

Earnings disappoint. Valuations remain attractive

August 17, 2010

ACCUMULATE

Price	Target Price
Rs1,805	Rs 2,200
Sensex	18,051

Price Performance

(%)	1M	3M	6M	12M
Absolute	(7)	(14)	(8)	16
Rel. to Sensex	(7)	(19)	(18)	(1)

Source: Bloomberg

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	2,542/1,372
Market Cap (Rs bn/USD mn)	63/1,345
Daily Avg Volume (No of sh)	24971
Daily Avg Turnover (US\$m)	1.0

Shareholding Pattern (%)

	Jun-10	Mar-10	Dec-09
Promoters	65.5	65.6	65.6
FII/NRI	16.0	15.8	15.1
Institutions	8.3	8.8	9.4
Private Corp	5.6	5.2	5.3
Public	4.6	4.6	4.7

Source: Capitaline

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- Shree Cement (Shree) Q1FY11 net profit at Rs1.05 bn below estimates led by lower than expected realisations & higher than expected P&F cost
- Revenues at Rs9.4 bn up 2.4% yoy, driven by 2.5 X increase in power revenues - led by addition of 100 MW of power capacity in Q4FY10. Cement revenues declined 8.1% yoy
- EBITDA at Rs 2.9 bn (our est Rs3.4 bn) decline by 32% led by lower realisations and higher P&F cost. Cut FY11E EBITDA by 4.1% on higher cost, EPS by 15% on higher depreciation
- Stock price correction provides opportunity to play Shree's superior strategy of utilizing cement cash flows for lucrative /high growth power business. ACCUMULATE – Target Rs2200

Revenue up 2.4 % yoy- 8.1% decline in cement revenues

Revenues for the quarter at Rs9.44 bn grew at a muted pace of 2.4% yoy, as 8.1% decline in cement revenues (Rs8.13 bn), was arrested by a sharp 2.6X jump in external power sales (Rs1.3 bn). Cement revenues decline of 8.1% was led by 2.8% decline in volumes (2.49 mt) and 5.5% decline in blended cement realisation (Rs3274/t). Though sequentially realisations declined 1.4%, Naked cement realisation (NCR-cement realisations ex freight on sales) improved by 0.6% qoq to Rs2707/t. Overall cement revenues came in below estimates on account of lower than expected cement realisations (Rs3274 v/s est of Rs3430/t).

... 2.6X jump in power sales

Driven by addition of 100 MW in Q4FY10, Shree's power revenues (external sales) at Rs1.3 bn grew 2.6X. However the revenues also include revenues from power trading. Excluding power trading revenues of Rs482 mn, power revenues at Rs825 mn, grew 126%, driven by 169% growth in volumes (142.6 mn units). Power realisation (ex power trading) declined 16% yoy & 16.7% qoq.

Steep increase in power cost drags EBITDA down by 32%

The dismal revenue growth, coupled with severe cost pressure (total cost /t @ Rs2272/t up 19% yoy , 7.9% qoq) dragged aggregate EBITDA to Rs2.9 bn (our est- Rs3.4 bn) down by 32% yoy. EBITDA margins at 30.6% declined by 1551 bps yoy & 715 bps qoq, while EBITDA/t at Rs1003 declined 35.6% yoy & 17.6% qoq. Key cost trends visible during the quarter were

- P&F cost @ Rs742/t – up 44.2% yoy 28.4% qoq – led by sharp increase in pet coke & fuel price
- RM cost @ Rs373/t increased 35.9% yoy 18.7% yoy
- Employee cost up 35.8% yoy 17.2% qoq, Other exp up 37% , 12% qoq
- The only silver lining was the freight cost, which @ Rs717/t (inclusive of clinker transfer cost) declined 0.5% yoy and 6% qoq, even after increase in diesel prices. The decline in freight charges is led by lower lead distance which is clearly visible in NCR (NCR up qoq even after realisation showing decline).

Financial Snapshot

YE-	Net	EBITDA		EPS	EPS	RoE		EV/	EV/	
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA	Tonne
FY09	27,106	9,508	35.1	6,089	174.8	103.5	50.3	10.3	6.8	149.9
FY10	36,321	14,919	41.1	7,395	212.3	21.5	40.3	8.5	4.3	124.4
FY11E	40,995	13,275	32.4	5,715	164.1	-22.7	24.5	11.0	4.6	82.1
FY12E	49,449	15,140	30.6	6,906	198.2	20.8	23.4	9.1	3.7	67.5

Sharp increase in depreciation & interest cost drag net profit down by 63.8%

With commissioning of 3 mtpa grinding capacity and 100 MW of power plants in Q4FY10, Shree's depreciation charge jumped 55.1% yoy to Rs1.5 bn, higher than estimates (Rs1.35 bn). Similarly interest expenses increased 163% yoy to Rs430 (Our est Rs190 mn). Consequently net profit at Rs1.05 bn for the quarter declined by 63.8% yoy.

Result Tables

Y/E, Mar (Rs. mn)	Q1FY10A	Q2FY10A	Q3FY10	Q4FY10	Q1FY11	YoY (%)	QoQ (%)
Net Sales	9,224	8,996	8,660	9,440	9,445	2.4	0.1
Total Expenditure	4,966	4,914	5,308	5,871	6,550	31.9	11.6
<i>as % of sales</i>	<i>54%</i>	<i>55%</i>	<i>61%</i>	<i>62%</i>	<i>69%</i>		
Consumption of RM	702	823	871	842	927	32.2	10.1
<i>as % of sales</i>	<i>8%</i>	<i>9%</i>	<i>10%</i>	<i>9%</i>	<i>10%</i>		
Stock Adjustment	-9	-225	65	-29	-299	3373.2	935.5
<i>as % of sales</i>	<i>0%</i>	<i>-2%</i>	<i>1%</i>	<i>0%</i>	<i>-3%</i>		
Purchase of traded goods	22	26	22	22	484	2132.1	2096.8
<i>as % of sales</i>	<i>0%</i>	<i>0%</i>	<i>0%</i>	<i>0%</i>	<i>5%</i>		
Employee Cost	352	362	373	408	478	35.8	17.2
<i>as % of sales</i>	<i>4%</i>	<i>4%</i>	<i>4%</i>	<i>4%</i>	<i>5%</i>		
Power, Oil & Fuel	1,399	1,361	1,566	1,779	2,274	62.5	27.8
<i>as % of sales</i>	<i>15%</i>	<i>15%</i>	<i>18%</i>	<i>19%</i>	<i>24%</i>		
Freight expenses	1,842	1,787	1,732	2,043	1,783	-3.2	-12.7
<i>as % of sales</i>	<i>20%</i>	<i>20%</i>	<i>20%</i>	<i>22%</i>	<i>19%</i>		
Other expenditure	659	781	678	807	903	37.0	12.0
<i>as % of sales</i>	<i>7%</i>	<i>9%</i>	<i>8%</i>	<i>9%</i>	<i>10%</i>		
EBIDTA	4,258	4,082	3,353	3,569	2,895	-32.0	-18.9
Depreciation	973	998	947	2,786	1,509	55.1	-45.8
EBIT	3,285	3,084	2,405	783	1,386	-57.8	77.1
Other Income	473	316	160	54	287	-39.4	427.2
Interest	160	155	115	163	420	163.0	157.5
PBT	3,599	3,245	2,451	674	1,253	-65.2	85.9
Total Tax	645	326	762	185	185	-71.4	0.2
Adjusted PAT	2,953	2,918	1,689	489	1,068	-63.8	118.2
(Profit)/loss from JV's/Ass/MI							
APAT after MI	2,953	2,918	1,689	489	1,068	-63.8	118.2
Extra ordinary items	42	29	14	1,203	9	-79.7	-99.3
Reported PAT	2,911	2,889	1,674	-714	1,059	-63.6	-248.5
Reported EPS	83.6	82.9	48.1	10.8	30.4	-63.6	180.7

Margins (%)						(bps)	(bps)
EBIDTA	46.2%	45.4%	38.7%	37.8%	30.6%	-1,551	-715
EBIT	35.6%	34.3%	27.8%	8.3%	14.7%	-2,094	639
EBT	39.0%	36.1%	28.3%	7.1%	13.3%	-2,575	612
PAT	32.0%	32.4%	19.5%	5.2%	11.3%	-2,071	612
Effective Tax rate	17.9%	10.1%	31.1%	27.4%	14.8%	-318	-1,263

Segmental Results

Revenue	Q1FY10A	Q2FY10A	Q3FY10	Q4FY10	Q1FY11	YoY (%)	QoQ (%)
Cement	8,860	8,560	8,232	8,900	8,138	-8.1	-8.6
Power	1,657	1,585	1,600	1,476	2,576	55.5	74.5
Total revenues	10,516	10,145	9,832	10,376	10,714	1.9	3.3
Less: Inter segment revenue	1,292	1,149	1,171	935	1,269	-1.8	35.7
Net segment revenue	9,224	8,996	8,660	9,440	9,445	2.4	0.1
Net power revenues	365	436	428	541	1,307	258.3	141.8

EBIT							
Cement	2,010	2,418	1,324	534	802	-60.1	50.2
Power	1,269	768	1,082	-54	585	-53.9	-1184.2
EBIT	3,279	3,185	2,406	480	1,387	-57.7	188.9

EBIT margin							
Cement	22.7%	28.2%	16.1%	6.0%	9.9%	-12.8	3.9
Power	76.6%	48.5%	67.6%	-3.7%	22.7%	-53.9	26.4

Per tonne analysis

Rs/t	Q1FY10A	Q2FY10A	Q3FY10	Q4FY10	Q1FY11	YoY (%)	QoQ (%)
Cement Sales (mn t)	2.56	2.48	2.56	2.68	2.49	-2.8	-7.3
Raw Material	274	332	340	314	373	35.9	18.7
Stocks	-3	-90	26	-11	-120	3471.9	1016.6
Purchase of trade goods*	8	10	9	8	4		
Employee	138	146	146	152	192	39.7	26.4
Power and fuel*	514	502	557	578	742	44.2	28.4
Freight expenses	721	720	676	762	717	-0.5	-5.9
Freight on interunit clinker	113	142	129	132	149	32.2	13.0
Freight & Selling Expenses	607	578	547	630	568	-6.5	-9.9
Other exp	258	314	265	301	363	40.9	20.8
Total Cost per tonne	1910	1933	2018	2105	2272	19.0	7.9
Realisation	3466	3449	3213	3321	3274	-5.5	-1.4
EBIDTA	1556	1516	1195	1216	1003	-35.6	-17.6
Naked cement realisation	2859	2871	2666	2691	2707	-5.3	0.6

Source: Company, Emkay Research

*Note: 1) purchase of goods excludes Rs 473 mn of cost on power trading.2) Excludes cost of power on external sales

Power segment analysis

Power	Q1FY10A	Q2FY10A	Q3FY10	Q4FY10	Q1FY11	YoY (%)	QoQ (%)
Sales	365	436	428	541	825	126.1	52.6
Realisation	6.9	6.9	6.1	6.9	5.8	-16.0	-16.7
EBITDA	280	320	290	310	394	40.8	27.2
EBITDA/unit	5.3	5.0	4.2	4.0	2.8	-47.7	-30.6
EBIDTA margin (%)	76.7	73.4	67.7	57.3	47.8	-28.9	-9.5

Source: Company

Capex update

55 MW thermal power plant commissioned in Q1FY11

During the quarter Shree commissioned 55 MW Thermal power plant at Rajasthan taking its power capacity to 265 MW, out of which approximately 100 MW would be used for captive consumption in FY2011 and the balance will be available for sale. Consequently we expect Shree to generate power revenues of almost Rs5 bn, reporting a growth of 180% yoy.

Cement capacity to jump to 13.5 mtpa by Q3FY11

Work on 1.5 mtpa grinding unit at Jaipur and 1 mtpa clinker capacity at Ras is progressing as per schedule and is expected to be completed by Q3FY11. Post this expansion Shree's cement capacity will jump to 13.5 mtpa.

Execution on 2x 150 MW TPP on track

Shree's third phase (first & second phase of 150 mw mentioned earlier), of setting up power plants with capacity of 300MW (150 MW X2) at a capex of Rs12 bn is on track for commissioning by June 2011. Post the completion of this project Shree' total power capacity will reach to 565 MW, out of this will 115 mw be used for the self consumption and the rest will be available for sale. With lucrative return ratios and attractive pay back period we believe, Shree's entry in to power business is extremely value accretive and expect the business to generate significant cash flows for the company.

Downgrade FY11E/12E earnings by 15%/4.5%

On account of higher than expected P&F cost & lower than expected cement realisations, we have cut our EBIDTA estimates by 4.1% for FY11 & 7.9% for FY12. On account of higher than expected depreciation we have cut our EPS by 15% for FY11 & 4.5% for FY12. In order to factor in the earnings downgrade we lower our target to Rs2200 (Earlier Rs2354). We have valued Shree's cement business at average of USD 100 EV/ton and EV/EBIDTA multiple of 6X for FY11 numbers, which gives us value of Rs1900/share. We have valued Shree's power business at 5X EV/EBIDTA for FY11 numbers, which gives us value of Rs299/share. We have not valued earnings of the 300 MW power plant that Shree will commission by Q1/Q2FY12.

	FY11			FY12		
	Earlier	Revised	change	Earlier	Revised	change
Sales	41323	40995	-0.8%	50400	49449	-1.9%
EBIDTA	13836	13275	-4.1%	16446	15140	-7.9%
EBIDTA (%)	33.5	32.4		32.6	30.6	
Net Profit	6727	5715	-15.0%	7231	6906	-4.5%
EPS	193	164	-15.0%	208	198	-4.5%

Price correction provides good entry point-Maintain ACCUMULATE

Though the Q1FY11 numbers have been disappointing (led by lower than expected cement prices), Shree's recent power capacity addition is expected to provide the company with enough ammunition to protect its profitability from expected FY11 downturn in cement price. Further the expected recovery in cement price in H2FY12 coupled with 300 MW of power capacity addition, is likely to fuel Shree's earnings growth in FY12. At current levels the stock is trading at 11X earnings, and EV/ton of USD 82 (Adjusted for value of power business at 5X EV/EBIDTA) for FY11 numbers. We see the stock price correction as an opportunity to play Shree's superior strategy of utilizing cement cash flows for lucrative high growth power business. ACCUMULATE – Target Rs2200.

Financials

Income Statement

Y/E, Mar (Rs. m)	FY09	FY10	FY11E	FY12E
Net Sales	27,106	36,321	40,995	49,449
Growth (%)	28.5	34.0	12.9	20.6
Total Expenditure	17,643	21,504	27,720	34,310
Raw Materials Cost	2,461	3,238	3,906	4,485
Employee costs	1,039	1,586	1,824	2,006
Power & Fuel cost	6,058	6,105	10,724	15,152
Freight	4,294	5,889	6,550	7,461
Others	3,790	4,687	4,717	5,205
EBIDTA	9,508	14,919	13,275	15,140
Growth (%)	10.2	56.9	-11.0	14.0
EBIDTA %	35.1	41.1	32.4	30.6
Depreciation	2,054	5,704	6,005	6,481
EBIT	7,453.8	9,214.6	7,270.0	8,658.3
EBIT margin (%)	27.5	25.4	17.7	17.5
Other income	829	1,284	1,218	1,458
Interest	744	1,185	1,344	1,484
EBT	7,538	9,314	7,144	8,632
Tax	1,449	1,918	1,429	1,726
Effective tax rate (%)	19.2	20.6	20.0	20.0
Adj PAT	6,089	7,395	5,715	6,906
Growth (%)	103.5	21.5	-22.7	20.8
Net Margin (%)	22.5	20.4	13.9	14.0
(Profit)/loss from JV's/Ass/MI				
Adjusted PAT After JVs/Ass/MI	6,089	7,395	5,715	6,906
Extra-ordinary	309	635	198	198
Reported PAT	5780	6761	5518	6708
Growth (%)	122.0	17.0	-18.4	21.6

Cash Flow

Y/E, Mar (Rs. m)	FY09	FY10	FY11E	FY12E
PBT (Ex-Other income)	7,538	9,314	7,144	8,632
Depreciation	2,054	5,704	6,005	6,481
Interest Provided	744	1,185	1,344	1,484
Other Non-Cash items				
Chg in working cap	-1,258	812	-1,385	-232
Tax paid	1,449	1,918	1,429	1,726
Operating Cashflow	6,576	13,277	10,137	12,958
Capital expenditure	-5,296	-11,834	-7,155	-6,371
Free Cash Flow	2,934	7,543	1,732	5,337
Other income	829	1,284	1,218	1,458
Investments	-2,538	-7,474	0	0
Investing Cashflow	-7,834	-19,308	-7,155	-6,371
Equity Capital Raised	0	10	0	0
Loans Taken / (Repaid)	1,655	6,101	-1,250	-1,250
Interest Paid				1,484
Dividend paid (incl tax)	-408	-529	-529	-529
Income from investments				
Others				
Financing Cashflow	1,247	5,582	-1,779	-295
Net chg in cash	-12	-449	1,204	4,808
Opening cash position	4,674	4,723	4,164	5,367
Closing cash position	4,723	4,164	5,367	10,175

Balance Sheet

Y/E, Mar (Rs. m)	FY09	FY10	FY11E	FY12E
Equity share capital	348	348	348	348
Reserves & surplus	11,752	17,984	22,973	29,152
Net worth	12,100	18,332	23,321	29,501
Minority Interest				
Secured Loans	12,205	17,885	16,635	15,385
Unsecured Loans	2,756	3,177	3,177	3,177
Loan Funds	14,962	21,062	19,812	18,562
Net Deferred Taxes	104	124	124	124
Total Liabilities	26,958	39,270	43,009	47,939
Gross Block	22,560	29,509	37,209	49,209
Less: Acc Depreciation	16,291	21,989	27,994	34,475
Net block	6,269	7,520	9,215	14,734
Capital WIP	4,789	9,674	9,129	3,500
Investment	8,448	15,922	15,922	15,922
Current Assets	14,294	15,822	18,797	24,879
Inventories	1,545	3,581	4,493	5,419
Sundry Debtors	583	824	1,685	2,032
Cash and Bank	4,723	4,164	5,367	10,175
Loans and Advances	7,368	7,140	7,140	7,140
Other current assets	75.52	112.784	112.784	112.784
Current Liab & Prov	6,842	9,666	10,053	11,095
Current liabilities	2,900	4,667	5,054	6,096
Provisions	3,942	4,999	4,999	4,999
Net current assets	7,452	6,156	8,744	13,784
Miscellaneous Exps	0	0	0	0
Total Assets	26,958	39,270	43,009	47,939

Key Ratios

Y/E, Mar	FY09	FY10	FY11E	FY12E
Profitability (%)				
EBITDA Margin	35.1	41.1	32.4	30.6
Net Margin	22.5	20.4	13.9	14.0
ROCE	35.4	31.7	20.6	22.2
ROE	50.3	40.3	24.5	23.4
RoIC	91.6	113.4	76.8	65.4
Per Share Data (Rs)				
EPS	174.8	212.3	164.1	198.2
CEPS	224.9	357.8	330.7	378.6
BVPS	347.3	526.2	669.4	846.8
DPS	10.0	13.0	13.0	13.0
Valuations (x)				
PER	10.3	8.5	11.0	9.1
P/CEPS	8.0	5.0	5.5	4.8
P/BV	5.2	3.4	2.7	2.1
EV / Sales	2.4	1.8	1.5	1.1
EV / EBITDA	6.8	4.3	4.6	3.7
Dividend Yield (%)	0.6	0.7	0.7	0.7
Gearing Ratio (x)				
Net Debt/ Equity	0.8	0.9	0.6	0.3
Net Debt/EBIDTA	1.1	1.1	1.1	0.6
Working Cap Cycle (days)	-10	-3	10	10

Recommendation History: Shree Cement – SRCM IN

Date	Reports	Reco	CMP	Target
24.05.2010	Shree Cement Q4FY2010 Result Update	Accumulate	1,990	2,354
22.01.2010	Shree Cement Q3FY2010 Result Update	Buy	2,109	2,290
29.10.2009	Shree Cement Q2FY2010 Result Update	Buy	1,574	1,904
28.07.2009	Shree Cement Q1FY2010 Result Update	Buy	1,540	1,650

Recent Research Reports

Date	Reports	Reco	CMP	Target
12.08.2010	Great Offshore Q1FY11 Result Update	Accumulate	406	506
10.08.2010	IVRCL Infrastructure Q1FY11 Result Update	Hold	170	185
03.08.2010	Madras Cements Q1FY11 Result Update	Reduce	100	101
02.08.2010	India Cements Q1FY11 Result Update	Sell	105	98

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