



**J K Cement - A Rising Star**

**Strong Buy**  
August 10, 2006

**CMP : Rs. 165 Potential Upside: 73%**  
**Target: Rs. 285 Time Frame: 12-18mths**

**Analyst**

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<b>Industry:</b>	<b>Cement</b>
BSE Group	B1
BSE Code:	532644
NSE Symbol	JKCEMENT
Bloomberg Code	JKCE.BO
BSE Sensex	11149
NSE Nifty	3260

**Market Data:**

Market Cap	1151 Cr.
Share Capital	69.93 Cr
52 Wk High/Low	211/109
Avg. Trading Vol.	63000
Face Value	Rs.10

**Shareholding Pattern:** %

Promoters	61.56
Institutions (including FII)	19.33
NRI/ OCB/Corporate	5.84
Public & Others	13.27

**Investment Rational**

**Strong Realisations and increasing volumes to drive future growth**  
JK Cement is expanding its Grey Cement capacities from 4mn tonne to 7mn tonne by FY08. It is also expanding its white cement capacity by .05mn tonnes. Cement prices are expected to be strong due to growth in demand driven by increased construction activity in both south and NCR region. JK cement is expected to benefit from both strong cement prices and volume growth due to capacity expansion. **We expect the topline to grow at a CAGR of 24.7 % and Net profit to grow at a CAGR of 150 % over next 2 years with operating margins expanding by 800bps.**

**Reduction of Power cost to be a margin booster:**

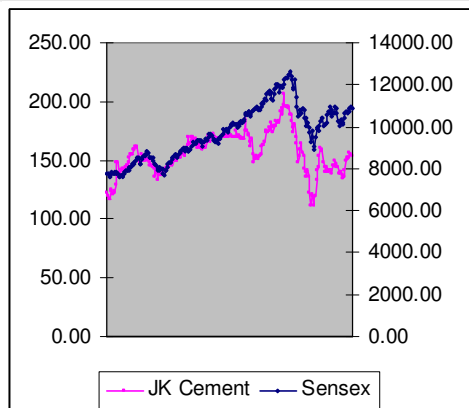
JK Cement is increasing its captive power capacity by replacement of existing 7.5MW thermal power turbine with a 10MW turbine. Further JK Cement is also setting up 20MW Pet coke based plant and 13.2MW waste heat recovery plant. **With the implementation of captive power plants the cost of power would reduce by approx Rs 2 per unit, which will lead to a saving of Rs 70Cr from FY08.**

**Low Supply in North India to favour producers:**

Northern region constitutes major chunk of the company's supplies with the balance going to Western & Central India. With strong demand growth of 11.5% in FY06, North is estimated to remain supply deficit till mid of FY09 as major capacity expansions come on stream only by Q1FY09. Commonwealth games in year 2010 will also give further fillip to the cement demand in the northern India

**Adequate Margin of Safety:** It is available at an enterprise value of US\$69 per ton. It is significantly lower compared to other cement companies which are available between average US\$130-\$150 per tonne

**Share Price Movement Vs Sensex**



**Valuation Summary**

Year	FY 08E	FY 07E	FY 06	FY05
Total Income (Rs Cr)	1725	1506	1118	433
TI Growth (%)	14.54	34.71	158.31	-
Net Profit (Rs. in Cr.)	200	144	33	6
Net Profit Growth (%)	38.90	341.32	417.81	-
EPS (Rs.)	28.55	20.55	4.66	1.26
P/E (@ Rs.165)	5.53	7.69	33.92	125.42
P/BV	1.11	1.37	1.64	2.01
EV/EBITDA	3.81	4.48	9.04	28.60
EV/ TON (US \$)	55	62	69	77



### **Expansion plans to drive future volume growth**

### **Green field project in Karnataka**

#### **Background**

JK Cement with a production capacity of 4mn tonnes p.a. for Grey Cement and 0.35mn tonnes p.a. of White Cement is one of the largest cement producers in northern India. JK cement plants are located in Nimbahera, Mangrol and Gotan in Rajasthan. Company also have access to large limestone reserves for both grey cement and white cement. JK cement was formed as a part of restructuring of JK synthetics and was hived off as a separate company in June 2005. Company is set to take full advantage of buoyant environment in the cement industry with a focused business model.

#### **Investment Rational:**

JK Cement is expanding its Grey Cement Capacity capacities from 4mn tonnes to 7mn tonnes by FY09 and white cement capacity from .35mn tonnes to .4mn tonnes by Sep06. Further it is also enhancing its captive power capacity by 43 MW during FY06-08.

Particulars	Capacity Addition	Capital Outlay (Rs Cr)	Target Completion Date
<b>Grey Cement</b>	.45 mn tones	22.5	Jul 06
	3 mn tonnes	600	Sep 09
<b>White Cement</b>	0.05 mn tones	9	Sep 06
<b>Turbine upgradation</b>	From 7.5-10MW	9.5	Dec 06
<b>Pet Coke Based Power Plant</b>	20 MW	86	Apr 07
<b>Waste recovery based Power plant</b>	13.2	59.4	Jun 07
<b>Total</b>		<b>786.4</b>	

Company plan to set up the additional 3mn tonnes green field plant in Mudhol Dist. Bhagalcoat in Karnataka. Company's 100% subsidiary J K Cem Ltd. owns significant limestone deposits, which are sufficient for 50 years of requirement. Company has already acquired 350 Acres of land and LOI for major plant and machinery are issued.

The capital outlay will be funded by a mix of equity, debt and internal accruals. During FY07 JK Cement mobilised Rs290Cr through a follow-on public issue for its capital expenditure (Capex) plan.

JK Cement is increasing its captive power capacity by replacement of existing 7.5MW thermal power turbine with a 10MW turbine. Further JK Cement is also setting up 20MW Pet coke based plant and 13.2-mw waste heat recovery plant. The cost of power would reduce by approx Rs.2 per unit with the implementation of power plant. It will lead to a saving of around **Rs70Cr** from FY08. Earlier the power cost of JK Cement was higher than the industry average significantly dragging down its operating margins. We expect the operating margin to improve as high as by 800bps by FY08 with new captive power plants.



**Operational efficiency to significantly improve margins**

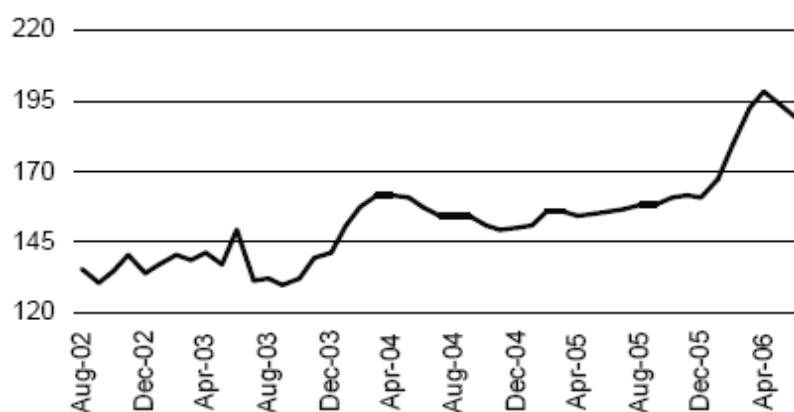
**Demand supply dynamics in favour of northern region**

**Adequate margin of safety – possible re-rating**

**Carbon credit to add further sparkle to profitability**

Northern region constitutes major chunk of the company's supplies with the balance going to Western & Central. With strong demand growth of 11.5% in FY06, North is estimated to remain supply deficit till mid of FY09 as major capacity expansions come on stream only by Q1FY09. Also commonwealth games in year 2010 will give a fillip to the construction activities in NCR region. We expect the demand to be above industry average in the northern region, keeping cement prices at a strong footing for next 2 years.

**Price Trend – Northern Region Rs Per bag**



JK Cement is available at an enterprise value of US\$69 per ton. It is significantly lower compared to other cement companies which are available between average US\$ 130-\$150 per tonne. JK Cement currently trades at a low enterprise value primarily due to its low operating margins. **However with implementation of captive power plants and increased blending of cement, going forward operating margins will significantly improve.** We believe that this will lead to a re-rating of the stock offering significant upside from the current levels.

The waste heat recovery (WHR) plant, which will generate power out of hot gases produced in the production process, would be entitled for carbon credits. This project has already been registered with United Nations Framework Convention on Climate Change (UNFCCC). **Company expects to generate recurring revenue of US\$2mn (approx Rs9Cr) per annum by selling carbon credits from FY09.**

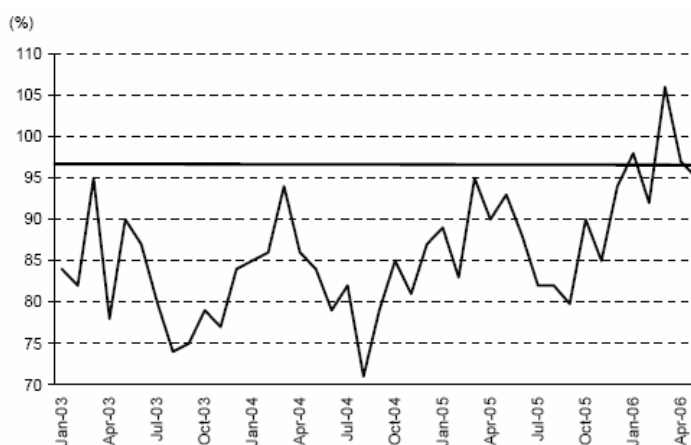


## Industry Outlook

India is the second largest cement consumer of the world with a consumption of 136mn tonnes in FY06 as against a capacity of 152mn tonnes. India also exported 9mn tonnes of cement and clinker in FY06. Despite being such a large market the per capita consumption of cement in India is very low at 122kg as against world average of 320kgs leaving huge growth potential in the coming future.

Indian cement industry has a positive correlation of 1.3x with the GDP growth rate. With GDP growing a more than 8%, cement demand is expected to be in the range of 10- 11% over next 3-5 years. Further strong growth in infrastructure creation may drive the growth rates even higher leading to strong cement prices over next 2 years till new capacities come on-stream and increase the supply.

### Capacity utilizations in cement industry



Due to strong demand, capacity utilizations in the cement industry have increased to more than 100%. Further most of the players have increased the proportion of blended cement leading to higher volumes. We expect capacity utilizations to remain firm in wake of strong demand leading to higher cement despatches.

India faces shortage of around 20mn houses and only 1.5mn houses are built every year. This along with government tax incentives and rising per capita income will act as a catalyst for housing demand.

Infrastructure creation is Also one of the major thrust areas in the government's agenda. Many large road projects like Golden quadrilateral, North-South-East-West Corridor etc, New Airports, Power plants, and Retail malls will ensure robust growth in cement consumption in next few years.

**Strong GDP growth to drive cement demand**

**Strong Capacity Utilizations and increased blending drive volume growth**

**Housing, Infrastructure and Retail are primary growth drivers**



### **Government Intervention – A hanging sword**

#### **Concerns:**

Any type of government intervention to keep the cement prices artificially low may act as a dampener for cement industry. In May 2006, government called a meeting of cement producers and asked them to keep the cement prices under control. Cement industry agreed to give discounts on cement prices to some large government projects. Such moves in future can prove to risk on the profitability of the cement industry.

### **Rising crude prices – a concern**

Cement is a bulk commodity and transportation accounts for approximately 12% of the total cost. Rising crude prices can be negative on the profitability of the cement industry with increasing freight cost. Supreme court ruling limiting truck loading to 9 Ton has already increased the freight cost of cement companies. High crude prices will eventually lead to increased fuel prices putting a pressure on profitability.

#### **Investment Triggers**

##### **Increase in production and dispatches due to following developments:**

- Increase in capacities by .5mn in FY07 and by 3mn tonnes in FY09
- Sale of PPC to increase from 28% in FY06 to 75% in FY07 and 90% in FY08
- Fly Ash mix to increase from 20% in FY06 to 25-26% in FY07 and 30-32% in FY08

##### **Improving profitability**

Operating margin is expected to improve from 12.75% in FY06 to 21% in FY08 mainly due to:

- Improved realisations per bag on back of strong cement prices
- Reduction of power cost by Rs 2 per unit leading to a saving of approx Rs 70Cr p.a. from FY08

#### **Valuation and Outlook**

At CMP of Rs165, JK Cement is trading at a PE multiple of 5.5x FY08E earnings and 7.7x FY07E earnings and EV/EBIDTA of 3.8x FY08E and 4.5x FY07E. At CMP of Rs165 JK Cement is available at EV/Ton of US\$69 for FY06, EV/Ton of US\$62 for FY07E and EV/Ton of US\$55 for FY08E. At this valuation stock is *cheapest* among its peers and offers significant upside potential. With better profitability and strong cement outlook we recommend a Strong BUY on JK Cement with a 12-18 months target of Rs.285. At our target price JK Cement will be available at a PE multiple of 10x FY08E earnings and EV/ Ton of US\$110 which will be at a discount to other cement companies.



## FINANCIALS

PROFIT & LOSS STATEMENT				
Year End	FY 2008E	FY 2007E	FY2006	(Rs. in Crores) FY 2005
<b>Revenue</b>	<b>1723</b>	<b>1502</b>	<b>1109</b>	<b>423</b>
<i>%age Change in Revenue</i>	<i>14.76</i>	<i>35.44</i>	<i>161.83</i>	<i>-</i>
<b>Other Income</b>	<b>2</b>	<b>5</b>	<b>9</b>	<b>9</b>
<b>Total Income</b>	<b>1725</b>	<b>1506</b>	<b>1118</b>	<b>433</b>
<b>Op. Profit</b>	<b>363</b>	<b>282</b>	<b>141</b>	<b>48</b>
<i>%age Change in Op. Profit</i>	<i>28.90</i>	<i>99.16</i>	<i>196.93</i>	<i>-</i>
<b>Interest</b>	<b>37</b>	<b>41</b>	<b>58</b>	<b>24</b>
<b>Gross Profit</b>	<b>326</b>	<b>240</b>	<b>83</b>	<b>23</b>
<i>%age Change in Gr. Profit</i>	<i>35.70</i>	<i>188.61</i>	<i>256.45</i>	<i>-</i>
<b>Depreciation</b>	<b>41</b>	<b>35</b>	<b>31</b>	<b>13</b>
<b>PBT</b>	<b>285</b>	<b>205</b>	<b>52</b>	<b>11</b>
<i>%age Change in PBT</i>	<i>38.90</i>	<i>293.29</i>	<i>383.87</i>	<i>-</i>
<b>Tax</b>	<b>86</b>	<b>62</b>	<b>20</b>	<b>5</b>
<b>PAT</b>	<b>200</b>	<b>144</b>	<b>33</b>	<b>6</b>
<i>%age Change in PAT</i>	<i>38.90</i>	<i>341.32</i>	<i>417.81</i>	<i>-</i>

BALANCE SHEET				
Year End	FY 2008E	FY 2007E	FY2006	(Rs. in Crores) FY 2005
<b>Equity Capital</b>	<b>70</b>	<b>70</b>	<b>70</b>	<b>50</b>
Reserves	924	736	604	343
<b>Shareholder's Fund</b>	<b>994</b>	<b>806</b>	<b>674</b>	<b>393</b>
Debt	411	491	582	641
<b>Total Liabilities</b>	<b>1405</b>	<b>1297</b>	<b>1256</b>	<b>1035</b>
Net Assets	1066	961	898	903
Cap. WIP	263	73	57	18
Investments	0	0	0	0
Cash	11	213	285	68
Net Current Assets	77	264	317	115
<b>Total Assets</b>	<b>1405</b>	<b>1297</b>	<b>1256</b>	<b>1035</b>



## KEY FINANCIALS & IMPORTANT RATIOS

Year End	FY 2008E	FY 2007E	FY 2006	FY 2005
<b>Key Financials:</b>				
EPS (Rs.)	28.55	20.55	4.66	1.26
CEPS (Rs.)	34.38	25.54	9.09	3.78
Book Value (Rs.)	142.11	115.27	96.42	78.78
<b>Performance Ratio:</b>				
OPM (%)	21.06	18.75	12.75	11.25
GPM (%)	18.92	16.00	7.51	5.51
NPM (%)	11.59	9.57	2.94	1.49
ROCE (%)	22.93	19.02	8.79	3.39
RONW (%)	20.09	17.83	4.83	1.60
<b>Leverage Ratio:</b>				
Debt/ Equity	0.41	0.61	0.86	1.63
Interest Coverage	8.70	5.96	1.90	1.44
<b>Dividend Payout (%)</b>	15.00	15.00	15.00	--
<b>Valuation Ratio: (@ Rs. 165)</b>				
P/E	5.78	8.03	35.43	130.98
P/BV	1.16	1.43	1.71	2.09
EV/EBITDA	3.81	4.48	9.04	28.60
EV/Sales	0.80	0.84	1.15	3.22
EBITDA/ Tonne	672	640	354	124
EV/ Tonne (in \$)	55	62	69	77

## Peer Comparison (FY06)

	Sales	PBDIT%	PAT%	EV/Ton (\$)
Gujarat Ambuja	3568	26.6	15.5	250
ACC	5220	16.8	8.4	220
Shree Cement	667	33.3	9.1	178
Ultratech	3255	18.0	6.1	131
JK Lakshmi	700	20.0	3.6	121
Birla Corp	1433	21.4	8.0	84
JK Cement	1108	12.7	2.9	69



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