



Cement earnings preview

The recent spike in cement price across the country will drive the earnings of most cement companies

We expect the cement sector as a whole to report an impressive performance for Q1FY2007 due to a 7-8% growth in the volume and a 19-20% rise in the realisation. We expect cement companies in the northern and southern regions, eg Shree Cement (north) and Madras Cement (south), to deliver a superlative performance. Amongst the cement companies in our coverage, JK Cement is expected to top the chart of earnings growth with a 273% growth in its net earnings. The contenders for the second and third slots would be Shree Cement, whose net earnings are expected to grow by 182%, and Madras Cement, whose net earnings are expected to grow by 77%, respectively. We expect the operating profit margin (OPM) of UltraTech Cement Company and ACC to expand because of cost savings and higher leverage to firm cement prices.

Following the sharp correction in the broader indices recently and the news of the government's intervention to control the cement prices, the stocks of the cement companies have witnessed a sharp correction in the last few trading sessions. The fears of an earnings downgrade as well as the overall lower valuations of the broader indices are now acting as an overhang on these stocks. However we believe the strong April-June quarter numbers and the new valuation benchmarks set by Holcim's recent acquisitions in India shall act as positive triggers for the cement stocks. We maintain our positive view on the sector with UltraTech Cement, ACC and Madras Cement as our top picks. We also like Orient Paper and JK Cement on account of their compelling valuations, which are much lower than the sector average.

Quarterly estimates (April-June 2006)

Rs crore	Sales	% yoy chg	Net profit	% yoy chg
ACC	1,276.0	15.2	213.2	63.0
Grasim	1,776.9	14.4	250.3	21.8
UltraTech	978.0	20.0	90.0	52.0
JAL	908.5	11.2	104.2	24.3
Madras Cement	288.0	33.6	32.0	77.0
Shree Cement	303.0	112.0	73.0	182.0
JK Cement	254.0	26.8	19.0	273.3

Cement sector to deliver impressive earnings growth

We expect the cement sector to report an impressive performance for the April-June quarter on account of the continued rise in cement consumption and prices. We expect most of the cement companies to register a very healthy growth of 15-20% yoy in the top line on the back of a decent 7-8% volume growth and a 19-20% realisation growth.

Companies in northern and southern regions to deliver superlative performance

Regional analysis shows that the northern region has reported the highest increase in the cement prices and the southern region has topped the chart in terms of cement dispatches. Cement prices in the northern region have risen by around 22-25% yoy. Similarly dispatches in the southern region have seen a very healthy growth of 16% yoy. Also with the assembly elections over in the southern region, the cement producers who were lagging behind in raising prices effected two price hikes during the quarter. Hence we expect the cement companies in the northern and southern regions, eg Shree Cement (north) and Madras Cement (south), to deliver a superlative performance for the first quarter.

JK Cement and Shree Cement to top earnings growth chart

Amongst the cement companies in our coverage, JK Cement is expected to top the chart of earnings growth with a 273% growth in its net earnings followed by Shree Cement with a net earnings growth of 182%. Shree Cement is likely to report a healthy volume growth owing to the commissioning of its new 1.2-million-tonne cement plant. This and the strong cement prices in the northern region are likely to lead to a staggering growth of 182% in its earnings.

Decent margin expansion for the cement majors

We expect the OPM of UltraTech Cement and ACC to expand, driven by cost savings and higher leverage to the firm cement prices. The cement division is expected to be the top performer for Grasim Industries; however lower VSF and sponge iron prices might affect the company's OPM.

Madras Cement—prime beneficiary of rising cement consumption down south

As expected, the southern region has continued with its impressive performance and consequently the dispatches in the region have grown at a healthy rate of 16% in the first two months of the current fiscal. The region has also witnessed a decent increase of 10-15% in cement prices. We expect Madras Cement to be the primary beneficiary of the buoyancy in the southern region. It should register a healthy volume growth of 23.9% year on year in Q1FY2007 on the back of a strong demand in south India. The higher volume growth, strong cement prices and lower sales tax rate (14.5% as compared to 23.5% earlier) would result in a substantial growth of 77% in its earnings.

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Cement valuation matrix

Companies	CMP (Rs)	PER		EV/EBIDTA		EV/Ton (\$ US/Ton)	
		FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
ACC	793	19.6	15.1	11.8	9.1	163.9	154.4
Grasim	1900	15.8	11.4	7.2	5.2		
UTCL	717	27.3	22.1	16.1	12.0	129.2	120.2
JP Associates	392	17.2	12.0	7.8	6.2		
Shree Cements	800	11.3	9.0	8.3	6.4	155.9	123.0
Madras Cement	2382	21.7	15.7	10.8	8.2	116.0	109.0
JK Cement	142	15.4	7.6	7.6	4.1	77.1	57.9

The author doesn't hold any investment in any of the companies mentioned in the article.

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