Industrials | India

Jain Irrigation Systems Ltd. JI IN

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COMPANY QUICK COMMENT

In the conference call today, the company's high receivables continued to be the Street's main concern. On an h-h basis, overall gross receivables remained flat at INR24.8bn, along with stable receivables at c.INR17bn from the MIS business including government subsidy at ~INR13bn. The company's focus remains on reducing the stress on its balance sheet by improving cash flows. We believe higher sales in 2HFY12F could lead to an increase in receivables if subsidy payments remain flat h-h. A decline in receivables though would likely be a key catalyst for the stock, in our view.

Price target: 229.0 INR **Price (09 Nov 2011): 118.55 INR**

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Conference call takeaways: gross receivables remained flat h-h, but should increase further in 2HFY12F

1. As of end-Sep11, total gross receivables remained flat h-h at INR24.8bn while receivables attributable to the MIS business also remained largely stable h-h at ~INR17bn. Of this ~INR17bn, the government subsidy accounted for ~INR13bn which was flat h-h as the company received ~INR5.5bn from the government in 1HFY12 while fresh receivables of ~INR5.5bn were created on new sales of INR8.64bn during the same period (based on avg. subsidy of c.65% on sales).

2. Maharashtra contributes nearly ~46% and Andhra Pradesh about ~20% to ~INR13bn government receivables pertaining to the MIS business.

3. The remaining INR4bn of MIS receivables (as of Sep-11) is attributable to private parties like dealers, sugar co-operatives and MIS exports. The company on average extends a credit period of 90 days to farmers, 12 months to sugar co-operatives and 3-6 months for exports.

4. The avg. no of receivable days in the MIS business stands at 355 days (> 12 months for government receivables), but the company expects this to come down to 300-315 days by end Mar-12, following release of payment from the AP, Tamil Nadu and Maharashtra governments. Management expects to receive INR5bn from Maharashtra in 3Q or 4QFY12F.

5. In other businesses (ex-MIS), no. of receivable days improved from 180 days in FY11 to 152 days in 1HFY12 (based on annualized sales for FY12). As of Sep-11, c.INR7.5bn is attributable to other businesses which include debtors on exports at c.INR2 bn, and pipes business at INR2.5 bn.

6. In our view, the challenge now is that with 2H being much larger for the MIS business, the company would need to receive higher cash flow from the government in 2H as compared to INR5.5bn in 1HFY12 to maintain gross receivables at Mar'11 levels. The company's target is INR12.5-13bn of MIS sales in 2HFY12F, which would be about 24-29% growth over 2HFY11 or 24-26% growth for FY12F over FY11. With 65% subsidy on average, the company would thus need to receive INR8-8.5bn from the government. This could be tough, in our view, and the possibility of increased receivables exists in FY12F though in terms of days of sales it could dip slightly.

7. To address concerns related to increasing account receivables in the MIS business, the company has now changed its sales strategy in Maharashtra (accounts for ~40% MIS sales). The company will now be taking 60% upfront cash from the farmers on sales made vs. 50% previously and the remaining 40% amount will be covered through post-dated cheques. This leads to the burden of subsidy recovery landing on the farmer and is a step towards the final NBFC based financing model.

8. Although, the company expects this change in strategy of payment collection in Maharashtra to hurt growth in MIS

business temporarily, it believes the same will be offset by higher growth from other businesses. The company remained confident it can achieve its overall sales growth of 20-25% for full-year FY12F.

9. MIS business grew 21%y-y during the quarter led by 100% y-y growth in the export market and 14% y-y growth in the domestic market. For better cash flow conversion in MIS business, the company now aims for lower sales from Andhra Pradesh and Tamil Nadu and is targeting Northern and Central states namely Gujarat, Rajasthan and MP to derive sales growth. These states are the backyard for Netafim and, in our view, could lead to some price competition and possibly lower margins, though the low contribution from these states initially could hide this fact on an overall basis.

10. On the NBFC business front, the company expects to receive a license from RBI in this quarter (3QFY12) and aims to start the business from 4QFY12. However, meaningful contribution from this business is expected to come through in FY13F.

11. Jain Irrigation intends to have 40% ownership in the NBFC business while the other 40% stake will be held by promoters of Jain Irrigation directly and the remaining 20% will be sold to other external shareholders. According to management, the company intends to keep its stake in the NBFC business below 50% as this will not result in consolidation of financial accounts of the NBFC business into Jain Irrigation's, resulting in lower gearing level on consolidated basis.

12. Overall interest cost rose 56%y-y to INR814mn INR521mn, attributable to high working capital and an increase in interest costs. As of end-Sep11, the company's net debt to equity stands at 2.0x on a consolidated basis. The company has no immediate plans for raising equity as management cited current low valuations being too low for the same.

13. The company suffered a mark-to-market forex loss of around INR593mn during the quarter on account of depreciation of the INR.

14. The tax rate in the current quarter was lower at 18.6% as the company availed tax benefits related to R&D expenditure. However, management expects a tax rate of c.27% for full-year FY12F.

Valuation Methodology and Investment Risks: We value Jain based on an earnings multiple of 16x our one-year-rolling forward EPS ofINR14.28 to arrive at our target price of INR229. This is slightly lower than the 17x atwhich it has traded, on average, in the past five years.Downside risks to our call are 1) increased working capital intensity, leading to reducedcashflows and margins; 2) reduction in government support for micro irrigation systems(MIS) and government spending on infrastructure projects; 3) increased competitiveintensity leading to lower margins or market share for Jain; 4) volatile raw materialprices, which could affect margins; 5) further depreciation of the rupee against the USdollar, which could increase forex losses; 6) acquired companies not achieving expectedprofitability; and 7) heavy investment requirement in the proposed NBFC and the inabilityto maintain loan quality.

Note: Ratings and Price Targets are as of the date of the most recently published report (http://go.nomuranow.com/research/globalresearchportal) rather than the date of this email.

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Mentioned companies

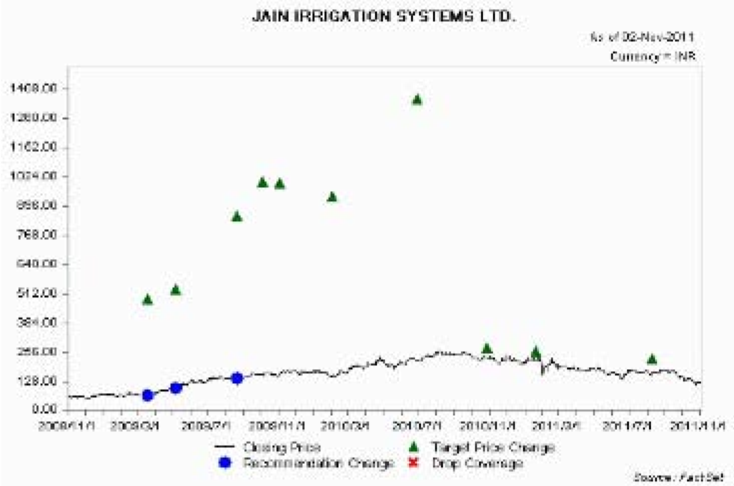
Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Jain Irrigation Systems Ltd.	JI IN	118.55 INR	09 Nov 2011	Buy	

Previous Rating

Issuer name	Previous Rating	Date of change
Jain Irrigation Systems Ltd.	Neutral	21 Aug 2009

Jain Irrigation Systems Ltd. (JI IN) **118.55 INR (09 Nov 2011)** Buy

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
11-Aug-2011		229.00	169.40
21-Jan-2011		261.00	215.75
29-Oct-2010		273.20	231.95
29-Jun-2010		1366.00	216.90
03-Feb-2010		939.00	153.11
03-Nov-2009		996.00	156.19
06-Oct-2009		1002.00	155.17
21-Aug-2009		852.00	143.02
21-Aug-2009	Buy		143.02
08-May-2009		529.00	97.90
08-May-2009	Neutral		97.90
20-Mar-2009		488.00	67.39
20-Mar-2009	Buy		67.39

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value JISL based on an earnings multiple of 16x our one-year-rolling forward EPS of INR14.28 to arrive at our target price of INR229. This is slightly lower than the 17x at which it has traded, on average, in the past five years.

Risks that may impede the achievement of the target price Downside risks to our call are 1) increased working capital intensity, leading to reduced cashflows and margins; 2) reduction in government support for micro irrigation systems (MIS) and government spending on infrastructure projects; 3) increased competitive intensity leading to lower margins or market share for Jain; 4) volatile raw material prices, which could affect margins; 5) further depreciation of the rupee against the US dollar, which could increase forex losses; 6) acquired companies not achieving expected profitability; and 7) heavy investment requirement in the proposed NBFC and the inability to maintain loan quality.

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009

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