

EQUITY RESEARCH

Pick of the Week

Date: Sep 30, 2019



Sudarshan Chemical Industries

Key Highlights

- ▶ Market Leader with long established track record
- ▶ Diversified Product Portfolio
- ▶ China's woes are blessings for Indian Chemical companies

- ▶ Company has plan in place to grab the opportunity
 - ❖ Large Capex in line
 - ❖ Divestment of all non-core businesses
 - ❖ To minimize impact on cost side

INDUSTRY

DYES & PIGMENTS

CMP

Rs. 375.6

RECOMMENDATION

Buy at CMP and add on declines

ADD ON DIPS TO

Rs. 375.6 - 350

SEQUENTIAL TARGETS

Rs. 445 - 510 **RED FLAG** Rs. 298

TIME HORIZON

4-6 quarters

GLOBAL PIGMENT GIANT IN THE MAKING

4th largest pigment manufacturing company globally and the largest in India, Sudarshan chemicals is now aspiring to become 3rd largest. Management has put many plans in place to achieve that in next 5 years.

China has been major player in Global Chemical business. But since last couple of years Chinese Chemical Industry has been facing many challenges because of stricter environmental norms.

US-China trade tensions, rising cost of labour and rising competition from Asian players, two global major players BASF and Clariant are looking to vacate this space and their lies the opportunity for the Sudarshan to become a global giant. Over FY19-21E, we expect revenues to witness 13% CAGR while Net profit to grow 47% CAGR on the back of 170bps margin expansion and lower tax rate according to new corporate tax announcement (tax rate will be reduced to ~25% from previous ~33%).

Company Profile:

Established in 1952, Sudarshan Chemical Industries Limited is a 4th largest pigment manufacturing company globally and largest domestically with 35% market share. Company is mainly engaged in the manufacturing of Organic, Inorganic and Effect pigments. Primarily, it serve the coatings, plastics, inks and cosmetics markets. The products are offered under the brands - Sudaperm, Sudafast, Sudacolor, Sumica and Sumicos. Company sales its products to more than 85 countries with 50+ sales team and 60+ channel partners. Since majority of the pigment market is in the developed market of Europe, North America and China management has set up marketing subsidiaries in these geographies. Sudarshan has two state-of-the-art manufacturing plants at Roha and Mahad, a dedicated R&D site at Ambadwet near Pune.

Investment Rationale:

- ❖ **Market Leader with long established track record**
- ❖ **Diversified Product Portfolio**
- ❖ **China's woes are blessings for Indian Chemical companies**
- ❖ **Sudarshan has plans in place to grab the opportunity**

View and valuation:

Over FY19-21E, We expect revenue to grow at 13% CAGR while Net profit may see faster 47% CAGR on the back of 170bps margin expansion and lower tax rate according to new corporate tax announcement (tax rate will be reduced to ~25% from previous ~33%). Despite huge capex, the debt to equity ratio is expected to remain around 0.5x, while RoCE is expected to improve by 200bps to 21.3% in FY21E. Sudarshan is currently trading at 17.7x FY21E earnings. We recommend Sudarshan Chemical Industries a BUY at CMP of Rs. 375.6 and add on dips to Rs. 350 for the sequential Price targets of Rs. 445 and Rs. 510 over next 4-6 Quarters.

HDFC Scrip Code	SUDCHE
BSE Code	506655
NSE Code	SUDARSCHEM
Bloomberg	SCHI
CMP Sep 27, 2019	375.6
Equity Capital (cr)	13.85
Face Value (Rs)	2
Eq- Share O/S(cr)	6.92
Market Cap (Rs cr)	2582
Book Value (Rs)	82
Avg.52 Wk Volume	73940
52 Week High	436.25
52 Week Low	291.10
Red Flag Price Level	298
PCG Risk Rating*	Yellow

Shareholding Pattern % (June 30, 2019)

Promoters	52.89
Institutions	9.90
Non Institutions	37.21
Total	100.00

FUNDAMENTAL ANALYST

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Key Highlights

- ❖ ***Sudarshan Chemical Industries is a 4th largest pigment manufacturing company globally and largest domestically with 35% market share.***
- ❖ ***Company sales its products to more than 85 countries with 50+ sales team and 60+ channel partners. Pigment exports constituted 45% of the total sales in FY19.***
- ❖ ***China's woes are blessings for Indian Chemical companies and Sudarshan has plan in place to grab the opportunity with large capex inline, focus on core business and backward integration.***
- ❖ ***Embarking to the next level of growth, company aspires to become 3rd largest in the world.***

Investment Rationale:

Market Leader with long established track record

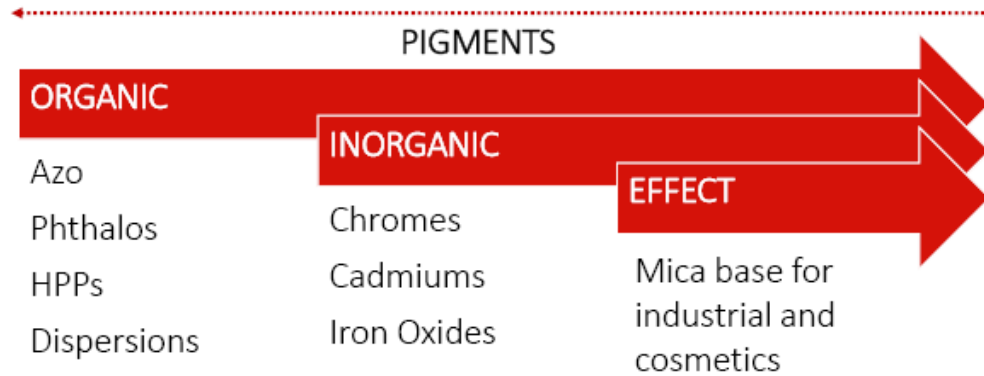
With over 60 years of operating track record Sudarshan has built strong relationships with customers and suppliers. The company dominates Indian pigment industry with a market share of around 35%. Sudarshan has presence in all the segment of pigments, which according to company no other domestic competition has.

In a space dominated by global giants like BASF, Clariant, Lanxess, Heubach, Sun Chemicals etc, Sudarshan has managed to secure 4th place and embarking to the next level of growth, company aspires to become 3rd largest in the world. Company sales its products to more than 85 countries with 50+ sales team and 60+ channel partners. Since majority of the pigment market is in the developed market of Europe, North America and China management has set up marketing subsidiaries in these geographies. Pigment exports constituted 45% of the total sales in FY19.

Manufacturing capital at Sudarshan has played a vital role in building its core competency. Sudarshan has two state-of-the-art manufacturing plants at Roha and Mahad, and a dedicated R&D site at Ambadwet near Pune with strong technical capabilities.

Diversified Product Portfolio

Sudarshan's evolution comprises adding a wide range of offering across various application. Today, it offers Organic, Inorganic and Effect pigments. **Sudarshan's strategy of diversified product range enables** its brands to cater the complete range of end application. Key customer industries are Coating industry, Inks, Plastic Industry and Cosmetics. The products are offered under the brands - Sudaperm, Sudafast, Sudacolor, Sumica and Sumicos. Currently, company has more than 400 products and management has guided that they will keep on adding 25-35 products annually to its portfolio Backed by its internal R&D and client requirements.



Organic Pigments: Made of organic compound with pigment properties. Commonly used for Coatings, plastics, Inks & Textile applications.

Inorganic Pigments: Made up of mineral compounds. They are mainly oxides, sulphides of one or more than one metals. Used for plastics and industrial coatings.

Effect Pigments: Pigments with mica base and coated with oxides to give shimmer and glow. Mainly used in plastics, automotive coatings and cosmetics applications.

Pigments Application:

COATINGS	PLASTICS	INKS	COSMETICS
High performance and special effect for the coating industry.	A pallette with a wide spectrum of colors and performance for plastic applications.	General purpose and high performance pigments for inks.	Effect pigments for cosmetics & personal care applications.
Our key focus area with targeted significant growth in the automotive and decorative segments.	Enjoy leadership position in plastics segment in multiple geographies; attributed to our detailed know-how of the industry.	Focus on niche applications in the ink industry with necessary expertise in offset and liquid ink segments.	A strategically important growth area for Sudarshan; we continue building capabilities in end application.

China's woes are blessings for Indian Chemical companies...

China has been major player in Global Chemical business. But since last many year Chinese Chemical Industry has been facing many challenges because of stricter environmental norms, US-China trade tensions, slower GDP growth and rising cost of labour.

Two Global major players BASF and Clariant revealed that they are aiming to sell off global pigments operation because of increased Raw material prices from China and rising competition because of Asian players.

This provides an opportunity to Indian players to enhance their share in the global export market. Indian Government through its Make in India campaign and other exports initiatives also provides support. The positive factor for Indian Pigment industry is the demand for its products is largely driven by domestic market and considering very low per capita consumption ratio holds promise.

.... and Sudarshan has plan in place to grab the opportunity

In 2008, Company had aspired to be the fourth largest Pigments producer globally and today they achieved it. Embarking to the next level of growth, company aspires to become 3rd largest in the world now. Management has put many plans in place to achieve that in next 5 years.

Large Capex in line:

Over last Ten years company has done around Rs 800 Cr of capex largely funded from internal accruals with no equity dilution. Due to which, company has recorded 10% CAGR in Top line and 20% CAGR in bottom line. Asset turnover ratio has also improved over the past few years. Now management, looking at growth opportunities, has guided Rs. 200 Cr capex plan for this year and another Rs. 200 Cr capex next year-FY21. Capex money will be largely sourced for internal resources. The money will be used to for launching new products, debottlenecking certain capacities, backward integration and some infrastructure related investment.

Divestment of all non-core businesses:

Over last Two years, management have divested a number of businesses and used that money for repayment of debt. Prescient Colour was sold to Americhem Inc in May'18 for a consideration of Rs 1.1 bn. Agro Chemicals Business was divested in June'18 for a fixed consideration of Rs 70 mn and variable component royalty on sales. Agro Chemicals fixed assets are being used for Pigment division. Industrial Mixing Solutions division-Rathi Vessels was divested to GMM Pfaunder Ltd in April'19 for a consideration of Rs 250 mn. Management is also planning to sale RIECO industries which runs an engineering business.

To minimize impact on cost side:

On the cost side - The industry witnessed significant raw material price increases and supply disruptions in the last one year due to plant shutdowns in China. Company has managed to pass on some cost with a lag effect, management has took several prudent cost management initiatives and now they are planning to do backward integration.

Risk & Concerns:

- **High Volatility in Raw materials price & Currency**
- **Macroeconomic slowdown**
- **Inability to scale up FMEG business**
- **Higher competition from organised players**

View and valuation:

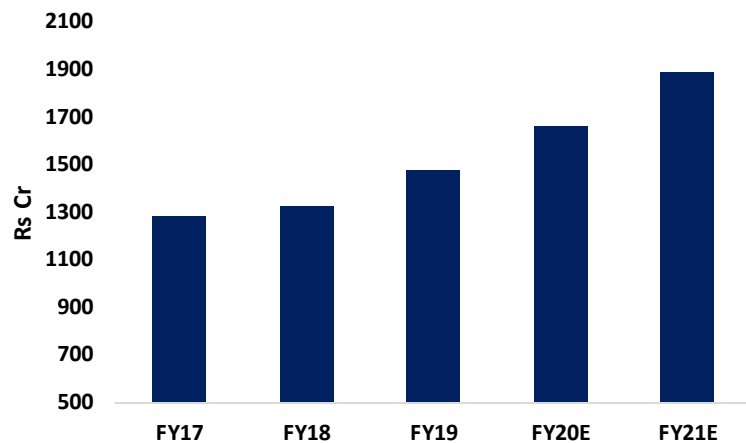
In a space dominated by global giants like BASF, Clariant, Lanxess, Heubach, Sun Chemicals etc, Sudarshan has managed to secure 4th place and embarking to the next level of growth, company aspires to become the 3rd largest in the world. Domestically also Company is the largest with 35% market share.

China's woes are blessings for Indian Chemical companies and Sudarshan has plan in place to grab the opportunity with large capex inline, focus on core business and backward integration.

Over FY19-21E, We expect revenue to grow at 13% CAGR while Net profit to grow 47% CAGR on the back of 170bps margin expansion and lower tax rate according to new corporate tax announcement (tax rate will be reduced to ~25% from previous ~33%). Despite huge capex the debt to equity ratio is expected to remain around 0.5x, while RoCE is expected to improve by 200bps to 21.3% in FY21E. Sudarshan is currently trading at 17.7x FY21E earnings.

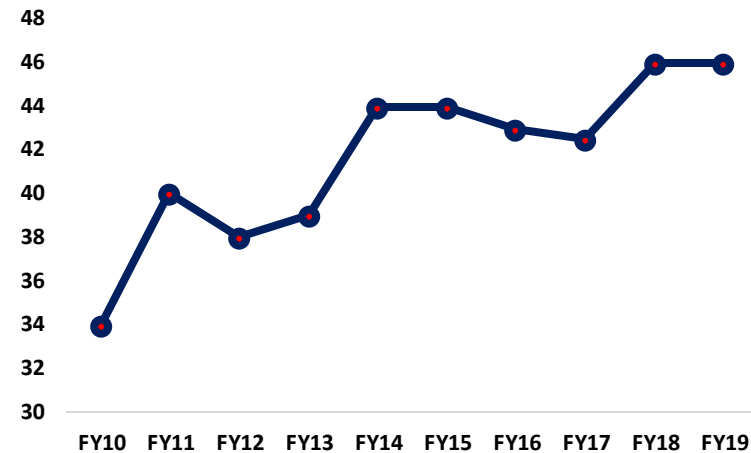
We recommend Sudarshan Chemical Industries a BUY at CMP of Rs. 375.6 and add on dips to Rs. 350 for the sequential Price targets of Rs. 445 and Rs. 510 over next 4-6 Quarters.

Estimate 13% revenues CAGR over FY19-21E



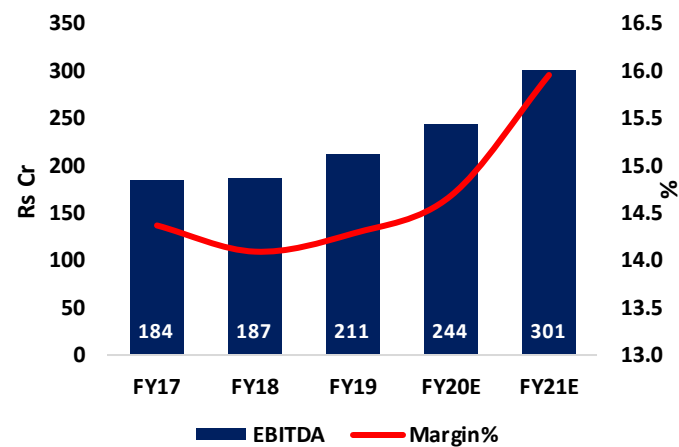
Source: Company, HDFC sec Research

Export contribution (%)



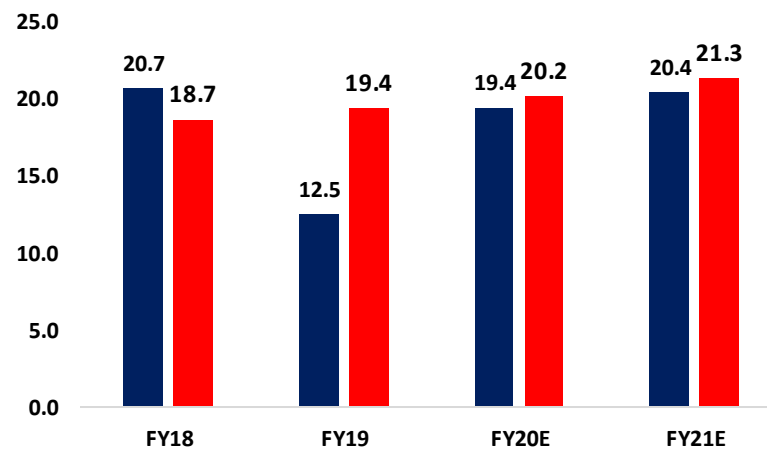
Source: Company, HDFC sec Research

EBITDA & EBITDA Margin



Source: Company, HDFC sec Research

Strong Return Ratios



Source: Company, HDFC sec Research

Income Statement (Consolidated)

(Rs Cr)	FY18	FY19	FY20E	FY21E
Net Revenue	1329	1477	1661	1885
Growth (%)	3.7	11.1	12.5	13.5
Operating Expenses	1142	1266	1417	1585
EBITDA	187	211	244	301
Growth (%)	1.7	12.6	15.6	23.4
EBITDA Margin (%)	14.1	14.3	14.7	16.0
Depreciation	57.7	64.9	71.4	88.4
EBIT	130	146	172	212
Interest	23.4	15.2	19.1	21.2
Other Income	9.2	5.7	7.0	5.0
PBT	115	136	160	196
Tax	38.4	69.0	45.4	49.4
RPAT	77	67	115	147
Growth (%)	-7.5	59.5	-0.4	8.8
APAT	84.9	135.4	134.9	146.7
EPS	12.2	19.5	19.5	21.2

Source: Company, HDFC sec Research

Balance Sheet (Consolidated)

As at March	FY18	FY19	FY20E	FY21E
SOURCE OF FUNDS				
Share Capital	13.9	13.9	13.9	13.9
Reserves	426	554	651	759
Shareholders' Funds	440	568	664	773
Long Term Debt	182	113	124	138
Long Term Provisions & Others	71	72	66	84
Total Source of Funds	693	753	855	995
APPLICATION OF FUNDS				
Net Block	481	489	654	819
Deferred Tax Assets (net)	7	2	0	0
Long Term Loans & Advances	33	32	27	24
Total Non-Current Assets	521	523	681	843
Current Investments	0	0	0	0
Inventories	273	308	323	364
Trade Receivables	333	346	378	418
Short term Loans & Advances	69	49	46	41
Cash & Equivalents	14	8	5	11
Other Current Assets	101	127	101	76
Total Current Assets	790	837	854	910
Short-Term Borrowings	179	190	209	236
Trade Payables	264	242	289	324
Other Current Liab & Provisions	167	164	172	189
Short-Term Provisions	7	12	10	9
Total Current Liabilities	618	607	680	758
Net Current Assets	172	230	174	152
Total Application of Funds	693	753	855	995

Source: Company, HDFC sec Research

Cash Flow Statement (Consolidated)

(Rs Cr)	FY18	FY19	FY20E	FY21E
Reported PBT	115	209	180	196
Non-operating & EO items	32	20	-7	-5
Interest Expenses	23	15	19	21
Depreciation	58	65	71	88
Working Capital Change	-139	-64	54	27
Tax Paid	-38	-69	-45	-49
OPERATING CASH FLOW (a)	51	176	272	279
Capex	-83	-69	-236	-253
Free Cash Flow	-32	107	36	25
Investments	20	6	7	3
Non-operating income	9	6	7	5
INVESTING CASH FLOW (b)	-54	-57	-222	-245
Debt Issuance / (Repaid)	49	-68	5	31
Interest Expenses	-23	-15	-19	-21
FCFE	-6	24	21	36
Share Capital Issuance	0	0	0	0
Dividend	-24	-42	-38	-38
FINANCING CASH FLOW (c)	2	-124	-52	-28
NET CASH FLOW (a+b+c)	-1	-6	-3	6

Source: Company, HDFC sec Research

Key Ratios

(Rs Cr)	FY18	FY19	FY20E	FY21E
Profitability (%)				
EBITDA Margin	14.1	14.3	14.7	16.0
EBIT Margin	9.7	9.9	10.4	11.3
APAT Margin	5.8	9.5	8.1	7.8
RoE	20.7	12.5	19.4	20.4
RoCE	18.7	19.4	20.2	21.3
Solvency Ratio				
D/E	0.8	0.5	0.5	0.5
Interest Coverage	5.5	9.6	9.0	10.0
PER SHARE DATA				
EPS	12.2	19.5	19.5	21.2
CEPS	20.6	28.9	29.8	33.9
BV	64	82	96	112
Dividend	3.5	6.0	5.5	5.5
Turnover Ratios (days)				
Debtor days	92	86	83	81
Inventory days	73	72	71	71
Creditors days	128	106	107	108
Working Capital Days	37	51	47	44
VALUATION				
P/E	30.6	19.2	19.3	17.7
P/BV	5.9	4.6	3.9	3.4
Dividend Yield	0.9	1.6	1.5	1.5

Source: Company, HDFC sec Research

Ratings Chart

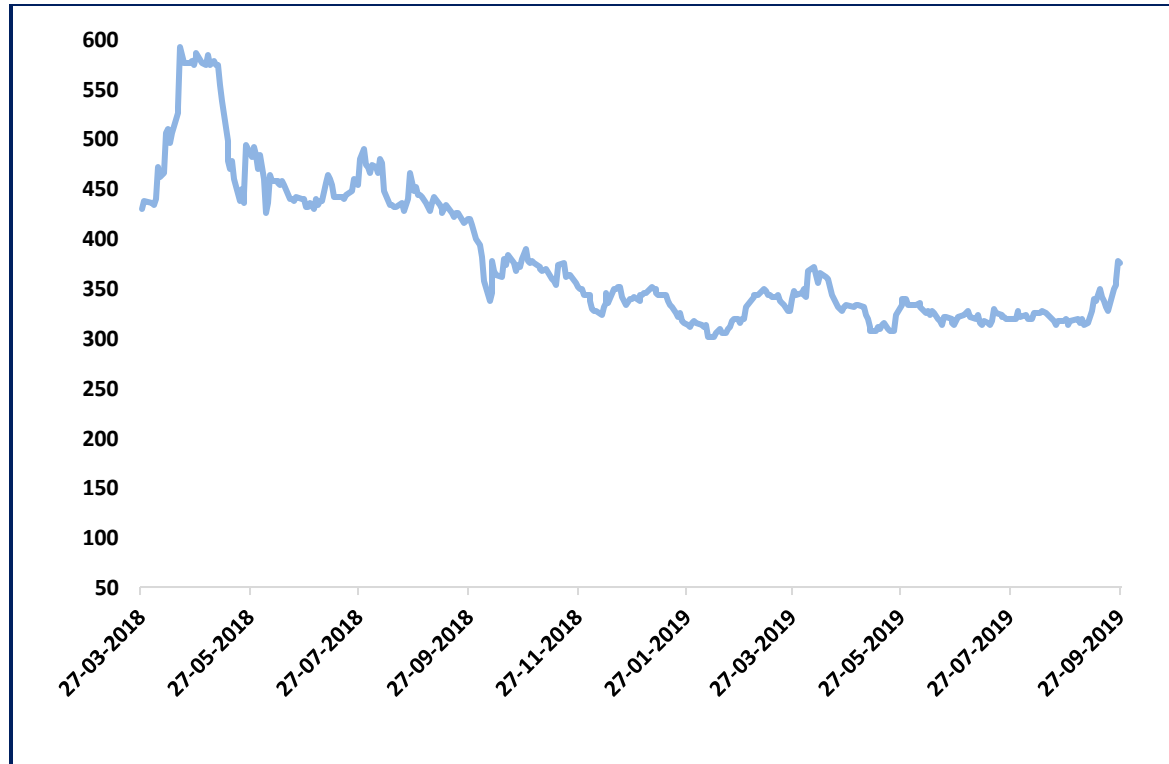
R E T U R N	HIGH			
	MEDIUM			
	LOW			
		LOW	MEDIUM	HIGH
		RISK		

Ratings Explanation:

RATING	Risk - Return	BEAR CASE	BASE CASE	BULL CASE
BLUE	LOW RISK - LOW RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 20% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 15% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 15%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 20% OR MORE
YELLOW	MEDIUM RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 35% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 20% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 35% OR MORE
RED	HIGH RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 50% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 30% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 50% OR MORE

Explanation of Red-flag Price level: **If stock prices starts sustaining below red-flag level, the premise of the investment needs to be reviewed. Risk averse investors should exit the stock and preserve capital. The downside of following red-flag level is that if the price decline turns out to be temporary and if it recovers subsequently, one won't be able to participate in the gains.**

Price Chart



Rating Definition:

Buy: Stock is expected to gain by 10% or more in the next 1 Year.

Sell: Stock is expected to decline by 10% or more in the next 1 Year.

Disclosure:

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Any holding in stock –No

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