

# SUDARSHAN

1<sup>st</sup> September, 2021

DCS – Listing  
BSE Limited  
Phiroze Jeejeebhoy Towers,  
Dalal Street,  
Mumbai – 400 001

Listing Department  
National Stock Exchange of India Limited  
Exchange Plaza, C-1, Block G,  
Bandra Kurla Complex,  
Bandra (East), Mumbai – 400 051

**Scrip Code - 506655**

**Scrip Symbol - SUDARSCHEM**

Dear Sir,

**Sub : Transcript of Analysts / Institutional Investors Conference Call**

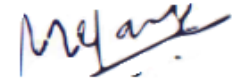
We are enclosing herewith a transcript of the conference call with analysts / institutional investors, which took place on 9<sup>th</sup> August, 2021, after announcement of the Unaudited Financial Results (Stand-alone and Consolidated) of the Company for the quarter ended 30<sup>th</sup> June, 2021.

The said transcript is also uploaded on the website of the Company.

Kindly take the same on record.

Thanking You,  
Yours Faithfully,

For SUDARSHAN CHEMICAL INDUSTRIES LIMITED



MANDAR VELANKAR  
DGM – LEGAL & COMPANY SECRETARY





**“Sudarshan Chemical Industries Limited Q1 FY22  
Earnings Conference Call”**

**August 9, 2021**

**MANAGEMENT: MR. RAJESH RATHI – MANAGING DIRECTOR  
MR. NILKANTH NATU – CHIEF FINANCIAL OFFICER  
MR. VIVEK THAKUR – GM (FINANCE)  
MR. AMEY ATHALYE – DGM (FINANCE)  
MR. MANDAR VELANKAR – COMPANY SECRETARY**

**MODERATOR: MR. ABHIJIT AKELLA – IIFL SECURITIES LIMITED**

**Moderator:** Ladies and Gentlemen, good day and welcome to Sudarshan Chemical Industries Limited Q1 FY22 earnings conference call hosted by IIFL Securities Limited.

As a reminder, all participants' lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal for an operator by pressing '\*' then '0' on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Abhijit Akella from IIFL Securities. Thank you and over to you, Mr. Akella.

**Abhijit Akella:** Ladies and gentlemen, good afternoon and thank you for joining us on the 1st quarter earnings conference call of Sudarshan Chemical Industries. It is my pleasure to introduce the company's senior management team who are here with us to discuss the results. We have with us Mr. Rajesh Rathi – Managing Director, Mr. Nilkanth Natu – Chief Financial Officer, Mr. Vivek Thakur – GM (Finance), Mr. Amey Athalye – DGM (Finance), and Mr. Mandar Velankar – Company Secretary.

We will begin the call with opening remarks by the management team and thereafter we will open up the call for a Q&A session. I would now like to hand the call over to Mr. Natu to take proceedings forward. Thank you and over to you, sir.

**Nilkanth Natu:** Good evening ladies and gentlemen, welcome to Sudarshan's Q1FY22 earnings conference call. Our Investor Presentation has been uploaded on the stock exchanges for your ready reference.

I would like to take you through the financial highlights for this quarter...

On a consolidated basis, total income from operations stood at INR 474 cr as compared to INR 352 cr for the same period last year, reporting a growth of 35% YoY.

EBITDA for the quarter stood at INR 62 cr as compared to INR 53 cr in Q1FY21. EBITDA margins stood at 13% as compared to ~15% over the same period last year.

Financial performance of Company's subsidiary Rieco was impacted due to higher cost of project execution which caused reduction in the consolidated profit by ~ INR 4.2 cr.

Profit after Tax stood at INR 26 cr as compared to INR 18 cr for the same period last year. PAT was up 44% YoY.

Now going into details of our Pigment business...

Income from operations stood at INR 453 cr, a growth of 33% YoY. EBITDA for the quarter stood at INR 66 cr as compared to INR 54 cr in Q1FY21. EBITDA margins stood at 14.5% as compared to ~15.7% over the same period last year.

Company continues to see good traction on the exports markets in all categories of product lines. Exports for the quarter were at INR 250 cr as compared to INR 221 cr, growth of 13% YoY.

Our Domestic sales for the quarter were at INR 203 cr as compared to INR 120 cr, growth of 68% owing to lower base effect. However, during Q1 the domestic market demand softened as covid wave 2 caused serious disruptions. The second wave of the pandemic did impact business due to the lockdowns imposed by states at various intervals starting from the month of April and continued restrictions through the quarter.

Masterbatch or the plastics segment had major impact due to lockdown as also increase in the other input material costs for plastics manufacturing. Sales into the Coatings and Ink segments were also impacted when we compare QoQ basis.

With normalcy returning due to easing of restrictions, we expect the momentum to gradually pick up in next few months in the Indian market.

Specialty Sales stood at INR 318 cr as compared to INR 240 cr for previous year same quarter, up 32% YoY. Non-Specialty sales for the quarter stood at INR 135 cr as compared to INR 101 cr for the same period last year, up 33% YoY.

Gross Margins for the quarter stood at 47.1% as compared to 43.9% for the same period last year. There have been sharp increases in the intermediate prices going into various pigment chemistries. We have passed on majority of the cost increases to customers. However, we continue to see price pressure on select intermediates and this is likely to continue for next few months.

Apart from raw material cost increases, we see energy and logistics costs also rising. Increase of >50% in the Coal prices is pushing up manufacturing costs. The challenges in the logistics area are continuing leading to freight cost escalations of ~50-60% and there is also problem with container availability.

Unlike in the immediately preceding year, we have given annual increments effective April this year. This had also been the practice we followed before the pandemic. Please note that Q1FY21 did not have any increment effect as it was rolled out from Oct-20. Two revisions are now reflecting in the employee costs for this quarter. Salary revisions along with onboarding of resources in various roles during previous year, is leading to higher employee benefits expenses, up by 20% YoY.

Q1FY21 had export benefits from MEIS. RoDTEP scheme was implemented from Jan-21. We keenly await details on rates under RoDTEP scheme and currently have not accrued any income.

All these factors together have led to EBITDA margins of 14.5% for the quarter.

Now coming to Capex projects under commissioning. Despite temporary disruption during wave-2, we are on track for completion of capex under execution during the current fiscal year. We expect to complete capex projects worth ~ INR 120 cr by end of Q2.

Our manufacturing plants continued to operate in line with the various directives of the Government during the last quarter and we continue to deploy & practice necessary safety precautions regularly, to ensure continuity & uninterrupted functioning of our plants with safety and welfare of our employees being of utmost importance.

We look forward to continuing our growth journey and delivering value to all our stakeholders. With this I now open the floor for questions and answers session....

**Moderator:** We will now begin the question & answer session. The first question is from the line of Ashwini Agarwal from Ashmore Investments. Please go ahead.

**Ashwini Agarwal:** Could you just help us understand what happened in that subsidiary which caused a loss of Rs. 4 crores. You briefly mentioned it in your opening comments, but can you just give some more color to it and what should one expect going ahead?

**Nilkanth Natu:** On the subsidiary part, as you are aware that this company is into the engineering business. It is a capital goods industry. Due to the Q1 partial lockdowns in the various states, they were not able to scale up the revenue. It is not on the order balance or backlog side issue. It is more on the execution because there were lockdowns, and due to this, the revenue has been lower than what we had expected, but we expect this subsidiary to make up this lost revenue for the Q1 based on the execution in the coming quarters and they would be able to become profitable from the coming quarters.

**Ashwini Agarwal:** If I adjust for this Rs. 4 crores, then on a consolidated basis, your EBITDA margin declined by about 100 basis points and there you mentioned that you have 2 salary increases and you have the MEIS benefit going away as well and your gross margin actually expanded on both on the year-on-year and quarter-on-quarter basis despite input cost pressures. So, is this a fair thing to say that if your subsidiary comes back in the coming quarters and MEIS gets restored as RoDTEP in some form or the other, then we should expect your EBITDA margins to expand as compared to what we saw for the full year last year? Would that be a fair expectation if these 2 things were to happen?

**Nilkanth Natu:** It's a very fair point. We agree with you. In terms of our pigment, EBITDA has been 14.5% wherein there has been a MEIS impact. What we also see is there has been a cost pressure and costs are increasing, whether it is coal cost or whether it is freight cost. And this trend, we expect, will continue. We expect that the margins will be under pressure and we are continuing to monitor this and try to improve it.

**Ashwini Agarwal:** On the subsidiary, could you broadly provide the EBITDA number? It comes to Rs. 4 crores if I just take the pigments and the consolidated. I am just wondering is there anything else there or that should be the gap for the subsidiary?

**Nilkanth Natu:** Yes, this is the gap. It is a small subsidiary, so around Rs. 4 crores is the gap.

**Moderator:** The next question is from the line of Sanjesh Jain from ICICI Securities. Please go ahead.

**Sanjesh Jain:** Two-fold question, both on the cost side. The one on the raw material inflation, we said that we have passed some raw material inflation but we continue to see some of the raw material prices going up. Is it fair to assume that in the medium term until the raw materials settle, there could be a volatility in the gross profit margins in the next few quarters? And this 43.6% can come down for a quarter or so before it goes up. Is it a fair assumption? And second, on the coal and

freight cost because the Other Expenses have declined by only 1.5% while our revenue decline is close to 17% to 18% on the quarter-or-on quarter basis. On the Other Expenses side, is the fuel and the freight the only reason? because generally from Q4 to Q1, we see a decline. That has been a historical trend for us, and this time it has been flattish. Is there anything more in the cost we need to understand or it is just the fuel and freight which is causing this high Other Expenses? These are the 2 questions on the cost.

**Nilkanth Natu:** I will answer the first question. Yes, what we have said that there is the raw material escalation we are seeing and there are many intermediates where the prices are going up. So, rightly pointed out by you, we expect this pressure or variability will be there for the short term. In terms of the other Expenses, yes, there has been a reduction, not in line with, what you have mentioned in terms of the sales revenue drop but the major cost increase which are coming, is from the coal as well as the freight. There are no one-timer in this particular cost. We continue to monitor this closely.

**Sanjesh Jain:** Second, on the product launches. In the Q4 call, we had mentioned that in September we were looking to launch a couple of products. Just wanted to understand the new product launches pipeline and because of this COVID thing, are there any changes in the product launches we were anticipating and can you just elaborate on what are the product launches planned for this year and a year after this?

**Rajesh Rathi:** You are right. Most of our product launches were planned for September. However, we still expect some launches to happen in September, but April and May as you are aware, a lot of CAPEX got delayed because of lack of availability of oxygen and also manpower. So, some CAPEX will get spilled over on the Q3. But by Q3 end, we expect most of our product CAPEX to be completed and product launches to be completed.

**Sanjesh Jain:** Can you give some color on the number of products we are looking at and whether it's in the speciality or non-speciality?

**Rajesh Rathi:** These are all specialties, and if you look at color group-wise, maybe 3 product lines, but in that, obviously each product line will have 10-15 products.

**Sanjesh Jain:** So, 3 product lines and each product line with 10 to 15 products in it is what we are trying to launch. This all should happen in this fiscal year, right?

**Rajesh Rathi:** Yes, absolutely sir.

**Sanjesh Jain:** And it's a commercial launch, not that we are sending this for client approval.

**Rajesh Rathi:** All that has been processed. So, it will be a commercial launch this financial year.

**Sanjesh Jain:** One last bit of question, more of a bookkeeping question on the Mahad facility which we shut due to the heavy rainfall. Can you just brief what was the impact and how should we look at Q2 on the backdrop of this shut down of the facility?

- Nilkanth Natu:** On the Mahad flood, our facility was not operational for 2 weeks after 22<sup>nd</sup> of July. We have resumed the operation since yesterday. So, there was a 2-week production loss and the operation has started from yesterday.
- Sanjesh Jain:** Do we also expect sales loss or we had enough inventory and we could manage it through Roha or this 2 week of production loss will also mean we would have lost certain revenue?
- Rajesh Rathi:** Yes, we did. Obviously, there was a production loss as those lines were running full. So, there was a sales loss.
- Moderator:** The next question is from the line of Ankur Periwal from Axis Capital. Please go ahead.
- Ankur Periwal:** First question on the revenue growth. Given the low base, we are looking at a strong growth year on year, but if I look at H2 average, let us say Q3-Q4 average run rate both on the domestic and exports, there is a pretty significant decline on the domestic side as well as subdued growth on the exports side. The reason I am taking Q3 and Q4 is when sort of COVID-led impact was easing out there, both in the international and domestic markets. Your comments there? Mid 20s, more like 24% to 25% decline on domestic, was it largely led by the plastics and ink segment which you highlighted in your initial comments? And importantly on the exports side if we are seeing any softening of demand there?
- Rajesh Rathi:** Basically, there are 2-3 factors. As Natuji has elaborated in his statement, domestic, because April, May, and part of June also was a COVID lockdown period, we saw a lot of demand was an issue. In addition to this, in the plastics industry, there was polymer availability issue, pricing issues, etc., which caused the India market to be a concern. In terms of exports in general, the trend is good. If you look at Q3 last year, there was some pent-up demand as supplies were an issue in the 1st half. So, going forward, barring a little bit of logistics issues which we are facing, some on the export front, we should be able to keep up the export and we see the sales picking up in Q2 for domestic too.
- Ankur Periwal:** On the revenue growth side, given most of the products may get sort of spilled over to maybe Q3 or Q4 launch, but FY23 will be a significant benefit of all these product launches there. Will it be fair to assume that unlike our last, let us say 4-5 years' average of 12%, 13%, early teens revenue CAGR, we should look at a reasonably higher number there, incremental contribution of these top products being there. Will that be a right assessment?
- Rajesh Rathi:** The CAPEX should definitely give us a boost in our revenue growth. However, like we have been saying, realization of the full potential of the CAPEX should be over 3 years, but of course, revenue growth will start as soon as some of the CAPEX goes live.
- Ankur Periwal:** One last clarification on the freight cost side. As I understand, the logistics cost being higher year on year, but these costs will be effectively passed through to the customers or do we take it on our books?

- Rajesh Rathi:** Some of the direct raw material cost is easier to pass on. First time we have experienced such a high cost on the indirect items like coal and freight. There is a lag, but we are making attempts to pass it on, but that's the area of concern.
- Ankur Periwal:** If I got you right, there will be a lag in passing through this, but it will be passed on as well, maybe by a lag of a couple of months.
- Rajesh Rathi:** Yes, lag by a quarter, I would say.
- Moderator:** The next question is from the line of Rohit Nagraj from Emkay Global. Please go ahead.
- Rohit Nagraj:** Sir, the first question is in terms of the CAPEX. You mentioned that about Rs. 150 crores will be commissioned by September. What is the timeline for next two years in terms of the incremental CAPEX? When is it likely to get commissioned? And to understand how the revenue profile will look for the next 3 to 4 years
- Nilkanth Natu:** I would like to clarify what I said in my opening remarks is, Rs. 120 crores by September end, not Rs. 150 crores.
- Rohit Nagraj:** My apologies, sorry. This Rs. 120 crores will be commissioned by September. For the rest of the projects, how do they look like over the next FY23 and FY24 in terms of commissioning?
- Nilkanth Natu:** The balance CAPEX projects, we will be completing in Q3, not in FY23. We will complete all these CAPEX projects in the current fiscal year itself.
- Rohit Nagraj:** Just to understand, Rs. 120 crores will be commissioned by September and are there any other capital work-in-progress which will get commissioned in subsequent quarters and in FY23?
- Nilkanth Natu:** Yes, sir. The balance capital WIP will get commissioned in Q3. We said around Rs. 300+ crores in our earlier presentation in Q4. So, Rs. 120 crores will get commissioned by Q2. Balance around Rs. 180 to 200 crores will get commissioned in Q3.
- Rohit Nagraj:** Sir, the second question is in terms of the orders. We have seen that last year because of the validation getting postponed due to COVID issues, the new product launches got delayed. Are we facing such delays still because of the second wave and the ongoing probable impact of the 3rd wave so that the product launches would further get delayed and may hamper our revenue profile despite being good in terms of the CAPEX being commissioned?
- Rajesh Rathi:** Natuji mentioned that because of the Q1 issues we had, the CAPEX did get slightly delayed but the team has done a great job in making up some of this and except for any unforeseen reason, we should complete everything by Q3, and the commercialization also should happen after that on speed.
- Moderator:** The next question is from the line of Archit Joshi from Dolat Capital. Please go ahead



- Archit Joshi:** Sir, my question is largely related to the mica-based pigments piece that we have in the business. I believe we have recently got some anti-dumping duty in the month of June for some of the products under that category. I just wanted to ask you if you can throw some light on what is the strategy that we are having on that front? What benefits you might accrue from this ADD and where are we in terms of any product launches or any capital expenditure on that part? Just a broad understanding on how that business unit is panning out for us.
- Nilkanth Natu:** Currently, this proposal is pending with the Ministry of Finance and we are awaiting the results. We will await for that notification and then we will see.
- Archit Joshi:** But sir, even otherwise without considering the anti-dumping duty impact which we probably might have clarification on later, how is the business on that front? I am supposing that the margin profile of that particular piece even if it is smaller in terms of the current capacity that we have, it's fairly higher than the blended margins that we are having in the other HPPs and some of the other pigments. Any thoughts on that front, how are you trying to ramp that up and how is the demand panning out in that particular smaller piece even if it is right now?
- Rajesh Rathi:** Majority of the market on the industrial side, we don't participate in a big way because of the dumping from China into the India market, and that's the reason actually the government is looking at protection for this. As soon as we are able to get that, we will be able to participate in that market. The margin profiles are not very different in those businesses.
- Archit Joshi:** For the same product, how are you faring on the exports side, the growth momentum if you can comment something on that as well?
- Rajesh Rathi:** That product range, on the industrial side, we don't participate in the global market because we sell more into the other markets – the automotive and cosmetics market.
- Moderator:** The next question is from the line of Dhaval Shah from Girik Capital. Please go ahead.
- Dhaval Shah:** Sir, just 1 broad level question. The global level consolidation which you have spoken about between the top 2-3 players how do you see it helping us, and also has there any capacity which is completely gone out or there is a consolidation, so it has not gone out of the global demand and supply?
- Rajesh Rathi:** Not the capacities have gone out, it's just consolidation, and we sense the No. 1 and No. 3 players become one and maybe it's the No. 2 and No. 5 players become two. We expect 2 areas – one is that customers are looking for alternatives and also some of the China crisis, India does look like a good alternative and that's where we are banking on this favorable tide towards us.
- Dhaval Shah:** Sir, how much capacity if you can quantify which has got out of the market and in which category it is?
- Rajesh Rathi:** No capacity has gone out of the market.
- Dhaval Shah:** Any specific product segment where we see a lot of opportunity because of this?

- Rajesh Rathi:** We see in all the organic pigments.
- Dhaval Shah:** On the organic side? Okay. So, that's where all the major top 3 are largely present.
- Rajesh Rathi:** Yes, that's right.
- Dhaval Shah:** Our focus will be also more on the cosmetics side going forward when we say about more complex or a speciality pigment?
- Rajesh Rathi:** No, not really sir. Coatings and plastics is our major focus.
- Moderator:** The next question is from the line of Naushad Chaudhary from Systematix Group. Please go ahead.
- Naushad Chaudhary:** Two-three questions. Firstly, in pigment business, I just wanted to understand from the client point of view, how important it is for them to have a balance, supplies, wallet share, or the concentration is okay from the client point of view?
- Rajesh Rathi:** From a client's perspective, usually there would be 2 suppliers at least for a product – generally a 2-supplier position.
- Naushad Chaudhary:** Secondly, in terms of raw material supply and availability, if you look back – 3-4 years back versus now – have there been any changes in terms of number of suppliers or availability? Has there been any change in terms of overall ecosystem?
- Rajesh Rathi:** Yes, there have been several issues from China and the perspective of raw materials and that's where we are seeing a lot of increase in the cost of raw materials.
- Naushad Chaudhary:** Have we seen any domestic capacity addition on those parts and some softness and easiness in terms of availability?
- Rajesh Rathi:** There have been some additions in India but it's not enough to meet the industry demand.
- Naushad Chaudhary:** Lastly, on the CAPEX part. During FY21 and 22 whatever we have planned, can we broadly split between how much we are spending in our classic Azo, phthalo, HPP, and backward integration, broadly in terms of percentage if you can split it?
- Rajesh Rathi:** Sir, it's a little bit competitively sensitive information to give SBU wise. That's why, we don't split that in the product line perspective.
- Moderator:** The next question is from the line of Amar Maurya from AlfAccurate Advisors. Please go ahead.
- Amar Maurya:** Sir, a couple of questions. Firstly, as you indicated that the domestic business which got impacted is largely linked to the plastic, coatings, and the printing ink business. What percentage of the overall domestic revenue would be linked to this particular industry?
- Rajesh Rathi:** That will be the large part, sir. They are the 3 main industries we serve.

- Amar Maurya:** And now you see the bounce and you expect the run rate to come back to the normal level?
- Rajesh Rathi:** We should see a normal off-take, but I am not sure whether we will be able to make up what is over now.
- Amar Maurya:** Similarly, sir, in terms of the exports, as you indicated that the new capacities and new products which are going to come in the 2<sup>nd</sup> half largely, but I believe our CAPEX or the capacities which had come to the last year like yellow pigments and all, those will give the good ramp-up in the 2<sup>nd</sup> half, right?
- Rajesh Rathi:** Sir, partly the major launch was the yellow pigment and that yellow pigment mainly goes into coatings which takes a little longer to get the approval, and as we had mentioned earlier, in this product line we did require a couple of cycles to change some of our products which took a little longer. So, we would expect some ramp-up but not a major ramp-up in the H2. We would expect some sales to come.
- Amar Maurya:** When do you see the major ramp-up for the yellow pigment, sir? FY23?
- Rajesh Rathi:** Yes, FY23 second half. Like I said, any CAPEX it would be about 3 years to scale up. So, gradually every year something should happen. This year I would count as year 1 for the yellow pigment.
- Amar Maurya:** Secondly, in terms of the gross margin improvement which we had seen in this quarter, is it also because as you said the raw material prices had gone up, so you would be having some inventory stocking – low-price inventory – and that is the reason you have seen the gross margin improvement and broadly this gross margin improvement also should fade in the 2<sup>nd</sup> quarter?.
- Rajesh Rathi:** Yes, sir.
- Moderator:** The next question is from the line of Abhijit Akella. Please go ahead.
- Abhijit Akella:** First, on RIECO just a clarification. Can we expect on a full-year basis that margins will be near normal levels or the losses that we have incurred in Q1, it's not possible to recover them over the life of the projects that we are executing? How should we think about margins going forward?
- Nilkanth Natu:** On the RIECO front, yes, Q1 has been a difficult quarter, but overall, the projection of the RIECO management and based on the current order balance, we expect that they will make a turnaround and by year-end, they will be able to get to the normalized margin level.
- Abhijit Akella:** Just to clarify, sir, when you say by year-end, are you saying on a full-year basis or you are saying that by Q4, the margin will start to approach normal levels?
- Nilkanth Natu:** We expect that they will be able to come to the normal margin levels on a full-year basis.

- Abhijit Akella:** Secondly, on the domestic revenues, we said that we expect normalcy to come going forward. Should we expect that Q2 will still be a little bit subdued given the gradual recovery in the domestic market, it might take a few months plus we had the Mahad incident also where we lost a couple of weeks? So, should we expect normalcy in domestic revenue run rate to come only from Q3 onwards?
- Nilkanth Natu:** Yeah, Abhijit. We expect that it will get restored to normalcy from Q3 onwards.
- Moderator:** The next question is from the line of Ashwini Agarwal from Ashmore Investments. Please go ahead.
- Ashwini Agarwal:** Just a small followup to one of an earlier questions and just thinking through your opening comments again, I am still a little intrigued that despite of all operating revenue in the pigment business, your gross margin came in at a fairly strong level notwithstanding the fact that raw material prices probably went up, you had additional costs given the restrictions on production arising from COVID and so on and so forth, I am still not able to square what we are seeing in gross margin in the 1<sup>st</sup> quarter with a very subdued outlook you are presenting. Is there something else that we are missing? Is there any one-off very profitable contract that helped you in Q1 from a gross margin perspective? What else is it?
- Rajesh Rathi:** Ashwiniji, there are 2 parts to it. One is, the gross margin has improved, but however, indirect costs have increased a lot in terms of logistics and some of the utilities like coal, etc. If you look at it, that's not helped the EBITDA margin. There is nothing like a one-time profitable thing. As we continue to see some of the cost increases, this was just to play out inventory versus the cost increases and that's why we are saying that the same gross margin may not continue. That's where we have been a little cautious from that perspective.
- Ashwini Agarwal:** Rajeshji, I hear what you are saying. Let me flip it around. Is the gross margin also higher because of the mix change you have lower contribution from domestic sales? Is that also a reason why gross margin is optically higher?
- Rajesh Rathi:** The gross margin has improved over a period of time. This quarter there is an additional inventory impact. That's what we are saying.
- Ashwini Agarwal:** The raw material inventory impact?
- Rajesh Rathi:** Yes.
- Ashwini Agarwal:** If I just zoom out and forget these quarters and all that, for the last 3 years or so, the trajectory was that your gross margins were going up, but your EBITDA margin was flattish or down because you were investing in the business, right? There was higher R&D cost, you had hired people in Europe, and invested in sales and marketing. The whole objective was that over a period of time, the increase in gross margin would feed through to the EBITDA level as well, and some of it we saw last year. Your EBITDA margins did improve significantly in fiscal 21 over average of 18, 19, and 20. Forget that some COVID-related disruptions happened in Q1, one understands that. In the medium term, that narrative should still hold, right? Say 2 years out,

let us say March 24 if we think about, would it be reasonable for us to aspire for something like 17% or 18% EBITDA margin?

**Rajesh Rathi:** I would not like to put a number, but Ashwiniji, the whole idea of transforming the business was that, right? That we change our product mix, we reach out to more global customers, and that's the narrative I would say is still continuing and that's what the basis of our strategy is. Like you said, if you zoom into a quarter, there were several issues that you are aware of – global issues, logistics cost, coal costs, which were not anticipated at all to have such a large impact. So, we are still confident on the perspective of what we are saying. In addition to that, Ashwiniji, I would add one more factor that because of these 2-3 lockdowns and issues of COVID, our CAPEX got delayed considerably, both in terms of implementation and none of the equipment suppliers could travel from abroad. So, we had to commission some of the things on our own.

**Ashwini Agarwal:** All that's done now, Rajeshji. Of course, you had a lot of air pockets over the last 1 to 1-1/2 years and hats off to you guys you've managed to commission the projects, you've managed to get everything online and it's visible in your numbers. So, directionally, if we look out 7-8 quarters, and like you said that whatever CAPEX you are implementing now will show up over the next 3 years. If I zoom forward 8 quarters from now and we are looking at let us say the June 23 quarter results, we should aspire for a structurally higher EBITDA margin and structurally higher gross margin because of the sales mix, because of the productivity gains, all of that it should come through. There is nothing to say that structurally anything has changed. That would be a fair comment on my part. I am not putting any numbers out there.

**Rajesh Rathi:** Yes, absolutely.

**Moderator:** The next question is from the line of Sanjesh Jain from ICICI Securities. Please go ahead.

**Sanjesh Jain:** Just one clarification on the CAPEX side. What is the total cash CAPEX we are looking at this year? It was Rs. 38 crores which was pending from the Rs. 600 crores which we had planned earlier. That's the cash CAPEX. What is the remaining cash CAPEX we are looking at for this year? Particularly from the cash outflow perspective and what should be the same in FY23?

**Nilkanth Natu:** I think you are referring to the Rs. 38 crores number which we presented in Q4 and that's what we said is balance.. This CWIP of around Rs 38 crores and there also has been the additional approval of Rs. 135 crores of CAPEX which we had already stated in the earlier call. So, we expect that the CAPEX outflow to that extent will cover this balance as well as the new one. When we also say that CWIP, there is also capital creditors on the other side. So, some part of the CWIP will also get paid out in this year.

**Sanjesh Jain:** So, basically 35 + 135 + some payout of the CWIP which is sitting in the CAPEX creditor will be the total cash outflow for this year. How should we see for next year?

**Nilkanth Natu:** Next year what we expect is, majority of this CAPEX which we have already stated will get commissioned by Q3. Out of Rs. 135 crores, since we have taken the approval now, there might be 20% to 25% of cash outflow which might go to the next year, but this also depends on the current situation and the execution, but I don't expect it is beyond 25% in FY 23.

- Sanjesh Jain:** From the commissioning perspective, last time we said that this Rs. 135 crores is largely to build the infrastructure and utility and also the Rs. 38 crores was only the commissioning part of it which was pending. It was a fairly small CAPEX to the quantum of CAPEX we have been doing. Why are we talking that to be commissioned only 38, it was a very small number to complete the CAPEX given that a large amount of CAPEX has been spent, what is causing such a small CAPEX such a large delay what I was trying to understand.
- Nilkanth Natu:** Sir, we also need to consider the CWIP which was there in March, Rs. 269 crores plus 38 balance to complete. So, we are looking at Rs. 300+ crores of number which will get executed in this year. Out of this, we are expecting Rs. 120 crores of capitalization by H1, i.e., September and balance will happen in Q3. That is what we have said.
- Sanjesh Jain:** That I understood, sir. My question is, CWIP means we have already incurred the CAPEX but it has not commissioned. That means the CAPEX has been incurred, the machinery and whatever the things are ready to go, the remaining balance that need to be executed. That Rs. 38 crores out of the Rs. 307 crores what was pending and just this Rs. 38 crores is holding up this Rs. 307 crores of commissioning. I just wanted to understand why this small amount of Rs. 38 crores of CAPEX, execution is taking 3 quarters of time?
- Nilkanth Natu:** Fair point, but we also have to understand that this CWIP which we already mentioned have been in the various stages of project execution. And that's the reason why we said that it will happen in Q2 and Q3. That is the way we look at it.
- Sanjesh Jain:** So, 120 by Q3 and remaining by Q4 is what we are expecting? This 307 should be completely commissioned by the end of this fiscal year.
- Nilkanth Natu:** Yes, sir, Rs 120 crs by Q2 and balance in H2.
- Moderator:** The next question is from the line of Alroy Lobo from Kotak Investment Advisors. Please go ahead.
- Alroy Lobo:** My first question is to understand the sales and distribution infrastructure you have built internationally and how are the sales people really incentivized for demand creation? Second is, if you can just comment on how easy it is for the customers to switch vendors when they are used to a particular vendor for a particular pigment or a product?
- Rajesh Rathi:** Our product is very sensitive to applications. So, there is a lot of vigor in application testing. Even our R&D has the application lab that a product gets tested either for cosmetic, paint, or plastic. So, it's not a percentage pure like caustic soda which is like bought on percentage purity. Each industry has a different time limit – coatings being the highest and printing inks being the lowest. In terms of sales, every geography has a different list but there is a fixed portion and a variable portion. as we have recruited these people from very reputed companies and they carry a high reputation.

- Alroy Lobo:** My question is, how do you evaluate whether those investments are really paying off? Are there any matrix that you use? The point I am trying to make is that once you set up the CAPEX, the general assumption is that you will get sales by utilizing your capacity. But I just wanted to understand, is there any challenge to convert your CAPEX into sales output? because maybe customers take time to approve or for that matter even switch from an existing vendor. So, do you see any challenges once your CAPEX is in place to actually generate the sales from that CAPEX?
- Rajesh Rathi:** Absolutely well put, and that's why we are saying that we will take at least 3 years for our CAPEX to get utilized. Generally, the customers do a good technical evaluation. The only way we prepare for this is, we send customers with some of our pilot plant samples, etc., where we do get some feedback from them – some of the leading customers – and that's how we commercialize the product and hoping that the product will be successful.
- Alroy Lobo:** Do you have any benchmarks on the sales that your salesperson should derive? Is there a kind of revenue per salesperson that you target from an incentivizing perspective?
- Rajesh Rathi:** It depends on the geography. What we have usually as a matrix is sales. The contribution margin generated by the sales, the opportunity funnel of the person, and geography of course we track, sales per person, etc.
- Alroy Lobo:** How many sales people have you recruited internationally and what is the cost of that sales force right now?
- Rajesh Rathi:** We can't disclose this in the public. We are not right now giving that. We will check this information. I don't have it hands on. Mr. Natu will check whether we can give.
- Alroy Lobo:** Maybe not the cost but at least the number of people that are in sales overseas?
- Rajesh Rathi:** Totally we have more than 55 to 60 sales people.
- Moderator:** The next question is from the line of Kush Tandon from Ananta Capital. Please go ahead.
- Kush Tandon:** Sir, I am just trying to understand one thing. If I see your last 9 quarters of pigment revenue, I see the entire FY20, four quarters were around Rs. 400 crores – 396, 400, 391, and 402. Then Q1 FY21, we had COVID impact, so we went down to 340. Then again Q2 was 400. So, sir, we were basically trending around Rs. 400 crores per quarter a pigment number and we did around Rs. 270 crores of CAPEX in FY20. So, the jump in Q3 and Q4 to Rs. 477 crores and Rs. 532 crores of revenue in the pigment business, is it fair to say that this jump from 400 to 477 and 532 and now to 453 from 400 each is because of the CAPEX coming online? Is that a fair way to model in our minds the business?
- Nilkanth Natu:** Fair point, sir, and thanks a lot for this analysis. Whatever Rs. 400 crores average quarterly sales that have been in the past year now are trending to 450 and 470 turnover. Yes, this has been also the factor which has given us from FY20 capitalization. So, the capitalization which we have done in the FY20 is helping us to get this growth in the sales number and it will ramp up.

**Kush Tandon:** Let us say 400, I am sure the products can be here and there, but broadly speaking, we can conclude that probably Rs. 400 crores was a stable run rate and whatever incremental CAPEX is coming online is adding to the incremental revenues. And in 3 years, whatever CAPEX you did in FY20, the revenue will be 2x of that CAPEX in the 3<sup>rd</sup> year. Is that a fair way to model this business?

**Nilkanth Natu:** Fair point, sir, but what we expect is, we had already mentioned in our presentation earlier saying that we expect this additional CAPEX to give us Rs. 1000 to 1200 crores of additional revenue and majority of the CAPEX which we have implemented or started the capitalization from FY20, so you can take from FY20 this additional incremental revenue for your modelling for the next 3 years.

**Moderator:** Ladies and gentlemen, that will be the last question for today. I will now hand the conference over to the management for closing comments.

**Nilkanth Natu:** Thank you participants for your time and interest in Sudarshan Chemicals. We remain confident in the long-term prospects of our business, and we look forward to engaging with you again. Thank you. Stay safe.

**Moderator:** On behalf of IIFL Securities Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines.

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