J K Cement

BSE SENSEX	S&P CNX
31,160	9,736

CMP: INR945 TP: INR1,196 (+26%) Buy

Stock Info

Bloomberg	JKCE IN
Equity Shares (m)	69.9
52-Week Range (INR)	1195/630
1, 6, 12 Rel. Per (%)	-4/-1/6
M.Cap. (INR b)	66.1
M.Cap. (USD b)	1.0
Avg Val, INRm	40.0
Free float (%)	35.8

Financials Snapshot (INR b)

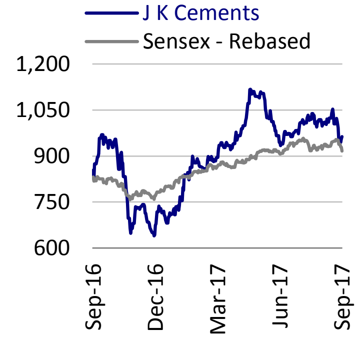
Y/E Mar	2017	2018E	2019E
Net Sales	39.7	44.4	50.1
EBITDA	6.7	7.8	9.0
PAT	2.4	2.8	3.8
EPS (INR)	33.7	39.7	54.4
Gr. (%)	329	18	37
BV/Sh (INR)	252	287	335
RoE (%)	14.4	14.8	17.5
RoCE (%)	9.7	9.8	11.2
P/E (x)	28.0	23.8	17.4
P/BV (x)	3.8	3.3	2.8

Shareholding pattern (%)

As On	Jun-17	Mar-17	Jun-16
Promoter	64.2	64.2	67.0
DII	13.1	16.7	13.7
FII	11.4	11.3	11.3
Others	11.3	7.9	7.9

FII Includes depository receipts

Stock Performance (1-year)



Grey cement assets available at discount to peers

Best-placed midcap cement company in North markets

- **JKCE's 10.5mt grey cement capacity is available at an EV/t of USD40-70 (64-34% discount to midcap cement) on FY19 basis, if we value its white cement business at 14-10x FY19E EV/EBITDA.**
- **Its white cement business deserves a premium over its grey cement business, given raw material constraint, JKCE's 45% market share, and superior profitability.**
- **The company is strategically placed, with 70-75% exposure to North markets as also considerable exposure to key markets of West and South India.**
- **North markets likely to see the highest price improvement, driven by increase in utilization on favorable base, limited supply addition and demand stabilization.**
- **With its grey cement business scaling up to ~14mt over the next 3-4 years, JKCE could see a multiple re-rating.**

Grey cement business at significant discount to peers

JKCE's grey cement capacity of 10.5mt is available at 64-34% discount to peers, if we value the white cement business at 14-10x FY19E EV/EBITDA. While ~30% of JKCE's grey cement capacity is inefficient due to legacy designing issues and old plants, the management has been successful in diversifying to efficient assets by way of a new unit in Mangrol and split grinding unit in Haryana. In our view, despite its inefficient assets, the steep 34-64% discount is not warranted, as the residual assets are earning good profitability for the segment.

White cement business deserves a premium

We believe that JKCE's white cement business deserves a premium over its grey cement business, as (i) raw material for white cement is scarce, and only two players – JKCE and UTCEM – have access to the same, (ii) white cement market in India is an oligopoly, with JKCE commanding 40-45% share, and (iii) profitability of the white cement business is far superior to the grey cement business.

Favorable market mix

JKCE has exposure to key markets where growth is expected to be strong in the medium term. It has exposure to key markets of the North, where demand is expected to be buoyant, as also in markets of West India and Karnataka, where demand outlook is healthy on the back of good monsoon and upcoming elections.

Key beneficiary of expected revival in North market

With 70% exposure to North markets, JKCE will be a key beneficiary of utilization improvement in the North on account of limited supply addition. The North is unlikely to see any clinker capacity addition for the next 12 months, which should result in strong utilization improvement and better pricing for the region.

Scaling up grey cement business to ~14mt in 3-4 years

JKCE intends to increase its grey cement capacity by ~33% over the next 3-4 years at an estimated capex of INR10b-15b. The expansion would be by way of brownfield expansion in the North, followed by greenfield expansion in the central region. This will help JKCE to reduce the proportion of inefficient assets from 30% to ~23% over the next 3-4 years and scale capacity, which could drive a re-rating.

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Valuation and view

JKCE is strategically placed to benefit from the expected price improvement in the North due to limited supply addition. Incrementally, the grey cement division should see marked improvement in profitability due to higher proportion of volumes from new efficient units. The white cement business has gained meaningful scale and deserves premium valuations, given raw material scarcity and JKCE's 40-45% share in the domestic white cement market. We value the white cement segment at an EV/EBITDA of 11.5x FY20E and the grey cement business at an EV/EBITDA of 8x (FY20E) to arrive at a target price of INR1,196 (implied EV/tonne of USD140 on standalone capacity). **Buy**.

Grey cement business at significant discount to peers

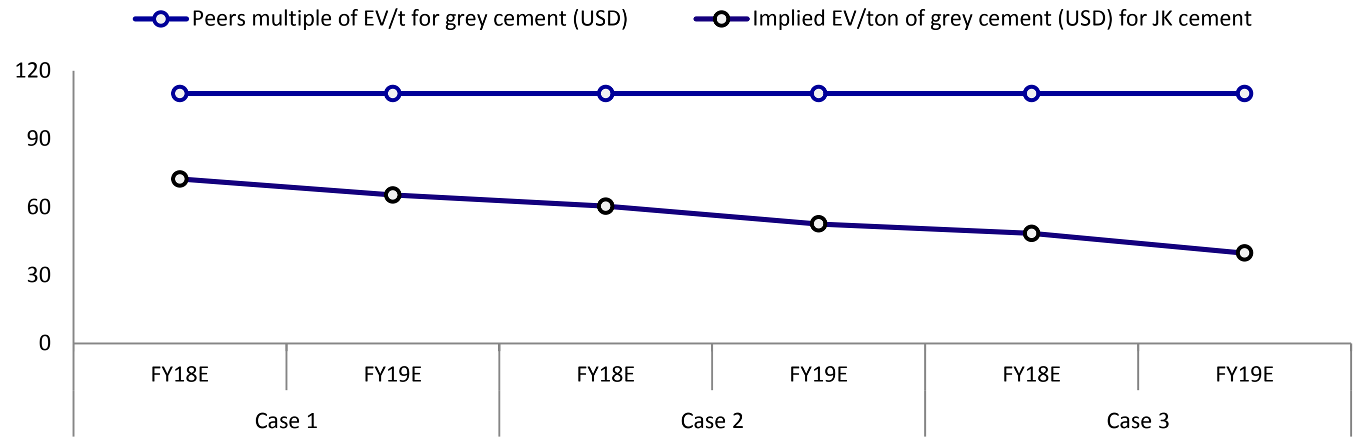
- We have valued the Fujairah, UAE business of JKCE at 6x EV/EBITDA and build scenarios with different multiples for the white cement business to analyze the valuation ascribed to its grey cement business.
- We have valued the white cement business at 10x/12x/14x FY19E EV/EBITDA, implying that the grey cement business is ascribed a valuation (USD/tonne) of 72/60/48 (FY18E) and 65/53/40 (FY19E).
- Valuing the white cement business at EV/EBITDA of 10x/12x/14x (FY19E), JKCE's grey cement business trades at 34%/45%/56% (FY18E) and 41%/52%/64% (FY19E) discount to peers.

Exhibit 1: Implied EV/t for JKCE's grey cement business for different EV/EBITDA multiples of white cement business

	Case 1		Case 2		Case 3	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
White cement						
EBITDA (INR m)	4,074	4,342	4,074	4,342	4,074	4,342
EV/EBITDA multiple(x)	10	10	12	12	14	14
EV (INR m)	40739	43417	48887	52101	57035	60784
Fujairah, UAE dual process						
EBITDA (INR m)	447	553	447	553	447	553
EV/EBITDA multiple(x)	6	6	6	6	6	6
EV (INR m)	2,680	3,318	2,680	3,318	2,680	3,318
Consol operations						
EV (INR m)	92690	91204	92690	91204	92690	91204
Implied grey cement EV (INR m)	49,271	44,469	41,123	35,785	32,975	27,102
Grey cement capacity	10.4719	10.4719	10.4719	10.4719	10.4719	10.4719
USD/INR	65	65	65	65	65	65
EV/tonne for grey cement (USD/ton)	72	65	60	53	48	40

Source: MOSL, Company

Exhibit 2: Grey cement business at significant discount to peers

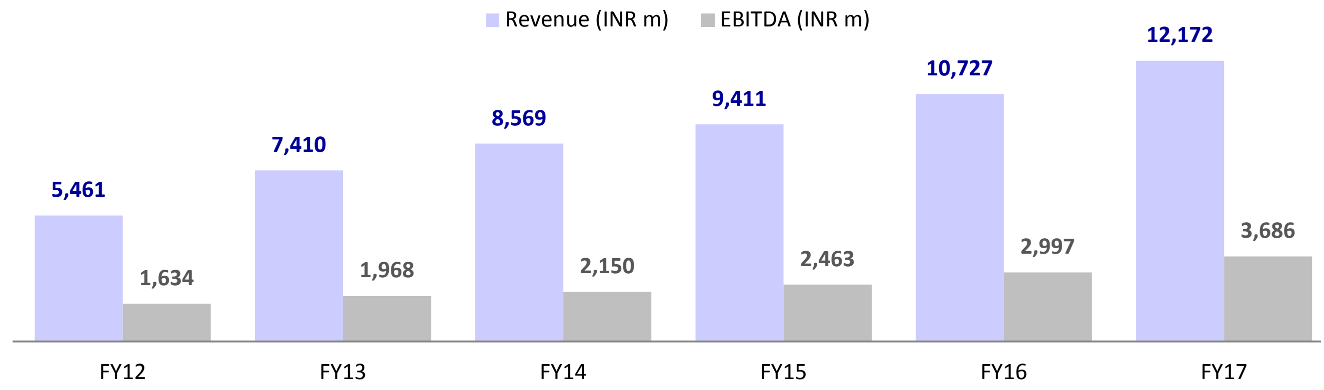


Source: MOSL, Company

White cement business deserves premium valuation

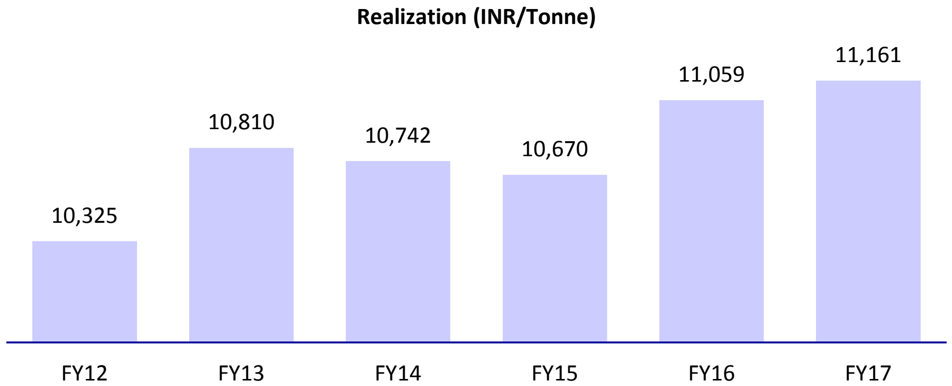
- Profitability of the white cement business has consistently improved over the last few years as is evident from the EBIDTA CAGR of ~18% over FY12-17. White cement contributed ~57% of JKCE's EBITDA in FY17, up from ~36% in FY13.
- We believe the segment deserves to get premium valuations, because:
  - Raw material for the production of white cement is scarce
  - JKCE is the second-largest player in white cement, with ~45% market share, and
  - Oligopoly structure of the market
- Additionally, JKCE is increasing its wall putty capacity, which should aid the next leg of growth in the segment. We expect white cement EBITDA to grow at a CAGR of ~10% over FY17-20.

Exhibit 3: White cement – revenue and EBITDA (INR m) trend



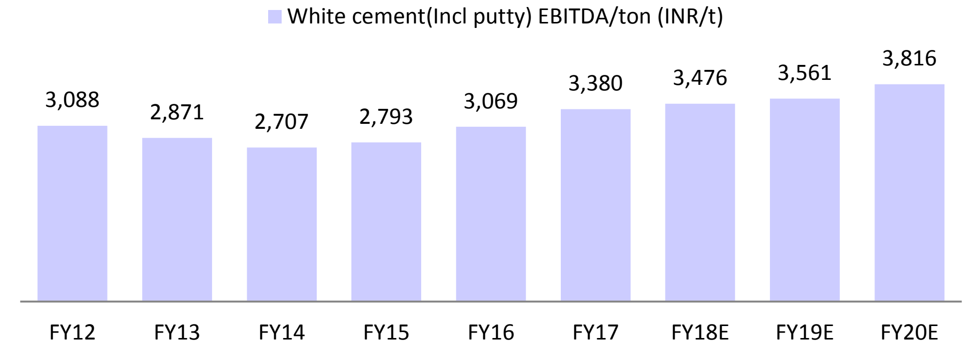
Source: Company, MOSL

Exhibit 4: White cement – realization (INR/tonne) trend



Source: Company, MOSL

Exhibit 5: White cement (including putty) EBITDA/t trend



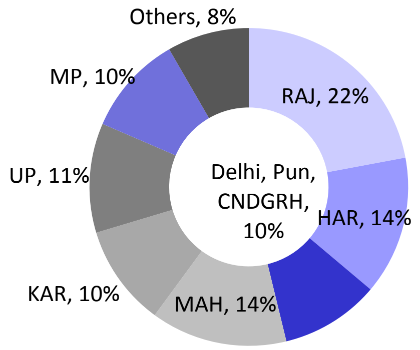
Source: MOSL, Company

Favorable market mix

JKCE is strategically placed in the North, where we expect price improvement to be the maximum due to (1) meaningful slowdown in supply addition in the region after five years, and (2) better pricing discipline, as demand uptick in the region should result in higher utilization levels.

Exposure to favorable markets like Rajasthan, Haryana and Madhya Pradesh (~46% of overall sales) is likely to benefit JKCE. JKCE also has ~25% volume exposure to Karnataka and Maharashtra, where prices are beginning to stabilize. However, entry of Shree Cements in the Gulbarga region could pose a threat in the medium term.

Exhibit 6: JKCE's market mix



Source: Company, MOSL

Exhibit 7: Demand trends for FY18

State	Demand trend for FY18
Maharashtra	❖ Good monsoon likely to drive further demand
Uttar Pradesh	❖ Demand destruction in short term due to sand mining ban, long term growth prospects intact
Karnataka	❖ Upcoming elections in 2018 to drive demand
MP	❖ Upcoming elections in next 15-18 months will drive demand
Gujarat	❖ Upcoming elections in Jan -18 to drive demand

Source: Company, MOSL

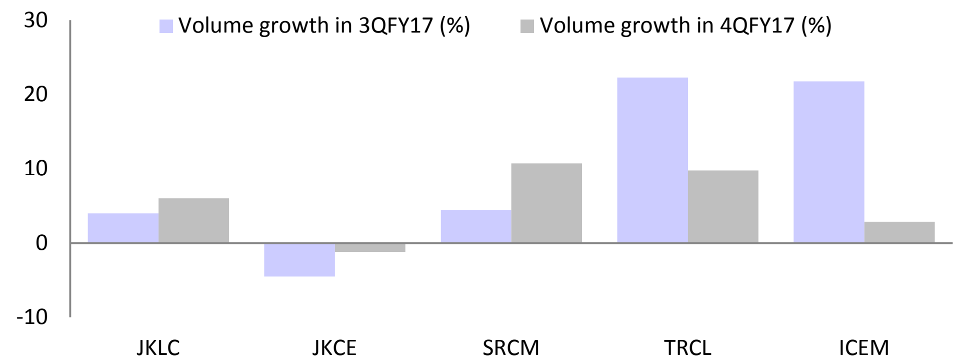
Key beneficiary of expected revival in North market: With 70% exposure to North markets, JKCE will be the key beneficiary of utilization improvement in the North on account of limited supply addition. The North is unlikely to see any clinker capacity addition for the next 12 months, which should result in strong utilization improvement and better pricing scenario for the region.

Favorable base from 2HFY17 should drive growth in North

- The northern region is witnessing stable demand emanating from Individual Housing Segment (IHB), resulting in demand increasing by 4-5% YoY for 2QFY18. Additionally, as the region has a favorable base for 2HFY18 due to accentuated impact of demonetization in 2HFY17, demand growth outlook in 2HFY18 appears positive.

- The region has witnessed some easing of supply as Binani Cement has withdrawn annual volume of 3-4mt (4-5% of regional volume) from the region due to financial troubles, resulting in market share gains for others.
- This coupled with the fact that the region is unlikely to see any clinker capacity addition over the next 18 months should bode well for pricing in the region and result in better utilization for the region.

Exhibit 8: Cement demand in the North is favorable due to low base from 1HFY17

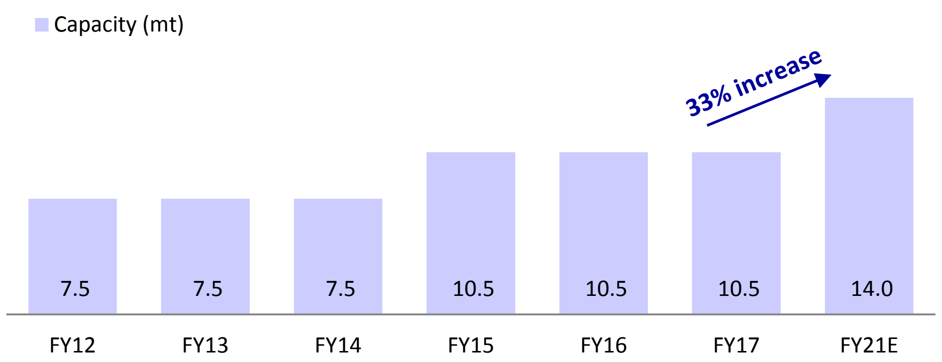


Source: MOSL, Company

Scaling grey cement capacity to ~14mt in 3-4 years

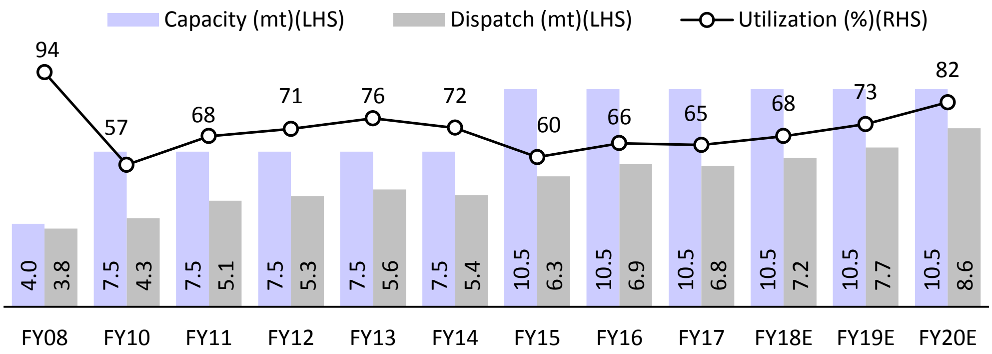
- JKCE intends to increase its grey cement capacity by ~33% over the next 3-4 years at an estimated capex of INR10b-15b. This would be by way of brownfield expansion in the North, followed by greenfield expansion in the central region.
- While the exact details for the expansion plan have not been firmed up, this will help JKCE to reduce the proportion of inefficient assets from 30% to ~23% over the next 3-4 years and also scale capacity, which could drive multiple re-rating.

Exhibit 9: JKCE's grey cement capacity to increase by ~33% over FY17-21E



Source: MOSL, Company

Exhibit 10: Grey cement volumes to grow at a CAGR of 8% over FY17-20E



Source: MOSL, Company

Valuation and view

JKCE is strategically placed to benefit from the expected price improvement in the North due to limited supply addition. Incrementally, the grey cement division should see marked improvement in profitability due to higher proportion of volumes from new efficient units. The white cement business has gained meaningful scale and deserves premium valuations, given raw material scarcity and JKCE's 40-45% share in the domestic white cement market. We value the white cement segment at an EV/EBITDA of 11.5x FY20E and the grey cement business at an EV/EBITDA of 8x (FY20E) to arrive at a target price of INR1,196 (implied EV/tonne of USD140 on standalone capacity).

Financials and Valuations

Income Statement								(INR Million)
Y/E March	**2013**	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Net Sales	**29,040**	**27,815**	**33,874**	**37,463**	**39,694**	**44,431**	**50,065**	**56,352**
Change (%)	14.4	-4.2	21.8	10.6	6.0	11.9	12.7	12.6
Total Expenditure	23,547	24,431	29,566	32,399	32,953	36,648	41,043	45,846
% of Sales	81.1	87.8	87.3	86.5	83.0	82.5	82.0	81.4
EBITDA	**5,493**	**3,384**	**4,308**	**5,065**	**6,741**	**7,783**	**9,021**	**10,507**
Margin (%)	18.9	12.2	12.7	13.5	17.0	17.5	18.0	18.6
Depreciation	1,287	1,342	1,461	1,974	2,169	2,157	2,070	2,129
EBIT	**4,206**	**2,042**	**2,847**	**3,091**	**4,572**	**5,627**	**6,952**	**8,378**
Int. and Finance Charges	1,398	1,526	2,291	3,049	2,954	2,748	2,702	2,664
Other Income - Rec.	567	626	713	895	1,432	808	874	956
PBT bef. EO Exp.	**3,375**	**1,142**	**1,269**	**936**	**3,049**	**3,686**	**5,124**	**6,670**
EO Expense/(Income)	0	0	-172	0	193	0	0	0
PBT after EO Exp.	**3,375**	**1,142**	**1,441**	**936**	**2,856**	**3,686**	**5,124**	**6,670**
Current Tax	1,071	392	22	388	649	1,184	1,583	2,015
Deferred Tax	0	0	0	0	0	-276	-264	-336
Tax Rate (%)	31.7	34.4	1.5	41.4	22.7	24.6	25.7	25.2
Reported PAT	**2,305**	**749**	**1,419**	**548.3**	**2,207.6**	**2,779**	**3,805**	**4,991**
PAT Adj for EO items	**2,305**	**749**	**1,250**	**548**	**2,357**	**2,779**	**3,805**	**4,991**
Change (%)	28.5	-67.5	66.8	-56.1	329.9	17.9	36.9	31.2
Margin (%)	7.9	2.7	3.7	1.5	5.9	6.3	7.6	8.9
Less: Mionrity Interest	-3.083	-22.1	-17.2	-30.2	-57.7	0.0	0.0	0.0
Net Profit	**2,308**	**772**	**1,267**	**578**	**2,415**	**2,779**	**3,805**	**4,991**

Balance Sheet								(INR Million)
Y/E March	**2013**	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Equity Share Capital	699	699	699	699	699	699	699	699
Total Reserves	16,206	16,762	15,470	15,171	16,896	19,361	22,747	27,211
Net Worth	**16,905**	**17,462**	**16,170**	**15,870**	**17,595**	**20,060**	**23,446**	**27,910**
Deferred Liabilities	2,490	2,685	2,798	2,165	2,111	1,835	1,571	1,235
Total Loans	12,482	27,750	30,308	31,204	31,306	30,306	30,306	30,306
Capital Employed	**31,925**	**48,041**	**49,404**	**49,337**	**51,052**	**52,241**	**55,363**	**59,491**
Gross Block	30,822	31,743	50,671	53,636	58,456	60,456	64,456	70,456
Less: Accum. Deprn.	7,132	8,474	9,935	11,100	13,039	15,196	17,265	19,394
Net Fixed Assets	**23,690**	**23,269**	**40,736**	**42,535**	**45,417**	**45,261**	**47,191**	**51,062**
Capital WIP	2,546	17,875	3,373	3,211	1,267	1,267	1,267	267
Total Investments	**324**	**675**	**365**	**786**	**803**	**803**	**803**	**803**
Curr. Assets, Loans&Adv.	**13,518**	**15,814**	**16,027**	**15,261**	**16,555**	**15,965**	**17,844**	**20,318**
Inventory	4,614	5,420	5,415	4,931	5,609	5,490	5,554	5,730
Account Receivables	1,153	1,117	1,771	2,113	2,019	2,509	2,828	3,191
Cash and Bank Balance	3,753	4,086	4,171	3,731	4,272	2,898	4,384	6,026
Loans and Advances	3,998	5,191	4,670	4,486	4,655	5,068	5,078	5,372
Curr. Liability & Prov.	**8,152**	**9,592**	**11,097**	**12,511**	**12,991**	**11,054**	**11,742**	**12,959**
Account Payables	1,966	4,401	3,071	3,047	2,337	3,379	3,809	4,297
Provisions	799	497	673	370	434	355	475	604
Net Current Assets	**5,365**	**6,222**	**4,929**	**2,750**	**3,565**	**4,911**	**6,102**	**7,359**
Appl. of Funds	**31,925**	**48,041**	**49,404**	**49,282**	**51,052**	**52,241**	**55,363**	**59,491**

E: MOSL Estimates

Financials and Valuations

Ratios

Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
Basic (INR) *								
Consol EPS	**33.0**	**10.7**	**17.9**	**7.8**	**33.7**	**39.7**	**54.4**	**71.4**
Cash EPS	51.4	29.9	38.8	36.1	64.7	70.6	84.0	101.8
BV/Share	241.7	249.7	231.2	227.0	251.6	286.9	335.3	399.1
DPS	6.5	3.0	4.0	4.0	8.0	7.0	7.0	7.0
Payout (%)	23.1	32.7	23.1	59.7	29.6	20.6	15.1	11.5
Valuation (x) *								
P/E				120.5	28.0	23.8	17.4	13.2
Cash P/E				26.2	14.6	13.4	11.2	9.3
P/BV				4.2	3.8	3.3	2.8	2.4
EV/Sales				2.4	2.3	2.1	1.8	1.6
EV/EBITDA				17.7	13.5	11.7	10.0	8.5
EV/Ton (US$)				119	120	120	118	117
Dividend Yield (%)				0.4	0.8	0.7	0.7	0.7
Return Ratios (%)								
RoIC	11.4	5.3	8.4	4.4	8.2	9.2	10.7	12.4
RoE	14.4	4.5	7.5	3.6	14.4	14.8	17.5	19.4
RoCE	11.3	4.7	7.6	5.0	9.7	9.8	11.2	12.5
Working Capital Ratios								
Asset Turnover (x)	0.9	0.6	0.7	0.8	0.8	0.9	0.9	0.9
Inventory (Days)	58.0	71.1	58.3	48.0	51.6	45.1	40.5	37.1
Debtor (Days)	13	13	17	18	16	18	18	18
Creditor (Days)	25	58	33	30	21	28	28	28
Working Capital Turnover (Days)	20	28	8	-10	-7	17	13	9
Leverage Ratio (x)								
Current Ratio	1.7	1.6	1.4	1.2	1.3	1.4	1.5	1.6
Debt/Equity	0.7	1.6	1.9	2.0	1.8	1.5	1.3	1.1

Cash Flow Statement

Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
Oper. Profit/(Loss) before Tax	4,206	2,042	2,847	3,091	4,572	5,627	6,952	8,378
Interest/Dividends Recd.	567	626	713	895	1,432	808	874	956
Depreciation	1,287	1,342	1,461	1,974	2,169	2,157	2,070	2,129
Direct Taxes Paid	-872	-198	91	-1,076	-648	-1,184	-1,583	-2,015
(Inc)/Dec in WC	419	-528	1,550	1,739	-274	-2,720	295	385
CF from Operations	**5,608**	**3,284**	**6,662**	**6,623**	**7,251**	**4,687**	**8,607**	**9,833**
EO expense	-1	4	0	0	0	-193	0	0
CF from Operating incl EO	**5,607**	**3,288**	**6,662**	**6,623**	**7,251**	**4,494**	**8,607**	**9,833**
(inc)/dec in FA	-3,451	-16,250	-4,426	-2,802	-2,877	-2,000	-4,000	-5,000
Free Cash Flow	**2,156**	**-12,962**	**2,237**	**3,820**	**4,374**	**2,494**	**4,607**	**4,833**
(Pur)/Sale of Investments	-232	-351	310	-421	-16	0	0	0
CF from investments	**-3,683**	**-16,601**	**-4,116**	**-3,224**	**-2,894**	**-2,000**	**-4,000**	**-5,000**
Issue of Shares	-91	30	-2,401	-551	114	0	0	0
(Inc)/Dec in Debt	-481	15,268	2,558	896	102	-1,000	0	0
Interest Paid	-1,398	-1,526	-2,291	-3,049	-2,954	-2,748	-2,702	-2,664
Dividend Paid	-532	-245	-327	-327	-654	-573	-573	-573
CF from Fin. Activity	**-2,503**	**13,527**	**-2,462**	**-3,031**	**-3,393**	**-4,321**	**-3,274**	**-3,237**
Inc/Dec of Cash	**-579**	**214**	**85**	**368**	**965**	**-1,827**	**1,333**	**1,596**
Add: Beginning Balance	4,332	3,753	4,086	4,171	3,731	4,272	2,898	4,384
Closing Balance	**3,753**	**3,967**	**4,171**	**4,540**	**4,696**	**2,445**	**4,231**	**5,980**

Disclosures:

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