

Cement Monthly – July 07

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30 August 2007

Capitalising on capacity shortages...

The month of July is typically characterised by low cement consumption arising from the slow pace of construction activities during the monsoon season. July 2007 fell in line with this trend, with the industry posting a 1.7% MoM decline in consumption during the month. On YoY basis, however, cement consumption grew by an impressive 14.5%; this increase was supported by factors such as a strong 9% GDP growth, government's focus on infrastructure development, irrigation projects undertaken by the government across the country, and the growing housing sector demand. A tight demand-supply scenario continued to keep cement prices firm during the month. With the overall industry capacity utilisation at 95%, we expect cement prices to remain firm until H2FY09, when cement capacity additions are likely to outpace demand. Thus, for next 12 months, the industry is expected to post strong revenue and profit growth.

Table 1. Region-wise scenario

Region	Consumption Mn tonnes	Consumption Growth		Details
		YoY	MoM	
North	2.6	11.9%	-2.2%	<ul style="list-style-type: none"> ✓ Growth driven by Haryana and Punjab; the cement demand in these states grew 18% and 12% YoY respectively. ✓ Cement demand is growing in Uttaranchal on the back of increasing investments in the state. Uttaranchal grew 11.3% YoY. ✓ Demand in Delhi grew 6% YoY and 6.5% MoM. Demand in Rajasthan is growing steadily at 11.6%YoY. However, MoM it was down 10.6% due to a higher base effect.
East	2.0	14.1%	-6.4%	<ul style="list-style-type: none"> ✓ A strong 16% YoY growth was seen in Bihar due to various infrastructure projects executed in the state. West Bengal managed to grow only 6% YoY and its demand declined 16% MoM. ✓ The extraordinary 38% YoY growth shown by Jharkhand and 24% YoY by Orissa was due to a lower base effect. There was a heavy drop in demand in July 2006 in these regions.
South	4.1	8.4%	3.8%	<ul style="list-style-type: none"> ✓ The southern region, except for Kerala, was least hit by monsoon. This is reflected in the good MoM performance achieved by the region. ✓ Tamilnadu and A.P. showed a strong growth of 18% and 13% YoY respectively. Growth in Karnataka, however, remained subdued. ✓ There was a sharp 15% YoY as well as MoM decline in demand in Kerala due to monsoon.
West	2.4	31.2%	-6.7%	<ul style="list-style-type: none"> ✓ Consumption in Maharashtra and Gujarat grew 36% and 23% YoY respectively. Consumption in Gujarat however went down 15% MoM due to heavy rainfalls. ✓ Growth in dispatches was lower than growth in consumption because of a 42% fall in overall exports; the western region has a 79% share in the country's exports.
Central	1.9	14.7%	-0.4%	<ul style="list-style-type: none"> ✓ Performance was in line with industry standards with demand in M.P. and U.P. growing by 24% and 11% YoY respectively. MoM, demand in M.P. declined by 4.1% but demand in U.P. increased marginally by 1.3%
Industry	13	14.5%	-1.7%	

Source: IISL research, company

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Cement Prices and capacity utilization

We expect the cement demand to increase at a 10% CAGR for the next three years supported by

- ▲ Strong 8-9% GDP growth
- ▲ Government's focus on infrastructure development
- ▲ Irrigation projects undertaken by the government across the country
- ▲ Growing housing sector demand.

Currently the industry is operating at 95% capacity utilisation levels. As per the announcements made by various companies, capacity additions during the next one year are expected to be limited. Moreover, these capacity additions too are getting delayed as the order books of domestic equipment manufacturers are already full. The current cement demand-supply scenario warrants an increase in cement prices until Q1FY09. We, however, believe that once fresh capacity additions become operational, cement prices may come under pressure subsequently. Region-wise, the correction in prices is likely to be more in north and south India, as most capacity additions in FY09 are expected in these regions. Table 2 outlines the cement prices and capacity utilisation levels, region-wise.

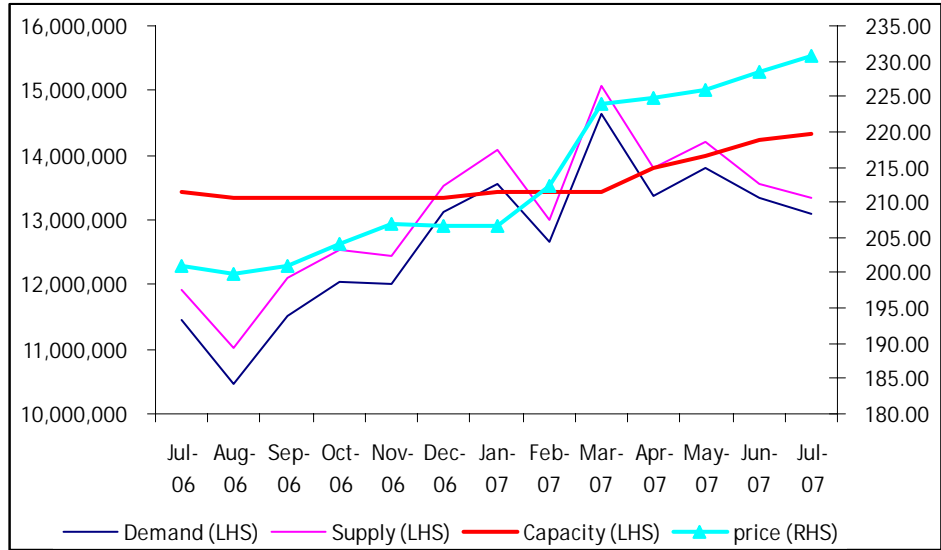
Table 2. Prices & capacity utilisation

Rs per bag	Jul-07	Jun-07	Chg. MoM Rs.	Jul-06	Chg. YoY Rs.	Comment	Monthly Capacity (mn tonnes)	Capacity Utilization
Northern region	224.3	223.1	1.3	201.6	22.7	Prices have remained firm since March 2007 and are expected to remain firm during the current fiscal as no major capacities are coming up until June 2008.	2.9	98%
Western region	241.5	239.9	1.6	210.3	31.3	Prices have remained firm since March 2007 and are expected to remain firm as there are hardly any capacity additions announced during next two to three years.	2.4	86%
Southern region	241.8	235.9	5.9	209.4	32.3	Prices have shown an upward trend since March 2007 on account of the strong demand arising from infrastructure and commercial construction activities in the region. Prices are expected to remain firm during the current fiscal as there are no major capacities coming up until Q1FY09.	4.6	99%
Eastern region	214.7	214.0	0.7	186.2	28.5	Prices have remained firm since March 2007 and are expected to remain firm during next two years as there are no major capacities coming up until March 2009.	2.2	86%
Central region	222.8	217.3	5.5	190.8	32.0	Prices have shown an upward trend since March 2007 and are expected to remain firm during the current fiscal as there are no major capacities coming up until Q1FY09.	1.9	104%
National Average	230.5	227.4	3.2	201.0	29.6		14.0	95%

Source: IISL research, company

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Chart 1. Demand, supply & prices



Source: IISL research, company

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Company-wise analysis

Table 2. Company dispatches (in tonnes)

	Capacity tonnes	July 07 Dispatches	June 07 Dispatches	MoM (%)	July 06 Dispatches	YoY (%)	YTD Dispatches	YoY (%)
ACC	1659090	1,616,490	1,678,330	(3.7)	1,423,170	13.6	6,815,060	10.8%
Birla Corp	481670	440,640	433,570	1.6	405,750	8.6	1,733,420	2.4%
Century Textiles	525000	543,690	584,730	(7.0)	561,680	(3.2)	2,280,690	4.4%
Dalmia	291670	325,550	281,230	15.8	235,050	38.5	1,163,790	47.1%
Grasim	1176250	1,311,700	1,341,500	(2.2)	1,162,820	12.8	5,379,520	9.8%
Ambuja Cement	1358320	1,392,160	1,385,180	0.5	1,164,440	19.6	5,778,310	4.0%
India Cement	734160	814,050	743,410	9.5	756,420	7.6	3,103,700	4.8%
Jaiprakash Industries	549990	515,270	576,740	(10.7)	514,500	0.1	2,192,820	2.7%
Kesoram Industries	379170	313,820	326,250	(3.8)	243,480	28.9	1,392,790	23.1%
Lafarge	416660	392,110	425,320	(7.8)	302,530	29.6	1,701,860	9.3%
Madras Cement	455830	468,600	471,170	(0.5)	481,490	(2.7)	1,850,500	8.4%
Mysore Cements	174590	189,280	181,260	4.4	183,360	3.2	757,480	5.8%
OCL	150000	156,490	161,920	(3.4)	154,300	1.4	676,120	0.9%
Prism	209170	202,360	196,190	3.1	189,530	6.8	808,960	4.7%
Rain Industries	125000	142,130	134,040	6.0	96,700	47.0	525,770	50.1%
Shree Cement	500000	444,910	477,820	(6.9)	319,430	39.3	1,848,380	26.6%
Ultra Tech Cemco	1416660	1,075,280	1,175,810	(8.5)	946,990	13.5	4,941,030	2.1%

Source: IISL research, company

- ▲ Players like Shree Cement, Kesoram and Dalmia Cement, who added capacities in the past one year, reported impressive performance during July 2007. Performance of big companies like Ambuja Cement and Ultratech Cement remained subdued due to limited incremental growth in volumes; this is because, these companies were already operating at full capacity utilisation levels since the previous financial year.
- ▲ We believe that companies that report volume growth led by immediate capacity expansions would emerge as sector out-performers. Thus, while we are positive on the sector from a one-year perspective, we expect the profitability of companies to go down from Q3FY09 onwards; this is because, prices would start to correct as major capacities would become operational in September 2008. We maintain our **Buy** rating on Shree Cements and Madras Cements.

Table 3. Financials and valuation

FY07	Price	EPS (Rs)	P/E (x)	EV/EBIDTA (x)	P/BV (x)	RoCE (%)	RoE (%)
ACC	1041.2	65.9	15.9	12.5	6.2	37.6	46.7
Gujrat Ambuja	133.0	11.7	17.1	11.9	5.9	48.0	60.6
Grasim	2909.7	167.5	17.8	12.1	4.3	27.1	26.7
India Cement	245.3	23.9	10.3	8.6	2.2	19.5	25.3
Madras Cement	3514.0	277.3	12.7	8.4	6.1	37.4	61.2
Shree Cement	1237.0	50.8	24.3	7.6	8.5	19.5	41.2
Ultra Tech Cemco	920.0	62.8	14.6	9.1	6.5	36.0	55.8

Source: IISL research, company

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Key developments during the month

- ▲ Holcim, the global cement major, plans to further increase its 32.3% stake in Ambuja Cements Ltd (ACL). Holcim also intends to acquire, from the founding families of ACL, another 3.9% stake in ACL at INR 154 per share (aggregating to approx. USD 220 mn). Holcim Mauritius would be making a mandatory open offer to the shareholders of ACL for acquiring 306.5 mn shares of ACL; these shares would represent 20% of the fully diluted equity voting capital of ACL at the same price of Rs 154 per share. Post public offer, Holcim's stake in ACL will rise to more than 56%. Currently, the stock is quoting at Rs.133 per share; the fair price after the open offer will be Rs.123 per share. Therefore, the acquisition is not expected to affect the stock price to a great extent.
- ▲ Mangalam Cement's 17.5 MW captive thermal power plant was commissioned during July 2007. Presently, the plant is generating between 10 to 14 MW of power and it is shortly expected to achieve its rated capacity.
- ▲ Binani Cement has acquired a Chinese cement company, Shandong Rongan Group Co Ltd for Rs 450 mn; this company has a capacity of 0.7-mn tonnes per annum (mtpa). Company plans to invest further 80 mn USD to increase the capacity of the Chinese company to 2.2 mn tonnes going forward.
- ▲ The 36-MW captive thermal power plant of J K Lakshmi Cement is now fully operational. Consequently, the company is likely to make considerable savings in cost of power, thereby improving its profitability. The company is also likely to emerge as self-sufficient in its power requirement. J K Lakshmi Cement has also prepaid its high-cost debt worth Rs 3000 mn and replaced it with a low-cost one.
- ▲ Birla Corp. has undertaken a brownfield expansion of its cement plants at Satna and Chanderia. The additional capacity of 1.7 mtpa is expected to be commissioned by FY09, taking the company's total capacity to 7 mtpa.

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