

Equities

17 March 2011 | 13 pages

UltraTech Cement (ULTC.BO)

Sell: Cement Prices Have Bounced But Downside Risks Remain

- Company Update
- Target Price Change
- Estimate Change

- **Await correction** — We raise TP to Rs985 (from Rs965) based on FY12E (rolling forward from Dec11) adj. EV/t of \$120. At our revised TP, UTCL would trade at an EV/EBITDA of 9.5x; P/E of 20x. While the recent price hikes have been positive, (and further hikes could lead to trading opportunities) there are downside risks due to surplus capacity/cost pressures. While UTCL (at \$124/t) does not appear overly expensive, all else being equal, we will likely become constructive when valuations dip below replacement costs (US\$120/t). We prefer Grasim for exposure to UTCL.
- **Cement prices have downside risk** — Cement producers have cut volumes and artificially boosted prices citing various factors (transport bottlenecks/shortage of rail capacity). This volume cut has helped producers raise prices over the last few months by 6-23% since Jan11 to compensate for lower volumes/rising costs. However the Indian cement industry remains oversupplied (with at least 10% surplus until FY13) and fragmented (~30 companies; top 5 control 55% of capacity) – and hence we think cement prices have downside risk.
- **Continued cost pressures** — Costs such as coal and freight continue to be a key issue for the cement industry. About a third of UTCL's coal is imported. The average coal cost in 3QFY11 was US\$110/t but should be ~US\$130/t in FY12. Additionally domestic coal linkage prices (a third of usage) have been hiked by Coal India by ~30% in end-Feb.
- **India's largest cement company is expanding further** — UTCL has a capacity of 49m tpa in India and controls ETA Star Cement (3m tpa based in UAE, Bahrain and Bangladesh). Capex over the next three years will be Rs100bn on clinker/cement capacity and upgradation/logistics. ULTC's cement capacity should rise by 9.2m tpa by early FY14, taking overall cement capacity to 61m tpa.
- **Upside risks** — Higher prices; capacity delays; better-than-expected demand.

Sell/Low Risk	3L
Price (17 Mar 11)	Rs1,021.50
Target price	Rs985.00
	<i>from Rs965.00</i>
Expected share price return	-3.6%
Expected dividend yield	0.5%
Expected total return	-3.1%
Market Cap	Rs279,929M
	US\$6,205M

Price Performance (RIC: ULTC.BO, BB: UTCEM IN)



Figure 1. UltraTech – Statistical Abstract

YE 31 Mar	Revenue (Rs m)	Net Profit (Rs m)	EBITDA (Rs m)	EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)	EV/tonne (US\$)
FY08	56,234	10,101	17,352	81.1		12.6	8.2	175
FY09	65,636	9,781	17,171	78.6	-3%	13.0	8.0	139
FY10	71,751	10,952	19,830	88.0	12%	11.6	6.3	121
FY11E	134,336	11,633	25,124	42.5	-52%	24.0	12.1	130
FY12E	173,762	13,512	29,545	49.3	16%	20.7	9.8	124
FY13E	192,018	13,946	30,656	50.9	3%	20.0	9.3	118

Source: Company Reports and Citi Investment Research and Analysis. Price as on 17 March 2011. Rs/\$ rate at 45.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

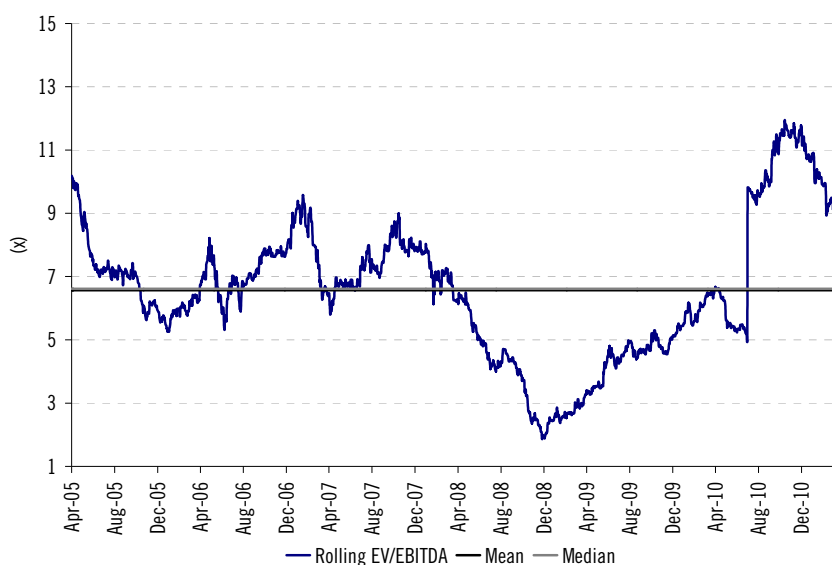
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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	13.0	11.6	24.1	20.7	20.1
EV/EBITDA adjusted (x)	16.2	13.6	10.6	9.7	10.1
P/BV (x)	3.5	2.8	2.5	2.2	2.0
Dividend yield (%)	0.5	0.6	0.5	0.5	0.5
Per Share Data (Rs)					
EPS adjusted	78.57	87.98	42.46	49.32	50.90
EPS reported	78.57	87.98	42.46	49.32	50.90
BVPS	290.10	371.09	412.07	455.56	500.63
DPS	5.00	6.00	5.00	5.00	5.00
Profit & Loss (RsM)					
Net sales	65,636	71,751	134,336	173,762	192,018
Operating expenses	-50,702	-54,597	-114,837	-151,153	-168,808
EBIT	14,934	17,153	19,498	22,609	23,211
Net interest expense	-1,256	-1,175	-2,867	-3,300	-3,320
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	13,678	15,978	16,631	19,309	19,891
Tax	-3,882	-5,010	-5,079	-5,956	-6,104
Extraord./Min.Int./Pref.div.	-16	-16	80	160	160
Reported net income	9,781	10,952	11,633	13,512	13,946
Adjusted earnings	9,781	10,952	11,633	13,512	13,946
Adjusted EBITDA	18,178	21,050	27,588	32,658	33,644
Growth Rates (%)					
Sales	16.7	9.3	87.2	29.3	10.5
EBIT adjusted	-6.5	14.9	13.7	16.0	2.7
EBITDA adjusted	-1.0	15.8	31.1	18.4	3.0
EPS adjusted	-3.2	12.0	-51.7	16.2	3.2
Cash Flow (RsM)					
Operating cash flow	14,477	15,931	14,057	30,118	26,752
Depreciation/amortization	3,244	3,897	8,090	10,049	10,433
Net working capital	-1,302	-795	-330	4,747	231
Investing cash flow	-16,527	-8,431	-23,079	-50,187	-43,318
Capital expenditure	-8,345	-2,723	-10,743	-53,300	-46,306
Acquisitions/disposals	-8,628	-6,283	-14,800	0	0
Financing cash flow	1,915	-7,401	9,262	21,103	20,083
Borrowings	4,024	-5,358	13,000	26,000	25,000
Dividends paid	-728	-728	-871	-1,597	-1,597
Change in cash	-134	98	240	1,034	3,517
Balance Sheet (RsM)					
Total assets	77,396	83,749	219,344	267,094	311,263
Cash & cash equivalent	1,047	1,117	2,267	3,300	6,817
Accounts receivable	1,889	2,100	5,669	7,266	8,059
Net fixed assets	53,338	52,185	141,954	185,205	221,078
Total liabilities	41,216	37,479	105,743	141,744	173,588
Accounts payable	11,290	11,411	27,586	35,786	40,495
Total Debt	21,429	16,071	54,498	80,498	105,498
Shareholders' funds	36,181	46,271	113,602	125,350	137,675
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	27.7	29.3	20.5	18.8	17.5
ROE adjusted	31.0	26.6	14.6	11.4	10.6
ROIC adjusted	21.3	22.1	13.6	9.4	8.0
Net debt to equity	56.3	32.3	46.0	61.6	71.7
Total debt to capital	37.2	25.8	32.4	39.1	43.4

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EV/EBITDA chart

Figure 2. UltraTech – 1-year forward rolling EV/EBITDA chart



Source: Datastream, Company Reports and Citi Investment Research and Analysis

Estimate changes

Figure 3. Estimate Changes, FY11-13E

	<u>FY11</u>			<u>FY12</u>			<u>FY13</u>		
	<u>Old</u>	<u>New</u>	<u>% change</u>	<u>Old</u>	<u>New</u>	<u>% change</u>	<u>Old</u>	<u>New</u>	<u>% change</u>
Net sales (Rs bn)	152.9	134.3	-12%	162.9	173.8	7%	181.5	192.0	6%
EBITDA (Rs bn)	32.6	25.1	-23%	27.3	29.5	8%	27.3	30.7	12%
Net profit (Rs bn)-adj	16.4	11.6	-29%	12.7	13.5	7%	12.6	13.9	11%
EPS (Rs)	59.9	42.5	-29%	46.3	49.3	7%	46.1	50.9	11%
Volumes - incl clinker (mt)	40.0	34.8	-13%	43.8	45.2	3%	47.8	49.9	4%
Net realization (Rs/t)	3,293	3,237	-2%	3,210	3,334	4%	3,295	3,404	3%

Source: Citi Investment Research and Analysis

3QFY11 results

Figure 4. UltraTech 3QFY11 Results

	3QFY11	3Q FY10	% chg
Net sales	37,152	36,819	1%
Total expenses	30,074	26,922	12%
EBITDA	7,078	9,897	-28%
EBITDA margin (%)	19.1%	26.9%	
EBITDA/t (Rs)	722	1,094	-34%
Interest	818		
Depreciation	2,191		
Other income	606		
PBT	4,675		
Tax	1,486		
Tax rate (%)	32%		
PAT	3,190	4,990	-36%
Operational data			
Grey cement prod vols (mt)	9.31	9.00	3%
Grey cement sales vols (mt)	9.34	9.17	2%
Grey cement (Rs/t)	3,279	3,330	-2%
Clinker sales vols (mt)	0.46	0.58	-21%
Realisation (Rs/t)	1,765	1,512	17%
White cement prod vols (mt)	0.15	0.14	7%
White cement sales vols (mt)	0.14	0.13	10%
White cement (Rs/t)	8,677	8,283	5%

Source: Citi Investment Research and Analysis

Quants View – Contrarian

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Data as of: 11-Mar-11

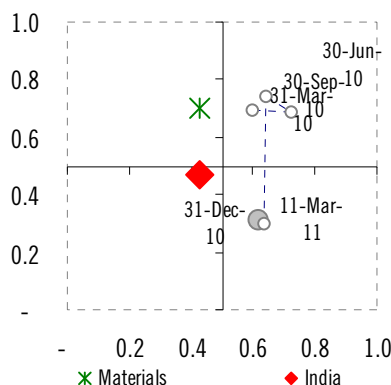
Ultratech Cement currently lies in the Contrarian quadrant of our Value-Momentum map with relatively weak momentum but strong value scores. It has been a resident there since the past 2 months. Compared to its peers in the Materials sector, Ultratech Cement fares better on the valuation metric but worse on the momentum metric. Similarly, compared to its peers in its home market of India, Ultratech Cement fares better on the valuation metric but worse on the momentum metric.

From a macro perspective, Ultratech Cement has a low Beta to the region, so can be expected to hold it's own given a decline in the regional market. It is also likely to benefit from falling EM yields.

Radar Screen Quadrant Definitions

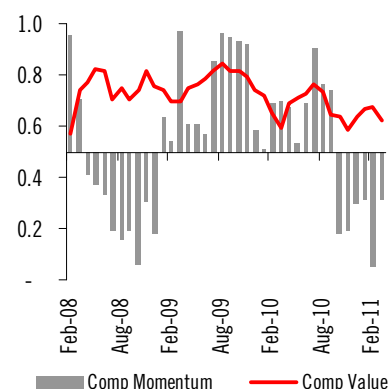
Glamor <i>Poor relative value but superior relative momentum</i>	Attractive <i>Superior relative value and superior relative momentum</i>
Unattractive <i>Poor relative value and poor relative momentum</i>	Contrarian <i>Superior relative value but poor relative momentum</i>

Figure 5. Radar Quadrant Chart History



Source: CIRA

Figure 6. Radar Valuation and Momentum Scores



Source: CIRA

Figure 7. Radar Model Inputs

IBES EPS (Actual and Estimates)			
FY(-2)	81.14	Implied Trend Growth (%)	(8.34)
FY(-1)	78.57	Trailing PE (x)	11.49
FY0	87.95	Implied Cost of Debt (%)	7.03
FY1	51.58	Standardised MCap	(0.02)
FY2	64.30		

Note: Standardised MCap calculated as a Z score – (mkt cap - mean)/std dev – capped at 3

Source: Citi Investment Research and Analysis, Worldscope, I/B/E/S

Figure 8. Stock Performance Sensitivity to Key Macro Factors

Region	0.62	Commodity ex Oil	0.03
Local Market	0.29	Rising Oil Prices	0.00
Sector	(0.44)	Rising Asian IR's	0.01
Growth Outperforms Value	0.19	Rising EM Yields	(0.67)
Small Caps Outperform Large Caps	0.32	Weaker US\$ (vs Asia)	0.22
Widening US Credit Spreads	(0.16)	Weaker ¥ (vs US\$)	0.26

Source: Citi Investment Research and Analysis

UltraTech Cement

Valuation

We use EV/tonne to value ULTC, a common metric used to value cement companies. We set our target price at Rs985, in line with current trends in replacement cost of US\$120/t. We value ULTC in line with replacement costs as cement demand growth is robust and new capacity creation is slowing down. Our target price of Rs985 equates to an EV/EBITDA valuation of 9.5x and a PE of 20x.

Risks

We rate ULTC as Low Risk in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key upside risks to our target price include: (1) Continued pricing strength; (2) Delays in capacity; (3) Higher rates of demand growth.

Grasim Industries

(GRAS.BO; Rs2,438.60; 1L)

Valuation

We value Grasim using SOTP. We value its 49mtpa cement capacity using an EV/tonne (a common metric used for cement companies) of US\$120/t for Dec-11E, in-line with replacement costs, but apply a 10% holding company discount due to the changed group structure, imputing a value of Rs1,570/share for Grasim's 60% holding in UTCL. We value Grasim in line with replacement costs as demand growth is robust and new capacity creation is slowing down. Grasim's other businesses (VSF/Chemicals) are valued at an EV/EBITDA of 6x Dec-11E, a ~10% discount to comparable hard commodity businesses, giving a value of Rs1,070/share. Our Grasim target price of Rs2,640 implies a Dec-11E EV/EBITDA of 6.2x and P/E of 12x.

Risks

We rate Grasim Low Risk, in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks to our target price include: (1) Sharp downward rating for cement stocks due to falling cement prices/demand; (2) Fall in prices of VSF and/or competing fibres would negatively impact margins; and 3) Changes in the duty/tax regime to the detriment of producers.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

UltraTech Cement (ULTC.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Pradeep Mahtani



Chart current as of 12 March 2011

	Date	Rating	Target Price	Closing Price
1	22-Jul-08	3M	*580.00	539.90
2	19-Oct-08	3M	*370.00	375.80

	Date	Rating	Target Price	Closing Price
3	28-Apr-09	3M	*500.00	569.60
4	27-Jul-09	3M	*745.00	796.25

	Date	Rating	Target Price	Closing Price
5	28-Oct-10	*3L	*965.00	1,093.90

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

UltraTech Cement (ULTC.BO)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Pradeep Mahtani

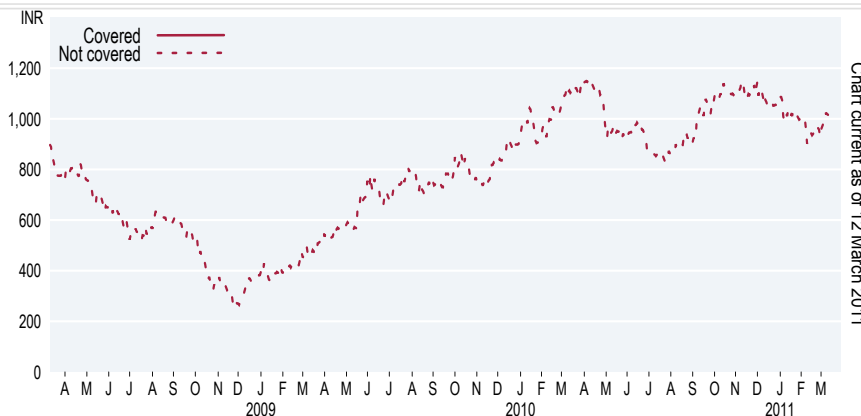


Chart current as of 12 March 2011

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Ultratech Cement Ltd (ULTC.NS)

Rating History
Global Quantitative Research
Asia Radar Screen

Analyst: Paul R Chanin



Date	Rating	Target Price	Closing Price	
1	21-Apr-08	*3	-	770.05
2	28-Apr-08	*1	-	777.55
3	5-May-08	*2	-	757.65
4	23-Jun-08	*1	-	574.65
5	30-Jun-08	*2	-	545.45
6	21-Jul-08	*1	-	538.50
7	28-Jul-08	*2	-	562.05
8	4-Aug-08	*4	-	573.60
9	19-Jan-09	*3	-	380.70
10	28-Jan-09	*1	-	412.15

Date	Rating	Target Price	Closing Price	
11	23-Feb-09	*2	-	416.95
12	27-Mar-09	*1	-	529.20
13	15-Jan-10	*2	-	1,036.95
14	2-Apr-10	*1	-	1,144.25
15	9-Apr-10	*2	-	1,159.90
16	23-Apr-10	*3	-	1,094.75
17	30-Apr-10	*1	-	972.75
18	7-May-10	*2	-	945.45
19	11-Jun-10	*NR	-	974.60
20	18-Jun-10	*1	-	960.10

Date	Rating	Target Price	Closing Price	
21	9-Jul-10	*2	-	858.25
22	16-Jul-10	*1	-	845.10
23	3-Sep-10	*2	-	920.20
24	10-Sep-10	*1	-	1,026.30
25	22-Oct-10	*4	-	1,112.80
26	19-Nov-10	*3	-	1,097.60
27	26-Nov-10	*4	-	1,123.55
28	3-Dec-10	*3	-	1,110.50
29	21-Jan-11	*4	-	1,024.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Ultratech Cement Ltd (ULTC.BO)

Rating History
Global Quantitative Research
World Radar Screen

Analyst: Chris Montagu
Covered since May 23 2009



Date	Rating	Target Price	Closing Price	
1	14-May-08	*3	-	666.55
2	3-Jul-08	*1	-	534.20
3	3-Aug-08	*2	-	566.55
4	8-Sep-08	*6	-	581.00
5	7-Oct-08	*5	-	461.55
6	7-Nov-08	*8	-	349.30
7	4-Dec-08	*4	-	279.75
8	7-Jan-09	*2	-	410.15
9	5-Feb-09	*3	-	410.10
10	4-Mar-09	*7	-	474.00

Date	Rating	Target Price	Closing Price	
11	7-Apr-09	*3	-	538.60
12	14-May-09	*2	-	569.85
13	10-Aug-09	*1	-	718.85
14	14-Sep-09	*2	-	730.15
15	8-Oct-09	*1	-	837.65
16	7-Dec-09	*2	-	835.50
17	1-Jan-10	*1	-	915.10
18	1-Feb-10	*3	-	932.90
19	1-Mar-10	*2	-	1,038.10
20	1-Apr-10	*7	-	1,144.20

Date	Rating	Target Price	Closing Price	
21	1-May-10	*6	-	972.35
22	1-Jun-10	*7	-	919.00
23	1-Jul-10	*1	-	865.60
24	1-Aug-10	*2	-	864.35
25	1-Sep-10	*4	-	908.95
26	1-Nov-10	*9	-	1,101.15
27	1-Dec-10	*7	-	1,145.65
28	1-Jan-11	*5	-	1,082.15

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Grasim Industries (GRAS.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Pradeep Mahtani



Date	Rating	Target Price	Closing Price	
1	22-Jul-08	3M	*1,667.30	1,592.79
2	24-Oct-08	3M	*1,007.61	951.99

Date	Rating	Target Price	Closing Price	
3	28-Apr-09	3M	*1,265.16	1,615.88
4	27-Jul-09	3M	*2,232.11	2,609.89

Date	Rating	Target Price	Closing Price	
5	28-Oct-10	*1L	*2,640.00	2,281.95

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Grasim Industries (GRAS.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Pradeep Mahtani



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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<i>Data current as of 31 Dec 2010</i>	12 Month Rating			Relative Rating		
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<i>% of companies in each rating category that are investment banking clients</i>	45%	44%	40%	0%	44%	0%
Citi Investment Research & Analysis Quantitative World Radar Screen Model Coverage	30%	40%	30%			
<i>% of companies in each rating category that are investment banking clients</i>	24%	23%	19%			
Citi Investment Research & Analysis Quantitative Decision Tree Model Coverage	45%	0%	55%			
<i>% of companies in each rating category that are investment banking clients</i>	55%	0%	50%			
Citi Investment Research & Analysis Asia Quantitative Radar Screen Model Coverage	20%	60%	20%			
<i>% of companies in each rating category that are investment banking clients</i>	23%	20%	20%			
Citi Investment Research & Analysis Australia Radar Model Coverage	51%	0%	49%			
<i>% of companies in each rating category that are investment banking clients</i>	30%	0%	15%			

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To satisfy regulatory requirements, we correspond Under Review to Hold in our ratings distribution table for our 12-month fundamental rating system. However, we reiterate that we do not consider Under Review to be a recommendation.

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