Sabero Organics Gujarat Ltd

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Rating	**Buy**
Price	Rs.73.95
Sensex	17578

Trading Data	
Market Cap(Rs.bn)	2.3
Shares o/s (mn)	31.09
P/E ratio	6.82
P/B ratio	2.16
P/S ratio	0.56
Sales CAGR(5yrs)	28%
Profit CAGR(5yrs)	62%

Major Shareholders	
Promoters	39%
Foreign	0.1%
Others	25%
Public	36%

Stock Performance	
1 month	0.2%
6 month	66%
12 month	583%

Executive Summary

Sabero Organics Gujarat Ltd (Sabero) is a leading manufacturer of crop protection chemicals in India. It is primarily focused on the export markets and manufactures a wide range of herbicides, fungicides and insecticides. Due to the severe food shortages that are developing around the world, agricultural productivity is going to be a key focus area for farmers as well as governments. Increase in usage of crop protection products is a key productivity enhancing measure. Given the low valuations, management team's focus, execution track record, demonstrated growth and opportunities in the industry, we believe that Sabero is an attractive investment opportunity with the potential to become a multibagger over the next 5 years.

Industry Background

Need to Increase Agricultural Productivity

The food grain demand-supply situation has laid the foundation for structural long term growth in the agri-input space. Increasing income levels and a rising global population are increasing demand for agricultural products at a rapid pace. Not only is demand for agri products for direct consumption by humans increasing, but as incomes rise, so does meat consumption in most countries. Animal feed is typically comprised of agricultural products, creating further demand for food products. The dramatic upswing in Asian economies is particularly affecting the global food situation. Rising standards of living are also leading to a diversion of food grain and oil seeds for the purpose of fuel production. If oil prices stage a rally again, it is very likely that food products will be diverted towards fuel production. On the supply side, increased urbanization, lack of rural manpower to participate in intensive farming and lower propensity to work as farmers is reducing supply of agricultural products. Given this supply-demand tension, the only way to service increased demand is to find ways to improve global agricultural productivity. Focus on better productivity coupled with government support and improved financing are likely to see a jump in the use of all agro-inputs like seeds, fertilizers, agrochemicals and farm equipment globally. The demand-supply mismatch is likely to remain for a long time, thereby making the agri inputs an essential component of productivity enhancements.

Agrochemical Market Size

The total global agrochemical market is $42 billion (*Source: Sabero Organics*) in 2008 and is expected to be worth $196 billion by 2014 (*Source: Sabero Organics*).

Agrochemical Product Segments

Agrochemicals are primarily used for crop protection. Products can broadly be divided into insecticides, herbicides and fungicides. Today, due to rapid advances in hybrid seeds development and usage, insect infestation has diminished in magnitude. As a result, the growth in agrochemicals is coming from herbicides and fungicides. Weeding is a manual process in several countries but with pressures on agricultural labor herbicides are being used to reduce the amount of labor involved, resulting in growing demand for this segment. Hybrid seeds have yet to tackle the problem of fungal infection and therefore, fungicides are also a high growth area. This aspect can be seen in the share of insecticides as a percentage of agrochemical sales, which has reduced from 72% in 2002 to 62% by 2007.

Agrochemical Producers

Agrochemical producers can be either innovators or generic manufacturers. Innovators are original patent holders with strong focus on R&D. Generic players operate in the off patented market, their key strengths being low cost manufacturing and strong distribution.

Innovators: The top six R&D based innovator players – Bayer Cropscience, Syngenta, BASF, Monsanto, Dow Chemicals and Dupont -- now command approximately 80% of the global agrichemicals market. Innovators enjoy higher margins since they are able to charge premium prices for their products.

Generics Manufacturers: These companies are not directly involved in high end R&D to find new active ingredients (AI). Generics producers manufacture products that have gone off patent. Even though they make off-patent products, generic players have to go through a difficult and time consuming registration process in every country they launch their product in. Their products go through various tests and certifications before launch which, depending on the country can take between 3 months and 5 years. The bulk of generic products sold are through the innovator companies. Innovators in recent times have tended to outsource production of generics to low cost destinations such as India. Using their vast marketing infrastructure and registration infrastructure, these innovators sold such outsourced products under their own brand name.

The India Opportunity

In India, population growth, higher disposable incomes and increasing urbanization have led to a spiraling demand for food grains. Unfortunately, food grain supply has been unable to meet the huge demand owing to stagnant area under cultivation, decreasing per capita agricultural production and scarcity of land for further cultivation. The demand supply mismatch is likely to increase over the next few years, resulting in a need for increasing domestic agricultural productivity.

It is estimated that India approximately loses 18% of crop yield valued at Rs.900 bn, due to pest attacks each year (*Source: Sabero Organics*). Only 21% of cultivated area is treated by pesticides. The Indian pesticide industry with an 85,000 MT production during FY07, valued at Rs.74 bn (including exports of Rs.29 bn), is ranked second in Asia (behind China) and twelfth globally. As can be seen from the table below, India's per hectare consumption pesticides is very low as compared to peer countries such as China.

Consumption Pattern of Pesticides in Different Countries	
Country	**Pesticide Use (Kg/Ha)**
Republic of Korea	16.559
Italy	13.355
Hungary	12.573
Japan	10.8
China	**2.0-2.5**
Europe	1.9
USA	1.5
World Avg	0.5
India	**0.381**

Source: 37th report of Dept of Chemicals & Petrochemicals, Govt of India.

Though the herbicide and herbicide markets in India are small, there are several demand drivers which will push up the need to use such products in India. Thanks to programs such as NREGA, urbanization and increased aspiration levels, availability of labor for agriculture has decreased significantly. Therefore hand weeding is slowly becoming less and less feasible for Indian farmers. As a result, the need for herbicides is increasing dramatically. Indian crops are also quite prone to fungal infection given the sub-tropical conditions that prevail across most of the cultivable land in the country. Fungal infections are not reduced through the use of BT seeds, so the only way to prevent loss of crops to infection is to use fungicides

Company Background

Sabero was established in the year 1991 to manufacture specialty chemicals and intermediates for the crop protection business. It then forward integrated in 1997 into manufacturing crop protection chemicals. In order to have a diversified portfolio, Sabero chose one or two key products in each sector such as Acephate and Monocrotophos (Insecticides), Glyphosate (Herbicide) and Mancozeb (Fungicide)

Sabero's is primarily an export driven company, generating 65% of sales from the international market. Several leading multinational names including Syngenta, Dow, Bayer, Nufarm, Arysta, Makhteshim and Dupont buy bulk products from Sabero. Within product segments, Sabero derives most of its revenue from fungicides (39%), followed by insecticides (34%). herbicides (20%) and specialty chemicals (7%) are relatively minor segments today.

The company's sales have grown at 27% and profits at 62% over the last 5 years.

The generic products Sabero currently makes include

Segment	Product	Uses
Fungicides	Mancozeb (35% of Sales)	Potatoes, Tomatoes, Apples, Wheat, Corn, Watermelons, Safflower, Sorghum, Cereal grains and Onions
	Maneb	
	Zineb	
	Propineb	
	Tricyclazole	
Herbicides	Glyphosate	Used in GM crops like soybean, maize, cotton and wheat.
	Triclopyr	
	Pretilachlor	
Insecticides	Chlorpyriphos	Cotton, Corn, Almonds, Oranges and Apples
	Acephate	Controls leaf miners, caterpillars, sawflies and thrips in crops as well as turf.
	Monocrotophos	Citrus, Olives, Rice, Maize, Sorghum, Sugarcane, Potatoes, Soybeans, Vegetables and tobacco
	Dichlorvos(DDVP)	Control pests in public places
	Methamidophos	
	Cypermethrin	
	Alphamethrin	
	Deltamethrin	
	Permethrin	
	Lambda Cyhalothrin	
	Acetamiprid	
Specialty Chemicals	Tri Ethyl Phosphite	Used as building blocks for manufacturing pesticides like profenophos, chloropyriphos, triazophos and D.D.V.P.
	Tri Methyl Phosphite	
	Phosphorus Tri-Chloride	

Source: Sabero

Product Profile

Sabero has also begun producing branded agrochemical formulations. The advantage of selling branded formulations is that the margins are higher. Some of the products it sells include:

Technicals	Brands
Mancozeb	Emthane-45
Glyphosate	Glyweed
Acephate	Acehero
Monocrotophos	Mophos
Chlorpyriphos	Robust
DDVP	Lava

Source: Sabero

Geographies

The Company has 6 subsidiaries and associate companies in Australia, Europe, Philippines, Argentina and Brazil, to obtain registrations in the relevant geographies. At present, Sabero has obtained 240 product registrations in 50 countries. It has a wide network of overseas distributors and agents who sell its products in these countries, including importers who have their own registrations. Being present in multiple geographies is a competitive advantage and a barrier to entry for competitors. No products in agrichemicals can be sold without registration. The more advanced the market, the more difficult the registration process.

Keys to Success

Based on our research, we have come to believe that a confluence of factors is necessary for success in this business. Since all these factors are interdependent, it is difficult to become successful without having all these factors present in the business. Key success factors in the plant protection business are:

- ***Product Development Capabilities.*** This involves both an understanding of the market as well as skills in chemistry. The market keeps continually changing because of new developments, products going off-patent and obsolescence of old products. Once a change is identified, it is important to have the skills to produce the new product, be able develop a registration dossier.
- ***Production Capacity.*** Having sufficient production capacity is a very significant success factor because scaling up requires capacities and as the registration process is launched in various geographies, the ability to produce enough quantities becomes very important.
- ***Quality.*** Since obtaining registrations depends critically on the ability to produce good quality products, ability to produce and maintain quality is a very key skill.
- ***Registrations.*** The registration process in itself is quite involved and complicated. Developing a registration dossier and working with the authorities in various countries to launch a product is not a skill set that is widely available. The absence of the ability to navigate regulatory issues can hamper the growth of any company in this field.

Once a combination of these factors is present, a company will dramatically be able to scale its business and improve its margins. We believe that Sabero has managed to develop all these abilities and is poised for dramatic growth in the coming few years.

Growth Drivers for Sabero Organics

The management of Sabero has told us that it is working on two dimensions to achieve sales growth: product launches and geographical expansion.

Product Launches

The Company is planning to launch 1-2 new products every year. A product launch is quite an intricate affair. It involves identifying a product, starting pilot production, development of a registration dossier. It takes roughly 1 year to configure a plant for a product, by which time, registrations can be obtained in the easier geographies. Once a product is launched in a highly regulated market like Brazil, it can generate between Rs.300 and Rs.400 mn in sales per year.

Geographical Expansion

Once a company has the capability to produce a product, the primary constraint to scaling up that product is to obtain the necessary product registrations in high potential countries. Sabero has obtained comprehensive registrations of its products from European and Indian labs. Sabero and its subsidiaries have got 240 registrations in 50 countries and are selling its products in these countries. Registrations are granted by the Environmental Protection Agency/Dept of Agriculture in respective countries and are a barrier to entry into that market and prerequisite to selling in that market. The registration process is tedious and can consume a large sum of money in the more regulated markets. It could take anytime between three months to even three years in certain regions to product registrations. The company is targeting two new product approvals every near for the next 5 years. This provides the company an ability to scale on the geographic dimension as well. In terms of immediate increase in reach, the company expects to receive three product registrations in Brazil in FY10, which will result in revenues in FY11.

Margin Expansion through Branded Formulations

In addition to selling to bulk customers in various target markets, the company is also enhancing margins by selling branded products to end users. One of the primary markets it is targeting with this strategy is India, where the management feels the Company is under-represented in some segments. Sabero has already been able to establish the brands of Mophos, Acehero & Glyweed among the top 5 brands domestically and aims to continue building other brands. The company expanded its operations to over 15 states in India and focusing on development work at the farmer level in order to enhance its brands for this purpose. It has built a sales force of over 50 people in various states of the country. This will enable the company to increase its market share in the country and abroad and also offer better margins compared to its technicals.

Competitive Advantage

Focus on Highly Regulated Markets

Brazil is the 2nd largest market for crop protection products. Like US, Europe and Japan entry into Brazil is not easy. Therefore, an entry here not only provides volume but also above average profitability. After learning to navigate the regulatory environment of Brazil, Sabero obtained registration for Chlorpyriphos there in April 2009 and expects registration for three more products in FY10. It entered into two joint ventures in Brazil to tap this market. One of the JVs is 44% owned by Sabero and is into distribution of agrochemicals. The other JV is 51% owned by Sabero and is into registration of products & their sale to distributors. EM-Brazil, a large distribution company with revenues of $400mn, is its JV partner in both the JVs, the Brazil market is highly regulated and the product registrations take nearly 3 years to get approved. The company expects sales of Rs 350 to 400 mn for every new product launch in this market.

Focus on Growth Segments

The global agrochemical industry has changed significantly since launch of genetically modified (GM) seeds. The share of insecticides has reduced from 72% in 2002 to 62% by 2007. Launch of GM seeds has reduced consumption of insecticide. However, fungicides and herbicides have gained in revenue share. The company is well positioned compared to its peers as it derives majority of its revenues from fungicides.

Other Growth Drivers

The company is currently exploring the possibility of entering a new chemistry for which a plant would be build in 2010-2011 at a cost of Rs 500 mn. This plant could potentially generate revenues of Rs 2000 mn. In addition, the company is also looking for a distribution outfit to acquire, potentially in geography like the USA. The planned time frame for this acquisition would be around the end of FY11 and the size of acquisition would be $25-30mn.

Financials

Projected Sales and Profit for the next 4 years

Rs mn	**Mar-08**	**Mar-09**	**Mar-10 E**	**Mar-11 E**	**Mar-12 E**	**Mar-13 E**
Sales*	2196.4	4010.0	4812.5	5774.4	6929.3	8315.1
PAT*	48.7	217.9	385.0	462.0	555.4	665.0

*Sales growth is estimated at 20% per annum and EBDITA margins around 17%, and net profit margin at 8%.

PE Sensitivity

PE	6.5	10	15	20
Mkt Cap at the end of Fy13 (Rs mn)	4323.9	6652.1	9978.2	13304.2

Peer Group Analysis

Company Name	Sales CAGR	PAT CAGR	P/E	P/B	P/S	Mkt Cap Rs mn	D/E ratio	RONW	Sales Rs mn
Sabero Organics Gujarat Ltd	27.6%	62.0%	6.46	2.1	0.5	2300	1.04	35.02	4098.8
Rallis India Ltd.	7.5%	23.0%	15.6	3.4	1.5	14150	0.24	16.31	9568.9
Bayer Cropscience Ltd.	11.0%	23.6%	16.2	3.7	1.3	21510	0.09	18.77	16038.1
United Phosphorus Ltd.	33.4%	37.9%	37.4	3.5	1.4	68570	1.17	5.59	50150.1

Going by the current performance of the company and the huge opportunity it has in the future, Sabero is positioned itself to grow rapidly in the next couple of years. Based on the above calculations, Sabero is better placed than its peers with a good growth number and with low price to earnings. At the current price of Rs. 73.80, it is available at 6.5 times, with a market cap of Rs2300 mn, Based on the above estimates, the market cap of the company at the end of FY2013 can be anywhere between Rs 4320 mn to Rs 13304.2 mn.

Concerns

Raw Material Price Fluctuations: Even though the raw material prices have stabilized over the last few quarters, there is always a risk of fluctuation in raw material prices that could affect the profitability of the company.

Currency Fluctuations: About 65% of the total sales of Sabero are exported to various countries around the world. Any adverse movement in the rupee will impact the margins of the company. It is therefore exposed to the currency fluctuation issues that could arise during export transactions. However, there is a natural hedge in the form of imported raw materials and domestic sales. So about 35% of topline at any point remains unhedged and the company has no current plans of hedging this exposure.

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