Company

29 July 2010 | 7 pages

UltraTech Cement (ULTC.BO)

Equity

Sell: 1QFY11 PAT Falls 42% YoY; In Line with Expectations

- **1QFY11 PAT sharply lower** — ULTC reported 1QFY11 PAT of Rs2.4bn, 42% lower YoY, and in line (+2%) with our expectations of Rs2.37bn. 1Q EBITDA (excluding other income) fell 43% YoY. EBITDA margins fell to 23.1% in 1QFY11 vs 37% last year, and vs. 21.4% in 4QFY10. EBITDA/t was Rs792 in 1Q vs Rs1,350 last year, and Rs705 in 4Q. This was lower than EBITDA/t for ACC (Rs1,049) and Ambuja (Rs1,130) as ULTC was hit by lower prices YoY and higher coal/freight costs.
- **Volumes, prices under pressure** — Sales volumes (cement+clinker) fell 4% YoY to 5.1m tonnes. Domestic cement sales rose only 2% to 4.6m tonnes, impacted by lower demand in south India (33% of ULTC's sales) and logistic issues in Western and Eastern markets. Domestic realisations fell 7% YoY, and were flat on a QoQ basis, impacted by oversupply: domestic cement capacity rose ~17% in FY10.
- **Cost rise: a key concern** —ULTC was impacted by higher cost of raw materials (slag/fly ash), higher freight costs (+15% per tonne), and higher coal costs. Lower linkage coal meant that ULTC had to buy domestic coal (e-auction coal is 50-60% higher) and imported coal (prices rose from $76/t to $110/t). These pressures are likely to continue, impacting margins further in a falling price environment.
- **Plans for new capacity** — The board announced Rs56bn capex to raise brownfield capacity by 9.2m tpa in Chattisgarh and Karnataka (taking group capacity incl. Samruddhi Cement to 58.2m tpa). The ETA Star Cement acquisition with capacity (3m tpa) in UAE, Bahrain and Bangladesh should be completed by 2QFY11.
- **Maintain Sell** — ULTC's merger with Samruddhi Cement (wef 1 July 2010) should not result in lower costs. While ULTC is trading at $100 EV/t, we think it is still early to get constructive as oversupply will keep cement prices under pressure.

Sell/Medium Risk	3M
Price (29 Jul 10)	Rs872.95
Target price	Rs745.00
Expected share price return	-14.7%
Expected dividend yield	0.6%
Expected total return	**-14.0%**
Market Cap	Rs108,671M
	US$2,324M

Price Performance (RIC: ULTC.BO, BB: UTCEM IN)

Figure 1. UltraTech Cement – Statistical Abstract

YE 31 Mar	Revenue (Rs m)	Net Profit (Rs m)	EBITDA (Rs m)	EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)	EV/tonne (US$)
FY07	49,105	8,215	14,178	66.0	258%	13.2	8.4	152
FY08	55,088	10,076	17,258	80.9	23%	10.8	7.2	148
FY09	63,831	9,770	17,064	78.5	-3%	11.1	7.0	118
FY10E	70,454	11,205	20,465	90.0	15%	9.7	5.5	107
FY11E	71,672	9,838	18,453	79.0	-12%	11.0	5.8	100
FY12E	73,391	8,221	15,975	66.0	-16%	13.2	6.2	86

Source: Company Reports and Citi Investment Research and Analysis estimates. Rs/US$ rate at 46.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

1QFY11 Results

Figure 2. UltraTech Cement – 1QFY11 Results

Rs m	1Q FY11	1Q FY10	% chg
Net sales	17,569	19,413	-10%
Total expenses	13,512	12,246	10%
EBITDA	**4,057**	**7,168**	**-43%**
EBITDA (%)	**23.1**	**36.9**	
EBITDA/tonne (Rs)	**792**	**1,350**	**-41%**
Interest	279	330	-15%
Depreciation	1,016	936	9%
Other income	483	342	41%
PBT	3,246	6,244	-48%
Total Tax	819	2,067	-60%
Tax Rate (%)	25.2	33.1	
PAT	**2,427**	**4,178**	**-42%**

Source: Company Reports and Citi Investment Research and Analysis

UltraTech Cement

Company description

UltraTech Cement (ULTC) has a current cement capacity of 23.1m tpa, making it one of India's largest cement companies. Based on its production for FY09, it had a domestic market share of ~9%. Its markets are well spread out. Based on its plant locations, its main markets are in west, south and east India. In FY09 it exported around 3% of its cement volumes and 16% of its total volumes (18.2m tpa in FY09 including clinker). It has no presence in the northern markets. Along with Grasim (which holds a 54.8% stake), ULTC is working toward rationalizing markets, cutting costs and improving average realizations. ULTC has been known for the consistent high quality of its cement, and manages to earn a premium price over other cement brands in several markets. The group companies had a total cement capacity of 41.6m tpa in FY09, which is expected to rise to about 49m tpa during FY10.

Investment strategy

We rate ULTC as Sell/Medium Risk (3M) with a target price of Rs745. ULTC has benefited from cement prices bouncing back from the low levels of November 2009, especially in a key market - south India. ULTC should continue to benefit in the near term as prices are expected to rise further, and due to increased captive power. We expect meaningful cement price falls as new capacity comes on stream even as demand weakens during the monsoon. Based on trends so far, we expect ULTC's domestic cement prices to rise ~2% in FY10 but fall 5% in FY11. We expect total cement and clinker volumes to grow 11% yoy in FY10, 5% in FY11 and 4% in FY12. ULTC has commissioned 192MW of captive power in FY09 taking total capacity to 236MW. The captive power, along with lower imported coal costs (40% of usage), should help reduce per tonne power and fuel costs by 23% in FY10. However, with the fall in cement prices that we expect in FY11-12, we expect a yoy profit decline in FY11-12 and that EBITDA margins fall from 32% in FY10 to 26% in FY11 and 22% in FY12.

Valuation

We use EV/tonne to value ULTC, a common metric used to value cement companies. Our target EV/tonne (Mar 11) value of US$85 is based on a 15% discount to the replacement cost of ~US$100/t. We use a discount to reflect our fears that profitability of cement companies will be impacted going forward on the back of increased new cement capacities and cost pressures. Our target price of Rs745 equates to an EV/EBITDA valuation of 4.9x and a PE of 9.4x.

Risks

We rate ULTC as Medium Risk. Our quantitative risk-rating system, which tracks 260-day historical share price volatility, suggests a High Risk rating for ULTC shares. However, based on its relatively healthy balance sheet (net debt to equity of 0.1x) and focus on cost cutting, we feel a rating of Medium Risk is more appropriate for ULTC. Key upside risks to our target price include: (1) further delays in industry capacity; (2) a higher level of domestic demand growth than we expect; (3) changes in the duty/tax regime in favor of producers; and (4) higher export prices than we have forecasted.

Appendix A-1

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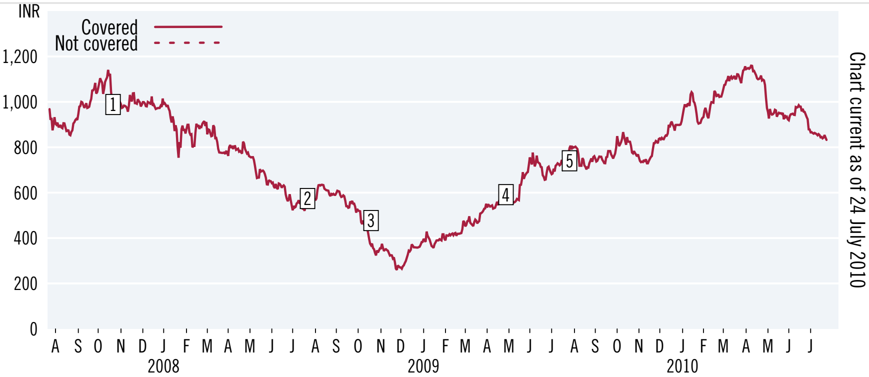
UltraTech Cement (ULTC.BO)
Ratings and Target Price History
Fundamental Research
Analyst: Pradeep Mahtani



	Date	Rating	Target Price	Closing Price
1	21-Oct-07	3M	*740.00	1,005.05
2	22-Jul-08	3M	*580.00	539.90
3	19-Oct-08	3M	*370.00	375.80
4	28-Apr-09	3M	*500.00	569.60
5	27-Jul-09	3M	*745.00	796.25

* Indicates change

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