

Orient Cement

6 November 2018

Reuters: ORCE.NS; Bloomberg: ORCMNT IN

Weak Prices Limit Cost Pass-through, Impact Performance

Orient Cement (ORCMNT) reported a weak operating performance in 2QFY19 as realisation declined and cost escalation continued, although the strong volume growth was maintained. Volume grew ~12% YoY to 1.47mnmt (below our estimate of 1.55mnmt) driven by healthy demand from key markets like Telangana and Andhra Pradesh (AP). Realisation, however, declined ~4.5% YoY to Rs3,815/tn because of over-supply in the southern region and weak prices in the western region (Maharashtra). Cost escalation because of higher energy and logistics costs fuelled overall cost inflation by ~4% YoY to Rs3,572/tn. With the double impact of cost inflation and realisation decline, EBITDA margin fell sharply by 790bps YoY to 6.4% YoY. EBITDA declined ~52% to Rs357mn and EBITDA/tn slipped ~57% YoY to Rs243 from Rs570 in 2QFY18. Interest expenses were marginally down YoY at Rs310mn from Rs336mn in 2QFY18. On a lower EBITDA base and higher depreciation and interest costs, ORCMNT posted a loss of Rs168mn compared with a PAT of Rs102mn in 2QFY18. We believe ORCMNT's performance was impacted by the double impact of cost inflation and limited pass-through in its key markets. However, the focus on cost rationalisation and a presence in most vibrant markets of AP and Telangana will help earnings revival. Following the weak 1HFY19 performance (below our expectations), we have revised our earnings estimates for FY19/FY20/FY21 to Rs1.7/Rs4.0/Rs5.9 (from Rs2.7/Rs5.1/Rs7.1, respectively, earlier). ORCMNT currently trades at a replacement cost of Rs3.8bn/mt, but we have assigned EV/tn of Rs4.7bn/mt one-year forward capacity (earlier Rs5.0bn/mt) to arrive at a fair value. We have revised our target price on the stock to Rs117 (from Rs129 earlier). We have retained our Buy rating on the stock.

Volume push continues, but realisation impacted: Volume jumped ~12.2% YoY to 1.47mnmt in the monsoon quarter owing to strong demand in Telangana and AP markets. However, the sales in PPC segment fell to 60% from 65% earlier, impacting the realisation. The premium products (launched recently) contributed in a small proportion. Weakness in Maharashtra markets further dented the realisation which fell ~4.5% to Rs3,815/tn.

Cost inflation and realisation decline impacts EBITDA margin: Energy costs (adjusted with raw material costs to neutralise the inventory impact) rose ~11% YoY on account of higher fuel prices. Logistics costs were up ~6% YoY at Rs1,096/tn because of higher diesel prices as ~85% of the cement is transported by road. However, other expenditure was controlled at Rs874mn flat YoY. Despite this, operating costs rose 4% YoY to Rs3572/tn. High cost inflation and realisation decline impacted sharply the EBITDA margin which fell 790bps YoY to 6.4%.

Our estimates revised downwards: We have revised our earnings estimates downwards to Rs1.7/Rs4.0/Rs5.9 (from Rs2.7/Rs5.1/Rs7.1 earlier) for FY19/FY20/FY21, respectively. This is a factor in the weaker-than-expected 1HFY19 performance of ORCMNT, continued over-supply in key markets and the impact of cost inflation. Quicker and better price recovery in Maharashtra market, higher-than-estimated cost savings (truck-loading norms and softening fuel prices) and quick ramp-up of premium product contribution in sales remain key risks to our earnings estimates.

Outlook: We believe ORCMNT's performance was impacted with the double impact of cost inflation and limited pass-through in its key markets. However, the focus on cost rationalisation and a presence in vibrant markets of AP and Telangana will help earnings revival. Following the weak 1HFY19 performance (below our expectations), we have revised our earnings estimates for FY19/FY20/FY21 to Rs1.7/Rs4.0/Rs5.9 (from Rs2.7/Rs5.1/Rs7.1, respectively, earlier). ORCMNT currently trades at a replacement cost of Rs3.8bn/mt, but we have assigned EV/tn of Rs4.7bn/mt one-year forward capacity (Rs5.0bn/mt earlier) to arrive at a fair valuation. We have revised our target price on the stock to Rs117 (from Rs129 earlier) and retained Buy rating on it.

BUY

Sector: Cement

CMP: Rs85

Target Price: Rs117

Upside: 38%

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Key Data

| | |
|--------------------------|----------|
| Current Shares O/S (mn) | 204.9 |
| Mkt. Cap (Rsbn/US\$m) | 17.5/239 |
| 52 Wk H / L (Rs) | 184/80 |
| Daily Vol. (3M NSE Avg.) | 133,013 |

Price Performance (%)

| | 1 M | 6 M | 1 Yr |
|---------------|-------|--------|--------|
| Orient Cement | (5.5) | (38.2) | (51.5) |
| Nifty Index | 2.1 | (0.8) | 0.7 |

Source: Bloomberg

| Y/E March (Rsmn) | 2QFY19 | 2QFY18 | YoY % | 1QFY19 | QoQ % |
|---------------------------------|--------------|--------------|---------------|--------------|---------------|
| Net sales | 5,608 | 5,231 | 7.2 | 6,399 | (12.4) |
| Operating expenses | 5,250.5 | 4,484.6 | 17.1 | 5,544.8 | (5.3) |
| EBITDA | 357 | 746 | (52.1) | 854 | (58.2) |
| EBITDA margin (%) | 6.4 | 14.3 | (789) | 13.3 | (698) |
| Other Income | 25 | 85 | (71.3) | 33 | (26.6) |
| Interest costs | 310 | 336 | (7.8) | 294 | 5.5 |
| Depreciation | 329 | 318 | 3.3 | 324 | 1.4 |
| PBT | (257) | 177 | - | 269 | - |
| Non-recurring items | - | - | - | - | - |
| PBT (after non-recurring items) | (257) | 177 | - | 269 | - |
| Tax | (89) | 75 | - | 109 | - |
| Reported PAT | (168) | 102 | - | 160 | - |
| Adjusted PAT | (168) | 102 | - | 160 | - |
| NPM (%) | (3.0) | 1.9 | (490) | 2.5 | (550) |
| Adjusted EPS (Rs) | (0.8) | 0.5 | - | 0.8 | - |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Operational details

| (Rs) | 2QFY19 | 2QFY18 | YoY % | 1QFY19 | QoQ % | 2QFY19E | Deviation % |
|---|------------|------------|---------------|------------|---------------|------------|---------------|
| Volume (mnmt) | 1.47 | 1.31 | 12.2 | 1.60 | (8.3) | 1.55 | (4.9) |
| Cement realisation (net of freight) (Rs/mt) | 3,815 | 3,993 | (4.5) | 3,992 | (4.4) | 4,052 | (5.9) |
| Operating costs (Rs/mt) | 3,572 | 3,423 | 4.3 | 3,459 | 3.3 | 3,591 | (0.5) |
| EBITDA (Rs/mt) | 243 | 570 | (57.3) | 533 | (54.4) | 461 | (47.2) |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Detailed quarterly financials

| (Rsmn) | 2QFY19 | 2QFY18 | YoY % | 1QFY19 | QoQ % | 2QFY19E | Deviation % |
|---------------------------------|--------------|--------------|-----------------|--------------|-----------------|--------------|-----------------|
| Net sales | 5,608 | 5,231 | 7.2 | 6,399 | (12.4) | 6,263 | (10.5) |
| Expenditure | | | | | | | |
| Change in stock | 38 | (99) | | (138) | | (55) | |
| Raw material costs | 708 | 630 | 12.4 | 803 | (11.8) | 781 | (9.3) |
| Purchased products | - | - | - | - | - | - | - |
| Power & fuel expenses | 1,550 | 1,314 | 17.9 | 1,778 | (12.9) | 1,770 | (12.4) |
| Freight costs | 1,687 | 1,414 | 19.3 | 1,867 | (9.6) | 1,832 | (7.9) |
| Employee costs | 393 | 347 | 13.3 | 400 | (1.6) | 399 | (1.4) |
| Other exp | 874 | 878 | (0.5) | 835 | 4.6 | 825 | 5.9 |
| Total operating expenses | 5,250 | 4,485 | 17.1 | 5,545 | (5.3) | 5,551 | (5.4) |
| EBITDA | 357 | 746 | (52.1) | 854 | (58.2) | 712 | (49.8) |
| EBITDA margin (%) | 6.4 | 14.3 | (789bps) | 13.3 | (698bps) | 11.4 | (500bps) |
| Other income | 25 | 85 | (71.3) | 33 | (26.6) | 25 | (1.9) |
| Interest costs | 310 | 336 | (7.8) | 294 | 5.5 | 295 | 5.1 |
| Depreciation | 329 | 318 | 3.3 | 324 | 1.4 | 311 | 5.7 |
| PBT | (257) | 177 | - | 269 | - | 131 | - |
| Non-recurring items | - | - | - | - | - | - | - |
| PBT (after non-recurring items) | (257) | 177 | - | 269 | - | 131 | - |
| Tax | (89) | 75 | - | 109 | - | 34 | - |
| Tax rate (%) | 35 | 43 | (18bps) | 41 | (14bps) | 26 | 34bps |
| Reported PAT | (168) | 102 | - | 160 | - | 97 | - |
| Adjusted PAT | (168) | 102 | - | 160 | - | 97 | - |
| NPM (%) | (3.0) | 1.9 | - | 2.5 | - | 1.5 | - |
| Adjusted EPS (Rs) | (0.8) | 0.5 | - | 0.8 | - | 0.5 | - |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Trend in operating costs/mt

| Operating costs/mt(Rs) | 2QFY17 | 3QFY17 | 4QFY17 | 1QFY18 | 2QFY18 | 3QFY18 | 4QFY18 | 1QFY19 | 2QFY19 | YoY % | QoQ % |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|------------|------------|
| Consumption of raw material | 444 | 601 | 471 | 440 | 405 | 495 | 470 | 414 | 508 | 25.3 | 22.5 |
| Power and fuel costs | 1,049 | 931 | 917 | 983 | 1,003 | 1,040 | 1,007 | 1,109 | 1,054 | 5.1 | (5.0) |
| Freight costs | 730 | 912 | 888 | 995 | 1,080 | 993 | 1,053 | 1,165 | 1,148 | 6.3 | (1.4) |
| Total costs per mt | 3,147 | 3,287 | 3,012 | 3,222 | 3,423 | 3,448 | 3,245 | 3,459 | 3,572 | 4.3 | 3.3 |

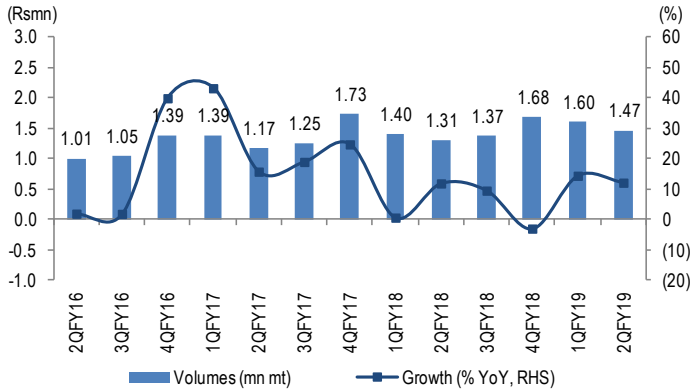
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Our revised estimates

| (Rsmn) | Old | | | New | | | Change (%) | | |
|--------------------------|--------|------------|--------|--------|------------|--------|------------|--------|--------|
| | FY19E | FY20E | FY21E | FY19E | FY20E | FY21E | FY19E | FY20E | FY21E |
| Net sales | 24,875 | 27,475 | 30,435 | 24,601 | 27,174 | 30,100 | (1.1) | (1.1) | (1.1) |
| Operating profit | 3,088 | 3,595 | 4,116 | 2,815 | 3,293 | 3,782 | (8.9) | (8.4) | (8.1) |
| Net profit | 558 | 1,048 | 1,457 | 352 | 827 | 1,210 | (37.0) | (21.0) | (17.0) |
| EPS (Rs) | 2.7 | 5.1 | 7.1 | 1.7 | 4.0 | 5.9 | (37.0) | (21.0) | (17.0) |
| Target price (Rs) | | 129 | | | 117 | | | | |
| Rating | | Buy | | | Buy | | | | |

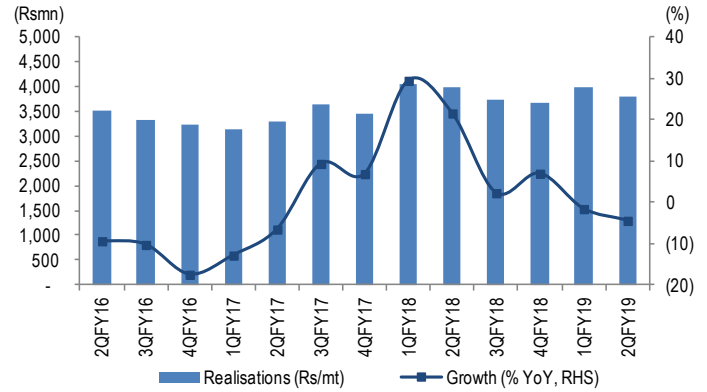
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Strong volume boosted by demand in key markets



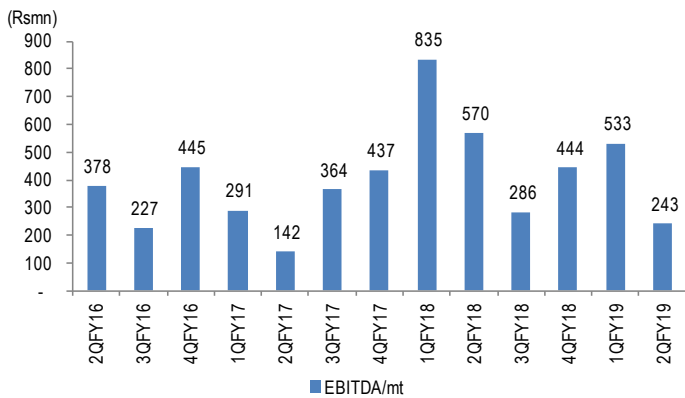
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Fall in realisation impacts margins



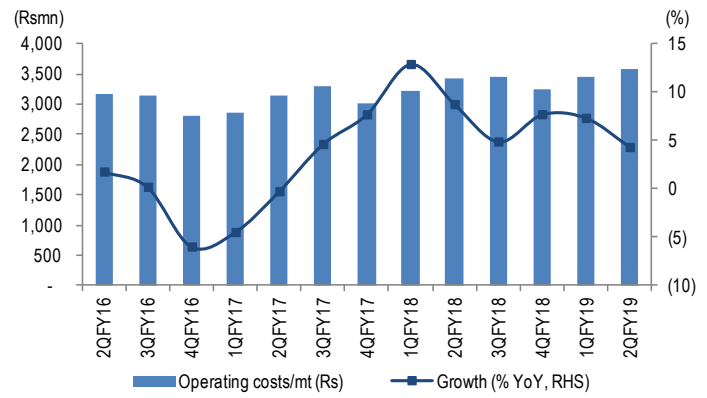
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Steep fall in EBITDA/t on limited cost pass-through



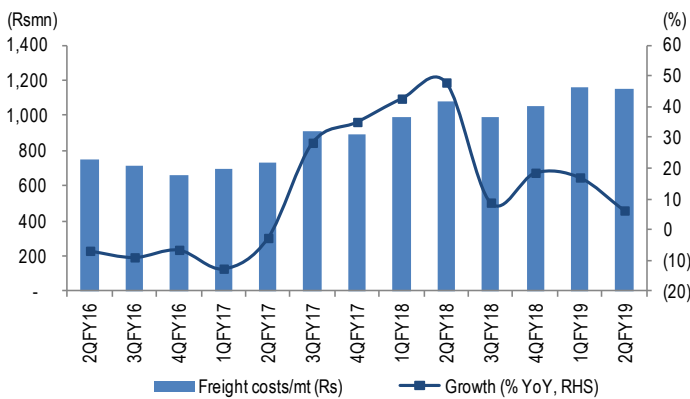
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Operating cost inflates ~4%/3% YoY/QoQ, respectively



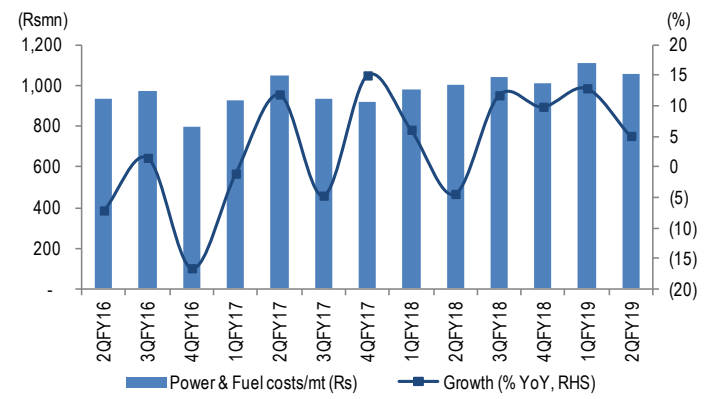
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: 85% road mix impact impacts logistics cost



Source: Company, Nirmal Bang Institutional Equities Research

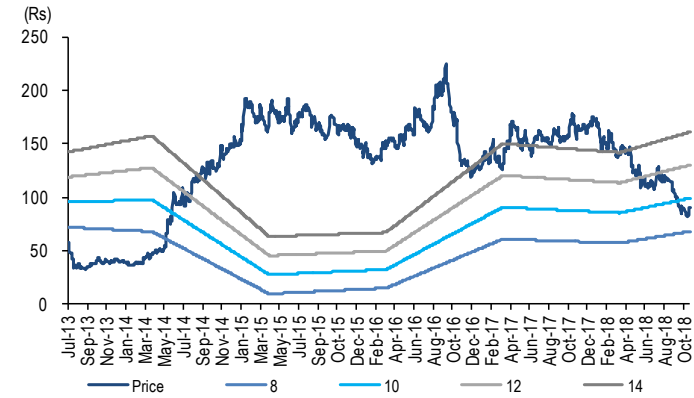
Exhibit 10: Fuel cost inflation continues



Source: Company, Nirmal Bang Institutional Equities Research

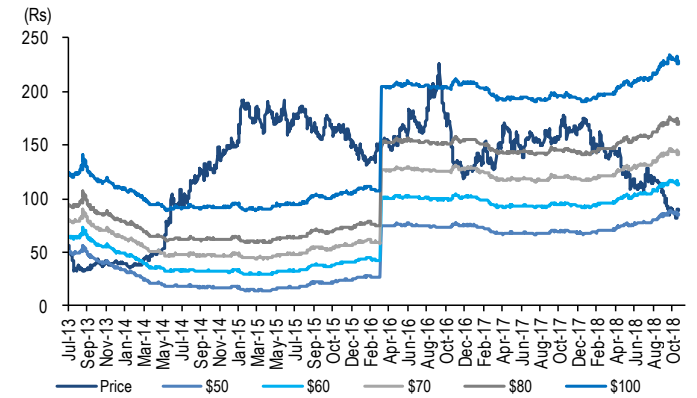
Exhibit 11: Valuation charts

EV/EBITDA



Source: Company, Nirmal Bang Institutional Equities Research

EV/tn



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 12: Income statement

| Year Y/E March (Rsmn) | FY17 | FY18 | FY19E | FY20E | FY21E |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|
| Net sales | 20,051 | 23,670 | 24,601 | 27,174 | 30,100 |
| Growth (%) | 28.1 | 18.1 | 3.9 | 10.5 | 10.8 |
| Operating expenses | (18,316) | (20,676) | (21,786) | (23,880) | (26,318) |
| EBITDA | 1,781 | 3,052 | 2,899 | 3,376 | 3,852 |
| Growth (%) | (2.9) | 71.3 | (5.0) | 16.5 | 14.1 |
| Depreciation & amortisation | (1,215) | (1,262) | (1,341) | (1,280) | (1,315) |
| EBIT | 689 | 1,992 | 1,625 | 2,178 | 2,637 |
| Other income | 123 | 202 | 67 | 82 | 100 |
| Interest paid | (1,353) | (1,292) | (1,159) | (1,045) | (1,002) |
| Extraordinary/exceptional items | | | | | |
| PBT | (665) | 700 | 466 | 1,133 | 1,635 |
| Tax | 344 | (258) | (114) | (306) | (425) |
| Effective tax rate (%) | (51.7) | (36.9) | (24.5) | (27.0) | (26.0) |
| Net profit | (321) | 442 | 352 | 827 | 1,210 |
| Minority interest | - | - | - | - | - |
| Reported net profit | (321) | 442 | 352 | 827 | 1,210 |
| Non-recurring items | - | - | - | - | - |
| Adjusted net profit | (321) | 442 | 352 | 827 | 1,210 |
| Growth (%) | (151.6) | n/a | (20.4) | 134.9 | 46.3 |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Balance sheet

| Y/E March (Rsmn) | FY17 | FY18 | FY19E | FY20E | FY21E |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Cash & bank balances | 825 | 331 | 407 | 307 | 248 |
| Other current assets | 4,080 | 4,988 | 5,070 | 5,627 | 6,178 |
| Investments | - | - | - | - | 2,600 |
| Net fixed assets | 23,146 | 23,297 | 23,718 | 24,092 | 24,658 |
| Goodwill & intangible assets | 738 | 791 | 792 | 793 | 853 |
| Other non-current assets | - | - | - | - | - |
| Total assets | 28,843 | 29,409 | 29,988 | 30,879 | 33,684 |
| Current liabilities | 5,295 | 5,643 | 6,372 | 6,763 | 7,100 |
| Borrowings | 12,885 | 12,628 | 12,350 | 12,215 | 13,665 |
| Other non-current liabilities | 750 | 854 | 867 | 880 | 893 |
| Total liabilities | 18,930 | 19,126 | 19,589 | 19,858 | 21,658 |
| Share capital | 205 | 205 | 205 | 205 | 205 |
| Reserves & surplus | 9,708 | 10,079 | 10,194 | 10,816 | 11,821 |
| Shareholders' funds | 9,913 | 10,283 | 10,399 | 11,021 | 12,026 |
| Minority interest | - | - | - | - | - |
| Total equity & liabilities | 28,843 | 29,409 | 29,988 | 30,879 | 33,684 |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Cash flow

| Y/E March (Rsmn) | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|----------------|----------------|----------------|----------------|----------------|
| Pre-tax profit | (665) | 700 | 466 | 1,133 | 1,635 |
| Depreciation | (3,958) | 1,237 | 1,341 | 1,280 | 1,315 |
| Chg. in working capital | 2,281 | (561) | 647 | (166) | (214) |
| Total tax paid | (134) | (153) | (101) | (293) | (412) |
| Other operating activities | 57 | 175 | 110 | 220 | 254 |
| Operating CF | (2,419) | 1,399 | 2,463 | 2,175 | 2,577 |
| Capital expenditure | 3,482 | (1,389) | (1,763) | (1,714) | (1,028) |
| Chg in investments | - | - | - | - | (2,600) |
| Other investment activities | - | - | - | - | - |
| Investing CF | 3,482 | (1,389) | (1,763) | (1,714) | (3,628) |
| FCF | 1,063 | 10 | 701 | 461 | (1,051) |
| Equity raised/(repaid) | - | - | - | - | - |
| Debt raised/(repaid) | (630) | (257) | (278) | (135) | 1,450 |
| Dividend (incl. tax) | (205) | (102) | (205) | (205) | (205) |
| Other financing activities | 219 | (145) | (142) | (220) | (254) |
| Financing CF | (616) | (504) | (625) | (560) | 991 |
| Net chg. in cash & bank bal. | 447 | (494) | 75 | (99) | (60) |
| Closing cash & bank bal. | 825 | 331 | 407 | 307 | 248 |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Key ratios

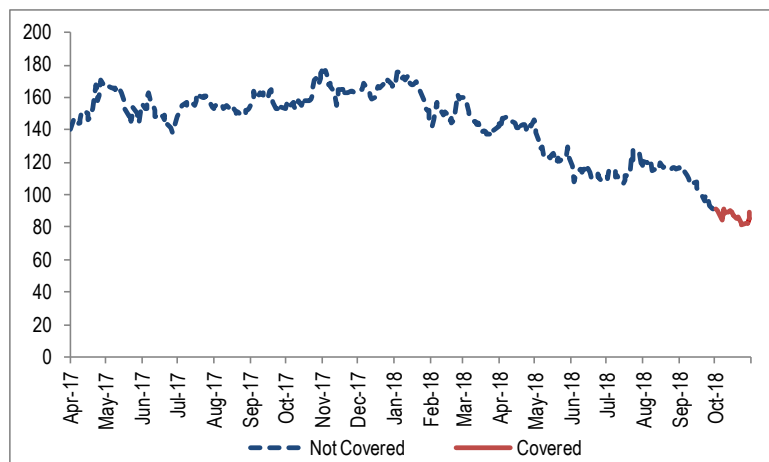
| Y/E March (Rsmn) | FY17 | FY18 | FY19E | FY20E | FY21E |
|--|-------|-------|-------|-------|-------|
| Profitability and return ratios (%) | | | | | |
| EBITDAM | 8.9 | 12.9 | 11.7 | 12.4 | 12.8 |
| EBITM | 3.4 | 8.4 | 6.6 | 8.0 | 8.7 |
| NPM | (1.6) | 1.9 | 1.4 | 3.0 | 4.0 |
| RoE | (3.2) | 4.4 | 3.4 | 7.7 | 10.5 |
| RoCE | 2.8 | 8.4 | 6.9 | 9.1 | 10.4 |
| RoIC | 1.4 | 5.5 | 5.3 | 6.8 | 8.2 |
| Per share data (Rs) | | | | | |
| O/s shares | 204.9 | 204.9 | 204.9 | 204.9 | 204.9 |
| EPS | (1.6) | 2.2 | 1.7 | 4.0 | 5.9 |
| FDEPS | (1.6) | 2.2 | 1.7 | 4.0 | 5.9 |
| CEPS | 4.4 | 8.3 | 8.3 | 10.3 | 12.3 |
| BV | 48.4 | 50.2 | 50.8 | 53.8 | 58.7 |
| DPS | 1.0 | 0.5 | 1.0 | 1.0 | 1.0 |
| Valuation ratios (x) | | | | | |
| P/E | n/a | 39.4 | 49.5 | 21.1 | 14.4 |
| P/BV | 1.8 | 1.7 | 1.7 | 1.6 | 1.4 |
| EV/EBITDA | 16.5 | 9.7 | 10.1 | 8.7 | 8.0 |
| EV/Sales | 1.5 | 1.3 | 1.2 | 1.1 | 1.0 |
| Other key ratios | | | | | |
| D/E (x) | 1.2 | 1.2 | 1.1 | 1.1 | 1.1 |
| DSO (days) | 26.7 | 25.3 | 26.0 | 26.5 | 27.0 |
| DuPont analysis - RoE | | | | | |
| NPM (%) | (3.2) | 4.4 | 3.4 | 7.7 | 10.5 |
| Asset turnover (x) | 0.7 | 0.8 | 0.8 | 0.9 | 0.9 |
| Leverage factor (x) | 2.9 | 2.9 | 2.9 | 2.8 | 2.8 |
| RoE (%) | (3.2) | 4.4 | 3.4 | 7.7 | 10.5 |

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

| Date | Rating | Market price (Rs) | Target price (Rs) |
|-----------------|--------|-------------------|-------------------|
| 3 October 2018 | Buy | 91 | 129 |
| 6 November 2018 | Buy | 85 | 117 |

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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