Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

UltraTech Cement Ltd

A resilient performance

Cement	Sharekhan code: ULTRACEMCO
Reco/View: Buy ⇔	CMP: **Rs. 6,398**
Price Target: **Rs. 7,700** ⇔	

↑ Upgrade ⇔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		⇔	
RQ		⇔	
RV		⇔	

ESG Disclosure Score NEW

ESG RISK RATING 35.92

Updated Aug 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 1,84,679 cr
52-week high/low:	Rs. 8,267 / 5,158
NSE volume: (No of shares)	4.9 lakh
BSE code:	532538
NSE code:	ULTRACEMCO
Free float: (No of shares)	11.6 cr

Shareholding (%)

Promoters	60.0
FII	13.1
DII	18.3
Others	8.6

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-1.2	5.0	-6.0	-10.3
Relative to Sensex	-0.2	-1.7	-9.7	-6.8

Sharekhan Research, Bloomberg

Summary

- We maintain Buy on UltraTech with an unchanged PT of Rs. 7,700, considering its long-term growth potential and reasonable valuation.
- Q2FY2023 standalone revenues were better than estimates while operational and net profitability came in a tad lower than estimate on account of higher-than-expected increase in power & fuel costs.
- The company remains on track to reach domestic cement capacity of 131.25mtpa and 153.85mtpa by FY2023 and FY2026 respectively. It remains opportunistic on any inorganic expansion.
- It would revert to negative working capital by FY2023 end while net cash positive status would be achieved by FY2024 end.

UltraTech Cement (UltraTech) reported better than expected standalone revenues while operational profitability was a tad lower than estimates for Q2FY2023. Standalone revenues grew 16.7% y-o-y to Rs. 13,482 crore led by both higher volumes (up 8.2% y-o-y) and blended realisations (up 7.9% y-o-y). The blended EBITDA/tone at Rs. 789 (down 39% y-o-y) was marginally lower than our estimate of Rs. 833/tonne. The rise in cost of production majorly led by power & fuel costs (up 59.4% y-o-y on per tonne basis) affected operating profit (down 34% y-o-y) and net profit (down 44.7% y-o-y). The power & fuel costs are expected to marginally lower over the next two quarters as pet coke prices reverted to $205 from the recent trough of $170. Its capacity expansion plan is to reach 131.25mtpa domestic capacity by FY2023 and 153.85mtpa remain on track. The company remains geographically wide open for inorganic expansion domestically as per CCI's norms. It expects to turn net cash positive by FY2024 end by turning net working capital negative by FY2023 end, financing growth Capex through internal accruals and generating strong operating cash flows.

Key positives

- Standalone business volumes and blended realisation rose by 8.2% y-o-y and 7.9% y-o-y respectively.
- Blended EBITDA/tonne at Rs. 789 remained aided by a rise in realization and despite a sharp rise in power & fuel costs (up 59% y-o-y on per tonne basis) and raw material costs (up 20% y-o-y).

Key negatives

- Pet coke prices revert to over $200 from a recent trough of $170. Consequently, power & fuel costs are expected to marginally decline over the next two quarters compared to the higher reduction expected earlier.
- Consolidated net debt increased by Rs. 2796 crore q-o-q to Rs. 8357 crores owing to higher working capital requirement and growth capex.

Management Commentary

- The management expects market sentiments to improve post-Diwali. The company expects to grow in double-digit y-o-y for this year and next year.
- It expects to turn net cash positive towards FY2024 end as against FY2023 end earlier. Over the next six months, the company will revert to negative working capital.
- For Q2FY2023, the conversion ratio stood at 1.41x, blended cement at 71%, trade cement mix at 68% and value added products mix at 18%. The lead distance during Q2 was 428kms.

Revision in estimates – We have downwardly revised our net profit estimates for FY2023 factoring gradual reduction in fuel costs than earlier expected. We have fine-tuned our estimates for FY2024-FY2025.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 7,700: UltraTech is expected to benefit from healthy cement demand over the long term, driven by timely capacity expansion. Demand is expected to be strong from segments such as infrastructure, rural housing and urban housing. However, volatility in energy costs remain a key challenge for the company as well as the industry. Although, a sustained strong demand environment and expected easing of energy costs remain key growth tailwinds for the company. We continue to maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 7,700, considering its long-term growth potential and reasonable valuation.

Key Risks

A weak macro environment leading to lower cement demand and pressure on cement prices would negatively affect profitability.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	50,663	61,316	69,165	78,094
OPM (%)	22.8%	19.1%	20.2%	21.5%
Adjusted PAT	5,549	5,573	6,915	8,737
% YoY growth	1.7%	0.4%	24.1%	26.4%
Adjusted EPS (Rs.)	192.2	193.1	239.6	302.7
P/E (x)	33.3	33.1	26.7	21.1
P/B (x)	3.7	3.4	3.0	2.7
EV/EBITDA (x)	16.7	16.6	13.5	10.9
RoNW (%)	12.0%	10.7%	12.0%	13.4%
RoCE (%)	10.2%	9.7%	10.9%	12.5%

Source: Company; Sharekhan estimates

Marginally lower operating performance

Ultratech reported standalone net revenues growth of 16.7% y-o-y at Rs. 13,482 crore which was 5% ahead of our estimate. Cement volumes were up 8.2% y-o-y (-8.3% q-o-q) at 21.75 MnT while blended realizations were up 7.9% y-o-y (flat q-o-q) at Rs. 6199/T. Blended standalone EBITDA/T at Rs. 789 (-39% y-o-y, -36.1% q-o-q) was marginally lower than our estimate of Rs. 833/T. The power & fuel costs stood at Rs. 1794/T (+59.4% y-o-y, +16.9% q-o-q), freights costs at Rs. 1378/T (+5% y-o-y, +0.6% q-o-q) and other expense at Rs. 846/T (+7.5% y-o-y, +15.3% q-o-q). Standalone operating profit declined by 34% y-o-y (-41.4% q-o-q) at Rs. 1716 crore, which was 5% lower than our estimate. The standalone net profit declined by 44.7% y-o-y (-53.8% q-o-q) at Rs. 718 crores (6% lower than our estimate). The consolidated net debt increased almost by Rs. 2800 crore q-o-q to Rs. 8357 crores owing to a rise in working capital and growth Capex.

Expansion plans remain on track

During Q2, it commissioned a 1.3mtpa brownfield capacity at Dalla, Uttar Pradesh, taking its India capacity to 115.85mtpa and 121.25mtpa globally. In H2FY2023, it would be adding 15.4mtpa of greenfield/brownfield capacities to reach 131.25mtpa capacity in India. Work on its second phase of capacity addition of 22.6mtpa has commenced with commercial production from these new capacities expected to go on stream in a phased manner by FY2025. Upon completion of the latest round of expansion, its capacity will grow to 159.25mtpa.

Key Conference call takeaways

- **Q2FY23 demand environment:** The delayed exit of the monsoon caused pressure on cement prices and consumption. However, all months saw growth in volumes with September witnessing higher demand than the prior two months.
- **Outlook:** The management expects market sentiments to improve post Diwali. The company expects to grow in double-digit y-o-y for this year and next year. For Ultratech, the geographic expansion remains wide open for consolidation which will be done opportunistically.
- **Capacity expansion:** It commissioned 1.3mtpa Dalla capacity taking total cement capacity in India to 115.85mtpa. The greenfield Bali unit and brownfield Dhar unit is expected to commission in Q3FY2023. By March 2023, the company's capacity will increase to 131.25mtpa. It has commenced phase 2 expansion of 22.6mtpa and spent Rs. 500 crores on advance payments, etc. The cement capacity would be increased to 153mtpa in India by FY2026.
- **Leverage:** It expects to turn net cash positive towards the FY2024 end as against FY2023 end earlier.
- **Capex:** In FY2023, the cash outflow for capex would be Rs. 6000 crores to Rs. 7000 crores.
- **Power & fuel costs:** The costs still remain elevated led by power & fuel. There was a brief period when pet coke prices dropped to $170. However, as of yesterday, pet coke prices are back to $205. The imported coal prices are stuck at $300-350. On a Kcal basis, power & fuel consumption was Rs. 2489/mn Kcal in Q2FY2023 compared to Rs. 2215/Rs. 1427 mn Kcal in Q1FY2023/Q2FY2022. The company would see a marginal reduction in power & fuel costs in the next two quarters.
- **Power & fuel mix:** The fuel-wise mix at Klin is domestic coal – 5%, imported coal – 50%, Pet coke – 40% and alternate fuel 5.2%. At TPP, the fuel mix is domestic coal – 56%, imported coal – 29%, pet coke – 5% and alternate fuel (including lignite) - 10%.
- **Working capital:** It had consciously increased inventory which has led to higher working capital. The inventory days increased to 55 days as against the normal of 45 days. Over the next six months, the company will revert to negative working capital.

- **Cement prices:** The cement prices continued to tread lower from May 2022 end. Currently, there have been attempts at price increase in some pockets, where some have settled and some have not.
- **Regional Q2 mix:** The region-wise capacity utilization was North – 85%, Central – 70%, East – 90%, West – 60%+ and South – 75%+. Cement prices were least impacted in East, while North and Central witnessed a decline and West remained neutral.
- **Maintenance costs:** It undertook maintenance shutdown for 19 Klins out of 43 Klins during Q2. The maintenance cost was Rs. 80 crores higher than planned partly because of rise in procurement costs and the addition of three Klins for maintenance.
- **Alternate fuel:** The company added 32MW of renewable power during Q2 to 318MW, comprising 5.6% of power consumption. It also commissioned 5MW WHRS capacity during Q2.
- **Putty capacity:** Its 4 lakh tonne putty capacity is under trial production and is expected to commercialise by mid-November.
- **Other highlights:** For Q2FY2023, the conversion ratio stood at 1.41x, blended cement at 71%, trade cement mix at 68% and value-added products mix at 18%. The lead distance during Q2 was 428kms. The company has Rs. 200 crores dues from Srilankan operations of which it received Rs. 40 crores last quarter. The export volume numbers for Q2 were 1 lakh tonnes.

Results (Standalone) Rs cr

Particulars	Q2FY2023	Q2FY2022	% yoy	Q1FY2023	% qoq
Net Sales	**13482.0**	**11548.4**	**16.7%**	**14715.5**	**-8.4%**
Operating Profit	**1716.0**	**2600.0**	**-34.0%**	**2929.4**	**-41.4%**
Other Income	164.5	141.8	16.0%	166.1	-1.0%
EBITDA	1880.5	2741.8	-31.4%	3095.5	-39.3%
Interest	186.7	182.8	2.2%	199.7	-6.5%
Depreciation	642.7	612.7	4.9%	628.2	2.3%
PBT	**1051.0**	**1946.3**	**-46.0%**	**2267.7**	**-53.7%**
Tax	332.7	646.2	-48.5%	713.6	-53.4%
Reported PAT	**718.4**	**1300.1**	**-44.7%**	**1554.0**	**-53.8%**
Exceptional items	0.0	0.0		0.0	
Adj.PAT	**718.4**	**1300.1**	**-44.7%**	**1554.0**	**-53.8%**
Margins			**Bps**		**Bps**
OPM	12.7%	22.5%	-979	19.9%	-718
PATM	5.3%	11.3%	-593	10.6%	-523
Tax Rate	31.7%	33.2%	-155	31.5%	18

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Improving demand brightens outlook

The cement industry has seen a sustained improvement in demand in the past 15 years, barring a couple of years, while regional cement prices have been rising in the past five years. Amidst COVID-19-led disruption, the cement industry continued to witness healthy demand from the rural sector, while infrastructure demand has started to pick up. The sector's long-term growth triggers in terms of low per capita consumption and demand pegged at 1.2x GDP remain intact. Evidently, the government's Rs. 111 lakh crore infrastructure investment plan from FY2020 to FY2025 would lead to a healthy demand environment going ahead.

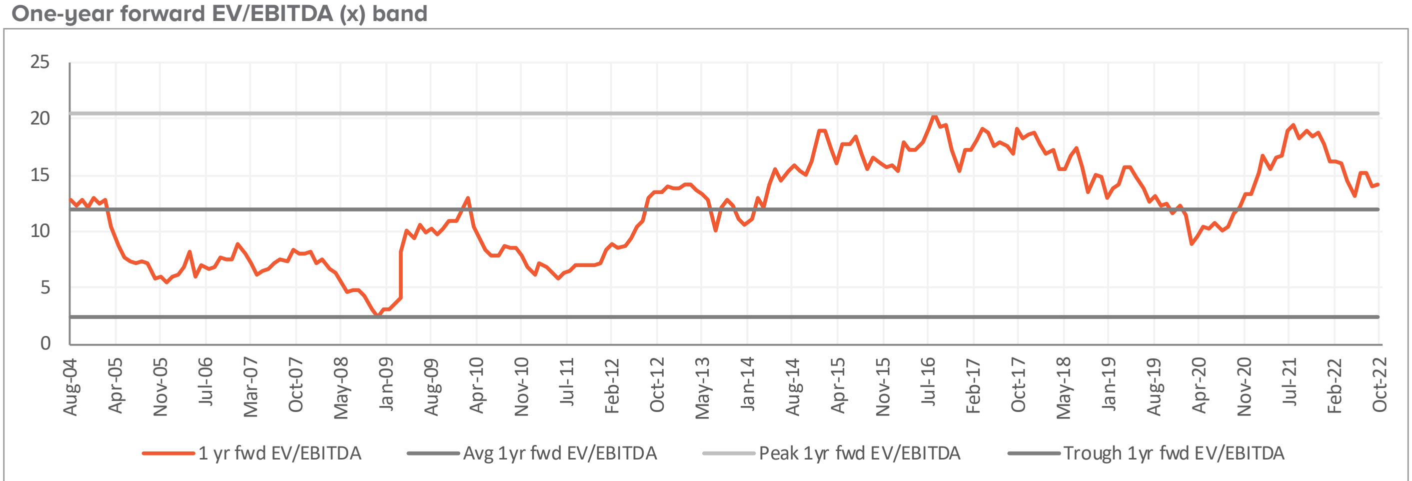
■ Company Outlook – Healthy cement demand, profitability, and balance sheet health to remain favorable

UltraTech is expected to see sustained demand emanating from the rural sector and infrastructure sector. Further, demand from the real estate segment in the urban market has started to witness strong traction with favourable government policies and a lower interest rate regime. Management is optimistic about a sustainable demand environment for the cement sector over a longer period, barring the near-term impact of the second wave of COVID-19. The company's capacity expansion plans for adding 19.9 mtpa at a cost of Rs. 6,527 crore is on track and expected to be completed by FY2023-end. Further, the company targets to achieve 25% RoE by FY2025 from 15% currently. The company is well placed to benefit from rising cement demand over the next four to five years. Overall, the company's outlook in terms of cement demand, profitability, and balance sheet is expected to remain favourable.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 7,700

UltraTech is expected to benefit from healthy cement demand over the long term, driven by timely capacity expansion. Demand is expected to be strong from segments such as infrastructure, rural housing, and urban housing. However, volatility in energy costs remains a key challenge for the company as well as the industry. Although, a sustained strong demand environment and expected easing of energy costs remain key growth tailwinds for the company. We continue to maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 7,700, considering its long-term growth potential and reasonable valuation.

One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
UltraTech Cement	33.1	26.7	16.6	13.5	3.4	3.0	10.7	12.0
Shree Cement	66.1	39.7	24.3	16.8	4.3	3.9	6.6	10.3
The Ramco Cement	31.6	20.2	16.2	12.1	2.4	2.1	7.7	11.1
Dalmia Bharat	48.0	33.0	11.7	9.6	1.7	1.7	3.7	5.1

Source: Company, Sharekhan estimates

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. With a consolidated grey cement capacity of 116.75 mtpa, it is the third largest cement producer in the world, excluding China, and the only one globally (outside China) to have 100mtpa of cement manufacturing capacity in a single country. The company's business operations span across UAE, Bahrain, Sri Lanka, and India.

Investment theme

UltraTech is India's largest cement company. We expect UltraTech to report industry-leading volume growth on account of timely capacity expansion (inorganic and organic expansions) and a revival in demand (demand pick-up in infrastructure and urban housing along with continued demand emanating from the rural housing segment). We expect the company to be the biggest beneficiary of themulti-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 utilization 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 and CFO
Mr. Sanjeeb K Chatterjee	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Grasim Industries Ltd.	57.28
2	Life Insurance Corp. of India	3.35
3	Standard Life Aberdeen PLC	1.90
4	SBI Funds Management Pvt. Ltd.	1.41
5	The Vanguard Group Inc.	1.40
6	Kotak Mahindra Asset Mgmt	1.29
7	Pilani Investment & Industries Corp. Ltd.	1.21
8	Franklin Resources Inc.	1.17
9	BlackRock Inc.	1.07
10	ICICI Prudential Life Insurance Co.	0.90

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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