SPA Securities Ltd

Kesar Enterprises Ltd

BUY

BSE Code: 507180

NSE Code: KESARENTER

Target Price: 425+

Current Market Price: 245.95

Initiated Coverage Date: March 23, 2006

Initiated Coverage Price: 210

Key Data

Sensex: 11835

52 W H/L (in Rs): 279.75/60.15

Face Value (in Rs.): 10

Outstanding Shares: 6339315

Free Float (in %): 48.76

Market Capitalisation (in Rs.cr): 155.91

3M Average Volumes: 47155

EPS TTM: 31.03

Source: Company Data

Shareholding Pattern (in %)

Promoters: 51.24

Institutions: 13.15

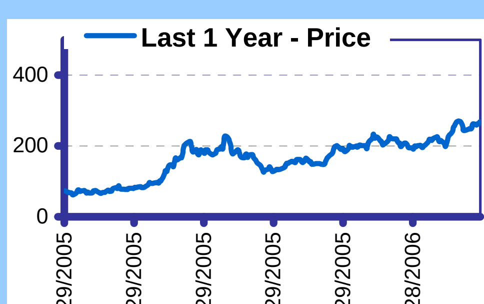
Foreign Holding: 1.97

Other Corporate Holding: 7.12

Indian Public & Others: 26.53

Source:: BSE

Price Chart



Investment Rationale:

27th April 2006

- The company was started in 1932, as a sugar unit. Later, it has fully integrated itself into various other fields.

- The company has presence in three segments, apart from sugar. I.e.

Hybrid Seeds

Storage

Distillery & IMFL

- All the activities are carried out under a single company, which has helped it in utilizing limited sources.

- Realizing the importance of backward integration, company has acquired 2000 acres of land over a period of time around the borders of Uttaranchal and Uttar Pradesh.

- The stock is quoted at 4.34 times its book value and has a market cap of Rs.156 crores with the net revenues of Rs.190 crores.

Financial Summary

(Rs. in crore)

Particulars	FY 2006 (E)	FY 2007 (E)	FY 2008 (E)
Sales	253.81	283.98	334.52
Growth (%)	19.64	12	18
PAT	15.75	25.19	34.02
Growth (%)	-4.5	26	35
EPS	24.83	39.72	43.39
Growth (%)	-5.25	26	9
PER (x)	9.90	6.19	5.67

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(In Rs. Cr)

	Actual	Estimated		
Particulars	**FY05**	**FY06**	**FY07**	**FY08**
Equity	6.29	6.34	6.34	7.84
FV (in Rs.)	10	10	10	10
Net Sales	188.48	225.5	283.9	334.5
Total Expenditure	162.95	191.7	230.7	265.2
PBIDT	32.27	33.73	57.48	73.52
Interest	8.62	7.75	15.25	18.25
PBDT	23.65	25.98	42.23	55.27
Depreciation	5.13	5.25	10.75	12.75
Tax	2.02	4.99	6.3	8.5
PAT	16.5	15.75	25.19	34.02
EPS (in Rs.)	26.21	24.83	39.72	43.39
OPM (%)	17.12	14.96	20.24	21.97
NPM (%)	8.75	6.98	8.86	10.16

Company Background

Kesar Enterprises (KEL) formerly The Kesar Sugar Works was incorporated in Aug.'33. It belongs to the Kilachand Devchand group. The company is at present managed by Harsh R Kilachand, chairman-cum-managing director.

Business Outlook

Sugar Industry

Sugarcane is broadly classified into three varieties early, general and unapproved. Cane is sowed during February and October every year. The first seed growth is known as the plant and subsequent growth after harvesting from the stem is known as Ratoon. The early variety has more sugar content than the general variety.

No. Of Working Sugar Factories	479
Cane Price Per Tonne	Rs.1550
No. Of cane farmers	5 Crore
Sugar Production	5 Crore Tonnes (Raw Value)
Annual Tax contribution to exchequer	Rs.3500 Crore
Employment including ancillary activities	0.5 Million People
Fuel Ethanol of 5% blend (Value)	Rs.1350 Crore

Every farmer within the command area of the Mill is provided with a calendar, which tells him when he can expect a Mill Supply Ticket (Purchy), against which he will deliver the sugarcane.

Process

Cane is weighed using an electronic weighbridge and unloaded into cane carriers. It is then prepared for milling by knives and shredders.

Sugarcane juice is then extracted by pressing the prepared cane through mills. Each mill consists of three rollers:

1. Extracted juice mixed with water is weighed and sent to the boiling house for further processing. Residual bagasse is sent to boilers for use as fuel for steam generation.

2. This juice is heated and then treated with milk of lime and sulphur dioxide. The treated juice is then further heated and sent to clarifiers for continuous settling. The settled mud is filtered by vacuum filters and filtered juice is returned to be further processed while the oliver cake is sent out

3. The clear juice is evaporated to a syrup stage, bleached by sulphur dioxide and then sent to vacuum pans for further concentration and sugar grain formation. Crystals are developed to a desired size and the crystallized mass is then dropped in the crystallizers to exhaust the mother liquor of its sugar as much as possible. This is then centrifuged for separating the crystals from molasses. The molasses is re-boiled for further crystallization

Thus, the original syrup is desugarised progressively (normally three times) till finally, a viscous liquid is obtained from which sugar can no longer be recovered economically. This liquid, which is called final molasses, is sent to the distillery for making alcohol.

SUPPLY AND DEMAND POSITION OF SUGAR (Million Tonnes)

	2004-05	2005-06	2006-07 (E)
Opening stock	8.5	4.5	4.5
Production	12.5	17.5	19.25
Imports	2.0	1.5	2.25
Total availability	23.0	23.5	26.00
Off-take for 1. Internal consumption	18.5	19.0	20.5
2. Export	-	-	3.0
Total	18.5	19.0	23.50
Closing stocks	4.5	4.5	2.50

In the current financial year and FY2007, the demand supply mismatch is likely to further increase, as the storm in Australia had destroyed the crop of cane and at the same time Russia is doing away with the farm subsidies, which would make the production of sugar unviable. With the increasing prices of crude oil, the production of methanol becomes more economical; as government has permitted blending upto 10% currently, which would be further increased to 15% in the coming years. These would to some extent reduce the pressure on import bill and the production of sugar would be under check, as the sugar companies would divert the resources towards the production of

Particulars	Unit	Present Cap.	After Expansion 2006-07	2007-08
Capacity	TCD	6500	7200	10000
Culturable Area	Hect	51700	66000	66000
Cane Area	Hect	30000	34000	40000
Cane Intensity	%	58	51	61
Yield	MT/He	61.05	62	63.5
Cane Production	**Lac MT**	**18.33**	**21.08**	**25.4**
Cane Crush	Lac MT	11.2	11.5	14
Drawl	%	61	62	63
Sugar Recovery	%	10.15	10.15	10.2

ethanol as it would be more profitable for them.

Kesar Enterprises has chalked out a capacity expansion in a phased manner, so that it could be funded through internal accruals rather than diluting the share capital.

Currently company has a capacity to crush around 6500 tonnes per day, which would be increased to 7200 tonnes per day in the FY2007 and 10000 tonnes in the FY2008.

The yield per hectare is likely to increase from 61.05 to 62 and 63.5 in FY2006, FY2007 respectively. The company is operating at optimum efficiency with regards to recovery of sugar from cane i.e. around 10.15%, which can be further improved up to 10.25% as per the industry standards.

The canes crushed would increase from 11.2 tonnes to 14 tonnes. The canes would be sourced from its own fields, as a result of which company would be saving on the increased price of canes; otherwise it would had paid to the cane growers.

With the increased crushing activities in the coming years, the company has decided that the bagasse, which would be left behind as a by-product could be used as a raw material in a 25MW co-generation power plant. The power plant is expected to be operational by June'07. The surplus power from the plant could be sold to the state electricity board.

Apart from these company would have larger availability of molasses at its disposal, which could be utilized for the distillery division and reduce the dependence on external sources.

Production Outlook Particulars	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
Crushing	80.86 lac qtls	84.88 lac qtls	110 lac qtls	115 Lac qtls	140 Lac qtls
Days	150	158	190	190	190
Production of Sugar	7.99 Lac qtls	8.41 Lac qtls	11.15 Lac qtls	11.60 ac qtls	14.25 Lac qtls
Sugar Recovery (%)	9.88	9.9	10.15	10.15	10.2
Molasses	3.71 Lac qtls	3.76 Lac qtls	5.05 Lac qtls	5.25 Lac qtls	6.39 Lac qtls
Surplus Bagasse	0.71 Lac qtls	2.56 Lac qtls	5.17 Lac qtls	5.40 Lac qtls	8.90 Lac qtls

Since the crushing days would be increased to 190 days, the company would be able to crush around 140 Lac qtls of sugar cane, giving an output of 14.25 Lac qtls of sugar. 6.39 Lac qtls of Molasses and 8.90 Lac qtls of bagasse in the FY2008.

The current rate of sugar in the wholesale market is around 1850 per quintal and keeping the current scenario in mind with regards to storm in Australia, cutting of subsidies in Brazil and small countries like Pakistan turning net importers of sugar, the prices of sugar are heading northwards and could increase by 15% to 20% in the next 15 to 20 months.

Even if the company is able to get Rs.18.25 per kg as average realisation in the FY2007 and Rs.18.75 per kg in FY2008 the revenues of the company alone form the sugar division would be in the range of Rs.210 crore and Rs.260 crore respectively, much higher then the current combined revenues from all the divisions.

Going forward operating margins of sugar division are likely to increase because of the increasing prices of sugar and back ward integration.

Hybrid Seeds

The company had incorporated a separate company known As "Kesar Seeds" for the hybrid business. The company is engaged in the cultivation of Hybrid seeds of Maize, wheat, Bt. Cotton etc. having huge demand. For cultivation, company uses 300 acres of land out of the 2000 acres, which the company has on the borders of Uttaranchal and Uttar Pradesh.

The company uses 100 acres of land for research and development purposes and 200 acres of land is being used for actual cultivation.

At present the revenues from the business is miniscule, as it contributes around Rs.2.25 crores as revenues to the company and around Rs.20 lac as bottom line. Going forward company is planning aggressive strategy to market its products and is targeting revenue of Rs.15 crore in the FY2008 and the contribution from it is expected to be in the range of Rs.1.5 crore to Rs.1.75 crore.

Storage and Infrastructure.

The company has storage facilities located at Kandla port in the form of storage tanks. At present the company has around 42 tanks, which has a storage capacity 87000 Kilo Liters. The company is in the position to command premium with respect to storage charges, as its facilities are strategically located near the jetties.

The revenues from the division has been increasing steadily, the margins are expected to remain steady in the coming years.

The division had been receiving increasing queries from the industrial houses to increase the capacity. In lieu of the increasing demand, the company had initiated an expansion program, according to which the present capacity a the Kandla port would be increased by 37000 Kilo Liters and construction activity at the new port would be commenced having a capacity of 40000 Kilo Liters. After the completion of program the total capacity of the division would be around 160000 Kilo Liters, with 85 tanks.

The company is planning to enter into the infrastructure sector and has filled tender for the construction of jetties at the Kandla Port; the projects are to the tune of Rs.200 crore. If the company is successful in getting the orders, it is planning to spin off the storage and infrastructure division into a separate company. If the demerger takes place, significant amount of value would be unlocked as infrastructure companies command higher discounting from the market.

Revenue (In Cr) **Year**	Amount
2000-2001	8.69
2001-2002	8.32
2002-2003	8.6
2003-2004	9.1
2004-2005	10.71
2005-2006 (E)	11.25
2006-2007 (E)	12.50
2007-2008 (E)	14.25

Distillery & IMFL

Products Stored	**Customers**
Kerosene	HLL
Castor oil	MSTC
Edible oil	Adani Exports Ltd
Acetone	Indian Acrylic Ltd
Methanol	SRF Ltd
Hexane	
HNP	

The company had been facing problems with regard to the distillery division because of frequent interruptions due to shut down. The company is believed to have rectified the problems and is ready to carry out the production of molasses in full capacity.

The company is an undisputed leader in white spirits in Delhi.

The companies total sales including the IMFL and country liquor is in the range of 20 Lac cases, which through aggressive marketing techniques it is planning to increase it upto 30 Lac cases over the period of 3 years.

Particulars	Production (Lac liters)				
	Jun-04	Jun-05	**Jun-06**	**Jun-07**	**Jun-08**
Rectified Spirit	115.29	113.82	117.25	125.75	135.25
ENA	23.09	15.48	15.75	17.25	19.25

Last year, since the crushing season of the sugar had been small, there had been shortage of molasses in the country, leading to an increase in prices. But in the current season, the crushing cycle had been normal and price of molasses are expected to ease down.

The company has launched various premium brands under its IMFL division and further with various contract-bottling arrangements, it expects a higher capacity utilisation and reduction in operating overheads.

The company enjoys 6% market share in country liquor in Delhi segment.

The company is very positive on the segment as it has introduced various semi-premium and premium brands and has reduced the operating cost by entering into contract bottling arrangement with various parties.

Though the brands of the company are not of premium segment to catch market fancy but acts as a good diversification and forward integration project for the company.

Whisky	Vodka	Gin&Duet	Rum	Brandy
Oxford club	Blue berry	Blue Berry Dry	Old magic rum	Grand Merrier
Old Magic	Blue berry	Blue berry Duet lime	Doctors Choice rum	Doctors Choice
Doctors choice	Kezar vodka	Lime drops	Yes Boss	Bumble bee

Valuations

The company has been very aggressive in the expansion program and is planning to spend Rs.197 crore over the next 15 months on various projects like power, new port and expansion of sugar factory.

The company is planning to raise Rs.131 crore through debt and remaining through internal accruals.

The company has sold its entire stake in Amber Distilleries to a closely held company for Rs.1.4 crore, which would help in streamlining the activities in the long run.

The equity of the company would increase to Rs.7.84 crore in the FY2008, as 16,60,000 warrants issued by the company would be converted into shares. These warrants are issued at a rate of Rs.97 per share to the promoters and the concern members.

The revenues of the company are likely to increase significantly from Rs.260 crore to Rs.430 crore due to the capacity expansion in the sugar unit. At the same time increasing revenues would be generated from the storage and handling division as 85 tanks would be operational by then.

The operating margins are likely to increase from 17% to 22% on the back of the rising sugar prices, but the net profit margins will not keep the same pace, as cost of interest and depreciation would increase significantly due to capex.

The profits of the company in the first six months of the current financial year has been Rs.11.2 crore, as the operating margins were 11.23% due to the fluctuating sugar prices.

The profits of the company by the end of the FY2007 is expected to be in the range of Rs.25.19 crore giving it an EPS of 39.72. During the same time 50% of the capacity expansion is due to be completed.

In FY2008 the profits of the company would be in the range of Rs.34.02 crore giving it an EPS of 43.39 on the enhanced capital of Rs.7.84 crore, by then the complete expansion is due to be completed.

Peer group comparison

At the current price of Rs.245.95 stock is trading at a P/E of 9.90 current year earnings and 5.67 times FY2008 earning estimates.

At the same time the other companies in the industry having similar capacities is trading at P/E of more than 20.

The company also has a storage division and infrastructure division unlike other companies, which should be commanding even higher multiples as infrastructure companies are trading at a P/E of more than 25.

Even if a P/E of 10 is given to the stock based on FY2008 earnings the scrip should be in the range of Rs.435.

Company	Capacity	Operating %	EPS	P/E
Oudh Sugar	10000	16.22	6.14	28.25
Upper Ganges	10000	13.12	19.07	20.5
Dwarikesh Suagr	6500	30.13	21.18	14.5
Kesar Entreprise	6500	17.12	26.02	8.07

Exhibit I

			(Rs. in crore)
Particulars	**FY05**	**FY04**	**FY03**
Equity	6.34	6.34	6.34
Reserves	32.72	34.10	33.27
Total Income	195.22	182.24	178.26
Total Expenditure	162.95	168.64	181.83
PBIDT	32.27	13.60	-3.57
Interest	8.62	7.57	6.85
PBDT	23.65	6.03	-10.42
Depreciation	5.13	5.00	4.45
Tax	0.62	0.14	0.01
PAT	16.50	0.75	1.68
Face Value (in Rs.)	10	10	10
Book Value (in Rs.)	61.61	63.79	62.48
EPS (in Rs.)	26.02	1.18	2.65
OPM (%)	17.12	7.63	-2.08
NPM (%)	8.75	0.42	-7.98

Exhibit II

			(Rs. in Crore)
Particulars	**9M FY06**	**9M FY05**	**Var (%)**
Equity	6.34	6.34	
Face Value	10	10	
Net Sales	165.96	130.65	27.02
PBIDT	24.65	11.14	121.27
PAT	7.13	-1.30	
Basic EPS	11.25	0	
OPM (%)	14.85	8.53	74.09
NPM (%)	4.30		

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