UltraTech Cement

STOCK INFO.	BLOOMBERG
BSE Sensex: 11,620	UTCEM IN
	REUTERS CODE
S&P CNX: 3,401	ULTC.BO

Equity Shares (Rs m)	124.4
52-Week Range	885/381
1,6,12 Rel. Perf. (%)	0/22/26
M.Cap. (Rs b)	93.4
M.Cap. (US$ b)	2.0

28 August 2006

Buy

Previous Recommendation: Buy

Rs751

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/06A	33,572	2,121	17.1	269.2	44.1	8.3	20.4	15.4	3.1	18.3
03/07E	43,113	6,208	49.9	192.7	15.1	5.6	44.5	43.4	2.3	8.0
03/08E	44,711	5,578	44.8	-10.2	16.8	4.4	29.5	39.1	2.1	8.4

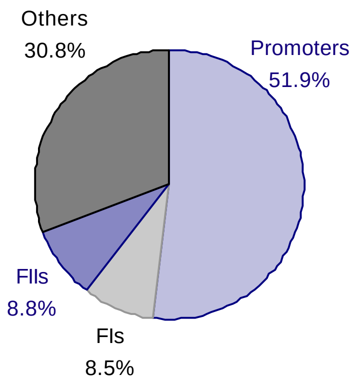
Significant improvement in operating performance: UltraTech Cement has shown considerable improvement in its 1QFY07 operating performance, buoyed by all-time high cement prices, high volume growth, better product mix and improved logistics. With cement prices remaining firm, we expect UltraTech to continue witnessing strong growth.

Near-term pricing outlook better than expectation: On account of high volume growth and limited supply, pricing outlook for the near term is positive. Cement prices have remained firm even during the monsoon, indicating that the industry has reasonably high pricing power. We expect this to reflect in high earnings growth in the coming quarters, resulting in a positive surprise on FY07 earnings.

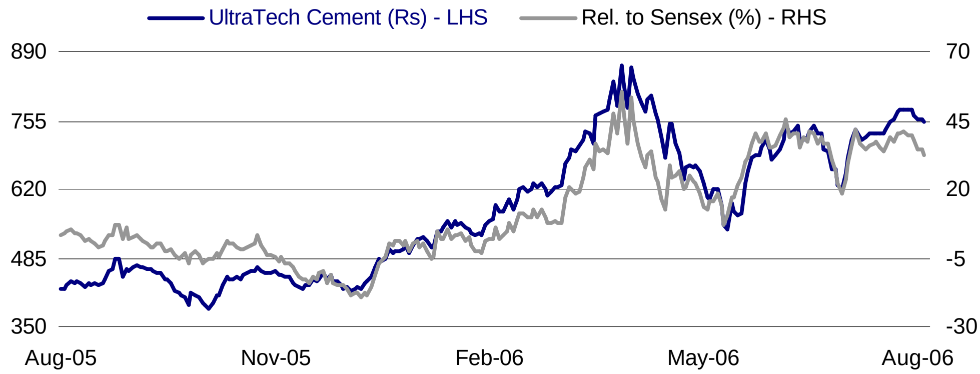
Cost saving, volume growth to drive re-rating: UltraTech has a higher cost structure than its peers, as 80% of its power requirement is met through furnace oil, naphtha-based or purchased power. The company is setting up a lignite/ coal-based captive power plant of 142MW. This plant is likely to be commissioned by the end of FY08 and would result in annual savings of Rs2b from FY09. UltraTech has also announced a 4m ton expansion at its Andhra Pradesh facility (current capacity 2.3m ton) at a capex of Rs12.7b (US$71/ton), which will increase its total capacity to 24m ton. We expect cost saving and organic growth at economical cost to drive a stock re-rating, bringing UltraTech's valuations at par with other cement majors'.

Attractive earnings and asset valuations: We estimate UltraTech's EPS at Rs49.9 for FY07. The stock quotes at 15.1x FY07E EPS and at an EV of 8x FY07E EBITDA, which is at a discount to other majors. On asset valuations also, the stock quotes at a 30% discount to peers at US$127/ton. We recommend **Buy**.

SHAREHOLDING PATTERN (%)



STOCK PERFORMANCE (1 YEAR)



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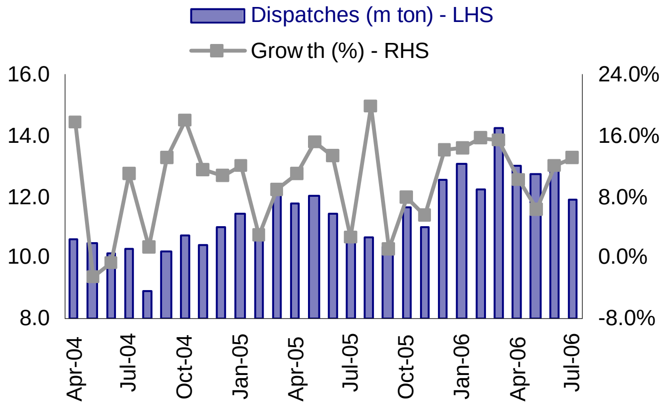
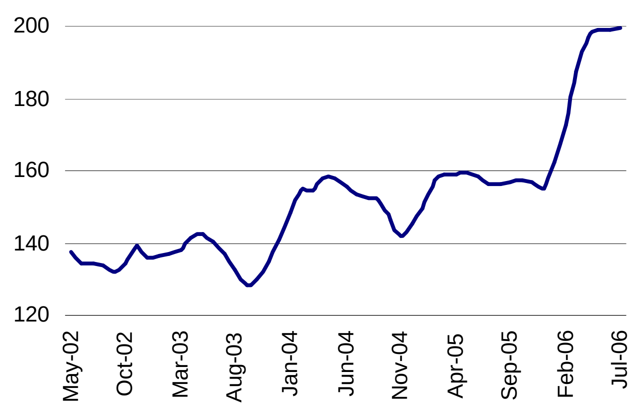
Cement prices have remained firm in the monsoon period, post all-time high in 1QFY07

Cement prices touched all-time highs in June 2006 and have remained firm even in the monsoon period due to strong demand. The national average retail price moved up sharply during April-July 2006 (25.3% YoY) to Rs199/bag. Despite a high base, cement demand grew 10.3% YTD (April-July). The strong upward movement in cement prices resulted in much better than expected performance by all cement companies in 1QFY07. There have also been significant earnings upgrades as a result.

STRONG CEMENT DEMAND...



... HAS LED TO A SHARP INCREASE IN PRICES



Source: Company/ Motilal Oswal Securities

Tight demand-supply leading to positive pricing scenario in the near term

Prices in the nrthern, western and central markets have remained flat during the monsoon, while there has been only a marginal weakening (Rs3-4 per bag) in the eastern and southern markets. Producers have been able to maintain the prices mainly on account of high demand growth (July month volumes were up 13%YoY), which has resulted in much better pricing power for the industry. The near-term outlook on cement prices remains positive.

Firm prices could lead to further earnings upgrades

In our estimates, we have factored in Rs150 per ton decline in 2QFY07. However, in the current scenario, when cement prices have weakened only by Rs50 per ton, 2QFY07 earnings for cement companies could be better than our as well as street's expectations. If the current pricing scenario continues, we may see cement companies reporting better than expected quarterly earnings, leading to further upgrades for FY07.

UltraTech – one of the biggest beneficiaries of high cement prices

UltraTech has the highest operating leverage in the cement industry due to its large cement capacity (18m ton). A 1% increase in cement prices results in a 4.9% increase in UltraTech's EPS. UltraTech's high earnings sensitivity to cement prices is working in its favor in the current scenario.

EPS SWING WITH 1% CHANGE IN REALIZATION (%)

	FY07	FY08
UltraTech Cement (Net of Freight)	4.9	5.6
ACC	4.3	4.8
Guj Ambuja	4.5	5.1

Source: Company/ Motilal Oswal Securities

If we increase our realization assumption of Rs2,506/ton by Rs200/ton, UltraTech's earnings increase by 38% to Rs68.3 per share which shows that if cement prices increase, UltraTech's valuations will look more attractive.

SENSITIVITY ANALYSIS (RS M)

	BASE CASE		CASE 1		CASE 2	
	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
Revenues	43,113	44711	46,582	48,458	39,644	40,963
PAT	6,208	5,578	8,498	8,051	3,918	3,104
EPS (Rs)	49.9	44.8	68.3	64.7	31.5	25.0
PER (x)	15.5	17.3	11.3	12.0	24.6	31.0

Source: Company/ Motilal Oswal Securities

Assumptions

Base Case: Blended realization of Rs2,506/ton in FY07 and Rs2,406/ton in FY08

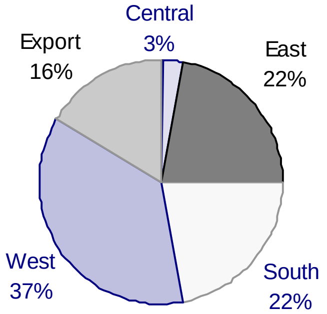
Case 1: Blended realization Rs200/ton higher than base case assumption

Case 2: Blended realization Rs200/ton lower than base case assumption

Favorable market mix helps push up overall realizations

UltraTech has high exposure to the western and southern markets. The West, the South and export markets put together account for 75% of its volume sales. All these markets have witnessed sharp increase in cement prices, driving up UltraTech's realizations.

ULTRATECH'S MARKET MIX (FY07)



Source: Company/ Motilal Oswal Securities

UltraTech's dispaches have gone up significantly during April-July 2006 and YTD volume growth is 11.7%, which is higher than industry dispatch growth of 10.3%. Although in August 2006, UltraTech's dispatches were impacted by floods in the Gujarat market, we believe that going forward also dispatch growth for UltraTech will be higher than industry growth, leading to higher market share for the company.

ULTRATECH: CONSISTENT GROWTH

	FY07	FY06	VAR. (%)
April	1.53	1.39	10.0
May	1.58	1.39	13.7
June	1.32	1.19	10.9
July	1.01	0.90	12.2
April - July 2006	5.45	4.88	11.7

Source: Company/ Motilal Oswal Securities

Significant cost savings to protect profitability in a scenario of falling prices

There is significant scope to improve UltraTech's cost structure. Almost 80% of its power requirement is met through furnace oil, naphtha-based or purchased power. Its average power cost of Rs4.5/unit is much higher than the average of Rs2.8 to Rs3 per unit. The company is setting up a 142 MW thermal power plant, with a capex of Rs8.1b. This is likely to be completed by the end of FY08 and would result in significant cost saving from FY09. We expect a saving of at least Rs2/unit, translating into a saving of Rs2b per year at the operating level from FY09.

UltraTech would also realize significant savings on the logistics front. We expect logistics synergies with Grasim to result in savings of Rs750m-1,000m in the next two years. Also, the company's cement clinker ratio is 1.18, which is lower than the industry average of 1.26. Therefore, there is significant scope to increase cement output and reduce cost by increasing the percentage of blending. We believe that lower power cost, logistics benefits and higher blending would result in considerable improvement in UltraTech's cost structure, which would help to protect its profitability when cement prices begin to weaken.

Economical cost of expansion could trigger a stock re-rating

UltraTech is setting up a brownfield cement plant at Tadpatri, Andhra Pradesh, with a total capacity of 4m ton and a split grinding unit. The company would be incurring a capex of Rs12.8b and is likely to complete the project in the next 2-3 years. The capital cost of this expansion at US$71/ton is significantly lower than UltraTech's current asset valuation. Organic growth at economical capital cost would help the company to maintain its market share and help create value for its shareholders. Apart from this, higher blending will increase its capacity by 10% in the next three years to 20m ton. Post all this, the full capacity in three years will be 24m ton.

Expect robust financial performance in FY07

Aided by all-time high cement prices, we expect UltraTech to report a sharp increase in net realization during FY07. In our estimates, we have factored in an increase of 17.5% (Rs375/ton increase) in net realization during FY07 and a 4% decline (Rs100/ton) in net realization during FY08. We expect volumes to grow in line with the industry.

REVENUE ESTIMATES (RS M)

	2005	2006E	2007E	2008E
Cement Volume (m ton)	15.5	15.7	17.2	18.6
YoY Growth (%)	*3.8*	*1.4*	*9.3*	*8.0*
Blended Realization	1,789	2,133	2,506	2,406
YoY Growth (%)	*16.7*	*19.2*	*17.5*	*-4.0*
Revenues	27,759	33,572	43,113	44,711
YoY Growth (%)	*21.1*	*20.9*	*28.4*	*3.7*

Source: Motilal Oswal Securities

We estimate a sharp 11.3% expansion in the company's margins to 28.5% in FY07. EBITDA is likely to grow 113% to Rs12.3b and PAT should move up by 190% to Rs6.2b. We expect UltraTech to witness the highest growth in EBITDA and PAT amongst the cement majors in FY07, driven by its highest sensitivity to cement prices.

Even in FY08, when we have factored in a decline of Rs100/ton in cement prices, UltraTech's operating margins are likely to remain strong at 25.4%, resulting in a modest 10% decline in PAT.

PROFIT ESTIMATES (RS M)

	2005	2006	2007E	2008E
EBITDA	3,828	5,761	12,296	11,374
YoY Growth (%)	*18.4*	*50.5*	*113.4*	*-7.5*
EBITDA Margin (%)	*13.8*	*17.2*	*28.5*	*25.4*
PAT	587	2,139	6,208	5,578
YoY Growth (%)	*240*	*264*	*190*	*-10*
EPS (Rs)	4.6	17.1	49.9	44.8

Source: Motilal Oswal Securities

Valuations attractive; maintain Buy

We estimate UltraTech's EPS at Rs49.9 for FY07. The stock quotes at 15.1x FY07E EPS and at an EV of 8x FY07E EBITDA, which is in line with its peers – ACC and Gujarat Ambuja. On asset valuations, however, the stock quotes at a 30% discount to peers at US$127/ton.

We believe that current valuations do not factor in UltraTech's highest operating leverage and cost saving potential. We expect the valuation disparity between UltraTech and other cement majors to narrow down significantly, with its asset quality improving post the commissioning of its new power plant. We maintain **Buy** on the stock and recommend it as one of our preferred bets in the cement sector.

COMPARATIVE VALUATIONS

		ULTRATECH	ACC	GACL
Capacity (Current)	m ton	18.5	21.0	15.0
EPS (Rs)	FY07E	49.9	48.7	6.6
	FY08E	44.8	45.9	5.8
P/E (x)	FY07E	15.1	18.8	17.6
	FY08E	16.8	19.9	20.1
EV/EBITDA (x)	FY07E	8.0	12.3	10.0
	FY08E	8.4	12.1	11.3
EV/Ton	FY07E	127	170	174

CONSOLIDATED PROFORMA INCOME STATEMENT (Rs Million)

Y/E MARCH	2004	2005	2006E	2007E	2008E
Net Sales	**22,920**	**27,759**	**33,572**	**43,113**	**44,711**
Change (%)		*21.1*	*20.9*	*28.4*	*3.7*
Total Expenditure	19,686	23,931	27,811	30,817	33,337
EBITDA	**3,234**	**3,828**	**5,761**	**12,296**	**11,374**
Margin (%)	*14.1*	*13.8*	*17.2*	*28.5*	*25.4*
Depreciation	2,475	2,310	2,361	2,460	2,633
Int. and Finance Charges	1,185	1,093	894	650	510
Other Income - Rec.	440	211	312	220	220
PBT	**15**	**637**	**2,818**	**9,406**	**8,451**
Extra Ordinary Expense/(Inco	0	1,202	0	0	0
PBT after EO expense	**15**	**-565**	**2,818**	**9,406**	**8,451**
Tax	-158	-44	679	3,198	2,873
Tax Rate (%)	*-1091*	*7.8*	*24.1*	*34.0*	*34.0*
Reported PAT	**173**	**-521**	**2,139**	**6,208**	**5,578**
Adj PAT	**173**	**587**	**2,139**	**6,208**	**5,578**
Change (%)		*240.1*	*264.1*	*190.3*	*-10.2*
Less: Mionrity Interest	1.2	13	17	0	0
Net Profit	**172**	**575**	**2,121**	**6,208**	**5,578**

CONSOLIDATED PROFORMA BALANCE SHEET (Rs Million)

Y/E MARCH	2004	2005	2006E	2007E	2008E
Equity Share Capital	1,244	1,244	1,244	1,244	1,244
Reserves	9,295	8,493	10,153	15,590	20,119
Net Worth	**10,539**	**9,737**	**11,397**	**16,834**	**21,363**
Deferred liabilities	6030	5661	5229	7708	9935
Loans	15,662	14,663	12,677	5,783	2,167
Capital Employed	**32,231**	**30,061**	**29,303**	**30,325**	**33,464**
Gross Block	47,355	48,355	50,652	51,852	57,852
Less: Accum. Deprn.	16,867	20,128	22,489	24,949	27,582
Net Fixed Assets	**30,488**	**28,227**	**28,163**	**26,903**	**30,270**
Capital WIP	277	850	500	500	500
Investments	0	299	299	299	299
Curr. Assets	**6,012**	**6,534**	**7,154**	**10,165**	**10,220**
Inventory	2,690	2,662	2,759	3,898	4,042
Account Receivables	1,816	1,901	2,116	3,189	3,307
Cash and Bank Balance	448	450	440	716	420
Others	1,058	1,521	1,840	2,362	2,450
Curr. Liability & Prov.	**4,868**	**6,016**	**6,980**	**7,414**	**7,991**
Account Payables	4,503	5,573	6,477	6,767	7,320
Provisions	366	443	504	647	671
Net Current Assets	**1,143**	**518**	**174**	**2,456**	**2,229**
Misc Expenditure	322	167	167	167	167
Appl. of Funds	**32,231**	**30,061**	**29,304**	**30,325**	**33,465**

E: MOSt Estimates

RATIOS

Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS	**1.4**	**4.6**	**17.1**	**49.9**	**44.8**
Cash EPS	21.3	23.2	36.0	69.7	66.0
BV/Share	82.1	76.9	90.3	134.0	170.4
DPS	0.5	0.8	3.3	5.0	7.0
Payout (%)	40.6	-20.4	21.6	11.4	17.8
Valuation (x)					
P/E		162.7	44.1	15.1	16.8
Cash P/E		32.4	20.9	10.8	11.4
P/BV		9.8	8.3	5.6	4.4
EV/Sales		3.9	3.1	2.3	2.1
EV/EBITDA		28.1	18.3	8.0	8.4
EV/Ton (Cap-US$)		136	134	125	114
Dividend Yield (%)		0.1	0.4	0.7	0.9
Return Ratios (%)					
RoE	1.7	5.8	20.4	44.5	29.5
RoCE	4.6	6.9	15.4	43.4	39.1
Working Capital Ratios					
Asset Turnover (x)	0.7	0.9	1.1	1.4	1.3
Debtor (Days)	24	21	20	24	24
Leverage Ratio					
Debt/Equity	1.5	1.5	1.1	0.3	0.1

CASH FLOW STATEMENT (Rs Million)

Y/E MARCH	2004	2005	2006E	2007E	2008E
Op. Profit/(Loss) before Tax	3,234	3,828	5,761	12,296	11,374
Interest/Dividends Recd.	440	211	312	220	220
Direct Taxes Paid	6,188	-325	-1,111	-720	-646
(Inc)/Dec in WC	-695	627	334	-2,005	227
CF from Operations	**9,167**	**4,341**	**5,296**	**9,791**	**11,174**
EO expense	0	1,202	0	0	0
CF from Operating incl	**9,167**	**3,139**	**5,296**	**9,791**	**11,174**
(inc)/dec in FA	-33,240	-621	-1,947	-1,200	-6,000
(Pur)/Sale of Investments	0	-299	0	0	0
CF from investments	**-33,240**	**-920**	**-1,947**	**-1,200**	**-6,000**
Issue of Shares	10,114	-19	-17	-62	-56
(Inc)/Dec in Debt	15,662	-999	-1,987	-6,894	-3,616
Interest Paid	-1,185	-1,093	-894	-650	-510
Dividend Paid	-70	-106	-461	-709	-993
CF from Fin. Activity	**24,521**	**-2,218**	**-3,359**	**-8,315**	**-5,175**
Inc/Dec of Cash	**448**	**2**	**-10**	**276**	**0**
Add: Beginning Balance	0	448	450	440	716
Closing Balance	**448**	**450**	**440**	**716**	**420**

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Disclosure of Interest Statement	**UltraTech Cement**
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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