

Shree Cements

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,314	SRCM IN
	REUTERS CODE
S&P CNX: 2,829	SHCM.BO

17 January 2006

Buy

Previous Recommendation: Buy

Rs538

Equity Shares (m)	34.8
52-Week Range	554/260
1,6,12 Rel. Perf. (%)	7/26/42
M.Cap. (Rs b)	18.7
M.Cap. (US\$ b)	0.4

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/05A	5,821	1,010	29.0	240.3	18.5	5.3	37.4	21.6	3.7	12.2
03/06E	6,732	1,360	39.0	34.6	13.8	4.1	39.1	25.9	3.3	9.7
03/07E	8,554	1,728	49.6	27.1	10.8	3.3	35.8	26.7	2.7	7.6

- Results were marginally below our estimates at the operating level due to lower volumes (18-day production shutdown for repair & maintenance). Shree Cements reported EBITDA of Rs549m v/s our expectation of Rs584m.
- Revenues are up 7.4% to Rs1.4b. Net realization increased by 8.4% to Rs100.5/bag from Rs92.7/bag. Sequentially however, realization improvement of 0.6% was lower v/s our expectation of around 4%.
- Volumes stayed flat at 0.72mt v/s our expectation of 8% growth owing to substantial repair and maintenance of units 1 and 2 (18-day shutdown). The Rs112m non-recurring expense incurred on this account is expected to result in increased productivity ahead.
- Cement-clinker blending ratio increased significantly to 1.3 from 1.25, and is reflected in the lower operating cost per ton. Operating cost has reduced by Rs64/ton YoY to Rs1,246/ton — amongst the lowest in industry.
- EBITDA margin expanded 860bp YoY from 29.4% to 38%; EBITDA per ton was up by Rs219 YoY to Rs764 per ton, the highest in the industry.
- Shree Cements is among the country's lowest-cost producer in the northern region, which is going through a cyclical upturn. The stock is quoting at a PER of 13.8x FY06E and 10.8x FY07E earnings. We maintain **Buy**.

QUARTERLY PERFORMANCE

(Rs Million)

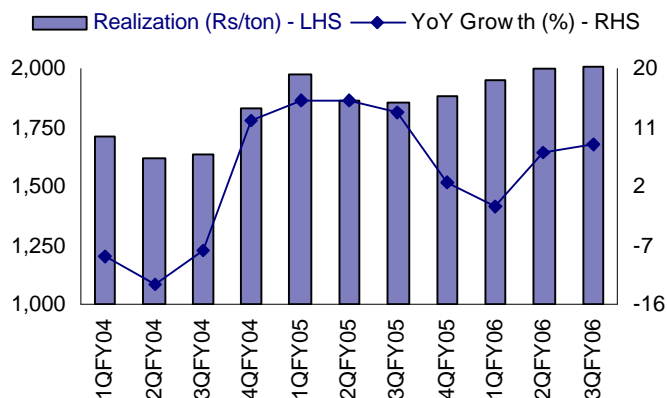
Y/E MARCH	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	1,427	1,405	1,344	1,634	1,425	1,554	1,443	2,310	5,821	6,732
YoY Change (%)	22.6	20.7	21.9	14.8	-0.1	10.6	7.4	41.4	23.0	15.7
Total Expenditure	923	1,013	949	1,158	982	1,032	894	1,531	4,055	4,440
EBITDA	504	392	395	476	443	522	549	779	1,766	2,292
Margins (%)	35.3	27.9	29.4	29.1	31.1	33.6	38.0	33.7	30.3	0.3
Depreciation	111	111	111	131	123	123	123	234	526	601
Interest	57	47	47	47	39	33	33	75	198	180
Other Income	8	13	4	15	3	8	7	13	41	30
PBT before EO Exp	344	247	241	312	284	374	400	483	1,082	1,540
Extra-Ord Expense	62	62	62	130	0	0	112	0	771	112
PBT after EO Exp	281	184	179	182	284	374	288	483	311	1,428
Tax	22	14	14	-26	24	0	3	78	24	105
Deferred Tax	0	0	0	0	0	0	0	62	-4	62
Rate (%)	7.8	7.8	7.8	-14.3	8.4	0.0	1.1	29.1	6.6	11.7
Reported PAT	259	170	165	208	260	374	285	343	291	1,261
Adj PAT	317	228	222	357	260	374	395	343	1,010	1,360
YoY Change (%)	139.7	423.0	84.5	82.3	-18.0	64.2	77.8	-4.0	240.3	34.6

E: MOST Estimates

Firm cement prices drive revenues

Revenues are up 7.4% to Rs1.4b. Higher realizations — up 8.4% to Rs100.5/bag from Rs92.7/bag drove the revenue growth. Sequentially however, realization improvement of 0.6% was lower versus our expectation of around 4%.

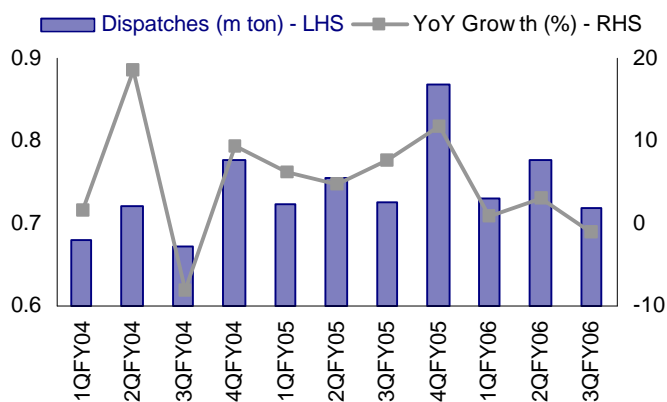
TREND IN REALIZATIONS



Source: Company/Motilal Oswal Securities

Volumes remained flat at 0.72mt against our expectation of 8% growth. This was on account of a major shutdown (18 days) for repairing and maintenance of its units 1 and 2. The company incurred a non-recurring expense of Rs112m for this purpose, which we expect will result in greater productivity ahead.

TREND IN DISPATCHES



Source: Company/Motilal Oswal Securities

Contained cost structure resulted in highest margin expansion

During 3QFY06, EBITDA moved up 39% YoY and 5% QoQ to Rs549m. The company has reported the highest EBITDA margin expansion — up 860bp to 38.0% YoY. EBITDA per ton increased by Rs219/ton to Rs764/ton.

Shree Cements has been able to post significantly higher operating margins owing to containing operating costs. Operating cost per bag declined by 4.9% YoY while most peers have witnessed double digit increases in their per ton operating costs. The company has been able to achieve this mainly on account of increasing the cement:clinker blending ratio to 1.29 from 1.25.

HIGHEST MARGIN EXPANSION IN THE SECTOR ... (RS/TON)

	2QFY06	3QFY05	YOY (%)	2QFY06	QOQ(%)
Net Realization	2,010	1,854	8.4	1,998	0.6
Raw Material Cost	209	195	7.2	237	-12.1
Staff Cost	111	74	50.4	96	15.0
Power & fuel	403	490	-17.8	391	2.8
Freight & Selling Exp	329	346	-5.0	343	-4.2
Other Exp	195	206	-5.3	259	-24.6
Total Exp	1,246	1,310	-4.9	1,327	-6.1
EBITDA	764	545	40.3	671	13.8
EBITDA Margin (%)	38.0	29.4		33.6	

Source: Company/Motilal Oswal Securities

...resulting in significant increase in recurring profit

The steep increase in operating margins and the lower interest costs resulted in PBT rising 66% to Rs400m. However, sans provisioning for tax, recurring PAT was up 77% to Rs395m.

Completion of 1.2m-ton expansion; work on another expansion started

Shree Cements has completed its first 1.2m-ton expansion. This will increase the company’s total capacity to 4.2m tons. Although production from the new plant has already started, this new unit will be capitalized from February 2006. The

company has also placed an order for plant and equipment for a further 1.2m-ton capacity expansion with a 36MW captive power plant, which will be completed by the end-June 2007.

Valuation and view

In line with our ongoing view, the northern and central regions are two regions which are going through a cyclical upturn and the current high capacity utilization may lead to short-term cement deficit in these markets. We believe that

Shree Cements — 86% of sales arising from northern India and the remainder, from central India — is '*Suitably placed*' (see our report dated 18 November 2004) to benefit from the upturn in the cement cycle. Operating cost being one of the lowest in industry, we expect the higher volumes and realizations will have a multiplier effect on earnings. At a PER of 13.8x FY06E and 10.8x FY07E earnings, the stock quotes at a significant discount to peers. We maintain **Buy** with price target of Rs596 (~12x FY07E EPS).

Shree Cements: an investment profile

Company description

Shree Cements is the largest single-location based integrated cement plant in northern India with installed capacity of 4.5 tons. It is strategically located in central Rajasthan from where it can cater to the entire Rajasthan market as well as Delhi and Haryana with economies of scale in its logistics. It is a significant player in Rajasthan (28.3% of volumes), Haryana (22.6%), Delhi (21.9%) and Punjab (12.6%). Over the years, it has established a reputation as one of the world's most efficient cement manufacturers.

Key investment arguments

- ✍ Amongst the most cost-efficient cement producers in the country
- ✍ Best positioned locationally (86% volumes from north and 14% from central India) to benefit from current tightening of demand-supply metrics and the consequent upturn in cement prices
- ✍ Best positioned to cater to demand growth, with the new 1.2m-ton integrated plant

Key investment risks

- ✍ Being a single location plant, it is dependent on the northern region; any downturn in prices in the northern market will adversely impact its profitability
- ✍ Increase in pet coke prices will impact profitability, as it uses pet coke as feedstock for its captive power plant as well as the fire kiln

Valuation and view

- ✍ Adjusted net profit is expected to grow at a CAGR of 30% during FY05-FY07E, driven by higher realizations and volume growth
- ✍ The stock trades at 13.8x FY06E PER and 10.8x FY07E PER
- ✍ We recommend **Buy** with a target price of Rs596 (~12x FY07E EPS)

Sector view

- ✍ Volume expected to grow by 8%, driven by continuous momentum in housing and infrastructure projects
- ✍ Improved demand-supply dynamics due to limited capacity addition in previous years. However greenfield capacity addition can disturb the tight demand-supply scenario envisaged by us

COMPARATIVE VALUATIONS

		SHREE CEMENT	GACL	CEMCO
P/E (x)	FY06E	13.8	21.6	37.0
	FY07E	10.8	16.9	19.3
P/BV (x)	FY06E	4.1	5.0	5.8
	FY07E	3.3	4.3	4.7
EV/Sales (x)	FY06E	3.3	3.5	2.2
	FY07E	2.7	3.0	1.9
EV/EBITDA (x)	FY06E	9.7	11.4	13.2
	FY07E	7.6	9.1	9.2

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	63.7	63.7	63.7
Domestic Institutions	11.7	12.2	9.7
FII's/FDIs	13.8	14.1	13.8
Others	10.8	10.0	12.8

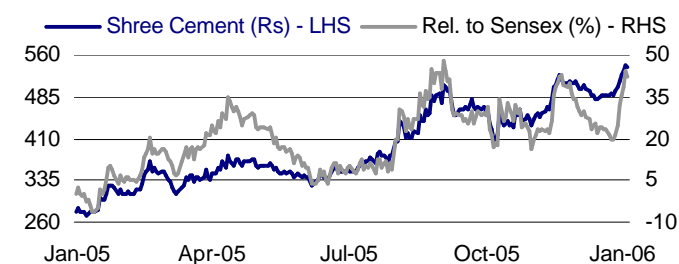
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	39.0	35.8	8.9
FY07	49.6	39.4	26.0

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
538	596	10.8	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Gross Sales	5,859	7,030	8,078	10,169	10,999	
Less: Excise Duty	1,127	1,209	1,346	1,616	1,810	
Net Sales	4,732	5,821	6,732	8,554	9,190	
Change (%)	3.9	23.0	15.7	27.1	7.4	
Total Expenditure	3,422	4,055	4,440	5,573	6,512	
% of Sales	72.3	69.7	66.0	65.2	70.9	
EBITDA	1,310	1,766	2,292	2,981	2,678	
Margin (%)	27.7	30.3	34.0	34.8	29.1	
Depreciation	457	526	601	748	700	
EBIT	853	1,240	1,690	2,233	1,978	
Int. and Finance Charges	387	198	180	239	270	
Other Income - Rec.	29	41	30	40	40	
PBT before EO Expense	494	1,082	1,540	2,033	1,748	
Extra Ordinary Expense/(Incom	277	771	112	0	0	
PBT after EO Expense	217	311	1,428	2,033	1,748	
Current Tax	17	24	105	305	232	
Tax Rate (%)	40.0	6.6	11.7	15.0	13.3	
Reported PAT	130	291	1,261	1,728	1,516	
PAT Adj for EO items	297	1,010	1,360	1,728	1,516	
Change (%)	35.6	240.3	34.6	27.1	-12.3	
Net Profit	297	1,010	1,360	1,728	1,516	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Equity Share Capital	348	348	348	348	348	
Total Reserves	3,052	3,181	4,243	5,773	7,091	
Net Worth	3,400	3,529	4,592	6,122	7,439	
Deferred Liabilities	635	631	693	836	927	
Total Loans	3,494	2,971	3,353	4,003	5,003	
Capital Employed	7,529	7,131	8,638	10,961	13,370	
Gross Block	9,874	9,875	12,660	13,160	15,660	
Less: Accum. Deprn.	3,835	5,043	5,645	6,393	7,093	
Net Fixed Assets	6,039	4,832	7,015	6,767	8,567	
Capital WIP	216	1,522	500	3,000	1,000	
Investments	8	0	0	0	0	
Curr. Assets	1,768	1,517	1,680	1,855	4,519	
Inventory	588	726	489	449	486	
Account Receivables	297	239	481	553	598	
Cash and Bank Balance	76	130	-75	16	2,530	
Others	807	421	785	837	905	
Curr. Liability & Prov.	503	739	557	662	716	
Account Payables	328	502	358	463	501	
Provisions	175	237	199	199	215	
Net Current Assets	1,265	778	1,123	1,193	3,803	
Appl. of Funds	7,529	7,131	8,638	10,961	13,370	

E: MOST Estimates

RATIOS						
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Basic (Rs)						
EPS	8.5	29.0	39.0	49.6	43.5	
Cash EPS	21.6	44.1	56.3	71.1	63.6	
BV/Share	97.6	101.3	131.8	160.7	198.5	
DPS	3.0	4.0	5.0	5.0	5.0	
Payout (%)	90.5	54.7	15.7	11.5	13.1	
Valuation (x)						
P/E		18.5	13.8	10.8	12.4	
Cash P/E		12.2	9.6	7.6	8.5	
P/BV		5.3	4.1	3.3	2.7	
EV/Sales		3.7	3.3	2.7	2.3	
EV/EBITDA		12.2	9.7	7.6	7.9	
EV/ton (US\$-Cap)		17.4	12.5	12.8	12.0	
Dividend Yield (%)		0.7	0.9	0.9	0.9	
Return Ratios (%)						
RoE	12.5	37.4	39.1	35.8	24.2	
RoCE	14.8	21.6	25.9	26.7	18.8	
Working Capital Ratios						
Asset Turnover (x)	0.6	0.8	0.8	0.8	0.7	
Debtor (Days)	19	12	22	20	20	
Inventory (Days)	45	46	26	19	19	
Working Capital Turnover (Day)	98	49	61	51	151	
Leverage Ratio (x)						
Debt/Equity	1.4	1.0	0.8	0.7	0.7	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Oper. Profit/(Loss) before Tax	1,310	1,766	2,292	2,981	2,678	
Interest/Dividends Recd.	29	41	30	40	40	
Direct Taxes Paid	-87	-21	-168	-305	-232	
(Inc)/Dec in WC	-263	541	-551	21	-96	
CF from Operations	988	2,327	1,604	2,737	2,390	
(inc)/dec in FA	-403	-1,395	-1,876	-3,000	-500	
CF from investments	-403	-1,387	-1,876	-3,000	-500	
(Inc)/Dec in Debt	-85	-527	445	792	1,092	
Interest Paid	-387	-198	-180	-239	-270	
Dividend Paid	-118	-159	-199	-199	-199	
CF from Fin. Activity	-590	-886	66	355	623	
Inc/Dec of Cash	-4	54	-206	92	2,513	
Add: Beginning Balance	81	76	130	-75	16	
Closing Balance	76	130	-75	16	2,530	



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Shree Cement

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| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |

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