

Adding legs to its table

After establishing cost, scale and brand leadership in ply, Century is deploying large capital in MDF (₹4.5bn; 75% of FY16 net worth) to prepare for impending disruption in wood substrate industry. Meanwhile, Century will continue to gain market share in ply given: (a) strong brand and improving distribution, (b) unparalleled raw material security, (c) balance sheet strength. As unorganized segment cedes market share, Century's bargaining power with channel will improve, lowering working capital (now 103 days, including buyer credit) and capital intensity. Stock trades at 21x FY18E EPS, 10-30% discount to "Little Giants" like Kajaria/ Astral; high earnings growth over FY18-20 and leadership consolidation (wider product portfolio) should close the gap.

Competitive position: **STRONG**

Changes to this position: **POSITIVE**

Set to slice a larger share of the pie

Indian plyboard industry (₹150bn) will face disruptions, due to (a) reducing supply of face veneer from South East Asia, (b) rising labour costs and reducing replacement cycles leading to adoption of cheaper alternatives, and (c) regulatory changes such as GST. A strong brand, distribution architecture and strategic assets such as raw material linkage (now Laos) will aid Century in consolidating its leadership position as the smaller players fail to cope.

Preparing for the disruption

Rising acceptance of MDF (as seen in Greenply's success) suggests industry will face disruptions. Whilst entry into MDF will raise capital intensity, Century could generate >20% ROEs as plant hits full utilization by FY20. After establishing the third-largest franchise in laminates (4.8mn sheets; 20% revenue CAGR over FY10-16), it is extending its brand to panel products like PVC sheets, cement fibre boards and allied products like wooden flooring and doors.

Full benefits of brand yet to be realized

Century will capture allied benefits of brand as market gets more organised, which will cut WC cycle to 80 days in FY20 from 103 now. Product extensions and market share gains will drive 24%/26%/27% sales/EBITDA/EPS CAGR over FY16-19; RoCE to hit 26% by FY20 as MDF plant reaches full utilisation.

Valuation: Multiples will evolve with the franchise

As Century climbs the evolution curve, it will mirror traits of champion Building Materials Franchises – sustained growth/margins, improving RoCEs and P/E re-rating. We upgrade our TP by 35% (₹282), implying 18x FY19E EPS, assuming quick ramp-up and 20%+ margin of the MDF plant. At 19.5x FY18 EPS, Century's 10% premium to Greenply is justified by superior RoEs (30% vs 20% for Green). Key risks: Raw material disruption, MDF plant commercialisation.

Key financials

Particulars	FY15	FY16	FY17E	FY18E	FY19E
Revenues	15,884	16,637	19,185	26,684	32,457
Adjusted EBITDA	2,559	2,888	3,353	4,727	5,882
EBITDA margin (%)	16.1%	17.4%	17.5%	17.7%	18.1%
Net Profit (Adj)	1,491	1,672	1,865	2,621	3,435
Adjusted EPS (₹)	6.7	7.5	8.4	11.8	15.5
ROE (%)	42.6%	35.7%	30.1%	32.5%	32.5%
P/E (x)	34.3	30.6	27.4	19.5	14.9

Source: Company, Ambit Capital research

Home Building

Recommendation

Mcap (bn):	₹50/US\$0.8
6M ADV (mn):	₹87/US\$1.3
CMP:	₹227
TP (12 mths):	₹282
Upside (%):	24

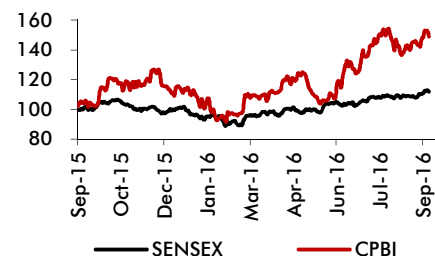
Flags

Accounting:	AMBER
Predictability:	AMBER
Earnings Momentum:	GREEN

Catalysts

- Further acceleration in market share in 2HFY17
- Reduction in cash conversion cycle by end-FY17
- Successful commissioning and ramp-up of the MDF plant in FY18

Performance (%)



Source: Bloomberg, Ambit Capital Research

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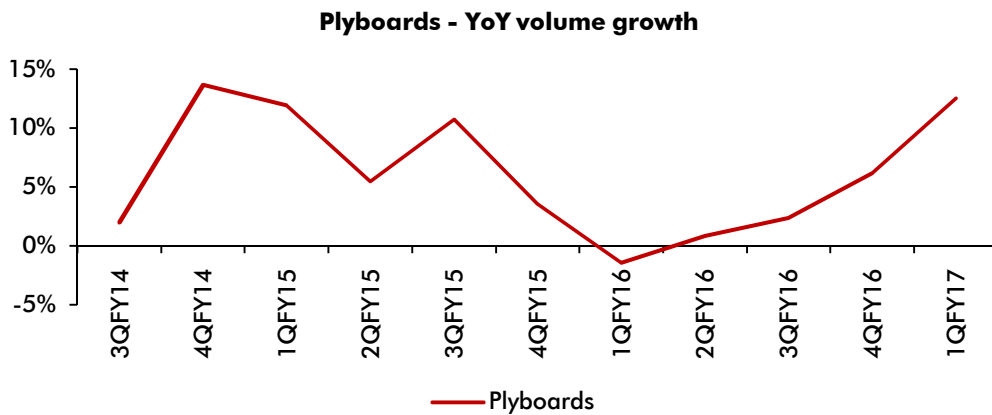
The strength of pole position

In FY16, building materials demand in India went through possibly its worst phase in the last decade; real estate construction slowed and working capital issues and black money clampdown hampered the channel’s ability to stock inventory. Whilst we are yet to notice any meaningful improvement in industry demand, we note that organized players in the wood panel industry such as Century and Greenply have outpaced industry growth and posted reasonable volume growth in 1Q as they gained market share from the struggling unorganized peers. As regulations such as GST change the face of building material industry in India, we believe companies such as Century with a strong brand, distribution and balance sheet bandwidth could emerge as much stronger franchises in the next decade. Evolution from a single product (ply) to a bouquet of wood-related products such as laminates, MDF, doors, flooring etc, will not only ensure sustainability but also fortify Century’s franchise.

Market share gains drove recent volume growth

Whilst volume growth for plyboard manufacturers has receded significantly since 4QFY15, we notice improving trends for organized players in the last two quarters. Although industry demand remains weak, the recent improvement in volumes of the organized players is owing to market share gains from the unorganized players as evident from sharp growth in mid-level ply category for both Century and Greenply.

Exhibit 1: Volume growth has picked up in last two quarters for Century and Green



Source: Company, Ambit Capital research. The above chart depicts the combined volumes of Century and Green

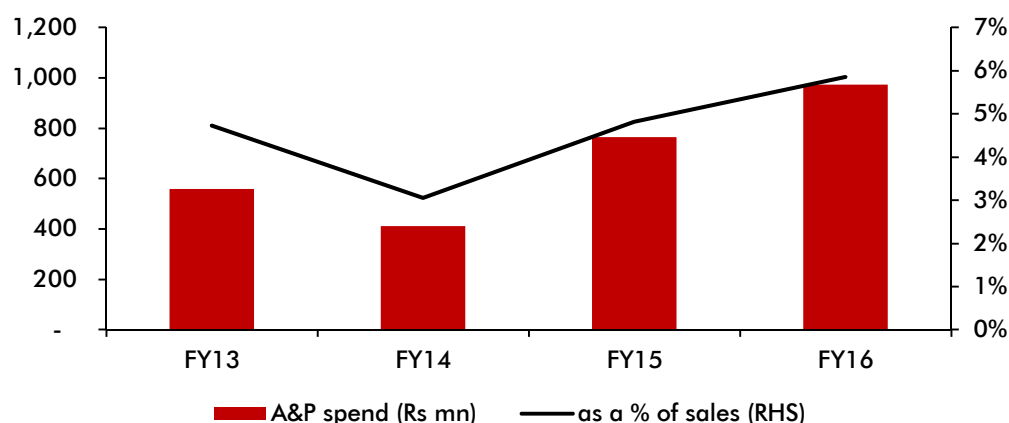
Our recent checks suggest that organized players like Century continue to gain share in the mid-category ply and is likely to sustain 10-12% volume growth (similar to 1QFY17) in FY17.

Steadily established sustainable moats

Century is the brand, scale and cost leader of the Indian wood panel industry. In an industry which has a high proportion of unorganized competition, the company has steadily built its competitive advantages, which will transpire into higher market share over the next few years as the unorganised segment makes way. Century's key competitive advantages are:

- **Brand:** Century is the most premium ply brand in India and commands a 5% premium over Greenply and a significant premium over unorganized peers (see table below). The company consistently spends >4% of its sales in branding and over the last few years has significantly increased its sales manpower and launched advertisement campaigns across its product portfolio to further strengthen its brand.

Exhibit 2: Increasing spending on branding and promotions



Source: Company, Ambit Capital research

Exhibit 3: Price comparison of various ply qualities (from the price list of a Mumbai-based distributor)

Type (₹/sq feet)	Century Ply	Greenply	Ikon	Redwood	Chakress	Kenwood	Anchor	Everest	MDF
4 mm	59	52	45	NA	NA	43	40	38	27
6 mm	73	68	53	47	42	56	52	49	31
9 mm	88	82	65	58	50	68	66	57	36
12 mm	109	103	83	68	59	80	80	71	50
16 mm	133	133	106	84	66	104	111	90	NA
19 mm	156	150	119	95	74	119	120	101	72
19 BB	153	150	119	95	74	89	91	101	81
Prem/Disc	Greenply	Ikon	Redwood	Chakress	Kenwood	Anchor	Everest	MDF	
4 mm	13%	30%	NA	NA	37%	47%	54%	117%	
6 mm	7%	38%	56%	73%	29%	41%	49%	135%	
9 mm	8%	36%	52%	75%	30%	34%	56%	146%	
12 mm	6%	31%	60%	85%	37%	37%	53%	117%	
16 mm	0%	25%	59%	102%	29%	20%	49%	NA	
19 mm	4%	31%	65%	110%	32%	30%	54%	117%	
19 BB	2%	28%	61%	105%	71%	68%	52%	89%	

Source: Ambit Capital research

- **Scale and balance sheet bandwidth:** Century has the highest installed capacity in the Indian plyboard industry and is further ramping up capacity through installing plyboard units in Punjab and Vietnam. Century and Greenply have a significantly better balance sheet compared to the other organized players and have been generating FCF for the last few years, which helps them to re-invest for further growth and in raw material security.

Exhibit 4: Century and Greenply are way ahead of peers in terms of their financial bandwidth

Company	Sales		EBITDA margin		EBITDA-capex		Debt/Equity
	FY16 (₹ mn)	CAGR FY13-16 (%)	FY16	Cum. FY13-16 (%)	FY16 (₹ mn)	CAGR FY13-16(%)	FY16 (X)
Century (Ply)	12,796	12	16.7	13.9	2,689	27	0.81
Greenply (Ply+MDF)	16,514	8	11.3	10.0	1,171	21	0.67
Sarda	1,824	(1)	0.1	1.2	(11)	(48)	3.90
Uniply	1,358	4	12.1	6.6	NA	NA	0.97
UV	579	4	4.0	3.0	NA	NA	0.62
Kitply	582	(4)	NA	NA	NA	NA	NA
National	388	8	NA	NA	NA	NA	NA

Source: Company, Ambit Capital research

Exhibit 5: Two leaders amongst several 'me-too' players

Company	Capacity		Raw material security	No of plants	Sales touch points	Reach	Ad spend - % of sales *	Price (₹/ sq ft for 19mm sheet)
	Plywood ('000 cubic metres)	Laminates						
Century	●	●	●	●	●	●	●	●
Greenply	●	●	●	●	●	●	●	●
Archid	●	●	●	●	●	●	●	●
Sarda	●	●	●	●	●	●	●	●
Uniply	●	●	●	●	●	●	●	●
National	●	●	●	●	●	●	●	●
Kitply	●	●	●	●	●	●	●	●

Source: Company, Ambit Capital research; Note: ● - Strong; ● - Relatively Strong; ● - Average; ● - Relatively weak

Exhibit 6: The numbers behind our competitive mapping

Company	Capacity		Raw material security	Number of plants	Sales touch points	Reach	Ad spend - % of sales *	Price (₹/ sq feet/19mm)
	Plywood ('000 cubic metres)	Laminates (mn sheets)						
Century	210	4.8	Yes	7	~10,000	Pan-India	4.0%	140
Green	129	NA	Yes	7	~15,000	Pan-India	2.80%	126
Archid	78	NA	No	3	~2,500	Regional	1.90%	120
Sarda	35	NA	No	2	~2,000	Regional	2.30%	125
Uniply	50	NA	No	1	~800	Regional	0.60%	110
National	25	1.8	No	2	~800	Regional	0.30%	115
Kitply	60	0.036	No	6	~1,000	Regional	1.30%	125

Source: Company, Ambit Capital research * four year average

- **Raw material linkage:** In a later section, we discuss the rising difficulty of sourcing raw material for plywood production. Century has assured raw material security through investments in face veneer capacity in Myanmar (32,000 CBM) and Laos (96,000 CBM), which adequately support its current face veneer requirement. Greenply has a JV in Myanmar and is setting up a peeling unit in Gabon, Africa to offset the impact of logging ban in Myanmar.

Domestic ply industry: Survival of the fittest

The ecosystem of the plyboard business will change over the next few years which will benefit the organized players. For several decades, building materials sales channel has been funded through black money, which is now facing severe constraints due to the clampdown administered by the NDA government. Moreover, with raw material sourcing becoming difficult, we believe the smaller players will find it even more difficult to compete with the larger brands. Whilst Century and Greenply have outpaced the ply industry's growth significantly in the past decade, we believe that over the next few years their market share gains will further accelerate given the abovementioned changes.

Raw material sourcing constraints

Face veneer is one of the most essential raw materials for plywood production. Whilst historically South East Asian countries (primarily Myanmar) have been the major source for the raw material, we note that that deforestation regulations in these countries have become stringent, leading to difficulty in procuring the raw material.

Timber logging ban in Myanmar: Whilst Myanmar banned exports of plyboards in April-14, companies such as Century and Greenply set up face veneer capacities to ensure raw material security. However, the newly elected government of leader Aung San Suu Kyi has decided to stop logging completely. This will lead to a major disruption in the raw material availability from the region. Whilst Century and Greenply have log reserves for the next few quarters, the unorganized sector will struggle to source the raw material.

Regulation changes implemented by the NDA government

Two seminal changes will have a significant impact on the building material ecosystem in India:

- (a) **Clampdown on black money:** The NDA government has administered serious measures to curtail black money generation and usage in India, such as passage of the Foreign Black money act, Benami transactions bill, PAN card mandatory for purchases above ₹20,000 and deposits above ₹500,000 etc. Based on our checks, the unorganized segment largely relies on cash transactions with the channel and hence the reduction in availability of black money has led to significant decrease in working capital availability? to the unorganized manufacturers and impacted the channel's ability to work with the smaller players.
- (b) **GST implementation:** The unorganised sector in India has hitherto avoided paying indirect taxes on inputs and outputs and hence has had cost advantages of around 13-30% relative to its organised counterpart. If GST is able to capture the unorganised sector in the tax net, then this competitive advantage for this sector will be eroded. As a result, in the Goods sectors in which unorganised accounts for the majority of the market share (e.g. light electricals, paints, pipes and plyboards), the organised players stand to be benefit regardless of the rate at which GST is introduced. GST will wipe out the competitiveness of the unorganised players. Whilst implementation of GST might get delayed, we believe that gradually the unorganized sector will make way and it will not only drive market share gains for the organized players but also lead to shrinking working capital cycles as the supply fragmentation reduces and the bargaining power of the organized players rises. Note in the table below that even if we assume a high GST rate of 24%, the cost for the company reduces marginally but because the cascading effect of indirect taxes will fade, the dealer will benefit by ~10%.

Exhibit 7: Tax structure under the current regime...

Particulars	Current
Company level	
BASIC PRICE	100.0
EXCISE DUTY @ 12.50%	12.5
BASIC + EXCISE DUTY	112.5
VAT @ 12.5%	14.1
TOTAL	126.6
Dealer level	
BASIC PRICE (COST 112.50 + 10% MARGIN)	123.8
VAT @ 12.5%	15.5
BASIC + EXCISE DUTY	139.2
LESS : INPUT CREDIT	14.1
TOTAL	125.2

Source: Industry sources, Ambit Capital research

Exhibit 8: ...and post GST implementation

Particulars	Under GST
Company level	
BASIC PRICE	100.0
GST @ 24%	24.0
BASIC + GST	124.0
Dealer level	
BASIC PRICE (COST 100.00 + 10% MARGIN)	110.0
GST @ 24%	26.4
BASIC + GST	136.4
LESS : GST INPUT CREDIT	24.0
TOTAL	112.4
BENEFIT TO DEALER UNDER GST	10%

Source: Industry sources, Ambit Capital research

Exhibit 9: Product pricing divergence between organised/unorganized

Home building segments	Market size (₹ bn)	Organised share (%)	Organised market size (₹ bn)	*Price difference (organised vs unorganised) (%)	Price difference explained by			
					Production costs	**Taxes	Labour payments	A&P/ others
Light Electricals	379	67%	254	30%	9%	8%	6%	7%
Paints	314	65%	204	13%	1%	3%	1%	8%
Tiles	230	40%	84	25%	8%	6%	5%	6%
Pipes	160	65%	78	25%	12%	10%	0%	3%
Plyboards	160	30%	45	30%	7%	15%	4%	4%
Sanitaryware	35	60%	14	20%	4%	9%	3%	4%

Source: Ambit Capital research, management meetings, Note: * As a percentage of market prices of organised players, ** Most important component of the price difference is excise duties

Disruption will drive innovation

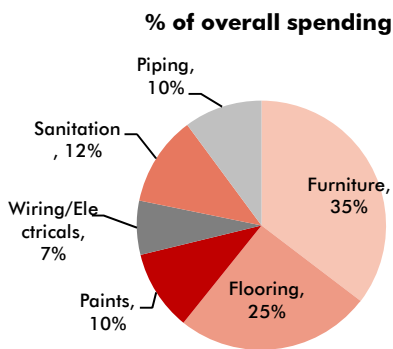
For the last few decades, the wood substrate industry in India has seen limited innovation/evolution (barring improvement in product quality such as borer/termite resistance, heat and water resistance, etc.). However, we believe that the industry is ripe to undergo disruption over the next decade, due to:

Rising labour costs and shifting consumption pattern: Our checks with dealers, architects etc. suggest that labour costs have risen sharply over the decade, which is giving rise to readymade solutions as against bespoke furniture. Note in the table below that furniture usually accounts for the highest spending in home furnishing and hence plywood and laminates account for a third of overall housing spending. Moreover, labour costs account for 44% of overall home furnishing expenditure, which is gradually resulting in consumers moving towards readymade rather than custom-made solutions.

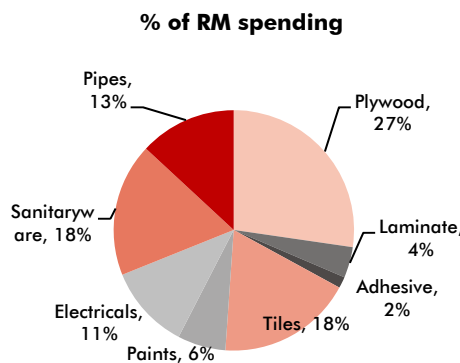
Exhibit 10: Furniture usually accounts for the highest cost amongst home furnishing

Exhibit 11: Plywood and laminates comprise 1/3rd of overall building material spending in the house

Exhibit 12: Labor costs are now 44% of the overall spending within internal spending of a house

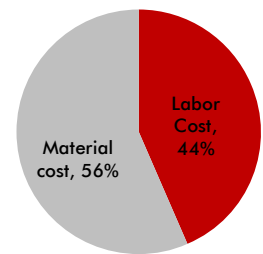


Source: Industry sources, Ambit Capital research



Source: Industry sources, Ambit Capital research

% of overall spending



Source: Industry sources, Ambit Capital research

Shrinking replacement cycles: Our checks with architects suggest that the replacement cycles in the urban markets have started shrinking, which is leading to increasing adoption of lesser quality raw materials for furniture such as MDF in applications which does not require strength/longevity.

Intermediary training: New age products will require training the intermediary with new applications and machining tools. Companies such as Greenply and Century have made large investments in MDF and begun started intermediary training to increase the acceptability of MDF. As the carpenters get trained to use MDF, the retail usage will increase.

Exhibit 13: Wood substrate products and their applications

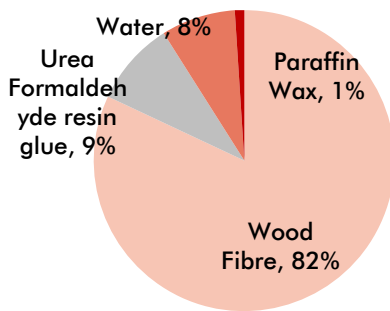
Product	Price/sq feet	Intermediary awareness	Applications
Plyboard			
High Quality	120	High	High-end furniture construction, including structures for wardrobes, beds, sofas, tables
Mid-quality	80	High	Applications are largely similar as the high-quality plyboard, however quality is cheaper
Low-quality	60	High	Used for panelling, cabinets and decorative purposes
Engineered boards			
MDF	60	Average	Used for decorative purposes, cladding, panelling, wardrobe fronts and other applications which does not require holding weight such as modular kitchens; also used in commercial applications
Particle board	45	Low	Used largely for ready-made furniture and applications wherein strength requirement is minimal
New-age			
Cement fibre boards	35	Low	Largely used for decorative purposes and paneling, flooring etc. Also used for external structures, wall cladding; false ceilings and partitions
PVC sheets	35	Low	Used for decorative purpose such as false ceiling, separations etc.
Wood plastic composite	50	Low	Decking, cladding, door-frames; still a nascent category in India

Source: Company, Ambit Capital research

Understanding the MDF market in India

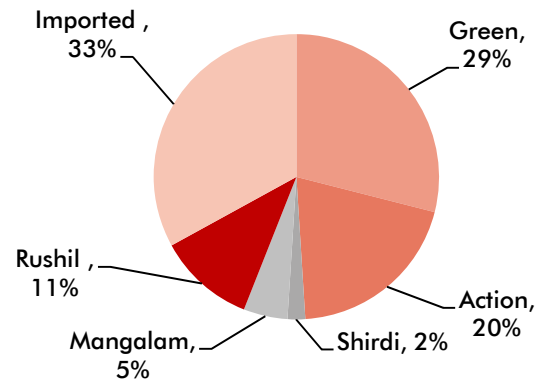
What is MDF? Medium-density fibreboard (MDF) is an engineered wood product made by breaking down hardwood or softwood residuals into woodfibres, often in a defibrator, combining it with wax and a resin binder, and forming panels by applying high temperature and pressure. MDF is generally denser than plywood. It is made up of separated fibres, but can be used as a building material similar in application to plywood. It is stronger and much denser than particle board. In India, MDF usage began in the mid-2000s primarily through imports from China and South East Asia. Wood fibre accounts for 82% of the overall MDF cost, which is procured from local traders.

Exhibit 14: Cost components of MDF production



Source: Company, Ambit Capital research

Exhibit 15: Greenply is the largest domestic manufacturer of MDF



Source: Company, Ambit Capital research

Exhibit 16: Supply structure of the domestic MDF manufacturers

Company	FY16 revenue	Market share	Expansion plans
Greenply	4,762	30	Company is setting up new greenfield MDF plant at Chittoor, Andhra Pradesh with an installed capacity to produce 1,200 cubic metres of MDF per day. This facility is expected to be commissioned in FY 2019. Expected cost is ₹.7bn
Century	NA	NA	The Company invested in a 198,000 cubic metre per annum MDF plant in Punjab (projected commissioning March 2017) Expected capex is ₹ 4.5 crores. The
Action Tesa	2,500	20	New plant has been commissioned at Sitargunj, Uttarakhand for Thin MDF, HDF Laminated Flooring, UV coated panels, Particleboards, Melamine door skins, HDF etc. Overall capacity is 1,80,000 CBM
Rushil	1,276	11	Company plans to establish the new project at South India to manufacture "Thin MDF" product (90,000 CBM/year) and expansion of the laminated sheets production.
Mangalam	396	5	One of the earlier entrants but now only a small player and does not intend to grow further
Shirdi Inds	700	2	Been scaling down production and is only a marginal player now

Source: Company, Ambit capital research

Exhibit 17: Comparison of MDF and plywood

Criteria	MDF	Plywood
Constituents	Made by wood fibres got by breaking down hardwood and softwood residuals which are combined using wax and resin.	Made by gluing together thin sheets of veneer.
Structure	Uniform, smooth and free of knots.	It has odd number of layers with grains of adjacent layers at right angles to each other.
Uses	Cabinet construction, crafts, Mouldings/trim, shelving (bookshelf sliding)	Roofs, Walls, Subfloors, Boxes, Packages, Sports equipment, Musical equipment, Playground equipment, High-end loud speakers.
Durability	MDF is not as hard as plywood and can be damaged easily when roughly handled.	Cross graining of plywood improves dimensional stability by reducing expansion and shrinkage. Even in extreme cold, the dimensions or strength of Plywood is unaffected.
Cost	MDF is ~30% cheaper than mid-end Plywood.	Plywood is usually expensive than MDF, a lot depends on the grade of plywood and types of wood used. Low grade plywood may be cheaper than MDF.

Source: Industry sources, Ambit Capital research

Types of MDF: The table below summarizes the types of MDF and their uses in various applications:

Exhibit 18: The types of MDF and their uses

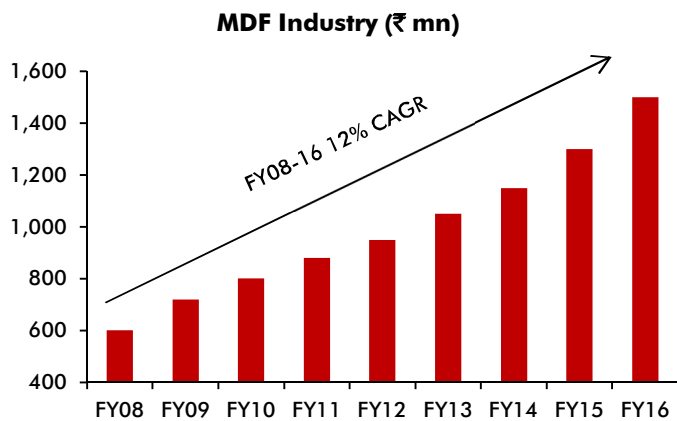
Name	Features	Thickness	Size	Uses
Plain MDF	Medium durability, not moisture resistant, vulnerable to swelling due to water, mouldable	2.3mm, 2.5mm, 3mm, 4mm, 5.5mm, 6mm, 8mm, 11mm, 12mm, 15mm, 17mm, 18mm, 25mm, 30mm and 35mm	8 X4 ; 8 X6 ; 7 X6 ; 7 X4 and 6 X4	Doors, internal Panelling, designed furniture, decorative furniture etc.
Pre-laminated MDF	High durability, better moisture resistance, mouldable, more resistant to termites	6mm, 8mm, 11mm, 12mm, 15mm, 17mm, 18mm, 25mm, 30mm and 35mm	8 X4 ; 8 X6 ; 7 X6 ; 7 X4 and 6 X4	Doors, designed furniture, decorative furnitures, windows, walls, cupboards etc.
Veneered MDF	High bonding strength, greater rigidity, higher resistance to wear and tear, high quality finishing, ideal for painting and polish, high resistance to termites	6mm, 8mm, 11mm, 12mm, 15mm, 17mm, 18mm, 25mm, 30mm and 35mm	8 X4 ; 8 X6 ; 7 X6 ; 7 X4 and 6 X4	High pressure usage, decorative articles, doors, cupboards, shelves etc.
Plain HDF	Denser and smoother surface, better finishing and modelling, all the features of Plain MDF	2.3mm, 2.5mm, 3mm, 4mm, 5.5mm, 6mm, 8mm, 11mm, 12mm, 15mm, 17mm, 18mm, 25mm, 30mm and 35mm	8 X4 ; 8 X6 ; 7 X6 ; 7 X4 and 6 X4	Indoor and outdoor decoration, high grade furniture, stereos, interior usage in cars and electronic industry
Pre-laminated HDF	Denser and smoother surface, better resistance to termites, all the features of Plain MDF	2.3mm, 2.5mm, 3mm, 4mm, 5.5mm, 6mm, 8mm, 11mm, 12mm, 15mm, 17mm, 18mm, 25mm, 30mm and 35mm	8 X4 ; 8 X6 ; 7 X6 ; 7 X4 and 6 X4	Flooring in computer rooms, doors, wall panels, shelves etc.
Moisture resistant MDF	Specific resistance to moisture	6mm, 8mm, 11mm, 12mm, 15mm, 17mm, 18mm, 25mm, 30mm and 35mm	8 X4 ; 8 X6 ; 7 X6 ; 7 X4 and 6 X4	Use in washrooms, kitchen furniture, places there is high contact with water etc.
Fire resistant MDF	Specific resistance to fire	6mm, 8mm, 11mm, 12mm, 15mm, 17mm, 18mm, 25mm, 30mm and 35mm	8 X4 ; 8 X6 ; 7 X6 ; 7 X4 and 6 X4	Use in kitchen, chimneys, places where there is high contact with fire etc.

Source: Company, Ambit Capital research

Growth over the last decade: Whilst the MDF industry was growing in high single digits over FY05-12, the growth rates tapered as commercial real estate slowed and MDF failed to establish itself as a retail product. However, post the ban of timber exports from Myanmar in FY15, the price of the low-quality plyboard rose sharply, leading to rising acceptance of MDF in the retail markets. In the last two years, acceptance of MDF has risen, driving growth rate to ~20%.

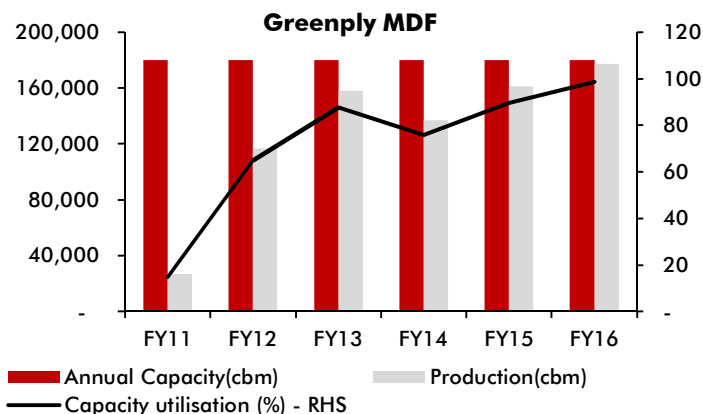
Rising acceptance of MDF and inability of Bajaj and Shirdi to service the demand led to a sharp uptick in the utilization of Greenply's MDF plant from 73% in FY14 to 99% in FY16.

Exhibit 19: MDF industry has expanded at a 12% CAGR in India over FY08-16



Source: Industry sources, Ambit Capital research

Exhibit 20: Sharp pick-up in utilization of Greenply’s MDF utilization



Source: Company, Ambit Capital research

Greenply – in its FY16 annual report

MDF owing to its salient features – affordability, carving and moulding attributes, increasing awareness and acceptance, and increasing applications – has grown in the last few years. Moreover, we are witnessing a shift in consumer preference from cheap plywood to MDF. The MDF division’s sales grew by 16.6% to ₹476.16 crore (₹4.8bn) in FY16.

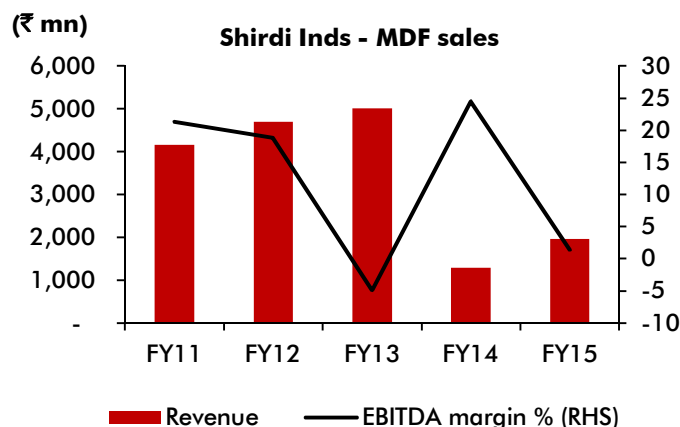
During 2015-16, we made major inroads into the rural market, educating influencers, dealers and customers about MDF. Moreover, we launched several new value added products. We saw significant acceptance of MDF among architects and Original Equipment Manufacturers (OEMs). Moreover, many government bodies have approved the usage of MDF across government establishments.

The bitter experience of the earlier entrants: Previous entrants such as Bajaj Hindusthan, Shirdi etc. failed to establish themselves in MDF. See in the table below that revenue of Shirdi Industries and Bajaj Hindusthan declined sharply due to their failure in the MDF business.

In Bajaj’s case, their plant was based on baggase, wherein price jumped six-fold over two years, thereby making the business unsustainable. Management mentioned in its FY12 annual report that “Operations at the Kundarkhi plant remained suspended due to non-availability of adequate quantity of sugarcane bagasse in and around that area”

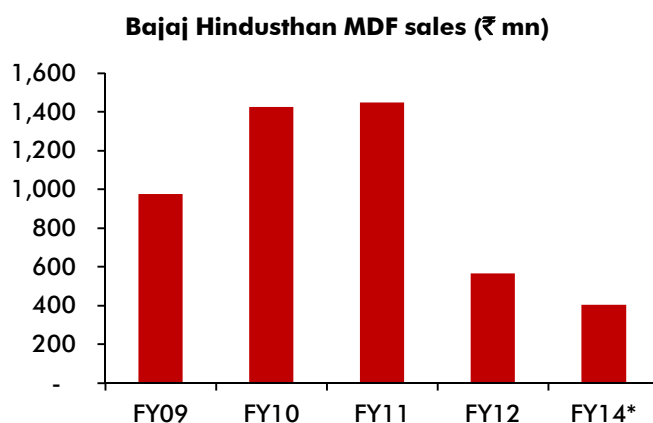
Hindrances for other players were low quality MDF imports from China, perception issues and no major marketing push by the larger brands.

Exhibit 21: Sharp decline in revenue growth and margin of Shirdi Industries...



Source: Company, Ambit Capital research

Exhibit 22: ...and Bajaj Hindusthan



Source: Company, Ambit Capital research. *FY14 is a fifteen month period

Channel checks on MDF: We spoke to dealers and architects in North and West India to understand the changing dynamics of MDF usage in India. Below is a summary of our key findings:

Exhibit 23: Dealer commentary on MDF

Dealer's View

Trade Terms	Dealers suggest that the credit period in MDF is shorter given limited unorganised players
Distribution Channel	Dealers suggest that the distribution channel is same for both Plywood and MDF. Companies have no objection in empanelment with the distributors for any of their products. It is on the respective distributor that whether he is able to market and sell the product effectively and efficiently.
Margin	Dealer margins in MDF are marginally better than Plywood, but the volumes for Plywood are much more. Dealer margin lies anywhere between 3-5%.
Carpenter outlook	Carpenters are well aware of MDF and its applications. For small residential projects, they buy Plywood, whereas for large commercial projects they prefer buying MDF due to lower costs. They believe that in commercial application uses furniture for 4-5 years, for which MDF will suffice at much lower costs. MDF is preferred for decorative furniture, moulding work etc., and Plywood is preferred where more durability is required. 90% of the tools used in MDF are same as Plywood. They are also well equipped with the tools required for use on MDF.
Pricing	MDF sells at a 20-30% discount than Plywood.
Architect outlook	Architects prefer using MDF in designing work, decorative work, moulding applications etc. as it can be perfectly gazed. Architects are also using MDF on a large scale. They prefer using MDF where the properties of MDF suit the best. Currently, the market share of MDF and Plywood is 30% and 70% respectively. Dealers believe that in next 5 years the market shares for MDF and Plywood will be equal. As the market size increases, production of furniture will increase and MDF sales will also increase, but it will never be able to become a substitute for Plywood as it cannot suffice for the requirements of Plywood. MDF and Plywood are separate products with separate properties, suitable for respective uses. Dealers don't think MDF market in India can become larger than the Plywood market, but they will become competing products.
Demand outlook for MDF	

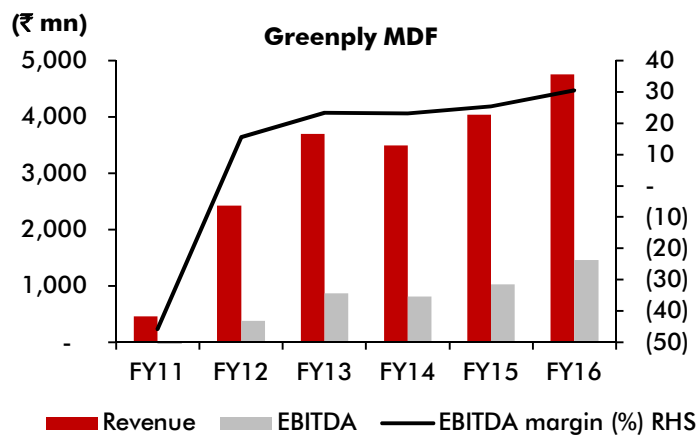
Source: Channel checks, Ambit capital research

MDF – is it different this time?

Given that MDF has had a bitter history in India, investors fear that the large investments by Century and Greenply in MDF could wipe out a significant proportion of their profitability as large supply comes online. However, as mentioned, MDF is fast gaining acceptance in the low-end panel substrate market and could become a much larger market in the next few years. A few points worth considering on MDF are:

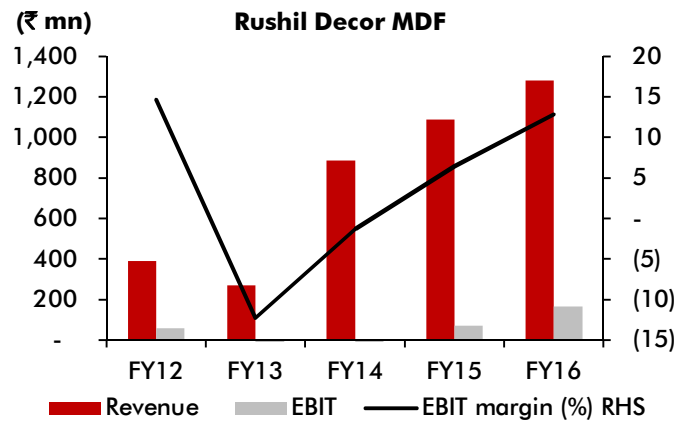
Improving financial performance of Greenply and Rushil: After weak financial performance in the initial years, focused companies such as Greenply and Rushil Décor have managed to turn around their MDF business with rising acceptance amongst the channel and intermediaries alongside cost inflation in low-cost plyboards. Moreover, with players such as Shirdi Industries and Bajaj Hindusthan largely vacating the market, players such as Greenply were able to increase market share.

Exhibit 24: Sharp pick-up in MDF revenue growth and EBITDA margin for Greenply...



Source: Company, Ambit Capital research

Exhibit 25: ..and Rushil



Source: Company, Ambit Capital research

Changing perception: MDF is not a poor quality product, the gap is in the perception. The initial usage of MDF-based furniture in India was low quality imported products from South-East Asia and China, which created a perception that MDF is not a reliable substitute of ply. Given that the machinery installed and the quality of MDF output of manufacturers such as Century and Greenply are superior, the output will be of a significantly better quality than that of imported furniture. With rising investments by these players in educating the intermediaries and increasing awareness of the product amid sharp increase in the price of mid-end plyboard, there is a high likelihood of rising usage of MDF in India. Lastly, implementation of anti-dumping duty should further aid market share gains of the domestic manufacturers.

Evolving furniture usage: Rising proliferation of readymade furniture has also led to higher usage of MDF in India, which is visible in popularity of online furniture sales portals such as Pepperfry.

Excerpts from the interview of Pepperfry's founder Mr. Ashish Shah

We recently shipped out our 100,000th furniture piece. We have managed to achieve this in a little over two-and-a-half years of operations, which for us is a big milestone. We have scaled from shipping 150 pieces of furniture a month to delivering 15,000 pieces a month.

The math behind shifting to MDF: A base level (non-branded ply) costs ~₹220/sq feet, with the cost split being plyboard ₹80, top laminate ₹30, base laminate/paint ₹20, Adhesive ₹10 and labour ₹80. A factory manufactured pre-lam MDF will be available at ₹60/sq ft, which is significantly lower than ply although the quality is slightly inferior.

Are Chinese imports a threat? Our channel checks suggest that MDF imports from China has reduced to a large extent. MDF imports in India were at a peak 4-5 years ago when domestic production of MDF was suffering since Indian manufacturers could not cope with low-cost Chinese imports. In 2011, the Indian Government imposed anti-dumping duty (ADD) on MDF imports from China which made the landed cost of MDF became higher than domestic MDF. Hence, Chinese imports reduced significantly. Chinese manufacturers used to circumvent the ADD by exporting MDF from other nearby countries; but that has also become difficult as the government has now imposed ADD on other South-East Asian countries such as Vietnam and Indonesia.

Levy of anti-dumping duty on imports on Vietnam and Indonesia: The finance ministry has levied ADD on imports of MDF from Vietnam and Indonesia, which together account for 30-35% of overall MDF imports. For example, US\$42/CBM has been levied on Sumetara Enterprises of Indonesia which is a large exporter into India but the extent is much lesser on Vietnamese players. Will keep you informed on further updates.

Key points to note:

- MDF is a ₹13bn industry in India and imports account for ~40%, with South-East Asian countries being the major exporters.
- Whilst the anti-dumping duty had already been levied on China, Chinese manufacturers were exporting to Indonesia and Vietnam and then to India to circumvent the rules.
- The MDF realization of Indian manufacturers is ~₹23,000, whereas imported price was ~₹21,000. US\$42 ADD has been levied on the major Indonesian exporter, Sumatra Enterprises, which means that they will not be competitive anymore. However, the extent of levy on the major Vietnamese exporter is only US\$15, which means that the price gap between Indian manufacturers and them will shrink from 10% to 5%.
- We do not have the split of imports in India from these two countries separately.

Will Indian companies traverse the path of the South-East Asian companies?

South-East Asian MDF manufacturers RoCE is in low-single digits currently. Note that majority of their revenues came through exports to Middle-East and USA. These companies were posting >10% RoCE till FY10, however a sharp increase in MDF and particle board capacities in China coincided with a slowdown in housing construction in large markets such as US and UK and deceleration in China (leading to pressure on realisations). Also, decline in raw material prices led to inventory losses for some companies such as Evergreen Fibreboards. On the other hand, for Indian companies >90% of revenue comes from the domestic market hence they were not significantly impacted by the housing slowdown in developed markets. We note that the financial performance of a few SE Asian companies improved in CY15 due to a sharp decline in rubber prices and depreciation of their currencies against the US\$.

Hence, we do not think that the fortunes of the Indian plyboard companies will mirror the South-East Asian countries.

Will Century make the cut in MDF?

Century is making its single largest investment ever since its inception (₹4bn; 75% of FY16 net worth) in setting up its MDF plant. Management is confident that the company will be able to commission the plant in Mar-17 and the employees have been incentivized to complete the project ahead of schedule. The civil work is underway and 40% of the equipment is already ordered and the balance equipment will be ordered by Nov-16.

Chinese machinery is not a worry: There are three components of an MDF plant (1) refiner, (2) forming/compression machine and (3) sanding machine. Of these, Century has sourced refiner and sanding machine from an Austrian manufacturer Andritz (one of the only two manufacturers of this machinery globally; Metso is the other one). The company is sourcing forming/compression machine (₹1bn; 25% of the overall project cost) from a Chinese equipment vendor Yaliyan. The Chinese manufacturer is the largest equipment vendor in China and has a high quality set-up. Moreover, since the process is fairly mechanical, it does not impact the quality of the MDF. Lastly, the Chinese vendor has innovated in process and hence its production is higher than the European vendors.

Started preliminary preparations: The company has started adding dealers and distributors for MDF and recently hired Mr. Avtar Singh Bhullar (ex-Greenply) for the marketing MDF. Mr. Bhullar has been in the marketing of building materials and related products for over two decades and has worked in organizations such as Kajaria, HSIL, Jaguar, Nitco tiles and Asahi.

Setting up the base for further expansions: The company has invested in setting up ancillary infrastructure for a quick implementation of phase II of the expansion. Once the MDF plant reaches full capacity utilization (Century has penciled FY19 for the plant to reach full capacity utilization), the company can double the capacity at ₹2bn within a year.

Raw material linkage: The company's plant is located in timber rich belt of Punjab, (Hoshiarpur) and it can source wood fibre at highly competitive prices from this area. Our checks suggest that the price of raw timber in Hoshiarpur is one of the lowest in India.

MDF financial assumptions – RoCE to surpass hurdle rate by FY20

- **Revenue:** Whilst management expects to reach 80% capacity utilization in FY18 and 100% in FY19, we build in 65% and 80% in both the years respectively. We build in realization akin to Greenply (₹26,000/CBM) and then build in a 4% increase each year. We expect 100% capacity utilization in FY20, while management believes the plant can operate at 110% capacity utilization as well.
- **EBITDA margin:** Given that the raw material is in close proximity to its plant, the company expects to generate 30% EBITDA margin. Greenply currently generates 28%; we build in 20% for Century in the first year and gradually scale margins by 200bps each in FY19 and FY20.
- **RoCE:** Whilst RoCE will remain in single digits in FY18, given the high capex and low interest and depreciation recovery we expect RoCE of 16% by FY20 when the plant reaches full utilization. We expect RoE of 24% by FY20. The company will start generating spare cash flows from FY19, which will be used to reduce leverage over the next few years.

Exhibit 26: Financial assumptions – MDF

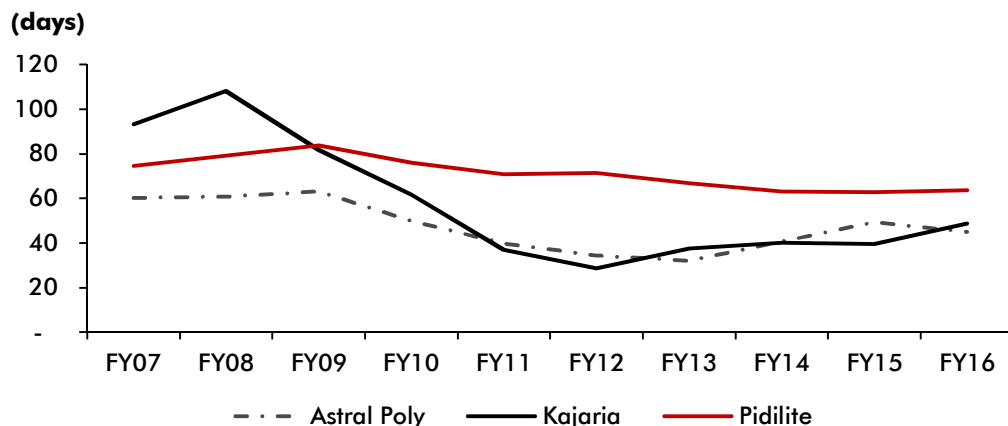
Particulars	FY18	FY19	FY20	Comments
Capacity	180,000	180,000	180,000	
Utilisation	65	80	100	We expect utilisation to reach 100% by FY20; management expects to reach full utilisation by FY19
Volume	117,000	144,000	180,000	
Realisation	27,000	28,080	29,203	We build in realisation in-line with Greenply in FY18 and increase it by 4% in the following years
Revenue	3,159	4,044	5,257	
EBITDA	632	890	1,262	
EBITDA margin	20%	22%	24%	Whilst management expects EBITDA margin of 30%, we assume 20% EBITDA margin and build in 200bps expansion thereon
Depreciation	200	200	200	5% of Gross Block of ₹4bn
EBIT	432	690	1,062	
Interest	225	202.5	157.5	9% of average borrowing
PBT	207	487	904	
Taxes (33%)	68	161	298	Earnings to improve sharply as utilisation scales up, driving significant improvement in interest and depreciation recovery
PAT	139	326	606	
Cash flows				
EBITDA	632	890	1,262	
Less: Taxes	68	161	298	
Less: Change in WC	433	121	166	
CFO	131	608	797	
Less: Capex	-	80	80	Maintenance capex - 2% of GB
Less: Int	225	203	158	
Spare cash flows	(94)	325	560	
Ratios				
Pre-tax RoCE	10	16	25	
Post-tax RoCE	7	11	16	Whilst return ratios will remain subdued in the initial years, it will improve meaningfully by FY20 when the plant reaches full capacity utilisation
RoE	8	17	24	

Source: Company, Ambit Capital research

Still to realize the benefits of its brand

Whilst Century has established a top-notch brand name that fetches it a premium over peers, it is yet to realize the allied benefits of a strong brand – ability to negotiate with the channel and reduce investments in working capital. As seen in the table below, as building material companies establish their brand the cash conversion cycle reduced significantly. We believe Century can traverse a similar path.

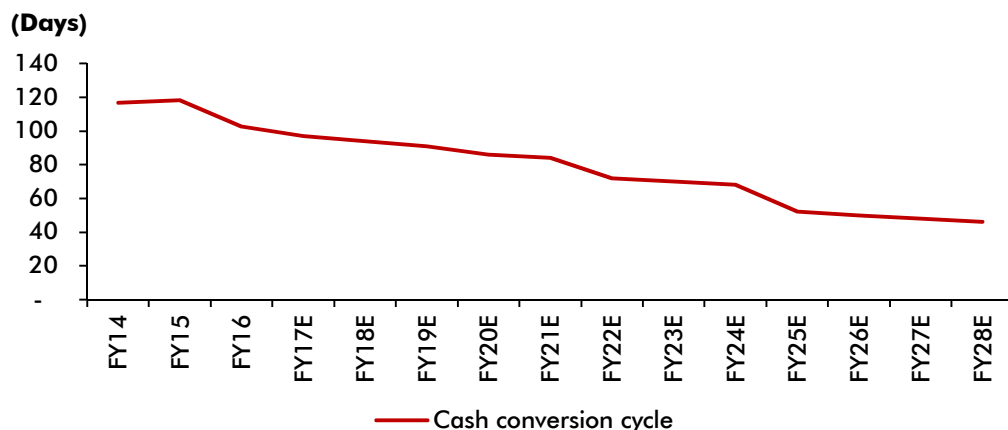
Exhibit 27: Cash conversion cycle of building material companies came off in the last decade



Source: Company, Ambit Capital research

Room for reduction in cash conversion cycle: Century's cash conversion cycle (debtor days + inventory days - creditor days) reduced to 103 days in FY16 from 117 in FY14. We see room for further decline as the revenue contribution of laminates and MDF rises and unorganized market share shrinks. We build in reduction in cash conversion cycle over the next decade to 46 days from 103 days currently. Note that we exclude buyers credit for our calculation of the cash conversion cycle; adjusted for the same, the cash conversion cycle will shrink to 70 days.

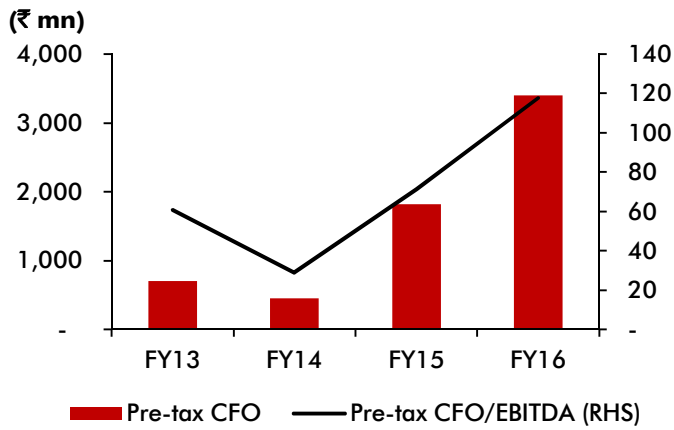
Exhibit 28: Century's cash conversion cycle to shrink over the next decade



Source: Company, Ambit Capital research

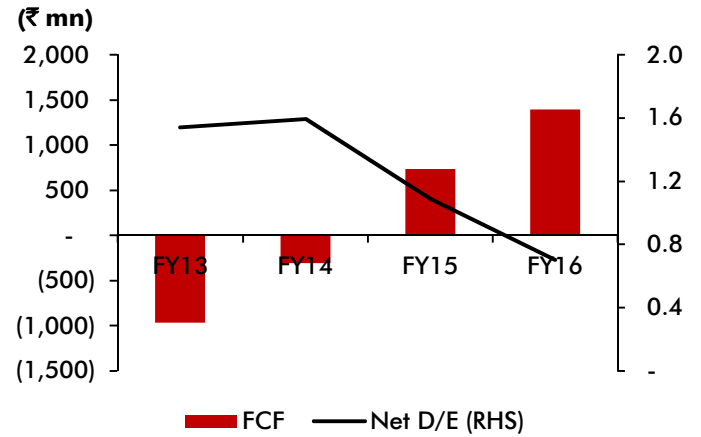
As the cash conversion cycle of Century shrank, the CFO to EBITDA conversion also improved materially (see exhibits below). Moreover, the company's FCF generation improved materially despite significant investments in raw material security, leading to reduction in net-debt/equity.

Exhibit 29: CFO/EBITDA for Century improved as cash conversion cycle shrank



Source: Company, Ambit Capital research

Exhibit 30: FCF generation improved, resulting in reduction in net D/E

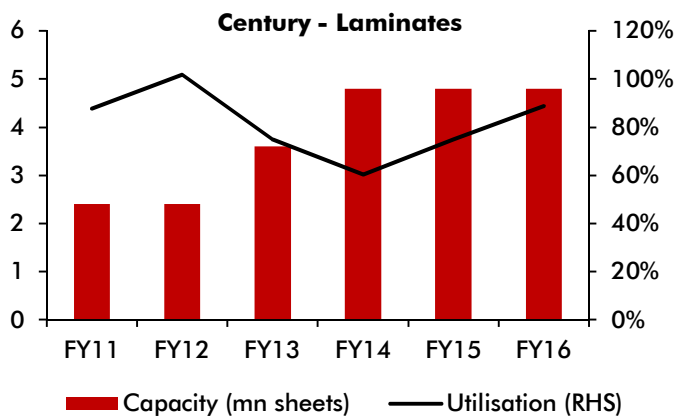


Source: Company, Ambit Capital research

Category creation: Century has effectively managed to leverage its brand into creating allied businesses. Laminates is a prime example where the company created the third-largest franchise India from no presence a decade back (20% revenue CAGR over FY10-16). The company doubled its laminate capacity in FY14 and reached full capacity utilization by the end of FY15. The company is likely to further enhance laminate capacity in FY18.

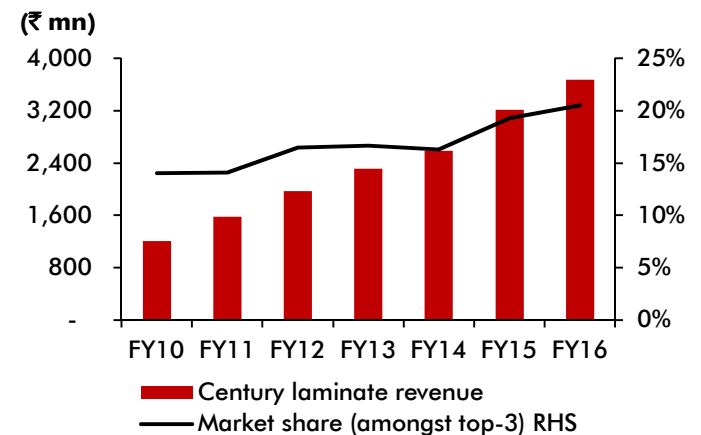
The company is flanking its brand into more allied products such as wooden flooring, doors, PVC sheets and cement fibre boards. Whilst these are small businesses for the company today and the company is currently supplying through imports, when these become large opportunities Century should commit capital for expanding the businesses.

Exhibit 31: Century doubled capacity and ramped-up utilization



Source: Company, Ambit Capital research

Exhibit 32: Century posted 20% revenue CAGR in laminates and is now the third-largest player in India



Source: Company, Ambit Capital research

Comparison with other building material companies

Working capital cycle: Century fares poorly in comparison to leaders like Asian Paints, Pidilite, Kajaria and Supreme. To reduce the gap it needs more IT investments for inventory management and better credit terms with dealers. All good companies have managed to reduce WC cycle as their franchises became stronger. For example, Pidilite's WC cycle reduced from 85 days in FY08 to 45 days in FY16 and they are keen to reduce it further.

Gross/EBITDA margin: Century has improved on this parameter over the years and its margins are now akin to companies such as Astral and Supreme.

CFO/EBITDA and D/E: The company's CFO/EBITDA conversion has been patchy and lower than most of the high quality building material names. D/E is also higher than most good quality companies (although ~35% of overall debt is due to buyer's credit against import of materials). All the good quality companies de-levered their balance sheets as they generated cash.

Capital employed turnover: Despite low gross block intensity, Century's CE turnover has been impacted by high working capital requirement. RoEs are similar to the good quality building material names.

Exhibit 33: Century's cash conversion cycle is higher than most other building material franchises

Particulars	Cash conversion cycle (Days)				Inventory Days				Debtor Days				Creditor Days			
	FY13	FY14	FY15	FY16	FY13	FY14	FY15	FY16	FY13	FY14	FY15	FY16	FY13	FY14	FY15	FY16
Coffee Can legends	58	55	53	53	57	56	54	51	37	37	38	39	36	39	39	38
Asian	27	25	27	26	45	45	44	40	19	19	18	17	37	39	36	31
Berger	72	69	64	59	72	72	68	65	46	48	49	49	46	51	53	55
Pidilite	74	70	69	72	54	53	51	49	45	45	46	51	25	28	28	27
The Little Giants	49	48	51	55	51	46	44	47	40	40	43	47	42	37	36	39
Kajaria	38	40	40	49	47	41	41	52	30	31	31	36	40	32	33	39
Somany	46	38	37	47	38	30	27	29	55	56	56	61	47	49	46	43
Supreme	32	36	37	37	42	44	41	44	20	20	20	20	30	29	25	27
Astral	32	41	49	45	61	58	59	58	46	42	48	49	75	60	58	62
Cera	98	88	91	97	68	54	51	51	47	52	59	68	17	18	19	22
Upcoming franchises	89	87	89	87	71	68	67	62	56	56	57	62	38	37	35	37
Century	105	117	118	103	71	82	77	66	56	57	62	64	22	22	21	26
Greenply	72	70	65	60	58	64	62	55	55	59	59	63	42	53	56	58
Century Vs Coffee Can Legends	50	50	60	61	26	16	18	18	21	15	17	22	(2)	(20)	(25)	(21)
Century Vs Little giants	58	57	63	59	32	26	29	22	18	12	12	14	(8)	(18)	(22)	(23)

Source: Company, Ambit Capital research

Exhibit 34: Whilst Century's margins are comparable to other high quality companies, CFO-EBITDA and D/E needs improvement

	Gross Margin				EBITDA margin				CFO/EBITDA				D/E (X)			
	FY13	FY14	FY15	FY16	FY13	FY14	FY15	FY16	FY13	FY14	FY15	FY16	FY13	FY14	FY15	FY16
Coffee Can legends	48%	49%	50%	54%	16%	16%	16%	20%	83%	87%	90%	108%	0.2	0.2	0.2	0.1
Asian	60%	61%	62%	65%	17%	17%	17%	19%	88%	88%	75%	104%	0.1	0.1	0.1	0.1
Berger	46%	47%	49%	52%	13%	14%	14%	17%	51%	88%	98%	113%	0.6	0.6	0.5	0.3
Pidilite	40%	39%	39%	45%	18%	17%	17%	24%	109%	83%	98%	108%	0.1	0.0	0.0	0.0
The Little Giants	44%	43%	44%	46%	14%	13%	13%	14%	84%	85%	76%	90%	0.6	0.5	0.4	0.3
Kajaria	58%	61%	66%	69%	16%	16%	16%	19%	76%	93%	82%	88%	0.9	0.5	0.3	0.3
Somany	41%	41%	41%	43%	8%	6%	7%	8%	101%	107%	43%	59%	1.1	0.8	0.7	0.6
Supreme	34%	32%	33%	36%	16%	15%	16%	17%	97%	76%	112%	74%	0.5	0.5	0.3	0.3
Astral	30%	28%	27%	31%	14%	14%	12%	12%	64%	58%	85%	127%	0.4	0.5	0.3	0.3
Cera	57%	54%	53%	53%	15%	14%	14%	15%	83%	91%	60%	102%	0.3	0.2	0.2	0.2
Upcoming franchises	40%	42%	45%	48%	12%	12%	14%	16%	68%	55%	93%	111%	1.8	1.6	1.2	0.8
Century	38%	42%	47%	51%	10%	12%	16%	17%	57%	29%	71%	118%	2.1	2.0	1.3	0.9
Greenply (ply+lam)	42%	42%	42%	46%	13%	12%	12%	14%	79%	81%	114%	104%	1.4	1.3	1.0	0.7
Century Vs Coffee Can Legends	-1084bps	-711bps	-359bps	-328bps	-568bps	-419bps	-5bps	-246bps	-2524bps	-5781bps	-1912bps	912bps	1.9	1.8	1.1	0.8
Century Vs Little giants	-620bps	-156bps	253bps	440bps	-325bps	-132bps	316bps	307bps	-2655bps	-5651bps	-495bps	2792bps	1.5	1.5	0.9	0.6

Source: Company, Ambit Capital research

Exhibit 35: Profitability ratios comparable to other high quality franchises

	Capital Employed Turnover (X)				Pre-tax RoCE				RoE			
	FY13	FY14	FY15	FY16	FY13	FY14	FY15	FY16	FY13	FY14	FY15	FY16
The coffee can legends	2.5	2.5	2.4	2.3	36.8%	35.0%	34.0%	40.7%	30.4%	27.7%	26.3%	30.5%
Asian	3.2	3.2	3.0	2.8	49.9%	47.2%	44.9%	48.3%	37.8%	34.0%	32.5%	34.4%
Berger	2.2	2.1	2.1	2.2	25.5%	24.4%	25.1%	31.7%	25.1%	24.1%	22.3%	27.0%
Pidilite	2.0	2.1	2.0	1.8	35.1%	33.4%	32.1%	42.0%	28.4%	24.8%	24.1%	30.0%
The Little Giants	2.8	2.8	2.7	2.4	30.9%	29.9%	27.5%	27.2%	29.8%	25.5%	23.4%	22.1%
Kajaria	2.6	2.5	2.5	2.2	32.4%	33.0%	34.1%	35.4%	33.5%	30.4%	29.7%	28.1%
Somany	3.5	3.6	3.7	3.1	21.5%	16.6%	19.2%	20.4%	23.4%	14.1%	19.1%	19.1%
Supreme	2.8	2.8	2.7	2.6	37.9%	34.0%	33.8%	34.7%	34.1%	28.6%	27.7%	27.3%
Astral	2.7	2.7	2.2	1.9	31.9%	33.8%	20.7%	18.1%	28.8%	28.6%	16.8%	14.5%
Cera	2.3	2.6	2.4	2.1	30.8%	32.3%	29.5%	27.5%	29.0%	25.7%	23.5%	21.6%
Upcoming franchises	1.4	1.7	1.8	1.8	13.4%	15.6%	19.7%	22.7%	20.2%	22.7%	33.2%	28.9%
Century	0.9	1.6	1.8	1.7	7.4%	14.3%	23.4%	25.3%	11.8%	23.2%	44.2%	36.6%
Greenply (ply+lam)	1.8	1.8	1.8	1.9	19.4%	16.8%	16.0%	20.0%	28.6%	22.2%	22.3%	21.3%
Century Vs Coffee Can Legends	(1.6)	(0.8)	(0.6)	(0.5)	-2939bps	-2068bps	-1062bps	-1540bps	-1865bps	-443bps	1787bps	611bps
Century Vs Little giants	(1.9)	(1.2)	(0.9)	(0.6)	-3043bps	-3039bps	-2881bps	-2824bps	-920bps	-1179bps	-1025bps	-1314bps

Source: Company, Ambit Capital research

Change in assumptions

- **Revenue:** We increase our revenue estimate by 1-5% over FY17-19%, led by 2% increase our plyboard volume growth assumption, given that the company has been able to gain market share in the mid-segment plyboard. We also increase our MDF revenue growth assumption, factoring in capacity utilization of 65% in year 1 as against 60% previously.
- **EBITDA:** We increase EBITDA by 5% in FY18 and 14% in FY19, factoring in 20% and 22% EBITDA margin in the MDF business as against 17% and 18% previously.
- **Depreciation and interest:** Increase in depreciation and interest expense is on account of assuming capitalization and loan intake of the MDF plant in FY17.
- **PAT:** The above mentioned changes lead to a 3% and 14% increase in FY18 and FY19 PAT.

Exhibit 36: Change in our financial assumptions

Particulars (₹ mn unless mentioned)	New Estimates			Old Estimates			Change (%)		
	FY17	FY18	FY19	FY17	FY18	FY19	FY17	FY18	FY19
Financials									
Net Sales	19,185	26,684	32,457	19,027	25,493	31,416	1%	5%	3%
Ply	14,048	16,835	20,700	13,661	16,371	20,130	3%	3%	3%
Lam	4,654	5,876	7,163	4,654	5,876	7,163	0%	0%	0%
MDF	-	3,159	4,044	-	2,592	3,816	NA	22%	6%
Reported EBITDA	3,353	4,727	5,882	3,334	4,487	5,149	1%	5%	14%
Reported EBITDA margin (%)	17.5%	17.7%	18.1%	0	0	0	-4 bps	12 bps	173 bps
Adjusted EBITDA	3,353	4,727	5,882	3,334	4,487	5,149	1%	5%	14%
Adjusted EBITDA margin (%)	17.5%	17.7%	18.1%	0	0	0	-4 bps	12 bps	173 bps
Depreciation	701	787	847	631	799	859	11%	-2%	-1%
Interest	381	632	652	336	565	630	13%	12%	4%
PAT	1,865	2,621	3,435	1,944	2,545	3,018	-4%	3%	14%
PAT margin (%)	9.7%	9.8%	10.6%	0	0	0	-50 bps	-16 bps	98 bps
Cash flow parameters									
CFO	2,968	3,075	3,650	3,029	2,348	3,053	-2%	31%	20%
Capex	(4,781)	(1,076)	(920)	(3,781)	(2,262)	(924)	26%	-52%	0%
FCF	(1,813)	1,999	2,730	(752)	86	2,129	141%	2230%	28%
Turnover ratios									
Working capital (ex-cash)	3.3	3.4	3.0	3	4	4	0.1	(0.5)	(0.6)
Gross Block	2.4	2.0	2.2	3	2	2	(0.1)	(0.3)	(0.2)
Capital employed	1.6	1.5	1.6	2	2	2	(0.0)	(0.2)	(0.2)
Profitability Ratios									
RoCE	18.9%	21.2%	22.6%	20%	22%	21%	-119 bps	-29 bps	181 bps
RoE	30.1%	32.5%	32.5%	31%	31%	29%	-111 bps	108 bps	348 bps
ROIC	20.1%	22.9%	26.3%	22%	22%	22%	-142 bps	61 bps	404 bps

Source: Company, Ambit Capital research

Valuation: Early stage of evolution curve

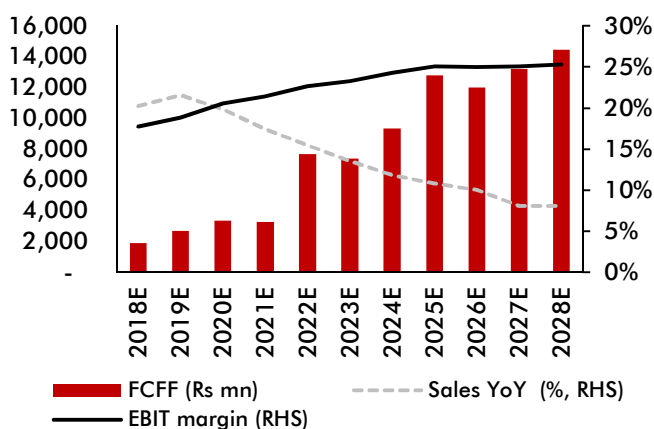
The evolution curve of building material companies in India comprises gaining scale, establishing the brand, educating the intermediary/channel, improving cash conversion cycle and finally innovation and building a strong employee eco-system. Note in the exhibit below that most of the building material companies exhibited strong and consistent growth and improved margins, cash generation and RoCE over their evolution, which led to a consistent re-rating of their multiples.

Upgrading valuation: We upgrade our target price of Century by 35% to ₹282/share and increase our FY18/FY19 earnings estimates by 2%/19%.

The key reason behind the upgrades is increasing visibility of MDF finding acceptance in the Indian market. Although the installed capacity in India will rise materially after the expansion of Greenply and Century, our checks suggest that MDF will be able to garner market share from plyboards over the next five years, which can expand the addressable market significantly. Note that even if 10% of the unorganized plyboard market shifts to MDF over the next five years, the addressable MDF market will double. Moreover, rising restrictions of import of MDF from the South-East Asian countries strengthens our belief that the domestic manufacturers will be able to capitalize on the MDF opportunity.

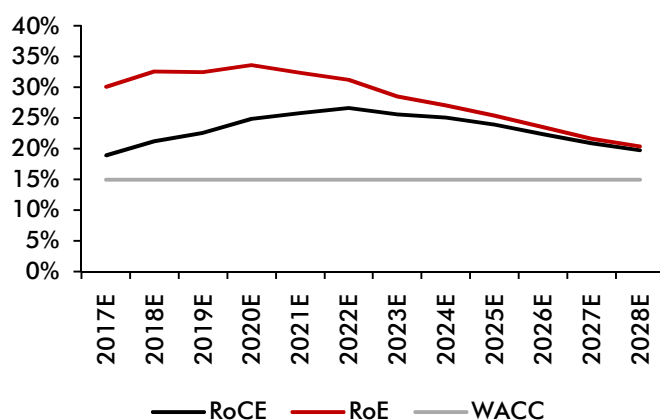
Whilst we build in 18% CFO CAGR in our DCF model over FY16-28, we believe the FCF CAGR will be 23% in the same period since capital intensity will reduce as the growth in plyboards will be driven by outsourcing.

Exhibit 37: FCFF generation profile – expect consistent FCFF generation post-FY18



Source: Company, Ambit Capital research

Exhibit 38: Expect RoCE/RoE to taper but remain comfortably higher than WACC



Source: Company, Ambit Capital research

Exhibit 39: Consistent revenue growth, stable margins and FCF generation...

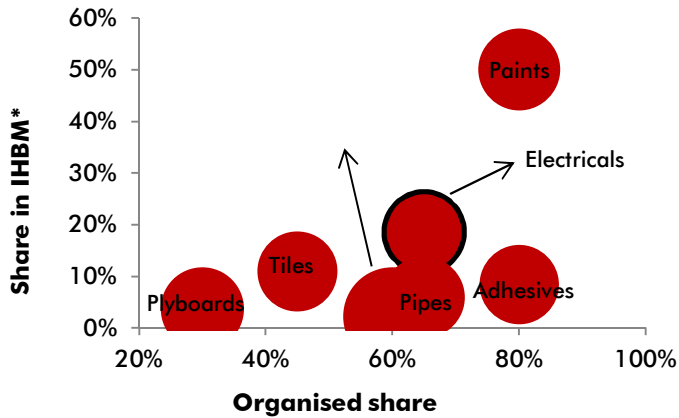
Company	Revenue CAGR (%)				EBITDA margin (%)				Cumulative FCF/CFO (%)			
	FY97-02	FY02-07	FY07-12	FY12-16	FY97-02	FY02-07	FY07-12	FY12-16	FY97-02	FY02-07	FY07-12	FY12-16
Asian	14.3	19.0	21.3	12.7	14.3	13.4	15.7	16.4	47.4	73.2	53.1	61.0
Berger	14.7	18.1	19.3	12.0	9.2	9.9	10.0	11.9	23.4	49.6	(1.5)	46.1
Kajaria	14.4	16.4	24.8	16.5	27.1	19.1	15.1	16.7	(94.5)	(95.5)	(13.4)	(12.4)
Pidilite	13.1	20.4	20.2	14.5	18.7	16.3	15.1	17.3	35.1	14.2	35.6	60.3
Supreme	10.4	14.5	20.3	0.4	15.8	10.9	14.1	15.5	21.9	38.7	28.3	48.7

Source: Company, Ambit Capital research

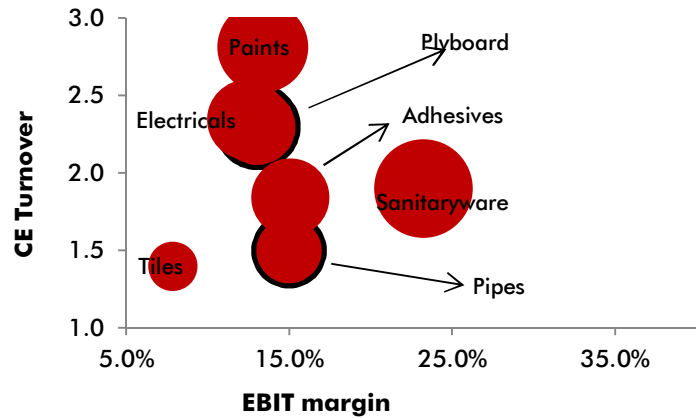
Exhibit 40: ... alongside, reduction in cash conversion cycle, and improvement in RoCEs, drives P/E re-rating

Company	Cash conversion cycle (Days)				Pre-tax RoCE (%)				P/E multiple (X)			
	FY97-02	FY02-07	FY07-12	FY12-16	FY97-02	FY02-07	FY07-12	FY12-16	FY97-02	FY02-07	FY07-12	FY12-16
Asian	74	47	36	32	24	34	47	42	10	14	20	33
Berger	95	76	71	63	19	23	20	23	7	12	16	30
Kajaria	156	113	71	40	13	15	15	31	4	8	14	25
Pidilite	81	83	83	47	25	24	21	30	9	12	18	30
Supreme	59	31	30	30	13	12	24	31	5	10	14	23

Source: Company, Ambit Capital research

Exhibit 41: Plyboard has a long way to go...


Source: Company, Ambit Capital research. Note: Size of the bubbles denotes sales CAGR for five years. *IHBM - internal home building materials

Exhibit 42: ...however, comparable profitability to several other sectors would drive a re-rating as scale increases


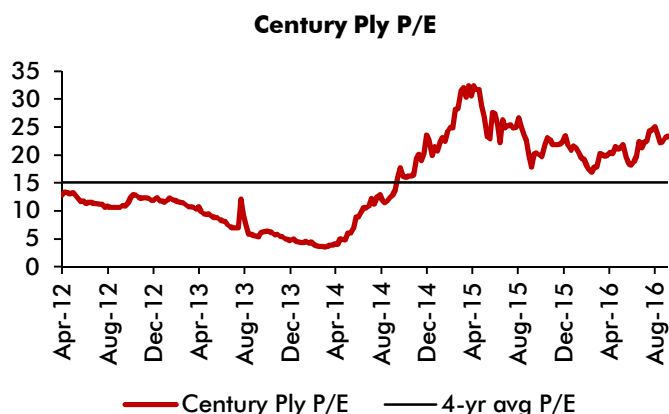
Source: Company, Ambit Capital research. Note: Size of the bubbles denotes RoE

Ply is positioned between tiles and pipes: We believe that ply's positioning is between tiles and pipes. Like the tile industry, the capital intensity of the business will reduce as the larger plywood players choose to outsource rather than manufacture it themselves; GST and shifting preference to engineered woods products will make some unorganized capacities/players redundant.

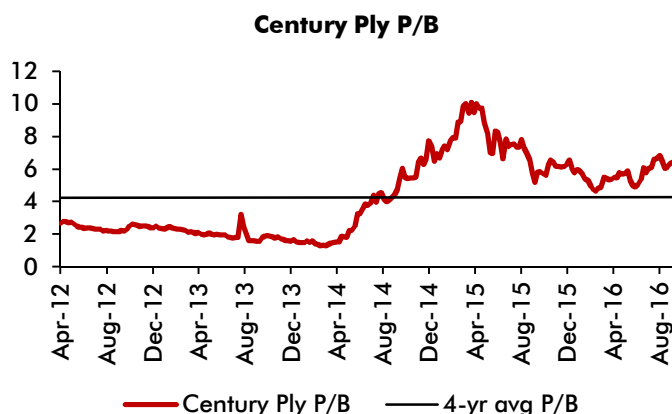
Like in the pipe industry, incumbents will have to disrupt their core products (GI to PVC to CPVC) and invest in training intermediaries given limited brand awareness among end-consumers. Moreover, in the wood substrate industry there is ample room for innovation and India remains way behind in acceptance of globally accepted products like wood plastic composites, cement fibre boards, PVC sheets etc.

Multiples of plyboards have room for further expansion as leaders face little credible competition and the large unorganized market is susceptible to regulatory changes and liquidity issues.

Century's multiples should be seen post full utilization of MDF plant: Given Century is making a large investment in MDF, return ratios will be impacted till the time the plant hits full capacity utilization. Century trades at 19.5x FY18 EPS. Whilst our target price implies 23x FY18 EPS, which appears slightly expensive, the multiples on FY19 earnings (post MDF reaches 85% utilization) is 18.5x, which is reasonable in our view. We believe that the company will deliver EPS CAGR of 29% over FY16-20 alongside 30%+ RoEs. We expect CFO and FCF CAGR of 20% and 23% over FY17-20, which will further drive multiple expansion.

Exhibit 43: After sharp re-rating last year, one-year forward P/E ratio has reverted close to four-year mean


Source: Bloomberg, Company, Ambit Capital research

Exhibit 44: Century is trading at a marginal premium to its four-year average P/B


Source: Bloomberg, Company, Ambit Capital research

Century vs Kajaria: Century and Kajaria are the brand, scale and cost leaders of the ply and tile industry respectively. Similar to Kajaria, Century has gradually managed to reduce capital intensity by increasingly outsourcing sales which has resulted in expansion of capital employed turnover (~2x for both companies). Whilst both have broadly comparable RoEs, the cash conversion cycle of Kajaria is materially shorter than Century's (40 days vs ~100 days for the latter). Kajaria trades at 30x FY18 EPS as against 21x for Century.

Exhibit 45: Comparison of Century and Kajaria on operational parameters

Parameter	Century	Kajaria
Scale and brand	Largest plyboard manufacturer with ~10% market share	Largest tile manufacturer with ~10% market share
Fixed capital intensity	Higher G/B turnover (3.5x in FY16) since ply is a low capital intensity business. Capital intensity will reduce in the ply business as the company increases outsourced sales	G/B turnover is ~2x and has been rising over the years as the mix of JV sales has been rising
Working capital intensity	High working capital intensity due to high industry fragmentation. Currently cash conversion cycle is 100 days	The company has managed to reduce working capital intensity over the last few years as its brand got established. Currently cash conversion cycle is 40 days
Employee architecture	Still building an employee architecture, needs to do a lot more work here	Been steadily hiring industry veterans in key positions. Increasing professional management in the business
Balance sheet	0.7x D/E equity. Debt set to rise to fund the MDF expansion and it will not generate FCF in FY17	Debt/Equity is similar to Century but will increase materially (to ~2x) given the large capital commitment in MDF (₹7bn)
Valuation	Trades at 20x FY18 EPS; expect 30% RoE over FY16-19	Trades at 30x FY18 EPS; expect 28% RoE over FY16-19

Source: Ambit Capital research

Century vs Greenply

Century and Greenply almost have similar scale in the plyboard business; however, Century has a better brand (~5% premium pricing) and superior raw material security. Moreover, Greenply has reduced investments on the ply business, whereas Century continues to ramp-up capacities (in Punjab and Vietnam). Greenply has a strong MDF franchise and will be thrice of Century's scale post expansions by both players. Century, on the other hand, has built a strong franchise in laminates which is a high-margin, fast growing business. Century's revenue growth, EBITDA margin and RoCE have been significantly better than Greenply's in the last three years. Century trades at a 15% premium to Greenply, which appears justified, given superior RoEs (30% for Century over FY16-18 vs 20% for Greenply), better raw material security and a wider product mix.

Exhibit 46: Comparison of Century and Greenply on operational parameters

Parameter	Century	Green
Scale and brand	Largest plyboard manufacturer with ~10% market share, it has the best face veneer linkage amongst Indian ply companies. It is the third largest laminate manufacturer and is adding an MDF plant post which will make it the second largest MDF manufacturer in India	Similar in scale and brand recall, however the company has begun to curtail investments in plyboards. It has the largest scale in MDF and will be thrice the size of Century in MDF by FY19
Fixed capital intensity	Higher G/B turnover (3.5x in FY16) since ply is a low capital intensity business. Capital intensity will reduce in the ply business as the company increases outsourced sales.	GB turnover is lower than Century, given that MDF is a much more capital intensive business compared to ply and laminates
Working capital intensity	High working capital intensity due to high industry fragmentation. Currently cash conversion cycle is 100 days	Lower working capital intensity than Century
Employee architecture	Still building an employee architecture, needs to do a lot more work here	Better than Century in this regard. Has more professional managers at the mid-tier
Balance sheet	0.7x D/E equity. Debt set to rise to fund the MDF expansion and it will not generate FCF in FY17	D/E will rise to 1.5x post the MDF expansion, will not generate FCF for the next three years
Valuation	Trades at 20x FY18 EPS; expect 30% RoE over FY16-19	Trades at 19x FY18 EPS; expect 20% RoE over FY16-19

Source: Ambit Capital research

Exhibit 47: Explanation for the accounting flags

Segment	Score	Comments
Accounting	AMBER	Century's cash conversion cycle is materially longer than that of other building material peers. However, we note that the cash conversion cycle and CFO-EBITDA improved materially in FY16. On our accounting checks, we do not see any cash pilferage concerns
Predictability	AMBER	Management commentary has been volatile around capex commitment and expansions outside India. Moreover, given that it is dependent on South-East Asian countries for its raw material sources, the predictability of the same (due to change in regulations) is poor
Earnings momentum	GREEN	Consensus estimates were marginally upgraded last month.

Source: Company, Bloomberg, Ambit Capital research

Exhibit 48: Ambit vs consensus

Particulars	Consensus	Ambit	Divergence	Comments
Revenue (₹ mn)				
FY17	18,568	19,185	3%	Our estimates are higher than consensus as we expect significant scale up in revenues post commissioning of the MDF plant
FY18	22,855	26,684	17%	
EBITDA (₹ mn)				
FY17	3,201	3,353	5%	Our EBITDA estimates are higher since we expect plyboard margins to sustain and 20% EBITDA margin in MDF
FY18	4,053	4,727	17%	
PAT (₹ mn)				
FY17	1885	1,865	-1%	Higher PAT estimate leads to higher PAT estimates for FY18
FY18	2367.5	2,621	11%	

Source: Bloomberg, Company, Ambit capital research

Relative valuation

Century trades at a 50% discount to the paints, 15% discount to the pipes, and a 30% discount to Kajaria despite comparable RoEs and earnings growth. It trades at a 15% premium to Greenply, but its margin and RoE profile is significantly superior to the latter s.

Exhibit 49: Relative valuations for the overall Home Building Materials space

Companies	Rating	6M	Mcap	EV/EBITDA (x)		P/E (x)		RoE (%)		CAGR (FY12-15) (%)			CAGR (FY16-18) (%)		
		ADV (USD mn)		US\$ mn	FY17	FY18	FY17	FY18	FY17	FY18	Sales	EBITDA	EPS	Sales	EBITDA
PAINTS															
Asian Paints	BUY	16.1	16,828	32.8	28.0	52.4	44.3	35.6	35.8	13.4	14.1	12.1	15.0	18.7	21.2
Berger Paints	BUY	1.8	3,904	30.9	26.1	53.6	44.2	29.1	29.8	13.6	19.8	13.7	13.3	21.6	26.4
ELECTRICALS															
Havells India	BUY	9.7	3,908	27.6	23.2	40.6	34.8	23.5	24.4	9.5	1.0	1.3	16.3	15.3	27.9
Finolex Cables	BUY	0.7	963	15.2	13.1	23.6	20.0	18.4	18.1	7.0	12.4	26.5	13.4	15.3	13.8
V-Guard	UR	1.5	838	25.4	21.3	38.1	31.3	27.5	27.2	24.5	11.9	11.6	16.1	20.7	26.4
Bajaj Electricals	BUY	1.1	408	9.4	NA	19.4	NA	16.5	17.9	11.1	(28.0)	NA	10.9	16.7	33.7
ADHESIVES															
Pidilite Industries	BUY	7.8	5,458	26.6	23.7	42.1	36.2	28.5	27.1	16.3	16.0	14.1	21.9	16.0	19.7
PIPES															
Supreme Industries	BUY	1.3	1,794	15.0	13.0	27.7	23.4	28.5	28.5	13.3	12.1	10.1	17.2	14.2	15.9
Astral Poly	NR	0.4	840	20.9	16.2	37.8	27.7	17.1	19.6	34.9	26.6	23.6	22.1	31.0	41.4
Finolex Inds	NR	0.6	874	13.5	12.0	21.7	18.8	25.6	26.6	5.6	(2.7)	(14.0)	9.4	14.1	14.1
PLYBOARDS															
Century Plyboard	BUY	1.3	756	17.0	13.4	26.8	21.3	30.6	30.1	(1.6)	(4.3)	6.6	17.7	18.5	19.0
Greenply	NR	0.6	503	12.7	11.0	22.6	18.7	21.8	20.8	(1.6)	2.8	31.6	12.2	14.4	17.3
Green Lam	NR	0.0	259	NA	12.1	28.2	19.5	19.6	19.1	NA	NA	NA	21.7	NA	53.6
TILES															
Kajaria Ceramics	NR	1.1	1,610	36.4	30.0	36.4	30.0	27.6	26.9	18.5	19.5	27.4	15.5	18.5	25.0
Somany Ceramics	NR	0.2	370	29.0	22.1	29.0	22.1	17.9	20.0	20.6	13.5	17.9	14.1	22.9	27.5
SANITARY WARE															
Cera Sanitaryware	NR	0.4	463	29.0	23.8	29.0	23.8	22.5	22.5	37.0	29.5	28.2	8.2	22.7	24.6
HSIL	NR	0.5	376	20.7	15.1	20.7	15.1	9.0	11.6	11.1	8.9	(3.1)	14.2	15.9	36.5

Source: Bloomberg, Company, Ambit Capital research

Catalysts

Further acceleration in market share gains driving volume growth in 2HFY17:

Century gained market share from unorganized players in last two quarters, which resulted in 10-12% volume growth. Given the challenges faced by the unorganized players, we believe Century will be able to improve volume growth run-rate in 2HFY17.

Reduction in cash conversion cycle: Century has one of the highest cash conversion cycles in the Indian building material space. The company managed to reduce its cash conversion cycle by 15 days in FY16; further reduction in cash conversion cycle will improve RoCE and cash generation. After a 15-day contraction in FY17, we expect cash conversion cycle to reduce by another 6 days in FY18.

Ramp-up of particle board plant and timely completion of MDF plant: Whilst the particle board plant has been commissioned, Century has not managed to generate any major revenues from the plant. Scale-up of the particle board plant will improve revenue and earnings growth in 2HFY17. The company is confident of commissioning the MDF plant in Mar-17 and start generating revenue from 1QFY18. Quick ramp-up of the MDF plant will be a major boost to earnings and will drive a re-rating.

Risks

Raw material disruption: Century is dependent on South-East Asian countries (dominant Laos now) for its face veneer requirements. These countries are susceptible to frequent changes in timber logging regulations, which could disrupt raw material security. Any such developments could adversely impact not only margin but also the capital allocated and the cost benefits that the company enjoys.

MDF – a large bet if goes slow/ wrong? The company is incurring its largest capex in its history in its MDF plant. The company will be taking ₹2.5bn debt to fund the acquisition, which will lead to its D/E increasing to 1x. If the venture fails, the company will be saddled with debt and interest commitments will wipe out profits.

Capital allocation outside India: Management has frequently shown an intent to deploy capital outside India in setting up MDF/plyboard plants. Any major capex in those markets could lead to a de-rating.

Consolidated Financials

Income statement

₹ mn unless mentioned	FY15	FY16	FY17E	FY18E	FY19E
Revenue	15,884	16,637	19,185	26,684	32,457
Plyboards	12,431	12,796	14,048	16,835	20,600
Laminates	3,213	3,669	4,654	5,876	7,163
MDF	-	-	-	3,159	4,044
Total expenses	13,326	13,749	15,366	18,519	22,469
EBITDA	2,559	2,888	3,353	4,727	5,882
Depreciation	485	484	701	787	847
EBIT	2,251	2,462	2,723	4,048	5,245
Other income	177	58	71	108	210
Adj PBT	1,796	1,981	2,343	3,416	4,593
Provision for taxation	338	364	469	786	1,148
Adjusted PAT	1,491	1,672	1,865	2,621	3,435
EPS basic (₹)	6.7	7.5	8.4	11.8	15.5

Source: Company, Ambit Capital research

Balance Sheet

₹ mn unless mentioned	FY15	FY16	FY17E	FY18E	FY19E
Share capital	223	223	223	223	223
Reserves and surplus	3,671	5,104	6,645	8,810	11,647
Total Networth	3,894	5,327	6,867	9,032	11,870
Loans	4,677	4,194	6,494	6,744	6,894
Of which Buyers credit	1,500	1,100	800	800	500
Deferred tax liability (net)	(63)	(130)	(130)	(130)	(130)
Sources of funds	8,564	9,481	13,330	15,754	18,751
Net block	2,456	2,627	6,707	8,022	8,095
Investments	4	2	31	31	31
Cash and bank balances	374	389	211	1,480	3,321
Sundry debtors	2,683	2,873	2,810	3,256	3,809
Inventories	3,322	2,975	3,065	3,625	4,332
Loans and advances	1,349	1,523	1,533	1,843	2,240
Total Current Assets	7,819	8,002	7,861	10,446	13,944
Current liabilities and provisions	2,041	2,175	2,295	2,745	3,319
Net current assets	5,777	5,827	5,566	7,701	10,625
Application of funds	8,564	9,481	13,330	15,754	18,751

Source: Company, Ambit Capital research

Cash flow statement

₹ mn unless mentioned	FY15	FY16	FY17E	FY18E	FY19E
PBT	1,796	1,981	2,343	3,416	4,593
Depreciation	485	484	701	787	847
Interest paid	456	481	381	632	652
CFO before change in WC	2,701	3,037	3,353	4,727	5,882
Change in working capital	(877)	359	84	(867)	(1,083)
Direct taxes paid	(337)	(468)	(469)	(786)	(1,148)
CFO	1,488	2,928	2,968	3,075	3,650
Net capex	751	1,533	4,781	1,076	920
CFI	128	(1,389)	(4,740)	(968)	(710)
Proceeds from borrowings	(649)	(461)	2,300	250	450
Change in share capital	-	20	-	-	-
Interest & finance charges paid	(335)	(272)	(381)	(632)	(652)
Dividends paid	(462)	(601)	(325)	(456)	(598)
CFF	(1,577)	(1,525)	1,594	(838)	(1,100)
Net increase in cash	39	14	(177)	1,269	1,840
FCF	737	1,395	(1,813)	1,999	2,730

Source: Company, Ambit Capital research

Ratios

Particulars	FY15	FY16	FY17E	FY18E	FY19E
Revenue growth (%)	17.9	4.7	15.3	39.1	21.6
EBITDA growth (%)	45	13	16	41	24
PAT growth (%)	137	12	12	40	31
EPS norm (dil) growth (%)	90	12	12	41	31
EBITDA margin (%)	16	17	17	18	18
EBIT margin (%)	14	15	14	15	16
Net margin (%)	9	10	10	10	11
RoCE (%)	22	22	19	21	23
RoC (%)	24	20	23	26	32
RoE (%)	43	36	30	33	33
Working capital turnover (x)	3.0	2.9	3.3	3.4	3.0
Debt/Equity (x)	1.2	0.8	0.9	0.7	0.6
Net debt/Equity (x)	1.1	0.7	0.9	0.6	0.3
Valuation metrics					
P/E (x)	34.3	30.6	27.4	19.5	14.9
P/B (x)	12.9	9.4	7.3	5.6	4.3
EV/Sales (x)	3.5	3.3	3.1	2.5	2.0
EV/EBITDA (x)	21.7	19.0	17.1	11.9	9.3

Source: Company, Ambit Capital research

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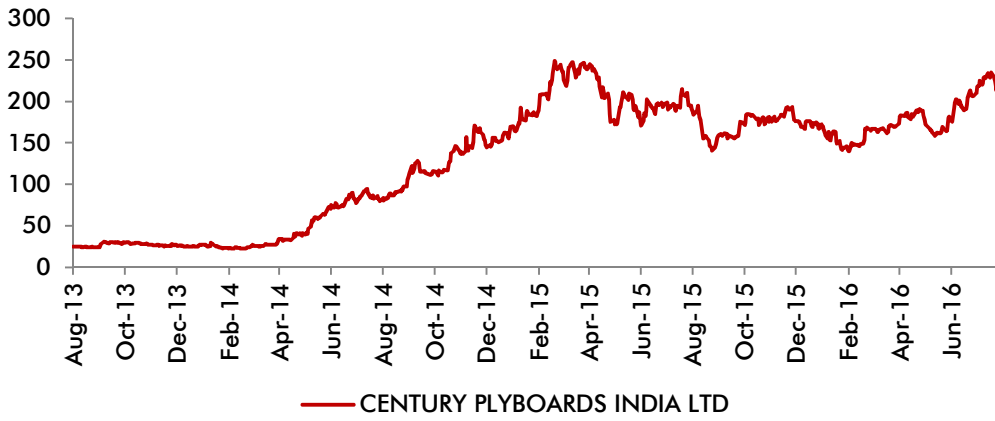
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Century Plyboards India Ltd (CPBI IN, BUY)



Source: Bloomberg, Ambit Capital research

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month)
BUY	>10%
SELL	≤10%
NO STANCE	We have forward looking estimates for the stock but we refrain from assigning valuation and recommendation
UNDER REVIEW	We will revisit our recommendation, valuation and estimates on the stock following recent events
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