

KAVERI SEED COMPANY LTD.

Analyst Recommendation: Buy

Buy

Accrue

Hold

Ease

Sell

BSE Code: 532899

NSE Code: KACL

Reuters Code: KVRI.BO

Bloomberg Code: KACL:IN

CMP: ₹485
3 months target: ₹583
SL: ₹461

EPS (₹) 31.0
 P/E (x) 15.7
 Revenue (₹mn) 2,336.9
 Operating Profit (₹mn) 548.7
 Operating Margin (%) 23.4
 EV/Operating Income (x) 2.9

Market Cap (₹mn) 6,657.2
 Free Float Mar Cap (₹mn) 2,413.9
 52 week high/low 494/263.5
 Total Debt (₹mn) 279.2
 Enterprise Value (₹mn) 6,891.0
 Book Value per Share (₹) 138.2
 P/BV (x) 3.5

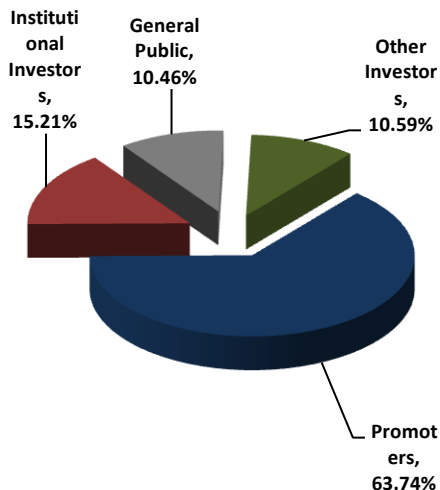
Opportunities in the Agricultural sector and development in Hybrid seeds to drive the growth of Kaveri

Given the structural demographic issues of rising population and surging food demand which is exerting pressure to raise crop yields on the back of shrinking farmland, the structural shift towards hybrid seeds has now turned a reality. Seeds being sequentially amongst the initial inputs used by farmers are now witnessing a conscious shift towards hybrids after tasting success with GM cotton seeds and success of programs like NREGA. Cotton is the best example of how hybrids have not only improved productivity and incomes of farmers but has also led to a decline in consumption of pesticides. In line with this trend Kaveri Seed Co. Ltd. (KACL) to improve its volumes of cotton seeds by 50% to more than 1.8mn packets during FY12 which on the back of a 25% rise in prices over last fiscal should ensure that KACL would derive half its total revenues in FY12 from cotton seeds in which it has half a dozen hybrids. Hybrid seeds would continue to remain the most profitable link in the agricultural value chain which should spur profits of pure hybrid seed companies like KACL with a predominantly domestic focus and helping KACL to attain 24% EBITDA margins in FY12.

Robust growth in the PBT in FY11-13E on strong company fundamentals

FY12 & FY13 should witness robust free cash flows since most of the capital expenditure is now behind KACL. With 9 seed processing plants having cob drying and cold storage facilities along with transgenic containment units, gene bank & a Green House, KACL which owns 600acres of farm land within the listed entity has completed most of its capital expenditure. With the investment phase behind it, KACL in our view is now poised for robust free cash generation this fiscal and during FY13 which bears testimony to the road map laid out by the management in building a sustainable growth oriented business model for KACL with a presence across crops.

Shareholding pattern as on March 31, 2011

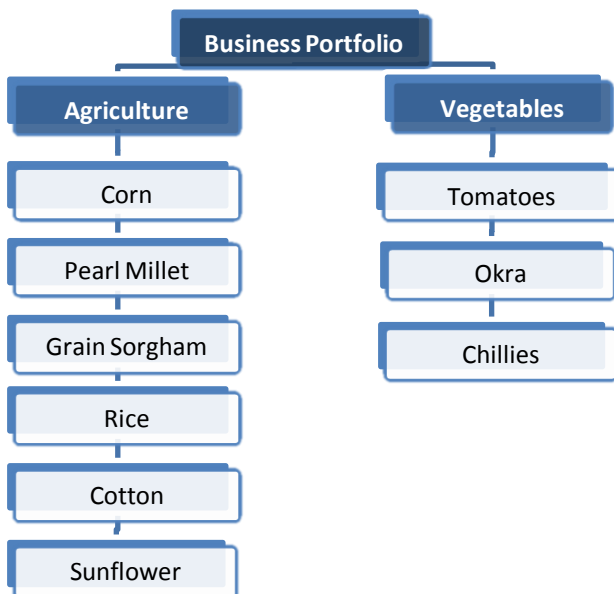


₹Million	FY10A	FY11A	FY12E	FY13E
Operating Income	1,621.4	2,336.9	3,049.6	3,653.4
Operating Profit	371.6	548.7	740.1	900.0
Net Profit	290.7	424.8	551.3	698.8
Share Capital	137.0	137.0	137.0	137.0
EPS (₹)	21.2	31.0	40.2	51.0
PE (x)	22.9	15.7	12.1	9.5
P/BV (x)	4.4	3.5	2.8	2.2
EV/Operating Income(x)	4.3	2.9	2.2	1.9
ROE (%)	19.3	22.4	22.9	22.7
ROA %	14.8	19.6	20.7	21.2

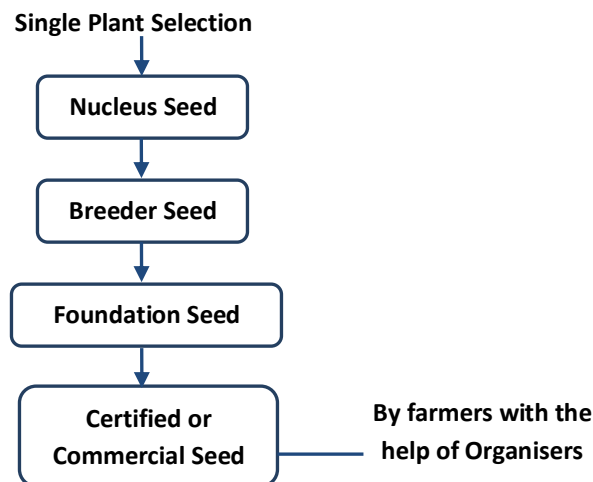
Best positioned to leverage the growing demand for Hybrid Seeds

India, which is still predominately an agricultural driven nation, is facing a huge challenge to feed its growing population on the back of scarce farm land. Now, about 70% of the seeds sown in India are those saved from the previous year. As a comparison to new seeds, it yields less and is more disease-prone. Roughly, there are two types of seeds, varieties (pollinate by themselves and can be reused, but with diminishing returns) and hybrids (which are developed through controlled pollination and cannot be reused). With the realization among farmers, that varieties comes cheap, but are more expensive in the long run, the demand for hybrid seeds is increasing rapidly.

Over the years, KSCL has diversified its product portfolio that comprise of Corn, Cotton, Sunflower, Pearl Millet Grain Sorghum and Rice, while under vegetables it includes Tomatoes, Okra, Chillies and Watermelon. Majority of the revenue is generated through seeds and the rest from organic manures and micronutrient. After the success story of hybrids of GM cotton seeds, and programs like NREGA, cotton is the best example of how hybrids lever productivity and incomes of farmers along with a decline in consumption of pesticides. Going forward, as the business of KSCL is shifting towards cotton BT seeds and with this trend the company is set to improve its volumes of cotton seeds by 50% to more than 1.8 million packets during FY12 alongside a 25% rise in prices over last fiscal, KSCL would derive half its total revenues in FY12 from cotton seeds in which it has half a dozen hybrids.



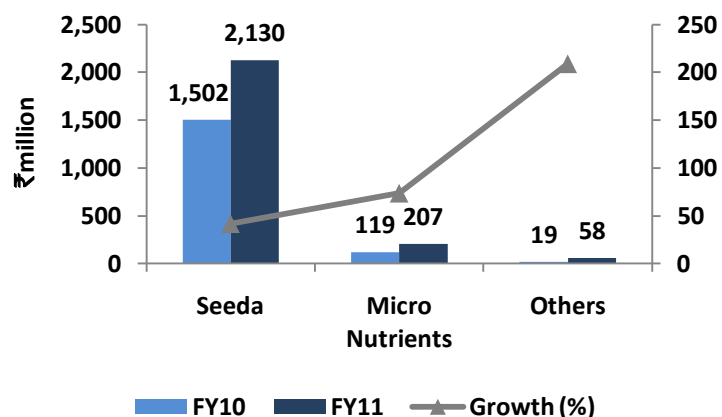
Seed Production Chain



Diversified portfolio to avert product or region-specific risk

KSCL has a strong product basket across crops and cropping patterns catering to diverse regions in the country. Its products are suited for various climatic and topographical conditions. In our view the diversified product portfolio and presence across the nation insulates KSCL from product and region specific risk thereby improving revenue visibility. Micro Nutrients as a percentage of total revenues would continue to remain low as it is more of a push product as compared to hybrid seeds which is a pull product.

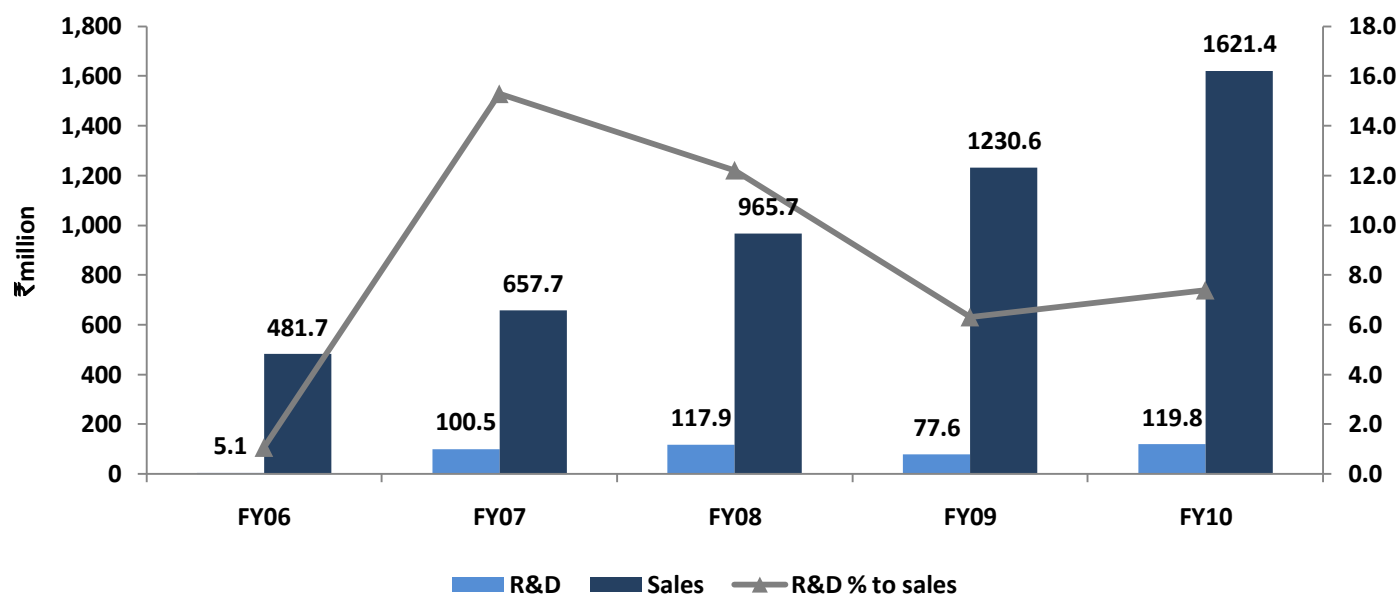
Segmental revenue comparison between FY10 & FY11



R&D: Backbone for the growth story

The key growth driver for any seed company is R&D and KSCL has focused its research for developing quality hybrid and inbred seeds that are high yielding and consume less water and fertilizer. The company is having R&D facilities located at Ranga Reddy District in AP which is recognized by the Department of Science & Technology, Government of India. It owns over 600 acres of farmland and has dedicated over 250 acres of land for R&D activities. The R&D focus is on conventional breeding and biotechnology to advance yield frontiers and stabilize it through incorporation of genetic resistance to biotic and abiotic stress. Current R&D infrastructure of the company comprises of bio-technology, micronutrients and bio-pesticide labs, ultra-modern seed testing labs, multi-season trials facility and cold/ DH storage for Germplasm. The company is also researching on fortifying BT cotton with herbicide tolerance (HT) and drought tolerance (DT). The company's expenditure on R&D activities as a percentage of total revenues is increasing and R&D expenditure as a % of revenues was 7.4% in FY10.

Increasing R&D expenses to drive quality of hybrid seeds



Source: Company

Shifting its focus towards Cotton BT seeds

During the year 2010-11, nearly 90% of cotton farms had BT seeds, thus yields increased from 302 kg a hectare to 503 kg a hectare. Moreover, production grew from 13.6 million bales to 32.5 million bales, turning India from cotton importer to the world's second-largest producer and exporter. Today, cotton accounts for half the hybrid seeds sold in India. Hybrids promise growth and value to the face of agriculture. KSCL has focused most of its research and operation on cotton hybrid seeds. Earlier, top-line of the company was heavily contributed by Corn and sunflower but after 2007 the company has shifted towards BT cotton seeds and the contribution of BT cotton to the top line was 25% during FY10 from 10% in FY07.

Keeping with this trend KSCL is expected to improve its volumes of cotton seeds by 50% to more than 1.8 million packets during FY12 on 25% rise in prices over last fiscal should ensure KSCL to achieve half of its total revenues in FY12 from cotton seeds in which it has half a dozen hybrids. This gives better visibility for the cotton seeds business of KSCL.

Successful transition from being a regional player to a Pan India player across all crops

KSCL has now evolved into a Pan-India player through its wide distribution network. The company started operations from the south and now has presence throughout the country. KSCL has more than 750 distributors spread across India and with its vast network it caters to the requirements of farmers in India. The success of agri-inputs business lies in reaching a geographically dispersed end-user at the right time at the right place with the right product. Competition in seeds and other agri-inputs is intense. Hence, KSCL's established relationships with its distributors and dealers will ensure that its distributors and dealers find its products to be commercially remunerative and have continuing demand from farmers. Besides, the company has been developing newer seeds that can be grown in various regional and diverse climatic conditions, thus gaining considerable market presence.

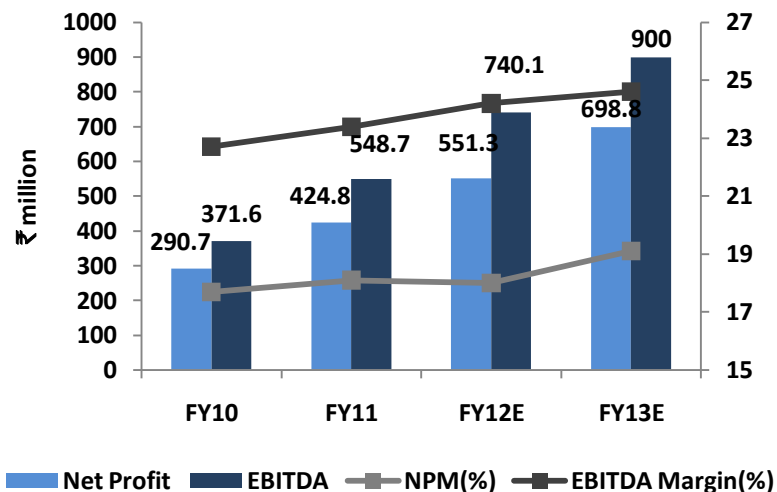
Seed companies located in South & Western India

Seed companies in India are mostly located in the southern and western parts of the country due to suitable climatic conditions for seed production and availability of skilled seed growers. Back in 2007, KSCL raised nearly ₹680 million in its Initial Public Offer (IPO), for acquisition of farmland for R&D near Hyderabad, setting up of marketing offices and building up of corn cob drying plants in Medak District, Andhra Pradesh. The Medak facility has facilities for cob drying, seed processing and cold storage on a farmland of 29 acres. The cold storage also facilitates to maintain seed bank for seed reserves and the cob drying process improves germination, vigour and viability of the corn seed that improves the yield of the seed. Further transgenic containment units are available along with greenhouses. KSCL conducts initial, advanced and multiple hybrid trials and is using biotechnology tools like molecular markers to shorten breeding cycles and exploit genetic gains to enhance crop yields. This enables KSCL to come up with products that work under both stress and controlled conditions.

Risk factors

- Adverse weather conditions can impact the business although the risk is mitigated due to presence across crops and both the cropping season.
- Adverse policy changes by the government could impact the business.
- The business of Seeds and agricultural inputs is highly seasonal in nature.
- Hybrid Seed business is dependent on the success of R&D and failure to develop new and improved products could adversely affect the business.

EBITDA margins of 24% in FY12 & FY13 sustainable



Business Overview

KSCL is one of the leading hybrid seed company having a Pan India presence through strong distribution network. In a clear reflection of the company's competitiveness and its strong R&D capabilities, KSCL is among the top three companies in hybrid maize, hybrid sunflower, pearl millet and paddy in its representative regions and is now moving higher on Cotton as well. Its key product segments include maize, sunflower, BT cotton, paddy, pearl millet and its micro nutrients business- Microtek. The company owns more than 600 acres of farmland and has 9 seed processing plants located across the country, with a processing and packing capacity of 58 tonnes per hour. KSCL is now working on fortifying BT cotton with herbicide tolerance (HT) and drought tolerance (DT).

Indian Seed industry

The agricultural sector contributes nearly one-fifth of the GDP in India and acreage under most of the agricultural crops in India have remained almost stable over the years. Seed is the most important input component for productive agriculture. The expansion of seed industry in India has occurred in parallel with growth in agricultural productivity along with increased seed replacement rates. With an estimated turnover exceeding ₹70 billion, India ranks fifth in the world seed trade and is poised to rise higher on the strength of its dynamic, innovative, internationally competitive, research based seed industry. The seed industry is growing at 12-13% p.a. and the commercial seed segment accounts for a mere 25% of the total market, hence going forward the potential for commercial seed is massive. Gross cropped area in the country is about 200 million hectares of which the majority is under cereal crops such as rice, wheat, corn, sorghum, millets, pulses, oilseeds etc. Other key crops are cotton, sugarcane and vegetables. The industry is dominated by cotton, corn, rice, wheat, sorghum, millets, sunflower and vegetables. In volume terms, it is dominated by open pollinated seeds of rice and wheat from the public sector. Cotton, corn and vegetables are the largest segments by value, as high percentage of cultivated area under these crops is in hybrids.

Potential and role of R&D

In India, nearly 70% of the seeds sown in India are reused for the next year and in comparison to new seeds, it yields less and is more disease-prone. The government has set a seed replacement rate—percentage of new seeds in a year—target of 40%. Once this materializes, the industry will grow at a rapid rate aided by the government's policy to increase consumption of new seeds. Presently, the industry is surviving on cutting edge technology that meets the requirements of farmers. Private companies are gaining market share from public enterprises as their efforts in R&D are inadequate. Most of the companies are reinvesting its profits in the research process as R&D is the key differentiator to increase value for a farmer.

Government's role in seed production, distribution

Indian seed industry needs government support to enable them to operate on free market principles and a well streamlined regulatory process. Public sector presence in seeds is restricted to wheat and paddy as it is considered necessary to ensure availability of these seeds to farmers at reasonable prices. Public private partnerships would pave the way towards better success in changing the face of agriculture in India and herald improved agricultural productivity.

Outlook going forward:

India is the largest producer of pearl millets and has the largest area under sorghum but the productivity is way below world average. Similarly area under hybridisation for paddy is extremely low at 3% of the total paddy growing area of 45 million hectares and this provides seed companies like KSCL a huge growth opportunity going forward. We believe that KSCL has the unique ability to work closely with breeders and localise product offerings with the speed to market.

Hybrid Seeds: Immense growth potential

There are mainly two types of seeds, one is varieties and the other is hybrids. During the year 2010-11, nearly 90% of cotton farms had BT seeds, thus yields increased from 302 kg a hectare to 503 kg a hectare. Moreover, production grew from 13.6 million bales to 32.5 million bales, turning India from cotton importer to the world's second-largest producer and exporter. Today, cotton accounts for half the hybrid seeds sold in India. Hybrids promise growth and value to the face of agriculture. Since seeds accounts for only 5-15% of the cost of production, farmers are willing to pay more for better production and consistent quality. Further, greater adoption of hybrids means more seeds sold, which will mostly benefit the private sector.

India's Production of breeder and Certified seeds & distribution of certified seeds

Year	Prod. of breeder seeds (Quintals)	Prod. of foundation seeds (quintals)	Dist. Of cert/quality seeds (mn quintals)
FY05	66460	6.9	11.3
FY06	68654	7.4	12.7
FY07	73829	7.96	15.5
FY08	91960	8.22	17.9
FY09	74361	9.69	21.6
FY10	94410	11.46	25.7

Balance Sheet

(₹ million)	FY10A	FY11A	FY12E	FY13E
Share Capital	137.0	137.0	137.0	137.0
Reserve and surplus	1,372.3	1,757.3	2,274.3	2,938.9
Net Worth	1,509.4	1,894.3	2,411.3	3,075.9
Loan Funds	455.2	279.2	250.0	220.0
Net Deferred Tax Liability	0.9	(1.1)	0.0	0.0
Capital Employed	1,965.5	2,172.4	2,661.3	3,295.9
Gross fixed assets	923.4	1,084.8	1,228.3	1,321.1
Less: accumulated depreciation	131.2	233.2	345.2	464.5
Net Fixed assets	792.1	851.6	883.8	857.4
Capital Work in Progress	299.5	264.5	286.5	308.5
Total Fixed Assets	1,091.6	1,116.1	1,170.2	1,165.9
Investment	20.3	368.3	200.0	250.0
Net Current Assets	852.8	687.5	1,290.1	1,879.0
Misc Exp	0.7	0.5	1.0	1.0
Capital Deployed	1,965.5	2,172.4	2,661.3	3,295.9

Profit & Loss Account

(₹million)	FY10A	FY11A	FY12E	FY13E
Net Sales	1,621.4	2,336.9	3,049.6	3,653.4
Other income	18.9	10.0	11.2	12.2
Total Income	1,640.3	2,346.9	3,060.8	3,665.6
Expenses	1,268.7	1,798.2	2,320.7	2,765.6
EBITDA	371.6	548.7	740.1	900.0
EBITDA Margin %	22.7	23.4	24.2	24.6
Depreciation	41.5	101.9	112.0	119.4
EBIT	330.1	446.7	628.1	780.6
Interest	18.2	43.5	47.8	45.0
Profit Before Tax	311.9	403.2	580.3	735.6
Tax	21.3	26.8	29.0	36.8
Excess prov. written off	0.0	48.3	0.0	0.0
Net Profit	290.7	424.8	551.3	698.8
Net Profit Margin (%)	17.7	18.1	18.0	19.1

Key Ratios & Valuations

	FY10A	FY11A	FY12E	FY13E
EBITDA Margin (%)	22.7	23.4	24.2	24.6
NPM (%)	17.7	18.1	18.0	19.1
ROCE (%)	16.8	20.6	23.6	23.7
ROE (%)	19.3	22.4	22.9	22.7
EPS (₹)	21.2	31.0	40.2	51.0
P/E (x)	22.9	15.7	12.1	9.5
BVPS	110.2	138.2	176.0	224.5
P/BVPS (x)	4.4	3.5	2.8	2.2
EV/Operating Income(x)	4.3	2.9	2.2	1.9
EV/EBITDA (x)	18.6	12.6	9.2	7.6
EV/EBIT (x)	20.9	15.4	10.9	8.7

Valuation

KSCL over the past few years has clearly demonstrated its ability to grow in a highly competitive business environment across its product categories. Poised for a 35% CAGR growth in pre tax profits over FY-11-13 on the back of a 25% CAGR growth in revenues over the same period, we believe KSCL trading at ₹485.9 is the best available stock to play the agricultural productivity theme in India. We expect KSCL to continue the growth momentum and recommend a BUY on the stock trading at 12.1x FY12E and 9.5x FY13E earnings.



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