Kaveri Seed Company

A rich harvest

The company's focus on the non-cotton segment will help diversify risk

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Investors with a long-term view can buy the stock of Kaveri Seed Company, one of India's largest hybrid seed manufacturers.

With climate change and pest and disease attacks becoming more prevalent, farmers are looking at hybrid seeds to get better yields from crops. Though buying these seeds will mean only a 5-10 per cent increase in cost, the rise in yields is substantial, resulting in better returns for farmers.

The offtake of hybrids for some crops is still low, presenting considerable opportunity for such seed manufacturers.

Penetration of hybrids in cotton is over 95 per cent; for rice, it is below 6 per cent; for vegetables, it is less than 15 per cent; for maize, it is 75 per cent and 60-65 per cent for bajra.

Among the few seed companies in India, the arguments in favour of Kaveri Seed Company are its over three-decade experience in the business and a strong R&D lineage. Over the next three to five years, the company is eyeing an annual revenue growth of about 15-20 per cent, with products lined up for launch and entry into new markets in the north. Kaveri is also exploring inorganic growth opportunities.

At the current market price of ₹641, the stock discounts its estimated earnings for 2018-19 by 18 times.

The stock trades at a PE of 21.5 times on a trailing earnings of last one year. Over the last three years, it has traded in a PE band of 10-28 times.

Promising business

Kaveri Seed has been in the business of selling hybrid seeds since 1976. While in the beginning the company sourced foundation seeds from multi-national companies, developed hybrids and marketed them in India, in 1991 it set up its own R&D facility and has been making and selling its own hybrids since then.

It started with maize and moved on to sunflower, cotton, bajra and other crops. In 2008, the company's cotton hybrid 'Jadoo' was well-received and Kaveri's market share in cotton seeds hit 18 per cent by 2014-15.

To de-risk its portfolio, the company is trying to move away from cotton, which contributed to about 60 per cent of revenue last fiscal. Since 2016, the price for cotton hybrids sold in the country is being fixed by the Centre as per the Cotton Seeds Price (Control) Order; this has reduced margins for cotton seed manufacturers. In cotton seeds, the profit margin is now about 12-15 per cent, but in non-cotton seeds, it is over 30 per cent. In 2017-18, Kaveri thus introduced three okra, six hot pepper, three tomato and eight hybrids in gourds.

Over the next three years, the company targets 55 per cent revenues from non-cotton.

Kaveri's large distribution network lends it a good market share in many crops. The company has a presence in 16 states with over 15,000 direct/indirect distributors.

The other strength for the company is its R&D. Kaveri, spends close to 4 per cent of its revenue on research and develepement. This proportion is a tad lower relative to peers in the market, as the company owns most of its infrastructure.

The years 2015-16 and 2016-17 were difficult for the company because of poor monsoon and drop in the price of cotton hybridys. However, there was a recovery in 2017-18, with a 15 per cent growth in revenue from operations to ₹772 crore. Net profit reported for the year was ₹210 crore.

In the first quarter of 2018-19, net sales declined by 1 per cent due to fall in cotton volumes and cut in cotton seed prices by the government. Revenue was also impacted by lower cotton acreage in Andhra Pradesh, Telangana and Karnataka.

However, the strong performance in the non-cotton business in both volume and value terms, helped. Volume in the non-cotton segment grew 25 per cent in the June 2018 quarter, helped by rice and sun flower. In Bajra, the new product's contribution in the crop increased to 20 per cent from 17 per cent.

Margin expansion scope

In 2017-18, Kaveri's operating profit margin was 28 per cent, up from 20.5 per cent in the previous year. The company's margins for the full year 2018-19 may be even better.

One, as the company is focussed more on non-cotton (high-margin) crops now and, two, in maize, it is moving from three/two-way to single cross hybrids that deliver superior profit margins.

Kaveri has no debt outstanding. It is also a cash rich company. As of March 31, 2018, it had about ₹575 crore in investments under current assets.

Risks

Investors must keep in mind that in bad monsoon years, the company's sales are bound to suffer. When the company is not able to sell all the hybrids produced, the inventory 'write-off' in its books of accounts will also impact its performance.