Mar 17, 2021 | PICK OF THE MONTH | VOL-7, NO-02

Industry: Agrochemicals

# Sumitomo Chemical India Limited

**BUY**

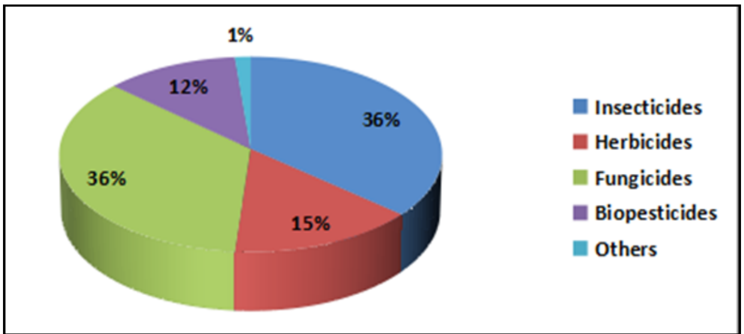
**CMP: Rs.275** | **TARGET PRICE: Rs.350** | **TIME : 12 months**

## Industry Overview: Agrochemical and Crop Protection Market

**Agrochemicals:** also known as crop protection chemicals/pesticides (CPC) are chemical agents that find application in farmlands with an aim to improve the yield of field or crops. These agents undergo a chemical or biochemical process that contains the active ingredient (AI) in an explicitly pre-defined concentration, designed to protect the crops from insects, diseases and weeds and eventually prevent the crop losses. Agrochemicals form the largest and are often regarded as the most diverse group of chemical compounds. In India, approx. 20-25% of the total food produced is damaged by the diseases and pests that feed on the produce, thus, agrochemicals play an important role as a key input for crop protection and better yield generation. CPC is broadly classified as **insecticides** (used for protecting plants against pests and insects), **fungicides** (used to control the spread of fungal diseases), **herbicides** (chemicals that are used to kill the growth of weeds in the cultivation area), **bio-pesticides** (pesticides of bio origin i.e. derived from animals, plants etc.) and **others** (this class includes plant growth regulators, rodenticides and fumigants).

Developing new molecules requires high investments in terms of capital as well as time. This also requires a very strong R&D team. Knowing these are some of the drawbacks in the Indian context, many Indian players have started building strategic partnerships with global players in the agrochemical and specialty chemicals domain. In exchange, the Indian companies offer base in the domestic market via strong distribution network and marketing & sales infrastructure.

**Exhibit 01: Agrochemical Products Share by Volume (FY18-19)**




*Source: FICCI Report– December 2020, Progressive Research*

## Indian Landscape:

The Indian agricultural sector and allied activities acts as the backbone of the economy. With the ever-increasing population and food production necessities, the growth of agrochemical industry becomes interdependent. The agrochemicals industry has been evolving in terms of the usage of AI, level of product innovation and regulatory regime. Presently, India is the 4$^{th}$ largest producer of agrochemicals in the world, after US, Japan and China. In terms of trade, exports of agrochemicals are higher as compared to the imports. India was the 5$^{th}$ largest exporter of agrochemicals in 2019. As per the FICCI Report, the Indian agrochemicals industry was valued at around Rs45k-cr in FY19, out of which the domestic consumption was worth around Rs20k-cr, while exports during the same period were ~Rs22k-cr. The industry is expected to grow at a CAGR of 8-10% till 2025; driven by several growth triggers like increasing population, decreasing arable land, increasing demand for high-value agricultural products, increasing efforts from the industry and GOI promoting awareness and technology penetration. In India, the quality of vegetables or quality of fruits for domestic consumption has been changing gradually with consumers asking for better quality, better taste, better finish of these produce from horticulture. This induces the farmers to use better molecules of agrochemicals to grow better products in the market. Moreover, these vegetable and fruits are also exported which also require good quality inputs of agrochemicals.

| SNAPSHOT | |
|---|---|
| 52 week H / L | Mcap (INR mn) |
| 339/153 | 137,090 |
| Face value: 10 | |
| BSE Code | NSE CODE |
| 542920 | SUMICHEM |

| Annual Performance | | | | |
|---|---|---|---|---|
| (Rs mn) | FY19 | FY20 | FY21E | FY22E |
| Total Revenue | 22,284 | 24,247 | 25,543 | 26,552 |
| EBITDA | 2,907 | 3,332 | 4,215 | 4,580 |
| EBITDA (%) | 13.0 | 13.7 | 16.5 | 17.3 |
| Other Income | 76 | 107 | 258 | 258 |
| Interest | 37 | 55 | 25 | 50 |
| Depreciation | 278 | 410 | 433 | 475 |
| PBT | 2,668 | 2,974 | 4,015 | 4,313 |
| PAT* | 1,658 | 2,047 | 3,011 | 3,235 |
| Equity ( Rs mn) | 4,991 | 4,991 | 4,991 | 4,991 |
| EPS (INR) | 6.0 | 4.1 | 6.0 | 6.5 |

| Quarterly Performance | | | | |
|---|---|---|---|---|
| Parameters (Rs mn) | Mar-20 | Jun-20 | Sept-20 | Dec-20 |
| Sales (Net) | 4,458 | 6,477 | 9,020 | 5,609 |
| EBITDA | 420 | 1,187 | 2,189 | 780 |
| EBITDA (%) | 9.4 | 18.3 | 24.3 | 13.9 |
| Other Income | 51 | 23 | 61 | 54 |
| Interest | 13 | 13 | 17 | 15 |
| Depreciation | 129 | 108 | 113 | 111 |
| PAT | 162 | 788 | 1565 | 546 |
| Equity ( Rs mn) | 4991 | 4991 | 4991 | 4991 |

| Ratio Analysis | | | | |
|---|---|---|---|---|
| Parameters (Rs mn) | FY19 | FY20 | FY21E | FY22E |
| EV/EBITDA (x) | 47.1 | 40.9 | 32.3 | 29.7 |
| EV/Net Sales (x) | 6.1 | 5.6 | 5.3 | 5.1 |
| M Cap/Sales (x) | 6.2 | 5.7 | 5.4 | 5.2 |
| M Cap/EBITDA (x) | 47.2 | 41.1 | 32.5 | 29.9 |
| Debt/Equity (x) | 0.2 | 0.2 | 0.2 | 0.2 |
| ROCE (%) | 26 | 26 | 29 | 25 |
| Price/Book Value (x) | 7.2 | 11.2 | 9.0 | 7.4 |
| P/E (x) | 43.7 | 58.2 | 45.5 | 42.4 |

| Shareholding Pattern as on 31st Dec, 2020 | | |
|---|---|---|
| Parameters | No of Shares | % |
| Promoters | 374,359,302 | 75.00 |
| Institutions | 38,741,602 | 7.76 |
| Public | 86,044,832 | 17.24 |
| TOTAL | 499,145,736 | 100.00 |

*Source: Annual Report*

*Note: All the data is calculated as per Market Price on 16th Mar, 2021*
**Exceptional Item-Merger related expenses*

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Industry: Agrochemicals | **Sumitomo Chemical India Limited** | BUY

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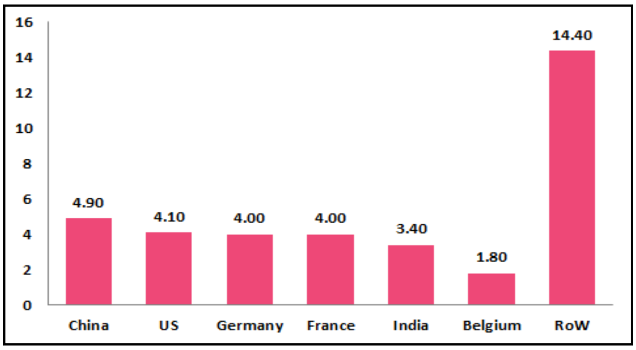
## OVERVIEW: Industry (contd.)

**Exhibit 02: Top Agrochem Exporters– 2019 (USD bn)**




*Source: FICCI Report– December 2020, Progressive Research*

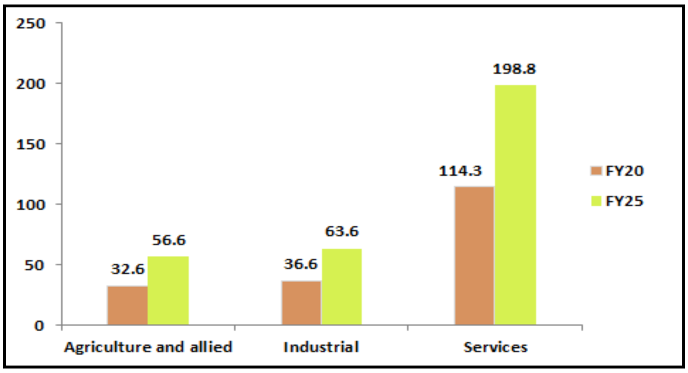
**Exhibit 03: Key Agrochem Export-Import (in 000' tonnes)**

| Parameters | 2018-19 | 2019-20 |
|---|---|---|
| **Exports** | | |
| Insecticides | 87 | 130 |
| Fungicides | 193 | 170 |
| Herbicides | 106 | 109 |
| **Imports** | | |
| Insecticides | 19 | 14 |
| Fungicides | 8 | 8 |
| Herbicides | 36 | 32 |

*Source: CARE Ratings, Progressive Research*

**Government Initiatives:** As a matter of fact, agriculture serves as the backbone for the Indian economy and the Indian agrochemical industry has an immense scope to unleash its potential due to the low level of agrochemical consumption as compared to the global norms. In terms of Gross Value Added (GVA), the agriculture sector contributed ~Rs32.6lk-cr (16% of the total GVA of Rs183lk-cr) in 2020. In order to achieve the mission of making India a USD5trn economy, the agriculture and allied sectors would be required to grow at a rate of almost 2.5x of their present growth rate of 3.8% (CAGR during 2015-20) *(As per FICCI Report)*. In order to give the sector, the necessary push, the government is working judiciously by providing a helping hand in developing and adopting newer technologies and techniques. These measures are undertaken with the intent to emphasize more towards domestic manufacturing; de-risking from a particular geography and to make India self-reliant. In order to implement a self-sufficient strategy with minimum imports, the government needs to work on a fast track mechanism needed for regulatory compliances, pending approvals of new molecules in the regulatory pipeline, drive the need for transformation with R&D investments, and develop methods that encompass both increased productivity and crop safety. Some of the **recent major initiatives** undertaken in 2020 include: **(i) November:** PLI scheme for promotion of domestic manufacturing of agrochemicals, **(ii) October:** PMFBY (Pradhan Mantri Fasal Bima Yojana), PM-Kisan and the Soil Health Card to be integrated through a common database, along with land record details. The Agriculture Commissioner, have asked the industry to bring in new molecules of global standards for the farmers' benefit, **(iii) September:** The Farmers' Produce Trade and Commerce (Promotion and Facilitation) Bill, 2020, The Farmers (Empowerment and Protection) Agreement of Price Assurance and Farm Services Bill, 2020, and The Essential Commodities (Amendment) Bill 2020. With all these initiatives coupled with creation of more consumer awareness, enabling more technological investments, increasing focus on R&D, improvement of policy environment to boost agricultural exports, traction of foreign investments, etc. would lead towards unlocking of true potential of the sector in times to come. As per Crisil Report, the revenue of the Rs47k-cr agrochemical sector is expected to grow at 12-14% in FY21 aided by a sharp recovery in off-take from the domestic agriculture sector and continued healthy exports.

**Exhibit 04: India's Economic Growth (Rs in lk-cr)**




*Source: FICCI Report– December 2020, Progressive Research*

**About the Company:** Sumitomo Chemical India Ltd. (SCIL) is a subsidiary of Sumitomo Chemical Company Limited (SCC), Japan, which is a diversified global chemical company. SCIL manufacture, imports and markets products for crop protection, grain fumigation, rodent control, bio pesticides, environmental health, professional pest control and feed additives for use in India. SCIL has 5 manufacturing facilities (4 in Gujarat and 1 in Maharashtra), as well as 4 branches and 68 depots across India. The company's production facilities are strategically located. The plants are well connected to all major cities with its proximity to main highways, ports etc., and thereby enabling swift and easy transport of products to customers across the country. The company has its spread across nearly 80 national locations and 2 international locations i.e. China and Vietnam. In addition to this, SCIL has also marked its presence in America, Latin America, Europe, Asia, Australia, Africa and several other geographies across the world. The fellow subsidiaries include Sumitomo Chemical Do Brazil Representacoes Ltd (Brazil), Valent BioSciences LLC-USA (previously known as Valent Biosciences Corporation), Sumitomo Chemical Asia Pte Limited-Singapore (previously known as Sumitomo Chemical (Asia Pacific) Pte Limited-Singapore) and Mycorrhizal Applications, LLC-USA. SCIL has a strong brand with a market leading position across its varied product categories. Having a network reach of 13,000+ distributors, ~40,000 dealers, sales workforce of ~600 members, SCIL has an in-depth knowledge of its own research products and a proven go-to-market strategy that acts as an enabler for a deep connect with 1 million plus farmers.

**About the Company (contd.)**

In order to adhere to applicable national & international standards via strict quality management systems, SCIL ensures its constant efforts to maintain and upgrade the quality of its products. SCIL continues to maintain ISO: 9001:2015, ISO14001:2015 and OHSAS18001:2007 for the manufacturing sites at Bhavnagar, Gajod and Silvassa. In addition to these, SCIL also continues to sustain its SA8000 Certification for Social Accountability in Bhavnagar and Gajod manufacturing sites. Recently, the plant at Tarapur successfully completed migration of OHSAS 18001:2007 to ISO 45001:2018 and integration of ISO 9001:2015, ISO 14001:2015 and ISO 45001:2018 systems. The plant at Vapi holds and maintains ISO: 9001:2015 certifications. The company is chaired by Dr. Mukul Govindji Asher and has Mr. Chetan Shantilal Shah as its Managing Director. The company is powered by a head count of 1652 employees, while total number of employees hired on temporary, contractual or casual basis stood at 3435 (31st March 2020).

**Exhibit 05: Manufacturing Locations**

| Plant Location | Segments Served | Product Manufactured |
|---|---|---|
| Bhavnagar | Manufacturing of technical grade pesticides and formulations | **Technical Grade Products:** Chlorpyriphos, Profenophos, Glyphosate, Tebuconazole Tech, Quinalphos, Imidacloprid, Thiacloprid, Acetamiprid, Byspyribac Sodium, Aluminium Phosphide, Zinc Phosphide, Sulphur WDG, Fenpropathrin |
| Gajod | Production and manufacturing of Metal phosphides, Sulphur WDG and other WDG formulations | |
| Tarapur | Production and manufacturing of Active Ingredients | |
| Vapi | Formulation & Packaging | |
| Silvassa | Formulation of Glyphosate and other Specialty products | Formulations for above TG products and several other specialty and generic products |

*Source: November 2020-PPT, Progressive Research*

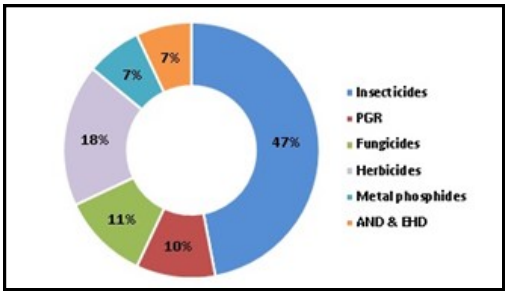
## INVESTMENT RATIONALE:

**A. Diversified Product Portfolio:** SCIL has a well-diversified portfolio that caters to both the domestic and international business. Under the **domestic business**, the company has a fundamental presence in manufacture and sales of specialty and generic products under the Agro Solutions Division (ASD), Environmental Health Division (EHD) and Animal Nutrition Division (AND). SCIL's bundle of innovations along with strong R&D capabilities, having more than 500+ qualified and skilled managers in the sales and marketing division, makes the company an impressive player in the crop protection space.

**(i) Agro Business (93% of FY20 revenues):** The company's products under the agro solutions include a full range of both chemically and biologically derived pesticides, herbicides and plant growth regulators (PGR). *PGR are chemical substances that are naturally produced by the plants themselves in order to manage their growth and development. These organic compounds are needed in addition to the external requirements such as light, water, oxygen.* SCIL has presence in all segments, with the revenue contributions (as of FY20) that stands as: Insecticides (47%), Herbicides (18%), PGR (10%), Metal Phosphides (7%), Fungicides (11%). For FY20, the revenues from this division came in at Rs22,335mn (inclusive of both domestic and exports mix) as against Rs20,628mn in FY19; growth of 8%. The company lays greater emphasis on its high growth, stable and highly profitable segments such as herbicides, PGR, bio-rational products. SCIL has witnessed increasing contribution from the PGR segment for both Kharif and Rabi crops which can help in reducing the risks associated to business seasonality.

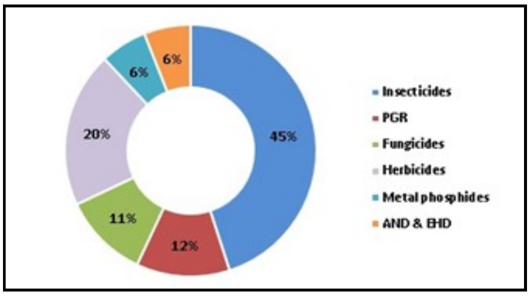
**(ii) Other Business (7% of FY20 revenues):** The Environmental Health Division and Animal Nutrition Division segments contributed 7% of the total revenues in FY20. The revenues from Others business division (inclusive of both domestic and high seas sales) came in at Rs1,577mn in FY20 as against Rs1,325mn in FY19; growth of 19%. As a part of the EHD, SCIL provides solutions to varied pest associated problems like dengue, malaria and damage caused by termites. Under the AND, the company is engaged in the supply and manufacture of methionine used as a feed additive; one of the essential amino acids for the development and growth of livestock.

**Exhibit 06: Product Breakup-FY20**




*Source: Q4FY20 PPT, Progressive Research*

**Exhibit 07: Product Breakup-9MFY21**




*Source: December 2020-PPT, Progressive Research*

Within the agro solutions business the company is well diversified. In the specialty segment, SCIL distributes SCC's global propriety products in Indian market due to its distribution reach, direct connect with the farmer and skillset to generate demand for innovative products. In the generic segment, SCIL has a robust product portfolio of several premium generic products with well-known brands with technical manufacturing capabilities. As of FY20, the specialty products formed 29% of total revenue while generics formed 71%. As of 9MFY21, the ratio of generics: specialty stood at 66:34. In the **international business,** the company is engaged in exporting its products to over 60 countries. SCIL has a higher proportion of branded exports of the products that are manufactured in India, especially to the African markets. The company also **undertakes exports of the bulk technical products to various global markets.** As of 9MFY21, 71% of the exports comprise of bulk molecules as against 85% towards domestic branded consumption. The ratio of domestic: international business stands at 80:20.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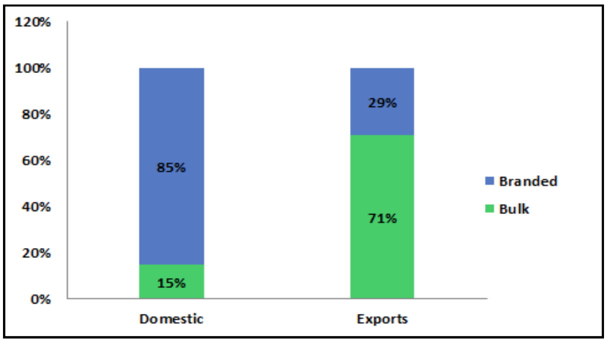
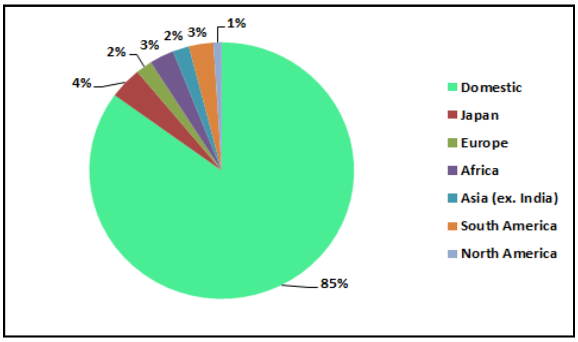
**INVESTMENT RATIONALE (contd.):**

**Exhibit 08: Bulk & Branded Breakup-9MFY21**




*Source: December 2020-PPT, Progressive Research*

**Exhibit 09: Geographic Breakup-9MFY21**

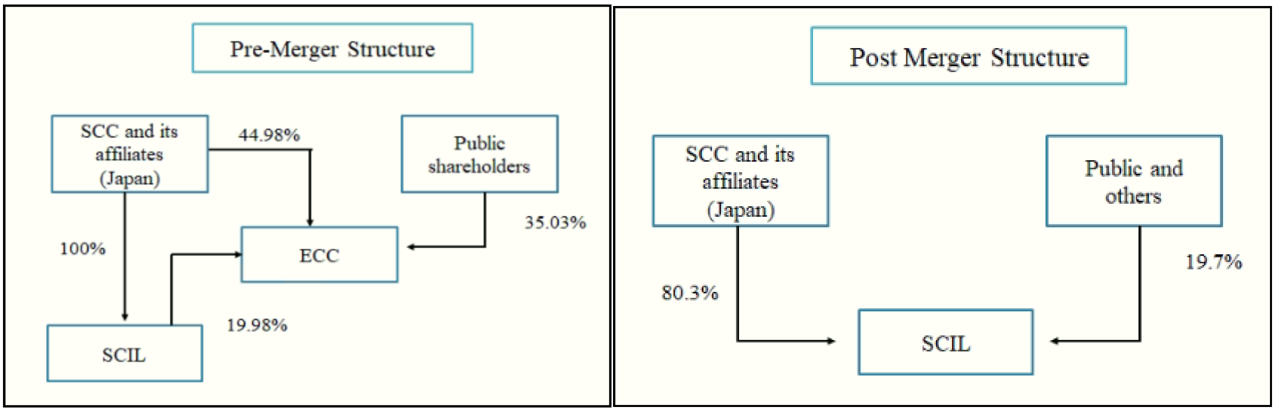



*Source: December 2020-PPT, Progressive Research*

**B. Synergies and Ancestral Benefits:**

**(i) Value Creation Through Synergies:** In Oct 2016, SCC together with SCIL had acquired ~65% stake in Excel Crop Care Ltd (ECCL) which was primarily engaged in the manufacturing and marketing of crop protection, soil nutrition, seed treatment and post-harvest products. Post the open offer, SCIL implemented a strategy of reverse merger with Excel w.e.f. 31st August, 2019, with an offer of 51 shares of SCIL with FV of Rs10 each for every 2 shares of FV of Rs5 each held in ECCL. Post-merger, SCC and its affiliates (Japan) held 80.3% shareholding in the merged entity SCIL, which is now reduced to 75% according to SEBI norms. In the view of similar businesses, the said merger is expected to benefit in the long run via high complimentary offerings and a well-diversified platter. With the continued support of SCC, SCIL will promote expansion of activities further in the crop protection field. As a result of the amalgamation, Excel Crop Care (Africa) Ltd (99.94%), Tanzania and Excel Crop Care (Europe) (99%) NV, Belgium too have become the subsidiaries of SCIL.

**Exhibit 10: Merger Structure**




*Source: November 2020-PPT, Progressive Research*

**(ii) Parental Benefits:** SCC is a leading Japanese research driven chemical company that offers array of products in the field of petrochemicals, energy and functional materials, health & crop sciences products and pharmaceuticals. The company's health and crop sciences sector manufacture specialized solutions that cater to crop protection and enhanced products in the agricultural markets. SCC have been positive on the growth trajectory of the Indian agrochemical industry. Consolidating the businesses in the Indian agrochemical space will help achieve operational synergies as well as provide flexibility to address growth opportunities in India. SCC Japan aims at supporting SCIL to achieve market leadership in Indian market via a strong portfolio of agro-solutions products.

The current Management of SCIL are well versed with the style of working and their philosophy of conducting a business of SCC. Some of these factors include safety in operations, respecting the human assets and not only working to generate profits but also ensure that the society is also benefited from the operations either via CSR or upgradation of the society. SCIL will benefit from the undivided focus from the parent company to drive the expansion in the future. The company is already planning to launch several unique products from the parent's portfolio in the Indian market which can also strengthen the domestic portfolio. In addition to this, SCIL can also improve its exports by leveraging global presence of the parent company while utilizing the manufacturing expertise of cost- effective base in India.



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## INVESTMENT RATIONALE (contd.):
## B. Synergies and Ancestral Benefits (contd.):

**Exhibit 11: Collaborative Privilege**

| Parameters | ECCL | SCIL (Pre-merger) | SCIL (Post-merger) |
|---|---|---|---|
| Manufacturing Facilities | Plants in Gujarat (2) and Dadra & Nagar Haveli (1) | Plant in Maharashtra (1) and Gujarat (1) | 5 plants in West India |
| Manufacturing Capabilities | Predominantly a formulation company with facilities for both formulation & technical | Manufacturing of formulations | Presence in both technical & formulation manufacturing |
| Distribution Capability | 4,700+ distributors located across India | 9,000+ distributors concentrated in few regions | Improved depth and breadth of the distributors |
| R&D Capability | 3 fully equipped R&D facilities for synthesis and formulation of chemicals | Outsources R&D requirements | Creating new combinations using SCIL's chemistries |
| Industry Sub-segments | Insecticides (44%), Herbicides (27%), Fungicides (11%), Metal Phosphides (13%), Others (5%) | Insecticides (63%), Fungicide (8%), Herbicide (7%) & Others (22%) | Insecticides (52%), Herbicides (19%), Fungicides (9%), Metal Phosphides (8%), Others (12%) |
| Product Capability | Major focus on Generics; nascent presence in Biopesticides | Major focus on Speciality Products | Presence across complete range of products |
| Business Segments | Presence only in agrochemical segment | Presence in ASD, AND & EHD segments | ASD focused with presence in AND & EHD |
| Range of Crops Served | Staple crops with major presence in Kharif season | Fruits and vegetable crops covering both Kharif and Rabi | Well diversified product range covering Kharif & Rabi crops |
| Customer Concentration | Top 5 customers contributes to ~12% of sales | Top 5 customers contributes to ~15% of sales | Top 5 customers contribute ~12% of sales |
| S&M Capability | Strong wide-spread presence with the distributors / retailers | High degree of engagement with the farmers | Strong presence with both the retailers and farmers |

*Source: November 2020-PPT, Progressive Research*

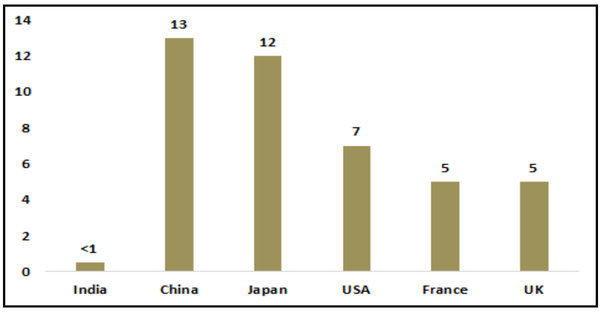
### Goodwill via Esteemed Parentage Includes:

- Strong pipeline of agro solutions and environmental health products with business potential of ~USD1.4-1.8bn
- SCC spends 8-9% of sales on R&D activities, which may help the Indian entity to launch proprietary products in domestic market
- Access to SCC's global supply chain and global R&D activities leading to a broad range of formulation research
- Benefits from global presence of SCC Japan to boost exports due to global distribution channels and presence across 40 countries
- Technical expertise, financial strength and market reach to witness strong improvement
- Inculcate the Japanese practices in long term strategic planning, manufacturing proficiencies, work culture, focus on teamwork
- Access to new AI without additional capex, keeping existing SCIL facilities available for manufacture of other molecules
- SCC acquired Nufarm's distribution in Latin America thereby gaining leadership position in Latin America generics market

### C. Sustainable Growth Drivers:

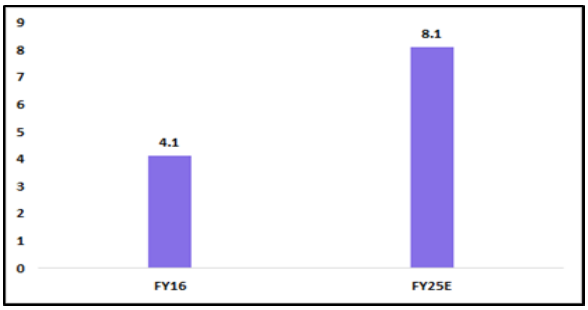
**(i) Strategic Growth:** SCIL has a balanced portfolio of generic and specialty products. The company has made efforts to leverage its expertise by launching successful products and undertaking capacity expansions as and when needed to fuel the growth journey. In order to enhance the overall agricultural output and safeguard the food availability, pesticides play a significant role in the Indian agricultural operation. India is a highly underpenetrated market when it comes to the consumption of pesticide. In order to reduce the crop losses, sizeable yield improvement is very crucial to increase the food production and thus serve the ever-growing population. This opens doors for Indian players in the agrochemical market which is expected to grow to USD8.1bn by FY25E from the earlier USD4.1bn in FY16. SCIL is aptly placed (market share of insecticides stood at 45% in 9MFY21) to grab the opportunity from any sector tailwinds. Some growth strategies adopted by the company include continued investment in R&D and pipeline of products, capacity expansions, further brand development, and development of combination products, expand export business etc.

**Exhibit 12: Pesticides Market Consumption (kg/ha)**




*Source: November 2020-PPT, Progressive Research*

**Exhibit 13: Agrochemical Market (in USDbn)**




*Source: November 2020-PPT, Progressive Research*

**INVESTMENT RATIONALE (contd.):**

**C. Sustainable Growth Drivers (contd.):**

**(ii) Recent Developments:** As reiterated earlier, SCIL is a formidable player in the agrochemical space and has a diversified product profile (no product under the basket of SCIL contributes more than 15% of the total revenue) across key crops with an effort to lay its concentration on fruits, vegetables, paddy and other high growth segments. The company has an extensive range of generics and specialty products. Currently, SCIL has 190 brands across its complete agrochemicals value chain basket with several brands. In the current year, the company has launched 4 new products (3 related to insecticides and 1 in PGR segment). These products are extensively promoted by the company with the aid of digital tools in order to connect with the farmers. Apart from this, several proprietary specialty products of SCC are under the various stages of evaluation and the company anticipates launching atleast one new innovative product in the Indian market every year. Further, SCIL has a pipeline of 9 new combination products/ pre-mixtures under the development stage (5 insecticides, 2 fungicides, 2 PGR) and 2 technical products (1 insecticide and 1 herbicide) for manufacturing in India. The latest digital launch of Sumi Pride- a solution to treat bed bugs already has received 500+ registrations.

**Exhibit 14: Key Product Basket**

| Product Name | Product Category | Indicative Use |
|---|---|---|
| Glyphosate | Herbicide | Tea Gardens, non-cropped |
| Profenophos | Insecticide | Cotton, Soya bean |
| Dantotsu | Insecticide | Vegetables |
| Tebuconazole | Fungicides | Wheat, Soya bean, Chilli |
| Progibb | PGR | Citrus Fruits |
| Aluminum Phosphide | Fumigant | Warehousing of Food Grains |
| Chlorpyrifos | Insecticide | Paddy, Beans, Gram |
| DL-Methionine | Animal Nutrition | Poultry |

*Source: November 2020-PPT, Progressive Research*

**(iii) Latin America Acquisition-Nufarm:** SCC has always strived to enhance its global footprint and explore opportunities in the crop protection space. Keeping the urge intact, SCC in April 2020, announced the completion of acquisition of 4 South American subsidiaries of Nufarm Limited (a leading Australian company in agricultural chemicals business) in Brazil, Argentina, Chile and Colombia. The South American region accounts for 25% of the global pesticides market, surpassing North America and China in terms of market size. This acquisition would enable SCC to build a sound base and sales network in the crop protection product market in South America, including Brazil. For the Indian counterpart, SCIL anticipates this as a good opportunity even though at the nascent stage as of now. SCIL already has registrations in Brazil and Latin America for 4 molecules (Tebuconazole, Chlorpyrifos, Fluroxypyr and Aluminum Phosphide). On the other hand, existing exports of Chlorpyrifos would prove to be beneficial for SCIL, as Sumitomo Latin America consumes large quantities of the same. Overall, this acquisition appears to be lucrative for SCIL CRAMs business in times to come.

**(iv) Technological Edge:** SCIL is reputed as a consistent and reliable quality supplier of products. Innovation and sustainable growth are one of the fundamental objectives of the Management. Product and process improvements are the areas of concentration while laying emphasis on enhancing yields and reducing manufacturing costs. In pursuit of the same, the company is also trying to stay innovative as well as competitive. The company puts in constant efforts to maintain and upgrade quality of products as well as match the applicable national and international standards via strict quality management systems. The company is also looking at certain initiatives to optimize utilization and also expand manufacturing capacities to meet demand. In addition to all of this, SCIL is also paying attention on energy conservation and energy cost reduction processes. With a strong pipeline of products for the future, the R&D team of SCIL focuses towards launch of off-patent products as well as at development of efficient processes. The capabilities of the team and processes include synthesis of newer chemistries, producing technical products and also developing formulations. The team has a head count of 75 members out of which 10 plus scientists have PhD qualifications and more than 15 years of experience in agrochemical R&D initiatives. In addition to this, the company is working on combination molecules which involve mixing some of the SCC's proprietary molecules with some of the generic molecules being manufactured by SCIL. Management mentions of having identified nine such combination products for further evaluation and have good commercial potential for the global markets. The company is laying more emphasis on the high growth, stable and highly profitable segments in the herbicides, PGR and biorational divisions.

Management aims to constantly try **to improve margins** by changing the product mix as and when required and introduce new products. Management agrees to the fact that Latin America has great opportunities for SCIL in a sturdy geography. With the help of SCC, a number of prospects can be explored in the long run as company already has some registrations in Brazil and Latin America which will help fetch orders for certain molecules. Moreover, if SCC intends to make any product in India, they will first approach SCIL. Management also has an ambitious vision of introducing one product every year either via Sumitomo molecules or **Valent Bioscience USA** molecules. SCIL already has some Valent products in the product range and is also working at rolling out one new molecule from Valent Bioscience in the near future. The company intends to formulate the product/ molecules, brand it and market the same. Valent Biosciences based out of USA is one of the leading companies in PGR and biorational space. In the Indian market, SCIL is exclusively distributing their global products. This is a newer segment in Indian agriculture industry where lot of investment will have to be made in terms of showcasing the products, explaining the benefits and then converting the same into sales to a farmer. SCIL already has shown some success in the products of the PGR segment which have been recently launched in the portfolio in the future. This segment is already contributing approximately 12% of the total revenue and has immense scope for further expansion. In the domestic, B2C branded marketing business, SCIL aims to take leadership position in India and are confident of the strategy which they have been using across different segments and products over the last 10 years or so.



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**Financials:**

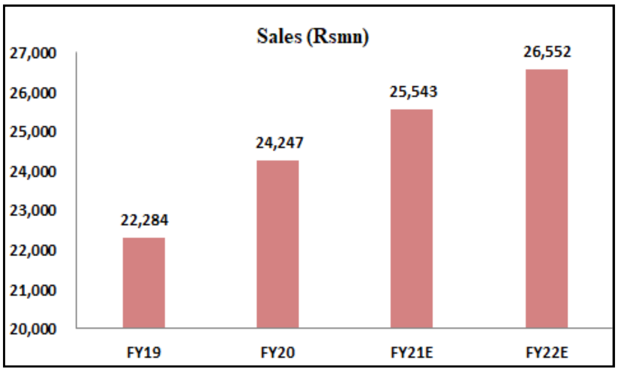
SCIL witnessed a gradual ramp up in its operations post a phased wise unlock. Over the past financial years, with the parental benefits and technological edge at its disposal, SCIL has been able to enhance its revenues at a CAGR of ~13% (FY18-20); whereas the net profits grew at a CAGR of ~19% for the same period. The company has maintained its legacy of rewarding its shareholders over the past financial years. From the recent quarterly results, it appears that SCIL has been able to play well with the product mix while at the same time is trying its best to achieve optimal utilization of available capacities in hand. In addition to this, expansion of gross margins (in the range of 35-40%) prove to be an indication of the synergy benefits looming for the company. Moreover, the company has opted for the new income tax regime, which allows it to opt for lower tax rate of 25%. SCIL has a net-debt free status with strong return ratios. ROCE performance has shown consistent improvement since FY18. The ratio improved from 25.2% in FY18 to 29.1% in FY20. Overall, the company has been reporting good margins and rewarding its shareholders with consistent dividend payouts, decent return ratios. Cash & cash equivalents and liquid investments stood at Rs6,800mn as of 31st Dec, 2020.

As far as **capital expenditure** is concerned, in the past the company has been typically spending around 14%-15% of the Ebitda. The company was chalking a plan of nearly Rs400mn to 600mn of capital investment (as per AGM FY20 commentary). In addition to this, the company was also looking at some new products to be manufactured for Japan in the year FY21-22.

As far as the **procurement of raw materials** is concerned, the same is well diversified; the company imports nearly 33% from China, almost 42-43% is procured within India and nearly 20% of the products come from the parent company either from Japan or from the USA. All contracts/arrangements/transactions entered by the company with related parties are on an arm's length basis. In order to mitigate the risks associated to China, the company has 3-5 suppliers in China located at different areas, thus avoiding the concentration of procurement from just one vendor/dependence; and also the company has been looking at developing toll manufacturers in India wherein SCIL gives the toll manufacturer the products' requirement, specifications, technology, and try to make that product in India. The company is already exploring the possibilities with two such products.

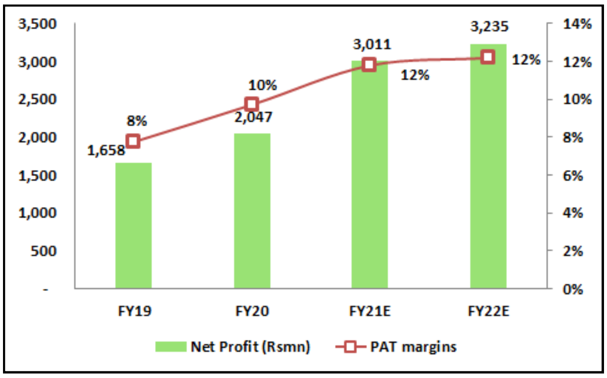
The company has been striving hard to ensure efficient operations by diligently managing its **working capital requirements** (the days reduced to 115 in FY20 from 119 in FY18). Collections in H1FY21 stood at Rs15,430mn as compared to Rs13,200mn in H1FY20; increase of 17% on y-o-y basis. For 9MFY21, collections stood at Rs23,760mn; increase of 10% y-o-y basis.

**Exhibit 15: Sales Trend**



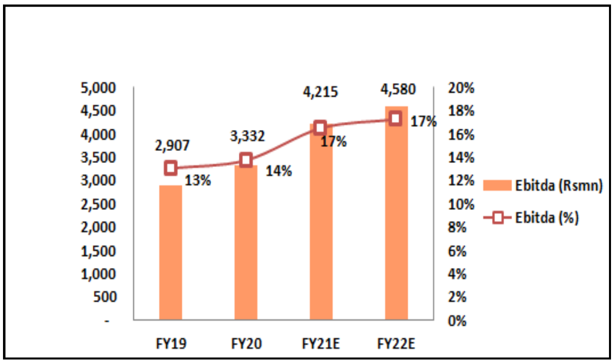

*Source: Annual Reports, Progressive Research*

**Exhibit 16: PAT v/s PAT Margins**



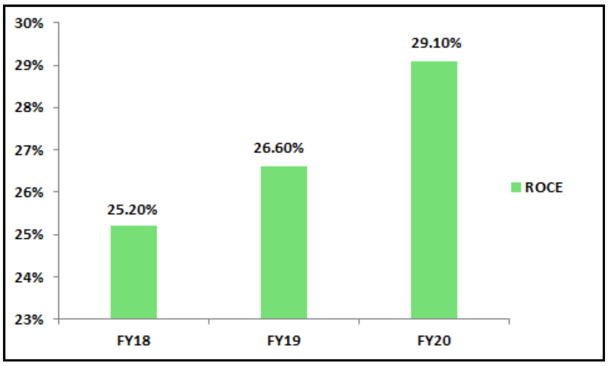

*Source: Annual Reports, Progressive Research*

**Exhibit 17: Ebitda v/s Ebitda Margins**




*Source: Annual Reports, Progressive Research*

**Exhibit 18: ROCE Trend**




*Source: Annual Reports, Progressive Research*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Industry: Agrochemicals **Sumitomo Chemical India Limited** BUY

CMP: Rs.275 TARGET PRICE: Rs.350 TIME : 12 months

**Risks and Concerns:**

Impact of draft order banning 27 Insecticides by Government of India: The Ministry of Agriculture issued a draft notification on 14th May, 2020 with the intent to ban certain chemicals that prove to be hazardous and toxic to the environment, humans and animals looking at a ban on import of 27 insecticides. This matter is being discussed with various industry and farmers associations who would eventually take necessary actions in order to defend these products such as filing suitable explanations and technical justifications. The list of products includes some of SCIL's products too, i.e. 2 technical grade products: (a) Chlorpyriphos and Quinalphos (the company exports these products which would be outside the purview of such proposal) (b) Some other products wherein technical grade is purchased by the company and later undertake formulations and distributions for the same. As per the management, the matter is not likely to have material adverse impact on the company's operations.

Impact of draft order on usage of Glyphosate formulations only through Pest Control Operators: The industry and the company have large export of Glyphosate which would be outside the purview of such proposal. In the opinion of SCIL, prima-facie the proposal, (if implemented), is not likely to have material impact on the operations. Glyphosate is one of the very good brands. The company doesn't have any product which is more than 15%. Similarly, Glyphosate maybe around 12-13% or so of the total revenues and it is an important product. As per the management commentary, they feel quite possibly in the next round of its review in 2022, Glyphosate could have another five years of extension. Simultaneously, the parent company is working on some herbicide molecule which can replace Glyphosate.

One of the major concerns in the Indian context is the complexity and challenges of rural marketing in a geographically vast country, with low literacy levels and low spending power of the farming community. In addition to this, the willingness to adopt better products or practices or technologies is another barrier to the sales and marketing teams on the rural front. The industry has a number of inherent problems prevalent in the Indian farming practices including seasonal fluctuations, excess production, slow adoption of latest technology and practices, some issues with the policy framework, unproductive produce prices etc. However, GOI is constantly working towards launching several initiatives and schemes aimed at improving farmers' welfare. The Indian agrochemicals industry and its operation require imports as well as exports of products, intermediates, raw materials etc., which invites the risks related to foreign exchange market fluctuations and drastic changes if any affects the business dynamics, profitability and or margins of the company. There are concerns also related to large working capital requirements. Moreover, the industry is dependent on China for sourcing some of the critical raw material and or intermediates which also is an area of worry. Quite a lot of environment activists and the local governments have started laying more emphasis on promoting environmentally safe cultivation practices while at the same time the regulatory authorities have restricted and or curtailed the sale and use of several agrochemical products; this is a major area of concern for the industry as well as the company as a whole. While at the same time, some players are getting drifted to genetically modified (GM) crops which represent a bigger challenge and threat to the industry. Some of the few regulatory developments and banning of certain pesticides grades introduced in the Indian industry are not favorable for some of the agrochemical players; however, many have already started altering the chemistry of the molecules which are under the radar. Regulatory price control mechanism if introduced in the industry too is disadvantageous to the industry. In addition to this, there is a threat related to sale of spurious/fake products, concoction/mixing of various chemicals sold as bio-pesticides, adulteration, sale of sub-standard products especially to the genuine agrochem players in particular.

**Outlook and Recommendations:**

Despite the uncertainties, the Indian agrochemicals industry appears to be on the door steps of an absolutely evolving dynamics of global trade and this is expected to continue in times to come as well with a promising future for the Indian agrochemical sector. SCIL is also one of the few industry players having both chemical and biological products in its portfolio. SCIL is currently concentrating on animal nutrition, household insecticides business and agrochemicals businesses in India and are contemplating on how to make the business bigger. The company intends to continue its focus on promoting the branded business in order to increase the customer interface. SCIL has a diversified portfolio, strong leadership position across its products and processes. SCIL has full faith and full cooperation from SCC which will help gain access to the global supply chain, R&D activities, etc. and thereby set a roadmap for the future. Additionally, SCIL is also in the process of developing molecules for its parent company that acts as a booster in order to strengthen its domestic market and product basket. SCC has a very strict audit process of the plants and treats the environment-related activities with keen interest and vigilance.

SCIL has to its credit the brand recall recognition from its deep farmers' connect on account of a transparent and ethical trading structure. With its state-of-the-art facilities, the management doesn't foresee any capacity constraints, which can lead to decent FCF generation in times to come. The company is cash rich and the management is open for any inorganic investments if the strategies match their domain. In addition to the large export portfolio of generic products which the company manufactures, SCIL is also looking at using Sumitomo's global marketing network and sales subsidiaries to increase foothold in more countries with existing products. With many agrochemical molecules likely to go off-patent; this would open doors for the Indian generic players and SCIL is aptly positioned in this space; having an at present patent count of 25+ (further 9 applications filed; 3 off-patent products under development for domestic and exports). Financially, the company has a strong balance sheet with zero leverage and over the past 2-3 financial years, the company has been able to gradually improve its return ratios. The company and its management are constantly attempting to grow business and enhance shareholders value. SCIL seems to be one of those ideas which is currently in the consolidation phase and very soon will enter into an accelerated growth-oriented phase. Some of the key factors which have strengthened the operations of the company include, strong parental synergies propelled by a strong management, market leadership position via global support, gradual diversification of the business with brand advantage, addition of new products, gradual and consistent growth over the years, competent sales force, wide distribution network, excellent farmers' connect etc. with equally good financials and return ratios. The company is richly valued because of the MNC factor and we initiate a Buy call on the stock with a target of Rs350 over a 12 months horizon.


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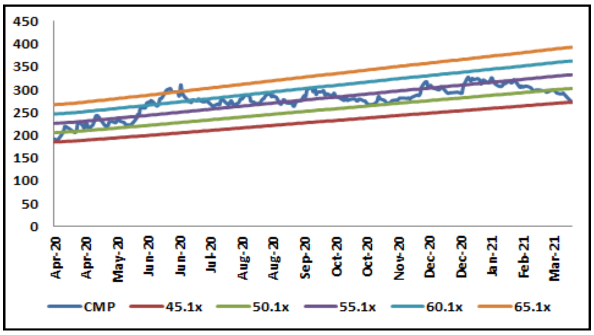
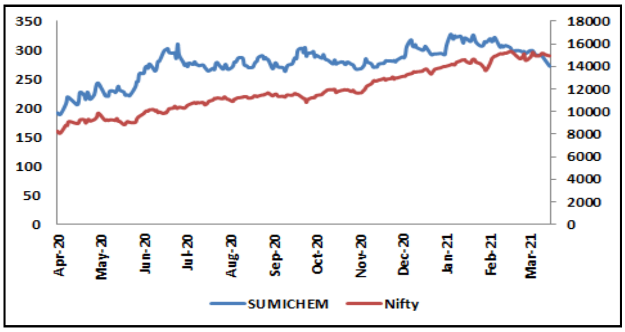
**Exhibit 19: One Year Forward P/E**




*Source: Ace Equity, Progressive Research*

**Exhibit 20: Price v/s Nifty**




*Source: Ace Equity, Progressive Research*

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