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In Focus

K S Oils

BUY	Rs 262	January 9, 2007

Well-Oiled for growth

We recently had the top management of K S Oils with us for a domestic roadshow. K S Oil is promoted by the Garg family, who set up the company over four decades ago. In the late 70s the company entered in to manufacturing and selling of edible oils especially mustard oil. Today the company has two plants located in Morena and Jodhpur with a total crushing capacity of 1,225 tons per day. The latter was recently acquired for a total cost of Rs.200m. With this, the company has established itself as the largest player in the country crushing about 3% of the country's mustard crop each year. The second largest has only one fifth of K S Oil's capacity. This is perhaps the only company in India with a fully integrated plant starting from crushing of the seeds, refining to solvent extraction and vanaspati.

Key Figures

Y/e March	FY04	FY05	FY06	H1FY07
Net Sales *(Rs m)*	4,681	4,525	6,082	4,419
EBITDA *(Rs m)*	135	157	287	287
EBITDA Margin (%)	*2.9*	*3.5*	*4.7*	*6.5*
PAT *(Rs m)*	22	34	152	196
EPS *(Rs)*	4.5	6.8	17.9	20.9
PER *(x)*	304.6	201.6	45.0	-
Cash EPS *(Rs)*	1.6	2.3	6.9	22.7
EV / EBITDA *(x)*	21.5	18.3	10.5	-
EV / Sales *(x)*	0.6	0.6	0.5	-
RoE (%)	*11.7*	*14.5*	*41.6*	*-*
RoCE (%)	*12.1*	*11.6*	*19.4*	*-*

Revenue growth driven by both volume and value expansion

We expect K S Oil to grow its revenues at a compounded annual growth rate of about 35-40% over FY07-09 on the back of both volume and value growth. In FY07 the company expects to nearly double revenues from Rs.6bn in FY06 to Rs.11bn. This is likely to be driven by higher utilization of existing capacity as well as capacity addition from the new unit at Jodhpur. Last year, it was operating at 45% capacity utilization, which has improved to 65% in the current fiscal and further rise to the optimal level of 70-75% in the next year.

The company expects a rise in volumes due to higher demand from increased health awareness (mustard oil has the lowest saturated fat content), shifting revenues from unbranded, loose oil sales to branded, retail pouches and sachets, entry in to new markets such as Uttaranchal, Orissa, Uttar Pradesh, Bihar and Chattisgarh. Prior to this the key markets were West Bengal, Rajasthan, Madhya Pradesh and Haryana.

(Stock price as on January 8, 2007)

Also the introduction of VAT is leading to fast elimination of competition from the unorganised market that was previously evading taxes and selling products cheaper than the organised market.

Volumes are expected to rise from 118,286 MT in FY06 to roughly 200,000 tons in FY07 and 310,000 tons in FY08E. Average realisations will also improve steadily from Rs.42.4 to Rs.47.1 over the same period.

Further growth through inorganic opportunities

After the recent acquisition in Jodhpur, the management is close to making yet another acquisition which is likely to happen by March this year. They will continue to keep a watch for further inorganic growth opportunities. All units are expected to be fully integrated with crushing, solvent extraction and refineries. In case of absence of either of these three, the same will be set up by K S Oil within the premises post acquisition.

Higher than proportionate rise in profits on back of increased branded, retail sales

K S Oils has various in house brands across the three-product categories; crude mustard oil, refined oil and vanaspati. It has two brands namely Kalash – targeted at the premium urban market, followed by Double Sher that caters to the mass market in the crude oil segment. Within the refined oil segment it has KS and KS Gold, of which K S Gold commands a premium over other brands and finally Gold and Gold Plus in vanaspati.

Of all the brands, Double Sher has the highest penetration and acceptance in the northern markets with a market share of over 50%.

The company sells its products in both the loose form as well as through smaller retail pouches, sachets, jars and bottles. A close look at the Indian consumer market helped the management discover the changing preference for smaller retail packs, which assures better quality, and tamper free products. In light of the same, they have increased their focus on these products and are accordingly targeting higher revenues from this segment viz a viz bulk sales. The same will be achieved through expansion of the distribution network from the current 8 CDPs (Central Distribution Point) to 15 CDPs by this year and further to 200 by end of FY08, which will in effect cover 200,000 retailers. Subsequently as against a ratio of 52%:48% for unbranded/loose oil sales to branded sales in FY06, the target is to achieve 42%:58% in FY07 and 41%:59% in FY08. This will also help improve the overall profitability of the company. The management has set aside a budget of Rs 80m to be spent on advertising and promotions in FY07 and FY08.

Better margins and return ratios as compared to competitors

Within the edible oil industry, there is no listed company with a business model similar to KS Oils. Both Ruchi Soya and Adani Wilmar who also sell mustard oil get it manufactured on contract-manufacturing basis. Agro tech and the recent entrant Bunge are present only in the Eastern India. With regards to revenues, Ruchi Soya is the largest followed by Agro Tech and then K S Oils but with regards to margins, K S oils enjoys the highest EBITDA margins of 4.5% (FY06) followed by Ruchi Soya with 3.0% and Vijay Solvex with 2.5%. K S also has the amongst the highest PAT margins in the industry of 2.5% as compared to the next best Ruchi Soya with 1.1%.

Resultant, both RoE and RoCE for this company is much higher (about 25% and 17% on a fully diluted equity of 26.1m shares) as compared to its peers. (Ruchi Soya reported RoE and RoCE of 15% and 14% in FY06).

Industry Overview

The size of the edible oil industry is pegged at Rs.600bn of which mustard oil accounts for 20% (Rs.120bn). The edible oil industry is expected to grow at a CAGR of 6% p.a. Within the industry the branded segment which today accounts for 15% market share is growing at a much faster pace of 20% YoY on back of increasing preference for sealed, unadulterated packages in smaller sizes (size of family has come down).

India has the fourth largest edible oil industry in the world after USA, China and Brazil and accounts for 7% of global production and 10% of global consumption each year. In India, the import bill of edible oil is the second largest, the first being petroleum.

Today, the northern and eastern Indian states are the largest consumers of mustard oil. With 20% of India's population concentrated in Uttar Pradesh, West Bengal, Rajasthan, Orissa, and Madhya Pradesh etc it account for 80% of the country's mustard oil consumption. Increasing health awareness is likely to increase the consumption of refined mustard oil over the next few years due to its lowest saturated fat content amongst all edible oils.

After the coastal-based manufacturers, it is the turn of the centrally located oil manufacturers who are witnessing consolidation. The unorganised market is losing steam due to the introduction of VAT. Over the next few years, only a few large players are expected to remain in this industry. Most small units are either being closed down or are being taken over by the larger players.

Financial Overview and valuations

K S Oil is expected to grow revenues from Rs.6bn in FY06 to roughly Rs.11bn in FY07 and Rs.17bn in FY08 and thereafter grow by 25-30% YoY. EBITDA margins are also expected to rise from about 4.8% to about 8.5% over the same period due to increased sales of branded retail products. Profits are expected to rise nearly three times to Rs.500m in FY07 and further to Rs.1bn by FY09. The same translates in to an EPS of Rs19 in FY07, Rs.32.5 in FY08 and Rs.41 in FY09 on a fully diluted equity of 26.1m shares (after assuming conversion of 4.0m warrants and private equity placement of 3.3m shares to CVC- Citigroup). The management vision is to achieve revenues of Rs.30bn by 2010.

At the current market price, the stock is quoting at 7.9x FY08E and 6.3x FY09E initial EPS estimates which appear attractive as compared to Ruchi Soya, which is trading at about 9.6x FY08E earnings. Based on our learning we are positive on the overall industry and K S Oil who we believe is very well positioned with its brands, fully integrated manufacturing capacities and years of experience to capture the growth opportunity. We will be releasing a detailed report shortly.

Income Statement *(Rs m)*

Y/e March	FY04	FY05	FY06	H1FY07
Net Sales	**4,681**	**4,525**	**6,082**	**4,419**
Expenditure				
Total RM Consumption	4,106	3,884	5,055	3,824
% of Net Sales	*87.7*	*85.8*	*83.1*	*86.5*
Personnel	25	27	31	9
% of Net Sales	*0.5*	*0.6*	*0.5*	*0.2*
Other Exp	415	457	708	299
% of Net Sales	*8.9*	*10.1*	*11.6*	*6.8*
Total Expenditure	4,546	4,368	5,794	4,132
EBITDA	**135**	**157**	**287**	**287**
EBITDA Margin (%)	*2.9*	*3.5*	*4.7*	*6.5*
Depreciation	20	25	29	17
EBIT	**116**	**132**	**259**	**270**
Net Interest	94	96	87	43
Non-operating income	4	6	4	3
PBT	**25**	**41**	**176**	**230**
Tax-Total	2	8	24	34
Tax Rate (%) - Total	*9.7*	*18.3*	*13.8*	*14.6*
Adj PAT	**22**	**34**	**152**	**196**