

Madras Cements

BSE Sensex 19,610	S&P CNX 5,939
Bloomberg	MC IN
Equity Shares (m)	238.0
M.Cap. (INR b)/(USD b)	52.7/0.9
52-Week Range (INR)	269/135
1,6,12 Rel. Perf. (%)	-9/7/38

CMP: INR222
TP: INR300
Buy
Valuation summary (INR b)

Y/E March	2013	2014E	2015E
Sales	37.9	42.4	48.7
EBITDA	9.6	11.1	13.6
NP	4.0	4.8	6.7
Adj EPS (INR)	17.0	20.2	28.0
EPS Gr. (%)	4.9	18.9	38.8
BV/Sh. (INR)	99.6	116.3	140.2
RoE (%)	18.3	18.7	21.8
RoCE (%)	15.8	17.9	22.3
Payout (%)	20.6	17.4	14.5

Valuations			
P/E (x)	13.1	11.0	7.9
P/BV (x)	2.2	1.9	1.6
EV/EBITDA (x)	7.9	6.4	4.6
EV/Ton (USD)	98	93	82

- Net sales up 1.7% YoY:** Volumes grew 0.5% YoY (13% QoQ) to 2.2MT (v/s our estimate of 2.36MT). Realization grew 8.4% YoY but was flat QoQ at INR4,465/ton (v/s our estimate of INR4,646/ton), despite a seasonally strong quarter. Net sales grew 1.7% YoY (declined 6% QoQ) to INR9.3b.
- EBITDA down 29% YoY:** EBITDA declined 29% YoY (30% QoQ) to INR1.4b (v/s our estimate of INR2.6b). EBITDA margin contracted ~7pp YoY (8pp QoQ) to 15.2%. Cement EBITDA/ton declined by INR176 YoY (INR264 QoQ) to INR740. The sequential decline in profitability was driven by flattish realization, and higher freight cost (+INR90/ton) and other expenditure (+INR109/ton). Energy cost moderated sequentially due to softening of imported coal prices. Other expenditure was up by INR220m due to increase in ad spends necessitated by entry into the eastern market (on dealer network, brand building, etc).
- PAT down 35% YoY:** PAT declined 35% YoY (24% QoQ) to INR642m, led by lower depreciation, interest and effective tax rate.
- Cutting estimates; maintain Buy:** We are downgrading our EPS estimates for FY14/15 by 9%/2% to factor in (1) change in realization estimates to INR6.5/bag for FY14 (INR13.5/bag earlier) and to INR15/bag for FY15 (INR12.5/bag earlier), (2) higher escalation in freight cost and other expenditure for entry into eastern market, and (3) lower interest and depreciation in FY14/15. The stock trades at 7.9x FY15E EPS, and at an EV of 4.6x FY15E EBITDA and USD82/ton. We maintain **Buy**, with a target price of INR300 (35% upside). The board has approved a dividend of INR3/share (v/s INR2.5/share in FY12).

Quarterly Performance

Y/E March	FY12				FY13				(INR Million)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	FY12	FY13
Sales Dispatches (m ton)	1.74	1.84	1.73	2.20	2.16	2.04	1.95	2.21	7.52	8.36
YoY Change (%)	-10.8	-3.0	4.9	22.1	24.2	10.7	12.8	0.5	3.0	11.2
Realization (INR/ton)	4,208	4,176	4,239	4,118	4,389	4,636	4,425	4,465	4,178	4,478
YoY Change (%)	24.5	37.9	23.4	8.8	4.3	11.0	4.4	8.4	22.8	7.2
QoQ Change (%)	11.1	-0.8	1.5	-2.8	6.6	5.6	-4.5	0.9		
Net Sales	7,642	8,190	7,410	9,119	9,893	9,995	8,725	9,272	32,030	37,884
YoY Change (%)	9.6	27.6	27.9	32.9	29.5	22.0	17.7	1.7	23.0	18.3
EBITDA	2,444	2,668	2,075	1,995	3,067	3,139	2,022	1,407	9,163	9,635
Margins (%)	32.0	32.6	28.0	21.9	31.0	31.4	23.2	15.2	28.6	25.4
Depreciation	642	625	613	659	781	749	695	581	2,539	2,806
Interest	476	425	374	310	543	507	429	307	1,585	1,785
Other Income	58	96	48	314	78	84	343	337	536	842
PBT before EO expense	1,384	1,714	1,136	1,340	1,821	1,967	1,242	857	5,575	5,887
Extra-Ord expense	0	0	0	-1	0	0	5	0	1	5
PBT	1,384	1,714	1,136	1,341	1,821	1,967	1,238	857	5,574	5,882
Tax	401	605	367	350	591	638	402	215	1,723	1,846
Rate (%)	29.0	35.3	32.3	26.1	32.4	32.4	32.4	25.1	30.9	31.4
Reported PAT	983	1,109	768	992	1,230	1,329	836	642	3,851	4,037
Adj PAT	983	1,109	768	991	1,230	1,329	839	642	3,852	4,040
YoY Change (%)	35.4	256.3	76.7	55.4	25.1	19.9	9.2	-35.3	83.0	4.9
Margins (%)	12.9	13.5	10.4	10.9	12.4	13.3	9.6	6.9	12.0	10.7

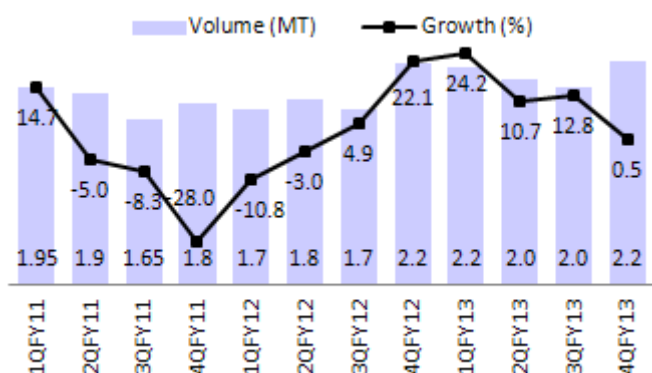
Jinesh Gandhi (Jinesh@MotilalOswal.com) + 91 22 3982 5416

Sandipan Pal (Sandipan.Pal@MotilalOswal.com); +9122 3982 5436

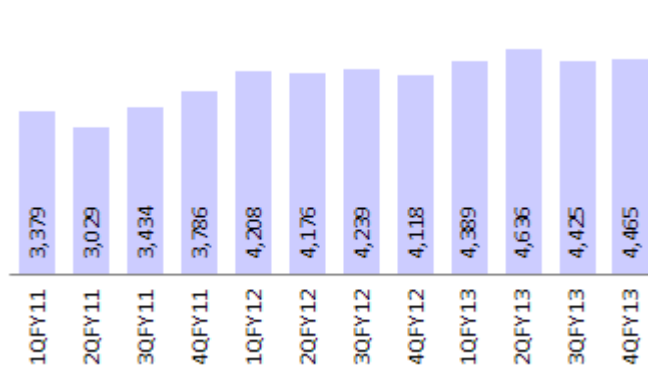
Revenue misses estimates with lower volume and realizations

- Volumes grew +0.5%YoY (+13%QoQ) to 2.2MT (est of 2.36MT). Subdued AP prices have been a drag on other southern states like Tamil Nadu and Kerala.
- Realization remains flat QoQ (+8.4%YoY) to INR4,465/ton (v/s est of INR4,646/ton) despite seasonally strong quarter.
- Net sales stood at INR9.3b (+1.7%YoY, -6%QoQ) which includes revenue from Power segment of INR58m (v/s est of INR88m and INR87m/INR67m in 3QFY12/2QFY13).

Trend in cement volumes



Realizations flat QoQ (INR/ton)



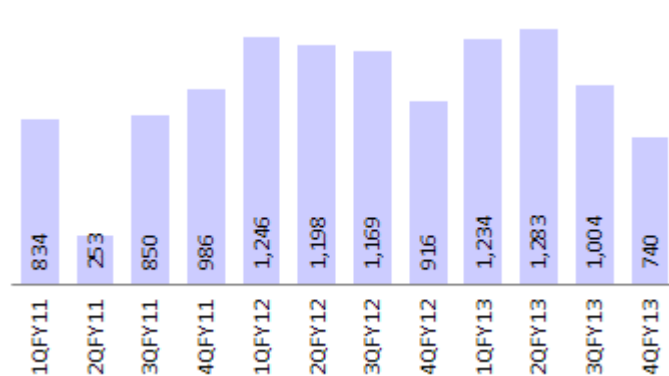
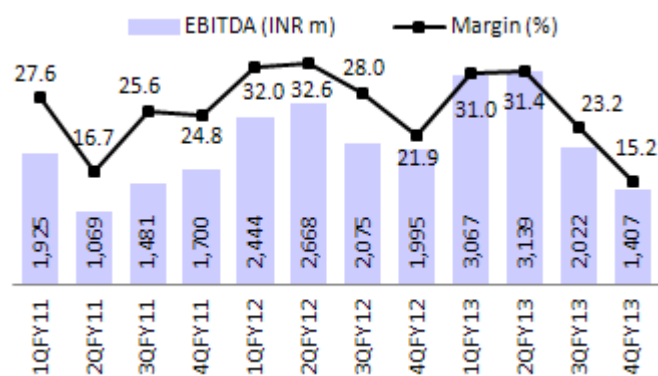
Source: Company, MOSL

Lower realizations, higher freight cost and other expense led to INR264/ton QoQ decline in cement EBITDA

- EBITDA de-grew 29%YoY (-30%QoQ) to INR1.4b (v/s estimate of INR2.6b), translating into contraction in EBITDA margin of 15.2% (down 8pp QoQ for 2nd consecutive quarter).
- Cement EBITDA/ton declined by INR264 QoQ (-INR176 YoY) to INR740.
- Decline in profitability was driven by to flattish realizations failing to pass on increase in freight cost (+INR90/ton) and other expense (+INR109/ton), due to limited operating leverage. Energy cost however was moderated sequentially due to softening of imported coal prices.
- Other expense was up by INR220m (+INR100/ton) due to increase in advertisement spending in entry into eastern market (on dealer's network, brand building etc).
- PAT stood at INR642m (-35%YoY, -24% QoQ) led by lower depreciation/interest and effective tax rates.
- Decline in interest expense QoQ was due to reclassification of exchange loss/gain into other expense, which was part of interest earlier. Due to same reason, 4Q interest was lower by INR47.7m and other expense was higher by similar amount. Depreciation was lower as it has stopped accounting for depreciation after 95% of assets in some factories / windmill (as per Companies Act), while effective tax rates were lower due to MAT provisions.

Cement segment EBITDA and margin trend

Trend in EBITDA/ton (INR)



Source: Company, MOSL

Per ton analysis (incl Windmills)

	FY12				FY13				FY12	FY13
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net realization	4,392	4,446	4,283	4,149	4,579	4,901	4,470	4,198	4,306	4,531
YoY (%)	22.8	31.6	22.0	8.8	4.2	10.2	4.4	1.2	20.7	5.2
RM Cost	678	533	454	646	594	638	607	693	581	634
Employee Expenses	239	233	249	198	208	252	249	231	228	234
Power, Oil & Fuel	938	1,004	1,021	936	985	1,002	1,019	878	972	969
Freight and Handling Outward	673	690	760	845	890	843	926	1,016	747	920
Other Expenses	459	537	600	616	482	627	633	743	556	622
Total Expenses	2,988	2,998	3,084	3,241	3,159	3,362	3,434	3,561	3,084	3,379
EBITDA	1,405	1,448	1,199	907	1,420	1,539	1,036	637	1,222	1,152
Cement EBITDA (ex Windmills)	1,246	1,198	1,169	916	1,234	1,283	1,004	740	1,119	1,061

Source: Company, MOSL

Revising estimates

We are downgrading our EPS for FY14/15 by 9%/2% to factor in for:

- Change in realizations estimates of INR6.5/bag in FY14 (v/s earlier est of INR13.5/bag) and INR15/bag in FY15 (v/s earlier est of INR12.5/bag).
- Higher escalation in freight cost and other expenses for entry in Eastern market.
- Lower interest and depreciation in 14/15.

Revised forecast (INR m)

	FY14E			FY15E		
	Rev	Old	Chg (%)	Rev	Old	Chg (%)
Net Sales	42,440	44,839	-5.4	48,698	50,836	-4.2
EBITDA	11,100	12,484	-11.1	13,596	14,281	-4.8
Net Profit	4,802	5,288	-9.2	6,666	6,801	-2.0
EPS (INR)	20.2	22.2	-9.2	28.0	28.6	-2.0

Source: MOSL

Valuation and view

- Madras Cements (MC) is likely to post ~7.5% volume CAGR over FY13-15 on the back of steady uptick in utilization of newly added capacities. It enjoys premium profitability (cement EBITDA/ton was INR1,061 v/s INR977 for MOSL Cement Universe in 13) due to superior brand and operational efficiencies.
- MC is likely to generate ~INR18.7b of FCF over FY14-15, which should lead to meaningful reduction in net debt by FY14/15 - we model net debt-equity of 0.4x by FY15. MC offers an attractive play on superior operating efficiency, premium profitability and strong FCF visibility.
- The stock trades at 7.9x FY15E EPS, and at an EV of 4.6x FY15E EBITDA and USD82/ton. We maintain **Buy**, with a target price of INR300 (35% upside).

Madras Cements: an investment profile

Company description

Madras Cements (MC) is one of the top three cement producers in South India with total nameplate capacity of 12.5mtpa (0.95mtpa in West Bengal and the balance in the South). It also has operational wind farm capacity of 159MW and 157MW of CPP capacity. Despite the unfavorable southern market, MC offers an attractive play due to superior operating efficiency, premium profitability and strong FCF visibility.

Key investment argument

- Stabilizing capacity to aid volume growth
- Operational efficiency, captive power drives superior profitability
- Moderating capex, FCF visibility to trigger de-leveraging

Key investment risks

- Concentrated in Southern India which has very adverse demand-supply equilibrium.
- Very high dependence on imported coal makes it vulnerable to volatile imported coal and forex rates.

Recent development

- Board approved dividend of INR3/share (v/s INR2.5/share in FY12).

Valuation and view

- The stock trades at 7.9x FY15E EPS, and at an EV of 4.6x FY15E EBITDA and USD82/ton.
- We maintain **Buy**, with a target price of INR300 (35% upside).

Sector view

- Unusual price weakness of 4QFY13 is expected to prevail in 1HFY14, as demand is expected to pick-up only post monsoon.
- Structural increase in cost base (both capex and opex) would necessitate higher cement prices.
- Revival in cement demand would be key catalyst for the stock performance.

Comparative valuations

		Madras Cements	Dalmia Bharat	Shree Cement
P/E (x)	FY14E	11.0	6.2	18.1
	FY15E	7.9	5.2	12.9
P/BV (x)	FY14E	1.9	0.4	3.9
	FY15E	1.6	0.3	3.1
EV/Ton (\$)	FY14E	93	40	128
	FY15E	82	40	121
EV/EBITDA (x)	FY14E	6.4	4.2	9.1
	FY15E	4.6	4.0	7.2

Shareholding pattern (%)

	Mar-13	Dec-12	Mar-12
Promoter	45.7	45.7	45.7
Domestic Inst	14.5	20.3	18.0
Foreign	13.8	5.8	6.5
Others	26.0	28.2	29.8

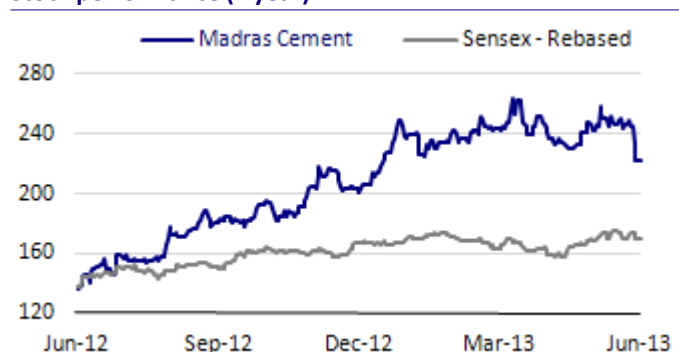
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY14	20.2	20.2	0.2
FY15	28.0	24.7	13.5

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
222	300	35.1	Buy

Stock performance (1 year)



Financials and Valuation

Income Statement					Ratios				
(INR Million)									
Y/E March	2012	2013	2014E	2015E	Y/E March	2012	2013	2014E	2015E
Net Sales	32,030	37,884	42,440	48,698	Basic (INR)				
Change (%)	23.0	18.3	12.0	14.7	Consol EPS	16.2	17.0	20.2	28.0
Total Expenditure	22,867	28,249	31,340	35,102	Cash EPS	26.9	28.8	32.6	40.8
% of Sales	71.4	74.6	73.8	72.1	BV/Share	86.2	99.6	116.3	140.2
EBITDA	9,163	9,635	11,100	13,596	DPS	2.5	3.0	3.0	3.5
Margin (%)	28.6	25.4	26.2	27.9	Payout (%)	18.0	20.6	17.4	14.5
Depreciation	2,539	2,806	2,946	3,054	Valuation (x)				
EBIT	6,624	6,830	8,154	10,542	P/E		13.1	11.0	7.9
Int. and Finance Charges	1,585	1,785	1,824	1,570	Cash P/E		7.7	6.8	5.4
Other Income - Rec.	536	842	839	830	P/BV		2.2	1.9	1.6
PBT bef. EO Exp.	5,575	5,887	7,169	9,803	EV/Sales		2.0	1.7	1.3
EO Expense/(Income)	1	5	0	0	EV/EBITDA		7.9	6.4	4.6
PBT after EO Exp.	5,574	5,882	7,169	9,803	EV/Ton (US\$)		98	93	82
Current Tax	1,121	1,174	1,878	2,451	Dividend Yield (%)		1.4	1.4	1.6
Deferred Tax	602	672	488	686	Return Ratios (%)				
Tax Rate (%)	30.9	31.4	33.0	32.0	RoE	20.4	18.3	18.7	21.8
Reported PAT	3,851	4,037	4,802	6,666	RoCE	15.4	15.8	17.9	22.3
PAT Adj for EO items	3,852	4,040	4,802	6,666	Working Capital Ratios				
Change (%)	83.0	4.9	18.9	38.8	Asset Turnover (x)	0.6	0.7	0.7	0.8
Margin (%)	12.0	10.7	11.3	13.7	Inventory (Days)	56.0	57.3	57.1	54.9
					Debtor (Days)	21	26	25	25
					Leverage Ratio (x)				
					Current Ratio	1.8	1.8	1.9	2.0
					Debt/Equity	1.3	1.1	0.8	0.5
Balance Sheet					Cash Flow Statement				
(INR Million)					(INR Million)				
Y/E March	2012	2013	2014E	2015E	Y/E March	2012	2013	2014E	2015E
Equity Share Capital	238	238	238	238	Oper. Profit/(Loss) before	6,624	6,830	8,154	10,542
Total Reserves	20,266	23,470	27,436	33,134	Interest/Dividends Recd.	536	842	839	830
Net Worth	20,504	23,708	27,674	33,372	Depreciation	2,539	2,806	2,946	3,054
Deferred Liabilities	6,492	7,164	7,652	8,338	Direct Taxes Paid	-1,121	-1,174	-1,878	-2,451
Total Loans	27,104	25,776	23,276	17,776	(Inc)/Dec in WC	155	-1,411	523	101
Capital Employed	54,100	56,647	58,602	59,487	CF from Operations	8,732	7,893	10,584	12,077
Gross Block	56,704	63,568	67,368	68,368	EO expense	-162	-5	0	0
Less: Accum. Deprn.	15,553	18,359	21,305	24,359	CF from Operating incl EO	8,570	7,888	10,584	12,077
Net Fixed Assets	41,152	45,209	46,063	44,009	(inc)/dec in FA	-5,419	-3,888	-3,000	-1,000
Capital WIP	5,276	2,300	1,500	1,500	(Pur)/Sale of Investments	8	7	0	0
Total Investments	2,665	2,658	2,658	2,658	CF from investments	-5,411	-3,881	-3,000	-1,000
Curr. Assets, Loans&Adv.	11,491	14,547	18,109	22,925	Issue of Shares	0	-3	0	0
Inventory	4,911	5,948	6,644	7,319	(Inc)/Dec in Debt	-808	-1,328	-2,500	-5,500
Account Receivables	2,079	3,028	3,322	3,812	Interest Paid	-1,585	-1,785	-1,824	-1,570
Cash and Bank Balance	475	536	2,960	6,000	Dividend Paid	-692	-830	-835	-968
Loans and Advances	4,026	5,035	5,183	5,794	CF from Fin. Activity	-3,084	-3,946	-5,160	-8,038
Curr. Liability & Prov.	6,483	8,067	9,727	11,605	Inc/Dec of Cash	75	61	2,424	3,040
Account Payables	4,892	6,194	6,910	7,929	Add: Beginning Balance	400	475	536	2,960
Provisions	1,591	1,873	2,817	3,676	Closing Balance	475	536	2,960	6,000
Net Current Assets	5,008	6,481	8,382	11,320					
Appl. of Funds	54,100	56,647	58,602	59,487					

E: MOSL Estimates; * Adjusted for treasury stocks

N O T E S

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In respect of any matter arising from or in connection with the research you could contact the following representatives of Motilal Oswal Capital Markets Singapore Pte Limited:

Nihar Oza

Email: niharoza.sg@motilaloswal.com

Contact: (+65) 68189232

Kadambari Balachandran

Email: kadambari.balachandran@motilaloswal.com

Contact: (+65) 68189233 / 65249115

Office address: 21 (Suite 31), 16 Collyer Quay, Singapore 049318



Motilal Oswal Securities Ltd

Motilal Oswal Tower, Level 9, Sayani Road, Prabhadevi, Mumbai 400 025

Phone: +91 22 3982 5500 E-mail: reports@motilaloswal.com