

Plant visit – Ground realities

Shree cement (RAS) and Grasim (Kotputli)

We recently visited the sites of Shree Cements and Grasim's (Kotputli) green-field plants. The key takeaways from our visit are i) capacity addition in the north is getting delayed for the larger players by 1-2 quarters, ii) expected production will be lower than our earlier estimates, and iii) supply will remain tight in FY 08E & FY 09E. This implies a positive pricing outlook in FY 08E & FY 09E.

Capacity addition in the north is getting delayed for the larger players by 1-2 quarters

New capacities in the northern region are getting delayed for the larger players by 1-2 quarters because of delays in civil construction and the supply of critical equipment such as high powered gear boxes for raw mills and cement mills. The shortage of skilled manpower in the civil construction companies and robust demand of high powered gear boxes globally is causing the delay. The delivery period of these gear boxes is ~20-22 months. We estimate that ~16mn MT out of the total 29.5mn MT of announced capacities in the northern region over FY 08-10E are expected to be delayed.

Expected production from new capacities will be lower than our earlier estimates on account of the delays

Due to the delay in civil construction work and the supply of critical equipment such as high powered gear boxes, the commissioning of new capacities is delayed. Earlier we had expected 39.1mn MT and 49.4mn MT of production from the effective capacities during FY 08E & FY 09E. However because of the delays the estimated production now comes to 34.5mn MT and 39.2mn MT which is 11.8% and 20.6% lower than our earlier estimates.

Figure 1: Revised estimated production in FY 08E & FY 09E

Effective production (mn MT)	FY 08E	FY 09E
Earlier estimates	39.1	49.4
New estimates	34.5	39.2
Difference	-11.8%	-20.6%

Source: Religare Institutional Equity Research

Supply will remain tight in FY 08E & FY 09E

Due to delay in commissioning of new capacities in the northern region, supply is expected to be tight in FY 08E & FY 09E. We estimate a deficit of 0.6mn MT in FY 08E and a surplus of 0.5mn MT in FY 09E. Cement demand is expected to grow at a CAGR of 10% over the period of FY 08-10E backed by housing, infrastructure and the forthcoming Commonwealth games to be held in 2010.

Prefer mid size players compared to larger ones

We continue to prefer the mid size players like Shree Cements and Mangalam Cements due to their attractive valuations and higher volume growth. The delay in the commissioning of new capacities of Grasim, Binani and Jaiprakash, augurs well for these companies. They will see strong volume growth in a positive pricing environment. We will be reviewing our call on the larger players shortly, after visiting the south based plants.

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Figure 2: Valuation Matrix

Cement	Price (Rs)	Market Cap (Rs mn)	EPS (Rs)		P/E (x)		EV/EBITDA (x)		EV/ton (USD)		EBITDA margins (%)		P/BV(x)		RoE(%)		RoCE(%)		Ratings
			FY08E	FY09E	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E	
Shree Cement*	1,235	43,020	133.6	152.6	9.2	8.1	5.9	4.0	125.8	109.4	42.4	41.9	4.5	3.0	64.1	44.3	48.4	47.5	ACC
Mangalam Cements*	163	4,606	32.8	35.6	5.0	4.6	3.0	2.2	74.9	60.6	30.0	30.7	2.0	1.4	40.2	31.6	50.5	44.3	BUY

Source: Religare Institutional Equity Research

*We will be revising our estimates upward shortly

Other highlights

Shree Cement's will enjoy a boom period due to timely commissioning of its new capacities

Shree cement's Unit-V & VI of 1.5mn MT each are expected to commission by their targeted dates of Sep'07 and Sep'08. Shree Cement's enjoys a market leadership position in Rajasthan, Delhi & Haryana. The timely commissioning of new capacities will increase Shree's market share in the northern region. Shree's move of setting up cement grinding units for Unit-V & VI at Khuskhera which is 70kms from Delhi will save ~Rs400mn on account of freight costs and will also reduce the risk of increased competition from Grasim's Kotputli plant which is 120kms from Delhi.

Grasim's Shambhupura & Kotputli plants face delays due to delay in civil construction work

Grasim's announced expansion plans of 4.4mn MT each at Shambhupura (Rajasthan) and Kotputli (Rajasthan) are facing delays due to delays in civil construction and critical equipment supplies such as raw mill gear boxes. Simplex Infrastructure is managing the civil construction work at both the locations and is facing huge turnover of skilled labour, which is causing a delay. Loesche is supplying plant and equipment to both the units and ~60% of the equipments has reached the sites whereas balance ~40% which includes critical equipments like high powered gear boxes is expected to reach the sites by Nov'07 and Feb'07.

Northern region capacity concerns are still 18 months away

With the commissioning of new capacities with a lag, we expect the favorable demand supply scenario to continue in the north in FY 08E & FY 09E which will in turn keep cement realizations firm in the region. Cement demand in north is expected to grow at a CAGR of 10% over the period of FY 08-10E backed by housing, infrastructure and construction activity for the forthcoming Commonwealth games to be held in 2010. The sustained growth in cement demand will keep capacity utilizations high in FY 08E and FY 09E. However from FY10E onwards effective production is likely to be higher than incremental demand thereby creating pressures on realizations. We expect a production surplus of 11.6mn MT in FY 10E compared to 0.5mn MT in FY 09E.

North India – Supply to remain tight in FY 08-09E

North India is the second largest of the five regions in terms of both consumption and despatches of cement in India. The northern region accounts for ~21% of the total cement production and despatches of India. Demand is expected to grow at a CAGR of 10% over the period of FY 08-10E driven by events like Commonwealth games and investments in infrastructure activities like SEZ's.

Figure 3: North India demand supply scenario

mn MT	FY05	FY06	FY07	FY08E	FY09E	FY10E
North						
Installed Capacity	27.4	30.7	32.4	38.4	53.1	61.8
Defunct Capacities	1.1	1.1	1.1	1.1	1.1	1.1
Actual Capacities	26.3	29.6	31.3	37.3	52.0	60.8
Cap growth (%)		12	6	19	39	17
Effective Capacities for production	26.3	29.6	31.3	34.6	41.4	57.9
Effective Production possible	26.7	29.7	32.1	34.5	39.2	53.8
% growth		11	8	7	13	37
% Effective utilization	101	100	103	100	95	93
Despatches	26.7	29.7	32.1	35.2	38.6	42.2
% growth		11	8	10	10	9
Domestic Consumption	24.3	27.1	29.9	33.0	36.5	40.0
% growth		12	10	10	11	10
Inflow to the region	2.8	3.1	4.0	4.0	4.0	4.0
Outflow from region	5.2	5.8	6.1	6.1	6.1	6.1
Net (Inflow)/Outflow	2.4	2.7	2.2	2.2	2.2	2.2
Cement Exports	0.0	0.0	0.0	0.0	0.0	0.0
Clinker Exports	0.0	0.0	0.1	0.1	0.1	0.1
Surplus/(Deficit)	0.0	-0.1	0.0	-0.7	0.5	11.6
Surplus/(Deficit) as a % of cap	0	0	0	-2	1	22

Source: CMA & Religare Institutional Equity Research

Note:

Effective capacities indicate the actual capacity available for production in the particular year. Outflow from the region is mainly to western and central regions

Major players

The key players in the region are Ambuja Cement (capacity of 6.4mn MT) and Shree Cements (capacity 6.0mn MT). The other majors, ACC (capacity 5.4mn MT) and JK Cement (capacity 4mn MT) also have a sizable presence in the region.

Capacity utilization will remain high due to sustained demand growth in FY 08 & 09E, but will fall in FY 10E due to higher production additions

Lag in new capacity additions will keep cement demand supply balance favorable till FY09; surplus of 11.6mn MT in FY 10E expected.

Figure 4: Capacity addition schedule in the northern region

Company	Comm. Date	Kiln Cap	C:C	mn	MT	Region	On time/delayed	Type of project	Project status
North									
Binani	Q3FY08	2.15	1.20	2.57		Rajasthan (Sirohi)	Delayed	Greenfield	Clinker production expected to start in Nov'07. Cement grinding will come in 2 phases one in Dec'07 and second in Mar'08
Grasim	Q1FY09	3.30	1.35	4.46		Rajasthan (Shambhupura)	Delayed	Brownfield	Clinker production expected to start in Apr-May'08. Cement grinding to start in Jun'08
Jaiprakash	Q4FY09	3.30	1.35	4.46		HP (Baga)	Delayed	Greenfield	Civil construction work is progressing. 60% equipment supplied by KHD Humboldt, lying half way to plant site
Grasim	Q4FY09	3.30	1.35	4.46		Rajasthan (Kotputli)	Delayed	Greenfield	Delay in civil construction work due to shortage of skilled manpower. Clinker production expected to start in Aug-Sep'08. Cement grinding unit will come in 2 phases one in Sep'08 and second in Nov'08. 60% of equipment is supplied. High powered gear boxes expected to reach by Dec'07
Sub total		12.05		15.94					

Company	Comm. Date	Kiln Cap	C:C	mn	MT	Region	On time/delayed	Type of project	Project status
North									
ACC	Q1FY08	0.70	1.35	0.95		Rajasthan (Lakheri)	On time	De-bottlenecking	Commissioned
Shree Cement (V)	Q3FY08	0.99	1.35	1.34		Rajasthan (Ras)	On time	Greenfield	Clinker & cement production expected to start in Sep'07. Cement grinding unit in Khushkhera which is 70kms from Delhi.
Mangalam Cement	Q3FY08			0.50		Rajasthan (Morak)	On time	De-bottlenecking	Expected to be commissioned by Oct'07
Ambuja Cements	Q3FY08	0.50	1.35	0.68		Rajasthan (Rabriyawas)	On time	De-bottlenecking	Up-gradation of pre stage heater. Expected to commission by Sep'07
Shree Cement (VI)	Q3FY09	0.99	1.35	1.34		Rajasthan (Ras)	On time	Greenfield	Pre stage heater construction started. Clinker & cement production expected to start from Sep'08
Ambuja Cements	Q1FY10	2.31	1.35	3.12		HP (Rauri)	On time	Greenfield	Raw Mill order placed with Pfeiffer India in May'07, Plant equipment orders placed with Polysius in May'07
Lafarge India	Q1FY10	2.18	1.35	2.94		HP (Alsindi)	On time	Greenfield	Order placed with Chinese Equipment Supplier Sinoma.
Jaiprakash	Q2FY10	1.98	1.35	2.67		HP (Chamba)	On time	Greenfield	Raw Mill order placed with Pfeiffer India in 2007
Sub total		9.65		13.52					
Total		21.69		29.46					

Source: Company & Religare Institutional Equity Research

All the larger capacity plants which together make up 15.94mn MT of capacity are delayed by 1-2 quarters. This is ~54% of the total announced capacity for FY 08E – FY 10E.

Figure 5: Comparison of production estimates (FY 08E)

Earlier Estimates mn MT	FY 08E		New Estimates mn MT	FY 08E		Reasons
	Capacity	Production		Capacity	Production	
Opening Installed Capacity	36.9	38.3	Opening Installed Capacity	32.4	32.9	
Shree (V)	1.3	0.6	ACC	1.0	0.6	Delayed by 1 quarter
Mangalam Cement	0.5	0.2	Binani	2.6	0.3	Delayed by 2 quarter
Total	38.7	39.1	Shree (V)	1.3	0.6	On time
			Mangalam Cement	0.5	0.1	Delayed by 1 month
			Ambuja Cements	0.7	0.1	On time
			Total	38.4	34.5	

Source: Company & Religare Institutional Equity Research

Figure 6: Comparison of production estimates (FY 09E)

Earlier Estimates mn MT	FY 09E		New Estimates mn MT	FY 09E		Reasons
	Capacity	Production		Capacity	Production	
Opening Installed Capacity	38.7	42.2	Opening Installed Capacity	38.4	35.9	
Grasim (Shambhupura)	4.1	3.5	Grasim (Shambhupura)	4.5	2.2	Delayed by 1 quarter
Shree (G)	1.8	1.5	Jaiprakash (Baga)	4.5	0.2	Delayed by 2 quarter
Jaiprakash (Baga)	4.5	1.3	Shree VI	1.3	0.4	On time
Shree VI	1.3	0.4	Grasim (Kotputli)	4.5	0.5	Delayed by 1 quarter
Grasim (Kotputli)	4.1	0.6	Total	53.1	39.2	
Total	54.5	49.4				

Source: Company & Religare Institutional Equity Research

Figure 7: Summary of project status

Projects on time	Projects delayed	Plants to be commissioned in FY 10E & equipments order placed
Shree Cement Line (V)	Binani (Rajasthan, Sirohi)	Ambuja Cements (HP Rauri)
Mangalam Cement (Morak)	Grasim (Shambhupura)	Lafarge India (HP Alsindi)
Ambuja Cements (Rabriyawas)	Grasim (Kotputli)	Jaiprakash (HP Chamba)
Shree Cement Line (VI)	Jaiprakash (Baga)	

Source: Company & Religare Institutional Equity Research

Inter regional movement of cement from northern region

Inter regional movement of cement in a particular region reveals the inflow and outflow of cement and the captive consumption of the region. The data reveals that the north is a net exporter of cement to the central and western regions and the south is a net exporter of cement to the western region. New capacities in the north and south could therefore affect prices in the central and western markets.

Inter regional movement of cement helps understand how supplies from other regions can affect the parent market

Figure 8: Inter regional movement of cement Apr-Jul 2007-2008

Inter Regional Movement of Cement 2007-2008 (Apr-Jul)						
Regions (mn MT)	North	East	South	West	Central	Total
North	9.3	0.0	0.0	0.8	1.4	11.5
<i>% captive consumption in region</i>	<i>80.7</i>	<i>0.0</i>	<i>0.0</i>	<i>6.7</i>	<i>12.5</i>	
East	0.1	7.6	0.0	0.0	0.2	7.9
<i>% captive consumption in region</i>	<i>0.6</i>	<i>96.4</i>	<i>0.1</i>	<i>0.4</i>	<i>2.4</i>	
South	0.0	0.1	15.8	1.9	0.0	17.9
<i>% captive consumption in region</i>	<i>0.0</i>	<i>0.8</i>	<i>88.5</i>	<i>10.6</i>	<i>0.1</i>	
West	0.0	0.0	0.4	7.8	0.1	8.3
<i>% captive consumption in region</i>	<i>0.0</i>	<i>0.4</i>	<i>4.3</i>	<i>93.5</i>	<i>1.8</i>	
Central	1.2	0.8	0.0	0.0	6.0	8.0
<i>% captive consumption in region</i>	<i>14.5</i>	<i>9.9</i>	<i>0.0</i>	<i>0.2</i>	<i>75.4</i>	
Total	10.5	8.6	16.2	10.5	7.8	53.6

Source: CMA & Religare Institutional Equity Research

Figure 9: Inter regional movement of cement Apr-Mar 2006-2007

Inter Regional Movement of Cement 2006-2007 (Apr-Mar)						
Regions (mn MT)	North	East	South	West	Central	Total
North	25.9	0.0	0.0	2.1	4.1	32.0
<i>% captive consumption in region</i>	<i>80.8</i>	<i>0.0</i>	<i>0.0</i>	<i>6.5</i>	<i>12.7</i>	
East	0.1	21.0	0.0	0.1	0.7	22.0
<i>% captive consumption in region</i>	<i>0.6</i>	<i>95.4</i>	<i>0.1</i>	<i>0.6</i>	<i>3.3</i>	
South	0.0	0.5	43.3	5.7	0.1	49.5
<i>% captive consumption in region</i>	<i>0.0</i>	<i>0.9</i>	<i>87.4</i>	<i>11.5</i>	<i>0.1</i>	
West	0.0	0.1	1.1	20.3	0.6	22.2
<i>% captive consumption in region</i>	<i>0.1</i>	<i>0.6</i>	<i>5.2</i>	<i>91.5</i>	<i>2.6</i>	
Central	3.8	2.4	0.0	0.0	17.0	23.3
<i>% captive consumption in region</i>	<i>16.5</i>	<i>10.5</i>	<i>0.0</i>	<i>0.0</i>	<i>73.0</i>	
Total	29.9	24.0	44.4	28.3	22.4	149.0

Source: CMA & Religare Institutional Equity Research

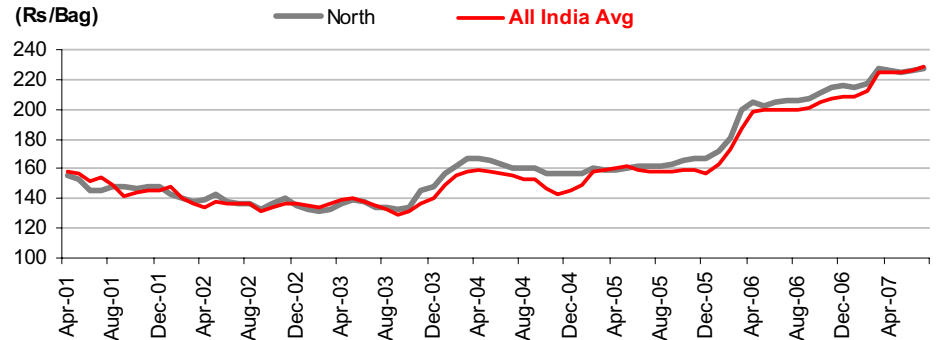
Price trend in the northern region

Cement prices in the northern region has been on an uptrend in the last 2-3 years. Based on our estimates and after considering production from newer capacities and inter regional movement, the northern region demand supply scenario looks tight in FY 08E and FY 09E respectively. This will keep cement prices firm across the northern region in FY 08E and FY 09E. However, with new capacities fully operational in FY 10E, there will be pressure on prices.

Northern region cement prices has been on an uptrend in the 2-3 years accounts for 21% of India's domestic cement consumption

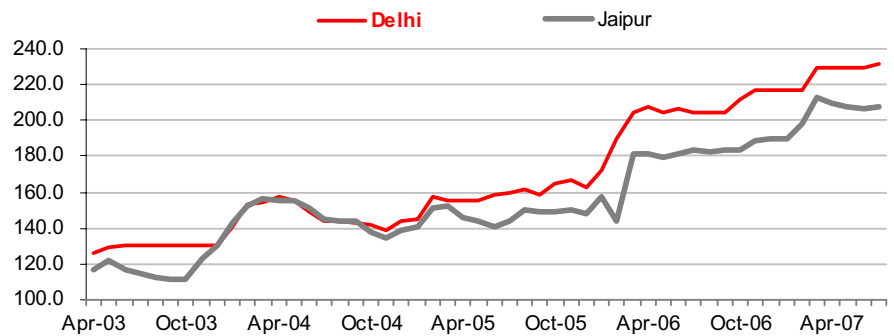
Lag in commissioning of new capacities due to delay in civil construction works and critical equipment supplies will keep cement prices firm in FY09E

Figure 10: Cement price trend in the northern region



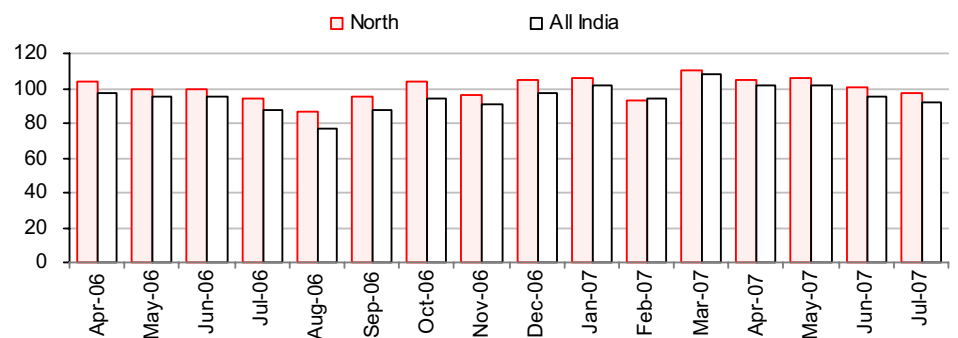
Source: Industry & Religare Institutional Equity Research

Figure 11: Price trend in the main markets of northern region



Source: Industry & Religare Institutional Equity Research

Figure 12: Capacity utilization trend in northern region



Source: CMA & Religare Institutional Equity Research

Capacity utilization level in the northern region is highest in the industry. Sustained demand growth will keep effective utilization rates at above 90% levels in spite of additions of new capacities

Risks to our call

- Cement imports from Pakistan are likely after the government's directive to MMTC (Minerals & Metals Trading Corp) to import cement even where BIS (Bureau of Indian Standards) approval is pending. However, inadequate port facilities could restrain large imports and thereby limits the risks/threats to the sector in a big way.
- If demand growth is lower than 10% in the region, the production surplus will be higher.

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