FUNDSINDIA

Equity Research Desk

ALPHA

10 JUN 2022

Sumitomo Chemicals Ltd. – Strong Parentage

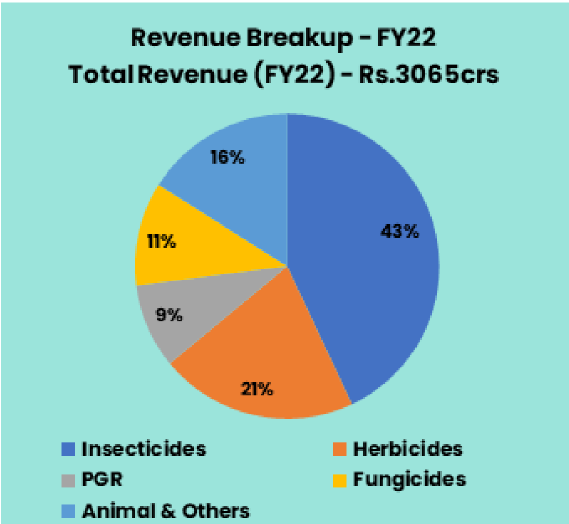
Market Data	
CMP	Rs.461
Date	10-Jun-22
Target Price	Rs. 550
Upside Potential	19.00%
52 Week High/Low	492/344
Sector	Agro Chemicals
Rating	Buy

Sumitomo Chemical India Ltd. (SCIL) is a subsidiary of Sumitomo Chemical Company Ltd. (SCCL), Japan, which is a diversified global chemical company. SCIL has 5 manufacturing facilities – 4 in Gujarat and 1 in Maharashtra – as well as 4 branches and 68 depots across India. The company has its spread across ~80 national locations and 2 international locations i.e., China and Vietnam. In FY17, SCIL acquired Excel Crop-care Limited (ECC), an existing listed company with 3 manufacturing facilities (2 in Gujarat and 1 in Dadra & Nagar Haveli) and 3 fully-equipped R&D centres. ECC was primarily a premium generic agro-chemical manufacturing company with focus on formulations and had facilities to manufacture both formulations and technical. After the acquisition of ECC, SCIL, merged ECC into itself and in the process, SCIL was listed on the Indian Stock Exchanges. SCIL has also marked its presence in Africa and several other countries (accounting for ~22% of sales).

Products & Services: The company produces several products under various categories like Herbicides, Fungicides, Insecticides, Fumigants, Plant Growth Regulator (PGR) and Animal Nutrition.

SHP	Mar - 22 (%)	Dec - 21 (%)	Change
Promoters	75.00	75.00	0.00
FPI	1.69	1.36	0.33
DII	6.36	6.17	0.19
Public & Others	16.95	17.47	-0.52
Pledged	0.00	0.00	0.00

Subsidiaries: As on 31st Mar 2022, the company has a total of 2 subsidiaries namely Excel Crop Care (Africa) Ltd. and Excel Crop Care (Europe) LLC (up to Dec 23, 2021.)



Margins - FY22	
Gross	38%
EBITDA	20%
PAT	14%

Key Rationale

- **Strong Parentage –** SCIL's parent SCCL is a leading R&D spender globally among agrochemical companies (spending ~9% of revenue on R&D). Strong parental support from SCCL gives SCIL unique advantages like access to world-class portfolio across geographies, greener chemistries and R&D expertise for developing proprietary products, financial strength and larger market reach. SCCL has a strong pipeline of agro solutions and environmental health products with revenue potential of ~US$1.4-1.8bn. SCCL holds 12,600+ patents out of which 34% is in health and crop science. Moreover, SCIL itself has a strong focus on R&D with 3 DSIR-approved R&D laboratories - located at Mumbai, Bhavnagar and Gajod, capable of synthesis, technical product and formulation development. R&D team comprises of 75+ qualified and dedicated engineers and scientists out of whom 10+ are PhDs with >15 years of experience.
- **Diversified Portfolio –** Product portfolio is well diversified with company's agro chemical products covering multiple crop segments in both Kharif and Rabi season and non-agrochemical including animal nutrition and environment health products. With over 16,000 distributors, SCIL's distribution network covers close to 85% of mainland India, providing geographic diversity. Further, close to 22% of the revenue (FY22) is generated from export markets, partially offsetting the risk related to demand cyclicality in the domestic market. Top 10 products contribute less than 45% of Total Revenue. No product/molecule contributes more than 16% of Total Revenue which again explains the diversity.
- **FY22 –** FY22 revenue stood at Rs.3,065 crs crossing a sales mark of Rs.3000 crs for the first time. The revenue growth was up 16% YoY with an improvement in Gross margin by 30bps to 37.7%. EBITDA growth was up 23% YoY at Rs.600crs from Rs.487crs in FY21. The Generic segment caters to 30% of the FY22 revenue whereas the Speciality segment caters to 70%. The company has launched 6 new products in the domestic market in FY22 with 1 product each in herbicide and fungicide segment and 4 new products launched in the insecticides category.
- **Financial Performance –** The company has generated a Revenue and PAT CAGR of 11% and 36% over the period of FY20-22. SCIL has a strong balance sheet with nil debt on books and cash and liquid investments to the tune of Rs.434 crs. The company's EBITDA Margin has been gradually improved from 13% in FY19 to 20% in FY22. The avg. ROCE of the company stood at 28% for the past 5 years. With efficient maintenance of working capital, robust EBITDA growth outlook and limited capex requirement, it is expected that SCIL's cash from operations and free cash flow to increase significantly, going ahead.

Ratios - FY22	
ROE	22%
ROCE	30%
Div. Yield	0.17%
PE Ratio	54.00
Face Value	10.00
EPS	Rs. 8.49

Industry Analysis

Agriculture is the primary source of livelihood for about 58% of India's population. Gross Value Added by agriculture, forestry, and fishing was estimated at Rs. 19.48 lakh crore (US$ 276.37 billion) in FY20. As per 1st advance estimates of National Income FY22, the percentage share of GVA of Agriculture and Allied Sectors is 18.8% of the total GVA. Globally, India is the third-largest consumer of polymers, fourth-largest producer of agrochemicals and sixth-largest producer of chemicals. The agrochemicals market in India is expected to register 8% CAGR to reach US$ 4.7 billion by FY25. India's agrochemical market forms 15 percent of the global market. The industry has a huge unrealized potential due to the low level of agrochemical consumption. India's per capita consumption is 0.6 kg/hectare as against China's 13.1 kg/hectare.

Growth Drivers

The government plans to introduce production-linked incentive (PLI) scheme to promote domestic manufacturing of agrochemicals.

The growing middle-class and increasing urbanisation is driving the demand for personal care, agrochemicals, food, paints & coatings resulting into higher consumption of chemicals per capita.

Between April 2020 and June 2021, FDI in agriculture services stood at US$ 2.31 billion.

Peer Analysis

Competitors: UPL, Rallis, etc.

SCIL tops in terms of Return ratios when compared to its peers. Robust fundamentals ask premium valuation and SCIL trading at a slight premium than its competitors. Though the valuation is premium, a visionary management along with a cash generating ability from the business makes the company stand out from its peers.

Company	CMP	Mcap.	ROE	ROCE	P/E	EPS
Sumitomo	461	23013	22.00%	30.00%	54	8.49
Rallis	197	3832	9.00%	12.00%	23	8.44
UPL	734	56111	18.00%	16.00%	15	47.46

Outlook

The company's superior growth momentum is likely to continue primarily led by a) healthy demand and price realizations in domestic market; b) new specialized/combination molecules launches in domestic market to support margins going forward; c) robust demand in the exports markets- particularly for generic molecules in LATAM markets; d) entering newer geographies (forayed in Australian markets in FY22; FY22 revenues at Rs.30.6crs); e) additional capex to service exports growth; received approval to supply 5 products in LATAM markets; capex of Rs.100crs with revenue potential of Rs.200-250crs over the next few years (Commercialization of 1st project in 2QFY23 and 2nd project in 1QFY24). The management also intends to launch 6-8 new products (Specialized molecules) in the domestic market over the next 12-18 months which in turn would support the revenues and margins going forward.

Valuation

The company's strong parentage, wide distribution network, rising share of exports revenue and continuous product launches will help it to take a big leap further. At CMP, the stock trades at 35x of FY24E EPS. We recommend a BUY rating in the stock with the target price (TP) of Rs.550, 42x FY24E EPS.

Risks

- **Working Capital Risk –** The agrochemical industry is characterised by working capital-intensive operations, due to large inventory requirement, seasonality in demand, and extended credit to dealers and distributors. While sales occur at the start of the season, payment is realised post-harvest, thus resulting in large receivables.

- **Weather related Risk -** Any drought on particular year will affect the farm output resulting in lower demand for Agro-chemical products, thus, could adversely impact its revenue.

- **Regulatory Risk -** The crop protection sector remains susceptible to specific and separate registration processes in different countries, and various environmental rules and regulations. Change in regulatory requirements, such as export and import policies, and environmental and safety requirements in countries where the company has significant exposure, could weaken growth prospects.

Source – Tickertape, Company's Website, BSE Website.

Thanks & Regards

Abeshek C V
Equity Research Analyst – Fundamental
Equity Research Desk

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Uttam Building, Third Floor,
No. 38 & 39, Whites Road, Royapettah, Chennai – 600014