

Rating Methodology for Pesticide Companies.

Industry Overview.

- ✓ India is predominantly an agricultural economy. Pesticide plays a significant role in enhancing agricultural productivity. Pesticides help reduce crop losses and thereby increase food safety and revenues for farmers.
- ✓ The domestic market depends on multitude of factors like monsoons, crop yield, pest attack, etc. and is relatively detached from the global dynamics. The domestic pesticide industry is highly seasonal in nature; the demand for pesticides is skewed towards kharif season (July – November).
- ✓ Bulk of the consumption in the domestic markets is of insecticides followed by fungicides and herbicides, unlike, high herbicide and fungicide usage globally. Biopesticides, which are derived from natural sources, are intrinsically less harmful than chemical pesticides. The market share for biopesticides in India is insignificant.
- ✓ On the supply side, the industry is characterized by over capacity & low off take leading to intense price competition among players. Spurious pesticides are a big nuisance and form almost 30%-33% of the domestic market size.
- ✓ Per hectare consumption of pesticides in India is paltry and usage is limited to few crops like cotton, rice leaving the gamut of so many other crops bereft from the benefits of pesticides.
- ✓ Low capital intensity & absence of product patent till 2005, induced many formulators to enter the market; hence the industry is highly fragmented with 30-40 large manufacturers and about 400 formulators.
- ✓ Certain Indian Companies have made a mark for themselves in the world markets. India is now recognized as an important source for supply of generic products and is a net exporter of pesticides.
- ✓ Currently R&D expense as a % of turnover in India is about 1% whereas globally it is very high at 11-12%. About 70% of all pesticides used in India are generics.

Rating Methodology:

CARE emphasizes on both quantitative as well as qualitative factors while rating pesticide companies. Quantitative analysis involves analyzing contribution from various product lines, export sales, operating efficiency etc. While qualitative analysis comprises analyzing the R&D capabilities, number of product registrations, product range, brand building efforts, etc.

CARE has identified following seven factors for the analysis of pesticide companies:

1. Product Portfolio
2. Operating Efficiency
3. R&D Capabilities
4. Number of Product Registrations /Acquisitions
5. Distribution Network
6. Brand building & Product Awareness Measures
7. Exports

Diversified Product Portfolio:

Most of the domestic pesticide (insecticide) usage is biased towards cotton crop. With growing acceptance for the Bt cotton, the insecticide demand will be affected going forward. Globally, GM seeds usage has been spreading to other crops like soyabean, maize, canola, etc. These developments make it imperative for companies to focus on other crops besides cotton, and allied agricultural products like seeds, GM seeds, for future growth.

Also, due to growing pest resistance and newer pest attacks/ diseases, it is essential for the companies to introduce new products/ molecules at regular intervals and provide newer solutions to crop problems.

Given the level of competition and nature of the market; diversified product range, ability to manufacture products with complexity, presence in allied products and services significantly enhances the competitiveness of the company. These factors have positive bearing on the analysis.

Operating Efficiency:

The industry is working capital intensive. Due to seasonal nature of the business and the uncertainties related to timing and coverage of monsoon, level of pest infestation etc. a large inventory is required to be maintained by the companies. Further, the industry needs to offer long credit periods to farmers due to intense competition and low off take. Also, farmers have little surplus money left for purchasing pesticides, as pesticides are the last link in agriculture operation. This leads to higher bad debts in events of crop failure or poor monsoon.

Steps taken by the company for working capital cycle management such as credit insurance cover on receivables, non-recourse factoring, efficient supply chain management etc. are viewed favorably for the analysis.

R&D Capabilities:

Due to lack of patents and data protection MNCs have been careful in introducing their successful molecules in India only after their patents have expired. Due to this Indian agriculture market has been deprived of the benefits of newer and more effective pesticides.

With the onset of product patent in India, MNCs are expected to launch newer molecules and to withstand the competition; strong R&D capabilities and investments in R&D will be critical for Indian companies. Further, products registered and launched in mid 1990s are going off patent. These products are mostly registered in the US / EU and offer a great opportunity for Indian generics manufacturers to enter these stable markets. Companies with strong R&D set up and proven abilities for applied research are better placed in terms of tapping these opportunities.

Investments in R&D, R&D pipeline of new products and JVs/agreements with MNCs etc. are analysed by CARE.

Product Registrations/ Acquisitions:

As pesticides enter the food chain, GoI regulates their export, import, sale & usage. No pesticide is allowed for production or import without registration.

For the exports, access to the markets is restricted through registration procedures stipulated by different countries. Registering agrochemical generics in US / EU is a time consuming process since it requires various types of studies to be carried out. One product registration takes about 3-5 years and costs about USD 10-15 mn. Registration process in India takes roughly 12-36 months. The investments both in terms of time and money act as effective entry barriers. Companies with high number of product registrations and patents are, therefore at an advantageous position.

Globally, the agrochemicals industry is going through a consolidation process. This often leads to antitrust judgments, forcing these companies to dispose off some products. This represents an inorganic growth opportunity for Indian companies to acquire those products and helps reduce the gestation time required for establishing the product in those markets.

CARE views ability to carry out registrations in different countries as per their regulatory requirements, higher number of patents, product registrations and acquisitions in the global market as a major strength for sustainable growth.

Distribution network:

According to CARE, pesticide companies having wide distribution set up and geographic spread in the domestic markets, are at an advantageous position to withstand the uncertainties due to monsoons and regional seasonality. It also provides them a channel for intensive farmer contact for educating them on new products & their applications.

Companies with wide distribution set up are at better position to take on the competition.

Brand building and product awareness measures

As of now, the market for pesticides is a low brand conscious and highly price sensitive market. Due to dominance of generic products, there are several 'me too' and spurious products

available in the market. In order to educate the Indian farmers and spread awareness about usage of quality pesticides, many large companies have started creating brand awareness for their products by organizing campaigns, setting up service centers & extensive farmer contact. Such efforts also help the companies in understanding the needs of the farmers and developing better products.

CARE opines that brand building and product awareness measures undertaken by the companies will help them in strengthening their market position.

Exports:

The increased export focus of the Indian pesticide industry is a consequence of seasonal demand, better price realization in the export markets, global outsourcing opportunity, low credit periods in export markets, domestic overcapacity and tax sops. Also with the availability of low cost high quality scientist pool, India is emerging as a destination for undertaking contract research.

To increase their global reach, companies are increasingly focusing on forming partnerships/ acquiring strong local players, who can provide support to register, launch and market products in their respective countries.

While assessing pesticide companies, strong marketing footprint in various countries and partnerships with the local players in those countries are viewed favorably by CARE.

Conclusion

The rating outcome is ultimately an assessment of the fundamentals and the probabilities of change in the fundamentals. CARE analyses each of the above factors and their linkages to arrive at the overall assessment of credit quality, by taking into account industry's cyclicity. While the methodology encompasses comprehensive technical, financial, commercial, economic, and management analysis, credit rating is an overall assessment of all aspects of the issuer.

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