

Weak performance; margin recovery key to watch...

About the stock: Established in 1951, Sudarshan Chemical is a leading player in the Indian colour pigment industry with ~35% market share and is also among the top four players globally.

- 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 and other applications

Q2FY23 Results: Sudarshan Chemical's numbers came in below our estimates, while EBITDA margins were marginally above our estimates.

- Reported revenue growth of 6.1% YoY to ₹ 528.4 crore, led by higher growth from engineering (up 4.8% YoY) & pigments (up 6.2% YoY)
- Gross margins fell 360 bps YoY to ~38.7% while EBITDA margins contracted 250 bps YoY to 8.1% due to higher COGS (+12.7% YoY)
- EBITDA declined 18.9% YoY to ₹ 42.9 crore. The decline was led by elevated level of Input costs and energy cross across multiple intermediates
- PAT was down 80% YoY to ₹ 4.5 crore

What should investors do? The stock depreciated at 0.2% CAGR in last three years.

- Maintain **HOLD** as we believe margin recovery is key besides sustained revenue traction

Target Price and Valuation: We value Sudarshan Chemicals at 16x P/E FY24E EPS to arrive at a revised target price of ₹ 385/share (earlier ₹ 515/share).

Key triggers for future price performance:

- Upcoming capex bodes well for speciality pigments revenue growth
- Higher share of value added business portfolio expected to improve margin profile of the business
- Allocation of incremental FCF towards organic/inorganic growth likely to expand return ratios further

Alternate Stock Idea: Apart from Sudarshan Chemical, in our chemical coverage we also like Neogen Chemical.

- For Neogen Chemical, future revenue growth is expected to be driven by increasing custom synthesis opportunity
- BUY with a target price of ₹ 1680

SUDARSHAN

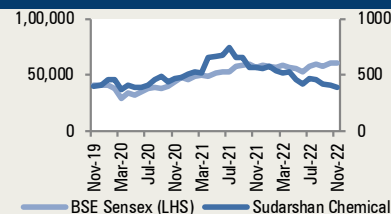
Particulars

Particular	Amount
Market cap (₹ Crore)	2,740
FY22 Total Debt (₹ Crore)	823
FY22 Cash & Inv (₹ Crore)	35
EV (₹ Crore)	3,528
52 Week H/L	640/393
Equity Capital (₹ Crore)	13.8
Face Value (₹)	2

Shareholding pattern

in %	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	35.7	35.8	35.8	35.8
DII	10.9	11.5	13.0	14.2
FII	8.5	7.9	6.0	4.2
Others	44.9	44.7	45.1	45.8

Price Chart



Recent event & key risks

- Input price inflation will be passed on during subsequent quarters
- Key Risk:** (i) Higher RMAT prices and inability to pass on to impact gross margins (ii) Slowdown in end user demand

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Revenue	1,593.1	1,708.2	1,864.1	2,200.8	11.4%	2,314.6	2,661.4	10.0%
EBITDA	204.1	246.3	287.8	274.8	7.8%	254.3	346.2	12.2%
EBITDA Margins (%)	12.8%	14.4%	15.4%	12.5%		11.0%	13.0%	
Adj.PAT	132.8	145.1	141.1	130.0	5.2%	72.6	165.9	13.0%
Adj. EPS (₹)	8.7	18.5	20.4	18.8		10.5	24.0	
EV/EBITDA	18.2x	14.6x	12.9x	14.2x		15.0x	10.7x	
P/E	65.3x	21.5x	22.1x	24.0x		42.9x	18.8x	
ROE (%)	10.7	21.3	19.0	15.6		8.2	16.4	
ROCE (%)	14.4	15.2	14.4	10.9		8.8	13.6	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlight

Q2FY23 Results: EBITDA margins impacted by escalation hike in RMAT, energy and logistics cost

- **Pigment business:** Revenues were up 6.2% YoY to ₹ 476.2 crore of which domestic revenues was down 2% YoY to ₹ 235 crore and export revenues were up 16% YoY to ₹ 242 crore, respectively. Revenue from the speciality pigment increased 10% YoY to ₹ 331 crore while the same from non-speciality pigment was down 1% YoY to ₹ 145 crore
- **Gross margins remain soft:** Although the management sounded confident of passing on higher input cost, there has been a fall in GPM by 360 bps YoY. Intermediates price increase pass through continued through Q2FY23. We expect part of this to be on account of a lag in passing on input price inflation. Moreover, higher energy and logistic cost also remains a key challenge for a subdued marginal performance. OPM contracted 250 bps YoY to 8.1%

Q2FY23 Earnings Conference Call highlights

Management comment on Q2FY23

- Escalation due to coal and logistics continues to impact EBITDA margins. Here, the company is unable to pass on the price hike of coal and logistics to its European customers
- Lower inventory at sales end is impacting the pricing volatility
- Demand slowing down for pigments from plastics industry leading to lower growth. Significant revenues from the domestic market were derived from the plastic industry. Demand was worst in the last quarter
- The management failed in anticipating the cost of RMAT and energy

Market outlook

- Export demands looks subdued
- Domestic demand is expected to start recovering from Q3. Largely the company expects growth to come from Q3. Good demand for red/yellow pigments can be expected in Q3
- The management believes there will be no more margin contraction from this level as raw materials have started to decline, which will help the company to maintain its margins

Capex - Update

- Total capex plan is ~₹ 750 crore of which total capex incurred ₹ 730 crore
- Capex overall revenue potential is estimated at ~₹ 1500 crore out of which ~₹ 600 crore is from new products. Fundamentals on new project are strong

Pigment industry view

- Global colour pigments market is ~\$10 billion and is expected to grow at ~3% CAGR over the next five years
- Input costs continue at an elevated level across multiple intermediates
- Impact due to coal and logistics cost escalation continuing
- Subdued demand across geographies and segments resulting in pricing pressure
- Geopolitical risk for potential cost inflation and demand side impacts

Demand outlook for new product

- New products were targeted. New plants to be commissioned in Q3
- Ramp up is anticipated to be faster on new products. No large growth is expected on existing products

Speciality revenue performance

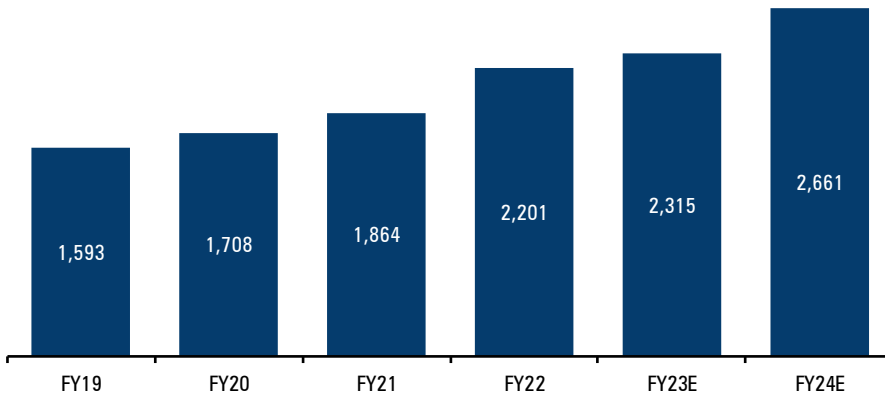
- Printing - Normal
- Coatings - Normal
- Plastic – Subdued. Demand was worst in Q1
- Cosmetic – Performing well

Others

- Engineering business – It is not seasonal as it is on project business. No such demand issue has been addressed as such
- Cost of debt for new products capex is ~4-4.5%
- Cash conversion cycle has increased from 96 days to 114 days led by reduction in creditors time cycle by 15 days

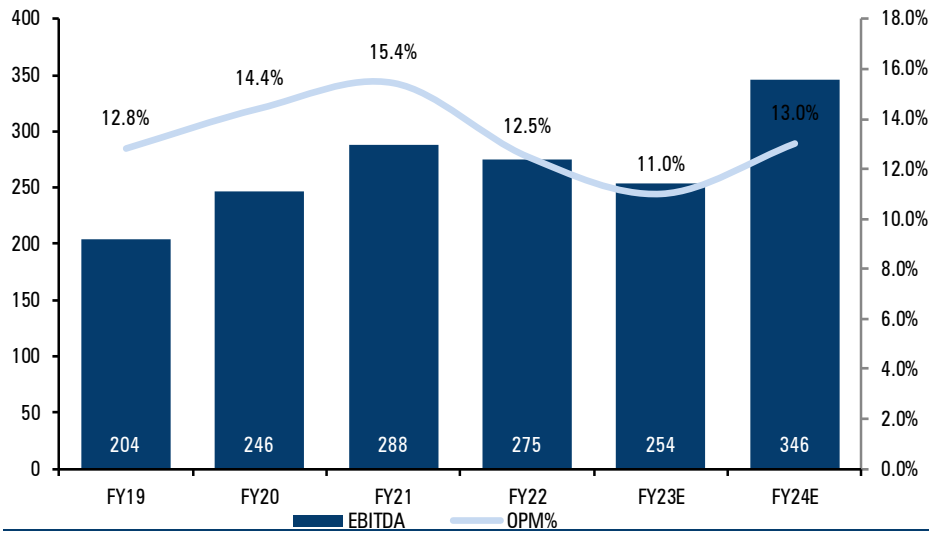
Financial story in charts....

Exhibit 1: Revenue trend (₹ crore)



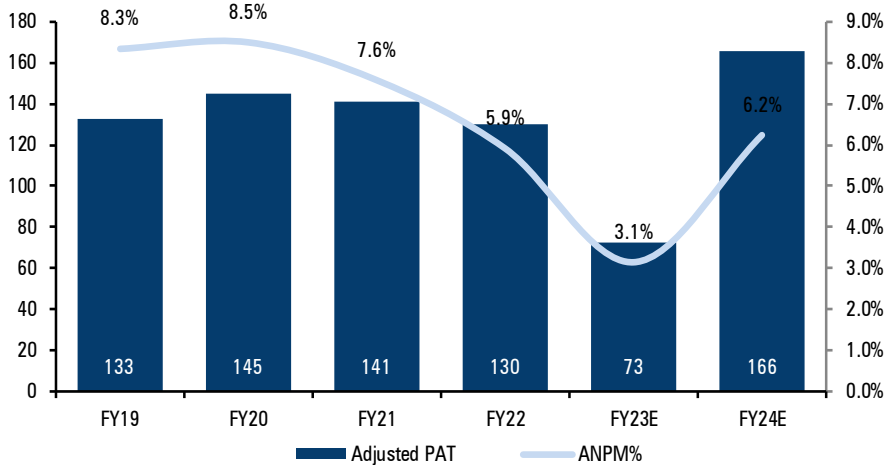
Source: Company, ICICI Direct Research

Exhibit 2: EBITDA (₹ crore) and OPM (%) trend



Source: Company, ICICI Direct Research

Exhibit 3: PAT growth trend (₹ crore)



Source: Company, ICICI Direct Research

Financial summary

Exhibit 4: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Total Operating Income	1,864.1	2,200.8	2,314.6	2,661.4
Growth (%)	9.1	18.1	5.2	15.0
Raw Material Expenses	1,060.5	1,270.4	1,375.1	1,546.0
Gross Profit	803.7	930.4	939.5	1,115.4
Gross Profit Margins (%)	43.1	42.3	40.6	41.9
Employee Expenses	155.7	184.0	192.8	223.6
Other Expenditure	360.2	471.6	492.4	545.6
Total Operating Expenditure	1,576.4	1,926.0	2,060.3	2,315.1
EBITDA	287.8	274.8	254.3	346.2
Growth (%)	16.8	-4.5	-7.5	36.1
Interest	17.9	19.4	26.2	18.4
Depreciation	86.5	89.3	110.8	120.0
Other Income	7.0	5.0	8.4	13.3
PBT before Exceptional Item	190.4	171.1	125.8	221.1
Less: Exceptional Items	0.0	0.0	0.0	0.0
PBT after Exceptional Items	190.4	171.1	125.8	221.1
Total Tax	49.3	41.2	53.2	55.3
PAT before MI	141.1	130.0	72.6	165.9
PAT	141.1	130.0	72.6	165.9
Growth (%)	-2.7	-7.9	-44.2	128.5
EPS (Adjusted)	20.4	18.8	10.5	24.0

Source: Company, ICICI Direct Research

Exhibit 5: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit/(Loss) after taxation	151.6	171.1	72.6	165.9
Add: Depreciation & Amortization	86.5	89.3	110.8	120.0
Net Increase in Current Assets	-176.1	-143.1	-57.2	-170.2
Net Increase in Current Liabilities	85.4	82.8	28.8	84.1
Others	17.8	-22.0	26.2	18.4
CF from Operating activities:	165.2	178.1	181.1	218.1
Investments	0.0	0.0	0.0	0.0
(Purchase)/Sale of Fixed Assets	-269.6	-310.2	-50.0	-50.0
Others	4.2	3.6	1.2	1.2
CF from Investing activities	-265.4	-306.6	-48.8	-48.8
(inc)/Dec in Loan	126.3	198.3	-80.0	-100.0
Dividend & Dividend tax	-0.4	-41.1	-18.7	-42.7
Other	-17.4	-19.4	-26.2	-18.4
CF from Financing activities	108.5	137.8	-124.9	-161.1
Net Cash Flow	8.2	9.3	7.4	8.2
Cash and Cash Equivalent	15.6	23.8	35.3	42.7
Cash	23.8	33.2	42.7	50.9
Free Cash Flow	-104.4	-132.1	131.1	168.1

Source: Company, ICICI Direct Research

Exhibit 6: Balance sheet				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Equity Capital	13.8	13.8	13.8	13.8
Reserve and Surplus	729.7	819.3	873.2	996.3
Total Shareholders funds	743.6	833.2	887.1	1,010.2
Total Debt	614.6	819.3	739.3	639.3
Deferred Tax Liability	52.9	59.5	60.7	61.9
Long-Term Provisions	23.9	26.4	26.9	27.4
Other Non Current Liabilities	15.5	17.5	17.8	18.2
Source of Funds	1,450.5	1,755.8	1,731.7	1,757.0
Gross Block - Fixed Assets	939.9	1,177.6	1,437.6	1,562.3
Accumulated Depreciation	331.8	352.9	463.6	583.6
Net Block	608.0	824.8	974.0	978.7
Capital WIP	278.3	284.7	74.7	0.0
Goodwill	6.8	6.8	6.8	6.8
Fixed Assets	893.2	1,116.3	1,055.6	985.6
Investments	1.3	1.7	1.7	1.7
Other non-Current Assets	77.3	45.6	46.5	47.5
Inventory	411.6	566.0	595.2	684.4
Debtors	484.7	500.7	526.5	605.4
Other Current Assets	111.5	103.2	105.3	107.4
Cash	23.8	35.3	42.7	50.9
Total Current Assets	1,031.6	1,205.1	1,269.7	1,448.1
Creditors	441.1	521.8	548.7	631.0
Provisions	2.3	2.5	2.5	2.6
Other Current Liabilities	109.4	88.7	90.5	92.3
Total Current Liabilities	552.9	612.9	641.7	725.8
Net Current Assets	478.7	592.2	628.0	722.3
Application of Funds	1,450.5	1,755.8	1,731.7	1,757.0

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
Reported EPS	20.4	18.8	10.5	24.0
Cash EPS	15.1	13.9	7.8	17.8
BV per share	107.4	120.4	128.1	145.9
Cash per Share	3.4	5.1	6.2	7.3
Dividend per share	5.3	4.8	2.7	6.2
Operating Ratios (%)				
Gross Profit Margins	43.1	42.3	40.6	41.9
EBITDA margins	15.4	12.5	11.0	13.0
PAT Margins	7.6	5.9	3.1	6.2
Cash Conversion Cycle	89.1	90.4	90.4	90.4
Asset Turnover	2.0	1.9	1.6	1.7
EBITDA conversion Rate	57.4	64.8	71.2	63.0
Return Ratios (%)				
RoE	19.0	15.6	8.2	16.4
RoCE	14.4	10.9	8.8	13.6
RoIC	17.5	12.9	8.9	13.3
Valuation Ratios (x)				
P/E	22.1	24.0	42.9	18.8
EV / EBITDA	12.9	14.2	15.0	10.7
EV / Net Sales	2.0	1.8	1.6	1.4
Market Cap / Sales	1.7	1.4	1.3	1.2
Price to Book Value	4.2	3.7	3.5	3.1
Solvency Ratios				
Debt / EBITDA	2.1	3.0	2.9	1.8
Debt / Equity	0.8	1.0	0.8	0.6
Current Ratio	1.8	1.9	1.9	1.9

Source: Company, ICICI Direct Research

Exhibit 8: ICICI Direct coverage universe (Chemicals)

Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
SRF	2482	2,900	Buy	73,579	63.5	61.1	81.3	39.1	40.6	30.5	24.2	24.5	18.7	23.8	19.6	22.6	22.1	18.4	20.5
PI Industries	3620	3,930	Hold	54,922	55.5	70.9	87.2	65.2	51.0	41.5	46.4	37.0	29.8	16.3	17.9	19.0	13.8	15.1	15.8
Aarti Industries	768	885	Hold	27,822	36.1	25.1	31.6	22.7	32.7	25.9	24.0	19.6	16.0	12.0	13.0	13.9	13.3	13.5	14.8
Tata Chemical	1134	1,345	Buy	28,832	47.5	61.2	70.7	23.9	18.5	16.0	14.4	11.1	8.5	6.6	8.1	8.8	6.6	8.0	8.6
Vinati Organics	1981	2,320	Buy	20,366	33.7	40.1	51.5	56.0	47.1	36.7	44.7	37.0	28.3	24.3	23.2	23.9	19.0	19.1	20.5
Sumitomo Chemical	493	570	Buy	24,735	8.5	11.2	12.9	58.1	44.1	38.3	40.3	31.0	26.6	30.2	30.9	28.7	22.0	23.0	21.4
Navin Fluorine	4400	4,570	Hold	21,738	52.3	64.4	91.4	84.2	68.3	48.1	61.2	45.5	31.3	17.8	18.0	20.1	14.0	15.2	18.4
Rallis India	227	250	Hold	4,420	8.4	8.9	12.4	26.9	25.6	18.3	15.5	15.6	11.1	12.7	11.6	15.3	9.7	9.5	12.1
Sudarshan chemical	391	383	Hold	2,740	18.8	10.5	24.0	24.0	42.9	18.8	14.2	15.0	10.7	10.9	8.8	13.6	15.6	8.2	16.4
Neogen Chemicals	1413	1,680	Buy	3,523	17.9	27.2	32.9	79.5	52.2	43.2	41.8	30.2	25.0	12.0	15.0	16.2	10.2	13.6	14.3
Astec Lifesciences	2134	2,186	Hold	4,184	45.1	53.0	66.3	47.3	40.2	32.2	28.9	24.9	19.8	19.3	17.2	18.8	22.3	20.8	20.6

Source: Bloomberg, ICICI Direct Research

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Sell: <-15%



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