

Rating Rationale

September 25, 2023 | Mumbai

Sudarshan Chemical Industries Limited

Rating reaffirmed at 'CRISIL A1+'

Rating Action

Rs.50 Crore Commercial Paper	CRISIL A1+ (Reaffirmed)
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Note: None of the Directors on CRISIL Ratings Limited's Board are members of rating committee and thus do not participate in discussion or assignment of any ratings. The Board of Directors also does not discuss any ratings at its meetings.

1 crore = 10 million

Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL Ratings has reaffirmed its 'CRISIL A1+' rating on the commercial paper programme of Sudarshan Chemical Industries Ltd (Sudarshan).

The ratings reflect the extensive experience of the promoters in the pigment industry and the established market position of Sudarshan. The ratings also factor in the diversified product range and end-user industry profile, strong distribution network, marquee clientele, and comfortable financial risk profile of the company. These strengths are partially offset by the industry based large working capital requirements, risks related to volatility in commodity prices and those related to ramp-up of capacities with regards to large capex incurred.

Revenues grew by 5% on-year to Rs. 2,302 crore during fiscal 2023 on account of muted volume growth, particularly during the first three quarters of the fiscal on account of buying deferment decisions in plastics and coating segments within domestic markets, and weak demand within overseas markets. That said, a sharp demand recovery was witnessed during the fourth quarter of fiscal 2023 with demand bounce back from plastic segment within domestic markets; however, coating segments continue to remain subdued on account of buying deferment decisions due to deflationary situation in raw material prices resulting in just-in-time inventory stocking. Overseas volumes also witnessed early signs of revival, however, the same is expected to remain uncertain on account of global macro-economic headwinds in European and US markets.

Operating margins contracted by nearly 265 basis points (bps) to 10.0% in fiscal 2023. Margin contraction was more visible in the nine months of the said fiscal on account of higher and volatile raw material and energy costs, but, during the fourth quarter onwards easing raw material and energy prices coupled with volume ramp up, enabled margin recovery. Overall subdued demand during the first three quarters resulted in limited ability of cost pass through of indirect costs, which resulted in operating profit levels declining to Rs. 231 crore during the said fiscal.

Operating income during the first quarter of fiscal 2024 increased 10% year-on-year (y-o-y) to Rs. 608 crore; however, on a sequential basis, 12% de-growth in revenues was witnessed. Demand recovery witnessed during 4Q'FY23, continued through to the first quarter of fiscal 2024. As a result, demand environment during the current quarter was comparatively better than the same period last fiscal, thereby resulting in higher volumes, but, due to downward correction in commodity prices, realizations were on the lower side. Operating margins on the other hand, improved by 400 bps on y-o-y basis to 11.5% during 1Q'FY24; however, operating margins were down by 70 bps on sequential basis due to lower operating leverage and annual employee increment effect.

The financial risk profile is expected to improve significantly in fiscal 2024 on the back of improvement in capital structure and key debt protection metrics. Capital structure marked by adjusted gearing (Gross Adjusted Debt / Adjusted Networth) peaked at 1.04 times in fiscal 2023 on account of large debt funded capital expenditures (capex) of Rs. 750 crore (75% debt funding). The company, during 1Q'FY24, monetized its freehold land which is primarily being utilized towards deleveraging the balance sheet. As a result, gearing is likely to improve to below 0.6 time over the medium term.

Analytical Approach

CRISIL Ratings has combined the business and financial risk profiles of Sudarshan and its subsidiaries, Sudarshan Europe B.V., Sudarshan North America, Inc., Sudarshan Shanghai Trading Company Ltd, Sudarshan Mexico S de R.L.de CV and Sudarshan Japan K.K. All these companies are collectively referred to as the Sudarshan group and have significant managerial, operational, and financial linkages. CRISIL Ratings has also consolidated the business and financial risk profiles of RIECO Industries Ltd which is a wholly-owned subsidiary of Sudarshan and also because of the support committed by the group and its track record demonstrated earlier.

Please refer Annexure - List of Entities Consolidated, which captures the list of entities considered and their analytical treatment of consolidation.

Key Rating Drivers & Detailed Description

Strengths:

- **Healthy market position in the pigment industry :** Sudarshan is the largest pigment manufacturer in India, with a market share of 35%, and as per company estimates, is the third largest pigment manufacturer in the world. The products are used in various end-user industries such as decorative and automotive coatings, plastics, inks, and cosmetics. The company, with a product base comparable to global leaders, aims to add more products to its portfolio. Its strong network comprises more than 60 channel partners and subsidiaries in the USA, the Netherlands, China, Mexico and Japan; for distribution of pigments worldwide. Exports accounted for 49% of revenue in fiscal 2023. The company is likely to see its growth strengthen further including global market position, aided by new products launched as a part of capex program which is recently concluded and "Go to Market" strategy initiative of the company post easing macro-economic headwinds and global uncertainties. Tailwinds like ongoing consolidation in the industry and China plus one strategy may also benefit the company.

At current, specialty pigments product portfolio accounts for around 68% of pigment business revenues, and the proportion is said to increase with new product launches within High Performance Pigments (HPPs) and Complex Inorganic Color Pigments (CICPs). The new products from the capex investments have higher skewness towards overseas markets, given the global shift toward specialty pigments due to higher durability and sustainability amidst growing environmentally friendly chemicals demand.

- **Comfortable financial risk profile:** Leverage marked by adjusted gearing is expected to improve to below 0.6 time over the medium term on account of balance sheet de-leveraging from the proceeds of asset monetization and due to efficient working capital management. Given the continuance of looming macro challenges in key overseas markets, resulting in delayed ramp-up of capex investments, reduction of leverage through monetization of freehold land, provides an additional layer of financial flexibility. In addition, key debt protection metrics marked by interest coverage is expected to remain comfortable at above 5.0 times over the medium term, thereby providing sufficient buffer in cash flows.

Weaknesses:

- **Large working capital requirement and exposure to volatility in commodity prices :** Gross current assets (net of cash) stood at 175 days as on March 31, 2023. Inventory requirement remains high as the company has multiple stock keeping units for pigments and several distribution centers both in India and abroad. Though working capital has been managed well by matching receivables with payables over the last few fiscals, reliance on working capital borrowing has increased because internal accruals were utilized to partly fund ongoing capex. The same is likely to be reduced over the medium term through high-cost borrowing reduction from asset monetization and incremental working capital requirements met through internal accruals given modest capex requirements.
- **Susceptibility to stabilization and offtake risk related to recent commissioning of large capex :** The company has incurred a total capex of nearly Rs 750 crore over fiscal years 2020 to 2023, towards multiple projects, capacity expansion and launch of new products. While all the major capex projects commissioning has been completed by 4Q'FY23, volume ramp-up from capex investment is expected to be slower-than-expected due to demand headwinds in the international markets, on account of geopolitical pressure leading to high inflation and likely volatility of commodity prices.

Liquidity: Strong

Expected annual net cash accruals of Rs. 180-200 crore and unencumbered cash surplus of Rs 20 crore as on March 31, 2023, will be sufficient to meet debt re-payment obligations, moderate capex requirements, and working capital requirements, with limited reliance on external funding. The company is not expected to incur any incremental expansionary capex over the medium term, except maintenance capex of Rs 50-70 crore. Also, fund-based limit of Rs 515 crore was utilized by 45% on average during the 12 months through July 2023. In addition, the one-time gain from the sale of freehold land shall be utilized to pay-down debt levels to de-leverage the balance sheet.

Rating Sensitivity factors

Downward factors:

- Any significant impact on operating profitability leading to weakening of operating margins below 10% on a sustained basis.
- Substantial increase in working capital requirement or large, debt-funded capex if any, leading to weakening of debt protection metrics.

About the Company

Sudarshan is a globally renowned pigment player and the largest in India, manufacturing a wide range of organic and inorganic pigments and mica-based effect pigments. The company, which was established in 1951, remained focused on the domestic market till 2006. The joint venture with Dainippon Ink Corporation (DIC) was operational between 1990 and 2006, post which Sudarshan went global, establishing its footprint in North America and Europe. The company has two manufacturing facilities in Roha and Mahad (both in Maharashtra).

During the three months ended June 30, 2023, on a consolidated basis, the company posted net profit (Incl. exceptional item) of Rs. 267 crore (Rs. 7 crore for the corresponding period of previous fiscal). Net profit posted for the period (Excl. Exceptional Item of Rs 246 crore) is Rs. 21 crore (Rs. 7 crore for the corresponding period of previous fiscal) on net sales of Rs. 608 crore (Rs. 554 crore).

Key Financial Indicators - CRISIL Ratings adjusted numbers

As on / for the period ended March 31		2023	2022
Revenue	Rs crore	2,302	2,201
Profit after tax (PAT)	Rs crore	45	130
PAT margin	%	1.9	5.9
Adjusted debt/Adjusted networkth	Times	1.04	1.04
Adjusted interest coverage	Times	4.95	12.50

Any other information: Not applicable

Note on complexity levels of the rated instrument:

CRISIL Ratings` complexity levels are assigned to various types of financial instruments and are included (where applicable) in the 'Annexure - Details of Instrument' in this Rating Rationale.

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Annexure - Details of Instrument(s)

ISIN	Name of the instrument	Date of Allotment	Coupon Rate (%)	Maturity Date	Issue size (Rs. Crore)	Complexity Level	Rating assigned with outlook
NA	Commercial Paper	NA	NA	7-365 Days	50	Simple	CRISIL A1+

Annexure – List of entities consolidated

Names of Entities Consolidated	Extent of consolidation	Rationale for consolidation
Sudarshan Europe B.V.	Full	Wholly owned subsidiaries, same business and significant managerial, operational, and financial linkages
Sudarshan North America, Inc.	Full	
Sudarshan (Shanghai) Trading Company Ltd	Full	
Sudarshan Mexico S de R.L.de CV	Full	
Sudarshan Japan K.K	Full	
RIECO Industries Ltd	Full	Wholly owned subsidiaries, commitment of support and past demonstrated track record of support

Annexure - Rating History for last 3 Years

Instrument	Type	Current		2023 (History)		2022		2021		2020		Start of 2020
		Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Commercial Paper	ST	50.0	CRISIL A1+		--	30-12-22	CRISIL A1+	30-12-21	CRISIL A1+	24-12-20	CRISIL A1+	Withdrawn
			--		--		--		--	03-02-20	CRISIL A1+	--

All amounts are in Rs.Cr.

Criteria Details

Links to related criteria
CRISILs Approach to Financial Ratios
Rating criteria for manufacturing and service sector companies
CRISILs Bank Loan Ratings - process, scale and default recognition
Rating Criteria for Chemical Industry
CRISILs Criteria for rating short term debt
CRISILs Criteria for Consolidation

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