Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

# Shree Cement Ltd

## Optimism overbuilt; Downgrade to Reduce

| Cement | Sharekhan code: SHREECEM |
|---|---|
| Reco/View: Reduce ↓ | CMP: Rs. 23,197 / Price Target: Rs. 21,500 ↓ |

↑ Upgrade ↔ Maintain ↓ Downgrade


**Summary**

- In Q3FY2023, standalone numbers remained broadly in-line, led by a strong volume growth of 23% y-o-y while lower OPM and high depreciation hit net profit y-o-y.
- The management expects 15% y-o-y sales volume growth for FY2023 aided by sustained strong demand environment and new capacity additions. Power & fuel costs are expected to tread lower q-o-q.
- Company's 9.5-mtpa cement capacity addition plan by Q2FY2025 remain intact while it remains committed to reach 80 mtpa by 2030. Focus on cost leadership and branding to increase.
- We downgrade Shree Cement to Reduce with a revised PT of Rs. 21,500, factoring downwardly revised estimates and assigning lower valuation multiple to factor in gradual improvement in operational profitability than earlier envisaged.


**Shree Cement Limited reported broadly in-line numbers for Q3FY2023. Standalone revenues for Q3FY2023 stood at Rs. 4,069 crore (up 14.6% y-o-y) driven by strong volume growth (up 22.6% y-o-y), while blended realisations declined by 6.6% y-o-y. Blended EBITDA/tonne at Rs. 882 (down 30% y-o-y) was tad lower than our expectation of Rs. 863 on account of marginally lower-than-expected operating costs. Weak OPM y-o-y and high depreciation led to 43.7% y-o-y dip in standalone net profit at Rs. 276.8 crore (marginally higher than our estimate). The management expects 15% y-o-y volume growth for FY2023 aided by sustained strong demand. The company's cement capacity expansion plan of 9.5 mtpa (3 mtpa – East, 3.5 mtpa – North and 3 mtpa – South) remain intact and is expected to complete by Q2FY2025 taking its total cement capacity to 57 mtpa from 47.4 mtpa currently. Further, its long-term cement capacity expansion plan to reach 80 mtpa by 2030 remain intact. Apart from capacity additions, the focus would be on maintaining cost leadership and branding apart from increasing green fuel mix and technology improvements.**

**Key positives**

- Cement volume offtake stood at 80.3 lakh tonne, rising 23% y-o-y.
- Blended opex/tonne was lower at Rs. 4185/tonne, as against our estimate of Rs. 4284/tonne.

**Key negatives**

- Blended realisations at Rs. 5067/tonne was down 6.6% y-o-y.
- Depreciation increased by 64% y-o-y and 13% q-o-q, led by commissioning of solar units at the end of Q3 and commissioning of a plant in March 2022.

**Management Commentary**

- It expects sales volumes of 32 MT for FY2023. The fuel cost is expected at Rs. 2.35 per Kcal in Q4FY2023 (Rs. 2.53 per Q3FY2023). It expects EBITDA/tonne for Q4FY2023 to be close to four digit number.
- Management would be focusing on 1) Improvement in scores on environment 2) building brand image 3) Maintaining cost leadership 4) Digital and IT adoption and 5) Reaching an 80 MT capacity target as early as possible.
- It incurred Rs. 2,200 crore capex during 9MFY2023. Capex for FY2023 and FY2024 is estimated at Rs. 2900 crore and Rs. 3300-3500 crore, respectively.

**Revision in estimates –** We have lowered our net earnings estimates for FY2023-FY2025 factoring lower operating margins, higher depreciation and increased interest expenses.

**Our Call**

**Valuation – Downgrade to Reduce with a revised PT of Rs. 21,500:** Shree Cement is on a healthy volume growth trajectory over the next two years aided by sustained healthy demand environment and new capacity additions. However, we believe operational profitability is expected to improve at a gradual pace than earlier envisaged. Further, other key peers are expanding capacities at a much faster clip along with strong operational efficiencies. The same can lead to possible market share loss in the medium to long term for the company. The stock is currently trading at an EV/EBITDA of 20.7x/16.4 its FY2024E/FY2025E earnings which we believe provides unfavourable risk reward. Hence, we downgrade the stock to Reduce with a revised price target (PT) of Rs. 21,500 factoring downwardly revised estimates and assigning lower valuation multiple to factor in gradual improvement in operational profitability than earlier envisaged.

**Key Risks**

Weak demand and pricing environment in North and East India can negatively affect profitability.

**Valuation (Standalone)** Rs cr

| Particulars | FY22 | FY23E | FY24E | FY25E |
|---|---|---|---|---|
| Revenue | 14,305.9 | 16,511.4 | 18,707.2 | 21,394.4 |
| OPM (%) | 26.3 | 17.3 | 19.7 | 21.5 |
| Adjusted PAT | 2,384.1 | 1,218.0 | 1,579.2 | 2,029.0 |
| % YoY growth | 3.1 | (48.9) | 29.7 | 28.5 |
| Adjusted EPS (Rs.) | 660.8 | 337.6 | 437.7 | 562.3 |
| P/E (x) | 36.1 | 70.6 | 54.5 | 42.4 |
| P/B (x) | 5.0 | 4.8 | 4.5 | 4.1 |
| EV/EBITDA (x) | 20.2 | 26.5 | 20.7 | 16.4 |
| RoNW (%) | 14.7% | 6.9% | 8.4% | 10.1% |
| RoCE (%) | 13.9% | 7.1% | 8.4% | 9.7% |

*Source: Company; Sharekhan estimates*

**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 28.11

Updated Dec 08, 2022

Medium Risk

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

*Source: Morningstar*

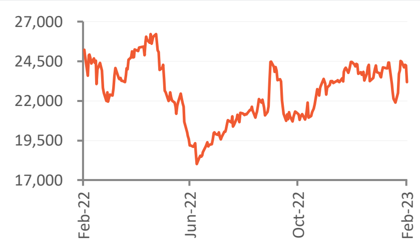
**Company details**

| | |
|---|---|
| Market cap: | Rs. 83,696 cr |
| 52-week high/low: | Rs. 26,333/17,900 |
| NSE volume: (No of shares) | 0.3 lakh |
| BSE code: | 500387 |
| NSE code: | SHREECEM |
| Free float: (No of shares) | 1.4 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 62.6 |
| FII | 12.5 |
| DII | 12.0 |
| Others | 13.0 |

**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | -1.5 | 3.5 | 9.9 | -8.1 |
| Relative to Sensex | -2.7 | 3.2 | 6.6 | -11.3 |

*Sharekhan Research, Bloomberg*

## Broadly in-line performance

Shree Cement reported a 14.6% y-o-y growth in standalone revenue to Rs. 4069 crore for Q3FY2023, which was in-line with our estimate. Cement volumes rose by 23% y-o-y (up 8% q-o-q) to 8 million tonnes, while blended realisation declined by 6.6% y-o-y (flat q-o-q). The company's blended EBITDA/tonnes at Rs. 882 (down 30% y-o-y, up 25.7% q-o-q) was marginally higher than our estimate of Rs. 863 per tonne on account of lower-than-expected operating costs per tonne. On the opex front, Power & fuel cost stood at Rs. 1622/tonnes (up 32% y-o-y, down 1% q-o-q), freight expenses at Rs. 1174/tonne (up 1% y-o-y, up 2% q-o-q) while other expense at Rs. 765/tonnes (down 13% y-o-y, down 4% q-o-q). Overall, operating profit declined by 14% y-o-y to Rs. 708 crore, which was 4% higher than our expectation. Further, Depreciation rose 64% y-o-y (up 14% q-o-q) to Rs. 414 crore and interest expenses was up 30% y-o-y (up 6% q-o-q) at Rs. 71 crore. Consequently, standalone net profit declined 44% y-o-y (up 46% q-o-q) at Rs. 277 crore which was 4% higher than our estimates.

**Per-tonne analysis (blended)**

| Particulars | Q3FY22 | Q4FY22 | Q1FY23 | Q2FY23 | Q3FY23 | y-o-y (%) | q-o-q (%) |
|---|---|---|---|---|---|---|---|
| Volume | 65,50,000 | 80,30,000 | 75,01,000 | 74,56,000 | 80,30,000 | 22.6% | 7.7% |
| Realisations | 5,423 | 5,104 | 5,603 | 5,071 | 5,067 | -6.6% | -0.1% |
| Cost break-up | | | | | | | |
| RM cost | 589 | 440 | 235 | 496 | 352 | -40.1% | -28.9% |
| Employee expenses | 300 | 245 | 290 | 281 | 271 | -9.6% | -3.5% |
| Power and fuel | 1,233 | 1,336 | 1,923 | 1,646 | 1,622 | 31.5% | -1.4% |
| Transportation and handling | 1,163 | 1,172 | 1,204 | 1,148 | 1,174 | 1.0% | 2.3% |
| Other expenses | 877 | 778 | 859 | 799 | 765 | -12.8% | -4.2% |
| **Total expenditure per tonne** | **4,162** | **3,970** | **4,511** | **4,369** | **4,185** | **0.6%** | **-4.2%** |
| **EBITDA per tonne** | **1,260** | **1,134** | **1,092** | **701** | **882** | **-30.0%** | **25.7%** |

*Source: Company, Sharekhan Research*

**Results (Standalone)** Rs cr

| Particulars | Q3FY2023 | Q3FY2022 | % y-o-y | Q2FY2023 | % q-o-q |
|---|---|---|---|---|---|
| **Net Sales** | **4068.8** | **3551.8** | **14.6%** | **3780.9** | **7.6%** |
| Total Expenditure | 3360.8 | 2726.2 | 23.3% | 3257.9 | 3.2% |
| **Operating profit** | **708.0** | **825.5** | **-14.2%** | **523.0** | **35.4%** |
| Other Income | 161.2 | 110.1 | 46.4% | 156.6 | 3.0% |
| EBIDTA | 869.2 | 935.7 | -7.1% | 679.6 | 27.9% |
| Interest | 71.4 | 55.1 | 29.5% | 67.6 | 5.7% |
| PBDT | 797.8 | 880.5 | -9.4% | 612.1 | 30.3% |
| Depreciation | 413.6 | 252.1 | 64.0% | 362.8 | 14.0% |
| **PBT** | **384.2** | **628.4** | **-38.9%** | **249.3** | **54.1%** |
| Tax | 107.4 | 136.4 | -21.3% | 59.7 | 80.0% |
| Extraordinary items | 0.0 | 0.0 | - | 0.0 | - |
| **Reported Profit After Tax** | **276.8** | **492.0** | **-43.7%** | **189.6** | **46.0%** |
| **Adjusted PAT** | **276.8** | **492.0** | **-43.7%** | **189.6** | **46.0%** |
| **Margins** | | | **BPS** | | **BPS** |
| OPM | 17.4% | 23.2% | -584 | 13.8% | 357 |
| PAT | 6.8% | 13.9% | -705 | 5.0% | 179 |
| Tax rate | 28.0% | 21.7% | 625 | 23.9% | 402 |

*Source: Company, Sharekhan Research*

## Conference Call Key Takeaways

- **Guidance:** It expects 32 MT sales volumes for FY2023. The fuel cost is expected at Rs. 2.35 per Kcal in Q4FY2023 (Rs. 2.53 per Q3FY2023). It expects EBITDA/tonne for Q4FY2023 to be close to four-digit number. Increase share of premium cement to 15% over next 3-4 quarters from 7% currently. The cement demand growth is expected to be 6-8% y-o-y per annum while supply is expected to rise at 3-4% y-o-y per annum which would lead to better demand supply dynamics.

- **Management focus areas:** The management would be focusing on 1) Improvement in scores on environment (greenest cement company, increase usage of agricultural and industrial waste, the fuel cost from waste is Rs. 1.5 on Kcal basis) 2) Building brand image 3) Maintaining cost leadership (increase rail dispatches from 12% by setting up railway sliding across plants) 4) Digital & IT adoption and 5) Reaching 80 MT capacity target as early as possible.

- **Q3FY2023 performance:** Sales volume increased 23% y-o-y to 8.03 MT, while cement realisations improved 2% y-o-y to Rs. 4854/tonne. EBITDA declined by 14% y-o-y to Rs. 708 crore. EBITDA/tonne stood at Rs. 881. Fuel consumption costs stood at Rs. 2.53 per Kcal versus Rs. 1.69/Rs. 2.83 per Kcal during Q3FY2022/Q2FY2023. Capacity utilisation stood at 72% as compared to 61% in Q3FY2023. Higher depreciation was on account of commissioning of solar units during Q2 end and commissioning of Raigad unit in March 2022.

- **Capacity expansions:** It is actively focusing on achieving its 80 MTPA capacity target by 2030. The projects under implementation is as follows: 1) The target completion for clinker grinding unit of 3.0 MT capacity at Purulia, West Bengal (through a wholly-owned subsidiary) is Q1FY2024. 2) The integrated cement unit of upto 3.50 MT capacity at Nawalgarh, Rajasthan is likely to be completed by Q3FY2024, one quarter ahead of earlier scheduled completion of Q4FY2024. 3) The completion of integrated cement unit of 3.0 MT capacity in Guntur district of Andhra Pradesh has been advanced by one quarter to Q2FY2025.

- **Green power:** The company completed 84 MW of solar power plants in different states during the current financial year. Another 44 MW of green power capacity is expected to be completed before FY2023 end. It is working on setting up more such plants with an aim to increase the share of green energy in total energy consumption to >55% in next 2 years.

- **Capex:** It incurred Rs. 2,200 crore capex during 9MFY2023. Capex for FY2023 and FY2024 is estimated at Rs. 2900 crore and Rs. 3300-3500 crore, respectively.

- **Debt:** The gross debt stands at Rs. 8300 crore while net cash is Rs. 5700 crore.

- **Other highlights:** The fuel mix stands at 58% petcoke, 28% coal and balance alternate fuels. Trade mix was 78-80%. Average lead distance was 450 km. The share of premium cement has been 7% over last few quarters.

## Outlook and Valuation

### Sector View – Improving demand brightens outlook

The cement industry has seen sustained improvement in demand in the past 15 years, barring a couple of years, while regional cement prices have been rising over the past five years. The cement industry is expected to see higher demand as the situation normalises from second wave of COVID-19 led by infrastructure and rural demand. The strong pick-up in the residential real estate sector is expected to sustain after the second wave of COVID-19. 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.

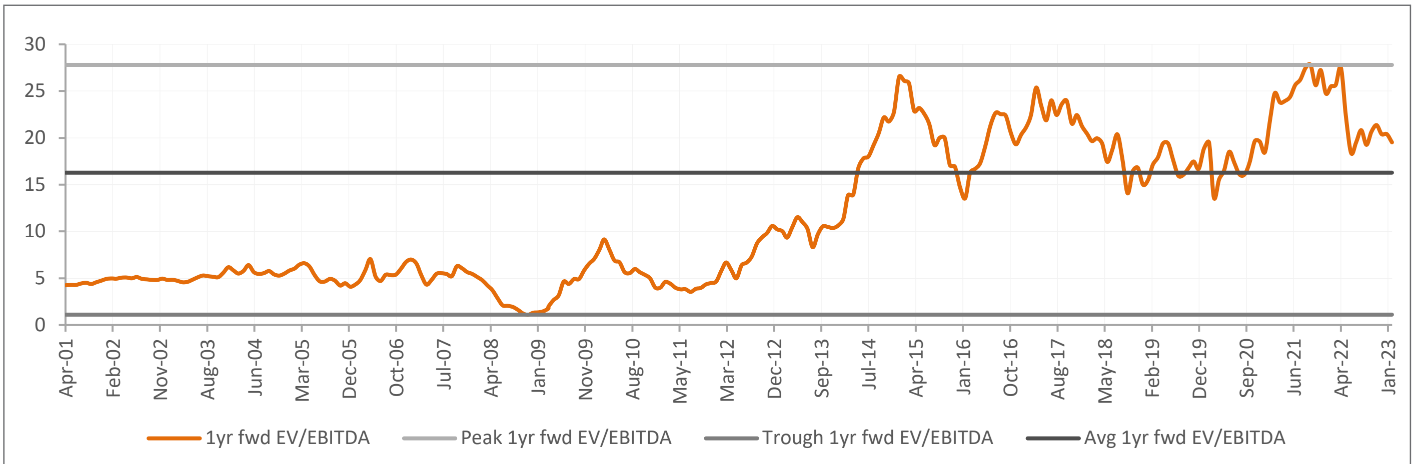
### Company Outlook – Company to outperform industry on volume offtake during FY2023E-FY2025E

The cement industry, which had been affected by the disruptions led by COVID-19, is seeing strong demand traction in key regional markets viz. Northern and Eastern India. Shree Cement has been outpacing industry volume offtake over most of the past four quarters and is further expected to outperform over FY2023E-FY2025E led by improving capacity utilisation and addition of newer capacities. The company is utilising the Rs. 2,400 crore raised through a QIP during Q3FY2020 for further capacity expansion. Firm cement demand has led the management venture on increasing capacity from 47.4 MTPA to 57 MTPA over three years and to 80 MTPA by 2030.

### Valuation – Downgrade to Reduce with a revised PT of Rs. 21,500

Shree Cement is on a healthy volume growth trajectory over the next two years aided by sustained healthy demand environment and new capacity additions. However, we believe operational profitability is expected to improve at a gradual pace than earlier envisaged. Further, other key peers are expanding capacities at a much faster clip along with strong operational efficiencies. The same can lead to possible market share loss in the medium to long term for the company. The stock is currently trading at an EV/EBITDA of 20.7x/16.4 its FY2024E/FY2025E earnings which we believe provides unfavourable risk reward. Hence, we downgrade the stock to Reduce with a revised price target (PT) of Rs. 21,500 factoring downwardly revised estimates and assigning lower valuation multiple to factor in gradual improvement in operational profitability than earlier envisaged.

**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 | 43.0 | 32.2 | 20.8 | 16.1 | 3.9 | 3.5 | 9.3 | 11.3 |
| Shree Cement | 68.7 | 53.0 | 25.7 | 20.1 | 4.6 | 4.3 | 6.9 | 8.4 |
| Dalmia Bharat | 53.1 | 43.8 | 14.6 | 12.0 | 2.2 | 2.1 | 4.2 | 4.9 |
| The Ramco Cement | 62.4 | 25.5 | 20.8 | 13.4 | 2.5 | 2.3 | 4.1 | 9.6 |

*Source: Company; Sharekhan Research*

## About company

Shree Cement, incorporated in 1979 by Kolkata-based Bangur Family, was listed in 1984. The company has a consolidated installed cement capacity of 47.4MTPA and power capacity of 711MW. Of the total cement capacity, 43.4MTPA is in India and 4MTPA is in UAE through subsidiaries. Domestically, the company's presence is predominately in the northern region, with installed capacity of 26.3MTPA, followed by east at 14.1MTPA and south at 3.0MTPA. Shree Cement is among the top three cement groups in India in terms of cement capacity.

## Investment theme

Shree Cement is seeing strong traction in demand from its key regional markets viz. North and East. It has been outpacing industry volume offtake over most of the trailing four quarters and is further expected to outperform over FY2023E-FY2025E led by improving capacity utilization and addition of newer capacities. However, operational profitability is expected to improve at a gradual pace than earlier expected. The firm cement demand has led to the management venturing in increasing capacity from 47MTPA to 57MTPA over three years period and to 80MTPA by 2030. However, major peers in the industry has taken a faster route of capacity additions along with improvement in operational efficiencies. The same may lead to market share loss for the company going ahead.

## Key Risks

- Slowdown in cement demand especially north, east and south affects overall volume growth of the company.
- Increased pet coke price and diesel price affect profitability.
- Decline in cement prices especially in its region of operations affects profitability.

## Additional Data

**Key management personnel**

| | |
|---|---|
| Mr. Hari Mohan Bangur | Chairman |
| Mr. Prashant Bangur | Vice Chairman |
| Mr. Neeraj Akhoury | Managing Director |
| Mr. Subhash Jajoo | Chief Finance Officer |

*Source: Company Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Shree Capital Services Ltd | 24.9 |
| 2 | Digvijay Finlease Ltd | 11.74 |
| 3 | FLT LTD | 9.98 |
| 4 | Mannakrishna Investments Pvt Ltd | 5.66 |
| 5 | Newa Investments Pvt Ltd | 3.81 |
| 6 | Life Insurance Corp of India | 3.68 |
| 7 | Ragini Finance Ltd | 3.52 |
| 8 | Didu Investments Pvt Ltd | 3.25 |
| 9 | SBI Funds Management Ltd | 3.00 |
| 10 | NBI Industrial Finance Co Ltd | 2.35 |

*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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