INITIATING COVERAGE REPORT

OCTOBER 9, 2020

Dalmia Bharat Ltd.

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Dalmia Bharat Ltd.

Sector: Cement

9th October 2020

Brief Overview

CMP (INR) (As on 8th Oct 2020)	764
Target (INR)	1010
Upside (%)	32
Recommendation	**STRONG BUY**

BSE Code	542216
NSE Code	DALBHARAT
Reuters Ticker	DALB.NS
Bloomberg Ticker	DBEL.IN

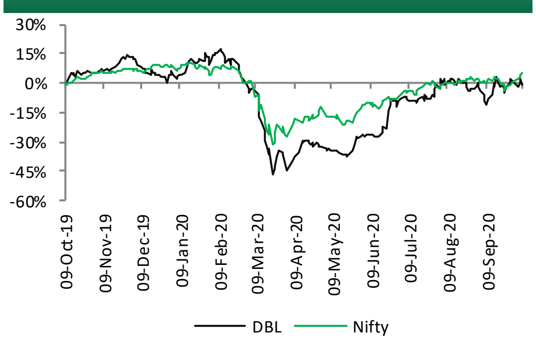
Stock Scan

Market cap (INR Cr.)	14276
Outstanding Shares Post Buyback (Cr.)	18.7
Face Value (INR)	2.00
Dividend Yield(%)	0.41
TTM P/E (x)	54.6
Industry P/E (x)	28.30
Debt/Equity (x)	0.56
Beta vs. Sensex	0.89
52 Week High/ Low (INR)	918/406
Avg. Daily Volume (NSE)/1yr	22198

Shareholding Pattern (%)

	June-2020	Mar-2020	Dec-2019
Promoters	55.81	54.28	54.26
Institutions	18.10	20.85	20.56
Non-Institution	26.09	24.87	25.18

Stock vs. Nifty (Relative Returns)



Source: NSE

Dalmia Bharat Ltd .

We initiate a coverage on Dalmia Bharat Ltd (DBL) with a **"STRONG BUY"** rating. Company is the fifth-largest cement player in India with current cement capacity of 26.5 Million Metric Tonnes (MMT) and power capacity of 195 MW. Furthermore, **DBL is in the process of expanding its present capacity by ~40% from 26.5 MMT to 37.3 MMT, with exposure across South, East, North East and West.** With access to 22 states, it has gradually elevated from the stature of a regional player. The company has undertaken steady expansion at an economical cost of ~$70/ tonne, lower compared to the replacement cost of setting up a new plant. **DBL has been generating healthy cash flows, helping the company to de-leverage the balance sheet, execute acquisitions, expansions and implementing buyback (recently completed a buy back of Rs 3.28 billion). We expect company is well-poised for a re-rating given growth visibility, improving balance sheet and attractive valuation.** Our key investment thesis are as follows.

- **Capacity expansion to drive growth & further strengthen its market presence:** DBL has pursued aggressive brownfield, greenfield & both organic & in-organic capacity expansions along with a focus on regions where it can attain a higher market share. Company is spending Rs 36– 38 billion cumulatively on the expansion of projects. The majority of these expansions are taking place (7.8 MMT) in the eastern region where the company has a good market position coupled with the acquisition of Murali Industries will allows the company to enter into western Maharashtra market.

- **Cost efficient cement producer:** DBL is among lowest cost cement producer and enjoys superior profitability due to (1) Higher blending & cement-to-clinker ratio (2) modernisation and upgradation of plants leading to industry-leading lower electricity consumption (3) Increased usage of alternate fuels like pet coke. Operating efficiency provides the company a significant cost advantage vs. peers in the environment of subdued demand, lower utilisations and rising costs.

- **Improving Financials:** Strong operating cash flows is expected to drive strong free cash flow (FCF) and reduce net debt from Rs 28 billion at the end of FY20 to Rs 16 billion in FY22E. In the absence of new projects, we expect company to become debt-free (net debt level) in FY23E.

We have valued the company assigning equal weightage to 8x FY22E consolidated EV/ EBITDA and assuming a replacement cost of USD75x FY22E EV/Tonne to arrive at target price of Rs 1010 per share.

Financial Performance at a glance (Consolidated)

Particulars (Rs Mn)	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	94840.0	96740.0	92475.4	111421.8	132853.9
Growth %	10.5%	2.0%	-4.4%	20.5%	19.2%
EBITDA	19420.0	21060.0	22748.6	27028.9	32048.4
EBITDA Margin (%)	20.5%	21.8%	24.6%	24.3%	24.1%
Net Profit	3080.0	2240.0	5155.2	7455.6	10524.2
Net Profit Margin (%)	3.2%	2.3%	5.6%	6.7%	7.9%
EPS	16.0	11.6	27.6	39.9	56.3
BVPS	551.7	548.6	574.1	611.4	665.3
P / E (x)	50.1	60.2	27.7	19.1	13.6
P / BV (x)	1.4	1.3	1.3	1.3	1.1
ROE (%)	2.9%	2.1%	4.8%	6.6%	8.5%
ROCE(%)	3.9%	3.5%	6.2%	8.1%	10.2%
ROCE (%) Ex Goodwill	9.6%	9.2%	11.6%	13.6%	15.7%
EV/EBITDA (x)	9.1	7.2	6.9	5.5	4.2
EV/Ton ($)	88.5	76.1	78.9	56.6	47.8

Source: Company Data, SMIFS Research

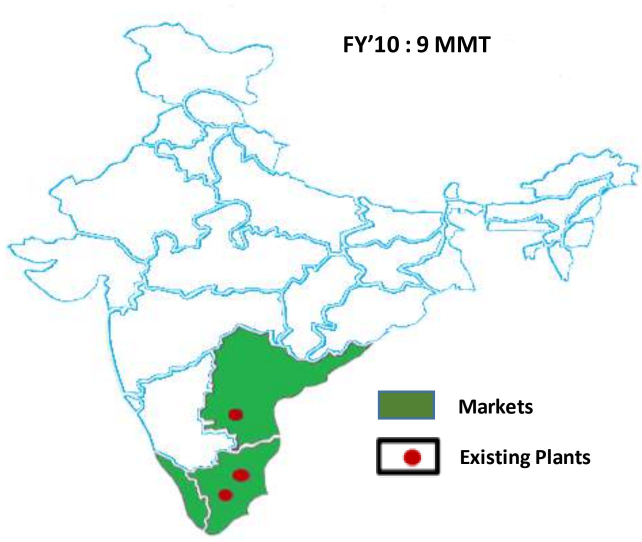
Investment Rationale

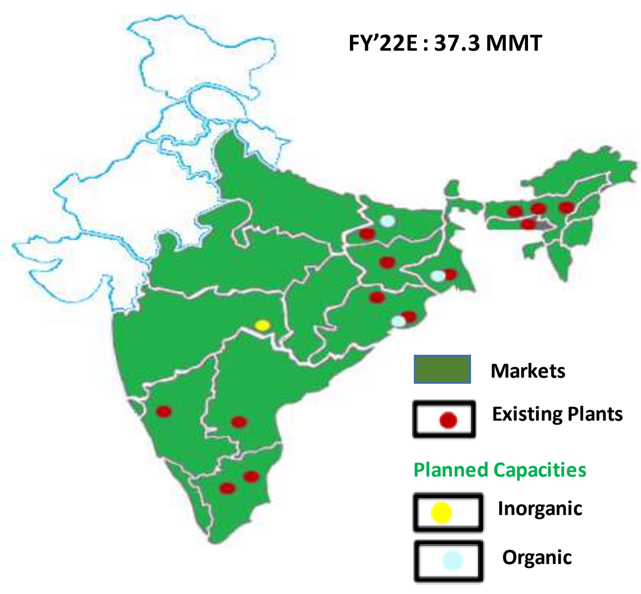
Capacity expansion to drive growth & further strengthen its market presence

DBL is probably the best growth story in the cement space in India. Company has expanded its cement capacity from 1.2 MMT in FY06 to current 26.5 MMT cement capacity, placing it among the top five players in the cement industry in India. DBL's cement capacity is well diversified with ~46% in the Southern region, ~39% in the East and balance in North- East which helps the company to relatively insulate from regional demand supply fluctuations. ***Furthermore, the company is having strong presence in its key markets with a 7% capacity share in Southern region, 13% in the Eastern region and 25% in North- East region. Moreover, DBL's sales volume grew at a CAGR of 8% over FY17-20, outperforming the cement industry that grew at a CAGR of 6% during the same period.***

DBL has pursued aggressive brownfield, greenfield & both organic & in-organic capacity expansions along with a focus on regions where it can attain a higher market share. Furthermore, DBL is in the process of expanding its present capacity by 40% (including acquisition of Murali Industries 3 MMT awarded under NCLT proceedings) from 26.5 MMT to 37.3 MMT, with exposure across South, East, North East and West. The company is spending Rs 36– 38 billion cumulatively on these expansion projects. Majority of these expansions are taking place (7.8 MMT) in the eastern region where the company has a good market position coupled with acquisition of Murali Industries will allow the company to enter the western Maharashtra market where currently company has no operating facility. A 3.0 MMT clinker line at Rajgangpur (Odisha) is undergoing trial runs and is expected to be commissioned in Q3FY21 which will help the company in meeting its clinker requirement.

DBL's addressable markets have increased to almost 20 states in the last decade





Source: Company, SMIFS Research

We believe that utilizations have bottomed out at current levels in South India, given that capacity addition in the region is expected to be minimal over FY20-FY22E. After a prolonged slowdown, cement demand in South India is expected to revive gradually on the back of an expected recovery in infrastructure development and incremental demand arising from Government spending in Andhra Pradesh & Telangana. With ~46% of the company's capacities concentrated in South India, DBL is well placed to benefit from an expected uptick in demand.

Investment Rationale

Moreover, cement demand in the Eastern India has been growing at a CAGR of 9% since FY10.We expect cement demand in FY21E to be estimated at ~76 MMT and ~85 MMT in FY22E in the region while Incremental demand from FY21E - FY23E to be around 9 MMT. Bihar and Odisha continue to witness strong demand from rural housing and the government's focus on infrastructure projects. With the expected commissioning of capacities in the East, we expect that the company will be in a position to benefit from increased demand in the eastern India.

Capacity Details for DBL, FY2019-23E

Region	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Cement (MMT)					
East & North East	13.3	14.4	14.4	22.2	22.2
South	12.1	12.1	12.1	12.1	12.1
West	—	—	—	3	3
Total Cement	**25.4**	**26.5**	**26.5**	**37.3**	**37.3**
Clinker (MMT)					
East & North East	8.1	8.8	8.8	8.8	8.8
South	8.0	8.0	8.0	8.0	8.0
West	—	—	1.7	1.7	1.7
Total Clinker	**16.1**	**16.8**	**18.5**	**18.5**	**18.5**
Cement (% mix)					
East & North East	52%	54%	54%	60%	60%
South	48%	46%	46%	32%	32%
West				8%	8%
Clinker (% mix)					
East & North East	50%	52%	48%	48%	48%
South	50%	48%	43%	43%	43%
West			9%	9%	9%

Source: Company, SMIFS Research

Acquisition of Murli Industries will facilitate DBL's entry into western Maharashtra market

DBL has completed the acquisition of Murli Industries having an integrated 3 MMT cement capacity. The plant is situated in Chandrapur district of Maharashtra and has commercial proximity to three more states – Telangana, Madhya Pradesh and Chhattisgarh. The company will pay Rs 400 crores for secured/unsecured financial and operational creditors, IRP costs, employees' dues and statutory dues payable in the phased manner. Additionally, company needs to incur capex of Rs 350-400 crores on restarting the operations at the Murli Industries plant.

Progressing well on turnaround of Kalyanpur Cements

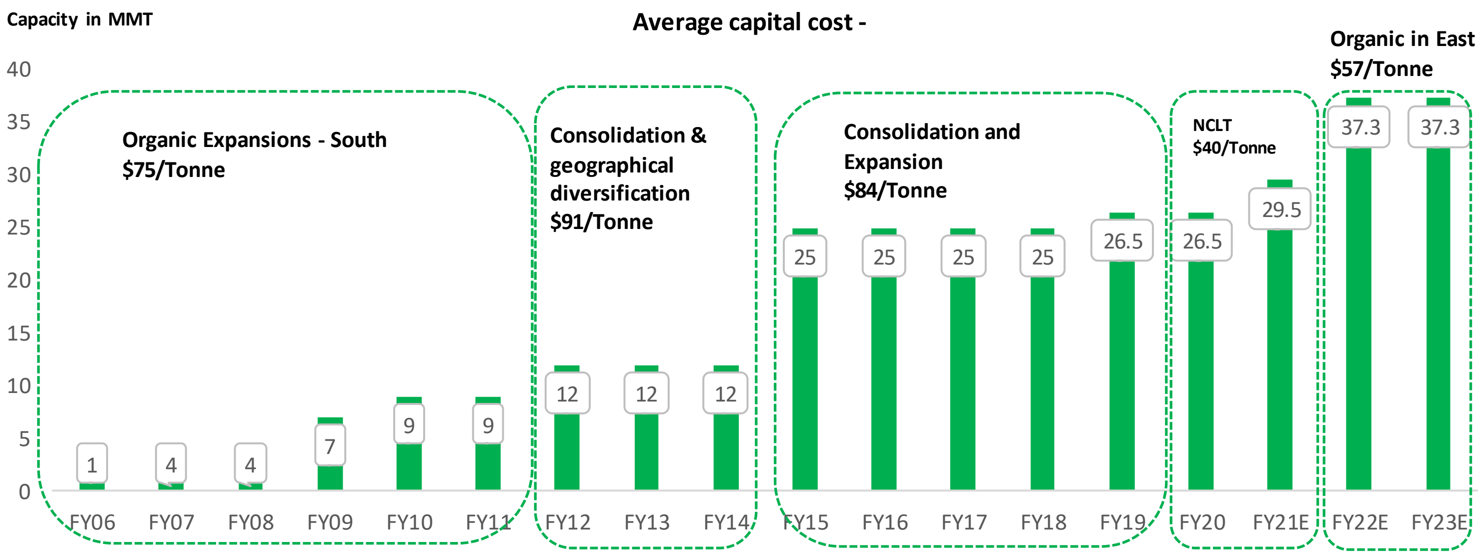
DBL acquired Kalyanpur Cements in April 2019 through the NCLT process. DBL had outlined a detailed plan to revive the sick unit . The ordering of major capital equipment was completed within the first 45 days of the acquisition. The cement grinding and packing unit became operational within the next 45 days. Kiln productivity was enhanced by 475 TPD to 1,550 TPD. The modification in the coal mill and firing system helped the unit run on pet coke. DBL plans to enhance clinker production from 1,550 TPD to 2,400 TPD in the next phase.

Investment Rationale

Efficient deployment of capital

DBL has followed a zonal approach in creating capacity and acquiring companies. The current footprint of the company is largely based in eastern and southern regions. While a large part of capacity in the southern region has grown organically, most of the capacity in eastern region came up through the inorganic route. Around 50% of existing capacity of DBL was created through acquisitions. The average cost of acquisition and capex for a new plant of DBL has been around US$70/tonne which is lower than average cost of setting up of new capacity for the industry.

DBL has added capacity at an average cost of US$70/tonne with a mix of organic and inorganic expansions



Source: Company, SMIFS Research

Below are the timeline of past key acquisitions and capacity creation by DBL

<u>Acquisition of OCL India:</u> DBL acquired 21.7% stake in OCL India in October 2007. DBL progressively raised its stake to 45.4% in 2010 to 48% in FY2014 and 74.6% in FY2015 (owning the entire promoter shareholding). DBL became a single cement entity of the group with a very simplified structure after the amalgamation of OCL India with DBL In November 2016.

<u>Acquisition of Calcom Cement (North East):</u> DBL acquired a 50% stake in Assam-based Calcom Cement in January 2012, increasing its stake to 75.6% in November 2012. At the time of the acquisition, Calcom's grinding and clinker capacity was 1.3 MMT and 0.3 MT respectively, which was subsequently expanded to 2.1 MMT of grinding and 1.3 MMT of clinker capacity.

<u>Acquisition of Adhunik Cement (North East):</u> DBL acquired the Meghalaya-based Adhunik Cement (1.5 MMT capacity) in September 2012.

<u>Acquisition of Dalmia Cement East Limited (erstwhile Bokaro Jaypee Cement Limited) (East):</u> DBL acquired a 100% stake (in two stages) in Bokaro Jaypee Cement (2.1 MMT split grinding unit) from Jaiprakash Associates in 2014 (with a 30- year slag and clinker supply agreement). The acquisition enabled the company to extend deeper into the growing markets of Bihar and Jharkhand.

Investment Rationale

Cost efficient cement producer

DBL is one of the most cost efficient cement producer in India. The company's operating cost/tonne of around Rs 3923 for FY20, is among the lowest in the industry. This is due to (1) increased use of blended cement to its overall production (2) low power and freight costs – which account for ~40-45% of overall costs for cement companies.

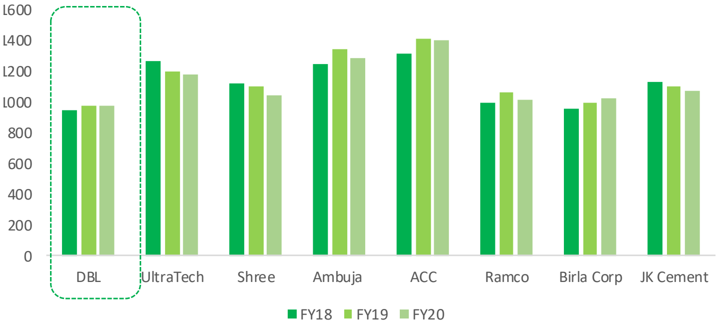
Blended Cement - DBL increased the proportion of blended cement in its overall product mix to >70% in FY20.Blended cement is not only more environmentally friendly over the usual cement varieties, but it also improves operating costs as the clinker factor in total output reduces. Moreover, blended cement uses waste products like fly ash and slag which are considered environmental hazards. ***Slag is the waste produced by steel plants and its use in cement has been as a cost-effective additive which helps in conservation of limestone reserves***. Fly ash is the waste produced by coal-based power plants; its increasing use in cement manufacture has helped in doing away with environmental problems in its disposal. DBL enhanced the use of fly ash and slag in cement substantially as compared to its historical benchmarks. DBL also moderated the consumption of power in the manufacture of cement.

The proportion of slag increased from around 55% a couple of years ago to 62% of the total volume of PSC manufactured. The company continues to optimise the fixed and variable costs through a low-cost fuel mix, increasing the share of alternative fuels, moderating cost centres and encouraging the use of lateral alternatives.

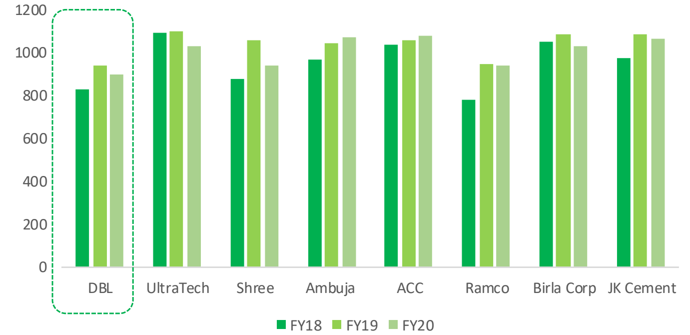
Power cost- ***DBL reduced power consumption per tonne of cement manufactured from 74 units in FY14 to 69.3 units in FY20, establishing a new benchmark in the Indian cement industry.*** The plants of DBL are equipped with multi fuel inputs, making them flexible when it comes to using different fuels, depending on their price. The current fuel mix of the company stands at Petcoke 65%, Coal 20%, AFR (Alternate fuel) 6%, and Lignite 9%. The company aims to increase the use of alternate fuel to 20% in a few years' time which will make it a more cost efficient producer of cement. **By 2030 the company aims to become a 100% green energy company.**

Freight cost: Company's units are strategically located in close proximity to end user markets. Since the company has an overall cement – clinker (CC) ratio of ~1.6x, it is much more economical to transport 1MT clinker to grinding units and then transport 1.6MT cement to nearby locations than to transport 1.6MT cement to longer distant markets. Furthermore, DBL is putting all efforts to largely shrink the lead distances (300 Km) to optimise the logistics cost through various systemic process to logistics movement on the back of loading confirmation, auto invoice creation and driver tracking, reduced the plant turnaround time and improved security.

Freight Cost per tonne lowest in the Industry



Power & Fuel Cost per tonne among the lowest in the Industry



Source: Company, SMIFS Research

Investment Rationale

Moreover, DBL has been able to reduce its operating costs over the past four years. Part of the decline can be contributed to:

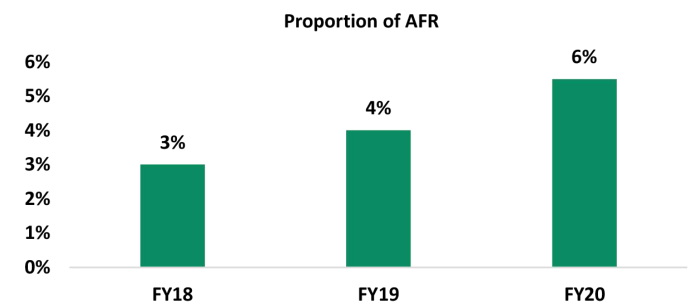
⇒ Higher production from new plants (most DBL plants are modern plants with higher efficiency)

⇒ Higher blending ratio and higher cement-to-clinker ratio

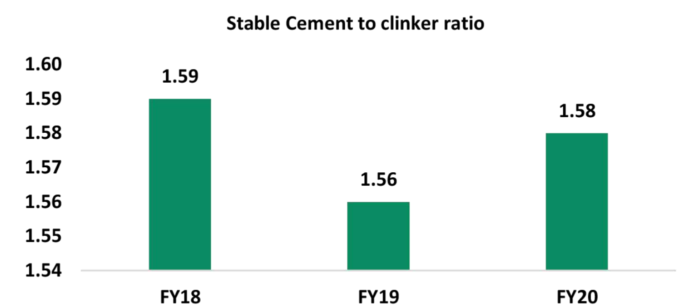
⇒ Modernisation and upgradation of plants leading to industry-leading lower electricity consumption and specific heat consumption

⇒ Increased usage of alternate fuels like pet coke.

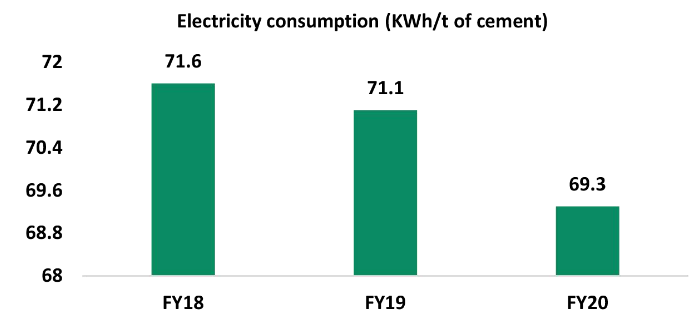
Thermal substitution rate



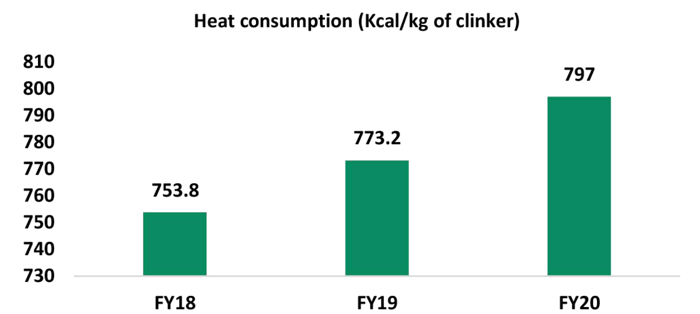
Stable Cement to clinker ratio



Electricity consumption per tonne of cement decreasing



However, heat consumption per tonne of clinker has been on a rise



Source: Company, SMIFS Research

Investment Rationale

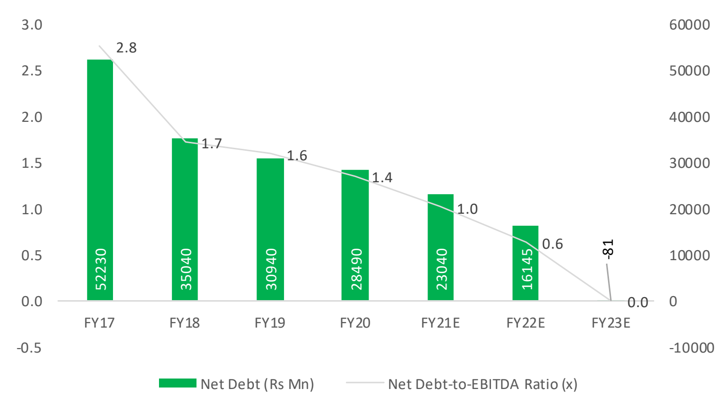
Free cash flow to ensure debt reduction

DBL has increased its cement capacity from 7 MMT to 26.5 MMT over last 10 years. As a result of this aggressive increase in capacity, debt levels of the company has increased over last few years. We expect over the next 2-3 years with increased capacity utilisation, cost leadership and better pricing in key markets should help the company in reduction of debt. Company refinanced its debt to not only reduce interest costs but also increase the debt tenure to improve liquidity. Longer tenure enhances free cash availability in the initial years when capacity utilisation is usually lower for new capacities.

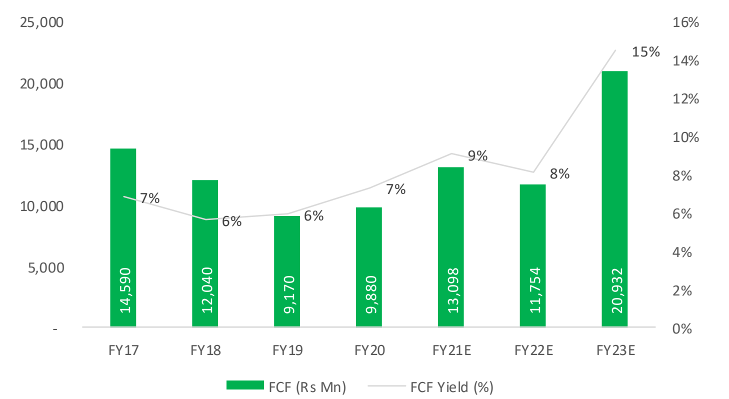
The company spent Rs 1,437 crores in FY20 on the project currently under implementation and expected to spend another Rs 1,150-1200 crores in FY21. DBL's 7.8 MMT organic expansions would complete in FY2022E with (1) 3 MMT clinker line in the East is expected to commission in October 2020, (2) 3.3 MMT grinding units in Jharkhand and West Bengal expected to commission by December 2020, (3) Odisha 2.25 MMT grinding unit to be completed by March 2020 and (4) Bihar 2.25 MMT grinding unit to commission in H2FY22.

DBL would be spending Rs 2,200-2,500 crores in FY2021-22E towards expansion. During Q1FY21, the company repaid Rs 500 crores of debt and plans repay Rs 1200 crores over the next 2 years. We expect strong operating cash flows would drive strong FCF which would help in reduction of net debt from Rs 2849 crores in FY20 to Rs 1615 crores in FY22E. In absence of new expansion plan, company is expected to become debt-free (net debt level) in FY2023E.

Leverage remains under control despite growth capex



DBL generates positive FCF despite high capex



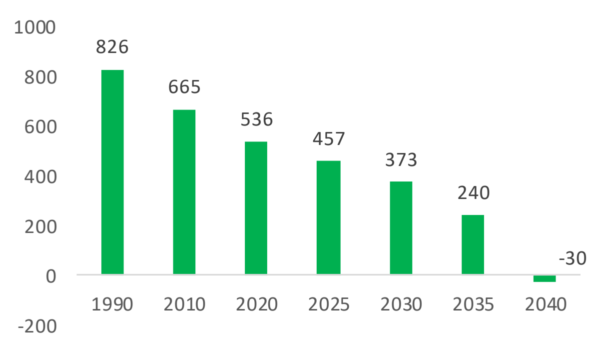
Source: Company Data, SMIFS Research

Investment Rationale

DBL is working on exiting non-core investments				
Treasury break-up of DBL	**FY17**	**FY18**	**FY19**	**FY20**
Investments				
Equity (quoted)				
IEX	3970	4860	5000	3840
Ramco		380	380	
Poddar Pigment	10	10	10	
Reliance Industries	50	20		
Corporate bonds (quoted)		2180	5990	9580
Commercial papers (unquoted)			1390	
MF (debt based schemes)	20710	21770	5160	8880
Certificate of deposits (quoted)				740
Other (unquoted)	1320	4860	5220	3940
Total - (Rs mn)	**26060**	**34080**	**23150**	**26980**

Source: Company Data, SMIFS Research

DBL aims to become carbon negative by 2040



Source: Company Data, SMIFS Research

IEX divestment and resolution of mutual fund case has strong re-rating potential

Company's FY20 annual report shows that it has moved its treasury investments towards high-rated quoted securities and also exited a few non-core equity investments. The company has completed a buyback of 6.16 mn equity shares for an aggregate amount of Rs 328 crores to reduce treasury. Furthermore, the strategy on IEX (10% of equity in IEX with current market value Rs 646 crores) would be finalized in March'21. As of now, this is at internal discussion stage and nothing has been finalized.

During FY19, certain mutual fund units appearing as current investments, valued at Rs. 381 crores as on 30th June, 2020, were illegally and fraudulently transferred by one of the Depository Participant using forged documents of DCBL's authorization in NSDL. Management is putting all its effort to get back its securities. Measures taken by the company as follows-

⇒ DBL had filed a criminal complaint with the Economic Offences Wing (EOW). Based on the complaint and after conducting a preliminary enquiry, EOW, Delhi directed the Clearing Agent of DP (i.e. ISSL) not to deal with the Securities and also freezed all such Securities till further orders.

⇒ The company also reported to National Securities Depository Ltd (NSDL), National Stock Exchange (NSE) and Securities and Exchange Board of India (SEBI).

Moreover, auditors have not forced the company to write-off its investment as it can weaken the case of the company. Management remains confident of arriving at a resolution in due course.

However, post mutual fund fiasco, the company has implemented stricter internal controls, including periodic review of treasury investment and regular monitoring of consolidated account statement (CAS) received from NSDL/CDSL.

Focus on sustainability is impressive-

DBL has one of the lowest carbon footprints among its peers globally (CO_2 emission kg/ton) of 536 versus India average of 550. DBL aims to turn carbon-negative by 2040, by avoiding 100% thermal power by 2030 and ***replacing it with renewable energy. The focus would be on using solar, wind, and WHRS power, and the company has already started exploring the possibility of putting up a solar power plant.*** Cement/clinker ratio of 1.6X is among the highest in India.

Industry Overview

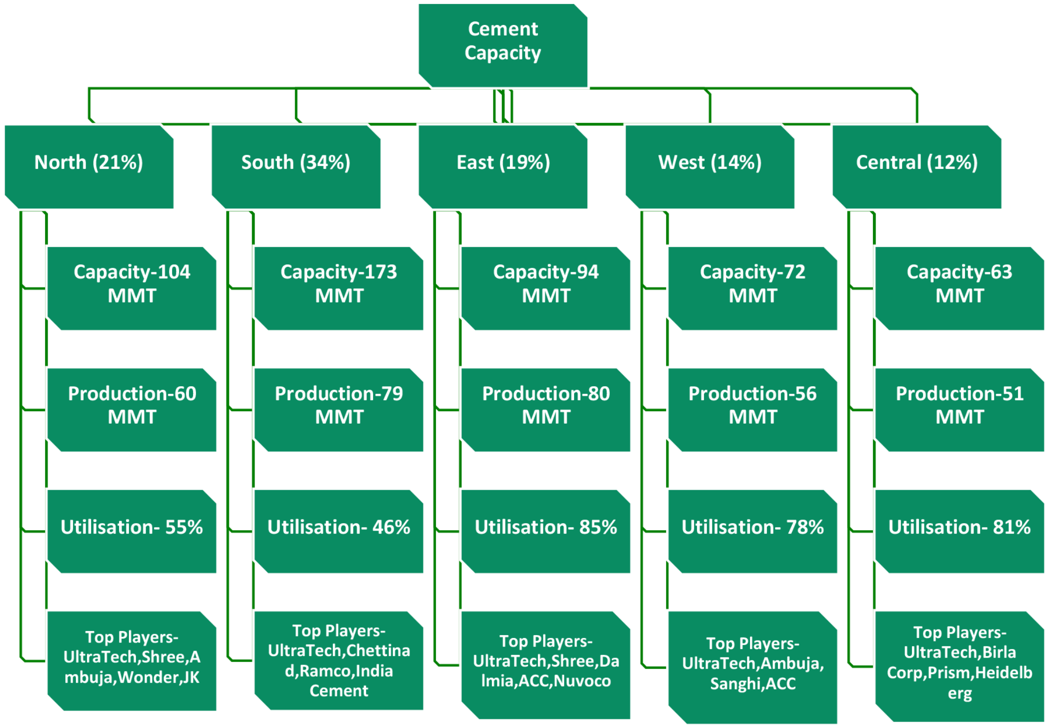
India is the second largest producer of cement in the world followed by China, with an annual installed capacity which is pegged at 506 Million Metric Tonnes (MMT) accounting for 8% of the global production of cement. The major share of cement production comes from South India, which contributes ~34% of the total production followed by North India which account for 21%, East 19%, West 14% and Central 12%.

The per capita consumption of cement in India is a mere ~225 kgs compared to a global average of 575 kgs, indicating headroom for growth in the cement industry.

Cement industry, after witnessing a healthy demand growth of ~14% in FY19, exhibited slowdown with de-growth of ~3% to 326 MTPA in FY20. Cement demand declined between June and October 2019 due to: 1) Muted government spending after the general elections in April-May 2019; 2) Change of governments in demand intensive states like Rajasthan, Andhra Pradesh, Karnataka and Maharashtra; and 3) Prolonged monsoon. Though the demand started indicating some signs of improvement since December, 2019, the momentum could not be sustained due to the outbreak of the COVID-19 pandemic and subsequent nationwide lockdown curtailed hopes of any near-term recovery.

However, Post the imposition of nationwide lockdowns, and its subsequent gradual lifting, execution restarted in month of May, and is now slowly coming back to pre-covid levels. Several industry players have been able to ramp-up utilisation levels which is encouraging. ***Cement demand gradually started picking up since May & June led by rural markets and we expect full recovery from Q4FY21E on the back of expected pickup in demand from infrastructure project and increased labour availability***.

Regional Snapshot



Source: Industry, SMIFS Research

Industry Overview

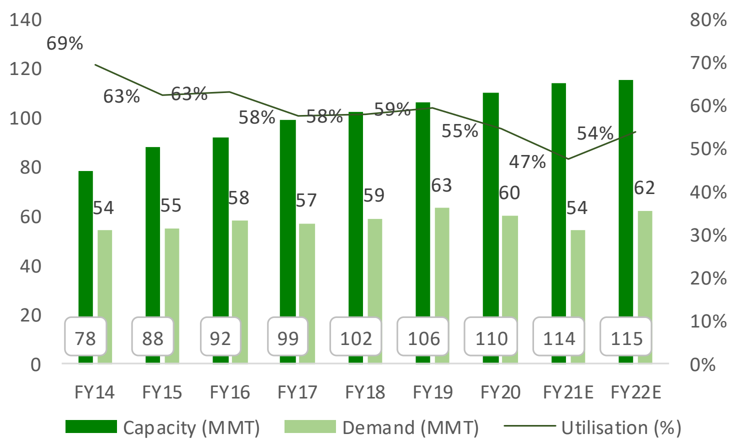
North India

Over FY14-FY20, North India witnessed a ~5.9% capacity CAGR and 2% demand CAGR. The increase in capacity was led by existing players (Shree, Ultratech, JK Lakshmi etc.) as well as entry of newer players like Wonder Cement. North India is a high cement consuming region with per capita consumption of ~269 kg.

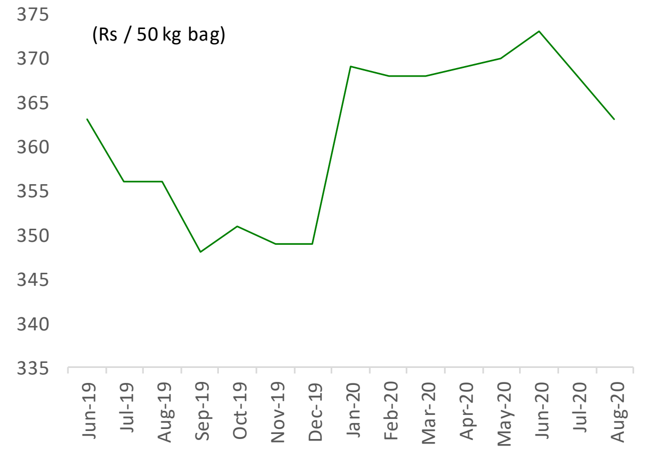
North India has reported ~5% demand decline in FY20 due to the formation of a new government in the key state of Rajasthan, which impacted government project related cement offtake. Moreover, in the last two years, Delhi and NCR witnessed muted cement demand due to construction ban in these regions because of pollution issues.

We expect the region will only have around 5 MMT of additional capacities over the next 2 years, after UltraTech Cement pushed forward its 3.5 MMT expansion at Pali. With lower capacity additions and demand recovery, we expect increase in utilisation over 60%+, going forward.

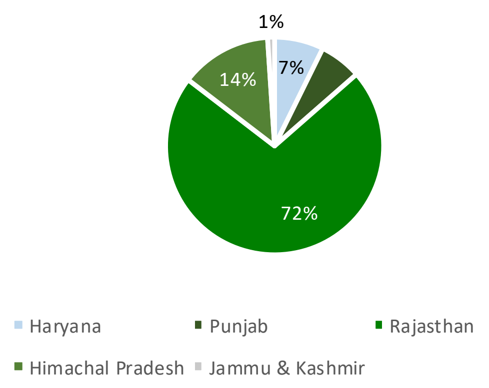
North- Utilisation to stay above 60%



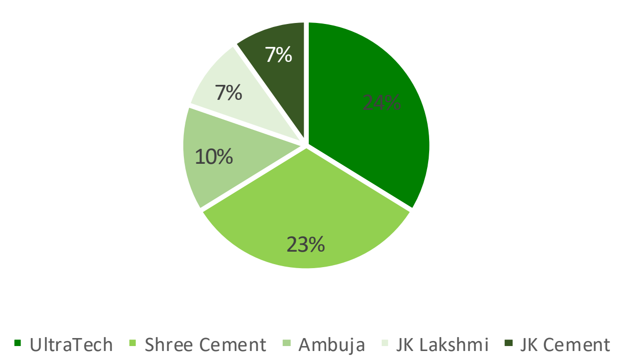
Pricing trend in North India



State-wise market share in capacity terms



Top 5 players market share in capacity terms



Source: Industry, SMIFS Research

Source: Industry, SMIFS Research

Industry Overview

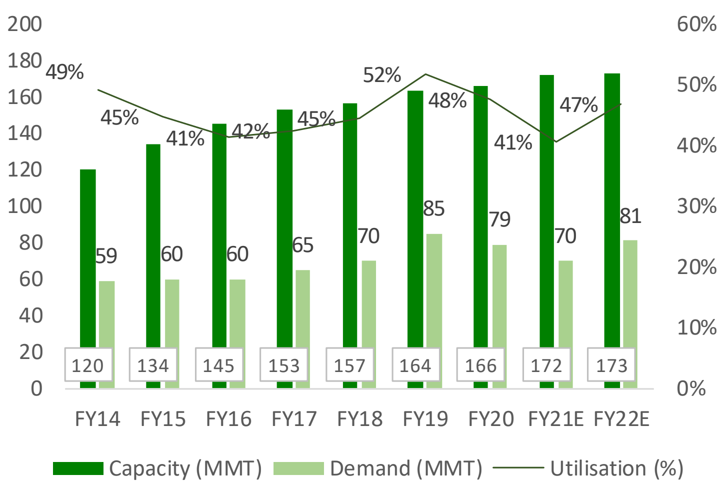
South India

Southern region has the highest capacity in the country and forms ~34% of installed capacity in the country. High limestone availability (~48% of India's limestone reserves) has driven high capacity in the region. However, in recent years, the region has seen a pace of capacity addition of 5.6% CAGR over FY14-20.

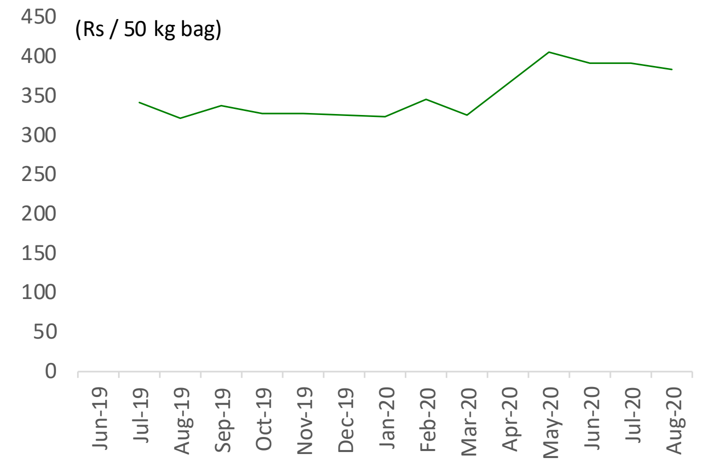
We expect demand to witness a sharp recovery in FY22 after 2 years of lower growth in South India compared to other regions which was largely impacted due to lower offtake from Andhra Pradesh and Telangana governments. However, we expect demand recovery in the Southern region driven by government led projects such as low-cost housing, irrigation and public welfare schemes.

We have witnessed strong pricing discipline during a low demand scenario. Higher demand will make players focus on volumes and hence the region may see some pricing pressure.

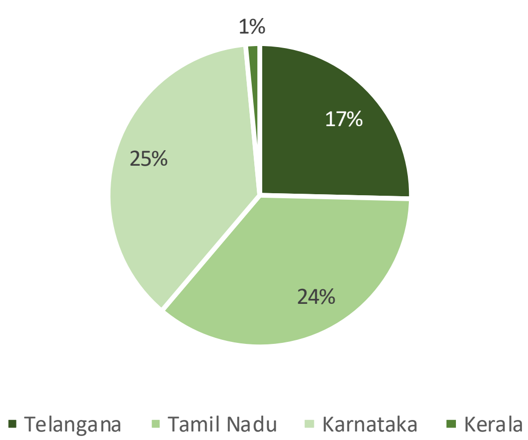
Govt. infrastructure and housing push to revive growth



Pricing trend in South India

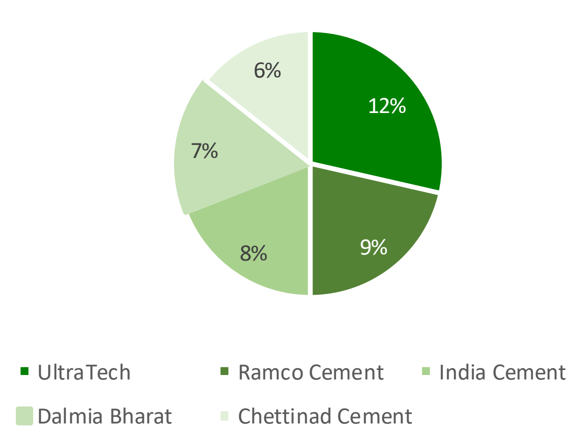


State-wise market share in capacity terms



Source: Industry, SMIFS Research

Top 5 players market share in capacity terms



Source: Industry, SMIFS Research

Industry Overview

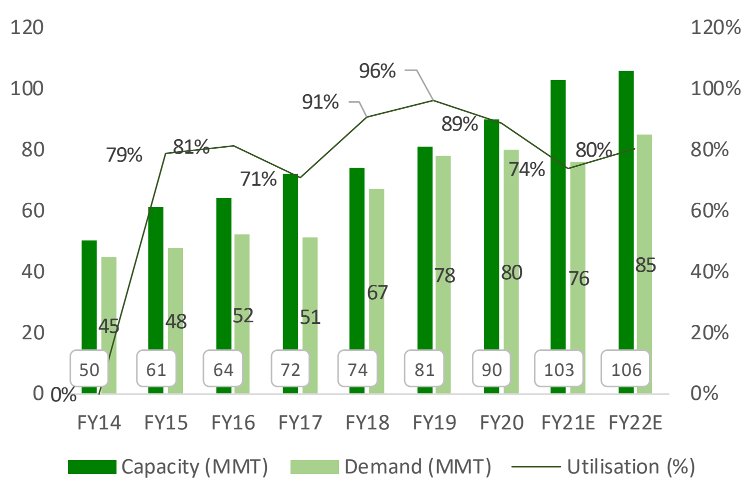
Eastern India

Eastern region remains India's lowest cement-consuming region with per capita consumption at ~131 kg. In last four years, several infra projects have been sanctioned and executed (including Roads) in the region, shoring up cement consumption (10.1% CAGR over FY14-20). The region remains deficient in terms of infra development and road connectivity, thus offering attractive growth potential.

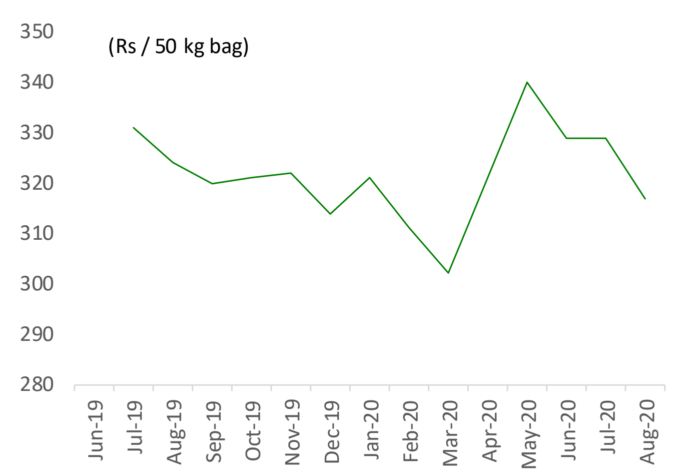
Bihar and Odisha continue to witness strong demand from rural housing and the government's focus on infrastructure. However, this strong growth outlook has attracted various players to create a base or consolidate their position in the market, thus leading to additional capacities.

We expect additional capacity addition of 15-20 MMT in eastern India over the next 2 years. Pricing has remained largely flat in the last 2 years due to inbound supply from Telangana and Andhra Pradesh. ***We expect pricing to remain stable over the next 2-3 years on increased demand led by infrastructure spending.***

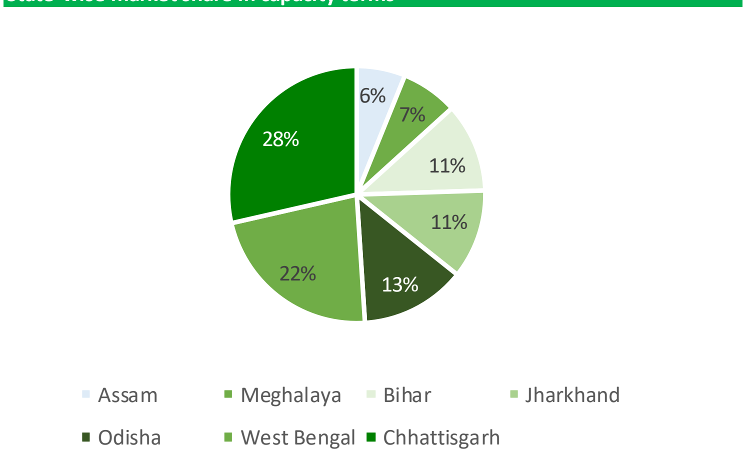
Growth to remain resilient



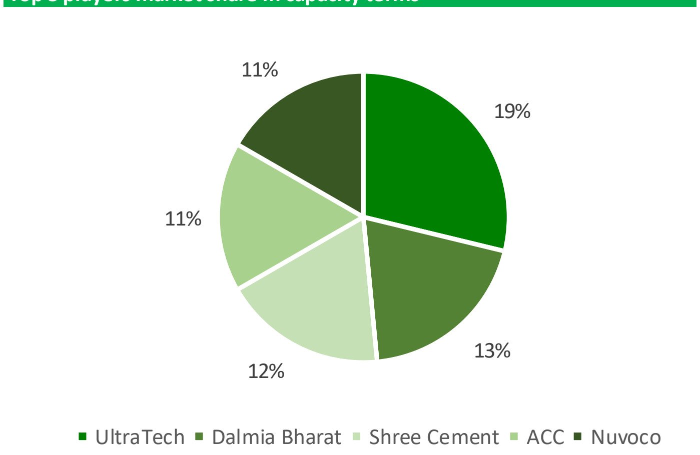
Pricing trend in Eastern India



State-wise market share in capacity terms



Top 5 players market share in capacity terms



Source: Industry, SMIFS Research

Source: Industry, SMIFS Research

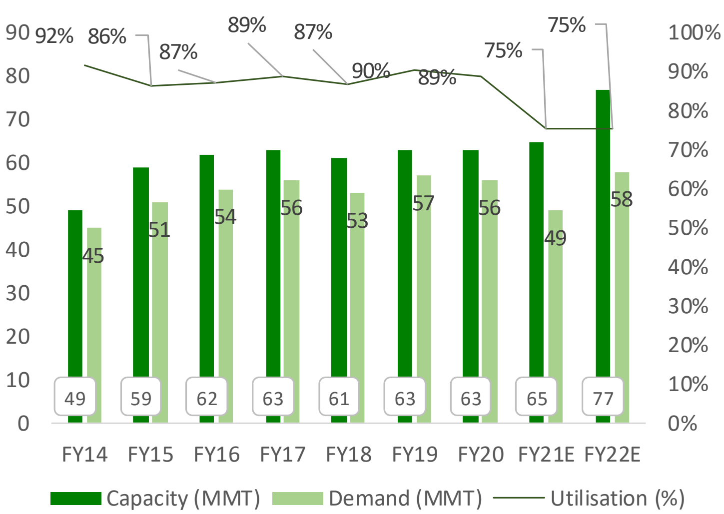
Industry Overview

Western India

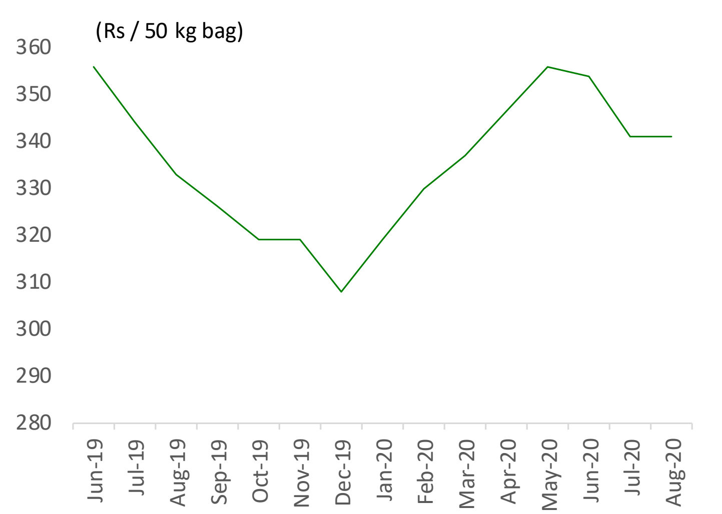
Western market is like North in terms of cement consumption, with per capita consumption at ~293 kg per annum. Over FY14-FY20, West India witnessed a capacity CAGR of ~4.3%. Though weakness in private real estate has persisted in last 3-4 years in both Gujarat and Maharashtra, construction of large infrastructure projects, including Dedicated Freight Corridor, DMIC and Metros have led to consistent growth in cement demand.

With additional capacities from players like Birla Corporation (4 MMT) and Shree Cement (3 MMT), regional utilisation is expected to stabilize at ~75%. We expect demand from the western region to grow at a CAGR of ~2% over FY20- FY22E, led by a pick-up in infrastructure projects and rural housing in Maharashtra. Demand in Gujarat remains strong at 6-8%, with the state government's focus on developing Tier II cities like Vadodara and Vapi. ***Prices at current level have bottomed out and we expect the prices may start reversing by the end of Q3FY21E***.

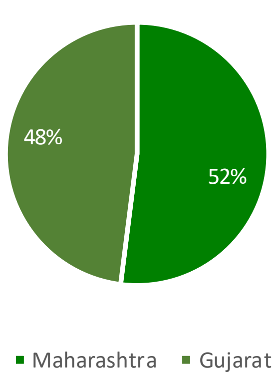
West- Utilisation to decline to 70% with 14 MMT of new capacity



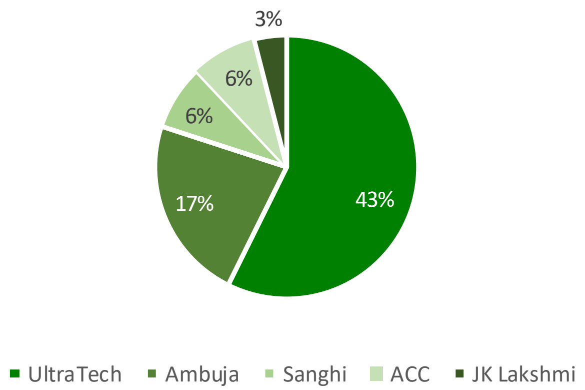
Pricing trend in western India



State-wise market share in capacity terms



Top 5 players market share in capacity terms



Source: Industry, SMIFS Research

Source: Industry, SMIFS Research

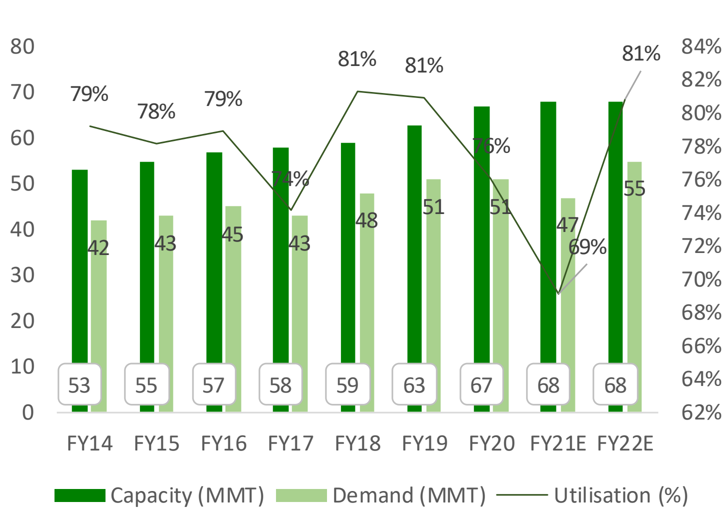
Industry Overview

Central India

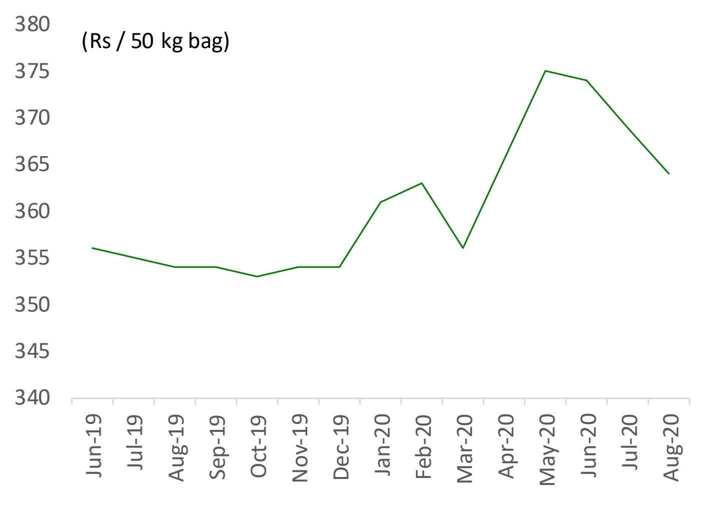
Central region, comprises of Uttar Pradesh and Madhya Pradesh, is a relatively low cement consuming region with per capita consumption at ~134 kg against a pan India average of 252 kg. Both states have been seeing govt-led infra investments in past 3-4 years and should see further improvement in public infrastructure and affordable housing segments.

We expect utilisation to remain above 80% and demand to remain flattish in FY22E at 55 MMT. Demand in a normal scenario will continue to grow over 4% CAGR. ACC was expected to add 4.8 MT of grinding capacity in central India in FY22. However, the same has been deferred by a few months. Over the next 2 years, the region is not expected to add any major capacity.

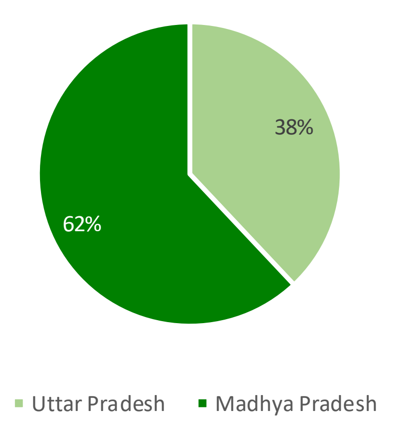
No major capacity addition seen in central India over the next 2 years



Pricing trend in Central India

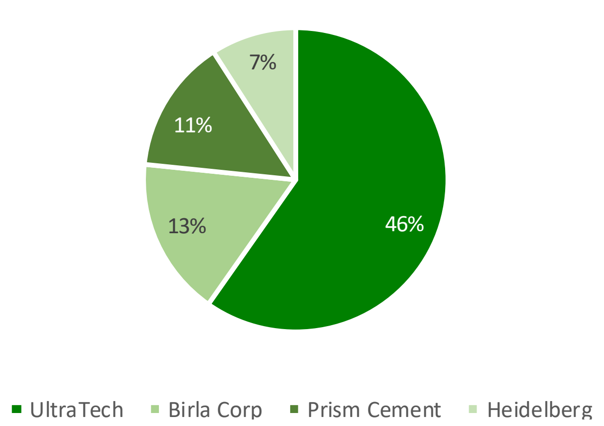


State-wise market share in capacity terms



Source: Industry, SMIFS Research

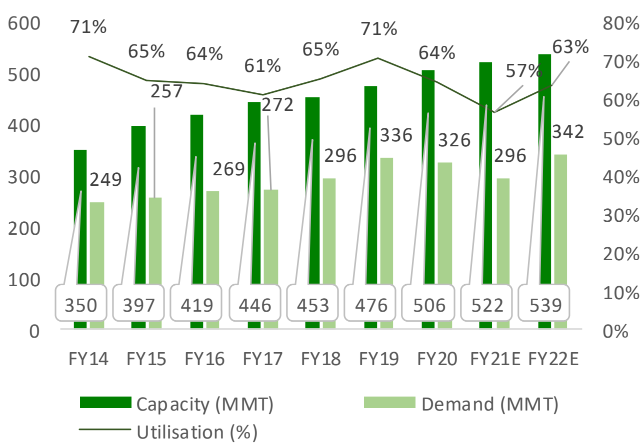
Top 5 players market share in capacity terms



Source: Industry, SMIFS Research

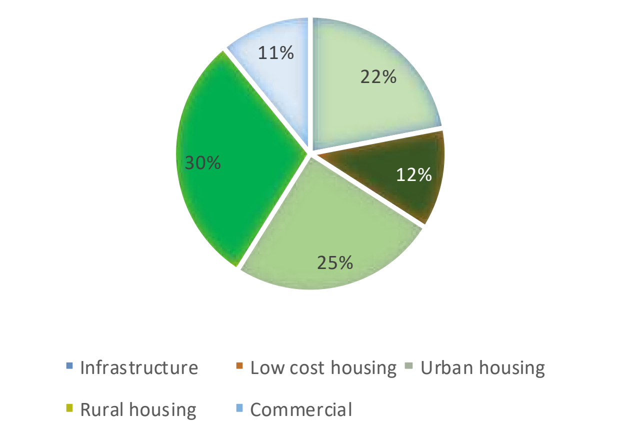
Industry Overview

Utilisation to drop to 57% in FY21E before recovering to 63%



Source: Industry, SMIFS Research

Drivers of cement demand



Source: Industry, SMIFS Research

The sector offers an attractive long-term opportunity but its fortunes are linked with growth rate of the Indian economy. With COVID-19 related headwinds, we expect cement industry volumes to decline by ~9-10% (YoY) in FY21E. Industry utilisation is expected to touch a multiyear low of ~55-57% in FY21 before an expected recovery in FY22E. Cement prices are expected to be stable as per the trends witnessed in H1FY21. The sector ranks high on governance with strong cash generation and three out of five players have a net cash balance sheet.

Long-term cement opportunity remains strong

Despite being the second largest market globally, Indian per-capita cement demand remains at a modest 252 kg, which is half the world average. A rising population, increasing nuclearisation of families, burgeoning middle-class, falling interest rates and government initiatives make Indian cement an attractive long-term growth story.

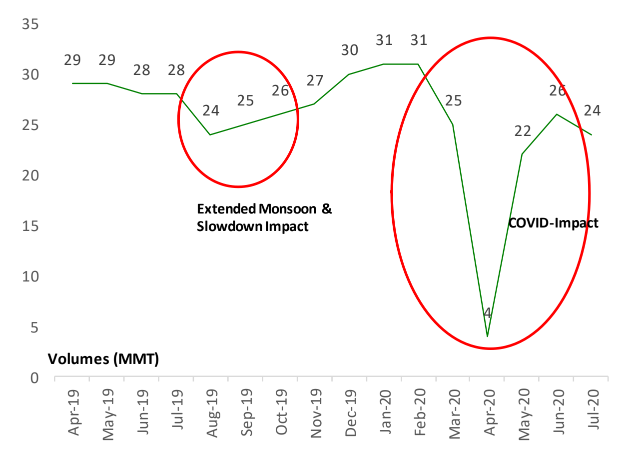
Housing remains the key driver contributing over 60% of the overall demand, with conversion of 'kuchha' house to 'pucca', government initiatives and rapid urbanisation propelling demand. Infra demand is also seeing a pick-up in the recent years, driven by irrigation projects, increased execution of highway construction, metros and airports, among others. With the recent changes to corporate tax structure, commercial demand also should see a pick-up as more manufacturing facilities shift to India, albeit over the longer term. Supply-glut has also been another issue plaguing the industry in the past. ***However, this is becoming less of a concern as entry barriers have been rising on a structural basis, led by an increase in project timelines due to issues in procurement of land, limestone mines and securing environmental clearances.***

Industry Overview

Long term demand drivers are intact-

The nationwide lockdown due to the spread of COVID-19 led to an 85-90% YoY decline in demand in April. However, the industry saw a sharp recovery in May and June, with production volumes down only by 22% and 7% YoY, respectively, versus initial expectations of a 45-50% decline.

Sharp drop in demand during the lockdown but recovery better than expected



Source: Industry, SMIFS Research

A large part of the recovery was driven by: 1) Rush to finish off pending private construction works before the onset of the monsoon season; 2) Pick up in ongoing government road and infrastructure projects; and 3) Higher government spending on MNREGA (Mahatma Gandhi National Rural Employment Guarantee scheme) to generate employment opportunities for labourers who migrated to their hometowns in rural India.

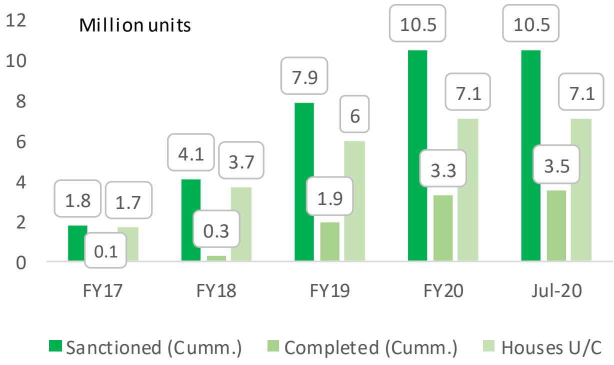
Demand since then has weakened as the cement industry entered a seasonally weak monsoon quarter. Large urban consumption centres like Mumbai, Delhi, Pune, Bengaluru and Chennai continued to remain severely impacted from the COVID-19 pandemic, which will likely delay an urban recovery of cement demand.

More importantly, the labourers are expected to return back to construction sites once travel facilities normalise and there is reduction in the severity of the pandemic in urban centres, which we believe is a post Diwali (Q3) phenomena. Demand will continue to remain muted in Q3FY21, before we see a sustained recovery from Q4FY21 onwards.

We believe, the cement industry will clock a normal average monthly run rate of 28-29 MT in FY22E, thereby reporting a 15-16% growth for FY22E.

Industry Overview

PMAY-U (progress)

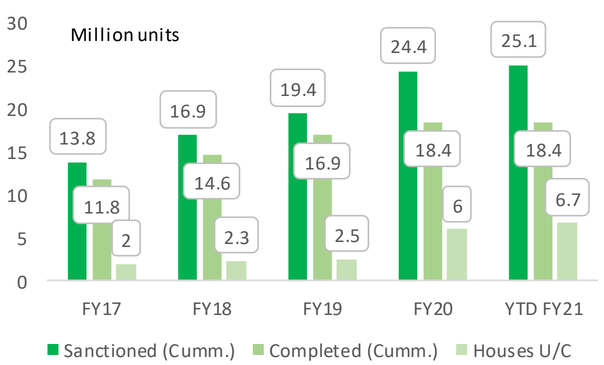


Source: Industry, SMIFS Research

PMAY-G estimated cement requirement	
Total target no. of Houses to be constructed	15 Mn
Completed till FY20	10 Mn
Average each unit size	270 sq ft
Cement consumption each sq ft	19 kg
Cement requirement in one unit	5130kg
Total Cement requirement	**25.7MMT**
Total Cement requirement per annum	**12.9MMT**

Source: Industry, SMIFS Research

PMAY-G (progress)



Source: Industry, SMIFS Research

PMAY-U estimated cement requirement	
Total target no. of Houses to be constructed	10 Mn
Completed till FY20	3 Mn
Average each unit size	350 sq ft
Cement consumption each sq ft	19 kg
Cement requirement in one unit	6650kg
Total Cement requirement	**46.6MMT**
Total Cement requirement per annum	**15.5MMT**

Source: Industry, SMIFS Research

Demand Drivers

Housing: PMAY-G The government of India launched Pradhan Mantri Awas Yojana to ensure Housing for All by 2022. The scheme has two different parts, i.e., Grameen (Rural) and Urban. The Ministry of Housing and Urban Affairs estimated an affordable housing shortfall of approximately 10 million units, attracting government priority through corresponding policies.

Rural housing (including Tier II and III), which is a major contributor (35-40%) to cement consumption, will continue to sustain its strong momentum given robust growth in rural income on the back of good sowing of khariff crops and increase in the minimum support price (MSP).

PMAY–G has set the target for construction of 15 million households in rural area, of which only 10 million were completed till FY20. Execution of the Centre's low-cost housing scheme will likely pick-up as the government look to meet its FY22 target to deliver 10 mn houses under PMAY G. The focus will likely be on completing 10 mn houses over next 2 years, substantially higher than the 3 mn run-rate at present.

PMAY-U:

The scheme has four components (1) Slum rehabilitation of Slum Dwellers with participation of private developers using land as a resource (assistance upto Rs1 lakh), (2) credit linked subsidy for weaker sections (eligibility up to Rs 18 lakhs household income p.a.), (3) Affordable housing in partnership with public & private sectors (state government bodies, e.g., CIDCO/MHADA can initiate projects) and (4) subsidy for beneficiary-led individual house construction or enhancement.

PMAY–U has set the target for construction of 10 mn households of which only 3 mn were constructed till FY20. Thus, remaining 7 mn house in PMAY–U would generate cement demand of 15.5 MMT. Normally, demand from rural housing — the backbone of cement consumption — has been growing at 4-5% for the last two years. Typically, there is 6 months to 1-year lag between monsoon (good or bad) and its subsequent impact on rural cement consumption.

Industry Overview

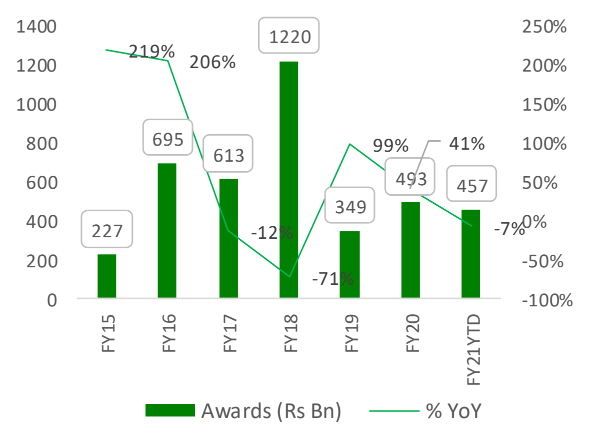
Year-wise sectoral allocation of NIP*

Sector (Rs trn)	FY20	FY21	FY22	FY23	FY24	FY25
Energy	2.3	4.4	4.4	4.7	5	4.7
Roads	3.3	3.8	3.6	2.5	2.4	3.3
Railways	1.3	2.6	3.1	2.7	2.2	1.7
Ports	0.1	0.2	0.2	0.2	0.1	0.1
Airports	0.2	0.2	0.2	0.2	0.3	0.1
Urban Infra	3	4.6	4	2.3	2.2	1.6
Irrigation	1.1	2	1.8	1.4	1.2	0.7
Rural Infra	1.4	1.8	2.1	1.1	1.1	0.3
Digital Infra	0.8	0.6	0.5	0.4	0.4	0.4
Agri & Food Proce.	0	0	0	0	0	0
Social Infra	0.6	0.8	0.9	0.6	0.5	0.3
Industrial Infra	0.2	0.4	0.4	0.4	0.2	0.1
Total	**14.4**	**21.5**	**21.3**	**16.5**	**15.4**	**13.2**

***NIP-National Infrastructure Pipeline**

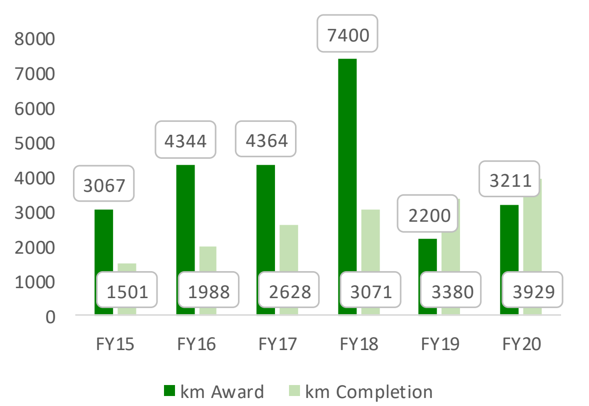
Source: IBEF, Industry, SMIFS Research

NHAI awarding trend – Rs Bn



Source: NHAI, Industry, SMIFS Research

NHAI Roads awarding and completion trend - km



Source: NHAI, Industry, SMIFS Research

Infrastructure projects will continue to generate cement demand

Despite concerns around COVID-19, for the Infrastructure sector, order award activities has started in full stream as (1) NHAI awarding started with a positive note (about to surpass FY20); (2) banks are using surplus liquidity and low interest rates to increase allocation to the sector; (3) increase in fuel cess to add Rs 1 trn to fund infra annually (total Rs 2.3 trn); (4) Atmanirbhar and NIP programs' on-ground execution lends visibility to longer duration Indian Infra buildout.

Post the imposition of nationwide lockdowns, and its subsequent gradual lifting, execution restarted in month of May, and is now limping back to pre-covid levels. EPC companies with higher share of orderbook in rural areas (like roads, irrigation, mining etc) reported execution back to 60-80% of pre-covid levels while companies with higher exposure to urban projects (buildings, metros etc) are still at 40-50% of pre-covid execution levels. Labour availability remains a challenge as 75% labourers are back in rural areas and 40% in urban areas. Execution is expected to be back to pre-covid levels in next 2-4 months.

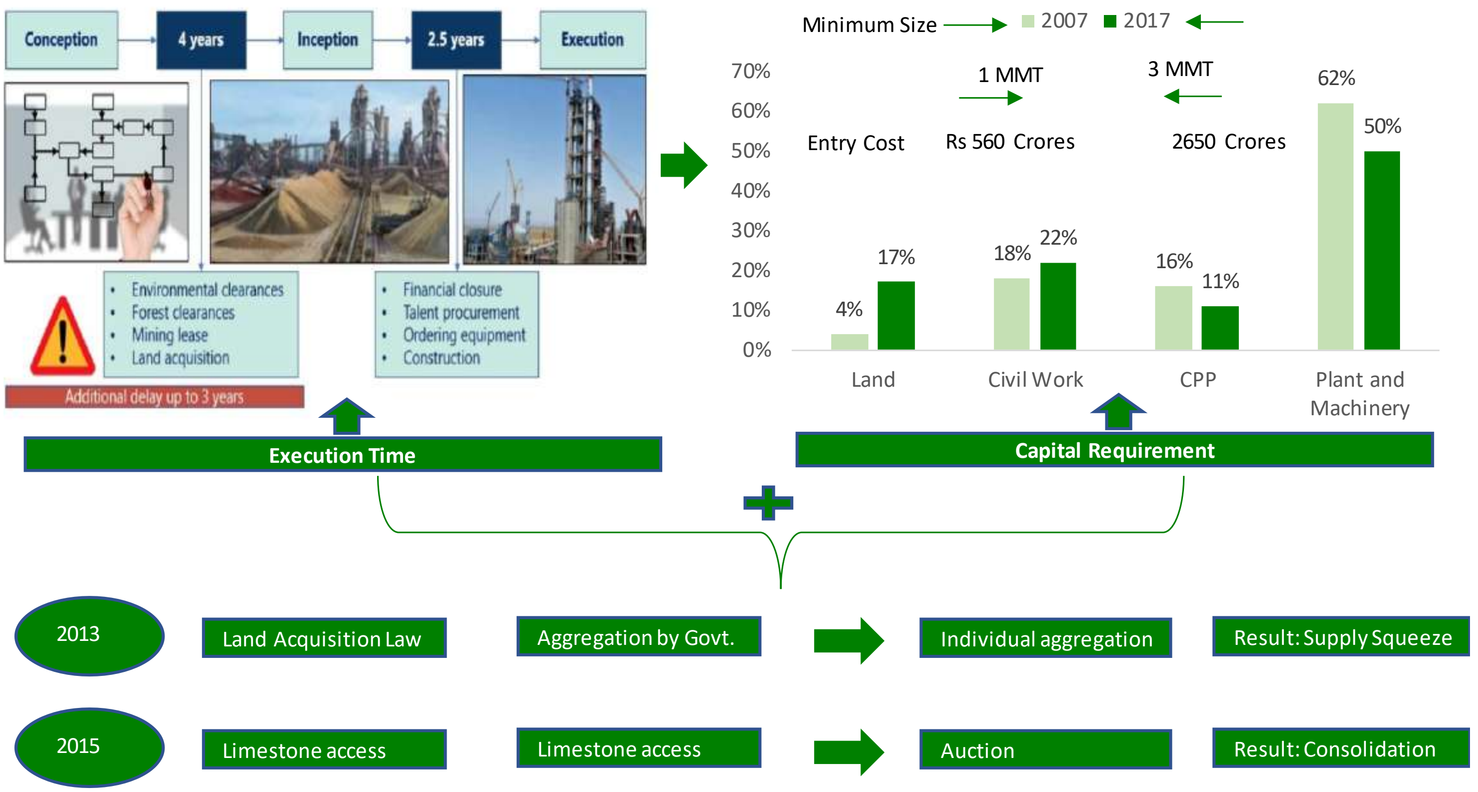
The NIP has a front-ended investment phasing as a result of which tangible outputs are expected to be visible by the end of the planned five-year period. Of this, around 79% (Central government – 39%, state – 40%) of the total investments are expected to be contributed by public sector agencies with the balance 21% to be met through private sector investments

The NHAI has set a target of building 4,500-kilometre highways in FY21, of which 40% would be executed on HAM and ~5-10% on the BOT model. The authority will execute the remaining road projects through EPC. This is expected to entail awards worth over Rs ~800 Bn in FY21. To drive the investor sentiment back in the BOT segment, the NHAI in February came out with a new set of guidelines, a draft Model Concessionaire Agreement (MCA).

Similar traction is also seen in awarding of metro projects and to an extent in large irrigation projects like Polavaram and the next phase of Kaleshwaram dam, which continues to be a key demand driver for cement companies.

Industry Overview

Entry barriers are rising structurally



Source: Industry, SMIFS Research

<u>From concept to commissioning, cement plant may take well over five years due to issues on securing limestone mines, buying land and getting clearances.</u>

Cement being a capital intensive business, very few companies have been able to add capacities consistently without impacting the balance sheet. Different types of expansion, viz. brownfield or greenfield capex, organic or inorganic acquisition, clinkerisation or a split grinding unit impact the overall cost and implementation time for a cement plant from concept to commissioning. ***Moreover, various types of approvals like environmental clearance, mining plan approval, pollution control board approvals, etc can take much longer than anticipated which can delay the capex plan.***

Cement is one of the highest polluting industries with relatively higher SOx, COx and NOx pollutants. Additionally, the production process also leads to higher particulate matter pollution in the vicinity of the plant. Recently, the new pollution control norms have set limits on SOx and NOx gases and particulate matter which involve addition of pollution control equipment, further increasing the overall capex cost for the cement plant.

In the recent past, companies have incurred average project cost of $130-140/tonne for a Greenfield integrated project, while for a brownfield grinding project the average project cost was ~$50/tonne

Industry Overview

Industry consolidation

New-entrants in the sector in the last 10-15 years

Company	Capacity (MMT)	Region	Remarks
Murli Industries	3	West	Despite setting-up a decade back, company could never ramp up its production; Later acquired by Dalmia Cement
ABG Cement	5	West	Group level debt resulted in a stake sale to Dubai based SIMEC group backed by KKR
JSW Cement	9	South and East	JSW group started its operations in 2009 and has done well in the markets of south; company built grinding units to be fed on imported clinker
Wonder Cement	9	North	Part of RK Marble group which is the largest Indian marble supplier; group got into cement business in 2012 and has been able to scale up well
Nirma Cement	13	North and East	After organic entry into Rajasthan, Nirma acquired Lafarge India which made it one of the top players in the region
Reliance Cement	6	Central	Group level debt resulted in sale to Birla Corp
Emami Cement	6	East	Group level debt has pushed to sell the business to Nirma

Source: Industry, SMIFS Research

Industry consolidation levels have gone up in the past decade. This has been primarily led by UltraTech, which has been fairly active on the M&A and also continued with its organic capacity additions and supported by players like Shree Cement & Dalmia Bharat.

Smaller players also have limited balance sheet strength to expand their existing capacities. Overall capacity share of large and mid-sized firms is expected to increase to 85% in FY21E from 80% in FY17.

Interestingly, the top three groups (considering ACC-Ambuja as one under LafargeHolcim) have gained share despite the fact that ACC and Ambuja have actually lost market share. Regionally, south has the lowest utilisation rate along with lowest consolidation levels.

All regions have seen consolidation in the past

Region	Top 3 (%)	Remarks
South	30	Most fragmented market with higest surplus - UltraTech, Ramco, Chettinad and India cements are key players
		Key M&A in the past - Anjani Portland (1.2 MMT) acquired by Chettinad , Shree Jayajothi (3.2 MMT) by My Home, BMM (1 MMT) by Sagar Cements, JP Associates (5 MMT) by UltraTech
		Shree Cement, My Home, Chettinad, Penna, Zuari and JSW are either foraying or expanding in south
West	63	UltraTech alone has a ~45% market share post acquisition of JPA (4.8 MMT) and Century (4.8 MMT) west capacities
		Ambuja-ACC also has a significant presence in the west
		Shree Cement, JSW, Birla Corp, and Sanghi have planned aggressive west expansion in the medium term
		Dalmia's acquisition of Murli Industries (3 MMT) has completed
East	49	UltraTech, Dalmia, ACC and Nuvoco are the key players
		Dalmia has done multiple acquisitions in the region including the Kalyanpur (1.1 MMT), Adhunik (1.5 MMT) and Calcom (2 MMT), along with restructing of the OCL stake
		During the 2016 restructuring of LafargeHolcim, the 11 MMT capacity of Lafarge India was bought by Nirma which later became Nuvoco Vistas - Nuvoco recently agreed to acquire the 8mt capacity of Emami Cement
		UltraTech acquired 4.4 MMT of Century assets in the East recently
Central	61	Fairly consolidated market with UltraTech, Birla Corp, Prism and Heidelberg as the key players
		Key acquisitions in the region were JP Associates (11 MMT) by UltraTech, Reliance Cement (5.5 MMT) by Birla Corp and Century (4.2 MMT) by UltraTech
North	63	Shree, UltraTech, Ambuja, Wonder and JK Cement are the key players
		Key M&A include Binani (6.25 MMT) and JPA (4.8 MMT) by UltraTech; Shree Cement's acquisition of 1.5 MMT from JPA

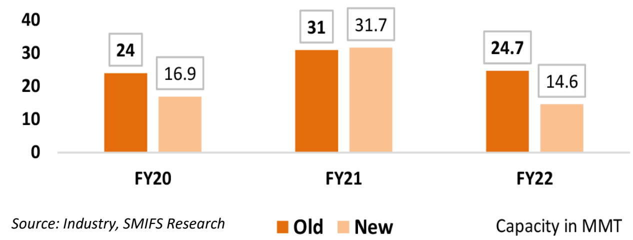
Source: Industry, SMIFS Research

Deferred capex plans due to COVID-19

On the back of strong growth outlook, cement companies had laid out aggressive expansion plans over FY20-22E, which could have added ~80 MMT of grinding capacity until FY22E. However, construction delays, muted demand outlook and need for conserving cash has led to deferring of ~17 MMT of capacities, which were to be commissioned by FY22E.

As per the commentaries and updated capex plans of companies, north and central India, which are already witnessing healthy utilisation trends, is seeing highest capacity deferrals of ~8 MMT and ~6 MMT, respectively. Companies have largely held on to their expansion plans for east India, with marginal 3-6 months of delay, as robust demand outlook for that region remains largely unchanged post the pandemic. ***Expansion plans of companies look much more staggered now, which will limit pricing pressure.***

Delayed capacity additions



Source: Industry, SMIFS Research

Cement players have deferred their expansion plans indicating importance of conserving cash

Company	Delayed project
UltraTech	Cuttack grinding unit - 2.2 MMT Work on waste heat recovery systems
Shree Cement	As against the earlier plan to double capacity in six years, management will now decide on expansion plans when demand improves
JK Lakshmi	Plans to expand capacities by 2-2.5 MMT in the North on hold
Birla Corporation	Work on 1.2 MMT Kudanganj grinding unit on hold

Limestone availability remains a key

While India has abundant reserves of limestone, key limestone bearing belts called clusters generally houses the majority of cement plants in the country. There are seven such clusters in India viz. Chanderiya (Rajasthan), Satna (Madhya Pradesh), Chandrapur (Maharashtra), Bilaspur (Chhattisgarh), Gulbarga (Karnataka), Yerraguntala (Andhra Pradesh) and Nalagonda (Andhra Pradesh). Despite the abundance of the mineral, key limestone bearing lands/mines are already being taken up by the incumbent players. ***Sourcing of new mines and erecting a cement plant on greenfield basis has become increasingly difficult and time consuming.***

Before the MMDR Act 2015, limestone mines were allotted for 30 years with one renewal option for maximum period of another 20 years. But post introduction of MMDR Act, new auctioned limestone mines leases can now be granted for fifty years at one go. However, after expiry of the said period of fifty years, renewal will not be possible, and the mines are compulsorily required to be auctioned again.

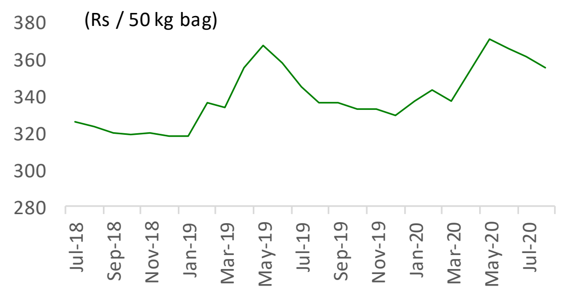
We believe that the companies which have historically done well have had the vision to identify and develop new sites for cement plants and execute their capex plan well.

Pricing remains the key

There are multiple variables that affect EBITDA of a cement company. These are volume, pricing and costs. While volume is a function of the ability of the company to push volume in the market profitably, costs are driven by efficiency and commodity prices. While the efficiency is driven by the company itself, it does not have control over commodity prices. So, despite having a lean cost structure, higher commodity prices may not be passed on to the consumers, leading to margin compression. ***Pricing has a larger delta on EBITDA than costs and barring a few regional instances over short term, cement pricing is largely driven by market conditions and hence not in control of the companies.***

Pricing remains the key

Average India pricing trend

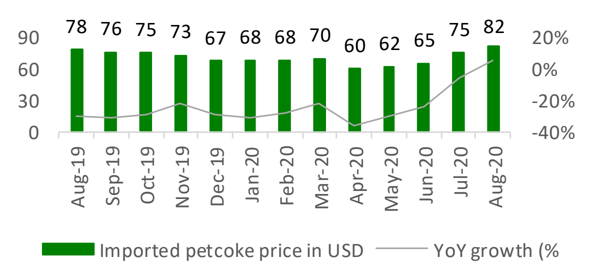


Source: Industry, SMIFS Research

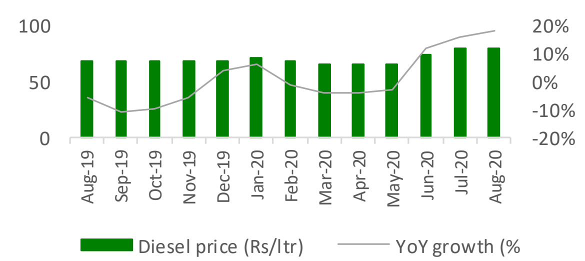
Since the relaxation of lockdown restrictions, cement companies had undertaken an average price hike of Rs 30-35/bag (8-10%), which largely sustained until June 15. Industry has seen some rollbacks to the tune of Rs 10-15/bag from June 15. We expect better pricing from Q4FY21 onwards on expected demand recovery.

Cost trends: High diesel prices to impact freight costs, pet coke prices too rising-

Imported petcoke prices up 5% YoY in Aug'20



Diesel prices up 18% YoY in Aug'20



Source: Industry, SMIFS Research

Pet coke prices started rising in Jul'20 after a ~23-25% (YoY) decline during Apr-Jun'20. Current imported pet coke prices are up ~48-49% from the lows of Jun'20. In the domestic market , Reliance increased pet coke price by 28% to Rs7,268/tonne from the low of Rs5,697/ tonne in Jun'20. The current imported pet coke price from USA/Saudi Arabia is US$85/tonne.

Diesel prices have increased to Rs 80/litre (up 20% from average prices in FY20).

However, any increase in variable costs of power and fuel and freight is likely to be moderated by lower spends on fixed costs (such as sales promotion, dealer spends, travel, rent, repairs, etc.), which have been curtailed due to COVID-19.

Increasing acceptability of blended cement to help the industry reduce costs and improve margins

Cement producers have been continuously shifting from manufacturing OPC to blended cement (PPC has highest share) in the last decade primarily due to latter's growing acceptability in the market and because it helps save limestone (a scarce natural resource). By blending fly ash or slag with OPC (which are available at marginal cost vs. Limestone), producers can lower power, fuel and raw material costs, thereby improving their operating margins. The BIS allows additions of up to 35% of fly ash in PPC and blast furnace slag up to 65% in PSC subject to meeting other quality requirements as prescribed. ***This substitution of clinker results in substantial cost savings for cement manufacturers as the consumption of clinker is 30%-40% lower than OPC. Additionally, the reduction in the cost of transportation of clinker (approximately 0.6 tonne per tonne of blended cement) from an integrated unit to a grinding unit further eases the cost of production.***

Increasing acceptability of blended cement to help the industry reduce costs and improve margins…

Traditionally, OPC was mainly preferred because of faster setting time and better compressive strength over PPC/ PSC and because it is approved by Central/state govt./local governing bodies. However, PPC has started gaining acceptance in Govt. projects and this would lead to improved utilization of the cement. Blended cements are normally suitable for high rainfall areas and coastal areas as they offer higher longevity of structures, offering highest resistance against sulphate and chloride attacks and environmental pollutants.

A recent trend in the industry is the emergence of composite cement (CC) which is produced by blending fly ash and blast furnace slag with OPC. It is manufactured by companies where both these commodities are easily available which currently is Eastern region. As per the BIS, the proportion of OPC in composite cement can be as low as 35%. However, composite cement is still not accepted in RCC by BIS which poses a challenge in selling it as an all-purpose cement, besides getting govt. approvals for composite products.

Proportion of blending in cement production

Proportion of RM %	OPC	PPC	PSC	GGBFS	CC
Clinker (%)	90-95%	60-65%	40-45%	-	35-65%
Slag (%)	-	-	50-55%	100%	20-35%
Fly Ash (%)	-	30-35%	-	-	10-25%
Gypsum (%)	5-10%	5%	5%	-	5%
Total	100%	100%	100%	100%	100%
Margin Profile	**Lowest Margin**	**Highest Margin**	**Highest Margin**		

*PSC: Portland Slag Cement, PPC: Portland Pozzolana Cement, OPC: Ordinary Portland Cement, GGBFS: Ground Granulated Blast Furnace Slag, CC: Composite Cement

Source: Industry, SMIFS Research

Sector's Balance sheet remains decent at an aggregate level

The cement sector remains a cleaner proxy to play the capex revival story. Although producer discipline, higher consolidation levels and benign costs should help in the long term, Covid-19 headwinds may result in return ratios slipping below cost of capital in the medium term. Although select players are currently levered as a result of recent consolidation or investment on growth, focus is high on deleveraging. We expect industry to focus on cash and, hence, capex would likely come off, which should support FCF.

Comparison for cement companies

	Capacity (MMT)	Realization (Rs/tn)			EBITDA/tn			Net-Debt/EBITDA			Interest Coverage (X)			ROCE (%)		
		FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20
UltraTech	114.8	5443	4775	5038	1057	855	1126	2.5	3.2	2.0	3.4	2.7	3.3	9.3%	7.9%	10.4%
Shree Cement #	40.4	4063	4139	4534	1097	1026	1474	0.4	0.9	0.0	11.6	5.1	6.9	13.5%	9.5%	12.2%
ACC *	33.0	4925	5103	5311	684	674	781	-0.2	-0.2	-2.0	13.7	17.8	24.6	15.3%	15.9%	19.2%
Ambuja *	29.7	4880	4674	4841	844	779	891	-0.6	-0.6	-0.5	16.1	19.3	24.3	8.8%	7.7%	9.4%
Dalmia Bharat	26.5	4385	4601	4605	1200	1040	1092	1.7	1.6	1.4	1.2	1.2	1.3	4.7%	3.9%	3.5%
Ramco	18.6	4732	4628	4811	1181	949	1024	0.9	1.5	2.6	17.3	18.9	14.7	16.3%	13.5%	12.2%
Birla Corp	15.6	4625	4798	5078	650	692	988	4.0	3.2	2.4	1.1	1.6	2.5	7.1%	9.0%	13.4%
JK Cement	14.0	5919	6115	6907	809	822	1209	2.5	1.5	1.7	1.8	2.2	3.5	13.4%	12.7%	16.9%

* CY ending , # SMIFS Coverage

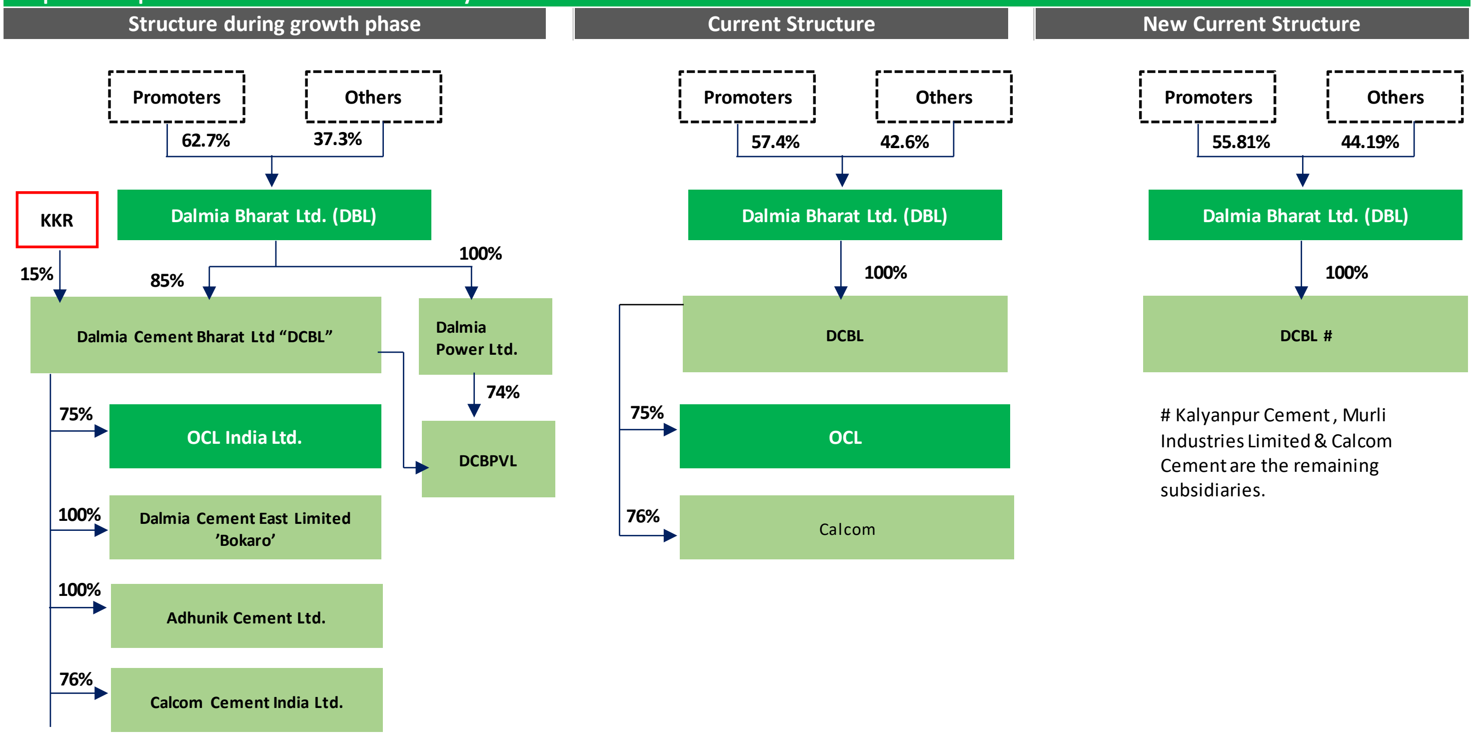
Company Overview

Dalmia Bharat Limited (DBL) is a part of the Dalmia group founded by Mr. Jaidayal Dalmia in 1935, is a diversified conglomerate with business interests in Cement, Sugar, Refractory and Power sectors across India. DBL is the listed holding company of the cement business in the Dalmia Bharat group. It is the fifth-largest cement player in India with current cement capacity of 26.5 Million Metric Tonnes (MMT) spread across South (46%), East (39%), and North East (15%) India and power capacity of 195 MW. It owns 100% of DCBL (Dalmia Cement Bharat Ltd) which is the main operating company and houses the group's entire cement business. DBL also owns 100% in DPL (Dalmia Power Ltd.) which holds the group's investment in IEX Ltd. At a standalone level, it derives revenue from providing management services to group companies. Additionally, refractory business contributes 5/2% to consolidated revenue/EBITDA .

Simplified corporate structure

The company has completed its corporate restructuring to become a single listed entity, reducing the number of subsidiaries from 6 to 2. DBL had initiated simplification of its holding structure in the early part of 2016 with the acquisition of KKR's stake in DCBL. It then amalgamated Adhunik Cement with DCBL. It also later amalgamated OCL and Bokaro to have better synergies in operations. The restructuring exercise resulted one listed entity and one cement operating company, which would help in consolidation and better management of cash flow.

Simplified corporate structure…One listed entity



Source: Company Data, SMIFS Research

- ⇒ In 2010, the company's Cement, Refractory and Power businesses were demerged from the group through a restructuring process into a separate listed entity 'Dalmia Bharat Enterprises Ltd.'
- ⇒ In FY13, the company was renamed 'Dalmia Bharat Ltd' (DBL).

Simplified corporate structure - Continued

⇒ In FY16, DBL acquired KKR's 15% stake in DCBL by way of Preferential issue of 7.5 million DBL shares valued at Rs. 825/ share and part cash consideration of Rs. 600 crores. KKR invested Rs 500 crores in DCBL in May 2010 for ~15% stake. Post this transaction, KKR hold 8.5% stake in DBL which was later sold to marquee investors.

⇒ At the time of restructuring, DCBL held 45.37% stake in OCL India (5.4 MMT capacity in Orissa), which was later increased its stake in OCL to 74.6%.

⇒ Company has also acquired companies in the North East (Adhunik & Calcom Cement) and Jharkhand (Bokaro plant of Jaiprakash Associates).

⇒ DBL and OCL India in their respective board approved the amalgamation of DBL with OCL. DBL shareholders received 2 shares of OCL for every 1 share held in DBL This resulted in the issuance of 177.6 mn new shares by OCL to DBL's shareholders.

Plant location

The company operates a manufacturing capacity of 26.5 MMT across 13 cement plants and grinding units, spread across 9 states. The Company enjoys a substantial presence in South India with cement plants located in Tamil Nadu (Dalmiapuram and Ariyalur), Andhra Pradesh (Kadapa) and Karnataka (Belgaum) with a capacity of 12.1 MMT. The Company has significant operations in the East and North East India with a total capacity (along with its subsidiaries and associate) of 14.4 MMT, which is expected to reach to 22.2 MMT after completion of capacity addition projects.

Company plants

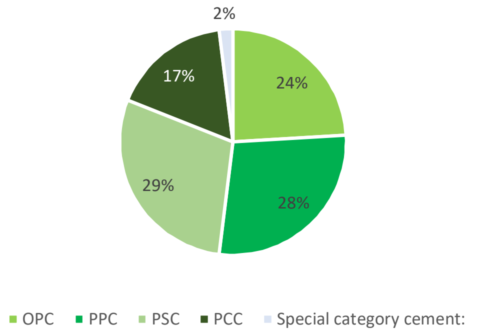
Plant Location	State	Region	Capacity (MMT)	Unit
Dalmiapuram	Tamil Nadu	South	4.2	Integrated
Kadapa	Andhra Pradesh	South	2.6	Integrated
Ariyalur	Tamil Nadu	South	2.6	Integrated
Belgaum	Karnataka	South	2.7	Integrated
Rajganjpur	Odisha	East	4	Integrated
Jaintia Hills	Assam	North East	1.5	Integrated
Lanka	Meghalaya	North East	2.1	Integrated
Kalyanpur	Bihar	East	1.1	Integrated
Kapilas	Odisha	East	1.4	Grinding
Medinipore	West Bengal	East	1.4	Grinding
Bokaro	Jharkhand	East	2.6	Grinding
Alsthom	Assam	North East	0.4	Grinding
Total Capacity (MMT)				
26.5				

Source: Company Data, SMIFS Research

Strong brands and market presence

DBL's availability spans across 22 states and union territories, mainly in East, North East and Southern India, with selective presence in Uttar Pradesh and Maharashtra. It offers a range of cement variants through its brand portfolio of three marquee brands: Dalmia Cement, Dalmia DSP and Konark Cement. These brands are available as PPC, PSC, Composite Cement, and OPC in select markets. Institutional brands comprise of Dalmia InfraPro, Dalmia Infra-green and Dalmia InstaPro. The company is a category leader in super-specialty cements used for oil well, railway sleepers and air strips.

Dalmia Bharat's product mix, FY20



Source: Company Data, SMIFS Research

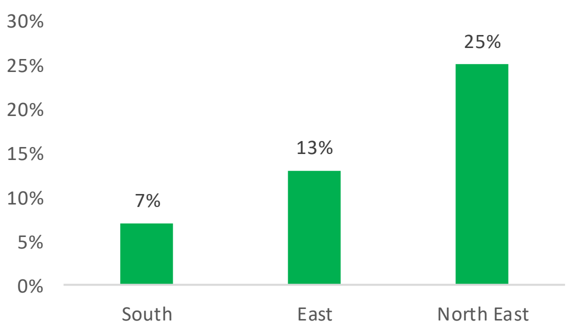
Brand portfolio

Dalmia Cement	Available in PSC, PPC and OPC 43 & 53.
Dalmia DSP Cement	Available in PSC and PPC.
Konark Cement	Available in PSC and PCC.
Dalmia Infra Pro	Available in OPC 53 & 43, PPC, PSC, PCC and a range of speciality cements.
Dalmia Infra Pro	Dalmia Infragreen is an innovative blended cement

Dalmia DSP – premium segment – accounts for 13% of the trade segment sales. 60% of the overall volumes is through dealers.

Market Share

Market Share (%)

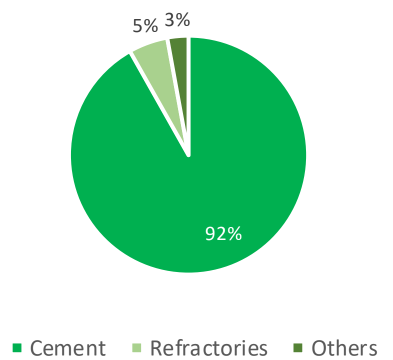


Source: Company Data, SMIFS Research

Along with scale, the focus of the company is to improve market share in its existing markets. DBL's geographic reach can be categorised in three segments - South, East and North East. Market share of the company in all these regions has improved over the past two to three years. In southern region, where fragmentation is very high, ***DBL has close to 7% market share with 12.1 MMT capacity. In eastern region, the company has 13% market share with 10.4 MMT capacity and in North-east region it has 25% market share with 4.0 MMT capacity.***

Revenue Mix

Revenue Mix (%) - FY20

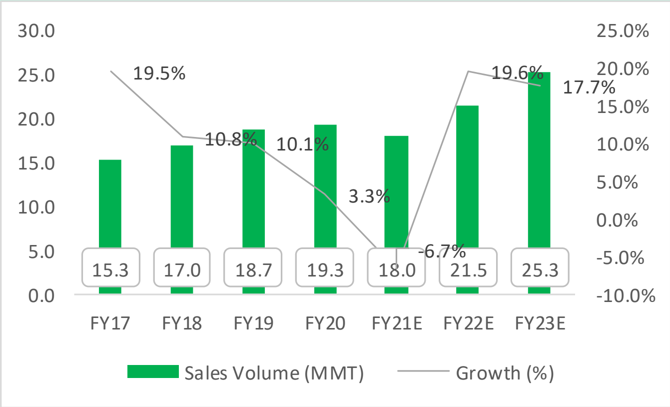


Source: Company Data, SMIFS Research

DBL has three business segments viz. cement, refractory and power. Cement vertical contributes ~92%+ of total sales whereas power and other vertical contributes ~7-8% of total sales. Management plans to hive off the low margin and unrelated refractory business (regulatory approvals awaited) to Dalmia Refractories Limited (DRL).

Key Performance Indicators

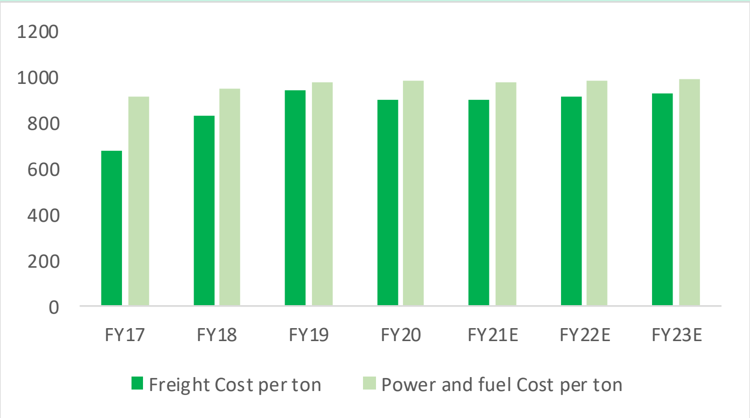
Better volume growth than Industry

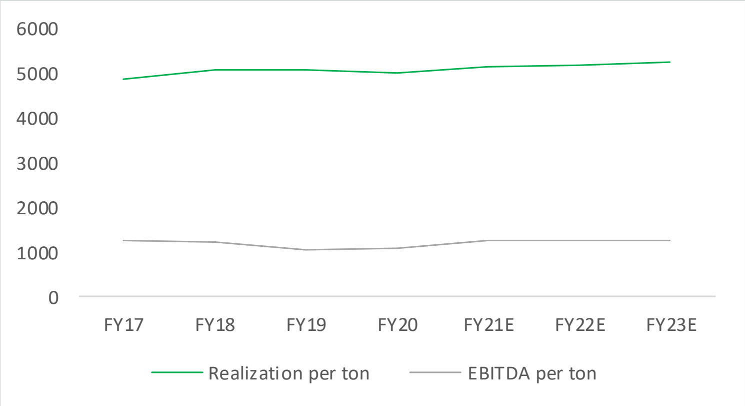


Source: Company Data, SMIFS Research

We expect volume CAGR of 10% over FY20-FY23E which is significantly higher than expected industry growth of 2.6% CAGR over the same period on the back of the extended capacity and better utilisation going forward.

Cost and Profitability





Source: Company Data, SMIFS Research

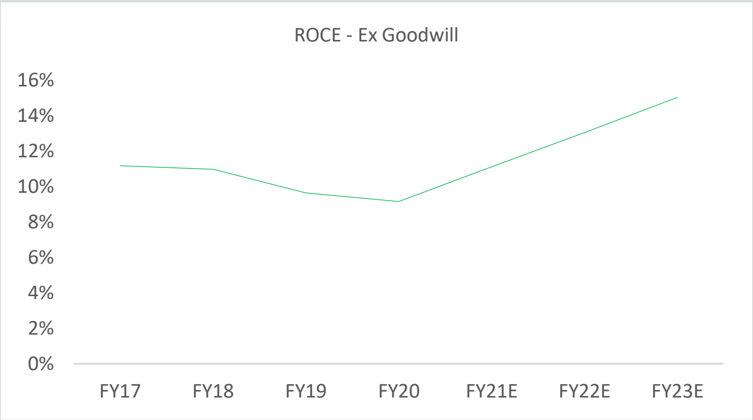
In Q1FY21, we believe that the average pet coke consumption price was US$70/tonne. Pet coke prices started rising from Jul'20 after a 23 -25% decline during Apr-Jun'20.The current imported pet coke price from USA/Saudi Arabia is US$85/tonne. We expect energy costs in Q2FY21E to remain flat or marginally lower than Q1FY21 levels as the benefits of low prices of May/Jun'20 may be reflected. However, if pet coke prices sustain at current levels, energy costs could rise from Q3FY21E onwards.

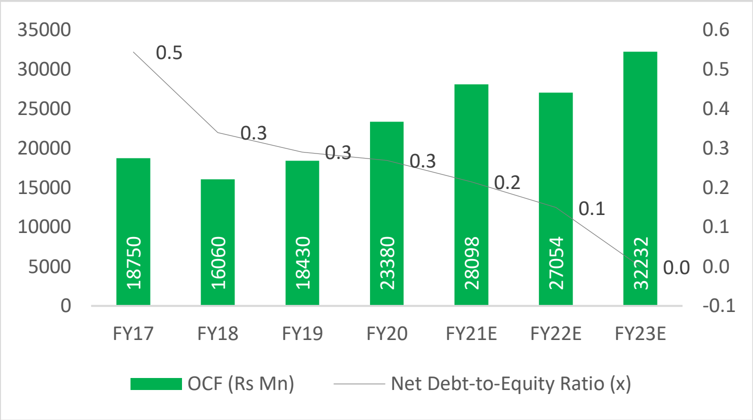
Diesel prices have increased to Rs 80/litre (up 20% from average prices in FY20).

However, any increase in variable costs of power and fuel and freight is likely to be moderated by lower spends on fixed costs (such as sales promotion, dealer spends, travel, rent, repairs, etc.), which have been curtailed due to COVID-19.

Key Performance Indicators

Improving Balance Sheet





Source: Company Data, SMIFS Research

Company reported an operating cash flow of Rs 2,338 crores in FY20 vs. Rs 1,843 crores in FY19, primarily led by profitability improvement (lower raw material/power & fuel costs) and efficient working capital management (working capital days declined from 27 days to 20 days led by inventory/receivables). The Net Debt/ Equity ratios stands at 0.3x and Interest coverage is 1.3x. As on 30th June'20 the company has cash & cash equivalents of Rs 3,363 crores which provides strength to the Balance Sheet.

Consequently, return ratios (ROE and ROCE) is expected to improve based on: (1) better asset sweating, (2) improvement in margins, and (3) higher free-cash generation leading to reduction in debt. We expect ROCE (Ex-Goodwill) at 14%/16% for FY22E/23E.

Outlook & Valuation

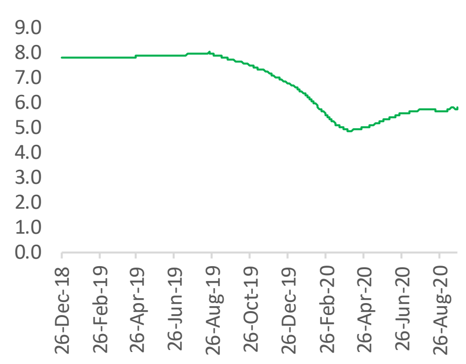
EV/EBIDTA - Basis	
EBIDTA (Rs mn) - FY22E	27029
Est EV/EBIDTA (x)	8
EV (Rs mn)	216231
Net Debt- FY22E	16145
Equity	200086
Fair Value (Rs per share)	1071
EV/Tonne - Basis	
Target Replacement Cost ($) - EV/Tonne	75
USD/INR	73
Target Replacement Cost (Rs mn)	5475
Total Capacity (Mn Tonnes)- FY22E	35
Target EV (Rs mn)	193268
Total Net Debt (Rs mn)	16145
Target M-cap (Rs mn)	177122
O/s Shares (mn Shares) - Post Buy back	187
Fair Value (Rs per share)	948
Consolidated Valuation	Weightage
EV/EBITDA Weightage	50%
EV/Ton Weightage	50%
Wtd Equity Value Per share	
EV/EBITDA Weightage	536
EV/Ton Weightage	474
Fair Value (Rs per share)	**1010**

Cement industry has been affected by both seasonality and easing of pent-up demand from IHB (Individual Home Builders) segments during July-September period till date. However, we believe cement demand would start improving from Q3FY21 onwards and followed by a healthy bounce back in FY2022. Improvement in demand is expected to help maintain a healthy pricing discipline to contain any rise in key input costs (power & fuel, freight) if sustains going ahead.

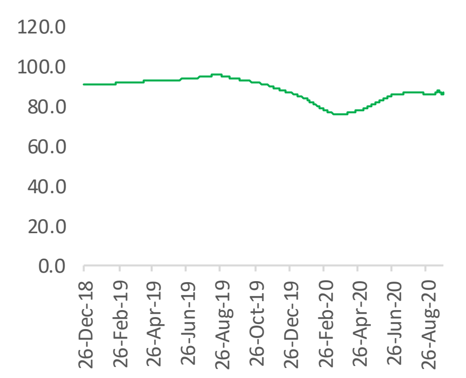
DBL is currently expanding its cement capacity by 7.8 MMT in eastern India at capex of USD70/tonne; the capacity should get commissioned in phases over the next 6–18 months. A new clinker line of 3 MMT to support these cement grinding units has already been completed and is undergoing trial run. While FY21 overall will be impacted due to COVID-19 and related volume loss, the outlook for the company in FY22E/FY23E is expected to be robust led by various projects related to infra and housing which is expected to pickup as the impact of pendemic recedes and situation improves. Thus, ***we expect the company to register Revenue/EBITDA/PAT CAGR of 11%/15%/68% from FY20-FY23E driven by volume CAGR of 10% over FY20-FY23E. Furthermore, DBL should also be able to generate strong FCF and reduce its net debt substantially to Rs 1,615 crores in FY22E from Rs 2,849 crores in FY20.***

The stock trades at an attractive valuation of 5.5x FY22E EV/EBITDA and USD57/tonne. We have valued the stock assigning equal weightage to 8x FY22E consolidated EV/EBITDA and assuming a replacement cost of USD75x FY22E EV/Tonne to arrive at target price of Rs 1010 per share .

EV/EBITDA band



EV/Tonne band



Source: Company Data, SMIFS Research

Peer Analysis

Comparison for cement companies

	Market Cap (Rs Bn)	ROE (%)			Debt/Equity			EV/EBITDA (X)			EV/EBIT (X)			M Cap/Sales (X)		
		FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20
UltraTech	1241.7	8.4%	8.5%	14.9%	0.7	0.9	0.6	20.5	19.0	14.4	29.4	28.5	20.3	3.7	2.8	2.3
Shree Cement #	758.0	15.6%	9.9%	12.1%	0.4	0.3	0.2	24.6	27.7	21.4	38.7	58.2	39.8	5.7	5.5	5.3
ACC *	285.2	10%	15%	12%	0.0	0.0	0.0	14.9	11.6	8.3	21.69	15.95	10.67	2.5	1.9	1.7
Ambuja *	470.7	6%	7%	7%	0.0	0.0	0.0	21.9	18.2	13.3	29.2	26.0	16.9	5.2	3.9	3.3
Dalmia Bharat	142.8	2.8%	2.9%	2.1%	0.7	0.6	0.6	11.7	9.1	7.2	28.9	27.2	26.2	2.1	1.4	1.3
Ramco	181.4	14%	12%	13%	0.3	0.4	0.6	16.1	17.7	12.8	21.63	24.59	17.51	3.9	3.4	2.3
Birla Corp	49.8	4%	4%	9%	0.6	0.5	0.5	17.0	11.9	6.1	27.28	17.13	7.70	1.5	0.9	0.7
JK Cement	125.6	17%	13%	13%	1.1	0.8	0.9	10.0	9.6	7.4	13.02	12.34	10.73	1.6	1.3	1.3

* CY ending , # SMIFS Coverage

Source: Company Data, SMIFS Research

Key Risks

- **Delay in capacity expansion & slowdown in cement demand:** DBL is currently expanding its cement capacity by 7.8 MMT in eastern India. Any delay in capacity expansion may risk our earnings estimate. Furthermore, any demand slowdown may lead to non absorption of the expanded capacity.

- **Un-availability of key raw materials:** The key raw material for cement is limestone and its availability are essential for upcoming cement capacities as well as production from existing plants. Limited reserves at existing mines and acquisition of new limestone mines being uncertain due to regulatory and competition issues could threat the expansion of volumes. However, DBL has adequate limestone reserves and continuously making efforts to conserve limestone by optimizing its usage.

- **Increase in freight expenditure:** The company is exposed to open market volatility in Diesel prices. Since Freight cost accounts for ~18-20% of total operating cost, any adverse movement in diesel prices could negatively impact the profitability of the company.

- **Increase in power & fuel cost:** The Company sources fuel from open market and hence, is exposed to volatility of market prices of the fuel. Power cost takes up ~23-25% of total operating cost and hence, any adverse movement in petcoke and coal prices could negatively impact the profitability of the company.

- **Any unfavorable verdict on the mutual funds case would materially impact company's credit profile as it would have to take a write-off to the extent of amount invested.**

Financial Details

Performance Analysis (Consolidated)					
Particulars	**FY19**	**FY20**	**FY21E**	**FY22E**	**FY23E**
Blended Realisation per tonne	**5077**	**5015**	**5139**	**5175**	**5244**
Material Cost per tonne	956	905	873	883	883
Employee Cost per tonne	347	350	350	360	365
Power Cost per tonne	940	901	900	915	930
Freight Cost per tonne	979	982	975	985	990
Other Expense per tonne	816	785	777	777	811
EBITDA/tonne	**1040**	**1092**	**1264**	**1255**	**1265**

Income Statement (Consolidated)					
Particulars (Rs Mn.)	**FY19**	**FY20**	**FY21E**	**FY22E**	**FY23E**
Net Revenues	**94840**	**96740**	**92475**	**111422**	**132854**
Expenses	75420	75680	69727	84393	100806
EBITDA	**19420**	**21060**	**22749**	**27029**	**32048**
Depreciation & Amortisation	12960	15280	13014	13965	14795
EBIT	**6460**	**5780**	**9735**	**13064**	**17253**
Other Income	2350	2170	2148	2320	2550
Interest Cost	5420	4380	3979	4048	3887
Exceptioanl Items	0	0	0	0	0
PBT	**3390**	**3570**	**7903**	**11337**	**15917**
Tax expense	-100	1190	2608	3741	5252
PAT	**3490**	**2380**	**5295**	**7596**	**10664**
Noncontrolling interests	410	140	140	140	140
Adj. PAT	**3080**	**2240**	**5155**	**7456**	**10524**

Balance Sheet (Consolidated)					
Particulars (Rs Mn.)	**FY19**	**FY20**	**FY21E**	**FY22E**	**FY23E**
Share Capital	**390**	**390**	**378**	**378**	**378**
Reserves & Surplus	106000	105220	106534	113430	123394
Non controlling interests	110	250	320	397	494
Networth	**106500**	**105860**	**107232**	**114204**	**124265**
Long term Borrowings	**49700**	**47040**	**37050**	**34700**	**31590**
Other Non-Current Liabilities	15760	16980	16997	17206	17441
Short term Borrowings	**9080**	**12460**	**12960**	**12760**	**12560**
Other Current Liabilities	24340	23770	27491	33273	41947
Total Equity & Liabilities	**205380**	**206110**	**201730**	**212143**	**227803**
Net Tangibile Asset	**140930**	**142950**	**144936**	**146272**	**142777**
Non Current Investments	1090	1180	925	1114	1329
Other Non Current Assets	9320	5290	5159	5623	6566
Inventories	10320	9740	9294	11198	13352
Trade Receivables	5490	3970	3791	4568	5447
Cash and Cash Equivalents	4690	4030	1077	2345	9689
Current Investments	23150	26980	25893	28970	34542
Other Current assets	10390	11970	10655	12054	14103
Total Assets	**205380**	**206110**	**201730**	**212143**	**227803**

Source: Company Data, SMIFS Research

***The company has recently concluded a share buyback of 6.2 mn shares at a price of Rs 532 which has reduced the shares capital to Rs 378 mn.**

Financial Details

Cash Flow Statement (Consolidated)					
Particulars (Rs Mn.)	FY19	FY20	FY21E	FY22E	FY23E
PBT	**3390**	**3570**	**7903**	**11337**	**15917**
Depreciation & Amortisation	12960	15280	13014	13965	14795
Interest expense	5160	3640	3979	4048	3887
(Increase)/Decrease in CA & CL	-1630	2740	5809	1447	2885
Others	-1210	-1190	0	0	0
Taxes Paid	-240	-660	-2608	-3741	-5252
Cash Flow from Operating Activities	**18430**	**23380**	**28098**	**27054**	**32232**
Capital Expenditure	-9260	-13500	-15000	-15300	-11300
Others	11130	-4100	1272	-3329	-5830
Cash Flow Investing Activities	**1870**	**-17600**	**-13728**	**-18629**	**-17130**
Buyback Expense	0	0	-3280	0	0
Increase/(Decrease) in Borrowings	-15050	120	-9490	-2550	-3310
Dividend Payment	-400	-930	-560	-560	-560
Others	-5220	-5110	-3979	-4048	-3887
Cash Flow from Financing Activities	**-20670**	**-5920**	**-17322**	**-7158**	**-7757**
Net Cash Flow	**-370**	**-140**	**-2953**	**1268**	**7344**
Opening Cash	**3150**	**4690**	**4030**	**1077**	**2345**
Closing Balance	**4690**	**4030**	**1077**	**2345**	**9689**

Key Ratios					
Margins					
Particulars	FY19	FY20	FY21E	FY22E	FY23E
EBITDA Margin	20.5%	21.8%	24.6%	24.3%	24.1%
PAT Margin	3.2%	2.3%	5.6%	6.7%	7.9%
Per Share Data					
BVPS	551.7	548.6	574.1	611.4	665.3
EPS	16.0	11.6	27.6	39.9	56.3
DPS	2.1	4.8	3.0	3.0	3.0
No. of Shares	193.0	193.0	186.8	186.8	186.8
Financial Ratios					
ROE	2.9%	2.1%	4.8%	6.6%	8.5%
ROCE	3.9%	3.5%	6.2%	8.1%	10.2%
ROCE -Ex Goodwill	9.6%	9.2%	11.6%	13.6%	15.7%
Debt/Equity(x)	0.6	0.6	0.5	0.4	0.4
Interest Coverage (x)	1.2	1.3	2.4	3.2	4.4
Valuation Ratios(x)					
P/E	50.1	60.2	27.7	19.1	13.6
P/BV	1.4	1.3	1.3	1.3	1.1
EV/EBITDA	9.1	7.2	6.9	5.5	4.2
EV/Tonne ($)	88.5	76.1	78.9	56.6	47.8

Source: Company Data, SMIFS Research

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