Karuturi Global

BSE code:	531687
NSE code:	KNL

CMP: Rs 25 **Target: Rs 35** **BUY**

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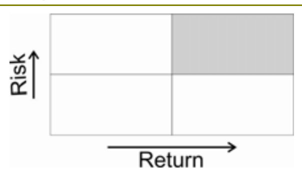
Company data

Particulars	
Market cap (Rs bn / US$ mn)	7.9/185.1
Outstanding equity shares (mn)	331.7
52-week high/low (Rs)	44/18
3-month average daily volume	1,685,493

Financial snapshot

Particulars	FY08	FY09E	FY10E
Sales (Rs mn)	4,010.3	5,812.5	7,672.5
Growth (%)	295.8	44.9	32.0
Adj net inc (Rs mn)	1,231.0	1,761.7	2,370.3
Growth (%)	215.3	43.1	34.5
FDEPS (Rs)	3.1	3.3	4.4
Growth (%)	(6.0)	5.8	34.5
P/E (x)	7.8	7.4	5.5
ROE (%)	36.2	22.9	22.3

Risk-return profile



Shareholding pattern

(%)	Mar-08	Dec-07
Promoters	28.7	31.1
FIIs	31.4	29.1
Banks & FIs	4.5	0.7
Public	35.4	39.1

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Karuturi Global	25	NA	49.5	(0.9)
Sensex	15,422	(11.5)	2.9	(19.2)

Company website	www.karuturi.com

A rosy future

World's largest rose producer witnessing robust global demand

Investment rationale

- International cut flower market valued at US$ 64bn; expected to grow at 10–12% CAGR. Roses command largest share of industry turnover at ~70% with Europe being the biggest cut flower market, accounting for 50% of global consumption. Cut flower cultivation shifting to developing countries like Kenya, Ethiopia and India due to favourable cost and climate conditions.
- Karuturi Global is the world's largest producer of roses, cultivating 585mn stems per annum. Boasts over a decade of experience in rose cultivation with operations in Ethiopia, Kenya and India. Strategic foothold in Ethiopia and Kenya would enable the company to cater to burgeoning demand from Europe and augment its global market share.
- Secured allotment of 450 hectares of land in Ethiopia from the government, which it intends to acquire over the next 3-4 years. This offers the advantages of low land costs, favourable climatic conditions and cheap labour together with easier accessibility to the European markets. Ethiopian and Kenyan operations to contribute significantly to financials going forward.
- Recently acquired 40,000 hectares of land in Ethiopia to foray into the lucrative food processing business. Proposes to produce rice, vegetables, palm oil, sugarcane and gherkins for export, which would diversify revenue streams from FY10; this would provide a further upside to our current valuations as we are yet to factor the venture into our projections.
- Revenues to clock a 38% CAGR over FY08-FY10 to Rs 7.7bn with operating profit CAGR of 40% to Rs 2.8bn and a PAT CAGR of 52% to Rs 2.4bn.

Key concerns

- Dependence on climatic conditions and rose floriculture without further diversification could be a cause for concern. Also, foreign currency fluctuations could affect our projections significantly.
- It seems that the promoter shareholding has reduced by 240bps to 28.7% as on March 2008. We expect it to decline further to 21.1% on a fully diluted basis as on March 2009. However, this is due to a near doubling in FCCB and warrant conversion. We do not see this as an area of concern as the promoter holding will increase by 20% in absolute terms to 114.1mn shares.

Valuation

- At the current level the stock is quoting at 7.4x and 5.5x its FY09E and FY10E earnings respectively. Considering the company's premium positioning in the industry and its recent foray into food processing, we have assigned the stock a P/E multiple of 8x on FY10E. This gives us a price target of Rs 35. Buy.

Cut flower sector – in full bloom

Valued at US$ 64bn, the international cut flower market is expected to grow at a 10–12% CAGR in coming years. Cut flowers account for a major portion of the floriculture industry, with roses, chrysanthemums, carnations and orchids attracting the largest demand. Of these, roses stand the tallest, contributing ~70% of the total cut flower industry.

Europe the biggest consumer

Europe is the largest consumer of cut flowers, accounting for 50% of global consumption. Demand from this geography remains steady throughout the year, but mounts during special occasions like Valentines Day, Christmas and Mother's Day, thus driving up prices in a cyclical manner.

India – a budding market

India's cut flower industry is growing at 40% p.a – faster than the global average

In India, the cut flower industry is still in a nascent stage, valued at US$ 250mn and contributing to less than 1% of the global floriculture market. However, domestic demand is rising rapidly, driving industry growth of 40% annually, which is higher than the global average. The Indian floriculture market is largely unorganised, implying significant potential for domestic players to bloom in the coming years.

Developing countries emerging as greenhouses of the world

Over the past few years, the floriculture industry has witnessed a marked shift in production base from developed markets to developing countries like Ethiopia, Kenya, China, India, Israel and Columbia, mainly due to the low cost of cultivation and steady supply of quality produce all year round.

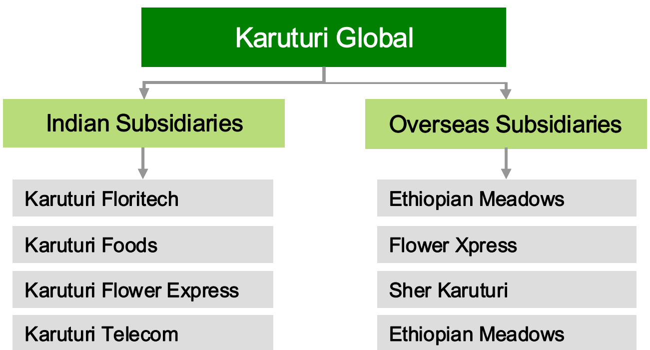
Further, these geographies offer the benefits of favourable climatic conditions, various sops from local authorities to boost the industry, and proximity to major consuming markets, thus saving on logistical costs. In contrast, economic development, rapid urbanisation (and hence reduced cultivation acreage) along with higher costs due to skyrocketing crude oil prices are major barriers for key flower producing countries like the Netherlands and Spain.

Karuturi Global – the world's largest producer of roses

Karuturi has the highest rose capacity globally at 585mn stems

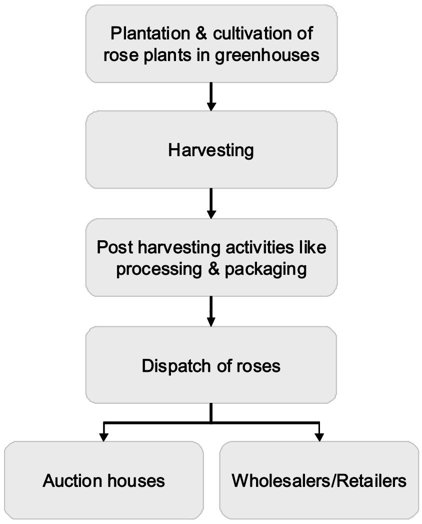
Established in 1996, Karuturi Global (KGL) is a Bangalore-based company engaged in the cultivation of roses. KGL grows roses in Ethiopia, Kenya and India with a cultivation acreage of 298 hectares, yielding 585mn stems per annum. The company's land bank includes 10 hectares in Bangalore, 100 hectares in Ethiopia held by its wholly owned subsidiary (of which 65 hectares were under production in FY08), and 188 hectares in Kenya.

KGL's subsidiaries in India and overseas



Source: Company, Religare Research

Rose production process



Source: Company, Religare Research

Rose cultivation a capital-intensive business

Rose cultivation is a capital-intensive business which requires a highly controlled environment and careful handling of the produce. The business also calls for substantial investment on staff education and training as well as on physical infrastructure required for growing flowers. In order to ensure quality produce in conjunction with high yields, roses are grown in greenhouses which have a strictly controlled climate.

A rose plant starts yielding produce about six months after it is planted, though production starts only after a gestation period of 18 months. Roses are broadly classified into three types, namely hybrid tee (HT), intermediate and sweetheart depending on the size and length.

Rose plant classification

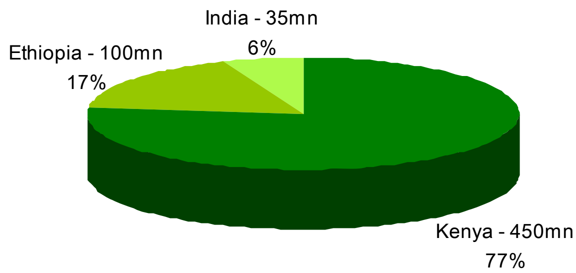
Type	Size	Length	Production cycle	Crops per year
Sweethearts	Small	40–55 cm	30 days	12
Intermediaries	Medium	50–70 cm	45 days	9
Hybrid tees (HT)	Large	60–90 cm	60 days	6

Source: Company

KGL's global footprint offers significant advantages

Over the last four years, KGL has expanded its operations overseas into Ethiopia and Kenya with an aim to cater to international demand. It acquired land in Ethiopia during FY05 and a company (Sher Agencies) in Kenya during FY07 for this purpose. KGL singled out these countries for their low-cost land, suitable climatic conditions, cheap labour, favourable government policies, tax incentives and accessibility to major consumers in Europe which leads to lower air freight cost.

Geography-wise rose production (Number of stems)



Source: Company, Religare Research

Acquired 188 hectares of rose-growing land in Kenya

Kenyan acquisition adds 188 hectares to land bank

KGL acquired Kenya-based Sher Agencies in FY08 for US$ 59mn. This gave the company an additional 188 hectares of land under rose cultivation, of which 150 hectares are under greenhouse cultivation. The sizeable augmentation of production capacity along with a relatively lower cost of operations and access to the Kenyan company's ready distribution chain resulted in exponential growth in KGL's financials for FY08.

Ethiopian operations to cover 550 hectares…

During FY05, the company forayed into Ethiopia by acquiring 100 hectares of land for rose cultivation. The HT variety of roses, which earn higher realisations, are mainly cultivated here. KGL has major expansion plans in Ethiopia and has already secured the allotment of 450 hectares of land from the government, with plans to acquire the same over the next three to five years.

Ethiopia to form growth base for future operations, with acreage of 550 hectares over 3-4 years

…and serve as a key growth base

Compared to Kenya, the area under cultivation as well as production capacity (in terms of number of stems) in Ethiopia is much less. However, due to higher realisations earned by HT varieties, and lower operational and lease rental costs, Ethiopia has a distinct edge. As KGL enhances its land base in the country, we expect its Ethiopian operation to out-run the Kenyan business by FY10 in terms of financial contribution.

New growth pastures

Foray into food processing

KGL has decided to enter into the gherkin business, which would harness its experience in dealing with farmers and also extract benefits from existing plants located in gherkin-producing belts. A gherkin is a small cucumber used to make pickles in vinegar or brine and is also consumed in salads. The US is the largest producer and consumer of this vegetable with 40% of the global produce and 50% of the consumption. European countries like Hungary, Ukraine and Turkey were large gherkin-producing nations, but have recently been losing market share to India.

Acquired 40,000 hectares in Ethiopia for foray into food processing

Acquired 40,000 hectares in Ethiopia

The company has scaled up its presence in the food processing business by acquiring 40,000 hectares of land in Ethiopia from the Ethiopian government for the cultivation of rice, vegetables, palm oil and sugarcane. It expects to record a part of the revenue from this venture from Q3FY09, while the sugar and palm oil cultivation would pay off from FY10 and FY11 respectively.

If the food processing business pans out as planned, it could contribute significantly to KGL's topline and bottomline going forward. However, we have not factored the positive impact into our earning estimates since it is in a nascent stage.

ISP business

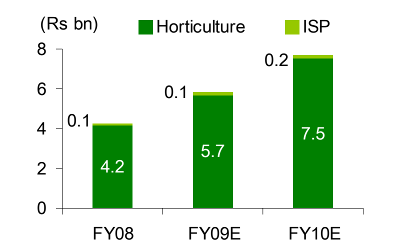
KGL also operates a broadband ISP (internet service provider) business through its subsidiary, Estel Communications. The company has a pan-Indian presence and mainly caters to SMEs, MNCs, midsize software companies and R&D units. It is looking to expand its service coverage to both corporate and consumers.

Strong financial outlook

Floriculture contributes 98% to overall revenues

We believe Ethiopian operations would contribute significantly to the overall revenues, as KGL adds more land to its current bouquet. Kenyan operations are also expected to deliver strong revenues. However, we do not anticipate any further land acquisition in India and Kenya, as the company is focussing on Ethiopia as a growth base.

Consolidated revenue growth



Source: Company, Religare Research

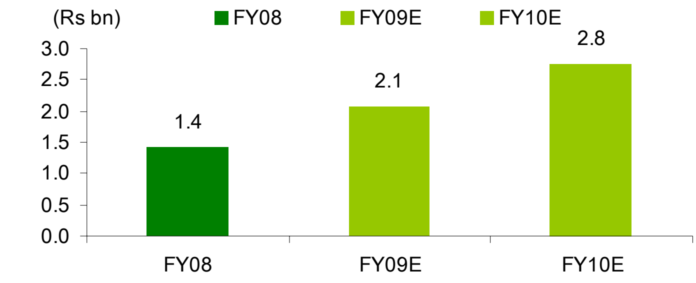
Floriculture revenue to log 31% CAGR over FY08-FY10

On the back of a higher contribution from overseas operations, we expect overall revenues from floriculture to grow at a 31% CAGR over FY08-FY10 to Rs 7.1bn. Overall revenues including the ISP business are expected to grow at a 35% CAGR to Rs 7.7bn. Higher revenues backed by increased volumes and realisations, along with cost rationalisation in Kenya would drive an operating profit CAGR of 40% through FY08-FY10 to Rs 2.8bn.

Operating margin to remain stable at ~35%; Expect PAT CAGR of 52%

We expect the overall operating margin to remain at ~35% during our forecast period. We do not anticipate any margin pressure since the global consumption pattern for cut flowers remains strong, while the industry is witnessing a supply crunch. Even in the event of higher operating costs, we believe the company would be able to pass along the burden to customers. With higher operating profits and virtually no tax outgo (since agricultural income is exempt), net profit is expected to record a 52% CAGR over FY08-FY10 to Rs 2.4bn.

Operating profit growth



Net profit growth

Source: Company, Religare Research

Shareholding pattern

The promoter shareholding has reduced by 240bps to 28.7% as on March 2008 and is expected to decline further to 21.1% on a fully diluted basis as on March 2009. However, this is attributed to a near doubling in FCCB and warrant conversion. In absolute terms, the promoter holding will actually increase by 20% to 114.1mn shares.

Change in shareholding pattern

	As on 31-Mar-08			Post-dilution		
Category	No of shares (mn)	% Holding	Increase in shares (mn)	No of shares (mn)	% Holding	Remarks
A) Promoters						
Shares	95.1	28.7	3.0	98.1	18.1	Open market purchase in Apr'08
Warrants	-	-	16.0	16.0	3.0	-
Total (A)	*95.1*	*28.7*	*19.0*	*114.1*	*21.1*	-
B) Others						
Shares	144.9	43.8	(3.0)	141.9	26.2	-
Warrants	3.0	0.9	116.0	119.0	22.0	Warrant conversion expected
FCCB 1	81.8	24.5	10.4	92.2	17.0	FCCB 1 conversion
FCCB 2	6.9	2.1	61.7	68.5	12.6	FCCB 2 conversion
ESOPs	-	-	6.0	6.0	1.1	ESOPs expected
Total (B)	*236.6*	*71.3*	*191.0*	*427.6*	*78.9*	-
TOTAL (A+B)	**331.6**	**100.0**	**210.0**	**541.7**	**100.0**	-

Source: Company

Key concerns

- **Vagaries of nature:** As KGL is in the business of agriculture, it is exposed to the vagaries of nature which could adversely affect production. This will directly impact the company's earnings.

- **Dependency on a single product:** Around 98% of the company's revenues come from the floriculture business. Crop failure for any reason would impact performance.

- **Currency fluctuation:** A significant amount of KGL's revenues are earned in euros. Thus, any adverse exchange rate movement will dent earnings.

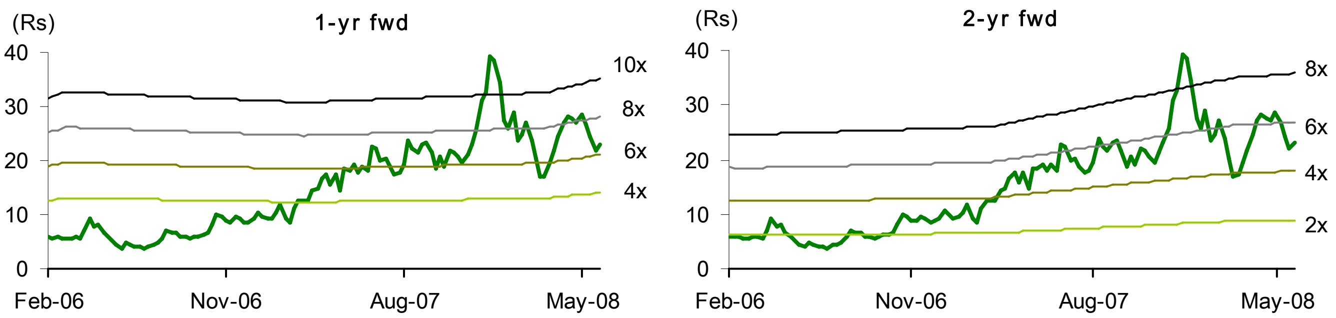
Valuation

Leadership position, strong growth strategy and new ventures to drive valuations

We value KGL at 8x FY10E EPS

At the current price of Rs 25, the stock is quoting at 7.4x and 5.5x its FY09E and FY10E earnings respectively. KGL has historically traded in a P/E band of 6–8x one-year forward, as shown in the chart below. Since it is a market leader in the global cut flower industry with a well defined growth strategy and diversification plans into allied businesses, we have assigned the stock a P/E multiple of 8x on FY10E earnings. This gives us a target price of Rs 35. Buy.

KGL's P/E band



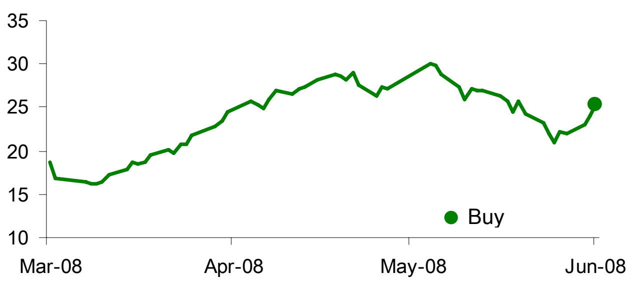
Source: Religare Research

Recommendation history

Date	Event	Reco price	Tgt price	Reco
19-Jun-08	Initiating Coverage	25	35	Buy

Source: Religare Research

Stock performance



Source: Religare Research

Consolidated financials

Profit and Loss statement

(Rs mn)	FY07	FY08	FY09E	FY10E
Revenues	1,013.2	4,010.3	5,812.5	7,672.5
Growth (%)	133.6	295.8	44.9	32.0
EBITDA	431.8	1,416.2	2,077.3	2,779.0
Growth (%)	198.8	228.0	46.7	33.8
Depreciation	39.1	160.3	261.5	358.5
EBIT	392.6	1,255.8	1,815.8	2,420.5
Growth (%)	187.3	219.8	44.6	33.3
Interest	3.3	33.0	61.8	59.4
Other income	4.4	10.7	12.0	15.0
EBT	393.8	1,233.5	1,766.0	2,376.1
Income taxes	3.4	2.5	4.3	5.8
Effective tax rate (%)	0.9	0.2	0.2	0.2
Adjusted net income	390.4	1,231.0	1,761.7	2,370.3
Growth (%)	180.6	215.3	43.1	34.5
Extra-ordinary items	(2.2)	211.1	-	-
Reported net income	392.6	1,019.9	1,761.7	2,370.3
Growth (%)	183.0	159.8	72.7	34.5
Shares outstanding (mn)	120.0	331.7	541.7	541.7
Basic EPS (Rs) (adj)	3.3	3.1	3.3	4.4
FDEPS (Rs) (adj)	3.3	3.1	3.3	4.4
DPS (Rs)	0.3	0.3	0.3	0.4

Source: Company, Religare Research

Balance sheet

(Rs mn)	FY07	FY08E	FY09E	FY10E
Cash and cash eq	1,014.5	2,047.3	4,024.8	4,130.6
Accounts receivable	422.5	1,703.0	2,547.9	3,468.4
Inventories	1.3	2.0	3.0	4.0
Others current assets	180.8	189.4	203.9	218.0
Current assets	1,619.0	3,941.6	6,779.6	7,821.0
Long-term investments	2.5	100.0	120.0	150.0
Net fixed assets	535.2	2,924.8	3,819.3	5,075.8
CWIP	181.9	-	-	-
Intangible assets	-	-	-	-
Deferred tax assets, net	-	-	-	-
Total assets	2,338.6	6,966.5	10,718.9	13,046.8
Accounts payable	105.8	368.6	500.2	616.6
Others	30.5	33.5	38.7	45.7
Current liabilities	136.2	402.1	538.9	662.3
Debt funds	1,230.0	720.9	600.0	650.0
Other liabilities	6.2	8.0	10.0	12.0
Equity capital	120.0	331.7	541.7	541.7
Reserves	846.2	5,503.9	9,028.4	11,180.8
Shareholder's funds	966.2	5,835.5	9,570.0	11,722.5
Total liabilities	2,338.6	6,966.5	10,718.9	13,046.8
BVPS (Rs)	8.1	17.6	17.7	21.6

Source: Company, Religare Research

Cash flow statement

(Rs mn)	FY07	FY08E	FY09E	FY10E
Net income	392.6	1,019.9	1,761.7	2,370.3
Depreciation	39.1	160.3	261.5	358.5
Other adjustments, net	(2.2)	211.1	-	-
Changes in working capital	(263.2)	(1,024.0)	(723.7)	(812.1)
Cash flow from operations	166.3	367.4	1,299.6	1,916.7
Capital expenditure	(563.7)	(2,368.1)	(1,156.0)	(1,615.0)
Change in investments	(2.5)	(97.5)	(20.0)	(30.0)
Other investing inc/(exp)	-	-	-	-
Cash flow from investing	(566.2)	(2,465.6)	(1,176.0)	(1,645.0)
Free cash flow	(399.9)	(2,098.2)	123.6	271.7
Issue of equity	212.0	3,949.4	2,136.2	-
Issue/repay debt	1,208.9	(509.1)	(120.9)	50.0
Dividends paid	(40.6)	(100.0)	(163.4)	(217.8)
Other financing cash flow	4.7	(209.3)	2.0	2.0
Cash flow from financing	1,385.0	3,131.0	1,854.0	(165.8)
Change in cash & cash eq	985.1	1,032.8	1,977.5	105.8
Opening cash & cash eq	29.4	1,014.5	2,047.3	4,024.8
Closing cash & cash eq	1,014.5	2,047.3	4,024.8	4,130.6

Source: Company, Religare Research

Financial ratios

	FY07	FY08E	FY09E	FY10E
EBITDA margin (%)	42.6	35.3	35.7	36.2
EBIT margin (%)	38.8	31.3	31.2	31.5
Net profit margin (%)	38.5	30.7	30.3	30.9
FDEPS growth (%)	88.5	(6.0)	5.8	34.5
Receivables (days)	94.8	96.7	133.5	143.1
Inventory (days)	0.8	0.2	0.2	0.3
Payables (days)	50.4	33.4	42.4	41.6
Current ratio (x)	11.9	9.8	12.6	11.8
Quick ratio (x)	11.9	9.8	12.6	11.8
Interest coverage ratio (x)	120.8	38.3	29.5	40.9
Debt / equity (x)	1.3	0.1	0.1	0.1
ROE (%)	57.1	36.2	22.9	22.3
ROA (%)	27.5	26.5	19.9	19.9
ROCE (%)	29.9	28.6	21.7	21.5
EV/Sales (x)	6.5	1.6	1.1	0.9
EV/EBITDA (x)	15.3	4.7	3.2	2.4
P/E (x)	7.3	7.8	7.4	5.5
P/BV (x)	3.0	1.4	1.4	1.1

Source: Company, Religare Research

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Recommendation parameters

Large-caps*	> 10%	< - 5%	Absolute Returns
	BUY	SELL	
Mid-caps**	> 25%	< 10%	

**Market cap over US$ 1bn **Market cap less than US$ 1bn*

Religare Securities

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Analyst's holding in the stocks mentioned in the report: NIL.