



Cement earnings preview

Concrete numbers expected

The cement industry witnessed a robust growth of 8.7% in volumes during 3QFY2006 despite a drop in exports and excessive rains in the southern region. During the period of April to December 2005, the dispatches grew at an impressive rate of 9.8%. Also on the realisation front, the average cement prices increased by 8.4% year on year (yoy) during the quarter. The healthy volume growth, stable cement prices post-monsoons, declining prices of pet coke and imported coal, and the benefits of the value-added tax (VAT) are likely to boost the Q3FY2006 results of cement companies. Further, the fourth quarter outlook is positive with the 12-month rolling capacity utilisation levels at around 92% at present. We reiterate our positive view on the sector with Associated Cement Companies (ACC), UltraTech Cement, and Orient Paper as our picks in the sector.

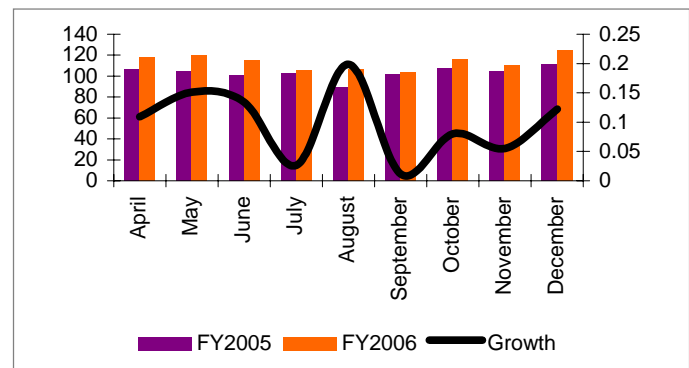
Q3FY2006 earnings estimates

| | Q3FY06 | Net profit Q3FY05 | % yoy chg |
|--------------------------------|--------|----------------------|-----------|
| Under our coverage | | | |
| ACC | 100.2 | 53.6 | 86.9 |
| Grasim Industries | 229.1 | 217.1 | 5.5 |
| UltraTech | 30.5 | -11.0 | |
| Jaiprakash | 66.4 | 45.0 | 47.6 |
| Shree Cement | 32.7 | 16.5 | 98.2 |
| Madras Cement | 9.5 | 2.8 | 239.3 |
| JK Cement | 5.2 | NA | |
| Outside of our coverage | | | |
| GACL | 109.6 | 89.6 | 22.3 |
| Birla Corp | 19.8 | 13.4 | 48.1 |

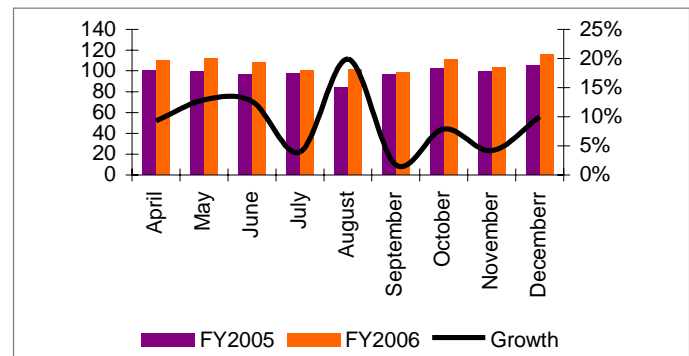
Impressive dispatch growth in Q3FY2006

The cement industry has registered an impressive growth of 8.7% yoy in volumes in Q3FY2006 and of 9.8% till M9FY2006. The dispatch figures were robust despite a temporary slowdown in the south in November due to heavy rains and floods.

All India dispatches



All India consumption



The northern region was the leader with a 14% growth in cement consumption followed by the southern region, which grew by 13% yoy despite heavy rains and floods. This is primarily because of a pick-up in infrastructure projects down south. The western and eastern regions grew by 5% and 3% yoy respectively. We believe the eastern region is currently witnessing some weakness in demand which is likely to continue for a couple of quarters.

All India cement prices up 8.4% yoy—regional cement—a mixed bag

The average cement prices in the country were up 8.4% yoy in the quarter and 6.8% in the year till date. Cement companies would also benefit from the implementation of VAT. The overall cement prices remained firm across the

country, whereas the regional disparity continued. The northern region has seen the maximum price growth of 15% during the quarter. Although excessive rains temporarily restricted the rise in cement prices, yet due to the low base of last year the same would still be up 10-12% yoy during Q3FY2006. The price growth was lower in the eastern region primarily due to the weakness in cement consumption. Cement prices in the west registered a growth of 5.2% during the quarter.

Average cement prices across the region

| | Q3FY05 | Q3FY06 | % yoy chg | 9M05 | 9M06 | % yoy chg |
|-----------|--------|--------|-----------|------|------|-----------|
| North | 141 | 162 | 15.4 | 146 | 160 | 9.8 |
| West | 165 | 174 | 5.2 | 168 | 169 | 0.5 |
| East | 174 | 178 | 2.2 | 172 | 183 | 6.6 |
| South | 148 | 166 | 12.6 | 156 | 173 | 11.0 |
| All India | 157 | 170 | 8.4 | 161 | 172 | 6.8 |

Except for freight rates, all the costs for the cement companies remained broadly stable during Q3FY2006. The prices of imported coal and pet coke have also come down. The diesel price hike of about 7% in September 2005 will cause the cost of freight to go up sequentially, partially offsetting the better pricing.

Maintain positive stance on the sector—ACC, UltraTech and Orient Paper as top picks

We reiterate our positive view on the sector with ACC, UltraTech and Orient Paper as our picks in the sector.

ACC

ACC has reported a healthy 11% growth in its Q3FY2006 cement dispatches. The company completed the capacity expansion of its Chaibasa plant during the quarter and also commissioned the phase I of the Gagal unit earlier this year. However as the company sold its refractory unit in Q2FY2006, the top line growth will be a bit muted. Hence the results will have to be adjusted for the sale of its refractory unit and a like-to-like comparison will show the true picture. There could be some one-time foreign exchange (forex) losses due to the depreciation of the rupee on account of debts denominated in forex. Adjusting for the same, we expect ACC to report an earnings growth of 87% during the quarter.

Note 1: ACC has changed its accounting year from March 31st to December 31st in line with Holcim's accounting practices. Hence this time the company will have nine-month year-ending results. Due to this realignment, the company will publish the audited accounts for FY2005 (covering the nine-month period from April 01, 2005 to December 31, 2005) within three months of closing its financial year.

Note 2: As mentioned earlier, the Q3FY2006 results will not include the numbers of the refractory business and adjusting for the same, we expect the company's earnings before interest and tax to register a growth of 70% on a like-to-like basis.

Note 3: ACC's Q3FY2006 results will also include that of two of its subsidiaries, Damodar Cement and Bargah Cement, and hence the reported figure will have to be adjusted for the same to see the like-to-like comparison. Further the company has sold 50% of its stake in Everest Industries for Rs99 crore. We estimate that the other income on account of this transaction would be in the range of Rs70 crore. But as this would be one-time in nature, the same would have to be accounted for below the line.

UltraTech

We expect UltraTech to continue to improve its profitability despite a 10% volume drop due to lower clinker exports and a change in the sales mix to increase high-margin retail sales. We expect the company to report a net profit of Rs30.5 crore as against a loss of Rs11 crore last year.

Grasim Industries

We expect the cement division to be the top performer for Grasim Industries, driven by the dispatch growth of 6% and improved realisations. Although we are beginning to see a marginal improvement in the viscose staple fibre margins with two price increases of 1.5% each over the last four months, yet it is 10% lower on a year-on-year basis. Lower sponge iron prices and a shortage of natural gas could affect its operating profit margin for the quarter. The net earnings for the quarter are expected to grow by 5.5% to Rs229.1 crore.

Madras Cements

We expect Madras Cements to register a healthy volume growth of 18-20% yoy on the back of a strong demand in south India during Q3FY2006 and M9FY2006. This coupled with the strong cement prices on a lower base of last year would result in an impressive top line growth. Further the company commissioned its Alathiyur unit's captive power plant during the quarter, which shall result in savings in power cost and consequently higher earnings.

Shree Cement

Shree Cement is likely to report a decent volume growth driven by the commissioning of its new 1.2-million-tonne cement plant during November 2005. This coupled with an impressive realisation growth and a drop in pet coke prices (Shree uses pet coke for its captive power plant) is likely to lead to an impressive growth in its earnings during the quarter.

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View

The healthy volume growth, stable cement prices post-monsoons, declining prices of pet coke and imported coal, and the benefits of VAT are likely to boost the Q3FY2006 results of cement companies. Further, the fourth quarter outlook is positive with the 12-month rolling capacity utilisation levels at around 92% at present. Overall, cement prices across the country have already begun to improve and the third quarter was significantly better. We expect a better performance in Q4FY2006. We reiterate our positive view on the sector with ACC, UltraTech and Orient Paper as our picks in the sector.

Cement valuation matrix

| Companies | CMP (Rs) | EPS (Rs) | | PER | | EV/EBIDTA | | EV/ton (\$ US/ton) | |
|---------------|-------------|----------|-------|-------|-------|-----------|-------|--------------------|-------|
| | | FY06E | FY07E | FY06E | FY07E | FY06E | FY07E | FY06E | FY07E |
| ACC | 534 | 26.1 | 30.4 | 20.5 | 17.6 | 11.2 | 9.9 | 116.5 | 112.7 |
| Grasim | 1462 | 109.9 | 125.9 | 13.3 | 11.6 | 6.1 | 0.0 | | |
| UTCL | 480 | 17.4 | 24.7 | 27.6 | 19.4 | 13.9 | 11.6 | 96.1 | 95.3 |
| JP Associates | 369 | 21.5 | 27.9 | 17.1 | 13.2 | 10.0 | 7.0 | | |
| Shree Cement | 524 | 33.8 | 44.8 | 15.5 | 11.7 | 11.2 | 8.9 | 133.0 | 106.0 |
| Madras Cement | 1768 | 63.6 | 104.2 | 27.8 | 17.0 | 12.5 | 9.0 | 92.5 | 88.1 |
| JK cement | 169 | 4.2 | 10.0 | 40.7 | 16.9 | 12.1 | 8.9 | 74.0 | 69.3 |
| GACL | 88 | 4.0 | 4.5 | 22.1 | 19.6 | 8.4 | | 158.9 | |
| Birla Corp | 265 | 17.3 | 28.0 | 15.3 | 9.4 | 9.0 | 6.1 | 85.4 | 81.7 |
| India cement | 119 | 2.9 | 10.0 | 41.3 | 11.9 | 14.0 | 9.3 | 101.2 | 95.1 |

The author doesn't hold any investment in any of the companies mentioned in the article.

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