15 November 2011

2QFY12 Results Update | Sector: Cement

India Cements

BSE SENSEX	S&P CNX
16,883	5,069

Bloomberg	ICEM IN
Equity Shares (m)	307.2
52-Week Range (INR)	121/62
1,6,12 Rel. Perf. (%)	-6/-11/-22
M.Cap. (INR b)	21.8
M.Cap. (USD b)	0.4

CMP: INR71 TP: INR100 Buy

YEAR END *	NET SALES (INR M)	PAT (INR M)	EPS (INR)	EPS GR. (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ EBITDA	EV/TON (US$)
03/10A	37,711	3,253	10.9	-38.5	6.5	0.5	8.4	10.6	5.1	59
03/11A	35,007	663	2.2	-79.6	31.9	0.5	1.6	3.6	10.5	58
03/12E	41,854	3,394	11.8	431.3	6.0	0.5	7.9	10.6	4.8	60
03/13E	47,033	3,755	13.1	10.6	5.4	0.4	8.3	10.5	4.2	57

* Consolidated

2QFY12 operating performance was in line with our estimates. EBITDA was INR2.52b, buoyed by higher IPL contribution at the EBITDA level. Key highlights:

- Volumes de-grew by 11% YoY (up 5% QoQ) to 2.43mt (against our estimate of 2.42mt), reflecting ~4% de-growth in South India. Realizations were INR4,223/ton (against our estimate of INR4,152/ton) up by 1.8% QoQ (~45% YoY) benefiting from production discipline in the southern market.
- EBITDA/ton was INR1,038/ton (against our estimate of INR998/ton and INR1,045/ton in 1QFY12) and EBITDA margins were 23.1% (against our estimate of 23.3%, up 20bp QoQ, up 19.7pp YoY). Operating performance got a boost from the highest ever EBITDA from IPL. IPL earned EBITDA of INR328m and shipping lost EBITDA of INR20m.
- Cost push was evident in RM and energy costs. Blended coal cost was higher by ~INR750/ton due to a strike at Singareni Coal mines, resulting in higher dependence on imported coal.
- The management indicated that demand had not recovered, but production discipline had resulted in a stable pricing environment. The management expects sustained stable pricing environment for FY12 and supply of coal from its Indonesian mine to start in 4QFY12 and expects savings of USD10-15/ton.
- We maintain our estimates for FY12 at INR11.8 and FY13 at INR13.1. We are not yet factoring in any benefit from the Indonesian coal mine and CPP units.
- The stock is valued at 5.4x FY13E EPS (ex-treasury stock), 4.2x FY13E EBITDA and USD57/ton (at 15.5mt capacity). Maintain **Buy** with a target price of INR100 (~5x FY13E EV/EBITDA).

Quarterly Performance (Standalone) (INR Million)

Y/E March	FY11				FY12E				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales Dispatches (m ton)	2.66	2.72	2.04	2.55	2.31	2.43	2.00	2.66	9.96	9.40
YoY Change (%)	8.0	-2.7	-26.1	-13.7	-13.0	-10.6	-2.0	4.5	-9.1	-5.6
Realization (Rs/ton)	3,211	2,909	3,665	3,812	4,148	4,223	4,203	4,312	3,375	4,225
YoY Change (%)	-14.0	-15.4	21.1	22.0	29.2	45.2	14.7	13.1	2.2	25.2
QoQ Change (%)	2.8	-9.4	26.0	4.0	8.8	1.8	-0.5	2.6		
Net Sales	**8,807**	**8,412**	**7,810**	**9,979**	**10,568**	**10,891**	**8,640**	**11,755**	**35,007**	**41,854**
YoY Change (%)	-7.6	-15.0	-9.6	3.5	20.0	29.5	10.6	17.8	-7.2	19.6
Total Expenditure	7,806	8,125	6,547	8,192	8,151	8,371	6,945	8,568	30,670	32,035
EBITDA	**1,001**	**286**	**1,263**	**1,787**	**2,417**	**2,520**	**1,695**	**3,187**	**4,337**	**9,819**
Margins (%)	11.4	3.4	16.2	17.9	22.9	23.1	19.6	27.1	12.4	23.5
Depreciation	599	610	617	615	619	626	700	857	2,440	2,802
Interest	298	315	371	434	583	652	650	668	1,417	2,553
Other Income	27	23	63	283	49	29	60	112	396	250
PBT before EO expense	**132**	**-615**	**338**	**1,021**	**1,265**	**1,270**	**405**	**1,774**	**875**	**4,714**
Extra-Ord expense	-142	-148	-18	285	36	244	0	0	-23	280
PBT	**274**	**-467**	**356**	**736**	**1,228**	**1,027**	**405**	**1,774**	**899**	**4,434**
Tax	24	-131	106	219	208	330	128	577	218	1,242
Rate (%)	8.8	28.0	29.8	29.7	16.9	32.1	31.5	32.5	24.2	28.0
Reported PAT	**250**	**-336**	**250**	**517**	**1,020**	**697**	**278**	**1,198**	**681**	**3,193**
Adj PAT	**120**	**-443**	**238**	**718**	**1,051**	**862**	**278**	**1,198**	**663**	**3,394**
YoY Change (%)	-90.8	-132.1	-12.4	143.8	774.3	-294.7	16.9	66.9	-79.6	411.6
Margins (%)	1.4	-5.3	3.0	7.2	9.9	7.9	3.2	10.2	1.9	8.1

E: MOSL Estimates

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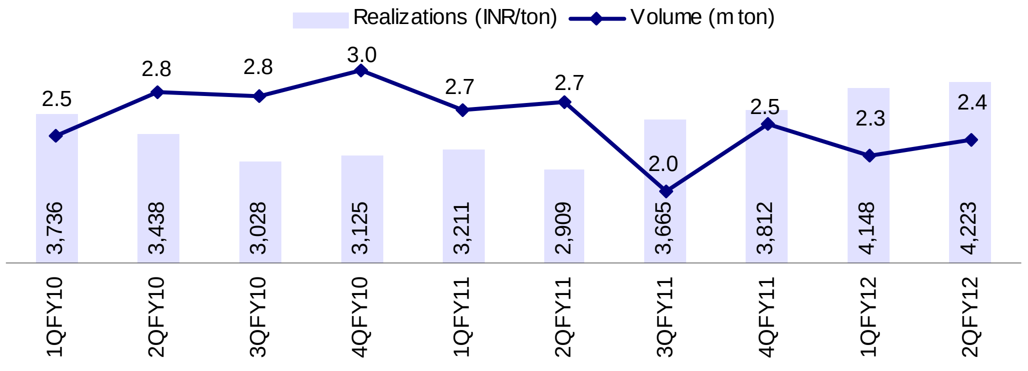
Production discipline leads to volume drop, stable prices…

- India Cements' (ICEM) revenue grew by 30% YoY (~3% QoQ) to INR10.9b (against our estimate of INR10.5b).
- Volumes de-grew by 11% YoY (up 5% QoQ) to 2.43mt (against our estimate of 2.42mt), impacted by demand de-growth in South India, especially its key market of Andhra Pradesh.
- However, production discipline led to stable cement prices with improvement of ~1.8% QoQ (~45% YoY) to INR4,223/ton (against our estimate of INR4,152/ton).
- Revenue from IPL was INR515m (v/s INR848m in 1QFY12 and our estimate of INR150m), whereas shipping freight revenues were INR67m (against our estimate of INR100m).

Trend in cement volumes and realizations

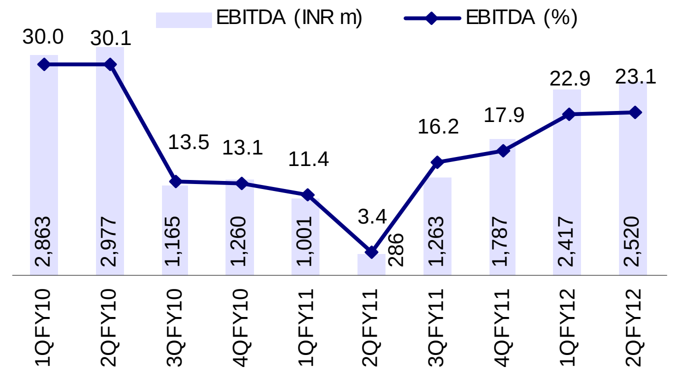


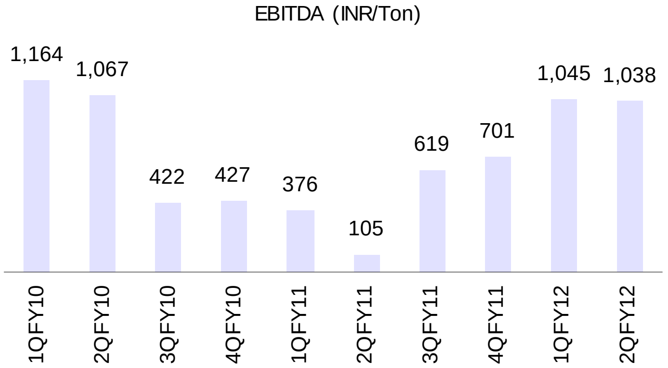
Source: Company/MOSL

…driving strong recovery in profitability

- Blended EBITDA/ton was INR1,038/ton (against our estimate of INR998/ton and INR1,045/ton in 1QFY12) and EBITDA margins were 23.1% (against our estimate of 23.3%; up 20bp QoQ, up 19.7pp YoY). Pure cement EBITDA was INR891/ton (against our estimate of INR998/ton and INR987/ton in 1QFY12).
- Operating performance got a boost from the highest ever EBITDA from IPL of INR328m and shipping lost EBITDA of INR20m.
- Cost push was evident in RM and energy costs. Blended coal cost was higher by ~INR750/ton due to a strike at Singareni Coal mines, resulting in higher dependence on imported coal.
- Higher interest costs and tax restricted adjusted PAT to INR862m (down 18% QoQ).
- ICEM booked MTM loss of INR244m on USD80m ECBs and working capital loans, restricting reported PAT to INR697m.

Trend in EBITDA





Key operating indicators* (INR/Ton)

	2QFY12	2QFY11	YoY (%)	1QFY12	QoQ (%)
Net realization	4,223	2,909	45.2	4,148	1.8
Expenditure					
RM Cost	613	519	18.2	574	6.8
Employee Expenses	289	222	30.3	275	5.1
Power, Oil & Fuel	1,119	964	16.1	1,032	8.4
Selling Expenses	790	685	15.2	779	1.4
Other Expenses	638	602	6.0	863	-26.1
Total Exp	3,449	2,992	15.3	3,524	-2.1
EBITDA	**1,038**	**105**	**884.8**	**1,045**	**-0.6**

'* Expenditure and EBITDA inclusive of IPL & Shipping businesses Source: Company/MOSL

Supply from Indonesian coal mine to start from 4QFY12; Regulatory changes to reduce benefit

- The ICEM management indicated that supplies from its recently acquired coal mine would begin on completion of supporting infrastructure, which is in an advanced stage of completion. It expects supplies to start by 4QFY12.
- ICEM acquired coal mining rights in Indonesia to meet its coal requirements. The mine has reserves of 30mt of coal with 5,500Kcal/kg. Its investment in the mine is ~USD20m.
- In the first full year of operation, ICEM will mine ~0.1mt/month (its current requirement is ~80k tons/month of imported coal, which would increase to ~0.1mt after its CPP start operations).
- However, recent regulatory changes in Indonesia linking royalty on exported coal to the Richard Bay Index will reduce savings on coal from the captive coal mine.
- Be4sides, ICEM acquired two ships last year, which will significantly reduce its exposure to volatile energy prices and shipping freight.
- ICEM's ongoing addition of 100MW CPP (expected commissioning in 3QFY12 and 2QFY13) will increase its dependence on CPP from the current 15% to ~75%.

Demand outlook remains challenging

- The management indicated that demand had not recovered but production discipline resulted in continuous price recovery. The management maintained its volume guidance of ~10mt (excluding the Rajasthan plant).
- The management indicated that the demand outlook in South India was challenging with its key markets of Andhra Pradesh and Karnataka showing no sign of improvement. Cement volumes in South India de-grew by 4% in 2QFY12. The management is hopeful of demand pick-up in January 2012.
- Muted demand coupled with excess capacities resulted in the utilization rate in South India dropping to ~65%.
- However, the management is hopeful that the current arrangement on production discipline will sustain for FY12 after cement manufacturers suffered cash losses.
- The management indicated that current realizations were higher by INR5/bag as the rail freight hike was fully passed on to consumers.

Valuation and view

- With demand in South India remaining muted, we believe the worst of the pricing scenario is behind us. We expect prices to be volatile, driven by seasonality and changes in the cartel. However, we do not expect prices to correct as much as they did in 1HFY11.
- The pace of capacity addition in South India is expected to slow as only 10-12mt of new capacities are expected to start operations over the next 18 months (against 30mt commissioning operations over the past 18 months).
- With very high operating leverage and relatively high gearing, ICEM would be one of the biggest beneficiaries of improvement in cement prices in South India.
- We are neither assigning any savings from the Indonesian coal mine nor any value to its IPL franchise 'Chennai Super Kings'.
- A breakdown in the cartel without improvement in demand would be the biggest concern.
- The stock is valued at 5.4x FY13E EPS (ex-treasury stock), 4.2x FY13E EBITDA and USD57/ton (at 15.5mt capacity). Valuations are attractive considering bottom of the cycle earnings. Maintain **Buy** with a target price to INR100 (~5x FY13E EV/ EBITDA).

India Cements: an investment profile

Company description

India Cements (ICEM) is among the top five players in India and a leader in southern India, with seven plants spread over Tamil Nadu and Andhra Pradesh and total capacity of 15.5mt. It owns Chennai Super Kings, a cricket team in the Indian Premier League.

Key investment argument

- Regional leader with a strong presence in South India, total capacity of 15.5mt and strong brand equity in its key markets.
- Strategically located plants with proximity to markets and to the port provide easy access to international markets and imported coal.
- Brown-field capacity expansion will lower capex requirement and the gestation period.

Key investment risks

- High gearing, despite repayment of loans after debt restructuring results in high financial leverage.
- ICEM's ambition to venture into new markets (Himachal Pradesh and Rajasthan) could pose a significant business cycle risk and put pressure on its balance sheet.

Recent developments

- Nil

Valuation and view

- The stock is valued at 5.4x FY13E EPS (ex-treasury stock), 4.2x FY13E EBITDA and USD57/ton (at 15.5mt capacity).
- Maintain **Buy** with a target price to INR100 (~5x FY13E EV/EBITDA).

Sector view

- Although the sector will continue to be plagued by over-capacity at least until December 2011 we expect volatility in cement prices and cement companies' performances over the next 6-9 months.
- However, we believe we have already witnessed bottom-of-the-cycle utilization and profitability and it should gradually improve from hereon, given sustainable demand drivers.
- Cement prices will face increased volatility over the next 6-9 months.

Comparative valuations

		India Cements	Shree Cement	UltraTech Cement
P/E (x)	FY12E	6.0	10.7	14.2
	FY13E	5.4	9.6	11.3
P/BV (x)	FY12E	0.5	3.2	2.5
	FY13E	0.4	2.8	2.1
EV/Ton ($)	FY12E	60	95	125
	FY13E	57	89	98
EV/EBITDA (x)	FY12E	4.8	6.3	7.8
	FY13E	4.2	4.9	6.2

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	11.8	7.6	54.9
FY13	13.1	10.4	25.4

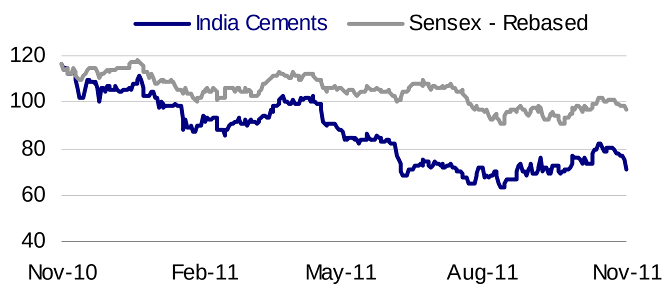
Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
71	100	40.8	Buy

Shareholding pattern (%)

	Sep-11	Jun-11	Sep-10
Promoter	25.8	25.4	25.2
Domestic Inst	16.7	17.7	15.1
Foreign	35.4	33.9	34.6
Others	22.2	23.1	25.2

Stock performance (1 year)



Financials and Valuation

Income Statement (INR Million)

Y/E March	2009	2010	2011	2012E	2013E
Net Sales	**34,268**	**37,711**	**35,007**	**41,854**	**47,033**
Change (%)	12.6	10.0	-7.2	19.6	12.4
Total Expenditure	24,306	29,445	30,670	32,035	36,363
% of Sales	70.9	78.1	87.6	76.5	77.3
EBITDA	**9,962**	**8,265**	**4,337**	**9,819**	**10,670**
Margin (%)	29.1	21.9	12.4	23.5	22.7
Depreciation	2,033	2,331	2,440	2,802	3,213
EBIT	**7,928**	**5,934**	**1,897**	**7,017**	**7,457**
Int. and Finance Charges	1,121	1,426	1,417	2,553	2,593
Other Income - Rec.	470	370	396	250	280
PBT bef. EO Exp.	**7,276**	**4,877**	**875**	**4,714**	**5,144**
EO Expense/(Income)	793	-436	-23	280	0
PBT after EO Exp.	**6,483**	**5,313**	**899**	**4,434**	**5,144**
Current Tax	1,862	1,633	168	1,197	1,234
Deferred Tax	299	137	50	44	154
Tax Rate (%)	33.3	33.3	24.2	28.0	27.0
PAT Adj for EO items	**4,851**	**3,253**	**663**	**3,394**	**3,755**
Change (%)	-27.2	-32.9	-79.6	411.6	10.6
Margin (%)	14.2	8.6	1.9	8.1	8.0

Balance Sheet (INR Million)

Y/E March	2009	2010	2011	2012E	2013E
Equity Share Capital	2,824	3,072	3,072	3,072	3,072
Fully Diluted excl Treasury	2,735	2,983	2,983	2,872	2,872
Total Reserves	33,490	38,286	37,826	40,252	43,083
Net Worth	**36,314**	**41,358**	**40,898**	**43,324**	**46,154**
Minority Interest	0	0	0	48	74
Deferred Liabilities	2,556	2,693	2,743	2,787	2,941
Total Loans	19,880	21,327	24,561	28,741	28,591
Capital Employed	**58,750**	**65,378**	**68,201**	**74,899**	**77,760**
Gross Block	53,136	57,102	65,099	71,599	79,599
Less: Accum. Deprn.	15,053	17,916	20,356	23,158	26,371
Net Fixed Assets	**38,083**	**39,186**	**44,743**	**48,441**	**53,228**
Capital WIP	9,040	7,029	4,000	5,000	1,000
Total Investments	**1,590**	**3,140**	**1,603**	**1,603**	**1,603**
Curr. Assets, Loans&A	**21,435**	**26,446**	**29,039**	**32,294**	**35,346**
Inventory	3,705	4,682	5,177	5,733	6,443
Account Receivables	3,540	2,534	2,544	3,440	3,866
Cash and Bank Balance	852	538	331	2,134	4,052
Loans and Advances	13,134	18,692	20,986	20,986	20,986
Real Estate Projects WIP	204	0	0	0	0
Curr. Liability & Prov.	**11,533**	**10,422**	**11,184**	**12,438**	**13,417**
Account Payables	7,445	7,296	7,070	6,509	6,774
Other Current Liabilities	3,234	2,028	3,357	4,013	4,510
Provisions	854	1,099	757	1,916	2,133
Net Current Assets	**9,902**	**16,023**	**17,855**	**19,855**	**21,929**
Appl. of Funds	**58,750**	**65,378**	**68,201**	**74,899**	**77,760**

E: MOSL Estimates; * Adjusted for treasury stocks

Ratios

Y/E March	2009	2010	2011	2012E	2013E
Basic (Rs) *					
Fully Diluted EPS	**17.7**	**10.9**	**2.2**	**11.8**	**13.1**
Cash EPS	25.2	18.7	10.4	21.4	24.2
BV/Share	132.3	138.7	137.1	150.8	160.7
DPS	2.0	2.0	1.5	2.0	2.5
Payout (%)	15.3	20.3	79.2	22.5	23.9
Valuation (x) *					
P/E	4.0	6.5	31.9	6.0	5.4
Cash P/E	2.8	3.8	6.8	3.3	2.9
P/BV	0.5	0.5	0.5	0.5	0.4
EV/Sales	1.1	1.1	1.3	1.1	1.0
EV/EBITDA	3.9	5.1	10.5	4.8	4.2
EV/Ton (US$)	58	59	58	60	57
Dividend Yield (%)	2.8	2.8	2.1	2.8	3.5
Return Ratios (%)					
RoE	15.7	8.4	1.6	7.9	8.3
RoCE	16.8	10.6	3.6	10.6	10.5
Working Capital Ratios					
Asset Turnover (x)	0.6	0.6	0.5	0.6	0.6
Inventory (Days)	39.5	45.3	54.0	50.0	50.0
Debtor (Days)	33	22	27	30	30
Leverage Ratio (x)					
Current Ratio	1.9	2.5	2.6	2.6	2.6
Debt/Equity	0.5	0.5	0.6	0.7	0.6

* Adjusted for treasury stocks

Cash Flow Statement (INR Million)

Y/E March	2009	2010	2011	2012E	2013E
Oper. Profit/(Loss) before	10,097	8,398	4,337	9,819	10,670
Interest/Dividends Recd.	444	335	396	250	280
Direct Taxes Paid	-830	-1,443	-168	-1,197	-1,234
(Inc)/Dec in WC	-2,206	-4,867	-2,038	-198	-156
CF from Operations	**7,506**	**2,422**	**2,527**	**8,674**	**9,560**
EO expense	0	0	23	-280	0
CF from Operating incl I	**7,506**	**2,422**	**2,550**	**8,394**	**9,560**
(inc)/dec in FA	-9,538	-2,961	-4,968	-7,500	-4,000
(Pur)/Sale of Investments	-324	-1,990	1,537	0	0
CF from investments	**-9,863**	**-4,952**	**-3,432**	**-7,500**	**-4,000**
Issue of Shares	28	2,831	-602	0	0
(Inc)/Dec in Debt	981	1,878	3,233	4,180	-150
Interest Paid	-1,398	-1,833	-1,417	-2,553	-2,593
Dividend Paid	-659	-661	-539	-719	-899
CF from Fin. Activity	**-1,048**	**2,215**	**675**	**909**	**-3,642**
Inc/Dec of Cash	**-3,404**	**-314**	**-207**	**1,803**	**1,918**
Add: Beginning Balance	4,256	852	538	331	2,134
Closing Balance	**852**	**538**	**331**	**2,134**	**4,052**

NOTES

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