

June 27, 2022

## China plus one strategy to usher resilient growth ahead

Over the last three years, we witnessed enormous volatility in the crude prices from negative US\$40/barrel to US\$139/barrel in March 2022. This was on the back of a recovery in demand environment across the globe post Covid-19 along with disruption in crude supply due to Russia-Ukraine war in February 2022. It led most crude intermediate prices to reach vigorously higher, in turn, affecting cost dynamics of most chemical downstream manufactures. Additionally, rise in logistic cost along with higher power remained a key whammy on the chemical companies' performance. Despite all the above headwinds, our chemical universe coverage companies reported strong growth last quarter (*revenues growing 31.6% YoY to ₹ 13305 crore, while EBITDA and PAT jumped by 51.2% YoY & 77% YoY to ₹ 2767 crore and ₹ 1746 crore respectively*).

Going ahead, since the strategy of most of our coverage universe companies changed to embrace additional inventories to contain the impact of RM volatility during recent unprecedented times, we expect most of our coverage universe companies to sustain gross margins. We expect the Indian chemical industry to perform in line with the growth of Chinese chemical industry during the era of 2008-18. This is on the back of China plus one strategy across US & Europe leading domestic players to garner incremental market share. Apart from this, greater focus towards backward integration, rise in the R&D spending, higher capex into petrochemicals & improvement in the logistic activity to assist domestic specialty chemical companies to hold meaningful market share in the value added portfolio over the long run. Since China constitutes ~20% of the global speciality chemical industry (\$800 billion), even ~5% shift in market share from China to India can translate into an \$8-billion opportunity for the Indian speciality chemical companies. Indian speciality chemical industry holds around 3-4% market share currently.

**We retain our sectoral view as positive with our top bets being PI Industries (BUY rating; target price: ₹ 3,155), Sumitomo Chemicals (BUY rating; target price: ₹ 520) and Neogen Chemicals (BUY rating; target price: ₹ 1,870).**

**Exhibit 1: India chemical deficit increasing largely due to input inflation (₹ crore)**



Source: Ministry of commerce, ICICI Direct Research

### Sector View: Positive

#### Top Picks in Chemicals Space

Company	CMP (₹/share)	Target Price (₹/share)	Upside (%)
PI Industries	2,627	3,155	20%
Sumitomo Chemicals	440	520	18%
Neogen Chemicals	1,377	1,870	36%

#### Key risks to our call

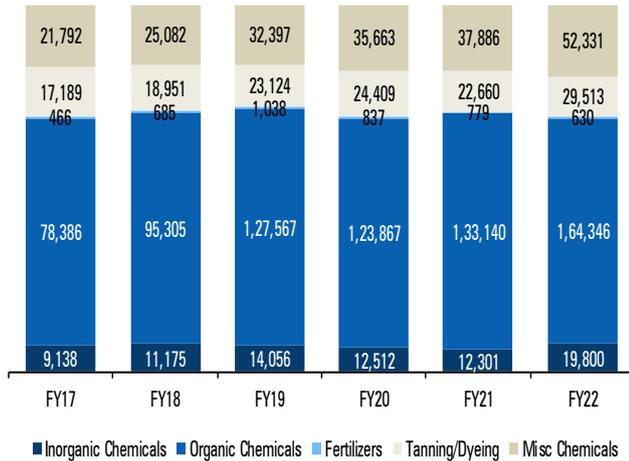
- Supply side challenges related to RM from China, to impact production value chain and thereby earnings growth
- Higher crude prices and depressed demand environment to limit cost inflation pass on and thereby affect GPM

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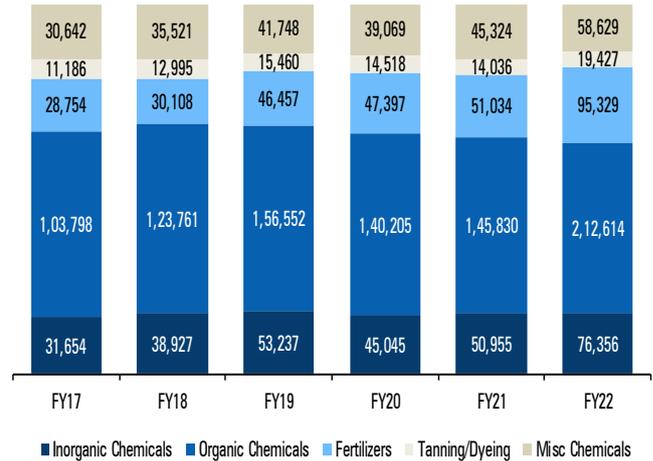
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Exhibit 2: India chemical exports (₹ crore)



Source: Company, ICICI Direct Research

Exhibit 3: India chemical imports (₹ crore)



Source: Company, ICICI Direct Research

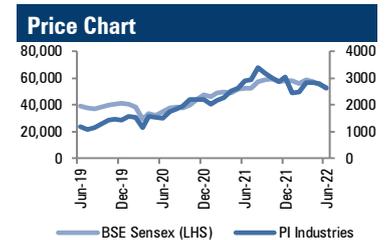
## Top bets in Chemical Coverage Universe

### PI Industries (PIIND)

Incorporated in 1947, PI Industries focuses on complex chemistry solutions in agri and pharma sciences.

- The company maintains a strong research presence through its R&D facility in Udaipur, where it has a dedicated team of over 300 scientists
- The revenues of the company can be subdivided into custom synthesis manufacturing (CSM) and domestic formulation business with the former contributing ~73% to overall revenue

We remain positive on PI Industries on the back of following reason. CSM business has a strong order backlog of around US\$ 1.4 billion, providing a revenue visibility of more than two years. This provides CSM business to grow in high teens CAGR for the foreseeable future. Apart from this, the company also plans to expand its presence into pharma domain by inorganic route, any success around that can diversify revenue stream to a large context. Moreover, pharma business is expected to drive higher margins than agro CSM and thus, higher share of pharma over long term to improve operational performance and thereby return ratios. We value PI Industries at 40x P/E FY24E EPS to arrive at a target price of ₹ 3155/share. We maintain **BUY** rating on the stock.



Particulars	
Particular	Amount
Market cap (₹ Crore)	39,930
FY22 Total Debt (₹ Crore)	268
FY22 Cash & Inv (₹ Crore)	2,265
EV (₹ Crore)	37,933
52 Week H/L	3535/2334
Equity Capital (₹ Crore)	15.2
Face Value (₹)	1

Exhibit 4: Financial summary for PI Industries

(₹ Crore)	FY19	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Revenue	2,840.9	3,366.5	4,577.0	5,299.5	18.4%	6,293.9	7,372.0	17.9%
EBITDA	576.4	717.8	1,012.2	1,142.4	15.6%	1,378.4	1,666.1	20.8%
EBITDA Margins (%)	20.3%	21.3%	22.1%	21.6%		21.9%	22.6%	
Adj.PAT	410.2	456.6	738.3	843.8	12.9%	978.8	1,199.7	19.2%
Adj. EPS (₹)	29.7	33.1	48.6	55.5		64.4	78.9	
EV/EBITDA	62.6x	50.8x	37.5x	33.2x		27.9x	22.6x	
P/E	88.4x	79.4x	54.1x	47.3x		40.8x	33.3x	
ROE (%)	17.9	17.4	13.8	13.8		13.9	14.7	
ROCE (%)	23.7	20.1	17.0	16.3		17.2	18.4	

Source: Company, ICICI Direct Research

## Sumitomo Chemicals (SUMCH)

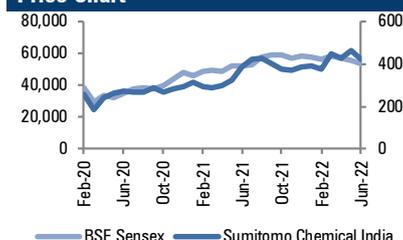
Incorporated in 2000, Sumitomo Chemical India (SCI) is present in the three business verticals of agro solutions (ASD), environmental health (EHD) and animal nutrition business (AND).

- SCI provides solutions for insecticide, herbicide, fungicide, plant growth regulator (PGR) under agro segment. Under animal nutrition, it manufactures methionine for feed additive use

- In terms of revenue contribution, insecticide constitutes ~51% while ~19% is from herbicide, 9% from fungicide and 20% from other segments such as PGR, AND & EHD

We retain our positive view on Sumitomo Chemical amid SCC Japan desiring to outsource its active intermediates to Sumitomo India. The company has been doing a capex of ₹ 100-110 crore with a revenue visibility of ₹ 200 crore initially. This would be for five molecules at the moment. However, we expect the scale to improve over the coming time. The company has also bought land parcel at Dahej. We expect meaningful capex announcement, going ahead, which would be used for export business. We expect this export business can be margin accretive to the overall group. We value Sumitomo Chemicals at 45x P/E FY24E EPS to arrive at a target price of ₹ 520/share. We maintain **BUY** rating on the stock.

### Price Chart



### Particulars

Particular	Amount
Market cap (₹ Crore)	21,064
FY22 Total Debt (₹ Crore)	0
FY22 Cash & Inv (₹ Crore)	435
EV (₹ Crore)	20,629
52 Week H/L	492/341
Equity Capital (₹ Crore)	499.1
Face Value (₹)	10

### Exhibit 5: Financial summary for Sumitomo Chemicals

(₹ Crore)	FY19	FY20	FY21	FY22	4 year CAGR (FY18-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Revenue	2,228.4	2,424.7	2,644.9	3,064.6	12.5%	3,438.7	3,832.0	11.8%
EBITDA	290.6	333.2	486.9	599.9	28.9%	701.5	797.1	15.3%
EBITDA Margins (%)	13.0%	13.7%	18.4%	19.6%		20.4%	20.8%	
Adj. PAT	165.7	204.7	345.4	423.5	30.7%	506.8	576.2	16.6%
Adj. EPS (₹)	3.3	4.1	6.9	8.5		10.2	11.5	
EV/EBITDA	39.8x	62.7x	42.2x	34.4x		28.8x	24.9x	
P/E	127.1x	102.9x	61.0x	49.7x		41.6x	36.6x	
ROE (%)	15.8	16.8	22.4	22.0		21.3	19.9	
ROCE (%)	25.3	24.8	29.8	30.2		28.6	26.7	

Source: Company, ICICI Direct Research

## Neogen Chemicals (NEOCHE)

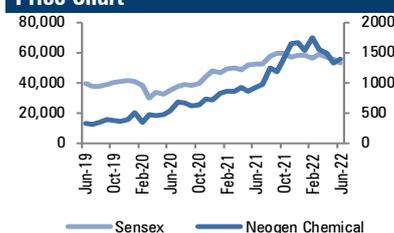
Commencing operations in 1991, Neogen Chemicals manufactures specialty organic bromine-based chemical compounds as well as specialty inorganic lithium-based chemicals compounds.

- The company's products find application in pharmaceutical intermediates, agrochemical intermediates, engineering fluids, polymers additives and water treatment chemicals, to name a few

- Neogen has two segments viz. (i) organic chemicals, (ii) inorganic chemicals of which organic chemical constitute ~80% of overall revenue while the rest comes from inorganic chemicals

With Phase 1 & phase 2 capex on stream, inching up utilisation to drive revenues in this year. Since the company is expanding capacity in lithium electrolyte, with backward integration of lithium salt, it is expected to gain meaningful market share in the medium to long run. Apart from this, Dahej plant has excess land available and hence, brownfield capex towards advanced bromine intermediates and CRAMS can be commissioned within 12 months with asset turn expected to be better, going ahead. This would support overall performance in the long run. We value Neogen Chemicals at 50x P/E FY24E EPS to arrive at a target price of ₹ 1870. We maintain **BUY** rating on the stock.

### Price Chart



Particular	Amount
Market cap (₹ Crore)	3,320
FY22 Total Debt (₹ Crore)	198
FY22 Cash & Inv (₹ Crore)	126
EV (₹ Crore)	3,391
52 Week H/L	1934/828
Equity Capital (₹ Crore)	24.9
Face Value (₹)	10

## Exhibit 6: Financial summary for Neogen Chemicals

(₹ Crore)	FY19	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Revenue	239.1	306.1	336.4	487.3	32.0%	688.7	805.6	28.6%
EBITDA	43.4	58.1	64.4	86.6	34.1%	130.8	161.1	36.4%
EBITDA Margins (%)	18.2%	19.0%	19.1%	17.8%		19.0%	20.0%	
Adj. PAT	21.0	28.6	31.3	44.6	42.2%	75.0	93.3	44.6%
Adj. EPS (₹)	10.4	12.3	13.4	17.9		30.1	37.4	
EV/EBITDA	64.2x	55.7x	51.4x	39.2x		27.1x	22.0x	
P/E	127.6x	108.4x	99.1x	74.4x		44.2x	35.6x	
ROE (%)	29.8	18.3	17.1	10.2		14.8	15.7	
ROCE (%)	22.2	18.4	15.1	12.0		15.7	17.1	

Source: Company, ICICI Direct Research

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Buy: >15%;

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%



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