Prabhudas Lilladher

P.I. Industries

Unique business model to drive growth

Q3FY14 Result Update

February 14, 2014

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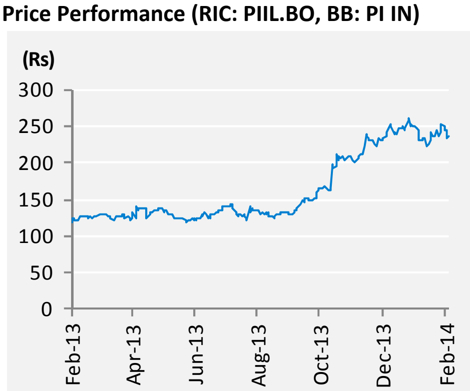
Rating	**BUY**
Price	Rs236
Target Price	Rs300
Implied Upside	27.1%
Sensex	20,367
Nifty	6,048

(Prices as on February 14, 2014)

Trading data			
Market Cap. (Rs bn)			32.0
Shares o/s (m)			135.5
3M Avg. Daily value (Rs m)			59.8
Major shareholders			
Promoters			58.57%
Foreign			19.60%
Domestic Inst.			5.51%
Public & Other			16.32%
Stock Performance			
(%)	**1M**	**6M**	**12M**
Absolute	(4.9)	81.3	90.7
Relative	(1.7)	76.2	86.3
How we differ from Consensus			
EPS (Rs)	**PL**	**Cons.**	***% Diff.***
2015	16.6	16.1	*2.7*
2016	20.7	21.7	*-4.2*

Price Performance (RIC: PIIL.BO, BB: PI IN)



Source: Bloomberg

PI Industries reported another quarter of outperformance driven by higher margins. Top-line growth at 29% YoY was higher than all other domestic peers. Adjusted PAT stood at Rs380m, 63% YoY, resulting into 9M EPS of Rs10.4. Company continues to deliver consistently far superior earnings growth due to its unique business model. For FY15E, they expect to clock 25-30% top-line growth, while maintaining margins. We believe such growth is easily achievable for PI driven by its unique business model; management highlighted that margin guidance is conservative which might result in outperformance. Jambusar Phase-II is likely to come up by next year (Q1FY16E) which will accelerate growth momentum. Reduction in net debt and improvement in working capital has further improved Balance Sheet. Robust cash flow generation, going forward, will be used to meet capex requirements. Product launches are likely to continue in FY15E. PI expects to commercialize three new products in Custom synthesis, while in domestic market, it will launch two products, either in Q4FY14E or by Q1FY15E. We maintain 'BUY' with target price of Rs300 (previous Rs280). With better revenue visibility, superior earnings growth and similar RoE/RoCE profile, we see no reason why PI should trade at a discount to Rallis. Maintain as top pick in agri-inputs space.

- **Q2 top-line growth stood at 29% YoY with margin improvement of 130bps YoY**: PI reported revenues of Rs3.6bn, 29% YoY in line with our estimates. Custom synthesis (CS) revenues clocked top-line of Rs2.3bn, implying growth of 33% YoY. Agri-inputs revenues grew by 20.0% YoY to Rs1.3bn.

  EBITDA for the quarter stood at Rs627m, 38% YoY, with margins of 17.3% (PLe of Rs575m with margins of 16.2%). Adjusted EPS for the quarter stood at Rs2.8. For 9MFY14, company has done EPS of Rs10.4.

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Key financials (Y/e March)	**2013**	**2014E**	**2015E**	**2016E**
Revenues (Rs m)	11,514	16,276	20,100	24,068
Growth (%)	*31.0*	*41.4*	*23.5*	*19.7*
EBITDA (Rs m)	1,809	2,917	3,641	4,442
PAT (Rs m)	976	1,746	2,244	2,810
EPS (Rs)	7.2	12.9	16.6	20.7
Growth (%)	*26.2*	*78.9*	*28.5*	*25.2*
Net DPS (Rs)	1.0	1.5	2.0	2.5

Profitability & Valuation	**2013**	**2014E**	**2015E**	**2016E**
EBITDA margin (%)	*15.7*	*17.9*	*18.1*	*18.5*
RoE (%)	*22.8*	*28.8*	*28.8*	*28.2*
RoCE (%)	*23.0*	*31.6*	*34.4*	*34.7*
EV / sales (x)	2.9	2.0	1.6	1.3
EV / EBITDA (x)	18.6	11.3	9.0	7.1
PE (x)	32.8	18.3	14.3	11.4
P / BV (x)	6.0	4.7	3.7	2.9
Net dividend yield (%)	*0.4*	*0.6*	*0.8*	*1.1*

Source: Company Data; PL Research

- **Custom synthesis continues to deliver robust growth; order book currently at US$365m implies visibility for next 2-2.5 years' of increased CSM capacities:** For 9MFY14, custom synthesis' top-line growth stood at 83% YoY. Under the CSM business, around 25-27 products are in the pipeline currently, while 14-15 products have been commercialized as of now. As of Dec'13, order book stood at US$365m which implies visibility for the next 2-2.5 years of company's CSM capacities. Second phase of the Jambusar facility is expected to be commissioned in Q1FY16 which will further accelerate growth. We would like to highlight that order book is understated, given the fact that it only includes multi-year orders, while expected annual renewals (40% of annual CS revenues) are not accounted for in the order book.

- **Domestic agri-inputs business benefitted from good monsoons, healthy reservoir levels, increased MSPs and better sentiments this year:** PI's domestic agri-inputs business grew by 22.0% YoY during 9MFY14 higher than average industry growth of 14-15%. Apart from favourable industry dynamics this year, PI's focus on in-licensed molecules and strengthening its distribution network has helped it in delivering above average industry growth. PI currently has 8-10 novel products in its pipeline and plans to launch two products annually over the next few years. We believe consistent launch of new molecules will enable PI to garner incremental market share and strengthen its positioning in the domestic market.

- **Expect earnings to compound at a CAGR of 42% over FY13-16E**: We expect PI's revenues to grow at a CAGR of 27.9% during FY13-16E (expect PI's domestic business to grow at a CAGR of 17.6% during FY13-16E, while custom synthesis is expected to grow at a CAGR of 36.4% over FY13-16E). Margins are likely to improve by 280bps to 18.5% by FY16E, driven by improvement in domestic agri-inputs business, increasing share of in-licensed business and higher proportion of custom synthesis which carries higher margins. We expect PI's earnings to increase at a CAGR of 42%, with EPS likely to increase to Rs20.7 in FY16E.

Exhibit 1: Q3FY14 Result Overview (Rs m)

Y/e March	Q3FY14	Q3FY13	YoY gr (%)	Q2FY14	9MFY14	9MFY13	YoY gr (%)
Net Sales	**3,634**	**2,826**	***28.6***	**4,628**	**12,322**	**8,202**	***50.2***
Expenditure							
Raw Materials	2,021	1,651	*22.4*	2,794	7,214	4,743	*52.1*
% of Net sales	*55.6*	*58.4*		*60.4*	*58.5*	*57.8*	
Personnel	260	200	*30.2*	237	771	610	*26.5*
% of Net sales	*7.2*	*7.1*		*5.1*	*6.3*	*7.4*	
Other Expenditure	726	522	*39.0*	676	2,000	1,466	*36.4*
% of Net sales	*20.0*	*18.5*		*14.6*	*16.2*	*17.9*	
Total Expenditure	3,007	2,373	*26.7*	3,707	9,985	6,819	*46.4*
EBITDA	**627**	**453**	***38.4***	**921**	**2,337**	**1,383**	***69.0***
Margin (%)	*17.3*	*16.0*		*19.9*	*19.0*	*16.9*	
Depreciation	79	50	*57.7*	80	232	149	*56.0*
EBIT	**548**	**403**	***36.0***	**841**	**2,105**	**1,234**	***70.6***
Interest	20	71	*(71.8)*	27	85	175	*(51.4)*
Other Income	40	21	*94.5*	31	78	49	*60.9*
PBT	**568**	**353**	***61.1***	**845**	**2,098**	**1,108**	***89.4***
Tax	188	120	*56.8*	267	721	336	*114.9*
Tax Rate (%)	*33.1*	*34.0*		*31.6*	*34.4*	*30.3*	
Adjusted PAT	**380**	**233**	***63.3***	**579**	**1,411**	**772**	***82.7***
Extraordinary Income	(33)	7	*NA*	(26)	8	(40)	*NA*
Reported PAT	**347**	**240**	***44.9***	**553**	**1,385**	**733**	***89.1***
Adjusted EPS	**2.8**	**1.9**	***51.0***	**4.3**	**10.4**	**6.2**	***68.9***

Source: Company Data, PL Research

Key Takeaways from Conference Call

- **Balance sheet improves further** - PI has reduced its net debt to Rs950m, bringing down debt-equity ratio to <0.15. Working capital has also improved with net working capital (NWC) reducing from 84 days for FY13 to 68 days for 9MFY14. Inventory level has reduced, bringing about WC improvement in both segments. Going forward, there is a scope to improve receivables
- **Jambusar ramp up -** Scale-up in Jambusar Phase-I has been pretty encouraging. Revenue contribution of Jambusar for 9M is Rs900m (Q3 Jambusar is Rs220m). Current capacity utilization is 85%. For FY14, Jambusar revenues are likely to be at ~Rs1.2bn
- **Order book -** Order book currently stands at US$365m
- **Capex guidance -** Capex guidance is Rs1.25bn-1.5bn each year for the next two years. This capex includes investment in R&D, balancing equipment in Panoli and other process improvements. Of this capex, 80-85% will be in Jambusar. FY14 capex is likely to be Rs1bn
- **Growth in CS over the medium term will be driven by-** capex, investment in balancing equipment, process improvement enhancing throughput from existing capacity etc. Till Jambusar Phase-II commercializes, growth will be from process improvements, slight ramp-up in existing capacity, bringing about process improvements
- **PI growth trajectory -** 25-30% growth in CS till Jambusar Phase-II comes up. After that, growth will accelerate. Phase-II is likely to come up by Q1FY16E
- **Guidance for FY15E –** 25-30% growth on a consolidated basis; hope to maintain margins
- **Guidance for FY14 -** Top-line of Rs16bn, PAT margins at 11-11.5%
- **Tax rate to go down from FY16 -** Tax rate will decline as the contribution of Jambusar increases further. Starting from FY16, Jambusar's contribution will become meaningful in terms of top-line as well as profitability. Hence, tax rate will decrease then
- **Q3 top-line break-up:** Q3 witnessed strong growth in domestic and encouraging ramp-up in CS; Agri inputs revenues stood at Rs1.3bn (9M Rs5.4bn) and CS stood at Rs2.3bn (9M Rs6.9bn)
- **Q3 margins:** In Q3, EBITDA margins for CS stood at 18.5-19%, while for domestic, it stood at 15.-16%
- Jambusar facility can have 5-6 phases
- **Gross margin improvement this quarter was driven by -** favourable product mix and business mix

- In Q4, CS revenues will be similar to Q3 revenues
- **Product launches to accelerate -** In Q3, PI launched one product in domestic market, while in CS, it commercialized one (intermediate) new product. In Q4, PI expects to commercialize one more product in CS

  In FY15, PI expects to commercialize three new products in CS (2 intermediates and 1 Active Ingredient). In domestic market, it will launch two products, either in Q4FY14E or Q1FY15E
- One product wheat herbicide named Mansa launched in Q3
- **Domestic market growth driven primarily in volume terms -** In domestic market, major growth during 9M has been driven by volumes; price increase is to the tune of 6-7%. Industry growth for 9M stands at 14-15%
- In-licensed contribution to revenues is 65% of sales in 9MFY14
- Current cash on books is Rs300m
- **Cash flow that will be generated going forward will be used to –** meet capex requirements, reduce debt and evaluating opportunities in terms of inorganic growth
- **9MFY14 capex-** that has been done is Rs650m (nothing significant has been utilised for Jambusar Phase-II)
- Jambusar Phase-II is likely to be commissioned by Q1FY16E
- **Product concentration in CS -** 14-15 products commercialized as of now (coming from 9-10customers), Top 5 products as well as Top 5 customers account for 55-60% of revenues in CS
- Order book execution time is ~3-3.5 years
- **Diversifying CS pipeline-** Non-agchem pipeline is 30% of order book (has increased from 5-7% couple of years back)
- CS margins can be scaled up to 20-22% over the medium term
- **Q3FY14 domestic business break-up -** Herbicides 35%, Insecticides 50%
- PI now has 28-29 products in domestic business and Top 5 products contribute 55% to domestic revenues
- **New product response -** *Osheen* and *Fluton* have received very encouraging response
- Sustainable margins in domestic business is 17-18%
- **Jambusar Phase I -** has reached breakeven; asset turnover 2x if we consider investment done only related to Phase-I

- PI might have to raise some short-term debt in FY15 due to timing issues of FCF generation compared to capex/WC requirements. Other than that, management's strategy is clearly focussed on reduction of debt over medium term
- Net WC in CS business is 30-35 days

Income Statement (Rs m)

Y/e March	2013	2014E	2015E	2016E
Net Revenue	**11,514**	**16,276**	**20,100**	**24,068**
Raw Material Expenses	6,745	9,603	11,859	14,200
Gross Profit	4,768	6,673	8,241	9,868
Employee Cost	886	1,270	1,568	1,877
Other Expenses	2,074	2,487	3,032	3,548
EBITDA	**1,809**	**2,917**	**3,641**	**4,442**
Depr. & Amortization	220	312	371	439
Net Interest	136	(2)	(30)	(40)
Other Income	82	108	130	130
Profit before Tax	**1,453**	**2,607**	**3,300**	**4,043**
Total Tax	477	860	1,056	1,233
Profit after Tax	**976**	**1,746**	**2,244**	**2,810**
Ex-Od items / Min. Int.	(6)	(16)	—	—
Adj. PAT	**976**	**1,746**	**2,244**	**2,810**
Avg. Shares O/S (m)	**135.5**	**135.5**	**135.5**	**135.5**
EPS (Rs.)	**7.2**	**12.9**	**16.6**	**20.7**

Balance Sheet Abstract (Rs m)

Y/e March	2013	2014E	2015E	2016E
Shareholder's Funds	5,317	6,819	8,749	11,165
Total Debt	1,873	1,200	1,000	900
Other Liabilities	1,761	1,761	1,761	1,761
Total Liabilities	**8,951**	**9,780**	**11,510**	**13,826**
Net Fixed Assets	5,336	6,024	6,953	7,814
Goodwill	50	50	50	50
Investments	115	115	115	115
Net Current Assets	3,450	3,592	4,392	5,848
Cash & Equivalents	*161*	*121*	*374*	*1,123*
Other Current Assets	*5,685*	*7,039*	*8,149*	*9,671*
Current Liabilities	*2,396*	*3,567*	*4,130*	*4,946*
Other Assets	—	—	—	—
Total Assets	**8,952**	**9,781**	**11,510**	**13,827**

Cash Flow Abstract (Rs m)

Y/e March	2013	2014E	2015E	2016E
C/F from Operations	2,595	1,866	2,038	2,502
C/F from Investing	(1,739)	(892)	(1,170)	(1,170)
C/F from Financing	(788)	(1,015)	(615)	(584)
Inc. / Dec. in Cash	68	(41)	253	749
Opening Cash	94	162	121	374
Closing Cash	162	121	374	1,123
FCFF	(949)	876	768	1,242
FCFE	(1,372)	203	568	1,142

Quarterly Financials (Rs m)

Y/e March	Q4FY13	Q1FY14	Q2FY14	Q3FY14
Net Revenue	**3,304**	**4,061**	**4,628**	**3,634**
EBITDA	**414**	**789**	**921**	**627**
% of revenue	*12.5*	*19.4*	*19.9*	*17.3*
Depr. & Amortization	69	73	80	79
Net Interest	12	31	(4)	(20)
Other Income	35	7	31	40
Profit before Tax	**333**	**685**	**845**	**568**
Total Tax	138	266	267	188
Profit after Tax	**231**	**485**	**553**	**347**
Adj. PAT	**194**	**452**	**579**	**380**

Key Financial Metrics

Y/e March	2013	2014E	2015E	2016E
Growth				
Revenue (%)	31.0	41.4	23.5	19.7
EBITDA (%)	26.2	61.2	24.8	22.0
PAT (%)	36.5	78.9	28.5	25.2
EPS (%)	26.2	78.9	28.5	25.2
Profitability				
EBITDA Margin (%)	15.7	17.9	18.1	18.5
PAT Margin (%)	8.5	10.7	11.2	11.7
RoCE (%)	23.0	31.6	34.4	34.7
RoE (%)	22.8	28.8	28.8	28.2
Balance Sheet				
Net Debt : Equity	0.3	0.2	0.1	—
Net Wrkng Cap. (days)	84	58	56	56
Valuation				
PER (x)	32.8	18.3	14.3	11.4
P / B (x)	6.0	4.7	3.7	2.9
EV / EBITDA (x)	18.6	11.3	9.0	7.1
EV / Sales (x)	2.9	2.0	1.6	1.3
Earnings Quality				
Eff. Tax Rate	32.8	33.0	32.0	30.5
Other Inc / PBT	5.7	4.1	3.9	3.2
Eff. Depr. Rate (%)	3.7	4.5	4.5	4.6
FCFE / PAT	(140.6)	11.6	25.3	40.7

Source: Company Data, PL Research.

Key Operating Metrics

Y/e March	2013	2014E	2015E	2016E
Revenues growth (%)				
Agri-Inputs	6.9	21.0	16.0	16.0
Custom synthesis	57.4	60.0	30.0	22.0

Source: Company Data, PL Research.

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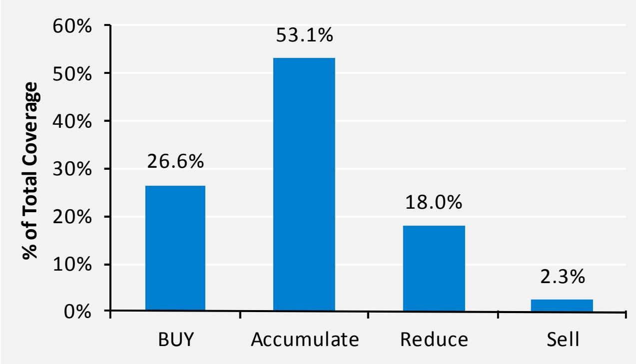

PL's Recommendation Nomenclature

BUY	:	Over 15% Outperformance to Sensex over 12-months	**Accumulate**	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months	**Sell**	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month	**Trading Sell**	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock	**Under Review (UR)**	:	Rating likely to change shortly

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