

## Shree Cement

Event update

14 July 2011

## Hold

Target Price: Rs2,033

CMP: Rs1,777\*

Upside: 14.4%

\*as on 14 July 2011

## Improvement in SEB's financial health could translate into higher merchant power rates

At a conference on "Distribution Sector Reforms" in New Delhi, states have agreed to take various initiatives to improve the financial health of their electricity distribution companies. The conference underlined the need for urgent steps to curtail and reverse growing losses in power distribution. Among the measures proposed are the conversion of loans from state governments to state electricity boards (SEBs) into equity and clearing all dues and subsidies to SEBs by state governments. We believe these measures would help improve the financial health of SEBs and translate into higher merchant power realizations in future (merchant power rates are currently under pressure due to weak financial health of SEBs). We have done a scenario analysis to find the impact of higher merchant power realizations on Shree Cement's earnings estimates and target price. However, we have not changed our estimates as of now, and would like to wait for further clarity on this front. We maintain our Hold rating with a target price of Rs2,033 (upside of 14.4% from CMP).

- **Conversion of loans to SEBS into equity:** States will consider converting loans to SEBs into equity. At the end of FY09, total loans of SEBs from state government amounted to Rs425.9bn, ~16% of the total debt outstanding.
- **Clearance of all dues and subsidies to SEBs:** State governments also agreed to clear all dues and subsidies to SEB. Also going ahead, subsidies will be released in advance. SEBs of Andhra Pradesh, Rajasthan and Jharkhand have not been receiving, or only received partial subsidies, from their state governments.
- **FY13E EPS will improve by 57% from current estimates:** We expect merchant power realizations to remain under pressure due to weak financial health of SEBs. However, if these positives measures are implemented, realizations may improve in future. Considering merchant power realization at Rs4.5/unit vs our current estimates of Rs3.3/unit in FY13E, Shree Cement's EPS of the company will increase by 57% to Rs202.5 (current estimates: Rs129).
- **Maintain Hold:** Though we believe that the current developments are positive for merchant power players, we are not changing our assumptions and await further clarity. At CMP, the stock trades at 14.4x FY13E earnings, 4x EV/EBIDTA, 2.6x P/BV and EV/tonne of US\$66.3 (considering cement segment's EV). Considering the concerns over merchant power business and non-revival of cement demand in the northern region, we maintain our Hold rating on the stock with a target price of Rs2,033.

## Sanjeev Kumar Singh

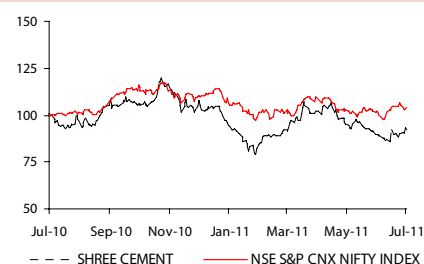
sanjeev.singh@centrum.co.in  
+ 91 22 4215 9643

## 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)	61.9/1.4
52 Wk H / L (Rs)	2,350/1,500
Daily Vol. (3M NSE Avg.)	10,255
Face Value (Rs)	10

USD = Rs44.5

## One Year Indexed Stock Performance



## Price Performance (%)

	1M	6M	1Yr
Shree Cement	2.3	(2.0)	(8.8)
NIFTY	1.8	(1.0)	4.0

Source: Bloomberg, Centrum Research  
\*as on 14 July 2011

Y/E Mar (Rs bn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Fully DEPS	RoE (%)	RoCE (%)	P/BV	P/E (x)	EV/EBITDA (x)
FY09	26.6	28.8	9.5	35.7	6.1	96.5	174.8	64.7	25.7	5.1	20.0	7.5
FY10	35.3	32.8	14.9	42.2	7.4	21.5	212.3	48.6	22.1	3.4	10.2	6.7
FY11E	35.1	(0.6)	8.9	25.2	2.4	(67.3)	69.4	12.7	8.7	3.1	8.4	4.2
FY12E	45.5	29.5	12.5	27.4	1.9	(22.8)	53.6	9.1	5.1	2.9	25.6	7.4
FY13E	52.5	15.4	13.7	26.2	4.5	140.6	129.0	19.3	11.2	2.5	33.1	4.8

Source: Company, Centrum Research Estimates

## Scenario Analysis

- We have estimated merchant power realizations at Rs4/unit and Rs3.3/unit for FY12E and FY13E, respectively. We believe the RoE of Shree Cement's power business will remain suppressed to 4.8% in FY13E and hence, we have assigned a target P/BV multiple of 0.7x for the power business.
- Assuming merchant power realization of Rs4.5/unit for FY12E and FY13E, our EPS estimates would improve by 36.3% to Rs 73.1 (current estimate: Rs53.6) for FY12E and by 57% to Rs202.5 (current estimate: Rs129) for FY13E. Consequently, the RoE of the power business will improve to 13.2% (from our current estimate of 4.8%) and hence, the business will command a higher valuation multiple, in our view. In this scenario, our target P/BV multiple of the power business would increase to 1.25x, which will result in a target price of Rs2,317 (14% above our current target price of Rs2,033).
- Assuming merchant power realization of Rs5/unit for FY12E and FY13E, our EPS estimates of the company will improve by 72.6% to Rs 92.5 (current estimate: Rs53.6) for FY12E and by 80.7% to Rs233.2 (current estimate: Rs129) for FY13E. Consequently, the RoE of the power business will improve to 21.3% from current estimates of 4.8% and hence, the business will command a higher valuation multiple, in our view. In this scenario, our target P/BV multiple of the power business would increase to 1.75x, which will result in a target price of Rs2,577 (26.7% above our current target price of Rs2,033).

### Exhibit 1: Scenario analysis on EPS and target price of higher merchant power realization

Particulars (Rs Mn)	FY12E			FY13E		
	Current estimates	Power realization	Power realization	Current estimates	Power realization	Power realization
	Power @ Rs4/unit	@ Rs4.5/unit	@ Rs5/unit	Power @ Rs3.3/unit	@ Rs4.5/unit	@ Rs5/unit
Revenue	45,472	46,444	47,416	52,490	56,250	57,817
EBITDA	12,460	13,307	14,154	13,740	16,942	18,276
EBITDA margin (%)	27.4	28.7	29.9	26.2	30.1	31.6
Adj PAT	1,868	2,546	3,223	4,495	7,056	8,123
Adj PAT margin (%)	4.1	5.5	6.8	8.6	12.5	14.0
<b>EPS (Rs)</b>	<b>53.6</b>	<b>73.1</b>	<b>92.5</b>	<b>129.0</b>	<b>202.5</b>	<b>233.2</b>
Increase from current estimates (%)	-	36.3	72.6	-	57.0	80.7
<b>Revenue (%)</b>						
Cement	77.9	75.1	72.3	77.3	69.0	65.5
Power	22.1	24.9	27.7	22.7	31.0	34.5
<b>EBITDA (%)</b>						
Cement	78.0	67.3	56.7	93.8	65.1	53.2
Power	22.0	32.7	43.3	6.2	34.9	46.8
<b>RoE (%)</b>				<b>4.8</b>	<b>13.2</b>	<b>21.3</b>
Target P/BV (x)				0.7	1.3	1.8
EV of power business				12,600	22,500	31,500
EV of cement business				48,590	48,590	48,590
<b>Total EV</b>				<b>61,190</b>	<b>71,090</b>	<b>80,090</b>
Net Debt				(9,639)	(9,639)	(9,639)
Target Mcap				70,829	80,729	89,729
No of Equity shares (mn)				35	35	35
<b>Target price/share (Rs)</b>				<b>2,033</b>	<b>2,317</b>	<b>2,575</b>
CMP (Rs)				1,777	1,777	1,777
Upside/ (downside) (%)				14.4	30.4	44.9

Source: Company, Centrum Research Estimates

## Lanco Infratech has sold higher power volumes at better realizations

Lanco Infratech's merchant power sales volume in Q4FY11 was 1,484 mn units, 5.8x higher than power sales volume of Shree Cement. At the same time, Lanco's realization/unit was Rs4.46/unit compared with Rs4.65/unit for Shree Cement. In the past also, Lanco has sold higher power volumes of 1,016 mn units in Q4FY10 and 1,185 mn units in Q1FY11 with higher realizations at Rs5.62/unit in Q4FY10 and Rs5.24/unit in Q1FY11. Higher sales volume of Lanco Infratech with better realizations supports our thesis of improved merchant power realizations in future, if the financial health of SEBs improves.

### Exhibit 2: Comparison of merchant power volume and realization of Shree Cement vis-à-vis Lanco Infratech

Particulars	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11
Shree Cement's power volume (mn units)	64	70	78	213	76	74	257
Realization/unit (Rs)	6.81	6.13	6.95	6.15	4.17	4.55	4.65
IEX realization/unit (Rs)	5.56	3.35	5.32	3.83	2.74	2.52	3.35
Lanco Infratech's power volume (mn units)	495	484	1,016	1,185	1,480	1,601	1,484
Realization/unit (Rs)	5.69	3.62	5.62	5.24	3.40	3.09	4.46

Source: Company, IEX, Lanco Infratech

## Maintain Hold with a target price of Rs 2,033

Though we believe that the current developments are positive for merchant power players, we are not changing our assumptions and await further clarity. At CMP, the stock trades at a 33.1x FY12E EPS of Rs53.6 and 13.8x FY13E EPS of Rs129. On EV/EBITDA basis, it trades at 4.8x FY12E and 3.8x FY13E and on EV/Tonne basis at US\$78.9 FY12E and US\$66.3 FY13E (considering cement segment's EV), respectively. The company has yet not signed any PPA and does not have coal linkages to meet the requirements of power plants, which makes it vulnerable to non-improvement in merchant power rates. We maintain Hold on the stock with a target price of Rs 2,033.

### Exhibit 3: Valuation summary

SOTP Valuation/Rsmn	FY13E
Cement (US\$81/tonne)	48,590
Power : 443 MW (0.7x Equity)	12,600
Total EV	61,190
Less: Net Debt	(9,639)
Equity Value	70,829
No of Equity shares (Mn)	35
Target Price (Rs)	2,033
CMP (Rs)	1,777
% Upside/ (downside)	14.4

Source: Company, Centrum Research Estimates

### Exhibit 4: Valuation summary after removing power business' EV

Particulars	FY12E	FY13E
SCL's EV	59,789	52,260
Power EV	12,600	12,600
EV (Cement business)	47,189	39,660
Implied EV/Tonne (USD)	78.9	66.3
Implied EV/EBITDA (x)	4.5	3.1
Implied P/E (x)	26.4	11.0

Source: Company, Centrum Research Estimates

## Financials

### Exhibit 5: Income Statement

Y/E March (Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
Net Sales	26,601	35,324	35,119	45,472	52,490
Total Expenditure	17,093	20,405	26,262	33,012	38,749
Raw Materials	2,417	3,136	3,723	3,890	4,107
Power & Fuel	6,058	6,105	9,123	13,857	17,694
Staff Cost	1,039	1,586	1,985	2,332	2,787
Transport & forwarding exp	4,294	5,889	7,751	8,125	8,752
Others	3,188	3,887	4,016	4,808	5,409
EBITDA	9,508	14,919	8,856	12,460	13,740
EBITDA margin (%)	35.7	42.2	25.2	27.4	26.2
Other Income	829	1,284	468	974	1,123
Depreciation	2,054	5,704	6,758	9,953	8,204
Interest	744	1,185	978	1,146	1,040
PBT	7,538	9,313	1,588	2,335	5,618
PBT margin (%)	28.3	26.4	4.5	5.1	10.7
Tax	1,449	1,918	-994	467	1,124
Adj PAT	6,089	7,395	2,419	1,868	4,495
PAT margin (%)	22.9	20.9	6.9	4.1	8.6
Diluted EPS (Rs)	174.8	212.3	69.4	53.6	129.0

Source: Company, Centrum Research Estimates

### Exhibit 6: Balance Sheet

Y/E March (Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
<b>Sources of Funds:</b>					
Share Capital	348	348	348	348	348
Reserves	11,752	17,984	19,513	20,966	24,808
<b>Shareholders Fund</b>	<b>12,100</b>	<b>18,332</b>	<b>19,862</b>	<b>21,314</b>	<b>25,156</b>
Debt	14,962	21,062	20,079	18,079	16,079
Net deferred tax	(104)	(124)	(723)	(723)	(723)
<b>Total Liabilities</b>	<b>26,958</b>	<b>39,271</b>	<b>39,218</b>	<b>38,670</b>	<b>40,513</b>
<b>Application of Funds:</b>					
Gross Block	22,559	29,509	49,183	53,696	55,696
Accumulated Depn	16,291	21,989	28,747	38,700	46,905
Net Fixed Assets	6,269	7,520	20,436	14,995	8,791
Capital WIP	4,789	9,674	1,513	1,000	2,000
Investments	8,448	15,922	11,965	16,965	21,965
<b>Current Assets</b>					
Inventories	1,545	3,581	4,042	4,360	5,033
Sundry Debtors	583	824	1,082	1,495	1,726
Cash & Bank balances	4,723	4,164	4,608	3,224	3,753
Loans & Advances	7,443	7,252	4,656	6,821	7,873
Total Current Assets	14,294	15,822	14,389	15,900	18,385
Sundry creditors	2,599	4,250	5,846	6,852	7,190
Other liabilities & provisions	3,885	4,999	2,820	2,920	3,020
Total Current Liabilities	6,842	9,667	9,084	10,190	10,628
Net Current Assets	7,452	6,155	5,305	5,710	7,757
<b>Total Assets</b>	<b>26,958</b>	<b>39,271</b>	<b>39,218</b>	<b>38,670</b>	<b>40,513</b>

Source: Company, Centrum Research Estimates

### Exhibit 7: Cash flow

Y/E March (Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
PBT & extraordinary Items	7,538	9,313	1,588	2,335	5,618
Add: Depreciation	2,054	5,704	6,758	9,953	8,204
Add: Interest	772	1,291	978	1,146	1,040
Add: Others	(580)	(1,161)	(697)	(723)	(973)
<b>Cash from operating activities</b>	<b>9,783</b>	<b>15,148</b>	<b>8,627</b>	<b>12,711</b>	<b>13,890</b>
Net changes - WC	232	(61)	3,473	(1,790)	(1,518)
Foreign exchange loss paid	(2)	(15)	-	-	-
Interest Paid	(783)	(1,332)	(978)	(1,146)	(1,040)
Direct taxes Paid	(1,644)	(1,897)	(2,396)	(467)	(1,124)
Extraordinary Items	(309)	(634)	-	-	-
<b>Net cash from operating</b>	<b>7,278</b>	<b>11,208</b>	<b>8,726</b>	<b>9,309</b>	<b>10,208</b>
Capital expenditure	(5,330)	(11,710)	(11,513)	(4,000)	(3,000)
Others	(3,215)	(5,174)	4,785	(4,277)	(4,027)
<b>Net Cash from investing</b>	<b>(8,545)</b>	<b>(16,885)</b>	<b>(6,727)</b>	<b>(8,277)</b>	<b>(7,027)</b>
<b>Net free cash flows</b>	<b>1,922</b>	<b>(518)</b>	<b>(2,787)</b>	<b>5,309</b>	<b>7,208</b>
Debt change	1,642	5,729	(983)	(2,000)	(2,000)
Dividend paid	(326)	(611)	(571)	(416)	(652)
<b>Net cash from financing</b>	<b>1,316</b>	<b>5,118</b>	<b>(1,554)</b>	<b>(2,416)</b>	<b>(2,652)</b>
Net change in cash	48	(559)	444	(1,384)	529
<b>Closing Cash Balance</b>	<b>4,723</b>	<b>4,164</b>	<b>4,608</b>	<b>3,224</b>	<b>3,753</b>

Source: Company, Centrum Research Estimates

### Exhibit 8: Key Ratios

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
<b>Valuations Metrics (x)</b>					
P/E	10.2	8.4	25.6	33.1	13.8
Price/Cash earnings	7.6	4.7	6.7	5.2	4.9
Price/BV	5.1	3.4	3.1	2.9	2.5
EV/Sales	2.4	1.8	1.9	1.3	1.0
EV/EBITDA	6.7	4.2	7.4	4.8	3.8
EV/tonne (USD)	155.5	125.9	106.9	97.7	85.4
<b>Profitability Metrics (%)</b>					
EBITDA margin (%)	35.7	42.2	25.2	27.4	26.2
EBITDA per Tonne (Rs) (Cement)	1,224.4	1,335.5	751.4	898.7	1,062.3
EBIT margin (%)	28.0	26.1	6.0	5.5	10.5
Adj PAT margin (%)	22.9	20.9	6.9	4.1	8.6
<b>Return Ratios (%)</b>					
RoE	64.7	48.6	12.7	9.1	19.3
RoCE	25.7	22.1	8.7	5.1	11.2
RoIC	27.9	22.5	4.2	5.0	10.7
<b>Growth Metrics (%)</b>					
Net Sales	28.8	32.8	(0.6)	29.5	15.4
EBITDA	10.2	56.9	(40.6)	40.7	10.3
EPS	96.5	21.5	(67.3)	(22.8)	140.6
<b>Per share (Rs)</b>					
Adjusted EPS	174.8	212.3	69.4	53.6	129.0
CEPS	233.7	376.0	263.4	339.3	364.5
Book Value per share	347.3	526.2	570.1	611.8	722.1
<b>Solvency Ratio (x)</b>					
D/E	1.2	1.1	1.0	0.8	0.6
Net D/E	0.1	0.1	0.2	(0.1)	(0.4)
Interest coverage	10.0	7.8	2.1	2.2	5.3
Current Ratio	2.1	1.6	1.6	1.6	1.7

Source: Company, Centrum Research Estimates

## Appendix A

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**Website:** www.centrum.co.in  
**Investor Grievance Email ID:** investor.grievances@centrum.co.in  
**Compliance Officer Details :**  
 Mr. C. Vijaya Rao; Tel: (022) 42159437; Email ID: vi.rao@centrum.co.in

**REGD. OFFICE Address**

Bombay Mutual Bldg., 2nd Floor, Dr. D. N. Road, Fort, Mumbai - 400 001

**Correspondence Address**

Centrum House, 6th Floor, CST Road, Near Vidya Nagari Marg, Kalina, Santacruz (E), Mumbai 400 098.  
 Tel: (022) 4215 9000