

## Sabero Organics (26 Aug 09): Rs.38

**Confluence of product registrations & capacity expansions: It can't get any better**

BSE Code	524446	Prom Holding	38.6%	Industry	Crop protection chemicals
Listed on	BSE, NSE	Total Shares	3.39 crores*		
Mkt. Cap	Rs.111 Cr.	Avg. Daily Trading Volume		4 Lakh shares (3 Months)	

\*including 46.72 lakh warrants outstanding

Sabero Organics is in the business of crop protection chemicals. It had revenues of Rs.377 crores & PAT of Rs.20 crores in FY09. It's an integrated producer of fungicides, herbicides, insecticides. Largest producer of Mancozeb & Glyphosate in India, Sabero is the 2<sup>nd</sup> largest producer of Mancozeb globally and the only global producer of TEP, an intermediate. It recently expanded its production capacities considerably, obtained product registrations in key markets for key products and is expected to obtain more such registrations in the months ahead. The confluence of capacity expansions & product registrations put the company in a sweet spot.

We estimate revenues to grow in excess of 25% in FY10 & FY11; PAT to grow 57% and 49% respectively in FY10 & FY11. Due to dilutive effect of warrants, EPS would grow at 35% and 49% respectively in FY10 & FY11. At the current price of Rs.38, it currently trades at 5x trailing EPS, 4x FY10 EPS and 2.7x FY11 EPS. Debt/Equity is 1.0x at the end of Mar-09. We expect the stock to be a multi-bagger with minimum price target of Rs.90.

### Weekly Chart from 01-Jan-08 to 25-Aug-09



## Key Products

Product Category	Usage	Products	% of FY09 Sales	Products to be introduced
Fungicides	Pre-treatment + used when fungus is seen	Mancozeb, Maneb, Propineb, Zineb	39%	
Insecticides	Pre-sprays + 4-5 sprays during rains when insects pressure is high	Acephate, Monocrotophos, Chlorpyrifos, Dichlorvos (DDVP)	34%	Fipronil
Herbicides	Used only when weeds are seen	Glyphosate	20%	Trichlopyr, Clodinafop Propargyl, Bispyribac sodium
Intermediates / specialty chemicals	Used as inputs to crop protection products	Phosphorus Trichloride (PCL3), Tri-Methyl Phosphite (TMP), Tri-Ethyl Phosphite (TEP)	7%	

### Mancozeb

Mancozeb, the largest selling fungicide globally with market of \$500mn, is used mainly for crops like potato, tomato, onions, apples, Bananas, grapes & vegetables. France is a significant market, as it uses it to protect grapes used in wines. Mancozeb is the single largest contributor to Sabero's revenues. It contributed 35% to FY09 sales. Mancozeb has 33 approvals including 26 SOLAs (specific off-label approvals) for control of several diseases including downy mildew, scab & black spot.

### Glyphosate

It's not only the largest consumed herbicide but also the largest consumed crop protection molecule in the world with global sales of around \$4bn. Monsanto is the largest producer (brand: Roundup). It is used largely on genetically modified crops like soybeans, maize, etc. Sabero is completely backward integrated starting from yellow phosphorus.

### TEP

Sabero is the sole global manufacturer of TEP, a niche intermediate, as the only other manufacturer Bayer shut down its plant in Germany in Dec-03.

### Monocrotophos

Sabero and United Phosphorus (UPL) are the only producers of this product in India. It's one of the largest selling insecticides in India with sales of around Rs.200 crores. Sabero is backward integrated, as it makes TMP & PCL3.

### **Acephate**

The third largest insecticide in India with sales of around Rs.200 crores, this new generation insecticide is also made in India by UPL, Rallis & Meghmani. Sabero is a key source of Acephate for three MNCs in USA.

### **Chlorpyrifos**

It's the largest selling insecticide in the world with global sales of \$500mn. Sabero obtained Brazil registration in Apr-09 and has got supply orders for FY10. Other manufacturers are Dow, Gharda, Meghmani & Makhteshim Agan group of Israel.

### **Dichlorvos (DDVP)**

DDVP is used as both agriculture and household insecticide. Sabero is completely backward integrated from phosphorus. UPL is main competitor.

### **Geographical break-up of FY09 Sales**

A quarter of the company's sales comes from regulated markets (markets where entry is not easy) of US, Europe, Brazil & Japan. India contributes a third to its sales. The balance sales come from multiple other countries.

Its customers include MNCs (Dow, Syngenta, Bayer, etc) and domestic companies (Rallis, Meghmani, Excel, etc). It also sells through its stockists & dealer network.

<b>Markets</b>	<b>% of FY09 Sales</b>
<b>Regulated Markets</b>	25%
<b>India</b>	33%
<b>Rest of World</b>	42%

## **Investment Arguments**

### **Long term growth potential in crop protection products globally**

To grow more food to feed growing population will require improvement in farm yields, as land is scarce. Moreover, per capita consumption of agri-products is also on the rise. One of the effective ways to raise yield is increased & appropriate use of crop protection products. There is considerable scope for improving yields. For example, European cereal yields are 3-4 times higher than that in Africa. In large agrarian countries like India, farmers lack enough knowledge leading to inadequate & unwise use of crop protection products. The industry has a mammoth task of educating farmers to drive its growth. Agrochemical usage in India is very low at 75 Kg/acre of arable land as against 470 Kg in Egypt, 430 kg in Netherlands, 270 Kg in china and 180 Kg in Bangladesh.

### **No.1 or 2 in key products**

Cost competitiveness & ability to scale up made Sabero global number two in Mancozeb after United Phosphorus (UPL). It's the only manufacturer of intermediate TEP in the world. It's India's number one in Mancozeb & Glyphosate and India's number two in Monocrotophos after UPL.

### **Production capacities being shut in developed countries**

Production capacities for some of the crop protection products are being shut in developed countries due to significantly higher cost structure there & lack of backward-integration. This resulted in considerable improvement in global demand-supply balance and therefore improved profitability. Dow AgroSciences closed down its largest Mancozeb plant (25,000 TPA) in France in Oct-08 due to high costs in Europe. Monocrotophos capacity reduction has been happening over the years, as lack of backward-integration makes them uncompetitive.

### **Increased costs for Chinese manufactures**

China had two kinds of impact on world crop protection business lately. One was temporary and another permanent. Before the Beijing Olympics, many plants were shut to contain pollution. This had led to a temporary improvement in demand-supply balance. Many of these units have been restarted post Olympics. The second and durable impact has been from the China's environment policy. China made its environment standards stringent as there has been wide-spread water pollution including drinking water pollution in China. This entailed additional costs for Chinese manufacturers towards pollution control & waste disposal. China has, however, not been a major competitor for Sabero's products due to quality of its products. China has very few product registrations in stringently regulated countries.

### **Significantly capacity expansion to aid growth going forward**

Sabero expanded capacities of key products at its plant at Sarigam in Gujarat. It expanded capacities of Mancozeb (doubled to 30,000 tpa), PMIDA, Glyphosate and Chlorpyrifos. It debottlenecked plants of Acephate, Monocrotophos, and ammonium chloride. With increased capacity, Mancozeb can contribute Rs.600 crores to sales at full capacity at current prices. With commissioning of Rs.35 crores capex in QE Jun09, Sabero's capacities are enough to take care of growth till FY12. A further capex of Rs.50 crores is planned to take care of growth beyond FY12. Sabero is also looking at acquisition opportunities to grow.

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### Increase in product registrations, a key entry barrier, to drive sales

In April-09, Sabero obtained Chlorpyrifos registration in Brazil, the 2nd largest market for agrochemicals. Chlorpyrifos is the largest selling insecticide in the world. It expects to receive registration for Mancozeb, Acephate & Glyphosate from Brazil in FY10. In this business, product registrations are effective entry barriers. It took it three years to get Chlorpyrifos registration. It also obtained registrations for Glyphosate technical in Europe & Acephate in USA. In all, it obtained 19 registrations in 11 countries in 2008 and plans to get 34 registrations from multiple countries in 2009. As a result of increase in the registrations, exports have been growing rapidly, as it sells products in additional geographies.

### Focus on Brazil, the 2<sup>nd</sup> largest market for agro-chemicals

Brazil is the 2nd largest market for crop protection products. Like US, Europe & Japan; entry into Brazil is not easy. Therefore, an entry here not only provides volume but also above average profitability. Sabero got registration for Chlorpyrifos there in Apr-09 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. These JVs do not contribute materially to operational results as yet.

## Risks / Concerns

### Global agro-climatic conditions

An adverse agro-climatic condition in large part of its markets is a risk. Exports contributed 63% to FY09 sales and 66% to QE Jun-09 sales. With significant exports to multiple countries around the world, risk of adverse agro-climatic condition in any part of the world is not material. Some of the countries always face adverse conditions. This year, insecticides sales in India may get impacted due to late and inadequate monsoon, as insecticides are mainly sold during monsoon. However, the impact of lower insecticide sales in India is not likely to make material impact on overall performance of the company.

Sabero is well diversified both geographically (sells in about 50 countries) and across product categories (Herbicides, Fungicides, Insecticides). This implies lower volatility in business performance. Different weather & crop seasons at different times of the year at different places imply that impact of seasonality is also not felt.

### **INR appreciation & rise in input prices**

INR appreciation impacts it adversely by way of lower realizations & lower contribution margin. Rise in prices of inputs (inputs are either crude oil derivatives or minerals) impacts margins. Both these impacts are, however, transitory as these are passed on though with a lag of 1-3 months.

### **Changed economics in any of the key products**

If demand-supply balance changes in any of its key products, it may impact its profits. At present, there is over capacity in Glyphosate leading to lower margins. Monsanto, the largest producer of Glyphosate, is saddled with high inventory at present. To counter the margin erosion, Sabero plans to focus on high-margin geographies like Europe, Brazil & Africa (there are few players with product registration there). Glyphosate is currently the only product from its portfolio where there is over capacity. It contributes 10-15% to its revenues currently. Last year when there was severe shortage of Glyphosate and price shot up from \$2 to \$11, China built huge capacity and that led to over-capacity. Chinese players, however, do not have product registrations in the key market of Europe.

### **Ban or regulation on any of the key products in key markets**

Currently there are talks of changes in legislations related to plant protection products in the US and Europe. There have been demands from NGOs world-over to ban some of the crop protection products that are endocrine disruptors. Though not known for sure, many claim that Mancozeb & Glyphosate, two key products of Sabero contributing about half its sales, are endocrine disruptors.

We are of the opinion that a ban on these products is highly unlikely. There are no effective alternatives that can be used as widely as these products are used. The alternatives should be effective to ward off pests, should be effective in managing resistance, cost-effective, and most important of all should not lower crop yields. A ban without suitable alternative would mean significantly lower food for the world population or food infested with various kinds of pests!

Biological agro products used in organic farming have significantly lower yields and hence cannot be a substitute. The need of the day is to raise yields substantially.

There are many products that are being currently used to fully or partially replace Mancozeb. For example, to prevent alternaria (early blight) in potatoes, an alternative to (Mancozeb+zoxamide) could be Tanos (cymoxanil+famoxate). For prevention of early

blight in potatoes & tomatoes, (Azoxystrobin+Chlorothalonil) is being preferred by some in the UK instead of Mancozeb. Propineb can be one of the substitutes of Mancozeb in many crops. A new Regalia formulation can be used to reduce the amount of Mancozeb used. However, none of these can be used widely and cost-effectively.

Mancozeb is a green-labeled product. Green labeled products are the least toxic. Sabero has lately been also making environment friendly versions of its products like water dispersible granules of Mancozeb and soluble granules of Glyphosate & Acephate.

Obama administration's recent appointment of Ex-Monsanto man Michael Taylor to USFDA indicates which side the US government is leaning. Monsanto is the largest producer of Glyphosate, which is a significant product for it.

### **Substantial selling by a large non-promoter shareholder**

Clearwater Capital Partners (Cyprus) Ltd held 11.4% stake (33.34 lakh shares) till 31-Mar-09. It had acquired these shares through preferential allotment. It has been selling its holding from Jun-09 onwards and has so far sold 8.4% stake (24.51 lakh shares). During this period, stock price went up 65% despite the selling. It still holds 3% stake (8.84 lakh shares). If & when, these shares are sold, there may be some weakness in the stock.

### **Ownership & Management**

As at the end of Jun-09, the company was 39% owned by promoters (Chuganee family). If we take into account outstanding warrants (which are deep-in-the-money), they effectively hold 43% of the company. Institutional holding is negligible. Chairman Hero J Chuganee (HJC) set up the company along with his sons Mohit and Sumit in 1994. With over 40 years' experience, HJC was CEO of Rohm & Haas India (Now part of Dow Chemicals) for 15 years. Mohit & Sumit, executive directors, are engineering & management graduates and have worked with MNCs in USA & Europe.

## Financials

Rs.mn	Sep-08	Dec-08	Mar-09	Mar-09	Mar-08	Change	Jun-09	Jun-08	Change	Mar-10	Mar-11
No. of months	3	3	3	12	12	%	3	3	%	12E	12 E
Net domestic revenues	458	240	176	1,384	1,200	15.3%	414	428	-3.2%	1,522	1,750
Exports	543	637	816	2,390	784	204.7%	805	393	104.6%	3,346	4,334
Net Sales	1,000	878	992	3,773	1,985	90.1%	1,219	821	48.5%	4,868	6,085
EBIDTA	146	109	123	507	273	85.7%	216	129	67.2%	772	1,039
Depreciation	14	14	16	57	53	7.9%	18	13	36.1%	98	103
EBIT	132	95	107	450	220	104.4%	198	116	70.8%	674	936
Other income	2	2	9	19	-		8	6	45.3%	22	10
Interest	41	37	52	185	148	24.5%	53	45	17.2%	211	223
PBT	94	60	64	284	72	295.0%	154	77	100.4%	485	723
Tax	13	10	43	80	19	317.7%	48	13	258.8%	165	246
PAT	80	50	21	204	53	287.1%	106	63	66.9%	321	477
Equity Capital	292	292	292	292	292	0.0%	292	292	0.0%	339	339
Annualized EPS (Rs)	10.99	6.86	2.91	7.00	1.81	286.8%	14.47	8.67	66.9%	9.46	14.09
EBITDA Margin (%)	14.5%	12.4%	12.3%	13.4%	13.8%		17.7%	15.7%		15.9%	17.1%
EBIT Margin (%)	13.2%	10.8%	10.8%	11.9%	11.1%		16.2%	14.1%		13.8%	15.4%
Adj PAT Margin (%)	8.0%	5.7%	2.1%	5.4%	2.7%		8.7%	7.7%		6.6%	7.8%
Other Income/PBT (%)	2.5%	3.4%	14.8%	6.6%	0.0%		5.5%	7.6%		4.6%	1.4%
Tax/PBT (%)	14.3%	16.9%	66.9%	28.1%	26.6%		31.3%	17.5%		34.0%	34.0%
Exports/Sales %	54.3%	72.6%	82.3%	63.3%	39.5%		66.0%	47.9%		68.7%	71.2%
RM & Traded Goods	619	610	734	2,544	1,277	99.3%	747	516	44.9%	3,145	3,985
% of Sales	64.2%	70.4%	68.8%	67.8%	64.3%	3.5%	62.8%	66.8%	-4.0%	64.6%	65.5%
Employees Cost	28	29	42	131	98	33.9%	37	25	46.4%	196	226
% of Sales	2.9%	3.4%	3.9%	3.5%	4.9%	-1.4%	3.1%	3.3%	-0.2%	4.0%	3.7%
Other Expenditure	172	119	169	570	337	69.2%	189	102	85.7%	755	834
% of Sales	17.8%	13.7%	15.9%	15.2%	17.0%	-1.8%	15.9%	13.2%	2.7%	15.5%	13.7%

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