Cement Sector

Institutional Equity Research

Results Preview | April 10, 2018

Soft Realisation & Cost Pressure Persist Despite Better Demand

Demand continued to witness a healthy up-tick in 4QFY18 mainly led by accelerated execution of infrastructure projects and benign trade segment demand. Central and Eastern regions saw better demand growth compared to other regions. Further, volume push towards the end of last month also aided volume growth for the companies. Contrary to the estimates, all-India average prices remained soft during the quarter. While Southern region saw the steepest sequential correction of ~5%, average prices in Northern and Western regions corrected by 1-1.5% QoQ. However, Central and Eastern markets witnessed improvement of ~4% and ~3% QoQ, respectively mainly aided by supportive demand. Notably, easing out of sand mining issues in UP and Bihar along with likely resolution of sand crisis in Tamil Nadu is a positive development during the quarter. However, higher fuel prices (petcoke price increased by ~6-8% QoQ) and higher diesel prices are likely to nullify the savings owing to higher utilisations and improved energy efficiency.

We expect the companies under our coverage universe to witness an average volume growth of 15% YoY and 12% QoQ mainly aided by >20% volume growth estimated to be registered by UltraTech Cement (+28% YoY and +14% QoQ) and JK Cement (+27% YoY and +21% QoQ). Further, average EBITDA is expected to witness an improvement of 16% YoY and 12% QoQ mainly led by higher volume and operational efficiency.

Sales Volume Continues to Remain Impressive

Having witnessed a sharp demand recovery in 3QFY18, cement demand continued to witness a healthy traction in 4QFY18 as well mainly on account of sustained pick-up in construction activities and benign trade segment sales. Despite persistent sand crisis in several states, a low base and reviving rural demand boosted the cement demand in 4QFY18. Notably, the companies under our coverage universe are expected to clock an average volume growth of ~15% YoY (+12% QoQ). The companies having exposure to Eastern, Central and Northern regions are expected to report better volume growth due to relatively better demand environment. UltraTech Cement, JK Cement, Mangalam Cement and Sagar Cements are expected to witness a stellar double-digit growth in volume on YoY comparison.

Soft Realisation Continues to Remain an Overhang

While demand environment was favourable during the quarter, average realisation continues to remain soft as excess supply and tendency of gaining/establishing market presence by cement companies restricted price recovery. As per our channel checks the average price in Southern, Northern and Western region sequentially contracted by ~5%, ~2% and ~1%, respectively, while Central and Eastern regions witnessed sequential improvement of ~4% and ~3%, respectively. However, as the prices witnessed an uptrend in Apr'18, we expect realisation to witness a decent recovery in FY19E.

Elevated Cost Pressure Persists

In a scenario of soft realisation, cement companies' concerns aggravated with sustained increase in operating cost, as petcoke prices increased by ~6-8% QoQ. As the fuel prices broadly surged in Mar'18, we do not expect any significant increase in fuel cost sequentially. Further, increased utilisation, resumption of petcoke usage and relatively lower maintenance expenditure in 4QFY18 by Northern companies are expected to arrest margin erosion to some extent. Further, we expect the cement companies to pass on higher cost in the current quarter.

Result Picks: HeidelbergCement India, Shree Cement, and Sagar Cements.

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Exhibit 1: Quarterly Results Preview

Company	1QCY18E	1QCY17	% yoy	4QCY17	% qoq	Comments
ACC						
Volume (mnT)	7.1	6.6	7.6	6.92	2.6	Firm demand in East and new capacity to aid volume growth
Realisation (Rs/tonne)	4,500	4,379	2.8	4,569	(1.5)	A sharp price correction in Southern regions drags QoQ Realisation
Net Sales (Rs mn)	34,650	30,997	11.8	34,171	1.4	
EBITDA (Rs mn)	3,298	3,418	(3.5)	3,656	(9.8)	
EBITDA margins (%)	9.5	11	(151 bps)	10.7	(118 bps)	Soft realisation and higher cost to drag margins
EBITDA/tonne (Rs)	442	497	(11.1)	506	(12.7)	
APAT (Rs mn)	1,805	1,887	(4.4)	1,817	(0.7)	
Ambuja Cements						
Volume (mnT)	6.3	6.0	4.0	5.9	6.6	Supportive demand in Northern and Western aided volume growth
Realisation (Rs/tonne)	4,400	4208	4.6	4,450	(1.1)	Soft prices and Western and Northern markets drag QoQ realisation
Net Sales (Rs mn)	27,544	25,334	8.7	26,120	5.5	
EBITDA (Rs mn)	4,344	3,651	19.0	4,401	(1.3)	
EBITDA margins (%)	15.8	14.4	136 bps	16.8	(108 bps)	Subdued realisations to impact sequential margins
EBITDA/tonne (Rs)	694	606	14.4	750	(7.5)	
APAT (Rs mn)	3,138	2,465	27.3	3,384	(7.3)	
Company	**4QFY18E**	**4QFY17**	**% yoy**	**3QFY18**	**% qoq**	
Ultratech Cement						
Volume (mnT)	18.0	14.07	28	15.85	13.6	Low base and incremental volume from new acquired units to aid volume
Realisation(Rs/tonne)	4,180	4,035	3.6	4,213	(0.8)	Steep price correction in West and South to drag QoQ Realisation
Net Sales (Rs mn)	84,268	65,000	29.6	74,710	12.8	
EBITDA (Rs mn)	14,358	11,829	21.4	11,503	24.8	
EBITDA margins (%)	17.0	18.2	(116 bps)	15.4	164 bps	Improving operational efficiencies in acquired units to aid QoQ margins
EBITDA/tonne (Rs)	798	841	(5.2)	726	9.9	
APAT (Rs mn)	6,026	6,883	(12.5)	4,215	43.0	

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Quarterly Results Preview

Company	4QFY18E	4QFY17	% yoy	3QFY18	% qoq	Comments
Shree Cement						
Cement Volume (mnT)	6.39	5.93	7.8	5.33	20.0	Firm demand in North and East markets to aid volume
Realisation (Rs/tonne)	4,060	3,771	7.7	4,120	(1.4)	Soft realisation in North and Project Segment sales to hurt QoQ realisation
Net Sales (Rs mn)	27,206	23,803	14.3	22,962	18.5	
Cement Rev. (Rs mn)	25,952	22,359	16.1	21,936	18.3	
Power Revenue (Rs mn)	1,254	1,443	(13.1)	1,026	22.2	
EBITDA (Rs mn)	6,769	5,112	32.4	5,696	18.8	
EBITDA margins (%)	24.9	21.5	341 bps	24.8	7 bps	Resumption of petcoke usage and operational efficiencies to aid margins
EBITDA/tonne (Rs)	1,041	818	27.2	1,080	(3.6)	
APAT (Rs mn)	3,952	3,045	29.8	3,333	18.6	
Ramco Cements						
Volume (mnT)	2.5	2.3	7.6	2.3	7.7	Better demand scenario in East and AP/Telangana/Karnataka to aid volume
Realisation (Rs/tonne)	4,500	4,450	1.1	4,606	(2.3)	Subdued Realisation in Southern to drag QoQ Realisation
Net Sales (Rs mn)	11,025	10,132	8.8	10,475	5.2	
EBITDA (Rs mn)	2,234	2,396	(6.8)	2,265	(1.4)	
EBITDA margins (%)	20.3	23.6	(338 bps)	21.6	(136 bps)	Dismal Realisation and higher fuel cost to impact margins
EBITDA/tonne (Rs)	912	1,052	(13.3)	996	(8.5)	
APAT (Rs mn)	1,199	1,345	(10.9)	1,228	(2.4)	

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Company	4QFY18E	4QFY17	% yoy	3QFY18	% qoq	Comments
India Cements						
Volume (mnT)	3.1	2.9	6.9	2.7	13.7	Healthy demand in AP/Telangana to aid volume growth
Realisation (Rs/tonne)	4,220	4,578	(7.8)	4,343	(2.8)	A steep decline in Southern and Western prices to drag avg. Realisation
Net Sales (Rs mn)	13,150	15,226	(13.6)	12,131	8.4	
EBITDA (Rs mn)	1,674	1,900	(11.9)	1,673	0.1	
EBITDA margins (%)	12.7	12.5	26 bps	13.8	(106 bps)	Dismal Realisation and higher fuel cost to hurt QoQ margins
EBITDA/tonne (Rs)	529	712	(25.8)	628	(15.8)	
PAT (Rs mn)	194	343	(43.4)	152	27.3	
J.K. Cement						
Volume (mnT)	2.4	1.9	26.8	2.0	21.0	Firm demand scenario in Northern and Southern markets to aid volume growth
Realisation (Rs/tonne)	3,720	3,715	0.1	3,816	(2.5)	Price decline in North, South and West to drag agv. Realisation on QoQ
Net Sales (Rs mn)	12,498	10,189	22.7	11,261	11.0	
EBITDA (Rs mn)	1,721	1,814	(5.1)	1,702	1.1	
EBITDA margins (%)	13.8	17.8	(403 bps)	15.1	(135 bps)	Higher fuel costs and soft realisations to drag margins
EBITDA/tonne (Rs)	624	842	(25.8)	733	(14.8)	
APAT (Rs mn)	817	914	(10.6)	729	12.0	
JK Lakshmi Cement						
Volume (mnT)	2.35	2.29	2.6	2.11	11.4	Firm demand in East and North to support volume growth
Realisation (Rs/tonne)	3,960	3,523	12.4	3,971	(0.3)	Soft realisation in North and West to hurt QoQ Realisation
Net Sales (Rs mn)	9,306	8,067	15.4	8,374	11.1	
EBITDA (Rs mn)	1,167	716	63.1	943	23.8	
EBITDA margins (%)	12.5	8.9	368 bps	11.3	128 bps	Better Eastern prices and operational efficiencies to aid margins
EBITDA/tonne (Rs)	497	312	59.0	447	11.1	
APAT (Rs mn)	294	209	40.8	86	242.7	

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Quarterly Results Preview

Company	4QFY18E	4QFY17	% yoy	3QFY18	% qoq	Comments
Mangalam Cement						
Volume (mnT)	0.8	0.7	15.4	0.7	8.3	Demand revival in UP aided volume growth
Realisation (Rs/tonne)	3,950	3,669	7.6	3,951	0.0	Soft realisation in North to result in muted sequential realisation
Net Sales (Rs mn)	3,160	2,543	24.3	2,920	8.2	
EBITDA (Rs mn)	327	248	32.3	81	301.9	
EBITDA margins (%)	10.4	9.7	63 bps	2.8	757 bps	Operational efficiencies in new SGU and better realisation in UP to aid margins
EBITDA/tonne (Rs)	409	357	14.6	110	271.2	
PAT (Rs mn)	131	35	276.5	27	384.4	
HeidelbergCement India						
Volume (mnT)	1.3	1.2	7.4	1.2	6.8	Demand recovery in Uttar Pradesh to aid strong sales volume
Realisation (Rs/tonne)	4,020	3,750	7.2	3,976	1.1	Firm realisation in Central to result in better realisation
Net Sales (Rs mn)	5,226	4,538	15.2	4,839	8.0	
EBITDA (Rs mn)	846	701	20.6	754	12.2	
EBITDA margins (%)	21.0	18.7	234 bps	19.0	207 bps	Firm pricing and cost saving measures to aid margins
EBITDA/tonne (Rs)	651	580	12.3	620	5.0	
APAT (Rs mn)	371	270	37.4	318	16.8	
Sagar Cements						
Volume (mnT)	0.8	0.64	23.9	0.68	17.1	Utilisation ramp up in SGU and firm demand to lead to robust volume growth
Realisation (Rs/tonne)	3,520	3,590	(1.9)	3,655	(3.7)	Soft realisation in South and West to impact realisation growth
Net Sales (Rs mn)	2,813	2,341	20.2	2,494	12.8	
EBITDA (Rs mn)	334	260	28.4	316	5.7	
EBITDA margins (%)	11.9	11.1	76 bps	12.7	(80 bps)	Higher fuel costs and soft realisation to impact QoQ margins
EBITDA/tonne (Rs)	419	405	3.6	465	(9.7)	
APAT (Rs mn)	58.0	(32.0)		30.0	91.1	

Source: Company, RSec Research

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Outlook & Valuation

While demand trend appears to be strong in 4QFY18, soft prices are likely to impact the profitability of cement companies especially companies having exposure to Southern region. Further, likely reduction in fixed overheads due to higher utilisation and resumption of petcoke usage during the quarter are expected to set off the impact of higher input cost. Sustained demand growth and possible up-tick in realisation in FY19 are likely to aid cement companies to improve profitability, in our view.

Notably, slower capacity addition, incremental demand from proposed "Housing for All" scheme and commencement of construction activities of Metro/Irrigation projects are likely to aid utilisation and profitability of the industry in the long-term. However, in our opinion several mid-cap stocks are still available at comfortable valuations and trade at a huge discount (30-60%) to their large-cap peers. Looking ahead, we expect likely improvement in return ratios will aid mid-cap counters to get re-rated. **We maintain our positive stance on UltraTech Cement and Shree Cement in the large-cap space, while we prefer J.K. Cement, Ramco Cements, JK Lakshmi Cement and Sagar Cements in the mid-cap space.**

Valuations table

	CMP*	Recommendation	Target Price	M.Cap	EV/tonne (US$)		EV/EBITDA (x)		RoE (%)	
	(Rs)		(Rs)	(Rs bn)	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
ACC Ltd^	1,539	BUY	1,900	289	118	113	11.6	9.5	14.1	15.7
Ambuja Cements^#	235	BUY	310	467	144	141	13.1	10.8	7.0	8.3
UltraTech Cement	3,931	BUY	5,100	1,079	199	193	14.9	12.5	13.2	15.0
Shree Cement	16,996	BUY	22,000	592	243	218	17.5	14.2	16.0	15.6
Ramco Cements	813	BUY	850	191	219	210	14.7	12.0	19.1	19.8
India Cements	152	BUY	220	47	75	72	8.9	7.1	3.9	5.8
J.K. Cement	947	BUY	1,235	66	119	124	9.3	8.5	18.9	20.4
JK Lakshmi	438	BUY	550	52	78	73	9.7	7.4	14.6	19.1
Mangalam Cement	324	BUY	475	9	42	37	5.9	4.3	14.7	18.6
HeidelbergCement India	156	BUY	205	35	105	97	9.5	7.6	18.1	20.0
Sagar Cements	954	BUY	1,200	19	84	80	9.8	7.3	10.9	14.6

*Source: Company, RSec Research ; Note: *CMP as on April 10, 2018, ^December end companies, # Ambuja's valuations include its stake in ACC*

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Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%

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