

BUY

TP: Rs 600 | ▲ 62%

UPL

Agrochemicals

23 May 2020

Margin miss but resilient outlook in tough environment

UPL's Q4 EBITDA was below our estimate at Rs 19bn as stronger revenue growth was offset by gross margin pressure and higher forex loss. Adj. EBITDA was still a 13% miss. Despite Covid-19 and currency headwinds, UPL expects growth and margin expansion in FY21 though specific guidance will be shared only in Q1. We continue to expect UPL to gain market leadership backed by an integrated model and transform into a significantly underlevered company by FY23/FY24. We cut FY21/FY22 EPS 12-15% on a weak Q4 and lower our TP to Rs 600 (vs. Rs 710).

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Good revenue growth but margin miss; long-term sales growth guidance of 7-10%:

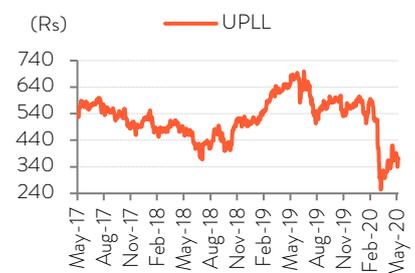
Strong 31% YoY revenue growth in Q4 was mainly driven by volumes (+29% YoY) while realisations/currency had a negative impact of 2%/2%. Sales across N. America/India/ROW were robust at 62%/39%/39% YoY, indicating continued market share gains. Brazil was lower than expected at 33% YoY due to stiff currency headwinds (INR/BRL down 20% YoY on average). EBITDA margin slipped 650bps QoQ to 17.1% due to an adverse regional mix (2ppt impact on gross margin) and forex loss (2ppt impact). Over 3-8 years, UPL expects 7-10% sales growth and monetisation of the higher margin Rs 200bn R&D pipeline.

Ticker/Price	UPLL IN/Rs 371
Market cap	US\$ 3.7bn
Shares o/s	765mn
3M ADV	US\$ 30.7mn
52wk high/low	Rs 709/Rs 240
Promoter/FPI/DII	28%/44%/10%

Source: NSE

Gradual progress toward balance sheet comfort: Net working capital has reduced to 80 days (from 119 in FY19) and management expects more improvement in coming years. UPL does not expect to make any debt repayment in the next 15 months but retains its commitment of achieving ~2x net debt/EBITDA by FY21 (from 2.7x in FY20). In the current climate, we think this goal can get deferred to FY22.

STOCK PERFORMANCE



Source: NSE

Earnings call takeaways: (1) Draft notification to ban 27 formulations to have limited impact. (2) UPL could gain on its RM platform as MNCs exit China. (3) Price hike to set-off BRL devaluation impact in Q1. (4) FY21 capex at US\$ 270mn.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue (Rs mn)	218,350	357,560	381,968	421,409	459,804
EBITDA (Rs mn)	38,110	66,910	75,912	89,197	101,318
Adj. net profit (Rs mn)	18,140	23,782	26,082	33,809	41,750
Adj. EPS (Rs)	23.7	31.1	34.1	44.2	54.6
Adj. EPS growth (%)	0.6	31.1	9.7	29.6	23.5
Adj. ROAE (%)	13.5	13.1	13.4	15.8	17.4
Adj. P/E (x)	15.7	11.9	10.9	8.4	6.8
EV/EBITDA (x)	8.4	6.5	6.9	5.7	4.9

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Q4FY20E	Var (%)	FY20P	FY19
Net Sales	111,410	85,250	30.7	88,920	25.3	106,377	4.7	357,560	218,370
EBITDA	19,040	12,910	47.5	21,020	(9.4)	25,000	(23.8)	66,930	38,130
Depreciation	5,950	4,310	-	4,950	-	5,544	-	21,430	9,690
EBIT	13,090	8,600	52.2	16,070	(18.5)	19,456	-	45,500	28,440
Interest	1,870	4,050	-	5,150	-	5,408	-	14,810	9,630
Other Income	210	480	-	200	-	250	-	1,040	2,400
PBT	11,430	5,030	127.2	11,120	2.8	14,299	(20.1)	31,730	21,210
Less: Taxation	2,110	(310)	-	1,990	-	2,421	-	5,210	1,650
Less: Minority Interest	1,440	290	-	1,370	-	200	-	3,634	430
Recurring PAT	7,880	5,050	56.0	7,760	1.5	11,678	(32.5)	22,886	19,130
Exceptional items	(1,710)	(2,990)	-	(750)	-	0	-	(6,230)	(4,510)
Reported PAT	6,170	2,060	199.5	7,010	(12.0)	13,517	(54.4)	16,656	14,620
Key Ratios (%)									
Gross Margin	43.9	41.7	-	50.2	-	46.0	-	47.4	50.1
EBITDA Margin	17.1	15.1	-	23.6	-	25.2	-	18.7	17.5
Tax / PBT	18.5	(6.2)	-	17.9	-	15.0	-	16.4	7.8
NPM	7.1	5.9	-	8.7	-	12.7	-	6.4	8.8
EPS (Rs)	10.3	6.6	-	10.1	-	17.7	-	29.9	25.0

Source: Company, BOBCAPS Research

FIG 2 – SEGMENT SALES

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Q4FY20E	Var (%)	FY20P	FY19
North America	25,401	15,650	62.3	12,880	97.2	18,032	40.9	56,350	36,970
Europe	20,417	20,060	1.8	7,670	166.2	13,806	47.9	53,760	35,320
LATAM	34,222	25,670	33.3	42,030	(18.6)	40,029	(14.5)	137,640	74,570
ROW	24,389	17,590	38.7	18,840	29.5	28,260	(13.7)	71,530	38,370
India	6,971	5,030	38.6	7,500	(7.1)	6,250	11.5	38,280	33,140
Net Sales	111,400	84,000	32.6	88,920	25.3	106,377	4.7	357,560	218,370

Source: Company, BOBCAPS Research

Valuation methodology

We see a convincing case for UPL to gain further market share across key geographies and to transform into a significantly underlevered company by FY23, thus unlocking value and paving the way for a stock rerating. In our view, strong execution across a wide portfolio, synergies from the Arysta LifeScience acquisition, >18% earnings growth through to FY24, working capital efficiency and robust annual cash flows of >US\$ 600mn can lead to substantial deleveraging, from ~3.2x to 1.3x by FY24.

We trim FY21/FY22 EPS estimates by 12-15% following the earnings miss for full-year FY20, possible slow offtake in Q1 due to Covid-19 and negative impact of BRL currency devaluation on growth in the LATAM region. In our view, near-term concerns of a stressed balance sheet are in the price and current valuations are attractive at 6.8x FY21E EV/EBITDA. We revise our Mar'21 target price to Rs 600 (from Rs 710), which is arrived at based on a probability weight for our scenario analysis (50% weight for base case, 40% for bull, 10% for bear – refer Fig 4); the implied 7.5x fwd EV/EBITDA is 40% below the five-year mean. Maintain BUY.

FIG 3 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Sales	357.6	382.0	421.4	352.2	397.9	447.3	1.5	(4.0)	(5.8)
EBITDA	66.9	75.9	89.2	74.3	86.8	100.2	(10.0)	(12.6)	(11.0)
EBITDA margin (%)	18.7	19.9	21.2	21.1	21.8	22.4	(239bps)	(195bps)	(124bps)
EPS (Rs)	31	34	44	33	40	50	(6.2)	(15.2)	(11.9)

Source: Company, BOBCAPS Research

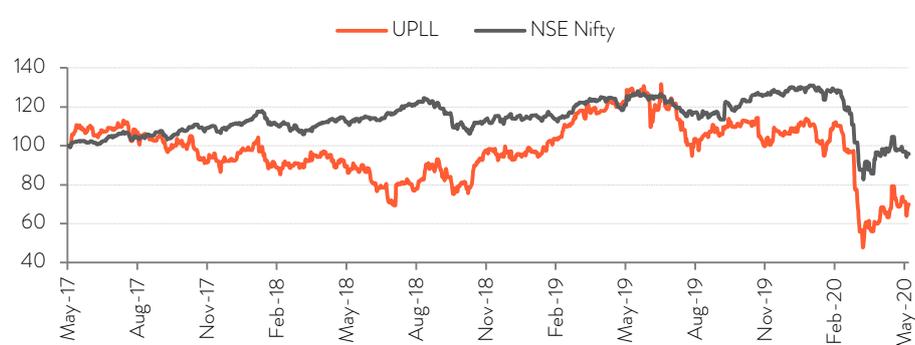
FIG 4 – TARGET PRICE CALCULATION – PROBABILITY ADJUSTED

(Rs mn)	Base case	Bull case	Bear case
Operating cash flow	86,247	88,544	78,985
Free cash flow	50,154	53,082	42,403
DCF value (a)*	776,986	936,859	545,136
EBITDA	101,318	104,190	92,230
(includes: Arysta synergies US\$ mn)	240	240	216
Target EV/EBITDA (x)	9.0	11.0	7.0
EV (b)	911,862	1,146,085	645,609
Total EV (average of a + b)	844,424	1,041,472	595,372
Net Debt	176,542	164,515	197,732
Net Debt-to-EBITDA (x)	1.7	1.6	2.1
Equity Value	667,881	876,957	397,640
Per share (Average of DCF based & EV/EBITDA less @ 22% Minority stake in UPL Corp)	698	909	419
(+) Buyback of TPG/ADIA stake (FY24 NPV basis)^	-	186	-
Value per Share (Rs)	698	1,094	419

(Rs mn)	Base case	Bull case	Bear case
% Upside/(Downside)	88.2	195.0	13.1
Probability weights (%)	50.0	40.0	10.0
Price target Mar-23	829		
% Upside	123		
Price target Rs/sh at Mar-21 (@18% discount rate)	600		
% upside	62		
Implied EV/EBITDA - FY22 (x)	7.4		
Implied P/E - FY22 (x)	13.6		

Source: Company, BOBCAPS Research | *We use a discount rate/terminal growth rate of 12%/4% in base case, 11%/4% in bull & 13%/3% in bear case. ^20% discount rate assumes buyback value escalates 20% from base price

FIG 5 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Adverse climatic conditions:** Demand for UPL's crop solutions are influenced by climatic conditions, agri-commodity pricing and pest infestations. For instance, drought may reduce the need for fungicides, which could result in fewer sales and higher unsold inventories in the market, whereas excessive rain could lead to increased plant disease or weed growth, requiring growers to purchase and use more pesticides. Also, adverse agri-commodity prices could negatively impact grower profits, affecting demand for UPL's products.
- Changing regulatory environment:** Changes in regulatory environment, particularly in the US, Brazil, China, Argentina and the EU, could adversely affect our growth estimates and margins. UPL is most sensitive to this general regulatory risk given the need to obtain and maintain pesticide registrations in every country. Many countries require re-registration of pesticides to meet new and more challenging requirements. Compliance with changing laws and regulations may involve significant costs or capital expenditures or require shifts in business practice that could result in reduced profitability.
- Limited access to external debt financing:** UPL's near-term liquidity position is constrained by high debt leverage and depends upon its credit ratings. This

could limit the company's ability to refinance borrowings, in turn restricting growth opportunities and adversely affecting operating results.

- **Shortfall in Arysta integration synergies:** Roughly 13-15% of our FY21-FY24 EBITDA is driven by Arysta-related synergies. So far, the anticipated cost savings and revenue synergies are ahead of management guidance for FY20. However, any failure in realising targeted synergies could adversely affect our margin and growth estimates
- **Higher raw material prices:** A sharp increase in crude oil prices can affect the prices of raw materials and production cost, impacting profitability. To mitigate this, UPL has backward integrated most of its operations and is less dependent on outside supply.
- **Adverse economic and political changes:** These include inflation rates, recession, trade restrictions, tariff increases or potential new tariffs and taxes that can affect UPL's business.
- **Forex risk:** The company operates in multiple markets with the US dollar, Euro, Japanese yen and British pound as major transaction currencies. Also, 85-90% of its debt is US dollar denominated. UPL takes adequate forward covers based on net open exposures as its exports act as a natural hedge.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue	218,350	357,560	381,968	421,409	459,804
EBITDA	38,110	66,910	75,912	89,197	101,318
Depreciation	9,690	21,430	24,082	25,022	25,962
EBIT	28,420	45,480	51,830	64,175	75,356
Net interest income/(expenses)	(9,630)	(14,857)	(16,982)	(16,052)	(14,213)
Other income/(expenses)	1,580	2,061	3,476	3,569	2,834
Exceptional items	0	0	0	0	0
EBT	20,370	32,684	38,324	51,691	63,976
Income taxes	1,650	4,903	6,898	10,338	12,795
Extraordinary items	(3,690)	(6,200)	0	0	0
Min. int./Inc. from associates	580	3,999	5,343	7,543	9,431
Reported net profit	14,450	17,582	26,082	33,809	41,750
Adjustments	(3,690)	(6,200)	0	0	0
Adjusted net profit	18,140	23,782	26,082	33,809	41,750

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Accounts payables	93,970	108,737	116,160	128,155	139,831
Other current liabilities	15,250	12,801	13,751	15,171	16,553
Provisions	21,840	35,764	38,206	42,151	45,991
Debt funds	289,970	277,178	312,885	262,181	232,281
Other liabilities	0	0	0	0	0
Equity capital	1,020	1,530	1,530	1,530	1,530
Reserves & surplus	208,412	218,344	235,247	257,581	285,561
Shareholders' fund	209,432	219,874	236,777	259,111	287,091
Total liabilities and equities	630,462	654,355	717,778	706,767	721,747
Cash and cash eq.	28,510	53,928	85,111	57,625	55,739
Accounts receivables	118,160	118,670	136,043	150,091	163,766
Inventories	92,700	78,500	100,463	107,373	117,156
Other current assets	47,190	60,785	64,934	71,640	78,167
Investments	7,062	7,062	7,062	7,062	7,062
Net fixed assets	46,540	45,110	44,028	43,006	40,050
CWIP	17,830	17,830	17,830	17,830	17,830
Intangible assets	272,470	272,470	262,306	252,142	241,978
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	630,462	654,355	717,778	706,767	721,747

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Net income + Depreciation	24,140	39,012	50,165	58,832	67,712
Interest expenses	9,630	14,857	16,982	16,052	14,213
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(63,680)	26,337	(32,671)	(10,303)	(13,086)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	(29,910)	80,206	34,476	64,580	68,840
Capital expenditures	(341,640)	(20,000)	(23,000)	(24,000)	(23,007)
Change in investments	3,278	0	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(338,362)	(20,000)	(23,000)	(24,000)	(23,007)
Equities issued/Others	0	510	0	0	0
Debt raised/repaid	222,580	(12,792)	35,706	(50,704)	(29,900)
Interest expenses	(9,630)	(14,857)	(16,982)	(16,052)	(14,213)
Dividends paid	(4,240)	(7,650)	(9,180)	(11,475)	(13,770)
Other financing cash flows	159,132	0	10,164	10,164	10,164
Cash flow from financing	367,842	(34,789)	19,708	(68,067)	(47,719)
Changes in cash and cash eq.	(430)	25,418	31,184	(27,487)	(1,886)
Closing cash and cash eq.	28,510	53,928	85,111	57,625	55,739

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20P	FY21E	FY22E	FY23E
Reported EPS	18.9	23.0	34.1	44.2	54.6
Adjusted EPS	23.7	31.1	34.1	44.2	54.6
Dividend per share	8.0	10.0	12.0	15.0	18.0
Book value per share	229.9	243.5	265.6	294.8	331.4

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20P	FY21E	FY22E	FY23E
EV/Sales	1.5	1.2	1.4	1.2	1.1
EV/EBITDA	8.4	6.5	6.9	5.7	4.9
Adjusted P/E	15.7	11.9	10.9	8.4	6.8
P/BV	1.6	1.5	1.4	1.3	1.1

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20P	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	89.1	72.8	68.1	65.4	65.3
Interest burden (PBT/EBIT)	71.7	71.9	73.9	80.5	84.9
EBIT margin (EBIT/Revenue)	13.0	12.7	13.6	15.2	16.4
Asset turnover (Revenue/Avg TA)	16.6	17.9	18.2	19.7	22.1
Leverage (Avg TA/Avg Equity)	2.5	2.8	2.7	2.5	2.2
Adjusted ROAE	13.5	13.1	13.4	15.8	17.4

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	25.6	63.8	6.8	10.3	9.1
EBITDA	8.7	75.6	13.5	17.5	13.6
Adjusted EPS	0.6	31.1	9.7	29.6	23.5
Profitability & Return ratios (%)					
EBITDA margin	17.5	18.7	19.9	21.2	22.0
EBIT margin	13.0	12.7	13.6	15.2	16.4
Adjusted profit margin	8.3	6.7	6.8	8.0	9.1
Adjusted ROAE	13.5	13.1	13.4	15.8	17.4
ROCE	9.1	9.5	10.6	12.7	15.0
Working capital days (days)					
Receivables	198	121	130	130	130
Inventory	155	80	96	93	93
Payables	157	111	111	111	111
Ratios (x)					
Gross asset turnover	0.7	1.1	1.1	1.1	1.1
Current ratio	2.2	2.0	2.3	2.1	2.0
Net interest coverage ratio	3.0	3.1	3.1	4.0	5.3
Adjusted debt/equity	1.6	1.5	1.5	1.2	0.9

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

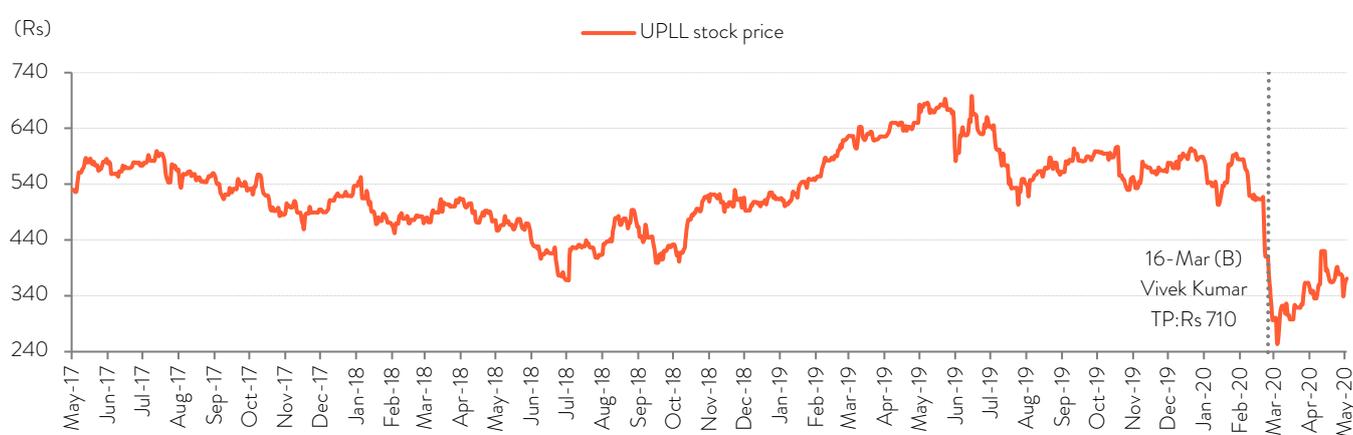
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: UPL (UPL IN)



B – Buy, A – Add, R – Reduce, S – Sell

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