14 November 2018

NCL Industries

Robust demand to push growth; Buy

Rating: **Buy**
Target Price: ₹185
Share Price: ₹130

Its subdued operating performance and higher fixed costs on account of new capacities pushed down NCL's Q2FY19EBITDA and PAT respectively 14% and 21% y/y. The expected drop in interest cost (on replacing high-cost NCDs), recovering Board margins, anticipated operational savings and robust demand would, we expect, help revive NCL's performance. We retain our Buy rating, with a lowerTP of ₹185.

Healthy demand. Assisted by strong demand in AP/Telangana, NCL's Q2 FY19 cement sales volumes grew 32% y/y to 0.49m tons. High power & fuel costs, stressed realisationsandthe rupee depreciation slashed its EBITDA/ ton 48% to ₹358. Management talked of 80%cement capacity utilisation in FY19 and expected operating benefits from the higher axle-load capacity and pet-coke added to the fuel mix. With firm demand and more trade sales, we expect the division's revenue to clock a 13% CAGR over FY18-20.

Boards division: margins improving. The Boards division bounced back to near earlier profit levels as teething issues at the new capacity were sorted out. The division's EBIT margin came at 12.8% (16.8% a year ago, 5.2% the prior quarter).While the 60,000tpaplant is running at full capacity, management spoke of ~30% utilisation atthe new capacity in FY19 supported by an APhousing project and improving margins. We expect an 11% CAGR in Boards revenue and its EBIT margin touching 15% in FY20.

Business outlook. In Q2, the company replaced its 15% NCDs with a 10% term loan. This would help reduce interest costs in coming quarters. Management said the MDF door capacity would be commissioned by end-FY19. With no major capex, we expect net D/E to shrink to 0.3x in FY20 (from 0.5x in FY18).Higher depreciation on the commissioning of the new plant and the subdued operating performance would result in PAT registering only a 17% CAGR over FY18-20.

Valuation. We retain our Buy rating, at a target ₹185 on 6.5x FY20e EV/EBITDA. **Risks:** Rise in input costs, demand slowdown.

Key financials (YE Mar)	FY16	FY17	FY18	FY19e	FY20e
Sales (₹ m)	6,608	7,655	8,804	10,724	11,480
Net profit (₹ m)	546	547	491	368	667
EPS (₹)	14.9	14.9	10.9	8.1	14.7
PE (x)	6.3	13.3	20.1	16.0	8.8
EV / EBITDA (x)	4.9	9.2	9.3	7.0	5.0
EV / ton($)	37.9	68.6	57.5	38.7	34.7
RoE (%)	32.7	26.8	14.3	7.7	12.8
RoCE (%)	16.0	13.9	9.1	6.7	9.3
Dividend yield (%)	2.1	1.3	1.1	0.7	1.4
Net debt/equity (x)	1.4	1.5	0.5	0.5	0.3

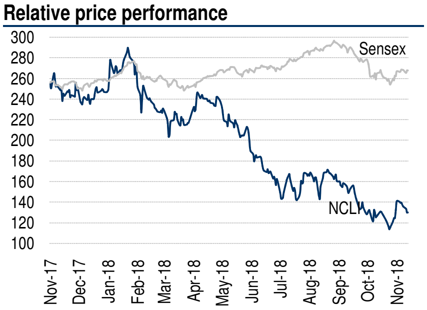
Source: Company, Anand Rathi Research

Key data	NCLI IN / NCLI.BO
52-week high/low	₹310 / 109
Sensex/Nifty	35,152 / 10,593
3-m average volume	$0.2m
Market cap	₹6bn / $81.6m
Shares outstanding	45m

Shareholding pattern (%)	Sept`18	Jun`18	Mar`18
Promoters	40.3	40.1	40.1
- of which, Pledged	*48.4*	*48.6*	*88.5*
Free float	59.7	59.9	59.9
- Foreign institutions	2.3	2.3	2.4
- Domestic institutions	18.0	16.9	18.4
- Public	39.4	40.8	39.1

Estimates revision (%)	FY19e	FY20e
Sales	(0.7)	(0.9)
EBITDA	(20.5)	(16.6)
EPS	(38.2)	(25.7)

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
Sales volumes (m tons)	**1.3**	**1.5**	**1.8**	**2.2**	**2.3**
Net revenues	6,608	7,655	8,804	10,724	11,480
Growth (%)	23.8	15.8	15.0	21.8	7.0
Direct costs	4,211	5,238	6,137	7,454	7,999
SG&A	1,187	1,275	1,336	2,049	1,912
EBITDA	**1,210**	**1,142**	**1,331**	**1,221**	**1,569**
EBITDA margins (%)	18.3	14.9	15.1	11.4	13.7
- Depreciation	252	251	347	400	420
Other income	32	36	71	40	40
Interest expenses	306	311	310	313	194
PBT	669	616	744	549	995
Effective tax rate (%)	20.6	11.3	34.0	33.0	33.0
+ Associates / (Minorities)					
Net income	531	547	491	368	667
Adjusted income	546	547	491	368	667
WANS	37	37	45	45	45
FDEPS (₹/ sh)	14.9	14.9	10.9	8.1	14.7
FDEPS growth (%)	483.5	0.1	-27.1	-25.1	81.3

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
Share capital	367	367	452	452	452
Net worth	1,808	2,267	4,612	4,927	5,497
Debt	2,662	3,408	2,619	2,790	1,940
Minority interest					
DTL/(Assets)	628	636	711	711	711
Capital employed	**5,099**	**6,310**	**7,943**	**8,428**	**8,149**
Net tangible assets	3,916	3,854	6,925	7,605	7,285
Net Intangible assets	-	-	-	-	-
Goodwill	-	-	-	-	-
CWIP (tang. &intang.)	106	1,522	330	100	100
Investments (strategic)	-	-	-	-	-
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	1,994	2,342	2,209	2,660	2,894
Cash	211	119	161	83	31
Current liabilities	1,128	1,526	1,682	2,019	2,161
Working capital	866	816	527	641	734
Capital deployed	**5,099**	**6,310**	**7,943**	**8,428**	**8,149**
Contingent liabilities	183	259	346	-	-

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
PBT	684	616	744	549	995
+ Non-cash items	252	251	347	400	420
Oper. prof. before WC	935	868	1,091	949	1,415
- Incr./(decr.) in WC	602	-50	-289	114	93
Others incl. taxes	129	62	177	181	328
Operating cash-flow	205	856	1,203	654	994
- Capex (tang. +intang.)	182	1,605	2,226	850	100
Free cash-flow	23	-750	-1,024	-196	894
Acquisitions					
- Div.(incl. buyback & taxes)	88	111	136	53	96
+ Equity raised	18	-	2,019	-	-
+ Debt raised	236	745	-789	171	-850
- Fin investments	-	-	-	-	-
- Misc. (CFI + CFF)	34	-22	28	-0	-0
Net cash-flow	155	-93	42	-78	-53

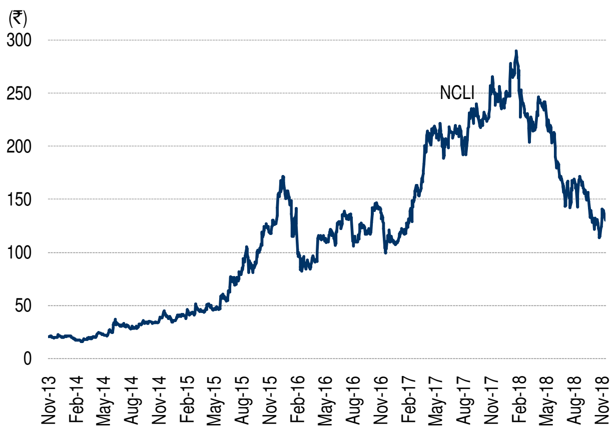
Source: Company, AnandRathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
P/E (x)	6.3	13.3	20.1	16.0	8.8
EV/EBITDA (x)	4.9	9.2	9.3	7.0	5.0
EV / sales (x)	0.9	1.4	1.4	0.8	0.7
P/B (x)	1.9	3.2	2.1	1.2	1.1
RoE (%)	32.7	26.8	14.3	7.7	12.8
RoCE (%) - after tax	16.0	13.9	9.1	6.7	9.3
DPS (₹ / sh)	2.0	2.5	2.5	1.0	1.8
Dividend payout (%) - incl. DDT	16.7	20.2	27.7	14.4	14.4
Net debt / equity (x)	1.4	1.5	0.5	0.5	0.3
WC days	48	39	22	22	23
EV / ton ($)	38	69	58	39	35
NSR / ton (₹)	5229	5203	5052	5254	5464
EBITDA / ton (₹)	746	569	605	460	557
Volumes (m tons)	1.3	1.5	1.8	2.2	2.3
CFO : PAT %	37.5	156.5	245.0	177.9	149.1

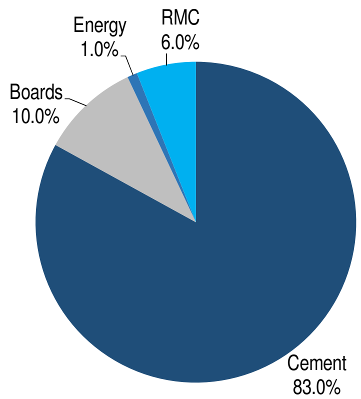
Source: Company, AnandRathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6– Segment-wiserevenue break-up (Q2FY19)



Source: Company

Company update

Promoted by the late K. Ramachandra Raju, the Hyderabad-based NCL Industries, incorporated in 1979, is into cement, particle boards, ready-mix concrete and hydro power For the past three decades it has been supplying the construction industry with its top quality Nagarjuna Cement brand.

It is a strong regional operator and has been a household name in Andhra Pradesh, popularly known as "Monagadu" cement in Telugu.It forward-integrated into value-added products with cement boards and ready-mix concrete. It has two small hydro-electric plants, of 7.5MW in Andhra Pradesh and 8.25MW in Karnataka.

NCL has one of the largest distribution networks across the country, with more than 1,600 cement dealers and 300 distributors for boards.Nagarjuna is the only private company in Andhra Pradesh which manufactures special 53-S grade cement.

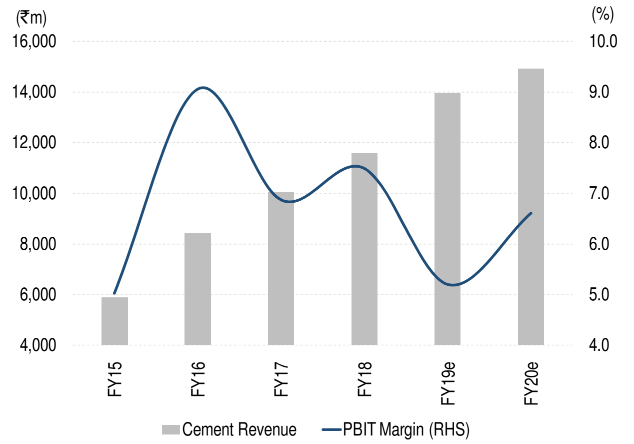
The cementdivision

With its strategically-located 2.7m-tpa cement capacity, and a well-established brand Nagarjuna Cement, NCL is a robust regional cement manufacturer in south India. It is strong in rural markets through its wide network of over 1,600 cement dealers and more than 100 distribution and consignment agents It recently expanded its clinker capacity in Nalgonda to 2.6m tons(from 1.6m tons).

It largely sells in the south, primarily in AP/Telangana (90%) and Tamil Nadu and Karnataka. Because of its brand's strong recall and the great emphasis on retail sales, NCL has been able to charge higher prices in north-coastal AP, resulting in higher realisation per ton than its peers.

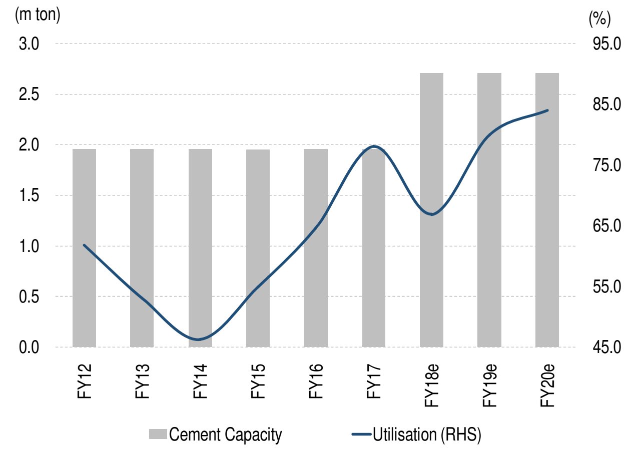
Boosted by the expanded capacities and swelling demand in its key region of operations, its cement volumes are expected to clock a 12% CAGR over FY18-20, with utilisation touching 84% in FY20

Fig 7 – Revenue and PBIT margins (cement)



Source: Company, Anand Rathi Research

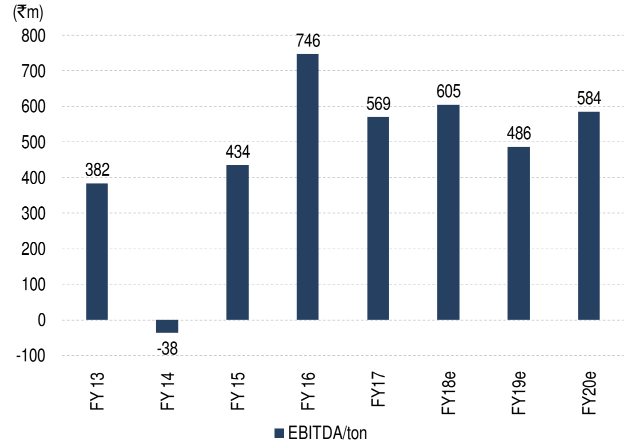
Fig 8 – Capacity and Utilisation (cement)



Source: Company, Anand Rathi Research

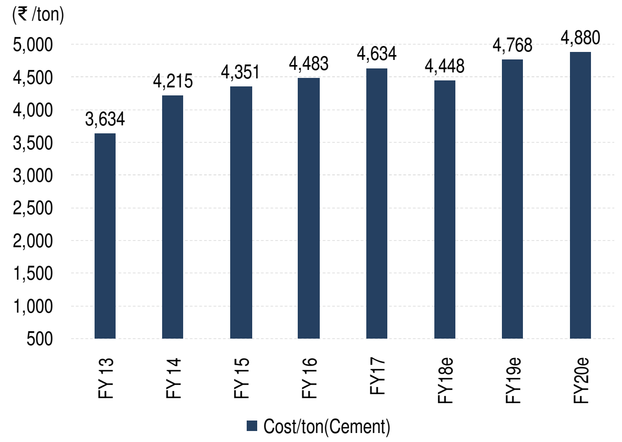
Cement revenue for the quarter increased 10% y/y, to ~₹2.8bn, as cement sales volumes rose 32% y/y to 0.49m tons. We expect volumes to clock a12% CAGRover FY18-20,boosted by greater demand in its key regions. The PBIT margin,however, slipped to 3.2% (7.5% a year earlier) hurt by higher power & fuel expenses,stressed realisations and rupee depreciation.

Fig 9 – EBITDA-per-ton trend



Source: Company, Anand Rathi Research

Fig 10 – Cost-per-ton trend



Source: Company, Anand Rathi Research

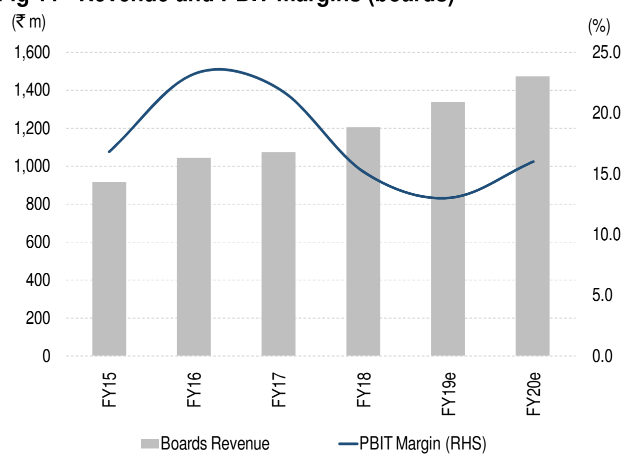
The Boards division

Cement-bonded particle boards, made of 62% cement and 28% wood, popularly known as Bison Panels, was introduced by NCL in 1990 in collaboration with Bison Werke (Germany), the world leader in particle-board technology. On one hand, the boards have the strength and durability of cement. On the other, they have the easy workability of wood. They are fire-, water- and termite-resistant and can be used externally and internally. To address mounting demand, NCL expanded its boards capacity by 30,000tpa in Q3 FY18 at ₹400m capex. Post-expansion, Bison boards are manufacturedat two plants, Mattapally (Telangana) and Paonta Sahib (HP), combined capacity being 90,000tpa.

With the expanded capacities, board volumes and revenue are expected to clock respectively9% and 11% CAGRs over FY18-20, with utilisation touching 82% in FY20

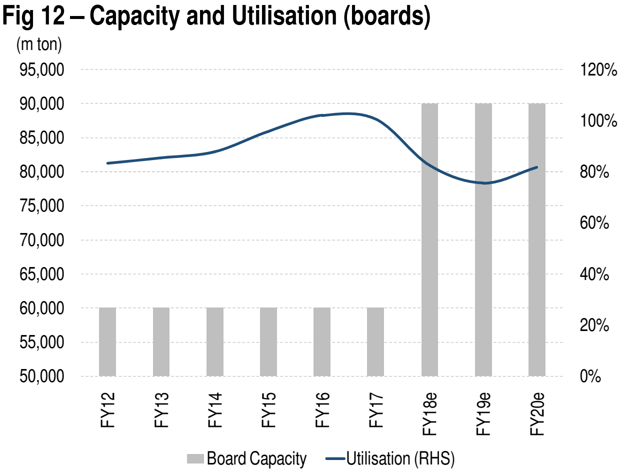
During Q2FY19, board revenue increased 16.6% y/y,wheresalesvolumes increased only 7% y/y to 16,728 tons. The boards division bounced back to near earlier profitability levels as the teething issues at the new capacity were ironed out. Hence, the PBIT margin came at 12.8%(5.2% the quarter prior, 16.8% a year earlier).

Fig 11– Revenue and PBIT margins (boards)



Source: Company, Anand Rathi Research

Fig 12 – Capacity and Utilisation (boards)



Source: Company, Anand Rathi Research

Energy and the RMCdivisions

The company is a relatively small operator in hydro-electric energy and ready-mix concrete, which together bring ~5% to its revenue.Its strong brand equity (Nagarjuna Cement) has led to its ready-mix concrete brand being marketed as Nagarjuna RMC. It has four RMC manufacturing plants, adequately geared to handle demand from vast urban housing development and infrastructure projects.

Equipped with twin-shaft concrete mixers to ensure a homogenous mix, plants have adequate control over the size, shape and grade of the aggregates and of optimal management of the water-cement ratio. The key ingredient of Nagarjuna RMC is its superior OPC-53 Nagarjuna Cement.

Its energy division operates two mini-hydel generating plants: one of 7.5MW over the Srisailam right main canal in AP, the other of 8.25MW on the right bank high-level canal of the Tungabhadra Dam in Karnataka.

Result highlights

Fig 13 – Quarterly Trend

(₹ m)	Q2 FY19	Q1 FY19	Q4 FY18	Q3 FY18	Q2 FY18	FY18	FY19e	FY20e
Sales	2,288	2,394	2,726	2,227	1,885	8,804	10,724	11,480
EBITDA	265	272	352	284	309	1,331	1,221	1,569
EBITDA margins (%)	*11.6*	*11.4*	*12.9*	*12.8*	*16.4*	*15.1*	*11.4*	*13.7*
EBITDA per ton	358	464	522	437	685	605	460	557
Interest	93	86	65	86	84	310	313	194
Depreciation	113	113	99	94	79	347	400	420
Other income	13	13	47	6	4	71	40	40
PBT	71	87	236	110	151	744	549	995
Tax	(6)	25	142	(27)	53	253	181	328
Adj. PAT	77	62	94	137	97	491	368	667

Source: Company, Anand Rathi Research

Fig 14– Segment-wise results

(₹ m)	Q2 FY19	Q1 FY19	Q4 FY18	Q3 FY18	Q2 FY18	FY18	FY19e	FY20e
Net revenue								
Cement division	2,794	3,241	3,546	2,884	2,535	11,562	13,834	14,753
Boards division	344	286	342	304	295	1,203	1,336	1,472
Energy division	29	-	4	31	7	42	42	42
RMC division	188	149	163	122	121	523	575	633
Segment PBIT								
Cement division	89	163	270	130	190	865	692	944
Boards division	44	15	33	46	50	182	147	221
Energy division	20	(8)	(4)	23	(1)	10	8	8
RMC division	11	3	1	(3)	(4)	(3)	14	16
PBIT margin (%)								
Cement division	3.2	5.0	7.6	4.5	7.5	7.5	5.0	6.4
Boards division	12.8	5.2	9.7	15.2	16.8	15.1	11.0	15.0
Energy division	70.2	NA	(115.5)	72.4	(8.6)	23.5	20.0	20.0
RMC division	5.7	1.8	0.7	(2.4)	(3.3)	(0.6)	2.5	2.5

Source: Company, Anand Rathi Research

Change in estimates

Factoring in the company's H1FY19 performance and the rising cost context, we reduce our FY19e and FY20e revenuerespectively 0.7%and 0.9%. Also, we lower our EBITDA estimates 20.5% and 16.6%,respectively, and PAT 38.2% and 25.7%.

Fig 15 –Change in estimates

	Old		New		Change (%)	
	FY19e	FY20e	FY19e	FY20e	FY19e	FY20e
Sales (₹ m)	10,798	11,588	10,724	11,480	(0.7)	(0.9)
EBITDA (₹ m)	1,536	1,881	1,221	1,569	(20.5)	(16.6)
PAT (₹ m)	595.0	897	368	667	(38.2)	(25.7)

Source: Anand Rathi Research

Key Takeaways and Concall highlights

Financial and Operational highlights

- InQ2FY19, ~83% of NCL's revenue arose from itscement division,10% from boards.
- Realisation/ton at the cement division was₹3,000 (₹3,369a year ago) hit by the ₹18/bag decline in prices y/y.
- The cement andBoards divisions contributed respectively ₹189m and ₹52m to EBITDA.
- Cement sales volumes grew 31% to 0.49m tons;board volumeswere up 6%to 16,728 tons.
- The rise in interest costswas due to an increase in working-capital loans
- The company replaced high-cost NCDs of ₹1.35bn with a low-cost term loan.
- The trade-nontrade mix was 65:35. Management said that the non tradeproportion would come down in the quarters ahead.

Outlook

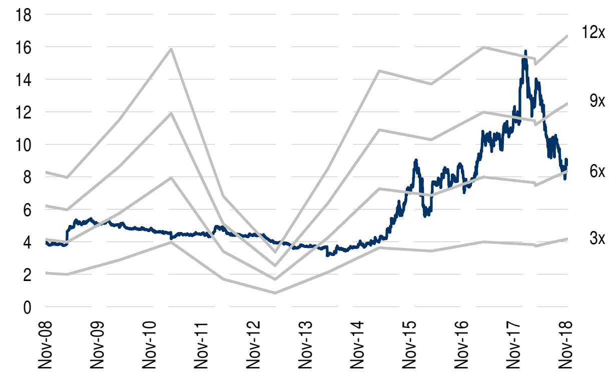
- Management talked of introducingpet-coke in the fuel (25% of the fuel mix)in coming months, resulting in 7-10% savings(in kilo calories).
- Management expects 80% capacity utilisation in the cement division, with sales of 2.1m tons in FY19.
- Management talked of 20-30% capacity utilisation at the new 30,000tpa Boards capacity in FY19
- It expects the MDF door expansion(at ₹500mcapex)to be commissioned by end-Q4FY19.
- The Polavaremproject and the two-BHK housing project at AP/Telangana are attracting increasing demand for both cement and boards.

Valuation

With its low-cost cement-capacity expansion (to 2.7m tpa) and particle-board facilities (to 90,000 tpa), NCL is set to derive the full benefit of the cement demand upswing and of the mounting demand for boards. Further, the anticipatedoperational savings and decline in interest costswouldhelp.

At the CMP, the stock trades at an EV/EBTIDA of 5x and an EV/ton of $34.7 on FY20e. We retain our Buy rating, at atarget price of ₹185, based on 6.5x FY20e EV/EBITDA.

Fig 16 – EV / EBITDA Band



Source: Bloomberg, Anand Rathi research

Fig 17 – Peer comparison - Valuations

	CMP	P / E (x)		EV / EBITDA (x)		EV / ton ($)	
	(₹)	FY19e	FY20e	FY19e	FY20e	FY19e	FY20e
NCL Indus	130	16.0	8.8	7.0	5.0	39	35
Birla Corp.	610	24.6	16.2	9.2	7.9	64	67
Dalmia Bharat	2,126	29.4	22.2	9.5	8.1	122	111
Deccan Cement	379	11.3	9.2	5.3	4.1	32.4	29.3
Heidelberg Cement	149	16.0	12.8	7.9	6.8	93	88
India Cement	90	16.2	9.0	7.4	5.8	51	50
JK Cement	695	17.1	15.0	9.9	9.4	83	69
JK Lakshmi	267	20.8	11.7	9.9	7.2	63	59
Mangalam Cement	213	NM	71.8	11.8	9.0	37	36
Orient Cement	85	50.8	19.1	10.5	7.9	50	57
Ramco Cement	611	29.8	22.6	17.1	13.3	174	174
Sagar Cement	655	43.3	14.2	11.8	7.2	50	44
Star Cement	100	17.5	13.0	9.5	7.4	171	119
Sanghi Industries	62	16.5	11.3	10.0	9.4	86	100
Visaka Indus	446	9.5	8.4	5.6	4.5	NA	NA

Source: Bloomberg, Anand Rathi Research

Risks

- Mounting competition and rising diesel prices.
- Demand slowdown.

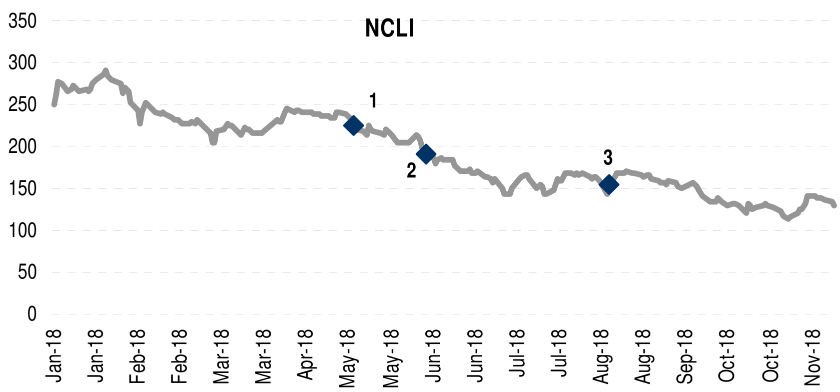
Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

Important Disclosures on subject companies

Rating and Target Price History (as of 14 November 2018)



	Date	Rating	TP (₹)	Share Price (₹)
1	03-May-18	Buy	357	240
2	02-Jun-18	Buy	320	198
3	14-Aug-18	Buy	258	155

Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

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