

Sector: Cement
Company Update

	Change
Reco: Buy	↔
CMP: Rs. 4,003	
Price Target: Rs. 5,000	↔
↑ Upgrade ↔ No change ↓ Downgrade	

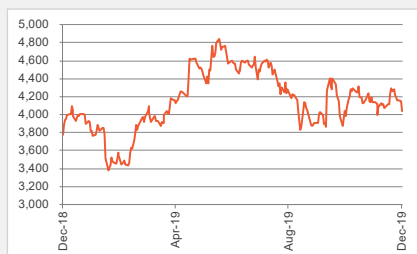
Company details

Market cap:	Rs. 1,09,955 cr
52-week high/low:	Rs. 4,904/3,340
NSE volume: (No of shares)	5.0 lakh
BSE code:	532538
NSE code:	ULTRACEMCO
Sharekhan code:	ULTRACEMCO
Free float: (No of shares)	10.5 cr

Shareholding (%)

Promoters	61.7
FII	17.9
DII	12.0
Others	8.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.6	3.4	-11.9	7.2
Relative to Sensex	-2.4	-4.7	-13.6	-7.9

Sharekhan Research, Bloomberg

UltraTech Cement (UltraTech) may be affected by weak demand in Q3FY2020 (October 2019 saw cement production dip by 7.7% y-o-y as per DIPP) owing to weak government spends on infrastructure, state elections, uncertainties on a change in state government and construction ban in Delhi-NCR, etc. Pan-India cement prices have fallen by 3.1% q-o-q during Q3FY2020 (till date), although they are up 5.8% y-o-y as against a -1.3% to +2.4% price variation seen in Q3 in the previous five years. Further, key input costs continued to drop as seen from the fall in petcoke prices (average US petcoke prices declined by 24.5% y-o-y for October-November 2019), and freight costs (average retail diesel prices across metros down 9.3% for October-November 2019). We believe with the pickup in government spending on infrastructure during Q4FY2020 to ease downward pressure on cement prices and aid in improving profitability as key operating costs remains under check. Hence, a ~18% correction in UltraTech's stock prices in six months provides an opportunity to invest as we believe the stock would be a major beneficiary of government's Rs. 100 lakh crore infrastructure spending in the next five years. Hence, we maintain Buy with unchanged price target (PT) of Rs. 5,000.

Weak demand but cement prices & input cost remain favourable: As per DIPP, cement production declined 7.7% y-o-y (down 0.6% y-o-y for April-October 2019) during October 2019. Weak government spends, state elections, uncertainties arising due to change of state government and pollution related construction ban in Delhi-NCR all contributed to low demand. Pan-India cement prices during Q3FY2020 (till date) declined by 3.1% q-o-q, although up 5.8% y-o-y as against -1.3% to +2.4% price variation seen in Q3 of the trailing five years. The decline in petcoke prices and diesel prices during Oct-Nov 2019 along with higher realisation is expected to compensate for weak demand during Q3FY2020 for UltraTech.

Our Call

Valuation – Maintain Buy with unchanged PT of Rs. 5,000: UltraTech has corrected by ~18% in the past six months as multiple headwinds are affecting cement demand - slowing government spending on infrastructure and region-specific issues as highlighted above. However, the cement sector has continued to show pricing discipline in Q3FY2020 especially in the wake of weak demand (as Q3 of past five fiscals show price variation of -2.6% to -1.6% q-o-q). The pick-up in government spending on infrastructure (expected during Q4FY2020) should ease downward pressure on cement prices going ahead. Hence, we see the correction in the stock's price as an opportunity to invest, believing the company to be a key beneficiary from the government's ambitious infrastructure spending target of Rs. 100 lakh crore over five years. Consequently, we reiterate Buy with unchanged PT of Rs. 5,000.

Key Risks

Weak macroeconomic environment leading to lower cement demand and pressure on cement prices could affect profitability.

Valuation (Standalone)

Particulars	FY18	FY19	FY20E	FY21E
Revenue	29,358	35,704	41,688	46,652
OPM (%)	22.1%	19.6%	22.6%	23.1%
Adjusted PAT	2,380	2,456	3,731	4,397
% YoY growth	-9.9%	3.2%	51.9%	17.8%
Adjusted EPS (Rs.)	82.4	85.1	129.3	152.3
P/E (x)	48.6	47.1	31.0	26.3
P/B (x)	4.5	4.1	3.7	3.3
EV/EBITDA (x)	21.5	19.3	14.5	12.3
RoNW (%)	9.5%	9.1%	12.6%	13.2%
RoCE (%)	8.7%	7.7%	9.7%	10.2%

Source: Company; Sharekhan estimates

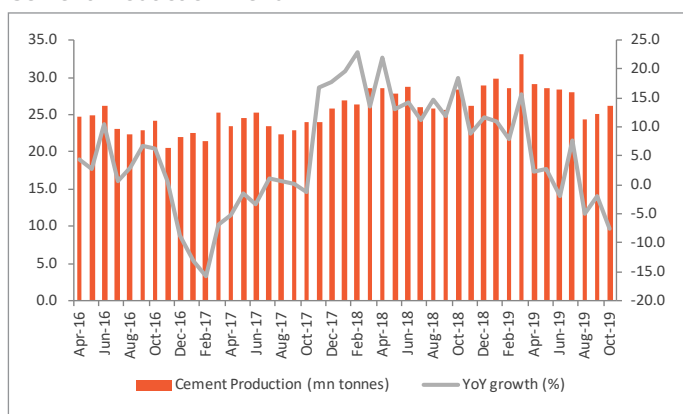
Muted government capex along with regional issues dampens cement demand

As per DIPP, cement production for October 2019 declined by 7.7% y-o-y (but was up 4.3% m-o-m). Cement production during April to October 2019 declined by 0.6% y-o-y. Further, as per our industry checks, cement demand continued to be weak in November 2019. A slowdown in government infrastructure spending along with regional issues like elections (Maharashtra, Haryana, Karnataka), uncertainties due to change in government (Andhra Pradesh), construction ban (Delhi-NCR), etc have affected cement demand for FY2020 YTD. Consequently, cement demand for FY2020 may grow in lower single digits y-o-y. The kickstart of government spending on infrastructure from Q4FY2020 remains a key monitorable to ease downward pressure on cement prices.

Cement prices for Q3FY2020 under pressure q-o-q, although up y-o-y

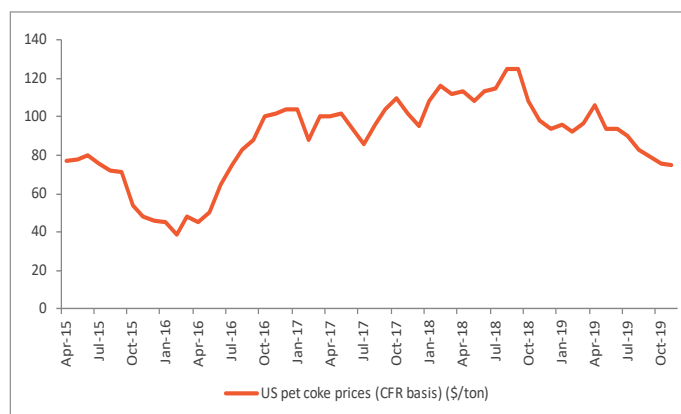
Average pan-India cement prices during Q3FY2020 (till date) declined 3.1% q-o-q owing to continued weakness in cement demand due to factors highlighted above. Although the dip in cement prices is higher than the -2.6% to -1.6% price variation seen in Q3 of the previous five fiscals, they are still trading higher by 5.8% y-o-y against -1.3% to +2.4% variation during corresponding periods of last the five fiscal years. Hence, although cement demand may remain weak during FY2020, higher realisations are expected to support UltraTech's revenue growth.

Cement Production Trend



Source: DIPP, Industry; Sharekhan Research

Pet Coke Price Trend

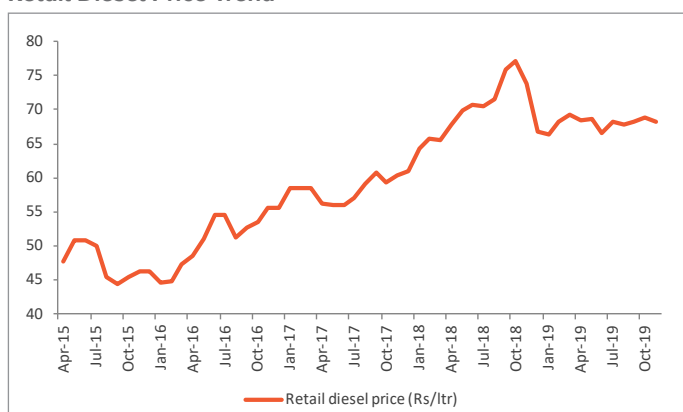


Source: DIPP, Industry; Sharekhan Research

Benefits of lower costs to continue

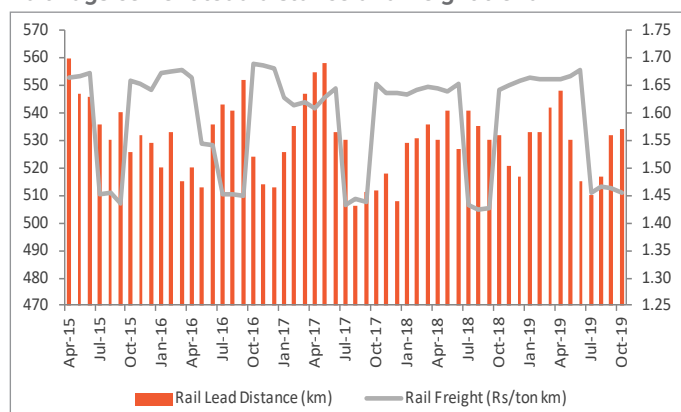
International average pet coke price has maintained its downward trajectory, with average pet coke price for October-November 2019 down 24.5% y-o-y. Weak cement demand and falling freight rates are expected to be key reason for downward pressure on petcoke prices. Further, average retail diesel prices across metros for the same period declined by 9.3% y-o-y, while rail freight charges for cement during October 2019 declined by 11.3% y-o-y. Hence, we expect Ultratech to benefit from higher realization and declining key input cost in the wake of weak demand.

Retail Diesel Price Trend



Source: Ministry of Petroleum, Ministry of Railways; Sharekhan Research

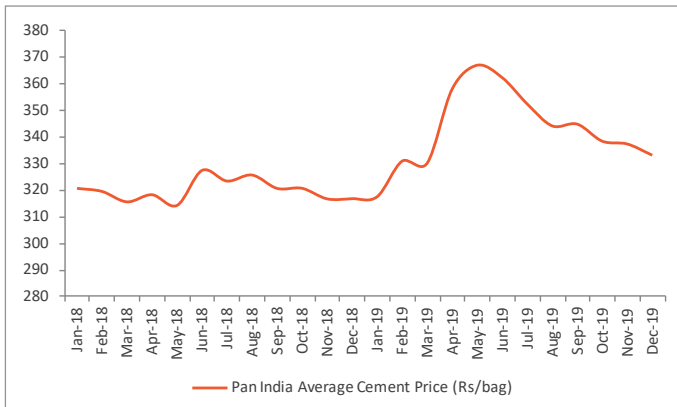
Railways cement lead distance and freight trend



Source: Ministry of Petroleum, Ministry of Railways; Sharekhan Research

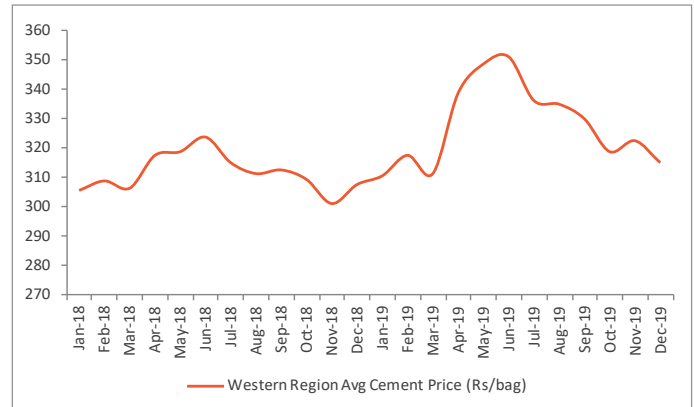
Financials in charts

Pan-India +5.8% y-o-y/-3.1% q-o-q



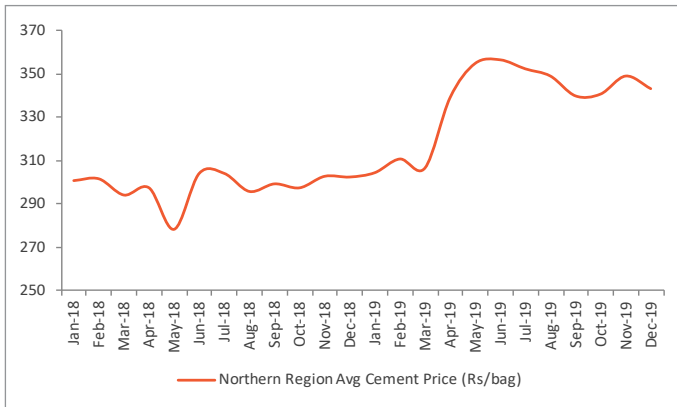
Source: Industry; Sharekhan Research

Western region price +4.2% y-o-y/-4.5% q-o-q



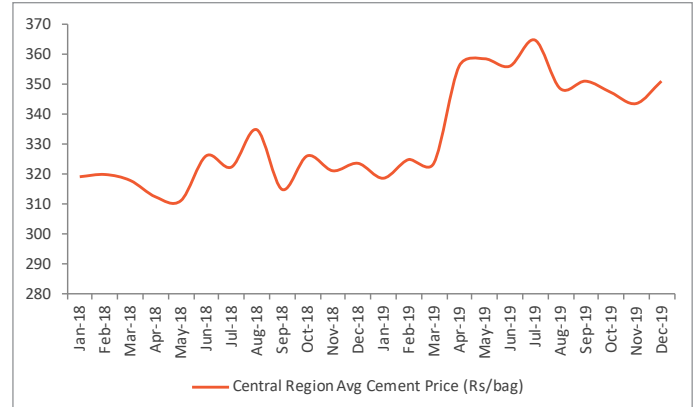
Source: Industry; Sharekhan Research

Northern region price +14.5% y-o-y/-0.8% q-o-q



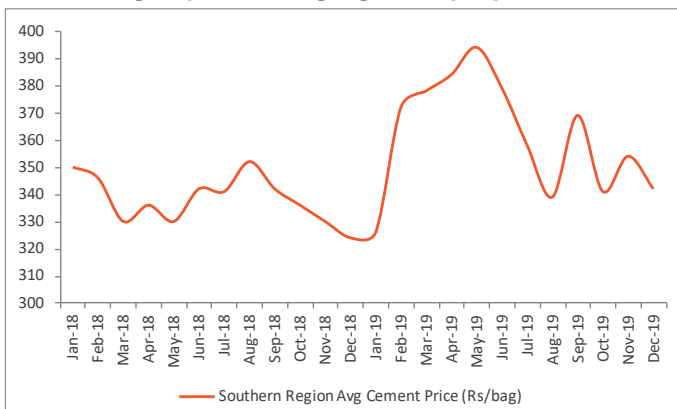
Source: Industry; Sharekhan Research

Central region price +7.3% y-o-y/-2.1% q-o-q



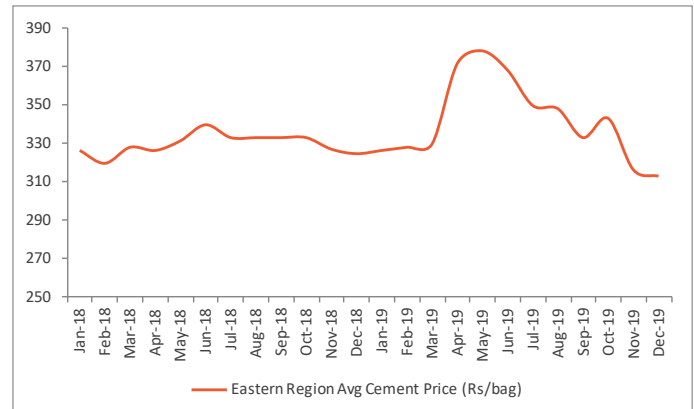
Source: Industry; Sharekhan Research

Southern region price +4.7% y-o-y/-2.7% q-o-q



Source: Industry; Sharekhan Research

Eastern region price -1.3% y-o-y/-5.7% q-o-q



Source: Industry; Sharekhan Research

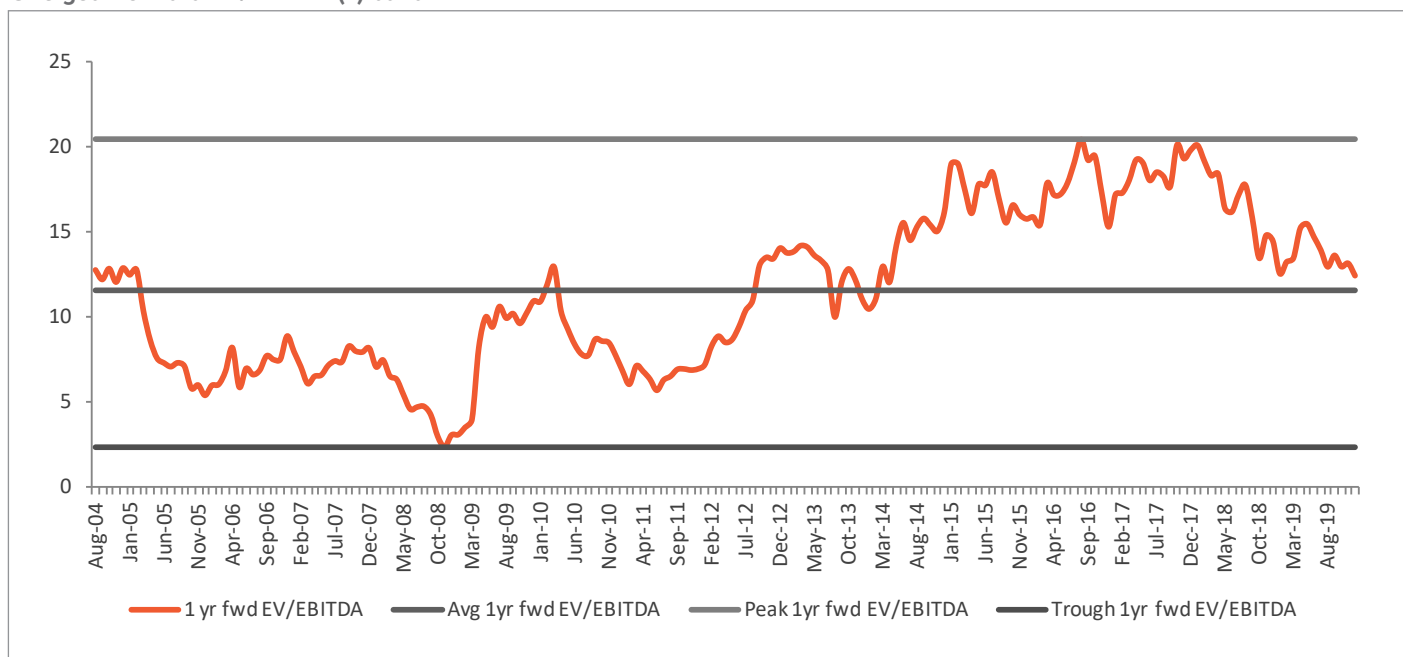
Outlook

Near-term demand headwinds: The cement sector is expected to face weak volume offtake for Q3FY2020, on multiple factors such as continued weakness in government infrastructure spending, state elections, uncertainties arising with change of state government and a construction ban in Delhi-NCR. Weak demand has caused average pan-India cement prices to dip by 3.1% q-o-q in Q3FY2020 (although they rose by 5.8% y-o-y). We expect government infrastructure spending to pick-up during Q4FY2020 to ease downward pressure on cement prices and lead to improvement in profitability given lower key input costs such as power & fuel and freight.

Valuation

Maintain Buy with unchanged PT of Rs. 5,000: UltraTech has corrected by ~18% in the past six months as multiple headwinds are affecting cement demand - slowing government spending on infrastructure and region-specific issues as highlighted above. However, the cement sector has continued to show pricing discipline in Q3FY2020 especially in the wake of weak demand (as Q3 of past five fiscals show price variation of -2.6% to -1.6% q-o-q). The pick-up in government spending on infrastructure (expected during Q4FY2020) should ease downward pressure on cement prices going ahead. Hence, we see the correction in the stock's price as an opportunity to invest, believing the company to be a key beneficiary from the government's ambitious infrastructure spending target of Rs. 100 lakh crore over five years. Consequently, we reiterate Buy with unchanged PT of Rs. 5,000.

One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
UltraTech Cement	31.0	26.3	14.5	12.3	3.7	3.3	12.6	13.2
ACC*	17.3	16.5	9.6	8.9	2.3	2.1	12.7	12.6
Ambuja Cements*	23.5	21.6	15.0	14.0	1.7	1.7	7.6	8.0
Shree Cement	46.7	37.6	18.3	15.8	6.4	5.5	14.5	15.8
The Ramco Cement	25.9	20.9	15.3	12.7	3.6	3.1	14.7	15.9
India Cement	14.7	12.8	5.9	5.6	0.4	0.4	2.9	3.2
JK Lakshmi Cement	11.3	9.3	5.5	5.0	1.8	1.5	16.9	17.5

Source: Sharekhan Research, * Bloomberg Estimates, Fiscal year ending December

About company

UltraTech's parent company, Aditya Birla Group, is in the league of Fortune 500 companies. UltraTech is the largest manufacturer of grey cement, ready-mix concrete (RMC), and white cement in India. The company is also one of the leading cement producers globally. The company has a consolidated capacity of 102.75 MTPA for grey cement. UltraTech has 20 integrated plants, one clinkerisation plant, 26 grinding units, and seven bulk terminals.

Investment theme

UltraTech is India's largest cement manufacturer. We expect UltraTech to report industry-leading volume growth on account of timely capacity expansion (acquisition of Jaypee Group's cement assets, Century's assets, and Binani Cement's assets) and a likely revival in demand (with the start of affordable housing projects and enhanced spending on infrastructure development). We expect the company to be the biggest beneficiary of multi-year industry upcycle being a market leader and its timely scaling up of capacities and profitability in the shortest possible time.

Key Risks

- ♦ Slowdown in government spending on infrastructure and increased key input costs led by pet coke and diesel prices.
- ♦ Slowdown in the housing sector, especially affordable housing projects.
- ♦ Inability to improve capacity utilisation and profitability of acquired units.

Additional Data

Key management personnel

Mr. Kumar Mangalam Birla	Non Independent Director-Chairman
Mr. KK Maheshwari	Managing Director
Mr. Atul Daga	Executive Director & CFO
Mr. Sanjeeb K Chatterjee	Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Grasim Industries Ltd	57.29
2	Life Insurance Corp of India	3.87
3	Pilani Investment & Industries Corp	1.6
4	Standard Life Aberdeen PLC	1.53
5	JPMorgan Chase & Co	1.36
6	Vanguard Group Inc/The	1.35
7	ICICI Prudential Life Insurance Co	1.21
8	BlackRock Inc	1.18
9	Franklin Resources Inc	1.08
10	SBI Funds Management Pvt Ltd	0.95

Source: Bloomberg

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