Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

UPL Ltd

Strong Q3; focus on deleveraging

Agri Chem	Sharekhan code: UPL

Reco/View: Buy ↔	CMP: **Rs. 757**	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 21.42

Updated Dec 08, 2022

Medium Risk

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

Source: Morningstar

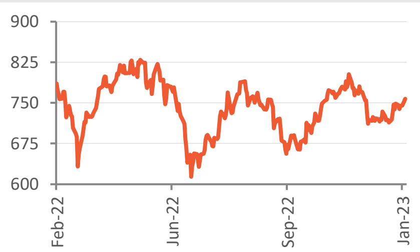
Company details

Market cap:	Rs. 57,857 cr
52-week high/low:	Rs. 848 / 608
NSE volume: (No of shares)	21.2 lakh
BSE code:	512070
NSE code:	UPL
Free float: (No of shares)	51.99 cr

Shareholding (%)

Promoters	31
FII	37
DII	16
Others	16

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.7	5.6	-1.6	-3.5
Relative to Sensex	7.8	8.2	-4.1	-4.7

Sharekhan Research, Bloomberg

Summary

- Q3FY2023 results were strong on the operational front with better-than-expected consolidated revenue growth of 21.1% y-o-y and a beat of 68 bps in EBITDA margins at 22.2%. Adjusted operating profit of Rs. 3,034 crore beat estimate by 8.5%. Adjusted PAT at Rs. 1,107 crore (up 11.9% y-o-y) beat our estimate by 15.1%, as a beat in operating profit got further improved by higher-than-expected other income and lower-than-expected tax rate.
- Revenue growth was led by 13% y-o-y improvement in prices, 7% positive currency impact, and 1% improvement in volumes. Price growth was led by strong agri-commodity prices and continued firmness in product prices across regions, specifically for insecticide products. Europe growth was muted due to devaluation of the Euro and geopolitical tensions.
- Management maintained its FY2023 revenue/EBITDA growth guidance to 12-15%/15-18% and targets to lower net debt by $1.3 billion in Q4FY2023. With 9MFY2023 revenue/EBITDA growth of 22%/24% y-o-y, we expect UPL to beat its growth guidance, as Q4 is normally strong quarter, and management expects strong volume growth despite some channel destocking in the agrochemical industry.
- We maintain Buy on UPL with an unchanged PT of Rs. 930, as valuation of 9.3x/8.1x its FY2024E/FY2025E EPS is attractive, considering a strong growth outlook, and management aim to deleverage the balance sheet. Focus on increasing share of high-margin, differentiated, and sustainable solutions would improve earnings quality and drive valuation re-rating.

UPL Limited (UPL) posted another quarter of strong performance with beat of 5.2%/8.5% in consolidated revenue/adjusted operating profit at Rs. 13,679 crore/Rs. 3,034 crore, up 21.1%/13.8% y-o-y, supported by strong double-digit growth across key regions (excluding Europe) with resilient contribution/EBITDA margin at 42.6%/22.2% in Q3FY2023. Management indicated that strong growth was led by continued firmness in product prices across regions, specifically for insecticide products, and tailwinds through strong agri-commodity prices and favourable exchange rates. Higher-than-expected revenue growth was led by a 13% y-o-y improvement in product realisations, 7% positive currency impact, and 1% y-o-y growth in volume. Regional revenue growth was 28%/30%/19%/12% y-o-y for LatAm/North America/India/RoW. However, Europe witnessed muted 3% y-o-y revenue growth mainly due to Euro devaluation, ongoing conflict, and products ban, while in Euro term business grew by 10% y-o-y. Strong revenue growth in the LatAm region was led by robust growth in insecticides primarily Brazil, launch of new product Evolution (fungicide), and NPP BioSolutions growth in Mexico, while North America witnessed benefit of strong commodity price, which resulted in improved volume growth (especially herbicides). India revenue growth was led by strong traction in the seed business, while strong price realisation was compensated for lower demand. OPM of 22.2% (down 141 bps y-o-y) was ~68 bps higher than our estimate of 21.5%, led by improved realisations, better product mix, and effective supply chain management. Adjusted PAT at Rs. 1,107 crore (up 11.9% y-o-y) was 15% above our estimate of Rs. 962 crore as beat in revenue/margin and lower tax rate was offset by Interest expense of Rs. 894 crore.

Key positives

- Stronger-than-expected revenue growth of 21.1% y-o-y led by robust double-digit growth across regions (ex-Europe).
- Revenue growth was led by a 13% y-o-y improvement in product realisations and 7% positive currency impact.

Key negatives

- European revenue growth was muted at only 3% y-o-y due to Euro devaluation, ongoing conflict, and products ban.
- Net working capital days increased to 121 in Q3FY2023 from 108 in Q3FY2022.
- Interest cost increased sharply by 69% y-o-y to Rs. 894 crore in Q3FY2023.

Management Commentary

- Management has maintained its revenue/EBITDA growth guidance to 12-15%/15-18%.
- Management has guided for strong volume growth for Q4FY23 despite some channel destocking in the agrochemical industry.
- Advanta reported strong performance – Revenue/EBITDA grew by 31%/54% y-o-y in Q3FY2023.
- The company is investing to strengthen customer relationships and farmer connect, building capabilities to drive the differentiated and sustainable portfolio.
- UPL aims to reduce net debt by $1.3 billion in Q4FY2023 with net debt/EBITDA target of ~1.4x by the end of FY2023.

Revision in estimates – We have fine-tuned our FY2023-FY2025 earnings estimate, as higher revenue growth assumption gets offset by increased interest cost.

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 11.1x/9.3x/8.1x its FY2023E/FY2024E/FY2025E EPS, considering the strong growth outlook (we expect a PAT CAGR of 22% over FY2022-FY2025E and RoE of ~20%). Hence, we maintain our Buy rating on UPL with an unchanged price target (PT) of Rs. 930.

Key Risks

Slowdown in the 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	55,257	59,677	65,048
OPM (%)	22.0	22.5	23.0	23.4
Adjusted PAT	3,950	5,231	6,199	7,119
% YoY growth	*27.1*	*32.4*	*18.5*	*14.8*
Adjusted EPS (Rs.)	51.6	68.4	81.0	93.1
P/E (x)	14.7	11.1	9.3	8.1
P/BV (x)	2.7	2.2	1.8	1.5
EV/EBITDA (x)	8.1	6.4	5.6	4.9
RoCE (%)	13.4	16.6	16.8	16.8
RoNW (%)	20.0	21.8	21.2	20.2

Source: Company; Sharekhan estimates

Good Q3 performance; Revenue/margin beat encouraging

The company reported strong Q3FY2023 results with beat of 5.2%/8.5% in consolidated revenue/adjusted operating profit at Rs. 13,679 crore/Rs. 3,034 crore, up 21.1%/13.8% y-o-y, supported by robust double-digit growth across key regions (excluding Europe) with resilient contribution/EBITDA margins at 42.6%/22.2% in Q3FY2023. Management indicated that strong growth was led by continued firmness in product prices across regions, specifically for insecticide products, and tailwinds through strong agri-commodity prices and favourable exchange rates. Higher-than-expected revenue growth was led by a 13% y-o-y improvement in product realisations, 7% positive currency impact, and 1% y-o-y growth in volume. Regional revenue growth was 28%/30%/19%/12% y-o-y for LatAm/North America/India/RoW. However, Europe witnessed muted 3% y-o-y revenue growth mainly due to Euro devaluation, ongoing conflict, and products ban; while in Euro term, business grew by 10% y-o-y. Strong revenue growth in the LatAm region was led by robust growth in insecticides, primarily Brazil, launch of new product – Evolution (fungicide), and NPP BioSolutions growth in Mexico, while North America witnessed benefit of strong commodity price, which resulted in improved volume growth (especially herbicides). India revenue growth was led by strong traction in the seed business, while strong price realisations compensated for lower demand. Operating profit margin (OPM) of 22.2% (down 141 bps y-o-y) was ~68 bps higher than our estimate of 21.5%, led by improved realisations, better product mix, and effective supply chain management. Adjusted PAT at Rs. 1,107 crore (up 11.9% y-o-y) was 15% above our estimate of Rs. 962 crore, as beat in revenue/margin and lower tax rate was offset by interest expense of Rs. 894 crore.

Q3FY2023 earnings call highlights

- **Management reiterated revenue/EBITDA growth guidance:** Management has maintained its revenue and EBITDA growth guidance of 12-15% and 15-18%, respectively, for FY2023. With 9MFY2023 revenue/ EBITDA growth of 22%/24% y-o-y, we expect UPL to beat its growth guidance as Q4 is normally a strong quarter for UPL.
- **Balance sheet deleveraging target:** UPL aims to reduce its net debt by $1.3 billion in Q4FY2023 with net debt/EBITDA target of ~1.4x by the end of FY2023. Management indicated that the release of working capital, higher EBITDA in Q4, and net cash inflow from corporate realignment would help reduce debt.
- **Factoring target:** UPL would maintain factoring at $1.6 billion, which is similar to last year. The company has factored $1.1 billion in 9MFY2023, of which $450 million is from Brazil. The company plans to reduce the factoring in Brazil as the factoring cost is high.
- **Volume/pricing outlook:** Volume growth for 9MFY2023 is flat y-o-y. As per management, adjusting for the impact of portfolio rationalisation, volume growth would have been 2%, and management has guided for strong volume growth in Q4 despite inventory destocking by customers. The company has managed to pass on inflation cost and price-led growth for 9MFY2023, which is 17% y-o-y.
- **Working capital cycle:** Working capital days increased by 13 days y-o-y to 121 days on account of 1) increased receivables due to robust growth of 23% in sales (TTM) and 2) short-term inventory build-up on account of strong expected demand in Q4FY2023 and in-lieu of uncertainties in the supply chain. The company expects working capital days to reduce by the end of Q4, led by volume growth.
- **Advanta performance:** Revenue/contribution profit/EBITDA witnessed 31%/34%/41% y-o-y growth to Rs. 912 crores/Rs. 557 crore/Rs. 275 crore in Q3FY2023. EBITDA margin was strong at 30.1% in Q3FY2023 versus 25.6% in Q3FY2022.
- **Other updates:** 1) The company gave a FY2023 capex guidance of Rs. 3,300 crore for tangible and intangible assets. 2) Net finance cost increased by 49% y-o-y to Rs. 732 crore due to rise in benchmark rates. Management expects interest cost to decline in Q4FY2023 due to a reduction in debt. 3) Effective tax rate in Q3 came at 11% and management has guided that ETR for FY2023 will be 15%.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Revenue	**13,679**	**11,297**	**21.1**	**12,507**	**9.4**
Total expenditure	10,795	8,853	21.9	10,063	7.3
Operating profit	2,884	2,444	18.0	2,444	18.0
Adjusted operating profit	**3,034**	**2,665**	**13.8**	**2,808**	**8.1**
Other Income	115	70	64.3	78	47.4
Depreciation	624	600	4.0	608	2.6
Interest	894	529	69.0	644	38.8
PBT	1,461	1,332	9.7	1,227	19.1
Tax	135	167	(19.2)	231	(41.6)
Reported PAT	1,087	936	16.1	814	33.5
Adjusted PAT	**1,107**	**989**	**11.9**	**857**	**29.2**
Adjusted EPS (Rs.)	14.8	13.2	11.9	11.4	29.2
Margins (%)			**BPS**		**BPS**
Adjusted OPM	22.2	23.6	(141)	22.4	(27)
Adjusted NPM	8.1	8.8	(66)	6.9	124
Tax rate	9.2	12.5	(330)	18.8	(959)

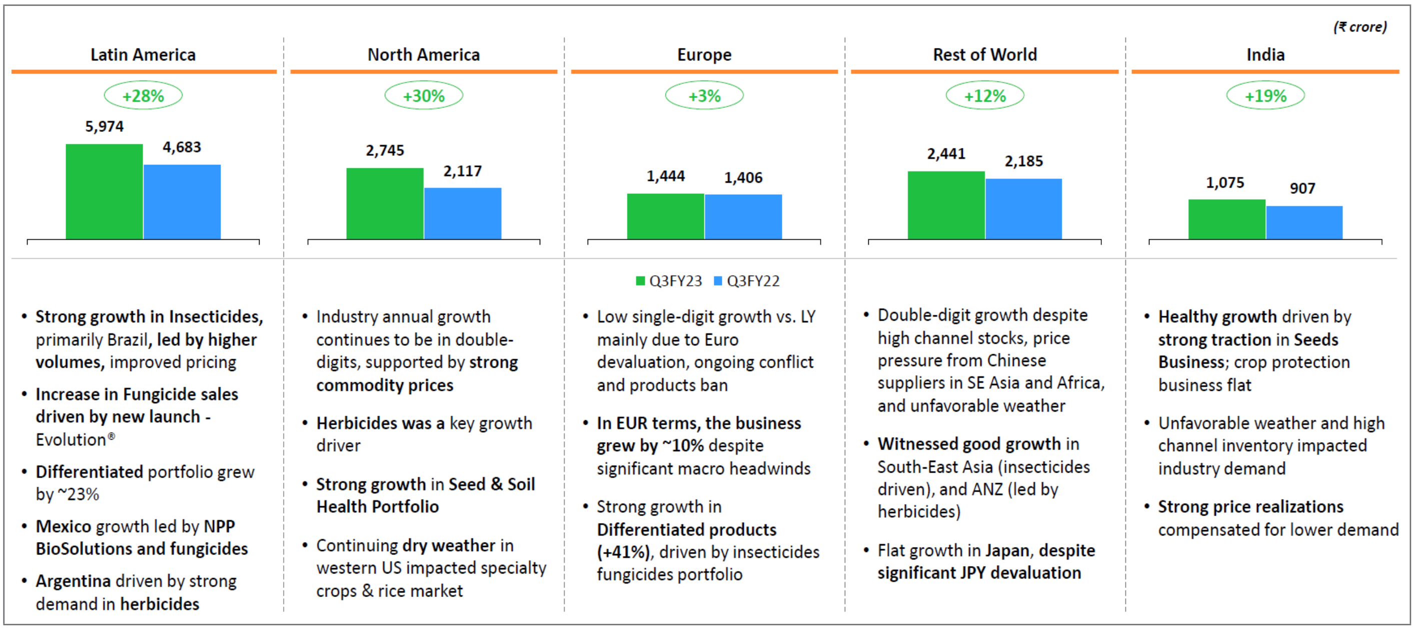
Source: Company; Sharekhan Research

Geographical revenue break-up Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Latin America	5,974	4,683	27.6	6,092	-1.9
Europe	1,444	1,406	2.7	1,354	6.6
North America	2,745	2,117	29.7	1,185	131.6
India	1,075	907	18.5	1,808	-40.5
Rest of the World	2,441	2,185	11.7	2,067	18.1
Total revenue	**13,679**	**11,297**	**21.1**	**12,507**	**9.4**

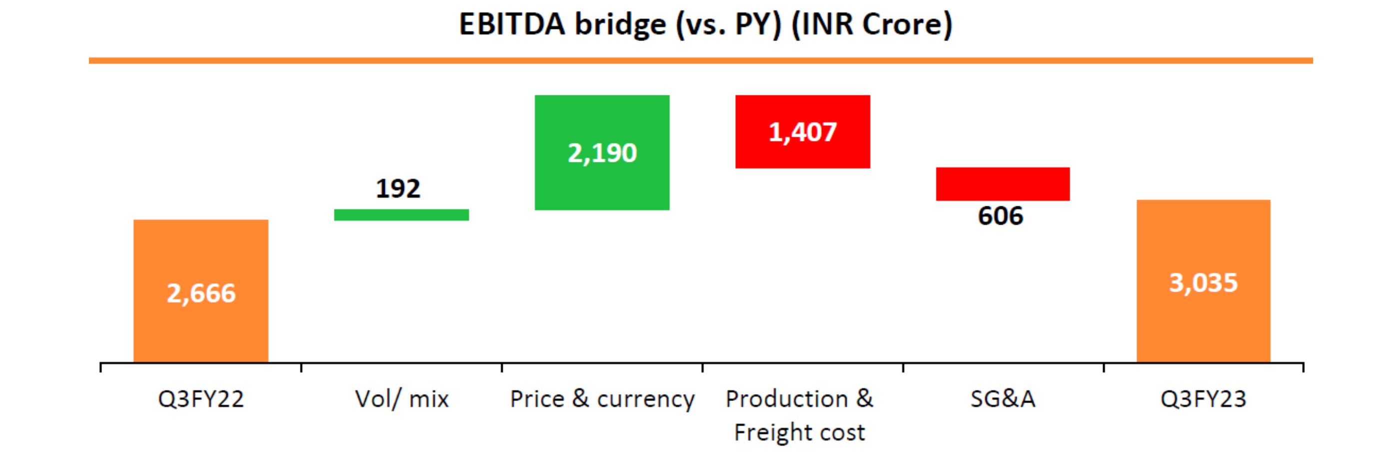
Source: Company; Sharekhan Research

Q3FY2023 regional performance – Double-digit growth across regions, except for Europe



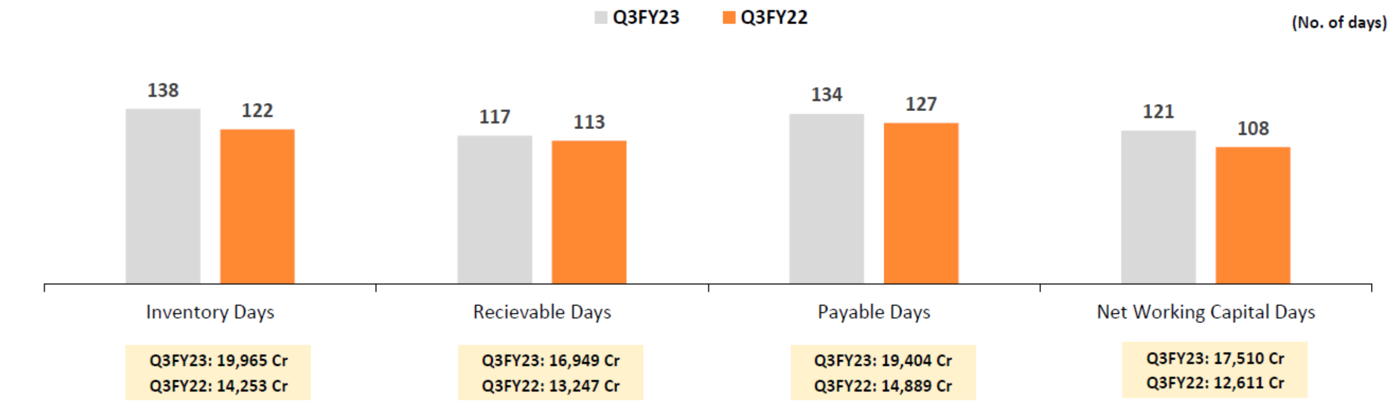
Source: Company

Q3FY2023 EBITDA bridge versus Q3FY2022



Source: Company

Increase in net working capital cycle due to robust growth



Note: As a risk management measure, the company sells its receivables on non-recourse basis to banks. Receivables sold as of 31 Dec'22 were INR 9,081 crore (US$ 1.1 Bn) 31 March'22: INR 12,099 crore (US$ 1.6 Bn) , 30 Sep'22: INR 6,671 crore (US$ 819 Mn), 31 Dec'21: INR 7,175 crore (US$ 965 Mn)

- **Working capital investment is higher in 9M FY23** primarily due to the - 1) increase in receivables due to robust growth of 23% in sales (TTM), and 2) short-term inventory build-up on the back of strong expected demand in Q4 FY23 and in-lieu of uncertainties in supply chain

Source: Company

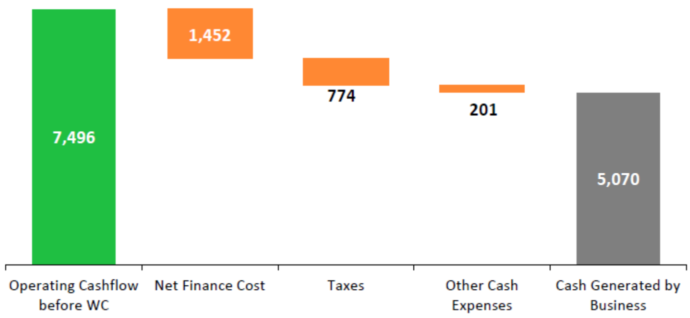
9MFY2023 Cash Flow and Debt Position as on December 31, 2022

Gross & Net Debt Position – Dec 2022

All figures are in ₹ Crore and US$ Mn

Particulars	Dec'22	Sep'22	Change	Mar'22
Gross Debt	32,803 $3,965	32,550 $3,995	+253 ($30)	25,866 $3,416
Cash and cash equivalent	5,275[2] $638	4,038[2] $496	1,237 $142	6,960 $919
Reported Net Debt	**27,528** **$3,328**	**28,512** **$3,500**	**(984)** **($172)**	**18,906** **$2,497**
Net Debt Adjusted for Currency Impact	***27,110[1]***	***28,512***	***(1,402)***	***18,906***

Cash generated by Business in 9M FY23



- **Business generated robust cash from operations of INR 5,070 crore**
- **Confident of reducing net to US$ 2 Bn by March 2023 through –**
  - Estimated working capital release
  - Higher EBITDA in Q4
  - Net cash inflow from corporate realignment

Note: [1]INR depreciated from 81.47 as on 30 Sep 2022 to 82.73 as on 31 Dec 2022. USD/INR - 31 March 2022: INR 75.72. [2]Includes liquid investment of INR 374 crore as of Dec'22 and INR 405 crore as of Sep'22.

Source: Company

Breakdown of Net Finance Cost – Q3FY2023 and 9MFY2023

Net Finance Cost Breakdown

(₹ crore)

Particulars	Q3FY23	Q3FY22	*Change*	9MFY23	9MFY22	*Change*
Interest on Borrowings	419	189	230	908	523	385
Interest on Leases & Others	188	172	16	712	404	309
Other Financial Charges	42	62	(20)	117	140	(23)
NPV – Interest & Finance	158	98	60	447	252	195
Interest Income	(76)	(28)	*(47)*	(204)	(87)	*(117)*
Total Net Finance Cost	**732**	**492**	**240**	**1,980**	**1,231**	**748**

Source: Company

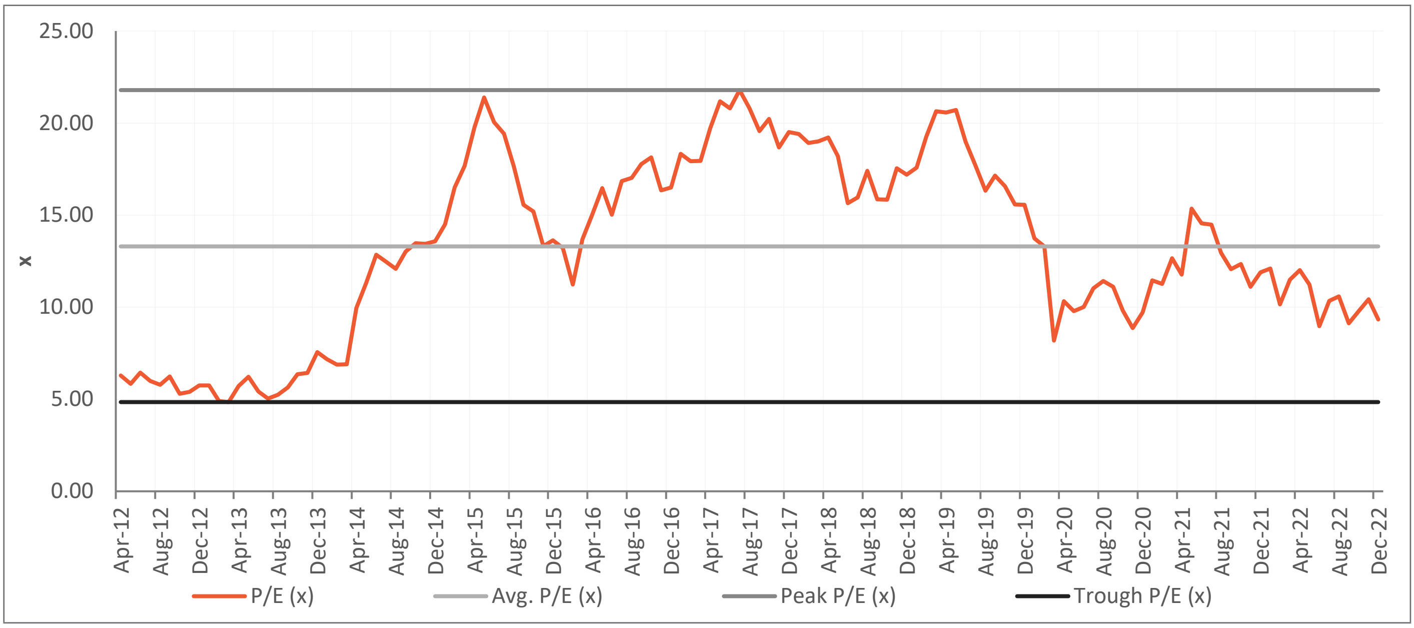
Outlook and Valuation

■ **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 at 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 FY2022-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 the 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 $1.3 billion in Q4FY2023).

■ **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 11.1x/9.3x/8.1x its FY2023E/FY2024E/FY2025E EPS, considering the strong growth outlook (we expect a PAT CAGR of 22% over FY2022-FY2025E and RoE of ~20%). Hence, we maintain our 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 an 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 a 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	8.14
2	JPMorgan Chase & Co	7.40
3	Massachusetts Financial Services C	3.92
4	Vanguard Group Inc/The	3.45
5	Norges Bank	2.86
6	Government Pension Fund	2.56
7	BlackRock Inc	2.25
8	SBI Funds Management Ltd	1.45
9	Dimensional Fund Advisors LP	1.25
10	Nordea Bank Abp	0.86

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

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Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O/ CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.