SMART SYNC SERVICES

Sudarshan Chemicals Q1FY21

Financial Results & Highlights

Brief Introduction:

Sudarshan Chemical Industries is manufactures and sells a wide range of Organic and Inorganic Pigments, Effect Pigments and Agro Chemicals. The Company also manufactures Vessels and Agitators for industrial applications.

Standalone Financials (In Crs)					
	Q1FY21	Q1FY20	YoY %	Q4FY20	QoQ %
Sales	332	384	-13.54%	370	-10.27%
PBT	33	63*	-47.62%	32	3.13%
PAT	24	45	-46.67%	34	-29.41%
Consolidated Financials (In Crs)					
	Q1FY21	Q1FY20	YoY %	Q4FY20	QoQ %
Sales	353	412	-14.32%	450	-21.56%
PBT	28	63*	-55.56%	30	-6.67%
PAT	19	43	-55.81%	27	-29.63%

*Includes exceptional item of Rs 19.32 Cr from the sale of its Industrial Mixing Solutions Division

Detailed Results:

1. Consolidated revenues were down 14.3% YoY. Profit was down 56% YoY and 29.6% QoQ in Q1.
2. EBITDA margin for Q1 was down 40 bps YoY to 15%. Without COVID-19, the EBITDA margin was expected to be at 15.4%. It is estimated that the plant shutdown caused a revenue loss of Rs 45 Cr and an EBITDA loss of Rs 12 Cr.
3. Exports stood at 64% of revenues in Q1 while 36% were from domestic sales.
4. Specialty chemicals continue to have stronger traction and saw lower de-growth as compared to non-specialty chemicals.
5. EBITDA for pigment business improved 370 bps QoQ but declined 60 bps YoY to 15.7% in Q1. Without COVID-19, this figure was expected to be at 17.1%. The estimated revenue loss and EBITDA loss in this business from COVID-19 were at Rs 45 Cr and 12 Cr respectively.
6. Gross margins improved to 44% in Q1 vs 41.1% a year ago.
7. ROCE declined to 11% in Q1 vs 14.6% a year ago.
8. Debt to equity was at 0.9 times.
9. Earnings per share declined to Rs 2.6 in Q1 from Rs 4.1 last year.
10. 15 days of production loss due to plant closure at Roha (Covid-19) in July, is expected to made up during Q2. The closure was due to Cyclone Nisarga.

Investor Conference Call Highlights

1. The improvement in gross margin is because of a continuous improvement in product mix and prudent pricing strategies. Margins have also benefited from a relatively stable raw material environment during the quarter.
2. The company is looking to reduce dependency on China for RM and is well stocked in major supplies for a while.
3. There hasn't been any major change in capex plans. Only the plans have gotten delayed by 6 months due to no availability of labour and the requirement for some of the commissioning of equipment where some of the company's people need to travel abroad.
4. The management maintains that there is indeed some tailwind for the Indian Chemicals industry from the China substitution phenomenon. The company is focussing on growing globally in the top 3 global players in the pigment industry. This is expected to involve the introduction of a much better product portfolio looking at some areas where the company can gain cost leadership.
5. Revenues for some of the previously guided blockbuster products will start coming in from next year onwards as these product launches may have been delayed from the delay in capex due to COVID-19.
6. The capex outflow in FY21 remains at Rs 250 Cr.
7. Net debt at the end of Q1 was at Rs 500 Cr.
8. The management expects to reach pre-COVID levels of production soon.
9. Domestic demand had recovered to 70-80% of last year in July. This is expected to rise to 90-100% in August.
10. In RM side, things are expected to stay stable at current levels going forward according to the management. Thus the management also expects current margins to persist going forward.
11. The biggest impact for the company is from the customer segment of the auto while the least impact in packaging as food packaging demand has risen.
12. The management maintains that the customers do not have enough bandwidth currently in labs to test the new products. Thus the company will be looking to focus on scaling production. As mentioned earlier, the realization for these new products is expected to be delayed by 4-6 months.
13. A very small amount of the company's capex in the next 2 years is for import substitution. Most of it is towards revenue generation and the introduction of new products and backward integration.
14. The pricing of products is expected to remain stable going forward. The company has taken price hikes in only a couple of products so far.
15. The revenue loss if Rs 45 Cr mentioned above is from plant shutdown
16. The management remains confident of making up for the production losses in Q2 and assures that the company has adequate capacity to fulfill this aim.
17. The management has stated that the third-largest player in pigments has sales of $500 million.

18. Most of the export traction for the company is coming from the USA, EU, and some parts of SE Asia.
19. The main areas the company is focussing on to drive its aim to crack the top 3 in the pigment industry are go-to-market experience & reach, comprehensive product portfolio, and cost leadership through backward integration.
20. The company is already looking at JVs for backward integration. It has also set up a special cell in R&D to develop some of these technologies that will focus on backward integration. This has already been done for 2-3 minor molecules.
21. Out of the company's proposed multi-year capex plan of Rs 1400 Cr, around Rs 450 Cr is already done while Rs 340 Cr is currently under execution.
22. The management has clarified that the revenue loss of Rs 45 Cr was for 1 week in June from Cyclone Nisarga. There will also be revenue loss in Q2 as the plant shutdown was till 15th July.
23. The capex of Rs 250 Cr from last has not started generating revenue yet and is expected to take 4-6 more months to do so.
24. The variance in forex loss from last quarter and gain in this quarter was Rs 10 Cr.
25. The management expects to add around Rs 200+ Cr to the company's debt in order to fulfill the multi-year capex plan for Rs 1400 Cr. Thus pea debt is expected to be Rs 700+ Cr.
26. Around 60-70% of capex from the pending Rs 1000 Cr is for capacity enhancement.
27. The payback period for this capex is expected to be around 4 years.
28. Currently, the company sources 25% of its RM requirements from China.

Analyst's View:

Sudarshan Chemicals is one of the largest pigment makers in the world. The company has done well to improve its gross margins steadily throughout FY20 and continue to do in Q1. The company did suffer a bit from the plant shutdown in Q1 from Cyclone Nisarga which led to a dip in EBIT margins. But the demand for the company products remains stable and the management expects to make up for this revenue loss in Q2 due to the steady demand. The company has a good opportunity for growth from the China substitution movement. It is also doing well to reduce dependence on China for raw materials and looking for opportunities for backward integration which would further its priority of establishing cost leadership. It remains to be seen how the domestic market will recover for the company and how long will it take for the company to reach its goal of cracking the global top 3 in the pigment industry. Nonetheless, given the company a strong position in both domestic and export markets and its steadily improving margins due to improving product portfolio, Sudarshan Chemicals is a pivotal chemical sector stock to watch out for.

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