Vilmorin Clause & Cie

Reuters: **VILM.PA** Bloomberg: **RIN FP** **Food Producers** France

BUY
€101.8

Full-year results

Next event**: 1Q sales - 04/11/03**

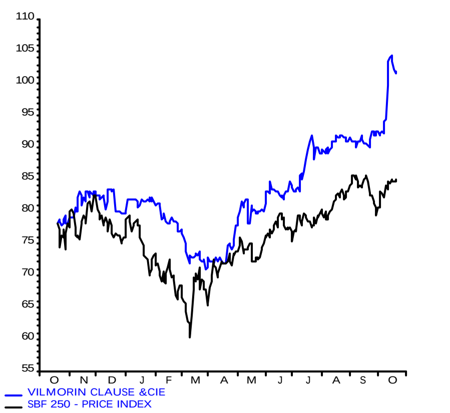
Market cap: **€325m**
Net debt 2004E: **€100m**
Book value per share 2004E: **€88.97**

Range (12m): **€104.6-71**
Av. daily volume: **1,400**
Free float: **30%**

Rel perf/SBF 250 (%):
1m **+13**
3m **+1**
12m **+20**

Abs perf (%):
1m **+13**
3m **+11**
12m **+31**

Vilmorin vs SBF 250 (1 year)



Source: Datastream

On the brink of global leadership?

- **An impressive anniversary.** Vilmorin Clause and Cie (VCC) has ended fiscal 2002/03 (year to 30th June) with the best results of its 10-year stockmarket history. These figures confirm both **the regular growth in sales, with an average annual increase of +9%** (acquisition growth included), and the company's capacity to generate a **high level of profitability** (operating profit of 10.7%), including significant phases of acceleration (2002/03 EPS +37%).

- **The major challenges.** VCC's task is far from over, however, with an even higher positioning at stake, based on an increase in the group's global market share. **Rising from No 5 in 1993 to No 2 ten years later, VCC has world leadership in its sights for the Trade segment** (a ranking already achieved in all segments combined). Indeed, the company is again likely to play a federating role in the market, faced with players currently undergoing restructuring (Seminis) and players of a less significant size (Bayer or family-owned companies). The group is also planning to reinforce its presence in the Asian zone.

- **On the verge of a world leadership valuation.** In view of these factors, we remain extremely confident in VCC's prospects. Despite the recent rise in the shares, we think the current valuation only partially reflects the quality of the group's fundamentals. **Our target price of €110.3 is based on modest ratios,** given: (i) the company's long-standing profitability; (ii) its capacity to manage acquisitions; and (iii) key transactions in the sector such as the sale of Seminis (for 1.5x sales).

Year to June	Sales (€m)	EBITDA (€m)	Attrib net profit (€m)	EPS * (€)	Net div (€)	P/E (x)	EV/ EBITDA (x)	Net yield (%)
2002	430.1	45.9	20.0	6.33	3.15	16.1	8.7	3.1
2003	429.8	51.9	23.3	8.67	3.80	11.7	7.8	3.7
2004E	490.9	64.6	27.6	9.33	4.32	10.9	6.6	4.2
2005E	511.2	69.0	30.3	10.18	4.75	10.0	6.0	4.7

** Before exceptionals and goodwill*

Note: this is a translation of a report in French published on 22nd October 2003

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Contents

Better performance than expected

The full-year results (for year ending 30th June 2003) reported by Vilmorin Clause & Cie were clearly good news, both in terms of **scale** (37% increase in EPS at €8.67 vs €6.33) and the nature of the increase **(1.3-point rise in the operating margin).**

Strong results

The lack of growth in sales (at €430m) in reality conceals the good performance delivered by the majority of the subsidiaries, several of them impacted by the depreciation of the dollar. This slide, estimated at 17% ($1.05 vs $0.90 per €1), generated a loss of nearly €22m in sales. Restated for the currency impact, sales would have shown growth of 5.1%, ie in line with the average annual trend reported by the group.

Currency impact under control

Overall, the currency impact has also been kept well under control in terms of profitability, as it has generated a loss of €1.6m in Ebit (€46.4m reported vs €48m at constant exchange rates), ie **3.3% of Ebit.** This is especially noteworthy when one considers that this last fiscal year benefited from a stronger contribution by the US subsidiaries to the group's earnings. This was particularly the case for the Consumer segment, with a positive contribution of €1.5m in net income versus a loss of €2.6m the previous fiscal year.

Numerous factors have contributed to the increase in the group's operating margin.

Operating margin

(%)	2000/01	2001/02	2002/03
Ebit	35.9	40.9	46.4
Operating margin	**8.5%**	**9.4%**	**10.7%**
Trade products	14.2%	15.6%	15.9%
Consumer products	1.9%	2.3%	4.8%

Source: Crédit Lyonnais Securities Midcap estimates

With the exception of the German subsidiary, the majority of the group's entities have delivered good performances. The increase in the **proportion of new varieties**[1] (81% of sales on 30th June 2003) has boosted the gross margin (increase of 2.4 points) and the group also benefited from strong campaigns in the spring for the Consumer segment. Price increases have also been possible (a new phenomenon, especially in the US), whilst the principal Consumer subsidiaries (including Oxadis in France) have successfully overhauled their catalogues, removing items with weaker margins[2].

Strong rebound by the General Public division

After two tough years, the Consumer division has once again generated a stronger contribution to earnings (historically between 5% and 6%, compared with 4.8% in 2002/03) which can largely be attributed to a better contribution by Oxadis (volume/mix effect) and a spectacular recovery by the American subsidiary Ferry Morse, which has reported an increase in sales of 32% (€28m) at constant exchange rates

[1] Products resulting from group research
[2] Stoppage of the distribution of plants (€4/5 m in sales) and certain pet shop items...

In view of the fact that the debt position is firmly under control (gearing of 27.8%) and that the rate structure is now more favourable (essentially a variable rate for 83% of the debt, with a small proportion denominated in dollars), the group has also been able to cut down its financial costs on a massive scale (€5.3m vs -€8.7m the prior year). One should also note the level of provisions for financial asset depreciation posted during the previous fiscal year, which has generated an improvement via a knock-on effect.

Change in main P&L items

(€m)	2000/01	2001/02	2002/03
Ebit	35.9	40.9	46.4
% change	-10.0%	+13.9%	+13.4%
Pre-tax profit before exceptionals	29.3	32.2	41.1
% change	-13.8%	+9.8%	+27.6%
Attributable net profit	17.6	20.0	23.3
% change	-22.4%	+13.6%	+16.5%

Source: Company

Finally, the performance is even more remarkable considering that the group has had to absorb exceptional costs of €3.9m, corresponding to restructuring expenses and fiscal disputes. The previous fiscal year had benefited from capital gains made on asset disposals.

On the brink of global leadership

Whilst VCC has reported **average sales growth of nearly 9% over the last 12 years,** it is also clear, when one considers the acquisitions made by the group (including Clause Harris Moran, the biggest of these), that VCC is not short of sources of growth for the next few years. Furthermore, the re-construction of the seed sector continues.

■ Growth drivers

Growth relies on[3]:

Sustained growth over a long period

1. **A broadening of product market share**. The recent takeover of a majority holding in the Israeli company Hazera is a good example of the broadening of product market share. The group now has world leadership in the most popular fruit & vegetable variety, ie the tomato. This transaction has also strengthened the group's presence in the fresh and the industrial (tinned foods) segments,

2. **New regions to develop**. Over the last 10 years, VCC has improved its coverage of its geographical potential, both in Europe and in the US. The Asian zone is now its new target, both Japan and China (which represents major potential). The current developments (Mikado and Kyowa) may seem long, but they are an inherent aspect of the Japanese market. Conversely, the difficulties encountered by the entire seed industry in Japan are a new feature and it is the native structures that are suffering the most (average increase in sales restricted to 3% for Takii, the No 1 in Japan, with sales of €150m). This could possibly **accelerate a concentration trend** within a market that is still very fragmented,

3. **The purchase of skills and know-how**. We have discussed this item in detail in previous reports.

VCC maintains a constant effort in terms of R&D (12% to 13% of Trade sales, representing an annual budget of around €30m) and this should be sustained in the long term. The acquisition of skills (Keygene is a good illustration of this) remains an important objective for the group in order to improve its R&D capacities and consequently sustain growth through the development of new varieties (protected by COV in Europe).

[3] see report of 23 May 2003

■ From No 5 to No 2...before becoming No 1

Worldwide leadership confirmed in all segments combined

By acquiring a majority stake in Hazera, VCC has pulled itself up to **No 2 rank worldwide in the Trade segment,** and has also reinforced its worldwide leadership overall (Trade and Consumer segments combined). The objective is also to eventually become world leader in the Trade segment.

Competition in the Trade segment

Sales (€m)	Company	1993	Company	2003
1.	Sandoz	150	Seminis	370
2.	Takii	110	**VCC + Hazera**	**245**
3.	Asgrow	110	Syngenta	235
4.	Peto	80	Takii	150
5.	**Vilmorin & Cie**	**60**	Sakata	105
6.	RPA/Lafarge	60	Bayer	100

Source: Company estimates

The performance over the last 10 years has been impressive, culminating in a world No 2 ranking. This positioning has of course been achieved through acquisitions (Clause Harris Moran amongst others) while the move towards consolidation has dominated the market (takeover of Asgrowand Peto by Seminis).

New challenges for the coming years

The principal factor at stake currently is the **future of Seminis,** which has just been taken over by American investment funds, and has recently been de-listed from the stockmarket. We have no specific information on the strategy that the new shareholders will be adopting, except that it is not their objective to hold on to this asset on an indefinite basis.

With this in mind, any outcome is possible, including disposals or withdrawals piecemeal, by product line or by geographical zone. If this is the case, VCC might be interested, as it would provide an opportunity for the group to increase its market share and thus become No 1 in the Trade segment. This hypothesis is all the more conceivable considering that VCC's financial structure is perfectly capable of absorbing such a transaction.

Furthermore, the strategies of players such as **Syngenta** (formerly Sandoz), which was market leader 10 years ago, and **Bayer** (currently No 6) have not been made clear. Their seeds division represents only a small proportion of these groups' global activities.

In more general terms, and in spite of the consolidation which has taken place over the last decade, both the Trade and the Consumer markets remain fragmented. For the record, the Japanese market (excluding the two biggest players Takii and Sakata, with sales of €157m and €118m respectively) consists of a multitude of small and often family-run businesses (with sales of $20m to $40m).

As an international specialist and not an agro-chemist, VCC should be seen as playing a federating role in this environment.

Potential intact for improving margins

In the aftermath of historically strong results, what are the prospects for improving margins?

A symbolic sales target of €500m

We remain confident that the group still has the potential to generate an average growth rate of between +5% and +7% (versus nearly 9% over recent years, acquisitions included). These hypotheses are based on organic growth in the market of 2% to 3%, with a probable increase in VCC's market share resulting from further acquisitions.

For fiscal 2003/04, **the symbolic sales target of €500 m** remains reasonable bearing in mind the additional sales of. €50 m generated by the integration of Hazera. We have nevertheless incorporated an average fall in the dollar of 10% against the average 2002/03 rate, which is responsible for a loss of sales of approximately €10 m.

Sales: €/$ rate

(€m)	2001/02	2002/03	2003/04 E	2004/05 E
Sales	430.1	429.8	490.9	511.2
% change.	+2.9%	-0.1%	+14.2%	+4.1%
Pro forma/ LfL currency	+5.5%	+5.1%	+4.6%	+4.1%
€/$	0.90	1.05	1.15	1.15
% change		-17%	-10%	-

Source: Crédit Lyonnais Securities Midcap estimates

It is more than likely that VCC should not only be capable of consolidating its margins but even improving them, for reasons expressed in detail elsewhere in the report. Two main factors should confirm the margin improvement trend:

Priority given to research and optimisation of distribution

1. Firstly, **the fact that the level of new varieties will remain high**. At 81% vs 70% 10 years earlier, and with the R&D budget remaining at around 12/13% of Trade sales, the group will continue to boost the proportion of its new varieties, which generate mark-ups of around 80 to 90%.

2. Secondly, **the continued recovery of the Consumer division**, a trend confirmed in 2002/03. This has been verified with Oxadis. The losses of the German subsidiary (net losses of -€1.6 m) will eventually be eliminated, with the repositioning of the group in the specialist market. The goal is to boost the operating margin up to over 5%, with **a medium term target of 6% to 8%.**

Operating margin forecasts

(€m)	2001/02	2002/03	2003/04 E	2004/05 E
Ebit	40.9	46.4	53.0	56.3
Op margin	**9.4%**	**10.7%**	**10.7%**	**10.9%**
Trade products	15.6%	15.9%	15.1%	15.7%
Consumer products	2.3%	4.8%	5.0%	5.0%

Source: Crédit Lyonnais Securities Midcap estimates

The assumption for the next two fiscal years are relatively conservative, bearing in mind the progress made in 2002/03 (gain of 1.3 points). Moreover, these assumptions do not incorporate the additional synergies generated by the integration of Hazera.

This integration is reflected on the basis of the only data available (ie Ebit of €5m and net income of €2m) excluding group synergies, ie globally earnings enhancing (estimated enhancement of approximately +6%, see our report of 23rd July 2003). Nevertheless, on the basis of an operating margin of 10%, the consolidation of Hazera will slightly impact the Trade segment's margin, hitherto at around 15/16%.

Forecast EPS

(€m)	2001/02	2002/03	2003/04 E	2004/05 E
Ebit	40.9	46.4	53.0	56.3
Op. margin	9.4%	10.7%	10.7%	10.9%
Pre-tax profit before execptionals	32.2	41.1	46.8	50.2
% change	+9.8%	+27.6%	+13.8%	+7.2%
Attributable net profit	20.0	23.3	27.6	30.3
% change	+13.6%	+16.5%	+18.4%	+9.7%
EPS*	**6.33**	**8.67**	**9.33**	**10.18**
% change	**+5.6%**	**+36.9%**	**+7.6%**	**+9.1%**
Annual average growth rate			**+9.2%**	

** Restated for exceptionals and goodwill*

Source: Crédit Lyonnais Securities Midcap estimates

Finally, our 2003/04 EPS assumptions have been revised upwards by 9.5% to €**9.33** vs €8.52 (prior to the release of the results) with an estimate of €10.18 for 2004/05, ie an increase of 9.1% versus the previous fiscal year.

The average annual increase of 9.2% has finally turned out to be close to the average annual increase over the last 10 years (8.6%) confirming the group's steady growth potential over a long period.

Buy recommendation unchanged

In spite of the recent market performance (+16% since July, +28% since May), we maintain our recommendation to **BUY** the stock**,** given the company's excellent fundamentals.

Our recommendation is based on:

1. A target price revised upwards due to the knock-on effect of stronger estimated earnings going forward.

2. Irreproachable fundamentals. VCC should be considered as a long-term player in a market with high capital intensity (the entry barriers are high on account of the strategic importance of genetic resources, and of course brand image).

The valuation remains modest (10.9x earnings and 0.86x sales)

On account of the adjustments made to our earnings growth forecasts (and at constant valuation methods), **we have raised our target price to €110.3 vs €101.1 previously.**

Target price revised up

(€)	2002/03	2003/04 E	2004/05 E
Old EPS	7.37	8.52	9.61
Target price		101.1[4]	
New EPS	8.67	9.33	10.18
Differential	+17.6%	+9.5%	+5.9%
New target price		**110.3**	
Differential		**+9.0%**	

Source: Crédit Lyonnais Securities Midcap estimates

This target price does not reflect any change in VCC's status resulting from the past and future reinforcement of its market share made with the aim of becoming world leader in the Trade segment (No 5 in 1993, No 2 in 2003, No 1…?).

A straightforward comparison between the current and historic ratios produces a clear undervaluation, solely as a result of the group's change in size (eg, sales x 2.4, Ebit x 2.9 and attributable net income x 3) and its role within the profession (market share positioning).

Current and historic ratios

2003/04	Current	Target price	Historic
P/E	10.9	11.8	12.7
P/E relative	0.74	0.80	0.82
P/CF	7.7	8.3	8.9
EV/sales	0.86	0.92	0.87
Market cap/sales	0.66	0.72	0.64
EV/Ebit	8.0	8.5	8.8
EV/Ebitda	6.5	6.9	8.2

Source; Crédit Lyonnais Securities Midcap estimates

Although the group's capital is 'locked-up' (with the majority [70%] controlled by Limagrain), a comparison with the other transactions in the sector is a useful approach. The recent takeover of the leader Seminis on the basis of **1.5x sales ($650m)** shows the value of an entry ticket and of several years of R&D.

[4] see our report of 23rd July 2003 following the acquisition of Hazera

Fair value will probably be over €110

Moreover, there is no comparison between the fundamentals of the two groups (Seminis and VCC), in terms of:

1. **The financial structure** (Seminis has debts of nearly $ 430 m and professional sales of the same amount, compared with VCC's net debt of €80m and Trade sales of €245m).

2. **The highest profitability in the profession** (recently overtaking Takii) versus losses for Seminis.

3. **Capacity to successfully integrate new entities** (Clause Harris Moran, Hazera for VCC) compared with a growth crisis poorly managed by Seminis (Asgrow, Peto, Royal Sluis, two Korean companies etc).

Transaction ratios

	VCC	Hazera	Seminis
EV/sales	0.86	1.0	1.5
EV/Ebit	8.0	9.2	ns

Source: Crédit Lyonnais Securities Midcap estimates

VCC's long-term upside potential is much greater than that of our immediate target price (€110).

This should confirm the **IRR** (internal rate of return) reported over the last 10 years[5]. Given the rise in the stock and the global return, this **IRR is close to 13.5%[6].**

IRR

(%)	1993/94 – 2002/03
Capital gains	8.1%
Yield	5.5%
TRI	**13.6%**
ROE	8.2%
RoCE	11.6%

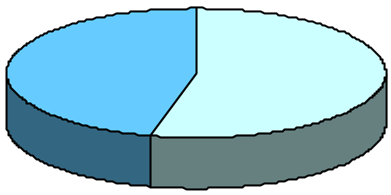
Source: Crédit Lyonnais Securities Midcap esimates

[5] Floatation on the Stock Market in 1993 at €46.65
[6] on the basis of a price of €101.8

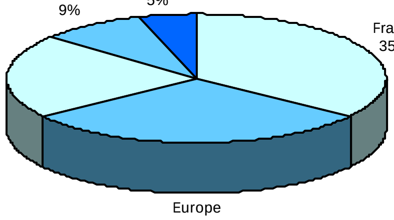
Profit and loss account 2002-05E

Year to June (€m)	2002	2003	2004E	2005E
Sales	**430.1**	**429.8**	**490.9**	**511.2**
% change	+2.9	-0.1	+14.2	+4.1
Labour cost	-115.7	-114.2	-124.5	-127.6
EBITDA	**45.9**	**51.9**	**64.6**	**69.0**
EBITDA margin (%)	+10.7	+12.1	+13.2	+13.5
Depreciation & provisions	-9.9	-12.3	-13.6	-12.6
Other items	4.9	6.8	2.0	0.0
EBIT	**40.9**	**46.4**	**53.0**	**56.3**
Net interest charge	-8.7	-5.3	-6.2	-6.1
Earnings before tax	32.2	41.1	46.8	50.2
Tax	-10.9	-12.1	-15.8	-16.6
Net associates after tax	0.1	-0.1	0.0	0.0
Minorities	-1.2	-1.2	-1.2	-1.2
Joint venture income	0.0	0.0	0.0	0.0
Exceptional items	0.1	-3.9	-1.0	-1.0
Goodwill amortisation	-0.3	-0.5	-1.2	-1.2
Attributable net profit	**20.0**	**23.3**	**27.6**	**30.3**
Adjusted profit before tax	31.1	39.8	45.6	49.0
Adj attributable profit	**20.2**	**27.7**	**29.8**	**32.5**
Tax rate (%)	33.9	29.5	33.8	33.0
Average workforce (unit)	2 857	2 786	3 050	3 126
Number of shares (m)	3	3	3	3
EPS reported (€)	**6.27**	**7.29**	**8.64**	**9.49**
EPS adj before goodwill (€)	6.33	8.67	9.33	10.18
Goodwill per share (€)	0.09	0.16	0.38	0.38
CFPS (€)	20.23	5.06	1.75	11.49
Free CFPS (€)	17.40	-1.21	-2.32	7.41
Book value per share (€)	82.75	83.95	88.97	94.44
Net dividend (€)	3.15	3.80	4.32	4.75

Sales by activity



Sales by region



Cash flow statement 2002-05E

Year to June (€m)	2002	2003	2004E	2005E
EBITDA	**45.9**	**51.9**	**64.6**	**69.0**
Exceptional items	0.1	-3.9	-1.0	-1.0
Change in working capital	38.2	-18.3	-37.0	-9.7
Provisions & other items	0.0	0.0	0.0	0.0
Operating cash flow	**84.2**	**29.7**	**26.6**	**58.3**
Net interest	-8.7	-5.3	-6.2	-6.1
Tax paid	-10.9	-12.1	-15.8	-16.6
Capital expenditure	-9.1	-16.1	-12.0	-12.0
Free cash flow	**55.5**	**-3.8**	**-7.4**	**23.6**
Dividends	-10.0	-10.3	-12.1	-13.8
Acquisitions/disposals	-3.5	-0.1	-21.0	0.0
Shares issued	0.0	0.0	0.0	0.0
Others (currency...)	-3.0	7.2	20.7	-0.3
Change in net cash	**39.0**	**-7.0**	**-19.8**	**9.6**

Balance sheet summary 2002-05E

Year to June (€m)	2002	2003	2004E	2005E
Fixed assets	**96.2**	**94.9**	**104.8**	**105.4**
Goodwill & intangibles	91.8	91.3	102.1	100.9
Non monetary working cap	179.1	197.4	234.4	244.0
Net cash/(debt)	**-72.8**	**-79.8**	**-99.6**	**-90.0**
Provisions & others	11.3	17.2	17.9	17.9
Shareholders' funds	**283.0**	**286.6**	**323.8**	**342.5**
Minorities & preference	19.1	18.9	40.1	41.3
Ordinary shareholders' equity	263.9	267.7	283.7	301.2

Investment ratios 2002-05E

Year to June	2002	2003	2004E	2005E
P/E before goodwill (x)	**16.1**	**11.7**	**10.9**	**10.0**
Reported P/E (x)	16.2	14.0	11.8	10.7
P/CF (x)	5.0	20.1	58.1	8.9
P/BV (x)	1.2	1.2	1.1	1.1
Net yield (%)	3.1	3.7	4.2	4.7
EV/sales (x)	0.9	0.9	0.9	0.8
EV/EBITDA (x)	**8.7**	**7.8**	**6.6**	**6.0**
EV/EBIT (x)	9.7	8.7	8.0	7.4
ROE (%)	7.6	10.4	10.8	11.1
ROCE (%)	10.5	12.3	12.8	12.6
Gearing (%)	25.7	27.8	30.8	26.3
Pay out (%)	50.2	52.1	50.0	50.0

Company data

Shareholders	70%	Groupe Limagrain Holding
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Source for all tables on this page: Company data/Credit Lyonnais Securities

Our system of recommendations reflects expected absolute returns in local currencies on a 6-month time horizon:

BUY = expected return above 15%
ADD = expected return between 0% and 15%
REDUCE = expected return between 0% and –15%
SELL = expected return worse than -15%

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