Company Flash

31 January 2008 | 6 pages

United Phosphorus (UNPO.BO)

Results

Buy: Inline Quarter

- **Inline quarter** — Sales and PAT grew 66% and 36% YoY, respectively. The lower EBIDTA margins (down 666bps YoY) was not a big surprise as 3Q07 did not include low margin Cerexagri sales, although one cannot rule out some hit due to the stronger rupee and higher raw material costs either. We reiterate that the sub par profitability in FY08 is a timing issue that should be corrected as the full upside from restructuring Cerexagri comes through in FY09.
- **Holding on to margins** — EBITDA margins were at 17.2% despite strong rupee appreciation and possible cost pressures on account of the impact of rising crude prices on cost of key raw materials and solvents. While we believe UPL has pricing power, this is unlikely to reflect immediately in numbers. We await further clarity on the different forces driving margins during the earnings call.
- **Higher other income boosts net profit** — Other income was high at Rs88m in 3QFY08, up vs. Rs18m in 3QFY07 and Rs17m in 2QFY08. We believe a significant portion of this is on account of interest earned on cash raised during the recent equity dilution. The full impact of this other income is likely to be reflected in 4QFY08.
- **Key issues requiring clarification on the earnings call** — a) Has rising crude prices impacted raw material costs materially and how much can be passed on through price increases?; b) What is the progress on the Cerexagri restructuring? When will the expected restructuring charges be borne?; c) How does the management propose to utilize the idle funds raised during the recent equity dilution?; d) Is there any further progress in the Nutrisun project?

Buy/Low Risk	1L
Price (31 Jan 08)	Rs345.25
Target price	Rs460.00
Expected share price return	33.2%
Expected dividend yield	0.3%
Expected total return	**33.6%**
Market Cap	Rs73,731M US$1,876M

Price Performance (RIC: UNPO.BO, BB: UNTP IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	2,163	11.34	20.4	30.5	5.2	21.0	0.3
2007A	2,897	14.41	27.1	24.0	4.6	20.9	0.3
2008E	3,877	19.28	33.8	17.9	3.9	23.8	0.4
2009E	5,775	28.72	49.0	12.0	3.0	28.3	0.4
2010E	7,145	35.53	23.7	9.7	2.3	26.9	0.4

Source: Powered by dataCentral

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

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Inline Quarter

UPL reported inline numbers in 3QFY08 with 66% and 36% YoY growth in sales and PAT respectively. The lower EBIDTA margins (down 666bps YoY) was not a big surprise as 3Q07 did not include low margin Cerexagri sales, although one cannot rule out some hit due to the stronger rupee and higher raw material costs either. We reiterate that the sub par profitability in FY08 is a timing issue that should be corrected as the full upside from restructuring Cerexagri comes through in FY09.

3QFY08 – Seasonally Weakest Quarter

Seasonally weak quarter, YoY numbers are not comparable due to inclusion of Cerexagi revenues from 4QFY07

Margin decline YoY due to lower margins on the Cerexagri business; we also believe that there may have been some cost push on account of the rising crude prices and its impact on key raw materials / solvents

Other income is higher QoQ as the funds raised in the recent equity issue have been invested – full impact to reflect from 4QFY08

PAT margins are lower QoQ due to significantly higher deferred tax component and lower share of income from associates

Figure 1. UPL – 3QFY08 Results Snapshot (Rupees in millions, percentage)

Year Ended March	3QFY07	3QFY08	% Ch YoY	2QFY08	% Ch QoQ
Revenues	**4,822**	**8,006**	***66.0***	**8,850**	***(9.5)***
Total Expenditure	3,671	6,628	*80.6*	7,123	*(6.9)*
EBITDA	**1,151**	**1,378**	***19.7***	**1,727**	***(20.2)***
EBITDA Margins (%)	***23.9***	***17.2***	***-666 bps***	***19.5***	***-230 bps***
Depreciation	409	487	*19.1*	503	*(3.2)*
Interest/Finance Charges	183	294	*61.1*	331	*(11.1)*
Other Income	18	88	*388.3*	17	*429.5*
PBT	577	685	*18.6*	910	*(24.7)*
Tax	47	22	*(52.1)*	10	*123.0*
Deferred Tax	174	179	*2.9*	102	*76.1*
Effective Rate (%)	*38.2*	*29.4*	*-880 bps*	*12.3*	*1,712 bps*
PAT	357	484	*35.5*	798	*(39.4)*
Income from Associates	-	2		85	
Recurring Net Income	**357**	**486**	***36.1***	**883**	***(45.0)***
Extraordinary exp / (inc)	-	-		-	
Reported Net Income	357	486	*36.1*	883	*(45.0)*
PAT Margins (%)	*7.4*	*6.1*	*-134 bps*	*10.0*	*-391 bps*

Source: Company Reports and Citi Investment Research

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 strategy

We rate the stock Buy/Low Risk (1L), with a target price of Rs460/share. 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 with its subsidiary (Search Chem). Our price target of Rs460/share is based on 16x FY09E earnings. We believe that FY09 estimates reflect the true earnings power of UPL, especially in the acquired Cerexagri business, as margins scale up to sustainable levels on the back of the restructuring efforts being undertaken by the company.

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 (4) Poor monsoons in India.

Appendix A-1

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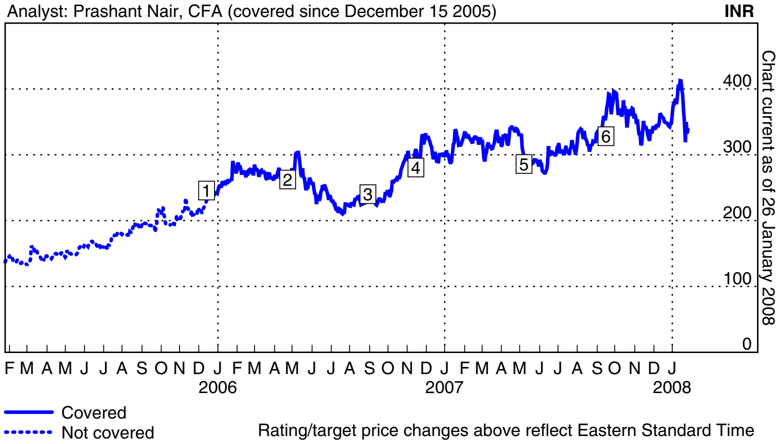
United Phosphorus (UNPO.BO)

Ratings and Target Price History - Fundamental Research

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



#	Date	Rating	Target Price	Closing Price
1:	14 Dec 05	1L	297.00	230.05
2:	24 Apr 06	1L	*317.00	269.10
3:	30 Aug 06	1L	*343.00	240.15
4:	15 Nov 06	1L	*383.00	308.55
5:	8 May 07	1L	*380.00	297.20
6:	17 Sep 07	1L	*460.00	358.15

*Indicates change.

Rating/target price changes above reflect Eastern Standard Time

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% of companies in each rating category that are investment banking clients	52%	53%	40%

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