Ultratech Cement Ltd - SELL

CMP Rs756, Target Rs640

Sector: Cement	
Sensex:	16,677
CMP (Rs):	756
Target price (Rs):	640
Downside (%):	15.3
52 Week h/l (Rs):	850 / 250
Market cap (Rscr) :	9,083
6m Avg vol ('000Nos):	262
No of o/s shares (mn):	124
FV (Rs):	10
Bloomberg code:	UTCEM IB
Reuters code:	ULTC.BO
BSE code:	532538
NSE code:	ULTRACEMCO

Prices as on 16 Sept, 2009.

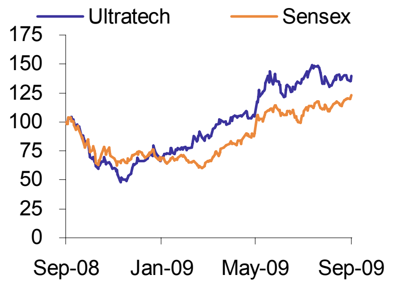
Shareholding pattern

June '09	(%)
Promoters	54.8
Institutions	11.2
Non-promoter corp hold	17.6
Public & others	16.4

Performance rel. to sensex

(%)	1m	3m	1yr
Ultratech	(6.9)	(5.5)	15.9
India Cement	(13.0)	(31.1)	(29.4)
ACC	(12.2)	(17.5)	16.3
Ambuja Cement	(8.9)	(9.9)	7.3

Share price trend



Faces pricing pressure in key markets

Cement players have enjoyed a strong pricing environment (with 10-30% hike in some regions) over the past six months. Acceleration in government related construction projects and rural housing demand were the key drivers of this robust phase. However, we believe the current cyclical upturn in prices is on its last legs as a medium term supply glut looms. Our dealer checks indicates prices have corrected by ~3-10% (Rs5-20 per bag) in most parts of Southern and Western India in the second half of Aug' 09. Dealers in North, Eastern and Central India also alluded to price cuts in the range of Rs3-5/bag.

Ultratech FY11 revenues to decline 3-5%

With the commissioning of 4.9mtpa capacity in Q1 FY10, the Southern region now accounts for 35% of Ultratech's capacity. Lower capacity utilization (88% in FY11 versus 95% in FY09) would limit volume growth to about 1% next year. Also, prices in South are likely to decline much more than our earlier expectation of 5-10%. A combination of muted volume growth and lower prices would lead to revenue decline of ~3-5% yoy in the next fiscal. We have factored in up to 6% fall in FY11 realization.

Margin to decline ~410bps over FY09-11

Over the FY09-11 period, we expect margin decline of ~410bps on account of lower cement realizations. We incorporate a 5-10% hike in coal prices next year based on expected price hike by Coal India. On the other hand, higher captive power utilization would partly negate an increase in fuel cost. Moreover, if the company absorbs the impact of any partial or complete roll back of excise duty cut, this could dampen net realizations.

Valuations appear expensive; downgrade to SELL

Ultratech compounded earnings are estimated to decline 11.3% over FY09-11, on margin squeeze and revenue degrowth. Moreover, return ratios are lower as compared to 20-24% for Ambuja and ACC. The stock appears expensive at 12.4x FY11 earnings considering the pricing pressure in key markets and lower capacity utilization. We downgrade Ultratech to SELL with a target price of Rs640.

Valuation summary

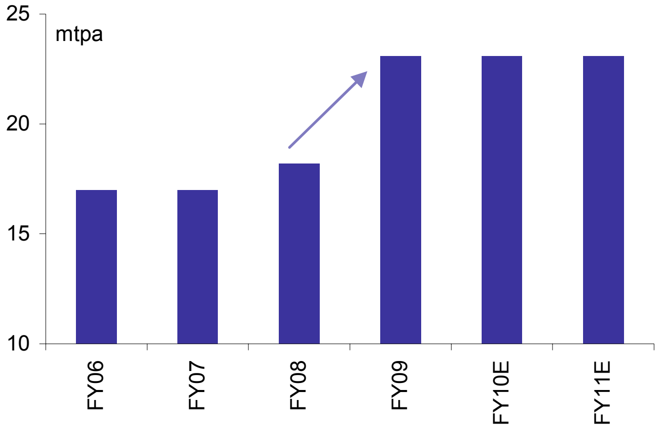
Y/e 31 Mar (Rs m)	FY08	FY09E	FY10E	FY11E
Revenues	56,368	65,720	72,316	69,136
yoy growth (%)	13.4	16.6	10.0	(4.4)
Operating profit	17,366	17,185	20,953	15,223
OPM (%)	30.8	26.1	29.0	22.0
Pre-exceptional PAT	10,114	9,833	11,220	7,728
Reported PAT	10,101	9,819	11,220	7,728
yoy growth (%)	28.7	(2.8)	14.3	(31.1)
EPS (Rs)	80.7	77.5	88.4	60.9
P/E (x)	9.4	9.8	8.6	12.4
Price/Book (x)	3.5	2.7	2.1	1.8
EV/EBITDA (x)	6.4	6.6	5.0	7.0
Debt/Equity (x)	0.6	0.6	0.4	0.2
RoE (%)	45.2	31.1	27.1	15.4
RoCE (%)	35.1	25.3	26.0	17.1

Source: Company, India Infoline Research

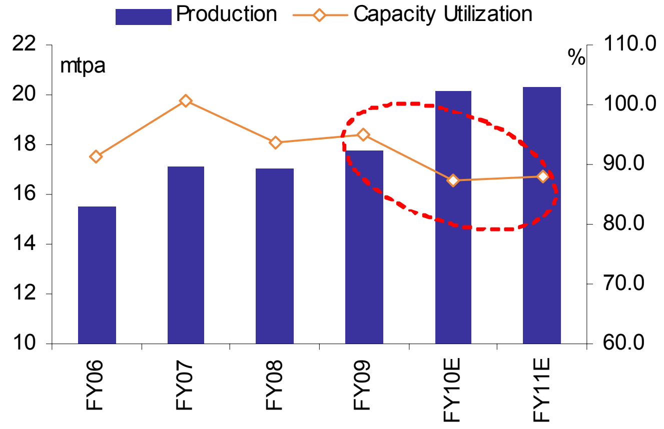
Supply glut to result in muted volumes

UCL volumes could increase ~1-2% yoy as supply surplus would dampen industry volume growth in FY11. Weak demand in Southern and Western along with supply glut would result in lower capacity utilization of about 87%, in line with the industry average. In Q1 FY10, UCL commenced operation at APCW (Andhra Pradesh) and Ginigera plants. However, stabilization of these units may take 1-2 quarters.

Capacity addition during FY09



Capacity utilization to remain in higher 80's



Source: India Infoline Research

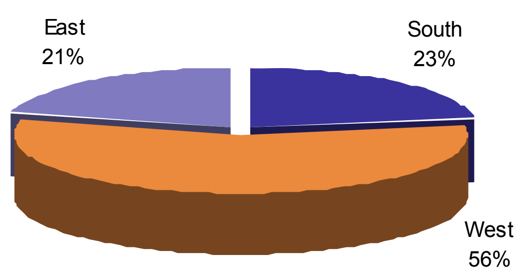
Exposure to South may weigh on realization

Post expansion, UCL exposure to South Indian market has increased form 23% to 35% of its total capacity. At the same time regional demand has slowed down significantly from double digit growth to about 4-5%. Consequently, lower demand along with fresh supplies has lead to incipient pricing pressure, corroborated by our dealer checks.

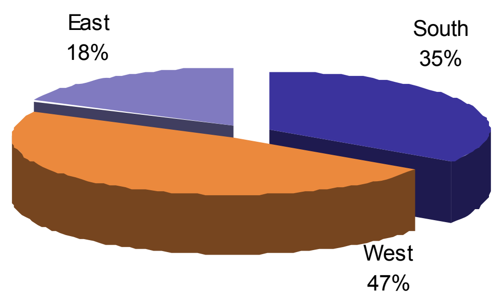
Moreover, cement capacity in the Southern region is likely to increase by an estimated ~40%, or ~26mtpa, over the next two years. Such an addition would outpace demand leading to acute drop in realization in the region.

Southern region accounts for 35% of UCL capacity post expansion

Pre-expansion



Post-expansion



Source: India Infoline Research

Oversupply seen in South by FY11

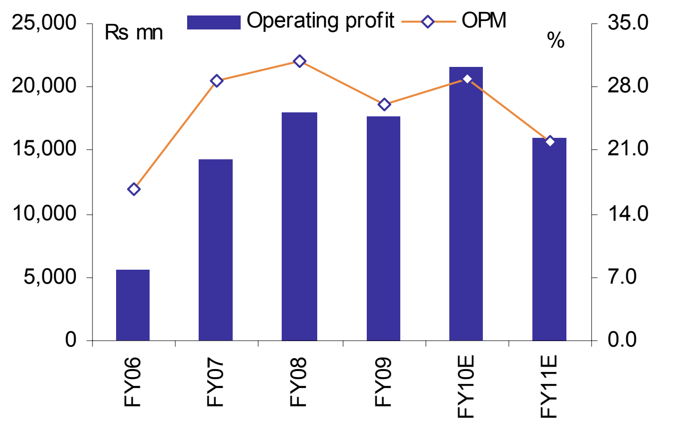
	FY08	FY09	FY10E	FY11E	FY12E
Effective cement capacity	56	66	82	98	105
Cement production	54	60	64	72	79
yoy growth (%)	-	11.1	6.7	12.5	9.7
Cement dispatches	54	60	64	72	79
yoy growth (%)	-	11.1	6.7	12.5	9.7
Capacity utilization	96	91	78	73	75
Possible production	54	60	74	93	100
Surplus/(Deficit)	-	-	10	21	21

Source: India Infoline Research

Margins

The company has recently added captive power plants (CPP) aggregating 96MW taking the total capacity to 236MW. Further, UCL is planning to set up a 25MW thermal power plant at its unit in Maharashtra along with waste heat recovery system. Post the addition of CPP capacity, captive power would account for 85% of total power requirements, thereby reducing dependence on high-cost power. In our estimates, we have factored in a 15-20% saving in power cost in FY11; but this would be nullified on account of an estimated 10% hike in fuel (coal) cost.

Margins to contract by 410bps over FY09-11E



Source: Company, India Infoline Research

Valuations appear expensive at 12x PER; downgrade to SELL

Ultratech trades at PER of 12.4x on estimated FY11 EPS of ~Rs61. A deteriorating demand-supply situation is expected to impact realizations from the next quarter. This would result in margin contraction in H2 FY10 and FY11. Consequently, UCL earnings are likely to contract by 22% over FY09-11E. Downgrade to SELL with a target price of Rs640 (earlier Rs720), implying a 15% downside.

Financials

Income statement

Y/e 31 Mar (Rs m)	FY08	FY09E	FY10E	FY11E
Revenue	56,368	65,720	72,316	69,136
Operating profit	**17,366**	**17,185**	**20,953**	**15,223**
Depreciation	(2,383)	(3,244)	(3,746)	(3,548)
Interest expense	(460)	(841)	(1,100)	(750)
Other income	643	592	640	700
Profit before tax	**15,167**	**13,692**	**16,747**	**11,625**
Taxes	(5,038)	(3,843)	(5,526)	(3,897)
Minorities	(15)	(16)	-	0
Adj. profit	**10,114**	**9,833**	**11,220**	**7,728**
Exceptional items	(14)	(14)	-	0
Net profit	**10,101**	**9,819**	**11,220**	**7,728**

Balance sheet

Y/e 31 Mar (Rs m)	FY08	FY09E	FY10E	FY11E
Equity capital	1,253	1,269	1,269	1,269
Reserves	25,773	34,852	45,450	52,556
Net worth	**27,026**	**36,121**	**46,719**	**53,826**
Minority interest	57			
Debt	17,405	21,429	19,714	11,829
Deferred tax liab (net)	5,454	7,276	6,224	6,224
Total liabilities	**49,942**	**64,825**	**72,658**	**71,878**
Fixed assets	48,011	53,338	55,692	64,788
Intangible assets	78	64	64	64
Investments	1,467	10,095	10,095	10,095
Net working capital	**(757)**	**342**	**(71)**	**(504)**
Inventories	6,197	7,056	7,544	7,677
Sundry debtors	2,026	1,889	2,491	2,637
Other curr assets	3,830	3,909	4,691	5,160
Sundry creditors	(11,546)	(11,290)	(13,575)	(14,756)
Other curr liab	(1,264)	(1,222)	(1,222)	(1,222)
Cash	1,143	987	6,879	(2,564)
Total assets	**49,942**	**64,825**	**72,658**	**71,878**

Cash flow statement

Y/e 31 Mar (Rs m)	FY08	FY09E	FY10E	FY11E
Profit before tax	15,167	13,692	16,747	11,625
Depreciation	2,383	3,244	3,746	3,548
Tax paid	(5,038)	(3,843)	(5,526)	(3,897)
Working capital Δ	1,876	(1,098)	413	433
Other op items				
Op cash flow	14,388	11,995	15,379	11,709
Capl expenditure	(18,042)	(8,557)	(6,100)	(12,645)
Free cash flow	**(3,654)**	**3,438**	**9,279**	**(935)**
Equity raised	(29)	(102)	-	-
Investments	3,126	(8,628)	-	-
Debt financing/disposal	1,619	4,024	(1,714)	(7,886)
Dividends paid	(728)	(622)	(622)	(622)
Other items	(191)	1,735	(1,052)	-
Net Δ in cash	**142**	**(156)**	**5,891**	**(9,443)**

Key ratios

Y/e 31 Mar	FY08	FY09E	FY10E	FY11E
Growth matrix (%)				
Revenue growth	13.4	16.6	10.0	(4.4)
Op profit growth	21.4	(1.0)	21.9	(27.3)
EBIT growth	26.5	(7.0)	22.8	(30.7)
Net profit growth	28.9	(2.8)	14.1	(31.1)
Profitability ratios (%)				
OPM	30.8	26.1	29.0	22.0
EBIT margin	27.7	22.1	24.7	17.9
Net profit margin	17.9	15.0	15.5	11.2
RoCE	35.1	25.3	26.0	17.1
RoNW	45.2	31.1	27.1	15.4
RoA	18.5	14.0	13.6	8.8
Per share ratios				
EPS	80.7	77.5	88.4	60.9
Dividend per share	5.0	4.9	4.9	4.9
Cash EPS	99.8	103.0	117.9	88.8
Book value per share	215.8	284.6	368.0	424.0
Payout (%)				
Dividend payout	7.2	6.3	5.5	8.0
Tax payout	33.2	28.1	33.0	33.5
Liquidity ratios				
Debtor days	13	10	13	14
Inventory days	40	39	38	41
Creditor days	75	63	69	78
Leverage ratios				
Interest coverage	34.0	17.3	16.2	16.5
Net debt / equity	0.6	0.6	0.3	0.3
Net debt / op. profit	0.9	1.2	0.6	0.9
Component ratios (%)				
Raw material	10.8	11.7	12.7	15.1
Power & fuel	22.2	26.1	21.8	24.0
Staff cost	3.0	3.4	3.8	4.2
Freight cost	17.2	16.3	16.2	17.3
Other operating exp	15.9	16.5	16.4	17.5

Du-Pont Analysis

Y/e 31 Mar (Rs m)	FY08	FY09E	FY10E	FY11E
Tax burden (x)	0.67	0.72	0.67	0.66
Interest burden (x)	0.97	0.94	0.94	0.94
EBIT margin (x)	0.28	0.22	0.25	0.18
Asset turnover (x)	1.03	0.94	0.88	0.79
Financial leverage (x)	2.45	2.22	1.99	1.74
RoE (%)	**45.2**	**31.1**	**27.1**	**15.4**

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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India Infoline Ltd. One India Bull Center, Jupiter Mill Compound, 841, Senapati Bapat Marg, Nr, Elphinstone Road, Lower Parel (W), Mumbai 400 013.

For Research related queries, write to: Amar Ambani at amar@indiainfoline.com or research@indiainfoline.com
For Sales and Account related information, write to customer care: info@5pmail.com or call on 91-22 4007 1000