Cement: 2Q FY11 results review

Sharp drop in realisations lead profits lower

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Cement sector cumulative financial highlights for 2Q FY11

- The cement sector saw a sharp drop in profitability during the September 2010 quarter, with cumulative EBIT declining by 68% y-y and 61% q-q. Out of 21 cement companies we reviewed, four reported losses at the PAT level and around 17 reported more than a 50% y-y decline in EBIT. The primary reason for this drop was about a 16% y-y decline in cement realisations and an increase in operating costs per tonne. Cumulative EBIT margin for the quarter stood at 10.6% compared to 30% during 2Q FY10, implying a drop of 1,940bp y-y.
- Overall revenue growth was down by 9% y-y and by 16% q-q. The drop was again led by lower realisations as volumes during the quarter increased by 5% y-y.
- Cement volume growth was also muted as a result of strong monsoon compared to earlier years and lower infrastructure demand. Cumulative volumes were up by 5% y-y and down significantly by 10% q-q compared to 6% growth for the entire industry in 2Q FY11. Realisations, on the other hand, were down by 16% y-y, which coupled with an increase in operating costs, led to a drop in margins.
- Freight and power& fuel costs were up for most companies as a result of a hike in diesel prices (up 15% y-y) and an increase in imported coal costs (up more than 40% y-y), leading to an overall increase in operating costs.
- We believe that 3Q FY11 will give some respite to cement companies on the back of improved realisations and better demand due to seasonal factors. However, if volume growth does not pickup post monsoon and the festive season, then we may see longer duration of subdued cement prices affecting margins negatively.
- We reiterate our UNDERWEIGHT view on the sector in the medium term on the back of the recent strong stock outperformance and believe that the recovery in 2H FY11 will not lead to the stocks' outperformance as they are already ahead of fundamentals. Ambuja (ACEM IN, TP: Rs112, SELL) is our top SELL idea while India cements (ICEM IN, TP: Rs173, BUY) is our top pick in the sector.

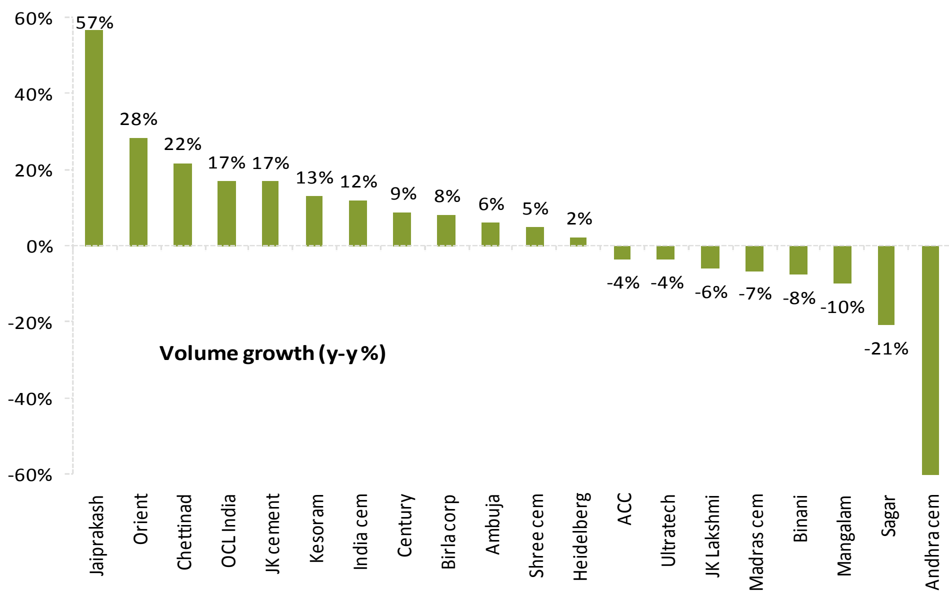
Cement: 2Q FY11 sector financials

Rs mn	2Q FY11	1Q FY11	2Q FY10	q-q %	y-y %
Net Sales	134,960	161,403	148,829	-16%	-9%
EBIT	14,261	36,321	44,601	-61%	-68%
EBIT Margins	10.6%	22.5%	30.0%	-11.9%	-19.4%
Cement volumes (mn tonnes)	41.1	45.6	39.2	-10%	5%
Realizations (Rs/tonne)	3,693	4,203	4,395	-12%	-16%

Note: data pertains to 22 listed cement companies. For conglomerates only cement segment revenue is considered
Source : Industry data, Quant Global Research

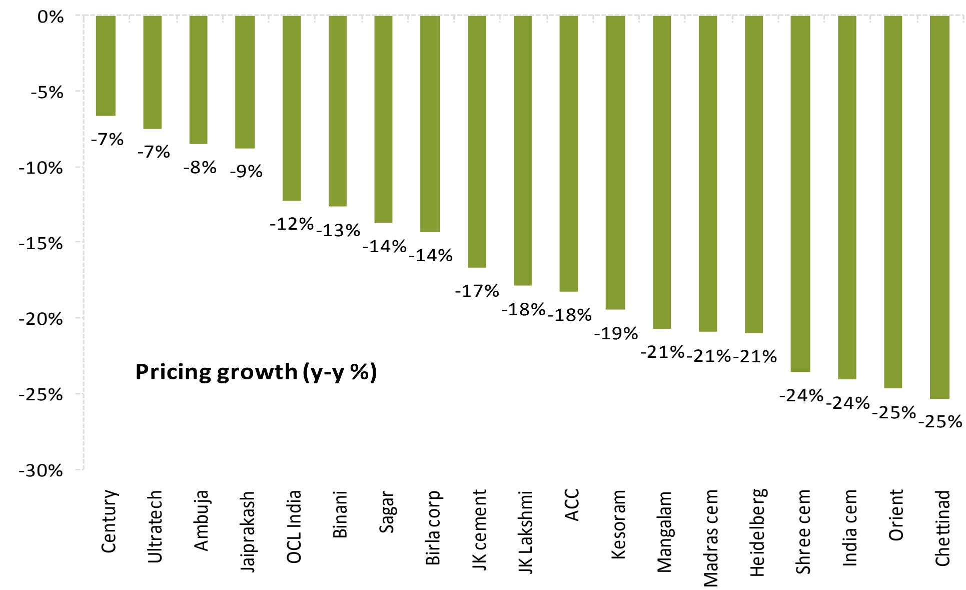
Volume growth driven by JAL whereas pricing was down for all players

Quarterly volume growth of cement companies



Source : CMA, Company data, Quant Global Research
Note: Volumes include cement as well as clinker sales

Pricing growth better for eastern and central region companies

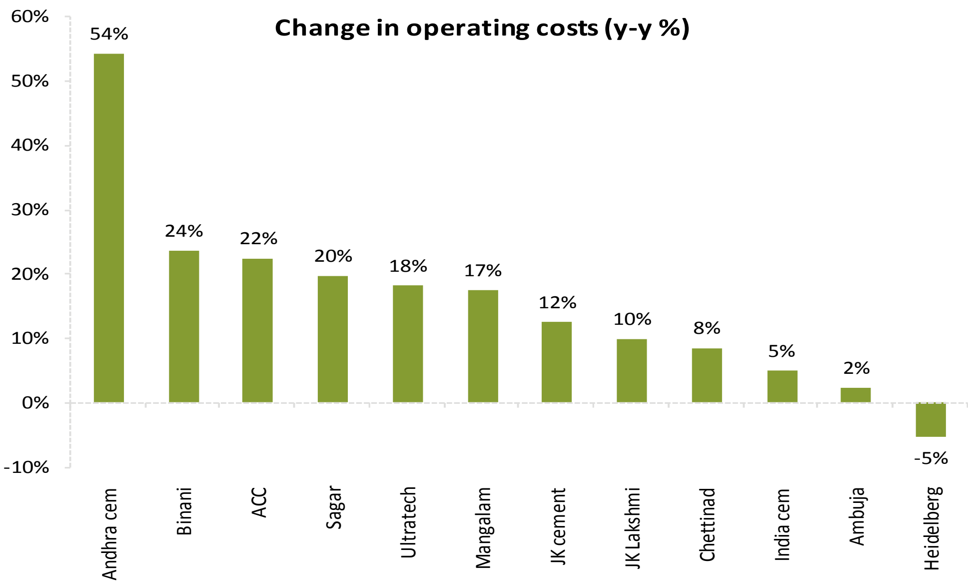


Source : CMA, Company data, Quant Global Research

- Typically companies with less than 10 mn tonnes of capacity and lower utilisation (due to recent capex) have been able to show strong volume growth with an exception of Jaiprakash (JAL). Out of the total 21 companies analysed, only nine have shown volume growth higher than the industry growth rate, while around eight companies have shown negative growth. Interestingly, out of the eight companies with higher-than-industry volume growth, four companies have higher exposure to the southern region, which has shown the least volume growth compared to other regions. Jaiprakash has been able to grow volumes (including clinker sales) at a much healthier pace due to a significant increase in capacity over the past year.
- Industry pricing growth for the quarter was dismal at (11.2)% y-y. Southern companies reported the maximum decline in realisations as pricing in the South dropped sharply in the September quarter. Companies with high exposure to the western and central parts of India were able to cap the pricing decline to a certain extent. Prices in the South have bounced back to their earlier peaks during the current quarter, although volume growth is still absent. We expect a sharp rise in profitability of southern players as pricing discipline has returned to the region.

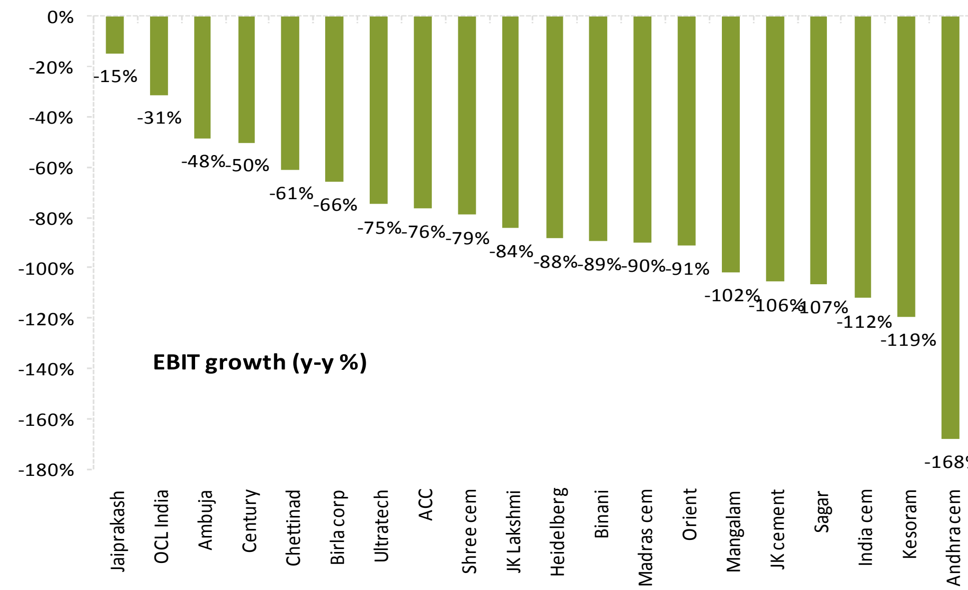
Operating costs growth on the higher side . . .

Operating costs per tonne grew at a higher pace. . .



Source : Company data, Quant Global Research

. . . .resulting in a drop in profitability

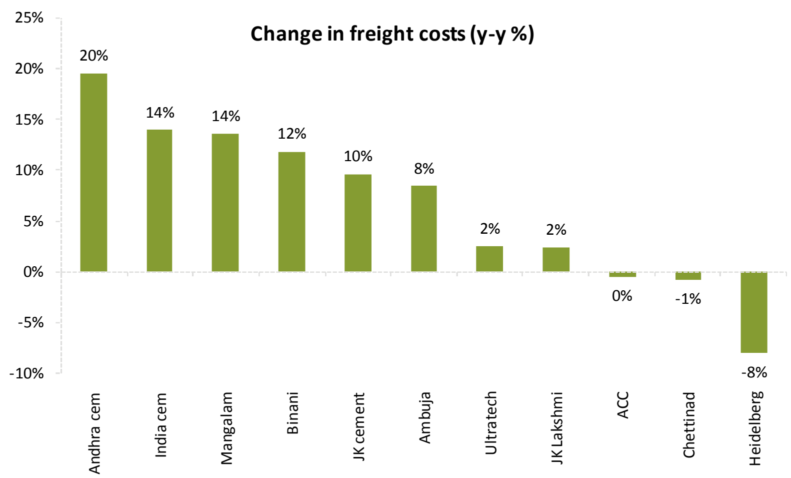


Source : Company data, Quant Global Research

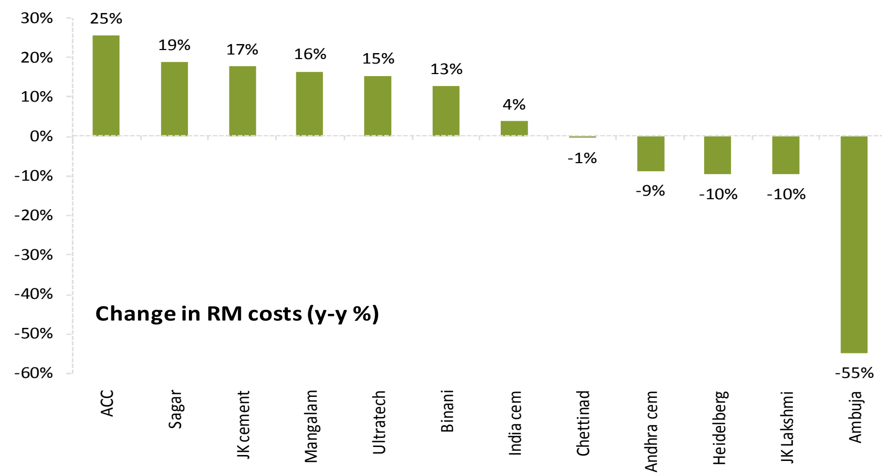
- Operating costs for most companies increased y-y as well as q-q. A hike in diesel prices and an increase in imported coal costs were key reasons for growth in operating costs. Ambuja was able to arrest its cost growth due to a higher cost base in the past year (as a result of higher clinker purchases, which were not present in this quarter). Companies with higher dependence on imported coal and higher lead distance were the most adversely affected.
- EBIT growth was negative for all companies. Despite a sharp rise in volumes, Jaiprakash reported a marginal y-y decline in EBIT whereas lower raw material costs and higher exposure to the western and northern regions (where pricing was better) helped Ambuja arrest its EBIT decline.
- A sharp fall in cement prices in the southern region led to a decline in EBIT for most South-based companies. The bottom five companies, with the highest drop in EBIT, have the highest exposure to the southern region.

. . .primarily due to an increase in freight and P&F costs

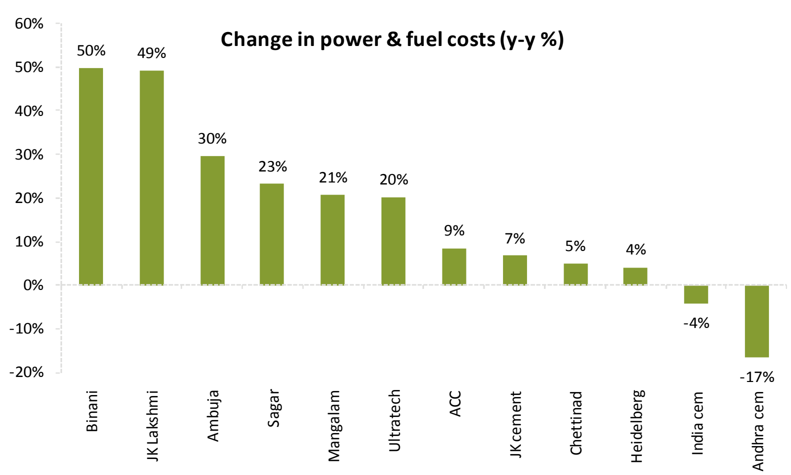
Freight costs increased as a result of diesel price hike



Raw material costs also higher y-y



Higher coal prices lead to an increase in P&F costs

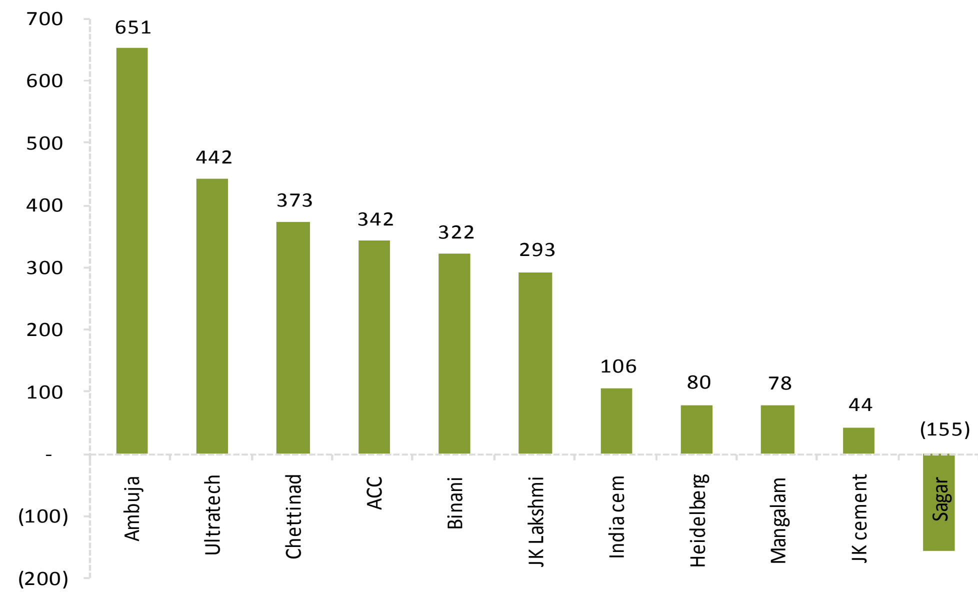


- Operating costs for most companies were up y-y as well as q-q.
- Freight costs increased for southern cement companies as they explored new cement markets because consumption in the South was lower and supply high.
- Raw material costs for Ambuja dropped substantially, leading to growth in EBIT as clinker purchases reduced post commissioning of its clinkerisation unit.
- The cost of coal has increased y-y, due to an increase in the proportion of imported coal in total coal consumption (due to lower availability of domestic coal) and a 40% y-y increase in international coal prices.

Note: data pertains to only 12 cement companies as conglomerates do not give breakdown of operating costs for cement business; Source: Company data, Quant Global Research

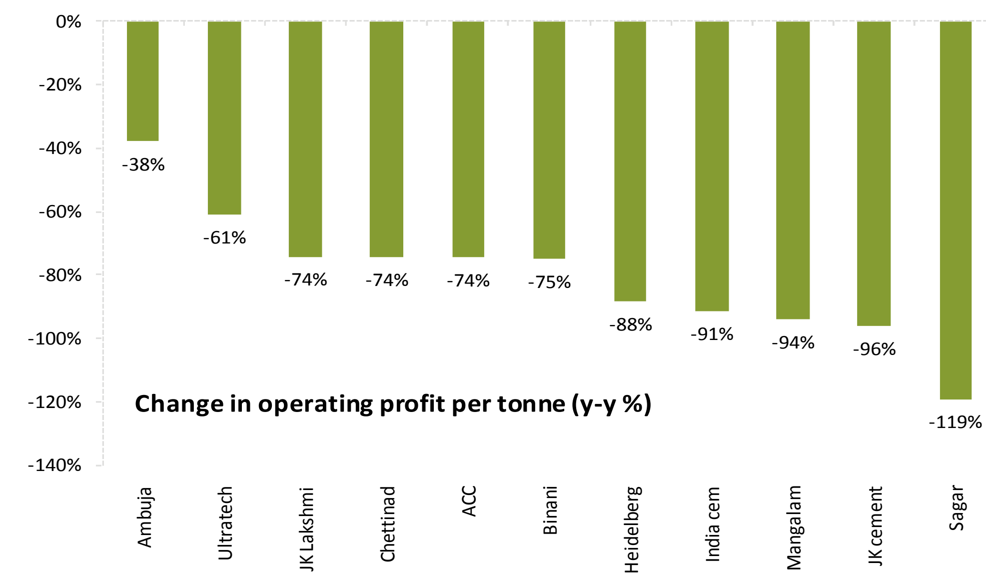
Operating profit per tonne down sharply

Operating profit per tonne during Sep-10 quarter (Rs/tonne)



Source : Company data, Quant Global Research

Significant drop in operating profit per tonne led by pricing declines



Source : CMA, Company data, Quant Global Research

- All companies reported a major drop in operating profit per tonne with Ambuja turning in better performance with an operating profit coming in at Rs651/tonne.
- As expected, southern companies' performance was muted, forming the bottom in terms of operating costs per tonne. Andhra Cement made a loss at the operating level. India Cement also reported loss at the PAT level.

Companies' regional sales proportion

Regional sales proportion of companies during 2Q FY11

Company	North	East	West	South
ACC	43%	18%	23%	16%
Ambuja	40%	17%	42%	2%
Grasim	41%	8%	34%	17%
Ultratech	0%	17%	44%	39%
India Cements	0%	4%	14%	82%
Madras	0%	5%	0%	94%
Andhra Cements	9%	23%	0%	68%
Birla Corp	62%	27%	12%	0%
Century	27%	38%	35%	0%
Chettinad	0%	0%	0%	100%
Jaypee	65%	14%	21%	0%
Kesoram	0%	2%	52%	45%
Lafarge	1%	88%	11%	0%
Mangalam	91%	0%	9%	0%
Mysore	47%	0%	45%	7%
Orient	2%	0%	65%	33%
Dalmia	0%	0%	0%	100%
Shree	93%	1%	6%	0%
Binani	61%	3%	36%	0%
OCL	0%	100%	0%	0%
JK Laksmi	57%	43%	0%	0%
Jk Cement	48%	19%	33%	0%

Note: data for ACC and Ambuja is as on June2009 and September2009, respectively; Source : CMA, Company data

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