

Madras Cements

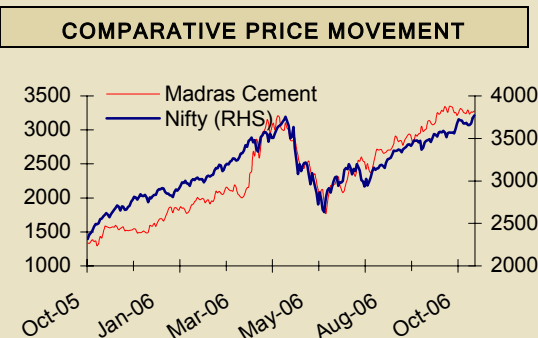
Rs 3,386

31st Oct 2006

Target price: 4,500

SCRIP DETAILS	
Market Cap (Rs crores)	4,090
P/E (x)-FY08(E)	10.8
Market Cap/Sales (x) FY08(E)	2.2
EV/EBIDTA (x) FY08(E)	6.7
EV/Ton (\$) FY08(E)	132
Equity Capital (Rs crores)	12.08
Face Value (Rs)	10
52 Week High/Low (Rs)	3,444/ 1,280
Website: www.madrascements.com	
NSE Code	MADRASCEM
Sensex	12,962
Nifty	3,744

(As on 30th Sep 2006)	
Promoters	42.4
Mutual Funds/ Banks/ FIs	22.3
FIIIs	1.9
Others	12.3
Public	21.1



Company Background

- Madras Cements Ltd (MCL), the flagship company of the Ramco Group, is a leading cement manufacturer in South India, with an annual manufacturing capacity of 5.99 million tons, forming 11.2% of South India cement manufacturing capacity.

State	Capacity	% of total capacity	% of total despatches
Tamil Nadu	3.9	65	45
Andhra Pradesh	1.6	27	17
Karnataka	0.5	8	6
Kerala	-	-	28
Total	6.0	100	100

- Besides sales, in domestic markets, MCL also exports some cement and clinker. Export sales accounted for 8.5% of total revenues in FY06.
- Apart from Cement, MCL has RMC and Dry Mortar divisions; however, the contribution from these divisions is not significant, as cement accounts for 98% of sales.
- MCL is a key beneficiary of the sharp rise in cement prices in South India, which are up by ~30% YoY, as is reflected by a hefty 31% growth in its realisations for H1FY07, to Rs 142 per bag. However, this growth is also helped by the rationalisation of sales tax, in its key market of Tamil Nadu, since Jan06, whereby, tax incidence was reduced, from a dual structure of 16-24% to 14%, and is expected to further benefit from implementation of VAT in the State, from Jan07, as the rate stands reduced to 12.5%.

- MCL is expanding its annual capacity by 4 million tons, at an outlay of Rs 1,052 crores. A Greenfield unit of 2 million tons per annum is to be set up in Tamil Nadu and an additional clinkering facility at its Jayanthipuram plant in Andhra Pradesh is to be installed, which would increase annual cement capacity by a further 2 million tons, taking total annual capacity to 10 million tons, by H1FY09. Further, the Company is installing an 18 MW captive power plant at the Jayanthipuram unit, expected to be operational by Dec06.

Q2FY07 Result Analysis

- MCL posted excellent results, with topline at Rs 407.3 crores, showing a growth of 65.5% YoY and 19.5% QoQ. Bottomline growth was even better, with net profit at Rs 90.1 crores, up 379% YoY and 14.3% QoQ. MCL is the only cement company that has shown a substantial QoQ growth.
- Despatches grew 18.7% YoY and were at 1.4 million tons, with the Company operating at 93.8% capacity, against 79% in the corresponding quarter of FY06. QoQ volume growth of 14.6% was one of the highest in the industry, as the Company improved its capacity utilisation substantially, from 81.8% in Q1FY07.

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- Realisations jumped sharply by 39.4% YoY, to Rs 2,900 per ton, mirroring strong price growth across its markets, since beginning FY07. Even on a QoQ basis, realisations were up 4.2% from Rs 2,782 per ton.
- Cost per ton has increased by 7.7% YoY (QoQ 6.2%), to Rs 1,773, primarily due to increase in the raw material cost to Rs 372.6 per ton vs. Rs 322.2 per ton, and other expenses to Rs 395 per ton vs. Rs 340 per ton. MCL has been successful in bringing down its power & fuel cost, to Rs 533 per ton from Rs 613 per ton, whereas freight costs have increased marginally. The QoQ-increase came primarily from increase in other expenses, which were up 23% in absolute terms.
- Due to robust realisations and higher volumes, OPM has increased to 38.9% against 20.9% (QoQ 40%) and EBITDA per ton stands at Rs 1,127 vs. Rs 434 (QoQ Rs 1113).
- Interest costs were lower, at Rs 4.2 crores vs. Rs 7 crores, while depreciation was up marginally. Thus, PAT was up 4.8x, at Rs 90.1 crores. Against Q1FY07 interest and depreciation were almost stable and PAT grew by 14.3%, which is the highest sequential growth when compared to its peers; however, this was aided partly by the fact that whereas Q2 symbolises monsoons for most parts of India, thus affecting despatches and realisations for most companies, Tamil Nadu, which forms a substantial part of MCL's despatches, gets rains only in Q3; thus, the coming quarter may witness marginally subdued results compared to those in Q2.

Financials

(YE March 31)	Q2FY07	Q2FY06	Chg (%)	H1FY07	H1FY06	Chg (%)	FY06
Net Sales	407.3	246.1	65.5	748.1	466.0	60.6	1,008.5
Stock adjustment	2.3	-5.8	-139.5	-7.8	-1.5	410.5	0.9
Raw Mat. consumed	52.8	37.4	41.3	98.0	67.4	45.4	152.1
Personnel	13.1	12.0	9.3	25.9	22.0	17.7	46.2
Power, Oil and Fuel	75.6	71.0	6.3	143.6	126.5	13.5	253.8
Freight	49.9	40.0	24.7	93.5	72.4	29.1	169.9
Other expenses	55.4	40.2	37.9	100.3	77.4	29.6	175.1
Total expenditure	249.0	194.7	27.9	453.5	364.1	24.5	797.8
Operating Profit	158.3	51.4	208.1	294.7	101.8	189.4	210.6
Other Income	1.7	1.0	65.7	4.6	2.0	133.0	4.9
Interest	4.2	7.0	-40.3	8.4	14.1	-40.2	34.4
Depreciation	18.4	16.6	10.9	35.7	33.1	8.0	65.2
PBT before extraord.	137.4	28.81	377.0	255.1	56.6	350.4	116.0
Extraordinary items	0.0	0.0	-	0.0	0.0	-	0.7
PBT	137.4	28.81	377.0	255.1	56.6	350.4	115.3
Tax	47.4	10.0	373.5	86.2	19.8	335.9	36.3
PAT	90.1	18.8	378.8	168.9	36.9	358.2	79.0
PAT (adj. for extraord.)	90.1	18.81	378.8	168.9	36.9	358.2	79.7
Equity Share capital	12.08	12.08	-	12.08	12.08	-	12.08
EPS (Rs)	74.6	15.6	378.8	139.9	30.5	358.2	66.0
OPM (%)	38.9	20.9	-	39.4	21.9	-	20.9
PBT (%)	33.7	11.7	-	34.1	12.2	-	11.5
Adjusted PAT (%)	22.1	7.6	-	22.6	7.9	-	7.9

Valuation and Conclusion

Cement demand in South India is showing a strong trend, with consumption growing by 10.5% in H1FY07 against All-India growth of 9.2%; this is expected to keep prices firm, atleast for the next 12 months, after which supply from fresh capacities may come up.

At the current market price of Rs 3,386, MCL trades at 12.5x and 10.8x its FY07(E) and FY08(E) EPS of Rs 270 and Rs 315, respectively, EV/ EBITDA of 8.1x and 6.7x and EV/ ton valuation of US\$ 173 and US\$ 132, respectively. We expect MCL to generate one of the best ROEs in the industry, at 61% for FY07(E) and 41% FY08(E); the low equity base is an added positive.

Recommendation: MCL is on a high growth trajectory and the scope for improving capacity utilization, coupled with its upcoming expansions, would ensure timely volume-growth to encash on the up-move in cement prices. Considering MCL's valuations and business prospects, we recommend a **Buy** on the scrip, with a 12-month price target of **Rs 4,500, an upside of 33%**. At our target price, the stock would value at US\$ 135 on the expanded capacity of 10 million tons.

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