

Harrison's Malayalam Ltd (Harrison's), a Cochin-based RPG Group company, is the largest rubber cultivator in India (49% of FY10 revenues); it has 11 rubber plantations spread over 7,338 hectares in Kerala. It also cultivates tea (46% of revenues) and other crops. We assign Harrison's a fundamental grade of '3/5', indicating that its fundamentals are 'good' relative to other listed securities in India.

### Largest domestic cultivator of rubber well placed to ride on higher prices

Average natural rubber prices are expected to rise by 30% in FY11 and remain firm over the medium term. With its superior quality rubber, which commands a premium over tyre-grade rubber, Harrison's is well placed to ride on higher rubber prices despite a drop in output due to replanting of older trees. Sales from the rubber segment are expected to grow at a CAGR of 3.5% over FY10-13 to Rs 1,776 mn. Since most of the realisation gains are expected to flow into profits, PBT from rubber is expected to grow at 35.6% CAGR to Rs 292 mn.

### Higher focus on tea segment expected to turn it around beyond FY14

Harrison's tea plantations are about 80-90 years old and are facing a structural decline in production. The declining yields have been insufficient to absorb the high costs of cultivation in South India, rendering the segment unprofitable over the past few years. Further, tea from South India typically enjoys lower realisations compared to tea from North India, which has led to losses in the tea segment. In FY10, the tea segment recorded profits mainly because of higher tea prices. With the management increasing its focus on the long-term viability of the tea segment, we expect a turnaround post FY14.

### Wage hike is a key monitorable

Harrison's plantations are located primarily in Kerala, where labour laws for plantation workers are subject to frequent state intervention and wages are revised upwards every three to three-and-a-half years. Although we believe higher rubber prices will mitigate the impact of a wage revision for the rubber segment, the profitability of the tea segment remains particularly vulnerable to wage hikes until improved productivity and higher volumes are able to absorb higher costs.

### Revenues to grow

We expect top line to log a CAGR of 11.5% over FY10-13 driven by higher traded volumes and supported by income from non-core businesses such as construction. Adjusted PAT is expected to increase at a CAGR of 34.9% over the same period.

### Valuations – Current market price has strong upside

We value Harrison's based on the discounted cash flow method to arrive at a fair value of Rs 113 per share. We initiate coverage on Harrison's with a valuation grade of '5/5', indicating that the market price of Rs 83 (as on November 03, 2010) has a 'strong upside' from the current levels.

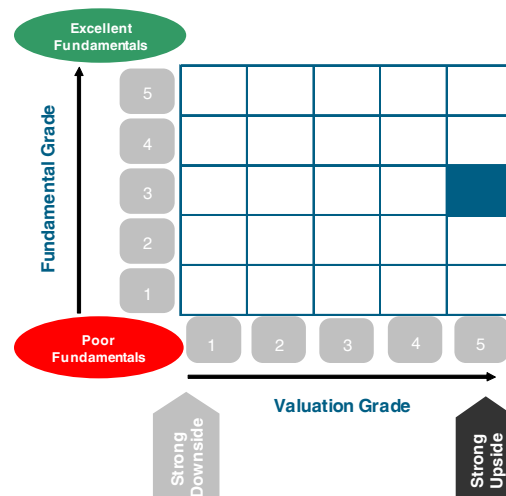
### Key forecast (Standalone)

(Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
Operating income	2,920	3,314	4,013	4,189	4,589
EBITDA	249	268	384	526	467
Adj Net income	60	74	165	273	181
EPS-Rs	3.3	4.0	8.9	14.8	9.8
EPS growth (%)	n.m.	64.1	66.4	65.5	(33.8)
PE (x)	12.6	33.7	9.3	5.6	8.5
P/BV (x)	0.5	1.5	0.9	0.8	0.7
RoCE(%)	8.4	8.5	12.5	16.8	14.0
RoE(%)	3.6	4.4	9.8	14.8	9.0
EV/EBITDA (x)	6.4	12.9	5.7	3.9	4.2

n.m.: not meaningful

Source: Company, CRISIL Equities

### CFV matrix

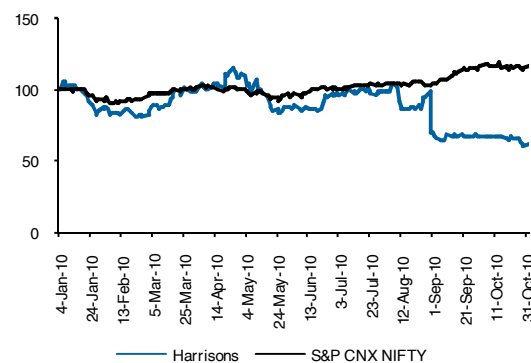


### Key stock statistics

BSE/NSE Ticker	HARRMAL/ HARRMALAYA
Fair Value (Rs per share)	113
Current market price (Rs per share)*	83
Shares outstanding (Mn)	18
Market cap (Rs Mn)	1,532
Enterprise value (Rs Mn)	2,502
52-week range (Rs) (H/L)	120/76
P/E on EPS estimate (FY11E)	9.3
Free float (%)	49.7
Average daily volumes	69,024

\* as on 03 November, 2010

### Share price movement



-Indexed to 100

### Analytical contact

Sudhir Nair (Head, Equities)	+91 22 3342 3526
Niyati Dave	+91 22 3342 3569
Arun Vasu	+91 22 3342 3529
Email: <a href="mailto:clientservicing@crisil.com">clientservicing@crisil.com</a>	+91 22 3342 3561

## Harrisons: Business environment

Parameter	Tea	Rubber	Others
Revenue contribution (FY10)	46%	49%	5%
Product / service offering	<ul style="list-style-type: none"> <li>Unbranded bulk tea sold mainly through auctions in South India</li> </ul>	<ul style="list-style-type: none"> <li>Superior quality centrifuge latex</li> <li>Used in the manufacturing of dipped goods such as examination gloves, contraceptives, elastic threads, etc.</li> </ul>	<ul style="list-style-type: none"> <li>Inter-crop cultivation of pineapple, banana, coffee, cocoa, etc. to augment revenues during rubber replanting phase</li> <li>Turnkey construction projects - the only significant project is a mall-cum- bus terminal project in Bangalore (order size Rs 460 mn - expected completion in FY11)</li> </ul>
Geographic presence	Plantations are located mainly in Kerala and some in Tamil Nadu		
Revenue drivers	<ul style="list-style-type: none"> <li>Higher trading volumes in order to offset lower production</li> <li>Expected rise in tea prices in the medium term, and higher realizations due to higher direct exports and non-auction sales</li> <li>Improved productivity over the longer term</li> </ul>	<ul style="list-style-type: none"> <li>Higher trading volumes in order to offset lower production</li> <li>Expected rise in rubber prices over the medium term</li> <li>Improved productivity over the longer term</li> </ul>	<ul style="list-style-type: none"> <li>Inter-crop cultivation to increase with larger area being replanted</li> </ul>
Margin drivers	<ul style="list-style-type: none"> <li>Tea segment has historically been unprofitable (except FY10)</li> <li>High cost base and low realisation expected to constrain profitability till FY14</li> </ul>	<ul style="list-style-type: none"> <li>Higher realisations to lead to margin expansion in FY11 and FY12</li> <li>Post FY13, margins to be tempered due to expected rise in wages</li> </ul>	-
Sales growth (FY07-FY10 – 3-yr CAGR)	14.6%	18.7%	5.4%
Sales forecast (FY10-FY13 – 3-yr CAGR)	9.3%	3.5%	-
Key monitorables	Tea prices, wage hike	Rubber prices, wage hike	-

Source: Company, CRISIL Equities

## Valuation

Grade: 5/5

We have used the discounted cash flow (DCF) method to value Harrisons and arrived at a fair value of Rs 113 per share. At this fair value, the implied P/E is 12.6x FY11E and 8.9x FY12E EPS. Consequently, we initiate coverage on Harrisons with a valuation grade of '5/5', indicating that the market price of Rs 83 has a 'strong upside'.

### Key components of our valuations

We have considered the discounted value of the firm's estimated free cash flow from FY12 to FY17

We have assumed cost of equity at 16%

Terminal growth rate of 3%.

Based on the above, we have arrived at a fair value of Rs 113.

**CRISIL Equities' fair value estimate is Rs 113 per share**

### Sensitivity of Fair Value

WACC	Terminal growth rate				
	1.0%	2.0%	3.0%	4.0%	5.0%
11.4%	121	132	146	164	187
12.4%	108	116	127	141	158
13.4%	97	104	<b>113</b>	123	136
14.4%	88	94	101	109	119
15.4%	80	85	91	97	105

Source: CRISIL Equities

**Annexure:**

Income statement						Balance Sheet					
(Rs mn)	FY09	FY10	FY11E	FY12E	FY13E	(Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
Net sales	2,670	3,061	3,822	3,990	4,370	Equity Share Capital	185	185	185	185	185
<b>Operating income</b>	<b>2,920</b>	<b>3,314</b>	<b>4,013</b>	<b>4,189</b>	<b>4,589</b>	Reserves	1,503	1,437	1,561	1,765	1,901
<b>EBITDA</b>	<b>249</b>	<b>268</b>	<b>384</b>	<b>526</b>	<b>467</b>	Equity (Including reserves)	1,687	1,621	1,745	1,950	2,085
<b>EBITDA Margin</b>	<b>9.3%</b>	<b>8.7%</b>	<b>10.1%</b>	<b>13.2%</b>	<b>10.7%</b>	Debt	920	1,043	1,033	994	967
Depreciation	34	44	45	46	47	Current liabilities and provisions	551	774	922	930	1,037
Interest	127	127	135	132	128	Deferred tax liability/(asset)	0	0	0	0	0
Other income	(7.9)	1.3	1.6	1.6	1.8	<b>Capital employed</b>	<b>3,159</b>	<b>3,438</b>	<b>3,700</b>	<b>3,874</b>	<b>4,090</b>
<b>PBT</b>	<b>80</b>	<b>98</b>	<b>206</b>	<b>349</b>	<b>294</b>	Net fixed assets	403	2,634	2,671	2,710	2,749
<b>PAT</b>	<b>60</b>	<b>74</b>	<b>165</b>	<b>273</b>	<b>181</b>	Capital WIP	34	36	36	36	36
<b>Adjusted PAT</b>	<b>60</b>	<b>74</b>	<b>165</b>	<b>273</b>	<b>181</b>	Investments	121	0	0	0	0
<b>Adj PAT Margin</b>	<b>2.3%</b>	<b>2.4%</b>	<b>4.3%</b>	<b>6.8%</b>	<b>4.1%</b>	Loans and advances	152	223	270	282	309
No. of shares (Mn No.)	18.5	18.5	18.5	18.5	18.5	Inventory	130	339	184	198	223
Earnings per share (EPS)	3.3	4.0	8.9	14.8	9.8	Receivables	2,229	134	173	192	223
						Cash & bank balance	90	73	366	456	550
						<b>Applications of funds</b>	<b>3,159</b>	<b>3,438</b>	<b>3,700</b>	<b>3,874</b>	<b>4,090</b>
Cash flow						Ratios					
(Rs Mn)	FY09	FY10	FY11E	FY12E	FY13E		FY09	FY10	FY11E	FY12E	FY13E
Pre-tax profit	80	98	206	349	294	Sales grow th	42.1	13.5	21.1	4.4	9.5
Total tax paid	(20)	(25)	(41)	(76)	(113)	EBITDA grow th	39.9	7.5	43.6	36.7	-11.2
Depreciation	34	44	45	46	47	EPS grow th	n.m.	64.1	66.4	65.5	-33.8
Change in working capital	(183)	2,038	217	(37)	24	Adjusted EPS grow th	n.m.	21.9	124.1	65.5	-33.8
<b>Cash flow from operating activities</b>	<b>(89)</b>	<b>2,155</b>	<b>427</b>	<b>282</b>	<b>252</b>	EBITDA margin (%)	9.3	8.7	10.1	13.2	10.7
Capital expenditure	(54)	(2,276)	(83)	(85)	(87)	PAT Margin	2.3	2.4	4.3	6.8	4.1
Investments and others	0	121	0	0	0	Return on capital employed (RoCE)	8.4	8.5	12.5	16.8	14.0
<b>Cash flow from investing activities</b>	<b>(54)</b>	<b>(2,155)</b>	<b>(83)</b>	<b>(85)</b>	<b>(87)</b>	Return on equity (RoE)	3.6	4.4	9.8	14.8	9.0
Equity raised/(repaid)	0	0	0	0	0	Dividend per share (Rs)	1.8	2.3	1.9	3.2	2.1
Debt raised/(repaid)	66	122	(10)	(39)	(27)	Dividend payout ratio (%)	53.6	43.6	21.4	21.4	21.4
Dividend (incl. tax)	(32)	(43)	(41)	(68)	(45)	Dividend yield (%)	4.3	1.7	2.3	3.8	2.5
Others (incl extraordinary)	0	-96	0	0	0	Earnings per share (Rs)	3.3	4.0	8.9	14.8	9.8
<b>Cash flow from financing activities</b>	<b>33</b>	<b>(17)</b>	<b>(51)</b>	<b>(107)</b>	<b>(72)</b>	Debt-equity	0.5	0.6	0.4	0.3	0.2
Change in cash position	(109)	(17)	293	90	94	Current ratio	4.7	1.0	1.1	1.2	1.3
Opening cash	199	90	73	366	456	Interest coverage	1.7	1.8	2.5	3.6	3.3
Closing cash	90	73	366	456	550	Price-earnings	12.6x	33.7x	9.3x	5.6x	8.5x
						Price-book	0.5x	1.5x	0.9x	0.8x	0.7x
						EV/EBITDA	6.4x	12.9x	5.7x	3.9x	4.2x

Source: Company, CRISIL Equities estimate

**Analyst Disclosure**

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

**Disclaimer:**

This **Company-commissioned Report (Report)** is based on data publicly available or from sources considered reliable. CRISIL Ltd. (CRISIL) does not represent that it is accurate or complete and hence, it should not be relied upon as such. The data / Report are subject to change without any prior notice. Opinions expressed herein are our current opinions as on the date of this Report. Nothing in this Report constitutes investment, legal, accounting or tax advice or any solicitation, whatsoever. The subscriber / user assumes the entire risk of any use made of this data / Report. CRISIL especially states that it has no financial liability, whatsoever, to the subscribers / users of this Report. This Report is for the personal information only of the authorized recipient in India only. This Report should not be reproduced or redistributed or communicated directly or indirectly in any form to any other person – especially outside India or published or copied in whole or in part, for any purpose.