Century Plyboards

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Quick Insight

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Focussing on margins rather than volume growth

Decline in plyboard volumes and margin contraction concerned investors, since Century's closest competitor, Greenply posted 6% volume growth. Management highlights that its focus is on maintaining prices and cash conversion cycle, rather than cut prices to spur demand ephemerally. Lower fixed cost absorption and reduction in face veneer margin led to compression in EBITDA margin on a high base of last year; management expects to maintain margin at 17% (17.7% in 9MFY16) in FY17. Century is doubling face veneer capacity in Laos (to 96k CBM) to improve its market share in veneer trading (from 10%) since the ban on timber imports has impacted availability of face veneer for Indian organised/unorganised manufacturers. We reduce our sales and EBITDA estimates by 5% and 7%-9% for FY17 and FY18, owing to weak demand for premium ply. Poor predictability of timber regulations and possibility of disruption in wood-based products will keep multiple expansion in check; our target price implies 16x FY18 EPS.

Post the results we spoke to several investors and the key concerns were as follows:

Century's volumes declined, whereas Greenply's volumes grew at 7%; is the company losing market share?

Whilst Century Plyboard's volume growth was higher than Greenply's for FY14 and FY15, volume growth tapered in FY16 and has been marginally lower versus Greenply. In 3QFY16, Century's plyboard volumes declined 2%, whereas Greenply posted 6% volume growth. Our checks suggest that competitors have been aggressive with pricing and have enhanced credit availability to the channel to spur volume growth. Century's management highlights that the company took a concerted decision to maintain prices rather than participate in price cuts to grow volumes. Management contends that cutting prices ephemerally drives volume growth but impacts the bargaining power with the channel in the long term. Note that Century's EBITDA margin has been higher vs Greenply's for the last two years; in 9MFY16/3QFY16 Century posted 16.9%/17.7% EBITDA margin vs 9%/9.4% for Greenply.

Why is Century not able to gain market share despite unorganised players facing liquidity and raw material challenges?

Century has been able to gain market share over the unorganised players in the mid-segment category *"Sainik"*, evident from strong volume growth in this segment in 3QFY16 and 9MFY16 (26% and 12%, respectively). The reason for an overall volume decline despite strong growth in *Sainik* is on account of a decline in the premium segment, where the unorganised players do not compete with the company. The premium plywood is sold largely in urban areas and to large-ticket housing wherein the slowdown is much more protracted than the smaller cities. The company continues to build capacities and distribution to cater to demand in the tier II/III markets to sustain the volume growth of mid-category plyboard offering.

What is the reason for the sharp decline in plyboard margin in 3QFY16?

Plyboard margin declined 440bps YoY and 100bps QoQ. The decline in margin can be explained by the following: **(a)** lower margin in face veneer- a significant shortage of face veneer in India meant that margin in face veneer was very high last year which is not sustainable and the sales mix of face veneer deteriorated due to lower timber availability during the quarter, **(b)** lower fixed cost recovery - whilst sales declined, employee costs rose by 26% YoY (17% of sales vs 13% last year) and other expenses rose by 7% YoY (18% of sales vs 17% last year), which also impacted margin; labour cost increased on account of increase in minimum wage rate for factory labour across India. Management highlights that the company will sustain 17% EBITDA margin (industry leading) for the next year as well.

Stock Information

Bloomberg Code:	CPBI IN
CMP (Rs):	152
TP (Rs):	203
Mcap (Rs bn/US$ bn):	40/0.6
3M ADV (Rs mn/US$ mn):	89/1.3

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	(14)	(13)	(21)	(12)
Rel. to Sensex	(9)	(6)	(5)	(7)

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs bn)

	FY15	FY16	FY17
Revenues	15.7	16.7	18.6
EBITDA	2.6	2.7	3.2
EPS (Rs)	6.7	7.9	9.4

Source: Bloomberg, Ambit Capital research

Flags

Accounting:	AMBER
Predictability:	RED
Earnings Momentum:	RED

Analysts

Achint Bhagat, CFA
achintbhagat@ambitcapital.com
Tel: +91 22 3043 3178

Nitin Bhasin
nitinbhasin@ambitcapital.com
Tel: +91 22 3043 3241

Why is the company expanding aggressively in face veneer in international geographies?

After establishing 32,000 CBM capacity for face veneer in Myanmar, Century Ply is expanding aggressively in Laos. The company has set up three peeling lines (48,000 CBM) already and will double capacity in the region. Management's rationale is that procuring face timber is becoming difficult for the plyboard industry due to strict norms on timber peeling in S E Asian countries. Hence, the company wants to ensure that Century has long term security for face veneer. The expansion in Laos is through a 51:49 JV with a local player, who will manage the operations and Century will use the existing shed of the JV partner. Given that the basic infrastructure is available, capex commitment will be limited (Rs50mn per timber peeling line). Also, the company has tied up with veneer distributors in India for sale of its Laos production.

Laminates appears to be doing well, why is the company not adding capacities in this segment?

Century posted 19% volume growth and 370bps YoY margin expansion in laminates in 9MFY16. Investors ask why the company is not expanding in this segment, given the strong performance in FY16 and rising capacity constraints since it is operating at >90% capacity utilisation. Management explains that the company has installed additional boilers at the plant to increase efficiency and utilisation to 110%-115%, similar to the level of Greenlam, to sustain growth in laminates in FY17. The company is actively considering expansion in laminates and is evaluating setting up a capacity in Western India.

What is the status of the particle board and MDF expansion?

The company's particle board expansion will be completed ahead of schedule and will be commissioned by March-16 as against initial expectations of June-16. The company expects to generate Rs600mn/Rs1,000mn of revenue in FY17/FY18. The company has started construction of the MDF plant and expects to commission the plant in the next 12-15 months. It will incur capex of Rs3bn for the MDF plant.

Where do we go from here? Cutting growth estimates to account for the weak demand environment

We reduce our revenue estimates by 5% each in FY17/FY18, led by 8% cut in the plyboard volumes. We reduce EBITDA estimates by 6%/7% for FY17/FY18 on account of reducing sales estimates and cut in margin estimates on account of lower fixed cost absorption. As a result, PAT reduces by 7% and 9% for FY17 and FY18. Our current estimates imply 18%/24% sales and EPS CAGR over FY15-FY18 and 32%-24% RoEs.

We acknowledge that demand recovery is uncertain currently (a point we made in our recently published thematic), which could weigh on volume growth of companies such as Century Ply. That said, we remain optimistic that the company's strategy of building scale assuring long term raw material availability despite a tepid growth environment bodes well over the long term.

Valuation: Despite the large addressable opportunity, predictability will keep multiples in teens

We continue to believe that ply is a large addressable market wherein the unorganised share is shrinking and which bodes well for a market leader like Century. Century is trading at 17x FY17E EPS, which is a significant discount to leading franchises in other building material categories such as tiles, paints and electricals (a 20%-35% discount). Our target price implies 16x FY18 EPS, however multiple expansion could be hindered by low predictability of timber regulations and the possibility of disruptions to the product category. Simultaneously, rising avenues of capital investment and increasing business complexity (international investments) should keep multiples lower than other 'otherwise predictable home building companies.'

Exhibit 1: Change in estimates

Particulars (Rs mn unless mentioned)	New Estimates		Old Estimates		Change (%)		Comments
	FY17	FY18	FY17	FY18	FY17	FY18	
Plyboard	197,266	220,938	213,997	239,676	-8%	-8%	Owing to weaker-than-expected demand for premium plywood
Laminate	4,634,078	5,468,212	4,752,900	5,608,422	-3%	-3%	
Realisation							
Plyboard (Rs/CBM)	69	74	68	73	1%	1%	
Laminate (Rs/sheet)	1,042	1,115	1,042	1,115	0%	0%	
Financials							
Net Sales	19,603	25,881	20,637	27,127	-5%	-5%	On account of lower plyboard volumes
Reported EBITDA	3,206	4,291	3,405	4,622	-6%	-7%	
Reported EBITDA margin (%)	16.4%	16.6%	0	0	-15 bps	-46 bps	Lower EBITDA margin due to lower operating leverage
Adjusted EBITDA	3,206	4,291	3,405	4,622	-6%	-7%	
Adjusted EBITDA margin (%)	16.4%	16.6%	16.5%	17.0%	-15 bps	-46 bps	
Depreciation	529	636	529	636	0%	0%	
Interest	303	304	303	304	0%	0%	
PAT	2,080	2,865	2,237	3,133	-7%	-9%	Marginal reduction in PAT is on account of lower volumes
PAT margin (%)	10.6%	11.1%	0	0	-23 bps	-48 bps	
Cash flow paramaters			-	-			
CFO	2,664	2,058	2,737	2,273	-3%	-9%	CFO decrease is on account of lower EBITDA
Capex	(1,479)	(2,227)	(1,479)	(2,227)	0%	0%	High capex in FY17/18 for MDF plant
FCF	1,185	(168)	1,258	47	-6%	NA	
Turnover ratios							
Working capital (ex-cash) (X)	2.9	3.5	3	3	(0.1)	0.0	
Gross Block (X)	2.7	2.9	3	3	(0.2)	(0.1)	
Capital employed (X)	1.7	1.9	2	2	(0.1)	(0.0)	
Profitability Ratios							
RoCE	21.8%	24.5%	23%	26%	-106 bps	-136 bps	Marginal reduction in RoCEs/RoE due to decline in PAT
RoE	33.1%	34.4%	35%	36%	-144 bps	-163 bps	
ROIC	24.4%	26.9%	25%	28%	-99 bps	-154 bps	
Target Price	**203**		**228**		**-9%**		

Source: Company, Ambit Capital research

Balance sheet

Rs mn unless mentioned	FY14	FY15	FY16E	FY17E	FY18E
Total Net worth	2,931	3,894	5,348	7,066	9,432
Loans	5,276	4,677	4,527	4,327	4,477
Of which Buyers credit	2,002	1,500	1,100	800	800
Sources of funds	8,314	8,564	9,877	11,404	13,931
Net block	3,164	2,456	3,499	4,449	6,040
Total Current Assets	6,793	7,819	8,085	8,886	10,549
Current liabilities and provisions	1,914	2,041	2,065	2,289	3,016
Net current assets	4,879	5,777	6,020	6,597	7,533
Application of funds	8,314	8,564	9,877	11,404	13,931

Income statement

Rs mn unless mentioned	FY14	FY15	FY16E	FY17E	FY18E
Revenue	13,477	15,727	17,368	19,630	25,995
Plyboards	*10,480*	*12,126*	*12,961*	*14,655*	*17,562*
MDF/Particle Board	-	-	-	*840*	*3,552*
Laminates	*2,587*	*3,372*	*4,249*	*4,954*	*6,255*
Total expenses	11,961	13,326	14,426	16,376	21,565
EBITDA	1,766	2,559	2,942	3,405	4,622
EBITDA margin	13.1%	13.1%	16.4%	17.2%	17.3%
Depreciation	387	485	425	529	636
EBIT	1,416	2,251	2,714	3,111	4,232
Other income	37	177	197	235	246
Adj PBT	629	1,795	2,402	2,808	3,928
Provision for taxation	124	338	480	562	786
Adjusted PAT	786	1,491	1,912	2,237	3,133
EPS basic (Rs)	4	7	9	10	14

Source: Company, Ambit Capital research

Cash flow statement

Rs mn unless mentioned	FY14	FY15	FY16E	FY17E	FY18E
PBT	**629**	**1,796**	**2,211**	**2,612**	**3,594**
Change in working capital	(1,168)	(877)	234	(19)	(1,514)
Direct taxes paid	(117)	(337)	(442)	(522)	(719)
CFO	**338**	**1,488**	**2,541**	**2,664**	**2,058**
Net capex	643	(68)	1,468	1,479	2,227
CFI	**(706)**	**128**	**(1,296)**	**(1,241)**	**(1,984)**
Interest & finance charges paid	(287)	(335)	(312)	(303)	(304)
Dividends paid	(60)	(462)	(306)	(362)	(498)
CFF	**(281)**	**(1,577)**	**(768)**	**(865)**	**(652)**
Net increase in cash	(649)	39	476	558	(578)
FCF	**(305)**	**1,556**	**1,072**	**1,185**	**(168)**
Opening cash balance	983	334	374	850	1,408
Closing cash balance	334	374	850	1,408	830

Source: Company, Ambit Capital research

Ratio analysis / Valuation parameters

	FY14	FY15	FY16E	FY17E	FY18E
RoCE	19	22	23	23	26
RoIC	23	25	25	28	30
RoE	36	43	40	35	36
Working capital turnover	2.5	3.0	2.9	3.0	3.5
Debt/Equity(x)	1.7	1.2	0.8	0.6	0.4
Net debt/Equity(x)	1.6	1.1	0.7	0.4	0.3
P/E (x)	44.4	23.4	18.3	15.6	11.1
P/B(x)	11.5	8.8	6.3	4.7	3.5
EV/EBITDA(x)	22.5	15.3	13.1	11.1	8.3

Source: Company, Ambit Capital research