Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

PI Industries

Q4 margin disappoints; healthy growth guidance

Agri Chem	Sharekhan code: PIIND
Reco/View: Buy ↔	CMP: Rs. 3,273 / Price Target: Rs. 4,200 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update

Result Update

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 34.61

Updated Mar 08, 2023

High Risk

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

Source: Morningstar

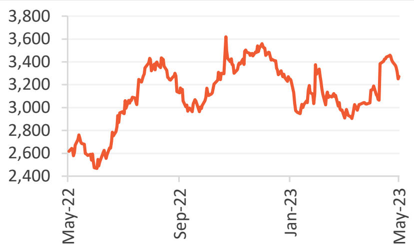
Company details

Market cap:	Rs. 49,657 cr
52-week high/low:	Rs. 3,699/2,444
NSE volume: (No of shares)	3.3 lakh
BSE code:	523642
NSE code:	PIIND
Free float: (No of shares)	8.2 cr

Shareholding (%)

Promoters	46
FII	19
DII	24
Others	11

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.6	-1.9	-0.8	25.1
Relative to Sensex	3.5	1.7	0.1	13.6

Sharekhan Research, Bloomberg

Summary

- Q4FY23 performance was a mixed bag as a 15% y-o-y growth in CSM revenues got offset by muted domestic revenues and 260 bps miss in OPM at 21.9% (flat y-o-y). The consolidated PAT of Rs. 281 crore (up 37.3% y-o-y) was 5% below our estimates of Rs. 294 crore as margin miss got partially offset by higher other income and lower interest cost.
- CSM business revenue growth of 15% y-o-y to Rs. 1,281 crore was led by a 17% y-o-y growth from price/currency/product mix and was partially offset by a 2% decline in volumes. Muted domestic revenue growth of 1% y-o-y given +2%/-1% volume/pricing. Margins were weak due to miss in gross margins and higher opex (one-time cost of Rs. 20-25 crore for strategic initiatives).
- Healthy FY24 revenue guidance (excluding pharma) of 18%-20% which would be led by volume growth and expectation of margin improvement (operating leverage benefits and increasing utilisation). PI is not seeing any change in demand for its products as its more toward specialty product while channel inventory is high for generic products.
- PI's pharma foray would remove the long pending overhang of QIP cash utilisation and bring the benefit of diversification. Our PAT growth expectation of a 19% CAGR over FY2023-FY2025E would further improve post integration of TRM and Archimica's acquisition. We maintain a Buy rating on PI Industries with an unchanged PT of Rs. 4,200. The stock trades at 29x its FY25E EPS.

Q4FY23 results were a mixed bag with sustained strong growth in CSM revenue getting offset by subdued domestic revenue and miss in margin and thus consolidated operating profit stood at Rs. 343 crore, up 12% y-o-y missed our estimate by 8%. The consolidated revenue of Rs. 1,566 crore (up 12% y-o-y) was 2.6% above our estimate of Rs. 1,526 crore, led by a stronger-than-expected revenue growth of 15% y-o-y (+17% y-o-y led by price, currency & product mix partially offset by 2% volume decline) in the CSM business to Rs. 1,281 crore while domestic revenue growth was muted at just 1% y-o-y (+2%/-1% y-o-y volume/price) to Rs. 284 crores. OPM remained flat y-o-y at 21.9% and was 260 bps below our estimate of 24.5% due to miss in gross margin by 118 bps at 44.8% (up 75 bps y-o-y) and higher operating cost (up 16% y-o-y, which included a one-time cost of Rs. 20-25 crore related to strategic initiatives). Excluding one-time cost, adjusted OPM was at 23.5%, up 163 y-o-y despite a challenging business environment. Consolidated PAT at Rs. 281 crore (up 37.3% y-o-y) was 5% below our estimates of Rs. 294 crore due to margin miss partially offset by higher other income and lower interest costs.

Key positives

- Strong revenue growth of 15% y-o-y in CSM business led by price/currency/product mix.

Key negatives

- CSM export volumes declined by 2% y-o-y
- Muted 1% y-o-y growth in domestic revenues.
- Miss of 260 bps in OPM at 21.9% due to 118 bps miss in gross margins and higher operating costs.

Management Commentary

- The management is targeting to achieve 18%-20% revenue growth (excluding pharma) in FY24 with continued improvement in margins and returns. Majority of revenue growth would be driven by volume growth as the company does not see any fluctuations in price/currency from here.
- Company expects FY24 margins to improve led by operating leverage benefits, increase in utilisation and efficiencies on both sides of manufacturing and marketing.
- Management guided for Rs. 850-900 crores of capex in FY24, the benefits of which will be seen FY25 onwards.
- The company expects Rs. 550-600 crores of revenues for Therachem and anticipates margins of 15-18% in the first year which will improve going forward.
- High cash and bank balance of Rs. 3,227 crore as on 31st March 2023 will be utilized over the years for several strategic initiatives, inorganic opportunities, strengthening the domestic market portfolio and expanding the global manufacturing capacity.
- **Other updates** – 1) Inventory days are now normalised 2) Tax rate guidance of 15-16% for FY24 3) Robust CSM order book of $1.8 billion 4) Target to commercialise 4-5 new molecules annually.

Revision in estimates: We have fine-tuned our FY23-25 earnings estimate to factor FY23 P&L and balance sheet numbers.

Our Call

Valuation – Maintain Buy on PI with an unchanged PT of Rs. 4,200: PI's pharma foray would diversify its earnings stream and drive medium to long-term growth for the company. Even after recent acquisitions, PI would has a strong net cash position of Rs. 2,304 crores to pursue both organic and inorganic growth opportunities. We expect PI's revenue/EBITDA/PAT to post a strong CAGR of 20%/19%/19% over FY2023-FY2025E, led by robust CSM order book of $1.8 billion and ramp-up of nine new products commercialised in the last one year. Growth would further improve post integration of TRM and Archimica's acquisition. We maintain a Buy rating on PI with an unchanged PT of Rs. 4,200. At CMP, the stock trades at 33.7x its FY2024E EPS and 29.1x its FY2025E EPS.

Key Risks

1) Delayed commissioning of projects or execution of orders or delayed orders by clients in the export business can affect revenue growth and 2) Higher-than-normal time lag in passing on the increase in raw-material prices could affect margins.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	5,300	6,492	7,818	9,281
OPM (%)	21.6	23.8	24.2	23.8
Adjusted PAT	840	1,223	1,484	1,718
y-o-y growth (%)	13.5	45.5	21.4	15.7
Adjusted EPS (Rs.)	55.0	80.0	97.2	112.6
P/E (x)	59.5	40.9	33.7	29.1
EV/EBITDA (x)	41.8	30.2	24.4	20.5
P/BV (x)	8.1	6.9	5.8	4.8
RoCE (%)	17.0	21.3	22.5	22.1
RoE (%)	14.6	18.3	18.7	18.1

Source: Company; Sharekhan estimates

Q4 PAT miss estimate due to miss in margin

Q4FY23 consolidated revenue of Rs. 1,566 crore (up 12% y-o-y) was 2.6% above our estimate of Rs. 1,526 crore, led by stronger-than-expected revenue growth of 15% y-o-y (+17% y-o-y led by price, currency & product mix partially offset by 2% volume decline) in the CSM business to Rs. 1,281 crore while domestic revenue growth was muted at just 1% y-o-y (+2%/-1% y-o-y volume/price) to Rs. 284 crore. OPM remained flay y-o-y at 21.9% and was 260 bps below our estimate of 24.5% due to miss in gross margin by 118 bps at 44.8% (up 75 bps y-o-y) and higher operating costs (up 16% y-o-y which included one-time cost of Rs. 20-25 crore related to strategic initiatives). Excluding one-time cost, adjusted OPM was at 23.5%, up 163 y-o-y despite a challenging business environment. Consolidated PAT at Rs. 281 crore (up 37.3% y-o-y) was 5% below our estimates of Rs. 294 crores due to margin miss partially offset by higher other income and lower interest costs.

Q4FY23 conference call highlights

- **Positive outlook** – The management is eyeing a 18-20% revenue growth (excluding pharma) in FY24 with continued improvement in margins and returns through R&D focused approach in CSM exports, launch of new products and portfolio diversification in domestic business and progress on strategic initiatives. Growth will largely be volume led as the management does not see any price/currency fluctuations from here.
- **Channel Inventory:** As PI Industries is into manufacturing of specialized products it does not expect to be impacted by channel inventory challenges currently being witnessed in generic products. Export volumes in Q4 declined by 2% y-o-y and management does not anticipate the trend to continue since it was only as per the planned customer schedules.
- **Margin performance/guidance** – Improvement in Q4 gross margin to 44.8% (up 74 bps y-o-y) on account of a favourable product mix was offset by higher operating cost (up 16% y-o-y) which led the EBITDA margins to stay flat y-o-y at 22%. Company expects FY24 margins to improve on account of operating leverage benefits, increase in utilizations and cost savings and efficiencies on both sides of manufacturing and marketing.
- **Capex guidance** – The management guided for Rs. 850-900 crores of capex in FY24, which includes Rs. 300 crores of carried over capex and Rs. 600 crores of capex in the core business areas both in exports and domestic business, the benefits of which will be seen FY25 onwards. This capex will be towards setting up 2 MPPs, quality improvements, automation, R&D and other technology improvements. Around $10-12 million dollars will be spent towards pharma capex.
- **Deployment of Cash & Bank Balance:** Consolidated cash and bank balance stood at Rs. 3,227 crores as on 31st March 2023 and management guided it will be utilized over the years for several strategic initiatives, inorganic opportunities, technology development, strengthening the domestic market portfolio, near shoring and expanding the global manufacturing capacity.
- **Product launches** – In FY23, the company commercialized four new products in CSM export business and seven new products in domestic agri brands. The company targets to commercialise 4-5 new molecules annually and has planned to launch 5 new innovative products in FY24.
- **Pharma acquisition updates**: Company expects Rs. 550-600 crores of revenues for Therachem and anticipates margins of 15-18% in the first year which will improve going forward. Management expects 2.5-3 years for pharma to reach the returns/margin profile of PI industries.
- **Other updates** – 1) Inventory days are now normalised since Covid-19, so there is less room for further improvement. 2) Revenue share of new product is 17-18%, 3) Tax rate guidance of 15-16% for FY24. 4) Robust CSM order book of $1.8 billion.

Results (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Revenue	**1,566**	**1,395**	**12.2**	**1,613**	**(3.0)**
Total expenditure	1,223	1,090	12.2	1,198	2.1
Operating profit	**343**	**305**	**12.4**	**415**	**(17.4)**
Other Income	50	20	147.5	50	(1.4)
Depreciation	58	54	7.6	57	1.8
Interest	3	3	22.2	9	(62.9)
PBT	**331**	**269**	**23.3**	**400**	**(17.1)**
Tax	52	65	(20.0)	48	7.2
Reported PAT	**281**	**204**	**37.3**	**352**	**(20.2)**
EPS (Rs.)	18.5	13.4	37.3	23.1	(20.2)
Margin (%)			**BPS**		**BPS**
OPM	21.9	21.9	4	25.7	(384)
NPM	17.9	14.7	327	21.8	(388)
Tax rate	15.7	24.2	(849)	12.1	356

Source: Company, Sharekhan Research

Revenue break-up Rs cr

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Domestic	284	281	1.1	285	(0.1)
Exports	1,281	1,114	15.0	1,329	(3.6)
Total revenues	**1,566**	**1,395**	**12.2**	**1,613**	**(3.0)**

Source: Company, Sharekhan Research

Targeting to achieve 18%-20% revenue growth in FY24 with continued improvement in margins and returns

Domestic:
Focus on portfolio diversification with launch of novel offerings

- Growth to be driven by portfolio of new product launches and the products launched over the last few years
- "Dual growth engine" with JIVAGRO focusing on horticulture segment with enhanced portfolio
- Strong pipeline of Biologicals and Biostimulant products at different stages of development
- Cautious optimism despite climate change forecast of El Niño and dropping prices of generic products

CSM Export:
R&D focused approach to drive incremental business

- Continued scale up in demand of the existing and newly commercialised products
- Solid R&D pipeline – 4 to 5 products to be commercialized every year
- Capacity expansion in line with plan
- Momentum in new enquiries and conversion to continue

Progressing on strategic initiatives in line with plan

- Forayed into pharma with twin acquisitions and build up of Hyderabad research center
- Working with global advisors for integration and transformation for value creation over time
- Discussions continues with global innovators for development partnership of promising R&D leads

Source: Company

Outlook and Valuation

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

The outlook for the Indian agrochemical industry is encouraging, primarily driven by rising foodgrain production and domestic demand, favourable regulatory reforms for farmers (government passed key agri-sector reforms namely Farmers Produce Trade and Commerce Bill 2020 and Farmers (Empowerment & Protection) Agreement of Price Assurance & Farm Services Bill) and the vast opportunity from products going off-patent. The government's focus is to double farmers' incomes (higher MSPs for crops); a near-normal monsoon and higher reservoir levels would augment demand for agri inputs in India. We also expect exports from India to grow at strongly as the country is being looked as the preferred supplier for agri inputs given supply disruption from China. Thus, we expect India's agrochemicals industry to grow by 7-8% annually on a sustained basis for the next few years.

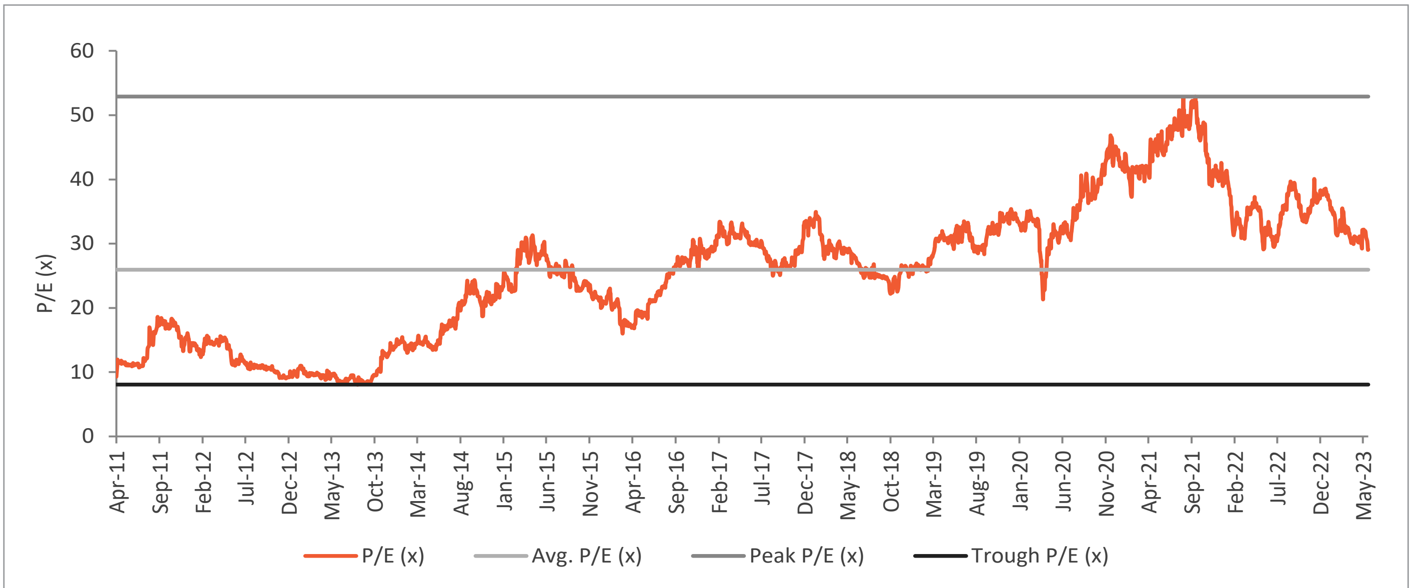
■ Company outlook - Strong growth outlook led by organic and inorganic opportunities

Demand remains encouraging in both domestic (strong Rabi season outlook) and export markets (order book of $1.8 billion) and the company has guided for 18-20% revenue growth and margin improvement for FY2024. Commissioning of additional capacity and contribution from newly launched brands would fuel growth. Moreover, utilisation of some portion of QIP money for recently announced pharma acquisition would drive inorganic growth in the medium to long term, apart from diversifying its business and enhancement of technological capabilities.

■ Valuation - Maintain Buy on PI with an unchanged PT of Rs. 4,200

PI's pharma foray would diversify its earnings stream and drive medium to long-term growth for the company. Even after recent acquisitions, PI would has a strong net cash position of Rs. 2,304 crores to pursue both organic and inorganic growth opportunities. We expect PI's revenue/EBITDA/PAT to post a strong CAGR of 20%/19%/19% over FY2023-FY2025E, led by robust CSM order book of $1.8 billion and ramp-up of nine new products commercialised in the last one year. Growth would further improve post integration of TRM and Archimica's acquisition. We maintain a Buy rating on PI with an unchanged PT of Rs. 4,200. At CMP, the stock trades at 33.7x its FY2024E EPS and 29.1x its FY2025E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Incorporated in 1947, PI Industries focuses on developing complex chemistry solutions in agri-sciences with an integrated approach. The company currently operates a strong infrastructure setup, consisting of three formulation facilities and fifteen multi-product plants under its four manufacturing facilities. These state-of-the-art facilities have integrated process development teams with in-house engineering capabilities. The company also maintains a strong research presence through its R&D facility at Udaipur and has a dedicated team of over 500 scientists and researchers.

Investment theme

A strong CSM order book of ~$1.8 billion and decent growth in domestic formulation business provides strong long term revenue growth visibility. The company has organic and inorganic growth aspirations in areas such as enhancement of technological capability, de-risking manufacturing concentration in India. The recent pharma acquisition would accelerate earnings growth prospects for the company.

Key Risks

- Delay in commissioning of projects or execution of orders or deferral of orders by clients in the CSM business can affect revenue growth.
- Higher-than-normal time lag in passing on increased raw-material prices could affect margins.

Additional Data

Key management personnel

Narayan K. Seshadri	Non-Executive & Independent Chairperson
Dr. Raman Ramachandran	Managing Director & Chief Executive Officer
Mayank Singhal	Vice Chairman and Managing Director
Rajnish Sarna	Executive Director
Arvind Singhal	Non-Executive - Non Independent Director
Manikantan Viswanathan	Chief Financial Officer
Naresh Kapoor	Company Secretary & Compliance officer

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management Co Ltd/India	5.69
2	Life Insurance Corp of India	2.88
3	Kotak Mahindra Asset Management Co	2.09
4	Vanguard Group Inc/The	2
5	BlackRock Inc	1.7
6	UTI Asset Management Co Ltd	1.58
7	Capital Group Cos Inc/The	1.57
8	Canara Robeco Asset Management Co	1.09
9	ICICI Prudential Life Insurance Co	0.84
10	SBI Funds Management Ltd	0.77

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

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