



**Chaman Lal Setia Exports (BSE Code: 530307) – Alpha/Alpha + stock  
report for Nov'16**

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## Company Snapshot (27<sup>th</sup> Nov'16)

**Rating** – Positive – 3% weightage; this is not an investment advice (refer rating interpretation), the rating is only for indicative purpose and please take your own decision regarding the same.

**CMP** – 59.95 (BSE)

**Dividend yield** – 0.73%

**BSE Code** – 530307

**Market capitalization** – Rs 310.00 cr.

**Total Equity shares** – 5.17 cr.

**Face Value** – Rs 2.00

**52 Weeks High/Low** – Rs 82.45/43.72

Particulars (in cr.)	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16
Exports	101.14	117.1	137.13	169.81	317.62	407.58	388.57
Domestic Sales	84.53	49.78	79.87	102.65	98.45	100.45	93.88
<b>Total Sales from operations</b>	<b>186.12</b>	<b>168.01</b>	<b>217.54</b>	<b>272.52</b>	<b>416.19</b>	<b>508.35</b>	<b>482.76</b>
<b>Total Cost of goods sold</b>	<b>149.62</b>	<b>130.11</b>	<b>167.09</b>	<b>213.94</b>	<b>330.66</b>	<b>401.11</b>	<b>341.01</b>
<b>Gross Profit</b>	<b>36.5</b>	<b>37.9</b>	<b>50.45</b>	<b>58.58</b>	<b>85.53</b>	<b>107.24</b>	<b>141.75</b>
<b>Gross Profit margin (%)</b>	<b>19.61%</b>	<b>22.56%</b>	<b>23.19%</b>	<b>21.50%</b>	<b>20.55%</b>	<b>21.10%</b>	<b>29.36%</b>
<b>EBITDA</b>	<b>14.25</b>	<b>13.02</b>	<b>17.35</b>	<b>23.82</b>	<b>32.25</b>	<b>36.84</b>	<b>58.56</b>
<b>EBITDA margin (%)</b>	<b>7.66%</b>	<b>7.75%</b>	<b>7.98%</b>	<b>8.74%</b>	<b>7.75%</b>	<b>7.25%</b>	<b>12.13%</b>
<b>Other Income</b>							
Interest and other income	0.46	0.25	1.21	0.68	1.06	1.01	2.47
Exchange gain/loss					1.16	1.00	2.52
<b>Depreciation</b>	<b>-1.67</b>	<b>-1.76</b>	<b>-2.19</b>	<b>-2.57</b>	<b>-2.97</b>	<b>-2.98</b>	<b>-2.87</b>
<b>Interest Cost</b>	<b>-2.79</b>	<b>-2.49</b>	<b>-5.35</b>	<b>-4.17</b>	<b>-4.34</b>	<b>-6.31</b>	<b>-3.53</b>
<b>PBT</b>	<b>10.25</b>	<b>9.02</b>	<b>11.02</b>	<b>17.76</b>	<b>27.16</b>	<b>29.56</b>	<b>57.15</b>
<b>PAT</b>	<b>6.99</b>	<b>6.02</b>	<b>7.70</b>	<b>11.98</b>	<b>18.24</b>	<b>19.5</b>	<b>37.24</b>
<b>ROAE</b>	<b>24.01%</b>	<b>18.06%</b>	<b>20.51%</b>	<b>26.06%</b>	<b>30.73%</b>	<b>26.61%</b>	<b>39.23%</b>
<b>Cash Flows from operations</b>	<b>-0.46</b>	<b>5.96</b>	<b>-1.89</b>	<b>14.28</b>	<b>-19.5</b>	<b>22.88</b>	<b>65.85</b>
<b>Net Debt</b>	<b>32.62</b>	<b>31.46</b>	<b>36.18</b>	<b>30.81</b>	<b>54.56</b>	<b>37.3</b>	<b>-25.49</b>
<b>Net Debt to equity ratio</b>	<b>1.03</b>	<b>0.90</b>	<b>0.90</b>	<b>0.59</b>	<b>0.82</b>	<b>0.47</b>	<b>0.00</b>

## Introduction

Promoted by Chaman Lal Setia, Vijay Setia and Rajeev Setia, Chaman Lal Setia Exports Limited (CLSE) was incorporated as a partnership firm in 1975, under the name Chaman Lal & Sons. In 1995, it went public under its present name to finance the expansion and modernisation of the units.

CLSE is engaged in the business of milling and processing of basmati rice. The company has a paddy unit in Karnal (Haryana) and Amritsar (Punjab) with a rice processing capacity (including both milling and sorting) of 14 tonnes per hour. The company also has a rice grading and sorting facility in Delhi.

We like the company on several fronts, though at the same time one will have to be watchful of risks/concerns as discussed in the risks/concerns section below.

As far as positives are concerned we like the way the operating performance of the company has shaped up over the years, company's increasing focus on exports, increasing focus on improving the share of branded sales under "Maharani" brand, induction of third generation promoters, high promoter holding, well managed working capital and lastly the valuations.

## Understanding Business and Company

As mentioned above, CLSE mills, processes, and trades in basmati rice in the domestic and export markets.

CLSE derives its revenue primarily from only one segment i.e. sale of rice. Besides purchasing paddy and processing at its own unit, the company is also engaged in procurement and sales of semi-processed rice. The company's product range covers raw, steamed and parboiled rice. The company also has two innovative products in its portfolio i.e. diabetic's basmati rice and pesticide-free basmati rice.

At present, the company operates rice milling units in Punjab at Amritsar and Karnal. The Karnal sheller also has a Sortex machine which incorporates state of-the-art technology for cleaning rice and removing impurities.

The company has a wide marketing network spread throughout the country and sells a whole range of basmati rice, including the premium variety, under its famous brand, 'Maharani'. Apart from this, it also exports rice under its own brand and in the form of private labels. As of date it operates with a capacity of 14 tonnes per hour.

Basmati Rice	Non Basmati Rice
<p><b>*1121</b></p> <ul style="list-style-type: none"> <li>o 1121 Steam Basmati Rice</li> <li>o 1121 White Parboiled(Sella)Basmati Rice</li> <li>o 1121 Golden Parboiled(Sella)Basmati Rice</li> <li>o 1121 Raw Old</li> </ul> <p><b>*Pusa</b></p> <ul style="list-style-type: none"> <li>o Pusa Steam Basmati Rice</li> <li>o Pusa White Parboiled(Sella)Basmati Rice</li> <li>o Pusa Golden Parboiled(Sella)Basmati Rice</li> <li>o Pusa Raw Old</li> </ul> <p><b>*1509</b></p> <ul style="list-style-type: none"> <li>o 1509 Steam Basmati Rice</li> <li>o 1509 White Parboiled(Sella)Basmati Rice</li> <li>o 1509 Golden Parboiled(Sella) Basmati Rice</li> </ul> <p><b>*Traditional Raw Basmati Rice</b></p> <ul style="list-style-type: none"> <li>o Tradition Basmati Raw Old</li> <li>o Tradition Basmati Brown</li> </ul> <p><b>*Brown Basmati Rice</b></p>	<p><b>*Sugandha</b></p> <ul style="list-style-type: none"> <li>o Sugandha Steam Rice</li> <li>o Sugandha White Parboiled(Sella)Rice</li> <li>o Sugandha Golden Parboiled(Sella)Rice</li> </ul> <p><b>*Sharbati</b></p> <ul style="list-style-type: none"> <li>o Sharbati Steam Rice</li> <li>o Sharbati White Parboiled(Sella)Rice</li> <li>o Sharbati Golden Paraboilrd(Sella)Rice</li> </ul> <p><b>*Prll</b></p> <ul style="list-style-type: none"> <li>o Prll Steam Basmati Rice</li> <li>o Prll White Parboiled(Sella)Basmati Rice</li> <li>o Prll Golden Parboiled(Sella) Basmati Rice</li> </ul> <p><b>*Sona Massouri</b></p> <ul style="list-style-type: none"> <li>o Sona Massouri Steam Basmati Rice</li> <li>o Sona Massouri Parboiled(Sella)Basmati Rice</li> <li>o Sona Massouri Golden Parboiled(Sella) Basmati Rice</li> </ul>

Source: <http://www.maharanirice.co.in/>

Chaman Lal is recognized as a star export house by the Government of India; also accredited with ISO 9001:2008, HACCP and FDA (USA) certifications.

Geographically, the company's revenues are diversified across domestic and international markets. Exports account for around 80% of the company's sales. Exports are further

diversified across the countries such as USA, UAE, Mauritius, Saudi Arabia, Malaysia, Kuwait, New Zealand, Australia and Singapore, among others. As per the management, no single country accounts for a very large share of exports as the company has been exploring markets outside the traditional Middle Eastern countries.

The company is also focused on carrying out R&D and coming out with new products. In the past the company has come out with products like: Maharani Rice with Low Glycemic Index Suitable for Diabetics and Bhatthi Sella Rice (Roasted Parboiled Rice)

Further, as per the management they have developed a novel process for reducing energy and water requirement in paddy parboiling process. As a result the water consumption and energy expenditure in mechanical parboiling of paddy has greatly reduced. The Company has also developed the novel process of recycling of most of hot water used for soaking of paddy during parboiling of rice, thereby generating little waste water and still having a high quality product.

### **Basmati Rice industry overview**

After wheat and maize, rice is the world's third principal staple food and is cultivated in more than 113 countries. Rice is one of the most crucial food crops in the world and a staple diet for nearly half the global population. Over 90% of the global rice output and consumption is centered in Asia, wherein the world's largest rice producers, China and India, are also the world's largest rice consumers.

There are two varieties of rice: Indica and Japonica. Over 40,000 sub-varieties have been derived from these two varieties. Basmati is an Indica variety.

Indica rice is long-grain rice and is usually grown in hot climate. This rice is fluffy and doesn't stick together on cooking. Japonica is a short-grain variety of rice (fat and round grain) which is mainly characterized by its unique stickiness and remains moist, which helps it to be eaten with chopsticks.

Rice can be consumed in three forms i.e. white rice, brown rice and parboiled rice. White rice is the polished rice because both the outer layers i.e. husk and bran is removed. In

brown rice only the husk is removed while the bran layer remains. Brown rice is more nutritive than white rice and has higher fiber and vitamin B content. Parboiled rice undergoes an additional process of boiling and steaming to capture the nutritive value of bran in the rice. Parboiled rice has good demand in Middle East.

**Basmati rice** – Basmati rice accounts for ~2-3% in terms of volumes of the global rice industry. India accounts for over 70% of the world's basmati rice production and the rest is accounted for by Pakistan. Basmati is unique to the region. It can be grown where precise climatic conditions, soil quality and temperature exist and this only occurs in the Indo-Gangetic area of the Himalayas. It is also legally protected as a trade name. “Basmati” is protected under “The Geographical Indications of Goods (Registration & Protection) Act, 1999” of India, which prevents any rice grown outside of the Indo Gangetic area from being called Basmati.

Basmati rice constitutes a small portion of the total rice produced in India. By volume, the share of basmati rice was around 6% in 2014-15, even as by value, basmati rice exports accounted for 57% in 2014-15 of India's total rice exports.

**PUSA 1121 - The future of Basmati** – There have been various varieties of Basmati notified under the Seed Act, 1966. PUSA 1121, which was developed in FY04, was recently in FY11 notified by the Government of India as a Basmati variety. PUSA 1121 has significantly altered the supply dynamics of the industry. PUSA 1121's share in total Basmati paddy cultivation is now more than 70% and has cannibalized other Basmati varieties and expanded the segment. PUSA 1121 has significant advantages over traditional varieties of Basmati.

Earlier, farmers preferred to grow non-basmati paddy variety due to the minimum support price (MSP) and relatively higher yield. However after the introduction of PUSA 1121 (trade term: duplicate basmati) the economics favored cultivation of basmati - as a result, the area under basmati cultivation nearly doubled in the past six years. The other approved Indian varieties include Dehradun, P3 Punjab, 386 Haryana, Kasturi (Baran, Rajasthan), Basmati 198, Basmati 217, Basmati 370, Bihar, Kasturi, Mahi Suganda, Pusa 1121, and Pusa 1509.

The government introduced the new variety, Pusa 1509, in FY14 – its yields are relatively higher and it is a short-duration crop (lowers crop cycle time by 30 days and saves 5-6 irrigations). Today, Pusa 1509 and Pusa 1121 occupy almost 85-90% of the gross sown area under basmati in the ratio of 25:75. However, Pusa 1509 has limited acceptance in the international market; therefore, it is priced at a discount to Pusa 1121.

		NON-BASMATI		BASMATI *		
			TRADITIONAL	PUSA 1121	PUSA 1509	
Yield	Quintal/acre	30	9	18	20	
Paddy Realization	Rs./kg	14.5	25	25	22	
Revenue	Rs./acre	43,500	22,500	45,000	44,000	
Cost	Rs./acre	27,720	8,840	17,680	19,294	
Profit	Rs./acre	15,780	13,660	27,320	24,706	

\*assumed mid cycle realization of Rs. 25/kg for Basmati variety

Source: Phillip Capital India Research

**PUSA 1121 leading to the creation of perfect substitutes** – Earlier certain rice processors were known for their ability to select finer quality paddy out of the traditional Basmati varieties, but that advantage is no longer relevant as most Basmati being grown is PUSA 1121. Whatever limited product differentiation existed are slowly being eroded due to increasing homogeneity of Basmati.

**Basmati exports** – Among the food grains exported from India, basmati is an important commodity. In the 1980s, most Indian basmati went to the USSR and very little was exported to other countries. However, by the end of 1980s, the export share of the USSR decreased slightly while the share of other countries, particularly to Saudi Arabia, increased substantially. Indian basmati was exported to Saudi Arabia in considerable quantities by the end of 1997-98 and USSR's share had gone down considerably by then.

India's Basmati rice exports have increased at an astounding compounded annual growth rate (CAGR) of 27% from Rs 28.24 billion in 2004-05 to Rs 275.98 billion in 2014-15.

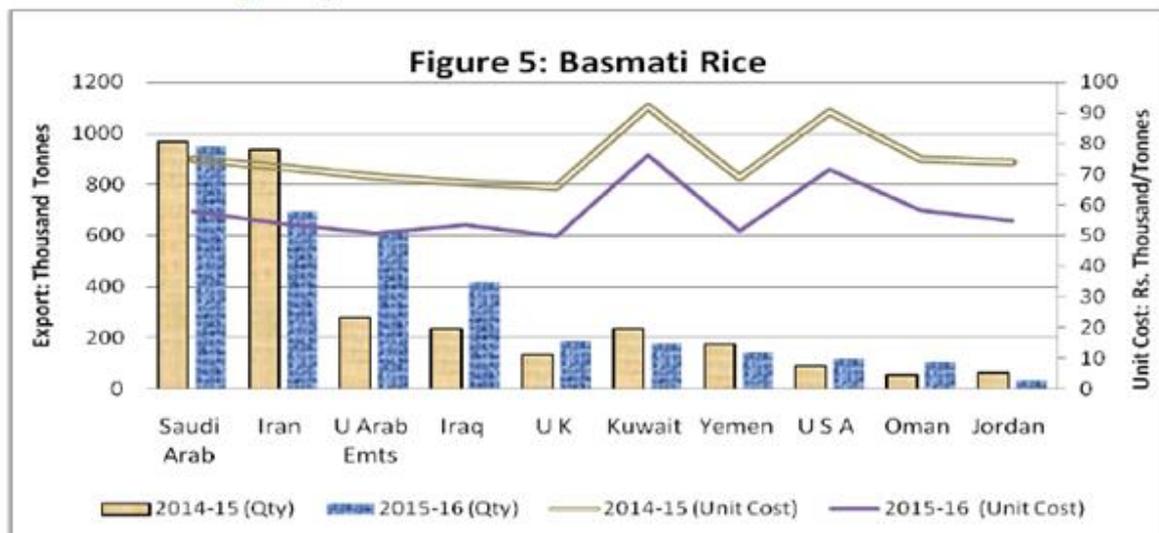
(Unit: Million Tonnes)

Year	Export		Import	
	Basmati	Non-basmati	Basmati	Non-basmati
2009-10	2.02	0.14	0	0
2010-11	2.37	0.10	0	0
2011-12	3.18	4.00	0	0
2012-13	3.50	6.64	0	0
2013-14	3.76	7.00	0	0
2014-15	3.70	8.23	0	0
2015-16	4.04	6.37	0	0
2016-17 (April to September, 2016)	2.67	3.37	0	0

Source: Department of Commerce

India exported substantial quantity of both Basmati as well as Non-basmati rice to the world, and import in the same categories were insignificant during 2009-10 and 2016-17 (up to September 2016). While basmati rice is consumed across the globe, West Asian countries account for ~75% of Indian basmati rice exports. Within West Asia, Iran and Saudi Arabia are the two largest buyers, together accounting for over 50% of basmati rice exports from India.

**India's Major Export Destinations for Basmati as well as Non-basmati Rice**



Source: Department of Commerce

Even as Iran emerged as one of the largest importers of basmati rice in recent years, the country imposed a ban on basmati rice imports from India in 2014-15, citing its own healthy rice crop and large basmati inventory; as a result Saudi Arabia has emerged as the top export destination for Indian Basmati rice.

With the opening up of new markets (Japan, Korea, and Indonesia under WTO regime) and also with the government of India removing minimum export price, the export of Indian rice has increased tremendously. China has decided to import Indian Basmati rice – this is likely to increase the demand for Indian basmati.

**Saudi Arabia has no domestic rice production** – The country depends fully on imports. Most Saudi nationals include rice as a major part of their daily diet. Most of the 10mn expatriates (from the Indian subcontinent and other Far East countries) living in Saudi Arabia (population 30.8mn, growing at 3% annually) are large consumers of rice. Basmati is the most popular rice variety in this country – Saudi Arabia imported about 1.4mmt of rice in FY15 and India remained the dominant rice supplier with its share steadily rising to 73% in FY15 from 56% in FY10.

**Domestic Basmati industry** – Basmati accounts for 75% of the branded rice market. The main growth drivers of branded rice are convenience of procuring clean rice packs from stores, rising income levels, urbanization, rise in food retail, and brand awareness. Consumption of branded rice is growing in both southern and northern India. However, grains sold in the south are generally smaller and are mainly non-basmati.

Growth in the modern retail segment boosted the branded rice market. As per industry estimates, the retail segment has been growing at 15-20% annually, and the growth rate is likely to jump to 25% by 2017. Last few years have seen many traders and millers launching their own rice brands – the latest entrant is Adani with the Fortune brand – this underscores the potential of the branded rice market in India. According to a report in ET, branded rice can command about 33% premium over loose rice at the retail level and a modern retailer can earn a 20% margin vs. 12% for loose rice.

Unbranded basmati (loose basmati) accounts for 74% of total basmati sales in the domestic market, lower than 86% in FY11 due to growing awareness – the potential to tap the conversion (consumer up trading) is still huge.

**Medium term view on Basmati rice industry** – As per ICRA basmati paddy is also vulnerable to cyclical price fluctuations. Higher prices in the market encourage higher basmati paddy cultivation, which increases supply in the next season.

This depresses the price, thereby erasing gains and shifting farmers away from basmati paddy cultivation. During the procurement season of 2012-13 and 2013-14, there was a steep rise in paddy prices from around Rs 18,000 per tonne (MT) in 2011-12 to around Rs 37,000 MT in 2013-14, due to strong demand in the international market.

Subsequently, the last two seasons were not so good due to excess supply and weak demand. Currently, the industry is under stress with weak export demand and excess supply; however, the pressure is likely to alleviate as demand picks up and cropping patterns shift away from basmati; leading to a price surge.

Domestic basmati demand has been growing at 15% in volume terms over the last five years as branded products are gaining acceptance. Going by the changing lifestyles of Indians, higher propensity to spend, convenience, and rising brand awareness; this trend should sustain. Further, with a rebound in crude oil prices and Iran lifting the import ban on rice from India; exports are also likely to improve.

### **Promoters/Management**

Chaman Lal Setia Exports is an owner operated business with Mr. Chaman Lal Setia and his sons Mr. Vijay Setia and Mr. Rajeev Setia at the helm of the affairs of the company.

Mr Vijay Setia is an Ex-President of All India Rice Exporters Association. Regd. (AIREA), Delhi and has been associated with an international company namely M/s. Gerson Lehrman Group as a consultant in the field of Food Technology for having in-depth knowledge of the subject.

The company has also seen induction of 3<sup>rd</sup> generation promoters with Mr. Ankit Setia and Mr. Sukarn Setia taking keen interest in the operations of the company.

As per one of the reports of CRISIL, with the induction of 3<sup>rd</sup> generation promoters the company has again started focusing on expansion of business and the results have paid off with opening of new export markets like Australia, New Zealand, Singapore, etc. It is also planning to increase marketing spend for its brand 'Maharani' to increase retail presence.

Overall the promoters have run the company well and much more efficiently than some of the larger listed peers.

The promoters of the company own more than 70% stake and therefore their interests are directly aligned with those of shareholders. Further, they have been continuously paying dividends since 2003.

We have also not come across any major red flags in terms of related party transactions.

### Shareholding pattern (as reported on BSE)

	28 <sup>th</sup> Oct'16	Sep'16	Jun'16
<b>Promoter and Promoter Group</b>	<b>74.82%</b>	<b>74.82%</b>	<b>74.83%</b>
India	74.82%	74.82%	74.83%
Foreign			
<b>Public</b>	<b>25.18%</b>	<b>25.18%</b>	<b>25.17%</b>
<b>Total</b>	<b>5,17,33,550</b>	<b>4,70,30,500</b>	<b>4,70,30,500</b>

As per the latest shareholding records, Promoters own 74.82% stake in the company which is just a tad bit lower than maximum they can hold as per minimum public shareholding norms.

It's important to note that in the last more than 10 years CLSE hasn't diluted equity in any major way and we like it when promoters value their stake in the company.

As on 28<sup>th</sup> Oct'16, the major shareholders of the company and their stakes are as below:

<b>Name of the shareholder</b>	<b>Category</b>	<b>% stake in CLSE</b>
<b>Promoters and PAC</b>	Promoters	74.82%
<b>Laj Capital Services</b>	Public	2.80%
<b>Sangeetha S</b>	Public	1.09%

## Chaman Lal Setia Exports – Performance Snapshot

One of the major positives of CLSE is its operating performance which has improved significantly over the years and is much better than some of its larger peers.

Particulars (in cr.)	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16
Exports	101.14	117.1	137.13	169.81	317.62	407.58	388.57
Domestic Sales	84.53	49.78	79.87	102.65	98.45	100.45	93.88
<b>Total Sales from operations</b>	<b>186.12</b>	<b>168.01</b>	<b>217.54</b>	<b>272.52</b>	<b>416.19</b>	<b>508.35</b>	<b>482.76</b>
<b>Total Cost of goods sold</b>	<b>149.62</b>	<b>130.11</b>	<b>167.09</b>	<b>213.94</b>	<b>330.66</b>	<b>401.11</b>	<b>341.01</b>
<b>Gross Profit</b>	<b>36.5</b>	<b>37.9</b>	<b>50.45</b>	<b>58.58</b>	<b>85.53</b>	<b>107.24</b>	<b>141.75</b>
<b>Gross Profit margin (%)</b>	<b>19.61%</b>	<b>22.56%</b>	<b>23.19%</b>	<b>21.50%</b>	<b>20.55%</b>	<b>21.10%</b>	<b>29.36%</b>
<b>EBITDA</b>	<b>14.25</b>	<b>13.02</b>	<b>17.35</b>	<b>23.82</b>	<b>32.25</b>	<b>36.84</b>	<b>58.56</b>
<b>EBITDA margin (%)</b>	<b>7.66%</b>	<b>7.75%</b>	<b>7.98%</b>	<b>8.74%</b>	<b>7.75%</b>	<b>7.25%</b>	<b>12.13%</b>
<b>Other Income</b>							
Interest and other income	0.46	0.25	1.21	0.68	1.06	1.01	2.47
Exchange gain/loss					1.16	1.00	2.52
<b>Depreciation</b>	<b>-1.67</b>	<b>-1.76</b>	<b>-2.19</b>	<b>-2.57</b>	<b>-2.97</b>	<b>-2.98</b>	<b>-2.87</b>
<b>Interest Cost</b>	<b>-2.79</b>	<b>-2.49</b>	<b>-5.35</b>	<b>-4.17</b>	<b>-4.34</b>	<b>-6.31</b>	<b>-3.53</b>
<b>PBT</b>	<b>10.25</b>	<b>9.02</b>	<b>11.02</b>	<b>17.76</b>	<b>27.16</b>	<b>29.56</b>	<b>57.15</b>
<b>PAT</b>	<b>6.99</b>	<b>6.02</b>	<b>7.70</b>	<b>11.98</b>	<b>18.24</b>	<b>19.5</b>	<b>37.24</b>
<b>ROAE</b>	<b>24.01%</b>	<b>18.06%</b>	<b>20.51%</b>	<b>26.06%</b>	<b>30.73%</b>	<b>26.61%</b>	<b>39.23%</b>
<b>Cash Flows from operations</b>	<b>-0.46</b>	<b>5.96</b>	<b>-1.89</b>	<b>14.28</b>	<b>-19.5</b>	<b>22.88</b>	<b>65.85</b>
<b>Net Debt</b>	<b>32.62</b>	<b>31.46</b>	<b>36.18</b>	<b>30.81</b>	<b>54.56</b>	<b>37.3</b>	<b>-25.49</b>
<b>Net Debt to equity ratio</b>	<b>1.03</b>	<b>0.90</b>	<b>0.90</b>	<b>0.59</b>	<b>0.82</b>	<b>0.47</b>	<b>0.00</b>

Processing and sale of rice is a capital intensive business; more so in the form of working capital needs due to ageing process. Ageing is necessary to (a) ensure a higher recovery of head rice and reduce the proportion of broken rice while processing, (b) remove moisture and (c) increase the aroma. Both paddy and rice are aged though there is a limit to the effectiveness of ageing paddy beyond six months. Rice can be aged for longer periods and rice aged beyond a year has a price premium but remains a niche product.

As per one of the reports there is minimal benefit of holding excess paddy inventory. The reason is that 'aged' paddy no matter whatever vintage (in terms of harvest year) is priced

the same. Consequently, if paddy is stored for more than a year then its value is determined by the next year's paddy prices. Rice processors like REI Agro, Usher Agro, etc have suffered immensely on account of holding excess inventory.

Inventory Holding Period (in Days)					
Days	FY 11	FY 12	FY 13	FY 14	FY 15
Chaman Lal Setia Exports	88	83	61	59	49
Kohinoor Foods	283	307	299	292	338
KRBL	235	274	219	193	208
LT Foods	220	194	124	132	133
Rei Agro	334	316	301	321	349

As far as CLSE is concerned, it's among the more efficient rice processors. Considering excess rice processing capacity in the country, the company hasn't expanded its capacity since long and has also focused on procurement of semi processed rice than storing excess paddy for long periods and processing it.

Average Cash Conversion cycle (in Days)					
Days	FY 11	FY 12	FY 13	FY 14	FY 15
Chaman Lal Setia Exports	126	104	89	77	79
Kohinoor Foods	321	357	331	314	382
KRBL	242	285	236	206	223
LT Foods	260	250	166	167	160

On account of the above steps, the company has spent negligible amount on CAPEX, while still has been able to grow its sales. Also, its working capital requirement and cash conversion cycle is much better in comparison to other rice processors.

With lower CAPEX and relatively lower working capital requirement, the company has much better balance sheet in comparison to its peers and there hasn't been any major dilution in equity over the last 10 years. Over the last few years the inventory days of the company have reduced from around 80-90 days to around 35-50 days. Similarly debtor days have reduced from around 120-130 days to around 60-80 days.

Important Numbers	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16
Exports	101.14	117.1	137.13	169.81	317.62	407.58	388.57
Domestic Sales	84.53	49.78	79.87	102.65	98.45	100.45	93.88
Inventory Days	73.25	88.22	83.15	60.79	59.24	48.93	37.35
Debtor Days	44.58	48.42	38.67	33.77	41.58	34.17	24.47
Cash Flows from operations	-0.46	5.96	-1.89	14.28	-19.50	22.88	65.85
ROAE%	24.01%	18.06%	20.51%	26.06%	30.73%	26.61%	39.23%
Debt to equity ratio	1.03	0.90	0.90	0.59	0.82	0.47	0.00
Net Debt	32.62	31.46	36.18	30.81	54.56	37.3	-25.49

On the growth front, despite no major CAPEX the company has been able to grow its sales at 17.5% CAGR over the last 6 years. This has been achieved on the back of growth in both volumes and realizations. In FY 16, the company reported lower sales in comparison to FY 15 despite more than 27% increase in volumes as the realizations for basmati rice declined.

What is interesting to note, that barring FY 16, from FY 10 to FY 15 the company could consistently maintain its EBITDA margins in the range of 7-9%. In FY 16, the EBITDA margins expanded to 12% + on the back of expansion in gross margins to 29% from ~20% in FY 15. We believe, lower decline in realizations against much higher decline in procurement of paddy and semi-processed rice helped the cause of margin expansion.

It remains to be seen if the company is able to sustain high gross margins of FY 16 or reverts back to previous levels of 21-22%.

As far as return ratios are concerned, the company has consistently been recording ROE and ROCE in excess of 15-20%.

## Valuations

At around current price of 60 the market capitalization of the company is Rs 310 crores and the enterprise value is ~ Rs 270 crores. The enterprise value is lower than market cap as the company is cash rich with surplus of around 40 crores as of 30<sup>th</sup> Sep'16.

For the trailing twelve months the stock has recorded PAT of Rs 37 crores and EBIT of Rs 55 crores. The stock is therefore trading at 8.38 times trailing twelve months earnings and EV/EBIT multiple of 4.90.

We believe the current valuations on absolute basis look low; however we would like to take average profitability of last 3 years as that would normalize the impact of gross margins expansion in FY 16 and H1 FY 17. Further, the last 3 years sales were in the range of 400-500 crores and therefore better indicative of performance of the company in comparison to previous years when the sales were much lower. Going forward, we expect sales to improve on the back of expected improvement in realizations of basmati rice.

The average net profit for the last 3 years is Rs 25 crores and the stock is trading at 12.4 times 3 years average PAT. In the rice processing segment, KRBL commands the highest valuations at 18 times TTM PAT; however KRBL has much bigger operations, well known brands like India Gate and also both forward and backward integrated operations.

### Dividend Policy

<b>Dividend Payout ratio</b>					
	<b>FY 12</b>	<b>FY 13</b>	<b>FY 14</b>	<b>FY 15</b>	<b>FY 16</b>
<b>Dividend Per share (in Rs.) Adjusted for split</b>	0.32	0.22	0.30	0.40	0.44
<b>Dividend Payout ratio</b>	19.56%	8.77%	7.75%	9.69%	5.55%

CLSE has been consistently paying dividends since the last 10 years and more and we believe it's a good sign considering CLSE is a very small company.

While there's no absolute stated dividend policy, since the last few years the dividend payout ratio has reduced. Prior to FY 13, the average dividend payout was in excess of 20%; however since FY 13 it's been below 10%.

We are not overly concerned about dividend payout as long as the management is efficient with capital allocation and able to deliver decent returns on retained earnings.

Also, the business is working capital intensive and we would rather like the company to fund growth through internal accruals than excess leverage.

## Risks & Concerns

CLSE derives 80% of its sales from exports. Import ban from major basmati rice importing nations like Iran, UAE, Kuwait, etc. can impact the sales and the profitability of the company.

The Middle East is the biggest export market for Indian basmati rice and accounts for over 70% of its exports. Hence, any political turmoil in this region may adversely impact India's exports.

The Indian government had banned exports of non-basmati rice in April 2008 to curb inflation and subsequently lifted this ban in September 2011. Although there has been no ban on basmati rice exports, any such policy change could significantly impact the industry.

Basmati rice commands premium over regular rice; however the pricing and branding power in the industry is still very low.

High volatility in the prices of paddy and semi-processed rice can have a negative effect on profitability for CLSE.

Despite increase in sales, profitability can remain flat or decline if the company isn't able to hold on to its gross margins of 29% reported in FY 16.

**Disclosure:** I don't have any investment in Chaman Lal Setia Exports and have not traded in the stock in the last 30 days.

Best Regards,

Ekansh Mittal

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### Rating Interpretation

Positive – Expected Absolute return of over 20%

Neutral – Expected Absolute return in the range of +/- 20%

Negative – Expected Absolute return of over -20%

% weightage – allocation in the subject stock with respect to equity investments

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