India I Equities

Cement

Company Update

Change in Estimates ☐ Target ☐ Reco ☐

17 December 2020

Orient Cement

Demand outlook positive; expansion still on hold; retaining a Buy

Rating: **Buy**
Target Price: Rs100
Share Price: Rs78

Key data	ORCMT IN
52-week high / low	Rs90 / 35
Sensex / Nifty	46666 / 13683
3-m average volume	$0.6m
Market cap	Rs16bn / $213.7m
Shares outstanding	205m

Shareholding pattern (%)	Sept'20	Jun'20	Mar'20
Promoters	37.4	37.4	37.4
- of which, Pledged	*19.4*	*16.1*	*16.1*
Free float	62.6	62.6	62.6
- Foreign institutions	3.0	3.1	7.5
- Domestic institutions	26.4	26.8	28.2
- Public	33.2	32.7	27.0

We recently spoke to Orient Cements' management for a perspective on its business operations and outlook. With the uncertain demand milieu and its focus on a lean balance sheet, its capacity expansion continues to be on hold, the priority being on essential capex. Cost pressures will rise with high input costs; however, management said profitability would improve on the better demand outlook and firm prices. We retain our Buy rating, with a target of Rs100.

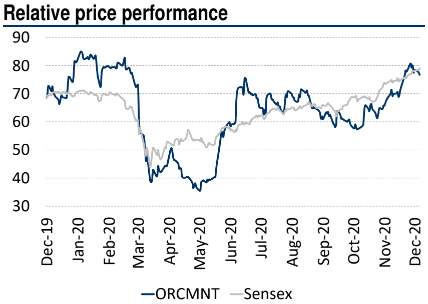
B/S improving; expansions still on hold. With 8m-ton capacity now, Orient Cement's further expansion plans at Devapur and Chittapur remain on hold due to uncertain demand and management's focus on a lean balance sheet. In line with this, it prepaid debt in H1 (~ Rs1.65bn) and has no debt liability till end-FY22. Further, on better working-capital management, OCF on 30th Sep'20 was ~Rs3.1bn (~Rs505m a year ago). The company will continue to invest in essential capex (WHRS, etc.).

Positive demand outlook. Trade demand has picked up, post-Diwali. Non-trade demand mostly arises from road projects (especially in Maharashtra). Infra projects (Polaveram/Kaleshwaram) continue to face funding issues. In its operating regions demand was flat in Oct/Nov and prices held up. Management spoke of sales of 5m tons in FY21 backed by greater demand and firm prices.

Rising cost pressure; profitability to be unharmed. The company reported a strong EBITDA/ton of Rs1,149 for H1 FY21 (Rs738 a year ago) backed by firm prices and postponed expenses (branding/shutdown, etc.) and low fuel costs. With petcoke unavailable and higher prices, management said H2 power cost would rise 12-15%; other expenses would be normal. However, it talked of profitability being unscathed, with EBITDA/ton at current highs.

Valuation. We retain our Buy rating, with a target price of Rs100, valuing the stock at 6x FY22e EV/EBITDA and an EV/ton of $47. **Risks:** Rising prices of pet-coke and diesel, demand slowdown.

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY18	FY19	FY20	FY21e	FY22e
Sales (Rs m)	22,223	25,222	24,218	22,307	24,770
Net profit (Rs m)	442	476	866	1,298	1,593
EPS (Rs)	2.2	2.3	4.2	6.3	7.8
PE (x)	65.0	34.9	10.6	12.3	10.0
EV / EBITDA (x)	13.6	9.4	5.5	5.9	5.1
EV / tonne ($)	71.1	50.0	36.1	43.6	39.5
RoE (%)	4.4	4.6	8.0	11.0	12.2
RoCE (%)	4.7	4.7	6.2	7.7	8.4
Dividend yield (%)	0.5	0.9	1.7	1.0	1.0
Net debt / equity (x)	1.3	1.2	1.1	0.8	0.5

Source: Company, Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Sales volume (m tons)	5.7	6.4	5.8	4.9	5.4
Net revenues	22,223	25,222	24,218	22,307	24,770
Growth (%)	*18.5*	*13.5*	*-4.0*	*-7.9*	*11.0*
Direct costs	14,353	16,586	14,881	12,884	14,566
SG&A	4,819	5,515	5,509	5,128	5,641
EBITDA	**3,052**	**3,120**	**3,829**	**4,296**	**4,563**
EBITDA margins (%)	13.7	12.4	15.8	19.3	18.4
- Depreciation	1,262	1,327	1,409	1,460	1,499
Other income	202	140	177	223	297
Interest expenses	1,292	1,185	1,223	1,093	947
PBT	700	748	1,374	1,966	2,414
Effective tax rate (%)	36.9	36.4	37.0	34.0	34.0
+ Associates / (Minorities)					
Net income	442	476	866	1,298	1,593
Adjusted income	442	476	866	1,298	1,593
WANS	205	205	205	205	205
FDEPS (Rs / sh)	2.2	2.3	4.2	6.3	7.8
FDEPS growth (%)	-237.8	7.5	82.1	49.9	22.8

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Share capital	205	205	205	205	205
Net worth	10,221	10,535	11,184	12,328	13,767
Debt	13,136	12,898	12,264	10,264	9,264
Minority interest					
DTL / (Assets)	854	961	1,219	1,219	1,219
Capital employed	**24,212**	**24,394**	**24,667**	**23,811**	**24,250**
Net tangible assets	21,857	22,932	22,098	21,706	20,706
Net intangible assets	650	613	617	617	617
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	1,582	478	668	100	100
Investments (strategic)	-	-	-	-	-
Investments (financial)	-	-	-	311	311
Current assets (ex cash)	4,949	4,958	5,255	4,888	5,428
Cash	331	288	360	467	1,838
Current liabilities	5,158	4,875	4,331	4,278	4,750
Working capital	-209	83	923	610	677
Capital deployed	**24,212**	**24,394**	**24,667**	**23,811**	**24,250**
Contingent liabilities	639	607	659	0	0

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
PBT (Adj. OI and Interest)	1,790	1,793	2,420	2,836	3,064
+ Non-cash items	1,262	1,327	1,409	1,460	1,499
Oper. prof. before WC	3,052	3,120	3,829	4,296	4,563
- Incr. / (decr.) in WC	385	291	841	-314	67
Others incl. taxes	-	-	-	-	-
Operating cash-flow	2,667	2,829	2,988	4,609	4,496
- Capex (tang.+ intang.)	1,413	1,261	768	500	500
Free cash-flow	1,253	1,568	2,220	4,109	3,996
Acquisitions					
- Div.(incl. buyback & taxes)	185	185	185	154	154
+ Equity raised	-	-	-	-	-
+ Debt raised	-225	-238	-634	-2,000	-1,000
- Fin investments	-	-	-	311	-
- Misc. (CFI + CFF)	1,151	1,188	1,328	1,538	1,471
Net cash-flow	-308	-44	73	107	1,371

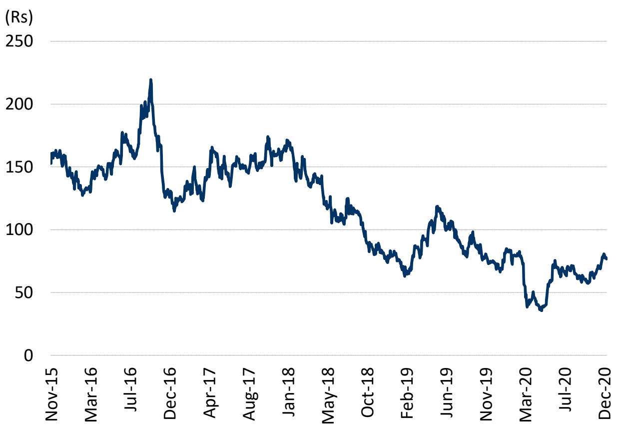
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
P/E (x)	65.0	34.9	10.6	12.3	10.0
EV / EBITDA (x)	13.6	9.4	5.5	5.9	5.1
EV / Sales (x)	1.9	1.2	0.9	1.1	0.9
P/B (x)	2.8	1.6	0.8	1.3	1.2
RoE (%)	4.4	4.6	8.0	11.0	12.2
RoCE (%) - after tax	4.7	4.7	6.2	7.7	8.4
DPS (Rs / sh)	0.8	0.8	0.8	0.8	0.8
Dividend payout (%) - incl. DDT	41.9	38.9	21.4	11.8	9.6
Net debt/equity (x)	1.3	1.2	1.1	0.8	0.5
WC days	-3.4	1.2	13.9	10.0	10.0
EV/ ton ($)	71.1	50.0	36.1	43.6	39.5
NSR / ton (Rs)	3,868	3,933	4,171	4,571	4,621
EBITDA / ton (Rs)	531	487	659	880	851
Volumes (m tons)	5.75	6.41	5.81	4.88	5.36
CFO : PAT %	603.0	594.9	345.1	355.2	282.2

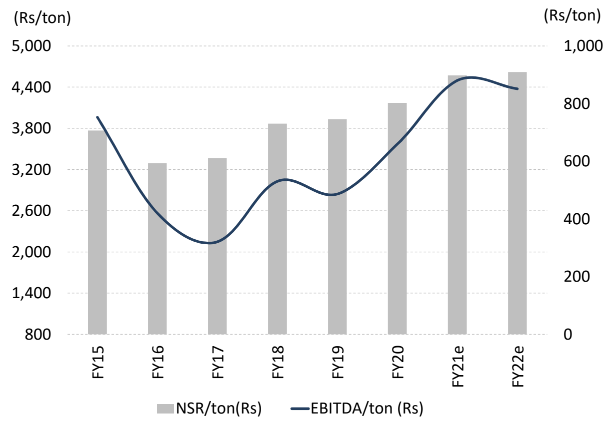
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Per-ton NSR and EBITDA trends



Source: Company

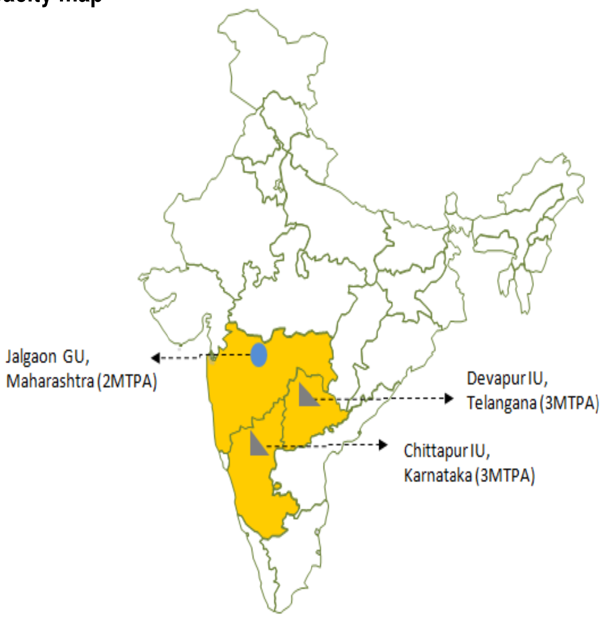
B/S better; expansion still on hold

Orient Cement has two cutting-edge integrated cement-manufacturing plants, at Devapur (Telangana) and Chittapur (Karnataka), as well as a clinker grinding unit in Jalgaon (Maharashtra) with an aggregate cement capacity of 8m tons and clinker capacity of over 5.5m tons.

Its key markets (Maharashtra 50%, Telangana/Karnataka/AP 35%), account for 85% of its revenue. The rest of its revenue arises from MP (10%) and the eastern region.

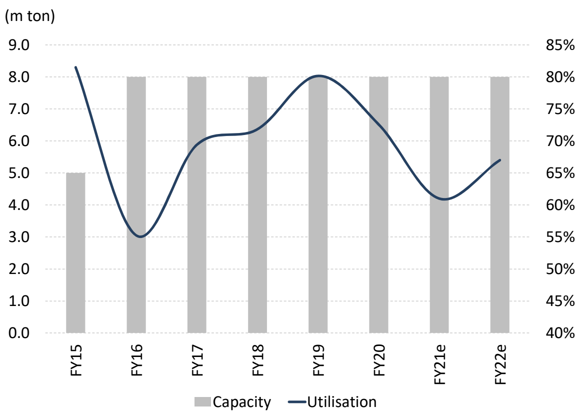
On the uncertain demand environment and lower capacity utilisations, it continues to keep on hold its capacity expansion at Devapur and Chittapur. However, approval of environmental clearances is going on. The expansions will take three years to complete and will be done in one after the other, following Board approval. The Devapur expansion will cater to Vidarbha (Maharashtra) and MP; Chittapur will address the Bengaluru, Mysuru, Kerala and TN markets.

Fig 7 – Capacity map



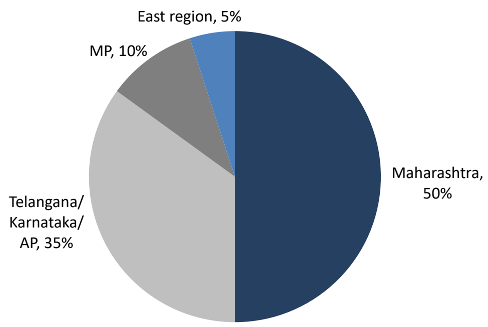
Source: Company, Anand Rathi Research

Fig 8 – Capacity and Utilisation



Source: Company, Anand Rathi Research

Fig 9 – Market mix

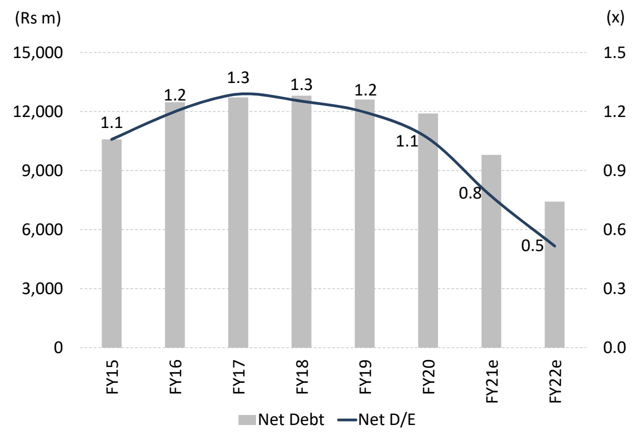


Source: Company, Anand Rathi Research

Net debt on 30th Sep was Rs9.2bn; net worth, Rs11.6bn. Better working-capital management strengthened its operating cash-flow to ~Rs3,067m (~Rs505m a year ago). Against debt repayment of Rs800m each for the next four years, the company repaid debt of Rs1.65bn in H1 FY21, meeting its debt repayment liability of the next two years.

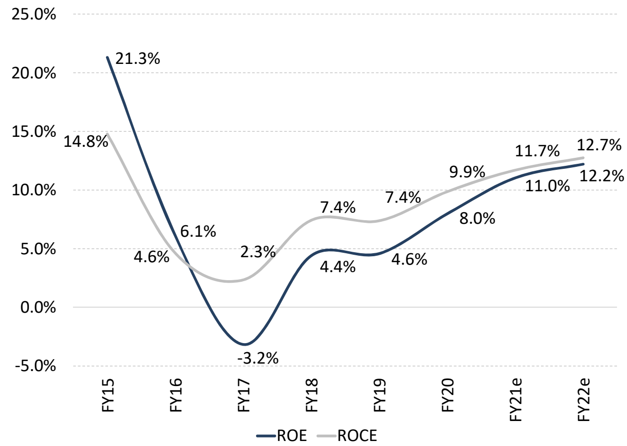
With no major capex announced, management talked of only essential capex (WHRS, etc.) in the near term and expects debt-to-EBITDA of 2x by end-FY22. Following greater profitability, return ratios improved in FY20: the RoE rose to 8% (4.6% a year back) and the RoCE to 9.9% (7.4%).

Fig 10 – Net debt and Net D/E



Source: Company, Anand Rathi Research

Fig 11 – Return ratios



Source: Company, Anand Rathi Research

Positive demand outlook

The huge Covid-19 impact and extraordinarily heavy rains in its operating regions resulted in subdued demand, leading to a huge decline (33%) in sales volumes in H1 to 1.84m tons. Realisations, though, rose 10.3% y/y to Rs4,823/ton. IHB sales improved, post-Diwali, Non-trade demand in Maharashtra mostly arises from road projects. The Polaveram project is facing funding issues between the state and Central governments, whereas the Kaleshwaram project has not yet commenced.

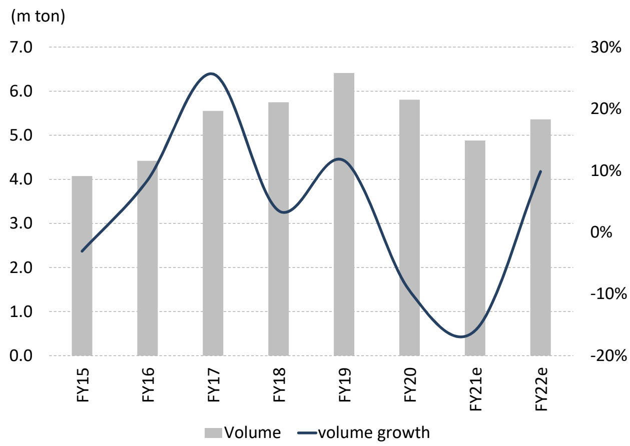
Sales of premium cement (Birla A1-Strongcrete, Birla A1 Premium Cement [PPC], etc.) were subdued due to low IHB demand and the lockdown-curbed travelling issues of technicians. Such sales were ~7% of trade sales the prior quarter, 2% a year ago. Premium cement is Rs30/bag higher than PPC cement, and adds ~Rs500/ton to realisations. PPC and the trade share of total volumes were 60% each.

Overall demand improved in Oct, whereas demand in Nov was only slightly hit due to Diwali. In the company's operating region, demand was flat/slightly negative in Oct and Nov combined. Prices were stable, and management said they would be firm in coming months, maintaining its guidance of sales of 5m tons in FY21.

Fig 12 – Sales and Sales growth

Source: Company, Anand Rathi Research

Fig 13 – Volume and Volume growth



Source: Company, Anand Rathi Research

Firm profitability despite rising costs

The company's H1 FY21 operating performance improved, backed by firm realisations and postponed expenses (branding/maintenance shutdown) along with low-cost pet-coke use. EBITDA rose 4% y/y to Rs2.1bn and EBITDA/ton shot up a robust Rs1,149/ton (up 56% y/y).

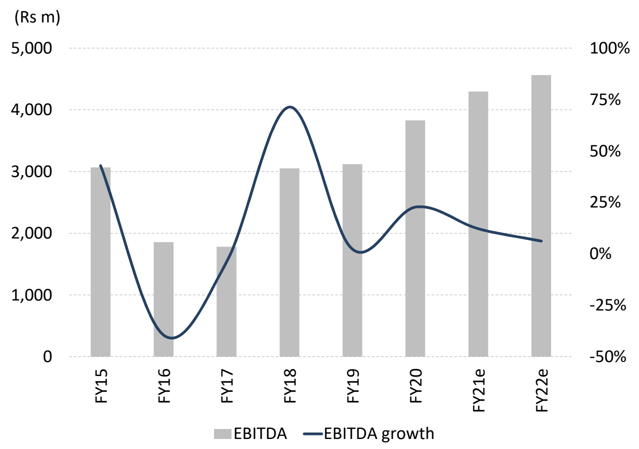
Management said other expenditure would rise with higher branding/advertising expenses, higher salaries and repairs & maintenance. It said profitability would be firm, nevertheless.

The company faced flyash non-availability in H1 as nearby thermal power plants were operating at low capacity or shut, leading to higher costs of procuring flyash from further. Flyash availability has improved with the thermal power plants starting.

The overall share of pet-coke was 62% in Q2 (the Chittapur plant uses only pet-coke). Due to the non-availability and higher prices of pet-coke (~$100/ton), the company switched to coal (international/domestic). Management expects energy costs to rise 12-15% in H2 FY21. Its focus was on restricting the average delivery distance to within 300km from its plants. In Oct, it shut down Line III of the Devapur plant for maintenance, which in the past had been done in the second quarter.

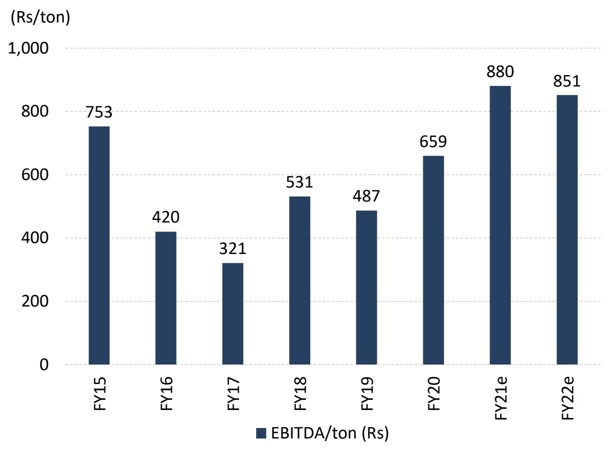
It intends to reduce carbon emissions ~40% by FY24 following waste-heat recovery and the increasing use of renewable energy and alternative fuels. On 3rd Dec'20, it agreed to acquire a 26% equity stake at Rs40.5m in AMP Solar Systems Pvt. Ltd. to put up a 13.5MW solar plant. It is also installing a 10MW WHRS at Rs1bn, to commence in 15-18 months. The payback period for the plant will be 2.5–3 years.

Fig 14 – EBITDA and EBITDA growth



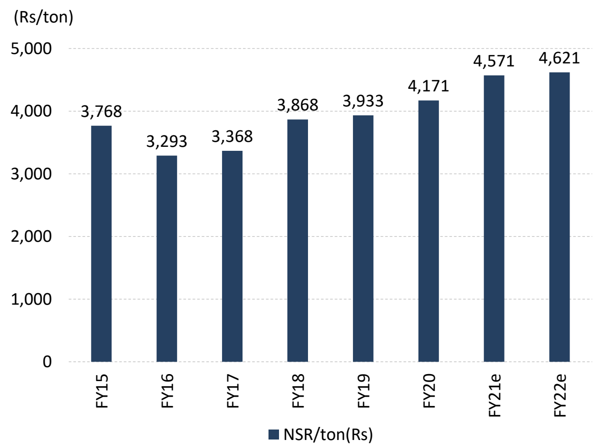
Source: Company, Anand Rathi Research

Fig 15 – EBITDA-per-ton



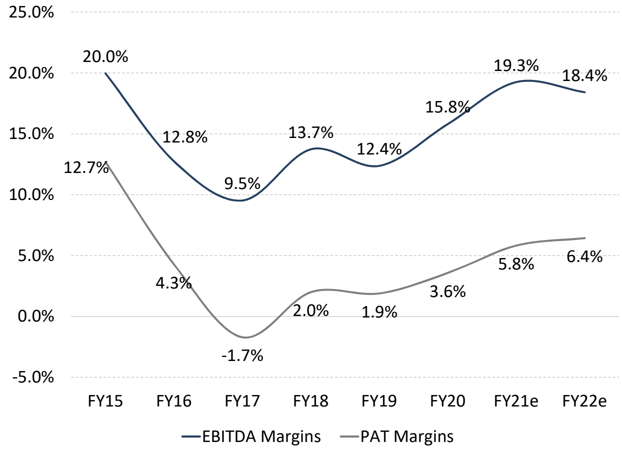
Source: Company, Anand Rathi Research

Fig 16 – NSR-per-ton



Source: Company, Anand Rathi Research

Fig 17 – EBITDA and PAT margins

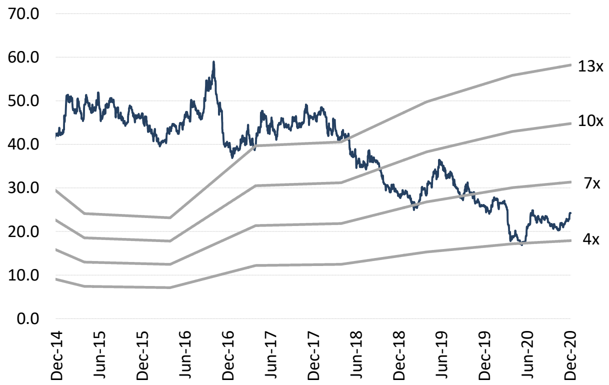


Source: Company, Anand Rathi Research

Valuations

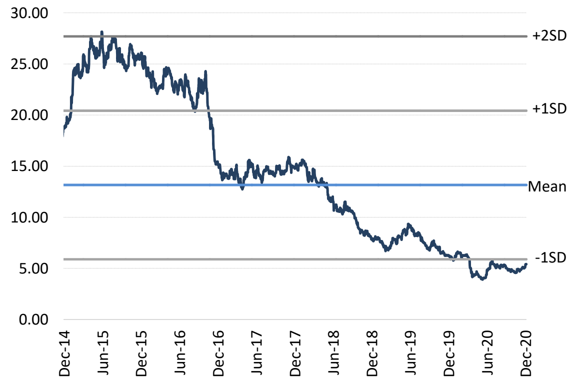
At the CMP of Rs78, the stock quotes at 5x FY22e EV/EBITDA, and an EV/ton of $40. We maintain our Buy rating with a target price of Rs100, valuing the stock at 6x FY22e EV/ EBITDA and an EV/ton of $47.

Fig 18 – EV/EBITDA band, one-year-forward



Source: Company, Anand Rathi Research

Fig 19 – EV/EBITDA: Standard deviation, one-year-forward



Source: Company, Anand Rathi Research

Fig 20 – Peer comparison on valuations

	CMP	P / E (x)		EV / EBITDA (x)		EV / ton ($)	
	(Rs)	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Orient Cement	**78**	**12.3**	**10.0**	**5.9**	**5.1**	**44**	**40**
Birla Corp.	728	13.1	12.6	7.4	7.0	68	56
Dalmia Bharat	1,090	31.4	31.6	9.1	8.4	147	121
Deccan Cement	379	5.8	6.0	3.2	2.6	27	22
Heidelberg Cement	212	19.8	15.4	9.9	8.0	100	94
India Cement	151	28.0	21.4	9.7	8.9	68	69
JK Cement	1,941	23.1	21.0	12.7	11.2	150	145
JK Lakshmi	338	13.9	11.8	6.8	5.7	56	49
Mangalam Cement	228	8.5	6.9	5.3	4.3	40	36
NCL Indus	143	14.7	12.8	6.8	6.2	44	46
Ramco Cement	856	36.1	23.4	21.0	15.2	161	151
Sanghi Industries	35	NA	21.6	14.1	8.9	53	51
Star Cement	94	19.5	15.1	10.7	8.5	85	87

Source: Anand Rathi Research

Risks

- Rising prices of pet-coke and diesel.
- Demand slowdown.

Appendix

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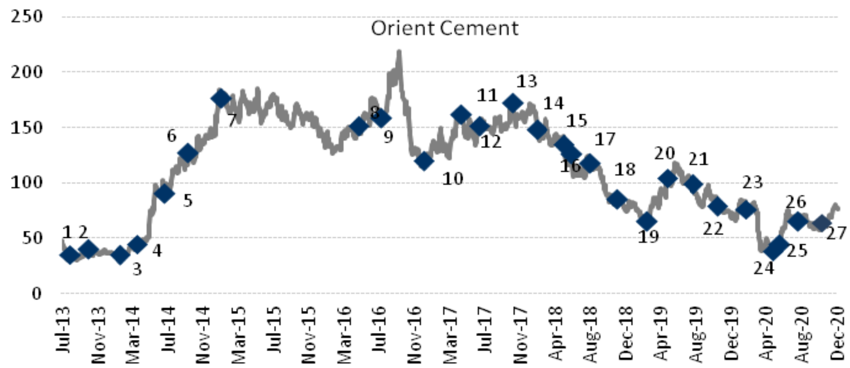
Important Disclosures on subject companies

Rating and Target Price History (as of 17 December 2020)



	Date	Rating	TP (₹)	Share Price (₹)
1	13-Aug-13	Buy	58	36
2	09-Oct-13	Buy	54	38
3	03-Feb-14	Buy	52	36
4	04-Apr-14	Buy	60	46
5	09-Jul-14	Buy	133	104
6	30-Sep-14	Buy	170	122
7	23-Jan-15	Buy	240	190
8	16-May-16	Buy	178	150
9	04-Aug-16	Buy	195	163
10	31-Dec-16	Hold	145	125
11	09-May-17	Hold	172	166
12	27-Jul-17	Hold	181	161
13	06-Nov-17	Hold	187	175
14	31-Jan-18	Hold	172	153
15	04-May-18	Hold	160	146
16	31-May-18	Buy	180	130
17	03-Aug-18	Buy	168	116
18	06-Nov-18	Buy	107	83
19	12-Feb-19	Buy	83	66
20	30-Apr-19	Buy	143	109
21	29-Jul-19	Buy	145	99
22	23-Oct-19	Buy	110	82
23	31-Jan-20	Buy	103	81
24	04-May-20	Buy	53	41
25	28-May-20	Buy	65	45
26	30-Jul-20	Buy	87	65
27	31-Oct-20	Buy	100	65

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Large Caps (>US$1bn)	>15%	5-15%	<5%
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