INITIATING COVERAGE

# Sharda Cropchem

## *Rich harvest ahead!*

**OUTPERFORMER**

**22 December 2014**

**BSE Sensex: 27372**

**Sector: Agro Chemical**

| **Stock data** | |
|---|---|
| CMP (Rs) | 251 |
| Mkt Cap (Rs bn/USD m) | 22.7 / 359 |
| **Target Price (Rs)** | **358** |
| Change in TP (%) | NA |
| **Potential from CMP (%)** | **+43** |
| **Earnings change (%)** | |
| FY16E | NA |
| FY17E | NA |
| Bloomberg code | SHCR IN |
| 1-yr high/low (Rs) | 309/156 |
| 6-mth avg. daily volumes (m) | NA |
| 6-mth avg. daily traded value (Rsm/USDm) | NA |
| Shares outstanding (m) | 90.2 |
| Free float (%) | 25.0 |
| Promoter holding (%) | 75.0 |

*Stock price as on 19 December 2014*

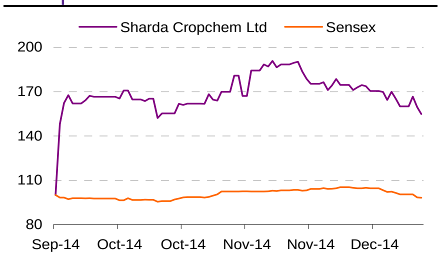
**Sharda Cropchem (Sharda) is a differentiated model in India's agrochemicals space with focus on exports (>95% of revenues) and nil investments in manufacturing assets. Sharda seeks to leverage its strong understanding of complex regulatory issues to secure expensive product registrations in regulated markets and cater to this demand through supplies from Chinese vendors. With US$128m sales (83% agrochemical sales) in FY14 and a steadily growing portfolio of new registrations in the EU/ US, we see strong growth ahead for Sharda (25%/ 24% revenue/ earnings CAGR over FY14-17E; ~27% RoCE in FY17E). We initiate coverage on the stock with Outperformer and a price target of 358.**

**Ability to secure registrations in EU/ USA:** USA, EU and Brazil are the most attractive global agrochemicals markets**.** With a complex process spanning four years and costing Euro3m-5m to secure a product registration, EU is the toughest generics market to enter. Sharda is the only Indian company other than UPL to have secured registrations in EU/ US and acquire critical mass in these markets (EU/ US – 50%/ 10% of FY14 agrochemical revenues).

**An asset light model with high EBITDA margins**: Sharda has been sourcing agrochemicals from China for nearly two decades now. With availability of sufficient manufacturing capacities in China, Sharda has opted for an asset light model which offers flexibility in responding to market dynamics. With tight cost controls, Sharda generates ~20% EBITDA margins (in line with peers).

**The best is ahead; Outperformer:** Sharda has been investing $10m-12m annually to create a pipeline of new registrations across the EU/ US and working on increasing sales infrastructure in key markets. Given its minuscule share of these markets, we expect a period of high growth trajectory for Sharda. At 11.2x FY17E earnings, we initiate coverage with Outperformer.

Price performance – relative and absolute




| (%) | 3-mth | 22 Sep 2014 |
|---|---|---|
| Sharda Cropchem | (12.2) | 61.3 |
| BSE Sensex | (2.4) | 0.6 |

Key valuation metrics

| As on 31 March | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| Net sales (Rs m) | 7,777 | 7,819 | 10,570 | 12,578 | 15,215 |
| Adj. net profit (Rs m) | 844 | 1,070 | 1,389 | 1,672 | 2,020 |
| Shares in issue (m) | 90 | 90 | 90 | 90 | 90 |
| Adj. EPS (Rs) | 9.4 | 11.9 | 15.4 | 18.5 | 22.4 |
| *% change* | *(83.0)* | *26.8* | *29.8* | *20.4* | *20.8* |
| PE (x) | 26.8 | 21.2 | 16.3 | 13.5 | 11.2 |
| Price/ Book (x) | 4.9 | 4.1 | 3.3 | 2.7 | 2.2 |
| EV/ EBITDA (x) | 15.6 | 14.5 | 10.2 | 8.5 | 7.0 |
| RoE (%) | 19.6 | 20.9 | 22.4 | 21.9 | 21.7 |
| RoCE (%) | 21.9 | 20.1 | 26.6 | 26.1 | 26.8 |

*Source: Company, IDFC Securities Research*

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# Sharda Cropchem – Rich Harvest Ahead

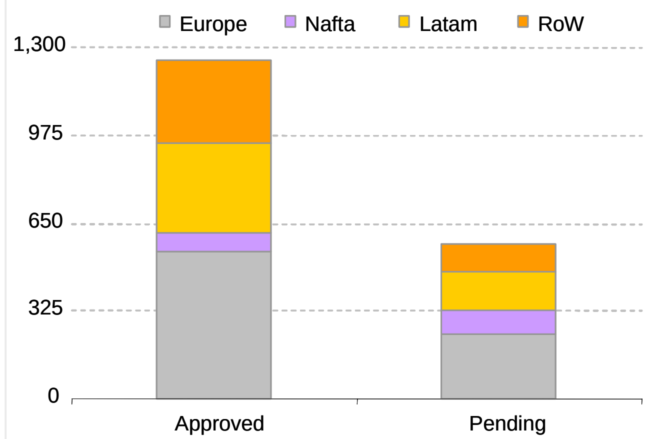
## Asset-light model with strong track record of registrations

**Limited overlaps with most agrochem**

**A differentiated business model**

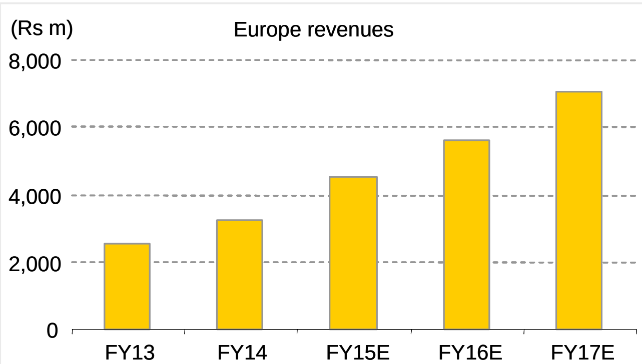
- **Focus on exports:** *(Exports comprise 95% of agrochem revenues)*
- **Asset-light model:** Does not own any manufacturing assets
- **Proven capability in securing registrations in regulated markets:** 600+ registrations in EU / US
- **Experienced management team and staff:** Promoters have >15 years of experience in global Agrochem industry
- **Cost-efficient model:** EBITDA margins comparable to peers despite outsourced manufacturing

**Existing registrations and pipeline across geographies**




## Europe would continue to be the biggest market

**EU business to cross Rs7bn (46% of total revenues) by FY17E**

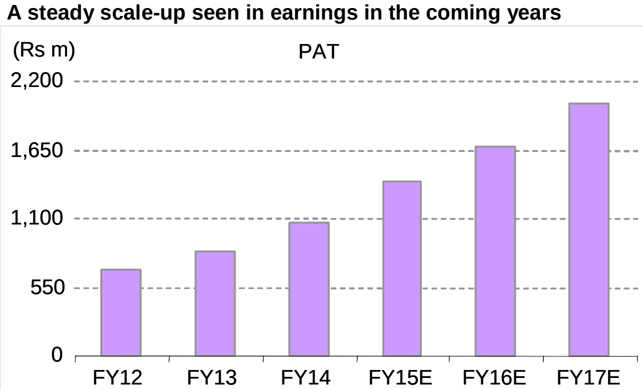



**Snapshot of Sharda's EU business**

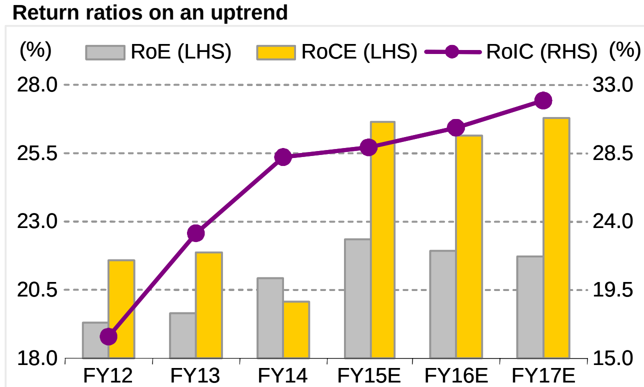
| | |
|---|---|
| Registrations secured (as of 30 September 2014) | 545 |
| Focus crops in Southern Europe | Fruits and vegetables |
| Focus crops in Central Europe | Oilseeds, cereals and potato |
| Largest molecules in Sharda's portfolio in EU | Tebuconazole, Quizalofop, Diquat, Imidacloprid and Nicosulfuron |

## Strong export footprint to drive profitability and return ratios

**A steady scale-up seen in earnings in the coming years**




**Return ratios on an uptrend**




Trading at attractive valuations of 11.2x FY17E EPS and 7x EV/ EBITDA

*Source: Company, IDFC Securities Research*

# Investment Argument

- **Given its presence in some of the largest global agrochemicals markets, a relatively minuscule share in these regions and aggressive investments in growth, Sharda makes a compelling growth story**
- **The management's long track record of dealing with global agrochemicals players and their deep involvement in the business has aided its success**
- **Investing US $10m-12m p.a. to create a pipeline of new registrations across the EU/ US and working on increasing sales infrastructure in key markets**
- **Significant growth opportunities through entry in new markets, launch of new molecules and label extension for new crops across geographies**
- **Strong growth potential with 25%/ 24% revenue/ earnings CAGR over FY14-17E and ~32% RoIC in FY17E; we initiate coverage on the stock with Outperformer and a price target of 358**

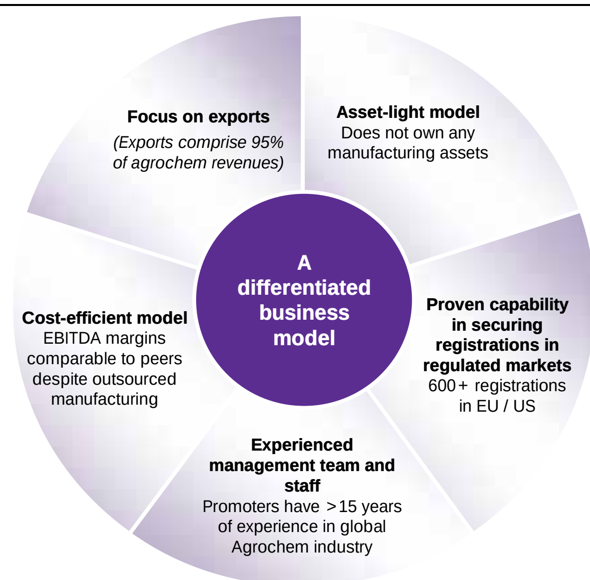
## Sharda: A differentiated business model

*Sharda emphasizes on identifying and registering molecules in high demand; unlike peers which focus on manufacturing*

Incorporated in 2004, Sharda is a global crop protection chemicals company with operations in more than 60 countries across Europe, NAFTA and LATAM. Sharda offers a wide product portfolio spanning fungicides, herbicides, insecticides and biocides. Unlike peers that focus on manufacturing, Sharda operates with an asset-light model with emphasis on identification and registration of potential molecules having strong demand.

Sharda primarily operates in highly regulated markets like the European Union and NAFTA, where high regulatory barriers give it a competitive edge. Sharda has an established marketing and distribution network across geographies. It has proven sourcing capabilities with access to a broad spectrum of cost-competitive manufacturers in China and India – another competitive advantage. The agro-chemicals business contributed ~83% to Sharda's consolidated revenues in FY14.

Exhibit 1: Sharda's business model has limited overlaps with most Indian agrochem peers



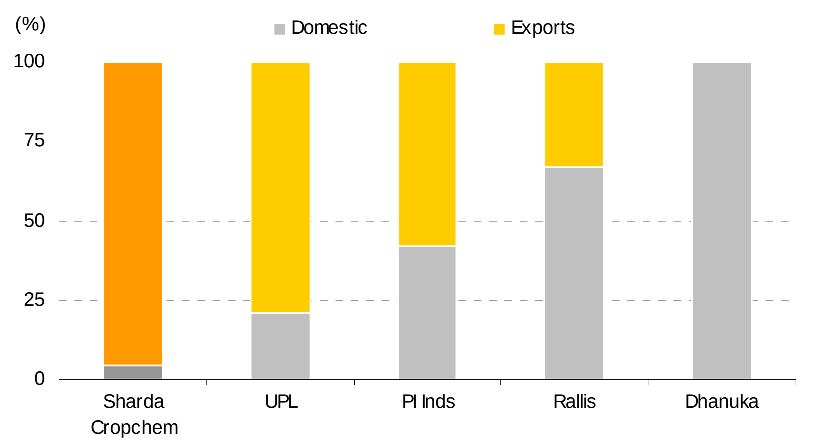

*Source: Company, IDFC Securities Research*

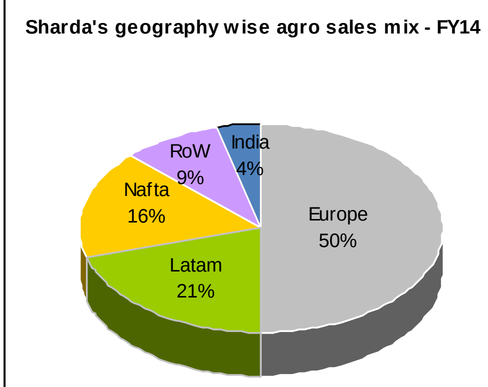
*About 95% of Sharda's sales come from overseas; EU accounts for ~50% of agro-chemical revenues*

## ❑ Focus on exports; strong presence in EU – a difficult market

Unlike most players in the Indian agrochemicals industry, Sharda has limited presence in the domestic market. Exports account for ~95% of the company's agrochemicals sales with EU being the largest market with ~50% of agro-chemical sales in FY14. Sharda's strong exports skew insulates it from being overly dependent on the Indian monsoon for growth, reduces dependence on a hyper competitive domestic agrochemicals market as also exposes it to a significantly larger market opportunity. However, Sharda's export focus also makes the business model vulnerable to the myriad currency movements and climatic fluctuations while reducing visibility on growth.

Exhibit 2: Sharda's export focus stands out with respect to peers




*Source: Company, IDFC Securities Research*

*Sharda sources its entire production from third-party manufacturers – a model more common in the West*

## ❑ An asset-light model – a key differentiator

Sharda follows an asset-light business model that involves no investment in manufacturing assets. The company sources its entire production from third-party manufacturers. The management has 20 years of experience in sourcing agrochemicals from China. In contrast, most Indian agrochemicals players have significant manufacturing assets. Sharda's approach of having an asset light model is aligned more with trends in the West with agrochemicals players outsourcing a significant proportion of their manufacturing.

*Capital spend focused on managing regulatory challenges and garnering product registrations*

An asset-light model, combined with availability of sufficient manufacturing capacities in China, has enabled Sharda to invest capital and time on the most challenging part of the global agrochemical value chain – managing the regulatory environment and securing registrations for products in regulated markets. Its asset-light model has also provided Sharda flexibility to respond to changes in demand across geographies.

Exhibit 3: An asset light model with no in-house active ingredient / formulation manufacturing

| | In-house active ingredient manufacturing | In-house formulation manufacturing |
|---|---|---|
| UPL | ✓ | ✓ |
| PI Industries | ✓ | ✓ |
| Rallis | ✓ | ✓ |
| Dhanuka | ✗ | ✓ |
| Sharda Cropchem | ✗ | ✗ |

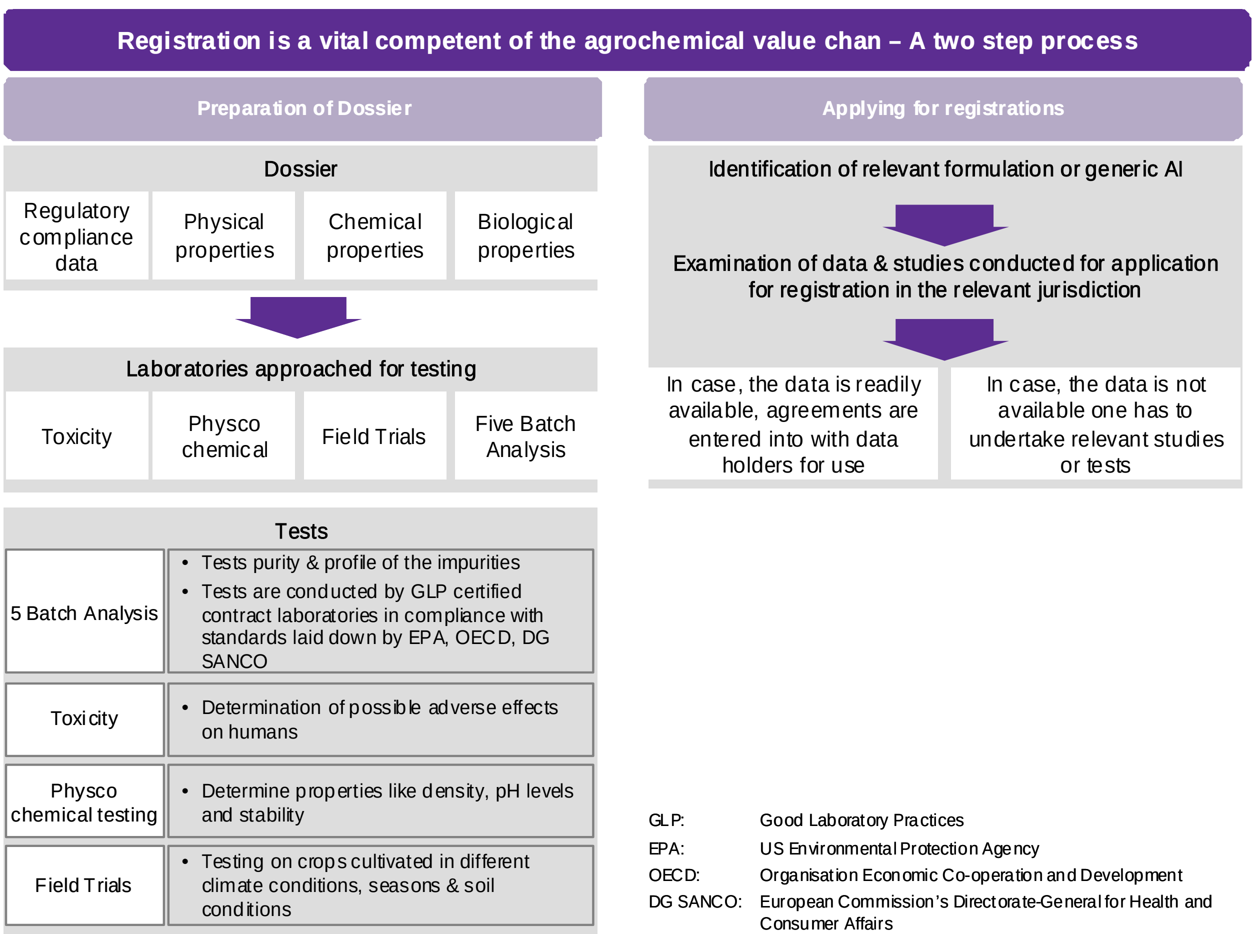
*Source: Company, IDFC Securities Research*

## ❑ Proven capability in securing registrations in regulated markets

***Capital-intensive and time consuming nature of registrations poses a huge entry barrier for new players***

Securing agrochemical product registrations is a challenging proposition, especially in developed markets. A typical new molecule registration process in the EU can cost Euro3m-5m and take more than four years to complete. Registrations are capital-intensive and time consuming and are, therefore, a huge entry barrier for new players.

Exhibit 4: Typical process involved in securing agrochemical product registrations in global markets

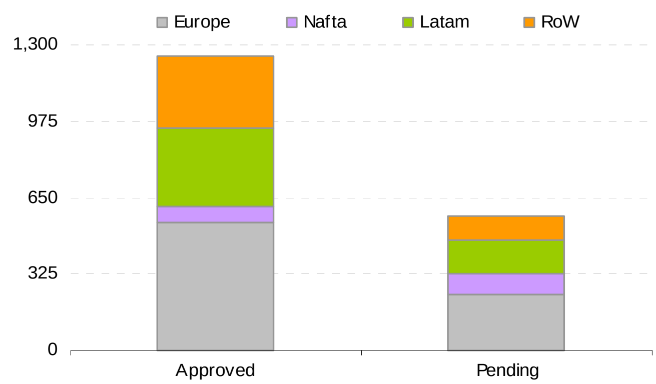


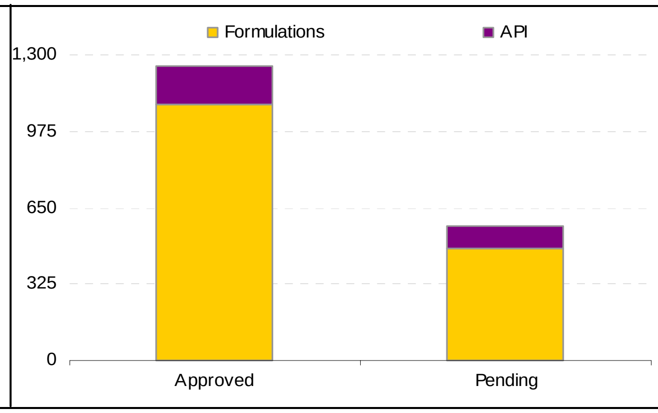

*Source: Company, IDFC Securities Research*

Sharda is one of the few players from India to have demonstrated the capability to secure agrochemical registrations in global markets. Sharda's core competencies in the area are: 1) identifying opportunities in generic molecules and corresponding formulations and generic active ingredients, 2) preparing dossiers, and 3) seeking registrations in some of the most complex markets like the EU and the US.

As of Sep-2014, Sharda owns 180+ GLP (Good Laboratory Practices) certified dossiers, 1,080+ registrations for formulations and 160+ registrations for Active Ingredients (AIs). As of Sep-2014, the company had ~575 registration applications pending approval globally. Cumulatively, Sharda has so far spent Rs4.1bn for registrations (including for products under development).

Exhibit 5: Sharda – number of approved/ pending registrations as of Sep-2014




*Source: Company, IDFC Securities Research*

***Sharda has been investing $10-12m p.a. for registrations, mostly in EU***

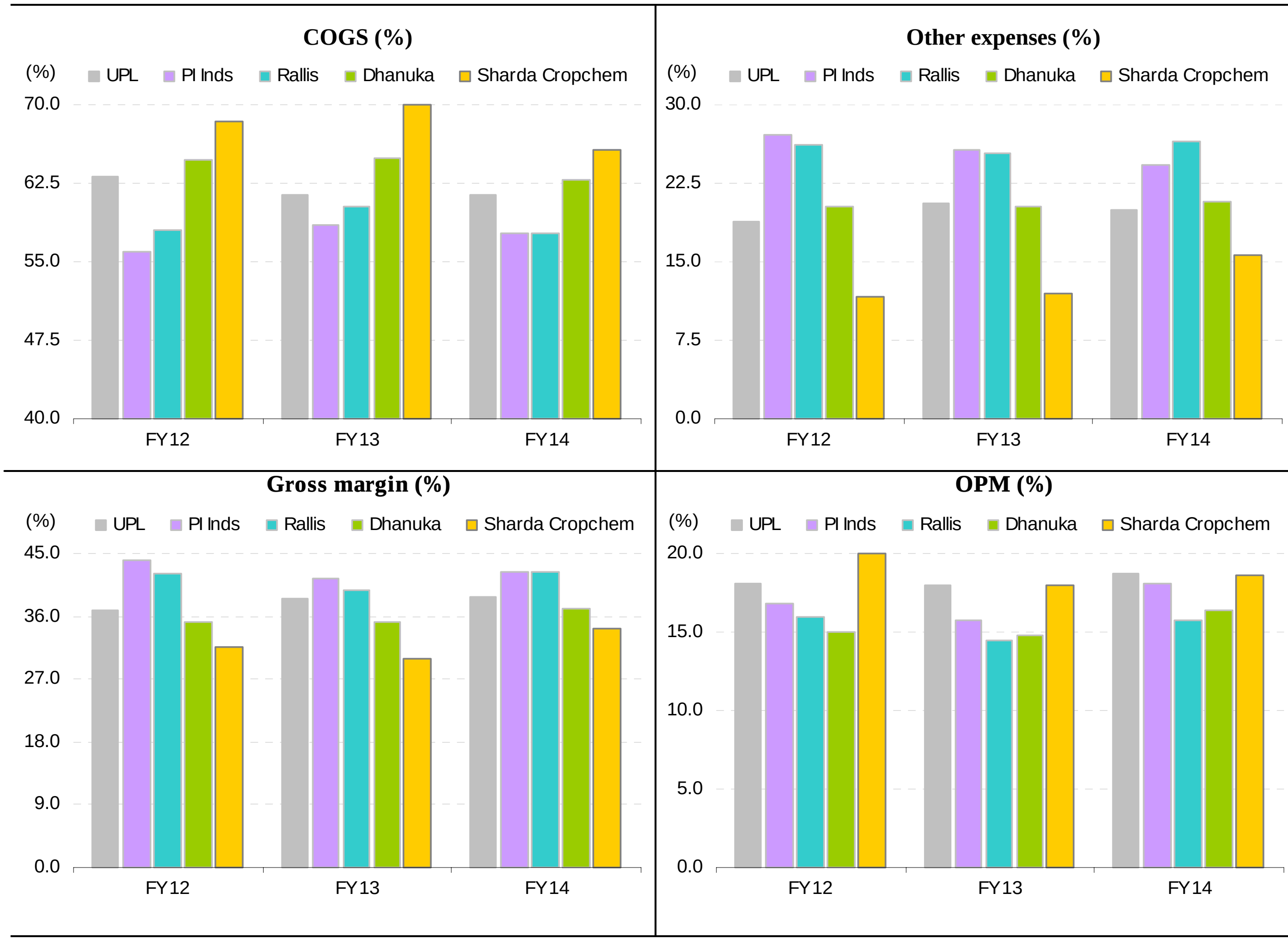
Sharda has been investing $10-12m per annum in registrations with a large proportion in the EU market. Going forward, registration spend is likely to steadily increase. The company has about 30 employees dedicated to securing registrations across various markets. Half of the team members are focused on the EU markets.

## ❑ A cost-efficient model; high operating leverage

***Access to cost-competitive producers and control on overheads have freed capital for strategic initiatives like registrations***

Sharda has superior sourcing capabilities with access to cost-competitive manufacturers in China and India. This has given the company an additional competitive edge and driven sustained gross profit margins of 32-36% despite third-party outsourcing. Further, the management's "hands on" operating style allows Sharda to exercise significant prudence in capital allocation and operational expense decisions, which enhances operating leverage by keeping overheads in control.

Exhibit 6: Despite lower gross margins, an optimized operating cost structure enables Sharda to generate competitive margins




*Source: Company, IDFC Securities Research*

## ❑ Experienced management team a key growth enabler

Sharda's promoters have significant experience in the agrochemicals business. Founder-promoter R.V. Bubna is an IIT-Mumbai graduate and was associated with Coromandel Fertilisers, Zuari Agrochemicals, Tata Oil Mills and other key companies before he set up Sharda. The second generation of promoters is represented by Ashish Bubna who has 22 years of experience in chemicals and agrochemicals marketing. He has been spearheading the company's product registration and market expansion efforts. The promoters are supported by a growing team of experienced professionals with considerable experience in the global agrochemicals industry.

## A multi-year growth story in the making…

***Geographic expansion, new molecules and label extensions to drive growth***

We expect 20%+ CAGR in revenues for Sharda over the next five years from Rs10.6bn in FY15E, helped by: 1) strong presence in some of the largest agrochemical markets (cumulative market size US $38bn across the EU, US and Latin America); 2) rapidly expanding portfolio of registrations across markets; and 3) steadily increasing direct sales infrastructure. Growth would be marked by expansion into new geographies, approval/ launch of new molecules and label extensions of approved molecules.

Exhibit 7: Sharda – a three-pronged growth strategy

**We expect revenue CAGR of 20%+ over FY14-17E**

- Expansion into new geographies
- Approval/ launch of new molecules
- Label extensions of approved molecules

*Source: Company, IDFC Securities Research*

### ❑ EU to remain the key growth driver

***EU is among the toughest regulatory regimes globally…***

Given a complex registration process that typically takes more than four years to complete and registration cost of Euro2m-4m per product, the EU is probably the toughest generics market. The approval process is complicated given the need to liaison with various local government bodies where it is quite difficult to secure appointments. Our discussion with the management has revealed that in many EU countries, ministry appointment slots are not available for 2015.

Besides UPL, Sharda is the only Indian company to have secured registrations in the EU and the US and to have acquired critical mass in these markets (EU/ US account for 50%/ 10% respectively of Sharda's FY14 agrochemical revenues with cumulative sales of Rs 4.31bn (US $71m).

***… acting as a strong entry barrier – a key advantage for players like Sharda***

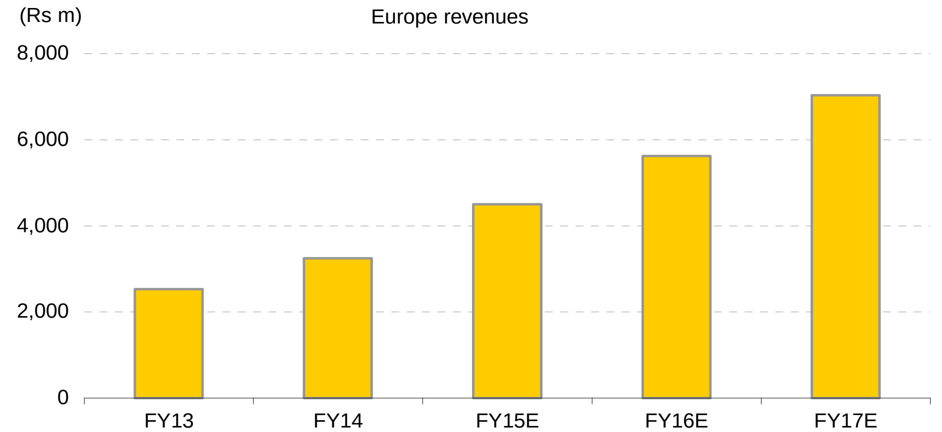
Sharda's EU revenues have registered 44% CAGR over FY12-14 to Rs3.24bn. EU would remain the primary growth driver for the company given tough entry barriers, highest profitability levels and Sharda's strong presence in the market. We expect the EU business to cross US$117m (Rs7bn) by FY17 from $54m in FY14. There could be positive surprises if the company secures some key approvals in the larger markets of Germany, France and Spain.

Exhibit 8: Snapshot of Sharda's EU business

| | |
|---|---|
| No. of registrations secured (as of 30 September 2014) | 545 |
| Focus crops in Southern Europe | Fruits and vegetables |
| Focus crops in Central Europe | Oilseeds, cereals and potato |
| Largest molecules in Sharda's portfolio in EU | Tebuconazole, Quizalofop, Diquat, Imidacloprid and Nicosulfuron. |

*Source: Company, IDFC Securities Research*

Exhibit 9: EU would continue to be the biggest market for Sharda




*Source: Company, IDFC Securities Research*

***We expect the EU business to cross US$117m (Rs7bn) by FY17 from $54m in FY14***

### *Label extensions of approved molecules*

***Sharda targets expanding its EU portfolio to 30-35 molecules from 20-22 currently***

Sharda has been investing aggressively in filing applications for label extensions in both existing and new molecules. Sharda has ~20 molecules approved in the EU and expects the portfolio to grow to ~30 molecules over the next 2-3 years. The management is positive on growth potential of the newer filings as they include some large products like generic formulations of Syngenta's Azoxystrobin and Cyproconazole fungicide formulations.

The management is also pursuing opportunities for application label extension for new crops for its approved molecules (~20) and sees it as a significant growth opportunity. Each crop label extension approval takes around four years and costs Euro50,000-70,000 per crop.

Label extension opportunities in the EU have been increasing with deepening of Sharda's sales network in the EU – leading to a greater number of interactions with various local distributors in new geographies and, consequently, new crop application possibilities.

### *Expansion into new geographies*

***Sharda shoring up "registration capabilities" with a spurt in number of active applications***

Sharda has been steadily strengthening and broad-basing its sales presence in the various EU countries. Sharda has ~25 sales people located at many countries including Germany, Hungary, Poland, Romania, Czech Republic, Spain, Italy and Portugal. The company continues to explore opportunities to establish sales presence in new markets and plans to enter Slovakia in FY15.

### *Launch of new molecules*

The management is also focusing on strengthening "registration capabilities" of the firm. It has ~20 people across various countries in the EU working on product registrations. Sharda expects the team to expand given a sharp increase in the number of active registration projects. As of August 2014, the company had filed more than 220 applications in Europe. The applications are in various stages of the registration process.

## ❑ Making inroads into NAFTA region

*Focus has been more on profitability than volumes in NAFTA region*

Sharda entered the NAFTA (North American Free Trade Agreement) region through the US and Mexico. The company made a strong entry in Canada in FY15 with the approval and launch of herbicide Diquat. Sharda's NAFTA revenues have registered a 10% compounded annual decline over FY12-14 to Rs1.1bn (US$18m) in the absence of a large repeat order in Mexico in FY14 and focus on profitability rather than volumes.

The US is currently Sharda's primary market in the NAFTA region. Sharda has 12 molecule registrations in the country with a focus on cereals and soybean. The company is currently focusing on the Mid-West region and is not looking to enter California or the West Coast in the near term.

Exhibit 10: Sharda – snap-shot of NAFTA business

| | |
|---|---|
| No. of registrations secured (as of 30 September 2014) | 68 |
| Focus crops in NAFA | Cereals and soybean |
| Focus molecules | Paraquat, Chlorpyriphos, Imidacloprid, Propiconazole and Fomesafen |

*Source: Company, IDFC Securities Research*

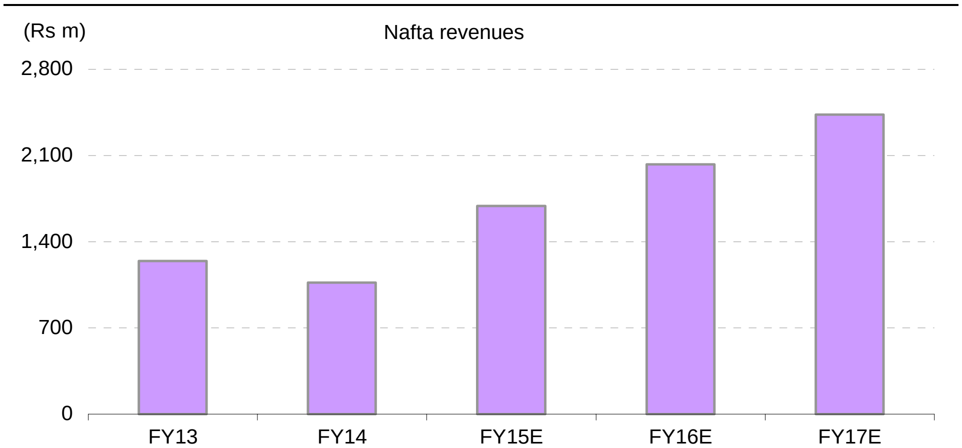
*Sharda targeting small local distributors to overcome fragmented nature of distribution in the US*

While the registration process is easier in the US than in EU, penetrating an extremely consolidated distribution channel poses a big challenge. To tackle this, the company has been targeting smaller local distributors with encouraging results. In contrast to its strategy of pursuing higher profitability (like in the EU), Sharda is now looking to prioritize volume growth over profitability in the US. Given its strategic focus on volume growth and success in penetrating the distribution channels, the company is quite optimistic on growth outlook of the US market.

Given lower competitive intensity and its ability to spot interesting product opportunities, Sharda also sees good growth prospects in the Canadian and Mexican markets. As of Sep-2014, Sharda has 80+ registration applications in NAFTA region. We expect Sharda's sales in NAFTA market to cross US$40m by FY17 from US$18m currently.

*We expect sales in NAFTA market to cross US$40m by FY17 from US$18m now*

Exhibit 11: Steady scale-up ahead, driven by the US and Canada




*Source: Company, IDFC Securities Research*

### ❑ LATAM business in early growth phase

*Colombia is key LATAM market, followed by Peru, Ecuador and Argentina*

Sharda's first LATAM registration was in Argentina. Subsequently, the company extended its operations to Brazil, Paraguay, Colombia, Peru and Ecuador. Revenues have seen a 9% compounded annual decline over FY12-14 to Rs1.3bn (US$22m) as sales were inflated in FY12 due to a one-time low-margin supply order for Acephate.

*Sharda has filed ~40 formulation applications in Brazil; approvals to accelerate LATAM sales*

Colombia is Sharda's key market in the region and has ~20 sales people (including third party contractors). The other fast growing markets are Ecuador, Peru and Argentina. In Brazil, Sharda does not have any approved formulations though it has nine API approvals. Sharda has filed ~40 formulation applications in the country. Approvals could be a significant game-changer for the company's Brazil and LATAM business.

As of Sep-2014, Sharda had 140+ registration applications pending approval across the region. We expect LATAM sales to cross US$47m (Rs2.8bn) by FY17 from US$22m now.

### ❑ RoW – exploring multiple new opportunities

*Sharda looking to boost the India business over next 3-5 years with innovative sourcing*

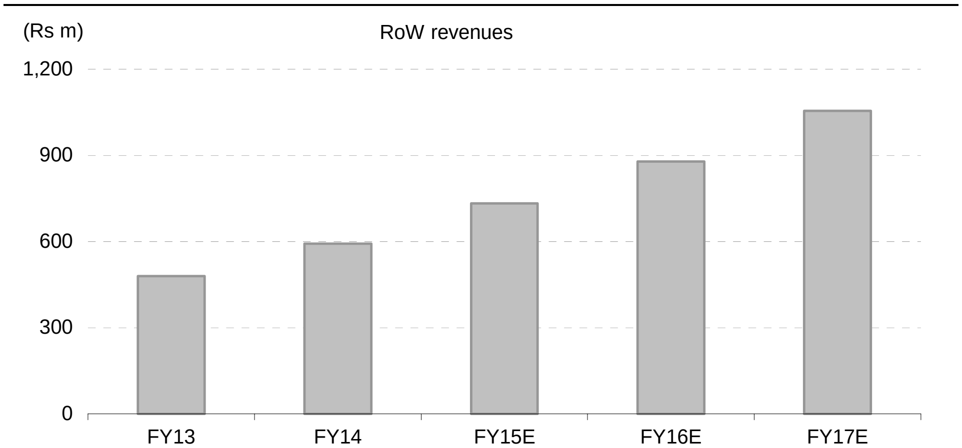
Sharda's RoW business (including India) is spread across ~20 countries. The company's India business has been clocking sales of ~Rs400m per annum and has a sales team of 40-45 members. Sharda is evaluating innovative sourcing strategies for certain large molecules to expand its India sales. If successful, these strategies could be a game-changer for the India business over the next 3-5 years.

Among other markets, Sharda's target geographies include Tunisia, Kenya, Egypt and South Africa. The company is also evaluating strategies to enter the Japanese market, which has high entry barriers.

*Sales have been flat over FY12-14; Sharda targeting markets like Japan, Tunisia, Kenya, Egypt and S. Africa*

RoW revenues include the trading business, which does not have a consistent growth trajectory. Revenues from RoW markets have remained flat over FY12-14, at Rs838m (US $14m). Some of Sharda's key generic molecules in RoW are Chlorpyriphos, Imidacloprid, Hexaconazole, Azoxystrobin and Glufosinate Ammonium.

Exhibit 12: New markets driving RoW growth




*Source: Company, IDFC Securities Research*

As of Sep-2014, Sharda had 100+ registration applications pending approval across the region. We expect the RoW business to cross US$18m (Rs1.1bn) by FY17 from US $10m now, aided by expansion into new geographies from a low base.

## Key financials: Business model beginning to deliver

*Huge investments in new registrations beginning to pay off; agrochem business at an inflection point*

Sharda's revenues have registered ~22% CAGR in the past four years with 21% CAGR in the agrochemicals segment (~83% of FY14 sales). As of Sep-2014, the company had 1,250+ approved registrations and another 575 registrations awaiting approval across various markets. Sharda has spent Rs4.1bn so far on these product registrations. With significant investments in new registrations over the last few years beginning to pay off, we believe Sharda's agrochemicals business is at a tipping point in its growth trajectory.

### ❑ H1 performance indicative of the model's growth potential

*Strong 50% growth in H1FY15 led by NAFTA region, which grew 80% yoy on entry into Canada market*

Sharda reported a strong performance in H1FY15 with 50% yoy revenue growth to Rs5.4bn. Almost all the geographies contributed to the performance, led by NAFTA which grew 80% yoy on Sharda's entry into the Canadian market.

Exhibit 13: H1 revenue performance – a positive surprise

| (%) | yoy growth in H1FY15 |
|---|---|
| LatAm | 37 |
| NAFTA | 80 |
| EU | 43 |
| RoW | 50 |

*Source: Company, IDFC Securities Research*

Over H1FY15, gross margins have expanded marginally by 20bp yoy – the stronger gross margin contribution from Canada was partially offset by higher discounts in the US. The company has been stepping up investments in growth, visible in an 83% increase in employee cost and 47% growth in other expenses.

Adjusted for forex losses and other non-recurring items, EBITDA grew 47% yoy to Rs1.04bn while operating profit margin was 50bp lower at 19.4%. For H1FY15, Sharda reported a PAT of Rs696m (up 25% yoy). PAT growth was hit by Rs94m of forex loss and Rs 22.5m of one-time intangible write-off.

In line with its geographical mix, Sharda's business has significant seasonality with Q4 and Q1 being the strongest quarters in terms of revenue / profitability and Q3 being the leanest. The company typically books 35-40% of annual revenues in Q4.

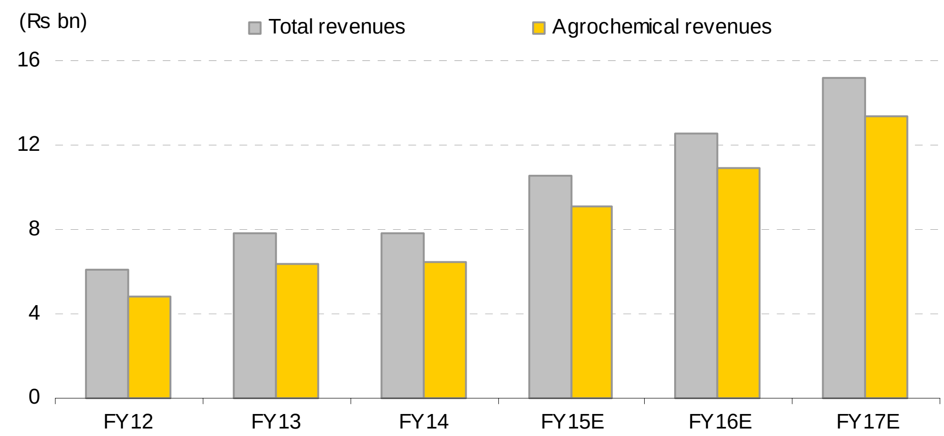
### ❑ New geographies and deeper penetration to drive growth

*Expect 25% CAGR in consolidated sales over FY14-17E, helped by entry into new markets and deeper penetration in existing markets*

Sharda's revenues have increased from Rs3.5bn in FY10 to Rs7.8bn in FY14 (~22% CAGR). With strong growth outlook across business segments, we expect the sales momentum to sustain in the coming years. In H1FY15, Sharda's revenues grew by 50% yoy to Rs5.4bn. Aided by entry into new geographies and increasing penetration in existing markets, we estimate a 25% CAGR in consolidated revenues over FY14-17E.

Along with the agrochemicals business, Sharda has a small trading business involving export of conveyor belts, rubber belts/ sheets, dyes and dye intermediates and other products. This business is managed by Manish Bubna, who is a member of the promoter family. This business has registered a CAGR of 14% over FY09-14, which we expect will sustain over the next few years. This is a relatively low-margin business, but has limited capital requirements and is free cash positive.

Exhibit 14: Revenues set to grow briskly



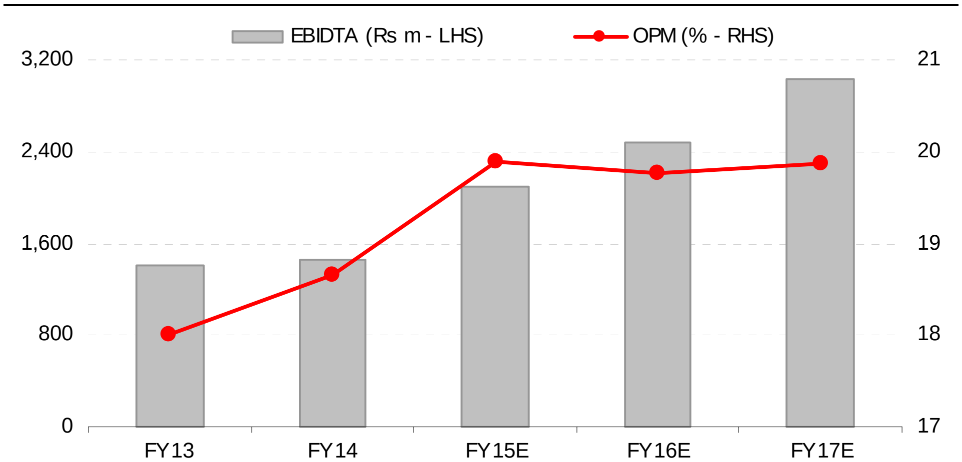

Source: Company, IDFC Securities Research

## ❑ Steady margin expansion

*Aggressive investments for growth will lead to back-ended operating leverage*

We estimate a 28% CAGR in consolidated EBITDA and ~120bp improvement in EBITDA margins to ~20% over FY14-17E, led by strong revenue growth and benefits of operating leverage. For H1FY5, the company reported 47% yoy growth in EBIDTA and operating profit margin of 19.4%. Given that Sharda is aggressively making investments in growth initiatives in terms of increasing sales force and offering discounts in certain geographies, the benefit of operating leverage may be back-ended, driving a steady improvement in EBITDA margins.

Exhibit 15: Increasing growth investments to cap margin expansion



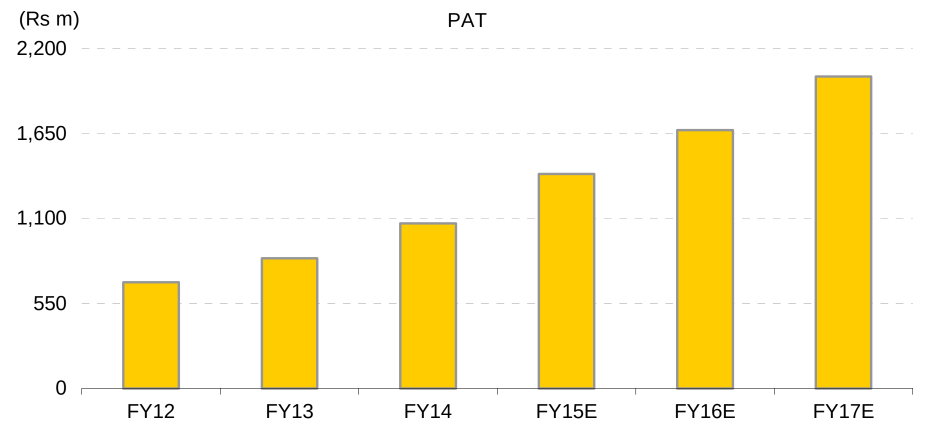

Source: Company, IDFC Securities Research

## ❑ Strong PAT CAGR of 24% over FY14-17E

*Large export footprint exposes Sharda to the risk of forex loss given currency volatility*

We expect Sharda's earnings to register a strong 24% CAGR over FY14-17E. Given the company's significant export footprint, the ongoing currency volatility would lead to forex losses or gains at various points in time.

Exhibit 16: A steady scale-up seen in earnings in the coming years



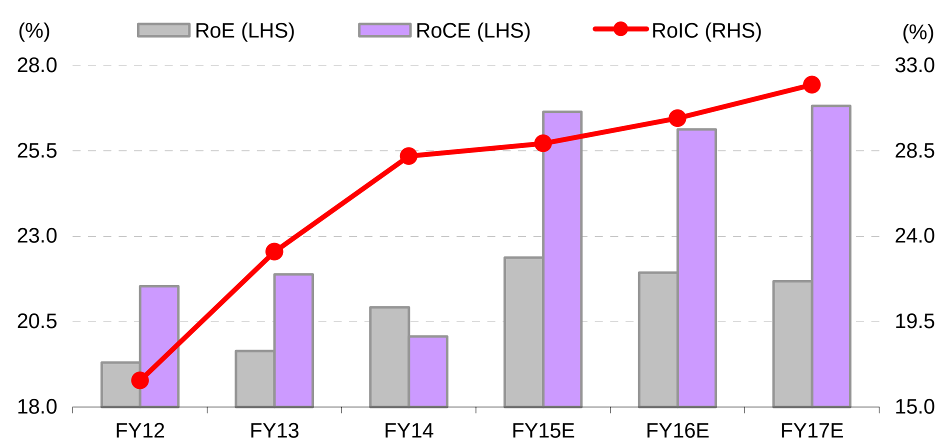

*Source: Company, IDFC Securities Research*

## ❑ Return ratios to improve further

*RoCE to increase from 20.1% in FY14 to 26.8% by FY17E with stabilization of net working capital days*

Sharda's return ratios improved over FY12-14 on the back of sustained revenue growth and margin expansion. Net working capital days have also improved with better inventory management. We expect revenue growth momentum in the agrochemicals business to continue along with stabilization in net working capital days. As a result, we expect RoCE to increase from 20.1% in FY14 to 26.8% by FY17.

Exhibit 17: Return ratios on an uptrend




*Source: Company, IDFC Securities Research*

*Strong free cash flows to help elevate RoIC to ~32% over FY16-17E*

Sharda will continue to generate free cash despite increasing investments in R&D and we estimate ~Rs2.7bn of cash on books as of Mar-2017 (Rs1.9bn as of Mar-2014). Consequently, return on invested capital (ROIC) will be even higher at ~32% for FY16/17.

### ❑ Recent IPO

In Sep-2014, Sharda successfully concluded its Initial Public Offering (IPO) involving an offer for sale (no fresh issuance of shares) of 25% of the company's equity. While the existing PE investor, HEP Mauritius (which invested in 2008), offered its equity stake amounting of 15.87% of the company's equity, the promoters offered the remaining 9.13% in the IPO.

## Valuations & View

***New products, geographic expansion and deeper market penetration to drive growth in the coming years***

We believe the best is ahead for Sharda given a differentiated business model that leverages its registration expertise and wider participation in the growing crop protection agrochemicals industry. We see immense potential in scale-up of the company's agrochemicals business, which is at an inflection point aided by product launches, geographic expansion and increasing penetration in existing markets. This can catapult Sharda in a higher growth trajectory in the medium term.

***We initiate coverage on the stock with Outperformer and price target of Rs358***

Return ratios should steadily expand with improvement in operating cash flows and working capital management. With a net cash balance sheet, RoIC of ~32% and strong medium-term revenue growth visibility, Sharda deserves to trade at a premium to peers which, given their high dependence on the domestic market, are entirely linked to the vagaries of Indian monsoons and/ or operate at significantly lower return ratios. At CMP of Rs251, Sharda trades at attractive valuations of 11.2x FY17E EPS and 7x EV/EBITDA. We initiate coverage on the stock with Outperformer and a 12-month price target of Rs358.

Exhibit 18: Comparative valuations

| Companies | Price | Mcap | Earnings CAGR (%) | P/E (x) | | EV/EBITDA (x) | | CY15E/FY16E |
|---|---|---|---|---|---|---|---|---|
| | (Rs/share) | ($ m) | CY13/FY14-CY16/FY17E | CY15E/FY16E | CY16E/FY17E | CY15E/FY16E | CY16E/FY17E | RoE (%) |
| Sharda Cropchem | 251 | 358 | 23.6 | 13.5 | 11.2 | 8.5 | 7.0 | 21.9 |
| UPL | 326 | 2,218 | 14.8 | 10.6 | 9.0 | 6.2 | 5.2 | 19.4 |
| PI Inds | 488 | 1,054 | 24.5 | 21.6 | 18.3 | 14.3 | 11.8 | 30.3 |
| Dhanuka Agrictech* | 517 | 409 | 22.7 | 19.1 | 15.0 | 14.3 | 11.5 | 28.4 |
| Rallis India* | 208 | 643 | 21.8 | 18.2 | 14.8 | 11.2 | 9.2 | 24.2 |
| **Global peers** | | | | | | | | |
| Nufarm* | A$5 | 1,022 | 13.3 | 12.3 | 10.4 | 6.4 | 5.8 | 6.3 |
| FMC Crop* | US$57 | 7,530 | 30.8 | 13.2 | 11.7 | 9.1 | 8.4 | 28.1 |
| **Average** | | | **21.6** | **15.5** | **12.9** | **10.0** | **8.4** | **22.7** |

*Source: Company, Bloomberg, IDFC Securities Research Note: * Bloomberg consensus*

## Key Risks

### ❑ Managing the transition to a much larger size

Sharda's promoter group's hands-on approach to the business has been a key driver of its success so far. With the company poised to be a >$200m business over the next two years or so and increasing geographical diversification, promoters' ability to put in place an organization structure to manage the complexity associated with growth will be vital to ensure successful transition to a much larger and complex business model. The company's ability to hire the requisite talent at different levels/ geographies will be critical.

### ❑ Exposure to vagaries of nature across geographies

Globally, the agrochemicals business is significantly exposed to periodic weather fluctuations across geographies. These variations are difficult to predict and can have a material impact on Sharda's business at different points in time. Climatic fluctuations occasionally have far significant impact on distribution channel partners and their ability to meet payment commitments.

### ❑ Managing expansion in new geographies

Expansion in new geographies is a new element of Sharda's growth strategy. While entry into new regions will likely provide occasional growth boosts, Sharda also needs to manage the risk associated with partnering with new distribution partners across geographies. Sharda's recent successful entry into Canada has been partially marred by the financial challenges faced by one of the channel partners.

### ❑ Managing risk emanating from currency volatility

Sharda's export focussed business model with significant geographical diversification will be exposed to the ongoing currency volatility across regions. While Sharda's USD denominated imports from China are a natural hedge, it will still be exposed to cross currency movement in EUR-USD, etc. Further, Sharda's relatively long receivables cycle enhances the currency volatility risk.

### ❑ Managing any risks related to sourcing from China

Sharda currently imports more than 90% of its formulations from Chinese vendors. While China remains a buyers' market, any regulatory changes that can put hurdles in sourcing from China can have an adverse impact on Sharda's business.

## Income statement

| Year to 31 Mar (Rs m) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| **Net sales** | **7,777** | **7,819** | **10,570** | **12,578** | **15,215** |
| *% growth* | *26.8* | *0.5* | *35.2* | *19.0* | *21.0* |
| Operating expenses | 6,377 | 6,360 | 8,468 | 10,092 | 12,190 |
| **EBITDA** | **1,399** | **1,459** | **2,102** | **2,486** | **3,025** |
| *% change* | *14.2* | *4.2* | *44.1* | *18.3* | *21.7* |
| Other income | 67 | 132 | 250 | 250 | 251 |
| Net interest | (4) | (14) | (24) | (21) | (15) |
| Depreciation | 367 | 289 | 253 | 326 | 375 |
| Pre-tax profit | 1,178 | 1,484 | 1,984 | 2,389 | 2,886 |
| Current tax | 334 | 415 | 595 | 717 | 866 |
| Profit after tax | 843 | 1,070 | 1,389 | 1,672 | 2,020 |
| **Net profit after non-recurring items** | **844** | **1,070** | **1,389** | **1,672** | **2,020** |
| *% change* | *22.8* | *26.8* | *29.8* | *20.4* | *20.8* |

## Balance sheet

| As on 31 Mar (Rs m) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| Paid-up capital | 902 | 902 | 902 | 902 | 902 |
| Reserves & surplus | 3,766 | 4,655 | 5,954 | 7,491 | 9,330 |
| Total shareholders' equity | 4,668 | 5,557 | 6,856 | 8,393 | 10,233 |
| Total current liabilities | 2,640 | 2,804 | 3,185 | 3,791 | 4,377 |
| Total debt | 459 | 399 | 299 | 224 | 149 |
| Deferred tax liabilities | 90 | 102 | 102 | 102 | 102 |
| Other non-current liabilities | 106 | 279 | 279 | 279 | 279 |
| Total liabilities | 3,296 | 3,584 | 3,865 | 4,395 | 4,907 |
| **Total equity & liabilities** | **7,964** | **9,142** | **10,721** | **12,789** | **15,139** |
| Net fixed assets | 1,526 | 1,975 | 2,559 | 3,233 | 3,858 |
| Investments | 48 | 52 | 52 | 52 | 52 |
| Total current assets | 6,390 | 7,114 | 8,110 | 9,504 | 11,229 |
| Working capital | 3,750 | 4,310 | 4,925 | 5,713 | 6,852 |
| **Total assets** | **7,964** | **9,142** | **10,721** | **12,789** | **15,139** |

## Cash flow statement

| Year to 31 Mar (Rs m) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| Pre-tax profit | 1,178 | 1,484 | 1,984 | 2,389 | 2,886 |
| Depreciation | 367 | 289 | 253 | 326 | 375 |
| Chg in Working capital | (226) | 70 | (1,033) | (633) | (1,039) |
| Total tax paid | (334) | (415) | (595) | (717) | (866) |
| Ext ord. Items & others | 1 | 172 | - | - | - |
| Operating cash Inflow | 984 | 1,601 | 609 | 1,366 | 1,356 |
| Capital expenditure | (684) | (738) | (837) | (1,000) | (1,000) |
| Free cash flow (a+b) | 300 | 862 | (228) | 366 | 356 |
| Chg in investments | (607) | (774) | 500 | - | - |
| Debt raised/(repaid) | 425 | (60) | (100) | (75) | (75) |
| Capital raised/(repaid) | - | - | - | - | - |
| Dividend (incl. tax) | (90) | (90) | (90) | (135) | (180) |
| Misc | 32 | (79) | - | - | - |
| Net chg in cash | 60 | (141) | 82 | 155 | 100 |

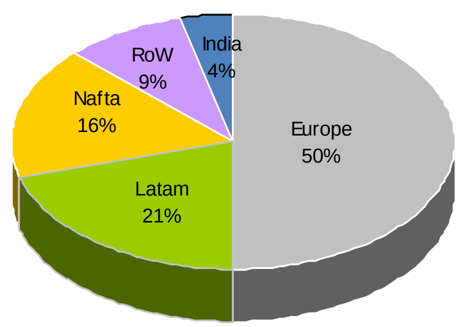
## Key ratios

| Year to 31 Mar | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| EBITDA margin (%) | 18.0 | 18.7 | 19.9 | 19.8 | 19.9 |
| EBIT margin (%) | 13.3 | 15.0 | 17.5 | 17.2 | 17.4 |
| PAT margin (%) | 10.8 | 13.7 | 13.1 | 13.3 | 13.3 |
| RoE (%) | 19.6 | 20.9 | 22.4 | 21.9 | 21.7 |
| RoCE (%) | 21.9 | 20.1 | 26.6 | 26.1 | 26.8 |
| Gearing (x) | (0.2) | (0.3) | (0.2) | (0.2) | (0.2) |

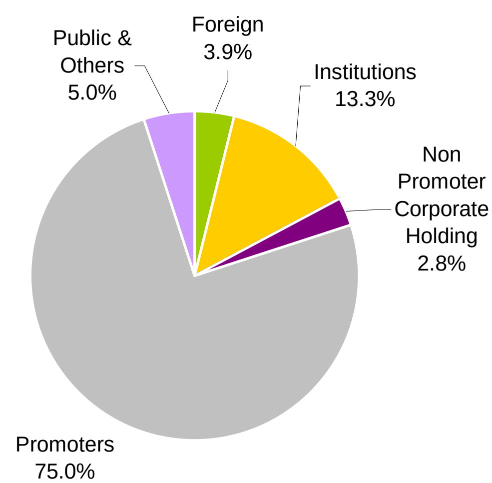
## Valuations

| Year to 31 Mar | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| Reported EPS (Rs) | 9.4 | 11.9 | 15.4 | 18.5 | 22.4 |
| Adj. EPS (Rs) | 9.4 | 11.9 | 15.4 | 18.5 | 22.4 |
| PE (x) | 26.8 | 21.2 | 16.3 | 13.5 | 11.2 |
| Price/ Book (x) | 4.9 | 4.1 | 3.3 | 2.7 | 2.2 |
| EV/ Net sales (x) | 2.8 | 2.7 | 2.0 | 1.7 | 1.4 |
| EV/ EBITDA (x) | 15.6 | 14.5 | 10.2 | 8.5 | 7.0 |
| EV/ CE (x) | 4.1 | 3.3 | 2.8 | 2.4 | 2.0 |

## Sharda's geography wise agro sales mix - FY14




## Shareholding pattern




*As of September 2014*

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