Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

UPL Ltd

Robust Q2; growth prospects bright

Agri Chem	Sharekhan code: UPL
Reco/View: Buy ↔	CMP: Rs. 717	Price Target: Rs. 930 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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 Updated July 08, 2022	23.61

Medium Risk

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

Source: Morningstar

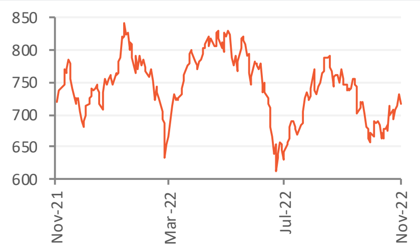
Company details

Market cap:	Rs. 54,786 cr
52-week high/low:	Rs. 848/608
NSE volume: (No of shares)	23.6 lakh
BSE code:	512070
NSE code:	UPL
Free float: (No of shares)	53.32 cr

Shareholding (%)

Promoters	29
FII	36
DII	17
Others	18

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.8	-3.0	-13.6	-0.4
Relative to Sensex	0.2	-8.1	-20.8	-2.2

Sharekhan Research, Bloomberg

Summary

- Q2FY23 results were strong on operational front with better-than-expected revenue growth of 18% y-o-y and a sharp beat of 213 bps in EBITDA margins at 22.1% (up 278 bps y-o-y). Thus, adjusted operating profit of Rs. 2,768 crore beat estimate by 13%; however adjusted PAT at Rs. 857 crore (up 27% y-o-y) was in-line.
- Revenue growth was led by 21% y-o-y improvement in prices, 4% positive currency impact partially offset by a 7% y-o-y decline in volume while margin improvement reflected higher gross margin of 42.6% (up 290 bps y-o-y). Volume decline is attributable to cautious volume (high-margin product with better credit terms) push in Brazil. Europe growth was muted due to devaluation of the Euro.
- Management maintained its FY23 revenue/EBITDA growth guidance to 12-15%/15-18% and targets to lower net debt by $500 million for FY23. With H1FY23 revenue/EBITDA growth of 22%/31% y-o-y, we expect UPL to beat its growth guidance as H2 is normally strong, given high revenue share from North America and commentary on mid-single digit volume/price hike in H2 would also aid growth.
- We maintain a Buy on UPL with an unchanged PT of Rs. 930 as valuation of 10.6x/9x its FY23E/FY24E EPS is attractive considering a strong growth outlook. Focus on increasing share of high margin, differentiated and sustainable solutions would improve earnings quality and drive valuation re-rating.

UPL Limited (UPL) posted yet another quarter of strong performance with beat of 3%/13% in consolidated revenue/adjusted operating profit at Rs. 12,507 crore/Rs. 2,768 crore, up 18.4%/35.4% y-o-y supported by high growth across key region (excluding Europe), expansion in gross/EBITDA margins by 290 bps/278 bps y-o-y to 42.6%/22.1% in Q2FY23. The marginally higher-than-expected revenue growth was led by a 21% y-o-y improvement in product realizations and 4% positive currency impact partially offset by 7% y-o-y decline in volume. The management indicated that volume decline was due to weak volume in Brazil as focus was on high margin products with better credit terms while other regions witnessed healthy mid singly digit volume growth. Regional revenue growth was 20%/24%/22%/21% y-o-y for LatAm/North America/India/RoW. However, Europe witnessed a muted 1% y-o-y revenue growth due to devaluation of Euro. Strong revenue growth in the LatAm region was led by improved herbicides pricing in Brazil, launch of new product Evolution (fungicide) and NPP BioSolutions growth in Mexico while North America witnessed benefit of strong commodity price which benefit volume growth (especially herbicides). India revenue growth was led by growth in glufosinate products, launch of new insecticides in Q2 in paddy/cotton, growth in NPP Biosolutions and improved pricing in key crops. OPM of 22.1% (up 278 bps y-o-y) was 213 bps higher than our estimate of 20% led by improved realizations, better product mix and effective supply chain management. Adjusted PAT at Rs. 857 crore (up 27.2% y-o-y) was in-line with our estimate of Rs. 859 crore as beat in revenue/margin was offset by exchange impact of Rs. 324 crore and higher-than-expected tax rate of 18.8% (versus assumption of 17%).

Key positives

- Stronger-than-expected revenue growth of 18.4% y-o-y led by robust growth across regions (ex-Europe).
- Beat of 213 bps in OPM at 22.1%, 278 bps y-o-y.

Key negatives

- European revenue growth was muted at only 1% y-o-y due to Euro devaluation.
- Net working capital requirement increased by Rs. 4,432 crore y-o-y.
- Interest cost increased sharply by 79% y-o-y to Rs.478 crore in Q2FY23 due to a steep rise in benchmark interest rates.

Management Commentary

- The management maintained its Revenue/EBITDA growth guidance of 12-15%/15-18%.
- Guided for mid-single digit volume growth for FY23.
- Target to lower net debt by $500 million for FY23 led by estimated release of WC in H2FY23 and net cashflow of $260 million from recently announced corporate restructuring would be utilised to reduce debt.

Revision in estimates – We have marginally increased our FY2023-FY0224 earnings estimates to factor H2FY23 performance and have introduced our FY2025 earnings estimates in this report.

Our Call

Valuation – Maintain Buy on UPL with an unchanged PT of Rs. 930: Industry-leading growth and target to increase revenue share from differentiated and sustainable solutions would improve margin/earnings profile and drive sustainable growth and valuation re-rating. Moreover, risk-reward seems favourable, given attractive valuations of 10.6x/9x/7.7x its FY2023E/FY2024E/FY2025E EPS, considering strong growth outlook (we expect a PAT CAGR of 21% over FY22-25E and RoE of ~20-21%). Hence, we maintain a Buy rating on UPL with an unchanged price target (PT) of Rs. 930.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	46,240	52,482	57,731	63,504
OPM (%)	22.0	23.0	23.4	23.8
Adjusted PAT	3,950	5,169	6,127	7,143
% YoY growth	27.1	30.9	18.5	16.6
Adjusted EPS (Rs)	51.6	67.6	80.1	93.4
P/E (x)	13.9	10.6	9.0	7.7
P/BV (x)	2.5	2.1	1.7	1.4
EV/EBIDTA (x)	7.7	6.2	5.4	4.7
RoCE (%)	13.4	16.0	16.5	16.6
RoNW (%)	20.0	21.6	21.1	20.3

Source: Company; Sharekhan estimates

Good Q2 performance with beat in revenue/margin

Consolidated revenue at Rs. 12,507 crore (up 18.4% y-o-y), was 2.5% above our estimate of Rs. 12,201 crore. The marginally higher than expected revenue growth was led by 21% y-o-y improvement in product realizations and 4% positive currency impact partially offset by 7% y-o-y decline in volume. Regional revenue growth was 20%/24%/22%/21% y-o-y for LatAm/North America/India/RoW. However, Europe witnessed muted 1% y-o-y revenue growth. Robust OPM of 22.1% (up 278 bps y-o-y) was 213 bps higher than our estimate of 20%. Strong margin performance was driven by improved realisations, a better product mix and effective supply chain management. Adjusted PAT at Rs. 857 crore (up 27.2% y-o-y) was in-line with our estimate of Rs. 859 crore as beat in revenue/margin was offset by exchange impact of Rs. 324 crore and higher-than-expected tax rate of 18.8%.

Q2FY23 earnings call highlights

- **Management reiterated revenue/EBITDA growth guidance –** Management has maintained its revenue and EBITDA growth guidance of 12-15% and 15-18% for FY23. With H1FY23 revenue/EBITDA growth of 22%/31% y-o-y, we expect UPL to beat its growth guidance as H2 is normally strong given high revenue share from North America and commentary of mid-single digit volume/price hike in H2 would also aid growth.
- **Balance sheet deleveraging target –** UPL aims to reduce net debt by $500 million in FY23 with net debt/EBITDA target of lower than 1.4x by end of FY23. Management indicated that release of working capital, EBITDA growth and net cash flow of $260 million from recently announced corporate restricting would help reduce debt.
- **Factoring target –** UPL would maintain factoring at $1.6 billion, which is similar to last year. The company would curtail factoring in some regions where benchmark interest rates are too high while would increase factoring in the US given rate of LIBOR + 200 bps.
- **Volume/pricing outlook –** The management indicated that H1FY23 volumes were flat on y-o-y as volume were impacted in Brazil as UPL focused on high margin products with better credit period in the region. However, all other regions witnessed healthy mid-single digit volume growth. The company expects to achieve mid-single digit volume growth for FY23. The global foodgrain price remain strong and feedstock price to product agrochemical is also high and thus expects product price hike could sustain in near term.
- **Raw material and freight cost –** There has been some softness in feedstock price/freight cost but the same has been largely offset currency devaluation.
- **Working capital –** UPL indicated that in-line with last year, ~75%-80% of the increase in working capital in H1 is converted to cash in H2FY23. This would help release working capital in H2FY23.
- **Advanta performance –** Revenue/contribution profit/EBITDA witnessed 30%/28%/30% y-o-y growth to Rs. 982 crore/Rs. 539 crore/Rs. 253 crore in Q2FY23. EBITDA margins remained steady at 25.8% in Q2FY23 versus 25.7% in Q2FY22.
- **Other updates –** 1) net WC increased to 124 days as of Sep-22 versus 114 days as of Sep-21, 2) Net debt increased by $734 million (post $260 million net cash flow from recent corporate restructuring) versus March-22's net debt of $2.5 bn, 3) global agrochemical industry volume growth expected at 3-4% while UPL would grow above the industry growth rate.

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	YoY(%)	Q1FY23	QoQ(%)
Revenues	**12,507**	**10,567**	**18.4**	**10,821**	**15.6**
Total expenditure	10,063	8,636	16.5	8,675	16.0
Operating profit	2,444	1,931	26.6	2,146	13.9
Adjusted operating profit	**2,768**	**2,045**	**35.4**	**2,383**	**16.2**
Other Income	78	47	66.0	73	6.8
Depreciation	608	566	7.4	588	3.4
Interest	644	359	79.4	519	24.1
PBT	1,227	1,013	21.1	1,034	18.7
Tax	231	249	(7.2)	59	291.5
Reported PAT	814	634	28.4	877	(7.2)
Adjusted PAT	**857**	**674**	**27.2**	**955**	**(10.3)**
Adjusted EPS (Rs.)	11.2	8.8	27.2	12.5	(10.3)
Margins (%)			**BPS**		**BPS**
Adjusted OPM	22.1	19.4	278	22.0	11
Adjusted NPM	6.9	6.4	47	8.8	(197)
Tax rate	18.8	24.6	(575)	5.7	1,312

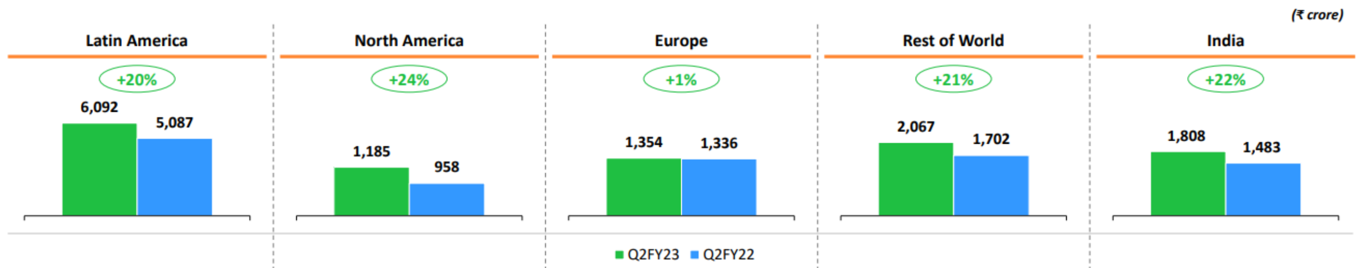
Source: Company, Sharekhan Research

Geographical revenue break-up Rs cr

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Latin America	6,092	5,087	19.8	3,464	75.9
Europe	1,354	1,336	1.3	1,728	-21.6
North America	1,185	958	23.7	1,796	-34.0
India	1,808	1,483	21.9	2,067	-12.5
Rest of the World	2,067	1,702	21.4	1,765	17.1
Total	**12,507**	**10,567**	**18.4**	**10,821**	**15.6**

Source: Company, Sharekhan Research

Q2FY2023 regional performance – Improved pricing led to strong growth across regions (excluding Europe)



Latin America

- **Improved herbicides pricing** led **growth** in Brazil
- **Fungicide sales driven by new launch** - Evolution® (vol. driven)
- **Mexico** growth led by **NPP BioSolutions**
- **Other growth regions** include **Argentina** and the **Andean**, driven by pricing in herbicides

North America

- Industry annual growth in double-digits in CYH1, supported by **strong commodity prices**
- **Herbicides** key growth driver, led by pre-emergent products
- Continuing **dry weather** in western US continues to impact specialty crops and rice market; **additional impact** due to **high channel inventory**

Europe

- Flat revenue vs. LY due to Euro devaluation; however, growth in Euro terms, despite unfavorable weather, products ban and ongoing conflict
- Strong growth in **DACH** and **Central Europe** driven by herbicide vol. and pricing
- Strong growth in **Differentiated products** vs. LY, driven by herbicides in **North Europe**, and insecticides in **Iberia**

Rest of World

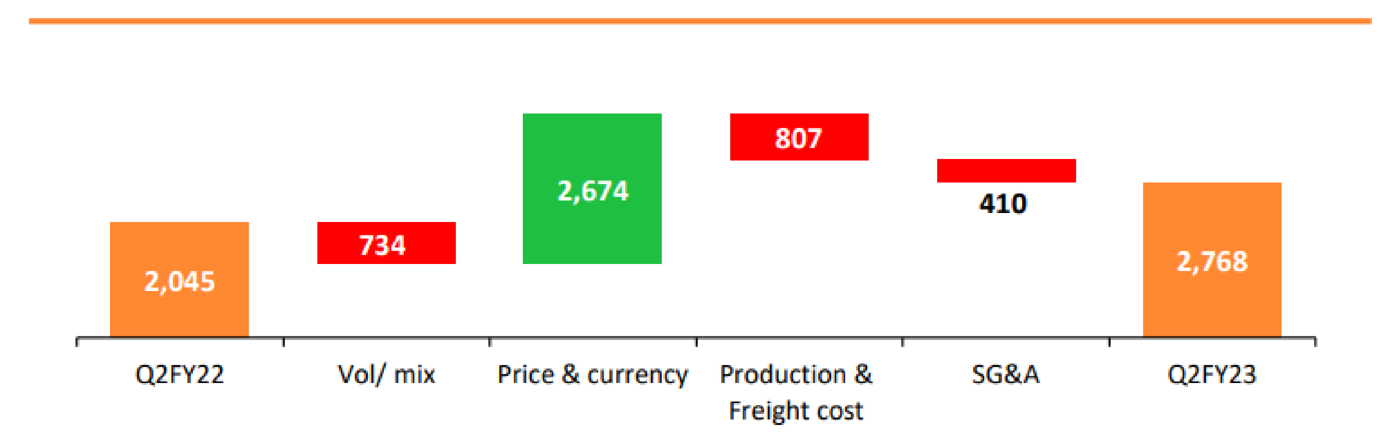
- Robust growth in **SE Asia** and **AUS/NZ**, despite high channel stocks, price pressure from Chinese suppliers, unfavorable market economics for key crops
- **Southern Africa's** strong growth led by herbicides
- Flat growth in **Japan**, **despite significant JPY devaluation against INR**

India

- **Growth** led by **glufosinate** products
- **New Insecticides launches** in Q2 in Paddy and Cotton
- **Significant growth** in **NPP Biosolutions** and products in **crop establishment** segment
- Improved pricing in Key crops : oilseeds +5%, cereals +15%, cotton -10%, sugarcane +10%

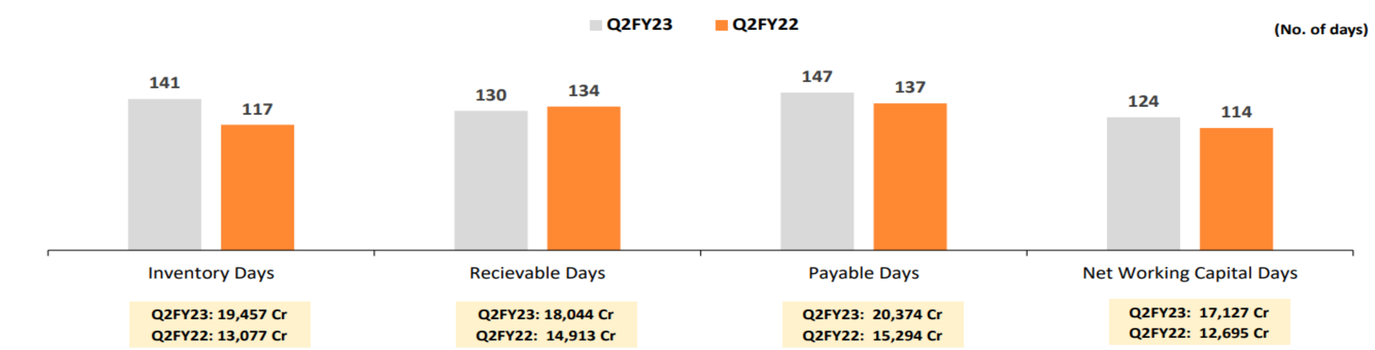
Source: Company

Q2FY23 EBITDA bridge versus Q2FY22



Source: Company

Increase in working capital due to higher sales and short-term inventory build-up

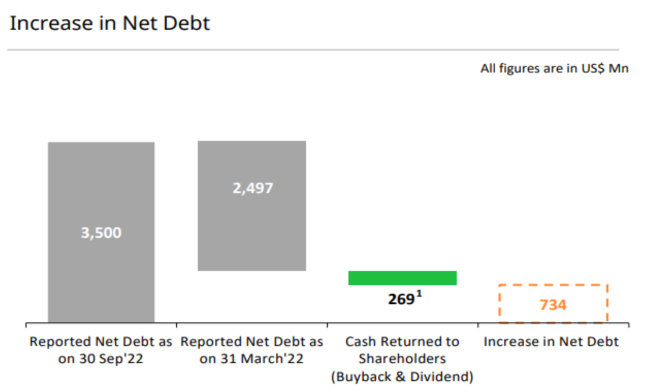


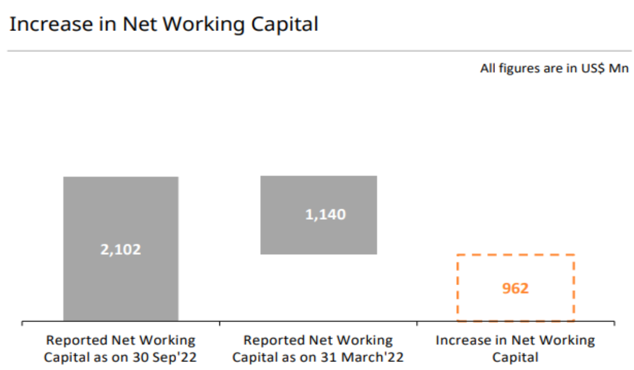
Note: As a risk management measure, the company sells its receivables on non-recourse basis to banks. Receivables sold as of 30 Sep'22 were INR 6,671 crore (31 March'22: INR 12,099 crore, 30 June'22: INR 9,010 crore, 30 Sep'21: INR 5,149 crore)

- **Working capital investment is higher in H1 FY23** primarily due to the - 1) robust growth of 22% in sales, and 2) short-term inventory build-up on the back of strong demand in H2 FY23 and in-lieu of uncertainties in supply chain

Source: Company

Increase in net debt and working capital





- Cash generation from operations is US$ 228 Mn in H1FY23 (increase in net working capital of US$ 962 Mn less the increase in net debt of US$ 734 Mn)
- In-line with last year, ~75% to 80% of the increase in working capital in H1 is converted to cash in H2FY23. **Estimated working capital release combined with the higher EBITDA in H2, will enable the company to meet its guidance of net debt reduction of US$ 400 Mn**
- **In addition, the net cash inflow of US$ 259 Mn from the recently announced corporate realignment will be used to further bring down debt**

Note: *[1]Taken Average USD/INR rate for H1 FY23 i.e., 78.44. USD/INR - 31 March 2022: INR 75.72, 30 September 2022: INR 81.47*

Source: Company

Break-up of finance cost **Rs. crore**

Particulars	Q2FY23	Q2FY22	*Change*	H1FY23	H1FY22	*Change*
Interest on Borrowings	274	170	*104*	489	335	*154*
Interest on Leases & Others	261	114	*147*	524	232	*292*
Other Financial Charges	49	28	*21*	74	78	*(4)*
Exchange impact in Finance Cost	(125)	(34)	*(91)*	(213)	169	*(382)*
NPV – Interest & Finance	185	81	*104*	289	154	*135*
Total Finance Cost	**644**	**359**	***285***	**1,163**	**966**	***197***

Source: Company

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.

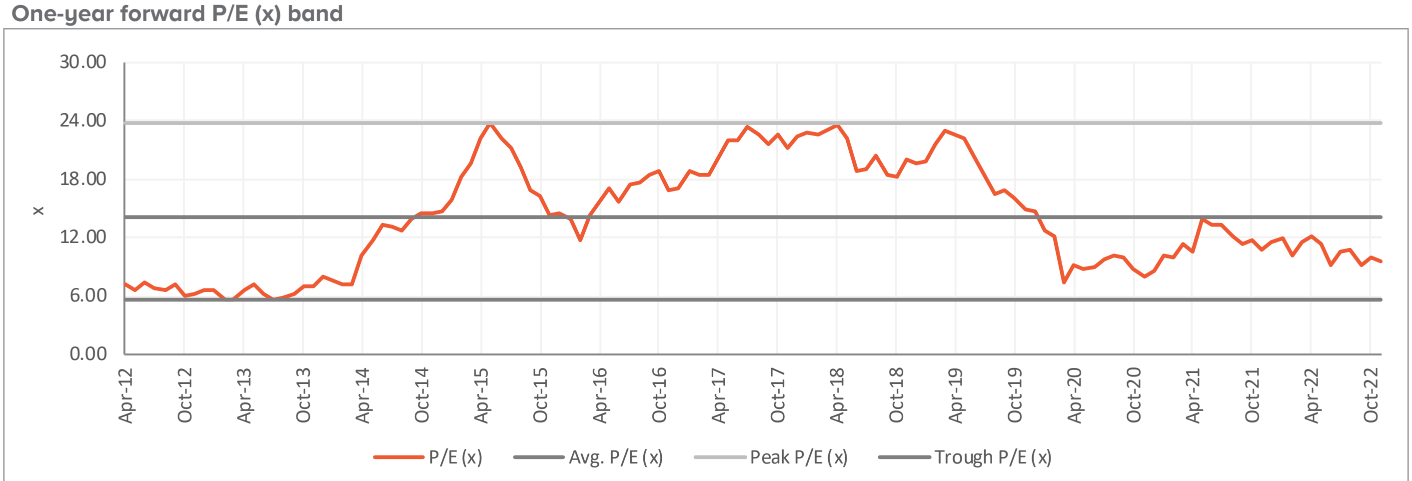
■ **Company Outlook – Robust prospects; earnings quality to improve as revenue share of differentiated and sustainable solutions rises**

Potential market share gain for UPL given its global scale, backward integration, and focus on high-growth bio-solutions space would drive industry-leading volume/revenue growth for UPL over FY2022E-FY2025E. Differentiated and sustainable solutions would be a key growth driver as this segment is growing at 15-20% and its gross margins are 1,000-1,500 bps higher versus normal products. Thus, management's aim to increase the share of differentiated and sustainable solutions to 50% by FY2027 would drive up margin to 24-25%. The company is expected to generate healthy cash flows, which would help further reduce debt (management has guided to lower debt by $500 million in FY2023).

■ **Valuation – Maintain Buy on UPL with an unchanged PT of Rs. 930**

Industry-leading growth and target to increase revenue share from differentiated and sustainable solutions would improve margin/earnings profile and drive sustainable growth and valuation re-rating. Moreover, risk-reward seems favourable, given attractive valuations of 10.6x/9x/7.7x its FY2023E/FY2024E/FY2025E EPS, considering strong growth outlook (we expect a PAT CAGR of 21% over FY22-25E and RoE of ~20-21%). Hence, we maintain a Buy rating on UPL with an unchanged price target (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 the 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 impact 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
Mike Frank	Group COO
Dhruv Sawhney	COO, nurture.farm
Anand Vora	Global CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	9.9
2	JPMorgan Chase & Co.	7.7
3	Massachusetts Financial Services Co.	3.4
4	Vanguard Group Inc.	3.0
5	Norges Bank	2.8
6	Government Pension Fund	2.8
7	Blackrock Inc.	2.2
8	SBI Funds Management Ltd.	1.5
9	Dimensional Fund Advisors LP	1.2
10	William Blair & Co LLC	0.9

Source: Bloomberg (Old data)

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

Sharekhan

by BNP PARIBAS

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