Company

26 July 2010 | 10 pages

United Phosphorus (UNPO.BO)

Equity ☑
Target price change ☑

Buy: High Base Overhang Behind; Growth Set to Pick Up

- **Encouraging Signs** — While headline 1QFY11 numbers appear weak (as expected) owing to the high base, we are enthused by the margin improvement achieved in a tough pricing and currency environment. We believe the worst in terms of high base is behind and growth rates are set to improve going forward. Valuations remain attractive at 11xFY11E EPS and c6% FCF yield (FY11E). We maintain Buy (1H) with a marginally higher TP of Rs250 (roll over to 14xSept 11E earnings).
- **1QFY11: High Base Challenge** — The high base in 1QFY10 and adverse exchange movement (on the euro, US$ and GBP) combined to make 1QFY11 a challenging quarter in terms of YoY comparisons. The 10% dip in the top line was driven by international markets (-15%) while India (+10%) was steady. However, EBIDTA margins improved 94 bps, as lower RM cost and UNTP's cost reduction efforts began bearing fruit. As such, recurring PAT grew marginally (c0.6% YoY).
- **Update on Key Markets** — Almost all international markets were hurt by adverse currency and pricing trends, while Europe witnessed a decline in volumes as well. This was largely accentuated by the high base effect. For instance, current pricing is only c2% lower than the average for FY10 & flat vis-à-vis 4QFY10. India sales grew 10% YoY, buoyed by a good monsoon & robust kharif crop outlook.
- **Guidance Maintained** — UNTP maintained the guidance it provided at the beginning of the year i.e. 8-10% top line growth (organic) and 200bps EBIDTA margin improvement. It did not revise its guidance explicitly to factor in the recent *Manzate* acquisition – probably keeping some buffer for any further adverse movement in currency and / or pricing. We retain our estimates.
- **Other Key Takeaways** — a) Working capital improvement continues: net WC days down to 52 (53 at FY10 end; 81 at June'09 end); b) Has been able to tie up long term debt (especially rupee) at very good terms; c) *Manzate* to be accretive to margins; d) Open to acquisitions that fall within its 3-4 year pay-back criterion; e) FCCBs with a face value of cUS$65m are still outstanding.

Buy/High Risk	**1H**
Price (26 Jul 10)	Rs179.25
Target price	Rs250.00
from Rs240.00	
Expected share price return	39.5%
Expected dividend yield	0.8%
Expected total return	**40.3%**
Market Cap	Rs78,792M
	US$1,679M

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 (%)
2008A	4,183	9.04	25.6	19.8	3.5	22.4	0.6
2009A	6,179	13.36	47.7	13.4	2.9	25.2	0.8
2010E	5,622	12.16	-9.0	14.7	2.5	19.3	0.8
2011E	7,551	16.33	34.3	11.0	2.0	20.8	0.8
2012E	8,865	19.17	17.4	9.4	1.7	19.6	0.8

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	19.8	13.4	14.7	11.0	9.4
EV/EBITDA adjusted (x)	12.3	8.9	8.5	6.2	4.9
P/BV (x)	3.5	2.9	2.5	2.0	1.7
Dividend yield (%)	0.6	0.8	0.8	0.8	0.8
Per Share Data (Rs)					
EPS adjusted	9.04	13.36	12.16	16.33	19.17
EPS reported	7.12	10.49	11.69	16.33	19.17
BVPS	50.93	60.81	71.40	89.28	106.74
DPS	1.00	1.50	1.50	1.50	1.50
Profit & Loss (RsM)					
Net sales	37,306	49,317	54,603	60,087	66,525
Operating expenses	-31,773	-41,483	-46,759	-50,086	-55,057
EBIT	**5,534**	**7,834**	**7,844**	**10,001**	**11,468**
Net interest expense	-1,208	-1,759	-1,828	-1,481	-1,218
Non-operating/exceptionals	-832	-1,154	76	506	581
Pre-tax profit	**3,493**	**4,921**	**6,092**	**9,026**	**10,831**
Tax	-424	-270	-814	-1,625	-2,166
Extraord./Min.Int./Pref.div.	222	200	128	150	200
Reported net income	**3,291**	**4,851**	**5,406**	**7,551**	**8,865**
Adjusted earnings	4,183	6,179	5,622	7,551	8,865
Adjusted EBITDA	7,056	9,761	9,991	12,295	13,968
Growth Rates (%)					
Sales	52.3	32.2	10.7	10.0	10.7
EBIT adjusted	37.8	41.6	0.1	27.5	14.7
EBITDA adjusted	24.4	38.3	2.4	23.1	13.6
EPS adjusted	25.6	47.7	-9.0	34.3	17.4
Cash Flow (RsM)					
Operating cash flow	**2,136**	**-1,164**	**12,944**	**6,984**	**9,819**
Depreciation/amortization	1,522	1,927	2,147	2,294	2,500
Net working capital	-2,407	-7,304	5,862	-2,928	-1,848
Investing cash flow	**-5,735**	**-4,453**	**-1,959**	**-1,518**	**-1,592**
Capital expenditure	-1,527	-1,015	-921	-660	-615
Acquisitions/disposals	-2,650	-731	0	0	0
Financing cash flow	**6,592**	**1,625**	**-2,727**	**-4,748**	**-6,744**
Borrowings	-3,279	3,639	-1,978	-3,959	-5,955
Dividends paid	-14	-513	-750	-789	-789
Change in cash	**2,993**	**-3,992**	**8,258**	**717**	**1,483**
Balance Sheet (RsM)					
Total assets	**52,707**	**64,765**	**66,641**	**71,793**	**76,724**
Cash & cash equivalent	5,086	5,539	13,984	14,851	16,534
Accounts receivable	8,541	11,406	12,130	13,742	15,210
Net fixed assets	12,776	15,074	15,474	15,794	16,202
Total liabilities	**30,272**	**37,940**	**35,100**	**30,349**	**27,205**
Accounts payable	12,514	15,402	14,540	16,167	17,894
Total Debt	15,683	20,665	18,688	11,588	5,633
Shareholders' funds	**22,435**	**26,825**	**31,541**	**41,444**	**49,519**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	18.9	19.8	18.3	20.5	21.0
ROE adjusted	22.4	25.2	19.3	20.8	19.6
ROIC adjusted	18.8	22.5	19.2	23.9	25.0
Net debt to equity	47.2	56.4	14.9	-7.9	-22.0
Total debt to capital	41.1	43.5	37.2	21.9	10.2

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High Base Overhang Behind

While headline 1QFY11 numbers appear weak (as expected) owing to the high base, we are enthused by the margin improvement achieved in a tough pricing and currency environment. We believe the worst in terms of the high base is behind and growth rates are set to improve going forward. Valuations remain attractive at 11xFY11E EPS & c6% FCF yield (FY11E). We maintain Buy (1H) with a marginally higher TP of Rs250 (roll over to 14xSept 11E earnings).

Key Results & Earnings Call Takeaways

Please see detailed financial tables / comments on pages 4-5

- **Mostly fine barring high base effect**: The high base in 1QFY10 and adverse exchange movement (on the euro, US$ and GBP) combined to make 1QFY11 a challenging quarter in terms of YoY comparisons. While top line fell back 10%, EBIDTA margins improved (94 bps) and recurring net income grew 0.6%.

- **Guidance**: UNTP maintained its guidance for the year (8-10% organic growth in revenues & EBIDTA margins of c20-21%). Upside from the Mancozeb acquisition should start coming through in 2Q but will be reflected fully from 2H, once all transition-related issues are sorted out. The acquisition should be accretive to margins. We were hopeful that UNTP will raise top-line guidance explicitly to incorporate the acquisition but it appears to be keeping some buffer to offset any further adverse change in currency / pricing.

- **Working capital improvement continues**: Net working capital dipped further to 52 days (53 days at end of FY10 and 81 days at end of June 2009). UNTP continues to maintain tight control over inventory and receivables, which has allowed it to keep net WC under control.

- **Pricing gradually stabilizing**: While the change in pricing on a YoY basis has been quite adverse in 1Q, current prices are only c2% lower vis-à-vis the average for FY10 and flat vis-à-vis the levels in 4QFY10. As such, the adverse impact of pricing on top-line growth would abate going forward, if current levels hold. RM prices remain stable at this point.

- **FCCBs Update**: UNTP had issued convertible bonds, amounting to US$150m in early 2006. Out of these, bonds with a face value of cUS$64.9m are outstanding and are due for redemption (unless converted into equity) towards the end of FY11. The conversion price is Rs136/share and, given the conversion premium of 30.87%, we believe it makes sense for holders to convert, if the stock is above cRs178/share. This could prove to be a technical overhang on the stock.

Financial Snapshot & Other Tables

Figure 1. United Phosphorus – 1QFY11 Earnings Summary (Rs m, %)

Year Ended March	1QFY10	1QFY11	% Ch YoY	4QFY10	% Ch QoQ
Revenues	**16,377**	**14,686**	**(10.3)**	**15,159**	**(3.1)**
Cost of Revenues	10,754	9,275	(13.8)	9,523	(2.6)
Gross Profit	**5,622**	**5,411**	**(3.8)**	**5,637**	**(4.0)**
Gross Margins (%)	*34.3*	*36.8*	*251 bps*	*37.2*	*-34 bps*
Operating Expenses	2,552	2,519	(1.3)	2,633	(4.4)
EBITDA	**3,070**	**2,892**	**(5.8)**	**3,004**	**(3.7)**
EBITDA Margins (%)	***18.7***	***19.7***	***94 bps***	***19.8***	***-12 bps***
Depreciation	501	472	(5.9)	558	(15.5)
Interest/Finance Charges	461	504	9.3	697	(27.7)
Other Income	65	186	186.6	154	20.7
PBT	2,173	2,103	(3.2)	1,903	10.5
Tax	187	206	10.5	8	2,650.7
Deferred Tax	98	-	(100.0)	116	(100.0)
Effective Rate (%)	*13.1*	*9.8*	*-331 bps*	*6.5*	*332 bps*
PAT	1,888	1,897	0.5	1,780	6.6
MI/Income from Associates	(26)	(23)	(10.1)	29	(179.5)
Recurring Net Income	**1,862**	**1,874**	**0.6**	**1,809**	**3.6**
Extraordinary exp / (inc)	99	450	352.5	(60)	(856.3)
Reported Net Income	1,763	1,424	(19.2)	1,868	(23.8)

CIRA Comments

Conclusion: No surprises. High base effect & adverse currency take a toll on topline while cost reduction & restructuring benefits at Cerexagri help improve margins

India the sole geography to see growth as currency & pricing takes a toll across international markets. Europe also sees some dip in volumes. Most of this boils down to the high base in 1QFY10

Lower RM cost (as prices decline) & tight control over fixed costs lead to higher gross & EBIDTA margins

Net interest cost falls on lower debt while depreciation is lower due to lower amortization of intangibles

Effective tax rate to be in the 15-18% range for FY11

Source: Company Reports and CIRA Estimates

Figure 2. United Phosphorus – 1QFY11 Revenue Break Up (Rs m, %)

Year Ended March	1QFY10	1QFY11	% Ch YoY	4QFY10	% Ch QoQ	CIRA Comments
International Sales	**12,759**	**10,820**	**(15.2)**	**13,264**	**(18.4)**	High base effect - currency & pricing hits all markets; Europe sees some dip in volumes as well
% of Total Sales	*77.6*	*72.8*		*86.6*		
North America	4,379	3,861	(11.8)	3,284	17.6	c8% exchange impact & some price correction; volumes flat to higher
Europe	4,855	3,647	(24.9)	5,430	(32.8)	C13% adverse exchange impact (Euro); volumes also hit to some extent
Rest of the World	3,525	3,312	(6.0)	4,550	(27.2)	Largely currency impact (mainly US$); volumes are higher
India Sales	**3,683**	**4,052**	**10.0**	**2,050**	**97.7**	Good monsoon drives volumes growth
% of Total Sales	*22.4*	*27.2*		*13.4*		
Revenues (sales + OI)	**16,442**	**14,872**	**(9.5)**	**15,314**	**(2.9)**	**Maintains FY11 Guidance of 8-10% organic growth**

Source: Company Reports and CIRA Estimates

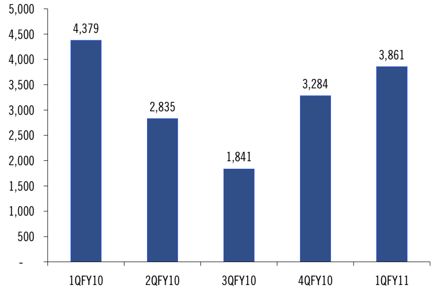
Revenues - Trends across Key Geographies

US & EU markets remain weak

US degrew 13% YoY – exchange impact of c8% plus some price correction – volumes have been flat to higher

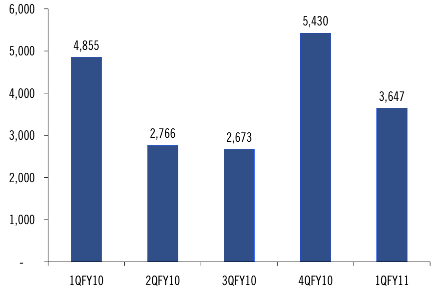
EU degrew 25% - exchange impact is around 13% (Euro) & 9-10% (GBP) – volumes have also been hit to some extent

Figure 3. North America Sales (Rs m)



Source: Company Reports

Figure 4. EU Sales (Rs m)



Source: Company Reports

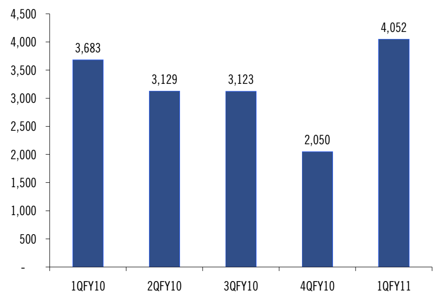
India sales have done well (+10% YoY), with the monsoon being good so far

Outlook for kharif crop is very good and if the current trend continues, the rabi crop should also be healthy

RoW markets have declined 6% - primarily due to exchange impact

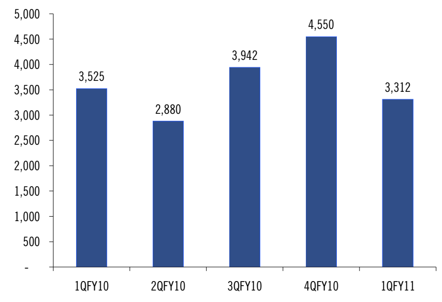
Targeting Brazil as the next big opportunity in RoW markets

Figure 5. India Sales (Rs m)



Source: Company Reports

Figure 6. RoW Sales (Rs m)



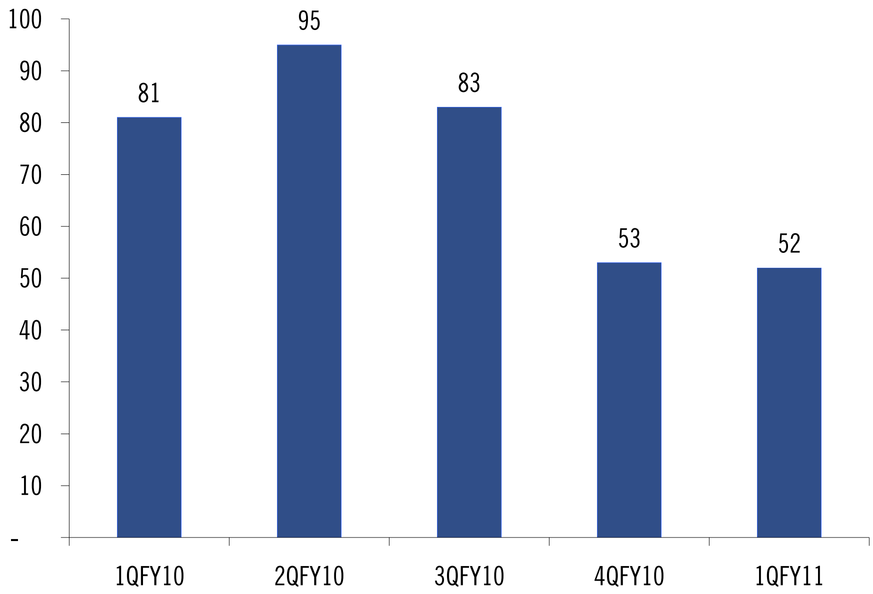
Source: Company Reports

Working Capital Continues to Improve

Net working capital down to 52 days due to lower inventories and receivable days – marginal improvement over end FY10

Cash released from working capital has been used partially to repay higher cost debt while the rest is being maintained as a war chest for potential acquisitions

Figure 7. United Phosphorus – Working Capital Cycle



Source: Citi Investment Research and Analysis

United Phosphorus

Company description

UNTP 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 & Europe, and has achieved success over the past decade. Apart from fully integrated manufacturing facilities, it also has strong distribution infrastructure across its targeted markets. Its 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, UNTP has emerged as the third-largest generics company in the world.

Investment strategy

We rate the stock Buy/High Risk (1H), with a target price of Rs250/share. UNTP is the only Indian play on the global crop protection market, with over 80% of revenues 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. UNTP has reached critical scale in the regulated markets of the EU and US through a series of acquisitions and organic growth. We believe that its growing free cash flows give it the ability to step up growth initiatives – both organic and inorganic. We forecast FY10-12E revenue and net profit CAGRs of 10% and 26% 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 metric to value companies such as UPL. Our target price is based on 14x 12-month forward earnings, which is the median P/E multiple for UPL over the last five years and 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 target price of Rs250/share is based on 14x Sept '11E earnings.

Risks

Our risk rating on UPL is High Risk, in line with our quantitative risk-rating system, in order to account for the volatility in the euro (a key invoicing currency) and RM prices. While we see no major concerns on the business front, the high institutional ownership of the stock leaves it vulnerable to redemption led selling pressures in the current environment. The main downside risks to our target price and estimates include: (1) Continued volatility in the availability & pricing of key raw materials; (2) Inability to effectively integrate any of its acquisitions; (3) Cut in farm subsidies in regulated markets, (4) Conversion of Dec 10 FCCBs could be an overhang.

Appendix A-1

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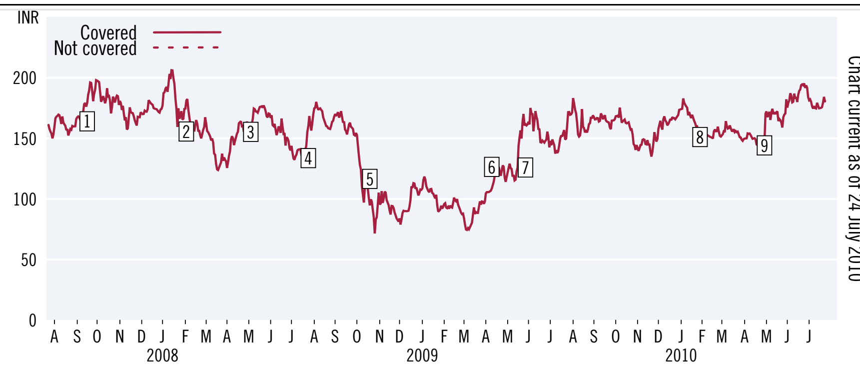
United Phosphorus (UNPO.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Prashant Nair, CFA



	Date	Rating	Target Price	Closing Price
1	17-Sep-07	1L	*230.00	179.08
2	3-Feb-08	1L	*222.50	174.60
3	4-May-08	1L	*229.00	157.63
4	24-Jul-08	1L	*242.50	160.13
5	20-Oct-08	*1H	*161.00	94.75
6	9-Apr-09	1H	*183.00	108.60
7	27-May-09	1H	*223.00	161.70
8	28-Jan-10	1H	*230.00	158.80
9	29-Apr-10	1H	*240.00	147.85

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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