Rating Methodology for Pesticide Companies

[In supersession of "Rating Methodology for Pesticide Companies" issued in June 2017]

Industry Overview

India is predominantly an agrarian economy. Pesticides play a significant role in enhancing agricultural productivity. They help reduce crop losses and thereby increase food safety and revenues for farmers.

The prospects for domestic pesticide sector depends on multitude of factors like monsoons, crop yield, incidence of pest attack, etc. and is relatively detached from the global dynamics. 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 usage of Bio pesticides has increased over the recent years and now occupies a share of about 10% of total pesticide consumption in the country.

On the supply side, the industry is characterized by overcapacity and low offtake leading to intense price competition among players. The industry is also plagued with spurious pesticide products which account for over one third of the domestic market size.

Per hectare consumption of pesticides in India is paltry and usage is limited to few crops like cotton and paddy.

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.

A few 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 percentage of turnover in India is about 1% compared to 11-12% globally. About 70% of all pesticides used in India are generics.

Rating Methodology

CARE Ratings has a standard methodology for rating of companies belonging to the manufacturing sector. As per this methodology, CARE's rating process begins with the evaluation of the economy/industry in which the company operates, followed by the assessment of the business risk factors specific to the company. This is followed by an assessment of the financial and project-related risk factors as well as the quality of the management. This methodology is followed while analyzing all the industries that come under the purview of the manufacturing sector. However, considering the size and diversity of the sector, CARE Ratings has developed methodologies specific to various industries within the sector. These methodologies attempt to point out factors, over and above those mentioned in the broad methodology, which will be assessed while carrying out rating exercises of companies belonging to the particular industry. The following is a list of such additional factors, along with their analytical implications, considered by CARE Ratings while arriving at the rating of the players that operate in the pesticide industry.

CARE Ratings considers both quantitative as well as qualitative factors while rating pesticide companies. Quantitative analysis involves analyzing contribution from various product lines, export presence, working capital management etc. Qualitative analysis comprises analyzing the R&D capabilities of the company, number of product registrations, product range, brand-building efforts, etc.

Business risk assessment of pesticide companies involves analysis of the following factors:

- Product Portfolio
- Operating Efficiency
- R&D Capabilities
- Number of Product Registrations /Acquisitions
- Distribution Network
- Brand Building & Product Awareness Measures
- Exports

Diversified Product Portfolio:

Domestic pesticide (insecticide) usage is skewed towards cotton crop. With growing acceptance for the Bt cotton which would impact the insecticide demand and widespread use of GM seeds in other crops like soyabean, maize, canola, etc. 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 and are key credit strengths.

Working Capital Management:

The pesticide industry is working capital intensive. Due to seasonal nature of the business and the uncertainties related to timing and overage of monsoon, level of pest infestation etc., the level of inventories the companies need to stock is large. Further, the industry needs to offer long credit periods to farmers due to intense competition and low offtake. Also, farmers tend to have little surplus money left for purchasing pesticides, as applying pesticides is the last leg in agriculture operation. This leads to higher bad debts in events of crop failure or poor monsoon. Various 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 favourably while assessing the credit risk profile of pesticide companies.

R&D Capabilities:

Due to slack 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 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 USA / 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 critically analysed by CARE.

Product Registrations/Acquisitions:

As pesticides enter the food chain, Government of India (GoI) regulates their export, import, sale & usage. No pesticide is allowed for production or import without registration. For 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 while the 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 large 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 of a company to obtain registrations in different countries as per their regulatory requirements and higher number of patents, product registrations and acquisitions in the global market as major strengths for sustainable growth.

Distribution Network:

Pesticide companies having wide distribution setup 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 and their applications. Companies with wide distribution setup are at a better position to take on competition.

Brand building and product awareness measures:

As of now, the market for pesticides is low brand conscious and highly price sensitive. 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 centres and extensive farmer contact. Such efforts also help the companies in understanding the needs of the farmers and developing better products. Brand building and product awareness measures undertaken by the companies help them in strengthening their market position and command higher margins.

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 preferred 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 is viewed favourably by CARE.

Conclusion

The rating outcome is ultimately an assessment of the fundamentals and the probabilities of change in the fundamentals. CARE Ratings analyses each of the above factors and their linkages to arrive at the overall assessment of credit quality, by taking into account the industry's cyclicality. 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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