Lakshmi Energy and Foods – BUY

LKEF IN	Rs122	AGRI	13 November 2009	Earnings upgrade

No drought fears

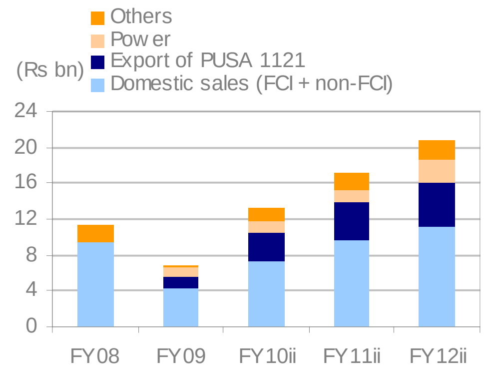
With domestic prices of rice up ~20% YoY owing to the drought, and the states of Punjab and Haryana being insulated from the drought's impact (thanks to irrigation), LKEF is well placed to gain from both volume and pricing growth. During FY09, LKEF had suffered from 60% YoY decline in demand from Food Corporation of India (FCI), its key customer, on account of lack of warehousing capacity. This year, the drought is likely to reverse its fortunes, as FCI has stepped procurement to ensure adequate supply of food-grains. Additionally, export demand for PUSA 1121 rice remains strong. Both these factors together should support volume growth of 50%YoY during this year. Accordingly, we raise our earnings estimates for FY10-12 by 8-22% and target price to Rs160. Buy.

No supply constraints: Our recent visits to Punjab and Haryana have allayed concerns of supply constraints; the two states have recorded 4% YoY growth in paddy production despite the steep rainfall deficiency. Availability of irrigation facilities coupled with sufficient supply of electricity has supported acreage and yield growth in both states. As LKEF procures all its raw material from these two states, we do not see any supply constraints.

Demand environment benign: In the backdrop of the drought, both the company's management as well as smaller millers in the state indicated an improvement in FCI's procurement activity this season (harvest began in mid-October). Additionally, the company's foray into the export market has been successful (it booked Rs1.4bn in export revenues in FY09); the company said it has secured orders worth Rs3bn, to be booked over the next couple of quarters.

Ban on basmati exports could pose a threat: Our estimates assume ~25% of revenues will come from export of PUSA 1121 during FY10. Domestic supply of paddy is estimated to decline by ~15% (according to Ministry of Agriculture). While the inventory with FCI should act as a buffer for the demand-supply imbalance, any pre-emptive ban on export of basmati rice in apprehension of food inflation would impair LKEF's earnings outlook and represent ~35% downside to our FY10 earnings estimate.

Topline set to rise with FCI procurement



Source: Company, IIFL Research

Financial Summary

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenues (Rs m)	15,402	6,938	13,062	17,123	20,853
EBITDA Margins (%)	21.3	31.8	25.4	23.5	27.4
Pre-Exceptional PAT (Rs m)	1,590	936	1,413	1,672	2,530
Reported PAT (Rs m)	1,590	936	1,413	1,672	2,530
EPS (Rs)	26.5	14.8	22.4	26.5	40.0
Growth (%)	153.1	-44.1	50.9	18.3	51.3
PER (x)	4.6	8.2	5.5	4.6	3.0
ROE (%)	32.7	16.1	19.6	18.8	22.1
Debt/Equity (x)	0.9	0.7	1.0	1.0	0.7
EV/EBITDA (x)	3.5	4.8	3.9	3.5	2.2
Price/Book (x)	1.5	1.3	1.1	0.9	0.7

Price as at close of business on 10 November 2009

12-mth TP	***(Rs) 160 (+30%)***
Market cap (US$ m)	**150**
52Wk High/Low (Rs)	212/62
Diluted o/s shares (m)	63
Daily volume (US$ m)	2
Dividend yield FY10ii (%)	0.0
Free float (%)	55.1

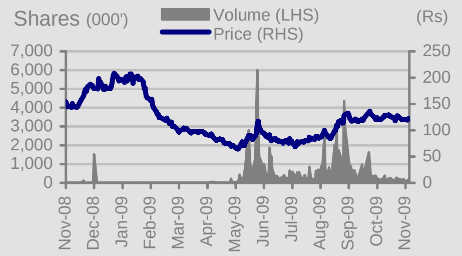
Shareholding pattern (%)

Promoters	44.9
FIIs	23.9
Domestic MFs	5.5
Others	25.7

Price performance (%)

	1M	3M	1Y
Lakshmi energy	1.3	40.0	-24.4
Rel. to Sensex	2.5	30.5	-80.4

Stock movement



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Demand set for significant uptick

LKEF's key customer historically has remained Food Corporation of India (FCI), to whom the company has sold >70% of its rice until FY09. During the past year, the company also diversified its customer base to include domestic wholesalers and retailers (through its branded rice) as well as the export market (mainly the Middle East) to whom it sold the PUSA 1121 variety of rice.

FCI offtake set to rise sharply: LKEF's FY09 topline was marred by low offtake from FCI (following a record year of procurement during FY08 and insufficient warehousing capacities). FY10 should witness a pick-up from FCI's procurement, which is likely to step up procurement to avert a food shortage caused by the drought.

FCI's buffer stock for paddy and wheat currently is less than 30m tonnes. By contrast, during the last drought in 2002, FCI's buffer of paddy and wheat had together risen by 60m tonnes, leaving much headway for increase in procurement this year.

Exports also likely to take-off following success of initial orders: The company started exporting the PUSA 1121 variety of basmati rice in FY09 and recorded revenues of Rs1.2bn from this business. Management said it has already received enquiries for >Rs3bn worth of exports over the next couple of quarters. Acreage for PUSA 1121 has also grown by 25% YoY in Punjab and Haryana, thus ensuring availability of raw material for the company this year.

No supply constraints, thanks to irrigation

Punjab, Haryana paddy output unaffected

Despite rainfall deficiency of 36-38% in the states of Punjab and Haryana during the kharif season, both states have announced stable to positive growth in paddy output during the current season. In Punjab, acreage under paddy has remained constant (at 2.7m ha). Haryana has witnessed a slight decline in acreage (down 9% YoY), but its impact is likely to have been offset by 14% YoY increase in yield, supporting 4% YoY growth in paddy production.

Our recent visits to these states indicated that presence of irrigation facilities coupled with uninterrupted power supply for farmers in these states has ensured stable yields and acreage sowing in these states.

Figure 1: Paddy output in Punjab and Haryana together estimated to grow by 3% YoY

	Acreage (m ha)	Yields (kg/ha)	Output (m tonnes)
Punjab			
2008-09	2.7	2,800*	7.6
2009-10	2.7	2,850*	7.7
Haryana			
2008-09	1.2	2,720	3.3
2009-10	1.1	3,100	3.4

Source: Government of Punjab, Government of Haryana, IIFL Research
Yield in Punjab is estimated based on IIFL surveys in the state during 2008 and 2009

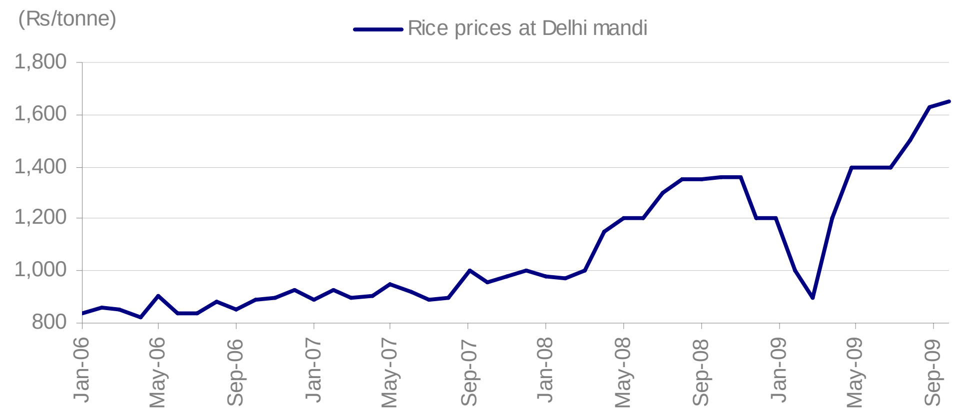
LKEF procures all of its rice from these states, thus ensuring adequate raw-material availability for the company, despite sharp fall in paddy output in the rest of India. Additionally, FCI's procurement activity is strongest in these two states (since they have the biggest paddy surpluses). Thus, LKEF is best placed to benefit from any spurt in FCI's procurement.

Topline growth driven both by volume and pricing

Domestic prices strong driven by shortage in rest of India

Paddy production in India is estimated to decline by ~15% (driven by the significant deficiency in rainfall in the rest of India, coupled with the lack of irrigation facilities in these states). Domestic prices are up ~20% YoY currently, reflecting the tightness in supply conditions. Ban on export of non-basmati rice remains in place, and is unlikely to be lifted any time soon.

Figure 2: FCI grade paddy price up ~20% YoY



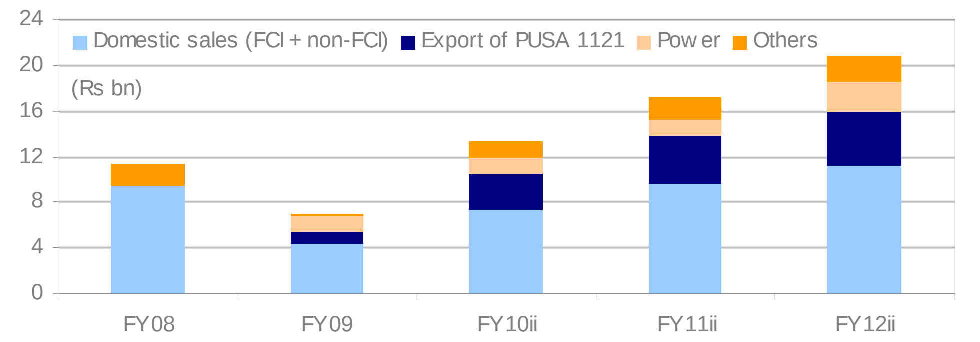
Source: Department of agriculture, IIFL Research

Power earnings stable

The company's 30MW power plant became fully operational in March 2009 and we estimate that sale of power contributed ~37% of the PAT during FY09. While we expect the average realisation from power to decline in FY10 vs FY09 (minimum guaranteed price offered by PTC has declined from Rs7.5/unit during FY09 to Rs6/unit in FY10), we expect revenues from sale of power to increase during FY10 (from Rs1.2bn in FY09 to Rs1.3bn in FY10), as the segment's contribution this year would be for 12 months, compared with nine months in FY09.

Hence, we expect LKEF's revenues to grow by 88% YoY during FY10, driven by 50%+ growth in volumes and 25%+ YoY growth in pricing.

Figure 3: Domestic sales to revert to FY08 levels during FY10, driven by FCI offtake



Source: Company, IIFL Research

Capacity expansion plans back on the board

Following last year's weak offtake, management put its capacity expansion plans on the backburner. With a clear revival in the demand environment, expansion plans are back on the board. Management plans to add a 50MW power plant within 18 months and to increase its rice milling capacity to 3m tonnes (from the current 1m tonnes) within the three years. Together, these plans are likely to cost Rs9bn, to be funded equally by debt and internal accruals.

Our earnings estimates assume that the 50MW power plant will begin to contribute to revenues from FY12 and 1.5mtpa of the rice milling capacity will become operational by FY12.

We raise earnings estimates on the strength of volume growth

Our recent visits to Punjab and Haryana have allayed our concerns regarding availability of raw material, thus supporting visibility for robust volume growth during FY10. Our visits also indicate a ramp-up in procurement activity by FCI and management's commitment to increase in-house capacities within the next three years. Accordingly, we raise our topline and earnings estimate for FY10-12 by 8-22%. The stock is currently trading at a one-year-forward P/E of 5.6x, against its historical average of 13.3x; we expect a re-rating once the company has begun to report robust earnings growth. We raise our target price to Rs160 (from Rs148), to factor in the increase in our earnings estimates and a one-year-forward P/E of 6x.

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenue	15,402	6,938	13,062	17,123	20,853
EBITDA	3,276	2,208	3,317	4,030	5,706
EBIT	2,940	1,904	2,903	3,556	5,227
Interest expense	567	638	794	1,061	1,451
Others items	27	12	0	0	0
Profit before tax	2,400	1,277	2,109	2,496	3,776
Tax expense	810	341	696	824	1,246
Net Profit	1,590	936	1,413	1,672	2,530

Cashflow summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Profit before tax	2,400	1,277	2,109	2,496	3,776
Depreciation & Amortization	336	304	414	474	480
Tax paid	144	193	422	499	755
Working capital change	-3,737	179	-3,004	-2,474	-2,097
Other operating items	-3	0	0	0	0
Operating Cash-flow	-1,148	1,568	-903	-4	1,403
Capital expenditure	-1,278	-700	-1,400	-1,000	-100
Free cash flow	-2,426	868	-2,303	-1,004	1,303
Equity raised	891	0	0	0	0
Investments	-490	0	0	0	0
Debt financing/disposal	3,165	-45	3,054	1,622	-778
Other items	3	0	0	0	0
Net change in Cash & cash equivalents	1,145	823	751	618	524

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Cash & cash equivalents	58	881	1,632	2,250	2,775
Sundry debtors	184	114	286	375	457
Trade Inventories	5,379	5,322	7,873	10,320	12,569
Other current assets	612	741	1,396	1,830	2,171
Fixed assets	3,750	4,179	5,165	5,692	5,312
Intangible assets	33	0	0	0	0
Other assets	601	601	601	601	601
Total assets	**10,618**	**11,838**	**16,953**	**21,068**	**23,885**
Short-term debt	3,151	3,106	3,857	4,475	5,000
Sundry creditors	289	181	373	497	575
Other current liabilities	365	654	835	1,208	1,705
Long-term debt/Convertibles	1,058	1,058	3,361	4,365	3,062
Other long-term liabilities	886	1,034	1,308	1,633	2,124
Networth	4,869	5,806	7,219	8,891	11,420
Total liabilities & equity	**10,618**	**11,838**	**16,953**	**21,068**	**23,885**

Ratio Analysis

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Sales growth (%)	121.2	-55.0	88.3	31.1	21.8
Core EBITDA growth (%)	180.7	-32.6	50.2	21.5	41.6
Core EBIT growth (%)	181.3	-35.2	52.5	22.5	47.0
Core EBITDA margin (%)	21.3	31.8	25.4	23.5	27.4
Core EBIT margin (%)	19.1	27.4	22.2	20.8	25.1
Net profit margin (%)	10.3	13.5	10.8	9.8	12.1
Tax rate (%)	33.8	26.7	33.0	33.0	33.0
Return on Assets (%)	85.2	56.5	77.4	74.1	46.3
Return on Equity (%)	32.7	16.1	19.6	18.8	22.1
Net debt / Equity (%)	15.0	7.9	8.3	7.9	10.6

Source: Company data, IIFL Research

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.
