KM Sugar Mills

View: Positive

Viewpoint

A spoonful of sweetener for your portfolio

CMP: Rs32

Key points

- **A mid-sized sugar company with integrated operations, low leverage and healthy free cash flows:** KM Sugar Mills (KSM) is an integrated sugar company based in one of the largest sugarcane producing states of India - Uttar Pradesh (UP). It has crushing capacity of 9,000TCD, distillery capacity of 45KLPD and power capacity of 30MW. The company's lower leverage position and strong relationships with the cane farmers (due to timely payment of cane prices) make KSM one of the better mid-cap sugar companies in the domestic market. Both these factors would help KSM to post a relatively better performance in a sugar downcycle compared to its close peers. We expect KSM to reap the benefits of high sugar prices in FY2017 and FY2018, and report a strong operating performance as against some of the earlier years.
- **Surge in sugar prices sustainable not only in FY2017 but also in FY2018:** The Indian sugar companies continue to remain in a sweet spot, as sugar prices have firmed up to Rs37-38 per kg in the domestic market (from the lows of Rs20 per kg in July 2015) due to the demand-supply mismatch in the domestic as well as international markets. The domestic sugar production is expected to decline further in SY2016-2017 owing to a significant drop in sugar production in Maharashtra (production is down by 40% YoY) and Karnataka due to shortage of water. This should help the sugar prices to remain in an upward trend in FY2018 too.
- **Stellar financial performance:** Buoyed by average realisation of around Rs35-36 per kg, KSM recorded a stellar performance in H1FY2017, with revenue up by 7% YoY and the PAT expanding 4x to about Rs14.5 crore (largely on account of strong improvement in OPM to 14% from 4% in H1FY2016). With cane crushing expected to increase by 8-10% and sugar prices rising to Rs37-38 per kg, KSM is likely to end FY2017 with a PAT of ~Rs25 crore (OPM expected to sustain at about 15%). With the demand-supply gap likely to sustain (due to a significant decline in sugarcane acreage in Maharashtra), sugar prices are likely to remain in an upswing, and therefore KSM's better operating performance is likely to sustain in FY2018 as well. Also, the strong performance of its allied businesses such as Power (likely to grow at a CAGR of 10% over the next two years) would support OPM in the coming years.
- **Substantial reduction in debt in 18 months; balance sheet sturdier vs other small sugar companies:** Improvement in profitability and better working capital management helped KSM to reduce its consolidated debt by about Rs90 crore in the last one and half years. The company's debt-to-equity ratio improved significantly to ~1x in H1FY2017 from 2.4x in FY2016. Further, the company is looking for various options to repay / restructure the high-cost debt in the coming quarters. Also, it is planning to raise money through preferential issue / issuance of NCDs for its future capex requirement, while its profitability will continue to see a material improvement. Therefore, we don't expect KSM's balance sheet to worsen from the current level. Its balance sheet is much better compared to some of the other UP-based small sugar companies such as Simbhaoli Sugar and Mawana Sugar Mills.
- **Preferred pick in mid-sized sugar space:** KSM is our preferred pick in the mid-sized sugar space. The company has efficient operations, a healthy balance sheet, strong relationships with cane farmers and an encouraging growth outlook aided by its Ghana project. The company's expansion in Ghana by 9,000TCD, without stretching the balance sheet, would result in a geographical diversification, along with a relatively brighter growth outlook. We have a positive view on KSM and expect returns of 20-25% over the next few months. The returns could be much better if its Ghana plant is commissioned in time.
- **Key risk:** Being a mid-cap company, any significant decline in sugar prices from the current level or any increase in the working capital requirement would act as a key risk to our earnings estimates.

Valuation **Rs cr**

Particulars	FY15	FY16	*FY17E
Revenues	557.6	359.0	394.9
Operating profit	23.2	19.3	59.2
OPM (%)	4.2	5.4	15.0
Reported PAT	7.4	11.7	25.4
EPS (Rs)	0.8	1.3	2.8
P/E (x)	39.1	24.9	11.5
Debt:Equity	7.1	2.4	0.8

* Based on rough cut estimates

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