Sector Update

Staring at near term headwinds

Cement

Q2FY2019 results preview

Elevated power and freight costs amidst marginal sequential rise in cement price to affect earnings: Cement companies under our coverage (ex-Grasim) are expected to witness revenue growth of 13% y-o-y in Q2FY2019. Growth is largely expected on the back of volume growth of 13% y-o-y on account of healthy demand from the government led infrastructure sector. Average cement prices for Q2FY2019 remained marginally higher q-o-q (up 1.3%), while they are flat y-o-y. We expect operating profit margin (OPM) of our coverage universe to contract by ~302 BPS y-o-y (down 8 BPS q-o-q) on account of elevated fuel & power costs and diesel prices. Consequently, net earnings of our coverage universe is expected to decline by 1.8% y-o-y (down 24.5% q-o-q). We expect Grasim, Ultratech and Birla Corporation to report higher earnings growth.

South witnessed sequential improvement in cement prices but still down y-o-y basis to lead to lower net earnings y-o-y: The average cement prices in South India have increased by 2.7% q-o-q but is still down 4.2% y-o-y. Further, volume growth for South India-based cement players such as The Ramco Cements and India Cements is likely to be healthy. However, lower realization y-o-y and elevated operating cost structure are likely to lead to a y-o-y decline in net earnings.

Outlook – Cement prices resilient but demand may face near term headwinds: Cement prices have improved sequentially on the back of elevated cost structure and higher utilization levels. However, near term headwinds especially from slowing government project awards in the road sector and muted housing activity may dampen the demand environment in the current fiscal. The slowing government spending in the midst of increased power & fuel and freight costs is a key near term risk for the cement industry.

Valuation – Downgrade to Neutral view on sector and recommend selective buying: The near term demand headwinds and elevated operating cost structure if sustained can put pressure on cement prices leading to erosion of profitability. Hence, we have changed our view for the sector to Neutral and selectively prefer companies like Grasim Industries, Ultratech Cement and Birla Corporation (Positive view).

Preferred picks: Grasim, Ultratech Cement, Birla Corporation

Leaders in Q2FY2019: Grasim, Ultratech, Birla Corporation

Laggards in Q2FY2019: Mangalam Cement, JK Lakshmi Cement, Shree Cement

Q2FY2019 results estimates

Particulars	Sales (Rs cr)				OPM (%)				PAT (Rs cr)			
	Q2 FY19E	Q2 FY18	YoY (%)	QoQ (%)	Q2 FY19E	Q2 FY18	YoY (%)	QoQ (%)	Q2 FY19E	Q2 FY18	YoY (%)	QoQ (%)
Coverage												
Grasim*	4657	4037	15.4%	-2.8%	20.4%	19.4%	95	-161	690	628	9.7%	7.3%
UltraTech	7557	6571	15.0%	-12.7%	18.8%	20.6%	-171	9	485	431	12.6%	-18.9%
Shree Cement	2430	2137	13.7%	-20.8%	18.6%	26.2%	-760	-11	147	212	-30.3%	-47.2%
The Ramco Cements	1168	1029	13.5%	-6.9%	20.5%	28.2%	-776	-122	126	156	-18.8%	16.4%
Soft Coverage												
Birla Corporation	1440	1235	16.5%	-13.0%	14.8%	14.3%	52	-5	44	1	-	-47.1%
India Cements	1350	1268	6.4%	-0.8%	11.8%	14.3%	-252	31	19	24	-19.4%	-9.3%
JK Lakshmi Cement	792	777	2.0%	-14.2%	10.5%	12.3%	-180	32	10	13	-25.8%	-28.6%
Mangalam Cement	249	237	5.0%	-2.0%	3.8%	11.5%	-769	205	-10	1	-	35.0%
Total	**19643**	**17292**	**13.6%**	**-10.6%**	**18.0%**	**20.1%**	**-208**	**-35**	**1512**	**1466**	**3.1%**	**-12.7%**
Total (ex-Grasim)	**14,986**	**13,255**	**13.1%**	**-12.7%**	**17.2%**	**20.2%**	**-302**	**-8**	**823**	**838**	**-1.8%**	**-24.5%**

*Standalone financials

Valuation

Companies	Reco	Price target (Rs)	CMP (Rs)	EV/EBITDA (x)			P/E (x)		
				FY18	FY19E	FY20E	FY18	FY19E	FY20E
Shree Cement	Hold	18,910	15936	21.9	17.7	14.1	41.1	38.7	28.2
UltraTech	Buy	4,585	3745	19.3	15.6	13.2	43.7	36.6	28.1
Grasim*	Buy	1,360	925	9.8	7.5	6.9	30.8	26.7	25.7
The Ramco Cements	Hold	754	618	14.2	13.5	12.8	27.0	23.3	22.1
India Cements#	Not Rated		92	7.5	6.5	5.9	28.2	20.4	15.0
JK Lakshmi#	Not Rated		274	10.3	9.4	7.6	38.4	29.5	17.8
Mangalam Cement#	Not Rated		210	9.9	9.8	7.2	77.7	58.4	19.1
Birla Corporation#	Positive		611	9.9	7.3	6.1	28.4	14.6	12.1

Soft coverage *Standalone estimates

Key expectations in Q2FY2019 results

Companies	Expectation
Shree Cement	Healthy demand in Northern region is expected to lead to 14% y-o-y growth in volume while realisation is expected to improve sequentially (up 1.6% q-o-q). However, higher fuel and freight cost are expected to lead to decline in net earnings.
UltraTech	Increased utilisation of acquired assets along with sequential improvement in pan-India prices is expected to aid heatlhy growth in topline. However, increased fuel and freight cost is likely to affect EBITDA/tonne y-o-y. Operational performance of acquired units and effeciencies in cost structure would be key monitorable.
Grasim Industries	We expect Grasim to continue to post healthy standalone performance backed by healthy volume offtake in its VSF and Chemical divisions. However operating margins to remain under pressue sequentially owing to increased fuel costs.
The Ramco Cements	Higher utilisation levels in Southern region and sequential improvement in pricing environment is expected to be marred by rising opex leading to decline in net earnings y-o-y for the quarter. The increased utilisation and realisation especially in South India will be key monitorable.
India Cements	We expect healthy volume offtake at 10% y-o-y, although realisations are expected to decline by 3% y-o-y. The increased opex is expected to lead to decline in net earnings for the quarter. The increased utilisation and realisation especially in South India will be key monitorable.
JK Lakshmi	Lower volume offtake y-o-y versus its peers in the region, flattish realisations and increased opex structure is likely to lead to decline in EBITDA/tonne and net earnings.
Mangalam Cement	An increased opex and lower volume offtake compared to peers is likely to lead to net loss for the quarter as witnessed during Q1FY2019.
Birla Corporation	The improved in profitability in its standalone operations along with increased utilisation level in acquired units is expected to lead to strong net earnings growth y-o-y.

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