Q3FY12 Result Update

February 01, 2012

CIL recently reported its Q3FY12 results, which were below street estimates. Given below are some of the key highlights, which we came across while reviewing the results.

Quarter Financials- Consolidated:

(Rs. in Cr)

Particulars	Q3FY12	Q3FY11	% Chg	Q2FY12	% Chg	Remarks
Net Sales	2538.5	2032.3	24.9%	2711.5	-6.4%	Rose y-o-y due to increase in fertiliser prices. But fertiliser volume dropped 1% y-o-y to 0.8 mn MT due to irregularity in North Eastern monsoons
Government Subsidies relating to earlier periods	11.6	11.0	5.2%	0.0	NA	
Other Operating Income	11.2	13.7	-18.4%	81.5	-86.3%	
Total Income	2561.3	2057.0	24.5%	2793.0	-8.3%	
Expenditure						
Raw Material Consumed	1588.2	1328.9	19.5%	1428.3	11.2%	
Stock Adjustment	-630.1	-33.7	1771.4%	-63.2	897.8%	Increase in inventory by Rs.630 cr is a concern reflecting resistance by farmers to high prices of complex fertilisers
Purchase of Finished Goods	1057.7	290.5	264.1%	708.3	49.3%	Trading activity rose sharply impacting margins
Employee Expenses	53.5	47.3	13.2%	53.3	0.5%	
Other Expenses	246.9	188.8	30.7%	264.6	-6.7%	
Total Expenditure	2316.2	1821.9	27.1%	2391.3	-3.1%	
EBIDTA	**245.1**	**235.1**	4.2%	**401.6**	-39.0%	
EBIDTA Margin%	*9.7%*	*11.6%*		*29.6%*		High trading volume and high cost of manufactured fertilisers led to contraction in EBIDTA margins
Other Income	21.2	19.4	9.2%	23.7	-10.6%	
Interest	30.4	21.8	39.3%	19.2	58.0%	
Depreciation	13.9	16.3	-14.4%	13.6	2.2%	
PBT	221.9	216.4	2.6%	392.4	-43.5%	
PBTM%	*8.7%*	*10.6%*		*28.9%*		
Tax	55.7	65.9	-15.5%	110.0	-49.4%	
Effective Tax Rate%	*25.1%*	*30.5%*		*28.0%*		
Reported Profit After Tax	166.2	150.5	10.4%	282.4	-41.2%	
Extra-ordinary Items	35.5	0.0	#DIV/0!	0.0	-	
Adjusted Net Profit	**130.6**	**150.5**	-13.2%	**282.4**	-53.7%	Higher interest cost and extraordinary expenses led to fall in net profit.
NPM%	*5.1%*	*7.4%*		*20.8%*		
EPS	**4.6**	**5.3**	-13.4%	**10.0**	-53.8%	
Equity	28.2	28.2	0.2%	28.2	0.1%	

(Source: Company, HDFC Sec)

Key highlights of Q3FY12 results:

- CIL's sales volumes declined by 1% y-o-y to 830,000 mt in Q3FY12 due to erratic nature of the North East monsoons and widening spread (over last 18 months) between urea and complex fertilizers which impacted offtake of complex fertilizers. Despite increase in acreages for wheat and paddy during the current rabi season, agricultural productivity was impacted due to the erratic nature of North East monsoons. While urea price has remained constant during past 18 months, prices of decontrolled fertilizers have almost doubled impacting their offtake. Manufactured volume dropped sharply by 36% y-o-y and 39% q-o-q.

- Urea & DAP industry dispatches were down by 1.8% and 12% y-o-y, whereas MOP and complex fertiliser sales were up by 6.3% and 4.4% y-o-y. After a prolonged potash holiday, MOP availability started since early October, which coincided with substantial demand for MOP during Q3FY12.

- Overall, the non-subsidy business has shown substaintial growth, the contribution of which is ~30% to EBIDTA. Organic fertiliser sales saw 40%-50% growth y-o-y and water soluble fertilser sales have also gone up y-o-y, but the agrochemical division was under pressure due to adverse seasonal factors and ban on endosulfan by Supreme Court.

- CIL's acquisition of Gujarat based agrochemical company Sabero Organics would continue to strengthen its topline growth. Sabero has a wide portfolio of 8-9 products across various categories like insecticides, herbicides and fungicides. Strong synergy benefit is expected from this acquisition going forward.

- CIL has not yet consolidated Sabero's financials (acquisition is effective Dec 17, 2011) and will start the same from Q4FY12 onwards. Sabero reported loss of Rs.21.5 cr for Q3FY12 on sales of Rs.95.6 cr.

- CIL has charged Rs.35.5 cr (net of tax Rs.24.9 cr) related to non-compete fees of Sabero, which has in turn adversely impacted CIL's bottomline.

- Revenue from Kakinada's new capacity is expected to start contribution from H2FY13. High fertiliser subsidy and fall in global P&K fertiliser prices could boost its consumption in coming quarters.

- CIL has received Gujarat Pollution Control Board's permission for enhancing the capacity utilisation to 75% of normal that could help it to improve the production. It is also putting up additional environment affluent treatment facilities, which could help it to ramp up the capacity usage. So over the next quarters, there could be an improvement q-o-q as far as Sabero production and sales volumes are concerned.

- Capacity additions and weak global demand to put pressure on international fertiliser prices. Further, the government is likely to consider a cut in subsidy rates for phosphatic fertilizers for FY13.

- In retail business, ~200 additional stores are in various stages of opening. Of this, 90 have been opened and the rest will start by March 2012, taking the total store count to 600.

- Coromandel SQM, a 50-50 joint venture between CIL and SQM of Chile, has commissioned its water-soluble specialty fertiliser plant at Kakinada. At present, the demand for water-soluble fertilizers in the country is 70,000 tonnes per annum. The plant now has a capacity of 15,000 tonne and will be doubled to 30,000 tonne with demand increasing. In the first two years, the JV would concentrate on the Indian market and later explore export possibilities. The use of these fertilizers could increase the yields substantially and require lesser labour, power and water. The JV firm will look to produce specific nutrient products for wheat and rice production and research on these lines is on. Blended products in will be launched in three to five months.

- The Board has approved interim dividend of 400% or Rs.4/share. Assuming a final dividend of Rs.3 and bonus debentures of Rs.15 per share, the stock currently offers an attractive dividend yield of 8%.

Guidance:

- The management is betting on farm mechanisation to provide a profitable new avenue for CIL in the coming years. In FY12 it is looking at 18,000-20,000 acre, mostly in AP (vs 8,000 acres in FY11). It buys equipment like harvesters, threshers & transplanters and employs a team of people to work on the farms and charges per acre. There is a huge potential for mechanisation. It also sees opportunity in providing extended services (developing nurseries, pre-plantation preparation to transplantation, basically, all other activities other than harvesting). The focus currently is on paddy and sugarcane with the project covering 8,000 acres and has plans to expand it to 20,000 acres in FY13E and ramp up about 4x-5x in subsequent years. CIL is pushing this through its retail centres in AP.

- Management indicated that subsidy levels for FY13 are likely to be revised downwards as global fertiliser prices have declined from their peaks and have now stabilized. DAP prices which were ruling at US$680/mt have declined to US$520-530/mt and are likely to stabilize around these levels. Consequently, government is likely to announce subsidy reduction for FY13 on decontrolled fertilizers. Global DAP capacity is also likely to witness addition in FY13 which would keep the supply of phospatic fertiliser intact. While Saudi Arabian Mining Company (Ma'aden)'s plant is likely to create additional supply of 1.5-2mn mt, commissioning of TIFERT could also aid volumes.

- CIL is planning to invest over Rs.500 cr in the next couple of years to ramp up its production capacity to 4 mn tonnes from the present 3.25 mn tonnes. This includes Rs.116 cr greenfield 800-tonne per day single super phosphate plant to be set up in Punjab. It is also planning to pump in about Rs.350 cr more in the expansion of Kakinada plant that is already under way.

Concerns

- CIL's 100% revenue comes from Indian farmers, monsoon performance could impart variability to its annual performance. However, given CIL's cost leadership, strong balance sheet and presence across agriculture value chain we believe it is well placed to limit the impact from this.

- Forex fluctuation in Rs/USD and Rs/Euro could impact its margins as it imports most of its raw materials.

- CIL derives a large portion of its revenue from fertilisers where it converts rock phosphate/phosphoric acid to DAP as well as other complex fertilisers. Given limited backward integration, its performance depends on global prices for these raw materials.

- With strong brand and market share in South India CIL plans to follow brand premium strategy in fertilisers. However, given the competition from imported fertilisers, CIL's margins could get hit if importers start eating up into its market share.

- Prices and availability of key raw materials - rock phosphate, potash and phosphoric acid could be an issue.

Conclusion & Recommendation

CIL reported weak numbers in Q3FY12 on account of lower crop acreage and erratic monsoon in the domestic market, while global fertilisers prices are coming off. The company is witnessing a demand contraction in phosphate fertilizers on account of higher prices and de-stocking happening at the dealers/retailers level. Further, field crops like paddy/wheat are seeing higher demand contraction compared to cash crops.

CIL's growth trajectory could be supported by expansion of phosphoric fertiliser capacity in Kakinada and addition of 200 retail stores. High fertiliser subsidy and fall in global P&K fertiliser prices would continue to boost its consumption in coming quarters. Also CIL's acquisition of Sabero Organics could continue to strengthen its topline growth. CIL's increasing non-subsidy portfolio through speciality fertiliser, pesticide, farm mechanisation, retail and organic manure also could work well for future growth.

CIL is targeting farm mechanisation for paddy crops, which is a main crop in South Indian states. Given large opportunity and unorganised nature, it could emerge as one of the leaders in this segment. It is scaling up its organic manure business with its brand Godavari Gold and plans to reach a sale of 1 mn tons within the next 3-4 years (FY12 estimates stand at 250,000 tons). Given strategic nature of vendor relationships especially in phosphoric acid, CIL is well placed to benefit from movement in raw material prices.

In Q4FY12, CIL may have to bear loss on fertilizer inventory as a result of falling global prices and recent Rupee depreciation and account for losses at Sabero Organics. It also faces the threat of lower subsidy by Government of India in FY13.

Post the not so encouraging Q3FY12 numbers, we are revising downwards our FY12 estimates. Though our FY13 estimates may need downward revision, we are not doing it at this point.

We had advised a buy on the stock in the band of Rs.296-311 in Q2FY12 result update dated October 31, 2011 (CMP Rs.334.50) for sequential targets of Rs.327 and Rs.342 over 1-2 quarters. The stock touched a low of Rs.253.1 on January 19, 2012 and a high of Rs.335.6 on November 4, 2011. At the CMP of Rs.269.4, the stock is trading at 12x its FY12RE earnings of Rs.22.5 and 8.7x FY13E earnings of Rs.31.1.

We believe given the poor performance over the past 2 quarters, high domestic prices and weakening demand, the stock price could see lower levels. Pending payouts of interim dividend and bonus debentures could support the stock price for some time, following which it could settle at lower levels.

Investors could exit the stock in the Rs.270-282 band. We will continue reviewing the stock and update investors on future entry opportunities.

Financial Estimates:

Particulars (Rs in Crs)	FY09	FY10	FY11	FY12 (OE)*	FY12 (RE)*	FY13 (E)*
Operating income	9533.5	6394.7	7528.0	9445.3	8467.9	10397.2
PBIDT	810.6	710.0	945.1	1138.2	975.3	1362.0
PBIDTM (%)	8.5%	11.1%	12.6%	12.1%	11.5%	13.1%
Profit after Tax	559.4	467.7	693.7	826.6	635.2	878.6
PATM (%)	5.9%	7.3%	9.2%	8.8%	7.5%	8.5%
EPS	19.9	16.6	24.6	29.3	22.5	31.1
P/E (x)	13.6	16.2	10.9	9.2	12.0	8.7

* - Quick Estimates, OE - Original Estimates, RE - Revised Estimates (**Source:** Annual Report, HDFC Sec Estimates)

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