Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

UPL Ltd

Subdued Q4; pricing pressures to persist

Agri Chem	Sharekhan code: UPL
Reco/View: **Buy** ↔	CMP: **Rs. 715** · Price Target: **Rs. 880** ↓

↑ 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 Mar 08, 2023

Medium Risk

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

Source: Morningstar

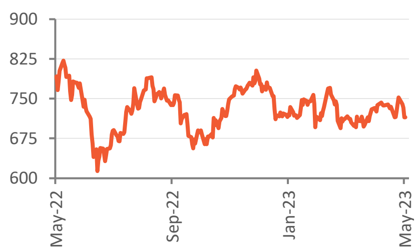
Company details

Market cap:	Rs. 54,610 cr
52-week high/low:	Rs. 827 / 608
NSE volume: (No of shares)	18.7 lakh
BSE code:	512070
NSE code:	UPL
Free float: (No of shares)	50.79 cr

Shareholding (%)

Promoters	32
FII	39
DII	14
Others	15

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.5	-0.3	-5.2	-8.1
Relative to Sensex	-4.7	-1.9	-6.4	-21.5

Sharekhan Research, Bloomberg

Summary

- Weak Q4FY23 results with a 2%/400 bps miss in consolidated revenue/EBITDA margin at Rs. 16,569 crore/18.2%, up/down 4.5%/445 y-o-y due to a decline in post-patent product price, idle capacity costs, and a higher share of low-margin LatAM region. Adjusted PAT of Rs. 821 crore (down 46% y-o-y and 52% below our estimate) was further impacted by higher depreciation and tax rate.
- North America revenue fell by 14% y-o-y to Rs. 3,009 crore due to steep decline in Glufosinate prices and delayed spring impacted herbicides/insecticides demand. Revenue from LatAM/Europe/India/RoW grew by 11.9%/6.5%/14.7%/5.9% y-o-y. Volume remained muted at +1% y-o-y while product realisation declined by 3% y-o-y and there was positive currency impact of 6% y-o-y.
- FY23 EBITDA growth of 10% missed guidance of 15-18% due to subdued Q4. FY24 revenue/EBITDA guidance growth of 6-10%/8-12% would also be dependent upon recovery in H2FY24 as oversupply from China would keep product price/margin under check in H1FY24. We thus cut our FY24/FY25 earnings estimate sharply by 24%/16%.
- Valuation of 11.4x/8.9x FY24E/FY25E EPS seems attractive and thus we maintain a Buy on UPL but with a lower PT of Rs. 880 (to reflect an earnings cut).

UPL Limited (UPL) posted subdued Q4FY23 results with a miss of 2%/20% in consolidated revenue/adjusted operating profit at Rs. 16,569 crore/Rs. 3015 crore, up/down 4.5%/16% y-o-y due to decline in post-patent product price given ramp-up in supply from China, idle capacity cost and unfavourable regional mix (increase in revenue share of low margin LatAM region to 39% versus 36% in Q4FY22). Q4FY23 EBITDA had negative impact of Rs. 1241 crore with Rs. 200-250 crore from idle capacity cost, Rs. 300-350 crore of inventory loss and remaining from unfavourable product mix and high product cost. Consolidated adjusted PAT of Rs. 821 crore (down 47% y-o-y) missed our estimate by 52% due to muted operating profit and further impact of rise in depreciation cost and higher tax rate (at 24.5% versus 14% in Q4FY22).

Key positives

- Stronger revenue growth 11.9%/14.7% y-o-y from LatAm/India.

Key negatives

- Sharp 14% y-o-y decline in revenue from North America given fall in glufosinate price and delayed spring impacted demand.
- Weak EBITDA margin of 18.2%, down 445 bps y-o-y and 400 bps below our estimate given pricing pressure and idle capacity cost.

Management Commentary

- FY24 revenue/EBITDA growth guidance of 6-10%/8-12% reflects continued pricing pressure in H1FY24 given oversupply from China.
- UPL Corp/UPL SAS/Advanta/specialty chemical revenue growth guidance of 4-8%/12-16%/11-15%/10-14% and EBITDA growth guidance of 6-10%/14-18%/14-18%/12-16% for FY24.
- Strong FY23 performance from Advanta/UPL SAS – Revenue growth of 26%/10% y-o-y and EBITDA growth of 29%/13% y-o-y.
- **Nurture Financials** – FY23 revenue of Rs. 72 crore and EBITDA loss of Rs. 282 crore. UPL targets to halve Nurture's EBITDA loss.
- UPL maintained its target to take share of differentiated & sustainable to 50% by FY27 versus 28% in FY23. Maintained long term revenue growth ambition of 7-10% for global crop protection (ex. India).
- UPL lowered net debt by $440 mn y-o-y to $2.1 billion in FY23 with net debt/EBITDA of 1.5x versus 1.85x in FY22.

Revision in estimates – We lowered our FY24-25 earnings estimate to factor lower revenue growth and margin given pricing pressure on post-patented products.

Our Call

Valuation – Maintain Buy on UPL with a revised PT of Rs. 880: UPL's target to increase revenue share from differentiated and sustainable solutions would improve margin/earnings profile and drive sustainable growth in the medium to long term. Moreover, attractive valuations of 11.4x/8.9x its FY2024E/FY2025E EPS makes risk-reward favourable given strong earnings growth outlook (expect 27% PAT CAGR over FY23-25E). Hence, we maintain a Buy rating on UPL but with a lower PT of Rs. 880.

Key Risks

A 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 continued oversupply of post-patented products may keep pricing/margins under check.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	46,240	53,576	57,862	63,070
OPM (%)	22.0	20.8	21.2	22.4
Adjusted PAT	3,950	3,740	4,721	6,014
% YoY growth	27.1	(5.3)	26.2	27.4
Adjusted EPS (Rs.)	51.6	49.9	63.0	80.2
P/E (x)	13.8	14.3	11.4	8.9
P/BV (x)	2.5	2.0	1.7	1.5
EV/EBITDA (x)	7.7	6.9	5.8	4.9
RoCE (%)	13.4	13.4	14.8	15.5
RoNW (%)	20.0	15.4	16.3	17.8

Source: Company; Sharekhan estimates

Pricing pressures weaken Q4

Q4FY23 results were weak with a miss of 2%/20% in consolidated revenue/adjusted operating profit at Rs. 16,569 crore/Rs. 3015 crore, up/down 4.5%/16% y-o-y due to a decline in post-patent product price given ramp-up in supply from China, idle capacity cost and unfavourable regional mix (increase in revenue share of low margin LatAM region to 39% versus 36% in Q4FY22). North America revenue declined by 14% y-o-y to Rs. 3,009 crore due to steep decline in Glufosinate price and delayed spring impacted herbicides/ insecticides demand. Revenue from LatAM/Europe/India/RoW grew by 11.9%/6.5%/14.7%/5.9% y-o-y. Volumes remained muted at +1% y-o-y while product realisation declined by 3% y-o-y and there was positive currency impact of 6% y-o-y. Q4FY23 EBITDA had negative effect of Rs. 1,241 crore with Rs. 200-250 crore from idle capacity cost, Rs. 300-350 crore of inventory loss and remaining from unfavourable product mix and high production cost. Consolidated adjusted PAT of Rs. 821 crore (down 47% y-o-y) missed our estimate by 52% led by muted operating profit, impact of a rise in depreciation cost and a higher tax rate (at 24.5% versus 14% in Q4FY22).

Key segmental performance

Segmental Revenue	Q4FY23	Q4FY22	YoY (%)	Comments
Crop protection (ex. India)	13,700	13,200	3.8	Volume/price/FX impact of 1%/-3%/+6%.
UPL SAS	1,062	916	15.9	Volume growth of 16%; strong traction in herbicide, insecticide and BioSolutions.
Advanta	849	759	11.9	Volume/price/FX impact of -4%/10%/+6%.
EBITDA	**Q4FY23**	**Q4FY22**	**YoY (%)**	
Crop protection (ex India)	2,425	3,049	-20.5	
UPL SAS	175	133	31.6	
Advanta	145	153	-5.2	
Margin				
Crop protection (ex India)	17.7	23.1	-530	Sharp decline in post-patented product price, unfavourable region mix and idle capacity cost.
UPL SAS	16	15	196	Improved share of differentiated & sustainable products at 24% versus 18% in Q4FY22.
Advanta	17	20	-308	Higher fixed overhead impact.

Source: Company; Sharekhan Research

Q4FY23 earnings call highlights

- **Consolidated FY24 guidance and FY23 performance:** Company guided FY24 revenue/EBITDA growth to be 6-10%/8-12% respectively and RoCE to improve by 125/175 bps. FY23 EBITDA growth of 10% was below company expectation of 15-18% due to the subdued profitability in Q4. FY23 revenue growth of 16% came above the company expectation of 12-15% on account of firm prices.
- **FY24 guidance for global crop protection business**: Company guided UPL Corporation Ltd's FY24 revenue/EBITDA growth to be at 4-8%/6-10%, respectively. The tailwinds of this assumption are strong farmgate demand and ramp up of new products & the headwinds are subdued prices of post-patent products and volume pressures due to excess capacity in China.
- **FY24 guidance for UPL SAS' crop protection business:** Company guided UPL SAS' crop protection business FY24 revenue/EBITDA growth to be 12-16%/14-18% respectively led by launch of new products & increase in the share of differentiated and a sustainable portfolio.
- **FY24 guidance for Advanta and Specialty chemicals business:** The company guided UPL Advanta Enterprises' FY24 revenue/EBITDA growth to be 11-15%/14-18%% respectively led by expansion of tropical corn and ramp up in growth of sorghum and expects UPL Specialty Chemicals Manufacturing's FY24 revenue/EBITDA growth to be 10-14%/12-16% respectively led by foray into new chemistries and expansion in capacity of existing molecules.

- **FY24 capex guidance:** The management guided FY24 capex to be $350 million out of which $160 million will be spent on manufacturing, $20 million on Advanta capex and the balance on intangible assets for the global crop protection business.
- **Debt:** Net debt/EBITDA for FY23 stood at 1.5x and management aspires to take it to 1x. It guided that going forward the free cash flows generated will be used to repay the debt.
- **Impact on Q4 margins:** Q4 margins were hit by one-off idle capacity cost (Rs. 200-250 crore), inventory loss (Rs. 300-350 crores) and balance from unfavourable regional/product mix and increase in cost of production.
- **China impact:** The management said excess capacity post the opening of China has led to increase in supply and fall in prices of post patented products which could continue till H2FY24.
- **Working capital days:** Net working capital days decreased by 5 y-o-y to 64 days due to better inventory management and faster cash collections. Inventory/Receivables/Payables days decreased by 9/12/16 days respectively y-o-y.
- **Others:** 1) The management guided to half Nurture's FY23 EBITDA loss of Rs. 284 crores in FY24 and reach EBITDA breakeven by FY25, 2) The management said ROCE% for the global crop protection business is low whereas the other businesses have ROCE at 20-30%, 3) The management guided that the revenue contribution for specialty chemical business to increase from 10-12% to 32-35% in 4-5 years and 3) Differentiated & Sustainable Portfolio Grew 12% in FY23 led by volume growth.

Results (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Revenues	**16,569**	**15,861**	**4.5**	**13,679**	**21.1**
Total expenditure	13,847	12,481	10.9	10,795	28.3
EBIDTA	2,722	3,380	(19.5)	2,884	(5.6)
Adjusted EBITDA	**3,015**	**3,592**	**(16.1)**	**3,074**	**(1.9)**
Other Income	211	116	81.9	115	83.5
Depreciation	727	642	13.2	624	16.5
Interest	906	800	13.3	894	1.3
PBT	1,271	1,886	(32.6)	1,461	(13.0)
Tax	311	265	17.4	135	130.4
Reported PAT	792	1,379	(42.6)	1,087	(27.1)
Adjusted PAT	**821**	**1,547**	**-46.9**	**1,107**	**(25.8)**
Adjusted EPS (Rs.)	10.9	20.2	-45.9	14.8	(25.8)
Margins (%)			**bps**		**bps**
Adjusted OPM	18.2	22.6	(445)	22.5	(427)
Adjusted PAT Margin	5.0	9.8	(480)	8.1	(314)
Tax rate	24.5	14.1	1,042	9.2	1,523

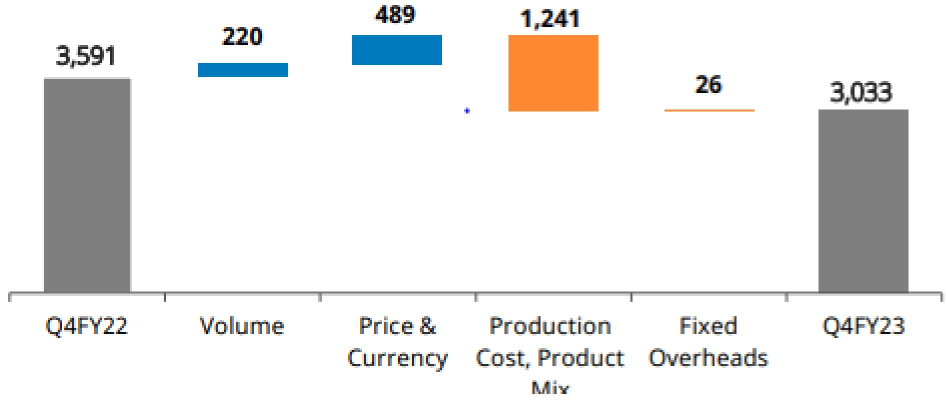
Source: Company; Sharekhan Research

Geographical revenue break-up Rs cr

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Latin America	6,444	5,761	11.9	5,974	7.9
Europe	2,800	2,629	6.5	1,444	93.9
North America	3,009	3,512	-14.3	2,745	9.6
India	1,588	1,384	14.7	1,075	47.7
Rest of the World	2,727	2,575	5.9	2,441	11.7
Total	**16,569**	**15,861**	**4.5**	**13,679**	**21.1**

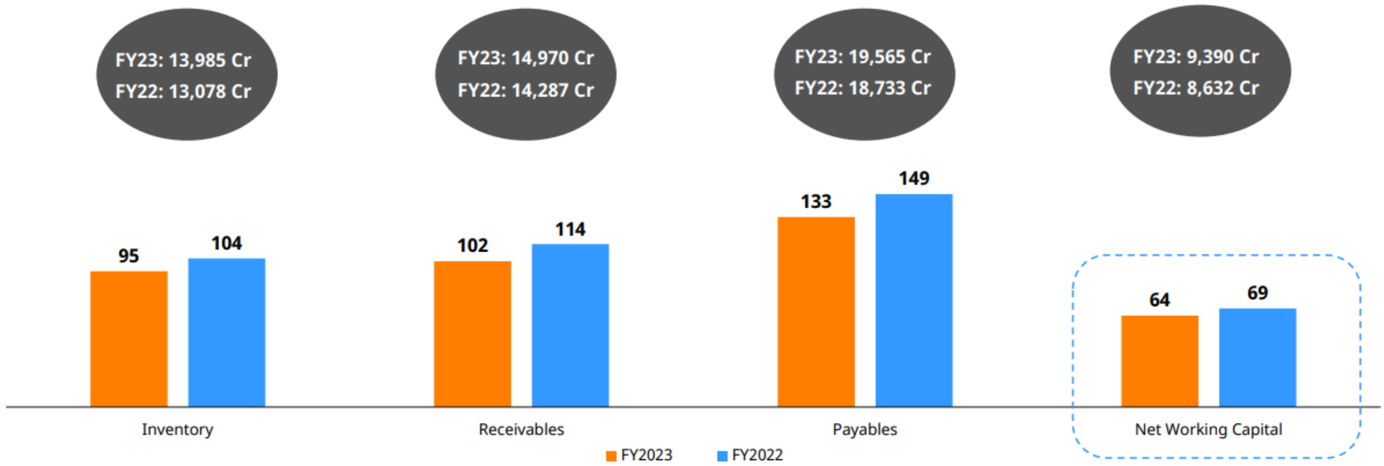
Source: Company; Sharekhan Research

Q4FY23 EBITDA bridge versus Q4FY22



Source: Company Data

NWC declined by 5 days to 64 days in FY23



Note: *Receivables sold as of 31 March'23 were INR 115 Bn (US$ 1.4 Bn); 31 March'22: INR 121 Bn (US$ 1.6 Bn); 31 Dec'22: INR 91 Bn (US$ 1.1 Bn)*

Source: Company Data

FY23 Cash Flow and Debt Position as on 31st March 2023

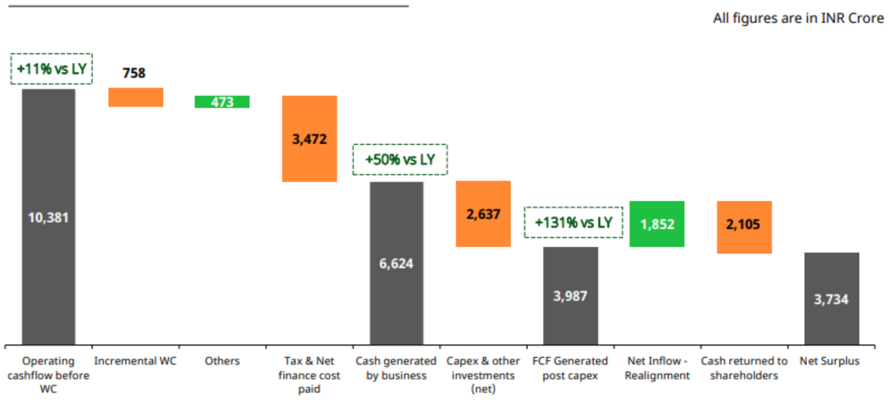
Net Debt Position - FY23

All figures are in INR Crore and US$ Mn

Particulars	FY23	FY22	Change
Gross Debt	22,999 $2,799	25,866 $3,416	(2,867) ($617)
Cash and cash equivalent	6,097 $742	6,960 $919	(864) ($177)
Net Debt	**16,902** **$2,057**	**18,906** **$2,497**	**(2,004)** **($440)**
Net Debt *'Adjusted for Currency Impact'*	**15,575**[1]	**18,906**	**(3,330)**
Net Debt to EBITDA	**1.53x**	**1.86x**	**-**

[1]Excluding impact of INR Depreciation in FY23 (from INR 75.72 on 31 Mar'22 to INR 82.17 on 31 Mar'23). INR Depreciation impact was INR 1,327 crore

Free Cash Flow Generated in FY23

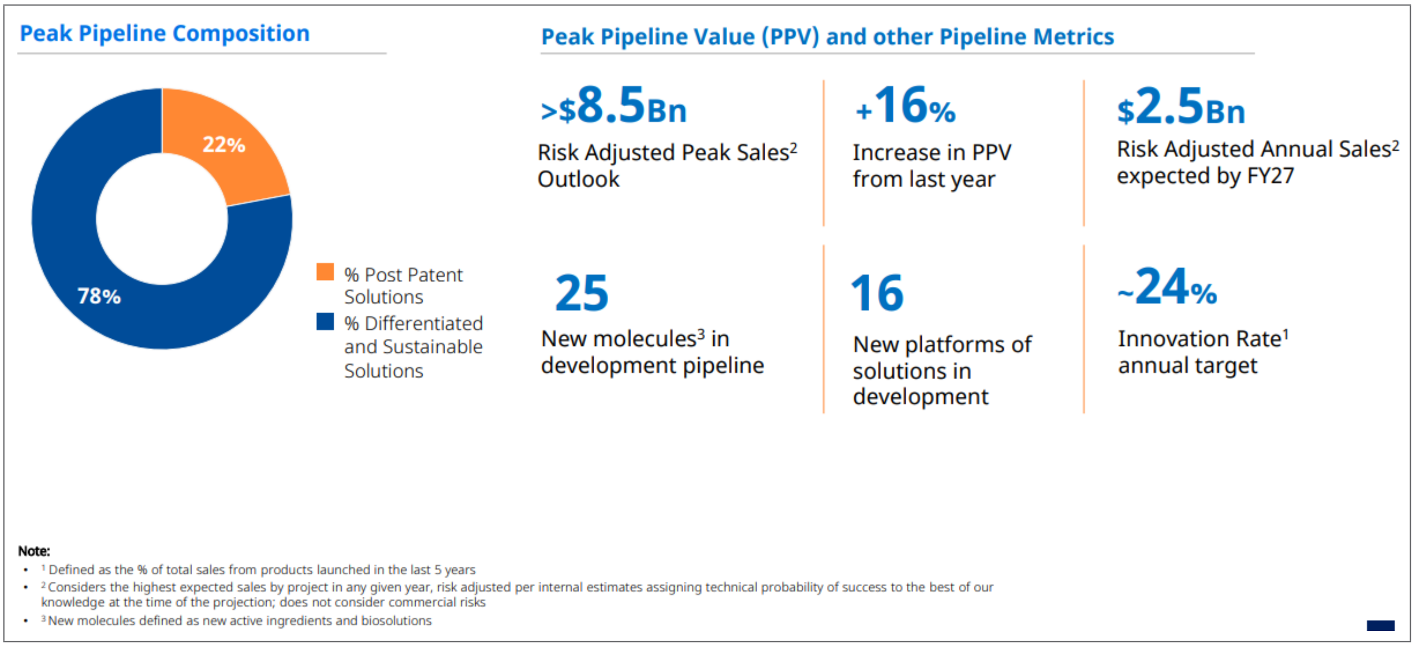


- **Strong Improvement in Cashflow Generation in FY23**
- **Utilized Higher Cash Flows to Deleverage and Return Cash to Shareholders:** Reduced gross debt by INR 2,867 crore (US$ 617 Mn) and returned INR 2,100 crore to shareholders through buyback and dividend
- **Reduced Net Debt by US$ 440 Mn despite lower factoring vs LY** (US$ 1.4 Bn in Mar'23 vs US$ 1.6 Bn in Mar'22)

Note: *Cash returned to shareholder includes dividends and buybacks. USD/INR Rates – FY23 (31st March'23): INR 82.17, FY22 (31st March'22): INR 75.72.*

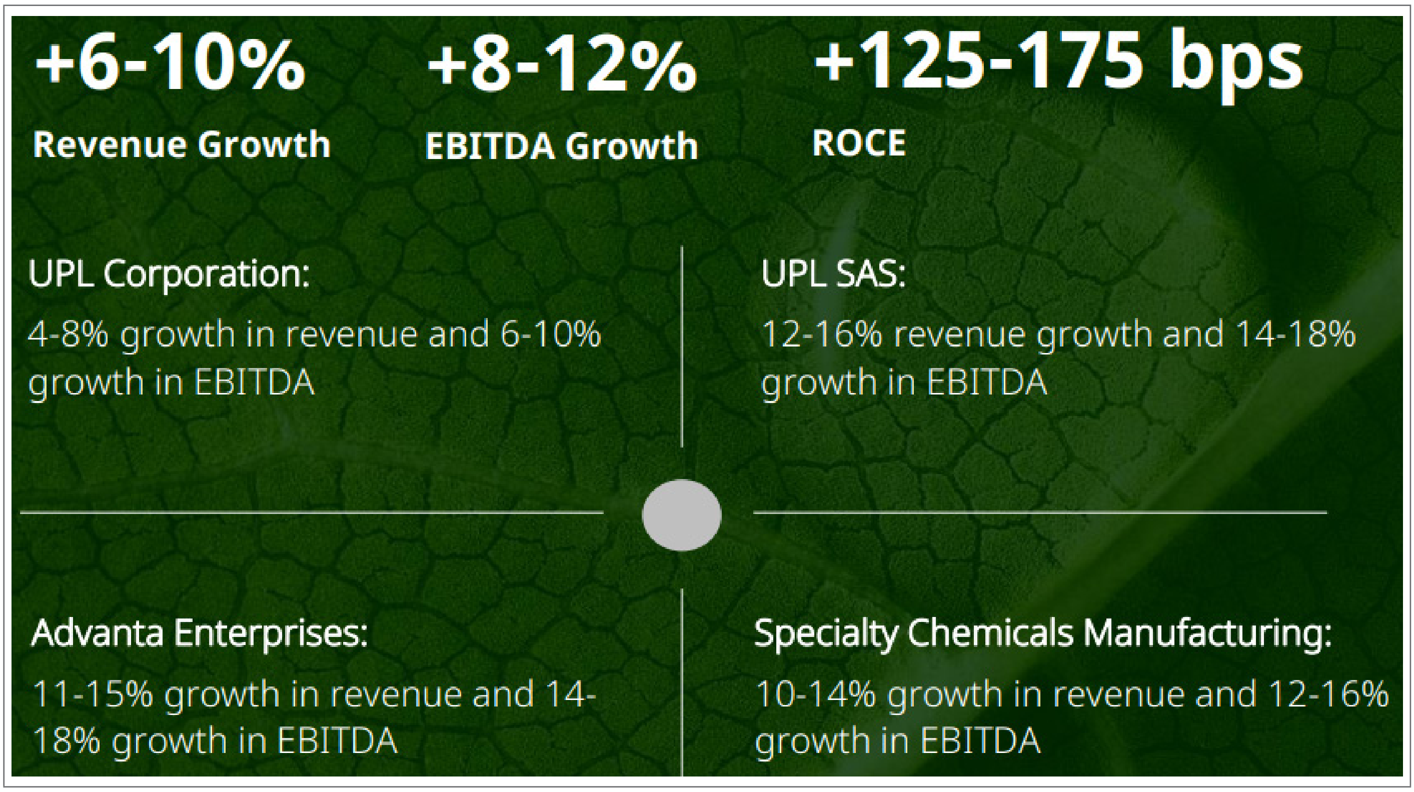
Source: Company Data

Crop protection + NPP BioSolutions pipeline



Source: Company Data

Revenue/EBITDA growth guidance for FY24



Source: Company Data

Outlook and Valuation

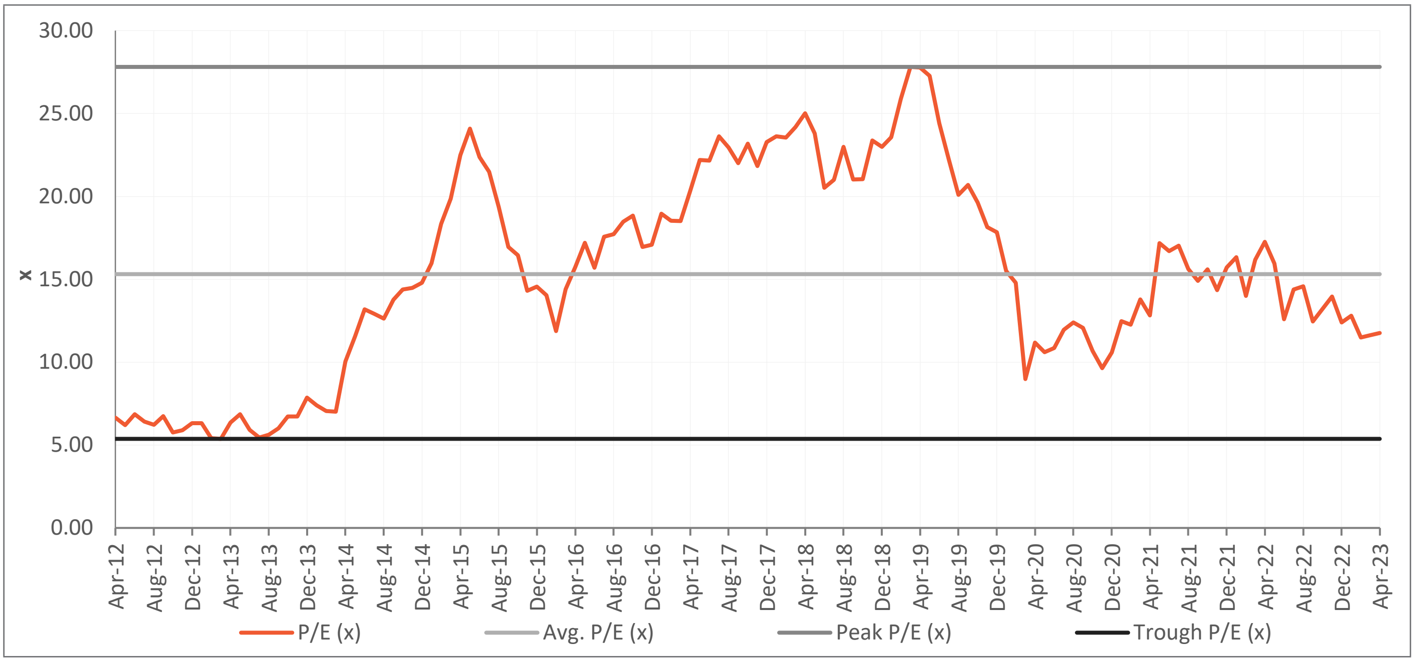
■ **Sector View – Rising food demand provides ample growth opportunities for agri-input players**

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 upon 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 FY2023-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 margins to 22-23%.

■ **Valuation – Maintain Buy on UPL with a revised PT of Rs. 880:** UPL's target to increase revenue share from differentiated and sustainable solutions would improve margin/earnings profile and drive sustainable growth in the medium to long term. Moreover, attractive valuations of 11.4x/8.9x its FY2024E/FY2025E EPS makes risk-reward favourable given strong earnings growth outlook (expect 27% PAT CAGR over FY23-25E). Hence, we maintain a Buy rating on UPL but with a lower PT of Rs. 880.

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.
- Continued oversupply of post-patented products may keep pricing/margin under check.

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

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by BNP PARIBAS

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