KARVY STOCK BROKING

Cement May 15, 2015

Mangalam Cement

India Research

INITIATION REPORT

Bloomberg: MGC IN
Reuters: MGLC.BO

BUY

Alluring valuations...

With the capacity expanded by over 60% to 3.25 mt in Q1FY15 (from 2 mt), Mangalam Cement (MCL) is well positioned to leverage the benefits of expected improvement in cement demand in North&Central India. Operating margin is expected to improve going ahead led by improvement in realisations and cost benefits. We expect 70% CAGR in EBITDA during FY15-17E on strong volume growth and margin improvement. The stock quotes at an attractive valuation of 4x FY17E EV/EBITDA ($48/ton). We initiate coverage on MCL with BUY and target price of Rs 330.

Capacity addition to ensure volume growth: MCL has increased its cement capacity from 2 mt to 3.25 mt in FY15 through a 1.25mt brownfield expansion at Morak (Rajasthan). The company's volume grew by 23.6% in FY15 on account of capacity expansion (vs. ~1% CAGR during FY10-14 as the cement capacity remained at 2mt during the period). MCL is further increasing its cement capacity to 3.75 mt through setting up of a grinding unit in Uttar Pradesh which is expected to be commissioned by Q1FY17E. During FY15-17E, we expect the volumes to grow by ~15% CAGR, led by gradual ramp-up of the new capacities and demand pick-up in North & Central regions.

Better market mix to support realisation growth: The company has a favourable sales-mix spread across Central and North markets of India (the North and Central regions account for 50% each of the output sale). We expect a favourable demand-supply scenario in the North and Central regions, going forward, which will help in realisation. We assume ~7% CAGR in realisation during FY15-17E.

Margins to improve significantly: On account of improvement in realisations (~7% CAGR during FY15-17E) and moderation in total cost per tonne (2.4% CAGR led by decline in total fixed cost and savings in power & fuel cost), we expect operating margins to improve significantly over FY15-17E (EBITDA/tonne expected at Rs717/t in FY17E as against from Rs329/t in FY15).

Valuation: The stock quotes at 7.1x/4.0x FY16E/FY17E EV/EBITDA. We value the company at EV/EBITDA of 5.0x, in-line with the average multiple of the last 6 years and ~35% discount to the other mid cap peers. We initiate coverage on Mangalam Cement with a Buy rating and a price target of Rs330.

Key Financials

Y/E March (Rsmn)	FY13	FY14	FY15P	FY16E	FY17E
Revenue	6,987	6,875	9,084	11,095	13,660
EBITDA	1,233	460	770	1,380	2,205
EBITDA margin (%)	17.6	6.7	8.5	12.4	16.1
Net profit	774	296	202	621	1,221
EPS (Rs)	29.0	11.1	7.6	23.3	45.7
RoE (%)	16.7	5.9	3.9	11.4	19.6
RoCE (%)	15.0	2.1	4.5	10.3	17.0
P/E (x)	8.2	21.4	31.3	10.2	5.2
EV/EBITDA (x)	5.1	15.8	12.6	7.1	4.0
EV/Tonne ($)	53	52	52	53	48

Source: Company, Karvy Stock Broking

Recommendation

CMP:	Rs237
Target Price:	Rs330
Upside (%)	40%

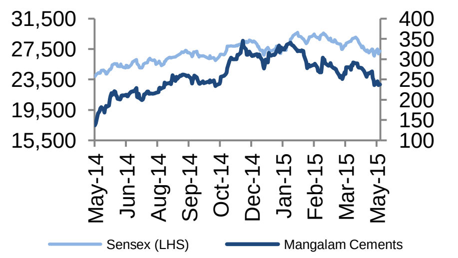
Stock Information

Market Cap. (Rs bn / US$ mn)	06/100
52-week High/Low (Rs)	354/134
3m ADV (Rs mn /US$ mn)	18/0.3
Beta	1.3
Sensex/ Nifty	27,206/8,224
Share outstanding (mn)	27

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	(17.8)	(15.6)	69.8	(23.7)
Rel. to Sensex	(12.3)	(9.8)	48.7	(22.9)

Performance



Source: Bloomberg

Analysts Contact

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Company Financial Snapshot

Profit & loss

Rsmn	FY15P	FY16E	FY17E
Net sales	9,084	11,095	13,660
EBIDTA	770	1,380	2,205
Depreciation	336	383	495
Interest Expense	383	402	385
PBT	224	776	1,526
Tax	11	155	305
Adj. PAT	202	621	1,221
EPS (Rs)	7.6	23.3	45.7
DPS (Rs)	2.0	4.0	6.0
Profit and Loss Ratios			
EBIDTA Margin %	8.5	12.4	16.1
Adj Net Margin %	2.2	5.6	8.9
Valuation Multiples			
P/E (X)	31.3	10.2	5.2
EV/EBIDTA (X)	12.6	7.1	4.0
EV/Tonne ($)	52.1	52.5	47.8

Company Background

Mangalam Cement was promoted by one of the most prominent industrialists of India, Mr B K Birla, in 1978. The company was promoted by Kesoram Industries and Cotton Mills Ltd. The company's ownership will be transferred to Vidula Jalan (maternal granddaughter of B K Birla), as per the recent will of Mr B K Birla. During FY14, the company increased its production capacity to 3.25mt from 2mt earlier. It has a 35MW thermal power plant and 13.65MW wind energy capacity at Jaisalmer, Rajasthan. Mangalam Cement is one of the most preferred brands in its marketing area and caters to the markets of Rajasthan, Delhi, Haryana, Uttar Pradesh and Madhya Pradesh. It produces and sells PPC and OPC (53 grade & 43 grade) under the brand of Birla Uttam Cement. The company has an extensive network of more than 1,150 dealers.

Balance Sheet

Rsmn	FY15P	FY16E	FY17E
Total Assets	**12,327**	**13,134**	**13,630**
Net Fixed Assets	7,874	8,441	8,147
Current Assets	3,694	3,934	4,724
Other Assets	759	759	759
Total Liabilities	**12,327**	**13,134**	**13,630**
Networth	5,210	5,705	6,738
Debt	3,647	3,547	2,847
Current Liabilities	2,856	3,268	3,430
Deferred Tax	614	614	614
Balance Sheet Ratios			
RoE %	3.9	11.4	19.6
RoCE %	4.5	10.3	17.0
Net Debt/Equity	0.6	0.6	0.4
Equity/Total Assets	0.4	0.4	0.5
P/BV (X)	1.2	1.1	0.9

Cash Flow

Rsmn	FY15P	FY16E	FY17E
PAT	179	621	1,221
Depreciation	336	383	495
Change in Wkg Cap	244	(16)	(437)
CF from Operations	**760**	**988**	**1,278**
Capex	(510)	(950)	(200)
Investments	2	-	-
CF from Investing	**(508)**	**(950)**	**(200)**
Change in Debt	(388)	(100)	(700)
Int/Dividends & others	(40)	(125)	(187)
CF from Financing	**(428)**	**(225)**	**(887)**
Change in Cash	(177)	(187)	190
Opening Cash	464	287	100
Closing Cash	287	100	290

Investment Rationale

Cement demand expected to pick-up led by revival of investment cycle; North&Central regions to benefit

We believe that the revival in India's investment cycle to drive the cement demand going forward. The government has budgeted 25.5% increase in total capital expenditure in FY16E, much higher than the 3.2% growth in revenue expenditure. The significant increase in allocation towards capital expenditure is on account of 33.8% increase in plan capex (led by 120% growth in roads/highways, 35.5% growth in urban development and 33% growth in railways).

Housing, which contributes ~60% of the total cement consumption, would remain a key demand driver. The government has also initiated "Housing for all", under which, 60mn pucca houses will be constructed by 2022 (40mn in rural and 20mn in urban areas), which will include the conversion of kuccha houses into pucca houses. Thus, on account of improvement in construction activities (from Housing & Infrastructure), cement demand is expected to pick-up going ahead.

The company sells ~50% of its cement output in the North region and ~50% in the Central region of the country. Rajasthan and Uttar Pradesh are two of the largest markets for the company (each contributes 35-40% to total sales) followed by Madhya Pradesh, Haryana and Delhi. We expect demand in the North&Central region to remain strong, led by execution of big infrastructure projects like Roads/Highways, Dedicated Freight Corridor and Metro rail projects.

Exhibit 1: Demand supply model of North region (mt)

North	FY13	FY14	FY15	FY16E	FY17E
Effective Supply	69.9	75.3	80.5	86.4	91.4
Production/Despatch	61.3	63.4	67.2	71.2	75.8
Effective Utilisation (%)	***88%***	***84%***	***84%***	***82%***	***83%***
Consumption	48.4	49.8	53.2	57.2	61.8
YoY Growth	*8.6%*	*2.8%*	*7.0%*	*7.5%*	*8.0%*

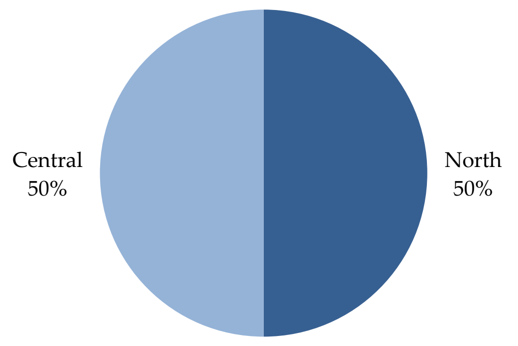
Source: Company, Karvy Institutional Research

Exhibit 2: Demand supply model of Central region (mt)

Central	FY13	FY14	FY15	FY16E	FY17E
Net Cement surplus	38.8	43.0	47.0	50.4	51.5
Production/Despatch	38.3	39.5	43.0	46.6	50.5
Effective Utilisation (%)	***99%***	***92%***	***92%***	***93%***	***98%***
Consumption	40.6	42.1	44.6	48.2	52.1
YoY Growth	*10.8%*	*3.8%*	*6.0%*	*8.0%*	*8.0%*

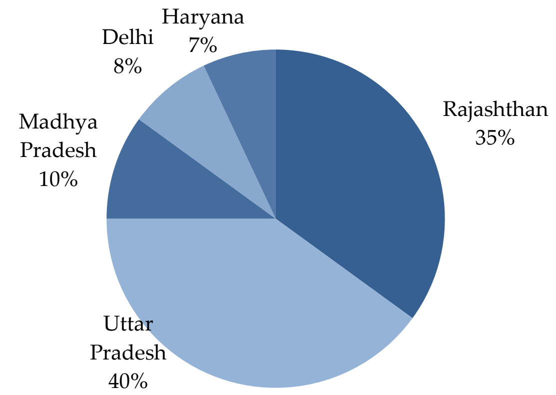
Source: Company, Karvy Stock Broking

Exhibit 3: Sales mix – region wise



Source: Karvy Stock Broking, Company

Exhibit 4: Sales mix – state wise

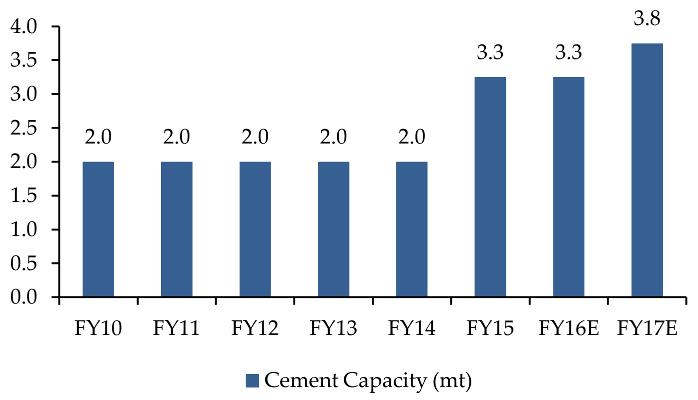


Source: Karvy Stock Broking, Company

Capacity additions to ensure volume growth

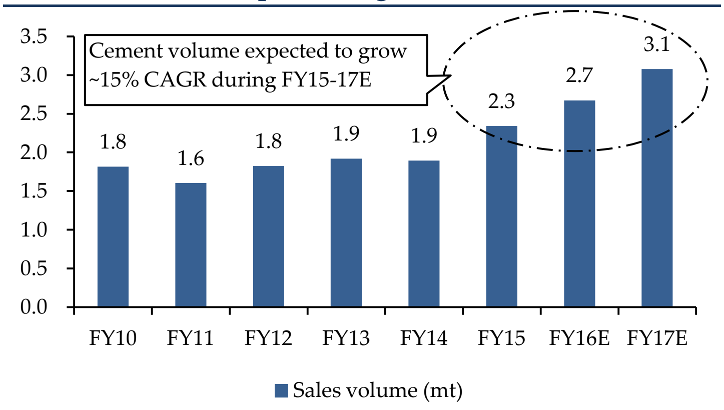
MCL has increased its cement capacity from 2 mt to 3.25 mt in FY15 through a 1.25mt brownfield expansion at Morak (Rajasthan). Correspondingly, the clinker capacity has been increased by 0.5 mt to 2.3 mt. The company's volume grew by just ~1% CAGR during FY10-14 as the cement capacity remained at 2mt during the period. The commercial production from this expanded capacity started in 1QFY15 which helped the company's volume to grow by 23.6% in FY15. MCL is further increasing its cement capacity to 3.75 mt through setting up a grinding unit at Aligarh (Uttar Pradesh) which is expected to be commissioned by Q1FY17E. During FY15-17E, we expect the volumes to grow by ~15% CAGR, led by gradual ramp-up of the Mangrol expansion (capacity utilisations to increase), Aligarh grinding unit and demand pick-up in North & Central regions.

Exhibit 5: Cement capacity to reach 3.75mt by FY17E



Source: Karvy Stock Broking, Company

Exhibit 6: Volume expected to grow ~15% CAGR

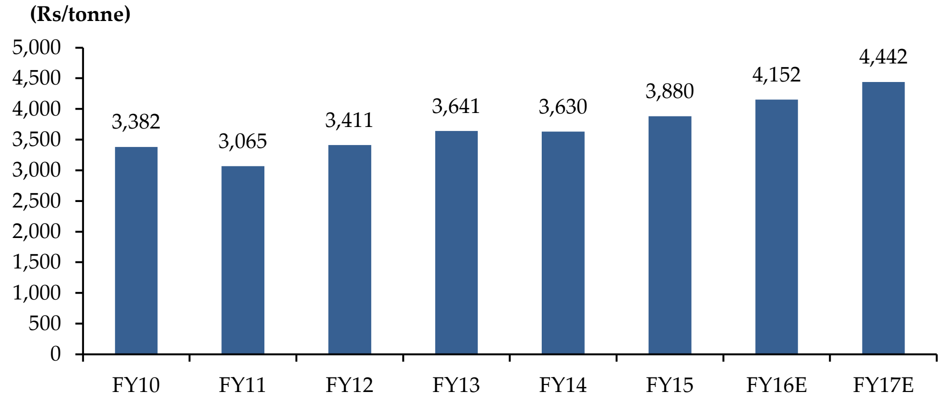


Source: Karvy Stock Broking, Company

Better realisation and cost savings to drive margins

We expect the favourable market mix of the company (North & Central regions account for 50% each of the volumes) to support realisation growth as we believe the two regions would see a gradual rise in utilisation rates over the next 3 years. We are modelling ~7% CAGR in realisation for the company over FY15-17E.

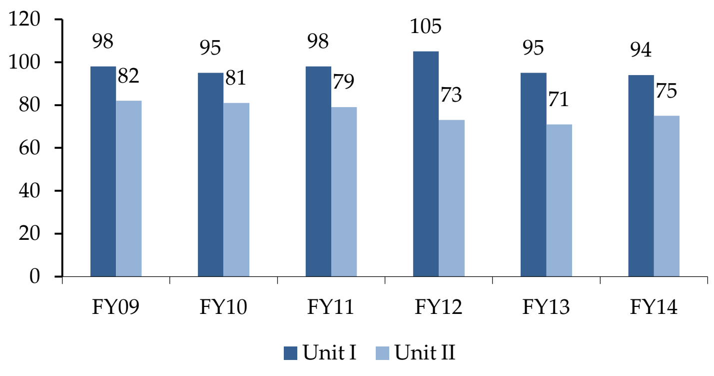
Exhibit 7: Realisation expected to improve ~7% CAGR over FY15-17E



Source: Company, Karvy Stock Broking

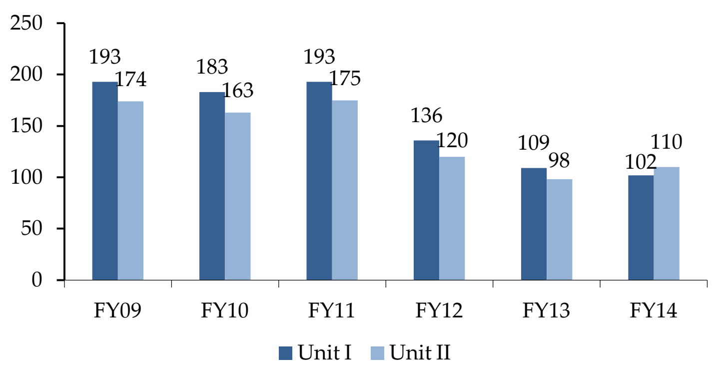
Coupled with the improvement in realisations, the total operating cost of the company is expected to increase moderately led by savings in energy cost and fixed cost (on account of operating leverage benefits). On the energy costs front, the company has been able to reduce its units consumption of power and fuel over the last few years on the back of modernisation and upgradation of clinker plant at Unit 1 (which is relatively old and has been less efficient than Unit 2). The company has captive power capacity of 48.65 MW (35 MW thermal based and 13.65 MW wind energy based) which is self sufficient for the expanded capacity of 3.25 mt. Also, the increasing usage of pet-coke (as a fuel for kiln operations) coupled with softening of the fuel prices is expected to benefit the company in total energy cost savings.

Exhibit 8: Power Consumption (Kwh per tonne of cement)



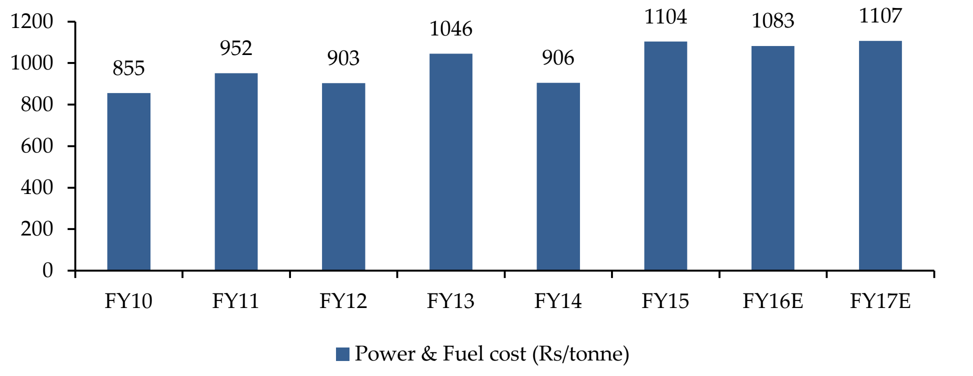
Source: Company, Karvy Stock Broking

Exhibit 9: Coal Consumption (kg per tonne of clinker)



Source: Company, Karvy Stock Broking

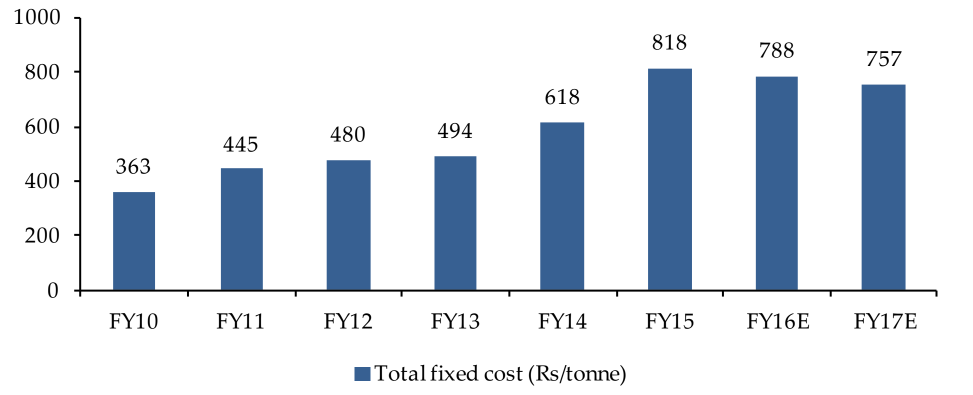
Exhibit 10: Power & Fuel cost trend



Source: Company, Karvy Stock Broking

MCL is also expected to see operating leverage benefits going ahead on account of increase in sales volumes. The total fixed cost (per tonne of cement) is expected to decline ~4% YoY each in FY16E/17E.

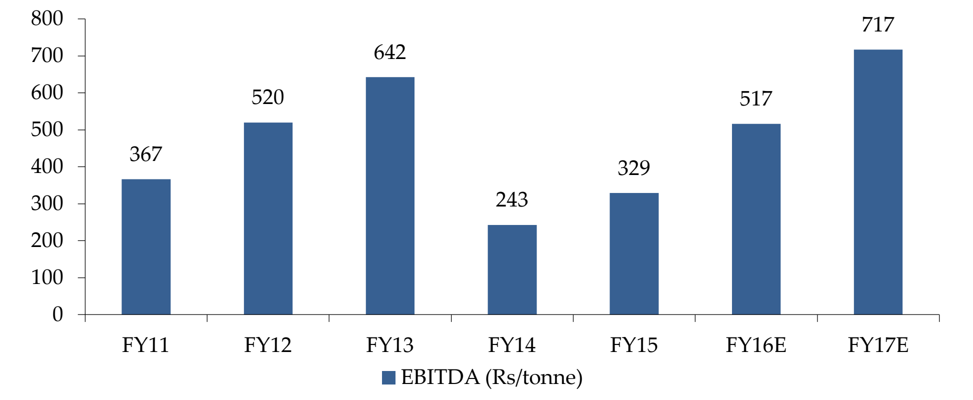
Exhibit 11: Total fixed cost trend



Source: Company, Karvy Stock Broking

Thus, on account of improvement in realisations (~7% CAGR during FY15-17E) and moderation in total cost per tonne (2.4% CAGR), we expect EBITDA/tonne to improve significantly to Rs 717/t in FY17E from Rs 329/t in FY15.

Exhibit 12: EBITDA per tonne expected to improve to Rs 717/t by FY17E



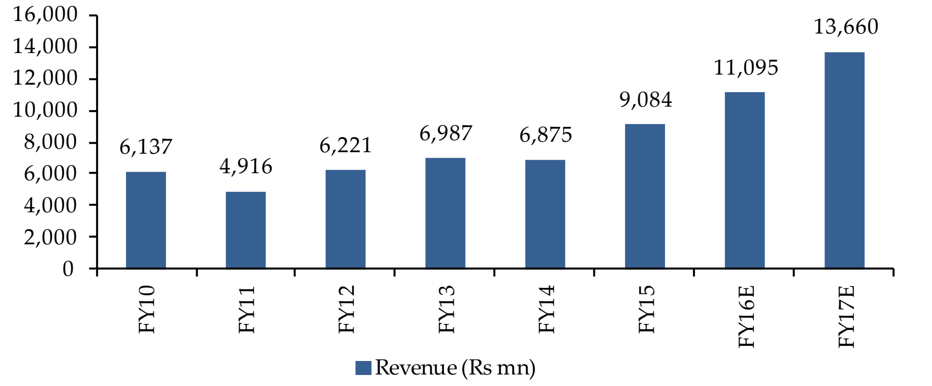
Source: Company, Karvy Stock Broking

Financial Analysis

Revenues expected to grow ~23% CAGR during FY15-17E

The net revenue of the company is expected to grow at a CAGR of 23% over FY15-17 on the back of ~15% CAGR in sales volume and ~7% CAGR in net realization.

Exhibit 13: Revenues to grow ~23% CAGR led by volume & realisation growth

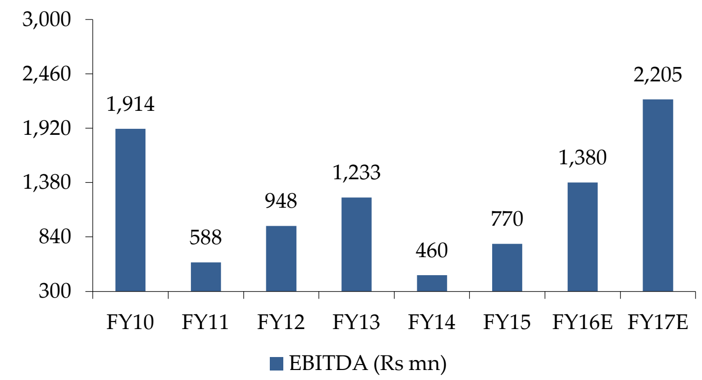


Source: Company, Karvy Stock Broking

Sharp improvement in profitability expected over FY15-17E

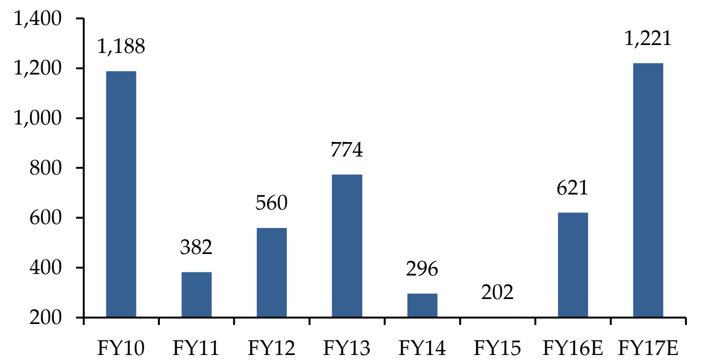
We expect EBITDA growth at ~70% CAGR over FY15-FY17E, driven by realization improvement, moderation in unit energy cost and operating leverage benefits. Net profit is expected to jump by ~6x over the period FY15-17E on account of significant improvement in operating profit.

Exhibit 14: EBITDA set to grow ~3x over FY15-17E



Source: Company, Karvy Stock Broking

Exhibit 15: PAT expected to grow ~6x over FY15-17E

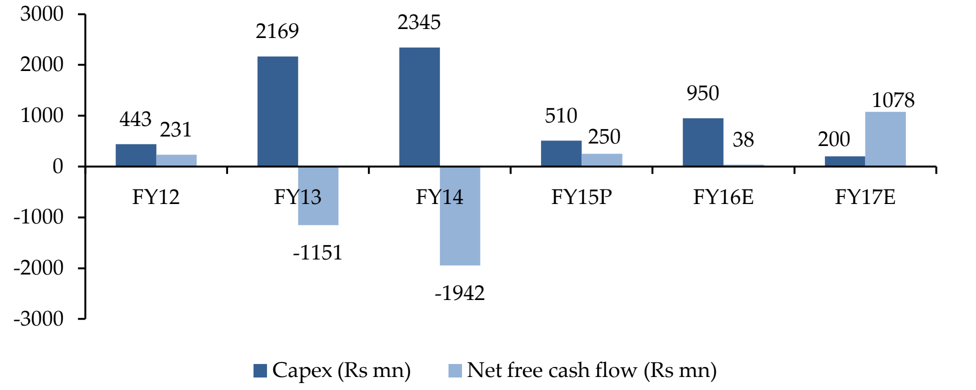


Source: Company, Karvy Stock Broking

Free cash flow positive from FY15

The free cash flow (FCF) was negative in FY13-14 due to high capex of ~Rs 4.5 bn during the period for the Morak expansion. In FY15, as the FCF came into positive as the majority of the capex was spent in FY13-14. Going ahead, the company will spend Rs 1bn during FY16-17E for Aligarh expansion. Given the sharp improvement in profitability, we expect the FCF to remain positive during the period.

Exhibit 16: Capex vs. FCF



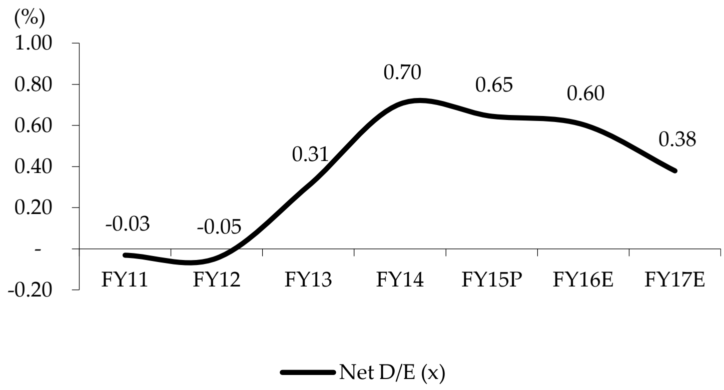
Source: Company, Karvy Stock Broking

Net D/E to improve going forward; Return ratios to improve significantly

Net debt of the company increased to Rs3.6bn in FY14 as against Rs1.5bn in FY13, primarily to fund capacity expansion. We expect Net debt to decline sharply going forward to Rs2.5bn in FY17E. Net D/E is likely to have peaked out in FY14 at 0.7x. It is expected to come down gradually to 0.38x by FY17E.

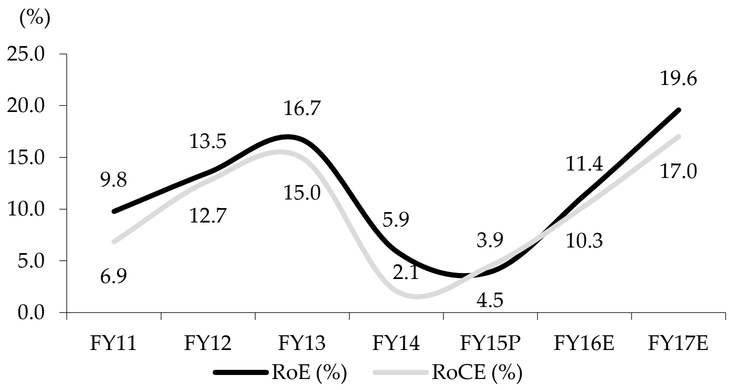
The return ratios, which declined over FY14-15, are expected to improve sharply over FY15-17E led by increase in profitability. RoE is expected to improve to ~20% by FY17 as against 3.9% in FY15. RoCE is expected to improve to ~17% by FY17E as against 4.5% in FY14.

Exhibit 17: Net debt peaked out in FY14



Source: Karvy Stock Broking, Company

Exhibit 18: Return ratios to improve



Source: Karvy Stock Broking, Company

Exhibit 19: Assumptions

	FY12	FY13	FY14	FY15	FY16E	FY17E
Sales volume (mt)	**1.8**	**1.9**	**1.9**	**2.3**	**2.7**	**3.1**
YoY Growth (%)		*5.2*	*-1.3*	*23.6*	*14.1*	*15.1*
Realisation (Rs/t)	**3411**	**3641**	**3630**	**3880**	**4152**	**4442**
YoY Growth (%)		*6.7*	*-0.3*	*6.9*	*7.0*	*7.0*
Total expenditure (Rs/t)	**2891**	**2998**	**3387**	**3551**	**3635**	**3725**
YoY Growth(%_		*3.7*	*13.0*	*4.8*	*2.4*	*2.5*
Raw materials	573	397	759	535	664	711
Power & Fuel	903	1046	906	1104	1083	1107
Freight	935	1061	1105	1095	1100	1150
Employees	177	199	225	247	238	231
Others	303	296	393	571	550	526
EBITDA (Rs/t)	**520**	**642**	**243**	**329**	**517**	**717**
YoY Growth (%)		*23.5*	*-62.2*	*35.6*	*57.0*	*38.8*

Source: Company, Karvy Stock Broking

Exhibit 20: Karvy Estimates vs. Bloomberg Consensus

Particulars	**KSBL estimates**	**BBG consensus**	***% difference***
	FY16E		
Revenue (Rsmn)	11,095	11,427	*(2.9)*
EBITDA (Rsmn)	1,380	1,575	*(12.4)*
EBITDA margin (%)	*12.4*	*13.8*	*(134bps)*
EPS (Rs)	23.3	25.4	*(8.3)*
	FY17E		
Revenue (Rsmn)	13,660	14,066	*(2.9)*
EBITDA (Rsmn)	2,205	2,290	*(3.7)*
EBITDA margin (%)	*16.1*	*16.3*	*(14bps)*
EPS (Rs)	45.7	46.2	*(1.0)*

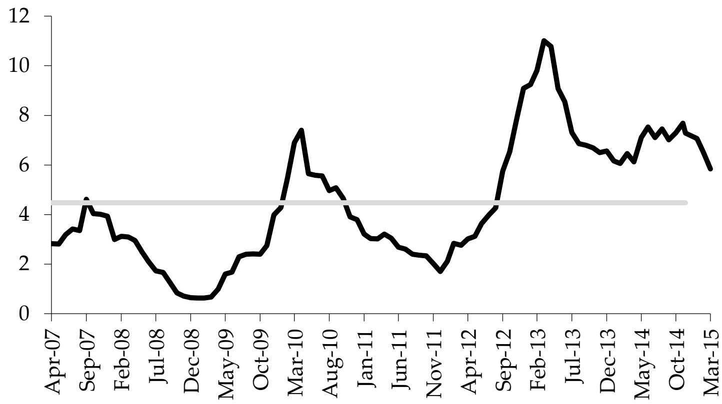
Source: Bloomberg, Karvy Stock Broking

Valuation:

The stock trades at 7.1x/4.0x EV/EBITDA on FY16E/17E against an average multiple of 5.1x in the last 6 years. On asset valuation basis, it is trading at $52/$48 per ton on FY16E/17E effective capacity of 3.1 mt (considering that maximum blending ratio of 1.35 on clinker capacity of 2.3 mt) which is steep discount to the mid cap peers and current replacement cost of $130-140/ton.

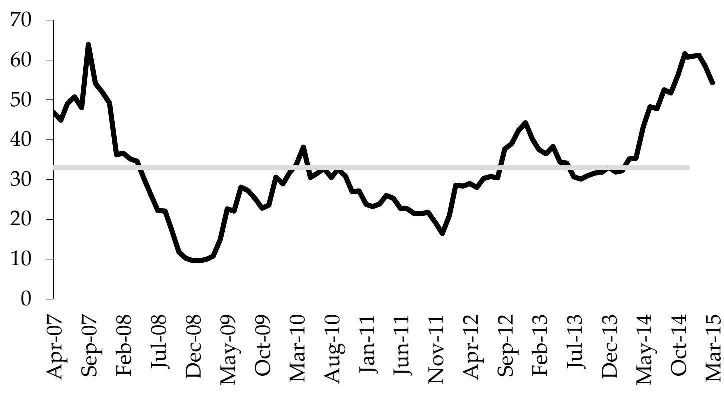
Given the sharp improvement in profitability in the next 2 years with balance sheet comfort, the valuation gap of ~40% (between other midcaps and Mangalam) should come down. We value the stock at 5x EV/EBITDA (in-line with the last 6 year average and ~35% discount to the mid cap peers) and initiate the company with target price of Rs 330 and BUY rating.

Exhibit 21: 1 yr forward EV/EBITDA (x)



Source: Company, Karvy Stock Broking

Exhibit 22: 1 yr forward EV/tonne (USD)



Source: Company, Karvy Stock Broking

Exhibit 23: Target price calculation

Target EV/EBITDA	**5.0**
EBITDA (FY17E)	2,205
Target EV	**11,026**
Net debt (FY17E)	2,199
Target Market Capital	**8,828**
No. of Shares	26.69
Target Price	**330**
CMP	237
Upside	**40%**

Source: Karvy Stock Broking, Company

Exhibit 24: Profit and Loss Statement

Y/E Mar Rs mn	FY13	FY14	FY15P	FY16E	FY17E
Revenue	6,987	6,875	9,084	11,095	13,660
% growth	12	-2	32	22	23
Operating expenditure	5,754	6,416	8,314	9,715	11,455
EBITDA	1,233	460	770	1,380	2,205
% growth	30	-63	68	79	60
Other Income	144	144	173	180	200
Depreciation	251	277	336	383	495
EBIT	1,126	326	608	1,177	1,911
Interest	48	87	383	402	385
PBT	1,078	239	224	776	1,526
Extraordinary Items	0	0	34	0	0
Tax	304	-57	11	155	305
Reported PAT	774	296	179	621	1,221
Adjusted PAT	774	296	202	621	1,221
% growth	38	-62	-32	207	97

Source: Company, Karvy Stock Broking

Exhibit 25: Balance Sheet

Y/E Mar Rs mn	FY13	FY14	FY15P	FY16E	FY17E
Cash & Cash equivalents	923	464	287	100	290
Trade receivables	302	227	288	340	407
Inventories	1,366	1,159	1,585	1,880	2,170
Loans & Advances	826	1,143	1,534	1,614	1,857
Investments	356	356	358	358	358
Fixed Assets	5,632	7,700	7,874	8,441	8,147
Other Assets	282	374	401	401	401
Total Assets	**9,687**	**11,423**	**12,327**	**13,134**	**13,630**
Current Liabilities & Provisions	1,750	1,707	2,856	3,268	3,430
Deffered tax assets (Liabilities)	584	610	614	614	614
Debt	2,431	4,036	3,647	3,547	2,847
Total Liabilities	4,764	6,353	7,117	7,429	6,891
Shareholder's equity	267	267	267	267	267
Reserves & Surplus	4,656	4,803	4,943	5,438	6,472
Shareholder's funds	4,923	5,070	5,210	5,705	6,738
Total Equity & Liabilities	**9,687**	**11,423**	**12,327**	**13,134**	**13,630**

Source: Company, Karvy Stock Broking

Exhibit 26: Cash Flow Statement

Y/E Mar Rs mn	FY13	FY14	FY15P	FY16E	FY17E
PAT	774	296	179	621	1,221
Add: Depn	251	277	336	383	495
Change in WC	-6	-170	244	-16	-437
Cash Flow from operations	**1,018**	**403**	**760**	**988**	**1,278**
Capex	-2,169	-2,345	-510	-950	-200
Change in Investments	-345	0	-2	0	0
Deffered tax Liab	-35	27	4	0	0
Cash Flow from Investing	**-2,548**	**-2,319**	**-508**	**-950**	**-200**
Change in equity	-	-	-	-	-
Change in debt	2,190	1,605	-388	-100	-700
Dividend paid	-187	-94	-62	-125	-187
Others	14	-56	23	0	0
Cash flow from financing	**2,017**	**1,456**	**-428**	**-225**	**-887**
Net cash Flow	**487**	**-460**	**-177**	**-187**	**190**
cash at the beginning	436	923	464	287	100
Cash at the end	**923**	**464**	**287**	**100**	**290**

Source: Company, Karvy Stock Broking

Exhibit 27: Key Ratios

Y/E Mar %	FY13	FY14	FY15P	FY16E	FY17E
EBITDA margin	17.6	6.7	8.5	12.4	16.1
EBIT margin	16.1	4.7	6.7	10.6	14.0
Net profit margin	11.1	4.3	2.2	5.6	8.9
Dividend payout ratio	20.7	27.0	26.4	17.2	13.1
Net debt/equity	0.31	0.70	0.65	0.60	0.38
Interest/EBIT	0.0	0.3	0.6	0.3	0.2
RoCE	15.0	2.1	4.5	10.3	17.0
RoE	16.7	5.9	3.9	11.4	19.6

Source: Company, Karvy Stock Broking

Exhibit 28: Valuation Parameters

Y/E Mar	FY13	FY14	FY15P	FY16E	FY17E
EPS (Rs)	29.0	11.1	7.6	23.3	45.7
DPS (Rs)	6.0	3.0	2.0	4.0	6.0
BVPS (Rs)	184.4	189.9	195.2	213.7	252.4
P/E (x)	8.2	21.4	31.3	10.2	5.2
EV/EBITDA (x)	5.1	15.8	12.6	7.1	4.0
P/BV (x)	1.3	1.2	1.2	1.1	0.9
EV/Tonne (USD)	53	52	52	53	48

Source: Company, Karvy Stock Broking

Stock Ratings		Absolute Returns
Buy	:	> 15%
Hold	:	5-15%
Sell	:	< 5%

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Disclosures Appendix

Analyst certification

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