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Sharda Cropchem Limited

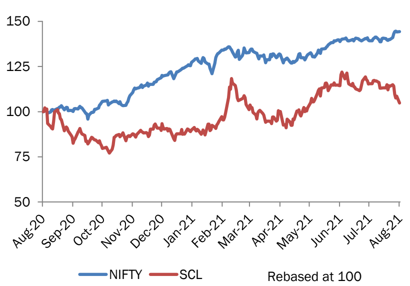
10 August 2021

A robust pipeline offers revenue visibility for this registration specialist

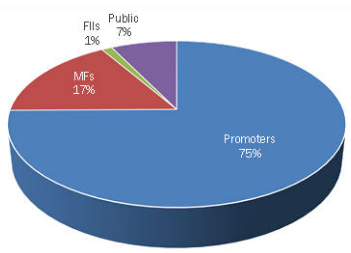
BUY

Sector	: Agrochemicals
Target Price	: ₹435
Last Closing Price	: ₹319
Market Cap	: ₹2,882 crore
52-week High/Low	: ₹387/231
Daily Avg Vol (12M)	: 1,68,750
Face Value	: ₹10
Beta	: 1.26
Pledged Shares	: 0.0%
Year End	: March
BSE Scrip Code	: 538666
NSE Scrip Code	: SHARDACROP
Bloomberg Code	: SHCR IN
Reuters Code	: SHCR.NS
Nifty	: 16,258
BSE Sensex	: 54,403
Analyst	: Ritwik Bhattacharjee

Price Performance



Shareholding Pattern



Introductory Note

Investment Summary

- Sharda Cropchem Limited (SCL) is a rapidly growing global agrochemicals company with a leadership position in generic crop protection chemicals comprising formulations and generic active ingredients (AIs) in the fungicide, herbicide and insecticide segments.
- An expanding global population, the need for food and nutritional security, and a decline in availability of arable land due to urbanisation and industrialisation will drive demand for agrochemicals globally.
- A wide range of products, geographically diversified revenue mix, and a robust global distribution model are SCL's key strengths. Accounting for 86% of overall revenues, 93% of agrochemicals sales came in from Europe and the Americas (Europe ~50%, NAFTA ~35%) in FY21.
- SCL employs an asset-light operating model by outsourcing manufacturing and focusing on registration opportunities offering scalable growth opportunities. The company has 2,570 registrations and a strong pipeline of 1,026 applications pending at different stages.
- A diversified sourcing model with long-term relationship with suppliers across China, Europe and the US mitigates the risk of supply chain disruptions. It also enables the company to procure manufactured products at good price points, empowering it to manage CoGs effectively and competitively price its products in the end market.
- Backed by a strong applications pipeline, the key driver of business growth for SCL, its topline is expected to witness healthy growth in the next 2 years. We have modelled lower EBITDA margin for FY22 to factor in higher raw material and shipping costs while increased D&A expenses arising from higher capitalised registration costs will result in lower PAT margins. At current levels, the SCL stock trades at an attractive 11.0x FY23E EPS. Assigning a target P/E multiple of 15.0x FY23E EPS, we value SCL at Rs 435, informing a BUY rating with an upside of 36%.

Key Financial Metrics

Rs crore	FY19A	FY20A	FY21A	FY22E	FY23E
Operating revenue	1,998	2,003	2,396	2,702	3,042
Growth		*0.3%*	*19.6%*	*12.8%*	*12.6%*
EBITDA*	327	351	455	497	578
EBITDA margin	*16.3%*	*17.5%*	*19.0%*	*18.4%*	*19.0%*
PAT	176	165	229	232	262
PAT margin	*8.8%*	*8.2%*	*9.6%*	*8.6%*	*8.6%*
Diluted EPS (Rs)	19.55	18.25	25.40	25.74	29.02

****Excluding write-off of intangible assets and intangible assets under development***
*Source: **Company data; Khambatta Research***

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Company Profile

Sharda Cropchem Limited's (SCL's) predecessors were the sole proprietorship firms Sharda International and Bubna Enterprises, which commenced business in 1987 and 1989, respectively. Subsequently in 2004, the two firms enagaged in the manufacture and export of dyes, dye intermediates, pesticides, agrochemicals and V-Belts, merged into Sharda Worldwide Exports Private Limited. In 2013, the company got its present name as it converted into a public limited entity.

SCL is a rapidly growing global agrochemicals company with a leadership position in generic crop protection chemicals comprising formulations and generic active ingredients (AIs) in the fungicide, herbicide and insecticide segments. The company has a significant presence in the high entry-barrier European and US markets as well as in other regulated markets in LatAm and other regions.

SCL's management is led by its CMD Ramprakash V Bubna, an IIT Bombay alum

Employing an asset-light business model, SCL focuses on identifying, marketing and distributing generic molecules. With core competency in developing product dossiers and seeking product registrations across global markets, the company possesses an extensive network of third-party distributors while also having its own sales force in Europe, Mexico, Colombia, South Afirca and India. SCL's non-agrochemical product portfolio comprises industrial belts, general chemicals, dyes and dye intermediates which enable the company to cater to customers across industry sectors.

SCL was founded by the company's promoter and CMD, Ramprakash V Bubna, a qualified chemical engineer and IIT Bombay alum. Mr. Bubna has over 50 years' experience in chemicals, agrochemicals and allied businesses and has been associated with large corporations such as Tata Oil Mills, Zenith, Piramal Rasayan, Coromandel Fertilisers and Zuari Argochemicals in the past.

Investment Thesis

An expanding global population and the need for food security will drive demand for agrochemicals across the globe. The global population witnessed a decadal growth rate of 8.7% to reach 7.8 billion in 2020. Along with rising income and affluence, this is leading to a shift in food consumption patterns. As disposable income rises and more people move up the economic pyramid, the big challenge for food and nutritional security is not only to increase production volumes but also to cater to the nutritional needs of an increasingly affluent population. The agrochemicals industry plays a critical role in ensuring food security by boosting agricultural output as it is challenged by loss of crops due to pest attacks. Further, industrialisation and urban expansion are leading to shrinkage in arable land area. The global crop area available for harvesting declined from was 1.8 billion ha in 2010 to 1.3 billion ha in 2017. The global agrochemicals market is estimated to reach US$ 281.7 bn, growing at a CAGR of 4.9% from 2018 to 2026. Rising demand for pesticides and increasing consumption of liquid agrochemicals

The global crop area available for harvesting declined from was 1.8 billion ha in 2010 to 1.3 billion ha in 2017 are amongst the key factors seen to drive the demand for agrochemicals globally. The pesticides segment of the agrochemicals market is forecast to expand to 1.5x of its size in 2018 to reach US$ 67.2 bn by 2026. *(Source: Persistence Market Research)*

A half of SCL's agrochemical revenues was from Europe while 35% came from NAFTA in FY21

A wide range of products, geographically diversified revenue mix and strong global distribution model are amongst SCL's key strengths. SCL's business can be broadly divided into agrochemicals and non-agrochemicals. Agrochemicals is the company's primary business, with a product portfolio comprising formulations and generic AIs for crop protection in the fungicide, herbicide and insecticide segments, disinfectant products in the biocide segment, and products for the turf and specialty markets. Agrochemicals accounted for 86% of revenues in FY21 with 51% of agrochemicals revenues generated from herbicides and another half coming from fungicides and insecticides. With its diversified range of products, SCL has business operations in more than 80 countries across Europe, NAFTA, Latin America and other parts of the globe. A half of agrochemical revenues came from Europe, 35% from NAFTA and the remainder from LatAm and the rest of the world in FY21. The company's robust distribution network comprises 500 third party distributors and a sales team of over 400 members.

With a portfolio of 2,570 registrations, SCL's registration pipeline comprises 1,026 applications pending at various stages

With an asset-light business model, SCL focuses on product registrations across global markets. With the acquisition of registrations being a key driver of future growth, SCL employs an asset-light operating model by outsourcing product manufacturing as it looks to channelise its effort and resources for identifying generic molecules and registration opportunities offering scalable growth opportunities. This way the company is able to more effectively utilise its core competency of developing product dossiers and seeking registration for products with limited capital requirements. With its robust experience and expertise in identifying molecules whose patents are expiring and seeking registration for their generic version, SCL possesses the knowledge and capability required for making registration applications across jurisdictions having different legal and regulatory setups. The company acquires between 100 and 150 registrations each year on average. As of 30 June 2021, the company had procured 2,570 registrations (2,292 for formulations and 278 for AIs). Additionally, 1,026 applications for registration are pending at different stages globally.

SCL sources products from manufacturers and formulators based out of China, Europe and the US

A diversified sourcing model mitigates the risk of supply shocks and supply chain disruptions. SCL sources formulations and AIs from various manufacturers and formulators based out of China, Europe and the US. This enables the company to procure manufactured products at good price points, empowering it to manage CoGs effectively and competitively price its products in the end market. SCL has established and maintains long-term relationships with multiple suppliers, which also mitigates risks associated with disruptions and shocks in the supply chain.

Valuation

At current levels, the SCL stock trades at an attractive 11.0x FY23E EPS

At 15.0x FY23E EPS, we rate SCL a BUY with a target price of Rs 435 and an upside of 36%. With a business model built around expertise in product registration and outsourced production, the key driver of business growth for SCL is its registrations pipeline. Backed by a strong pipeline of applications, SCL is expected to witness healthy topline growth in the next 2 years. We have modelled lower EBITDA margin for FY22 to factor in higher raw material and shipping costs, and increased D&A expenses arising from higher capitalised registration costs. At current levels, the SCL stock trades at an attractive 11.0x FY23E EPS. Assigning a target P/E multiple of 15.0x FY23E EPS, we value SCL at Rs 435, informing a BUY rating with an upside of 36%.

Abridged Profit & Loss Account

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Key Risks

- Agrochemicals being a highly regulated sector with different legal and regulatory framework across jurisdictions, major policy/regulatory changes in any of SCL's key markets can potentially affect the company's business prospects.
- Extension of patent on molecules can lead to a delay or postponement in SCL securing registration and launching products in key markets, and consequently affect its growth potential.
- As SCL outsources the manufacturing, supply chain disruptions pose a significant risk to the company's operations.
- An extended economic downturn and supply chain disruptions owing to a drawn-out COVID-19 pandemic may lead to underperformance of our forecasts.
- As a major part of SCL's sales and costs are denominated in foreign currencies while it reports in INR, the company's financial results are exposed to transaction and translation impacts of FX fluctuations.
- Climate change as well as responses to it can potentially affect agrochemicals use.

Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

Stock ratings

Buyrecommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Hold recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

Sell recommendations are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

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