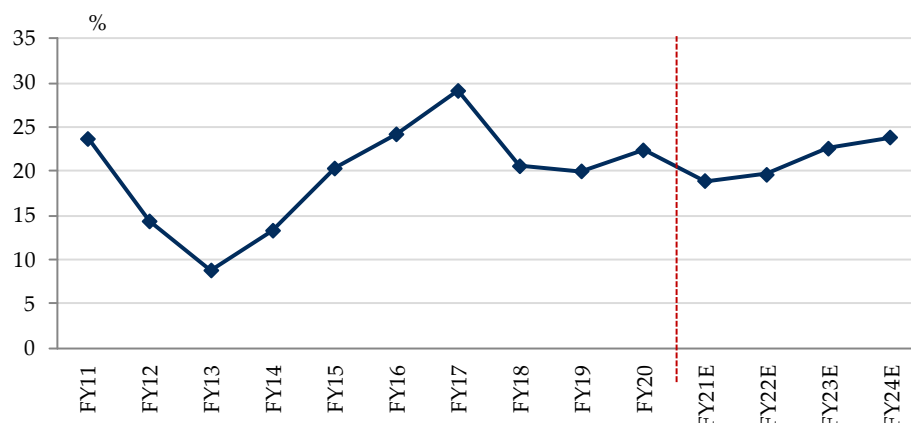
Source: Company, HSIE Research

RoE and RoIC to expand from 19.0/11.5% in FY21E to 23.9/15.3% in FY24E

The ROIC of SCIL in FY20 was 12%, while the average ROIC stood at 10% over FY11-20. Post completion of earlier Capex programme during FY12-13, the company's ROIC fell to 7.5% owing to fall in operating margins as well as asset turnover. However, the ROIC recovered to 12% in FY20 with steady improvement in EBIT margin to 10% from 6% and asset turnover to 2.3x from 1.7x.

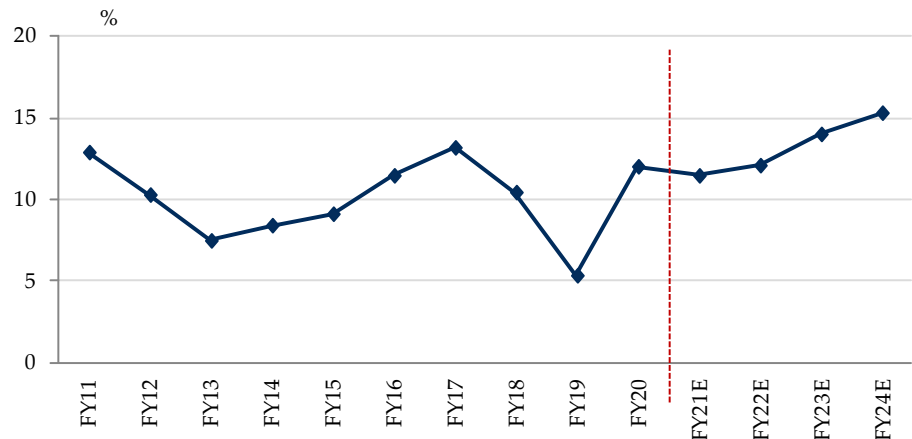
We expect ROIC to improve from 12% in FY20 to 15% in FY24E. SCIL has been in high-Capex mode and spent INR5.5bn by FY20, of the total planned Capex of INR 10bn. SCIL has commissioned some capacities in FY20 while the remaining capacities will be commissioned in FY21 and FY22. The product approvals from end-user companies require 18-24 months. Therefore, we expect the benefits of the ongoing Capex programme to reflect from FY23 onwards.

Exhibit 32: Return on equity ratio (%)



Source: Company, HSIE Research

Exhibit 33: Return on invested capital (%)

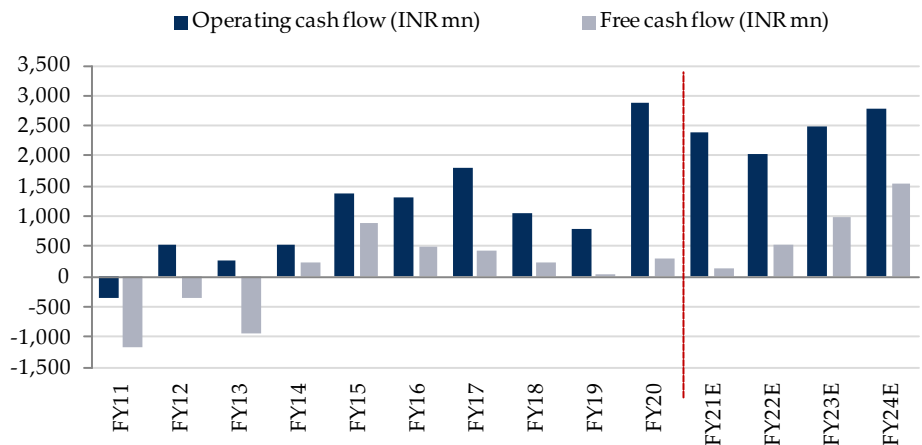


Source: Company, HSIE Research

Free cash flow positive since FY16 and expect to go up

SCIL is one of the few chemical companies which is generating free cash flows. Since FY14, it is generating FCF. We expect this to continue over FY21E to FY24E, despite Capex spend of INR 5.5bn. The company will generate FCF of INR 3.2bn over FY21-24E. The FCF yield will be 4.2% in FY24E.

Exhibit 34: Operating cash flows and free cash flows over the years

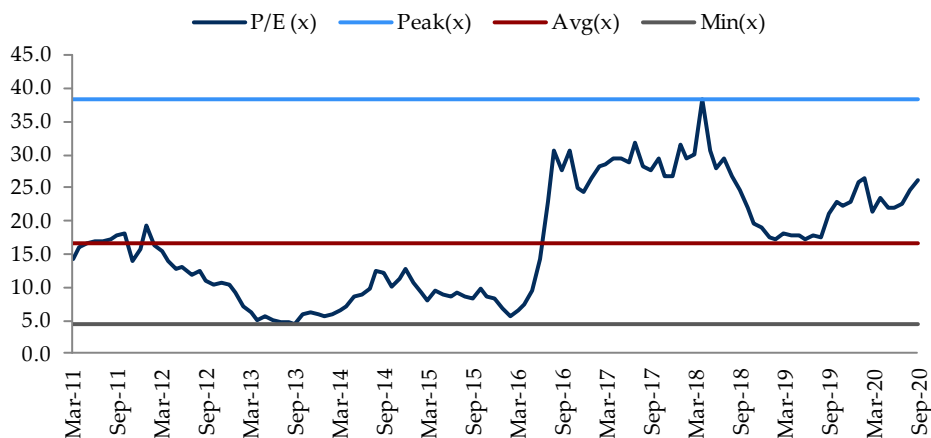


Source: Company, HSIE Research

Valuation

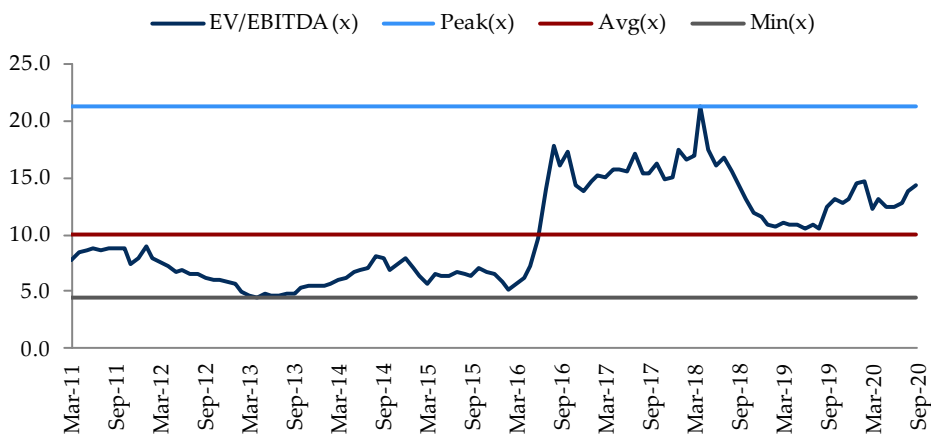
We initiate coverage on SCIL with BUY and target price of INR 550, (WACC 10%, terminal growth 3%). The stock is trading at 23/18x on FY22/23E EPS.

Exhibit 35: 1-year forward P/E chart



Source: Company, HSIE Research

Exhibit 36: 1-year forward EV/EBITDA chart



Source: Company, HSIE Research

Exhibit 37: Consolidated peer set comparison

Company	CMP (INR)	RECO	TP (INR)	P/E (x)			ROE (%)			EV/EBITDA (x)			Dividend yield (%)			FCFF yield (%)		
				FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Sudarshan Chemical	453	BUY	550	26.2	22.8	17.9	19.0	19.7	22.6	14.7	12.8	10.8	1.5	1.8	2.5	0.4	1.4	2.7
Aarti Industries	1,147	BUY	1,285	46.1	40.5	31.1	13.7	13.7	15.6	25.3	21.6	17.7	0.2	0.2	0.3	(1.6)	0.9	1.7
Alkyl Amines	3,387	BUY	4,025	30.1	26.3	23.3	35.8	30.5	26.6	21.0	17.9	15.4	0.3	0.3	0.3	1.6	2.8	3.9
Balaji Amines	985	BUY	1,000	23.2	18.7	16.6	17.1	17.5	16.6	14.2	11.7	10.2	0.1	0.1	0.1	2.6	1.4	1.9
Galaxy Surfactants	1,895	BUY	2,265	24.3	20.2	17.9	23.5	23.5	22.8	15.5	13.3	11.8	0.9	1.1	1.2	3.0	1.2	3.4
Navin Fluorine	2,605	ADD	2,410	59.7	43.1	34.8	14.1	17.1	18.7	37.8	27.1	21.4	0.4	0.6	0.7	0.4	0.2	1.6
SRF Ltd	5,051	BUY	5,600	29.6	29.3	26.9	18.3	15.9	15.1	16.8	16.1	14.7	0.3	0.3	0.4	1.6	1.6	2.4
Vinati Organics	1,180	SELL	925	41.7	35.5	32.3	20.9	20.7	19.1	31.7	25.9	22.9	0.5	0.5	0.5	(1.3)	(0.7)	(0.8)

Source: Company, HSIE Research

What is a pigment?

A pigment is a material that changes the colour of reflected or transmitted light as the result of wavelength-selective absorption. In other words, it's a substance that appears a specific colour because it selectively absorbs a particular wavelength of light.

The primary purpose of pigments is to provide colour to materials, whether they are textiles or paints. People often consider pigments and dyes to be the same, but they're quite different. The significant difference between both is in terms of their solubility.

While a dye can dissolve by itself in a liquid, pigments can only dissolve using a binder. Dyes are primarily applied in the textile and paper industry, while pigments are used in industries such as colouring paints, inks, cosmetics, and plastics.

The role of pigments in paints determines:

- Chroma- Relative brightness
- Opacity- Opaque, translucent, and transparent
- Colour strength
- Lightfastness- How long before colour shifts or fades

Binder is the acrylic polymer emulsion. Binder determines:

- Clarity- Clear binders make true colour paint
- Drying time- How fast can the colour dry?
- Handling- Physical qualities (thick/fluid/sticky/smooth/brush drag)
- Archival
- Environmental effects
- Film hardness- Harder film is more durable over time
- Flexibility of film
- Adhesion

Types of pigments

Based on the method of their formulation, pigments can be categorised into two types: inorganic and organic.

Organic pigments:

- These types of pigments occur naturally, and they've been used for centuries. They're quite simple in their chemical structure. They're named organic as they contain minerals and metals that give them their colour. Organic pigment manufacturers produce them through a simple process that's made of washing, drying, powdering and combining into a formulation.
- Compared to inorganic pigments, the usage of these pigments is less frequent, and that's why there is a limited number of organic pigment suppliers. These pigments are used when the required colour strength isn't too much.

Inorganic pigments:

- These types of pigments are precisely opposite to organic pigments. These pigments are also known as "synthetic pigments." They're formulated in labs and offer a great scope of control to inorganic pigment manufacturers. Inorganic pigments are manufactured by relatively simple chemical processes such as oxidation.
- Inorganic pigment suppliers supply these type of pigments mainly to paints, plastics, synthetic fibres and ink industries. In uses where bright colours are required, organic pigments are used as they bolster high colour strength. Inorganic pigments include white opaque pigments, which are commonly used to lighten other colours and provide opacity.

Two other types of pigments are metallic pigments and industrial pigments.

- Metallic pigments, as implied in the name, include metal pigments such as zinc and aluminium pigments. At the same time, industrial pigments are the pigments that are widely used in the industrial applications and include organic, inorganic and metallic pigments.
- Effect Pigments are as flake or platy structures that impart a directional light reflectance, scattering, absorption, or optically variable appearance to the substrate in or on which they are applied. Effect pigments give glossy or other finishing to pigment. They are used in cosmetics and coatings.

Exhibit 38: Difference between dyes and pigments

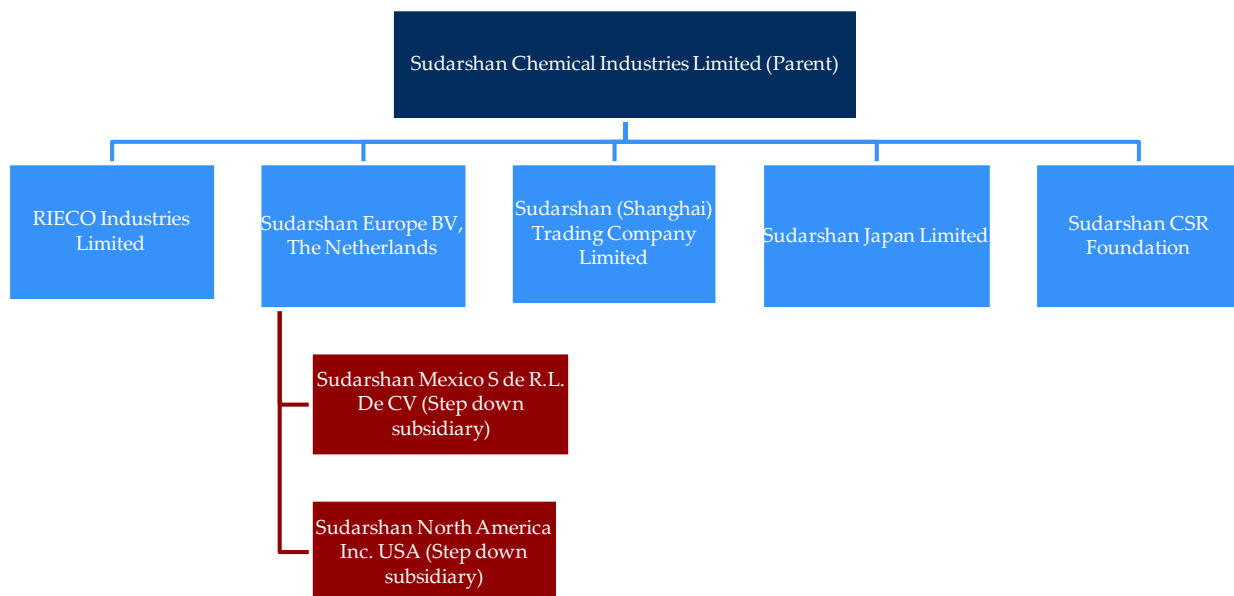
Key Difference Between Pigments & Dyes		
Category of difference	Dyes	Pigments
Solubility	Soluble	Insoluble
Lightfastness	Vulnerable to fading	Resistant against fading
Bonding	Functional groups bond between dye and substrate	Functional groups do not bond; typically requires a binder
Structure during application	Structure alters	Retains particulate form
Combustion properties	Often combustible	Relatively less combustible
Chemical properties	Typically organic	Typically (but not always) inorganic
Longevity	Shorter	Longer

Source: Company, HSIE Research

About the company

Sudarshan Chemical Industries Ltd is the fourth-largest pigment manufacturing company globally, and the largest domestically (35% market share). It started manufacturing pigments in 1952 with a handful of inorganic pigments and has flourished with a breadth of products ranging from organic, inorganic, and effective pigments, to performance colourants, pearlescent pigments, and speciality chemicals. It serves the coatings, plastics, inks, textiles, and cosmetics markets. It offers products under the brands Sudaperm, Sudafast, Sudacolor, Sumica, Sudafine, Sudadur, Sudatex and Sumicos. SCIL has two state-of-the-art manufacturing plants at Roha and Mahad, along with four R&D laboratories, including a newly-established one in Germany. The company sells its products to over 85 countries, and has offices in North America, Europe, China, Mexico, and Japan, apart from India. It has five wholly-owned subsidiaries and two step-down subsidiaries. Five of its subsidiaries are outside India. Pigment exports constituted 50% of total sales in FY20. Sudarshan holds the vision to become the third-largest pigment manufacturing company globally in the coming years.

Exhibit 39: Company structure



Source: Company, HSIE Research | All subsidiaries are wholly owned subsidiaries of SCIL

Financials (Consolidated)

INCOME STATEMENT

INR mn	FY18	FY19	FY20	FY21E	FY22E	FY23E
Revenues	13,294	15,930	17,082	16,708	19,332	21,982
<i>Growth %</i>	3.7	19.8	7.2	(2.2)	15.7	13.7
Raw Material	7,631	9,422	9,762	9,353	10,969	12,501
Employee Cost	944	1,244	1,457	1,574	1,731	1,904
Other Expenses	2,846	3,224	3,400	3,286	3,744	4,147
EBITDA	1,873	2,040	2,463	2,496	2,888	3,429
<i>EBITDA Margin (%)</i>	14.1	12.8	14.4	14.9	14.9	15.6
<i>EBITDA Growth %</i>	1.7	9.0	20.7	1.3	15.7	18.7
Depreciation	577	656	735	872	1,027	1,099
EBIT	1,295	1,385	1,728	1,624	1,861	2,330
Other Income (Including EO Items)	92	793	218	58	73	73
Interest	234	170	142	197	230	230
PBT	1,153	2,007	1,804	1,485	1,704	2,173
Tax	384	680	353	286	329	419
Profit after tax from discontinued operations	78	23	(5)	0	0	0
RPAT	847	1,351	1,445	1,198	1,374	1,753
EO (Loss) / Profit (Net of Tax)	-	340	134	-	-	-
APAT	847	1,011	1,311	1,198	1,374	1,753
Share from associates	-	-	-	-	-	-
Minority Interest	-	-	-	-	-	-
Consolidated APAT	847	1,011	1,311	1,198	1,374	1,753
<i>Consolidated APAT Growth (%)</i>	(16.4)	19.3	29.7	(8.6)	14.7	27.6
AEPS	12.2	14.6	18.9	17.3	19.9	25.3
<i>AEPS Growth %</i>	(16.4)	19.3	29.7	(8.6)	14.7	27.6

Source: Company, HSIE Research

BALANCE SHEET

INR mn	FY18	FY19	FY20	FY21E	FY22E	FY23E
SOURCES OF FUNDS						
Share Capital	138	138	138	138	138	138
Reserves and Surplus	4,261	5,539	5,869	6,493	7,207	8,014
Total Equity	4,400	5,677	6,008	6,631	7,346	8,152
Minority Interest	-	-	-	-	-	-
Long-term Debt	1,820	1,131	2,250	4,250	4,250	4,250
Short-term Debt	2,489	2,540	2,736	2,736	2,736	2,736
Total Debt	4,309	3,671	4,986	6,986	6,986	6,986
Deferred Tax Liability	448	546	446	459	473	487
Long-term Provision and others	193	157	193	203	213	224
TOTAL SOURCES OF FUNDS	9,349	10,051	11,632	14,279	15,017	15,849
APPLICATION OF FUNDS						
Net Block	4,754	4,650	6,271	7,326	7,825	8,239
Capital WIP	56	240	480	802	776	763
LT Loans and Advances	326	321	845	861	879	896
Total Non-current Investments	5	0	9	9	9	9
Total Non-current assets	5,141	5,211	7,604	8,999	9,489	9,907
Inventories	2,729	3,077	4,107	4,017	4,648	5,285
Debtors	3,333	3,461	3,641	3,561	4,120	4,685
Cash and Cash Equivalents	142	81	156	1,570	1,283	1,164
Other Current Assets	1,692	1,753	733	748	763	778
Total Current Assets	7,896	8,373	8,637	9,896	10,814	11,911
Creditors	2,644	2,422	3,717	3,636	4,207	4,783
Other Current Liabilities & Provns	1,044	1,111	891	980	1,078	1,186
Total Current Liabilities	3,688	3,533	4,608	4,616	5,285	5,970
Net Current Assets	4,208	4,840	4,028	5,280	5,528	5,942
TOTAL APPLICATION OF FUNDS	9,349	10,051	11,632	14,279	15,017	15,849

Source: Company, HSIE Research

CASH FLOW STATEMENT

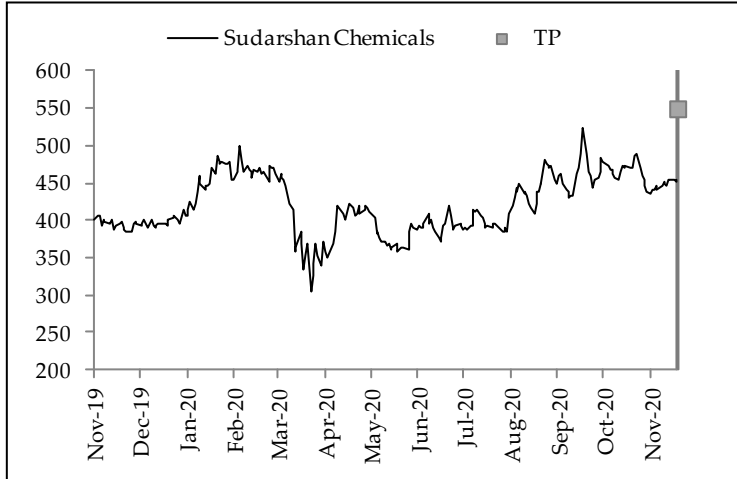
(INR mn)	FY18	FY19	FY20	FY21E	FY22E	FY23E
Reported PBT	1,231	2,031	1,799	1,485	1,704	2,173
Non-operating & EO Items	(92)	(793)	(218)	(58)	(73)	(73)
Interest Expenses	234	170	142	197	230	230
Depreciation	577	656	735	872	1,027	1,099
Working Capital Change	(667)	(693)	887	163	(536)	(533)
Tax Paid	(246)	(582)	(453)	(273)	(315)	(405)
OPERATING CASH FLOW (a)	1,038	789	2,891	2,386	2,037	2,492
Capex	(789)	(736)	(2,597)	(2,250)	(1,500)	(1,500)
Free Cash Flow (FCF)	249	54	295	136	537	992
Investments	(0)	5	(9)	-	-	-
Non-operating Income	92	793	218	58	73	73
Others	182	5	(523)	(17)	(17)	(18)
INVESTING CASH FLOW (b)	(516)	67	(2,910)	(2,209)	(1,445)	(1,445)
Debt Issuance/(Repaid)	(17)	(638)	1,315	2,000	-	-
Interest Expenses	(234)	(170)	(142)	(197)	(230)	(230)
FCFE	(2)	(755)	1,467	1,939	307	762
Share Capital Issuance	-	-	-	-	-	-
Dividend	(288)	(82)	(1,002)	-	-	-
Others	6	(26)	(77)	(566)	(650)	(936)
FINANCING CASH FLOW (c)	(533)	(917)	94	1,238	(879)	(1,166)
NET CASH FLOW (a+b+c)	(11)	(61)	75	1,414	(287)	(119)
EO Items, Others						
Closing Cash & Equivalents	142	81	156	1,570	1,283	1,164

KEY RATIOS

	FY18	FY19	FY20	FY21E	FY22E	FY23E
PROFITABILITY %						
EBITDA Margin	14.1	12.8	14.4	14.9	14.9	15.6
EBIT Margin	9.7	8.7	10.1	9.7	9.6	10.6
APAT Margin	6.4	6.3	7.7	7.2	7.1	8.0
RoE	20.6	20.1	22.4	19.0	19.7	22.6
RoIC	10.4	5.3	12.0	11.5	12.1	14.0
RoCE	11.1	11.2	13.1	10.5	10.6	12.6
EFFICIENCY						
Tax Rate %	33.3	52.9	21.7	19.3	19.3	19.3
Fixed Asset Turnover (x)	2.4	2.6	2.3	1.7	1.7	1.7
Inventory (days)	75	70	88	88	88	88
Debtors (days)	92	79	78	78	78	78
Other Current Assets (days)	46	40	16	16	14	13
Payables (days)	126	94	139	142	140	140
Other Current Liab & Provns (days)	29	25	19	21	20	20
Cash Conversion Cycle (days)	58	71	23	19	20	19
Net Debt/EBITDA (x)	2.2	1.8	2.0	2.2	2.0	1.7
Net D/E	0.9	0.6	0.8	0.8	0.8	0.7
Interest Coverage	5.5	8.1	12.1	8.3	8.1	10.1
PER SHARE DATA (Rs)						
EPS	12.2	14.6	18.9	17.3	19.9	25.3
CEPS	20.6	24.1	29.6	29.9	34.7	41.2
Dividend	3.5	6.0	6.3	6.9	7.9	11.4
Book Value	63.6	82.0	86.8	95.8	106.1	117.8
VALUATION						
P/E (x)	37.0	31.0	23.9	26.2	22.8	17.9
P/Cash EPS (x)	22.0	18.8	15.3	15.1	13.1	11.0
P/BV (x)	7.1	5.5	5.2	4.7	4.3	3.8
EV/EBITDA (x)	19.0	17.1	14.7	14.7	12.8	10.8
EV/Revenue (x)	2.7	2.2	2.1	2.2	1.9	1.7
Dividend Yield (%)	0.8	1.3	1.4	1.5	1.8	2.5
OCF/EV (%)	2.9	2.3	8.0	6.5	5.5	6.7
FCFF/EV (%)	0.7	0.2	0.8	0.4	1.4	2.7
FCFE/M Cap (%)	(0.0)	(2.4)	4.7	6.2	1.0	2.4

Source: Company, HSIE Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
20-Nov-20	453	BUY	550

Rating Criteria

- BUY: >+15% return potential
- ADD: +5% to +15% return potential
- REDUCE: -10% to +5% return potential
- SELL: > 10% Downside return potential

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