MOTILAL OSWAL

United Phosphorus

STOCK INFO.	BLOOMBERG
BSE Sensex: 16,741	UNTP IN
	REUTERS CODE
S&P CNX: 4,971	UNPO.BO

Equity Shares (m)	439.6
52-Week Range (Rs)	186/65
1,6,12 Rel. Perf. (%)	-7/-22/-12
M.Cap. (Rs b)	67.4
M.Cap. (US$ b)	1.4

26 October 2009

Buy

Previous Recommendation: Buy

Rs153

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/08A	37,616	3,954	8.6	18.7	17.9	1.5	21.2	15.8	1.9	10.7
03/09A	49,735	4,921	10.6	24.4	14.4	2.5	20.0	18.4	1.6	8.4
03/10E	55,459	5,605	12.1	13.9	12.7	2.2	19.5	15.6	1.3	7.5
03/11E	62,762	7,368	15.9	31.4	9.6	1.8	21.8	17.7	1.1	5.5

United Phosphorus' 2QFY10 performance is significantly below estimates with no revenue growth, 190bp YoY decline in margins and 16% YoY decline in PAT. PAT has de-grown for the first time since 3QFY04. Key highlights include:

- Muted volume growth of 3%, decline in realizations of 5% results in flat revenue growth
- Gross margins better than estimates at 38.6% (down 220bp YoY). However, negative operating leverage resulted in an EBITDA margin decline of 190bp YoY to 17.3% (v/s est 18.2%), translating into PAT de-growth of 16% at Rs1.02b (v/s est Rs1.43b).
- Erratic climatic patterns, leaner channel inventory due to risk-averseness are key challenges for the business. Consumer demand drivers intact.

Downgrading estimates to factor in challenging business environment: We are downgrading our earnings estimates for FY10 by 12.4% to Rs12.1 and for FY11 by 12.8% to Rs15.9, to factor in the challenging business environment prevailing for the global agro-chemical industry. The management has guided for a 10% revenue growth in FY10 driven by volumes and EBITDA margins of 18-19%.

Valuation and view: Short-term business environment for the agro-chemical industry is challenging. Valuations at 12.7x FY10E and 9.6x FY11E EPS (fully diluted), do not reflect growth potential (organic and inorganic) for the company. Maintain **Buy** with a target price of Rs199/share (~12.5x FY11E EPS).

QUARTERLY PERFORMANCE (CONSOLIDATED) (RS MILLION)

Y/E MARCH	FY09				FY10				FY09	FY10E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Gross Revenues	**13,141**	**11,648**	**10,944**	**14,002**	**16,442**	**11,610**	**11,871**	**15,536**	**49,735**	**55,459**
YoY Change (%)	*55.5*	*31.4*	*35.2*	*14.7*	*25.1*	*-0.3*	*8.5*	*11.0*	*32.2*	*11.5*
Total Expenditure	10,484	9,407	8,990	10,987	13,306	9,606	9,798	12,358	39,868	45,067
EBITDA	**2,657**	**2,242**	**1,954**	**3,015**	**3,135**	**2,005**	**2,073**	**3,179**	**9,867**	**10,392**
Margins (%)	*20.2*	*19.2*	*17.9*	*21.5*	*19.1*	*17.3*	*17.5*	*20.5*	*19.8*	*18.7*
Depreciation	378	455	457	638	501	547	570	594	1,927	2,212
Interest	634	600	810	875	578	405	450	526	2,919	1,959
PBT before EO Expense	**1,645**	**1,187**	**687**	**1,502**	**2,056**	**1,053**	**1,053**	**2,058**	**5,021**	**6,221**
Extra-Ord Expense	0	0	0	101	0	0	0	0	101	0
PBT after EO Expense	**1,645**	**1,187**	**687**	**1,401**	**2,056**	**1,053**	**1,053**	**2,058**	**4,921**	**6,221**
Tax	99	59	54	77	268	165	316	185	289	933
Deferred Tax	92	21	23	-160	0	0	0	93	-19	93
Rate (%)	*11.6*	*6.7*	*11.1*	*-5.9*	*13.0*	*15.7*	*30.0*	*13.5*	*5.5*	*16.5*
Reported PAT	**1,454**	**1,108**	**611**	**1,484**	**1,789**	**888**	**737**	**1,780**	**4,651**	**5,194**
Income from Associate Co	22	113	36	29	-26	135	125	177	200	411
Adjusted PAT	**1,477**	**1,220**	**646**	**1,620**	**1,763**	**1,023**	**862**	**1,957**	**4,946**	**5,605**
YoY Change (%)	100.1	38.3	33.1	-15.1	19.4	-16.2	33.4	20.8	25.1	13.3
Margins (%)	*11.2*	*10.5*	*5.9*	*11.6*	*10.7*	*8.8*	*7.3*	*12.6*	*9.9*	*10.1*

E: MOSL Estimates

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Muted volume growth, lower realization result in flat revenues

Consolidated revenues were flat at Rs11.6b (v/s est Rs13.9b), being impacted by a slowdown in the global agro-chemicals industry due to erratic climatic patterns and changes in the purchasing patterns of consumers. Revenues declined by 2% in exports and grew 4% in the domestic market. Revenues in the US market de-grew 12.4% and European revenues declined by 2.3%. Volumes grew by 3% and realizations declined by 5%. Favorable forex movement added 2% to sales.

TREND IN MARKET-MIX (RS M)

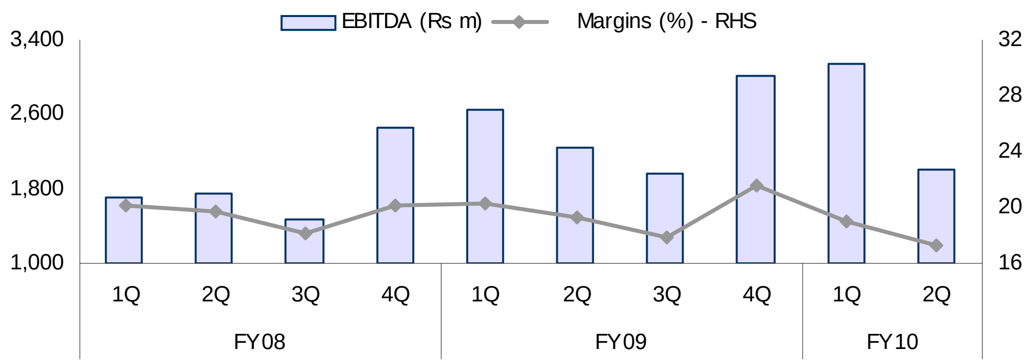
	2QFY10	2QFY09	YOY (%)	1QFY10	QOQ (%)
Domestic Business	3,129	3,000	4.3	3,683	-15.0
Contribution (%)	*27.0*	*25.8*		*22.4*	
International Business					
US	2,835	3,237	-12.4	4,379	-35.3
Contribution (%)	*24.4*	*27.8*		*26.6*	
EU	2,766	2,832	-2.3	4,855	-43.0
Contribution (%)	*23.8*	*24.3*		*29.5*	
RoW	2,880	2,579	11.7	3,525	-18.3
Contribution (%)	*24.8*	*22.1*		*21.4*	
Total International Revenues	8,481	8,649	-1.9	12,759	-33.5
Contribution (%)	*73.0*	*74.2*		*77.6*	
Total	**11,610**	**11,648**	**-0.3**	**16,442**	**-29.4**

Source: Company/MOSL

Gross margins in line, negative operating leverage impacts EBITDA margins

2QFY10 gross margins of 38.6% (down 220bp YoY) are better than estimates, driven by higher- than-estimated QoQ savings in raw material costs. But negative operating leverage resulted in an EBITDA margin decline of 190bp YoY to 17.3% (v/s est 18.2%).

TREND IN EBITDA



Source: Company/MOSL

Lower interest cost (due to no forex loss) negated the impact of higher depreciation. Higher tax provisioning at 15.7% (v/s est 12% and 6.7% in 2QFY09) further impacted PAT, translating into de-growth of 16% to Rs1.02b (v/s est Rs1.4b).

COMMON SIZE STATEMENT (%)

	2QFY10	2QFY09	CHG (BP)	1QFY10	CHG (BP)
Sales	100	100		100	
RM Cost	52.4	47.3	510	58.1	-570
Staff Cost	10.3	9.5	80	7.6	270
Other Exp	20.0	23.9	-390	15.3	470
EBITDA	17.3	19.2	-200	19.1	-180

Source: Company/MOSL

Moderation in working capital cycle

UPL has witnessed moderation in its working capital cycle after seeing a substantial increase in 2HFY09. During 1HFY10 it witnessed improvement in working capital by six days to 95 days (v/s 100 days in March 2009). However, the management indicated that there was limited scope to further improve and expect normalizing creditor days. However, its overall investment in working capital increased by Rs1b in September 2009 to Rs13.2b.

Focus on completing Cerexagri restructuring

The company announced the restructuring in a plant in Rotterdam over the next six months. This restructuring will drive the last leg of expected synergies. It was delayed due to a surge in demand. Rotterdam is its biggest facility in Europe. The company is focused on increasing efficiency of the plant and will not shut it down.

Downgrading estimates to factor in challenging business environment, cautious guidance

We are downgrading our earnings estimates for FY10 by 12.4% to Rs12.1 and for FY11 by 12.8% to Rs15.9 to factor in the challenging business environment in the global agro-chemical industry. Our estimates factor in:

- Revenue growth of 11.5% in FY10 (implying 10% growth in 2HFY10) and 13.2% in FY11
- 90bp margin expansion to 19.2% in 2HFY10 over 1HFY10, driven by benefit of lower RM cost
- USD/INR at current levels of Rs46.6/USD.

The management has guided for 10% revenue growth in FY10 driven by volumes and EBITDA margins of 18-19%.

REVISED FORECAST (RS M)

	FY10E			FY11E		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	55,459	59,373	-6.6	62,762	67,017	-6.3
EBITDA (%)	18.7	19.2	-2.3	20.7	21.5	-3.9
Net Profit	5,605	6,400	-12.4	7,368	8,451	-12.8
EPS (Rs)	12.1	13.8	-12.4	15.9	18.3	-12.8

Source: Company/MOSL

Valuation and view

The business environment for the agro-chemical industry is challenging and is estimated to remain challenging in 2HFY10 as well. United Phosphorus has underperformed the benchmark by 22% over the past six months. Given the challenging business environment, we expect under-performance to continue over at least the next three months. However, the long-term outlook remains positive. This, coupled with integration, benefits from Cerexagri and the indirect presence in high-growth seeds business offers a well diversified portfolio focused on agri-inputs. Valuations at 12.7x FY10E and 9.6x FY11 EPS (fully diluted), do not reflect growth potential (organic and inorganic) for the company. Maintain **Buy** with a target price of Rs199/share (~12.5x FY11E EPS).

United Phosphorus: an investment profile

United Phosphorus is a US$1.2b company with a strong presence in crop protection and industrial chemicals. With around 80% of its revenues coming from international markets, the company has emerged as the third largest generic player in the world. United Phosphorus' growth strategy is built around filing its own registrations globally and acquiring tail end brands of global majors in regulated markets.

Key investment argument

- One of the largest (and most competitive) global generic players in crop protection – well poised to leverage the increasing conversion to generics globally.
- Improving cash flows gives it a war chest to scale up new registrations and acquisitions.
- Increasing share of global revenues (80% in FY10E) to improve profitability and reduce dependence on the volatile Indian market.

Key investment risks

- Volatility in raw material prices, rupee appreciation could subdue margins, if adequate price hikes cannot be taken.
- Business is working capital intensive, thereby restricting the free cash available to seed growth.

Recent developments

- Announced restructuring of operations at the Rotterdam, Netherland plant of Cerexagri, with a focus on improving its efficiency.

Valuation and view

- Valuations at 12.7x FY10E and 9.6x FY11E EPS (fully diluted), do not reflect growth potential (both organic and inorganic) for the company.
- Maintain **Buy** with a target price of Rs199/share (~12.5x FY11E EPS).

Sector view

- Short term business environment for the agro-chemical industry is challenging, but long term potential intact.
- High degree of consolidation in the market, strong entry barriers and limited price erosion make the generics opportunity very attractive for established players.
- Companies that have achieved critical scale and established strong relationships with major distributors are expected to benefit the most.

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOSL FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY10	12.1	13.6	-11.3
FY11	15.9	16.6	-4.5

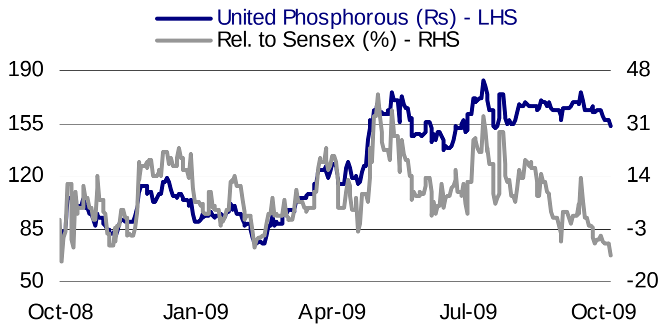
TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
153	199	30.1	Buy

SHAREHOLDING PATTERN (%)

	SEP-09	JUN-09	SEP-08
Promoter	28.0	28.0	28.0
Domestic Inst	19.5	19.7	18.4
Foreign	37.1	37.0	41.1
Others	15.5	15.3	12.6

STOCK PERFORMANCE (1 YEAR)



CONSOLIDATED INCOME STATEMENT					(Rs Million)
Y/E MARCH	2007	2008	2009	2010E	2011E
Net Revenue	**24,710**	**37,616**	**49,735**	**55,459**	**62,762**
Change (%)	*37.1*	*52.2*	*32.2*	*11.5*	*13.2*
Total Expenditure	18,827	30,250	39,868	45,067	49,774
EBITDA	**5,883**	**7,366**	**9,867**	**10,392**	**12,988**
Margin (%)	*23.8*	*19.6*	*19.8*	*18.7*	*20.7*
Depreciation	1,656	1,522	1,927	2,212	2,382
EBIT	4,227	5,844	7,940	8,179	10,606
Int. and Finance Charges	1,046	1,688	2,919	1,959	2,312
PBT before EO Expense	**3,181**	**4,156**	**5,021**	**6,221**	**8,294**
EO Expense/(Income)	76	1,144	101	0	0
PBT after EO Expense	3,105	3,012	4,921	6,221	8,294
Tax	525	424	269	1,026	1,534
Tax Rate (%)	*16.9*	*14.1*	*5.5*	*16.5*	*18.5*
Profit after Tax	**2,580**	**2,588**	**4,651**	**5,194**	**6,760**
Add: Share of profits of associa	242	222	200	411	608
Less: Minority Interest	0	10	25	0	0
Reported PAT	**2,821**	**2,800**	**4,826**	**5,605**	**7,368**
Adjusted PAT	**2,884**	**3,954**	**4,921**	**5,605**	**7,368**
Change (%)	*33.4*	*37.1*	*24.5*	*13.9*	*31.4*
Margin (%)	*11.7*	*10.5*	*9.9*	*10.1*	*11.7*

CONSOLIDATED BALANCE SHEET					(Rs Million)
Y/E MARCH	2007	2008	2009	2010E	2011E
Equity Share Capital	375	439	879	879	879
Reserves & Surplus	14,579	21,940	25,851	29,981	35,805
Net Worth	**14,954**	**22,380**	**26,730**	**30,860**	**36,685**
Minority Interest	49	60	95	106	117
Total Loans	20,315	16,233	20,914	26,260	26,260
Capital Employed	**35,317**	**38,672**	**47,739**	**57,226**	**63,062**
Gross Block	28,453	25,826	29,603	31,853	33,853
Less: Accum. Deprn.	10,470	11,251	12,348	14,561	16,943
Net Fixed Assets	**17,984**	**14,575**	**17,255**	**17,292**	**16,910**
Capital WIP	753	1,418	1,239	750	750
Investments	3,910	7,430	4,332	4,743	5,351
Curr. Assets	**25,169**	**28,718**	**41,173**	**54,389**	**62,695**
Inventory	10,435	10,853	16,849	18,233	18,915
Account Receivables	5,697	8,541	11,406	12,915	14,616
Cash and Bank Balance	4,604	5,086	5,539	16,176	21,599
Other CA	4,433	4,238	7,380	7,065	7,566
Curr. Liability & Prov.	**12,504**	**13,473**	**16,260**	**19,949**	**22,644**
Account Payables	12,504	12,514	15,402	17,473	19,774
Provisions	0	959	858	2,476	2,870
Net Current Assets	**12,665**	**15,245**	**24,913**	**34,440**	**40,051**
Misc Expenditure	7	5	0	0	0
Appl. of Funds	**35,317**	**38,672**	**47,739**	**57,226**	**63,062**

E: MOSL Estimates

RATIOS					
Y/E MARCH	2007	2008	2009	2010E	2011E
Basic (Rs)					
EPS	**7.7**	**9.0**	**11.2**	**12.8**	**16.8**
Fully diluted EPS	**7.2**	**8.6**	**10.6**	**12.1**	**15.9**
Cash EPS	24.2	24.9	15.6	17.8	22.2
BV/Share	79.7	101.9	60.8	70.2	83.5
DPS	0.5	2.0	1.5	3.0	3.0
Payout (%)	10.0	19.9	16.6	29.7	22.8
Valuation (x)					
P/E	21.3	17.9	14.4	12.7	9.6
Cash P/E	6.3	6.2	9.8	8.6	6.9
P/BV	1.9	1.5	2.5	2.2	1.8
EV/Sales	3.2	1.9	1.6	1.3	1.1
EV/EBITDA	14.1	10.7	8.4	7.5	5.5
Dividend Yield (%)	0.3	1.3	1.0	2.0	2.0
Return Ratios (%)					
RoE	20.8	21.2	20.0	19.5	21.8
RoCE	13.9	15.8	18.4	15.6	17.7
Working Capital Ratios					
Asset Turnover (x)	0.7	1.0	1.0	1.0	1.0
Debtor (Days)	84	83	84	85	85
Inventory (Days)	154	105	124	120	110
Leverage Ratio					
Debt/Equity (x)	1.4	0.7	0.8	0.9	0.7

CONSOLIDATED CASH FLOW STATEMENT					(Rs Million)
Y/E MARCH	2007	2008	2009	2010E	2011E
Profit/(Loss) before Tax	3,690	4,501	8,603	8,433	10,676
Direct Taxes Paid	-476	260	-828	-1,026	-1,534
(Inc)/Dec in WC	4,424	-2,407	-7,304	1,111	-188
CF from Operations	**7,639**	**2,354**	**471**	**8,517**	**8,954**
EO Expense	289	1,370	274	0	0
CF frm Oper. incl EO exp	**7,350**	**985**	**197**	**8,517**	**8,954**
(Inc)/Dec in FA	-5,619	-3,396	-4,140	-1,761	-2,000
(Pur)/Sale of Investments	-7,565	-1,925	-731	-411	-608
CF from Investments	**-13,184**	**-5,322**	**-4,871**	**-2,172**	**-2,608**
Issue of Shares	-1	11,381	0	68	0
(Inc)/Dec in Debt	7,239	-5,051	3,639	5,346	0
Dividend Paid	-454	-14	-513	-1,543	-1,543
CF from Fin. Activity	**6,784**	**6,316**	**3,127**	**3,871**	**-1,543**
Inc/Dec of Cash	**950**	**1,979**	**-1,547**	**10,216**	**4,803**
Add: Beginning Balance	4,158	5,108	7,086	5,539	15,755
Closing Balance	**5,108**	**7,086**	**5,539**	**15,755**	**20,558**

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Disclosure of Interest Statement	United Phosphorus
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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