

UPL Ltd | BUY

Indian MNC on course to become global Heavyweight

UPL Ltd (UPL) has announced that it has signed a definitive agreement to acquire Arysta LifeScience Inc. Arysta is a global provider of innovative crop protection solutions, including BioSolutions and Seed Treatment. The all cash c.USD 4.2bn acquisition will be done through UPL Corporation (UPL Corp.), currently a 100% subsidiary of UPL. Private equity firm TPG and Abu Dhabi Investment Authority (ADIA) will each invest USD 600 mn equity in UPL Corp. for a minority stake (11% each) (Exhibit 1). This values UPL Corp. at c. USD 5.45 bn against USD 4bn market cap of UPL. The remaining USD 3 bn will be raised via a 5 year bullet repayment loan. The deal will result into UPL becoming the fifth largest (by revenue) agriculture solution provider in the world (Exhibit 2). We believe that the synergies of the acquisition will be positive from a medium to long-term but are cautious on the high debt in the interim. We await further clarity on detailed financials of Arysta, but given risks on higher debt and given the recent correction in agro-chemical companies, we reduce the P/E multiple from 16 to 14. This reduces the target price to INR 815.

- **Synergies from the deal...:** (i) UPL and Arysta have geographical as well as product synergies in various regions and the acquisition will give UPL market access to 90% of world's food basket (Exhibit 3). This will further de-risk UPL's business from vagaries in a specific region (ii) Similarly, in terms of products, UPL was focussed on Cotton and Soyabean while Arysta was focussed on Sunflower, Cocoa, and Cereals. This complimentary mix will allow UPL to offer a wider basket of products and make optimum use of the resources (iii) Arysta has an asset light model which compliments with the manufacturing capability of UPL (iv) UPL will be able to increase penetration in Africa, Europe and Japan and will have c.13,000 product registrations.
- **...will result into long-term gains but will increase short-term concerns on high-debt :** (i) UPL, after the acquisition, will have c USD 5 bn in revenue, c USD 1 bn in EBITDA and c.USD4bn of gross debt (ii) UPL believes it can additionally save c. USD 200 mn by way of synergies in optimised manufacturing, overheads and sales. Out of this USD 200mn, UPL believes that it can save c.USD 70-80 mn by optimised manufacturing since Arysta used to out-source some manufacturing (iii) UPL expects an EPS accretion of c. INR 10 -12 in FY20 (iv) UPL said the Net Debt : EBITDA will decline from Pro-Forma at closing of 3.2x – 3.5x to 2.5x – 2.7x with run-rate synergies. (v) UPL will bear an interest cost of c USD 120 mn (4%-4.5% interest rate) (vi) UPL expects FCF of c. USD 600-700 mn after acquisition (vii) However, in the short-term, concerns on high-debt could keep the stock subdued. (viii) Depreciation post-acquisition could be higher due to good-will amortisation.
- **Maintain BUY but cut the P/E multiple from 16 to 14 :** The acquisition of Arysta at an EV/EBITDA of c.11 times (based on reported EBITDA) is broadly in-line with peers (Exhibit 5). We believe that there is a risk to the estimate of INR 10-12 accretion to EPS in FY20 on back of amortisation of good-will. While we continue to like the long-term derisked business model of UPL, we are constrained to cut the P/E ratio from 16 to 14 to capture the recent market correction and higher risk on back of the acquisition.



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Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	815
Upside/(Downside)	28.9%
Previous Price Target	935
Change	-12.8%

Key Data – UPL IN

Current Market Price	INR632
Market cap (bn)	INR321.9/US\$4.7
Free Float	71%
Shares in issue (mn)	509.2
Diluted share (mn)	509.1
3-mon avg daily val (mn)	INR1,147.9/US\$16.7
52-week range	903/537
Sensex/Nifty	36,719/11,085
INR/US\$	68.9

Price Performance

%	1M	6M	12M
Absolute	-1.3	-21.7	-26.8
Relative*	-4.0	-22.9	-36.1

* To the BSE Sensex

Financial Summary

Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Net Sales	1,40,482	1,63,118	1,73,780	1,92,426	2,23,759
Sales Growth (%)	16.2	16.1	6.5	10.7	16.3
EBITDA	23,950	29,852	35,050	40,350	48,301
EBITDA Margin (%)	17.0	18.3	20.2	21.0	21.6
Adjusted Net Profit	10,508	17,998	21,086	23,463	29,639
Diluted EPS (INR)	20.6	35.4	41.4	46.1	58.2
Diluted EPS Growth (%)	-23.3	71.3	17.2	11.3	26.3
ROIC (%)	17.6	21.1	23.3	23.0	25.1
ROE (%)	17.9	27.3	25.8	23.5	24.2
P/E (x)	30.6	17.9	15.3	13.7	10.9
P/B (x)	4.6	4.4	3.6	2.9	2.4
EV/EBITDA (x)	15.0	11.9	9.8	8.3	6.7
Dividend Yield (%)	0.8	0.7	0.9	1.0	1.0

Source: Company data, JM Financial. Note: Valuations as of 23/Jul/2018 ; Pre-acquisition Numbers

Thank you for your ongoing support in the [Asiamoney Annual Brokers Poll](#).

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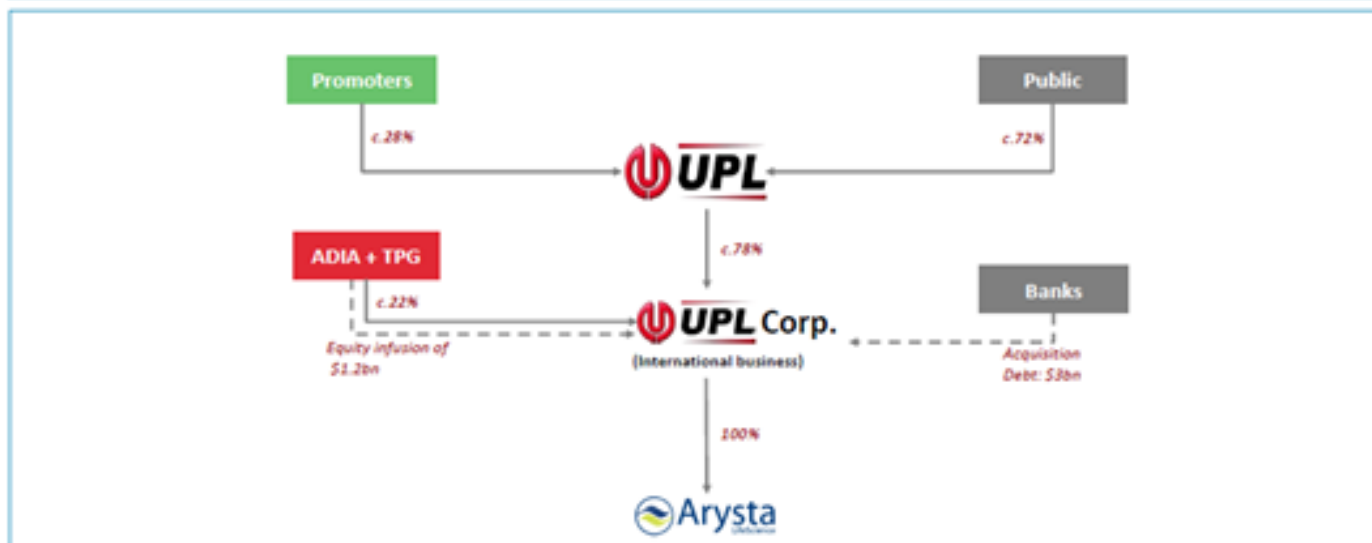
JM Financial Research is also available on: Bloomberg - JMFR <GO>, Thomson Publisher & Reuters S&P Capital IQ and FactSet Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Exhibit 1. Transaction Structure



Transaction structure

Post-acquisition holding structure



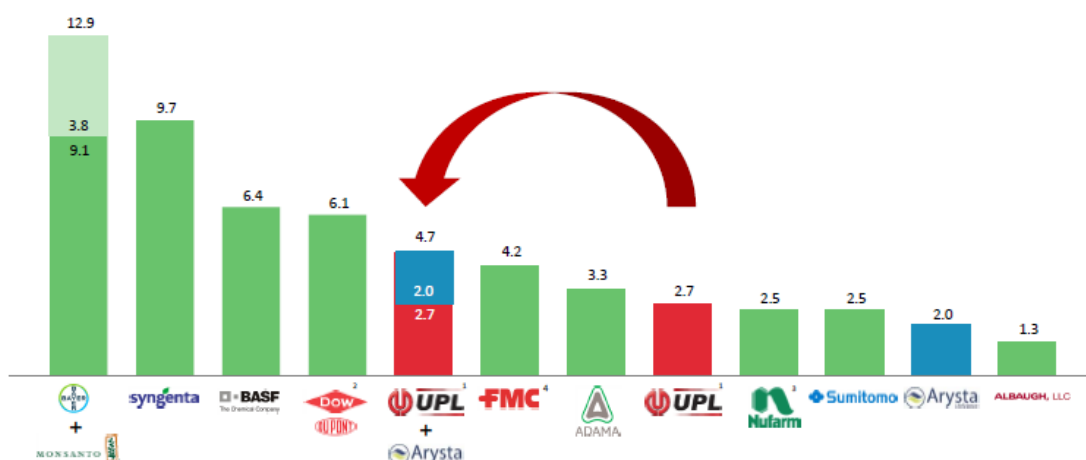
Source: Company

Exhibit 2. The big jump



Economies of scale: Creating a top 5 player in Agricultural solutions market

Agrochemical Revenue (US\$bn)



Achieves critical size in a rapidly consolidating industry

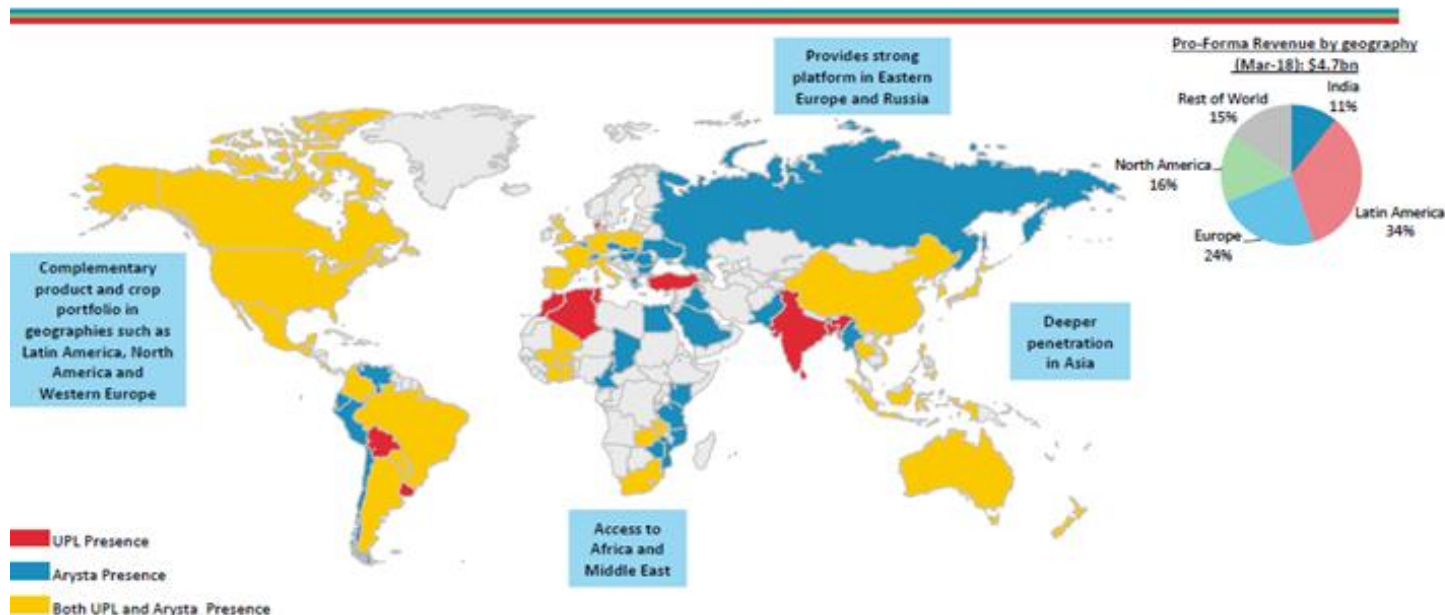
Source: Philip McDougall 2017, ¹ FY16 Mar-16 Turnover, ² Year ending Nov 30, 2017, ³ Year ending Jan 31, 2018, ⁴ PF for Dupont assets

Source: Company

Exhibit 3. Diversified portfolio



Highly diversified across geographies and crops



Market access to 90% of world's food basket with focus on high growth regions

Source: Company

Exhibit 4. Arysta Financials



Financial summary – Arysta

US\$mm	CY15	CY16	CY17
Net sales	1,741	1,818	1,897
Cost of sales	1,138	1,086	1,122
Gross profit	603	732	775
SG&A expenses and overheads	223	334	356
Reported EBITDA	358	368	388
Corporate costs	24	33	32
Adj. EBITDA ²	382	401	420
Capital expenditure	57	59	69
Net working capital ¹	382	501	718

FYE – 31-Dec; ¹ Excludes debt; ² Management adjusted EBITDA for corporate costs

Source: Company

Exhibit 5. Valuation Comparisons among peers

Ticker	ROE				EV/EBITDA				P/E				P/B			
	PY	CY	1Y F	2Y F	PY	CY	1Y F	2Y F	PY	CY	1Y F	2Y F	PY	CY	1Y F	2Y F
Nufarm Ltd / Aust	6.3	7.6	9.3	9.5	9.7	8.3	6.4	6.1	22.3	20.2	14.3	12.8	1.6	1.4	1.3	1.2
Bayer AG	20.0	14.3	23.3	22.1	10.2	8.3	7.0	6.4	11.1	14.6	11.6	10.6	2.1	1.9	1.7	1.7
DowDupont	#N/A N/A	9.5	10.6	11.2	24.3	9.5	8.5	7.7	55.9	15.7	13.5	12.1	1.5	1.5	1.4	1.4
Monsanto	37.5	35.0	31.0	26.7	15.6	13.8	13.1	12.7	24.8	22.1	20.8	19.5	7.3	7.4	6.4	5.5
UPL	24.5	22.8	22.2	21.2	9.0	7.9	6.9	6.2	13.9	11.9	10.2	9.1	3.1	2.5	2.1	1.8
Platform specialt	-8.1	9.9	11.4	11.6	15.3	10.0	9.3	9.0	-11.7	12.6	11.0	9.6	1.2	1.2	1.1	1.0

Source: Bloomberg

Exhibit 6. Valuation

PE multiple	14
FY20 EPS	58.22
TP	815

Financial Tables (Consolidated)

Income Statement					(INR mn)
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Net Sales	1,40,482	1,63,118	1,73,780	1,92,426	2,23,759
Sales Growth	16.2%	16.1%	6.5%	10.7%	16.3%
Other Operating Income	0	0	0	0	0
Total Revenue	1,40,482	1,63,118	1,73,780	1,92,426	2,23,759
Cost of Goods Sold/Op. Exp	67,805	78,162	81,120	89,478	1,02,929
Personnel Cost	14,335	16,269	17,130	19,186	21,488
Other Expenses	34,392	38,835	40,480	43,413	51,041
EBITDA	23,950	29,852	35,050	40,350	48,301
EBITDA Margin	17.0%	18.3%	20.2%	21.0%	21.6%
EBITDA Growth	1.6%	24.6%	17.4%	15.1%	19.7%
Depn. & Amort.	6,760	6,720	6,750	7,324	8,219
EBIT	17,190	23,132	28,300	33,026	40,082
Other Income	3,157	4,436	4,140	4,892	5,240
Finance Cost	7,041	7,351	8,177	8,612	8,364
PBT before Excep. & Forex	13,307	20,217	24,263	29,306	36,959
Excep. & Forex Inc./Loss(-)	-1,291	-808	-570	0	0
PBT	12,016	19,410	23,693	29,306	36,959
Taxes	1,648	1,888	2,843	5,568	7,022
Extraordinary Inc./Loss(-)	0	0	0	0	0
Assoc. Profit/Min. Int.(-)	974	253	265	275	297
Reported Net Profit	9,394	17,269	20,585	23,463	29,639
Adjusted Net Profit	10,508	17,998	21,086	23,463	29,639
Net Margin	7.5%	11.0%	12.1%	12.2%	13.2%
Diluted Share Cap. (mn)	509.2	509.1	509.1	509.1	509.1
Diluted EPS (INR)	20.6	35.4	41.4	46.1	58.2
Diluted EPS Growth	-23.3%	71.3%	17.2%	11.3%	26.3%
Total Dividend + Tax	2,140	2,170	3,664	3,969	3,969
Dividend Per Share (INR)	5.0	4.2	6.0	6.5	6.5

Source: Company, JM Financial ; Pre-acquisition Numbers

Balance Sheet					(INR mn)
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Shareholders' Fund	58,881	73,158	90,079	1,09,573	1,35,244
Share Capital	857	1,014	1,014	1,014	1,014
Reserves & Surplus	58,024	72,144	89,065	1,08,559	1,34,230
Preference Share Capital	0	0	0	0	0
Minority Interest	438	330	405	489	596
Total Loans	48,230	61,398	70,400	68,400	66,400
Def. Tax Liab. / Assets (-)	-5,093	-6,701	-6,701	-6,701	-6,701
Total - Equity & Liab.	1,02,456	1,28,186	1,54,183	1,71,762	1,95,539
Net Fixed Assets	45,212	50,367	57,115	67,274	76,608
Gross Fixed Assets	60,726	69,512	80,512	95,512	1,10,512
Intangible Assets	7,636	7,517	7,517	7,517	7,517
Less: Depn. & Amort.	26,276	32,996	37,247	42,088	47,754
Capital WIP	3,125	6,333	6,333	6,333	6,333
Investments	1,603	2,050	2,050	2,050	2,050
Current Assets	1,17,954	1,44,685	1,72,661	1,83,868	2,11,659
Inventories	37,866	41,559	45,380	48,502	56,399
Sundry Debtors	51,002	56,568	60,570	63,790	74,178
Cash & Bank Balances	11,892	28,940	49,092	53,957	63,464
Loans & Advances	4,558	3,444	3,444	3,444	3,444
Other Current Assets	12,637	14,175	14,175	14,175	14,175
Current Liab. & Prov.	62,312	68,916	77,642	81,430	94,778
Current Liabilities	45,970	54,896	62,803	64,044	73,487
Provisions & Others	16,342	14,020	14,840	17,386	21,291
Net Current Assets	55,642	75,769	95,018	1,02,438	1,16,881
Total - Assets	1,02,456	1,28,186	1,54,183	1,71,762	1,95,539

Source: Company, JM Financial ; Pre-acquisition Numbers

Cash Flow Statement					(INR mn)
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Profit before Tax	13,307	20,217	24,263	29,306	36,959
Depn. & Amort.	6,760	6,720	4,252	4,841	5,666
Net Interest Exp. / Inc. (-)	7,041	7,351	8,177	8,612	8,364
Inc (-) / Dec in WCap.	-5,342	-4,687	903	-2,554	-4,937
Others	-1,371	-2,648	-2,460	-3,870	-4,218
Taxes Paid	-4,092	-1,888	-2,843	-5,568	-7,022
Operating Cash Flow	16,303	25,065	32,291	30,766	34,811
Capex	-9,538	-11,875	-11,000	-15,000	-15,000
Free Cash Flow	6,765	13,190	21,291	15,766	19,811
Inc (-) / Dec in Investments	332	-447	0	0	0
Others	-7,405	1,480	1,700	3,680	4,028
Investing Cash Flow	-16,610	-10,842	-9,300	-11,320	-10,972
Inc / Dec (-) in Capital	0	157	0	0	0
Dividend + Tax thereon	-2,134	-3,148	-3,664	-3,969	-3,969
Inc / Dec (-) in Loans	9,568	13,168	9,002	-2,000	-2,000
Others	-5,333	-7,351	-8,177	-8,612	-8,364
Financing Cash Flow	2,101	2,826	-2,839	-14,581	-14,333
Inc / Dec (-) in Cash	1,794	17,049	20,152	4,865	9,506
Opening Cash Balance	10,098	11,892	28,940	49,092	53,957
Closing Cash Balance	11,892	28,940	49,092	53,957	63,464

Source: Company, JM Financial ; Pre-acquisition Numbers

Dupont Analysis					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Net Margin	7.5%	11.0%	12.1%	12.2%	13.2%
Asset Turnover (x)	1.3	1.3	1.1	1.1	1.1
Leverage Factor (x)	1.8	1.9	1.9	1.8	1.6
RoE	17.9%	27.3%	25.8%	23.5%	24.2%

Key Ratios					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
BV/Share (INR)	137.5	144.3	177.7	216.2	266.8
ROIC	17.6%	21.1%	23.3%	23.0%	25.1%
ROE	17.9%	27.3%	25.8%	23.5%	24.2%
Net Debt/Equity (x)	0.6	0.4	0.2	0.1	0.0
P/E (x)	30.6	17.9	15.3	13.7	10.9
P/B (x)	4.6	4.4	3.6	2.9	2.4
EV/EBITDA (x)	15.0	11.9	9.8	8.3	6.7
EV/Sales (x)	2.6	2.2	2.0	1.7	1.5
Debtor days	133	127	127	121	121
Inventory days	98	93	95	92	92
Creditor days	124	134	149	139	140

Source: Company, JM Financial ; Pre-acquisition Numbers

History of Earnings Estimate and Target Price

Date	Recommendation	Target Price	% Chg.
27-Nov-16	Buy	745	
27-Jan-17	Buy	750	0.7
2-May-17	Buy	916	22.1
1-Aug-17	Buy	968	5.8
31-Oct-17	Buy	921	-4.9
29-Jan-18	Buy	959	4.1
30-Apr-18	Buy	900	-6.2

Recommendation History

