JK Lakshmi Cement Ltd.

Slowly unfolding

22 April 2010

Company Update

Investment rationale

Presence across strong markets

J K Lakshmi Cement Ltd. (JKLC), with operations in Rajasthan and Gujarat, sells cement under the *JK Lakshmi Cement* brand and caters to the western, northern and central markets. These markets have exhibited a better pricing discipline compared to the southern market.

Power capacity addition

JKLC has a power capacity of 36MW, which will further strengthen to 66MW by March 2011. It has also inked a power supply agreement with V S Lignite (operational since April 2010) for 21MW. Thus, the company is self-sufficient in meeting its power requirement.

Capacity expansions

The company is undertaking a capacity expansion to 8mmt from 4.75mmt by setting up a 0.55mmt split grinding unit at Jhajjar (Haryana) and a 2.7mmt integrated unit at Durg (Chattisgarh). While the Jhajjar unit is expected to be commissioned by March 2011, the Durg unit is targeted for December 2012.

Healthy balance sheet

As on December 2009, the company has an interest bearing debt of INR4.7bn against a cash balance of INR5.5bn. Thus, it should be able to meet the total capex requirement of INR15.5bn on the above expansion, largely through internal accruals and debt.

Valuations

At the CMP of INR75, the stock trades at a P/E and EV/EBIDTA 4.2x and 3.3x respectively, discounting its FY12e. On EV/tonne basis, it trades at an attractive USD65 against the replacement cost of USD120/tonne. We maintain our BUY recommendation with an 18 month base price target of INR112 (based on FY12e EV/EBIDTA of 4.5x), presenting a potential upside of 49%.

Key financials

Year ended March	FY08	FY09	FY10e	FY11e	FY12e
Net revenues (INRm)	11,077	12,245	14,549	14,752	15,963
EBITDA (INRm)	3,518	3,106	4,394	4,136	4,503
EBITDA growth (%)	37.4	(11.7)	41.5	(5.9)	8.9
PAT (INRm)	2,242	1,786	2,331	1,994	2,161
PAT growth	25.9	(20.3)	30.5	(14.5)	8.4
EPS (INR)	20.0	14.6	19.0	16.3	17.7
EPS growth (%)	25.9	(20.3)	30.5	(14.5)	8.4
P/E (x)	3.7	5.1	3.9	4.6	4.2
P/BV (x)	1.4	1.1	0.9	0.8	0.7
EV/EBITDA (x)	3.2	3.5	1.9	3.2	3.3
RoE (%)	46.4	24.2	25.0	17.8	16.6

Source: Company, Antique

BUY
CMP : INR75
Target Price : INR112

Market data

Sector	:	Cement
Market Cap (INRbn)	:	9.1
Market Cap (USDbn)	:	203
O/S shares (m)	:	122.4
Free Float (m)	:	58.3
52-wk HI/LO (INR)	:	85 / 27
Avg daily Vol ('000)	:	257.7
Bloomberg	:	JKLC IN
Reuters	:	JKLC.BO

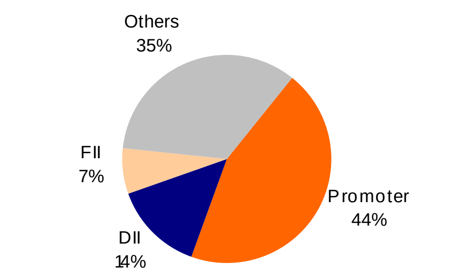
Source: Bloomberg

Returns (%)

	1m	3m	6m	12m
Absolute	(0.1)	(8.2)	6.3	165.2
Relative	1.0	(7.7)	5.8	68.0

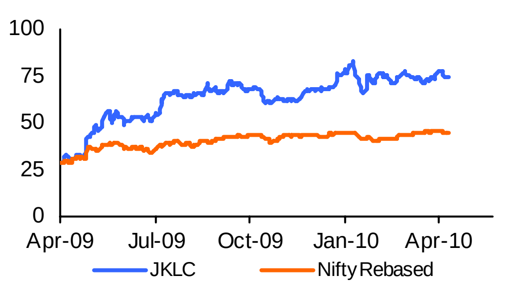
Source: Bloomberg

Shareholding pattern



Source: BSE

Price performance *vs* Nifty



Source: Bloomberg

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Company Background

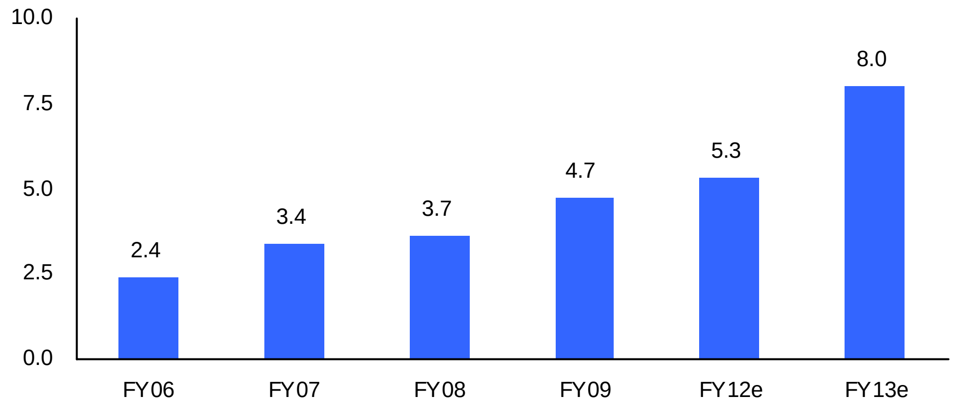
J K Lakshmi Cement Ltd. (JKLC) is a part of Hari Shankar Singhania led J K Group; apart from cement, it also has interests in tyres, paper and sugar. It is a mid-sized cement company with a capacity of 4.75mmt for cement and 3.63mmt for clinker, with operations across two units - Sirohi (Rajasthan) and Kalol (Gujarat).

Over the last 4-5 years, the company has significantly improved its operational performance by capitalising on firm cement prices, volumes growth and better operational efficiencies in the form of higher blending ratio and commissioning of captive power plant at Sirohi.

OPC:PPC mix improved from 80:20 in FY04 to 32:68 in 3QFY10, resulting better costing metrics

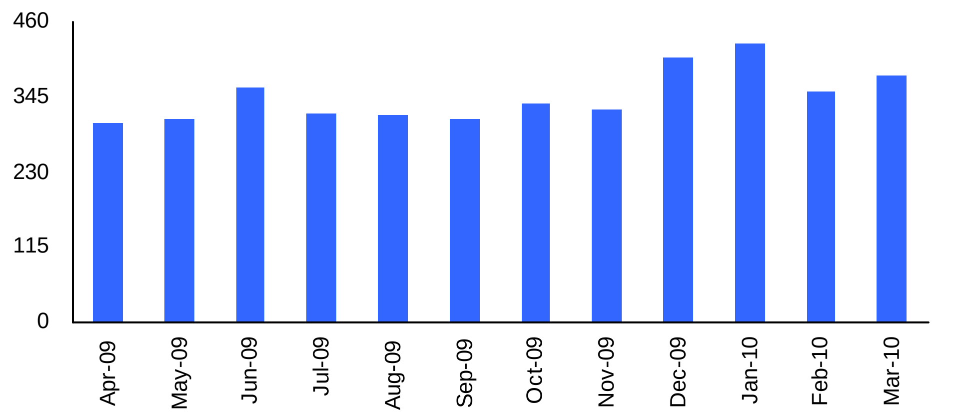
It has consistently improved its OPC:PPC mix from 80:20 in FY04 to 32:68 in 3QFY10, which resulted in better costing metrics, due to savings on power and fuel cost on account of lower clinker requirement. Further, savings in power costs accrued from commissioning of 36MW thermal power plant in FY08, at a cost of INR1.5bn. These measures coupled with firm cement prices resulted in margin expansion from 13.9% in FY05 to 30.7% in 9MFY10.

JKLC's yearly capacity (mmt)



Source: Company, Antique

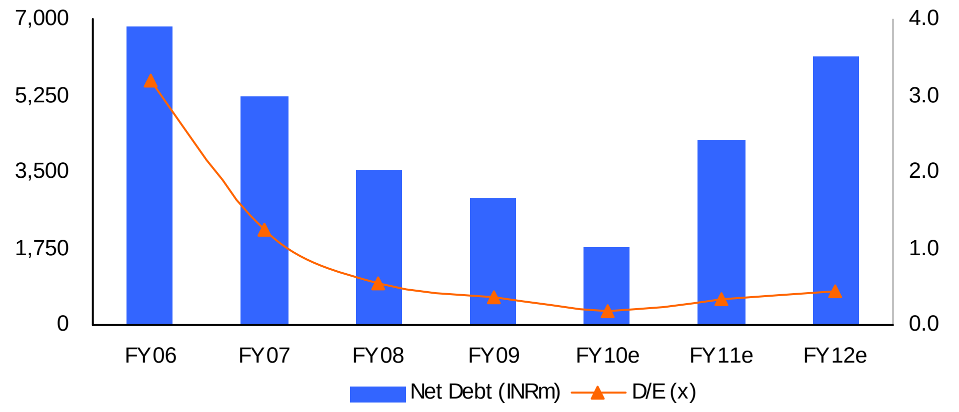
Trend in monthly despatches ('000mt)



Source: CMA

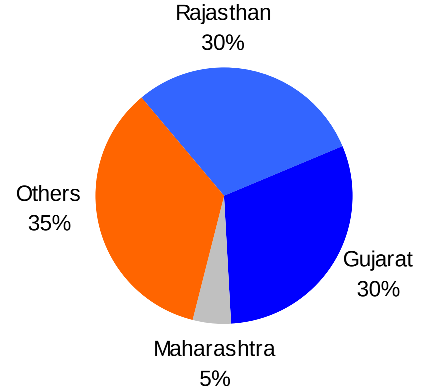
JKLC's profitability in the past was also impacted by the high interest servicing cost due to its leverage. With improving profitability and prudently planned expansion, it has been able to pare its debt levels from INR6.8bn in FY06 to INR2.9bn in FY09. It is currently a debt free company with an interest bearing debt of INR4.7bn against a cash balance of INR5.5bn as on December 2009.

JKLC's yearly debt and D/E



Source: Company, Antique

JKLC's region-wise despatches



Source: Company

The company also uses a mix of fuels like coal, petcoke and biomass for the kilns and power plant, depending on the prevailing costing. Presently, it uses a mix of around 85% petcoke and balance 15% coal/biomass.

The company sells cement under the *JK Lakshmi Cement* brand and caters to the western, northern and central markets. While 65% of the despatches are to Maharashtra, Gujarat and Rajasthan, balance 35% is sold in Uttar Pradesh, Punjab, Haryana and Delhi. Its presence across seven states has also resulted in a higher lead distance of around 520kms. JKLC has managed to increase the share of rail transport to the present ~55% against 32% in FY06.

Tie-up with V S Lignite

JKLC has entered into an agreement with V S Lignite (a KSK group company) for sourcing 21MW of power annually at a fixed rate of INR3.3/unit for 20 years. Earlier set to commence from 3QFY10, there has been some delays in commissioning the power plant and the same has started w.e.f. April 1, 2010. The contracted rate is fixed at INR3.3/unit for a period of 20 years, irrespective of the fuel costs. Presently, the company meets the shortfall by sourcing the same from the grid at ~INR4.5/unit.

Expansion plans

Expanding capacity to 8mmt from the present 4.75mmt by December 2012

JKLC's current cement and clinker capacities stand at 4.75mmt and 3.63mmt, respectively. While the clinker capacity is located at Sirohi, cement operations are spread across two units Sirohi (4.2mmt) and Kalol (0.55mmt). The company is expanding its grinding capacity to 8mmt by setting up a 0.55mmt split grinding unit at Jhajjar (Haryana) and a 2.7mmt integrated unit at Durg (Chattisgarh). To cater to the additional clinker requirement at Jhajjar, it is also enhancing the clinker capacity at Sirohi to 3.96mmt.

To meet the power requirement on expanded capacities, it is augmenting its power capacities from the present 36MW to 66MW. Of the 30MW of additional capacities, 18MW will be thermal and 12MW will be WHRS.

Commissioning of the split grinding unit at Jhajjar, clinker expansion and the 30MW power capacity are expected to be commissioned by March 2011. On the capex front, the split grinding unit is expected to cost INR800m, clinker expansion INR650m and power expansion INR2.05bn (INR800m on thermal and INR1.25bn on WHRS).

Although the cost of setting up a WHRS-based power plant stands at INR104m/MW against INR44m/MW for a conventional power plant, fuel cost is negligible as the waste heat is generated in kilns. Thus, the generation cost post interest and depreciation stands at INR0.5/unit.

Durg expansion

Setting up a greenfield capacity at Durg, comprising 2.7mmt of grinding capacity and 1.5mmt of clinker capacity

JKLC is setting up a greenfield capacity at Durg, which will consist of 2.7mmt of grinding and 1.5mmt of clinker capacity. The company has already commenced land acquisition process for this unit and has acquired ~75% of the 1,000 acres land. Expected to cost INR12bn, the unit is slated for December 2012 commissioning. The unit will cater to the eastern and central markets.

We believe that the company will have to rely on outside clinker purchases, as captively produced clinker will be insufficient for the cement production.

Funding

The total capex on the above expansion plan is estimated at INR15.5bn over the next 7-8 quarters. Given the comfortable leverage position coupled with stable cash flows, the company will meet the entire funding requirement from debt and internal accruals. It plans to raise debt of INR10-11bn and balance from internal accruals. However, we believe that the debt requirement will be less that INR10bn, given the cash flows generated over the same period.

Capex plans

	Capacity	Cost (INRm)
Split grinding at Jhajjar (mmt)	0.55	800
Clinker expansion at Sirohi (mmt)	0.33	650
Power - Thermal (MW)	18	800
Power - WHRS (MW)	12	1,250
Durg expansion (mmt)	2.7	12,000
Total		**15,500**

Source: Company

With 66MW of power capacity and another 21MW through sourcing agreement with V S Lignite, JKLC will be self-sufficient in its power consumption as its requirement on expanded capacity will stand at ~75MW. However, it will have to rely on grid supply for its Durg facility, as the unit is not supported by a CCP while the surplus power at Sirohi would be sold in the open market.

Industry Scenario

JKLC operates in the western, central and northern India markets, which are better placed in terms of pricing discipline when compared to the southern market where price discipline is difficult to be maintained on account of fragmented capacities. These regions account for around 19%, 15% and 18%, respectively, of the Indian cement consumption.

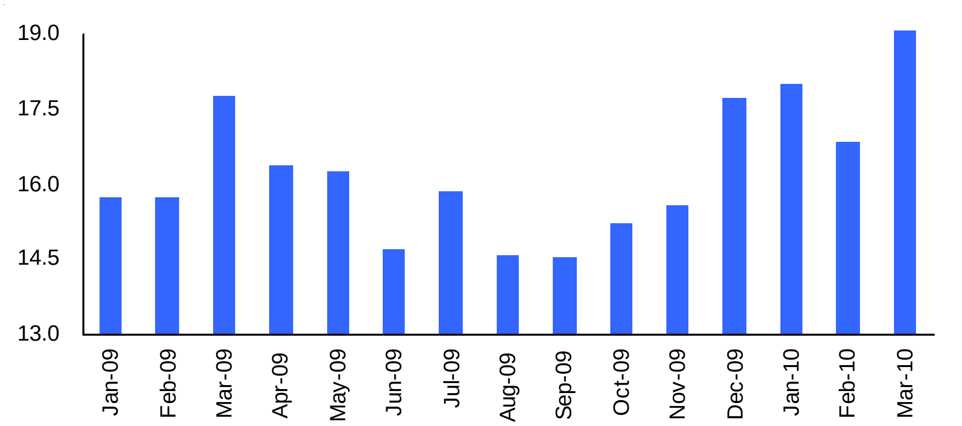
Cement prices were relatively stable in northern and western regions compared to southern region

Cement prices are relatively stable in the two regions compared to south on account of higher concentration of capacities between the top five players. This was visible in the August–December 2009 period where the price correction was less severe compared to southern region. Also the demand in the southern region was impacted by political tensions in Andhra Pradesh coupled with slowdown in infrastructure spend.

However, from December 2009 onwards, prices started firming up due to off-take from the infrastructure and housing segments coupled with shortage of rail wagons. Some amount of price rise can also be attributed to cost push factors like increase in fuel and transportation costs. The buoyant trend in cement off-take is also visible in the monthly despatch figures of 17.7mmt and 18mmt for December 2009 and January 2010. However, the growth momentum slowed down in February 2010 with despatches of ~16.9mmt, the same stood at 19.5mmt for March 2010. For FY10, the domestic consumption posted a growth of 9.8% to 195mmt. With India expected to post a GDP growth in excess of 7.5% from FY11e onwards over the next few years and infrastructure spend planned to increase to 9% of GDP against an average of ~7.5% expected in 11th FYP, we expect the industry to continue its growth momentum of 11-12% and reach a consumption figure close to 240mmt by FY12e.

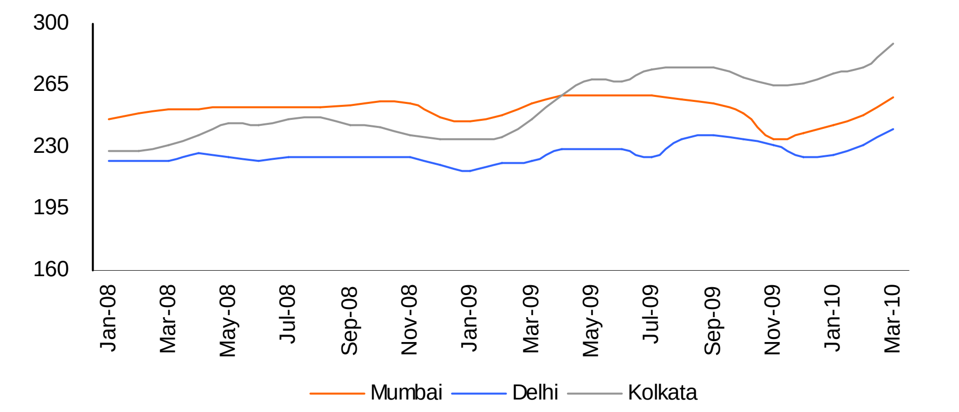
Domestic consumption to exceed 240mmt by FY12

Monthly all India despatches (mmt)



Source: CMA, ACC and Ambuja

Cement prices in key markets (INR/bag)



Source: CMIE

Companies able to pass on the 2% rollback in excise duty

Robust off-take has also enabled companies to pass on the increase in fuel and transportation costs coupled with the 2% rollback in excise duty announced in the Union Budget 2010. As per the new excise structure, the duty has been increased from INR230/mt to INR290/mt for cement priced below INR190/bag and the same hiked from 8% to 10% for cement above INR190/bag at the retail level. The impact of increase in excise duty is INR3/bag for <INR190/bag and a minimum of INR3.8/ bag for >INR190/bag.

Excise duty structure

	Old	New
Cement		
Retail price of <INR3,800/mt	INR230/mt	INR290/mt
Retail price of >INR3,800/mt	8.0%	10.0%
Clinker	INR300/mt	INR375/mt
Impact		
Cement		
Retail price of <INR3,800/mt		INR3/bag
Retail price of >INR3,800/mt		INR3.8/bag (min)
Clinker		INR3.75/bag

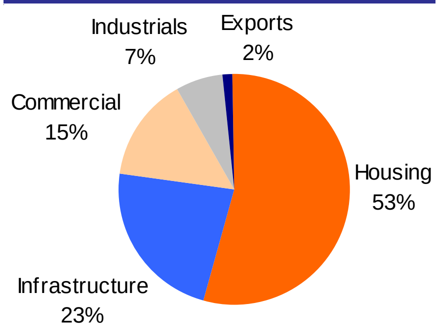
Source: Antique

We expect prices to weaken for the next two - three quarters

Although cement prices have remained stable, we expect prices to be under pressure from May 2010 onwards on account of seasonality coupled with commissioning of additional as well as ramping up of recently commissioned capacities across the country. However, if the current trend in off-take from infrastructure and housing segment continues, the impact of the same on prices will be minimised. We expect prices to weaken for the next two to three quarters, post which the natural demand growth would absorb the incremental supply.

The key driver for cement consumption in the northern region presently has been the off-take from the Common Wealth Games. However, post that, we expect the demand to be substituted by the housing segment on the back of recovery in residential housing segment. Additionally, the infrastructure projects coupled with resurgence in the industrial capex cycle would further drive the demand and absorb the incremental supply.

Demand break-up



Source: Industry

Northern and western markets

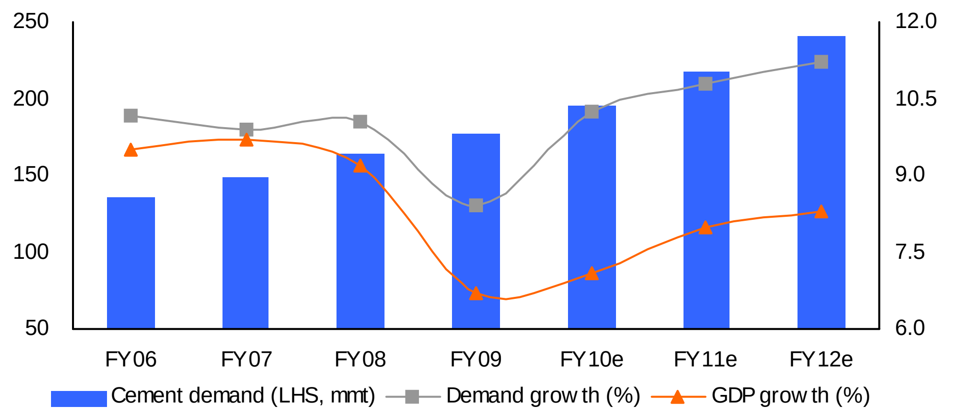
JKLC sells under the JK Lakshmi Cement brand and targets the western and northern markets for majority of its sales. In the northern market, the key players are Ambuja Cement, ACC, Shree Cement, Grasim, UltraTech and JK Group. In the western markets, the key players are Grasim, UltraTech, Ambuja Cement, ACC, Sanghi Ind and Century. The two regions are expected to witness capacity additions over the next two-three years, which is shown in the following table:

Capacity expansions in Northern and Western markets (mmt)

Company	Unit	State	4QFY10	FY11e	FY12e
ACC	Chanda	Maharashtra		3.0	
Ambuja	Nalagarh	HP	1.5		
Ambuja	Dadri	UP		1.5	
Ambuja	Maratha	Maharashtra		0.5	
Birla Corp	Chanderia	Rajasthan		1.2	
Century Cement	Manikgarh	Maharashtra			2.5
Grasim	Kotputli	Rajasthan	1.6		
India Cement	Indo Zinc	Rajasthan		1.5	
JP Associates	Sewagram	Gujarat	2.4		
JP Associates	Wanakbori & GACL	Gujarat		2.4	
JK Lakshmi	Jhajjar	Haryana		0.6	
UltraTech	Jaffrabad	Gujarat			1.1
Shree Cement	Suratgarh	Rajasthan	1.5		
Shree Cement	Roorkee	Uttarakhand	1.5		
Shree Cement	Jaipur	Rajasthan		1.5	

Source: Industry, Antique

Trend in cement consumption and GDP



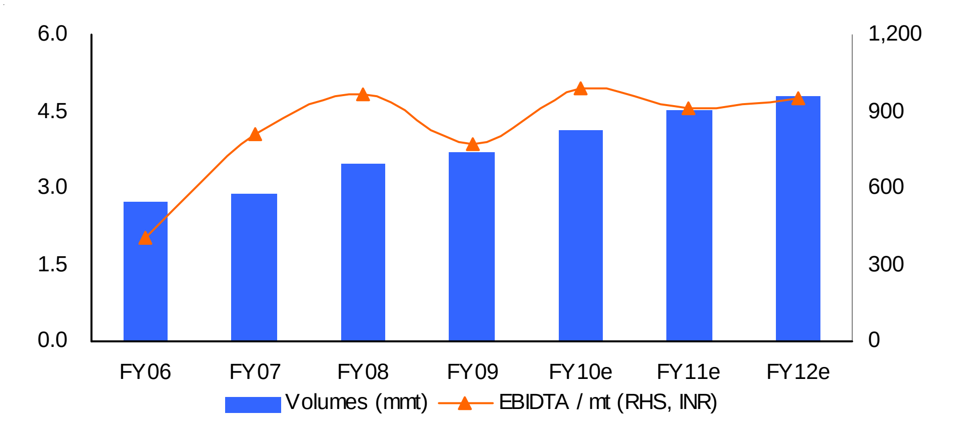
Source: Industry, Antique

Our View

We expect the company to achieve a volume growth of 5-6% in FY11e and FY12e, as the Jhajjar unit will be under stabilisation phase till 2QFY12. However, volume growth would pick up post commissioning of the Durg unit by 3QFY13.

We expect JKLC to post revenues of INR14.8bn and INR16bn in FY11e and FY12e. Margins in FY11 are expected to decline by 220bps, as impact of higher fuel and freight costs would be offset by savings on power cost post sourcing of power from V S Lignite. However, margins are expected to stabilise at 28.2% in FY12e. We anticipate the company to post profits of INR2bn and INR2.1bn in FY11e and FY12e, respectively.

Volumes and EBIDTA/mt



Source: Company, Antique

Valuations and recommendation

At the CMP of INR74, the stock trades at a P/E and EV/EBIDTA 4.2x and 3.3x respectively, discounting its FY12e. On EV/tonne basis, it trades at an attractive USD65 against the replacement cost of USD120/tonne.

Increasing scale of operations coupled with self sufficiency in power requirement should result in volume growth coupled with stable margins. Additionally, robust government spends on infrastructure and gradual recovery of the real estate segment should help minimise the impact of excess supply from commissioning of new capacities. We maintain our BUY recommendation with an 18 month base price target of INR112 (based on FY12e EV/EBIDTA of 4.5x), presenting a potential upside of 49%.

Risks and concerns

- Delay in commissioning of capacities will lower the volume estimates, thereby impacting its profitability.
- Rising fuel and freight costs can impact the profitability in case companies are not able to pass it on.
- Any slowdown in infrastructure and housing segments will put pressure on the margins of the companies as the same will coincide with new capacities coming on stream.

Financials

Profit and loss account (INRm)

Year ended 31st Mar	2008	2009	2010E	2011E	2012E
RRevenues	11,077	12,245	14,549	14,752	15,963
Expenses	7,559	9,140	10,155	10,616	11,460
Operating Profit	3,518	3,106	4,394	4,136	4,503
Other income	67	61	79	79	79
EBIDT	3,585	3,167	4,473	4,215	4,582
Depreciation	585	691	760	868	956
Interest expense	279	209	180	325	351
Profit before tax	2,721	2,267	3,532	3,021	3,275
Taxes incl deferred taxation	269	481	1,201	1,027	1,113
Profit after tax before EO Items	2,451	1,786	2,331	1,994	2,161
Extra ordinary Items	210	-	-	-	-
Profit after tax	2,242	1,786	2,331	1,994	2,161
Diluted EPS (INR)	20.0	14.6	19.0	16.3	17.7

Balance sheet (INRm)

Year ended 31st Mar	2008	2009	2010E	2011E	2012E
Share Capital	612	612	612	612	612
Reserves & Surplus	5,812	7,701	9,745	11,453	13,327
Networth	**6,424**	**8,313**	**10,357**	**12,064**	**13,939**
Debt	7,078	7,027	7,616	7,451	9,351
Deferred Tax Liability	(120)	351	669	941	1,236
Capital Employed	**13,382**	**15,690**	**18,642**	**20,456**	**24,526**
Gross Fixed Assets	14,741	17,605	18,775	22,575	22,925
Accumulated Depreciation	6,633	7,474	8,234	9,103	10,058
Net Assets	**8,108**	**10,131**	**10,541**	**13,473**	**12,867**
Capital work in progress	1,011	970	2,240	3,840	8,640
Investments	130	889	889	889	889
Current Assets, Loans & Advances					
Inventory	622	660	853	883	929
Debtors	186	233	320	325	351
Cash & Bank balance	3,476	3,267	5,022	2,416	2,384
Loans & advances and others	1,619	2,159	1,601	1,601	1,601
Current Liabilities & Provisions					
Creditors	1,332	1,713	1,918	2,064	2,229
Other liabilities & provisions	438	906	906	906	906
Net Current Assets	**4,133**	**3,700**	**4,972**	**2,255**	**2,130**
Application of Funds	**13,383**	**15,690**	**18,642**	**20,456**	**24,526**

Per share data

Year ended 31st Mar	2008	2009	2010E	2011E	2012E
No. of shares (m)	122	122	122	122	122
BVPS (INR)	52.5	67.9	84.6	98.6	113.9
CEPS (INR)	23.1	20.2	25.3	23.4	25.5
DPS (INR)	1.3	2.0	2.0	2.0	2.0

Margins (%)

Year ended 31st Mar	2008	2009	2010E	2011E	2012E
EBITDA	31.8	25.4	30.2	28.0	28.2
EBIT	27.1	20.2	25.5	22.7	22.7
PAT	20.2	14.6	16.0	13.5	13.5

Source: Company, Antique

Cash flow statement (INRm)

Year ended 31st Mar	2008	2009	2010E	2011E	2012E
EBT	**2,716**	**2,267**	**3,532**	**3,021**	**3,275**
Depreciation & amortisation	585	691	760	868	956
Interest expense	540	495	180	325	351
Interest / Dividend Recd	(261)	(286)	(79)	(79)	(79)
Other Adjustments	(47)	(44)	-	-	-
(Inc)/Dec in working capital	551	253	483	112	92
Tax paid	(258)	(259)	(883)	(755)	(819)
CF from operating activities	**3,826**	**3,117**	**3,994**	**3,492**	**3,776**
Capital expenditure	(1,613)	(2,246)	(2,440)	(5,400)	(5,150)
Net Investments	496	(749)	-	-	-
Income from investments	156	339	79	79	79
CF from investing activities	**(961)**	**(2,656)**	**(2,361)**	**(5,321)**	**(5,071)**
Inc/(Dec) in share capital	360	-	-	-	-
Inc/(Dec) in debt	(428)	(52)	589	(165)	1,900
Dividends & Interest paid	(828)	(618)	(467)	(612)	(638)
CF from financing activities	**(895)**	**(670)**	**122**	**(777)**	**1,262**
Net cash flow	**1,969**	**(209)**	**1,755**	**(2,605)**	**(33)**
Opening balance	1,507	3,476	3,267	5,022	2,416
Closing balance	**3,476**	**3,267**	**5,022**	**2,416**	**2,384**

Growth indicators (%)

Year ended 31st Mar	2008	2009	2010E	2011E	2012E
Revenue	31.3	10.6	18.8	1.4	8.2
EBITDA	37.4	(11.7)	41.5	(5.9)	8.9
PAT	25.9	(20.3)	30.5	(14.5)	8.4
EPS	25.9	(20.3)	30.5	(14.5)	8.4

Valuation (x)

Year ended 31st Mar	2008	2009	2010E	2011E	2012E
PE	3.7	5.1	3.9	4.5	4.2
P/BV	1.4	1.1	0.9	0.8	0.6
EV/EBITDA	3.2	3.5	1.9	3.1	3.3
EV/Sales	1.0	0.9	0.6	0.9	0.9
Dividend Yield (%)	1.7	2.7	2.7	2.7	2.7

Financial ratios

Year ended 31st Mar	2008	2009	2010E	2011E	2012E
RoE (%)	46.4	24.2	25.0	17.8	16.6
RoCE (%)	26.5	18.3	23.9	20.3	22.3
Debt/Equity (x)	1.1	0.8	0.7	0.6	0.7
EBIT/Interest (x)	10.8	11.8	20.6	10.3	10.3

Source: Company Antique

Important Disclaimer:

	Firm	Directors	Analyst
Ownership in Stock	No	No	No

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