

Shree Cements

Q2FY11 Result update

12 November 2010

Hold

Target price under review

CMP: Rs2,245*

*as on 11 November 2010

Inline results; positive triggers missing

Shree Cements' Q2FY11 numbers were broadly inline with our estimates. The company reported net sales of Rs7.17bn, 2.6% above our estimate of Rs6.99bn. EBITDA was Rs1.43bn vs our estimate of Rs1.51bn. However, adjusted PAT came to Rs 180 mn vs our expectations of a loss of Rs106mn due to lower interest (down 54.6% QoQ) and depreciation expenses (down 14.8% QoQ).

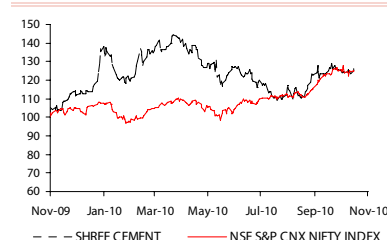
- **Q2 result review:** Net sales declined 20.2% YoY on account of the 22.6% YoY decline in cement revenues and 27.6% YoY decline in power revenues. EBITDA declined 65% YoY to Rs1.43bn and adjusted PAT plunged 93.8% YoY to Rs180mn.
- **Utilization levels to remain stable:** About 87% of the company's sales are derived from the northern region where we expect the effective utilization rate to remain stable at 86% in FY12E and improve to 90.7% in FY13E. Though we expect 6% YoY decline in realizations during FY11E due to a decline in utilization rates, we believe prices would improve by 4% YoY in FY12E and 6% YoY in FY13E.
- **Maintain Hold; target price under review:** At the CMP, the stock trades at 12x FY12E earnings, 5.5x EV/EBIDTA, 2.82x P/BV and EV/ton of \$97 (adjusted for merchant power business). The stock has appreciated by 19% since our last recommendation post Q1FY11 results breaching our target price of Rs2,075. Going forward, EBITDA margins will be under pressure due to lower utilization rates in the cement business, declining merchant power rates and rising pet coke prices. We maintain our Hold rating due to reasonable valuations and will revise our rating and estimates in our sector report shortly.

Key Data

Bloomberg Code	SRCM IN
Reuters Code	SHCM.BO
Current Shares O/S (mn)	34.8
Diluted Shares O/S (mn)	34.8
Mkt Cap (Rsbn/USDbn)	78.1/1.8
52 Wk H / L (Rs)	2,542/1,677
Daily Vol. (3M NSE Avg.)	25,439
Face Value (Rs)	10

USD = Rs44.3

One year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Shree Cement	10.0	5.9	30.0
NIFTY	1.7	20.1	25.1

Source: Bloomberg, Centrum Research
*as on 11 November 2010

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Y/E Mar (Rsmn)	Q2FY11	Q2FY10	YoY (%)	Q1FY11	QoQ (%)	Q1FY11E	Variance (%)
Cement Sales	6,860	8,860	(22.6)	8,138	(15.7)	6,692	2.5
Power Sales	315	436	(27.6)	1,307	(75.9)	301	4.8
Net Sales	7,176	8,996	(20.2)	9,445	(24.0)	6,993	2.6
EBITDA	1,427	4,082	(65.0)	2,895	(50.7)	1,510	(5.5)
EBITDA margin (%)	19.9	45.4	(2,549 bps)	30.6	(1,077 bps)	21.6	(170 bps)
Depreciation	1,285	998		1,509		1,509	
EBIT	142	3,084		1,386		1	
Interest	137	155		302		302	
Other Income	255	316		168		168	
PBT	260	3,245		1,253		(133)	
Provision for tax	80	326		185		(26.5)	
Effective tax rate (%)	30.7	10.1		14.8		20.0	
Reported PAT	105	2,889	(96.4)	1,059	(90.1)	(106)	
Exceptional Items	75	29		9		0	
Adjusted PAT	180	2,918	(93.8)	1,068	(83.1)	(106)	
Adj PAT margin (%)	2.5	32.4	(2,993 bps)	11.3	(880 bps)	(1.5)	403 bps
EPS (adjusted)	5.2	83.8	(93.8)	30.7	(83.1)	(3.0)	

Source: Company, Centrum Research

Y/E Mar (Rsbn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Fully DEPS	RoE (%)	RoCE (%)	P/BV	P/E (x)	EV/EBITDA (x)
FY08	21.1	50.1	8.6	40.9	2.9	81.3	82.6	51.1	18.9	11.6	27.1	9.3
FY09	27.2	28.7	9.5	35.0	5.5	92.2	158.9	58.8	28.3	6.5	14.1	7.7
FY10	36.3	33.8	15.0	41.4	7.2	30.2	206.9	47.3	23.7	4.3	10.8	5.0
FY11E	37.9	4.3	10.7	28.2	4.1	(43.5)	116.8	20.3	11.8	3.6	19.2	6.5
FY12E	43.7	15.5	12.4	28.3	6.5	59.6	186.4	26.2	15.9	2.8	12.0	5.5

Source: Company, Centrum Research Estimates

Please refer to important disclosures/disclaimers in Appendix A

Q2FY11 review

Q2 net sales declined 20.2% YoY (and 24% QoQ) to Rs7.18bn on account of the 22.6% YoY fall in cement revenue and 27.6% YoY decline (fall was 75.9% QoQ) in power revenue. EBITDA during the quarter declined 65% YoY and 50.7% QoQ to Rs1.43bn, mainly impacted by a decline in volume and realization and increase in power and fuel costs apart from employee expenses. EBITDA margin declined 2,549bp YoY and 1,077bp QoQ to 19.9%. Adjusted PAT plunged 93.8% YoY and 83.1% QoQ to Rs180mn.

Exhibit 1: Variance in results vis-à-vis estimates

Rsmn	Q1FY11A	Q1FY10A	YoY (%)	Q4FY10A	QoQ (%)	Q1FY11E	Variance (%)
Cement Sales	6,860	8,860	(22.6)	8,138	(15.7)	6,692	2.5
Power Sales	315	436	(27.6)	1,307	(75.9)	301	4.8

Source: Company, Centrum Research

Cement segment's performance

Sales volume (cement & clinker) during the quarter declined 8.8% YoY and 8.4% QoQ to 2.28mt. Blended realization during the quarter declined 12.1% YoY and 8% QoQ to Rs3,010/tonne. Revenue from cement division declined 19.9% YoY and 15.7% QoQ to Rs6.86bn. The cement segment's share to total revenues stood at 95.6% during Q2FY11 vs 95.2% during Q2FY10 and 86.2% during Q1FY11.

Power business performance

Revenue from power business (including trading business) was down 27.6% YoY and 75.9% QoQ to Rs315.5mn. Power sales volume during the quarter was 50.3 mn units against 64 m units during Q2FY10 and 142.6 mn units during Q1FY11. Power realization during the quarter declined to Rs 4.17/kwh against Rs 6.8/kwh during Q2FY10 and Rs 5.8/kwh during Q1FY11. Revenue from power trading was Rs 106 mn during the quarter. This segment's share to total revenues was 4.4% against 4.8% during Q2FY10 and 13.8% during Q1FY11.

Exhibit 2: Per tonne realization and cost trends

Particulars	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	YoY (%)	QoQ (%)
Net Realization/MT (Rs)	3,426	3,213	3,249	3,272	3,010	(12.1)	(8.0)
EBITDA/MT (Rs)	1,633	1,309	1,188	1,164	626	(61.7)	(46.2)
Raw Material	329	340	308	373	332	0.8	(10.9)
Staff Cost	145	146	182	192	216	48.8	12.2
Power & Fuel	545	611	649	914	773	42.0	(15.5)
Freight & Selling	574	547	698	567	570	(0.7)	0.5
Other Expenses	464	403	432	707	550	18.6	(22.2)
Total cost/MT	1,967	2,072	2,258	2,634	2,523	28.3	(4.2)

Source: Company, Centrum Research

Increasing thrust on merchant power

Shree Cements commissioned 96MW power capacity (46MW from waste heat recovery plants and 50MW pet-coke-based plants) during Q4FY10 and further commissioned another 50MW during Q1FY11.

The company expects its 300MW (150 MWx2) power plant, meant for merchant sales, to be commissioned during Q1FY12. The company has commissioned 1mt clinkerization unit at Jaipur during the quarter and the grinding unit of 1.5mt is expected to be commissioned during Q3FY11E. In our view, increase in clinker capacity would enable the company to lower its clinker sale going forward, and thus improve its product-mix and profitability.

We expect the share of power segment to revenue and EBITDA to increase to 19.6% and 32.5%, respectively, during FY12E against 4.9% and 7.5% during FY10. We expect power EBITDA to register 89% CAGR over FY10-12E. A sharp increase in power business profitability would de-risk the company from the cyclical nature of cement business.

Exhibit 3: Segment-wise break-up

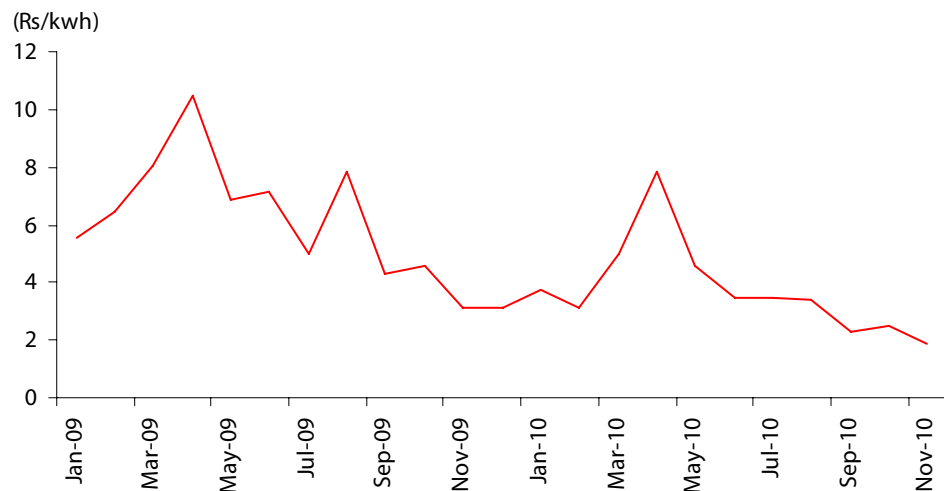
(Rs mn)	FY10	FY11E	FY12E
Cement			
Volumes (mt)	10.3	10.9	11.6
Revenue	34,552	33,121	35,150
% of total	95.1	87.5	80.4
EBIDTA	13,905	8123	8,350
% of total	92.5	76.2	67.5
Power			
Volumes (mn units)	264	1,055.6	1,907.8
Revenue	1,770	4,750	8,585
% of total	4.9	12.5	19.6
EBIDTA	1120	2542	4017
% of total	7.5	23.8	32.5

Source: Centrum Research Estimates

Merchant power realizations tumble; cost push to hurt further

Merchant power realization is on a declining trend. Average merchant rate in Northern region is currently Rs 1.86/kwh against Rs 5.3/kwh in Q1FY11 and Rs 3.1/kwh in Q2FY11. Besides, the energy cost push on rising pet-coke prices (Rs 7,500/tonne prevailing at present vs Rs 6,000-6,300/ton during Q1FY11) is likely to further affect profitability, going ahead. Average pet coke cost in Q2FY11 was Rs 7030/tonne.

Exhibit 4: Power price at Indian Energy Exchange (Northern Zone)



Source: IEX

Positive triggers missing; but maintain Hold on reasonable valuations

At the CMP, the stock trades at P/E of 12x FY12E earnings, 5.5x EV/EBIDTA, 2.82x P/BV and EV/ton of \$95 (adjusted for merchant power business). The stock has appreciated by 19% since our last recommendation post Q1FY11 results breaching our target price of Rs2,075 (we are in the process of reviewing our target price). We believe positive triggers are already priced and going forward, EBITDA margins will be under pressure due to lower utilization rates of cement business, declining merchant power rates and rising pet coke prices. We maintain our Hold rating on the stock due to reasonable valuations and will revise our rating and estimates in our sector report shortly.

Financials

Exhibit 5: Income Statement

Y/E Mar (Rsmn)	FY08	FY09	FY10	FY11E	FY12E
Revenues	21,091	27,150	36,321	37,871	43,735
Growth in revenues (%)	50.1	28.7	33.8	4.3	15
Power and Fuel	3,672	6,058	6,105	8,059	8,702
% of Sales	17.4	22.3	16.8	21.3	19.9
Freight	3,598	4,593	6,298	6,582	7,004
% of Sales	17.1	16.9	17.3	17.4	16.0
Other Expenses	1,850	2,524	2,847	3,285	3,602
% of Sales	8.8	9.3	7.8	8.7	8.2
EBITDA	8,624	9,508	15,025	10,665	12,367
EBITDA Margin	40.9	35.0	41.4	28.2	28
EBITDA/Ton (Rs)	1,360	1,122	1,328	742	719
Depreciation	4,788	2,054	5,704	5,143	3,296
PBIT	3,837	7,454	9,321	5,522	9,070
Interest expenses	497	744	766	1,174	1,174
PBT from operations	3,339	6,709	8,555	4,348	7,896
Other non operating income	733	829	758	1,723	1,790
PBT before extra-ordinary items	4,072	7,538	9,313	6,070	9,687
Extra-ordinary income/ (exp)	(389)	309	634	-	-
PBT	3,683	7,848	9,948	6,070	9,687
Provision for tax	1,079	1,449	1,918	2,003	3,197
Effective tax rate	29.3	18.5	19.3	33.0	33.0
PAT	2,604	6,398	8,030	4,067	6,490
PAT margin	13.6	20.4	19.8	10.7	15
Cash Profit	7,666	7,586	12,908	9,210	9,787
Growth in Cash Profit (%)	29.5	(1.0)	70.2	(28.6)	6.3
PAT margin	36.3	27.9	35.5	24.3	22.4

Source: Company, Centrum Research Estimates

Exhibit 6: Balance Sheet

Y/E Mar (Rsmn)	FY08	FY09	FY10	FY11E	FY12E
Share Capital	348	348	348	348	348
Reserves	6,380	11,752	17,984	21,440	27,319
Shareholders' fund	6,728	12,100	18,332	21,788	27,667
Minority Interest					
Debt	13,307	14,962	21,062	21,062	21,062
Deferred Tax Liability	(185)	(104)	(124)	(124)	(124)
Total Capital Employed	19,851	26,958	39,271	42,727	48,606
Gross Block	21,873	22,559	29,509	39,109	51,109
Accumulated dep.	14,273	16,291	21,989	27,132	30,429
Net Block	7,600	6,269	7,520	11,977	20,680
Capital WIP	180	4,789	9,674	10,074	4,074
Total Fixed Assets	7,779	11,057	17,194	22,051	24,754
Investments	5,910	8,448	15,922	15,922	15,922
Inventories	1,766	1,545	3,581	3,631	4,194
Debtors	494	583	824	1,245	1,438
Cash & bank balances	4,674	4,723	4,164	2,528	5,880
Loans and Advances	4,026	7,443	7,252	7,252	7,252
Total current assets	10,960	14,294	15,822	14,657	18,764
Current lia & provisions	4,799	6,842	9,667	9,903	10,835
Net current assets	6,161	7,452	6,155	4,753	7,929
Misc. Expenditure	-	-	-	-	-
Total Assets	19,850	26,958	39,271	42,727	48,606

Source: Company, Centrum Research Estimates

Exhibit 7: Cash flow

Y/E Mar (Rsmn)	FY08	FY09	FY10	FY11E	FY12E
CF from operating					
Profit before tax	3,683	7,229	8,679	6,070	9,687
Depreciation	4,788	2,054	5,704	5,143	3,296
Interest expenses/other	334	472	748	(549)	(617)
OP profit before WC change	8,804	9,755	15,132	10,665	12,367
Working capital adjustment	(539)	219	(61)	(235)	177
Gross cash from operations	8,265	9,975	15,071	10,430	12,544
Direct taxes paid	(1,235)	(1,644)	(1,897)	(2,003)	(3,197)
Cash from operations	7,030	8,331	13,174	8,426	9,347
Cash From Op Ex OI	6,641	8,021	12,539	8,426	9,347
CF from investing					
Investment	(4,768)	(3,215)	(5,174)	-	-
Cash from investment	(9,002)	(8,545)	(16,885)	(10,000)	(6,000)
CF from financing					
Proceeds from sh cap & prem.	-	-	-	-	-
Interest paid	(476)	(755)	(1,332)	549	617
Cash from financing	3,517	573	3,786	(62)	5
Net cash increase/ (dec)	1,157	50	(559)	(1,636)	3,352

Source: Company, Centrum Research Estimates

Exhibit 8: Key Ratios

Y/E Mar	FY08	FY09	FY10	FY11E	FY12E
Margin Ratios (%)					
EBITDA Margin	40.9	35.0	41.4	28.2	28.3
PBIT Margin	18.2	27.5	25.7	14.6	20.7
PBT Margin	19.3	27.8	25.6	16.0	22.1
PAT Margin	13.6	20.4	19.8	10.7	14.8
Growth Ratios (%)					
Revenues	50.1	28.7	33.8	4.3	15.5
EBITDA	45.6	10.2	58.0	(29.0)	16.0
Net Profit	81.3	92.2	30.2	(43.5)	59.6
Cash Earning	34.8	9.3	57.2	(26.0)	6.3
Return Ratios (%)					
ROCE	18.9	28.3	23.7	11.8	15.9
ROIC	31.5	48.1	34.4	17.6	24.3
ROE	51.1	58.8	47.3	20.3	26.2
Turnover Ratios					
Asset turnover ratio (x)	1.1	1.0	0.9	0.9	0.9
Working capital cycle (days)	(43.9)	(63.4)	(52.9)	(48.4)	(43.4)
Avg collection period (days)	8.5	7.8	8.3	12.0	12.0
Avg payment period (days)	83.0	92.0	97.1	95.4	90.4
Inventory holding (days)	30.6	20.8	36.0	35.0	35.0
Per share (Rs)					
Fully diluted EPS	82.6	158.9	206.9	116.8	186.4
CEPS	207.9	227.2	357.3	264.5	281.0
Book Value	193.1	347.3	526.2	625.4	794.2
Solvency ratios					
Debt/ Equity	2.0	1.2	1.1	1.0	0.8
Net Debt/Equity	0.4	0.1	0.0	0.1	(0.0)
Interest coverage	17.3	12.8	19.6	9.1	10.5
Valuation parameters (x)					
P/E	27.1	14.1	10.8	19.2	12.0
P/BV	11.6	6.5	4.3	3.6	2.8
EV/ EBITDA	9.3	7.7	5.0	6.5	5.5
EV/ Sales	4.1	2.9	2.2	2.1	1.8
M-Cap/ Sales	3.7	2.9	2.2	2.1	1.8

Source: Company, Centrum Research Estimates

Appendix A

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