Century Plyboards

BUY

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Warming up for the marathon

Whilst the plyboard industry's revenues declined by ~8-10% in 1HFY16, Century posted 6% revenue growth, 340bps margin expansion (aided by raw material linkages) and improvement in cash conversion. Alongside scale expansion and brand building initiatives, its focus on cost leadership, when smaller players are losing ground, bodes well for long-term profitability. With MDF gradually finding acceptance over low-quality plywood, Century's expansion (at low capital intensity - ₹2.5bn for 600 CBM) is required even if it disrupts its own ply market. Demand slowdown will not suppress Century's valuations (17x FY17E EPS), as long as the company is able to use its brand, scale and cost architecture to gain market share, launch effective products and reinvest surplus cash to sustain/improve RoEs (~35% over FY15-18E).

Competitive position: STRONG Changes to this position: POSITIVE

Credible performance in difficult times

Significant slowdown in secondary real estate transaction led to a sharp decline in plyboard sales for the last 18 months. Century sustained industry-leading growth through scale/product expansion and penetration in smaller markets. Strong margin expansion (340bps), owing to raw material linkages in Myanmar and Laos, drove 48% PAT growth in 1H. Moreover, its cash conversion cycle improved in 1HFY16, led by lower inventory and debtor days.

Strengthening its back-end to lead from the front

Century doubled its ply/lam capacities, invested in branding (₹2.2bn; 3% of sales over FY10-15) and hired senior mid-level managers for business verticals in the last five years. Now, it is doubling its face veneer capacities to gain cost leadership, whilst its smaller competitors continue to face challenges to procure the raw material. Moreover, the company has forayed in MDF, with the product finding acceptance and with the costs of equipment reducing.

Well positioned to benefit from the demand recovery

Whilst demand recovery will take some time, Century will continue to gain market share in the interim, as regulatory changes and liquidity challenges wipe out the low cost advantage of unorganised players. We expect the company to post 17%/23%/33% revenue/EBITDA/PAT CAGR and 34% RoEs over FY15-18. Unhedged forex exposure (₹1.5bn) is the risk to our estimates.

Multiples have room for further expansion

A large addressable market with shrinking unorganised share bodes well for Century. Century trades at 17x FY17E EPS, a 15-35% discount to other building materials; its multiples will expand as the opportunity translates into sustained earnings growth/profitability; our target price implies 21x FY17E EPS. Whilst competition may be less of a risk, product disruption and capex needs for MDF should keep multiples under check.

Key financials

Year to March	FY14	FY15	FY16E	FY17E	FY18E
Net Revenues (₹ mn)	13,477	15,648	17,495	20,809	24,955
EBITDA (₹ mn)	1,766	2,488	3,018	3,675	4,589
EBITDA margin (₹ mn)	13.1%	15.9%	17.3%	17.7%	18.4%
Net Profits (₹)	786	1,365	1,864	2,423	3,215
EPS (₹)	3.5	6.1	8.4	10.9	14.5
RoE (%)	36.1%	36.4%	35.2%	33.2%	32.3%
P/E (x)	50.7	29.2	21.3	16.4	12.4

Source: Company, Ambit Capital research

Building materials

Recommendation

Mcap (bn):	₹145/US$2.7
6M ADV (mn):	₹177/US$3.3
CMP:	₹192
TP (12 mths):	₹230
Upside (%):	20

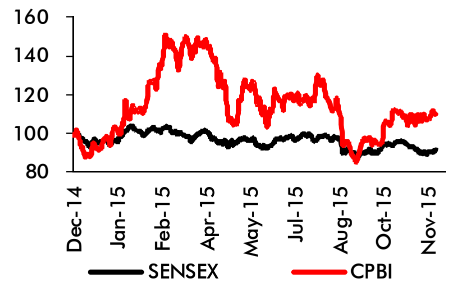
Flags

Accounting:	AMBER
Predictability:	AMBER
Earnings Momentum:	GREEN

Catalysts

- Uptick in volume growth from 2HFY17 onwards as demand recovers
- Market share gain from unorganised in FY16 and FY17 led by regulatory re-sets
- Better pricing power, with lower industry fragmentation driving margin expansion

Performance (%)



Source: Bloomberg, Ambit Capital Research

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Exhibit 1: Assumptions summary

Particulars (₹ mn unless mentioned)	FY16	FY17	FY18	Change (%) FY16	FY17	FY18	Comments
Volumes							
Plyboard (CBM)	201,057	213,997	239,676	2%	6%	12%	Volume growth in in FY16 and FY17 largely driven by Sainik. We expect strong recovery in FY18, led by recovery in construction
Laminate (Sheets)	4,320,818	4,752,900	5,608,422	20%	10%	18%	Volume growth in FY18 to be driven by capacity expansion
MDF (CBM)	-	-	108,000				MDF capacity will start contribution to sales from FY18, we build in 60% capacity utilisation in the first year
Realisation							
Plyboard (₹/CBM)	64	68	73	5%	6%	7%	Realisation improvement to be driven by price hikes
Laminate (₹/sheet)	983	1,042	1,115	5%	6%	7%	Realisation growth to be driven by improving product mix
MDF (Rs/CBM)		-	24				We estimate 10% lower realisation to Greenply
Financials							
Net Sales	17,495	20,601	27,090	12%	18%	31%	Significant volume growth in ply and lam will drive strong revenue growth in FY18. We include revenue for the particle board unit of ₹840mn and ₹960mn in FY16 and FY17 assuming 70% and 80% capacity utilisation and ₹2.6bn revenue from MDF in FY18 (Assuming 60% utilisation)
Adjusted EBITDA	3,018	3,493	4,720	21%	16%	35%	Margin expansion is largely a function of lower raw material prices
Adjusted EBITDA margin (%)	17.3%	17.0%	17.4%	135 bps	-30 bps	47 bps	
Depreciation	450	554	659	0%	23%	19%	Increase as capacities get capitalised
Interest	314	305	306	-27%	-3%	0%	
PAT	1,833	2,155	3,054	34%	18%	42%	Sharp increase with higher EBITDA and lower interest costs
PAT margin (%)	10.5%	10.5%	11.3%	176 bps	-2 bps	81 bps	
Cash flow parameters							
CFO	2,539	2,847	2,393	77%	12%	-16%	High working capital investment will restrict CFO growth in FY16
Capex	(1,468)	(1,484)	(2,231)	267%	1%	50%	Capex to fund office building, maintenance and addition of new plyboard/laminate and MDF
FCF	1,071	1,363	162	4%	27%	-88%	FCF to remain positive leading to debt repayment
Turnover ratios							
Working capital (ex-cash)	3.0	3.1	3.6	0.0	0.2	0.5	Improving WC cycle with lower inventory days and mostly towards FY18
Gross Block	3.0	2.7	2.9	(0.1)	(0.3)	0.1	GB turnover to improve as utilisation rates increase
Capital employed	1.9	1.8	2.0	0.0	(0.0)	0.2	Higher GB and WC turnover to drive capital employed turnover
Profitability Ratios							
RoCE	22.7%	22.6%	25.8%	82 bps	-18 bps	329 bps	Improvement in EBIT margins and higher capital employed turnover to drive profitability for the company
RoE	40.2%	34.7%	36.5%	34 bps	-547 bps	183 bps	
ROIC	24.0%	24.5%	27.7%	94 bps	50 bps	327 bps	

Source: Bloomberg, Ambit Capital research

Exhibit 2: Ambit vs consensus

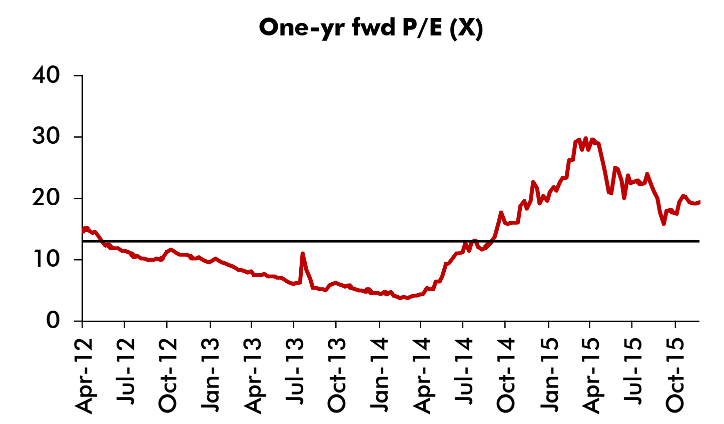
Particulars	Consensus	Ambit	Divergence	Comments
Revenue (₹ mn)				
FY16	17,476	17,368	-0.6%	Our revenue estimates are lower than consensus as we build in tepid demand growth for ply until FY17
FY17	21,145	19,630	-7.2%	
EBITDA (₹ mn)				
FY16	2,974	3,018	1.5%	Our EBITDA estimates are lower than consensus despite similar margins in FY17 due to lower revenues
FY17	3,757	3,493	-7.0%	
PAT (₹ mn)				
FY16	1776	1,833	3.2%	Our PAT is higher than consensus despite lower EBITDA, since we do not build forex loss
FY17	1819	2,216	21.8%	

Source: Bloomberg, Ambit Capital research

Valuation: Stretched multiples but large opportunity

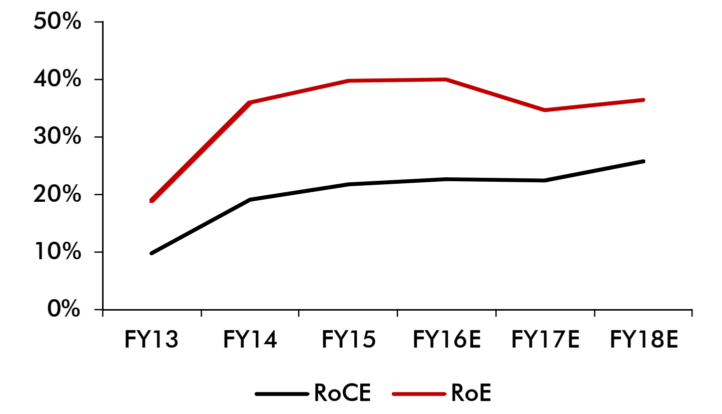
Ply is a large category, wherein 50% market share is held by unorganised players, which is facing rising liquidity and regulatory challenges. The organised market is largely oligopolistic, and over the last four years, Century has done the right things in terms of building scale and brand, ramping up distribution and assuring long-term raw material supply. In a category which is undergoing a structural shift, near-term earnings multiples often look stretched. However, this should be seen in light of the long-term earnings growth potential, which is higher than most other categories, provided incumbents are able to re-invest efficiently, launch new products which will replace wood products (polymers/wood plus paper composites) and sustainably improve asset turnover and RoEs. The stock is trading at 16x FY17E EPS; our estimates imply 33% EPS CAGR and 34% average RoEs over FY15-18E; our target price implies 21x FY17E EPS.

Exhibit 3: CPBI re-rated significantly…



Source: Bloomberg, Company, Ambit Capital research

Exhibit 4: …but premium profitability justifies premium multiples



Source: Bloomberg, Company, Ambit Capital research

Exhibit 5: Explanation for the accounting Flags

Segment	Score	Comments
Accounting	AMBER	Century's cash conversion cycle is materially longer than Greenply (110-130 days in FY13-14 as against 70-76 days for Greenply), mainly due to significantly lower creditor days (16-20 days in FY13-14 against 53-60 days for Greenply. Century's CFO/EBITDA has been low at <50% for the two years, as revenue growth required investment in working capital.
Predictability	AMBER	Management has made time announcements of capacity expansion and volume growth guidance has been fair. The only concern is unpredictable forex losses.
Earnings momentum	GREEN	Consensus estimates have remained flat in the last month.

Source: Company, Bloomberg, Ambit Capital research

Key catalysts

Further margin improvement: We have built in 50bps margin expansion both in FY16 and FY17, led by lower input prices. Improvement in margin alongside improving revenue growth will be a key catalyst for the stock.

Market share gains: Century has continuously gained market share over peers for the last 2-3 years. We have built in higher than industry volume growth for the company on the premise that its established scale and RM security will accelerate market share gains. Higher than industry volume growth could be a key positive catalyst

Success in particle boards and MDF: Whilst we have built in 50% utilisation rates in initial years, which could need upgrades if the company is able to launch these products successfully.

Price hikes and further decline in input costs: If unorganised players lose competitiveness, the organised players' pricing power will improve which means that even in a deflationary input cost environment, incumbents will be able to push through price hikes. We have built in 4% price hikes in FY17.

Risks

Product disruption: Given that timber reserves globally are shrinking, there is a major risk that innovative product launches (specifically plastic composites - already eating into the wood market in the US), would displace plyboards. Century needs to actively think through long-term disruptions or it risks losing the opportunity to a global innovator.

INR depreciation: The company has ₹1.4bn of buyers credit outstanding in USD and if the INR depreciates before the payments, the company will suffer forex losses.

Face veneer export ban in Myanmar: Myanmar has banned the export of raw timber but face veneer export is allowed. If Myanmar were to ban exports of face veneer as well, a key raw material source would be eradicated.

Capital misallocation: Century is incurring ₹500mn to build a corporate headquarters in Kolkata. The management's argument is that, given the increasing scale of the business and high-profile talent acquisition, the company needs a corporate office. We believe that Century's CFO generation will be much higher than it capex needs and if the company misallocates or digresses in unrelated businesses, it will erode shareholder value. In the past, the Group has expanded into multiple businesses from one listed entity; in the last year, the company has demerged its cement business into a separate ferro chrome and cement subsidiary (Star Ferro and Cement).

Balance Sheet

₹ mn unless mentioned	FY14	FY15	FY16E	FY17E	FY18E
Share capital	223	223	223	223	223
Reserves and surplus	2,708	3,526	5,066	7,068	9,723
Total Networth	2,931	3,749	5,289	7,290	9,946
Loans	5,276	4,677	4,427	4,077	3,627
Of which Buyers credit	2,002	1,500	1,100	800	800
Sources of funds	8,314	8,418	9,708	11,360	13,566
Net block	3,164	2,781	3,484	3,559	3,888
Capital work-in-progress	-	-	-	-	-
Investments	31	4	31	31	31
Cash and bank balances	387	374	914	2,325	3,143
Sundry debtors	2,089	2,683	2,855	2,989	3,595
Inventories	3,029	3,322	3,093	3,261	3,857
Loans and advances	1,100	1,323	1,475	1,631	1,961
Total Current Assets	6,793	7,819	8,453	10,322	12,673
Current liabilities and provisions	1,914	2,041	2,114	2,407	2,882
Net current assets	4,879	5,778	6,338	7,915	9,791
Miscellaneous expenditure	151	-	-	-	
Application of funds	8,314	8,418	9,708	11,360	13,566

Source: Company, Ambit Capital research

Income statement

₹ mn unless mentioned	FY14	FY15	FY16E	FY17E	FY18E
Revenue	13,477	15,525	17,368	19,838	23,861
Plyboards	*10,480*	*12,126*	*12,961*	*14,655*	*17,562*
Laminates	*2,587*	*3,372*	*4,249*	*5,179*	*6,540*
yoy growth	15%	15%	12%	14%	20%
Total expenses	11,961	13,015	14,350	16,315	19,463
EBITDA	1,766	2,488	3,018	3,675	4,589
yoy growth	52%	41%	21%	22%	25%
Depreciation	387	448	426	464	484
EBIT	1,416	2,231	2,641	3,324	4,291
Interest and financial charges	603	432	311	295	273
Other income	37	46	49	113	186
Adj PBT	629	1,654	2,330	3,029	4,019
Provision for taxation	124	290	466	606	804
Adjusted PAT	786	1,365	1,864	2,423	3,215
yoy growth	63%	74%	37%	30%	33%
Reported PAT	633	1,509	1,864	2,423	3,215
EPS basic (₹)	4	6	8	11	14

Source: Company, Ambit Capital research

Cash Flow statement

₹ mn unless mentioned	FY14	FY15	FY16E	FY17E	FY18E
PBT	**629**	**1,799**	**2,330**	**3,029**	**4,019**
Depreciation	387	448	426	464	484
Interest paid	603	432	311	295	273
CFO before change in WC	1,623	2,633	3,018	3,675	4,589
Change in working capital	(1,168)	(911)	(21)	(166)	(1,057)
Direct taxes paid	(117)	(290)	(466)	(606)	(804)
CFO	**338**	**1,432**	**2,531**	**2,904**	**2,728**
Net capex	643	400	1,128	539	813
CFI	**(706)**	**(327)**	**(1,106)**	**(426)**	**(628)**
Proceeds from borrowings	372	364	(250)	(350)	(450)
Change in share capital	-	-	-	-	-
Interest & finance charges paid	(287)	(432)	(311)	(295)	(273)
Dividends paid	(60)	(516)	(324)	(422)	(559)
CFF	**(281)**	**(1,118)**	**(885)**	**(1,066)**	**(1,282)**
Net increase in cash	(649)	(13)	540	1,411	819
FCF	**(305)**	**1,032**	**1,403**	**2,365**	**1,915**
Opening cash balance	983	387	374	914	2,325
Closing cash balance	334	374	914	2,325	3,143

Source: Company, Ambit Capital research, Note: All financials pertain to IFRS consolidated accounts

Ratio Analysis

	FY14	FY15	FY16E	FY17E	FY18E
Revenue growth	14.7	15.2	11.9	14.2	20.3
EBITDA growth	52	41	21	22	25
PAT growth	25	138	24	30	33
EPS norm (dil) growth	63	74	37	30	33
EBITDA margin	13	16	17	19	19
EBIT margin	11	14	15	17	18
Net margin	6	9	11	12	13
RoCE	19	22	23	25	27
RoIC	23	25	30	35	37
RoE	36	36	35	33	32

Source: Company, Ambit Capital research

Valuation Parameter

	FY14	FY15	FY16E	FY17E	FY18E
Working capital turnover	2.5	2.9	2.9	2.8	2.7
Debt/Equity(x)	1.7	1.2	0.8	0.6	0.4
Net debt/Equity(x)	1.6	1.1	0.7	0.2	0.0
P/E (x)	51.8	29.8	21.8	16.8	12.7
P/B(x)	13.4	10.7	7.6	5.5	4.1
EV/Sales(x)	3.4	2.9	2.5	2.1	1.7

Source: Company, Ambit Capital research