

Riding the outsourcing bandwagon

14th December 2009

NOT COVERED

Price

Rs 65

Sensex – 17,098

Price Performance

(%)	1M	3M	6M	12M
Absolute	39	43	176	401
Rel. to Sensex	37	36	146	184

Source: Bloomberg

Stock Details

Sector	Chemicals & Fertilisers		
Reuters	SBRO.BO		
Bloomberg	SOG@IN		
Equity Capital (Rs mn)	292		
Face Value (Rs)	10		
No of shares o/s (mn)	29		
52 Week H/L (Rs)	70/10		
Market Cap (Rs bn/USD mn)	2/40		
Daily Avg Vol (No of shares)	658417		
Daily Avg Turnover (US\$ mn)	0.8		

Shareholding Pattern (%)

	30/09/09	30/06/09	31/06/09
Promoters	39.1	38.6	38.8
FII/NRI	13.4	17.6	24.0
Institutions	0.0	0.0	0.0
Private Corp	7.0	7.4	4.2
Public	40.4	36.4	33.0

Source: Capitaline

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We met the management of Sabero Organics Gujarat Ltd. (SOL) to discuss the changing dynamics of the agrochemicals industry, in general and the company's future plans, in particular.

SOL is a generic agrochemical player with a global presence. Domestic sales account for 35% of revenues while balance 65% is through exports. Its portfolio comprises of a balanced mix of fungicides (40%), insecticides (32%) and herbicides (19%). SOL has filed for 8-10 new product registrations in various key markets like US, Argentina, Brazil, Australia etc with each offering an opportunity of Rs 400 mn to Rs 800 mn. About 3-4 products have already been registered in the previous 4-6 quarters and more are likely to follow suit in the next 2-4 quarters. In FY09, the company increased its capacity of various key products (Mancozeb, Glyphosate, Acephate, Monocrotophos etc) at a capex of Rs 350 mn with estimated incremental revenues of ~Rs 2 bn.

Going forward, growth is likely to be driven by a ramp up in sales of its existing products, product approvals in other key markets and new product launches in the domestic as well as global markets. In previous two years, company has significantly benefited from operating leverage and its EBITDA margins improved from ~10% in FY05-07 to ~19% recently which has boosted its bottomline growth. Management believes that company can potentially report a revenue growth (CAGR) of 25-30% for the next 2 years. At current valuations of 4.6x FY10 annualised EPS of Rs 14 and EV/EBITDA of 3.1x, we find the stock attractive compared to leading peers in the industry.

Diversified product portfolio and export market focus to reduce volatility

Herbicides, fungicides and insecticides contribute 19%, 40% and 32% to the topline of the company. In fungicides, Mancozeb is the highest contributor with 80-90% of its fungicides revenues and SOL is the world's 2nd largest manufacturer of Mancozeb after United Phosphorus Ltd. In herbicides, the company's main product is Glyphosate (50-60% of herbicides revenues) while in insecticides, key products are Acephate (25-30%), Monocrotophos (25-30%) and Chloropyriphos (25-30%).

Unlike a domestic agrochemicals company, SOL is fairly insulated from volatility in revenues owing to its balanced product portfolio and global exposure.

Significant operating leverage to drive bottomline

Company has witnessed sharp expansion in EBITDA margins from ~10% in FY05-07 to 16.5% by FY09 and 19.6% by H1FY10 which is mainly driven by higher operating leverage. Since fixed cost has not increased in proportion to revenues, it has improved company's margins. Asset turnover has also improved from ~1.5x in Fy05-07 to ~2.5. Going forward, its asset turnover is likely to improve further since company can generate revenues of ~7 bn with current assets. Significant operating leverage is likely to drive company's PAT margins and return ratios.

Non-branded – B2B segment dominates its portfolio

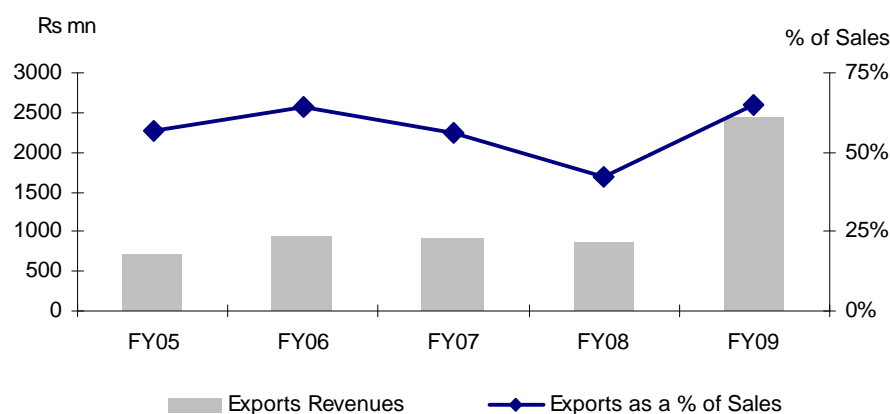
Sabero Organics has both branded and unbranded products in its portfolio. Products sold under the company's brand name (sold to dealers and distributors) contribute ~25% to the company's topline and command higher margins (2-4% higher than average margins) compared to its unbranded business. Its unbranded business primarily comprises of B2B under which, Sabero's products are packaged and sold to other companies who then sell them under their own brand name. SOL has, over a period of time, established brands like Mophos, Acehero and Glyweed, which are currently amongst the top 5 brands in the country. Its other brands include Robust, Lava and Emthane 45.

Diversified export destinations with focus in key markets

Sabero is exports focused company since approximately 30-35% of the volumes are sold in the domestic market while exports to other key markets like Europe, Columbia, Latin America, Africa, Australia etc contribute the remaining 65%. The company has recently entered into a few new markets, which are important for agrochemicals like Brazil, USA, Argentina etc and revenue contribution from these markets is likely to ramp up in the near future. In the international market, SOL caters to leading global players like Syngenta, Dow, Bayer, Nufarm, Arysta, Makhteshim, Dupont etc.

The company is strengthening its focus on the European and the Latin American markets. It already owns 240 registrations in 50 countries. Sabero has recently acquired its first registration of Chloropyriphos in Brazil in Apr '09 and is conducting field trials in Europe.

Export revenues as a % of sales



Source: Company, Emkay Research

Launched 4-5 new products in key global markets, few more in pipeline over the next two quarters

SOL has been aggressively filing for new product registrations in key markets like US, Europe, Australia, Argentina, Brazil, Latin America etc over the last 2-3 years. In the previous 3-4 quarters, it has already registered 4-5 new products in key markets like Australia, Argentina etc. Management expects approval of 3-4 more products in the next two quarters. All these product registrations offer a revenue potential Rs 400 mn to Rs 800 mn each (US\$ 8 mn – 15 mn) and is expected drive company's topline.

Invested Rs 350 mn to double its capacities

SOL has recently concluded its capex program to almost double the capacities of its key products like Mancozeb, Glyphosate, Chloropyriphos etc with an investment of Rs 350 mn. With expanded capacity, the company can potentially generate revenues of approximately Rs 7 bn, 2x its FY09 revenues. Higher utilization of existing assets is likely to drive operating leverage and improve its return ratios like RoCE and RoE.

Current v/s old capacities of key products

Product	Old Capacity	Post expansion capacity
Mancozeb	13,000 MT pa	32,000 MT pa
Chloropyriphos	1,000 MT pa	2,080 MT pa
Glyphosate	2,500 MT pa	5,000 MT pa

Source: Company, Emkay Research

Company is targeting products with potential revenues of Rs 400 mn to Rs 800 mn each

On expanded capacity, company can achieve revenues of Rs 7 bn, 2x its FY09 revenues

Other product capacities

Product	TPA
PCL3	20,000
TMP / TEP (multipurpose plant)	6,000 / 5,200
DETC / DMTC Amide (currently discontinued product)	2,000
Monocrotophos	1,980
Chloropyriphos	2080
Mancozeb Technical	32,000
DDVP	1,500
Glyphosate Tech	5,000
Acephate	2,600

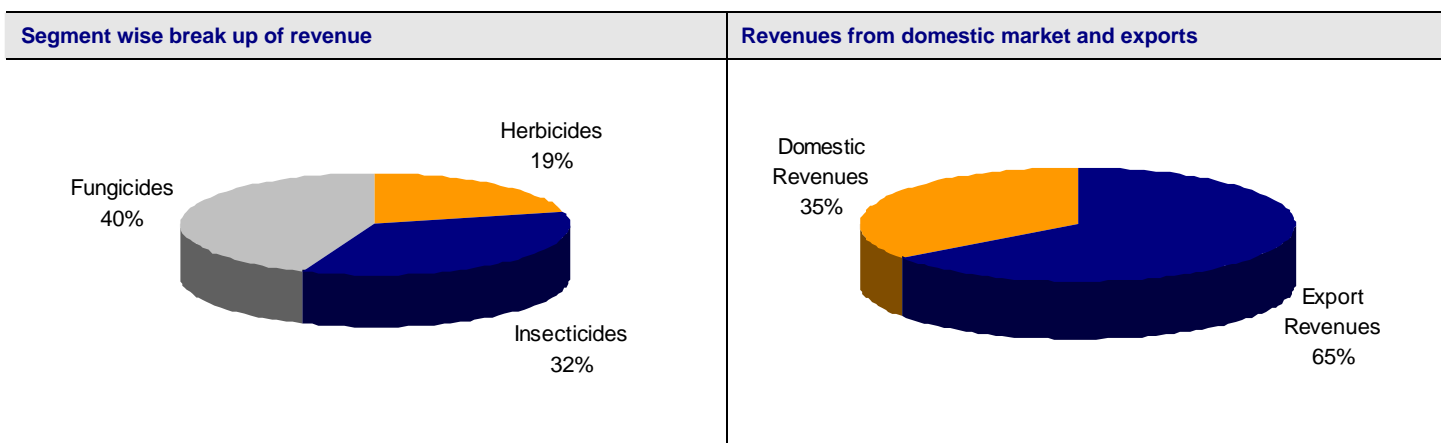
Source: Company, Emkay Research

Aggressive plans to drive future topline growth

Growth going forward is likely to be combination of –

- Leveraging existing product portfolio
- Launching new products in domestic as well globally
- Acquisition of products / companies

- Company has plans to expand its focus in Brazil, which is the 2nd largest agrochemical market in the world after the US. In the current financial year, it expects to obtain three more registrations for Mancozeb, Acephate & Glyphosate in Brazil.
- In the domestic market, company is targeting a revenue of Rs 4 bn in the next 2-3 years from Rs 1.4 bn in FY09. It expects this to be met by Rs 2 bn sales from its branded portfolio and balance Rs 2 bn through B2B segment sales. The company has expanded its operations to over 15 states in India with renewed focus to push its own brands at the farmer level.
- SOL's medium term ambitious plans target revenues of Rs 8 bn and Rs 10 bn by FY12 and FY13, which will be driven by both – domestic sales and exports.
- To accelerate growth, the company is also open to inorganic growth opportunities with acquisition targets of US\$ 20-30 mn. SOL may look at either product acquisition or target a company having a strong distribution reach and product portfolio.
- The company has already enhanced capacity at its existing plant, which can support revenues of approximately Rs 7 bn. To drive its revenues further, it may require a capex of Rs 500 mn, which can subsequently add Rs 2 bn to its revenues.



Source: Company presentation, Emkay Research

Source: Company presentation, Emkay Research

SOL's product portfolio

Product	Type of Product	About the product	Contribution	Biggest Markets	Main Competitors	Developments in the company
Mancozeb	Fungicide	Biggest selling fungicide in the world with a market size of US\$ 500 mn. Global capacity stands at 1,00,000 tonnes	~35-40% to the topline	USA, Europe	United Phosphorus, Indofil Chemicals	Recent expansion of capacity to 30,000 tonnes, which can potentially deliver a sales value of US\$ 125 mn at full capacity , giving the company a 25% global market share. Currently, the company has a capacity utilization of 50%.
Glyphosate	Herbicide	Biggest selling pesticide in the world. Total market size @ US\$ 4 bn. Global capacity at 500,000 tonnes. Currently, accounts for 30% of global herbicide sales . Expected to grow at a CAGR of 12%	15-20% of topline	USA, European Union, Argentina	Monsanto, Excel Crop Care	The company is completely backward integrated in Glyphosate starting from Yellow Phosphorus. It has recently obtained registrations in Europe – significant market for Glyphosate
Monocrotophos	Insecticide	Older organophosphate @ US\$ 200 mn. Banned in US, Europe, Australia India's largest selling insecticide at Rs 2 bn	~7% to the topline and 25% to the total Insecticide sales	India, South America, Far East, parts of Africa	United Phosphorus, almost no domestic competition	Sabero is backward integrated due to its TMP and PCL3 production
Acephate	Insecticide	Third largest insecticide in India at Rs 2 bn. Total Global capacity 20,000 tonnes	~7% to the topline and 25% to the total Insecticide sales	USA, Brazil, China, India, Argentina, Vietnam, Japan and Paraguay	United Phosphorus, Rallis, Meghmani, Arysta, Sumitomo	The company has registered in US for 3 MNC's (MAI, Arysta & Syngenta) and is currently selling the product via the unbranded route. Sabero has a total capacity of 2,500 tonnes with a capacity utilization of 50%.
Chloropyriphos	Insecticide	World's largest selling insecticide with global sales of US\$ 500 mn.	~7% to the topline and 25% to the total Insecticide sales	USA, South America (Brazil, Argentina)	Dow AgriSciences, Gharda (largest producer), MAI, Meghmani	The company has recently expanded its capacity to 2080 tonnes p.a. It has recently acquired registration for Chloropyriphos in Brazil and has booked orders of 800 MT from Brazil alone for FY10.

Source: Company presentation, Emkay Research

Products to be introduced

Products like : Fipronil (insecticide), Trichlopyr, Clodinafob Propargyl and Bispyribac Sodium (herbicides) are in the pipeline and the company is planning to introduce them shortly in the market.

Company Background

Promoted by Mr Hero Chuganee and Gujarat Industrial Investment Corporation, Sabero Organics was incorporated in 1991. It has its manufacturing facilities in Gujarat. It began operations in 1994 to manufacture organophosphorus intermediates for the crop protection business like Phosphorus Trichloride (PCL3), Tri Methyl Phosphite (TMP) & Di Ethyl Thio Phosphoryl Chloride (DETC). The company then forward integrated to manufacture active ingredients for agrochemicals like: Acephate (insecticide) and Glyphosate (herbicide) in 1998. It strengthened its focus in the international market in 1999 by setting up 6 subsidiaries and commenced exports to Asia, Europe and Australia. Further, it started production of Mancozeb (fungicide) in 2000, which is a key product of the company today and contributes 35 – 40% to its topline. Sabero Organics took its forward integration a step further by foraying into branded agrochemical formulations and built an all India distribution network to push its products in the market. The company ventured into Monocrotophos (India's largest selling insecticide) and DDVP in 2002. In 2005, it started manufacturing Chloropyriphos (world's largest selling insecticide).

After gaining a respectable market share in these products, the company shifted its focus to expansion and growth. During the financial year 2008-09, it embarked on a major capex program to expand its Mancozeb, Chloropyriphos and Glyphosate capacities. Its Acephate and Monocrotophos plants also underwent debottlenecking creating opportunities for efficiency improvement.

About the management

- Sabero Organics is promoted by the Chuganee family, which has more than 3 decades of experience in the business.
- The company was incorporated by Mr. Hero Chuganee, who has extensive work experience in the specialty chemicals industry. Prior to promoting Sabero Organics, he was the CEO for Rohm & Haas, India for 15 years – a premier specialty chemicals company. Currently, the company is headed by Mr. Mohit Chuganee, Vice-Chairman & MD along with Mr. Sumit Chuganee, Joint MD both of whom have a comprehensive working experience with US multinationals.

Financials and Valuations

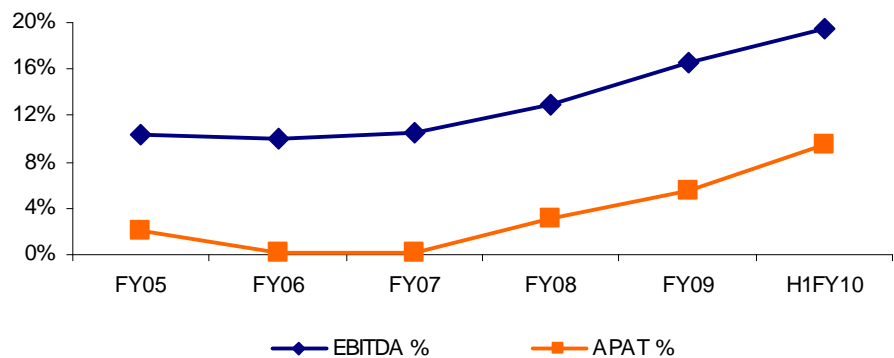
Sharp jump in EBITDA margins boosted profitability

Increased revenues with EBITDA margin expansion has increased profit margins from ~0% in FY07 to ~5% in FY09

SOL's EBITDA margins have almost doubled to 19.6% in H1FY10 from 10.3% in FY05. This significant improvement in margins is driven by higher operating leverage which company was able to achieve over a period of time. As witnessed from the chart below, EBITDA margins have improved from 10% in FY05-FY07 16.5% in FY09 and further to 19.6% by H1FY10. This sharp jump in EBITDA margins is contributed to –

- Reduction in Power and fuel cost since company started getting gas (previously based on furnace oil) since FY07, resulting in annual savings of approximately savings of Rs 40 mn.
- With topline growth of 32% (FY05-09 CAGR) staff and other expenditure have increased only at a CAGR of 19% during the same period and hence driving company's EBITDA margins.

EBITDA and APAT Margins



Source: Company, Emkay Research

EBITDA margin expansion facilitated bottomline growth

Driven by topline growth and margin expansion, PAT has increased multifold from a mere Rs 26 mn in FY05 to Rs 204 mn by FY09 resulting PAT margins have also improved significantly to 5%+ which was almost nil in FY05-07 period. It reported an EPS of Rs 7 in FY09. Its RoE has averaged a meager 15.5% for the last 3 years while FY09 saw a commendable performance with 35.2% RoE.

Net sales for H1FY10 grew by 25% YoY to Rs 2.2 bn with an EBITDA margin of 19.6%. The company reported APAT of Rs 213 mn for H1FY10 (up 46% YoY) and an EPS of Rs 5.

Valuations are attractive compared to peers

Sabero at 4.6x FY10 annualised EPS looks attractive compared to its peers, which are at 13-14x FY10E.

At the current price of Rs 65, the stock trades at FY09 P/E of 8.7x, EV / EBITDA of 3.5x and Mcap / Sales of 0.5x. Company has achieved an EPS of Rs 7 in H1FY10. At an annualized EPS of Rs 14, the stock trades at 4.6x FY10 earnings. Considering the other leading players in the industry like Rallis India and United Phosphorous which are trading at FY10 P/E of (Emkay est EPS) 13-14x we found that valuations of Sabero are attractive.

Valuations are attractive compare to peers

Rs mn	FY09						
	Sabero Organics	Nagarjuna Agrichem	Meghmani	Excel Cropcare	Dhanuka Agritech	Rallis #	UPL #
CMP (Rs)	65	275	16	131	224	915	161
Market Cap	1897	4098	4069	1441	2056	11858	72768
Net Sales	3667	6054	7747	6848	3366	8328	49317
EBITDA	763	1080	1015	1057	382	1159	9449
EBITDA %	20.8%	17.8%	13.1%	15.4%	11.3%	13.9%	19.2%
APAT	218	493	505	278	232	836	5366
APAT %	5.9%	8.1%	6.5%	4.1%	6.9%	10.0%	10.9%
EPS	7.0	32.2	1.9	24.4	24.3	63.3	12.2
Debt-Equity	1.03	0.68	0.44	1.05	0.86	0.19	0.74
RoE	35.2%	37.7%	17.1%	21.1%	38.8%	25.5%	21.9%
RoCE	37.5%	45.2%	17.7%	22.4%	41.3%	34.6%	15.7%
P/E	8.7	8.5	8.3	5.4	9.2	14.5	13.2
EV / EBITDA	3.5	4.5	5.9	2.8	6.8	10.9	7.5
P/ BV	2.6	2.7	0.9	1.0	3.0	4.2	3.9

Source: Capitaline, Emkay Research

Note: As per Emkay Estimates

Prices as on 14th December, 2009

Risks and Concerns

- Mancozeb is the largest product of the company. It contributes 35-40% to its topline. Large share of one product in the portfolio makes the company vulnerable to price and demand fluctuations.
- Agrochemical prices are dependant on crude and crude linked derivatives. As crude prices fluctuate, it impacts the prices of various crop protection products.
- China is a large producer of many agrochemical products and due to its economies of scale, it poses significant threat to smaller Indian players like Sabero Organics (especially in highly commoditized products like Glyphosate).
- As the company exports ~65% of its products, it is exposed to the severe currency fluctuations we have witnessed in the recent past.

Financials

Profit & Loss account

Rs mn	FY05	FY06	FY07	FY08	FY09
Net Sales	1219	1441	1613	2064	3752
Raw Material + Variation in Inventory	770	900	985	1355	2544
% of Sales	63.1%	62.4%	61.1%	65.6%	67.8%
P&F	132	187	193	155	202
% of Sales	10.8%	12.9%	12.0%	7.5%	5.4%
Staff Cost	62	71	78	98	129
% of Sales	5.1%	4.9%	4.8%	4.7%	3.4%
Freight	42	56	67	66	83
% of Sales	3.4%	3.9%	4.1%	3.2%	2.2%
Other expenses	88	84	120	124	174
% of Sales	7.2%	5.9%	7.5%	6.0%	4.6%
Total Exp	1093	1297	1443	1797	3131
EBITDA	126	144	169	267	621
% of Sales	10.3%	10.0%	10.5%	12.9%	16.5%
Depreciation	47	49	50	53	57
EBIT	79	95	119	214	564
Interest	76	87	109	150	185
Forex loss	0	0	0	0	111
Other Income	11	6	3	24	19
PBT	14	14	13	88	287
Tax	-12	12	10	24	82
APAT	26	2	3	63	204
% of Sales	2.1%	0.1%	0.2%	3.1%	5.4%
Prior Period Adjustments	0	0	0	-4	0
Minority Interest	0	0	0	0	0
EO Income / Provision	5	13	1	0	0
RPAT	31	15	4	59	204
AEPS	1.5	0.6	0.1	2.0	7.0

Source: Company, Emkay Research

Quarterly Performance

Rs mn	Q1FY09	Q2FY09	Q1FY10	Q2FY10	H1FY09	H1FY10	%YoY
Net Sales	797	1000	1213	1031	1797	2243	24.9%
Raw Material + Variation in Inventory	546	654	772	625	1201	1397	16.4%
% of Sales	68.6%	65.4%	63.6%	60.7%	66.8%	62.3%	
Staff Cost	24	28	35	32	52	67	29.9%
% of Sales	3.0%	2.8%	2.9%	3.1%	2.9%	3.0%	
Manu, Admin, Other expenses	96	172	188	152	268	340	27.0%
% of Sales	12.1%	17.2%	15.5%	14.8%	14.9%	15.2%	
Total Exp	666	854	994	810	1520	1805	18.7%
EBITDA	130	146	218	221	276	439	58.8%
% of Sales	16.3%	14.6%	18.0%	21.4%	15.4%	19.6%	
Depreciation	13	14	18	19	27	37	35.9%
EBIT	117	132	200	202	249	402	61.3%
Interest	42	41	48	49	83	97	17.5%
Other Income	5	2	8	8	8	15	95.2%
PBT	80	94	160	160	174	320	83.6%
Tax	14	14	48	59	28	107	281.8%
APAT	66	80	112	101	146	213	45.7%
% of Sales	8.3%	8.0%	9.2%	9.8%	8.2%	9.5%	
EO Income / Provision	0	0	0	0	0	0	
RPAT	66	80	112	101	146	213	45.7%
AEPS	2.27	2.75	3.84	3.47	5.02	7.31	45.7%

Source: Company, Emkay Research

Balance Sheet

Rs mn	FY05	FY06	FY07	FY08	FY09
Equity Capital	207	255	273	292	292
Reserves & Surplus	72	179	165	230	436
Total Debts	573	599	622	553	801
Deferred tax liability	20	30	37	46	63
Minority interest	0	0	0	0	0
Capital Employed	872	1063	1097	1121	1592
Gross Block	953	991	1028	1062	1431
Depreciation	329	377	427	480	536
CWIP	0	0	0	13	24
Net Fixed Assets	624	614	601	595	919
Intangible Assets	0	0	0	0	21
Investments	0	0	0	0	0
Inventory	239	337	422	397	508
Debtors	166	191	179	370	634.216
Cash and Bank	47	71	90	133	185
Loans & Advances	132	163	204	238	406
Total Current Assets	584	763	895	1137	1733
Current Liabilities	329	312	402	596	1027
Provisions	7	3	2	16	55
Total Current Liabilities & Provisions	336	314	404	612	1081
Net Current Assets	248	449	491	525	652
Misc exp	0	0	5	0	0
Total Assets	873	1064	1097	1121	1592

Source: Company, Emkay Research

Ratio Analysis

	FY05	FY06	FY07	FY08	FY09
EBIDTA %	10.3%	9.9%	10.5%	12.9%	16.5%
EBIT%	6.5%	6.6%	7.4%	10.4%	15.0%
NPM %	2.1%	0.1%	0.2%	3.1%	5.4%
Adj ROCE (%)	9.1%	9.0%	10.8%	19.1%	35.4%
Adj ROE (%)		4.2%	0.9%	12.3%	32.7%
Adj EPS	1.5	0.6	0.1	2.0	7.0
Cash EPS	3.1	2.9	2.3	4.1	9.6
Book Value	13	17	16	18	25
DPS	0	0	0	0	0
Debtors days	50	48	40	65	62
Creditors days	150	122	149	163	141
Debt Equity (x)	2.0	1.4	1.4	1.1	1.1
PE (x)	43.5	111.9	434.2	32.2	9.3
Cash P/E (x)	0.05	0.04	0.03	0.06	0.15
P/BV (x)	4.8	3.8	4.1	3.6	2.6
EV/Sales (x)	1.6	1.6	1.5	1.2	0.7
EV/EBITDA (x)	15.2	15.7	14.2	9.2	4.3
M cap / Sales (x)	1.1	1.2	1.1	0.9	0.5

Source: Company, Emkay Research

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