

Strong demand across geographies drives growth...

Sudarshan Chemical's Q3FY21 results were higher than I-direct estimates on all fronts. Revenues grew 19.6% YoY to ₹ 506.4 crore (I-direct estimate: ₹ 464.3 crore) led by 22.1% growth in pigment segment to ₹ 477.1 crore amid revival in domestic demand and continuous traction in export markets. EBITDA margins improved 138 bps YoY to 15.7% (I-direct estimate: 15.7%) mainly due to lower other expenditure and partially offset by increase in raw material prices. PAT grew 38.4% YoY to ₹ 39.2 crore (I-direct estimate: ₹ 34.5 crore), in line with operational performance.

Favourable competitive landscape for Indian players

Indian pigment production has increased at a CAGR of ~8% in FY13-19 compared to global growth of 3-4%. This was on the back of: 1) strong demand from domestic end users, 2) global consolidation and exits of top players like BASF, Clariant to focus on different priorities besides unfavourable economies of scale and 3) diversification of end users' preference to India from China due to supply disturbances amid recurring issues like pollution concerns, US-China trade war and now Covid. Apart from the above factors, focus on fast growing organic segment (~84% of domestic production), cheap labour, strong technical capability and chemistry knowledge are add-on advantages for the Indian players.

Prime beneficiary due to leadership, capex

Sudarshan's estimated pigment volumes grew ~10% during same period, outpacing industry growth propelled by huge product offerings, robust cost and technical capability for consistent launches of new and customised products besides strong environmental compliance record. We believe the company is finely poised to reap the benefits of favourable macro factors and increasing domestic demand. Looking at the opportunities, Sudarshan has earmarked an aggressive capex plan of ₹ 585 crore (₹ 225 crore spent in FY20) largely spend on capacity addition for growth projects (new and existing) mainly in margin accretive HPP and speciality segments. Post pandemic, we expect the company to grow at ~12% CAGR in FY21-23E amid 20-25 annual new launches, capacity addition and strong demand.

Valuation & Outlook

The company's operations and demand from end users are reverting back to normal as the economy opens up. The company's H2 is also likely to benefit amid some pent-up demand. Owing to strong demand, the company is trying to expedite its growth capex plans of ₹ 585 crore (which have been bit delayed amid Covid), which gives strong visibility and management commitment towards future growth. Sudarshan's strong track record, with favourable macro factors and strong domestic demand are key catalysts for it. Margins are also likely to improve due to backward integration and change in product mix towards margin accretive products. We maintain **BUY** recommendation with a target price of ₹ 605 (24x FY23E EPS of ₹ 25.2) vs. earlier target price of ₹ 550.

Key Financial Summary

₹ Crore	FY20	FY21E	FY22E	FY23E	CAGR FY20-23 (%)
Revenues	1708.2	1796.3	2024.5	2261.2	9.8
EBITDA	246.3	280.3	320.7	375.4	15.1
EBITDA Margins (%)	14.4	15.6	15.8	16.6	
Net Profit	145.1	127.7	141.3	174.6	6.4
EPS (Adjusted)	18.5	18.4	20.4	25.2	
PE (x)	24.2	27.5	24.9	20.1	
EV to EBITDA (x)	16.2	14.5	13.1	11.0	
RoCE (%)	15.2	13.6	13.7	15.4	
RoE (%)	21.3	18.4	17.7	18.8	

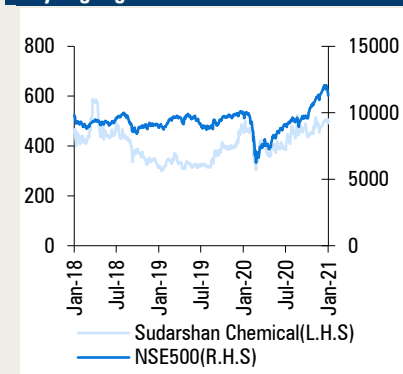
Source: ICICI Direct Research; Company

SUDARSHAN

Particulars

Particular	Amount
Market Capitalisation	₹ 3514 crore
Debt (FY20)	₹ 499 crore
Cash (FY20)	₹ 16 crore
EV	₹ 3997 crore
52 week H/L	538/290
Equity capital	₹ 13.8 crore
Face value	₹ 2

Key Highlights



Source: ICICI Direct Research, Company

Key risks to our call

- Slowdown in end user demand
- Higher than expected volatility in

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Exhibit 1: Variance Analysis

	Q3FY21	Q3FY21	Q3FY20	Q2FY21	YoY (%)	QoQ (%)	Comments
Revenue	506.4	464.3	423.5	428.9	19.6	18.1	YoY robust growth mainly due to demand pick-up in domestic market supported by steady demand from export markets. Beat vis-à-vis I-direct estimates mainly due to higher than expected demand in both domestic and export markets
Raw Material Expenses	289.7	260.0	241.2	239.4	20.1	21.0	
Gross margins (%)	42.8	44.0	43.0	44.2	-26 bps	-140 bps	Gross margins impacted amid increase in raw material prices and MEIS benefit gone away
Employee Expenses	42.9	38.5	35.3	36.5	21.5	17.4	YoY increase mainly due to annual increments and addition of head count
Other Expenditure	94.2	92.9	86.3	85.3	9.1	10.3	
Total Operating Expenditure	426.7	391.4	362.8	361.2	17.6	18.1	
EBITDA	79.6	72.9	60.8	67.7	31.0	17.7	
EBITDA (%)	15.7	15.7	14.3	15.8	138 bps	-5 bps	YoY improvement was mainly due to lower other expenditure, which was partially offset by higher raw material prices
Interest	4.6	5.1	3.8	5.1	21.5	-10.7	
Depreciation	21.7	21.9	17.8	21.9	21.8	-1.0	
Other income	2.6	1.4	1.4	1.8	83.7	40.7	
PBT before EO	55.9	47.3	40.6	42.5	37.8	31.7	
Less: Exceptional Items	0.0	0.0	0.0	0.0	0.0	0.0	
PBT	55.9	47.3	40.6	42.5	37.8	31.7	
Tax	16.8	12.8	12.3	12.1	36.4	38.2	
MI & Share of loss/ (gain) ass	0.0	0.0	0.0	0.0	0.0	0.0	
Adj. Net Profit	39.2	34.5	28.3	30.3	38.4	29.1	YoY growth mainly driven by strong operational performance and higher other income
Key Metrics							
Pigments	477.1	427.7	390.9	402.0	22.1	18.7	
Others	29.3	29.4	32.6	26.9	-10.2	8.8	

Source: ICICI Direct Research

Exhibit 2: Change in Estimates

(₹ Crore)	FY22E			FY23E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	1,973.5	2,024.5	2.6	2,206.4	2,261.2	2.5	
EBITDA	314.3	320.7	2.0	366.3	375.4	2.5	
EBITDA Margin (%)	15.9	15.8	-6 bps	16.6	16.6	0 bps	
PAT	142.7	141.3	-1.0	173.0	174.6	0.9	
EPS (₹)	20.6	20.4	-0.9	25.0	25.2	0.9	

Source: ICICI Direct Research

Conference Call Highlights

- Volume growth in specialty pigment was 21% YoY and 24% in non-specialty segment. Amid strong end user demand, the management expects similar strong growth in Q4 as well
- Export and domestic pigment mix was 44:56 in Q3FY21
- As per management, increase in raw material price is likely to take one quarter lag to pass on end users
- From the ₹ 585 crore of capex guidance – FY20 spent -- ₹ 225 crore, FY21 -- ₹ 150 crore and FY22 -- ₹ 210 crore
- 70% of this capex to be spent on growth projects, which it expects to generate 2-2.5x of assets turnover. Remaining capex is expected to be spent on infrastructure
- Full potential benefit of this capex will likely take two to three years
- Yellow Pigment – expects customer approval in FY22
- Expects 20-25 launches including four to five major high performance pigment in FY22
- Withdrawal of merchandise exports from India Scheme (MEIS) scheme impacted ₹ 2.4 crore in Q3. The company expects similar impact in Q4FY21

Exhibit 3: Trends in quarterly performance

(₹ crore)	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	YoY (%)	QoQ (%)
Total Operating Income	362.8	391.2	429.9	410.7	424.9	423.5	449.1	352.3	428.9	506.4	19.6	18.1
Raw Material Expenses	207.5	234.8	258.8	242.0	241.8	241.2	251.1	197.2	239.4	289.7	20.1	21.0
% of Revenue	57.2	60.0	60.2	58.9	56.9	57.0	55.9	56.0	55.8	57.2	26 bps	140 bps
Gross Profit	155.3	156.5	171.1	168.7	183.0	182.3	198.0	155.1	189.5	216.6	18.8	14.3
Gross Profit Margin (%)	42.8	40.0	39.8	41.1	43.1	43.0	44.1	44.0	44.2	42.8	-26 bps	-140 bps
Employee Expenses	28.7	35.2	26.6	34.1	35.2	35.3	41.1	36.8	36.5	42.9	21.5	17.4
% of Revenue	7.9	9.0	6.2	8.3	8.3	8.3	9.2	10.4	8.5	8.5	14 bps	-5 bps
Other Expenditure	80.2	81.6	80.8	72.0	81.5	86.3	102.9	65.3	85.3	94.2	9.1	10.3
% of Revenue	22.1	20.8	18.8	17.5	19.2	20.4	22.9	18.5	19.9	18.6	-177 bps	-130 bps
Total Expenditure	316.4	351.5	366.2	348.2	358.6	362.8	395.1	299.3	361.2	426.7	17.6	18.1
% of Revenue	87.2	89.9	85.2	84.8	84.4	85.7	88.0	85.0	84.2	84.3	-138 bps	5 bps
EBITDA	46.4	39.7	63.7	62.6	66.3	60.8	54.0	53.0	67.7	79.6	31.0	17.7
EBITDA Margin (%)	12.8	10.1	14.8	15.2	15.6	14.3	12.0	15.0	15.8	15.7	138 bps	-5 bps
Depreciation	15.9	16.7	16.9	17.0	17.1	17.8	21.6	21.6	21.9	21.7	21.8	-1.0
Interest	2.6	4.5	5.1	3.7	3.7	3.8	3.0	3.9	5.1	4.6	21.5	-10.7
Other Income	7.5	2.2	3.8	20.2	1.5	1.4	1.0	0.3	1.8	2.6	83.7	40.7
Less: Exceptional Items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
PBT	35.5	20.6	45.5	62.0	47.0	40.6	30.4	27.8	42.5	55.9	37.8	31.7
Total Tax	10.9	2.7	19.7	19.3	0.8	12.3	3.0	9.6	12.1	16.8	36.4	38.2
Tax rate (%)	30.6	13.1	43.3	31.1	1.6	30.3	10.0	34.5	28.6	30.0	-30 bps	141 bps
PAT	24.6	17.9	25.8	42.7	46.2	28.3	27.3	18.2	30.3	39.2	38.4	29.1
PAT Margin (%)	6.8	4.6	6.0	10.4	10.9	6.7	6.1	5.2	7.1	7.7	105 bps	66 bps
EPS (₹)	3.6	2.6	3.7	6.2	6.7	4.1	3.9	2.6	4.4	5.7		

Source: ICICI Direct Research

Company Background

Sudarshan Chemicals is a significant part of the Pune-based Rathi Group, established in 1951. The company is currently a market leader in the Indian pigment industry with 35% market share and fourth-largest player (will become third largest post completion of BASF business acquisition by DIC) in the world. It has a wide portfolio of 4,000+ varieties of products of Azos, blue and green, high performance pigments (HPPs), effects, pigment preparations and inorganics. Among end users, coatings industries contribute highest followed by plastics, Inks, cosmetics other applications. It produces a range of classical organic pigments for coloration of publication and commercial printing inks for magazines, direct mail and other commercial printing. Sudarshan offers its pigments under various brands, including Sudaperm, Sudafast, Sudacolor, Sudadur, Sudafine, Sumicos, Prestige and Sumica. The company exports (45% of revenues) to 85+ countries and has offices in the US, Europe, China, Mexico and Japan. Apart from increasing end user demand of pigments in Asian markets, Sudarshan is also prime beneficiary of exit of global giants (BASF, Clariant), recurring issues in China (including China-US trade war) mainly due to its leadership position, low cost advantage, wide product basket and technical capability.

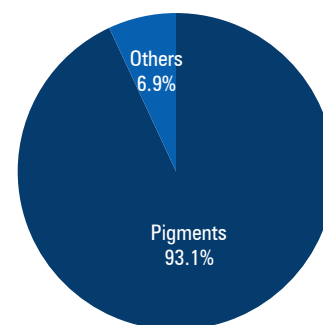
The company owns two manufacturing plants in Roha and Mahad, Maharashtra. Sudarshan manufactures azo, HPPs and effect pigments at the Roha plant. At the Mahad plant it manufactures blue and green, HPPs and effect pigments. The company's plants have been '5-Star Certified' by British Safety Council and have also been awarded the prestigious Sword of Honour. Sudarshan has an R&D centre in Sutarwadi (Pune), which houses over 50 technologists and has additional 50 chemists in the R&D and quality control labs in Roha & Mahad who are working on new and customised solutions.

Exhibit 4: Timeline of events

Years	Details
1951	Established as Sudarshan Chemical Industries Private Limited
1952	Started first manufacturing facility in Swargate, Pune
1967	Commenced exporting globally
1973	Inaugurated manufacturing facility at Roha
1976	Got listed on BSE
1989	Collaborated with the world leader, DIC, Japan
1994	Initiated manufacturing plant in Mahad for Pthalos and Effect pigments
2006	Created a state-of-the-art technology R&D centre at Sutarwadi
2007	Established subsidiary Sudarshan Europe BV
2009	Expanded footprints in the USA, incorporation of Sudarshan North America
2018	Established Sudarshan Mexico
2018	Became number 4 in pigment industry
2019	Sudarshan established laboratory in Germany
2020	Established Sudarshan Japan K.K.

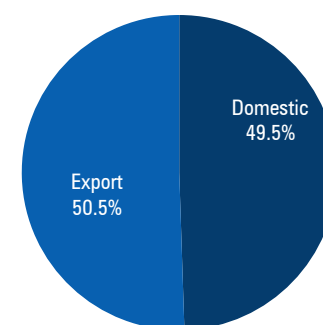
Source: ICICI Direct Research, Company

Revenue Bifurcation



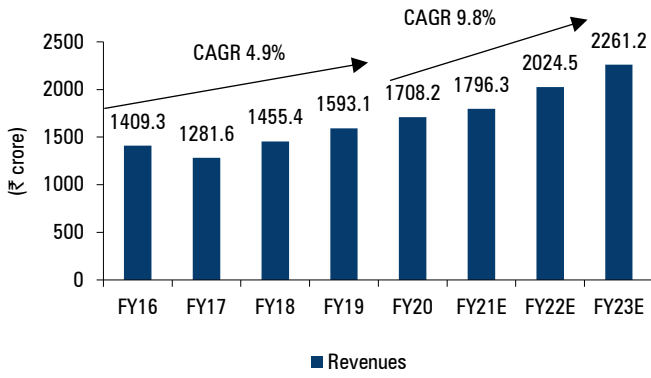
Source: ICICI Direct Research, Company

Geographical Bifurcation



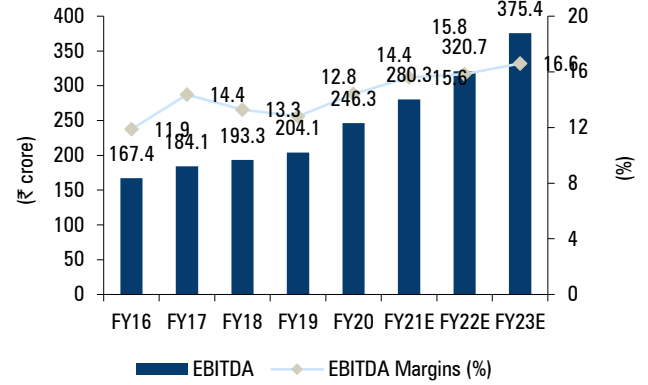
Source: ICICI Direct Research, Company

Exhibit 5: Revenues to grow at 10% CAGR in FY20-23E



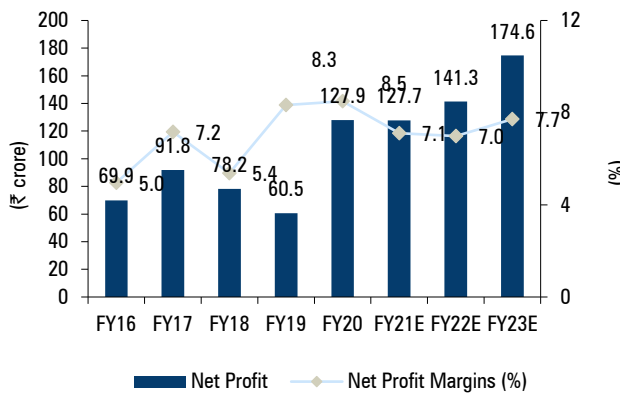
Source: ICICI Direct Research, Company; *Ex demerged entity

Exhibit 6: EBITDA & EBITDA margins trend



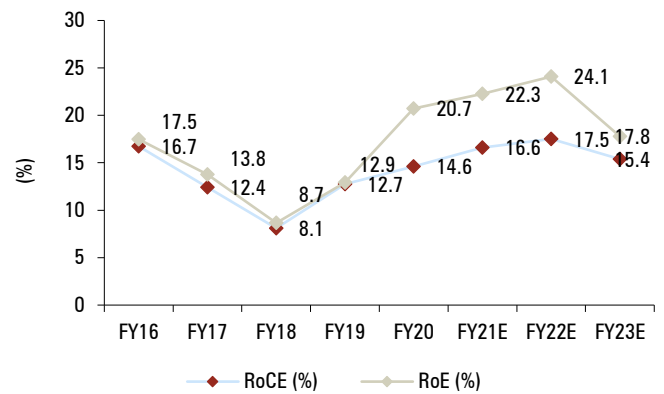
Source: ICICI Direct Research, Company

Exhibit 7: PAT & PAT margins trend



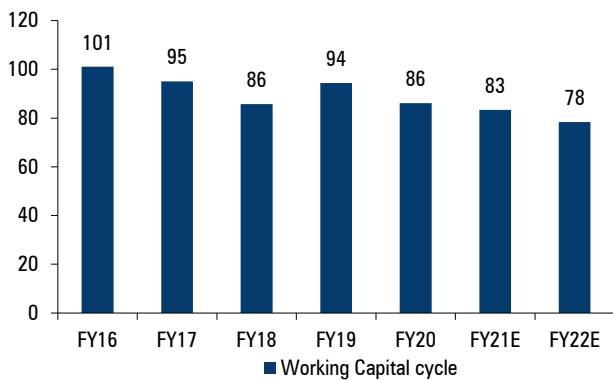
Source: ICICI Direct Research, Company

Exhibit 8: RoE & RoCE trend



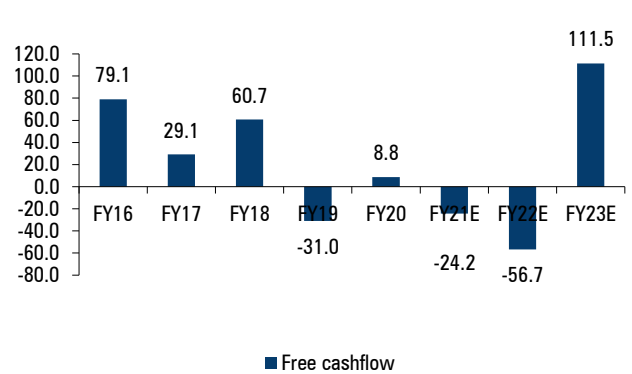
Source: ICICI Direct Research, Company

Exhibit 9: Working capital cycle



Source: ICICI Direct Research, Company

Exhibit 10: Aggressive capex to impact free cash flow



Source: ICICI Direct Research, Company

Financial Summary

Exhibit 11: Profit and loss statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Total Operating Income	1,708.2	1,796.3	2,024.5	2,261.2
Growth (%)	7.2	5.2	12.7	11.7
Raw Material Expenses	976.2	1,010.2	1,133.7	1,266.3
Gross Profit	732.0	786.1	890.8	994.9
Gross Profit Margins (%)	42.9	43.8	44.0	44.0
Employee Expenses	145.8	159.2	179.5	208.0
Other Expenditure	340.0	346.5	390.6	411.5
Total Operating Expenditure	1,461.9	1,516.0	1,703.7	1,885.8
EBITDA	246.3	280.3	320.7	375.4
Growth (%)	20.7	13.8	14.4	17.0
Interest	14.2	18.2	19.6	19.6
Depreciation	73.5	86.8	106.5	117.8
Other Income	4.7	5.8	1.6	4.5
PBT before Exceptional Item	163.2	181.0	196.3	242.6
Less: Exceptional Items	-17.2	0.0	0.0	0.0
PBT after Exceptional Items	180.4	181.0	196.3	242.6
Total Tax	35.4	53.3	55.0	67.9
PAT before MI	145.1	127.7	141.3	174.6
PAT	145.1	127.7	141.3	174.6
Growth (%)	9.3	-12.0	10.7	23.6
EPS (Adjusted)	18.5	18.4	20.4	25.2

Source: ICICI Direct Research

Exhibit 12: Cash Flow Statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Profit/(Loss) after taxation	101.7	127.7	141.3	174.6
Add: Depreciation & Amortiza	73.5	86.8	106.5	117.8
Net Increase in Current Asset	-51.0	-27.9	-75.5	-103.9
Net Increase in Current Liabili	101.8	21.0	51.5	53.4
Others	36.6	18.2	19.6	19.6
CF from Operating activities	262.6	225.8	243.3	261.5
Investments	0.0	0.0	0.0	0.0
(Purchase)/Sale of Fixed Ass	-253.8	-250.0	-300.0	-150.0
Others	41.4	-0.5	-0.5	-0.5
CF from Investing activities	-212.4	-250.5	-300.5	-150.5
(inc)/Dec in Loan	75.1	200.0	0.0	0.0
Dividend & Dividend tax	-100.2	-32.9	-36.4	-45.0
Other	-14.2	-18.2	-19.6	-19.6
CF from Financing activities	-39.4	148.9	-56.0	-64.6
Net Cash Flow	10.9	124.2	-113.1	46.4
Cash and Cash Equivalent	4.8	15.6	139.8	26.7
Cash	15.6	139.8	26.7	73.2
Free Cash Flow	8.8	-24.2	-56.7	111.5

Source: ICICI Direct Research

Exhibit 13: Balance Sheet				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Equity Capital	13.9	13.9	13.9	13.9
Reserve and Surplus	586.9	681.7	786.7	916.3
Total Shareholders funds	600.8	695.6	800.5	930.1
Total Debt	498.6	698.6	698.6	698.6
Deferred Tax Liability	50.1	51.1	52.1	53.2
Long-Term Provisions	15.7	16.1	16.4	16.7
Other Non Current Liabilities	3.6	3.7	3.7	3.8
Source of Funds	1,168.8	1,465.0	1,571.3	1,702.4
Gross Block - Fixed Assets	870.2	1,120.2	1,420.2	1,570.2
Accumulated Depreciation	245.3	332.1	438.7	556.4
Net Block	624.9	788.0	981.5	1,013.8
Capital WIP	48.0	48.0	48.0	48.0
Fixed Assets	672.8	836.0	1,029.5	1,061.7
Investments	0.9	0.9	0.9	0.9
Other non-Current Assets	92.2	94.1	95.9	97.9
Inventory	410.7	418.3	443.7	495.6
Debtors	364.1	382.8	431.5	481.9
Other Current Assets	73.3	74.8	76.3	77.8
Cash	15.6	139.8	26.7	73.2
Total Current Assets	863.7	1,015.8	978.2	1,128.5
Creditors	371.7	390.9	440.5	492.0
Provisions	7.1	7.2	7.3	7.5
Other Current Liabilities	82.1	83.7	85.4	87.1
Total Current Liabilities	460.8	481.8	533.2	586.6
Net Current Assets	402.8	534.0	445.0	541.9
Application of Funds	1,168.8	1,465.0	1,571.3	1,702.4

Source: ICICI Direct Research

Exhibit 14: Ratio Analysis				
(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
Reported EPS	21.0	18.4	20.4	25.2
Cash EPS	10.9	13.7	15.2	18.7
BV per share	86.8	100.5	115.6	134.4
Cash per Share	2.3	20.2	3.9	10.6
Dividend per share	7.6	4.8	5.3	6.5
Operating Ratios (%)				
Gross Profit Margins	42.9	43.8	44.0	44.0
EBITDA margins	14.4	15.6	15.8	16.6
PAT Margins	7.5	7.1	7.0	7.7
Cash Conversion Cycle	86.1	83.4	78.4	78.4
Asset Turnover	2.0	1.6	1.4	1.4
EBITDA conversion Rate	106.6	80.6	75.9	69.7
Return Ratios (%)				
RoE	21.3	18.4	17.7	18.8
RoCE	15.2	13.6	13.7	15.4
RoIC	15.6	15.1	14.3	16.3
Valuation Ratios (x)				
P/E	24.2	27.5	24.9	20.1
EV / EBITDA	16.2	14.5	13.1	11.0
EV / Net Sales	2.3	2.3	2.1	1.8
Market Cap / Sales	2.1	2.0	1.7	1.6
Price to Book Value	5.8	5.1	4.4	3.8
Solvency Ratios				
Debt / EBITDA	2.0	2.5	2.2	1.9
Debt / Equity	0.8	1.0	0.9	0.8
Current Ratio	1.8	1.8	1.8	1.8
Quick Ratio	0.9	0.9	1.0	1.0

Source: ICICI Direct Research

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Buy: >15%;

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%



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