India Research

Cement

Q1FY17E: Strong volumes to drive performance

Jun'16 Quarterly PAT

Company	Karvy Est(Rsmn)
ACC	2,280
Ambuja	3,243
UltraTech	7,439
Shree Cem	2,535
Ramco Cem	1,411
JK Cement	568
JK Lakshmi	389
Orient Cem	41
Mangalam Cem	240
Dalmia Bharat	934

Source: Karvy Stock Broking

Ratings and change in Target Price

Company	Old	New TP	Ratings
ACC	1,556	1,724	HOLD
Ambuja	230	255	SELL
UltraTech	3,605	3,970	BUY
Shree Cem	12,300	13,550	SELL
Ramco Cem	483	615	HOLD
JK Cement	765	885	BUY
JK Lakshmi	458	525	BUY
Orient Cem	187	216	BUY
Mangalam Cem	255	345	HOLD
Dalmia Bharat	1,130	1,495	BUY

Source: Karvy Stock Broking

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Aggregate volume growth of coverage is estimated at ~10% YoY in Q1FY17

Industry volume growth for Q1FY16 is expected to be at ~4% YoY, slowing down from significant growth of ~11% YoY seen in Q4FY16. Cement production (as per eight core industries data) grew by 3.4% YoY during Apr-May 2016 as compared to 8% YoY during H2FY16 (which was primarily led by low base). Aggregate volume growth of our cement coverage universe is expected at 9.8% YoY in Q1FY17, indicating market share gain by most of the players. The overall demand had been weak during the year FY16 at 4-5% YoY (vs. ~6% in FY15) because of slow growth in household and corporate capex. The weakness in rural economy (which consists of ~40% of the total country's demand) has been the key drag due to delay in govt spending on infrastructure and slowdown in rural economy. Going ahead, we expect the demand to pick-up during FY17-18E led by increase in Govt. capex towards infrastructure (mainly Roads/Highways and Urban Infra) and pick-up in rural housing sector.

Cement prices in North/Central/West picked up during Apr-June 2016

All India average cement price improved by ~3% on sequential basis led by North, Central and West regions. However, East and South regions have seen some softness during the period. However, the average realisation of our cement coverage universe is expected to be flattish YoY and 3.5% increase on QoQ basis. Ambuja, Shree Cement, JK Cement, JK Lakshmi and Mangalam would be the key beneficiaries.

Aggregate EBITDA of cement universe is expected to increase ~38% YoY

We expect aggregate revenues of our cement universe to increase by ~9% YoY, primarily led by ~10% volume growth as the average realisation has been flattish. Average EBITDA/t is expected to increase by ~26% YoY (led by moderation in costs). Thus, increase in volume coupled with improvement in EBITDA/ton would lead to 38% YoY growth in aggregate EBITDA of our coverage. Coupled with low base effect, companies with recent capacity additions are expected to post better volume growth. Orient, JK Lakshmi and Dalmia are expected to outperform with ~40%/~27%/~23% YoY growth followed by Shree Cement (+20% YoY), Ramco (+16% YoY), JK Cement (+6.8% YoY) and UltraTech (+6% YoY). Other majors like ACC and Ambuja are expected to report muted volume growth of 1.5-2% (due to lack of capacity additions).

Retain positive view on the sector; prefer UTCM, JKLC, JKCE, ORCMNT & DBEL

We maintain our FY17E/18E estimates for the companies under coverage. We maintain positive stance on Cement sector as we believe that improvement in utilisations (led by demand pick-up & slowdown in supply additions) would help in pricing power. We expect significant improvement in EBITDA/t during FY16-18E leading to 29% EBITDA CAGR. We have increased valuation multiples for all the companies considering the improvement in sector dynamics going ahead. We maintain our ratings on all the companies and prefer UltraTech Cement in large-cap cement space and JK Lakshmi, JK Cement, Orient Cement & Dalmia Bharat in mid-caps.

Q1FY17 Estimates

Exhibit 1: June 2016 Result preview

(Rs mn)	June'16E	June'15	YoY (%)	Mar'16	QoQ (%)	Comment
ACC(ACC IN EQUITY, HOLD, CMP: Rs.1,620, TP: Rs1,724, Mcap: Rs.304bn)						
Sales	29,943	29,612	1.1	29,274	2.3	Cement volume is expected to increase by ~2% YoY due to lack of capacity additions by the company). Net realisation is expected to increase by ~3% QoQ (flat YoY) because of increase in pricing across North, Central and West regions. EBITDA/t is expected to increase by 40% YoY to Rs 631/t led by lower costs which negates the impact of flattish YoY realisation.
EBITDA	3,976	2,795	42.3	3,696	7.6	
EBITDA margin (%)	13.3	9.4		12.6		
PBT	3,166	1,771	78.8	3,220	-1.7	
PAT	2,280	1,314	73.5	2,322	-1.8	
Ambuja Cement(ACEM IN EQUITY, SELL, CMP: Rs.261, TP: Rs255, Mcap: Rs.405bn)						
Sales	25,961	24,928	4.1	24,183	7.4	Cement volume is expected to increase by ~2% YoY due to lack of capacity additions. Net realisation is expected to increase by ~5% QoQ (+2% YoY) as the prices surged in its selling markets (primarily in North, Central and West region). EBITDA/t is expected to increase by 32% YoY (+23% QoQ) to Rs 823/t.
EBITDA	4,936	3,661	34.8	4,235	16.6	
EBITDA margin (%)	19.0	14.7		17.5		
PBT	4,504	3,094	45.6	4,202	7.2	
PAT	3,243	2,264	43.3	3,038	6.8	
UltraTech Cement(UTCM IN EQUITY, BUY, CMP: Rs.3,487, TP: Rs3970, Mcap: Rs.957bn)						
Sales	64,026	60,382	6.0	64,359	-0.5	Cement volume is expected to increase by ~6% YoY led by ramp-up of new capacities. Net realisation is expected to increase by ~3% QoQ on account of increase in cement prices in its selling markets of North, Central and West region. EBITDA/t is expected to increase by 18% YoY to Rs 1046/t (+11% QoQ).
EBITDA	13,701	10,926	25.4	12,850	6.6	
EBITDA margin (%)	21.4	18.1		20.0		
PBT	10,191	8,309	22.7	9,301	9.6	
PAT	7,439	5,908	25.9	6,814	9.2	
Shree Cement(SRCM IN EQUITY, SELL, CMP: Rs.16,032, TP: Rs13,550, Mcap: Rs.559bn)						
Sales	21,214	17,194	23.4	20,174	5.2	Cement volume is expected to increase significantly by ~20% YoY benefiting from capacity additions in North and East. Cement realisation is expected to increase by ~9% QoQ on account of surge in prices in North and Central regions. EBITDA/t is expected to increase by 52% YoY to Rs 1041/t.
EBITDA	6,323	3,516	79.8	5,050	25.2	
EBITDA margin (%)	29.8	20.4		25.0		
PBT	2,983	1,314	127.0	2,182	36.7	
PAT	2,535	1,281	97.9	2,234	13.5	
Ramco Cement(TRCL IN EQUITY, HOLD, CMP: Rs.583, TP: Rs615, Mcap: Rs.139bn)						
Sales	9,754	9,225	5.7	9,788	-0.4	Cement prices in South region have seen softness during the quarter which would lead to 1% QoQ decline in realisation. Cement volume is expected to increase by ~16% YoY because of pick-up in demand in South. EBITDA/t is expected to increase by ~13% YoY (down 7% QoQ) to Rs 1384/t on account of moderation in costs.
EBITDA	2,906	2,230	30.3	3,093	-6.1	
EBITDA margin (%)	29.8	24.2		31.6		
PBT	2,106	1,377	52.9	2,386	-11.7	
PAT	1,411	975	44.7	2,043	-31.0	
JK Cement(JKCE IN EQUITY, HOLD, CMP: Rs.708, TP: Rs885, Mcap: Rs.50bn)						
Sales	9,043	8,107	11.6	9,496	-4.8	Grey cement volume is expected to grow by ~4% YoY led by ramp-up of new capacity expansions. White cement (including wall putty) volume is expected to increase by 36% YoY. Grey realisation is expected to increase by ~4% QoQ (due to increase in pricing in North & Central region markets). Blended EBITDA/t is expected to increase significantly by ~92% YoY (+12% QoQ) to Rs 895/t.
EBITDA	1,731	844	105.1	1,730	0.1	
EBITDA margin (%)	19.1	10.4		18.2		
PBT	811	-11	-7410.0	974	-16.8	
PAT	568	2	35351.6	706	-19.6	
JK Lakshmi Cement(JKLC IN EQUITY, BUY, CMP: Rs.403, TP: Rs525, Mcap: Rs.47bn)						
Sales	7,690	5,908	30.2	7,351	4.6	Cement volume is expected to increase by ~27% YoY benefiting from recent commisioning of cement kiln at Durg (Chhattisgarh). However, cement realisation is expected to increase by ~7% QoQ on account of increase in prices in North, West and Central regions. EBITDA/t is expected to increase significantly by 95% YoY to Rs 599/t (+50% QoQ).
EBITDA	1,257	507	148.0	859	46.4	
EBITDA margin (%)	16.3	8.6		11.7		
PBT	457	-349	NA	305	49.8	
PAT	389	-180	NA	484	-19.7	

Orient Cement(ORCMNT IN EQUITY, BUY, CMP: Rs.182, TP: Rs216, Mcap: Rs.37bn)						
Sales	4,355	3,489	24.8	4,473	-2.6	Cement volume is expected to increase by ~40% YoY led by commisioning of Karnataka Plant. However, softness in cement prices in Telangana and Maharashtra markets during Q1FY17 would lead to decline in realisation by ~1% QoQ (down by ~11% on YoY). EBITDA/t is expected to decline significantly by 34% YoY to Rs 402/t led by sharp YoY decline in realisation.
EBITDA	547	591	-7.5	597	-8.3	
EBITDA margin (%)	12.6	17.0		13.3		
PBT	62	465	-86.7	107	-42.2	
PAT	41	279	-85.3	194	-78.8	
Mangalam Cement(MGC IN EQUITY, HOLD, CMP: Rs.305, TP: Rs345, Mcap: Rs.8bn)						
Sales	2,352	2,114	11.3	2,102	11.9	Cement volume is expected to increase by ~6% YoY benefiting from the commisioning of cement capacity at Morak (Rajasthan). However, cement realisation is expected to increase by ~5% YoY (+9% QoQ) on account of increase in prices in North, West and Central regions. EBITDA/t is expected to increase significantly by to Rs 717/t (from –Rs 67/t) led by YoY increase in realisation and decline in costs.
EBITDA	464	-41	-1230.9	294	57.6	
EBITDA margin (%)	19.7	-1.9	(42 bps)	14.0	224 bps	
PBT	293	-207	NA	171	71.3	
PAT	240	-188	NA	141	70.2	
Dalmia Bharat (DBEL IN EQUITY, BUY, CMP: Rs.1212, TP: Rs1,495, Mcap: Rs.108bn)						
Sales	18,227	15,720	15.9	18,805	-3.1	Cement volume is expected to increase by ~23% YoY led by full consolidation of OCL India and ramp up of recent commisioning of Karnataka Plant. However, softness in cement prices in South & East during Q1FY17 would lead to decline in realisation by ~1% QoQ (down by ~6% on YoY). EBITDA/t is expected to decline by 5% YoY to Rs 1109/t led by lower realisation.
EBITDA	4,364	4,012	8.8	5,019	-13.0	
EBITDA margin (%)	23.9	25.5		26.7		
PBT	1,334	1,461	-8.7	2,710	-50.8	
PAT	934	416	124.4	1,149	-18.7	

Source: Company, Karvy Stock Broking

Re-rating of cement stocks holds a strong case; target prices revised upwards

We maintain positive stance on the Cement sector as we believe that the cement companies are poised for strong earnings growth between FY16-18 led by increase in volumes and realisations with significant improvement in margins during the period. We believe that the cement industry would see a gradual improvement in capacity utilisation rates across the regions (as incremental cement demand is set to outpace incremental cement supply) which would provide pricing power to manufacturers. We estimate all India cement demand to grow at a CAGR of 8% over FY16-18E led by sharp increase in investments in infrastructure and housing segments.

We believe that the companies which have been expanding their capacities or commissioning in the near to medium term stand to benefit from higher volume growth and operating leverage. Many of the companies are operating at high utilization rates, due to their presence in favorable regions and hence, we expect the recent capacity additions to capitalize on the demand revival and boost volumes.

In the large cap space, UltraTech Cement and Shree Cements are expected to see volume growth of ~10% and ~12% (CAGR), respectively, during FY16-18E. ACC and Ambuja Cements are likely to lag behind industry with volume growth of 5-9% (CAGR) during the period. In the mid-cap space, Orient Cement is expected to see strong volume growth of ~22% CAGR over FY16-18E followed by Dalmia (~12%), Ramco (~10%), JK Cement (~9%) and JK Lakshmi Cement (~10%). EBITDA/t is estimated to expand by an average ~Rs320 over the period FY16-18E led by improvement in realisations, cost rationalization and operating leverage benefits.

Outlook on cement stocks

ACC: We have maintained our CY16E/17E estimates. We estimate cement volume to grow at 6% CAGR during CY15-17E and and realisation growth of ~5% during the same period. We expect EBITDA/t to improve to Rs 779/t by CY17E from Rs496/t in CY15, implying EBITDA CAGR of 33% during the period. Valuation at 16.8x/13.1x EV/EBITDA CY16E/17E looks fair (post the recent run up in stock price) even after considering the earnings rebound in CY16-17E and strong balance sheet. We have increased our target multiple to 14x EV/EBITDA for CY17E (earlier 12.5x) to value the stock considering the gradual improvement in sector dynamics (like pick-up in demand, bottoming out of utilisation rates and improvement in pricing) which would lead to strong volume growth, improvement in margins and return ratios going ahead. However, we maintain Hold with a revised target price of Rs 1,724 (earlier Rs 1,556).

Ambuja Cement: We have maintained our CY16E/17E estimates. We estimate cement volume to grow at ~5% CAGR during CY15-17E. We expect EBITDA/t to improve to Rs 1018/t by CY17E from Rs671/t in CY15, implying EBITDA CAGR of 30% during the period. Valuation at 19.8x/14.3x EV/EBITDA CY16E/17E looks expensive (post the recent run-up) considering the low volume growth (losing market share due to lack of capacity expansions) and cash outflow for ACC's stake. Though we have increased target multiple to 14.5x EV/EBITDA to value CY17E standalone EBITDA (from ealier 13x) considering improvement in sector dynamics, we reiterate Sell with a revised target price of Rs 255 (earlier Rs 230).

UltraTech Cement: We have maintained our estimates for FY17E/18E. We estimate cement volume to grow at ~10% CAGR during FY16-18E. We expect EBITDA/t to improve to Rs 1121/t by FY18E from Rs894/t in FY16, implying EBITDA CAGR of 23% during the period. Valuation at 17.6x/13.5x EV/EBITDA FY17E/18E looks attractive (even after the recent run-up in stock price) considering strong volume growth, operating leverage benefits, strong balance sheet (despite continous capex). We have increased target multiple to 15.5x EV/EBITDA to value FY18E EBITDA (from 14x) considering overall improvement in sector dynamics. We maintain Buy with a revised target price of Rs 3,970 (earlier Rs 3,605).

Shree Cement: We have maintained our estimates for FY17E/18E. We estimate strong volume growth of ~12% CAGR during FY16-18E and EBITDA/t improvement to Rs 1241/t by FY18E from Rs709/t in FY16, implying EBITDA CAGR of 49% during the period. Valuation at 23.5x/18x EV/EBITDA FY17E/18E looks expensive (post recent run-up) and has factored in most of the positives. Though we increase target multiple to 15x EV/EBITDA (from 13.5x) for FY18E, we maintain Sell with a revised target price of Rs 13,550 (earlier Rs 12,300).

Dalmia Bharat: We maintain our estimates for FY17E/18E. We estimate strong volume growth of ~12% CAGR during FY16-18E and EBITDA/t improvement to Rs 1341/t by FY18E from Rs1234/t in FY16, implying EBITDA CAGR of 17% during the period. The stock is trading at 8.7x/7.3x EV/EBITDA FY17E/18E which looks attractive considering the strong earnings growth, improvement in margins and simplification of corporate structure. We increase our target multiple to 8.5x EV/EBITDA (from 7x) considering the improvement in sector dynamics (like bottoming out of utilisation rates and improvement in pricing) going ahead. Maintain Buy with a revised target price of Rs 1495 (earlier Rs 1130).

JK Cement: We have maintained our estimates for FY17E/18E. We estimate volume growth of ~9% CAGR during FY16-18E and EBITDA/t improvement to Rs 906/t by FY18E from Rs625/t in FY16, implying EBITDA CAGR of 32% during the period. Valuation at 10.5x/8.0x EV/EBITDA FY17E/18E looks attractive (even after the recent run-up in stock price. We increase target multiple to 9.5x EV/EBITDA (from 8.5x) for FY18E considering improvement in sector fundamentals and maintain Buy with a revised target price of Rs 885 (earlier Rs 765).

JK Lakshmi Cement: We have maintained our estimates for FY17E/18E. However, we estimate strong volume growth of ~10% CAGR during FY16-18E and EBITDA/t improvement to Rs 884/t by FY18E from Rs369/t in FY16, implying EBITDA CAGR of 70% during the period. Valuation at 11.5x/7.5x EV/EBITDA FY17E/18E looks attractive considering better volume growth and realisations going ahead (on account of East India expansion). We have increased target multiple to 9x EV/EBITDA to value FY18E standalone EBITDA (from ealier 8x) considering improvement in sector dynamics. We maintain Buy with a revised target price of Rs 525 (earlier Rs 458).

Ramco Cement: We have maintained our estimates for FY17E/18E. We estimate volume growth of ~10% CAGR during FY16-18E and EBITDA/t improvement to Rs 1,518/t by FY18E from Rs1450/t in FY16, implying EBITDA CAGR of 13% during the period. Valuation at 13.4x/10.9x EV/EBITDA FY17E/18E looks fair (post the recent run-up in stock price) and has factored in most of the positives. We have increased target multiple to 11.5x EV/EBITDA to value FY18E EBITDA (from ealier 9.5x) considering significant improvement expected in south region demand (led by infra activities in AP/Telangana). We maintain Hold with a revised target price of Rs 615 (earlier Rs 483).

Orient Cement: We have maintained our estimates for FY17E/18E. However, we estimate strong volume growth of ~10% CAGR during FY16-18E and EBITDA/t improvement to Rs 872/t by FY18E from Rs399/t in FY16, implying EBITDA CAGR of 80% during the period. The stock is trading at 11.4x/8.3x EV/EBITDA FY17E/18E which looks attractive considering the strong earnings growth after the commissioning of Karnataka plant. We increase our target multiple to 9.5x EV/EBITDA (from 8.5x) considering the improvement in sector dynamics (like bottoming out of utilisation rates in South region and improvement in pricing) going ahead. Maintain Buy with a revised target price of Rs 216 (earlier Rs 187).

Mangalam Cement: We have maintained our estimates for FY17E/18E. We expect volume to grow at ~13% CAGR during FY15-18E and EBITDA/t improvement to Rs 560/t by FY18E from Rs145/t in FY16, implying EBITDA CAGR of 121% during the period. Valuation at 13.8x/6.4x EV/EBITDA FY17E/18E looks fair considering the high sensitivity to decline in realisations. We increase our target multiple to 7x EV/EBITDA (from 6x) considering the improvement in sector dynamics going ahead. We maintain Hold with a revised target price of Rs 345 (earlier Rs 255).

Exhibit 2: Valuation Matrix

Company Name	CMP	Mcap (Rs bn)	TP	Upside/ Downside	Rating	P/E			EV/EBITDA			EV/Ton (USD)		
						FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E
ACC	1620	304	1724	6%	Hold	40.9	30.2	24.0	24.6	16.8	13.1	127	124	119
Ambuja Cement	261	405	255	-2%	Sell	45.5	37.3	25.4	24.2	19.8	14.3	182	180	180
UltraTech Cement	3487	957	3970	14%	Buy	44.0	33.0	24.3	22.1	17.6	13.5	195	191	181
Shree Cement	16032	559	13550	-15%	Sell	122.2	47.5	32.3	41.1	23.5	18.0	320	296	291
Ramco Cement	583	139	615	5%	Hold	24.9	24.8	19.6	14.9	13.4	10.9	159	154	149
Dalmia Bharat	1212	108	1495	23%	Buy	56.4	22.9	17.1	10.7	8.7	7.3	107	105	100
JK Cement	708	50	885	25%	Buy	48.7	20.7	13.3	14.7	10.5	8.0	89	88	83
JK Lakshmi Cement	403	47	525	30%	Buy	279.1	31.2	14.1	23.2	11.5	7.5	114	97	89
Orient Cement	182	37	216	19%	Buy	60.0	27.0	16.7	28.3	11.4	8.3	104	93	90
Mangalam Cement	305	8	345	13%	Hold	-39.7	76.4	10.1	32.9	13.8	6.4	50	44	41

Source: Company, Karvy Stock Broking *Note: FY16E/17E/18E denotes CY15E/16E/17E for ACC and Ambuja Cement*

Stock Ratings		Absolute Returns
Buy	:	> 15%
Hold	:	5-15%
Sell	:	< 5%

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