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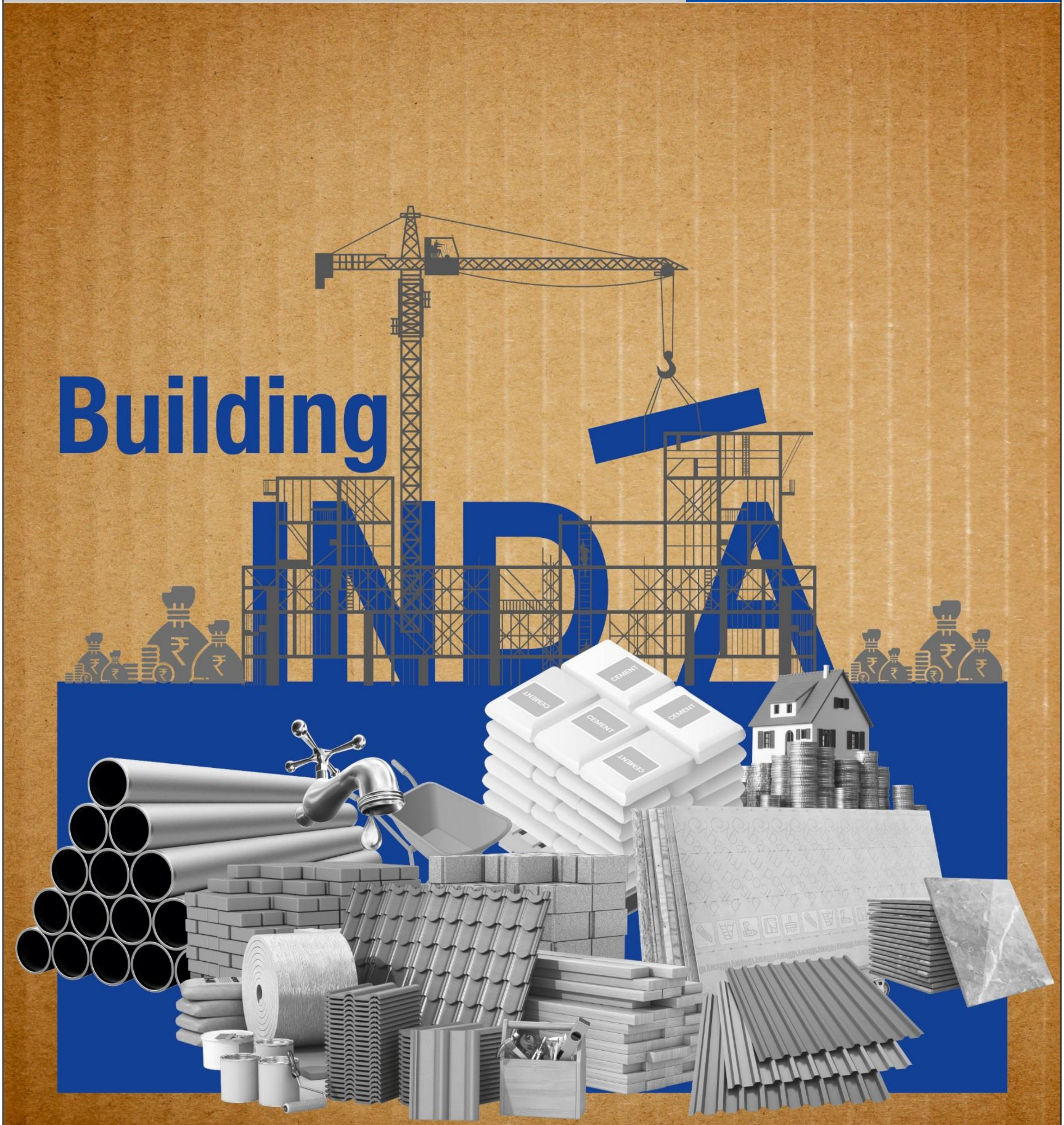

Building INDIA

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Executive Summary

Without the expansion of homeownership and the strength of our housing market, our nation would not have the economic growth we are experiencing today.

Matthew Desmond, Pulitzer Prize Winner 2017

India's economy, propelled by the demographic dividend and low debt, is estimated to clock average 8% CAGR to touch a whopping USD5tn by 2025. For an economy to grow at this mammoth rate, multiple engines need to fire, of which housing is most pivotal, in our view. Its significance can be gleaned from the fact that impact of investments in the housing sector on GDP and employment is ranked third among 14 sectors in terms of linkage and fourth on income multiplier (ahead of agriculture) metric. Ergo, it's not surprising that the government has trained focus on the housing sector underpinned by its affordable housing push, which targets "Housing For All" by 2022. Commendably, the scheme has gained palpable traction with ~INR280bn budget outlay in FY18. Burgeoning income levels, urbanisation push via Smart Cities & AMRUT, greater affordability spurred by lower interest cost & credit subsidies, low inflation boosting disposable incomes and benign property prices are envisaged to trigger housing boom. Housing is an important cog in a country's economic wheel as it gives the much needed impetus to allied industries like housing finance, cement and home building materials.

1) Housing Finance

Sustainable low interest rate regime and low mortgage penetration (penetration as percentage of GDP at paltry 9%) are a few potent macro factors driving underlying housing credit demand. Moreover, property price-to-income ratio has sustainably dipped from 4.6x in 2014 to 3.8x in 2017. The government, cognizant of the acute under-penetration of home ownership among lower income groups, has aligned regulations and tax benefits to address this gap. In our view, NBFCs are likely to benefit the most as they are specialists at operating lower down the pyramid versus banks, which tend to focus on higher ticket size and salaried clients.

2) Building Materials

India's building material industry is estimated to catapult to INR7.0tn by FY21 from INR4.8tn currently (8.5% CAGR). Although the material is utilised across various real estate construction segments, residential constitutes lion's share at 80%. Building materials consists of cement, structural steel, bricks, paints, plumbing, ceramic tiles, sanitary ware, plywood & laminates and lighting products.

a) Cement

The domestic cement sector has been plagued by low volumes induced by subdued construction activities and capex boom over 2007-16. Consequently, utilisation plummeted from a peak of 90% in FY07 to 67% in FY17 and realisation grew at a tepid pace. This took a heavy toll on the industry's profitability. However, the government's renewed focus on construction and affordable housing is envisaged to drive 7.5% demand CAGR over FY17-25 and catapult utilisation to 90% in FY25 from 67% currently. This, in turn, will propel the industry's realisation and profitability.

b) Home building products

The share of building materials (excluding cement) is estimated to jump to INR3.8tn by FY21 from INR2.5tn currently. Over the past 2 years, while price surge has taken a toll on urban demand, demonetisation and weak monsoon have been the culprits impacting rural demand. In each home building materials segment, the share of unorganised segment is more than 50% (in some cases even 70%). However, revision in GST rates for these products from 28% to 18% is anticipated to accelerate demand shift from unorganised to organised segment as price differential across similar quality products is likely to plummet to 7-10% from 25-30%.

In this report, we have evaluated macro drivers and government initiatives which are anticipated to kick start significant investments in the housing sector. These are envisaged to open a plethora of growth opportunities for housing finance, cement and home building material players. **Key beneficiaries in these segments will be GIC Housing, Canfin Homes, PNB Housing, Sanghi Industries, Birla Corp, Sagar Cement, Shankara Building Products, Century Ply, Asian Granito and Everest Industries.**

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	(INR)	(INR Cr)	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Housing Finance	CMP	M.Cap	NII Growth (%)			PPP Growth (%)			PAT growth (%)			P/E (x)			P/ABV (x)			ROE (%)		
GIC Housing Finance	424	2283	22	31	20	25.9	32.5	20.5	19	27	29	15.4	12.1	10.4	2.7	2.3	1.5	18.8	20.5	18.0
Can Fin Homes Ltd.	458.65	6100	40	26	26	42.1	29.5	26.8	50	38	24	25.9	20.1	16.2	5.7	3.7	3.1	24.1	22.8	20.7
PNB Housing Finance	1375.15	22908	45	49	40	54.7	51.3	44.0	60	54	39	38.2	28.8	20.7	4.1	3.7	3.2	13.6	13.7	16.8
Cement	CMP	M.Cap	Sales Growth (%)			EBITDA Margin (%)			PAT growth (%)			P/E (x)			EV/tonne (USD/tonne)			ROE (%)		
Sanghi Industries	121.9	2682	-4	18	22	19.9	23.6	25.0	-24	49	40	42.3	28.3	20.2	113.4	113.4	113.4	5.8	8.1	10.4
Birla Corporation	1081.5	8329	33	25	14	14.3	18.6	20.4	31	41	59	33.4	23.6	14.8	107.9	105.9	106.4	7.0	9.0	13.1
Sagar Cement	817.65	1668	8	31	20	5.8	5.0	4.8	-109	-1448	117	NA	31.6	14.6	68.1	71.2	68.5	-0.6	6.7	13.3
Home Building Materials	CMP	M.Cap	Sales Growth (%)			EBITDA Margin (%)			PAT growth (%)			P/E (x)			EV/EBITDA (x)			ROE (%)		
Plastic Pipes & Fittings																				
Astral Poly Technik Ltd.	803	9,619	13.0	18.0	20.0	14.0	14.5	15.2	42.0	25.0	33.0	66x	53x	39x	35x	30x	24x	18.6	18.9	21.2
Finolex Industries Ltd.	623	7,726	5.1	9.5	12.6	18.8	14.5	17.1	53.2	-17.5	36.8	22x	27x	19x	14x	17x	12x	18.2	12.3	15.6
Supreme Industries Ltd.	1,126	14,302	16.2	13.0	16.0	17.2	15.3	15.9	38.3	10.0	26.0	39x	35x	28x	20x	20x	16x	25	23.6	25.8
Roofing and Cement Boards & Panels																				
Everest Industries Ltd.	467	726	-11.1	8.8	9.0	3.1	7.6	8.1	NA	NA	24.4	NA	16x	13x	25x	9x	7x	0.4	12.5	14
HIL Ltd.	1,336	997	-4.0	9.0	12.0	9.7	10.0	10.4	44.0	-3.0	21.0	18x	16x	14x	10x	9x	8x	11.4	12.1	12.9
Visaka Industries Ltd.	598	950	-4.0	6.0	7.0	11.9	12.3	12.9	67.0	9.0	36.0	23x	21x	17x	10x	9x	7x	10.8	10.9	12.6
Sanitaryware																				
CERA Sanitaryware Ltd.	3,554	4,622	10.0	17.0	18.0	17.2	16.2	16.5	17.0	16.0	27.0	47x	40x	32x	26x	24x	20x	20.7	20	20.6
HSIL Ltd.	529	3,826	13.0	4.0	16.0	13.0	14.1	14.8	-8.0	15.0	35.0	33x	29x	22x	14x	13x	10x	7.1	8.1	10.2
Tiles																				
Asian Granito India Ltd.	494	1,486	7.2	9.7	20.2	11.6	13.3	14.1	67.6	38.6	50.6	37x	29x	19x	14x	11x	9x	10.4	12.1	15.7
Kajaria Ceramics Ltd.	728	11,563	5.7	13.2	17.2	19.5	20.1	20.3	5.3	27.8	24.4	43x	34x	27x	22x	19x	15x	22.1	23.5	24.1
Somany Ceramics Ltd.	850	3,603	5.8	8.1	19.1	10.6	10.8	11.7	40.7	12.9	41.1	38x	33x	24x	20x	17x	13x	19.9	19	22.3
Wood-Panel																				
Century Plyboards Ltd.	296	6,572	10.8	15.7	19.6	17.2	15.6	17.7	14.0	-12.0	60.0	34x	37x	23x	22x	21x	15x	30.6	22.6	30.1
Greenply Industries Ltd.	321	3,936	1.0	9.0	19.0	15.0	14.9	14.7	-4.0	16.0	11.0	31x	26x	24x	17x	16x	13x	18.1	17.0	17.0
Greenlam Industries Ltd.	1,000	2,412	4.0	11.0	15.0	13.4	13.6	14.6	31.0	39.0	37.0	48x	34x	25x	19x	16x	13x	18.6	21.4	23.5
Home Building Materials Retail																				
Shankara Building Products Ltd.	1,640	3,746	13.5	9.5	11.0	6.7	7.4	7.8	48.1	43.1	25.5	62x	43x	35x	25x	21x	14x	17.6	19.7	20.3

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*Edelweiss Investment Research Long Term Recommendation

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Economic Overview

Economic Overview

Housing Led Economic Growth

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Without the expansion of homeownership and the strength of our housing market, our nation would not have the economic growth we are experiencing today.

Matthew Desmond, Pulitzer Prize Winner 2017

The IMF has envisaged India to be USD 5 trillion economy by 2025. Buoyed by the demographic dividend and low debt, India is estimated to clock average CAGR of 8% over next 8 years. For an economy to grow at this rate, all the engines driving the economy need to fire. Of which, we believe housing will be the highest moving factor. **Housing & real estate currently contribute ~7% to GDP; we estimate it to jump to ~10% by 2025.**

Housing vital because of multiple linkages: Impact of investment in the housing sector on GDP and on employment has found to be highest while it ranks fourth in terms of income multiplier and is ahead of sectors like transport & agriculture. Also, the housing sector has seen the highest migration of labourers from agriculture and other allied activities.

Government's affordable housing push: Prime Minister Narendra Modi's thrust on the housing sector is apparent in his vision of "Housing for All by 2022". Although affordable housing has been prevalent, the scheme has gained palpable traction with ~INR280bn budget outlay in FY18**. We expect housing to clock CAGR of 15% in next 4 – 5 years.**

Housing gap pegged at 110mn units; PMAY to provide 50mn: Nuclearisation of households and steady population growth have kept the housing gap at 110mn units. Pradhan Mantri Awas Yojana (PMAY) alone is expected to provide 50mn units**.**

Significant demand drivers in place for housing: Growth in income levels, holistic thrust on urbanisation through initiatives like Smart Cities & AMRUT, greater affordability due to lower interest cost and credit subsidies, low inflation boosting disposable incomes and benign property prices are some of the many factors which will drive housing demand**.**

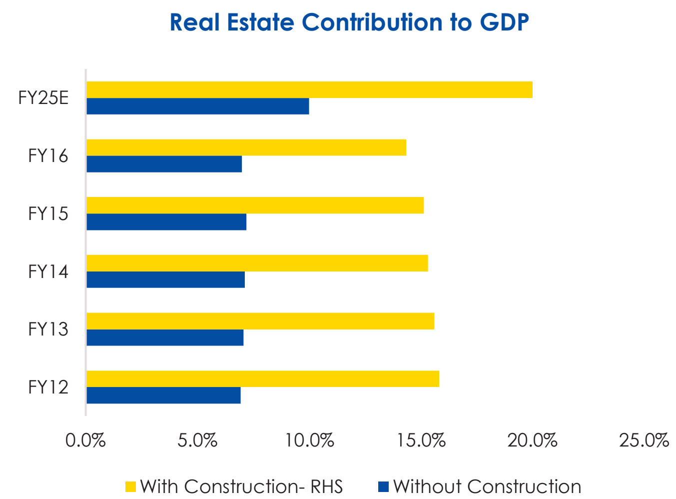
Multiple forward and backward linkages: Housing has been an engine of economic growth is several other economies. It acts as a catalyst in driving up investments. Housing contributes about 37% to India's capital formation. Also, tax collections via GST and stamp duty increase spur boom in the housing sector. Similarly, housing gives the much needed impetus to allied industries like cement, steel, transportation, building materials and enhances capacity utilisation of these industries. Moreover, housing finance companies and banks will also benefit due to higher demand for housing loans.

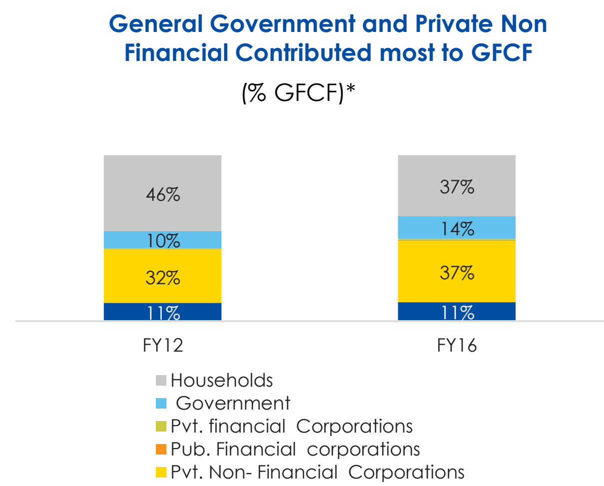
Structural reforms + Housing push = Economic boom: GST implementation has created a transformational environment by shifting demand from informal to formal economy. Additionally, demonetisation has led to shift of money flow to the formal economy. Clearly, access to and availability of formal source of finance has gained momentum. **With a pro-reform environment, road for the next wave of economic growth has been paved.**

Date: 4th December 2017

I. Housing sector : Key economic growth driver

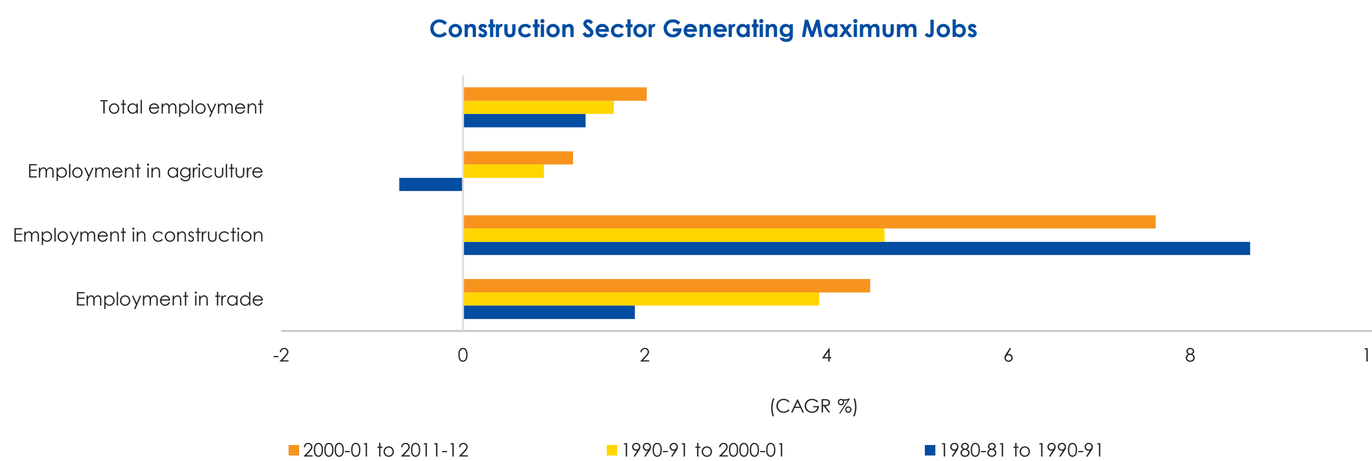
Housing not just desirable for social upliftment, but also economically relevant: Real estate & housing contribute ~8% to GVA and 7% to GDP. If we add construction (includes road & other infra construction) to this, the contribution jumps to 14%. Though post the taper tantrum and housing sector slowdown in 2013, its contribution has reduced slightly, the housing sector's significance cannot be undermined. We expect housing led economic expansion to gain momentum due to significant demand and supply side levers. As a result, according to our estimates, real estate's contribution to GDP is going to significantly rise to 10% by 2025.





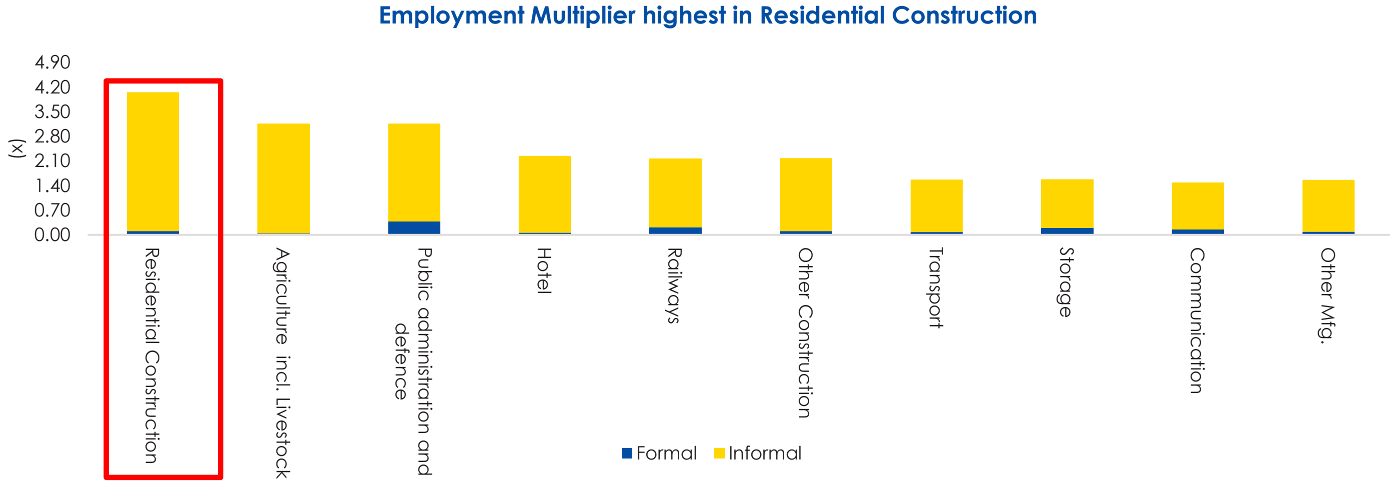
*GFCF- Gross Fixed Capital Formation
Source: MOSPI, Edelweiss Investment Research

Construction sector vital source of employment generation: According to International Labour Organisation's (ILO) 2016 report, the biggest increase in non-agricultural employment has been in the construction sector, where the share of employment in rural areas catapulted to 30.1% in 2011-12 from 14.4% in 1999-00.The last decade has also witnessed shift out of agriculture which is traditionally the largest source of employment in India. Construction has absorbed a large chunk of the migration of agricultural workers. Thus, focus on housing will not only entail direct effect, but will also create multiplier effect.

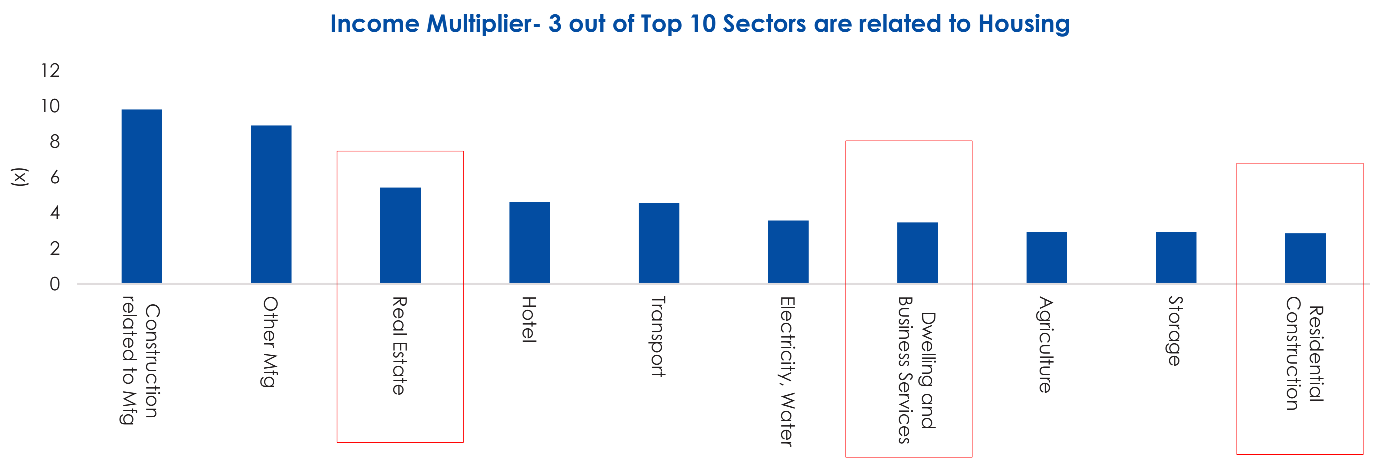


Source: NSSO survey, Edelweiss Investment Research

Employment multiplier of housing highest: Employment multiplier can be described as change in employment with change in increase of investment in housing. As an example, it indicates with every Rupee 1 more spent in residential construction, employment increases by 4x.



Income multiplier of housing robust: Income multiplier is also similar to employment multiplier. Income multiplier indicates the impact of change in demand/money spent on housing and its effect on income levels. To simplify, INR 1 spent more on real estate services can increase income levels 5.4x. Among the top 10 sectors which have highest income multiplier, 3 are housing related, clearly indicating the sector's multiplier effect.



Source: NCAER Calculations

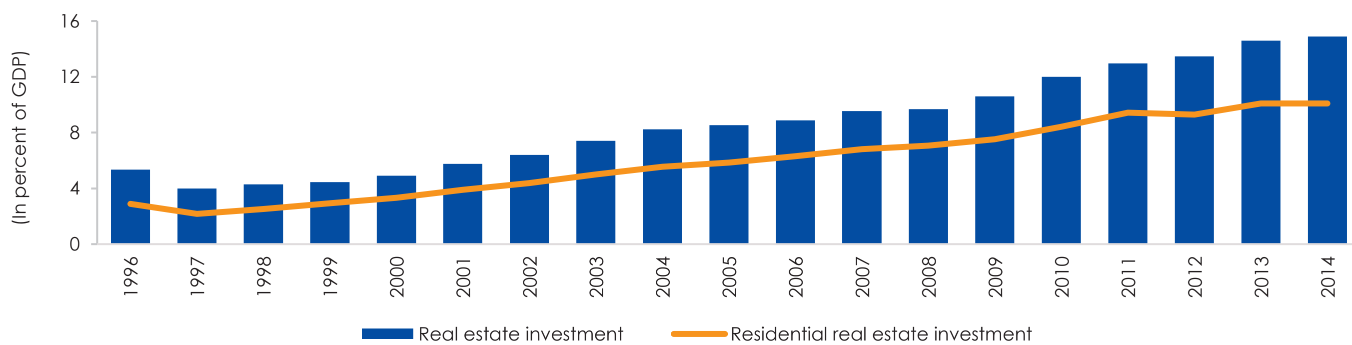
Housing-led growth in China

Housing growth in China can be explained in 2 parts. From **2003-08**, as China rapidly transitioned from a USD 2 tn economy to a USD 5 tn economy, income levels rose sharply and demand for housing catapulted. This demand-led housing growth spurred economic growth further. In this phase, housing investment's contribution to GDP grew from 6% to 8%.

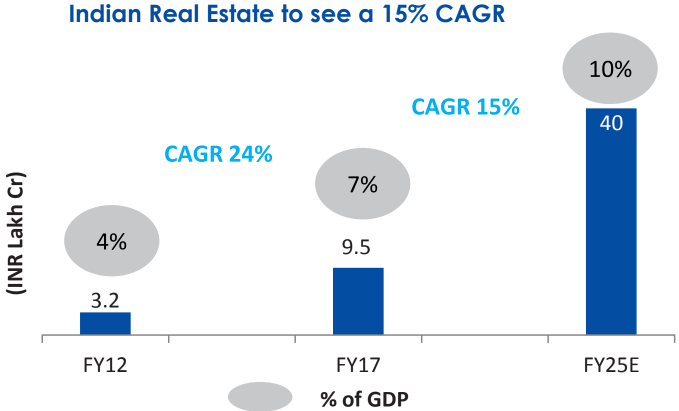
Post the 2008 crisis, China focussed more on domestic-driven growth than on exports-led growth. It injected USD580bn as stimulus package to help the economy withstand the global financial crisis. As credit disbursement rose, housing-led economic boom also gained momentum. This phase can be described as supply-led housing and economic growth. Housing investment as percentage of Chinese GDP rose from 8% to 12%.

In both these phases, contribution of housing growth was significant. Currently, real estate contributes ~15-16% to China's GDP versus just 7% in India. **If India emulates China, the housing sector could contribute 10% to India's GDP while the economy transitions from a USD 2 tn economy to USD 5 tn economy**.

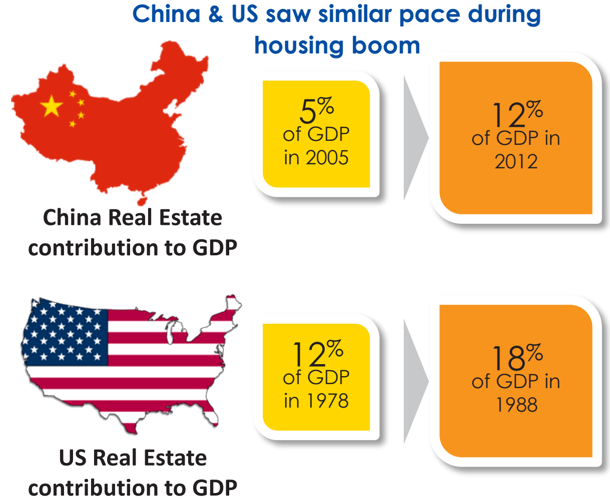
China Real Estate Investment



Indian Real Estate to see a 15% CAGR



China & US saw similar pace during housing boom

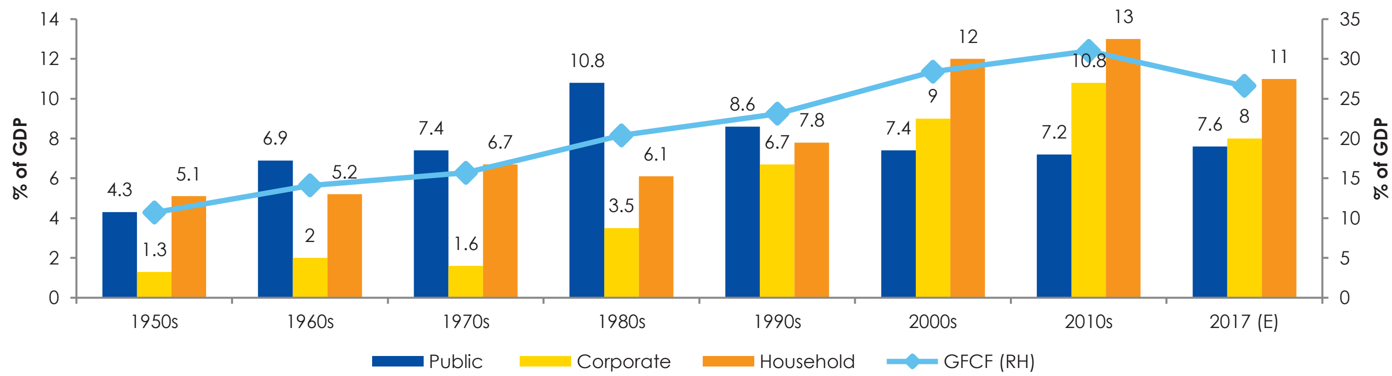


Source: Edelweiss Investment Research

II. Government expenditure gaining momentum

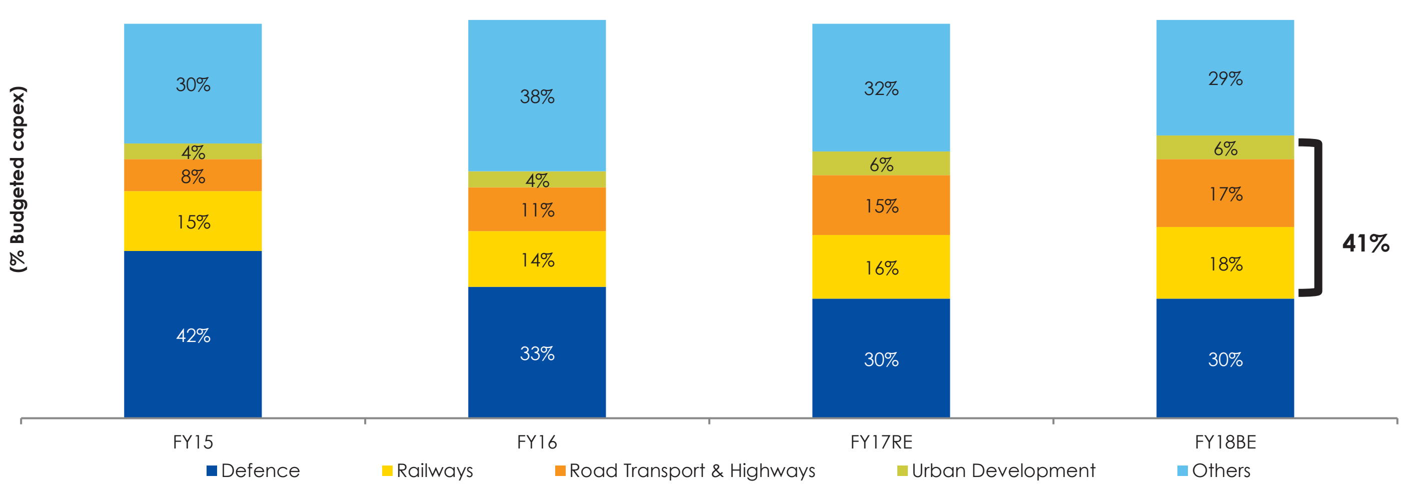
Government expenditure, over the past 2 years, has been buoyant. With focussed capital expenditure, the government has been substituting for low private investments. Budgetary allocation, especially in specific areas like roads, railways affordable housing and urban development, has risen steadily.

Government's Contribution to GFCF at its highest



*GFCF- Gross Fixed Capital Formation

Railways, Roads and Urban Dev. Now Comprise of 41% of Budgeted Capex for Centre in FY18

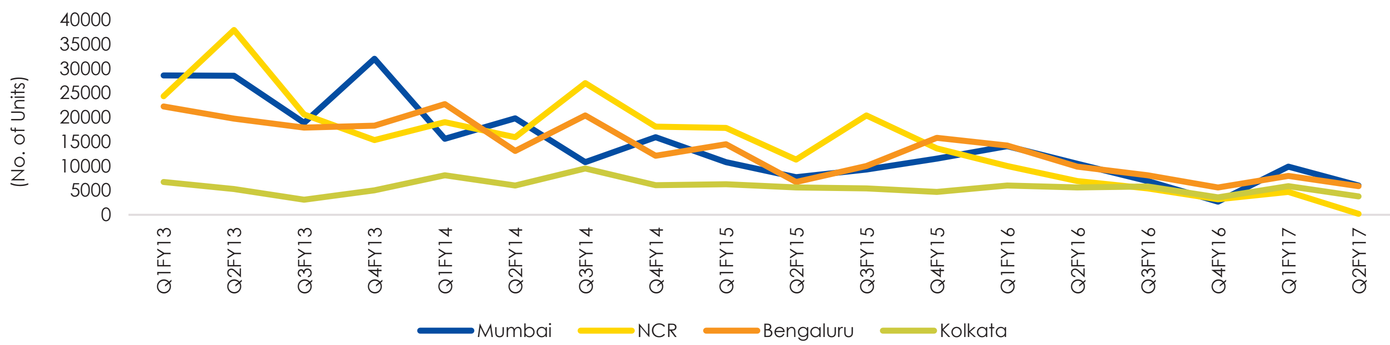


Source: MOSPI, Budget documents, Edelweiss Investment Research

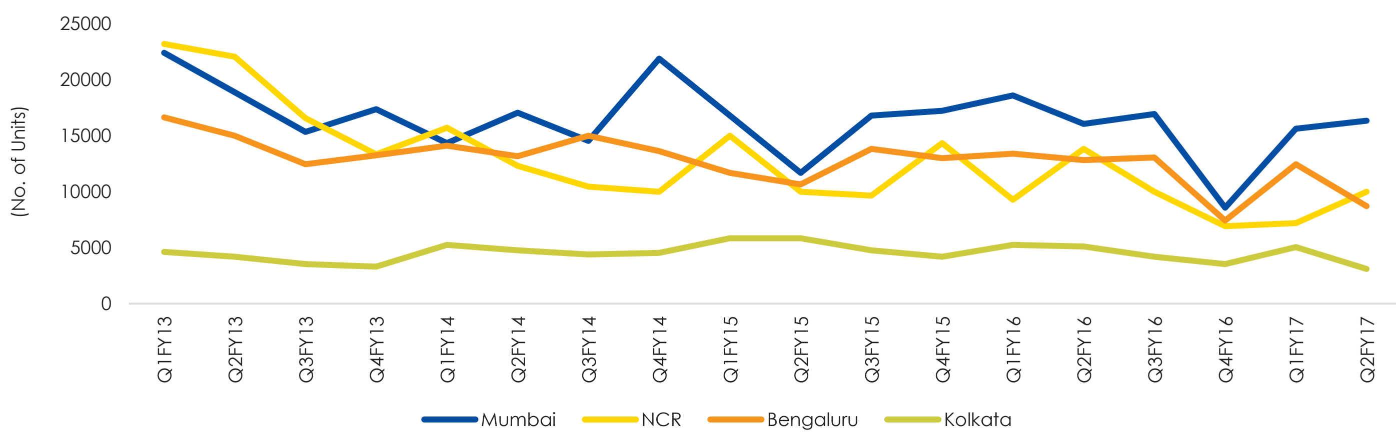
III. Government's affordable housing push

Growth in the housing sector was buoyant until 2012; post 2013, it has been sluggish. Piling debt on balance sheets of developers and subdued demand have taken a toll on announcement of new residential projects. Moreover, the sector was worst affected post demonetisation as about 20% or more transactions in the real estate market were financed through the black market. Apart from this, piling up of unsold inventory and lack of clarity on the Real Estate Regulation (RERA) bill introduced in 2016 further worsened woes.

New Launches of Residential Units



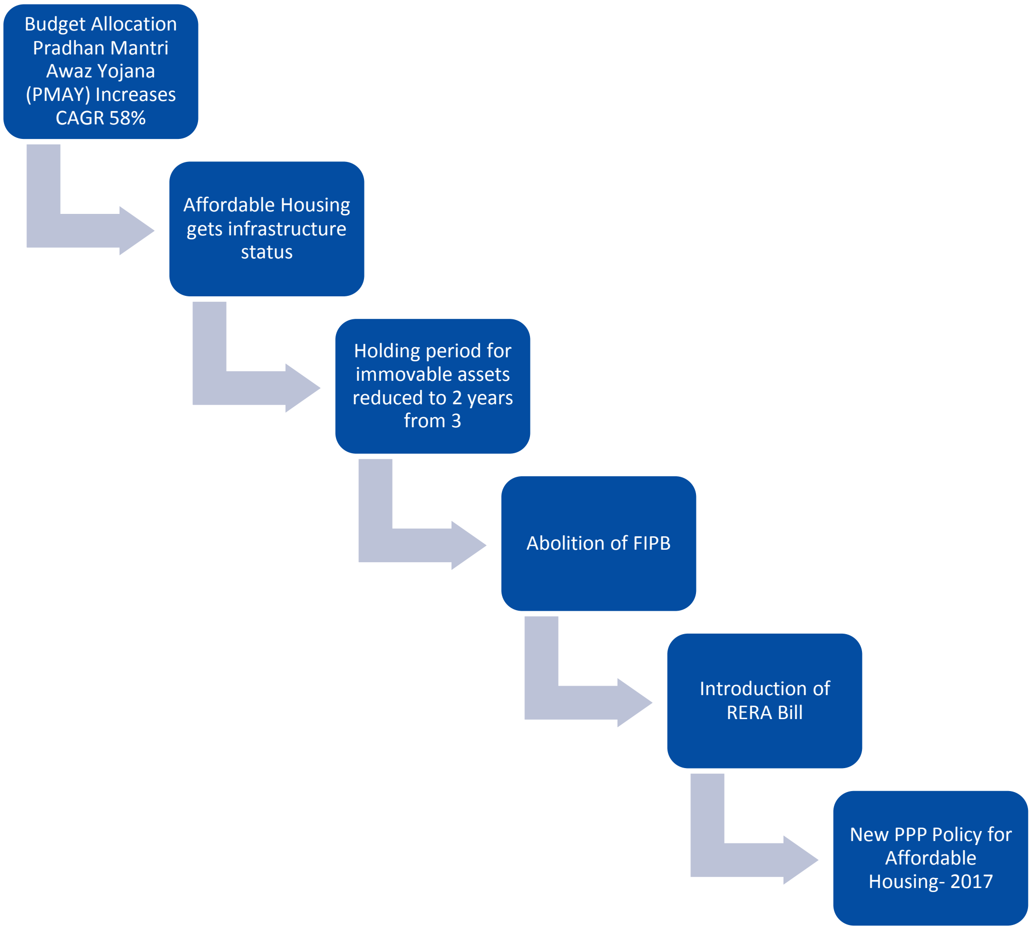
Sale of Residential Units



Source: NHB, Edelweiss Investment Research

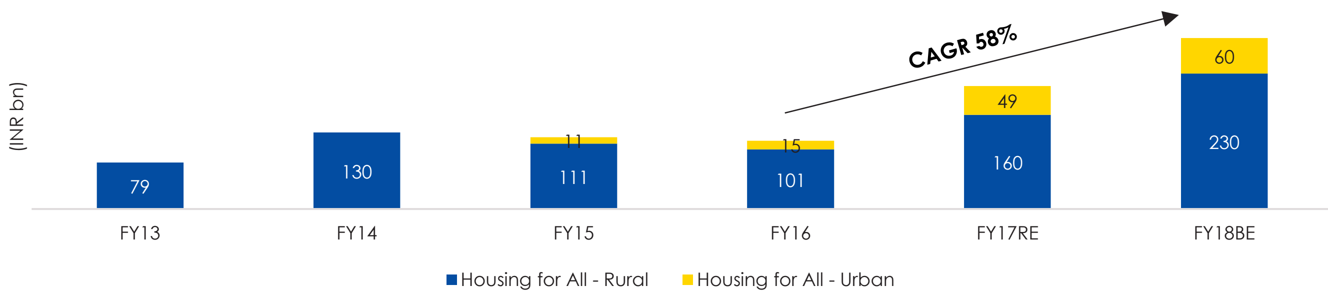
Amidst this slowdown, the government's *Housing for All by 2022* mission has provided the much needed succour to the beleaguered sector. The government, under Pradhan Mantri Awas Yojana (PMAY), an affordable housing initiative, is planning to provide homes to 20mn households in urban India and nearly 30mn in rural India. According to government estimates, there is a shortage of about 60mn housing units currently—20mn in urban areas and 40mn in rural areas. In order to bridge this gap, it has announced various incentives in Union Budget 2017 and thereon to push affordable housing.

Timeline of Recent events in Affordable Housing



In November 2016, government expanded PMAY to rural areas too , under which, there is an aim to develop pucca houses in rural areas.

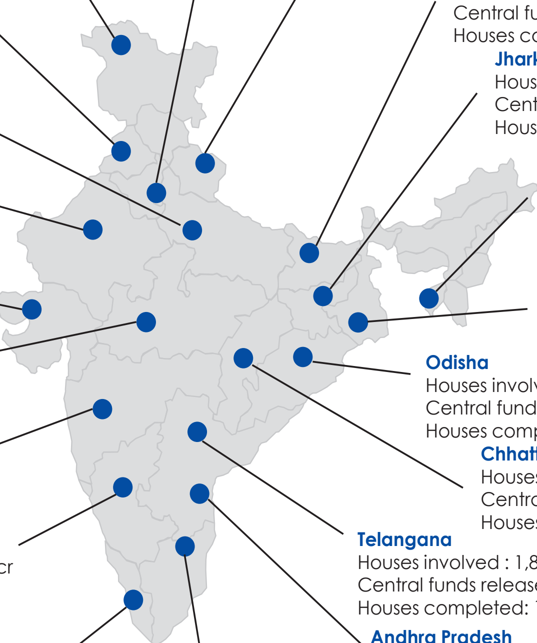
Budgetary Allocation for PMAY has been steadily rising



Source: Budget documents

PMAY (Urban): Progress

The NDA government has approved about 18lakh affordable housing projects across 2,008 cities versus 14lakh affordable housing projects during 10 years of the UPA rule till April 2017. Similarly, investment s of ~INR963bn have been approved for construction of houses for urban poor versus ~INR327bn during 2004-14.



Source: www.pmaymis.gov.in

PMAY Status

PMAY (Urban)	
Target Houses to be built by 2022	2,00,00,000
Houses built until Oct, 2017	2,16,435
Remaining Houses to be built	1,97,83,565
Remaining Months	54
Houses to be built per month for PMAY (Urban)	3,66,362
PMAY (Rural)	
Target Houses to be built by 2022	3,00,00,000
Houses built until Oct, 2017	8,68,262
Remaining Houses to be built	2,91,31,738
Houses to be built per month for PMAY (Rural)	5,39,477
Total Houses to be built every month	**9,05,839**

Source: www.pmaymis.gov.in
Source: www.iay.nic.in

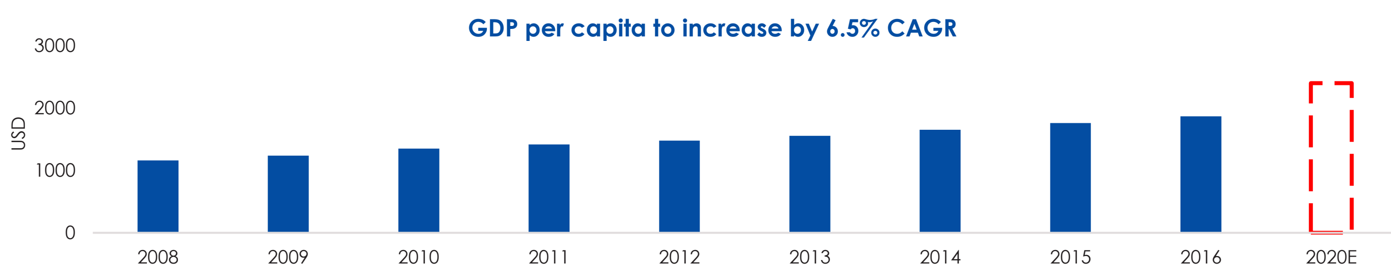
IV. Key drivers in place for housing demand boom

There are more than a couple of factors which are favourable for affordable housing. While some factors like economic growth, urbanisation and nuclearisation are well documented, others like lower inflation and higher affordability have emerged with government incentives.

Economic Growth	Rising Income Levels	Urbanization	Nuclearization	Lower Inflation	Greater Affordability
• Exports and Consumption is expected to drive the growth for next 1- 2 years • Focussed Capital Expenditure by Government is also expected to be growth supportive.	• Per capita income is expected to reach $2400 by 2020 with 6.5% CAGR • Aim to " Double Farmer's Income by 2022" by rising agricultural productivity. • State and centre both have awarded HRAs. • Increase in construction activity	• About 10 million per annum peple are expected to move to urban cities. • "Smart cities" initiative- A target of developing 100 smart cities has been envisaged.	• Average Household size has been decreasing in India to 4.6 from 4.8 in next two years. • Smaller household size is expected to add incremental demand for about 2.5 million new housing units per annum	• Inflation has been at sub 4% levels consistently. • Lower Inflation leads to higher disposable icome and	• Interest rate cut of about 175 basis points in last two years has reduced the lending rate by banks. • Credit Linked Subsidy Scheme (CLSS) has on average made buying houses about 10-15% cheaper for affordable housing

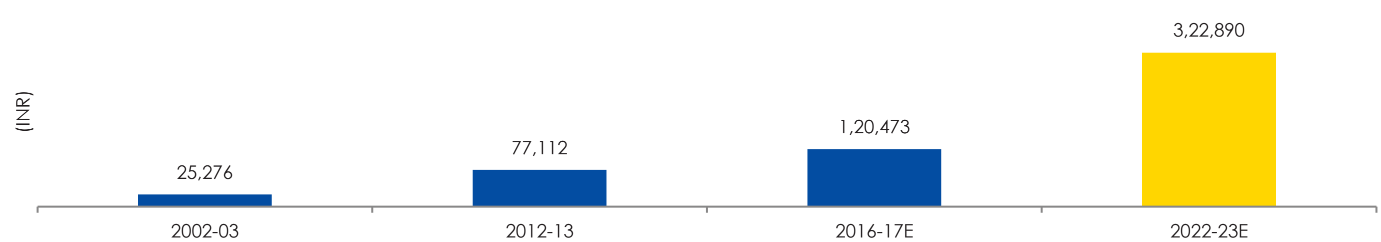
CAGR Growth of 15% in Housing and 25% in Affordable Housing Segment

1. Economic growth: Economic growth will also drive per capita incomes higher…



Source: CMIE, Edelweiss Investment Research

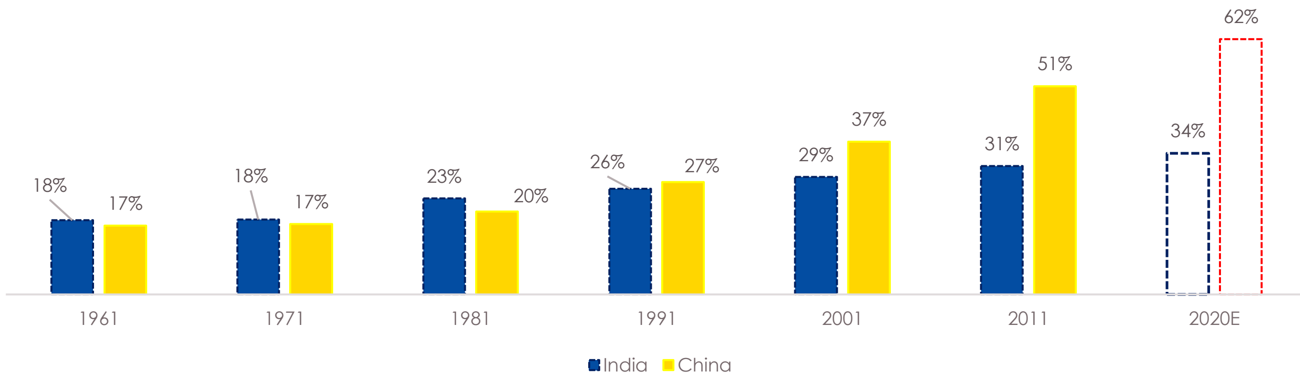
2. **Rising income levels Government's focus on doubling farmers' incomes by 2022**: Farmer household income has doubled every 7 years in nominal terms, so the government's target does not look realistic. Higher rural incomes will boost discretionary spending, thereby spurring stronger growth in the country. Rising income levels is envisaged to spur housing demand.



Source: NSSO survey, Edelweiss Investment Research

3. **India's urban awakening to drive housing demand**: In 1950, India was more urbanised (17% of population lived in cities) than China. However, as China rapidly progressed, urbanisation gathered pace. In 2011, about 51% of China's population resided in urban areas versus 32% in India. **Currently, there is an addition of 11-12mn to urban population per annum. This itself will increase urban housing requirement by 2.5-3.0mn houses per annum.** Going forward, India is envisaged to emulate China's pace of urbanisation in its high growth period. Urbanisation is expected to impact almost all cities, leading to further economic development and demand for housing.

Pace of Urbanization to Accelerate

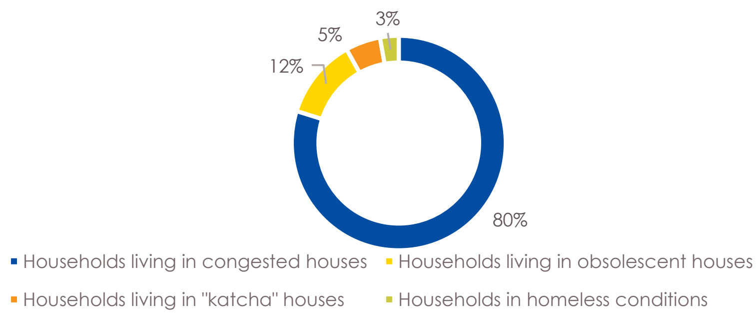


Source: CEIC, CMIE, Edelweiss Investment Research

Housing demand gap in urban areas

According to a KPMG-NAREDCO report, shortage of urban houses stood at 18.8mn units in 2012 and is estimated to jump to 34.1mn units by 2022.

Urban Housing Shortage

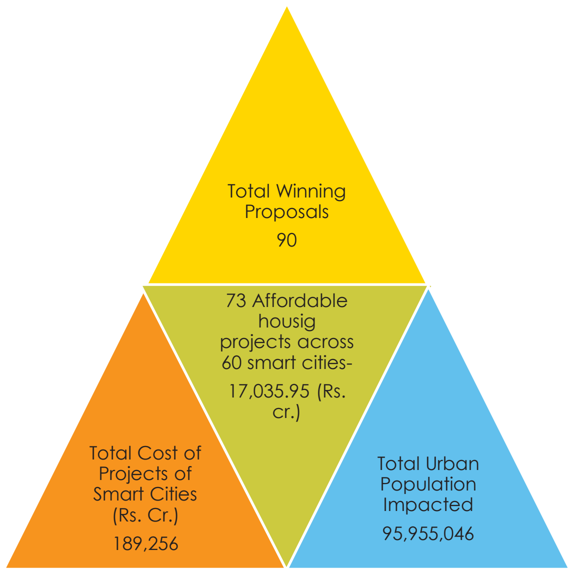


Source: Technical group on urban housing shortage (2012-17)

To address, this issue, the central government announced Pradhan Mantri Awas Yojana (PMAY)-Urban with the target to provide 20mn houses in urban India by 2022.

Paradigm shift in urbanisation strategy: There has been a paradigm shift in the way the government has been targeting urban transformation. Focus is on holistic urban development through better resource mobilisation and targeted results. As part of this strategy, schemes like **PMAY, Amrut, Smart Cities, Swach Bharat and Urban Transport were launched.**

Smart Cities—Cities of Tomorrow: PM Modi launched the *Smart City* mission in 2015 with the promise to redefine urban living by providing infrastructure to improve quality of life. This mission is expected to accelerate urbanisation and also enhance demand for affordable housing. Contribution of real estate to GDP is expected to rise to 10-12% by 2022 from 6% currently.



Source: www.smartcities.gov.in

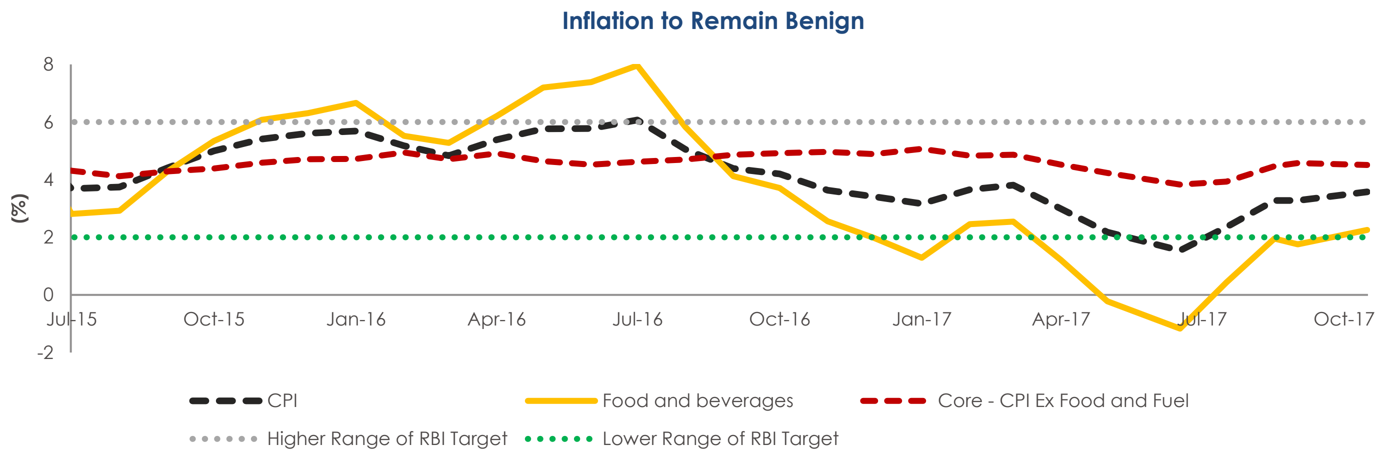
4. Nuclearisation leading the away: Average household size of Indian families has been steadily shrinking due to rapid urbanisation and growing working age population. Census 2011 indicated that about half of India's households are nuclear. Also, contrary to popular perception, nuclear families in rural areas jumped 29% versus mere 9% in urban households. Affordability is key in urban areas. Nuclearisation is expected to gather further momentum as houses become more affordable. Nuclearisation itself is expected to add about 6-7mn households per year.

Family Dynamics: 52% families are now nuclear, only 16% are joint

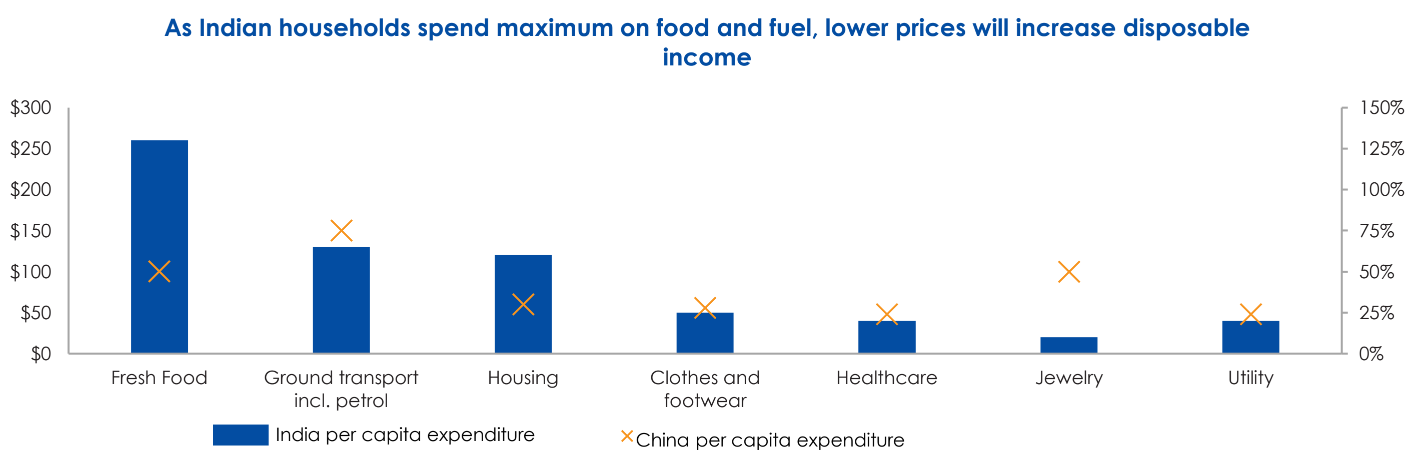
Type of households	Share in total households (%)	Change 2001 to 2011 (%)
Single person	4	35
Nuclear	52	30
Sub-nuclear	5	14
Supplemented nuclear	16	33
Broken extended	4	**18**
Joint	16	9
Others	2	49
Total	**100**	**29**

Source: Census survey

5. Benign Inflation boosts disposable incomes: Households at the bottom of the pyramid spend more than 50% of their disposable income on food and essentials. Benign inflation will enhance disposable incomes, in turn spurring discretionary spending.

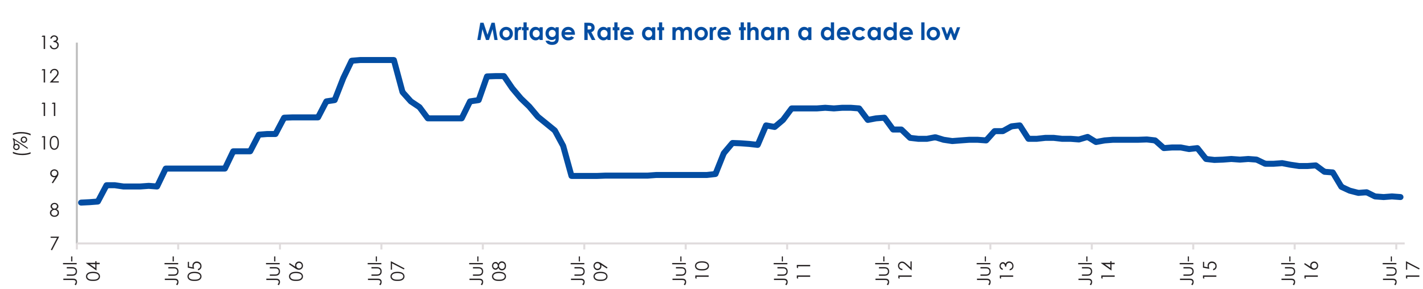


Source: CMIE, Edelweiss Investment Research



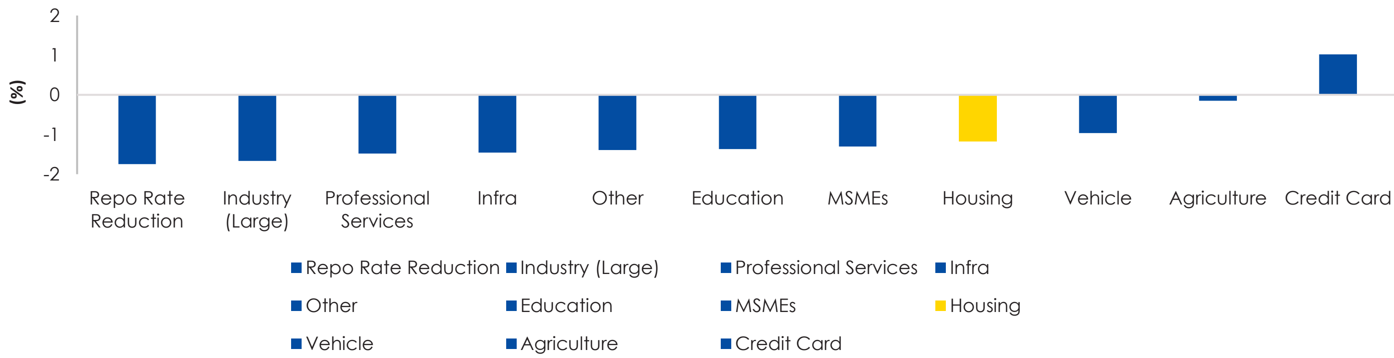
Source: CMIE, CEIC

6.Lower mortgage rates and higher transmission enhances affordability: Low inflation has transcended into decade low mortgage rates. With RBI enforcing Marginal Cost of Lending Rate (MCLR) as a new methodology for determining lending rates, monetary transmission or pass through of interest rate cuts has been more effective. All these factors have resulted in higher affordability.



Source: RBI, Edelweiss Investment Research

Policy Transmission During RBI's Interest Rate Cuts



Source: RBI, Edelweiss Investment Research

Additionally, Credit Linked Subsidy Schemes (CLSS) have lowered cost of credit

Under CLSS, the government will offer interest rate subsidy ranging between 3.0% and 6.50% on housing loans for lower and middle income class categories.

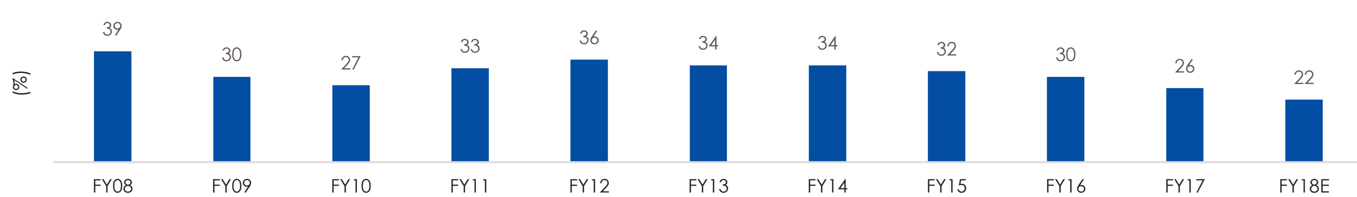
Category	Loan Amount	Interest Subsidy (%)	Subsidy Calculated	Balance Loan	Initial EMI @ 8.5%	EMI after Subsidy	Monthly Saving	Annual Saving
EWS/LIG	6,00,000	6.50%	2,67,280	3,32,720	4,250	2,357	1,893	22719
MIG-I	9,00,000	4.00%	2,35,068	6,64,932	6,375	4,710	1,665	19981
MIG-II	12,00,000	3.00%	2,30,156	9,69,844	8,500	6,870	1,630	19,563

*Loan Tenure: 240 months= 20 years, NPV = 9%

EWS – Economically weaker section, LIG – Low income group, MIG- Middle income group

…leading to greater affordability

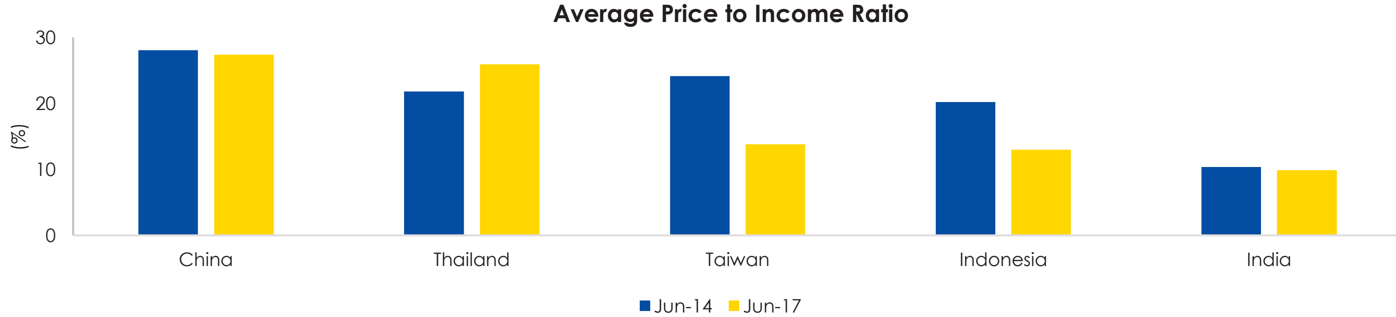
Mortgage Payment to post-tax income ratio



Source: RBI, Edelweiss Investment Research

Property Prices have remained stable

Average Price to Income Ratio



Source: RBI, Edelweiss Investment Research

VI. Affordable housing demand gaining significant traction; revival in other segments to follow suit

Though there is a lot to be achieved, the affordable housing segment has jumped 27% YoYacross top 8 Indian cities, while new launches in other segments have remained muted or declined.

Affordable Housing Spur			
Cities	**2017**	**2016**	**% Growth**
Ahemdabad	2532	2106	20%
Bengaluru	923	2881	-68%
Chennai	643	1300	-51%
Delhi NCR	1662	2613	-36%
Hyderabad	2110	231	813%
Kolkata	3886	3698	5%
Mumbai	10573	2454	331%
Pune	3752	5202	-28%
Total	**26081**	**20485**	**27%**

Cities	Affordable	Mid Ranged	High End	Luxury	Total (Jan-Sep-2017)	Total (Jan-Sep 2016)	% Growth
Ahemdabad	2532	1278	254	0	4064	6972	-42%
Bengaluru	923	7110	100	145	8278	15887	-48%
Chennai	643	1961	181	0	2785	5662	-51%
Delhi NCR	1662	3400	1500	0	6562	9373	-30%
Hyderabad	2110	2797	178	0	5085	9686	-48%
Kolkata	3886	1384	274	0	5544	8828	-37%
Mumbai	10573	8052	788	0	19413	19201	1%
Pune	3752	4463	164	30	8409	14361	-41%
Total	26081	30445	3439	175	60140	89970	-33%

Source: Cushman and Wakefield

VII.Other Recent Annoncements by Government which are Positive for Housing

Increase of Carpet Area for MIG : Union Cabinet approved the enhancement of the carpet area of houses for the middle-income group (MIG) category under the Pradhan Mantri Awas Yojana-Urban (PMAY-U). Under the MIG-I category, the carpet area of the houses has been enhanced from 90 square meter to 120 square meter, while under the MIG-II segment, it has been increased to 150 square meter from the current 110 square meter. This could help in clearing unsold stocks as many more projects will now become eligible to benefit from this scheme. It will also encourage developers in launching new projects.

Lower GST Expected on Affordable Homes : Rajiv Kumar, Chairman of National Real Estate Development Council (NAREDCO) told that government may lower GST on under construction affordable homes to 8% from the current 12%. If this materializes, then this could be another positive for the housing sector.

VIII. A few challenges

Though affordable housing has gained momentum, still a lot has to be achieved in terms of meeting the target. As of October 23, 2017, about 2.16lakh houses were built and 1.76lakh houses were occupied in urban areas. The gap is more in the rural region. This is still far from the government's target of provide homes to 48mn households. Land acquisition and poor records of property are some of the challenges faced. Also, for such a mammoth task, PMAY will require higher funding of about 0.5% of GDP, which could be an issue. Lack of clarity on RERA is also a deterrent. There is a large shift towards financial assets like shares debentures, mutual funds and fixed deposits and away from real assets like land and houses, impacting demand for houses.

In spite of these challenges, we envisage the next round of investment growth to be supported by boom in the affordable housing sector. This will create ample growth opportunities for allied sectors as well.

Housing Finance	Cement	Building Materials
•Mortgage Penetration is only 9% of GDP vis a vis global average of 25% creating ample unexplored opportunities •Shift from Formal to Informal source of finance improving the pie of opportunity.	•67% of Cement Production is used in building houses.	•Tiles, Sanitary Ware, Roofs are all highly related to building houses. • The shift will be amplified b shift from unorganized to organized

Strong reforms + push to housing= Economic boom

Implementation of GST & Bankruptcy code, impetus on enhancing productivity and increase in capital expenditure have clearly paved the way for growth. However, we believe housing and allied sectors will spearhead the boom by driving next wave of economic growth.

Housing Finance

Housing Finance

Outsized opportunity, ignore transient concerns

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GST and RERA creates asymmetry over the medium term; concerns to subside over the long-term

The advent of GST has created an Under Construction property vs 'Ready to Move In' property conundrum on the ground but HFCs with low exposure to Under (Builder) Construction property as a proportion of loan book will be minimally impacted over the medium term. Over the long-term, the conundrum will resolve favourably since the government will ensure pass-through of GST benefits by builders to home buyers by creating an eco-system that cracks down on Profiteering backed by a National Anti-Profiteering Authority. RERA, for its part, has affected near term supply since less sophisticated small-sized builders have found registration with RERA authorities difficult due to seemingly onerous compliance requirements. However, we consider this impact to vary across HFCs and, importantly, will be transient as well.

Multitude of macro factors driving underlying housing credit demand

Young populace, nuclearisation of family setup, urbanisation, improving affordability, sustainable low interest rate regime and low mortgage penetration are some of the powerful macro factors driving underlying housing credit demand. Specifically, Property price to Income ratio has continued to fall from 4.6x in 2014 to 3.8x in 2017. Further, government commitment to fiscal consolidation, targeted subsidy spend backed by JAM trinity, controlled rate of MSP increase and improved investment climate (which provides incremental fillip to BoP math) have all combined to facilitate a stable low interest rate regime.

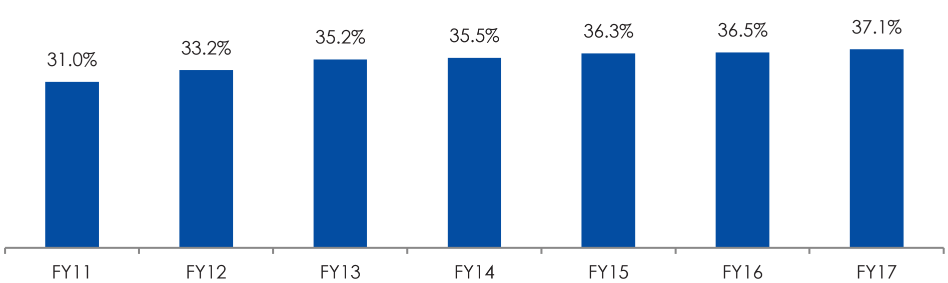
Government acutely focused on home ownership and facilitating housing credit

Tax incentives for borrowers acquiring their first home, tax sops to developers, credit-linked subsidy scheme (CLSS) under the Pradhan Mantri Awas Yojna, RERA addressing trust deficit between prospective buyers and developers are some of the key steps from the government side that aim to aid home ownership, especially by facilitating housing credit. Tax incentives for home buyers using credit include Section 80C, Section 24 and Section 80EE of the Income Tax Act.

The housing credit opportunity is greatest lower down the pyramid, which is positive for HFCs, ceteris paribus

Subsidy incentives of CLSS scheme are available only to lower income groups and incentives improve as we move lower down the pyramid. Similarly, tax sops to developers are available to those which are engaged specifically in Affordable Housing. C.95% of urban housing shortfall of 1.9cr units falls under EWS and LIG income groups. These aspects are positive for HFCs, when compared with Universal Banks, ceteris paribus, as HFCs are more focused on catering to small-ticket housing loan clients compared with Universal Banks. Among other reasons, this has led HFCs to steadily gain market share over Universal Banks over FY11-17.

Market share of HFCs in Housing Loans – Evolution over FY11-17



Date: 4th December 2017

Impact of GST varying amongst players and (impact) to reduce over long-term

GST throws open a Ready to Move In vs Under Construction conundrum and myraid new apsects

Since Under Construction flats fall under the purview of Work Contracts, GST is automatically applicable to flats. While the Union government is mulling applying GST to the Real Estate sector as a whole, thus far, Ready to Move In propoerties are outside the purview of GST. This, in effect, creates a differential tax regime for Under Construction properties vis-a-vis Ready to Move In (completed) properties.

Ready to Move In properties currently in favour due to Home Buyers "seeing"a lower tax rate

For properties not under GST, the pre-existing tax regime of Service Tax at 4.5% and VAT levied at 1-2% (depending on the State) under the Composition Scheme is applicable. Thus, the applicable tax during sale of Ready to Move In properties totals to 5.5-6.5%. In comparison, the applicable tax on Under Construction properties is 12% (effectively) under the current GST regime. This is what the Individual customer "sees" and hence, ceteris paribus, is looking to avoid Under Construction properties when compared with Ready to Move In properties.

Over the long-term, Under Construction properties should not remain under stress

Under Construction properties, in the future, will be able to avail higher Input Tax Credit (ITC) under the GST regime. This aspect is very clearly delineated in a Press Release of the Government of India dated 15th June 2017. The pointers of this Press Release are as given below

1. According to the MoF, the construction of flats, complex, buildings will have a lower tax incidence under GST compared with what they face under the previous tax regime.
2. Central Excise Duty @12.5% on most construction material, VAT on construction material @12.5 to 14.5%, Entry Tax on construction material are all ineligible for Input Tax Credit under Service Tax or VAT. There is cascading effect.
3. These tax costs are passed on by the builder to the home buyer and, as such, these costs are not visible to the latter.
4. The tax charged on the purchase cost is Service Tax @4.5% and VAT @1% under Composition Scheme. In some states, VAT may be levied @2%+ under the Composition Scheme.
5. Under GST, full input credit would be available for offsetting the headline rate of 12%. The input taxes embedded should not form part of the purchase cost for the home buyer.
6. The input tax credits will take care of the headline rate of 12% and hence, refund of overflow of input tax credits to the builder has been disallowed.
7. For Under Construction properties, builders should not ask customers to pay higher tax rate on instalments to be received after implementation of GST.
8. If a builder resorts to such practice, it will be deemed to be Profiteering under Section 171 of GST law.

The Union Government will crack down on Anti-Profiteeting and mulls the NAA

What the above Press Release essentially implies is that Under Construction properties, prospectively, shall have a lower sale price (on which GST would be applicable) compared with the previous tax regime, in which lower ITC benefits were available. It is, of course, imperative that the builders pass on these benefits to the end consumer. The government will ensure this by cracking down on Profiteering and an Anti-Profiteering clause is enhsrined in the GST law itself. In this regard, the Union Government has mulled the National Anti-Profiteeting Authority (NAA), which has already recieved approval from the Union Cabinet.

Differential between Ready to Move In and Under Construction may persist in the near term

While things may sort themselves out over the long-term, at the moment there are several properties which are Under Construction but where significant degree of construction has already been carried out. Here, there may not be adequate ITC available to the builders. At the same time, there is ample Ready to Move In inventory available and ready to be offloaded. So, while over the long-term, every construction will be subject to GST regime (when all current inventory, complete or incomplete will have been offloaded), over the near to medium term, this differential between Ready to Move In and Under Construction may persist. It is not straightforward to provide an accurate timeline as to when things will stabilize. This lack of clarity is probably what explains the general de-rating of the HFC sector, among other reasons, since the implementation of GST on the ground.

Impact on specific HFCs due to GST may vary depending on exposure to Under Construction properties

While the impact of GST on Under Construction properties may persist in the near term, the impact on specific HFCs may differ, depending on the extent to which each lends against Under Construction properties. Here, we differentiate between Self Construction, an activity which, as such, has not been impacted significantly by GST and Under Construction properties being sold by builders.

Impact of RERA on sector is negative for near-term disbursement but transient

Smaller builders are not fully on board with RERA

As one moves lower down the pyramid, the degree of sophistication of the builder drops and so does his ability to comply with the onerous requirements of registering with RERA authority. In fact, the smallest of builders constructing properties on essentially bilateral agreements with end customers, who generally own the land, are nothing but contractors, with least sophistication and ability of quickly adhering to RERA norms. As a result, there is currently a paucity of such small-sized builders who are in positiion to supply flats lower down the pyramid. This, at the margin, is having an impact on disbursements.

Some small-sized builders will be exempt from RERA given they fall below relevant thresholds

Some small-sized builders will naturally be exempted from RERA due to the threshold requirements that make is necessary to register with RERA. The thresholds are simply (1) 500 sqm and (2) 8 house units i.e. where the construction land is 500 sqm or lower and house units to be constructed are 8 units or lower need not register with RERA. These give some proverbial breathing space to contractors operating lower down the pyramid.

Several macro factors at play that create huge underlying housing credit demand

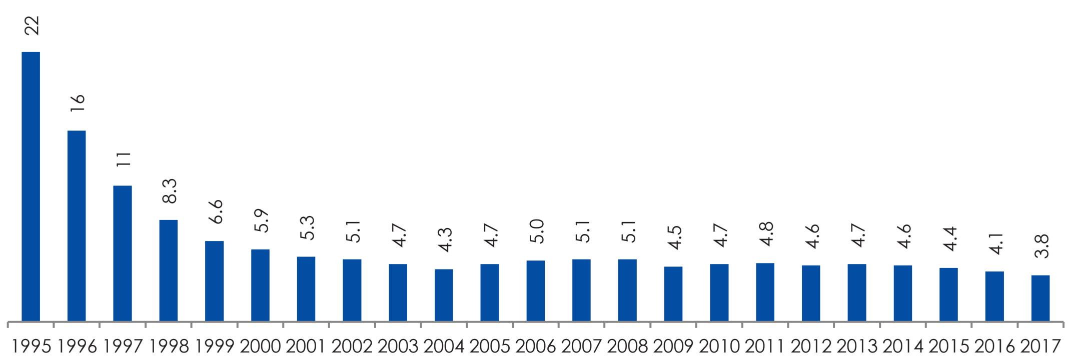
Some of these key factors supporting underlying housing credit demand include: -

1. 66% of India's population is below 35 years of age indicating strong underlying generic demand
2. Shift towards nuclear family setup from joint family structure will further augment demand
3. Urbanisation trend to help – % of Indian population living in urban areas to move from 28% currently to 40% by 2020
4. Improving affordability as rise in disposable income outpaces rise in real estate prices
5. Low interest rate regime to incrementally help real estate purchases
6. Mortgage penetration in India at 9% of GDP is still low compared with most other nations

Property purchase is more affordable for the Indian home buyer than ever before

Despite the optically high property prices, it is important to note that the income of the Indian home buyer has more than kept pace with the rise of property price. As of 2017, the ratio of Property prices to income stands at 3.8x. While this ratio hovered within a relatively tight range of 4.4-4.8x over 2009-2015, 2016-2017 has seen a reduction in this ratio, indicating increased affordability.

Property price to Income Ratio – 1995-2017



Source: HDFC Limited

The underlying conditions for a low interest rate regime have been set in place

The single most important factor in laying the foundation for a relatively low interest rate regime has been the clear intent of the present government to control inflation, setting the stage for interest rate cuts by the RBI and general fall in interest rate regime, as indicated by the government bond yield.

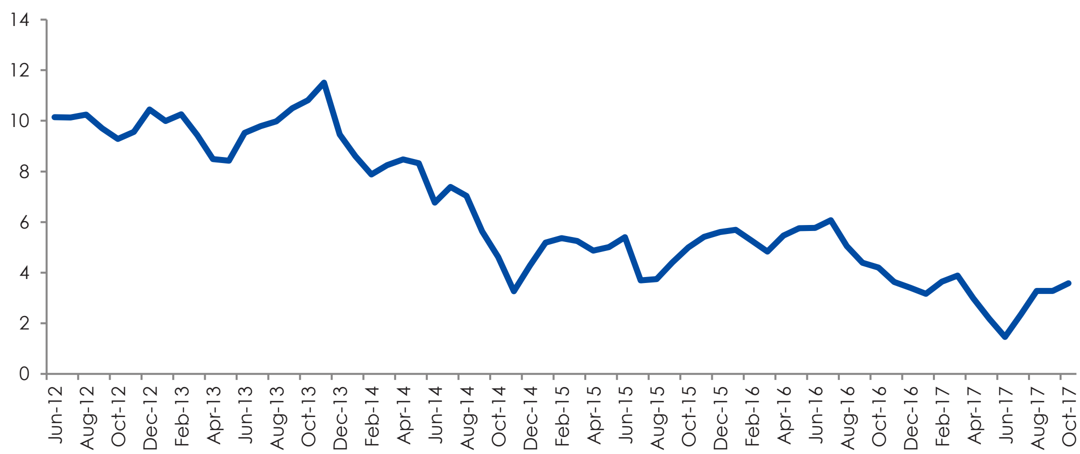
The government has shown the intent for inflation control through: -

1. General committment to fiscal consolidation
2. Targeted subsidy spend backed by JAM trinity reducing spillover
3. Controlled rate of increase in MSP
4. Generally superior Balance of Payments math due improved investment climate resulting in controlled depreciation of INR and check on import of inflation

The government's actions have led to a stable low inflation regime

CPI inflation, the metric officially targeted by the RBI, has fallen from 10%+ levels in 2012 to sub 4% levels in 2017. This laid the platform for the RBI to cut interest rates. The RBI has the mandate to maintain CPI inflation at 4% plus or minus 2% till FY22.

CPI Inflation – June 2012- October 2017



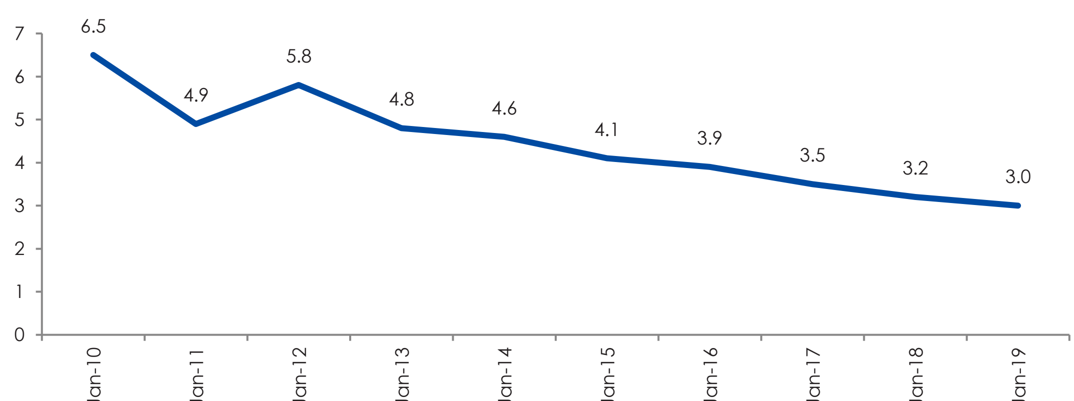
Source: Bloomberg

The government's committment to fiscal consolidation is evident in numbers

The current government has displayed significant committment to fiscal consolidation. It underlined that fiscal targets would not be compromised at any stage by sticking to and delivering the FY17 Fiscal Deficit target of 3.5% of GDP for FY17, which was largely against market expectations, which pointed to a relaxation of this target. The governement is targeting a reduction of the Fiscal Deficit to 3% of GDP by FY19.

While quality of fiscal deficit is also key, in general, ceteris paribus, a controlled fiscal deficit helps rein in inflation expectations.

Annual Fiscal Deficit – FY10-FY19

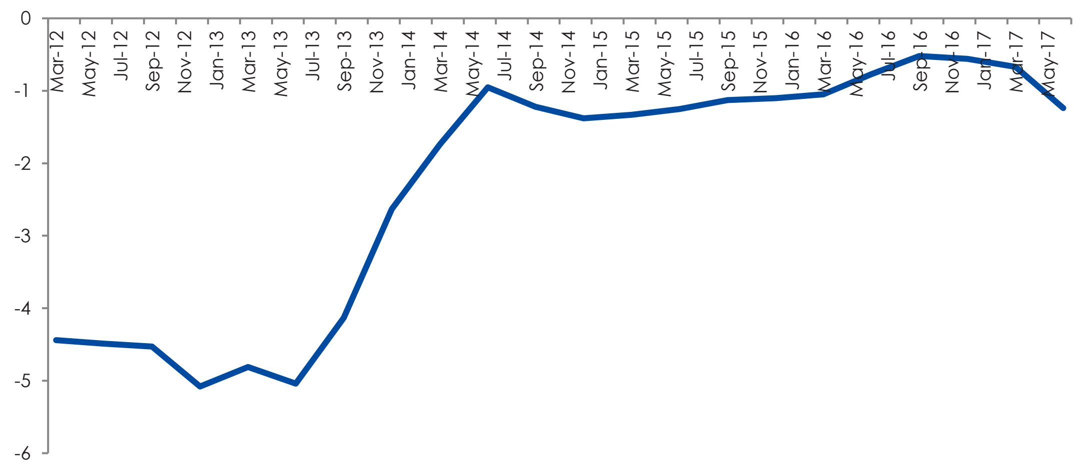


Source: Bloomberg

Favourable BoP math has resulted in a check on imported inflation

Various factors have combined to improve India's Balance of Payments math in favour of the INR vis-a-vis other currencies. Some of these key factors are (1) Global crude oil prices moving into a 'new normal' price range due a persistent supply glut driven by Shale oil supply above reasonably low threshold price levels (2) Controlled import of Gold on the back of targeted government policies (3) Improved export performance of India.

Current Account Deficit as a % of GDP – Mar 2012- Jun 2017



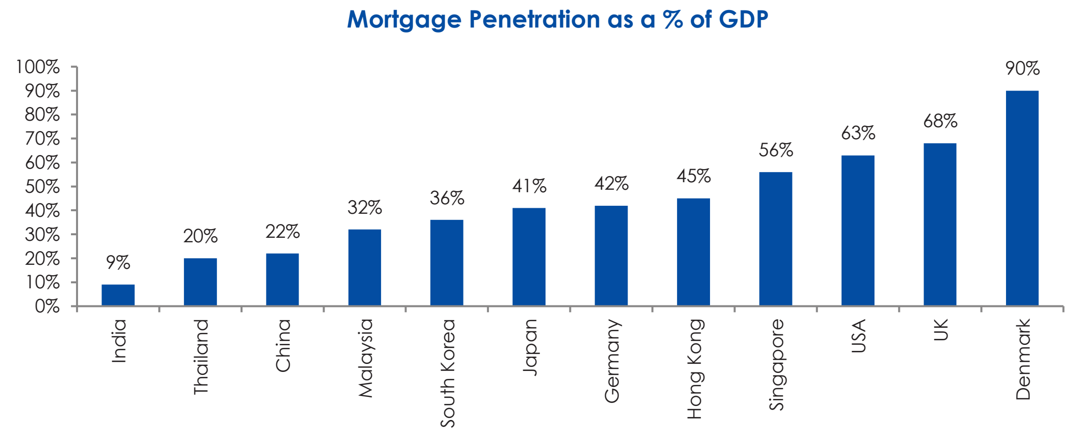
Source: Bloomberg

In this backdrop, the INR has been materialy more stable compared with the time during the 'Taper Tantrum' and generally higher CAD and BoP deficits. On balance, a stronger INR implies imports are cheaper leading lower importation of inflation on the external front.

Home buying more sensitive to interest rates compared with other discretionary purchases

The variety of macro factors that support a stable low interest rate regime is key for housing credit since the proportion of homes bought using borrowed money is generally high compared with purchases of other items, indicating a higher sensitivity to interest rates, ceteris paribus.

Low mortgage penetration in India indicates high potential upside for housing credit



Source: HDFC Limited

India's mortgage penetration as a percentage of GDP stands at a low 9%. Asian peers like Thailand (20%), China (22%) and Malaysia (32%) are at materially higher penetration levels, indicating significant potential upside for India on this metric.

Low mortgage penetration is also indicative that the Indian retail consumer is under-leveraged
The low mortgage penetration in India is also, in a sense, indicative of the Indian retail consumer being, as such, underleveraged. This is stark contrast to, for example, the retail consumer in the US, which was the epicentre of the Great Recession of 2008 and, more specifically, at the heart of the US banking crisis of the previous decade. The then eco-system in the US was such that both Banks and retail consumers (many of whom were Sub-prime borrowers) were willing to transact to the extent that, in hindsight, we know was beyond the means of the consumers and beyond the risk limits of the respective banks.

The under-leveraged Indian retail consumer aids the stability of Indian Residential real estate
In the Indian Banking sector, it is the corporate segment that has been generally over-leveraged and the main contributor to bad asset accretion. The Indian retail consumer has been prudently conservative unlike its US counterpart and this has resulted in generally superior asset quality. This, also, in part, explains the general stability of the Indian residential real estate sector from a price level perspective.

Regardless of Demonetisation, the likelihood of a US-like real estate crisis in India seems low
Demonetisation was a black swan event that has affected price levels in markets where cash component is said to be high, especially in parts of north India. Other areas like Mumbai region have been more stable. The price correction in specific markets has been reasonably deep but has not affected asset quality significantly as loans are given as per price declared in transaction document and, as such, excludes the cash component aspect. By and large, a real estate crisis of the nature seen in the US does not look like a realistic possibility in India.

Consequently, asset quality of HFCs generally superior to other NBFCs

By and large, the asset quality of the Indian HFC industry has been fairly sound with GNPA Ratios mostly in the 0.4-1.1% range barring outliers, GICHF (2.4%; primarily due to idiosyncratic company policy) and Repco (4%; primarily due to transient aspects related to gerographical concentration).

This is in stark contrast to a whole host of segments of the Indian credit industry such as PSU Banks, select Corporate-focused private sector banks, Power Sector NBFCs and select Auto NBFCs, among others. The superior asset quality of the Indian HFC industry can be attributed to the following factors :-

1) Focus on the Individual consumer
2) Nature of collateral

Focus on the Individual Consumer:

The Indian credit industry has seen a general divergence in NPA accretion trends for entities focused on corporates compared with those focused on the Individual consumer. Unlike certain sections of the corporate sector, as explained earlier, the Indian Individual consumer is laregly not over-leveraged.

Nature of collateral:

The probability of default is determined by underlying human psychology and economic trade-offs. Housing as collateral is generally a non-depreciating asset. This is not true for PPE, Vehicles and similar collateral assets, which are, as such, continually depreciating assets. Furthermore, housing collateral is often self-occupied and default would result in significant lifestyle changes compared with default on other types of assets.

The government is acutely focused on house ownership for its citizens

Some of the key steps taken by the government include: -

1. Tax (deduction) incentives for first time home borrowers are particularly helpful for low ticket purchases – reduces effective home loan yield from c.9.5% to c.4% or even lower
2. There is boost to affordable housing through tax incentives as well as granting of infra status
3. Govt. schemes like Housing for All by 2022 (Pradhan Mantri Awas Yojna), Smart Cities Mission, Atal Mission for Rejuvenation and Urban Transformation (AMRUT) are game changers
4. Real Estate (Regulatory & Development) Act, 2016 will make real estate sector more transparent and attract more buyers
5. Funding sources are increasingly available with ECBs for affordable housing, masala bonds and enhanced investment limits for insurance companies for highly-rated HFCs

A plethora of Tax Incentives for Home Buyers using Credit

Tax Deduction of upto INR 1.5 lacs available under Section 80C of the Income Tax Act

A tax deduction of upto INR 1.5 lacs under Section 80C is available on the Principal component of EMI arising from a housing loan backed by a completed property. It is to be noted that this deduction is not available for properties under construction. It may also be noted that if the buyer were to transfer the purchased home within 5 years from the date of possession, the previous deduction availed will be null and void, retrospectively and tax liability will be applicable.

Tax Deduction of upto INR 2 lacs available under Section 24 of the Income Tax Act

A tax deduction of upto INR 2 lacs under Section 24 is available on the Interest component of EMI arising from any housing loan, whether for a completed property or one under construction. It is to be noted that the deduction is available against Income from House Property and the latter is reduced by the Interest component for tax calculation.

Tax Deduction of upto INR 50,000 under Section 80EE of the Income Tax Act

A tax deduction of upto INR 50,000 under Section 80EE is available on the Interest component of EMI arising from a housing loan. This is over and above what is available under Section 24. Certain requirements need to be fulfilled in order to avail deduction under this section and these are (1) The value of the property must be below INR 50 lacs (2) The quantum of loan availed should be under INR 35 lacs (3) The borrower should not already own a property (4) The loan should be availed from a financial institution.

Housing credit demand will also be buoyed by underlying housing demand

The housing opprtunity is defined by a significant shortfall in housing units

The Minstry of Housing and Urban Poverty Alleviation has estimated that the current shortfall in house units in urban India is as much 1.9 cr units.

The above figure considers only the shortfall in urban India. The current shortfall in rural India is even higher at 4 cr units, as mentioned in the Presentation (dated August 2017) of Arihant Superstructures, a key real estate developer focused on affordable housing.

Housing Credit Opportunity based on Current Shortfall

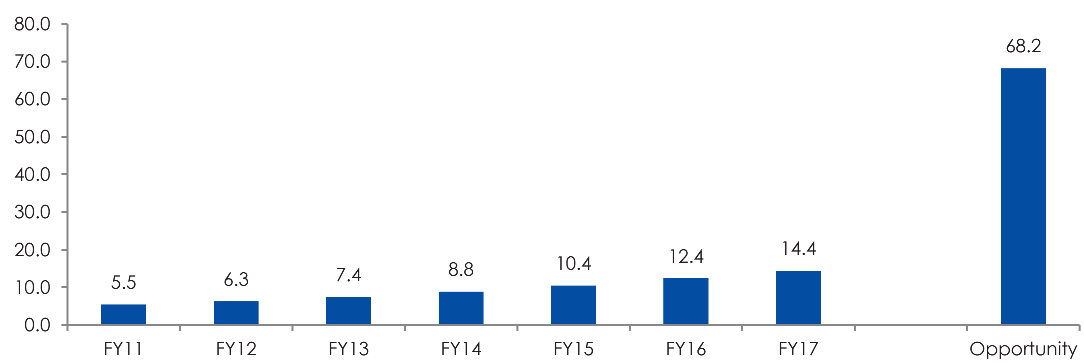
Housing Units' shortfall in Urban India (cr)	1.878
Loan per Unit in Urban India (INR lacs)	15
Opportunity size in Urban India (INR lac cr)	28.17
Housing Units' shortfall in Rural India (cr)	4
Loan per Unit in Rural India (INR lacs)	10
Opportunity size in Rural India (INR lac cr)	40
Opportunity size in India (INR lac cr)	68.2

Source: MHUPA, Arihant Superstructures, Edelweiss Investment Research

Housing Credit opportunity size humungous even on conservative estimates

Based on the current shortfall estimates, which could be revised upwards in coming years, the opportunity size for Housing Credit is a outsized INR 68.2 lac cr, based on reasonably conservative average ticket size assumptions. Given that, the current Housing Finance outstanding loan book is INR 14.4 lac cr, there is significant upside in terms of Housing Credit opportunity from current industry levels.

Housing Finance Industry – Outstanding Loans – Evolution and Opportunity (INR lac cr)



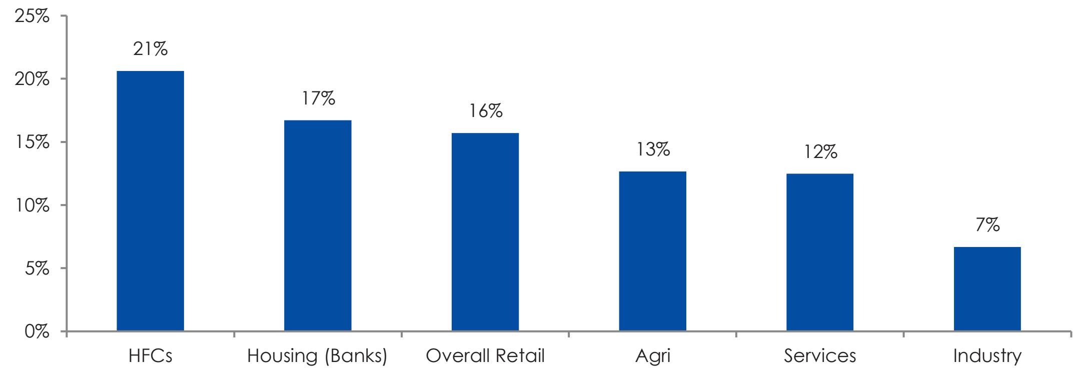
Source: PNB Housing Finance, Edelweiss Investment Research

Growth picture of credit universe shows that Housing credit is seeing traction

Housing credit is the bright spot in the overall Indian credit market

Housing credit in general and, specifically, loans by HFCs have generally outpaced the growth trajectories of other lending segments of the Indian credit market.

FY12-17 CAGR for various lending segments of Banking sector vs HFCs



Source: PNB Housing Finance, RBI

Within the Banking sector, the Housing segment has been growing faster than other portions of the credit market. The data for Bank segments is gleaned from RBI's Sectoral breakdown data (prepared from Bank data that represents 95% of Non Food Credit from Scheduled Commercial Banks in India). The HFC data point is taken from the PNB Housing Finance Presentation.

"Industry" above represents essentially the Manufacturing sector lending in India and this has slowed to a CAGR of 7% over FY12-17, a stark contrast to the cyclically high 24% they enjoyed over FY07-12. The problems afflicting the manufacturing sector lending from an asset quality perspective are well known. In sharp contrast, we see that Overall Retail Loans have grown at a faster clip of 16% over FY12-17 compared with 11% over FY07-12. Housing Loans, which are a subset of Overall Retail, have grown at 17% over FY12-17 compared with 11% over FY07-12. This is driven by the under-penetration of the Indian Individual / Retail consumer from a housing credit perspective (discussed earlier).

Banks and lending organisations have increasingly oriented themselves towards the Indian Individual / Retail Consumer and, specifically, towards Home Buyers. HFCs have grown at a CAGR of 21% over FY12-17, outpacing Banks over the same period and winning market share. We will specifically discuss market share evolution in the next section.

Housing credit opportunity is greatest lower down the pyramid which favours NBFCs, ceteris paribus

95% of the shortfall in urban India, it is estimated, falls under Economically Weaker Sections (EWS) and Low Income Groups (LIG).

Government schemes to facilitate housing credit are focused lower down the pyramid

The government is cognizant of this acute under-penetration of home ownership among lower income groups and has ensured that regulations are aligned to address this gap. The Credit Linked Subsidy Scheme (CLSS) under Pradhan Mantri Awas Yojna (PMAY) / Housing for All by 2022 are structured in a manner that they target lower income groups and the best incentives are earmarked for those lowest down the pyramid.

Interest subsidy under PMAY across household categories

	EWS	LIG	MIG - I	MIG - II
Household Income (INR lacs)	0 to 3	3 to 6	6 to 12	12 to 18
Interest Subsidy (% pa)	6.5%	6.5%	4%	3%
Maximum loan tenure	20 years	20 years	20 years	20 years
Eligible Loan Amount (INR lacs)	6	6	9	12
Dwelling Unit Carpet Area	30 sqm	60 sqm	120 sqm	150 sqm
Discount Rate for NPV (% pa)	9%	9%	9%	9%

Source: NHB

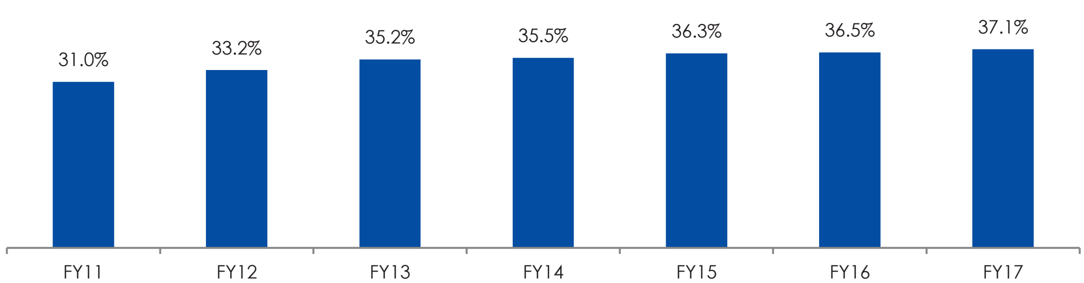
The quantum of interest subsidy as we move lower down the pyramid is higher as the subsidy for EWS / LIG families is 6.5% compared with 4% and 3% for MIG – I and MIG – II categories.

HFCs specialise in catering to the housing finance opportunity at the bottom of the pyramid

HFCs are specialists at operating lower down the pyramid (lower income groups) and Universal Banks have not been the best fit as far client-servicer relationship is concerned. While there is nothing that outright prevents Banks from operating lower down the pyramid, Universal Banks (1) tend to focus on higher ticket sizes (2) are not able to provide adequate service levels to lower income groups due to their lower ticket sizes (3) tend to focus on salaried clients and less so on non-salaried clients.

These differences in approach makes HFCs a somewhat more natural business model to exploit the bottom of the pyramid opportunity. Small Finance Banks may also become competitive in this area over the long-term.

Market share of HFCs in Housing Loans – Evolution over FY11-17



Source: PNB Housing Finance

Partly, as a consequence of their lower ticket size focus, HFCs have managed to increase their market share from 31% in FY11 to 37% in FY17.

Significant tax incentives to developers focused on affordable housing

- For developers, 100% deduction for profits from house units below 30 sqm (1 sqm = 10.76 sqft) in 4 metros and below 60 sqm in rest of the cities, with MAT still applicable (deduction applicable to projects approved between Jun 2016 to Mar 2019 and completed within 3 years)
- Furthermore, house units below 60 sqm constructed for Central or State government schemes or PPP schemes will be exempt from service tax. The government is mulling an extension of this though process under the GST regime as well

Infrastructure status to Affordable Housing lowers cost of funds for the latter

As per the RBI, banks would not have to maintain CRR / SLR on funds raised through bonds meant for extending credit to the Infrastructure sector.

Affordable Housing has been kept under the ambit of Infrastructure and hence, the above benefit is available to the former. Loans upto INR 50 lacs in Metros for houses of value upto INR 65 lacs and loans upto INR 40 lacs outside Metros for houses of value upto INR 50 lacs are defined as Affordable Housing.

Due to CRR / SLR waiver, the effective cost of funds for banks for Affordable Housing business is lower.

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Long Term recommendation: Can Fin Homes Ltd.

Low risk, high-growth play on generic opportunity

CMP INR: 475
Rating: BUY
Target Price INR: 588
Upside: 24%

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Can Fin Homes (CFH) is a Housing Finance Company with a loan book of INR 14456 cr and pan-India network of 132 branches across 19 states. Cost of Borrowings leadership, best-in-class asset quality, minimal impact from GST/ RERA and superlative opex control will combine to deliver high RoE profile of 21-23% over FY18E-20E. Given reasonable valuations of 3.2x FY19E P/B for forecast return ratios, we initiate coverage with a BUY Rating on CFH.

CFH is the sector leader on Cost of Funds on the back of key idiosyncratic factors

CFH's Cost of Borrowings for Q1FY18 stands at 7.8% compared with key HFC peers ranging between 8.1-8.8%. There are several idiosyncratic reasons providing this advantage. Firstly, given that Canara Bank, an important part of the PSU eco-system, is its parent, CFH has ample access to cheap Banking funding lines with Cost of Bank Borrowings (19% of Funding mix) slightly below 8% compared with 8.3-8.8% for key HFC peers. Secondly, CFH's credit risk perception provides superior access to DCM (52% of Funding) at 7.8% compared with 8%+ for key peers. Furthermore, c.10% of CFH's loan book qualifies for ultra-cheap NHB funding at 4.86%. Being a Deposit-taking NBFC, c.2% of CFH Funding is from cheap Institutional Deposits at c.6.5% and on which SLR is not required.

CFH underwriting standards are best-in-class leading to pristine asset quality

CFH's GNPA Ratio at the end of Q1FY18 stands at 0.38% compared with 0.43-4% for key HFC peers. Rigour of CFH under-writing standards can be gauged from the fact that Non Salaried (26% of total loans) book GNPA Ratio is marginally superior to that of Salaried portion. CFH has altogether avoided the high risk large-ticket LAP sub-segment keeping the average ticket size of Non Housing Loans at INR 11 lacs and has also kept LAP LTV on a tight leash at 40% compared with 46-55% for key peers.

CFH sits at a sweet spot of the generic opportunity and is minimally impacted by GST and RERA

CFH has a low average ticket size of INR 17 lacs indicating its focus lower down the pyramid and 91% of fresh approvals qualify for CLSS, which means CFH sits at a sweet spot of the generic affordable housing opportunity. Furthermore, impact of GST on the ground for CFH is minimal since it has miniscule exposure to Under (Builder) Construction properties at less than 1% of loan book. Also, impact from RERA, though present at the margin, would not be significant given that c.90% of loan book is derived from Tier 1 centres, implying the degree of sophistication for associated builders may be reasonably adequate for RERA compliance.

Successful outsourcing and prudent HR strategy drives superior C/I Ratio

CFH had a superior C/I Ratio of 14.9% in Q1FY18 compared with 15.5-23.4% for key HFC peers, barring IBHF at 12.9%, HDFC Limited (7.4%) and LICHF (4.3%). HDFC and LICHF are not comparable since they possess non-replicable advantages of having priority access to HDFC Bank and LIC parent workforces. In that context, CFH's opex control is superlative, which it is able to achieve through cheap external DSA sourcing (46% of total sourcing) and maintaining a young workforce (average age < 30 years).

Valuation and Rating: Initiate with BUY, PT of INR 588.

We use Residual Income Model to arrive at a Price Target of INR 588 for CFH, at which the stock trades at 3.9x FY19E book, and initiate with BUY rating. The stock currently trades at a P/B of 3.2x FY19E book value for an FY18E-20E RoE of 21%-23%.

Year to March (INR cr)	FY16	FY17	FY18E	FY19E	FY20E
Net Interest Income	301	422	531	668	859
Profit after tax	157	235	324	403	525
Basic EPS	11.8	17.7	22.8	28.4	37.0
P/E	40.2	26.9	20.8	16.7	12.8
Book value per share	66	81	124	150	184
P/B	7.2	5.9	3.8	3.2	2.6
RoAE	19.0%	24.1%	22.8%	20.7%	22.1%

Bloomberg:	CANF:IN
52-week range (INR):	666.00 / 277.60
Share in issue (cr):	13.3
M cap (INR cr):	7,043
Avg. Daily Vol. BSE/NSE :('000):	683
Promoter Holding (%)	30.70

Date: 27th November 2017

Can Fin Homes: Cost of Borrowings leadership + Most prudent under-writing standards + Significant benefits from government focus + Stellar opex control = High RoE delivery

Can Fin Homes (CFH) is the Cost of Borrowings leader among HFCs. It also possesses pristine asset quality on the back of the most prudent underwriting standards. Furthermore, it falls into a sweet spot of the generic opportunity created by CLSS and it is also doing a stellar job on the opex control front. The combination of these factors will help drive superlative RoAE of 21-23% over FY18E-20E for CFH.

CFH Cost of Borrowings is 7.8% in Q1FY18 compared with 8.1-8.8% for key HFC peers

	FY15	FY16	FY17	FY18E	FY19E	FY20E
NII	178	301	422	531	668	859
Other Income	29	39	47	63	85	114
Opex	53	67	81	91	115	144
PAT	86	157	235	324	403	525

Prudent underwriting standards have resulted in superior GNPA Ratio of 0.38% in Q1FY18 compared with 0.43-4% for key HFC peers

	FY15	FY16	FY17	FY18E	FY19E	FY20E
RoAA	1.21%	1.65%	1.94%	2.12%	2.08%	2.12%
RoAE	14.1%	19.0%	24.1%	22.8%	20.7%	22.1%

Being in the sweet spot of the CLSS-driven opportunity, we expect a loan CAGR of 27% for CFH over FY17-20E

PB Multiple	FY19E BVPS	CMP / Target
3.2x (CMP)	150	475
3.9x (Target)	150	588

At CMP, FY19E P/B is 3.2x + **FY18E-20E RoE of 21-23%** + **At Target Price, FY19E P/B is 3.9x**

Upside of 24%

Price Target	**INR 588**	We use the Residual Income Valuation Model to value CFH. We assume a long-term risk-free rate of 7% for India, a Beta of 1.14 for CFH and an India Equity Risk Premium of 6% and arrive at an overall Cost of Equity of 13.8% for CFH. We arrive at a price target of INR 588, at which the stock will trade at 3.9x FY19E book value.
Bull 5.0x 2019E BPS	**INR 790**	Our bull case assumes a faster ability to grow Loans at a FY17-20E CAGR of 30%, a lower C/I profile of 12.5-14.0% over FY18E-20E and higher average NIM of 3.85% over FY18E-20E resulting in an FY18E-20E RoE profile of 23%-26%.
Base 3.9x 2019E BPS	**INR 588**	Our base case assumes a FY17-20E Loan growth CAGR of 27%, a C/I profile of 14.8-15.3% over FY18E-20E and average NIM of 3.51% over FY18E-20E resulting in an FY18E-20E RoE profile of 21%-23%.
Bear 2.8x 2019E BPS	**INR 414**	Our bear case assumes a slower ability to grow Loans at a FY17-20E CAGR of 25%, a higher C/I profile of 15.7-16.5% over FY18E-20E and lower average NIM of 3.34% over FY18E-20E resulting in an FY18E-20E RoE profile of 20%-22%.

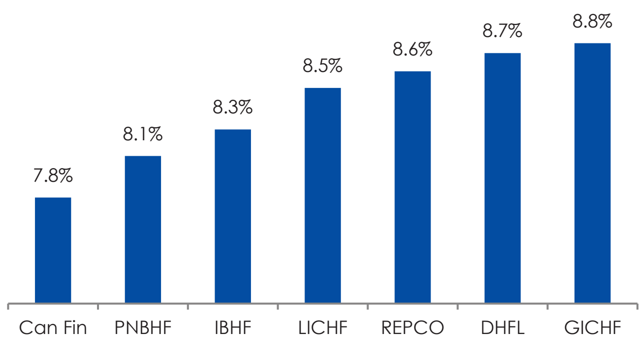
Average Daily Turnover (INR cr)			Stock Price (CAGR)				Relative to Sensex, CAGR (%)			
3 months	6 months	1 year	1 year	3 years	5 years	10 years	1 year	3 years	5 years	10 years
33.8	38.2	31.2	55%	`73%	80%	42%	27%	68%	68%	36%

Business Value Drivers

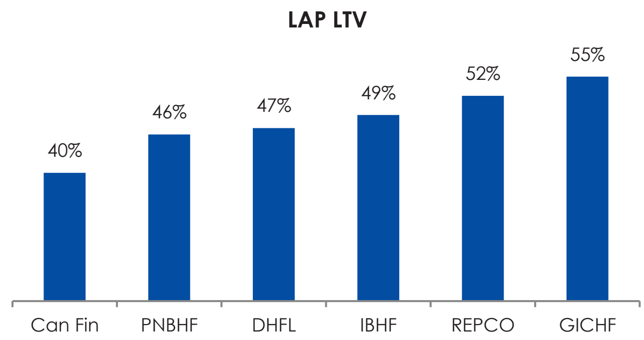
Nature of Industry	The Housing Finance industry comprises Banks, and HFCs. HFCs have gained market share vis-à-vis Banks from 31% in FY11 to 37% in FY17 via, among other reasons, greater focus on small-ticket lending where the opportunity is superior due to government support.
Opportunity Size	On the back of a current Urban housing units shortfall of 1.9 cr units and a Rural housing units shortfall of c.4 cr units, we estimate an opportunity size of INR 68 lac cr for Housing Finance.
Capital Allocation	CFH is a specialist in Retail / Individual home loans and intends to remains so. Their exposure to Large Ticket Non Housing Non LAP lending is a miniscule 0.1% (Builder loans) of Q1FY18 loan book. LAP exposure is also small at 5.9% of Q1FY18 loan book.
Predictability	Predictability is particularly high on the back of significantly tight under-writing standards. We expect Credit Costs to remains below 20 bps over FY18E-20E.
Sustainability	CFH is well capitalised with Total Capital Ratio of 18.79% against NHB requirement of 12%. Tier 1 Capital Ratio is 16.51% against regulatory requirement of 10%. We assume an equity capital raise on INR 400 cr in FY18E since an approval for INR 1000 cr (outer limit) has been taken.
Disproportionate Future	There could be disproportionate rise in the pace of loan book growth as awareness regarding CLSS schemes increases lower down the income pyramid.
Business Strategy & Planned Initiatives	CFH is steadily increasing the count of its Affordable Housing Loan Centres (AHLC), which are branches with sanctioning authority for loans upto INR 20 lacs. Such outlets focus on the periphery of Tier 1 locations, the latter comprising c.90% of loan book.
Near Term Visibility	Near-term visibility seems optically challenged due to the implementation of GST and RERA but, Q2FY18 yoy loan growth stood at 21%, which is commendable since associated teething problems were at their peak.
Long Term Visibility	Generic housing credit opportunity coupled with prudent management approach will ensure robust growth over the long-term from a relatively smaller loan book base.

Focus Charts – Story in a nutshell

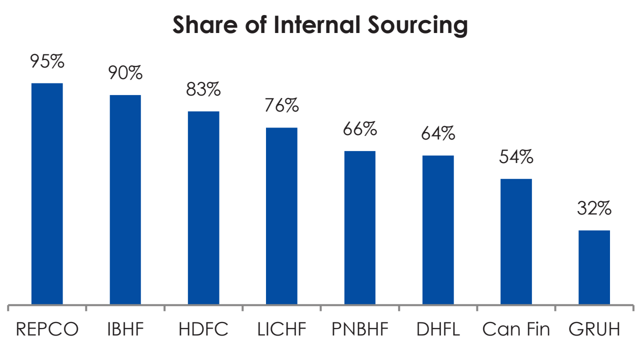
CFH is the Cost of Borrowings leader due to idiosyncratic reasons



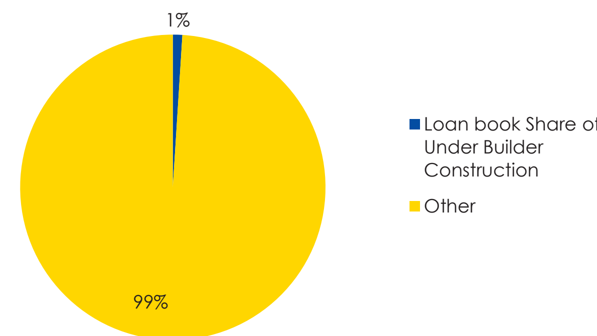
CFH has best-in-class asset quality on the back of prudent underwriting standards



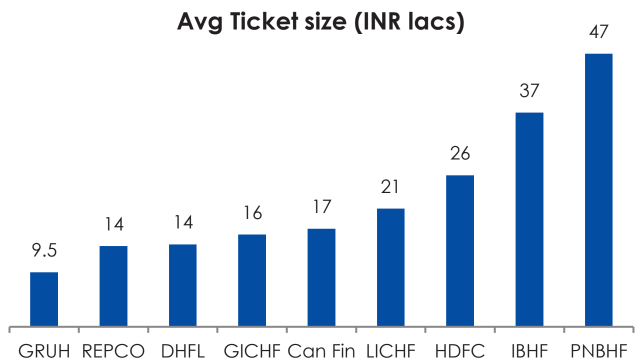
Judicious external sourcing has proved beneficial for CFH opex efficiency



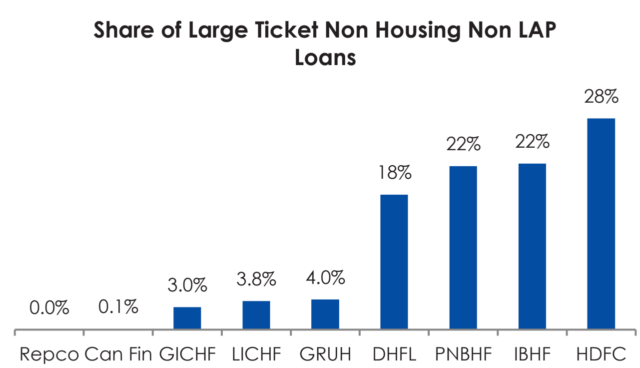
Impact of GST minimal for CFH even over the near to medium term



CFH a prime beneficiary of CLSS from a ticket size perspective



CFH is a pure play on Retail / Individual Home Loans

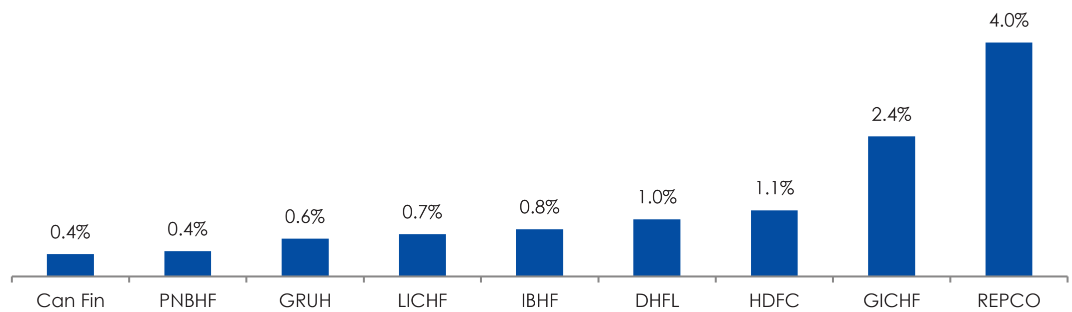


Source: Edelweiss Investment Research

Can Fin Homes has the best Asset Quality among all major HFCs

As of Q1FY18, Can Fin Homes has a GNPA Ratio of 0,4%. Only PNHF has a similar GNPA Ratio while key peers range between 0.6-4%.

GNPA Ratio for HFCs– Q1FY18



Source: Company data

As is evident from the chart above, Can Fin Homes enjoys the best asset quality among HFCs in India. Some reasons, among others, behind this is (1) prudent focus on lower risk Salaried clientele (75% of loan book) and (2) avoidance of higher-risk LAP business (5.9% of loan book) (3) avoidance of higher-risk Large-ticket Non-Housing businesses (0.1% of loan book).

However, importantly, there are other reasons driving their superior asset quality and these are not merely related to choice of business.

Can Fin Homes' superior asset quality more a consequence of underwriting standards than choice of buisness

It is also important to stress that Can Fin Homes'underwriting standards are particularly strong and its superior asset quality is not merely a function of the composition of its loan book.

Interestingly, there is, as such, little difference between the asset quality of Can Fin Homes' Salaried book versus its Non Salaried book. In fact, the asset quality of its Non Salaried book is marginally superior to that of its Salaried portion.

This is partly a consequence of the events surrounding Demonetisation. Soon after Demonetisation, RBI had come out with a 90-day moratorium for NPA recognition for loans below INR 1 cr. What this resulted in was that some of those Salaried clients who had not repaid dues for months in a row were unable to repay when the moratorium suddenly expired.

This is not concerning in the overall context as the GNPA Ratio of Can Fin Homes, we re-iterate, is the best in the HFC industry, at 0.38%. Importantly, we wishe to drive home the point that the GNPA Ratio of the Non Salaried portion, which is now as much as 26% of loan book, is close to and, in fact, slightly better than the overall ratio of 0.38%.

Can Fin Homes' credit appraisal process is particularly robust even for Non Salaried clients

The credit appraisal process for Can Fin Homes involves carrying out an exhaustive bank-like KYC, collecting all relevant supporting documents related to the property to be used as collateral as well as acquiring all relevant documents that act as supporting documents for income levels of the potential borrower. The process also involves a stringent verification process by both internal as well as external staff. Valuers are also involved in arriving at an accurate value of the property in question.

In particular, for Non Salaried clients, a visit to the shop front is carried out but, at the same time, utmost conservativeness is retained while making judgements about the income levels of such a potential borrower. While sit visit may, at a given point in time, indicate a certain income level, Can Fin Homes still insists on an Income Tax Return. In fact, even for Non Salaried clients, they acquire the last 3 years' Income Tax Returns and calculate the simple of average of 3 year's declared income. This is the primary basis of deciding disbursement amount. If site vist indicates higher income level than what is declared, the average of declared salary level is what is considered.

Similarly, if Spouse's Income Tax Return is submitted along with own Income Tax Return the former is not taken into consideration unless a clear alternate source of income is visible and discernible from the spouse's perspective.

Choice of Client categories is key for HFCs and Can Fin Homes made sound long-term choices

There are two broad Client categories - Salaried and Non Salaried

As far as Individual Retail Housing Loans are concerned, there are broadly 2 client categories in (1) Salaried and (2) Non Salaried clients. Salaried clients typically have formal documents such as Salary Slips and Income Tax Returns, which makes it more straightforward for HFCs to carry out their credit appraisal. Due to a lack of such documents for Non Salaried clients, the opposite holds true as far as credit appraisal is concerned.

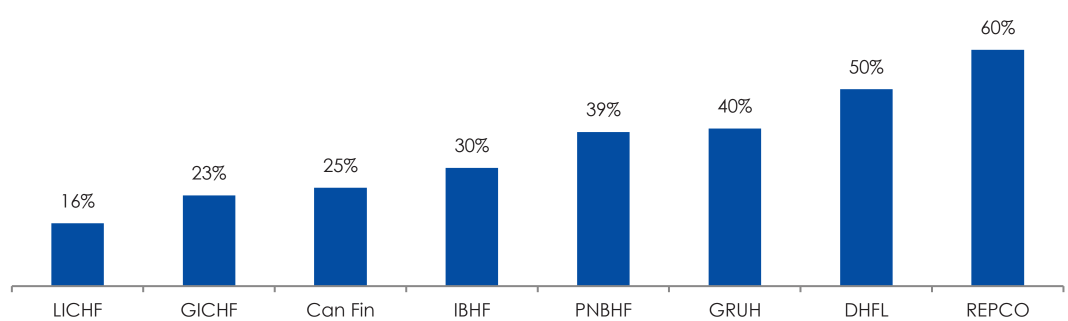
SENP category is another classfication used

Non Salaried clients are sometimes also termed Self Employed Non Professional (SENP) though, strictly speaking, Self Employed Professional (SEP) clients (e.g. Doctors, Accountants, Lawyers, etc) are Non Salaried but not SENP. Such SEP clients do not possess Salary Slips (from Employers) but may still possess Income Tax Returns. Can Fin Homes classifies SEP clients as Non Salaried.

Credit appraisal is tougher for Non Salaried but yields are higher

For credit appraisal of the SENP category, the HFCs typically send personnel to client site for a better understanding of their cash flows. Even so, the lack of formal income documents earmarks SENP clients as a higher risk client category compared with Salaried clients. While the asset quality of Non Salaried client set is likely to be worse compared with Salaried client set, ceteris paribus, it is also true that HFCs attempt to compensate for this by charging a higher credit risk premium on the final lending rate to Non Salaried clients. Such higher lending rates (from HFCs) is generally accepted by Non Salaried clients as their access to Bank finance remains constricted due to the relatively risk-averse stance of Banks vis-a-vis Non Salaried clients.

Non Salaried clients as a proportion of Loan book – Q1FY18



Source: Company data; IBHF, Gruh and GICHF figures pertain to recent periods prior to Q1FY18

IBHF figure is for Q2FY17, Gruh for FY16 and GICHF for Q3FY17.

LICHF, GICHF and Can Fin Homes focused on Salaried; Repco and DHFL on Non Salaried

As can be seen from the chart above, the likes of LICHF (16% to Non Salaried), GICHF (23%) and Can Fin Homes (25%) have been focused on Salaried clients whereas Repco Home Finance (60% to Non Salaried) and DHFL (50%) have been focused on Non Salaried clients.

Can Fin Homes' Average Ticket Size sits at a sweet spot from a CLSS perspective

Lower the Average Ticket Size, greater the proportion of clients eligible for CLSS, ceteris paribus

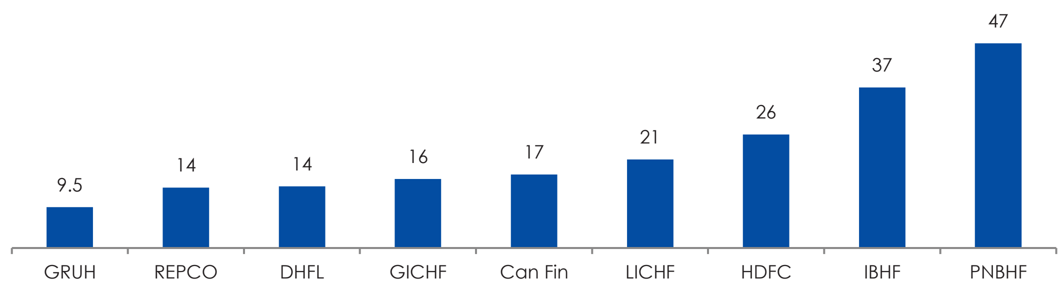
Average Ticket Size is a key metric from the perspective of HFCs as it gives us a sense of the degree of applicability of CLSS to their respective loan books. CLSS was applicable to the EWS and LIG income segments to begin with and MIG-I and MIG-II income segments have been included as well (Dec 2016). As on date, the inclusion of MIG-I and MIG-II segments stands till the end of FY19. The Eligible Loan Amount for CLSS also varies concomitantly with the specific income group. In other words, the smaller the Average Ticket Size for an HFC, the greater the proportion of customers that would be eligible for CLSS, ceteris paribus.

Contours of CLSS across Income Groups

	EWS	LIG	MIG - I	MIG - II
Household Income (INR lacs)	0 to 3	3 to 6	6 to 12	12 to 18
Interest Subsidy (% pa)	6.5%	6.5%	4%	3%
Maximum loan tenure	20 years	20 years	20 years	20 years
Eligible Loan Amount (INR lacs)	6	6	9	12
Dwelling Unit Carpet Area	30 sqm	60 sqm	120 sqm	150 sqm
Discount Rate for NPV (% pa)	9%	9%	9%	9%

Source: NHB

Average Ticket Size – Q1FY18



Source: Company data; Reasonable approximations made in some names

For the chart above, Average On-book Ticket sizes have been considered except in the case of Gruh, GICHF and Can Fin Homes, where incremental ticket sizes have been considered. For IBHF and PNBHF, Corporate Mortgages and Construction Finance, respectively, have been excluded from Average Ticket Size calculation and their figures would, otherwise, be higher still.

Can Fin Homes among HFCs whose clients more likely to be eligible for CLSS

As is evident from the comparative chart above, the likes of Gruh, Repco, DHFL, GICHF and Can Fin Homes are particularly focused on small-ticket clients and therefore, a larger proportion of their clients are likely to be eligible for CLSS benefits, ceteris paribus. What this means is that, with increasing awareness, this could incrementally drive loan growth for CFH going forward.

Impact of GST varying amongst players and (impact) to reduce over long-term

GST throws open a Ready to Move In vs Under Construction conundrum and myraid new apsects

Since Under Construction flats fall under the purview of Work Contracts, GST is automatically applicable to flats. While the Union government is mulling applying GST to the Real Estate sector as a whole, thus far, Ready to Move In propoerties are outside the purview of GST. This, in effect, creates a differential tax regime for Under Construction properties vis-a-vis Ready to Move In (completed) properties.

Ready to Move In properties currently in favour due to Home Buyers "seeing"a lower tax rate

For properties not under GST, the pre-existing tax regime of Service Tax at 4.5% and VAT levied at 1-2% (depending on the State) under the Composition Scheme is applicable. Thus, the applicable tax during sale of Ready to Move In properties totals to 5.5-6.5%. In comparison, the applicable tax on Under Construction properties is 12% (effectively) under the current GST regime. This is what the Individual customer "sees" and hence, ceteris paribus, is looking to avoid Under Construction properties when compared with Ready to Move In properties.

Over the long-term, Under Construction properties should not remain under stress

Under Construction properties, in the future, will be able to avail higher Input Tax Credit (ITC) under the GST regime. This aspect is very clearly delineated in a Press Release of the Government of India dated 15th June 2017. The pointers of this Press Release are as given below

1. According to the MoF, the construction of flats, complex, buildings will have a lower tax incidence under GST compared with what they face under the previous tax regime.
2. Central Excise Duty @12.5% on most construction material, VAT on construction material @12.5 to 14.5%, Entry Tax on construction material are all ineligible for Input Tax Credit under Service Tax or VAT. There is cascading effect.
3. These tax costs are passed on by the builder to the home buyer and, as such, these costs are not visible to the latter.
4. The tax charged on the purchase cost is Service Tax @4.5% and VAT @1% under Composition Scheme. In some states, VAT may be levied @2%+ under the Composition Scheme.
5. Under GST, full input credit would be available for offsetting the headline rate of 12%. The input taxes embedded should not form part of the purchase cost for the home buyer.
6. The input tax credits will take care of the headline rate of 12% and hence, refund of overflow of input tax credits to the builder has been disallowed.
7. For Under Construction properties, builders should not ask customers to pay higher tax rate on instalments to be received after implementation of GST.
8. If a builder resorts to such practice, it will be deemed to be Profiteering under Section 171 of GST law.

The Union Government will crack down on Anti-Profiteeting and mulls the NAA

What the above Press Release essentially implies is that Under Construction properties, prospectively, shall have a lower sale price (on which GST would be applicable) compared with the previous tax regime, in which lower ITC benefits were available. It is, of course, imperative that the builders pass on these benefits to the end consumer. The government will ensure this by cracking down on Profiteering and an Anti-Profiteering clause is enhsrined in the GST law itself. In this regard, the Union Government has mulled the National Anti-Profiteeting Authority (NAA), which has already recieved approval from the Union Cabinet.

Differential between Ready to Move In and Under Construction may persist in the near term

While things may sort themselves out over the long-term, at the moment there are several properties which are Under Construction but where significant degree of construction has already been carried out. Here, there may not be adequate ITC available to the builders. At the same time, there is ample Ready to Move In inventory available and ready to be offloaded. So, while over the long-term, every construction will be subject to GST regime (when all current inventory, complete or incomplete will have been offloaded), over the near to medium term, this differential between Ready to Move In and Under Construction may persist. It is not straightforward to provide an accurate timeline as to when things will stabilize. This lack of clarity is probably what explains the general de-rating of the HFC sector, among other reasons, since the implementation of GST on the ground.

Impact on specific HFCs due to GST may vary depending on exposure to Under Construction properties

While the impact of GST on Under Construction properties may persist in the near term, the impact on specific HFCs may differ, depending on the extent to which each lends against Under Construction properties. Here, we differentiate between Self Construction, an activity which, as such, has not been impacted significantly by GST and Under Construction properties being sold by builders.

Impact of RERA on sector is negative for near-term disbursement but transient

Smaller builders are not fully on board with RERA

As one moves lower down the pyramid, the degree of sophistication of the builder drops and so does his ability to comply with the onerous requirements of registering with RERA authority. In fact, the smallest of builders constructing properties on essentially bilateral agreements with end customers, who generally own the land, are nothing but contractors, with least sophistication and ability of quickly adhering to RERA norms. As a result, there is currently a paucity of such small-sized builders who are in positiion to supply flats lower down the pyramid. This, at the margin, is having an impact on disbursements.

Some small-sized builders will be exempt from RERA given they fall below relevant thresholds

Some small-sized builders will naturally be exempted from RERA due to the threshold requirements that make is necessary to register with RERA. The thresholds are simply (1) 500 sqm and (2) 8 house units i.e. where the construction land is 500 sqm or lower and house units to be constructed are 8 units or lower need not register with RERA. These give some proverbial breathing space to contractors operating lower down the pyramid.

Can Fin Homes' loan growth outlook minimally impacted by GST and RERA

To begin, we estimate an outsized INR 68 lac cr opportunity for Housing loans. Secondly, Can Fin Homes falls in a ticket size sweet spot from a CLSS perspective (discussed in the previous section). Thirdly, and importantly, Can Fin Homes' growth outlook has not been derailed by the key regulatory changes viz. GST and RERA.

Can Fin Homes hardly funds Home Buyers buying Under Construction properties

Can Fin Homes' loan book exposure to Under Construction properties being built by Builders is less than 1%. This means that the near to medium term impact on Under Construction property sales is not something that impacts Can Fin Homes, as such.

RERA may have impacted Can Fin Homes at the margin but nothing significant

As discussed previously in this report, builders who are less sophisticated have found registering with RERA authorities onerous. This may have impacted Can Fin Homes' disbursements at the margin but we do not think the impact would be significant.

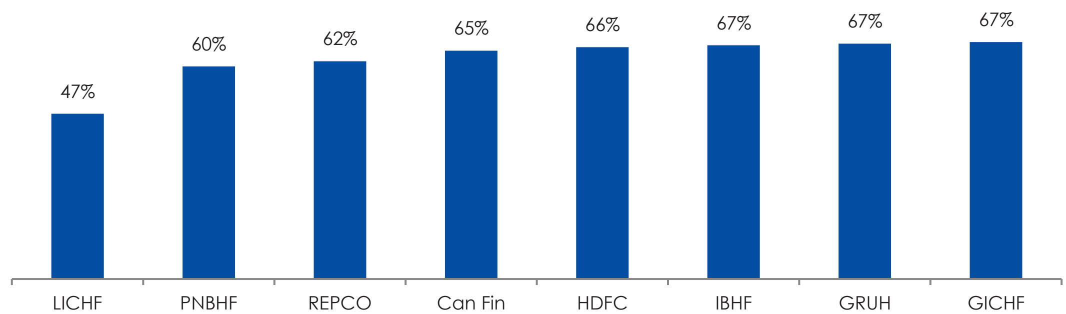
It is interesting to note that while Can Fin Homes focuses on small ticket lending, it has a Tier 1 focus. C.90% of loan book is from Tier 1 centres. So, the level of sophistication of the type of builders that Can Fin Homes' customers work may be reasonably good and they may not necessarily going unregisterd with RERA authorities in a very significant way. It may noted that the yoy loan book growth for Can Fin Homes at the end of Q2FY18 was a reasonable 21%. It cannot be said that that Q2FY17 was a low base since it was the quarter prior to Demonetisation and hence, this growth delivery reasonable on the part of Can Fin Homes, given it came in Q2FY18, when teething problems related to GST were at their peak.

Can Fin Homes' Loan to Value (LTV) Ratio is reasonable

LTV is a key metric to gauge risk management practices

The Loan to Value (LTV) Ratio is a key metric to judge the risk management practices of HFCs. A high LTV may indicate a propensity to generate higher topline, ceteris paribus, by an HFC while not paying adequate heed to risk aspects.

Overall LTV (Loan to Value) Ratio – Q1FY18



Source: Company data; Reasonable approximations made in some names

In the chart above, the overall on-book LTV has been considered except for LICHF, for which incremental LTV has been considered. For PNBHF and IBHF, the LTV has been calculated excluding Construction Finance and Corporate Mortgages, respectively. PNBHF and Repco figures are for Q2FY17 and the Gruh figure is for FY16.

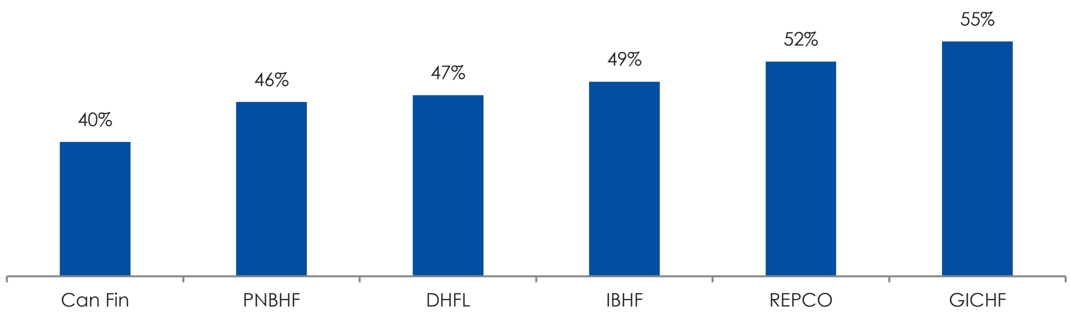
Can Fin Homes strictly follows the policy of calculating LTV based on registered value

It is to be kept in mind that Can Fin Homes strictly follows the policy of calculating LTV on the basis of property value as given in the document of registration. This brings in an element of significant incremental conservativeness as comparedto LTV calculated on the basis of market value.

This is because the value of property in document of registration is generally lower than market value. The property value in the registration document, in fact, is generally close to the Circle Rate / Ready Reckoner Rate of the particular area where the property is located.

Can Fin Homes generally keeps LTV for Home Loans below 70% on the basis of registered property value. For LAP, while a strict cap of 50% is part of the internal rule book for Can Fin Homes, the actual LTV for LAP business is actually kept below a particularly conservative 40%.

LAP LTV (Loan to Value) Ratio – Q1FY18



Source: Company data; Reasonable approximations made in some names

In the chart above, PNBHF and Repco figures are for Q2FY17 and the DHFL figure is for Q3FY17.

LAP LTV for Can Fin Homes is the most conservative among key HFC peers
LAP LTV for Can Fin Homes is as low as 40% compared with 46-55% for key peers and bears testimony to the tight underwriting standards for the company.

Can Fin Homes were not led to hyper-competition in LAP segment

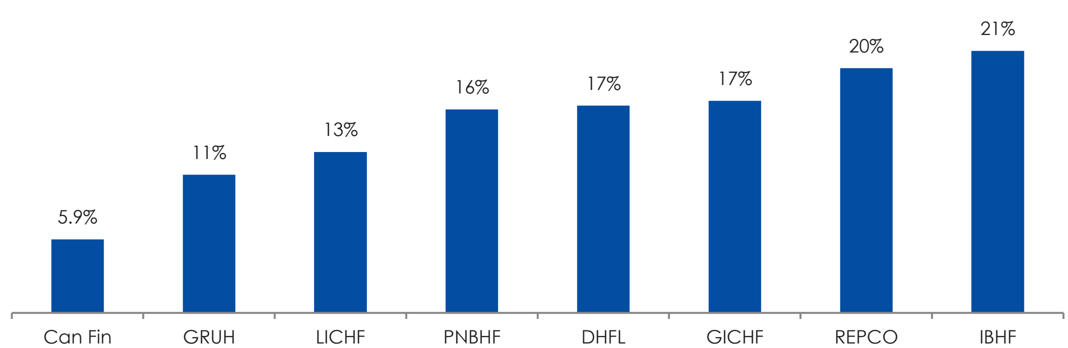
While Client Categories (Salaried vs Non Salaried) are, strictly speaking, something that define "type" of business, in this section, we discuss aspects other than the aforementioned Client Categories.

Loan book exposure to LAP an independent vector in gauging asset quality risk

The first dimension to consider is Home Loan vs Loan Against Property (LAP). A Home Loan is given to a customer to prospectively buy a property whereas LAP is disbursed against property already owned by a customer. Fundamentally, there is no difference in these two categories of loans but the difference has, rather, been created by the treatment of the loan categories by the HFC industry.

LAP is typically disbursed to Non Salaried clients and the typical end-use of the loan is MSME and, as a consequence, the risk in the LAP has been higher than than in Home Loans. Furthermore, due to hyper-competition is the LAP category, there has been a certain extent of dilution in under-writing standards in this category. As a result, loan bok exposure to LAP can be considered as an independent vector of default risk, ceteris paribus.

LAP as a % of Loan book – Q1FY18



Source: Company data; Reasonable approximations made in some names

N.B. GICHF figure is for Q3FY17.

Can Fin Homes has lowest exposure to the LAP segment among HFC peers

Can Fin Homes has a 6% exposure to the LAP sement compared with 11-21% for key HFC peers. It has shown the least propensity to participate in the hyper-competition that ensued in the LAP segment that led to a dilution of underwriting standards in the segment.

Can Fin Homes does not do large-ticket LAP, which is the higher risk business

It has been observed that the business risk is higher for LAP where ticket sizes exceed c.INR 50 lacs. Can Fin Homes does not, as such, do such large-ticket LAP. The incremental averag ticket size for Non Housing Loans (11% of total loans, of which 6% is LAP) is INR 11 lacs for Can Fin Homes. In comparison, the average ticket size for Indiabulls Housing Finance for the LAP business happens to be as much as INR 73 lacs. The average ticket size for Non Housing Loans (54% of which is LAP) for PNB Housing Finance is as much as INR 79 lacs.

Can Fin Homes is a specialist in Individual / Retail Housing Loans

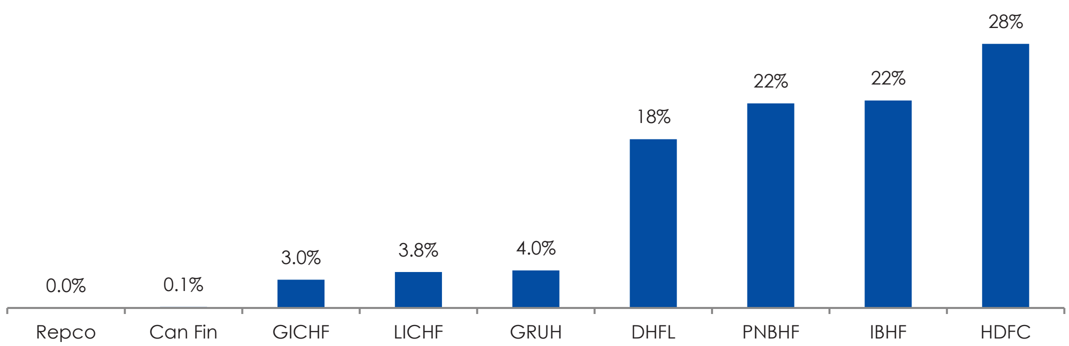
Large-ticket Non-Housing Loans carry different risk compared with Individual Loans

Certain HFCs conduct a variety of other businesses that carry a different nature of risk compared with Individual Housing Loans (Home Loan or LAP). These are (1) Construction Finance (2) Builder / Developer Loans (3) Corporate Mortgages (4) SME (5) Lease Rental Discounting (LRD). These are large ticket in nature and carry different (as such, higher) macro risk than Individual / Retail Housing Loans. Hence, it is necessary to track loan book exposure to Large-ticket Non-Housing loans as a separate metric to gauge extent of loan book risk.

It may be mentioned here that not all LAP loans are small-ticket in nature but we have separately examined LAP exposure earlier. In fact, the larger ticket size of many of the LAP loans implies higher macro risk for such loans and has been a contributing factor to incremental asset quality risk. Asset quality risk has been high as LAP ticket sizes cross the ballpark of c.INR 50 lacs.

At the same time, not all LRD exposure is large-ticket in nature. However, since LRD is generally backed by rent agreements where the tenant is corporate in nature and is generally, large-ticket in nature.

Large-ticket Non-Housing Loans as a % of Loan book – Q1FY18



Source: Company data; Reasonable approximations made in some names

Can Fin Homes has low expsoure to Large-ticket Non-Housing Loans

It is evident from the comparative chart above that the likes of Repco (0%), Can Fin Homes (0.1%), GICHF (3%), LICHF (3.8%) and Gruh (4%) have minimal exposure to Large-ticket Non-Housing Loans and are essentially HFCs that are focused on Individual / Retail Housing Loans. (GICHF figure is from Q3FY17).

Macro risks lower and macro tailwinds support Individual / Retail Housing Loans

Apart from not carrying the macro risk of Large-ticket Non-Housing Loans, the macro tailwinds due to (1) Retail Housing under-penetration (c.95% of Urban housing unit shortfall falls under EWS/LIG) (2) Government support by way of CLSS (EWS/LIG benefits superior to MIG; No benefit to HIG) also apply, as such, largely to Individual / Retail Housing Loans.

Can Fin Homes' displays Cost of Funds leadership due to idiosyncratic factors

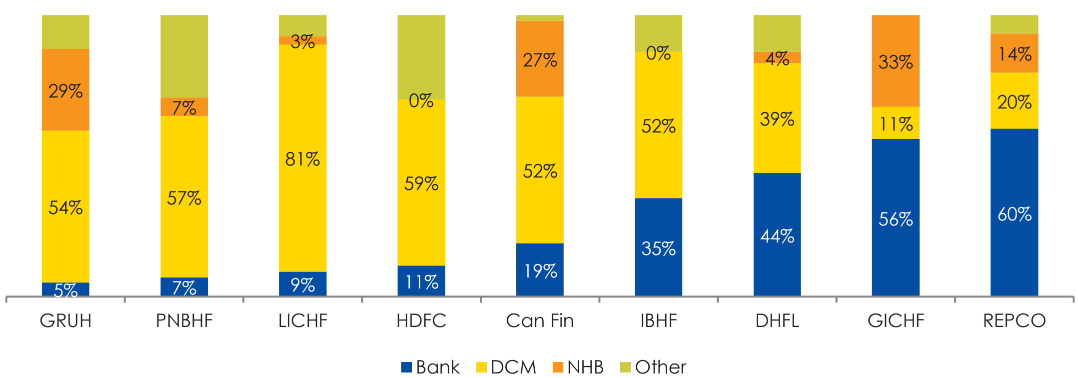
Optimal Funding Mix for an HFC an exercise in optimisation

A key aspect of an HFC's competitiveness is its Cost of Funds, which is a function of its Funding Mix, among other factors. The optimal Funding Mix adopted by an HFC is an exercise in optimisation. Funding cost is generally lower in the Debt Capital Market (DCM) as compared with Bank funding and, in order to better access (i.e. at lower cost) the DCM, the credit rating (and general creditworthiness) of an HFC has to be superior. Credit rating is primarily a function of asset quality, among other factors. Asset quality, in turn, is dependent on client category focus.

Business mix optimisation needs to be carried out with a view to maximising return ratios

By focusing on client categories that are generally lower risk, ceteris paribus, viz. Salaried as opposed to Non Salaried, Home Loans as opposed to LAP and Individual / Retail as opposed to Large-ticket Non-Housing, an HFC can keep asset quality in control. This would lead to superior credit rating and generally lower Cost of Funds. However, this approach would also, ceteris paribus, cause an HFC to sacrifice on yield on the asset side. Hence, the need for an optimal approach in this regard.

Funding Mix for HFCs – Q1FY18

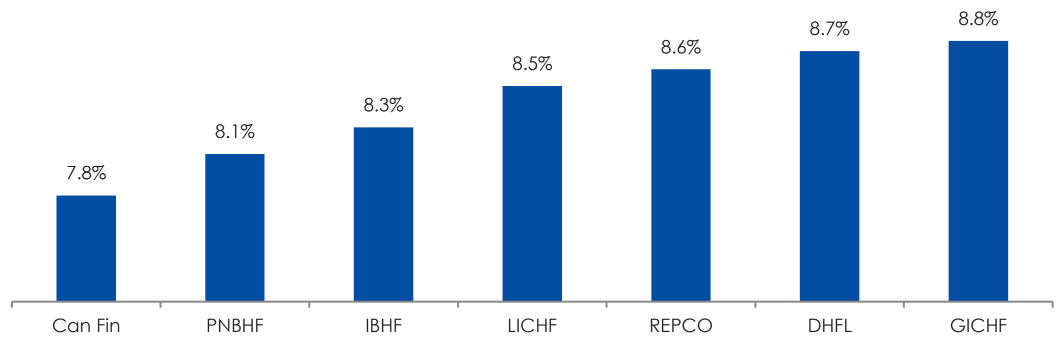


Source: Company data; GICHF figure from Q4FY17

Can Fin Homes has low dependance on higher cost Bank Funding

The likes of Gruh (5%), PNBHF (7%), LICHF (9%), HDFC (11%) and Can Fin Homes (19%) have low dependence on Bank Funding. This generally helps these entities to keep their Cost of Borrowings low and remain, on balance, more competitive on lending rates, especially for Salaried clients.

Cost of Borrowings for HFCs – Q1FY18



Source: Company data; GICHF figure is for FY17

Can Fin Homes has the lowest Cost of Borrowings among key HFC peers

Can Fin Homes's Cost of Borrowings at 7.8% is the lowest among key HFC peers whose Cost of Borrowngs ranges betwee 8.1-8.8%. There are several reasons behind this.

Can Fin Homes has been able to successfully access Debt Capital Markets

Can Fin Homes is AAA rated and is able to access Debt Capital Markets as per need. As much as 52% of Q1FY18 funding is derived from Debt Capital Markets. The degree of access to DCM, however, is not unique to Can Fin Homes. In fact, all HFCs disscussed in this report, aside of Repco Home Finance and GIC Housing Finance, are AAA-rated. Consequently, only GICHF (11%), Repco Home Finance (20%) and DHFL (39%) have comparably lower access to DCM, when compared with DCM.

Nevertheless, the actual pricing achieved when an HFC accesses the DCM also depends on the market perception of the credit risk associated with the HFC. For example, the average Cost of DCM Borrowings for DHFL for Q1FY18 was 8.75% whereas that for LICHF was 8.57%. For Can Fin Homes, the average Cost of DCM Borrowings is as low as c.7.75%.

The latest NCD borrowing for Can Fin Homes, in fact, was carried out at 7.42%. Furthermore, the repayment term for this borrowing is on single annual payment basis. In comparison, NCD borrowings could have monthly repayment terms. For example, for a monthly repayment NCD to be economically equivalent to a 7.42% annual repayment NCD, it would need to have a headline borrowing cost of c.7.1%.

There is no shortage of cheap Bank funding lines for Can Fin Homes due to its parentage
Can Fin Homes's parent is Canara Bank, one of the leading PSU Banks in India with reasonably strong banking relationships being an important part of the banking eco-system as such. Consequently, Can Fin Homes has strong access to Bank Funding lines from across the Banking system. As a result, the average Cost of Bank Borrowings is slightly below 8% for Can Fin Homes. In comparison, the same is 8.77% for DHFL in Q1FY18 and 8.32% for LICHF.

Can Fin Homes is able to do business that NHB lends at cheaper rates for
Overall share of NHB funding for Can Fin Home is reasonably high at 27% of Q1FY18 funding mix. Only Gruh Finance (29%) and GIC Housing Finance (33%) have a higher share of NHB funding. Vanilla funding from NHB at standardised rates does not provide a great advantage as NHB's rates are similar to generic Bank Borrowing.

However, for certain specific schemes, the interest rate at which the NHB lends to HFCs is much lower. These are the Rural Housing Fund scheme and the Urban Housing Fund scheme and the interest rates applicable under these funds is as low as 4.86%. The loan book exposure to these schemes for Can Fin Homes is c.10%, which enables Can Fin Homes to incrementally lower its Cost of Borrowings.

Being a Deposit-taking NBFC, Can Fin Homes is able to raise cheap Instituional Deposits
Can Fin Homes is a deposit-taking NBFC. Raising deposits from the general public may not be attractive given that one has to build a public deposits franchise using physical infrastructure and also provide SLR on such deposits. However, raising Corporate Deposits is attractive since the Cost of Borrowing for these is similar to the Commercial Paper rates of c.6.5%.

This, however, is a small portion of Funding at about 2% of overall mix and has remained so over the past one year. This is because these instuments can be redeemed early by the investors and Can Fin Homes does not wish to keep liqudity risk beyond a point.

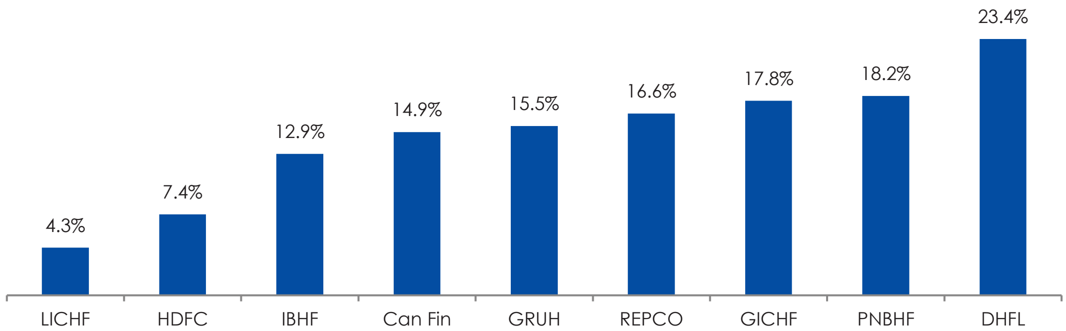
Can Fin Homes' foremost concern is long-term risk management even while managing funding
While Can Fin Homes can take share of DCM much higher than the 52% share in Q1FY18, it is comfortable with the current ballpark as excessive dependence on DCM can become a trap. Interest rates, theoretically, could fall further and then an HFC would be forced to redeem borrowings early with a view to repricing them lower but this may not easy to execute in the open market.

Can Fin Homes' doing a superlative job of Opex control

Can Fin Homes' Cost to Income Ratio is among the best for major HFCs

Aside of LICHF and HDFC Limited, which have essentially non-replicable idiosyncratic factors working in their favour, Can Fin Homes has the best Cost to Income Ratio among major HFCs, barring IBHF.

Cost to Income Ratio for HFCs – Q1FY18



Source: Company data; LICHF, HDFC numbers are for FY17

Both LICHF and HDFC Limited have large external workforces of related party companies originating loans for them at a minimal cost. In LICHF's case, the vast individual agency network of its parent LIC, whose employee expenses, as such, are booked on the parent's P&L, originate loans for LICHF at a very low cost. Similarly, for HDFC Limited, the employees of its associate company, HDFC Bank, have a similar role to play. With 21% stake in HDFC Bank, most of the salary expenses for such employees are not consolidated in to the parent's P&L.

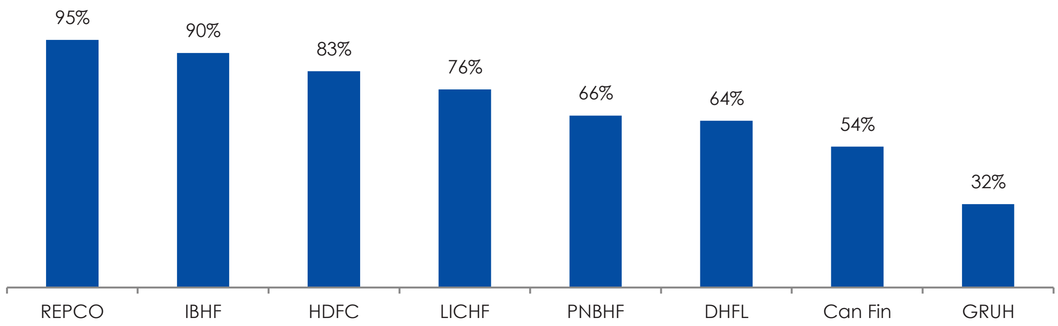
Aside of such companies with largely non-replicable advantages, the Cost to Income Ratio of Can Fin Homes is among best-in-class.

Proportion of "Internal" Sourcing a monitorable with regard to Opex

A key parameter in understanding opex is the extent to which an HFC is able to source loans "internally" through "in-house" channels. As such, we consider any channel of on-roll employees or those of related parties (and not likely to charge high commission rates) as "internal". Hence, we regard LIC individual agency force and HDFC Bank employees, in this regard, as internal from the perspective of LICHF and HDFC, respectively.

The "External" sourcing channel is typically Direct Selling Agents, popularly abbreviated as DSAs. These are entities external to the HFC and gneerally charge higher commission rates. From a nomenclature perspective, it is important to differentiate between a "direct sales" team, which is internal to an HFC and a DSA.

Proportion of "Internal" Sourcing for HFCs – Q1FY18



Source: Company data; Reasonable approximations made in certain names

In the above chart, the DHFL figure is for FY17, the Gruh Finance number is 100% less the share of Gruh Referral Associates for FY17 Retail Disbursements and for Repco, the FY17 Annual Report states that the share of DSA is less than 5%.

There is merit in outsourcing to DSAs and Can Fin Homes benefits from it

From the chart above, there does not seem to be an exact case by case correlation between the headline "Internal" Sourcing number with Cost to Income Ratio. For instance, the share of Internal Sourcing is low for Can Fin Homes and Gruh Finance but their Cost to Income Ratios are also reasonably low. This means that there is merit in outsourcing the task of sourcing to low cost DSA, especially in the example of Can Fin Homes and Gruh Finance.

Obviously, the nature of the Internal Sourcing for HDFC and LICHF is also key. The LIC parent and HDFC Bank associate employees are altogether not on the rolls of the respective HFCs.

In IBHF's case, a key advantage is their success in sourcing loans through the internet. The share of eHome Loans for IBHF is 20%.

Key Metrics

	FY15	FY16	FY17	FY18E	FY19E	FY20E
Net Interest Income	178	301	422	531	668	859
Other Income	29	39	47	63	85	114
Total Income	207	340	469	594	753	973
Operating Expenses	53	67	81	91	115	144
Pre-Provisioning Operating Profit	154	273	388	503	638	830
Provisions excl for Tax	16	19	19	29	34	41
Profit Before Tax	137	254	370	474	604	788
Profit After Tax	86	157	235	324	403	525
Basic EPS	6.48	11.80	17.68	22.79	28.35	37.01
P/E	73.2	40.2	26.9	20.8	16.7	12.8
Book value per share	58.0	66.0	80.9	124	150	184
P/B	8.2	7.2	5.9	3.8	3.2	2.6
Provisions on Average Advances	0.23%	0.20%	0.16%	0.19%	0.18%	0.17%
GNPA Ratio	0.17%	0.19%	0.21%	0.25%	0.30%	0.35%
NNPA Ratio	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
C/I Ratio	25.6%	19.6%	17.2%	15.3%	15.3%	14.8%
Yield on Average Interest Earning Assets	11.08%	10.95%	10.80%	10.38%	10.38%	10.39%
Cost of Average Interest Bearing Liabilities	9.65%	8.84%	8.29%	7.79%	7.79%	7.79%
Net Interest Margin	2.50%	3.16%	3.49%	3.51%	3.51%	3.51%
Return on Average Assets	1.21%	1.65%	1.94%	2.12%	2.08%	2.12%
Return on Average Equity	14.1%	19.0%	24.1%	22.8%	20.7%	22.1%

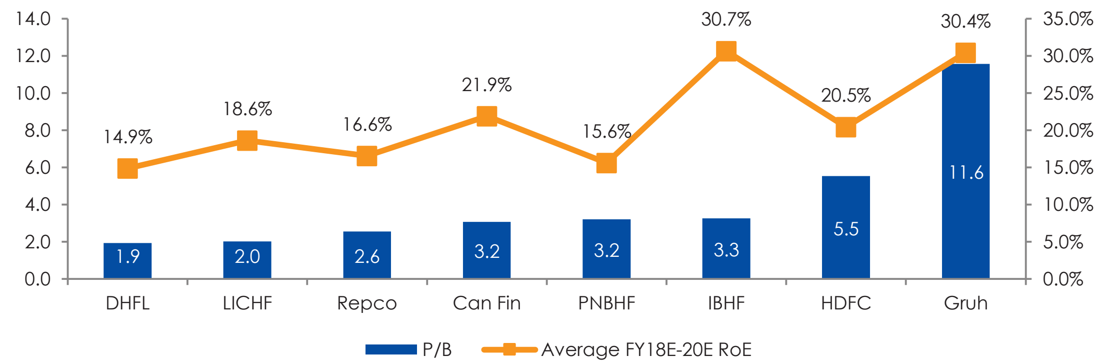
Valuation

We use the Residual Income Valuation Model to value Can Fin Homes. We assume a long-term risk-free rate of 7% for India, a Beta of 1.14 for Can Fin Homes and an India Equity Risk Premium of 6% and arrive at an overall Cost of Equity of 13.8% for Can Fin Homes. We arrive at a price target of INR 588, at which the stock will trade at 3.9x FY19E book value.

At CMP, Can Fin Homes trades at P/B of 3.2x FY19E book, which we believe is attractive given FY18E-20E RoE of 21-23%. Consequently, we believe the multiple of 3.9x implied by our price target of INR 588 is reasonable.

The stock trades at P/E of 16.7x FY19E EPS for FY17-20E EPS CAGR of 28%. Hence, we conclude that Can Fin Homes is attractive from P/E basis as well.

Valuation comparison of Can Fin Homes with HFC peers



Source: Bloomberg (for peers), Edelweiss Investment Research

PNB Housing Finance trades at 3.2x FY19E book for an average FY18E-20E RoE profile of 16%, which is significantly lower than the average FY18E-20E RoE profile of 22% for Can Fin Homes.

As such, given lower risk on all fronts, we believe Can Fin Homes deserves to trade at our FY19E target P/B multiple of 3.9x.

Financials

Income Statement (INR cr)

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Interest income	1,044	1,306	1,570	1,976	2,542
Interest charges	743	884	1,039	1,308	1,683
Net interest income	301	422	531	668	859
Other income	39	47	63	85	114
Net revenues	340	469	594	753	973
Operating expense	67	81	91	115	144
- Employee exp	33	39	49	62	80
- Depreciation / amortisation	3	4	0	0	0
- Other opex	30	38	42	53	64
Preprovision op. profit	273	388	503	638	830
Provisions	19	19	29	34	41
PBT	254	370	474	604	788
Taxes	97	135	150	201	263
PAT	157	235	324	403	525
Extraordinaries	0	0	0	0	0
Reported PAT	157	235	324	403	525
Basic number of shares (cr.)	13.3	13.3	14.2	14.2	14.2
Basic EPS (INR)	11.80	17.68	22.79	28.35	37.01

Growth Ratios

Year to March	FY16	FY17	FY18E	FY19E	FY20E
NII growth	69%	40%	26%	26%	29%
Net Revenues growth	64%	38%	27%	27%	29%
Opex growth	26%	21%	13%	26%	25%
PPOP growth	78%	42%	30%	27%	30%
Provisions growth	19%	-3%	56%	15%	22%
PAT growth	82%	50%	38%	24%	31%

Operating Ratios

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Yield on Average Interest Earning Assets	11.0%	10.8%	10.4%	10.4%	10.4%
Cost of Average Interest Bearing Liabilities	8.8%	8.3%	7.8%	7.8%	7.8%
Spread	2.1%	2.5%	2.6%	2.6%	2.6%
Net Interest Margin	3.2%	3.5%	3.5%	3.5%	3.5%
Cost to Income Ratio	20%	17%	15%	15%	15%
Tax Rate	38%	36%	32%	33%	33%

Balance Sheet (INR cr)

As on 31st March	FY16	FY17	FY18E	FY19E	FY20E
EQUITY AND LIABILITIES					
Share Capital	27	27	28	28	28
Reserves and Surplus	851	1,050	1,730	2,099	2,590
Total	**878**	**1,076**	**1,759**	**2,127**	**2,618**
Share application money pending allotment:	0.5	0.5	0.5	0.5	0.5
Total Shareholder's Funds	**879**	**1,077**	**1,759**	**2,127**	**2,619**
Long-term borrowings	6,965	8,028	9,980	12,675	16,477
Deferred Tax Liabilities (Net)	57	114	114	114	114
Long-term provisions	70	82	101	129	167
Total Non-Current Liabilities	**7,092**	**8,223**	**10,195**	**12,917**	**16,758**
Short-term borrowings	1,626	3,205	3,985	5,060	6,578
Other current liabilities	1,040	826	1,027	1,304	1,695
Short-term provisions	120	126	157	199	259
Total Current Liabilities	**2,785**	**4,157**	**5,168**	**6,564**	**8,533**
Total Liabilities	**9,877**	**12,381**	**15,363**	**19,481**	**25,291**
Total Equity and Liabilities	**10,756**	**13,458**	**17,122**	**21,608**	**27,910**
ASSETS					
Tangible Assets	9	10	10	10	10
Capital work in progress	0	0	0	0	0
Non-Current Investments	15	16	16	16	16
Deferred Tax Assets (Net)	0	0	0	0	0
Long-Term Loans and Advances	10,617	13,280	16,508	20,965	27,255
Total Non-Current Assets	**10,641**	**13,306**	**16,534**	**20,991**	**27,281**
Cash and Bank Balances	17	20	22	24	27
Short-Term Loans and Advances	98	132	248	273	354
Others	0.2	0.2	319	320	248
Total Current Assets	**115**	**152**	**588**	**617**	**629**
Total Assets	**10,756**	**13,458**	**17,122**	**21,608**	**27,910**

RoAE Decomposition

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Net Interest Income / Assets	2.8%	3.1%	3.1%	3.1%	3.1%
Other Income / Assets	0.4%	0.3%	0.4%	0.4%	0.4%
Net Revenues / Assets	3.2%	3.5%	3.5%	3.5%	3.5%
Operating Expense / Assets	0.6%	0.6%	0.5%	0.5%	0.5%
Provisions / Assets	0.2%	0.1%	0.2%	0.2%	0.1%
Taxes / Assets	0.9%	1.0%	0.9%	0.9%	0.9%
Total Costs / Assets	1.7%	1.7%	1.6%	1.6%	1.6%
Return on Assets	1.5%	1.7%	1.9%	1.9%	1.9%
Assets / Equity	12.2	12.5	9.7	10.2	10.7
Return on Period-end Equity	17.9%	21.8%	18.4%	18.9%	20.1%

Valuation Metrics

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Basic EPS	11.8	17.7	22.8	28.4	37.0
EPS growth	82%	50%	29%	24%	31%
BVPS	66.0	80.9	124	150	184
Basic P/E	40.2	26.9	20.8	16.7	12.8
P/B	7.2	5.9	3.8	3.2	2.6

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Coverage Stock: GIC Housing Finance

Changing gear to drive growth

CMP INR: 425
Target INR: 631
Rating: BUY
Upside: 48%

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Harshit Gandhi
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Bloomberg:	GICHF:IN
52-week range (INR):	623 / 250
Share in issue (Crs):	5
M cap (INR crs):	2,754
Avg. Daily Vol. BSE/NSE :('000):	157
Promoter (%)	42.2

Initiated Date: 7th April 2017

Initiated Price: INR 440

GIC Housing Finance (GICHFL) is a well-capitalised retail HFC with >97% of loans financed to individuals and up to INR 15lakh loans constituting 50% of the loan book. While housing loans account for ~83% of loan book, balance are LAP. The company's risk profile is low and, therefore, it prefers to finance the salaried class, which forms 73% of the loan book; balance loans are to self-employed & non-professionals. In order to minimise risk, GICHFL's LTV is reasonably low—housing loan LTV 70% and 55% for LAP. We believe, the company entails immense potential to outstrip industry growth as: a) it offers insurance for accidents and mortgage property at a low cost; b) it is pursuing rapid branch expansion in unbanked areas; c) the agency force of promoter GIC will help in lead generation for housing loans; and d) it will be one of the biggest beneficiaries, because of its lower ticker size, of government's focus on affordable housing. We re-iterate 'BUY' with target price of INR631, implying an upside of 48% from CMP.

Humungous untapped market and policy push significantly burnish prospects

Fuelled by the huge opportunity pie of housing finance in India, GICHFL has raised its loan growth target significantly—to INR160bn by March 2019 from INR 92.7bn in March 2017, implying 31% CAGR over FY17-19E. To achieve this, management is planning to utilise the expertise of parent GIC's financial advisors to generate leads for housing loans. Ergo, GIC's humungous work force is anticipated to augment GICHFL's housing loan sales in the medium to long term.

Dip in high-cost borrowings and rising share of high-yield loans to boost NIM

GICHFL has been consistently pruning the share of high-cost borrowings and simultaneously increasing the proportion of cheaper sources of funds. The share of high-cost borrowing was 75% in FY15, which fell to 55% in FY17 versus industry average of 25%. Management has guided to cut it to ≤50%. Moreover, the company has increased the share of LAP from 2.1% in FY11 to ~20% in FY17, implying 75% CAGR over FY11-17. Considering the growth potential, we have estimated the company to clock LAP CAGR of 37% over FY17-19E. Since FY12, NIM has increased significantly because of steady decline in high-cost borrowings and rising share of LAP. We envisage steady dip in bank borrowings and rising LAP share to boost NIM to 3.9% over FY17-19E.

Healthy earnings to propel RoAA and RoAE

We estimate GICHFL's earnings to jump significantly over FY17-19E on account of: a) target to double loan book to INR160bn over FY17-19E; b) plan to increase the share of LAP from ~17% to 23%; and c) goal to steadily cut borrowings from commercial banks to ≤50% from 55% in FY17. Ergo, we anticipate, NII and net profit to clock CAGR of 25% and 28%, respectively, over FY17-19E. Hence, we estimate RoAE and RoAA to jump from 18.8% and 1.7% to 19% and 1.8%, respectively, over FY17-19E.

Outlook and valuations: Geared for growth; re-iterate with 'BUY'

At CMP of INR425, we re-iterate on GICHFL with '**BUY**' recommendation. At CMP, the stock is trading at 2.3x and 1.5x FY18E and FY19E, respectively, adjusted book value (ABV), ~36% discount to peers. Based on 2.2x FY19E P/ABV, we arrive at a target price of INR631, implying an upside of 48% from CMP.

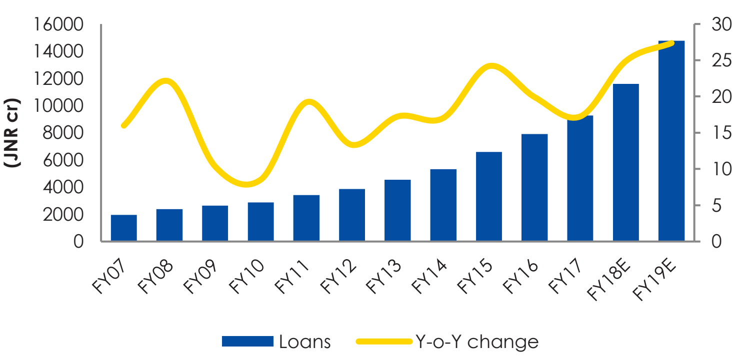
Year to March (INR cr)	FY15	FY16	FY17	FY18E	FY19E
Net Revenue	224	276	334	438	550
Profit after tax	103	125	148	187	256
Basic EPS	19	23	27	35	43
P/E	22.2	18.4	15.5	12.2	9.9
Book value per share	122.6	135.9	155.7	184.5	286.8
P/B	3.5	3.1	2.7	2.3	1.5
RoAE	16.2	17.9	18.8	20.5	19.0

Date: 24th October, 2017

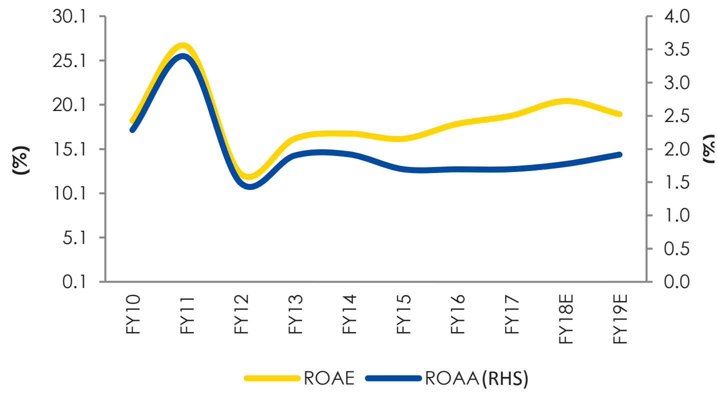
Focus Charts

Average Daily Turnover (INR cr)			Stock Price (CAGR)				Relative to Sensex, CAGR (%)			
3 months	6 months	1 year	1 year	3 years	5 years	10 years	1 year	3 years	5 years	10 years
5.1	4.5	4.8	51%	33%	30%	20%	27%	6%	12%	6%

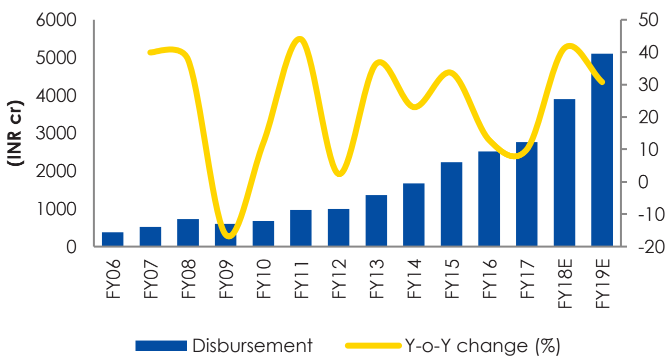
AUM Growth



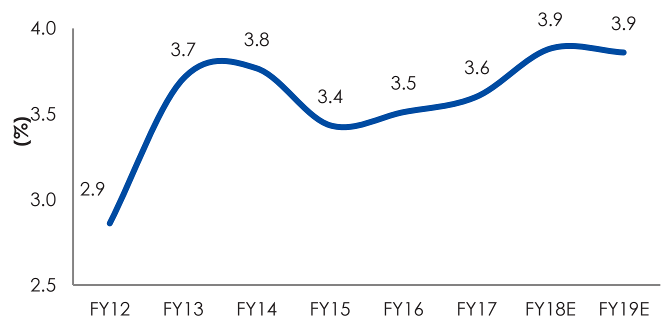
RoAA and RoAE



Disbursement



Net Interest Margin



Source: Company, Edelweiss Investment Research

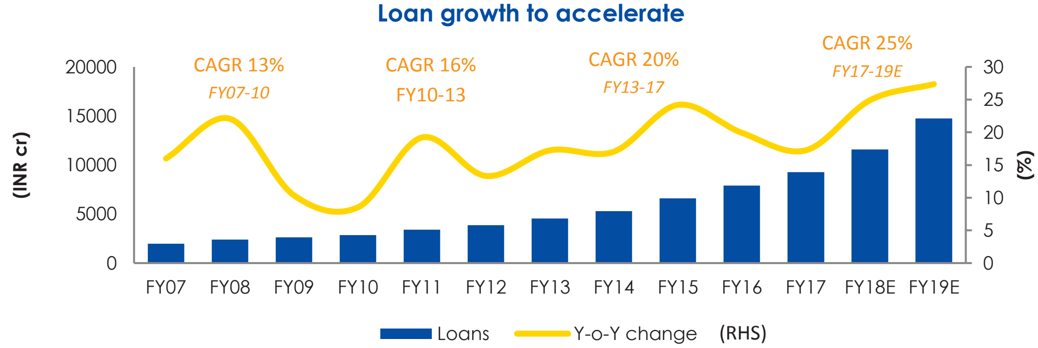
Investment Rationale

I. Humungous untapped market, policy push burnish prospects

Fuelled by the huge opportunity size of housing finance in India, GICHFL has raised its loan growth target significantly—double the loan book to INR160bn by March 2019 from INR92.7bn in March 2017, implying 31% CAGR over FY17-19E. However, we have projected INR 147.6bn, implying 26% CAGR over FY17-19E. The company's loan book grew 17% over FY06-17 and clocked 20% CAGR over FY13-17, in line with the industry average. With an aim to propel its loan book, management is planning to utilise the expertise of parent GIC's financial advisors to generate leads for housing loans. Ergo, GIC's humungous work force is anticipated to augment GICHFL's housing loan sales in the medium to long term.

Other factors that augur well for the company's loan growth are: a) government's subsidy scheme under the Prime Minister Awas Yojana (PMAY) to accomplish the Housing For All By 2022 mission, such as interest subsidy to economically weaker section (EWS) / lower income group (LIG) / middle income group (MIG-I & MIG-II); b) significantly untapped HFC space; c) rising affordability; d) falling interest rates; and e) sustained branch network expansion.

Loan growth to accelerate



Source: Company, Edelweiss Investment Research

a. Subsidy linked subsidy scheme to boost affordable housing demand

Housing shortage in India at the beginning of the 12th Five Year Plan was pegged at 18.8mn units. Of this, 96% shortage pertains to households falling in EWS and LIG segments. In order to provide housing to all by 2022, the Ministry of Housing and Urban Poverty Alleviation (MHUPA) launched the ambitious PMAY scheme in June 2015. Under the scheme, citizens falling under EWS and LIG segments are eligible for housing loan subsidy under the Credit Linked Subsidy Scheme (CLSS) with certain limitations.

i. CLSS: EWS/LIG

Under EWS and LIG, households seeking housing loans for acquisition/construction of houses from banks/HFCs will be eligible for an interest subsidy with the following features.

Particulars	EWS	LIG
Household income (Lakh)	3	6
Interest subsidy	6.5%	6.5%
Maximum loan tenure	15	15
Eligible housing loan amount for Interest subsidy (Lakh)	6	6
Carpet unit (Sq. m.)	30	60
Discount rate for NPV calculation for interest subsidy	9%	9%

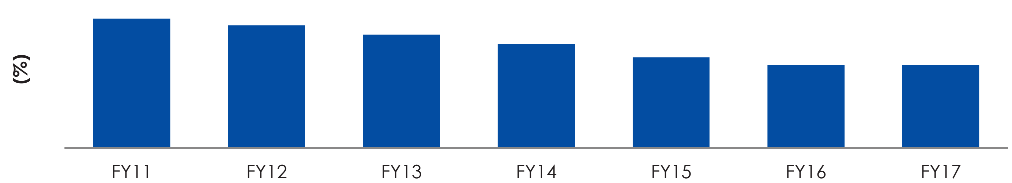
ii. CLSS: MIG

The government has launched CLSS-II under which eligible housing loan amount and household income limit have been enhanced significantly. Initially it was launched for one year but meeting the challenges of housing shortage, Govt. has increased it from Dec. 2017 to March 2019. We believe interest subsidy under MIG-I & MIG-II will continue to accomplish the Housing For All By 2022 mission. Higher loan amount and higher household income limit are positives for GICHFL on account of favourable ticket size and geographical expansion. Following are the features of MIG:

Particulars	MIG-I	MIG-II
Household income (Lakh)	12	18
Interest subsidy	4%	3%
Maximum loan tenure	20	20
Eligible housing loan amount for Interest subsidy (Lakh)	9	12
Carpet unit (Sq. m.)	120	150
Discount rate for NPV calculation for interest subsidy	9%	9%

The average ticket size of GICHFL's housing loan is ~INR1.6mn and INR1.2mn for LAP. The ticket size up to INR1.5mn is ~50% of loan financed. Given the lower ticket size, the company is poised to avail the opportunity of CLSS under PMAY.

Majority loans are of sub-INR1.5mn ticket size

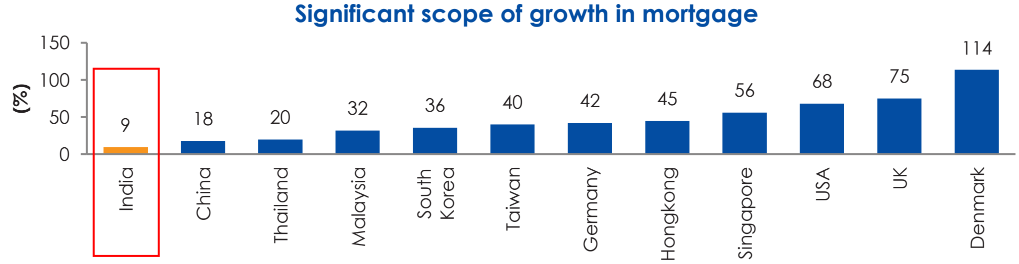


Source: Company, Edelweiss Investment Research

b. Mortgage penetration poised to jump significantly

Mortgage penetration in India is substantially low currently compared to developed and developing nations, entailing humungous scope for growth in demand for housing loans due to: a) interest subsidy by government on affordable housing; b) tax deduction on housing loan is INR2lakh on interest payment and total tax rebate is INR4lakh per annum, includng interest and principal; c) rising affordability; d) rapid urbanisation (currently at ~32%; and estimated to touch 40% by 2030); and e) falling interest rates. In light of these factors, we envisage mortgage penetration in India to catapult going forward.

Significant scope of growth in mortgage

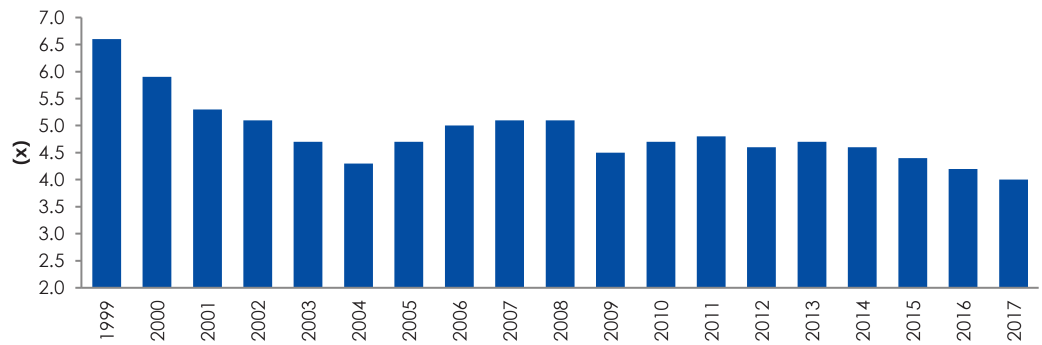


Source: Company, Edelweiss Investment Research

c. Significant spurt in affordability

Over the past few years, housing affordability has jumped significantly on account of buoyancy in individual earnings growth. This is substantiated by a survey of metros and large cities.

Affordability has increased significantly

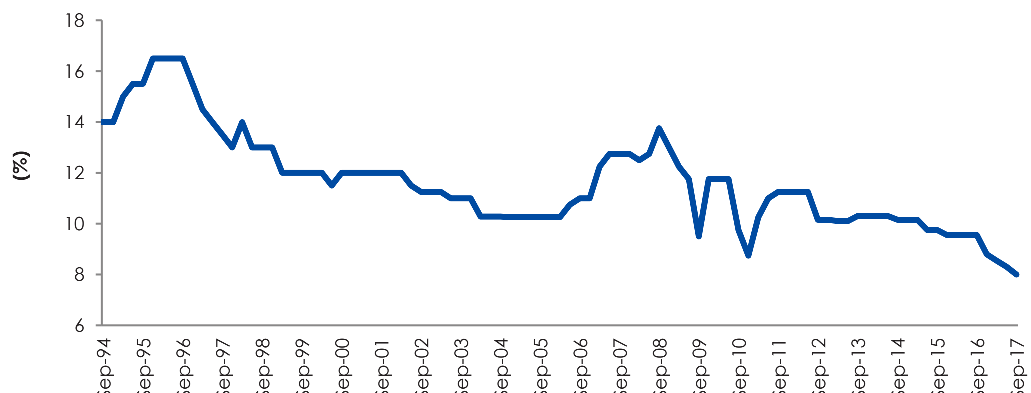


Source: Company, Edelweiss Investment Research

d. Interest rate on housing loans continues to fall

We expect huge demand for housing loans riding falling interest rates, rapid urbanisation, rising disposable incomes, favourable demographics and interest subsidy on affordable housing. Housing For All By 2022, Smart Cities and PMAY are a few initiatives that the government has launched to bridge the housing shortage. We expect short-term demand to be under pressure due to demonetisation, but the 7th Pay Commission payout, interest subsidy on affordable housing and falling house prices are anticipated to bolster demand in the medium to long term.

Home loan interest rate continues to decline

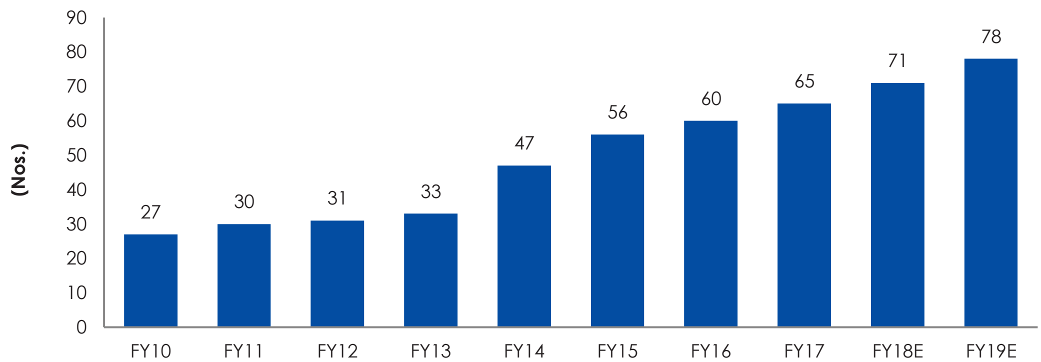


Source: Company, Edelweiss Investment Research

e. Branch expansion to accelerate loan surge

GICHFL believes that branch expansion is essential to accelerate the pace of loan growth. Therefore, it has almost doubled branches to 65 over FY13-17, implying 22% CAGR, while loan growth was 20%. Management has guided to open 5-10 branches per year over the next few years to bolster growth.

Branch expansion spree to sustain

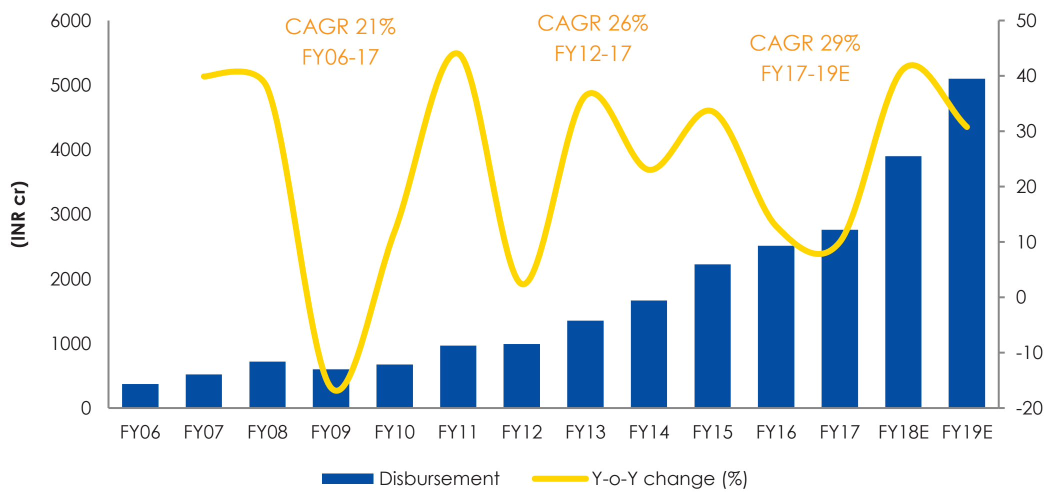


Source: Company, Edelweiss Investment Research

II. Redemptions ahead of schedule moderating; disbursement and loan growth gap to narrow further

GICHFL's redemptions ahead of schedule have moderated significantly in last few years. Therefore, the gap between disbursements and loan growth is expected to dip. While disbursement growth remained buoyant over FY06-17 clocking 21% CAGR, loan growth was 17%. Disbursements jumped 26% over FY12-17 versus loan growth of 19%. The scheduled repayment of principal and interest and redemption ahead of schedule was ~20% in FY14, which moderated to 16.0-16.5%. Moderating redemption ahead of schedule will marginally bridge the gap between disbursements and loan growth. We have estimated disbursement CAGR of 29% and loan growth of 26% over FY17-19E.

Buoyant disbursement growth



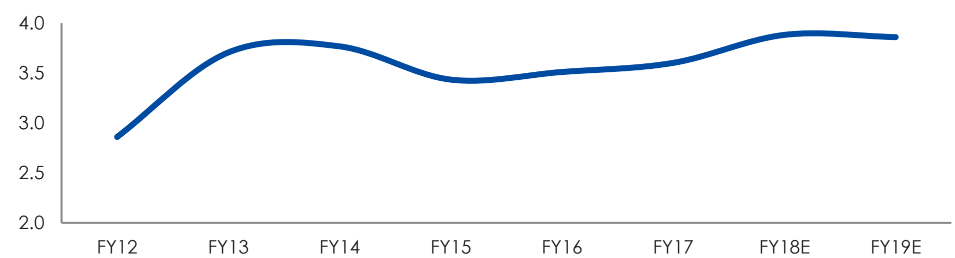
Source: Company, Edelweiss Investment Research

III. Dip in high-cost borrowings, rising proportion of high-yeild loans to boost NIM

GICHFL has been consistently pruning the share of high-cost borrowings. Simultaneously, it has been proportionately increasing the share of cheaper sources of funds, i.e., commercial papers and NHB borrowings. The share of high-cost borrowing was 75% in FY15, which fell to 55% in FY17 versus industry average of 25%. Management has guided to cut it to ≤50% and increase the proportion of cheaper funds.

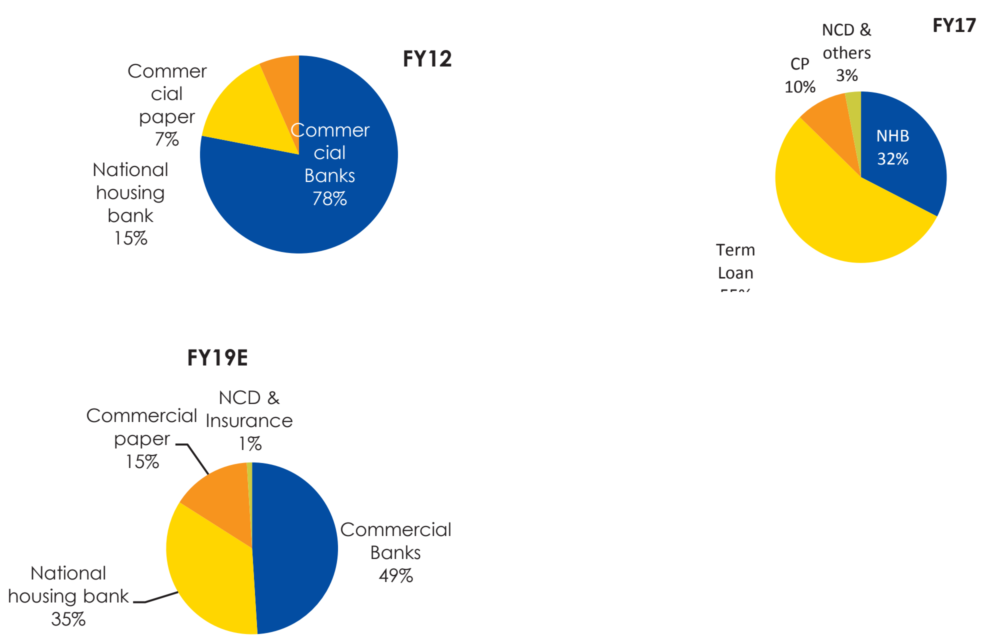
Moreover, GICHFL has increased the share of LAP from 2.1% in FY11 to ~17% in FY17, implying 75% CAGR over FY11-17. Considering the growth potential, we have estimated LAP CAGR of 37% over FY17-19E. Since FY12, NIM has increased signifcantly because of steady decline in high-cost borrowing and rising share of LAP. We believe, steady decline in bank borrowings and rising LAP share will boost NIM to 3.7-3.8% over FY17-19E.

Net interest margin to improve



Source: Company, Edelweiss Investment Research

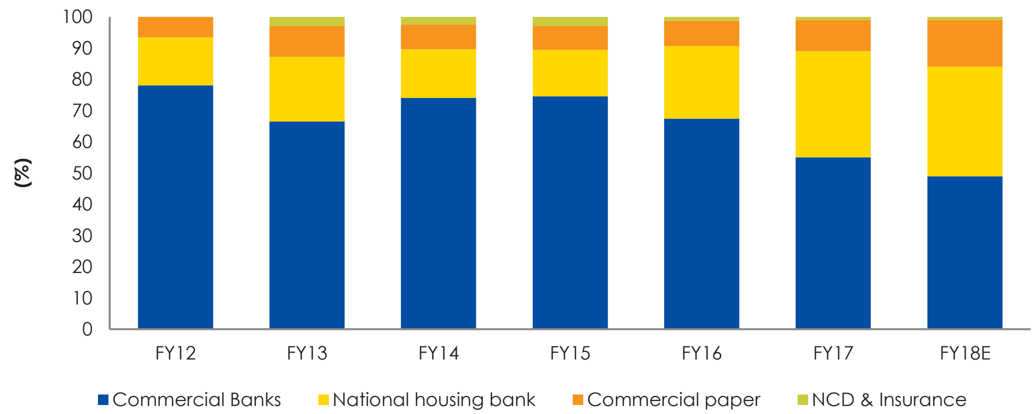
a) Shift in borrowing profile over the period



Source: Company, Edelweiss Investment Research

Borrowing from commercial banks is one of the most expensive sources of funds. Over the past few years, GICHFL has consistenly cut borrowing from banks and we forecast it to be ≤50% by FY18 from 55% in FY17

Share of low-cost borrowing rising consistently

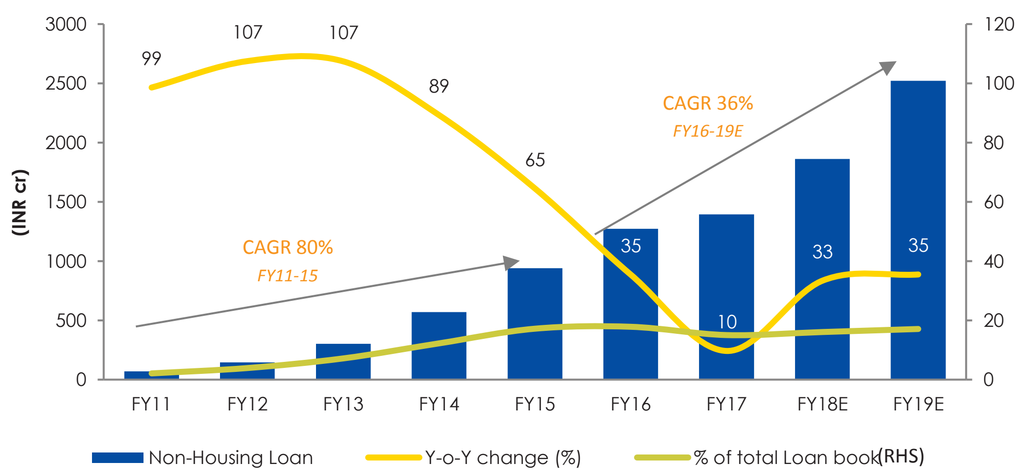


Source: Company, Edelweiss Investment Research

b) Increasing share of high yielding mortgage loans (LAP)

GICHFL has been sharpening focus on non-housing loans (LAP) while keeping risk under control via reasonalbly lower loan to value (LTV), higher share of loans to salaried class and residential property mortgages against LAP. The spread between housing loan and LAP is ~2.5%. Therefore, the company generates higher margin in LAP compared to housing loans. GICHFL reported CAGR of 75% in LAP over FY11-17, which contributed ~17% to its loan book versus 2% in FY11. The industry average of LAP/non-housing loan is ~25% versus GICHFL's 17%. Therefore, incremental scope for growth is huge. Considering the opportunity size, we have assumed 37% CAGR over FY17-19E and consequently LAP proportion will increase to ~25% from ~17% currently. We believe, LAP loans will enhance growth and yield in the medium to long term because of higher yield compared to plain-vanilla housing loans.

LAP to bolster growth



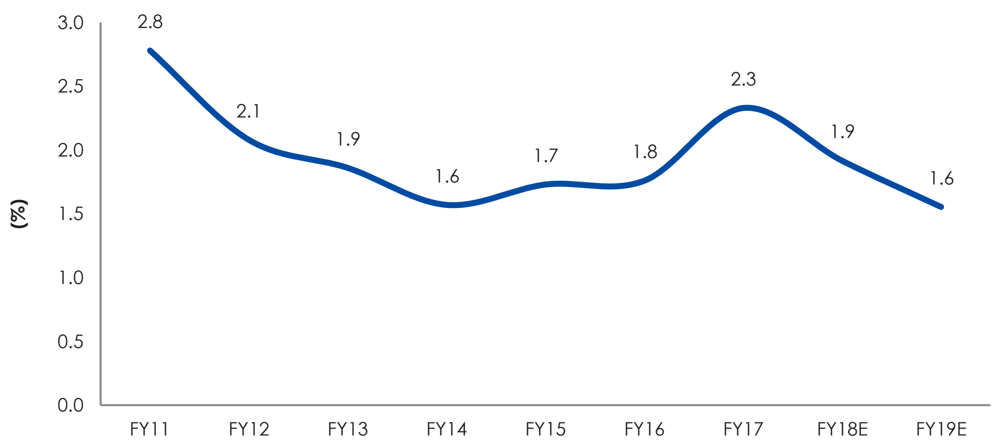
Source: Company, Edelweiss Investment Research

IV. Reversal of stressed assets policy, active recovery bound to bolster asset quality

Asset quality of HFCs is superior compared to other asset financing companies. However, while GICHFL's GNPA was on the higher side compared to other HFCs, its net NPA remained zero because of 100% provisioning. Demonetisation has impacted asset quality across asset financing companies and average slippage run rate for HFCs remained elevated in Q3FY17 & Q4FY17. The impact of demonetisation and transition from cash to non-cash reflected in GICHFL's asset quality as well in H1FY17. Consequently, its GNPA catapulted to 3.03% in Q2FY18. It has not written-off any stressed assets and has not sold any stressed assets to ARC since inception. Consequently, its GNPA has accumulated over the years. At present, management is contemplating stressed assets to sellto ARC, which will be improve the asset quality.

Management is contemplating write-offs and sale to ARC in the near future. Importantly, GICHFL is now focused on active recovery going forward. We believe, the company's asset quality will improve on account of a) expediting recovery and up-gradation procee; b) strengthening credit mechanism process and c) planning to write-off and sale to ARC. Consequently, we forecast GNPA to stablise from 1.9% in FY17, but believe it will improve thereon. In our GNPA assumption, we have not considered any write-offs and sale to ARC. The asset quality will improve significanlty in due course if stressed assets are either written off or sold to ARC or both.

Asset quality to improve

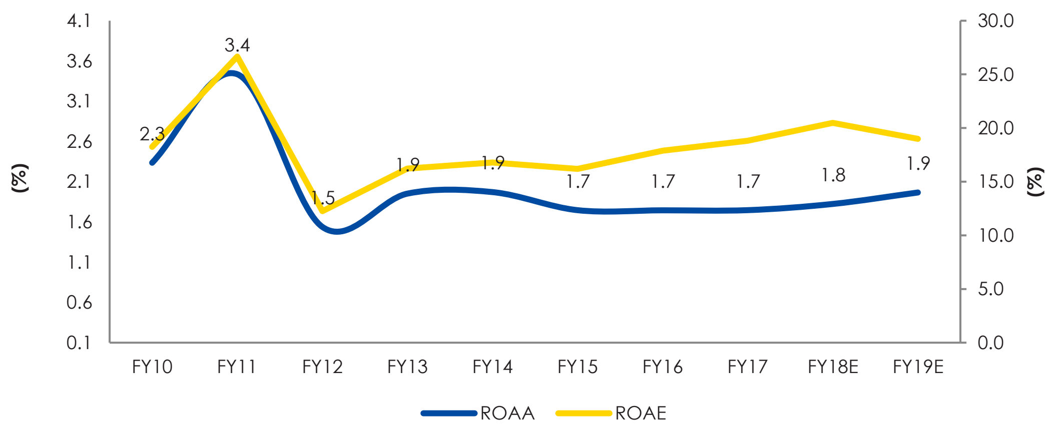


Source: Company, Edelweiss Investment Research

V. Healthy earnings to boost RoAA and RoAE

We estimate GICHFL's earnings to jump significantly over FY17-19E on account of: a) target to double loan book to INR160bn over FY16-19; b) plan to increase the share of LAP from ~17% to 25%; and c) goal to steadily cut borrowings from commercial banks to ≤50% from 55% in FY16. **Ergo, we believe, NII and net profit will clock CAGR of 25% and 28%, respectively, over FY17-19E. Hence, we expect RoAE and RoAA to improve from 18.8% and 1.7% to 19% and 1.8%, respectively, over FY17-19E.**

RoAA/RoAE to improve



Source: Company, Edelweiss Investment Research

RoAE decomposition (%)

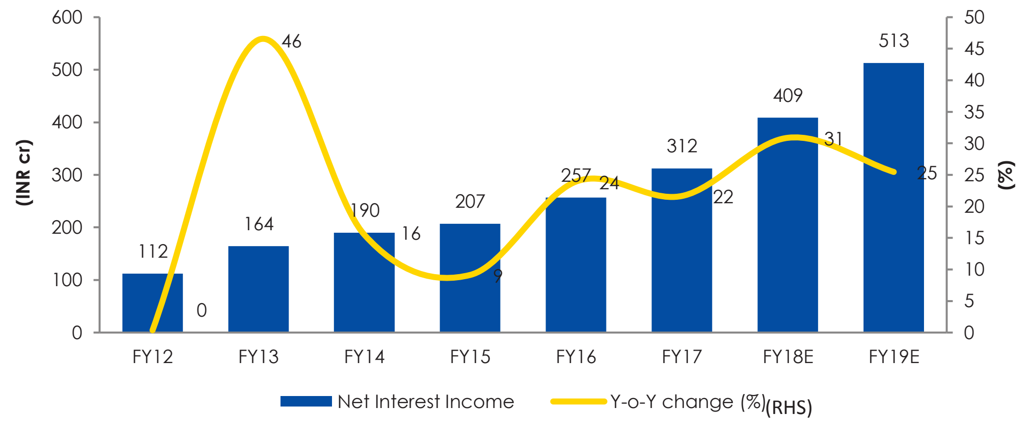
Year to March	FY15	FY16	FY17	FY18E	FY19E**
Net interest income/Assets	3.4	3.5	3.6	3.9	3.9
Other Income/Assets	0.3	0.3	0.3	0.3	0.3
Net revenues/Assets	3.7	3.8	3.9	4.2	4.1
Operating expense/Assets	1.0	0.9	0.8	0.9	0.8
Provisions/Assets	0.2	0.2	0.4	0.6	0.4
Taxes/Assets	0.8	0.9	0.9	0.9	1.0
Total costs/Assets	2.0	2.1	2.1	2.4	2.2
ROA	1.7	1.7	1.7	1.8	1.9
Equity/Assets	11.0	10.0	9.7	9.4	12.8
ROAE	16.2	17.9	18.8	20.5	19.0

** 10% equity dilution

a. NII growth to improve over FY17-19E

GICHFL reported 23% growth in NII over FY12-17 and we have estimated 24% growth over FY16-19 riding: a) significant loan book spurt; b) rising share of LAP; and c) falling share of high-cost borrowings.

Net interest income to grow at a faster clip

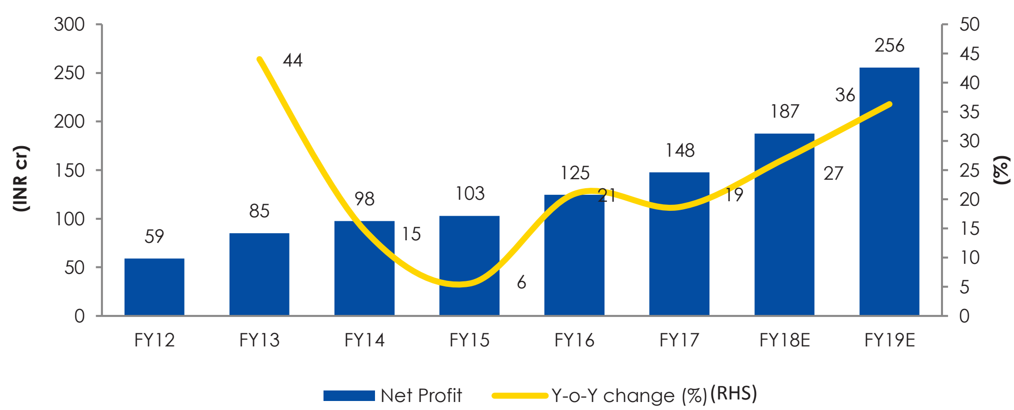


Source: Company, Edelweiss Investment Research

b. PAT growth to accelerate over FY17-19E

GICHFL reported 21% net profit jump over FY12-17 and we estimate 28% growth over FY17-19E on account of: a) marginal improvement in cost-to-income ratio from 22% in FY17 to 21% in FY19E; and b) declining provisions & contingency expenses.

PAT to improve



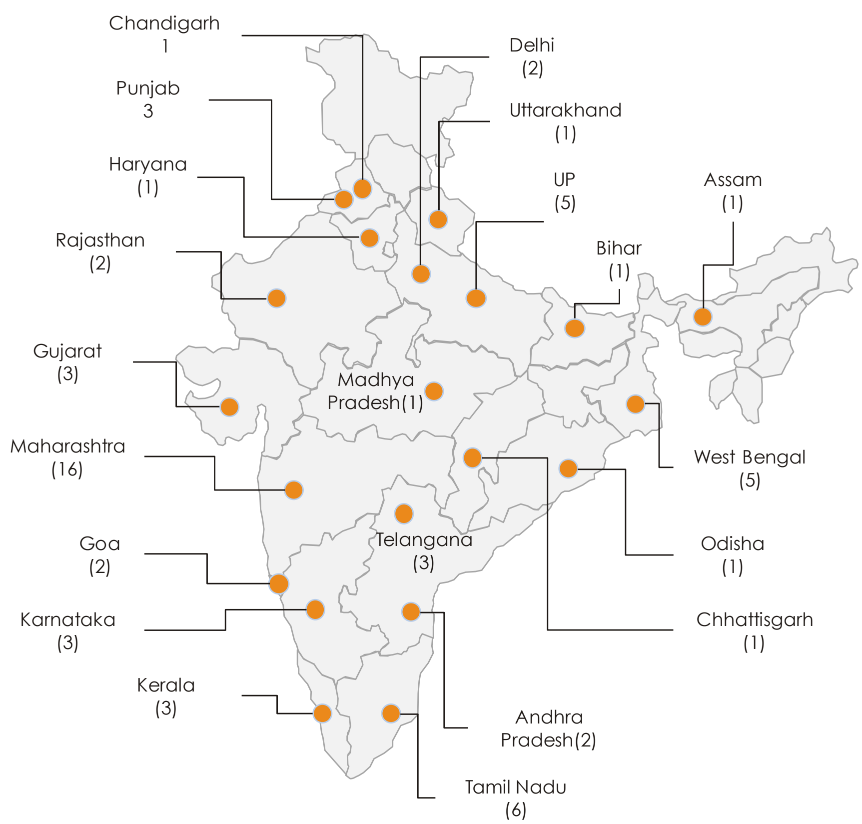
Source: Company, Edelweiss Investment Research

Company Description

GICHFL is a HFC promoted by General Insurance Corporation of India (GIC) and its erstwhile subsidiaries. The company's primary business is granting housing loans to individuals and entities/persons engaged in the construction of houses for residential purposes. It is a leading retail HFC with a loan book of INR92.7bn as of FY17. GICHFL has a strong presence in West India with c.45% plus of total branches, especially in Mumbai & its suburbs; while c.20%plus branches are located in South & North, balance are in the East. GICHFL has sharpened focus on East and South India, where the company has recently opened branches in Guwahati and Calicut, taking its total branch strength to 65 from 60 a year ago. In the past 4 years, the company has doubled its branch strength from 33 to 65 and is planning to open 5-10 branches every year over the next few years.

The company's capital adequacy ratio stands at 17.4% (all tier 1), well above the 12% minimum required level prescribed by the National Housing Bank (NHB). Also, it has not been dependent on tier-II capital for maintaining its capital adequacy ratio.

Geographical presence



Key Risks

Unforeseen NPA accretion in LAP book

LAP has been a higher risk lending area for HFCs since the emergence of hyper-competition in the segment a few years ago and resultant dilution of underwriting standards. Assessment of credit risk in this segment has been more challenging since this segment's marginal borrower has been non-salaried and who generally lacks authentic financial statements such as salary slips and income tax returns. GICHFL's loan book exposure to this segment stands at 17% as of FY17 and is a focus area with an aim to increase its share in the loan book.

Unexpected rise in cost of borrowings

As of FY17, banking funding constitutes 55% of GICHFL's borrowing mix, which is on the higher side. While banks have passed on some of the reduction in key interest rates, the reduction in interest rates seems to have stalled, given sticky core inflation. Furthermore, the expected improvement in credit rating may not materialize and an increase in share of capital market borrowings may not, therefore, work out.

Slower-than-expected loan CAGR

GICHFL may not be able to access captive network of GIC's (parent) financial advisors to generate leads for loans. Furthermore, some of the loan growth hinges on timely opening of branches and they maturing at a reasonable pace, both of which may not pan out as planned.

Valuation

GICHFL is a well capitalised retail HFC with >97% of loan financed to individuals and up to INR15lakh loans constituting 50% of the loan book. While housing loans account for ~83% of loan book, balance are LAP. The company's risk profile is very low and, therefore, it prefers to finance the salaried class, which is 73% of the loan book, and remaining to the self-employed & non professionals (SENP). The average ticket size for housing loan is ~INR16lakh and LAP is ~INR12lakh. In order to minimise risk, GICHFL's LTV is reasonably low—housing loan LTV is 70% and 55% for LAP. Under LAP, the company finances against the residential property instead of commercial property. **In order to minimise risk further, it is mandatory for all borrowers to opt for: a) personal accidental insurance; and b) insurance of mortgage property, while purchase of life insurance is optional**.

We believe GIC has immense potential to outstrip industry growth as: a) it offers insurance for accidents and mortgage property at a low cost; b) it is pursuing rapid branch expansion in unbanked areas; c) the agency force of promoter GIC will help in lead generation for housing loans; and d) GICHFL will be one of the biggest beneficiaries because of its lower ticker size of government's focus on affordable housing.

Also, during a recent media interview, the new CEO & MD outlined a vision wherein he is targeting to double the loan book to INR160bn from INR92.7bn in FY17, translating into CAGR of 31% over FY17-19E. We have projected loan book CAGR of 26% over FY17-19E to INR 147.6bn, while NII, operating profit and PAT are estimated to grow 25%, 26% and 28%, respectively.

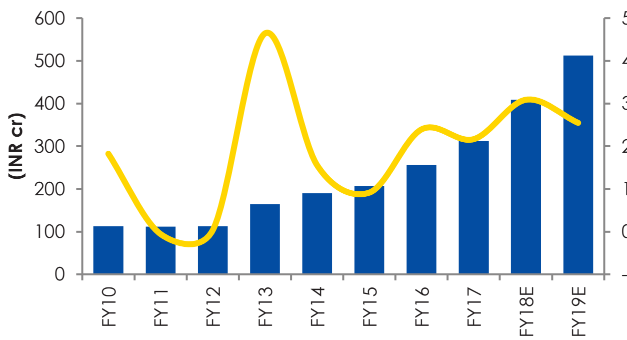
At CMP of INR432, we re-iterate '**BUY**'. At CMP, the stock is trading at 2.3x/1.5x FY18E/FY19E ABV and 12.4x/10.6x FY18E/FY19E EPS, respectively. GICHFL is trading at 36% discount to peers. The stock entails the potential to trade at a higher multiple because of expected improvement in asset quality, higher growth and improvement in profitability. Based on 2.2x FY19E P/ABV (we have assumed 10% equity dilution in FY19), we arrive at target price of INR 631, implying an upside of 48%.

Financial Outlook

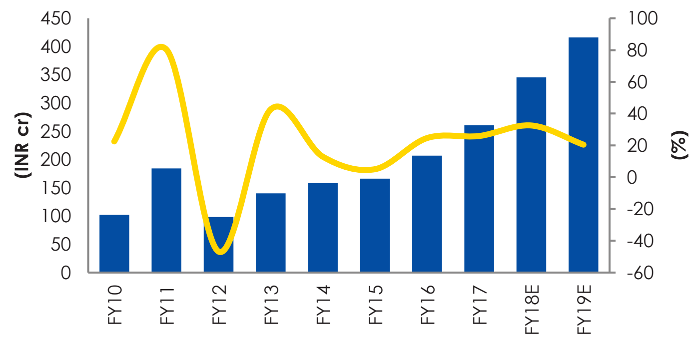
NII and growth to improve over FY17-19E

GICHFL reported 23% growth in NII over FY12-17 and we estimate 25% growth over FY17-19E due to: a) significant growth in loan book; b) rising share of LAP; and c) falling share of high-cost borrowings.

Net interest income to increase at faster clip



Operating profit to augment on account of stable cost to income



Source: Company, Edelweiss Investment Research

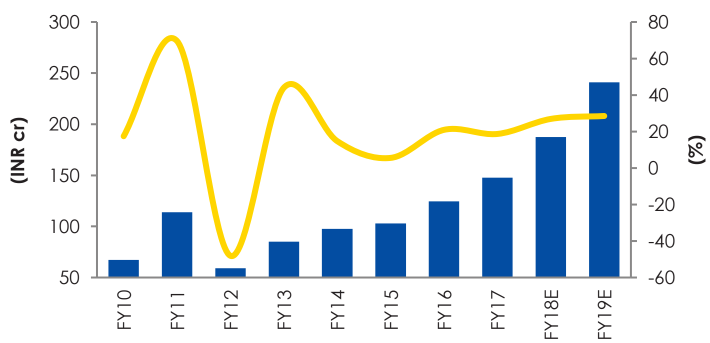
Operating profit and growth to improve over FY17-19E

We believe GICHFL's operating expenses will remain stable due to controlled branch expansion. We have projected 26% CAGR over FY17-19E.

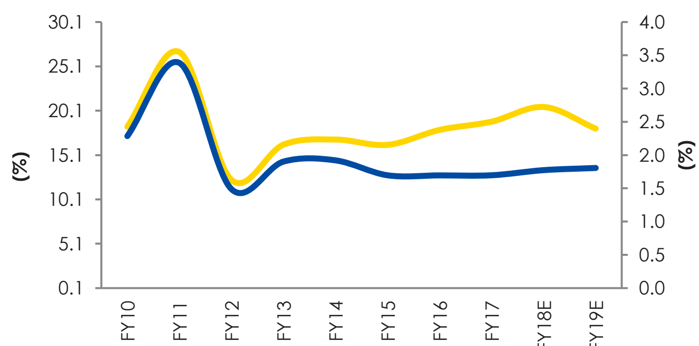
PAT and growth to improve over FY16-19E

GICHFL reported 21% growth in net profit over FY12-17 and we estimate 28% spurt over FY17-19E on account of: a) marginal improvement in cost-to-income ratio from 22% in FY17 to 21% in FY19E; b) declining provisions & contingency expenses; and c) margin expansion.

PAT growth to accelerate



RoAE and RoAA to improve through cost control



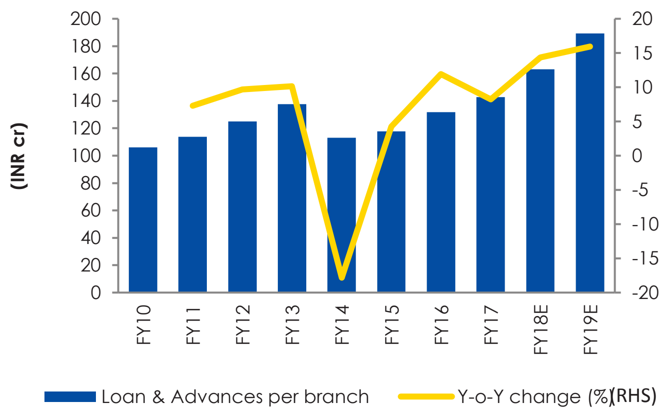
Source: Company, Edelweiss Investment Research

As a result, we expect RoAA and RoAE to jump from 1.7% & 17.9% to 1.8% & 19.9%, respectively, over FY17-19E.

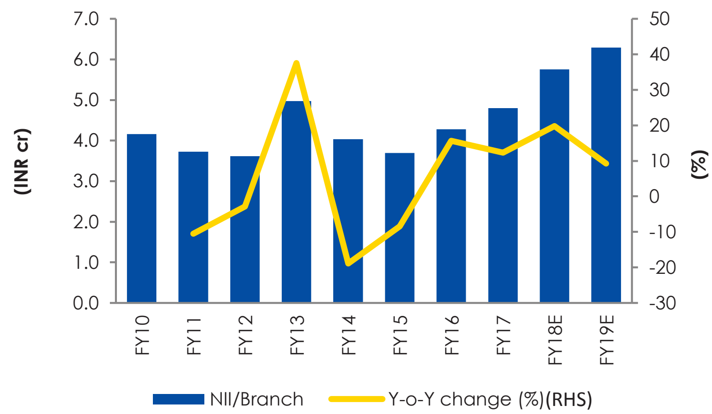
Branch Efficiency to Improve (FY14 had seen massive branch expansion)

We believe overall the branch efficiency will improve from the current level due to change in operational approach following the advent of new management .

Loans per branch to improve

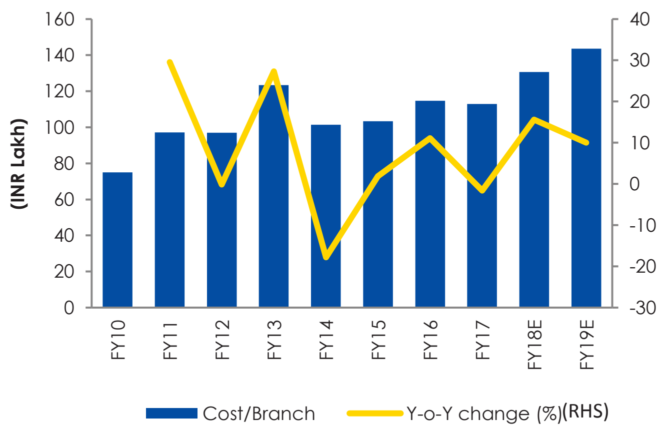


NII per branch to pick-up

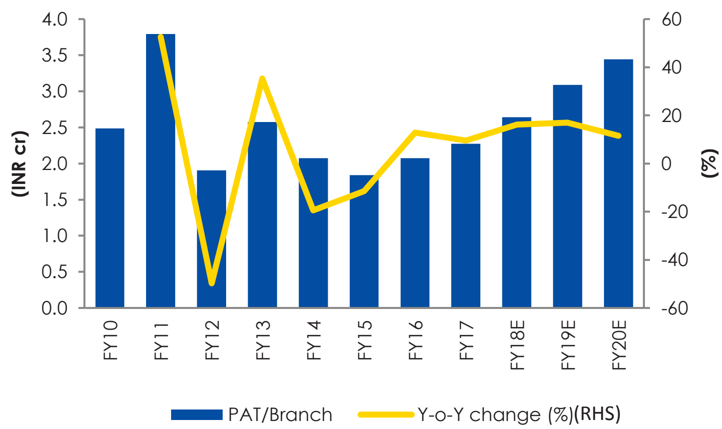


Source: Company, Edelweiss Investment Research

Cost per branch to increase in-line with revenue

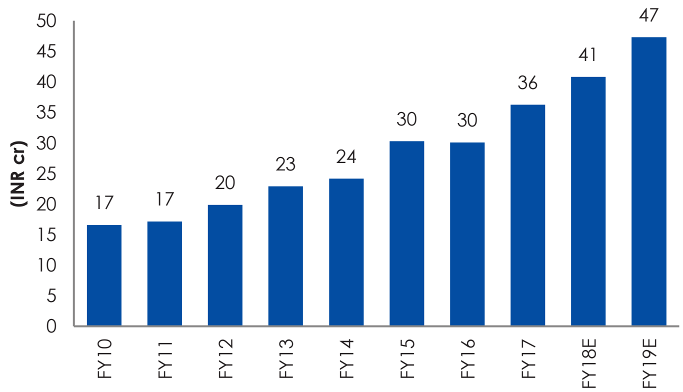


PAT per branch to grow at faster pace on lower provisions and margin expansion

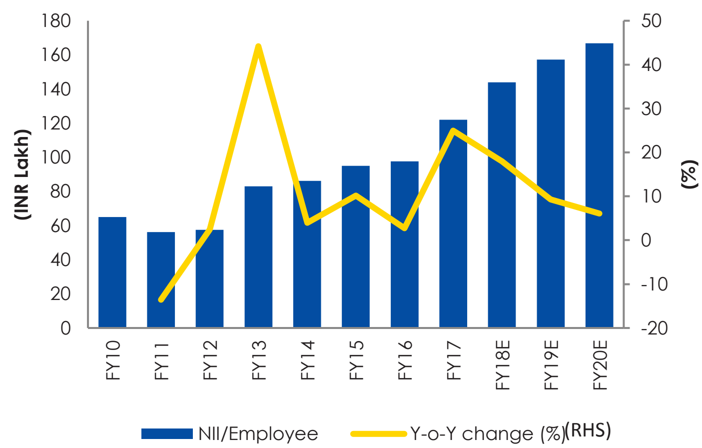


Source: Company, Edelweiss Investment Research

Loan Per Employee to increase steadily

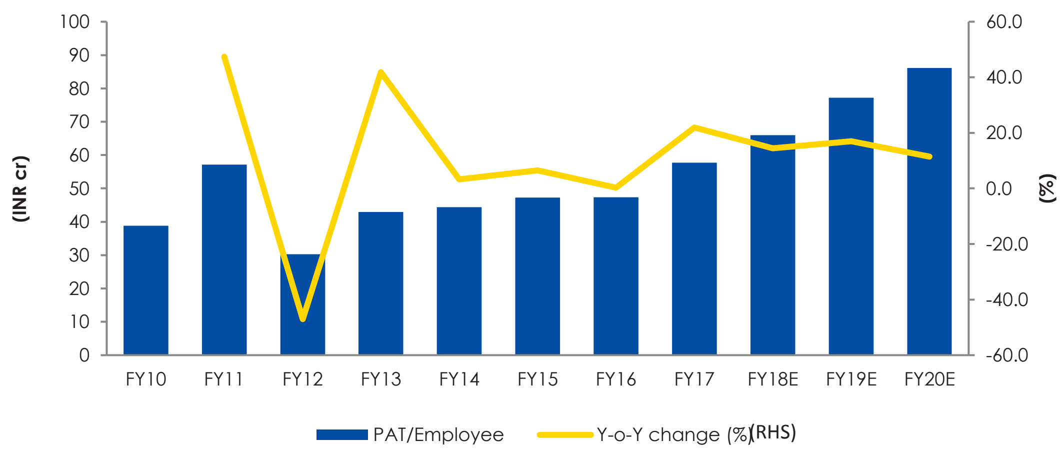


NII per employee to grow consistently



Source: Company, Edelweiss Investment Research

PAT per employee to improve



Source: Company, Edelweiss Investment Research

Financials

Income statement					(INR cr)
Year to March	FY15	FY16	FY17	FY18E	FY19E
Interest income	716	857	980	1,152	1,390
Interest charges	509	601	668	743	877
Net interest income	207	257	312	409	513
Fee & other income	17	19	22	29	37
Net revenues	224	276	334	438	550
Operating expense	58	69	73	93	112
- Employee exp	20	23	26	31	37
- Legal & Professional fees	16	25	26	35	45
- Other opex	23	21	21	27	30
Preprovision profit	166	207	261	345	438
Provisions	12	16	33	63	53
PBT	154	191	227	283	385
Taxes	51	67	79	95	130
PAT	103	125	148	187	256
Extraordinaries	0	0	0	0	0
Reported PAT	103	125	148	187	256
Basic number of shares (mn)	5	5	5	5	6
Basic EPS (INR)	19	23	27	35	43
Diluted number of shares (mn)	5	5	5	5	6
Diluted EPS (INR)	19	23	27	35	43
DPS (INR)	5	5	5	6	6
Payout ratio (%)	26	22	18	17	14

Growth ratios (%)					
Year to March	FY15	FY16	FY17	FY18E	FY19E
NII growth	9.1	23.9	21.7	30.9	25.5
Net revenues growth	8.8	23.2	21.1	31.2	25.6
Opex growth	21.4	19.1	6.6	26.3	20.8
PPP growth	5.0	24.6	25.9	32.5	26.9
Provisions growth	(50.4)	28.3	111.9	87.4	(15.8)
PAT growth	5.5	20.9	18.7	26.9	36.3

Operating ratios (%)					
Year to March	FY15	FY16	FY17	FY18E	FY19E
Yield on advances	11.9	11.8	11.4	11.0	10.5
Cost of funds	9.7	9.4	8.8	8.0	7.5
Spread	2.2	2.4	2.6	3.0	3.0
Net interest margins	3.4	3.5	3.6	3.9	3.9
Cost-to-income	25.8	25.0	22.0	21.2	20.4
Tax rate	33.0	34.9	34.9	33.7	33.7

Balance Sheet					(INR cr)
Year to March	FY15	FY16	FY17	FY18E	FY19E
Paid Capital	54	54	53.9	54	59
Reserve & Surplus	607	678	784	940	1,640
Shareholder's Fund	660	732	838	993	1,699
Total Borrowings	5,794	7,001	8,237	10,258	13,029
Other Liabilities	228	277	329	486	215
Total Liabilities	6,683	8,010	9,404	11,738	14,942
Cash & Bank Balance	42	52	62	76	97
Investment	10	10	26	26	26
Loan & Advances	6,598	7,912	9,277	11,586	14,757
Net Fixed Assets	3	2.16	2.27	2	3
Other assets	31	33	37	46	59
Total Assets	6,683	8,010	9,404.49	11,738	14,942

Balance sheet ratios (%)					
Year to March	FY15	FY16	FY17	FY18E	FY19E
Loan growth	24.2	19.9	17.2	24.9	27.4
EA growth	22.9	19.9	17.5	24.8	27.3
Disbursement growth	33.6	12.9	10.0	41.2	30.8
Gross NPA ratio	1.7	1.8	2.3	1.9	1.6
Net NPA ratio	0.0	0.0	0.3	0.5	0.4
Provision coverage	100.0	100.0	87.6	73.9	74.3

RoE decomposition (%)					
Year to March	FY15	FY16	FY17	FY18E	FY19E
Net interest income/Assets	3.4	3.5	3.6	3.9	3.9
Other Income/Assets	0.3	0.3	0.3	0.3	0.3
Net revenues/Assets	3.7	3.8	3.9	4.2	4.1
Operating expense/Assets	1.0	0.9	0.8	0.9	0.8
Provisions/Assets	0.2	0.2	0.4	0.6	0.4
Taxes/Assets	0.8	0.9	0.9	0.9	1.0
Total costs/Assets	2.0	2.1	2.1	2.4	2.2
ROA	1.7	1.7	1.7	1.8	1.9
Equity/Assets	11.0	10.0	9.7	9.4	12.8
ROAE	16.2	17.9	18.8	20.5	19.0

Valuation metrics					
Year to March	FY15	FY16	FY17	FY18E	FY19E
Diluted EPS (INR)	19.1	23.1	27.4	34.8	43.1
EPS growth (%)	*5.5*	*20.9*	*18.7*	*26.9*	*23.9*
Adjusted BV per share	122.6	135.9	155.7	184.5	286.8
Diluted P/E (x)	22.2	18.4	15.5	12.2	9.9
Price/Adj. Book Value(x)	3.5	3.1	2.7	2.3	1.5
Price/ Earning (x)	22.2	18.4	15.5	12.2	10

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Long Term Recommendation: PNB Housing Finance Ltd

Steller performance to continue

CMP INR: 1344
Rating: BUY
Target Price INR: 1659
Upside: 23%

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PNB Housing Finance (PNBHF) is the fastest-growing and fifth-largest housing finance company in India. The company's outstanding AUM is pegged at INR512bn as on H1FY18 and it has ~5% market share amongst domestic housing finance players. The company offers a bouquet of products for residential and non-residential segments spanning retail housing, construction/developer finance, LAP, LRD, CTL and NRPL. Housing loans constitute ~71% of total loan book, of which retail housing pie stands at 59%. PNBHF is among 18 housing companies which accept deposits, which currently constitute 28% of its total borrowings. The company's loan book grew ≥2.5x industry's average growth over FY12-17 with one of the finest asset qualities in the industry. Management is targeting to grow 1.50-1.75x industry's average growth. We estimate 38% loan surge over FY17-20 compared to 58% over FY12-17. Net revenue and PAT are estimated to jump 39% and 42% compared to 54% and 47% over FY12-17, respectively. Hence, we initiate with 'BUY' and target price of INR1, 659, implying 23% upside from CMP.

Ample catalysts in place to sustain stellar outperformance to industry

PNBHF's loan book catapulted 58% over FY12-17, far outpacing industry's 18% average growth. Of this, while housing loans clocked 56% CAGR, non-housing loans jumped 63% over FY12-17. We estimate the company to grow 38% over FY17-20 fuelled by rapidly expanding Tier 1 & 2 branch presence to grab Govt.'s push under the PMAY interest subsidy opportunity. We envisage recent government initiatives under MIG to propel large-ticket size housing finance companies like PNBHF.

PNBHF will continue to capture market share over medium to long term

The company has gained significant market share over the past few years on account of aggressive expansion of products, branches and headcounts and we expect this momentum to sustain. Since FY11, PNBHF's market share has jumped 355bps and currently stands at ~5%. Management is targeting ≥1.5-1.75x of industry's average growth. Eventually, we expect market share gain to continue.

Superior asset quality to sustain despite minor hiccups

PNBHF boasts of best asset quality is the industry with GNPA of 0.34% compared to 0.8% average of top 5 players in H1FY18. The robust asset quality is underpinned by stringent credit appraisal mechanism and majority of retail loan generated self. Though we anticipate stress level to inch up to 0.45-0.6% in the near future due to external factors such as demonetization, GST and RERA. We believe, despite minor hiccups, PNBHF's asset quality is expected to be superior compared to its peers.

Tight leash on cost to spur return ratios

The stellar AUM spurt led to higher cost-to-income riding on significant branch expansion and increasing headcount. However, we expect the pace of branch and headcount addition to moderate from FY19. Over the past 2 years, the company's cost-to-income ratio has fallen 650bps on economy of scale; we estimate further 700bps dip over FY17-20. Consequently, PNBHF's RoA improved from 1.3% in FY15 to 1.5% in FY17; we estimate RoA and RoE to improve to 1.6% and 19% in FY20E from 1.5% and 14% in FY17, respectively.

Valuation

At CMP of INR 1,344, we initiate coverage on the stock with a 'BUY'. At CMP, the stock is trading at 3.1x/2.7x FY19E/FY20E ABV and 20x/15x FY19E/FY20E earnings respectively. Based on 3.3x FY20E P/ABV, we arrive at a target price of INR 1,659, implying an upside of 23%.

Bloomberg:	PNBHOUSI:IN
52-week range (INR):	1,717.65 / 800.20
Share in issue (cr):	14
M cap (INR cr):	25,283
Avg. Daily Vol. BSE/NSE :('000):	303
Promoter Holding (%)	38.86

Year to March (INR cr)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenue	838	1,264	1,846	2,551	3,381
Profit after tax	326	524	802	1,109	1,487
Basic EPS	27	37	48	67	90
P/E	48.9	37.2	28.2	20.4	15.2
Book value per share	168.9	336.3	374.8	428.6	502.8
P/B	8.0	4.0	3.6	3.1	2.7
RoAE	17.5	13.6	13.6	16.6	19.2

Date: 28th November 2017

PNB Housing : Catapulted Loan book + rapidly expanding presence + Significant benefits from government focus + Superior asset quality + Tight leash on cost = High ROE

PNB housing is expected to deliver NII of 40% CAGR over FY17-20E on back of 38% loan growth and marginal expansion in net interest margin (NIM). In FY17, Net Revenue grew 51% to INR 1,264crs aided by 10bps expansion in NIM and significant growth in non-interest income . In FY18 we expect ~43% loan growth on back of ~39% disbursement growth.

Aggressive branch expansion and headcount increased the C/I(x) but branch expansion to moderate onward FY18 and also economy of scale to help in reducing the C/I(x).

	FY16	FY17	FY18E	FY19E	FY20E
NII	686	996	1,474	2,047	2752
Net Revenue	838	1,264	1,846	2,551	3381
PPOP	586	907	1,382	1,974	2674
PAT	326	524	802	1,109	1487

PNBHF's cost of borrowings and lending rate is very competitive; hence spread to continue

	FY16	FY17	FY18E	FY19E	FY20E
RoAA	1.4%	1.5%	1.6%	1.6%	1.6%
RoAE	17.5%	13.6%	13.6%	16.6%	19.2%

Consequently RoA and RoAE are likely to improve from 1.5% and 13.6% to 1.6% and 19% over FY17-19.2

P/ABV	FY20E ABV (inr crs)	CMP / Target
3.1x (CMP)	502.8	1344
3.3x (Target)	502.8	1659

Entry = INR 1344 at 3.1x FY19E P/ABV

+

Loan book is expected to grown at CAGR 38% FY17-20E.

Upside of 23%

Price Target	**INR 1659**	At CMP of INR 1,344, we initiate coverage on the stock with a 'BUY'. At CMP, the stock is trading at 3.1x/2.7x FY19E/FY20E ABV and 20x/15x FY19E/FY20E earnings respectively. The premium valuation is justified by: a) loan growth is ≥2.5x the industry average, b) average GNPA of top 5 companies was 0.8% whereas PNBHF's GNPA stands at 0.34% in H1FY18, and c) expansion in return ratios due to cost control. Based on 3.3x FY20E P/ABV, we arrive at a target price of INR 1,659, implying an upside of 23%.
Bull	**INR 2,011**	PNBHF has potential to trade at higher multiple on account of a) loan book to grow at higher pace from our estimate; b) the cost-to-income ratio will decline at faster pace and c) asset quality to remain above our projection. As a consequence of this, RoA and RoAE will be higher from our estimate. In light of aforesaid development, we value the PNBHF's share at 4.0x FY20E ABV and arrive at a target price of INR 2,011 per share.
Base	**INR 1659**	At CMP of INR 1,344, we initiate coverage on the stock with a 'BUY'. At CMP, the stock is trading at 3.1x/2.7x FY19E/FY20E ABV and 20x/15x FY19E/FY20E earnings respectively. The premium valuation is justified by: a) between FY12-17, loan growth is ≥2.5x the industry average, b) average GNPA of top 5 companies was 0.8% whereas PNBHF's GNPA stands at 0.34% in H1FY18, and c) expansion in return ratios due to cost control. Based on 3.3x FY20E P/ABV, we arrive at a target price of INR 1,659, implying an upside of 23%.
Bear	**INR 1156**	We believe external factors can dent the loan growth and deteriorate asset quality such as RERA and GST did in last quarters. Any such external factors can dent loan growth and weaken the asset quality. In light of these factors, we value the PNBHF's share at 2.3x FY20E ABV and arrive at target price of INR 1,156 per share.

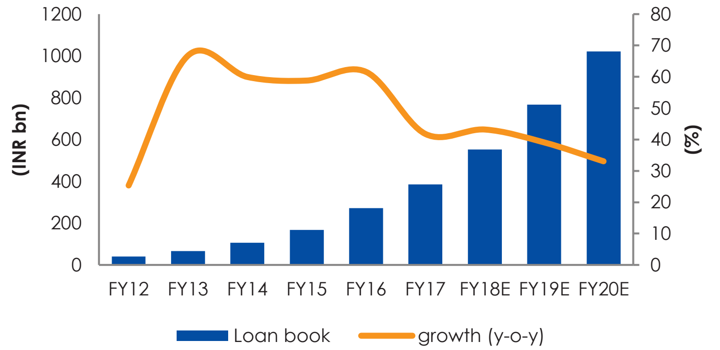
Average Daily Turnover (INR cr)			Stock Price (CAGR)				Relative to Sensex, CAGR (%)			
3 months	6 months	1 year	1 year	3 years	5 years	10 years	1 year	3 years	5 years	10 years
51.6	102.6	192	59%	NA	NA	Na	31%	NA	Na	NA

Business Value Drivers

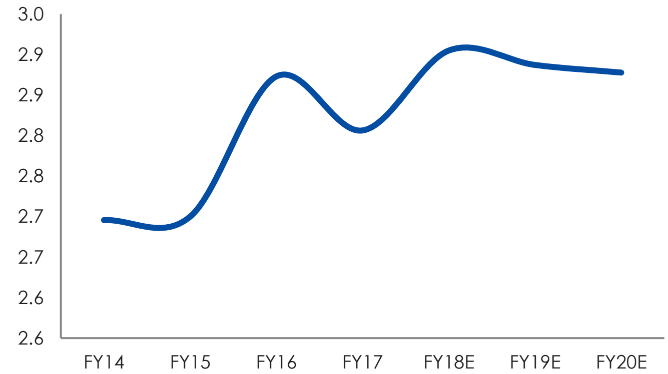
Nature of Industry	The Housing Finance industry comprises Banks, and HFCs. HFCs have gained market share vis-à-vis Banks from 31% in FY11 to 39% in FY17 via, among other reason, greater focus on small-ticket lending where the opportunity is superior due to government support.
Opportunity Size	With government support on increasing affordability and urbanisation the loan disbursements can reach 9.86 lakh crore by 2021E from INR 4.15 lakh crore in H1FY18.
Capital Allocation	PNBHF's loan book catapulted 58% over FY12-17, far outpacing industry's 18% average growth. Of this, while housing loans clocked 56% CAGR, non-housing loans jumped 63% over FY12-17
Predictability	Historically PNBHF grew ≥2.5x between FY12-17 and Company has created the bandwidth to grow at higher pace. The predictability is very high that PNBHF will surpass our estimates.
Sustainability	PNBHF boasts of best asset quality is the industry with GNPA of 0.34% compared to 0.8% average of top 5 players in H1FY18. The robust asset quality is underpinned by stringent credit appraisal mechanism and majority of retail loan generated self.
Disproportionate Future	The company has grown ≥2.5x of industry average and we have projected 38% CAGR growth over FY17-20E. Any short term disruptions could cause economic slowdown which could dent our growth projections.
Business Strategy & Planned Initiatives	A bouquet of products along with geographical expansion in the right direction will help PNBHF to sustain the current growth trajectory. Company's superior growth is the outcome of a superiorly experienced team, higher ticket size and an increasing presence in tier 1 and tier 2 cities at a significant pace. We expect PNBHF to report 38% CAGR over FY17-20E.
Near Term Visibility	With implementation of DeMon, GST and RERA, the near term visibility seemed challenged but with loan book growing 42% and GNPA in control, things are falling in place for PNBHF.
Long Term Visibility	Mortgage penetration in India is substantially low currently compared to that of the developed nations, entailing tremendous scope for demand growth in housing loans based on: a) interest subsidy by government for affordable housing; b) tax deduction on housing loans at INR 2 lakh on interest payment; c) rising affordability; d) rapid urbanisation (currently at ~32%; and estimated to touch 40% by 2030); and e) falling interest rates. In the light of this factors, we envisage mortgage penetration in India to catapult going forward.

Focus Charts – Story in a nutshell

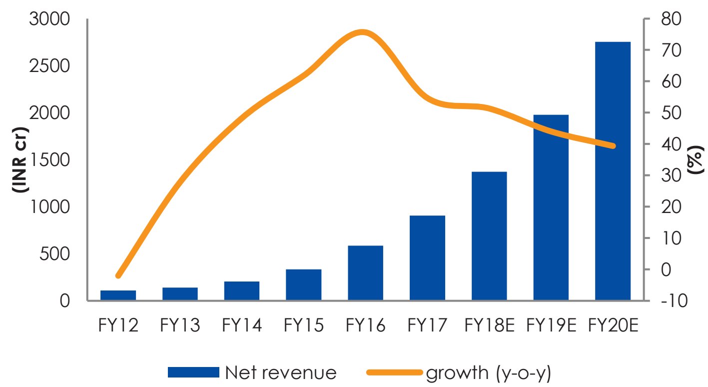
Loan book continuous to outperform



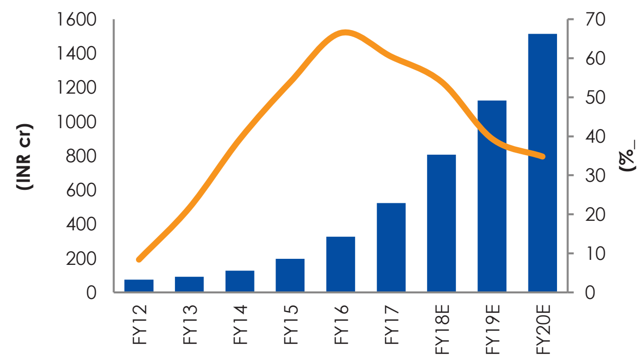
Marginal improvement in Margin



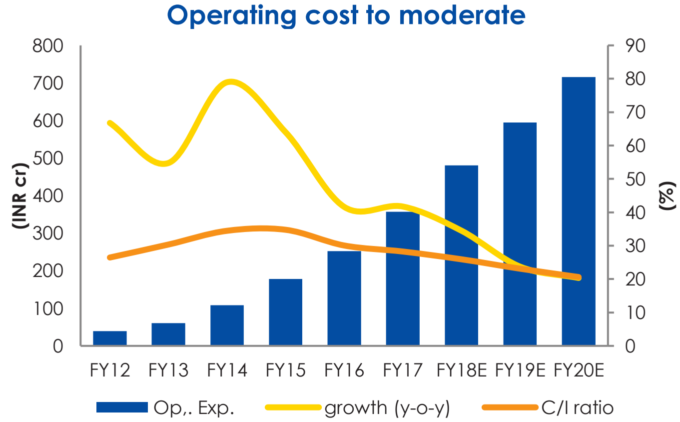
Net revenue to accelerate on back of marginal imporvement margin



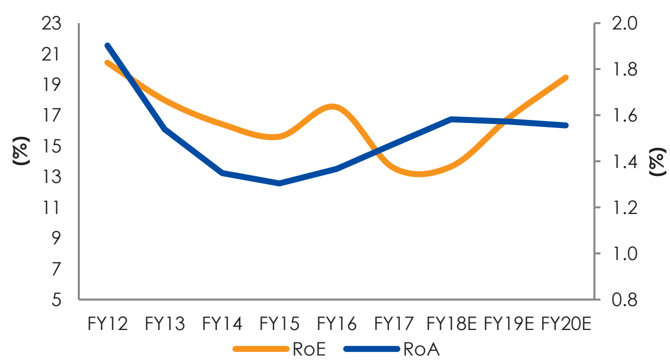
PAT growth to be slower due to higher cost credit



Operating cost to moderate



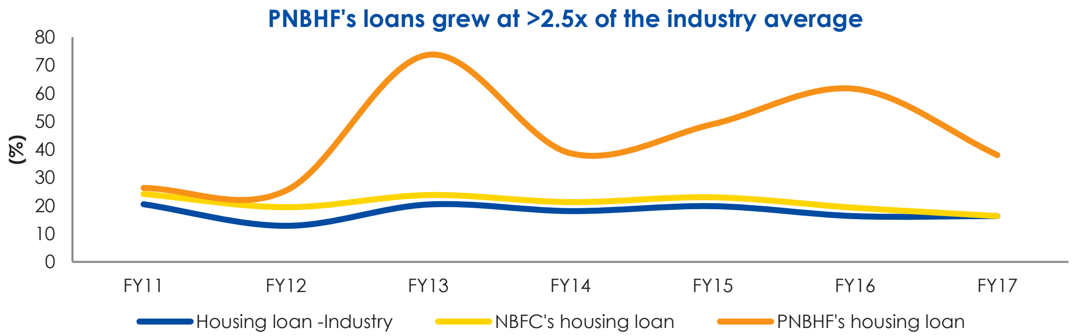
Return ratio to improve due to cost control



Source: Edelweiss Investment Research

1. Loan growth to be the highest among housing finance companies

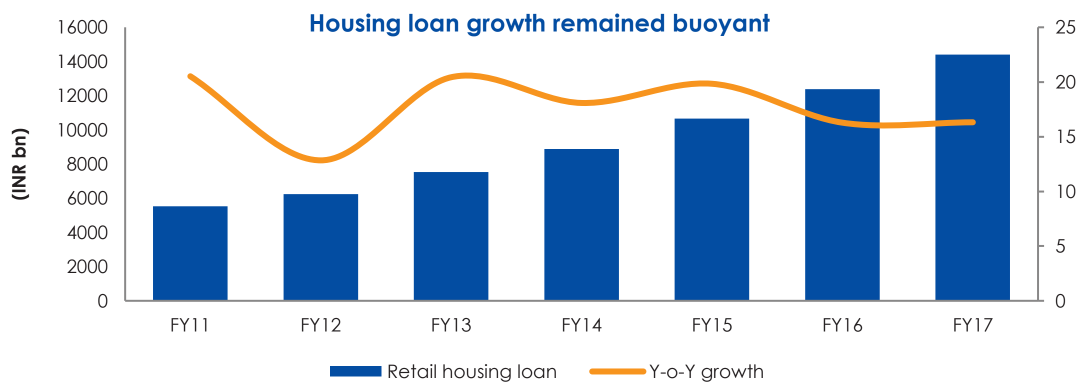
PNBHF has recorded 58% growth in loan book over FY12-17 compared with the industry average of 18% growth. However, housing finance companies reported 21% growth whilst the banking sector reported 17% growth in retail housing loans over the same period. Consequently, non-banking finance companies (NBFCs) gained share in housing finance. We have projected 38% growth over FY17-20E riding on the dynamic branch presence in tier 1 and tier 2 cities to gain from the opportunities such as: a) government thrust under PMAY; b) housing shortage in India expected to catapult by ~110mn to 2022, c) consumers' rising affordability; and d) falling interest rate. These remain key catalysts for home buyers.



Source: Company, Edelweiss Investment Research

Home loan has shown continuous traction

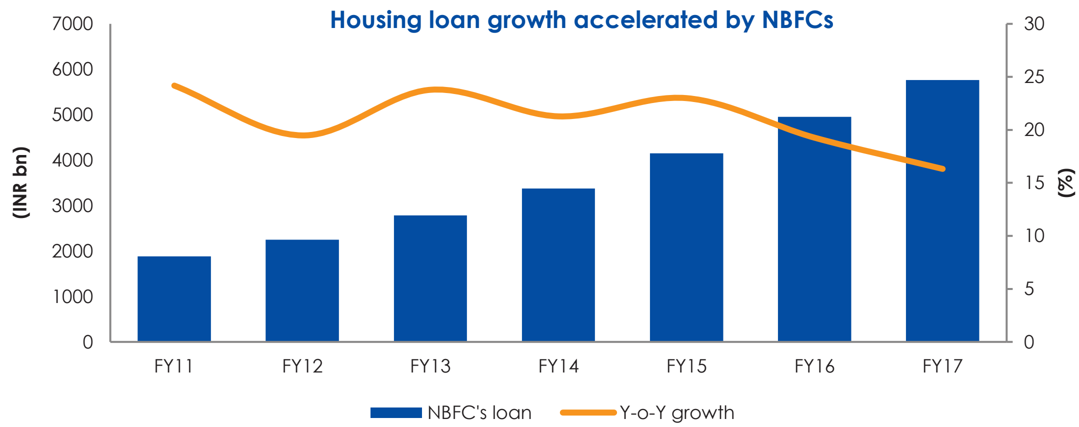
Retail mortgage market grew at 18% over FY11-17 riding on increasing affordability and urbanization. We believe the prevailing growth rate in the mortgage market will accelerate as several concessions are being offered by the Government of India in recent years for both borrowers and real estate developers. We expect the housing sector to grow at ≥20% over the next few years.



Source: Company, Edelweiss Investment Research

Housing finance companies drive mortgage market growth

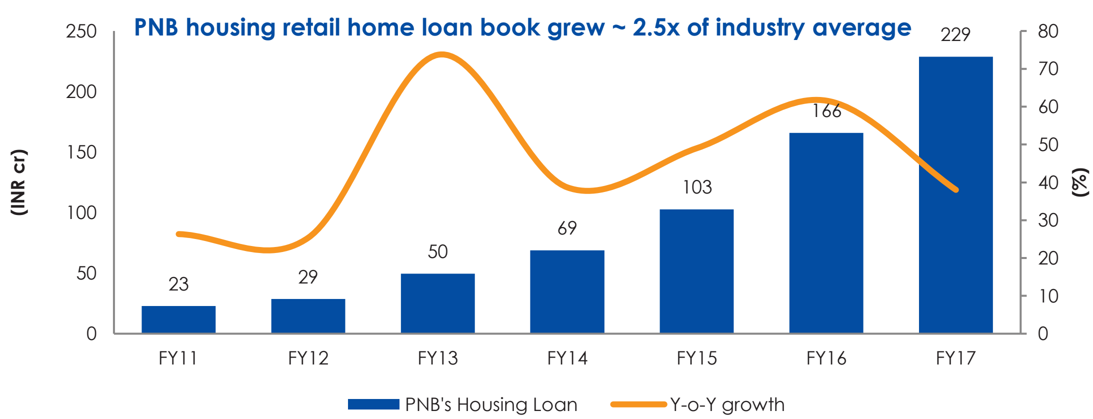
The housing finance companies (HFCs) have reported 21% growth over FY11-17 versus 18% growth in the home loan portfolio. HFCs are expected to deliver superior growth with robust asset quality versus banks. HFCs have key advantages which drive growth such as: a) market penetration; b) low turnaround around time and c) robust distribution channels. Considering these advantages, we believe HFCs to post superior growth going forward.



Source: Company, Edelweiss Investment Research

Superior growth to continue

PNB Housing's retail home loan portfolio grew at 44% CAGR over FY10-17 versus 18% industry growth and 21% growth reported by HFCs. We believe the superior growth is the outcome of a superiorly experienced team, higher ticket size and an increasing presence in tier 1 and tier 2 cities at a significant pace. We expect PNBHF to report 1.5 to 1.75x growth over FY17-20E.

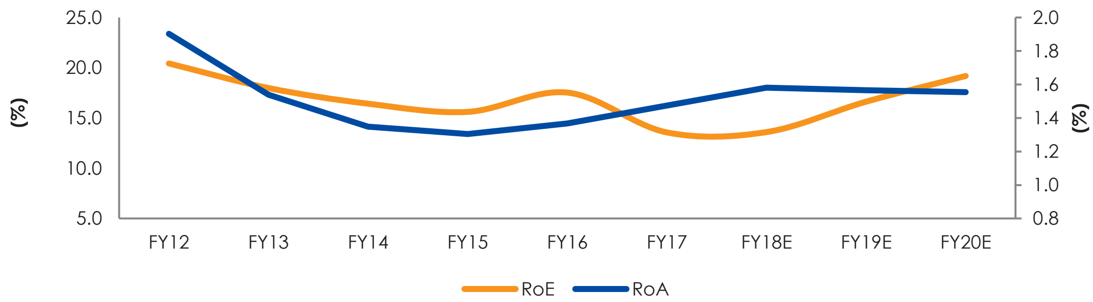


Source: Company, Edelweiss Investment Research

2. Return ratios to improve on account of cost control

The stellar growth in AUM led to higher cost-to-income due to significant branch expansion and increasing headcount. The total branch strength stood at 73 as on H1FY18, of this ~62% is less than 18 months old and in the last two and half years, branch strength has almost doubled. We believe that as the branches mature, the cost-to-income ratio will reduce. As a result, RoA is expected to improve from 1.5% in FY17 to 1.6% in FY18 and RoAE is expected to improve from 13.6% in FY17 to 19.1% by FY20E.

Return to improve on cost control

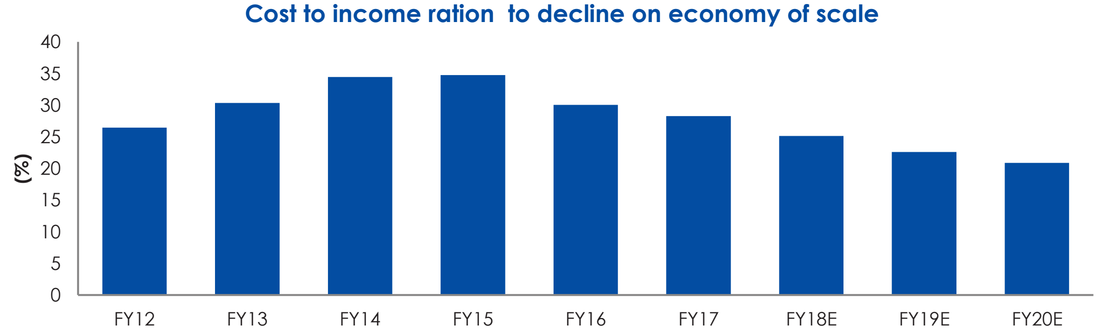


Source: Company, Edelweiss Investment Research

Maturing branches and economies of scale will help to reduce operating costs

We expect maturing branches and economies of scale to help reduce costs. The pace of branch addition is expected to continue in H2FY18 and we expect branch expansion to moderate post this period.

Cost to income ration to decline on economy of scale

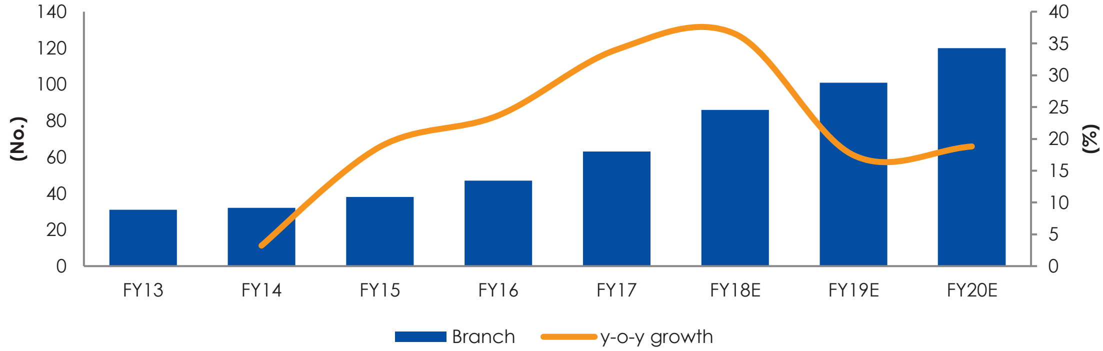


Source: Company, Edelweiss Investment Research

The pace of branch addition is expected to moderate

Management has plans to reduce the pace of branch addition beyond FY18E. In H1FY18, the company opened 10 branches and has plans to open 10 more branches in H2FY18E. In FY19E, we expect branch strength to cross 100 in FY19 and onward that we expect 12-15% addition in branch.

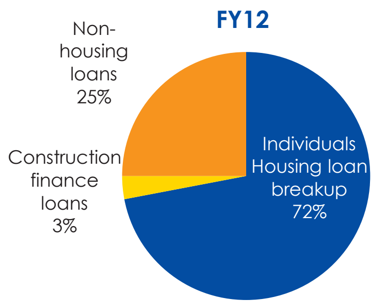
The pace of branch addition to moderate in next couple of years

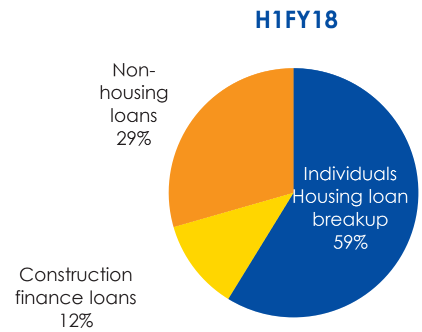


Source: Company, Edelweiss Investment Research

3. Product diversification, expansion, in right direction to help sustain growth

A bouquet of products along with geographical expansion in the right direction will help PNBHF to sustain the current growth trajectory. At present, the company offers five products in its bouquet — housing retail and construction/developers loans, LAP, LRD, CTL and NRPL. In retail housing loans, the company provides home purchase loans, residential plot loans, residential plot cum construction loans, self construction loans and home improvement/extension loans. PNBHF has initially launched several products which led to shrinkage of retail housing loans from 72% in FY12 to 59% in H1Y18. We believe the bouquet of products will help in continuing the growth momentum.

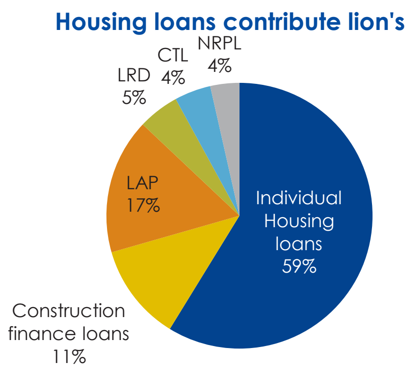


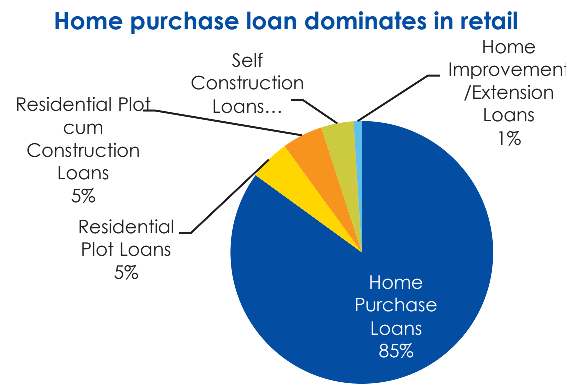


Source: Company, Edelweiss Investment Research

Housing loans contribute the lion's share of the entire loan book

The housing loans contribute ~71% to the entire loan book while retail loans continue to dominate. In the retail loans category, home purchase loans constitute a major share. We believe the bouquet of products in retail housing loans will help maintain the higher growth trajectory.



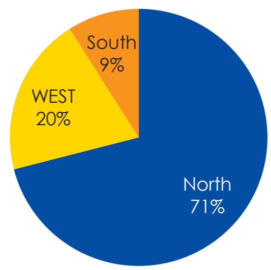


Source: Company, Edelweiss Investment Research

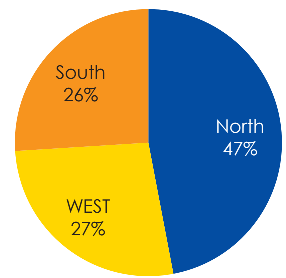
Strategic branch expansion drives growth; we believe this will sustain the growth trajectory

Branch expansions have taken place in the right direction. As the western region contributes ~40-45% housing disbursements, the north and south contribute 22-25% each to the total disbursement pie while the remainder is contributed by the eastern region. Having analyzed the demand pattern, the company expanded its branches in the south and west. We believe these expansions will aid and sustain the growth trajectory.

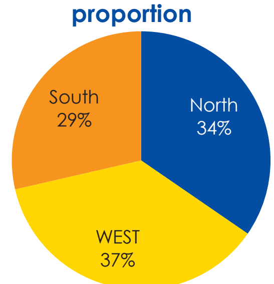
FY12 - North dominates



FY15 - Expansion in right direction



FY17 - moving in-line with disbursement proportion

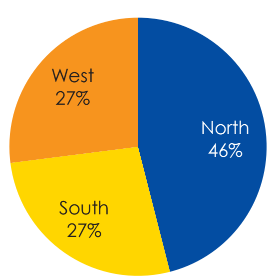


Source: Company data

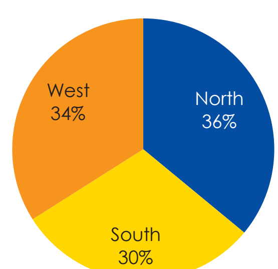
Branch expansion alignment along with demand origination is visible from disbursement shift

PNBHF has expanded its branches in line with industry's disbursement origination. Hence PNBHF opened the maximum branches in the south and west. In FY12 the south and west contributed 9% and 20% respectively to total branch strength, which increased to 29% and 37% respectively by FY17. This expansion led to a disbursement shift from the north to the west and south and we believe this change will help sustain the growth trajectory.

FY14 - Geographical mix



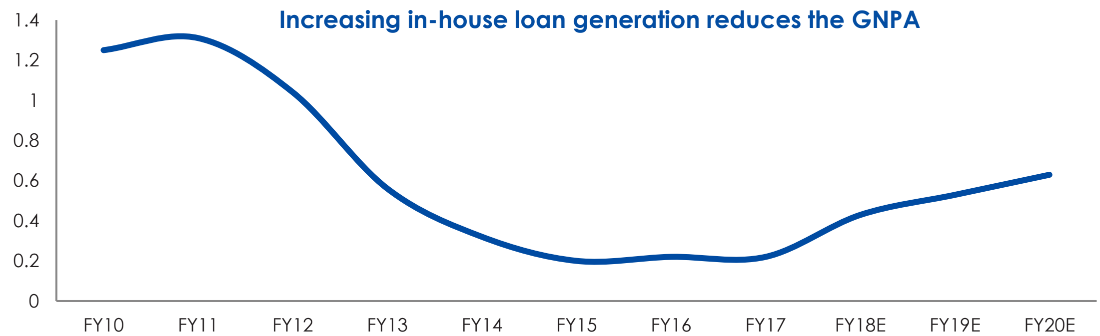
FY17 - Geographical mix



Source: Company, Edelweiss Investment Research

4. Superior asset quality to continue on back of robust credit appraisal mechanism

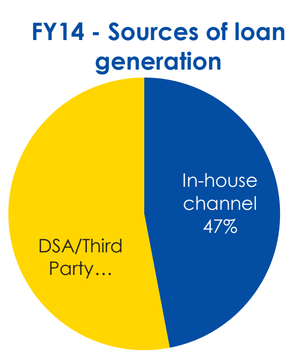
PNB Housing has the best asset quality among HFCs. GNPAs of PNBHF stand at 0.34% in Q2FY18 compared with the average of 0.8% for the top 5 companies. In-house channels have contributed ~60% of the total loan generation in FY17 versus 47% in FY14. As the in-house loan generation increases, the stress levels appear to reduce. In addition to that, PNBHF's credit appraisal module passes through several stringent channels which reduce the scope of default. As of a result of these, stress levels of PNBHF are the lowest amongst the top 5 companies.

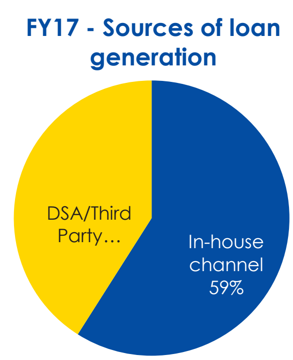


Source: Company, Edelweiss Investment Research

In-house channels continue to lead loan generation

PNBHF has strengthened its in-house channels for lead generation because: a) the average cost of client acquisition is lower compared to a third-party, b) the redemption before maturity is comparatively lower, and c) delinquencies are lower in in-house channels versus a third-party. We believe the reliability and strengthening process for in-house channels will likely continue, and as a consequence of this, incremental delinquencies will remain moderate.

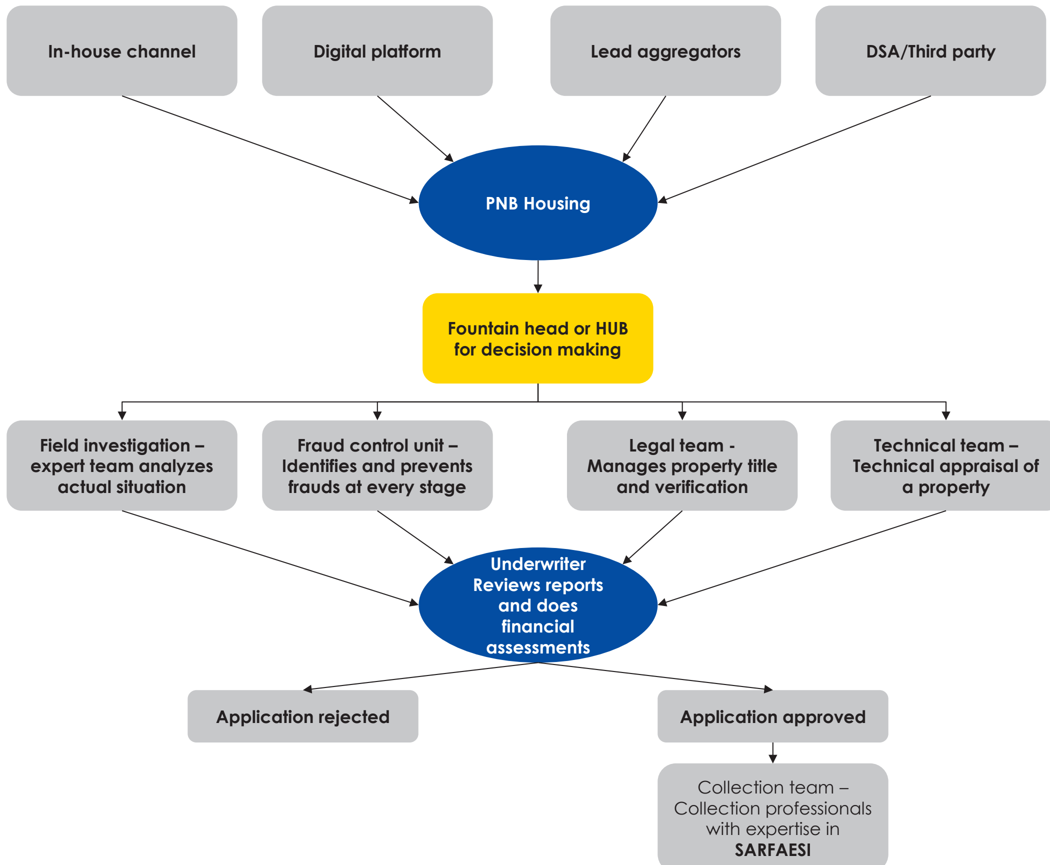




Source: Company, Edelweiss Investment Research

The credit appraisal mechanism passes through many phases

The credit appraisal mechanism passes through a multi-channel framework as follows



5. Humungous untapped market, policy push burnishes prospects

The current macroeconomic conditions support accelerated growth in various segments such as: a) Pradhan Mantri Awas Yojana (PMAY) scheme to accomplish the 'Housing For All' mission by 2022, with interest subsidy to economically weaker sections (EWS)/lower income group (LIG)/middle income groups (MIG-I and MIG-II); b) significant untapped HFC space; c) greater consumers' affordability in recent years on account of softer property prices, low interest rate and marginal wage growth and d) lowering interest rates to enhance property buying.
Credit linked subsidy scheme to boost affordable housing demand

The housing shortage in India at the beginning of the 12th Five Year Plan was pegged at 60mn units. Around 96% of this shortage pertains to households falling in the EWS and LIG segments. In order to provide housing for all by 2022, the Ministry of Housing and Urban Poverty Alleviation (MHUPA) launched the ambitious PMAY scheme in June 2015. Under the scheme, citizens falling under EWS and LIG segments are eligible for housing loan subsidies under the credit linked subsidy scheme (CLSS), but with certain limitations.

I. CLSS: EWS/LIG

Under EWS and LIG, households seeking housing loans for acquisition/construction of houses from banks/HFCs will be eligible for interest subsidy under the following conditions:

Particulars	EWS	LIG
Household income (lakh)	3	6
Interest subsidy	6.5%	6.5%
Maximum loan tenure	15	15
Eligible housing loan amount for interest subsidy (lakh)	6	6
Carpet unit (Sq. m.)	30	60
Discount rate for NPV calculation for interest subsidy	9%	9%

II. CLSS: MIG

The government has launched CLSS-II on 31 December 2016; under which the eligible housing loan amount and household income limit have been enhanced significantly. Initially the CLSS-II was applicable from January 1, 2017 to December 31, 2017. Realizing the need, the government has increased the interest subsidy period from December 31, 2017 to March 31, 2019 and also the carpet areas from 90sq.ft.to 120sq.ft. and 110sq.ft t0 150sq.ft. The enhanced carpet area is favourable for PNBHF.

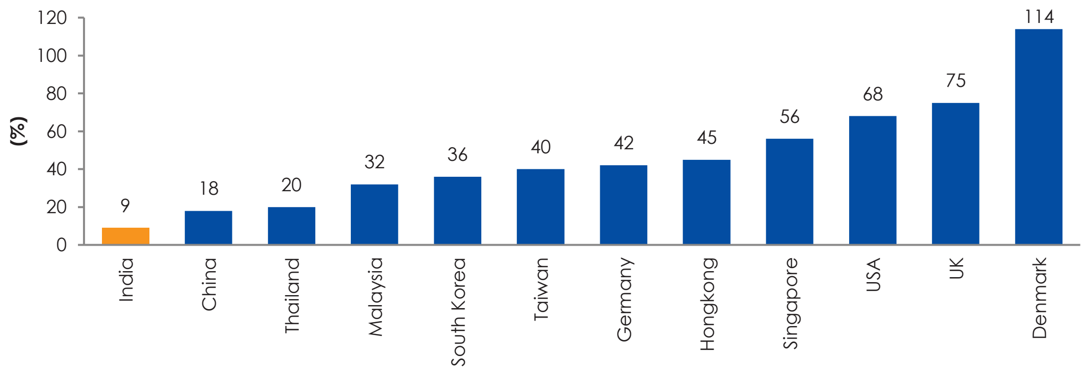
Particulars	MIG-I	MIG-II
Household income (lakh)	12	18
Interest subsidy	4%	3%
Maximum loan tenure	20	20
Eligible housing loan amount for Interest subsidy (lakh)	9	12
Carpet unit (Sq. m.)	120	150
Discount rate for NPV calculation for interest subsidy	9%	9%

The average ticket size of PNBHF's housing loan is ~INR 3.1mn. However, PNBHF has a presence in the large ticket sizes, although 25% of retail housing loans fall under the PMAY interest subsidy category. We believe the enhanced carpet area will augment the retail housing loans under the PMAY category.

Mortgage penetration poised to jump significantly

Mortgage penetration in India is substantially low currently compared to that of the developed and developing nations, entailing tremendous scope for demand growth in housing loans based on: a) interest subsidy by government for affordable housing; b) tax deduction on housing loans at INR 2 lakh on interest payment and total tax rebate at INR 4 lakh per annum, including interest and principal; c) rising affordability; d) rapid urbanisation (currently at ~32%; and estimated to touch 40% by 2030); and e) falling interest rates. In the light of this scenario, we envisage mortgage penetration in India to catapult going forward.

Significant scope for growth in mortgages

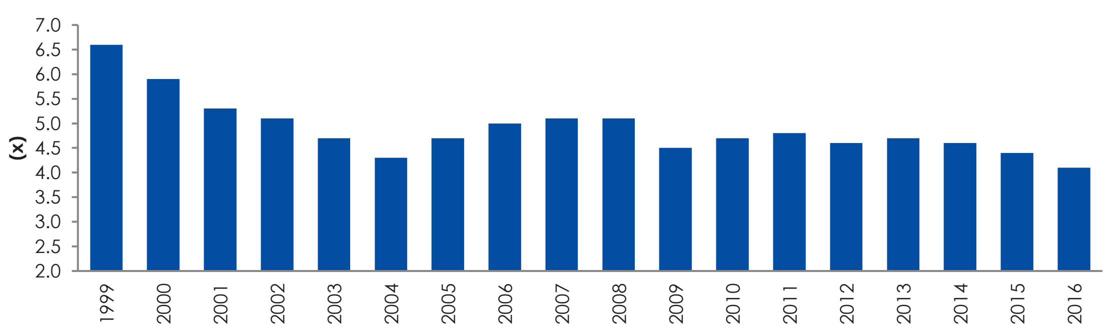


Source: Industry, Edelweiss Investment Research

Significant spurt in affordability

Over the past few years, consumers' affordability has jumped significantly on account of buoyancy in an individual's earnings. This is substantiated by a survey of metros and large cities.

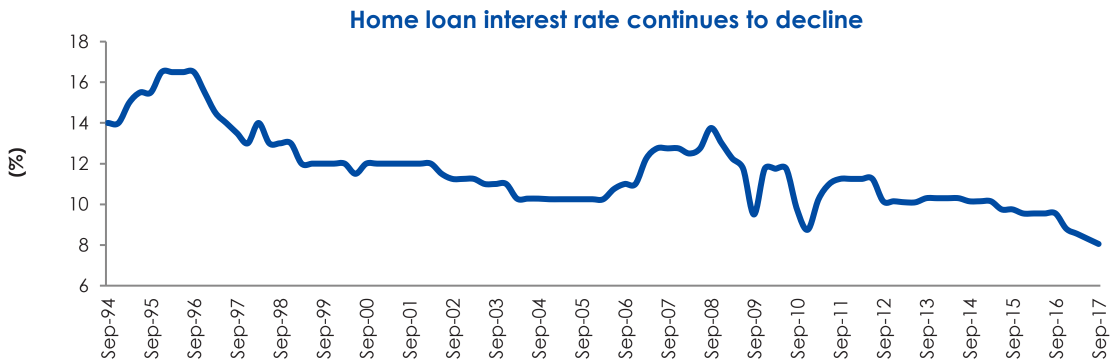
Affordability has increased significantly



Source: Industry, Edelweiss Investment Research

Interest rate on housing loans continues to fall

We estimate the keen demand for housing loans to ride on falling interest rates, rapid urbanisation, rising disposable incomes, favourable demographics and the various interest subsidy schemes for affordable housing. 'Housing for All' by 2022, Smart Cities and PMAY are a few initiatives that the Government of India has launched to overcome the housing shortage. We expect short-term demand to be under pressure due to demonetisation, but the 7th Pay Commission payout, interest subsidies for affordable housing and falling home prices are anticipated to bolster demand in the medium-to-long term.



Source: Edelweiss Investment Research

Company Description

PNB Housing Finance Ltd (PNBHF) was promoted by Punjab National Bank (PNB) in 1988 with an objective to increase presence in the housing loan segment. The company has grown at a tepid pace since inception to 2010 and post that period, growth escalated as the company strengthened its team of professionals. At present, the company has 73 branches in 41 cities as of H1FY18; the comparable figures were 32 branches and 27 cities in FY14! PNBHF is the fastest growing housing finance company with outstanding AUM of INR 512bn as on H1FY18. PNBHF is the fifth largest housing finance company with a market share of ~5% amongst housing finance companies. The company offers a bouquet of products for the residential and non-residential categories. The product basket of the company spans retail housing, construction/developer finance, LAP, LRD, CTL and NRPL. Housing loans constitute ~71% of the total loan book; of this, retail loans constitute 59%. PNBHF is amongst the 18 housing companies that accept public deposits. The deposits of PNBHF are the second highest amongst HFCs, contributing 28% to total borrowings.

PNB Housing stands tall today, with unprecedented growth and an impressive performance delivery, despite stiff competition and a challenging environment. With a strong framework and robust structure, it has emerged on the home loan landscape as an organization that has helped millions of Indians realize one of their most important aspirations in life — of owning a home.

Key risks

Unforeseen NPA accretion in LAP book

LAP has been a high risk lending area for HFCs since the emergence of hyper-competition in the segment a few years ago and resultant dilution of underwriting standards. Assessment of credit risk in this segment has been more challenging since this segment's marginal borrower has been the non-salaried class who generally lacks authentic financial statements such as salary slips and income tax returns. PNBHF's loan book exposure to this segment stands at ~16% as of Q2FY18 and is a focus area with an aim to increase its share in the loan book.

Slower-than-expected loan CAGR

The company has grown ≥2.5x of industry average and we have projected 38% CAGR growth over FY17-20 on account of: a) expanding presence at a rapid pace, b) favorable interest rate environment, c) rising affordability and d) continuous government support. We believe all these factors to come to play enhancing the environment for housing finance. However, any short term disruptions could cause economic slowdown which could dent our growth projections.

Valuation

PNBHF is the fastest growing housing finance company in India with outstanding AUM of INR 512bn as on H1FY18. PNBHF is the fifth largest housing finance company with a market share of ~5% amongst housing finance companies. PNBHF has the second largest deposits book amongst leading housing finance companies in India. The company offers a bouquet of products for residential and non-residential categories. The product basket of the company spans retail housing, construction/developer finance, LAP, LRD, CTL and NRPL. Housing loans constitute ~71% of total loan book, of this, retail loans comprise 59% of total loan book.

The company's loan book grew at ≥2.5x the industry average growth over FY12-17 with one of the finest asset qualities in the industry. Management aims to achieve growth at 1.5x to 1.75x the industry average over next few years. We have estimated 38% loan growth over FY17-20E compared with 58% growth over FY12-17 and we have also projected net revenue and PAT to grow at 39% and 42% compared with 54% and 47% over FY12-17 respectively.

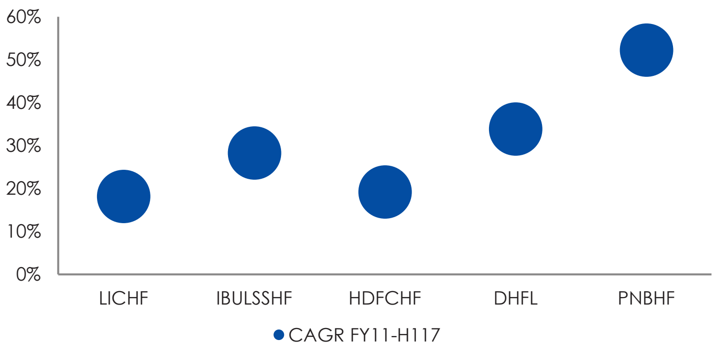
At CMP of INR 1,344, we initiate coverage on the stock with a 'BUY'. At CMP, the stock is trading at 3.1x/2.7x FY19E/FY20E ABV and 20x/15x FY19E/FY20E earnings respectively. The premium valuation is justified by: a) loan book grew ≥2.5x the industry average between FY12-17, b) average GNPA of top 5 companies was 0.8% whereas PNBHF's GNPA stands at 0.34% in H1FY18, and c) expansion in return ratios due to cost control. Based on 3.3x FY20E P/ABV, we arrive at a target price of INR 1,659, implying an upside of 23%.

	CMP	P/ABV		P/E (x)		RoAE (%)		RoA (%)		NIM (%)		C/I(x)		GNPA (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
LICHF	597	2.4	2.1	15.9	13.6	17.4	18.0	1.4	1.4	2.5	2.5	15.3	14.4	0.7	0.8
IBHFL	1199	3.9	3.4	14.9	12.9	27.3	29.2	3.1	3.0	3.9	3.8	10.6	9.8	0.8	0.8
DHFL	617	2.3	2.1	16.7	14.3	14.2	15.1	1.3	1.4	2.8	3.0	23.5	22.2	1.1	1.3
HDFC	1725	4.2	3.4	23.3	20.1	19.4	20.5	2.3	2.300	3.1	3.1	7.4	7.0	0.7	0.7
PNBHF	1344	3.6	3.1	28.2	20.4	13.6	16.6	1.6	1.6	2.9	2.9	25.1	22.6	0.4	0.5

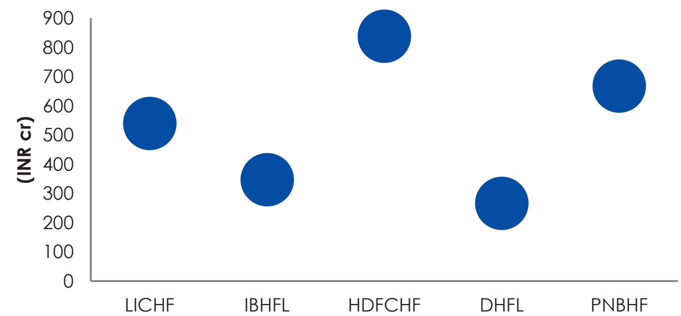
Peer comparison: A perspective

PNBHF's loan book grew at ≥2.5x industry average and 1.57x of top 5 companies. We expect the growth trajectory to continue on account of bouquet of products, competitive interest rate and geographical expansion.

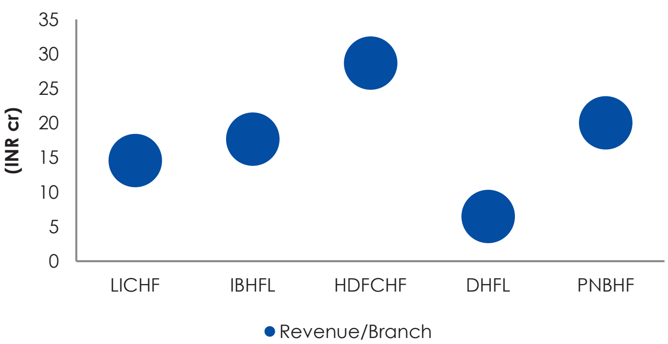
PNBHF has reported ≥2.5x growth in loans between 2011-H1FY18



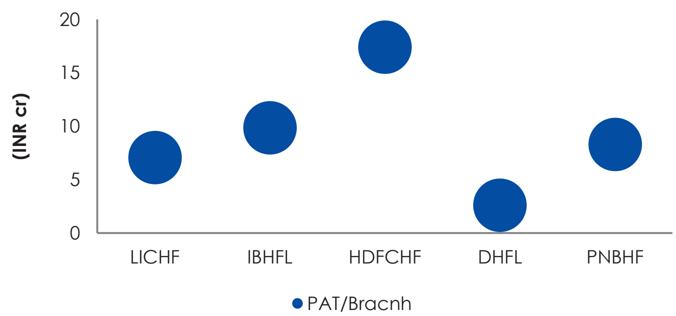
one of the highest loans per branch; maturing branches will increase the loan per branch



Net revenue per branch is one of the highest. We believe that as the branch matures, the revenue per branch will increase.

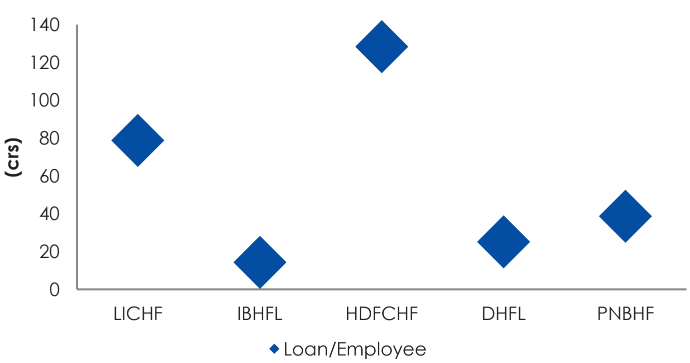


PAT per branch to increase as the branch turns older

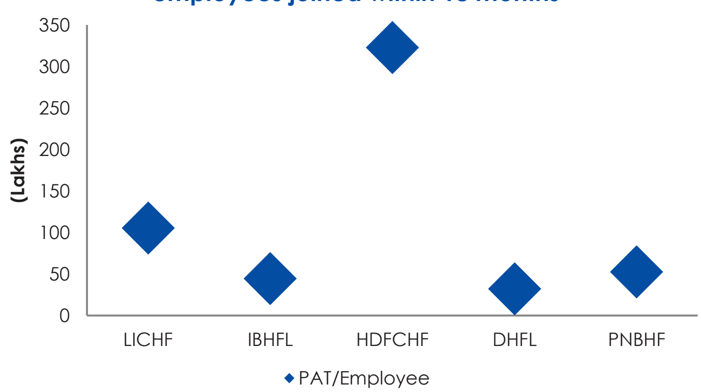


Source: Edelweiss Investment Research

Revenue per employee is in top 3 but we expect it to increase as ~66% employees joined within 18 months

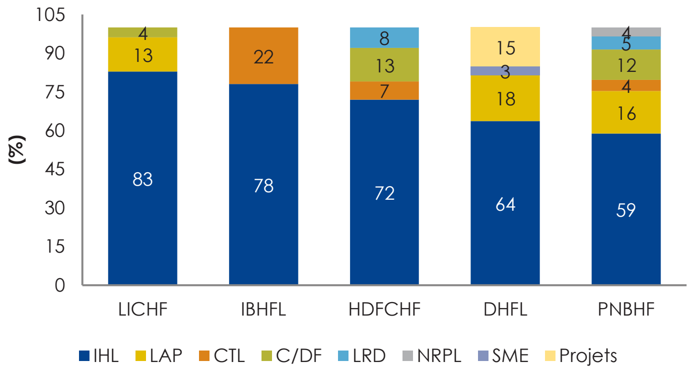


PAT per employee is marginally lower due to majority of employees joined within 18 months

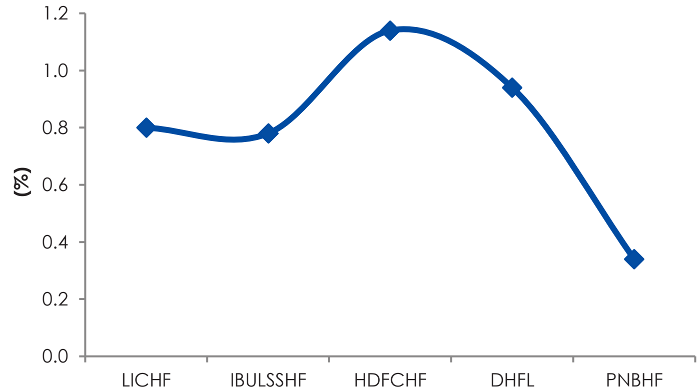


Source: Company, Edelweiss Investment Research

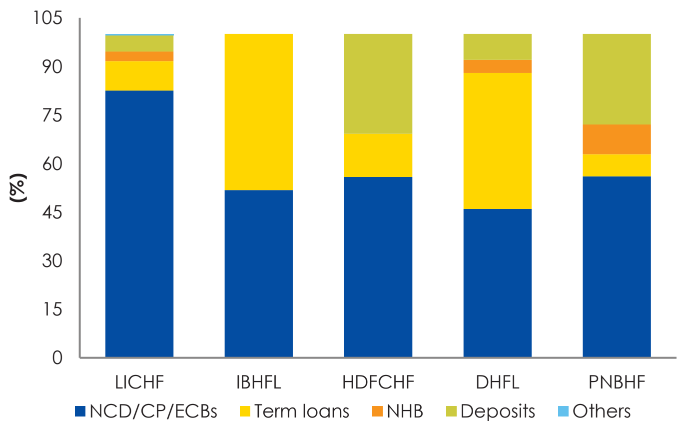
Bouquet of products will help sustain the growth trajectory and also protect margins



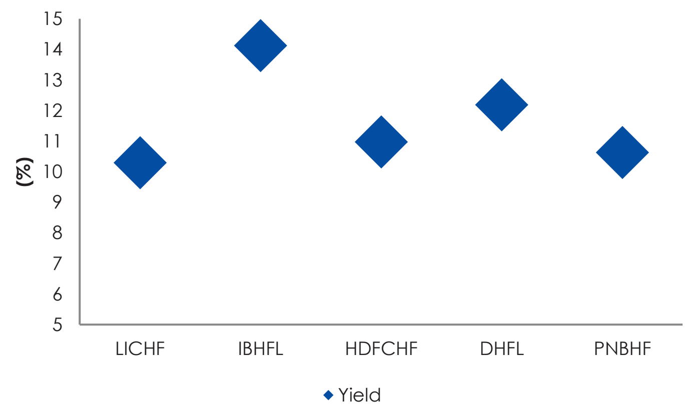
Lowest GNPA amongst leading housing finance companies



Optimization of liability franchise



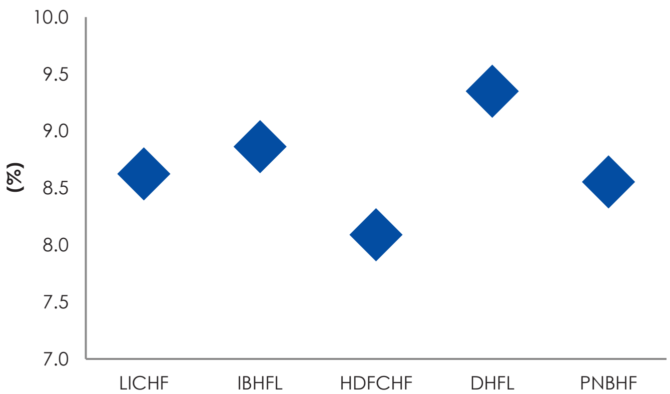
Impact of competitive pressure is expected to be lower because of competitive rate of interest



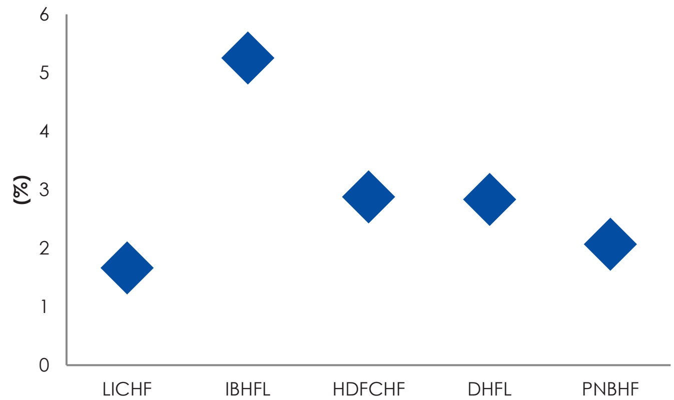
Source: Edelweiss Investment Research

IHL – Individual Housing Loan
LAP – Loan against property
LRD – Lease rental discounting
NRPL – Non resident property loan
C/DF – Corporate/Developer Financing
CTL – Corporate tenant lease
SME- Small-medium enterprise

Optimization of borrowings leads to one of the lowest cost of funds

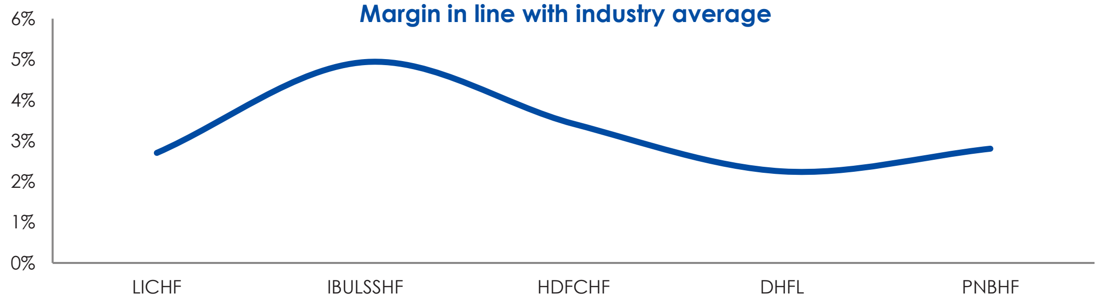


In order to remain competitive, PNBHF's rate of interest is in line with large peers; hence spread is marginally lower but it is expected to remain stable



Source: Edelweiss Investment Research

Margin in line with industry average

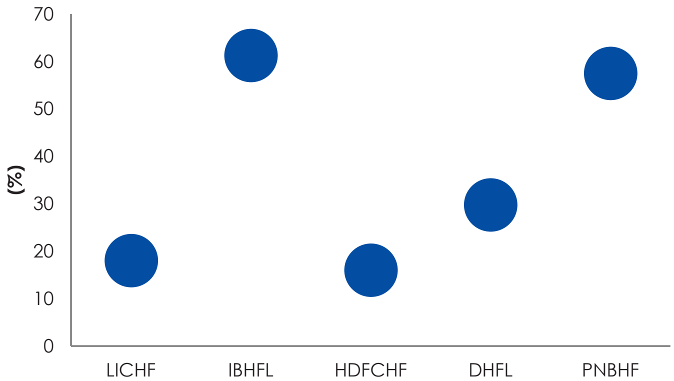


Source: Edelweiss Investment Research

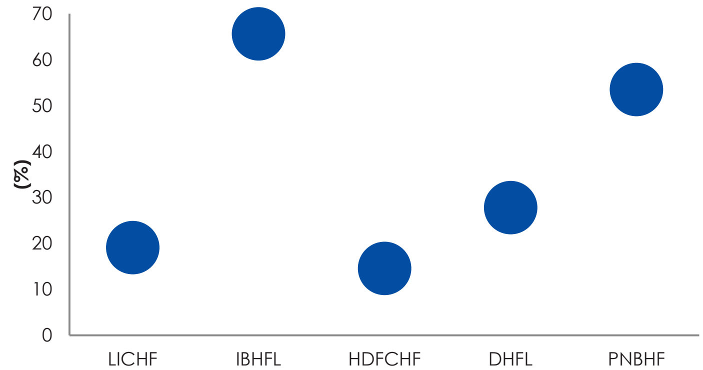
Is premium valuation justified?

Historically PNBHF has outperformed peers by a substantial margin. Loan book, net revenue and PAT respectively grew by 1.57x, 1.48x and 1.45x the average of the top 5 companies over FY12-17.

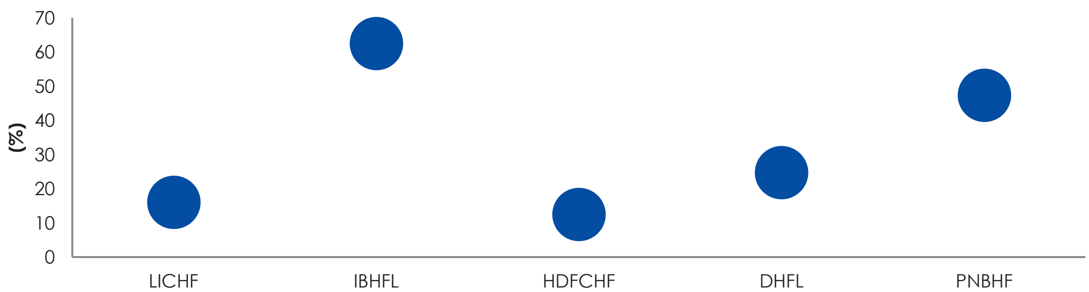
Loan book grew 1.57x of average of top 5 companies between FY12-17



Net revenue grew 1.48x of average of the top 5 companies between FY12-17



PAT grew 1.45x of average of top companies between FY12-17

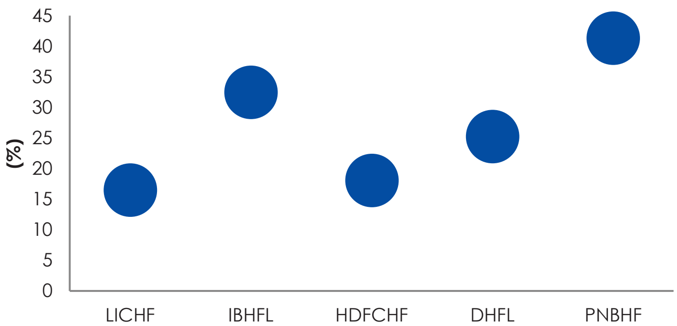


Source: Edelweiss Investment Research

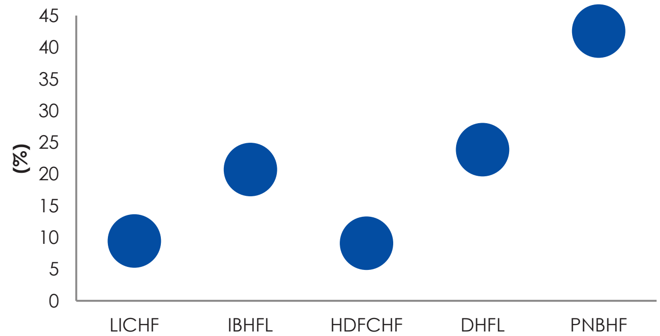
PNBHF continues to outperform peers

We have projected PNBHF's loan book, net revenue, PAT and EPS to respectively grow by 1.5x, 2.0x, 1.9x and 1.9x over FY17-19E.

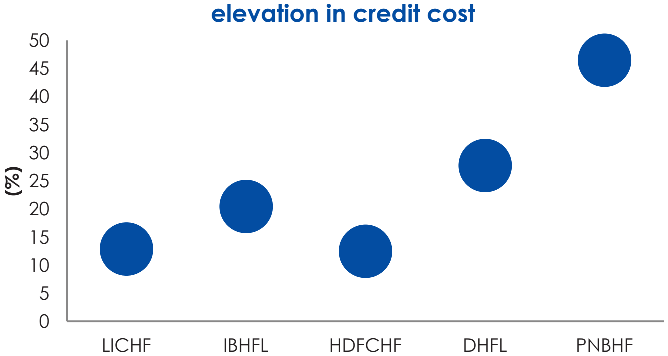
Loan book to grow 1.5x of average of top 5 companies; however management is planning growth at 1.5x-1.75x of industry average



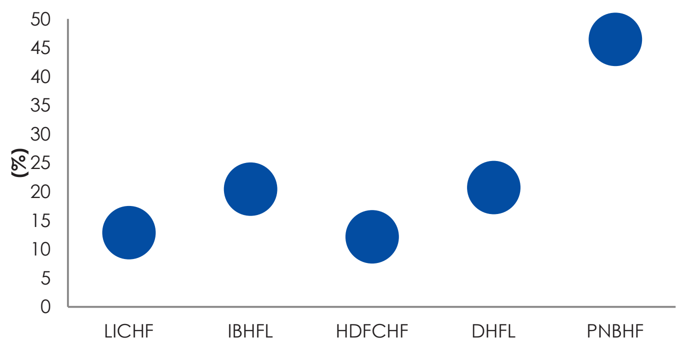
Net revenue to grow at 2.0x the top 5 companies because of rationalisation of rate of interest of its peers; consequently the net revenue growth of its peers to be slower as compared to loan book growth



PAT to grow at 1.9x of average of these top 5 companies; growth is slightly lower than the revenue growth due to an elevation in credit cost



EPS of PNBHF to grow in line with PAT as we have not considered any dilution till FY19E

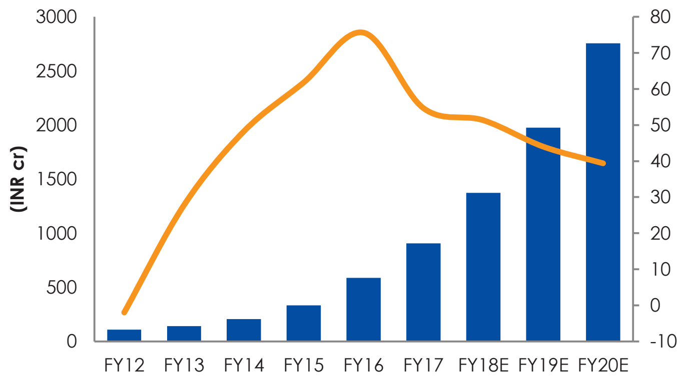


Source: Edelweiss Investment Research

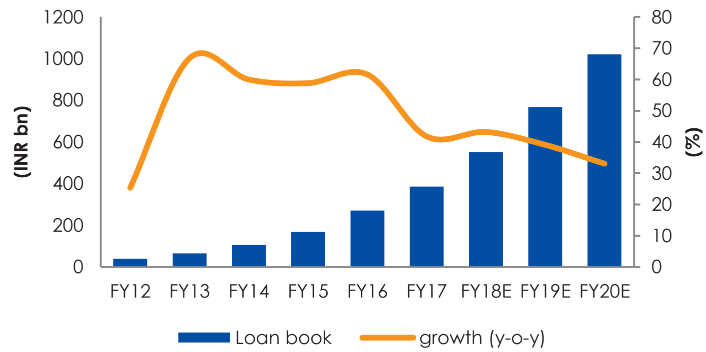
Financial outlook

PNBHF has reported 58% and 53% growth between FY12-17 in loan book and net revenue. We have projected 38% growth in loan book and 39% growth in revenue over FY17-20E. The revenue growth is expected to be slightly higher because of its increasing presence in non-metros and due to moving to lower ticket sizes. We believe these transitions will help in a stable spread.

Net revenue to accelerate on back of stable margins

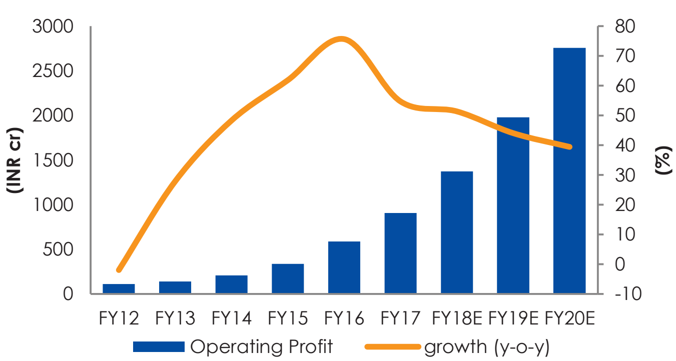


Loan book continuous to outperform

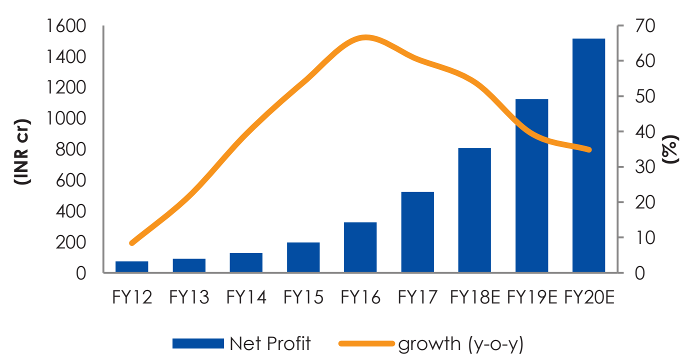


Operating profit and net profit registered 53% and 47% growth from FY12 to FY17 and we have projected 43% and 42% growth in operating profit and net profit over FY17-20E. Operating expenses are expected to moderate but credit cost is expected to inch-up in near future. As a result of this, PAT is expected to grow at a slower pace compared to operating profit.

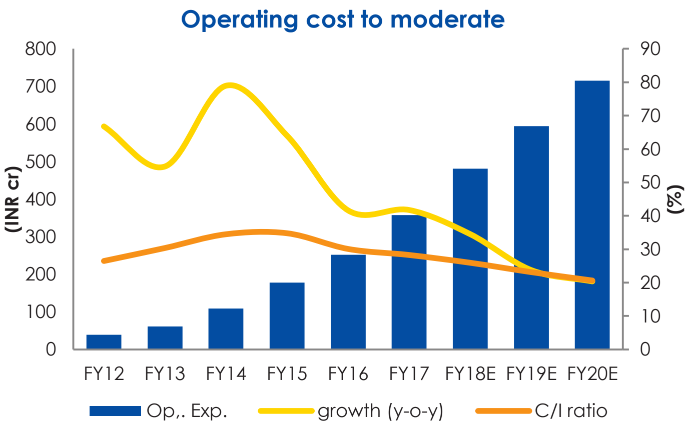
Operating growth to remain elevated on cost

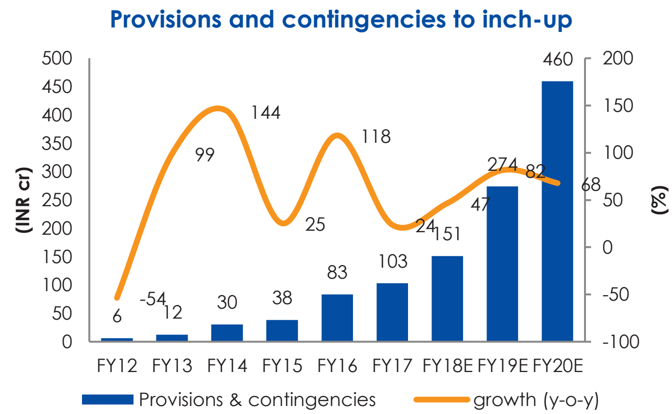


PAT growth to be slower due to higher credit cost

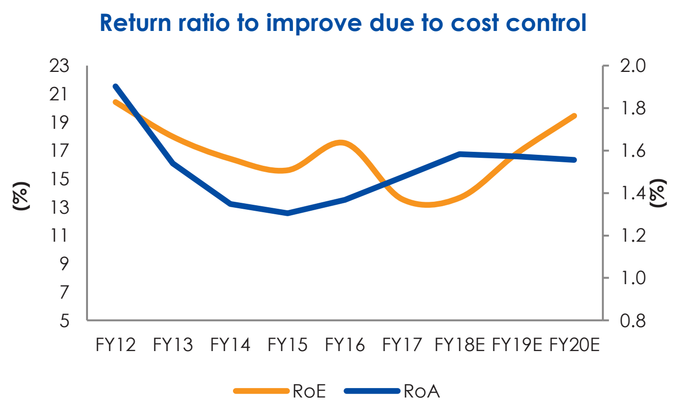


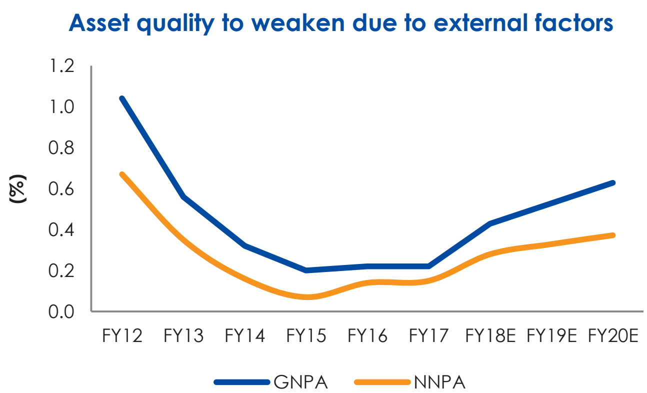
Operating expenses remained elevated due to significant branch expansions. We believe the operating expenses to moderate on account of: a) economies of scale, and b) branch expansions to slow down from next year. The provisions and contingencies of PNBHF were lowest in the industry but we expect it to surge due to some external shocks such as RERA and GST.



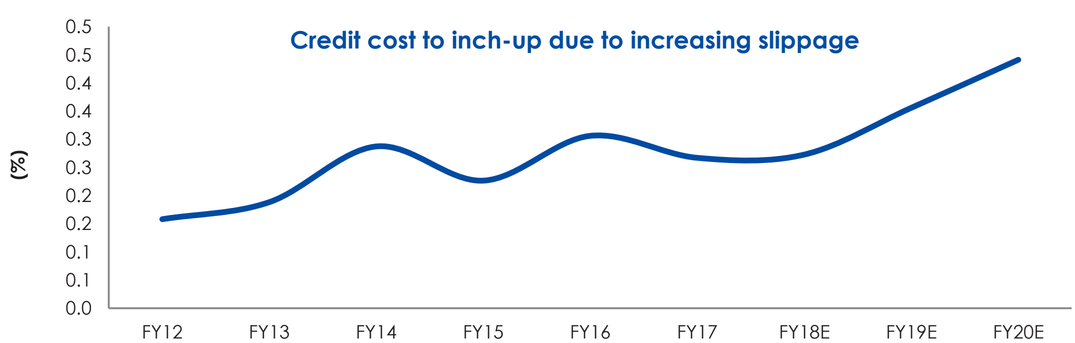


We expect RoA and RoAE to increase as cost-to-income ratio will moderate due to slower pace of branch additions and economy of scale. The return ratios will likely improve but at a moderate pace due to deteriorating asset quality.





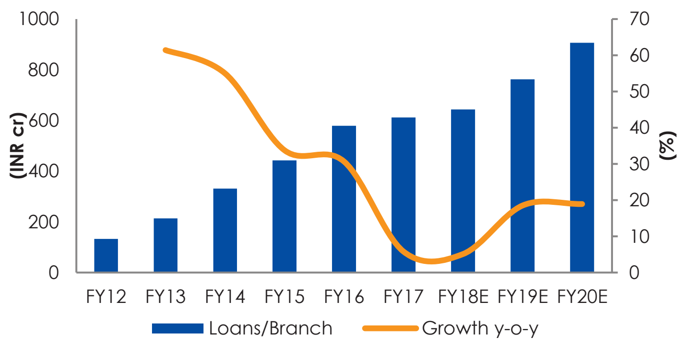
As a consequence of this credit costs will likely increase ahead.



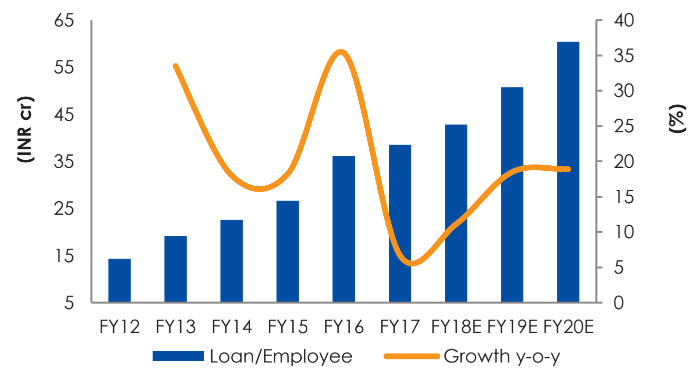
Source: Company, Edelweiss Investment Research

We believe PNBHF gets the premium valuation from its peers on account of superior growth from its peers with healthy asset quality.

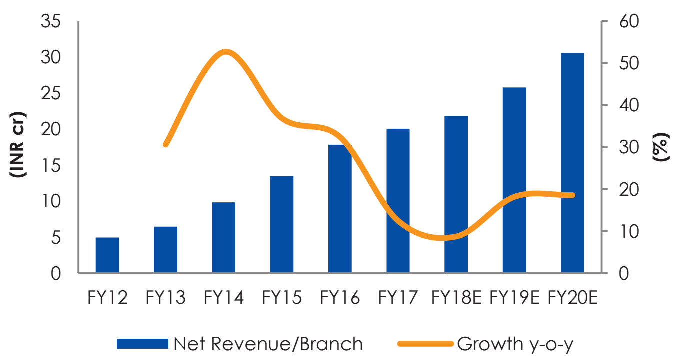
Loan per branch surged from INR 132crs to 612crs from FY12 to FY17 and we have projected INR 906crs by FY20E. Growth/branch is likely to slow down due to rapid pace of branch expansion.



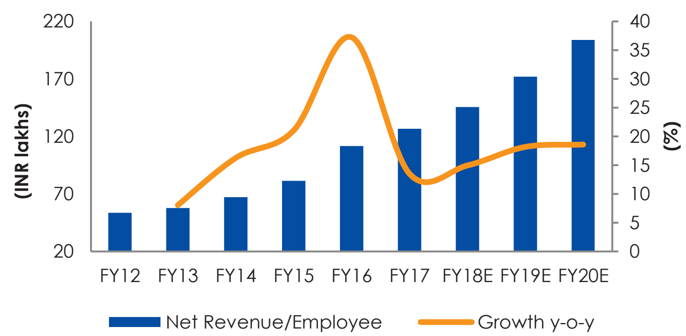
Loan per employee increased from INR 14crs to 39crs and we have projected INR 60crs loan per employee by FY20E.



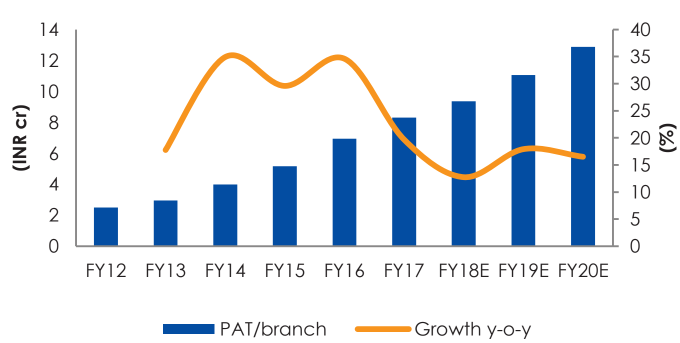
Revenue per branch reported 32% growth over FY12-17 to INR 20crs and we have projected 15% CAGR between 2017-20E to INR 31crs.



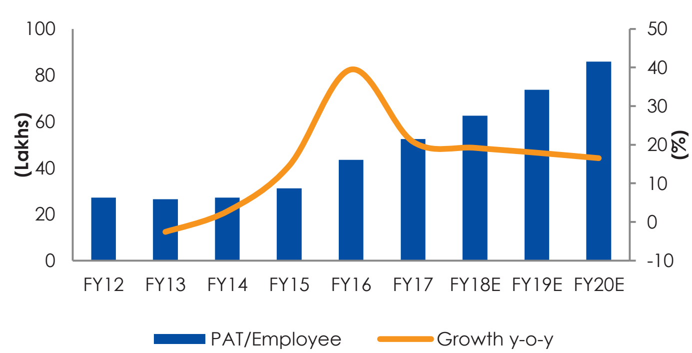
Revenue per employee increased from INR 53lakh to in FY12 to INR 127lakh in FY17 and we have projected this to catapult to INR 204lakh by FY20E.



Net profit per branch grew to 3.3x over FY12-17 to INR 8crs and we have projected 1.5x growth over FY17-20E to INR 13crs.



Net profit per employee grew to 1.9x over FY12-17 to INR 52lakh and we have projected 1.6x growth over FY17-20E to INR 86lakh.



Source: Edelweiss Investment Research

Financials

Income statement					(INR cr)
Year to March	FY16	FY17	FY18E	FY19E	FY20E
Interest income	2,546	3,640	5,060	6,930	9,145
Interest charges	1,860	2,644	3,586	4,883	6,393
Net interest income	686	996	1,474	2,047	2,752
Fee & other income	153	268	373	504	629
Net revenues	838	1,264	1,846	2,551	3,381
Operating expense	252	357	464	577	707
- Employee exp	75	101	133	168	207
- Loans acquisition & CSR Cost	54	94	118	149	187
- Other opex	123	162	213	261	312
Preprovision profit	586	907	1,382	1,974	2,674
Provisions	83	103	150	270	390
PBT	503	804	1,232	1,704	2,285
Taxes	177	280	430	595	797
PAT	326	524	802	1,109	1,487
Extraordinaries	0	0	0	0	0
Reported PAT	326	524	802	1,109	1,487
Basic number of shares (mn)	12	14	17	17	17
Basic EPS (INR)	27	37	48	67	90
Diluted number of shares (mn)	12	14	17	17	17
Diluted EPS (INR)	27	36	48	66	88
DPS (INR)	3	6	8	10	12
Payout ratio (%)	12	16	17	15	13

Growth ratios (%)					
Year to March	FY16	FY17	FY18E	FY19E	FY20E
NII growth	68.9	45.3	47.9	38.9	34.5
Net revenues growth	63.8	50.8	46.1	38.2	32.5
Opex growth	41.6	41.7	29.9	24.4	22.4
PPP growth	75.6	54.7	52.4	42.8	35.5
Provisions growth	118.4	23.7	46.0	79.6	44.4
PAT growth	66.5	60.4	53.1	38.3	34.1

Operating ratios (%)					
Year to March	FY16	FY17	FY18E	FY19E	FY20E
Yield on advances	11.2	10.6	10.3	10.1	9.8
Cost of funds	8.7	8.6	8.2	7.9	7.6
Spread	2.5	2.1	2.1	2.1	2.2
Net interest margins	2.9	2.8	2.9	2.9	2.9
Cost-to-income	30.1	28.3	25.1	22.6	20.9
Tax rate	35.1	34.9	34.9	34.9	34.9

Balance Sheet					
Year to March	FY16	FY17	FY18E	FY19E	FY20E
Paid Capital	127	166	166	166	166
Reserve & Surplus	2,019	5,412	6,054	6,964	8,212
Shareholder's Fund	2,146	5,577	6,220	7,130	8,378
Total Borrowings	26,145	35,674	51,360	71,817	96,069
Other Liabilities	1,380	1,708	2,797	4,585	6,120
Total Liabilities	29,671	42,960	60,377	83,532	1,10,567
Cash & Bank Balance	249	151	166	192	204
Investment	1,622	3,280	4,144	5,381	6,649
Loan & Advances	27,177	38,531	55,175	76,739	1,02,108
Net Fixed Assets	62	60	65	70	75
Other assets	561	937	828	1,151	1,532
Total Assets	29,671	42,960	60,377	83,532	1,10,567

Balance sheet ratios (%)					
Year to March	FY16	FY17	FY18E	FY19E	FY20E
Loan growth	61.6	41.8	43.2	39.1	33.1
EA growth	55.3	44.5	41.8	38.4	32.4
Disbursement growth	53.1	42.8	38.9	32.9	25.9
Gross NPA ratio	0.2	0.2	0.4	0.5	0.6
Net NPA ratio	0.1	0.2	0.3	0.3	0.4
Provision coverage	36.4	31.8	34.8	37.8	40.8

RoE decomposition (%)					
Year to March	FY16	FY17	FY18E	FY19E	FY20E
Net interest income/Assets	2.9	2.8	2.9	2.9	2.9
Other Income/Assets	0.6	0.8	0.7	0.7	0.7
Net revenues/Assets	3.5	3.6	3.6	3.6	3.5
Operating expense/Assets	1.1	1.0	0.9	0.8	0.7
Provisions/Assets	0.3	0.3	0.3	0.4	0.4
Taxes/Assets	0.7	0.8	0.8	0.8	0.8
Total costs/Assets	2.1	2.1	2.1	2.0	2.0
ROA	1.4	1.5	1.6	1.6	1.6
Equity/Assets	9.0	15.7	12.3	10.1	8.8
ROAE	17.5	13.6	13.6	16.6	19.2

Valuation metrics					
Year to March	FY16	FY17	FY18E	FY19E	FY20E
Diluted EPS (INR)	27.5	36.2	47.7	65.9	88.4
EPS growth (%)	*12.6*	*31.6*	*31.9*	*38.3*	*34.1*
Adjusted BV per share	168.9	336.3	374.8	428.6	502.8
Diluted P/E (x)	48.9	37.2	28.2	20.4	15.2
Price/Adj. Book Value(x)	8.0	4.0	3.6	3.1	2.7
Basic EPS (INR)	27.5	36.7	48.4	67.0	89.8
Price/ Earning (x)	48.9	36.6	27.8	20.1	15.0

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Cement

Cement sector

Housing for all to boost Cement demand

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The domestic cement sector has been plagued by a decade of low volumes induced by subdued construction activities and healthy capex over 2007-16. Consequently, utilisation plummeted from a peak of 90% in FY07 to 67% in FY17 and realisation grew at a tepid pace than input price. This took a heavy toll on the industry's profitability. However, we perceive a change in the sector's fortunes. The government's renewed focus on construction (road, metro, dam, railway), Housing For All by 2022 along with Smart Cities initiatives are envisaged to drive cement demand at >2.0x capacity addition over the next decade. We estimate cement demand to clock 7.5% CAGR over FY17-25 and catapult to 490mt from current 280mt. Our deep dive analysis indicates strong correlation between utilisation and realisation. Hence, we estimate utilisation to jump to 90% in FY25 from 67% currently, which, in turn, is bound to strengthen realisation. Our back-of-the-envelope calculation indicates that EBITDA increases ~4% on every 1% rise in cement price. Ergo, we surmise, anchored by the aforementioned catalysts, that outlook for the cement industry is promising.

Utilisation to inch up gradually; East and Central to lead other regions

We expect utilisation to inch up as construction under PMAY in the affordable segment has accelerated over the past 2 years. Central and East contribute 50% to total housing shortage and houses constructed under PMAY in these two regions were ~50% in FY17 and we expect the construction activities in the aforesaid region to continue. We believe the sector has potential to grow ≥7.5% over 2017-25; over 1990-2016, it clocked 7.5% CAGR.

Improving utilisation & marginal uptick in realisation: Key EBITDA expansion catalysts

Cement companies have successfully passed on rising costs, thus maintaining pricing power and ensuring it even during a weak demand-supply scenario. Post demonetisation, cement price/bag jumped 10-20% and the hike has sustained. Our deep dive analysis indicates that 1% expansion in realisation boosts EBITDA ~4%. We estimate the industry's EBITDA to improve from current INR858 per tonne as: a) rising utilisation boosts realisation; and b) realisation per tonne of cement has remained soft compared to input price. Hence, we estimate EBITDA per tonne to improve in the medium to long term.

Our valuation approach and top picks

We retain our positive stance on the cement sector and anticipate government spending on affordable housing and interest subsidy under EWS/LIG/MIG to spearhead the next upcycle. Our framework to pick top bets involves evaluating companies with frugal capital allocation and their ability to gain market share & cost leadership. Moreover, improving macro-economic indicators along with stable pricing are bound to propel long-term growth. Though economic recovery is anticipated to be broad based, South, East and Central regions remain our preferred bets. Return ratios in small and mid-cap companies are expected to be higher as their RoAs have fallen from peak of ~27% in FY07 to ~7% and are currently improving at a healthy pace. This, along with leaner balance sheets and medium-term demand recovery triggers, portend ample headroom for further re-rating of the mid-cap universe in light of the much anticipated improvement in return ratios in line with utilisation spurt.

Our top picks are BCorp, SANGI, SRG and JKLCM. SNGI is doubling the cement capacity to 8.2mt by FY20E, SRG is increasing the capacity from 4.3mt to 5.5mt in FY19E, BCorp is in advance stage to set up 4-5.5mt and taking total capacity to ~20mt next 2-3 years and JKLCM is planning to increases capacity from existing 12.5mt to ~20mt in next 4-5 years. We believe, these stocks have potential upside of 1.7-2.1x in the next 2-3 years on account of: a) improving return ratios; b) rising margin as realisation improves; and c) incremental capex at lower cost. Therefore, we recommend these stocks from the medium to long-term perspective.

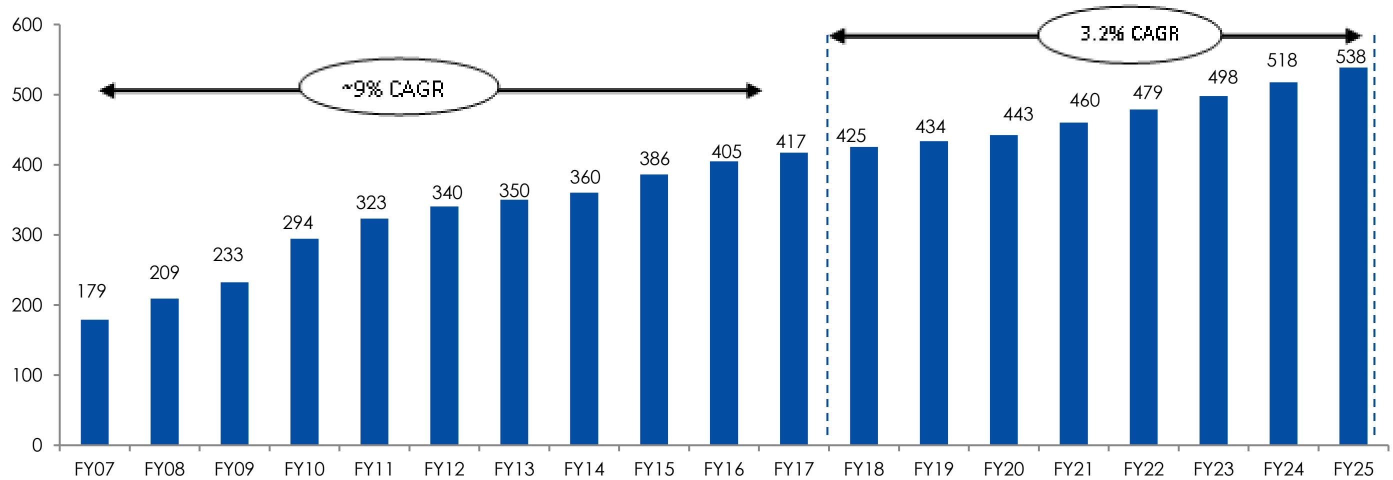
Particulars	Bcorp		JKLC		SGR		SNGI	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Net Revenue	5568	6210	3470	4084	1063	1271	1177	1436
EBITDA	992	1221	477	748	185	259	278	359
EBITDA margin	18	20	14	18	17	20	24	25
Adj. PAT	238	421	121	328	53	104	94	132
Adj. EPS (INR)	31	55	10	28	26	56	4	6
P/E(x)	35	20	38	14	33	15	29	20
EV/EBITDA(x)	11.8	9.7	14.2	9.0	11.2	7.7	10.9	8.4

Date: 4th December 2017

Capacity expansion set to moderate

Capacity expansion over 1990-2016 was 7.5%, which escalated at CAGR of 9% over 2007-17. We have projected 3.2% capacity addition, slightly lower, because current capacity utilisation is ~67-68% and we expect significant consolidation in the sector. Hence, fresh capacity addition is expected to be at a slower pace.

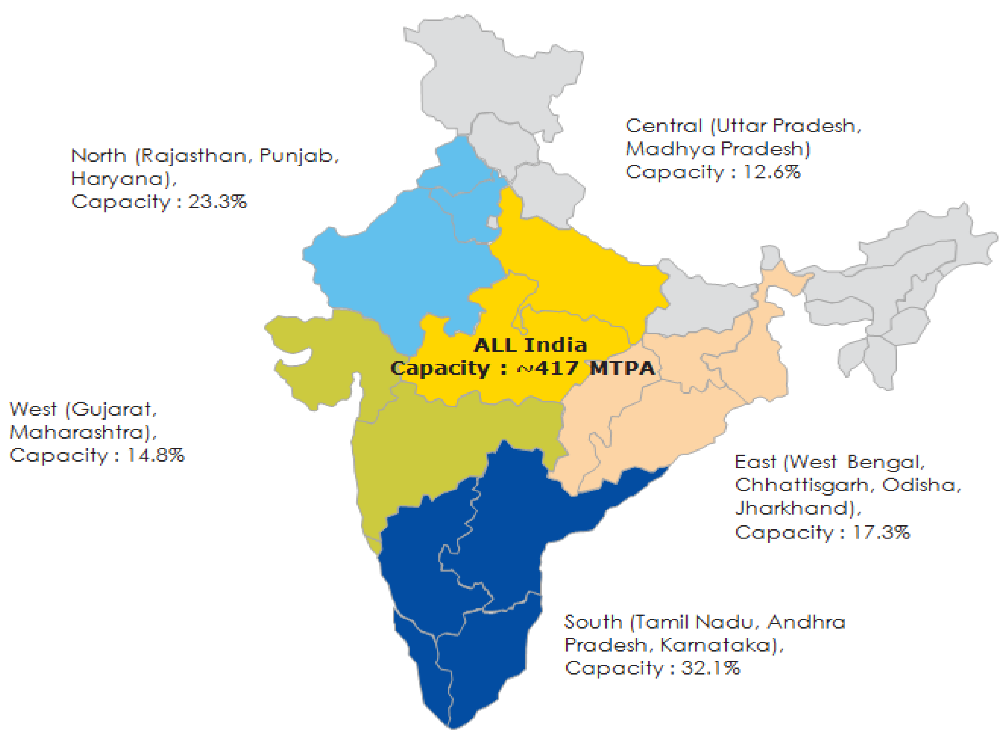
All India Capacity (MTPA)



Source: Edelweiss Investment Research

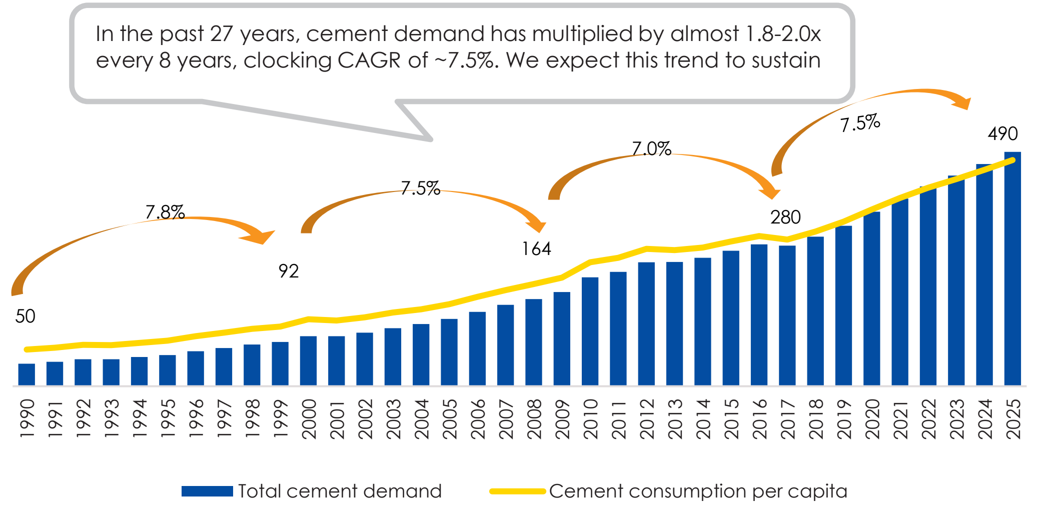
Cement capacity zone-wise

India is world's second-largest cement market, in production as well as consumption. It has 575 operational cement plants with combined capacity of ~417mt as of FY17. Cement demand is supported by high level of activity in real estate and high government spending on Smart Cities & urban infrastructure. The domestic cement industry is divided into 5 zones viz., North, Central, East, South and West with capacities of 97MTPA, 53MTPA, 71MTPA, 134MTPA and 62MTPA, respectively. Cement prices vary depending on demand and supply in each zone.



Demand envisaged to catapult to 490mt by 2025

Historically, cement demand has doubled almost every 8 years. With a modest 7.5% CAGR, Cement demand to jump to 490mt by 2025, largely driven by robust demand in the much anticipated sector upcycle in the medium term.



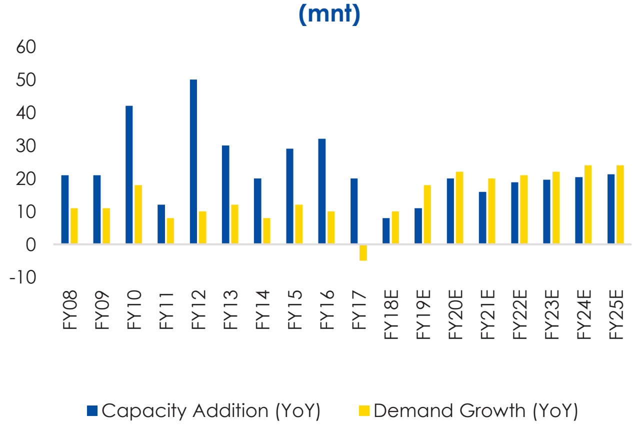
Source: Edelweiss Investment Research

Demand set to outpace capacity addition

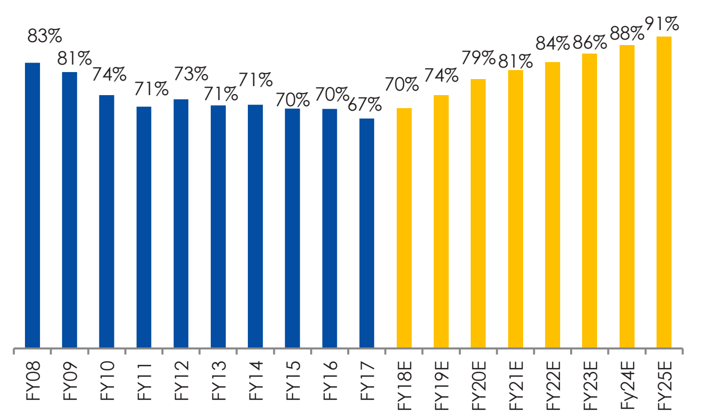
For the first time in the past 11 years, incremental cement demand will overtake incremental cement capacity addition. We expect industry utilisation to bottom out at 67% and rise to 72-75% by FY20. Cement production has clocked CAGR of 6.44% to 279.98mt over FY07–17. Availability of fly ash (from thermal power plants) and use of advanced technology have boosted production of blended cement. The environment-friendly blended cement is more cost-efficient to produce as it requires lesser input of clinker and energy. Domestic consumption may outpace supply in the ensuing 3 fiscals.

FY17 utilisation rate was the lowest in the past decade, but it seems to have bottomed out and is expected to move up. Demand is envisaged to outpace capacity addition in coming years, in turn boosting utilisation.

Incremental Capacity addition vs. demand (mnt)

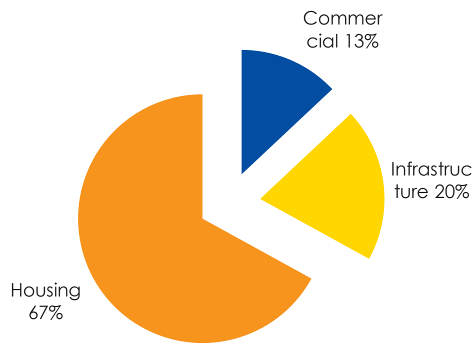


Capacity Utilisation



Source: Edelweiss Investment Research

Cement Demand



Demand for cement is expected to grow at a healthy clip over the next 7-9 years, primarily led by increased consumption from housing and infrastructure segments. Over the next 7-9 years, housing will remain the largest end-user of cement; within the sector, individual housing projects, especially in rural and semi-urban areas, are likely to drive incremental demand.

Source: Edelweiss Investment Research

Demand Drivers. . .

- The housing segment accounts for major portion of the total domestic demand for cement in India.
- Growing urbanisation, an increasing number of households and higher employment are primarily driving demand for housing, accounting for 67% of total consumption.
- Initiatives by government like Housing For All, etc., are expected to provide an impetus to construction activity in rural and semi-rural areas.
- Infrastructure status to affordable housing is a landmark announcement for real estate industry. The allocation under the Pradhan Mantri Aawas Yojana-GraminAawas also increased to INR23,000crore from last year's INR5,000crore.

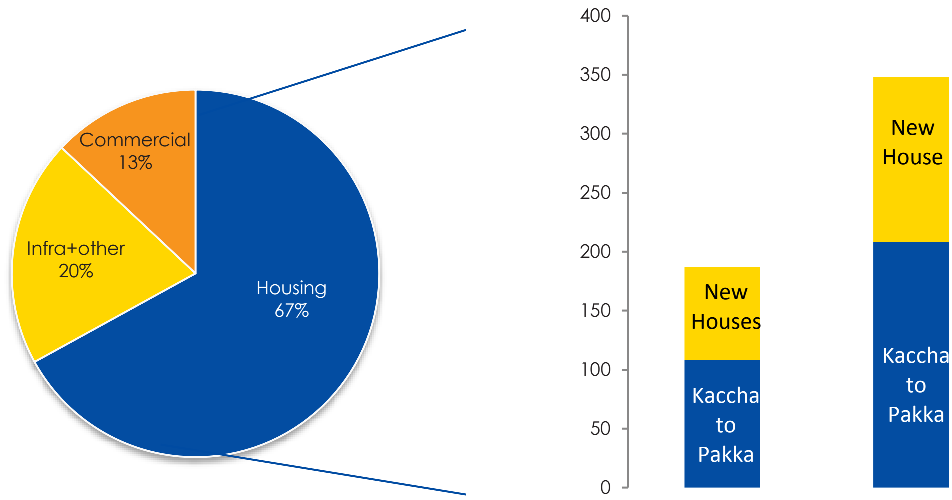
- The government is focussed on infrastructure development to boost economic growth and is targeting 100 Smart Cities.
- It plans to increase investment in infrastructure to USD1tn in the 12th Five Year Plan (2012-17) compared to USD514bn under 11th Five Year Plan (2007-12).
- Infrastructure projects such as Dedicated Freight Corridors as well as new and upgraded airports and ports are expected to further drive construction activity.
- The government intends to expand the capacity of railways and facilities for handling and storage to ease the transportation of cement and reduce transportation cost.

- Commercial Real estate market is expected to grow at 11.6% over 2011-20, with market expected to reach USD180bn by 2020.
- Government has introduced Real Estate Investment Trust (REIT) which can be a game changer. India (top 7?8 metros) has rent generating assets totalling ~540msf, which should translate into INR3,780?4,860bn overall REIT?able superset.

Source: Edelweiss Investment Research

Assuming one house is ~600-650sq.ft, cement required per house construction is ~10-11tonnes. At a run-rate of new house roll-out of 8-12m/yr, Annual demand from new Houses could be over 131mt/year, driving up total housing demand to 348mt/yr

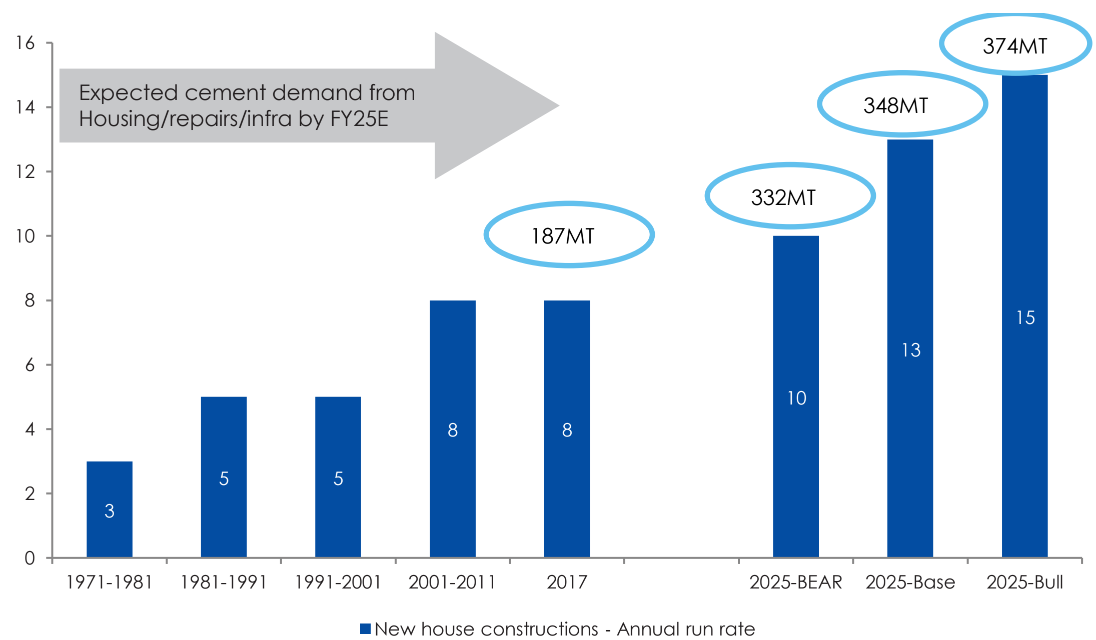
Indian Cement consumption by housing: New houses & conversion/maintenance



Source: Edelweiss Investment Research

Housing stock build-out annual run rate and cement demand

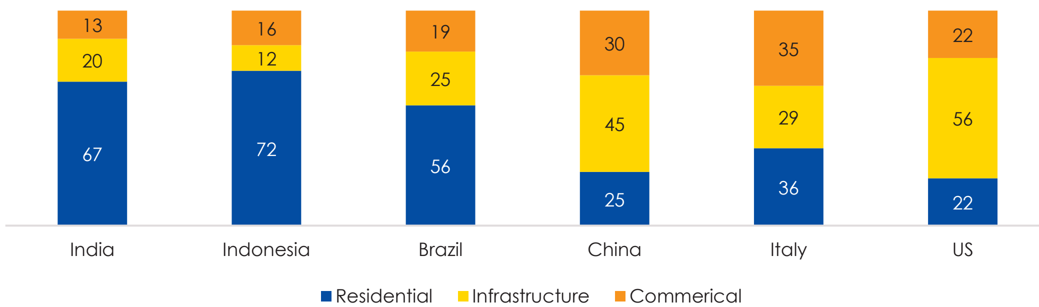
Over the past 5 years, urban housing projects propelled cement demand from the housing segment. While demand from rural housing projects posted CAGR of 6-7%, urban housing demand clocked CAGR of 8-9% during the same period. The urban housing market has boomed over the past few years owing to rising affordability, better financing penetration, change in demographic pattern and an increase in the number of nuclear families due to urbanisation.



Source: Edelweiss Investment Research

Housing remains major demand driver

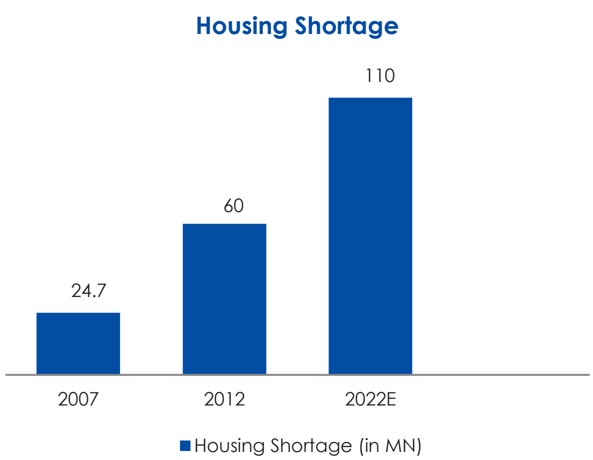
India is the second largest producer of cement in the world with a total capacity of ~417mtpa. The cement industry is a vital cog in the country's economy. The housing sector was the biggest demand driver of cement, accounting for about 67% of total consumption. India's cement demand is expected to reach 490mtpa by 2025.

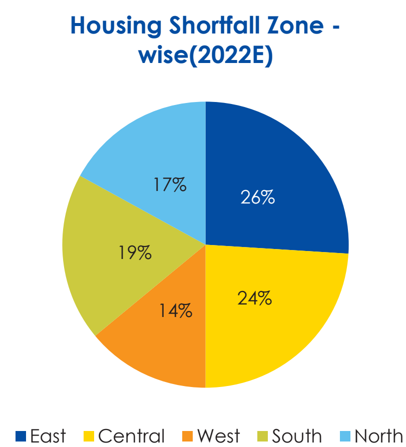


Source: Edelweiss Investment Research

Housing shortfall to boost demand

At the beginning of 12th 5 year plan, the housing shortage in India was 60mn, which is at all-time high and estimated to double to 110mn by FY22. As families become more nuclear and the number of family members per household dips, housing demand will balloon. The incremental households-to-population ratio is at 3.1 members per household versus 4.8 earlier. Rising income levels, urbanisation and lower household-to-population ratio will lead to higher cement intensity.

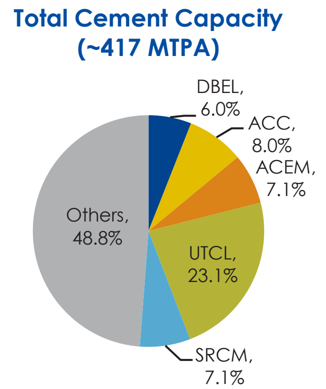


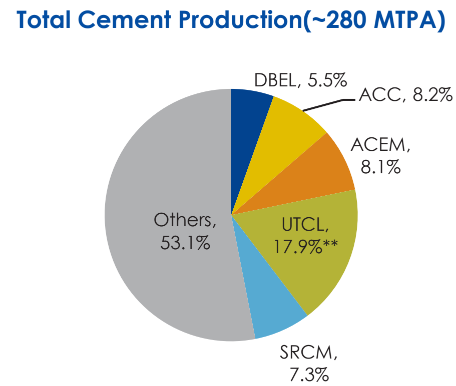


Source: Edelweiss Investment Research

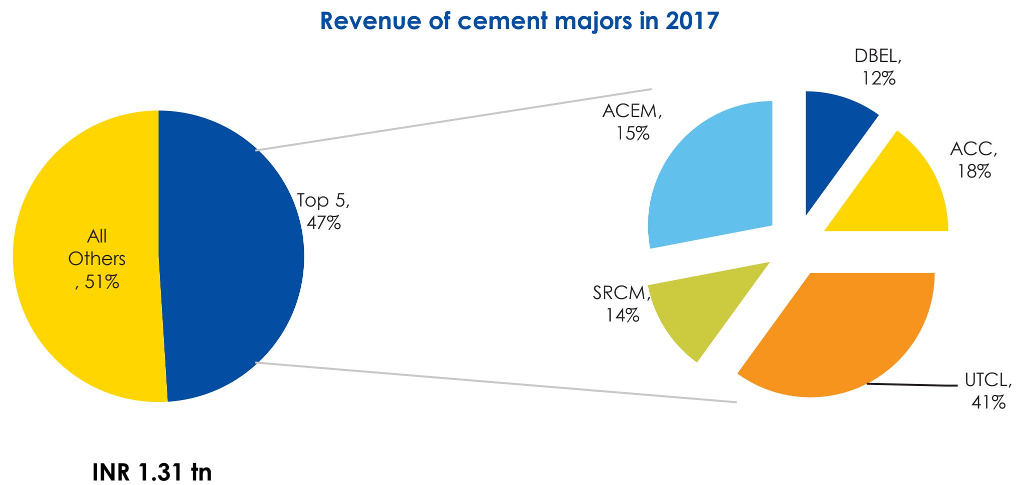
Domestic market: Large players control market

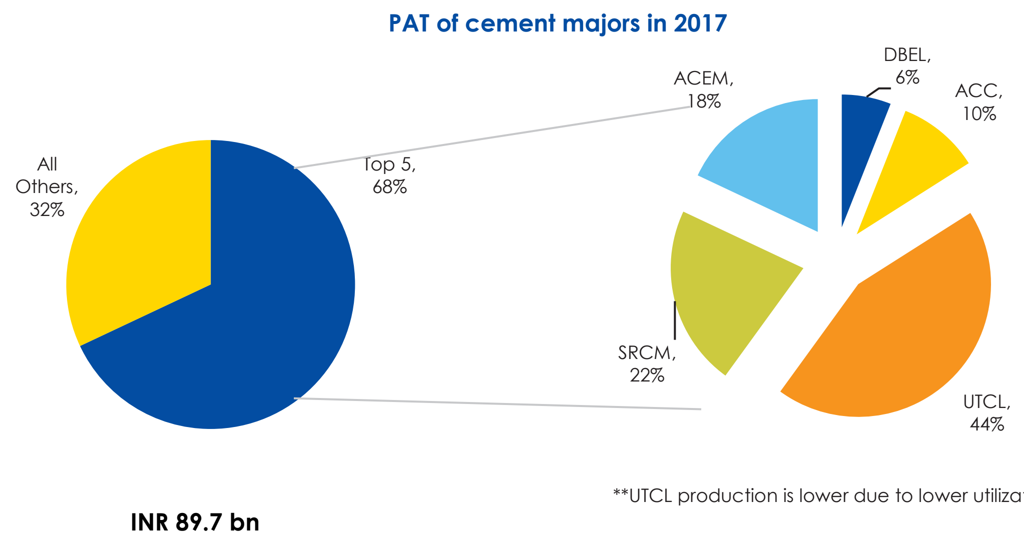
The domestic cement market is oligopolistic, characterised by tacit collusion, where large players partially control supply for better price discipline. The cement industry seems to be bottoming out with growth and demand picking up. The top 5 players control market with 51% of industry revenue and 73% of industry PAT. They also control 51% o total cement capacity in India with 47% of total domestic production. This dominance is likely to continue in coming years.





Source: Edelweiss Investment Research





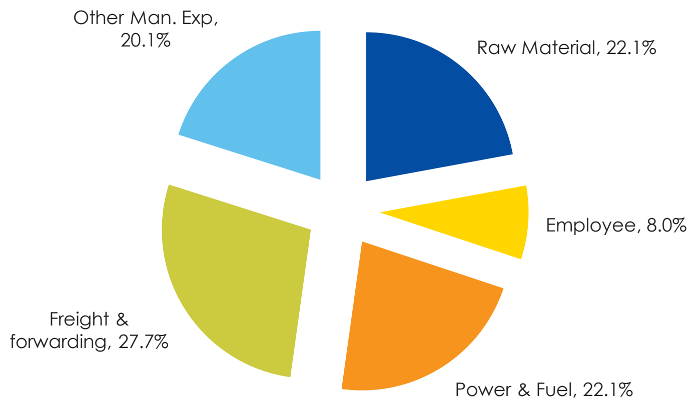
**UTCL production is lower due to lower utilization of JPA

Source: Edelweiss Investment Research

Pet coke and diesel prices lead to volatility in variable cost

Power & fuel and freight are major components of costs of the cement industry given that it is an energy and freight intensive industry. Power & fuel costs as well as transport/freight costs contribute about 22-23% each to the overall cost of production. Therefore, margins are susceptible to adverse changes in these inputs costs. Coal prices have started to firm up since July 2016. Further, price of pet coke, an alternative to coal, has also increased since February 2016 (up 78%) primarily due to supply constraints as well as high demand. Hence, the ability of players to pass on the rise in input costs will be crucial to sustain margins.

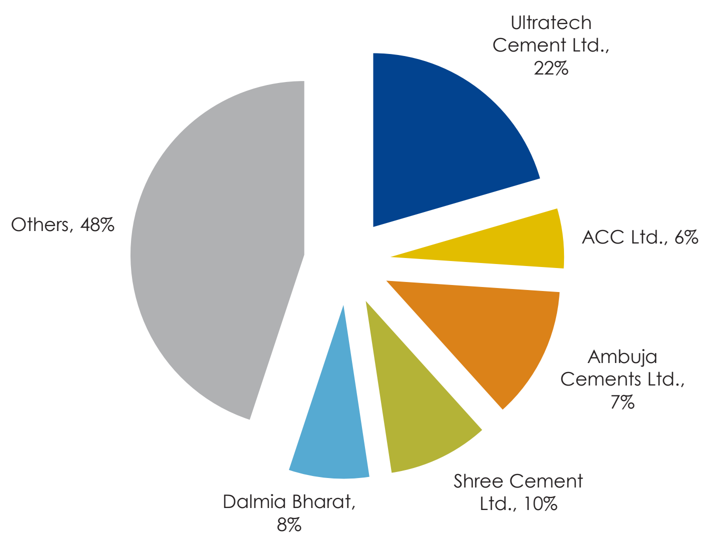
Industry cost in FY17



Source: Edelweiss Investment Research

With variable input costs, EBITDA margins are always under pressure. The top 5 companies contribute to ~57% to industry EBITDA. Relatively better and widespread monsoon this year was expected to favourably impact cement demand starting H2FY17. However, demonetisation in November 2016 has impacted the industry's demand growth.

Top 5 players contribute more than 50% of Industry's EBITDA

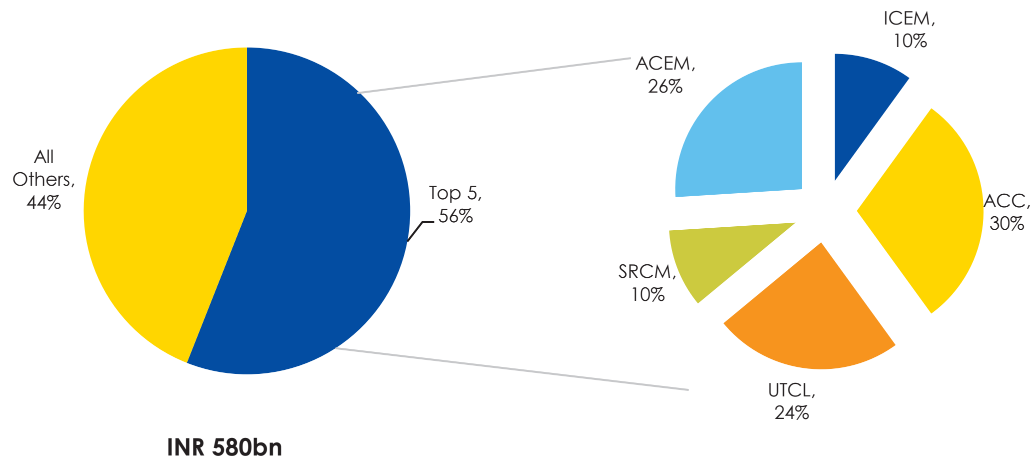


Source: Edelweiss Investment Research

Continuous capacity addition and improvement in profitability helped in market cap expansion

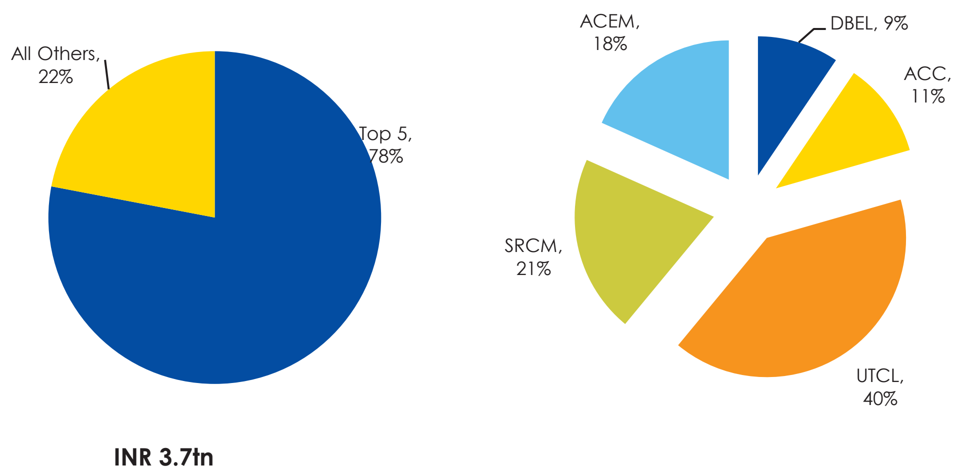
Over the past 11 years, increase in market cap has reflected volume growth trend. Market caps of SRCM and UTCL jumped 18.6x and 12.6x, respectively, in the previous decade compared to 5.8x rise in industry's market cap. SRCM expanded capacity 4.6x during the period, giving investors returns of over 32% CAGR. Even UTCL's market cap clocked an impressive 27% CAGR during the period. Below chart indicates that the top 5 players have gained significant market share in the previous decade.

Market cap of cement majors in 2006



Source: Edelweiss Investment Research

Current market cap of cement majors in 2017

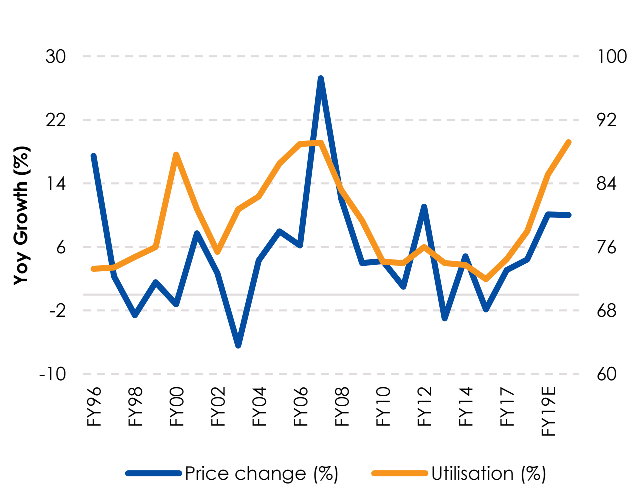


Source: Edelweiss Investment Research

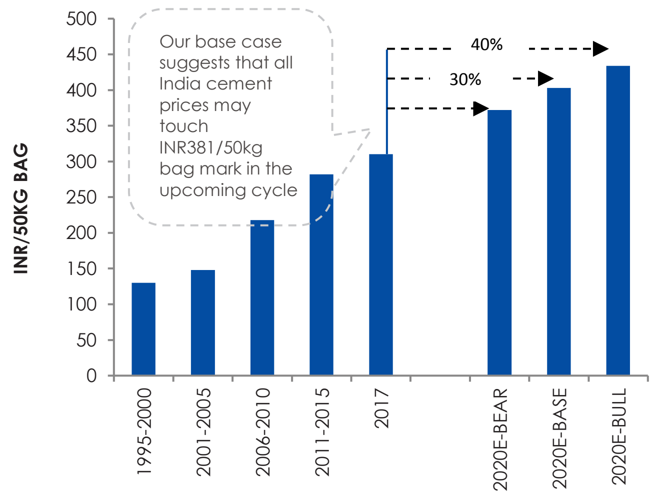
Cement upcycle could start from FY19

Over the next 12-18 months, we expect cement prices to partially offset increase in input prices as utilisation levels will increase over the next few years. Average cement prices across India rose from ~INR148/bag during FY01-05 to ~INR218/bag in FY06-10 and then averaged at ~INR282/bag during FY11-15. Current run rate of ~INR310/bag is ~13% higher than average price during FY11-15. Historically, every 5 years, average selling price moved up 15-25% when utilisation levels were fairly steady. During periods of rising utilisation, prices were hiked 30-40%. We expect prices to rise as utilisation too jumps in coming years.

High correlation between utilisation and price growth



All-India - Shift in avg. cement prices every 5 years

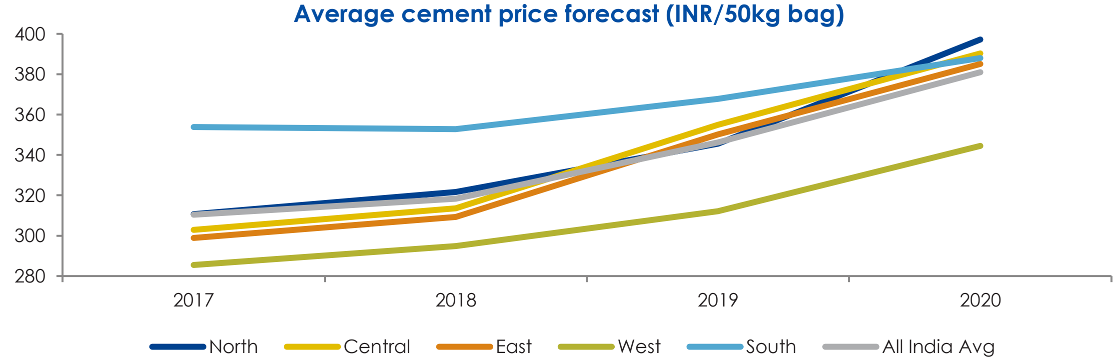


Source: Edelweiss Investment Research

Cement prices in Tamil Nadu are already close to INR400/bag. We believe, as these prices have been absorbed by end consumers, we do not perceive any issues in acceptance of INR400/bag price at the all India level. Accordingly, it's a matter of time before these prices are absorbed in the market. With utilisation likely to cross the 82-85% threshold over the next few years, we estimate margin to rise closer to 30-35%, implying 20-30% jump in cement prices over the next 2-3 years.

The following table depicts our price assumptions till FY20.

Average cement price forecast (INR/50kg bag)



Source: Edelweiss Investment Research

Consolidation in the sector leads to enhancement in profitability

UltraTech Cement has completed the INR16,189crore acquisition of Jaiprakash Associates' 6 integrated cement plants and 5 grinding units, having a capacity of 21.2mt.

Birla Corp completed acquisition of Reliance Cement's 5.58mtpa plants at Maihar (MP), Kundanganj (UP) and at Butiburi (Maharashtra) for INR4,800crore.

Boards of ACC and Ambuja Cements, both part of the LafargeHolcim Group, decided to merge and create a single large entity.

JSW Cement has acquired 37.16% stake from the promoters of Shiva Cement for INR97crore.

The merger of Dalmia Bharat (DBL) with OCL India (OCL) will create the fourth largest cement maker in India with an installed capacity of 25mtpa.

Orient Cement acquired 2 entities, Bhilai Jaypee Cement and Nigrie Cement Grinding Unit, from Jaypee Group for INR1,946crore.

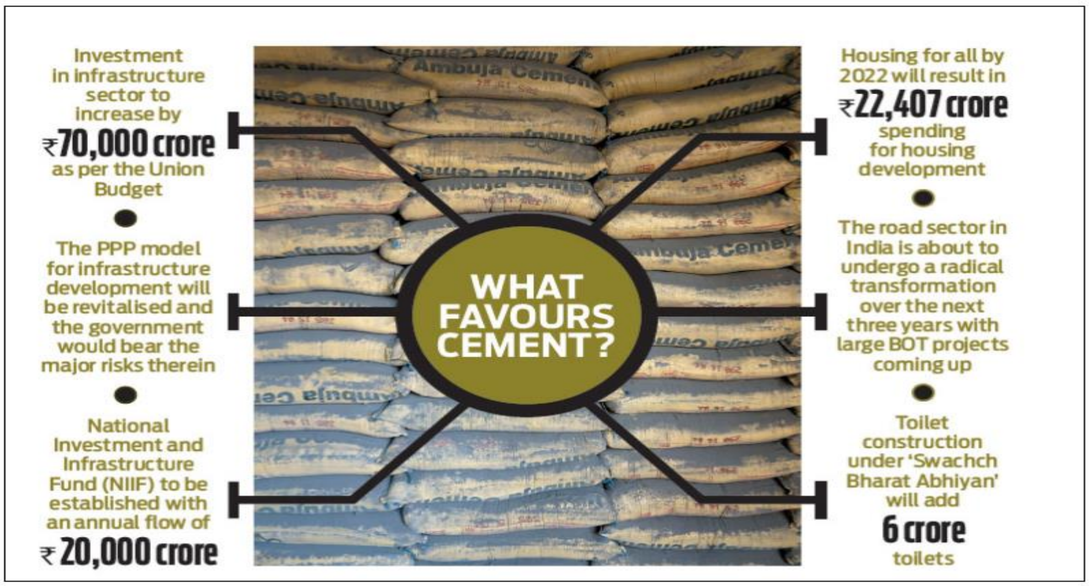
Detergent maker Nirma aquired LafargeHolcim India's 11 MTPA cement plants for an enterprise value of ~INR9,400crore, taking its cement capacity to 13.28mtpa.

Profitability increases along with capacity expansions

	EBITDA Margin	PAT Margin
Industry	17.9%	6.3%
Capacity > 20MTPA	19.8%	8.7%
Capacity between 10-20MTPA	17.3%	5.6%
Capacity < 10MTPA	15.6%	3.4%

Policy and Initiatives

Union Budget 2017-18	▪ The Union Budget has proposed to assign infrastructure status to affordable housing projects and facilitate higher investments and better credit facilities, in line with the government's aim to provide housing for all by 2022 which will boost cement demand.
Housing Loans	▪ The National Housing Bank will refinance individual housing loans of about Rs 20,000 crore (US$ 3 billion) in 2017-18. The Finance Minister proposed to complete 1 crore houses by 2019. All these developments are expected to boost cement demand.
Pradhan Mantri Awaas Yojana - Gramin scheme	▪ The increased allocation to rural low-cost housing under Pradhan Mantri Awaas Yojana- Gramin scheme to Rs 23,000 crore (US$ 3.45 billion) from Rs 16,000 crore (US$ 2.4 billion) in FY17 is likely to drive a 2 per cent increase in cement demand.



Edelweiss

Coverage Stock: Birla Corporation Ltd.

Moving to next orbit

CMP INR: 1082
Target INR: 1296
Rating: BUY
Upside: 20%

Birla Corporation (BCorp) is a Kolkata based geographically well diversified cement manufacturer with 15.4mt grinding capacity and 10mt clinker plants. With eye on growth, the company has chalked out a comprehensive capacity expansion programme spanning FY18-H1FY21 entailing a 4mt grinding unit in Mukutban (Maharashtra), which is envisaged to propel total capacity to ~20mt. Post this expansion, BCorp will be the fifth largest cement manufacturer in India. Besides this, it has sought environmental clearance to set up 1.5mt cement capacity at Chanderia (Rajasthan) and also valuable mineral concessions in Karnataka, Rajasthan, AP, HP and MP would provide ample opportunity to expand manufacturing plants across India. We estimate BCorp's revenue to post 19% CAGR over FY17-19E primarily led by higher volume and marginal growth in realisation. We have forecast 42%, 55% and 50% EBITDA, EBIT and PAT growth respectively over FY17-19E. We re-iterate our 'BUY' recommendation with TP of INR 1,296.

Next leg of expansion to propel among top 5 cement players in India

BCorp has chalked out a comprehensive capacity expansion programme spanning FY18-H1FY21E. The next leg of capex entails 4mt grinding unit and 3mt clinker plants in Mukutban (Maharashtra), which will propel the company's total capacity to ~20mt. In addition, BCorp has sought environmental clearance to set up 1.5mt cement capacity at Chanderia in Rajasthan. Also, its expansion potential is enhanced significantly by valuable mineral concession in Karnataka, Rajasthan, AP, HP and MP.

Reliance Cement acquisition: Significant margin and market share booster

The company has acquired Reliance Cement's 5.6mt grinding and 3.3mt clinker plants for INR48bn. Reliance Cement generated EBITDA per tonne of ~INR1,100 in FY17 and ~INR1,200 in Q1FY18. Consequently, BCorp's consolidated EBITDA margin surged 557bps to 14.3% and EBITDA per tonne catapulted 79% YoY to INR567. We anticipate the EBITDA expansion to sustain on account of accelerating growth, improving utilisation and marginal cost control. Hence, we have projected ~600bps margin expansion to 20.4% and EBITDA per tonne to improve from INR567 to INR919 over FY17-19E.

Lowest cost producer edge to improve further

BCorp is one of the lowest cost producers amongst mid & large size cement companies. The company's freight & forwarding, raw material and other manufacturing costs are 23%, 15% and 5%, respectively, lower than average cost of top 10 cement companies, while power & fuel cost is 10% higher. We believe post installation of 12MW WHRS at Satna (MP) power cost will dip ~4% of total P&F cost. Ergo, we anticipate further reduction in variable cost going forward.

Outlook and valuations: Firming up; initiate with 'BUY'

BCorp is currently trading at attractive valuation of 12.8x FY18E and 10.6x FY19E EV/EBITDA and EV/tonne of USD128 versus average of 12.3x FY19E EV/EBITDA and EV/tonne of USD170, ~33% discount to peers. . Based on P/E(x), EV/EBITDA and EV/Tonne, we have arrived at a target price of INR 1,296 per share. At current market price of INR1082, we re-iterate **'BUY'** with target price of INR1,296.

Year to March	FY15	FY16	FY17	FY18E	FY19E
Revenues (INR Cr)	3210	3268	4348	5568	6210
Rev growth (%)	6.4	1.8	33.0	28.1	11.5
EBITDA (INR Cr)	302	286	623	992	1221
Net Profit (INR Cr)	175	168	219	238	421
P/E (x)	53.4	55.8	42.6	39.4	22.2
EV/EBITDA (x)	30.6	31.1	20.6	12.8	10.6
RoACE (%)	3.1	2.8	6.0	6.6	8.7
RoAE (%)	6.8	6.0	7.0	7.0	11.5

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Bloomberg:	BCORP:IN
52-week range (INR):	1225/ 608
Share in issue (cr):	8
M cap (INR cr):	8,475
Avg. Daily Vol. BSE/NSE :('000):	89
Promoter Holding (%)	62.9

Initiation Date: 10th October 2017

Intiation Price: INR 952

Date: 4th December, 2017

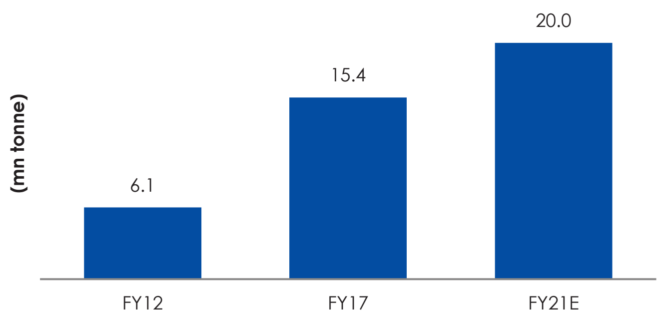
Average Daily Turnover (INR cr)			Stock Price (CAGR)				Sensex CAGR (%)			
3 months	6 months	1 year	1 year	2 years	5 years	10 years	1 year	2 years	5 years	10 years
8.22	7.91	6.79	66%	34%	36%	12%	27%	6%	10%	6%

Business Value Drivers

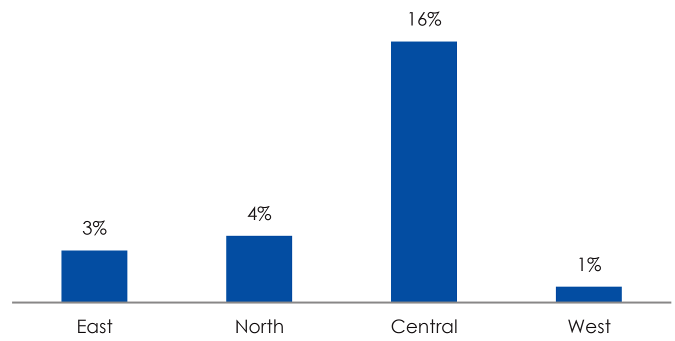
Nature of Industry	Top 5 companies control ~51% of total installed capacity, ~59% of revenue, ~65% of industry EBITDA and 73% of industry PAT. Top 10 companies contribute 69% of installed capacity while revenue, EBITDA and PAT contribute 79%, 84% and 89% respectively.
Opportunity Size	Industry has positive correlation with GDP and generally grows at ~1.0x of real GDP growth. Cement demand is expected to accelerate on account of potential demand from Road sector, Metro and housing. We have projected ~7.5% growth over FY17-25E.
Capital Allocation	BCorp has chalked out a comprehensive capacity expansion programme of INR 24bn, spanning till H1FY21. The next leg of capex entails 4mt grinding unit and 3mt clinker plants in Mukutban (Maharashtra), which will propel the company's total capacity to ~20mt.
Predictability	Cement demand has positive correlation of ~1.0x of real GDP growth rate and good Monsoon also accelerates the growth. We believe the near term growth is expected to remain healthy on account of good monsoon, housing for all by 2022 and construction of Road and Metro at double pace.
Sustainability	Well diversified geographical presence ensures the sustainability of cement sales volume and revenue. In past, BCorp has reported higher growth in volumes and revenue aided by higher utilisation.
Future Prospect	The future outlook of the industry is likely to be promising on account of good monsoon, pay hike, smart cities and housing for all by 2022 and BCorp has been growing at higher pace than the industry average in term of capacity expansion and cement sales volume.
Business Strategy & Planned Initiatives	Company is planning to enhance the installed capacity from 15.4mn tonne to ~20mn tonne by 2021. Therefore BCorp has chalked out a comprehensive capacity expansion programme spanning till H1FY21. The next leg of capex entails 4mt grinding unit and 3mt clinker plants in Mukutban (Maharashtra), which will propel the company's total capacity to ~20mt. The expansion will catapult the company to fifth largest cement manufacturer in India with significant presence in West & Central regions.
Near Term Visibility	To enhance the installed capacity and presence in West.
Long Term Visibility	Valuable mineral concessions in Karnataka, Rajasthan, AP, HP and MP entail lucrative opportunities to expand manufacturing plants across India.

Focus Charts

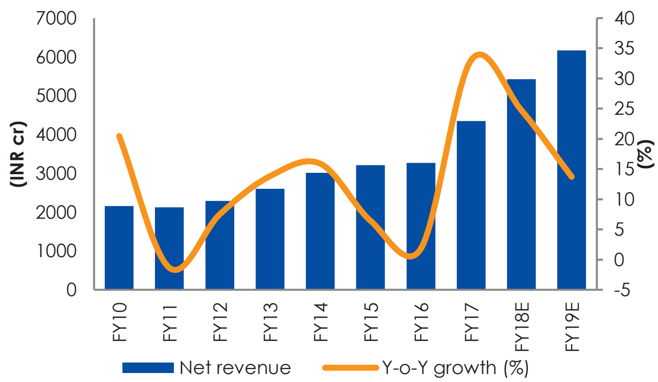
Capacity addition to continue



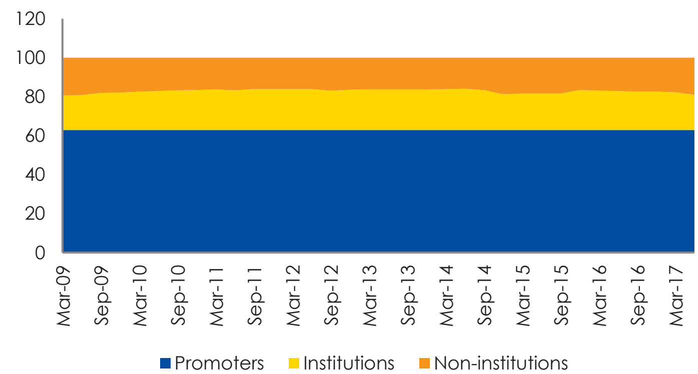
Acquisition of Reliance cement strengthened presence in Central



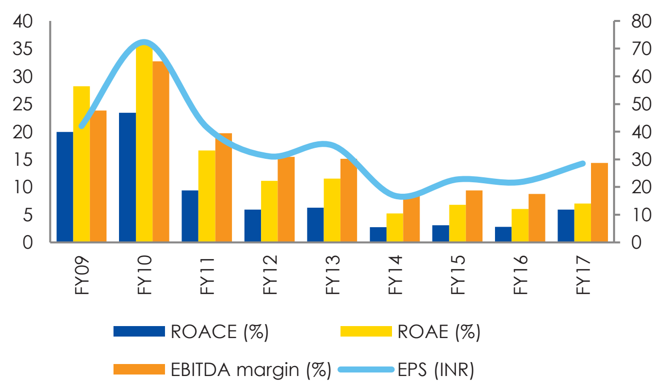
Revenue growth accelerated post acquisition of Reliance cement



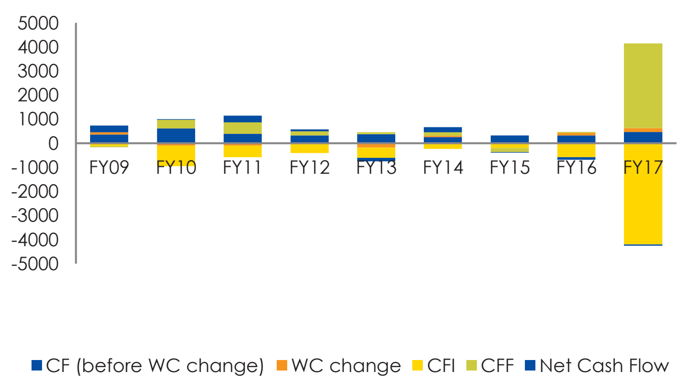
Promoters holding remain stable



Return ratios and margin to improve on back of double digits volume growth and marginal uptick in realisation



Company generates positive cash flow consistently



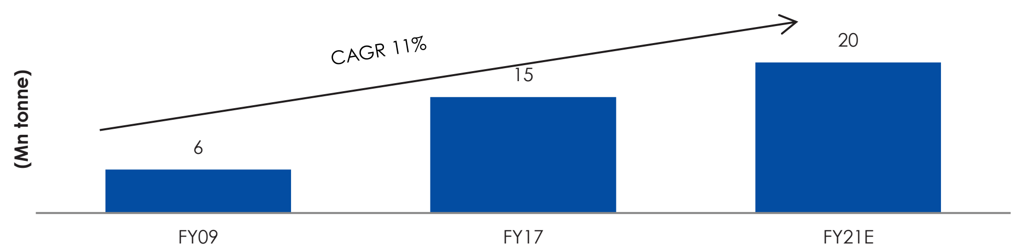
Source: Company, Edelweiss Investment Research

Investment Rationale

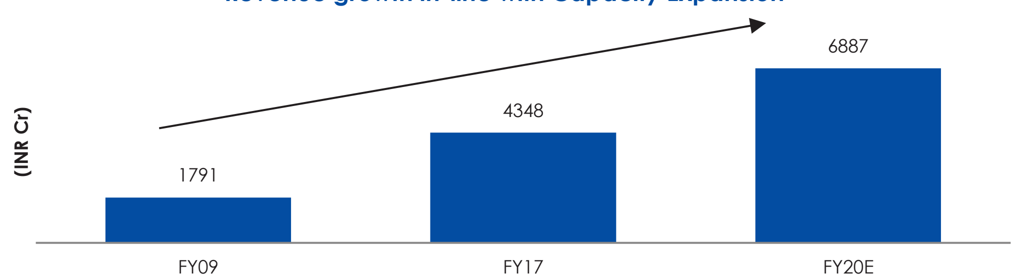
I. Capacity expansion envisaged to trigger re-rating

BCorp has chalked out a comprehensive capacity expansion programme spanning till H1FY21 in order to strengthen its presence in West India. On receiving mining lease at Mukutban (Maharashtra), on the anvil is a 4mt grinding unit and 3mn clinker plant, which will catapult BCorp's total capacity to ~20mt. This expansion will render it the fifth largest cement player in India. Moreover, it is anticipated to increase BCorp's market share in West to ~7% from 1% and is estimated to comprise 24% of the company's total installed capacity. Also, the company has sought environmental clearance to set up 1.5mt cement capacity at Chanderia in Rajasthan. This expansion is expected post lifting of the mining ban (through blasting), which has been imposed since August 2011. Apart from this, valuable mineral concessions in Karnataka, Rajasthan, AP, HP and MP entail lucrative opportunities to expand manufacturing plants across India.

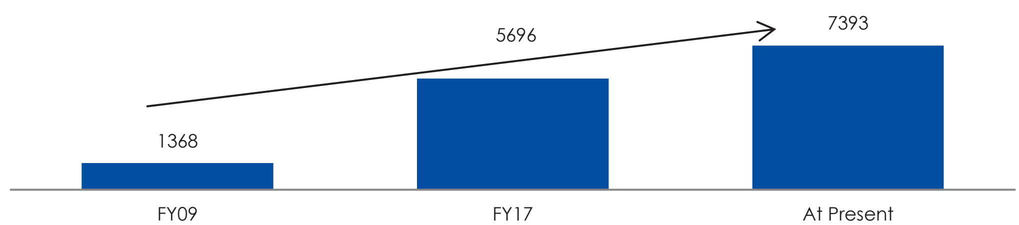
BCorp's capacity growth exceeded Industry's average growth rate



Revenue growth in-line with Capacity Expansion



Market Cap jumped 2.1x of average of Capacity and Revenue jumped over FY09-17



Source: Company, Edelweiss Investment Research

a) There is a direct correlation between the cement industry's margins and capacity expansion. Expansions boost margin as: a) incremental capex consumes lower cost & time, which in turn prunes fixed & finance costs; b) per unit cost of production and sale dips as scale expands; c) geographical expansion protects revenue and sales volume from vagaries of regional demands; and d) volumes surge spurred by a wider range of product offerings on account of enhanced brand visibility. In light of these benefits, profitability remains healthy.

Profitability increases along with capacity expansions

EV/EBITDA	EBITDA Margin	PAT Margin
Industry	17.9%	6.3%
Capacity > 20MTPA	19.8%	8.7%
Capacity between 10-20MTPA	17.3%	5.6%
Capacity < 10MTPA	15.6%	3.4%

b) Market cap of the top 10 listed companies jumped 7.6x over FY09-17 while revenue and capacity jumped 2.3x and 2.3x during the same period. Conseqeuntly, Market cap grew 3.35x of the average of capacity and revenue growth over FY09-17. These players' capacity jumped 10.8% over FY09-17 compared to industry's 7.5%. However, the capacity expansion benefit failed to percolate to revenue due to muted realisation growth and steady dip in utilisation. Hence, net revenue of these companies grew mere 11.1% over the period.

Market Cap jumped is ~3.32x of average Revenue and Capacity growth over FY09-17

	Capacity	Revenue	Market Cap
ACC ACC Limited	1.4x	1.5x	2.8x
Ambuja Cement	1.3x	1.5x	3.0x
UltraTech CEMENT The Engineer's Choice	4.4x	3.7x	15.9x
Shree Cement	3.2x	3.1x	24x
Dalmia Bharat Cement	1.7x	4.2x	11.6x

Thus, there is a direct correlation between market cap growth and capacity expansion. Hence, companies with faster pace of capacity expansion clock higher market cap spurt.

Market Cap jumped is ~3.0x of average Revenue and Capacity growth over FY09-17

	Capacity	Revenue	Market Cap
JK Cement LTD	2.5x	2.3x	23.6x
JK Lakshmi Cement Ltd.	2.6x	2.4x	20.7x
RAMCO SUPERGRADE Engineered for Concrete	1.7x	1.6x	9.4x
The India Cements Ltd	1.2x	1.7x	1.7x
BIRLA CORPORATION LIMITED	2.7x	2.4x	4.2x

c) Peer analysis indicates that valuations re-rate once certain capacity threshold is crossed, which is ≥20mt. BCorp's current capacity stands at 15.4mt. On the anvil is 4mt capacity in Maharashtra, for which it already has a mining lease and most of the approvals are in place. In addition, the company has bagged environmental clearance to set up 1.5mt capacity in Rajasthan post lifting of mining ban. Consequently, BCorp's capacity is estimated to cross 20mt in H1FY21, valuation re-rating trigger. Players with ≥20mt capacity generally trade ~2.0x of those with capacity between 10mt and 15mt. While BCorp's revenue and capacity jumped 2.4x and 2.7x, respectively, over FY09-17, its market cap rose 4.2x. We believe, post capex, valuation re-rating is imminent.

Valuation expansions happens along with Capex

EV/tonne	Capacity ~15MTPA	Capacity ~20MTPA	Current
ACC Limited	59	128	144
Ambuja Cement	131	240	213
UltraTech Cement	69	154	199
Shree Cement	181	264	335
Dalmia Bharat Cement	44	68	177

Also, EV/EBITDA jumps meaningfully post crossing the ~20mt milestone.

Valuation expansions happens along with Capex

EV/EBITDA	Capacity ~15MTPA	Capacity ~20MTPA	Current
ACC Limited	10.1	20.0	21.8
Ambuja Cement	11.6	10.4	24.4
UltraTech Cement	15.4	6.6	25.6
Shree Cement	7.1	28.3	27.8
Dalmia Bharat Cement	10.7	16.6	15.6

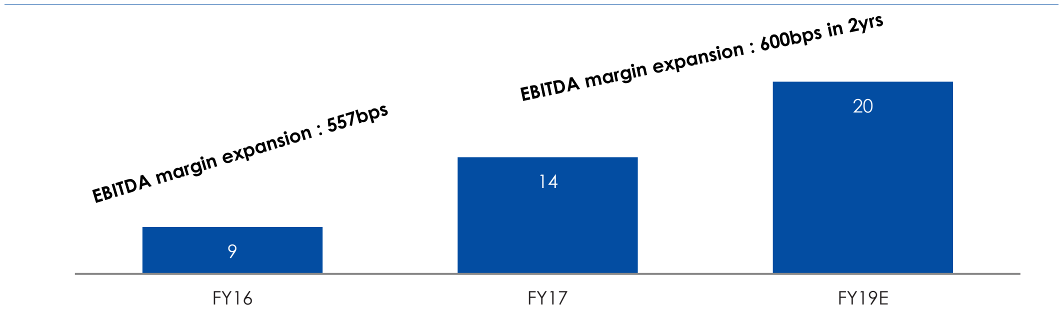
Source: Company, Edelweiss Investment Research

II. Reliance Cement buy: Margin, market share booster

BCorp acquired 5.6mt grinding and 3.3mt clinker plants from Reliance Cement for INR48bn in FY17. Reliance Cement's plants are located in Madhya Pradesh (Maihar, 3mt unit), UP (Kundanganj, 2mt grinding unit) and Maharashtra (Butibari, 0.6mt grinding unit). Reliance Cement generated ~INR1,100 EBITDA/ tonne in FY17 and ~INR1,200 in Q1FY18, marginally contributed by VAT, CST and SGST refunds. Consequently, BCorp's consolidated EBITDA margin surged 557bps to 14.3%, EBITDA/ tonne jumped 79% YoY to INR567 and absolute EBITDA rose 118% YoY to INR623cr in FY17. Consolidated EBITDA margin catapulted 189bps YoY to 16.5% and EBITDA/ tonne increased from INR560 to INR695 in Q1FY18.

For BCorp, we have estimated 13% volume CAGR over FY17-19 factoring in consolidation of Reliance Cement's sales volume for first 5 months of FY18, which was excluded in FY17 as the consolidation concluded on August 22, 2017. Hence, FY18 cement sales volume is estimated to jump 21.0% compared to 24.5% in FY17. We have estimated 6.3% growth in realisation/ tonne over FY17-19E due to muted growth in pricing over the past 8 years and potential improvement in demand. We expect the EBITDA expansion to sustain on account of accelerating growth, improving utilisation and cost control. Hence, we have projected ~600bps margin expansion to 20.4% and EBITDA/ tonne to jump from INR567 to INR919 over FY17-19.

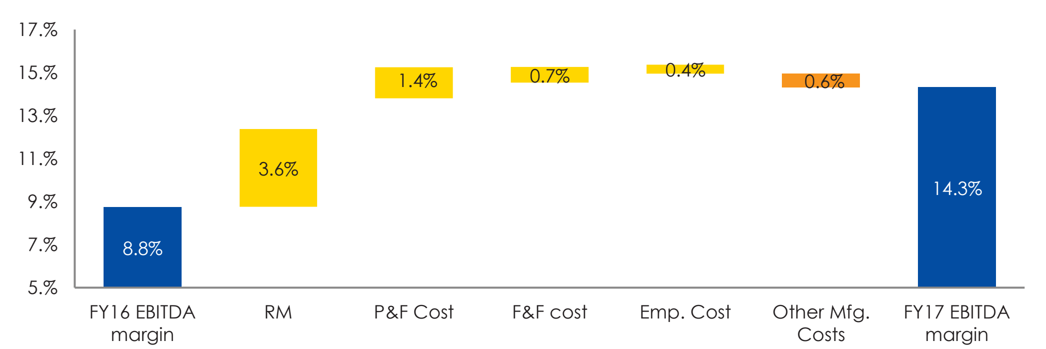
Improving realization and marginal cost control boost EBITDA margin



Source: Company, Edelweiss Investment Research

In FY17, lower raw material and power & fuel cost contributed 3.6% and 1.4%, respectively, to EBITDA margin expansion. While freight & forwarding and employee costs enhanced margin 60bps and 40bps, respectively, other variable costs offset it by 60bps. Consequently, EBITDA margin jumped 557bps to 14.3%.

Margin expansion through cost control



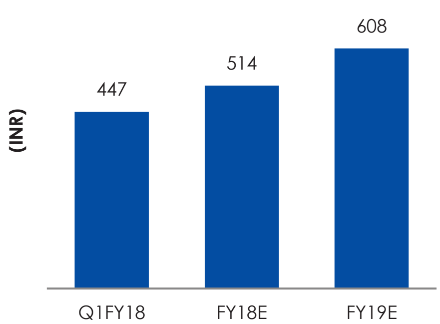
Source: Company, Edelweiss Investment Research

a) Fiscal incentive continues to drive margin

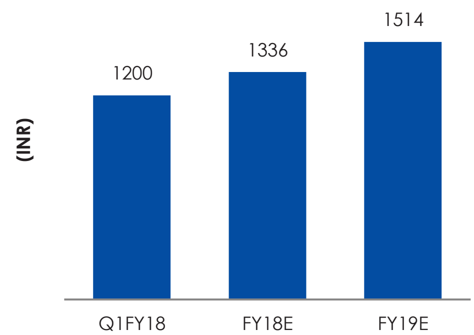
I. **Existing incentives:** BCorp acquired 3 manufacturing units from Reliance Cement located in MP, UP and Maharashtra. The latter's plants have been granted "Mega Project" status by respective state governments and hence they enjoy special incentives of VAT refunds. The benefits are as follows: a) MP will refund 75% VAT, CST and SGST for over 7 years starting November 2014; b) UP will refund 80% of VAT, CST and SGST for over 15 years starting November 2014 and the plant also gets 5% interest subsidy through reimbursement on the term loan taken for procuring plant & machinery; and c) Maharashtra refunds 100% VAT, CST and SGST and has exempted electricity for 7 years starting April 2013. These incentives boost EBITDA/ tonne.

II. **Next phase of capex will attract higher fiscal incentives:** BCorp is setting up a 4mt grinding unit in Maharashtra at an investment of INR24bn, which is near a limestone mine. The plant's proximity to the mine will prune raw material cost and also incentive from the government will accentuate margin going forward. BCorp bagged an established distribution network via Reliance Cement, which will help expand sales. Anticipated fiscal incentives are: a) refund of 100% VAT, CST and SGST for 20 years. We have not factored Mukutban's sales volume and margin expansion in our projection as the benefit will accrue from FY20.

Standalone EBITDA per tonne

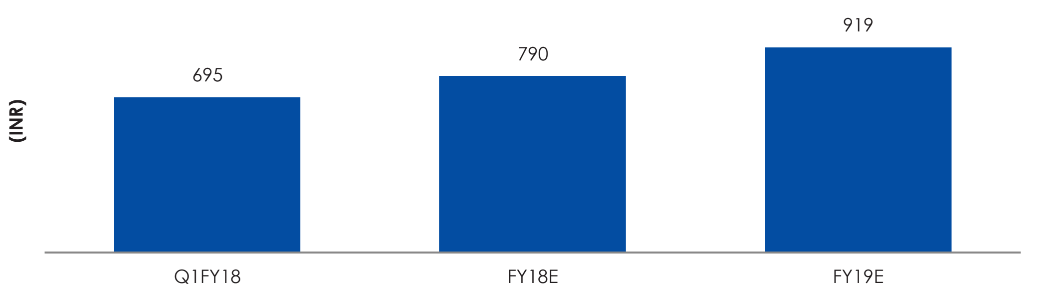


Reliance EBITDA per tonne



Source: Company, Edelweiss Investment Research

Consolidated EBITDA per tonne

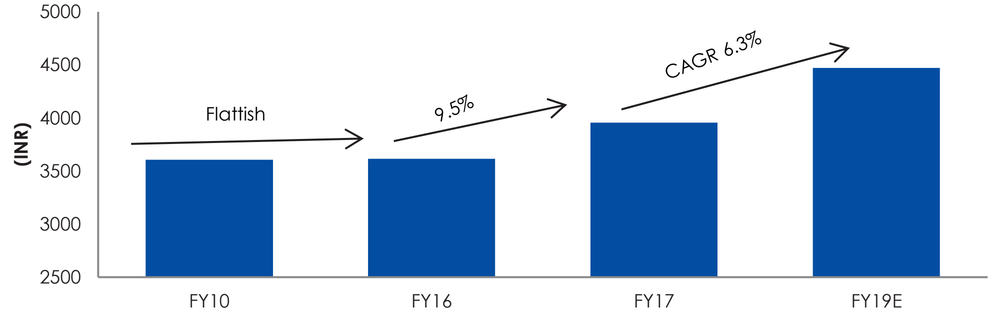


Source: Company, Edelweiss Investment Research

b) Realisation to firm up on higher demand, muted growth over past 6 years

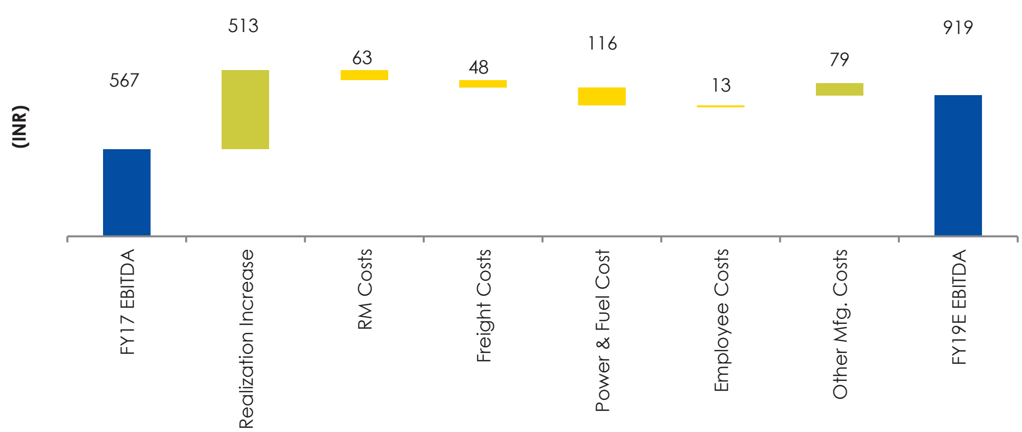
FY10-16 realisation remained flat at INR ~3,600 per tonne due to over capacity and moderating demand. In FY17, realisation rose 9.5% due to Reliance Cement's acquisition and marginal hike in cement price per bag post demonetisation, which is holding firm. We have estimated 6.3% growth in cement realisation over FY17-19E on account of marginal incentive on Reliance Cement and burgeoning demand.

Realisation is expected to firmup on volume growth



Source:,Company,Edelweiss Investment Research

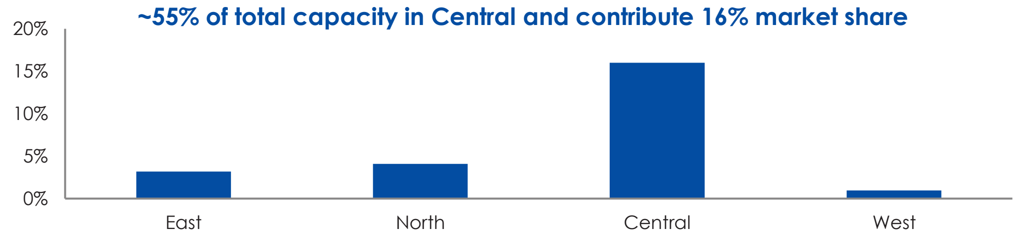
EBITDA/ tonne is estimated to jump from INR567 to INR919 over FY17-19E , primarily driven by rise in realisation and dip in other manufacturing expenses. In FY17, EBITDA/ tonne rose 79% YoY to INR567 from INR316 in FY16, aided by consolidation of Reliance Cement's revenue from August 22, 2016. We envisage full year consolidation in FY18 to significantly fuel EBITDA/ tonne. In Q1FY18, EBITDA/ tonne jumped from INR560 in Q1FY17 to INR695. We have estimated power & fuel cost to increase 5% over FY17-19 despite WHRS installation in Satna, while F&F and employee costs to grow at a moderate pace. Consequently, EBITDA/ tonne is estimated to improve from INR567 to INR919 over FY17-19E.



Source:,Company,Edelweiss Investment Research

III. Strong presence in one of the highest growing markets

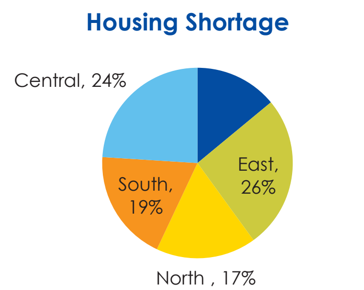
BCorp has strengthened its position in Central India through acquisition of Reliance Cement, rendering it the third largest cement player in the region with 8.5mt installed capacity. The housing shortage in Central region is one-fourth of the entire country and government's push for housing is envisaged to boost cement demand at a higher clip. According to our analysis and 2011 census data, India needs ~10mn houses every year for the next 8-10 years. We estimate 7-8% CAGR in cement demand up to FY25, taking annual demand to ~500mt.



Source: Company, Edelweiss Investment Research

a) Central and East account for ~50% housing shortage in India

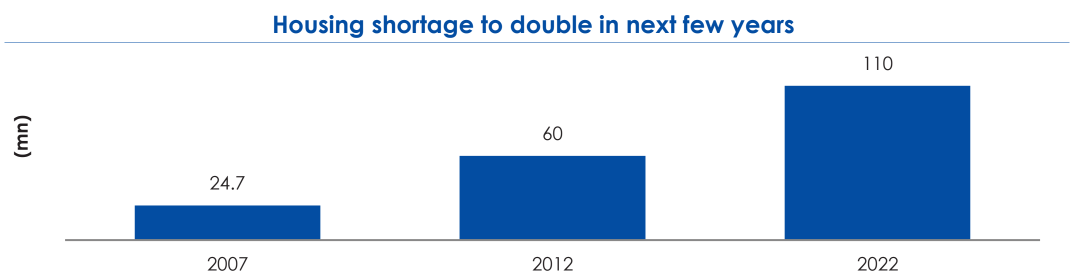
According to our analysis and 2011 census data, bulk of housing shortage is in East and Central India. Moreover, shift from Kuccha (houses built of mud & bricks) and slums to Pucca (cement) houses can propel annual cement demand 7-8%. Central and East India account for ~50% of total housing requirement.



Source: Company, Edelweiss Investment Research

b) Housing shortage to double by 2022

The housing shortage in India is pegged to double by 2022 to 110mn houses from 60mn in 2012. Ergo, we envisage housing construction to accelerate. India's per capita income jumped from USD1,130 in 2007 to ~USD1,835 in 2016 and is estimated at USD2,832 by 2022 with 7.5% growth over 2016-22. In light of these factors, housing demand is bound to jump, which in turn will boost cement demand.

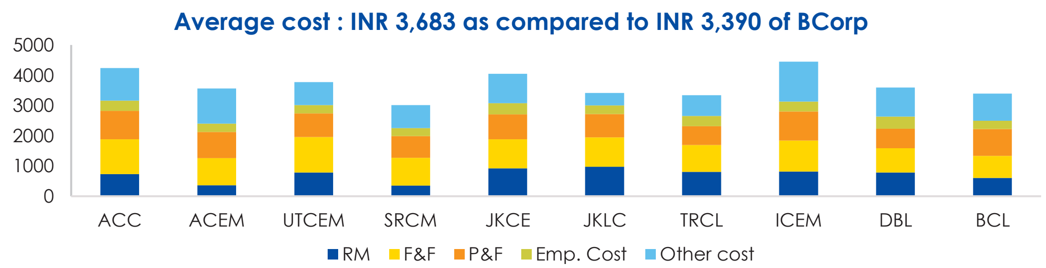


Source: Company, Edelweiss Investment Research

IV. Lowest cost producer; improvement anticipated

BCorp's variable cost is one of the lowest amongst mid & large size companies by ~8% due to lower raw material (RM) cost and freight & forwarding (F&F) cost. Currently, the company's power & fuel (P&F) cost is higher than the average of top 10 companies. However, we expect the 12MW WHRS installation in Satna to reduce the cost by ~4% of total P&F cost. While F&F, RM and other manufacturing costs are 23%, 15% and 5%, respectively, lower than average cost of top 10 cement companies, P&F cost is 10% higher. We expect further reduction in variable cost going forward.

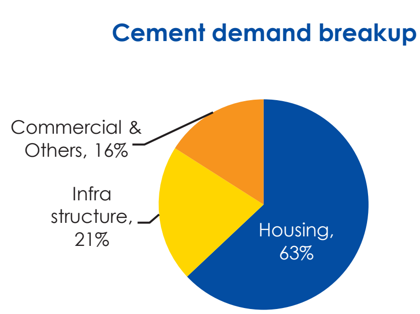
The lower F&F cost is attributable to proximity to key markets. We expect this cost to dip marginally as road efficiency is expected to improve due to elimination of toll plazas at check nakas post GST implementation. BCorp's RM cost is lower than industry as: a) primary RM is procured mostly from its mines situated near plants; b) transportation through long belt conveyor/ropeway reduces the cost; and c) the company has its own slag processing plant near steel plant and procures fly ash & slag from nearby areas. Other manufacturing cost is lower as employee expenses as well as other overheads are lower. P&F cost is higher than the industry average, which is likely to dip as BCorp is installing 12MW WHRS in Satna.



Source: Company, Edelweiss Investment Research

Key demand drivers in place

The housing sector is a key demand driver of cement in India aided by rapid urbanisation, rising per capital incomes, government subsidy and increasing disposable incomes. Renewed focus on Housing For All by 2022, Smart Cities, interest subsidy and redefinition of affordable housing are expected to alter the demand pattern in the medium to long term. Above all, falling interest rate is bound to spur housing demand, translating into higher demand for cement.

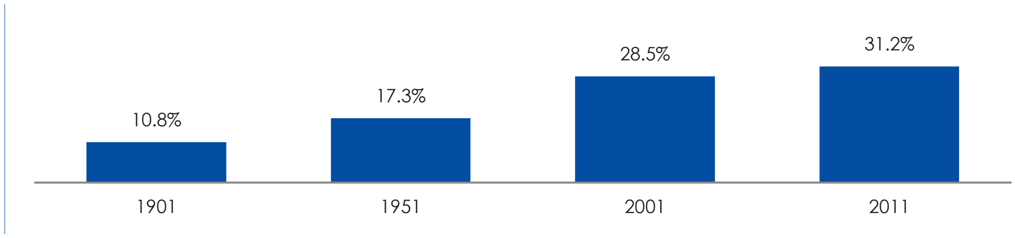


Source: Company, Edelweiss Investment Research

a) Accelerating urbanisation propelling cement demand

Rising urbanisation and growing per capita incomes are expected to strengthen housing demand. Urbanisation in India was 10.8% in 1901, which jumped to 17.31% in 1951 and 28.53% in 2001. It rose to 31.16% in 2011 from 28.53% in 2001, up 2.63%. We anticipate the pace of urbanisation to increase due to industrialisation and Smart Cities leading to increase in cement demand.

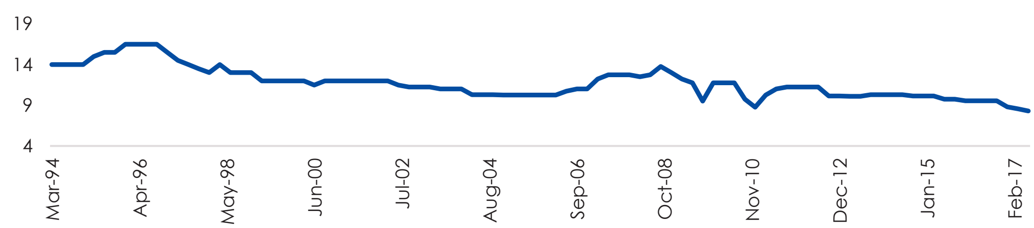
Urbanisation create extra requirement of housing, translating higher demand of cement



b) Interest rates on housing loans will continue to head South

We expect huge demand for housing riding falling interest rates, rapid urbanisation, rising disposable incomes, favourable demographics and interest subsidy on affordable housing. *Housing For All by 2022, Smart Cities* and PMAY are a few government initiatives to bridge the housing shortage gap. We expect short-term demand to be under pressure due to demonetisation, but the 7th Pay Commission payout, interest subsidy on affordable housing loans and falling housing rates are envisaged to bolster demand in the medium to long term.

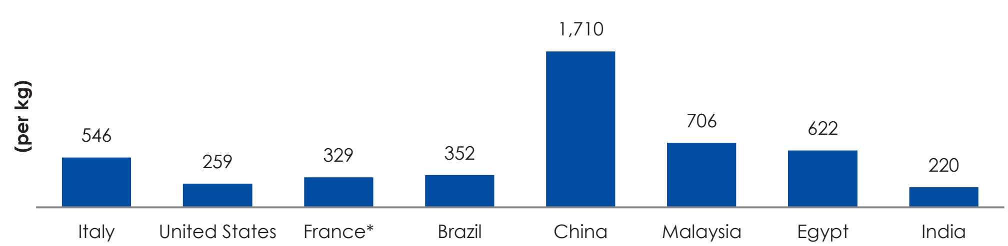
Interest rate continue to fall



Low per capita cement consumption entails humungous growth opportunity

Though India is the second largest cement manufacturer in the world, its per capita consumption is <50% of the world and <15% China's. We believe, the current cycle will boost cement demand because of favourable catalysts such as low interest rates, interest subsidy and policy push. Consequently, per capita cement consumption is expected to rise.

Per capita cement consumption to accelerate



Source: Company, Edelweiss Investment Research

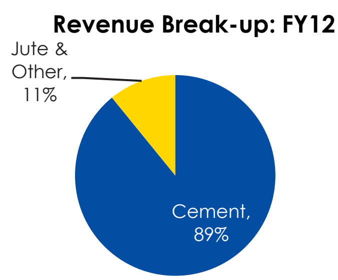
Company Description

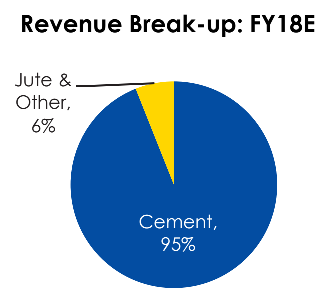
BCorp is the flagship company of the M.P. Birla Group with significant presence in cement. The company is primarily engaged in cement and jute businesses. Currently, cement contributes ~92% to total revenue, which is inching up to ~95% due to inorganic growth in cement. Though jute division's performance has been satisfactory over the past few years, supply constraint and dwindling demand are major growth hurdles.

BCorp has acquired 100% shares of Reliance Cement, a subsidiary of Reliance Infrastructure (RIL), for an enterprise value of INR48bn. Reliance Cement has 5.6mt grinding and 3.3mt clinker plants located in Madhya Pradesh (Maihar, 3mt integrated unit), Kundanganj in UP (2mt grinding unit) and Butibori in Maharashtra (0.6mt grinding unit). This acquisition provided BCorp with the ownership of high-quality assets, propelling its total capacity from 10mt to 15.4mt.

The company is planning to set up 4mt grinding units and 3mt clinker units in Mukutban (Maharashtra), which will take total capacity to ~20mt. Post this expansion, BCorp will be the fifth largest cement manufacturing company in India with significant presence in West and Central India. The upcoming capacity is anticipated to increase its market share in West from 1% to ~7% and will contribute 24% to total installed capacity. In addition, BCorp has sought environmental clearance to set up 1.5mt cement capacity at Chanderia in Rajasthan. This expansion is likely post lifting of mining ban (through blasting), which was imposed by the Jodhpur High Court in August 2011. Apart from this, valuable mineral concessions in Karnataka, Rajasthan, AP, HP and MP provide an opportunity to expand manufacturing plants across India.

End markets are expected to grow at a rapid pace





Source: Company, Edelweiss Investment Research

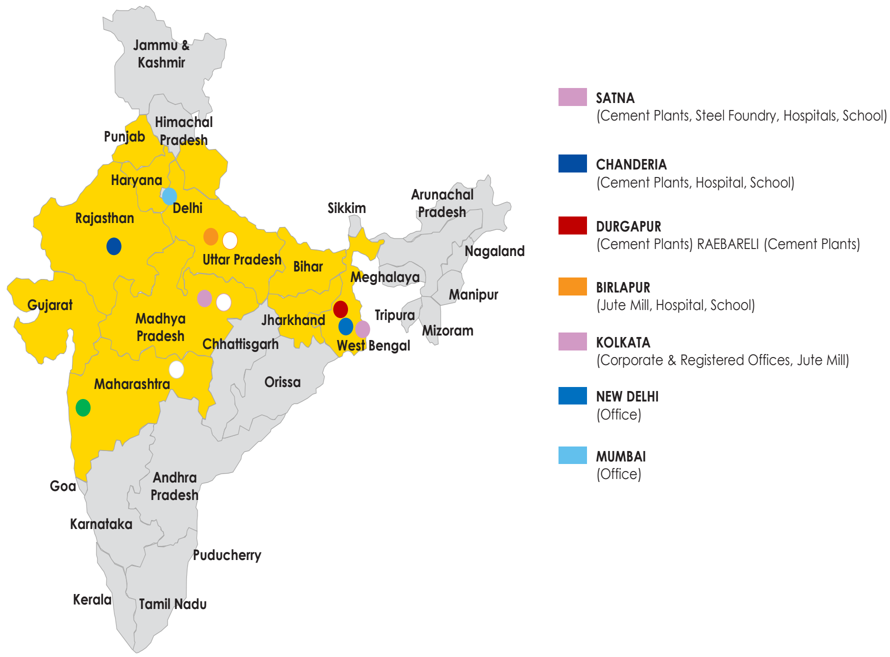
Key Risks

Cement demand fails to accelerate

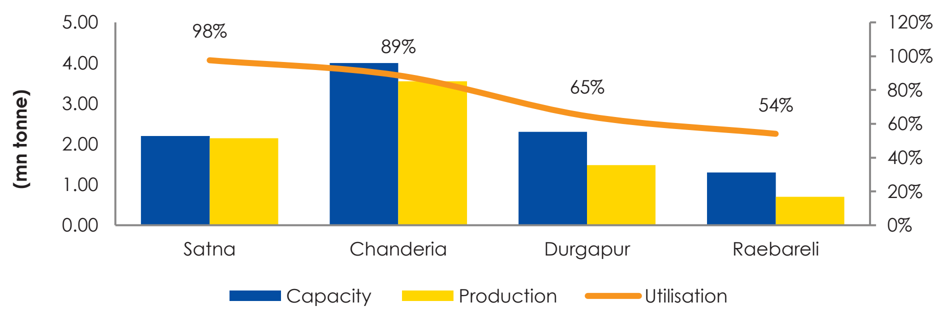
We have assumed cement demand to accelerate propelled by government push to affordable housing and renewed focus on infra spending. Any major delay in execution of affordable housing under PMAY and infra spending will negatively impact our assumptions.

Expansion delays may dent profitability

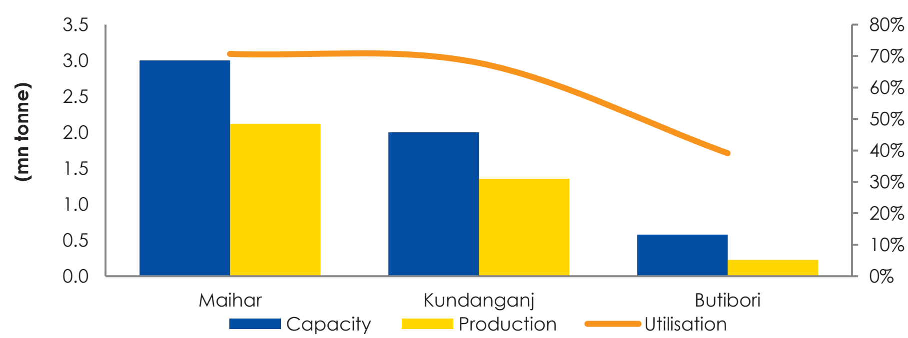
The company is planning to set up 4mt grinding units and 3mt clinker unit in Mukutban, Maharashtra. We estimate capex to be completed in early FY21. Any major delay in capex will not lead to multiple re-rating, which is key assumption of our hypothesis.



BCorp - Capacity utilisation remains robust



RCCL - Capacity utilisation to improve on back of strong distribution channel



Source: Company, Edelweiss Investment Research

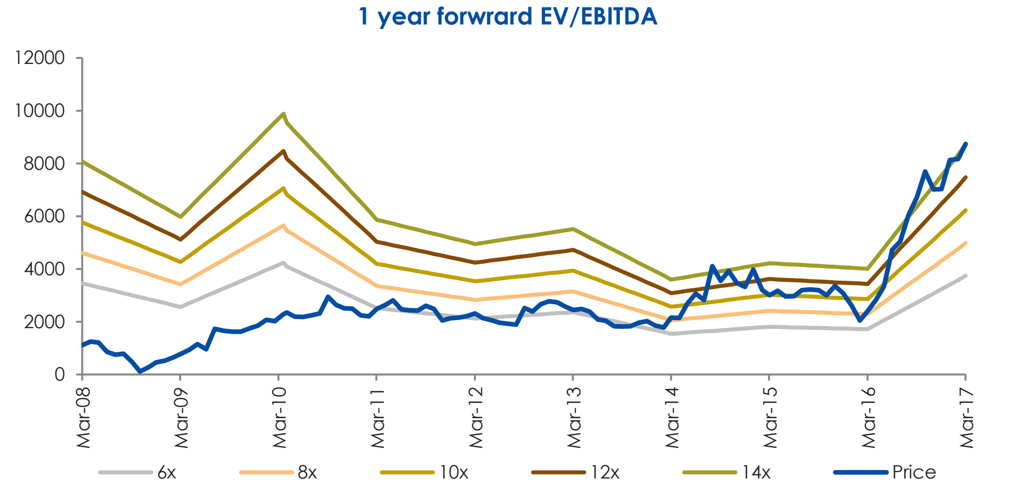
Valuations

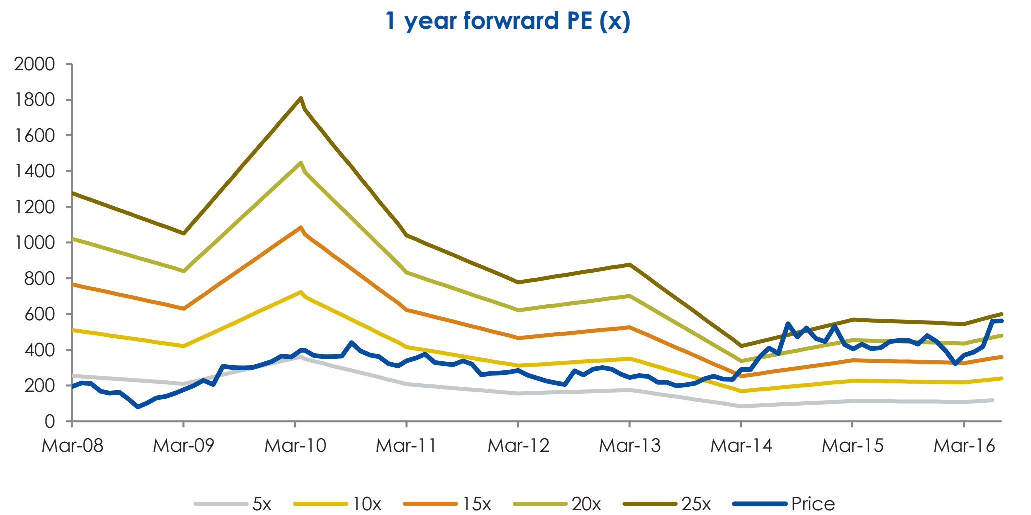
We estimate BCorp's revenue to post 19% CAGR over FY17-19E primarily led by higher volume and marginal growth in realisation. We have projected 13.6% CAGR in cement sales volume and 6.3% CAGR in realisation over FY17-19. The volume spurt will be driven by acquisition of Reliance Cement. We have forecast 42%, 55% and 50% EBITDA, EBIT & PAT growth respectivvely over FY17-19E. Profitability is expected to surge due to realisation improvement and cost control.

BCorp has chalked out a comprehensive capacity expansion programme spanning early FY21. The next leg of capex entails 4mt grinding unit in Mukutban, Maharashtra, which will propel the company's total capacity to ~20mt. Post this expansion, BCorp will be the fifth largest cement manufacturing company in India. In addition, it has also sought environmental clearance to set up 1.5mt cement capacity at Chanderia in Rajasthan. This expansion is expected to post lifting of mining ban (through blasting) in Chittorgarh. Apart from this, valuable mineral concessions in Karnataka, Rajasthan, AP, HP and MP provides an opportunity to expand manufacturing plants across India.

BCorp is currently trading at attractive valuation of 12.8x FY18E and 10.6x FY19E EV/EBITDA and EV/tonne of USD128 versus average of 12.3x FY19E EV/EBITDA and EV/tonne of USD170, ~33% discount to peers. . Based on P/E(x), EV/EBITDA and EV/Tonne, we have arrived at a target price of INR 1,296 per share. At current market price of INR1082, we re-iterate 'BUY' with target price of INR1,296.

EV/EBITDA Multiple			
Particulars	**Methodology**	**Multiple**	**Target Price**
FY19E EBITDA	EV/EBITDA	11.0	13,433
Net Debt			3,456
Fair value of Equity			9,977
No of shares (Crs)			7.7
Price/Share			1,296
Upside/Downside			20%





Source: Company, Edelweiss Investment Research

Peer Comparison

Company	EV/tonne		EV/EBITDA		P/E(x)		P/BV		P/Sales	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
ACC	140.8	137.8	17.3	13.4	41.3	29.5	3.7	3.6	2.6	2.3
ACEM	213.1	207.9	21.1	16.9	36.5	28.5	2.2	2.2	4.2	3.8
UTCEM	196.9	191.9	18.3	12.3	38.9	23.7	4.1	3.6	3.6	2.8
DBL	178.0	173.4	13.5	11.8	47.0	35.6	4.6	4.1	2.9	2.5
SRCM	277.3	221.7	23.1	17.7	36.3	30.2	6.9	5.5	6.3	5.0
TRCL	164.0	163.7	12.8	11.4	20.5	17.7	3.7	3.1	3.8	3.4
ICEM	82.1	78.2	8.5	6.7	20.8	13.5	1.1	1.0	0.9	0.8
BCL	105.9	106.4	10.5	8.5	23.6	14.8	2.1	1.8	1.0	0.9
Average	**169.8**	**160.1**	**15.7**	**12.3**	**33.1**	**24.2**	**3.6**	**3.1**	**3.2**	**2.7**

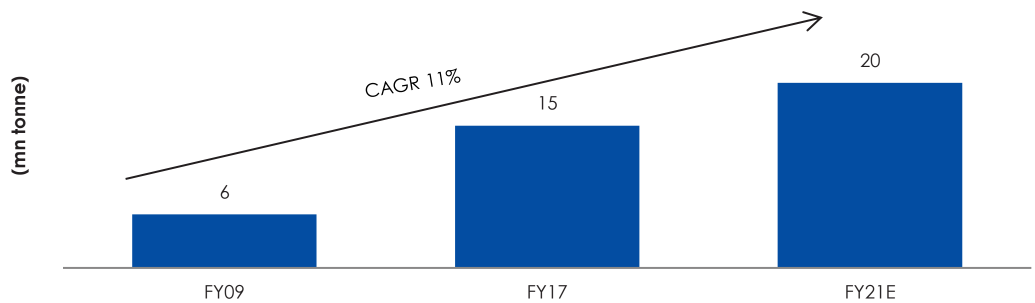
Company	Revenue Growth		EBITDA Margin		PAT margin		RoAA (%)		RoAE (%)	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY18E	FY19E	FY18E	FY19E	FY18E
ACC	13.40	11.30	13.9	15.9	6.2	7.8	8.4	11.3	9.1	12.3
ACEM	11.32	12.10	18.9	20.6	11.6	13.2	6.0	7.5	6.3	7.8
UTCEM	25.85	28.02	22.2	25.0	9.3	11.9	6.8	9.2	9.2	11.4
DBL	14.49	15.56	25.3	24.5	7.7	8.8	4.3	5.6	7.7	8.5
SRCM	21.5	26.6	27.2	27.4	17.4	16.5	18.3	17.4	19.3	18.3
TRCL	9.51	12.95	31.7	31.6	18.7	19.2	14.4	17.6	15.8	19.1
ICEM	9.99	11.53	15.4	16.6	4.3	5.9	3.1	4.8	5.8	7.2
BCL	24.7	13.7	18.6	20.4	5.7	8.0	7.9	9.9	9.0	13.1
Average	**16.3**	**16.5**	**21.6**	**22.7**	**10.1**	**11.4**	**8.6**	**10.4**	**10.3**	**12.2**

Company	Debtor Days		Inventory Days		Creditors Days		Cash Conversion Cycle		Asset turnover (x)	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY18E	FY19E	FY18E	FY19E	FY18E
ACC	13.2	13.5	34.1	35.1	37.1	40.4	10.2	8.2	1.5	1.6
ACEM	11.8	11.2	37.2	35.5	43.9	42.8	5.1	3.8	0.6	0.6
UTCEM	21.2	19.8	36.6	33.8	36.3	35.1	21.4	18.5	0.8	0.9
DBL	31.5	31.9	35.0	34.9	68.6	68.8	-2.0	-2.0	0.6	0.7
SRCM	15.2	14.2	56.4	51.0	24.4	22.8	47.1	42.5	1.2	1.2
TRCL	53.6	54.4	54.5	55.3	4.3	5.9	73.2	74.1	0.9	1.1
ICEM	34.1	32.2	51.1	52.6	94.7	99.9	-9.5	-15.1	0.7	0.8
BCL	7.7	8.0	38.6	40.3	25.2	22.8	21.1	25.4	1.1	1.2
Average	**23.5**	**23.2**	**42.9**	**42.3**	**41.8**	**42.3**	**20.8**	**19.4**	**0.9**	**1.0**

Company performance – per tonne analysis

Capacity growth over FY07-17 surpassed industry average

Over FY07-17, while the cement industry's capacity grew ~8.8%, BCorp's jumped 10.3%. We have projected 8% growth over FY17-21E on account of green filed expansion in Mukutban, Maharashtra.

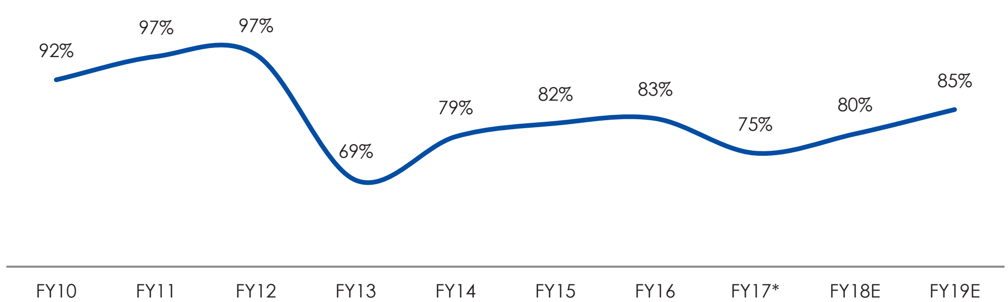


Source: Company, Edelweiss Investment Research

Attractive market protected utilisation

BCorp's utilisation has always remained above industry average because of proximity to one of the highest growing markets and lower capacity addition in the same zone. In Q1FY18, the company's annualised capacity utilisation was 85%, but we have projected 80% in FY18 due to slack in Q2 and 85% in FY19.

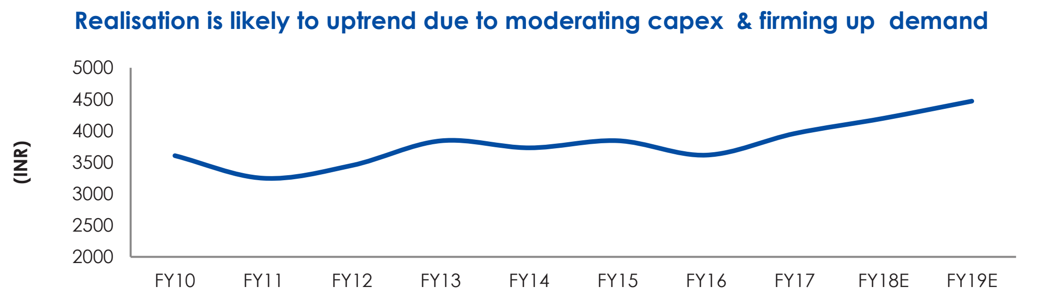
Utilisation dented in FY13 & 17 due to Capex by 53% & 59% respectively



Source: Company, Edelweiss Investment Research
*Reliance cement sales volume annualised

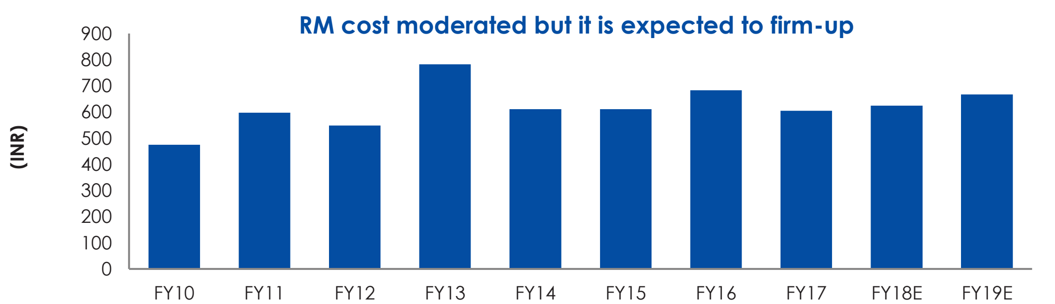
Realisation per tonne expected to firm up

Realisation per tonne remained unchanged between 2010 and 2016, but in FY17 it jumped 9.5% due to marginal price hike and acquisition of Reliance Cement. The latter enjoys refunds of VAT, CST and SGST, which enhanced FY17 realisation. The consolidation was completed on August 22, 2016, hence revenue was consolidated from the same date. In Q1FY18, reliasation surged 10% YoY and we have projected marginally lower realisation for FY18. We have estimated 6% growth over FY17-19, which is in line with the industry.



Raw material cost subsidised due to acquisition

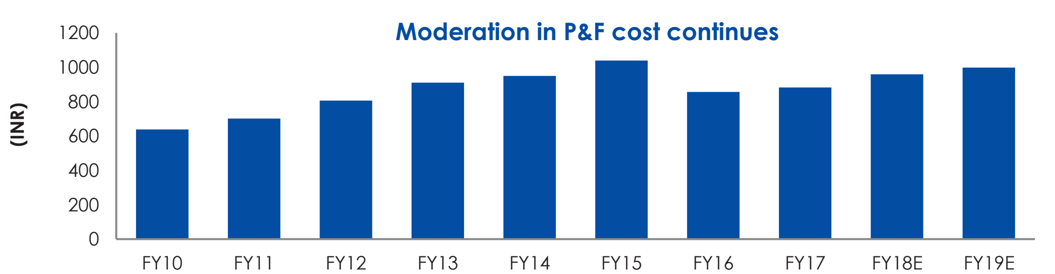
Raw material cost declined in FY17 post Reliance Cement's acquisition. The Raw material cost per tonne fell 11.5% YoY to INR605 and in absolute terms revenue grew 33%, while Raw material expenses grew 7.5% YoY. We have projected Raw material cost in line with revenue growth.



Source: Company, Edelweiss Investment Research

Power & fuel cost continues to moderate

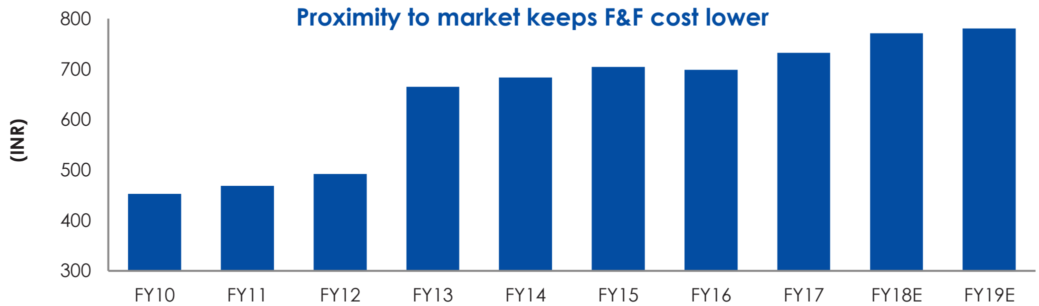
Over the past 2 years, P&F cost per tonne has moderated and we expect further reduction post WHRS installation in Satna. Based on our projections, P&F cost will dip ~4% post WHRS installation.



Source: Company, Edelweiss Investment Research

One of the lowest freight & forwarding costs

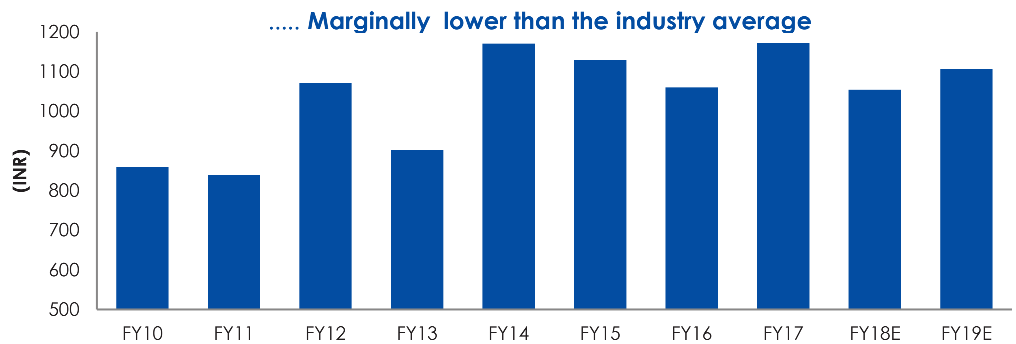
BCorp's F&F cost is one of the lowest in the industry due to proximity to end consumers. The F&F cost is INR732 per tonne, 23% lower than the average of top 10 cement companies.

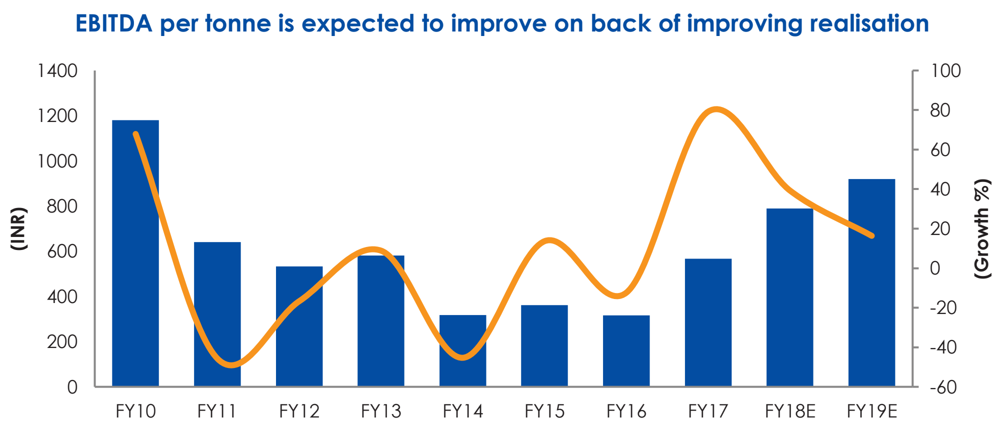


Source: Company, Edelweiss Investment Research

High other manufacturing cost in FY17 one off; to soften marginally

Other manufacturing cost including employee cost was higher in FY17, but ~5% lower than the average of top 10 companies. This was an aberration, which is expected to soften going forward and we have projected 3% decline over FY17-19.





Source: Company, Edelweiss Investment Research

Peer comparisons, capacity ≥15mt

Acquisition provides opportunity in one of the highest growing markets

In FY17, while average realisation of top 10 companies declined by 0.4%, BCorp's jumped 9.5% over its peers on account of the Reliance Cement acquisition. Post acquisition, the company has strengthened its position in high growing market, especially Central India, which is expected to be one of the highest growing markets. We have projected 6.3% growth in realisation over FY17-19, which is in line with market expectation.

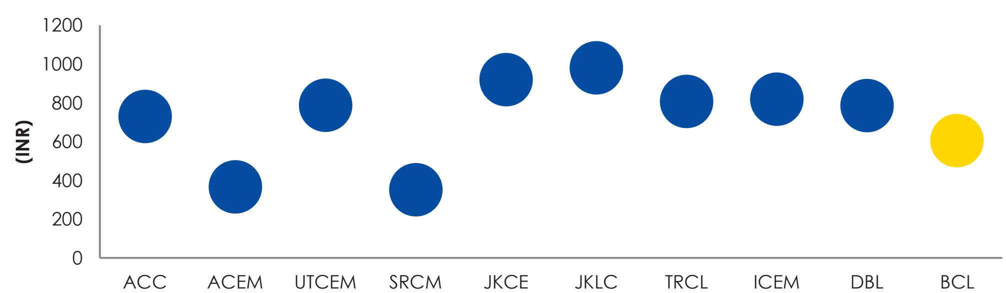
Realisation improved on back of acquisition

Source: Company, Edelweiss Investment Research

One of the lowest raw material cost per tonne

BCorp's raw material cost is ~15% below the average of top 10 companies. The company's raw material cost has plummeted 360bps over FY16-17, primarily driven by acquisition. In FY18, it will reap the benefit of full year operation of Reliance Cement. Hence, we expect further fall in raw material cost.

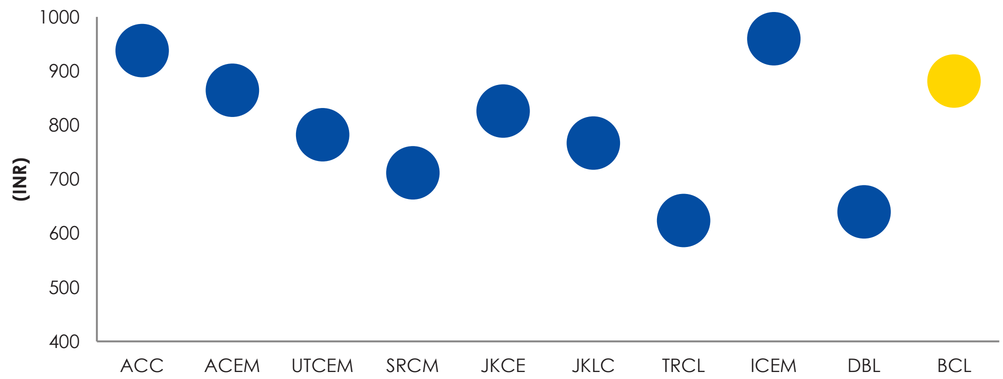
Raw material cost is 15% below the average cost of these companies



Source: Company, Edelweiss Investment Research

At present, the Power & Fuel (P&F) cost is marginally higher than its peers but post installation of WHRS in Satna will reduce the cost by INR 50-55crs, which is ~4% of total P&F expenses in FY19E.

Power & Fuel cost is expected to come down post WHRS installation in Satna

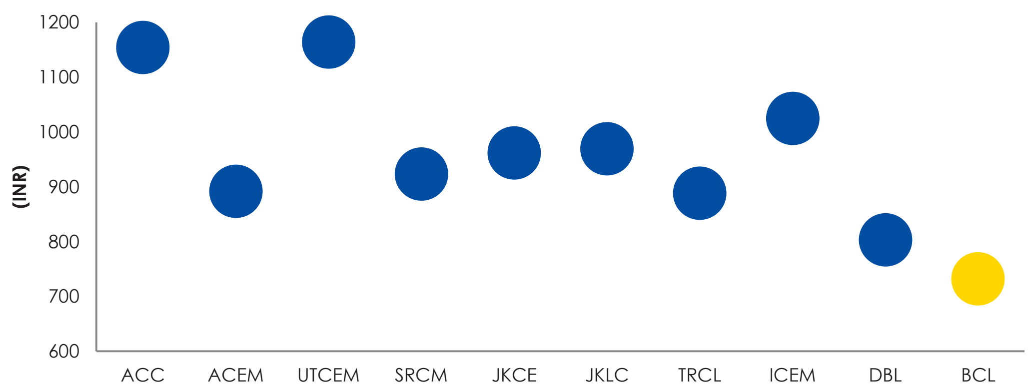


Source: Company, Edelweiss Investment Research

One of the lowest freight & forwarding cost

BCorp's freight & forwarding cost is ~23% below the average of top 10 companies because of its proximity to markets. We expect the cost to remain under control as fresh capex is expected to be near mines and target market is also close to plants.

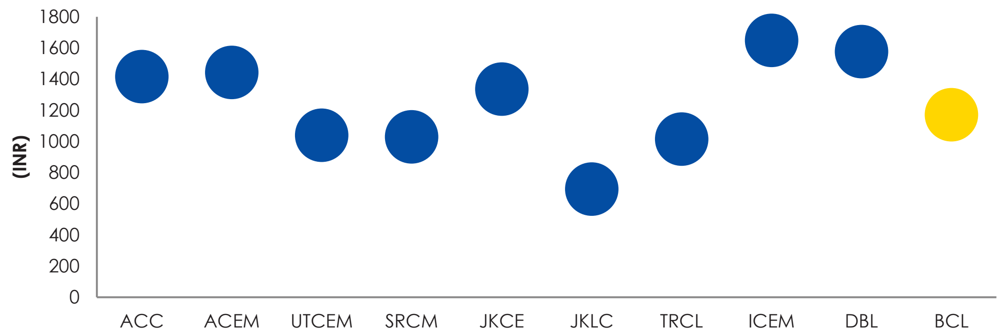
One of the lowest F&F cost



Source: Company, Edelweiss Investment Research

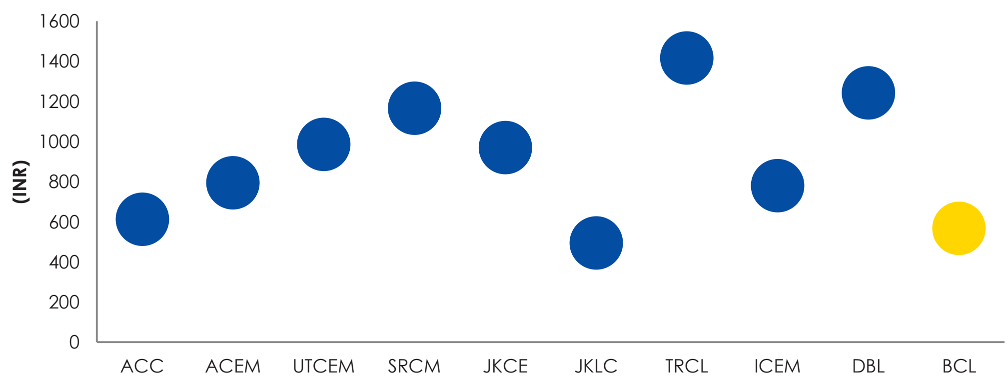
Other variable cost s lower than industry average due to lower employee cost

BCorp's other variable cost is ~5% lower than the average of top 10 companies, primarily driven by lower employee cost. We expect the variable cost to remain stable going forward because of scalability.



EBITDA/ tonne to improve on cost control and higher realisation

The acquisition of Reliance Cement helped BCorp to improve EBITDA / tonne from INR316 to INR567, up 79% YoY. The jump is attributable to cost control and incentive on VAT, CST and SGST, which are likely to sustain. Consequently, EBITDA/ tonne is likely to improve going forward.

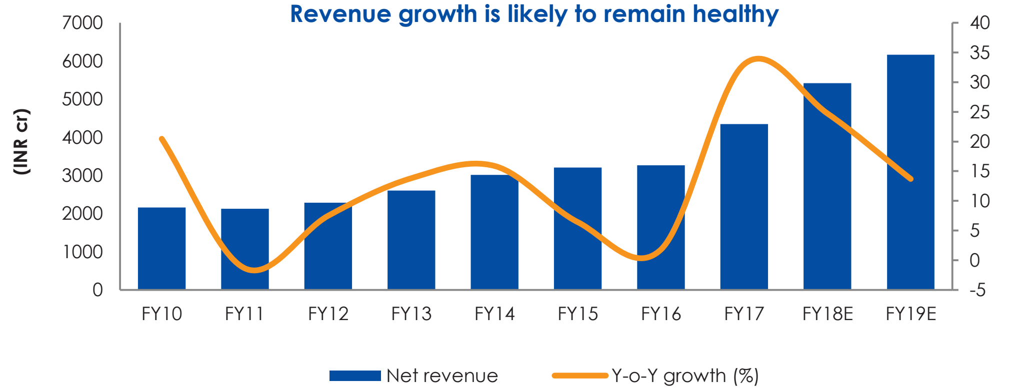


Source: Company, Edelweiss Investment Research

Financial Outlook

We expect acquisition of Reliance Cement to accelerate growth and hence estimate 19% net revenue growth over FY17-19 spearheaded by 13.6% surge in cement sales volume and 6% growth in realisation over FY17-19 compared to 11% revenue growth and 3% realisation growth over FY12-17.

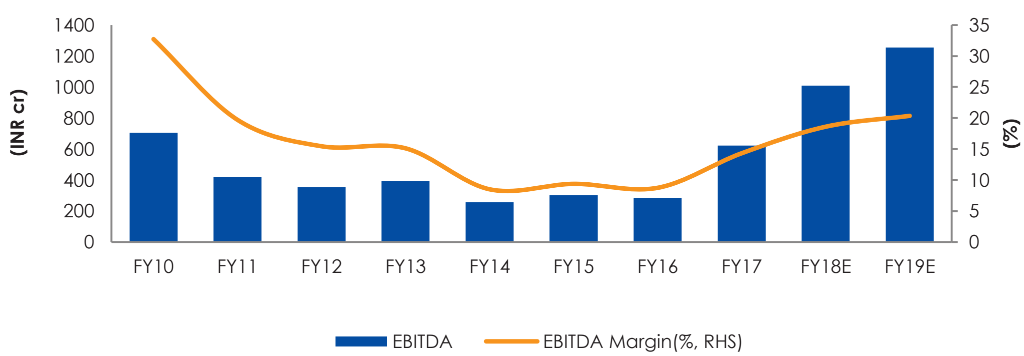
Revenue growth is likely to remain healthy



Source: Company, Edelweiss Investment Research

We estimate EBITDA CAGR of 40% over FY17-19 riding cement sales volume growth and marginal uptick in realisation. In FY17, EBITDA grew 118%, EBITDA margin expanded 557bps and EBITDA per tonne jumped 79% YoY to INR567. We expect full year consolidation of Reliance Cement's sales volume to boost growth and margin, in turn propelling EBITDA per tonne.

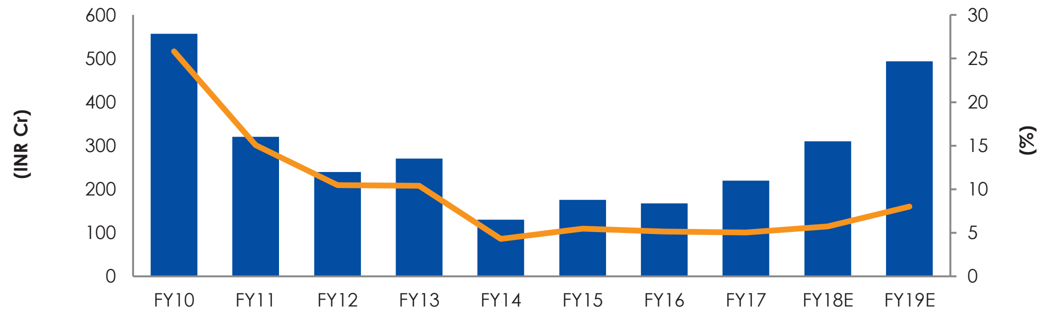
EBITDA, EBITDA margin to increase on cost control and higher realisation



Source: Company, Edelweiss Investment Research

Net profit is expected to increase at a higher clip compared to net revenue on account of cost control and realisation expansion. Hence, we estimate 39% CAGR over FY17-19. We have projected PAT margin to improve from 5% to 8% over FY17-19.

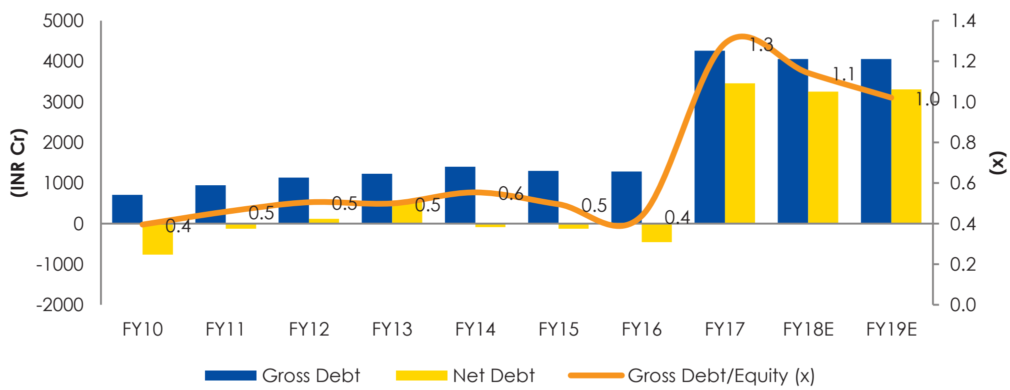
... Stable fixed and finance cost will enhance PAT margin



Source: Company, Edelweiss Investment Research

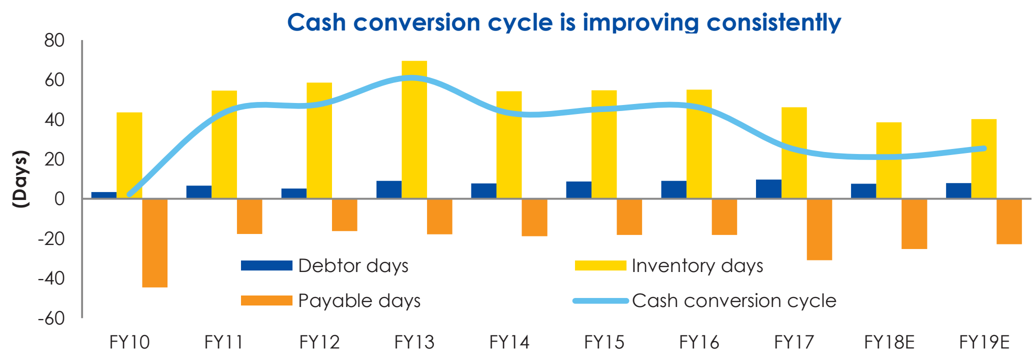
BCorp's net debt has remained negative and gross debt to equity at ~0.5x over the past 7 years on an average. Lower debt helped the company acquire Reliance Cement. Based on current capex programme, gross debt to equity will remain at 1.1x from current level of 1.3x. There is room for fresh debt, which will further boost inorganic growth.

Lower gross D/E helped in acquisition



Source: Company, Edelweiss Investment Research

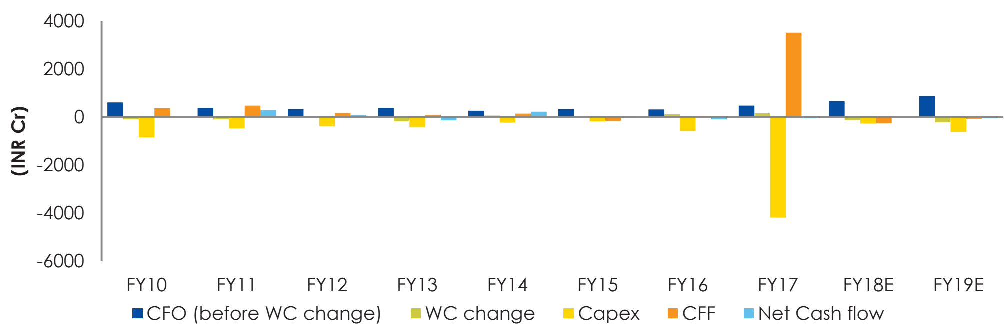
The cash conversion cycle at peak was 61 days, which dipped to 46 in FY16 and further to 25 post the Reliance Cement acquisition. We have projected cash conversion cycle to remain at ≤25 days.



Source: Company, Edelweiss Investment Research

Positive cash flow has strengthened balance sheet

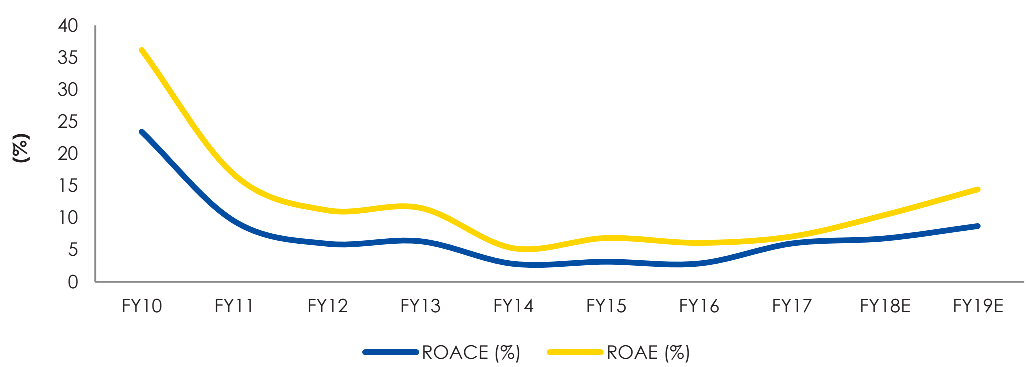
BCorp has consistently generated positive operating cash flow and free cash, except in years of capex.



Source: Company, Edelweiss Investment Research

Return ratios to improve

RoAE and RoACE have bottomed out and we expect them to improve on account of burgeoning revenue and profitability.



Source: Company, Edelweiss Investment Research

Financials

Income Statement (INR cr)

Year to March	FY15	FY16	FY17	FY18E	FY19E
Net revenue	3,210	3,268	4,348	5,568	6,210
Materials costs	510	618	665	794	917
Gross profit	2,700	2,650	3,683	4,775	5,293
Power & Fuel Cost	868	775	968	1,248	1,325
Freight Cost	628	671	861	1,282	1,357
Other Cost	902	918	1,231	1,253	1,389
EBITDA	302	286	623	992	1,221
Depreciation & Amortization	154	149	256	332	327
EBIT	148	137	367	660	894
Other income	156	177	147	58	46
EBIT incl. other income	304	315	514	717	940
Interest expenses	78	82	277	412	414
Profit before tax before EI	225	232	237	306	526
Exceptional Items	(13)	(31)	(7)	-	-
PBT	213	201	230	306	526
Provision for tax	37	33	11	68	105
Reported PAT	175	168	219	238	421
Adjustment in PAT	(0)	(0)	(0)	(0)	(0)
Adj Net Profit	175	168	219	238	421
Basic shares outstanding (crs)	8	8	8	8	8
EPS (Rs.)	23	22	28	31	55
Dividend per share (Rs.)	6	6	7	7	8
Dividend payout (%)	26.4	27.5	22.8	22.7	13.7

Common Size

Year to March (%)	FY15	FY16	FY17	FY18E	FY19E
Gross profit margin	**84.1**	**81.1**	**84.7**	**85.7**	**85.2**
Power & fuel	27.0	23.7	22.3	22.4	21.3
Freight & forwarding	**19.6**	**20.5**	**19.8**	**23.0**	**21.9**
Other manufacturing cost	28.1	28.1	28.3	22.5	22.4
EBITDA margin	**9.39**	**8.75**	**14.33**	**17.81**	**19.66**
Depreciation	4.8	4.6	5.9	6.0	5.3
Interest expenses	**2.4**	**2.5**	**6.4**	**7.4**	**6.7**
Tax rate	16.6	14.3	4.6	22.2	20.0
Net profit margins	5.5	5.1	5.0	4.3	6.8

Growth Ratios

Year to March (%)	FY15	FY16	FY17	FY18E	FY19E
Revenues	6.4	1.8	33.0	28.1	11.5
EBITDA	17.4	-5.1	117.7	59.3	23.1
PBT	39.5	-5.5	14.6	32.7	72.3
Net profit	35.0	-4.3	30.8	8.3	77.2

Balance Sheet (INR cr)

As on 31st March	FY15	FY16	FY17	FY18E	FY19E
Equity capital	77	77	77	77	77
Preference Share Capital	0	0	0	0	0
Reserves & surplus	2550	2848	3228	3401	3752
Borrowings	1302	1281	4255	4055	4055
Deferred Tax Liabilities (Net)	244	183	565	565	565
Sources of funds	4173	4390	8124	8097	8449
Net Fixed Assets	2050	2097	7168	7012	7185
Investments	1309	1690	564	632	708
Inventories	553	567	630	808	960
Sundry debtors	88	94	133	161	191
Cash & Bank Balances	468	363	312	216	40
Other Current assets	200	204	516	474	563
Loans and advances	327	213	374	472	543
Total current assets	1636	1442	1965	2131	2297
Sundry creditors	159	163	368	380	392
Provisions	105	59	75	97	115
Other Liabilities	558	618	1131	1225	1307
Total current liabilities & provisi	822	840	1573	1702	1815
Net current assets	814	602	392	429	482
Uses of funds	4173	4390	8124	8073	8375

Free cash flow

Year to March	FY15	FY16	FY17	FY18E	FY19E
Net profit	175	168	219	238	421
Add : Depreciation	154	149	256	332	327
Operating profit (before W C ch	329	316	475	570	748
Less: Changes in W C	19	-107	-160	134	229
Operating cash flow	310	423	634	436	520
Less: Capex	194	195	5326	200	550
Free cash flow	115	228	(4,692)	236	(30)

Cash Flow Statement

Year to March	FY15	FY16	FY17	FY18E	FY19E
Cash flow from operations	310	423	634	436	520
Cash Flow from investing activi	-179	-576	-4201	-268	-626
Cash Flow from financing activi	-155	-77	2918	-265	-70
Adjustments	-11	125	597	0	0
Capex	-194	-195	-5326	-200	-550
Dividends	56	56	56	65	70

Profitability & Efficiency Ratios

Year to March	FY15	FY16	FY17	FY18E	FY19E
ROAE (%)	6.80	6.04	7.05	7.01	11.53
ROACE (%)	3.10	2.82	5.95	6.56	8.70
ROA	2.92	2.68	5.60	6.11	8.15
Inventory day	54.62	55.06	46.18	38.14	40.62
Debtors days	8.71	9.14	9.71	7.60	8.10
Payable days	18.10	18.17	30.88	24.90	23.06
Cash conversion cycle (days)	45.23	46.03	25.00	20.85	25.67
Current ratio	1.99	1.72	1.25	1.25	1.27
Gross debt/equity	0.50	0.44	1.29	1.17	1.06
Adjusted debt/Equity	0.32	0.31	1.19	1.10	1.05
Interest coverage ratio	1.89	1.67	1.33	1.60	2.16

Turnover Ratios

Year to March	FY15	FY16	FY17	FY18E	FY19E
Total asset turnover	0.9	0.9	0.8	1.0	1.0
Fixed asset turnover	1.8	1.8	1.1	1.1	1.2
Equity turnover	1.4	1.4	1.6	2.3	2.4

Du Pont Analysis

Year to March	FY15	FY16	FY17	FY18E	FY19E
NP margin (%)	5.46	5.13	5.05	4.27	6.78
Total assets turnover	0.82	0.80	0.74	0.74	0.81
Leverage multiplier	1.52	1.47	1.89	2.23	2.11
ROAE (%)	6.80	6.04	7.05	7.01	11.53

Valuation Parameters

Year to March	FY15	FY16	FY17	FY18E	FY19E
Adjusted Diluted EPS (INR)	22.8	21.8	28.5	30.9	54.7
Y-o-Y growth (%)	35.0	-4.3	30.8	8.3	77.2
Adjusted Cash EPS (INR)	42.7	41.1	61.7	74.0	97.2
Diluted P/E (x)	53.4	55.8	42.6	39.4	22.2
P/BV (x)	3.6	3.2	2.8	2.7	2.4
EV/tonne (USD/tonne)	152.8	139.7	128.2	127.1	128.9
EV/sales (x)	2.9	2.7	2.9	2.3	2.1
EV/EBITDA (x)	30.6	31.1	20.6	12.8	10.6
EV/EBITDA (x), 1 yr fwd.	32.3	14.3	12.9	10.4	8.5

Long Term Recommendation: Sagar Cements Ltd.

Operational Efficiency to drive profitability

CMP INR: 860
Rating: BUY
Target Price INR: 1137
Upside: 32%

Sagar Cements Ltd (SGC) is primarily a south-based cement player having a total capacity of ~4.3 MT. Over the years, the company has diversified its operations into other regions like Maharashtra and Orissa. The recent acquisition of BMM's 1mt cement plant has taken the company's overall capacity to ~4.3 MT. The acquisition helped SGC to reduce its lead distances, thereby saving on its overall logistic costs. Being an Andhra Pradesh (AP)-Telangana centric company, SGC is expected to be a key beneficiary of the expected uptick in cement demand on account of the state's bifurcation. We believe, with the incremental cost savings and better realizations at BMM, the overall EBITDA/tonne for the company is expected to move from ~INR 655/tonne in H1FY18 versus INR 505 in H1FY17 to INR 1,021/tonne inFY20. Additionally, we believe the incremental demand triggers and imminent improvement in utilization levels augurs well for the company. The stock is currently trading at 7.7x/4.6x FY19E/FY20E EV/EBITDA. We re-initiate coverage with a 'BUY' rating and a target price of INR 1,137 (average of 7x FY20E EV/EBITDA, 12.0x FY20E earnings and EV/tonne of USD95).

Comprehensive capacity expansion programme burnishes prospects

SGC's capacity is in tandem with industry capacity and demand. In FY16, the company acquired a 1mn tonne grinding unit along with a 25MW captive power plant from BMM Cements (Gudipadu, AP). The company has also acquired a 0.2mn tonne grinding unit from Toshali Industries in FY17. Post acquisition from Toshali Industries, the company expanded capacity from 0.2mn tonne to 0.3mn tonne, taking its grinding capacity to ~4.3mn tonne. The company has plans to set up an additional 1.2mn tonne at Toshali (Vishakapatnam, AP) in Q3FY19 taking its total capacity to 5.5mn tonne in FY19.

Proximity of plants to raw material source lends distinct cost edge vs peers

SGC's limestone mine is located within 4 km of its plant. The mine has reserves of more than 1,000 MT, which can serve SGC's requirement for 100+ years. The acquired plant, BMM Cements, also has land of ~3,000 acres within 2 km of SGC's plant boundary, out of which it has been granted the limestone mining lease over an area of 1,123 acres for a period of 20 years. Proximity to raw materials from the plant and long term lease provide stability in raw material cost. We believe SGC's raw material costs will likely remain lower going forward.

Margin expansion through cost reduction

The power and fuel (P&F) costs for SGC is the highest amongst peers but installation of a waste heat recovery system (WHRS) in June 2017, is expected to reduce P&F costs in the medium to long term. We expect P&F costs to reduce by ~2% of net revenue. SGC has completed construction of its captive railway siding, at a cost of INR 123 crore. SGC is targeting a road:rail mix of 80:20 and expects to net states and towns such as Orissa, Assam, Bangalore and Kerala at competitive rates. We expect EBITDA margin to improve 23% in FY20 from 16.4% in H1FY18.

Outlook and valuation: Value play; recommend 'BUY'

SGC is currently trading at an attractive valuation of 7.7x & 4.6x FY19E & FY20E and an EV/tonne of USD71/tonne compared with peers of 5.6x FY20E EV/EBITDA and EV/tonne of USD81. We believe the stock should trade at a higher multiple on account of: a) margin expansion via geographical expansion and cost reduction, and b) return ratios to likely improve ahead. At the current market price of INR 860, we re-initiate coverage on SGC with a 'BUY' recommendation and a target price of INR 1,137 (average of 7x FY20E EV/EBITDA, 12.0x FY20E earnings and EV/tonne of USD95).

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Revenues (INR Cr)	753	814	1063	1271	1682
Rev growth (%)	–	8.0	30.6	19.6	32.3
EBITDA (INR Cr)	122	109	185	259	379
Net Profit (INR Cr)	44	-4	53	104	191
P/E (x)	32.6	-431.4	32.0	16.2	8.9
EV/EBITDA (x)	14.8	17.6	10.9	7.5	4.5
RoACE (%)	–	5.1	8.9	12.0	16.7
RoAE (%)	–	-0.6	6.7	12.2	19.2

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Bloomberg:	SGC:IN
52-week range (INR):	942.15 / 602.90
Share in issue (cr):	2
M cap (INR cr):	1,757
Avg. Daily Vol. BSE/NSE :('000):	12.2
Promoter Holding (%)	50.03

Date: 29th November 2017

New Capacity addition + Reducing freight distance+ improving power costs + demand up-stick + higher utilisation in acquired plants = Higher EBITDA/Ton

With the incremental cost savings and better realizations at BMM, Sagar Cements (SCL) overall EBITDA/tonne is expected to move from ~INR 654/tonne in H1FY18 to INR 1,021 in FY20E versus INR 505 in H1FY17..

We have estimated 27% CAGR in net revenue on back of 19% growth in volume and 5-6% growth realisation

	FY16	FY17	FY18E	FY19E	FY20E
Net Revenue	753	814	1,063	1,271	1,682
EBITDA	122	109	185	259	379
EBIT	87	67	131	198	321
PAT	44	-3.9	52.9	104.5	190.6

EBITDA/tonne is expected to improve from INR 655 in H1FY18 to INR 1,021 on back of cost control and marginal uptick in realisation

	FY16	FY17	FY18E	FY19E	FY20E
RoAA	4.98%	5.1%	8.9%	12.0%	16.7%
RoAE	8.1%	-0.6%	6.7%	12.2%	19.1%

Consequently, RoA is expected to increase from 5% to 17% over FY17-20E and RoAE from negative to 19% during the same period.

EV/ EBITDA	FY20E EBITDA (in crs)	CMP / Target
4.5x (CMP)	379	860
7x (Target)	379	1137

At CMP, FY20E EV/EBITDA is 4.5x + FY20E RoE of 19% + At Target Price, FY20E EV/EBITDA is 7x

Upside of 32%

Price Target	**INR 1137**	For valuation purpose, we have taken the average of EV/EBITDA, PE Multiple and EV/ton to value SGC's common share. Based on 7x FY20E EV/EBITDA, 12.0x FY20E earnings and EV/tonne of USD95, we arrive at target price of INR 1,137, entailing 32% upside.
Bull	**INR 1500**	In bull case, We believe SGC's stock has potential to trade at 9.0x FY20E EV/EBITDA, 16.0x FY20E earnings and EV/tonne of USD120 and we arrive at target price of INR 1,500, entailing 74% upside.
Base	**INR 1137**	SGC is currently trading at an attractive valuation of 7.7x & 4.6x FY19E & FY20E and an EV/tonne of USD71/tonne versus an average of 5.6x FY20E EV/EBITDA and EV/tonne of USD81. We believe the stock should trade at a higher multiple on account of: a) margin expansion via geographical expansion and cost reduction, and b) return ratios likely to improve ahead. At the current market price of INR 860, we re-initiate coverage on SGC with a 'BUY' recommendation and a target price of INR 1,137 (average of 7x FY20E EV/EBITDA, 12.0x FY20E earnings and EV/tonne of USD95).
Bear	**INR 636**	Failing to meet our estimates by huge margin, we will assign a target price of 636 per share (average of 4.0x FY20E EV/EBITDA, 7.0x FY20E earnings and EV/tonne of USD60).

Sagar Cements Ltd.

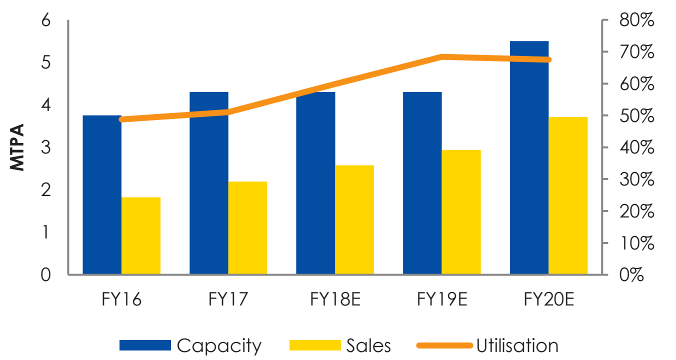
Average Daily Turnover (INR cr)			Stock Price (CAGR)				Relative to Sensex, CAGR (%)			
3 months	6 months	1 year	1 year	3 years	5 years	10 years	1 year	3 years	5 years	10 years
6.69	4.21	7.94	18.9%	37.2%	31.3%	13.1%	-7.3%	31.8%	19.6%	7.4%

Business Value Drivers

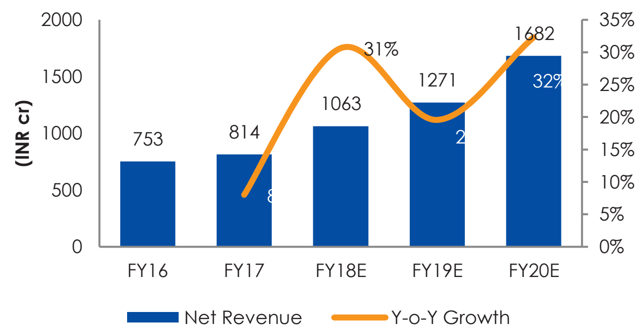
Nature of Industry	Top 5 companies control ~51% of total installed capacity, ~59% of revenue, ~68% of industry EBITDA and 73% of industry PAT. Top 10 companies contribute 69% of installed capacity while revenue, EBITDA and PAT contribute 79%, 84% and 89% respectively.
Opportunity Size	Industry has positive correlation with GDP and generally grows at ~1.0x of real GDP growth. Cement demand is expected to accelerate on account of potential demand from Road sector, Metro and housing. With new Telangana capital Amravati developing SGC has huge opportunity size.
Capital Allocation	Capex is nearing completion for SGC. It has recently commissioned 6MW WHRS. The18MW thermal power plant and 1.2mn capacity addition will be completed by September 2019 and December 2019 respectively.
Predictability	Cement demand has positive correlation of ~1.0x of real GDP growth rate and good Monsoon also accelerates the growth. We believe the near term growth is expected to remain healthy on account of good monsoon, housing for all by 2022 and construction of Road and Metro at double pace.
Sustainability	With acquisition of BMM plant and expansion at bayyavarm plant, the market reach has expanded with freight cost to reduce drastically.
Disproportionate Future	Any delay in Government's affordable housing thrust, delay in recovery of demand in its targeted market and increasing raw material and coal prices can create slower earnings for SGC.
Business Strategy & Planned Initiatives	With its planned capex close to completion, current strategy is to ensure higher utilization in all plants with lower operational cost.
Near Term Visibility	Near-term visibility remains strong due to the soon to be completed capex. New plant is expected to expand market reach and reduce freight cost.
Long Term Visibility	Capex cycle is expected to be completed; debt levels are going to remain low. Along with demand tailwinds picking up in its core markets and huge spending in Amravati. SGC is expected to benefit from this.

Focus Charts – Story in a nutshell

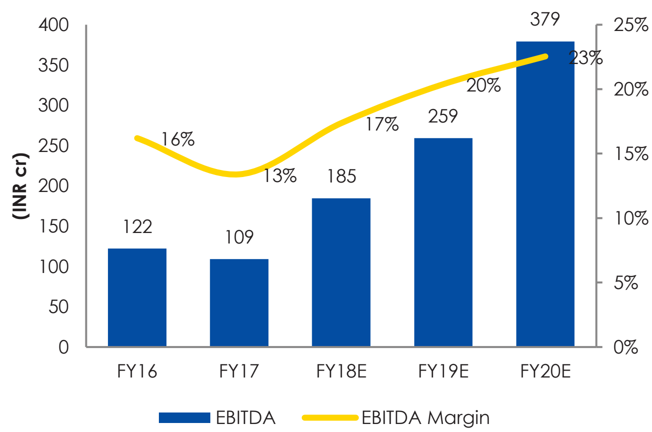
Capacity Growth in line with demand scenario



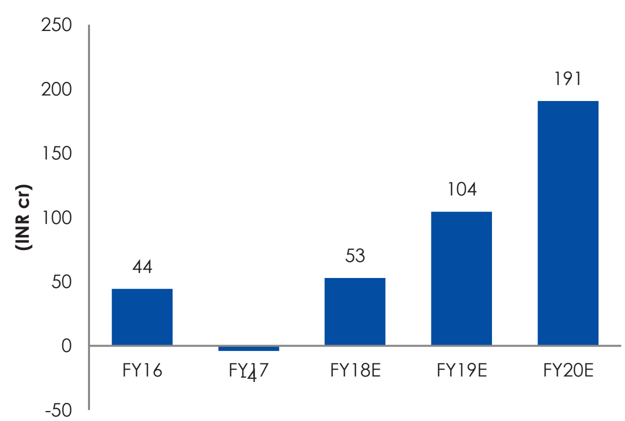
Net Revenue to grow at higher pace



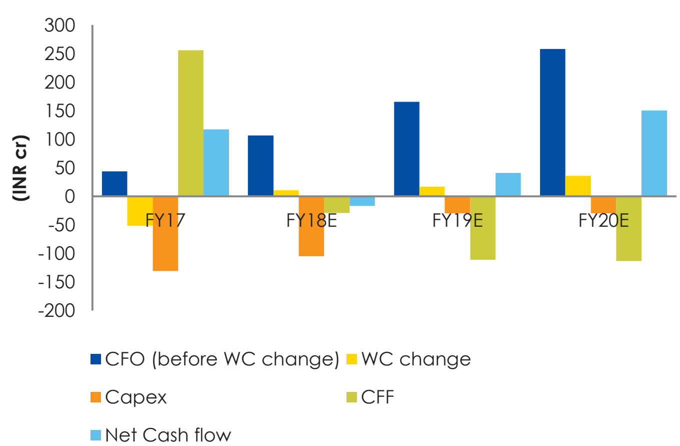
EBITDA margin to increase on cost control



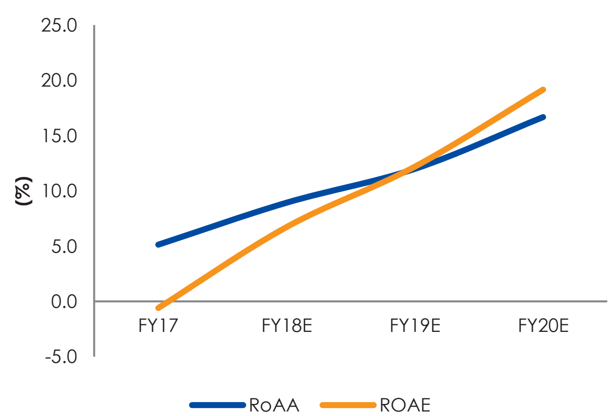
Net Profit is expected to remain healthy



Cashflow is expected to turn positive



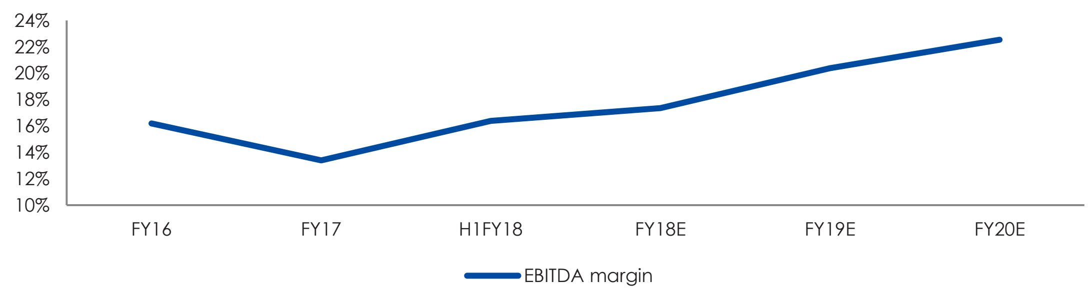
Return ratio to improve



Source: Edelweiss Investment Research

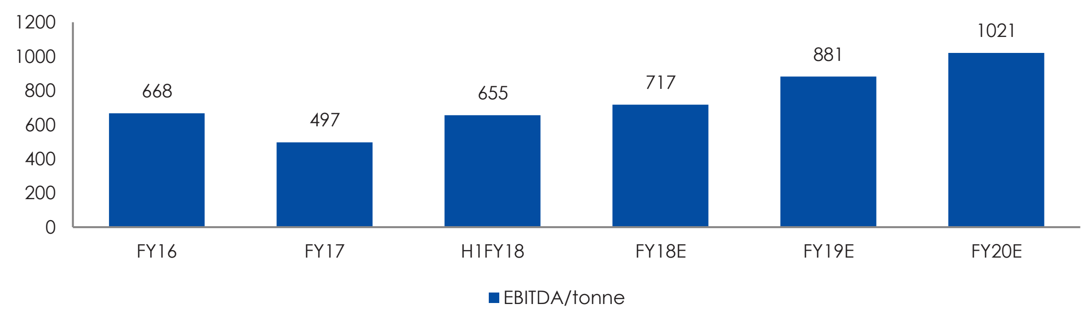
I. Margin expansion via cost reduction

SGC has reported substantial margin improvement post integration of BMM and Toshali. For FY17, the consolidated EBITDA margin stood at 13.6%, which increased to 16.4% in H1FY18. We expect margins to improve on account of: a) installation of a 6MW WHRS in Q1FY18 that is likely to save INR 25 crore in power and fuel costs; b) acquisition of BMM and Toshali has reduced the lead distance from Kerala, Karnataka, Tamil Nadu and Orissa, and additionally, commencement of the captive railway siding unit will further reduce freight costs; and c) benefit of the mining lease of BMM is expected to accrue for the next few quarters. In the light of these benefits, we have estimated EBITDA margin to improve from 16.4% in H1FY18 to 23% in FY20.



Source: Company, Edelweiss Investment Research

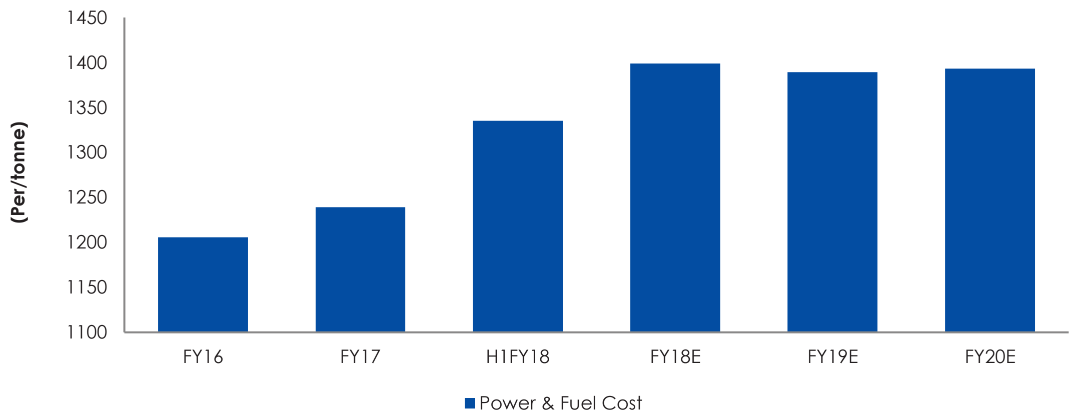
EBITDA per tonne is expected to improve on cost control



Source: Company, Edelweiss Investment Research

Power & fuel cost to grow at moderate pace

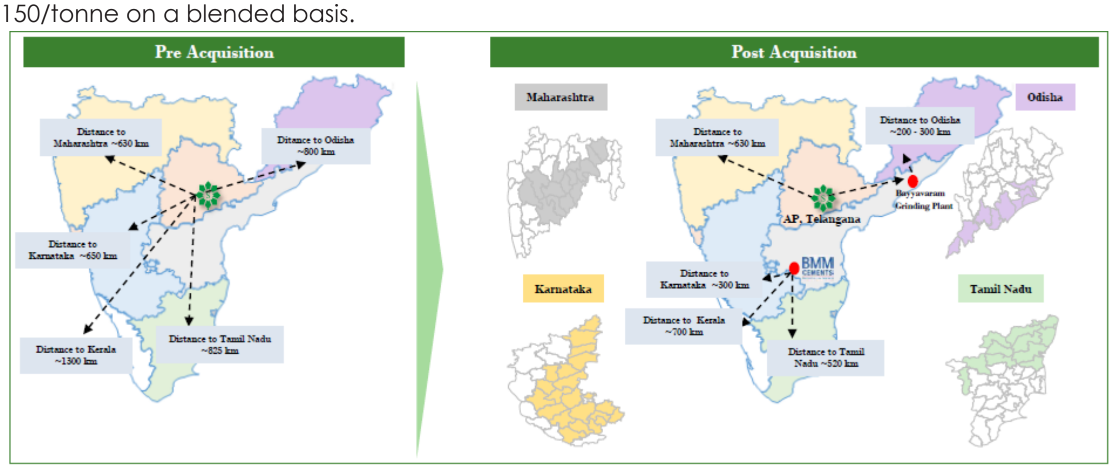
SGC has recently set up a 6MW WHRS in Mattampally at INR 65.23crs and another 18MW thermal power plant is likely to be commissioned in September 2018 at a cost of INR 99.41 crore. The BMM plant has a 25MW captive thermal power plant. SGC has a power purchase agreement (PPA) with Singareni coalfields for supply of coal. However, SGC's consumption is skewed towards international coal. The domestic: international coal mix stands at 4:96. According to management, the quality of international coal grade variety is far superior, thereby increasing the price competitiveness. At present, the P&F cost is INR 1,300-1,400/tonne; this is expected to remain moderate.



Source: Company, Edelweiss Investment Research

Reduction in freight cost

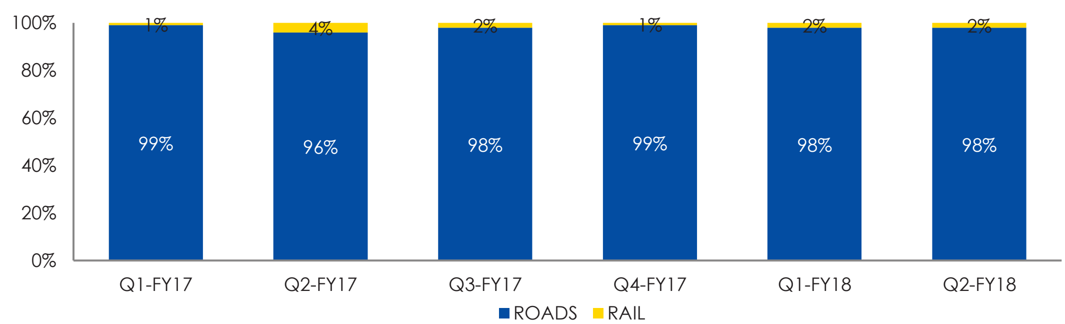
The lead distance of Kerala, Tamil Nadu and Karnataka from SGC's parent plant was very high; however acquisition of BMM has reduced this lead significantly. The distance from the parent plant to Kerala, Tamil Nadu and Karnataka was 1,300km, 825km and 650km, which reduced to 700km, 520km and 300km respectively after BMM's acquisition. BMM is expected to serve the above markets while the parent company will focus on supply to Maharashtra and its home state — Telangana; and the Bayyavaram plant is expected to focus on the Orissa market. The distance to Orissa's market has reduced from 800km to 200-300km post the Bayyavaram acquisition. These states account for 31% of SGC's volumes. The F&F for these markets is expected to reduce from ~INR 1,200/tonne to INR ~600/tonne, which translates to a total freight saving of ~INR 140-150/tonne on a blended basis.



Commencement of a captive railway siding unit at BMM plant to further reduce freight costs

Sagar has completed construction of its captive railway siding, at a cost of INR 123 crore. SGC utilised roadways to carry 100% of its cement dispatches in the absence of railway connectivity to its plant. Hence, the railway siding was constructed with the aim of reducing freight costs and enhance the company's presence in faraway markets such as Orissa, Bangalore and Kerala at competitive rates. This would enable Sagar to optimize its freight cost by reducing its dependence on road transport (target for road:rail mix is 80:20) and increase volumes by reaching out to newer markets. This new freight mix will reduce costs translating into operating margin expansion.

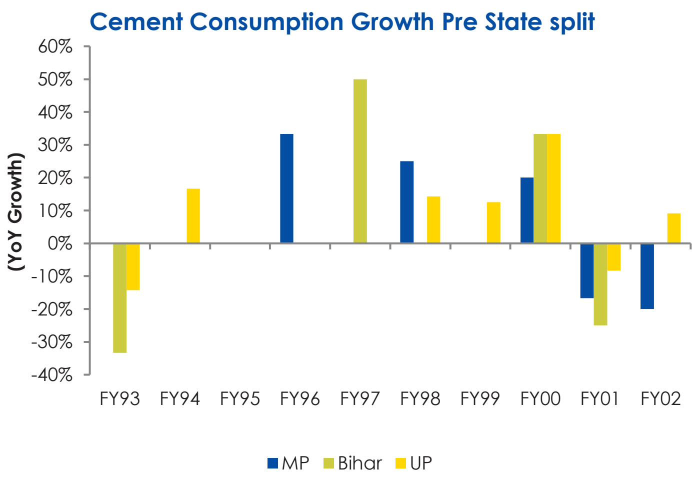
Dependency on road route to decrease

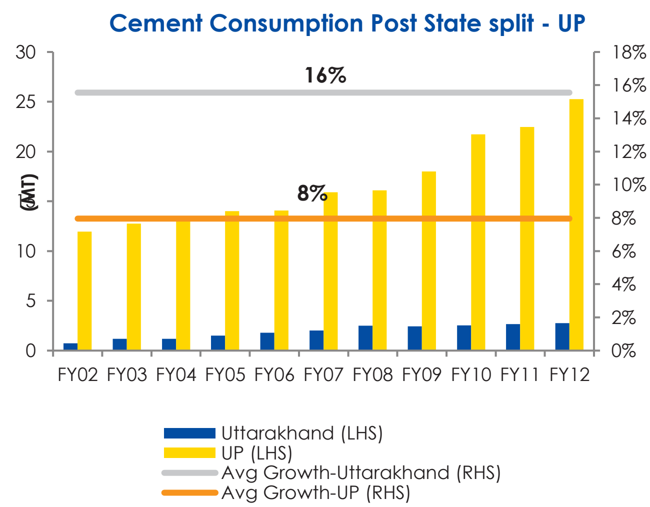


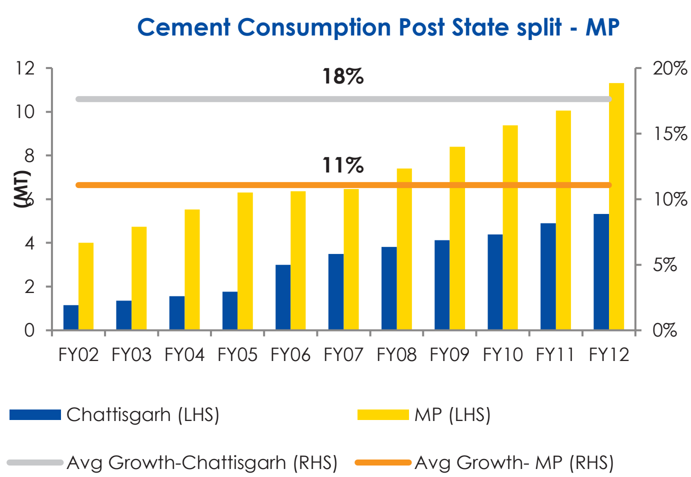
Source: Edelweiss Investment Research

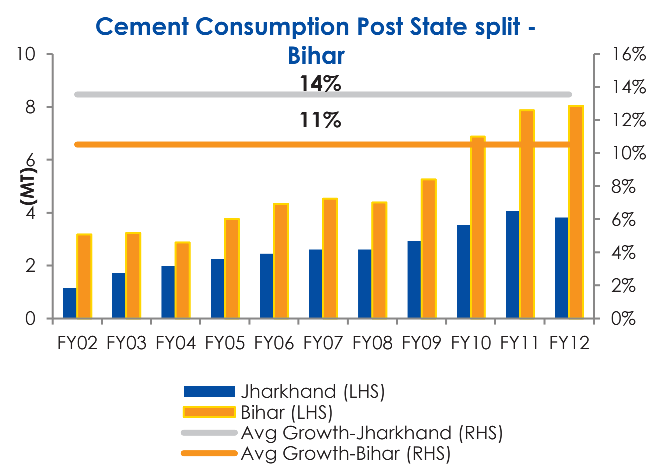
II. SGC likely primary beneficiary of state's infrastructure recovery: Key catalyst to propel long term growth

Historically, we have noted that the new state formation has resulted in a sharp uptick in cement demand for both states, higher than demand generated from the erstwhile combined state, on the back of increase in budget allocation, resulting in higher spending on infrastructure and housing. This was seen in three different cases when the states of Chhattisgarh, Jharkhand and Uttarakhand were carved out of Madhya Pradesh, Bihar and Uttar Pradesh respectively. In all these cases, consumption had registered significant growth after creation of the new states. We believe this is strong evidence and expect similar demand pull in Andhra Pradesh over next five years. Further, an incremental cement demand is expected over the next 5-10 years.





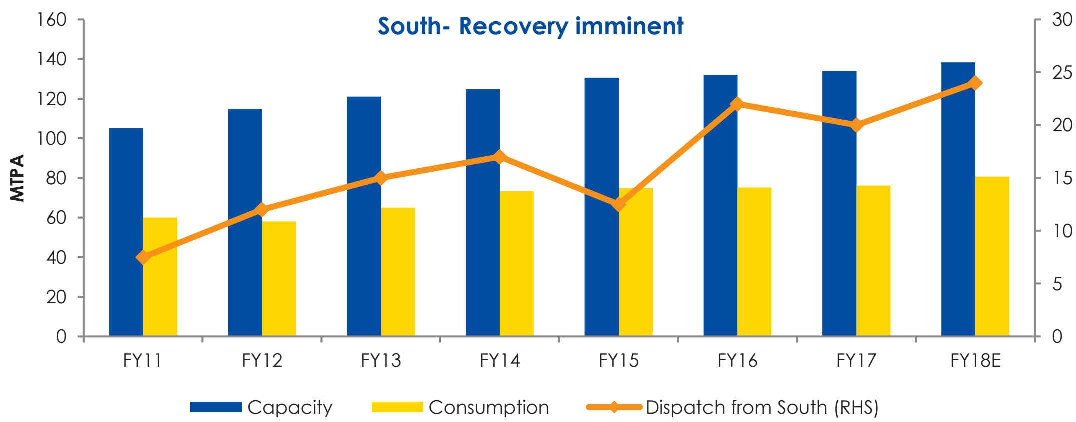




Source: Edelweiss Investment Research

The capacity addition is moderrating; hence positive for SGC

New capacities are expected to remain moderate because presently utilization levels in the region are reasonably low. However, we expect utilization to improve from current levels of ~57% to ~68% (on expanded capacity from 4.3mn tonne to 5.5mn tone) in FY20E. Various demand triggers in terms of both infrastructure and housing are expected to drive incremental cement demand in the region. The southern region accounts for 27 of the 98 Smart cities proposed, four of the eight metro projects currently under implementation and ~20% of the housing shortage being targeted by various government schemes. Andhra Pradesh and Telangana currently have key infrastructure projects underway, including ports, airports and an industrial corridor. The Telangana government is also fast tracking irrigation projects and is estimated to spend INR 81,000 crore over the next three years on the sector. In addition, 25,000 km of cement concrete roads are expected to be laid over the next four years at a cost of INR 8,000 crore in villages in Andhra Pradesh. Proximity of SGC's plants to key infrastructure projects, particularly Andhra Pradesh and Telangana, bodes well for the company and is expected to boost volumes going forward.



Source: Edelweiss Investment Research

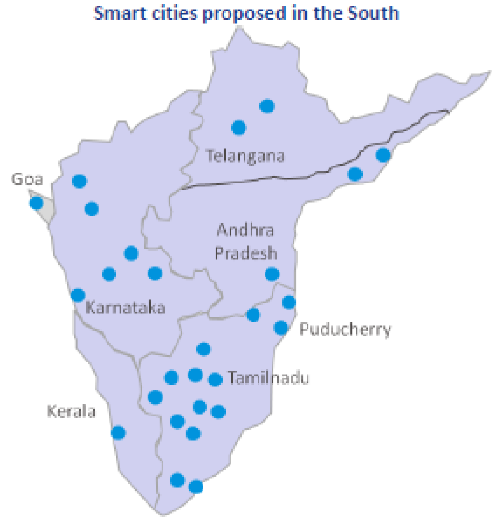
Proximity to new capital of Andhra Pradesh to likely drive demand

SGC stands to gain from having both its units within a distance of ~250 km from Amravati, the proposed new capital of Andhra Pradesh, which is expected to herald a big construction boom in the region. SGC would be a key beneficiary of incremental demand of ~2-4mn tonnes expected annually from Amravati. Although this would fuel prospects of the entire cement industry, companies like SGC having their units in proximity to the proposed capital would benefit the most since logistics is a key cost in the industry.

Irrigation projects to spur cement demand

Implementation of the mega multi-purpose Polavaram irrigation project in Seemandhra in addition to a revival of several irrigation projects in Telangana is expected to be among the key demand drivers of cement in the southern region. The Polavaram project in Andhra Pradesh, which is being treated as a national project, is expected to see an outlay of INR 160 bn. In addition, the Telangana government is undertaking two large irrigation projects at a total project cost of INR 750 bn. All the three projects are being targeted to be completed over the next four years. In particular the Telangana government is laying greater stress in irrigation projects as irrigation levels in Telengana are significantly lower versus the rest of India. Irrigation is the single largest component for capital expenditure in Telangana government's budget and accounts for ~45% of total expenditure on the capital account.

Smart cities proposed in the South



Metro Rail Projects in the south

City	Length Remaining (Kms)
Banglore	27.8
Chennai	18
Hyderabad	35.6
Kochi	16.7

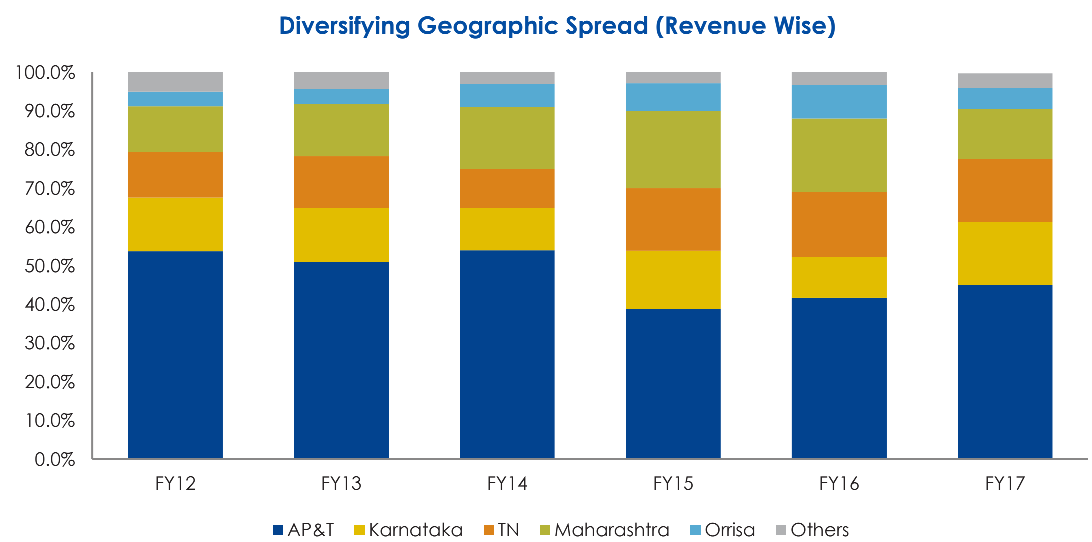
Irrigation Projects in Telangana

Project	Cost	Estimated Spending until 2019
Palamuru-Ranga Reddy	RS 35,200 crs	RS 13,400 crs
Pranahitha-Chevella	RS 40,300 crs	RS 17,000 crs
Nakkalagandi	RS 6,190 crs	RS 5,261 crs

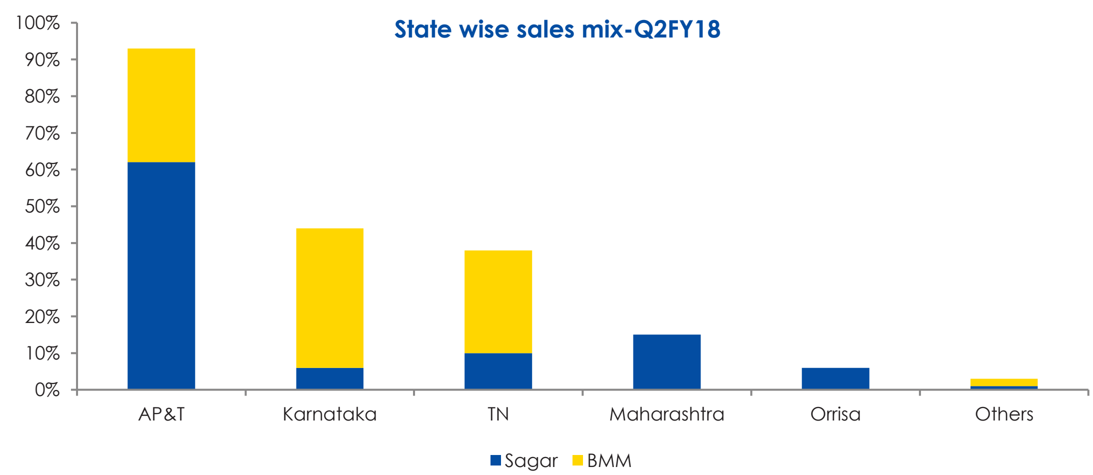
Source: Edelweiss Investment Research

III. Increasing geo presence ensures revenue visibility and growth in medium to long term

In the last few years, SGC has been reducing dependency on its home state and has increased the revenue mix from other geographies. Post the BMM and Bayyavaram acquisitions, revenues from the other geographies are expected to grow at a faster pace because the lead distance from SGC's parent plant has reduced significantly. We expect an impressive set of numbers in the foreseeable future on the back of recovering demand in the SGC's operating markets, incremental volumes from the recently acquired BMM & Bayyavaram units and healthy pricing levels. SGC's net revenue grew at ~11% CAGR over FY11-17, mainly on account of a ~7% CAGR on volume growth and 4.2% CAGR on realization growth. We have estimated revenue and EBITDA to grow at 27% and 52% CAGR on back of 19% volume growth and 5-6% realization growth respectively from FY17-20E.



Source: Edelweiss Investment Research



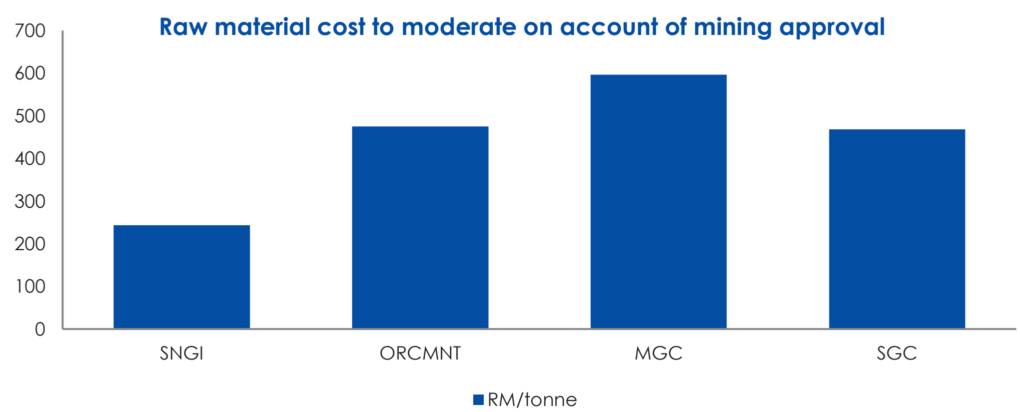
Source: Edelweiss Investment Research

IV. Incremental capex supports volume growth

SGC's capex plans for an 18MW thermal power plant at Mattampally and a 1.2 MTPA grinding unit in Bayyavaram near Vishakapatnam are on track and expected to be completed by September 2018 and December 2018 respectively. Capex required is about INR ~2.75bn-3bn to be spent over the next two years, of which INR ~50m each will be the maintenance capex for Sagar's two plants and INR ~75m each for BMM's two plants. The grinding unit at Vishakapatnam requires INR ~1.7bn capex whereas the power plant at Mattampally requires INR 1bn. The company has set up a 6MW WHRS plant at Mattampally which has been operational from June 2017. SGC has raised INR ~2.2 bn through a QIP and preferential allotment, INR ~500 mn through internal accruals and remainder via loans.

V. Proximity of plants to raw material lends a distinct cost edge vs peers

SGC's limestone mine is located within 4 km of its plant. The mine has reserves of more than 1,000 MT, which can serve SGC's requirements for 100+ years. The acquired plant, BMM, also has land of ~3,000 acres within 2 km from the plant's boundary, out of which it has been granted the limestone mining lease over an area of 1,123 acres for a period of 20 years. Proximity to raw materials from the parent plant and long term lease provide stability in raw material cost. We believe the raw material cost to remain lower going forward.



Source: Edelweiss Investment Research

Company Background

Sagar Cements Limited (SGC) is a southern India based company, engaged in the manufacture of cement at its plant in Mattampally, Nalgonda district, Telangana. Beginning with a mere 0.06mt clinker and cement capacity in 1985, SGC has moved into higher gear with its clinker and cement production capacity having increased to ~3.62 MT and ~4.3 MT respectively. The company manufactures various varieties of cement such as ordinary Portland cement (OPC) of 53 grade, 43 grade, Portland Pozzalona cement (PPC) and sulphate resistant cement (SRC) to suit different needs of customers. All these products are being sold under the brand, Sagar.

Sagar Cements has also recently completed the acquisition process of BMM Cements, which has a clinker and cement production capacity of 0.82 MT and 1 MT respectively along with a captive power plant of 25MW. The company has also acquired a 0.2mn tonne grinding unit from Toshali Industries (Bayyavayam) in FY17. The company has a well spread out distribution network aiding cement sales in multiple territories like Telangana, Andhra Pradesh, Tamil Nadu, Karnataka, Maharashtra, and Orissa. Limestone requirement of the plant is met from the company's captive mine located adjacent to the plant.

Sagar Cements (Consolidated)
FY17 Revenues : INR 814 Cr.

Capacity
Cement: 4.3 MTPA
Clinker: 3.62 MTPA
Utilization: 52%

Geography Mix:
AP & T: 45%
Karnataka:16.3%,
TN: 16.3%
Maharashtra: 12.8%,
Orrisa: 5.6%

Channel Mix
Non- Trade : 30%
Trade : 70%

Freight Mix
Roads: 98%
Rail: 2%

Key risks

Delayed macro-economic recovery

The demand for cement is directly dependent on the GDP growth in the country. Any delay in recovery of demand in its target markets due to slow macro-economic recovery will lead to a change in our estimates.

Increasing raw material price

Any significant increase in key input costs such as the prices of raw materials (limestone, slag, iron ore etc.) and energy cost beyond a certain level can have a direct impact on the company's profitability.

Increase in costs

SGC is completely dependent on coal for its fuel requirement and uses a blend of imported and domestic coal from linkages. Any sharp increase in the imported coal price, currency fluctuation and increase in the domestic coal rate can impact profitability.

Asset overview

Sagar Cements, with a grinding capacity of ~4.3 mn tonnes (including 1 mn tonnes post acquisition of BMM Cements) is a dominant player in south India with presence across all five key states – Andhra Pradesh, Telangana, Tamil Nadu, Kerala and Karnataka. In addition, it has also expanded its geographic reach to Maharashtra and Orissa. However, it continues to earn nearly~70% of its revenues from the south.

Sagar has recently completed acquisition of BMM Cements, which has a grinding capacity of 1 MTPA for INR 540 crore. It has also acquired 0.2 MTPA grinding unit of Toshali Industries for INR 60 crore. The company also increased its grinding capacity to 0.3 MTPA incurring a cost of INR 6 crore. Post these acquisitions, the grinding capacity of the company has increased to ~4.3 MTPA from 2.75 MTPA.

Sagar Plant	
Capacity	**3 MTPA**
Location	Mattampally, Telangana
Utilisation	53%
Limestone	more than 600 mn Tonnes (100 yrs Lease)
Captive Power Plant	6 MW WHRS, 18 MW Thermal Power plant (Expected to commission in Sept. 2018)
Markets Catered	AP, Telangana, Odisha, Maharashtra

SC (R) Plant (formerly BMM)	
Capacity	**1 MTPA**
Location	Gudipadu, AP
Utilisation	67%
Limestone	174.7 mn Tonnes (20 Yrs Lease)
Captive Power Plant	25 MW
Markets Catered	AP, Karnataka, TN

Bayyavaram Plant	
Capacity	**0.3 MTPA**
Location	Vizag, AP
Utilisation	53%
Limestone	NA
Markets Catered	Visakhapatnam, Vizag, Srikakulam and parts of Odisha

Valuation and outlook

The strategic acquisition of BMM Cements has led to cost efficiencies for SGC, mainly in terms of freight cost reduction and providing an additional revenue stream in the form of power sales. The company is further expected to be a key beneficiary of recovery in the southern region driven by a demand revival in Andhra Pradesh-Telangana. SGC, with presence across all key states in southern India, remains a prime beneficiary of the expected demand revival in the region. Having plants in close proximity to the proposed new capital of Andhra Pradesh will enable SGC to significantly gain from expectation of incremental demand. Further, the strategic location of units within striking distance of key raw material sources, coal mines and ports, makes it one of the lowest cost producers of cement in southern India.

We expect net revenue and EBITDA to grow at 27% and 52% CAGR on back of 19% volume growth and 5-6% realization growth respectively from FY17-20E while net profit is expected to report INR 191 crore compared with INR 4 crore losses in FY17.

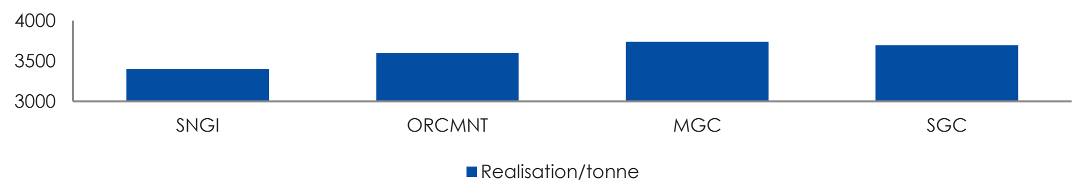
SGC is currently trading at an attractive valuation of 7.7x & 4.6x FY19E & FY20E and an EV/tonne of USD71/tonne versus an average of 5.6x FY20E EV/EBITDA and EV/tonne of USD81. We believe the stock should trade at a higher multiple on account of: a) margin expansion via geographical expansion and cost reduction, and b) return ratios likely to improve ahead. At the current market price of INR 860, we re-initiate coverage on SGC with a 'BUY' recommendation and a target price of INR 1,137 (average of 7x FY20E EV/EBITDA, 12.0x FY20E earnings and EV/tonne of USD95).

Company	EV/tonne		EV/EBITDA		P/E(x)		P/BV		EV/Sales	
	FY19E	FY120E	FY19E	FY120E	FY19E	FY120E	FY19E	FY120E	FY19E	FY120E
SNGI	113.4	113.4	8.7	6.3	20.2	15.8	2.0	1.8	2.2	1.6
MNGLM	51.8	46.9	6.7	4.5	11.9	7.4	1.5	1.3	1.0	0.8
Orient	85.6	81.5	9.8	7.1	26.2	14.3	2.9	2.5	1.6	1.3
SCL	71.7	62.7	7.7	4.6	16.8	9.2	1.9	1.6	1.6	1.0
Average	80.6	76.1	8.2	5.6	18.8	11.7	2.1	1.8	1.6	1.2

Company	Revenue Growth		EBITDA Margin		PAT margin		RoAA (%)		RoAA (%)	
	FY19E	FY120E	FY19E	FY120E	FY19E	FY120E	FY19E	FY120E	FY19E	FY120E
SNGI	21.9	35.6	25.0	25.4	9.2	8.7	10.3	11.9	7.6	8.4
MGC	16.6	15.0	14.3	16.9	6.4	8.9	11.1	14.6	13.3	18.6
Orient	15.5	19.5	16.3	17.9	4.6	7.1	10.9	14.3	11.8	18.8
SGC	19.6	32.3	20.4	22.5	8.2	11.3	12.0	16.7	12.2	19.2
Average	18.4	25.6	19.0	20.7	7.1	9.0	11.1	14.4	11.2	16.2

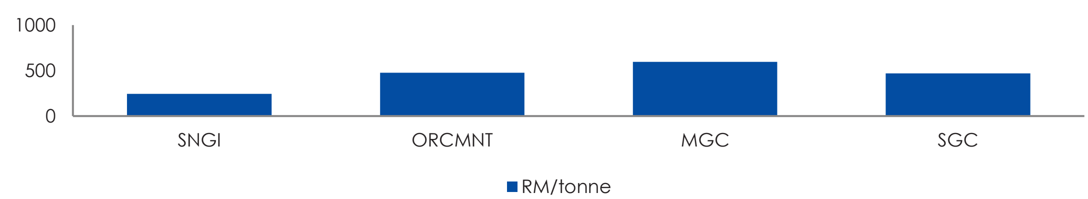
Peer Comparisons, capacity ≤10mn tonne

In FY17, the average realisation of top 4 companies in its peers set reported INR 3,609/tonne while SGC reported 2% higher than the industry average. We believe the realization to inch-up along-with the industry movement.



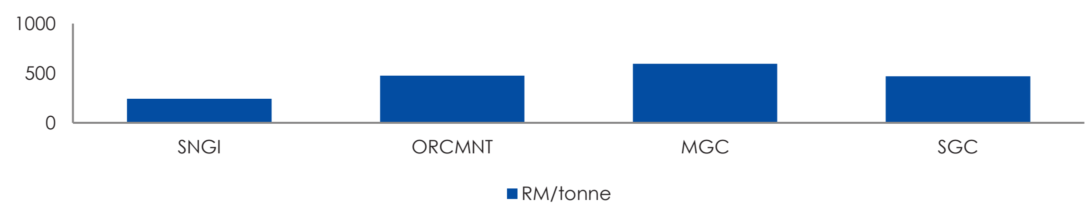
One of the lowest raw material cost per tonne of cement manufactures

SGC's raw material cost is ~5% higher than its peers. BMM was procuring RM from outside due to which the RM cost was higher. In FY17, BMM got the approval of mining lease which is near to its plant. We expect, RM cost to moderate as BMM received approval for mining lease



Power & Fuel cost is expected to come down post WHRS & 18MW thermal power installation

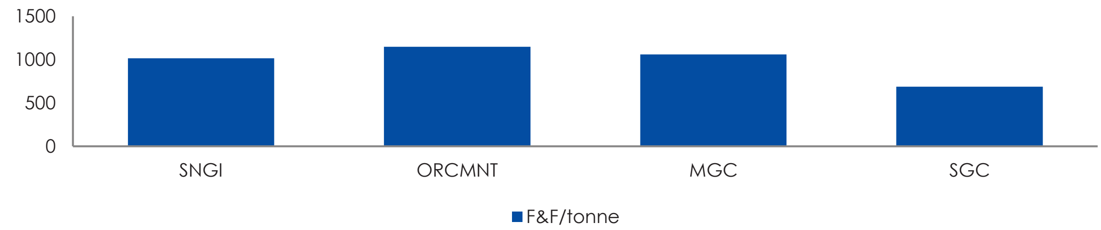
At present, the Power & Fuel (P&F) cost of SGC is 30% of higher than its peers but we expect P&F cost to come down as 6MW WHRS installed in Q1FY18 and 18MW thermal power is expected to come in H1FY19. Consequently, P&F cost is expected to come down.



Source: Edelweiss Investment Research

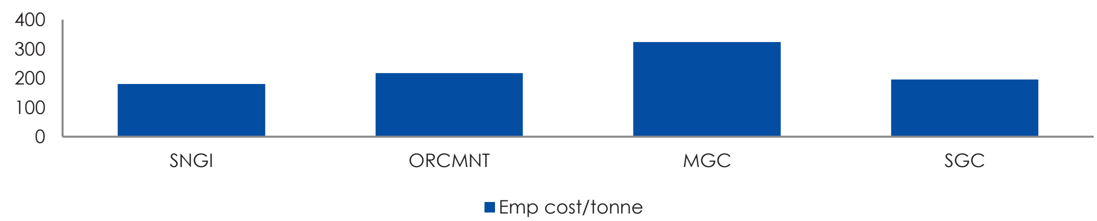
One of the lowest Freight & Forwarding cost amongst peers

The freight & forwarding cost is ~30% below the average of these companies because of presence in the vicinity of the market. The acquisition of BMM and Bayyavaram reduced the lead distance. We expect further reduction in F&F cost going forward.



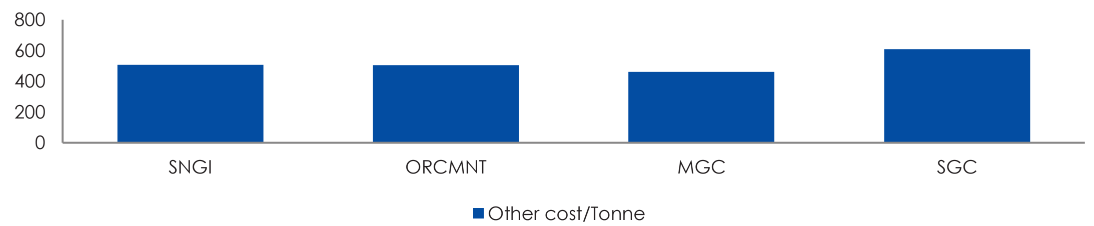
Employee cost is lower than the industry average

The Employee cost of SGC is lowest amongst its peers due to lower employee cost of BMM. The Employee cost of BMM is comparitively low. We expect Employee cost to move in-line with industry average.



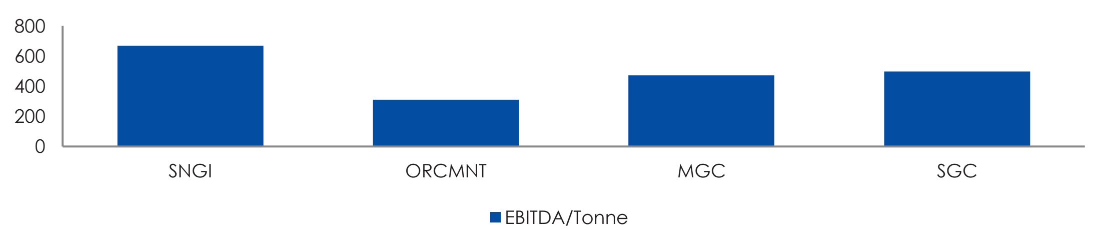
Other variable cost is marginally higher than its average

The other variable cost is marginally higher due to integration of two acquired cement plants. We expect Other variable cost to moderate as acquisition process is completed.



EBITDA per tonne is expected to improve on back of cost control and higher realisation

The EBITDA per tonne of SGC improved to INR 655/t from INR 498/t in FY17. The expansion in EBITDA/t is repercussion of reduction of lead distance, installation of WHRS in Q1FY18 and approval of mining lease for BMM. We expect, EBITDA/t growth will be accruing going forward.

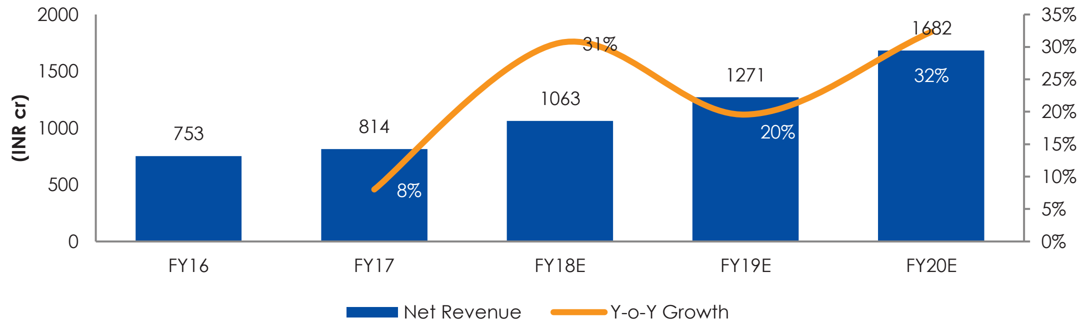


Source: Edelweiss Investment Research

Financial Outlook

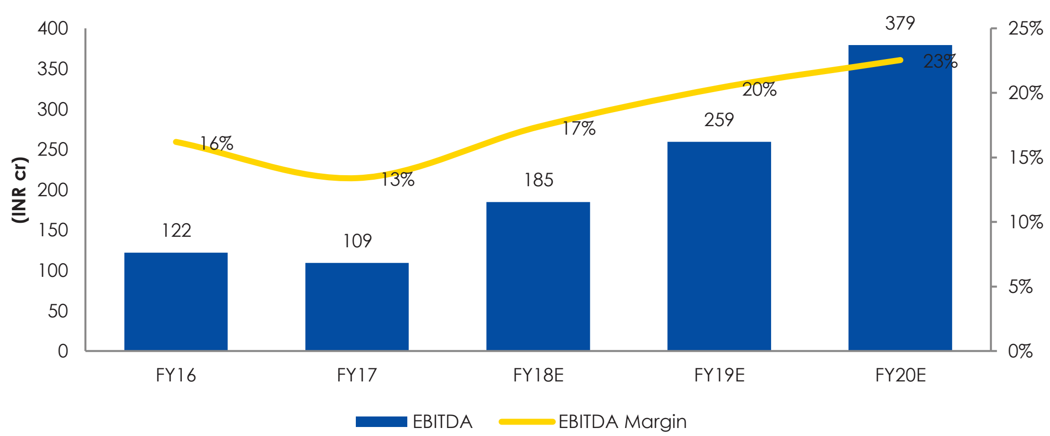
We expect acquisition of BMM and Bayyavaram Cement to accelerate growth and hence we have estimated 27% net revenue growth over FY17-20E spearheaded by 19% volume growth and 5-6% realization growth respectively from FY17-20E.

Net revenue to grow at higher pace on account of healthy volume growth and marginal uptick in realisation



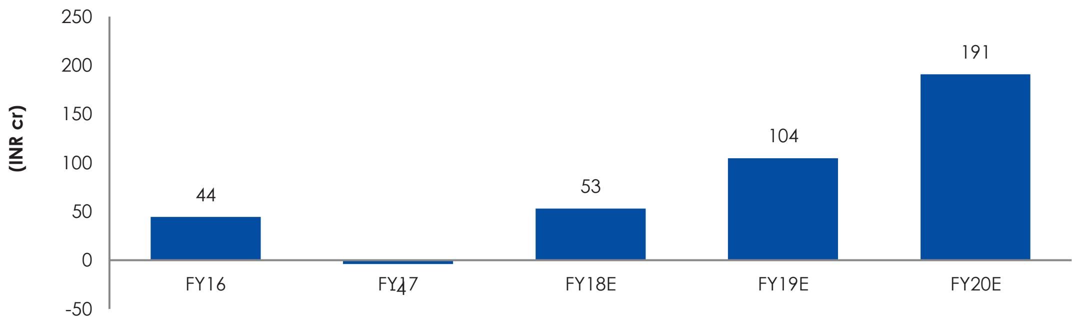
We estimate EBITDA CAGR of 52% over FY17-20 riding on cost improvement, economy of scale and marginal uptick in realisation. In H1FY17, EBITDA margin imporved to 16.4% from 13.6% in FY17. We expect EBITDA margin to improve going forward.

EBITDA margin to increase on cost control and higher realisation

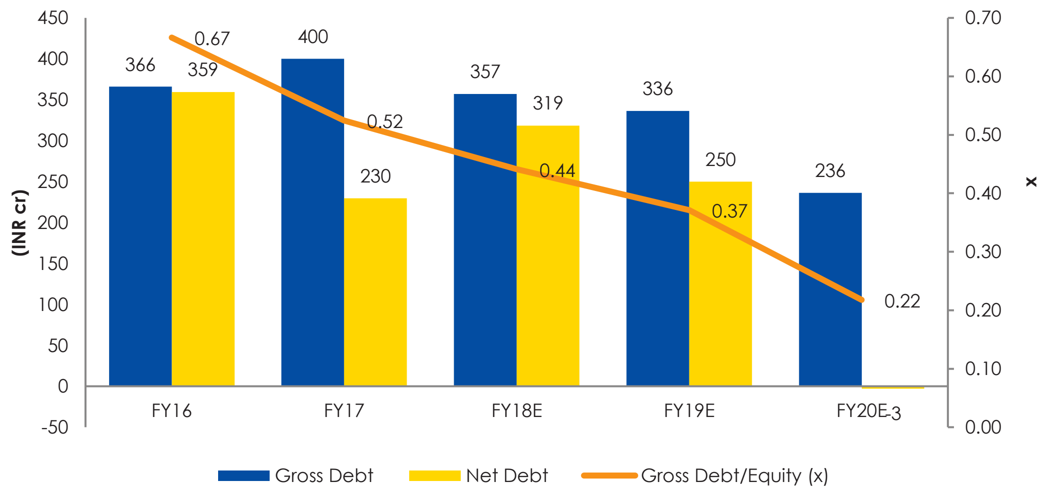


Net profit is expected to increase at a higher clip compared to net revenue on account of cost control and realisation expansion. Hence, we estimate net profit of INR 191crs in FY20E as compared to INR 4crs loss in FY17. However in H1FY18, SGC reported ~ INR19crs of PAT.

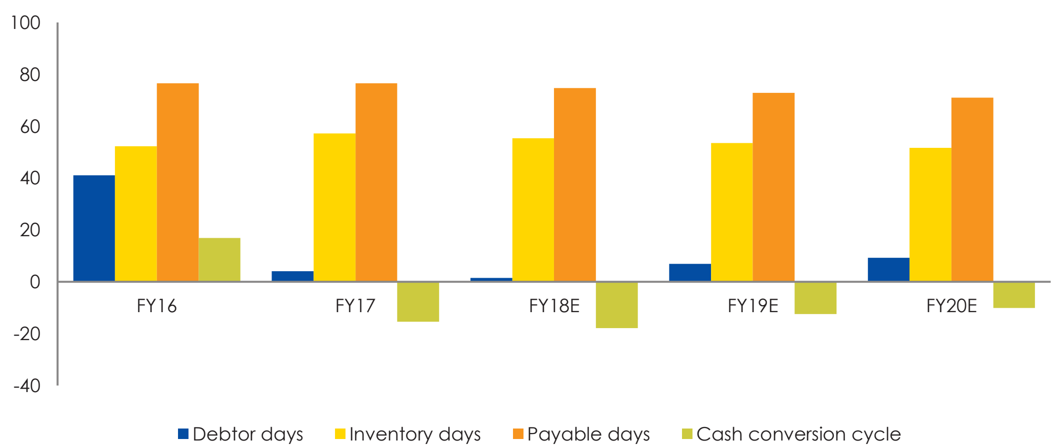
Net Profit is expected to remain healthy



SGC net debt to equity is at below the industry average. The next leg of expansion will not require any incremental debt as company raised capital through equity. Net debt is expected to turned negative in FY20E.



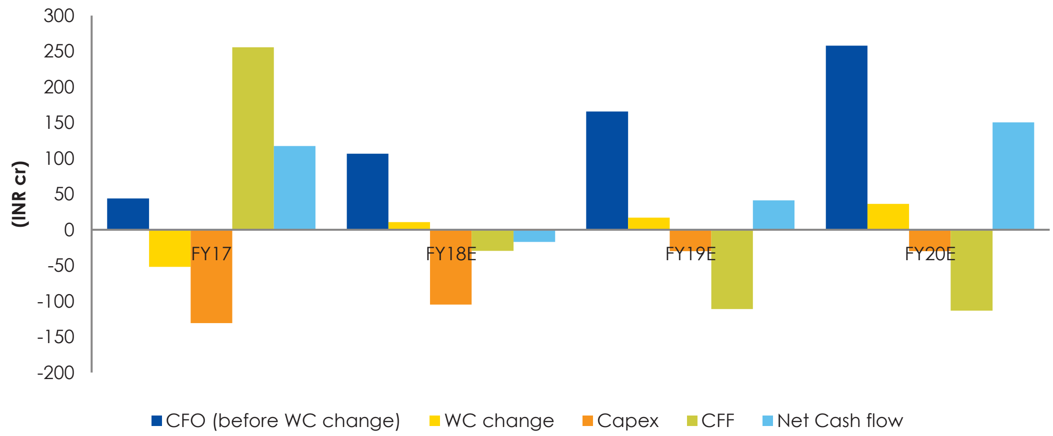
The cash conversion cycle turned negative post acquisition of BMM and Bayyvaram.



Source: Edelweiss Investment Research

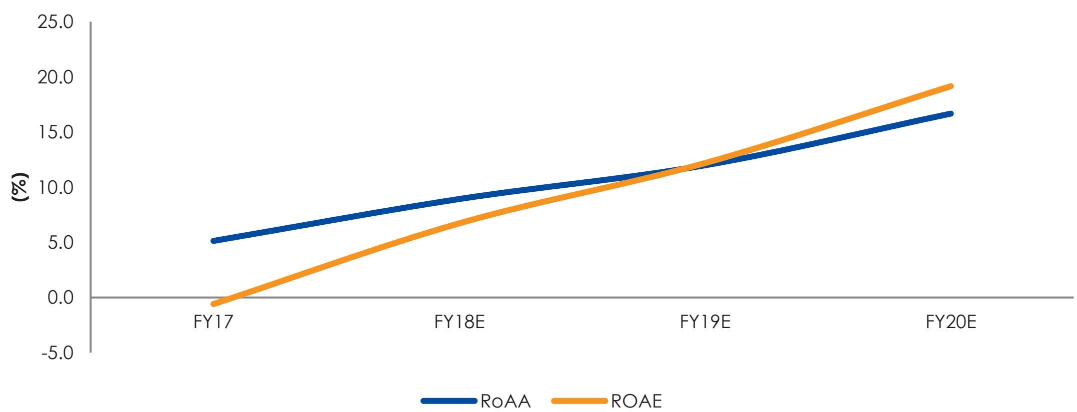
Cash flow is expected to turn positive

SGL's free cash flow is expected to turn positive in FY18E as major capex is expected to be completed in next 3-4 quarters.



Return ratios to improve

RoAE and RoACE have bottomed out and we expect them to improve on account of burgeoning revenue and profitability.

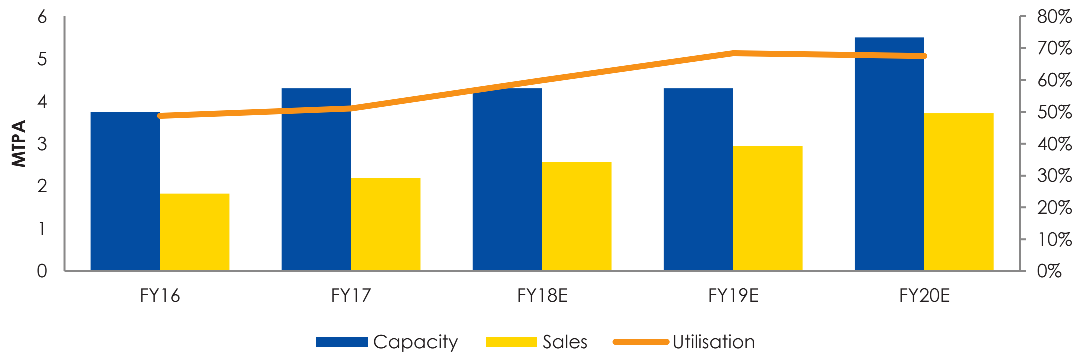


Source: Edelweiss Investment Research

Company performance – per tonne analysis

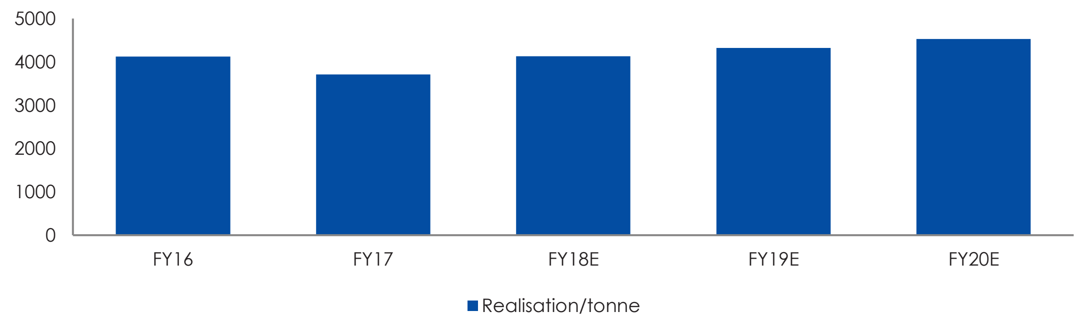
Capacity growth in-line with demand scenario

SGC is likely to setup 1.2mn tonne capacity at Vizag (Bayyavaram) and taking total capacity to 5.5mn tonne by FY19E.



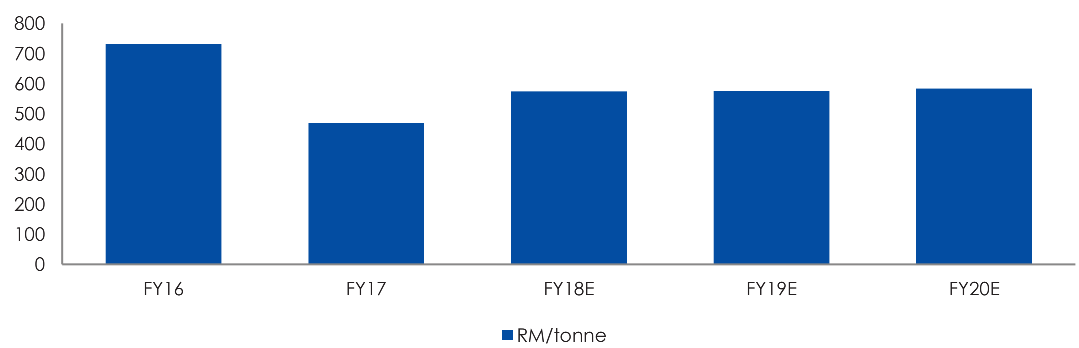
Realisation per tonne expected to firm up

Realisation per tonne is expected to firmup due to increasing cement sale volume in high realisation zone. We have projected 5% CAGR in realisation over H1FY1-20E to INR 4,528/t from INR 3,996 in H1FY18.



Raw material cost subsidised due to acquisition

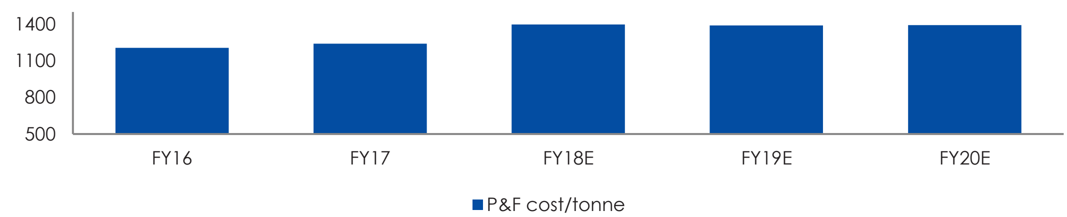
Raw material cost is expected to decline as BMM got the mining lease near to its plant for next 20 years. Prior to this lease, company procured the raw material from outside which was slightly costlier. We expect RM/t to grow at CAGR of 7% over FY17-20E to INR 584/t.



Source: Edelweiss Investment Research

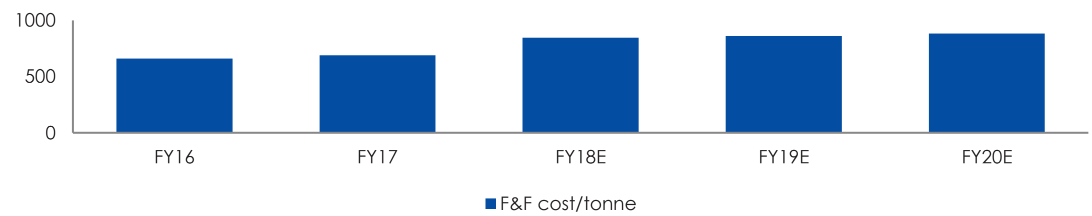
Power & fuel cost is expected to moderate

The power & fuel cost is comparatively higher than the industry average due to procuring power from outside for parent plant and in BMM company has already power plant. Company has setup the 6MW WHRS and annother 18MW thermal power will be set up in H1FY!9. Hence, we exepect power & Fuel cost to grow at moderate rate at CAGR of 4% over FY17-20E to INR 1,393/t of power production.



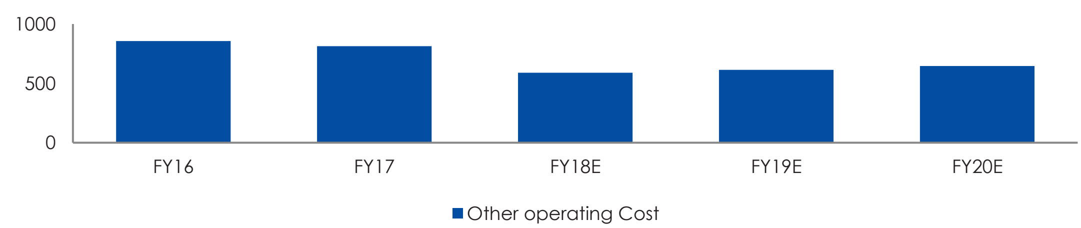
One of the lowest freight & forwarding costs

SCG's freight & forwarding cost is one of the lowest in its peer and expect to remain moderate. We have projected volume growth of 19% and F&F cost growth of 9% over the same period.

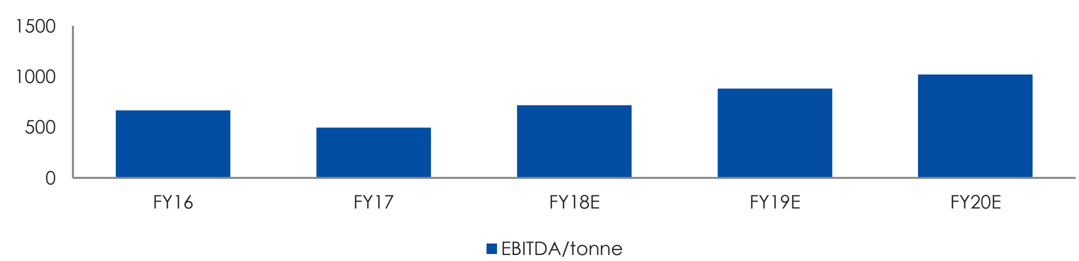


Other manufacturing cost to soften marginally

Other manufacturing cost including employee cost was higher in previous two years due to acquisition and integration. Our projection is based on H1FY18. We expect, other manufactuing cost to moderate going forward.



EBITDA per tonne is expected to improve on back of cost control and improvement in realisation



Source: Edelweiss Investment Research

Financials

Income Statement (INR cr)

Year to March	FY16	FY17E	FY18E	FY19E	FY20E
Net revenue	753	814	1,063	1,271	1,682
Materials costs	134	103	148	169	217
Gross profit	619	711	915	1,102	1,465
Power & Fuel Cost	220	272	360	409	517
Freight Cost	120	151	218	253	328
Other Cost	157	179	152	181	240
EBITDA	122	109	185	259	379
Depreciation & Amortization	35	48	54	61	67
EBIT	87	61	131	198	312
Other income	5	5	8	11	16
Interest expenses	42	62	59	51	39
PBT	51	4	80	158	289
Provision for tax	6	8	27	54	98
Reported PAT	44.27	(3.92)	52.86	104.49	190.64
Adjustment in PAT	-	-	-	-	-
Adj Net Profit	44	(3.9)	53	104	191
Basic shares outstanding (crs)	2	2	2	2	2
EPS (Rs.)	25.5	(1.9)	25.9	51.2	93.5
Dividend per share (Rs.)	5.0	1.5	2.5	3.5	4.5
Dividend payout (%)	0.20	na	0.10	0.07	0.05

Common Size

Year to March (%)	FY16	FY17E	FY18E	FY19E	FY20E
Net Sales	100	100	100	100	100
Raw material consumed	18	13	14	13	13
Gross profit margin	82	87	86	87	87
Power & fuel	29	33	34	32	31
Freight & forwarding	18	21	21	20	20
Other manufacturing cost	18	19	14	14	14
EBITDA margin	16	13	17	20	23
Depreciation	5	6	5	5	4
Interest expenses	6	8	6	4	2
Tax rate	1	1	3	4	6
Net profit margins	6	0	5	8	11

Growth Ratios

Year to March (%)	FY16	FY17E	FY18E	FY19E	FY20E
Revenues		8	31	20	32
EBITDA		(11)	69	40	46
PBT		(92)	1,792	98	82
Adjusted profit		(109)	(1,448)	98	82
EPS		-108	-1448	98	82

Balance Sheet (INR cr)

As on 31st March	FY16	FY17E	FY18E	FY19E	FY20E
Equity capital	17	20	20	20	20
Reserves & surplus	532	743	789	885	1,065
Networth	549	763	810	906	1,085
Borrowings	366	400	357	336	236
Deferred Tax Liabilities (Net)	2	-	-	-	-
Sources of funds	917	1,163	1,167	1,242	1,321
Net Fixed Assets	972	1,056	1,202	1,246	1,209
Investments	58	45	45	45	45
Inventories	91	110	133	148	184
Sundry debtors	81	81	121	145	190
Cash & Bank Balances	6	170	39	86	239
Other Current assets	14	20	26	30	39
Loans and advances	25	26	33	39	51
Total current assets	216.54	407.80	352.34	448.80	704.47
Sundry creditors and others	132.4	148	180	202	254
Provisions	198	198	253	296	383
Total current liabilities & provision:	330	345	433	498	637
Net current assets	-114	62	-80	-49	68
Uses of funds	917	1163	1167	1242	1321

Free cash flow

Year to March	FY16	FY17E	FY18E	FY19E	FY20E
Net profit		-4	53	104	191
Add : Depreciation		48	54	61	67
Operating profit (before WC changes)		44	107	165	258
Less: Changes in WC		52	(11)	(17)	(36)
Operating cash flow		(8)	117	182	294
Less: Capex		131	200	105	30
Free cash flow		-139	-83	77	264

Cash Flow Statement

Year to March	FY16	FY17E	FY18E	FY19E	FY20E
Cash flow from operations		-8	117	182	294
Cash Flow from investing activities		-131	-200	-105	-30
Cash Flow from financing activities		256	-49	-29	-111
Adjustments		47	-	-	-
Capex		(131)	(200)	(105)	(30)
Dividends		4	6	9	11

Profitability & Efficiency Ratios

Year to March	FY16	FY17E	FY18E	FY19E	FY20E
ROAE (%)		(0.6)	6.7	12.2	19.2
ROACE (%)		5.1	8.9	12.0	16.7
Inventory day	52	57	55	53	52
Debtors days	41	4	1	7	9
Payable days	77	77	75	73	71
Cash conversion cycle (days)	17	(15)	(18)	(12)	(10)
Current ratio	0.7	1.2	0.8	0.9	1.1
Gross debt/equity	0.7	0.5	0.4	0.4	0.2
Adjusted debt/Equity	0.7	0.3	0.4	0.3	(0.0)
Gross debt/EBITDA	3.0	3.7	1.9	1.3	0.6
Interest coverage ratio	2.1	1.1	0.4	3.5	3.7

Turnover Ratios

Year to March	FY16	FY17E	FY18E	FY19E	FY20E
Tax Burden	0.9	(0.9)	0.7	0.7	0.7
Interest Burden	0.6	0.1	0.6	0.8	0.9
EBIT M	0.1	0.1	0.1	0.2	0.2
Assets T/O	0.8	0.8	0.9	1.1	1.3
Finanical Leverage	1.7	1.6	1.5	1.4	1.3
ROE (%)	8.06	-0.60	6.72	12.18	19.15

Valuation Parameters

Y e (Mar)	FY16	FY17E	FY18E	FY19E	FY20E
Basic EPS (INR)	25.5	-1.9	25.9	51.2	93.5
Y-o-Y growth (%)		na	na	97.7	82.4
Adjusted Cash EPS (INR)	45.4	21.4	52.2	81.1	126.4
Basic P/E (x)	32.6	-431.4	32.0	16.2	8.9
P/BV (x)	2.6	2.2	2.1	1.9	1.6
EV/tonne (USD/tonne)	73.9	68.7	71.9	69.4	60.4
EV/sales (x)	2.4	2.4	1.9	1.5	1.0
EV/EBITDA (x)	14.8	17.6	10.9	7.5	4.5
EV/EBITDA (x), 1 yr fwd.	16.5	10.4	7.8	5.1	3.6

Edelweiss

Long Term Recommendation: Sanghi Industries Limited

Strengthening geographical presence to boost profitability

CMP INR: 121
Target INR: 153
Rating: BUY
Upside: 26%

Sanghi Industries (SNGI) is a well integrated cement manufacturing player based in Gujarat with an installed grinding capacity of 4.1MTPA, clinker capacity of 3.6MTPA and a 60MW multi-fuel power plant. Easy access to excellent quality raw material lends it the distinction of being the lowest cost cement producer in the state and also leads to production of the best quality cement, which commands a price premium in the Gujarat market. Moreover, the company is undertaking a comprehensive capacity expansion plan which will take total capacity of grinding to 8.1mt, clinker to 6.6mt and power to 126MW. Additionally, in order to make inroads in the high realisation Mumbai market, SNGI has set up terminals at Navlakhi in Gujarat & Dharamtar in Maharashtra and also bought 2 ships to cater to the market via the coastal route. Shipment via the sea route will prune transportation cost by 35% and also boost realisation. We estimate SNGI to clock 20% revenue CAGR over FY17-19 led primarily by higher volume CAGR of 8.6% and 5% realisation CAGR. The volume spurt will be spearheaded by Mumbai and local markets. We forecast 35% EBITDA CAGR, 48% EBIT CAGR and 44% PAT CAGR over FY17-19E.

Proximity of plants to premium quality raw material lends distinct cost edge over peers

Proximity of SNGI's clinker plants to best quality limestone is the company's core strength. While availability of abundant resources near the manufacturing site reduces transportation cost, premium quality of limestone (47-48% CaCo3 content) leads to production of superior quality cement. Availability of premium quality raw material within 3km of the plant and access to fly ash within 170km helped the company generate ~93% gross margin. Moreover, SNGI generates one of the highest EBITDA per tonne in the western market on account of: a) lower raw material cost; b) lowest labour cost; and c) lowest power & fuel cost in the industry because of multi-fuel power plant, own jetty to import coal & pet coke and availability of lignite within 43km range.

Deeper inroads in lucrative Mumbai market to boost realisation and margin

Currently, SNGI sells 15-20k tonne cement per month in Mumbai, which is expected to catapult to 60k-70k tonne cement per month, resulting 7.5-8.5lakh tonne per annum. Mumbai's current market size is about 6mt per annum, which is expected to jump exponentially as slum rehabilitation accelerates under PMAY and also construction of the Navi Mumbai airport will provide another tailwind. Considering the opportunity pie, the company has set up terminals at Navlakhi in Gujarat & Dharamtar in Maharashtra and also bought 2 ships to cater to the Mumbai market via the coastal

Valuation

SNGI, a low cost producer, has also secured a long term contract for raw material near to its plant at a cheap rate providing an edge over its peers. As a result, it generates an EBITDA per tonne of INR >985 (average of last two quarters) wherein only few top companies generate an EBITDA of INR ≥950. Increasing market share in Mumbai and other lucrative markets will boost the margin. SNGI is currently trading at 8.7x FY19E EV/EBITDA and an EV/tonne of USD 113. Based on 11.0x FY19E EV/EBITDA, we arrive at a target price of INR153 per share which entails 26% upside. At CMP, we continue our recommendation to "BUY" with a target price of INR 153 per share.

Year to March	FY15	FY16	FY17E	FY18E	FY19E
Revenues (INR Cr)	932	777	998	1,177	1,436
Rev growth (%)	-11.1	11.1	-3.7	18.0	21.9
EBITDA (INR Cr)	157	141	198	278	359
Net Profit (INR Cr)	31	62	63	94	132
P/E (x)	86.9	1739.7	42.3	28.3	20.2
EV/EBITDA (x)	20.0	22.1	15.7	11.2	8.7
RoACE (%)	3.4	5.7	7.6	7.6	8.4
RoAE (%)	3.4	0.2	5.8	8.1	10.3

*9M data

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Bloomberg:	SNGI:IN
52-week range (INR):	137 / 47
Share in issue (Crs):	22
M cap (INR crs):	2,534
Avg. Daily Vol. BSE/NSE :('000):	316
Promoter (%)	74.98

Initiated Date: 8th March 2017

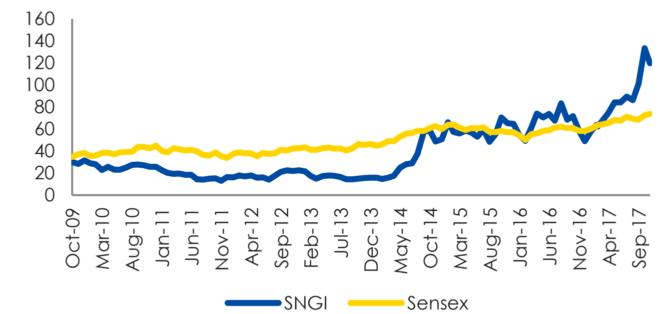
Initiated Price: INR 62

Date: 4th December, 2017

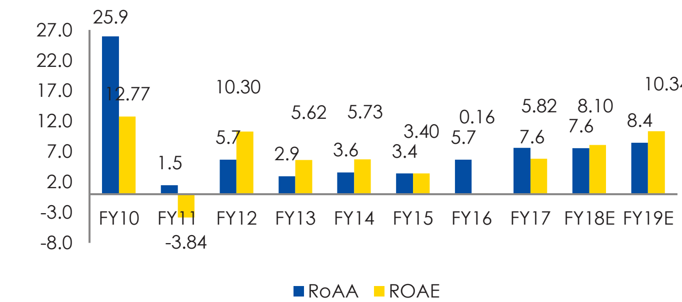
Focus Charts

Average Daily Turnover			Stock Price (CAGR)				Stock Price (CAGR)			
3 months	6 months	1 year	1 year	3 years	5 years	10 years	1 year	3 years	5 years	10 years
1.7	2.1	1.5	105%	35%	40%	4%	27%	6%	12%	6%

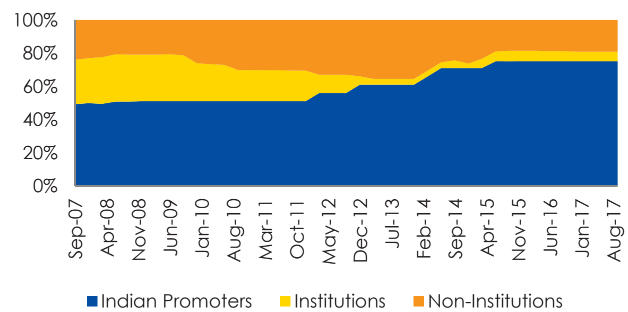
Stock Price



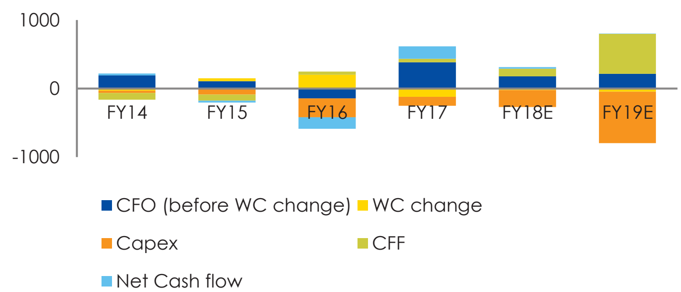
Return Ratios



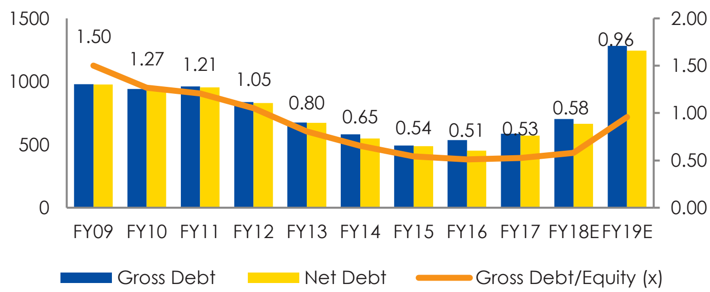
Movement in Share Holding



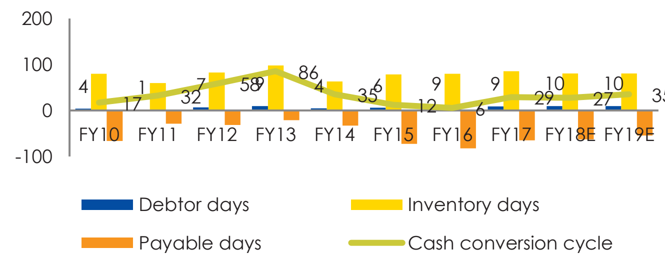
Cash Flow Analysis



Debt Analysis



Working Capital Analysis



Source: Company, Edelweiss Investment Research

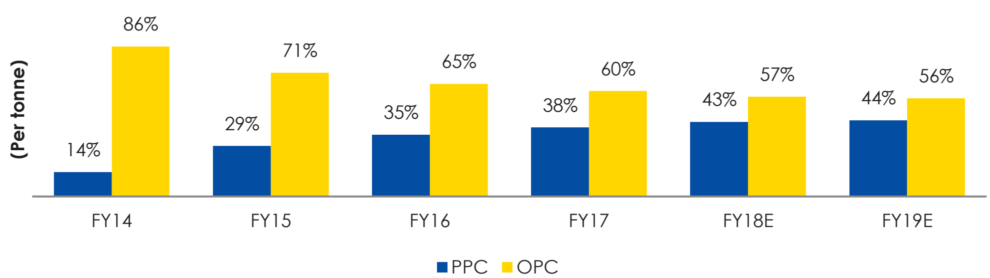
Investment Rationale

I. Rising share of high margin PPC and strengthening coastal volumes to augment

EBITDA per tonne

SNGI entered the high margin PPC segment in FY14 and expanded the market by setting up a 1.2mn PPC plant in FY16. Ergo, the product's contribution to revenue mix has catapulted to 38% in FY16 from 14% in FY14 and we estimate it to jump to 44% by FY19E. The cost of PPC is marginally lower than OPC because of the blending mix—composition is clinker, fly ash and gypsum versus clinker and gypsum in OPC. The cost of fly ash is lower than clinker which augments profitability.

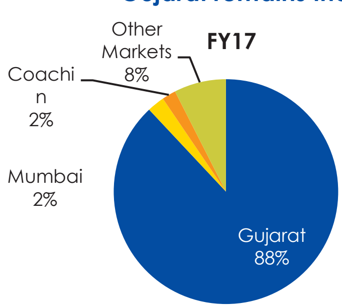
Increasing PPC share to increase the profitability



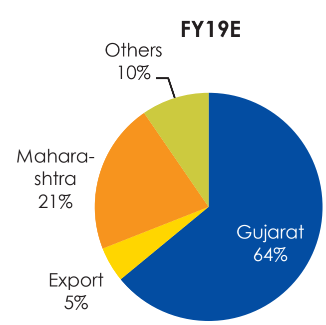
Source: Company, Edelweiss Investment Research

Moreover, currently, the coastal market contributes 6-7% (Mumbai 4% and Kerala 2-3%) to the company's total revenue, which is anticipated to increase to 24-25% by FY19. SNGI is targeting to grow Mumbai's market volume to 60-70k tonne/month from H2FY18 from 7.5-8k tonne/month currently. The company has its own jetty which handles 10,000 tonne/day of loading and unloading. Moreover, to accelerate supply to the Mumbai market, SNGI has ordered 2 new ships which are delivered in July 2017. We anticipate freight cost to the Mumbai market to plummet by 35% and realisation to firm up as sales volume to Mumbai market jumps significantly.

Gujarat remains the primary market



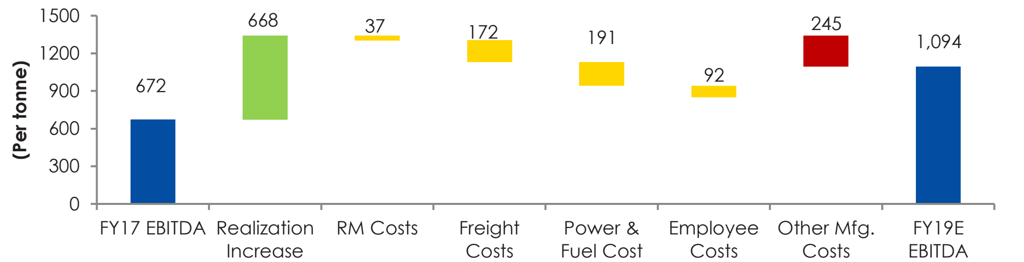
Growing market share in high margin zone



Source: Company, Edelweiss Investment Research

Consequently, we estimate SNGI's core EBITDA per tonne to jump to INR 1094 by FY19E from INR 672 currently on n account of 8% realization CAGR over FY17-19 but in H1FY18, realization was up by >10%, while operating cost is estimated to grow at mere ~10% over FY17-19E. The operating cost growth is marginally lower because of advantage accruing from rising coastal market volumes.

Improving realization and cost control augment the EBITDA from 672 per tonne to INR 1094

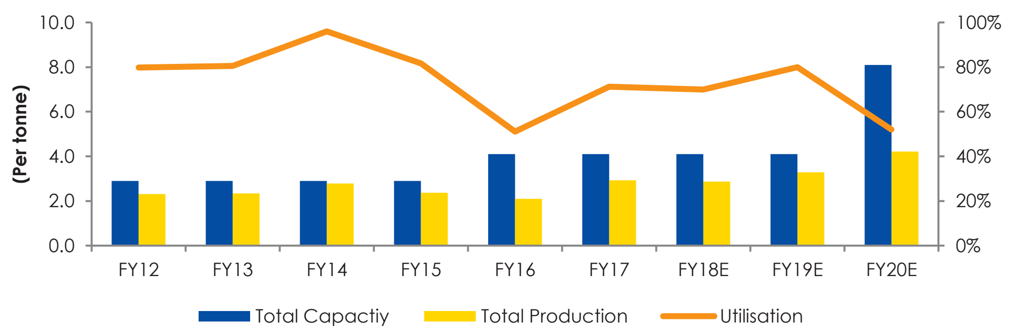


Source: Company, Edelweiss Investment Research

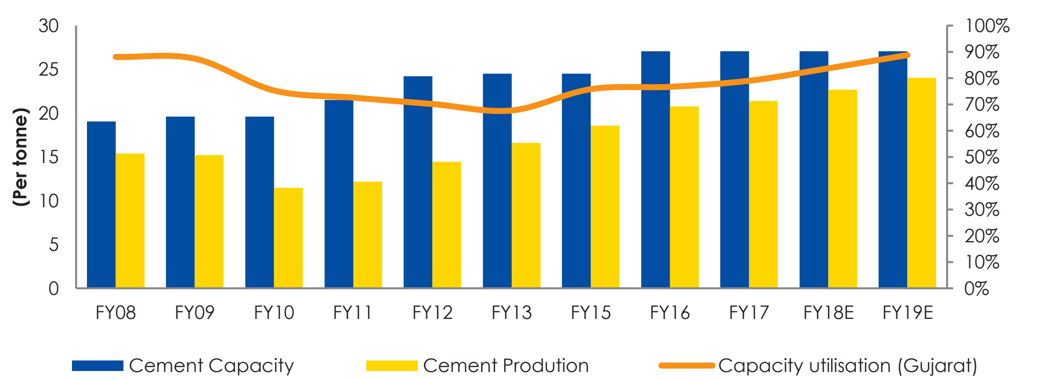
a) Moderation in fresh capacity addition in attractive Gujarat market to boost utilsation

SNGI is adding 4mt capacity in Gujarat and no fresh incremental cement capacity addition is on the cards in the Gujarat market in the near term. This market has always remained attractive for cement manufacturers because of availability of abundant resources, healthy demand and export opportunity to Gulf & African countries via the sea route. Moreover, cement utilisation in the state remains high compared to the Western region and India—about 77% in FY17 compared to 70% across India and 74% in West. While we expect Gujarat's capacity utilisation to improve from 77% currently to 89% in FY19E and that of West region from 74% in FY16 to 81% in FY19E.

Sanghis Capacity and Utilisation



Gujarat market attractiveness reflecting in Utilisation

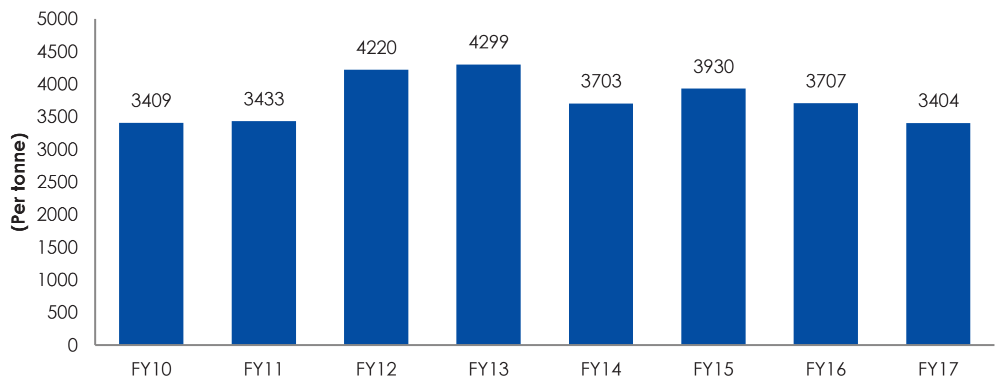


Source: Company, Edelweiss Investment Research

b) Superior realisation by virtue of premium brand

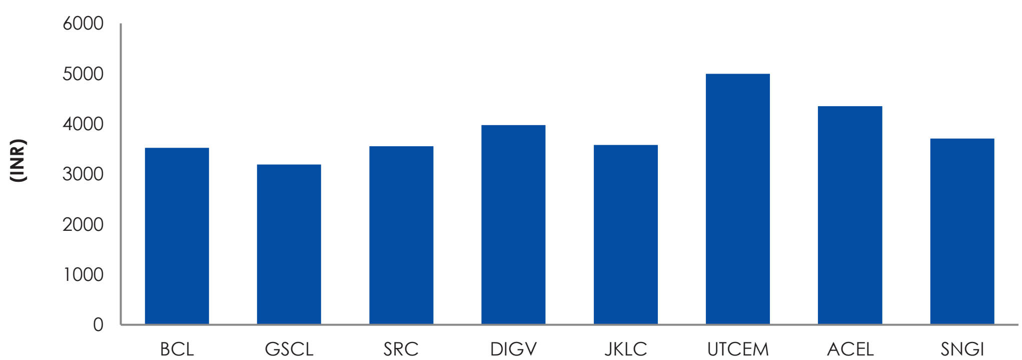
SNGI's per tonne realisation is one of the highest in the Gujarat market by virtue of its premium brand. While average realisation of Gujarat-based cement companies was INR3,858 per tonne (excluding Ultratech and Ambuja, the average realisation was INR 3,564) in FY17, SNGI's stood at INR3,404. The higher realisation is attributable to premium quality raw material, which helps produce suprerior quality cement.

A grade brand is reflecting in realisation



Source: Company, Edelweiss Investment Research

Realisation of Gujarat based cement manufacturers



Source: Company, Edelweiss Investment Research

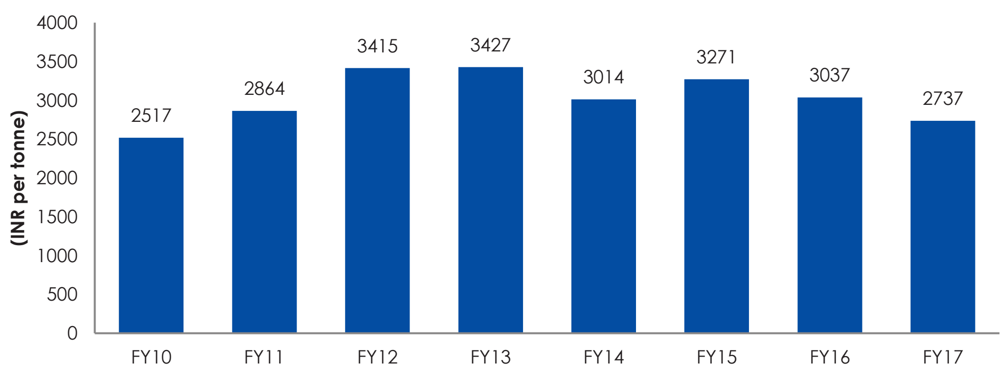
II. Proximity to premium quality raw material enhances operational efficiency

Proximity of SNGI's clinker plant to best quality limestone is the company's core strength. While availability of abundant resources near the manufacturing site reduces transportation cost, premium quality of limestone—CaCo3 in limestone is 47-48% versus 42-43% requirement—leads to superior quality of cement. Availability of premium quality raw material within 3km of the plant and access to fly ash within 170km helped the company generate 93% gross margin in FY17.

The distance from clinker plants to available resources are:

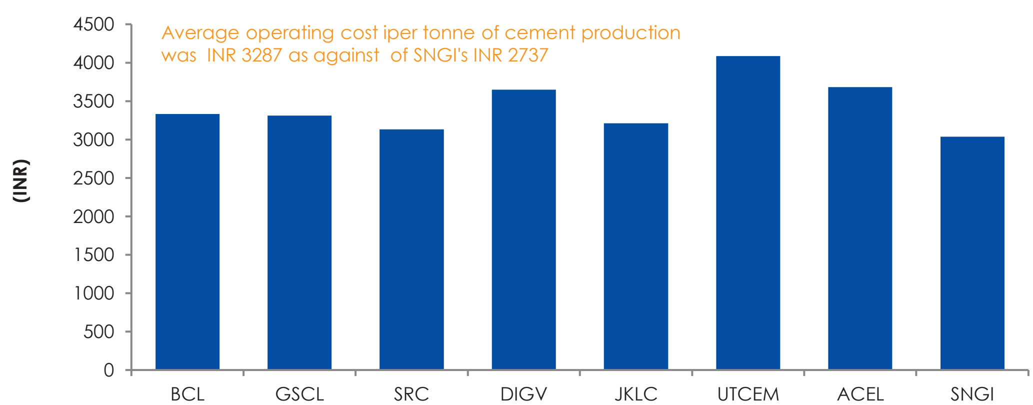
Particulars	Distance in KM
Power plants	8
Grinding Units	10
Fly Ash (Mundra UMPP)	170
Lignite (GMDC)	43
Jetty from grinding units	1
Limestone mines	3

SNGI's operating cost per tonne of cement production



Source: Company, Edelweiss Investment Research

Operating cost of peer based on Gujarat

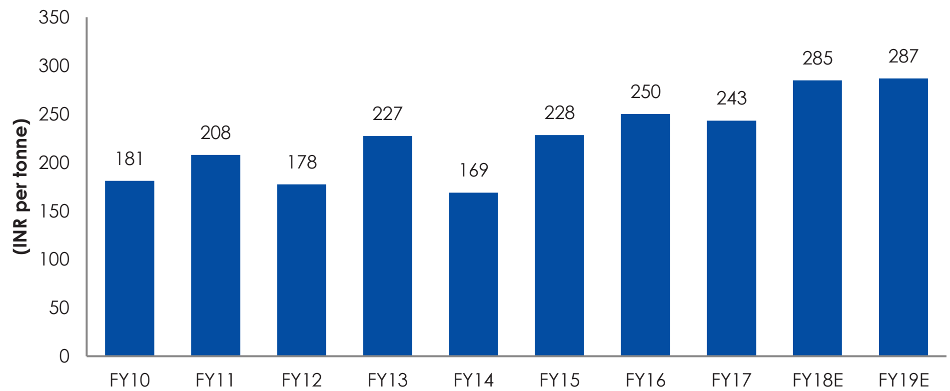


Source: Company, Edelweiss Investment Research

a) Raw material

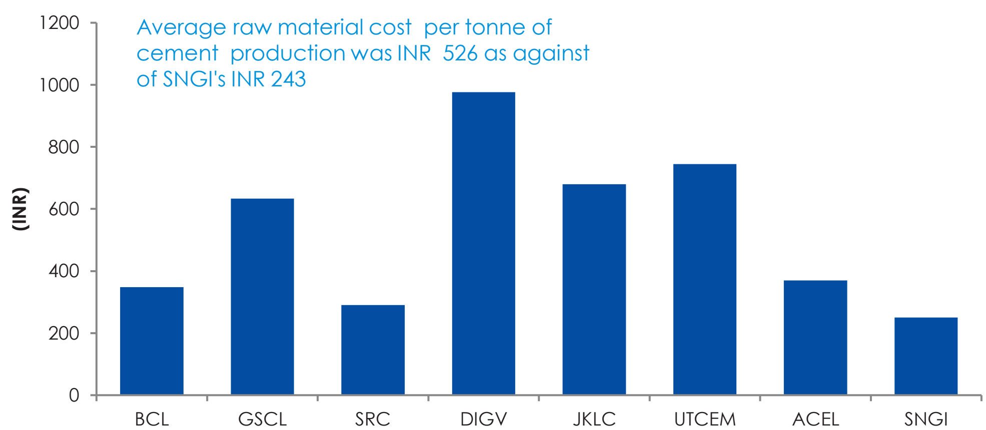
The proximity to and superior quality of raw material reduces per tonne of cement production cost substantially. Industry's raw material cost per tonne of cement production was INR 526 whereas SNGI's stood at INR 243 per tonne.

Raw material cost per tonne of cement production



Source: Company, Edelweiss Investment Research

RM cost per tonne of cement production Gujarat



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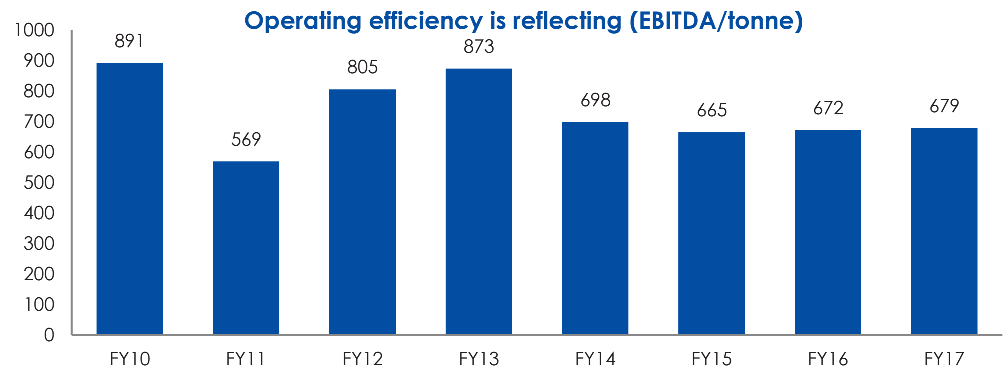
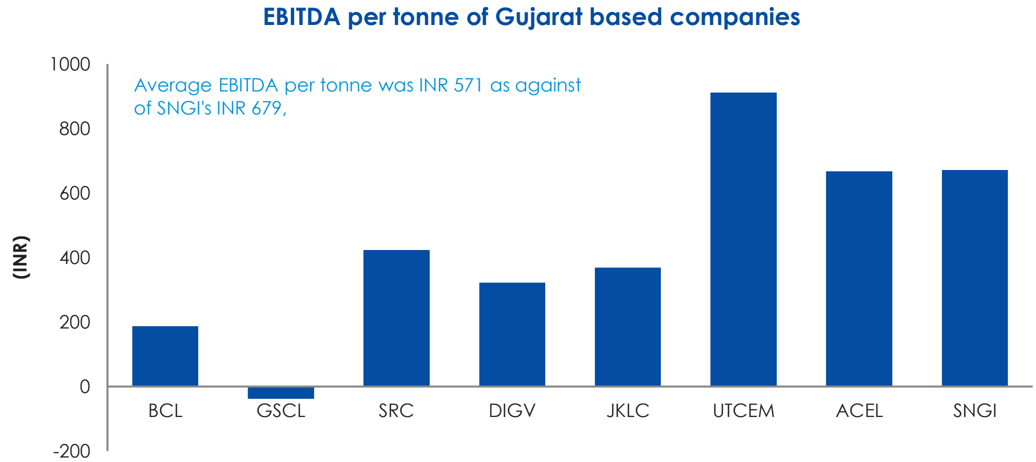
Source: Company, Edelweiss Investment Research

III. Boasts of higher EBITDA per tonne by virtue of lower operating cost

SNGI generates one of the highest EBITDA per tonne in the industry on account of: a) lower raw material cost; b) lowest labour cost; and c) lowest power and fuel cost in the industry because of multi-fuel power plant, own jetty to import coal & pet coke and availability of lignite within 43km range. However, the company's transportation cost is slightly higher because of longer lead distance. We believe the lead distance will reduce as SNGI is setting up a grinding unit in Gujarat and will preferably opt for the sea route to cater to coastal sales. In H1FY18, SNGI generated an EBITDA per tonne of INR 985 on account of higher realization.



Source: Company, Edelweiss Investment Research

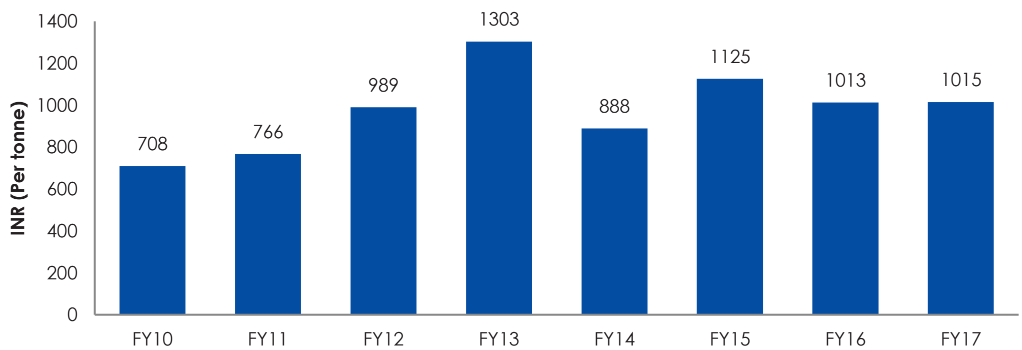


Source: Company, Edelweiss Investment Research

IV Strengthening of sea route to prune freight cost and boost margin

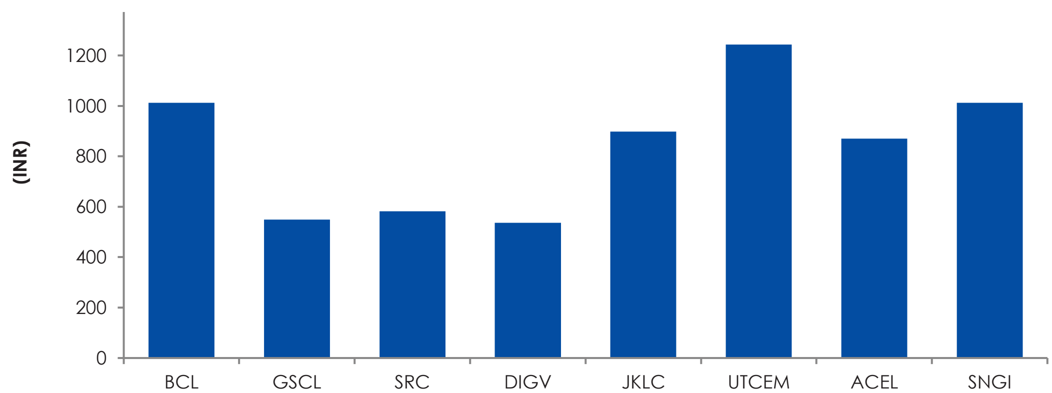
Currently, SNGI's freight and forwarding cost is marginally higher than the industry average as lead distance is higher. However, we expect the company's transportation cost to fall as cement despatches to Mumbai market are expected to accelerate from 7.5-8.0k tonne/month currently to 60-70k tonne/month from H2FY18 via the sea route. The company has its own jetty which handles 10,000 tonne/day of loading and unloading. Moreover, to accelerate supply to the Mumbai market, SNGI has bought 2 new ships. We anticipate freight cost to the Mumbai market to plummet by 35% and realisation to firm up as sales volume to the mumbai market increases.

Freight and forwarding cost per tonne of cement is expected to dip as sales via sea route increase.



Source: Company, Edelweiss Investment Research

Freight & Forwarding cost is expected to come down as transportation to Mumbai market will happen through our own ships

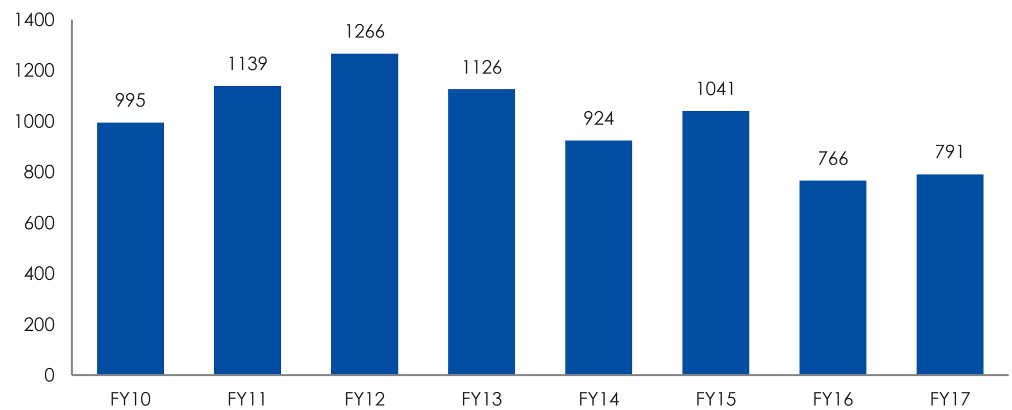


Source: Company, Edelweiss Investment Research

V. Multi-fuel power plant, WHRS to propel significant savings in power and fuel cost

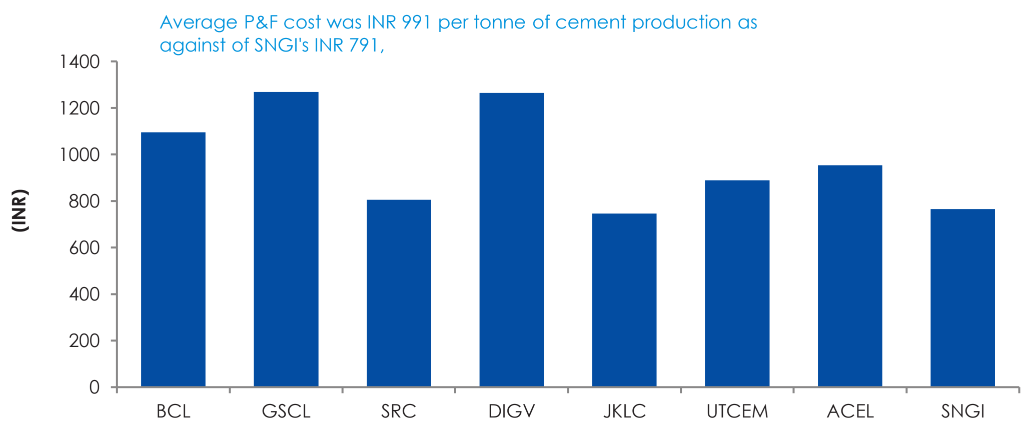
SNGI has a 63MW multi-fuel power plant which significantly enhances efficiency. Moreover, on the anvil is a 13MW Waste heat recovery system (WHRS), which will prune power generation cost substantially. WHRS is expected to be installed by H2FY18 at a cost of INR1.2bn. Power generation through WHRS will cost <INR0.8/kwh compared to weightage average cost of power reduced to INR2.88/kwh through CPP in FY17 from INR2.68/kwh in FY16, due to improvement in utilisation from 45% to 56%. The multi-fuel power plant provides an edge in inter-changing fuels, while WHRS will further enhance cost reduction. The average power & fuel (P&F) cost of all companies was INR 973 in FY17, while SNGI's P&F cost was INR 791. We believe, WHRS installation will prune power cost significantly.

Tight leash on power & fuel cost per tonne of cement production



Source: Company, Edelweiss Investment Research

Power & Fuel cost per tonne of cement produced by Gujarat based Companies



Source: Company, Edelweiss Investment Research

VI. Comprehensive expansion plan

SNGI has chalked out the next leg of capacity expansion at the existing site and in Surat at total capital outlay of INR12bn. The capex includes 4 mt of grinding units (2 mt in Surat and 2 mt at existing site), 3.3mt of clinker and a 63MW power plant. The capital expenditure is pegged at INR1.5bn, INR4.5bn and INR6.5bn in FY17, FY18 and FY19, respectively. The debt to equity ratio for the upcoming projects is estimated at 2:1. The company has given mandate to a leading bank for debt closure, but approval is awaited. SNGI has a huge land bank in existing plants and land acquisition in Surat is in advanced stages. Management has guided to complete the Surat grinding unit earlier as installation of grinding unit takes less time compared to a clinker plant, which generally takes 18-24 months. The installation cost for Surat grinding unit is estimated at INR1.5bn; balance INR10.5bn is expected to be incurred at the existing site.

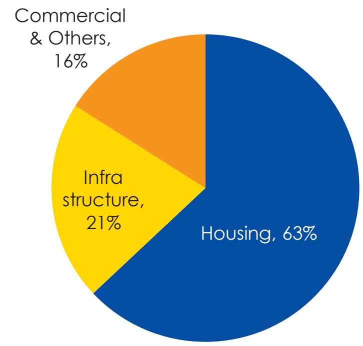
Particulars	Capacity expansion details
Grinding unit at existing site (MTPA)	2
Grinding unit at Surat (MTPA)	2
Clinker capacity 10000 TPD	3.3 (MTPA)
Captive Power Plant (MW)	63
Total capital Outlay (INR cr)	1200
Debt to Equity	2:1

Resources/approvals required	Status
Land	Adequate land for existing site and land acquisition in Surat is progressing well
Raw Materials	Abundant reserve of limestone
Ancillary Infrastructures	in place
Approval	not a hurdle (can get easily)
Contracts	Identification of suppliers is in progressed
Funding	In advance stage

Key demand drivers in place

The housing sector is a key demand driver of cement in India aided by rapid urbanisation, rising per capital incomes, government subsidy and increasing disposable incomes. Renewed focus on Housing For All by 2022, Smart Cities, interest subsidy and redefinition of affordable housing are expected to alter the demand pattern in the medium to long term. Above all, falling interest rate is bound to spur housing demand, translating into higher demand for cement.

Cement demand breakup

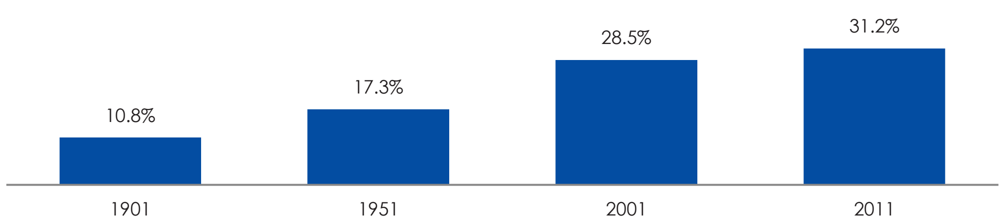


Source: Company, Edelweiss Investment Research

(1) Accelerating urbanisation propelling cement demand

Rising urbanisation and growing per capita incomes are expected to strengthen housing demand. Urbanisation in India was 10.8% in 1901, which jumped to 17.31% in 1951 and 28.53% in 2001. It jumped to 31.16% in 2011 from 28.53% in 2001, up 2.63%. We anticipate the pace of urbanisation to increase due to industrialization, creating smart cities leading to increase in cement demand.

Urbanisation create extra requirement of housing, translating higher demand of cement

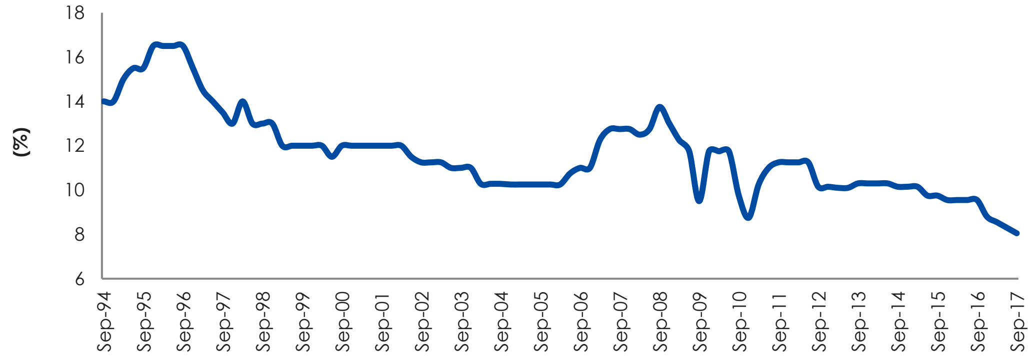


Source: Census, Edelweiss Investment Research

(2) Interest rates on housing loan continue to fall

We expect huge demand for housing on back of falling interest rates, rapid urbanisation, rising disposable incomes, favourable demographics and interest subsidy on affordable housing. Housing For All by 2022, Smart Cities and PMAY are a few government initiatives to bridge the housing shortage gap. We expect short-term demand to be under pressure due to demonetisation, but the 7th Pay Commission payout, interest subsidy on affordable housing loans and falling housing rates are envisaged to bolster demand in the medium to long term.

Home interest rate continues to decline

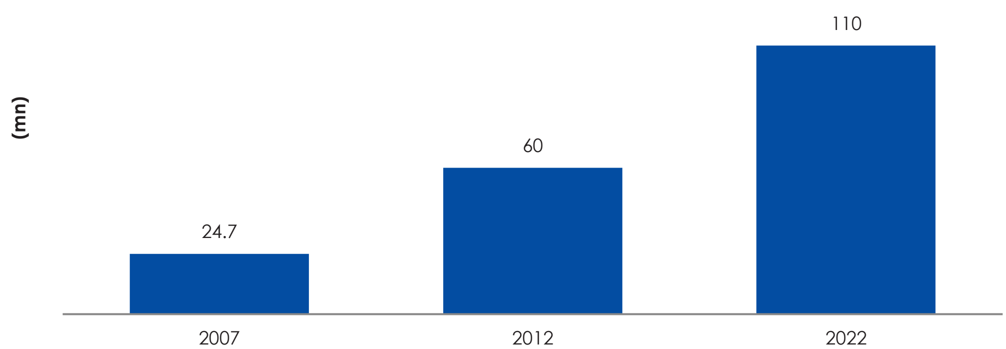


Source: Company, Edelweiss Investment Research

(3) Housing shortage to double by 2022

The housing shortage in India is expected to double by 2022 to 110mn houses from 60mn in 2012. Ergo, we envisage housing construction to accelerate. India's per capita income jumped from USD1,130 in 2007 to ~USD1,835 in 2016 and is estimated at USD2,832 by 2022 with 7.5% growth over 2016-22. In light of these factors, housing demand should jump, which in turn will boost cement demand.

Housing shortage to augment

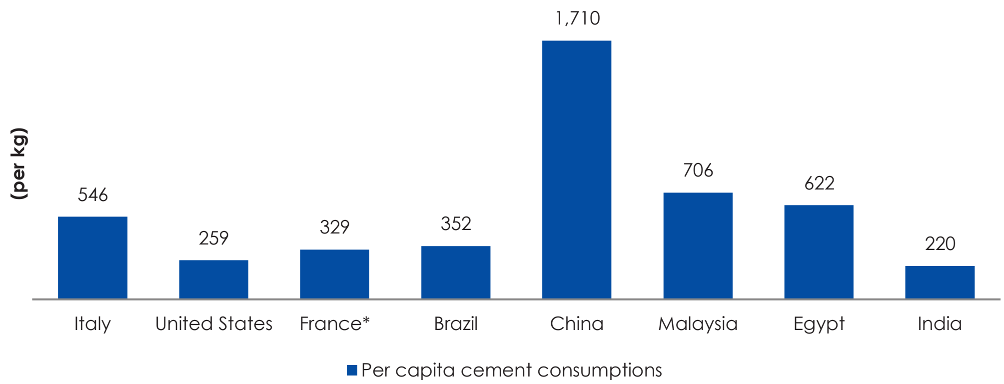


Source: Census, Edelweiss Investment Research

(4) Low per capita cement consumption entails humungous growth opportunity

Though India is the second largest cement manufacturer in the world, its per capita consumption is <50% of the world and <15% of China. We believe, the current cycle will boost cement demand because of favourable catalysts such as low interest rates, interest subsidy and policy push. Consequently, per capita cement consumption is expected to rise.

Per capita cement consumption to accelerate



Source: Company, Edelweiss Investment Research

Company Description

SNGI is a well integrated cement manufacturer and distributor of the *Sanghi* brand based in Kutch, Gujarat. In Gujarat, *Sanghi* is acknowledged as a premium brand because of the higher CaCo3 in limestone. The company has 4.1mt of grinding units, 3.3mt clinker, 30M^3 per hour capacity RMC plant at Ahmedabad and a 63MW multi- fuel power plant. It has a huge land bank at existing site, which is envisaged to support the next phase of capacity expansion. SNGI has a captive port which currently handles about 1MMTPA cargo.

In light of the abundant resources at cheaper cost of per tonne cement production, huge land bank and large opportunities, SNGI decided to double its capacity. The company is in advance stage to set up a 4mt grinding unit, 3.3mt of clinker plant at Kutch and 63MW captive power plant including 13MW of WHRS. These initiatives will take the company's total grinding capacity to 8.1mt, clinker capacity to 6.6mt and captive power capacity to 126MW. The total capital outlay for the aforementioned expansion is envisaged at around INR12.0bn with debt to equity of 2:1.

SNGI has lease up to 2046 for "A" grade marine limestone reserves of 1,000MMT within 3km of its clinker plant. Fly ash at Mundra UMPP supports the 1.2mt PPC plant. The company has captive port facilities to import fuel and export clinker and cement. It has abundant lignite available at GMDC plant which is costlier compared to pet coke and coal, but per Kcal is higher.

Gujarat remains the company's primary market with 10-12% share, which is expected to increase to 16-18% with next phase of expansion. Considering the coastal opportunity, SNGI has bought 2 ships to increase presence in coastal areas of Mumbai and Kerala. Currently, SNGI sells 7.5-8k tonne cement per month in Mumbai, which is expected to increase to 60k-70k tonne, resulting in 7.5-8.5lakh tonne per annum. The current market size of Mumbai is about 6mt per annum, which is expected to increase as slum rehabilitation is expected to accelerate aided by PMAY and also construction of the Navi Mumbai airport.

Successfully exited from CDR before schedule date

SNGI's cement and clinker plant were delayed substantially because of litigation related to environment clearance, leading to massive debt pile up. Hence, SNGI was unable to service its debt repayment obligations. Consequently, the company has endeavoured to restructure its outstanding debt. It has been engaged in negotiations with lenders for restructuring outstanding debt under the aegis of the Corporate Debt Restructuring Scheme of the Reserve Bank of India notified under circular number DBOD No. BP.BC. 68/21.04.114/2002-03. The restructuring package and the terms thereof (CDR Scheme) were approved by the Corporate Debt Restructuring Cell.

SNGI issued 2,59,11,465 Optionally Convertible Cumulative Participating Preference (OCCPPS) shares of INR100 each to banks consortium, aggregating INR 259 cr. As certified by the company, 92,36,730 Optionally Convertible Cumulative Participating Preference shares are outstanding as on date. The balance have been redeemed/ waived under the Corporate Debt Restructuring Scheme. As per the terms of the CDR package, the OCCPPS will be repaid in 7 years from the quarter ended June 2011 to quarter ending March 2018. However, the OCCPPS will be convertible into equity shares in the event of default by the company.

SNGI repaid outstanding CDR loans before time, along with Right of Recompense to Lenders and net effect of this has been treated as Exceptional Items - One-time Expenditure of INR60.39cr.

In order to repay existing CDR loans, SNGI has raised INR 257 cr by issue of 15.50% Redeemable Non-Convertible Debentures on private placement basis. The funds have been partly utilised to make early settlement of loans and redemption of preference shares. Balance funds have been retained for general corporate expenses. The money has been largely used for repayment of loans ahead of schedule and balance amount is likely to be used about INR 100 cr for capacity expansion.

Board of Directos	
Ravi Sanghi	Chairman and Managing Director
Aditya Sanghi	Executive Director
Alok Sanghi	Executive Director
Bina Engineer	Executive Director
N. B. Gohil	Executive Director
D. K. Kambale	Director
Sadashiv Sawrikar	Director
D. B. N. Rao	Director
R. K. Pandey	Director
T. M. Jagan Mohan	Director
M.K. Doogar	Director
Jayesh Desai	Director

Key Risks

Cement demand fails to accelerate

We have assumed cement demand to accelerate propelled by government push to affordable housing and renewed focus on infra spending. Any major delay in execution of affordable housing under PMAY and infra spending will negatively impact our assumptions.

Failure of initiatives to enhance coastal revenue mix

SNGI has developed terminals and ordered 2 ships to increase coastal cement sales volume. The company is planning to increase coastal revenue mix from 6-7% currently to 23-24% over the next 2 years. We believe any delay in execution will negatively impact margin, resulting in lower profitability.

Expansion delays may dent profitably

The company is doubling capacity of cement, clinker and power with debt to equity ratio of 2:1. We estimate capex to be completed by FY20E. Any major delay in capex may increase the financial cost, which will negatively impact our estimates and earnings.

Company	Bloomberg code
Binani Cement	BCL
Gujarat Sidhee Cement	GSCL
Saurastra Cement	SRC
Shree Digvijay Cement	DIGV
JK Lakshmi Cement	JKLC
UltraTech Cement	UTCEM
Ambuja Cements	ACEM
Sanghi Industries	SNGI
JK Cement Ltd.	JKCE
Mangalam Cement Ltd.	MGC
OCL India Ltd.	OSC
Orient Cement Ltd.	ORCMNT

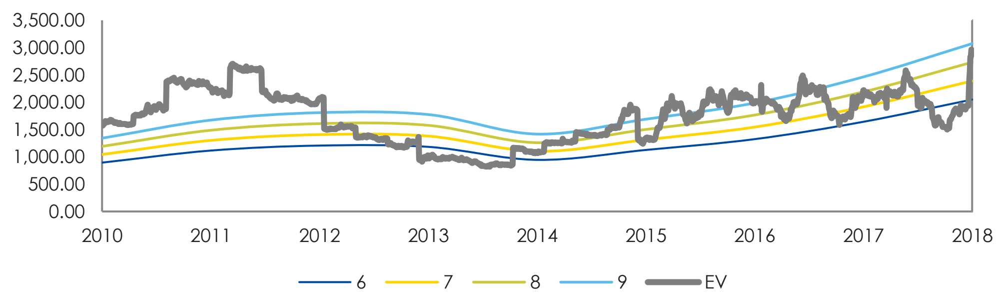
Valuations

We estimate SNGI's revenue to post 20% CAGR over FY17-19E led primarily by higher volume CAGR of 12% and 13% CAGR in realization over FY17-19, however realization projection from H1FY18 is up by 1% to INR 4,365 as compared to INR 4,313 in H1FY18. The volume growth will be driven by Mumbai and local market. We have forecast 35% EBITDA growth, 48% EBIT growth and 44% PAT growth over FY17-19.

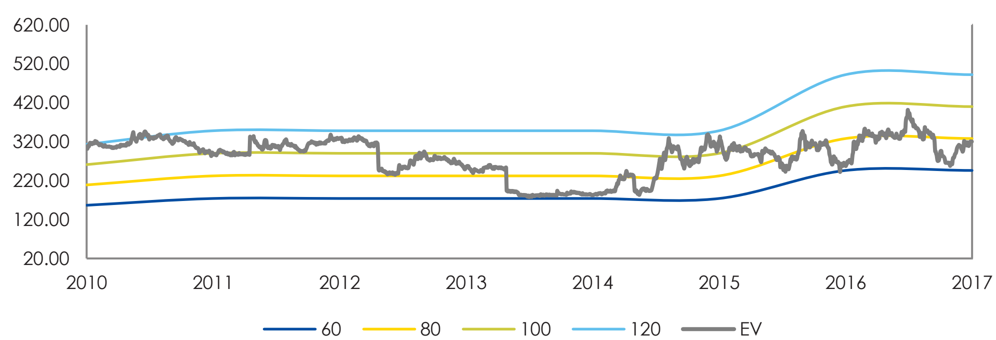
Next phase of expansion is envisaged to boost realisation and margin as cement sales in coastal areas are expected to increase. The company is planning to double cement, grinding and power capacities by FY20 at the existing site. These expansions will not only prune power cost, but also enhance cement sales volume in coastal areas. Moreover, realisation per tonne of cement in Mumbai is higher than in Gujarat and transportation cost is also estimated to dip by ~35%. Consequently, realisation and margin will improve.

SNGI, a low cost producer, has also secured a long term contract for raw material near to its plant at a cheap rate providing an edge over its peers. As a result, it generates an EBITDA per tonne of INR >985 (average of last two quarters) wherein only few top companies generate an EBITDA of INR ≥950. Increasing market share in Mumbai and other lucrative markets will boost the margin. SNGI is currently trading at 8.7x FY19E EV/EBITDA and an EV/tonne of USD 114. Based on 11.0x FY19E EV/EBITDA, we arrive at a target price of INR153 per share which entails 26% upside. At CMP, we continue our recommendation to "BUY" with a target price of INR 153 per share.

One Year Forward EV/EBITDA Band



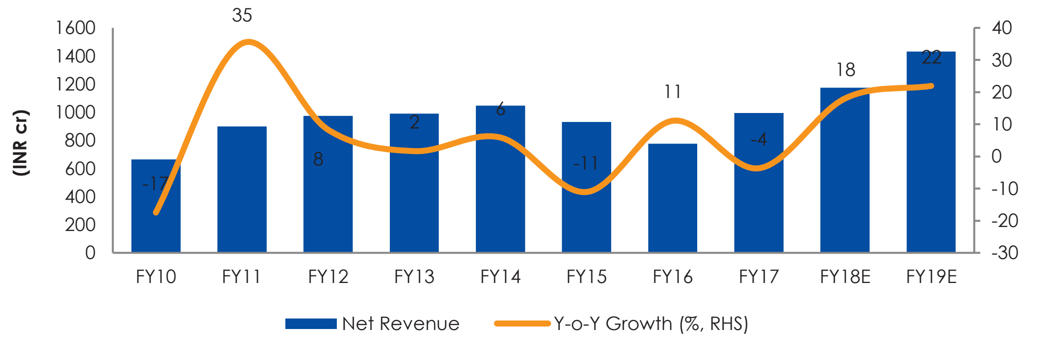
EV/Tonne



Source: Company, Edelweiss Investment Research

Financial Outlook

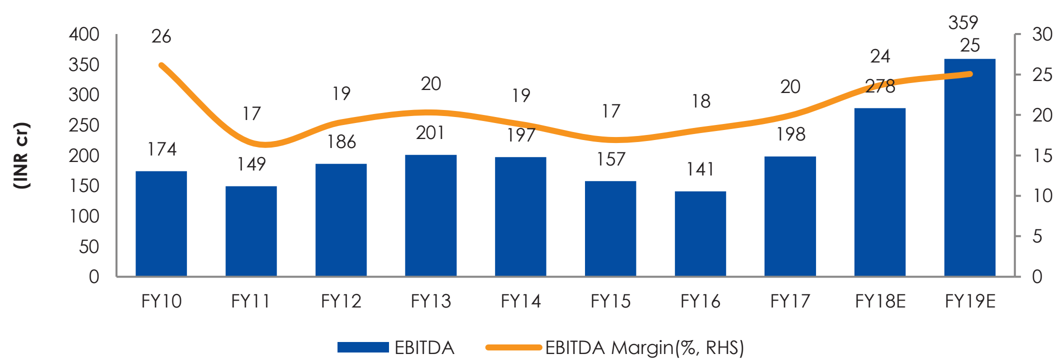
We estimate SNGI's revenue to post 20% CAGR over FY17-19E led primarily by higher volume CAGR of 12% and 13% CAGR in realization over FY17-19, however realization projection from H1FY18 is up by 1% to INR 4,365 as compared to INR 4,313 in H1FY18. Clinker and RMC sales are expected to remain subdued as SNGI is likely to shift focus to cement sales.



*Revenue is for nine months but growth is annualised
Source: Company, Edelweiss Investment Research

The company's EBITDA margin is estimated to inch up on account of higher realisation and moderating other manufacturing cost benefit. Average EBITDA margin between FY09 and FY17 was 20.1%; we forecast 20-25% over FY17-19E.

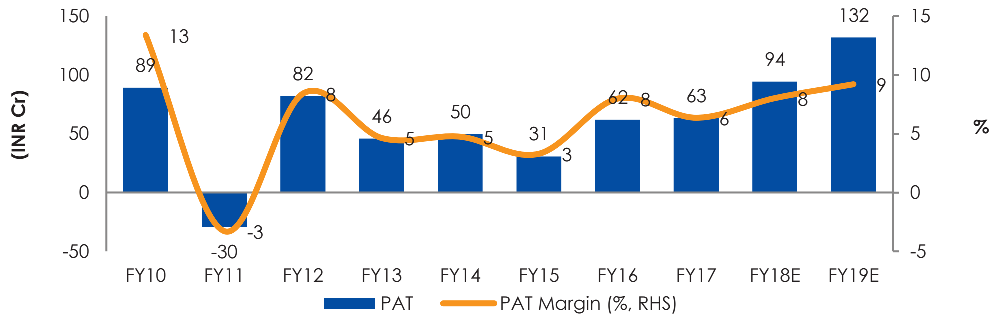
EBITDA and EBITDA margin are expected to increase on cost control and higher realisation



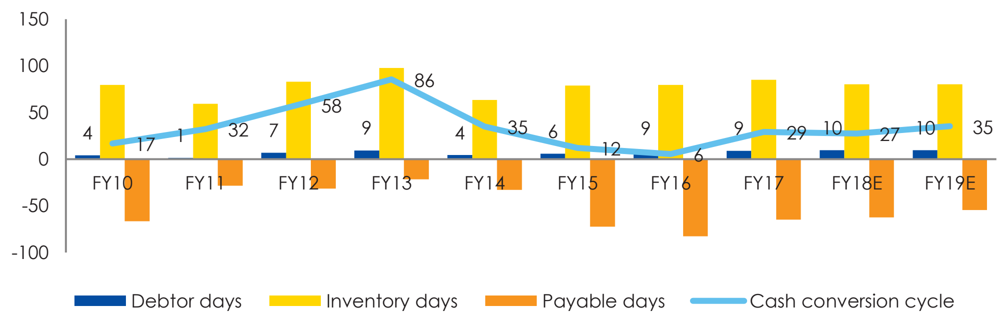
Source: Company, Edelweiss Investment Research

Net profit is expected report 44% CAGR over FY17-19E on account of increasing moderating cost. We have projected PAT margin to improve to 6-9% over FY17-19E compared to an average of 6% over FY09-17.

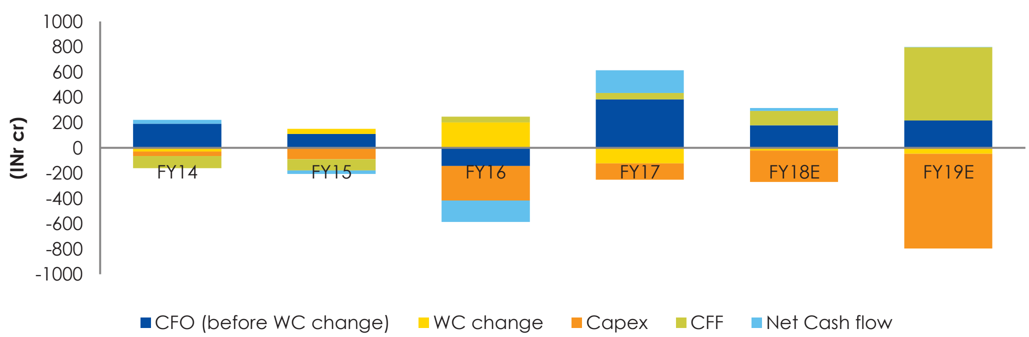
Net PAT and PAT margin



Cash conversion cycle is within the industry range



Operating Healthy cash flow supports further leveraging

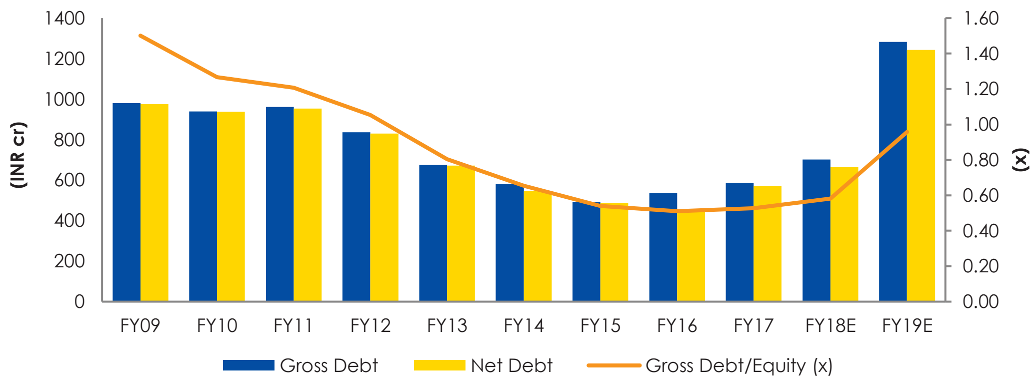


Source: Company, Edelweiss Investment Research

Continuous deleveraging to support next leg of capex

SNGI has consistently repaid debt and its current long-term outstanding debt stands at about INR 586 cr compared to INR 1,004 cr in FY08. The company entered in to CDR in June 2011 with a repayment period of 7 years, which was expected to be completed in March 2018. However, it repaid the entire outstanding in FY16 and exited CDR. Its current gross debt to equity stands at 0.53x compared to 1.33x in FY09, which is expected to rise to 0.96x with the next capex phase. We estimate SNGI's long-term debt to rise to INR 1,282cr by FY19, translating into gross debt to equity of 0.96x in FY19E.

Debt to Equity



Source: Company, Edel Invest Research

Financials

Income Statement (INR cr)

Year to March	FY15	FY16*	FY17	FY18E	FY19E
Net revenue	932	777	998	1,177	1,436
Materials costs	54	52	71	82	94
Gross profit	878	724	927	1,096	1,342
Power & Fuel Cost	247	160	231	254	314
Freight Cost	267	212	296	329	389
Other Cost	208	211	201	234	280
EBITDA	**157**	**141**	**198**	**278**	**359**
Depreciation & Amortization	106	54	73	83	85
EBIT	51	87	125	195	273
Other income	7	3	2	7	9
Interest expenses	27	27	64	68	94
Profit before tax before EI	31	62	63	134	188
Exceptional Items	-	(60)	-	-	-
PBT	31	2	63	134	188
Provision for tax	-	0	-	40	56
Reported PAT	31	1.52	63	94	132
Adjustment in PAT	-	60.4	(0)	-	-
Adj Net Profit	31	62	63	94	132
Basic shares outstanding (crs)	22	22	22	22	22
EPS (Rs.)	1.4	2.8	2.9	4.3	6.0
Dividend per share (Rs.)	-	-	-	-	-
Dividend payout (%)	0.00	0.00	0.00	0.00	0.00

Common Size

Year to March (%)	FY15	FY16	FY17	FY18E	FY19E
Gross profit margin	**94.2**	**93.3**	**92.9**	**93.1**	**93.4**
Power & fuel	26.4	20.7	23.2	21.6	21.9
Freight & forwarding	**28.6**	**27.3**	**29.7**	**28.0**	**27.1**
Other manufacturing cost	22.3	27.2	20.1	19.9	19.5
EBITDA margin	16.9	18.1	19.9	23.6	25.0
Depreciation	**11.4**	**7.0**	**7.3**	**7.1**	**6.0**
Interest expenses	2.9	3.5	6.4	5.7	6.6
Tax rate	**0.0**	**0.6**	**0.0**	**30.0**	**30.0**
Net profit margins	3.3	0.2	6.3	8.0	9.2

Growth Ratios

Year to March (%)	FY15	FY16**	FY17	FY18E	FY19E
Revenues	-11.1	11.1	-3.7	18.0	21.9
EBITDA	-20.1	19.2	5.6	40.2	29.1
PBT	-29.7	-91.7	2379.3	112.9	39.9
Adj. Net profit	-38.2	169.5	-23.7	49.4	39.9

Balance Sheet (INR cr)

As on 31st March	FY15	FY16	FY17	FY18E	FY19E
Equity capital	220	220	220	220	220
Preference Share Capital	43	0	0	0	0
Reserves & surplus	691	831	894	988	1120
Borrowings	492	536	587	702	1282
Deferred Tax Liabilities (Net)	-59	-59	-59	-59	-59
Sources of funds	**1387**	**1529**	**1642**	**1851**	**2563**
Net Fixed Assets	1294	1561	1619	1786	2450
Investments	0	0	0	0	0
Inventories	167	138	187	198	237
Sundry debtors	15	18	24	31	38
Cash & Bank Balances	6	83	16	38	39
Other Current assets	46	134	120	147	179
Loans and advances	174	27	42	56	68
Total current assets	402	318	372	431	521
Sundry creditors and others	153	144	142	154	161
Provisions	161	289	223	249	286
Total current liabilities & provisions	314	433	365	403	447
Net current assets	88	-115	7	27	74
Uses of funds	**1387**	**1529**	**1642**	**1851**	**2563**

Free cash flow

Year to March	FY15	FY16	FY17	FY18E	FY19E
Net profit	31	62	63	94	132
Add : Depreciation	106	54	73	83	85
Adjustment	-27	-258	247	0	0
Operating profit (before WC changes)	110	-142	384	177	217
Less: Changes in WC	-40	-202	122	20	47
Operating cash flow	150	60	262	157	171
Less: Capex	89	274	131	250	750
Free cash flow	60	-214	131	-93	-579

Cash Flow Statement

Year to March	FY15	FY16	FY17	FY18E	FY19E
Cash flow from operations	177	318	14	157	171
Cash Flow from investing activities	-89	-274	-131	-250	-750
Cash Flow from financing activities	-89	44	50	115	580
Capex	-89	-274	-131	-250	-750

Profitability & Efficiency Ratios

Year to March	FY15	FY16	FY17	FY18E	FY19E
ROAE (%)	3.4	0.2	5.8	8.1	10.3
ROACE (%)	3.4	5.7	7.6	7.6	8.4
Inventory day	78.7	79.5	85.2	80.3	80.3
Debtors days	5.7	8.7	8.8	9.6	9.6
Payable days	72.3	82.6	64.9	62.5	54.6
Cash conversion cycle (days)	12.1	5.5	29.1	27.4	35.3
Current ratio	1.5	1.5	2.4	2.0	1.7
Gross debt/equity	0.5	0.5	0.5	0.6	1.0
Adjusted debt/Equity	0.5	0.4	0.5	0.5	0.9
Interest coverage ratio	1.9	3.2	1.9	2.9	2.9

Turnover Ratios

Year to March	FY15	FY16	FY17	FY18E	FY19E
Total asset turnover	0.6	0.5	0.6	0.7	0.7
Fixed asset turnover	0.7	0.6	0.7	0.8	1.0
Equity turnover	1.0	0.8	0.9	1.0	1.1

Du Pont Analysis

Year to March	FY15	FY16	FY17	FY18E	FY19E
NP margin (%)	3.29	0.20	6.33	8.02	9.20
Total assets turnover	0.65	0.53	0.63	0.67	0.65
Leverage multiplier	1.60	1.49	1.46	1.50	1.73
ROAE (%)	3.41	0.16	5.84	8.13	10.36

Valuation Parameters

Y e (Mar)	FY15	FY16**	FY17E	FY18E	FY19E
Adjusted Diluted EPS (INR)	1.4	0.1	2.9	4.3	6.0
Y-o-Y growth (%)	-38.2	-93.3	2986.8	49.4	39.9
Adjusted Cash EPS (INR)	6.2	2.5	6.2	8.1	9.9
Diluted P/E (x)	86.9	1739.7	42.3	28.3	20.2
P/BV (x)	2.9	2.5	2.4	2.2	2.0
EV/tonne (USD/tonne)	162.1	113.4	113.4	113.4	113.4
EV/sales (x)	3.4	4.0	3.1	2.7	2.2
EV/EBITDA (x)	20.0	22.1	15.7	11.2	8.7
EV/EBITDA (x), 1 yr fwd.	22.4	15.7	11.2	8.7	6.3

Home Building Material

Home Building Materials

Structural, sustainable & scalable growth

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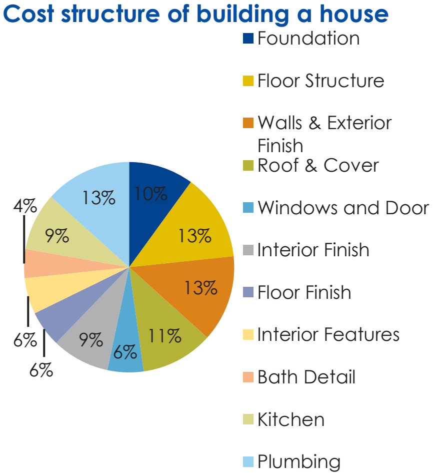
The share of home building materials (excluding cement) is estimated to touch INR 3.8tn by FY21 from INR 2.5 tln currently. In the last two years, growth has been depressed due to weak housing demand. Demand has been impacted in urban pockets due to increase in prices while events like demonetization and weak monsoon impacted rural demand. In all home building materials segments, the share of unorganised segment is more than 50% (in some cases even 70%). However the revision of GST rates from 28% to 18% for these products is expected to result in a big shift from unorganised to organised. The government has laid emphasis on the housing sector with its affordable housing push and target of "Housing for All" by 2022. As 85% demand for home building materials is from new house constructions, the government thrust on housing will aid this sector.

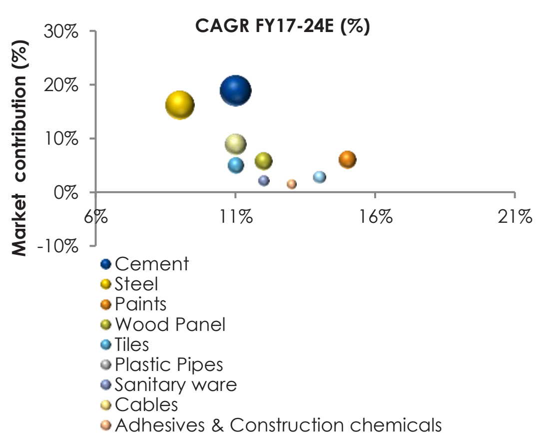
2 years of tempered growth for home building material players to be a temporary phenomenon
Building material players, who were historically growing at 15%, have grown only 5-10% over the last 2 years as housing demand has been muted. A Knight Frank report points out; that while the residential market got hugely impacted by the demonetisation move, the compliance needs driven by the implementation of the Real Estate Regulatory Authority (RERA) in May 2017 has further impacted fresh launches in the market. However the newfound thrust on real estate due to government initiatives like Housing for All, along with improving monsoons are expected to result in growth in housing demand in urban and rural areas.

Current scenario of domination by unorganised players to change post GST
In each home building materials segment, the share of unorganised segment is more than 50% (in some cases even 70%). GST is likely to narrow the price gap between organised and unorganised. Also, with GST at 18% and the expected introduction of the E-way bill, a lot of unorganised players are expected to become tax compliant which would narrow the pricing gap further between unorganised and organised from 20% to ~5-7%. This will facilitate a much faster shift from unorganised to organised players.

Cost structure of building a house



Housing building material market



Source: Company, Edelweiss Investment Research

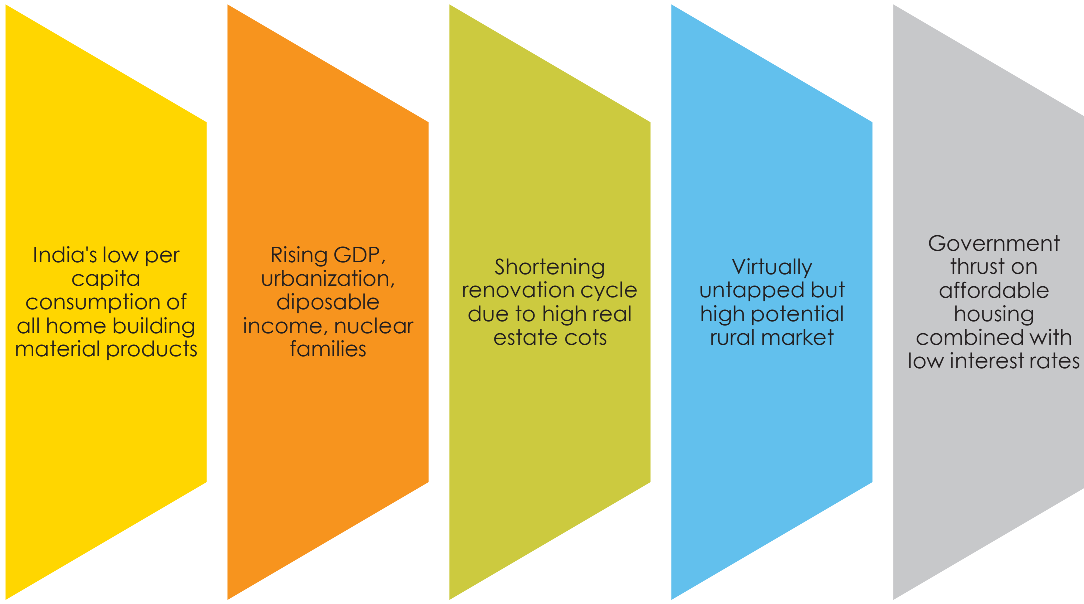
Home Building material top picks:

- **Century Ply:** Entry in MDF and expansion in plywood and laminates nearing completion; benefits to accrue
- **Asian Granito:** Strong volume growth visibility for the next 2 years and reasonable valuation
- **Shankara Building Products:** Only organised player in retail of home building materials
- **Everest Industries:** Focus on enhancing capacity utilisation & consumer centric value added products along with healthy order book in PEBs.
- **Finolex Industries:** Largest backward integrated PVC pipe manufacturer

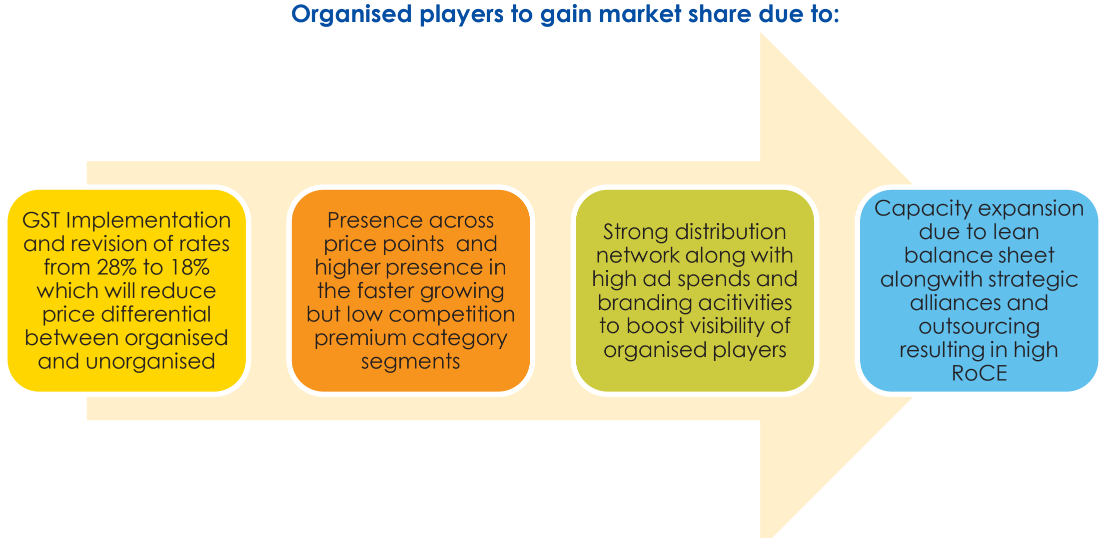
We have **'BUY'** rating of Century Ply, Asian Granito, Everest Industries, Finolex Industries and Shankara with target prices of INR390, INR640, INR 624, INR 800 and INR1,575, respectively.

Date: 4th December 2017

Major growth drivers for home building materials



Organised players to gain market share due to:



Home Building Materials

Major Home Building Material segments

	Market size (INR cr)	Industry CAGR FY17-24E (%)	Organized: Unorganized	Replacement Potential	% of Building Cost	Key Influencers	Strong brands
Tiles	24,000	11%	50:50	Average	5%	Architect/ Dealers	Kajaria/ Somany/ AGL
Plastic Pipes & fittings	10,000	14%	65:35	Average	2%	Plumber/ Contractor	Supreme/ Astral
Sanitaryware	3,500	12%	65:35	Low	1%	Consumer/ Architect	HSIL/Cera
Faucetware	5,000	12%	55:45	High	1%	Consumer/ Architect	Jaquar/ Grohe
Roofing & CBPs	43,000	9%		Average	9%	Consumer/ Dealers	Everest/ Visaka/ HIL
Plywood	18,000	9%	30:70	High	4%	Consumer/ Architect	Centuryply/ Greenply
Laminate	5,000	9%	55:45	High	1%	Consumer/ Architect	Greenlam/ Merino
Engineered Wood Panel (MDF/Particleboard)	4,000	15-17%	50:50	High	1%	Consumer/ Architect	Greenply/ Centuryply

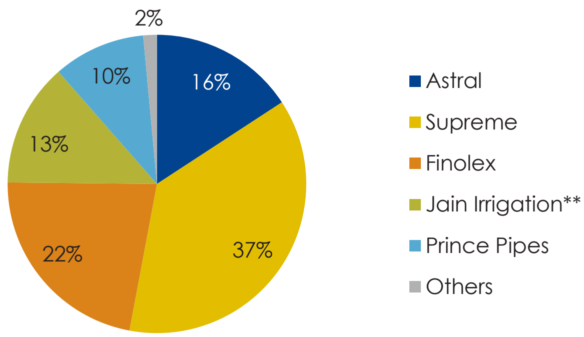
Peer Comparison

Name	CMP	M.Cap	P/E (x)			EV/EBITDA (x)			ROE (%)		
	(INR.)	(INR Cr.)	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Home Building Materials											
Plastic Pipes & Fittings											
Astral Poly Technik Ltd.	803	9,619	66x	53x	39x	35x	30x	24x	18.6	18.9	21.2
Finolex Industries Ltd.	623	7,726	22x	27x	19x	14x	17x	12x	18.2	12.3	15.6
Supreme Industries Ltd.	1,126	14,302	39x	35x	28x	20x	20x	16x	25.0	23.6	25.8
Roofing and Cement Boards & Panels											
Everest Industries Ltd.	467	726	NA	16x	13x	25x	9x	7x	0.4	12.5	14.0
HIL Ltd.	1,336	997	18x	16x	14x	10x	9x	8x	11.4	12.1	12.9
Visaka Industries Ltd.	598	950	23x	21x	17x	10x	9x	7x	10.8	10.9	12.6
Sanitaryware											
CERA Sanitaryware Ltd.	3,554	4,622	47x	40x	32x	26x	24x	20x	20.7	20.0	20.6
HSIL Ltd.	529	3,826	33x	29x	22x	14x	13x	10x	7.1	8.1	10.2
Tiles											
Asian Granito India Ltd.	494	1,486	37x	29x	19x	14x	11x	9x	10.4	12.1	15.7
Kajaria Ceramics Ltd.	728	11,563	43x	34x	27x	22x	19x	15x	22.1	23.5	24.1
Somany Ceramics Ltd.	850	3,603	38x	33x	24x	20x	17x	13x	19.9	19.0	22.3
Wood-Panel											
Century Plyboards Ltd.	296	6,572	34x	37x	23x	22x	21x	15x	30.6	22.6	30.1
Greenply Industries Ltd.	321	3,936	31x	26x	24x	17x	16x	13x	18.1	17.0	17.0
Greenlam Industries Ltd.	1,000	2,412	48x	34x	25x	19x	16x	13x	18.6	21.4	23.5
Home Building Products											
Shankara Building Products Ltd.	1,640	3,746	62x	43x	35x	25x	21x	14x	17.6	19.7	20.3

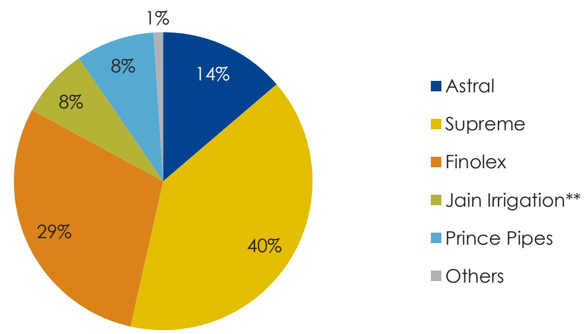
Plastic Pipes & Fittings

FY17

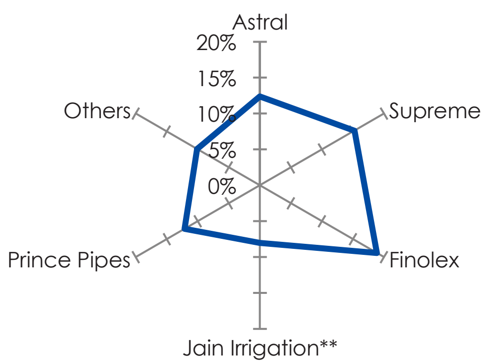
Plastic Pipes & Fittings Revenue Mix



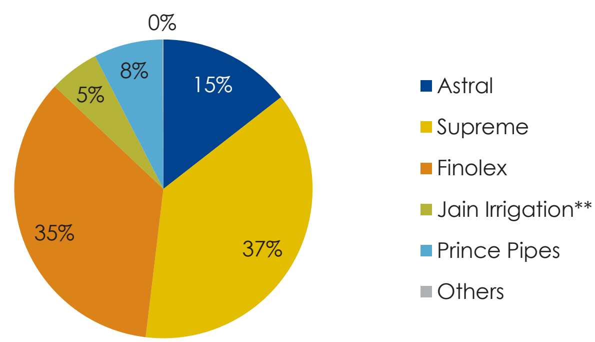
Plastic Pipes & Fittings EBITDA Mix



Plastic Pipes & Fittings EBITDA Margin



Plastic Pipes & Fittings PAT Mix

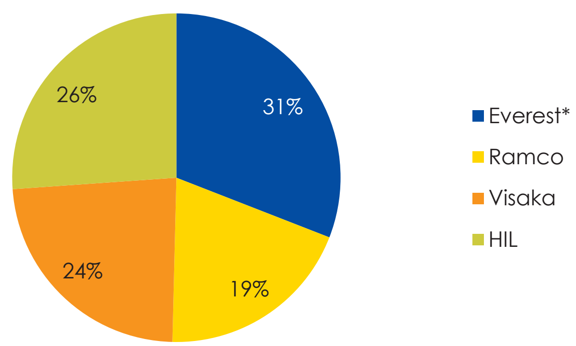


Source: Edelweiss Investment Research
**only pipe division

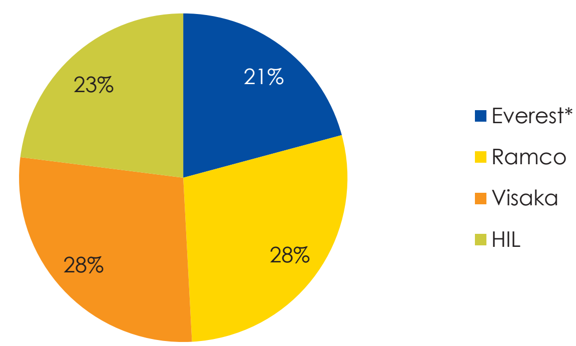
Roofing and Cement Boards & Panels

FY17

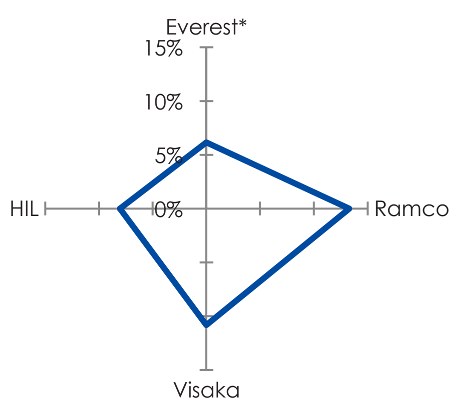
Roofing and Cement Boards & Panels Revenue Mix



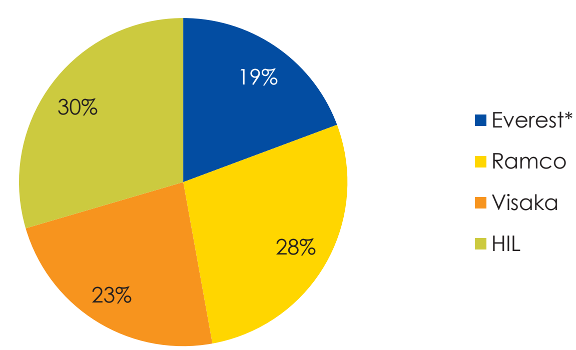
Roofing and Cement Boards & Panels EBITDA Mix



Roofing and Cement Boards & Panels EBITDA Margin



Roofing and Cement Boards & Panels PAT Mix

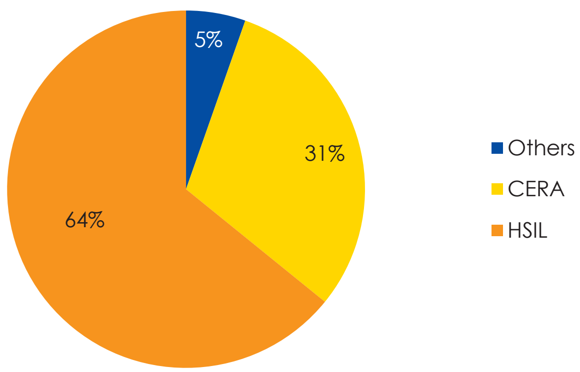


Source: Edelweiss Investment Research
*FY16 numbers

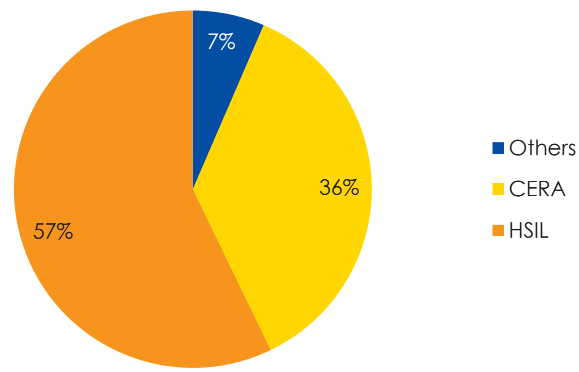
Sanitaryware

FY17

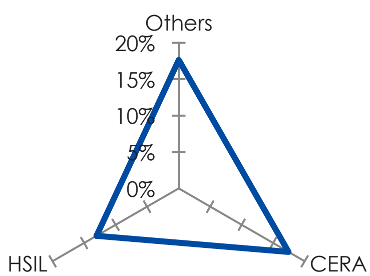
Sanitaryware Revenue Mix



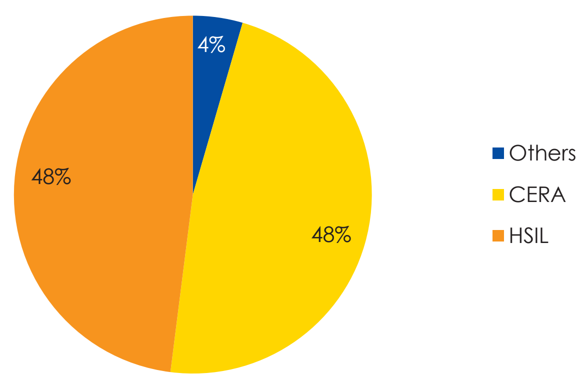
Sanitaryware EBITDA Mix



Sanitaryware EBITDA Margin



Sanitaryware PAT Mix

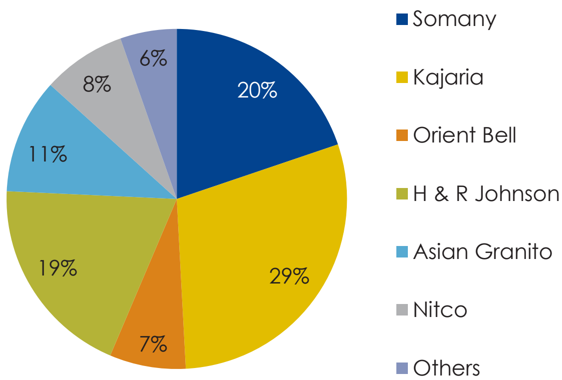


Source: Edelweiss Investment Research

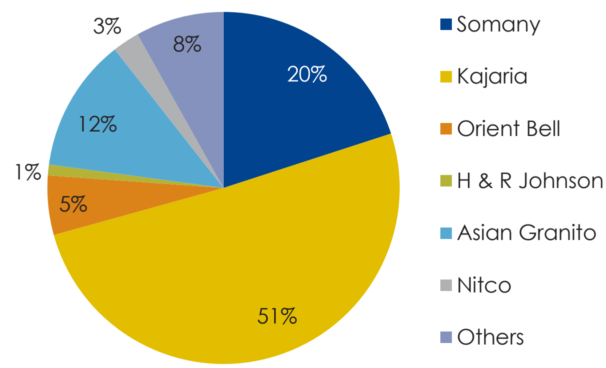
Tiles

FY17

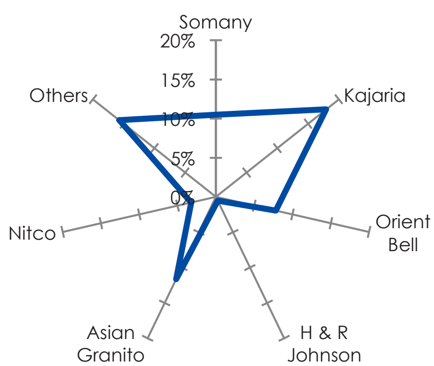
Tiles Revenue Mix



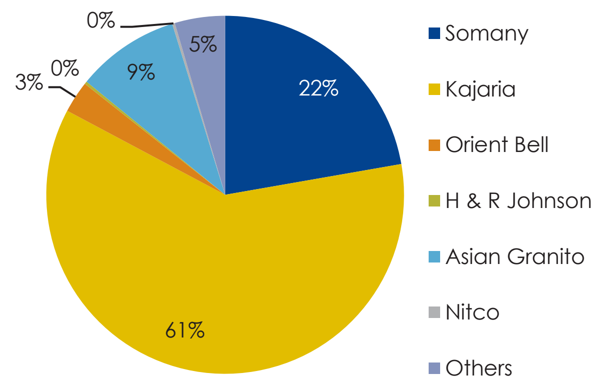
Tiles EBITDA Mix



Tiles EBITDA Margin



Tiles PAT Mix

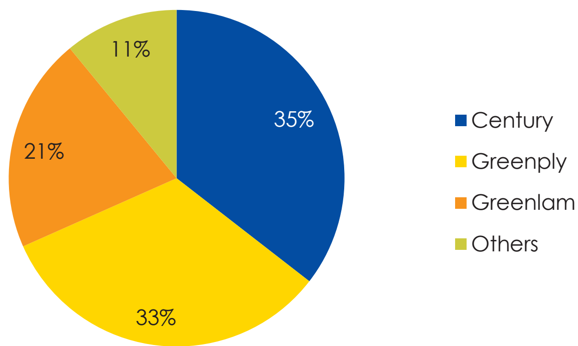


Source: Edelweiss Investment Research

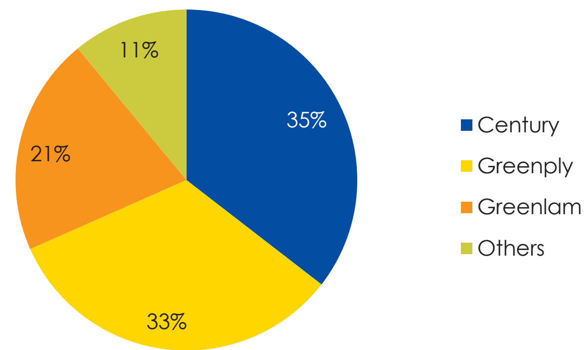
Wood-Panel

FY17

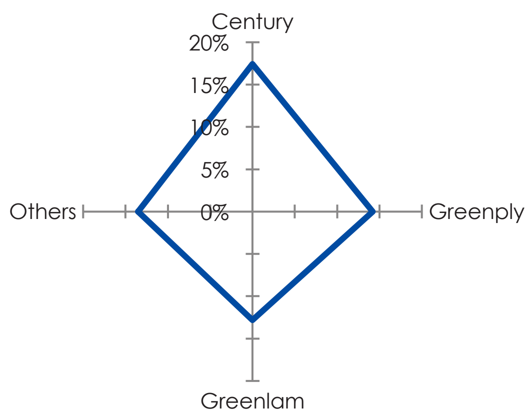
Wood-Panel Mix



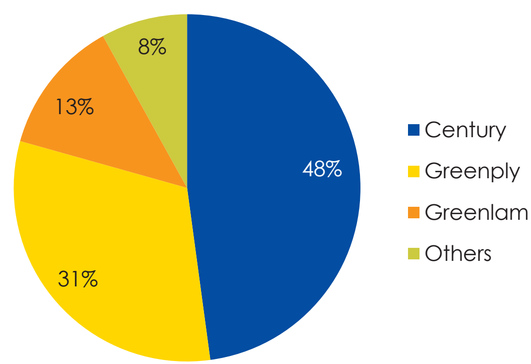
Wood-Panel EBITDA Mix



Wood-Panel Margin



Wood-Panel PAT Mix



Source: Edelweiss Investment Research

Home Building Materials - Tax Structure

Sector	Pre-GST	Post GST	Companies to benefit
Building Products			
Roofing (Asbestos)	28%	18%	Everest, HIL, Visaka, Ramco
Cement	27-32%	28%	Birla Corp, Sagar Cement, Sanghi Cement
Plastic Pipes			
Plastic Pipes & Fittings	18%	18%	Supreme, Astral Poly Technik, Finolex Industries
Sanitary-ware			
Faucets & Sanitary-ware	28%	18%	CERA, HSIL
Tiles			
Ceramic Tiles, Granite	26%	18%	Kajaria Ceramics, Jhonson, Somany Ceramics, Asian Granito
Wood-panel			
Plywood, Particle-board, Fibre-board	28%	18%	Century Plyboards, Greenply , Greenlam

Source: Edelweiss Investment Research

Plastic Pipes & Fittings

Plastic Pipes & Fittings

Piping growth

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Plastic pipes sector

The domestic pipe industry is dominated by plastic pipes, which clocked 10-12% CAGR over FY12-17 to reach INR280bn. We expect the momentum to sustain over the coming years and estimate it to register 14% CAGR over FY17-24. Major growth catalysts are: a) burgeoning demand from construction & building industries and irrigation sector; b) government's infra push & sharpening focus on urban/rural development; and c) Smart City initiatives. Among several variants, demand for UPVC and CPVC, is rising due to their affordability, high quality and durability. Moreover, organised players are envisaged to reap benefits of demand shift from the unorganised segment and government's focus on irrigation as well as low cost housing projects, which are estimated to propel the pipes industry to ~INR420bn by FY20. The share of organised players, currently at ~60% with CPVC being much more organised in nature (~80%) compared to PVC (~55%), is growing at a faster clip than unorganised share. The plastic pipe market is outpacing growth in other pipes (GI, cement) due to their lighter weight, ease in transportation & installation and longer life span.

Pipes

Metal
- Copper
- Galvanized Steel
- Stainless Steel
- Cast Iron
- Black Iron

Plastic
- Grey Plastic Polybutylene (PB)
- Creamy Plastic Chlorinated Polyvinyl Chloride (CPVC)
- Polyvinyl Chloride (PVC)
- Cross Linked Polyethylene (PEX)
- Acrylonitrite-butadiene-styrene (ABS)
- High density polyethylene (HDPE)

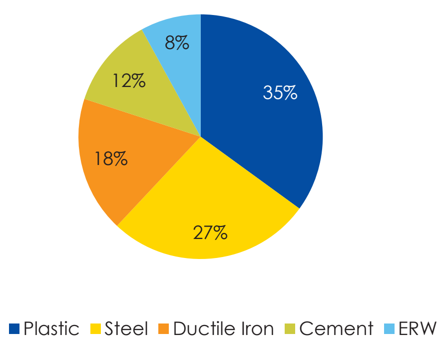
Year to March (FY17)	Astral	Finolex	Prince-Pipes	Supreme
Net sales (INR cr)	1,892	2,988	1,314	4,584
3 Year Revenue CAGR (%)	20.6%	6.8%	9.3%	5.0%
Operating Margin (%)	13.9%	18.8%	12.3%	16.6%
Net Profit (INR cr)	145	352	75	429
3 Year PAT CAGR (%)	22.5%	21.2%	31.4%	15.1%
RoE (%)	18.6	18.2	34.9	28.6
RoCE (%)	20.7	23.3	25.6	31.0
Market Cap (INR cr)	9,619	7,726	NA	14,303
Diluted P/E (x)	66.4	21.9	NA	33.4

Date: 4th December 2017

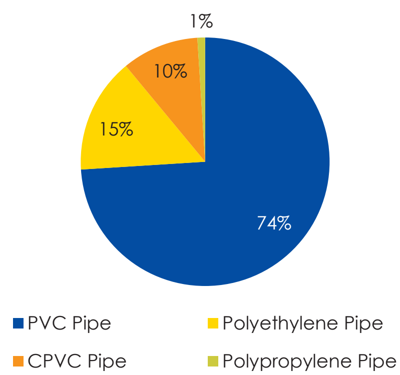
Plastic pipe industry: Healthy growth pace

The domestic pipe industry is dominated by plastic pipes, whose market is pegged at INR280bn with organised players cornering lion's share of ~60%. The plastic pipe market is growing at a faster pace than other pipes' segments (GI or cement) due to lighter weight, ease of transportation & installation and a longer life span. The government's push for cleanliness, sanitation and building affordable houses is expected to drive strong demand growth for PVC/CPVC pipes.

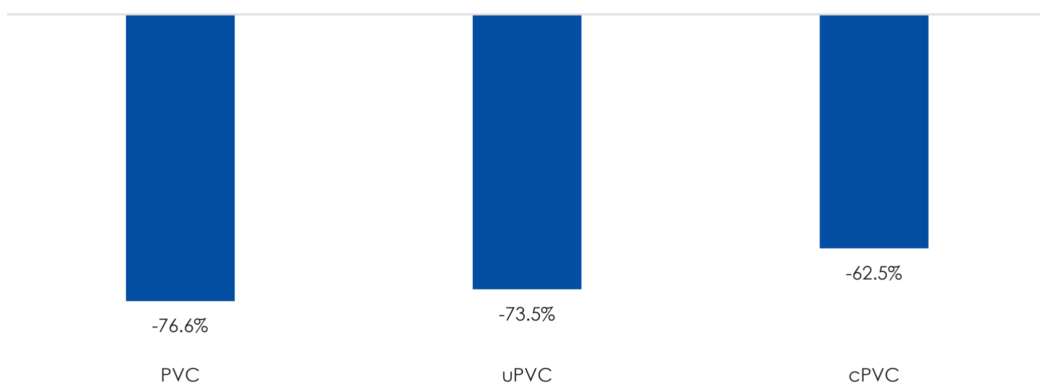
Indian Pipe Market - 5mn MTPA



Indian Plastic Pipe Market - 3mn MTPA



Plastic pipes are available at a significant discount to GI pipes – Reason for replacement



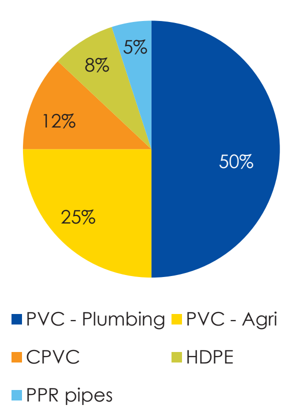
Source: Edelweiss Investment Research

Plastic Pipes and Fittings

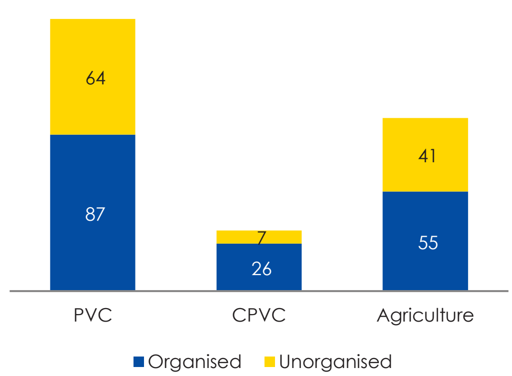
Type of pipes – comparison

	Galvanised iron (GI)	UPVC	CPVC	HDPE	PPR
Life (years)	15-20	20-25	30-35	50	50
Max operating temperature (degrees Celsius)	200-250	60-70	90-100	90-100	90-100
Strength (hoop)	Higher than plastic pipes	500-600	450-550	350-400	250-300
Cost	Costlier than plastic	Cheaper than GI	Cheaper than GI, costlier than UPVC	Cheaper than GI, costlier than UPVC	Cheaper than GI, costlier than UPVC
Corrosion	Corrodes faster	No effect due to chemical resistance	Has anti-corrosive properties	Excellent anti-corrosion and chemical resistance	Good chemical resistance and corrosion resistance
Leakage	Vulnerable to leakage	Leakage-free	Leakage-free for lifetime	Leakage-free	Relatively leak-free but requires installation by skilled manpower
Bacterial growth	More prone to bacterial growth compared with plastic	Relatively low compared with GI	Extremely low compared with GI	Extremely low compared with GI	Relatively low compared with GI
Installation	Time- and energy-consuming	Done through cold welding	Done through cold welding	Cold welding. Known for more tolerance to poor installation	Fusion-welded system which requires specialised training and equipment
Thermal conductivity and insulation	Needs insulation as heat loss occurs faster due to high thermal conductivity	Requires less insulation as low thermal conductivity reduces heat loss	Requires less insulation as low thermal conductivity reduces heat loss	Require less insulation as low thermal conductivity reduces heat loss	Higher thermal conductivity than CPVC, requires insulation

Indian Plastic Pipe Market - INR 280bn

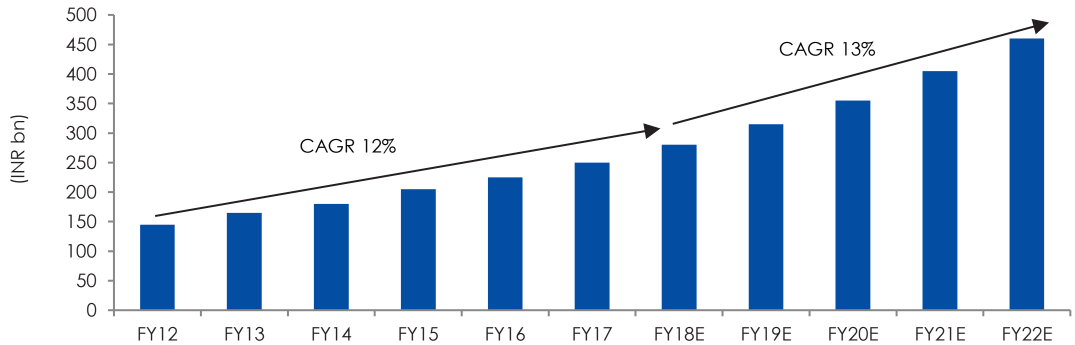


Plastic Pipe segment breakup (INR bn)



Source: Edelweiss Investment Research

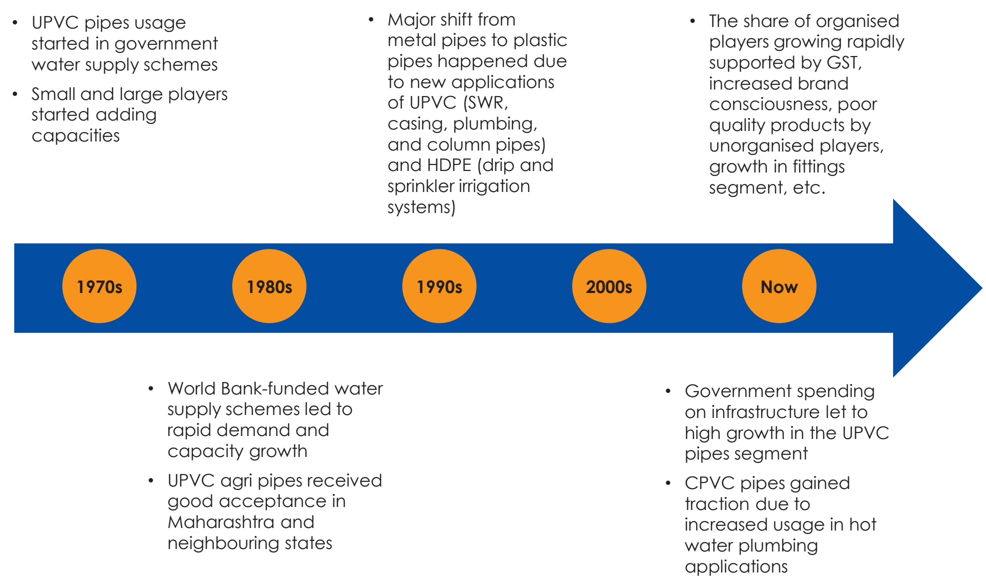
Indian Plastic Pipe continue to grow

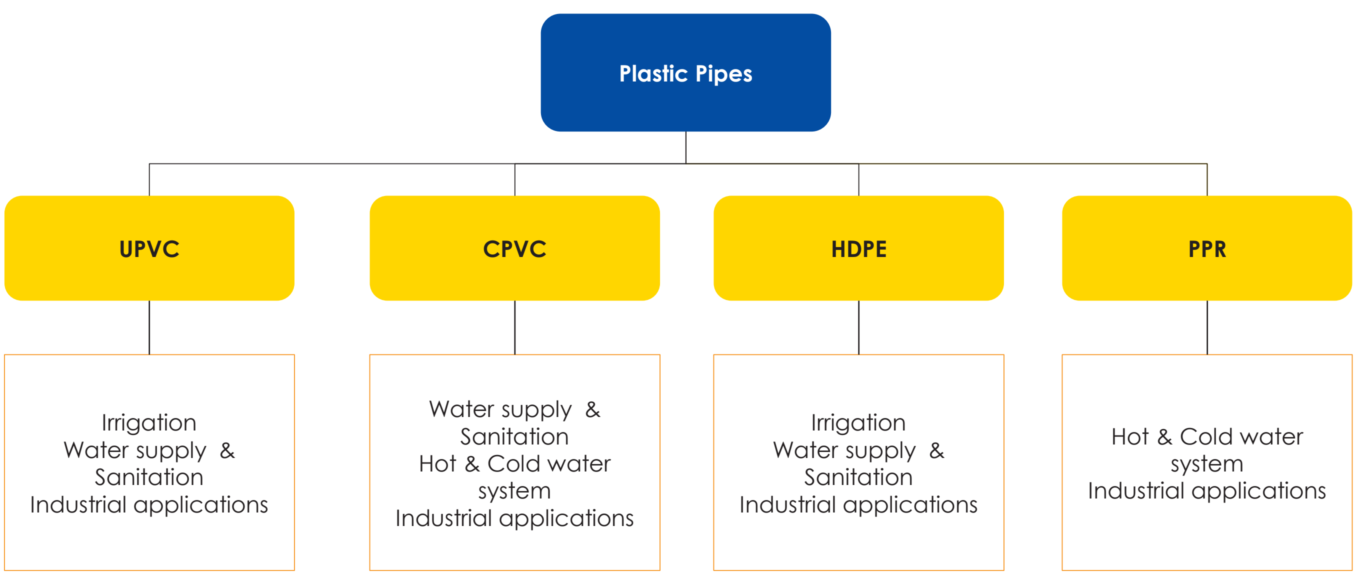


Source: Edelweiss Investment Research

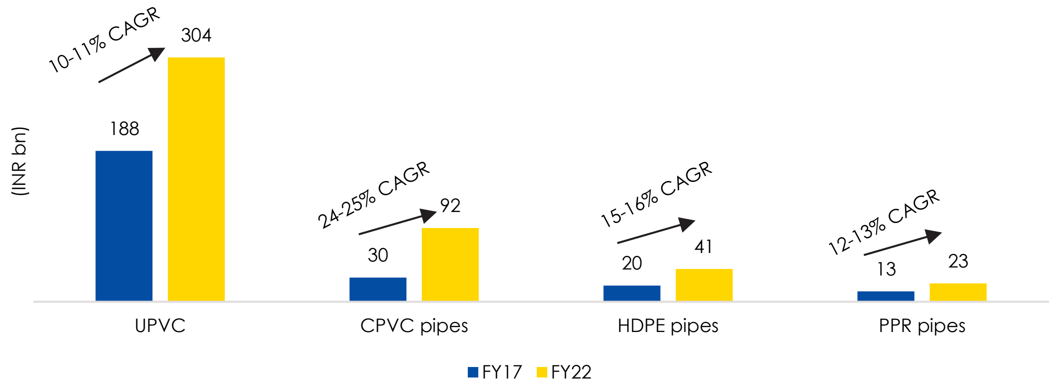
Domestic plastic pipes industry: Evolution

Branded players recorded higher sales growth in the past decade due to burgeoning demand for specialised products.





Plastic pipes - Growth across each segment

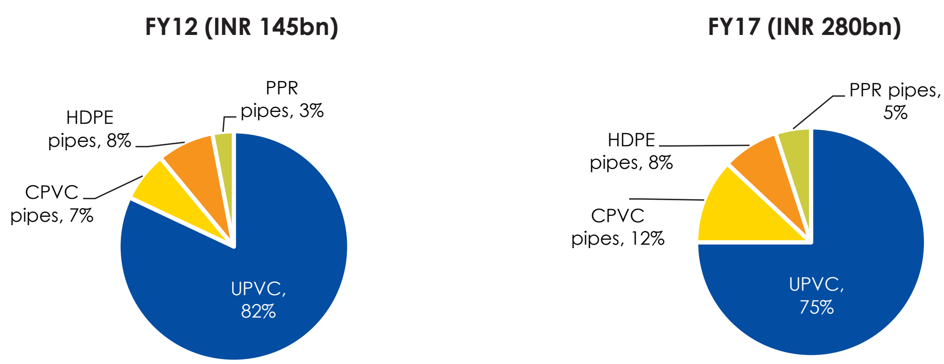


Source: Edelweiss Investment Research

Plastic Pipe industry breakup based on use

Type of pipes	Market size (INR bn)	Organised %	Applications	Major Players
PVC – Plumbing	140	60%	Plumbing and Agriculture, Water Supply, Sewage, Irrigation	Supreme Industries, Finolex, Astral, Ashirvad, Jain irrigation, Price Pipe
PVC - Agri	90	60%	Drainage, Irrigation	Finolex, Jain irrigation
CPVC	30	85%	Plumbing	Astral, Ashirvad, Supreme
HDPE	20	50%	Water Sopply, sewage, Industrial applications, drainage	Supreme Industries, Jain irrigation

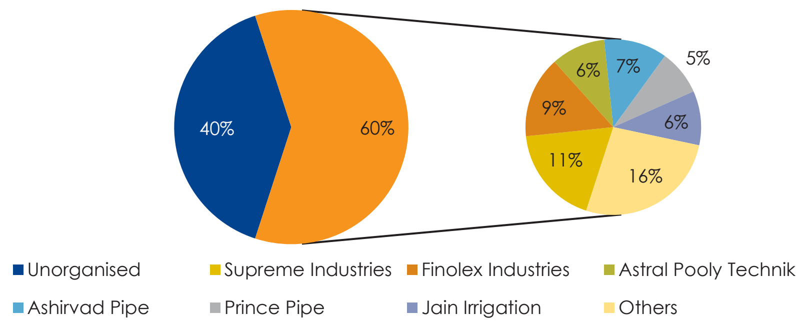
Plastic pipes – Shift in demand segmentation by type



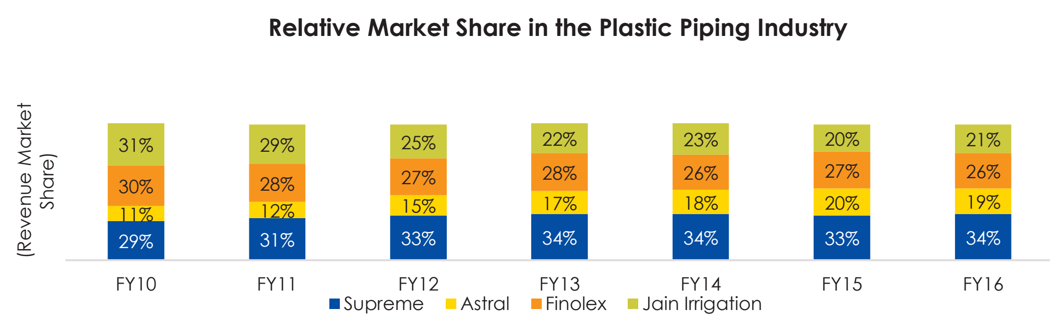
Source: Edelweiss Investment Research

Domestic market share: Plastic pipes and fittings (value terms)

Organised players continue to dominate the sector underpinned by wide distribution network, brand focus and quality. The top 6 organised players, which collectively control 44% market share, are outperforming industry growth.

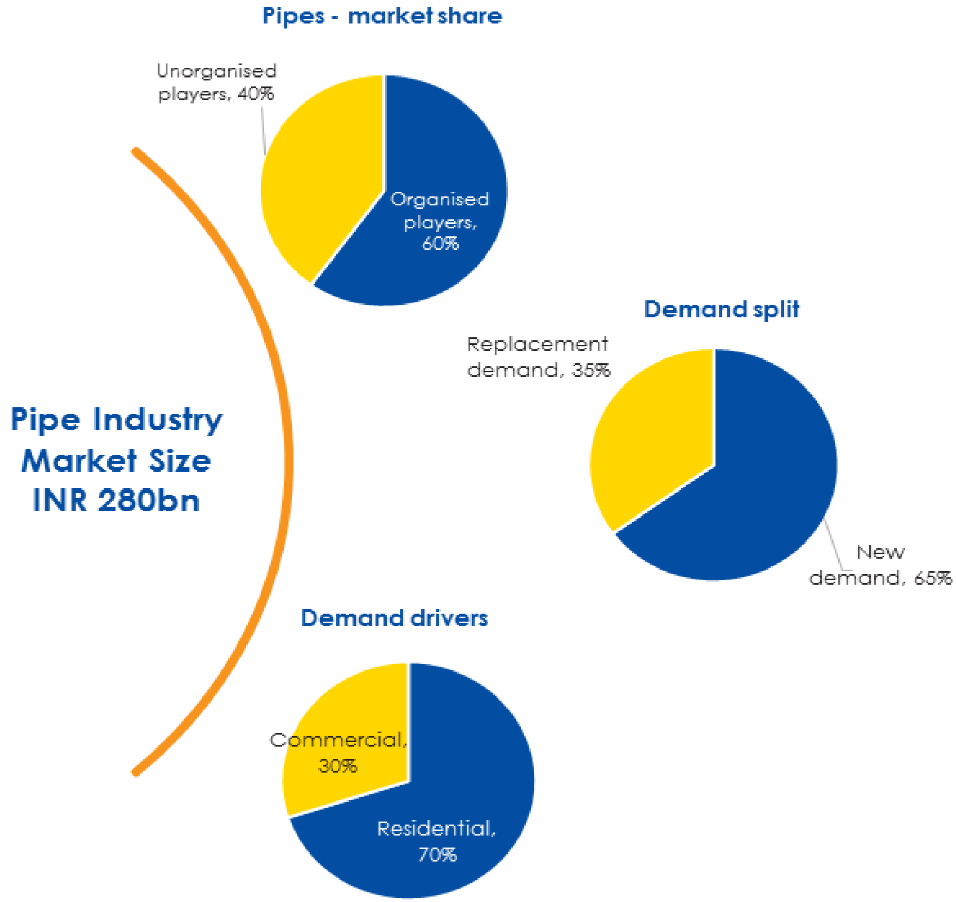


Source: Industry report, Company, Edelweiss Investment Research



Source: Edelweiss Investment Research

Major Companies - segment breakup



Source: Edelweiss Investment Research

Plastic Pipes and Fittings

Major Companies details

Company	Capacity (MT)	Products	No. of Plants	Rev. contribution - categories	Rev. contribution - products	Product - SKUs	Expansion Plans
Supreme Industries	400k	UPVC, CPVC, HDPE, PPR pipes and fittings	7	Housing - 60% Agriculture - 35% Industrial - 5%	CPVC-15%, PVC-80%, others-5%	7,300	Greenfield expansion planned in Assam & Telangana
Finolex Industries	290k	UPVC pipes and fittings	3	Housing - 70% Agriculture - 25% Industrial - 5%	CPVC-5%, PVC-95%	1,400	30k MT addition each year in coming years
Astral Poly Technik	138k	UPVC, CPVC pipes and fittings	3	Housing - 85% Industrial - 15%	CPVC-55%, PVC-45%	~2,500	Facility planned at Rajasthan to produce PVC pipe
Ashirvad Pipe	130k	UPVC, CPVC and fittings	2				
Prince Pipe	180k	UPVC, CPVC, PPR pipes and fittings	5	Housing - 42% Agriculture - 36% Industrial - 22%	CPVC-19%, PVC-74%, PPR-7%	7,500	New plants planned in Rajasthan & Telangana
Jain Irrigation	200k	UPVC, HDPE pipes and fittings					
Skipper	41k	PVC, CPVC					100k MT panned by CY19
APL Pipes	55k	PVC, CPVC					75k MT planned by CY19

Major Companies - Regional presence

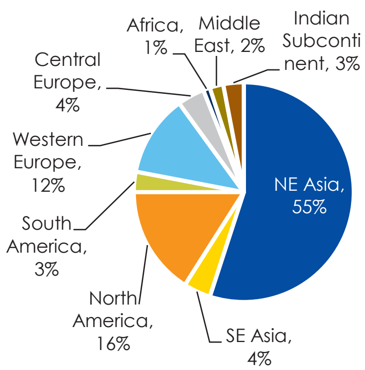
Region	Demand Split	Major Players
West	35%	Astral, Finolex, Supreme, Prince, Jain Irrigation
South	35%	Astral, Finolex, Supreme, Prince, Ashirvad
North	20%	Finolex, Supreme, Prince
East	10%	Finolex, Supreme

Source: Edelweiss Investment Research

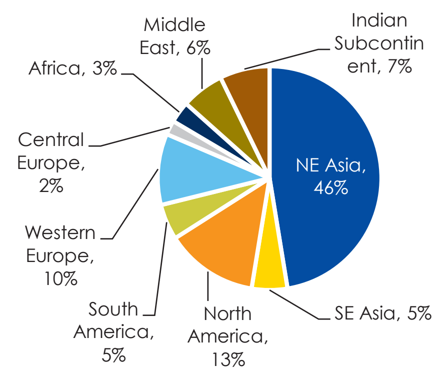
Polymer consumption improving with macroeconomic environment

Polymer consumption growth has historically surpassed GDP. However, in FY14, it tumbled to 2.72%. The industry's growth is driven by surge in consumption of plastic pipe industry as it consume maximum polymer produced. In India, PVC is widely used polymer and it is expected to clock double digit growth in coming years. Some of the major drivers contributing to this spurt include high growth in the agricultural sector, building & construction sector, automobile industry and medical devices.

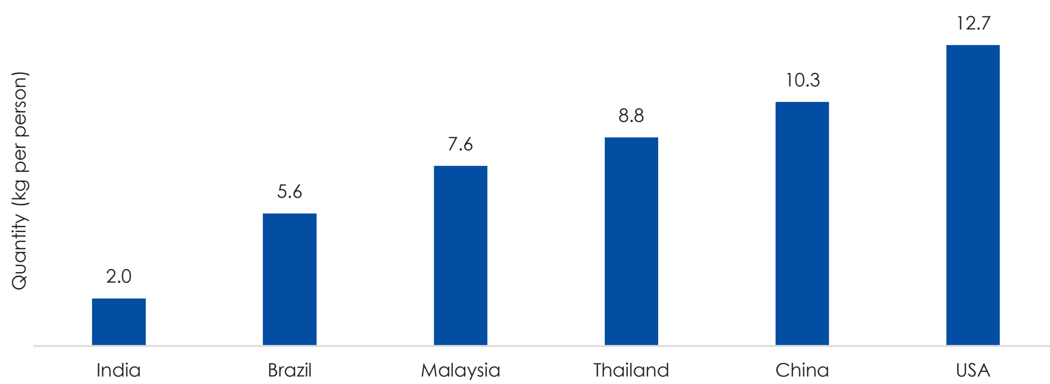
Global PVC capacity break-up (%)



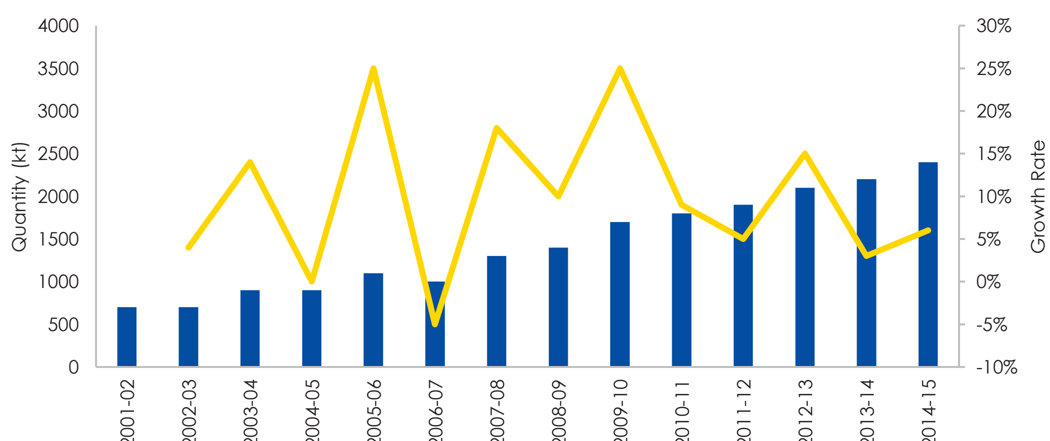
Global PVC demand break-up (%)



Global per capita consumption of PVC

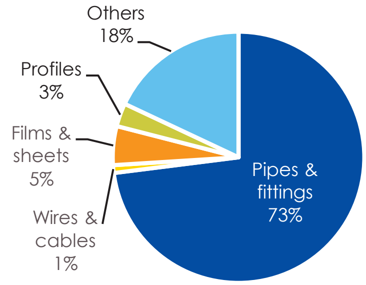


Robust growth in PVC consumption in India

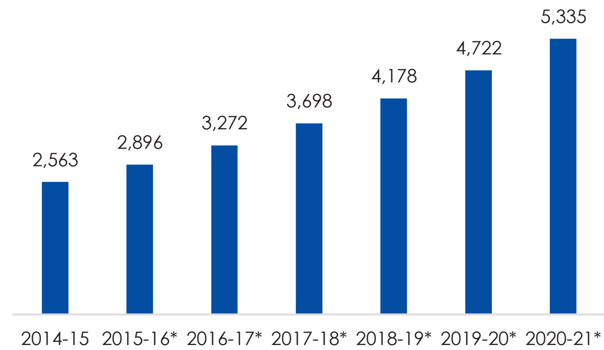


Source: Edelweiss Investment Research

Indian usage of PVC



Demand forecasting for PVC (kt)

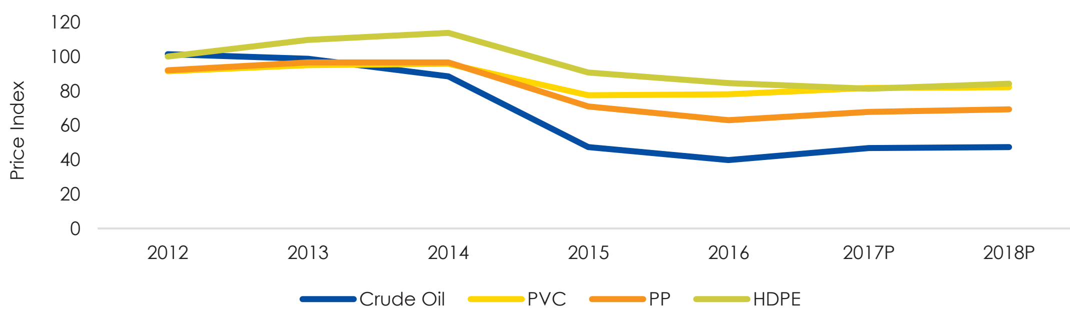


Source: Edelweiss Investment Research

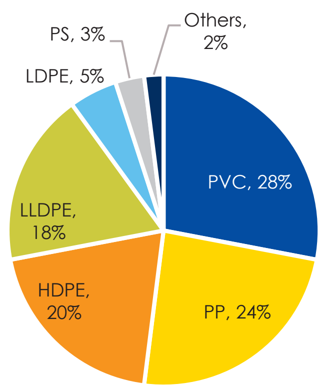
Correction in raw material price to drive volumes

Polymer prices have fallen between 24% and 30% from their peak level across various polymers over Oct-Dec 2014. Prices are expected to stabilise at the current level, which is expected to reduce working capital requirements.

Trend in Raw Material Prices



Demand breakup of polymers for plastic products



Source: Chemical & Petrochemical Statistics, Edelweiss Investment Research

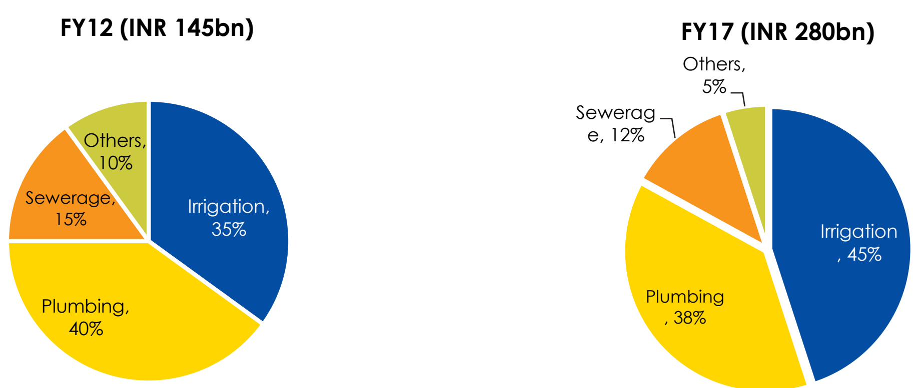
Plastic pipes: Growth drivers

I. Housing: Near- and long-term drivers in place

The plastic pipe industry can also count on the structurally sound future of housing demand in India. As India becomes a more services/manufacturing oriented economy (at the expense of agriculture), demand for urban/semi-urban housing is expected to continue its secular uptrend. Even today, the country's housing demand far outpaces supply (~59mn houses as of date). While private players in the real estate industry continue to address this situation, even the government has increased thrust on this sector, especially on low-cost housing. Given that plumbing/sewerage remains an essential component of real estate, organised players (who have the capacity/reach to satisfy this institutional demand) are well placed to capture this growing market. In addition, replacement market remains robust as the shift from GI pipes to plastic alternatives like PVC/CPVC is sustaining. The government's thrust on cleanliness & sanitation and building affordable houses is expected to drive strong demand for PVC/CPVC pipes.

The housing shortage in urban/rural area is ~22 mn/~54 mn units, respectively, although unofficial estimates peg the figure at higher levels. The government is targeting construction of 20mn/40mn units in urban/rural areas, respectively, by 2022. One unit in urban area consumes ~200kg of PVC products like pipes, flooring, doors, windows etc. In rural area it consumes ~75kg. This, coupled with fast changing rural and semi-urban housing landscape, the tier II and tier III cities offer potential growth as they are less penetrated, provides opportunity for the housing industry and ultimately to plastic industry. Thus, we expect robust growth in the PVC segment, especially in pipes and fittings, from agriculture and plumbing segments in coming years.

Shift in demand segmentation by end-users



Source: Edelweiss Investment Research

II. Replacement market: PVC/CPVC preferred over GI

In existing real estate units, the market is fast moving away from cement-based, cast iron and galvanized iron (GI) pipes towards plastic-based PVC/CPVC pipes, as there is growing awareness about the advantages of the latter. PVC/CPVC pipes are economical and last 2x longer than GI pipes. PVC/CPVC pipes are also increasingly being preferred by industries given their relative durability and strength versus conventional iron or lead pipes. As per our interactions with companies, it can be estimated that the replacement market for housing related plastic pipes is valued at ~INR60bn (~20% of total plastic pipe demand).

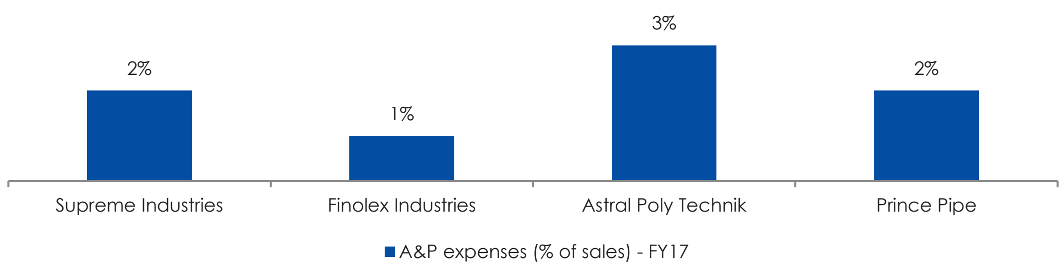
GI vs PVC vs CPVC - Why PVC/CPVC pipes are preferred over GI

Parameters	GI	PVC	CPVC
Life	15-20 years	20-25 years	30-35 years
Cost	Costliest vs PVC/CPVC	Cheapest vs GI/CPVC	Cheaper vs GI
Corrosion Resistance	No	Yes	Yes
Fire Resistance	Yes	No	Yes
Leakage	Vulnerable to leakage	Leakage Free	Leakage Free
Installation Issues	Time/Energy Consuming	Easier through Cold Welding	Easier through Cold Welding
Hot Water Issue	Requires extra insulation	No	Yes

III. Brand building & distribution: Driving organised players' surge

Plastic pipe companies are strengthening their brands in 2 ways: a) by increasing expenditure on advertisement through electronic & print media and participating in several exhibitions in India and abroad along with organising large meets of plumbers, dealers, retailers & architects; and b) taking legal recourse to contain counterfeit products in the plastics pipe system.

Major Companies - A&P expenses



Source: Edelweiss Investment Research

Major Companies - sales network (Plastic Pipe division)

	Distributors	Touch Points (Retailer + Dealers)
Supreme Industries	916	25,000
Finolex Industries	800	18,000
Astral Poly Technik	750	25,000
Prince Pipe	766	-
Ashirvad Pipe	1,100	36,000
Jain Irrigation	6,526	16,000

IV. Irrigation: Immense growth potential

Despite India having one of the largest land-banks in the world under agriculture, less than half of it is under irrigation. Given that Indian farmlands are largely dependent on rains for water supply, any vagaries in monsoon directly hit agricultural yields (which at ~3,000kg/ha is far lower than the global average of ~4,500 kg/ha). To address this problem, the central government has sharpened focus on irrigation projects (large-scale as well as micro-irrigation projects) through its flagship PMKSY scheme. Other initiatives include supporting farm incomes (through crop insurance and interest subventions) as well as local government level initiatives to encourage farmers to adopt irrigation systems to reduce their dependence on monsoon as well as improve yields. Given the immense potential available for irrigation/micro-irrigation, organised pipe players are in a sweet spot to capitalise on this opportunity as government projects are only limited within the organised PVC pipe makers based on their longevity and quality.

Polymers used in Agricultural Plastic Applications

Applications	PVC	LDPE	LLDPE	HDPE	PP
Drip Irrigation	Main/sub main lines	-	Laterals/emitting Pipes	Screen filter	Drippers/emitters
	Control valves	-	Micro tubes	Disc filter	Fittings
Sprinkler irrigation	Main/sub main lines	Connecting line	-	Main/sub main lines	Fittings
	Control valves	-	-	Nozzles	Nozzles
Greenhouse	Main/sub main lines	UV films	UV films	Main.sub main lines	Ropes
Low Tunnel	-	UV films	-	Hoops	Ropes
Mulching	-	-	UV films	-	Non Woven

Peer Comparison – Financial parameters

		Prince Pipes and Fittings	Supreme Industries Ltd	Finolex Industries Ltd	Astral Poly Technik Ltd	Jain Irrigation Systems Ltd	Ashirvad Pipes Private Ltd
Year	**Unit**	**FY17**	**FY17**	**FY17**	**FY17**	**FY17**	**FY16**
Operating Income	INR cr	1,259	4,442	2,988	1,477	3,710	1,614
Share of plastic pipes	%	100	62	74	100	44	100
OPM	%	12.9	17.17	19.03	14.45	16.33	15.05
RoCE	%	22.46	33.33	24.09	17.79	10.02	23.06
ROE	%	30.53	27.56	18.27	13.66	3.8	23.67
NPM	%	5.14	8.54	11.79	7.22	4.41	6.67
Sales growth	%	24.8	13.05	5.88	12.32	-12.55	15.33
NP growth	%	108.14	33.6	38.43	46.36	167.87	-8.63

Source: Edelweiss Investment Research

Segmental revenue (Plastic Pipes)

(INR cr)	FY15	FY16	FY17
Prince Pipes and Fittings	957	1,009	1,259
Revenue growth (%)		5.4%	24.8%
Supreme Industries	2,113	1,802	2,765
Revenue growth (%)		14.1%	14.7%
Finolex Industries	1,694	2,031	2,217
Revenue growth (%)		19.9%	9.2%
Astral Polytechnik	1,253	1,315	1,477
Revenue growth (%)		4.9%	12.3%
Ashirvad Pipes	1,400	1,614	N.A.
Revenue growth (%)		15.3%	–
Jain Irrigation	NA	1,569	1,640
Revenue growth (%)			4.5%

Segmental margins (Plastic Pipes)

(%)	FY15	FY16	FY17
Prince Pipes and Fittings	9.0	10.2	12.9
Supreme Industries	13.4	10.3	12.2
Finolex Industries	7.9	8.8	8.0
Astral Polytechnik	12.1	12.7	14.4
Ashirvad Pipes	12.9	15	N.A.
Jain Irrigation	N.A.	8.6	10.0

Return ratios

RoCE (%)	Mar-15	Mar-16	Mar-17
Prince Pipes and Fittings	12.2	15.8	22.5
Supreme Industries	32.2	28.9	33.3
Finolex Industries	7	24.3	24.1
Astral Polytechnik	18.2	15.6	17.8
Ashirvad Pipes	29.2	23.1	N.A.
Jain Irrigation(3)	7.5	8.9	10.0

RoE (%)	Mar-15	Mar-16	Mar-17
Prince Pipes and Fittings	11.4	18.1	30.5
Supreme Industries	28.8	24.5	27.6
Finolex Industries	3.5	21.6	18.3
Astral Polytechnik	13.5	10.9	13.7
Ashirvad Pipes	31.7	23.7	N.A.
Jain Irrigation(3)	1.6	2.7	3.8

Source: Edelweiss Investment Research

Astral Poly Technik Ltd.

Pioneer in branded plumbing pipes

CMP INR 803
Rating: Not Rated

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Leader in CPVC pipes

Astral Poly Technik (Astral) is a leading plastic pipes company that manufactures and trades in CPVC and PVC plumbing systems for residential, commercial and industrial applications. With acquisition of a majority stake in Resinova Chemie and Seal IT Services, Astral has an adhesive business as well. Astral has six manufacturing facilities for pipes and adhesives across the country and one each in the UK and the US; three in Gujarat, two in Uttar Pradesh and one in Tamil Nadu. Astral is expanding its pipes capacity by building another manufacturing facility at Giloth, Rajasthan with 20,000 MT and at Hosur in southern India with 18,000 MT by FY18.

Healthy growth in the pipes industry

Growth in the piping industry is being driven by increased construction, replacement of conventional piping systems like borewells etc. and an increase in demand for branded pressure piping applications in agriculture and plumbing applications in residential/commercial piping. In the last five years, whilst industry has grown at ~13% CAGR, Astral has grown at a faster rate. Astral supplies mainly to the construction segment — the GoI's initiatives such as thrusting construction projects, aiming for 100 smart cities, providing stimulus to cleanliness, sanitation etc, will give a boost to the real estate and construction sectors and thereby the piping industry. The company aims to enhance size of the plastic piping industry to achieve growth at a CAGR of 15%+ over the next five years. Going by the new demand in housing, infrastructure etc, Astral will likely enjoy a healthy growth opportunity, near term, in both size and scale of the piping industry.

Adhesive business: Robust growth and margin improvement

Astral has acquired Resinova Chemie and Seal IT Services, to become a sizeable player in the adhesive space. With these acquisitions, Astral has entered the adhesive business thereby diversifying its business from being a predominant plastic pipe player. It is expected that Astral will leverage on the brand of the acquired entity, geographic strengths and existing distribution network along with its own cross-selling opportunities to gain share in the high-growth adhesive segment and is expected to grow at 20%+ over the next few years. Astral has been continuously improving the margin of its adhesive business from 7.5% in FY14 to 13% in FY17 (sales grew to INR 455 crore in FY17 from INR 328 crore in FY14) and expects to improve its margin by 100bps each year over the next few years. Astral has 4,50,000 touch points for its adhesive business and with the branding, management expects healthy growth ahead.

Outlook

Capacity additions and new product launches have positioned the company strategically to maintain its healthy growth momentum ahead in the domestic market. Astral is trading at a high valuation of 61x FY17 earnings.

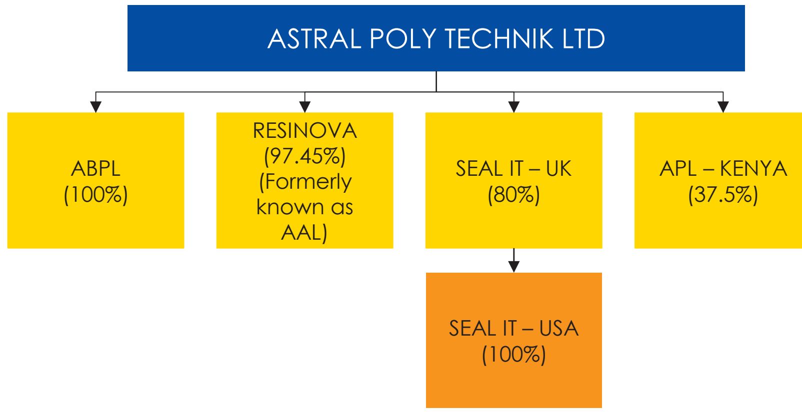
Bloomberg:	ASTRA:IN
52-week range (INR):	814.95/367.05
Share in issue (cr):	12
M cap (INR cr):	9,583
Avg. Daily Vol. BSE/NSE :('000):	46
Promoter Holding (%)	58.50

Year to March	FY15	FY16	FY17
Revenues (INR Cr)	1,430	1,678	1,892
Rev growth (%)	32.4	17.3	12.7
EBITDA (INR Cr)	168	207	263
Net Profit (INR Cr)	78	102	145
P/E (x)	125.3	95.3	66.4
EV/EBITDA (x)	57.6	47.2	37.4
RoACE (%)	19.9	18.4	20.7
RoAE (%)	16.2	15.2	18.6

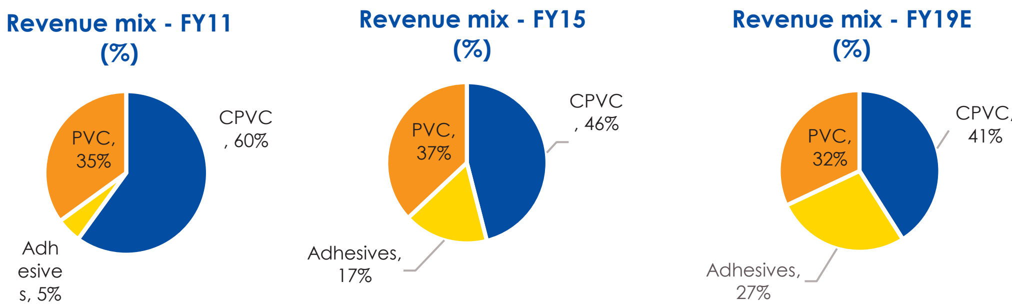
Date: 4th December, 2017

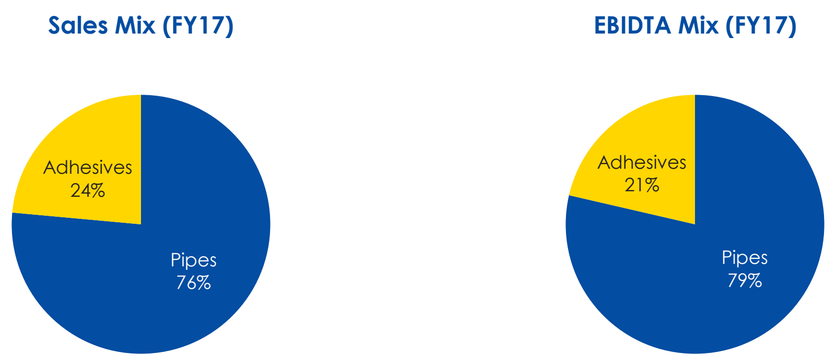
ASTRAL – Scaling in building materials segment

Astral has created a superior brand in the plumbing pipes segment with its wide products basket, distribution reach and branding. Astral has strategically expanded its adhesive space and gained share in a short span with its distribution reach and branding coupled with capacity expansion. Astral's products basket includes pipes, epoxy systems, epoxy putty, construction chemicals, instant adhesives, PVA adhesives, solvents, solvent cements and silicone sealants. Astral aims to replicate its success in plumbing pipes in adhesives/construction chemicals as well.



Scaling in building materials sector





Source: Edelweiss Investment Research

Manufacturing facilities and capacity expansion

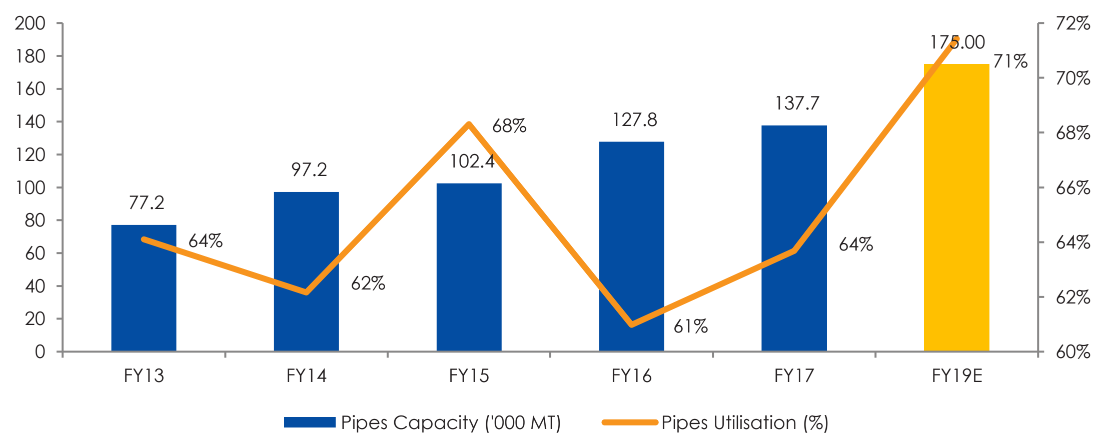
Location	Product	Capacity
Santej, Gujarat		62,839 MT
Dholka, Gujarat	Pipes	52,163 MT
Hosur, Tamil Nadu		22,706 MT
Unnao, Kanpur, UP		
Raina, Kanpur, UP	Adhesives	-
Santej, Gujarat		
UK		
North Carolina, US	SEAL IT services	-

Pipes – capacity expansion and segment penetration

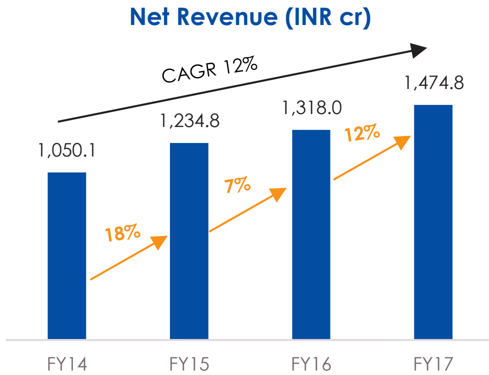
Astral's piping business has delivered healthy revenue growth of 12% and volume growth of 15% in FY17 whereas growth at the industry level has been low owing to a slowdown in the real estate business. Astral has achieved the highest ever EBDITA of INR 215cr in FY17 with a margin improvement of ~200 bps y-o-y on account of efficient procurement planning of PVC at a lower cost, logistics advantage owing to scale up of operations at the southern facility, launch of high-margin products and backward integration of CPVC compounding.

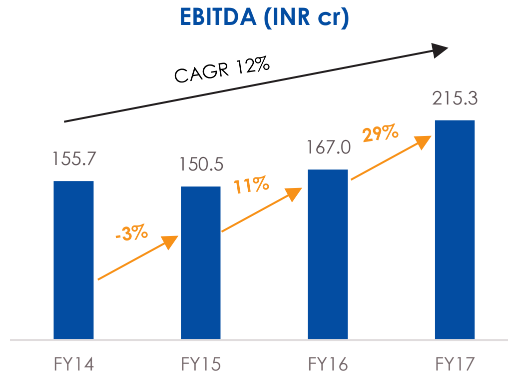
Astral is expanding its pipes capacity by building another manufacturing facility at Giloth, Rajasthan with 20,000 MT and at Hosur in southern India with 18,000 MT by FY18. Further, capacity expansion is being planned in eastern India as well with 20,000 MT. Capacity is expected to reach 1,75,000 MT by end-FY19. Capex of INR 150 crore for two years is also planned; thereafter Astral's focus will be on continuous utilisation improvement.

Pipe capacity and utilisation



Source: Edelweiss Investment Research

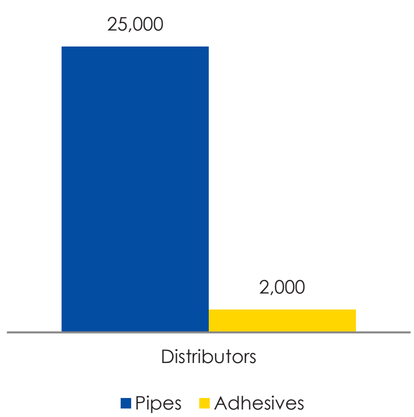


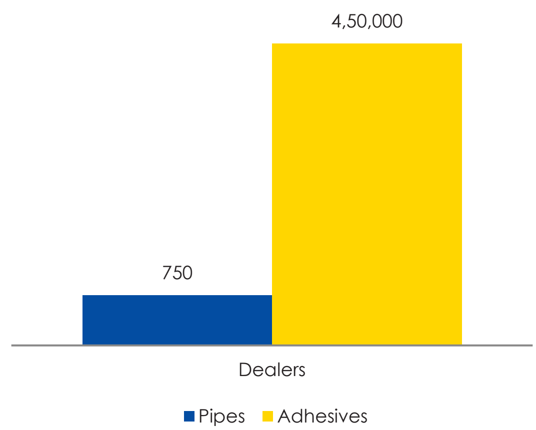


Source: Edelweiss Investment Research

Strong distribution network

Astral has a strong distribution network with over 785 distributors and 25,000 dealers in the piping division. Post acquisition of Resinova in 2014, Astral gained access to 2,000+ distributors and 4,50,000+ dealers in the adhesives division.





Source: Edelweiss Investment Research

Adhesives business: Huge opportunity

Astral's piping business has traditionally been considered a growth driver but now the adhesives business has shown good momentum and is growing consistently at a higher EBDITA margin. Astral is continuously increasing its products basket – catering to the B2C segment, expanding its geographical reach to leverage on Resinova's strong distribution strengths. The adhesives business has delivered strong growth of 20%+ and its margin has improved to 18-19% in a short span. With normalisation in SEAL-IT businesses in the UK and the US; growth and margins are expected to improve further for adhesives.

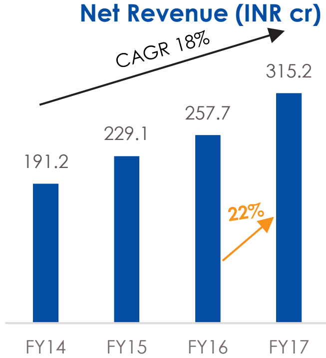
Resinova Chemie Limited (Resinova) has reported healthy revenue growth of 22% with margin improvement to 16% in FY17 from 11% compared to previous year. Subsequent to acquisition of Resinova in 2014, the company has undertaken structural changes and invested in packaging capacities. This has begun to yield results and this momentum is expected to continue ahead.

Table Heading

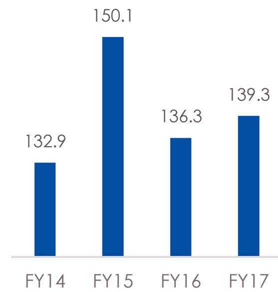
	Pidilite market share	Market size (in INR bn)	Astral (Resinova) penetration
Polyvinyl acetate - Water based glue	70%	~26	Weak
Rubber adhesive	45%	~12	Weak
Acrylics	60%	~6	Strong
Epoxy Sealant	60%	~3.5	Strong
Epoxy Adhesive	7%	~8	Strong
Construction chemicals	50% (in waterproofing)	~40	Weak

Adhesive business details

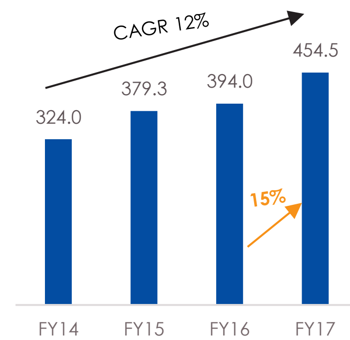
RESINOVA Net Revenue (INR cr)



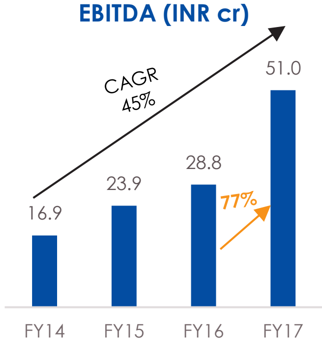
SEAL IT - UK & USA Net Revenue (INR cr)



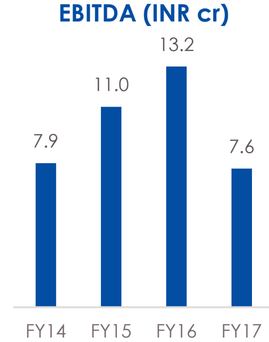
Net Revenue (INR cr)



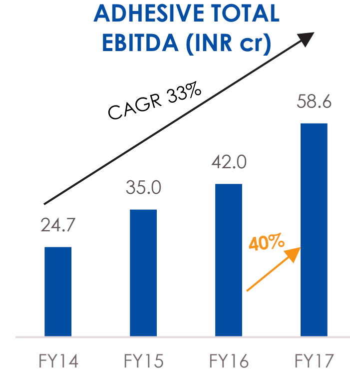
RESINOVA EBITDA (INR cr)



SEAL IT - UK & USA EBITDA (INR cr)



ADHESIVE TOTAL EBITDA (INR cr)

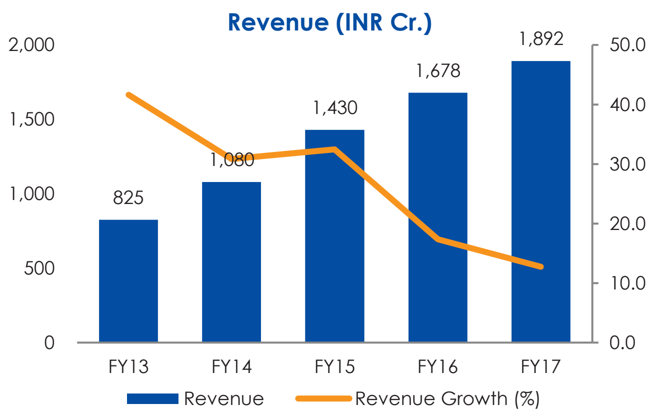


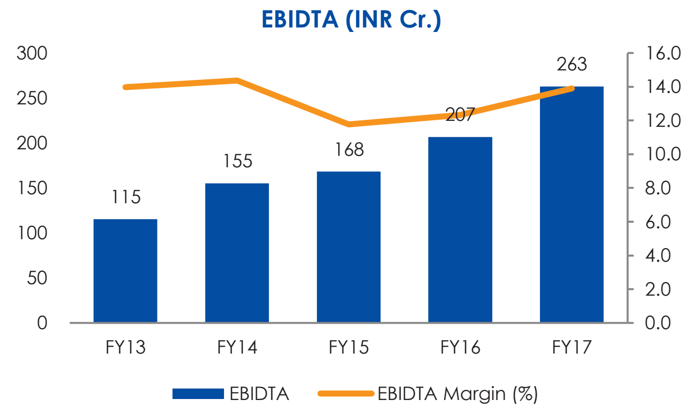
Source: Edelweiss Investment Research

Product portfolio

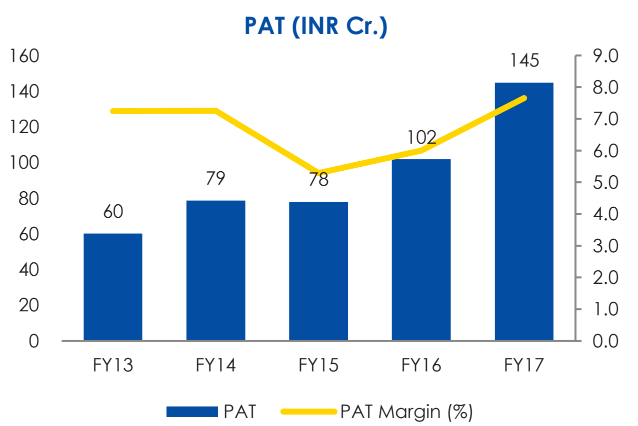
Financial analysis

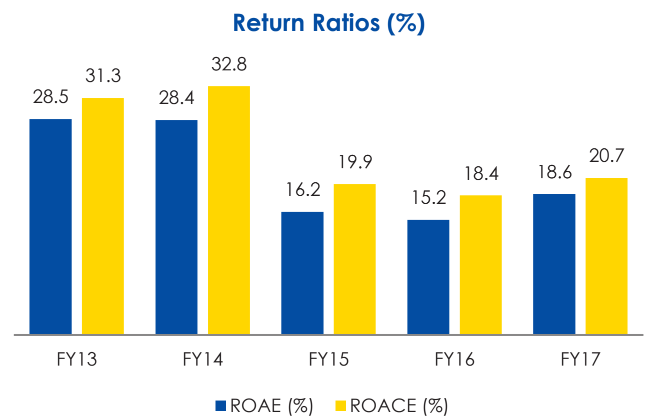
Consolidated revenue grew at a CAGR of 27% in the last four years from INR 825cr in FY13 to INR 1,892cr in FY17 on account of continuous capacity increases in the pipes and adhesives divisions alongside an increase in distribution reach. Margin improvement was owing to backward integration of its CPVC pipes segment and increase in B2C adhesive sales. PAT grew from INR 60cr in FY13 to INR 145cr in FY17 with a CAGR of 30% over the last five years. Astral has a limited capex plan and expected to improve cash flow generation. Post FY19, Astral's key focus will be to improve utilisation and increase market penetration, which will likely lead to improving returns.





Source: Edelweiss Investment Research





Source: Edelweiss Investment Research

Financials

Income statement (INR cr)

Year to March	FY15	FY16	FY17
Income from operations	1,430	1,678	1,892
Direct costs	1,078	1,237	1,350
Employee costs	48	75	89
Other expenses	183	234	279
Total operating expenses	1,262	1,471	1,629
EBITDA	168	207	263
Depreciation and amortisation	36	42	50
EBIT	132	165	213
Interest expenses	25	30	18
Other income	3	-3	7
Profit before tax	110	132	201
Provision for tax	31	30	56
Core profit	78	102	145
Extraordinary items	-0	-0	0
Profit after tax	78	102	145
Minority Interest	-2	-1	0
Share from associates	0	0	0
Adjusted net profit	76	101	145
Equity shares outstanding (mn)	12	12	12
EPS (INR) basic	6.4	8.4	12.1
Diluted shares (Cr)	11.8	12.0	12.0
EPS (INR) fully diluted	6.4	8.4	12.1
Dividend per share	0.4	0.4	0.5
Dividend payout (%)	5.7	4.7	4.1

Common size metrics- as % of net revenues

Year to March	FY15	FY16	FY17
Operating expenses	88.2	87.7	86.1
Depreciation	2.5	2.5	2.7
Interest expenditure	1.8	1.8	1.0
EBITDA margins	11.8	12.3	13.9
Net profit margins	5.3	6.0	7.7

Growth metrics (%)

Year to March	FY15	FY16	FY17
Revenues	32.4	17.3	12.7
EBITDA	8.5	22.9	27.1
PBT	4.8	20.1	52.6
Net profit	(1.4)	30.4	41.8
EPS	(8.7)	31.5	43.4

Balance sheet (INR cr)

As on 31st March	FY15	FY16	FY17
Equity share capital	12	12	12
Preference Share Capital	0	0	0
Reserves & surplus	607	696	835
Shareholders funds	619	708	847
Secured loans	188	197	225
Unsecured loans	15	0	3
Borrowings	203	197	227
Minority interest	17	13	12
Sources of funds	**838**	**918**	**1,086**
Gross block	697	687	830
Depreciation	140	42	89
Net block	557	645	741
Capital work in progress	27	15	25
Total fixed assets	584	660	766
Unrealised profit	0	0	0
Investments	0	0	0
Inventories	266	277	272
Sundry debtors	233	227	339
Cash and equivalents	12	50	17
Loans and advances	58	59	48
Other current assets	0	0	0
Total current assets	568	614	675
Sundry creditors and others	300	359	339
Provisions	8	2	7
Total CL & provisions	308	361	346
Net current assets	260	253	329
Net Deferred tax	-18	-21	-26
Misc expenditure	12	26	18
Uses of funds	**838**	**918**	**1,086**
Book value per share (INR)	52	59	71
	0	0	-0

Cash flow statement

Year to March	FY15	FY16	FY17
Net profit	78	102	144
Add: Depreciation	36	42	50
Add: Misc expenses written off	-2	-14	9
Add: Deferred tax	6	3	6
Add: Others	-2	-1	0
Gross cash flow	116	132	209
Less: Changes in W. C.	87	-46	110
Operating cash flow	29	178	99
Less: Capex	323	118	156
Free cash flow	**-293**	**59**	**-57**

Ratios

Year to March	FY15	FY16	FY17
ROAE (%)	16.2	15.2	18.6
ROACE (%)	19.9	18.4	20.7
Debtors (days)	59	49	65
Current ratio	1.8	1.7	2.0
Debt/Equity	0.3	0.3	0.3
Inventory (days)	68	60	53
Payable (days)	77	78	65
Cash conversion cycle (days)	51	32	52
Debt/EBITDA	1.2	1.0	0.9
Adjusted debt/Equity	0.3	0.2	0.2

Valuation parameters

Year to March	FY15	FY16	FY17
Diluted EPS (INR)	6.4	8.4	12.1
Y-o-Y growth (%)	*(8.7)*	*31.5*	*43.4*
CEPS (INR)	9.5	11.9	16.3
Diluted P/E (x)	125.3	95.3	66.4
Price/BV(x)	15.4	13.6	11.4
EV/Sales (x)	6.8	5.8	5.2
EV/EBITDA (x)	57.6	47.2	37.4
Diluted shares O/S	11.8	12.0	12.0
Basic EPS	6.4	8.4	12.1
Basic PE (x)	125.3	95.3	66.4
Dividend yield (%)	0.0	0.0	0.1

Finolex Industries Ltd.

CMP INR 623 Target INR 800

Rating: BUY Upside: 28%

Integrated PVC pipe manufacturer

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Kshitij Kaji
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Largest agricultural PVC pipe player

Finolex Industries Ltd. (FIL), erstwhile Finolex Pipes, was incorporated in 1981. It is the largest PVC pipes manufacturer in India. The company started as a rigid PVC pipe manufacturer before opting for backward integration in 1994 to manufacture PVC resins. The company has two divisions: PVC resins and pipes, mostly PVC pipes. Recently the company started CPVC pipe manufacture in a tie-up with Lubrizol for CPVC compounds. FIL is one of the largest PVC resin manufacturers with capacity of 270,000 MT. The PVC pipes division produces 290,000 MT and for CPVC, FIL has signed an agreement for the manufacture and sale of Finolex FlowGuard Plus pipes and fittings in India with Lubrizol.

Market leader in agri PVC pipes with strong brand saliency

FIL is the largest PVC pipes manufacturer in India (~15% organized market share). Over the years, the company has established strong brand saliency in agricultural PVC pipes. Further, its PVC pipes are sold to its dealers on the cash-and-carry model — a reflection of its strong brand equity. The company guided to take piping capacity to 450,000 MT (a mix of agri and non-agri businesses). The increase in SKUs (to ~1,500 from 1,400 in FY17), dealer network (added 100 in FY17 over the base of ~800) and sub-dealer network (rose to 18,000), increasing high-margin products (130 SKUs of CPVC, which is continuously increasing) and rise in internal consumption of PVC resin (at 79% internal consumption in Q1FY18), will likely drive sales and maintain margins ahead.

PVC resin internal consumption increasing

FIL has shifted focus from the PVC resins business to pipes, which is likely to improve overall RoCEs and reduce earnings volatility. As at FY13, the pipes business accounted for 63% of total revenue, which is expected to increase to more than 90% by FY18E. The spreads between PVC and EDC has been US$ 725 per MT as the price of EDC has been reducing with capacity addition in EDC and chlorine. The price of PVC resin has fallen with currency movement; however, spread has improved and will benefit the company ahead.

Outlook and valuation: Fundamentals intact; Maintain BUY

FIL continues to improve its revenues from: (i) PVC pipes and fittings and its new line of business — CPVC pipes (expected to reach 50,000 MTPA by FY20); (ii) margin expansion with product mix change in favour of high-margin products; and (iii) reduced forex losses (via appropriate hedging). All of this will likely result in strong earnings growth going forward. FIL is trading at a P/E of 19x FY19E and 17x FY20E earnings, delivering sustainable RoCE of ~20%+. We maintain 'BUY'.

Bloomberg:	FNXP:IN
52-week range (INR):	756.05/390.00
Share in issue (cr):	12.4
M cap (INR cr):	7,835
Avg. Daily Vol. BSE/NSE :('000):	37
Promoter Holding (%)	52.47

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Revenues (INR Cr)	2,843	2,988	3,270	3,682	4,231
Rev growth (%)	14.8	5.1	9.5	12.6	14.9
EBITDA (INR Cr)	404	563	474	629	723
Net Profit (INR Cr)	254	352	290	398	464
P/E (x)	33.6	21.9	26.6	19.4	16.7
EV/Sales (x)	2.8	2.6	2.4	2.1	1.8
RoACE (%)	20.7	23.3	16.2	20.6	22.1
RoAE (%)	19.5	18.2	12.3	15.6	16.8

Date: 4th December, 2017

Finolex Industries — Segment details

Finoflex Industries has three business verticals; **PVC pipes & fittings** (manufactures a wide range of products catering to the agriculture and non-agriculture sectors), **PVC resin** (manufactures high quality resin providing consistent raw material for captive consumption and sales in the open market) and **power plant** energy production (produces power for captive consumption).

Agriculture Segment Products

Agriculture pipes and fittings

- Selfit PVC-U Pipes
- Ringfit PVC-U Pipes
- Various types of moulded and fabricated fittings

Casting pipes

- CS Casing Pipes
- CM Casing Pipes
- Screen Pipes with ribs
- SDR series Casing Pipes

Column pipes

- PVC-U Column Pipes

Solvent cement

- PVC-U Solvent cement for agriculture applications
- PVC-U Solvent cement for higher dia agriculture applications
- Rubber Lubricant

Non-Agri Segment Products

Finolex FlowGuard Plus CPVC pipes and fittings

- Finolex FlowGuard Plus CPVC pipes
- Various types of Finolex FlowGuard fittings

Plumbing pipes and fittings

- Heavy Pressure Plumbing Pipes
- ASTM PVC-U Pipes
- Various types of fittings

Sewerage pipes (Underground Drainage Pipes)

- Selfit sewerage pipes
- Ringfit sewerage pipes

Solvent cement

- Medium duty PVC-U Solvent cement for plumbing applications
- Heavy duty PVC-U Solvent cement for plumbing applications
- PVC-U Solvent cement for SWR applications
- CPVC solvent cement for hot and cold water plumbing applications
- Rubber Lubricant
- Primer

SWR pipes and fittings

- SWR Selfit pipes
- SWR pipes with integrated rings
- SWR Selfit moulded fittings and SWR fittings with integrated rings

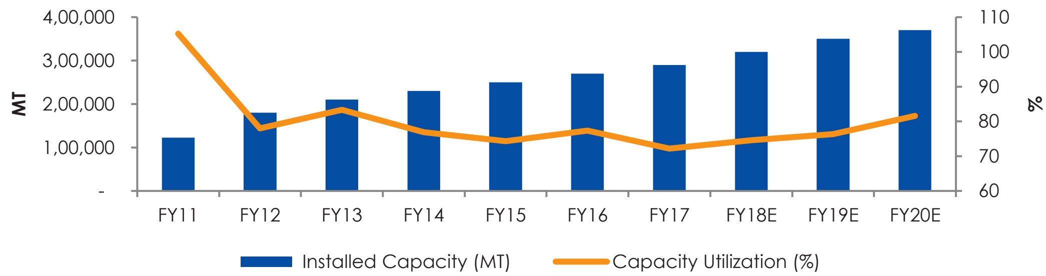
Plastic Pipe: Wide Product Portfolio

Source:Edelweiss Investment Research

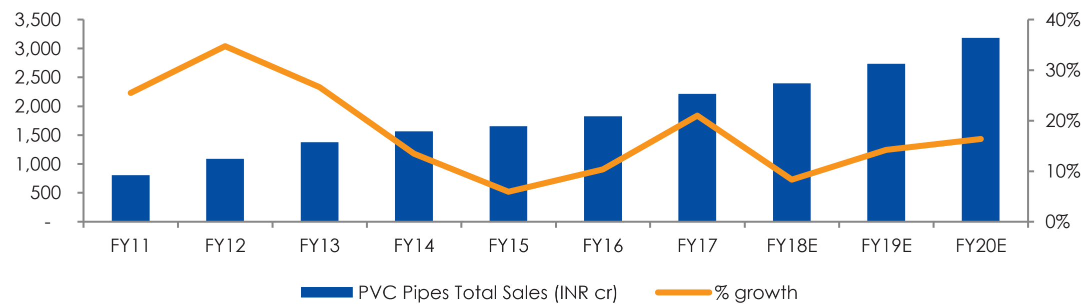
Market leader in PVC pipes with strong brand saliency

FIL is the largest PVC pipes manufacturer in India (~28% organised market share). The company's PVC pipes division produces 290,000 MT spread across its two ultra modern plants in Pune and Ratnagiri. FININD also manufactures specialty pipes and fittings, namely SWR (soil, waste and rain water) pipes and fittings for the construction and agri industry. Over the years, the company has established a strong brand saliency in agricultural PVC pipes. Moreover, its PVC pipes are largely sold to its dealers on the cash-and-carry model, which is a reflection of its strong brand equity.

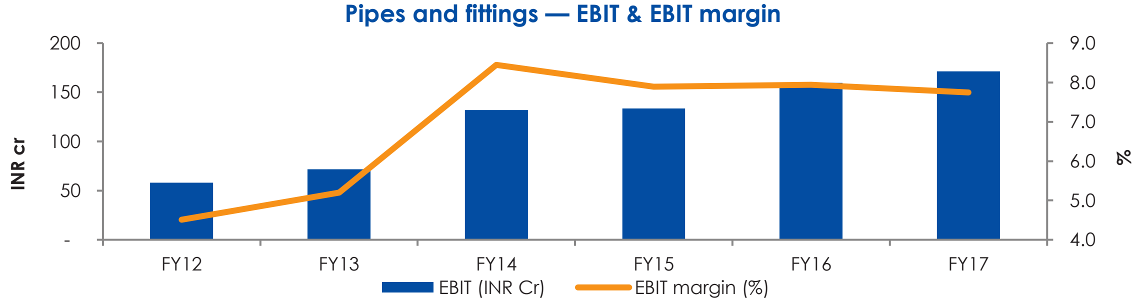
Pipes and fittings — Sales volume and growth



Pipes and fittings — Sales and growth



Pipes and fittings — EBIT & EBIT margin



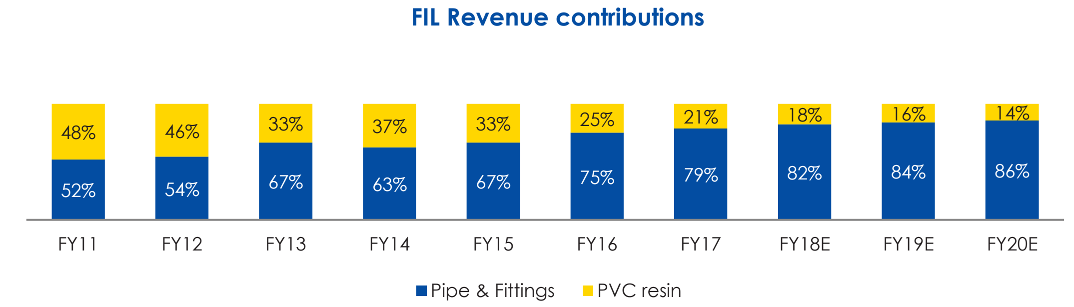
Manufacturing facilities and capacity expansion

Location	Product	Capacity (MTPA)
Ratnagiri, Maharashtra	PVC resin	2,72,000
Ratnagiri, Maharashtra		
Urse, Pune, Maharashtra	PVC Pipes	2,90,000
Masar, Gujarat		

Source: Edelweiss Investment Research

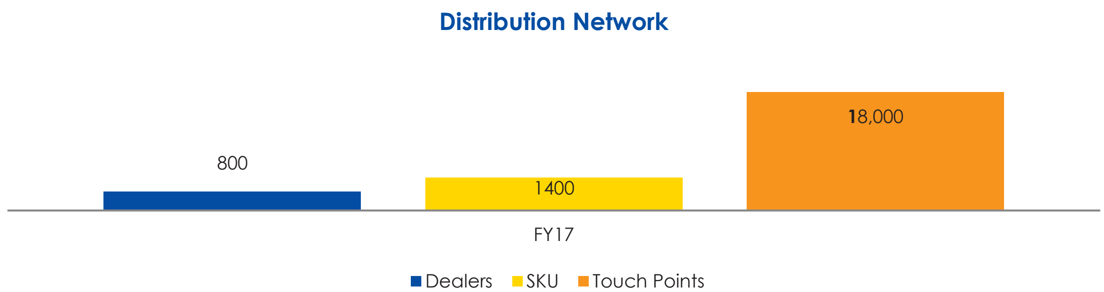
Shifting focus from PVC resin (B2B) to PVC pipes (B2C) to reduce earnings volatility

FIL has shifted its focus from the business of PVC resins to PVC pipes, which will likely improve overall RoCEs and reduce earnings volatility. The company expects to use the excess capacity of PVC resins for captive consumption of PVC pipes business. As at FY13, PVC pipes business accounted for 63% of total revenues, which is expected to increase in the forthcoming years.



Strong distribution network

The company has a robust distribution network with 800 dealers and about 18,000 touch points across India. Th company has four distribution warehouses: Chinchwad, Cuttack, Delhi and Indore and 10 branch offices in India.



Source: Edelweiss Investment Research

Finolex Industries – Key strategies

EXPANDING FOOTPRINT

Expand distribution network in all geographies with higher focus in the northern and eastern regions

CAPACITY EXPANSION

Increase installed capacities of PVC pipes and fittings in order to capture expected increase in demand.

CASH-N-CARRY

Follow Cash-n-carry model to keep the balance sheet light.

BRANDING

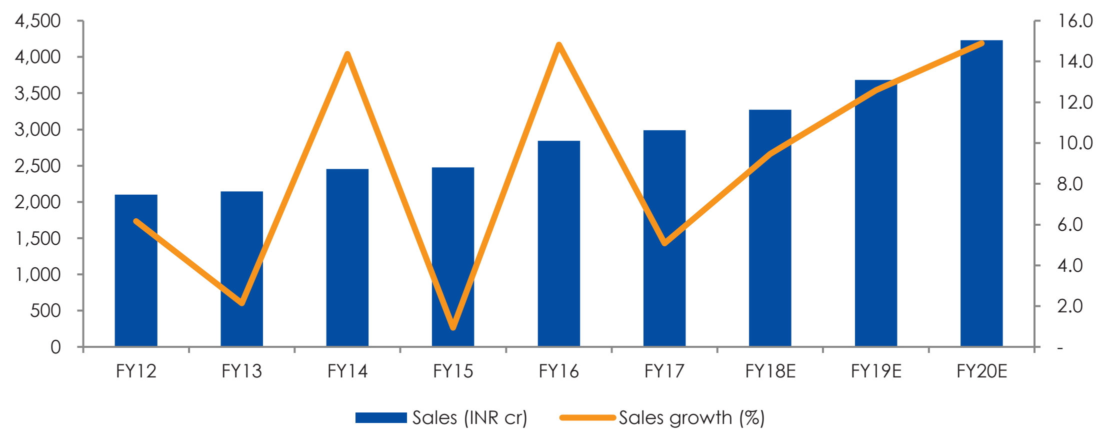
Promote brand and quality consciousness amongst consumer.

Source: Edelweiss Investment Research

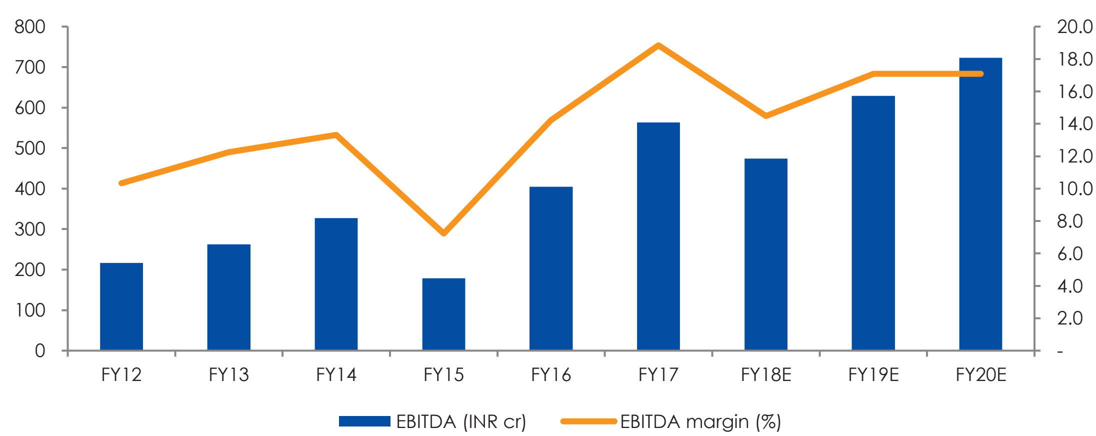
Financial Analysis

FIL has delivered sales/EBITDA/PAT CAGR of 4%/11%/19%, respectively, over FY12-17. Its pipe and fittings capacity has grown from 1,80,000 MT to 2,90,000 MT and operates at ~75-77% utilisation. However, PVC resin sales have reduced with the increase in internal consumption of PVC resin. FIL's return ratios are set to expand significantly on the back higher margins, lower forex losses and improved asset turns due to reduction in excess buyers' credit. With the company now availing far lesser trade credit, this could result in a significant reduction in working capital debt going forward, which in turn would trim its balance sheet size. Increased earnings, resulting from higher margins and anticipation of lower forex losses over the next three-years could significantly expand RoCEs to +20% over FY17-18E.

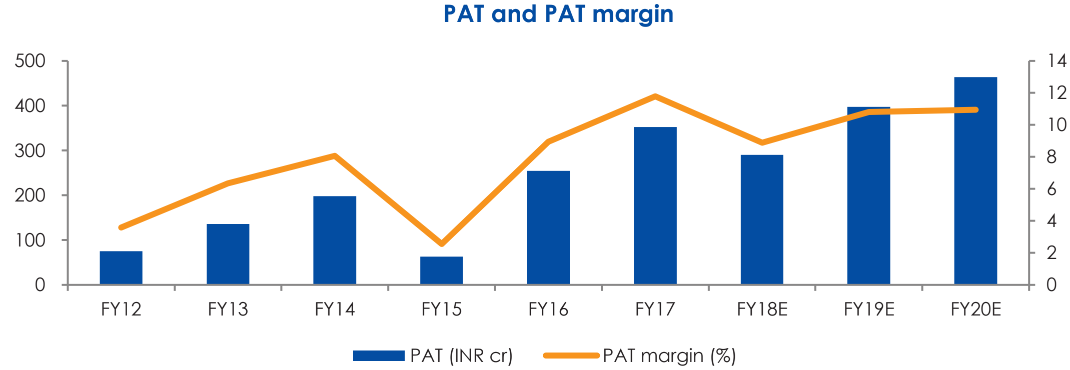
Revenue and revenue growth

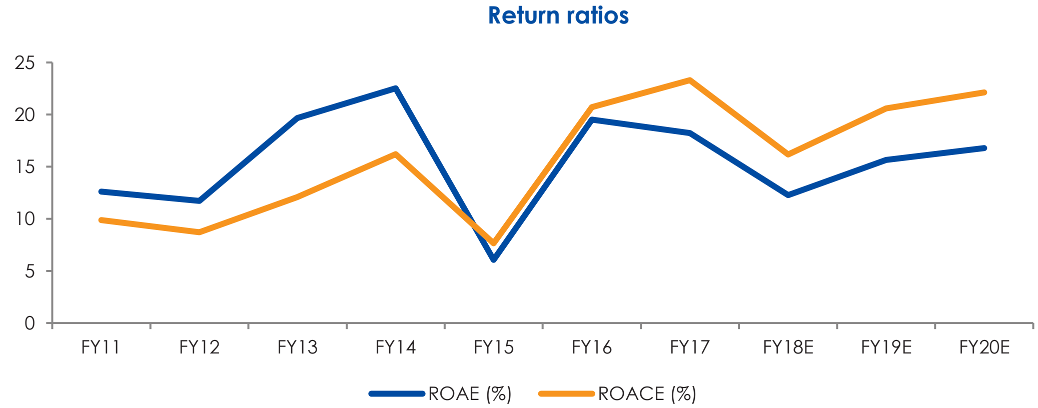


EBITDA and EBITDA margin



Source: Edelweiss Investment Research





Source: Edelweiss Investment Research

Financials

Income statement (INR Cr)

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Income from operations	2,843	2,988	3,270	3,682	4,231
Direct costs	2,009	1,995	2,257	2,541	2,919
Employee costs	93	105	115	129	149
Other expenses	430	430	540	512	589
Total operating expenses	2,439	2,425	2,797	3,053	3,508
EBITDA	404	563	474	629	723
Depreciation and amortisatio	51	55	59	59	59
EBIT	354	508	415	570	664
Interest expenses	45	15	15	16	16
Other income	40	24	27	29	32
Profit before tax	349	517	427	584	680
Provision for tax	119	165	136	186	217
Core profit	230	352	291	398	463
Extraordinary items	24	0	0	0	0
Profit after tax	254	352	291	398	463
Minority Interest	0	0	0	0	0
Share from associates	0	0	0	0	0
Adjusted net profit	254	352	291	398	463
Equity shares outstanding (Cr)	12	12	12.4	12	12
EPS (INR) basic	18.5	28.4	23.4	32.0	37.3
Diluted shares (Cr)	12.4	12.4	12.4	12.4	12.4
EPS (INR) fully diluted	18.5	28.4	23.4	32.0	37.3
Dividend per share	10.0	11.5	9.5	13.0	15.1
Dividend payout (%)	54.0	40.5	40.5	40.5	40.5

Common size metrics- as % of net revenues

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Operating expenses	85.8	81.2	85.5	82.9	82.9
Depreciation	1.8	1.8	1.8	1.6	1.4
Interest expenditure	1.6	0.5	0.5	0.4	0.4
EBITDA margins	14.2	18.8	14.5	17.1	17.1
Net profit margins	8.9	11.8	8.9	10.8	10.9

Growth metrics (%)

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Revenues	14.8	5.1	9.5	12.6	14.9
EBITDA	125.9	39.2	(15.8)	32.8	14.9
PBT	331.7	48.2	(17.5)	36.8	16.5
Net profit	381.0	53.2	(17.5)	36.8	16.5
EPS	381.0	53.2	(17.5)	36.8	16.5

Balance sheet (INR Cr)

As on 31st March	FY16	FY17	FY18E	FY19E	FY20E
Equity share capital	124	124	124	124	124
Preference Share Capital	0	0	0	0	0
Reserves & surplus	1,446	2,167	2,317	2,521	2,759
Shareholders funds	1,570	2,291	2,441	2,645	2,883
Secured loans	112	94	124	124	124
Unsecured loans	99	0	0	20	20
Borrowings	211	94	124	144	144
Minority interest	0	0	0	0	0
Sources of funds	**1,781**	**2,386**	**2,565**	**2,789**	**3,027**
Gross block	1,926	1,987	2,051	2,115	2,179
Depreciation	1,077	1,132	1,191	1,250	1,309
Net block	850	855	860	865	870
Capital work in progress	7	22	22	22	22
Total fixed assets	856	877	882	887	892
Unrealised profit	0	0	0	0	0
Investments	817	1,222	1,322	1,442	1,592
Inventories	447	557	610	687	789
Sundry debtors	18	52	57	65	74
Cash and equivalents	10	16	33	48	19
Loans and advances	0	0	0	0	0
Other current assets	0	0	0	0	0
Total current assets	475	626	701	800	883
Sundry creditors and others	375	361	361	361	361
Provisions	12	12	12	12	12
Total CL & provisions	387	374	374	374	374
Net current assets	89	253	327	427	510
Net Deferred tax	-103	-91	-91	-91	-91
Misc expenditure	122	125	125	125	125
Uses of funds	**1,781**	**2,386**	**2,565**	**2,789**	**3,027**

Cash flow statement (INR crs)

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Net profit	205	352	291	398	463
Add: Depreciation	51	55	59	59	59
Add: Misc expenses written	-72	-3	0	0	0
Add: Deferred tax	-8	-12	0	0	0
Add: Others	0	0	0	0	0
Gross cash flow	176	392	350	457	522
Less: Changes in W. C.	-337	158	58	84	112
Operating cash flow	513	234	292	373	410
Less: Capex	29	76	64	64	64
Free cash flow	**485**	**158**	**228**	**309**	**346**

Ratios

Year to March	FY16	FY17	FY18E	FY19E	FY20E
ROAE (%)	19.5	18.2	12.3	15.6	16.8
ROACE (%)	20.7	23.3	16.2	20.6	22.1
Debtors (days)	2	6	6	6	6
Current ratio	1.2	1.7	1.9	2.1	2.4
Debt/Equity	0.1	0.0	0.1	0.1	0.1
Inventory (days)	57	68	68	68	68
Payable (days)	48	44	40	36	31
Cash conversion cycle (days)	12	30	34	39	43
Debt/EBITDA	0.5	0.2	0.3	0.2	0.2
Adjusted debt/Equity	0.1	0.0	0.0	0.0	0.0

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Diluted EPS (INR)	18.5	28.4	23.4	32.0	37.3
Y-o-Y growth (%)	*381.0*	*53.2*	*(17.5)*	*36.8*	*16.5*
CEPS (INR)	22.6	32.8	28.2	36.8	42.1
Diluted P/E (x)	33.6	21.9	26.6	19.4	16.7
Price/BV(x)	4.9	3.4	3.2	2.9	2.7
EV/Sales (x)	2.8	2.6	2.4	2.1	1.9
EV/EBITDA (x)	19.6	13.9	16.5	12.4	10.9
Diluted shares O/S	12.4	12.4	12.4	12.4	12.4
Basic EPS	18.5	28.4	23.4	32.0	37.3
Basic PE (x)	33.6	21.9	26.6	19.4	16.7
Dividend yield (%)	1.6	1.8	1.5	2.1	2.4

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Prince Pipes and Fittings Ltd.

Rating: Not Rated

One among key organised players

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Beneficiary of GST implementation

The Prince Group, incorporated in 1970, is among the leading polymer pipes and fittings manufacturers in India. The company entered PVC pipes manufacturing in 1983 with the name, Prince Pipes and Fittings Pvt Ltd (PRINCE). PRINCE is a national player in the manufacturing of PVC, PPR and CPVC pipes and fittings with a capacity of 179,849 MTPA. The company markets products under two brand names — Prince Piping Systems and Trubore Piping Systems.

Continues to optimise market penetration and product mix to improve margins

Being among the leading organised players, PRINCE has a share of ~5%, and more than 7,500 SKUs. Sales comprise 42% from plumbing, 36% from irrigation, 21% from sewage disposal use and 1% from others. PRINCE has five manufacturing facilities and 766 pan-India distributors who have assisted in market penetration – 40%, 26%, 25% and 9% of the company's total sales arises from the north, south, west and eastern India respectively. PRINCE has increased its plumbing products (42% of total sales) that rein in higher margins, as well as improve the mix of pipes and fittings to maximize margins. PRINCE has plans to increase the product portfolio of its premium brand, Trubore, acquired in October 2012, to cater to the building and infrastructure segment; this is expected to enhance margins.

Expanding capacity and reach

PRINCE has plans to set up two manufacturing plants, one in Jobner (Rajasthan) with an installed capacity of 55,750 MTPA (to be operational by FY19) and the other in Sangareddy (Telangana) with an installed capacity of 91,332 MTPA (to be operational by FY20). Also, these facilities will enable PRINCE to reduce the lead time for its stock to reach distributors based in southern India. PRINCE is also focused on improving its distribution network throughout India, by increasing the number of retailers, cities under coverage and sales force.

Outlook

The unorganised players mostly compete with organised players on the parameter of prices rather than quality. Prices of products manufactured by the unorganised segment are lower, as tax compliance by these players is lower unlike organised players. Thus, post GST implementation, we believe, tax compliance by unorganised players will result in a reduced price differential between organised and unorganised players. Consequently a player such as PRINCE would be a major beneficiary. Industry is expected to grow at ~15% and we expect PRINCE to outperform the market on account of its brand strength, pan-India distribution, product portfolio and capacity expansion.

Year to March	FY15	FY16	FY17
Revenues (INR Cr)	957	1,009	1,314
Rev growth (%)	(4.9)	5.4	30.2
EBITDA (INR Cr)	86	98	162
Net Profit (INR Cr)	17	29	74
P/E (x)	–	–	–
EV/EBITDA (x)	–	–	–
RoACE (%)	11.8	14.7	25.6
RoAE (%)	11.3	17.0	34.9

Date: 4th December, 2017

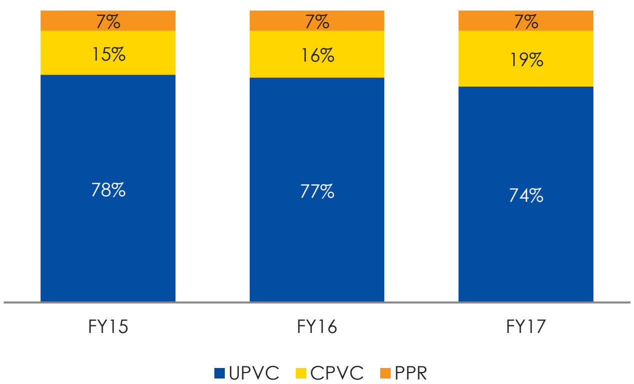
PRINCE: Product range and portfolio expansion

Prince Pipes manufactures polymer pipes and fittings using four different polymers: UPVC; CPVC; PPR; and PP. With a product range of more than 7,500 SKUs, PRINCE's products are used for varied applications; plumbing, sewage and sewage disposal. PRINCE markets its products under two brand names — Prince Piping Systems and Trubore Piping Systems. The company acquired the Trubore brand in October 2012, this brand has had a long history in the Tamil Nadu market. PRINCE is among the only two companies in India to manufacture products across the UPVC, CPVC and PPR polymers. PRINCE plans to further expand its products portfolio by entering the HDPE segment with DWC pipes.

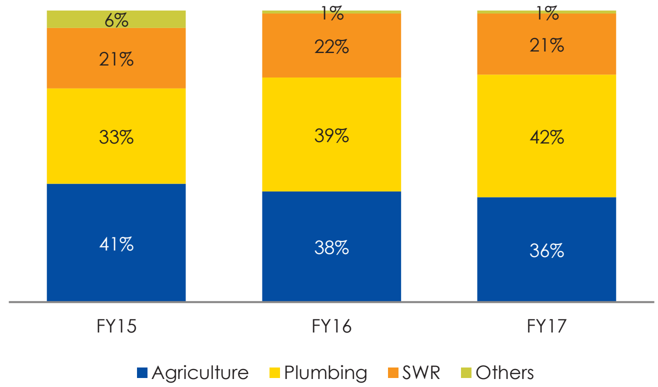
End Use	Polymer	Products	Brand
Plumbing	UPVC	RAINFIT – roof-water collection and disposal.	Prince Piping Systems
		EASYFIT – plumbing systems for easy installation.	
		UPVC Plumbing Systems – user-friendly for indoor and outdoor use in hot and cold water applications, in residential complexes and commercial buildings, public utilities and swimming pools, RO and DM water plants, and for concealed, down take and terrace looping.	Trubore Piping Systems
	CPVC	SMARTFIT – hot and cold plumbing systems.	Prince Piping Systems
		CPVC Plumbing Systems – all-weather plumbing systems for indoor and outdoor use in hot and cold water applications (from 0°C to 93°C only), in residential and commercial buildings, public utilities, swimming pools and industrial applications, RO and DM water plants, and for concealed, down take and terrace looping.	Trubore Piping Systems
	PPR	GREENFIT – use in commercial buildings and industrial applications.	Prince Piping Systems
Irrigation	UPVC	SAFEFIT – borewell systems for groundwater extraction complement the agriculture piping systems.	Prince Piping Systems
		AQUAFIT – pressure and non-pressure piping systems in the agriculture segment.	
	UPVC	Agri Pressure and Non-Pressure Piping Systems – use in agriculture sector for water supply and distribution schemes, and irrigation; other uses – drinking water supply and distribution, cable ducting, ventilation pipe line and slurry lines.	Trubore Piping Systems
	UPVC	Borewell Piping Systems – for safe extraction of ground water in farms and fields, and for connections to residential and commercial building, public places, etc.	
Sewage Disposal	UPVC	ULTRAFIT – Soil, Waste and Rainwater (SWR) systems with world-class seals.	Prince Piping Systems
		SILENTFIT – low-noise SWR piping systems.	
		FOAMFIT – underground drainage pipes with solid PVC inner and outer layer to prevent disfiguration under heavy underground loads.	
		DRAINFIT – conventional underground UPVC drainage pipes.	
		UPVC Underground Drainage Pipes – underground drainage systems.	Trubore Piping Systems
	Others	DURAFIT – durable manhole and chamber covers.	Prince Piping Systems
	UPVC	SWR Piping Systems – for inside and outside building drainage systems including ventilation, rain water discharge and harvesting for residential buildings/complexes and commercial, and for application in industrial buildings and public utilities.	Trubore Piping Systems

Source: Edelweiss Investment Research

Product-wise Revenue Mix



End-usage Revenue Mix (% of Revenue)



Source: Edelweiss Investment Research

A major share of its revenue (~74% of gross; INR 994 crore) arises from the UPVC division, followed by CPVC (INR 255 crore) and then PPR (INR 94 crore). PRINCE also manufactures products using PP but revenue from the division is insignificant.

PRINCE: Expanding its product portfolio

The company plans to expand the reach of its products for applications in the underground drainage division by entering the HDPE segment with DWC pipes. DWC pipes are used in underground sewer systems, are optimised for maximum efficiency, and have advantages in handling, storage , installation and maintenance.

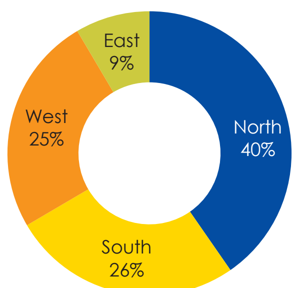
The 'Trubore brand' escapades

The Trubore brand has had a long history in the Tamil Nadu market; however its products are primarily sold to the agricultural segment. PRINCE plans to increase the product portolio under the brand name to cater to the building industry as well as to the infrastructure segment. The company plans to increase its marketing efforts and increase the number of dealers for the Trubore brand outside Tamil Nadu to help them increase sales in existing as well as new geographies.

Strategically located manufacturing facilities

The company has established five plants which are stituated across the country, and has contract manufacturers in Haridwar (Uttarakhand), Chennai (Tamil Nadu) and Kolhapur(Maharashtra). The pan-India facilities have assisted in market penetration and developing a strong presence in the north, west and south of India.

Geographical Mix



Source: Edelweiss Investment Research

Manufacturing facilitie

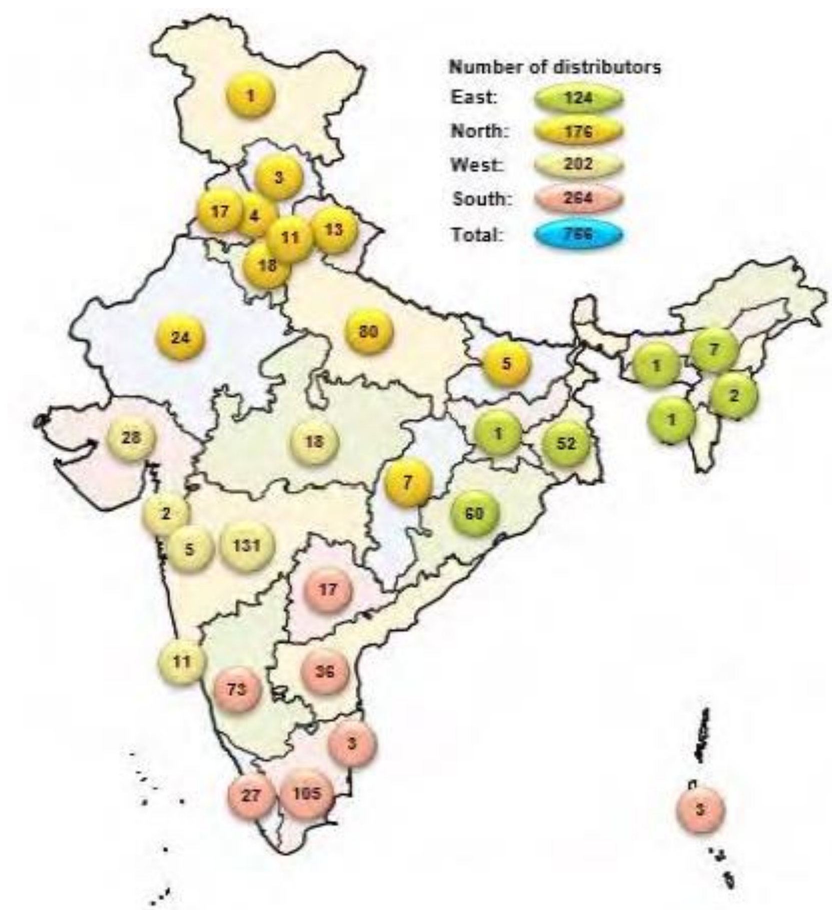
Location	Product	Capacity
Haridwar, Uttarakhand	Pipes & fittings	67,044 TNPA
Dadar, Maharashtra	Pipes	61,517 TNPA
Chennai, TN	Pipes	43,675 TNPA
Kolhapur, Maharashtra	Pipes	23,501 TNPA
Athal	Fittings	14,909 TNPA

PRINCE: Expanding capacity

The company plans to set up two new manufacturing units: one in Jobner, Rajasthan with a capacity of 55,750 TPA and the other in Sangareddy, Telangana with a capacity of 91,322 TPA. The Rajasthan plant is expected to commence production in FY19 and the Telangana plant, in FY20. Both these plants will manufacture DWC pipes alongside UPVC and CPVC products.

Distiribution network

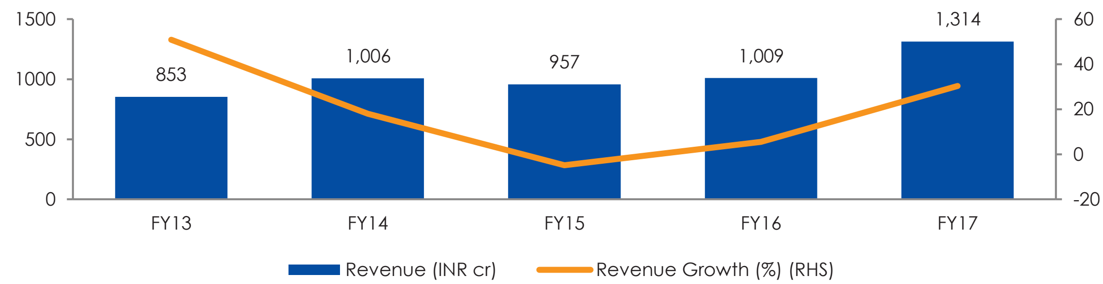
The company has a pan-India distribution network with about 766 distributors countrywide. The company has enhanced its distribution network by 20% compared with FY16.

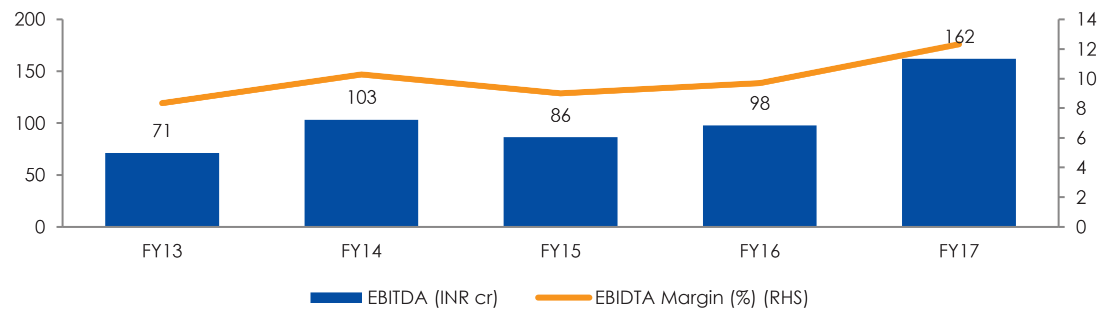


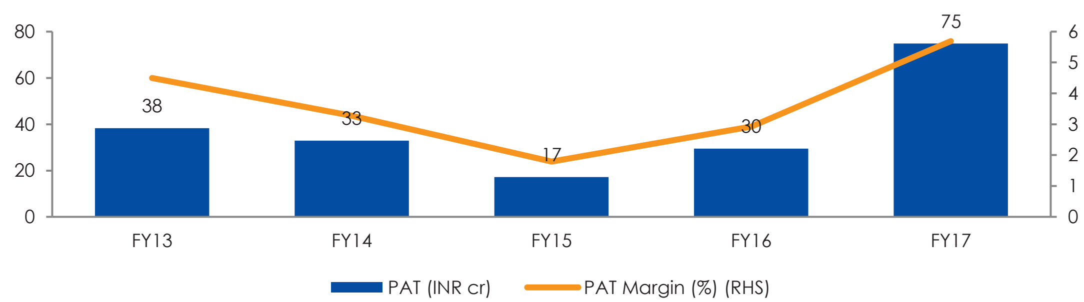
Source: Edelweiss Investment Research

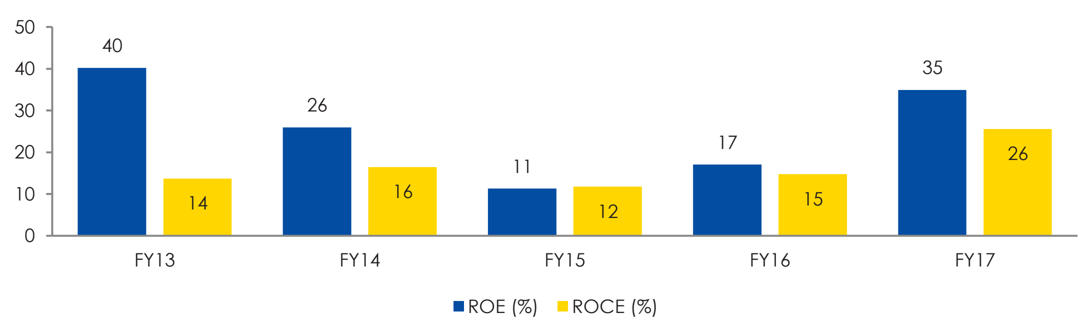
Financial Analysis

The consolidated revenue of the company grew at a CAGR of 17% over the last two years with revenue of INR 1,314 crore in FY17. PAT grew at a staggering 109% CAGR over the last five years owing to margins having improved to 5.7% in FY17 from 1.8% in FY15. The company also witnessed strong growth in RoE and RoCE over the past two years.









Source: Edelweiss Investment Research

Financials

Income statement			(INR cr)
Year to March	**FY15**	**FY16**	**FY17**
Income from operations	957	1,009	1,314
Direct costs	755	775	978
Employee costs	47	51	58
Other expenses	116	136	174
Total operating expenses	871	911	1,152
EBITDA	86	98	162
Depreciation and amortisation	29	29	32
EBIT	58	69	130
Interest expenses	37	33	36
Other income	2	1	1
Profit before tax	22	37	95
Provision for tax	5	7	21
Core profit	17	29	74
Extraordinary items	0	0	0
Profit after tax	17	30	75
Minority Interest	0	0	0
Share from associates	0	0	0
Adjusted net profit	17	30	75
Equity shares outstanding (mn)	48	48	45
EPS (INR) basic	0.4	0.6	1.7
Diluted shares (Cr)	48.0	48.0	45.0
EPS (INR) fully diluted	0.4	0.6	1.7
Dividend per share	0.0	0.0	0.0
Dividend payout (%)	0.0	0.0	0.0

Common size metrics- as % of net revenues			
Year to March	**FY15**	**FY16**	**FY17**
Operating expenses	91.0	90.3	87.7
Depreciation	3.0	2.8	2.4
Interest expenditure	3.9	3.3	2.7
EBITDA margins	9.0	9.7	12.3
Net profit margins	1.8	2.9	5.7

Growth metrics (%)			
Year to March	**FY15**	**FY16**	**FY17**
Revenues	(4.9)	5.4	30.2
EBITDA	(16.6)	13.4	65.6
PBT	(36.6)	63.6	161.1
Net profit	(48.0)	71.2	153.4
EPS	(48.0)	71.2	172.0

Balance sheet			(INR cr)
As on 31st March	**FY15**	**FY16**	**FY17**
Equity share capital	48	48	45
Preference Share Capital	0	0	0
Reserves & surplus	112	136	197
Shareholders funds	160	184	242
Secured loans	200	235	237
Unsecured loans	99	41	58
Borrowings	300	275	295
Minority interest	0	0	0
Sources of funds	**460**	**459**	**537**
Gross block	362	399	461
Depreciation	138	164	193
Net block	224	235	267
Capital work in progress	4	14	18
Total fixed assets	229	249	285
Unrealised profit	0	0	0
Investments	0	1	0
Inventories	113	101	174
Sundry debtors	212	239	237
Cash and equivalents	6	9	12
Loans and advances	29	44	44
Other current assets	0	0	0
Total current assets	359	392	467
Sundry creditors and others	103	160	188
Provisions	2	2	2
Total CL & provisions	105	163	191
Net current assets	255	230	276
Net Deferred tax	-11	-11	-12
Misc expenditure	-13	-11	-14
Uses of funds	**460**	**459**	**537**
Book value per share (INR)	3	4	5
	0	0	0

Cash flow statement			
Year to March	**FY15**	**FY16**	**FY17**
Net profit	17	29	74
Add: Depreciation	29	29	32
Add: Misc expenses written off	5	-2	3
Add: Deferred tax	0	-0	1
Add: Others	0	0	0
Gross cash flow	50	56	110
Less: Changes in W. C.	-37	-28	43
Operating cash flow	88	83	67
Less: Capex	30	49	68
Free cash flow	**57**	**34**	**-1**

Ratios			
Year to March	**FY15**	**FY16**	**FY17**
ROAE (%)	11.3	17.0	34.9
ROACE (%)	11.8	14.7	25.6
Debtors (days)	81	86	66
Current ratio	3.4	2.4	2.4
Debt/Equity	1.9	1.5	1.2
Inventory (days)	43	36	48
Payable (days)	39	58	52
Cash conversion cycle (days)	85	65	62
Debt/EBITDA	3.5	2.8	1.8
Adjusted debt/Equity	1.8	1.5	1.2

Valuation parameters			
Year to March	**FY15**	**FY16**	**FY17**
Diluted EPS (INR)	0.4	0.6	1.7
Y-o-Y growth (%)	*(48.0)*	*71.2*	*172.0*
CEPS (INR)	1.0	1.2	2.4
Diluted P/E (x)	-	-	-
Price/BV(x)	-	-	-
EV/Sales (x)	-	-	-
EV/EBITDA (x)	-	-	-
Diluted shares O/S	48.0	48.0	45.0
Basic EPS	0.4	0.6	1.7

Supreme Industries Ltd.

Diversified plastic processing player

CMP INR 1126
Rating: Not Rated

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Largest plastic processing company

Supreme Industries (SI) is one of the largest plastic processing companies in India, processing over 3.4 lakh MT annually. The company caters to the entire domestic plastic market with its capabilities of wider reach and strong brand. With introduction of GST, the share of organised players is expected to further improve and SI could be a key beneficiary. Historically, SI has been growing at 9% revenue CAGR and 10% PAT CAGR over the past five years (FY12-17) with positive cash flows and high RoCE of ~32%.

Sustained growth and new products to support market share

SI has delivered consistent ~7% volume growth in the plastics business over the last five years and continues to launch new products to maintain its market share. With 7,300 products in the plastic piping division, SI is a leading player in the cross laminated film products (Silpaulin) segment and the second largest player in the furniture segment. SI is expected to continue to remain in a dominant position with its wider reach and product mix. With introduction of GST, the share of organised players will likely further improve and SI could be a key beneficiary.

Focus on generating strong cash flows and high RoCE

SI has delivered impressive RoCE of ~32% with strong positive operating cash flows. The efficient assets utilisation (~2x) along with diverse products mix and increasing share of value added products has positively impacted margins. We expect return ratios of the company to improve further with rising utilisation of its Kharagpur plant.

Focus on value added products

SI is keenly focusing on increasing the sale of value added products in every business segment (currently ~34%) along with improving its distributor network and enhancing brand building. The company's business share of premium products in the furniture segment has increased to 48% and CPVC contribution to the piping segment has reached 15%+, which should improve profitability ahead.

Bloomberg:	SI:IN
52-week range (INR):	1,442.60/789.50
Share in issue (cr):	13
M cap (INR cr):	14,263
Avg. Daily Vol. BSE/NSE :('000):	36
Promoter Holding (%)	49.70

Outlook

With diversification in business mix, focus on value added products and improvement in macroeconomic environment (as the piping market grew at 1.5x GDP), we expect that SI will deliver consistent performance over the next few years. Further, the price of raw material is, to some extent, linked to the International crude price and the company is expected to maintain its gross margin. At CMP, Supreme is trading at 33x FY17 earnings.

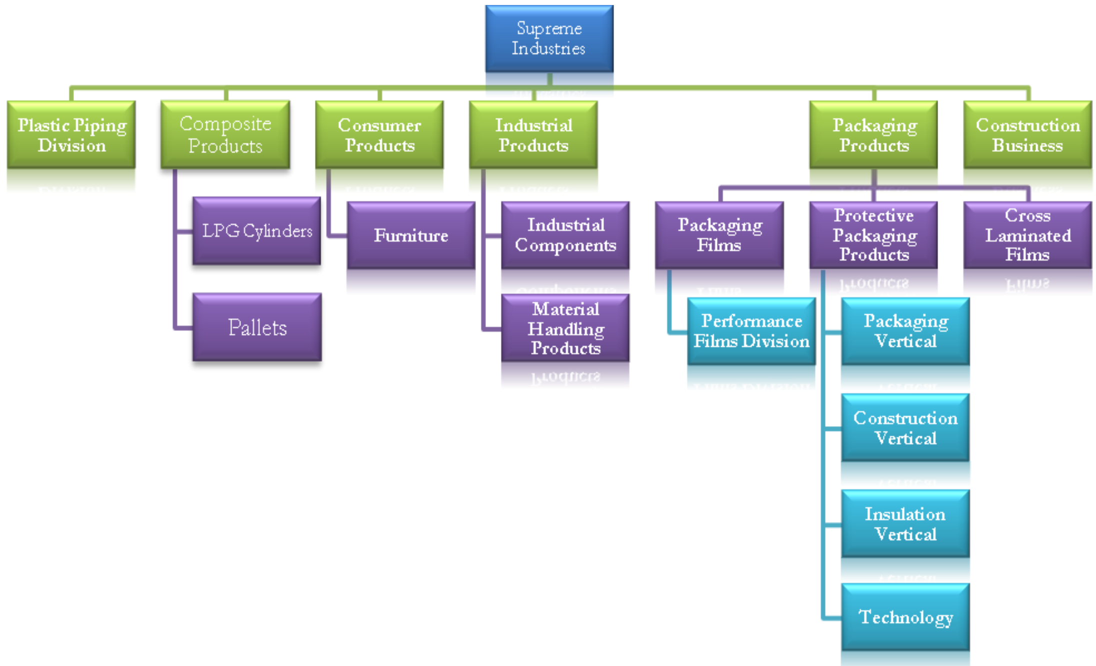
Year to March	FY15	FY16	FY17
Revenues (INR Cr)	4,255	2,960	4,584
Rev growth (%)	7.4	-7.2	16.2
EBITDA (INR Cr)	666	453	762
Net Profit (INR Cr)	310	209	375
P/E (x)	44.4	64.6	33.4
EV/EBITDA (x)	21.8	32.4	19.0
RoACE (%)	31.7	19.8	31.0
RoAE (%)	28.6	17.5	28.6

Date: 4th December, 2017

Supreme Industries – Diversified product portfolio

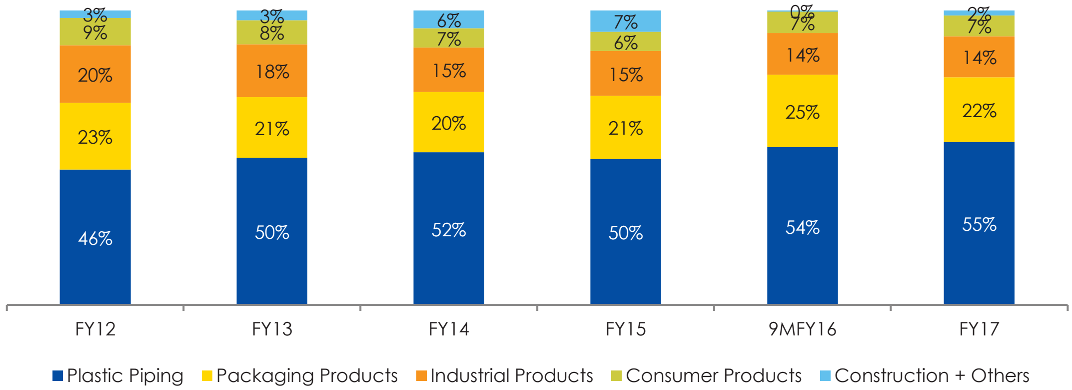
SI has diversified its business efficiently thereby mitigating the adverse impact of slowdown in any one product segment and catering to several end-user industries. SI has five business verticals — plastic piping system, consumer products, industrrial products, packaging products and composite products. Within these verticals SI has a wide variety of products. A major share of revenue is derived from the plastic piping segment.

SI – Business verticals

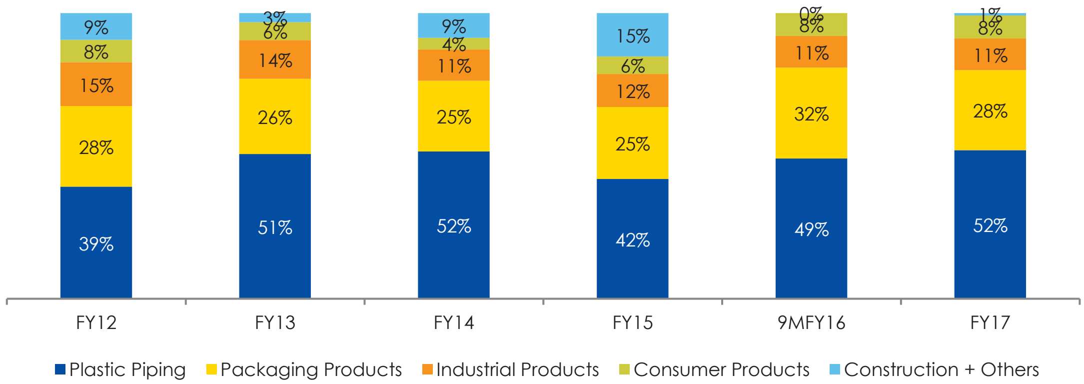


Business Vertical	Product Portfolio	Targeted Customer Segment
Plastic Piping System	uPVC Pipes, Injection Moulded fittings, Handmade fittings, Polypropylene Random, Co-polymer Pipes & Fittings, HDPE Pipe Systems, CPVC Pipes Systems, Inspection Chambers, Water Tanks, Septic Tanks, DWC HDPE PIPE, Bath Fittings, Solvents	▪ Potable Water Supply ▪ Irrigation ▪ Drainage & Sanitation ▪ Housing
Consumer Products	Furniture	▪ House Hold ▪ Office Establishments ▪ Institutions
Industrial Products	Industrial Components Material Handling Products (Crates, Pallets, Bins & Dustbins)	▪ Auto Sector ▪ Electronic Household Appliances ▪ Water Purification - filters ▪ Soft Drink Companies ▪ Agriculture & Fisheries
Packaging Products	Specialty Films Protective Packaging products Cross Laminated film products Cross Line Bonded Film Products	▪ Electronics ▪ Agriculture ▪ Food Industry ▪ Floriculture ▪ Sports Goods ▪ Horticulture ▪ Insulation ▪ Grain Storage ▪ Construction ▪ Tarpaulin ▪ Pond lining
Composite Products	LPG Cylinders	▪ Retail / Household

Revenue contributions – segment-wise.



EBITDA contributions – segment-wise



Source: Edelweiss Investment Research.

Capacity expansion, major facility at Kharagpur, benefit in the long run

The company has increased its capex plans to expand further with the correction in raw material prices and better demand opportunities. The measures e.g. to automate the plant for manpower rationalisation, consistency in quality and improving productivity, have started yielding good results. The company plans to add more plants at new locations by FY19, up from its existing 23 plants, with a total capex of ~ Rs 14 bn.

Manufacturing facilities and capacity expansion

Location	Product
Derabassi ,Punjab	Industrial & Consumer
Durgapur, WB	Industrial & Consumer
Gadegaon, Maharashtra	Industrial, Consumer, Packaging & Plastic
Guwahati, Assam	Consumer Products
Halol, Gujrat	Packaging & Composites
Hosur, TN	Packaging Products
Jalagaon, Maharashtra	Plastic Products
Kanhe, Maharashtra	Industrial products
Kanpur, UP	Plastic Products
Kharagpur, WB	Consumer, Packaging & Plastic Products
Khopoli, Maharashtra	Packaging Products
Khushkeda, Rajasthan	Industrial Products
Malanpur, Madhya Pradesh	Packaging & Plastic Products
Noida, UP	Industrial products
Pondicherry	Industrial & Consumer
Silvassa	Packaging Products
Sriperumbudur, TN	Industrial products
Urse, Maharashtra	Packaging Products

Supreme Industries is adding further capacity by setting up three more manufacturing units: in Rajasthan, Assam and Telangana. The Rajasthan plant will make industrial components, the Assam plant will manufacture the plastic piping system whilst the Telangana unit will produce the Plastic Piping Systems, protective packaging products and furniture.

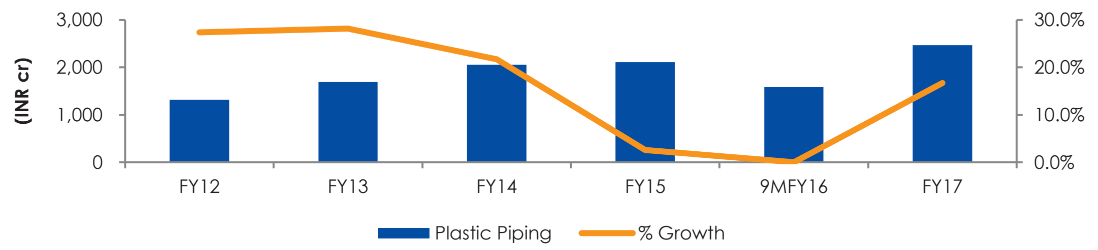
Distribution network

Supreme has a strong distribution network with about 3,000 distributors, 800+ channel partners and secures its production with 25 manufacturing units across India. This ensures presence of a large number of satisfied customers and a significant market share. SI is focusing on increasing reach in existing locations as well as capturing share in untapped locations. The company's key market is western India, which accounts 47% of India's plastic consumption.

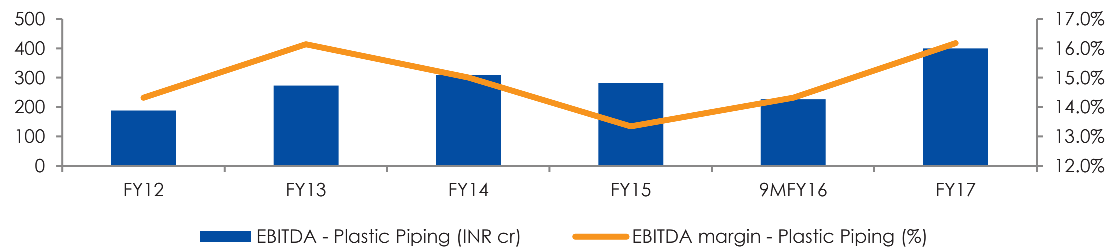
Plastic piping segment – strong growth

The plastic piping segment has registered sales CAGR of 13% over FY12-17, this notwithstanding the several adverse factors such as a sluggish economy, substantial correction in raw material prices, anti-dumping levy on PVC imports, extended monsoons, hailstorms and slowdown in the infrastructure sector.

Plastic pipe and fittings – sales



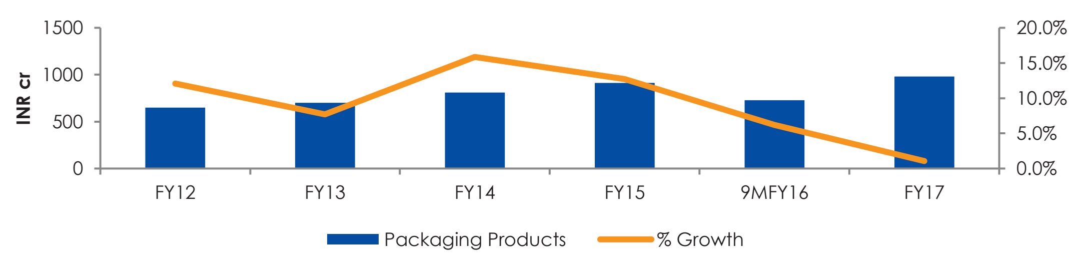
Plastic pipe and fittings – EBITDA and EBITDA margin



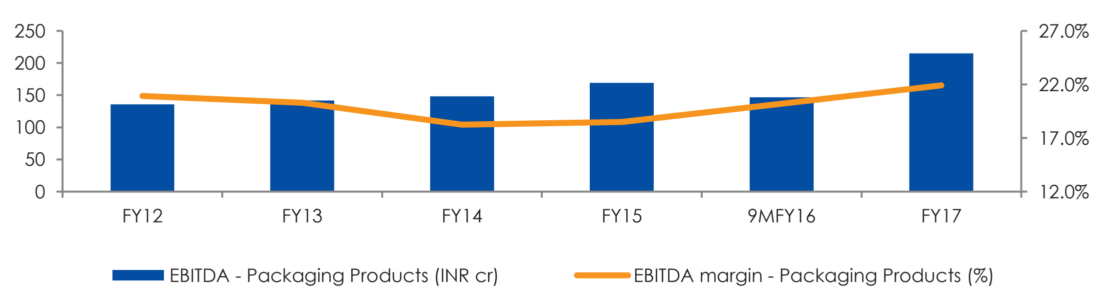
Packaging segment continues to deliver healthy numbers

SI is a dominant player in the packaging products segment in India and exports. SI is the only company to have the technology to manufacture patented cross laminated film products under the brand name 'Silpaulin'. Silpaulin is one-sevenths the weight of the conventional cotton tarpaulin, but has a high strength-to-weight ratio. This division has grown at 9% CAGR in value terms over FY12-17. SI is expected to post healthy growth in this segment in the forthcoming years and to continue to maintain its dominant position in the domestic market with a healthy operating margin of ~20%+.

Packaging segment – sales



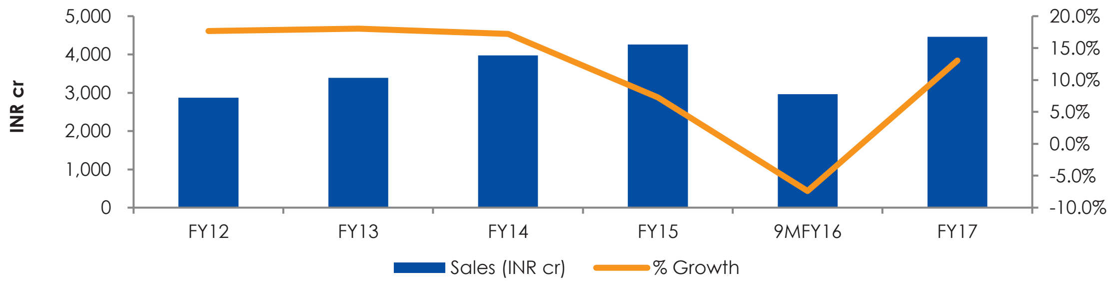
Packaging segment – EBITDA & EBITDA margin

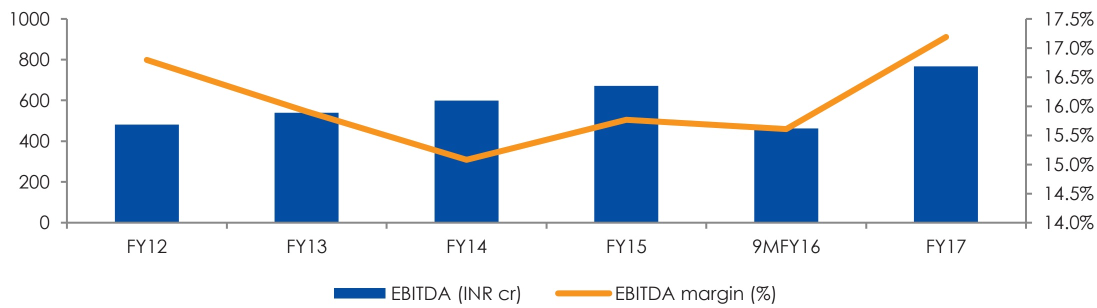


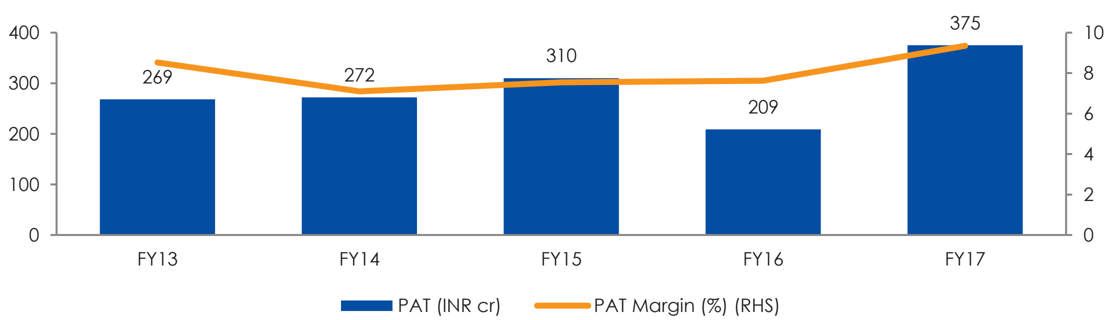
Source: Edelweiss Investment Research.

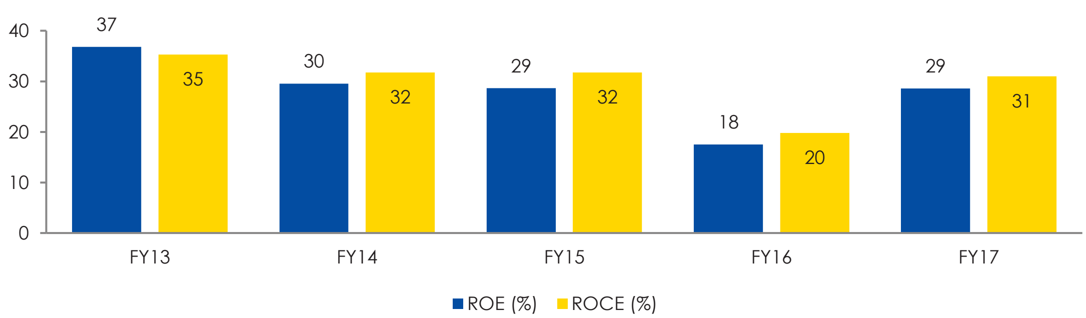
Financial analysis

Sales has grown at a CAGR of 9% over FY12-17 and EBITDA at a CAGR of 10% over the corresponding period along with 40bps expansion in EBITDA margin to 17.2%. The company's return ratios (RoCE and RoE) have consistently been impresive at ~30-33%, historically, and particularly as the company has restricted net debt-to-equity ratio to lower than 0.2x.









Source: Edelweiss Investment Research.

Financials

Income statement (INR cr)

Year to March	FY15	FY16	FY17
Income from operations	4,255	2,960	4,584
Direct costs	3,051	2,065	3,177
Employee costs	168	131	187
Other expenses	538	442	645
Total operating expenses	3,589	2,507	3,822
EBITDA	666	453	762
Depreciation and amortisation	139	105	154
EBIT	527	349	608
Interest expenses	60	32	34
Other income	5	5	8
Profit before tax	472	322	582
Provision for tax	160	118	206
Core profit	312	204	377
Extraordinary items	-2	4	-2
Profit after tax	310	209	375
Minority Interest	11	17	54
Share from associates	0	0	0
Adjusted net profit	321	226	429
Equity shares outstanding (mn)	13	13	13
EPS (INR) basic	25.4	17.4	33.7
Diluted shares (Cr)	12.7	12.7	12.7
EPS (INR) fully diluted	25.4	17.4	33.7
Dividend per share	9.0	7.5	3.0
Dividend payout (%)	35.5	43.0	8.9

Common size metrics- as % of net revenues

Year to March	FY15	FY16	FY17
Operating expenses	84.3	84.7	83.4
Depreciation	3.3	3.5	3.4
Interest expenditure	1.4	1.1	0.7
EBITDA margins	15.7	15.3	16.6
Net profit margins	7.5	7.6	9.4

Growth metrics (%)

Year to March	FY15	FY16	FY17
Revenues	7.4	(7.2)	16.2
EBITDA	13.2	(9.3)	26.1
PBT	13.9	(9.0)	35.7
Net profit	13.6	(12.6)	38.3
EPS	13.7	(8.4)	45.2

Balance sheet (INR cr)

As on 31st March	FY15	FY16	FY17
Equity share capital	25	25	25
Preference Share Capital	0	0	0
Reserves & surplus	1,186	1,290	1,670
Shareholders funds	1,212	1,316	1,696
Secured loans	295	201	50
Unsecured loans	98	211	229
Borrowings	393	412	279
Minority interest	0	0	0
Sources of funds	**1,604**	**1,728**	**1,975**
Gross block	1,845	2,086	2,298
Depreciation	812	901	1,035
Net block	1,033	1,185	1,263
Capital work in progress	100	68	46
Total fixed assets	1,132	1,253	1,309
Unrealised profit	0	0	0
Investments	121	126	175
Inventories	465	558	777
Sundry debtors	238	236	275
Cash and equivalents	182	29	80
Loans and advances	128	154	147
Other current assets	0	0	0
Total current assets	1,012	977	1,279
Sundry creditors and others	495	553	677
Provisions	157	27	36
Total CL & provisions	652	579	712
Net current assets	360	397	566
Net Deferred tax	-90	-105	-116
Misc expenditure	80	57	41
Uses of funds	**1,604**	**1,728**	**1,975**
Book value per share (INR)	95	104	133
	0	0	0

Cash flow statement

Year to March	FY15	FY16	FY17
Net profit	313	200	378
Add: Depreciation	139	105	154
Add: Misc expenses written off	-23	24	16
Add: Deferred tax	-27	16	11
Add: Others	11	17	54
Gross cash flow	412	361	613
Less: Changes in W. C.	-152	190	118
Operating cash flow	564	171	495
Less: Capex	165	225	211
Free cash flow	**399**	**-54**	**285**

Ratios

Year to March	FY15	FY16	FY17
ROAE (%)	28.6	17.5	28.6
ROACE (%)	31.7	19.8	31.0
Debtors (days)	20	29	22
Current ratio	1.6	1.7	1.8
Debt/Equity	0.3	0.3	0.2
Inventory (days)	40	69	62
Payable (days)	42	68	54
Cash conversion cycle (days)	18	30	30
Debt/EBITDA	0.6	0.9	0.4
Adjusted debt/Equity	0.2	0.3	0.1

Valuation parameters 1087

Year to March	FY15	FY16	FY17
Diluted EPS (INR)	25.4	17.4	33.7
Y-o-Y growth (%)	*13.7*	*(31.3)*	93.6
CEPS (INR)	36.3	25.7	46.0
Diluted P/E (x)	44.4	64.6	33.4
Price/BV(x)	11.8	10.9	8.4
EV/Sales (x)	3.4	5.0	3.2
EV/EBITDA (x)	21.8	32.4	19.0
Diluted shares O/S	12.7	12.7	12.7
Basic EPS	25.4	17.4	33.7
Basic PE (x)	44.4	64.6	33.4
Dividend yield (%)	0.8	0.7	0.3

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Roofing and Cement Boards & Panels

Roofing and Cement Boards & Panels

Top of the world

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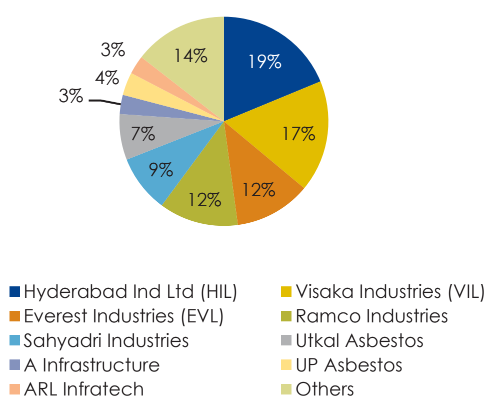
Roofing – Asbestos Cement roofing Sheets

Asbestos cement roofing sheets (ACS), present in India for the past 80 years, is a convenient roofing product in rural and semi-urban areas; nearly half of the country's rural population lives in kutcha or semi-pucca dwellings where this product is a convenient fit. The product addresses a large national sweep—68% of India's population is rural, translating into huge market opportunity. 60% of Indian houses were classified as pucca, 28% semi-pucca and 12% as kutcha, as per our last national census. Thus, 40% of Indian houses are still without a pucca roof and this presents a significant growth opportunity. Among pucca houses, less than half used RCC slabs; the rest use ready-house roofing products (fibre cement roofing and metal roofing). The cost of fibre cement roofing is only a third of the cost of a RCC ceiling slab. Cement asbestos products continue to be in demand because of their affordability, corrosion resistance and weather & fire proof nature. The roofing industry is pegged at ~INR 42,000cr and estimated to post 6-8% CAGR depending on rural growth and monsoon.

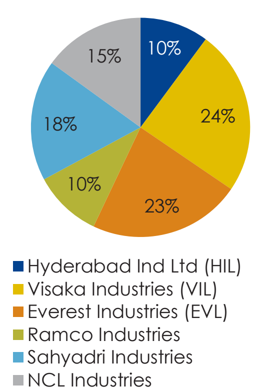
Fiber cement boards & panels (fibre cement flat sheets)

Fiber cement board is a building material used to cover the exterior/interior of a building in commercial and domestic applications. Fiber cement is a composite material made of sand, cement and cellulose fibers. The industry has been posting 15% CAGR and major players are planning to expand capacities to capitalise on the burgeoning demand. The industry's current capacity stands at ~4,70,000MT. Consumption of fibre cement boards in India is still low at 0.4 kg per person.

ACS – Marketshare



CBPs – Marketshare



Source: Edelweiss Investment Research.

Major Players

Year to March (FY17)	Everest*	HIL	Ramco	Visaka
Net sales (INR cr)	1,313	1,053	879	969
3 Year Revenue (CAGR)	9%	7%	3%	3%
Operating Margin (%)	6.5	9.0	13.3	11.8
Net Profit (INR cr)	34	52	198	41
3 Year PAT CAGR	(13)%	83%	N/A	50%
RoE (%)	10.3	11.3	7.8	11.1
RoCE (%)	9.4	8.5	3.0	12.3
Market Cap (INR cr)	726	997	2,420	950
Diluted P/E (x)	20.6	19.1	12.2	23.3

Notes: *Everest FY16 number

Date: 4th December 2017

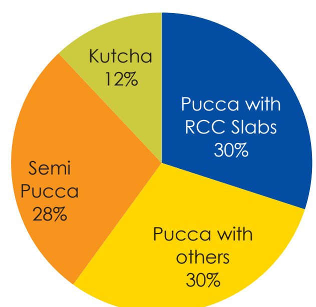
Roofing: Asbestos cement roofing sheets

ACS is a convenient roofing product in rural and semi-urban India; nearly half the country's rural population lives in kutcha or semi-pucca dwellings where this product is a convenient fit. Among pucca houses, less than half use RCC slabs; the rest use ready-house roofing products (fibre cement roofing and metal roofing). The cost of fibre cement roofing is only a third of the cost of a RCC ceiling slab.

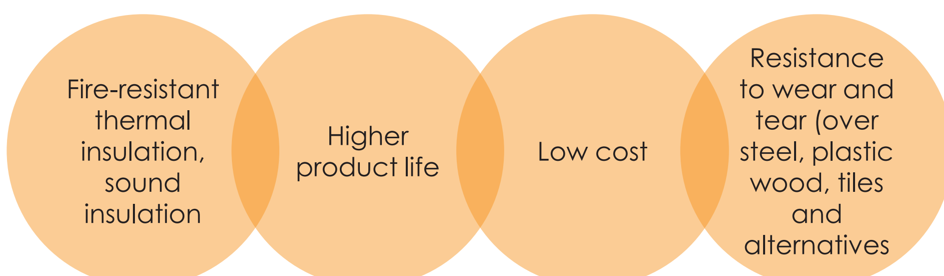
Roofing products

- Corrugated Cement Fibre Sheets
- Close Fitting Adjustable Ridges
- Apron Piece
- Cladding/Walling
- North Light Ridges
- Barge Boards
- North Light Curve
- Serrated Adjustable Ridges
- Roof Lights
- Ridge Finials

Indian Households - Opportunity



Advantage of ACSs

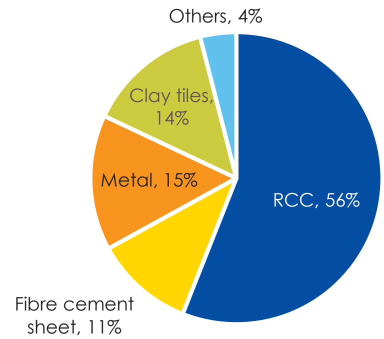


Source: Edelweiss Investment Research.

Roofing and Cement Boards & Panels

Currently, there are about 30 players in the industry with an annual capacity of ~6mn MT. The roofing industry is valued at ~INR 42,000cr and is estimated to post 6-8% CAGR contingent on rural growth and monsoon. In India, the asbestos industry is pegged at INR13,000cr. The products are marketed under respective brand names primarily via dealers for the retail segment and directly for projects and government departments.

Roofing Market share



Source: Edelweiss Investment Research.

The fibre cement roofing industry in India is oligopolistic with the top 6 players collectively controlling ~75% market. Hyderabad Industries (HIL), Visaka Industries, Everest Industries, Ramco Industries, Sahyadri and Utkal Industries are leading players.

ACS Major players – Market share

Companies	Capacity (K- MT)	Sales Mkt share (%)	Regional Presence	Plant Location	No. Manufacturing Plants	Brand Names	Sales (INR cr)	Sales contri-bution (%)
Hyderabad Ind Ltd (HIL)	1,140	20%	Pan India	Odisha, UP, Jharkhand, Andhra Pradesh, Kerala, Maharashtra	7	Charminar	739	67%
Visaka Industries (VIL)	802	14%	Pan India barring north	AP, TN, Karnataka, WB, Odisha, UP, Maharashtra	8	Visaka/ Shakti	607	63%
Everest Industries (EVL)	718	12%	Pan India	Uttarakhand, Maharashtra, West Bengal, Madhya Pradesh, Tamil Nadu, Odisha	6	Everest	544	47%
Ramco Industries	746	13%	Pan India barring north	Tamil Nadu, Karnataka, MP,Dadra & Nagar Haveli, West Bengal, AP, Gujarat, Bihar	9	Ramco	526	54%
Sahyadri Industries	540	9%	West & South			Swastik		
Utkal Asbestos	430	7%	WB, Orissa and UP			Konark		
A Infrastructure	180	3%	North, Central & West			Jai Kirti		
UP Asbestos	216	4%	North and Central			UPAL		
ARL Infratech	175	3%	North and Central			Ankur		
Others	880	15%	Mostly regional			N/A		

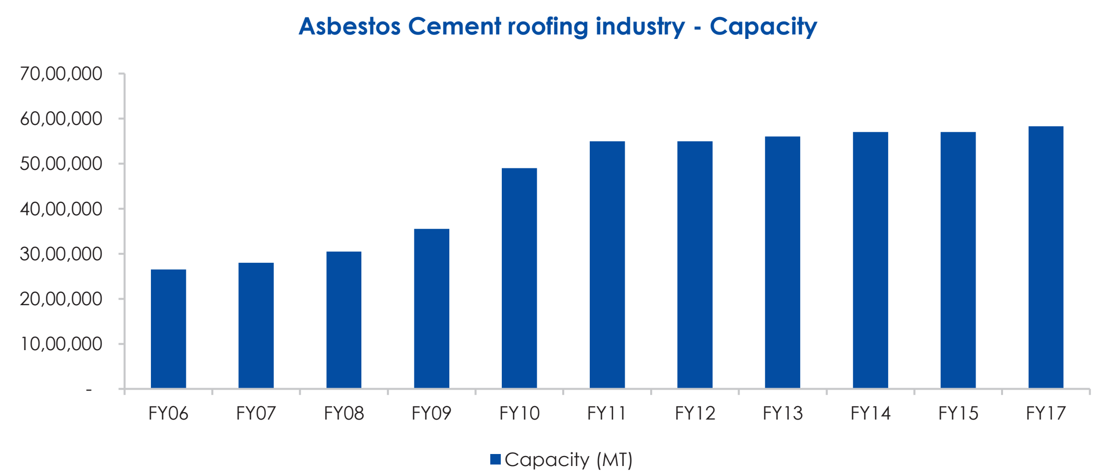
Source: Edelweiss Investment Research.

Roofing and Cement Boards & Panels

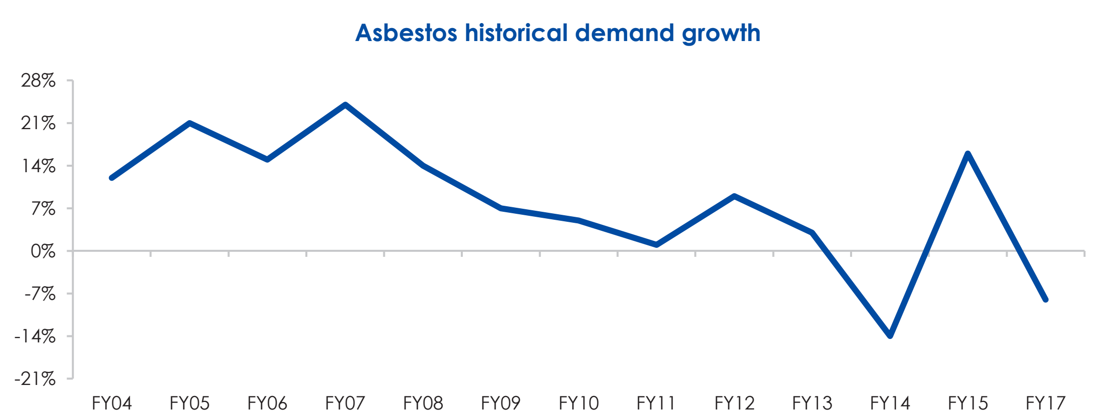
Comparative Characteristics of Various Roofing Materials

Characteristics	Fibre Cement Sheets	Corrugated Galvanised Iron Sheets (CGI)	Aluminium Sheets	Red Mud Plastic (RMP)
Life Span (years)	50 (Min) Non-Corrosive	5-10 Not (Corrosive)	-	5 (Tends to get Flattened)
Maintenance	Nil	Every 3-5 years	Nil	Nil
Fire Rating	Retardant	Tendency to twist & melt	Tendency to twist melt	Fire Prone
Thermal Conductivity/Insulation	Good	Poor	Poor	Fair
Accoustic rating	Good	Poor	Poor	Poor
Absorption of rain & Wind Noise	Good (Deadens these Noise)	Poor	Poor	Poor
Energy Consumption (KWH/Sqm)	3	36.6	33	48
Manpower Potentail	Intensive	Low	Low	Low
Imported Content (INR/Sqm)	5.6	15-22.5	1	33
Wind Resistence when installed	Good	Poor	Poor	Poor

Source: Edelweiss Investment Research.



Source: Edelweiss Investment Research.



Source: Edelweiss Investment Research.

Currency fluctuation to impact raw material cost leading to fluctuation in ACS margin

Chrysotile fibre is a key ingredient in manufacturing ACS, which constitutes ~50-55% of the total raw material cost and is 100% imported. Other key raw material used is cement, fly-ash, wood pulp and dry waste. Since there are limited number of Chrysotile suppliers (majorly 3 players based in Russia, Kazakhstan and Brazil) the cost depends on demand and currency movements.

Companies maintain fibre inventory of about 45 days and generally do not hedge their USD purchase requirements. Amidst weak demand over the past 3-4 years leading to low gross margin, ACS' EBITDA margin has hovered ~10%. The segment's EBITDA margin becomes susceptible to sharp depreciation in INR against USD. For every 1% appreciation in USD, ACS' margin dips 30-35bps (assuming no cost pass through).

Comparison – Everest has lower cost as % sales

	FY10	FY11	FY12	FY13	FY14	FY15	5-yr Avg.
Everest Industries (EIL)							
Chrysotile cost (INR cr)	136.9	142.6	160.9	223.5	205.3	239.6	
% of Building Products sales	25.9	25.4	24.2	29.1	27	27.6	26.7
% of net sales	20.9	19.7	18.1	22	19.8	19.5	19.8
Visaka Ind (VIL)							
Chrysotile cost (INR cr)	158.5	161.9	197.9	298.5	254.2	269.8	
% of Building Products sales	32.7	31.9	32.6	40.1	36.1	32.4	34.6
% of net sales	26.1	24.7	26.4	32.6	28.5	26.4	27.7
HIL Ltd							
Chrysotile cost (INR cr)	196.5	204.1	246	314.7	268.1	338.1	
% of Building Products sales	28	28.2	28.8	30.5	30.9	30.6	29.8
% of net sales	27.9	28.2	28.7	30.4	33.8	33.7	30.9
Ramco Industries							
Chrysotile cost (INR cr)	149.2	141.2	187	240.4	186.7	227.5	
% of Building Products sales	34.6	31.7	33.1	37.2	35.4	36.7	34.8
% of net sales	29.2	25.2	27.7	30.7	27.9	30.2	28.4

Opportunities and threats:

Cement asbestos sheets (CAS) are primarily used as roofing materials in rural & semi-urban housing and by industries & the poultry sector. The sheets are popular as they are inexpensive, need no maintenance and last longer compared to competing products such as thatched roofs, tiled roofs and galvanized iron sheets. In India, almost 60% of rural population uses thatched roof/tiles for shelter. Thatched roof needs regular replacement and tiled roof needs continued maintenance. Therefore, whenever the economic conditions improve, the first choice of the rural poor is to replace the roof with an affordable and relatively durable product i.e., CAS.

Risks and concerns:

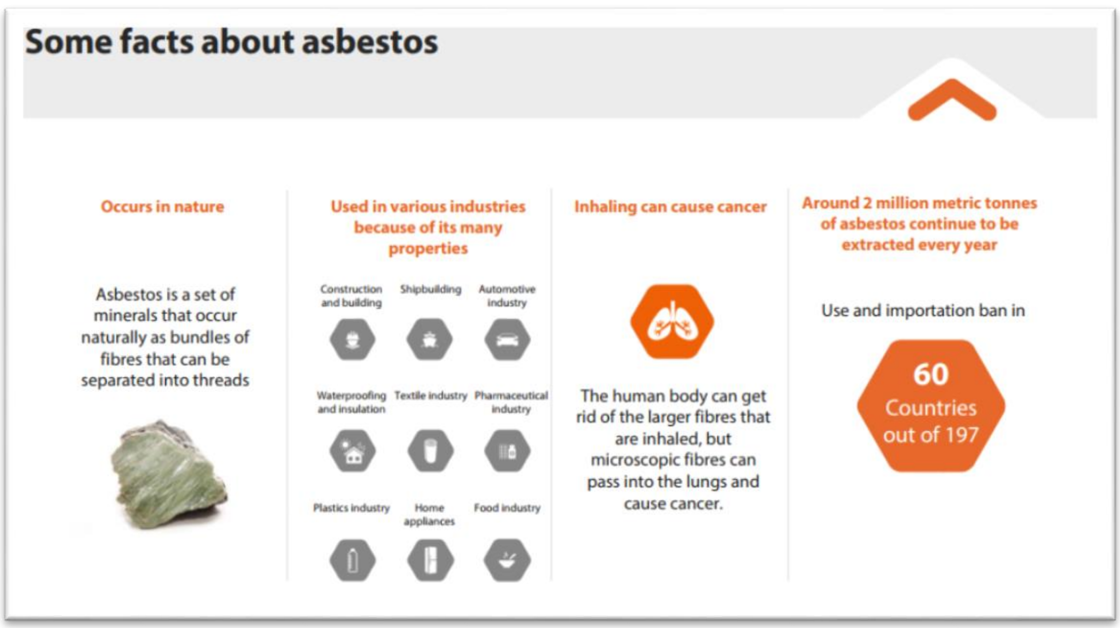
Absence of entry barriers: Lack of entry barriers is attracting new entrants into this segment.

Ban Asbestos Lobby: The activities of the Ban Asbestos Lobby instigated by the manufacturers of substitute products continue to be a matter of concern. The Government of India along with the Russian government opposed the move to put any conditions on this industry in the recent Rotterdam Convention held in Geneva.

Outlook:

The dip in rural inflation and sales contraction of steel sheets are expected to catalyse the offtake of asbestos products. Organised players are continuously striving to enhance the product's distribution reach and expand market presence by strengthening network of stockists, resorting to aggressive advertisement campaigns and capitalising on their brands. These, coupled with inherent advantages associated with the product such as cost affordability etc., are envisaged to drive 5-10% CAGR in coming years. Demand is expected to recover riding:

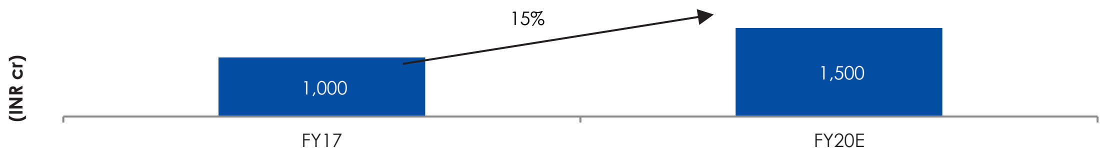
- Healthy sales in coming years on account of better monsoon and moderating inflation.
- Decline in rural inflation is expected to boost rural cement asbestos products demand.
- Declining competition from colour coated steel sheets following increase in steel prices.
- Consumers' dissatisfaction with experience of functionality of colour coated sheets adds to reconversion.



Fiber cement boards & panels (fibre cement flat sheets)

Fiber cement board is a building material used to cover the exterior of a building in commercial and domestic applications. It is a composite material made of sand, cement and cellulose fibers.

Market size



Source: Edelweiss Investment Research.

Traditional construction practices in India are moving to "dry construction" methods. These methods ensure that the construction is lighter, faster and also becomes high performance, particularly in terms of heat and sound insulation. This method is used for constructing walls, flooring, ceiling and panelling using products like plywood, particle boards, MDF, laminated boards, gypsum boards and fibre cement boards.

Fibre cement boards have some inherent advantages—water resistant, termite resistant and have acoustic insulation properties, good thermal insulation—over other dry construction products and can also be used indoors and outdoors. This is driving its penetration in the residential segment (especially wet areas) and in hotels & hospitals. The market for CBPs is registering CAGR of 15%; this momentum is likely to sustain on account of its rising adoption in a wide variety of applications. There are 6 players in the industry producing identical or similar products with an annual capacity of ~4,70,000 MT (~80% of total industry). Consumption of fibre cement boards in India is still low at 0.4kg per person.

Fibre Cement Boards consumption

	KG/Person	SM/Person
Australia	12.5	18.0
Thailand	5.0	7.1
USA	3.4	4.9
Vietnam	1.1	1.6
Indonesia	0.6	0.9
India	0.2	0.4

Source: Company, Edel Invest Research

Fiber Cement Boards & Panels major players

Companies	Capacity (MT)	Mkt share (%)	Regional Presence	Plant Location	No. Manufacturing Plants	Brand Names	Sales (INR cr)	Sales contribution (%)
Hyderabad Ind Ltd (HIL)	54,000	11.5%	Pan India	AP, Haryana	3	Aerocon/ Charminar		
Visaka Industries (VIL)	129,750	27.6%	Pan India barring north	Telangana, Maharashtra	3	V Boards	175	18%
Everest Industries (EIL)	120,000	25.5%	Pan India	Uttarakhand, Maharashtra	2	Everest	185	16%
Ramco Industries	53,688	11.4%	Pan India barring north	Tamil Nadu,Rajasthan		Ramco Hilux (Calcium Silicate Based)	92	9%
Sahyadri Industries	95,000	20.2%	West & South	Maharashtra		Cemply, Ecopro		
NCL Industries	80,000	17.0%		Uttarakhand, AP		Bison Panel (wood mixed with cement)	95	
Total	**470,000**							

Source: Edelweiss Investment Research.

CBPs is a non-asbestos, autoclaved, fibre cement board manufactured using Hatschek process and High Pressure Steam Curing (HPSC) technology. CBPs comprises a composite mix of nonasbestos cellulose fibres, ordinary Portland cement, fine silica, quartz, fly ash and mineral additives. The product is also delivered in textured surface finishes to address modern building applications.

It is used for internal and external applications (false ceiling, internal walls, mezzanine flooring, partitions and doors, cup boards, shelves, wardrobes, non-movable furniture, among others). The products offer distinctive features (fire, water and termite-resistance, better acoustic properties and thermal insulation over plywood and particle boards), enhanced affordability, low maintenance cost, low installation cost, greater functionality, easy transportability (obviating the need for mixing onsite) and greater safety in seismic zones. The result is that these boards have been used in prominent buildings on account of the time and resource savings on the one hand and for reasons of safety and aesthetics on the other.

Fiber Cement products versus plywood

Parameter	Fiber Cement products	Plywood products
Cost	Cheaper by nearly 40%	Costly as compared to V-next products
Durability/Life	Over 15-20 years	Nearly 5-10 years
Resistance to weathering	Yes	No
Environmental friendly	Yes	No
Fire/termite/water resistant	Yes	No
Time saving	Yes	Yes in some cases
Aesthetics	Excellent	Require other material

Source: Edelweiss Investment Research.

Demand triggers driving urban sales of CBPs in India

Office Space	As per NASSCOM estimates, IT/ITES sector absorbed ~52% of new office space coming up since 2010. It expects the momentum to sustain as the number of employees in the IT/ITES sector is estimated to increase by 2.4mn to 5.1mn by 2022, creating continued demand for office space. Another major sector occupying office space is BFSI (~16% of total office space). The Planning Commission expects the workforce in this sector to increase by 8.5mn between 2012 and 2020.
Organised retail	Retailing in India is expected to post 8% CAGR between 2012 and 2020, with the organised sector contributing ~20% CAGR. This implies strong furnishing demand.
Healthcare industry	As per a McKinsey study, the healthcare industry in India is expected to grow at a fast pace during 2012-20 to USD280bn by 2020. Of these, hospitals will witness the maximum uptick and account for ~70% of the healthcare pie, implying rising demand for these construction materials going forward.
Hotel industry	With the expected rise in urbanisation and tourism industry in India, even the number of hotel rooms is estimated to jump 50% over FY14-19E. The hotel industry is a major consumer of CBPs (along with particle boards/MDFs).

Opportunities and threats:

FCB are environment friendly, save time, are cost effective as well as a good substitute for wood and thus help reduce deforestation. Further, they can also be a substitute for gypsum boards in certain applications.

These products have good aesthetic appeal. They can be used internally and externally. They are also durable and have a life of over 25 years or more with proper maintenance. Further, the product has triple advantages of fire, water and ermite resistance. FCB is suitable for any type of finish— paint, laminate, wall paper, tiles, marble etc.

FCB products are well accepted in office and commercial segments for partitions, seamless false ceilings and grid false ceilings etc. Wet area application of the product has become an accepted norm and its ability to take the finish of marble or tiles is an added advantage. Industrial segment has started using FCBs for mezzanine application and double skin partitions.

On the negative side, cellulose pulp has to be imported. Compared to wood and plywood, workability is a matter of concern. Further, initial handling is comparatively difficult. While consumers are preferring this product, applicators like carpenters were resisting initially due to difficulty in working on FCB compared to plywood.

Risks and Concerns:

Absence of entry barriers as well as import of cement board materials from Philippines, Thailand, China and Malaysia are matters of concern. However, they are not competitively priced.

Outlook:

The industry has been posting 15% CAGR and major players are planning to expand capacities to capitalise on the expanding demand. The market for CBPs had been limited to urban centres; however, players are taking initiatives to raise awareness and foster nationwide acceptance for these products.

Roofing and Cement Boards & Panels

Peer Comparison

	Revenue growth (%)			PAT growth (%)			EBITDA margin (%)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Everest Industries	(11.1)	8.8	9.0	NA	NA	24.4	3.1	7.6	8.1
Visaka Industries	(4.0)	6.0	7.0	67.0	9.0	36.0	11.9	12.3	12.9
Ramco Industries	2.0	NA	NA	(4.0)	NA	NA	13.3	NA	NA
HIL Ltd	(4.0)	9.0	12.0	44.0	(3.0)	21.0	9.7	10.0	10.4

	RoE (%)			Diluted PE (x)			EV/EBITDA (x)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Everest Industries	0.4	12.5	14.0	NA	15.8	12.7	24.8	8.6	7.2
Visaka Industries	10.8	10.9	12.6	10.5	23.1	16.9	9.5	8.7	7.2
Ramco Industries	7.8	NA	NA	12.1	NA	NA	22.9	NA	NA
HIL Ltd	11.4	12.1	12.9	17.9	16.4	13.6	9.9	9.3	8.1

Note: Everest Industries Edelweiss Investment Research estimates
Source: Bloomber, Edelweiss Investment Research

Trading Buy: Everest Industries Ltd.

Increasing utilization to spur margins across segments

CMP: INR 457
Target Price: INR 624
Upside: 34%
Rating: Trading BUY

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Complete building solutions provider

Everest Industries Limited (EIL) was incorporated in 1934 and has over eight decades of expertise in manufacturing Building and Steel Products. The company is the pioneer of fibre cement products in India and manufactures roofing, ceiling, wall, flooring and cladding products besides offering pre-engineered steel buildings (PEBs) for industrial, commercial and residential applications. It is among the largest PEB companies in India with over 2,000 PEB projects designed and erected. It is also among India's leading building solution providers, offering detailed technical assistance in the form of designs, drawing and implementation for every project. Everest has a capacity of 8,65,000 MT for building material products and 72,000 MT for its steel building plants. It has totally nine manufacturing plants India-wide and serves over 600 cities and 100,000 villages.

Building materials demand: Riding on government initiatives

EIL is focussed on enhancing capacity utilisation, launching new products mainly consumer centric and value added and initiating projects like 'Pehchan' to educate the influencer/fabricator — expected to drive healthy volume growth in the building products (BP) segment. Further: (i) GST implementation (18% GST rate will improve size of the market as these products are more affordable for end consumers); and (ii) governmnet initiatives such as 'Housing for All' will boost demand for EIL products. The rising demand for boards and panels with its inherent advantages over other similar products, is expected to add to the growth curve of EIL ahead. Sales volume of EIL's BP segment is expected to register ~7% CAGR over FY17-20E whilst this segment's revenue will be mostly led by future volumes.

PEB segment: Healthy order book

The PEB sector is poised for growth with rising demand for warehouses on the back of the rise in e-commerce and agricultural enterprises. EIL is well positioned to gain in tandem with industry growth, record a healthy order book of 26,518 MT by end-H1FY18 and is expected to register revenue growth of ~13% led by ~11% sales volume growth.

Outlook and valuation: Initiate with a trading 'BUY'

EIL is a key beneficiary of government initiatives such as 'Housing for All', migration from '*kuccha*' to '*pucca*' roofs and implementation of GST. Further, higher infrastructure spend in India, e-commerce growth, increasing warehousing and improvement in rural markets will likely drive overall growth. EIL is trading at 12.7x/10.3x PER and 7.1x/6.0x EV/EBIDTA FY19E/FY20E, respectively. We initiate a trading BUY with a target price of INR 624, valuing the stock at 26% discount to historical 1-year fwd average multiple of 19x i.e. 14xFY20E earnings.

Bloomberg:	EVI:IN
52-week range (INR):	519.60 / 180.30
Share in issue (cr):	1.5
M cap (INR cr):	728
Avg. Daily Vol. BSE/NSE :('000):	75
Promoter Holding (%)	48.66

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Revenues (INR Cr)	1,313	1,168	1,271	1,386	1,514
Rev growth (%)	3.6	-11.1	8.8	9.0	9.3
EBITDA (INR Cr)	86	36	96	112	130
Net Profit (INR Cr)	34	1	46	57	69
P/E (x)	20.6	576.7	15.6	12.5	10.3
EV/EBITDA (x)	10.5	24.5	8.5	7.1	6.0
RoACE (%)	9.4	1.8	12.6	15.4	16.9
RoAE (%)	10.3	0.4	12.5	14.0	15.1

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Date: 27th November 2017

I. Building products segment – Healthy demand with wide product portfolio

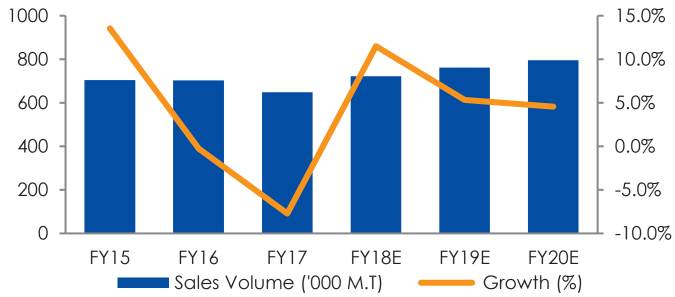
EIL provides building products and building solutions for commercial, industrial and residential sectors. EIL has a wide product range of value added products like cement boards and panels for faster and modern construction of ceilings and walls. EIL has two chief divisions in the building products segment: (a) roofing - fibre cement roofing sheets (ACB); and (b) boards and panels

- EIL has over the last ten years diversified into products other than asbestos-cement for roofing. The revenue contribution from non-roofing products has increased to 16% in FY17 and ~26% of building products revenue, will contniue grow in coming years.
- EIL is continuously focused on launching variants with value-added features, sales to nearby areas to reduce logistics costs and entering into annual contracts for cement and fibre purchases to cushion against price volatility. All of this along with an expected rise in demand for boards and panels, and we estimate volumes of the BP segment to register ~7% CAGR over FY17-20E.

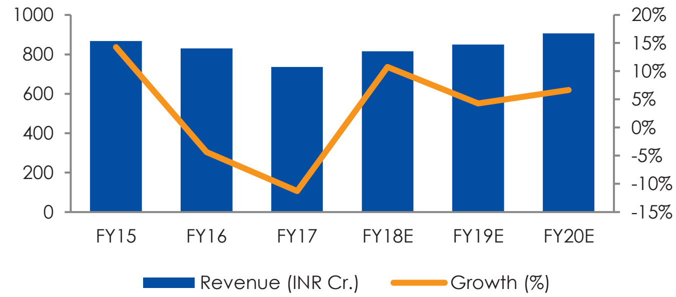
Building products segment — EIL's Growth drivers

- Enhanced capacity utilisation
- Volume pick-up in value added products
- New product launches – focus on more consumer centric products
- Educating the influencer/fabricator – initiated project 'Pehchan' to educate influencing communities to use modern methods of construction e.g. fiber cement boards and panels (FCBs).
- GST implementation – the GST rate at 18% will improve the market size as these products are more affordable for end consumers. This will in turn boost sentiment for demand growth.
- Government initiatives – 'Housing for All' - Pradhan Mantri Awas Yojana (PMAY i.e. affordable housing) expected to spur demand for speedier and faster construction. The government aims to build ~20mn homes by year 2020.
- Increase in rural income – Government of India's focus on doubling rural income by the year 2020. To achieve this GoI has initiated projects like 'Pradhan Mantri Krishi Sinchai Yojana', 'Fasal Bima Yojna' schemes and an increase in MGNREGA allocation to INR 48,000 crore from INR 38,500 crore.
- Migration from 'kuccha'to 'pucca'roofs – the opportunity size for mere migration to pucca roofing is 4.8mn MT of roofing sheets.

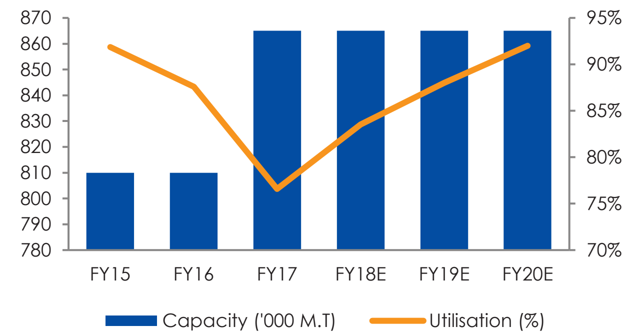
Rise in BP sales volume ...



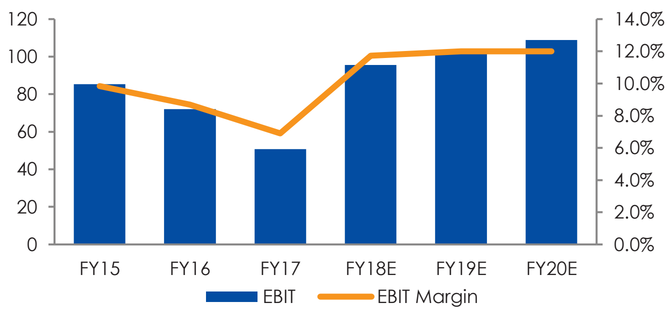
... healthy growth in BP sales



Improvement in BP capacity utilisation ...



... leads to improve BP EBIT



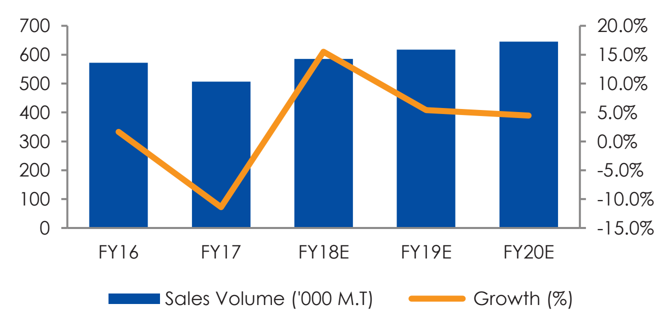
Source: Company, Edelweiss Investment Research

(A) Roofing products - fibre cement roofing sheets (ACB)

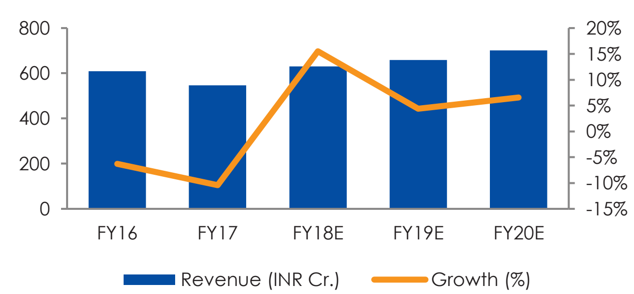
Everest's roofing system consists of corrugated fiber cement roofing sheets, non-asbestos modern roofing system (Everest Hi-tech), metal roofing sheet, Everest rooflight – polycarbonate and roofing accessories like ridges, gutters, north light curves etc. EIL has maintained its ~12-15% market-share in the roofing business.

The roofing sheet business was affected by a combination of weak monsoons and rural inflation during the last few years. This impacted disposable incomes and increased sales of colour coated steel sheets on account of a drastic fall in steel prices. With favourable external factors like normal to above monsoons – agricultural incomes rebounded, there was a perceptible shift from the use of colour coated steel sheets due to an increase in steel prices and the government's thrust on doubling rural income, we believe this sector is on the threshold of a revival. We estimate ~9% revenue CAGR over FY17-20E.

Roofing - Sales volume growth ...

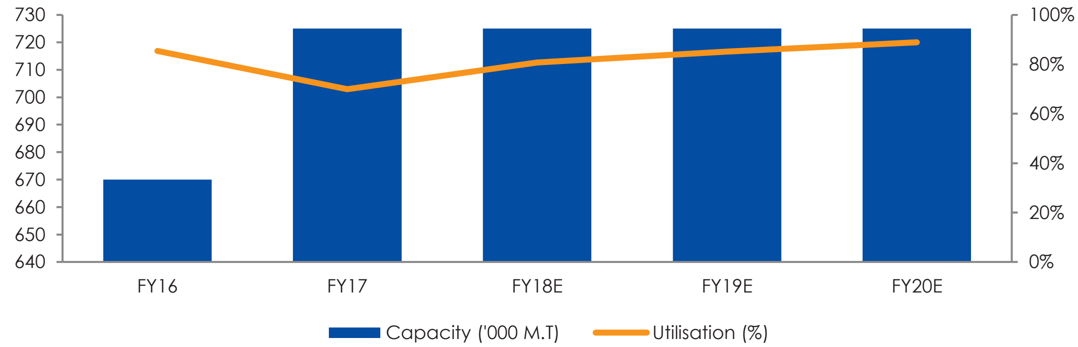


Roofing - Net sales rise ...



Source: Company, Edelweiss Investment Research

Roofings - Utilisation improvement ...



Roofings opportunity size

Potential size of roofing sheets market	
Total population (cr)	132
% population in rural areas	69%
Rural population (cr)	91
% kuccha homes	38%
Rural population living in kuccha houses (cr)	35
Avg. household size	5
Potential homes moving to pucca roofing (cr)	6.9
Roofing sheets required/ 1000 sq.ft (MT)	1.4
Average household size (Sq. ft)	500
Potential roofing sheet demand (mn MT)	48
EIL capacity (mn MT)	0.7

Comparison of roofing solutions

Parameters	Non Asbestos Roofing	AC Roofing	Metal Roofing
Resistance to Natural Weathering / Corrosion	Excellent	Excellent	Poor
Thermal and Sound Insulation	Excellent	Excellent	Poor
Conformance to International Specification	Excellent	Poor	Excellent
Chemical Resistance	Excellent	Excellent	Poor
Aesthetics - Long Term	Excellent	Poor	Good
Combustible / Fire Resistance	Excellent	Excellent	Poor
Vapour Permeability / Condensation Control	Good	Good	Poor
Flexural Rigidity	Excellent	Excellent	Poor
Dimensional Stability	Good	Good	Poor
Advanced Evaluation Parameter-IMOR / Impact Resistance	Good	Poor	Good

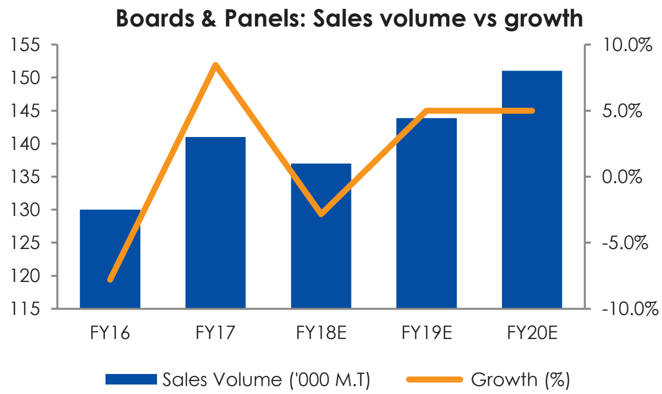
Source: Company, Edelweiss Investment Research

(B) Boards and panels

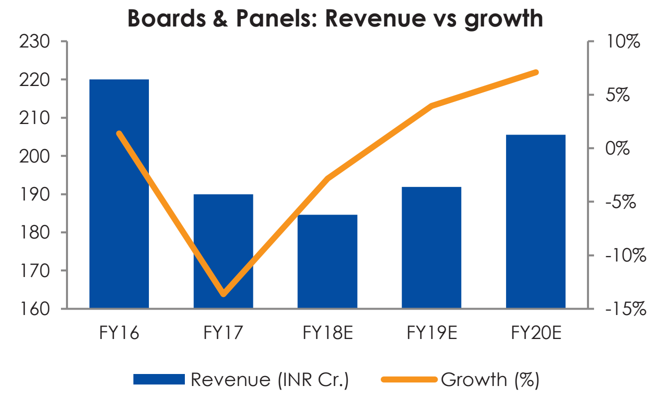
The new trend in construction has led to adoption of ready-to-use products like plywood, particle boards, MDF, laminated boards, gypsum boards and fibre cement boards (FCBs). Fibre cement boards have some inherent advantages over others — they are water resistant, termite resistant, have accoustic insulation properties and good thermal insulation and can be used both indoors and outdoors. The fiber cement boards & panels industry is about 4,70,000 MT in India and growing rapidly in different segments as the consumption of FCBs in India is still at an abysmally low level of 0.28 kg per person.

- The company expects demand for boards and panels (B&P) to rise 3-5x in forthcoming years whereas we have assumed EIL's B&P segment to grow at ~3% with capacity remaining constant, thereby offering greater room for capacity expansion.

Boards & Panels - Sales volume growth

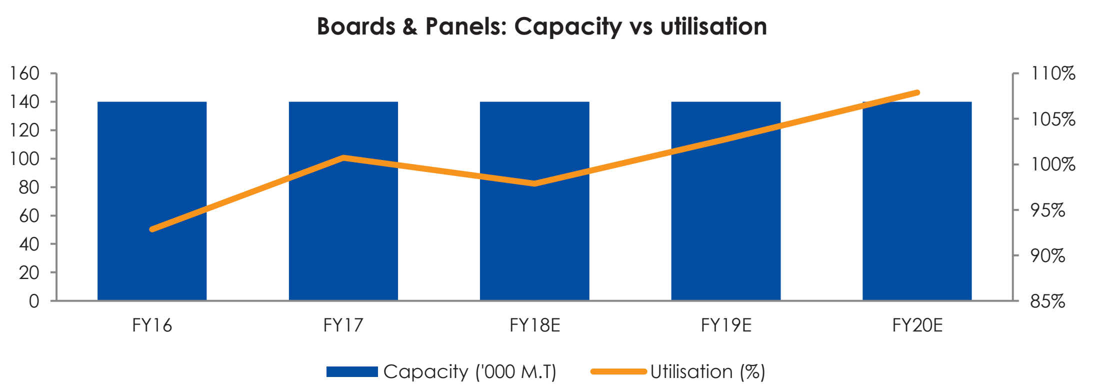


Board & Panels - Net sales rise ...



Source: Company, Edelweiss Investment Research

Board & Panels - Utilisation improvement ...



Source: Company, Edelweiss Investment Research

II. Pre-engineered buildings (PEBs) – Healthy order book and a revival in this segment

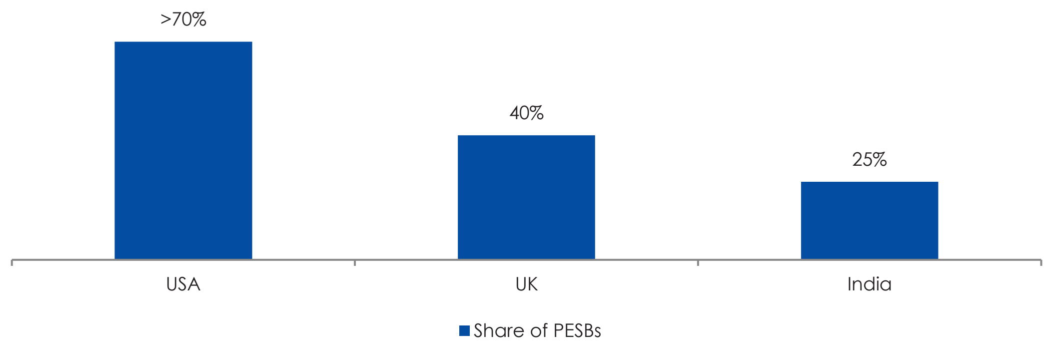
The pre-engineered building segment enjoys increasing acceptance, replacing RCC and conventional steel structures and is a fast growing segment. EIL's PEB segment has erected and designed more than 2,000 PEBs by FY17. EIL forayed into the PEBs segment in FY09 by providing turnkey services for complex structures including factories, warehouses, supermarkets, offices etc.

- This segment is poised to grow with the increasing demand for warehouses owing to the rise of e-commerce and agricultural enterprises, as well as rising investments in manufacturing, metro railways, aviation, solar energy and automotives.
- The market for PEBs in India is growing at 25-30% annually. In India, at present, only 25% of all new low rise industrial/commercial buildings are PEBs, whereas, in the United States, more than 70% of all low rise industrial/commercial buildings are PEBs.
- EIL has gradually diversified its revenue mix from a building products player to being a dominant player in the pre-engineered buildings space. The PEBs segment which was about 17% of EIL's revenues in FY10, currently constitutes ~36% to EIL's revenues (FY17). PEB revenue has grown at a CAGR of ~27% over FY10-16.
- The PEB segment has been impacted due to volatile steel prices, which is now managable/supported by a cost-escalation clause against volatile steel prices. The PEBs segment registered an EBIT margin of 6% in FY12; however, the segment was impacted severely in the last three years, resulting in EBIT losses in FY17. Everest has shown signs of recovery in this segment in H1FY18 and has reported 13.2% in EBIT margin/~15% of EBITDA margin. We believe that the cost escalation clause and the government's thrust to infrastructure growth will likely boost PEBs segment's sales. We estimate 13% sales CAGR over FY17-20E and EBIT margin to be maintained at ~13%.

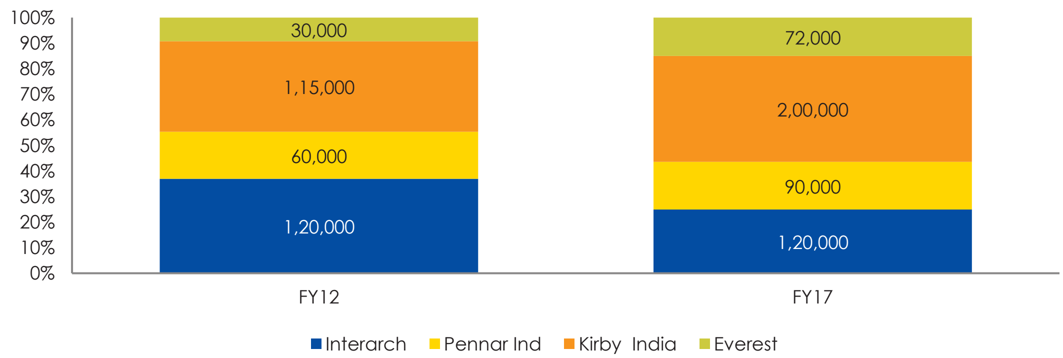
Growth Drivers

- **Reorganization of logistics post GST implementation** – will increase demand for warehouses, can provide a huge opportunity for EIL's PEB segment.
- **Thrust on green buildings** – the private sector has started placing greater focus on green buildings; this trend will likely directly benefit PEBs companies. Everest will directly benefit as it is in a position to provide the best alternative construction method which is three times faster than conventional construction methods.
- **Focus on educating customers and creating brand awareness** – EIL is continuously participating in seminars and exhibitions to educate consumers and fabricators, also educating young architects in colleges and increasing its focus on creating more brand awareness and repeat customers.
- Commodity prices are increasing, but we expect a stable price regime for steel. The company has a cost-escalation clause which will help maintain the segment's net margin.

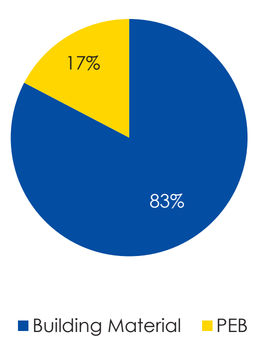
Share of PEBs in newly constructed industrial/commercial buildings



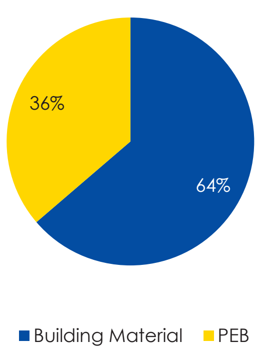
PEBs – major players in India Capacity (in M.T)



EIL Revenue breakup (FY10)

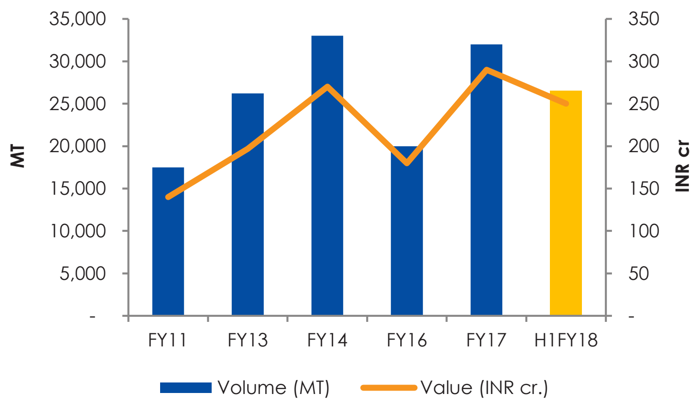


EIL Revenue breakup (FY17)

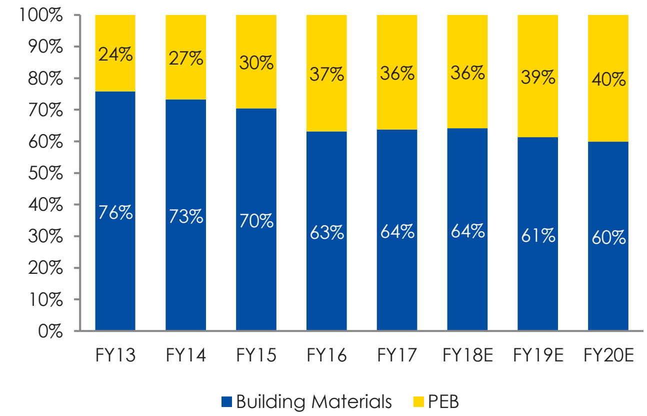


Source: Company, Edelweiss Investment Research.

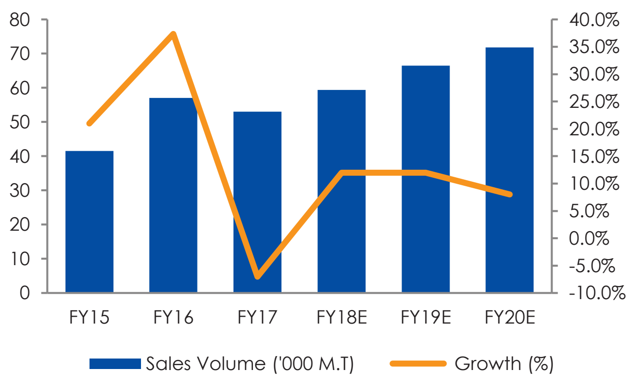
Healthy order book ....



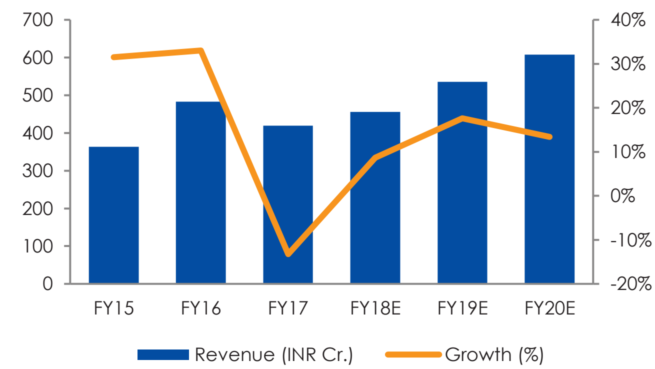
.... increases PEBs sales contribution



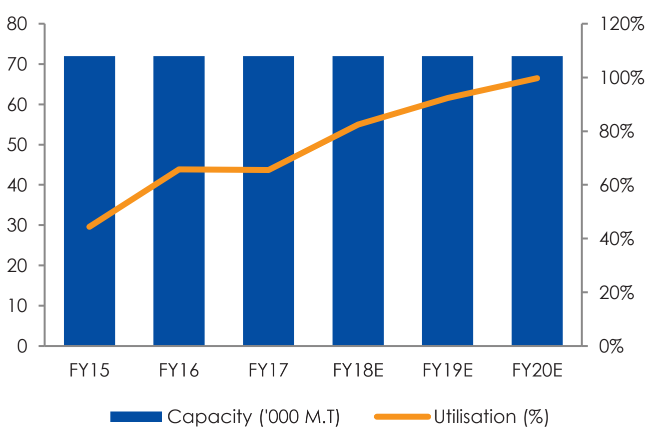
Rise in PEBs sales volume ...



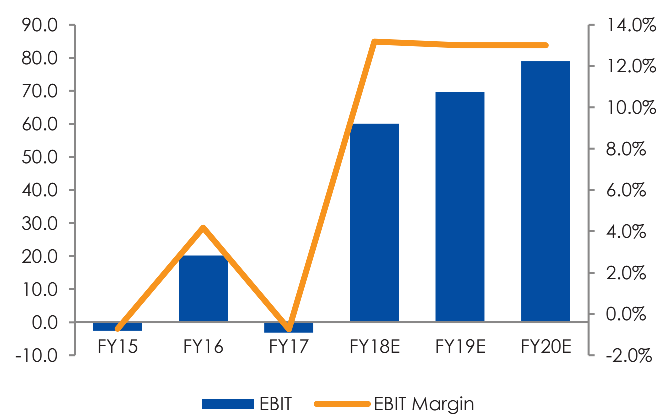
...Healthy growth in PEBs sales



Improvement in PEBs capacity utilisation ...



... leads to improve PEBs EBIT



Source: Edelweiss Investment Research.

Major projects handed over in Q2FY18

Reliance - Jhajjar, Haryana

Centurion - Bhubhaneswar

Gokuldas – Bilaspur, Chhattisgarh

RO-RO Ferry Terminal – Dahej, Gujarat

Rapid Metro-Gurugram, haryana

Technip – Dahej, Gujarat

III. Strong distribution network

Everest has a robust distribution network with 40 sales depots and over 6,000 dealers spanning 600 cities and 100,000 villages.

IV. GST implemetation – Advantage organised players

The lower GST rate (18%) on fibre cement roofs and boards has rendered such products affordable to end-consumers. Also, these products are now more competitive and affordable in a scenario wherein steel sheet prices as well as import levies are rising. Implementation of GST is expected to boost sales of organised players.

Everest Industries – Outlook and valuation

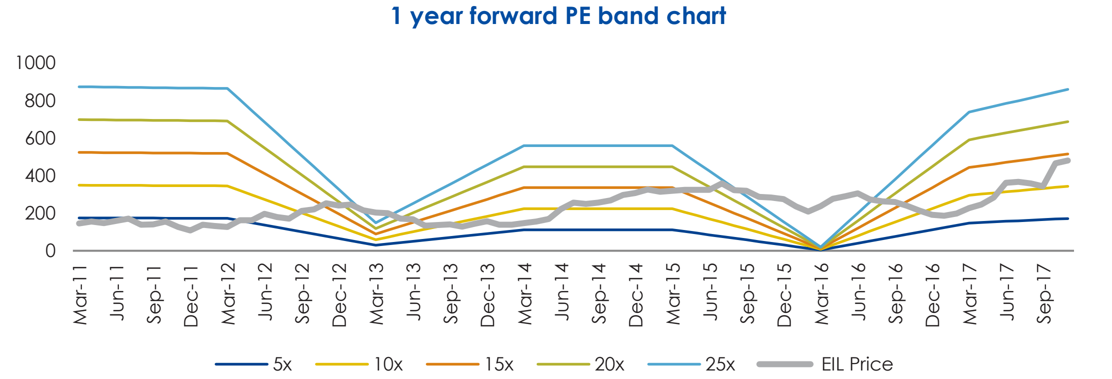
EIL is among the key beneficiaries of government initiatives such as 'Housing for All', migration from '*kuccha*' to '*pucca*' roofs and implementation of GST. Further, improvement in infrastructure spending in India, e-commerce growth, increasing warehousing and improvement in the rural market will likely drive overall growth. Implementation of GST will accelerate the shift from unorganised to organised sector and will lower the price differential between organised and unorganised players, as tax compliance costs would increase for the latter. In the past, EIL's businesses were affected by steep fluctuations in raw material prices, poor monsoons and currency weakness; and we believe that with the above stated drivers, EIL will deliver healthy numbers. We expect normalcy to return in the coming years; EIL is trading at 12.7x/10.3x PER and 7.1x/6.0x EV/EBIDTA FY19E/FY20E, respectively. We initiate our trading BUY on EIL with target price of INR 624, valuing the stock at 26% discount to historical 1-year forward average multiple of 19x i.e. 14x FY20E earnings.

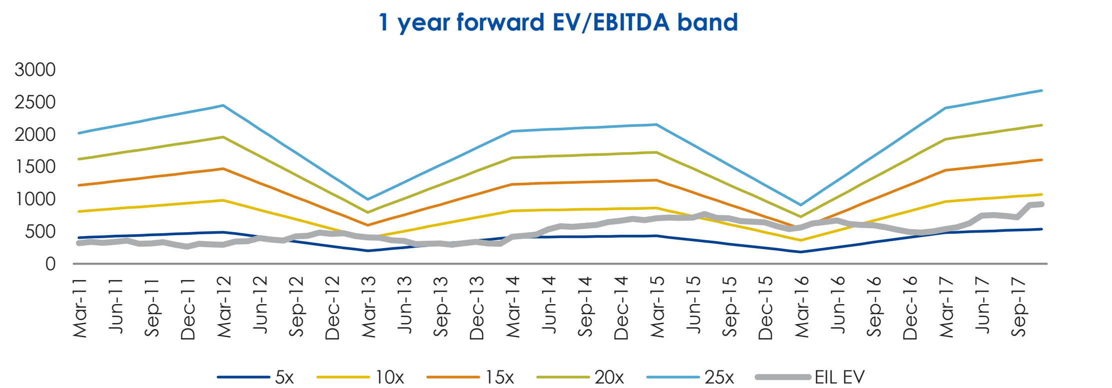
Peer comparison

	Revenue growth (%)			PAT growth (%)			EBITDA margin (%)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Everest	-11.1	8.8	9.0	-96.4	NA	24.4	3.1	7.6	8.1
Visaka	-4.0	6.0	7.0	67.0	9.0	36.0	11.9	12.3	12.9
HIL	-4.0	9.0	12.0	44.0	-3.0	21.0	9.7	10.0	10.4

	RoE (%)			Diluted PE (x)			EV/EBITDA (x)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Everest	0.4	12.5	14.0	NA	15.6	12.5	24.5	8.5	7.1
Visaka	10.8	10.9	12.6	10.5	23.1	16.9	9.5	8.7	7.2
HIL	11.4	12.1	12.9	17.9	16.4	13.6	9.9	9.3	8.1

Source: Company, Edelweiss Investment Research.





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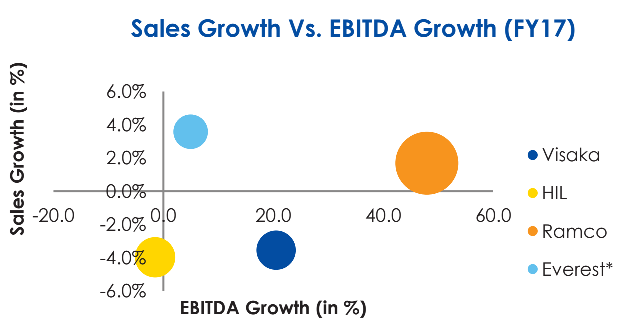
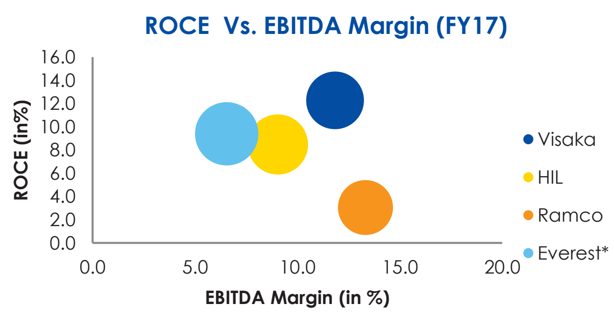


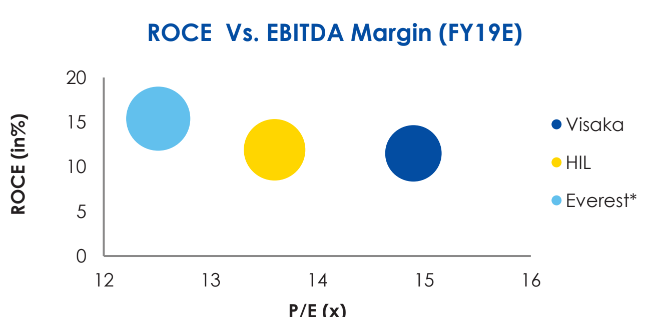
*FY16 financials for EIL

Bubble Size –Market cap (Rs.Cr.)

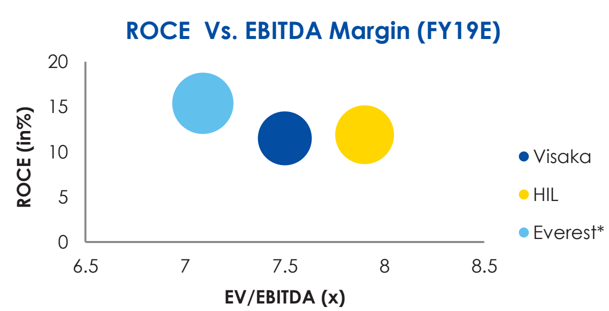


*FY16 financials for EIL

Bubble Size –Net Sales (Rs.Cr.)



Bubble Size - Net Sales (Rs.Cr.)



Bubble Size –Net Sales (Rs.Cr.)

Source: Edelweiss Investment Research.

Key management

Name	Designation	Profile
Mr A V Somani	*Chairman*	Mr. A V Somani has an overall experience of 25+ years in real estate, construction, building products, textiles and information technology management. He holds an MBA degree from the University of Pittsburgh, USA, PGDBM from SP Jain Institute of Management and Research and B.Com., M.Com. from Sydenham College of Commerce & Economics.
Mr M L Gupta	*Vice Chairman*	Mr. M L Gupta has a long and varied experience of handling building products businesses. He was the MD of Everest from 2002 to 2010. He holds a B.Tech. (Hons) from IIT Kharagpur.
Mr. Manish Sanghi	*Managing Director*	Mr. Manish Sanghi has a rich experience across industries he has worked with—Castrol, BHEL, Eicher and General Motors prior to joining Everest in 2001. He has joined EIL in 2001 as Marketing Director and took over charge as Managing Director in 2010. He holds a B.E. (Mech) and a PGDM (IIM-A) degree.

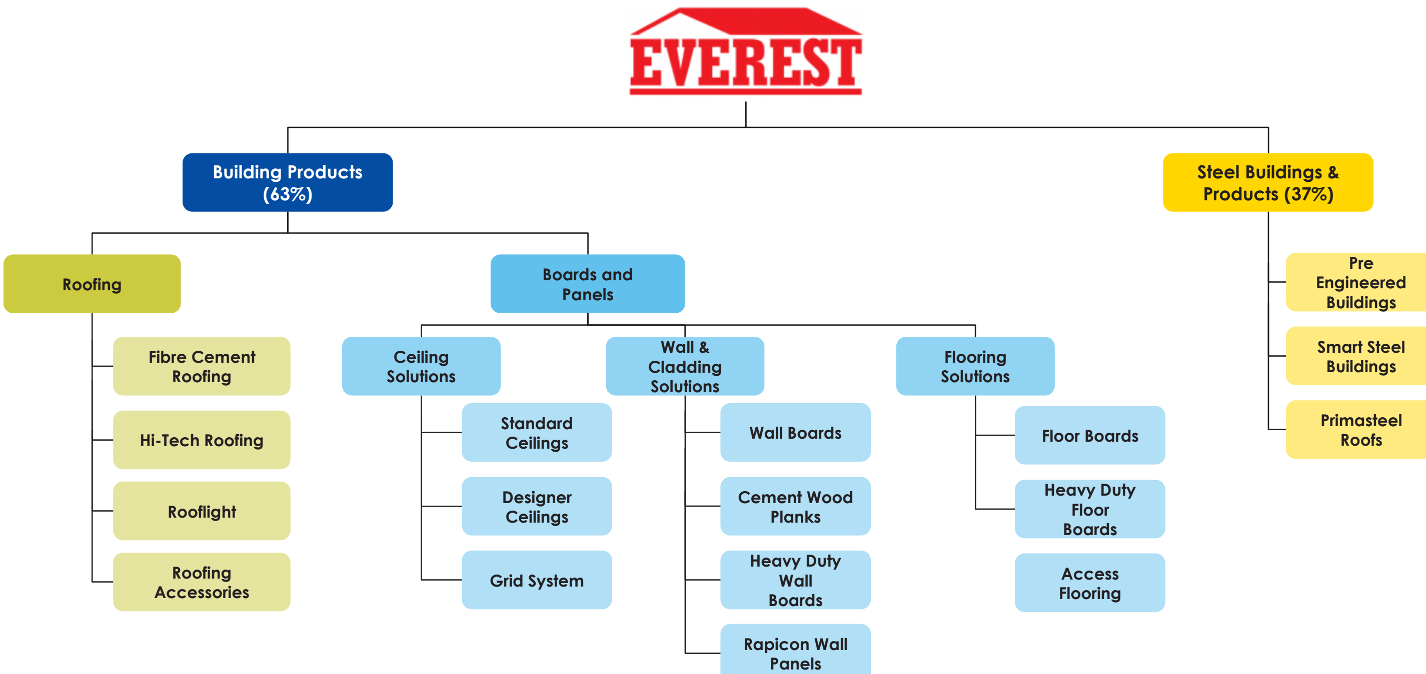
Key risks

- Any disruption in logistics or adverse exchange rate movement may have a significant impact on the company's operations and profitability, as EIL imports asbestos fibre (the key Chrysotile Asbestos Fiber manufacturers are based in Russia, Kazakhstan and Brazil)
- Volatility in steel price poses a significant risk
- High dependence on rural spending, seasonality in business.

Everest Industries Ltd. – A brief summary

EIL has two distinct business segments - Building Products and Steel Buildings. The building products segment contributes 63% to the company's revenue including fibre cement roofing sheets, fibre cement boards, Rapicon wall panels and their accessories. The steel building segment accounted for 37% of total revenue, which includes customized building solutions in steel such as pre-engineered steel buildings, smart steel buildings, metal roofing and cladding.

Business overview



Manufacturing facilities

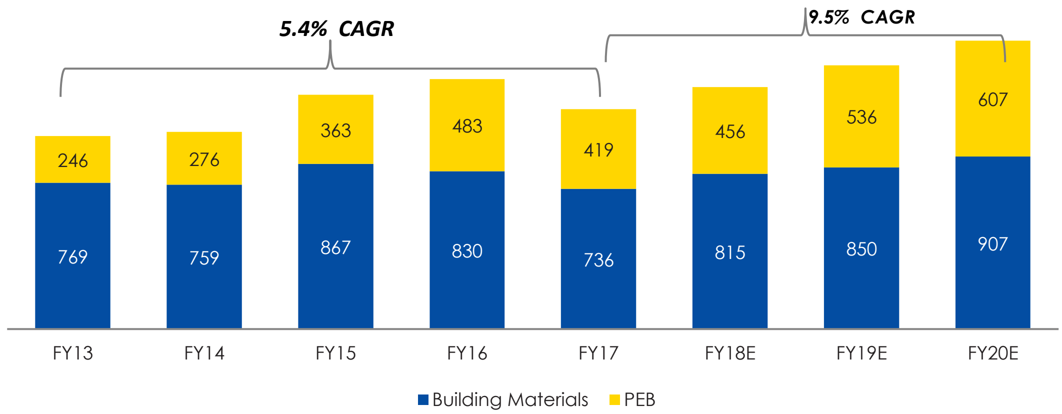
Location	Products	Capacity (MTPA)
Bhagwanpur, Uttarakhand	Building Products	8,65,000
Lakhmapur, Maharashtra		
Kolkata, West Bengal		
Kymore, Madhya Pradesh		
Podanur, Tamil Nadu		
Somnathpur, Odisha		
Bhagwanpur, Uttarakhand	Steel Buildings	72,000
Dahej, Gujarat		
Ranchi, Jharkhand		

Financial analysis

Utilisation improvement drives revenue

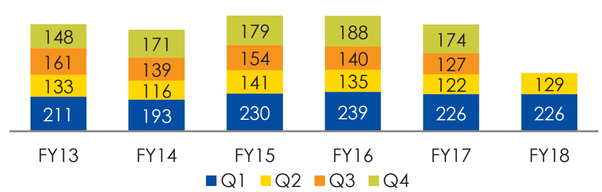
EIL expected to deliver sales volume growth of ~7%/~11% in BP division/PEBs division over FY17-20, mostly with the improvement in utilisations and realisations expected to be flat over FY17-20E, would results 9.4% revenue CAGR during FY17-20E.

Consolidated revenue (INR cr)

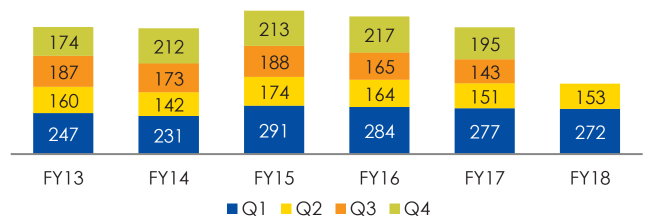


Sales & Volume – BP segment

Building Material Sales Volume (in '000 M.T)

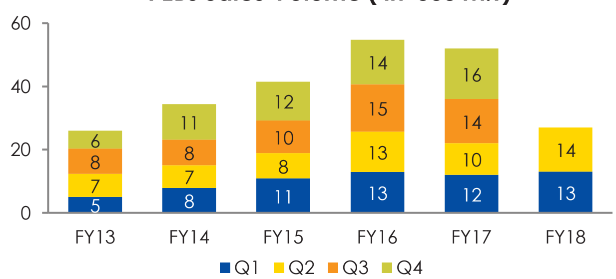


Building Material Revenue (INR Cr.)

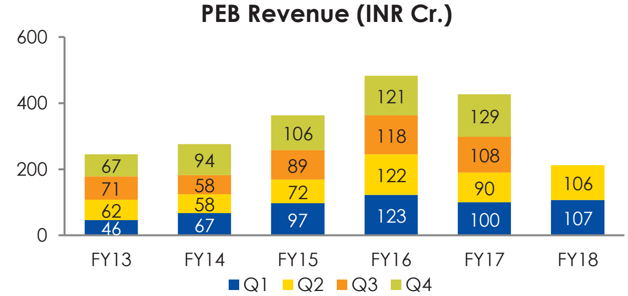


Sales & Volume – PEBs segment

PEBs Sales Volume (in '000 M.T)



PEB Revenue (INR Cr.)

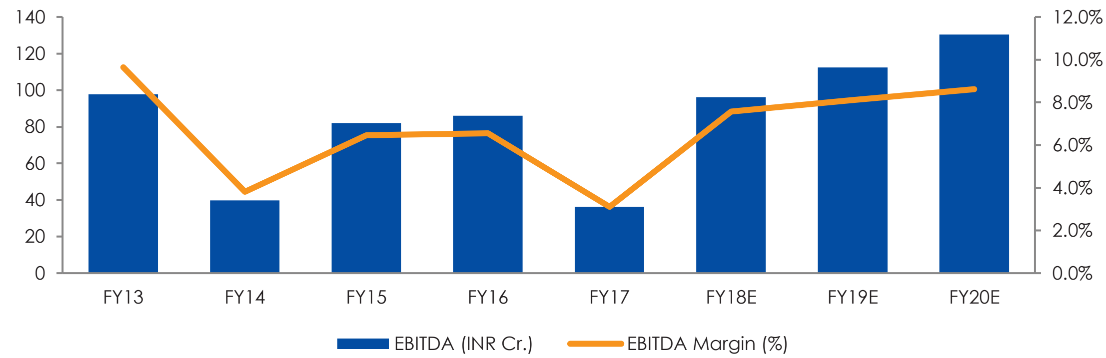


Source: Edelweiss Investment Research.

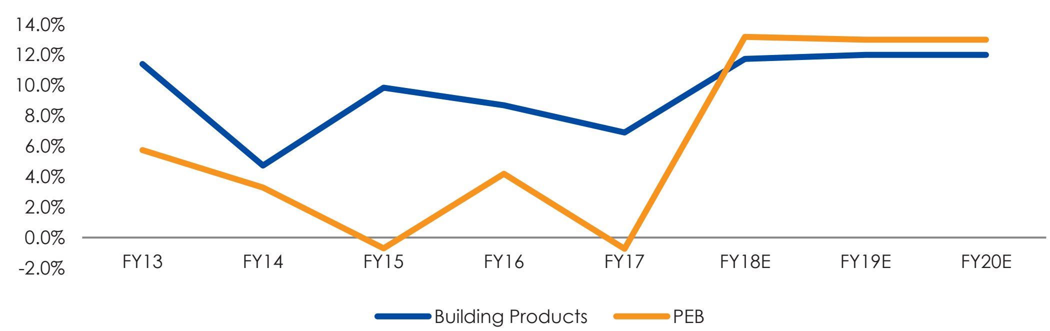
Operational efficiency, higher value-added productss to boost operating margin

We estimate EBITDA margin to improve by ~200 bps over the next two years, considering FY16 as the base year (as FY17 was a one off year impacted by several adverse factors), on account of improvement in utilisation, stability in raw material cost and increment in value-added products in the portfolio. EIL has already reported ~7% of EBITDA margin in H1FY18.

EBITDA & EBITDA margin



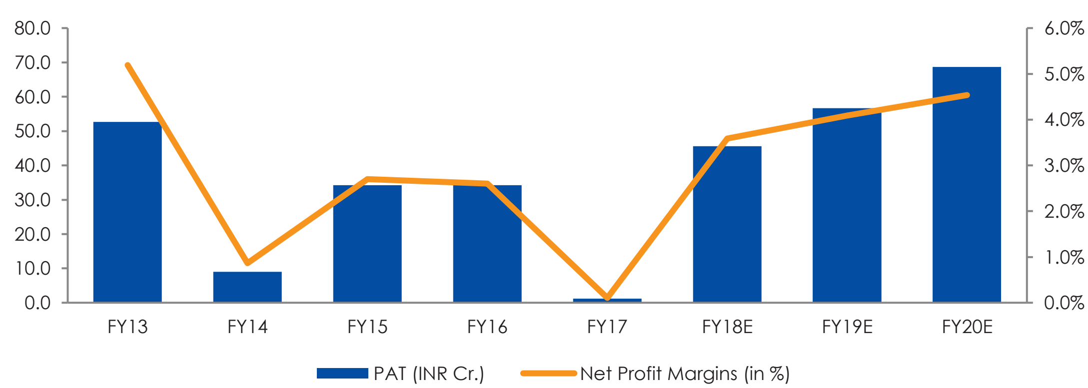
EBIT margins – BP & PEBs segments



Robust PAT growth to improve margin

With healthy sales growth, margin improvement, restricted depreciation and interest expenses are expected to result in positive PAT growth over FY17-20E. PAT margin is estimated to improve to 4.5% in FY20E from 2.6% in FY17. EIL has already achieved a PAT margin of 3.7% in H1FY18.

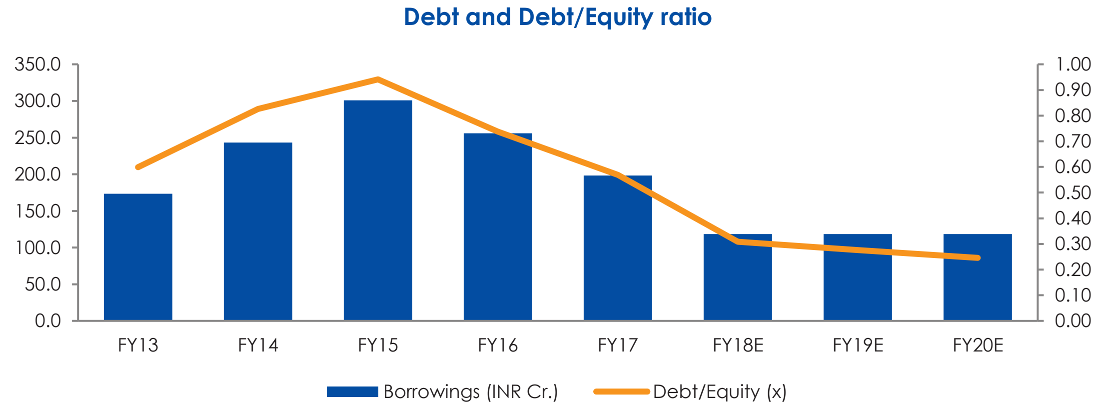
PAT and PAT margin



Source: Edelweiss Investment Research.

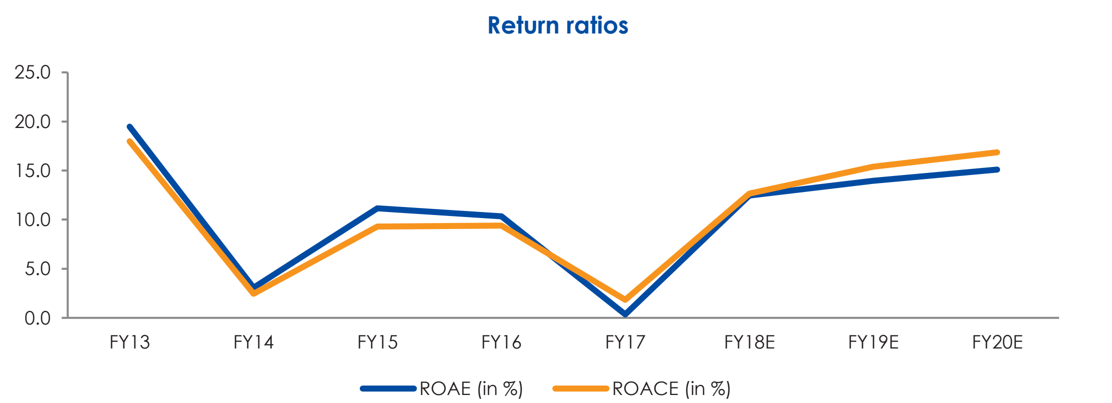
Debt to dip significantly

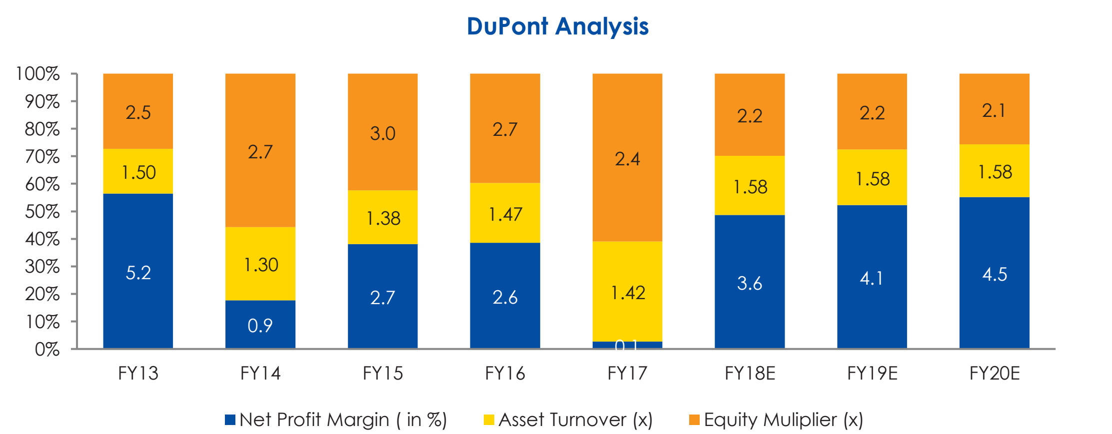
We estimate EIL's debt-equity ratio to improve to 0.2x by FY20E with positive free cash flow. There is no capex planned and the focus is on operational efficiency.



Return ratios to improve as utlilisation picks up

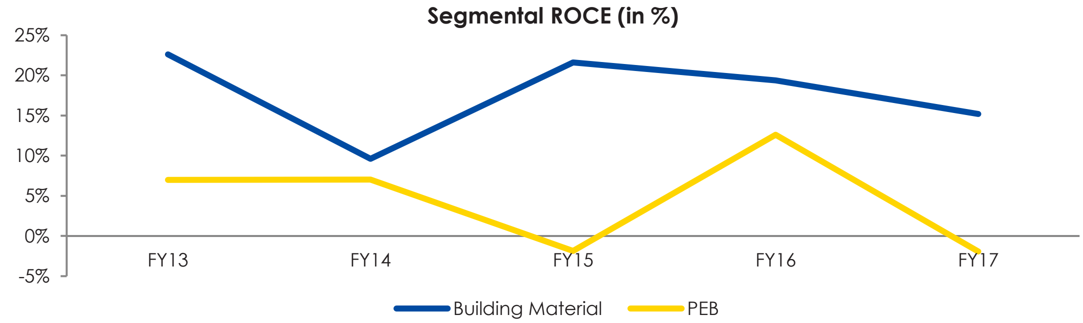
With improving margin, we estimate EIL's RoCE and RoE to improve by ~750 bps and 480 bps, respectively, over the next two years, considering FY16 as the base year (as FY17 was a one-off year). We expect the company to clock higher RoCE on account of better product mix and higher operational efficiencies.



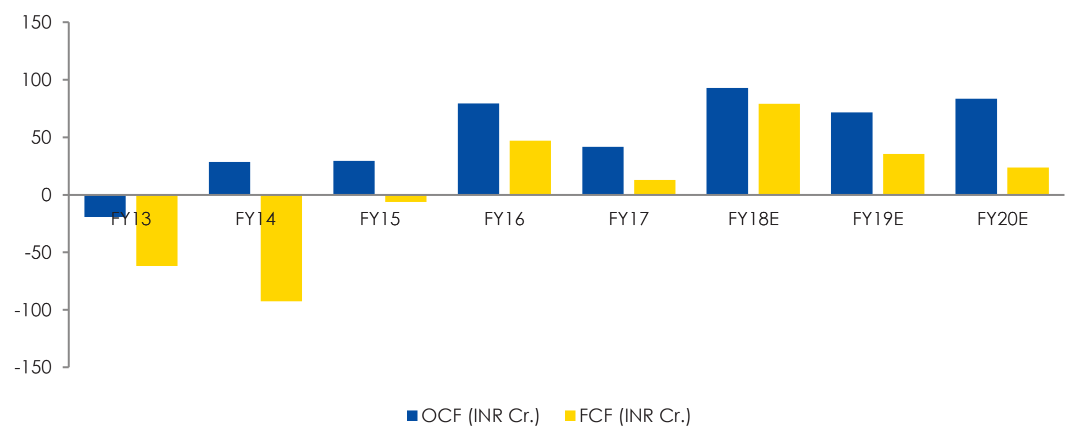


Source: Edelweiss Investment Research.

RoCE – BP & PEBs segments



Cash flows: OCF vs FCF



Source: Edelweiss Investment Research.

Everest Industries Ltd.

Financials

Income statement (INR cr)

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Income from operations	1,313	1,168	1,271	1,386	1,514
Direct costs	768	681	727	790	863
Employee costs	129	130	127	139	151
Other expenses	459	450	448	484	521
Total operating expenses	1,227	1,132	1,175	1,273	1,384
EBITDA	86	36	96	112	130
Depreciation and amortisation	26	25	26	27	29
EBIT	60	11	70	85	102
Interest expenses	23	19	13	10	10
Other income	13	9	8	9	9
Profit before tax	50	1	65	85	101
Provision for tax	16	0	20	28	32
Core profit	34	1	46	57	69
Extraordinary items	-0	0	0	0	0
Profit after tax	34	1	46	57	69
Minority Interest	0	0	0	0	0
Share from associates	0	0	0	0	0
Adjusted net profit	34	1	46	57	69
Equity shares outstanding (mn)	2	1.5	1.5	1.5	1.5
EPS (INR) basic	22.4	0.8	29.5	36.8	44.6
Diluted shares (Cr)	1.5	1.5	1.5	1.5	1.5
EPS (INR) fully diluted	22.4	0.8	29.5	36.8	44.6
Dividend per share	5.0	0.0	6.5	8.1	9.8
Dividend payout (%)	22.4	0.0	22.0	22.0	22.0

Common size metrics- as % of net revenues

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Operating expenses	93.5	96.9	92.4	91.9	91.4
Depreciation	2.0	2.2	2.0	1.9	1.9
Interest expenditure	1.7	1.6	1.0	0.7	0.7
EBITDA margins	6.5	3.1	7.6	8.1	8.6
Net profit margins	2.6	0.1	3.6	4.1	4.5

Growth metrics (%)

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Revenues	3.6	(11.1)	8.8	9.0	9.3
EBITDA	5.0	(57.8)	165.0	16.9	16.0
PBT	4.5	(97.4)	4,794.0	30.0	19.4
Net profit	0.6	(96.4)	3,604.3	24.4	21.2
EPS	(0.0)	(96.4)	3,604.3	24.4	21.2

Balance sheet (INR cr)

As on 31st March	FY16	FY17	FY18E	FY19E	FY20E
Equity share capital	15	15	15	15	15
Preference Share Capital	0	0	0	0	0
Reserves & surplus	331	333	368	412	466
Shareholders funds	347	348	384	428	481
Secured loans	256	198	118	118	118
Unsecured loans	0	0	0	0	0
Borrowings	256	198	118	118	118
Minority interest	1	0	0	0	0
Sources of funds	**603**	**547**	**502**	**546**	**600**
Gross block	596	608	633	658	708
Depreciation	245	271	297	323	352
Net block	350	337	336	334	356
Capital work in progress	9	26	15	26	36
Total fixed assets	360	364	351	360	392
Unrealised profit	0	0	0	0	0
Investments	0	0	0	0	0
Inventories	253	237	244	266	290
Sundry debtors	113	108	117	128	140
Cash and equivalents	63	18	8	31	39
Loans and advances	81	81	76	83	91
Other current assets	0	0	0	0	0
Total current assets	509	445	445	508	560
Sundry creditors and others	264	273	297	324	354
Provisions	27	6	6	7	7
Total CL & provisions	291	278	303	330	361
Net current assets	218	166	142	177	199
Net Deferred tax	-32	-31	-31	-31	-31
Misc expenditure	57	48	40	40	40
Uses of funds	**603**	**547**	**502**	**546**	**600**
Book value per share (INR)	225	226	249	277	312
	0	0	0	0	0

Cash flow statement

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Net profit	35	1	46	57	69
Add: Depreciation	26	25	26	27	29
Add: Misc expenses written off	27	10	8	0	0
Add: Deferred tax	3	-1	0	0	0
Add: Others	0	0	0	0	0
Gross cash flow	90	35	79	84	97
Less: Changes in W. C.	11	-7	-13	12	14
Operating cash flow	79	42	93	71	84
Less: Capex	32	29	14	36	60
Free cash flow	**47**	**13**	**79**	**35**	**24**

Ratios

Year to March	FY16	FY17	FY18E	FY19E	FY20E
ROAE (%)	10.3	0.4	12.5	14.0	15.1
ROACE (%)	9.4	1.8	12.6	15.4	16.9
Debtors (days)	31	34	34	34	34
Current ratio	1.7	1.6	1.5	1.5	1.6
Debt/Equity	0.7	0.6	0.3	0.3	0.2
Inventory (days)	70	74	70	70	70
Payable (days)	48	55	55	55	55
Cash conversion cycle (days)	54	53	48	48	48
Debt/EBITDA	3.0	5.5	1.2	1.1	0.9
Adjusted debt/Equity	0.6	0.5	0.3	0.2	0.2

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Diluted EPS (INR)	22.4	0.8	29.5	36.8	44.6
Y-o-Y growth (%)	*(0.0)*	*(96.4)*	*3,604.3*	*24.4*	*21.2*
CEPS (INR)	39.0	17.1	46.4	54.3	63.1
Diluted P/E (x)	20.6	576.7	15.6	12.5	10.3
Price/BV(x)	2.0	2.0	1.8	1.7	1.5
EV/Sales (x)	0.7	0.8	0.6	0.6	0.5
EV/EBITDA (x)	10.5	24.5	8.5	7.1	6.0
Diluted shares O/S	1.5	1.5	1.5	1.5	1.5
Basic EPS	22.4	0.8	29.5	36.8	44.6
Basic PE (x)	20.6	576.7	15.6	12.5	10.3
Dividend yield (%)	1.1	0.0	1.4	1.8	2.1

Hyderabad Industries Ltd. (HIL)

In good health

CMP INR 1,336

Rating: Not Rated

Hyderabad Industries Ltd. (HIL) was established in 1946 and is among the largest companies in the building material segment for the last seven decades. HIL is a part of the CK Birla group. HIL manufactures roofing products, provides building solutions and also provides thermal insulation for energy intensive industries. Close to 95% of the company's revenue arises from roofing products and building solutions. Headquartered in Hyderabad, it has 20 manufacturing facilities spread across India with close to 14 lakh MT in building material capacity. The company has a pan-India presence and a strong distribution network with over 4,500 dealers and retailers. HIL is India's leading manufacturer and supplier of fibre cement sheets and also exports products and machinery for the manufacture of building products to many countries.

Developing non-asbestos products to expand geographic reach

The company maintains leadership with its Charminar brand accounting for 19% market share in the asbestos cement sheets market. HIL has plans to increase its reach by developing non-asbestos products. This should help the company penetrate the institutional segment as well as aid sales.

Coloured steel sheets expansion: Increasing customer base

To cater to the demands of urban customers, HIL set up a second plant of CC sheets in Orissa with a capacity of 1,500 M.T a month. Beginning operations in April 2017, the plant will supply the requirements in Orissa, Jharkhand and West Bengal.

Pipes and fittings expansion complete: HIL expects robust growth ahead

The company recently completed a INR 130 crore expansion plan for its pipes and fittings segment with an ultimate capacity of over 7,500 MT. In FY17, this segment contributed INR 40 crore to topline; going forward the company expects strong revenue growth with revenue from this segment growing by 9-10x.

Outlook

HIL is considering enhancing and widening its business segments and geographic reach via introduction of new products and expanding their capacities. The company's plan to penetrate the institutional segment with non-asbestos products and expansion of its piping segment will likely boost revenue going forward. The company's valuation appears good considering its growth outlook. The stock is currently trading at a P/E of 19x FY17 earnings.

Year to March	FY15	FY16	FY17
Revenues (INR Cr)	1,108	1,096	1,053
Rev growth (%)	27.4	(1.0)	(4.0)
EBITDA (INR Cr)	114	97	95
Net Profit (INR Cr)	67	40	55
P/E (x)	15.0	25.2	19.1
EV/ EBITDA (x)	9.8	11.9	11.2
RoACE (%)	14.6	9.0	8.5
RoAE (%)	16.2	8.9	11.3

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Bloomberg:	HIL:IN
52-week range (INR):	1,424.00 / 584.95
Share in issue (cr):	1
M cap (INR cr):	938
Avg. Daily Vol. BSE/NSE :('000):	13
Promoter Holding (%)	40.99

Date: 4th December 2017

HIL: Business segments & brands

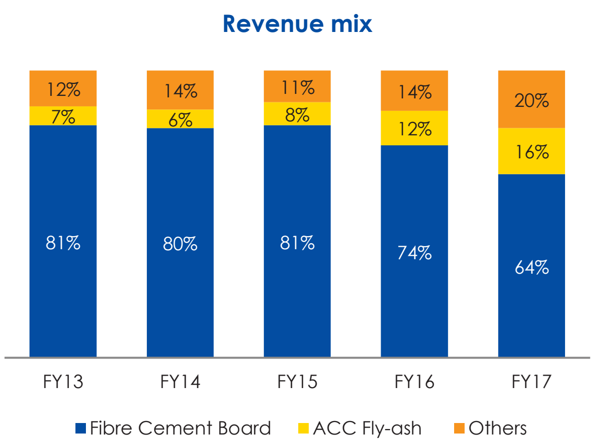
HIL has three main product divisions: Roofing, Walling and Plumbing and calcium silicate insulation for energy intesnsive industries. The brands related to the above divisons are Charminar, Birla Aerocon and Hysil.

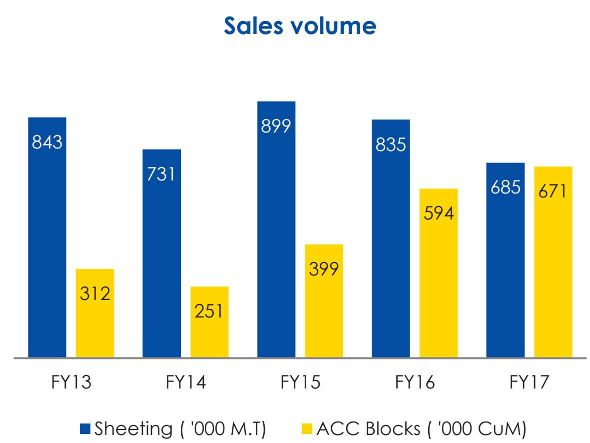
CHARMINAR
- Fibre Cement Sheets
- Coloured Steel Sheets

HYSIL Calcium Silicate Insulation
- Insulation for energy-intensive industries

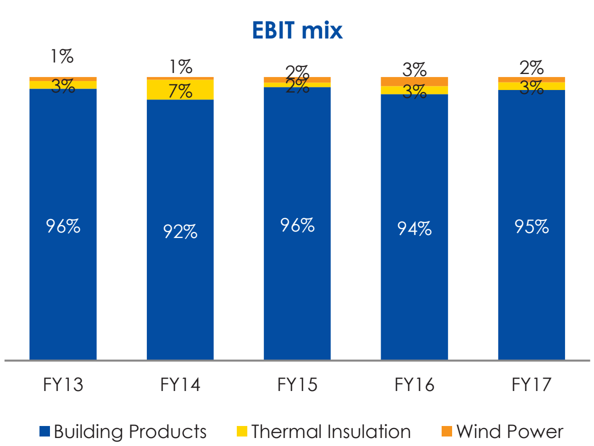
BIRLA AEROCON
- Solid Wall Panels
- Fly-Ash Bricks (AAC)
- FOB & C-Boards
- Dry Mix
- Pipes & Fittings

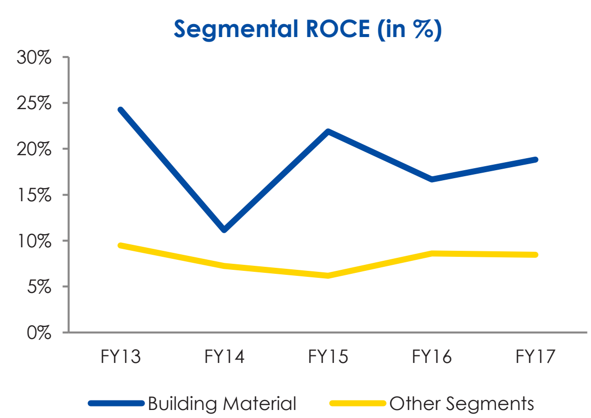
HIL is the market leader in asbestos cement sheets and a majority of the company's revenue arises from the roofing segment; accounting for 64% of the topline followed by walling solutions (ACC fly ash) clocking 16% of the topline.





Currently, HIL mantains a healthy segmental RoCE in building material; close to 20%.





Source: Edelweiss Investment Research

Manufacturing facilities

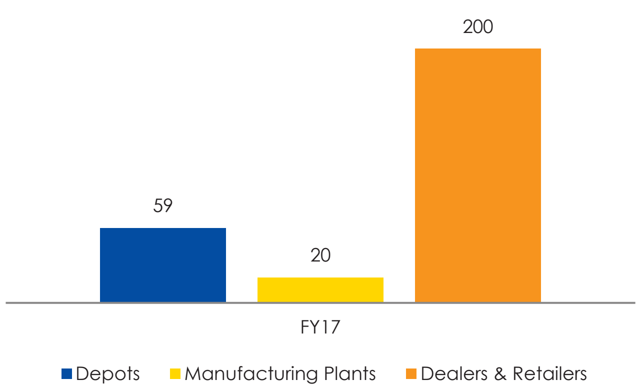
HIL has 20 manufacturing facilities spread across the country with a capacity of 11.5 lakh MT in AC sheets and a fly ash capacity of 8.25 lakh CBM; its two key revenue sources. In addition to these, HIL also has six turbines (wind power) which have a combined capacity of 9.35 MW present in Gujarat, Tamil Nadu and Rajasthan. HIL has close to 14 lakh MT in building material capacity.

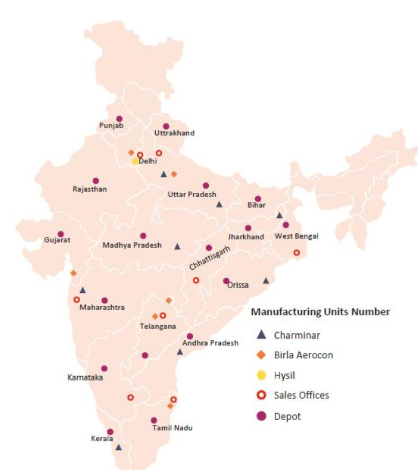
Location	Product	Capacity
Balasore , Orissa	AC Sheets	11.5 Lakh MT
Faridabad, Harayana		
Jasidih, Jharkhand		
Kondapalli, Andhra Pradesh		
Satharia, Uttar Pradesh		
Thrissur, Kerala		
Wada, Maharashtra		
Balasore, Orissa	CC steel sheets	27,600 MT
Wada, Maharashtra		
Faridabad, Uttar Pradesh	Solid wall panels	78,000 MT
Timmapur, Karnataka		
Jhajjar, Harayana	Fly-ash Bricks	8.25 Lakh CBM
Chennai, Tamil Nadu		
Golan, Gujrat		
Timmapur, Karnataka		
Hyderabad, Andhra Pradesh	FOB & c-board	54,000 MT
Jhajjar, Harayana	Dry-mix	72,000 MT
Faridabad, Harayana	Pipes & fittings	7,555 MT
Timmapur, Karnataka		
Dharuhera, Harayana	Calcium Silicate Insulation	4,800 MT

Robust distribution network

HIL has a strong distribution network with 20 manufacturing units spread across India, 43 sales depots, eight sales offices, 2,500 loyal distributors and 6,500 sub-dealers with deeper market penetration in rural areas.

Distribution Network

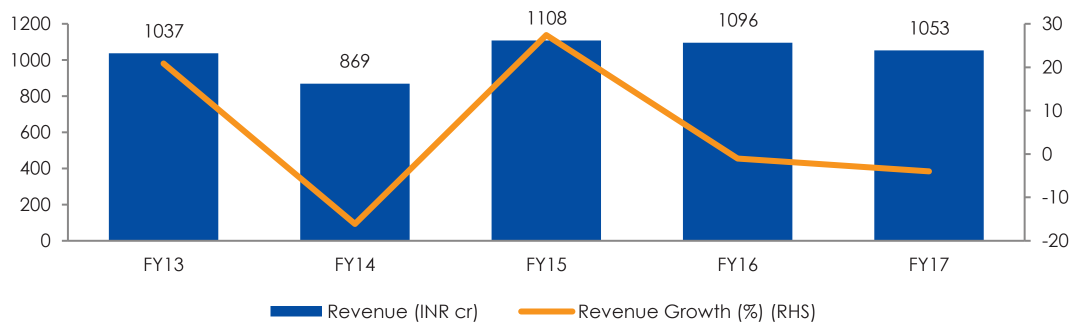


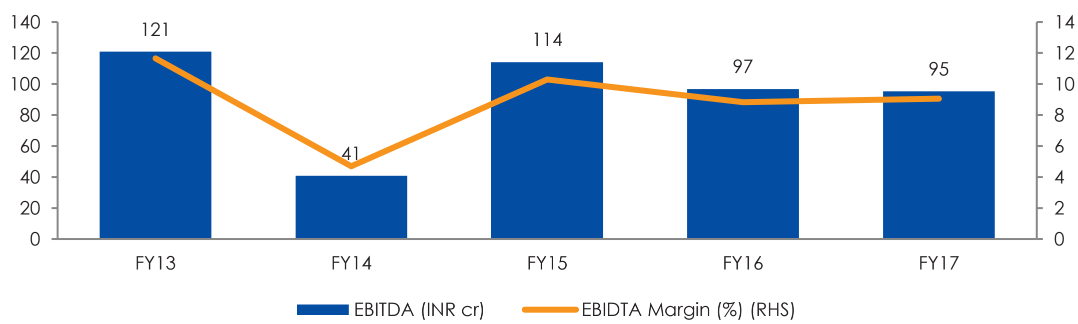


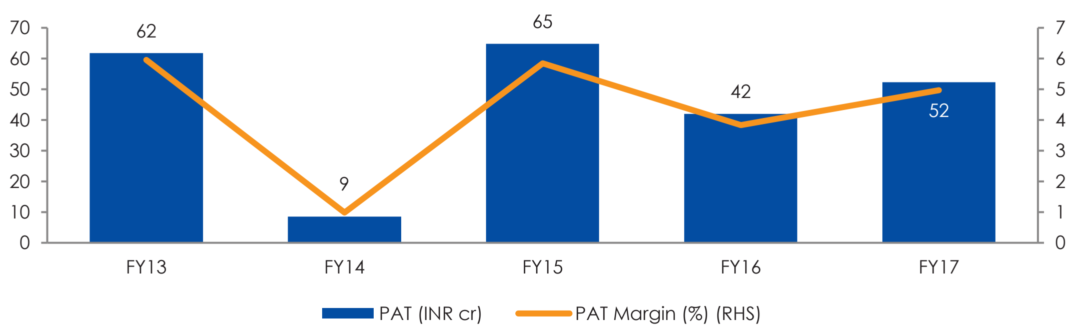
Source: Edelweiss Investment Research

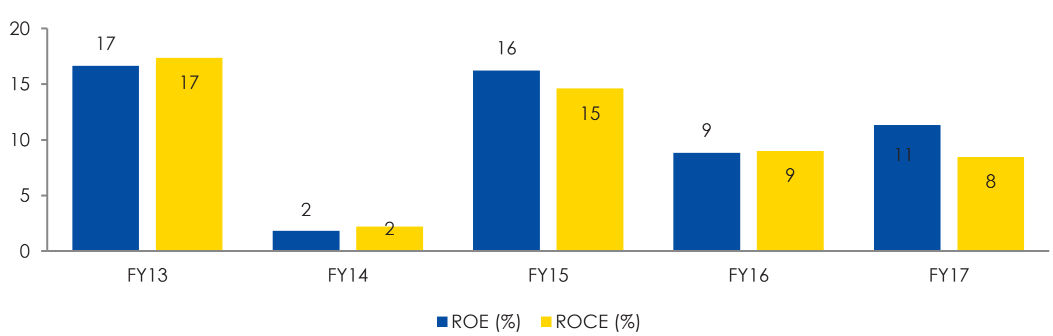
Financial Analysis

HIL's topline has grown at a CAGR of 7% over the last three years with revenue of INR 1,053 crore in FY17. The company's PAT grew at a staggering CAGR of 83% over the same period with EBITDA growing at 33% CAGR over the stated period with EBITDA of INR 95 crore in FY17









Source: Edelweiss Investment Research.

HIL Ltd

Financials

Income statement (INR cr)

Year to March	FY15	FY16	FY17
Income from operations	1,108	1,096	1,053
Direct costs	662	676	620
Employee costs	104	114	120
Other expenses	332	324	337
Total operating expenses	994	1,000	957
EBITDA	114	97	95
Depreciation and amortisation	34	40	41
EBIT	80	57	54
Interest expenses	6	9	5
Other income	18	12	24
Profit before tax	92	60	73
Provision for tax	25	20	19
Core profit	67	40	55
Extraordinary items	-2	2	-2
Profit after tax	65	42	52
Minority Interest	0	0	0
Share from associates	0	0	0
Adjusted net profit	65	42	52
Equity shares outstanding (mn)	1	1	1
EPS (INR) basic	89.3	53.0	69.9
Diluted shares (Cr)	0.7	0.7	0.7
EPS (INR) fully diluted	89.3	53.0	69.9
Dividend per share	19.9	17.4	10.0
Dividend payout (%)	22.3	32.9	13.7

Common size metrics- as % of net revenues

Year to March	FY15	FY16	FY17
Operating expenses	89.7	91.2	91.0
Depreciation	3.1	3.6	3.9
Interest expenditure	0.5	0.8	0.5
EBITDA margins	10.3	8.8	9.0
Net profit margins	5.8	3.8	5.0

Growth metrics (%)

Year to March	FY15	FY16	FY17
Revenues	27.4	(1.0)	(4.0)
EBITDA	179.5	(15.2)	(1.5)
PBT	830.8	(34.7)	22.3
Net profit	839.2	(40.7)	37.6
EPS	839.2	(40.7)	31.9

Balance sheet (INR cr)

As on 31st March	FY15	FY16	FY17
Equity share capital	7	7	7
Preference Share Capital	0	0	0
Reserves & surplus	428	453	494
Shareholders funds	436	460	501
Secured loans	71	140	65
Unsecured loans	49	18	7
Borrowings	120	158	72
Minority interest	0	0	0
Sources of funds	**556**	**618**	**573**
Gross block	722	781	790
Depreciation	242	276	309
Net block	480	505	482
Capital work in progress	7	11	7
Total fixed assets	487	516	489
Unrealised profit	0	0	0
Investments	9	9	41
Inventories	220	222	206
Sundry debtors	69	101	86
Cash and equivalents	6	4	10
Loans and advances	38	37	25
Other current assets	0	0	0
Total current assets	333	364	327
Sundry creditors and others	231	218	245
Provisions	15	19	9
Total CL & provisions	246	237	254
Net current assets	87	128	74
Net Deferred tax	-45	-46	-44
Misc expenditure	18	12	14
Uses of funds	**556**	**618**	**573**
Book value per share (INR)	582	614	669
	-0	-0	0

Cash flow statement

Year to March	FY15	FY16	FY17
Net profit	69	37	57
Add: Depreciation	34	40	41
Add: Misc expenses written off	3	6	-3
Add: Deferred tax	5	1	-2
Add: Others	0	0	0
Gross cash flow	111	84	93
Less: Changes in W. C.	35	43	-60
Operating cash flow	76	42	153
Less: Capex	109	69	13
Free cash flow	**-33**	**-27**	**140**

Ratios

Year to March	FY15	FY16	FY17
ROAE (%)	16.2	8.9	11.3
ROACE (%)	14.6	9.0	8.5
Debtors (days)	23	34	30
Current ratio	1.4	1.5	1.3
Debt/Equity	0.3	0.3	0.1
Inventory (days)	73	74	71
Payable (days)	76	73	85
Cash conversion cycle (days)	19	35	17
Debt/EBITDA	1.1	1.6	0.8
Adjusted debt/Equity	0.3	0.3	0.1

Valuation parameters

Year to March	FY15	FY16	FY17
Diluted EPS (INR)	89.3	53.0	69.9
Y-o-Y growth (%)	*839.2*	*(40.7)*	*31.9*
CEPS (INR)	134.7	106.0	127.5
Diluted P/E (x)	15.0	25.2	19.1
Price/BV(x)	2.3	2.2	2.0
EV/Sales (x)	1.0	1.1	1.0
EV/EBITDA (x)	9.8	11.9	11.2
Diluted shares O/S	0.7	0.7	0.7
Basic EPS	89.3	53.0	69.9
Basic PE (x)	15.0	25.2	19.1
Dividend yield (%)	1.5	1.3	0.7

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Visaka Industries Ltd.

Moving to 'The Next Level'

CMP INR 598

Rating: Not Rated

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Company overview - Well diversified business

Visaka Industries was established in 1985. Visaka has two main divisions; Building Products division which manufactures cement asbestos products as well as fibre cement flat products and the Textile division. The Building Products division accounts for a majority of the revenue – over 80%. The company is the second largest manufacturer of cement asbestos products in India. Headquartered in Hyderabad, Visaka has 11 manufacturing facilities across India with an aggregate production capacity of 802 kTPA in cement asbestos sheets, 130 kTPA in V-boards and panels and 10,000 MT of yarn production per annum.

Visaka - prominent rural and semi-urban brand in building materials

Visaka and Shakti brands, the prominent building product brands in rural and semi-urban India, account for 18% share of India's cement asbestos market. Visaka's manufacturing facilities and wide distribution network are spread India-wide, enabling it to penetrate pan-India. The more than 6,000 retailers in the rural and semi-urban markets garner 90% of sales, whilst institutional sales to the government, industry and poultry enterprises constitute the remaining 10%. Visaka ventured into the manufacturing boards and panels segment, which is used in prominent buildings on account of time and resource savings as well as for considerations of safety and aesthetics.

Textiles – Improving realisation and robust offtake

Visaka manufactures niche, value-added yarns - utilised in demanding fabric applications, generating realisations that are amongst the highest in the country's yarn sector. The company's spinning capacity expanded 26% in FY17, which will enhance the manufacture of premium yarns with higher realisation yields and result in a robust offtake. With improvement in trade normalisation, demand and asset utilisation are expected to hit 90%, boosting margins.

Outlook

The better monsoons and decline in rural inflation are expected to increase demand for rural cement asbestos products. Moreover, steel sheet demand would be restricted with the increase in steel prices. The increasing utilisation and probable revival in exports is expected to strengthen EBITDA margin. Visaka is trading at a P/E of 23x FY17 earnings.

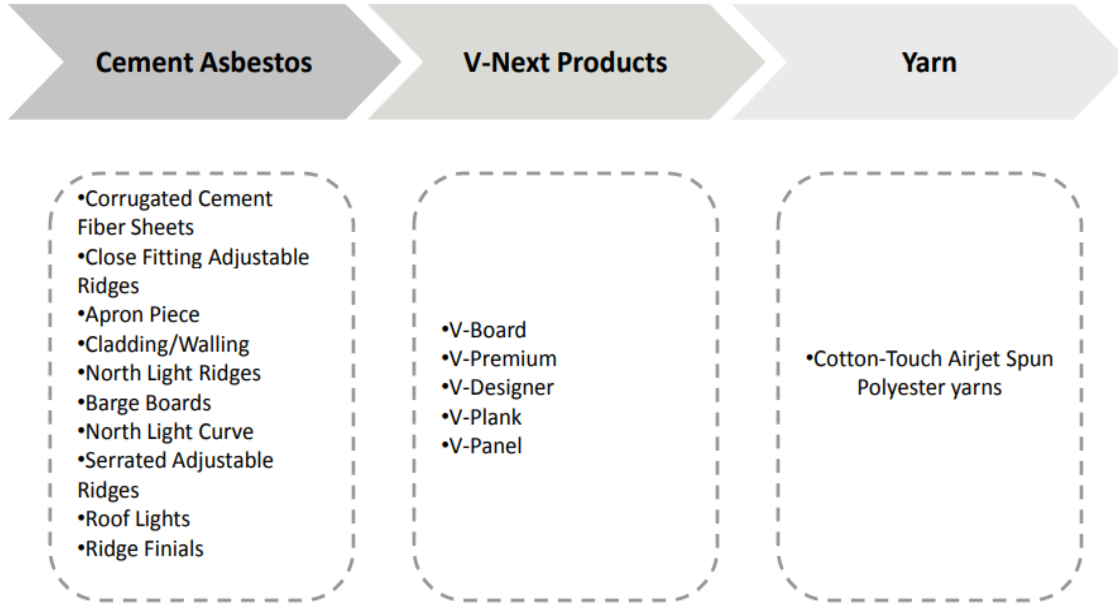
Bloomberg:	VSKI:IN
52-week range (INR):	733.95/172.25
Share in issue (cr):	2
M cap (INR cr):	1,125
Avg. Daily Vol. BSE/NSE :('000):	80
Promoter Holding (%)	41.23

Year to March	FY15	FY16	FY17
Revenues (INR Cr)	1,021	1,005	969
Rev growth (%)	14.5	(1.6)	(3.5)
EBITDA (INR Cr)	96	95	115
Net Profit (INR Cr)	21	24	41
P/E (x)	44.8	39.0	23.3
EV/EBITDA (x)	12.8	12.6	9.8
RoACE (%)	8.2	8.7	12.3
RoAE (%)	6.4	7.2	11.1

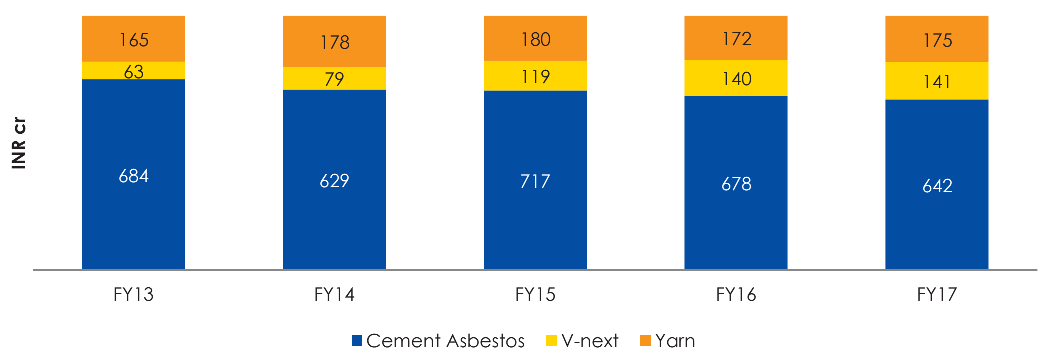
Date: 4th December, 2017

Visaka — Segment details

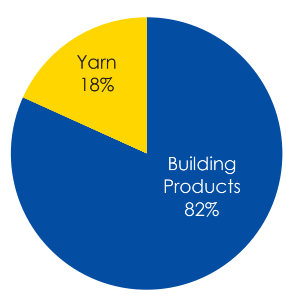
Visaka has three main divisions: Cement Asbestos, V-next Products and Yarn. Cement asbestos and V-next products fall under the head, Building Products. Visaka has a strong distribution network with over 6,000 dealers pan-India.



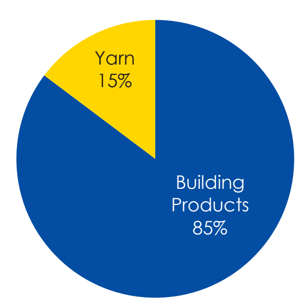
Visaka: Segmental revenue breakup



Revenue mix



EBIDTA mix



Source: Edelweiss Investment Research

Visaka: Manufacturing facilities and capacity expansion

Location	Product	Capacity
Patancheru (Telangana) Vijayawada (Andhra Pradesh) Paramathi (Tamil Nadu) Tumkur (Karnataka) Midnapore (West Bengal) Rae Bareli (Uttar Pradesh) Pune (Maharashtra) Sambalpur (Odisha)	Cement Asbestos	802000 TPA
Miryalguda (Telangana) Delwadi (Maharashtra)	V-next	129750 TPA
Nagpur (Maharashtra)	Yarn	2752 Spinning Pos.

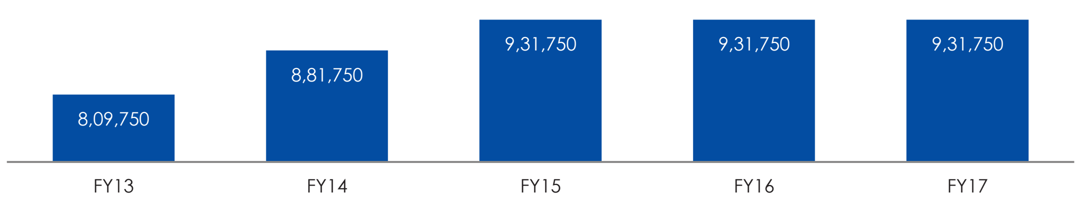
Visaka — Building Product division

Visaka has two segments in the Building Product division – (a) Cement asbestos business, and b) Fibre cement boards and panels (non-asbestos)/V-Next. Visaka's Building Products division went into business in 1985 with the manufacture of cement asbestos sheets. This latter business has an installed capacity of 802,000 TPA and is presently operating at an 88% utilisation rate – contributing 67% to the company's total revenue.

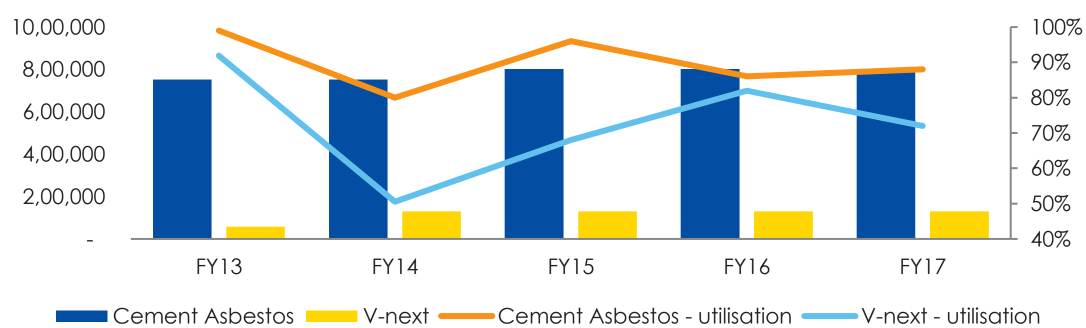
Visaka's V-Board and Panels has an intalled cpacity of 129,750 TPA and operates at 72%. However, production declined by 12% during FY17 mainly on account of a decline in the Middle East market. This segmnet contributes ~15% to the total revenue.

Visaka is investing in a boards and panels (V-next) manufacturing unit in Haryana with a capacity of 50,000 MT.

Building material capacity expansion (TPA)



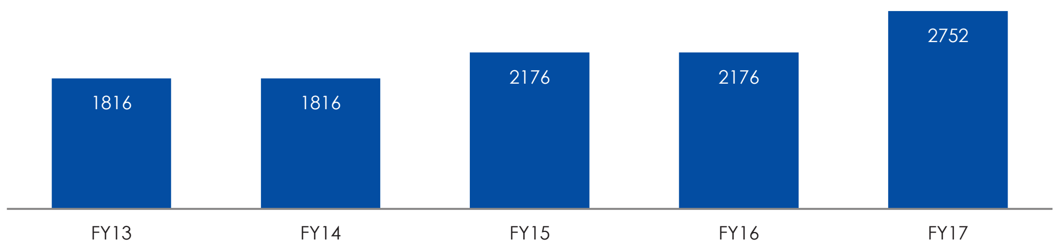
Visaka — Building products capacity and utilisation



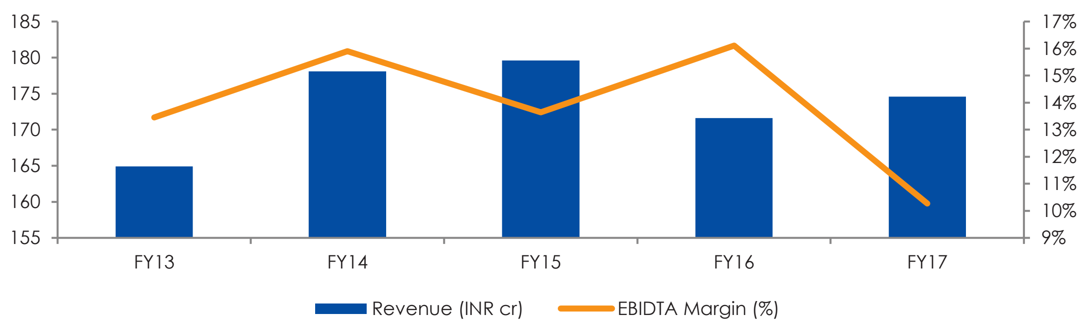
Visaka — Yarn division

The company manufactures polyester spun yarn as well as synthetic yarn from counts of 30s to 76s – double yarn. The company widened its product range to manufacture mélange yarn, high-twist yarn and specialty yarn across blends and styles. The asset utilisation of this segment along with the expanded capacity is expected to hit 95% utilisation in forthcoming years and the margins are expected to rebound; demand is likely to improve following trade normalisation.

Yarn capacity expansion (spinning positions)



Yarn division – Sales and margins

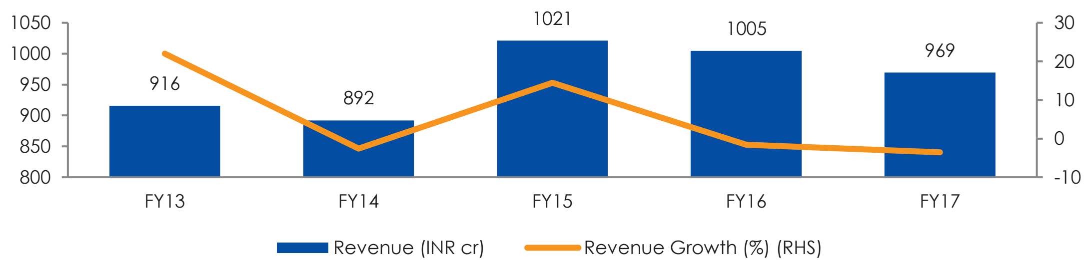


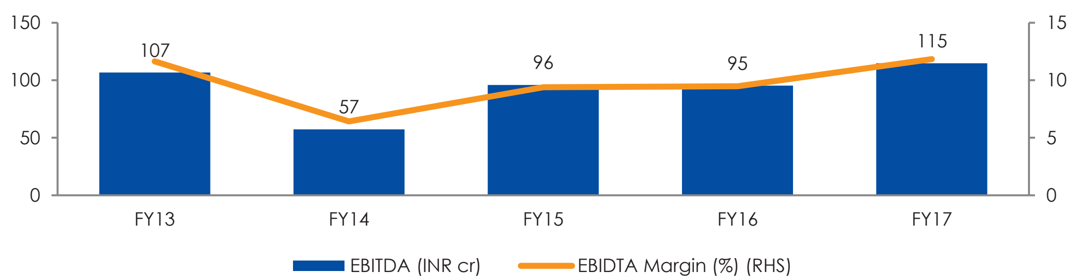
Source: Edelweiss Investment Research

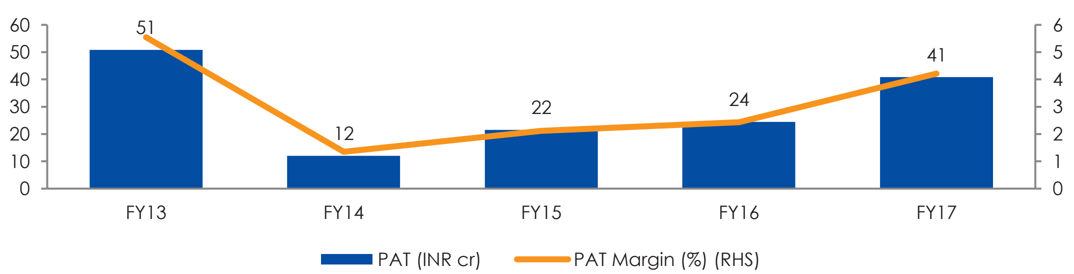
Financial analysis

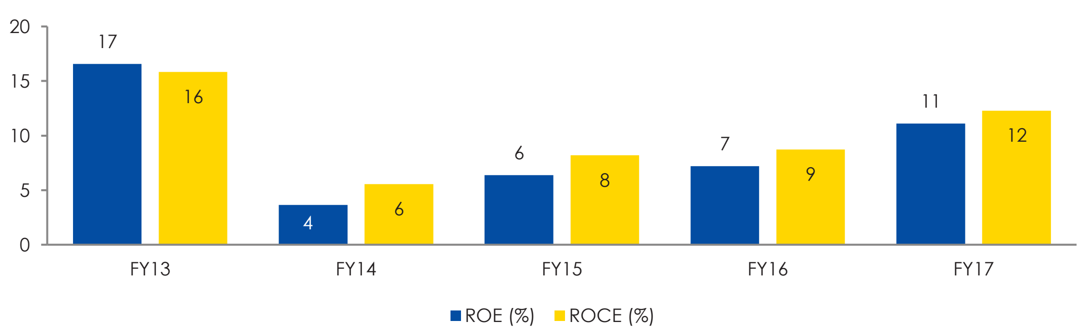
Operational improvement leads to continued robust finacials

Visaka has delivered revenue CAGR of 3% over FY14-17, driven by 21% revenue CAGR in its boards & panels division. Visaka has posted 26%/50% EBITDA/PAT CAGRs over FY14-17, led by strong margin expansion (benefits of operating leverage and higher realisation) of the boards & panels segment. The return ratios have improved steadily on account of overall improvement in the financial performance.









Source: Edelweiss Investment Research

Financials

Income statement (INR cr)

Year to March	FY15	FY16	FY17
Income from operations	1,021	1,005	969
Direct costs	628	621	547
Employee costs	59	68	77
Other expenses	297	288	307
Total operating expenses	925	910	855
EBITDA	96	95	115
Depreciation and amortisation	43	36	34
EBIT	53	59	81
Interest expenses	22	21	18
Other income	2	3	4
Profit before tax	33	40	66
Provision for tax	12	16	26
Core profit	21	24	41
Extraordinary items	0	0	0
Profit after tax	22	24	41
Minority Interest	0	0	0
Share from associates	0	0	0
Adjusted net profit	22	24	41
Equity shares outstanding (mn)	2	2	2
EPS (INR) basic	13.3	15.3	25.6
Diluted shares (Cr)	1.6	1.6	1.6
EPS (INR) fully diluted	13.3	15.3	25.6
Dividend per share	5.0	5.0	0.0
Dividend payout (%)	37.4	32.5	0.0

Common size metrics- as % of net revenues

Year to March	FY15	FY16	FY17
Operating expenses	90.6	90.5	88.2
Depreciation	4.2	3.6	3.5
Interest expenditure	2.2	2.1	1.9
EBITDA margins	9.4	9.5	11.8
Net profit margins	2.1	2.4	4.2

Growth metrics (%)

Year to March	FY15	FY16	FY17
Revenues	14.5	(1.6)	(3.5)
EBITDA	67.4	(0.7)	20.5
PBT	76.6	21.6	64.5
Net profit	77.1	15.1	67.0
EPS	77.1	15.1	67.0

Balance sheet (INR cr)

As on 31st March	FY15	FY16	FY17
Equity share capital	16	16	16
Preference Share Capital	0	0	0
Reserves & surplus	316	331	372
Shareholders funds	332	347	388
Secured loans	182	169	147
Unsecured loans	122	152	67
Borrowings	304	321	215
Minority interest	0	0	0
Sources of funds	**637**	**668**	**603**
Gross block	567	584	651
Depreciation	255	290	324
Net block	312	294	327
Capital work in progress	0	4	12
Total fixed assets	313	298	339
Unrealised profit	0	0	0
Investments	15	10	0
Inventories	250	232	196
Sundry debtors	129	147	156
Cash and equivalents	28	75	38
Loans and advances	37	28	22
Other current assets	0	0	0
Total current assets	444	482	413
Sundry creditors and others	90	122	139
Provisions	12	6	6
Total CL & provisions	101	129	145
Net current assets	343	353	268
Net Deferred tax	-26	-22	-21
Misc expenditure	-7	29	18
Uses of funds	**637**	**668**	**603**
Book value per share (INR)	209	218	244
	0	-0	0

Cash flow statement

Year to March	FY15	FY16	FY17
Net profit	21	24	41
Add: Depreciation	43	36	34
Add: Misc expenses written off	1	-36	11
Add: Deferred tax	-4	-4	-1
Add: Others	0	0	0
Gross cash flow	61	21	85
Less: Changes in W. C.	77	-36	-49
Operating cash flow	-16	57	134
Less: Capex	0	22	74
Free cash flow	**-16**	**35**	**59**

Ratios

Year to March	FY15	FY16	FY17
ROAE (%)	6.4	7.2	11.1
ROACE (%)	8.2	8.7	12.3
Debtors (days)	46	53	59
Current ratio	4.4	3.7	2.8
Debt/Equity	0.9	0.9	0.6
Inventory (days)	89	84	74
Payable (days)	32	44	52
Cash conversion cycle (days)	103	93	80
Debt/EBITDA	3.2	3.4	1.9
Adjusted debt/Equity	0.8	0.7	0.5

Valuation parameters

Year to March	FY15	FY16	FY17
Diluted EPS (INR)	13.3	15.3	25.6
Y-o-Y growth (%)	*77.1*	*15.1*	*67.0*
CEPS (INR)	40.4	38.1	47.0
Diluted P/E (x)	44.8	39.0	23.3
Price/BV(x)	2.9	2.7	2.5
EV/Sales (x)	1.2	1.2	1.2
EV/EBITDA (x)	12.8	12.6	9.8
Diluted shares O/S	1.6	1.6	1.6
Basic EPS	13.3	15.3	25.6
Basic PE (x)	44.8	39.0	23.3
Dividend yield (%)	0.8	0.8	0.0

Sanitaryware

Sanitaryware

Swachh Bharat Abhiyan to lend a helping hand

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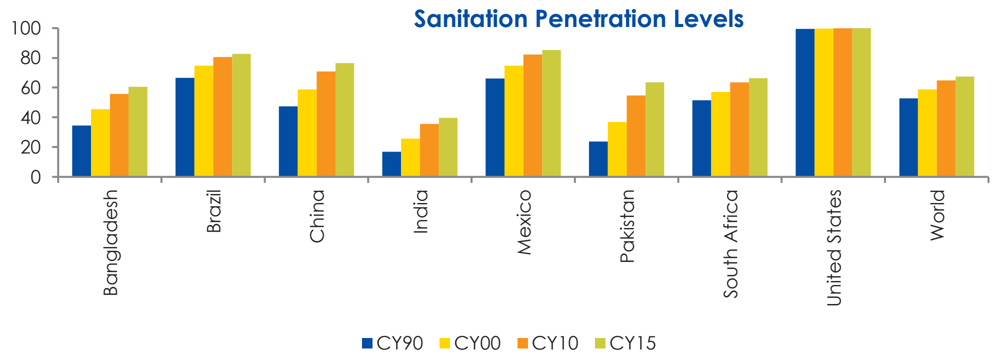
India's sanitation penetration at ~40% is way below the global average of ~68% and also below Pakistan & Bangladesh's ~60%. In terms of people practicing open defecation, India is again one of the highest in the world with ~35% compared to world average of 12%. Hence, the government of India has launched the *Swachh Bharat Abhiyan* (SBA) on October 2, 2014, which aims to achieve an open defecation free India by October 2, 2019, by constructing 1.2cr toilets in rural India at a projected cost of INR1.96lakh cr. Although we do not expect SBA to directly contribute to organised players' growth, we do envisage the increase in awareness regarding sanitation and hygiene to have an add-on effect on demand for sanitaryware and accelerate organised players' growth. Improvement in the housing sector will add additional growth leg for sanitaryware players.

India's sanitaryware industry is pegged at meagre INR4,000cr, clocking 10-12% CAGR. The industry is equally split between organised & unorganised players and dominated by 3 players. The domestic faucetware industry, though small at INR7,000cr, is growing at a much faster clip than sanitaryware at 13-15%. While 80% of faucetware is bathroom related, balance 20% is kitchen faucetware. The organised segment accounts for ~50% and is primarily dominated by Jaguar. Faucetware has transcended from a functional product to a fashion & style statement and, therefore, demand for premium products is expected to be robust versus higher growth for mass products in sanitaryware.



Source: Company, Edelweiss Investment Research

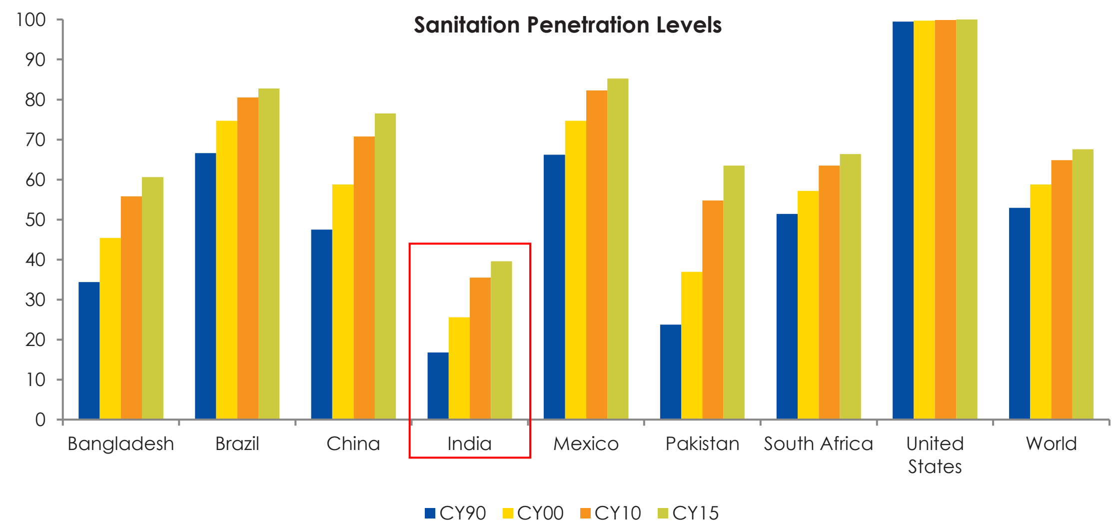
Year to March (FY17)	HSIL	Cera
Net sales (INR cr)	2,085	1,006
3 Year Revenue (CAGR)	4%	15%
Operating Margin	14%	17%
Net Profit (INR cr)	102	98
3 Year PAT CAGR	44%	23%
RoE (%)	7.1	21.1
RoCE (%)	7.3	24.8
Market Cap (INR cr)	3,700	4,600
Diluted P/E (x)	37.2	47.1

Date: 4th December 2017

India's sanitation levels are abysmal

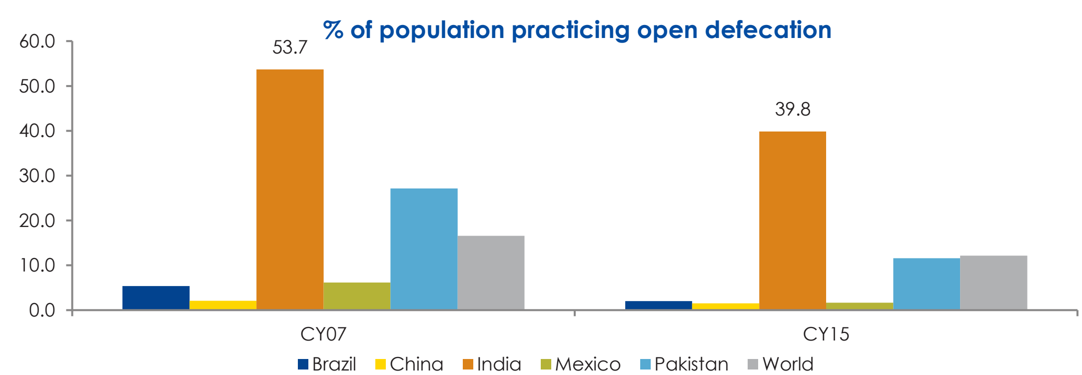
According to a 2015 WHO report, India's sanitation penetration levels are at ~40%, way below the global average of ~68% and also below Pakistan & Bangladesh's ~60%. While other developing countries like Brazil and Mexico have a penetration of over 80%, it is 100% in the US.

India's sanitation penetration way below global average and lower than Pakistan, Bangladesh



Source: WHO, Edelweiss Investment Research

In terms of people practicing open defecation, India again is one of the highest in the world with close to 35%. The world average is close to 12% and even Pakistan's is at 12%.

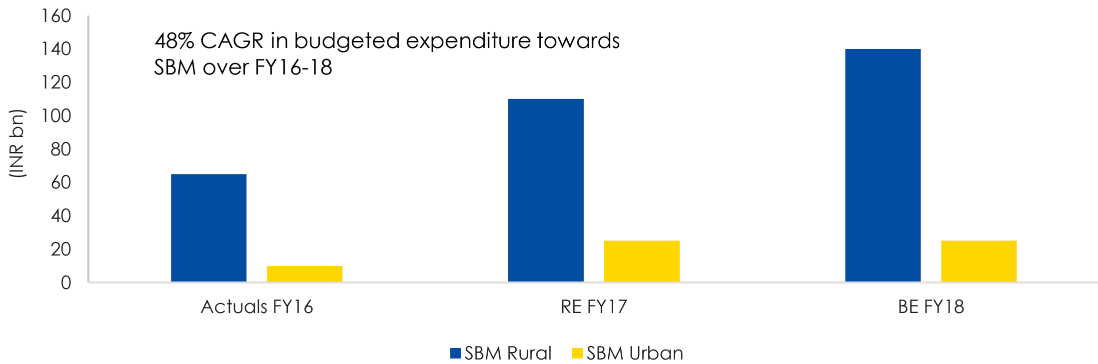


Source: WHO, Edelweiss Investment Research

Swachh Bharat Abhiyan (SBA)

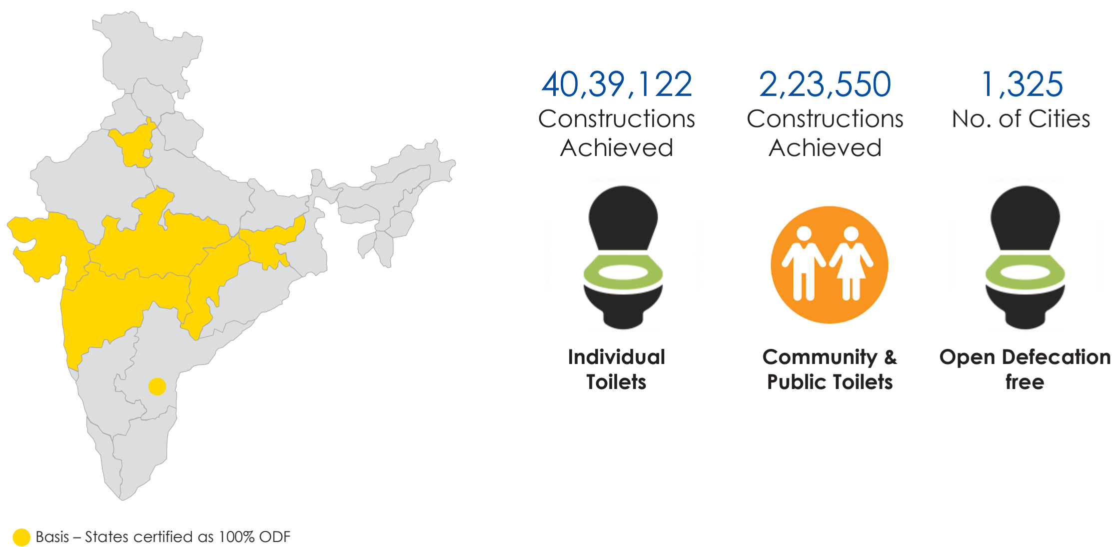
India, on all parameters, is one of the worst countries in terms of hygiene and sanitation facilities. Taking cognizance of this, the government on October 2, 2014 launched the *SBA*, a campaign which aims to clean up streets and eliminate open defecation through the construction of household and community toilets. The government's budget towards SBA has increased every year as seen below.

Budgeted capex for SBM for is at a massive INR 162bn for FY18



Source: Budget Documents, Edelweiss Investment Research

SBA aims to achieve an open defecation free India by October 2, 2019, by constructing 1.2cr toilets in rural India at a projected cost of INR1.96lakh cr. The government's initiatives have yielded significant results with a few states already becoming open defecation free.



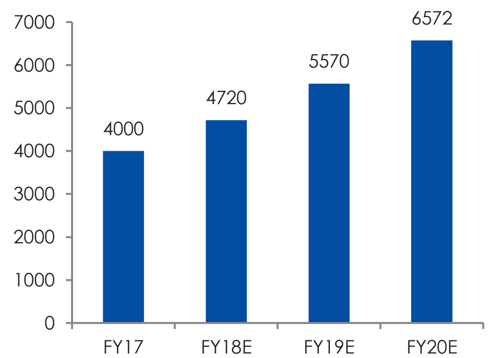
Source: Swachh Bharat Abhiyan website, Edelweiss Investment Research

Although we do not expect SBA to directly contribute to organised players' growth, we do envisage the increase in awareness regarding sanitation and hygiene to have an add-on effect on demand for sanitaryware and help organised players grow faster.

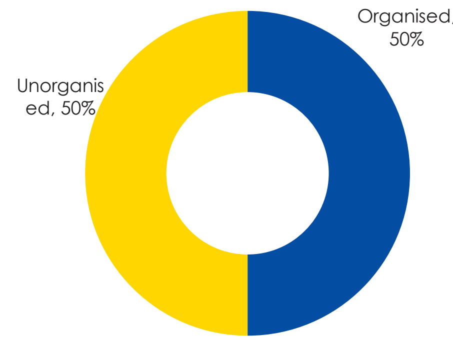
A) Sanitaryware

The domestic sanitaryware industry is pegged at meagre **INR4,000cr** and is growing at 10-12%. Although no benefits of SBA have accrued to organised players in terms of higher revenue growth, SBA will definitely help create awareness of the importance of sanitation and hygiene, which will help organised players in the future. The industry is equally split between organised and unorganised segments.

Sanitaryware can grow 15-18% over the next few years



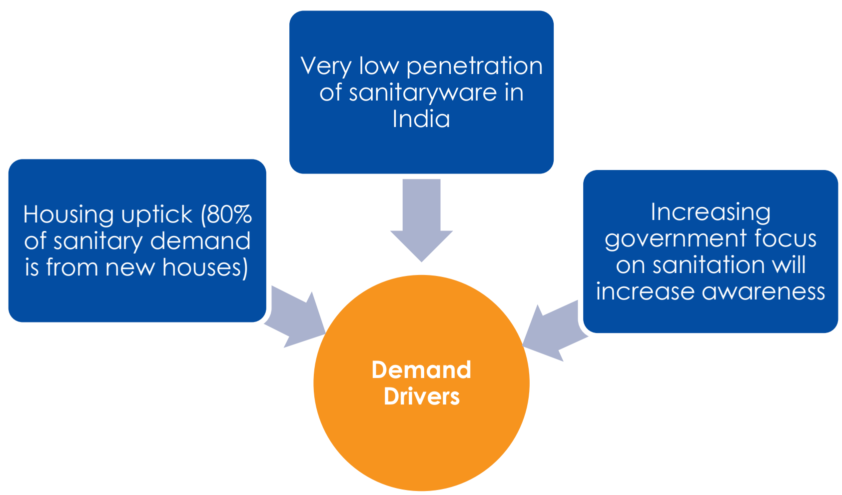
Share of organised and unorganised



Source: Company, Edelweiss Investment Research

Structural levers in place to drive demand

In India, only 15% demand for sanitaryware is driven by replacement demand due to the small market size. However, for most developed countries, this ratio is reversed as close to 80% of the incremental demand is replacement driven. There are various other macroeconomic led structural drivers which will drive incremental demand for sanitaryware.

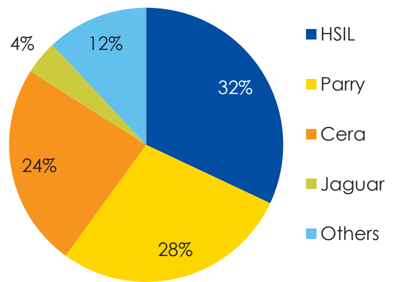


Source: Company, Edelweiss Investment Research

Organised players poised to grow

Top 3 organised players account for 84% of the organised size dominated by HSIL, Parryware and Cera Sanitaryware. While their revenues are primarily driven by retail sales, institutional sales have been tepid recently.

Organised market share of key players



Organised players grow fast due to following reasons		
Brand awareness due to higher marketing, brand building and strong distribution	Presence across price points and higher presence in the faster growing premium category	Only 3 big organised players and no major capacity expansion plans leading to lower competition

Source: Company, Edelweiss Investment Research

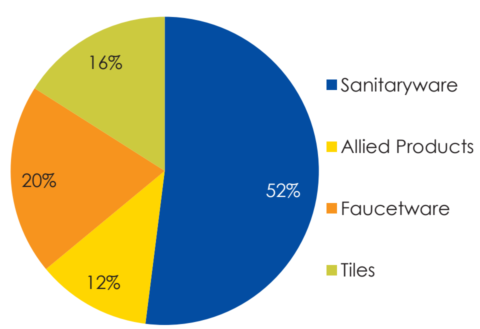
Organised players to benefit from entry in premium segment and strong distribution network

Cera and HSIL have successfully diversified into the premium segment. Starting with low and mid end WC and fittings, Cera has developed a premium range of luxury products such as its wellness collection, jacuzzis, etc. HSIL has launched Hindware Italian Collection and Hindware Art in the premium segment. It also houses brands like Amore (wellness products) and Queo in the super premium segment. Cera and HSIL have strong distribution networks of 1,500 and 3,200 dealers, along with 15,000 and 21,000 retail touch points, respectively.

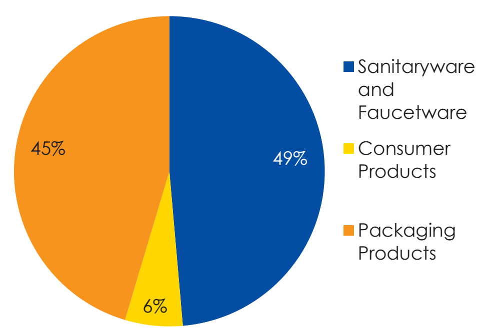
Organised players have diversified into other segments to boost grow

Cera has gradually diversified its product basket from a sanitaryware player to a dominant player in the faucetware space and has also entered the tiles segment. Sanitaryware and allied products, which accounted for ~87% of Cera's revenue in FY11, form roughly only 64% of current revenue. HSIL, meanwhile, is present in packaging products and has recently also announced entry in PVC pipes.

Cera FY17 Revenue breakup



HSIL FY17 Revenues breakup

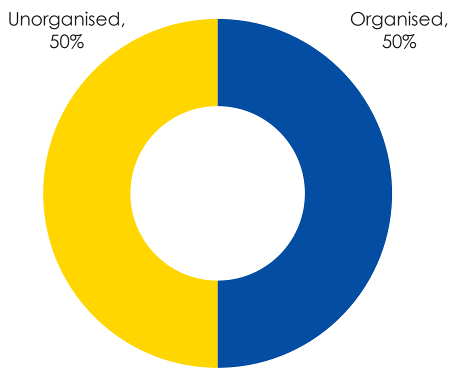


Source: Company, Edelweiss Investment Research

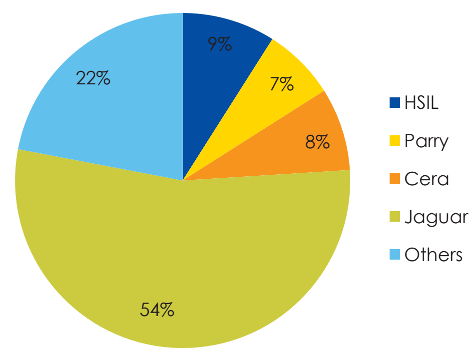
B) Faucetware

The domestic faucetware industry is also minuscule at **INR7,000cr,** but is growing at a much faster clip than sanitaryware at 13-15%. SBA is likely to help create awareness for faucetware as well and we expect the segment to post 15-18% CAGR over the next few years. While 80% of faucetware is bathroom related, balance 20% is kitchen faucetware. The organised segment is close to 50% and is mainly dominated by Jaguar.

Share of organised and unorganised

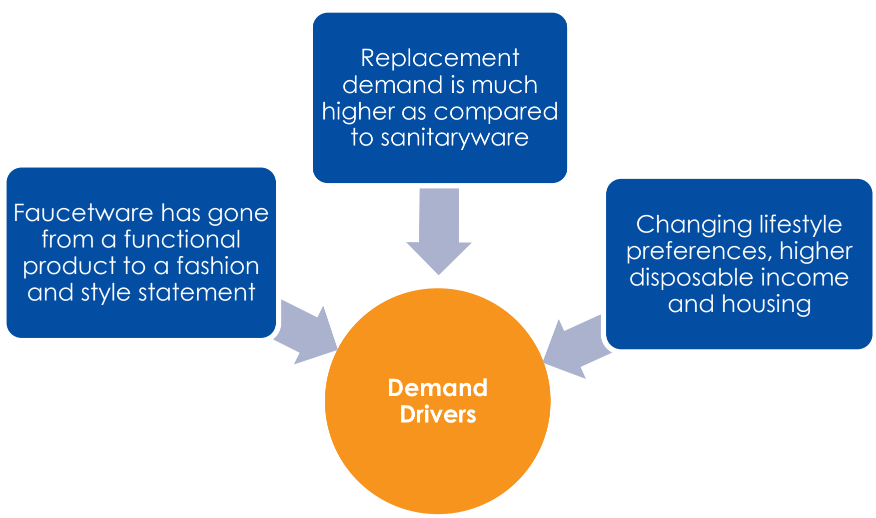


Organised market share of key players (%)



Source: Company, Edelweiss Investment Research

Recently, many MNC (Grohe, Kohler and Roca) and domestic players have entered the faucetware segment as it remains one of the fastest growing segments in the building materials sector with extremely low penetration.



Source: Company, Edelweiss Investment Research

Faucetware has transformed from being a mere functional product to a fashion & style statement. Therefore, demand for more premium products is expected to be robust versus higher growth for mass products in sanitaryware.

Peers comparison

	Revenue growth (%)			PAT growth (%)			EBITDA margin (%)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Cera	10	17	18	17	16	27	17	16	17
HSIL	13	4	16	-8	15	35	13	14	15

	RoE (%)			Diluted PE (x)			EV/EBITDA (x)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Cera	21	20	21	47	40	32	26	24	20
HSIL	7	8	10	37	31	24	15	13	11

Source: Bloomberg Estimates

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Cera Sanitaryware

Sustained growth momentum

CMP INR 3554

Rating: Not Rated

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Cera was incorporated as Madhusudan Ceramics, a unit of Madhusudan Industries Ltd (MIL) in 1981. MIL had a sanitaryware and ceramics division but the latter was demerged in 2002 to form Cera Sanitaryware Ltd. Today, Cera is the third largest company in the Indian sanitaryware industry with 24% share in the organised segment and the third largest player in the faucetware segment with 7% share in the organised segment. Cera has an extensive product portfolio that includes high end showers, steam cubicles, whirlpools, besides sanitaryware and faucets. Cera plans to increase production capacity of sanitaryware from 3 mln pieces p.a. to 3.3 mln pieces p.a. and the faucetware capacity to 10,000 pieces per day from the current 7,200 pieces per day.

Consistently gaining market share

The sanitaryware division accounts for nearly 65% of Cera's revenues and has consistently grown at over 20% over several years, except during the last two years wherein demand has slowed down. This growth is far ahead of the industry growth of 12-15% and has helped Cera gain market share. The growth has been led by an expanding distribution network which is now 1,600 dealers and 15,000 retailers strong. Along with this, CERA has spent substantially on its state-of-the-art manufacturing plant and on innovations like the water-saving twin-flush coupled WCs, 4-litre flush WCs, one-piece WCs etc.

Foray into faucetware and tiles to become a complete home solutions provider

Cera expanded into the larger faucetware segment in FY09 through the outsourcing model. Over the last eight years Cera has gradually expanded its capacity to 7,200 pieces per day growing much faster than the industry as it gained market share from the unorganised players. Recently Cera floated a 51% JV with Anjani tiles to produce 3.65 MSM of tiles at a facility in Andhra Pradesh. We expect this division to also grow rapidly on a low base with its share in total revenues expected to grow from 16% in FY17 to 21% in FY19E. Faucetware and tiles constitute around 35% of Cera's revenues.

Outlook

Cera is expected to continue to grow faster than the industry over the long term and is likely to maintain its current profile of healthy margins and return ratios in excess of 20%. Swachh Bharat Abhiyan, a Central government initiative, is intended to create greater awareness of sanitation and hygiene in India, which is likely to benefit organised players like Cera. Given the vast and growing opportunity size, we remain positive on Cera over the long term. The stock is trading at 47x FY17 P/E.

Bloomberg:	CRS:IN
52-week range (INR):	3,772.95 / 1,880.45
Share in issue (cr):	1.3
M cap (INR cr):	4,622
Avg. Daily Vol. BSE/NSE :('000):	4
Promoter Holding (%)	54.75

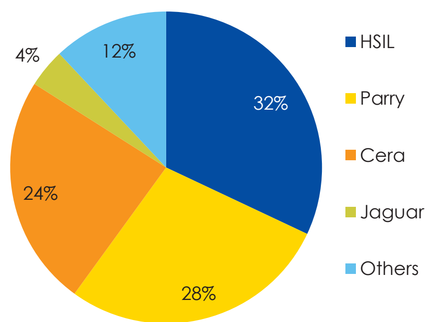
Year to March	FY15	FY16	FY17
Revenues (INR Cr)	822	917	1,006
Rev growth (%)	23.8	11.6	9.6
EBITDA (INR Cr)	118	141	172
Net Profit (INR Cr)	68	83	97
P/E (x)	68.1	55.2	47.0
EV/EBITDA (x)	39.5	32.6	27.0
RoACE (%)	27.6	25.3	24.8
RoAE (%)	23.5	21.6	21.1

Date: 4th December 2017

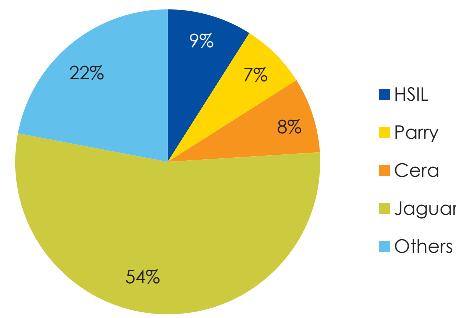
Among India's largest players in the sanitaryware and faucetware segments

Cera is the third largest company in the Indian sanitaryware industry with a 24% share in the organised segment and the third largest player in the faucetware segment with a 7% share in the organised segment. In both segments the split between organised and unorganised segments is equal. Hence there is considerable room for Cera to capture greater market share going forward.

Organised market share of key players - Sanitaryware



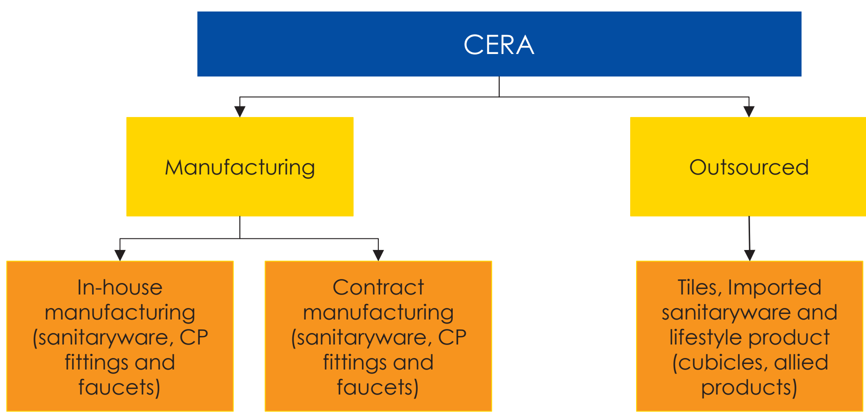
Organised market share of key players - Faucetware



Source: Company, Edelweiss Investment Research

A majority of Cera's revenues is outsourced

Outsourced revenues comprise nearly 50% of Cera's total revenues. Most of the outsourced products are for low price items and are mostly in the tiles, imported sanitaryware and lifestyle product (cubicles, allied products) segments. In spite of high outsourcing, margins remain strong at around 18%.



Source: Company, Edelweiss Investment Research

Cera has recently announced expansion plans

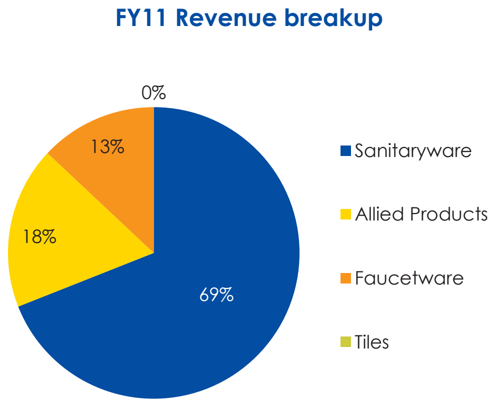
CERA plans to expand capacity of the current facility, Sanitaryware's capacity post-expansion will be 3.3 million pcs p.a. while the Faucetware's capacity will become 10,000 pcs per day from the current 7,200 pcs per day.

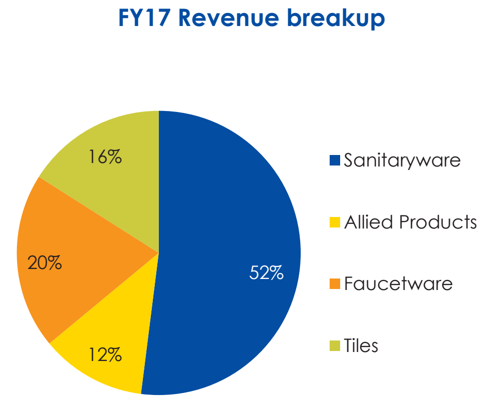
Location	Product	Current Capacity	Post expansion
Kadi, Gujarat	Sanitaryware	3 mln pieces p.a.	3.3 mln pieces p.a.
	Faucetware	7,200 pieces per day	10,000 pieces per day

Source: Company, Edelweiss Investment Research

Transforming from a sanitaryware player to a home solution provider

Cera has gradually diversified its product basket from a sanitaryware player to a dominant player in the faucetware space and has also entered the tiles segment. Sanitaryware and allied products which were about 87% of Cera's revenues in FY11, form roughly only 64% of Cera's current revenues. Tiles revenue has tripled over the last three years registering strong growth.

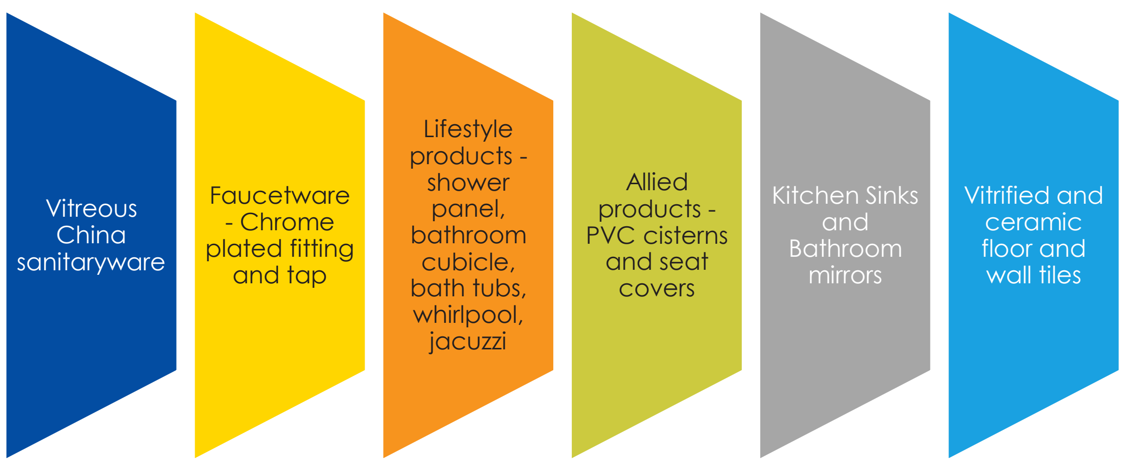




Source: Company, Edelweiss Investment Research

Diversified product range post transformation

Cera was earlier present in mass market products but as the market opened up to more premium products, Cera has successfully diversified. Starting with low and mid-end WC and fittings, Cera has developed a premium range for mid-users. It has also ventured into luxury products such as its wellness collection, jacuzzi, etc. and introduced a designer segment.



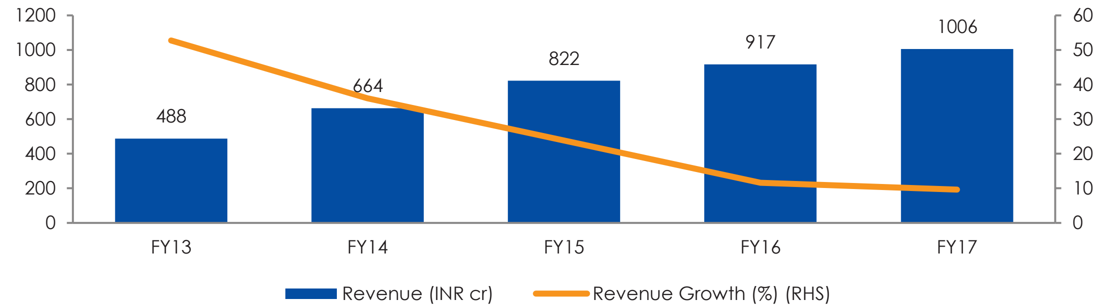
Source: Company, Edelweiss Investment Research

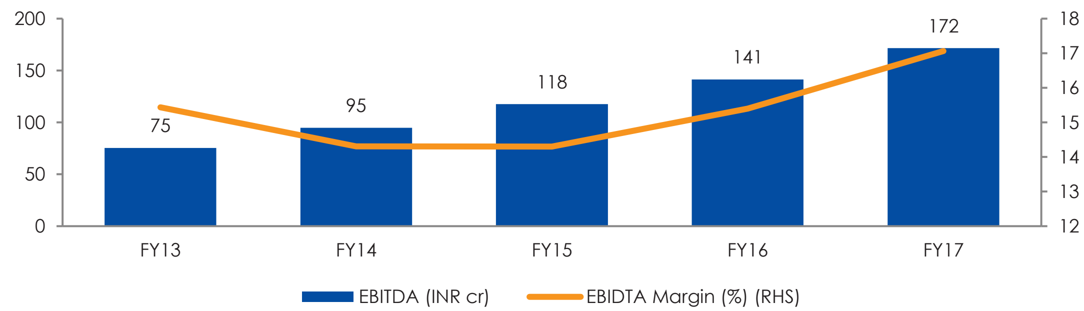
Strong distribution network; E-commerce picking up

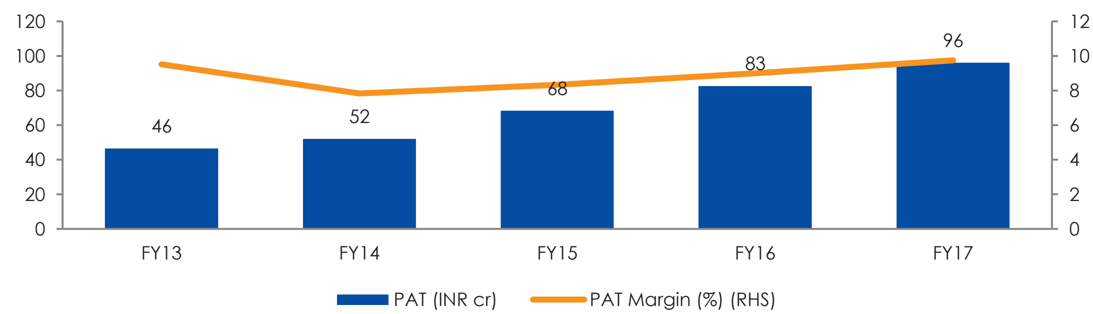
Cera has a strong distribution network with 1,500 distributors and 15,000 retailers. It also has 20 major stock points across India along with 10 Cera Style Studios and over 100 Cera Style Galleries. Online trade has picked up recently with Cera being the first to initiate and provide support to a 3-D designing concept – 'DESIGN YOUR OWN BATHROOM Cera also currently sells through various E-Com platforms such as Amazon, Snapdeal and Flipkart.

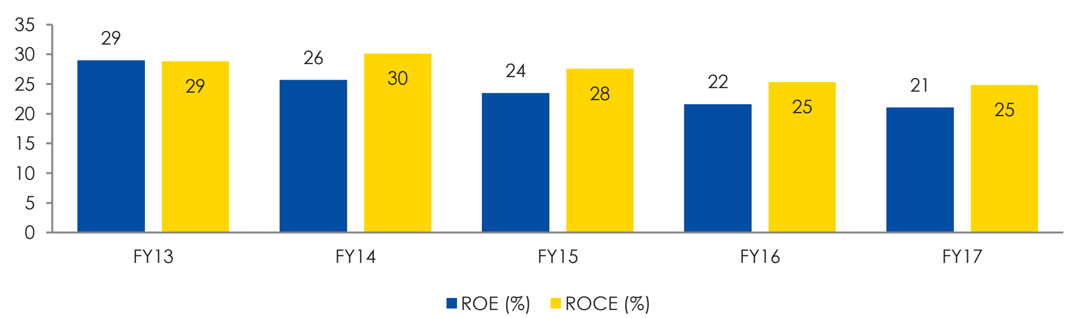
Financial analysis

As with other segments in building materials, growth in sanitaryware has also slowed down over the past two years after exhibiting stellar growth from FY13 to FY15. However, lower gas prices and premiumisation of products has helped improve EBITDA margin every year; and this trend has also led to an improvement in PAT margin.









Source: Edelweiss Investment Research

Financials

Income statement

Year to March	FY13	FY14	FY15	FY16	FY17
Income from operations	488	664	822	917	1,006
Direct costs	237	337	418	472	472
Employee costs	58	74	92	111	123
Other expenses	176	232	286	304	362
Total operating expenses	413	569	704	776	834
EBITDA	75	95	118	141	172
Depreciation and amortis	9	12	15	16	22
EBIT	66	83	102	125	149
Interest expenses	7	6	8	5	8
Other income	9	6	7	10	14
Profit before tax	68	82	101	129	156
Provision for tax	22	30	33	46	58
Core profit	46	52	68	83	97
Extraordinary items	0	0	1	-1	-1
Profit after tax	46	52	68	83	96
Minority Interest	0	0	0	0	2
Share from associates	0	0	0	0	0
Adjusted net profit	46	52	68	83	98
Equity shares outstanding	1	1	1	1	1
EPS (INR) basic	36.5	41.0	52.0	64.2	75.4
Diluted shares (Cr)	1.3	1.3	1.3	1.3	1.3
EPS (INR) fully diluted	36.5	41.0	52.0	64.2	75.4
Dividend per share	4.0	5.0	6.3	9.0	0.0
Dividend payout (%)	11.0	12.2	12.0	14.0	0.0

Common size metrics- as % of net revenues

Year to March	FY13	FY14	FY15	FY16	FY17
Operating expenses	84.6	85.7	85.7	84.6	82.9
Depreciation	1.9	1.8	1.9	1.8	2.2
Interest expenditure	1.5	1.0	0.9	0.6	0.8
EBITDA margins	15.4	14.3	14.3	15.4	17.1
Net profit margins	9.5	7.8	8.3	9.0	9.7

Growth metrics (%)

Year to March	FY13	FY14	FY15	FY16	FY17
Revenues	52.8	36.0	23.8	11.6	9.6
EBITDA	41.1	26.0	23.8	20.2	21.4
PBT	39.8	21.5	22.5	28.3	20.1
Net profit	44.3	12.3	30.3	23.4	16.6
EPS	44.3	12.3	26.9	23.4	17.4

Balance sheet (INR cr)

As on 31st March	FY13	FY14	FY15	FY16	FY17
Equity share capital	6	6	7	7	7
Preference Share Capital	0	0	0	0	0
Reserves & surplus	173	218	345	414	514
Shareholders funds	180	224	352	421	520
Secured loans	61	48	68	67	84
Unsecured loans	0	0	0	0	0
Borrowings	61	48	68	67	84
Minority interest	0	0	0	16	22
Sources of funds	**241**	**272**	**420**	**504**	**626**
Gross block	175	212	288	315	451
Depreciation	50	60	73	85	106
Net block	125	152	215	230	345
Capital work in progress	4	5	8	65	0
Total fixed assets	129	157	222	295	345
Unrealised profit	0	0	0	0	0
Investments	1	12	48	47	87
Inventories	94	105	126	136	149
Sundry debtors	83	107	161	188	221
Cash and equivalents	40	31	30	60	57
Loans and advances	10	14	25	40	61
Other current assets	0	0	0	0	0
Total current assets	228	256	342	424	488
Sundry creditors and other	83	108	140	186	233
Provisions	14	18	22	29	16
Total CL & provisions	96	125	162	215	249
Net current assets	131	130	180	209	239
Net Deferred tax	-16	-20	-28	-34	-39
Misc expenditure	-5	-7	-3	-13	-6
Uses of funds	**241**	**272**	**420**	**504**	**626**
Book value per share (INR	142	177	271	324	400
	-0	-0	0	0	0

Cash flow statement

Year to March	FY13	FY14	FY15	FY16	FY17
Net profit	46	52	67	84	99
Add: Depreciation	9	12	15	16	22
Add: Misc expenses	-2	2	-4	10	-7
Add: Deferred tax	3	4	8	7	5
Add: Others	0	0	0	0	2
Gross cash flow	57	70	86	117	120
Less: Changes in W. C.	20	9	51	-2	33
Operating cash flow	36	61	35	119	87
Less: Capex	38	40	81	89	72
Free cash flow	**-1**	**21**	**-46**	**30**	**15**

Ratios

Year to March	FY13	FY14	FY15	FY16	FY17
ROAE (%)	29.0	25.7	23.5	21.6	21.1
ROACE (%)	28.8	30.1	27.6	25.3	24.8
Debtors (days)	62	59	72	75	80
Current ratio	2.4	2.0	2.1	2.0	2.0
Debt/Equity	0.3	0.2	0.2	0.2	0.2
Inventory (days)	70	58	56	54	54
Payable (days)	62	59	62	74	85
Cash conversion cycle (dc	71	57	66	55	50
Debt/EBITDA	0.8	0.5	0.6	0.5	0.5
Adjusted debt/Equity	0.1	0.1	0.1	0.0	0.1

Valuation parameters

Year to March	FY13	FY14	FY15	FY16	FY17
Diluted EPS (INR)	36.5	41.0	52.0	64.2	75.4
Y-o-Y growth (%)	*44.3*	*12.3*	*26.9*	*23.4*	*17.4*
CEPS (INR)	43.9	50.7	63.9	76.8	93.3
Diluted P/E (x)	97.1	86.4	68.1	55.2	47.0
Price/BV(x)	25.0	20.0	13.1	10.9	8.9
EV/Sales (x)	9.2	6.8	5.7	5.0	4.6
EV/EBITDA (x)	59.8	47.4	39.5	32.6	27.0
Diluted shares O/S	1.3	1.3	1.3	1.3	1.3
Basic EPS	36.5	41.0	52.0	64.2	75.4
Basic PE (x)	97.1	86.4	68.1	55.2	47.0
Dividend yield (%)	0.1	0.1	0.2	0.3	0.0

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HSIL Ltd.

CMP INR 529

Rating: Not Rated

Demerger to unlock value

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Hindustan Sanitaryware and Industries Ltd (HSIL) was initially set up in 1960 as Hindustan Twyfords Ltd, in technological collaboration with Twyfords UK, post which, the company was renamed Hindustan Sanitaryware & Industries Ltd. in 1969. It was the first company to introduce vitreous china sanitaryware to the Indian consumer in 1962. Today HSIL is the biggest organised player in the sanitaryware segment in India with 32% share in the organised space. It is also the second biggest organised player in the faucetware segment with 9% share in the organised space. It has a growing portfolio in the sanitaryware space across price points. HSIL acquired Associated Glass Industries Limited (AGI) in 1981 and entered glass bottle manufacturing followed by the addition of PET bottles in 2011.

Leading player in the sanitaryware and faucetware space

HSIL is the biggest organised player in the sanitaryware segment under its popular brand 'Hindware' amongst others. Today it has a diversified product portfolio with value brands such as Raasi and Benelave, followed by the Hindware Italian Collection and Hindware Art in the premium segment. It also houses brands like Amore (wellness products) and Queo in the super premium segment. The company is expanding its manufacturing capacity by building a unit in Medak, Telangana, which will make CPVC, UPVC pipes and fittings as the company plans to expand its building materials segment from just sanitaryware to include pipes.

Expect profitability to improve in other divisions

In 2007 HSIL set up Hindware Home Retail Pvt Limited (HHRPL) which launched the brand EVOK, housing a chain of large retail stores offering home interiors (water heaters, hobs and hoods, air coolers and air purifiers). There are currently 18 such stores. Currently this segment has not broken even and the company is putting in additional effort to ensure a turnaround. HSIL is the second largest container glass packaging player in India after HNG. We expect a revival in this segment too as HNG has entered BIFR. HSIL is also setting up a security caps and closures manufacturing facility to complement the existing packaging segment.

Outlook

HSIL is trading at a steep discount to players like Cera in spite of being bigger in size and having the strongest brand in terms of Hindware. This is due to inferior return ratios than peers due to losses in the consumer products division and lower profitability in the packaging products division. However, the company plans to demerge the building products division and list it separately to unlock value, which is a positive. HSIL is trading at 33x P/E FY17.

Bloomberg:	HSI:IN
52-week range (INR):	564.00 / 273.20
Share in issue (cr):	7.2
M cap (INR cr):	3,825
Avg. Daily Vol. BSE/NSE :('000):	72
Promoter Holding (%)	48.4

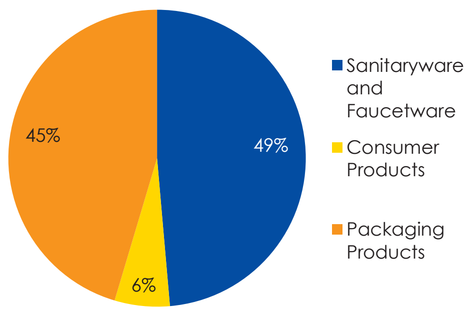
Year to March	FY15	FY16	FY17
Revenues (INR Cr)	1,981	1,979	2,085
Rev growth (%)	6.6	(0.1)	5.4
EBITDA (INR Cr)	333	299	287
Net Profit (INR Cr)	85	108	100
P/E (x)	44.4	35.0	37.1
EV/EBITDA (x)	13.7	14.7	16.0
RoACE (%)	9.2	8.3	7.3
RoAE (%)	7.3	8.0	7.1

Date: 4th December 2017

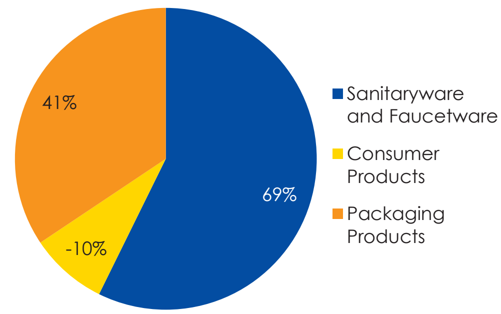
HSIL has multiple verticals with sanitaryware being the most profitable

Although the sanitaryware segment and packaging products contribute equally to revenues, the former contributes close to 70% of the EBIT for HSIL. The consumer products division has not yet broken even and management expects to turn it around soon and improve profitability of the packaging products division.

FY17 revenues split



FY17 EBIT split



Source: Company, Edelweiss Investment Research

HSIL to enter new verticals

The company is expanding its manufacturing capacity at Medak, Telangana where it will manufacture security caps, closures (to complement the packaging products division) and CPVC, UPVC pipes and fittings (to extend its presence in the building material segment).

Location	Product	Capacity
Bahadurgarh, Haryana	Sanitaryware	2 mln pieces p.a.
Bibinagar, Telangana		2.2 mln pieces p.a.
Kaharani, Rajasthan	Faucets	2.5 mln pieces p.a.
Bhiwadi, Rajasthan		0.5 mln pieces p.a.
Sanathnagar, Telangana	Glass Containers	650 TPD
Bhongir Telangana		950 TPD
Selaqui, UK	PET Bottles	2350 TPA
Dharwad, Karnataka		7300 TPA

Source: Company, Edelweiss Investment Research

Strong distribution network

HSIL has a large distribution network of 3,200 dealers in the sanitaryware segment which comprises multiple retail formats and a presence in 2,100 retail touchpoints. HSIL also has 340+ distributors and 5,500+ retailers in the consumer products division.

Building materials segment

HSIL is the largest company in the Indian sanitaryware industry with 32% share in the organised segment and is the second largest player in the faucetware segment with 9% share in the organised segment. Its product range spans mass level products to super premium.

Mass	Premium	Super Premium	Luxury
VITREOUS RAASI BENELAVE	Hindware Hindware Art Hindware Italian Collection	Alchymi	Queo Amore

The company has also recently announced its entry into the pipes segment and will have a significant presence in the building materials space.

Sanitywear	Faucets	Wellness	Allied Products	Pipes and fittings
Water Closets Wash Basins Pedestals Squatting Pans Urinals Cisterns Bidets	Showers Bathroom faucets Kitchen faucets	Bath tubs Shower panels Shower enclosures Whirlpools Steam generators	Concealed Cisterns Seat covers PVC cisterns	CPVC pipes UPVC pipes Fittings

Packaging products segment

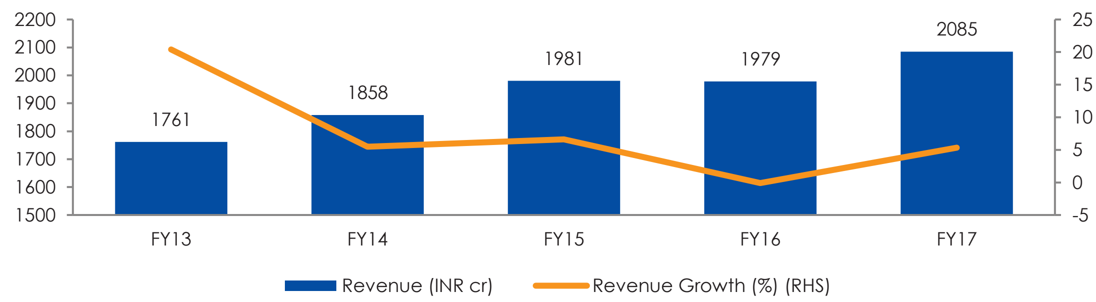
HSIL is the second largest container glass packaging player in India after HNG. We expect a revival in this segment too as HNG is now a BIFR case. It also manufactures a wide range of PET bottles. Glass is the preferred packaging choice for certain product categories like, liquor, beer and pharma. Key clients include Abbott, Bacardi, Carlsberg, Coca Cola, Dabur, Diageo, Dr. Reddys, GSK, HUL, Nestle, Parle, Pepsi, Sun Pharma etc. HSIL is also setting up a security caps and closures manufacturing facility to complement the current packaging segment.

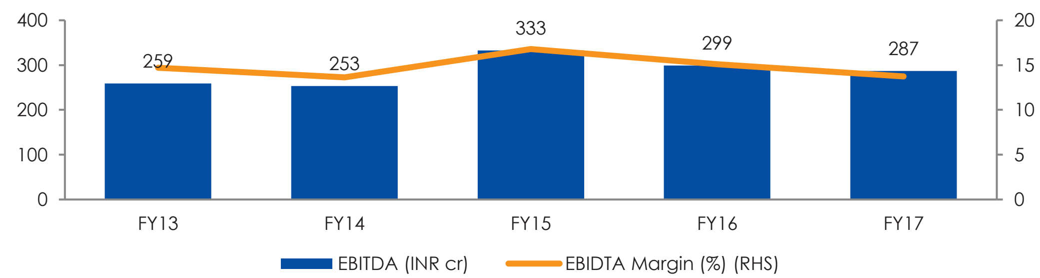
Consumer products segment

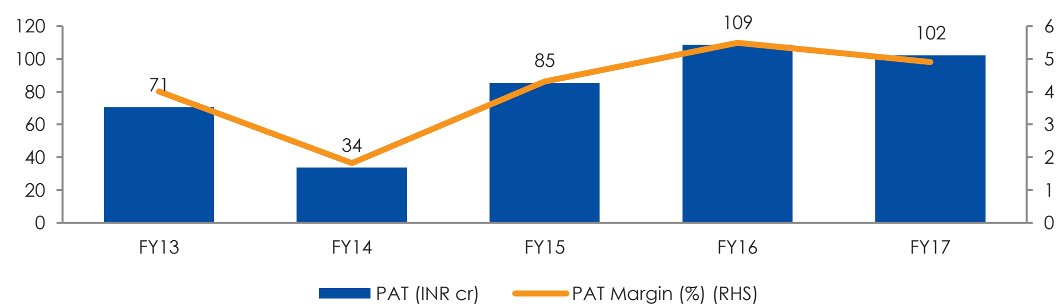
HSIL operates 18 large retail stores pan-India under the brand name 'EVOK Homes with Soul' and the store showcases 20,000+ world class contemporary products comprising home furniture, soft furnishing, home decor and accessories, modular kitchens and modular wardrobes.

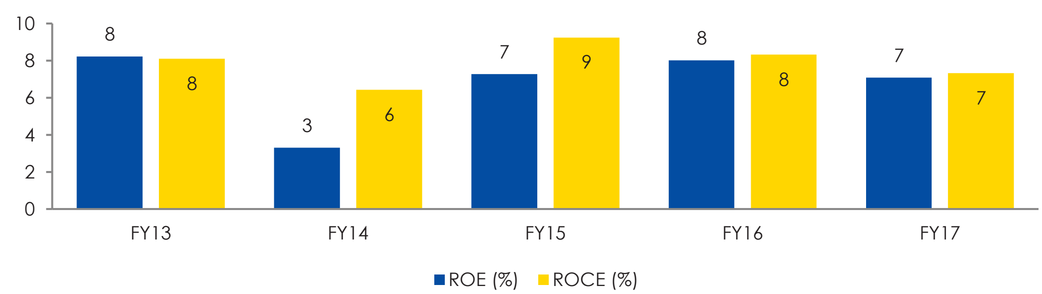
Financial analysis

Like other segments in building materials, the growth in sanitaryware has also slowed down over the past two years after stellar growth from FY13 to FY15. While lower gas prices and premiumisation of sanitary products should have helped HSIL's margins, its investments in the packaging business and in the consumer products division have not been profitable and has thus led to flat margins and lower RoEs.









Source: Edelweiss Investment Research.

HSIL Ltd

Financials

Income statement (INR cr)

Year to March	FY15	FY16	FY17
Income from operations	1,981	1,979	2,085
Direct costs	1,015	998	1,060
Employee costs	216	251	287
Other expenses	633	682	738
Total operating expenses	1,648	1,680	1,798
EBITDA	333	299	287
Depreciation and amortisation	125	115	111
EBIT	207	184	176
Interest expenses	78	41	33
Other income	4	31	5
Profit before tax	134	174	147
Provision for tax	48	66	47
Core profit	85	108	100
Extraordinary items	-0	0	2
Profit after tax	85	109	102
Minority Interest	0	0	0
Share from associates	0	0	0
Adjusted net profit	85	109	102
Equity shares outstanding (mn)	7	7	7
EPS (INR) basic	11.8	15.0	14.1
Diluted shares (Cr)	7.2	7.2	7.2
EPS (INR) fully diluted	11.8	15.0	14.1
Dividend per share	3.5	0.0	0.0
Dividend payout (%)	29.6	0.0	0.0

Common size metrics- as % of net revenues

Year to March	FY15	FY16	FY17
Operating expenses	83.2	84.9	86.2
Depreciation	6.3	5.8	5.3
Interest expenditure	3.9	2.1	1.6
EBITDA margins	16.8	15.1	13.8
Net profit margins	4.3	5.5	4.9

Growth metrics (%)

Year to March	FY15	FY16	FY17
Revenues	6.6	(0.1)	5.4
EBITDA	31.3	(10.1)	(4.1)
PBT	77.5	30.4	(15.6)
Net profit	151.5	27.0	(7.6)
EPS	129.8	27.0	(5.8)

Balance sheet (INR cr)

As on 31st March	FY15	FY16	FY17
Equity share capital	14	14	14
Preference Share Capital	0	0	0
Reserves & surplus	1,309	1,372	1,432
Shareholders funds	1,323	1,387	1,447
Secured loans	595	426	637
Unsecured loans	191	197	296
Borrowings	786	622	933
Minority interest	0	0	0
Sources of funds	**2,109**	**2,009**	**2,380**
Gross block	2,263	1,628	1,730
Depreciation	675	113	223
Net block	1,588	1,514	1,507
Capital work in progress	34	63	152
Total fixed assets	1,622	1,577	1,659
Unrealised profit	0	0	0
Investments	11	29	136
Inventories	474	490	493
Sundry debtors	414	390	398
Cash and equivalents	25	20	144
Loans and advances	52	51	68
Other current assets	0	0	0
Total current assets	965	952	1,102
Sundry creditors and others	351	407	449
Provisions	41	3	3
Total CL & provisions	392	410	452
Net current assets	573	541	650
Net Deferred tax	-105	-208	-208
Misc expenditure	8	69	142
Uses of funds	**2,109**	**2,009**	**2,380**
Book value per share (INR)	183	192	200
	0	0	0

Cash flow statement

Year to March	FY15	FY16	FY17
Net profit	86	108	98
Add: Depreciation	125	115	111
Add: Misc expenses written off	29	-62	-73
Add: Deferred tax	-11	103	0
Add: Others	0	0	0
Gross cash flow	228	264	137
Less: Changes in W. C.	18	-27	-15
Operating cash flow	210	291	152
Less: Capex	108	70	193
Free cash flow	**103**	**222**	**-41**

Ratios

Year to March	FY15	FY16	FY17
ROAE (%)	7.3	8.0	7.1
ROACE (%)	9.2	8.3	7.3
Debtors (days)	76	72	70
Current ratio	2.5	2.3	2.4
Debt/Equity	0.6	0.4	0.6
Inventory (days)	87	90	86
Payable (days)	65	75	79
Cash conversion cycle (days)	99	87	77
Debt/EBITDA	2.4	2.1	3.3
Adjusted debt/Equity	0.6	0.4	0.5

Valuation parameters

Year to March	FY15	FY16	FY17
Diluted EPS (INR)	11.8	15.0	14.1
Y-o-Y growth (%)	*129.8*	*27.0*	*(5.8)*
CEPS (INR)	29.1	30.9	29.2
Diluted P/E (x)	44.4	35.0	37.1
Price/BV(x)	2.9	2.7	2.6
EV/Sales (x)	2.3	2.2	2.2
EV/EBITDA (x)	13.7	14.7	16.0
Diluted shares O/S	7.2	7.2	7.2
Basic EPS	11.8	15.0	14.1
Basic PE (x)	44.4	35.0	37.1
Dividend yield (%)	0.7	0.0	0.0

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Tiles

Tiles

Organised players firming up

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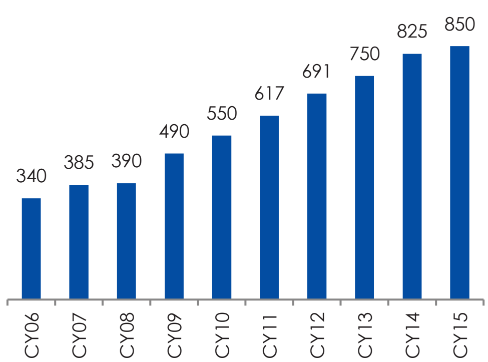
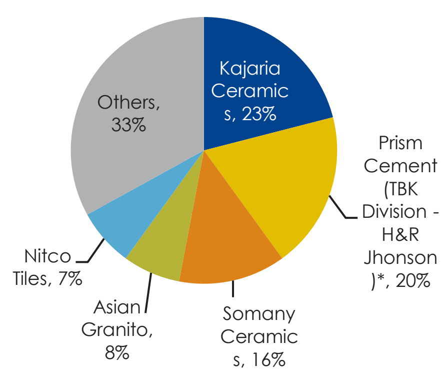
India is envisaged to be the second largest tiles producer in the world with 7% share and 900MSM manufacturing capacity. Domestic tile production has been clocking robust 11% CAGR over the past 10 years, which is estimated to jump to 13% over the next few years. 70% of tiles demand is from the residential sector and a slew of government incentives in housing are likely to drive growth of the real estate sector. Moreover, only 4% of rural population lives in houses with tile flooring and 55% in houses with mud flooring, implying the yet untapped, but highly potential rural market.

India's tile industry is pegged at ~INR28,000cr. While it is equally split between organised and unorganised segments in volume terms, the split is 60:40 in value terms in favour of the organised segment. Top 5 players account for 67% of the organised pie and ~33% of India's tiles production. Organised players are expected to capture higher share from the unorganised sector due to aggressive marketing and branding. Additionally, the shift to premium products such as PVT & GVT and the asset light JV model are expected to further boost organised players. Also recently, the sector has been buoyed by favourable tailwinds such as anti-dumping duty, expanding exports and falling gas prices.

India Tile Production (MSM) growing at a CAGR of 11%



Organised market share of key players



Source: Company, Edelweiss Investment Research

Among domestic players, we have initiated coverage on AGL and also like Kajaria.

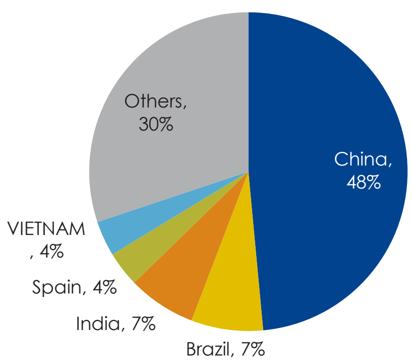
Year to March (FY17)	Kajaria	Somany	AGL
Net sales (INR cr)	2,537	1,805	1,066
3 Year Revenue (CAGR)	11%	13%	17%
Operating Margin (%)	19.6	10.4	11.6
Net Profit (INR cr)	255	93	40
3 Year PAT (CAGR)	25%	53%	74%
RoE (%)	23.6	19.6	10.4
RoCE (%)	27.6	19.2	12.6
Market Cap (INR cr)	11,600	3,800	1,500
Diluted P/E (x)	45.4	39.1	37.5

Date: 4th December 2017

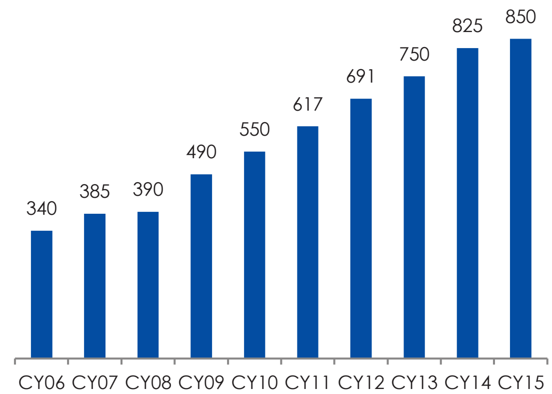
India ranks 3rd in terms of tile production with a capacity of close to 900 MSM

Global tile production is currently 12,355MSM, clocking ~6% CAGR with an approximate size of USD55-60bn in CY16. China is the largest producer of tiles with 50% share, followed by Brazil and India, both manufacturing close to 900MSM (7% share each) each as of FY17. India's tile production has been posting 11% CAGR over the past 10 years and we estimate the momentum to improve over the next few years to 13% CAGR.

CY15 Global Tiles Production Share



India Tile Production (MSM) growing at a CAGR of 11%

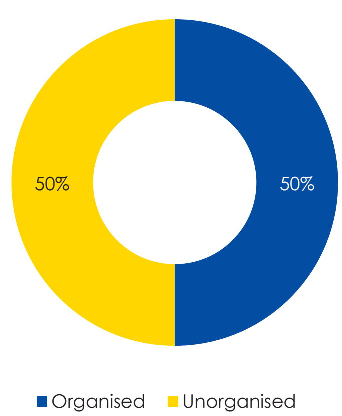


Source: Company, Edelweiss Investment Research

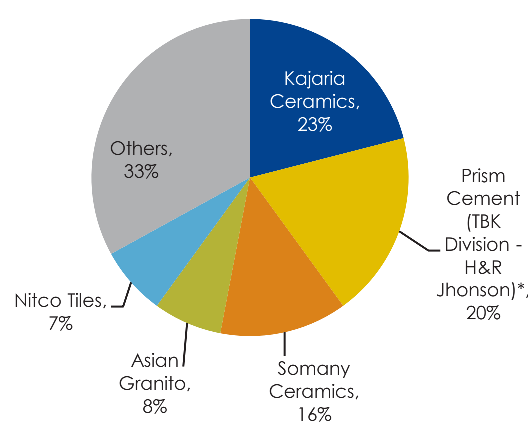
Currently production split equally between organised and unorganised

India's tile industry is pegged at ~INR28,000cr. The market is equally split between organised and unorganised segments in volume terms, while it is 60:40 in value terms in favour of the organised segment. Top 5 players account for 67% of the organised pie and ~33% of the entire tile production in the country.

Share of organised and unorganised



Organised market share of key players



Source: Company, Edelweiss Investment Research

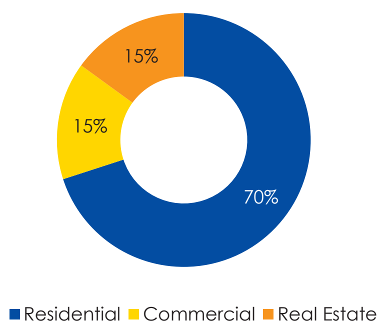
Structural catalysts in place to boost consumption

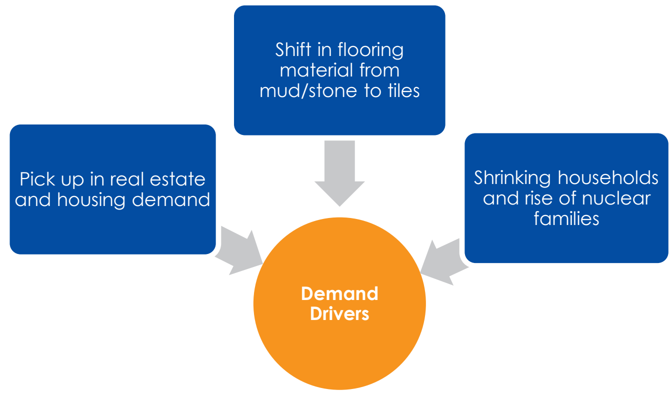
Demand drivers in place to fuel 13% CAGR

The share of real estate sector in GDP is estimated to jump to 13% by 2028 from 6% in 2013. In absolute terms, the sector's size is estimated to catapult 7x to USD853bn in 2028 from USD121bn in 2013, 14% CAGR. This entails humungous growth potential for the tiles industry as housing constitutes 70% of tiles demand, followed by commercial (15%) and replacement market (15%).

The domestic tiles industry is expected to clock volume CAGR of 13% over the next few years

Tile industry constituents





Only 4% of rural population lives in houses with tile flooring and 55% in houses with mud flooring, implying the yet untapped, but highly potential rural market. Flooring/tile accounts for ~5% of cost of construction of a building.

Only 10% of Indian households had mosaic/floor tiles as of 2011

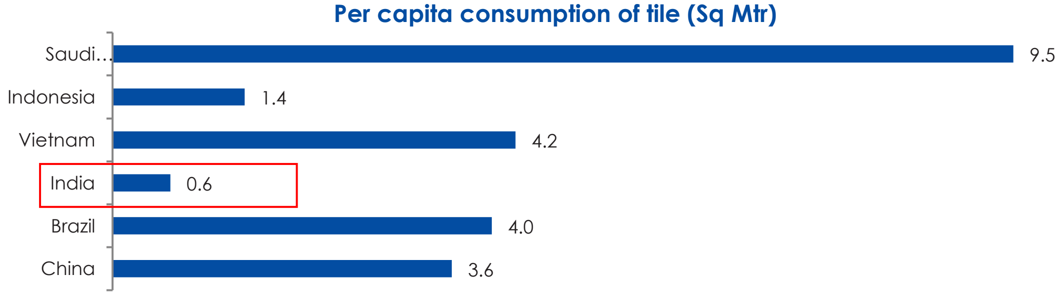
Particulars	India			Rural		Urban	
	1991	2001	2011	2001	2011	2001	2011
Mud	67	57	47	72	63	18	12
Stone		6	8	5	6	9	12
Cement	21	27	31	18	24	48	46
Mosaic/Floor tiles	4	7	10	2	4	21	26
Others	8	3	4	3	3	4	4
Total	100	100	100	100	100	100	100

Source: Budget documents, Edelweiss Investment Research

India's low per capita tiles consumption

In India, per capita consumption of tiles is as low as 0.60 sq mtr compared to China (2.6 sq mtr), Europe (5-6 sq mtr) and Brazil (3.4 sq mtr). Hence, rising disposable incomes of a burgeoning middle class and ~4cr units of housing shortage entail huge potential.

Per capita consumption of tile (Sq Mtr)

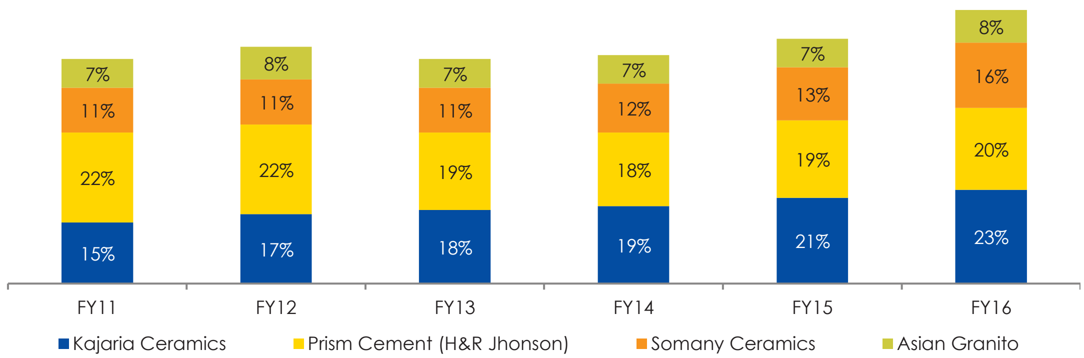


Source: Company, Edelweiss Investment Research

Organised players poised to capture lion's share of demand

The 50% organised pie of the domestic tiles industry is dominated by a few players such as Kajaria, Johnson, Somany and Asian Granito. Leading players are Kajaria (69MSM capacity – 23% organised share), followed by H&R Jhonson (61MSM capacity – 20% organised share), Somany and AGL.

Share of Top 4 Organised players



Source: Company, Edelweiss Investment Research

GST implementation could aid organised players' growth potential by 1.5-2.0%

GST is envisaged to accelerate the shift of demand to the organised sector as it will lower tax rates and strengthen competitive positioning of organised players by eliminating/reducing tax arbitrage (including tax evasion) and advantages currently enjoyed by unorganised players.

Thus, it will create a level playing field between unorganised and organised players. The sector has ~50% unorganised players and ~70% of India's total production of tiles is from Morbi. We believe the following scenarios may play out:

- Morbi players may convert into organised players as GST will be difficult to bypass.
- Morbi players could focus on export markets to take advantage of anti-dumping duty on China by other countries.
- Morbi players could outsource their facilities to organised players.

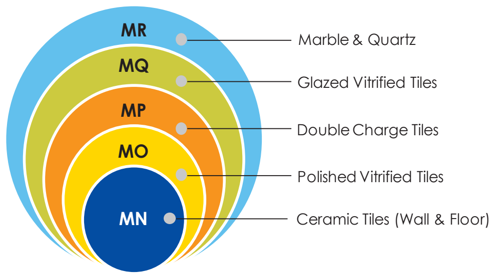
Asset light JV model aiding organised players

The JV model benefits both partners. Unorganised players' capacity utilisation improves and they do not have to worry about branding and logistics as sales are guaranteed by organised players and costs are pre-determined. Organised players, on the other hand, benefit since capital deployment is much lower than greenfield projects and small gestation period resulting in quicker growth. We believe, this business model has benefitted organised players like Kajaria, Somany and HR Johnson, who are able to access capacity easily with low investment. JVs help organised players to capture share at a faster rate and assure reasonable RoE/RoCE despite low margin.

Organised players shifting towards higher value products

Organised share has catapulted to 60% in FY17 from 40% in FY08 in value terms and estimated to increase further. Organised players are likely to dominate due to premiumisation, innovation, higher ad spending, robust distribution network, etc.

Focus on high value product mix (Polished and Glazed Vitrified Tiles)

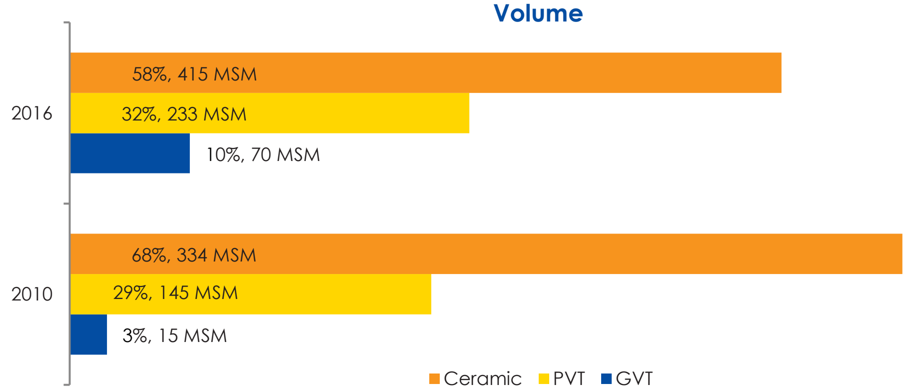


Type of Tiles	Average Realization
Ceramic	INR 30-65/sq ft
Polished Vitrified Tiles (PVT)	INR 50-135/sq mt
Glazed Vitrified Tiles (GVT)	INR 70-165/sq mt
Double Charge	INR 80-170/sq mt

Source: Company, Edelweiss Investment Research

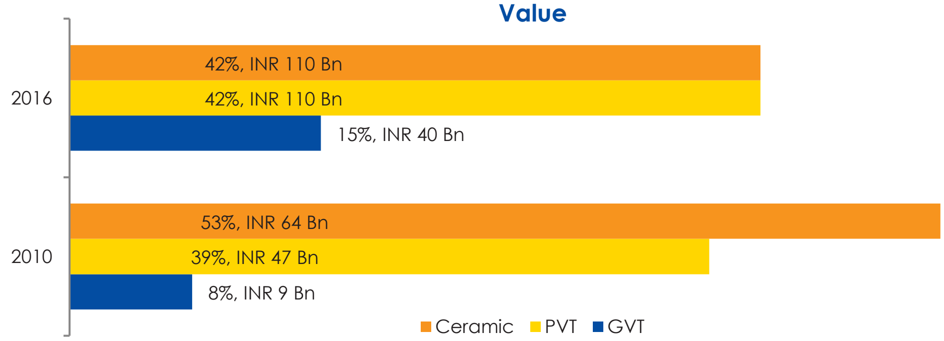
There has been a gradual shift from ceramic tiles to vitrified tiles over the years and this shift is likely to sustain. This will result in a structural shift of consumer preference towards superior value products and thus drive growth and profitability of organised players.

Volume



Volume and value growth for GVT has clocked the highest CAGR of 21% over the past 6 years, followed by ~14% CAGR for PVT over the same period. While ceramic tiles' volume has posted 6% CAGR, value growth has been 11% CAGR over the past 6 years on account of premiumisation.

Value

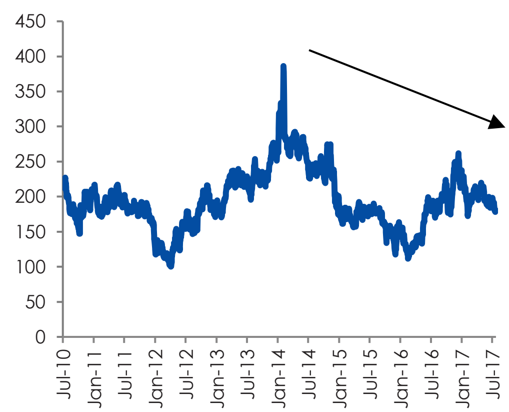


Source: Company, Edelweiss Investment Research

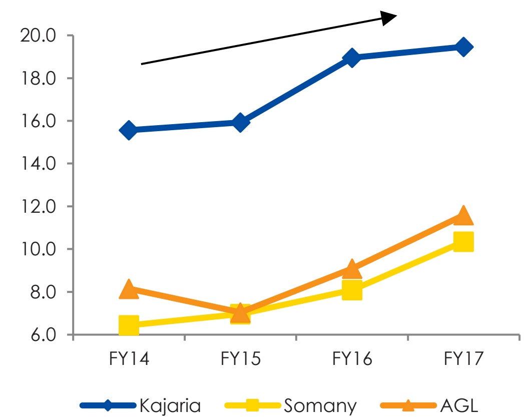
Sharp dip in fuel cost a margin booster

Natural gas is the key source of fuel for the tiles industry and profitability is highly dependent on its availability and price. Correction in natural gas price from INR372 per MMBTU (Million Metric British Thermal Unit) in Feb 2014 to INR190 per MMBTU currently (INR41 per SCM to INR23 per SCM) and renegotiation of pricing formula for long-term contract of GAIL with Qatar-based RasGas has successfully reduced fuel costs by ~40% YoY. Therefore, fuel expenses, which were ~14-15% of revenue, fell to 12-13%, thus boosting margins of all players by 2-3%.

Natural gas price movement (INR per MMBTU)



As gas prices fell, margins of players improved



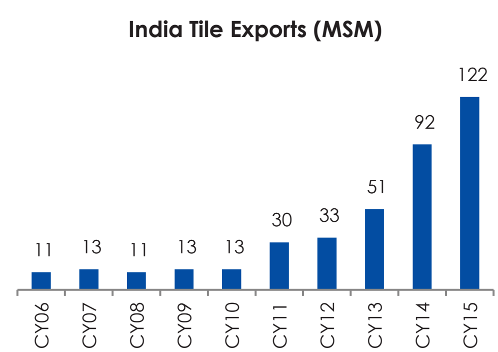
Source: Company, Edelweiss Investment Research

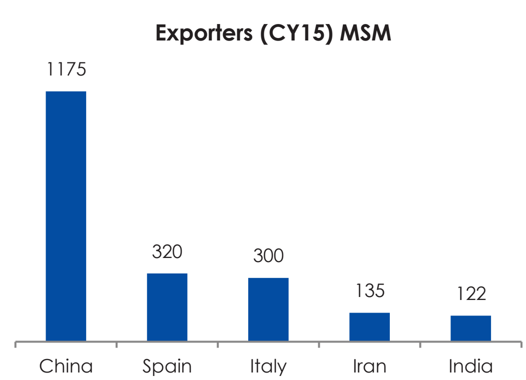
Duty on China and huge exports opportunity driving growth of domestic players

The Directorate General of Anti-Dumping and Allied Duties (DGAD) has imposed anti-dumping duty on Chinese vitrified tiles for the next 5 years (up to 2022). The DGAD had recommended imposition of anti-dumping duty on imports. Hence, the government imposed a provisional anti-dumping duty between USD0.79 per sq mt and USD1.87 per sq mt. Vitrified tiles (polished and glazed) constitute almost ~50% of India's total tiles consumption and most of the Chinese imports are in South India.

Post the anti-dumping duty, Chinese tiles will be expensive by INR30 per sq mtr, creating room for domestic players to hike prices, depending on demand. The anti-dumping duty imposed on China—largest tiles exporter globally—by European countries (in May 2013 for 5 years) has provided an exports opportunity to Indian players. As these duties have been imposed for ~5 years, Indian players will continue to tap newer markets and gain market share. India is currently the fifth largest tiles exporter in the world.

Indian tile exports have been growing and India is now the 5th largest tile exporter in the world

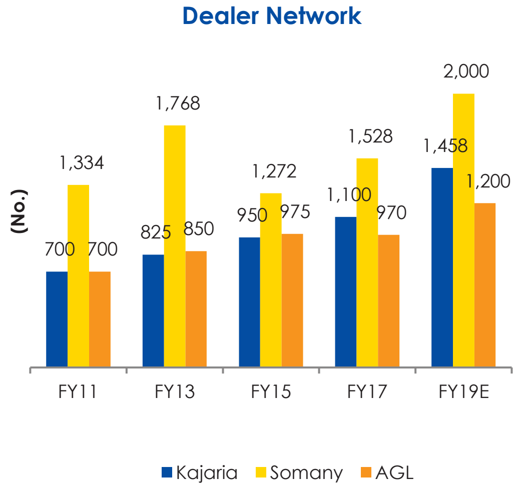


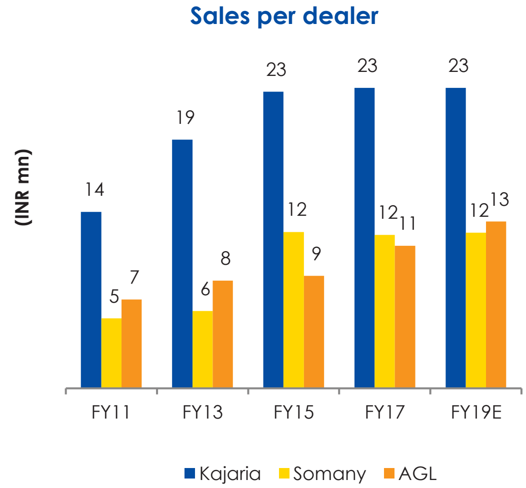


Source: Company, Edelweiss Investment Research

Organised players adding dealers and marketing aggressively

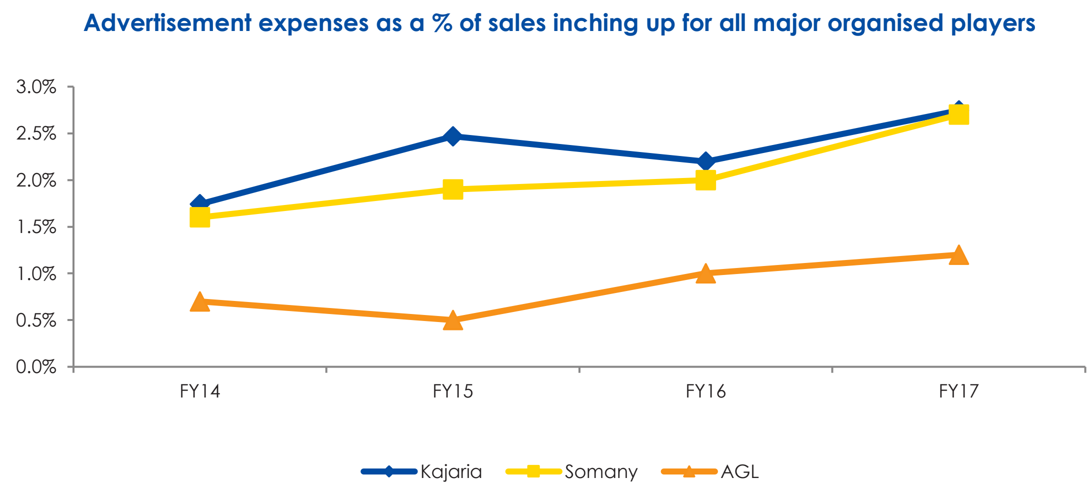
Organised players such as Kajaria, Somany and AGL have rapidly expanded their dealer networks over the past few years. Their sales per dealer have also been gradually expanding.





Source: Company, Edelweiss Investment Research

Along with increasing their dealer network, organised players have spent heavily on advertising and promotion of their brands. All these steps have ensured that organised players continuously gain market share from unorganised players.



Source: Company, Edelweiss Investment Research

Among domestic players, we have initiated coverage on AGL and also like Kajaria and Somany.

Peers comparison

Company	Revenue growth (%)			EBITDA margin (%)			PAT growth (%)			ROACE (%)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Kajaria	5.6	13.2	17.2	19.5	20.1	20.3	9.3	27.8	24.5	30.7	32.5	34.3
Somany	5.8	8.1	19.1	10.6	10.8	11.7	41.4	12.9	41.1	22.7	22.9	29.1
Asian Granito	**7.2**	**9.7**	**20.2**	**11.6**	**13.3**	**14.1**	**67.6**	**38.6**	**50.6**	**12.6**	**15.7**	**19.7**

Company	Cash conversion cycle (days)			Debt/Equity (x)			Total asset turnover (x)			Diluted PE (x)			EV/EBITDA (x)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Kajaria	83.0	89.0	82.0	0.2	0.1	0.1	1.7	1.7	1.7	43.0	33.6	27.0	22.4	18.8	15.4
Somany	45.0	48.0	43.0	0.5	0.3	0.1	2.2	2.2	2.5	37.7	33.4	23.7	19.7	16.9	12.8
Asian Granito	**109.4**	**94.0**	**90.0**	**0.8**	**0.7**	**0.6**	**1.0**	**1.1**	**1.2**	**37.5**	**28.6**	**19.4**	**14.5**	**11.2**	**9.0**

Source: Bloomberg and Edelweiss Investment Research Estimates

Long Term Recomendation: Asian Granito India Ltd.

Beneficiary of GST + Product mix driving profitability

CMP INR 494
Target INR 640
Rating: BUY Upside: 30%

Asian Granito India (AGL) is the fourth largest tiles manufacturer in India, with ~33MSM capacity and accounts for ~8% of the organised tiles market. AGL produces ceramic wall & floor tiles and digital, polished/glazed vitrified tiles. It is also engaged in marble and quartz manufacturing with an annual installed capacity of 1.3MSM. The company has a wide range of tiles portfolio offering 1,200 plus designs across the INR 30 to INR 165 per sq ft price range. A vibrant product range, aggressively expanding distribution network, sustained capacity expansion and potential benefits of shift of market share to organised players are expected to aid AGL outperform peers. We estimate AGL to clock revenue/PAT CAGR of ~15%/44.5% over FY17-19E, respectively, with healthy RoCE of ~20%. We re-iterate our 'BUY' rating with target price of INR 640.

Ample catalysts to spur outperformance

AGL's is expected to clock revenue CAGR of ~15% over FY17-19E primarily driven by increase in tiles sales volume CAGR by 12%, improvement in utilization, introduction of new products and increase in distribution reach to 5,500 sales points. AGL is targeting INR 2,000 cr sales over FY17-21E. GST implementation is expected to lead to market share gains for organised players as Morbi players: a) may convert into organised players as it will be difficult to bypass GST; b) may shift focus to export markets to replace anti-dumping duty hit China, thus helping organised players like AGL gain domestic market share; or c) could outsource their facilities to organised players.

Ample levers to spur operating margin

We estimate AGL's operating margin to catapult 250bps over FY17-19E on account of: (a) increased contribution of VAPs; (b) higher B2C sales; c) lower gas prices; d) sharpening focus on branding; and e) expansion of dealers' network— planning to add another 90; targeting 1,200 dealers by FY19. Ergo, we estimate the company's EBITDA margin to jump to 14.1% by FY19E.

Outlook and valuations: On strong turf; re-iterate with 'BUY'

The key drivers that will spur AGL's surge are: 1) rising capacity; 2) focused vertical for value-added products; 3) aggressive launch of new products; 4) expanding network; and 5) demand recovery. These, we believe, will boost the company's profitability in coming years, which is likely to lead to re-rating of valuation multiple. We re-iterate our **'BUY'** recommendation with target price of INR 640 based on 25x FY19E earnings (12% discount to Kajaria's target multiple). The stock is currently trading at 28x/19x FY18E and FY19E earnings, respectively.

Year to March	FY15	FY16	FY17E	FY18E	FY19E
Revenues (INR Cr)	846	994	1,066	1,169	1,404
Rev growth (%)	9.1	17.5	7.2	9.7	20.2
EBITDA (INR Cr)	60	90	124	156	198
Net Profit (INR Cr)	13	24	40	55	83
P/E (x)	74.6	45.4	37.5	28.6	19.4
EV/EBITDA (x)	21.2	15.5	14.5	11.2	9.0
RoACE (%)	8.1	10.8	12.6	15.7	19.7
RoAE (%)	5.2	7.6	10.4	12.1	15.7

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Bloomberg:	ASIAN:IN
52-week range (INR):	500/ 176
Share in issue (cr):	3
M cap (INR cr):	1,212
Avg. Daily Vol. BSE/NSE :('000):	56
Promoter Holding (%)	32.4

Initiated Date: 22nd August 2017

Initiation Price: INR 407

Date: 4th December 2017

AGL's is expected to clock revenue CAGR of ~15% over FY17-19E primarily driven by increase in tiles sales volume CAGR by 12%, improvement in utilization, introduction of new products and increase in distribution reach to 5,500 sales points. AGL's tiles division expected to grow at 17% CAGR over FY17-19E with the increase in capacity & distribution network. A vibrant product range, aggressively expanding distribution network, sustained capacity expansion and potential benefits of shift of market share to organised players are expected to aid AGL outperform peers. We estimate the company to clock revenue and PAT CAGR of ~26% and 44.5% over FY17-19E, respectively, with healthy RoCE of ~20%.

AGL is targeting INR 2,000 cr sales over FY17-21E, driven by - rising capacity, increase VAPs, expanding network and demand recovery

	FY17	FY18E	FY19E
Revenue	1,066	1,169	1,404
EBITDA	124	1576	198
EBITDA Margin (%)	11.6	13.3	14.1
PAT	40	55	83

Multiple levers for margin expansion - increase VAPs and B2C sales

	FY17	FY18E	FY19E
RoACE (%)	12.6	15.7	19.7
EV/Sales (x)	1.5	1.3	1.1

Higher free cash flow generation & lighter balance sheet to help further growth

FY19E	Adj EPS (INR)	Proj Multiple PER (x)	Price Target (INR)
AGL	25.1	25x	640

Entry = INR 494

+

PAT CAGR of 44.5% over FY17-FY19E to lead to exit multiple of 25x FY19E P/E

Total Return of 30%

Price Target	**INR 640**	We have arrived at target price of INR 640, assigning 25x FY19E earnings. The company's revenue is estimated to clock CAGR of ~15% over FY17-19E driven primarily by the increase in tiles sales volume (12% CAGR over FY17-19E), improvement in utilization, introduction of new products and increase in distribution reach to 5,500 sales points. With the healthy sales growth, margin improvement and restricted depreciation & interest expenses, expected to result a PAT CAGR of 44.5% over FY17-19E.
Bull 25x Bull Case FY20E EPS	**INR 1,023**	Assuming higher revenue growth 25% and330bps improvement in EBITDA margins, we expect AGL to generate EPS of INR 41 in FY19E. Assigning 25x FY19E earnings.
Base 25x Base Case FY19E EPS	**INR 640**	Assuming higher revenue growth ~15% and 250bps improvement in EBITDA margins, we expect AGL to generate EPS of ~INR 25.1 in FY19E. Assigning 25x FY19E earnings.
Bear 25x Bear Case FY20E EPS	**INR 385**	Assuming higher revenue growth 13% and 100bps improvement in EBITDA margins, we expect AGL to generate EPS of ~INR 15 in FY19E. Assigning 25x FY19E earnings.

Asian Granito India Ltd.

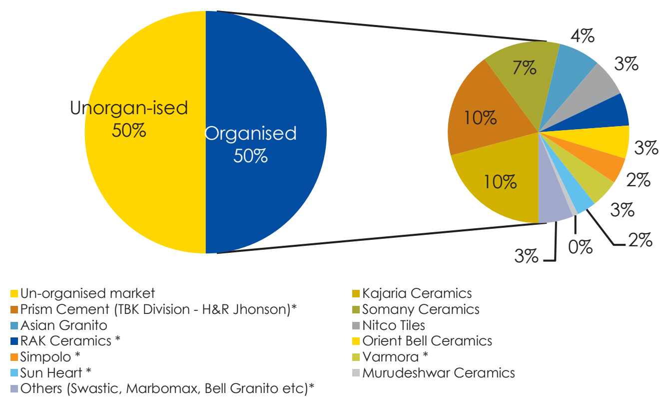
Average Daily Turnover (INR cr)			Stock Price				Relative to Sensex, CAGR (%)			
3 months	5 months	1 year	1 month	3 months	5 months	10 months	1 month	3 months	5 months	10 months
5.2	4.4	3.9	98.7%	272.9%	775.9%	323.8%	14.2%	16.2%	82.6%	138.0%

Business Value Drivers

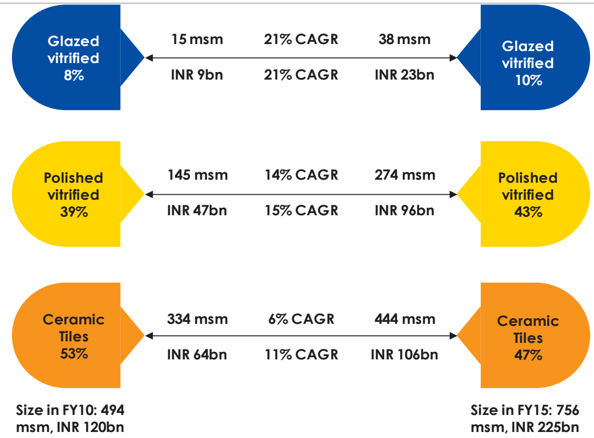
Nature of Industry	The Indian tiles industry, worth INR 260bn, is the third-largest tiles producer and consumer in the world with an annual consumption of ~763 MSM. The sector is fragmented between organised and unorganised players, each ~50%; sector clocked 9.6%/15.9% volume/value CAGR over FY08-15, respectively. Top 5 companies control 70% of organised market & sector moving towards premium tiles segment.
Opportunity Size	The current composition of industry provided opportunity for consolidation and scaling up the operations for organised players with the GST implementation – 50% unorganised pie & ~70% of India's total production of tiles from Morbi, which move to outsource their facilities or vacate market for organised players – big beneficiaries would be mid segment players like AGL. Industry, worth INR 260bn, expected to grow at ~13% y-o-y.
Capital Allocation	In last five years, AGL has done capex of INR 379cr (including amalgamation) and generated additional sales of INR 442cr, including outsource sales. AGL expected to spend INR 120cr in coming years towards doubling quartz capacity new joint ventures and maintenance activities.
Predictability	With the shift from unorganised to organised with regulatory changes, shift towards uses of value added products and increasing pan India presence – key drivers for growth and AGL with its capacity expansion, large product portfolio and wide distribution reach would be biggest beneficiary.
Sustainability	The major five players accounts for 70% of organised pie and with their distribution, innovative products and capacity (own + outsourced) expected to sustain their dominance in market. AGL is driven by the goal of achieving INR 2,000 cr in revenues by FY21 accompanied by margin expansion with increase in retail sales and VAPs mix, expected to achieve with the sector structural changes.
Disproportionate Future	With the increasing product mix towards value added vitrified tiles and quartz improve margins and increase in market share with sales volume expansion and geographic penetration – ensure that the future performance in terms of return ratios will be better than past.
Business Strategy & Planned Initiatives	Current focus of capacity expansion (own + outsource), geographic penetration, asset light model (JV expansion), margin improvement with change in product mix and increase in B2C sales.
Near Term Visibility	With the healthy sales growth (~15% CAGR over FY17-19E), margin improvement (250bps expansion over FY17-19E) and restricted depreciation & interest expenses, expected to result a PAT CAGR of 44.5% over FY17-19E.
Long Term Visibility	To remain one of the biggest Tiles manufacturer in India with the increasing domestic market share and increasing export sales.

Focus Charts – Story in a nutshell

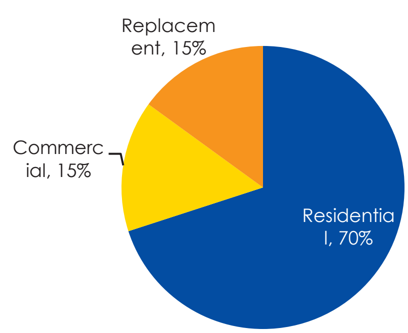
Indian industry – Top 5 companies control 70% organised market



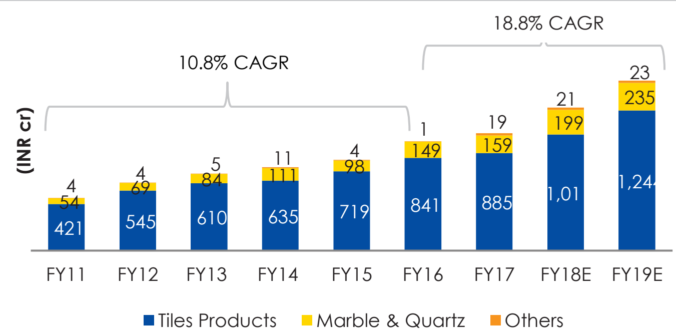
Tiles sector: Shift towards value-added products



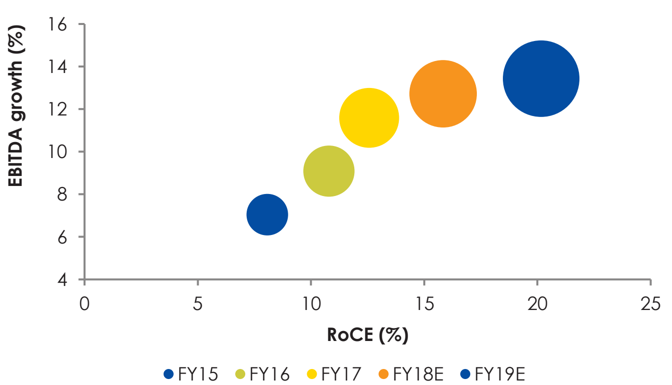
Residential consumes larger pie of demand



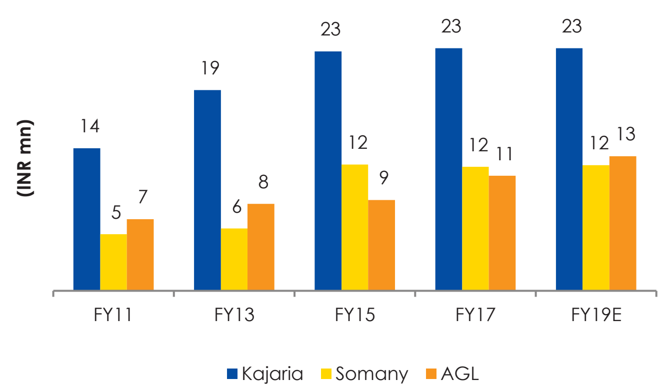
AGL: Capacity addition and improvement in utilisation drives revenue



AGL: Low fuel cost, higher value-added products to boost operating margin



AGL: Sales per dealer improving faster than peers



Source: Company, Edelweiss Investment Research

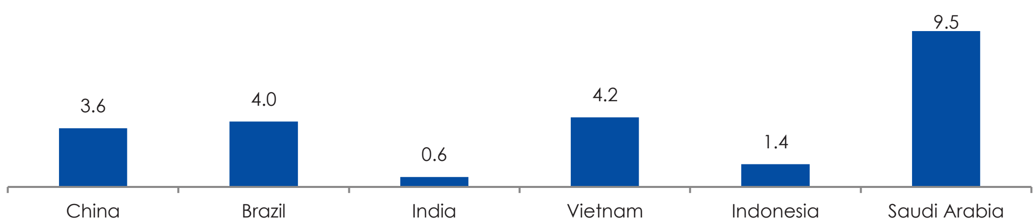
I. Tiles industry: Shift from unorganised to organised

Macro improvement, pick up in discretionary spending and government policy push are envisaged to spur the building products industry. Flooring/tile accounts for ~5% of cost of construction of a building. Housing constitutes 70% of tiles demand, followed by commercial (15%) and replacement market (15%). The domstic tiles indutry is expected to clock volume CAGR of 13.0%, in coming years and organised players envisaged to outperform the industry with the implementation of GST and with the increase in value added product mix. In India, per capita consumption of tiles is as low as 0.60 sq mtrs compared to China (2.6 sq mtrs), Europe (5-6 sq mtrs) and Brazil (3.4 sq mtrs). Hence, rising disposable incomes of a bugeoning middle class and ~4 cr units of housing shortage entail humungous potential.

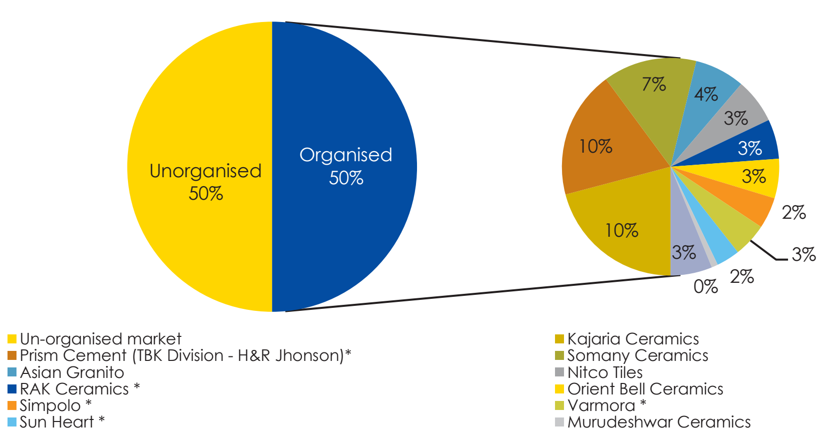
Cost structure of building a house

	% Total Cost	Cost (INR per sq ft)
Foundation	9	113
Floor Structure	12	150
Walls & Exterior Finish	12	150
Roof & Cover	10	125
Windows and Door	5	63
Interior Finish	8	100
Floor Finish	5	63
Interior Features	5	63
Bath Detail	4	50
Kitchen	8	100
Electrical	10	125
Plumbing	12	150
Total Cost	**100**	**1,250**

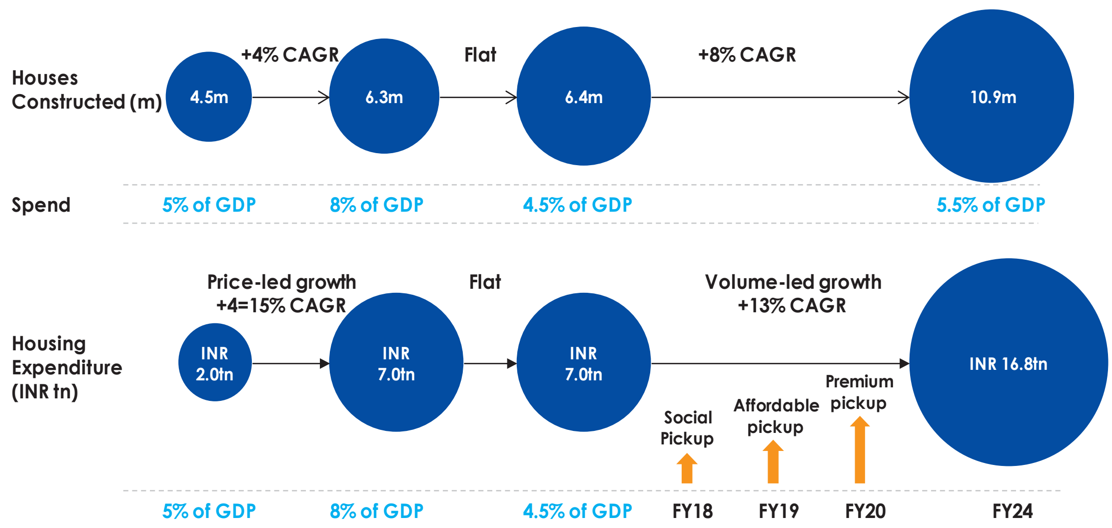
Per capita consumption of tile (Sq Mtr)



Indian industry – Top 5 companies control 70% organised market



Real Estate on verge of revival



Source: Company, Edelweiss Investment Research

Multiple catalysts for tiles demand in India

Urbanisation

- Urban housing demand in India is set to grow nearly 15mn units by end CY19. The top eight cities could account for nearly 3.4 mn units

Expanding growth markets for Indian housing

- Eleven small cities are expected to generate incremental housing demand of 9.44 lakh units in coming five years

Increase of discresanary income

- Seventh Pay Commission recommendations
- RBI's initiative to reduce loans cost

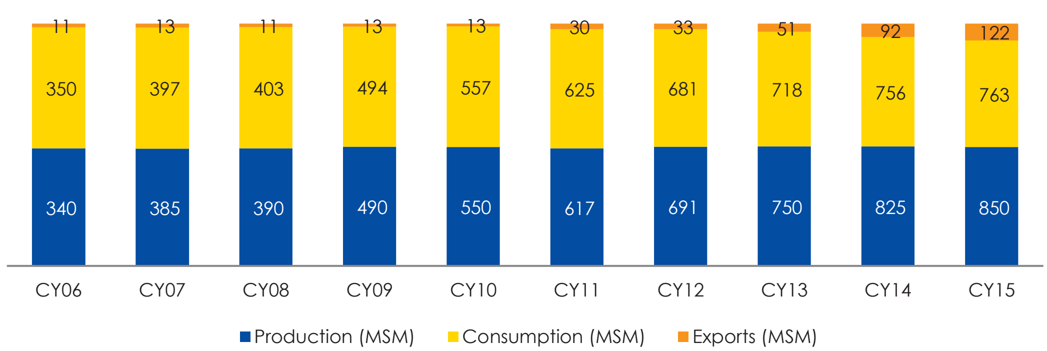
Govertment initiatives

- Smart Cities Mission
- Swachh Bharat Abhiyaan
- Atal Mission for Rejuvenation & Urban Transformation (AMRUT)
- Housing For All by 2022
- Implementation of Goods and Service Tax (GST)

Growing replacement market

- Technological advancements have strengthened the aesthetic appeal of tiles, making them an integral home improvement component
- Replacement of natural stone as well as a lot of low/high end marble

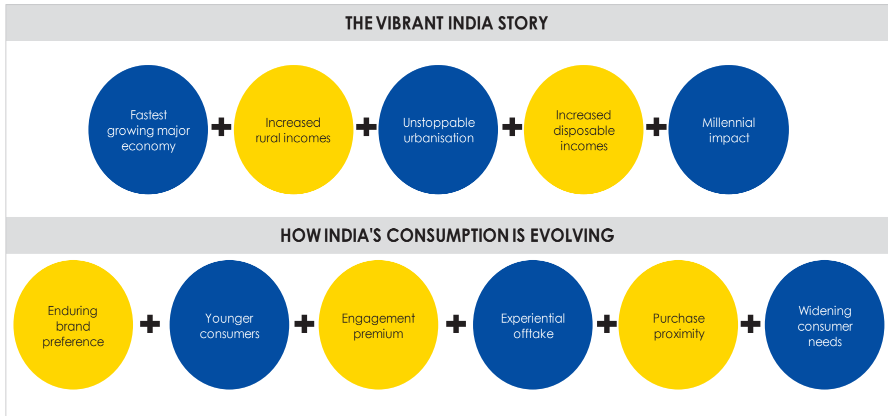
India tile industry



Source: Company, Edelweiss Investment Research

Urban housing shortage across India could catapult to an estimated 3.41 cr units by CY22 (*source RNCOS)*, primarily on account of demand-supply gap and rising income levels among the working class seeking to purchase houses. Hence, we expect the tiles sector to gain palpable momentum over coming years.

Domestic tile industry evolving with demand

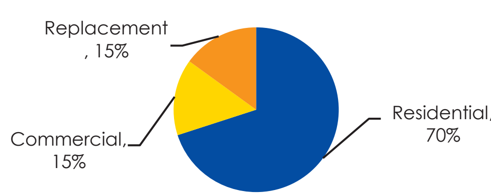


Demand for tiles is expected to grow in India in coming years on account of expanding real estate demand, rising disposable incomes and burgeoning middle class, along with government's initiatives such as "Housing For All 2022".

Ceramic tile industry statistics

World production:	12,355 MSM
India's Share:	850 MSM
World ranking (in production):	3
Per capita consumption:	0.60 sq. m
Global Industry Growth Rate:	6%
Growth Rate (India Domestic Market):	13%
Major National Player's Turnover (India):	~INR 8800 Cr
a) Glazed Wall Tile share:	45%
b) Glazed Floor Tile share:	8%
c) Vitrified Tile share:	40%
d) Industrial Tile Share:	7%
Unorganised Player's Turnover:	INR 12,900 Cr
Organised Sector:	
a) Share of Production (volume):	50%
b) Share of Production (value):	60%
Unorganised Sector:	
a) Share of Production (volume):	50%
b) Share of Production (value):	40%
Job Potential:	50,00 direct & 500,000 indirect
Investments in last 6 years:	INR 6000 Cr

Residential consumes larger pie of demand



Source: Company, Edelweiss Investment Research

II. Anti-dumping duty

a) Duty on China to boost organised players

The Directorate General of Anti-Dumping and Allied Duties (DGAD) has imposed anti-dumping duty on Chinese vitrified tiles for the next 5 years (valid up to 2022). The action was taken on an application filled by Gujarat Granito Manufacturers Association and Sabarkantha District Ceramic Association along with 24 producers of vitrified tiles in India for initiation of anti-dumping investigation and imposition of anti-dumping duty concerning imports of vitrified/porcelain tiles which originate in or are exported from China.

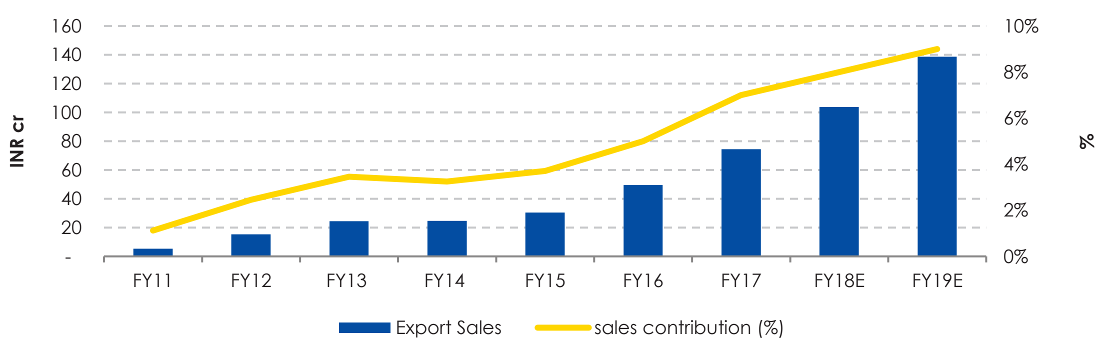
The DGAD had recommended imposition of anti-dumping duty on imports of glazed/unglazed porcelain/vitrified tiles in polished or unpolished finish with less than 3% water absorption to protect domestic players. Hence, the government imposed a provisional anti-dumping duty between USD 0.79 per sq mt and USD 1.87 per sq mt.

Vitrified tiles (polished and glazed) constitute almost ~50% of total India tiles consumption and most of the Chinese imports are in South India. AGL is expanding its capacity in South India via a JV plant and has also launched products like 800 x 800 mm/1000 x 1000 mm vitrified tiles to grab the potential opportunity and save freight cost. Post the anti-dumping duty, Chinese tiles will be expensive by INR 30 per sq mtr, creating room for domestic players to hike prices depending on demand.

b) Huge exports opportunity

The anti-dumping duty imposed on China—largest tiles exporter globally—by European countries (in May 2013 for 5 years), Korea, Vietnam, Brazil, Chile, Taiwan etc., provided an exports opportunity to Indian players. As these duties have been imposed for ~5 years, Indian players will continue to tap newer markets and gain market share. AGL exports its products to 53 countries and exports contribute ~7% (FY17) to consolidated sales, up from 3% in FY14.

AGL: Export sales increasing



Source: Company, Edelweiss Investment Research

III. GST: Advantage organised players

The current composition of industry provided opportunity for consolidation and scaling up operations for organised players with GST implementation. The sector have ~50% unorganised players and ~70% of India's total production of tiles from Morbi, which we beileve will outsource their facilities or vacate market for organised players with the GST implementation – big beneficiaries would be mid segment players like AGL. Industry, worth INR 260bn, expected to grow at ~13% y-o-y.

AGL is expected to gain domestic market share with implementation of GST and gain from cost savings in octroi, freight, etc. We believe, the company will be major beneficiary of GST and following are probable outcomes of GST implementaion:

a) Morbi players may convert into organised players as GST will be difficult to bypass.

b) Morbi players could focus on export markets to take advantage of anti-dumping duty on China by other countries. This could help organised players like AGL gain domestic market share.

c) Morbi players could outsource their facilities to organised players.

We believe, GST is one of the key factors which will drive shift of market share to the organised segment and major beneficiaries will be players who have:

a) Lower price differential with unorganised players.

b) Better product quality and larger product basket.

c) Established brand.

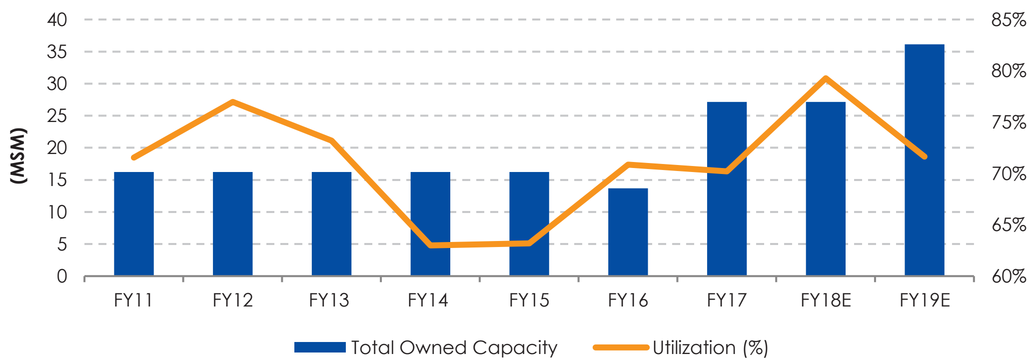
d) Robust distribution network and availability of products.

IV. Asian Granito: Rise in capacity & utilisation

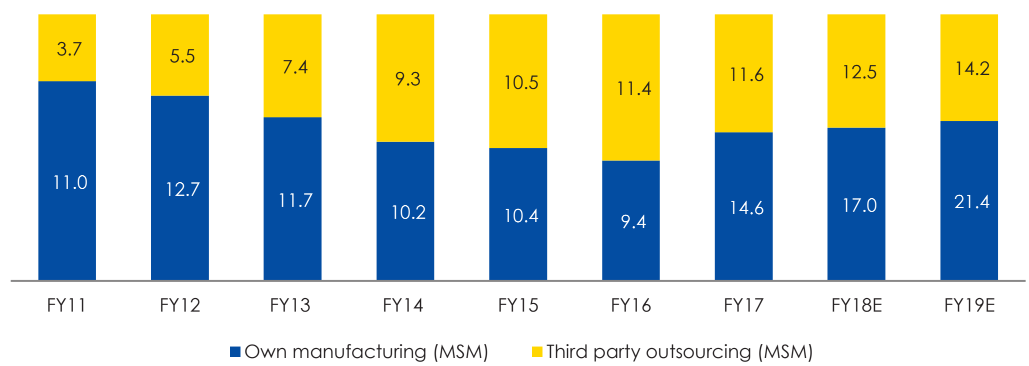
a) Improvemnet in ownned capacity & utilisation

AGL is the forth largest player in the domestic market with owned capacity of 33 MSM, which is estimated at 36 MSM post expansion. The company's total sales volume has jumped to 31 MSM in FY17 and expected to touch 36 MSM by FY19E.

AGL: Owned capacity and utilisation



AGL: Sales volume

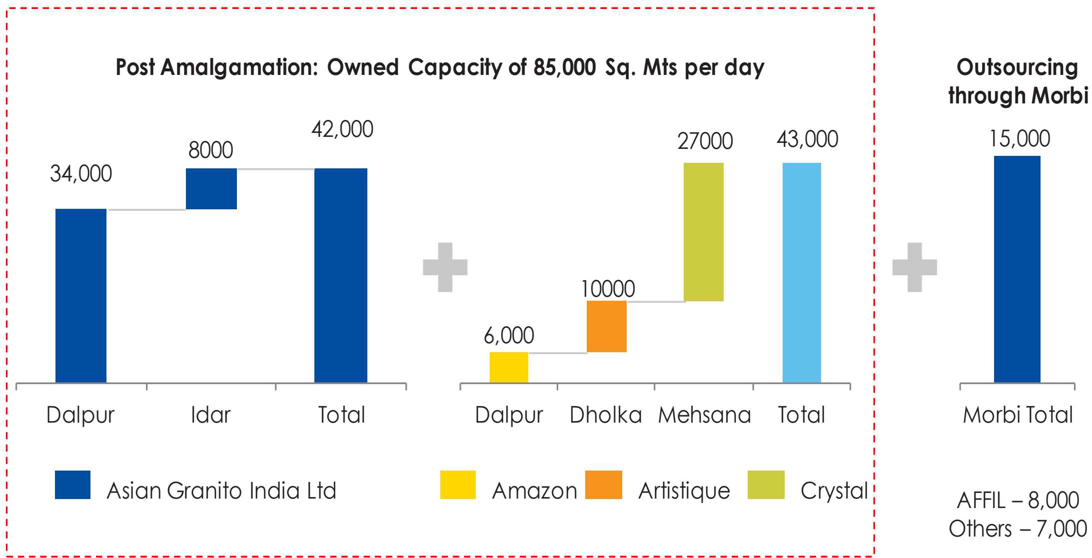


Source: Company, Edelweiss Investment Research

AGL: Manufacturing details

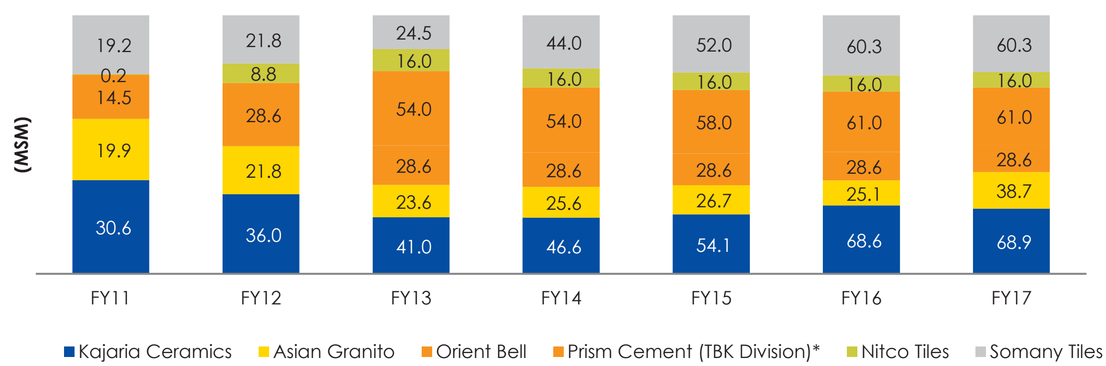
Location	Capacity	
FY17	**sq mtrs/day**	**mn sq mtrs/annum**
Dalpur, Himmatnagar	34,000	12.41
Idar	8,000	2.92
Dalpur, Himmatnagar (Amazoon)	6,000	2.19
Dholka (Artistique)	10,000	3.65
Mehsana (Crystal)	27,000	9.86
Morbi (Outsourcing)	15,000	5.48
Total	**100,000**	**36.50**

AGL: Total capacity



Combined Capacity of 100,000 Sq. Mtrs per day (Incl. Outsource)

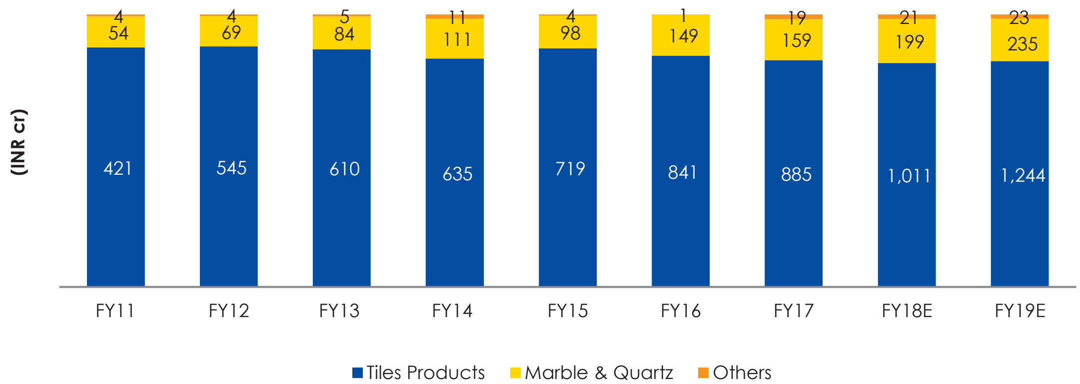
b) AGL: Capacity addition – Highest in past three years



c) Focus on premiumisation

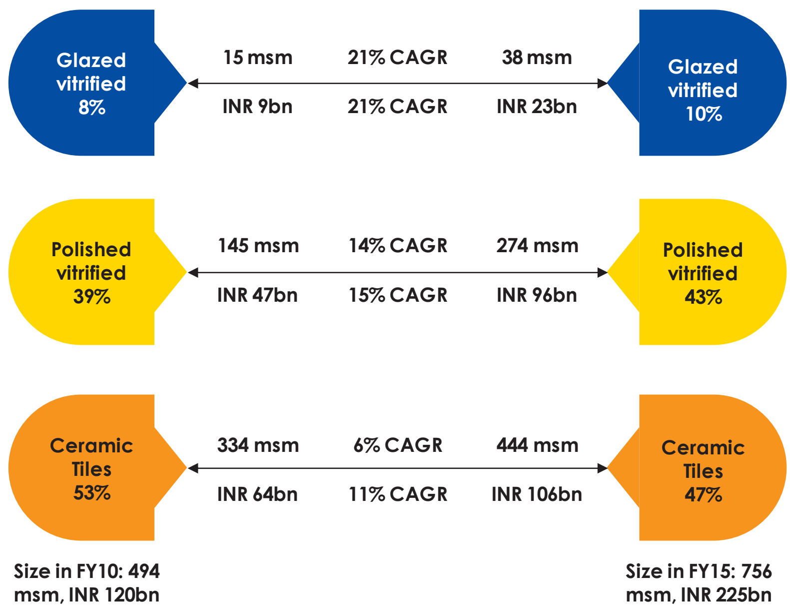
AGL is gradually shifting focus to the value-added segment—from ceramic to vitrified tiles and quartz—which enjoys better realisations. Contribution of value-added products is estimated to rise to ~50% in next couple of years. The company has created a separate vertical for its very high-value product range to sharpen focus on the segment. Further, to support this segment, AGL has widened its product basket through launch of multiple designs, sizes, textures and colours (revenue target of INR 2,000 cr by FY21).

Segment contribution



Source: Company, Edelweiss Investment Research

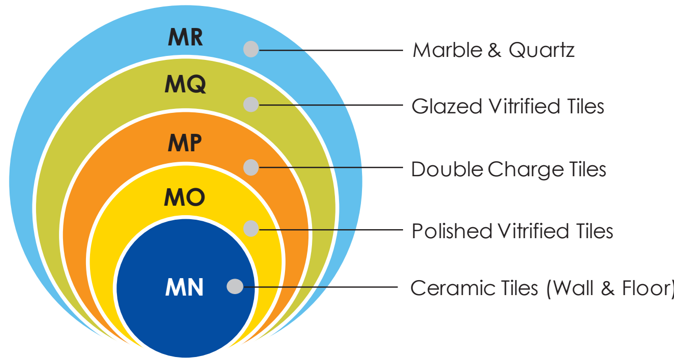
Tiles sector: Shift towards value-added products



AGL: Reveneue mix shifting towards value-added products

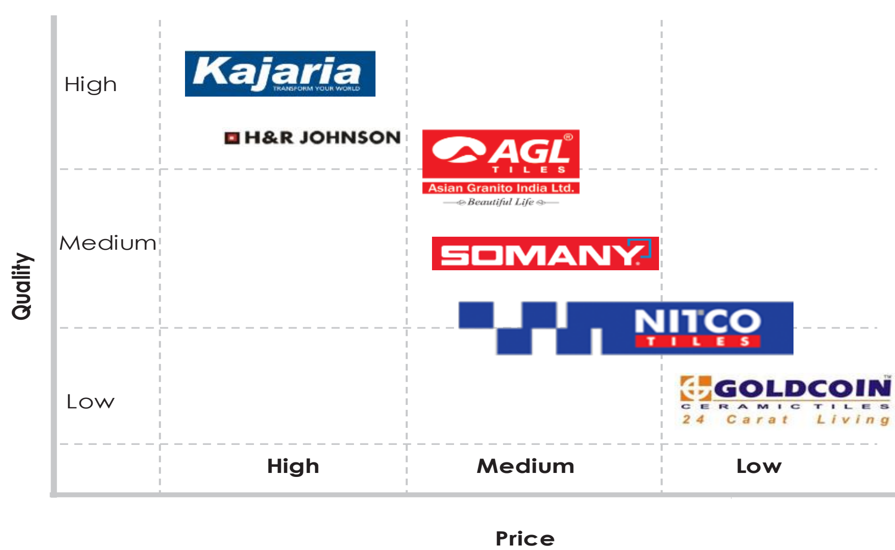
Type of Tiles - Sales Contribution (%)	FY13	FY14	FY15	FY16	FY17
Ceramic (INR 30-65/sq ft)	46	49	43	44	36
PVT (INR 50-135/sq mt)	39	34	30	24	23
GVT (INR 70-165/sq mt)	11	11	14	16	19
Double Charge (INR 80-170/sq mt)	4	6	13	16	22

Focus on high value product mix



Product positioning

	Products pricing	New product/design launches in the last two years
Asian Granito	Ceramic Rs 30-65/sq ft Vitrified Rs 40-110/sq ft Glazed vitrified Rs 70-165/sq ft	• CARARRA White unglazed large format Double Charge • XXL – Polished Glazed Vitrified Tile • Big Crack Stone – Double charged polished vitrified tile • Hardstonee) Grandura (Parking Tiles) • Hexabon tiles
Kajaria Ceramics	Ceramic Rs 28-100/sq ft Vitrified Rs 42-120/sq ft Glazed vitrified Rs 60-350/sq ft	• Strome Hi definition Digital ceramic wall tiles • Eternity HD (Digital Glazed/polished Vitrified Tiles • The Beast 120 x 240 cm (Italian tile)
Somany Ceramics	Ceramic Rs 30-65/sq ft Vitrified Rs 40-120/sq ft Glazed vitrified Rs 75-145/sq ft	• Rock Solid tiles – floor tile • New size addition 800 x1200 mm PVT with ultra-charge • Slip Shield – slip resistant technology



d) Sustained launch of new products

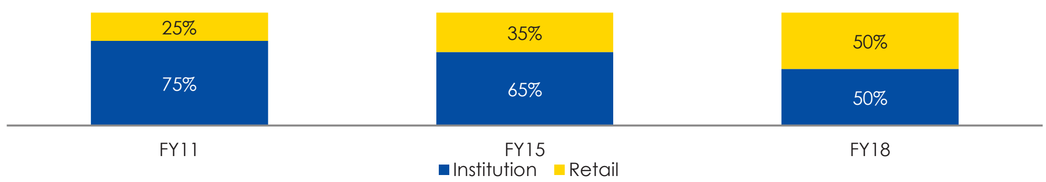
AGL is continuously lauching new products, ranging from affordable tiles to upper-end glazed vitrified tiles. The expanding product basket has started creating a 'pull' for its products and also improved its realisations.

Product Name	Size in mm
Rainbow Glitz - 9 COLOR DIGITAL TILES WITH SPECIAL EFFECTS	300x900mm 300x600mm
GLISTER – POLISHED PORCELAIN TILES	600X600MM
STEP & RISER	300X1000MM 300X800MM
ECO BLANCO	300X300MM
Engineered Quartz (Different Sizes to cater to different markets)	1400 x 3100 1600 x 3200
Grestek – Splendour Series – Introduced 13 SKU's	800 x 1600
Grestek – Marvel Colour Body Tiles	300 x 600, 600 x 1200, 600 x 600, 196 x 1200
Imperio – Double Charge – Introduced 17 SKU's	800 x 800
Jumbo - Double charge – Introduced 16 SKU's	1000 x 1000
CARARRA White (World's Whitest Tile – in unglazed large format Double Charge)	800 x 800
XXL – Polished Glazed Vitrified Tile	800 x 1200
Polished Vitrified Tile (Double Charge) & Big Crack Stone (new design introduced first time in India)	800 X 1200 & 1000 X 1000
Hardstone (Outdoor Tiles in 16 mm & 10 mm thickness)	600 x 600
Grandura (Parking Tiles)	300 x 300 & 400 x 400
Hexacon Tiles (first to introduce)	304 x 350
Grestek SLIMGRES	600 x 1200

e) Moving to B2C sales

AGL's sharpened focus on retail sales is reflected in the continuously rising retail sales contribution from 25% to 35% over the past four years. The company is also enhancing its retail presence through a large network of distributors, retailers and exclusive showrooms. It is targeting retail sales of 50% in coming years via addition of new dealers & sub-dealers and exclusive showrooms. It is also eyeing geographical expansion, which will boost volumes, and higher retail presence will improve realisation, resulting in improved earnings.

Moving towards retail network

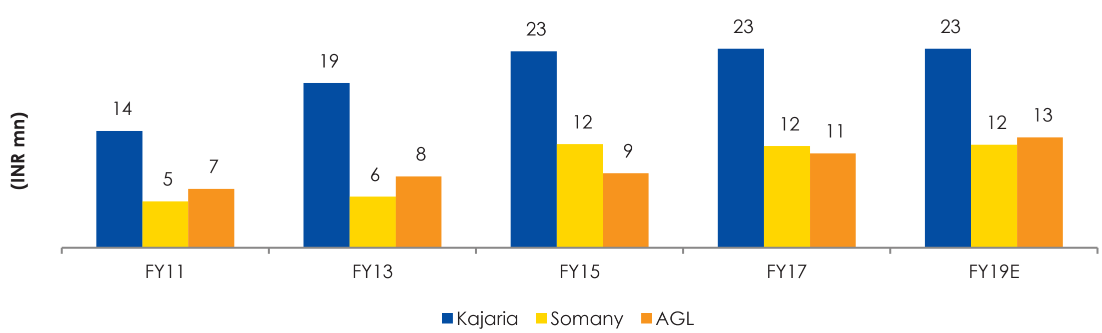


Source: Company, Edelweiss Investment Research

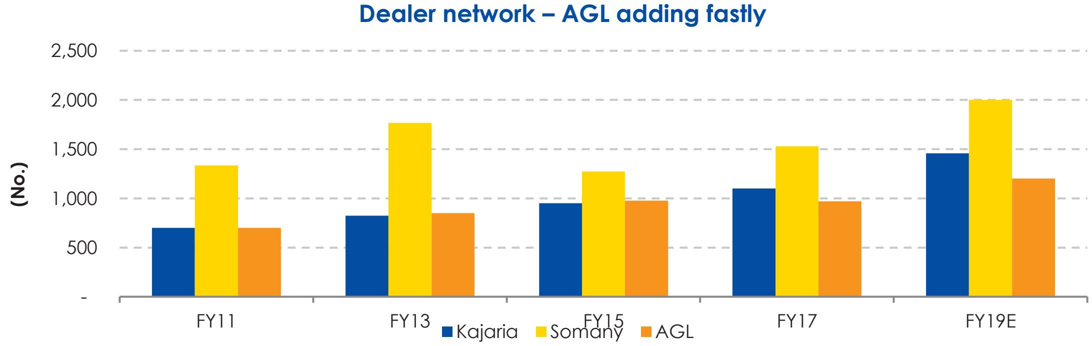
f) Strengthening its network—970 direct dealers

AGL is expanding its distribution network aggressively and also improving sales per dealer. The company has a strong and widespread dealership network of 970 currently (versus Kajaria's 1,100 and Somany's 1,528), up from 700 in FY11, and expected to reach 1,200 by FY19. It added 25 dealers in Q1FY18. The company's sales per dealer has been improving over the past three years (12.5% CAGR over FY15-17) against flat for Kajaria as well as Somany. Its dealers cater to ~4,330 sub-dealers/associate dealers across the country, almost at par with industry leader (Kajaria).

AGL: Sales per dealer improving faster than peers

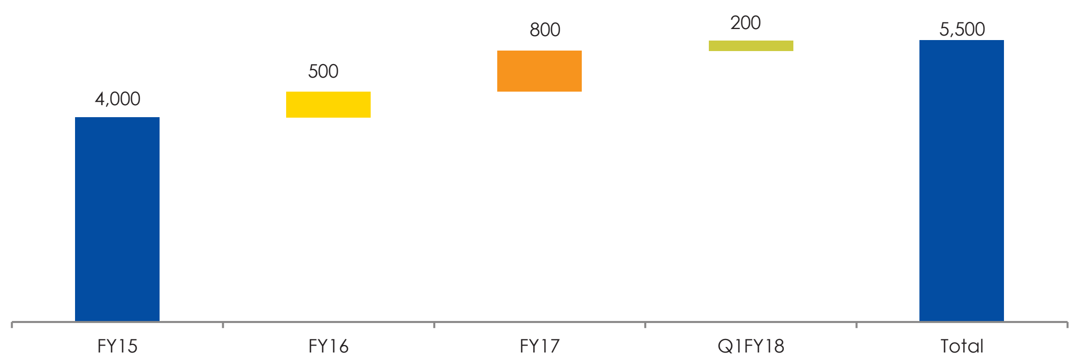


Dealer network – AGL adding fastly



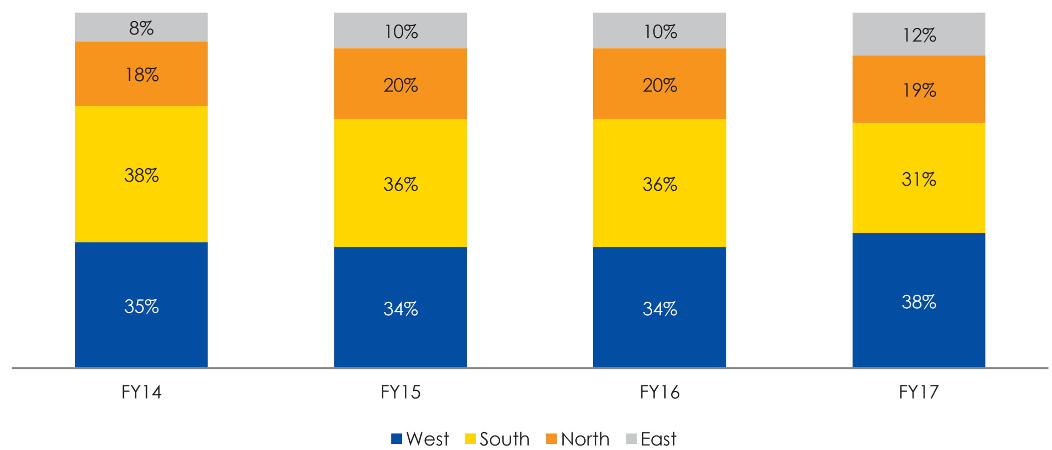
Source: Company, Edelweiss Investment Research

Addition in dealers & sub-dealers



Source: Company, Edelweiss Investment Research

Geographical revenue break up

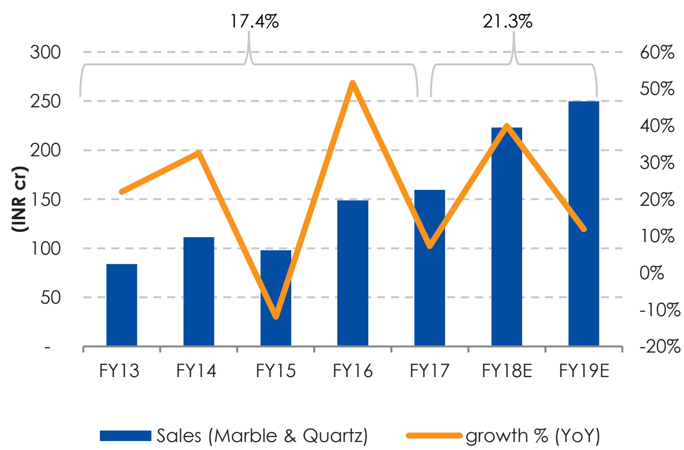


Source: Company, Edelweiss Investment Research

V. AGL: Quartz expansion

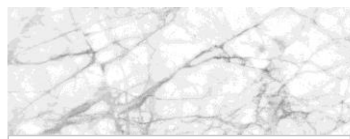
The Indian marble & quartz industry was pegged at ~INR 350cr compared to INR 50,000cr global market and AGL's marble division is engaged in the manufacture of marble and quartz with a market share of 45%. India is one of the key players in the global export of natural stone and is growing at faster rate. The domestic industry has posted ~14% revenue CAGR over last five years. AGL manufactures marble and quartz across a range of prices addressing the mass / mid and premium ranges. AGL has more than 102 projects customers with a diverse portfolio of >140 products in marble and quartz and a manufacturing capacity of 105,000 sq mtrs per annum. AGL has added 45 New dealers to this business in FY16 reach to 385 total dealers. AGL has strated 3rd line of Quartz commissioned in April-17 at Dalpur, resulted Quartz capacity from 2.64lac sq mt to 5.3lac sq mt, which expected to generate additional INR 40 cr sales.

AGL: Marble & quartz sales



AGL's product portfolio – Marble & quartz

Marble



- Multi Colour Marble
- Nano Crystal Marble
- Imported Natural Marble
- Onyx Marble

Quartz

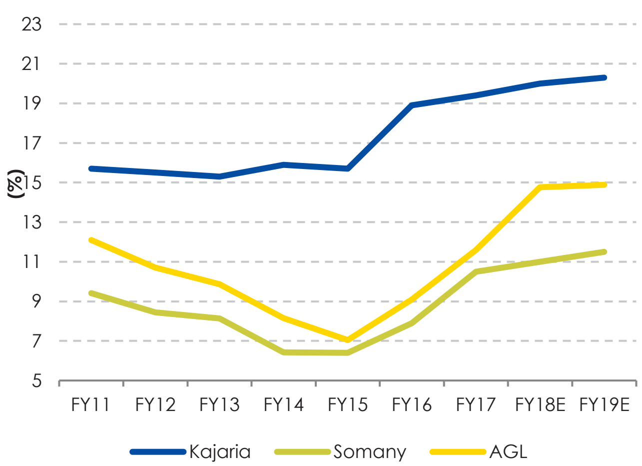
- Multi Colour Quartz
- E - Stone(Different Sizes to cater to different markets : 12mm, 15mm, 18mm, 20mm, 30mm)

Source: Company, Edelweiss Investment Research

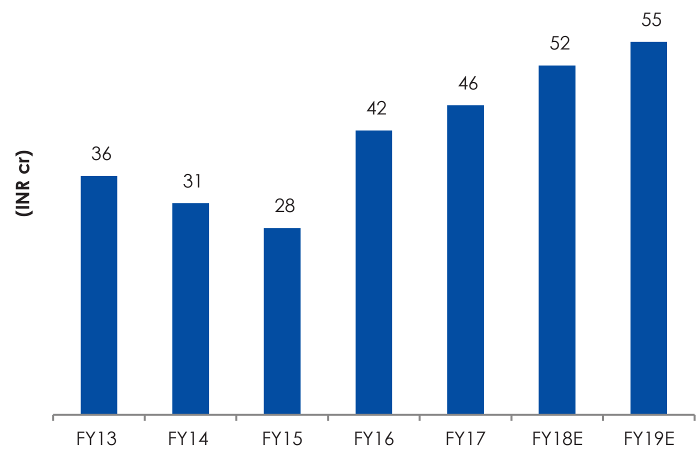
VI. Improvement in realisation to expand margin

AGL's average realisation is estimated to increase 2-3% over the next two years primarily driven by change in product and market mix. On the anvil are new products launches (like 1,000 x 1,000 mm and 800 x 1,200 mm) with higher VAPs and focus to enhance retail volumes. This is likely to lead to contribution of value-added products jumping from 35% currently to ~50% over the next two years. Also, we expect better realisations to improve the company's EBITDA margin.

AGL: EBITDA margin improving



AGL: Improving EBITDA per sq mtr



Source: Company, Edelweiss Investment Research

VII. Sharp reduction in fuel cost

Natural gas is the key source of fuel for the tiles industry and profitability is highly dependent on its availability and price. We believe, AGL is in a sweet spot on these two counts considering:

1) Correction in natural gas price from INR 372 per MMBTU (Million Metric British Thermal Unit) in Feb 2014 to INR 190 per MMBTU currently, (INR 41 per SCM to INR 23 per SCM).

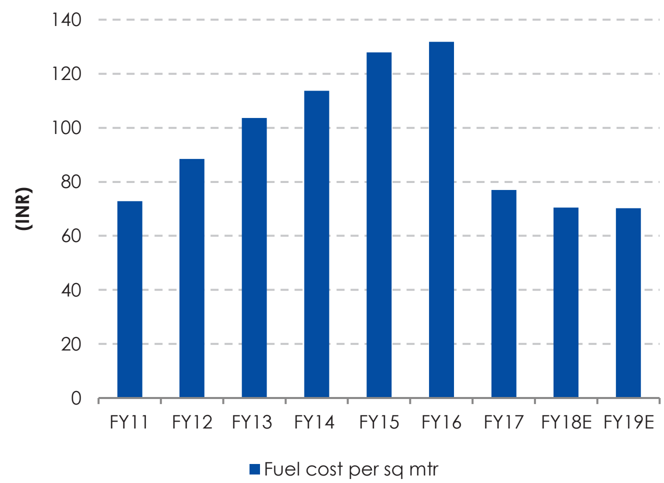
2) Renegotiation of pricing formula for long-term contract of GAIL with Qatar-based RasGas.

3) ACPL and Crystal's contract prices at ~INR 14/scm and INR 12/scm, respectively, which are significantly lower than the spot price (INR 23 per SCM).

AGL had long-term contracts with GAIL, GSPL, IOCL and Sabarmati Gas. ACPL and Crystal Ceramics have long-term natural gas supply agreements with RasGas and ONGC, respectively, at a fixed price. ACPL and Crystal having contract price at ~INR 14/scm and INR 12/scm which is significantly lower than spot price. Hence, AGL's fuel cost reduced by ~40% y-o-y to INR 77 per sq mtrs.

Natural gas price movement (INR per MMBTU)

AGL: Fuel cost per sq mtr



Source: Company, Edelweiss Investment Research

AGL: SWOT Analysis

Strengths

- One of India's largest ceramic tile companies with a footprint across 50+ countries.
- The company has 6000+employees, 5000 sub-dealers and exclusive showrooms.
- India's fastest growing ceramic, vitrified tiles, marble and quartzcompany.

Weakness

- Lower experience compared to domestic competitors.

Growth Opportunity

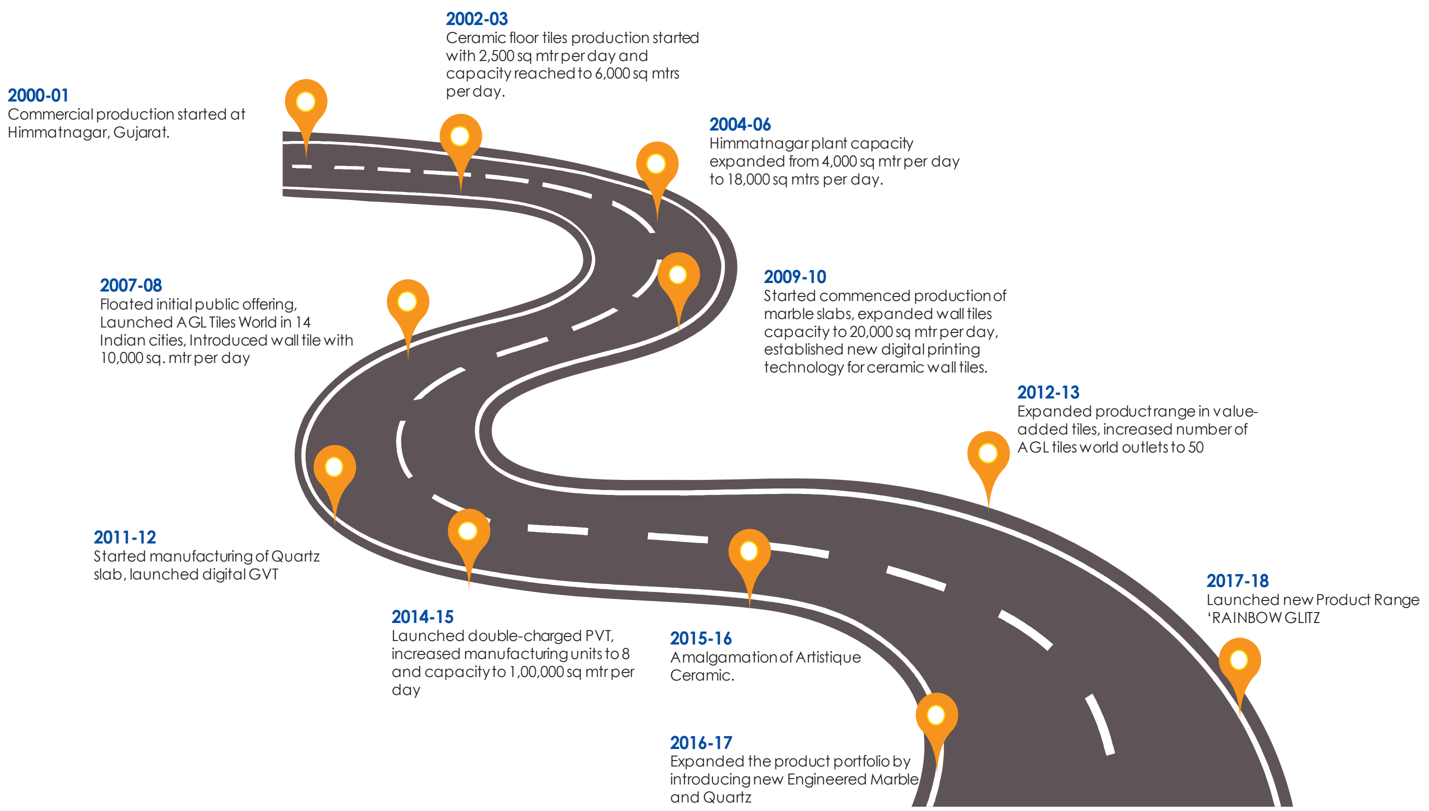
Opportunities

- Untapped national consumption potential
- Greater emphasis on exports
- Mergers and acquisitions

Threats

- Growing competition from domestic and established international brands

AGL: Key Milestones



AGL: Outlook & Valuations

AGL is currently best placed in the ceramics & tiles industry given company-specific sales and margin initiatives and significant financial and operating leverage that amplifies EPS growth in better sales environments. We expect AGL to benefit from its focus on branding and value proposition, which have driven favourable sales trend. In addition, internal initiatives enable AGL to gain market share versus competitors. The key growth drivers for AGL are: 1) rising capacity; 2) focused vertical for value-added products; 3) aggressive launch of new products; 4) expanding network; and 5) demand recovery. These, we believe, will spur the company's profitability in coming years, which is likely to lead to re-rating of valuation multiple. We re-iootereate our **'BUY'** recommendation with target price of INR 640 based on PER of 25x FY19E earnings (12% discount to Kajaria's target multiple). The stock is currently trading at 28x/19x FY18E and FY19E earnings, respectively. On EV/EBITDA basis, the stock is trading at 11x FY18E EV/EBITDA and 9x FY19E EV/EBITDA.

Peer Comparison

	Kajaria	Somany	Orient Bell	Asian Granito
Total capacities (Current)				
Tiles (mn sq mtrs)	62.1	51.7	30	33
Sanitaryware (mn pcs)	0.7	0.3	–	–
Faucetware (mn pcs)	1	**Outsourced**	–	–
Outsourced capacities (%)				
Tiles	42	58	20	13
Sanitaryware	NA	NA	–	
Faucets	NA	100	–	–
Expansion				
Tiles (mn sq mtrs)	12.2	8	4.2	3.2
Sanitaryware (mn pcs)	–	–	–	–
Faucetware (mn pcs)	–	–	–	–
Market share (%) (Organised)				
Tiles	23	16	7	8
Sanitaryware	**Negligible**	2	–	–
Faucetware	**Negligible**	1	–	–
Revenue contribution (%)				
Tiles	95+	96	100	85
Sanitaryware		2	–	–
Faucetware	**Below 5**	2	–	–
Number of dealers/ distributors/retailers	10,000+	10,000+	4,000+	5,500+
Advertisement expenses as a % of sales (FY15)	2.5	1.9	1.2	0.5
Key brand	**Kajaria**	**Somany**	**Orient Bell**	**AGL Tiles**

Asian Granito India Ltd.

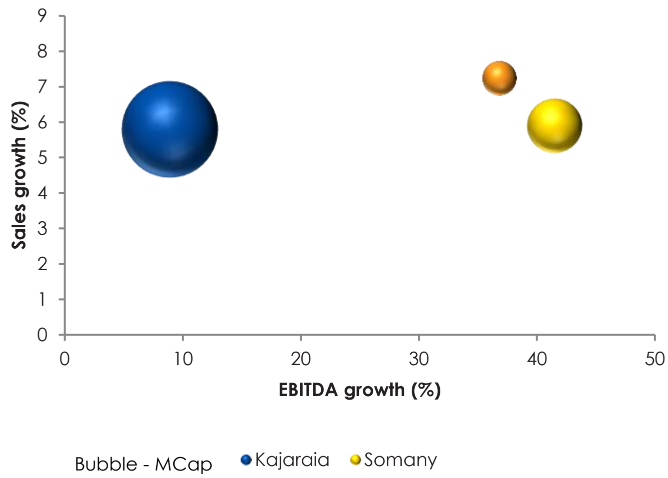
On historical average, AGL has been trading at a discount to Kajaria's one-year forward PER and EV/EBITDA. This is primarily on account of the latter's significantly better return ratios, superior EBITDA margin and lion's market share. We anticipate improvement in AGL's operating performance riding margin expansion and improving RoE & RoCE. Hence, we expect the the valuation gap between Kajaria and AGL to shrink.

Peers comparison

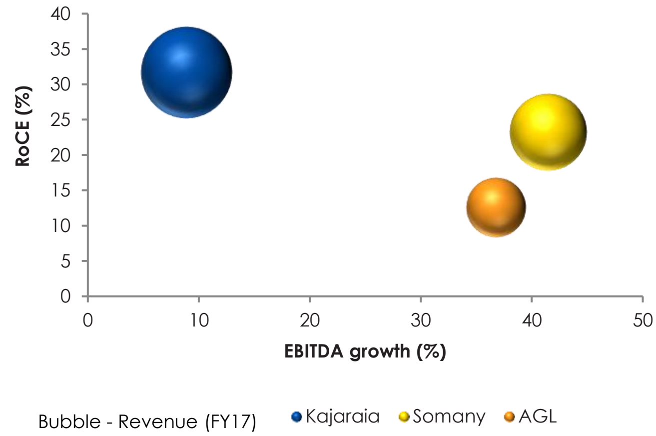
Company	Revenue growth (%)			EBITDA margin (%)			PAT growth (%)			ROACE (%)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Kajaria	5.6	13.2	17.2	19.5	20.1	20.3	9.3	27.8	24.5	30.7	32.5	34.3
Somany	5.8	8.1	19.1	10.6	10.8	11.7	41.4	12.9	41.1	22.7	22.9	29.1
Asian Granito	**7.2**	**9.7**	**20.2**	**11.6**	**13.3**	**14.1**	**67.6**	**38.6**	**50.6**	**12.6**	**15.7**	**19.7**

Company	Cash conversion cycle (days)			Debt/Equity (x)			Total asset turnover (x)			Diluted PE (x)			EV/EBITDA (x)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Kajaria	83.0	89.0	82.0	0.2	0.1	0.1	1.7	1.7	1.7	43.0	33.6	27.0	22.4	18.8	15.4
Somany	45.0	48.0	43.0	0.5	0.3	0.1	2.2	2.2	2.5	37.7	33.4	23.7	19.7	16.9	12.8
Asian Granito	**109.4**	**94.0**	**90.0**	**0.8**	**0.7**	**0.6**	**1.0**	**1.1**	**1.2**	**37.5**	**28.6**	**19.4**	**14.5**	**11.2**	**9.0**

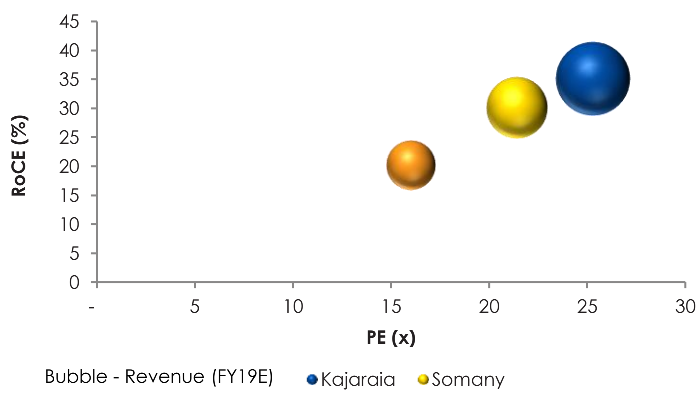
Peers: Sales & EBITDA growth (FY17)



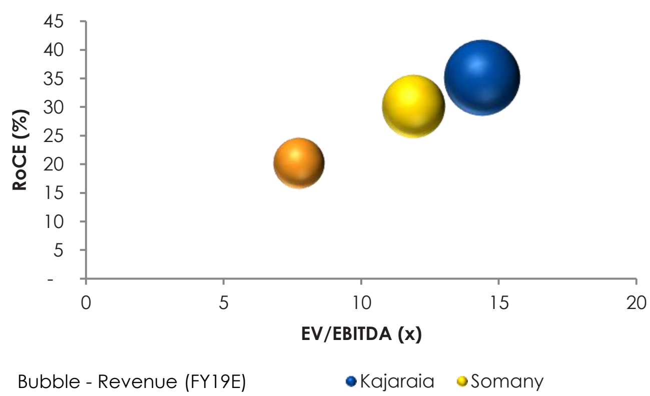
Peers: Operating margin with returns



Peers Valuations



Peers Valuations



Source: Company, Edelweiss Investment Research

Key Management

Name	Designation	Profile
Mr. Kamlesh Patel	*Chairman*	Mr. Kamlesh Patel has an overall experience of 18+ years in the tiles industry. He holds BBA degree from Sardar Patel University. Mr. Patel started his career with the foundation of Kedia Industries, a wall tiles manufacturer, in 1994. In 1999, along with Mr. Mukesh J. Patel, he started Asian Tiles.
Mr. Mukesh Patel	*Managing Director*	Mr. Mukesh Patel has 20+ years' experience in the tiles industry. He started his career with the foundation of Kedia Industries, a wall tiles manufacturer, in 1994. In 1999, along with Mr. Kamlesh Patel he started Asian Tiles.
Mr. Tapan Jena	*CEO*	Mr. Tapan Jena has an experience of ~28 years in Strategy Planning, Sales and Service Operations, Business Development as well as Team Management. He is also experienced in building material industries covering different product lines – ceramic tiles (wall, floor, designer and industrial)/construction chemicals/sanitary ware and CP fittings.

Key Risks

- Inability to pass on fluctuating raw material prices.
- User industry growth remains muted.
- Rising competition from domestic players and neighbouring countries.

Business Overview

Company description

AGL was incorporated in 2000 by Gujarat-based entrepreneurs Mr. Kamlesh Patel and Mr. Mukesh Patel. AGL is the fourth largest tiles manufacturer in India with ~33MSM capacity. The company manufactures ceramic wall & floor tiles and digital/ polished/glazed vitrified tiles. It also manufactures marble & quartz with an annual installed capacity of 1.3MSM. AGL accounts for ~8% of the domestic organised tiles market. The company has wide range of tiles portfolio which offers 1,200+ designs across Rs 30 to Rs 165 per sq ft range.

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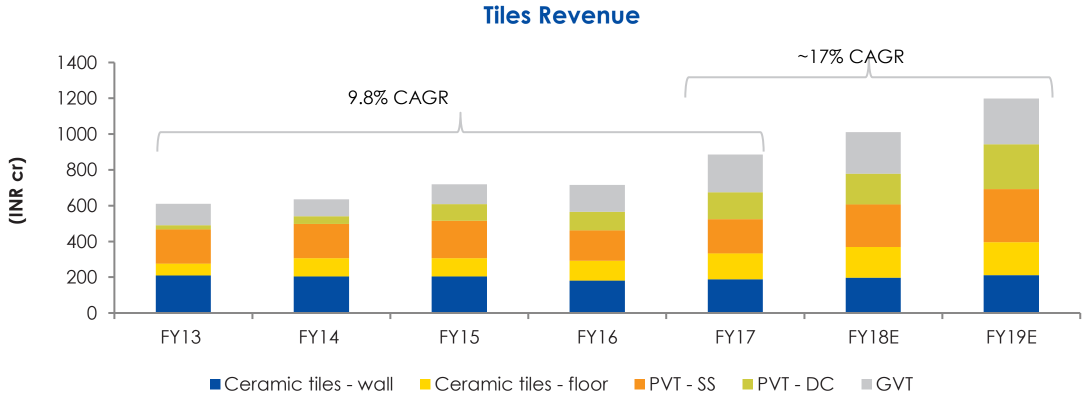
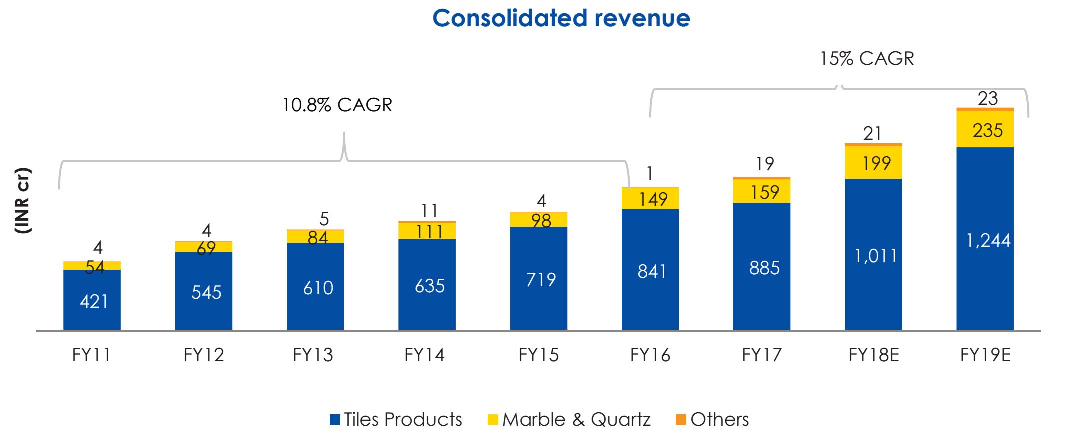
Business Model	The company has 4 segments. 1) Tiles division 2) Marble and quartz division 3) Agri-products business 4) Chemical products business
Strategic Positioning	AGL is gradually shifting focus to the value-added segment—from ceramic to vitrified tiles and quartz—which enjoys better realizations and towards retail sales via addition of new dealers & sub-dealers and exclusive showrooms, estimated to rise to ~50% in next couple of years.
Competitive Edge	• Presence: The Company has its presence across India (Tier I and Tier II cities as well as metros) along with a global presence in 50+ countries through trade associates. • Technology: The Company's joint ventures with international partners in Italy have ensured access to cutting-edge technology catalyzing innovation and value-added product manufacture (digitally printed tiles and online vitrified manufacturing technology). • Product portfolio: The Company's product basket comprises tiles in a variety of sizes, designs and finishes, addressing virtually the widest consumer preference even wide range of prices addressing the mass / mid and premium ranges. • Showrooms: AGL has 16 display centres and 166+ exclusive showrooms, enhancing visibility.
Financial Structure	AGL focus on widen product range, aggressively expanding distribution network and sustained capacity expansion, which will result ~19% revenue CAGR over FY17-19E. Further, AGL would be potential beneficiary of shift of market share towards organised players with GST implementation.
Key Competitors	Kajaria Ceramics, Somany Ceramics, Orient Bell
Industry Revenue Drivers	Macro improvement, pick up in discretionary spending and government policy push are envisaged to spur the building products industry. The domestic tiles industry is expected to clock volume CAGR of 13.0%, in coming years and organised players envisaged to outperform the industry with the implementation of GST and with the increase in value added product mix.
Shareholder Value Proposition	The company is likely to clock 40% earnings CAGR over FY17-19E, results an EPS of INR 25 in FY19E. A 25x valuation can give price target of INR 640 for the company which gives an upside of 30%

Financial Analysis

Capcity addition and improvemnet in utilisation drives revenue

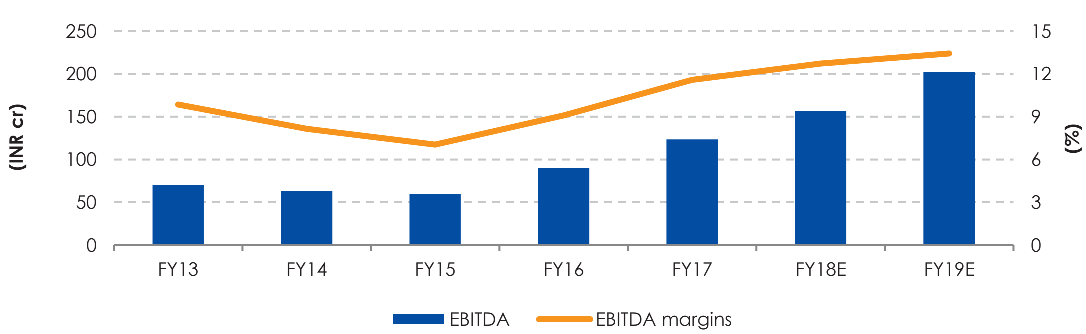
AGL expected to increase its tiles sales volume by 12% CAGR over FY17-19E and improve its realisation by 5% over FY17-19E, results ~17% revenue CAGR during FY17-19E higher than industry's ~13% sales CAGR.

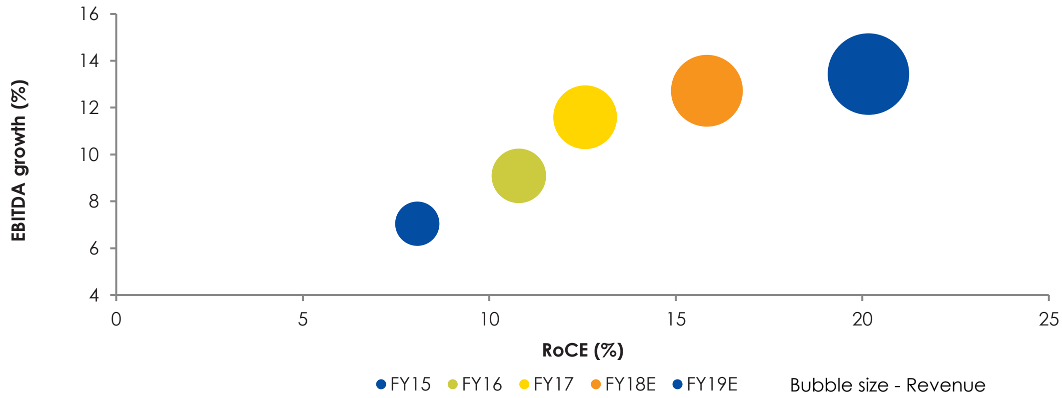




Low fuel cost, higher value-added products to boost operating margin

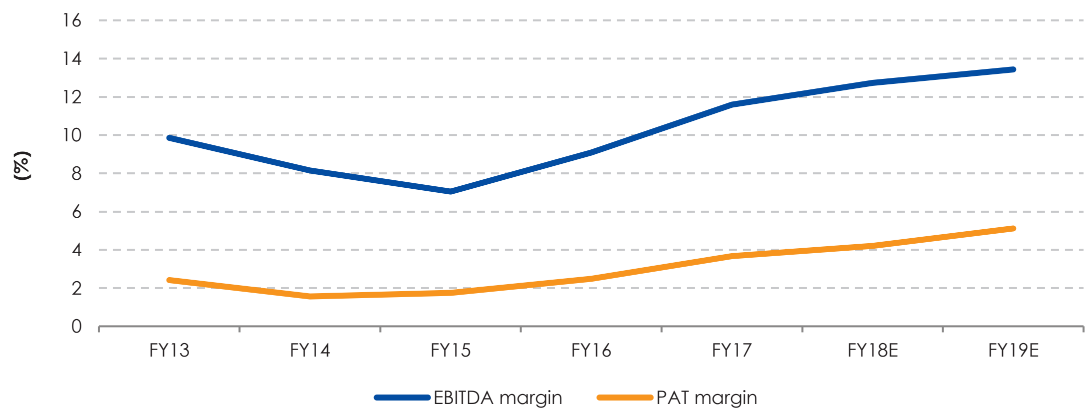
We estimate EBITDA margin to improve by ~250 bps over the next two years on account of benefits from merger, lower fuel cost and incremental value-added products in the portfolio. EBITDA is estimated to post CAGR of ~26% over FY17-19E.





Source: Company, Edelweiss Investment Research

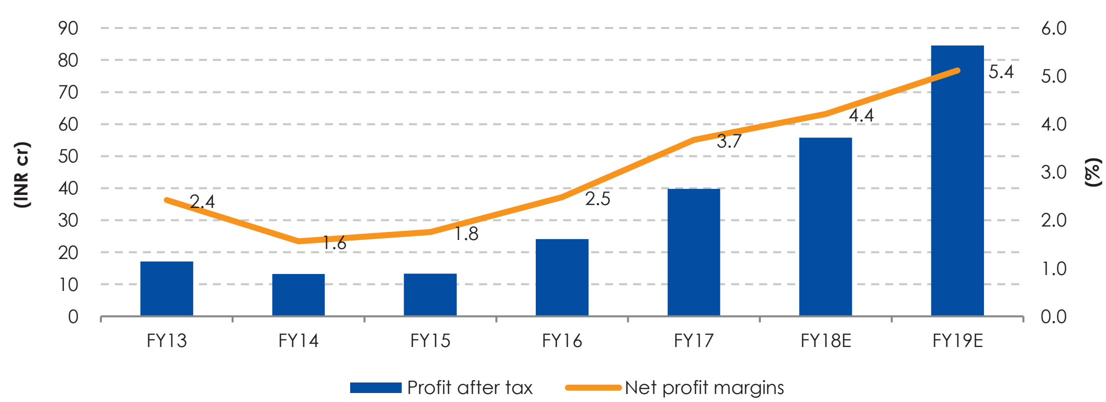
EBITDA and PAT margin improving



Robust PAT growth to sustain

With the healthy sales growth, margin improvement and restricted depreciation & interest expenses, expected to result a PAT CAGR of 44.5% over FY17-19E. PAT margin is estimated to improve from 3.7% in FY17 to 5.4% in FY19E.

Net profit margin

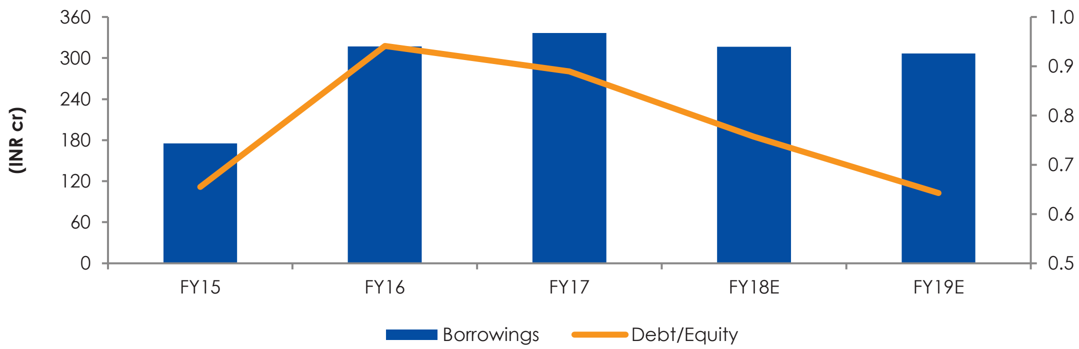


Source: Company, Edelweiss Investment Research

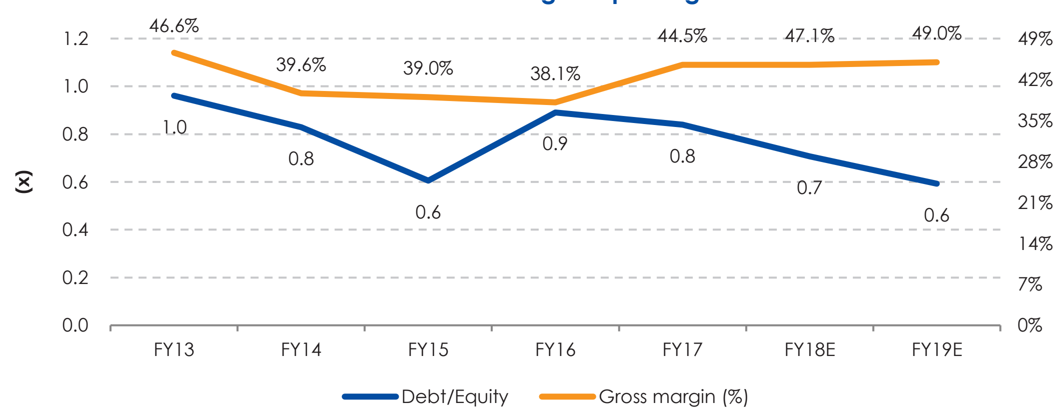
Debt to dip significantly

We estimate AGL's debt-equity ratio to improve to 0.6x in FY19E with positive free cash flow. Capacity expansion via the joint venture model will keep balance sheet stress free and help improve return ratios going forward.

Debt/Equity



Gross margin improving

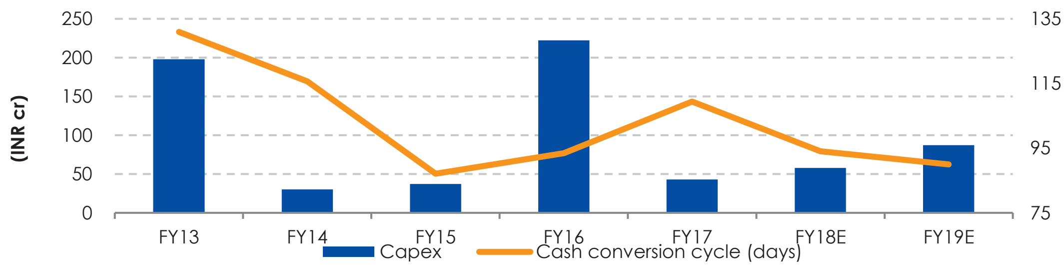


Source: Company, Edelweiss Investment Research

Lower capex & improving cash conversion cycle

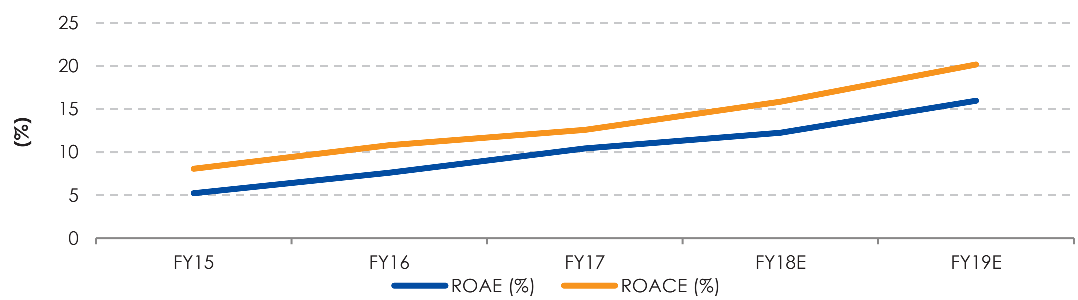
AGL's cash conversion cycle (days) have improved from 131 to 93 from FY13 to FY16 on account of improvement in product mix and expansion in distribution network, majorly with improvement in its debtors days.

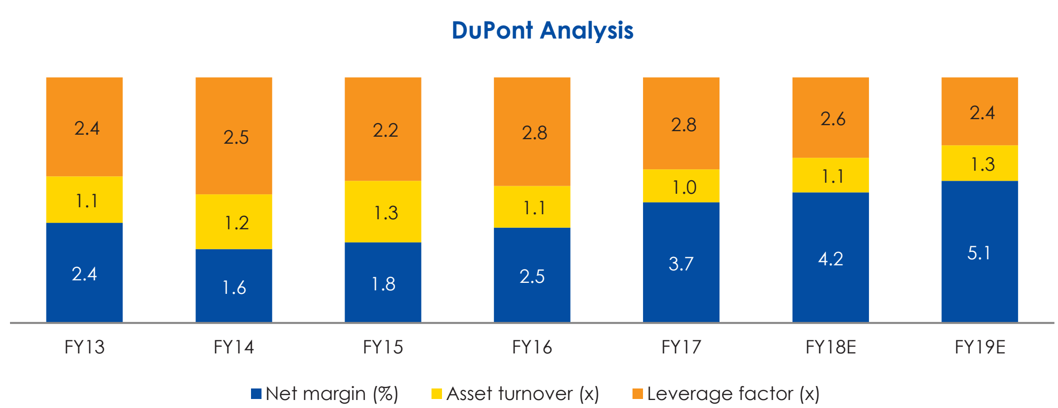
We believe, there are still many untapped markets wherein AGL can extend its distribution reach. The company keeps dealers continuously motivated via attractive promotional schemes, apart from ensuring adequate stock levels and quick availability of products across range and designs, which is an advantage over competitors. This has resulted in AGL increasing its fanancially healthy dealers network, thereby keeping its working capital cycle largely under check. Apart from having an exhaustive and nation-wide dealer network, the company also has 182+ showrooms.



Return ratios to improve as utlilisation picks up

With improving margin, we estimate AGL's RoCE and RoE to improve ~720 bps and 530 bps, respectively, over the next two years. We expect the company to clock higher RoCE on account of better product mix and lower operational cost.





Source: Company, Edelweiss Investment Research

Asian Granito India Ltd.

Income statement (INR cr)

Year to March	FY15	FY16	FY17	FY18E	FY19E
Income from operations	846	994	1,066	1,169	1,404
Direct costs	667	743	733	768	894
Employee costs	44	59	71	93	116
Other expenses	120	160	210	245	313
Total operating expenses	786	904	942	1,013	1,207
EBITDA	60	90	124	156	198
Depreciation and amortisation	19	28	34	38	41
EBIT	40	63	89	118	157
Interest expenses	23	29	39	38	37
Other income	1	1	4	3	5
Profit before tax	19	35	53	82	124
Provision for tax	6	11	13	27	41
Core profit	13	24	40	55	83
Extraordinary items	0	0	0	0	0
Profit after tax	13	24	40	55	83
Minority Interest	1	1	-1	-4	-8
Share from associates	0	0	0	0	0
Adjusted net profit	15	25	39	51	76
Equity shares outstanding (mn)	2	2	3	3	3
EPS (INR) basic	6.5	10.8	13.0	17.1	25.1
Diluted shares (Cr)	2.3	2.3	3.0	3.0	3.0
EPS (INR) fully diluted	6.5	10.8	13.0	17.1	25.1
Dividend per share	0.0	0.0	1.3	1.5	2.0
Dividend payout (%)	0.0	0.0	10.0	8.8	8.0

Common size metrics- as % of net revenues

Year to March	FY15	FY16	FY17	FY18E	FY19E
Operating expenses	93.0	90.9	88.4	86.7	85.9
Depreciation	2.3	2.8	3.2	3.3	2.9
Interest expenditure	2.7	2.9	3.7	3.3	2.6
EBITDA margins	7.0	9.1	11.6	13.3	14.1
Net profit margins	1.8	2.5	3.7	4.4	5.4

Growth metrics (%)

Year to March	FY15	FY16	FY17	FY18E	FY19E
Revenues	9.1	17.5	7.2	9.7	20.2
EBITDA	(5.7)	51.6	36.8	26.3	26.6
PBT	(12.5)	85.3	51.8	54.8	50.6
Net profit	0.8	78.6	67.6	38.6	50.6
EPS	22.1	64.3	20.9	31.3	47.1

Balance sheet (INR cr)

As on 31st March	FY15	FY16	FY17	FY18E	FY19E
Equity share capital	23	23	30	30	30
Preference Share Capital	0	8	0	0	0
Reserves & surplus	267	333	371	417	485
Shareholders funds	290	363	401	447	515
Secured loans	165	256	127	0	0
Unsecured loans	10	61	209	0	0
Borrowings	175	317	337	317	307
Minority interest	0	19	22	22	22
Sources of funds	**465**	**699**	**760**	**786**	**844**
Gross block	338	609	652	710	796
Depreciation	149	211	245	283	324
Net block	188	398	406	426	471
Capital work in progress	15	0	0	0	0
Total fixed assets	203	398	406	426	471
Unrealised profit	0	0	0	0	0
Investments	11	13	17	17	17
Inventories	191	245	273	269	308
Sundry debtors	166	197	311	288	308
Cash and equivalents	15	17	19	41	2
Loans and advances	21	28	33	36	43
Other current assets	0	2	2	2	2
Total current assets	392	489	638	636	663
Sundry creditors and others	155	187	265	256	269
Provisions	5	6	14	15	16
Total CL & provisions	159	193	279	271	285
Net current assets	233	296	359	365	378
Net Deferred tax	-18	0	0	0	0
Misc expenditure	37	-8	-22	-22	-22
Uses of funds	**465**	**699**	**760**	**786**	**844**
Book value per share (INR)	128	158	133	149	171
	-0	0	0	0	0

Cash flow statement

Year to March	FY15	FY16	FY17	FY18E	FY19E
Net profit	13	23	40	55	83
Add: Depreciation	19	28	34	38	41
Add: Misc expenses written off	5	45	14	0	0
Add: Deferred tax	2	-18	0	0	0
Add: Others	1	1	-1	-4	-8
Gross cash flow	40	78	88	89	117
Less: Changes in W. C.	-44	61	62	-16	52
Operating cash flow	84	18	26	106	65
Less: Capex	37	222	43	58	86
Free cash flow	**47**	**-205**	**-17**	**48**	**-21**

Ratios

Year to March	FY15	FY16	FY17	FY18E	FY19E
ROAE (%)	5.2	7.6	10.4	12.1	15.7
ROACE (%)	8.1	10.8	12.6	15.7	19.7
Debtors (days)	71	72	107	90	80
Current ratio	2.5	2.5	2.3	2.3	2.3
Debt/Equity	0.6	0.9	0.8	0.7	0.6
Inventory (days)	82	90	94	84	80
Payable (days)	67	69	91	80	70
Cash conversion cycle (days)	87	93	109	94	90
Debt/EBITDA	2.9	3.5	2.7	2.0	1.6
Adjusted debt/Equity	0.6	0.8	0.8	0.6	0.6

Valuation parameters

Year to March	FY15	FY16	FY17	FY18E	FY19E
Diluted EPS (INR)	6.5	10.8	13.0	17.1	25.1
Y-o-Y growth (%)	*22.1*	*64.3*	*20.9*	*31.3*	*47.1*
CEPS (INR)	15.0	23.0	24.5	29.7	38.8
Diluted P/E (x)	74.6	45.4	37.5	28.6	19.4
Price/BV(x)	3.8	3.1	3.7	3.3	2.8
EV/Sales (x)	1.5	1.4	1.7	1.5	1.3
EV/EBITDA (x)	21.2	15.5	14.5	11.2	9.0
Diluted shares O/S	2.3	2.3	3.0	3.0	3.0
Basic EPS	6.5	10.8	13.0	17.1	25.1
Basic PE (x)	74.6	45.4	37.5	28.6	19.4
Dividend yield (%)	0.0	0.0	0.3	0.3	0.4

Kajaria Ceramics Ltd.

CMP INR 727

Rating: Not Rated

Undisputed Leader of the Indian Tiles Market

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Kshitij Kaji
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Kajaria was incorporated in 1985 by Mr. Ashok Kajaria in technical collaboration with the world's second largest tiles manufacturer Todagres and is currently India's leading manufacturer of ceramic and vitrified tiles. Kajaria Ceramics has increased its capacity in the last 29 years from 1 MSM to 69 MSM capacity in tiles distributed across 8 plants - Sikandrabad in Uttar Pradesh, Gailpur & Malootana in Rajasthan, four plants in Gujarat and one at Vijayawada in Andhra Pradesh. Kajaria offers more than 2000 SKUs in ceramic, vitrified and designer tiles.

Market leader due to unwavering brand focus, new designs and robust distribution

Kajaria has grown at a CAGR of 11% in terms of volumes over FY12 to FY17 which is the highest in the tiles space and has helped it gain market share. Today Kajaria has a ~11% share in the overall tiles market and ~23% share in the organised tiles market led by various measures the company has taken over the years. Kajaria has worked hard to create a brand over the past few years with advertisement spends increasing to over 3% of sales (~1.8% of sales in FY14). Kajaria has increased its distribution network over the years from 700 dealers in FY11 to 1,100 dealers currently with sales per dealer increasing from INR 1.4 Cr to INR 2.3 Cr. The company has an in-house research and development facility which focuses on developing new designs and creating cost-effective products.

Premiumisation and JV/outsourced model will aid return ratios

Over the last few years Kajaria has undergone a shift in terms of its products with a shift from ceramic tiles to vitrified tiles. Vitrified tiles, which comprised only ~30% of volumes in FY11, has contributed 57% in FY17 leading to higher realisations. The share of vitrified tiles in the tile industry has increased from ~34% to only 44% over the same period. It has also been able to expand rapidly through the asset light JV and outsourced model which has helped improve return ratios. The company has been picking up 51% equity in JVs, which has helped improve returns. Currently, Kajaria has 7 JVs and contributing 40% to revenues and ~10% contribution from outsourcing.

Outlook

Over the last 2 years, volume growth has been tepid due to lower demand, GST implementation, etc. However Kajaria has sustained its market share during this period. We expect demand to pick up and GST implementation to aid a structural shift from unorganised to organised players. At CMP, the stock trades at 45x FY17 EPS and we remain positive on the stock.

Bloomberg:	KJC:IN
52-week range (INR):	789.80 / 437.35
Share in issue (cr):	15.9
M cap (INR cr):	11,562
Avg. Daily Vol. BSE/NSE :('000):	220
Promoter Holding (%)	47.58

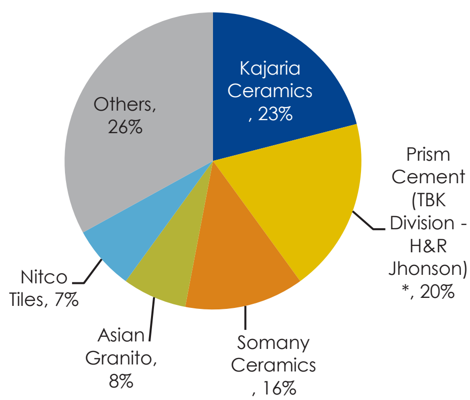
Year to March	FY15	FY16	FY17
Revenues (INR Cr)	2,187	2,413	2,537
Rev growth (%)	19.1	10.4	5.1
EBITDA (INR Cr)	348	457	496
Net Profit (INR Cr)	185	236	254
P/E (x)	66.1	50.1	45.4
EV/EBITDA (x)	34.0	26.0	23.7
RoACE (%)	29.2	30.0	27.6
RoAE (%)	28.2	27.0	23.6

Date: 4th December 2017

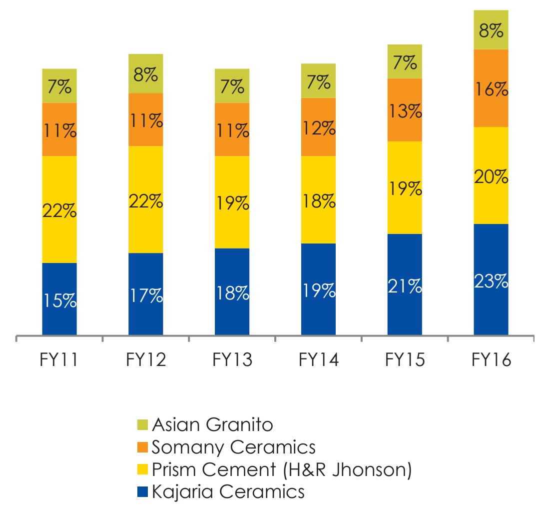
Kajaria is currently the biggest player in the Indian Tile market

Kajaria has grown at a CAGR of 11% in terms of volumes over FY12 to FY17 which is the highest in the tiles space and has helped it gain market share. Today Kajaria has a ~11% share in the overall tiles market and ~23% share in the organised tiles market led by various measures the company has taken over the years.

Organised market share of key players



Share of Top 4 Organised players



Source: Company, Edelweiss Investment Research

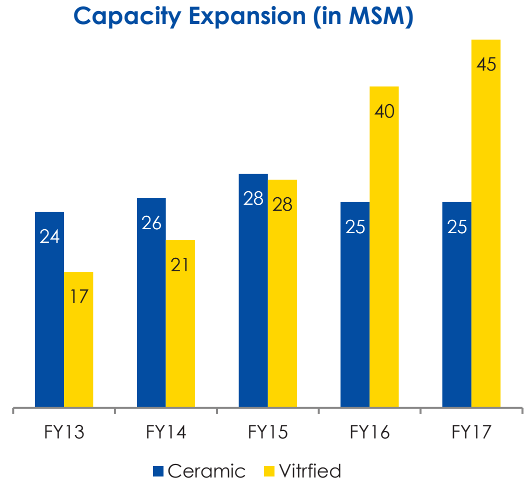
Kajaria today has a 69 MCM capacity in tiles and 1.2 mn pieces in sanitaryware distributed across 8 plants - Sikandrabad in Uttar Pradesh, Gailpur & Malootana in Rajasthan, four plants in Gujarat and one at Vijayawada in Andhra Pradesh.

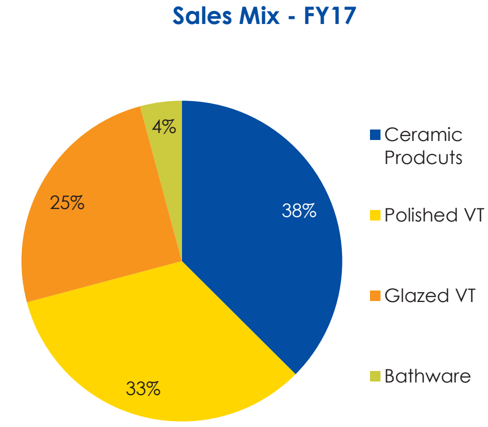
(MSM)	Location	Ceramic	Polished VT	Glazed VT	TOTAL
Own	Sikanrabad, UP	-	-	8.4	8.4
	Gailpur, Rajasthan	18.9	-	7.7	26.6
	Malootana, Rajasthan	-	6.5	-	6.5
JV	(Jaxx) Morbi, Gujarat	-	10.2	-	10.2
	(Cosa) Morbi, Gujarat	-	5.7	-	5.7
	(Taurus) Morbi, Gujarat	-	5	-	5.0
	(Soriso) Morbi, Gujarat	3.6	-	-	3.6
	(Vennar) Vijayawada, AP	2.9	-	-	2.9
TOTAL		**25.4**	**27.4**	**16.1**	**68.9**

Source: Company, Edelweiss Investment Research

Kajaria has gradually undergone a shift in terms of products

Over the last few years Kajaria has undergone a shift in terms of its products as seen from the chart below. Vitrified tiles capacity which was lower than ceramic tiles in FY13, is now almost 2x in size with barely any addition to basic ceramic products. Today vitrified products contribute over 57% of Kajaria's revenues. Kajaria also has a bathware segment which manufactures close to 1.2 mln pieces of faucetware.

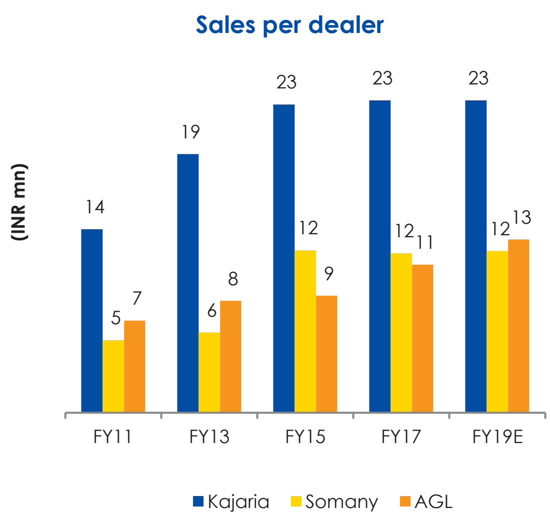


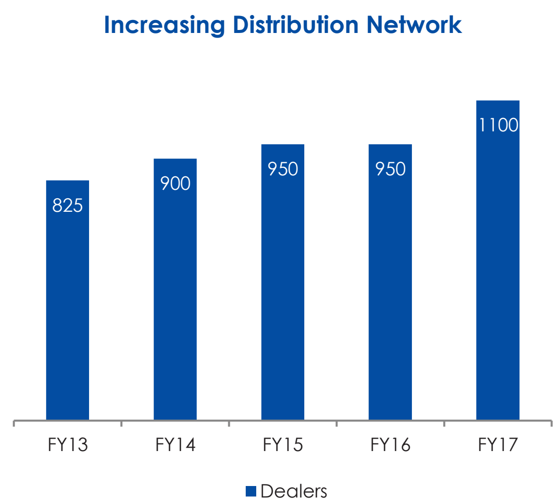


Source: Company, Edelweiss Investment Research

Strong Distribution Network

Kajaria has worked hard to create a brand over the past few years with higher advertisement spends than any other player in the industry at over 3% of sales. Kajaria has steadily increased its distribution network to 1,100 dealers currently with sales per dealer increasing from INR 1.4 Cr in FY11 to INR 2.3 Cr in FY17.

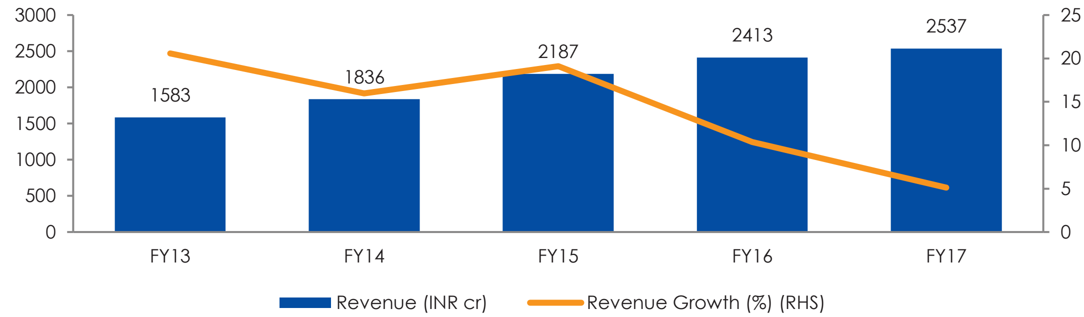


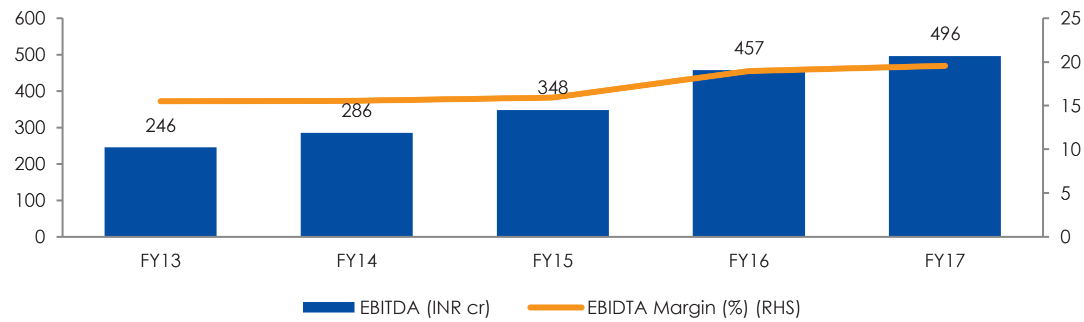


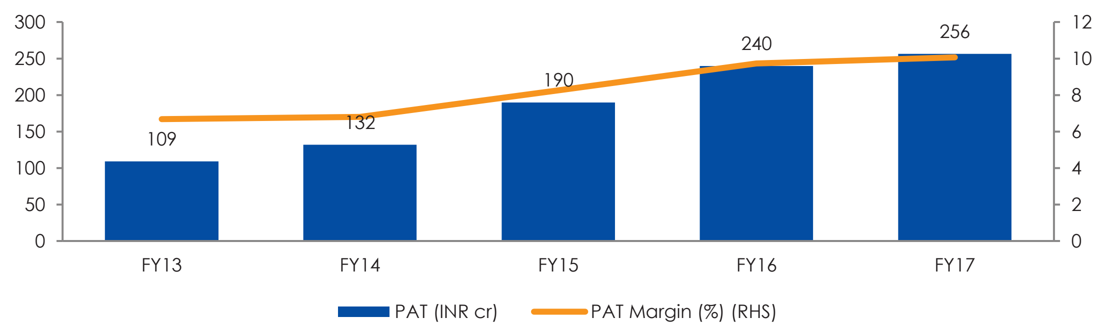
Source: Company, Edelweiss Investment Research

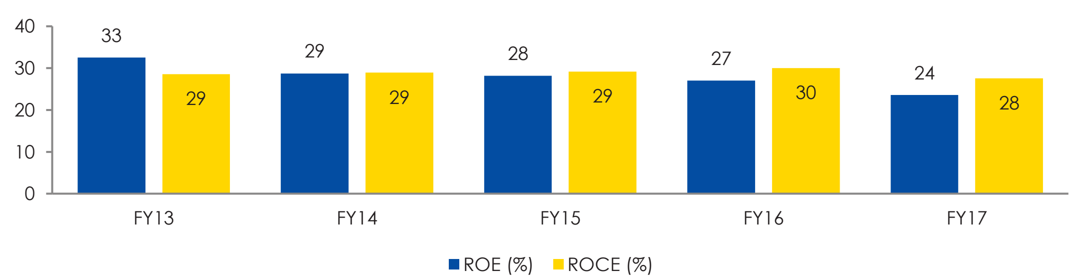
Financial Analysis

Kajaria's revenue's which were growing at close to 20% from FY13 to FY15 have slowed to a 5-10% growth due to housing slowdown and GST. However we expect growth to bounce back in the coming years post GST implementation. EBITDA margins have surged due to lower gas prices which has also led to an increase in PAT margins.









Source: Edelweiss Investment Research

Financials

Income statement (INR cr)

Year to March	FY15	FY16	FY17
Income from operations	2,187	2,413	2,537
Direct costs	1,221	1,327	1,355
Employee costs	207	252	289
Other expenses	618	629	686
Total operating expenses	1,839	1,956	2,041
EBITDA	348	457	496
Depreciation and amortisation	56	73	81
EBIT	293	385	415
Interest expenses	29	34	34
Other income	7	10	15
Profit before tax	270	361	396
Provision for tax	85	125	142
Core profit	185	236	254
Extraordinary items	5	4	3
Profit after tax	190	240	256
Minority Interest	-9	-5	-1
Share from associates	0	0	0
Adjusted net profit	180	235	255
Equity shares outstanding (mn)	16	16	16
EPS (INR) basic	11.1	14.6	16.1
Diluted shares (Cr)	15.9	15.9	15.9
EPS (INR) fully diluted	11.1	14.6	16.1
Dividend per share	2.0	2.5	3.0
Dividend payout (%)	18.1	17.2	18.9

Common size metrics- as % of net revenues

Year to March	FY15	FY16	FY17
Operating expenses	84.1	81.0	80.4
Depreciation	2.6	3.0	3.2
Interest expenditure	1.3	1.4	1.3
EBITDA margins (RHS)	15.9	19.0	19.6
Net profit margins	8.2	9.7	10.1

Growth metrics (%)

Year to March	FY15	FY16	FY17
Revenues	19.1	10.4	5.1
EBITDA	21.9	31.3	8.5
PBT	35.7	33.5	9.8
Net profit	40.8	27.7	7.5
EPS	34.5	31.7	10.4

Balance sheet (INR cr)

As on 31st March	FY15	FY16	FY17
Equity share capital	16	16	16
Preference Share Capital	0	0	0
Reserves & surplus	725	956	1,159
Shareholders funds	741	972	1,175
Secured loans	206	240	146
Unsecured loans	38	54	68
Borrowings	243	294	213
Minority interest	62	76	76
Sources of funds	**1,047**	**1,342**	**1,464**
Gross block	1,245	1,541	1,662
Depreciation	385	421	485
Net block	860	1,121	1,177
Capital work in progress	78	8	8
Total fixed assets	938	1,128	1,186
Unrealised profit	0	0	0
Investments	0	0	0
Inventories	303	384	372
Sundry debtors	207	274	339
Cash and equivalents	11	22	52
Loans and advances	59	80	61
Other current assets	0	0	0
Total current assets	580	760	824
Sundry creditors and others	373	450	434
Provisions	50	22	20
Total CL & provisions	423	472	455
Net current assets	157	288	369
Net Deferred tax	-79	-95	-111
Misc expenditure	31	20	20
Uses of funds	**1,047**	**1,342**	**1,464**
Book value per share (INR)	47	61	74
	0	0	0

Cash flow statement

Year to March	FY15	FY16	FY17
Net profit	180	233	251
Add: Depreciation	56	73	81
Add: Misc expenses written off	-11	11	-0
Add: Deferred tax	8	16	16
Add: Others	-9	-5	-1
Gross cash flow	223	327	347
Less: Changes in W. C.	26	121	50
Operating cash flow	197	206	297
Less: Capex	262	263	139
Free cash flow	**-64**	**-57**	**158**

Ratios

Year to March	FY15	FY16	FY17
ROAE (%)	28.2	27.0	23.6
ROACE (%)	29.2	30.0	27.6
Debtors (days)	35	41	49
Current ratio	1.4	1.6	1.8
Debt/Equity	0.3	0.3	0.2
Inventory (days)	51	58	54
Payable (days)	62	68	63
Cash conversion cycle (days)	23	31	40
Debt/EBITDA	0.7	0.6	0.4
Adjusted debt/Equity	0.3	0.3	0.1

Valuation parameters

Year to March	FY15	FY16	FY17
Diluted EPS (INR)	11.1	14.6	16.1
Y-o-Y growth (%)	*34.5*	*31.7*	*10.4*
CEPS (INR)	14.6	19.1	21.0
Diluted P/E (x)	66.1	50.1	45.4
Price/BV(x)	15.7	11.9	9.9
EV/Sales (x)	5.4	4.9	4.6
EV/EBITDA (x)	34.0	26.0	23.7
Diluted shares O/S	15.9	15.9	15.9
Basic EPS	11.1	14.6	16.1
Basic PE (x)	66.1	50.1	45.4
Dividend yield (%)	0.3	0.3	0.4

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Somany Ceramics Ltd

Taking the big leap

CMP INR 850

Rating: Not Rated

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Somany was founded in 1969 as Somany Pilkington in collaboration with UK-based Pilkington Tiles and is the third largest player in the Indian tile industry. In 2007, the company's name was changed to Somany Ceramics. In the past seven years, it has increased capacity by almost 3.5x from 17 MSM in FY10 to 60 MSM currently (including the 9 MSM outsourced capacity). The eight manufacturing plants are spread across Gujarat and Haryana. By profitability, Somany is the second biggest player in India and is now present across ceramic tiles, vitrified tiles, digital tiles. Somany has also commenced in house manufacturing of sanitaryware products with a capacity of 0.3mn pieces p.a.

Strong brand recall in the North

Somany has grown at 10% CAGR in volume terms over FY12 to FY17 which just trails Kajaria (11% CAGR volume growth over the same period). Today Somany has an ~8% share in the overall tiles market and ~16% share in the organised tiles market owing to various measures the company has taken over the years. Like Kajaria, Somany has also invested substantially to create a strong brand in north India. Somany's advertisement spend increased to 3% of sales (~1.5% of sales in FY14) and it has also increased its distribution network over the years from 1,300 dealers in FY11 to 2,000 dealers currently with sales per dealer rising from INR 0.5 crore to INR 1.2 crore. Sustained investments in the R&D facility at the Kassar plant have led to a wide range of innovative products. The sanitary product category is also doing well and its share is expected to jump to 10% in FY19E.

Aggressive shift to asset light model is aiding return ratios

Somany has an asset light business model compared with peers, with only a little above 55% revenues coming from own manufacturing/JV units. Excluding JVs, own manufacturing is only 40% of revenues and this has led to lower EBITDA margins for Somany (margins of 11% vs. 18% for Kajaria). Over the last few years Somany has undergone a shift in terms of its products with a shift from ceramic tiles to vitrified tiles. Vitrified tiles, which comprised only ~30% of volumes in FY11, have contributed 54% in FY17 leading to higher realisations.

Outlook

Over the last 2 years, volume growth has been tepid due to lower demand, GST implementation, etc. However Somany has maintained its market share during this period. We expect demand to pick up and GST implementation to aid a structural shift from unorganised to organised players. At CMP, the stock is trading at 38x FY17 EPS and we remain positive on the stock.

Bloomberg:	SOMC:IN
52-week range (INR):	886/ 470
Share in issue (cr):	4.2
M cap (INR cr):	3,600
Avg. Daily Vol. BSE/NSE :('000):	16
Promoter Holding (%)	51.5

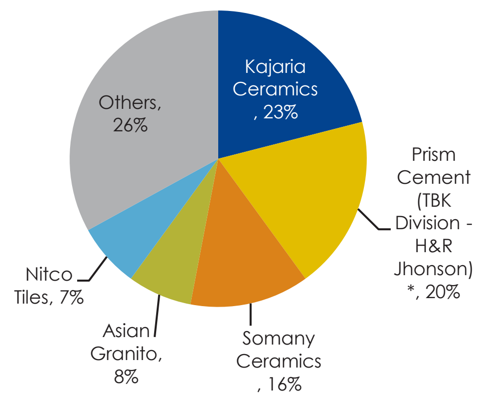
Year to March	FY15	FY16	FY17
Revenues (INR Cr)	1,543	1,712	1,805
Rev growth (%)	22.0	10.9	5.5
EBITDA (INR Cr)	108	138	187
Net Profit (INR Cr)	46	66	94
P/E (x)	71.5	56.0	38.9
EV/EBITDA (x)	32.5	27.8	20.7
RoACE (%)	17.8	18.2	19.2
RoAE (%)	19.3	18.9	19.6

Date: 4th December 2017

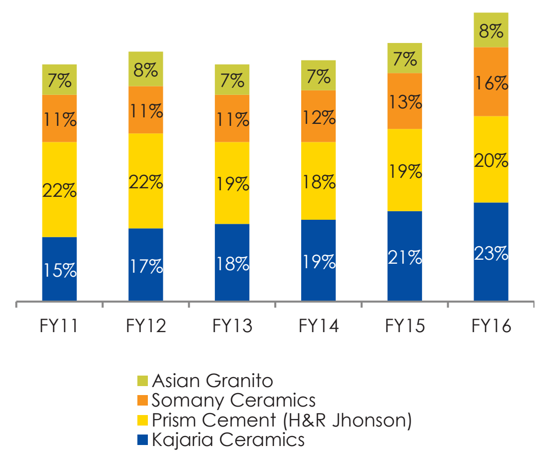
Somany is currently the 3rd biggest player in the Indian tile market by volume

Somany has grown at a CAGR of 10% in terms of volumes over FY12 to FY17 which is the second highest in the tiles space and has helped it gain market share. Today Somany has a ~8% share in the overall tiles market and ~16% share in the organised tiles market led by various measures the company has taken over the years.

Organised market share of key players



Share of Top 4 organised players

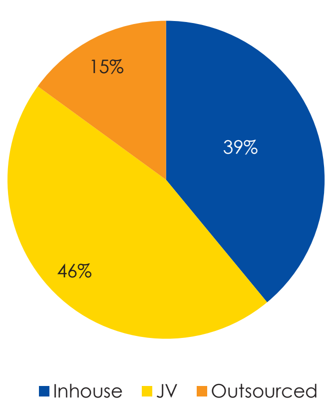


Source: Company, Edelweiss Investment Research

Somany follows an asset light model with higher JVs and outsourcing

In the past seven years, Somany has increased tiles capacity by almost 3.5x from 17 MSM in FY10 to 60 MSM currently (including its 9 MSM outsourced capacity). Its 8 manufacturing plants are spread across Gujarat and Haryana. Almost 54% of Somany's capacity is outsourced or through JVs which have led to lower margins versus peers but return ratios such as RoE and RoCE are in a similar range.

FY17 - Manufacturing Split

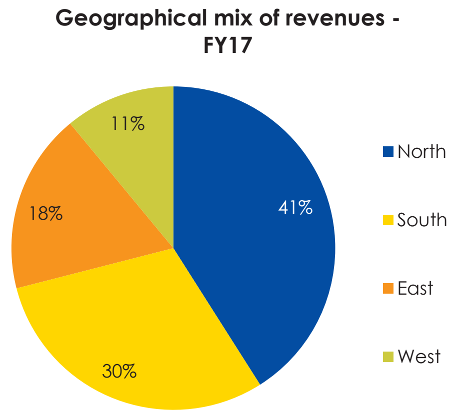


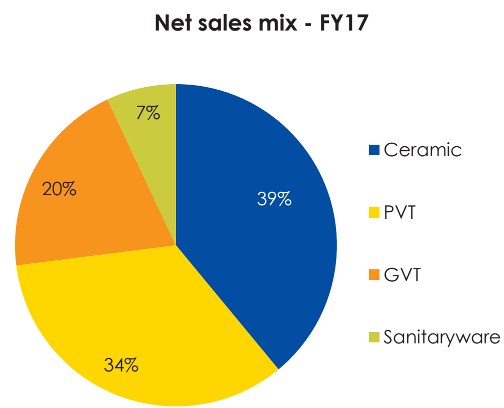
	Location	Capacity (MSM)
Own (Tiles)	Kassar, Haryana	17.13
	Kadi, Gujrat	8.42
Subsidiary (Tiles)	Amora Tiles	4.58
	Somany Fine VT	4.29
	Vintage Tiles	2.99
	Acer Granito	5.1
	Commander VT	4.76
	Vicon Ceramics	3.98
Outsource (Tiles)	Outsourced	9
Subsidiary	Sanitaryware	3,03,000 pcs p.a

Source: Company, Edelweiss Investment Research

Diversified product profile and geographical reach

Somany is extremely strong in the northern region as its capacity in Haryana is among the few big capacities outside Morbi in Gujarat. However, over the years, Somany has managed to expand pan-India and has now become a strong player in the south as well. There has also been a shift in terms of the product profile. Vitrified tiles, which comprised only ~30% of volumes in FY11, has contributed 54% in FY17 leading to higher realisations. Sanitaryware now contributes 7% of revenues and is expected to contribute 10% in FY19E.

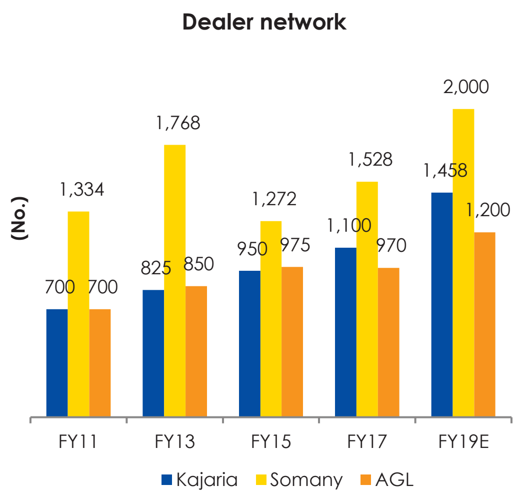


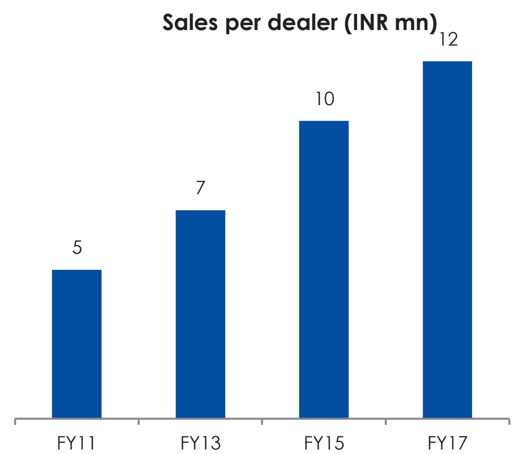


Source: Company, Edelweiss Investment Research

Strong distribution network

Somany has the widest distribution network of any player in the tiles space at 1,500 plus dealers, and which is expected to continue its strong growth trajectory and reach 2,000 dealers by FY19E. Although its sales per dealer has almost doubled over the last two years, it still lags behind Kajaria and Asian Granito.

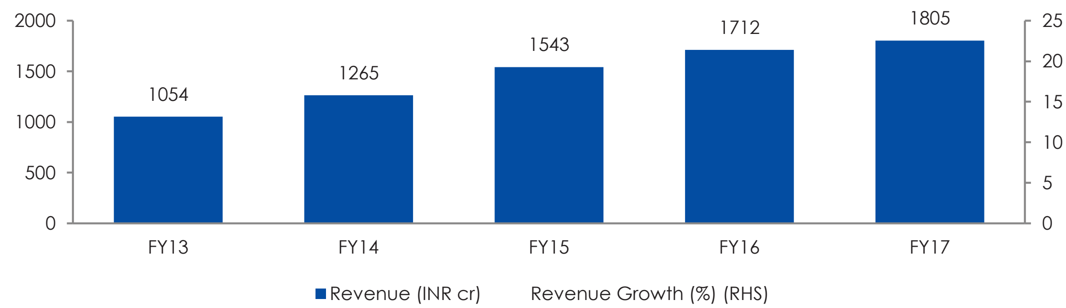


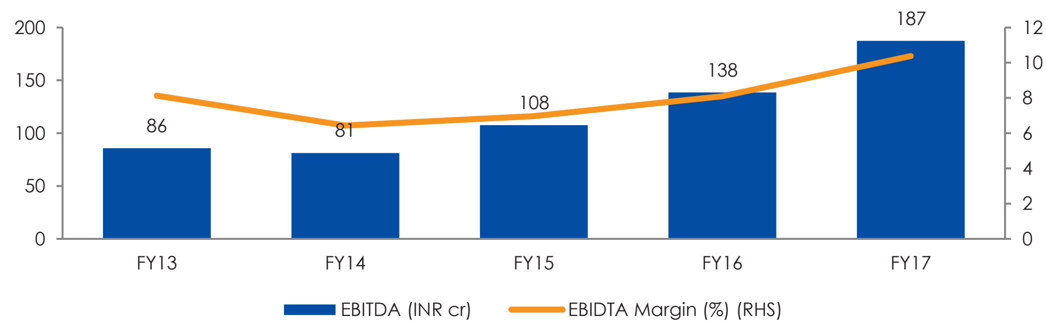


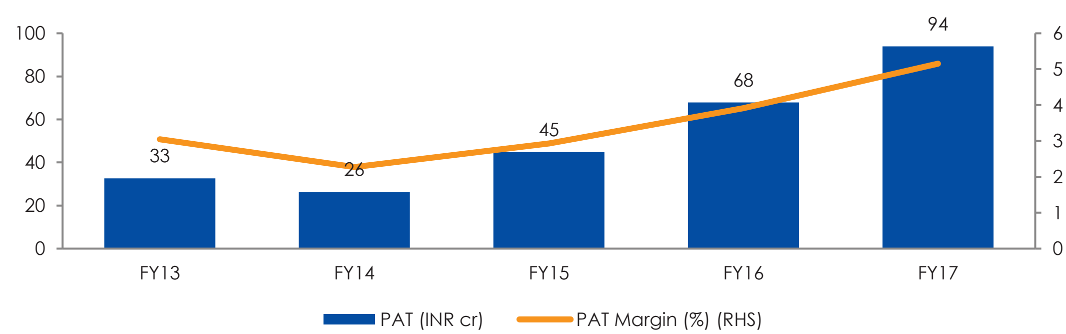
Source: Company, Edelweiss Investment Research

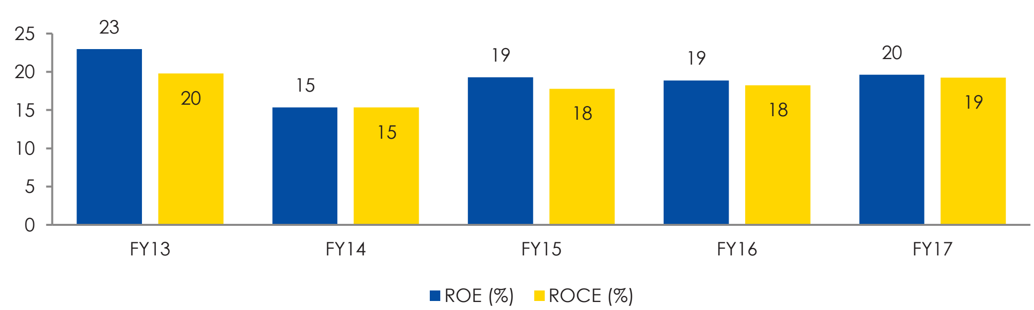
Financial analysis

Somany's revenues and margin trends mirror the industry and the leader Kajaria. Revenues which were growing at close to 20% from FY13 to FY15 have slowed to a 5-10% growth due to lower demand for tiles. However, we expect growth to bounce back in the coming years post GST implementation. EBITDA margin has surged due to lower gas prices which has also led to an increase in PAT margin.









Source: Edelweiss Investment Research

Somany Ceramics Ltd

Financials

Income statement			(INR cr)
Year to March	**FY15**	**FY16**	**FY17**
Income from operations	1,543	1,712	1,805
Direct costs	1,107	1,219	1,177
Employee costs	101	123	158
Other expenses	328	354	440
Total operating expenses	1,436	1,573	1,618
EBITDA	108	138	187
Depreciation and amortis	27	28	35
EBIT	81	110	152
Interest expenses	21	22	23
Other income	8	9	15
Profit before tax	68	97	144
Provision for tax	22	31	50
Core profit	46	66	94
Extraordinary items	-1	2	-0
Profit after tax	45	68	94
Minority Interest	0	-1	-1
Share from associates	0	0	0
Adjusted net profit	45	67	93
Equity shares outstanding	4	4	4
EPS (INR) basic	11.9	15.3	21.9
Diluted shares (Cr)	3.9	4.2	4.2
EPS (INR) fully diluted	11.9	15.3	21.9
Dividend per share	2.0	2.3	2.3
Dividend payout (%)	16.8	15.1	10.5

Common size metrics- as % of net revenues			
Year to March	**FY15**	**FY16**	**FY17**
Operating expenses	93.0	91.9	89.6
Depreciation	1.7	1.7	1.9
Interest expenditure	1.3	1.3	1.3
EBITDA margins	7.0	8.1	10.4
Net profit margins	2.9	3.9	5.2

Growth metrics (%)			
Year to March	**FY15**	**FY16**	**FY17**
Revenues	22.0	10.9	5.5
EBITDA	32.2	28.7	35.3
PBT	56.5	42.1	49.0
Net profit	73.2	42.7	43.4
EPS	60.7	27.8	43.8

Balance sheet			(INR cr)
As on 31st March	**FY15**	**FY16**	**FY17**
Equity share capital	8	8	8
Preference Share Capital	0	0	0
Reserves & surplus	250	420	513
Shareholders funds	258	428	521
Secured loans	189	241	247
Unsecured loans	2	3	28
Borrowings	191	243	274
Minority interest	5	20	27
Sources of funds	**455**	**692**	**823**
Gross block	494	633	656
Depreciation	231	252	279
Net block	264	381	377
Capital work in progress	1	6	36
Total fixed assets	265	387	412
Unrealised profit	0	0	0
Investments	47	108	151
Inventories	136	139	150
Sundry debtors	259	317	410
Cash and equivalents	15	18	12
Loans and advances	42	54	54
Other current assets	0	0	0
Total current assets	452	528	626
Sundry creditors and other	268	281	322
Provisions	11	15	4
Total CL & provisions	279	295	325
Net current assets	174	233	300
Net Deferred tax	-29	-33	-37
Misc expenditure	-2	-3	-3
Uses of funds	**455**	**692**	**823**
Book value per share (INR	66	101	123
	-0	0	-0

Cash flow statement			
Year to March	**FY15**	**FY16**	**FY17**
Net profit	47	63	94
Add: Depreciation	27	28	35
Add: Misc expenses	-3	1	0
Add: Deferred tax	0	4	4
Add: Others	0	-1	-1
Gross cash flow	71	96	133
Less: Changes in W. C.	59	56	74
Operating cash flow	12	40	59
Less: Capex	48	151	60
Free cash flow	**-36**	**-110**	**-2**

Ratios			
Year to March	**FY15**	**FY16**	**FY17**
ROAE (%)	19.3	18.9	19.6
ROACE (%)	17.8	18.2	19.2
Debtors (days)	61	68	83
Current ratio	1.6	1.8	1.9
Debt/Equity	0.7	0.6	0.5
Inventory (days)	32	30	30
Payable (days)	63	60	65
Cash conversion cycle (dc	30	37	48
Debt/EBITDA	1.8	1.8	1.5
Adjusted debt/Equity	0.7	0.5	0.5

Valuation parameters			
Year to March	**FY15**	**FY16**	**FY17**
Diluted EPS (INR)	11.9	15.3	21.9
Y-o-Y growth (%)	*60.7*	*27.8*	*43.8*
CEPS (INR)	18.8	21.9	30.2
Diluted P/E (x)	71.5	56.0	38.9
Price/BV(x)	12.9	8.5	6.9
EV/Sales (x)	2.3	2.2	2.2
EV/EBITDA (x)	32.5	27.8	20.7
Diluted shares O/S	3.9	4.2	4.2
Basic EPS	11.9	15.3	21.9
Basic PE (x)	71.5	56.0	38.9
Dividend yield (%)	0.2	0.3	0.3

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Wood Panel

Wood Panel Industry

The Dark Horse

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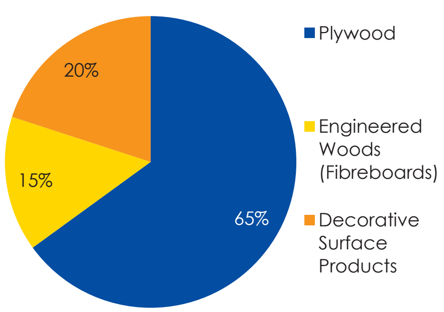
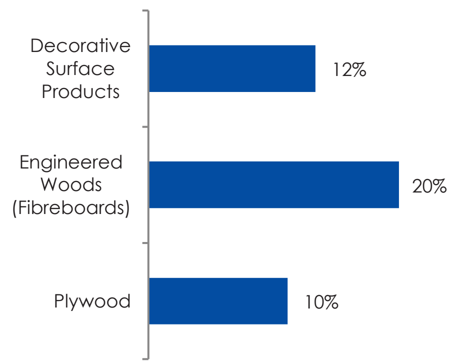
The domestic wood panel industry is pegged at ~INR28,000cr. As products are used primarily in furniture, 90% demand emanates from new houses, while 10% is from renovation. The wood panel industry includes: a) Plywood; b) Engineered wood panels (MDF & particle board); and c) Decorative surface products (laminates). While globally the share of MDF is 65%, in India it is only 10%. MDF is suitable for readymade furniture due to its higher flexibility, raw material availability and being cheaper than plywood. It is the fastest growing segment in the wood panel industry.

India Wood Panel Industry



Growth Rates (last 3 years)



Source: Company, Edelweiss Investment Research

The plywood industry is the biggest segment in the wood panel sector at INR18,000cr. Organised players constitute only 30% of the market and the top 2 players (Century and Greenply) control 50% of the market. MDF is currently only INR2,000cr industry, but growing at a rapid pace. There are no unorganised players in the segment and organised players (75% of the market) continue to capture share from imports (balance 25%).

While the domestic laminates industry is estimated at INR4,000cr, the decorative veneers industry is INR2,000cr; share of organised players is 65% and 50%, respectively, in these segments. The laminates segment is growing faster than plywood, but slower than MDF.

Among domestic players, we have initiated coverage on Century Ply

Year to March (FY17)	Century Ply	Greenply	Greenlam
Net sales (INR cr)	1,819	1,700	1,072
2 Year Revenue (CAGR)*	7%	3%	8%
Operating Margin (%)	17.2%	14.1%	13.1%
Net Profit (INR cr)	193	125	50
2 Year PAT (CAGR)*	13%	1%	60%
RoE (%)	31%	18%	19%
RoCE (%)	26%	18%	17%
Market Cap (INR cr)	6,500	4,000	2,400
Diluted P/E (x)	34	31	48

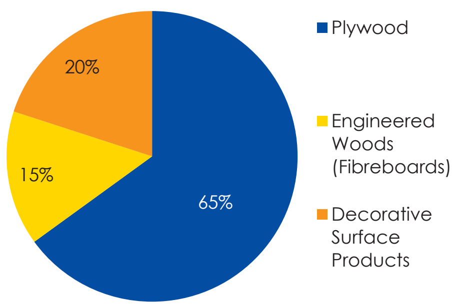
Date: 4th December 2017

Domestic wood panel industry

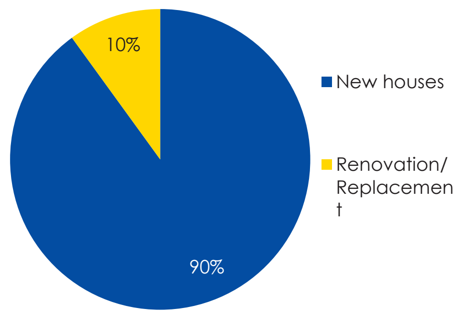
The domestic wood panel industry is estimated at INR28,000cr. These products are used primarily in furniture and hence 90% of demand emanates from new houses, while 10% is from renovation. The wood panel industry includes:

a) Plywood
b) Engineered wood panels (fibreboard/MDF and particle board)
c) Decorative surface products (laminates)

India Wood Panel Industry



Demand drivers

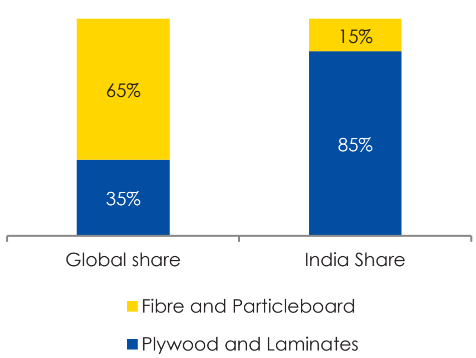


Source: Company, Edelweiss Investment Research

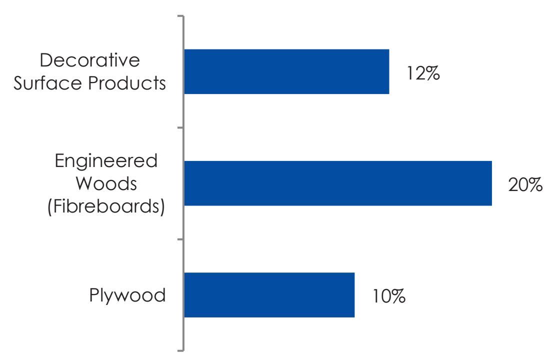
Preference shifting from plywood to particleboards, in-line with global trend

While globally the share of fibreboards is 65%, in India it is at mere 15%. Fibreboards are suitable for readymade furniture and are in demand globally due to their flexibility, uniformity in construction, expensive carpenter costs, etc. As all these issues were not present in India, cheap plywood was the preferred raw material for furniture. However, over the past 2-3 years, preference has been shifting to readymade furniture. As engineered wood is cheaper than low quality plywood and due to easier raw material availability, its demand in India has been increasing.

Wood Panel Industry Breakup



Growth Rates (last 3 years)

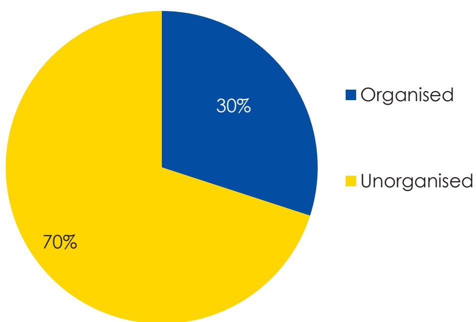


Source: Company, Edelweiss Investment Research

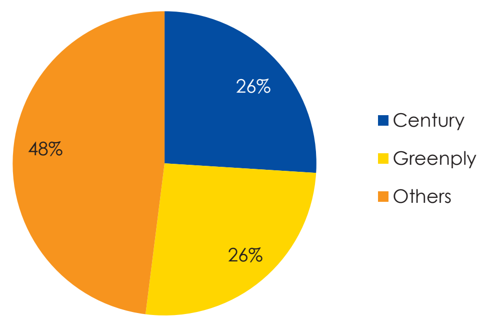
A) Plywood: Dominated by unorganised players

The domestic plywood industry, pegged at INR18,000cr, constitutes ~60% of the wood panel industry and has clocked 9% CAGR over FY12-17. While organised players, ~30% of the plywood market, have grown at a faster pace, the unorganised segment has posted mere 5-7% CAGR. The organised segment is a duopolistic market with the top 2 players controlling lion's share. Other organised players are much smaller in size.

Plywood share



Organised Market - Controlled by top 2 players



Source: Company, Edelweiss Investment Research

The Indian plywood market is divided into 3 segments as under:

Segment	Premium	Mid/Commercial	Low
Size (INR Cr)	3,600	9,000	5,400
Organised share	70%	15%	0%
CAGR Growth	10-12%	5-7%	Flat/De-growth
Price (Assuming 19mm thickness)	100-140 per sq ft	70-90per sq ft	40-60 per sq ft
Biggest Players	Century and Greenply have 65% share	None	None
Key Brands	Century Architect Green Club	Sainik Ecotec	None
Current Scenario	Facing slowdown due to low residential growth in Tier 1 cities which is the main market for this category	Although current growth rate is around 5-7%, affordable housing could result in an uptick for this segment	In addition to MDF, huge challenges due to face veneer availability and prices (ban in Myanmar), GST, working capital issues.
Other information	• Tier 1 (luxury brands) is INR 1,600 Cr growing at 20% CAGR • Tier 2 (premium brands) is INR 1,000 Cr growing at 15% CAGR • Tier 3 is 1,000 Cr growing at 10% CAGR	• Tier 1 is INR 500 Cr growing at 12% CAGR • Tier 2 is INR 850 Cr growing at 6% CAGR • Tier 3 is 7,650 Cr and barely growing • Gap between Tier 1 and Tier 2 is narrowing and trend of outsourcing is increasing	MDF is replacing this segment

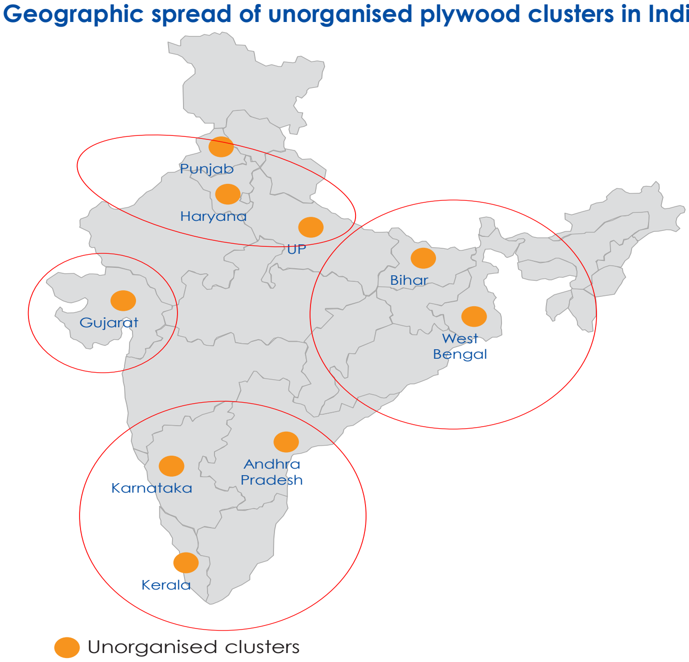
Organised players are outsourcing to capture share in under penetrated segments

Greenply was the first company to start the trend of outsourcing, wherein the strategy is to outsource the component that constitutes the low and mid-end segments where organised players have lower presence. This has several benefits:

- Asset light model improves return ratios.
- Frees up existing capacities for premium products.
- Enables higher focus on brand and distribution.
- Reduces logistics cost due to geographical spread of unorganised plywood clusters.

The unorganised segment in the plywood industry is spread all over India, hence outsourcing saves on freight cost and gives presence across the country. Yamuna Nagar in Haryana is a cluster of small & medium plywood industries with 300 units and produces 50% of the plywood used in India. Other unorganised clusters include Gandhidham (Gujarat), Perumbavoor & Kannur (Kerala) and Uttar Pradesh, while smaller clusters include Kolkata, Punjab, Bihar, Mangalore and Vizag.

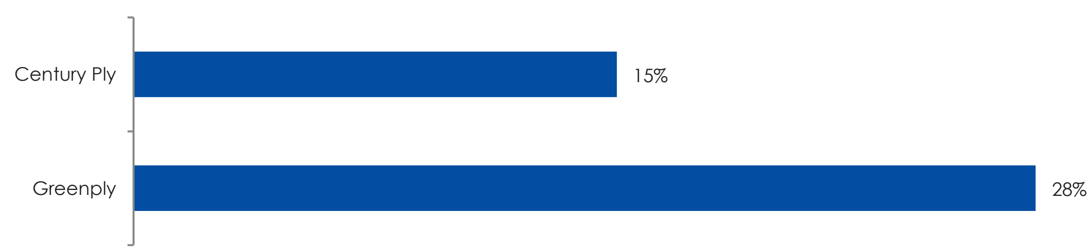
Geographic spread of unorganised plywood clusters in India



Source: Company, Edelweiss Investment Research

In the organised/branded plywood space, there are only 2 big players who have the balance sheet might to take advantage of the outsourcing opportunity. Currently, Greenply outsources 28% and Century Ply 15%.

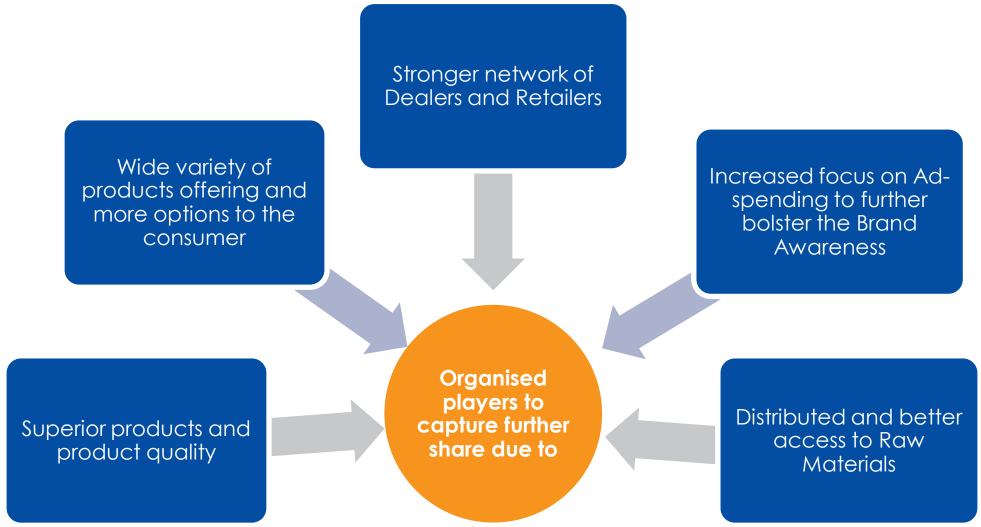
Share of outsourcing of the 2 biggest organised players



Source: Company, Edelweiss Investment Research

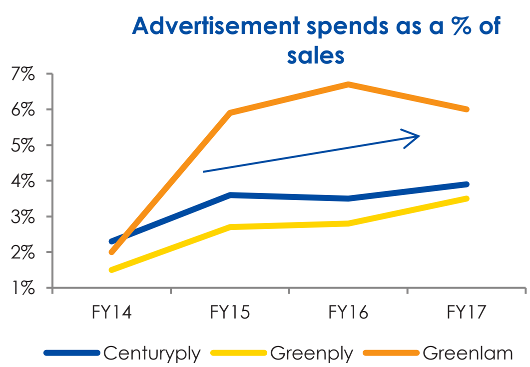
Organised players to capture further share in already penetrated segments

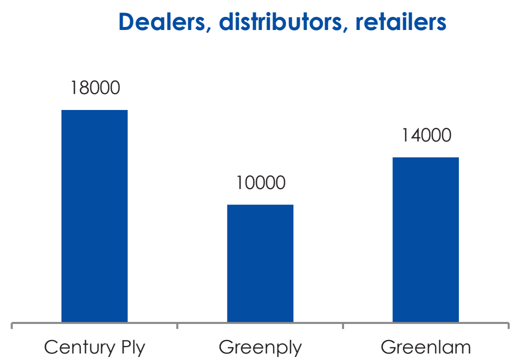
Apart from the outsourcing opportunity, organised players have steadily captured share in the premium and high mid level segments of plywood over the years. We envisage their dominance to sustain anchored by better volumes and distribution channels. We expect the trend to continue due to following reasons:



Source: Company, Edelweiss Investment Research

Moreover, organised players have spent aggressively on advertisements and building their retail network over the years, which has helped them outpace industry growth.





Source: Company, Edelweiss Investment Research

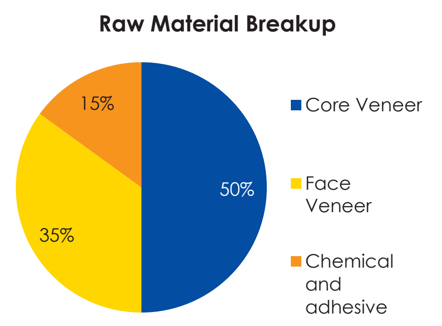
GST at 18% will be a game changer

The share of organised players was a meagre 10% in FY07. The government's decision to cut excise duty from 12% to 6% had led to these players clocking significant market share gains. However, a few years later, the duty was reinstated at 12%, derailing the demand shift from unorganised to organised segment; share of organised players' at 30% currently.

However, with GST at 18% and the anticipated introduction of the e-way bill, many unorganised players are envisaged to become tax compliant, which will narrow the pricing gap between the two from 20% to ~5-7%. This will facilitate a much faster market share shift from unorganised to organised players.

Raw material: Key risk or vital entry barrier?

The raw material for plywood is made up of 3 components—face veneer (30%), core/panel veneer (55%) and chemicals & adhesives (15%). Core veneer is available domestically from eucalyptus, poplar and rubber wood.



Raw Material	Status
Core Veneer	Easily available domestically
Face Veneer	Imported from other countries
Chemicals	Sourced domestically

Source: Company, Edelweiss Investment Research

Core veneer is found in abundance in India. Yamuna Nagar in Haryana is the largest poplar market in Asia and is also the biggest plywood hub in India. Also, production in this area has increased recently due to a boom in poplar farms on account of government initiatives.

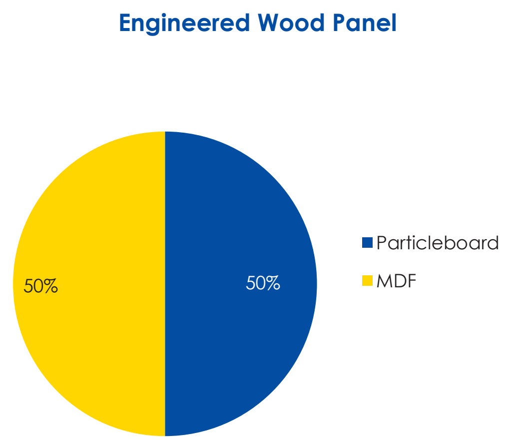
Face veneer is imported from other countries as there is a ban on felling of trees in India. Currently, it is imported from Myanmar and other South-East Asian countries (Laos, Vietnam, Thailand and Malaysia). However, recently, export of timber logs from Vietnam, Laos and Thailand was banned. Myanmar, which had also banned the export of timber logs, has relaxed it from April 2018, Indian plywood manufacturers have moved to other countries like Papua New Guinea, Solomon Island, Gabon, Liberia and Cameroon to source face veneer.

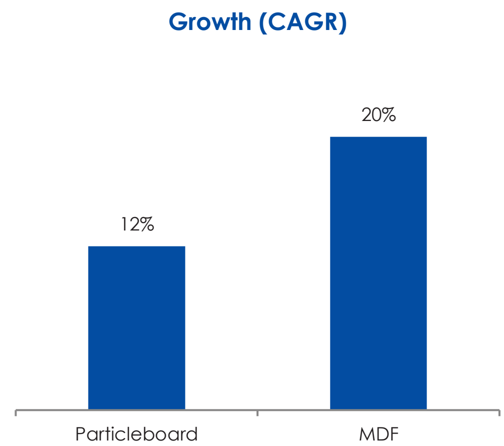
Raw material poses bigger challenge for new entrants or unorganised players

Top Indian organised players such as Greenply and Century Ply have set up factories in Myanmar, Gabon, Solomon Islands, etc., which will be difficult for unorganised players or new entrants.

B) Engineered wood panel (MDF/Particleboard)

The **engineered wood panel** segment comprises:
a) Particleboard – INR2,000cr industry.
b) MDF – INR2,000cr industry.

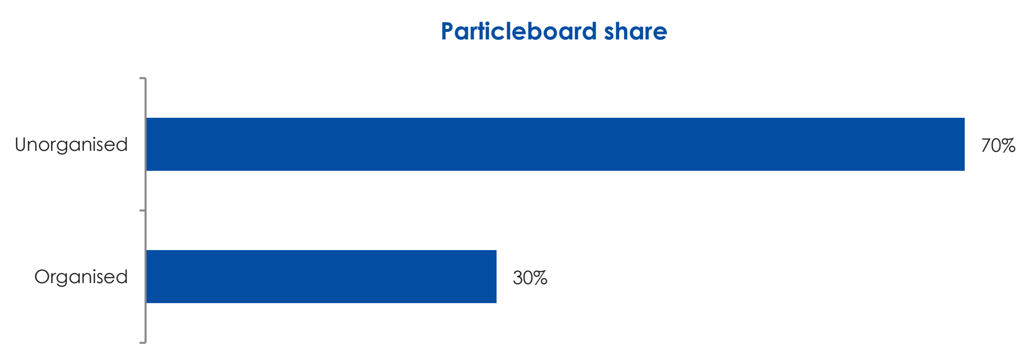




Source: Company, Edelweiss Investment Research

a) Particleboard: More unorganised and growing slower than MDF

Particleboard is growing slower than MDF at 10-15% and akin to plywood, while the unorganised segment constitutes 70%, the organised segment stands at mere 30%. Century Ply has recently set up a small capacity in particleboard. No other big organised player is present in this segment.



Source: Company, Edelweiss Investment Research

Particleboard is a waste wood product made by heat pressing sawdust and resin. Although particleboard is 20% cheaper than MDF and can be easily moulded and used for making readymade furniture like MDF, it has certain disadvantages such as:

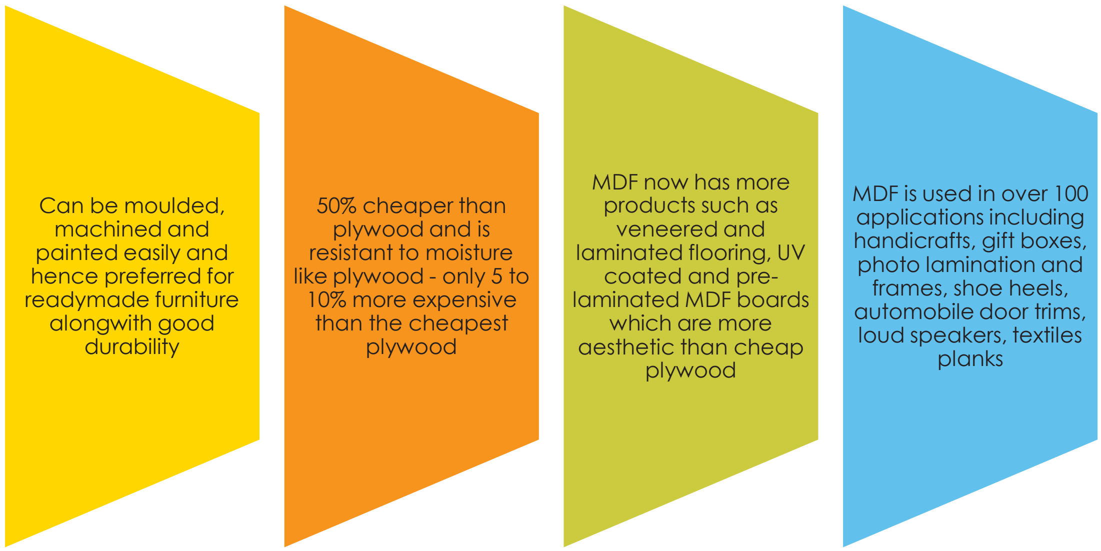
- Lower strength and weight than plywood and MDF.
- Swells on contact with moisture, unlike MDF.

Therefore, MDF is preferred to particleboard globally and in India

b) MDF

MDF is produced by breaking down hardwood and softwood residuals into wood fibres. Wood fibres are then combined using wax and resin and heat pressed. It is suitable for wardrobe doors and shutters of kitchen cabinets.

Why MDF?

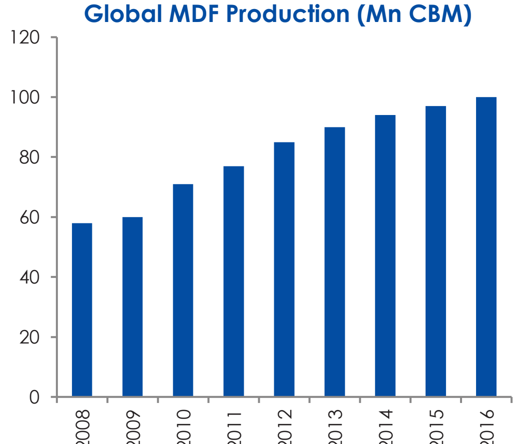


Source: Company, Edelweiss Investment Research

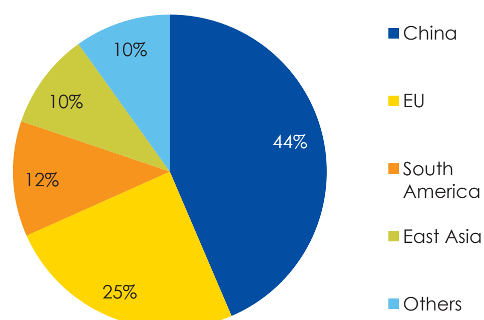
Globally MDF is popular

The global MDF capacity has touched 100mn CBM and has posted 7% CAGR over the previous decade. Nearly half of the production is in China, while the balance is divided across the world.

Global MDF Production (Mn CBM)



MDF Global Capacity Split

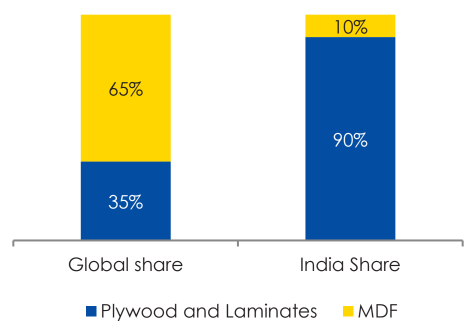


Source: Company, Edelweiss Investment Research

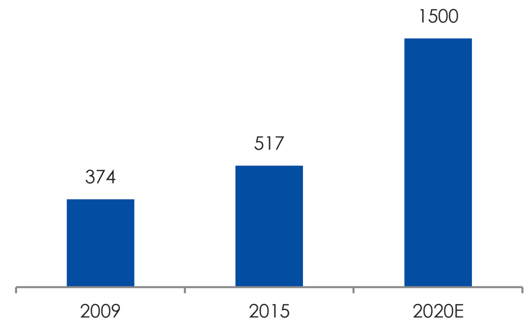
India is now shifting from cheap plywood to MDF

While globally the share of fibreboards is 65%, it is only 15% in India. However, MDF is currently growing at 20% plus as it continues to wrest share from cheap plywood. This has led to many players planning MDF capacities. MDF capacity is expected to nearly triple over the next 5 years.

India's MDF share is miniscule



India MDF Production ('000 CBM)



Source: Company, Edelweiss Investment Research

Gaining popularity in India as well due to:

Fibreboards are suitable for readymade furniture, which has higher demand globally due to higher flexibility, uniformity in construction, expensive carpenter costs, etc. As all these issues were not present in India, plywood continued to be the preferred source of furniture.

Source: Company, Edelweiss Investment Research

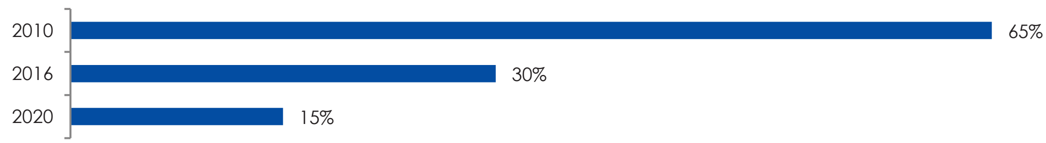
However, the past 2-3 years have seen rising preference for readymade furniture. MDF's demand is correlated to the furniture industry, which is currently estimated at USD20bn and is largely unorganised (~85%). Home furniture constitutes 65% of the furniture industry and is growing at 20% p.a. E-tailing has further enhanced demand for furniture.

Source: Company, Edelweiss Investment Research

Domestic MDF market dominated by organised players currently Century Ply and Greenply

MDF has zero presence of unorganised players as the industry requires high capital expenditure. MDF imports were as high as 65% in FY10 as there were hardly any manufacturers of MDF in India and demand exceeded supply. However, domestic players, realising the vast potential and growing acceptance of MDF, set up capacities. Ergo, the share of imports has reduced to 30% currently and is estimated to dip to 15% over the next 2-3 years as capacity is expected to triple. Anti-dumping duty will also help prune imports.

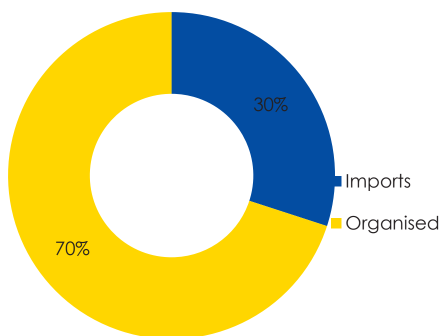
MDF Imports are reducing as Indian players expand capacity



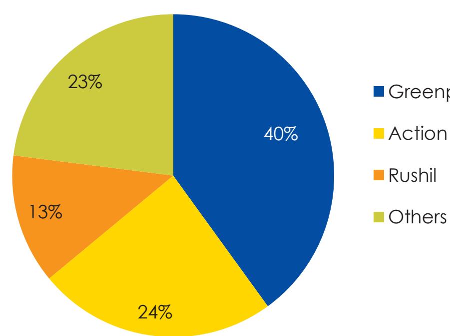
Source: Company, Edelweiss Investment Research

In the MDF segment, the top 2 players till FY17 were Greenply & Action; they accounted for 60% of the share of organised players. **However, Century Ply has recently commissioned its first MDF plant of 1,98,000CBM, rendering it the largest player currently.**

MDF share



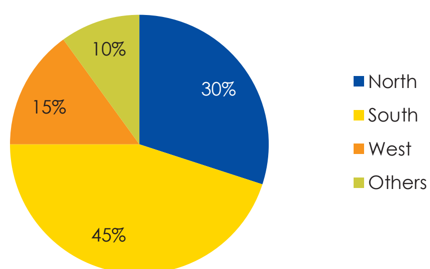
Organised players share (FY17) - MDF



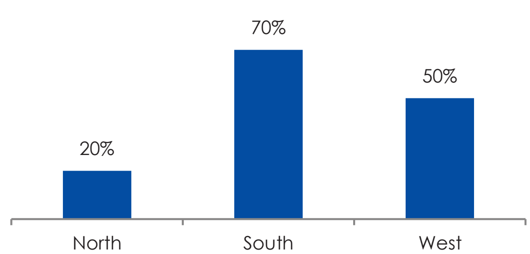
Source: Company, Edelweiss Investment Research

Key MDF imports are from Thailand, Malaysia, Sri Lanka, China, New Zealand, Indonesia and Vietnam where the landed cost of imports of plain MDF boards is 5-15% cheaper than domestic especially near ports in South India. However, Greenply has firmed up capex plans to set up huge capacity in South India to capitalise on the key MDF market and turn competitive by saving on logistic costs.

MDF regional demand



MDF Imports by region



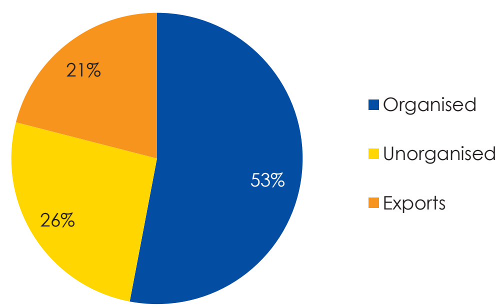
Source: Company, Edelweiss Investment Research

C) Decorative surface products/laminates

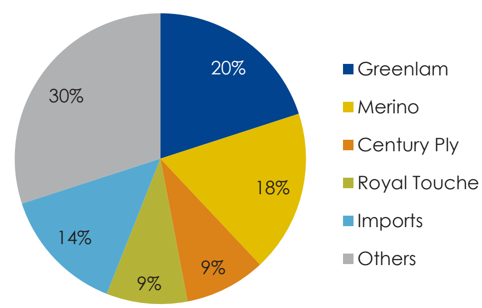
a) Laminates

The laminates industry is estimated at INR5,000cr, of which the domestic revenue aew pegged at INR4,000cr while exports out of India are INR 1,000 Cr. Organised share is INR2,700cr in the laminates industry. The industry's growth hinges on growth in the substrate (plywood, particleboard, MDF) industry, which is posting 9% CAGR. The share of organised players has catapulted from 49% to 65% (including exports) over the past 5 years as organised players grew faster than the industry at 12% CAGR. The top 2 players are Greenlam and Merino, which account for 38% of the organised segment.

Laminates Industy



Biggest organised players



Source: Company, Edelweiss Investment Research

The organised segment is growing at a faster clip due to increasing shift from unbranded to branded, focus on 1mm & higher thickness laminates and value-added products (textured laminates, exterior grade, compact laminates).

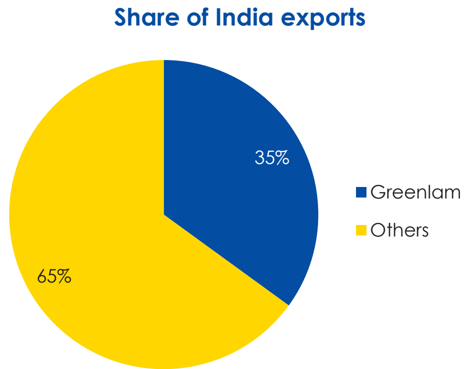
The Indian laminates industry (10 Cr sheets) is divided into 3 segments as under:

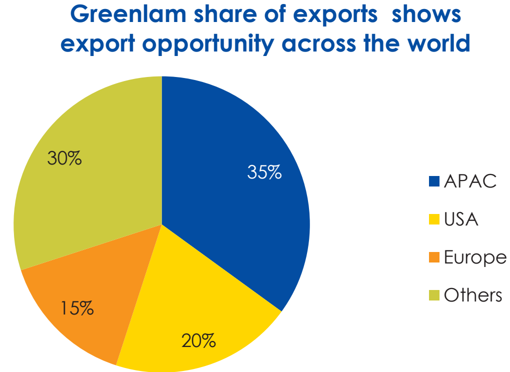
Segment	1 mm thickness	0.7 and 0.8 mm thickness	0.5 and 0.6 mm thickness
Size of industry	INR 3,000 Cr	INR 1,500 Cr	INR 500 Cr
Percentage Share Volume	40%	40%	20%
Percentage Share Value	60%	30%	10%
Organised Share	60%	40%	20%
Realization per sheet	INR 600	INR 300	INR 200
CAGR Growth	10-15%	5-10%	No growth

Source: Company, Edelweiss Investment Research

Exports: Humungous potential

While the global laminates market is pegged at USD7bn, Indian exports are mere INR1,000 cr, entailing huge opportunity. Greenlam is the biggest exporter from India with nearly 35% share.

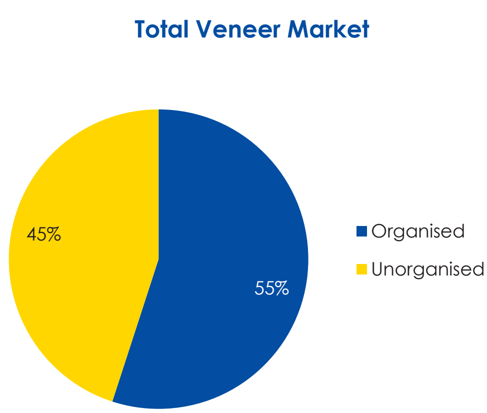


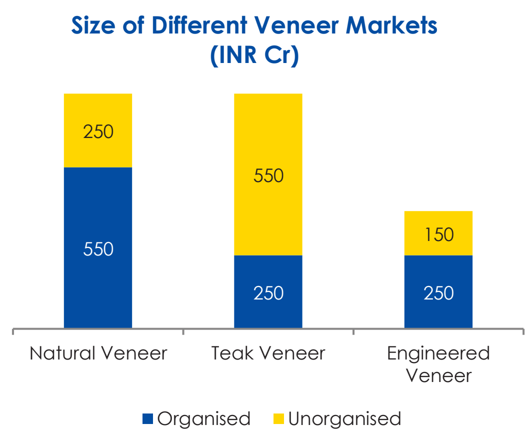


Source: Company, Edelweiss Investment Research

b) Veneers and allied products

The domestic veneers market is currently estimated at INR2,000cr and more than 50% is dominated by organised players. However, even the share of organised players is fragmented with Greenlam and Century Ply being the biggest players. The veneer market is further divided into natural veneer, teak veneer and engineered veneer.





Source: Company, Edelweiss Investment Research

c) New opportunities

There are growth opportunities in veneer allied products such as Mikasa wooden flooring and Mikasa doors and frames. Deepening market reach with architect/designer engagements and more B2B outreach will help expand demand. Players are also increasing retail footprint via exclusive display centres. Demand for these products will be driven by renovation market as well as new construction & development.

Among domestic players, we have initiated coverage on Century Ply and also like Greenply and Greenlam.

Peers comparison

	Revenue growth (%)			PAT growth (%)			EBITDA margin (%)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Century Ply	11	16	20	12	-8	58	17.2	15.6	17.7
Greenply	1	9	19	-4	16	11	15	14.9	14.7
Greenlam	4	11	15	30	35	33	13.4	13.6	14.6

	RoE (%)			Diluted PE (x)			EV/EBITDA (x)		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Century Ply	31	23	30	34	37	23	22	21	15
Greenply	18	17	17	31	26	24	17	16	13
Greenlam	19	21	24	48	34	25	19	16	13

Note: Century Ply - Edelweiss Investment Research estimates
Note: Greenply and Greenlam - Bloomberg Estimates

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Long Term Recommendation: Century Plyboards (India) Ltd

Capex nearing completion; benefits to accrue

CMP INR 295
Target INR 390
Rating: BUY   Upside: 33%

Century Plyboards (Century) is present across the entire gamut of wood panel products—plywood, MDF, particleboard, laminates, veneers, etc. The company has recently expanded its plywood capacity, commissioned a new MDF facility and is in the process of expanding its laminates facility, which is envisaged to drive earnings over FY18-20. The cut in GST rate on plywood from 28% to 18% is envisaged to have a huge positive impact on organised players as unorganised share at 70% in the segment is the highest in any building material category. Century's prudent raw material sourcing strategy and capital allocation are estimated to yield ~30% RoCE (higher than any building materials company) in FY20E. Given the undemanding valuations, we initiate coverage with 'BUY' and target price of INR390.

Diversified portfolio, GST sweetener, deepening reach: Market share gain catalysts

Century has, over the years, diversified its portfolio across all wood panel products—plywood, veneer, laminates, MDF, etc—and is currently amongst the top 3 organised players in every segment. Robust distribution network and healthy advertisement spends will ensure that market share gains sustain. Moreover, cut in GST to 18% and ban on timber export by Myanmar & other neighbouring countries are likely to provide significant challenges for unorganised players. This will not only propel Century's market share, but will also enhance outsourcing of lower quality products to struggling unorganised players. Recent capacity additions in MDF and laminates make it the largest and third biggest player in these segments, respectively.

Capacity augmentation spurred utilisation improvement to boost return ratios

The company's capacity augmentation plan included 12% increase in plywood capacity, 50% in laminate capacity and a new 1,98,000CBM MDF plant (largest in the segment by any player). Most of this capex has been completed, with the entire exercise envisaged to be over by FY18. With ramp up in utilisation over the next 2 years and no firm capex plans on the horizon, we anticipate huge free cash flow generation. Jump in utilisation will improve return ratios with RoCE estimated at ~30% in FY20.

Outlook and valuations: Leading the pack; initiate with 'BUY'

Century is a leader across various wood panel segments and is expected to outpace industry growth. GST at 18% and government's thrust on affordable housing are potent tailwinds for this segment. Inspite of superior return ratios compared to other building material peers and high free cash flow generation, Century is trading at attractive valuations than most peers. We initiate coverage with **'BUY'**, valuing it at 25x FY20E P/E and thus arrive at a target price of INR390.

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Revenues (INR Cr)	1641	1819	2103	2515	2889
Rev growth (%)	3.3	10.8	15.7	19.6	14.9
EBITDA (INR Cr)	289	312	328	445	521
Net Profit (INR Cr)	170	193	170	272	344
P/E (x)	38.0	33.8	36.8	23.2	18.5
EV/EBITDA (x)	23.7	22.4	21.1	15.0	12.5
RoACE (%)	26.2	22.7	18.2	26.0	30.8
RoAE (%)	36.8	30.6	22.6	30.1	31.0

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Bloomberg:	CPBI:IN
52-week range (INR):	314.00 / 154.45
Share in issue (cr):	22
M cap (INR cr):	6,500
Avg. Daily Vol. BSE/NSE :('000):	200
Promoter Holding (%)	72

Date: 27th November 2017

Century is a leader across various wood panel segments and is expected to grow faster versus industry. GST at 18% and government initiatives for affordable housing could provide a tailwind for this segment. In spite of superior return ratios compared with other building material peers and superior free cash flow generation, Century is trading at valuations that are cheaper versus most peers.

Diversified portfolio: Several triggers to gain share in each vertical

	FY17	FY18E	FY19E	FY20E
Revenue	1,819	2,103	2,515	2,889
EBITDA	312	328	445	521
EBITDA Margin	17.2	15.6	17.7	18.0
PAT	193	170	272	344

Capex across verticals nearing completion

	FY17	FY18E	FY19E	FY20E
RoACE (%)	23	18	26	31
Debt to Equity (x)	0.9	0.8	0.5	0.3

The unorganised share in plywood is 70%; and the reduction in GST rates is expected to benefit organised players.

PB Multiple	Multiple	Price Target
Century Plyboards	25x P/E FY20E	390

Entry = INR 295

+

Exit = INR 390

Total Return of 32%

Price Target	**INR 390**	Assuming 83% utilization in plywood, 80% utilization in laminates (new capacity) and 105% utilization in MDF in FY20E along with margins slightly below previous peak levels, we arrive at an EPS estimate of INR 15.7 for FY20E. We assign a 25x P/E multiple and arrive at a price target of INR 390
Bull	**INR 500**	Assuming 90% utilization in plywood, 100% utilization in laminates (new capacity) and 105% utilization in MDF in FY20E along with peak margins, we arrive at an EPS estimate of INR 16.7 for FY20E. We assign a 30x P/E multiple and arrive at a price target of INR 500
Base	**INR 390**	Assuming 83% utilization in plywood, 80% utilization in laminates and 105% utilization in MDF in FY20E along with margins slightly below previous peak levels, we arrive at an EPS estimate of INR 15.7 for FY20E. We assign a 25x P/E multiple and arrive at a price target of INR 390
Bear	**INR 290**	Assuming 80% utilization in plywood, laminates (new capacity) and MDF in FY20E along with flat margins, we arrive at an EPS estimate of INR 14.5 for FY20E. We assign a 20x P/E multiple and arrive at a price target of INR 290

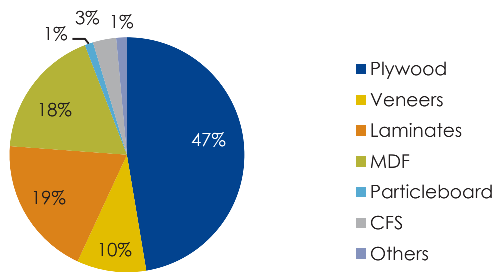
Average Daily Turnover (INR cr)			Stock Price CAGR (%)				Relative to Sensex, CAGR (%)			
3 months	6 months	1 year	1 year	3 years	5 years	10 years	1 year	3 years	5 years	10 years
7.5	15	9	59%	24%	38%	21%	18%	11%	13%	12%

Business Value Drivers

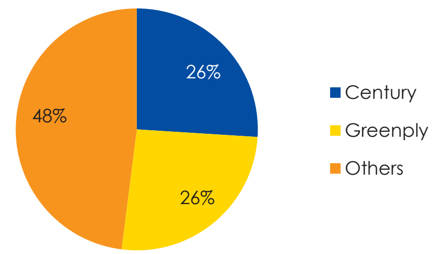
Nature of Industry	The Indian wood-panel industry includes: a) Plywood, b) Engineered wood panels (MDF and particleboard), c) Decorative surface products (laminates). The industry is largely unorganised except for the MDF segment
Opportunity Size	The wood panel industry is ~INR 28,000 crore in size with 90% of its demand coming from new house construction and 10% from renovation. Opportunity size will be increase in the size of the industry due to housing thrust along with market share gains from the unorganised sector
Capital Allocation	Capex is nearing completion for Century. It has recently increased its plywood capacity by 15%, commissioned a new MDF facility of 1,98,000 CBM and increased laminate capacity by 50%
Predictability	Century's topline has been subdued over the last 2 years due to minimal capacity expansion and slowdown in housing demand. It has still been able to maintain its margins and grow its bottomline. We expect steady growth on all financial parameters
Sustainability	Organised players market share has steadily increased from 10% in FY07 to 30% in FY17 led by branding, strong distribution network and prudent capital allocation
Disproportionate Future	Government's affordable housing thrust along with reduction in GST rates from 28% to 18% is likely to result in reducing price differential for similar quality products between the organised and unorganised segment, resulting in higher growth for the organised segment in the coming years
Business Strategy & Planned Initiatives	With its planned capex close to completion, current strategy is to ensure higher utilization in each segment and simultaneously firm up capex plans for faster growing segments
Near Term Visibility	Near-term visibility remains strong due to the soon to be completed capex. MDF and laminate capacities are expected to drive strong topline and margin growth
Long Term Visibility	Century is amongst the top 3 in every segment in the wood panel industry. It plans to keep expanding capacities in wood panel segments which are growing. Capex is nearly complete.

Focus Charts – Story in a nutshell

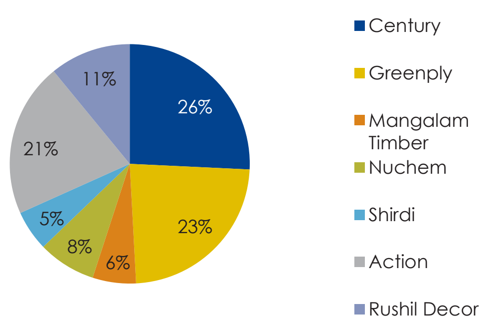
Century has a well diversified portfolio in the wood panel industry



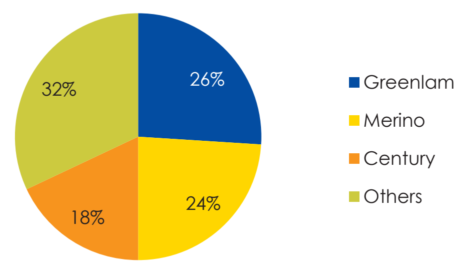
Century is the joint biggest organised player in the plywood segment



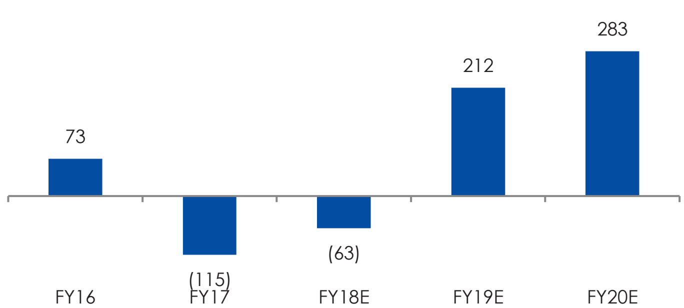
Post its recently commissioned MDF plant, Century is currently the biggest MDF player in India



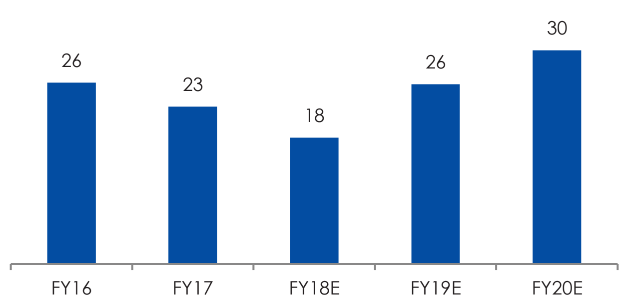
Century is the 3rd biggest player in the laminate segment



Strong Free Cash flow generation over next 2 years due to completion of capex



Return ratios to improve as utilisation ramps up; MDF to improve margins



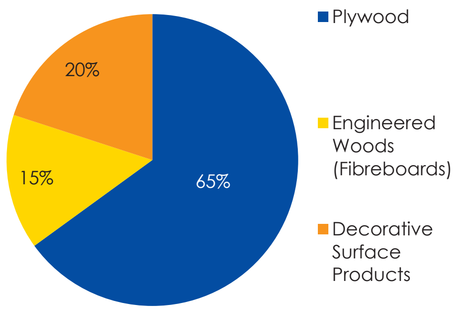
Source: Edelweiss Investment Research

I. Century: A well diversified portfolio in the wood panel industry

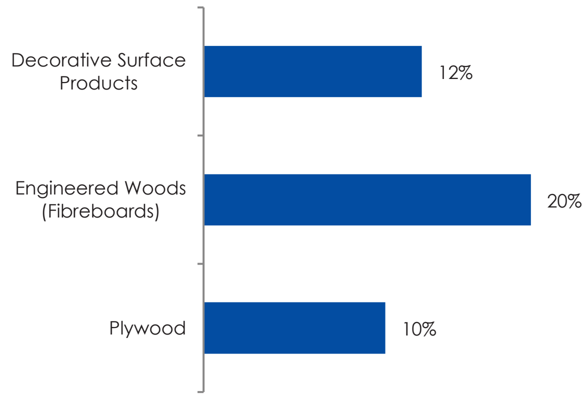
The Indian wood-panel industry is ~INR 28,000 crore in size with 90% of its demand coming from new house construction and 10% from renovation. The wood panel industry includes:

- Plywood
- Engineered wood panels (fibreboard/MDF/particleboard)
- Decorative surface products (laminates)

India wood panel industry



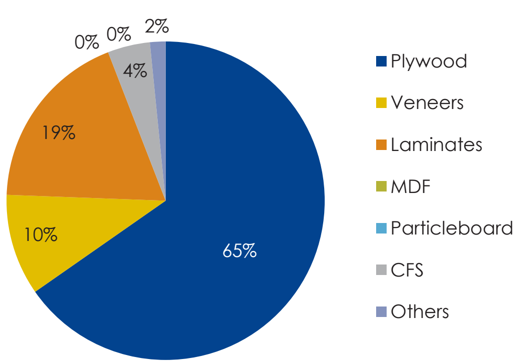
Growth rates (last 4 years)



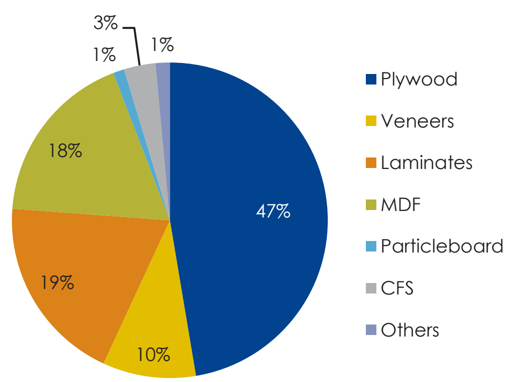
Source: Company, Edelweiss Investment Research

Century has over the years diversified its portfolio across all wood-panel products - plywood, veneer, laminates, MDF etc. and is today amongst the Top 3 organised players in every segment.

FY14: Century — Revenue split



FY20E: Century — Revenue split

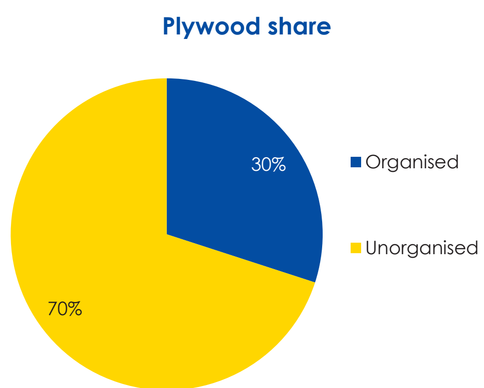


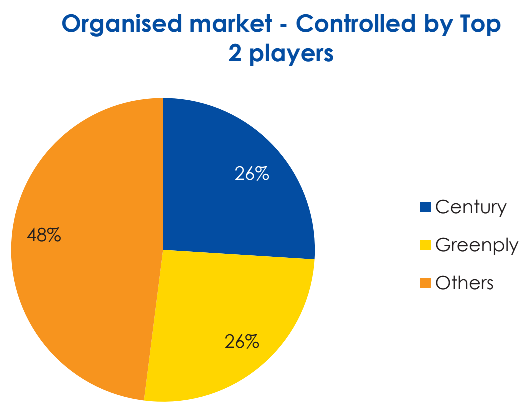
Source: Company, Edelweiss Investment Research

II. Century is the joint biggest player in the plywood segment along with Greenply; and likely to gain substantial share from unorganised players

A. Plywood segment dominated by unorganised players

The Indian plywood industry is the biggest segment in the wood-panel industry with a market size of INR 18,000 Cr., of which the organised segment accounts for only 30%. Century and Greenply control 50% of the organised market while no other organised player has a market share greater than 5%.





Source: Company, Edelweiss Investment Research

B. Century is close to completing its plywood capacity expansion

Century has 7 plywood manufacturing units spread across the country along with a unit in Myanmar. These units have a combined capacity of over 2,10,000 CBM currently but Century is close to completing its expansion plans which will take its total capacity to 2,45,000 CBM.

Ply manufacturing unit	
Location	**Current capacity ('000 CBM)**
Bishnupur, Kolkata	37
Gumudipundi, Chennai	39
Karnal, Haryana	36
Mirza , Guwahati	35
Kandla, Gujarat	31
Roorkee, Uttarakhand	25
Myanmar	6
Total	**210**

Source: Company, Edelweiss Investment Research

C. Century to gain market share across all segments in plywood

The plywood industry is broadly divided into three segments wherein organised players are dominant only in the premium category with Century and Greenply having a combined share of 65%. Other organised players are much smaller than Century and Greenply.

The plywood segment is divided into three categories:

Segment	Premium	Mid/Commercial	Low
Size (INR cr)	3,600	9,000	5,400
Organised share	70%	15%	0%
CAGR growth	10-12%	5-7%	Flat/De-growth
Price (assuming 19mm thickness)	100-140 per sq ft	70-90per sq ft	40-60 per sq ft
Century share	Century has a 33% share	Century has a miniscule market share	None
Century to gain market share due to:	**Biggest distribution network along with highest marketing spends and best in class raw material sourcing capability to lead to market share gain**	**Century has entered this segment through its economy brand called "Sainik". It outsources products sold in this segment which will help it gain share faster**	**MDF is quickly replacing the low plywood category and Century has set up a new 1,98,000 CBM capacity (highest in the industry)**

Source: Company, Edelweiss Investment Research

D. GST at 18% will be a game changer to gain market share

The share of organised players was a meagre 10% in FY07. The government's decision at that time to reduce the excise duty from 12% to 6% resulted in a big gain in market share temporarily. However a few years later, the duty was revised back and the shift from unorganised to the organised segment slowed down and the organised players' share is only at 30% today.

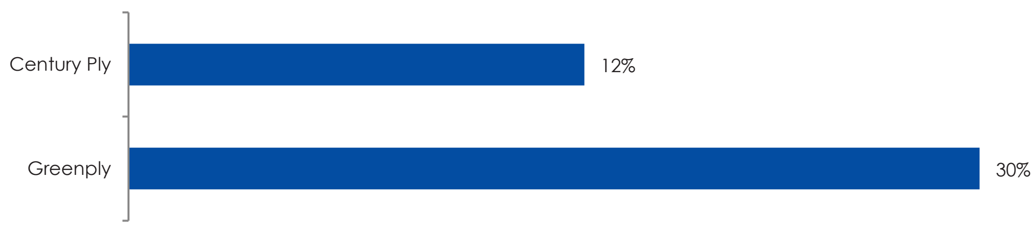
GST is likely to narrow the price gap between organised and unorganised. Also, with GST at 18% and the expected introduction of the E-way bill, a lot of unorganised players are expected to become tax compliant which would narrow the pricing gap further between unorganised and organised from 20% to ~5-7%. This will facilitate a much faster shift from unorganised to organised players.

E. Players like Century are increasing outsourcing

GST is likely to result in difficulties for smaller players in terms of working capital and their ability to compete against the larger players. We expect organised players to take advantage of this phenomenon and increase their share of outsourcing.

Currently Century outsources 12% of its total sales in plywood; this number is expected to increase in the next 2 years. Century will outsource production of its Sainik (mid premium) brand which will help the company gain traction in this segment and will help free up capacities for its premium variants.

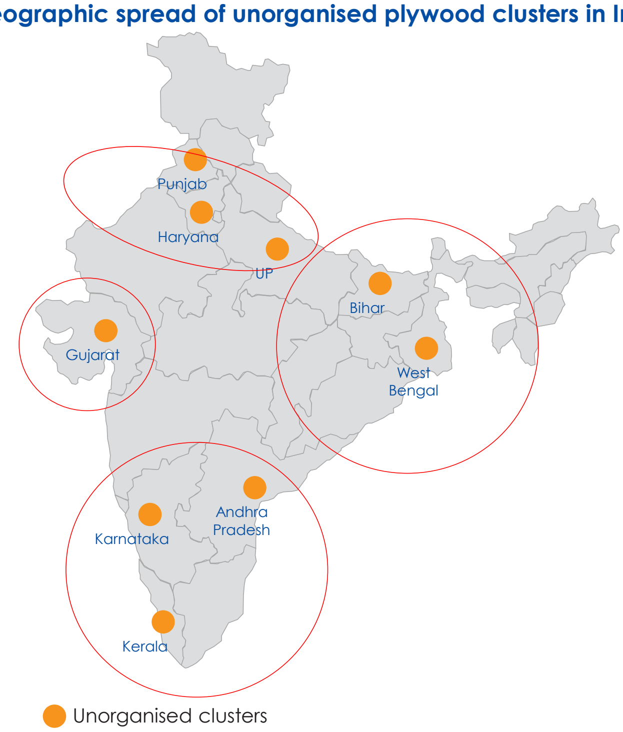
Share of outsourcing of the 2 biggest organised players



Source: Company, Edelweiss Investment Research

Unlike the tiles segment, the unorganised segment is spread out all over India as shown in the map below and hence outsourcing would save a lot on freight cost as well, and give presence across the country. Yamuna Nagar in Haryana is a cluster of small & medium plywood industries with 300 plywood units and produces 50% of the plywood used in India. Other unorganized clusters include Gandhidham (Gujarat), Perumbavoor & Kannur (Kerala) & Uttar Pradesh while smaller clusters include Kolkata, Punjab, Bihar, Mangalore & Vizag.

Geographic spread of unorganised plywood clusters in India

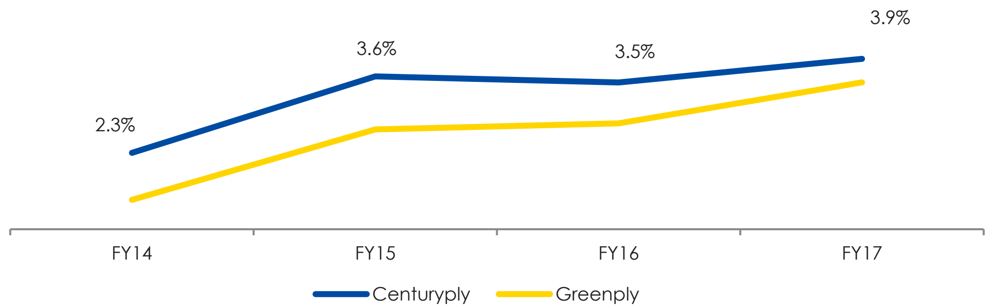


Source: Company, Edelweiss Investment Research

F. Aggressive ad spends and robust distribution network to spur share gains

The organised players have spent aggressively on advertisement and building their retail network over the years which have helped grow faster than the industry. Century has the highest advertisement spends at ~4% of sales and this number has been increasing every year.

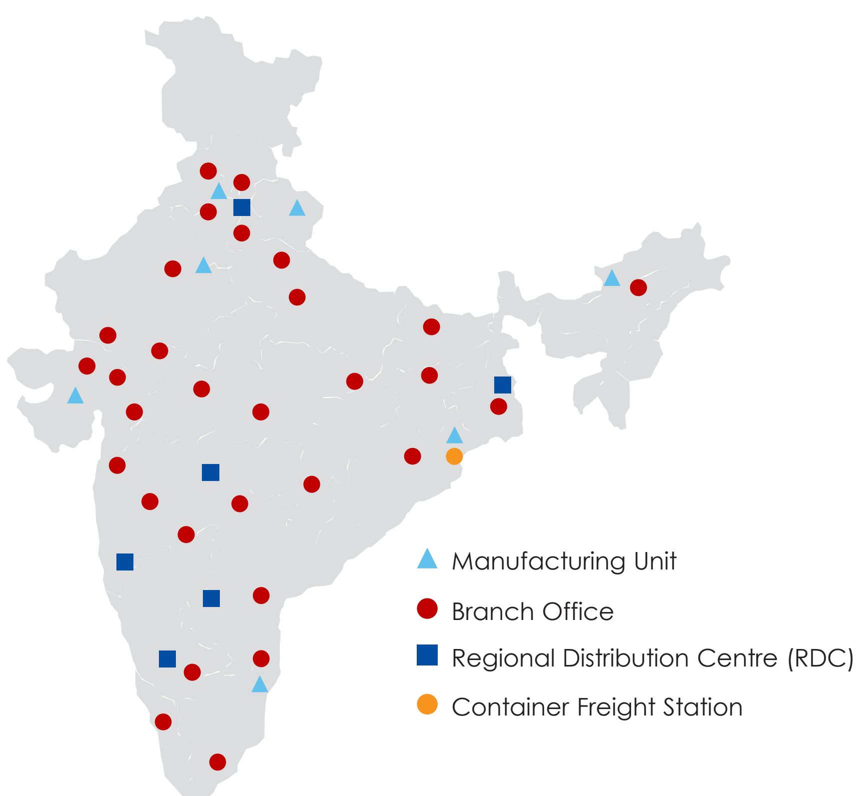
Advertisement spend as a % of sales



Source: Company, Edelweiss Investment Research

Century also has a robust distribution network spread across India. It has over 31 branch offices, 6 regional distribution centres and has a distribution network of 18,000 retail, dealer and distributor touch points.

Domestic Network

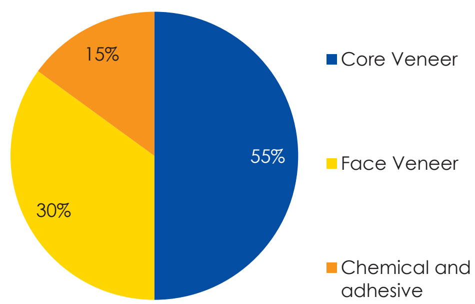


Source: Company, Edelweiss Investment Research

G. Century has the best raw material sourcing in the plywood industry

The raw material for plywood is made up of 3 components - face veneer (30%), core/panel veneer (55%) and chemicals and adhesives (15%). Core Veneer is found in abundance in India. Core veneer is made from poplar trees and Yamuna Nagar in Haryana is the largest poplar market in Asia and also the biggest plywood hub in India. Production in this area has increased recently due to a boom in poplar farms on account of government initiatives. Face Veneer has been the biggest challenge for plywood players over the years. As there is a ban on felling of trees in India, currently face veneer is imported from Myanmar, Laos, Vietnam, Gabon, etc.

Raw material breakup



Raw Material	Status
Core Veneer	Easily available domestically
Face Veneer	Imported from other countries - challenge
Chemicals	Sourced domestically

Source: Company, Edelweiss Investment Research

Century has best in class raw material sourcing

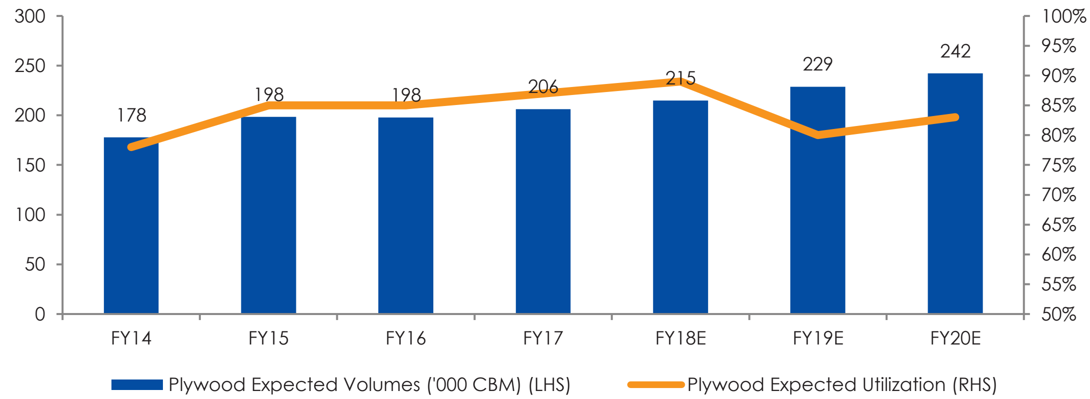
Myanmar, which was one of the key providers of timber logs, banned the export of raw timber in 2014. Century was the first company to establish a face veneer plant in Myanmar which de-risked Century from such judgements. This had an added advantage as the import of face veneer instead of timber logs resulted in a huge transport cost saving as raw timber loses around 30% moisture when made into face veneer and another 30% weight is lost during peeling. The export ban of raw timber is likely to be lifted by March 2018.

Century had also expanded its sourcing to **Laos,** by setting up its own subsidiary for supply of face veneer. The Laos government however imposed a ban on exports of timber logs and veneer in May 2016, which is still in force.

Post the ban in Laos, Century has moved to **Solomon Islands** where it has identified timber varieties that are of the same quality as those from Laos and Myanmar but cheaper. There is no expected ban on selling of raw timber from Solomon Islands.

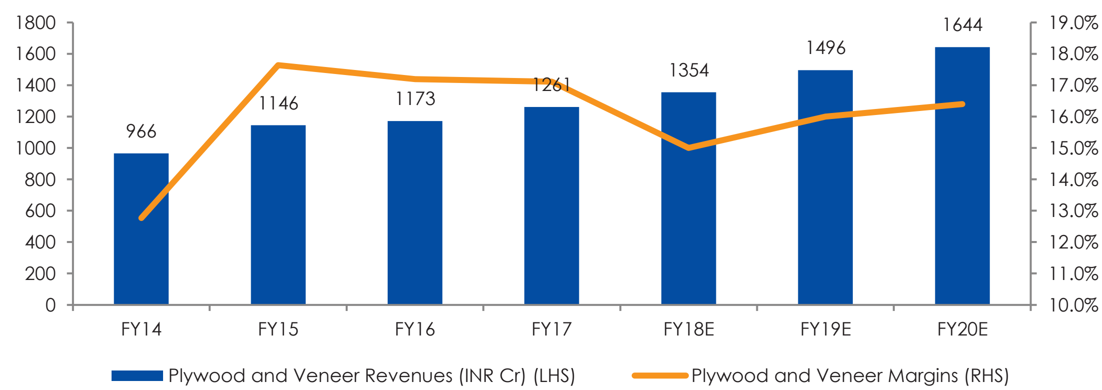
Raw material prices have been stable for the last few years inspite of bans and we believe they pose an entry barrier for new entrants and a challenge for unorganised players. Also total amount of face veneer is expected to be only 8% of Century's revenues in FY20E. Therefore, volatile movements in raw material prices are unlikely to have a big impact on Century.

With the ramp up in capacities, we expect utilization to have a slight dip next year, post which it will pick up in FY20E. Inspite of higher outsourcing and new capacity addition from 2,10,000 CBM to 2,45,000 CBM in FY18E, we have built in a conservative volume growth of 5% CAGR over FY17-20E.



Source: Company, Edelweiss Investment Research

FY18E margins were impacted by GST as unorganised players seemed to benefit due to lenient GST implementation, delay of E-way bill and GST rate at 28% which encouraged unorganised players to evade tax. Margins would definitely improve from FY19E but are still expected to be below 17% margins generated from FY15-17, as focus on volume growth to capture share from unorganised will take precedence. FY15 margins expanded ~400 bps as Century set up a peeling factory in Myanmar which reduced raw material price volatility and resulted in freight savings.



Source: Company, Edelweiss Investment Research

III. Century has entered the engineered wood panel segment with a bang

The **engineered wood panel** segment of India is extremely small in size and comprises of a) Particleboard which is INR 2,000 Cr industry size and MDF which is a further INR INR 2,000 Cr in size.

a) Particleboard

Particleboard is a waste wood product made by heat pressing sawdust and resin. Although particleboard is 20% cheaper than MDF and can be easily moulded and used for making readymade furniture like MDF, it has certain disadvantages such as:

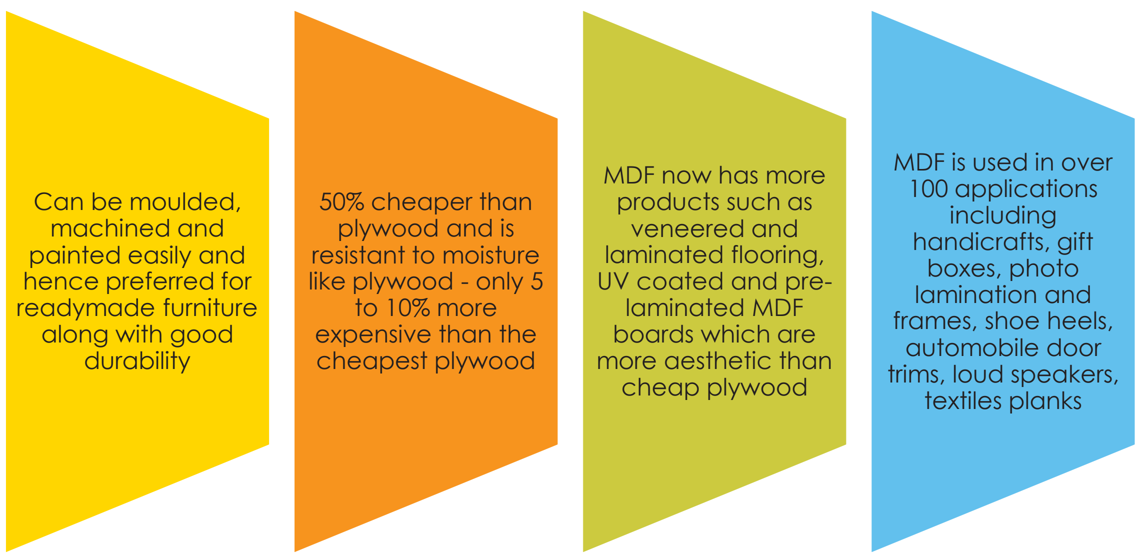
- Lower strength and weight than plywood and MDF
- Material swells in contact with moisture unlike MDF

It is growing slower than MDF at 10-15% and 70% of the industry is unorganised players. **Century is the only big organised player and has commissioned a 54,000 CBM manufacturing facility in FY17. However this is a small unit and is hardly expected to contribute 2-3% to Century's revenues at full utilization.**

b) MDF

MDF is produced by breaking down hardwood and softwood residuals into wood fibre. Wood fibres are then combined using wax, resin and heat press. It is suitable for wardrobe doors and kitchen cabinet shutters.

Why MDF?

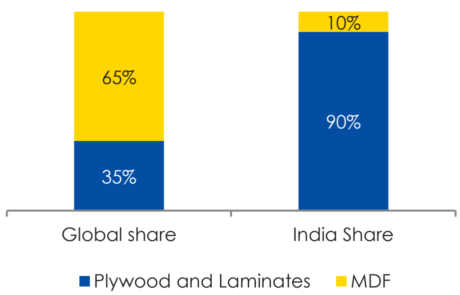


Source: Company, Edelweiss Investment Research

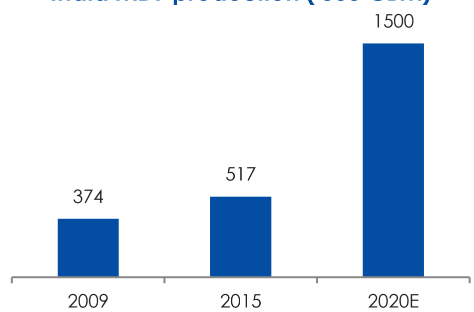
Shift from cheap plywood to MDF has begun in India

Globally the share of fibreboards is 65%, which is diametrically opposite to the Indian share of fibreboards at only 15%. However, MDF is currently growing at 20% plus as it continues to cannibalise the cheap plywood market. This has led to many players proposing to set up/increase their MDF capacity. MDF capacity is expected to nearly triple over the next five years.

India's MDF share is minuscule



India MDF production ('000 CBM)



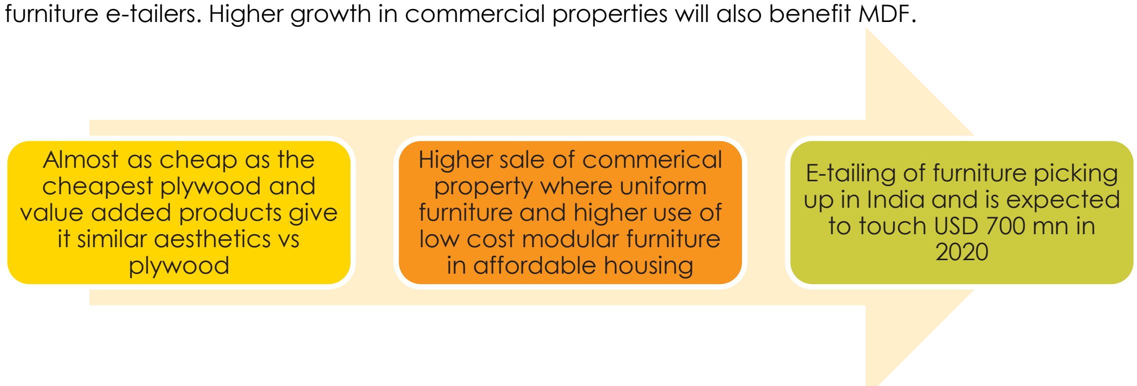
Source: Company, Edelweiss Investment Research

Reasons why MDF has not been popular in India

Source: Company, Edelweiss Investment Research

However popularity in India is growing now due to:

Over the last 2-3 years we have seen a rising preference for readymade furniture. MDF's demand is correlated to the furniture industry which is estimated at USD 20 bln and largely unorganised (~85%) with home furniture making up 65% of the furniture industry. E-tailing has further increased the demand for furniture with online furniture market expected to reach USD 700 mln by 2020. Superior personalisation, consultation services and faster delivery time are driving growth for furniture e-tailers. Higher growth in commercial properties will also benefit MDF.

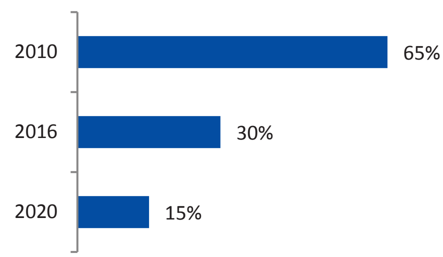


Source: Company, Edelweiss Investment Research

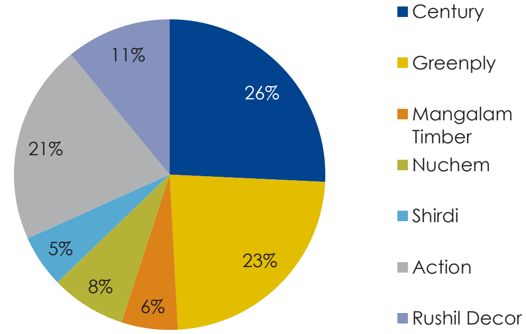
Century's entry into MDF is expected to capture the rapid segmental growth

The Indian MDF market size is INR 2,000 crore but is growing rapidly at 20% plus with 70% being contributed by the organised sector and 30% from imports. The MDF market has no unorganised player due to the high capex requirement for MDF. Incremental domestic capacity along with anti-dumping duty on exports has led to reducing share of imports. **Century has entered the MDF segment by commissioning its 1,98,000 CBM MDF plant in Q2FY18E, which is the biggest capacity of any player currently.** However, Greenply and Action are increasing capacity in FY19E.

MDF imports are reducing as Indian players ramp up capacity



Current MDF capacity share

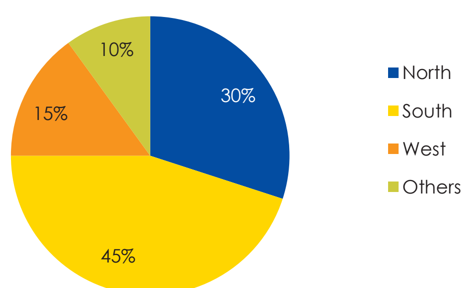


Source: Company, Edelweiss Investment Research

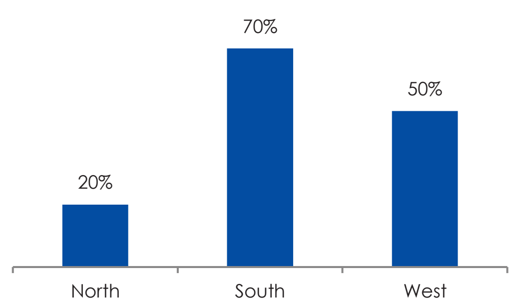
Century's MDF facility is strategically located

Century's MDF plant is strategically located in Punjab. Its plant is present close to a "mandi" where there is constant supply of raw materials at favourable prices. Also although demand is high in the North, the threat of imports is low resulting in lower competition. Key MDF imports are from Thailand, Malaysia, Sri Lanka, China, New Zealand, Indonesia and Vietnam and arrive at southern ports. Post freight charges required to transport to the North, it would be unlikely for imports to compete with domestic producers.

MDF regional demand



MDF imports by region

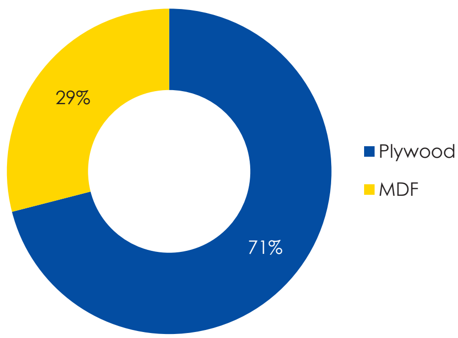


Source: Company, Edelweiss Investment Research

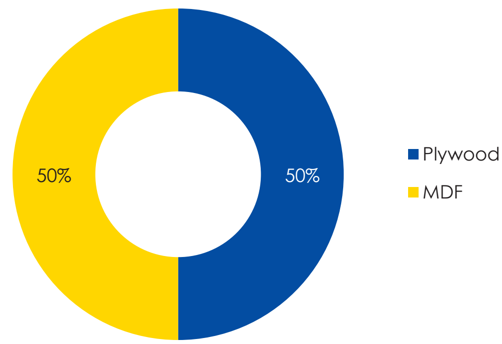
High margin MDF to boost Century's margins

MDF is a high margin business. While plywood margins are close to 16% for Century, MDF margins are expected to be between 25-30% (most peers with operational capacities have margins of 28-30% currently. This can be seen in Greenply's topline and EBITDA contribution mix. While MDF contributes 30% to revenues, it contributes 50% to EBITDA for Greenply.

Greenply topline mix (FY17)



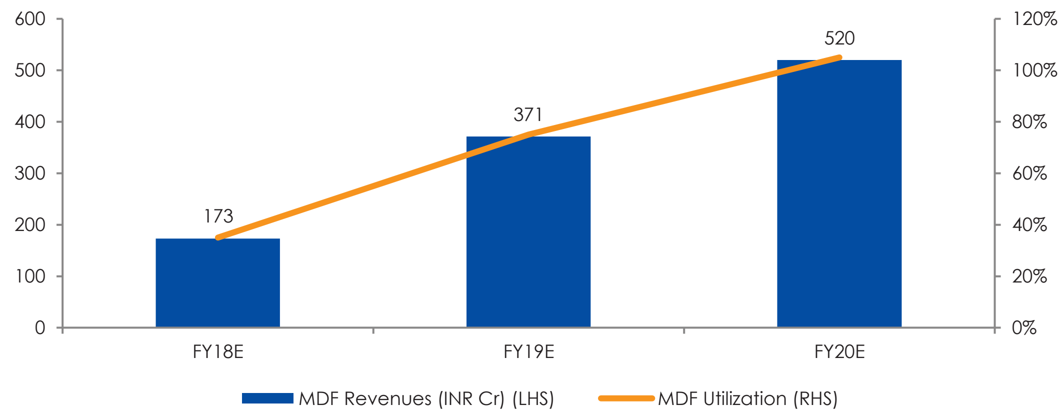
Greenply EBITDA mix (FY17)



Source: Company, Edelweiss Investment Research

We expect swift ramp up in MDF capacity utilisation for Century

Century commenced in MF facility towards the end of Q2FY18 and has already reached 75% utilization. We expect Century to maintain this utilization over the next year and improve it further in FY20E. We expect slight pressure in margins as Century is likely to sacrifice margins to gain initial market share. Margins are expected at 25% in FY19E and FY20E as against close to 30% for peers running at full capacity.

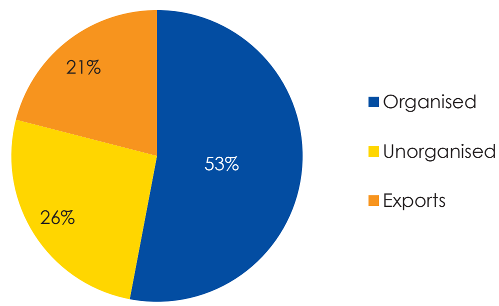


Source: Company, Edelweiss Investment Research

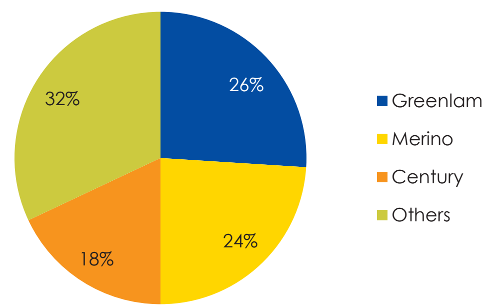
IV. Century is also set to complete ramp up of its laminate segment

The Indian laminates industry is INR 5,000 Cr of which the domestic Indian laminates industry is estimated to be INR 4000 Cr while exports are INR 1,000 Cr. Of the total pie of domestic and exports, organised share is 55% (INR 2,700 Cr). The growth of this industry depends on the growth in the substrate (plywood, particleboard, MDF) industry which is growing at a 9% CAGR. The share of the organised player has increased vastly from 49% of the industry size to 65% (including exports) in the last five years as the organised players grew faster than the industry at a CAGR of 12%. Post its recently soon to be completed expansion, **Century will be the third biggest player in laminates with a share of 18% in the organised segment.**

Laminates industy



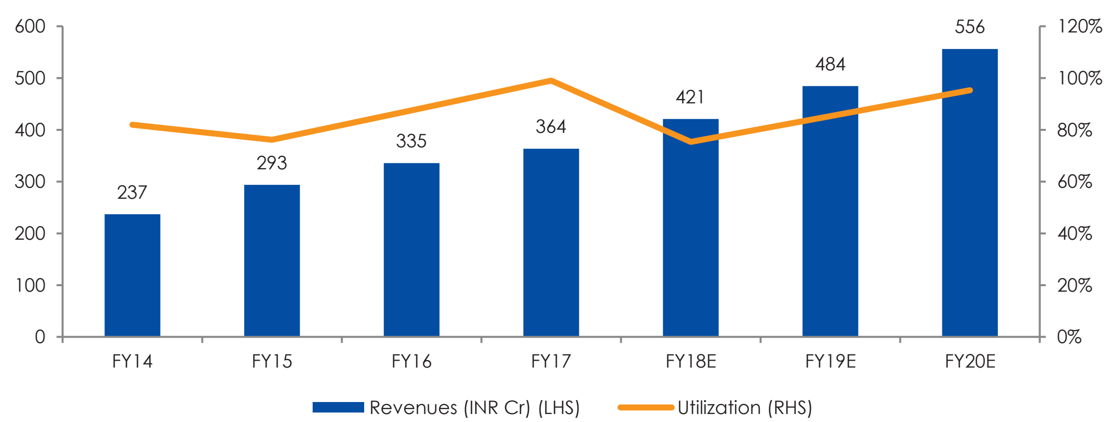
Laminates organised players share



Source: Company, Edelweiss Investment Research

Century to complete 50% increase in laminates capacity

Century is increasing its capacity in laminates from 4.8 mln sheets to 7.2 mn sheets. The capex is almost complete and should aid Century as its existing capacity was operating at 100% utilization. We expect strong utilization in new facilities as organised segment is growing much faster due to increasing shift from unbranded to branded, focus on 1mm (higher thickness) laminates and value added products (textured laminates, exterior grade, compact laminates).



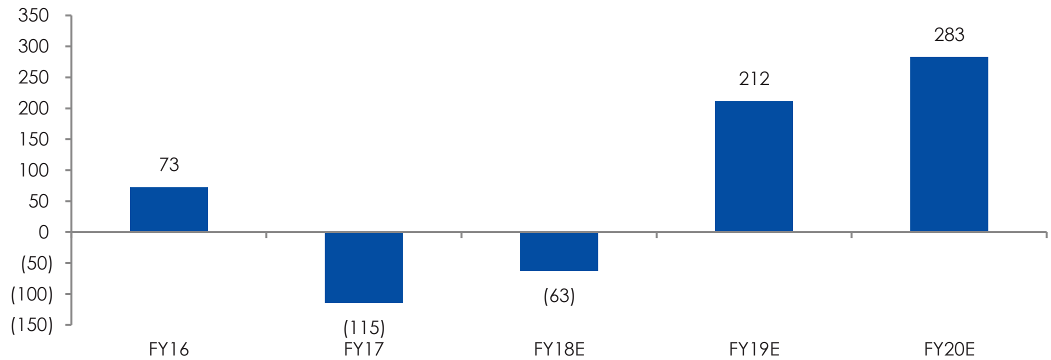
Source: Company, Edelweiss Investment Research

V. Capex complete; significant free cash flow generation and surge in RoCE

Strong free cash flow generation

Century had planned 12% plywood capacity increase, 50% laminate capacity increase and a fresh MDF plant of 1,98,000 CBM (biggest capacity of any player in the MDF segment. Century has completed most of this capex with any pending capex expected to be complete in FY18E itself. With ramp up in utilization over the next 2 years and no firm capex plans on the horizon, we expect huge free cash flow generation.

Free cash flows

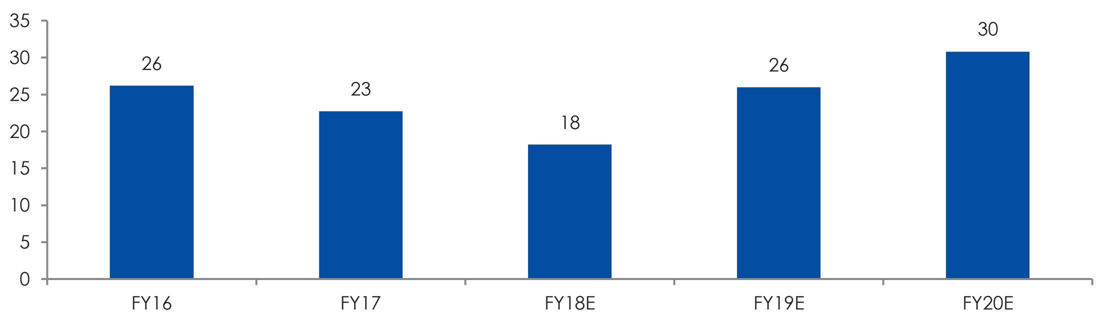


Source: Company, Edelweiss Investment Research

Robust return ratios

The higher utilisation will likely result in meaningful return ratios with RoCE expected to be close to 30% in FY20E.

RoCE



Source: Company, Edelweiss Investment Research

VI. Valuation and peers

Century is a leader across various wood panel segments and is expected to grow faster than the industry. GST at 18% and government initiatives of affordable housing could provide tailwinds for this segment. In spite of superior return ratios compared with other building material peers and high free cash flow generation, Century is trading at valuations that are cheaper versus peers. We initiate coverage with a 'BUY' rating, valuing Century at 25x FY20E P/E and thus arrive at a target price of INR 390.

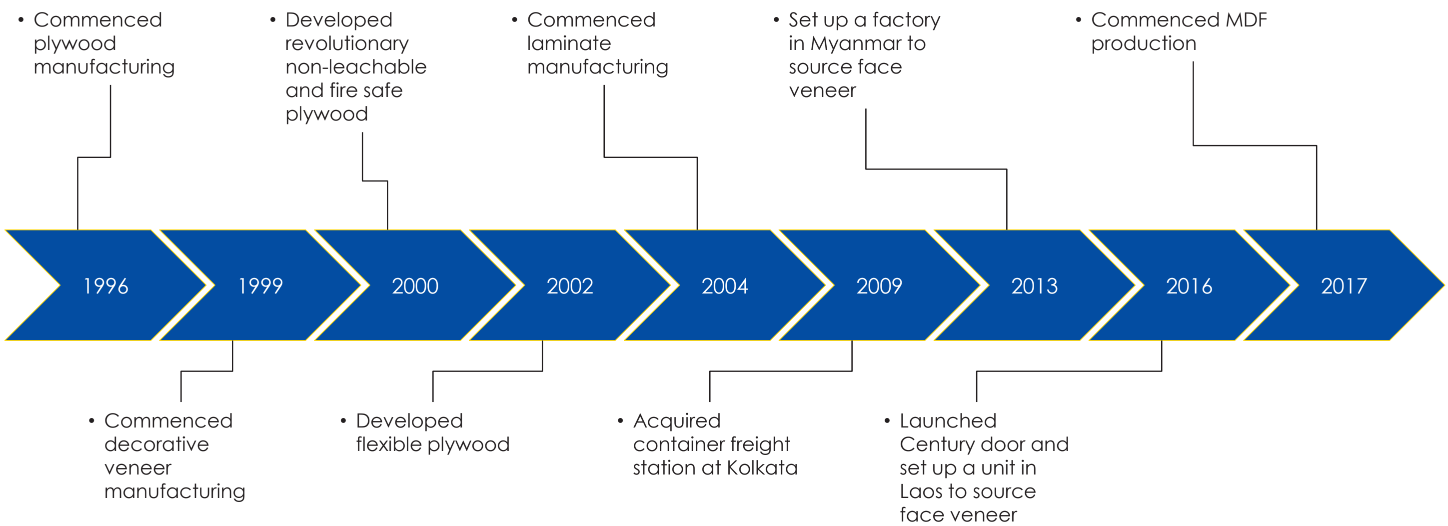
Estimated EPS (FY20E)	Target multiple	Target price
15.6	**25x**	**390**

PAT growth is depressed due to FY18E PAT decline on account of GST. We expect a 35% plus PAT CAGR for FY19E and FY20E.

	Revenue growth (FY17-20E)	PAT growth (FY17-20E)	RoE (FY20E)	P/E (FY20E)
Kajaria	9%	17%	21	23.2
Somany	14%	22%	22	20.4
CERA	16%	20%	22	24.8
HSIL	10%	23%	13	15.3
Greenlam	15%	34%	25	19.1
Greenply	15%	20%	19	17.9
Supreme	16%	21%	27	22.3
Astral	17%	33%	23	28.1
Century	**17%**	**22%**	**30**	**18.9**

Source: Company, Edelweiss Investment Research

TIMELINE


• Commenced plywood manufacturing
• Developed revolutionary non-leachable and fire safe plywood
• Commenced laminate manufacturing
• Set up a factory in Myanmar to source face veneer
• Commenced MDF production
1996
1999
2000
2002
2004
2009
2013
2016
2017
• Commenced decorative veneer manufacturing
• Developed flexible plywood
• Acquired container freight station at Kolkata
• Launched Century door and set up a unit in Laos to source face veneer

Key Management

Name	Designation	Profile
Mr. Sajjan Bhajanka	*Chairman*	**Mr. Sajjan Bhajanka** is a graduate with over 45 years of industry experience. He is directly responsible for the overall strategic direction, production, finance and treasury. He is also the president of the Federation of Indian Plywood and Panel Industry and All India Veneer Manufacturers Association and a governing body member of Indian Plywood Industry Research and Training Institute.
Mr. Sanjay Agarwal	*Managing Director*	**Mr. Sanjay Agarwal** is the CEO and Managing Director, and is also one of the co-founders. He is a graduate with 30 years of Industry experience and is responsible for sales, marketing, IT and HR. The CenturyPly brands was his brainchild, which has today reached great heights.
Mr. Keshav Bhajanka	*Executive Director*	**Mr. Keshav Bhajanka** is the Executive Director. He is responsible for the growth in the decorative vertical which includes successful implementation of new supply chain projects and foray into new businesses such as MDF, Exteria and flooring

Key Risks

a. Slowdown in housing

b. Raw material price volatility

c. Increase in competition in MDF segment

Business Overview

Company Brief

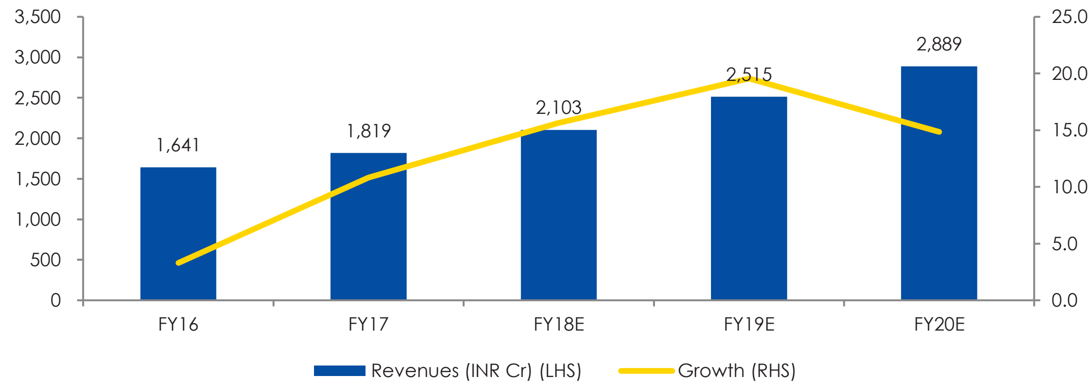
Century Plyboards (Century) is present across the entire gamut of wood panel products such as plywood, MDF, particleboard, laminates, veneer etc. Century has recently expanded its plywood capacity, commissioned a new MDF facility and is in the process of expanding the laminates facility, all of which will likely drive earnings in the forthcoming two years.

Business Model	The company has 3 major segments. 1) Plywood 2) MDF and Particleboard 3) Laminates
Strategic Positioning	The company is the joint leader in plywood, currently the biggest player in MDF and the third biggest player in laminates
Competitive Edge	Diversified portfolio Prudent raw material sourcing Efficient capital allocation Strong brand and distribution network
Financial Structure	Completion of capex will result in high free cash flows. Ramp up in utilization and improvement in margins to aid return ratios
Key Competitors	Greenply and unorganised competition
Industry Revenue Drivers	Various government initiatives such as affordable housing thrust and GST. Macroeconomic tailwinds and a very high unorganised share to aid the industry
Shareholder Value Proposition	In spite of superior return ratios compared with other building material peers and superior free cash flow generation, Century is trading at valuations that are cheaper versus most peers. We initiate coverage with a 'BUY' rating, valuing Century at 25x FY20E P/E and thus arrive at a target price of INR 390.

VII. Financial Analysis

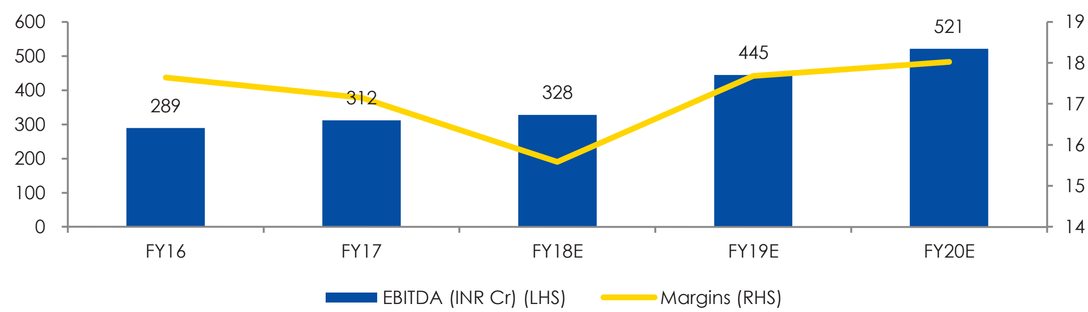
MDF and laminates to drive revenue growth

Revenue growth has been muted for the last 2 years but is expected to significantly pick up due to the commissioning of a new MDF facility in Q2FY18, along with an expansion in laminate capacity and plywood capacity.



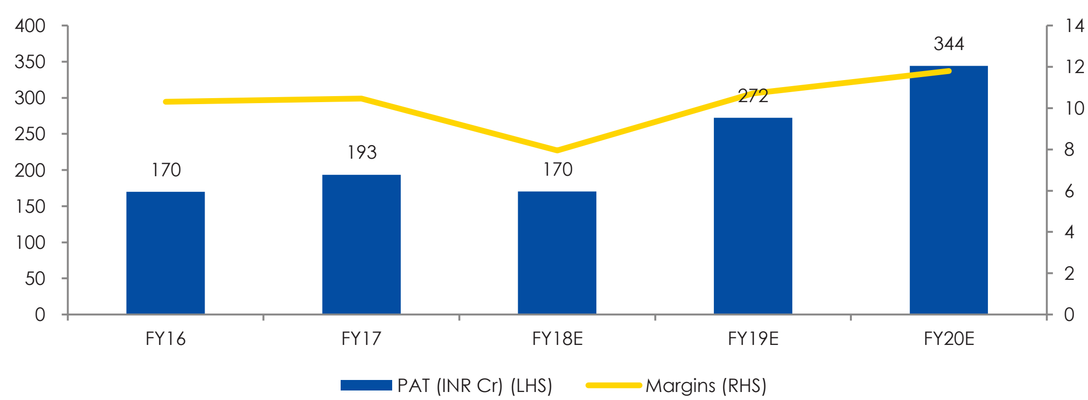
Increasing MDF share to drive margins

MDF is a high margin business. While plywood margins are close to 16% for Century, MDF margins are expected to be between 25-30%. This can be seen in Greenply's topline and EBITDA contribution mix. While MDF contributes 30% to revenues, it contributes 50% to the EBITDA.



PAT and PAT margin to improve substantially

Completion of pending capex in FY18E is likely to result in flattish depreciation and interest expenses and thus we expect strong bottomline growth from FY19E.



Source: Company, Edelweiss Investment Research

Century Plyboards

Financials

Income statement					(INR crs)
Year to March	FY16	FY17	FY18E	FY19E	FY20E
Income from operations	1,641	1,819	2,103	2,515	2,889
Direct costs	854	938	1,094	1,278	1,461
Employee costs	236	273	316	378	434
Other expenses	498	569	682	792	907
Total operating expenses	1,351	1,507	1,776	2,070	2,368
EBITDA	289	312	328	445	521
Depreciation and amortisation	47	59	80	73	71
EBIT	242	253	248	372	450
Interest expenses	48	30	45	40	28
Other income	6	23	15	15	15
Profit before tax	200	245	218	347	438
Provision for tax	30	52	47	75	94
Core profit	170	193	170	272	344
Extraordinary items	0	-0	0	0	0
Profit after tax	170	193	170	272	344
Minority Interest	-1	-3	-3	-3	-3
Share from associates	0	0	0	0	0
Adjusted net profit	169	190	167	269	341
Equity shares outstanding (mn)	22	22	22	22	22
EPS (INR) basic	7.6	8.6	7.9	12.4	15.7
Diluted shares (Cr)	22.3	22	22	22.25	22
EPS (INR) fully diluted	7.6	8.6	7.9	12.4	15.7
Dividend per share	2.2	0	3	4	5
Dividend payout (%)	29.6	0.0	34.8	34.8	34.8

Common size metrics- as % of net revenues					
Year to March	FY16	FY17	FY18E	FY19E	FY20E
Operating expenses	82.4	82.8	84.4	82.3	82.0
Depreciation	2.9	3.3	3.8	2.9	2.4
Interest expenditure	2.9	1.7	2.1	1.6	1.0
EBITDA margins	17.6	17.2	15.6	17.7	18.0
Net profit margins	10.3	10.5	7.9	10.7	11.8

Growth metrics (%)					
Year to March	FY16	FY17	FY18E	FY19E	FY20E
Revenues	3.3	10.8	15.7	19.6	14.9
EBITDA	13.1	7.8	5.1	35.6	17.1
PBT	11.5	22.4	(11.2)	59.5	26.1
Net profit	13.2	14.0	(12.0)	60.0	26.3
EPS	13.5	12.6	(8.2)	58.5	25.9

Balance sheet					(INR cr)
As on 31st March	FY16	FY17	FY18E	FY19E	FY20E
Equity share capital	22	22	22	22	22
Preference Share Capital	0	0	0	0	0
Reserves & surplus	507	693	807	987	1,214
Shareholders funds	529	715	829	1,009	1,237
Secured loans	470	521	571	371	221
Unsecured loans	5	97	97	97	97
Borrowings	474	619	669	469	319
Minority interest	9	12	12	12	12
Sources of funds	**1,012**	**1,345**	**1,509**	**1,490**	**1,567**
Gross block	298	412	592	622	662
Depreciation	48	106	186	259	330
Net block	250	306	406	363	332
Capital work in progress	102	299	100	0	0
Total fixed assets	352	605	506	363	332
Unrealised profit	0	0	0	0	0
Investments	6	6	6	6	6
Inventories	298	301	403	448	491
Sundry debtors	284	342	396	462	514
Cash and equivalents	39	67	193	208	220
Loans and advances	90	160	200	239	274
Other current assets	0	0	0	0	0
Total current assets	711	870	1,192	1,357	1,500
Sundry creditors and others	153	219	242	282	317
Provisions	9	19	20	21	22
Total CL & provisions	162	238	262	303	338
Net current assets	549	633	930	1,054	1,161
Net Deferred tax	65	67	67	67	67
Misc expenditure	39	34	0	0	0
Uses of funds	**1,012**	**1,345**	**1,509**	**1,490**	**1,567**
Book value per share (INR)	24	32	37	45	56

Cash flow statement					(INR crs)
Year to March	FY16	FY17	FY18E	FY19E	FY20E
Net profit	170	194	178	280	352
Add: Depreciation	47	59	80	73	71
Add: Misc expenses written off/Other	23	5	34	0	0
Add: Deferred tax	-59	-2	0	0	0
Add: Others	-1	-3	-3	-3	-3
Gross cash flow	180	252	289	350	419
Less: Changes in W. C.	-14	55	172	108	96
Operating cash flow	194	197	117	242	323
Less: Capex	121	312	180	30	40
Free cash flow	**73**	**-115**	**-63**	**212**	**283**

Ratios					
Year to March	FY16	FY17	FY18E	FY19E	FY20E
ROAE (%)	37	31	23	30	31
ROACE (%)	26	23	18	26	31
Debtors (days)	63	69	69	67	65
Current ratio	4.4	4	5	4	4
Debt/Equity	0.9	0.9	0.8	0.5	0.3
Inventory (days)	66	60	70	65	62
Payable (days)	34	44	42	41	40
Cash conversion cycle (days)	95	85	97	91	87
Debt/EBITDA	1.6	2	2	1	1
Adjusted debt/Equity	0.8	1	1	0	0

Valuation parameters					
Year to March	FY16	FY17	FY18E	FY19E	FY20E
Diluted EPS (INR)	7.6	8.6	7.9	12.4	15.7
Y-o-Y growth (%)	*13.5*	*12.6*	*(8.2)*	*58.5*	*25.9*
CEPS (INR)	9.7	11.2	11.5	15.7	18.8
Diluted P/E (x)	38.0	33.8	36.8	23.2	18.5
Price/BV(x)	12.2	9.0	7.8	6.4	5.2
EV/Sales (x)	4.2	3.8	3.3	2.7	2.3
EV/EBITDA (x)	23.7	22.4	21.1	15.0	12.5
Diluted shares O/S	22.3	22.3	22.3	22.3	22.3
Basic EPS	7.6	8.6	7.9	12.4	15.7
Basic PE (x)	38.0	33.8	36.8	23.2	18.5
Dividend yield (%)	0.8	0.0	0.8	1.3	1.6

Greenply Industries

Imminent leader in plywood and MDF

CMP INR 321

Rating: Not Rated

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Research Analyst
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Greenply was established as Mittal Laminates Private Limited in 1990; the company went public in the year 1994, and was renamed Greenply Industries Ltd (GIL) in 1996. The promoters are Shiv Prakash Mittal, Rajesh Mittal and Shobhan Mittal. Greenply is today India's joint largest plywood manufacturer with a 26% share in the organised segment and the second largest MDF manufacturer. Recently, the company has firmed up capex plans to expand its plywood and MDF capacities which will make it the biggest organised player in both these segments. Greenply has a strong portfolio of brands such as Greenply Plywood, Green Club Ply, Ecotec, Green Panelmax, and Green Floormax.

Imminent plywood leader

Greenply has four ply manufacturing units spread across the country with a combined capacity of 32.4 MSM. These units are working at 108% utilization and hence the company is undertaking a greenfield expansion in Uttar Pradesh that will increase capacity by 13.5 million sqm making it the market leader in the organised segment. This expansion is set to be completed by 3QFY19. Greenply follows an asset light model with the company outsourcing 30% of its mid-premium segment plywood production which will help free up capacities for its premium segment. The company has also de-risked raw materials by setting up a new peeling unit in Gabon. Greenply has a strong retail network with 48 branches across India and presence in over 300 cities through 12,000 distributors, dealers, sub-dealers and retailers.

Mega MDF capacity on its way

Currently Greenply is the second biggest player in the MDF market with 1,80,000 CBM capacity. Greenply's MDF plant was the first of its kind when commissioned in 2010 and had the largest MDF capacity in India until Century Ply overtook it by setting up a 200,000 CBM capacity in FY17. However Greenply is set to triple its capacity in the next two years with a new 3,60,000 CBM plant, making Greenply the biggest player in India with a 40% MDF share. The new plant will be in south India as Greenply plans to capture the market share of MDF imports into India. As MDF is a higher margin business versus plywood, we expect Greenply's margins to inch up steadily.

Outlook

We expect growth to pick up in FY19 with increase in MDF and ply capacities and predict subdued net profit growth over the following two years owing to higher interest and depreciation. However in FY20 we expect significant topline and bottomline growth. Greenply is trading at 31x FY17 P/E.

Bloomberg:	MTLM:IN
52-week range (INR):	337.60 / 238.50
Share in issue (cr):	12.3
M cap (INR cr):	3,953
Avg. Daily Vol. BSE/NSE :('000):	50
Promoter Holding (%)	51.03

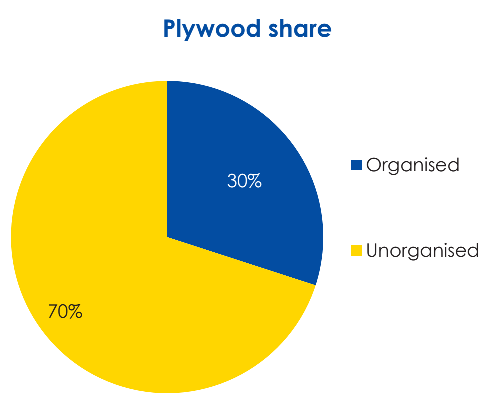
Year to March	FY15	FY16	FY17
Revenues (INR Cr)	1,567	1,646	1,700
Rev growth (%)	(29.3)	5.1	3.3
EBITDA (INR Cr)	210	239	240
Net Profit (INR Cr)	124	128	125
P/E (x)	31.3	30.3	31.1
EV/EBITDA (x)	20.1	17.2	17.8
RoACE (%)	14.5	21.8	18.3
RoAE (%)	23.2	23.3	18.1

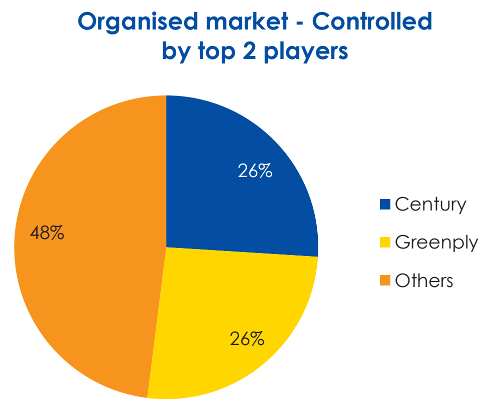
Date: 4th December 2017

I. Plywood

Greenply is the joint leader in plywood

Greenply is today India's joint largest plywood manufacturer with a 26% share in the organised segment along with Century Ply. Greenply has four ply manufacturing units spread across the country with a combined capacity of 32.4 MSM.





Source: Company, Edelweiss Investment Research

As Greenply's existing units are presently running at 108% utilization, the company is undertaking a greenfield expansion in Uttar Pradesh that will increase capacity by 13.5 MSM thereby making it the market leader in the organised segment. This expansion is set to be completed by 3QFY19.

Location	Capacity (MSM)
Tizit, Nagaland	4.5
Kriparampur, West Bengal	6
Pantnagar, Uttarakhand	10.5
Bamanbore, Gujarat	11.4
Sandila, Uttar Pradesh (new facility)	13.5
Total (FY19E)	**45.9**

Source: Company, Edelweiss Investment Research

Prudent raw material sourcing

The company has secured the sourcing of face-veneer from a joint venture it has set up in Myanmar and has set up a new unit in Gabon where it has commenced production, with three peeling lines out of six currently operational. The remaining three peeling lines are expected to be commissioned by December 2017.

Outsourcing to free up capacities going forward

Greenply follows an asset light model and is outsourcing 30% of its mid-premium segment plywood production, which will help the company free up capacity for its premium segment.

Strong distribution network

Greenply has a strong retail network with 48 branches across India and presence in over 300 cities through 12,000 distributors, dealers, sub-dealers and retailers.

II. MDF

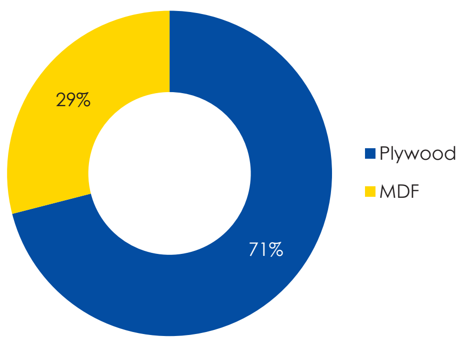
Greenply to nearly triple its MDF capacity

Currently Greenply is the second biggest player in the MDF marketplace with a 1,80,000 CBM capacity. Greenply's MDF plant was the first of its kind when it was commissioned in 2010 and had the largest MDF capacity in India until Century Ply overtook it by setting up a 200,000 CBM capacity. However Greenply is expected to almost triple its capacity in the next two years with a new 3,60,000 CBM plant at Chittoor, Andhra Pradesh. The expansion will completed by July 2018, with Greenply alone accounting for ~40% of the total domestic MDF capacity.

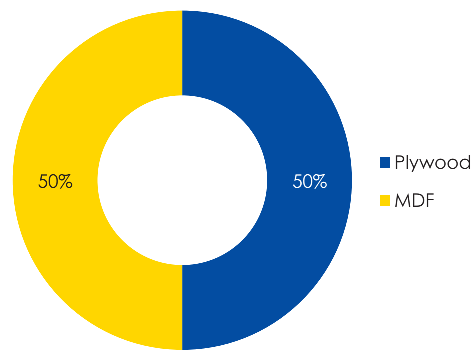
MDF to boost margins

MDF is a high margin business. While the margins from plywood are close to 16%, those from MDF are between 25-30%. While MDF contributes 30% to Greenply's revenues, it contributes 50% to the company's EBITDA. Post commissioning of the new plant at Chittoor, the company will likely witness an increase in the margins from MDF.

Greenply topline mix (FY17)



Greenply EBITDA mix (FY17)

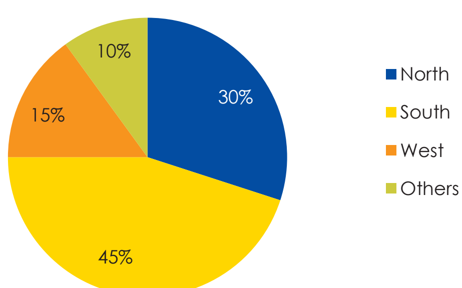


Source: Company, Edelweiss Investment Research

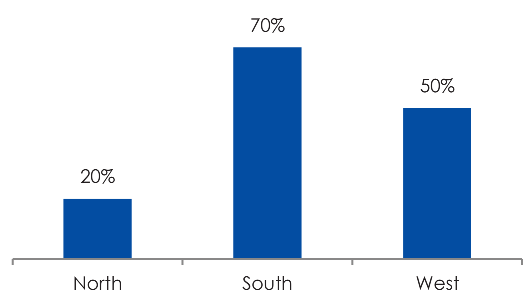
MDF plant strategically located in the south

Greenply's MDF plant is strategically located in the south where the demand for MDF is the highest. Currently MDF is imported from Thailand, Malaysia, Sri Lanka, China, New Zealand, Indonesia and Vietnam. The goods arrive at southern Indian ports; however this region still experiences demand that is greater than the supply. Greenply has an objective to capture the market share from MDF imports.

MDF regional demand



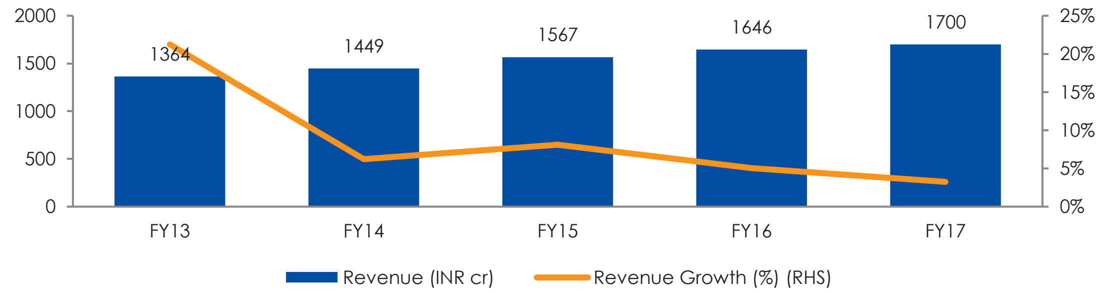
MDF imports by region

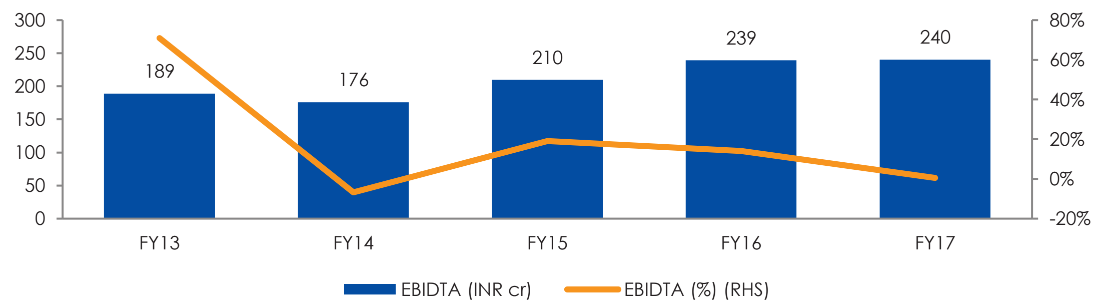


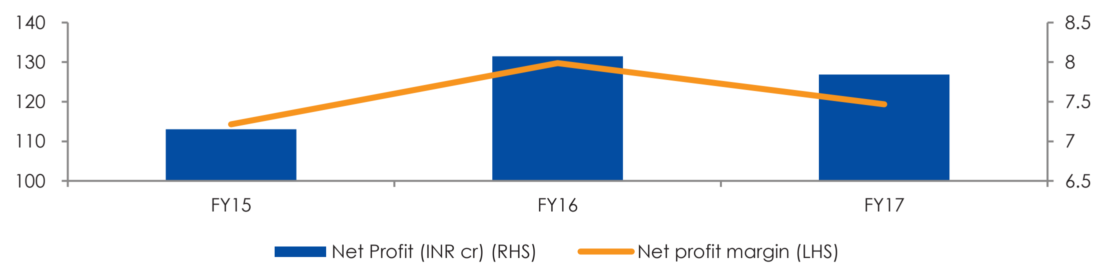
Source: Company, Edelweiss Investment Research

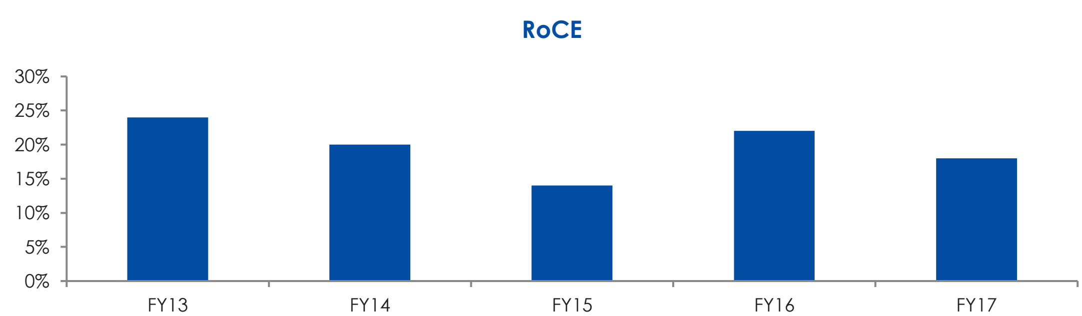
Financial analysis

Greenply's revenues have barely grown at a 5% CAGR over the last few years due to no capacity expansion. Margins have steadily improved and would continue to improve as the higher margin MDF segment grows faster than the plywood segment. We do expect some pressure on depreciation and interest for FY18-19E due to the substantial capex undertaken by Greenply. However FY20 should see robust topline and bottomline growth.









Source: Edelweiss Investment Research

Note: As Greenlam was demerged from Greenply in 2014, we do not have PAT numbers of Greenply prior to 2015.

Greenply Industries

Financials

Income statement (INR cr)

Year to March	FY15	FY16	FY17
Income from operations	1,567	1,646	1,700
Direct costs	975	986	990
Employee costs	145	167	177
Other expenses	382	421	470
Total operating expenses	1,357	1,407	1,459
EBITDA	210	239	240
Depreciation and amortisatio	47	50	51
EBIT	163	190	190
Interest expenses	38	31	21
Other income	17	11	12
Profit before tax	141	170	181
Provision for tax	17	41	56
Core profit	124	128	125
Extraordinary items	-11	3	1
Profit after tax	113	131	127
Minority Interest	0	0	0
Share from associates	0	0	0
Adjusted net profit	113	131	127
Equity shares outstanding (mr	12	12	12
EPS (INR) basic	10.3	10.6	10.4
Diluted shares (Cr)	12.1	12.1	12.3
EPS (INR) fully diluted	10.3	10.6	10.4
Dividend per share	0.6	0.0	0.0
Dividend payout (%)	5.8	0.0	0.0

Common size metrics- as % of net revenues

Year to March	FY15	FY16	FY17
Operating expenses	86.6	85	86
Depreciation	3.0	3.0	3.0
Interest expenditure	2.4	1.9	1.2
EBITDA margins	13.4	14.5	14.1
Net profit margins	7.2	8.0	7.5

Growth metrics (%)

Year to March	FY15	FY16	FY17
Revenues	(29.3)	5.1	3.3
EBITDA	(21.9)	14.1	0.4
PBT	(7.6)	20.2	6.8
Net profit	5.6	3.3	(2.2)
EPS	5.7	3.3	(2.6)

Balance sheet (INR cr)

As on 31st March	FY15	FY16	FY17
Equity share capital	12	12	12
Preference Share Capital	0	0	0
Reserves & surplus	474	602	760
Shareholders funds	486	614	773
Secured loans	216	173	346
Unsecured loans	116	97	51
Borrowings	332	270	397
Minority interest	0	0	0
Sources of funds	**818**	**884**	**1,170**
Gross block	726	774	774
Depreciation	193	232	272
Net block	533	542	526
Capital work in progress	14	9	269
Total fixed assets	547	551	795
Unrealised profit	0	0	0
Investments	35	29	26
Inventories	190	139	158
Sundry debtors	257	333	302
Cash and equivalents	8	35	78
Loans and advances	97	74	66
Other current assets	0	0	0
Total current assets	552	580	605
Sundry creditors and others	255	284	340
Provisions	13	3	5
Total CL & provisions	267	287	344
Net current assets	285	293	261
Net Deferred tax	-40	0	-14
Misc expenditure	-9	11	102
Uses of funds	**818**	**884**	**1,170**
Book value per share (INR)	40	51	63
	0	0	0

Cash flow statement

Year to March	FY15	FY16	FY17
Net profit	135	125	124
Add: Depreciation	47	50	51
Add: Misc expenses written	52	-20	-91
Add: Deferred tax	-9	-41	14
Add: Others	0	0	0
Gross cash flow	225	114	97
Less: Changes in W. C.	-232	-19	-76
Operating cash flow	457	134	173
Less: Capex	-222	54	294
Free cash flow	**679**	**79**	**-121**

Ratios

Year to March	FY15	FY16	FY17
ROAE (%)	23.2	23.3	18.1
ROACE (%)	14.5	21.8	18.3
Debtors (days)	60	74	65
Current ratio	2.1	2.0	1.8
Debt/Equity	0.7	0.4	0.5
Inventory (days)	44	31	34
Payable (days)	53	55	64
Cash conversion cycle (days)	51	49	35
Debt/EBITDA	1.6	1.1	1.7
Adjusted debt/Equity	0.7	0.4	0.4

Valuation parameters 0

Year to March	FY15	FY16	FY17
Diluted EPS (INR)	10.3	10.6	10.4
Y-o-Y growth (%)	*5.7*	*3.3*	*(2.6)*
CEPS (INR)	14.2	14.7	14.4
Diluted P/E (x)	31.3	30.3	31.1
Price/BV(x)	8.0	6.3	5.1
EV/Sales (x)	2.7	2.5	2.5
EV/EBITDA (x)	20.1	17.2	17.8
Diluted shares O/S	12.1	12.1	12.3
Basic EPS	10.3	10.6	10.4
Basic PE (x)	31.3	30.3	31.1
Dividend yield (%)	0.2	0.0	0.0

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Greenlam Industries Ltd.

The growth plank

CMP INR 999

Rating: Not Rated

Greenlam Industries (GRLM) is currently the market leader in the laminates segment. It is a one stop solution provider for all surfacing needs with the largest capacity of laminates & compact laminates in Asia and the largest capacity of decorative veneer in India located at state of the art manufacturing facilities situated at Behror - Rajasthan and Nalagarh - Himachal Pradesh. Strong distribution network of over 12000 dealers and distributors in India and a robust export presence brighten prospects significantly. GRLM has a production capacity of 14 mn laminate sheets which can be easily scaled up without entailing high capex. The company has also recently expanded its presence to other categories such as engineered wood flooring under the brand called Mikasa and engineered door solutions. It is the first company in India to manufacture these product segments.

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Among the World's top 3 laminates producer

GRLM has 2 state-of-the-art manufacturing facilities with combined capacity of 14mn sheets, the largest in Asia. Also, its 4.2MSM decorative veneer capacity is the largest in India. The company enjoys market leadership with a share of 18% in the organised domestic market and 35% share in the export market, rendering it a leader in both the markets.

Extensive geographical presence underpinned by deepening each

Exports account for 45% of GRLM's sales and the company's exports have been clocking 15% CAGR over the past 5 years. It has a strong presence in over 100 countries including the US, UK, Singapore, Hong Kong and UAE. The company has a strong pan-India distribution network with 11 company-owned large distribution centres, 32 branches and over 14,000 distributors, dealers & retailers. GRLM's focus is on consolidating and improving depth in existing markets in volume & value.

Bloomberg:	GRLM:IN
52-week range (INR):	1,067 / 561
Share in issue (cr):	2.4
M cap (INR cr):	2,412
Avg. Daily Vol. BSE/NSE :('000):	3
Promoter Holding (%)	54.7

Vibrant and innovative portfolio to drive revenue spurt

With diversified product offerings and new variants, GRLM has a huge scope to gain market share with enhanced utilisation and penetration of new variants. It is India's only manufacturer of engineered wood flooring and first organised manufacturer of engineered doors with 1MSM and 120,000 doors capacities, respectively. The engineered wood flooring is under the brand called Mikasa.

Outlook

We envisage addition of new and value-added products to propel GRLM's top line and margin. Unwavering focus on export and domestic markets leaves ample scope to expand and capture market share. Moreover, the laminates segment's capacity can be increased to 20mn sheets to cater to expanding market demands. The stock trades at 48x FY17 P/E.

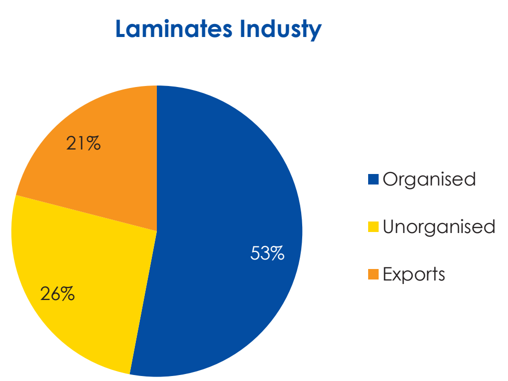
Year to March *	FY15	FY16	FY17
Revenues (INR Cr)	926	1,030	1,072
Rev growth (%)	-	11.2	4.1
EBITDA (INR Cr)	93	130	139
Net Profit (INR Cr)	19	38	50
P/E (x)	124.9	64.0	48.3
EV/EBITDA (x)	30.1	21.3	18.9
RoACE (%)	19.0	15.0	17.4
RoAE (%)	17.6	16.2	18.6

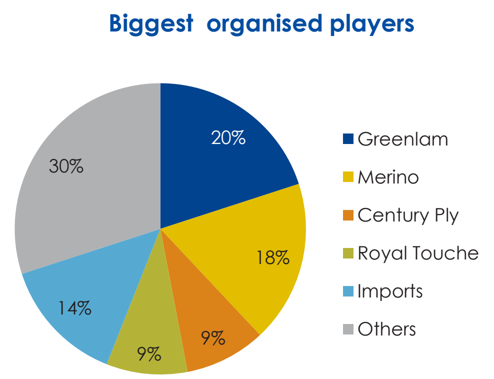
*Greenlam got demerged from Greenply in FY14 and hence financials available from FY15

Date: 4th December 2017

Market leader in export and domestic laminates markets

GRLM is the market leader in the domestic laminates market with 18% share in the organised domestic industry.

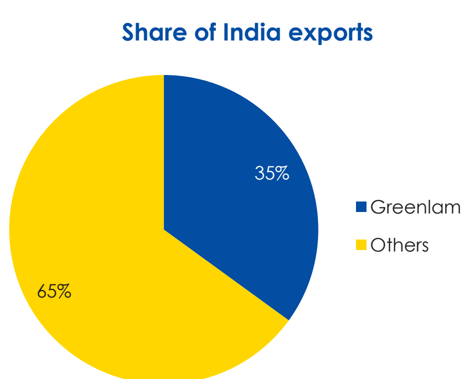


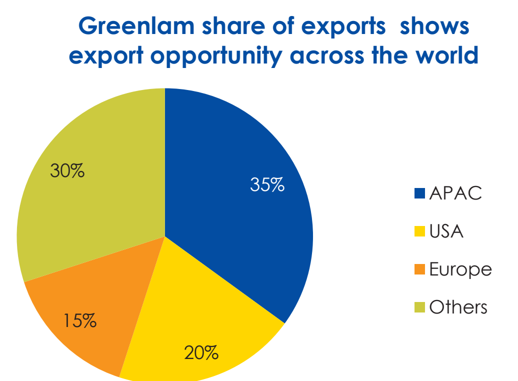


Source: Company, Edelweiss Investment Research

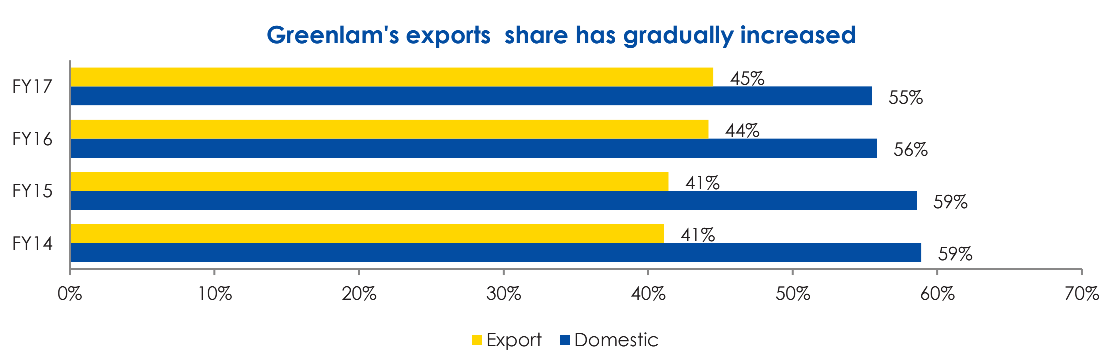
Biggest laminates exporter from India

While the global laminates market is estimated at USD7bn, clocking 2-3% CAGR, Indian exports are pegged at mere INR1,000cr, thus entailing huge export opportunity. GRLM is the biggest exporter from India with nearly 35% share.





Source: Company, Edelweiss Investment Research



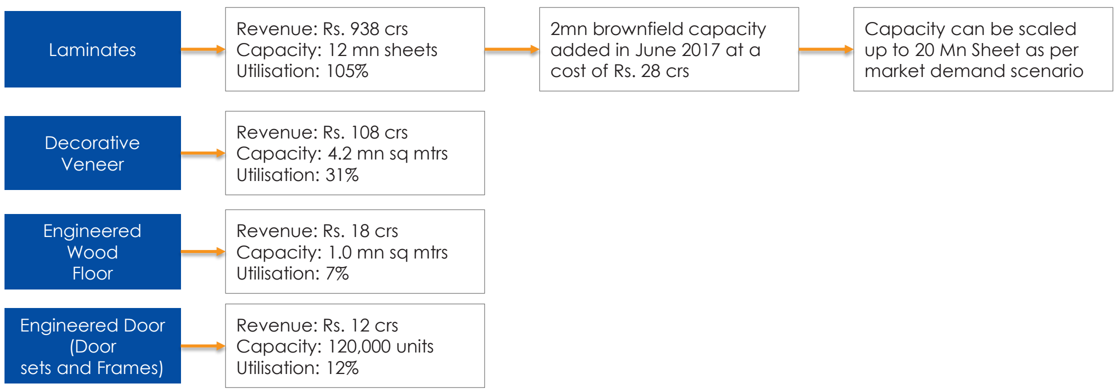
Source: Company, Edelweiss Investment Research

Capacity in place to cater to anticipated demand uptick

GRLM has added a 2mn sheets brownfield capacity in June 2017, which can be scaled up to 20mn sheets without significant capex to cater to additional demand. It is the first and the only domestic company to manufacture engineering wood flooring and door sets with a capacity of 1MSM and 120,000 doors, respectively.

Product	Capacity	Status
Laminates and compact laminates	12.02 mn sheets	Largest in Asia
Decorative veneers	4.20 mn sq.m	Largest in India
Melamine-faced chipboard	2.00 mn sq. m	Complements the laminates and allied products range
Engineered wood flooring	1.00 mn sq. m	First and only manufacturer in India
Engineered door sets	0.12 mn doors	First and only manufacturer in India

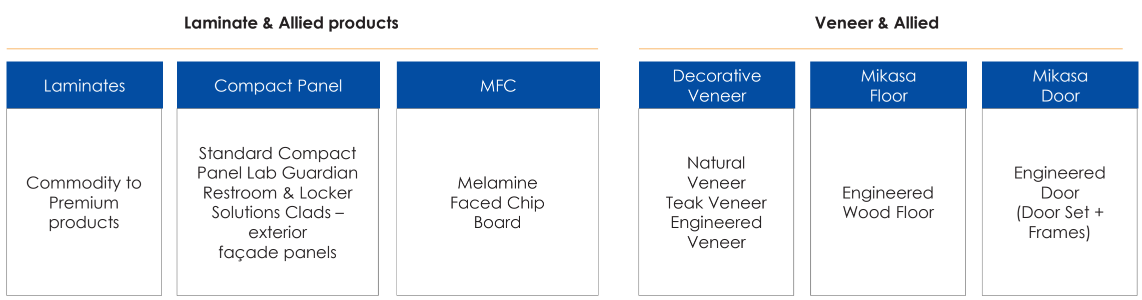
Source: Company, Edelweiss Investment Research



Source: Company, Edelweiss Investment Research

With diversified product offerings & new variants, GRLM has huge scope to gain market share going forward with increased utilisation and penetration of new variants.

Our Products



A large portfolio of surfacing product catering to various segments across price points

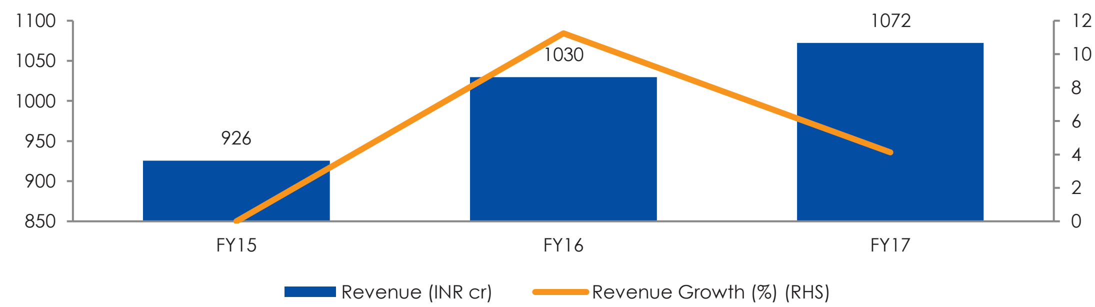
Source: Company, Edelweiss Investment Research

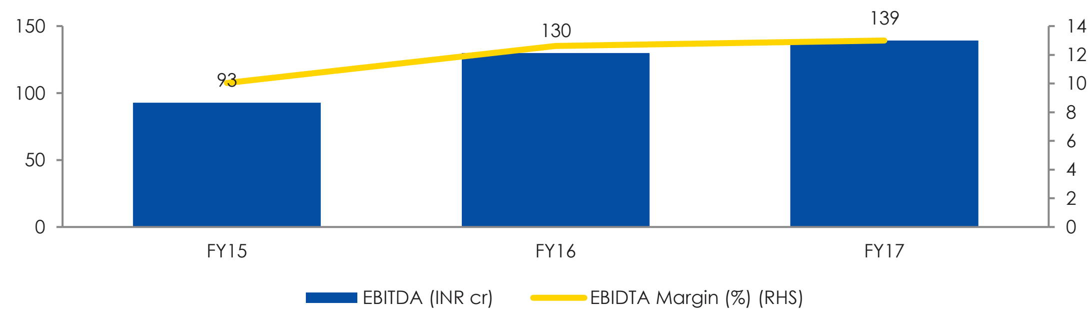
Robust distribution network

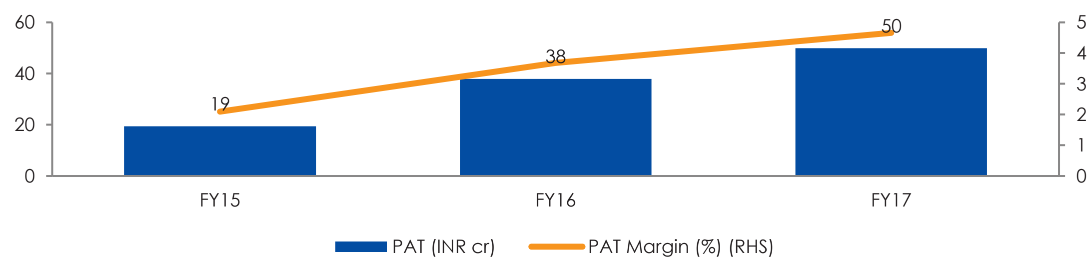
GRLM has a robust domestic distribution network with over 14,000 distributors, dealers & retailers, 11 distribution channels and 32 branches. The company also has a strong global footprint with presence in over 100 countries, 13 international offices and 4 overseas subsidiaries.

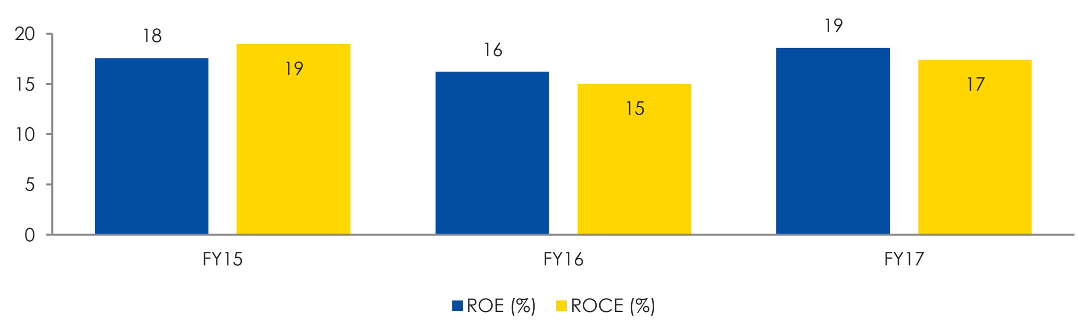
Financial Analysis

While GRLM's top line growth over the past 2 years has been subdued at 8% CAGR, the company's EBITDA clocked 22% CAGR over the past 2 years from INR 93cr in FY15 to INR139cr in FY17 owing to expanding margin in the laminates segment. PAT has registered even stronger spurt at 60% CAGR over the past 2 years.









Source: Company, Edelweiss Investment Research

*Greenlam got demerged from Greenply in FY14 and hence financials available from FY15

Financials

Income statement (INR cr)

Year to March	FY15	FY16	FY17
Income from operations	926	1,030	1,072
Direct costs	554	564	590
Employee costs	112	140	154
Other expenses	279	335	343
Total operating expenses	833	900	933
EBITDA	93	130	139
Depreciation and amortisation	33	35	37
EBIT	60	95	102
Interest expenses	33	35	30
Other income	2	3	4
Profit before tax	28	62	76
Provision for tax	9	25	26
Core profit	19	38	50
Extraordinary items	0	0	0
Profit after tax	19	38	50
Minority Interest	-0	-0	-0
Share from associates	0	0	0
Adjusted net profit	19	38	50
Equity shares outstanding (mn)	2	2	2
EPS (INR) basic	8.0	15.6	20.7
Diluted shares (Cr)	2.4	2.4	2.4
EPS (INR) fully diluted	8.0	15.6	20.7
Dividend per share	0.5	1.0	1.5
Dividend payout (%)	6.3	6.4	7.3

Common size metrics- as % of net revenues

Year to March	FY15	FY16	FY17
Operating expenses	90.0	87.4	87.0
Depreciation	3.6	3.4	3.4
Interest expenditure	3.6	3.4	2.8
EBITDA margins	10.0	12.6	13.0
Net profit margins	2.1	3.7	4.7

Growth metrics (%)

Year to March	FY15	FY16	FY17
Revenues	–	11.2	4.1
EBITDA	–	39.9	7.2
PBT	–	119.1	22.1
Net profit	–	95.1	32.1
EPS	–	95.2	32.5

Balance sheet (INR cr)

As on 31st March	FY15	FY16	FY17
Equity share capital	12	12	12
Preference Share Capital	0	0	0
Reserves & surplus	208	233	279
Shareholders funds	220	245	291
Secured loans	292	345	225
Unsecured loans	101	20	0
Borrowings	393	365	225
Minority interest	0	0	0
Sources of funds	**613**	**610**	**515**
Gross block	480	539	559
Depreciation	152	186	219
Net block	328	353	341
Capital work in progress	9	4	5
Total fixed assets	337	357	346
Unrealised profit	0	0	0
Investments	0	0	0
Inventories	231	247	228
Sundry debtors	182	184	145
Cash and equivalents	6	5	8
Loans and advances	72	71	47
Other current assets	0	0	0
Total current assets	491	508	428
Sundry creditors and others	204	214	212
Provisions	2	3	6
Total CL & provisions	206	218	218
Net current assets	285	290	210
Net Deferred tax	-15	-26	-25
Misc expenditure	6	-11	-16
Uses of funds	**613**	**610**	**515**
Book value per share (INR)	91	102	120
	-0	-0	0

Cash flow statement

Year to March	FY15	FY16	FY17
Net profit	19	38	50
Add: Depreciation	33	35	37
Add: Misc expenses written off	-6	16	5
Add: Deferred tax	15	11	-2
Add: Others	-0	-0	-0
Gross cash flow	62	100	90
Less: Changes in W. C.	279	6	-83
Operating cash flow	-217	94	173
Less: Capex	371	55	26
Free cash flow	**-587**	**39**	**147**

Ratios

Year to March	FY15	FY16	FY17
ROAE (%)	17.6	16.2	18.6
ROACE (%)	19.0	15.0	17.4
Debtors (days)	72	65	49
Current ratio	2.4	2.3	2.0
Debt/Equity	1.8	1.5	0.8
Inventory (days)	91	88	78
Payable (days)	80	76	72
Cash conversion cycle (days)	82	77	55
Debt/EBITDA	4.2	2.8	1.6
Adjusted debt/Equity	1.8	1.5	0.7

Valuation parameters

Year to March	FY15	FY16	FY17
Diluted EPS (INR)	8.0	15.6	20.7
Y-o-Y growth (%)		95.2	32.5
CEPS (INR)	21.8	30.1	35.9
Diluted P/E (x)	124.9	64.0	48.3
Price/BV(x)	11.0	9.8	8.3
EV/Sales (x)	3.0	2.7	2.5
EV/EBITDA (x)	30.1	21.3	18.9
Diluted shares O/S	2.4	2.4	2.4
Basic EPS	8.0	15.6	20.7
Basic PE (x)	124.9	64.0	48.3
Dividend yield (%)	0.1	0.1	0.1

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Home Building Material Retail

Long Term Recommendation: Shankara Building Products Ltd.

Best of both worlds

CMP INR 1,640
Target INR 1,575
Rating: BUY

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Shankara Building Products (Shankara) is a leading organised retailer of home improvement and building products with presence across retail network of 114 stores in 9 states. The company caters to end-user segments in Tier 1, 2 and 3 towns, through its multi-channel sales approach, processing facilities and logistics capabilities. It ventured into the retail space in FY06 offering only steel-based products. However, the company realized the vast retail opportunity present in other home improvement and building products and has steadily expanded its SKUs in the retail channel to over 20,000 to become the leader. Expansion of product portfolio in favour of high margin offerings (plumbing, sanitary, flooring and electrical) and various macro tailwinds are potent enablers. We perceive Shankara to be an excellent proxy to play growth in the home building space as well as retail spurt in India. We, therefore, re-iterate 'BUY'.

Bloomberg:	SHANKARA:IN
52-week range (INR):	1,785 / 555
Share in issue (cr):	2.3
M cap (INR cr):	3,746
Avg. Daily Vol. BSE/NSE :('000):	133
Promoter Holding (%)	56.2

Efficient retail model

Shankara offers structural steel, cement, roofing solutions, plumbing, tiles, sanitary ware, water tanks, plywood, kitchen sinks and lighting at its retail outlets. Apart from providing its own branded products (CenturyRoof, Ganga and Loha), the company also offers third party brands. It has dominant presence in South India via retail network of 115 stores, which is expected to increase by 20 stores p.a. Shankara has clocked 24% average SSG in the past 3 years along with margin improvement from 5% in FY14 to 10% in FY17 in retail.

Humongous opportunity in home improvement retail, to be aided by macro tailwinds

The building materials market is estimated to touch INR 8 lakh cr in FY21, of which 38% or roughly INR 2.5 lakh cr will be through the retail network, thus providing a massive growth opportunity. Government push for affordable housing, Smart Cities, implementation of RERA, falling interest rates along with increase in urbanization and disposable incomes are huge macro positives for Shankara.

Outlook and valuations: initiate with 'BUY'

Retail has driven Shankara's financial metamorphosis over the past 3 years and this segment (currently 46% of revenue) will continue to grow faster than the other 2 segments, which will help the company sustain its recent transformation. Strong SSG of 20%, minimal capex spends on new stores and efficient working capital management will ensure RoCE improvement. Factoring in the opportunity size and macro tailwinds, we re-iterate BUY.

Initiation Date: 5th September 2017

Initiation Price: INR 1316

Year to March	FY15	FY16	FY17	FY18E	FY19E
Revenues (INR Cr)	1979	2036	2310	2530	2809
Rev growth (%)	2.7	2.9	13.5	9.5	11.0
EBITDA (INR Cr)	90	120	154	186	219
Net Profit (INR Cr)	23	41	60	86	108
P/E (x)	159.0	88.1	62.1	43.4	34.6
EV/EBITDA (x)	43.3	31.8	25.3	20.7	17.4
RoACE (%)	14.9	20.3	25.0	26.0	27.0
RoAE (%)	9.3	15.0	17.6	19.7	20.3

Date: 4th December 2017

Price Target	**INR 1,575**	Our TP is arrived at by assigning a 35x P/E multiple to the retail segment and 7x EV/EBITDA to the channel and enterprise segment. We are assuming an SSG of 20% for retail (below last 3 years average of 24% SSG) for both FY18E and FY19E
Bull	**INR 1,950**	Assuming a higher SSG of 25% for both FY18E and FY19E, and assigning a higher 40x P/E to the retail segment and 8x EV/EBITDA to the channel and enterprise segment on FY19E numbers, we arrive at a TP of 1,950
Base	**INR 1,575**	Assuming our base case scenario of 20% SSG (below last 3 years average of 24% SSG) for retail for both FY18E and FY19E. Giving a 35x P/E multiple to the retail segment and 7x EV/EBITDA to the channel and enterprise segment, we arrive at a target price of 1,550
Bear	**INR 1,225**	Assuming a lower SSG of 15% for both FY18E and FY19E, and assigning a lower 30x P/E to the retail segment and 6x EV/EBITDA to the channel and enterprise segment on FY19E numbers, we arrive at a TP of 1,225 and hence we feel that there is no significant downside from the current levels.

Shankara Building Products Ltd.

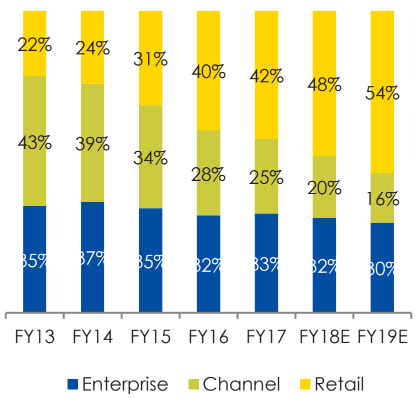
Average Daily Turnover (INR cr)			Stock Price				Relative to Sensex, CAGR (%)			
3 months	5 months	1 year	1 month	3 months	5 months	10 months	1 month	3 months	5 months	10 months
3.2	3.6	NA	22%	48%	98%	NA	-2%	2%	6%	NA

Business Value Drivers

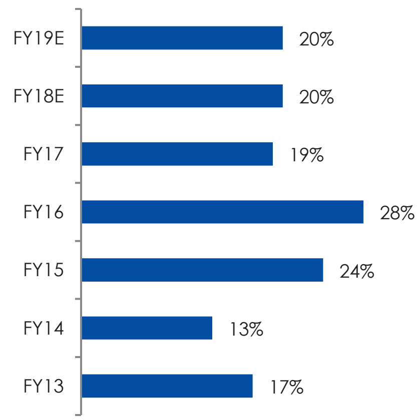
Nature of Industry	Retail of home improvement and building material is still at a nascent stage with Shankara being the biggest organised player in this space.
Opportunity Size	Building materials industry is estimated to post 8.0-8.5% CAGR to INR 7 lac cr by FY21, of which ~35% will be sold through the retail network, thus entailing a market opportunity size of INR 2.5 lac cr.
Capital Allocation	Capex will be for debottlenecking of processing facilities, inventory and for the planned opening of 20 stores each year. Total capex could be between INR 30-40 Cr per year.
Predictability	Going by the past 3 years' performance, which has been consistent despite challenges like demonetization, GST and higher focus on turning around prior acquisitions, we believe the next 2-3 years should be predictable.
Sustainability	As Shankara has hardly tapped the vast opportunity size of this industry, we believe SSG of 20% plus and 25-30% top line growth in retail will be sustainable for the next few years on a small base.
Disproportionate Future	Retail has driven the financial transformation over the past 3 years and this segment (currently 46% of revenue) will continue to grow faster than the other 2 segments, which will help Shankara sustain its recent transformation. As the share of retail revenue continues to rise, we anticipate meaningful change in margins and return ratios in the future.
Business Strategy & Planned Initiatives	Shankara's core focus will remain on the retail segment, wherein the company is planning 20 store openings p.a. for the next few years. Existing stores are being simultaneously upgraded with new higher-margin products.
Near Term Visibility	Near-term visibility remains strong as SSG and new store addition should significantly aid top line in retail. With only 114 stores across South India, near-term growth should not be a concern.
Long Term Visibility	Although the company has not outlined long-term plans or targets, Shankara's retail model is definitely scalable in the long term.

Focus Charts – Story in a nutshell

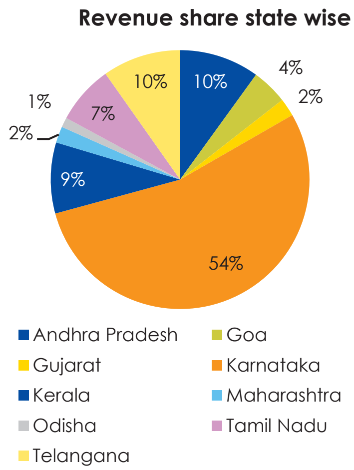
Share of Retail Revenues to increase



To be driven by strong SSG in retail

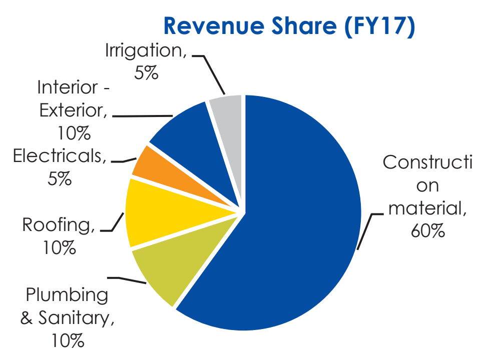


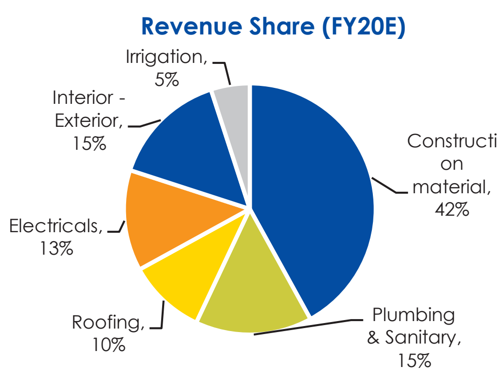
And vast untapped opportunity



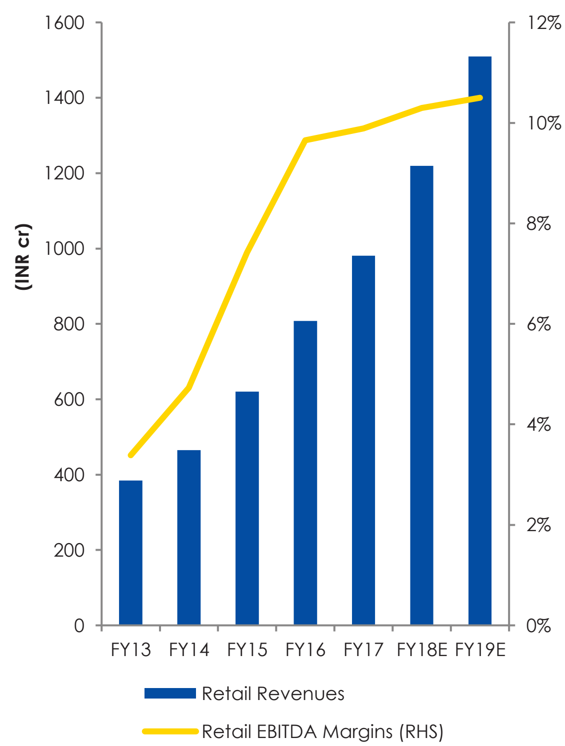
Expansion of product portfolio in favour of high margin offerings to lead to higher gross margins

(plumbing, sanitary, flooring and electrical)





Retail segment will continue to drive financial transformation of Shankara



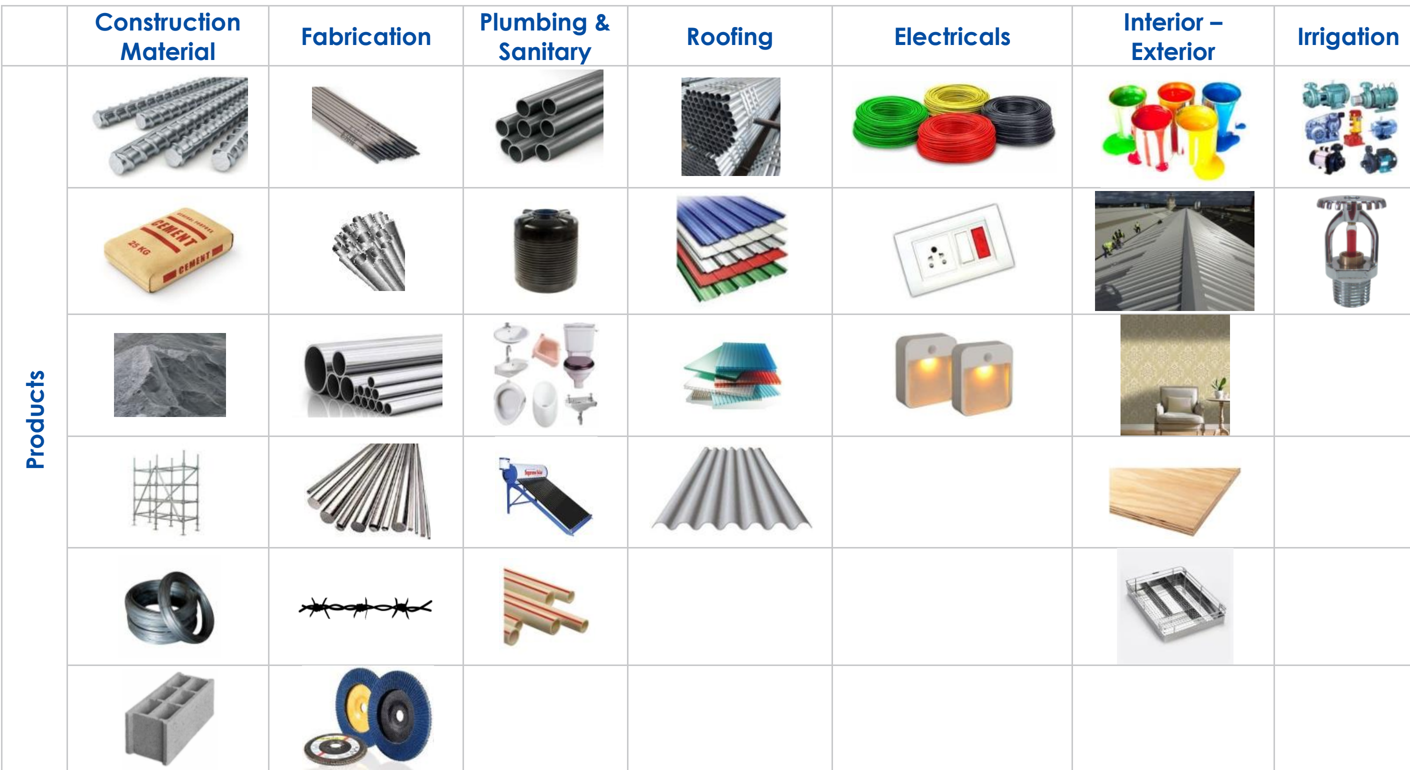
Source: Company, Edelweiss Investment Research

I. Shankara's retail segment: At nascent stage

A) One stop shop to capture full construction cycle

Although Shankara debuted in the retail segment in FY06 with first store, it has taken a while to scale up. The company was initially present only in retail of construction material and fabrication. However, gradually it has expanded its product portfolio to cover products required for the entire construction cycle of 18-24 months for a home owner building his house from scratch.

Shankara's comprehensive product range—SKUs scaled up from 6,800 in FY13 to 20,000 in FY17



Source: Company, Edelweiss Investment Research

Shankara currently sells most top brands in South India in each home improvement and building material segment. It is planning to soon house the top 3 pan-India brands in all its retail stores. Also, with expansion of its product portfolio, the company has seen rise in footfalls of end home owners (owners of houses of average 2000 sq ft) in its retail shops as its outlets have matured from a mere hardware store to a one-stop stop for all home improvement and building material. Retail clients include home owners, professional customers (architects, contractors, plumbers) and small enterprises.

Shankara's current 3rd party and own brands – 3rd party brands scaled up from 16 in FY13 to 100 in FY17

	Construction Material	Plumbing & Sanitary	Flooring	Electricals	Interior – Exterior	Irrigation	OWN
Some of Shankara's Brands	JSW Neosteel Pure TMT Bars	Somany	Kajaria	Philips Lighting	Alstone	Astral Pipes	Ganga
	ACC	hindware	Greenply Plywood	Havells	Futura Sinks That Think	Finolex gets people together	Taurus
	Zuari Cement Italcementi Group	ashirvad	Archidply	Crompton Greaves Everyday Solutions	Carysil	Vishakha Irrigation Pvt. Ltd	Prince wire
	UltraTech Building Products	Roca	Centuryply	GM Switch to a better world	Berger Paints	Jindal Aluminium Ltd.	Prince Galva GI Pipes
	Essar Steel	Johnson Redefining Lifestyles, Worldwide.	Johnson Redefining Lifestyles, Worldwide.	Finolex gets people together	GEM Paints	APL Apollo Tubes for every reason	Shankara Solar
	Kamdhenu Steel	Parryware			Swastik Roofing	Supreme People who know plastics best	Loha
	Norton Saint-Gobain	Cera			Everest Roofing Solution		Century Roof
	Bosch	Texmo Pipes and Products Limited					
	Hitachi Inspire the Next	Sintex					

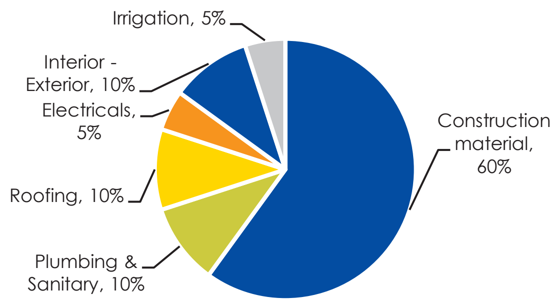
Source: Company, Edelweiss Investment Research

A) Widening and changing product mix: Gross margin kicker

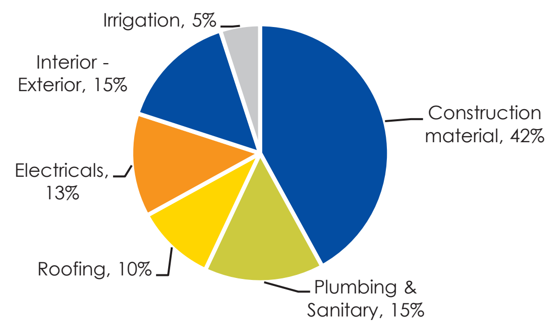
Currently, own products/brands in the construction material and roofing segments (Shankara only processes/customizes products) contribute 55% to revenue of retail shops. This is expected to dip to 25% gradually post addition of new products such as plumbing, sanitary, flooring and electrical in new and old stores. Moreover, the company is planning to refresh at least 10% of SKUs every year to keep up with latest trends. Also, product mix in stores will depend on consumer preferences in a particular area as assortment of products will be key to generate higher SSG and ensure a moat for the business.

Revenue mix to change post addition of new product categories

Revenue Share (FY17)



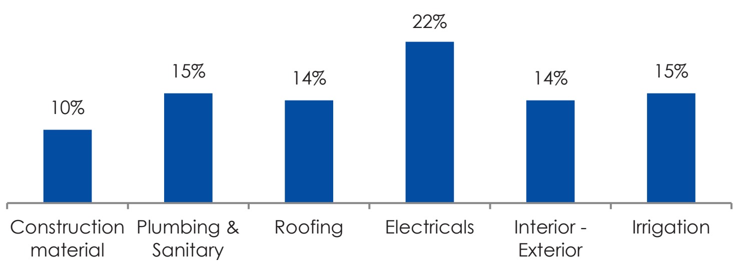
Revenue Share (FY20E)

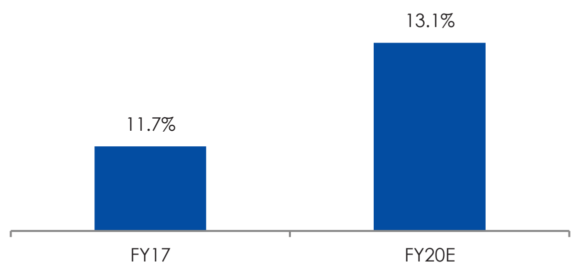


Source: Company, Edelweiss Investment Research

Margins in new product categories such as plumbing, sanitary, flooring and electrical are higher than traditional products, which will aid gross margin expansion. Shankara is upgrading all its stores with the extended product range—has upgraded 15 stores till now and on the anvil is upgrade of 30 more in FY18 and 70 stores by FY19. Only 2 of the 15 upgraded stores are marginally below target, to rectify which the company has already undertaken measures to improve customer proofing. It still sources from a distributor for most of its products. Scale has been achieved only in its traditional product segments such as basic construction material like different steel tubes & bars and in roofing. Post achieving scale in other products as well, the company will have higher bargaining power, which could aid gross margin expansion.

Increasing share of higher gross margin products and increasing bargaining power with suppliers to aid gross margins



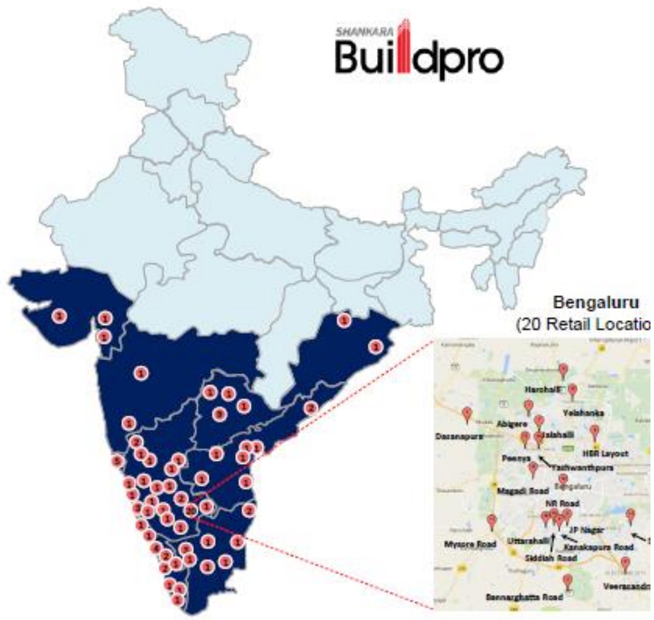


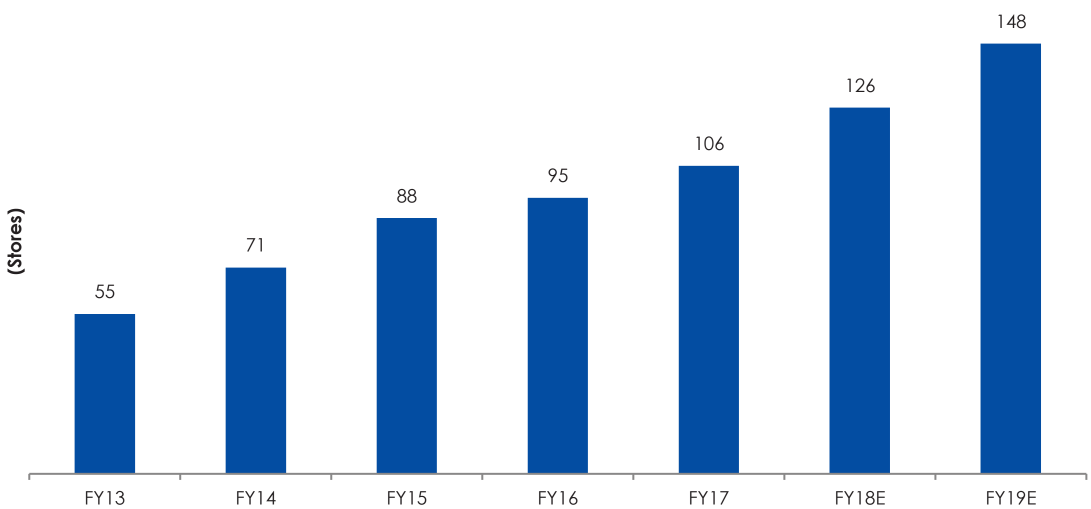
Source: Company, Edelweiss Investment Research

B) Ample headroom for retail revenue expansion

Shankara currently has 114 retail outlets across 9 states in South India. The company is planning to add 20 stores p.a. in the next 2-3 years, restricted to South India, depending on consumer behaviour and demand.

Shankara plans to add 20 stores every year to the 106 stores at the end of FY17



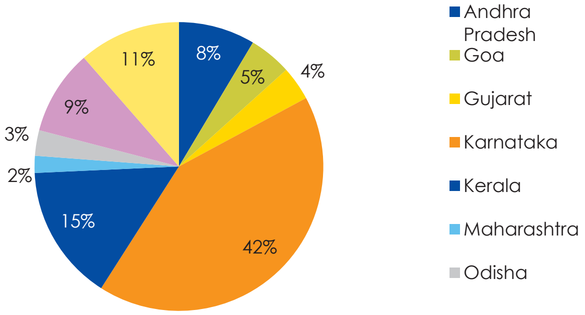


Source: Company, Edelweiss Investment Research

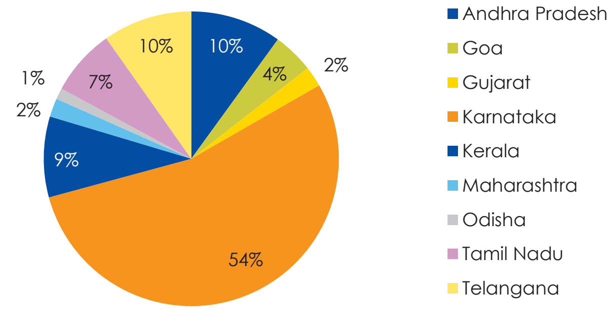
A deep dive analysis reveals that the company's revenues and stores are largely concentrated in Karnataka—41% stores and 54% revenue. Even within Karnataka, 20 of the 44 stores are present in Bengaluru, which currently generates INR 300 cr revenue with 20% growth. Veera Sankara, a 10,000 sq ft store in the Electronic City, clocks INR 50 cr sales p.a. and there is potential to have 40 stores in the garden city itself. Convenience is of prime important as consumers do not want to commute and hence there is ample head room to grow.

41% of Stores and 54% of revenues is currently from Karnataka only, thus providing lot of headroom for growth

Stores Breakup



Revenue share state wise

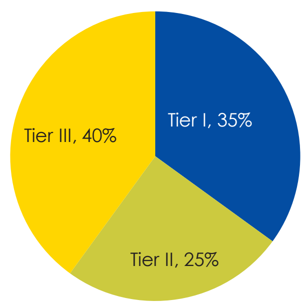


Source: Company, Edelweiss Investment Research

Revenue growth and store additions are likely across Tier 1, 2 and 3 cities, as seen historically. Shankara has opened the highest stores in Tier 3 towns over the past few years wherein its revenue share has increased from 30% to 40%. Tier 1 is the next strongest growth area for the company with Tier 2 yet to gain traction.

Tier 3 has been the strongest growth area for Shankara, followed by Tier 1

FY17 Revenue mix across Cities



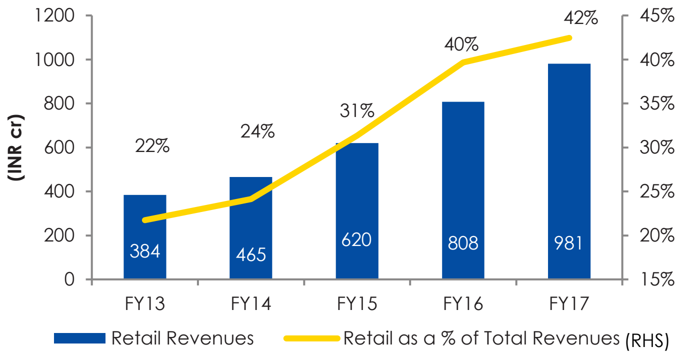
Tier 1	**FY14**	**FY17**
Stores	23	32
Revenues (INR Cr)	180	350
Revenue per store	7.8	10.9
Tier 2		
Stores	27	33
Revenues (INR Cr)	140	229
Revenue per store	5.2	6.9
Tier 3		
Stores	21	43
Revenues (INR Cr)	145	379
Revenue per store	6.9	8.8

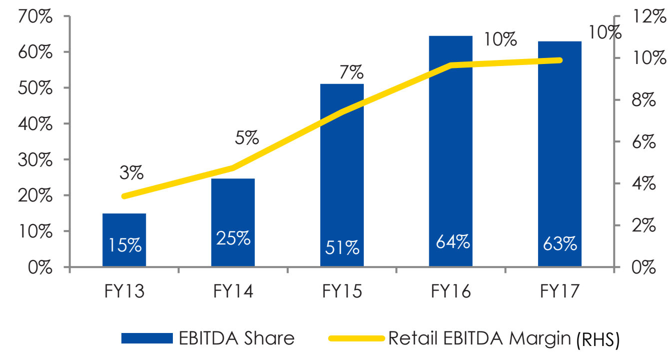
Source: Company, Edelweiss Investment Research

II.Shankara's retail segment has witnessed robust growth and profitability

Shankara has seen stupendous growth in top line and margin over the past few years. While retail top line has jumped 2.5x from INR 384 cr to INR 981 cr in 4 years, EBITDA margin has expanded from 3% in FY13 to 10% in FY17.

Retail Sales have grown 2.5x in 4 years and EBITDA has grown from INR 22 Cr in FY14 to INR 97 Cr in FY17





Source: Company, Edelweiss Investment Research

A) Various improving factors....

Shankara has provided details of per store dynamics and overall retail performance which shows improvement on all parameters over the years. From per store figures, to per sq ft figures, there is consistent growth. In fact, as new products are introduced, we estimate the growth trend to sustain for the next few years.

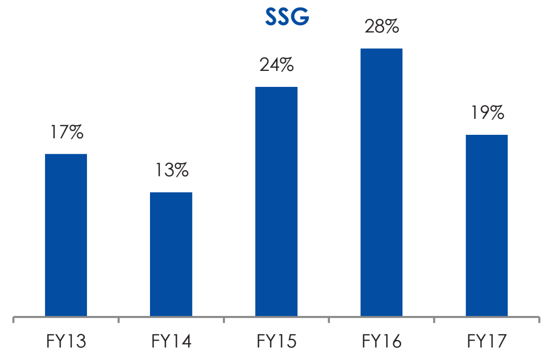
RETAIL	FY13	FY14	FY15	FY16	FY17
Per Store Revenue	7.0	6.5	7.0	8.5	9.3
Per Store EBITDA	0.2	0.3	0.5	0.8	0.9
Per Sq Ft Revenue	21333	21136	21379	25250	25816
Per Sq Ft EBITDA	722	1000	1586	2438	2553
Average Ticket Size (INR)	18545	20617	19358	20413	23244
Annual transactions	149947	225375	319935	395697	421926

Source: Company, Edelweiss Investment Research

B) Spearheaded by robust SSG surge

The improving financials on per store and per sq ft basis are due to strong SSG—~20% over the past 3 years. A deep dive analysis of SSG numbers indicates that new stores take time to mature and generate revenue, while sales per store of older stores have grown steadily from INR 6.1 cr in FY14 to INR 9.1 cr in FY17.

	FY14	FY15	FY16	FY17
Retail Sales	465	620	808	981
SS Sales	434	577	794	962
SSG	**13%**	**24%**	**28%**	**19%**
New addition Sales	31	43	14	19
Stores	71	88	95	106
Addition	16	17	7	11
Total	87	105	102	117
Sales (existing) Per Store	**6.1**	**6.6**	**8.4**	**9.1**
Sales (new) Per Store	1.9	2.6	2.1	1.8



Source: Company, Edelweiss Investment Research

C) Robust store level economics

Shankara's retail division is highly profitable due to robust store level economics of minimal capex and opex. Rent, which is generally one of the highest opex costs for modern retail, is less than 1% of revenue for Shankara as rather than leasing space in high street malls, the company leases land. The total initial capex per store is only INR 50 lac for fixtures and inventory each. Any store can be easily dismantled and relocated with only 10% loss to the original cost due to minimal fixture spends on a store. It has closed only 1 store till date.

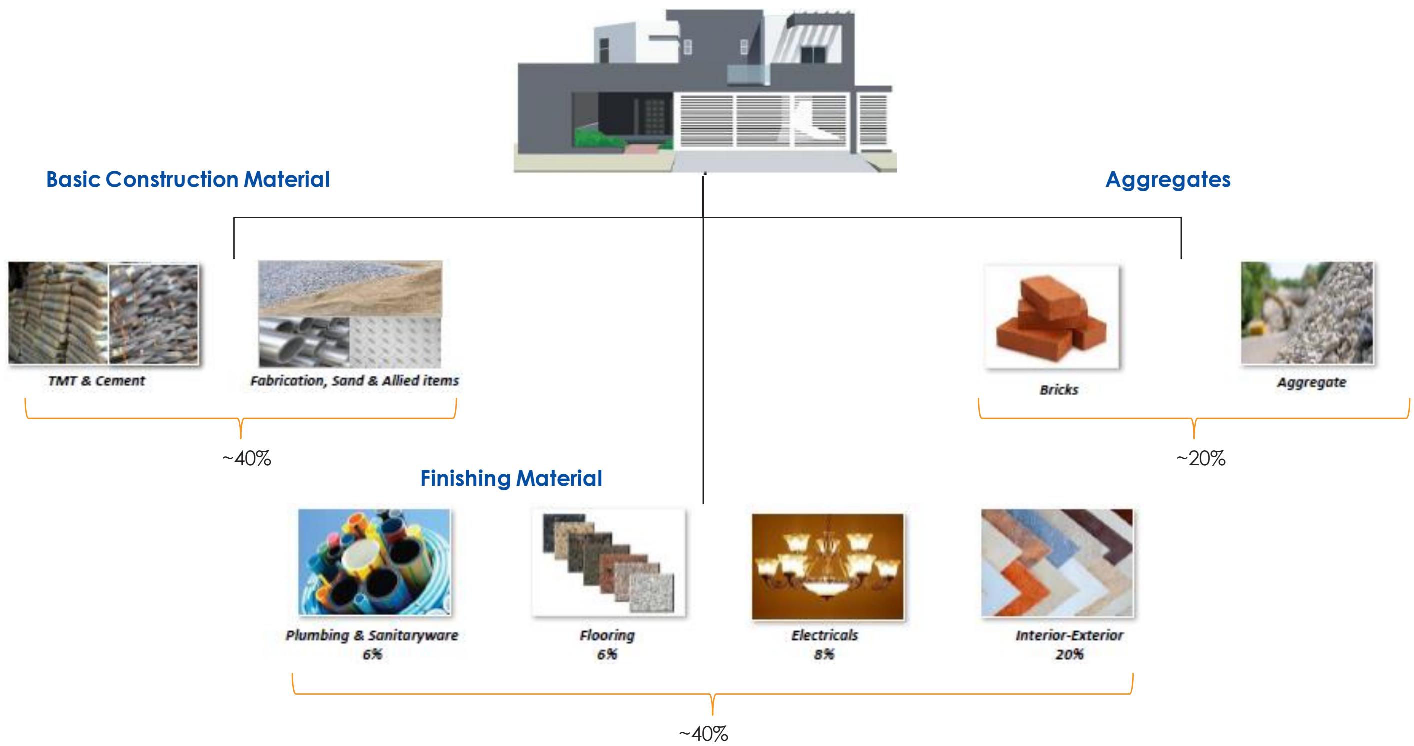
Store Dynamics (5000 sq ft)	New Store (1st year)	Mature Store (ended 2nd/3rd year)
Revenues (INR Lakh)	480	1560
Gross Margin	10%	12%
Gross Profit (INR Lakh)	48	187
Overhead (INR Lakh)	10	15
Lease Rental (INR Lakh)	13.4	14.1
EBITDA (INR Lakh)	24.6	158.2
EBITDA Margin	5.10%	10.20%
Capex (INR Lakh)	50	50
WC (INR Lakh)	50	100
Total Capex (INR Lakh)	100	150

III. Industry Overview: Big opportunity size with macro tailwinds and no formal competition

A) Huge scale up potential due to massive opportunity size

Shankara is present in the entire gamut of building materials in its retail network. Product assortment is different in different stores as per consumer demands and preferences, but every store will house materials used for the entire construction cycle of 18-24 months.

Materials required for a home construction - Shankara's retail network houses all of the following products



The market size of materials mentioned above is estimated to clock 8.0-8.5% CAGR to INR 7 lac crore by FY21, of which ~ 35% will be sold via the retail network, thus entailing a market opportunity of INR 2.5 lac crore pan India.

Source: Company, Edelweiss Investment Research

B) Various tailwinds can aid Shankara

Shankara's expected SSG of 15-20% can materially improve in the future with the aid of various government initiatives such as *Housing for All, Smart Cities*, RERA, *Swacch Bharat Abhiyan*, etc. In addition, there are many macro economic factors that can spur SSG such as urbanisation, rising per capita disposable incomes, easy finance availablity, etc.

Retail Home Improvement Drivers

Population Growth	Increase in Population is expected to see housing demand touch 285mn from 246mn households
urbanization	Nearly 36% of India is expected to live in Urban India by 2020 from the 31% in 2011
Increase in Income levels	India's per capital disposable income is on an uptrend having risen from Rs. 73,476/- in 2012 to Rs.107,817/- in 2016
Nuclear Families	Increased nuclearization on account of formation of small families out of large families, increased mobility of labour in search for job opportunities is expected to increase housing demand
Finance Availability	Easy availability of finance is expected to boost housing segment and serve as a potent driver for Building Products
Product & Brands	Customers are increasingly aware of innovative products and brands across each Product line
Changing Trends in Renovation	Home Renovations is no longer linked to major life events but is a reflection of one's personality. The frequency of renovation has undergone a major change

Source: Company, Edelweiss Investment Research

C) Very few segments penetrated by retail and that too is fragmented

Except for tiles and plywood, most other segments are under-penetrated in retail, resulting in lesser competition for Shankara. Retail channel sales are also currently fragmented, thus providing significant opportunity for a player like Shankara to rapidly capture market share.

Particulars	Market Size (IN INR bn) in 2015-16	Growth Forecast for next 5 years	Share of Organized vs. Unorganized	Typical levels of Customer involvement in purchase of products (Home Owners)	Indicative share of sales via retail channels
Cement	1,300-1,400	8.0%-8.5%	75%	25%	50%
Structural Steel	1,300-1,400	7.0%-8.0%	75%	25%	25%
Bricks	600-650	8.0%-10.0%	75%	25%	25%
Paints	385-395	12.0%-14.0%	75%	75%	50%
Plumbing – PVC Pipes	260-170	10.0%-12.0%	50%	25%	25%
Ceramics Tiles & Sanitaryware	250-255	10.5%-11.0%	50%	75%	75%
Plywood & Laminates	245-250	11.0%-11.5%	25%	75%	75%
Lighting	180-185	11.0%-13.0%	75%	75%	50%
Total	**4,520-4,805**				

Source: Company, Edelweiss Investment Research

IV. Processing facilities contribute ~50% of retail sales and cater to the enterprise segment

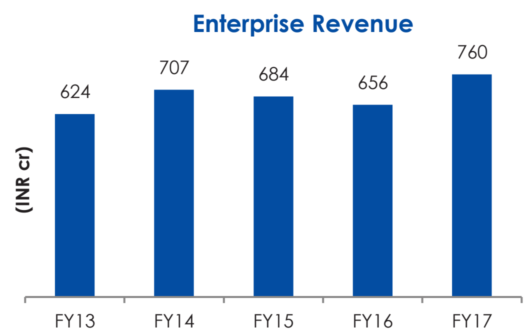
Facilities give presence across value chain alongwith strong vendor network and association with brands which helps in retail

Shankara has 12 backward integrated processing facilities with an installed capacity of ~3,25,000 TPA operating at 94% capacity utilization over the past few years. In these facilities, he company assembles and processes steel pipes, colour coated roofing sheets, bright rods, galvanized strips and cold rolled strips. It sells these products under its own brands like *Century Roof, Ganga, Loha, Taurus* and *Prince Galva*. These products contribute 50% to sales via the retail segment.

Facilities help cater to the enterprise segment which is expected to clock moderate growth

The below mentioned capacities and products help cater to bulk orders of contractors and OEMs, primarily for steel pipes and tubes. The India ERW steel pipe market is pegged at ~7 mt and INR 30,000 cr, but it is growing at a rapid pace as these pipes have found preference in modern infrastructure (airport, mall, metro, bus body and pre fabricated structure) versus traditional use in auto, oil & gas and water transportation, etc.

Capacity	FY14	FY15	FY16	FY17
Steel Pipe & Tube	1,13,000	1,51,400	1,98,600	2,31,600
Galvanized Strip	36,000	36,000	42,000	42,000
Roofing Sheet	10,000	19,200	27,600	32,800
Bright Rods	800	6,000	6,000	6,000
Cold Rolles Strips	8,000	10,000	12,000	1,20,000
Stainless Steel				1,200
Total	**1,67,800**	**2,22,600**	**2,86,200**	**3,25,600**



Source: Company, Edelweiss Investment Research

The customer base is spread across industries like auto ancillaries, boiler manufacturers, electrical panel boards, textile machinery, medical equipment & pharmaceuticals, plantation equipment, renewable energy, etc.. These customers regularly require customized products (kit based, cut-to-size, ready-to-use assembled products) with timely delivery. Shankara also caters to one-off requirements of projects, including space frames for airports, metro stations and malls, city skywalks, airport tubular structures and road dividers. Its dependence on any specific customer is very low, as Top 10 customers account for less than 10% of total revenue.

Robust back end infrastructure to support own products sales and enterprise segment

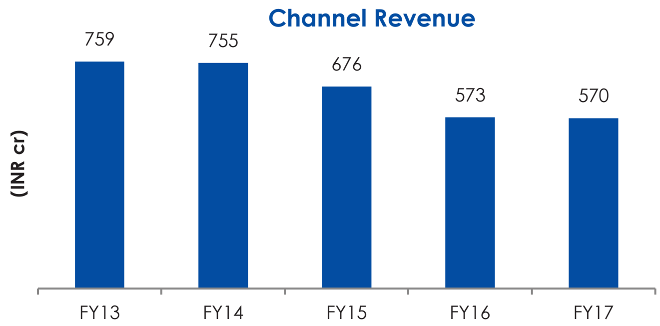
Shankara's supply chain and logistics network is through its 56 warehouses and 44 owned trucks. The company has a warehouse space of 0.59 mn sq ft, which is largely owned. The warehouses act as storage facilities for delivery of merchandise to stores and enterprise clients, ensuring timely delivery. GST has had a positive impact as it has enabled seamless movement across states.

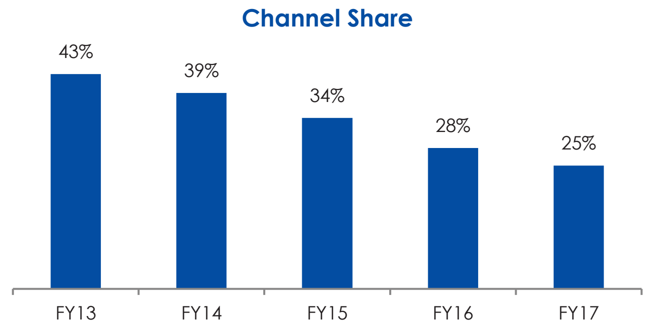
ERP and MIS controls across all segments

ERP and MIS controls are key to understanding customer preferences in different locations. For retail SSG, product assortment is key and hence coordination between teams is important. These systems help monitor inventory levels, allocation of products to stores and budget planning, which aids overall efficiency.

V. Channel segment though declining helps guage the market

Shankara curently has 1,924 dealers in its channel segment spread across central and South India. As margins in this business are declining, the company has taken a concious decision to dim focus on this segment—revenue contribution has plummeted from 43% in FY13 to 25% in FY17. However, it has not exited the channel segment as it helps the company have its fingure on the pulse for geographies for new stores, customer peferences and demand for new product segments, etc., and therefore aids retail expansion.

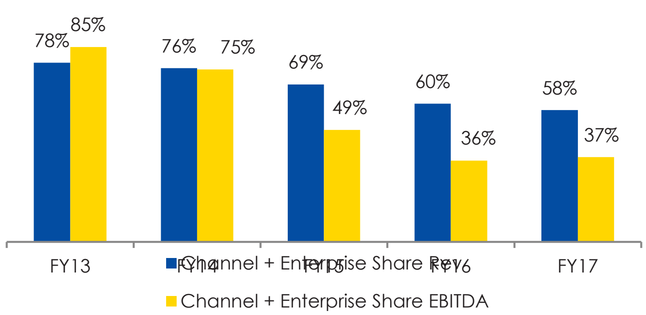


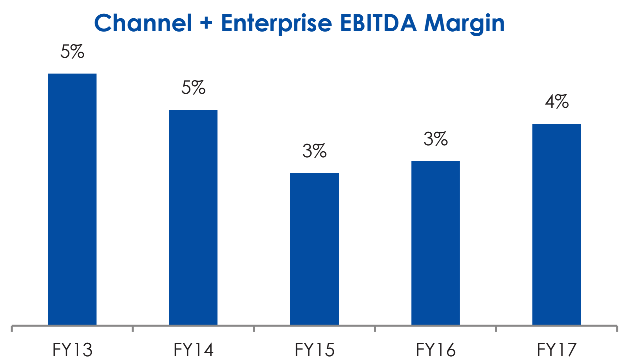


Source: Company, Edelweiss Investment Research

Channel and enterprise share to continue to decline

Over the past few years, channel and enterprise margins have been flattish due to higher focus on working capital. Going forward as well we do not expect any big uptick in margins of these segments. Also, as retail share keeps expanding, share of channel and enterprise segments will continue to decline. As these are lower margin and RoCE segments compared to retail, it bodes well for Shankara's overall financials.





Source: Company, Edelweiss Investment Research

TIMELINE

1995
Started as a distributor of steel pipes and tubes

2003
Opened an integrated warehousing facility of 55,000 sq.ft. in Bangalore and achieved INR 100 Cr revenues

2006
Shankara opened its first retail shop in Bangalore

2007-08
Commenced retail operations in other states like Gujarat, Goa and Orissa

2009
Achieved INR 100 Cr revenues in the retail segment

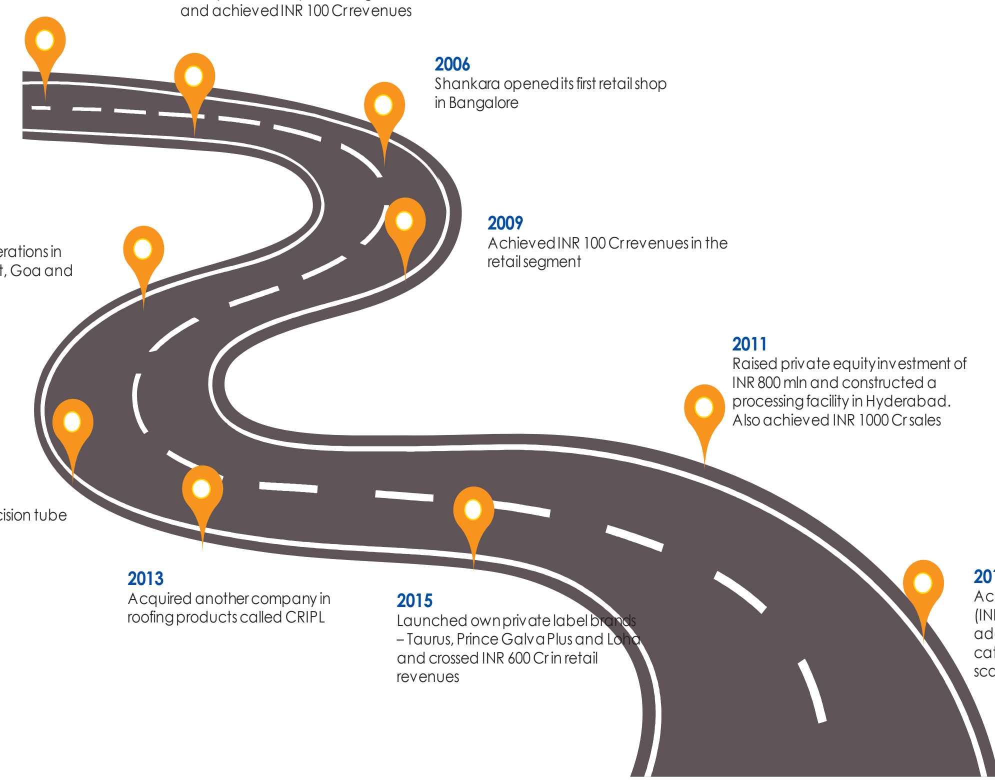
2010
Acquired VPSPL - a precision tube processing unit

2011
Raised private equity investment of INR 800 mln and constructed a processing facility in Hyderabad. Also achieved INR 1000 Cr sales

2013
Acquired another company in roofing products called CRIPL

2015
Launched own private label brands – Taurus, Prince Galva Plus and Loha and crossed INR 600 Cr in retail revenues

2016
Achieved INR 2000 Cr turnover (INR 800 Cr in retail) and added new products categories – cement, tiles, scaffolding and solar products



VI. Valuations & Peers

Retail has driven Shankara's financial transformation over the past 3 years, which has helped the company clock PAT growth of 28% with company level margin improving from 4.6% in FY14 to 6.7% in FY17. The retail segment (currently 46% of revenue) will continue to grow faster than channel and enterprise segments, which will help Shankara sustain its recent transformation. Strong SSG of 20%, minimal capex spends on new stores and efficient working capital management will ensure improvement in RoCE. Factoring in the opportunity size and macro tailwinds, we have done an SOTP valuation assigning 35x FY19E P/E to Shankara's retail business. We re-iterate BUY and believe it is the best proxy to play the anticipated growth in building materials and retail in India.

	FY19E		FY19E
Retail PAT (INR Cr)	92	Enterprise + Channel EBITDA (INR Cr)	58
P/E	35	EV/EBITDA	7
Retail Market Cap (INR Cr)	3234	EV (INR Cr)	409
		Less:Debt (INR Cr)	120
		Enterprise + Channel Market Cap (INR Cr)	289

Our domestic peer universe includes home building material players and retailers as there is no pure play competition. International players like Home Depot and Lowe which are in similar line of business as Shankara (retail of home building materials) have been included in the peer comparison below. However, Shankara's bottom line growth along with robust capital efficiency in the retail segment are superior to most peers inspite of which it trades at a discount to most of them.

	Revenue Growth (FY17-19E)	PAT Growth (FY17-19E)	ROCE (FY19E)	P/E (FY19E)	EV/ EBITDA (FY19E)
D Mart	30%	37%	20%	71x	33x
Home Depot	5%	18%	31%	18x	11x
Lowe	4%	14%	16%	14x	8x
Kajaria	15%	26%	24%	28x	14x
Havells	25%	25%	32%	32x	20x
Finolex	12%	8%	22%	17x	11x
Shankara (Retail)	**25%**	**40%**	**50%**	**26x**	**15x**

Key Management

Name	Designation	Profile
Mr. Sukumar Srinivas	*Managing Director*	Mr. Sukumar Srinivas is the promoter and has 33 years of experience in the building products industry. He holds a bachelor's degree in commerce from Loyola College, Chennai, University of Madras, and a PGDBM from the IIM, Ahmedabad.
Mr. C. Ravikumar	*Executive Director*	Mr. C. Ravikumar has 29 years of experience in the steel pipes and building products industry. He holds a bachelor's degree in science from Bangalore University and has been associated with Shankara since 1995 and was appointed as a director of the company in 2001.
Mr. Siddhartha Mundra	*CEO*	Mr. Siddhartha Mundra was appointed CEO in June 2017 after having served as a nominee director of Fairwinds to the Board of the Company since 2011. He holds a bachelor's degree in engineering with specialisation in computer science from NIT, Warangal (formerly REC, Warangal) and a PGDBM from the IIM, Ahmedabad.
Mr. Alex Varghese	*CFO*	Mr. Alex Varghese joined the company on October 13, 1995. He holds a bachelor's degree in commerce from MG University and has been associated with Shankara for over 20 years

Key Risks

a. Dependent on third-party suppliers and sub-contractors

b. Slowdown in real estate

c. Increase in competition

d. Working capital challenges

Business Overview

Company Brief

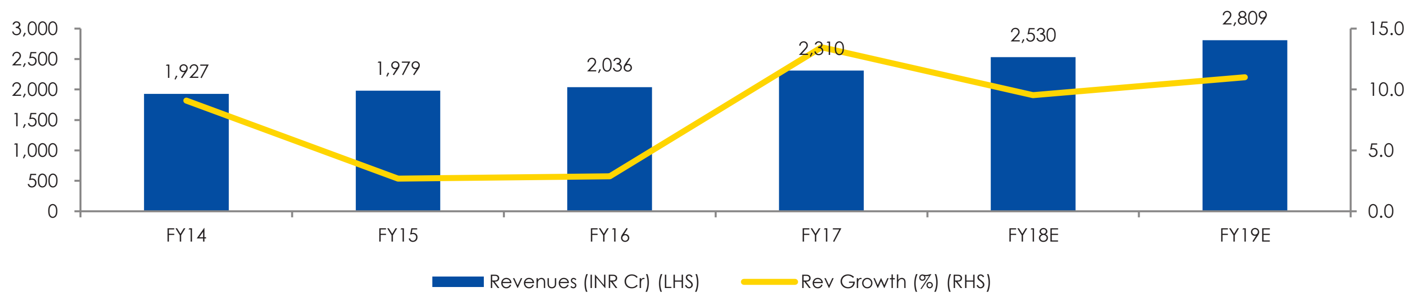
Shankara is a leading organised retailer of home improvement and building products with presence across a retail network of 114 stores across 9 states in India. The company caters to various end-user segments in urban and semi-urban markets through its multi-channel sales approach, processing facilities, supply chain and logistics capabilities. Apart from providing its own branded products (CenturyRoof, Ganga and Loha), it also offers products of third party brands like Johnson, Sintex, APL Apollo, Astral Pipes, etc. Shankara also has 12 processing facilities with an installed capacity of 3,24,200 tpa which can be scaled up as per requirement. To cater to this growing retail network, the company has a strong logistics network comprising 56 warehouses and a fleet of 44 owned trucks to boost last mile delivery.

Business Model	The company has 3 segments. 1) Retail 2) Enterprise 3) Channel
Strategic Positioning	The company is the leader in home improvement and building materials retail in India
Competitive Edge	Understanding of consumer behaviour and demand of various products in home improvement and building materials Scale through its 114 stores present in 9 states Efficient supply chain and inventory management Minimal capex spend on stores ensures robust return ratios
Financial Structure	Growth in top line and bottom line will be driven through growth in the retail segment which will help boost margins and return ratios and help generate higher free cash flow
Key Competitors	Unorganised competition
Industry Revenue Drivers	Various government initiatives and macroeconomic tailwinds with a massive opportunity size
Shareholder Value Proposition	Our TP of 1,575 is arrived at by assigning a 35x P/E multiple to the retail segment and 7x EV/EBITDA to the channel and enterprise segment. We are assuming an SSG of 20% for retail (below last 3 years average of 24% SSG) and a 24% topline growth for both FY18E and FY19E

VII. Financial Analysis

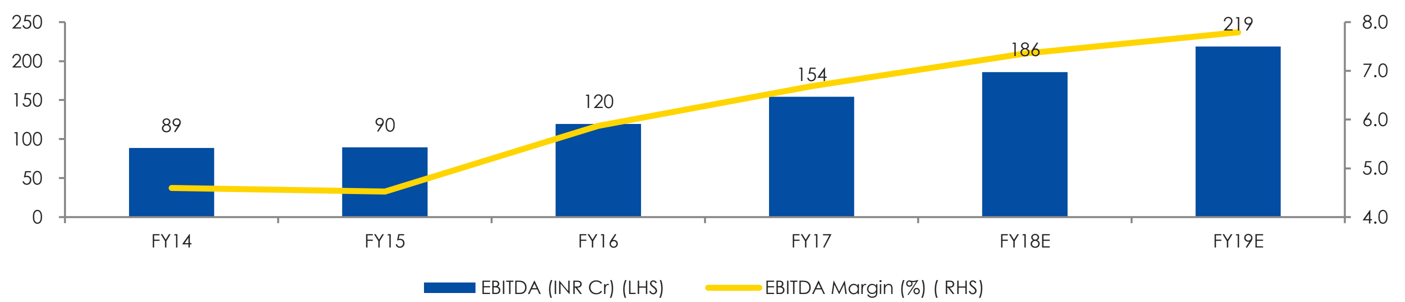
Revenue growth to be driven by the retail segment

Revenues should grow at a CAGR of 10-12% as the channel segment will degrow while the enterprise segment is expected to show flattish growth. We are expecting a strong growth in the retail segment of 24% CAGR over the next few years driven by SSG of 20% (below last 3 years average of 24% SSG).



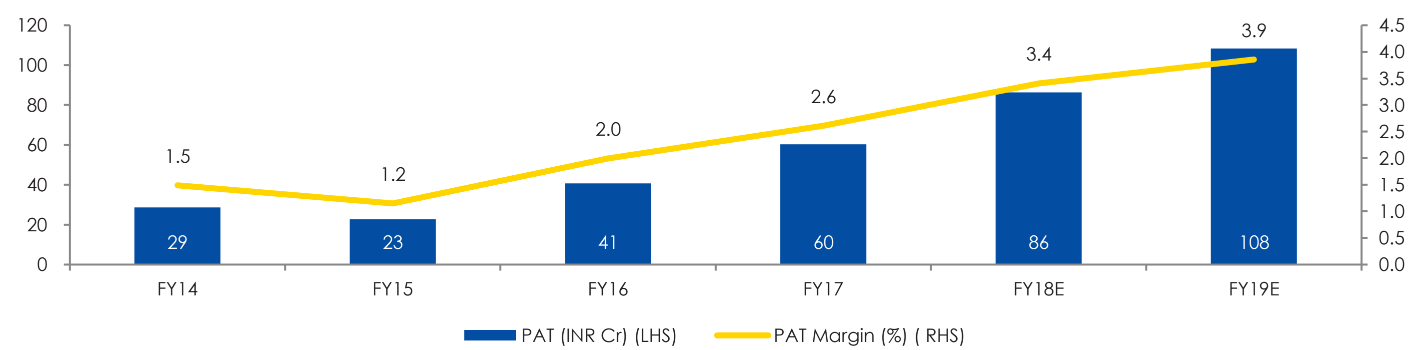
Increasing retail share to continue gradual uptrend of margins

We expect the share of retail revenues to grow from 42% in FY17 to 55% in FY19E (already 46% in Q1FY18). As retail margins are currently more than 2x of channel and enterprise margins, we expect company level margins to improve from 6.7% in FY17to 7.8% in FY19E.



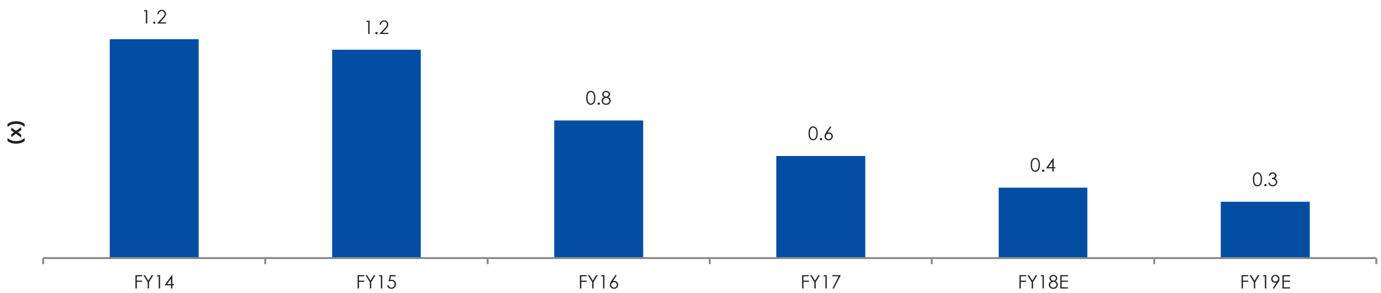
PAT and PAT margin to improve substantially

Topline growth coupled with margin expansion and debt reduction will result in a significant growth in PAT and PAT margins. We are expecting PAT to increase from INR 60 Cr in FY17 to INR 109 Cr in FY19E.



Debt to dip

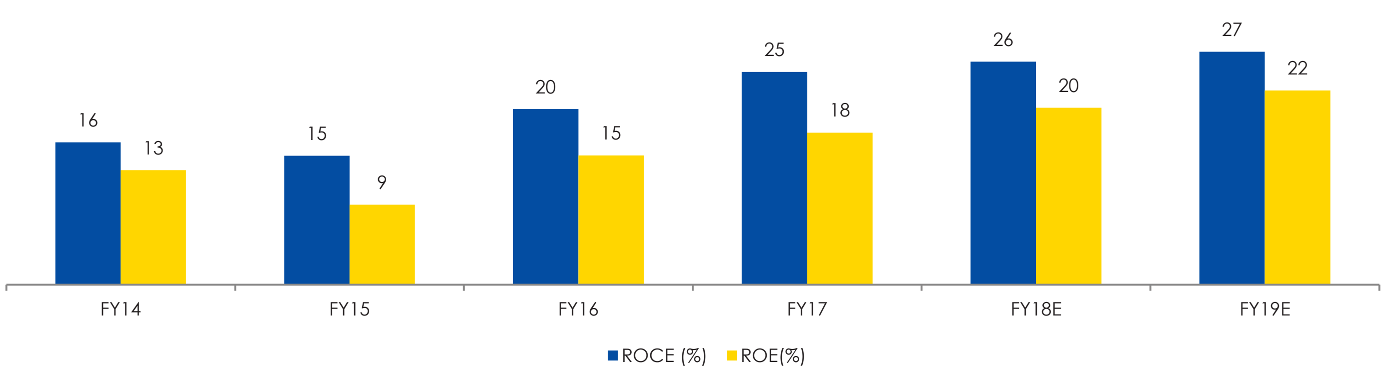
Shankara already has a low debt to equity ratio of 0.6x in FY17. We expect Shankara to pay off a small portion of its debt and thus expect the debt to equity ratio to futher reduce in the next 2 years.



Source: Company, Edelweiss Investment Research

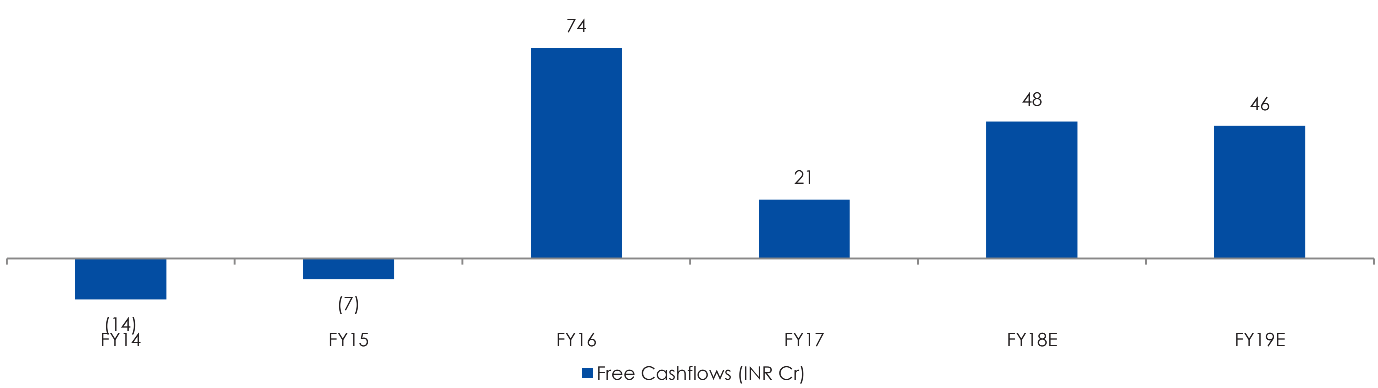
Return ratios to improve

As retail share increases, we expect return ratios to improve further as the retail segment has a higher capital efficiency as compared to the channel and enterprise segment.



Free cash flow generation to increase due to minimal capex

Shankara expects a capex outlay of INR 30-40 Cr each for the next 2 years of which INR 20 Cr will be for new retail stores and the balance will be for maintanance capex of processing facilities.



Financials

Income statement (INR cr)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	2,036	2,310	2,530	2,809
Direct costs	1,778	1,993	2,170	2,402
Employee costs	41	49	54	65
Other expenses	138	163	174	188
Total operating expenses	1,916	2,156	2,344	2,590
EBITDA	120	154	186	219
Depreciation and amortisation	10	11	13	14
EBIT	110	143	173	204
Interest expenses	46	51	41	41
Other income	1	0	0	0
Profit before tax	65	93	132	164
Provision for tax	24	32	46	56
Core profit	41	60	86	108
Extraordinary items	-0	0	0	0
Profit after tax	41	60	86	108
Minority Interest	-0	-0	-0	-0
Share from associates	0	0	0	0
Adjusted net profit	41	60	86	108
Equity shares outstanding (mn)	2	2	2	2
EPS (INR) basic	18.6	26.4	37.8	47.4
Diluted shares (Cr)	2.2	2	2	2.29
EPS (INR) fully diluted	18.6	26.4	37.8	47.4
Dividend per share	1.5	0	0	0
Dividend payout (%)	8.1	0.0	0.0	0.0

Common size metrics- as % of net revenues

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	94.1	93.3	92.6	92.2
Depreciation	0.5	0.5	0.5	0.5
Interest expenditure	2.3	2.2	1.6	1.4
EBITDA margins	5.9	6.7	7.4	7.8
Net profit margins	2.0	2.6	3.4	3.9

Growth metrics (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	2.9	13.5	9.5	11.0
EBITDA	33.6	29.1	20.5	17.6
PBT	87.5	42.9	43.1	24.0
Net profit	80.4	48.1	43.1	25.5
EPS	80.4	41.9	43.0	25.5

Balance sheet (INR cr)

As on 31st March	FY16	FY17	FY18E	FY19E
Equity share capital	22	23	23	23
Preference Share Capital	0	0	0	0
Reserves & surplus	269	371	457	565
Shareholders funds	291	394	480	588
Secured loans	208	209	194	194
Unsecured loans	15	15	15	15
Borrowings	223	224	209	219
Minority interest	0	0	0	0
Sources of funds	**514**	**617**	**689**	**807**
Gross block	279	315	355	395
Depreciation	45	56	68	83
Net block	233	259	286	312
Capital work in progress	0	0	0	0
Total fixed assets	233	259	286	312
Unrealised profit	0	0	0	0
Investments	0	0	0	0
Inventories	256	279	306	340
Sundry debtors	281	312	342	380
Cash and equivalents	2	66	99	155
Loans and advances	12	13	14	16
Other current assets	0	0	0	0
Total current assets	551	671	761	891
Sundry creditors and others	257	295	323	359
Provisions	15	19	20	21
Total CL & provisions	272	314	343	379
Net current assets	279	357	419	511
Net Deferred tax	-13	-16	-16	-16
Misc expenditure	14	17	0	0
Uses of funds	**514**	**617**	**689**	**807**
Book value per share (INR)	133	172	210	257

Cash flow statement

Year to March	FY16	FY17	FY18E	FY19E
Net profit	41	60	86	108
Add: Depreciation	10	11	13	14
Add: Misc expenses written	-0	-3	17	0
Add: Deferred tax	3	3	0	0
Add: Others	-0	-0	-0	-0
Gross cash flow	53	72	116	123
Less: Changes in W. C.	-58	14	29	36
Operating cash flow	112	58	88	86
Less: Capex	38	37	40	40
Free cash flow	**74**	**21**	**48**	**46**

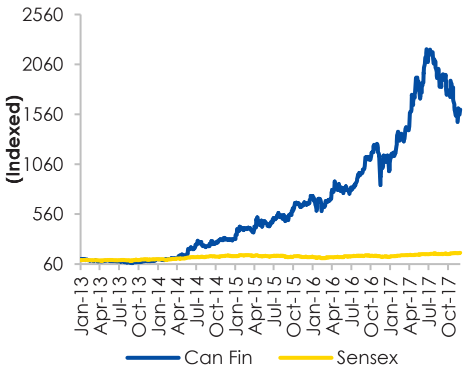
Ratios

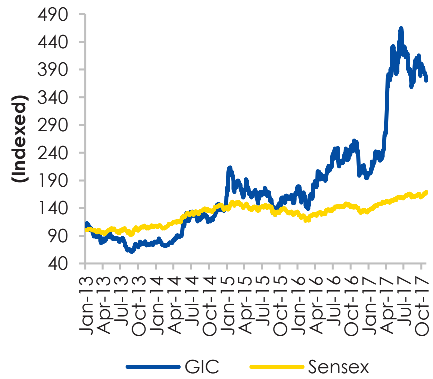
Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	15.0	17.6	19.7	20.3
ROACE (%)	20.3	24.6	25.9	26.8
Debtors (days)	50	49.3	49.3	49.3
Current ratio	2.0	2.1	2.2	2.3
Debt/Equity	0.8	0.6	0.4	0.4
Inventory (days)	46	44.2	44.2	44.2
Payable (days)	46	46.6	46.6	46.6
Cash conversion cycle (days)	50	46.9	46.9	46.9
Debt/EBITDA	1.9	1.4	1.1	1.0
Adjusted debt/Equity	0.8	0.4	0.2	0.1

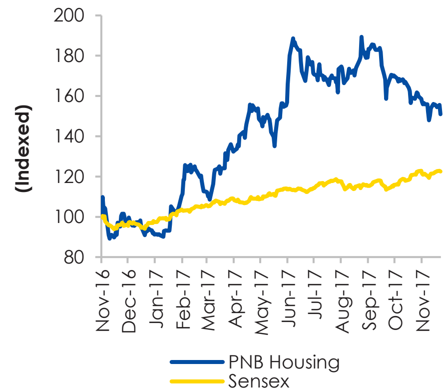
Valuation parameters

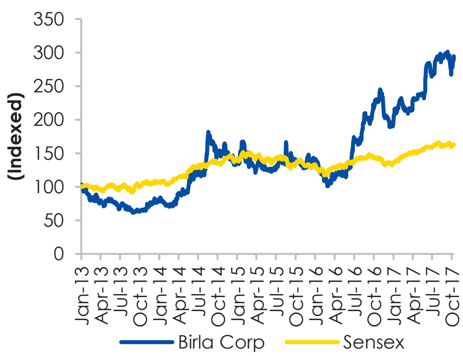
Year to March	FY16	FY17	FY18E	FY19E
Diluted EPS (INR)	18.6	26.4	37.8	47.4
Y-o-Y growth (%)	*80.4*	*41.9*	*43.0*	*25.5*
CEPS (INR)	23.0	31.4	43.4	53.7
Diluted P/E (x)	88.1	62.1	43.4	34.6
Price/BV(x)	12.3	9.5	7.8	6.4
EV/Sales (x)	1.9	1.7	1.5	1.4
EV/EBITDA (x)	31.8	25.3	20.7	17.4
Diluted shares O/S	2.2	2.3	2.3	2.3
Basic EPS	18.6	26.4	37.8	47.4
Basic PE (x)	88.1	62.1	43.4	34.6
Dividend yield (%)	0.1	0.0	0.0	0.0

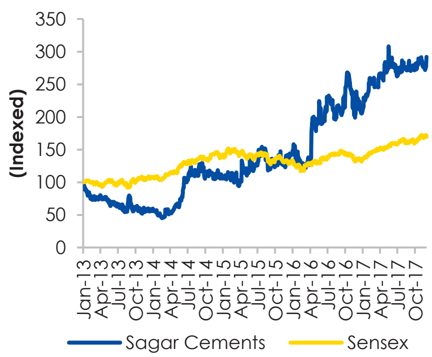
Price Charts

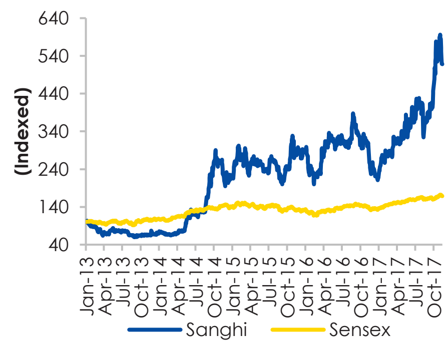


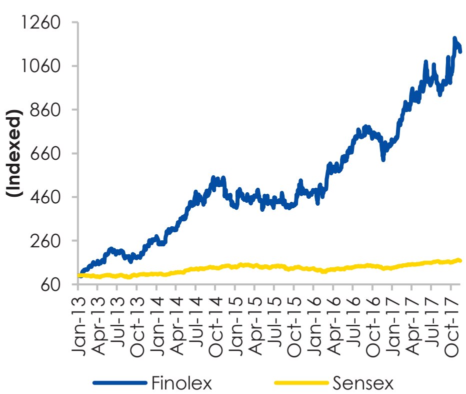


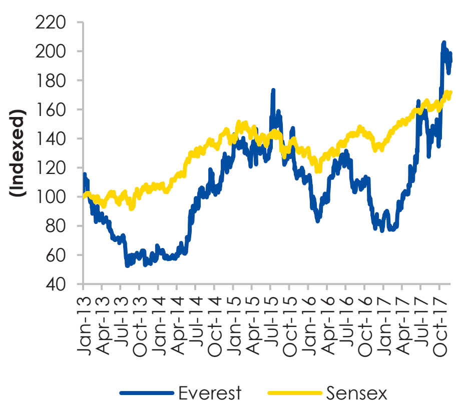


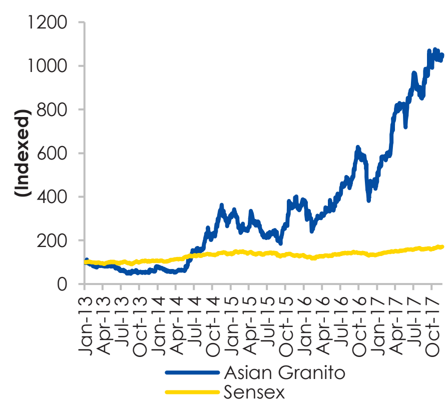


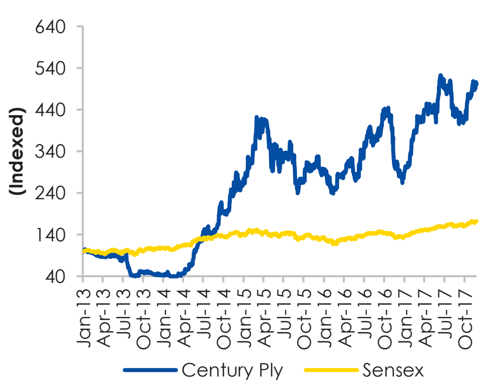


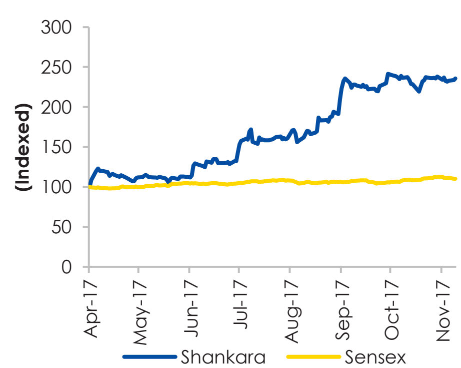












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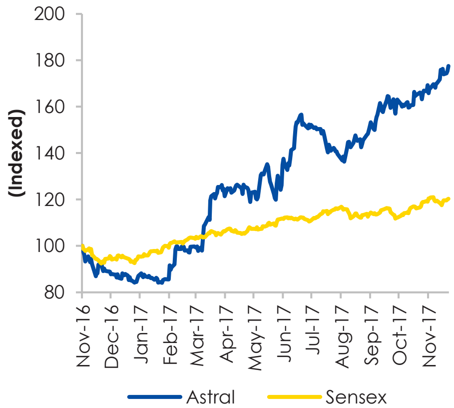

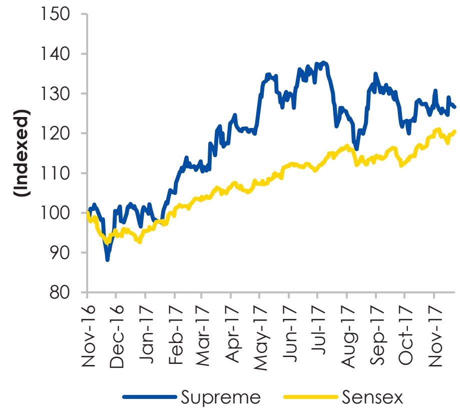

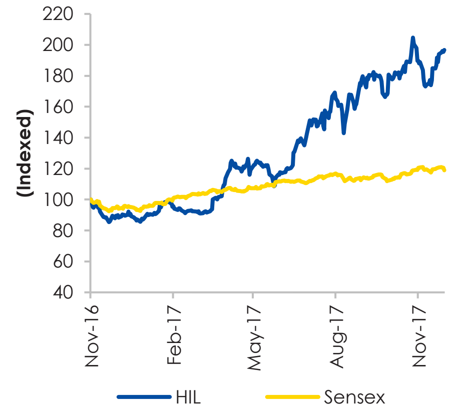

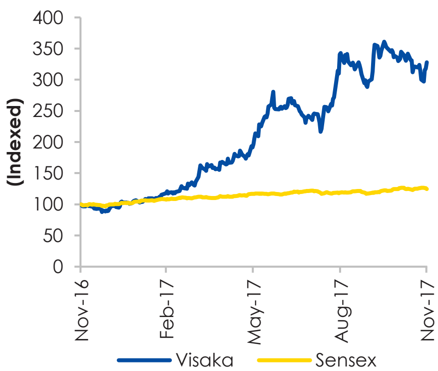

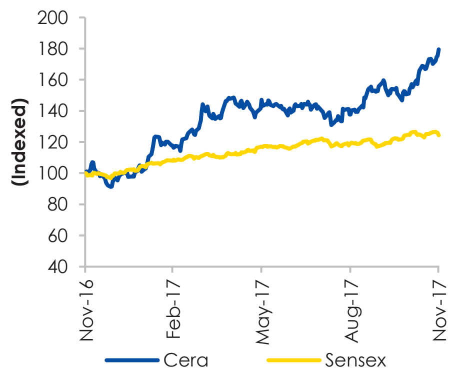

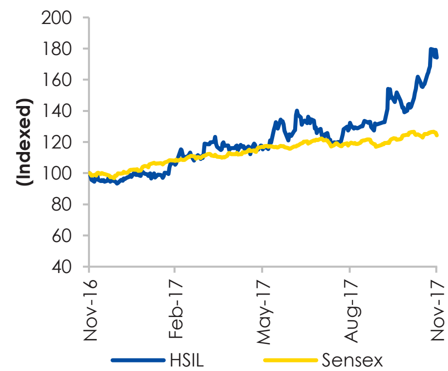

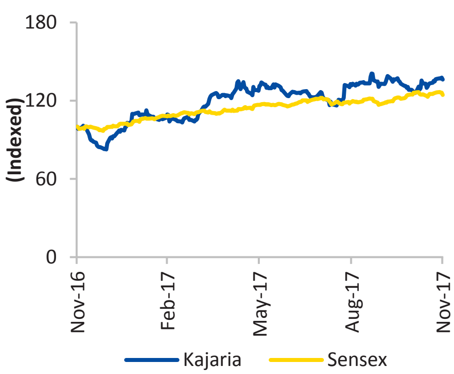

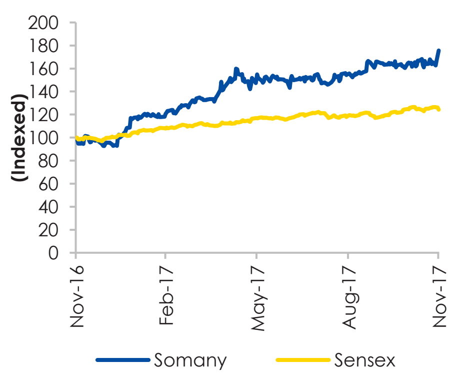

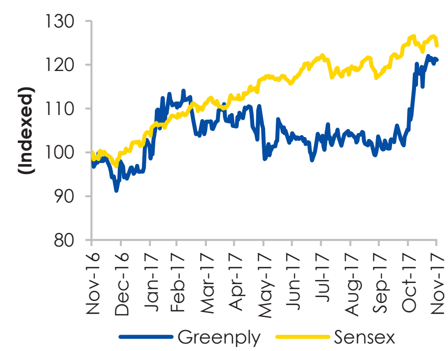

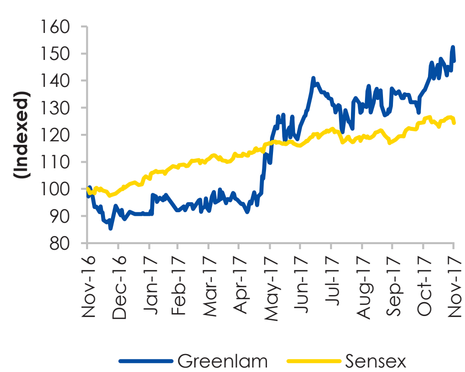

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