Mangalam Cement Ltd.

Stock Idea

Date: 17th Aug, 2018
CMP: Rs.252
Price Target: Rs.334
Recommendation: Buy

MARKET DATA	
NSE TICKER	MANGLMCEM
Net worth FY17 (Rs in Crs)	506
P/BV Ratio (FY17) (x)	1.32
EPS (FY17)(Rs.)	13.72
Market Price (Rs.)	252
P/E Ratio (FY17) (x)	23.38X
52 Week High (Rs)	479.55
52 Week Low (Rs)	178
Market Capitalisation (Rs. Cr)	640.25

AVERAGE MONTHLY VOLUME ('000)	
BSE	2.99
NSE	32.69

SHARE HOLDING PATTERN	
Promoter	16.51
FII	10.46
DII	2.91
Public	83.49

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Mangalam Cement Limited (MCL), started in 1978, is a part of the BK Birla Group. The company is engaged in the manufacturing of cement and has a capacity of 4MTPA for cement manufacturing and 48.65 MW of captive power production. Its cement and power plants are located at Rajasthan and UP. It sells 3 types of cement- PPC (Pozzolona Portland Cement), Ordinary Portland Cement (OPC) 43Grade and Ordinary Portland Cement (OPC) 53 Grade. The company sells 70% of the cement produced in the northern region while the remaining 30% volume is sold in the central region.

Favorable Demand Scenario

A favourable demand scenario for cement exists due to increased government focus on infrastructure development ahead of the election year and due to housing development under the PM's Pradhan Mantri Gramodaya Yojna (PMGY).

Capacity Expansion

The company has completed the 0.75 MTPA expansion plan in its Aligarh plant; the total capacity is now 4 MTPA. The Aligarh plant operated at merely 45% utilization because of fly ash availability issue. Now that the fly ash issue is resolved and due to favourable demand condition in central India, there is a scope for volume increase in the Aligarh plant as the utilization climbs to 75%.
Also, the existing plant in Rajasthan will ramp up capacity utilisation due to low capacity expansion in Northern and Central regions (approx. 9MTPA in the next 3 years in the northern region and 6MTPA in Central regions).

Cost Rationalization

The company is going to set up a 11 MW Waste Heat Recovery Plant (WHRP) in Rajasthan which will reduce its power cost by 40-50 Rs/Tonne or 8 to 10 Cr annually. Also, according to the new axle norm, the Ministry of Road Transport and Highways has increased the maximum permissible axle loads on new trucks and existing trucks by 15%. This will result in a benefit of approximately 5% of freight cost.

Valuation.

A favourable pricing environment exists in North India as no major player is embarking on capacity expansion for the next 3 years. Thus, the increase in demand will result in greater capacity utilization of the players and will boost realization. Mangalam is well poised to benefit from the increased realization combined with the increased production volume due to ramp up of Aligarh plant's capacity utilization. Its margins are expected to improve due to freight cost rationalization and with the setup of WHRP in Rajasthan.
We are valuing Mangalam Cement Ltd with a price objective of Rs.334 using the EV/EBITDA multiple of 8x on FY20 EBITDA.

Financials:

DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
Revenue (Cr Rs)	841.75	908.57	1086.14	1242.54	1395.35
EBITDA (Excluding OI)	44.68	121.40	86.33	106.79	145.06
EBITDA Margins %	5.31%	13.36%	7.95%	8.59%	10.40%
PAT (Cr Rs)	-21.47	36.63	11.43	21.52	43.43
PAT Margins %	-2.55%	4.03%	1.05%	1.73%	3.11%
EPS (Rs)	-8.04	13.72	4.28	8.06	16.27
ROE (%)	-4.54%	7.24%	2.22%	4.01%	7.49%
P/E (x)	0	23.38	55.79	30.24	14.98

❖ About the Company:

Company Background:

Mangalam Cement was founded by one of the most prominent industrialists of India, Mr B K Birla, in 1978.
As of now, the company has total cement capacity of 4 MTPA (3.25 in Rajasthan and 0.75 in Aligarh, UP); before the establishment of Aligarh Plant it was 3.25 MTPA. It has a 35MW thermal power plant and 13.65MW wind energy plant at Jaisalmer, Rajasthan. It produces and sells PPC and OPC (53 grade & 43 grade) under the brand of Birla Uttam Cement. It has a network of 1150 dealers and 2057 retailers. It sells 70% of its cement in the Northern Region and the rest in Central Region. Its main markets are Rajasthan, Delhi, Haryana, UP and MP.

❖ Industry Analysis

The cement companies had peak EBITDA/Tonne during FY07 to FY10 and during this period the industry utilization was about 85%. In such an environment, most cement firms executed large capacity expansion projects and subsequently due to this capacity addition, the supply outran demand leading to lower utilization levels. This shrank the EBITDA per tonne of each company.
Also, sand mining ban and political issues (the creation of Telangana) lead to a slowdown in construction activities which caused a drop in demand for the cement. In this environment, there was excess supply which reduced the realization, EBITDA margin, and EBITDA/ton.

Demand Scenario-

Major cement demand comes from the housing sector- rural and urban housing constitute 35% and 30% respectively of the total cement demand, Infrastructure constitutes 15% of the total cement demand and the balance 20% demand comes from the commercial segment. The rural housing and urban housing segments are expected to grow at a CAGR of 9.5% and 6.5% respectively over the next 3 years. Infrastructure is likely to grow at 10.5% CAGR and commercial by 5% CAGR for the next 3 years.
The housing sector will see growth majorly because of the PMAY and also from the growth in urban demand. The infrastructure sector will grow because of 1) Bharatmala project where the budget for the National Highway's road construction has been increased in the latest budget. 2) The high speed rails and the Metro projects.3) Ports, airports etc.

Supply Scenario-

Post the period of FY07 to FY10 which had high capacity utilizations and high EBITDA margins, major cement companies incurred a huge capex to increase their capacities. This created excess supply and led to lower utilization levels in the coming years. The excess supply came at a bad time; demand was reduced due to slowdown in construction because of sand mining issues. Now the demand is expected to increase as the sand mining ban is being resolved. This will create a balanced supply demand scenario.
Major capacity will be added in the South and then Western India, while Central and North India have the least capacity addition in pipeline for the next 3 years.

Input Costs-

Pet Coke Prices-

Pet coke is majorly used instead of coal because it provides more energy (i.e more heat per KG as well as per Rupee). Pet coke gives about 8000Kcal to 8200Kcal energy per KG while coal gives 6000 to 6100 Kcal energy per KG. Even though pet coke is more expensive, (per KG) it is still used as a major source because of its higher energy density. This helps provide net cost saving.
The pet coke price increased because the import duties were hiked from 2.5% to 10%. Also, pet coke was banned in the central regions to curb pollution. The depreciation of Rupee vs USD exacerbated the impact as pet coke is majorly imported from U.S.A and Saudi Arabia.
The pet coke prices in June -17 was 94 \$/Tn but in June -18 it is at 112\$/Tn an increase of 19% Y-o-Y. This can be contrasted with June -16 rate of 65\$/Tn, a 72% increase on a 2 year basis. Such a huge increase in pet coke price is increasing the power cost for cement companies and thus pressurizing margins.

Freight Costs-

The increase in the Freight cost is majorly due to the significant increase in diesel prices. The diesel price in June-17 was 62 Rs/Litre but in June-18 it is 73Rs/Litre, an 18% increase Y-o-Y. In June-16 diesel price was 50 Rs/Litre, a 46% increase on a 2 year Basis. This large increase in the diesel price has led to substantial increase in logistics cost and is reducing the margins of cement companies.

Packaging Costs-

The packaging cost increases in line with the crude oil price, and thus a huge increase in crude prices (40% over the last year) in FY18 have also led to the increase in the packaging costs.

❖ Investment Rationale:

Major Market is the Northern Market

The Northern Region has the least capacity additions planned for the next 3 years and this is a big positive for Mangalam cement. This will help the capacity utilization to improve to meet the increasing demand. It will also aid in increasing the realization.

Demand drivers in the Northern Markets

Major Market for Mangalam cement is the Northern market where it sells 70% of the cement. Central India constitutes the other important market. There is going to be a boost in demand because major states of North and Central India like Rajasthan, MP and UP have elections. In those states the government will carry out a lot of construction activities as well as spend on housing schemes like PMAY.

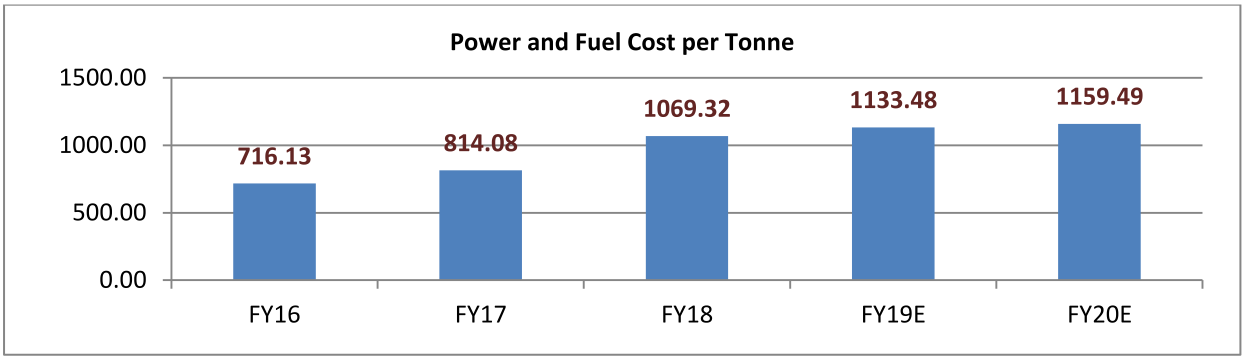
Pet Coke Ban uplift

In Rajasthan where the large plant of Mangalam cement operates, the use of Pet coke was banned by Supreme Court. In this plant, Mangalam Cement used pet coke for all of its energy requirements. This ban has now been uplifted but the import duty has been hiked from 2.5% to 10%.

Power and Fuel Cost Trend

In Rs.

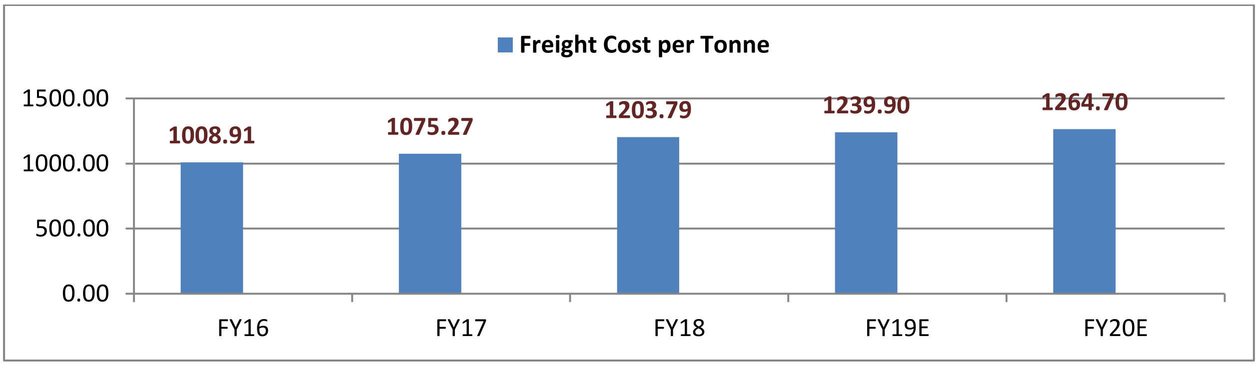
DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
Power and Fuel Cost per Tonne	716.13	814.08	1069.32	1133.48	1159.49



Freight Costs

The Reason for a large increase in the Freight costs was the increase in the diesel prices in line with the increasing crude oil price and depreciating Rupee. There will be some relief in the freight costs due to the new Axle norm where the Ministry of Road Transport and Highways has increased the maximum permissible axle loads on both new trucks and existing trucks by 15%. This will result in a benefit of approximately 5% of freight cost.

Freight Cost Trend					***in Rs***
DESCRIPTION	**FY16**	**FY17**	**FY18**	**FY19E**	**FY20E**
Freight Cost per Tonne	1008.91	1075.27	1203.79	1239.90	1264.70



Sand Mining ban

The sand mining from rivers was banned as the sand taken from the river bed causes environmental damage. This has stalled the construction activities in Rajasthan adversely affecting the demand of cement.

Recently the Department of Mines has offered a substitute which is 'Manufactured Sand' also called M Sand. The M Sand is made from locally available materials like granite, basalt, silica and sandstone which are available in abundance. The cost of producing M Sand is the same as ordinary sand which is Rs 500 per Tonne and it does not cause any environmental hazards.

This development is good news for cement companies such as Mangalam as it will kick start construction activities which will bring the demand of cement back on track.

Aligarh Plant

Mangalam Cement added a grinding unit with a capacity of 0.75 MTPA in Aligarh (in UP). This will enhance the capacity of Mangalam cement from 3.25 MTPA to 4MTPA. In FY18, the capacity utilization of this plant was just 45% because of the fly ash unavailability issue. Fly Ash issue has now been resolved and the capacity utilization of this plant can inch up to 70-75% in the coming years. This will increase the cement sales of Mangalam.

Waste Heat Recovery Power Plant (WHRP)

Nearly 35% of the heat lost in a cement plant (70-75 MW) is from preheater and cooler waste gases. This energy can be tapped by installing a Waste Heat Recovery Power Plant to convert the heat which would have been lost to electrical energy. So WHRP helps in reducing the electricity costs for cement plants. Mangalam Cement is setting up 11MW WHRP at Rajasthan by April 2019 and this plant will help save Rs 8-10 Crs annually.

Captive Power

Mangalam Cement has a captive power plant of 35 MW which is currently under-utilized as its power requirement is only 25 to 30 MW for its cement production of 2.8MTPA (as of FY 18). Furthermore, another 11 MW capacity from WHRP will come online by April 2019. Thus power will not be a constraint in any further volume expansion, as Mangalam is generating more than enough power to meet its needs.

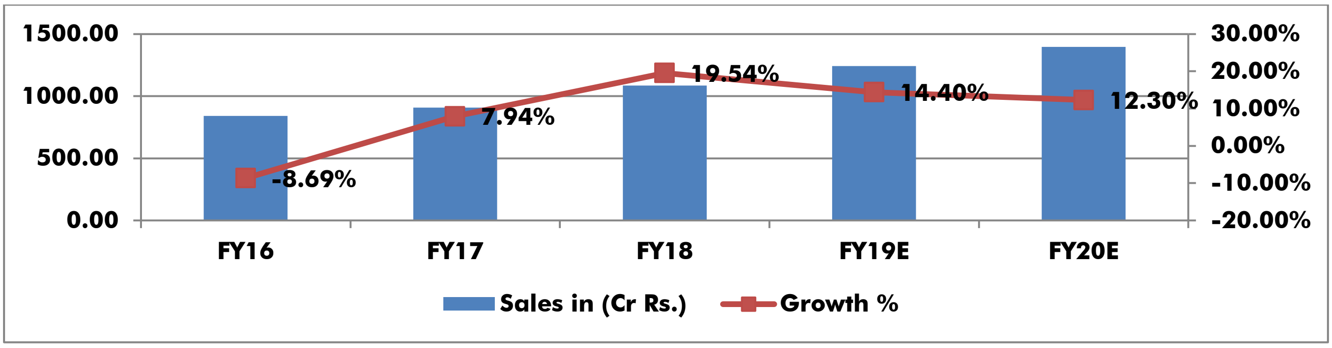
Sales and Realizations growth backed by Government Expenditure and Election Year in Major States

Increased government spending on infrastructure due to higher budgetary allocation towards road and affordable housing, and elections in the state of Rajasthan, MP and UP will boost demand for cement. Furthermore, the revival in rural economy will boost the demand for retail sale of cement. Mangalam cement is expected to post a sales volume growth of 9.25% CAGR over the period of FY18-FY20 from 2.8MTPA in FY18 to 3.34MTPA in FY20. The increased demand will be met by Aligarh plant's increased capacity utilization and also by ramp up in capacity of the plant in Rajasthan. Also, as per Management guidance, a higher proportion of PPC Cement will be sold which has higher realizations as compared to the Ordinary Portland Cement (OPC) 43 Grade and Ordinary Portland Cement (OPC) 53 Grade. This will help the company to improve the realizations.

We expect realizations to grow by 3.75% CAGR over the period of FY18-FY20 from 3879 Rs/Tonne in FY18 to 4175 Rs/Tonne in FY20. Sales are expected to grow at 13.35 % CAGR over the period of FY18-FY20 from Rs1086Crs in FY18 to 1340 Crs in FY20.

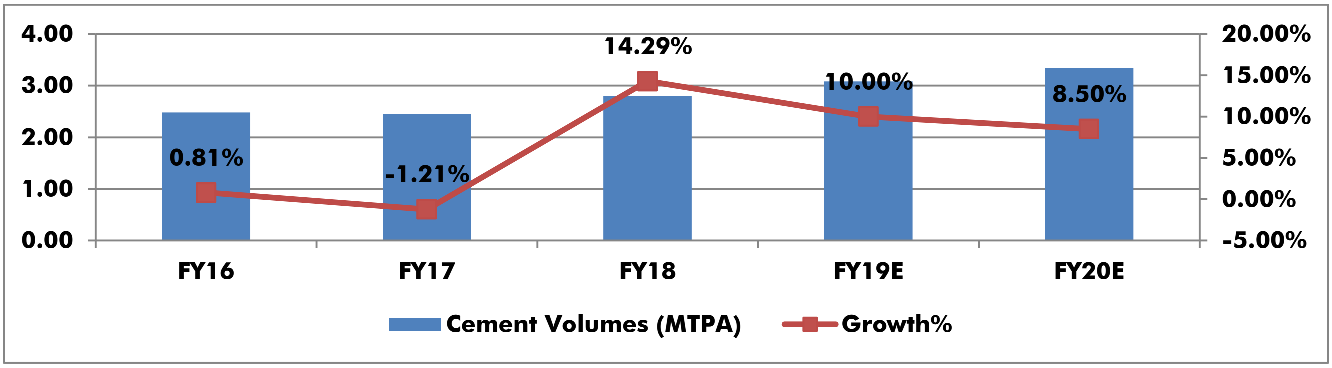
Sales Trend

DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
Sales in (Cr Rs.)	841.75	908.57	1086.14	1242.54	1395.35
Growth %	-8.69%	7.94%	19.54%	14.40%	12.30%



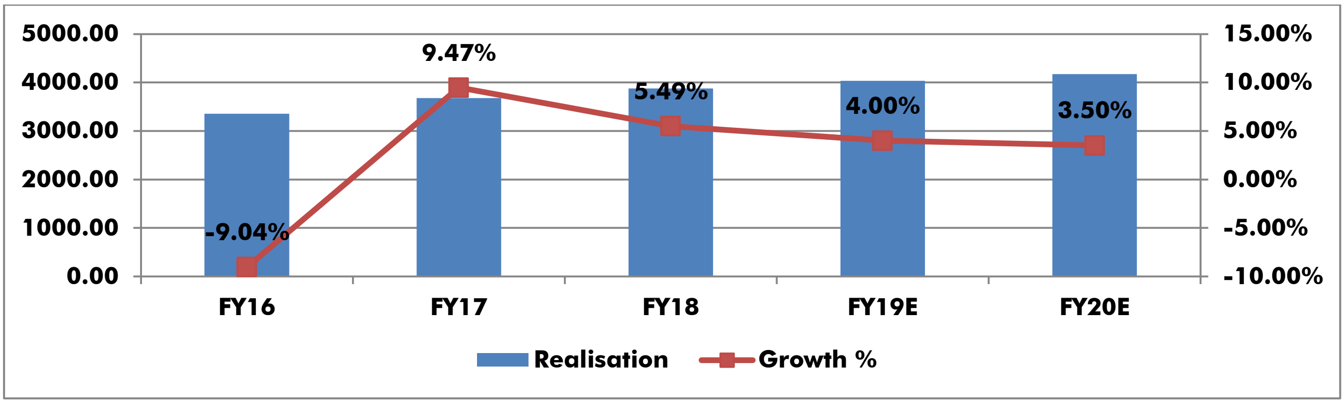
Volume Trend

DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
Total Capacity (MTPA)	3.25	3.25	4	4	4
Cement Volumes (MTPA)	2.48	2.45	2.80	3.08	3.34
Capacity Utilization %	76.31%	75.38%	70.00%	77.00%	83.55%
Growth%	0.81%	-1.21%	14.29%	10.00%	8.50%



Realisation Trend

DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
Realisation	3359.07	3677.06	3879.07	4034.23	4175.43
Growth %	-9.04%	9.47%	5.49%	4.00%	3.50%



Cost on per Tonne Basis

DESCRIPTION	FY16	FY17	FY18
Cement Volumes (in MTPA)	2.48	2.45	2.80
Raw Material	845.97	699.50	693.24
Power and Fuel Cost	716.13	814.08	1069.32
Employee Cost	292.14	318.12	314.57
Freight	1008.91	1075.27	1203.79
Total Cost	3213.99	3212.93	3570.74
EBITDA	180.18	495.52	308.33

EBITDA Profile

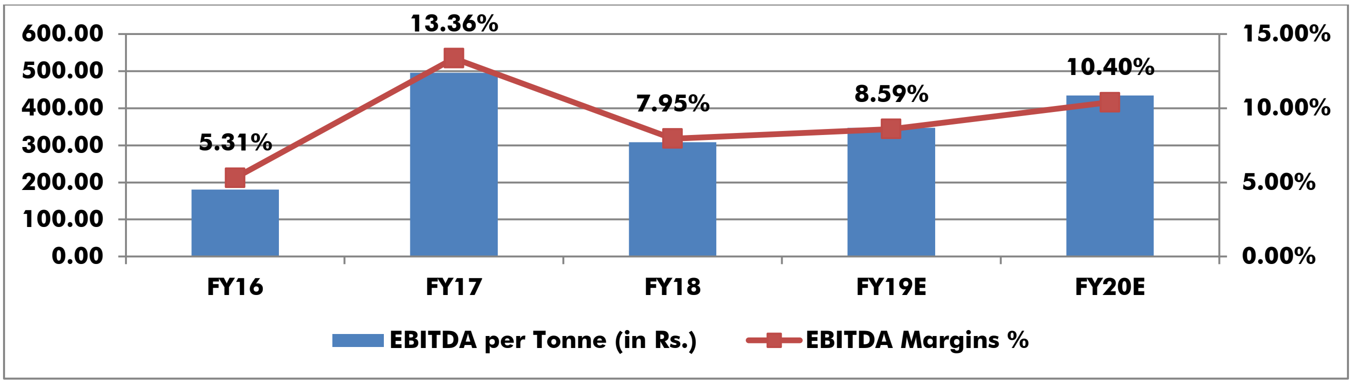
The EBITDA per ton of Mangalam cement was 496 Rs/Tonne in FY17 but it drastically decreased to 308 Rs/Tonne in FY18, a fall of 38% because of the higher power and fuel costs. Power costs increased by 50% from 200 Crs in FY17 to 300 Crs in FY18 and freight costs increased by 28% from 263Crs in FY17 to 337 Crs in FY18.

The Power and Fuel cost per tonne were 814 Rs/Tonne in FY17 and increased to 1070 Rs/Tonne in FY18 an increase of 31%. We expect the power and fuel costs per tonne to increase by 8.4% from 1069Rs/Tonne to 1159Rs/Tonne over the period of FY18-FY20.

The freight cost per tonne was 1075 Rs/Tonne in FY17 and increased to 1203.79 Rs/Tonne in FY18, an increase of 12%. We expect the freight cost to increase at a low rate because the crude oil prices have peaked. Furthermore, the axle norm which allows 15% more loading will help reduce the logistical costs. We expect freight cost per Tonne to increase by 5% from 1204 Rs/Tonne to 1265 Rs/Tonne over the period of FY18-FY20.

EBITDA Trend

DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
EBITDA per Tonne (in Rs.)	180.18	495.52	308.33	346.72	434.09
EBITDA Margins %	5.31%	13.36%	7.95%	8.59%	10.40%

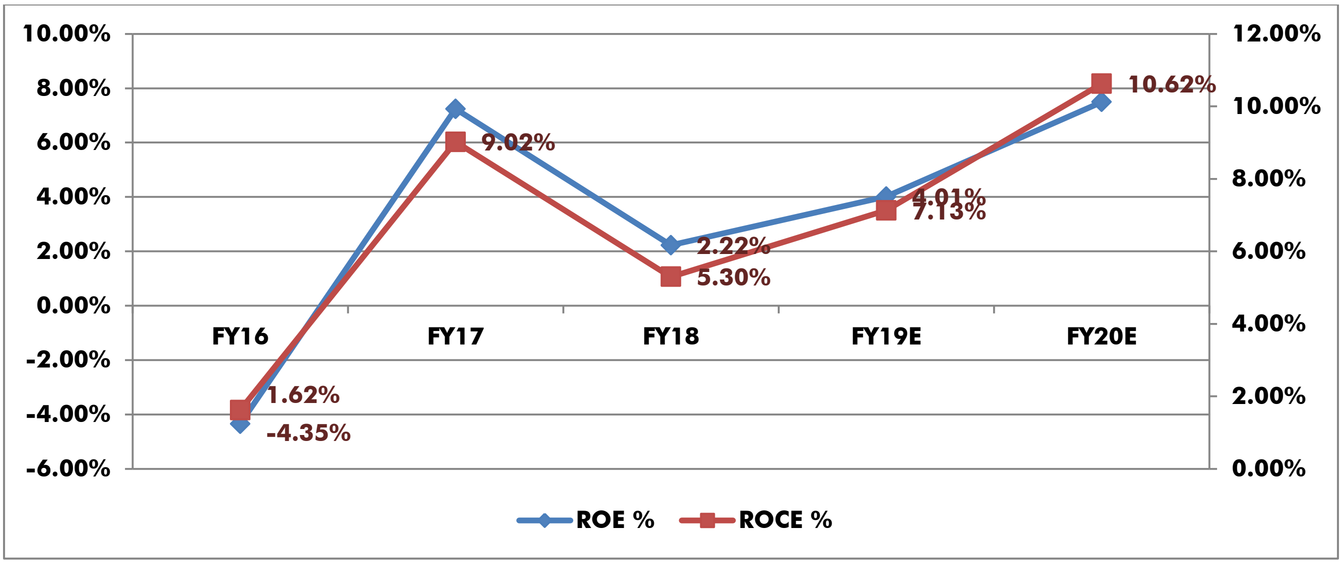


Returns Profile

The best performing year in terms of ROE% and ROCE% was the year FY17 where ROE and ROCE were 7.24% and 9.02% respectively. But as of FY18, the ROE and ROCE fell drastically by 70% and 41% respectively. This was majorly because of higher costs which lead to a fall in EBITDA margin and in turn the PAT margin. We expect the ROE and ROCE to expand by 527 BPs and 532 BPs respectively over the period FY18 to FY20E

Returns Profile

DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
ROE %	-4.35%	7.24%	2.22%	4.01%	7.49%
ROCE %	1.62%	9.02%	5.30%	7.13%	10.62%



Valuations

A favourable pricing environment exists in North India as no major player is embarking on capacity expansion for the next 3 years. The demand is expected to increase because of large governmental expenditure on roads, infrastructure and housing ahead of election in major states of Rajasthan, UP and MP. Thus, the increase in demand combined with inadequate capacity addition will result in increased capacity utilization from 70% in FY18 to 85% in FY20. The higher demand combined with changing product mix in favour of higher margin PPC cement will boost realization. Mangalam is well poised to benefit from the increased realization combined with the increased production volume due to ramp up of Aligarh plant's capacity utilization. Its margins are expected to improve due to freight cost rationalization, the setup of WHRP at Aligarh, and improving product mix.

We are valuing Mangalam cement Ltd with a price objective of Rs.334 using the EV/EBITDA multiple of 8x on FY20 EBITDA.

Key Assumptions

DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
Capacity (MTPA)	3.25	3.25	4	4	4
Cement Volumes (MTPA)	2.48	2.45	2.80	3.08	3.34
Realisation in Rs/Tonne	3359.07	3677.06	3879.07	4034.23	4175.43
EBITDA Per Tonne	180.18	495.52	308.33	346.72	434.09

Margins

DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
EBITDA Margins %	5.31%	13.36%	7.95%	8.59%	10.40%
EBIT Margins %	0.95%	8.92%	3.88%	4.83%	6.72%
PBT Margins %	-3.72%	5.55%	1.75%	2.62%	4.72%
PAT Margins %	-2.55%	4.03%	1.05%	1.73%	3.11%

Key Ratios

DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
ROE %	-4.35%	7.24%	2.22%	4.01%	7.49%
ROCE %	1.62%	9.02%	5.30%	7.13%	10.62%
P/E Ratio (x)	0	23.38	55.79	30.24	14.98
P/B (x)	1.24	1.71	1.25	1.23	1.14
Interest Coverage (x)	0.32	1.71	0.89	1.77	2.65
Debt/Equity (x)	0.9	0.78	0.54	0.57	0.52
ROA %	-1.76%	2.99%	0.94%	1.65%	3.11%
EV/EBITDA (x)	19.21	10.17	10.46	9.00	8.00

Peer Comparison (FY18 Numbers)

Company Name	JK Cement Ltd.	JK Lakshmi Cement Ltd.	Orient Cement Ltd.	Mangalam Cement Ltd.
Total Capacity in MT	11.70	10.00	7.98	4.00
Vol in MT	9.39	8.51	5.75	2.76
CU%	80.26%	85.10%	72.06%	69.00%
RM Cost/tonne	777.83	686.43	473.96	720.61
Power & Fuel Cost/ tonne	947.48	935.22	1,009.93	1,084.82
Freight Exp/tonne	1,142.11	1,025.37	1,032.53	1,221.21
EBITDA/tonne	810.08	483.38	530.75	312.63
EBITDA	760.66	411.36	305.18	86.29
EV/EBITDA	9.34	14.75	11.93	11.75
EV/Tonne	756.77	713.00	633.14	367.46
MCAP 3/8/2018	5,295.94	3,906.06	2,360.09	648.39
EV	7,106.10	6,067.64	3,640.58	1,014.19

Mangalam Cement is available at an attractive valuation compared to its peers based on the EV/EBITDA and EBITDA per tonne. The low capacity utilisation adds more confidence to this assessment.

Key Risks

Pet Coke Price and availability

Any further increase in the pet coke prices may further erode the EBITDA margins of Mangalam Cement. Pet coke price may increase if the government imposes any further duty hike due to environmental concerns in Rajasthan. If pet coke is completely banned and the company is forced to use coal, Mangalam's cost will increase by 5 to 7%.

Freight Charges

Freight Charges may increase if the crude price increases or if the Rupee weakens against the U.S Dollar.

Sand Mining Issue

Selling high margin cement is dependent on the high end construction activities which in turn is dependent on sand availability. Whether the introduction of M-sand will be able to replace the regular sand, and if companies will be willing to use that sand will be a major question looking ahead

❖ Financials:

Mangalam Cement Ltd.- Profit and Loss Statement					in Crs
DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
Net Revenue	841.75	908.57	1086.14	1242.54	1395.35
Less: Expenditure	797.07	787.17	999.81	1135.75	1250.28
EBITDA	44.68	121.40	86.33	106.79	145.06
Other Income	6.58	5.64	24.16	6.55	7.33
Depreciation	36.66	40.31	44.21	46.74	51.24
EBIT	14.61	86.73	66.28	66.60	101.15
Exceptional Items	0.00	11.23	0.00	0.00	0.00
Interest	45.94	47.49	47.27	34.00	35.35
PBT	-31.34	50.47	19.01	32.61	65.81
Taxes	-9.87	13.84	7.58	11.09	22.37
PAT	-21.47	36.63	11.43	21.52	43.43

Mangalam Cement Ltd.-Balance Sheet					in Crs
DESCRIPTION	FY16	FY17	FY18	FY19E	FY20E
Liabilities					
Equity Capital	26.69	26.69	26.69	26.69	26.69
Reserve and Surplus	446.55	479.31	488.27	509.79	553.22
Total Shareholders funds	473.25	506.00	514.96	536.48	579.91
Total Debt	433.98	393.16	280.14	306.04	303.37
Deferred Tax Liability	33.14	36.83	41.78	41.78	41.78
Other Liabilities	85.63	68.39	57.66	65.96	74.07
Current Liabilities	175.49	221.24	325.18	350.69	397.21
Total Liabilities	**1201.49**	**1225.62**	**1219.72**	**1300.96**	**1396.35**
Assets					
Gross Block	780.92	890.35	952.29	1001.34	1141.36
Less: Acc Depreciation	36.66	76.76	121.01	167.75	218.98
Net block	744.26	813.59	831.28	833.59	922.38
Capital WIP	70.93	48.77	5.09	45.00	0.00
Total Fixed Assets	815.20	862.35	836.37	878.59	922.38
Investments	75.54	53.68	61.58	70.45	79.11
Inventories	115.93	101.57	111.91	112.90	129.21
Sundry Debtors	34.70	34.34	36.49	43.92	49.32
Cash and Bank	29.49	25.06	22.47	22.47	22.47
Other Current Assets	130.63	148.62	150.90	172.63	193.86
Total Current Assets	310.7528	309.592	321.77	351.918	394.861
Total Assets	**1201.49**	**1225.62**	**1219.72**	**1300.96**	**1396.35**

Mangalam Cement Ltd.- Cash Flow Statement				*in Crs*
DESCRIPTION	**FY17**	**FY18**	**FY19E**	**FY20E**
PBT	50.47	19.01	32.61	65.81
Add: Depreciation	40.31	44.21	46.74	51.24
Changes in working cap.	47.10	70.54	-5.20	3.02
Cash Flow after W/C	137.88	133.77	74.14	120.07
Less: Tax Paid	-13.84	-7.58	-11.09	-22.37
Cash Flow from Operation	***124.04***	***126.19***	***63.05***	***97.69***
Cash Flow From Investing Activity	***-87.26***	***-18.26***	***-88.96***	***-95.03***
Free Cash Flow	36.78	107.92	-25.90	2.67
Cash Flow From Financing Activity	***-41.22***	***-110.51***	***25.90***	***-2.67***
Opening Cash	29.49	25.06	22.47	22.47
Closing Cash	25.06	22.47	22.47	22.47

ANALYST CERTIFICATION

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