MOTILAL OSWAL

14 September 2018

Update | Sector: Cement

Dalmia Bharat

BSE SENSEX	S&P CNX
38,091	11,515

Stock Info

Bloomberg	DBEL IN
Equity Shares (m)	89
M.Cap.(INRb)/(USDb)	239.8 / 3.3
52-Week Range (INR)	3349 / 2174
1, 6, 12 Rel. Per (%)	3/-20/-22
12M Avg Val (INR M)	374
Free float (%)	42.1

Financials Snapshot (INR b)

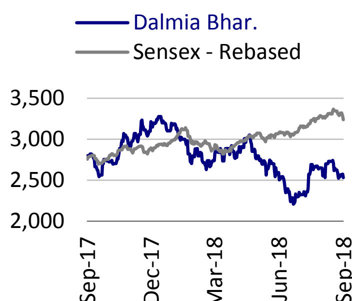
Y/E Mar	2018	2019E	2020E
Net Sales	85.8	99.8	120.3
EBITDA	20.4	22.8	27.7
Net Profit	5	6.4	9.2
EPS (INR)	55.7	71.6	102.9
EPS Gr. (%)	106.3	28.4	43.8
BV/Sh. (INR)	673	741	839
RoE (%)	9	10.1	13
RoCE (%)	8.3	8.7	10.1
P/E (x)	48.3	37.6	26.2
P/BV (x)	4.0	3.6	3.2
EV/EBITDA (x)	14.2	12.5	10.1
EV/Ton (USD)	170	166	141

Shareholding pattern (%)

As On	Jun-18	Mar-18	Jun-17
Promoter	57.9	57.9	58.0
DII	5.9	6.5	7.7
FII	20.2	19.6	17.4
Others	16.0	15.9	16.9

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR2,690 TP: INR3,141 (+17%) Buy

Best is yet to come for the Indian cement industry

Pace of demand growth to outpace supply

We hosted Mr. Puneet Dalmia, Managing Director of Dalmia Bharat (DBEL), as part of 'CEO Track' at our annual conference. Key takeaways:

- **The Indian cement industry witnessed a supply CAGR of 11% over FY07-17; however, the pace of capacity addition slowed down from 46mtpa in FY08-10 to 21mtpa in FY14-17. Demand during the same period increased at only 6% CAGR leading to utilization levels reducing from 90% in FY07 to 62% in FY18.**
- **Capacity is expected to grow at 4% CAGR over FY18-23, driven by difficulty in limestone access and credit availability. Rise in cost of land and quick insolvency processes should further restrict aggressive capacity addition.**
- **As a result, the industry should witness consolidation and the top-5 players who constitute 47% of the capacity share should account for 55% in FY21.**
- **Demand is expected to grow at a CAGR of 8% over FY18-23 driven by housing projects like Pradhan Mantri Awas Yojana (PMAY) and various road projects.**
- **Thus DBEL expects utilization levels to increase from 62% in FY18 to 79% in FY23.**
- **Mr. Dalmia expects pricing to also pick up as with rising replacement cost, it would become imperative for incremental capacities to generate higher EBITDA/ton in order to meet the cost of capital.**
- **Dalmia should continue to achieve growth through organic and inorganic route. Capacity is expected to increase from the current 25mt to 29mt in FY19 through acquisition of Murli Industries and Kalyanpur Cement at USD38/t. The company further plans to grow organically by adding 8mt capacity in the East at a capex of USD71/t. As a result, east would constitute ~49% of DBEL's capacity in FY21 as against 37% in FY18 while south which contributed to 48% of the capacity in FY18 would account for 40% in FY21.**
- **Various cost-reduction initiatives like the use of Alternate Fuel Resources (AFR), green power along with sale of premium products (which are priced INR 25-30/bag higher) should aid profitability improvement.**
- **Dalmia Bharat's net debt reduction of ~INR7.5b/INR17.2b in FY17/FY18 should reverse over FY18-20, with net debt increasing to INR49b by FY20 in order to fund acquisitions and organic capacity addition. Operating cash flow is likely to improve strongly, led by volume growth on the back of acquisitions and growth in underlying markets. Synergy benefits from OCL-DBL merger should further improve cash flow, FY19 onwards. We value the stock at 11.5x FY20E EV/EVITDA (2-year average of 1-year forward EV/EBITDA as DBEL's multiple was re-rated in the last two years, post deleveraging of balance sheet) and arrive at a target price of INR3,141/share (implied EV/ton of USD163).**

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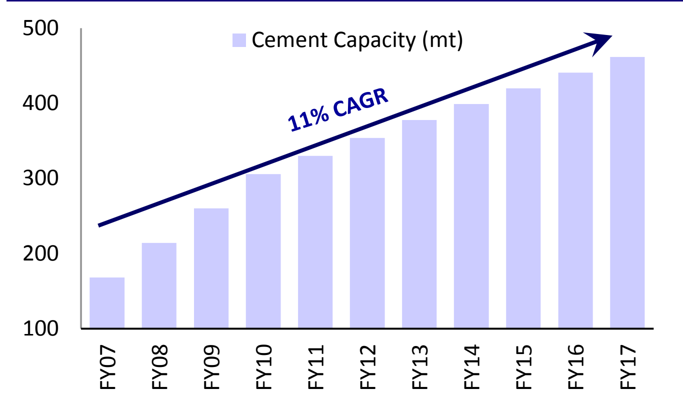
Investors are advised to refer through important disclosures made at the last page of the Research Report.
Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Reduction in pace of supply addition

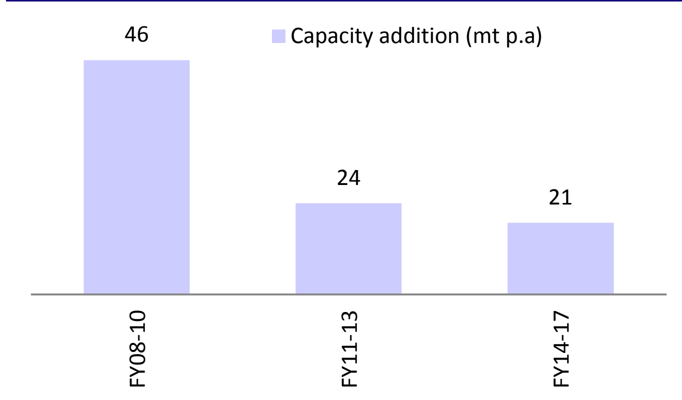
- The Indian cement industry witnessed supply growing at a CAGR of 11% over FY07-17. The availability of easy credit in FY06-07 led to a supply shock in FY06-07.
- However, the pace of capacity addition has declined over the years. Capacity addition declined from 46mtpa in FY08-10 to 24mtpa in FY11-13 and further to 21mtpa in FY14-17. Also, around this time, green-field capital costs were constantly increasing due to higher underlying prices of land. Green-field capital costs increased from USD100/t in 2012 to USD120/t in 2017 due to higher land prices and also due to a rise in overall lead time for the construction of projects.
- Demand during FY07-17 grew at a 6% CAGR (much lower rate than supply rate of 11%). As a result, utilizations for the industry declined from 90% in FY07 to 62% in FY18.
- Cement prices over the last 17 years increased at a 5% CAGR and have shown negative growth only for three years, during FY07-17. Prices witnessed maximum growth in FY06-07 on account of consolidation in the industry when Ultratech acquired L&T Cement and Holcim acquired ACC/Ambuja.

Exhibit 1: While capacity increased at a CAGR of 11% over FY07-17…



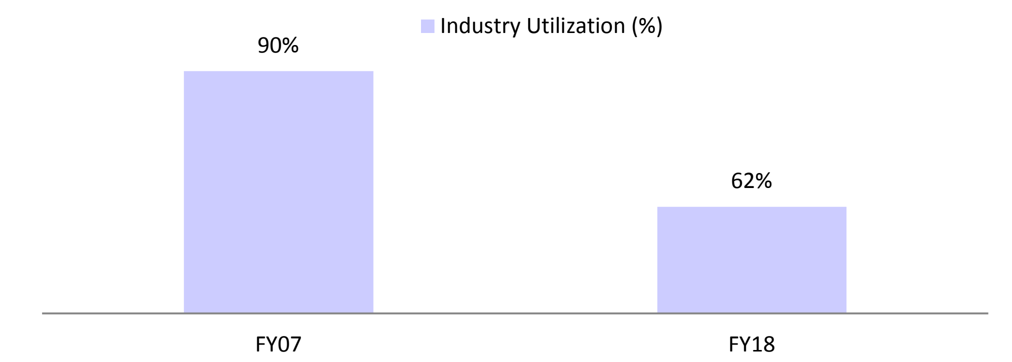
Source: Company

Exhibit 2: …pace of capacity addition slowed down



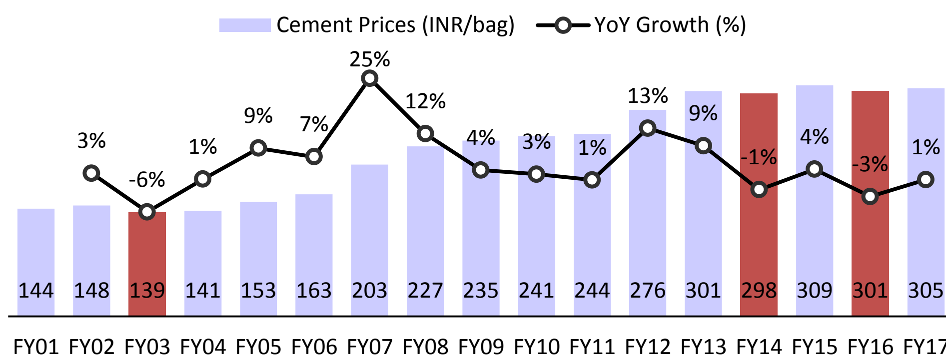
Source: Company

Exhibit 3: Utilization levels reduced from 90% in FY07 to 62% in FY18



Source: Company

Exhibit 4: De-growth in prices for only three years during FY01-17

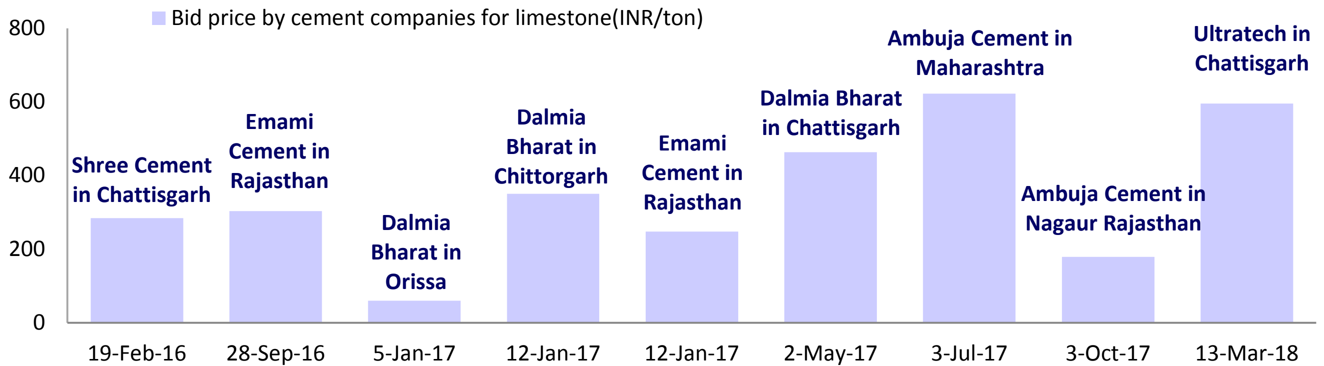


Source: Company

High entry barriers should result in supply CAGR of only 4% over FY18-23

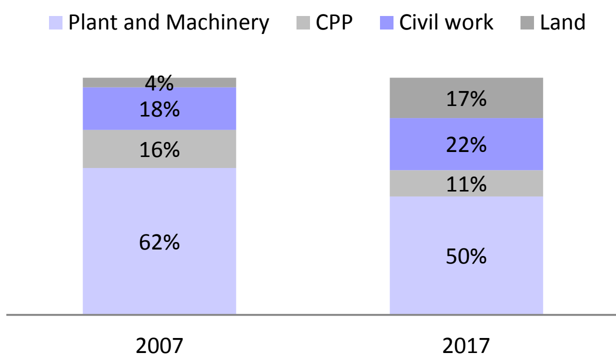
- Capacity addition is expected to slow down going forward due to rising entry barriers in the following form.
  - Difficulty in limestone access
  - Increase in prices of land
  - Availability of credit turning more stringent
  - Quick insolvency laws
- The last few limestone bids—by Emami Cement, Dalmia Cement and Ambuja Cement–point to a sharp increase in the cost of acquisition of limestone. Acquiring limestone at a bid price of INR400-600/ton should lead to an increase of ~INR300/ton in raw material costs, which translates into an increase of ~INR30/bag in cement prices.
- Thus, players acquiring new capacities should be at a cost disadvantage to players holding legacy assets.
- Land prices have also increased over the years. Cost of land, which accounted for only 4% of the total capex for a new plant in FY07, increased to 17% of the total capex in FY17.
- It should also be noted that the minimum size of capacity to be created has increased from 1mt in FY07 to 3mt in FY17, while the cost to create the same has also increased from INR 5600/t to INR 8800/t. This translates to an entry cost increase—from INR 5.6bn in FY07 to INR 26.5bn in FY17.
- Apart from this, availability of credit has also become difficult. The new insolvency laws have become much quicker in terms of execution.
- As a result, supply is expected to grow at a CAGR of only 4% over the next five years.

Exhibit 5: Limestone prices on a rise



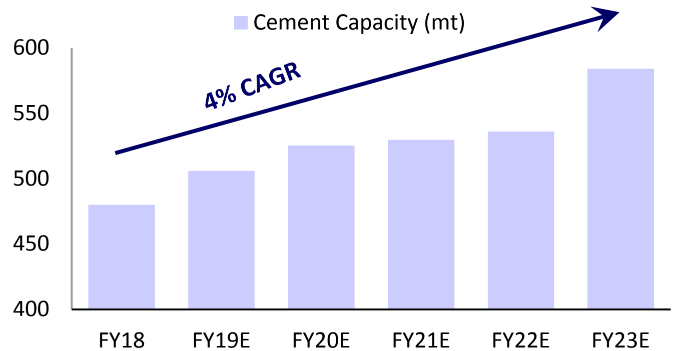
Source: MOSL, Company

Exhibit 6: Cost of land has increased significantly in the past decade



Source: Company

Exhibit 7: Supply to grow at a CAGR of 4% over FY18-23E

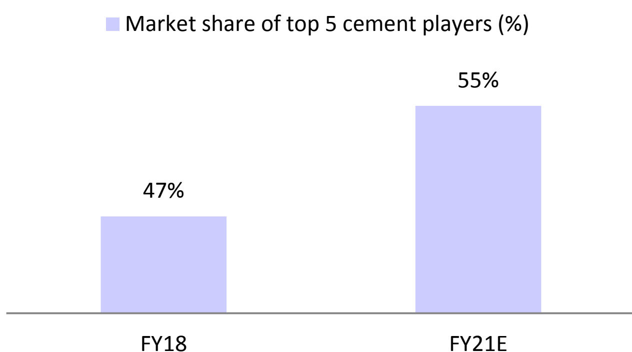


Source: Company

Consolidation is the way forward for the Industry

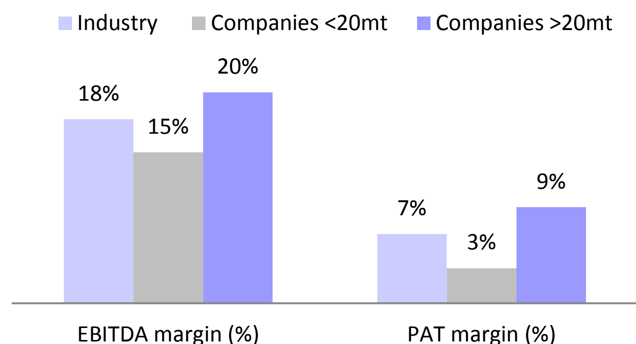
- The industry should witness consolidation going forward, owing to rising entry barriers. As a result, top-5 players in the industry, who constitute 47% of the capacity share in FY18 should account for 55% capacity share in FY21.
- Rise in consolidation should lead to stronger players gaining more scale, as a result of which, percentage of companies with capacity more that 10mt would increase. Empirical data suggests that players with scale have an ability to invest in branding and in cost-control measures; and are therefore able to gain higher profitability.

Exhibit 8: Consolidation is the way forward for the industry



Source: Company

Exhibit 9: Profitability increases with scale

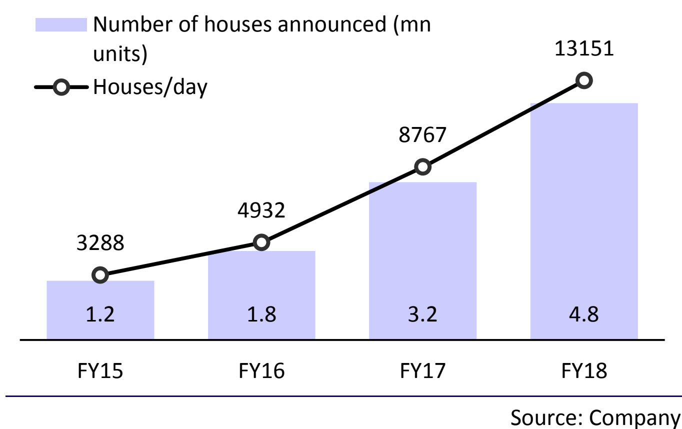


Source: Company

Demand to grow at a CAGR of 8% over FY18-23 led by housing and roads

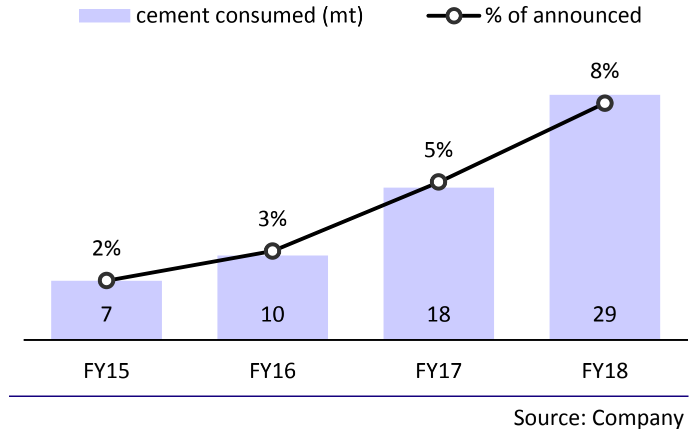
- The number of houses sanctioned under the Pradhan Mantri Awas Yojana has increased from 1.2m in FY15 to 4.8mn in FY18. The execution rate has also increased from 3,288houses/ day to 13,151 houses/ day.
- Pick-up in the execution rate has resulted in cement consumption increasing from 7mt in FY15 to 29mt in FY18.
- In order to achieve a target of 60m houses by FY22, cement requirement should shoot up to ~418mt over the next five years. If even 20% of this target is achieved, ~17mt additional annual demand should be created through housing projects.
- There has also been a pick-up in road construction projects. ~83,677km of roads have been announced, which would require 180mt of cement. Assuming 20% execution, we arrive at an annual cement demand of 7mt over the next five years. Thus, roads and housing along with demand from other infrastructure activities should result in demand of ~438 by FY23, implying ~8% CAGR over the next five years.
- With supply expected to grow at a CAGR of 4% over the next five years and demand at a greater pace of 8% CAGR, utilizations are expected to increase from 62% in FY18 to 79% in FY23.

Exhibit 10: Execution rate for housing project has increased significantly



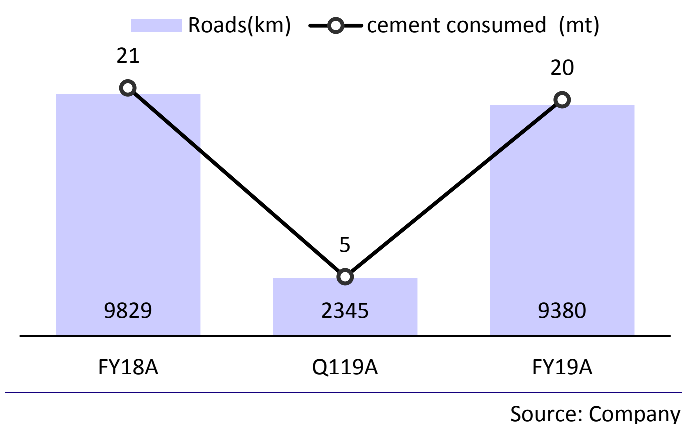
Source: Company

Exhibit 11: ~180mt of demand is expected to be created from road projects



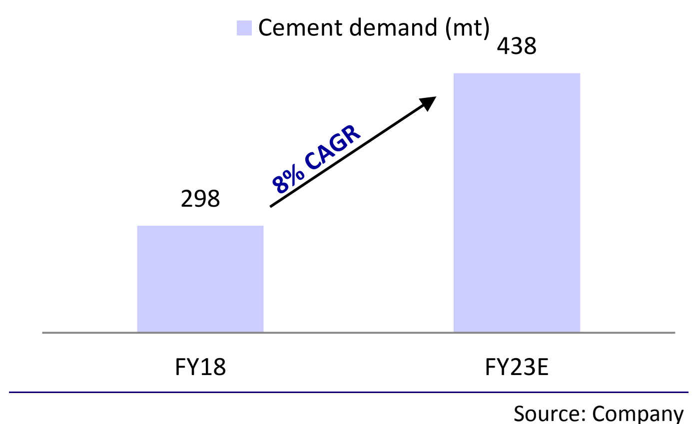
Source: Company

Exhibit 12: ~180mt of demand is expected to be created from road projects as execution picks up over next 5 years



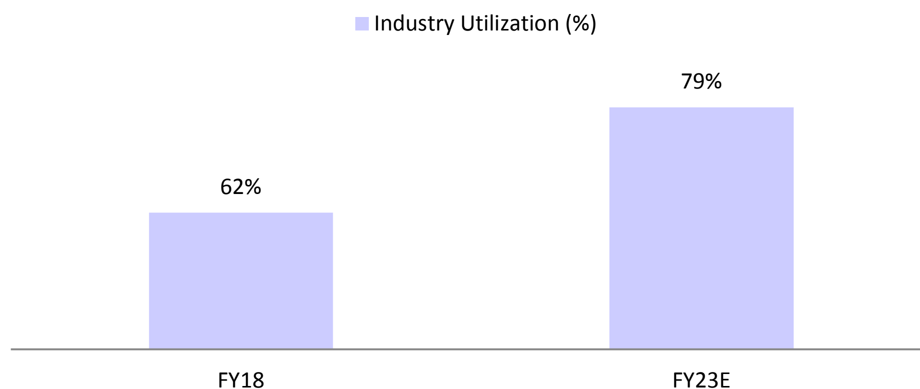
Source: Company

Exhibit 13: Demand to grow at a CAGR of 8% over FY18-23



Source: Company

Exhibit 14: Expect utilizations to increase from 62% in FY18 to 79% in FY18



Source: Company

Pricing ought to improve to meet the required cost of capital for incremental capacities

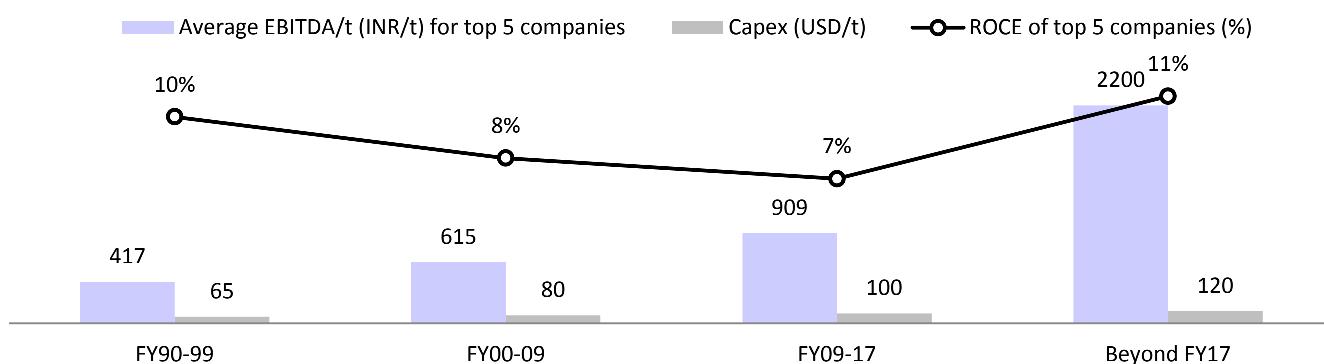
- Utilization improvement should result in pricing improvement over the years in order for players to meet the cost of capital for incremental capacities.
- The post-tax ROCEs for the top-5 players has decreased from 10% in the '90s to 7% currently as replacement costs increased from USD65/t to USD 100/t.
- With the current replacement cost of USD120/t, in order to achieve a post-tax ROCE of 11%, the required EBITDA/t should be ~INR2200/t—this appears unfeasible to achieve. However, it would still be imperative for the industry to improve upon its profitability from the current levels of INR909/t.

Exhibit 15: EBITDA/t required for incremental capacities is as high as INR 2200/t to achieve 11% post-tax ROCE

EBITDA/t (INR/t)	2200
EBITDA at 80% utilization for 1mt capacity (INR m)	1760
Capex (USD/t)	120
Capex (INR m)	8400
Depreciation at 5% of capex (INR m)	420
EBIT (INR m)	1340
Tax at 30%	
EBIT*(1-t) (INR m)	938
ROCE	11%

Source: Company

Exhibit 16: With rising capex cost, EBITDA/t required for new capacities to meet cost of capital has increased

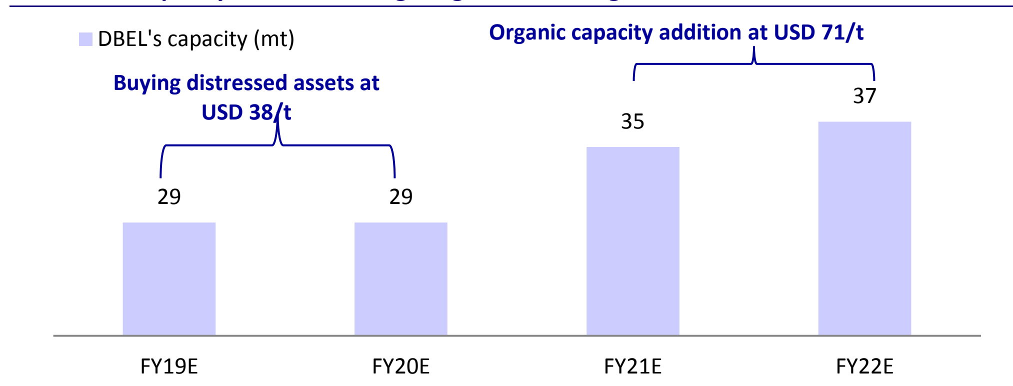


Source: Company

Expect DBEL to witness volume-driven growth in profitability

- **Volume growth led by organic and inorganic growth:** DBEL is likely to register a healthy volume CAGR of 15% over FY18-20, led by growth in the underlying markets of the South and the East, and by the ramp-up of acquired capacities of Murli Industries and Kalyanpur Cement. We expect the underlying markets of the South and the East to grow at a CAGR of 9-10% over FY18-20, driving overall volume growth for DBEL. We estimate a gradual ramp-up of acquired assets of Murli and Kalyanpur to be ~40% by FY20. Sustainable volume growth beyond FY20 would be secured by way of 8mt of capacity addition in the East by FY21. DBEL plans to achieve this organic growth at a capex of USD 71/t.
- **Higher proportion of volumes from non-South market:** As a result of the 8mt of capacity addition in the east, proportion of capacity in East would increase from 37% in FY18 to 49% in FY21. South which contributed to 48% of the capacity in FY18 would account for 40% in FY21. We estimate EBITDA/t to largely remain flat over FY18-20 due to a higher proportion of volumes from the lower-priced non-South markets. Additionally, acquired units in Murli and Kalyanpur, which are expected to contribute ~8-9% to volumes—should witness lower margins due to underutilization. We, thus, estimate EBITDA CAGR of 15% over FY18-20, primarily led by volume growth.
- **Cost initiatives along with corporate restructuring should bode well:** Various cost initiative measures like usage of green power and alternate fuels should aid profitability growth. DBEL has the lowest carbon footprint in the cement world and is also ranked first in the ***CDP (Carbon Disclosure Project) League Table for Low Carbon Economy Transition***. The company has also simplified its organisation structure from a 'diversified conglomerate' to a 'pure play'. Use of composite cement and increase in proportion of premium products (which are priced at INR 25-30/bag higher) will lead to an improvement in profitability.

Exhibit 17: Capacity addition through organic and inorganic route continues



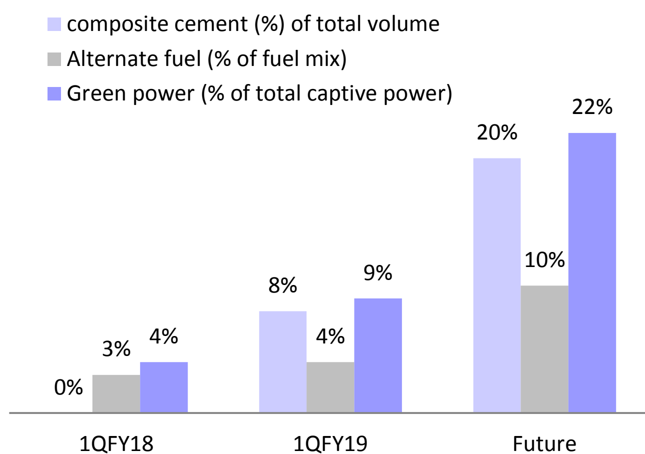
Source: Company

Exhibit 18: Focus on sale of premium products…

Premium over 'A' category → Rs. 25-30 per bag

Source: Company

Exhibit 19: ..and cost reduction measures should aid profitability



Source: Company

Exhibit 20: Simplified corporate structure should bode well for the company

	Then	Now
Family Structure	Running SBU's	Strategic Direction
Corporate Structure	Diversified Conglomerate	Pure plays
Ownership Structure	Retail	FII's/ Institutions

Source: Company

Exhibit 21: DBEL ranks first in CDP League Table for Low Carbon Economy Transition

League Rank Table	Company	League Table weighted rank
1	Dalmia Bharat	4.64
2	Ambuja Cement	5.62
3	Cement Argos	5.9
4	Shree Cement	5.91
5	Lafarge Holcim	6.03

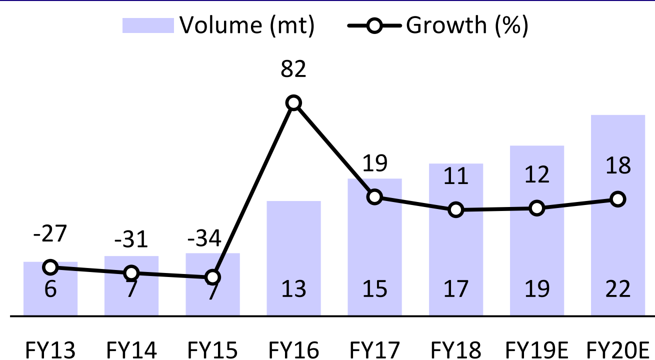
Source: DBEL

Valuation and view

- DBEL is likely to garner an annual operating cash flow in excess of INR15b, led by strong operating profit on the back of healthy margins. The company is likely to incur a capex of ~INR40b over FY18-20, including INR10-12b towards acquisition of Kalyanpur and Murli's assets, and INR26b towards capacity expansion in the East. We expect DBEL's net debt to increase from INR35b in FY18 to ~INR49b by FY20 on account of acquisitions and organic capacity addition.
- We believe that net debt reduction of ~INR7.5b/INR17.2b in FY17/FY18 should reverse over FY18-20, with net debt increasing to INR49b by FY20 in order to fund acquisitions and organic capacity addition. Operating cash flow is likely to improve strongly, led by volume growth on the back of acquisitions and growth in underlying markets. OCL-DBL merger synergy benefits could further improve cash flow, FY19 onwards. We value the stock at 11.5x FY20E EV/EVITDA (2-year average of 1-year forward EV/EBITDA as DBEL's multiple was re-rated in the last two years, post deleveraging of balance sheet) and arrive at a target price of INR3,141/share (implied EV/tonne of USD163).

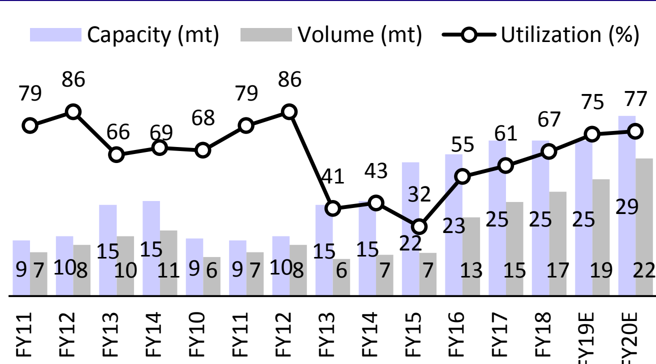
Story in charts

Exhibit 22: Robust volume CAGR of ~15% over FY18-20E



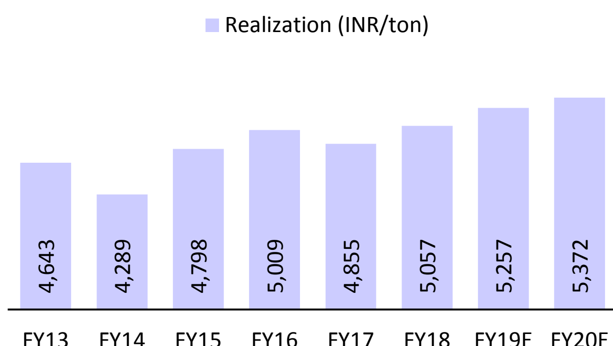
Source: MOSL, Company

Exhibit 23: Steady growth in capacity and utilization



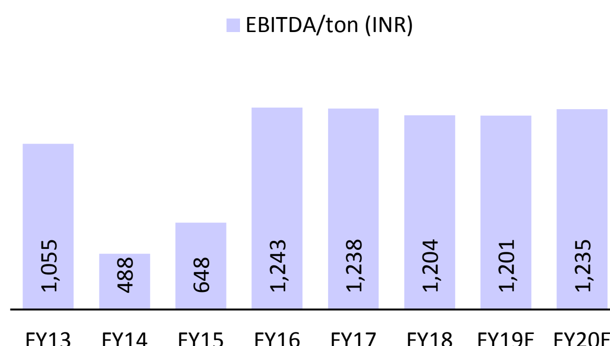
Source: MOSL, Company

Exhibit 24: Realization (INR/ton) trend



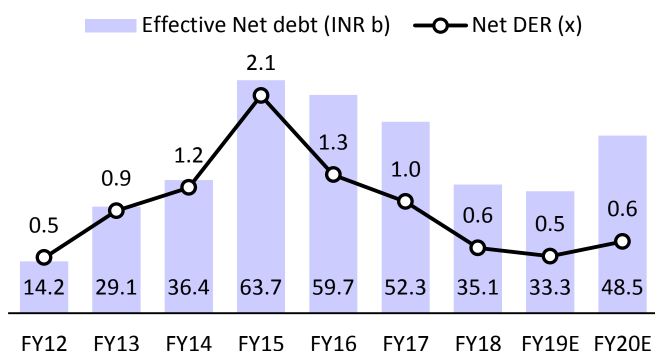
Source: MOSL, Company

Exhibit 25: EBITDA/ton trend



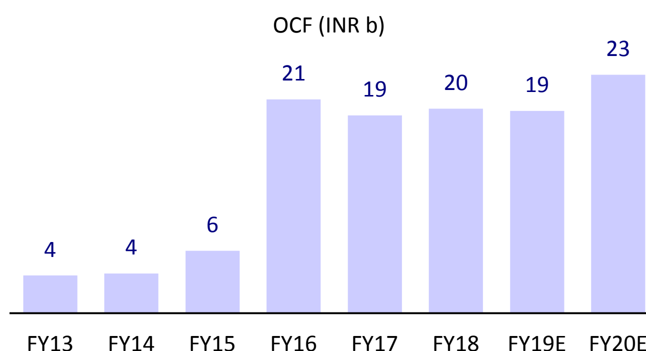
Source: MOSL, Company

Exhibit 26: Net debt to increase over FY18-20 led by acquisition/capex



Source: MOSL, Company

Exhibit 27: Gradual uptick in operating cash flows



Source: MOSL, Company

Financials and Valuations

Income Statement (INR m)

Y/E March	2013	2014	2015	2016	2017	2018	2019E	2020E
Net Sales	**27,906**	**28,670**	**33,662**	**64,113**	**74,235**	**85,771**	**99,801**	**120,301**
Change (%)	19.1	2.7	17.4	90.5	15.8	15.5	16.4	20.5
Total Expenditure	21,564	25,407	29,116	48,196	55,300	65,356	76,994	92,643
% of Sales	77.3	88.6	86.5	75.2	74.5	76.2	77.1	77.0
EBITDA	**6,342**	**3,263**	**4,546**	**15,916**	**18,935**	**20,415**	**22,807**	**27,657**
Margin (%)	22.7	11.4	13.5	24.8	25.5	23.8	22.9	23.0
Depreciation	2,059	2,422	2,716	5,809	7,262	7,037	7,181	7,350
EBIT	**4,282**	**842**	**1,830**	**10,107**	**11,674**	**13,378**	**15,626**	**20,307**
Int. and Finance Charges	2,314	3,151	4,344	7,302	8,689	7,049	6,256	6,742
Other Income - Rec.	769	2,081	2,413	2,294	2,862	2,784	2,200	2,400
PBT bef. EO Exp.	**2,738**	**-229**	**-101**	**5,100**	**5,846**	**9,112**	**11,570**	**15,966**
EO Expense/(Income)	0	0	0	-1	-150	-390	0	0
PBT after EO Exp.	**2,738**	**-229**	**-101**	**5,101**	**5,996**	**9,502**	**11,570**	**15,966**
Current Tax	1,336	644	469	2,456	2,573	3,067	4,049	5,588
Tax Rate (%)	48.8	-281.5	-463.5	48.2	42.9	32.3	35.0	35.0
Reported PAT	**1,402**	**-873**	**-570**	**2,645**	**3,423**	**6,436**	**7,520**	**10,378**
Minority and Associates	569	789	661	-745	-870	-1,078	-1,141	-1,208
PAT Adj for EO items	**1,971**	**-84**	**92**	**1,898**	**2,402**	**4,968**	**6,379**	**9,170**
Change (%)	-13.1	-104.3	-209.2	1,969.8	26.6	106.8	28.4	43.8
Margin (%)	7.1	-0.3	0.3	3.0	3.2	5.8	6.4	7.6

Balance Sheet (INR m)

Y/E March	2013	2014	2015	2016	2017	2018	2019E	2020E
Equity Share Capital	162	162	162	178	178	178	178	178
Total Reserves	30,517	30,785	30,539	45,715	50,206	59,795	65,863	74,619
Net Worth	**30,679**	**30,947**	**30,702**	**45,893**	**50,384**	**59,973**	**66,042**	**74,797**
Deferred Liabilities	1,638	1,865	4,279	16,746	14,479	14,548	14,548	14,548
Minority Interest	5,181	4,464	7,477	5,259	6,129	7,206	8,347	9,555
Total Loans	35,744	42,760	84,797	87,567	80,462	72,751	68,251	83,251
Capital Employed	**73,242**	**80,036**	**127,254**	**155,464**	**151,454**	**154,478**	**157,187**	**182,151**
Gross Block	49,979	52,446	84,123	103,106	106,610	113,721	118,721	130,721
Less: Accum. Deprn.	7,410	9,852	25,890	6,056	12,030	19,068	26,249	33,599
Net Fixed Assets	**42,569**	**42,594**	**58,233**	**97,050**	**94,580**	**94,653**	**92,472**	**97,122**
Capital WIP	5,503	12,379	19,142	2,355	1,280	1,670	6,500	25,500
Total Investments	**11,804**	**12,336**	**16,905**	**26,665**	**27,393**	**35,045**	**35,045**	**35,045**
Curr. Assets, Loans & Adv.	**16,139**	**15,560**	**30,147**	**26,502**	**22,321**	**27,804**	**30,908**	**38,547**
Inventory	3,520	3,311	7,293	6,976	6,518	7,792	8,750	10,877
Account Receivables	2,572	2,843	9,118	9,349	5,639	5,217	8,203	10,877
Cash and Bank Balance	999	844	5,281	2,336	1,748	3,538	831	644
Loans and Advances	9,048	8,562	8,455	7,841	8,415	11,257	13,125	16,150
Curr. Liability & Prov.	**6,899**	**7,523**	**16,816**	**24,231**	**25,862**	**28,737**	**33,074**	**39,400**
Account Payables	6,241	6,874	15,833	20,290	23,408	27,195	32,264	38,562
Provisions	658	649	984	3,942	2,454	1,543	810	838
Net Current Assets	**9,240**	**8,037**	**13,331**	**2,271**	**-3,541**	**-934**	**-2,167**	**-854**
Appl. of Funds	**73,242**	**80,036**	**127,254**	**155,464**	**151,454**	**154,478**	**157,187**	**182,151**

E: MOSL Estimates

Financials and Valuations

Ratios								
Y/E March	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019E**	**2020E**
Basic (INR) *								
EPS	**24.3**	**-1.0**	**1.1**	**21.4**	**27.0**	**55.7**	**71.6**	**102.9**
Cash EPS	49.6	28.8	34.6	86.8	108.6	134.7	152.1	185.3
BV/Share	377.8	381.1	378.1	516.8	566.4	672.7	740.8	839.0
DPS	2.0	2.0	1.5	1.5	2.0	2.0	3.0	4.0
Payout (%)	9.6	NM	NM	8.2	8.6	4.2	4.9	4.5
Valuation (x) *								
P/E					99.6	48.3	37.6	26.2
Cash P/E					24.8	20.0	17.7	14.5
P/BV					4.7	4.0	3.6	3.2
EV/Sales					3.9	3.2	2.7	2.2
EV/EBITDA					16.6	14.2	12.5	10.1
EV/Ton (US$)					167	170	166	141
Dividend Yield (%)					0.1	0.1	0.1	0.1
Return Ratios (%)								
RoIC	4.6	5.9	14.7	5.0	5.4	7.7	8.9	11.2
RoE	6.6	-0.3	0.3	5.0	5.0	9.0	10.1	13.0
RoCE	4.5	15.9	25.3	5.2	6.3	8.3	8.7	10.1
Working Capital Ratios								
Asset Turnover (x)	0.4	0.4	0.3	0.4	0.5	0.6	0.6	0.7
Inventory (Days)	46	42	79	40	32	33	32	33
Debtor (Days)	32	39	122	126	71	53	67	62
Leverage Ratio (x)								
Current Ratio	2.3	2.1	1.8	1.1	0.9	1.0	0.9	1.0
Debt/Equity	1.2	1.4	2.8	1.9	1.6	1.2	1.0	1.1

Cash Flow Statement								(INR m)
Y/E March	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019E**	**2020E**
OP/(Loss) before Tax	2,738	-229	-162	5,100	7,080	9,502	11,570	15,966
Depreciation	2,059	2,438	2,716	5,809	6,027	7,037	7,181	7,350
Interest & Finance Charges	2,190	2,977	4,126	6,929	8,653	7,049	6,256	6,742
Direct Taxes Paid	-1,019	-483	-1,354	-304	-555	-3,067	-4,049	-5,588
(Inc)/Dec in WC	-2,352	-880	689	3,054	-2,163	-818	-1,474	-1,500
CF from Operations	**3,617**	**3,823**	**6,015**	**20,588**	**19,041**	**19,704**	**19,484**	**22,969**
Others	-303	-385	-567	-1,438	-1,865	0	0	0
CF from Operating incl EO	**3,314**	**3,437**	**5,448**	**19,149**	**17,176**	**19,704**	**19,484**	**22,969**
(Inc)/Dec in FA	-3,398	-7,000	-4,953	-4,141	-3,366	-7,500	-9,830	-31,000
Free Cash Flow	**-84**	**-3,562**	**496**	**15,008**	**13,810**	**12,204**	**9,653**	**-8,031**
(Pur)/Sale of Investments	731	260	-6,041	-8,067	1,090	-7,651	0	0
Others	-3,450	-1,138	-19,363	-4,884	47	12,202	-1,293	0
CF from Investments	**-6,118**	**-7,878**	**-30,356**	**-17,092**	**-2,230**	**-2,949**	**-11,123**	**-31,000**
Issue of Shares	0	0	0	11	21	0	0	0
Inc/(Dec) in Debt	5,724	8,340	34,939	4,129	-6,826	-7,712	-4,500	15,000
Interest Paid	-2,445	-3,896	-5,432	-8,607	-8,727	-7,049	-6,256	-6,742
CF from Fin. Activity	**3,139**	**4,285**	**29,345**	**-5,002**	**-15,533**	**-14,968**	**-11,067**	**7,844**
Inc/Dec of Cash	**336**	**-155**	**4,437**	**-2,945**	**-586**	**1,787**	**-2,706**	**-187**
Opening Balance	664	999	844	5,281	2,336	1,750	3,537	831
Closing Balance	**999**	**844**	**5,281**	**2,336**	**1,750**	**3,537**	**831**	**644**

Explanation of Investment Rating

Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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