March 09, 2021 REINITIATION REPORT VOL-7, NO-1

Punjab Chemicals and Crop Protection Ltd

BUY

CMP: Rs. 968 **TARGET PRICE: Rs.1250** **TIME : 12 months**

REINITIATION REPORT:

We had initiated coverage on Punjab Chemicals and Crop Protection (PCCPL) on 10th September 2020 (Vol-6 No-15) at Rs602 with a target price of Rs750, revised to Rs900 and further upgraded to Rs1250. Considering the recent developments, healthy financials, renowned clientele and turnaround in the company, the positive outlook for the company is further fortified and we thereby re-initiate a fresh BUY call on the stock at CMP of Rs968.

About the Company:

PCCPL was incorporated in 1975 and would initially cater only to the domestic needs of some basic chemicals such as oxalic acid & diethyl oxalate. With time, the company has grown by leaps and bounds and currently caters to different industries via its agrochemicals, pharmaceuticals, intermediates, industrial & specialty chemicals and an international trading division. PCCPL is in the business of manufacturing of performance chemicals, technical grade chemicals, agrochemicals and speciality chemicals while major products of the company include metamitron, phosphorous acid, oxalic acid. PCCPL has one subsidiary i.e. SD AG Chem located in Belgium, Europe which has various marketing registrations for supply of products from Europe.

INVESTMENT RATIONALE:

(A) Supportive Macro Environment:

China has been undergoing structural changes and stringent laws related to environment have resulted in clamping of manufacturing facilities. Additionally, major players are looking to de-risk the supply chain and are assessing alternatives to China via plus one strategy. This temporary blip in the chemical market is an opportunity to many countries involved in the agrochems and speciality chemicals. This also bodes well for many Indian players in the CRAMS market, including the likes of PCCPL. Opening up of gaps in supply chain has resulted in a shift in strategy thus propelling export of agrochems via India. Make in India will further boost low cost manufacturing and the intent of GOI to make India an important part of supply chain will help the sector grow. Furthermore, shortage of arable land, need for high yielding crops and higher acreage will help agrochemical players. Additionally, large numbers of molecules are going off-patent and this would benefit CRAMS and generic players. Opportunities for Indian CRAMS players has started ticking up, which also implies there will be ample of work for each of these players depending on the chemistries they expertise in. Many Japanese agrochem players are looking at India as a reliable source of quality and consistent supply of products. Such contracts are generally long term in nature and can provide vision of consistent revenue flow for many Indian players. At the same time, many Japanese and Indian players are concerned about the environmental issues and are drifting more towards better technologies. If one manoeuvres through some challenges, tremendous growth opportunity exists for players in the agrochem and pharma space.

(B) Recent Developments:

The company has seen a smart turnaround in the recent times, which is clearly contributed by the addition of new customers as well as addition of new niche verticals in the CRAMS business.

(i) Growing Clientele: PCCPL is a major CRAMS player and has been able to get global players on board which essentially includes the Japanese customers who follow strict operational due diligence. PCCPL caters to a reputed clientele and has signed long term contracts with players like UPL, Adama, Corteva, Nippon Kayaku and Coca Cola. Among these Adama contributes approximately 20-25% to the revenues of the company whereas UPL contributes around 35% and companies from Japan contribute around 30%. PCCPL expects contribution from Adama to grow by 2-3 times from current revenue of Rs1,500mn in next couple of years. PCCPL has been smartly making use of these partnerships to its advantage to avail cost benefits in securing raw materials. As unlike its peers, PCCPL does not intend to market its products thus eliminating the risk of sales and marketing and the onus goes to the CRAMS customer.

SNAPSHOT

52 week H / L	Mcap (Rs mn)
234 / 1027	17,870
Face value: 10	
BSE Code	NSE CODE
506618	PUNJABCHEM

Annual Performance

(Rs mn)	FY19	FY20	FY21E	FY22E
Sales (Net)	6,404	5,475	6,341	7,249
EBITDA	659	412	869	1,011
EBITDA (%)	10.3	7.5	13.7	14.0
Other Income	104	192	192	192
Interest	171	179	137	103
Depreciation	186	154	167	185
PBT	406	271	757	915
PAT	203	158	560	684
Equity	123	123	123	123
EPS (INR)	17	13	46	56

Quarterly Performance

Parameters (Rs mn)	Mar-20	Jun-20	Sept-20	Dec-20
Sales (Net)	1,066	1,310	1,634	1,723
EBITDA	91	211	222	275
EBITDA (%)	8.6	16.1	13.6	15.9
Other Income	96	6	1	2
Interest	50	40	34	30
Depreciation	34	38	35	35
PAT	48	102	114	156
Equity (Rs mn)	123	123	123	123

Ratio Analysis

Parameters (Rs mn)	FY19	FY20	FY21E	FY22E
EV/EBITDA (x)	19.4	30.9	14.3	12.3
EV/Net Sales (x)	2.1	2.4	2.0	1.7
M Cap/Sales (x)	1.9	2.2	1.9	1.6
M Cap/EBITDA (x)	18.0	28.8	13.7	11.7
Debt/Equity (x)	2.8	2.6	1.6	1.2
ROCE (%)	38.5	31.2	55.5	48.6
Price/Book Value (x)	11.7	10.4	7.1	5.1
P/E (x) TTM	41.5	75.2	21.2	17.3

Share Holding Pattern as on 31 December 2020

Parameters	No of Shares	%
Promoters	48,08,890	39.2
Institutions	4,58,027	3.7
Public	69,95,268	57.1
TOTAL	1,22,62,185	100.0

Source: Annual Report

Note: All the data is calculated as per Market Price on 08th March,2021

Please Turn Over

Punjab Chemicals and Crop Protection Ltd

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INVESTMENT RATIONALE (contd.)

(B) Recent Developments (contd.)

(ii) Business Units: The company has 4 business units i.e. agrochemicals, pharmaceuticals, intermediates, industrial & specialty chemicals and an international trading division for imports. Agrochemicals contribute around 80-85% to revenues followed by single digit contribution from pharma and fine chemicals. Out of the total agrochemical share around 65-70% comes from CRAMS. With the type of pick-up in demand, Management expects agrochem division's contribution to grow by 3-4 times over next couple of years. PCCPL also manufactures intermediates for agriculture/chemical and pharmaceutical industries and even though intermediates is a small business but, is a niche business with a turnover of around Rs150mn. Furthermore, the company manufactures various grade of phosphoric acid and supplies phosphoric acid (food grade) to domestic clients such as Coca-Cola India Pvt. Ltd and Pepsico India (high grade product) and also supplies analytical reagent to pharma companies including Divis Labs etc. Fine chemcials contributes around Rs300-400mn.

(iii) Future Ready: The company has a robust pipeline for new products and launches which will propel future growth. New launches, new products and new contracts are anticipated to fetch nearly 70% to 80% of the turnover. The company also intends to diversify and expand into new geographies such as Latin America and Australia. The company also expects to improve its domestic foothold as many domestic companies are looking for import substitutes. PCPPL is constantly working on new products and expects commercialisation of some in FY22. PCCPL has been closely watching the developments of its products for change in strategy so as to ensure its products' life cycle meets no abrupt end.

(C) Fuelling Growth Parameters:

The company has been an exporter and with the ongoing customer addition, growth triggers to enhance revenue seems intact. In addition to this, the company is also open to further expansion plans if required while catering to CRAMs customers.

(i) Export Oriented: Around 65% of revenue contribution is from exports. Europe is a major market for PCCPL as in FY20, 32% of revenue was contributed from the same followed by Japan (16.5%). The company is also looking to penetrate and grow in the domestic market as well. Additionally, PCCPL also intends to expand its positioning in the Australian and Latin American market with new contracts and products.

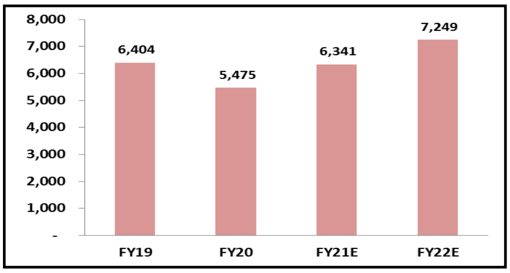
(ii) Ongoing Contracts: The company currently has ongoing contracts with 6 customers, it has signed 2 more contracts and 3 are under-negotiation. PCCPL signed a long-term contract last year with Nippon Kayaku on exclusive buy-back basis. This project is expected to commence in near term while the revenues are expected to flow from mid FY22. The company has additionally signed a contract with Singapore based (China backed) company which serves European and Australian markets for a grass herbicide product. The project commenced on trial basis in January, 2021 revenues are expected to flow from April, 2021.

(iii) Capex: Planned capex for the next couple of years is around Rs500-600mn.The company recently finished construction of the new building and the same is in operation (post installation of plant & machinery) to majorly serve Latin America market for a herbicide and an agrochemical Indian company. The company has a huge land bank (around 49 acres) and can undertake brown-field expansion as and when required. Its Lalru facility is spread over 25 acres and the company currently occupies only 11 acres of the same; the available spare land provides a cushion for expansion if any. Generally 60% of the capex is funded by the customer, which is then amortised while rest is funded by the company through a combination of internal accruals and debt. Payback period for PCCPL is around 2 years.

Financials:

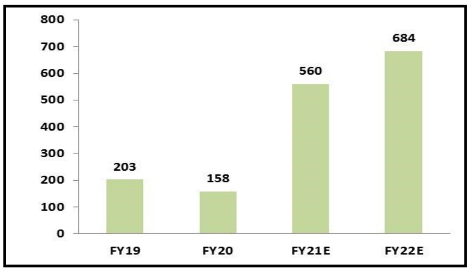
For 9MFY21, revenue de-grew by 3.3% to Rs4667mn as compared to Rs4825mn in 9MFY20, however Ebitda margins have grown significantly to 15.2% in 9MFY21 from 8.8% in 9MFY20. Gross margins have also expanded to 41.4% in 9MFY21 as compared to 37.2% in 9MFY20. Management believes, Ebitda and Gross margins can be sustainable, however uncertainty around RM cost prevails. All contracts entered by PCCPL incorporates clauses related to recheck RM prices, thus providing a win-win situation for PCCPL and its customers. The company also has a take or pay clause in place, thus ensuring manufactured products are picked up by clients. The company ensures clarity and transparency in business operations as customers are informed about any price fluctuations in RM. PAT for 9MFY21 has increased 2x to Rs372mn, from Rs181mn in 9MFY20. Company witnessed turnaround in last 3/4years and has an ambitious vision of revenue to grow to Rs15bn in next 4-5 year. PCCPL has already repaid debt of Rs300mn in FY21 and as on 31st December, 2020 the debt stands at Rs620mn; the Management expects the company to be debt free within next 2 year

Exhibit 01: Sales (Rs mn)



Source: Annual Report, Progressive Research

Exhibit 02: Net Profit (Rs mn)



Source: Annual Report, Progressive Research

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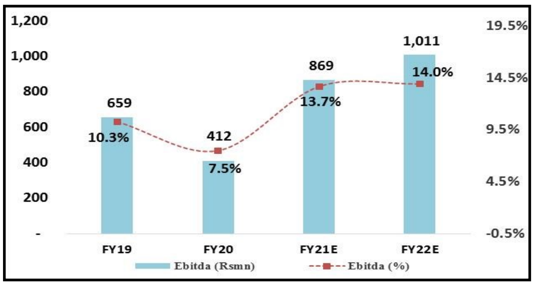
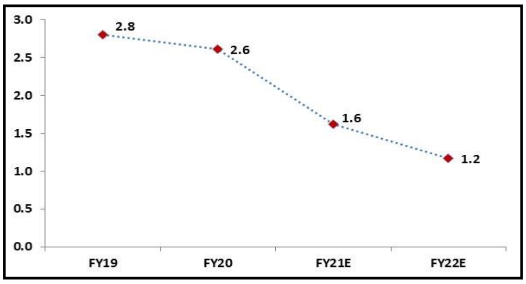
Financials (contd.)

Exhibit 03: Operational Performance



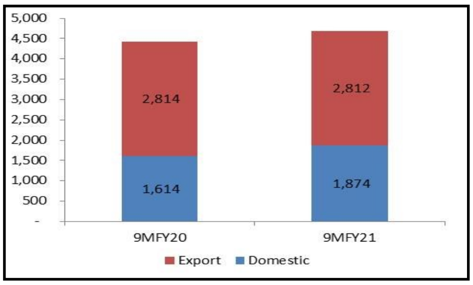
Source: Annual Report, Progressive Research

Exhibit 04: Debt Equity Ratio



Source: Annual Report, Progressive Research

Exhibit 05: Geographical Split (Rs mn)



Source: Company Presentation

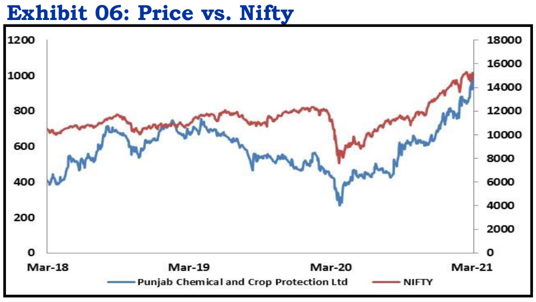
Risks and Concerns:

Fluctuation in raw material prices is an inherent risk to margins of the company, however as the company has a re-check clause, the same is mitigated to a larger extent. PCCPL's products are also dependent on weather conditions as good monsoon plays a major role for demand of its products. As a big part of PCCPL's revenues is from contract manufacturing, company's growth is linked to growth and vision of its CRAMS customers. The company is exposed to forex risk fluctuations, owing to higher exports to multiple geographies. As the company has few long-term contracts with few customers, PCCPL faces the risk of product concentration. To manage the same, the company constantly needs to re-calculate life cycle of existing products and monitor negative development of the same including cancelation of registrations. Technologically advanced products and low-cost manufacturing are need of the hour and thus there is constant emphasis on R&D while the company also needs to continuously upgrade/ tweak its plants.

Outlook and Valuations:

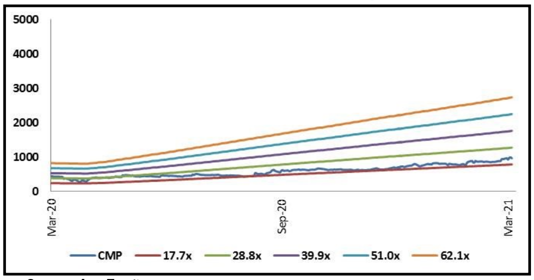
PCCPL has managed to partner with some global giants in the agrochem & pharma space via long term contracts with better margins which has been the key reason for a sharp turnaround in the business. Management's efforts to enter newer geographies and higher margin products is paying off well as profits have grown considerably. Further growth is expected to stem from new launches, new products and new contracts. The company is following a new approach as a CRAMS player where PCCPL has placed itself in a position to avoid the risks associated to marketing its products. With the help of its customers / partners, the company is able to fetch additional benefits associated as a reliable supplier of good quality products. Apart from expanding capacities, PCCPL continues to leverage its existing plants for strategic contract manufacturing partnership and signs exclusivity arrangement contracts for new and patented (or off-patented) products with innovators / customers. Gaps in the supply chain have opened up resulting in increased inquiry from overseas as well as domestic customers, providing improved revenue visibility and order book. The company ensures it manufactures quality products consistently placing emphasis on health, safety and environment. We have been conservative with our projections, however we expect to revise them based on the progress and development going forward. PCCPL will grow along with the growth of its customers / clients. Management's ambitious vision has helped us build our conviction and thus considering these above factors, we have reinitiated a BUY on the stock with a target price of Rs1250.

Exhibit 06: Price vs. Nifty



Source: Ace Equity

Exhibit 07: One Year Forward P/E



Source: Ace Equity

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