

Strong volume growth moderates earning decline

Deccan Cements (DCL) registered 23% YoY volume growth in Q1FY19, buoyed by strong demand across all south markets. Still, aggressive competition is preventing price recovery while fuel and freight costs are on rise, leading to 7% EBITDA decline YoY. We continue to like DCL owing to (1) its strong balance sheet and (2) as we expect pricing to recover in south which should help the industry pass on the energy cost inflation. DCL is trading at extremely cheap valuations (14% AOCF/EV yield, 4.6x FY20E EBITDA and USD40/MT replacement cost). We reiterate BUY with a TP of Rs670.

- **Strong demand in south keeps volume momentum strong, pricing remain weak:** DCL's sales volume rose 23% YoY (down 1% QoQ) to 0.42mn MT in Q1FY19, leading to 75% utilisation vs 61% YoY and 76% QoQ. Management said sustained strong demand in AP/T helped them register strong volume growth. However, the management said that there is good competitive pressure from all brands in the region and hence there is no pricing gain despite robust demand. NSR thus stood flat QoQ (down 3% YoY). FOR based reporting wef Q2FY18 had padded up NSR and freight cost thereafter. Hence, while cement prices are down more than 5% YoY, reported NSR appears lower by 3%.
- **Cost inflation moderates on increased linkage coal usage, high utilisation:** DCL's unitary cost inflation rose a modest 1% YoY (down 1% QoQ). On QoQ basis, input costs per MT fell 5% thus moderating the same by 2% YoY. As per the management, increased usage of linkage coal in during the quarter moderated fuel inflation QoQ. Freight cost went up 7% QoQ mainly on rising diesel price. On YoY basis, freight inflation is higher at 33%, owing to both higher diesel prices and FOR based reporting changes. DECM also reported 26% YoY and 6% QoQ reduction in fixed costs, thus moderating overall cost inflation to 1% YoY. Unitary EBITDA down 24% YoY to Rs546/MT, owing to weak pricing. Thus, despite 23% volume offtake, EBITDA fell 7% YoY. Higher other income (aided by higher cash balance) led to flattish PAT YoY.
- **While earnings declined, cashflows recovered in FY18, DCL turned net cash in FY18:** We expect pricing power to follow during H2FY19, aided by rising industry utilisation. This should help the industry including DCL to pass on the cost inflation and also aid margin expansion. Thus, we retain our earnings estimates. As against large op cash generation, DCL is currently incurring only maintenance capex, leading to surge in free cashflow and hence a net cash company in FY19.
- **Trading at very cheap valuations, Maintain BUY:** We maintain BUY on DCL with a TP of Rs670 valuing it at 8.9% AOCF/EV yield on its FY16-20E average AOCF (implying 7.2x FY20 EBITDA). Despite strong demand outlook for south and DCL's robust balance sheet, DCL's stock is currently trading at cheap valuations of ~14% AOCF yield on FY16-20E avg AOCF, at 4.6x FY20E EBITDA and at replacement cost of USD40/MT. Even if the pricing recovery is delayed, leading to further earnings downgrades, the valuations would still be attractive (ie AOCF yield at 10-11% and replacement value below USD45/MT).

Target Price	Rs670	Key Data	
CMP*	Rs441	Bloomberg Code	DECM IN
Upside	52%	Curr Shares O/S (mn)	14.0
Previous Target	Rs670	Diluted Shares O/S(mn)	14.0
Previous Rating	Buy	Mkt Cap (Rsbn/USDmn)	6.2/90
Price Performance (%)*		52 Wk H / L (Rs)	660/388.1
	1M 6M 1Yr	5 Year H / L (Rs)	660/71
DECM IN	7.3 (23.0) (20.6)	Daily Vol. (3M NSE Avg.)	4910
NIFTY	5.7 9.7 15.8		

*as on 9 August 2018; Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Jun - 18	Mar - 18	Dec - 17	Sep - 17
Promoter	56.2	56.2	56.2	56.2
FIs	1.7	1.8	1.4	1.2
Dom. Inst.	13.9	13.9	12.3	12.3
Public & Others	28.3	28.2	30.1	30.3

Source: BSE, *as on 9 August 2018

Operational performance

	Q1FY19	Q1FY18	YoY (%)	Q4FY18	QoQ (%)
Sales vol (mn MT)	0.42	0.34	23.3	0.43	(1.1)
Rs/ MT trends					
NSR	3,841	3,973	(3.3)	3,845	(0.1)
Raw materials	331	443	(25.4)	440	(24.8)
Power & fuel	1,203	1,116	7.7	1,181	1.8
Freight/Distn	1,149	862	33.2	1,069	7.4
Employee	154	178	(13.5)	116	32.8
Other Exp	459	653	(29.7)	535	(14.2)
Opex	3,296	3,253	1.3	3,342	(1.4)
EBITDA	546	720	(24.2)	503	8.6

Source: Company, Centrum Research

Centrum vs. Bloomberg Consensus*

Particulars (Rs mn)	FY19E			FY20E		
	Centrum	BBG	Var (%)	Centrum	BBG	Var (%)
Net Sales	6,374	6,436	(1.0)	7,125	7,227	(1.4)
EBITDA	1,014	1,042	(2.7)	1,217	1,212	0.4
PAT	526	497	5.7	676	615	9.8

Bloomberg Consensus*				Centrum Target Price (Rs)	Variance (%)
BUY	SELL	HOLD	Target Price (Rs)		
7	0	0	654	670	2.5

*as on 9 August 2018; Source: Bloomberg, Centrum Research Estimates

Y/E Mar (Rsmn)	Q1FY19	Q1FY18	YoY (%)	Q4FY18	QoQ (%)	Q1FY19E	Variance(%)
Net Sales	1,617	1,357	19.2	1,636	(1.2)	1,529	5.8
Op. cost	1,387	1,111	24.9	1,423	(2.5)	1,338	3.7
EBITDA	230	246	(6.6)	214	7.4	191	20.0
EBITDA margin (%)	14.2	18.1	(39.2)	13.1	11.3	12.5	16.9
Depreciation	53	56	(5.8)	57	(7.3)	56	(5.8)
Interest	16	14	17.6	14	16.8	13	25.6
Other Income	17	4	305.8	6	168.7	8	114.3
PBT	178	180	(1.4)	150		131	36.2
Taxes paid	65	67	-	63	-	46	41.1
Adjusted PAT	113	114	(0.4)	87	30.4	85	33.5

Source: Company, Centrum Research Estimates

Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	APAT	YoY (%)	DEPS (Rs)	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY16	5,396	32.5	1,146	21.2	456	129.2	32.5	17.2	11.2	7.7	3.5
FY17	4,962	(8.0)	997	20.1	469	2.9	33.5	15.2	10.8	14.0	6.8
FY18	5,702	14.9	852	14.9	385	(17.8)	27.5	11.1	8.4	21.0	9.0
FY19E	6,374	11.8	1,014	15.9	526	36.3	37.5	13.6	10.5	11.8	5.2
FY20E	7,125	11.8	1,217	17.1	676	28.5	48.2	15.4	12.2	9.2	4.6

Source: Company, Centrum Research Estimates, Standalone Financials

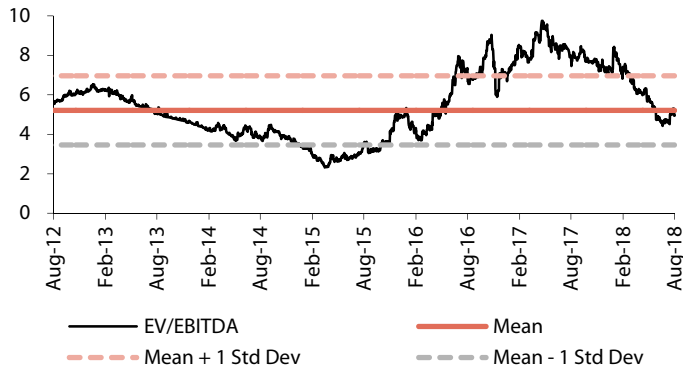
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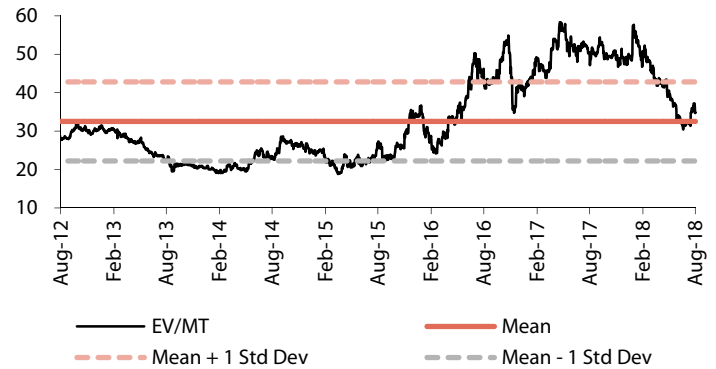
Valuations, peer comparisons and key assumptions

Exhibit 1: 1-yr forward EV/EBITDA chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 2: 1-yr forward EV/MT chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 3: Comparative Valuations

Company	Mkt Cap (Rs bn)	CAGR FY18-20E (%)			EBITDA margin (%)			RoCE (%)			RoE (%)			EV/EBITDA (x)			EV/MT (x)		
		Rev.	EBITDA	PAT	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
Deccan Cements	6.2	11.8	19.5	32.4	14.9	15.9	17.1	8.4	10.5	12.2	11.1	13.6	15.4	9.0	5.2	4.6	53	36	39
Orient Cement	24.9	12.9	17.1	66.7	13.7	13.4	14.8	5.2	6.2	8.5	4.4	6.3	10.9	12.3	10.6	8.8	72	70	63
Ramco Cements	155.6	15.9	14.4	21.5	25.0	23.3	24.3	9.9	10.3	12.2	14.3	14.5	16.5	16.3	13.9	11.4	184	170	149
JK Cement	54.8	12.2	15.3	22.5	16.2	15.8	17.1	9.6	10.2	10.6	16.3	17.2	18.2	12.0	9.2	8.3	101	83	80

Source: Company, Centrum Research Estimates

We retain BUY on the stock, with a revised TP of Rs670. We expect DCL to deliver 5-year avg AOCF of Rs787mn during FY16-20E. We apply target AOCF/EV yield of 8.9%. Our TP implies 7.2x EV/EBITDA on our FY20 estimates and replacement value of USD60/MT (FY20E). Given the strong company fundamentals (unlevered balance sheet, good return ratios) and rising demand outlook for south market, we believe the valuations to rebound.

Exhibit 4: Cash flow-based valuation

Average AOCF/EV Yield - % - FY14-18	8.9
Premium assigned - %	0
Target AOCF/EV Yield - %	8.9
Implied EV/5-yr AOCF Multiple (x)	11.2
5-yr avg. AOCF (Rs mn) - FY16-20E	787
EV (Rs mn)	8,832
Less: Net Cash - FY20E (Rs mn)	(549)
Fair value mkt cap (Rs mn)	9,381
No. of shares (mn)	14.0
Target price/share (Rs)	670

Source: Company, Centrum Research Estimates

Exhibit 5: Key Operational Assumptions

Particulars	FY15	FY16	FY17	FY18	FY19E	FY20E
Capacity (mn MT)	2.3	2.3	2.3	2.3	2.3	2.3
Sales Volume (mn MT)	1.1	1.3	1.3	1.5	1.6	1.7
YoY change (%)	0.1	22.0	1.5	9.8	8.0	8.0
Utilisation (%)	48.0	58.5	59.4	65.2	70.5	76.1
(Rs/ MT trend)						
NSR	3,772	4,097	3,712	3,885	4,021	4,162
YoY change (%)	10.6	8.6	(9.4)	4.7	3.5	3.5
Raw Materials & stock adj	324	376	339	403	400	410
Power & Fuel	1,247	1,123	1,067	1,155	1,212	1,249
Freight costs	835	940	815	1,075	1,113	1,140
Employee cost	156	166	168	165	163	163
Other expense	612	622	577	507	493	488
Total Opex	3,174	3,227	2,966	3,304	3,381	3,451
EBITDA per MT	598	870	746	581	640	711
YoY change (%)	12.5	45.5	(14.3)	(22.2)	10.1	11.1

Source: Company, Centrum Research Estimate

Exhibit 6: Quarterly financials trend

Y/E Mar (Rs mn)	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19
Net Sales	1,291	1,139	1,352	1,357	1,362	1,341	1,636	1,617
Total Expenditure	1,019	904	1,094	1,111	1,151	1,159	1,423	1,387
Raw Materials	118	56	148	151	134	118	187	139
Power and Fuel	357	347	393	381	373	437	503	506
Employee	47	48	74	61	69	62	49	65
Selling & Distn exp	402	365	282	294	498	381	455	484
Others	94	88	197	223	76	160	228	193
EBITDA	272	234	258	246	210	182	214	230
Depreciation	53	53	60	56	57	57	57	53
EBIT	219	182	199	190	153	125	157	177
Interest	18	16	24	14	15	14	14	16
Other Income	6	5	9	4	9	21	6	17
PBT	207	170	184	180	147	131	150	178
Taxes	71	59	76	67	52	42	63	65
Exceptional inc/ (exp)	-	(1)	-	-	-	-	-	-
Reported PAT	136	111	108	114	95	89	87	113
Adjusted PAT	136	111	108	114	95	89	87	113
YoY Growth (%)								
Revenue	(10.0)	(2.8)	3.6	15.5	5.5	17.8	21.0	19.2
EBITDA	(27.5)	9.9	(14.7)	4.9	(22.8)	(22.1)	(17.2)	(6.6)
PBT	(38.4)	30.1	(20.8)	3.8	(29.1)	(22.9)	(18.6)	(1.4)
Adj PAT	(41.7)	78.1	8.4	0.6	(29.9)	(19.6)	(19.4)	(0.4)
Margins (%)								
EBITDA	21.1	20.6	19.1	18.1	15.4	13.6	13.1	14.2
PBT	16.0	15.0	13.6	13.3	10.8	9.8	9.1	11.0
Adj PAT	10.5	9.8	8.0	8.4	7.0	6.7	5.3	7.0
Operational Trends								
Sales Vol (mn MT)	0.34	0.29	0.36	0.34	0.34	0.36	0.43	0.42
YoY Growth (%)	2.0	0.9	1.5	(1.0)	0.5	23.1	18.6	23.3
Trends (Rs/mt)								
Net avg realisation	3,797	3,903	3,767	3,973	3,984	3,737	3,845	3,841
YoY Growth (%)	(11.8)	(3.7)	2.0	16.7	4.9	(4.3)	2.1	(3.3)
Raw material cost	346	190	412	443	392	329	440	331
Power and fuel cost	1,051	1,190	1,094	1,116	1,093	1,219	1,181	1,203
Employee cost	139	166	205	178	202	174	116	154
Selling & Distn exp	1,181	1,252	787	862	1,458	1,062	1,069	1,149
Other expenses	277	302	549	653	224	445	535	459
Operating cost	2,996	3,101	3,047	3,253	3,369	3,229	3,342	3,296
EBITDA - Cement (Rs/MT)	801	802	720	720	615	508	503	546

Source: Company, Centrum Research

Financials- Standalone

Exhibit 7: Income Statement

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Revenues	5,396	4,962	5,702	6,374	7,125
Materials cost	495	453	591	634	702
% of revenues	9.2	9.1	10.4	9.9	9.9
Employee Cost	218	224	242	259	279
% of revenues	4.0	4.5	4.2	4.1	3.9
Others	3,536	3,288	4,017	4,467	4,927
% of revenues	65.5	66.3	70.4	70.1	69.1
EBITDA	1,146	997	852	1,014	1,217
EBITDA Margins (%)	21.2	20.1	14.9	15.9	17.1
Depreciation & Amortisation	203	217	227	234	237
EBIT	943	780	626	780	980
Interest expenses	152	68	57	31	21
PBT from operations	791	712	569	748	959
Other Income	15	24	40	60	80
Exceptional loss/(gain)	-	-	-	-	-
PBT	806	736	608	808	1,039
Taxes	350	267	223	283	364
Effective tax rate (%)	43.5	36.3	36.6	35.0	35.0
PAT	456	469	385	526	676
Reported Net Profit	456	469	385	526	676
Adj Net Profit	456	469	385	526	676

Source: Company, Centrum Research Estimates

Exhibit 8: Key Ratios

Y/E March	FY16	FY17	FY18	FY19E	FY20E
Growth ratios (%)					
Revenues	32.5	(8.0)	14.9	11.8	11.8
EBITDA	77.5	(13.0)	(14.5)	18.9	20.0
Adj Net Profit	129.2	2.9	(17.8)	36.3	28.5
Margin ratios (%)					
EBITDA Margin	21.2	20.1	14.9	15.9	17.1
PBT from operations Margin	14.7	14.3	10.0	11.7	13.5
Adj PAT Margin	8.4	9.4	6.8	8.2	9.5
Return Ratios (%)					
RoE	17.2	15.2	11.1	13.6	15.4
RoCE	11.2	10.8	8.4	10.5	12.2
RoIC	11.8	11.5	9.1	12.0	13.7
Turnover Ratios (days)					
Gross block turnover (x)	1.2	1.3	1.4	1.5	1.7
Debtors	5	8	9	9	9
Inventory	36	42	38	37	37
Creditors	3	2	2	2	2
Cash conversion cycle	38	48	45	43	45
Solvency Ratio					
Net debt-equity	0.2	0.1	(0.1)	(0.2)	(0.1)
Debt-equity	0.3	0.2	0.1	0.1	0.1
Interest coverage ratio	6.2	11.4	11.0	25.1	46.9
Gross debt/EBITDA	0.7	0.7	0.4	0.3	0.2
Current Ratio	2.9	4.1	3.2	3.5	2.9
Per Share (Rs)					
Adjusted EPS	32.5	33.5	27.5	37.5	48.2
BVPS	203.8	237.2	260.8	292.3	332.1
CEPS	47.0	49.0	43.7	54.2	65.1
DPS	2.5	3.0	3.0	5.0	7.0
Dividend payout %	9.2	10.8	13.1	16.0	17.5
Valuations (x)(Avg Mkt Cap)					
P/E (adjusted)	7.7	14.0	21.0	11.8	9.2
P/BV	1.2	2.0	2.2	1.5	1.3
EV/EBITDA	3.5	6.8	9.0	5.2	4.6
EV/ton (USD \$)	27	46	53	36	39
Dividend yield %	1.0	0.6	0.5	1.1	1.6
5 Yr Avg AOCF/EV yield %	12.4	7.2	7.7	13.8	14.0

Source: Company, Centrum Research Estimates, FY16/FY17/FY18 valuations are on historical annual average market caps

Exhibit 9: Balance Sheet

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Equity Share Capital	70	70	70	70	70
Reserves & surplus	2,785	3,253	3,584	4,025	4,582
Total Shareholders' Fund	2,855	3,323	3,654	4,095	4,652
Total Debt	795	702	361	261	261
Def tax liab. (net)	850	933	984	999	1,015
Total Liabilities	4,500	4,958	4,999	5,355	5,928
Gross Block	3,423	3,988	4,072	4,252	4,352
Less:- Accumulated Depreciation	0	217	442	676	913
Net Block	3,423	3,771	3,630	3,576	3,439
Capital WIP	340	1	44	14	1,014
Net Fixed assets	3,764	3,772	3,674	3,590	4,453
Investments	4	4	5	1	1
Inventories	538	575	589	637	727
Sundry Debtors	80	107	134	153	178
Cash & bank balances	335	527	758	1,205	811
Loans & Advances	31	41	81	64	71
Other Assets	136	320	354	414	463
Total current assets	1,120	1,570	1,916	2,473	2,250
Trade payables	51	31	26	32	36
Other current liabilities	301	315	526	632	695
Provisions	36	42	45	45	45
Net current assets	732	1,182	1,319	1,764	1,474
Total	4,500	4,958	4,999	5,355	5,928

Source: Company, Centrum Research Estimates

Exhibit 10: Cash Flow

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Op profit before WC changes	969	783	660	735	853
Working capital changes	433	(169)	70	17	(88)
Cash from Operations	1,402	614	730	752	765
Adj. OCF (OCF-Interest)	1,242	545	686	721	744
Net capex	(77)	(277)	(86)	(150)	(1,100)
Adj. FCF (AOCF-Capex)	1,165	267	600	571	(356)
Cash from investing	(68)	(268)	(67)	(90)	(1,020)
Cash from financing	(1,247)	(153)	(433)	(215)	(139)
Net change in cash	87	193	230	447	(394)

Source: Company, Centrum Research Estimates

Appendix A

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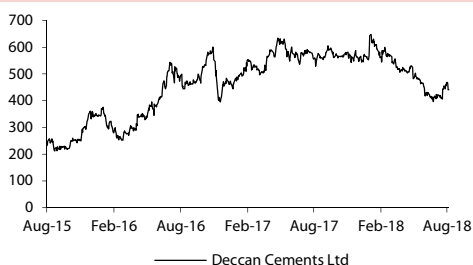
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Deccan Cements price chart



Source: Bloomberg, Centrum Research

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Hold	Upside between -20% to +20%	Upside between -15% to +15%	Upside between -10% to +10%
Sell	Downside > 20%	Downside > 15%	Downside > 10%

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