



INDEPENDENT EQUITY RESEARCH

**Punjab Chemicals and Crop
Protection Ltd**

Initiating coverage

Enhancing investment decisions

Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade) The fundamental grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals) The valuation grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Fundamental Grade	Assessment	CRISIL Valuation Grade	Assessment
5/5	Excellent fundamentals	5/5	Strong upside (>25% from CMP)
4/5	Superior fundamentals	4/5	Upside (10-25% from CMP)
3/5	Good fundamentals	3/5	Align (+-10% from CMP)
2/5	Moderate fundamentals	2/5	Downside (negative 10-25% from CMP)
1/5	Poor fundamentals	1/5	Strong downside (<-25% from CMP)

Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

Additional Disclosure

This report has been sponsored by NSE - Investor Protection Fund Trust (NSEIPFT).

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Punjab Chemicals and Crop Protection Ltd

Heavy debt bends the beams

Fundamental Grade	1/5 (Poor fundamentals)
Valuation Grade	3/5 (CMP is aligned)
Industry	Chemicals

Punjab Chemicals and Crop Protection Ltd (Punjab Chemicals) is a prominent player in the agrochemical industry with a presence in India, Europe, South East Asia, Latina America and the US. Debt-funded overseas acquisitions have tightened Punjab Chemicals' liquidity significantly. We assign Punjab Chemicals a fundamental grade of '1/5', indicating that its fundamentals are 'poor' relative to other listed securities in India.

Debt-funded inorganic growth in the past has caused financial stress

The company borrowed heavily to fund its overseas acquisitions during FY06 and FY07, which led to a severe financial crisis within the group during the downturn. The overall debt-equity ratio has increased from 1.5x in FY05 to 4.6x in FY08 and 13.0x in FY10 (due to loss of profit on account of fire at the company's Chandigarh plant).

Stretched financials will affect future prospects

The global agrochemical industry is estimated at US\$42 bn and is controlled 80% by the top six MNCs. However, lower margins in the off-patent products, high registration cost and a stringent regulatory environment will lead to a shift in the focus of innovators towards high-margin patented products. These products or brand divestments will create a golden opportunity for the generic players. Punjab Chemicals may not be able to reap the full benefit of this situation because of its overstretched financials.

Thrust on food security, rising crop prices should provide respite

Various forms of government aids to farmers for bringing more area under cultivation, higher minimum support prices for crops and rising crop prices have led to better profitability for farmers, which will lead to higher usage of agrochemicals to protect the crops, ensuring better yields. This augurs well for players like Punjab Chemicals, who are operating in the generic segment.

Expect three-year revenue CAGR of 17%

Revenues (consolidated) are expected to grow at a three-year CAGR of 17% to Rs 9.2 bn in FY13 driven by growth in the agrochemical segment. EBITDA margins are expected to improve to 11.6% in FY13 from 6.1% in FY10 driven by higher margins of overseas subsidiaries and increasing utilisation at the restored Indian plant. EPS is expected to increase to Rs 12.7 in FY13 from negative Rs 77.9 in FY10.

Valuations – the current price is 'aligned' with fair value

CRISIL Equities has used the EV/sales method to value Punjab Chemicals and arrived at a fair value of Rs 126 per share. We initiate coverage on Punjab Chemicals with a valuation grade of '3/5'.

KEY FORECAST

(Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
Operating income	7,387	5,822	6,735	8,137	9,238
EBITDA	1,097	356	714	910	1,068
Adj Net income	4	(560)	(198)	(6)	101
EPS-Rs	0.6	(77.9)	(26.3)	(0.7)	12.7
EPS growth (%)	(103.8)	NM	NM	NM	NM
PE (x)	55.9	NM	NM	NM	9.5
P/BV (x)	0.2	1.9	2.5	2.3	2.0
RoCE (%)	13.6	0.2	5.9	9.3	12.2
RoE (%)	0.4	(79.1)	(49.1)	(1.5)	22.6
EV/EBITDA (x)	4.7	17.6	8.6	6.8	5.6

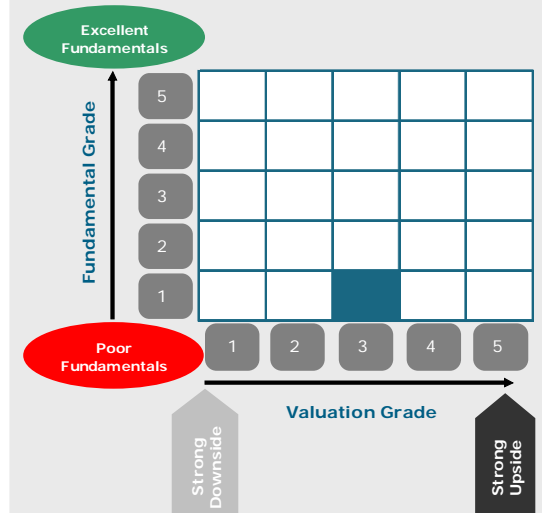
Source: Company, CRISIL Equities estimate

NM: Not meaningful; CMP: Current Market Price

December 02, 2010

Fair Value Rs 126
CMP Rs 121

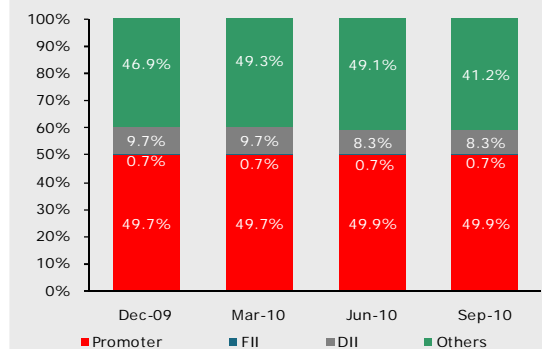
CFV MATRIX



KEY STOCK STATISTICS

NIFTY	5,900
NSE ticker	PUNJABCHEM
Face value (Rs per share)	10
Shares outstanding (mn)	7.5
Market cap (Rs mn)/(US\$ mn)	912/20
Enterprise value (Rs mn)/(US\$ mn)	6,152/136
52-week range (Rs) (H/L)	197/110
Beta	0.67
Free float (%)	50.1%
Avg daily volumes (30-days)	5,899.67
Avg daily value (30-days) (Rs mn)	0.80

SHAREHOLDING PATTERN



PERFORMANCE VIS-À-VIS MARKET

	Returns			
	1-m	3-m	6-m	12-m
PUNJABCHEM	-12%	-6%	-10%	-29%
NIFTY	-3%	9%	20%	16%

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Table: 1 Punjab Chemicals: Business environment

Agri Chemicals	Agrochemicals	Pharmaceuticals	Industrial chemicals	International trading
Revenue contribution (FY10)	75%	12%	8%	5%
Revenue contribution (FY13)	81%	8%	7%	4%
Product / service offering	Herbicides, fungicides and insecticides, technical and formulations. Bio-agro products through Sintesis Quimica in Argentina	APIs and intermediates	Oxalic and phosphoric acid and its derivatives and intermediates	Imports products from China and other markets, and supplies in the domestic market
Geographic presence	India, Europe, Israel, South East Asia, Latin America, the US, Canada. More than 50% revenues generated abroad	India	India	India
Market position	Small player with focus on herbicides, fungicides, technical and formulations. Niche player in bio-agro products	NA	Largest manufacturer and exporter of oxalic acid in the world	NA
End market and top clients	<ul style="list-style-type: none"> Farmers through distributors Syngenta, MAI, Dow Chemicals, Dupont, MAI Bayer Crop 	GSK, Ranbaxy, Cadila Healthcare	Coca Cola, Pepsi, IPCA, GSK, Ranbaxy, Dr Reddy's	Different domestic players
Key competitors	<ul style="list-style-type: none"> International players - Bayer, Syngenta, Dow Chemicals, BASF, etc. Domestic players - Rallis India, Gharda Chemicals, United Phosphorus, Insecticides India, PI Industries, Dhanuka Agritech, etc. 	Divi's Lab, Matrix Lab, Nectar Life Sciences, Wanbury, etc.	Various local players	Small unorganised local players
Future plans	<ul style="list-style-type: none"> Focus on contract manufacturing Focus on introducing bio-agro products in India Looking at opportunities to acquire product portfolio or registrations in newer markets, especially the US 	Hive off this division by selling it or dedicating 80% of the plant to a US entity in order to lower the debt burden	Continue to supply the current range of products	Continue to import and cater to the demand of domestic players
Sales growth (FY07-FY10 – 3-yr CAGR)	17.1% (43% between FY06-08)	26.6%	8.7%	13.4%
Sales forecast (FY10-FY13 – 3-yr CAGR)	19.9%	5.0%	10.0%	5.0%
Demand drivers	<ul style="list-style-type: none"> Awareness of usage and benefits of herbicides, fungicides and bio-agro products among Indian farmers Increase in wealth of farmers Entry into newer markets 	NA	Increase in consumption of soft beverages	Rising demand from domestic players
Margin drivers	<ul style="list-style-type: none"> Ability to charge higher prices due to a rise in minimum support prices for farm output Focus on catering to the overseas markets Increasing focus on niche bio-agro products, which enjoy higher margins in India because of limited players 			

Source: Company, CRISIL Equities

GRADING RATIONALE

A well-known agrochemical player

Punjab Chemicals is a fast growing agrochemical company present across the entire value chain - intermediates, technical bulks and branded formulation of herbicides, fungicides and insecticides. It also manufactures industrial and specialty chemicals, specialised bio-products and plant growth regulators. It has a synergistic active pharmaceutical ingredients (API) plant in Lalru, Chandigarh. In FY10, the agrochemical division contributed 80% to consolidated revenues, while the industrial chemicals and pharmaceutical divisions contributed 10% each. Exports account for 50% of its revenues.

Large product portfolio with wide distribution network

Punjab Chemicals manufactures agrochemicals with a focus on herbicides and fungicides as against highly-competitive insecticides; herbicides and fungicides account for 60% and 25%, respectively, of the total agrochemical sales while insecticides make up the rest. The acquisition of Sintesis Quimica of Argentina in 2006 has also given it an access to fast-growing and environment-friendly bio-agro products. Apart from in-house consumption of technical bulks (for manufacturing formulations), the company also sells them to large B2B players (MNCs and domestic companies – Syngenta, Dow Chemicals, Agan, Bayer Crop Science). The company also supplies technical bulks to two of its European subsidiaries who in turn convert them into formulations and sell them under their own brand. The company has developed a large portfolio of more than 40 branded formulation products in India, which cater to the need of all major crop-growing areas and find application in all seasons, thereby eliminating cyclicity concern. Of total formulation sales, ~75% is branded sales.

Punjab Chemicals' agrochemical segment contributes 80% to consolidated revenues

The company has more than 40 branded formulation products in India

Table 2: Punjab Chemicals' agrochemicals formulation range in India

Particulars	Insecticides	Pesticides	Fungicides	Herbicides	Bio-agro products
Basic use	Kills insects	Kills pests	Prevents/treats growth of fungus	Soil nutrients. Prevents growth of weeds	Nutrients for soil. Non-chemical based
Main crops	Seeds - wheat, paddy, cereals, etc.	Seeds - wheat, paddy, cereals, etc.	Fruits, tea, vegetables, paddy, wheat	All crops, sugar and beet products	Wheat and paddy
40+ branded products	13	8	13	7	4
Key regions and seasons	Across India, all seasons (kharif and rabi)	Across India, all seasons (kharif and rabi crops)	West India (horticulture belt), South India (tea), North India (apples)	Across India with major focus on the western market	Growing with the awareness. Environment-friendly

Source: Company, CRISIL Equities

In India, the company predominantly caters to the North, South and Western markets through a wide network of ~4,000 distributors. Overseas it supplies to Europe, the USA, Israel, South East Asia, Canada and Latin America through its subsidiaries which operate through its own network of distributors and retailers.

Punjab Chemicals and Crop Protection Ltd

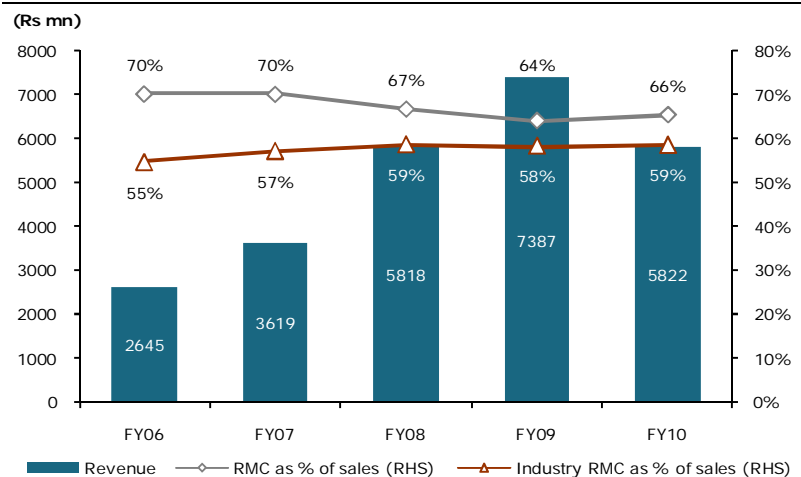
Such a wide distribution network and association with large MNCs ensure deeper penetration of the company's products.

R&D focus reduced material cost, but still high

The in-house R&D facilities - both locally and internationally - continue to focus on reducing raw material costs while maintaining product quality. R&D helped the company reduce the raw material cost as a percentage of sales from 70% in FY06 and FY07 to 67% in FY08 and 64% in FY09 despite an increase in commodity prices during FY08 and FY09. However, it is still higher than the industry average of 59%. Benzene (crude oil derivative, procured mostly from Reliance Industries), sugar, yellow phosphorus (imported from China), rice husk (used by plant boilers), alcohol and nitrates are the major raw materials. Besides, ~40% of the indigenously manufactured (at the Derabassi plant) oxalic acid and its derivatives are being used as raw material for manufacturing agro-chemicals, which further reduces dependence on an external source.

Raw material cost as percentage of sales is higher than the industry average

Figure 1: Punjab Chemicals' RMC higher than industry's



Source: Company, CRISIL Equities

Strong entry barriers – an edge to players with registration

Globally, the agrochemical industry is highly consolidated due to the upfront requirement of high investments for product registrations, a stringent and time-consuming process, and setting up of manufacturing facilities. Agrochemical companies have to compulsorily undergo field trials for each molecule and in each geography where the products are to be marketed. Field trials are carried out by independent agencies across crops and seasons, which could take two-five years depending on the market and government regulations.

Product registration is time consuming and expensive. Punjab Chemicals has US\$32 mn worth of product registration in the Netherlands subsidiary

Registration costs are very high and vary. In Europe, the registration cost is Rs 15-20 mn, whereas in the USA it is Rs 20-25 mn. We believe that Punjab Chemicals is well placed to take advantage of this. Through its European subsidiary, the company owns US\$32mn worth of product registrations or 52 registered products in its European entities. Punjab Chemicals has also procured registration for four products for Australia. When Punjab Chemicals acquired Vadodara-based Parul Chemicals in 2008 in order to enter the formulation

business in India, Parul already had more than 100 registrations for various formulations. As per the management, the company is also trying to obtain registrations for the US market but we believe that this will take time as it would require significant funds.

Debt-funded acquisitions stretch financials notably

Over the past five years, Punjab Chemicals has grown stupendously by acquiring companies locally and globally. Revenues grew from Rs 1.9 bn in FY05 to Rs 7.4 bn in FY09 and Rs 5.8 bn in FY10 (de-growth in FY10 is on account of nine months production loss due to a major fire at the Derabassi plant). The European acquisition has enabled the company to enter the regulated markets of Europe and Latin America. It has also given it an immediate and direct access to the the overseas market with a set customer profile. Moreover, the acquisition of Sintesis has enabled Punjab Chemicals to enter the bio-agro space. The company has brought the concept into the Indian market and demonstrated on soyabean with Ruchi Soya where the initial results were encouraging.

Acquisitions through debt have stretched the overall financials

Table 3: Punjab Chemicals' acquisition history

Period	Target company	Amt paid (US\$ mn)	Products	Remark
2006	Sintesis Quimica SAIC	10	<ol style="list-style-type: none"> Bio-agro (inoculants for soyabean, wheat and corn). Agro-based products and formulations (soil disinfectants, sprout suppressants in potatoes, onions, garlic, fungicides, insecticides and herbicides) Industrial and formulation-based products for leather industry and wood preservation 	<ol style="list-style-type: none"> Gave an access to comprehensive product range of Sintesis with two manufacturing facilities in Argentina and a strong distribution network in South America. Exports to countries like Latin America, South East Asia, the USA, Canada, Europe, etc. Services global agro formulation client like Nufarm and Syngenta. Syngenta Argentina's 80% formulation business is being done by Sintesis. Major crop focus is soyabean, peanuts, oil seeds. Present in herbicides, fungicides and bio-agro products. 40% of overall sales come under the bio-agro category and remaining under agro-based products and formulations, and industrial and formulation-based products. Entry in the regulated markets of Europe and Latin America. Access to development of bio-agro products. Widened the product basket.
2007	Agrichem B.V.	40	Agro-based technicals and formulation with a product range of herbicides, fungicides, insecticides and fungicides	<ol style="list-style-type: none"> US\$32 mn has been paid for acquiring portfolio of registered products. Access to in-house R&D facility, quality control facility, own formulation facilities and crop protection registration department at the Netherlands. Gave an access to branded formulation and distribution network which does third party generics. Major crop focus on beets, cereals, flower bulbs, fruit dipping and rapeseed.
2007	Source Dynamics PLC	*	Is a holding company of Solera Sd which is into agro-technicals and formulations	Was acquired with a motive of using Solera as a marketing arm for its product in the USA.
2008	Parul Chemicals	1.4	Manufactures agro formulations	Enabled Punjab Chemicals to enter the formulation business in India.

Source: Company, CRISIL Equities

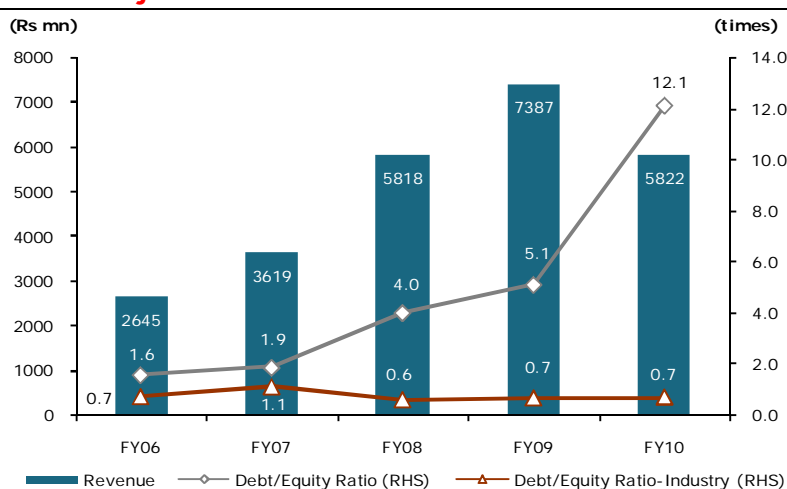
* Price details not available

Punjab Chemicals and Crop Protection Ltd

Globally too the agrochemical industry has grown inorganically over the past five-six years. The industry is highly consolidated with 80% of revenues being contributed by the top six companies, who are also the innovators. Lengthy registration processes, stringent regulatory environment and access to distribution channels have created strong entry barriers for new players in the market and to avoid such barriers generic players usually follow the inorganic route. However, unlike Punjab Chemicals, a majority of these players have funded acquisitions through internal accruals thereby enabling them to leverage the synergy effect which never materialised in case of Punjab Chemicals. The strong growth in revenues has not translated into a strong bottom-line growth because of funding these acquisitions through debt which has led to a massive interest burden.

Growth in revenues due to acquisitions has not trickled to the bottom line due to high interest cost

Figure 2: Punjab Chemicals' stretched financials



Debt-equity ratio increased from 1.5x in FY05 to 4.6x in FY08 and 13.0x in FY10

Source: Company, CRISIL Equities

Massive debt obligation hinders future growth

Punjab Chemical's acquisition strategy has affected inorganic growth plans. The company borrowed heavily to fund its overseas acquisitions during FY06 and FY07, which led to a severe financial crisis within the group during the downturn. Further, the strategy to hedge the currency and raw material price volatility during FY09 has led to mark-to-market losses of Rs 150 mn. The overall debt burden worsened with the agro-technical plant in Derabassi, Chandigarh catching fire in April 2009 which has led to a nine-month loss of production during FY10. The plant resumed operations in January 2010 and the company has received an insurance claim of Rs 140 mn (Rs 60 mn as a loss of profit). The overall debt has increased from Rs 0.5 bn in FY05 (debt-equity was 1.5x) to Rs 4.5 bn in FY08 (debt-equity increased to 4.6x) and Rs 5.7 bn in FY10 (debt-equity increased to 13.0x, due to erosion of net worth because of derivative loss and fire). The company needs to retire Rs 1.5 bn worth of debt over the next one year for which the promoter is planning to infuse Rs 110 mn by way of preferential allotment, Rs 600 mn by way of hive-off of the pharmaceutical division and balance by way of bringing in strategic investors. The company is also in talks with its major bankers - State Bank of India, Union Bank of India

Punjab Chemicals needs to retire Rs 1.5 bn worth of debt over the next one year

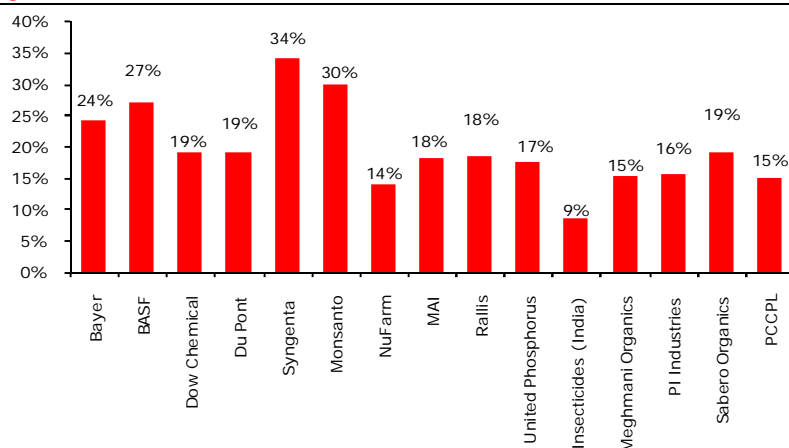
and Bank of Baroda - for reduction in interest rates, conversion of cash credit limit to working capital demand loan and deferment in loan repayment due dates by one year. CRISIL Equities believes that an internal restructuring plan will have its own challenges and will remain a key monitorable. Though we are optimistic about the growth of the agrochemical industry, we believe that the current debt obligations will continue to hinge on the future performance of the company unless it deleverages itself.

Aggressive acquisition approach may lead to pharma division hive-off

The overseas agrochemical acquisitions through debt have led to an acute financial crisis within the group and may force the management to hive off of the pharmaceutical division under Chandigarh-based Alpha Drugs Ltd, which it acquired in 2004 from DSM for Rs 2.5 mn. This was the first acquisition of the company and was merged with itself. The division manufactures anti-bacterial active pharmaceutical ingredients (API) of penicillin-based antibiotics, trimethoprim, gallic acid and its derivative products. This division contributed Rs 700 mn to FY10 consolidated revenues (12% of overall revenues). Ernst & Young, appointed for valuing this business, has assigned an enterprise value of Rs 800 mn. The dedicated debt for this division is worth Rs 200 mn. As per the management, the company is either planning to sell this division or dedicate 80% of the plant to a US-based entity. If any of these plans materialise, the company will be able to raise Rs 600 mn. Though we have not built in the sale of this division into our earnings estimates, we believe that selling this division or dedicating the plant to a US entity may not be difficult since the plant is a pioneer in the manufacture of import substitute intermediates for semi-synthetic penicillin.

The pharmaceutical division may be hived off due to the huge debt burden

Figure 3: Punjab Chemicals' margins lower than that of other players



Source: Company annual reports, CRISIL Equities

Thrust on food security and rising crop prices may provide respite

Governments of various countries, including India, are focusing on providing various forms of aids (higher farm subsidies, higher support prices, easy credit availability and rural infrastructure development) to the farmers to bring more area under cultivation, improve yield and ensure food security. Also, higher minimum support prices and rising crop prices have led to better profitability for farmers. This will lead to significant growth in the usage of agrochemicals in order to protect the crops, ensuring better yields. This augurs well for local players like Rallis India, United Phosphorus, Insecticides India, PI Industries, Dhanuka Agritech and Punjab Chemicals.

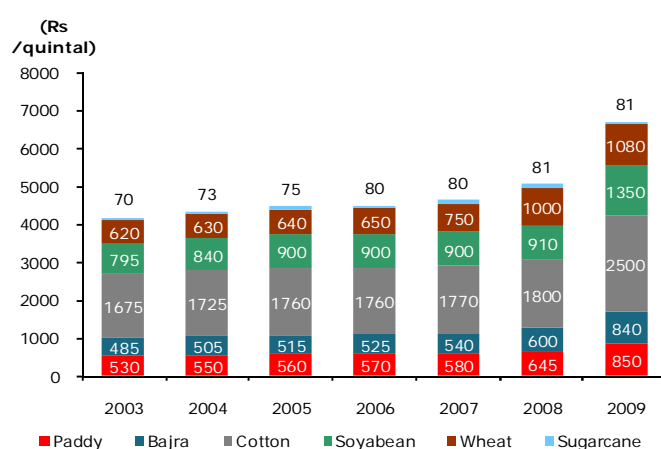
Rising MSP prices will motivate the farmers to use agrochemicals in order to improve farm yields

Table 4: GOI's agriculture investment plan

Name of the program	Planned expenditure	Period
Bharat Nirman	Rs 2.6 tn	2005-11
Electrification- Rajiv Gandhi	Rs 55 bn	2008-11
Grameen Vidyutikaran Yojna		
National Agriculture Development Programme	Rs 250 bn	Launch in FY08
National Food Security Mission	Rs 13.5 bn	2010-11
National Agriculture Innovation Project	Rs 14 bn	2007-11
Integrated Watershed Management Programme	Rs 24.6 bn	2010-11
Dept of Agriculture Research & Education	Rs 20.1 bn	2010-11

Source: Ministry of Finance, CRISIL Equities

Figure 4: Rising MSP prices



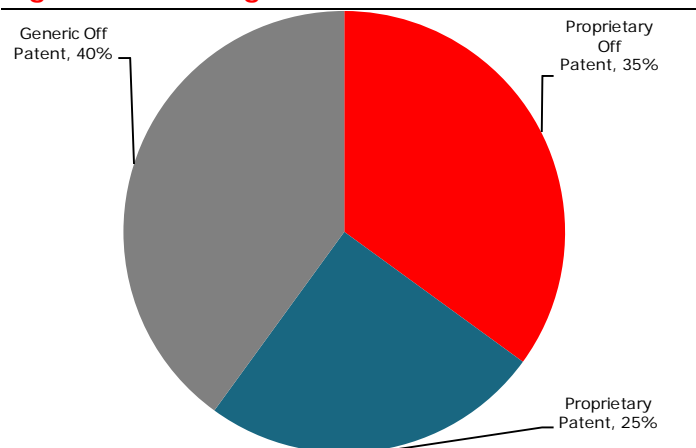
Source: Agricoop, CRISIL Equities

Generic market to provide huge opportunities...

The global agrochemical industry is estimated to be US\$ 42 bn industry and can be broadly divided into two segments – innovators and generics. Innovators are the original patent holders with a strong focus on R&D, whereas generic players operate in the off-patented product segment their key strength being low-manufacturing cost and strong distribution network. They manufacture off-patent products. Punjab Chemical is a generic player. Currently, patented products account for just 25% of the total agrochemical market; they are supplied by the top six innovators - Syngenta, Bayer, Monsanto, BASF, Dow Chemicals and Dupont. Out of the 75% market that is controlled by generic products, generic players account for only 30% while the rest is controlled by innovators. We believe that lower margins in the off-patent products, high registration cost and stringent regulatory environment will lead to a shift in the focus of innovators toward development of newer molecules or concentrate on the high-margin patented products. These products or brand divestments will create a golden opportunity for the generic players. Besides, as per Nufarm and MAI, patents worth US\$3.6bn or 52-56 product patents are expiring between 2009 and 2014, further widening the opportunity for generic players.

Global agrochemical industry is valued at US\$42 bn

Figure 5: Global agrichem market



Source: CRISIL Equities

Table 5: Products going off-patent

Products going off-patent (2009-13)	2007 sales (US\$ mn)
Herbicides	800
Insecticides	1350
Fungicides	1448
Other	50
Total	3648

Source: Nufarm, MAI, CRISIL Equities

... Punjab Chemicals may not reap the full benefit

However, CRISIL Equities believes that the current tight liquidity situation may not enable the company to reap the full benefit of imminent opportunities. Over the next few years, while local generic players will fight aggressively to acquire registrations for new off-patented products to strengthen their market share, Punjab Chemicals will have to be more focussed on lowering its massive debt burden.

Generic products comprise 75% of the total agrochemical market

Key risks

Weather vagaries could affect top line

Favourable weather increases the demand for agrochemicals. Hence, any seasonal vagaries will affect the demand for agrochemicals and consequently our earnings estimates.

GM seeds could reduce the usage of agrochemicals

The use of genetically modified (GM) hybrid seeds, largely immune to the common crop diseases, reduces the usage of agrochemicals. Hence, growth and acceptance of GM seeds among the farming community poses a threat to agrochemical sales which could hinder Punjab Chemicals' profitability.

Foreign exchange fluctuations

Punjab Chemicals earns 50% of its revenues in foreign currencies. Currently, it does not hedge its foreign currency position after it incurred a MTM derivative loss of Rs 150 mn in FY09. Any significant appreciation in the Indian rupee will impact our earnings estimates significantly.

Raw material volatility could affect margins

Punjab Chemicals' main raw materials are benzene, sugar, alcohol and yellow phosphorus. Benzene is a crude oil derivative and is subject to price fluctuations. Sugar and alcohols are government-controlled commodities, which could impact the company's margins if there is a spurt in prices. Yellow phosphorus is produced from China and is subject to significant price fluctuations.

Increasing usage of GM hybrid seeds can reduce dependence on agrochemicals

50% of the company's revenues are in foreign currencies

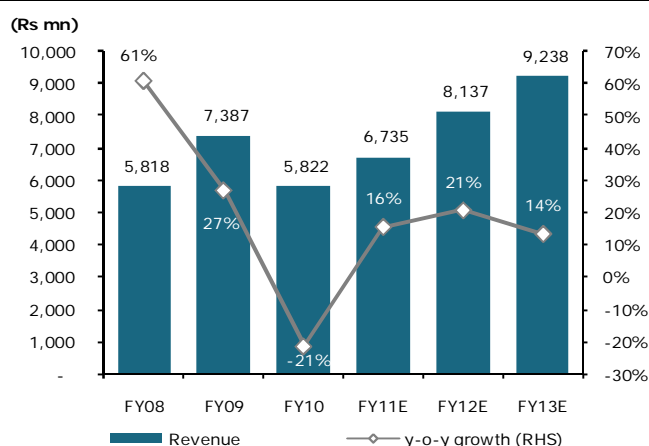
Financial Outlook

Revenues to grow at three-year CAGR of 17%

Punjab Chemicals' consolidated revenues are expected to grow at a three-year CAGR of 17% to Rs 9.2 bn in FY13 driven by growth in the agrochemical segment. This segment of the company is expected to grow at a three-year CAGR of 20% to Rs 7.5 bn in FY13 due to rising demand for its registered products in the regulated markets of Europe and Latin America. Other segments, viz. pharmaceuticals, industrial chemicals and trading are expected to report moderate growth. The fire at Derabassi agro-technical plant in FY10 has hit the company's operations for the first nine months and has led to fall in revenues by 21% to Rs 5.8 bn.

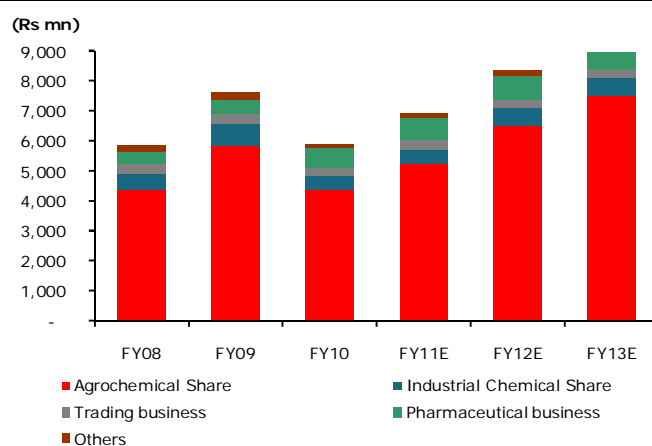
Revenues likely to grow at a three-year CAGR of 17% to Rs 9.2 bn in FY13 driven by growth in the agrochemical segment

Figure 6: Revenues and growth



Source: Company, CRISIL Equities

Figure 7: Agrochemical segment dominates



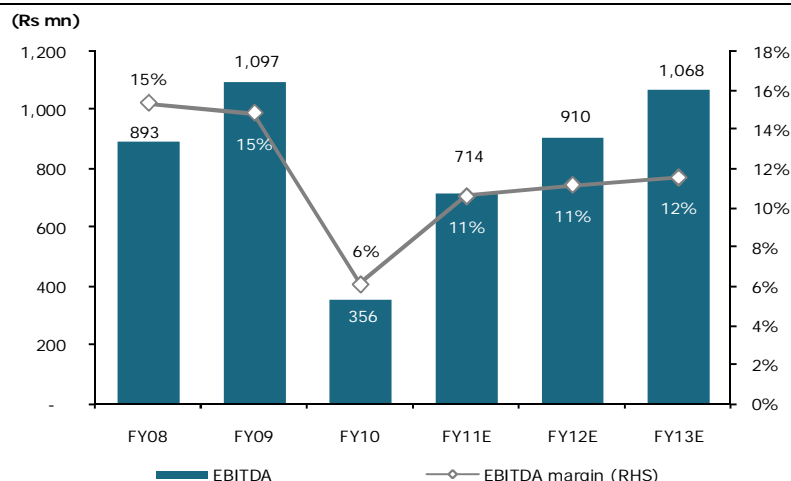
Source: Company, CRISIL Equities

EBIDTA margins to improve to 11.6% in FY13

We expect consolidated EBIDTA margins to improve to 11.6% in FY13 from 6.1% in FY10. The improvement will be driven due to higher margins of 19-20% contributed by its overseas subsidiaries and increasing utilisation at the restored Indian agro-technical plant. Punjab Chemicals reported ~15% margins in FY08 and FY09, which declined significantly in FY10 on account of the nine-month loss in production.

EBIDTA margins are expected to improve to 11.6% in FY13

Figure 8: EBIDTA margins to improve to 11.6% in FY13



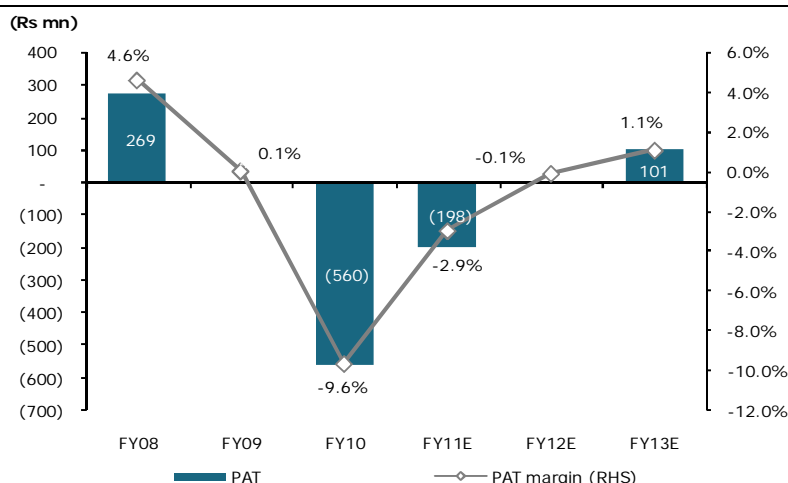
Source: Company, CRISIL Equities

PAT to become positive by FY13. EPS to improve to Rs 13 in FY13 from negative Rs 78 in FY10

Punjab Chemicals' consolidated PAT is expected to turn positive to Rs 101 mn only by FY13 on account of growth in the top line, improvement in EBIDTA margins and reduction in interest rates. EPS is expected to increase to Rs 12.7 in FY13 from negative Rs 77.9.

PAT to turn positive only in FY13. EPS is expected to improve to Rs 12.7 in FY13

Figure 9: PAT to turn positive only by FY13



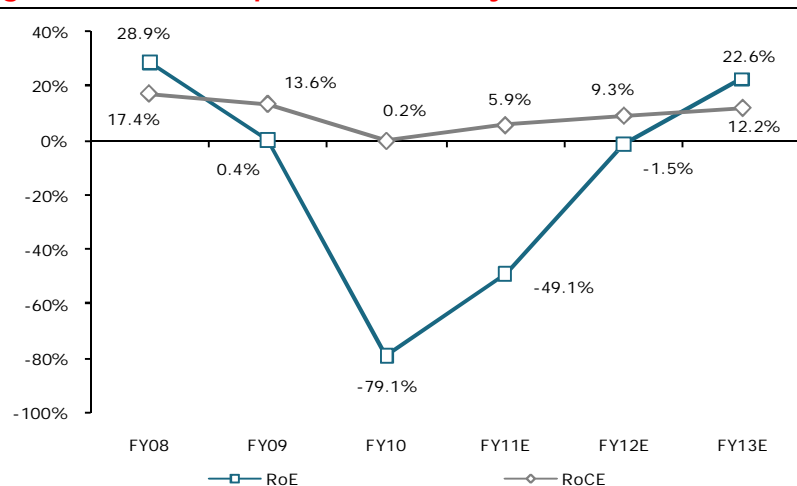
Source: Company, CRISIL Equities

RoE to improve to 22.6% in FY13

We expect RoE to improve to 22.6% in FY13 from negative 79.1% in FY10 due to improvement in net margin and increase in asset turnover to 2.85x by FY13 from 2.01x in FY10.

RoE is expected to improve to 22.6% in FY13

Figure 10: RoE to improve to 22.6% by FY13



Source: Company, CRISIL Equities

Management Overview

CRISIL's fundamental grading methodology includes a broad assessment of management quality, apart from other key factors such as industry and business prospects, and financial performance. Overall, we feel that Punjab Chemicals' management has strong domain expertise but their past acquisition strategy has gone sour.

Experienced top management with strong domain knowledge

Punjab Chemicals is headed by Mr Shalil Shroff (managing director) with over two decades of experience in the agrochemicals domain. He has been associated with the company since 1991-92 and has been responsible for driving the business in domestic and global markets. He is assisted by Mr Avtar Singh (whole time director - operations and business development), who has been with the company since 1980. He also served as a Junior Chemist at Gharda Chemicals (P) Ltd.

Experienced second line of management

Punjab Chemicals has an experienced second line of management with 20-25 years of experience each in their respective domains.

Mr Vipul Joshi (CFO) is a chartered accountant and has two decades of experience in accounts, audit and taxation; Mr Anand Gadre (SVP - formulations) has been with the company since the past two years and brings with him over two decades of experience in chemical formulations. Mr Mahadev Suvarna (VP – sales and marketing) is an MTech with over 17 years of experience in the field of marketing and business development. We did not get a chance to interact with the team of overseas subsidiaries and hence would not be in a position to comment.

Aggressive strategy led to financial stress

The management's strategy of growing inorganically using borrowed funds has stretched the overall financial situation. The company's plans to fund the overseas acquisition through debt, hoping to leverage growth prospects in the global agrochemical industry, has drained the company's financial during the global downturn. Besides, the aggressive approach to hedge its foreign currency exposure in FY09 had further strained its financial by yielding Rs 150 mn MTM derivative losses.

Overall, the past strategy followed by the management has led them into a tight liquidity situation.

Management's strategy of debt-funded acquisition has led to significant stress on the overall financial

Corporate Governance

CRISIL's fundamental grading methodology includes a broad assessment of corporate governance and management quality, apart from other key factors such as industry and business prospects, and financial performance. In this context, CRISIL Equities analyses shareholding structure, board composition, typical board processes, disclosure standards and related-party transactions. Any qualifications by regulators or auditors also serve as useful inputs while assessing a company's corporate governance.

Overall, Punjab Chemicals' corporate governance practices need to be strengthened.

Board composition and processes

The board consists of 12 directors of whom four are independent, which meets the minimum stipulated SEBI listing guidelines. Mr G. Narayana is a non-executive and non-independent chairman. Mr Vijay Rai, one of the independent directors, has close to three decades of experience in the food processing, chemicals, fertilisers and engineering industries. He has served as CEO of Rallis India for over 12 years. Besides, the company has three committees – audit, remuneration and investor grievance, each chaired by an independent director.

Fairly good disclosure levels

Punjab Chemicals' quality of disclosure can be considered fairly good, judged by the levels of information and details furnished in the annual reports, quarterly disclosure, website and other publicly available data.

Internal control systems need to be strengthened

Overall internal control systems seem inadequate at Punjab Chemicals and need significant improvement. There has been a series of auditors' qualifications and some of them have been continuing since the past three to four years.

Table 6: Series of auditors' qualification with regard to inadequate internal control systems and delay in honoring statutory liabilities

Qualifications	
1	Process of physical verification of the fixed assets, though done by the management as per the regular programme, needs to be strengthened with regard to the size of the company and nature of assets.
2	The company is not providing for diminution other than temporary, in value of certain long-term investment amount to Rs 9.8 mn as required by the ICAI accounting standards. This qualification is continuing since the past four years.
3	The company is not regular in depositing statutory dues with appropriate authorities and there have been serious delays in a large number of cases. This has been continuing since FY09 because of liquidity problems.
4	The company has delayed certain repayment of dues (including interests) to domestic financial institutions and banks. This has been continuing since FY09 because of liquidity problems.
5	The company has used funds raised on short-term basis amounting to Rs 423 mn for long-term purposes like purchase of fixed assets, investments and funding of operating losses.
6	The company is not consolidating certain of its subsidiaries and associates and hence full impact is not ascertainable by the auditors. This has been continuing since FY07.

Source: Company, CRISIL Equities

Overall corporate governance practices need to be strengthened

Punjab Chemicals and Crop Protection Ltd

Valuation

Grade: 3/5

We have used EV/sales method to value Punjab Chemicals and arrive at a fair value of Rs 126 per share. The stock is currently trading at Rs 121 per share. Consequently, we initiate coverage on Punjab Chemicals and assign a valuation grade of '3/5'. This grade indicates that the current market price is 'aligned' with the fair value.

We have assigned a one-year forward EV/sales multiple of 0.8x to Punjab Chemicals' FY12 revenues of Rs 7.9 bn. The assigned multiple is based on the median EV/sales multiple of 12 peers including top six innovators. We have considered global players also since Punjab Chemicals generates 50% of its revenues overseas. These 12 companies are currently trading at a one-year forward median EV/sales multiple of 1.3x. We have assumed a discount of 40% to the median multiple considering the high debt-equity ratio in case of Punjab Chemicals which will not enable revenue growth to flow into the bottom line. Hence, our fair value estimate based on the assigned EV/sales multiple of 0.8x is Rs 126 per share.

We initiate coverage on Punjab Chemicals with a valuation grade of '3/5'

Table 7: Punjab Chemicals' valuation summary

Particulars	Rs mn
FY12 revenues	7,940
Median multiple	1.3
Assigned multiple	0.78
Enterprise value	6,193
Less: Net debt	5,244
Equity value	949
No of shares	8
Fair value	126

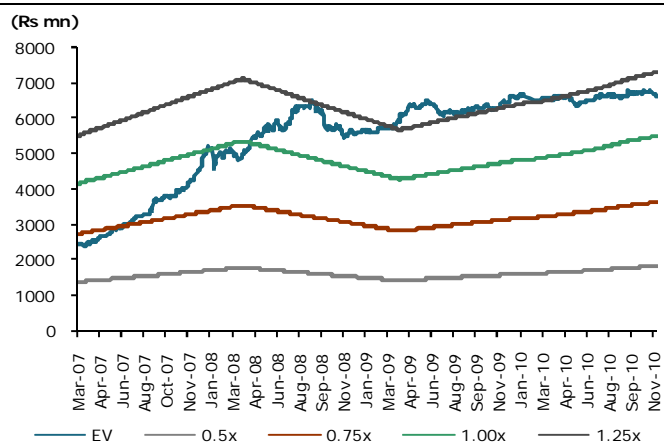
Table 8: Peer comparison

Companies	Market Cap (in mn)	Sales (in mn) FY10	EBITD A (%) FY10	ROE (%) FY10	EV/EBITDA (x)			EV/Sales (x)		
					FY10	FY11E	FY12E	FY10	FY11E	FY12E
Punjab Chemicals	912	5681	6%	-79%	17.6	8.6	6.8	1.11	0.94	0.78
Global Innovators & Generics (US\$)										
Bayer*	66,355	43,462	24%	8%	5.8	6.4	6.0	1.4	1.3	1.3
BASF*	57,237	70,688	17%	8%	6.3	5.1	4.9	1.1	0.9	0.8
Dow Chemical*	36,319	44,875	9%	2%	13.3	7.7	7.0	1.2	1.1	1.0
Du Pont*	42,002	26,109	12%	25%	11.7	6.4	6.0	1.4	1.2	1.1
Syngenta *	26,824	10,992	22%	23%	12.0	11.8	10.4	2.6	2.5	2.3
Monsanto ^	31,931	10,502	24%	11%	11.5	9.8	8.7	2.8	2.6	2.4
NuFarm #	1,164	1,927	5%	-2%	18.5	7.4	6.5	1.0	0.8	0.8
MAI *	2,077	2,215	1%	3%	13.0	11.8	8.8	1.3	1.2	1.3
Median			14%	8%	11.8	7.6	6.7	1.3	1.2	1.2
Average			14%	10%	11.5	8.3	7.3	1.6	1.4	1.4
India Generics (Rs)										
Rallis	25,577	8,787	18%	30%	15.1	11.6	9.3	2.8	2.3	1.909
United Phosphorus	83,427	52,900	17%	20%	9.8	7.4	6.4	1.7	1.5	1.329
Insecticides (India)	2,693	3,969	9%	25%	9.1	NA	NA	0.8	NA	NA
Meghmani Organics	4,158	8,163	15%	11%	NA	NA	NA	1.3	NA	NA
PI Industries	5,513	5,425	16%	19%	8.8	NA	NA	1.4	NA	NA
Sabero Organics	1,792	4,303	19%	41%	3.2	2.8	2.2	0.6	0.5	0.405
Median			16%	23%	9.1	7.4	6.4	1.3	1.5	1.3
Average			16%	24%	9.2	7.3	6.0	1.4	1.4	1.2
Overall median			16%	15%	11.5	7.4	6.5	1.3	1.2	1.3
Overall average			15%	16%	10.5	8.0	6.9	1.5	1.4	1.3

Source: CRISIL Equities

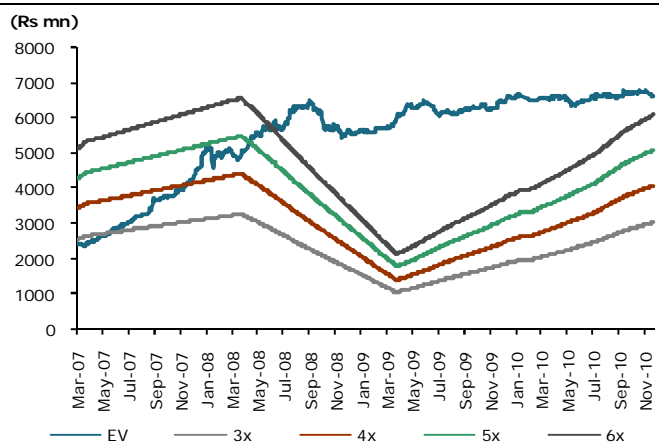
* For CY2010 and CY 2011, ^ Year end August, # Year end July

One-year forward EV/Sales band



Source: Company, CRISIL Equities

One-year forward EV/EBITDA band



Source: Company, CRISIL Equities

Company Overview

Incorporated in 1975, in joint collaboration with Excel Industries Ltd, Mumbai and PSIDC, Punjab Chemicals initially started as a manufacturer of oxalic acid and diethyl oxalate. After a decade of mastering the oxalic chemistry, the company diversified into agrochemicals (technical and formulation) and specialty chemicals. In 2004, it started manufacturing pharmaceutical APIs and intermediates by acquiring Lalru (Chandigarh)-based Alpha Drugs Ltd. In 2006, the company entered the international trading business in order to address the customer requirements for products not manufactured by the company. To expand its global presence, it set up a subsidiary in Belgium by the name of Source Dynamics Agrochemicals (SDAG) and acquired 100% stake in AgriChem BV, the Netherlands and 85% stake in Sintesis Quimica, Argentina, which are engaged in the manufacturing of agrochemicals, industrial chemicals and bio-agro products. Punjab Chemicals is the world's largest manufacturer of oxalic acid with an annual capacity of 15,850 MT; this acid is used for textile processing, leather finishing and metal treatment and also as raw material for producing agro-technicals. The Indian manufacturing sites are located in Derabassi in Punjab – which manufactures agrochemical technical and intermediates in the field of crop protection; in Chiplun in Maharashtra and Vadodara in Gujarat – which manufacture agrochemical formulation; Lalru in Punjab – which manufactures pharmaceuticals API and intermediates; and Tarapur in Maharashtra – which manufactures industrial and specialty chemicals.

Incorporated in 1975, the company manufactures agrochemicals, industrial and specialty chemicals and pharmaceuticals APIs

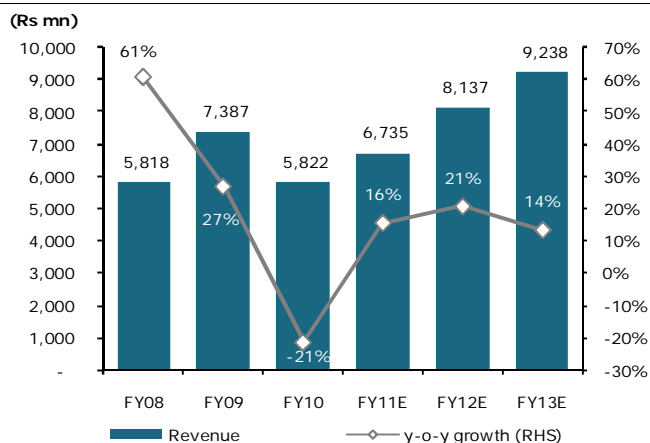
Table 9: Key milestones

1975	Started in joint collaboration with Excel Industries Ltd, Mumbai and PSIDC under the name of Punjab United Pesticides & Chemicals Ltd
1981	Began manufacturing oxalic acid
1983	Diversified into the manufacture of diethyl oxalate and specialty chemicals and increased manufacturing capacity of oxalic acid to 2,000 MT
1989-90	PSIDC divested its stake by selling the same in the market
1991	Discovered a method to recover waste NOX tail gases and manufacture sodium nitrite
1991-92	Mr Shalil Shroff joined to develop domestic and export markets
1993-94	Forayed into the manufacturing and marketing of agrochemicals
1994-95	Began product portfolio expansion
1997	Launched new products like FAO, EOC, MMH and increased export turnover on the back of high-value herbicides and intermediates like metamitron
2003	Started manufacturing pharmaceutical APIs by acquiring Alpha Drugs from DSM
2005-06	Entered the pesticides formulation business
2006	Amalgamation of all group companies ADIL/IA & IC/STS/PAURAJ
2006	Formation of SDAG Chem Belgium to cater to European markets
2006	SDAG acquired 85% stake in Sintesis Quimica, Argentina for US\$10 mn
2007	SDAG acquired 100% stake in Agrichem BV, the Netherlands for US\$40 mn
2007	SDAG acquired a 20% stake in Source Dynamic PLC, US

Source: Company, CRISIL Equities

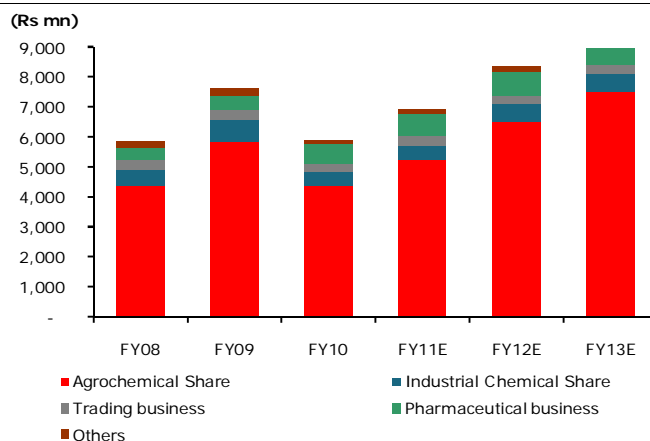
Focus Charts

Revenues and growth



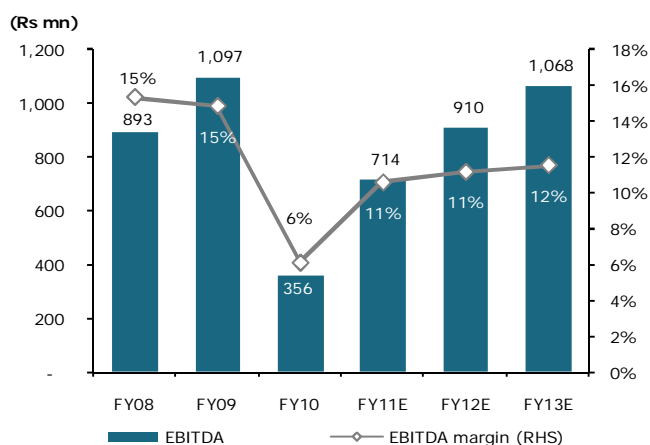
Source: Company, CRISIL Equities

Segment-wise revenues



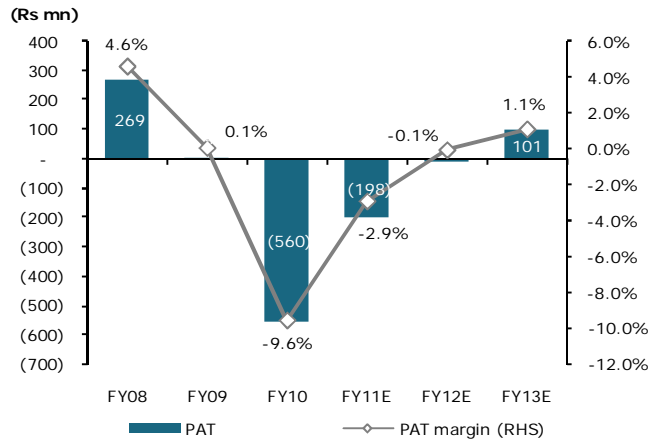
Source: Company, CRISIL Equities

EBITDA and EBITDA margin trend



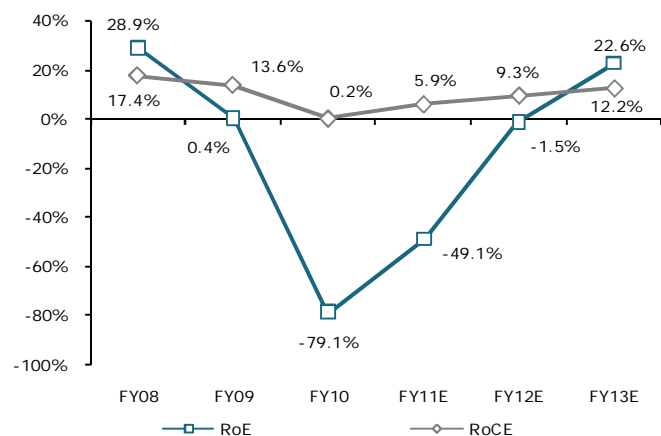
Source: Company, CRISIL Equities

PAT and PAT margin trend



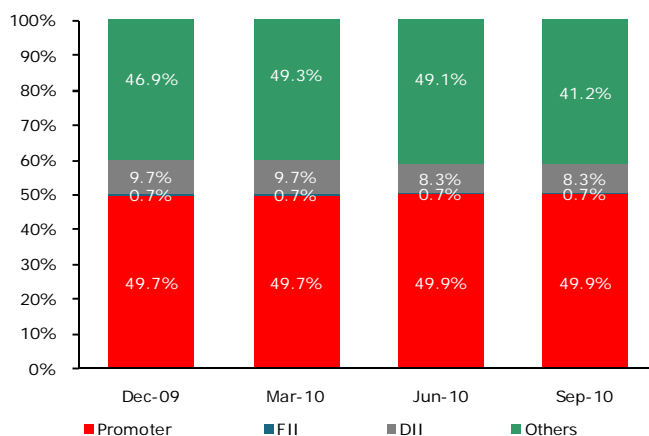
Source: Company, CRISIL Equities

RoE to turn positive only in FY13



Source: Company, CRISIL Equities

Shareholding pattern over the quarters



Source: Company, CRISIL Equities

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