Company

21 July 2009 | 7 pages

# UltraTech Cement (ULTC.BO)

Equity

## Sell: 1QFY10 – Very Strong Margins; But Unlikely to Sustain

- **Strong EBITDA/t in 1Q** — This was a bumper quarter for ULTC as PAT rose 58% to Rs4.2bn (13% above estimates), and EBITDA margins were 37% (vs. 30% last year) on higher realizations, strong volumes and lower costs. EBITDA/t grew 29% yoy to Rs1,350/t, substantially higher than in the past.
- **Surge in volumes** — Sales volumes (including clinker) rose 24% to 5.3m tonnes; domestic cement sales increased 17% yoy to 4.5m tonnes due to the commissioning of the 4.9mtpa Andhra Pradesh plant taking ULTC's capacity to 23mtpa. Buoyant demand also supported the growth. We forecast volume growth (including clinker) of 11% in FY10 to 20.2m tonnes.
- **Good quarter for pricing** — Strong demand trends and temporary disruptions in cement supply kept prices firm in 1Q. Average domestic realizations for ULTC rose 9% yoy and 5% qoq to Rs3,700/t. Realizations are expected to decline in coming quarters due to the substantial increase in cement capacity. Prices have already begun to decline in the South, where ULTC's new capacity has come up and which accounted for ~25% of its FY09 sales.
- **Lower power & fuel costs** — Per tonne power and fuel costs fell 20% yoy in 1Q due to (1) lower coal costs as ULTC imports ~40% of usage; (2) benefit of captive power plants, which should meet ~80% of requirements. Per tonne raw material costs rose 9% yoy (23% qoq) due to clinker purchases.
- **Maintain Sell** — While cost pressures will be less of an issue for ULTC in FY10E-11E, price declines are likely to cause margins to fall.

| Sell/Medium Risk | 3M |
|---|---|
| Price (21 Jul 09) | Rs775.70 |
| Target price | Rs500.00 |
| Expected share price return | -35.5% |
| Expected dividend yield | 0.5% |
| **Expected total return** | **-35.0%** |
| Market Cap | Rs96,564M |
| | US$2,007M |

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


**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 | 7,824 | 14,793 | 62.8 | 241% | 12.3 | 7.2 | 134 |
| FY08 | 55,092 | 10,076 | 18,199 | 80.9 | 29% | 9.6 | 6.1 | 131 |
| FY09E | 63,637 | 9,771 | 18,101 | 78.5 | -3% | 9.9 | 6.3 | 110 |
| FY10E | 68,216 | 9,434 | 18,804 | 75.8 | -3% | 10.2 | 5.7 | 99 |
| FY11E | 67,362 | 4,524 | 11,951 | 36.3 | -52% | 21.3 | 8.6 | 95 |

Source: Company Reports and Citi Investment Research and Analysis. Price as on 21 July 2009. Rs/US$ rate at 47.

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

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## 1QFY10 Results

**Figure 2. UltraTech Cement – 1QFY10 Results**

| **Rs m** | **1Q FY10** | **1Q FY09** | **% chg** |
|---|---|---|---|
| Net sales | 19,413 | 14,952 | 30% |
| Total expenses | 12,246 | 10,494 | 17% |
| **EBITDA** | **7,168** | **4,458** | **61%** |
| **EBITDA margin (%)** | **36.9%** | **29.8%** | |
| **EBITDA/tonne (Rs)** | **1,350** | **1,044** | **29%** |
| Interest | 330 | 247 | 33% |
| Depreciation | 936 | 711 | 32% |
| Other income | 342 | 266 | 29% |
| Pre-tax profit | 6,244 | 3,766 | 66% |
| Total Tax | 2,067 | 1,116 | 85% |
| Tax Rate (%) | 33.1% | 29.6% | |
| **Net profit for the period** | **4,178** | **2,650** | **58%** |
| | | | |
| **Sales Break-up** | | | |
| Clinker sales (Rs m) | 1,348 | 862 | 56% |
| Clinker tonnes sold | 0.76 | 0.38 | 100% |
| Net Realization (Rs/t) | 1,774 | 2,268 | -22% |
| | | | |
| Cement export sales (Rs m) | 256 | 200 | 28% |
| Cement exports tonnes sold (m) | 0.10 | 0.08 | 25% |
| Net Realization (Rs/t) | 2,563 | 2,497 | 3% |
| | | | |
| Cement domestic sales (Rs m) | 16,465 | 12,954 | 27% |
| Cement domestic tonnes sold (excl traded) | 4.45 | 3.81 | 17% |
| Net Realization (Rs/t) | 3,700 | 3,400 | 9% |

Source: Company Reports and Citi Investment Research and Analysis

# UltraTech Cement

## Company description

UltraTech Cement (ULTC) has a current cement capacity of 21.9m tpa which will rise to 23.1m tpa by early FY10E, 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 40m tpa in FY09, which is expected to rise to about 49m tpa during FY10E.

## Investment strategy

We rate ULTC as Sell/Medium Risk (3M) with a target price of Rs500. ULTC has benefited recently (in 4QFY09) from higher realizations and volumes and lower costs of power and fuel due to cheaper international coal and increased captive power. Prices could remain firm in the near-term, but we expect meaningful price falls as new capacity comes on stream even as demand weakens during the monsoon. Based on trends so far, we expect ULTC's cement prices to decline 2% in FY10E and by 8% in FY11E. We expect total cement and clinker volumes to grow 11% yoy in FY10E and 5% in FY11E. 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 19% in FY10E. However, this is unlikely to help compensate for the price declines we expect. We expect a yoy profit decline in FY10E-11E and that EBITDA margins fall from 27% in FY09 to 26% in FY10E and 16% in FY11E.

## Valuation

We use EV/EBITDA to value ULTC, a common metric used to value cement companies. ULTC has a short valuation history relative to other cement majors as it was only listed in August 2004, after its de-merger from L&T. We therefore base our target price on relative valuations versus majors such as Ambuja Cements. Over the past two years, ULTC has traded at a 25% discount to ACL on EV/tonne, due to its slightly lower EBITDA margin and lower liquidity. We maintain this discount of 25% to arrive at an EV/EBITDA multiple of 4.6x and applying this to our Sept-2010 earnings imputes a target price of Rs500. At our target price, ULTC would trade at an EV/tonne of US$61 and P/E of 8.9x.

## 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 0.5x) 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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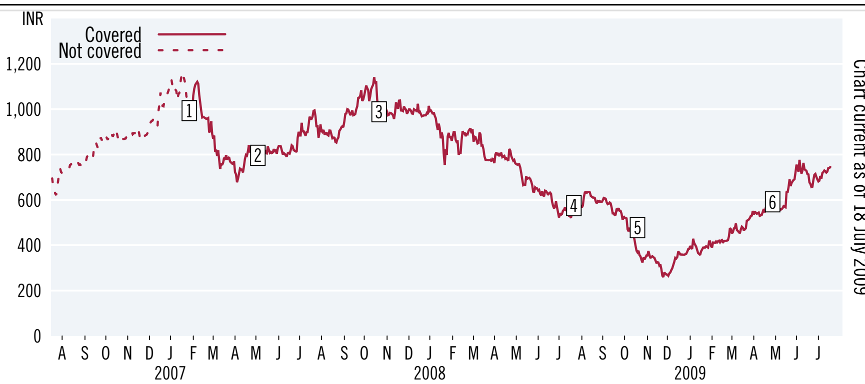
**Fundamental Research**

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 | 22-Jul-08 | 3M | *580.00 | 539.90 |
| 5 | 19-Oct-08 | 3M | *370.00 | 375.80 |
| 6 | 28-Apr-09 | 3M | *500.00 | 569.60 |

* Indicates change

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|---|---|---|---|
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