STALLION ASSET
CREATING ALPHA

2016

MANGALAM CEMENT

CMP: 219.60

Target: 330

MANGALAM CEMENT

Cement stock in recent 2 weeks have been buzzing with large volumes. The likelihood of this been just a technical rally is diminishing by every passing day. This sector is the first sector to clearly breakout out of a bear market increasing odds of cement being the leader of the next bull market. There are only two sectors to play the INDIAN INFRASTRUCTURE growth story i.e. Road Companies and Cement Companies. Since Majority of Road Companies have either corporate governance issues (you cannot win Road contracts from the government in India without Bribing) or broken balance sheet, the markets have made it clear that they want to invest in a cleaner sector like cement where there is no corporate governance issues involved.

About Cement Industry Key Points

1) Cement is a commodity which isn't easily transportable hence the prices in region will depend upon the location of the factory. There can be variability of price between 2 regions by as much as 40-50%.
2) The total Industry capacity is 390 Million Tonnes (MT) but the utilization is 277 MT (71%)
3) The Industry has been going through an extremely tough time due to drop in Infrastructure execution in last 4-5 years. Their Fortunes of the Industry are changing especially due to large road projects being executed
4) The highways building pace has reached 20 km a day at present from a mere 11-12 Km a day when the Narendra Modi government took over and by May 2016 it is likely to reach 30 km a day. The numbers itself talk about the growth which has already picked up and has a room to expand further.
5) In India 33% of Cement demand comes from Infrastructure, and 67% comes from Housing. The opportunities remain large in both segments as there are 60 million houses to be constructed till 2022 in government housing for all schemes.
6) Currently, the total cement industry has capacity of 390 MT which is expected to grow to 421 MT by FY17.This capacity increase cannot come overnight, as they will take time to commission them. So the companies having low capacity utilization will benefit the most.

Mangalam: North India cement story

1) **Placed in favourable location of northern India through its dealer network**
2) **Trading at lesser valuations as compared to its peers**

In a market scenario were all cement stocks are going up and many factors are favouring the industry as discussed above, you might want to know why Mangalam cement is our pick out of an odd dozen!

No doubt about the fact that Managalam's profitability has reduced. This has happened due to two reasons:

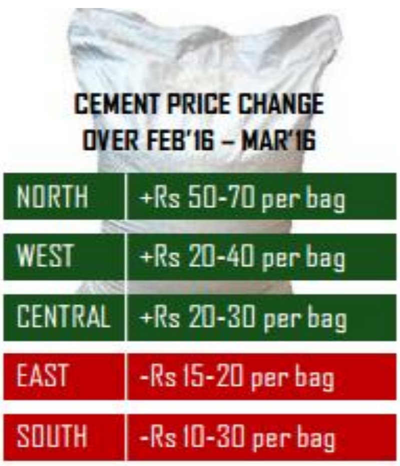
First, due to lack of demand and no major infra activity in last two years the demand of cement had reduced drastically hence affecting the profitability of the company. Secondly, every region of the country has its own price on the basis of demand –supply match. Hence if there is no demand in a particular region, the prices of the cement goes down(cement is a commodity so no pricing power).Now, Mangalam cement in particular has its plant located in Kota District, Rajasthan with a strong dealer network in Jaipur, Chhattisgarh and Delhi.

Due to strong presence in the northern region and a little capacity additions made during the year, the company can take full advantage of the recent price increase in that region.

Amidst positive sentiment in the market, all the cement companies are going to do well whether they are fundamentally good or bad. Inspite of slower growth, the company's scope to grow in the coming few quarters is as bright. Since its a BK Birla company we strongly believe some day it will be taken over by Aditya Birla group and probably be merged with Ultratech Cement.

Price Rise is beneficial for the company

In the northern India, cement prices per bag has risen by Rs. 50-70 per 50 bag which means without any sales growth also the profitability shall improve in the coming quarters. Moreover, the cement industry has lately shown spurt in the volume with a volume growth of 8% in Dec Quarter. In February Cement Production Growth was 13.5%.



CEMENT PRICE CHANGE OVER FEB'16 – MAR'16

NORTH	+Rs 50-70 per bag
WEST	+Rs 20-40 per bag
CENTRAL	+Rs 20-30 per bag
EAST	-Rs 15-20 per bag
SOUTH	-Rs 10-30 per bag

About Mangalam Cement

Mangalam Cement Limited is an India-based cement manufacturing company. The Company offers its products under the brand name, Birla Uttam Cement. The Company has its cement and coal-based power plant at Aditya Nagar, Kota district (Rajasthan).

The company is a Birla Group company which is not only efficiently managed but also has immense experience. Today this conglomerate group has various companies.

Key Points of the company:

- The capacity utilization for the year 2014-15 was 67% with a total capacity of 3.25 MT.
- Profitability of the company has come down due to ongoing expansion.
- Mangalam had a sales of 922 Cr with a market cap of 585 Cr.

Why Mangalam?

Cement is a fixed overhead business i.e. cost remain the same but the profits fluctuate due to changes in Pricing ; if the selling price of cement is 200 per bag or 250 per bag the cost remains the same.

December 2015 quarter Mangalam had a operating margin of 4% i.e. when prices were Rs. 200 per bag. Assuming that prices have increased Rs. 50 per bag or 25% and the cost structure remains the same, Mangalam will have an operating profit margin of 25%.Now this is the best case scenario. We believe that the growth in infrastructure is here to stay and the prices will remain same or increase for the next one-two years.

Assuming a 15% operating margin (worse case) and sales at Rs. 922 Cr (Same as FY15), gives us an operating profit of 138.3 Cr. Finance cost similar to last year at 10 Cr per quarter gives us a profit before tax of 98.3 Cr and profit after tax of 72 Cr (assuming 25% tax rate).Our worst case scenario is that the company will make profits of 72 Cr and the company is trading at 8 times.

FY 17 Projection			
	Best Case	**Worst Case**	**Base Case**
Sales(FY15 Sales Added 10% for increase Prices)	922	922	922
Operating Margin	25%	15%	20%
Operating Profit	230.5	138.3	184.4
Interest Payments	40.0	40.0	40.0
Profit Before Tax	190.5	98.3	144.4
Tax @25%	47.6	24.6	36.1
Profit After Tax	142.9	73.7	108.3
PE	4.1	7.9	5.4

*No Volume Growth Case at 240 Per bag Prices

Now it really makes sense in buying Mangalam Cement as large cement companies like UltraTech cement is already working at 90% capacity in their Northern plants. Mangalam's capacity levels were low at 67% in FY15. Hence the near term demand will easily help Mangalam to increase its utilization levels which is currently below industry average.

Conclusion – We like this stock with a stop loss of 200 because

1) 95% Probability of entry of Aditya Birla Group
2) Infrastructure revival in North India
3) Capacity utilization at 67% now but as demand increases operating leverage will be in play
4) Technically Cement Breakout Sector
5) Valuations are reasonably Comfortable

Analyst ownership of the stock: No

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