United Phosphorus UNPO.NS UNTP IN

INDUSTRIALS

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Strong operating performance; Maintain Buy

Quick Note

January 30, 2012	
Rating Remains	**Buy**
Target price Remains	INR 205
Closing price January 30, 2012	INR 144

United Phosphorus reported robust 3QFY12 earnings, with net sales up ~58% y-y, beating our and consensus estimates by a wide margin. On PAT level, results were largely in line on the back of a higher tax rate (due to a one-off impact) and higher minority interest/lower associate income. Better realisation (+8% y-y), supported by new acquisitions and INR depreciation helped company report strong numbers. Overall, these are a good set of numbers and we remain positive on the stock. We reiterate our Buy as the stock is currently trading at 7.7x our FY13F earnings estimate.

Key highlights

Strong top-line growth above expectations

- Revenues at INR19.3bn (+58% y-y and 9% q-q) was ~15-16% higher than our as well as consensus estimates of ~INR16.8-16.6bn. Better realisation (+8% y-y) plus depreciation of INR helped United Phosphorus achieve strong revenue growth. The company's business in Europe also showed resilience with 31% y-y revenue growth after it had been weak over the last two years, a positive for the stock.
- For 9MFY12, the company recorded top-line growth of 40% y-y; to achieve our target of 31.5% for FY12F, United Phosphorus only has to grow 11% y-y in 4QFY12. We believe the company will be able to achieve growth that will surpass our expectations of 31.5% y-y revenue increase.
- Revenue contribution from the acquisitions of RiceCo and DVA Agro in 3QFY12 has been ~INR3.0 bn, and hence, organic growth for the company in 3QFY12 works out to 31%, which is much higher than in the past and should be a positive for the stock.

Operating performance beats our estimates by 18%

- On the cost front, higher-than-expected raw material cost and employee cost was more than offset by the decline in other manufacturing expense. This led to EBITDA margin of 18.1% higher than our expectation of 17.6%. The slight slippage in the EBITDA margin on a sequential basis (18.1% vs. 18.3% in 2QFY12) was on account of higher employee cost. Depreciation in INR against various currencies was the primary reason for this increase.
- Higher revenue coupled with slightly better-than-expected margin resulted in **EBITDA at INR3.5bn (+57% y-y and 7% q-q), which beat our as well as consensus expectations by 18% and 9%, respectively**.
- On sequential basis, interest and financial costs was down 57% to INR826mn because the company has recognized a MTM loss of INR1.1bn on account of foreign currency debt in the last quarter. Although some of these losses were reversed as the company realised gains on hedging derivates it has used on foreign debt but

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these gains were more or less offset by forex loss on account of rupee depreciation in the reported quarter.

- At the operating level, the company's performance exceeded our as well as the Street's expectations. However, on the bottom line, adjusted PAT (forex loss and tax benefit from the forex loss) at INR1.1bn was largely in line with our expectations due to the higher tax rate and higher minority interest / lower associate income. The effective tax rate at ~32% was a result of amalgamation of 100% United Phosphorus' Mauritius subsidiary into a stand-alone India entity. The company has guided for an effective tax rate in the range of 23-25%.

Takeaways from management's call

- Management remained confident that the company would be able to achieve a revenue growth of 30-35% for FY12F, which should be driven by a Brazilian acquisition in 4QFY12 due to the seasonally strong quarter in Latin America. The weaker 15% y-y growth in 3QFY12 for India business was on the back of challenging weather conditions in Southern India, particularly Andhra Pardesh. In the short term, management sees some headwinds due to continuing challenging conditions in AP.
- The company continues to expect to generate a PBDIT margin to the tune of 19-20% in FY12F. Any volatility in raw material prices can lead to slippage in margins as cost increases can only be passed on to its customers with a lag.
- New acquisitions have resulted in margins turning out to be lower than earlier, and management believes that it will take another 3-4 quarters to bring them back to earlier levels. Specifically, DVA Agro, which was acquired by the company in July 2011 has a gross margin ranging between ~28-30%, ie, lower than the company's overall gross margin of around ~46%. Sipcam UPL Brasil, in which the company picked 50% stake in April 11 recorded a loss of INR 110mn (propionate share) in 2QFY12. Management expects a total loss of ~INR300mn on full year basis from Sipacam UPL Brasil.
- The performance of European business has showed resilience after UNTP's post-harvest treatment product, Decco, was restricted in EU after May 2010. Management indicated that the increase in its average realisation from the European market has been higher than its overall 8% y-y increase.
- On the working capital front, the increase in the no. of inventory days to 99 days from 86 days in the last quarter was partly attributable to inventory restocking due to upcoming crop season (Feb-July) in North America and European markets.
- On the balance sheet side, the company's average cost of debt continues to be in the range of 7-8% on a consolidated basis and the company an outstanding net debt of around INR 25bn (as of Dec-11).
- South America has experienced a weather disturbance known as La Niña but as of now the impact from this seen is seen to be minimal.

Fig. 1: Snapshot of 3QFY12 results (INR mn)

(INR. mn)	3QFY12A	3QFY12E (Nomura estimtes)	2QFY12A	QoQ growth (%)	3QFY11A	YoY growth (%)
Net Sales	**19,288**	**16,781**	**17,757**	9%	**12,221**	58%
Raw material costs	**10,305**	**8,772**	**9,700**	6%	**5,695**	81%
% of net sales	53.4%	52.3%	54.6%		46.6%	
Employee costs	**1,948**	**1,650**	**1,511**	29%	**1,298**	50%
% of net sales	10.1%	9.8%	8.5%		10.6%	
Other expenses	**3,551**	**3,413**	**3,291**	8%	**3,014**	18%
% of net sales	18.4%	20.3%	18.5%		24.7%	
Total expenses	**15,804**	**13,835**	**14,502**	9%	**10,007**	58%
EBIDTA	**3,484**	**2,947**	**3,255**	7%	**2,215**	57%
Other income	107	140	196	-45%	262	-59%
PBIDT	**3,590**	**3,086**	**3,451**	4%	**2,477**	45%
Depreciation	785	700	719	9%	491	60%
Interest	826	800	1,918	-57%	893	-7%
PBT	**1,979**	**1,587**	**814**	143%	**1,093**	81%
Tax	626	579	151	315%	266	135%
PAT	**1,353**	**1,007**	**663**	104%	**827**	64%
Minority loss/(profit)	216	(40)	(51)	-527%	(12)	-1854%
Extraordinary profit/(loss)	(13)	800	(144)		-	
Reported PAT	**1,124**	**1,847**	**570**	97%	**839**	34%
Adjusted PAT	**1,124**	**1,191**				
EBIDTA margins (%)	18.1%	17.6%	18.3%	0%	18.1%	
PBIDT margins (%)	18.5%	18.2%	19.2%	-1%	19.8%	

Source: Company data, Nomura estimates

Fig. 2: Geographical breakdown (in INR mn)

	3QFY11	4QFY11	1QFY12	2QFY12	3QFY12
North America	2,220	4,100	5,110	2,990	3590
India	3,320	3,030	5,360	5,690	3810
Europe	2,020	4,490	3,760	2,230	2650
Rest of World	4,920	7,200	4,620	7,040	9340
Total	**12,480**	**18,820**	**18,850**	**17,950**	**19,390**
(y-y)% growth	**3QFY11**	**4QFY11**	**1QFY12**	**2QFY12**	**3QFY12**
North America	21%	25%	32%	13%	62%
India	6%	48%	32%	25%	15%
Europe	-24%	-17%	3%	8%	31%
Rest of World	25%	58%	39%	98%	90%
Total	**8%**	**23%**	**27%**	**40%**	**55%**

Source: Company data

Fig. 3: Sale variance breakup

	3QFY11	4QFY11	1QFY12	2QFY12	3QFY12
Exchange impact	-5%	1%	1%	5%	19%
Rate variance	-3%	3%	1%	4%	8%
Quantity variance	14%	20%	25%	31%	31%
Total	**6%**	**24%**	**27%**	**40%**	**58%**

Source: Company data

Appendix A-1

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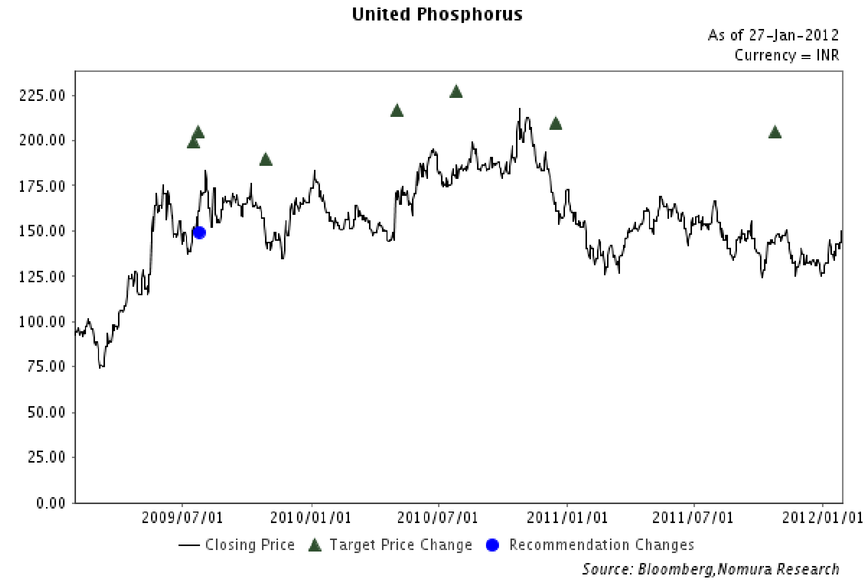
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
United Phosphorus	UNTP IN	INR 144	30-1-2012	Buy	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
United Phosphorus	Not Rated	16-7-2009

United Phosphorus (UNTP IN) **INR 144 (30-1-2012)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
25-Oct-11		205.00	146.30
16-Dec-10		209.90	161.05
27-Jul-10		227.00	186.30
03-May-10		217.00	172.00
27-Oct-09		190.00	145.55
24-Jul-09		205.00	161.00
16-Jul-09	Buy		152.60
16-Jul-09		199.00	152.60

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology In valuing UNTP, we apply a 10% discount to the stock’s six-year historical average rolling forward P/E multiple of 11.2x to our one-year rolling forward EPS forecast (INR20.5). Our target price is INR205.

Risks that may impede the achievement of the target price Downside risks include: 1) a fall in crop prices and de-stocking of inventory, which may lead to lower demand for crop-protection chemicals; 2) an increase in raw material prices, which could hit margins; 3) changes in approval regulations; 4) a fluctuation in forex rates; 5) expensive future acquisitions; and 6) inconducive weather patterns for agriculture.

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

STOCKS

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