

Rich

LT Foods

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Rice sector in India specially Basmati rice producers and exporters are witnessing a lot of tail winds and the sector is getting re-rated fast but that's not why we are bullish about the business of LT Foods, we are bullish about it for a few game changing developments within and outside the company which is orbit shifting as per our belief. We believe, it is a well identified stock for its today but hugely under discovered for its tomorrow.

About the Company:

LT Foods Limited formerly known as LT Overseas was established in 1990, is a diversified agribusiness and foods company, is engaged in the milling, processing, marketing, storage, packing, and distribution of food grains worldwide. The company has a strong nationwide distribution network in the domestic market that sells products such as branded rice, wheat and pulses, healthy snacks, spices and other value-added products like brown flex seeds and cashew nuts. The company's rice product portfolio comprises basmati and non-basmati rice, brown rice, white rice, steamed rice, parboiled rice, organic rice, quick cooking rice, value added rice, and flavored rice. It also offers organic food comprising organic rice, soya, maize, wheat, sugar, pulses, spices, and nuts; and other value-added products, such as brown flex seeds and cashew nuts. In addition, the company provides healthy snacks, including rice based chips, crisps, and mixes; and staples, such as wheat flour, semolina, gram flour, flattened rice, bulgur, and refined flour.

LT Foods Limited offers its food products under the Daawat, Heritage, Chef's Secretz, Devaaya, Royal, Ecolife, and Rozana brand names. Further, it is involved in the international trading of merchandise; and provision of other products, including jasmine rice, arborio rice, couscous, grape seed oil, tea, dried mangoes, specialty rices, etc.

Basmati Rice Industry Overview:

The basmati rice industry is highly competitive and fragmented in nature, marked by the presence of some established players and numerous medium to small sized players. Further, the industry faces sizeable inventory price risks on account of high inventory levels and volatility in realizations, especially in the export market.

Given that majority of the basmati paddy is procured during the months of October-December (procurement season) and is held for 8-12 months for ageing purposes (which fetches higher realizations), the business is inherently working capital intensive. However, this risk is partly mitigated by strong brand strength which ensures steady order inflow.

For LT Group, branded sales account for ~70% of total basmati rice sales this has supported its margins.

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Basmati Exports: Basmati rice accounts for ~2-3% in terms of volumes of the global rice industry. India accounts for over 70% of the world's basmati rice production and the rest is with Pakistan. Basmati is unique to the region. It can be grown where precise climatic conditions, soil quality and temperature exist and this only available in the Indo- Gangetic area of the Himalayas. It is also legally protected as a trade name "Basmati". Basmati rice constitutes a small portion of the total rice produced in India. By volume, the share of basmati rice was around 6% in 2014-15, but by value, basmati rice exports accounted for 57% in 2015-16 of India's total rice exports. Rice exports accounted for 18% of India's total farm exports in 2015-16.

India exported substantial quantity of both Basmati as well as Non-basmati rice to the world, and import in the same categories were insignificant during 2009-10 and 2016-17. While basmati rice is consumed across the globe, West Asian countries account for ~75% of Indian basmati rice exports. Within West Asia, Iran and Saudi Arabia are the two largest buyers, together accounting for over 50% of basmati rice exports from India.

Even as Iran emerged as one of the largest importers of basmati rice in recent years, the country imposed a ban on basmati rice imports from India in 2014-15, citing its own healthy rice crop and large basmati inventory; as a result Saudi Arabia has emerged as the top export destination for Indian Basmati rice.

China is another important export destination for India which happens to be both the largest consumer and importer of rice's. In value term, India's rice exports dropped to \$5.79 billion in 2015-16 from \$7.84 billion a year earlier followed by a ban imposed by China and Iran.

Domestic Market: – Basmati accounts for 75% of the branded rice market. The main growth drivers of branded rice are convenience of procuring clean rice packs from stores, rising income levels, urbanization, rise in organized retail, and brand awareness.

Consumption of branded rice is growing in both southern and northern India. However, grains sold in the south are generally smaller and are mainly non-basmati. Growth in the modern retail segment boosted the branded rice market. As per industry estimates, the modern retail segment has been growing at 15-20% annually, and the growth rate is likely to jump to 25% by 2017.

According to a report in ET, branded rice can command about 33% premium over loose rice at the retail level and a modern retailer can earn a 20% margin vs. 12% for loose rice. Unbranded basmati (loose basmati) accounts for 74% of total basmati sales in the domestic market lower than 86% in FY11.

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Basmati Rice experiencing great tail winds

Due to good production and falling price, import bans from different export destinations like China, Iran etc last 2 years wasn't been good for the sector and players struggled to meet their top line and bottom line targets. However, recently the sector is witnessing lot of tail winds in domestic as well as the export front and all the frontline Basmati players are to benefit from the same.

Domestic tail winds:

Shift from unbranded to branded Basmati: Given to consumer awareness, increasing income levels, increasing reach of modern retail, high decibel media campaign, branded Basmati is fast eating into the share of loose Basmati (74% of Basmati market) and trend can aggravated with more category marketing spends (Entry of Adani group) and GST implementation.

Rice is a cyclical commodity and we are at the bottom: From 2011 onwards, the Basmati rice industry has been under financial stress on account of excess paddy supply and weak international demand, leading to a sharp decline in realizations.



Figure 1: International Rice Price Chart

As we can see from the above chart rice price has bottomed out and we are seeing a sharp recovery starting from Dec2016 onwards. From Nov 2016 till date international price of rise has seen a sharp upmove to the tune of almost 20%. But as a cyclical commodity rice prices has still a long way to go.

We can expect basmati prices to further increase as international buying will begin and production expected to be lower than the previous year," said Sabyasachi Majumdar, senior vice-president, ICRA. He said domestic consumers might see a slight increase in prices and current discounts ranging from 10-20% being offered by branded players might be reduced or withdrawn.

Export tail winds:

Exports too had been dull for last few years for the branded Basmati industry following a ban from two major rice importers China and Iran, making the price fall and inventory pile up with large players. However recently the export sector is too looking up and should do even better in H2 FY17 and FY18. According to Deepak Jotwani, assistant vice president, ICRA “The export demand, which has remained subdued for the last two years, is expected to witness a pickup in the coming months when a majority of the export orders are received. This is expected to push up the realizations in H2 FY2017 and FY2018. Most of the large exporters, who are holding relatively lower priced inventory, are expected to benefit from this as paddy prices have inched up in the current procurement season.”

Iran is about to lift ban on Indian Basmati Imports: India exported 4.05 million tonnes in 2015-16, out of which 1 million tonnes was to Iran. So, that’s the importance of Iran as an export destination and Iran is in the verge of lifting the ban. A formal notification is awaited, but exporters and companies have started getting queries from Iran and some have even started signing contracts. This will have significant impact on the major Indian Basmati player’s revenue in coming years.

China lifts ban on Indian Rice Imports: China, the world’s top rice consumer and importer, has granted phytosanitary clearances to 14 Indian rice exporters, including established ones like LT Foods, Kohinoor Foods and Amira Pure Foods, opening its market to the Indian grain after years of restricting such supplies through non-tariff barriers. According to an International Grains Council (IGC) forecast, China will import as much as 4.1 million tonnes of rice in 2016-17 and now Indian companies are open to fight for that pie.

So, as of now we are talking about a business which is one of the lead players in a cyclical industry and the industry is likely to rebound in coming years due to favorable tailwinds. So, all good players in the Basmati industry are likely to benefit from it, what’s so special about LT foods?

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The special points that make LT food stand apart are as below

1. Grown in strength through the bad times
2. Strengthening the brand and branded portfolio
3. Strategic initiatives to bolster distribution and geographic coverage
4. An orbit shifting effort to become a FMCG play, that can sky rocket the valuation

1. Grown in strength through the bad times:

- Though last few years were extremely difficult for Basmati players, still LT foods grown consistently over the last 3 years. Their revenue growth had been moderate 10% CAGR over last 3 years and profit growth had been at good 20%
- LT foods had bolstered its presence through Daawat and Royal brand, in high value US market, where they are the undisputed leader with more than 50% market share and growing at a pace of 30% CAGR. With 81% of LTF's business being branded, flagship brand "Royal" continues its ascent as the No. 1 Basmati brand in the important market of US.
- Volume off take has grown by whopping 25% CAGR during the period though it is not showing in books due to subdued price of Basmati. With increased price coupled with 25% volume growth suddenly revenue and earnings will start looking big.

2. Strengthening the brand and branded portfolio

- During this period of lull LT food upped their sales and marketing expenditure by 50% without denting the books much. Roped in brand ambassadors Amitabh Bacchan and Sanjeev Kapoor. These campaigns helped to create recall value for Daawat brand and as per consumer tracks; "Daawat" ranks the best in terms of consumer perceptions on most of the key basmati quality parameters.
This investment on brand building will go a long way to create value when the tide turns.
- During the year, LT Foods also introduced staples line under Royal brand, which are fast gaining wide acceptance across all marketing channels. In addition, they launched organics line under the "EcoLife" brand, which is gaining increasing buyer interest in the evolved market.

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- Company launched “Devaaya” staples product and believes it will garner steady growth as more and more consumers switch to this brand for peace of mind when it comes to being both clean and safe. This brand will not only be available in India, but also globally - especially in the USA and the Middle East. Management expects to “Devaaya” a brand in the same league as “Daawat” with time.

These are organic brand launch and brand extension stories, however the biggest push in the brand space came from the inorganic acquisition of frontline brands that will help LT Food to dominate newer and important markets thereby increasing geographic reach.

3. Strategic initiatives to bolster distribution and geographic coverage

- In July, 2016, LT Foods entered into an agreement to acquire the Branded Rice Business of Deva Singh Sham Singh (DSSS) through its UK subsidiary LT Foods International Limited. With this, they gain a decades old iconic brand “817 Elephant”, which has a strong recall and presence particularly within the ethnic markets of Canada, USA and Dubai. This acquisition will broaden their basket of offerings of brands with a high recall value. This can also improve margin profiles from the synergies of Supply Chain Management and Back-End Processing.
- **The biggest of all is the inorganic acquisition of HUL brands:** Company took highly calculated and strategic steps in terms of its **inorganic growth in the Middle East, the largest market for basmati rice in the world. They acquired brands from HUL, Gold Seal Indus Valley and Rozana**, which have more than 40 fast selling SKUs. This allowed LT Foods to strengthen position in the Middle East, This acquisition gave a speedy entry into regions such as Qatar, Bahrain and Oman, quickly fortifying their position in the branded rice segment within this region. They were also able to leverage the strengths of HUL’s distribution network and develop relationships with large key distributors to improve the reach and margins. All this might have taken years to accomplish organically.
- Though LT Foods had been traditionally stronger in export market, India had been a weak position for them compared to the Indian leader KRBL. To counter this weakness LTF management played a master stroke to **enter a pact with Kishor Biyani lead Future Consumer to distribute LT food products through their branded retail chains.** This will not only increase LT Foods distribution strength exponentially but also will put their products in the fore front in the modern trade where the growth is maximum, for branded rice players. This makes LT Foods the brand of choice for all Future Group modern trade outlets.

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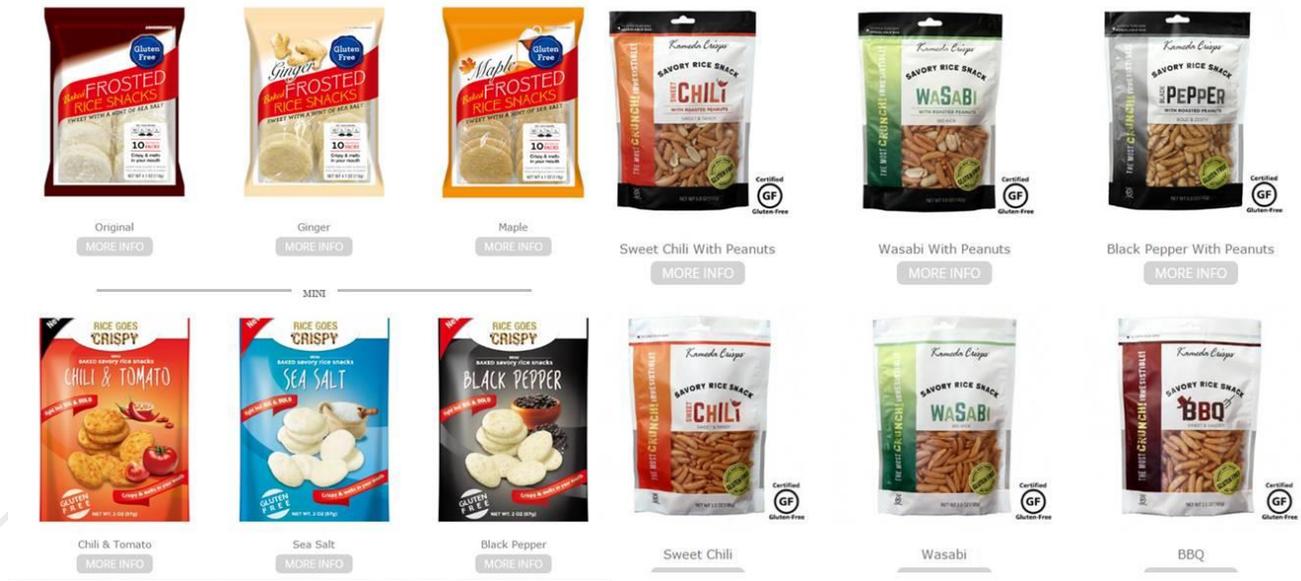
- On the unorganized retail front too, LT food made significant advancement over the last three years, the number of distributors has more than doubled, to cross 450 as of now. They also ramped up the number of retailers to more than 150,000 today, making direct coverage across India one of the most extensive in the business.

4. The orbit shifting effort to become a FMCG play

The best was probably still left to come, LT Foods inked a 51:49 joint venture with leading Japanese snacking firm Kameda Seika, to sell rice-based snacks in India. The products are supposed to come in stores from April 2017.

Now, what is Kameda Seika and why this can be orbit shifting for LT Foods?

Kameda is a Japanese confectionary and snacks giant mainly focusing on Rice snacks and is one of the formidable names globally in the arena of rice snacks. They dominate Japanese market with a formidable share of 30% of Rice snacks market. They are also present in different developed markets like US, Europe etc. Find below some products images from their US product line.



So, these are the kind of advanced snacks LT food may launch in near future in Indian retail. LT Foods announced that the snacks will steer clear of the Rs. 10 and Rs. 5 price points and will be priced at a premium. Powered by the pact with Future Group and their own distribution chain this is a bet to become a FMCG from a mere branded commodity player.

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Now remember Tasty Bite or DFM Foods and what valuations they are trading at? We believe if the products start delivering, LT Food can get past the current valuation zone and get valued much higher in line with other snacks players in the listed space.

Investment concerns:

Given that the LT Group operates in the agro-based industry, it remains exposed to the inherent cyclicity, volatility in prices, and changes in government regulations, not just domestically but also the regulations of the export destinations.

Additionally as a significant portion of the turnover is contributed to by export revenues, the LT Group faces risk of adverse movement in foreign exchange rates.

Stock has climbed up a bit given the sectoral tail winds along with all other stocks in sector, reducing bit of margin of safety.

Views and valuations:

As per management guidance LT Foods will double their topline by 2020 to Rs. 6000 crs. But as of today what are we getting?

1. A leading business of Basmati manufacturing and exports 2. A business that have been through the toughest time and still managed to grow and now started experiencing sectoral rebound 3. Bolstered its brands and branded portfolio 3. Entered in countries of great export importance with strategic brand acquisitions 4. Strengthened its domestic distribution abilities through strategic pact with largest modern retail chain of India and 5. Taking a bold step through a JV to transform itself in to a FMCG player.

We are getting this in sales to market cap ratio 0.3. Which we believe is reasonable and this leaves us with significant upside potential. So, we initiate a BUY call on this stock at CMP

Buy Strategy

Stock has run up a bit in last few days and so, we will keep our allocation at reasonable levels to leave us with opportunity to buy more if we experience a fall.

Buy in the price range of 400-460. The lower you can buy the better.

Allocate 5% of your portfolio value within the given buy range.

We wish to eventually take up allocation to 10-12%

Averaging up or down suggestions will be provided at opportune time

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Statutory Disclosure:

SEBI Research Analyst Registration # INH300003173

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