Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 28.87

Updated Nov 08, 2021

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

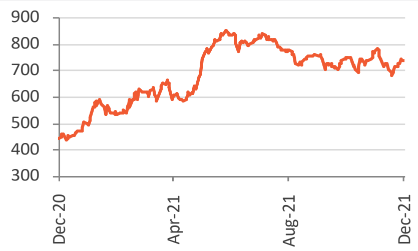
Company details

Market cap:	Rs. 56,528 cr
52-week high/low:	Rs. 865/416
NSE volume: (No of shares)	29.3 lakh
BSE code:	512070
NSE code:	UPL
Free float: (No of shares)	55.04 cr

Shareholding (%)

Promoters	28
FII	35
DII	18
Others	19

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.6	-1.7	-11.4	67.4
Relative to Sensex	-1.6	-1.8	-22.3	41.4

Sharekhan Research, Bloomberg

UPL Ltd

On a sustainable growth path

Agri Chem	Sharekhan code: UPL

Reco/View: **Buy**	↔	CMP: **Rs. 740**	Price Target: **Rs. 930**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Potential market share gains given a global scale, backward integration and focus on high growth bio-solutions space would drive industry leading volume/revenue growth for UPL over FY22E-24E; expect it to beat FY22 revenue growth guidance of 7-10% given H1FY22 growth of 14% y-o-y and as H2 is normally a strong growth period.
- Differentiated & sustainable solutions would be a key growth driver as this segment is growing at 15-20% rate and its gross margins are ~1,000-1,500 bps higher than that of normal products. Thus, management's aim to increase share of differentiated & sustainable solutions in to 50% by FY26, which would drive margin expansion to 24-25%.
- We expect UPL's EBITDA to clock a 14% CAGR over FY21-24E and generate cumulative FCF of Rs. 11,642 crore over FY22E-24E, which would help UPL to further deleverage its balance sheet (management target of net debt/EBITDA target to <2x by March'22).
- A 14% fall in UPL's stock price from 52-week high makes risk reward favourable given attractive valuation of 11.7x/10.1x FY23E/FY24E EPS considering improving earnings profile (higher margin and RoE) and management focus to strengthen balance sheet. Hence, we maintain our Buy rating on UPL with an unchanged PT of Rs930.

We believe that UPL has a strong case for sustained industry leading volume growth led by market share gain (was at 8-9% in FY21) on consolidated in global agro-chemical space and focus on high margin high growth bio-solutions. Additionally, UPL's backward integration (75% of raw material requirement is met in-house) has significantly de-risked it from recent supply chain issues in China, while high global crop prices provide room for price hikes (UPL has hiked prices by 7-30% across product baskets till now) to improve EBITDA margin over Q3-Q4 of FY22. Strong volume growth and scope for EBITDA margin improvement to 24-25% would drive sustainable long-term earnings growth. We expect UPL's revenue/EBITDA/PAT to clock 10%/14%/22% CAGR over FY21-24E and see upside to its FY22 revenue growth guidance of 7-10% and is likely to achieve higher end of EBITDA growth guidance of 12-15%.

- **Industry-leading volume growth and price hikes provides upside to revenue growth guidance of 7-10%:** We believe that UPL is well-placed to outpace industry growth rate (reflected in its robust volume growth of 11% y-o-y in H1FY22) supported by its strong global market presence, differentiated solutions for farmers and benefit of backward integration. Moreover, potential consolidation in global agro-chemical market would aid market share gains for top five players in the industry. Additionally, high global crop price would help UPL to consistently take price hike (took price hike of 7-30% across products to pass on raw material price hikes and protect margin). We see upside to UPL's FY22 revenue growth guidance of 7-10% as H2 is normally a strong period (led by the US and Europe) and UPL has already posted 14% y-o-y revenue growth in H1FY22.
- **Potential rise in share of bio-solutions to drive up margins to 24-25%:** UPL has been able to improve EBITDA margin by 412 bps over FY19-21 to 21.6% led by synergy benefit from Arysta integration, benefit of backward integration which significantly de-risked its reliance from China and rise in share of high margin bio-solution. We believe that bio-solutions would be new growth engine for UPL as this high margin product is growing at very high rate of 15-20% and a faster switch to chemical-free products by major economics would further accelerate the growth prospects. UPL's global presence allows it benefit of cross-selling opportunities and thus management targets to take share of differentiated & sustainable solutions to 50% by FY26E from 29-30% currently. Thus, we see ample scope for further margin expansion to 24-25% level.
- **Balance sheet de-leveraging to continue:** UPL has achieved significant balance sheet deleveraging with is reflected in lower net debt to EBITDA of 2.2x in FY21 versus 3x/4.2x as of FY20/FY19. We believe that balance sheet deleveraging to continue as strong earnings growth outlook (EBITDA CAGR of 14% over FY2021-FY2024E) and efficient working capital management would result into robust FCF generation of Rs. 11,642 crore over FY2022E-FY2024E. Thus, UPL seems on track to achieve net debt/EBITDA target to <2x by March 2022.

Our Call

Valuation – Maintain Buy on UPL with an unchanged PT of Rs. 930: Industry-leading growth, target to increase share of revenue from differentiated & sustainable solutions and further balance sheet deleveraging would improve margin/earnings profile and drive sustainable growth and valuation re-rating. Moreover, a 14% fall in UPL's stock price from 52-week high makes risk reward favourable given attractive valuation of 11.7x FY23E EPS and 10.1x FY24E EPS considering robust earnings growth outlook and RoE of ~20%. Hence, we maintain a Buy rating on UPL with an unchanged PT of Rs. 930.

Key Risks

A slowdown in the global agrochemical industry and delay in product launches could affect revenue growth. Currency fluctuations might hit the company, as UPL has a significant presence in various geographies. Fresh ongoing US-China trade war post COVID-19 crisis might impact commodity prices.

Valuation (consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	38,694	42,563	46,820	51,502
OPM (%)	21.6	22.8	23.6	23.9
Adjusted PAT	3,109	4,164	4,819	5,614
% YoY growth	29.6	33.9	15.7	16.5
Adjusted EPS (Rs)	40.6	54.4	63.0	73.4
P/E (x)	18.2	13.6	11.7	10.1
P/BV (x)	3.2	2.6	2.2	1.8
EV/EBITDA (x)	9.0	7.7	6.6	5.8
RoCE (%)	12.0	13.7	14.5	14.7
RoNW (%)	18.2	21.1	20.4	19.8

Source: Company; Sharekhan estimates

Focus on differentiated solutions and market share gain to drive sustained 8-10% revenue growth annually

We believe that UPL is well placed to outpace industry growth rate (reflected in its robust volume growth of 11% y-o-y in H1FY22) supported by its strong global market presence, differentiated solutions for farmers and benefit of backward integration. Additionally high global crop price would help UPL to consistently take price hike (took price hike of 7-30% across products to pass on raw material price increase and protect margin). We thus expect UPL to deliver sustainable 810% annual growth in revenue, outpacing the industry-level rate of 3-4%, owing to: 1) product innovation to gain market share in off-patent products, 2) UPL's focus to increase the share of differentiated & sustainable solutions in revenue to 50% by FY2026E from 29-30% currently and 3) cross selling opportunities available to UPL given its global presence. We highlight here that differentiated & sustainable solutions would grow at 15-20% annually with rising adoption of Biosolutions in developed countries.

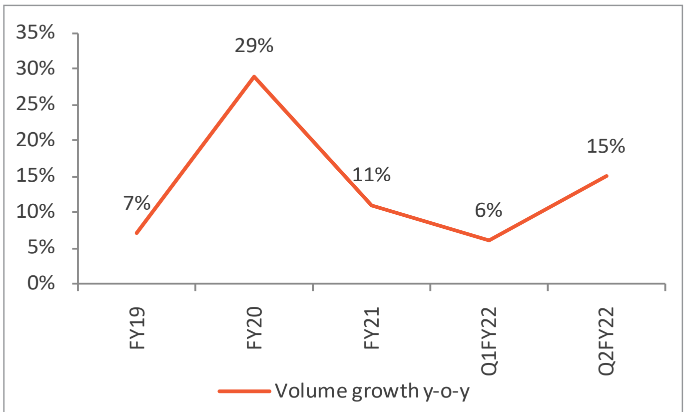
Growth outlook across geographies

North America and Europe – The management has indicated that both US and Europe have expected to witness healthy double digit revenue growth in H2FY2021 led good agronomics in the region (US – price hikes will help negate input price inflation) and Europe (strong performance led by buoyant product demand and price hikes).

Latin America – The region is expected to post healthy double-digit growth in H2FY22 led by volume growth and price hikes.

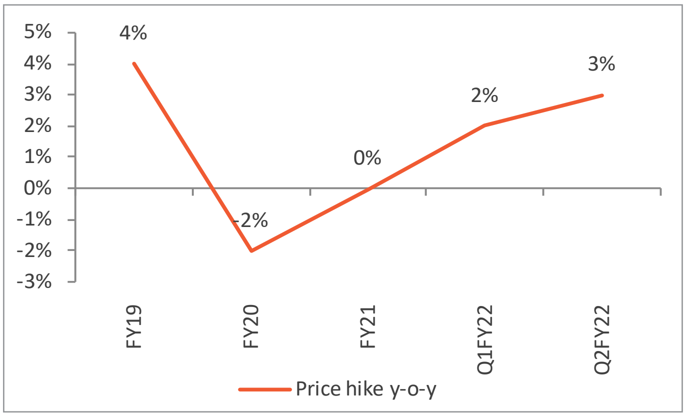
India – The region is expected to see mid-to-high single digit growth in H2FY22 given decent demand outlook for Rabi season and Favorable commodity prices.

UPL volume growth trend



Source: Company, Sharekhan Research

Price hikes back on cards



Source: Company, Sharekhan Research

UPL's management expects differentiated & sustainable solutions (including Biosolutions) to grow at a much higher rate of 15-20% annually as compared to the traditional agrochemical products and would be the key driver for the industry leading revenue growth for UPL in the next couple of years. The company targets to increase the share of differentiated & sustainable solutions to 50% by FY2026E from 29-30% currently. The key driver of the same would-be rising demand for biosolutions, which is at a nascent stage currently but is expected to gain acceptance due to environmental benefits and as it offers improvement in crop yields. The global market size for biosolutions is estimated to be at ~$6 billion and is expected to grow at 15-20% annually (versus only 3-4% growth for global agrochemicals). Arysta's acquisition has provided UPL access to Biosolutions space; and the company intends to build on products such as ProNutiva crop packages for accelerated growth. The company is aggressively pushing for products with crop chemicals and Biosolutions, as the same would improve farm yield and productivity.

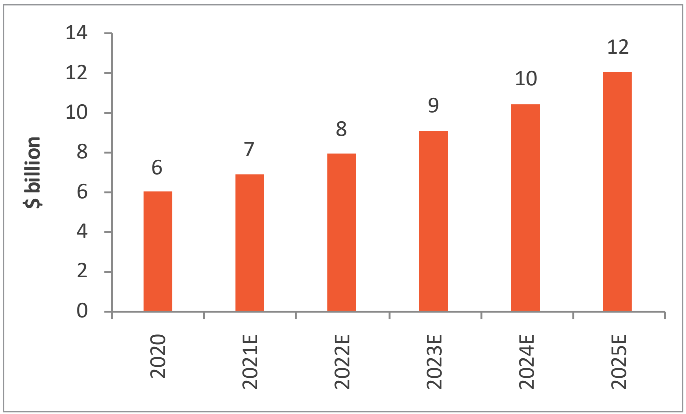
UPL's ProNutiva (a combination of conventional, differentiated and biosolutions) Sada Samrudh Groundnut programme in Gujarat - increases yield and oil content in groundnut crop

The first pilot programme was implemented with 8,500 farmers, which was taken up in the year 2020, in the key groundnut belts in Gujarat which helped double their yields and income, now it has covered over 2.5 lakh acres of farmland over 50,000 farmers. The overall increase in groundnut yield is of 50-60%, with an increase in oil extraction of 1 percent. In addition, it led to an increase of fodder yield of 35%, which helped improve the farmers' dairy income.

Under the ambit of the Pronutiva Sada Samrudh project, groundnut farmers were offered integrated agricultural services like IPM Kits, Soil Testing, Weather Services, Crop Advisory and High-Tech Enabled Farmer Mechanization Services to increase groundnut yield and income. Farmers also used UPL's ground-breaking product 'ZEBA', which absorbs water and nutrients and releases it to the plant when it's needed by the plant.

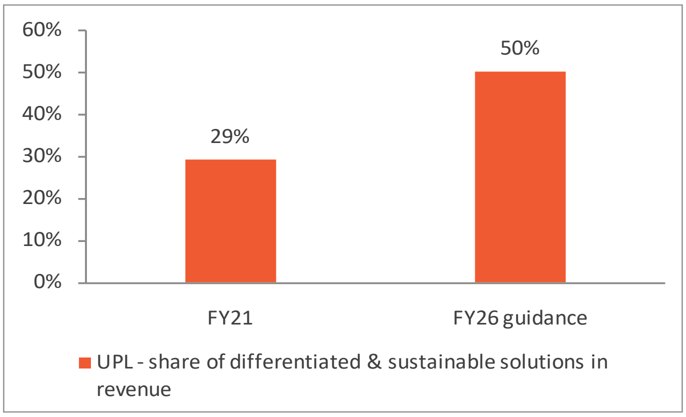
Source: Company; media articles; Sharekhan Research

Global bio-pesticides market expected to grow 15% annually



Source: Company, Sharekhan Research

UPL share of differentiated & sustainable solutions in revenue



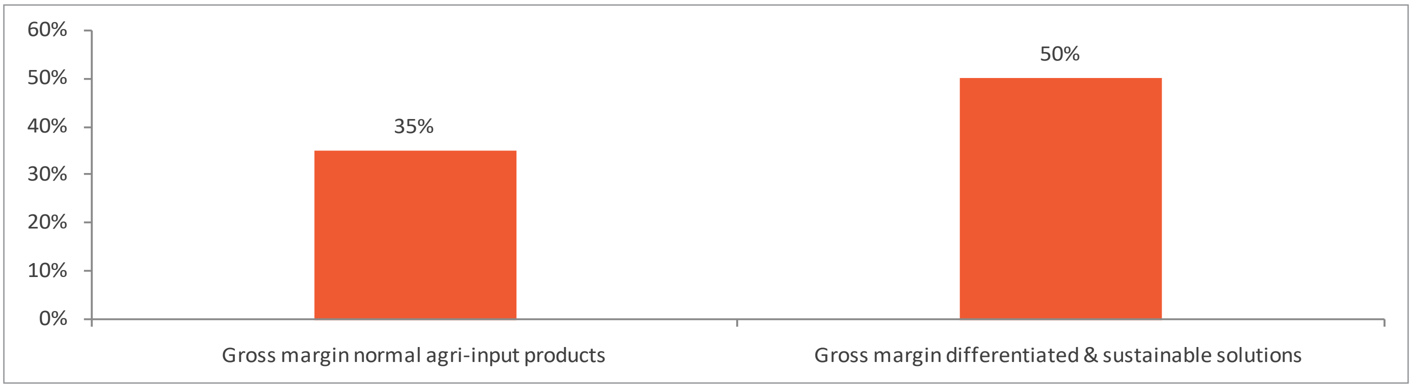
Source: Company, Sharekhan Research

Multiple levers for margin improvement to 24-25% by FY24E

UPL has multiple levers for margin expansion to 24-25% including – 1) the management's aim to the share of differentiated & sustainable solutions to 50% over 3-5 years from 30% currently, 2) backward integration (75% of raw material requirement met in-house) has significantly de-risked it from recent supply chain issues in China and 3) high global crop prices providing room for price hikes (UPL has undertaken 7-30% price hikes across product baskets), 4) better utilisation for specialty chemical portfolio and 4) improved operating leverage given expectation of volume growth.

We highlight here that gross margins for differentiated & sustainable solutions are higher by 1000-1500 bps as compared to gross margin of 35% for normal products in agri-input space. This likely rise in the share of revenues from differentiated & sustainable solutions would play a crucial role in margin expansion for UPL.

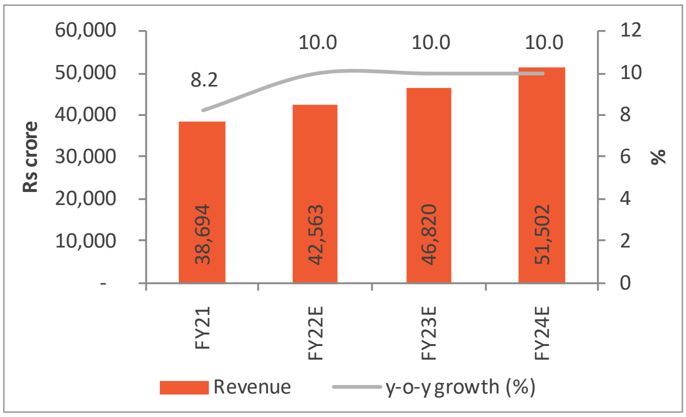
Differentiated & sustainable solutions gross margin higher by 1000-1500 bps versus normal products



Source: Company; Sharekhan Research

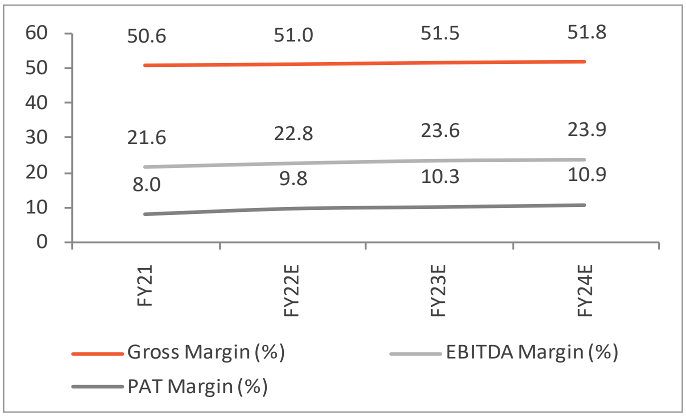
Financials in charts

Revenue to clock 10% CAGR over FY21-FY24E



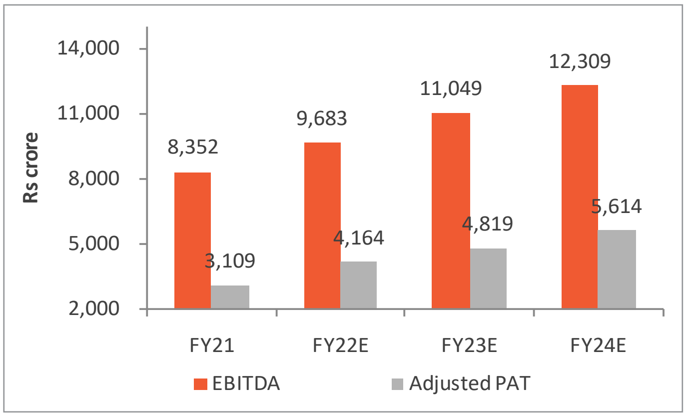
Source: Company, Sharekhan Research

Margin to improve on rise in share of high margin products



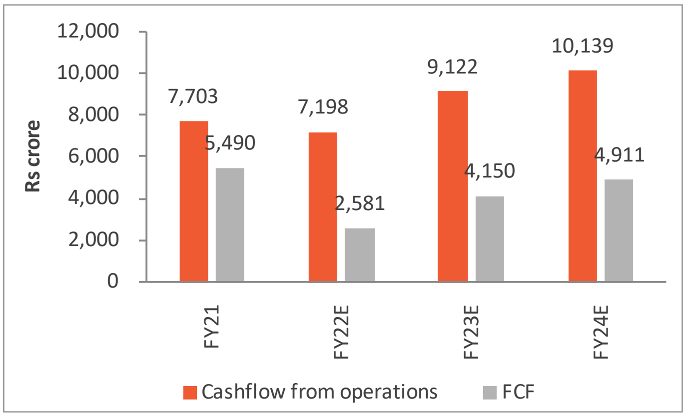
Source: Company, Sharekhan Research

EBITDA/PAT to post a 14%/22% CAGR over FY2021E-FY2023E



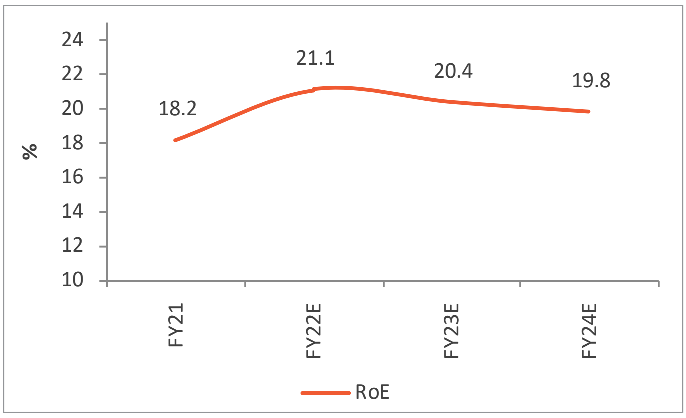
Source: Company, Sharekhan Research

Robust FCF to help deleverage the balance sheet



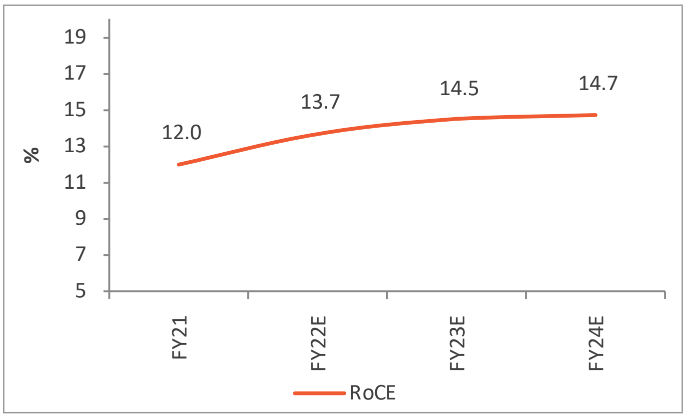
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Rising food demand provides ample growth opportunities for agri-input players

The Indian agrochemical industry's outlook is encouraging, primarily driven by rising foodgrain production and domestic demand, favourable regulatory reforms for farmers, and a vast opportunity from products going off-patent. The government's focus is to double farmers' income (higher MSPs for crops). Above-normal monsoons and higher reservoir levels would augment demand for agri-inputs in India. We also expect exports from India to grow strongly as India is being looked as the preferred supplier for agri-inputs, given supply disruptions in China. Thus, we expect India's agrochemical industry to witness 7-8% growth annually on a sustained basis over the next few years. Moreover, international markets such as Latin America would continue to grow robustly, supported by higher demand for crop protection and farm solutions mitigating slower growth in the US and Europe.

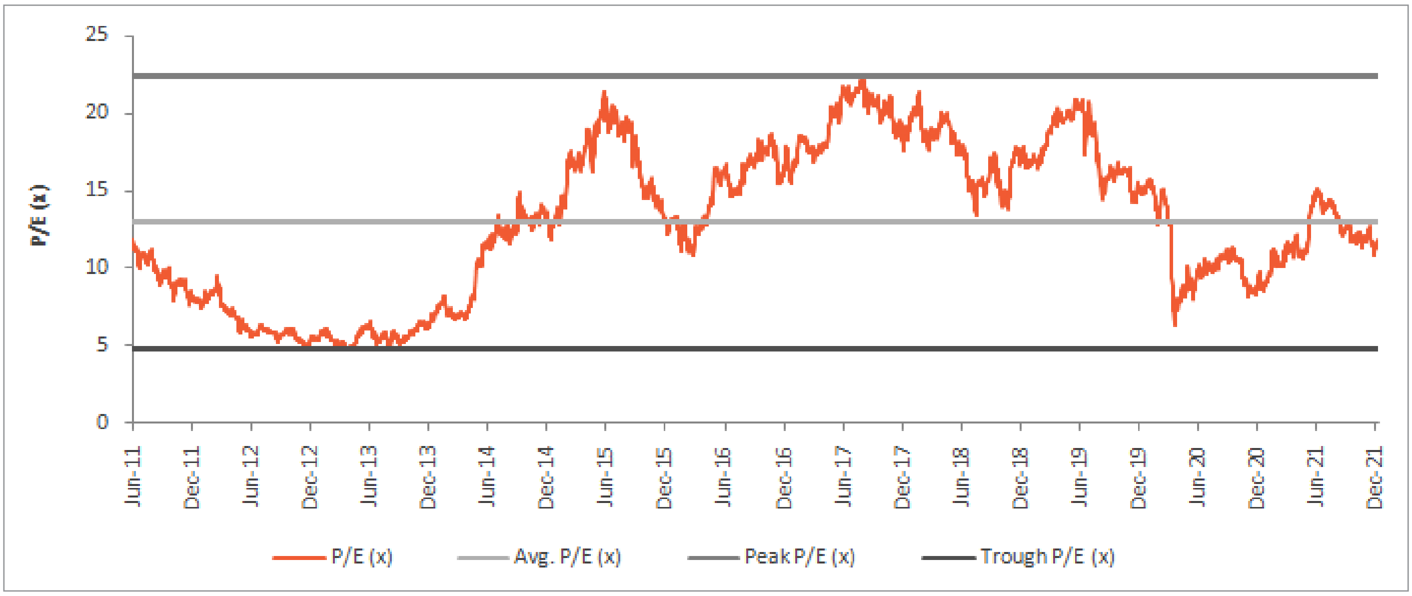
■ Company outlook - Strong growth outlook across regions; eye on deleveraging balance sheet

The management anticipates good agronomic conditions in most key markets, which is expected to drive robust demand going forward. Revenue synergies via cross-selling of products and price hikes in a few markets are expected to drive revenue growth, while cost synergies and cost efficiencies would enhance margins. The company is expected to generate healthy cash flows, which would help further reduce debt and has guided for a net debt/ EBITDA of >2x for FY2022).

■ Valuation - Maintain Buy on UPL with unchanged PT of Rs. 930

A robust earnings growth outlook (expect a CAGR of 22% in PAT over FY2021-FY2024E) would help UPL generate a robust cumulative free cash flow (FCF) of Rs. 11,642 crore over FY2022E-FY2024E, further help deleverage balance sheet and drive re-rating. Moreover, UPL's recent collaboration with MNCs for new products and target to increase share of revenue from differentiated and sustainable solutions would improve margin/earnings profile and drive sustainable growth. Valuations are attractive at 11.7x its FY2023E EPS and 10.1x its FY2024E EPS. Hence, we maintain a Buy rating on UPL with an unchanged PT of Rs. 930.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

UPL is a global leader in agricultural solutions and has a healthy mix of high-value crops and high-growth geographies. The company is well positioned to achieve sustainable growth as it is present across the agricultural input segment, ranging from seeds to crop-protection products and post-harvest activities. Arysta's acquisition strengthens UPL's global position and helps it to emerge as an end-to-end solutions provider in the global agri input space. The company has manufacturing facilities across 48 locations (earlier 34) and is present across more than 138 countries. The company's thrust on research and innovation has helped it garner 1,023 patents and over 12,400 registrations. The acquisition has strengthened UPL's long-term growth prospects as product registration has doubled from its earlier levels of 6,500, considering the fact that it takes between 2-5 years for getting products registered. The company has a workforce representation of over 75 countries with total employee strength of over 10,300.

Investment theme

UPL has moved up in global ranking to the fifth position post Arysta's acquisition (earlier seventh). The company has successfully integrated 25+ companies post the acquisition in the past 20 years. The company is among the top five post patent agrochemical manufacturers in the world and is the largest producer of agrochemicals in India. UPL has mostly outperformed the industry's growth rate. The acquisition (UPL + Arysta) brings in a prudent mix of own manufacturing and outsourcing, which is expected to lead to improved margin profile coupled with capital efficiencies resulting in better return ratios. New product launches in key geographies and flowing of synergy benefits of Arysta's acquisition are likely to fuel growth at a faster pace.

Key Risks

- Slowdown in the global agrochemical industry and delay in flow of benefits from Arysta's integration might impact performance.
- Currency fluctuation might have an impact, as UPL has a significant presence in various geographies.
- Fresh ongoing US-China trade war post COVID-19 crisis might have an impact on commodity prices.

Additional Data

Key management personnel

Rajnikant Devidas Shroff	Chairman and Managing Director
Sandra Rajnikant Shroff	Vice Chairman
Jaidev Rajnikant Shroff	Global CEO of the Group
Vikram Rajnikant Shroff	Executive Director
Arun Chandrasen Ashar	Executive Director Finance
Carlos Pellicer	Global COO
Rajendra Darak	Group CFO
Anand Vora	Global CFO

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	10.1
2	JPMorgan Chase & Co.	8.2
3	Norges Bank	3.7
4	Vanguard Group Inc/The	3.3
5	Massachusetts Financial Services Co.	2.9
6	GOVERNMENT PENSION FUND - GLOBAL	2.8
7	BlackRock Inc	2.2
8	SBI Funds Management Pvt. Ltd	1.8
9	Lazard Ltd	1.0
10	Skagen AS	0.9

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research