CAPITA TELEFOLIO DIAL-O-FORTUNE
Telefolio Plus
Friday

Vol. No. : 13 **Issue No.** : 18 Friday, March 23, 2007

Agro Tech Foods

The Popcorn growth story

The MNC associate is set to make the most of the rising consumption of popcorn at home and at the organised retail outlets

Buy	Agro Tech Foods
BSE Code	500215
NSE Code	ATFL
Bloomberg	ATFL@IN
Reuter	ITCA.BO
52-week High/Low	Rs 171/ Rs 70
Current Price	Rs 76 (as on 23rd Mar'07)

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ConAgra Foods Inc of USA, world's third largest foods company, holds a majority stake of 48.3% in Agro Tech Foods, through CAG Tech Holdings, Mauritius. The company's well-known brands are Sundrop, ACT 11 and Rath. The company has a dominant market share and value leadership in the refined sunflower oil segment, primarily led by its flagship brand Sundrop.

The company operates in two business segments namely in the branded foods segment and bulk and processed commodities segment. In the Branded Foods Segment, the company has two very successful brands namely Sundrop in edible oil business and ACT II (the No 1 Popcorn brand in the world) for popcorns. Some other brands include Vanaspati oil like Crystal, Rath etc. The company stopped its non-profitable brands of corn chips and potato popz and Atta business and has developed a strategy of focusing only on products with gross margins above 20%.

Bulk and Processed Commodities Segment includes oils and grains procured, processed and distributed by the commodity sourcing & exports and the seed buying operation. This segment is the non-focus area.

Set to leave the bitter history behind

In 1986, Pre Conagra, the company was a group company of ITC and was having its manufacturing plant at Mantralayam. Subsequently, the plant was sold off to ITC and was leased back to the company at Rs 16 crore of fixed contract based on 99 years of lease agreement. Subsequent to Conagra taking the majority stake, the Parent found this arrangement totally unviable as reflected in poor margins and losses.

After a long conflict between the company and ITC over the agreement of Mantralayam undertaking, the London Court passed an order of settlement over the issue under which the company had to pay Rs 43 crore to ITC to be paid in phases (as reflected in extraordinary items over the past few years).

Cash flow to improve

Out of the total Rs 43 crore of settlement cost, Rs 38 crore has been paid and the balance Rs 5 crore will be paid in June'07. There will not be any further outflow on this account. Notably the entire Rs 43 crore has already been written-off and there will not be any further provision for this in the accounts in future (the Rs 5 crore to be paid is already provided for and will not be charged to the profit again).

Presently the company has no manufacturing plant, as there is excess capacity available in the unorganised sector. The company provides the raw material and the manufacturing process and packaging, and manufacturing is outsourced to unorganized players under its quality control. Hence there is no need to do any capex or any other significant investment for increasing the volume.

Further the company's focus on products with better gross margin enables it to generate sufficient cash from its operations, which it will be used for further brand building.

Tax dispute set to get resolved soon

The long awaited Income tax matter on Mantralayam sale will end soon. In 1996, when the company sold the Mantralayam undertakings to ITC, the company sold off the entire plant as a slump sale unit. Hence the company anticipated no capital gain tax. Unfortunately the IT department rejected the claim of a slump sale and considered the sale as a short-term capital gain and levied a tax liability of Rs 12.87 crore on the company. The company paid the same amount and appealed the judgement, which was going on in the Tribunal.

The hearing of the same was over on 18th Dec'06, and now the final order can come anytime. Hence if the order is negative, then the company having already paid the claim will route the tax payments through P&L, which will be an extraordinary loss. There will be no cash outflow, since the same has already been paid in 1996-97.

On the other hand, if the company wins the judgment, then there will be the cash inflow of Rs 12.87 crore plus an interest income for 9 years, which will further improve the cash flow position of the company substantially. If it is routed through P&L, it will be treated as extraordinary income. This cash inflow can itself increase its book value by more than Rs 10.

As the payment has already been made, the order will be either neutral or a big positive for the company.

Sundrop continues to grow smoothly

Sundrop normally contributes nearly one-third of the total turnover of the company. The brand continues to grow at pace of 10%. The company is operating this brand at gross profit margin of around 15%, which it intends to increase to 20% with deeper penetration and promotional activities of Sundrop and its other variants like Sundrop Heart and Sundrop Nutrilite. With growing consumption and income level, the shift towards, premium quality in general and Sundrop oil in particular will sustain the profitable growth of this brand.

Potential for ACT II is huge

Currently ACT II brand is available at over 120 locations across the country, where hot, fresh and tasty popcorn is served. Target market for the vending popcorn is the cinema theatres, amusement parks, shopping malls, coffee parlors, college canteens or even railway stations and bus stands.

Over the next 12 months, the company plans to increase the availability of ACT 11 vending operations in over 400 locations across the top 14 towns. A separate Vending team is put into place to expand the location base and ensure that customers get consistent quality products, delivered in a clean and hygienic ambience.

The company's ACT II Ready to eat brand, which was launched 6 months back has also received a very positive response from the market.

Overall the brand contributes nearly Rs 25 crore to the topline of the company with a gross margin of around 30%. Going forward, this brand has scope for almost doubling sales every year from both the vending popcorn segment as well as from the ready to eat segment considering the huge untapped rural and urban markets with hardly any competition.

Focus on profits and not sales – sales can fall, but profits will grow

Conagra world over has 27 strong brands like ACT 11. In 2003, there was a change in the CEO of the Parent, which changed the vision of the company. In 2003, the turnover of the company stood at US $ 20 billion, which in 2006 stood at US $ 12.5 billion. However the PBT level remained same at US $ 2 billion. Thus the parent is constantly focusing on the brand building and gross margin products and discontinuing the low margin, high volume products.

Also, the parent has started to report its international business as a separate segment from 2006 onwards and has also started its business in China. For Conagra, the US market has reached at saturation point from where growth may not be possible and hence the Parent is constantly focusing on its international business particularly India and China

In line with the focus of the Parent on brand building and gross margin of products, Agro Tech Foods has already started to concentrate only on those products that will give a gross margin of 20%. This includes Sundrop and ACT 11. The company intends to continue the Rath, Crystal and other brands in its Brand food segment, as long as these brands share the distribution cost of its main focused brand Sundrop oil.

Similarly the company restricted some of its product business in Bulk Commodity business and going forward, if it is able to identify strong brand for acquisition, may even stop this trading and procurement business. The company operates at very thin margin of in this segment.

So the strategy is on brand building, improving profit margins and improvement in ROI. This may lead to fall in sales as low-margin or loss-making businesses are discontinued.

Edible oil prices rise passed on, Budget is favourable

Edible oil is the key raw material for Sundrop. Normally the prices of this commodity increase during May-Oct and then keep on declining. This time the edible oil prices behaved surprisingly and kept on rising. The company did not anticipate such a rise and hence did not raise the prices of Sundrop, until Nov'06, when the company passed on the entire rise in raw material cost to the final product. Hence the Oct'06 month was a very sluggish month for the company and as a result of which the company operated at margin of 1.9% in Dec'06 as against 2% in Dec'05. With Sundrop prices having been increased and high margin ACT 11 set to grow at a scorching pace, the operating margin should improve continuously going forward.

Depending upon the price of sunflower oil in domestic and international markets, the company either imports or sources it domestically. In the latest budget, the import duty on sunflower oil was reduced from 57.5% to 51.5% which is positive for the company as it makes the imported raw material cheaper.

Valuation is attractive

For FY'07, we expect the company to register net sales and net profit of Rs 1041.30 crore and Rs 12.86 crore. For FY'08, we expect the company to register net sales and PAT of Rs 1000 crore and Rs 16 crore. This gives an EPS of Rs 5.3 for FY'07 and Rs 6.6 for FY'08. At current market price of Rs 76 (one-year High/Low: Rs 171/ Rs 70, two-year High/Low: Rs 171/ Rs 64), the scrip trades at

14.3 times its FY'07 earnings and 11.5 times its FY'08 earnings. This discounting is very low

Agro Tech Foods: Financials

	0303 (12)	0403 (12)	0503(12)	0603(12)	0703(12P)	0803(12P)
Net Sales	1113.06	1260.36	1042.3	937.90	1041.30	1000.00
OPM %	-0.9	0.3	0.9	1.7	1.8	2.6
OP	-9.54	3.84	9.70	16.30	18.80	26.00
Other income	6.03	8.39	6.10	1.70	2.00	2.00
PBIDT	-3.51	12.23	15.80	18.00	20.20	28.00
Interest	8.28	7.77	6.20	3.90	2.30	2.30
PBDT	-11.79	4.46	9.60	14.10	17.90	25.70
Depreciation	1.07	2.24	2.50	2.30	2.20	2.20
PBT	-12.86	2.22	7.10	11.80	15.70	23.50
Tax	-0.34	-0.42	-1.90	1.70	2.84	7.50
PAT	-12.52	2.64	9.00	10.10	12.86	16.00
EO (net of tax)	0.06	-6.44	-8.90	-5.60	0.00	0.00
PAT after EO	-12.58	9.08	0.10	4.50	12.86	16.00
EPS*	-	1.1	3.7	4.1	5.3	6.6

*Annualised on current equity of Rs 24.4 crore of face value of Rs 10 each
(P): Projections, Figures in crore, Source: Capitaline Corporate Database

Agro Tech Foods: Results

	0612(03)	0512(03)	Var. (%)	0612(09)	0512(09)	Var. (%)	0603(12)	0503(12)	Var. (%)
Sales	258.70	245.60	5	785.30	697.50	13	937.9	1042.3	-10
OPM %	1.9	2.0		1.6	1.6		1.7	0.9	
OP	4.80	4.90	-2	12.80	10.90	17	16.30	9.70	68
Other Income	0.30	0.20	50	1.70	1.50	13	1.70	6.10	-72
PBIDT	5.10	5.10	0	14.50	12.40	17	18.00	15.80	14
Interest	0.30	0.90	-67	2.00	3.40	-41	3.90	6.20	-37
PBDT	4.80	4.20	14	12.50	9.00	39	14.10	9.60	47
Depreciation	0.50	0.60	-17	1.70	1.70	0	2.30	2.50	-8
PBT	4.30	3.60	19	10.80	7.30	48	11.80	7.10	66
Tax	0.70	0.40	75	2.20	1.20	83	1.70	-1.90	PL
PAT before EO	3.60	3.20	13	8.60	6.10	41	10.10	9.00	12
EO(net of tax)	0.00	-19.10	0	0.00	-5.60	0	-5.60	-8.90	-37
PAT after EO	3.60	-15.90	LP	8.60	0.50	999	4.50	0.10	999
EPS*	5.9	5.2		4.7	3.3		4.1	3.7	

*Annualised on current equity of Rs 24.4 crore of face value of Rs 10 each
(P) : Projections, Figures in crore, Source: Capitaline Corporate Database

Agro tech foods: Segmental Results

	0612(03)	0512(03)	Var%	% of total	0612(09)	0512(09)	Var%	% of total	0603(12)

Segmental revenue									
Branded Foods	140.8	127.9	10	48	392.8	360.3	9	45	487.7
Bulk & Processed commodities	149.6	159.2	-6	52	486.4	446.4	9	55	597.7
Total revenue	290.4	287.1	1		879.2	806.7	9		1085.4
Less: Inter segment	31.7	41.5	-24		93.9	109.2	-14		147.5
Net Sales	258.7	245.6	5		785.3	697.5	13		937.9
PBIT									
Branded Foods	3.7	3.9	-5		10.6	9	18		15.6
Bulk & Processed commodities	3.2	2.5	28		8.8	6.8	29		8.7
Total	6.9	6.4			19.4	15.8			24.3
Less;									
Interest	0.3	0.9	-67		2	3.4	-41		3.9
Other un-allocable exp.	2.3	1.9	21		6.6	5.1	29		8.6
PBT & EO	4.3	3.6			10.8	7.3			11.8
Capital Employed									
Branded Foods	42.7	46.5	-8		42.7	46.5	-8		40.6
Bulk & Processed commodities	48.5	28.4	71		48.5	28.4	71		56.8
Other unallocable	-3.2	1.3	-346		-3.2	1.3	-346		-17.2
Total	88	76.2	15		88	76.2	15		80.2
Figures in crore, Source: Capitaline Corporate Database									

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