Company

17 January 2010 | 8 pages

# UltraTech Cement (ULTC.BO)

Equity ☑
Estimate change ☑

## Sell: 3Q Feels Southern Damp; Price Hikes Largely Discounted

- **3QFY10 net falls 18%; profitability falls further** — UltraTech Cement's (ULTC) PAT fall to Rs1.96bn (in line) was largely due to a sharp fall in cement prices in the south (30% of its volumes), and higher freight and packing costs. EBITDA margins continue to decline: to 23.4% in 3Q vs 31% in 2Q and 37% in 1Q. EBITDA/t fell to Rs760 vs Rs1,130 in 2Q and Rs1,350 in 1Q.

- **Estimate revisions; TP unchanged** — We cut PAT estimates by 17% for FY10 and raise them by 14-18% for FY11-12 to account for results/trends so far: 1) We now expect prices to rise 2% yoy in FY10 (we expected a rise of 4%) and a yoy decline of 5% (vs 9% earlier) in FY11. We maintain a 2% yoy price fall in FY12; 2) We expect overall volumes to grow 11% in FY10 (vs 16% earlier). TP is unchanged (Rs745) based on EV/t of US$85, but we roll forward from Sep 10 to Mar 11.

- **Volume growth at 11%; prices hit in 3Q** — Overall volume growth could have been higher but demand growth was somewhat subdued in ULTC's main markets of south and west India (70-75% of sales). Avg. domestic realizations fell 6% yoy and 11% qoq (more-than-expected) due to oversupply especially in the south. Export realizations fell due to a sharp fall in demand from the Middle East.

- **Costs: mixed trend in 3Q** — ULTC gained from: 1) lower coal costs yoy (40% of coal is imported); and 2) higher proportion of captive power. However, profits were adversely impacted by: 1) higher raw material costs (clinker purchases from Grasim) and 2) higher packing and clinker freight costs (taken in other expenses).

- **Maintain Sell** — ULTC's merger with Grasim's cement division (wef 1 July 2010) would result in 49mtpa of capacity, but no further synergies (already tapped). Prices could continue to rise from depressed levels in the near term but this appears factored in (ULTC trades at FY11E EV/t of US$119). Moreover, we expect further price declines post-monsoon due to oversupply. Sell.

| Sell/Medium Risk | 3M |
|---|---|
| Price (15 Jan 10) | Rs1,036.75 |
| Target price | Rs745.00 |
| Expected share price return | -28.1% |
| Expected dividend yield | 0.5% |
| **Expected total return** | **-27.6%** |
| Market Cap | Rs129,061M<br>US$2,819M |

**Price Performance (RIC: ULTC.BO, BB: UTCEM IN)**

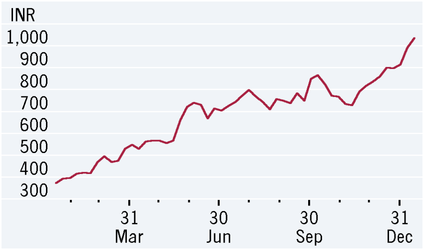


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**Figure 1. UltraTech Cement – Statistical Abstract**

| YE 31 Mar | Revenue (Rs m) | Net Profit (Rs m) | EBITDA (Rs m) | EPS (Rs) | EPS growth (%) | P/E (x) | EV/EBITDA (x) | EV/tonne (US$) |
|---|---|---|---|---|---|---|---|---|
| FY07 | 49,105 | 8,215 | 14,178 | 66.0 | 258% | 15.7 | 9.8 | 178 |
| FY08 | 55,088 | 10,076 | 17,258 | 80.9 | 23% | 12.8 | 8.4 | 172 |
| FY09 | 63,831 | 9,770 | 17,064 | 78.5 | -3% | 13.2 | 8.2 | 139 |
| FY10E | 70,454 | 11,205 | 20,465 | 90.0 | 15% | 11.5 | 6.5 | 126 |
| FY11E | 71,672 | 9,838 | 18,453 | 79.0 | -12% | 13.1 | 6.9 | 119 |
| FY12E | 73,391 | 8,221 | 15,975 | 66.0 | -16% | 15.7 | 7.5 | 112 |

Source: Company Reports and Citi Investment Research and Analysis. Price as on 15 Jan 2010. Rs/US$ rate at 46. Note – EBITDA differs from the Datacentral sheet on page 2 as Datacentral EBITDA includes other income.

See Appendix A-1 for Analyst Certification and important disclosures.

| Fiscal year end 31-Mar | 2008 | 2009 | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|
| **Valuation Ratios** | | | | | |
| P/E adjusted (x) | 12.8 | 13.2 | 11.5 | 13.1 | 15.7 |
| EV/EBITDA adjusted (x) | 7.8 | 7.9 | 6.3 | 6.7 | 7.1 |
| P/BV (x) | 4.8 | 3.6 | 2.8 | 2.3 | 2.0 |
| Dividend yield (%) | 0.5 | 0.5 | 0.5 | 0.5 | 0.4 |
| **Per Share Data (Rs)** | | | | | |
| EPS adjusted | 80.94 | 78.48 | 90.01 | 79.03 | 66.04 |
| EPS reported | 80.94 | 78.48 | 90.01 | 79.03 | 66.04 |
| BVPS | 216.65 | 289.36 | 372.93 | 446.11 | 507.47 |
| DPS | 5.00 | 5.00 | 5.50 | 5.00 | 4.00 |
| **Profit & Loss (RsM)** | | | | | |
| Net sales | 55,088 | 63,831 | 70,454 | 71,672 | 73,391 |
| Operating expenses | -39,195 | -48,961 | -52,536 | -56,055 | -60,362 |
| **EBIT** | **15,893** | **14,870** | **17,918** | **15,617** | **13,029** |
| Net interest expense | -823 | -1,255 | -1,195 | -1,149 | -939 |
| Non-operating/exceptionals | 0 | 0 | 0 | 0 | 0 |
| **Pre-tax profit** | **15,070** | **13,615** | **16,723** | **14,468** | **12,090** |
| Tax | -4,994 | -3,844 | -5,519 | -4,630 | -3,869 |
| Extraord./Min.Int./Pref.div. | 0 | 0 | 0 | 0 | 0 |
| **Reported net income** | **10,076** | **9,770** | **11,205** | **9,838** | **8,221** |
| Adjusted earnings | 10,076 | 9,770 | 11,205 | 9,838 | 8,221 |
| Adjusted EBITDA | 18,266 | 18,100 | 21,765 | 19,653 | 17,375 |
| **Growth Rates (%)** | | | | | |
| Sales | 12.2 | 15.9 | 10.4 | 1.7 | 2.4 |
| EBIT adjusted | 23.0 | -6.4 | 20.5 | -12.8 | -16.6 |
| EBITDA adjusted | 20.3 | -0.9 | 20.3 | -9.7 | -11.6 |
| EPS adjusted | 22.7 | -3.0 | 14.7 | -12.2 | -16.4 |
| **Cash Flow (RsM)** | | | | | |
| **Operating cash flow** | **13,818** | **14,576** | **13,568** | **14,730** | **12,705** |
| Depreciation/amortization | 2,372 | 3,230 | 3,847 | 4,036 | 4,346 |
| Net working capital | 703 | -1,106 | -3,386 | -396 | -489 |
| **Investing cash flow** | **-14,418** | **-16,454** | **-5,810** | **-5,960** | **-3,480** |
| Capital expenditure | -17,741 | -8,226 | -7,110 | -7,160 | -4,880 |
| Acquisitions/disposals | 3,126 | -8,639 | 0 | 0 | 0 |
| **Financing cash flow** | **711** | **1,917** | **-4,923** | **-5,950** | **-3,667** |
| Borrowings | 1,619 | 4,011 | -3,000 | -4,000 | -2,000 |
| Dividends paid | 0 | -728 | -728 | -801 | -728 |
| **Change in cash** | **111** | **38** | **2,834** | **2,819** | **5,558** |
| **Balance Sheet (RsM)** | | | | | |
| **Total assets** | **62,584** | **77,094** | **87,866** | **95,088** | **102,767** |
| Cash & cash equivalent | 1,007 | 1,045 | 3,879 | 6,699 | 12,257 |
| Accounts receivable | 2,166 | 1,862 | 3,428 | 3,650 | 3,716 |
| Net fixed assets | 47,836 | 53,130 | 56,392 | 59,516 | 60,050 |
| **Total liabilities** | **35,614** | **41,073** | **41,441** | **39,554** | **39,594** |
| Accounts payable | 11,530 | 11,209 | 12,738 | 13,571 | 14,669 |
| Total Debt | 17,405 | 21,416 | 18,416 | 14,416 | 12,416 |
| **Shareholders' funds** | **26,970** | **36,021** | **46,424** | **55,534** | **63,173** |
| **Profitability/Solvency Ratios (%)** | | | | | |
| EBITDA margin adjusted | 33.2 | 28.4 | 30.9 | 27.4 | 23.7 |
| ROE adjusted | 45.2 | 31.0 | 27.2 | 19.3 | 13.9 |
| ROIC adjusted | 26.6 | 21.4 | 21.5 | 17.5 | 14.1 |
| Net debt to equity | 60.8 | 56.6 | 31.3 | 13.9 | 0.3 |
| Total debt to capital | 39.2 | 37.3 | 28.4 | 20.6 | 16.4 |

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## Estimate Revisions

**Figure 2. UltraTech Cement – Estimate Revisions, FY10-12E**

| | FY10E | | | FY11E | | | FY12E | | |
|---|---|---|---|---|---|---|---|---|---|
| | Old | New | % chg | Old | New | % chg | Old | New | % chg |
| Net sales (Rs bn) | 74.4 | 70.5 | -5% | 70.4 | 71.7 | 2% | 71.2 | 73.4 | 3% |
| EBITDA (Rs bn) | 23.7 | 20.5 | -14% | 16.7 | 18.5 | 11% | 14.3 | 16.0 | 12% |
| Net profit (Rs bn)-adj | 13.6 | 11.2 | -17% | 8.7 | 9.8 | 14% | 7.0 | 8.2 | 18% |
| EPS (Rs) | 109.1 | 90.0 | -17% | 69.5 | 79.0 | 14% | 56.1 | 66.0 | 18% |
| Net realization (Rs/t) | 3,656 | 3,575 | -2% | 3,327 | 3,396 | 2% | 3,260 | 3,328 | 2% |
| Volumes, incl clinker (mt) | 21.0 | 20.2 | -4% | 21.5 | 21.2 | -1% | 21.7 | 21.9 | 1% |

Source: Citi Investment Research and Analysis. Note – Net realization is domestic.

## 3QFY10 Results

**Figure 3. UltraTech Cement – 3QFY10 Results**

| Rs m | 3Q FY10 | 3Q FY09 | % chg |
|---|---|---|---|
| Net sales | 16,408 | 16,254 | 1% |
| Total expenses | 12,572 | 11,946 | 5% |
| **EBITDA** | **3,836** | **4,308** | **-11%** |
| **EBITDA (%)** | **23.4%** | **26.5%** | |
| **EBITDA/tonne (Rs)** | **761** | **943** | **-19%** |
| Interest | 262 | 359 | -27% |
| Depreciation | 985 | 805 | 22% |
| Other income | 300 | 204 | 47% |
| PBT | 2,888 | 3,348 | -14% |
| Total Tax Paid | 928 | 964 | -4% |
| Tax Rate (%) | 32.1% | 28.8% | |
| **Net profit** | **1,960** | **2,384** | **-18%** |
| | | | |
| **Sales break-up** | | | |
| Clinker sales (Rs m) | 850 | 1,523 | -44% |
| Clinker tonnes sold (m) | 0.57 | 0.58 | -2% |
| Net realization (Rs/tonne) | 1,491 | 2,625 | -43% |
| | | | |
| Cement export sales (Rs m) | 373 | 645 | -42% |
| Cement exports tonnes sold (m) | 0.16 | 0.19 | -16% |
| Net realization (Rs/tonne) | 2,330 | 3,397 | -31% |
| | | | |
| Cement domestic sales (Rs m) | 14,011 | 13,102 | 7% |
| Cement domestic tonnes sold (m) | 4.31 | 3.80 | 13% |
| Net realization (Rs/tonne) | 3,251 | 3,448 | -6% |

Source: Company reports, Citi Investment Research and Analysis

# UltraTech Cement

## Company description

UltraTech Cement (ULTC) has a current cement capacity of 23.1m tpa, making it one of India's largest cement companies. Based on its production for FY09, it had a domestic market share of ~9%. Its markets are well spread out. Based on its plant locations, its main markets are in west, south and east India. In FY09 it exported around 3% of its cement volumes and 16% of its total volumes (18.2m tpa in FY09 including clinker). It has no presence in the northern markets. Along with Grasim (which holds a 54.8% stake), ULTC is working toward rationalizing markets, cutting costs and improving average realizations. ULTC has been known for the consistent high quality of its cement, and manages to earn a premium price over other cement brands in several markets. The group companies had a total cement capacity of 41.6m tpa in FY09, which is expected to rise to about 49m tpa during FY10.

## Investment strategy

We rate ULTC as Sell/Medium Risk (3M) with a target price of Rs745. ULTC has benefited from cement prices bouncing back from the low levels of November 2009, especially in a key market - south India. ULTC should continue to benefit in the near term as prices are expected to rise further, and due to increased captive power. We expect meaningful cement price falls as new capacity comes on stream even as demand weakens during the monsoon. Based on trends so far, we expect ULTC's domestic cement prices to rise ~2% in FY10 but fall 5% in FY11. We expect total cement and clinker volumes to grow 11% yoy in FY10, 5% in FY11 and 4% in FY12. ULTC has commissioned 192MW of captive power in FY09 taking total capacity to 236MW. The captive power, along with lower imported coal costs (40% of usage), should help reduce per tonne power and fuel costs by 23% in FY10. However, with the fall in cement prices that we expect in FY11-12, we expect a yoy profit decline in FY11-12 and that EBITDA margins fall from 32% in FY10 to 26% in FY11 and 22% in FY12.

## Valuation

We use EV/tonne to value ULTC, a common metric used to value cement companies. Our target EV/tonne (Mar 11) value of US$85 is based on a 15% discount to the replacement cost of ~US$100/t. We use a discount to reflect our fears that profitability of cement companies will be impacted going forward on the back of increased new cement capacities and cost pressures. Our target price of Rs745 equates to an EV/EBITDA valuation of 4.9x and a PE of 9.4x.

## Risks

We rate ULTC as Medium Risk. Our quantitative risk-rating system, which tracks 260-day historical share price volatility, suggests a High Risk rating for ULTC shares. However, based on its relatively healthy balance sheet (net debt to equity of 0.1x) and focus on cost cutting, we feel a rating of Medium Risk is more appropriate for ULTC. Key upside risks to our target price include: (1) further delays in industry capacity; (2) a higher level of domestic demand growth than we expect; (3) changes in the duty/tax regime in favor of producers; and (4) higher export prices than we have forecasted.

# Appendix A-1

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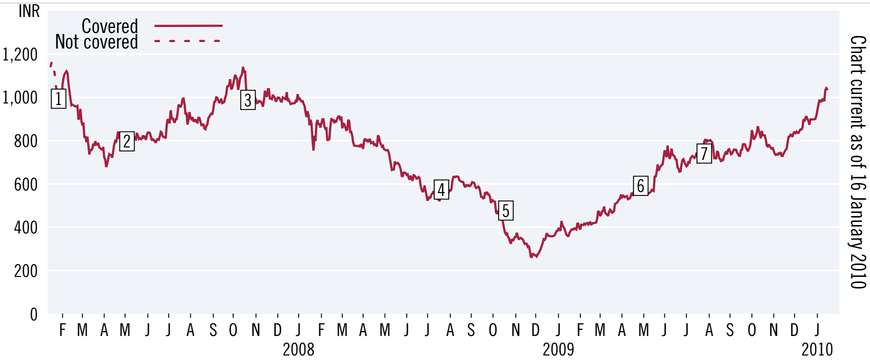
**Fundamental Research**

Analyst: Pradeep Mahtani
Covered since January 26 2007




| | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1 | 26-Jan-07 | *1M | *1,290.00 | 1,034.50 |
| 2 | 3-May-07 | *3M | *730.00 | 833.95 |
| 3 | 21-Oct-07 | 3M | *740.00 | 1,005.05 |
| 4 | 21-Jul-08 | 3M | *580.00 | 538.65 |
| 5 | 19-Oct-08 | 3M | *370.00 | 375.80 |
| 6 | 28-Apr-09 | 3M | *500.00 | 569.60 |
| 7 | 27-Jul-09 | 3M | *745.00 | 796.25 |

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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