RESULT UPDATE

Teena Virmani
teena.virmani@kotak.com
+91 22 6218 6432

SHREE CEMENTS LTD

PRICE: RS. 19512 | **RECOMMENDATION: ACCUMULATE**
TARGET PRICE: RS. 20748 | **FY20E P/CEPS: 20.3X**

- Company's revenues for Q3FY18 reported an improvement of 25% YoY, in line with our estimates. Growth in revenues was led by 8.4% YoY improvement in cement volumes and 11.4% YoY jump in cement realizations. Power segment sales have also witnessed drastic improvement on YoY basis.
- Operating margins stood strong at 24.8% for the quarter and impacted by sharp jump in power and fuel cost and freight cost on YoY basis. Better than expected margins and lower tax expense led to net profit coming ahead of our estimates.
- We introduce FY20 estimates and roll over our valuations on FY20 estimates.
- At current market price of Rs 19512, stock is trading at 20.9x and 20.3x P/CEPS and 19.2x and 18x EV/EBITDA on FY19/FY20 estimates respectively. We believe that Shree Cement is adequately positioned with its expanded capacities to capture the upswing in demand and prices in northern India. However, the risk of potential ban on pet coke usage or import of pet coke would have an adverse impact on the overall power and fuel cost for the company. We roll forward our valuations on FY20 and arrive at a revised price target of Rs 20748 based on average of 18x EV/EBITDA and $230 per tonne on EV/Tonne and adding valuations of power business. Owing to limited upside from the current levels, we maintain ACCUMULATE rating on the stock. We would be watchful of further updates on pet coke usage and pet coke import ban.

Summary table

(Rs mn)	FY18E	FY19E	FY20E
Sales	98,000	117,400	127,480
Growth (%)	16.3	19.8	8.6
EBITDA	26,100	32,650	33,850
EBITDA margin (%)	26.6	27.8	26.6
PBT	17,192	22,037	22,947
Net profit	14,097	18,070	18,816
EPS (Rs)	404.6	518.7	540.1
Growth (%)	5.3	28.2	4.1
CEPS (Rs)	769.4	932.4	962.1
Book value (Rs/share)	2,298.0	2,792.7	3,308.8
Dividend per share (Rs)	24.0	24.0	24.0
ROE (%)	19.2	20.4	17.7
ROCE (%)	21.5	23.1	20.4
Net cash (debt)	39,987	54,008	69,558
NW Capital (Days)	47.0	47.0	47.0
P/E (x)	48.2	37.6	36.1
P/BV (x)	8.5	7.0	5.9
EV/Sales (x)	6.5	5.3	4.8
EV/EBITDA (x)	24.5	19.2	18.0
P/CEPS(x)	25.4	20.9	20.3

Source: Company, Kotak Securities – Private Client Research

Financial highlights

Rs million	Q3FY18	Q3FY17	YoY (%)
Net Sales	**22,962**	**18,434**	**25%**
Expenditure	17,266	13,744	
Inc/Dec in trade	-239	-170	
RM	1,809	1,615	
As a % of net sales	7.9%	8.8%	
Staff cost	1,466	1,313	
As a % of net sales	6.4%	7.1%	
Power and fuel	5,055	2,991	
As a % of net sales	22.0%	16.2%	
Transportation & Handling	5,948	4,204	
As a % of net sales	25.9%	22.8%	
Other expenditure	3,228	3,791	
As a % of net sales	14.1%	20.6%	
Operating Profit	**5,696**	**4,689**	**21%**
Operating Profit Margin (%)	24.8%	25.4%	
Depreciation	2,100	3,176	
EBIT	**3,596**	**1,513**	**138%**
Interest	207	411	
EBT(exc other income)	3,389	1,103	
Other Income	873	1,356	
Exceptional items	0	0	
EBT	**4,262**	**2,459**	**73%**
Tax	928	105	
Tax Rate%	21.8%	4.3%	
PAT	**3,333**	**2,354**	**42%**
Extraordinary Items	47	-38	
Net Profit	**3,380**	**2,317**	**46%**
NPM%	14.7%	12.6%	
Equity Capital	348.4	348.4	
EPS (Rs / share)	97.0	66.5	
Cash EPS (Rs / share)	157	158	

Source: Company

Revenue growth led by volume and pricing jump on yearly basis

Company's revenues for Q3FY18 reported an improvement of 25% YoY, in line with our estimates. Growth in revenues was led by 8.4% YoY improvement in cement volumes and 11.4% YoY jump in cement realizations. Power segment sales have also witnessed drastic improvement on YoY basis. Volume improvement is led by capacity ramp up in the eastern region as well as also helped by low base of Q3FY17 which was impacted by demonetization.

For the quarter, company sold 5.325 MT of cement as against 4.913 MT for corresponding quarter same year. During the quarter, average cement realizations stood at Rs 4120 per tonne, up by 11.4% YoY and down by 1% QoQ. Cement prices witnessed a decline during Q3FY18 on a sequential basis due to weak demand, disruption in the demand owing to pet coke usage ban in NCR and nearby regions. Demand was impacted in the quarter owing to sand unavailability issues too in key markets of the company.

Power segment sales jumped sharply over the same period last year. Power segment volumes for the quarter stood at 273 mn Units for Q3FY18 as against 78.6 mn Units for same period last year. Price per unit of power improved to Rs 3.8 per unit as compared to Rs 3.5 per unit in Q3FY17.

Shree Cement has also announced the **acquisition of Union Cement Company (UCC), UAE,** with a 4mtpa (3.3mtpa clinker) plant at an enterprise valuation of US$303mn translating into $75.7 per tonne. The deal value is at 17% premium to UCC's market cap but much lower than the acquisition price paid by its competitors for acquiring assets in middle-east market.

The target company deals in variety of cement like OPC, Sulphate resistant cement and Oil well cement. UCC has one subsidiary UCC Norcem, in which it owns 60% stake, which is engaged in marketing of oil well cement.

Acquisition details

Particulars	Description
Capacity	Union Cement company has a capacity of 3.3MT of clinker and 4MT of cement. It has been operating in UAE for last more than 4 decades and has consistent track record of stable turnover and profits.
Rationale of acquisition	To establish foot print outside India. Also, the asset was available at attractive valuations.
Valuation	Company has evaluated 100% stake at an enterprise valuation of US$303mn translating into $75.7 per tonne. It has agreed to acquire minimum 92.83% of shareholding.
Time period	Transaction is expected to be completed in 9 months from the date of execution of agreement.

Source: Company

Key financials of UCC

Year	Revenue ($ mn)	EBITDA($ mn)
CY16	153.4	33.73
CY15	174.4	39.77
CY14	149.3	34.21

Source: Company

Capex details – Shree Cement is expanding its capacity by another 9.2MT between FY18-19 with capex largely to be funded via internal accruals. Expansion plan includes de-bottlenecking at Bihar Grinding unit for 0.9MT, new cement grinding unit of 5.5 MT in Bihar, new clinker unit of 2.8MT at its integrated cement plant of 2.6MT in Raipur, Chattisgarh by March, 2018 and a 2.4MT clinker unit in Gulbarga district of Karnataka in due course of time. During the quarter, company has lighted up its clinkerisation unit of 2.6MT in Chattisgarh. Overall the entire capex plan is likely to take its capacity to almost 43MT by FY19 which is likely to support its volume growth going forward.

We maintain our estimates and introduce FY20 estimates and expect company's volumes and revenues to grow at a CAGR of 11.7%/15% between FY17-20.

Operating margins impacted by higher costs

Operating margins stood strong at 24.8% for the quarter and impacted by sharp jump in power and fuel cost and freight cost on YoY basis. Cement EBITDA per tonne stood strong at Rs 1080 per tonne as compared to Rs 975 for Q3FY17.

Operating costs per tonne witnessed an increase on yearly basis due to disruption led by pet coke usage ban and sourcing of higher cost coal and higher diesel prices. Domestic pet coke prices have also moved up during the quarter by 23% YoY and with increase in import duty on pet coke, it is likely to remain at higher levels. Freight costs had moved up due to higher diesel prices and lead distance. Overall cost per tonne is not likely to come down henceforth improvement in operating margins is expected to be led by cement price hikes.

For the quarter, cement EBITDA per tonne stood at Rs 1080 while power EBITDA per unit stood at (20) paisa per unit.

Sales and cost break up (Rs per tonne)

	Q3FY18	Q3FY17
Dispatches(mn tonne)	5.325	4.913
Blended Cem Realisation/tonne (Rs)	4120	3697
YoY (%)	11.4%	
Per tonne analysis (Rs)		
Inc/Dec in trade	-45	-35
Raw material	340	329
Staff cost	275	267
Power and fuel	949	609
Transportation & Handling	1117	856
Other expenditure	606	772
Total costs per tonne	**3242**	**2797**

Source: Company, Kotak Securities – Private Client Research

We maintain our estimates and expect margins of 27.8%/26.55% for FY19/20 respectively. Better than expected margins and lower tax expense led to net profit coming ahead of our estimates.

Valuation and recommendation

We maintain ACCUMULATE on Shree Cements Ltd with a price target of Rs.20748

At current market price of Rs 19512, stock is trading at 20.9x and 20.3x P/CEPS and 19.2x and 18x EV/EBITDA on FY19/FY20 estimates respectively. We believe that Shree Cement is adequately positioned with its expanded capacities to capture the upswing in demand and prices in northern and eastern India. However, the risk of potential ban on pet coke usage or import of pet coke would have an adverse impact on the overall power and fuel cost for the company. We roll forward our valuations on FY20 and arrive at a revised price target of Rs 20748 based on average of 18x EV/EBITDA and $230 per tonne on EV/Tonne and adding valuations of power business. (earlier target of Rs 18834 based on FY19 estimates). Owing to limited upside from the current levels, we maintain **ACCUMULATE** rating on the stock. We would be watchful of further updates on pet coke usage and pet coke import ban.

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Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 9 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 9 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 9 months
SELL	–	We expect the stock to deliver negative returns over the next 9 months
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NA	–	Not Available or Not Applicable. The information is not available for display or is not applicable
NM	–	Not Meaningful. The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 9-month perspective. Returns stated in the rating scale are our internal benchmark.

FUNDAMENTAL RESEARCH TEAM

Sanjeev Zarbade
Capital Goods, Engineering
sanjeev.zarbade@kotak.com
+91 22 6218 6424

Ruchir Khare
Capital Goods, Engineering
ruchir.khare@kotak.com
+91 22 6218 6431

Amit Agarwal
Logistics, Paints, Transportation
agarwal.amit@kotak.com
+91 22 6218 6439

Nipun Gupta
Information Technology
nipun.gupta@kotak.com
+91 22 6218 6433

K. Kathirvelu
Production
k.kathirvelu@kotak.com
+91 22 6218 6427

Teena Virmani
Construction, Cement, Building Mat
teena.virmani@kotak.com
+91 22 6218 6432

Ritwik Rai
FMCG, Media
ritwik.rai@kotak.com
+91 22 6218 6426

Jatin Damania
Metals & Mining
jatin.damania@kotak.com
+91 22 6218 6440

Jayesh Kumar
Economy
kumar.jayesh@kotak.com
+91 22 6218 5373

Arun Agarwal
Auto & Auto Ancillary
arun.agarwal@kotak.com
+91 22 6218 6443

Sumit Pokharna
Oil and Gas
sumit.pokharna@kotak.com
+91 22 6218 6438

Pankaj Kumar
Midcap
pankajr.kumar@kotak.com
+91 22 6218 6434

Ashini Shah
Midcap
ashini.shah@kotak.com
+91 22 6218 5438

TECHNICAL RESEARCH TEAM

Shrikant Chouhan
shrikant.chouhan@kotak.com
91 22 6218 5408

Amol Athawale
amol.athawale@kotak.com
+91 20 6620 3350

DERIVATIVES RESEARCH TEAM

Sahaj Agrawal
sahaj.agrawal@kotak.com
+91 79 6607 2231

Malay Gandhi
malay.gandhi@kotak.com
+91 22 6218 6420

Prashanth Lalu
prashanth.lalu@kotak.com
+91 22 6218 5497

Prasenjit Biswas, CMT
prasenjit.biswas@kotak.com
+91 33 6625 9810

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