

Company Flash

27 June 2007 | 5 pages

United Phosphorus (UNPO.BO)

Buy: Accretive, but Small Acquisition

- Strengthening product basket** — UPL's acquisition of 2 brands from Dupont is another step to augment its product basket by inorganic means. We expect the deal to be accretive from the outset; while the financial upside would be limited given UPL's high scale of operations, we expect such efforts to broaden the product basket will improve the company's positioning with customers.
- The deal** — UPL has acquired 2 brands from Dupont, viz. *Super Tin* (Triphenyltin hydroxide/TPTH; contact fungicide for potatoes, sugar beet & pecans) and *Vendex* (Fenbutatinoxide miticide/TNTO; largest tin acaricide used in citrus & pome fruit) – with sales primarily across N America, LatAm and RoW markets. Under the arrangement, UPL would commence sales on its own from Oct 2007, while Dupont would act as its agent during this transition period.
- Accretive, but small** — The deal strengthens UPL's position in the fruit, nut, vegetable & row crop markets. While UPL has not disclosed the size, it has indicated that it is quite small relative to UPL's scale of operations. The deal would however be accretive from the first year, as gross margins are higher than UPL's gross margins even with the current manufacturing arrangement.
- Maintain Buy/Low Risk** — We believe that the suppressed profitability in FY08E is a timing issue and does not arise from any fundamental negative in the business. With rapidly growing scale and global presence in crop protection and the 49.9% stake in Advanta adding an element of innovation to the business, we believe that UPL's best years lie ahead.

Buy/Low Risk	1L
Price (27 Jun 07)	Rs300.00
Target price	Rs380.00
Expected share price return	26.7%
Expected dividend yield	0.4%
Expected total return	27.1%
Market Cap	Rs56,176M US\$1,376M

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	2,164	11.35	20.5	26.4	4.5	21.0	0.3
2007A	2,902	14.46	27.4	20.8	3.9	20.7	0.4
2008E	3,876	19.31	33.6	15.5	3.3	23.2	0.5
2009E	5,775	28.77	49.0	10.4	2.6	27.8	0.5
2010E	7,145	35.59	23.7	8.4	2.0	26.5	0.5

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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United Phosphorus

Company description

UPL is the only Indian play on the global generics opportunity in crop protection products. It has focused on the generics opportunity in the regulated markets of the US and Europe, and has achieved success over the past decade. Apart from fully integrated manufacturing facilities, UPL also has strong distribution infrastructure across its targeted markets. UPL's growth strategy is built around filing its own registrations and acquiring tail-end brands of global majors in regulated markets. With c.80% of its revenue coming from global markets and a strong direct presence in the targeted markets, UPL has emerged as the third-largest generics company in the world.

Investment thesis

We rate the stock Buy/Low Risk (1L), with a target price of Rs380. UPL is the only Indian play on the global crop protection market, with around 80% of revenue coming from global markets. The global crop protection market looks attractive and is highly consolidated, with limited generics penetration, due to the high entry barriers that generate pricing discipline. UPL has reached critical scale in the regulated markets of the EU and US through a series of acquisitions over the past two to three years. We believe that UPL's growing free cash flows give it the ability to step up growth initiatives - both organic and inorganic. We expect this to lead to a pickup in the rate of growth and forecast FY07-10E revenue and net profit CAGRs of 21% and 35%, respectively.

Valuation

The generics crop protection segment is likely to witness healthy growth, with leading companies such as UPL expected to be among the key beneficiaries. We therefore believe that P/E vs. earnings CAGR or EV/EBIDTA vs. EBIDTA CAGR is the correct metrics to value companies such as UPL. Our target price is based on 16x P/E, which is within its trading range of 9-21x since January 2004, when the stock got re-listed post the reverse merger. Our price target of Rs380 is based on average of FY08E and FY09E FD EPS estimates. We believe that FY08 estimates do not reflect the true earnings power of UPL, especially in the acquired Cerexagri business, where margins are expected to witness a sharp improvement in FY09 over FY08. We therefore believe that using an average of FY08E and FY09E earnings would normalize Cerexagri's earnings and provide a more accurate base for valuations.

Risks

We rate UPL Low Risk according to our quantitative risk-rating system. The main downside risks to our target price and estimates include: (1) Cut in farm subsidies in regulated markets; (2) Inability to effectively integrate one of its acquisitions - slower than expected ramp-up in Cerexagri's profitability; (3) shift in acreage to corn (8-9% of US sales) from cotton (15-18% of US sales), provided this cannot be made up by higher supplies to other parts of the world; and (4) Poor monsoons in India.

Appendix A-1

Analyst Certification

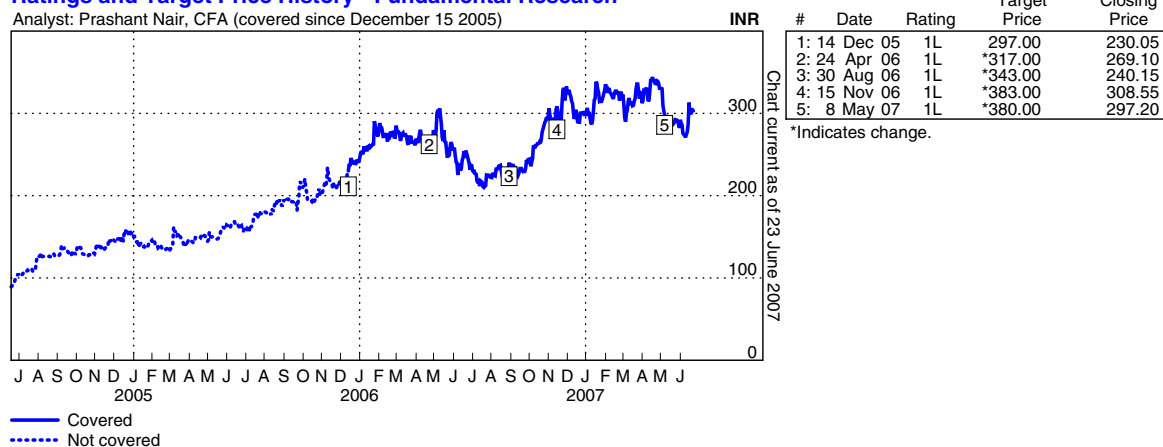
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United Phosphorus (UNPO.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Prashant Nair, CFA (covered since December 15 2005)



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