Century Plyboards

BUY

Result Update

Topline miss offset by sharp margin improvement

A sharp decline in plyboard volumes (down 9.4% YoY) led to an 8% topline miss in 1QFY16; however, savings in raw material costs drove gross margin expansion of 650bps and EBITDA margin expansion of 520bps, which led to a 22% PAT beat (up 54% YoY). The laminate segment's revenue grew by 23% YoY and EBITDA margin increased to 16% (vs 10% last year), driven by operating leverage and lower selling and advertising expenditure. Decline in plyboard volume was a function of the sharp slowdown in housing, channel-stuffing and possibly a decision to avoid price wars to grow volumes. Whilst we do not doubt the company's long-term growth longevity, a prolonged real estate slowdown will impact near-term volume growth. We will moderate our plyboard volume growth assumption in FY16 and FY17, to account for the significant demand deceleration; however, our EBITDA margin estimate will need upward revision to account for raw material cost savings. The stock is trading at 23x FY16E EPS; our target price implies 21x FY17E EPS. We will revisit our estimates post the conference call on Thursday.

Results overview—Sharp decline in plyboard volumes but strong EBITDA margin

Century's 1QFY16 revenue was 8% lower than our estimate, mainly on account of an unexpected drop in plyboard revenue (down 6% YoY, against our expectations of an 8% growth). However, a 520bps YoY improvement in EBITDA margin (17.8% excluding forex gains) offset lower revenue and led to 41% EBITDA growth. PAT grew by 54% YoY due to better depreciation and interest cost recovery.

The segment-wise summary is as follows:

Plyboards—Sharp volume decline

Revenue in the plyboard segment declined by 6% YoY, led by a 9.4% volume decline (indicative, as the management is yet to share volume details) and by a marginal 2% realisation growth. The sharp and unexpected decline in plyboard volume can be explained by: (a) significant slowdown in housing and real estate, hurting sales across home-building categories, (b) high channel inventory as was evident in the sharp increase in inventory days in Mar-15, and (c) a concerted decision of the management to not participate in price cuts to push volume growth. EBITDA margin improved by 456bps to 18.9%, led largely by savings in raw material costs: (a) lower face veneer cost given expensive inventory last year, (b) lower core timber prices owing to lower domestic prices and low-cost imports from Europe, and (c) savings in crude-linked inputs.

Laminates—Strong revenue growth and margin expansion

Laminates revenue grew by 23% YoY led by 25% volume growth and 2% realisation growth, partially negated by decline in exterior grade laminate sales. Laminate EBITDA margin expanded by 600bps YoY, due to scale-led operating leverage benefits and lower sales and promotion expenditure (the company incurred significant expenses last year, as it was ramping up the dealer network post doubling the capacity in laminates). Laminates is operating at near-full capacity utilisation and the company has increased the working shift to seven days (from six days earlier).

Board approval to set-up an MDF plant in Punjab

The company has proposed to set-up an MDF plant in Punjab; however, this is in the preliminary stage. Our estimates suggest that the company will at best have free cash flow after interest payments of Rs2bn over FY16-17 and hence it can have a deployable cash of Rs4bn for the expansion (assuming 1:1 debt/equity).

Stock Information

Bloomberg Code:	CPBI IN
CMP (Rs):	195
TP (Rs):	242
Mcap (Rs bn/US$ bn):	44/0.7
3M ADV (Rs mn/US$ mn):	125/2.0

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	(3)	(14)	112	23
Rel. to Sensex	(6)	(16)	103	21

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs bn)

	FY15	FY16	FY17
Revenues	15.5	18.3	22.1
EBITDA	2.5	3.1	3.9
EPS (Rs)	6.8	8.5	11.5

Source: Bloomberg, Ambit Capital research

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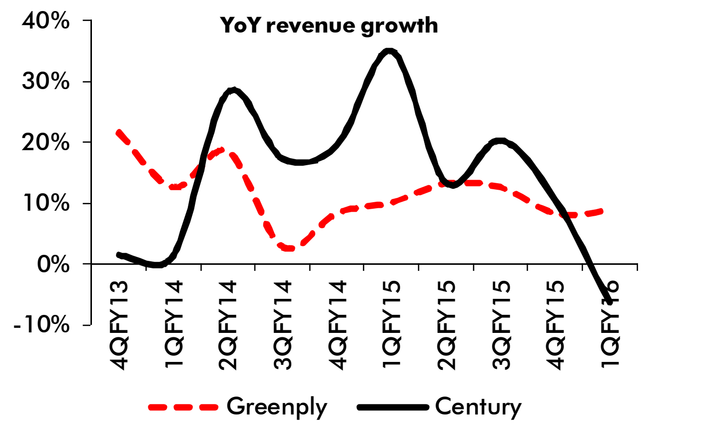
Century vs Greenply—Century focusses on EBITDA and Greenply on volumes

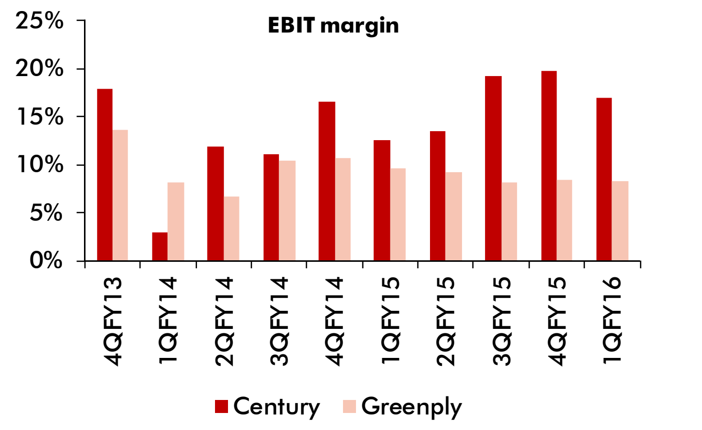
Greenply's plyboard volume grew by 8% YoY, whereas Century's volumes dropped by 9.4%. However, the company's plyboard EBITDA margins dropped by 140bps YoY to 8.6%, whereas Century's EBITDA margin increased by 455bps to 18.9%. It appears that Greenply passed on some of the savings in raw material costs to the customers, which restricted margin expansion but supported volume growth, whereas Century maintained pricing at the cost of lower volume growth.

Exhibit 1: Greenply's ply revenue growth was higher than Century's...



Source: Company, Ambit Capital research

Exhibit 2: ...but its EBITDA margin was significantly lower



Source: Company, Ambit Capital research

Where do we go from here? Near-term challenges; long-term story intact

We retain our long-term thesis on the company that Century's scale expansion, strong brand and expansion of product-lines will improve market share in the Indian plyboard industry, which is currently dominated by the unorganised sector (70% market share); however, the unorganised sector is losing competitiveness due to raw material availability issues, rising brand awareness and improving reach of organised manufacturers. That said, we are concerned about the near-term volume growth, as a prolonged slowdown in housing/real estate will impact volume growth at least for the next 2-3 quarters. As a result, we will have to moderate our plyboard volume growth expectations for Century (10%/14% growth in FY16/FY17) significantly. However, on the positive side, costs remain benign and hence our EBITDA margin estimate (15.9%/16.6% currently) will require upward revisions. Hence, despite lower revenue growth than previously anticipated, we do not see significant downgrades to our PAT estimates.

We await certain clarifications from the management in the conference call scheduled on Thursday (23rd July 2015) before revisiting our estimates.

Valuation and recommendation—Limited levers for near-term multiple expansion

The stock is trading at 23x FY16E EPS, 10% lower than categories such as tiles but at a 35% discount to paints. Our target price of Rs242 implies 21.0x FY17E EPS, which is not excessive when seen in light of 34% EPS CAGR and 34-35% RoE over FY15-17E. Whilst we believe that the company's multiples will re-rate in the mid-to-long term, as industry volumes improve and unorganised share drops further, multiples in the near term face risks from decelerating demand and non-improvement in cash generation.

Exhibit 3: Quarterly results snapshot

Particulars (Rs mn unless mentioned)	1QFY15	4QFY15	1QFY16	YoY (%)	QoQ (%)	Ambit Est	Dev (%)	Comments
Net Sales	3,608	4,049	3,680	2.0	(9.1)	3,995	(7.9)	Lower-than-expected revenue growth owing to an unexpected decline in plyboard volumes
Operating costs	3,156	3,299	3,042	(3.6)	(7.8)	3,409	(10.8)	Margin expansion driven by raw material cost savings
EBITDA	472	793	668	41.5	(15.9)	616	8.4	
EBITDA margin	13.1	19.6	18.1	507 bps	-145 bps	15.4	272 bps	Higher-than-expected margin was a function of better realisations and raw material cost savings
EBITDA (ex-forex)	454	710	655	44.4	(7.8)	616	6.3	
EBITDA margin (ex-forex)	12.6	17.5	17.8	523 bps	26 bps	15.4	238 bps	
Other income	13	9	3	(75.2)	(61.9)	13	(75.2)	
Depreciation	104	119	101	(3.4)	(15.0)	115	(12.4)	YoY decline is on account of change in depreciation rate as per the new Companies Act
EBIT	381	684	554	45.6	(18.9)	514	7.8	Strong EBIT growth was a function of high EBITDA growth and no forex losses
Interest cost	74	90	123	66.5	36.0	108	13.5	
PBT	307	593	447	45.7	(24.6)	406	10.1	
Tax	50	114	51	1.4	(55.4)	81	(37.7)	
PAT	257	480	397	54.3	(17.3)	325	22.1	Higher-than-expected EBITDA drove the sharp increase in PAT
PAT (adjusted for forex gains/losses)	242	429	386	59.3	(10.0)	325	18.7	
EPS	1.2	2.2	1.8	54.3	(17.3)	1.5	22.1	

Source: Company, Ambit Capital research

Exhibit 4: Significant improvement in plyboards EBIT margin

Segmental Sales (Rs mn)	1QFY15	4QFY15	1QFY16	YoY (%)	QoQ (%)
Plyboard	2,749	2,918	2,576	(6.3)	(11.7)
Laminates	627	805	772	23.0	(4.1)
CFS	154	174	174	13.0	(0.1)
Others	84	160	165	96.7	2.9
Segmental Volumes					
Plyboard (cbm)	47875	50296	43383	(9.4)	(13.7)
Laminates (pieces)	725,136	1,028,241	909,079	25.4	(11.6)
Segmental Realisation					
Plyboard (per CBM)	57	58	59	3.4	2.4
Laminates (per piece)	865	782	849	(1.9)	8.5
Segmental EBITDA					
Plyboard	394	631	487	23.6	(22.7)
Laminates	67	99	127	89.4	28.6
Segmental EBITDA Margin (%)					
Plyboard	14.3%	21.6%	18.9%	457	(270)
Laminates	10.7%	12.3%	16.4%	576	418
Segmental EBIT (Rs mn)					
Plyboard	348	576	438	26.0	(24.0)
Laminates	37	65	101	175.2	56.9
CFS	33	60	54	62.6	(9.5)
Others	(3)	(8)	(1)	(50.6)	(81.6)
Segmental EBIT (%)					
Plyboard	12.6	19.8	17.0	436 bps	-275 bps
Laminates	5.9	8.0	13.1	726 bps	511 bps
CFS	21.6	34.2	31.0	945 bps	-321 bps
Others	(3.5)	(5.0)	(0.9)	266 bps	409 bps

Source: Company, Ambit Capital research

Balance Sheet

Year to March (Rs mn)	FY14	FY15	FY16E	FY17E
Total Networth	2,931	3,749	5,310	7,422
Loans	5,276	4,677	4,427	4,077
Of which Buyers credit	2,002	1,500	1,100	800
Sources of funds	8,314	8,418	9,730	11,491
Net block	3,164	2,781	3,484	3,559
Cash and bank balances	387	374	631	1,832
Total Current Assets	6,793	7,819	8,590	10,716
Current liabilities and provisions	1,914	2,041	2,230	2,670
Net current assets	4,879	5,778	6,360	8,046
Application of funds	8,314	8,418	9,730	11,491

Source: Company, Ambit Capital research

Income statement

Year to March (Rs mn)	FY14	FY15E	FY16E	FY17E
Revenue	13,477	15,525	18,350	22,072
Total expenses	11,961	13,015	15,290	18,356
EBITDA	1,766	2,488	3,059	3,867
Net depreciation / amortisation	387	448	426	464
EBIT	1,416	2,231	2,673	3,490
PBT	629	1,654	2,363	3,196
Adjusted PAT	786	1,365	1,890	2,557
EPS diluted (Rs)	4	6	9	12

Source: Company, Ambit Capital research

Cash flow statement

Year to March (Rs mn)	FY14	FY15E	FY16E	FY17E
PBT	**629**	**1,799**	**2,363**	**3,196**
Change in working capital	(1,168)	(911)	(325)	(486)
Direct taxes paid	(117)	(290)	(473)	(639)
CFO	**338**	**1,432**	**2,262**	**2,742**
Capex	643	400	1,128	539
CFI	**(706)**	**(327)**	**(1,115)**	**(451)**
Proceeds from borrowings	372	364	(250)	(350)
CFF	**(281)**	**(1,118)**	**(890)**	**(1,090)**
Net increase in cash	(649)	(13)	257	1,201
FCF	**(305)**	**1,032**	**1,134**	**2,203**

Source: Company, Ambit Capital research

Ratio analysis / Valuation parameters

Year to March	FY14	FY15E	FY16E	FY17E
RoCE	19	22	23	26
RoE	36	36	36	34
Debt/Equity(x)	1.7	1.2	0.8	0.5
Net debt/Equity(x)	1.6	1.1	0.7	0.3
P/E (x)	55.2	31.8	22.9	17.0
P/B(x)	14.2	11.4	8.1	5.8
EV/EBITDA(x)	27.3	19.1	15.4	11.8

Source: Company, Ambit Capital research