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LAKSHMI ENERGY AND FOODS LTD. - "BUY"

19th November,2009

STOCK DETAILS

BSE Code	519570
CMP – 19th November, 2009	Rs. 124.3
Market Capitalisation	Rs. 7,854 mn
Face Value (Rs.)	2
Book Value (Rs.)	Rs. 82/-
52 Wk High (BSE)	Rs. 210 (Jan 01, 2009)
52 Wk Low (BSE)	Rs. 61.55 (May 14, 2009)

COMPANY PROFILE

Lakshmi Energy and Foods Ltd. (LEAF) formerly known as Lakshmi Overseas is one of the largest food grain processing companies in India and in the world. It is among India's largest producers of non basmati varieties of rice. A conglomerate carefully promoted and nurtured by the Uppal family in 1981.

LEAF is located in the paddy-growing region of Punjab, situated at 45 km from Chandigarh and 50 km from Ludhiana. Punjab despite primarily a wheat consuming state, is also a key producer of rice with the highest yield per hectare, on account of its edge in terms of climate, soil quality & irrigation facilities.

LEAF has come a long way from rice trading & refining of raw rice to become an integrated player operating from sourcing paddy to processing rice with solvent extraction & refinery capacities in place for its by-products.

Subsidiaries:

Punjab Greenfield Resources Ltd (PGRL): This wholly owned subsidiary of the company was incorporated on 31st Jan, 2007. The objective of this subsidiary is to procure and distribute food grains, pulses, vegetables, fertilizers, seeds and pesticides and undertake contract farming and farm research and development. LEAF is also venturing into the branded foods category through PGRL for which it has set aside an initial investment of Rs. 500 mn.

About the Business

Engaged in the business of rice processing, Rice bran oil refining, wheat flour milling, Biomass Power generation from rice husk and packaging and retailing of foods.

From a modest beginning - paddy processing capacity of 100 MT/day in Oct, 1981 at Khamanon in Punjab, its present capacity is 1.2 MTPA.

Non Basmati Rice processing constitutes more than 90% of revenues. It is a key supplier of rice to Food Corporation of India (FCI) and is located in close proximity to FCI warehouses (1 km) and railway yards. The non-basmati rice segment is a stable business in terms of pricing as most of the sales are done to Food Corporation of India (FCI), resulting in high volumes and assured prices. Bulk of the company's rice is sold to the government at a fixed price known as the minimum support price (MSP).

LEAF also produces value added products from it's by – products like rice bran oil, de – oiled cake, boiler fuel, cattle feed, ash bricks etc.

LEAF is a fully integrated player from sourcing paddy to processing of finished rice with solvent extraction and refinery capacities in place for its by – products.

LEAF acts as bridge in the paddy processing segment. It is uniquely positioned in the two growing sectors: Food and Power. Fragmented market provides an opportunity for integrated processors like LEAF.

Segment wise /product wise performance

Rice continues to be the dominant product contributing ~ 90% of revenue, and remaining coming from rice bran oil, De – Oiled Cake, Cattle Feed, Power generation from rice husk.

INDUSTRY OVERVIEW

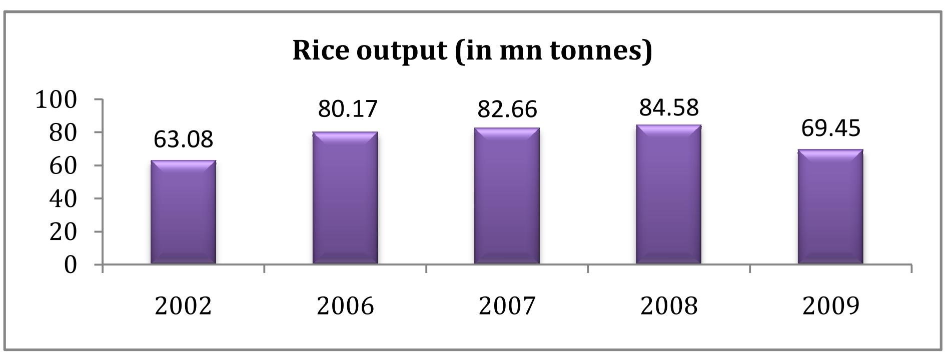
The new global crisis is ***"food shortage"***. The demand for food is growing at a pace which is almost two times than the growth in population. The steady growth of population, rising income levels in developing countries, diversion of food grains for bio-fuel production and industrial uses is accelerating the demand. The supply of food grains is not keeping pace with plateauing of productivity in agriculture due to under investment in farm sector for the last many years and nearly zero growth in land area under agriculture.

India had been self-sufficient in food except wheat and edible oil. But with under investment in farm sector the growth in agriculture has slowed down. India's GDP has grown at a rate of 7.1% CAGR since the year 2000, whereas farm output has grown at 2.5% only.

India is still maintaining self-sufficiency in Rice though, the Government for the first time, imposed ban on export of non-Basmati rice to check soaring domestic rice prices and preserve the stocks.

The Indian rice industry is highly fragmented, thus the efficiency levels are poor and wastage is high. Multitude of small units lack integration, and are unable to make use of by-products. LEAF is the largest organized player in non-basmati rice space. The large capacity has resulted in complete downstream integration, thus leading to almost zero wastage in the production process; adding value to each by-product; reducing power consumption and labour cost.

In addition to the above, the worst recorded South – West monsoon since 1972 has taken a heavy toll in this year's kharif crop especially rice.



The demand for food grains all over the world and India would continue to grow with rise in income levels. With the change in lifestyle of the people, the demand for package rice, wheat flour and rice oil would also grow in the years to come. The government has also started rebuilding its buffer stocks to avert any food crisis in future.

INDUSTRY OVERVIEW

Current Scenario

Rice accounts for 1/3rd of India's agriculture production, 13% of overall agriculture exports and 1.6% of total exports from India.

India is the 2nd largest producer of rice (25% of global output). However, the recent drought would result in degrowth of rice production

There are 1,39,000 rice processing mills in India for processing 134 m MT of paddy. There are around 6,800 mills in Punjab and the state cultivates around 15 m MT of paddy. The government procures 95% of the rice produced in the state at fixed prices thus reducing the risk for processors. The prices of the levy rice are fixed by the central government. The prescribed specifications are offered for sale at specified centres and are bought by the public procurement agencies at support prices – (MSP – Minimum support price). MSP is announced every year (Rs. 950 per 100 kg in 2009). The producers can either sell it to FCI (Food Corporation of India)/state agencies at MSP or in open market.

Rice Shortage….

Shortfall in Rice output due to drought in the northern India and floods in Southern India especially in Karnataka is estimated to be ~15 mn tonnes. Rice output this summer is estimated at only 69.45 mn tonnes this Khariff season as compared to 84.58 mn tones last year.

Source: The Economic Times – 19th Nov 2009

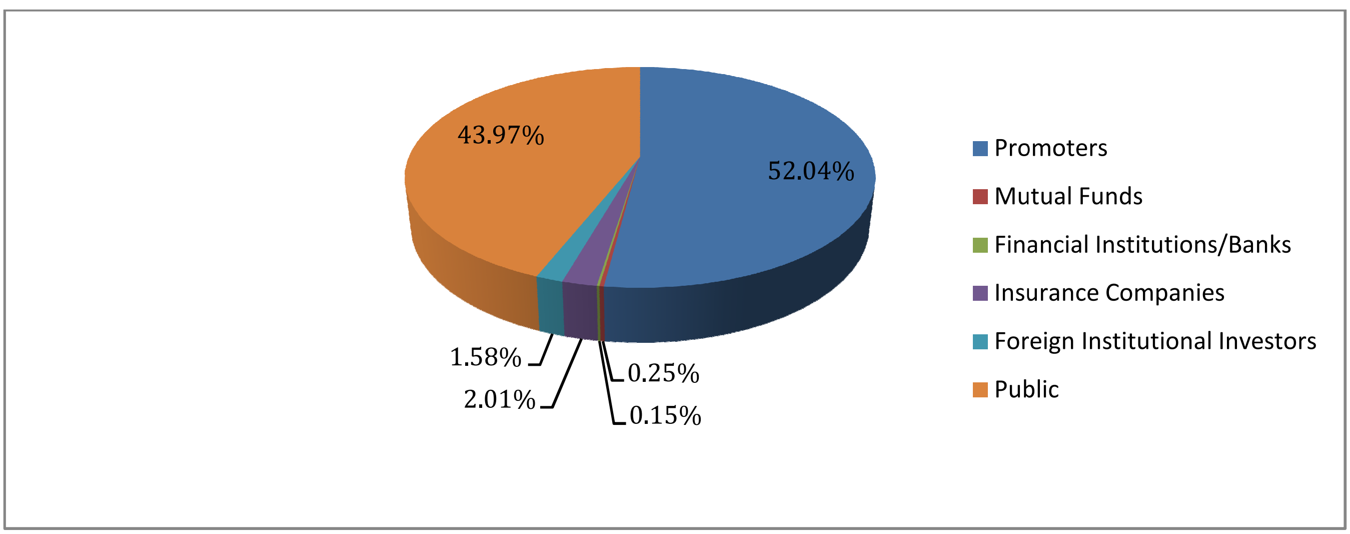
Though the new rice marketing season started from 1st October, 2009 with about 17 mn tonnes of rice stocks, well above the minimum buffer norm of 5.2 mn tones for FCI, retail prices were already up by 14% YoY. This was because the market were sensitive to production shortage signals and it got jittery after several nervous decisions of the *government such as delaying the advance estimates on crop output, extension of stock holding limits by traders and continuing with the export ban on non-premium rice.*

Globally, *Rice is commanding the highest price in more than 9 months as India, the world's second largest rice grower, returns to the import market.* (Source: Hindu Business Line/Bloomberg)

Financial highlights

Particulars (Rs. In millions)	FY 08 (18 months)	FY 09	FY 10E
Sales	16,018	6,944	10,900
EBITDA	3,220	2,213	2,998
EBITDA Margin	20%	32%	28%
Net Profit	1612	936	1311
PAT Margin	10%	13%	12%
No. of Equity Shares (mn)	63.19	63.19	63.19
Diluted EPS	25.51	14.81	20.71
EPS growth	75.9%	(41.9)%	39.8%
P/E (x)	10	9.36	5.53
Book Value (Rs.)	78	79	85

Shareholding pattern as on June 2009



Growth Drivers

1) **Packed branded Rice products to drive growth:** LEAF is reducing its dependence on FCI and promoting sale of packed branded rice in the open market.

2) **Power Division to drive growth:** LEAF commissioned its maiden power plant run on rice husk in August 2008 having a capacity of 15 MW. Another 15MW was commissioned in February 2009. The biomass based power plants were envisaged keeping in view the availability of in-house rice husk available as a by-product of paddy processing facility in the same premises at Khamanon. It is planning to expand its capacity to 60 MW by FY11 from current 30 MW and upto 105 MW in phased manner over the next 3 years. The in-house power consumption of the company is ~3MW. Surplus “green power” would be sold by PTC (Power Trading Corporation) under the Open Access Policy.

   Power Purchase Agreement (PPA) with PTC is for a period of 5 years at a minimum assured price of Rs.7.50/- per unit for one year w.e.f 1st October, 2008.

   In Feb 09, the power was sold at ~ Rs. 8.45 per unit. It had earlier signed a MOU with Punjab State Electricity Board (PSEB) to supply electricity from this plant @ Rs. 3.69 per unit. Biomass power enjoys 100% tax exemption and 80% depreciation benefit in the first year. It is also eligible to earn carbon credits and encash them for 10 years. Going forward, this would result in addition to the bottomline of LEAF.

Capex plans

LEAF has dismantled 60 MT/hour of its old inefficient paddy processing capacity and added a further 165 MT/hour of new capacity at its existing location at Khamanon near Chandigarh, taking its total paddy processing capacity to 330 MT/hour (2 mtpa). It also plans to add another 1 mtpa of paddy processing capacity at Moga (Punjab). The company is expected to expand its by-products capacity in sync with its rising paddy processing capacity. It has also set up a new 100 MT/day wheat flour mill. Capacity expansion plans also include setting up of new rice packing machines for its entry into branded foods.

Risks and concerns

Weather conditions: Natural calamities like Drought and Floods can dampen the production of rice which would affect the revenues.

Regulatory Risk: The Government policies in relation to procurement of paddy/rice and their pricing for the Public Distribution System and the policy on exports of non-basmati rice would continue to affect LEAF in as much as the rice industry in general. However, the large production capacity of LEAF including by-product processing and its diversification into power will always mitigate such potential risk to the industry.

Major chunk of rice is sold to Food Corporation of India (FCI). Any problems of procurement at FCI will directly affect LEAF's profitability. LEAF's margins are dependent on MSP fixed by the government.

Scrapping of customs duty: The Union government has scrapped customs duty (70%) on rice (semi-milled or wholly milled rice, whether or not polished or glazed) till September 2010 to augment domestic supply, as twin – impact of drought and floods have resulted a shortfall in rice output by as much as ~15mn tones.

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FINANCIALS - Income Statement – (Rs. in millions)

Particulars	FY 08 (Apr 07 – Sep 08)	FY 09 (Unaudited)	FY 10E
Sales	**16,018**	**6,944**	**10,900**
Expenditure			
(Increase)/Decrease in inventory	(2599)	(2,016)	(1,000)
Cost of Material	14876	6,275	8,393
Manufacturing Expenses	178	91	120
Personnel Expenses	58	66	69
Other Expenditure	285	314	320
EBITDA	**3,220**	**2214**	**2,998**
Depreciation	337	304	395
EBIT	**2,883**	**1,910**	**2,603**
Interest	496	638	660
Other Income	39	6	22
Net Profit before tax	**2,426**	**1,278**	**1,965**
Less: Tax	808	342	654
Net Profit after tax	**1,618**	**936**	**1,311**
Less: Minority Interest	6	-	-
Income attributable to Consolidated Group	**1,612**	**936**	**1,311**
No. of equity shares (in mn)	**63.19**	**63.19**	**63.19**
EPS (Rs.)	**25.51**	**14.81**	**20.75**

Consolidated Balance Sheet – (Rs. in millions)

Particulars	FY 08 (Apr 07 – Sep 08)	FY 09 (Unaudited)	FY 10E
LIABILITIES			
Share Capital	126	126	126
Reserves and Surplus	4,789	4,882	4,997
Secured Loans	4,118	5,285	5,555
Unsecured Loans	91	127	128
Net Deferred Tax Liability	887	1,034	1,273
Minority Interest	23	23	23
Total	**10,034**	**11,477**	**12,102**
ASSETS			
Fixed Assets	4,858	5,463	6,823
Less: Depreciation	1,016	1,321	1,716
Net Fixed Assets	**3,842**	**4,142**	**5,107**
CWIP	**33**	**-**	**-**
Investments	**101**	**101**	**101**
Current Assets, Loans & Advances (A)	**6,780**	**8,646**	**9,635**
Current Liabilities and Provisions (B)	**722**	**1,412**	**2,741**
Net Current Assets: (A) – (B)	**6,058**	**7,234**	**6,894**
Total - ASSETS	**10,034**	**11,477**	**12,102**

Consolidated Cash Flow Statement – (Rs. in millions)

Particulars	FY 08 (Apr 07 – Sep 08)	FY 09 (Unaudited)	FY 10E
Operating Cash Flow before Working Capital Changes	3,259	2,220	3,018
Net Cash Flow from Operating Activities (A)	(1,482)	(616)	1,113
Net Cash Flow from Investing Activities (B)	(1,904)	(572)	(1,360)
Net Cash Flow from Financing Activities (C)	2,860	1,182	242
Increase/(Decrease) in cash & cash equivalents during the year	(526)	(6)	(5)
Cash and Cash Equivalents at the beginning of the year	587	61	55
Cash and Cash Equivalents at the end of the year	61	55	50

Ratio analysis

Particulars	FY 08 (18 months)	FY 09 (12 months)	FY 10E (12 months)
EBITDA Margin	20%	32%	27%
PAT Margin	10%	13%	12%
EV/Sales	1.27	2.01	1.31
EV/EBITDA	6.30	6.31	4.76
ROE (%)	33%	19%	26%
ROCE (%)	21%	13%	16%
Debt/Equity	0.86	1.08	1.11
Fixed Assets Turnover Ratio	4	1.68	2.13
Inventory days	95	343	269
Debtors days	3	5	3
Creditors days	9	8	13

Investment Rationale

India to import rice for the first time in 21 years

According to the Government of India, rice output is expected to decline to 69.45 mn tonnes as compared to an output of 84.5 mn tonnes last year. Although India has stock reserves of ~6 mn tones, ***it is going to face a deficit of ~15 mn tonnes.*** The biggest hit is taken by average quality rice in Punjab and Haryana on account of poor rains which has affected market sentiments adversely and impacted rice prices.

According to the US Department of Agriculture (USDA), India the 2nd largest rice producer in the world, may import as much as 2,00,000 tonnes of rice if there is greater price parity to meet domestic demand for the 1st time in 20 years to meet a projected shortfall of the crop hit by drought and floods. (*Source: The Economic Times – 19th Nov 2009)*

FCI purchases no more a concern

FCI purchases ~12 – 15% of rice output during the year. It maintains a minimum buffer stock of ~5.2 mn tones. The country expects rice output to be ~69.45 mn tonnes. FCI purchases would be ~8.33 mn tones.

LEAF deals with (FCI). It supplies non basmati rice to FCI. The non-basmati rice segment is relatively a much more stable business in terms of pricing as most of the sales are done to FCI, thereby resulting in high volumes and assured prices. Bulk of the company's rice is sold to the government at a fixed price known as the minimum support price (MSP). MSPs have seen a strong upward trend in recent times due to continuous shortage of foodgrains, and the same is expected to continue. ***The output produced by LEAF would be fully absorbed by FCI (Food Corporation of India). This provides good revenue visibility for LEAF.***

Paddy: Rise in MSP (Rs. per quintal)

Particulars	FY 06	FY 07	FY 08	YoY increase	FY 09	FY 10
Common grade	570	580	645*/850**	11.2%	850^	950^^
Grade A	600	610	675*/880**	10.7%	880^	980^^

(Source: Ministry of agriculture)

Investment Rationale

*Note: *An additional incentive bonus of Rs. 100 per quintal is payable over the MSP*

^Bonus of Rs. 50 per quintal is payable over the Minimum Support Price (MSP)

^^ Bonus of Rs. 50 per quintal on paddy to be procured during 2009 -10 marketing season (Oct – Sept.)

Further, LEAF's integrated business coupled with significant economies of scale in procurement and selling and strategically located operations will not only aid in expansion of its topline, but will also boost the company's margins. LEAF's Procurement cost is incurred to the tune of 17.5% on MSP. This is on account of 4% VAT, 4% Mandi Tax, 2% Handling Cost (incl. brokerage), 4% Transport/Freight and 3.5% Agent's Commission. LEAF has been granted a waiver of 4% market fee for 10 years on paddy purchases until 2017, due to its biomass energy initiative. The net impact would be limited to 15 - 16% on MSP. The processing costs (incl. interest & depreciation) range from Rs. 35 to Rs. 50 per quintal depending on scale & efficiency.

Decrease in acreage paddy sowing

In view of the decrease in acreage paddy sowing of 62.61 lakh hectares, we expect negative growth in non basmati rice harvest in North India and expect prices to firm up further from the existing levels. FCI buffer stocks are likely to deplete on account of drought situation and this would imply higher offtake at higher MSP.

The Commission for Agricultural Costs and Prices (CACP) has recommended a price of Rs. 950/quintal for the current season (Oct 2009 – Sep 2010) to GoI. However, various state governments have resisted such a low hike and want a higher MSP.

Declining domestic inventory as % of consumption

As per statistics of USFDA, the domestic inventory as a % of consumption has declined since 1980's which has led to demand and prices of rice staying firm.

VALUATION

At CMP of Rs. 124.3/-, the stock is trading at a PE of 5.99 x FY10E earnings. We believe that at P/BV of 1.46x FY 10E it is undervalued and therefore warrants a rerating. Based on an EPS of Rs. 20.75 in FY 10E, we assign a P/E of 8.29 x and target price of **Rs. 172/-** within 12 months horizon.

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