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Century Plyboard

Riding on cyclical recovery

Initiating Coverage

May 28, 2014

Rating

Buy

CMP	**Target Price**
Rs58	Rs80

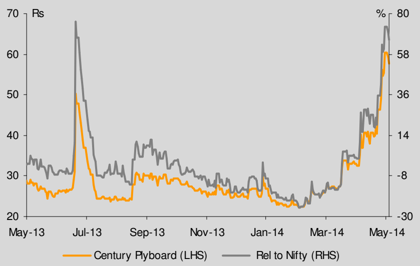
EPS Chg FY15E/FY16E (%)	NA
Target Price change (%)	NA
Nifty	7,318
Sensex	24,550

Price Performance

(%)	1M	3M	6M	12M
Absolute	77	160	132	101
Rel. to Nifty	63	123	93	64

Source: *Bloomberg*

Relative price chart



Source: *Bloomberg*

Stock Details

Sector	Building Materials
Bloomberg	CPBI IB
Equity Capital (Rs mn)	222
Face Value(Rs)	1
No of shares o/s (mn)	222
52 Week H/L	63/ 22
Market Cap (Rs bn/USD mn)	13/ 217
Daily Avg Volume (No of sh)	879,521
Daily Avg Turnover (US$mn)	0.7

Shareholding Pattern (%)

	Mar'14	Mar'14	Dec'13
Promoters	72.9	72.9	72.9
FII/NRI	1.2	1.2	1.2
Private Corp	14.0	14.0	12.9
Public	11.9	11.9	13.1

Source: *Bloomberg*

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- **Century Plyboards (CPL), a premier home-building material company, is a classic mean reversion play on margins, GST implementation, and lower forex volatility**
- **20% expansion in plywood and 2x expansion in laminate capacity, along with commensurate expansion in distribution network, to drive healthy 16% revenue and 50% EPS CAGR**
- **Compelling value proposition; stock trades at PER of 8.6x FY16e a steep 44% discount to its building materials peers**
- **Improving return ratios, cash flow and divided payouts to re-rate stock valuations. Initiate coverage with a BUY and target price of Rs80 valuing the stock at 12x FY16e earnings**

Century Plyboards a solid home-building material play

In our view, Century Plyboards (India) Ltd. (CPL), a premier branded home-building material manufacturer, is a classic play on an expected cyclical reversion and structural theme. On the cyclical side, we believe, the company is a primary beneficiary of two reversions to the mean themes: 1) recovery in India's housing segment, driving demand for the wood panel industry and 2) normalcy of currency volatility that impacted margins of this import-based company (Forex loss of Rs440 mn, almost 2/3rd of FY14 PBT).

Structural shift in favour of organized players; GST potential Game Changer

Plywood market today is largely controlled by the unorganized sector which accounts for 75% of the market. However, driven by lower price differential and increasing preference for branded wood panel products there is a clear shift, with the organized players growing at 15.2% over FY08-13 as compared to industry growth of 6-8%. We believe that implementation of GST is a potential "Game Changer" for plywood manufacturers as further lowering differential in indirect taxes would mean acceleration in the pace of consumer shift from unorganized players to branded organized market which in turn would improve the growth trajectory for players like CPL.

Capacity expansions and distribution to drive 50% earnings CAGR

With 20% capacity expansion in plywood division (taking capacity to 200K CBMs) and a massive 2x expansion in the laminates segment (taking capacity to 4.8 mn sheets), coupled with a commensurate expansion in the distribution network (addition of 1500 dealer on current base of 5000), we expect CPL to deliver a healthy 16% revenue CAGR over FY14-16e. With improving utilization for the Kandla Plant and Kolkata laminate capacity, coupled with minimal forex loss (FY14 forex loss at Rs440 mn) we expect CPL to see earnings CAGR of 50% over FY14-16e with EPS of Rs6.8 in FY16.

Compelling value proposition; Initiate with a BUY- Target Rs80

CPL is trading at PER of 8.6x its FY16E EPS (steep 44% discount to the average of 15x by its peers), which we believe is unjustified given the fact that the company's return ratios are similar to its peers. We believe the strong earnings trajectory, improving return ratios, improving cash flow and decent payouts will drive the re-rating for the stock. We initiate coverage on the stock with a BUY rating and a target price of Rs80, valuing the stock at 12x FY16E, a 20% discount to average PER of 15x commanded by its peers.

Financial Snapshot (Standalone) **(Rsmn)**

YE-Mar	Net Sales	EBITDA (Core)	(%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
FY13A	11,311	1,128	10.0	527	2.4	-12.4	18.7	24.5	14.9	5.2
FY14A	12,840	1,482	11.5	669	3.0	27.1	24.7	19.3	11.9	4.4
FY15E	14,880	1,938	13.0	1,209	5.4	80.6	36.8	10.7	9.2	3.5
FY16E	17,414	2,483	14.3	1,503	6.8	24.4	36.5	8.6	7.0	2.8

Company Background

Established in 1982, Century Plyboards (India) Ltd. (CPL) is India's premier wood panel company. It operates mainly in two segments: plywood and laminates. These segments contribute 93% of CPL's total revenues, while its container freight station (CFS) at Kolkata port contributes 4%.

With a market share of 21% in the organized plywood industry, CPL is a leading plywood player and second biggest player of total penal products while it is the third-largest prayer in the laminates segment, with a market share of 9%. CPL enjoys an extremely strong position, thanks to its brands such as Century Ply and Century Lam.

Exhibit 1: Plywood – Plant locations and capacities

Location	Capacity (CBM)
Standalone	**178456**
Kolkata	37036
Chennai	39420
Guwahati	35000
Karnal	36000
Bachau	31000
Subsidiaries	**31000**
Roorkee – Auro Sundaram Ply & Door Pvt Ltd	25000
Myanmar – century Myanmar Pvt Ltd.	6000
Total	**209456**

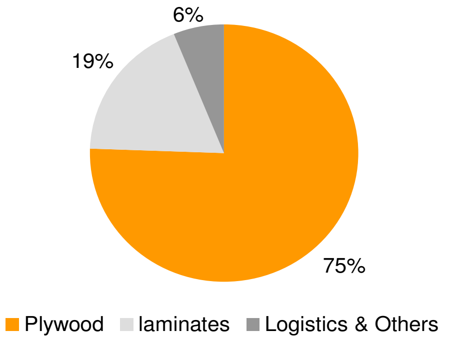
Source: Emkay Research

Exhibit 2: Major segment details (Standalone)

	FY10	FY11	FY12	FY13	FY14
Capacities					
Plywood (CBM)	147456	147456	147456	172456	178456
Laminates (Nos.)	2400000	2400000	2400000	3600000	4800000
Production					
Plywood (CBM)	92657	111414	124624	117648	133488
Laminates (Nos.)	1804273	2090764	2373697	2812686	2950000
Utilization					
Plywood	63%	76%	85%	68%	75%
Laminates	75%	87%	99%	78%	61%
Sales Volume					
Plywood (CBM)	116763	140859	160393	154733	176211
Veneer (CBM)	25738	32879	36954	36644	45142
Laminates (Nos.)	1822774	2106653	2444042	2698740	2916000
Gross Revenue (Rs Mn)					
Plywood	5269	5953	7628	7805	8797
Veneer	608	606	924	1288	1742
Laminates	1045	1171	1533	1800	2021

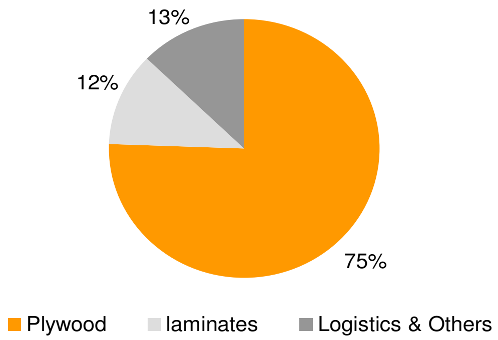
Source: Company

Exhibit 3: Revenue contribution – Standalone (FY14)



Source: Company

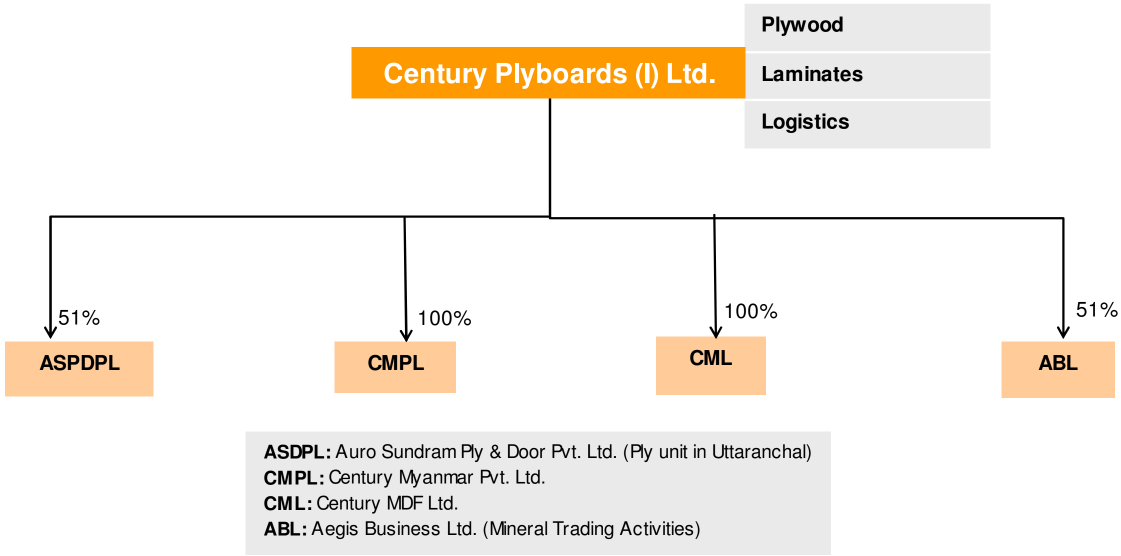
Exhibit 4: EBITDA contribution – Standalone (FY14)



Source: Company

Corporate structure

Exhibit 5: Corporate structure



Source: Company, Emkay Research

Exhibit 6: Porter's Five Forces model for plywood and laminate industry

Source: Company, Emkay Research

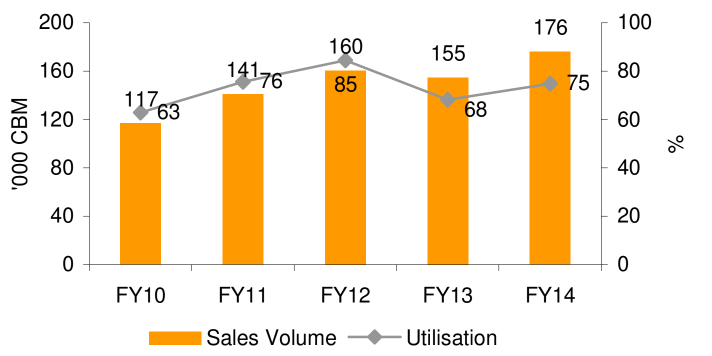
Century Ply vs. Green Ply

Exhibit 7: Comparison between Century Ply and GreenPly

	Units	Century Ply	Green Ply
Plywood			
Plywood capacity	CBM	178456	129600
Plywood capacities in subs	CBM	31000	
Production	CBM	133488	139968
Plywood volumes	CBM	176211	174328
FY10-14 volume CAGR		10.8%	11.0%
Plywood market share (FY13 Organized)		21%	24%
Plywood and allied products revenue	Rsmn	9648	10318
FY10-14 revenue CAGR		17.2%	15.6%
EBITDA	Rsmn	1212	1238
EBITDA (%)		12.56	12.00
FY10-14 EBITDA CAGR		29%	14%
Laminate			
Laminate capacity	Mn sheets	4.8	10.0
Laminate volume	Mn sheets	2.9	10.8
FY10-14 volume CAGR		12%	11%
Laminate market share (FY13 organized)		9%	28%
Laminate segment revenues	Rsmn	2367	7663
FY10-14 revenue CAGR		18%	27%
EBITDA	Rsmn	190	723
EBITDA (%)		8%	9%
FY10-14 EBITDA CAGR		9%	20%

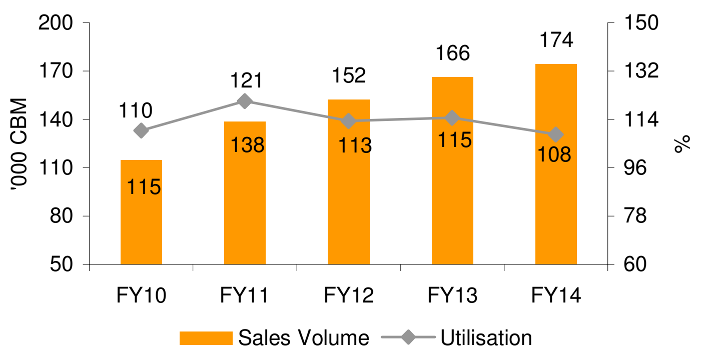
Source: Company, Emkay Research

Exhibit 8: Century Ply – Plywood volume and utilization



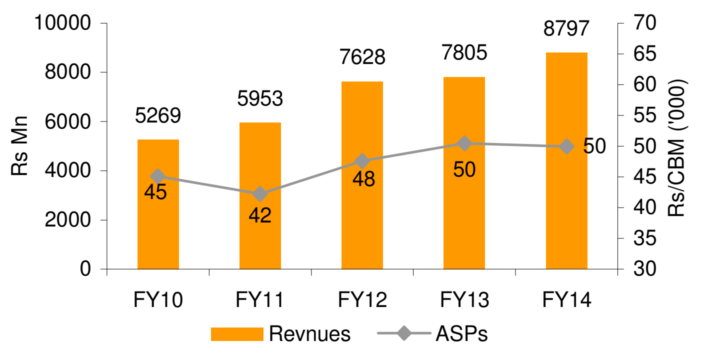
Source: Company

Exhibit 9: Green Ply – Plywood volume and utilization



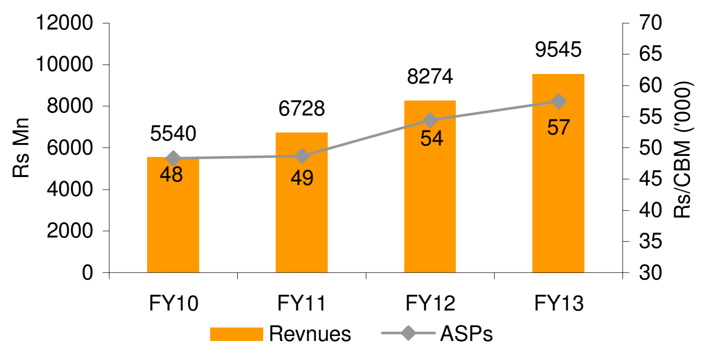
Source: Company

Exhibit 10: Century Ply – Plywood revenue and realization



Source: Company

Exhibit 11: Green Ply – Plywood revenue and realization



Source: Company

Investment Rationale

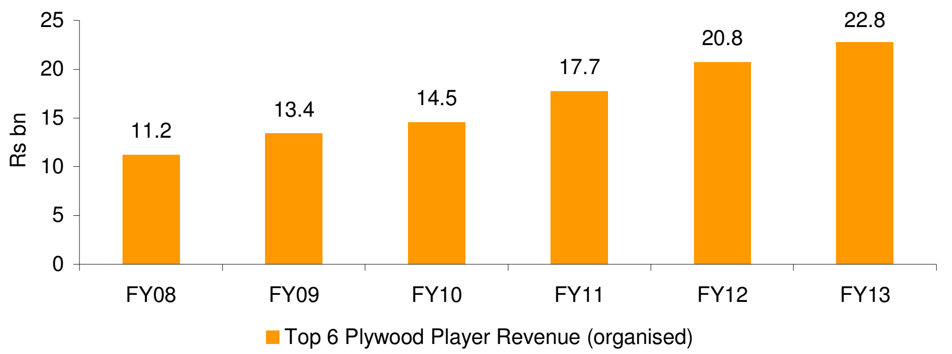
Century Ply, a solid home-building material play, on margin reversion to mean and implementation of GST

In our view, CPL, a premier branded home-building material manufacturer, is a classic play that is on an expected cyclical reversion and structural theme. On the cyclical side, we believe, the company is a primary beneficiary of two reversions to the mean themes: 1) recovery in India's housing market, driving demand for the wood panel industry and 2) normalcy of currency volatility that impacted margins of this import-based industry (Forex loss of Rs440 mn, almost 2/3rd of FY14 PBT) driving margins reversion to mean. Moreover, the company is also a big beneficiary of GST. A big structural change in indirect taxes, we believe, could be a potential game changer for organized wood panel manufacturers. A 20% expansion in the plywood capacity and a huge 2x expansion in laminates segment, coupled with a commensurate expansion in the distribution network, coupled with minimal forex losses are expected to drive healthy 16% revenue and 50% earnings CAGR over FY14-16e.

Structural trends for the wood panel market; increasing preference and lowering price differential driving the shift to branded organized players

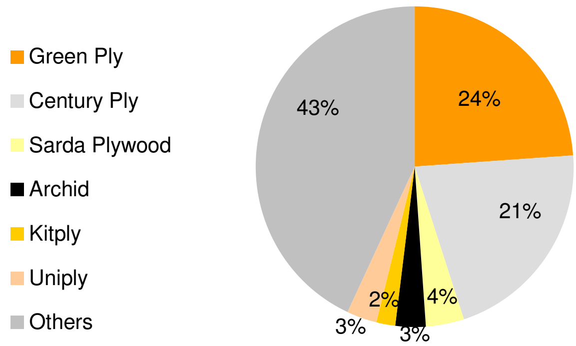
The size of the Indian plywood and laminate (wood panel) industry, which has an extremely fragmented structure, has been pegged at around Rs200bn, with the organized players controlling a mere 30%. The unorganized segment enjoys advantages in terms of excise waivers and other benefits on account of its SSI status. In FY08, excise duty on plywood-related products was cut by half to 8%, which is now pegged at 12%. Narrowing excise differences and the eligibility to claim MODVAT benefits on inputs have put the organized sector not only on par compared to the unorganized sector, but also in an advantageous position, due to volume, quality and brand equity. Hence organized players have seen their revenue grow at 15.2% over FY08-13 vs overall industry growth of 6-8%.

Exhibit 12: Organized players have seen revenue growth of 15% (CAGR)



Source: Emkay Research

Exhibit 13: Market share of companies in organized market



Source: Company, Emkay Research

GST a potential Game Changer for plywood manufacturers

As mentioned earlier, the plywood market today is largely controlled by the unorganized sector, which accounts for a huge 75% of the total size. Evidently, the uneven indirect duty structure in favour of unorganized players provides them a huge price advantage vis-à-vis organized manufacturers.

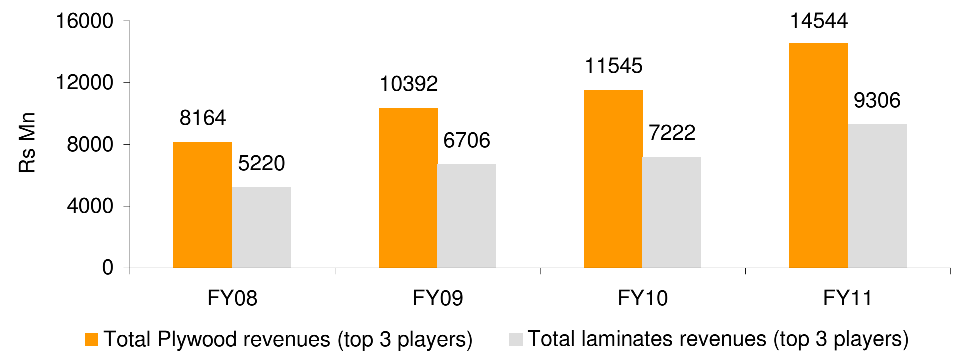
With implementation of GST, we believe, this large indirect tax differential will wane, bringing both organized and unorganized players on an even tax platform. We see this as a potential 'Game Changer' for plywood manufacturers that could give them an opportunity to tap into the unorganized market, whose size currently stands at a whopping 3x that of the organized market.

The business dynamics could change dramatically due to the following plausible factors:

- Pricing power could strengthen with a sizeable chunk shifting to the organized market.
- CPL could leverage the opportunity by capitalizing on the outsourcing model.
- Sizeable business expansion on an improving working capital term

We see acceleration in pace of consumer shift from unorganized players to the branded organized market. This, in turn, would improve the growth trajectory for players such as CPL. We notice that during FY08-11, the two largest organized players saw their combined revenue of plywood and laminates grow at a CAGR of 21%, as they saw excise duty being brought down from 16% to 8%, which provided a level playing field to players in the organized sector.

Exhibit 14: Plywood and laminates revenues (top-3 players) grew ~21% (CAGR) over FY08-11



Source: Company, Emkay Research

Ban on Raw Timber Imports from Myanmar to increase raw material security and competitive advantage for Century Ply

Following the trend set by other timber-rich nations, Myanmar, which boasts of the best quality timber worldwide, has decided to ban the export of raw timber from the country beginning April 1, 2014. The move aims at establishing a domestic wood-processing industry that would enhance value-addition, which, in turn, would generate duty/tax and increase employment opportunity.

India used to procure a sizeable proportion of its timber requirement from Myanmar for manufacturing plywood. Century Ply (India) Ltd. (CPL) was among the large importers of the material. However, the ban on raw timber imports has turned out to be a boon for CPL, as the company already has a 100% timber peeling and plywood manufacturing subsidiary, Century Myanmar Pvt. Ltd. (CMPL), in Myanmar.

About Century Myanmar Pvt. Ltd. (CMPL): the Company has a timber peeling and plywood manufacturing capacity of 16,000cbm and 6,000cmb, respectively.

What CMPL plans to do?

CMPL is established to retain CPL's raw material requirement from Myanmar, but instead of importing raw timber logs by itself the latter will be importing face veneers (an intermediate product for production of plywood), which the former will be manufacturing. CMPL will be procuring timber from auction conducted by the Myanmar government-nominated authority.

How does the scenario change for CPL?

CMPL provides CPL a first-mover advantage, since it retains raw material security: CPL is already setting up a unit in Myanmar, which not only will ship face veneers but also help the company gain a significant first-mover advantage over its competitors, and, in the process, it will retain its raw material security for the best quality timber. Incidentally, unorganized players do not have the capability to set up units in Myanmar, while even among organized players only Greenply Industries is planning to set up a unit through a 50:50 joint venture partnership. We believe CPL is likely to enjoy this first-mover advantage over the medium term, as setting up the unit in Myanmar is a time-consuming and cumbersome process.

To enhance competitive advantage: In our view, CMPL would provide a significant competitive advantage to CPL, since Indian plywood producers would find it difficult to procure high-quality Myanmar timber/veneer. Hence, CPL (along with Greenply Industries) would be able to dominate the quality-conscious segment of the market, thereby enhancing its growth profile and aiding in the already superior margin profile at the top-end of the market.

To reduce landed cost of intermediate enhancing margins: Usually, the cost of transporting raw timber from Myanmar is very high because of its bulky nature. However, once converted to veneers, the bulk weight reduce substantially, as typically 30% of the moisture content in logs is removed, and post-peeling the weight further reduces by another 30%. Hence, in the veneer form the total bulk handling weight reduces by 50%. With CPL now importing the raw material in an intermediate form (veneers vis-à-vis raw logs), the company is expected to see benefits of lower transportation costs, with a significant reduction in landed costs of veneers.

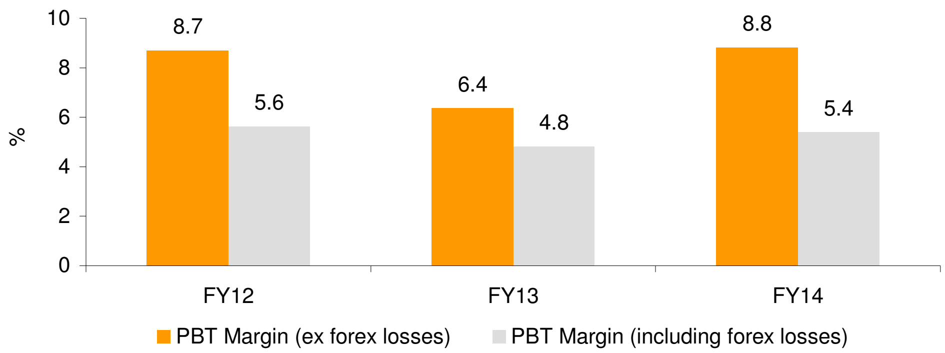
Short-term opportunity to exploit divergent price trend in timber and veneer: As explained in the Annexure, in the plywood manufacturing process, plywood is made of multiple layers of veneers (thin slices of wood), which are obtained from logs of trees. The top and the bottom layers are known as face veneers, whereas the middle layers are called core veneers. CPL, which sells surplus face veneers in the market, is a leader in this segment, with a market share of 30%.

CMPL is expected to ramp up its operation fully by September 2014. In the interim, CPL is comfortably sitting on an 8/9-month inventory of timber logs imported from Myanmar. We notice that at the end of FY14, CPL's raw material inventory stood at Rs2.15, which is 40% higher than FY13. As per management, post the ban on raw timber imports from Myanmar, the price of face veneers in India has shot up by around 25%, while the price of raw timber logs in Myanmar has declined by 20-25%. Hence, CPL's margin on the sale of veneers has shot up sharply. Although it is a short-to-medium term phenomenon, this is expected to boost margins of CPL's plywood segment, which is yet to be factored in our numbers.

Lower currency volatility to reduce forex losses

As mentioned earlier, a large branded organized player typically imports 70% of the raw material requirements such as logs, paper and chemicals. This makes an organized player vulnerable to large forex volatility (similar to the one seen over the last few years) and may lead to forex losses. Over the last 3 years, CPL's total forex loss has been estimated at around Rs1bn. However, with the Indian currency attaining stability over the past 6 months and the expectation of its continued firmness, we expect CPL not only to witness minimal forex losses, but also to pass on the cost rise due to INR depreciation through a price hike.

Exhibit 15: Forex losses impacted margins



Source: Company, Emkay Research

Greenfield plywood plant at Kandla (Gujarat) to expand geographical footprint and improve margins

Currently, CPL's manufacturing facilities are located in the northern region (91,000cbm capacity at Karnal, Haryana), the eastern region (35,000cbm capacity in Guwahati, Assam and 75,600cbm capacity in Bishnupur, Kolkata), and the southern region (72,220cbm capacity in Gumudipundi, Chennai). By and large, these facilities cover every region in the country except the western region. With the commencement of operation of a 31,000cbm Greenfield plywood plant at Kandla in Gujarat, CPL has completed its geographical presence as far as manufacturing facilities are concerned. The total capital expenditure on this plant was Rs450 mn. Though the company already had a pan-India presence, with an extensive dealer and distributor network, the new expansion is expected to enhance its reach in the western region's major markets.

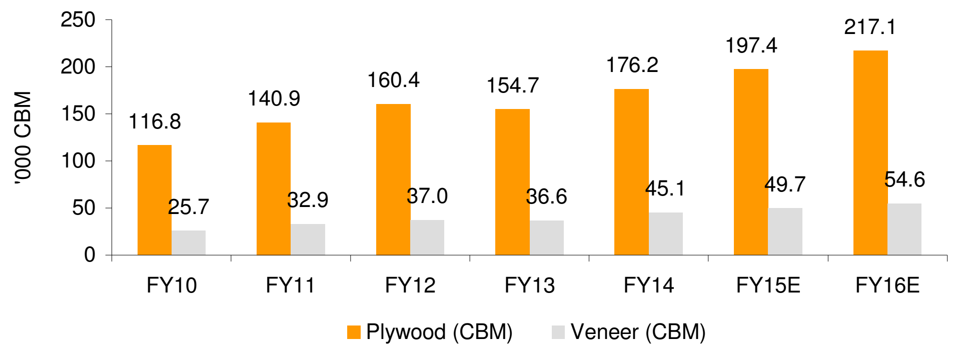
The Gujarat plant will not only enhance CPL's penetration into large markets such as Maharashtra and Gujarat, but also lift its margins, as the company would be able to save significantly on its logistics and distribution costs by reducing the lead distance to the markets. Prior to the commissioning of this plant, the western markets were catered to by Haryana and Uttarakhand facilities. This meant very high logistics and distribution costs for serving the western markets, since the logs being imported at Kandla Port were transported to Haryana and Uttarakhand facilities and dispatched again back to Gujarat and Maharashtra markets. This led to a relatively high lead distance and inefficient bulk handling for a bulky commodity like timber and plywood. The plant's location at Kandla port is expected to cut down transportation costs for import of raw materials, besides reducing the lead distance. This would also help CPL save logistics and transportation costs to the extent of 4-5% for sales to the western markets.

Exhibit 16: Kandla plant to complete geographical presence

Location	State	Region	Capacity (CBM)	Share of total
Bishnupur	Kolkata	East	37036	21%
Gumudipundi	Chennai	South	39420	22%
Guwahati	Assam	East	35000	20%
Karnal	Haryana	North	36000	20%
Kandla	Gujarat	West	31000	17%
Total			**178456**	

Source: Company

Exhibit 17: Kandla expansion to help in increasing volumes (11% CAGR during FY14-16E)

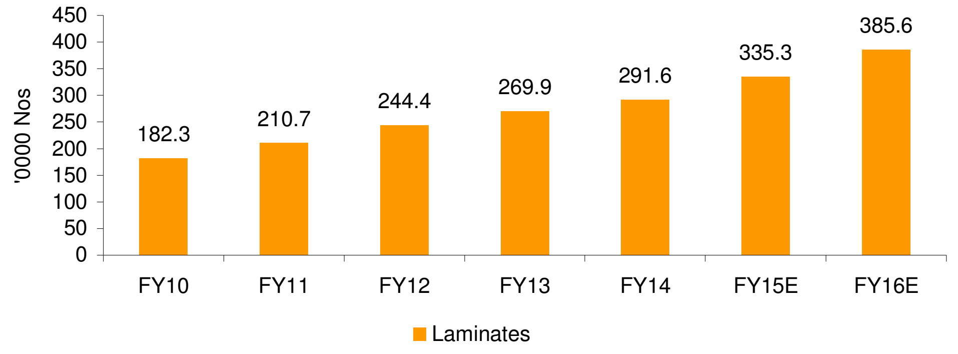


Source: Company, Emkay Research

2x expansion in laminates to remove capacity constraints

Today, CPL is the third-largest player in the laminate segment, though with a market share of a mere 9% of the organized industry. The company has seen capacity constraints in FY13, with utilization of around 95%. With aggressive growth plans for the division, it has recently augmented its capacity by 2 x by adding two more production lines, with a capacity of 2.4mn sheets at Bishnupur, near Kolkata, effectively taking its total capacity to 4.8mn sheets. The company has spent Rs200 mn on this expansion.

Exhibit 18: Increase in laminates capacity and SKU addition to help 15% volume CAGR



Source: Company, Emkay Research

Aggressive SKUs addition to laminated segment to drive market share gain

Typically, laminate is a high-margin business with a lesser presence of unorganized players, besides usually being a brand-driven category. However, since laminate is an exterior panel product, the category is subjected to low product lifecycle. Hence, a key success factor in the category is new design introduction, which would necessitate a library of high stock keeping units (SKUs). Today, GreenLam, the biggest player in the industry, has 1200 SKUs and 400 SKUs in laminate and decorative veneer segments, respectively. In comparison, CPL has 600 SKUs in laminate and 450 SKUs in decorative business segments, respectively. The company has plans to add 80 more SKUs to laminate and decorative veneers. We believe with the removal of capacity constraints and expansion of its dealership network, along with a planned SKUs addition, CPL is likely to witness a steep growth trajectory, driven largely by significant market share gains. We expect CPL to witness a laminate volume CAGR of 15% over FY14-16 with FY16e volume of 3.8 mn sheets.

Capacity expansion complemented by significant dealer network expansion

As the plywood and laminate business is distribution-intensive, CPL would ideally complement its capacity expansion by enhancing its distribution strength. Today, the company has an extensive network of 5000 dealers and has chalked out an aggressive expansion strategy, with a planned annual dealer addition of 1500 (30% of existing) over the next 2-3 years. To this end, the company has strengthened its sales force by 30% to 600 sales executives.

CPL's controls 50% of CFS capacity at Kolkata Port

In FY08, CPL entered the container freight station (CFS) business in Kolkata by winning a bid to acquire 0.1mn sq. mtr. of Kolkata Port Trust land. On account of heavy congestion faced at the port, the Port Trust has mandated that cargo has to be cleared within a day and stored in the CFS. With total capacity of 160000 TEUs across its two CFS at Sonai (40000 TEUs) and Jingira Pool (120000 TEUs) CPL boasts of controlling almost 50% of the CFS capacity at Kolkata Port.

Risks and Concerns

Foreign exchange risk

Century Ply is exposed to the substantial foreign exchange risk as it imports over 65% of its raw material requirements. Raw material cost is a major component of the company's total operational expenditure. It accounts for ~68% of the total expenditure and ~60% of the net sales. Thus, an adverse volatility and any depreciation of Indian currency would negatively impact the company's operating margins and profitability.

Interest rate risk

CPL is also exposed to the interest rate fluctuations on its borrowings. The company has a gross debt of Rs 4.9 bn of which Rs 930 mn is the foreign currency. Thus, any increase in interest rates in domestic and international market could negatively impact company's profitability.

Product substitutes

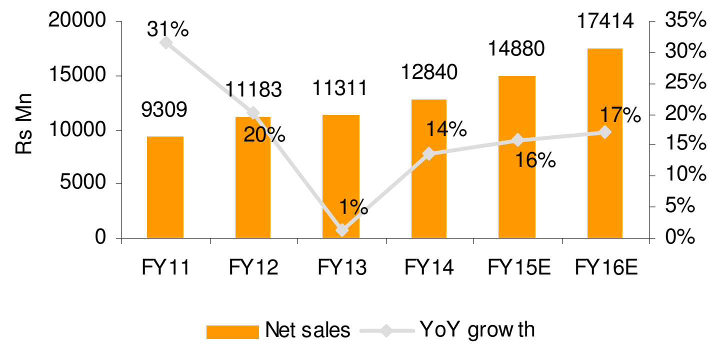
Plywood has been the material of choice when it comes to making wooden furniture for our homes. It is cheaper than quality solid wood furniture (e.g. teak wood furniture), and is also easily available at local dealers. However in recent times, a few alternatives to plywood like MDF (Medium Density Fibreboard) have gained in popularity especially in the ready-made furniture market. MDF, which is cheaper than Plywood, is made from very small fibres of wood firmly glued together to form a hard surface. It is not as strong as plywood, but looks quite attractive because of its smooth laminated surface finish. MDF boards are usually pre-laminated at the time of their manufacture using LPL (Low Pressure Laminates), and standard size MDF furniture is also assembled in factories and shipped to dealers for selling. Thus, though Plywood is a tougher material and it lasts longer than Particle board or MDF furniture, it's higher cost (than MDF) a risk in product substitute.

Financials

Capacity & distribution expansions to drive a top-line CAGR of 16%

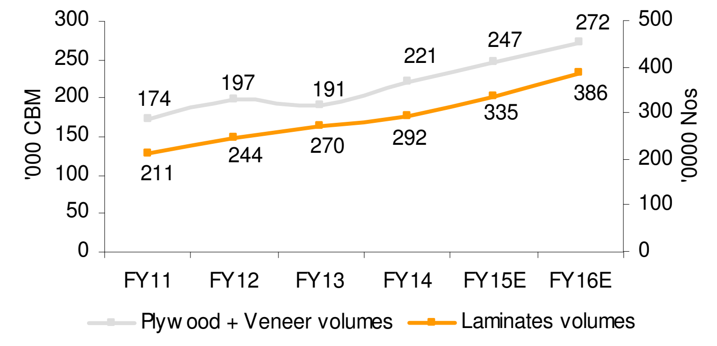
With the 20% capacity expansion in its plywood division and the 2x expansion in the laminates segment, along with a commensurate expansion in the distribution network and sales force, we expect CPL's plywood volume to improve at a CAGR of 11% and laminate volume to grow at a CAGR of 15%. With a likely improvement in the demand trajectory for organized plywood and laminate manufacturers, we expect realizations to improve at a CAGR of 6% for both divisions. Hence, we expect revenue to grow at a CAGR of around 16% during FY14-16E, with FY16e revenues of Rs17.41bn.

Exhibit 19: Net sales to grow ~16% CAGR (FY14-16E)



Source: Company, Emkay Research

Exhibit 20: Segment volume growth

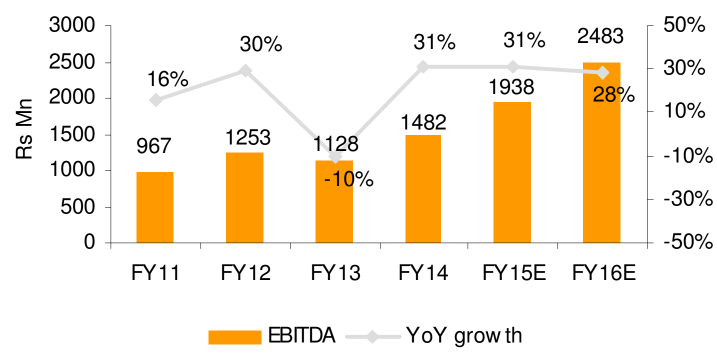


Source: Company, Emkay Research

Improving utilization to help register EBITDA CAGR of 29%

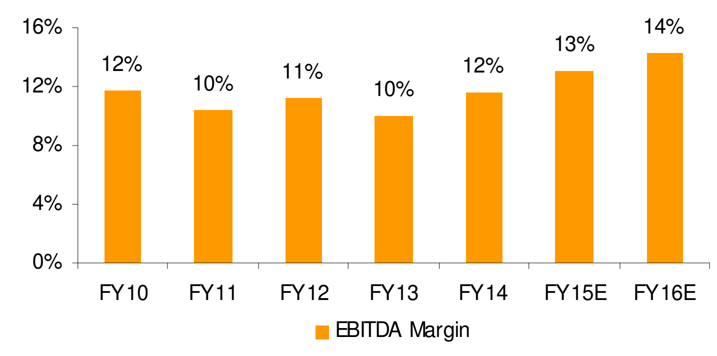
With improving capacity utilization at its laminate factory in Kolkata and plywood facility in Kandla, we expect CPL to derive benefits of operating leverage. Taking into account the benefits of operating leverage and building in no forex losses, we expect the company's margins to improve with an EBITDA margin of 13% and 14.3% for FY15E and FY16E, respectively, compared with FY14 margins of 11.5%. We believe our margins estimates are conservative, since we model in a 60% jump in advertising expenses. Hence, compared to the ex-forex loss margin of 12.8% in FY14, our EBITDA margins for FY15 are expanding by just 20 bps. Nevertheless, we expect CPL to clock an EBITDA growth of 29% (CAGR) over FY14-16E, with EBITDA of Rs2.48bn in FY16e.

Exhibit 21: EBITDA to grow ~29% CAGR during FY14-16E



Source: Company, Emkay Research

Exhibit 22: EBITDA margins to expand

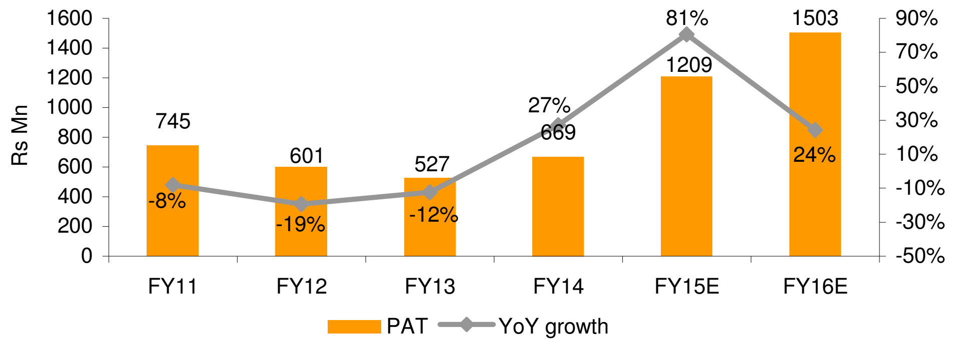


Source: Company, Emkay Research

Currency stability to boost earnings; EPS to rebound sharply with a CAGR of 50%

As mentioned earlier, due to huge import requirements of raw materials, plywood manufacturers are vulnerable to large forex volatility. Over the last 3 years, CPL has seen a total forex loss of roughly Rs1bn. However, with the Indian currency seeing stability over the last 6 months and its likely continuation, we expect CPL to see a minimal forex loss. This, coupled with a CAGR of 29% in operating profit, is expected to further boost the earnings growth trajectory for the company, with its EPS expected to grow by around 50% (CAGR) over FY14-16E and EPS of Rs6.8 in FY16.

Exhibit 23: PAT to grow ~50% CAGR during FY14-16E

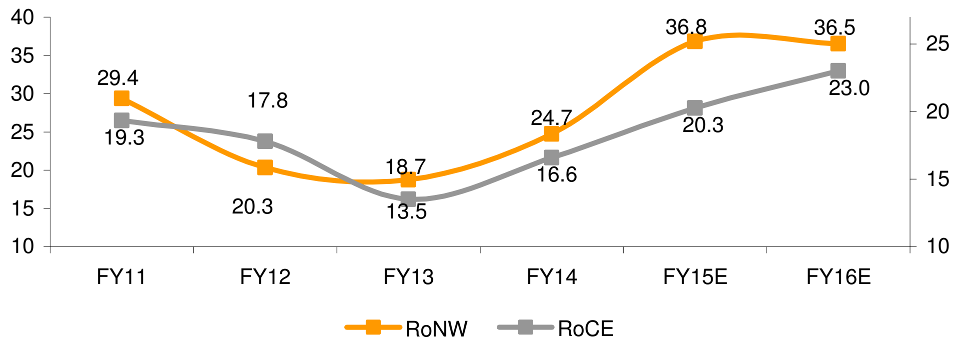


Source: Company, Emkay Research

Return ratios to improve substantially; RoCE to cross the 20%-mark

With improving capacity utilization and a margin rebound, we expect CPL to witness a sharp improvement in return ratios, with RoE expected to improve by 1180bps to 36.5% in FY16E from 24.7% in FY14, while RoCE likely to move upwards by around 640bps to about 23% in FY16E from around 16.6% in FY14.

Exhibit 24: RoNW to improve to 36% by FY16e; RoCE expected at 23%

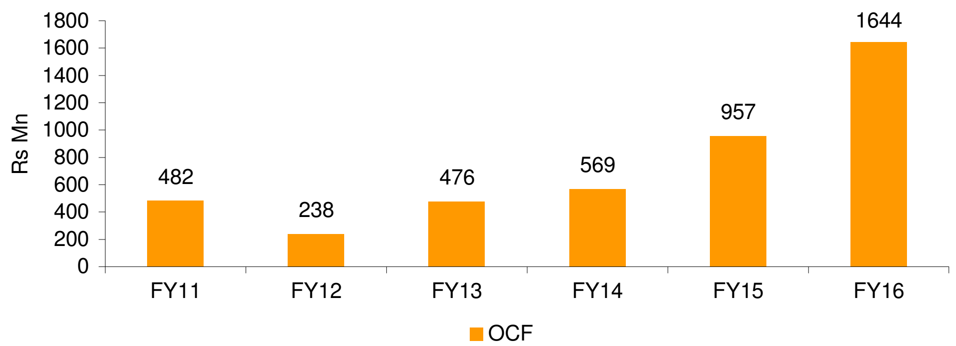


Source: Company, Emkay Research

OCF generation to improve

On account of ~50% CAGR growth in earnings during FY14-16E, we expect CPL to generate operating cash flow (OFC) of roughly Rs2.6 bn over FY15-16 which is higher than it generated in the last four years (FY10-14).

Exhibit 25: OCF generation



Source: Company, Emkay Research

Valuations

Compelling value proposition; severe discount to other building materials

For the purpose of comparison, we believe, the company should be compared to ceramic tiles and sanitary manufacturers, which have similar industry characteristics, with a large presence of unorganized players and a tangible shift of organized manufacturers garnering a market share. Over FY10-13, revenue CAGR of major building materials peers has been around 29%, which is higher than about 20% (CAGR) registered by CPL for its combined ply and laminate divisions. However, the company's combined ply and laminate EBITDA CAGR of 20% over FY10-13 has been pretty close to 25% registered by its building products peers.

Also, we notice that in spite of its lower EBITDA margins, CPL's average RoCE (FY10-13) for the two segments at 20% is close to RoCE of 21% clocked by its building products peers.

Exhibit 26: CPL EBITDA CAGR of 20% and RoCE 20% comparable to its building products peers

Plywood + Laminates (Rs Mn)	FY10	FY11	FY12	FY13	FY14
Revenues	7130	9374	10524	11361	13081
EBITDA	576	588	1039	995	1402
EBITDA margin	8.1%	6.3%	9.9%	8.8%	10.7%
EBIT	464	461	900	807	1150
Capital employed	2358	2783	4123	4968	6323
RoCE	20%	18%	26%	18%	20%

Source: Company, Emkay Research

At CMP of Rs58, CPL is trading at PER of 8.6x its FY16E EPS, which is a steep 44% discount to the average PER of 15x commanded by its building products peers (see Exhibit below). Though we agree that CPL warrants a discount to its building products peers on account of slower top-line growth and exposure to forex volatility, we believe the discount of 44% is unjustified given the fact that the company's return ratios are much similar to its peers.

We believe the strong earnings trajectory, improving return ratios, improving FCF and decent payouts will drive the re-rating for the CPL stock. We initiate coverage on the stock with a BUY rating and a target prices of Rs80, value the stock at 12x FY16E EPS of Rs6.8. Our target multiple of 12x is based on a 20% discount to average PER of 15x commanded by its peers.

Exhibit 27: Peer Financials

Rs bn	CAGR (FY10-13)			Sales			EBITDA			PAT			EPS		
Company	Sales	EBITDA	PAT	FY14	FY15E	FY16E	FY14	FY15E	FY16E	FY14	FY15E	FY16E	FY14	FY15E	FY16E
Kajaria Ceramics	29.3%	22.6%	41.9%	18.77	21.77	25.02	2.33	3.09	3.74	1.17	1.55	2.20	15.70	20.87	29.59
Cera Sanitary	36.7%	29.8%	32.8%	6.64	8.06	9.98	0.95	1.12	1.39	0.52	0.63	0.79	41.02	49.49	62.41
HSIL	25.9%	22.5%	17.7%	17.51	19.61	21.32	2.44	2.72	3.23	0.48	0.70	1.01	7.34	10.54	15.29
Somany Ceramics	25.5%	13.8%	10.9%	12.09	15.88	19.26	0.74	1.05	1.29	0.29	0.47	0.62	8.29	13.51	17.83
Greenply Ind.	28.9%	36.3%	23.5%	21.56	23.51	26.27	2.71	2.93	3.21	1.11	1.22	1.39	45.91	50.47	57.63
Century Ply	19%	20%	NA	12.84	14.88	17.41	1.48	1.94	2.48	0.67	1.21	1.50	3.0	5.4	6.8

Source: Company, Emkay Research

Exhibit 28: Peer Valuations

	Market Cap	PE (x)			Price to Book Value (x)			EV to EBITDA (x)			RoE (%)		
Company	Rs bn	FY14	FY15E	FY16E	FY14	FY15E	FY16E	FY14	FY15E	FY16E	FY14	FY15E	FY16E
Kajaria Ceramics	41.5	35.0	27.9	22.8	8.0	6.9	5.8	18.1	13.6	11.3	26.7	26.2	27.6
Cera Sanitary	14.9	28.5	23.6	18.7	6.6	5.3	4.3	15.6	13.2	10.7	25.7	24.7	25.2
HSIL	14.3	28.4	19.2	12.1	1.3	1.2	1.2	9.3	8.3	7.0	5.0	7.1	8.3
Somany Ceramics	8.9	28.4	18.9	14.4	4.0	3.3	2.8	11.5	9.0	7.3	15.1	19.1	21.0
Greenply Ind.	11.5	10.8	9.9	8.7	2.1	1.7	1.1	6.3	5.8	5.3	19.0	17.4	16.8
Average		**26.2**	**19.9**	**15.3**	**4.4**	**3.7**	**3.0**	**12.1**	**10.0**	**8.3**	**18.3**	**18.9**	**19.8**
Century Ply	12.9	19.3	10.7	8.6	4.4	3.5	2.8	12.1	9.4	7.2	23.0	33.1	32.9

Source: Company, Emkay Research

Annexure

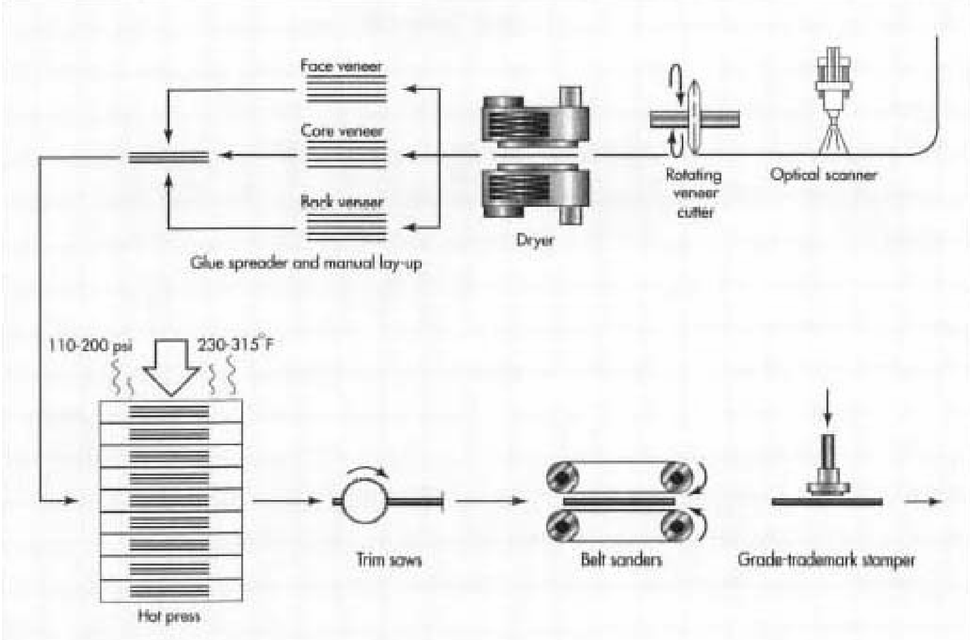
Plywood manufacturing process

Veneers, which are thin slices of wood, are obtained from logs of trees. The logs are mounted on a lathe machine and are rotated about their longitudinal axis, while a cutter peels off thin layers from the log, which is somewhat similar to the way we peel layers from vegetables.

Glue is applied to all these peeled slices of wood veneers (plies), using glue spreader machines, and the plies are placed one upon the other. The number of plies in every plywood sheet is usually an odd number, such as 3-ply, 5-ply and 7-ply. The stack then goes into a hot press machine, which firmly presses veneers together and forms a strong bond between the individual plies, so that they do not come apart. Thus, a plywood sheet or board is made.

Two types of glues are used: one is urea formaldehyde (UF) resin, and the other is phenol formaldehyde (PF) resin. PF resins are considerably better than UF resins, because they can form a stronger bond between the plies (phenol is the material from which all plastics are made.).

Exhibit 29: Plywood manufacturing process



Source: Emkay Research

Economics of a new plywood plant (12,000 CBM)

Exhibit 30: RoE 26% in 3rd year (project cost assumption – Rs250mn for 12 CBM)

Project cost (Rs mn)			250	
Equity			85	34%
Debt			165	66%

Rs mn.	**Yr 0**	**Yr 1**	**Yr 2**	**Yr 3**
Capacity (CBM)		12000	12000	12000
Production (CBM)		9000	10800	12000
Capacity utilization		75%	90%	100%
Sales volume (CBM)		9000	10800	12000
Realization (Rs/CBM)		53000	55650	58433
Sales		**477**	**601**	**701**
Variable cost		334	421	491
RM		286	361	421
Other variables		48	60	70
Fixed cost		104	111	119
Staff		54	58	63
Other		50	53	56
Total cost		438	532	610
EBITDA		**39**	**69**	**91**
EBITDA margin (%)		8.2%	11.5%	13.0%
Depreciation		13	13	13
EBIT		**27**	**56**	**79**
Interest		24	26	26
PBT		2	31	53
Tax @ 30%		0	8	13
PAT		**2**	**23**	**40**
Balance sheet				
Equity	85	87	111	150
Project debt	165	165	155	105
Working Capital debt	30	90	90	90
Total Liabilities	280	342	356	345
Net block	235	220	184	132
Net current assets	0	119	150	175
WC interest	0	6	8	9
Cash	45	3	21	38
Total Assets	280	342	356	345
RoE		3%	21%	26%
RoCE		11%	21%	27%
Cashflow				
PAT	0	2	23	40
Depreciation	0	12.5	12.5	12.5
Change in WC	0	119	31	25
CFO	**0**	**-104**	**5**	**27**
Investing cash flow	**-250**	**0**	**0**	**0**
Financing cash flow	**280**	**62**	**13**	**-10**
Net cash flow	**30**	**-42**	**18**	**17**
Cash at the beginning of yr	0	45	3	21
Cash	**30**	**3**	**21**	**38**

Source: Emkay Research

Key Financials (Standalone)

Income Statement

Y/E Mar (Rsmn)	FY13A	FY14A	FY15E	FY16E
Net Sales	**11,311**	**12,840**	**14,880**	**17,414**
Growth (%)	*1.1*	*13.5*	*15.9*	*17.0*
Expenditure	**10,183**	**11,358**	**12,942**	**14,931**
Raw Material	7,059	7,593	8,831	10,299
Operating Expenses	3,124	3,597	4,111	4,633
Other Expenses	0	167	0	0
EBITDA	**1,128**	**1,482**	**1,938**	**2,483**
Growth (%)	*-10.0*	*31.3*	*30.8*	*28.1*
EBITDA margin (%)	***10.0***	***11.5***	***13.0***	***14.3***
Depreciation	267	333	355	373
EBIT	**861**	**1,149**	**1,583**	**2,110**
EBIT margin (%)	***7.6***	***9.0***	***10.6***	***12.1***
Other Income	73	95	95	100
Interest expenses	390	551	408	517
PBT	**544**	**693**	**1,270**	**1,693**
Tax	**17**	**24**	**61**	**189**
Effective tax rate (%)	*3.2*	*3.4*	*4.8*	*11.2*
Adjusted PAT	**527**	**669**	**1,209**	**1,503**
Growth (%)	*-12.4*	*27.1*	*80.6*	*24.4*
Net Margin (%)	***4.7***	***5.2***	***8.1***	***8.6***
(Profit)/loss from JVs/Ass/MI	0	0	0	0
Adj. PAT After JVs/Ass/MI	**527**	**669**	**1,209**	**1,503**
E/O items	0	0	0	0
Reported PAT	**527**	**669**	**1,209**	**1,503**
PAT after MI	**527**	**669**	**1,209**	**1,503**
Growth (%)	-12.4	27.1	80.6	24.4

Balance Sheet

Y/E Mar (Rsmn)	FY13A	FY14A	FY15E	FY16E
Equity share capital	223	223	223	223
Reserves & surplus	2,274	2,692	3,432	4,351
Net worth	**2,497**	**2,915**	**3,654**	**4,574**
Minority Interest	**0**	**0**	**0**	**0**
Secured Loans	4,678	4,912	5,096	5,896
Unsecured Loans	0	0	0	0
Loan Funds	**4,678**	**4,912**	**5,096**	**5,896**
Net deferred tax liability	-2	-5	-5	-5
Total Liabilities	**7,172**	**7,821**	**8,745**	**10,464**
Gross Block	3,199	3,744	3,944	4,144
Less: Depreciation	1,342	1,624	1,979	2,352
Net block	**1,857**	**2,120**	**1,965**	**1,792**
Capital work in progress	360	188	188	188
Investment	**156**	**378**	**378**	**378**
Current Assets	**5,978**	**6,482**	**7,864**	**10,023**
Inventories	2,177	2,927	3,261	3,721
Sundry debtors	1,816	2,046	2,446	2,863
Cash & bank balance	797	181	217	1,361
Loans & advances	612	701	1,312	1,450
Other current assets	576	628	628	628
Current lia & Prov	**1,179**	**1,346**	**1,650**	**1,916**
Current liabilities	1,090	1,243	1,560	1,826
Provisions	89	104	90	90
Net current assets	**4,799**	**5,136**	**6,214**	**8,107**
Misc. exp	0	0	0	0
Total Assets	**7,172**	**7,821**	**8,745**	**10,464**

Cash Flow

Y/E Mar (Rsmn)	FY13A	FY14A	FY15E	FY16E
PBT (Ex-Other income)	**471**	**598**	**1,175**	**1,593**
Depreciation	267	333	355	373
Interest Provided	390	551	408	517
Other Non-Cash items	0	0	0	0
Chg in working cap	-594	-957	-1,042	-749
Tax paid	-58	44	61	-89
Operating Cashflow	**476**	**569**	**957**	**1,644**
Capital expenditure	-377	-423	-200	-200
Free Cash Flow	**99**	**146**	**757**	**1,444**
Other income	73	95	95	100
Investments	577	-222	0	0
Investing Cashflow	**-940**	**-594**	**-200**	**-200**
Equity Capital Raised	-5	0	0	0
Loans Taken / (Repaid)	1,133	234	184	800
Interest Paid	-390	-551	-408	-517
Dividend paid (incl tax)	130	-251	-469	-584
Income from investments	0	0	0	0
Others	0	0	0	0
Financing Cashflow	**868**	**-568**	**-694**	**-301**
Net chg in cash	**403**	**-593**	**64**	**1,143**
Opening cash position	421	797	181	217
Closing cash position	**797**	**181**	**217**	**1,361**

Key Ratios

Y/E Mar	FY13A	FY14A	FY15E	FY16E
Profitability (%)				
EBITDA Margin	10.0	11.5	13.0	14.3
Net Margin	4.7	5.2	8.1	8.6
ROCE	13.5	16.6	20.3	23.0
ROE	18.7	24.7	36.8	36.5
RoIC	15.6	17.8	21.1	25.6
Per Share Data (Rs)				
EPS	2.4	3.0	5.4	6.8
CEPS	3.6	4.5	7.0	8.4
BVPS	11.2	13.1	16.4	20.6
DPS	0.2	1.0	1.8	2.2
Valuations (x)				
PER	24.5	19.3	10.7	8.6
P/CEPS	16.2	12.9	8.2	6.9
P/BV	5.2	4.4	3.5	2.8
EV / Sales	1.5	1.4	1.2	1.0
EV / EBITDA	14.9	11.9	9.2	7.0
Dividend Yield (%)	0.4	1.7	3.1	3.9
Gearing Ratio (x)				
Net Debt/ Equity	1.6	1.6	1.3	1.0
Net Debt/EBIDTA	3.4	3.2	2.5	1.8
Working Cap Cycle (days)	129.1	140.8	147.1	141.4

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