COMPANY UPDATE

JK CEMENT

Opportune capex

India Equity Research| Cement

JK Cement's (JKCE) recently announced 4.2mtpa capex is well timed as it imparts much-needed growth visibility to its North operations where clinker utilisations are already at ~85% (implying limited scope for volume growth beyond FY20). Moreover, expansion on home turf has added advantage of easy volume acceptability in the market and lead distance optimisation. Even though JKCE is yet to finalise capex funding mix, we see little cause for concern over potential equity dilution (if any). Our scenario analysis assuming ~7-9% equity dilution (~INR5-7bn fund raise) indicates no major change in target price and EPS. While net debt rise is imminent (irrespective of funding mix), we believe the rock-steady white segment entails potential to cushion against any volatility in grey cement. With superior RoE, we value JKCE at 11x FY20E EV/EBITDA and maintain 'BUY' with TP of INR1,371.

Timely capex imparts volume growth visibility on home turf

With JKCE's clinker utilisation in North already at ~85%, we believe the recently announced 4.2mtpa expansion (40% of existing capacity) is well timed. Except for the 0.7mtpa split grinding unit in East Gujarat, the balance 3.5mtpa is dedicated to the company's home turf in North India, assuring easy volume acceptability and lead distance optimisation. The project is expected to get commissioned by end of FY20.

Overhang of equity dilution? Time to look beyond

While funding mix for the INR20bn capex is yet to be finalised, equity dilution overhang should not deter investors. Our scenario analysis assuming ~7-9% equity dilution indicates no major change in our TP (refer table 1). The recent ~10% stock correction (tracking weak cement prices in current busy season, primarily in North, and overall weakness in markets) offers good entry point from medium- to long-term perspective.

Outlook and valuations: On terra firma; maintain 'BUY'

JKCE is on solid turf given: i) its grey segment will benefit from rising industry clinker utilisation; ii) recently announced capex offers visibility on future growth; and iii) steady growth in robust white cement business entails potential to mitigate risks in grey cement business. Factoring superior RoE over peers, we continue to value JKCE at 11x FY20E EV/EBIDTA and maintain **'BUY/SO'** with TP of INR1,371. Disappointment in price/volume trend or huge jump in energy cost are key risks.

Financials **(INR mn)**

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	40,623	47,449	52,725	58,020
EBITDA	7,670	8,017	9,345	11,583
Adjusted Profit	2,415	2,900	3,436	4,735
Diluted P/E (x)	29.9	24.9	21.0	15.3
EV/EBITDA (x)	13.2	12.4	11.1	9.4
ROAE (%)	14.4	15.5	16.2	19.2

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA *(R: JKCE.BO, B: JKCE IN)*

CMP	: INR 1,034
Target Price	: INR 1,371
52-week range (INR)	: 1,196 / 836
Share in issue (mn)	: 69.9
M cap (INR bn/USD mn)	: 72 / 1,116
Avg. Daily Vol.BSE/NSE('000)	: 41.9

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	64.2	64.2	64.2
MF's, FI's & BK's	16.7	16.4	13.3
FII's	10.6	11.2	11.3
Others	8.5	8.3	11.2

** Promoters pledged shares (% of share in issue) : NIL*

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Construction Material Index
1 month	(8.3)	(4.9)	(5.9)
3 months	0.8	0.6	(1.9)
12 months	15.0	16.7	21.5

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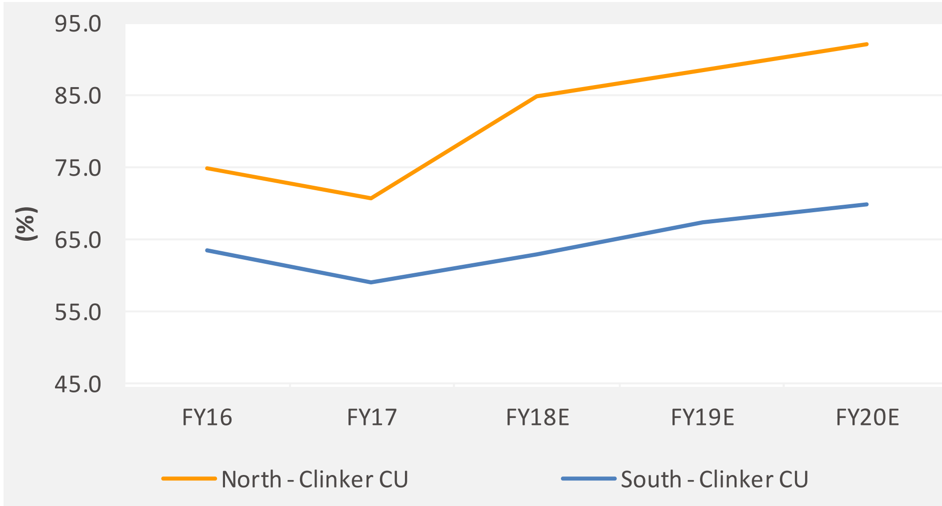
February 21, 2018

Rising clinker utilisation in North demands future capex

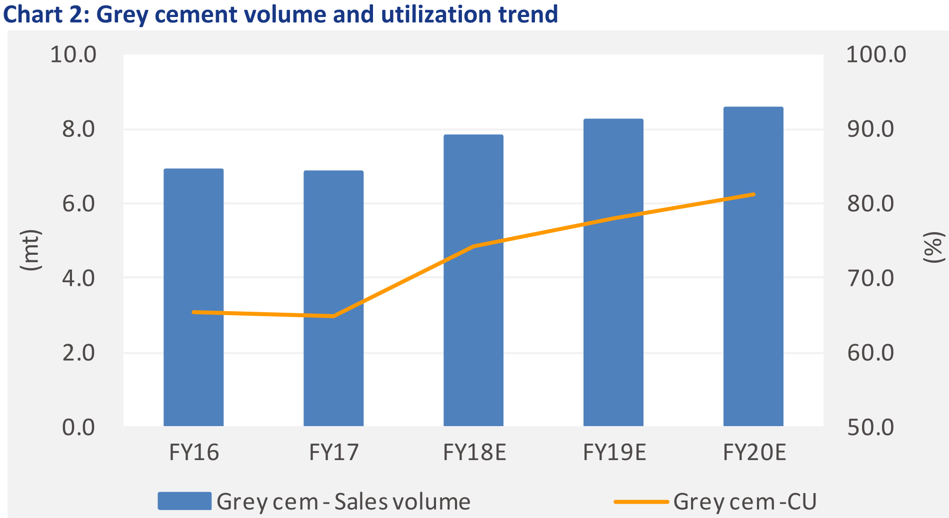
While JKCE's FY18 clinker utilisation is pegged at ~79% (67% in FY17), for its operations in the North it is pegged at a high of 85%. To cater to volume growth beyond the next two years in North, capacity expansion was imperative.

Chart 1: Clinker utilisation in North nearing peak



Source: Company, Edelweiss research

Chart 2: Grey cement volume and utilization trend



Source: Company, Edelweiss research

Equity dilution, if any, not likely to erode investor value

Even though JKCE is yet to finalise the funding mix for the INR20bn capex, a potential equity dilution must not deter investors, in our view. As per our scenario analysis, a 7-9% equity dilution (implying INR5-7bn equity fund raise) will not materially impact our target price.

Table 1: Equity dilution—Scenario analysis

Capex Funding	Scenario I No Equity Dilution	Scenario II INR 5bn fund raise assuming ~7% equity dilution	Scenario III INR 7bn fund raise assuming ~9% equity dilution
Project cost (INR mn)	20,000	20,000	20,000
Equity fund raise (INR mn)	-	5,000	7,000
Equity Dilution (%)	-	6.5	9.1
Shares o/s (mn)	69.9	74.5	76.3
Net debt (INR mn)			
FY18	26,404	26,404	26,404
FY19	31,605	26,486	24,442
FY20	36,936	31,522	29,363
Net debt/ EBITDA (x)			
FY18	3.3	3.3	3.3
FY19	3.4	2.8	2.6
FY20	3.2	2.7	2.5
EPS (INR)			
FY18	41.5	41.5	41.5
FY19	49.1	48.3	48.0
FY20	67.7	68.1	68.2
ROE (%)			
FY18	15.5	15.5	15.5
FY19	16.2	15.1	14.7
FY20	19.2	16.9	16.2
Target price working (INR mn)	**Current TP**		
EV/EBITDA multiple (x)	11.0	11.0	11.0
FY20E EBITDA	11,583	11,583	11,583
EV	127,445	127,445	127,445
FY19E Net Debt	31,605	26,486	24,442
MCap	95,840	100,959	103,003
Shares o/s (mn)	70	74	76
Target price per share (INR)	1,371	1,356	1,350

Source: Company, Edelweiss research

Key assumptions for the above scenario analysis are:

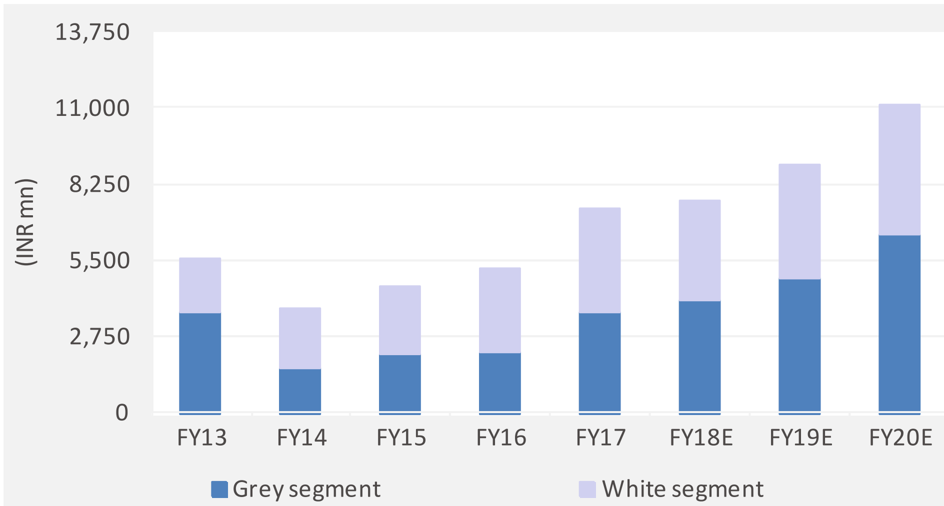
1. Cash outflow of INR8bn in FY19 and INR10bn in FY20 towards the new project, excluding ~INR2bn p.a. of maintenance and other capex.
2. Net debt is for the consolidated entity including working capital loan.
3. We have assumed a price of INR1,100/share for calculating equity dilution.

White cement business capable of mitigating potential risks

We believe, JKCE's white segment has potential to mitigate risks in grey cement business. For FY17, the segment reported EBITDA of ~INR4bn, of which ~INR3.7bn was from domestic operations (i.e., ~50% of standalone EBITDA). Since FY11, the domestic white cement segment has clocked 20% EBITDA CAGR and we peg it at 13% over the next two years.

As per our current estimates, without assuming any equity fund raise, the consolidated net debt will rise to ~INR37bn by FY20 (INR26.4bn in FY18E). White segment entails potential to meet the cost of JKCE's entire debt, thereby cushioning against any volatility in the grey cement business.

Chart 3: Robust white cement contributes ~50% to EBITDA



Source: Company, Edelweiss research

Company Description

JKCE is one of the leading cement manufacturers in India and also the second-largest white cement manufacturer in the country. It is an affiliate of the JK Organisation, which was founded by Mr. Lala Kamlapat Singhania. Currently, the company has grey cement installed capacity of 10.5mtpa with manufacturing plants at Nimbahera, Mangrol and Gotan in Rajasthan and Muddapur in Karnataka. JKCE is second largest producers of white cement in India with a capacity of 0.6mtpa and also is a leading manufacturer of putty with installed capacity of 0.7mtpa. The company also has an overseas subsidiary which operates a 0.6mtpa white cement plant in Fujairah, UAE.

Investment Theme

We continue to like JKCE as it is likely to be one of the beneficiaries of anticipated rise in industry clinker utilisation rates for grey cement (especially in North). Steady volumes and EBITDA growth in white cement cushion downside risks, if any, from price volatility in grey cement. Factoring in superior RoE of 19% in FY20E and capex completion benefits in FY21, we value JKCE at 11x FY20E EV/EBITDA.

Key Risks

Sharp decline in cement prices/demand and/or sharp increase in input cost.

Financial Statements

Key Assumptions

Year to March	FY17	FY18E	FY19E	FY20E
Macro				
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.8	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
USD/INR (Avg)	67.1	64.5	65.0	66.0
Company				
Inst capacity (mtpa)	12	12	13	13
Capacity Utilisation (%)	65	74	78	81
Grey Cem Sales Vol (mt)	6.8	7.8	8.2	8.5
White Cem Sales Vol (mt)	1.1	1.2	1.3	1.4
Grey Cem realiztn(INR/t)	3,648	3,920	4,092	4,317
Wht Cem realiztn (INR/t)	11,222	11,332	11,569	11,916
RM cost per tonne	926	902	917	944
P&F cost per tonne	809	943	1,017	1,047
Freight cost per tonne	927	1,104	1,146	1,180
Employee cost per tonne	384	383	379	383
Other expenses per tonne	967	893	919	922
Total expenses per tonne	4,013	4,226	4,377	4,477
Grey Cmt EBITDA/t (INR)	535	517	587	755
White Cmt EBITDA/t (INR)	3,399	3,149	3,239	3,396
Effective tax rate (%)	22.7	25.0	25.0	25.0
Debtor days	19	16	16	15
Inventory days	88	76	72	69
Payable days	45	32	32	31

Income statement **(INR mn)**

Year to March	FY17	FY18E	FY19E	FY20E
Income from operations	40,623	47,449	52,725	58,020
Materials costs	7,599	8,421	9,088	9,796
Power and fuel	6,645	8,800	10,076	10,861
Freight	7,615	10,304	11,355	12,239
Employee costs	3,155	3,573	3,751	3,976
Other Expenses	22,198	27,439	30,540	32,664
EBITDA	7,670	8,017	9,345	11,583
Depreciation	2,169	2,169	2,232	2,295
EBIT	5,500	5,848	7,114	9,288
Add: Other income	503	847	253	72
Less: Interest Expense	2,954	2,829	2,785	3,046
Profit Before Tax	2,856	3,866	4,581	6,313
Less: Provision for Tax	649	967	1,145	1,578
Less: Minority Interest	(58)	-	-	-
Reported Profit	2,265	2,900	3,436	4,735
Adjusted Profit	2,415	2,900	3,436	4,735
Shares o /s (mn)	70	70	70	70
Adjusted Basic EPS	34.5	41.5	49.1	67.7
Diluted shares o/s (mn)	70	70	70	70
Adjusted Diluted EPS	34.5	41.5	49.1	67.7
Adjusted Cash EPS	65.6	72.5	81.0	100.5
Dividend per share (DPS)	8.0	8.0	8.0	8.0
Dividend Payout Ratio(%)	28.9	22.6	19.0	13.8

Common size metrics

Year to March	FY17	FY18E	FY19E	FY20E
Operating expenses	81.1	83.1	82.3	80.0
EBITDA margins	18.9	16.9	17.7	20.0
Net Profit margins	5.8	6.1	6.5	8.2

Growth ratios (%)

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	7.3	16.8	11.1	10.0
EBITDA	40.4	4.5	16.6	23.9
Adjusted Profit	317.4	20.1	18.5	37.8
EPS	317.4	20.1	18.5	37.8

Balance sheet (INR mn)

As on 31st March	FY17	FY18E	FY19E	FY20E
Share capital	699	699	699	699
Reserves & Surplus	16,896	19,141	21,922	26,003
Shareholders' funds	17,595	19,840	22,621	26,702
Minority Interest	40	40	40	40
Short term borrowings	4,455	4,455	4,455	4,455
Long term borrowings	29,062	27,062	28,062	33,062
Total Borrowings	33,517	31,517	32,517	37,517
Def. Tax Liability (net)	4,629	4,629	4,629	4,629
Sources of funds	**55,779**	**56,025**	**59,806**	**68,886**
Gross Block	59,488	60,988	62,988	64,488
Net Block	45,184	44,515	44,284	43,489
Intangible Assets	233	233	233	233
CWIP (incl. intangible)	1,267	1,767	9,767	19,767
Total Fixed Assets	46,685	46,517	54,285	63,491
Non current investments	803	803	150	150
Cash and Equivalents	4,271	4,460	911	580
Inventories	5,609	5,858	6,122	6,352
Trade receivables	2,019	2,198	2,342	2,493
Loans & Advances	2,251	2,251	2,251	2,251
Other Current Assets	2,404	2,404	2,404	2,404
Current Assets (ex cash)	12,283	12,711	13,119	13,500
Trade payable	2,337	2,540	2,733	2,908
Other Current Liab	5,925	5,925	5,925	5,925
Total Current Liab	8,262	8,465	8,658	8,833
Net Curr Assets-ex cash	4,021	4,246	4,461	4,667
Uses of funds	**55,779**	**56,025**	**59,806**	**68,886**
BVPS (INR)	251.6	283.7	323.5	381.9

Free cash flow (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Reported Profit	2,265	2,900	3,436	4,735
Add: Depreciation	2,169	2,169	2,232	2,295
Interest (Net of Tax)	2,283	2,122	2,089	2,285
Others	1,635	(2,122)	(2,089)	(2,285)
Less: Changes in WC	758	226	214	206
Operating cash flow	7,595	4,843	5,453	6,824
Less: Capex	3,447	2,000	10,000	11,500
Free Cash Flow	**4,147**	**2,843**	**(4,547)**	**(4,676)**

Cash flow metrics

Year to March	FY17	FY18E	FY19E	FY20E
Operating cash flow	7,595	4,843	5,453	6,824
Investing cash flow	(3,329)	(2,000)	(9,347)	(11,500)
Financing cash flow	(3,724)	(2,655)	345	4,345
Net cash Flow	542	188	(3,549)	(331)
Capex	(3,447)	(2,000)	(10,000)	(11,500)
Dividend paid	(337)	(655)	(655)	(655)

Profitability and efficiency ratios

Year to March	FY17	FY18E	FY19E	FY20E
ROAE (%)	14.4	15.5	16.2	19.2
ROACE (%)	12.0	13.1	13.8	15.7
Debtors Days	19	16	16	15
Payable Days	45	32	32	31
Cash Conversion Cycle	62	60	56	53
Current Ratio	2.0	2.0	1.6	1.6
Gross Debt/EBITDA	4.4	3.9	3.5	3.2
Gross Debt/Equity	1.9	1.6	1.4	1.4
Adjusted Debt/Equity	1.9	1.6	1.4	1.4
Interest Coverage Ratio	1.9	2.1	2.6	3.0

Operating ratios

Year to March	FY17	FY18E	FY19E	FY20E
Total Asset Turnover	0.7	0.8	0.9	0.9
Fixed Asset Turnover	0.9	1.1	1.2	1.3
Equity Turnover	2.4	2.5	2.5	2.3

Valuation parameters

Year to March	FY17	FY18E	FY19E	FY20E
Adj. Diluted EPS (INR)	34.5	41.5	49.1	67.7
Y-o-Y growth (%)	*317.4*	*20.1*	*18.5*	*37.8*
Adjusted Cash EPS (INR)	65.6	72.5	81.0	100.5
Diluted P/E (x)	29.9	24.9	21.0	15.3
P/B (x)	4.1	3.6	3.2	2.7
EV/tonne (USD/tonne)	122	124	127	129
EV / Sales (x)	2.5	2.1	2.0	1.9
EV / EBITDA (x)	13.2	12.4	11.1	9.4
EV/EBITDA (x)+1 yr fwd.	12.7	10.6	9.0	-
Dividend Yield (%)	0.8	0.8	0.8	0.8

Peer comparison valuation

	Market cap	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
Name	(USD mn)	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
JK Cement	1,116	24.9	21.0	12.4	11.1	15.5	16.2
ACC	4,754	33.7	29.5	14.8	13.4	10.2	10.9
India Cements	754	52.8	15.5	10.7	7.2	1.8	5.9
Shree Cements	9,099	43.9	33.4	23.4	17.3	16.1	18.1
UltraTech Cement	17,540	46.0	30.7	21.2	15.4	9.9	13.3
Median	-	43.9	29.5	14.8	13.4	10.2	13.3
AVERAGE	-	40.3	26.0	16.5	12.9	10.7	12.9

Source: Edelweiss research

Additional Data

Directors Data

Dr. K.B Agarwal	Independent, Non Executive (Chairman)	Shri Yadupati Singhania	Managing Director & CEO
Mr. Paul Heinz Hugentobler	Additional Director	Shri Achintya Karati	Independent
Smt Sushila Devi Singhania	Non-Independent	Shri J.N.Godbole	Independent
Shri Shyam Lal Bansal	Independent	Shri K.N. Khandelwal	Independent
Shri R.K. Lohia	Independent	Shri Suparas Bhandari	Independent

Auditors - P.L. TANDON & CO.

**as per last annual report*

Holding – Top 10

	Perc. Holding		Perc. Holding
Franklin Resources	9.09	FMR LLC	4.37
HDFC Life Insurance Co Ltd	3.04	Franklin Templeton India Pte Ltd	2.83
Mirae Asset Global Investment	1.60	Sundaram Asset Management Co Ltd	1.40
DSP Blackrock Investment Manager	1.27	Kotak Mahindra	1.07
IDFC Mutual Fund	1.01	General Insurance Corp of India	1.00

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ACC	BUY	SP	M	Ambuja Cement Ltd	HOLD	SU	M
Grasim Industries	BUY	SO	M	India Cements	BUY	SP	H
JK Cement	BUY	SO	M	Shree Cements	BUY	SO	M
UltraTech Cement	BUY	SO	M				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Cement

ACC, Ambuja Cement Ltd, Grasim Industries, India Cements, JK Cement, Shree Cements, UltraTech Cement

Recent Research

Date	Company	Title	Price (INR)	Recos
20-Feb-18	**Ambuja Cement**	Good show; positives priced in; *Result Update*	264	Hold
14-Feb-18	**Grasim Industries**	Standalone operations continue to excel; *Result Update*	1,127	Buy
09-Feb-18	**India Cements**	Fixed cost control drives outperformance; *Result Update*	161	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

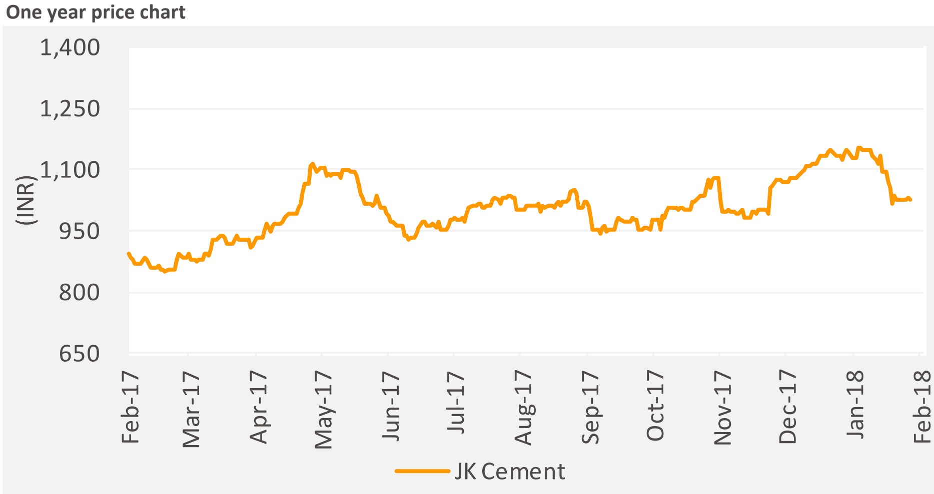
	Buy	Hold	Reduce	Total
Rating Distribution* * 1stocks under review	161	67	11	240

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	156	62	11

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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