

Independent Equity Research

Enhancing investment decisions



In-depth analysis of the fundamentals and valuation

KSE Ltd

Q1FY11 Result update

Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade)

Fundamental Grade

CRISIL's Fundamental Grade represents an overall assessment of the fundamentals of the company graded in relation to other listed equity securities in India. The grade facilitates easy comparison of fundamentals between companies, irrespective of the size or the industry they operate in. The grading factors in the following:

- Business Prospects: Business prospects factors in Industry prospects and company's future financial performance
- Management Evaluation: Factors such as track record of the management, strategy are taken into consideration
- Corporate Governance: Assessment of adequacy of corporate governance structure and disclosure norms

The grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals)

CRISIL Fundamental Grade	Assessment
5/5	Excellent fundamentals
4/5	Superior fundamentals
3/5	Good fundamentals
2/5	Moderate fundamentals
1/5	Poor fundamentals

Valuation Grade

CRISIL's Valuation Grade represents an assessment of the potential value in the company stock for an equity investor over a 12 month period. The grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Valuation Grade	Assessment
5/5	Strong upside (>25% from CMP)
4/5	Upside (10-25% from CMP)
3/5	Align (+-10% from CMP)
2/5	Downside (negative 10-25% from CMP)
1/5	Strong downside (<-25% from CMP)

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.

Additional Disclosure

This report has been sponsored by NSE - Investor Protection Fund Trust (NSEIPFT).

Disclaimer:

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KSE Ltd's (KSE's) Q1FY11 revenues exceeded CRISIL Equities' expectations driven by an increase in sales volumes, but EBITDA and PAT were disappointing. The company reported a lower EBITDA of Rs 18 mn vis-à-vis Rs 48 mn in Q4FY10 due to a steep rise in raw material costs. EBITDA margin declined to 1.7% compared to 4.9% in Q4FY10 and our FY11 estimate of 5.0%. While we had factored in a steady rise in raw material costs and a concurrent increase in cattle feed prices for FY11, Q1 saw raw material costs increasing substantially without any increase in cattle feed realisations. Raw material costs are expected to be firm in Q2FY11, but the company has increased its cattle feed prices in end-July. Besides, raw material costs are expected to come down towards the end of Q2FY11 owing to the kharif harvest. Hence, we are optimistic that in the following quarters KSE will be able to make up for the dismal performance in Q1FY11 and, therefore, maintain our earnings estimates. We maintain the fundamental grade of '3/5', indicating KSE's fundamentals are 'good' relative to other listed securities in India. We also maintain the valuation grade of '3/5', indicating that the current market price of Rs 198 is 'aligned' with our one-year fair value of Rs 200 per share.

Q1FY11 results analysis

- KSE's Q1 revenues increased 17% y-o-y and were above CRISIL Equities' FY11 estimate of 10%, mainly due to higher cattle feed sales volumes.
- Strong y-o-y growth in the top line was offset by a 23% increase in raw material costs, leading to EBITDA margin of 1.7% in Q1FY11 compared to 6.6% in Q1FY10. Hence, the company reported a near zero profit of Rs 0.4 mn for the quarter.

Cattle feed sales to gain momentum because of increase in milk prices

Cattle feed sales volume registered a 13% y-o-y increase to 78,550 MT in Q1FY11 backed by improved demand. We continue to be upbeat on the cattle feed industry's growth prospects in Kerala. Further, the milk price in Kerala has been increased by Rs 3 per liter to about Rs 23 per liter by The Kerala Co-operative Milk Marketing Federation Ltd from June 28. Consequently, dairy farmers are expected to earn an additional Rs 2.8 per liter from the sale of milk, which is expected to increase their purchasing power resulting in higher demand for cattle feed.

No change in earnings estimates

Cattle feed sales volumes were higher-than-expected in Q1FY11. However, cattle feed realisations did not increase despite an increase in raw material costs. Although we expect sales volumes to be higher than our estimates, cattle feed realisations for FY11 are expected to be lower than expected. Thus, overall we expect FY11 revenues to be close to our estimate of Rs 4.0 bn. Also, despite earning a negligible profit in Q1FY11, we expect overall PAT for FY11 to be close to our estimate of Rs 94 mn. This is driven by our expectation of a fall in raw material costs in the following quarters.

Valuations – aligned at current levels

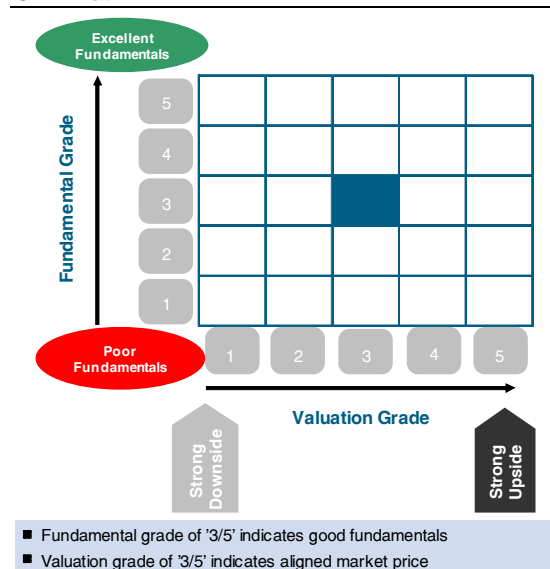
We continue to value KSE at Rs 200 based on the discounted cash flow method. We initiated coverage on KSE with a fair value of Rs 200. The market price of the stock, which was Rs 210 then (May 11, 2010) is currently at Rs 198. Hence, we maintain the valuation grade of '3/5', indicating that the market price continues to be 'aligned' with our fair value.

Key forecast

(Rs mn)	FY08	FY09	FY10	FY11E	FY12E
Operating income	2,899	3,505	3,713	4,053	4,430
EBITDA	95	117	189	201	198
Adj Net income	26	30	82	94	96
EPS-Rs	8.1	9.5	25.8	29.4	29.9
EPS growth (%)	(355.5)	24.1	158.1	13.7	1.8
PE (x)	24.9	21.4	7.8	6.7	6.6
P/BV (x)	2.4	2.3	2.0	1.7	1.5
RoCE (%)	13.4	17.4	25.1	26.6	26.6
RoE (%)	10.0	11.1	27.2	26.6	23.6
EV/EBITDA (x)	8.3	7.7	4.3	4.0	3.7

Source: Company, CRISIL Equities estimate

CFV matrix

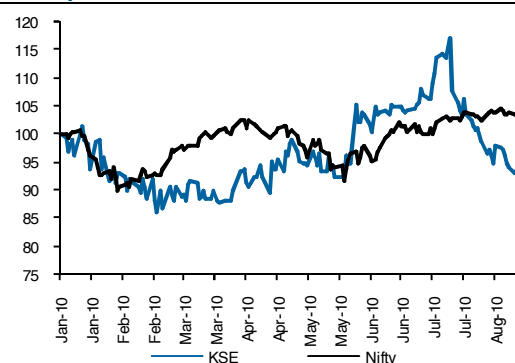


Key stock statistics

	KSELTD
NSE Ticker	KSELTD
Fair Value (Rs per share)	200
Current market price*	198
Shares outstanding (Mn)	3.2
Market cap (Rs Mn)	634
Enterprise value (Rs Mn)	840
52-week range (Rs) (H/L)	270/163
P/E on EPS estimate (FY12E)	6.6
Beta	1.70
Free float (%)	65.0%
Average daily volumes	1,282

* as on Aug 27, 2010

Share price movement



- Indexed to 100

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Key developments

Milk prices in Kerala have increased by 15%

The Kerala Co-operative Milk Marketing Federation Ltd (Milma) had sought the state government's permission to raise the price of milk by Rs 5 a litre because of rising input costs for dairy farmers. After a study conducted by National Dairy Research Institute, Bangalore, concurring to the rising cost concerns, the state cabinet gave a go-ahead to Milma's proposal for a hike in prices. The price of milk has been increased by Rs 3 per litre to Rs 23 per litres. Although the hike in milk price is lesser than demanded, almost Rs 2.8 per litre is expected to be passed on to dairy farmers, which is expected to increase their purchasing power resulting in higher demand for cattle feed.

Increase in milk prices will translate into higher demand for cattle feed

Valuation

We continue to value KSE at Rs 200 based on the discounted cash flow method. We initiated coverage on KSE with a fair value of Rs 200. The market price of the stock was Rs 210 then (please refer to our initiation report dated May 11, 2010 on www.ier.co.in). Since then, the stock price has been very volatile. However, we maintain our valuation grade at '3/5', indicating that the valuations of the company are 'aligned' with the current market price of Rs 198 (August 27, 2010). At our fair value of Rs 200 per share, the implied P/E is 6.8x FY11E EPS and 6.7x FY12E EPS.

We continue to value KSE at Rs 200 per share

Figure 2: Share price movement since CRISIL initiated coverage

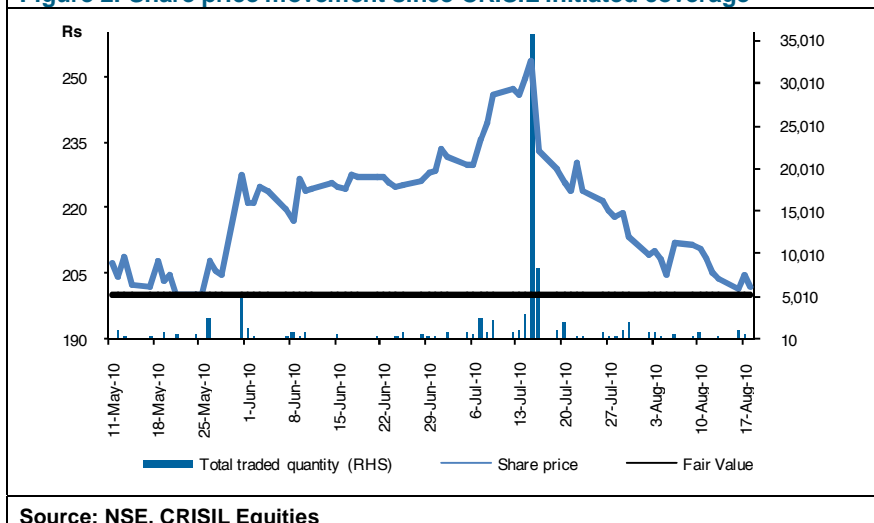


Table 2: Reports released on KSE Ltd

Date	Nature of report	Fundamental grade	Fair value	Valuation grade	Market price (on the date of report)
11-May-10	Initiating coverage	3/5	Rs 200	3/5	Rs 210
04-June-10	Q4FY10 result update	3/5	Rs 200	3/5	Rs 218
27-August-10	Q1FY11 result update	3/5	Rs 200	3/5	Rs 198

* For detailed initiating coverage report please visit: www.ier.co.in

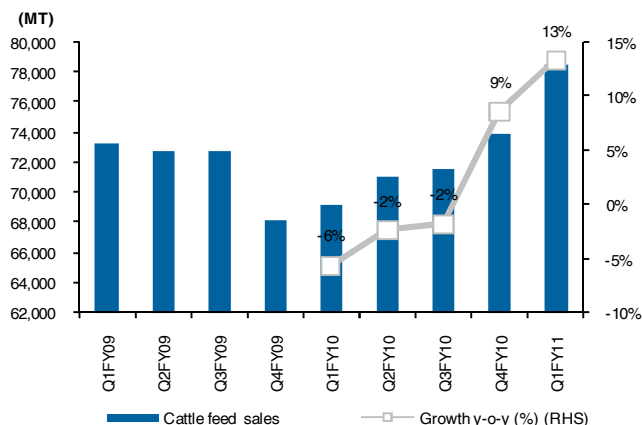
Q1FY11 result analysis

KSE (Rs mn)	Q1FY11	Q4FY10	Q1FY10	q-o-q (%)	y-o-y (%)
Net sales	1,020.3	986.2	871.6	3.5	17.1
(Inc)/dec in stock	5.1	5.4	(11.0)	(5.6)	(146.0)
Consumption of raw materials	856.8	798.2	694.9	7.3	23.3
Purchase of traded goods	-	0.0	9.9	n.m.	(100.0)
Employees cost	41.7	47.9	32.3	(13.1)	29.2
Other expenses	99.1	86.3	87.8	14.9	13.0
Cost of sales	1,002.6	937.8	813.8	6.9	23.2
EBITDA	17.7	48.4	57.8	(63.5)	(69.4)
Interest and finance charges	6.0	5.9	6.1	2.0	(1.8)
EBTDA	11.7	42.6	51.7	(72.5)	(77.3)
Depreciation	11.1	12.5	6.1	(11.0)	82.0
Operating PBT	0.6	30.1	45.6	(98.0)	(98.7)
Other Income	-	1.7	-	(100.0)	n.m.
PBT	0.6	31.8	45.6	(98.1)	(98.7)
Tax	0.2	11.6	15.5	(98.3)	(98.7)
PAT	0.4	20.1	30.1	(98.0)	(98.6)
No of equity shares (mn)	3.2	3.2	3.2	-	-
EPS (Rs)	0.1	6.3	9.4	(98.0)	(98.6)

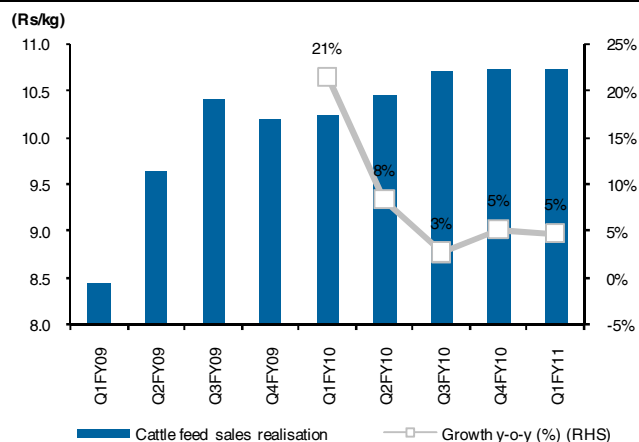
Source: Company, CRISIL Equities

Focus Charts

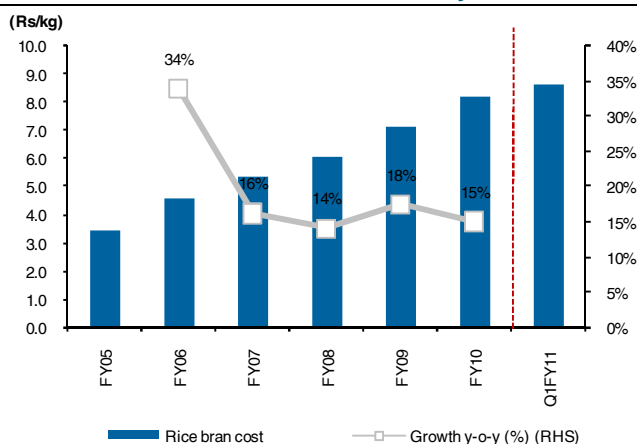
Sales volumes have picked up in past two quarters



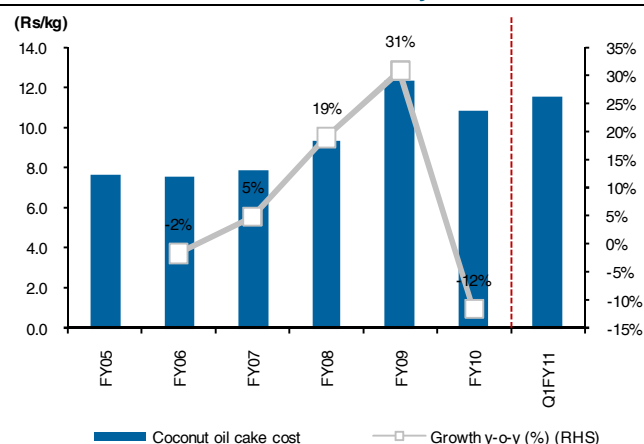
Cattle feed realisations were flat in past three quarters



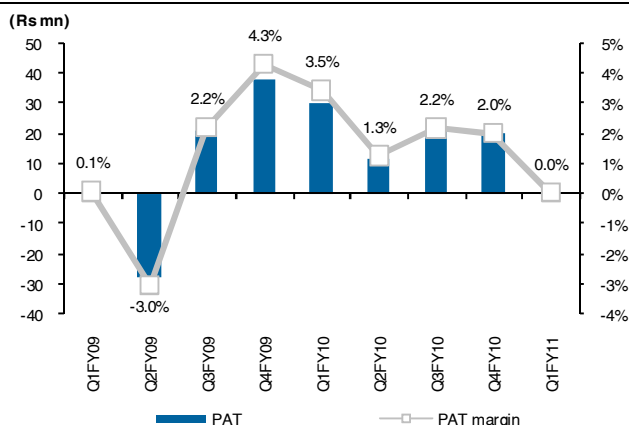
Rice bran cost has further increased by 5% in Q1FY11



Coconut cake cost has increased by 7% in Q1FY11



Quarterly performance of KSE is highly volatile



There are no institutional holdings in KSE

Category of shareholders	Jun-10	Mar-10	Change
Promoter	32.2	32.1	0.3%
Corporate bodies	17.9	17.2	4.2%
Individuals	48.4	49.1	-1.5%
Others	1.5	1.6	-4.5%
Total	100.0	100.0	

Source: Company, NSE, CRISIL Equities

Annexure: Financials

Income Statement

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Net sales	2,894	3,500	3,709	4,047	4,424
Operating Income	2,899	3,505	3,713	4,053	4,430
EBITDA	95	117	189	201	198
Depreciation	29	26	38	39	40
Interest	26	46	27	24	18
Other Income	2	4	3	4	5
PBT	42	49	126	143	145
PAT	26	30	82	94	96
No. of shares	3	3	3	3	3
Earnings per share (EPS)	8.1	9.5	25.8	29.4	29.9

Balance Sheet

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Equity capital (FV - Rs 10)	32	32	32	32	32
Reserves and surplus	235	248	294	350	397
Equity (including reserves)	267	280	326	382	429
Debt	198	300	292	216	162
Current Liabilities and Provisions	102	114	126	128	140
Deferred Tax Liability/(Asset)	15	17	24	24	25
Capital Employed	581	712	768	750	756
Net Fixed Assets	284	284	390	365	331
Capital WIP	10	100	10	5	5
Investments	0	1	41	1	1
Loans and advances	37	33	30	38	42
Inventory	193	247	208	286	312
Receivables	4	3	3	4	4
Cash & Bank Balance	53	44	86	52	63
Applications of Funds	581	712	768	750	756

Source: Company, CRISIL Equities estimates

Cash Flow

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Pre-tax profit	42	49	126	143	145
Total tax paid	(6)	(16)	(37)	(48)	(48)
Depreciation	29	26	38	39	40
Change in working capital	44	(37)	53	(84)	(18)
Cash flow from operating activities	109	22	181	50	118
Capital expenditure	(15)	(116)	(54)	(10)	(5)
Investments and others	-	(1)	(40)	40	-
Cash flow from investing activities	(15)	(116)	(94)	30	(5)
Equity raised/(repaid)	-	-	-	-	-
Debt raised/(repaid)	(75)	102	(8)	(76)	(54)
Dividend (incl. tax)	(13)	(19)	(37)	(37)	(49)
Others (incl extraordinary)	1	2	0	0	(0)
Cash flow from financing activities	(87)	85	(45)	(114)	(103)
Change in cash position	7	(9)	42	(34)	11
Opening Cash	46	53	44	86	52
Closing Cash	53	44	86	52	63

Ratios

	FY08	FY09	FY10	FY11E	FY12E
Growth ratios					
Sales growth (%)	5.3	20.9	6.0	9.1	9.3
EBITDA growth (%)	179.9	23.2	61.6	6.7	(1.9)
EPS growth (%)	(355.5)	24.1	158.1	13.7	1.8
Profitability Ratios					
EBITDA Margin (%)	3.3	3.3	5.1	5.0	4.5
PAT Margin (%)	0.9	0.9	2.2	2.3	2.2
Return on Capital Employed (RoCE) (%)	13.4	17.4	25.1	26.6	26.6
Return on equity (RoE) (%)	10.0	11.1	27.2	26.6	23.6
Dividend and Earnings					
Dividend per share (Rs)	4.1	5.8	11.7	10.0	13.0
Dividend payout ratio (%)	50.7	58.4	45.1	34.0	43.4
Dividend yield (%)	2.0	2.9	5.8	5.0	6.5
Earnings Per Share (Rs)	8.1	9.5	25.8	29.4	29.9
Efficiency ratios					
Asset Turnover (Sales/GFA)	5.5x	6.5x	6.0x	5.8x	6.3x
Asset Turnover (Sales/NFA)	9.9x	12.3x	11.0x	10.7x	12.7x
Sales/Working Capital	18.8x	23.3x	26.1x	25.7x	21.2x
Financial stability					
Debt-equity	0.7	1.1	0.9	0.6	0.4
Interest Coverage	2.5	2.0	5.5	6.8	8.9
Current Ratio	2.8	2.9	2.9	3.0	3.0
Valuation Multiples					
Price-earnings	24.9x	21.4x	7.8x	6.7x	6.6x
Price-book	2.4x	2.3x	2.0x	1.7x	1.5x
EV/EBITDA	8.3x	7.7x	4.3x	4.0x	3.7x

Source: Company, CRISIL Equities estimates

About CRISIL Limited

CRISIL is India's leading Ratings, Research, Risk and Policy Advisory Company

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