

22 October 2008

HOLD

Price Target Price
Rs494 Rs557

Sensex **10,683**

Price Performance

(%)	1M	3M	6M	12M
Absolute	(10)	(4)	(54)	(64)
Rel. to Sensex	18	25	(27)	(41)

Source: Capitaline

Stock Details

Sector	Cement
Reuters	SHCM.BO
Bloomberg	SRCM@IN
Equity Capital (Rs mn)	348
Face Value (Rs)	10
No of shares o/s (mn)	35
52 Week H/L (Rs)	1,600/450
Market Cap (Rs bn/USD mn)	17/346
Daily Avg Vol (No of shares)	26541
Daily Avg Turnover (US\$ mn)	0.3

Shareholding Pattern (%)

	S'08	J'08	M'08
Promoters	63.7	63.7	63.7
FII/NRI	15.9	17.9	18.7
Institutions	9.6	7.7	7.2
Private Corp	4.9	4.9	4.9
Public	5.9	5.8	5.6

Source: Capitaline

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Shree Cement Ltd

Q2FY2009 results – Ahead of expectations

Result
Update

Shree Cement' (Shree) Q2FY2009 pre exceptional PAT of Rs1.17 billion is sharply ahead of our expectations mainly on account of higher than expected realizations, additional contribution from the power segment and higher contribution from other income. Sales for the quarter witnessed a rise of 34.9% yoy to Rs6.29 bn on account of a 16.2% increase in cement volumes and 13.7% yoy increase in realizations. The realisations were higher on account of higher proportion of cement volumes in sales. However the benefits of higher prices and volumes could not flow to the operating levels on account of steep increase in power and fuel cost (Rs918/ton up 55% yoy) and freight cost (Rs652/ton up 47% yoy). Consequently operating profit witnessed a 9.1% yoy decline to Rs1.83 bn and OPMs declined by 1408 bps to 29%. As international coal prices have cooled off substantially, it seems by and large the Indian cement industry has passed the worst phase of cost pressures. But we believe that the profitability of industry will continue to be under pressure as the cement consumption growth is expected to face strong headwinds as high interest rates and medium term liquidity crunch hits housing demand and demand from infrastructure sector. Add to it the impending oversupply of cement on back of capacity addition, would lead to weakening of pricing power of cement producers. We believe that the cement industry will continue to witness a long period of muted earnings growth and deteriorating return ratios. Meanwhile, we maintain our earnings estimate for Shree at Rs121.8 for FY09E and Rs99.8 for FY10E. We maintain our HOLD rating on the stock.

Result highlights:

- Shree Cement' (Shree) Q2FY2009 pre exceptional PAT of Rs1.17 billion is sharply ahead of our expectations mainly on account of higher than expected growth in realizations, additional contribution from the power segment and higher contribution from other income.
- Net sales for the quarter witnessed a rise of 34.9% yoy to Rs6.29 bn on account of a 16.2% increase in cement volumes and 13.7% yoy increase in realizations to Rs3550 per ton.
- But at the operating level, total costs showed a much higher than estimated growth of 68.3% yoy to Rs4.46 billion. Power and fuel expenses increased by a steep 55.3% yoy to Rs918 per ton thus reflecting the phenomenal rise witnessed in the coal & pet coke prices during the quarter. Similarly freight expense witnessed a 47.3% yoy increase to Rs652 per ton. Employee costs increased by 53% yoy to Rs247 mn while other expenses at Rs754 mn registered an increase 49.7%.
- The increase in key operating costs had its bearing on the operating profit of Shree which witnessed a 9.1% yoy decline to Rs1.83 bn and OPM witnessed a huge decline of 1408 bps to 29%.
- Other income for the quarter grew by 15.4% to Rs336 mn. Interest cost for the quarter almost doubled to Rs167 mn on account of debt taken by Shree to fund its aggressive capex program, while depreciation charge witnessed a fall of 21.9% (Shree follows WDV method of depreciation).
- Tax rate for the quarter was at a lower 19.7% while the reported PAT witnessed a marginal increase of 1.2% yoy to Rs1.08 bn.

Result Table

	Q2FY09	Q2FY08	Var (%)	H1FY09	H1FY08	Var (%)
Net Sales	6291.8	4663.8	34.9%	12435.1	8922.1	39.4%
Total Expenditure	4464.2	2652.2	68.3%	8501.9	5095.5	66.9%
Raw material consumed	596.7	555.5	7.4%	1187.2	1072.4	10.7%
Stock Adjustement	141.9	-112.6		79.5	-187.5	
Employee Expenses	246.7	161.2	53.0%	497.7	315.0	58.0%
Power, Oil & Fuel	1594.1	883.5	80.4%	3109.1	1706.7	82.2%
Freight expenses	1131.1	661.0	71.1%	2313.8	1280.6	80.7%
On interunit clinker	180.2	0.0		340.2	0.0	
On sales	950.9	0.0		1973.7	0.0	
Other Expenses	753.8	503.7	49.7%	1314.6	908.4	44.7%
Operating profit	1827.6	2011.6	-9.1%	3933.1	3826.6	2.8%
Other Income	335.9	291.1	15.4%	453.5	417.3	8.7%
EBIDTA	2163.5	2302.7	-6.0%	4386.7	4243.9	3.4%
Interest	166.7	84.5	97.3%	337.3	123.7	172.7%
PBDT	1996.8	2218.2	-10.0%	4049.4	4120.2	-1.7%
Depreciation	537.0	687.7	-21.9%	997.6	1045.6	-4.6%
PBT	1459.8	1530.5	-4.6%	3051.8	3074.6	-0.7%
Tax	287.8	468.0	-38.5%	705.5	851.0	-17.1%
Adjusted PAT	1171.9	1062.5	10.3%	2356.8	2223.6	6.0%
Extra ordinary income	0.0	0.0		0.0	0.0	
Extra ordinary expenses	97.0	0.0		172.8	0.0	
Tax thereon	0.0	0.0		0.0	0.0	
Reported PAT	1074.9	1062.5	1.2%	2183.9	2223.6	-1.8%

Margins	Q2FY09	Q2FY08	H1FY09	H1FY08
OPMs	29.0%	43.1%	31.6%	42.9%
EBT	23.2%	32.8%	24.5%	34.5%
EAT	18.6%	22.8%	19.0%	24.9%
Tax rate	19.7%	30.6%	22.8%	27.7%

Per tonne analysis

	Q2FY09	Q2FY08	Var (%)	H1FY09	H1FY08	Var (%)
Raw Material	344	372	-7.6%	337	369	-8.7%
Stocks	82	-75		23	-65	
Employee	142	108	31.7%	141	108	30.4%
Power and fuel	918	591	55.3%	883	588	50.3%
Freight	652	442	47.3%	657	441	49.1%
Other exp	434	337	28.8%	373	313	19.4%
Total Cost per tonne	2572	1775	44.9%	2415	1755	37.7%
Realisation	3550	3122	13.7%	3533	3072	15.0%
EBIDTA	978	1346	-27.3%	1117	1318	-15.2%

Valuation and View

At current levels Shree is trading at 4.8X its FY2010 earnings and 2X its FY2010 EBIDTA. We believe that the cement industry will continue to witness a long period of muted earnings growth and deteriorating return ratios. In such a scenario the stock's valuation even attractive, is unlikely to have significant room for improvement. However after the recent market mayhem the stock might just witness a sharp technical pull back. We maintain our HOLD rating on the stock with a revised price target of Rs560. Our price target is derived as average of four valuation measure, PER, P/B, EV/EBIDTA and EV/Ton. We have valued Shree on 5X its FY2010 earnings (earnings decline of 20% in FY2010), 1.5X its FY2010 book value (ROE of 25.4% in FY2010), EV/EBIDTA of 2.5X and EV/Ton of USD 50 per ton. Our PER and EV/Ton multiple for Shree imply a 15% discount to our target multiples for Ultratech. The calculation of price target is given in the following exhibit.

Price Target	Multiple	Value Per share
PER	5	485
P/B	1.5	558
EV/EBIDTA	2.5	540
EV/Ton (USD/ton)	50	646
Average		557

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