Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Insecticides (India) Ltd

Dismal Q4; subdued near term outlook but priced-in

Agri Chem	Sharekhan code: INSECTICID
Reco/View: Buy ↔	CMP: **Rs. 442**
	Price Target: **Rs. 540** ↓

↑ 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		↔	

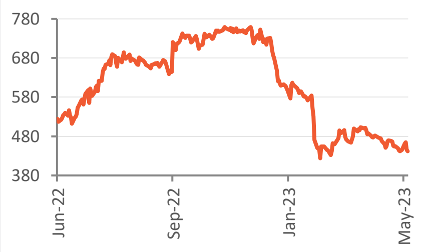
Company details

Market cap:	Rs. 1,308 cr
52-week high/low:	Rs. 789 / 420
NSE volume: (No of shares)	0.2 lakh
BSE code:	532851
NSE code:	INSECTICID
Free float: (No of shares)	0.82 cr

Shareholding (%)

Promoters	72
FII	6
DII	11
Others	11

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7.1	4.3	-40.7	-15.7
Relative to Sensex	-8.9	-1.7	-40.0	-27.6

Sharekhan Research, Bloomberg

Summary

- Q4FY23 results were weak as a net loss of Rs. 29 crore was significantly higher than our estimate of net loss of Rs. 4 crore due to negative OPM of 9.4% given the hit from provisions on liquidation of high-cost inventory and a mark-to-market (MTM) loss of Rs. 15-20 crore.
- Management guided revenue growth of 10-12% and subdued EBITDA margin of 9-10% (lower than 11-12% historically) for FY24 as liquidation of high-cost inventory would continue in Q1FY24. Ramp-up of recently commissioned capacity expansion at Chopanki & new products along with recovery in export revenues could drive earnings recovery over Q2FY24-FY25.
- We cut our FY24/FY25 earnings estimate sharply by 28%/22% to factor lower revenue/margin guidance which reflects near-term concerns amid high channel inventory and product prices pressure given excess supply from China.
- The steep 40% fall in stock price in CY23YTD largely factors in margin concerns. Ramp-up of new capacity and recovery in export revenue could drive earnings recovery from Q2FY24. Hence, we maintain a Buy on Insecticides (India) but with a lower PT of Rs. 540. Valuation of 13x/9x its FY2024E/FY2025E EPS is attractive.

Insecticides (India) Limited (IIL) reported weak Q4FY2023 results with loss at operating level as erosion in gross margins and higher operating cost led to negative OPM. Consolidated revenues grew by 8.6% y-o-y to Rs. 302 crore (in-line with our estimates) led by volume growth despite pressure on product prices. B2C/exports revenues grew by 36%/52% y-o-y to Rs. 106 crore/Rs. 42 crore while B2C revenues declined by 11% y-o-y to Rs. 154 crore. The gross margin of 12.4% (down 1919 bps y-o-y) was 759 bps below our estimate of 20% as the company had to take hit for provision related to liquidation of high-cost inventory and mark-to-market (MTM) loss of Rs. 15-20 crore in Q4FY23. A significantly lower gross margin and higher operating cost (employee/other expenses were up by 7%/31% q-o-q) led to negative OPM of 9.4% (versus estimate of 1.8%). Consequently, the company posted operating loss/net loss of Rs. 28 crore/Rs. 29 crore (versus operating profit/PAT of Rs. 34 crore/Rs. 22 crore in Q4FY22) which was well below our operating profit/net loss estimate of Rs. 6 crore/Rs. 4 crore.

Key positives

- B2C/exports revenue grew by 36%/52% y-o-y.

Key negatives

- Gross margin shrunk sharply by 1,919 bps y-o-y to 12.5%.
- Negative OPM of 9.4% versus an estimated positive OPM of 1.8%.

Management Commentary

- Management expects revenue to grow by 10-12% in FY24 with the EBITDA margin to remain in the range of 9%-10%.
- Q4 margins came under pressure due to high-cost inventory purchased before sudden price corrections, MTM/forex losses and low selling prices. High-cost inventory effect will spill over in Q1FY24, and the trend of falling prices will see a reversal soon.
- Company launched 6 products in FY23 and will launch 4-5 products in FY24. Company launched the granule insecticide “Mission” used for paddy and sugarcane in Q4FY23 and plans to introduce its liquid version in Q1FY24.
- It commenced production at the upgraded Chopanki (Rajasthan) facility in Q4 and acquired new site at Sotalana (Rajasthan) which will be used for Formulations in Phase 1 and for Technicals and Biologicals in Phase 2.
- Company is working on registration in new countries with over 100 export agreements and is planning to increase exports to more than 25 countries to serve over 100 clients by FY24.

Revision in estimates – We have sharply cut our FY24-25 earnings estimate to factor in near term demand and margin pressure.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 540: While the near-term margin concern would continue for IIL until higher cost inventory is fully liquidated but steep 40% fall in the stock price in CY23YTD largely factors in concern of high channel inventory in the system. In fact, Q2FY24 is likely to witness a rebound supported by ramp-up of new products post capacity expansion and a potential recovery in margin with a rise in share of high margin branded products (Maharatna brands). Thus, we expect a strong EBITDA/PAT CAGR of 40%/52% over FY2023-FY2025E along with healthy RoE of 18% on low base of FY23 (PAT decline of 41%). Hence, we maintain our Buy rating on IIL but with a lower price target (PT) of Rs. 540. At CMP, the stock is trading at an attractive valuation of 13x its FY2024E EPS and 9x its FY2025E EPS.

Key Risks

Poor demand or delayed product launches is likely to affect revenue visibility, while volatility in input costs may impact margins. The government’s intention to ban 27 pesticides could impact the company’s performance; but the final decision is yet to come.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	1,504	1,801	1,981	2,279
OPM (%)	11.3	6.8	9.0	10.5
Adjusted PAT	107	63	100	146
y-o-y growth (%)	3.7	(41.2)	58.2	45.6
Adjusted EPS (Rs.)	36.3	21.4	33.8	49.2
P/E (x)	12.3	20.9	13.2	9.1
P/B (x)	1.5	1.4	1.3	1.1
EV/EBITDA (x)	7.8	12.0	7.6	5.7
RoCE (%)	15.8	9.6	13.6	18.0
RoE (%)	12.7	7.1	10.4	13.5

Source: Company; Sharekhan estimates

Q4 net loss due to margin erosion amid liquidation of high-cost inventory & high cost

Q4FY2023 results were weak with loss at operating level as erosion in gross margins and higher operating cost led to negative OPM. Consolidated revenues grew by 8.6% y-o-y to Rs. 302 crore (in-line with our estimates) led by volume growth despite pressure on product prices. B2C/exports revenues grew by 36%/52% y-o-y to Rs. 106 crore/Rs. 42 crore while B2C revenues declined by 11% y-o-y to Rs. 154 crore. The gross margin of 12.4% (down 1919 bps y-o-y) was 759 bps below our estimate of 20% as the company had to take hit for provision related to liquidation of high-cost inventory and mark-to-market (MTM) loss of Rs. 15-20 crore in Q4FY23. A significantly lower gross margin and higher operating cost (employee/other expenses were up by 7%/31% q-o-q) led to negative OPM of 9.4% (versus estimate of 1.8%). Consequently, the company posted operating loss/net loss of Rs. 28 crore/Rs. 29 crore (versus operating profit/PAT of Rs. 34 crore/Rs. 22 crore in Q4FY23) which was well below our operating profit/net loss estimate of Rs. 6 crore/Rs. 4 crore.

Q4FY23 conference call highlights

- **Revenue and EBITDA guidance:** The management expects topline to grow by 10%-12% in FY24, mainly driven by commencement of new facilities, addition of new-generation products and adding a significant number of product registrations in the export market. New-generation products will not only help topline grow but also aid margin accretion. EBITDA margin is expected to stay at 9-10%.
- **Q4 margin pressure:** Q4 EBITDA margins were under pressure due to the high-cost inventory purchased before price corrections (sudden 20% to 50% drop in raw material purchases from China) and forex losses. The company has also booked MTM losses for inventory amounting to Rs. 14 crores in FY23. Around 70% of sales were of high-cost inventory and company was compelled to sell the goods at competitive prices in the market. The high-cost inventory effect will spill over into Q1FY24, but company is actively liquidating the inventory and implementing measures to stabilise its margins from Q2 onwards. Management said the low prices are not sustainable and will see a price reversal soon.
- **Product launches:** The company has launched a total of 6 products in FY23 and expects an increase in contribution from new generation products in FY24. The company also plans to launch 4-5 products in FY24. The company has launched the granule insecticide “Mission” used for paddy and sugarcane in Q4FY23. A liquid version of Mission will be introduced in Q1FY24 intended for use on multiple crops.
- **Expansion project update:** IIL commenced production at the upgraded Chopanki (Rajasthan) facility in Q4 which will enable the company to reduce its dependency on China for raw materials, achieve cost reductions, facilitate backward integration and strengthen its B2B business through new products and molecules from the plant. Company has also acquired new site (over 15 acres) at Sotalana (Rajasthan) to enhance the capacity of formulation facilities and present an opportunity to establish new R&D centers. Company expects to start Phase 1 of Formulations by end of FY24 and could also start manufacturing Technicals and Biologicals in Phase 2 later.
- **Export focus:** IIL is working on registration in new countries with over 100 export agreements and is planning to increase exports to more than 25 countries to serve over 100 clients by FY24.

Results (Consolidated) | **Rs cr**

Particulars	Q4FY23	Q4FY22	Y-o-Y %	Q3FY23	Q-o-Q %
Revenue	**302**	**278**	**8.6**	**357**	**(15.3)**
Total expenditure	330	244	35.2	333	(0.9)
Operating profit/(loss)	**(28)**	**34**	**NA**	**23**	**NA**
Other Income	0	2	(80.2)	0	10.2
Depreciation	7	7	(2.0)	6	3.2
Finance Cost	4	1	320.8	5	(7.8)
Profit/(loss) before tax	(39)	28	NA	12	NA
Tax	(10)	6	NA	3	NA
Reported PAT/(loss)	**(29)**	**22**	**NA**	**9**	**NA**
Reported EPS (Rs.)	(9.9)	7.5	NA	3.2	NA
Margin			**BPS**		**BPS**
OPM	(9.4)	12.2	NA	6.5	NA
Adjusted NPM	(9.7)	8.0	NA	2.6	NA
Tax rate	25.5	20.3	515	24.8	73

Source: Company; Sharekhan Research

Revenue mix by segments | **Rs cr**

Particulars	Q4FY23	Q4FY22	Y-o-Y %	Q3FY23	Q-o-Q %
B2C	154	172	-10.7%	278	-44.6%
BCB	106	78	35.8%	64	64.6%
Exports	42	28	52.0%	14	196.4%
Total revenues	**302**	**278**	**8.6%**	**357**	**-15.3%**
Revenue mix (%)			**bps**		**bps**
B2C	51.0	62.0	-1100	78.0	-2700
BCB	35.0	28.0	700	18.0	1700
Exports	14.0	10.0	400	4.0	1000

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Rising food demand provides 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 and Farm Services Bill). Moreover, there is a vast opportunity from products going off-patent. The government's focus is to double farmers' income (higher MSPs for crops); near-normal monsoons and higher reservoir levels would augment demand for agri-input in India. We also expect exports from India to grow strongly as India is being looked as the preferred supplier for agri-input products, given supply disruptions from China. Thus, we expect India's agrochemical industry to grow by 7-8% annually on a sustained basis over the next few years.

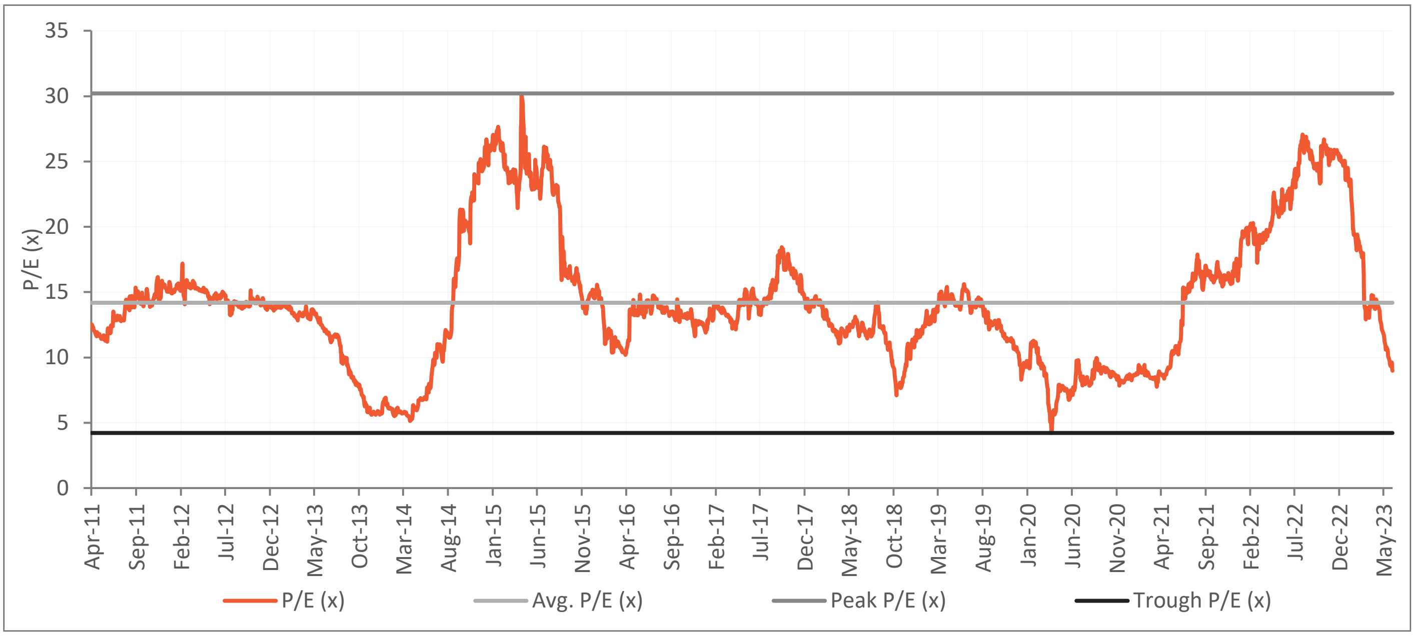
■ Company Outlook – Near-term demand/margin concern; recovery hinges on ramp-up of new capacity & timely liquidation of high-cost inventory

IIL's management guided revenue growth of 10-12% and subdued EBITDA margin of 9-10% (lower than historical range of 11-12%) as high-cost inventory liquidation would continue in Q1FY24. We believe that ramp-up of recently commissioned capacity expansion at Chopanki, new production and recovery in export revenue given higher registration could drive earnings recovery over Q2FY24-FY25. We expect a 52% PAT CAGR over FY2023-2025E on a low base of FY23.

■ Valuation – Maintain Buy with a revised PT of Rs. 540

While the near-term margin concern would continue for IIL until higher cost inventory is fully liquidated but steep 40% fall in the stock price in CY23YTD largely factors in concern of high channel inventory in the system. In fact, Q2FY24 is likely to witness a rebound supported by ramp-up of new products post capacity expansion and a potential recovery in margin with a rise in share of high margin branded products (Maharatna brands). Thus, we expect a strong EBITDA/PAT CAGR of 40%/52% over FY2023-FY2025E along with healthy RoE of 18% on low base of FY23 (PAT decline of 41%). Hence, we maintain our Buy rating on IIL but with a lower price target (PT) of Rs. 540. At CMP, the stock is trading at an attractive valuation of 13x its FY2024E EPS and 9x its FY2025E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

IIL is India's leading and one of the fast-growing agrochemical companies. The company has emerged as a frontline performer in India's crop care market and is all set to grow impressively. The company has more than 100+ formulation products and 22 technical products and manufactures all types of insecticides, weedicides, fungicides, and PGRs for all types of crops and households. The company owns the prestigious Tractor brand, which is highly popular among farmers. This umbrella brand of its agro products, such as Lethal, Victor, Monocil, Xplode, Hijack, Pulsor, and Hakama, signifies IIL's deep connection with farmers.

The company has five state-of-the-art formulation facilities in Chopanki (Rajasthan), Samba, Udhampur (Jammu & Kashmir), and Dahej (Gujarat). The company also has two technical synthesis plants at Chopanki and Dahej to manufacture technical-grade chemicals, providing a competitive edge by backward integration. The company also has a bio manufacturing unit and four dedicated research facilities. The company markets its products through more than 60,000 retail outlets with the help of 3,000 distributors and 31 depots/branches having sales team of over 500 personnel.

Investment theme

Strategic transition yielding results: IIL's management took strategic steps towards realigning the product mix by introducing NewGen products through higher R&D thrust and weeding out the old generic products for more sustainable growth visibility with improved margin trajectory. The transition has started yielding results, with strong new launches and improved margins.

Four growth pillars driving performance: IIL's management has chalked out a four-prolonged strategy for long-term sustainable growth acceleration with new product launches – (1) reverse engineering; (2) combination products; (3) biological products; and (4) product discovery.

Key Risks

- Poor demand offtake or delay in the launch of new products is likely to affect revenue visibility, while volatility in input cost may impact margin profile.
- The government's intention to ban 27 pesticides could have an adverse impact on the company's performance; however, the final decision is yet to come.

Additional Data

Key management personnel

Hari Chand Aggarwal	Chairman
Rajesh Aggarwal	Managing Director
Mrs. Nikunj Aggarwal	Whole Time Director
Sandeep Aggarwal	Chief Financial Officer
Sandeep Kumar	Company Secretary and Compliance office

Source: Company Website

Top shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	8.79
2	Nippon Life India Asset Management	1.71
3	FMR LLC	0.81
4	Dimensional Fund Advisors LP	0.39
5	American Century Cos Inc	0.01

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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Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. (CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

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Compliance Officer: Ms. Binkle Oza; Tel: 022-61169602; email id: complianceofficer@sharekhan.com

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