Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

UltraTech Cement Ltd

Marginal miss in profitability

Cement	Sharekhan code: ULTRACEMCO
Reco/View: Buy ↔	CMP: Rs. 6,847
Price Target: Rs. 8,100 ↓	

↑ 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 Dec 08, 2022

High Risk

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

Source: Morningstar

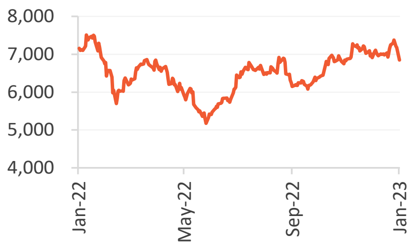
Company details

Market cap:	Rs. 1,97,6856 cr
52-week high/low:	Rs. 7576/5158
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	14.6
DII	17.7
Others	7.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.2	7.1	7.3	-4.3
Relative to Sensex	-3.8	5.2	-2.0	-10.3

Sharekhan Research, Bloomberg

Summary

- We maintain Buy on UltraTech with a revised PT of Rs. 8,100, factoring downwardly revised estimates and long-term growth potential and reasonable valuation.
- Q3FY2023 standalone revenues were better than estimates, while operational and net profitability came in a tad lower than estimate on account of lower-than-expected blended realisations.
- It would revert to four digit EBITDA/tonne in Q4 expecting strong demand, lower power & fuel costs and stable pricing environment.
- It commissioned 6.8mtpa cement capacities during 9MFY2023 while it would be commissioning ~10 mtpa in next few months. Petcoke are prices expected to remain rangebound, while cement prices to be firm with upward bias.

UltraTech Cement (UltraTech) reported better-than-expected standalone revenues while operational profitability was a tad lower than estimates for Q3FY2023. Standalone revenues grew 20.3% y-o-y to Rs. 15,008 crore led by both higher volumes (up 12.3% y-o-y) and blended realisations (up 7.1% y-o-y). The blended EBITDA/tonne at Rs. 884 (down 14% y-o-y) was marginally lower than our estimate of Rs. 949/tonne. Lower than expected realization led by lower-than-expected operational profitability while opex/tonne remained largely in-line (opex/tonne declined by 1.9% q-o-q). Overall, standalone operating profit (down 3.5% y-o-y) and net profit (down 9.3% y-o-y) came in marginally lower than expected. The company commissioned 6.8 mtpa cement capacity during 9MFY2023 and would be commissioning 10mtpa cement capacities in next few months commencing FY2024 with a 130 mtpa cement capacity from 121.35 mtpa domestic cement capacity currently. The management expects strong demand, lower power & fuel costs and stable pricing environment to aid in four digit EBITDA/tonne for Q4FY2023.

Key positives

- Standalone business volumes rose by 12.3% y-o-y and 11.5% q-o-q respectively.
- Standalone free cash flow generation of Rs. 719 aided by decline in working capital and despite incurring capex of Rs. 1514 crore. Consolidated net debt reduced Rs. 635 crore q-o-q to Rs. 7722 crore.

Key negatives

- Lower-than-expected blended realisations at Rs. 6189 (up 7.1% y-o-y, flat q-o-q) leading to miss on standalone operational profitability.
- Power & fuel costs were up 1% q-o-q to Rs. 1811, which is expected to be the peak (Q4FY2023 to witness decline q-o-q).

Management Commentary

- Company expects cement demand to remain on solid footing in Q4FY23. It expects to cross four digit EBITDA/tonne mark for Q4FY2023. It would also see higher release of working capital.
- It did not see a significant move in prices during Q3. It does not expect undue pressure on cement prices despite capacity additions owing to strong demand outlook.
- The petcoke prices are expected to be rangebound with elevated prices compared to last year being a new normal. Higher petcoke prices would be owing to no new pet coke capacities coming up globally, increasing domestic cement demand and China re-opening.

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

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 8,100: UltraTech is expected to benefit from sustained healthy cement demand although petcoke/coal prices are expected to remain rangebound with very low probability of sharp decline. It would be targeting Rs. 1000-1200 EBITDA/tonne in the near to medium term with expectations of a firm to upward trend in cement prices. It continues to remain on track with respect to its capacity expansion plans owing to strong demand outlook in infrastructure, rural housing and urban housing segments. We have lowered our price target to Rs. 8100 owing to downward revision in earnings estimates penciling higher power & fuel costs than earlier. We maintain our Buy rating on the stock, considering its long-term growth potential and reasonable valuations.

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	61,054	69,273	78,213
OPM (%)	22.8%	17.3%	19.2%	20.5%
Adjusted PAT	5,549	4,812	6,441	8,193
% YoY growth	1.7%	-13.3%	33.9%	27.2%
Adjusted EPS (Rs.)	192.2	166.7	223.2	283.9
P/E (x)	35.6	41.1	30.7	24.1
P/B (x)	4.0	3.7	3.3	2.9
EV/EBITDA (x)	17.9	19.9	15.4	12.4
RoNW (%)	12.0%	9.3%	11.3%	12.9%
RoCE (%)	10.2%	8.6%	10.4%	12.0%

Source: Company; Sharekhan estimates

Marginally lower operating performance

UltraTech reported standalone net revenues growth of 20.3% y-o-y at Rs. 15,008 crore which was marginally ahead of our estimate. Cement volumes were up 12.3% y-o-y (+11.5% q-o-q) at 24.25 MnT while blended realizations were up 7.1% y-o-y (flat q-o-q) at Rs. 6189/T. Volumes came in ahead of our estimates while blended realisations marginally lagged. Blended standalone EBITDA/T at Rs. 884 (-14% y-o-y, +12.1% q-o-q) was marginally lower than our estimate of Rs. 949/T. Standalone OPM stood at 14.3% (-352bps y-o-y, +156bps q-o-q). The power & fuel costs stood at Rs. 1811/T (+34.8% y-o-y, +1% q-o-q), freights costs at Rs. 1414/T (+6.6% y-o-y, +2.6% q-o-q) and other expense at Rs. 738/T (-3.6% y-o-y, -12.7% q-o-q). Standalone operating profit declined by 3.5% y-o-y (+25% q-o-q) at Rs. 2145 crore, which was 4% lower than our estimate. Standalone net profit declined by 9.3% y-o-y (+38.4% q-o-q) at Rs. 994 crore (4% lower than our estimate). Net debt decreased by Rs. 635 crore q-o-q to Rs. 7722 crore while it generated Rs. 719 crore free cash flows.

Expansion plans remain on track

During Q3, it commissioned 5.5mtpa new capacity while in 9MFY2023, it commissioned 6.8mtpa new capacities. It targets to commission ~10mtpa new cement capacity over the next few months. The work on the second phase of growth of 22.6 mtpa has been commenced with commercial production to go on stream in a phased manner by FY2025. Upon completion of these expansions, its capacity will grow to 159.25 mtpa.

Key conference takeaways:

- **Q4FY23 outlook:** The company expects cement demand to remain on solid footing in Q4FY23 (December saw a 92% capacity utilisation). It expects to cross four-digit EBITDA/tonne mark for Q4FY2023. It would also see higher release of working capital with expectation of release of upfront payments from government.
- **Capacity expansion:** It added 6.8mtpa capacities during 9MFY2023. It would be adding 10 mtpa in next few months. It would start next fiscal with 130 mtpa capacity. The 22.6 mtpa second phase of capacity additions would start coming in from FY2025.
- **Cement prices:** UltraTech did not see a significant move in prices during Q3. Management expects prices to firm up with increased capacity utilisations levels. It does not expect undue pressure on cement prices despite capacity additions owing to strong demand outlook.
- **Power & fuel costs:** Fuel costs for Q3 was Rs. 2.6/Kcal as against Rs. 2.5/Kcal in Q2. Q3 saw the highest power & fuel costs per tonne. Q4 would see lower power and fuel costs per tonne. The pet coke prices are expected to be rangebound with elevated prices as compared to last year being a new normal. Higher pet coke prices would be owing to no new petcoke capacities coming up globally, increasing domestic cement demand and China re-opening.
- **Sri Lanka operations:** The Sri Lankan operations are resolved. The exports to Sri Lanka stood at ~40000 tonnes in Q3. Sri Lankan government is likely to clear Rs. 65 crores overdue by February. Over next 2-3 months, exports to Sri Lanka would be back to normal levels.
- **Freight costs:** The company managed freight costs very well despite rise in Rail surcharge from mid-October. The lead distance lowered to 413 km from 428 km in Q2. Apart from lower lead distance, it improved upon efficiency and throughput of vehicles.
- **Fly ash:** Fly ash costs are not expected to come down as demand for the same is expected to increase while thermal power plants are not expected to come up.
- **Trade mix:** The trade mix for Q3 was 66% while blended cement mix was 68%. Rural mix comprise 62% of trade mix.
- **Super Dalla unit:** The 2.3 mtpa clinker capacity Super Dalla unit is under arbitration and the matter is sub judice. The limestone reserve is under forest litigation.
- **Capex:** The company retained Rs. 6000-7000 crore capex target per annum.
- **WHRS:** It would be adding 30MW WHRS in Q4 taking total WHRS capacity to 238 MW by March 2023.

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Net Sales	**15008.0**	**12470.6**	**20.3%**	**13482.0**	**11.3%**
Operating Profit	**2144.8**	**2221.5**	**-3.5%**	**1716.0**	**25.0%**
Other Income	158.2	108.8	45.4%	164.5	-3.8%
EBITDA	2303.0	2330.3	-1.2%	1880.5	22.5%
Interest	193.7	165.0	17.4%	186.7	3.7%
Depreciation	653.5	608.9	7.3%	642.7	1.7%
PBT	**1455.8**	**1556.4**	**-6.5%**	**1051.0**	**38.5%**
Tax	461.6	460.1	0.3%	332.7	38.8%
Reported PAT	**994.2**	**1631.5**	**-39.1%**	**718.4**	**38.4%**
Exceptional items	0.0	535.2		0.0	
Adj.PAT	**994.2**	**1096.3**	**-9.3%**	**718.4**	**38.4%**
Margins			**Bps**		**Bps**
OPM	14.3%	17.8%	-352	12.7%	156
PATM	6.6%	8.8%	-217	5.3%	130
Tax Rate	31.7%	29.6%	214	31.7%	5

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. Amid 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.

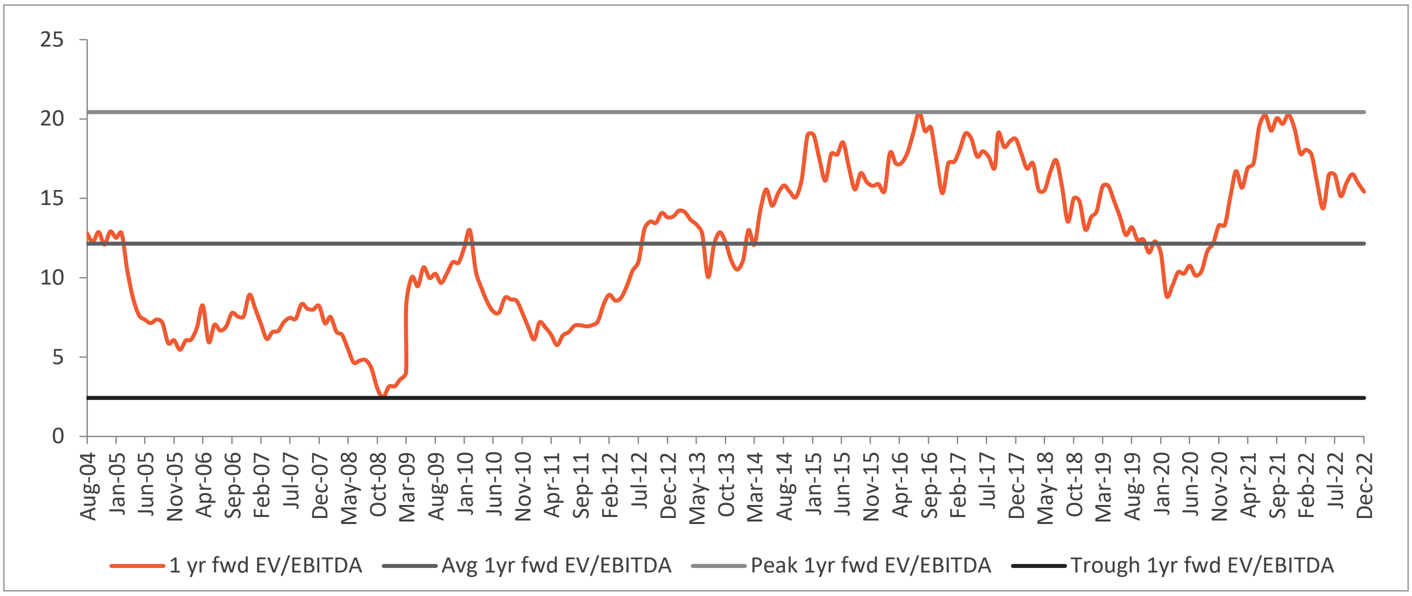
■ Company outlook - Healthy cement demand, profitability, and balance sheet health to remain favorable

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. The management is optimistic about a sustainable demand environment for the cement sector over a longer period. The company's capacity expansion plans for adding 19.5 mtpa capacity is on track and expected to be completed by FY2023-end while it targets to achieve 159.25mtpa cement capacity by FY25-FY26. 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 a revised PT of Rs. 8,100

UltraTech is expected to benefit from sustained healthy cement demand although petcoke/coal prices are expected to remain rangebound with very low probability of sharp decline. It would be targeting Rs. 1000-1200 EBITDA/tonne in the near to medium term with expectations of a firm to upward trend in cement prices. It continues to remain on track with respect to its capacity expansion plans owing to strong demand outlook in infrastructure, rural housing and urban housing segments. We have lowered our price target to Rs. 8100 owing to downward revision in earnings estimates penciling higher power & fuel costs than earlier. We maintain our Buy rating on the stock, considering its long-term growth potential and reasonable valuations.

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	41.1	30.7	19.9	15.4	3.7	3.3	11.3	12.9
Shree Cement	71.5	43.0	26.6	18.4	4.6	4.2	6.6	10.3
The Ramco Cement	81.0	24.0	22.9	13.1	2.5	2.3	3.1	9.8
Dalmia Bharat	57.2	41.8	14.0	11.7	2.0	1.9	3.6	4.7

Source: Company; Sharekhan Research

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. Ultra Tech is the third largest Cement producer in the world, outside of China, with a consolidated Grey Cement capacity of 126.75 mtpa. The company's business operations span across UAE, Bahrain, Sri Lanka, and India. t is a signatory to the GCCA Climate Ambition 2050 and has committed to the Net Zero Concrete Roadmap announced by GCCA.

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 the 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 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

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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