12 June 2003
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KSB Pumps

Not Rated

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Rs87

KSB Pumps India, a leading manufacturer of pumps and valves, in the last two quarters has come out with good numbers. We met the management to know more about the company and future prospects. *Key takeaways from our meeting.*

Leader in pumps and valves

KSB Pumps India is a leading producer of pumps and valves primarily required for fluid handling including water in India. They find major application in diverse industries such as chemicals and petrochemicals, fertilisers, refineries and power generation – both thermal and nuclear for water feeding to boilers. Submersible pumps are used for irrigation purposes and tube wells. Submersible pumps are generally low end products.

Competitive edge over peers

Within the KSB Group globally, KSB India has relatively the highest range of pumps and valves to offer. Even among its competitors in India, KSB India has a large range of pumps to offer under one roof. Both these give the company the required competitive edge over its peers.

Pumps and valves form part of large projects across the aforesaid industries. Demand from industries depend on the rate of capital formation, which in turn depends on a host of macro and micro factors such as overall GDP growth rate, level of industrial production, demand-supply dynamics of products, imports, etc. Hence, specific market size for pumps in general on a yearly basis is not feasible to assign.

Pumps are manufactured both in the organised as well as unorganised sectors. The unorganised sector is mainly into low-end submersible pumps. Many of the organised players, besides being into high-end industrial applications are also into submersible pumps segment. Organised players include Sulzer, Kirloskar Brothers, Mather & Platt, Worthington Pumps and the Indian arm of Danish company Grundfoss.

For KSB India, business comes from all the aforementioned areas. However, the company faces good deal of competition from all of the above players. The company no longer holds a monopoly position that it once enjoyed in respect of pumps used in nuclear power generation.

Of the total pumps sales, the company derives nearly 50% of this from submersible pumps segment while the balance 50% coming from industrial pumps and exports. The company's total pump sales for CY02 stood at Rs1.88bn.

Electricity Bill, Power Reforms to drive growth

The management is of the view that the recent major changes and regulatory relaxations sweeping the Indian power sector such as enactment of the Electricity Act and power consumption in agricultural operations eventually getting paid for should drive future growth.

Submersible pumps

The company's submersible pumps are 30-40% efficient over the unorganised sector's offering in this segment. Submersible pumps have a comparatively better operating costs matrix including that for power consumption over that of submersible pumps supplied by unorganised sector. The company aims to improve its market share in a major way from the present 15-20%. The total market size for submersible pumps (standard products) is around Rs4.5bn annually.

Valves segment
KSB India has a fair range of valves too including the new generation Butterfly valves. The other frontline players in the valves segment are BHEL, Audco Valves and L&T. The company's valves business though has been a laggard. The business clocked a loss before interest and tax of Rs7mn in CY02; in Q1CY03, the loss before interest and tax was Rs6mn, the same loss that it suffered in Q1CY02. However, efforts are under way to improve performance of this segment.

The company holds a 49% stake in the joint venture MIL Controls Limited with the balance 51% being held by the parent. MIL Controls is into specialty controlled valves that don't overlap with the valves' range of KSB India. The PSU Instrumentation India is a major player in this field. KSB India's management is not aware of whether Instrumentation India being PSU avails of price preference. For CYO2, MIL Controls' PBT declined by 37% to Rs12.8mn on an annualized basis. Pumps and valves per se don't have high replacement demand except in case of some chemical processes involving corrosive chemicals.

Thrust on spares business
The company is also into the spares business. The company would be looking at improving this business though no gameplan has been drawn out. This is so because many of the company's spares are not very sophisticated in nature and are largely manufactured by SSIs.

Exports: Expected to grow 5-10% per annum
Exports were around 15% of total sales to Rs270mn in CY02. The company exports a mix of pumps and valves (70:30). Pumps include both submersible as well as industrial. In the past 3 years, the company's exports have been growing at 5-10% per annum. Going forward, no major change is envisaged in this respect. It's not always that margins in exports are always better than that in domestic sales. KSB India is looking at expanding its overseas markets. There is often competitive bidding from other Group companies in case of overseas supply contracts for pumps and valves.

VAT implementation: A major positive
VAT, as and when implemented would impact the company positively. Presently the company's products attract a basic customs duty of 45% and a special additional duty of 5%. Submersible pumps attract 16% excise duty (earlier exempted). However, the company doesn't expect this to adversely affect it vis-à-vis the small players in the unorganised sector as many of them are large enough to be covered by excise. In the ensuing 2-3 years when customs duty would be made WTO compatible, some of the company's products are likely to be become cheaper.

10-12% growth in CY03
Present order book position was not divulged by the management, as it is generally not in the public domain. The management also refused to assign specific topline growth numbers for the next 2-3 years. But considering that the India's GDP is expected to grow at more than 5% in the next 2-3 years, industrial recovery seen in H2FY03 getting sustained, a normal exports growth and no major outsourcing by the parent, we believe that KSB India should grow at 10-12% YoY in CY03.

No outsourcing on the anvil
Currently, the parent has no strategic plans for outsourcing of specific products from KSB India. Nevertheless, the parent would increase its buying from KSB India whenever possible. Within the Group, KSB India is not highly competitive across the product range. Besides the production facilities in India, the parent has manufacturing units in China, Indonesia and Australia in this part of the globe.

High staff costs to be pruned
The staff cost at nearly 17% to sales is relatively on the higher side for a Rs2bn plus engineering company like KSB India. The total staff strength is 1900 plus. The company has five production units in India with many processes and functions getting duplicated, which explains the high employee

numbers. Added to this, the company's production facilities are neither flexible nor do they offer scope for consolidation. However, the company proposes to reduce its present high staff costs through various operational restructuring measures such as centralization of certain business processes. VRS is also an option being contemplated.

Financial Performance

EBIDTA margins 13.6% in Q1CY03 (5.8% Q1CY02)
We estimate the company's EBITDA margins excluding other income to improve marginally over CY02 levels of 11.1%. EBITDA margins excluding other income improved from 5.8% in Q1CY02 to 13.6% in Q1CY03. Sales in Q1CY03 grew 23% YoY to Rs640mn. KSB is a full tax paying company.

Double digit PBT/ Total Income ratio in 2-3 years
Going forward, the company expects to achieve sustainable double-digits PBT/ Total Income ratio, which has been in the 6-8% range in the past 3 years. Notably, it did achieved PBT / Total Income excluding extraordinary gain of 10.4% in Q1CY03.

Targets to become a Debt-free company
KSB India targets to become a debt-free company in the next 2-3 years from debt levels of Rs284mn at end of CY02 and with borrowings as and when they get matured. In Q1CY03 KSB India prepaid a sales tax deferral loan of Rs59mn (CY02 end) and earned extraordinary profit of Rs30mn on the same. At CY02 end, the company had cash of Rs200mn on its Balance Sheet parked in the current account.

Plans for higher dividend payout ratio
The company wishes to increase its 30% dividend payout ratio going forward. In the past, this was on the higher side due to lower earnings. Based on our estimates for CY03, this payout ratio entails dividend of 30% for CY03, the same that was paid in CY02.

Post visit development
Recently BHEL, which is already into the production of valves, decided to manufacture of pumps. As and when BHEL's plans materialise, it would pose a major challenge to KSB India as well as others in the industry since BHEL is a major customer for pumps used in its power projects.

View
At the current price of Rs87, KSB trades at 10x CY03 estimated earnings of Rs8.87. Over more than three years to date, KSB India's 1-year forward PE multiple has been consistently declining from a high of 25x to a low of 7x. Over the past 18 months though, the company's 1-year forward PE multiple has largely stabilised in the 7-9x range. This premium slicing was on the back of growth uncertainties emanating from economic slowdown, increasing competition and better alternative equity investment opportunities.

However, since mid-April 2003, the stock has appreciated sharply by 53% from a low of Rs57 to present levels. In view of the sharp run in the stock price and other missing triggers such as lack of outsourcing by the parent and lack of visibility on the operational restructuring front, we would look at Buying, if any, at lower levels (closer to Rs60-65 levels). If there are any material changes affecting the earnings or valuations of the company we would keep our investors updated.

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Shareholding Pattern

Promoters	
- Indian	25.95%
- Foreign	40.54%
UTI and MFs	6.25%
Banks / FIs / Insurance Cos	7.19%
Public	20.07%

Financials **Rs Million**

	Q1CY03	Q1CY02	%Chg	CY01 (9 mths)	CY02	CY03E	%Chg
Net Sales	**639.0**	**518.0**	**23.4%**	**1628.9**	**2289.5**	**2518.5**	**10.0%**
Other Income	7.4	11.0	-32.7%	45.3	45.3	40.0	-11.7%
Total Income	646.4	529.0	22.2%	1674.2	2334.8	2558.5	9.6%
EBITDA	**94.4**	**41.0**	**130.2%**	**201.6**	**300.0**	**348.5**	**16.2%**
Interest	4.0	8.0	-50.0%	29.6	22.9	15.4	-32.9%
Gross Profit	90.4	33.0	173.9%	172.0	277.1	333.1	20.2%
Depreciation	23.0	22.0	4.5%	67.7	91.0	93.8	3.0%
PBT (Ex. Extraordinary item)	67.4	11.0	512.7%	104.3	186.1	239.4	28.6%
Extraordinary (Exp) / Inc	30.6	00.0	N. A.	00.0	00.0	30.6	N. A
Adjusted PBT	98.0	11.0	800.0%	104.3	186.1	270.0	45.1%
Tax	21.0	2.0	950%	34.0	66.2	95.8	44.8%
PAT	**77.0**	**9.0**	**755.6%**	**70.3**	**119.9**	**174.1**	**45.2%**
OPM (Ex. OI)	13.6%	5.8%		9.6%	11.1%	12.25%	
Tax Rate	23.5%	36.4%		32.6%	35.6%	35.5%	
EPS (Rs)				**5.39***	**6.89**	**8.87**	**28.8%**
Dividend				26.67%*	30%	30%	

* Annualised

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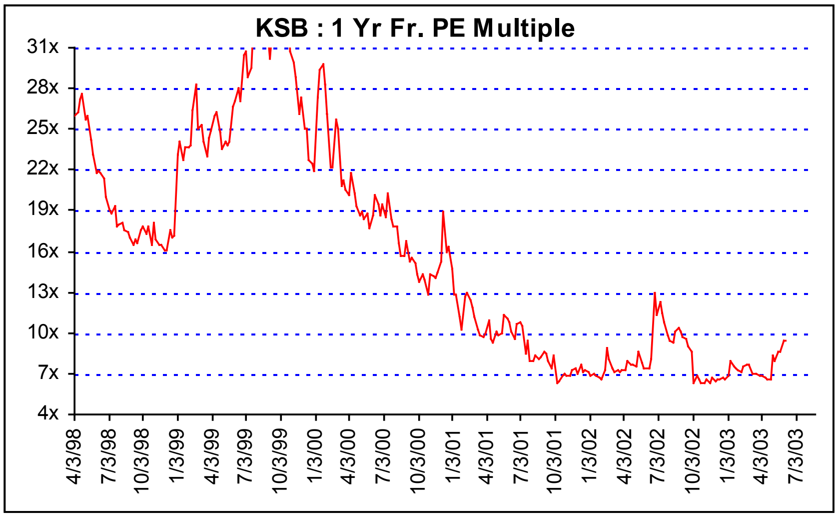

Stock Ratings		Absolute Returns
Buy	:	> 25%
Out Performer	:	16 - 25%
Market Performer	:	0 - 15%
Under Performer	:	< 0%

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