InCred Equities

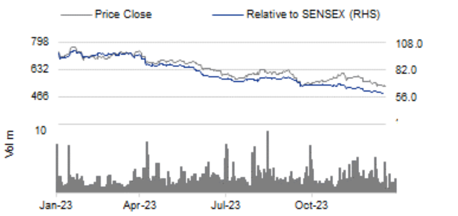
UPGRADE

## India

**ADD** *(previously HOLD)*

| Consensus ratings*: | Buy 23 Hold 7 Sell 2 |
|---|---|
| Current price: | Rs534 |
| Target price: ▼ | Rs694 |
| Previous target: | Rs754 |
| Up/downside: | 30.0% |
| InCred Research / Consensus: | 4.6% |
| Reuters: | UPLL.NS |
| Bloomberg: | UPLL IN |
| Market cap: | US$4,830m |
| | Rs400,562m |
| Average daily turnover: | US$19.3m |
| | Rs1598.9m |
| Current shares o/s: | 765.0m |
| Free float: | 67.7% |

**Source: Bloomberg*




*Source: Bloomberg*

| Price performance | 1M | 3M | 12M |
|---|---|---|---|
| Absolute (%) | (10.2) | (1.3) | (23.4) |
| Relative (%) | (10.3) | (11.9) | (35.3) |

| Major shareholders | % held |
|---|---|
| Promoter & Group | 32.3 |
| Life Ins. Corp. of India | 7.3 |
| ICICI Prudential | 3.0 |

# UPL Limited

## Going through worst phase-buy on declines

- Agrochemical majors are being hit hard by high channel inventory. See report IN: Chemicals - Others - Agrochemicals - channel inventory too high.
- At this time of the cycle, it's imperative to save balance sheet and vendor base. UPL is doing right thing by not increasing receivables and saving its vendors.
- We value UPL at 20x FY26F P/E with a TP of Rs694. Stock remains volatile at cusp of cycle change. Buy aggressively on dips. Risk-reward 2:1, in our view.

### High channel inventory is hitting hard and UPL is no exception

Global agrochemical majors are being hit hard by high channel inventory and this is in line with our earlier report: IN: Chemicals - Others - Agrochemicals - channel inventory too high. We had asked investors to be cautious about various management claims and the same has happened. Please listen to the conference-call of UPL to get an idea about the extent of problem in the industry: (https://www.upl-ltd.com/investors/financial-results-and-reports/financial-results). While we believe the problem can remain for another two-to-three quarters, maybe it's the time to buy generic agrochemicals shares with a 12-month view. Please note that generic agrochemicals have bleak long term demand scenario hence, our recommendation to buy is purely because of a mean reversion of earnings.

### UPL is doing right by saving its balance sheet at the expense of EPS

Normally, when analysts project a Rs50 EPS and the company ends up on the path of doing -Rs40, then its management's propensity is to save P&L and sell on credit. We are very pleased to see these two things: 1) Receivables have not gone up significantly. 2) The company has increased its payables, which means it is saving the supply chain and the vendor base. Remember that unlike what was believed earlier, most Indian chemical companies sell cyclical products and there is no China+1 story in agrochemicals. Please listen to the commentary of agrochemicals majors and see how dumping by China is eroding the prices. Remember that, at best, customers can shift some of their volume to India but that doesn't mean they will offer significantly higher prices as well.

### We upgrade the stock to ADD with a 12-month target price of Rs694

UPL has not shown such a horrendous performance in the last 20 years, yet again fear-driven demand was understood by a few businesses and UPL is not alone. The fear was of getting materials on time and that's why everyone overstocked, and markets thought that demand had suddenly increased. This happened in steel, aluminium, chemicals, and agrochemicals (almost all commodities). There is no point in talking about the disaster of 3QFY24, as it was expected. When revenue declines, then normally the impact on P&L is always miscalculated. It happens during a period of steep rise as well as a steep fall in revenue. We value the stock at 20x FY26F EPS to arrive at a new target price of Rs694 (Rs754 earlier). When the cycle turns, the stock remains volatile and it's likely that UPL may fall 20% from here on but that will be the time for very aggressive buying. We see the risk-reward ratio at 2:1 from this point. Downside risk: China lowering its prices by 20-30%.

| Financial Summary | Mar-22A | Mar-23A | Mar-24F | Mar-25F | Mar-26F |
|---|---|---|---|---|---|
| Revenue (Rsm) | 462,400 | 535,760 | 409,155 | 490,986 | 589,183 |
| Operating EBITDA (Rsm) | 101,500 | 112,830 | 50,890 | 74,593 | 109,019 |
| Net Profit (Rsm) | 42,440 | 35,700 | (27,796) | 5,159 | 26,542 |
| Core EPS (Rs) | 59.3 | 60.7 | (18.5) | 16.7 | 44.5 |
| Core EPS Growth | 23.9% | 2.4% | (130.5%) | (189.9%) | 167.2% |
| FD Core P/E (x) | 9.62 | 11.44 | (14.69) | 79.14 | 15.38 |
| DPS (Rs) | 14.6 | 12.3 | 0.0 | 1.8 | 9.1 |
| Dividend Yield | 2.73% | 2.30% | 0.00% | 0.33% | 1.71% |
| EV/EBITDA (x) | 6.64 | 5.87 | 13.65 | 9.78 | 6.93 |
| P/FCFE (x) | 11.28 | (317.45) | 5.43 | 18.02 | 7.68 |
| Net Gearing | 64.5% | 47.6% | 56.0% | 59.2% | 56.3% |
| P/BV (x) | 1.66 | 1.37 | 1.46 | 1.39 | 1.26 |
| ROE | 22.9% | 19.2% | (5.5%) | 5.0% | 12.2% |
| % Change In Core EPS Estimates | | | (131.06%) | (72.08%) | (25.41%) |
| InCred Research/Consensus EPS (x) | | | | | |

SOURCE: INCRED RESEARCH, COMPANY REPORTS

### Research Analyst(s)

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# High channel inventory hits hard

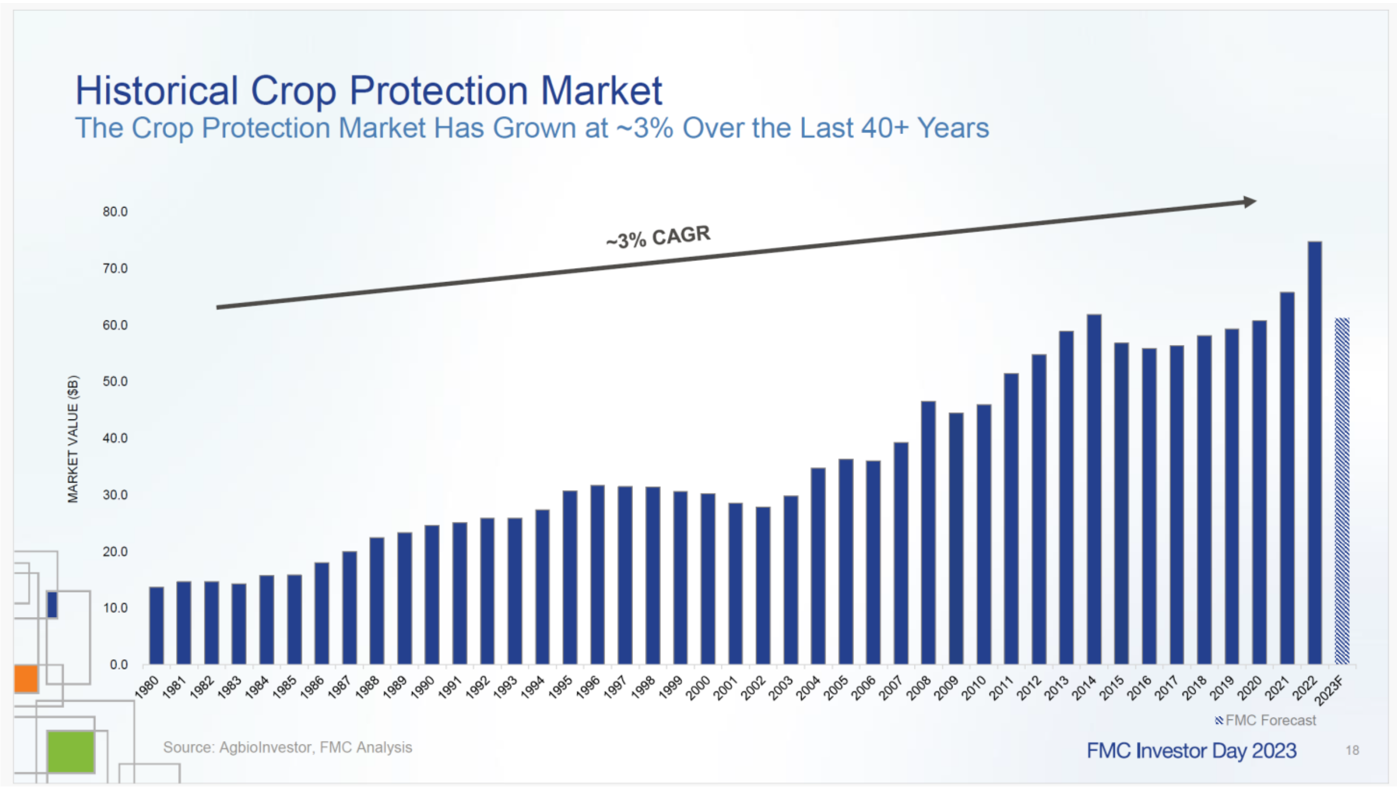
Global agrochemical majors are being hit hard by high channel inventory and this is in line with our earlier report: IN: Chemicals - Others - Agrochemicals - channel inventory too high. We had asked investors to be cautious about various management claims and the same has happened. Please listen to the call of UPL to get an idea about the extent of problem in the industry: (https://www.upl-ltd.com/investors/financial-results-and-reports/financial-results). While we believe the problem can remain for another two-to-three quarters, maybe it's the time to buy generic agrochemical companies' shares with a 12-month view. Remember generic agrochemicals have no future and hence, our recommendation to buy is purely because of a mean reversion in earnings.

## 2022-23 was a year when agrochemicals sales were driven by inventory-filling, which is being shed

The supply chain must shed 30% extra volume which got accumulated in CY22. While channel destocking is a tedious process, as per our estimate, it can spill over to a better part of CY24F as well. Probably, for Indian companies, FY25F will also be a washout.

### FMC stated that the rise in agrochemical sales in 2022 was ~20%

**Figure 1: Global agrochemical sales rose by 20% in CY22**

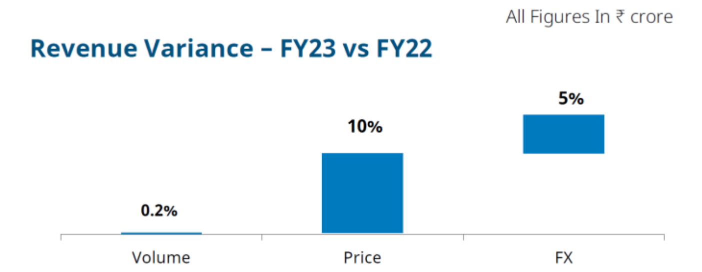



SOURCE: COMPANY REPORTS, INCRED RESEARCH

### It appears that volume growth was only 10% and the rest was driven by price rise

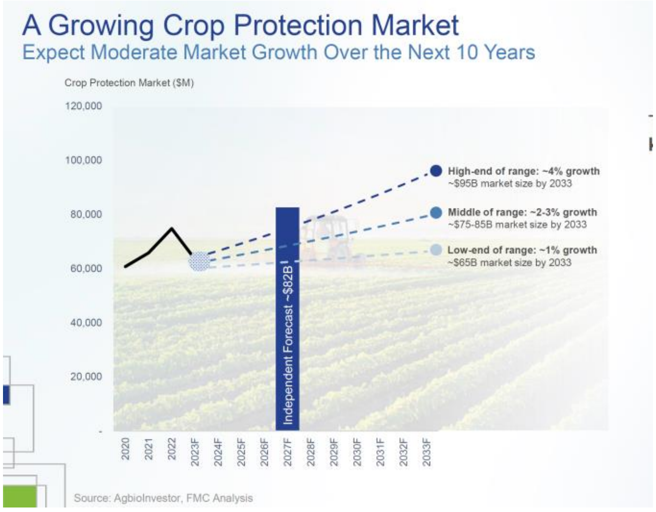
UPL's sales mix, which is a good indicator of the global generic agrochemicals market, indicates that volume grew by 10% and pricing by another 10%. Going ahead, global agrochemicals sales growth can fall to 1-1.5%, after the decline in CY23F.

**Figure 2: UPL's presentation gives a rough idea of the global agrochemicals sales volume growth of ~10%**




SOURCE: COMPANY REPORTS, INCRED RESEARCH

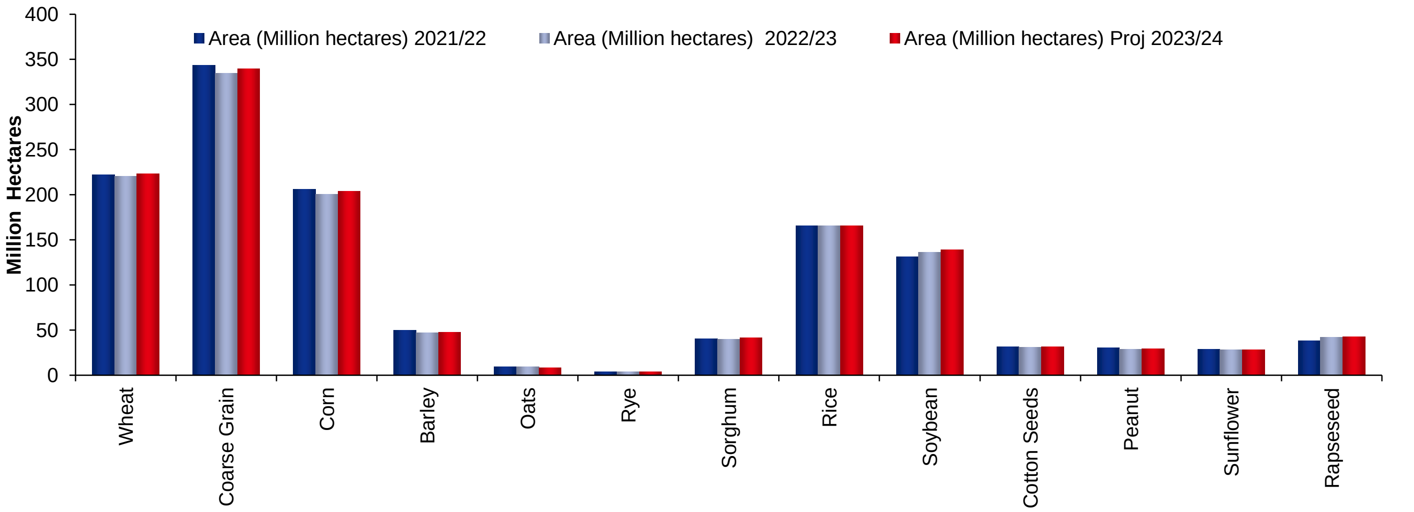
**Figure 3: As per FMC, growth in the coming years is likely to very tepid in US$ terms, at best 1-1.5%**




SOURCE: COMPANY REPORTS, INCRED RESEARCH

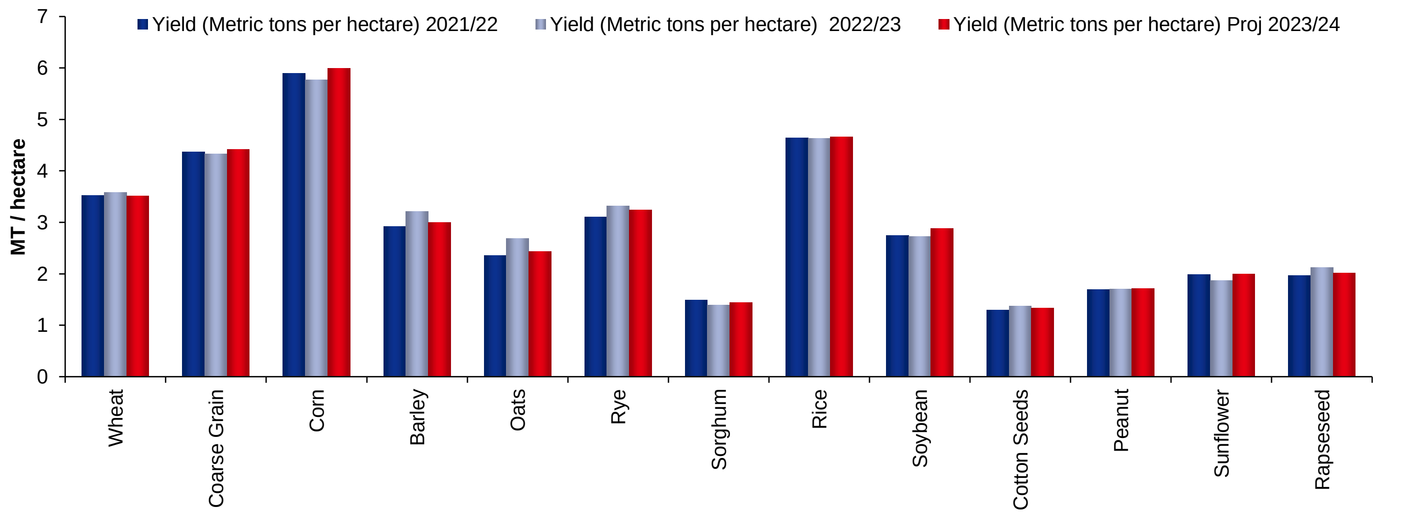
## It appears that all the extra volume was sold in the supply chain as global acreage for agri products is the same as it was in CY21 ➤

**Figure 4: We don't see any significant increase in global crop acreage in CY22-23…**




SOURCE: COMPANY REPORTS, INCRED RESEARCH

**Figure 5: …and neither there has been any increase in yields or any big incident of insect or fungus attack globally**




SOURCE: INCRED RESEARCH, COMPANY REPORTS

All the above data suggests that extra sales have gone into channel-filling.

### It appears the supply chain must shed 30% extra volume which, in turn, means two years of negative growth

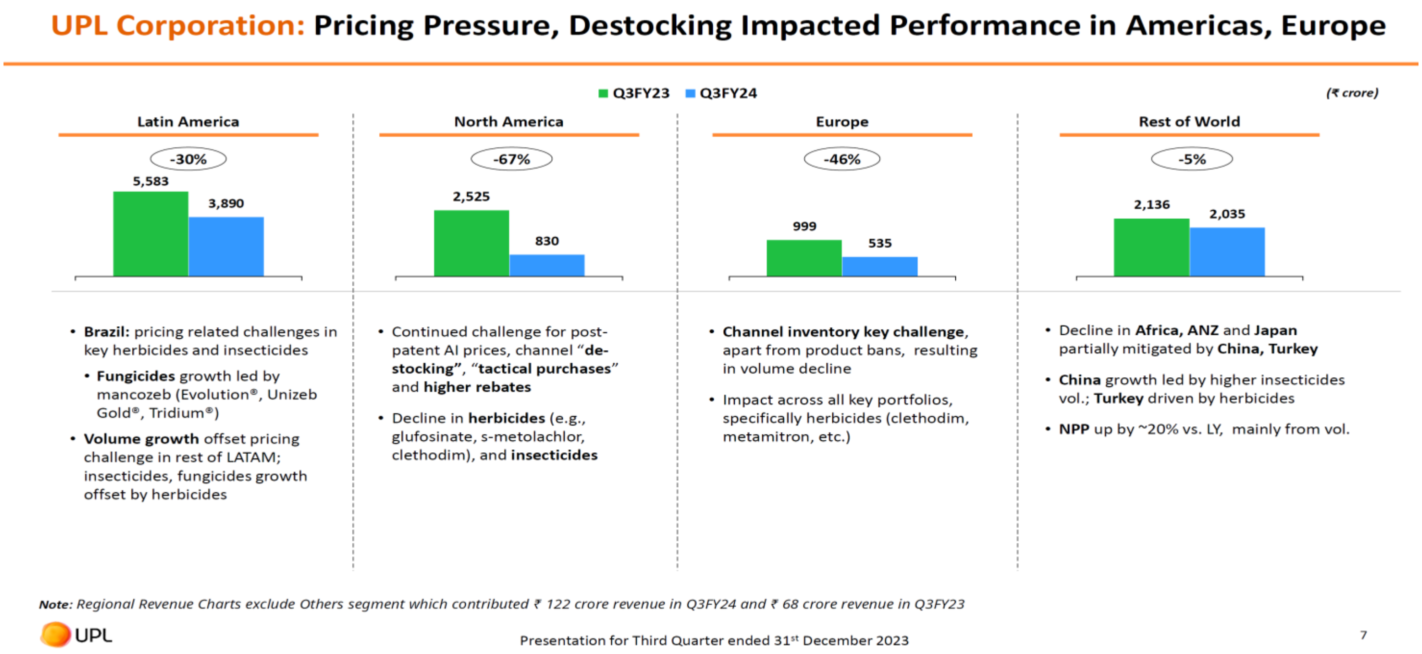
The supply chain must shed 30% extra volume, which got accumulated in CY22. While channel destocking is a tedious process, as per our estimate, it can spill over to a better part of CY24F as well. Probably, for Indian companies, FY25F will also be a wash out.

## The commentary of the generic agrochemical majors is indicating the pain in the system

### UPL is saying that it may take longer than earlier indicated to revive sales

In a sharp contrast to its earlier comments, UPL now claims that it will take longer to come out of the oversupply, inventory overhang and pricing pressure scenario.

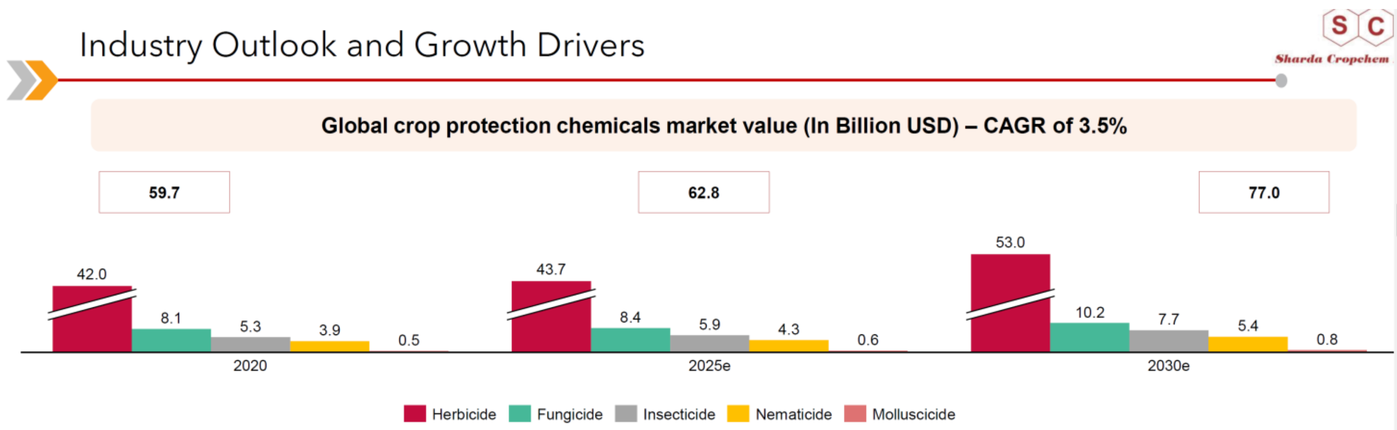
**Figure 6: The decline in revenue in key regions shows the extent of channel overstocking - it will make at least another two-to-three quarters before things come back to the earlier trajectory of 1-2% growth**




SOURCE: INCRED RESEARCH, COMPANY REPORTS

### Even Sharda Cropchem, which runs a distribution business, is taking a bearish stance

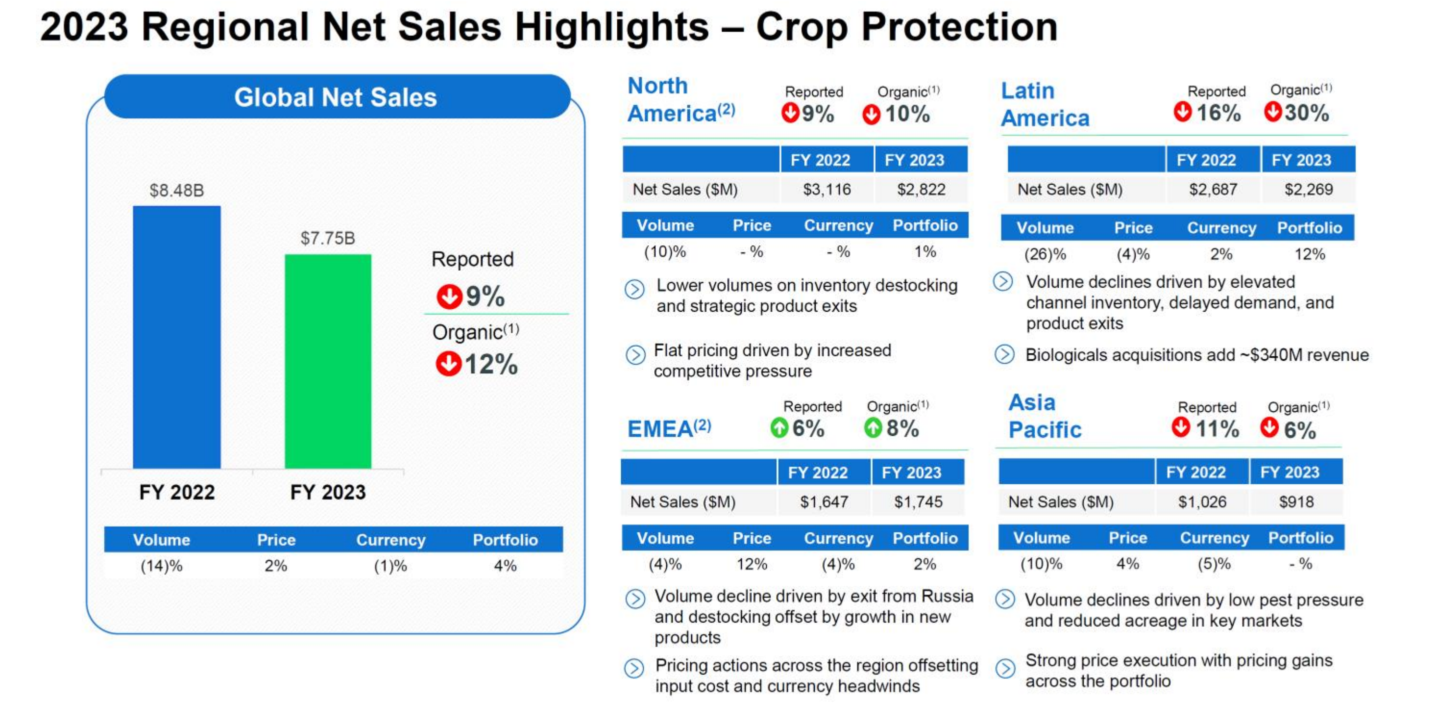
**Figure 7: Combining FMC and Sharda Cropchem data, it's clear that industry sales will decline for the next three years but the big purge in channel inventory will happen in the next two quarters (some hit has already taken place in 3QFY24)**




SOURCE: INCRED RESEARCH, COMPANY REPORTS

## Even Corteva has suffered massively in the agrochemicals business ›

Figure 8: Corteva's agrochemical business has suffered massively

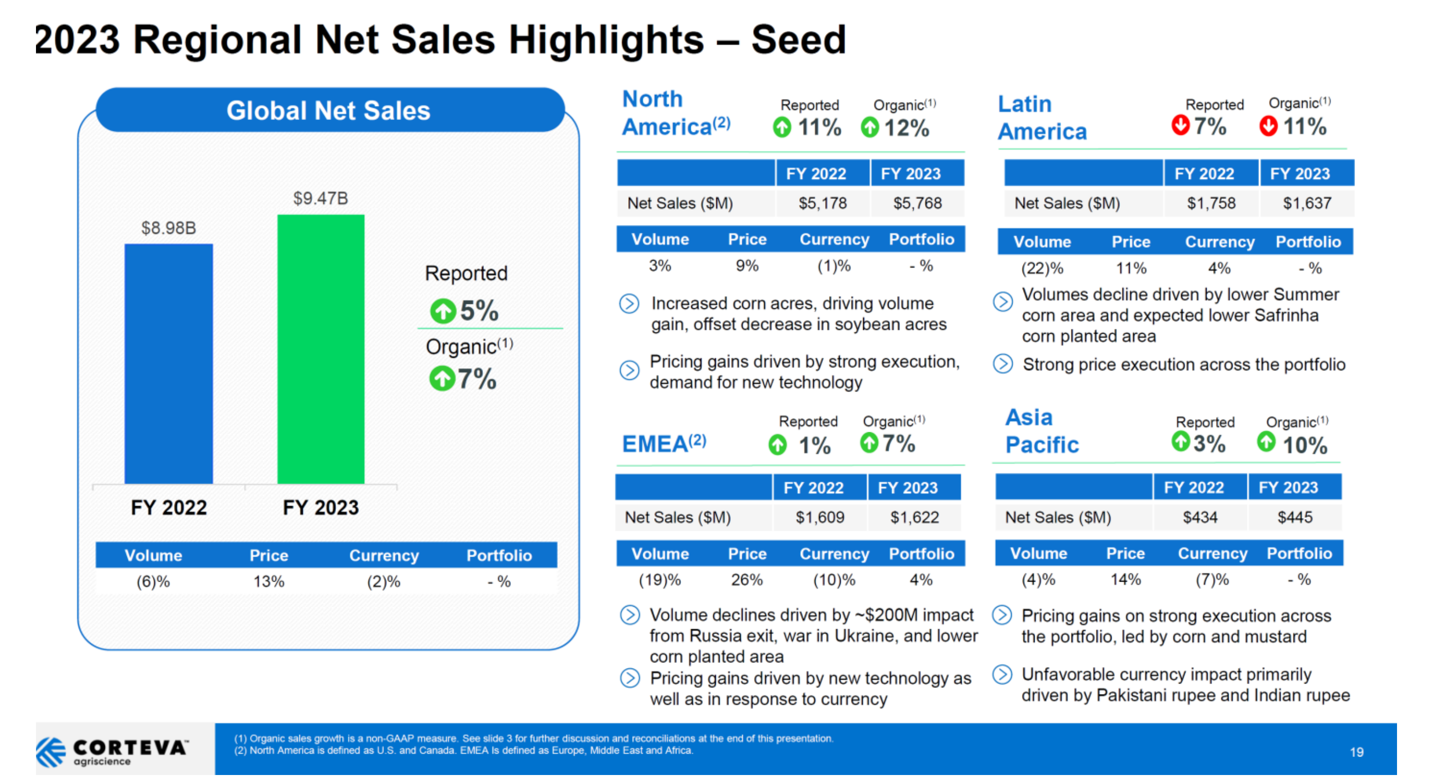



SOURCE: INCRED RESEARCH, COMPANY REPORTS

## However, Corteva's as well as UPL's seed business has done pretty well in North America and Asia ›

The seed business has done quite well in the Asia Pacific region as well as North America for both Corteva and UPL, as seeds are a perishable item and normally cannot be overstocked in the supply chain.

Figure 9: Corteva has done quite well in seed sales in North America and Asia




SOURCE: COMPANY REPORTS, INCRED RESEARCH

**Figure 10: Even UPL's seed business has done well because its mainly present in the Asia Pacific region**

## Advanta: Delivered Healthy Growth with Improved Margins in 9MFY24

| (₹ Crore ) | Q3 FY24 | Q3 FY23 | YoY% | 9M FY24 | 9M FY23 | YoY% |
|---|---|---|---|---|---|---|
| **Revenue** | 898 | **910** | (1%) | 3,029 | **2,724** | 11% |
| **Contribution Profit** | **567** | **526** | **8%** | **1,831** | **1,539** | **19%** |
| ***Contribution Margin*** | ***63.2%*** | ***57.9%*** | ***531 bps*** | ***60.5%*** | ***56.5%*** | ***395 bps*** |
| Fixed Overheads | 304 | 265 | 15% | 938 | 768 | 22% |
| **EBITDA** | **264** | **262** | **1%** | **893** | **771** | **16%** |
| ***EBITDA Margin*** | ***29.4%*** | ***28.7%*** | ***63 bps*** | ***29.5%*** | ***28.3%*** | ***118 bps*** |

***Note:*** *Q3FY23 and 9MFY23 financials restated to represent Advanta Enterprises Limited*

### Q3 & 9MFY24 Performance Update

- Revenue Variance:
  - **9MFY24 up 11% driven by** higher prices and volumes in Sunflower, Corn, Canola, Sorghum & Vegetables portfolios
  - **Q3FY24 flat vs LY due to** lower sales of Sunflower (Argentina, Europe), Corn (Ecuador), and Sorghum (Brazil, US)
- **Contribution margins up ~531 bps YoY in Q3 and ~395 bps YoY in 9M** driven by improved mix, lower COGS and improved B2C performance in Indonesia and Vietnam
- **Healthy EBITDA growth in 9MFY24** driven by improved contribution margins and controlled overheads

### Outlook

- **Expect to close FY24 with low-double digit growth in EBITDA**

SOURCE: COMPANY REPORTS, INCRED RESEARCH

### Based on sales numbers of key global players, we can guesstimate that agrochemicals market in 2023 may have shrunk by 15% ➤

While we don't have concrete data but as per our guesstimate, global agrochemicals market may have shrunk by ~15% (in value terms) in CY23. This, in turn, means that CY23 sales were ~US$62bn. It's likely that we may see a further 5-10% decline in the market during CY25F.

## UPL's problems will linger for the next two-to-three quarters, but buy the stock now

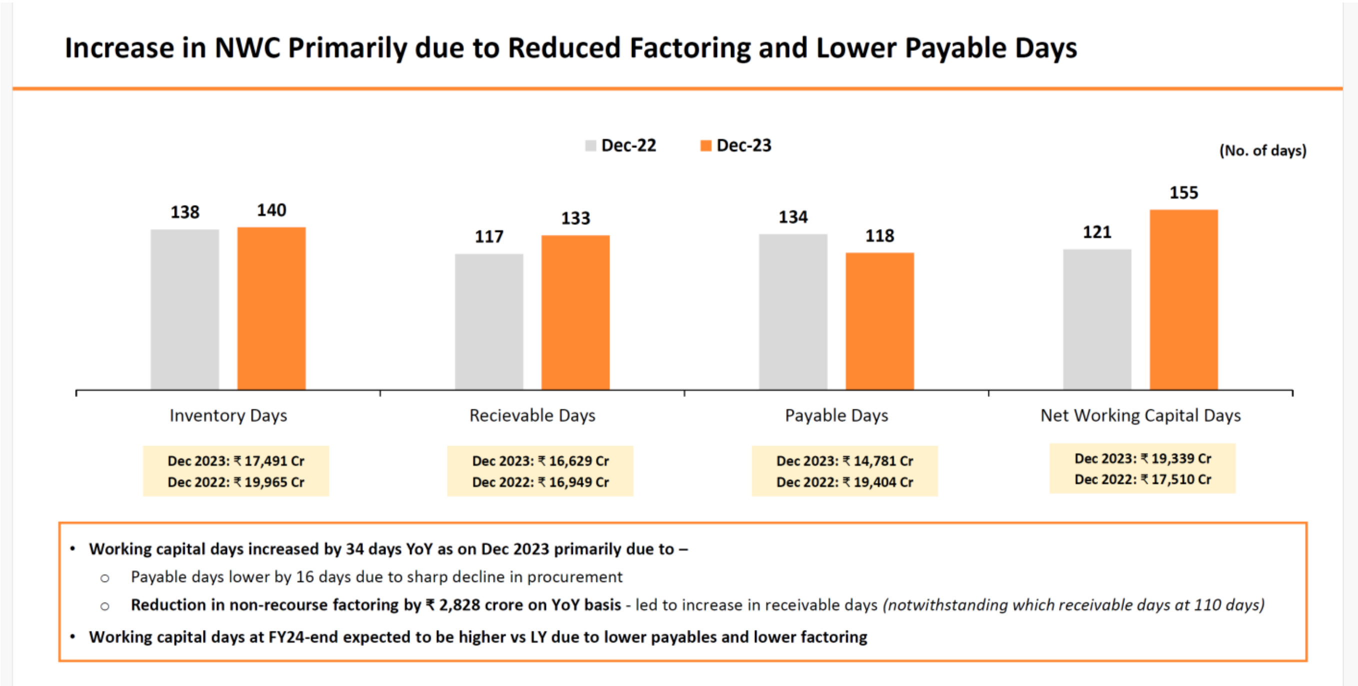
While the conference-call tone was unmistakeably of being resigned to fate, it's possible that when the markets open on Monday the stock may open 5-10% down but that's the time to accumulate it. While the P&L will look horrible for a couple of quarters, but we trust the cycle and bet on management maintaining the balance sheet. The urgency to show lower losses appears to be less now or else UPL would have been sitting on much higher receivables as of now.

### P&L will turn horrible for the next two-to-three quarters ➤

We believe that UPL will make losses in 4QFY24F as well and FY24F will be the worst year for the company in terms of P&L. Its management's propensity to save the balance sheet at the expense of P&L will be a clear indicator of how soon the P&L business recovers. While it may look ugly to show a loss of Rs40/share in FY24F when consensus was projecting Rs50 EPS at the beginning of the year, the desire to show lower losses must be curbed.

## As of now, management appears to be on the right path and is protecting the balance sheet

**Figure 11: UPL has not increased its receivables days significantly, which is a clear indicator that it understands the cycle and is not leveraging its balance sheet unnecessarily; the increase in payable days is good as the company is saving its vendor base; lower volume and increased payables days would have killed its vendors**

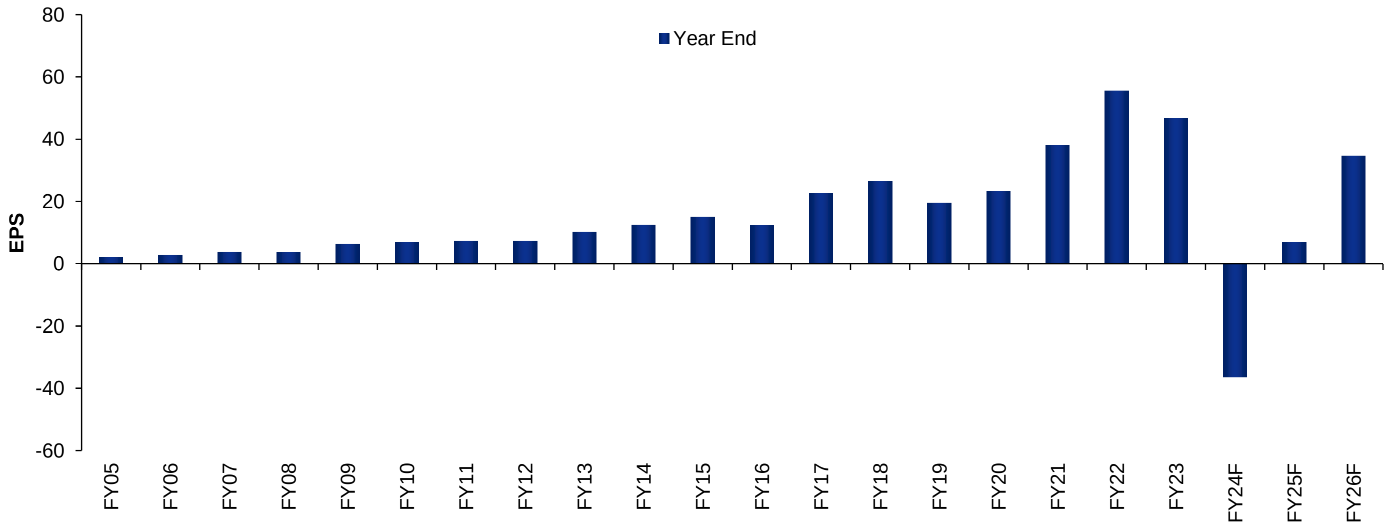



SOURCE: INCRED RESEARCH, COMPANY REPORTS

## There is no point in talking about margins and growth at this point of the cycle

UPL has not shown such a horrendous performance in the last 20 years but yet again the Covid-19 pandemic-driven bullishness and fear-driven demand was understood by a few businesses and UPL is not alone in this.

**Figure 12: There is no point in talking about the disaster of 3QFY24, as it was expected; when revenue declines, then normally the impact on P&L is always miscalculated; it happens during the period of a steep increase as well as a steep decline in revenue**




SOURCES: COMPANY REPORTS, INCRED RESEARCH

## We expect excess inventory in the supply chain to be absorbed by 2QFY25F

As we have stated earlier, we expect the excess inventory in the supply chain to be absorbed by 2QFY25F. We expect global agrochemicals sales to decline in 1QCY25 and the start stabilizing, which will give some breathing space for UPL from 2QFY25F.

## Buy only if you can withstand seeing losses for atleast one more quarter as the stock can fall by 10-12%, but the risk-reward ratio is favourable

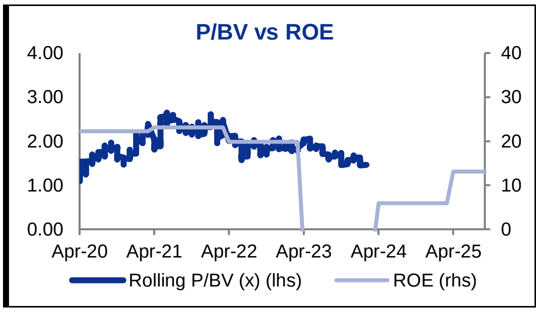
**Figure 13: We upgrade UPL's rating to ADD (from HOLD) with a 12-month target price of Rs694**

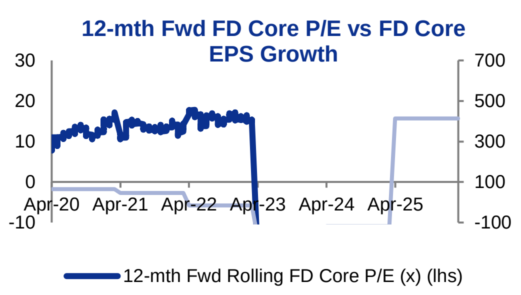
**Target Price Methodology**

| Item | Unit | Valuation |
|---|---|---|
| FY25F EPS | Rs/share | 6.7 |
| FY26F EPS | Rs/share | 34.7 |
| P/E multiple | x | 20.0 |
| Target price | Rs/share | 694 |

SOURCE: INCRED RESEARCH, COMPANY REPORTS

## BY THE NUMBERS




### Profit & Loss

| (Rs mn) | Mar-22A | Mar-23A | Mar-24F | Mar-25F | Mar-26F |
|---|---|---|---|---|---|
| **Total Net Revenues** | **462,400** | **535,760** | **409,155** | **490,986** | **589,183** |
| **Gross Profit** | **241,680** | **262,950** | **182,920** | **225,853** | **282,808** |
| **Operating EBITDA** | **101,500** | **112,830** | **50,890** | **74,593** | **109,019** |
| Depreciation And Amortisation | (23,590) | (25,470) | (26,450) | (21,111) | (24,182) |
| **Operating EBIT** | **77,910** | **87,360** | **24,440** | **53,482** | **84,837** |
| Financial Income/(Expense) | (22,950) | (29,630) | (37,620) | (29,663) | (29,663) |
| Pretax Income/(Loss) from Assoc. | 1,340 | 1,570 | (1,670) | 887 | 886 |
| Non-Operating Income/(Expense) | 2,810 | 4,770 | 5,080 | 5,080 | 5,080 |
| **Profit Before Tax (pre-EI)** | **59,110** | **64,070** | **(9,770)** | **29,785** | **61,139** |
| Exceptional Items | (3,270) | (12,570) | (13,610) | (10,000) | (10,000) |
| **Pre-tax Profit** | **55,840** | **51,500** | **(23,380)** | **19,785** | **51,139** |
| Taxation | (5,290) | (7,360) | 4,044 | (4,762) | (12,664) |
| Exceptional Income - post-tax | | | | | |
| **Profit After Tax** | **50,550** | **44,140** | **(19,336)** | **15,023** | **38,476** |
| Minority Interests | (8,110) | (8,440) | (8,460) | (9,864) | (11,933) |
| Preferred Dividends | | | | | |
| FX Gain/(Loss) - post tax | | | | | |
| Other Adjustments - post-tax | | | | | |
| **Net Profit** | **42,440** | **35,700** | **(27,796)** | **5,159** | **26,542** |
| Recurring Net Profit | 45,400 | 46,474 | (14,186) | 12,752 | 34,066 |
| **Fully Diluted Recurring Net Profit** | **45,400** | **46,474** | **(14,186)** | **12,752** | **34,066** |

### Cash Flow

| (Rs mn) | Mar-22A | Mar-23A | Mar-24F | Mar-25F | Mar-26F |
|---|---|---|---|---|---|
| EBITDA | 101,500 | 112,830 | 50,890 | 74,593 | 109,019 |
| Cash Flow from Invt. & Assoc. | | | | | |
| Change In Working Capital | (17,670) | (13,690) | 23,030 | (27,740) | (20,893) |
| (Incr)/Decr in Total Provisions | | | | | |
| Other Non-Cash (Income)/Expense | (3,530) | 19,933 | 5,839 | 9,601 | 11,751 |
| Other Operating Cashflow | (2,430) | (24,343) | 37,179 | 15,219 | (584) |
| Net Interest (Paid)/Received | (22,950) | (29,840) | (37,620) | (29,663) | (29,663) |
| Tax Paid | 10,040 | 12,620 | (4,044) | 4,762 | 12,664 |
| **Cashflow From Operations** | **64,960** | **77,510** | **75,273** | **46,772** | **82,294** |
| Capex | (18,990) | (16,010) | (18,000) | (25,000) | (30,000) |
| Disposals Of FAs/subsidiaries | | | | | |
| Acq. Of Subsidiaries/investments | | | | | |
| Other Investing Cashflow | (19,200) | 1,110 | 3,290 | 887 | 886 |
| **Cash Flow From Investing** | **(38,190)** | **(14,900)** | **(14,710)** | **(24,113)** | **(29,114)** |
| Debt Raised/(repaid) | 9,420 | (63,896) | 14,610 | | |
| Proceeds From Issue Of Shares | | 26,990 | | | |
| Shares Repurchased | | | | | |
| Dividends Paid | (9,220) | (7,500) | | (1,355) | (6,970) |
| Preferred Dividends | | | | | |
| Other Financing Cashflow | (19,410) | (17,864) | (37,620) | (29,663) | (29,663) |
| **Cash Flow From Financing** | **(19,210)** | **(62,270)** | **(23,010)** | **(31,018)** | **(36,634)** |
| Total Cash Generated | 7,560 | 340 | 37,553 | (8,360) | 16,546 |
| **Free Cashflow To Equity** | **36,190** | **(1,286)** | **75,173** | **22,658** | **53,180** |
| **Free Cashflow To Firm** | **49,720** | **92,450** | **98,183** | **52,322** | **82,843** |

SOURCE: INCRED RESEARCH, COMPANY REPORTS

## BY THE NUMBERS…cont'd

### Balance Sheet

| (Rs mn) | Mar-22A | Mar-23A | Mar-24F | Mar-25F | Mar-26F |
|---|---|---|---|---|---|
| Total Cash And Equivalents | 69,600 | 61,430 | 52,263 | 27,472 | 13,545 |
| Total Debtors | 153,280 | 182,240 | 145,726 | 167,010 | 200,412 |
| Inventories | 130,780 | 139,850 | 123,307 | 128,163 | 153,795 |
| Total Other Current Assets | 43,680 | 36,420 | 43,524 | 43,787 | 44,102 |
| **Total Current Assets** | **397,340** | **419,940** | **364,821** | **366,432** | **411,854** |
| Fixed Assets | 203,300 | 74,610 | 59,980 | 83,660 | 93,369 |
| Total Investments | 10,820 | 15,780 | 10,820 | 10,820 | 10,820 |
| Intangible Assets | 183,640 | 198,980 | 198,980 | 198,980 | 198,980 |
| Total Other Non-Current Assets | 31,690 | 34,740 | 35,731 | 36,011 | 36,212 |
| **Total Non-current Assets** | **429,450** | **324,110** | **305,511** | **329,472** | **339,381** |
| Short-term Debt | 42,610 | 28,550 | 28,550 | 28,550 | 28,550 |
| Current Portion of Long-Term Debt | | | | | |
| Total Creditors | 165,520 | 176,140 | 168,146 | 161,420 | 193,704 |
| Other Current Liabilities | 73,830 | 85,680 | 70,752 | 76,140 | 82,313 |
| **Total Current Liabilities** | **281,960** | **290,370** | **267,447** | **266,110** | **304,567** |
| Total Long-term Debt | 216,050 | 201,440 | 216,050 | 216,050 | 216,050 |
| Hybrid Debt - Debt Component | | | | | |
| Total Other Non-Current Liabilities | 10,430 | 12,880 | 12,880 | 12,880 | 12,880 |
| **Total Non-current Liabilities** | **226,480** | **214,320** | **228,930** | **228,930** | **228,930** |
| Total Provisions | 25,270 | 26,790 | 25,160 | 25,178 | 25,196 |
| **Total Liabilities** | **533,710** | **531,480** | **521,538** | **520,218** | **558,693** |
| Shareholders Equity | 246,610 | 298,440 | 279,104 | 292,772 | 324,277 |
| Minority Interests | 46,470 | 55,850 | 64,310 | 74,174 | 86,107 |
| **Total Equity** | **293,080** | **354,290** | **343,414** | **366,946** | **410,384** |

### Key Ratios

| | Mar-22A | Mar-23A | Mar-24F | Mar-25F | Mar-26F |
|---|---|---|---|---|---|
| Revenue Growth | 19.5% | 15.9% | (23.6%) | 20.0% | 20.0% |
| Operating EBITDA Growth | 17.5% | 11.2% | (54.9%) | 46.6% | 46.2% |
| Operating EBITDA Margin | 22.0% | 21.1% | 12.4% | 15.2% | 18.5% |
| Net Cash Per Share (Rs) | (247.14) | (220.34) | (251.42) | (283.83) | (302.03) |
| BVPS (Rs) | 322.37 | 390.12 | 364.84 | 382.71 | 423.89 |
| Gross Interest Cover | 3.39 | 2.95 | 0.65 | 1.80 | 2.86 |
| Effective Tax Rate | 9.5% | 14.3% | | 24.1% | 24.8% |
| Net Dividend Payout Ratio | 24.4% | 19.4% | | 8.9% | 19.1% |
| Accounts Receivables Days | 111.91 | 114.29 | 146.29 | 116.24 | 113.81 |
| Inventory Days | 186.04 | 181.04 | 212.28 | 173.10 | 167.96 |
| Accounts Payables Days | (240.42) | (228.56) | (277.73) | (226.85) | (211.54) |
| ROIC (%) | 15.4% | 21.6% | 6.6% | 12.7% | 18.8% |
| ROCE (%) | 14.3% | 14.7% | 4.0% | 8.6% | 12.9% |
| Return On Average Assets | 10.0% | 11.0% | 4.5% | 8.0% | 10.8% |

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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