

CEMENT

Feedback from 'Edelweiss Cement Dealers Day' in India

India Equity Research | Cement



We hosted India's top cement distributors from all corners of the country, including the pan-India marketing head for institutional sales of India's largest cement company. Key takeaways were: a) the strong surge in cement demand in Uttar Pradesh (UP) is currently absorbing surpluses from East/Central/North. H2 could be unusually strong, if we were to add all the enquiries received by these distributors for project work in infra/irrigation in North/East/West; (b) for cement prices, participants agreed that fight for market share is now rare and limited. July and August would be the acid test for players to adhere to the discipline and if they do so, the risk for remaining part of the year is quite low; (c) in an informal survey, cement distributors opined that Shree Cement (SRCM), by far, has India's best distribution reach in terms of cost, flexibility and innovation. UltraTech Cement (UTCL) is following SRCM. For others, the journey is a long one. In South, Ramco (Not Rated) has done a commendable work. Our top picks are SRCM and UTCL.

Who all are consuming cement?

Urban households continue to be a drag on cement demand. However, what's pushed up the cyclical in few states is spending by the government on: (a) metro railways - in UP, construction work at both Lucknow/Noida is in full swing, enquiries are also beginning to come for the Mumbai metro; (b) bridge work in Bihar, irrigation/water sanitation work in many parts of UP; (c) in East - revival of affordable housing projects driven by fiscal support is leading to better demand outlook; and (c) hope for demand revival in South, but still there is more hope than actual data. Upcoming capacities, such as those by Emami, may supply bulk of their output for in-house projects.

Which are India's best cement companies?

Participant from South India was unequivocal in praising Ramco Cement as best in the South. Not much change is visible in India Cements in the way it operates. We were surprised with the feedback that 3 senior management personnel of UTCL have joined Century Textiles and are leading transformation of that organisation. The North and East distributors have so far not found much change in the way JK Cement/JK Lakshmi operates. For us, an additional data-point worth noting is that new CEO of UTCL is driving a change which could accelerate further cost reduction for the company. We were also surprised to learn that UTCL could save anything between INR150-250/t in warehouse handling once GST is implemented. It could lead to direct supplies to customers, currently not permissible under state/central tax laws.

Valuations: Stock corrections an opportunity to BUY our top picks

We maintain our positive stance on the sector factoring in expected demand revival, slow capacity additions, and imminent industry consolidation. Our top picks are SRCM, UTCL and Grasim.

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Chennai (South)

South is set for demand recovery after a long haul of muted volume growth. Although the major uptick is expected after 1-1.5 years, better volume growth rates will lead to an increase of INR500-1,000/t in cement players' realisation by H2FY17. Andhra Pradesh and Telangana are expected to register faster growth, Karnataka moderate, while Tamil Nadu and Kerala will clock relatively slower growth rate in ensuing years. Overall, it is envisaged that regional capacity utilisation rates will be over 70% by FY19 from current 55%, driving up sector profitability. Also, some amount of consolidation is anticipated in next 5 years.

Key highlights

- The region is set for demand uptick going ahead led by resolution of multiple issues including shortage of power, split of states, political uncertainties, etc., in past 2-3 years.
- Better monsoon and Seventh Pay Commission hikes are expected to drive demand in housing segment. Accordingly, expect volume growth to improve in H2FY17, driving cement players' realisations to grow by another 5-10% by end FY17.

Table 1: Cement realisations in South (INR/t)

Realisations	Tamil Nadu	Andhra Pradesh	Karnataka	Kerala
Present	5,000+	3,500-4,000	4,500-5,000	5,000+
To increase by?	400+	800-1,000	500-600	400+
By FYE – FY17	5,400	4,300-5,000	5,000-5,500	5,400

Source: Cement Distributors Data, Edelweiss research

- Based on the announcements so far, no major expansions are expected in next 2 years, which is expected to push capacity utilisations to over 70% by FY19 from current 55% in the region.
- On an average, expect market to touch growth rate of nearly 9-10% in next 2-2.5 years.

Table 2: Estimated medium term growth rates – State-wise

States	(%)
Tamil Nadu	8%+
Andhra Pradesh	10-15%
Karnataka	8-10%
Kerala	8%+

Source: Cement Distributors Data, Edelweiss research

- Broadly, expect demand from government projects to double in next 2 years, from about 10% of total regional demand at present to ~20% by FY19.
- Major government projects are expected from Andhra Pradesh and Telangana, some of which have already begun though progressing at slower pace than anticipated.
- Apart from Amravati, the Andhra Pradesh government has been focusing on developing 4 zones, which is expected to drive demand for cement in upcoming years.

Table 3: Andhra Pradesh zones

Zones/Category	Area
Food Processing	Vijayawada
IT	Vizag
Tourism	Tirupati
Industrial	Nellur - Tirupati

Source: Cement Distributors Data, Edelweiss research

- We may see some amount of consolidation in South region in next 5 years as the expected industry upturn provides higher valuation for sellers, which seems to have been their concern for not selling their assets so far.
- Ramco Cements, India Cements, UltraTech, Chettinad Cement and Dalmia Cement are among the top players in the region.

Ludhiana (North)

Weak property market has been a drag on cement demand in the state. In addition, imports from Pakistan, priced at ~INR50/bag below the Indian cement prices, also impacted volumes of domestic players, though marginally. Overall, the participant was positive on the demand and price outlook in the short to medium term.

Key highlights

- Volumes have been largely weak in Punjab in past 3 years.
- Present demand is primarily from individual housing and partly from commercial projects, while demand from property markets and government projects has been submissive.
- No major pre-election spending so far and do not expect it to happen.
- In the short-term, we may see demand revival only after monsoon season.
- Most of the non-trade buyers are also opting for imported cement from Pakistan, which is available at INR50/bag lower compared to Indian cement (A-Grade).

Delhi (North & Central)

Industry trend has been encouraging with strong recovery in prices, but amidst muted volume growth. Growth outlook remains benign and expect roads (concrete national highways) to be the major volume driver within infrastructure segment. Positive view on management change in UTCL and the new management is believed to have saved ~4-5% of freight/logistics costs in the region.

Key highlights

- Average cement prices in the region are about INR310-320/bag (A-Grade), with a possible variation of INR10-20/bag in different states.
- Present operating rate stands at ~75% in the region, as a whole.
- Multiple infrastructure projects are under construction across the region/country and progressing at slower pace than anticipated. Nonetheless, demand from roads (concrete national highways) is going to be one of the major volume drivers within infrastructure segment.

- In recent few weeks, construction activity, especially government related projects, has improved drastically in UP with the upcoming state elections generating strong demand for cement in the state.
- H2FY17 can be unusually strong, if we consider all the enquiries received by distributors for project work in infrastructure and irrigation segments in North/East/West regions.
- The inventory level at dealers' level has come down over the years as most of the plants have now been set up closer to dealers/end-users.
- Consider management change at UTCL a positive and new management was able to save ~4-5% of freight costs in North region.
- GST may provide cost savings of ~INR150-250/t, that can be expected post 3 months of its implementation. GST could lead to direct supplies to customers, which is not permissible under current state/central tax laws.

Kolkata (East)

Our channel partner was positive on the cement sector outlook and anticipates prices to touch ~INR360/t in the next 12 months from INR325/bag at present. Top 4 players account for almost 60% of West Bengal cement market and believes that UTCL will be the biggest beneficiary of sector up-cycle both at country and state levels (due to plant's proximity to consumption locations).

Key highlights

- West Bengal has about 10 cement grinding units with UTCL's Dhankuni plant being the latest one. Expect UTCL to benefit most from this plant as it is closer to consumption destination, paving way for freight cost savings.
- Two new grinding units (Emami and JSW Cement) are expected to be added in the state in upcoming years. Work at Emami's plant has already began and expected to be commissioned by year end, while JSW Cement has acquired the land where it proposes to set up the grinding unit.
- The state has total demand of 13-14mt, with top 4 players (including, Lafarge, UltraTech and Ambuja Cement) accounting for 60% of the market.
- Overall demand is split into 70% housing, 10% government projects and rest from commercial and industrial segments.
- Contemplating good days ahead for cement sector in the region, participant believes UTCL would be the biggest beneficiary of the same due to its plant locality advantage.
- Expect cement prices to touch INR360/bag in 12 months period compared to INR325/bag at present.

Regional price trends: North and Central lead the recovery

Chart 1: All-India prices - At historical peak?

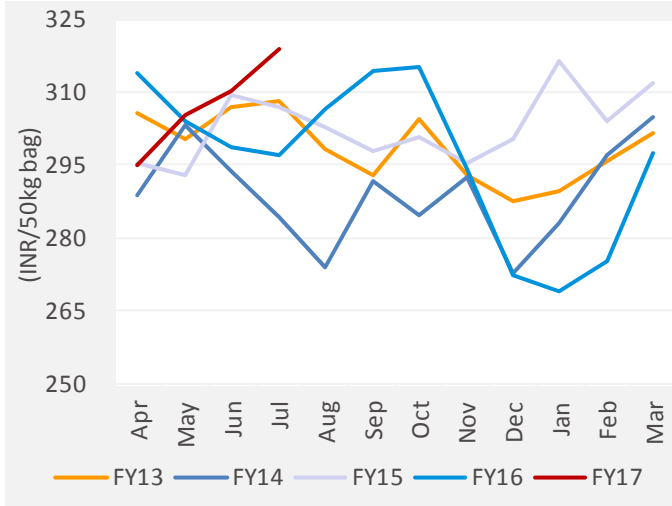


Chart 2: North: Rally of cement prices continues

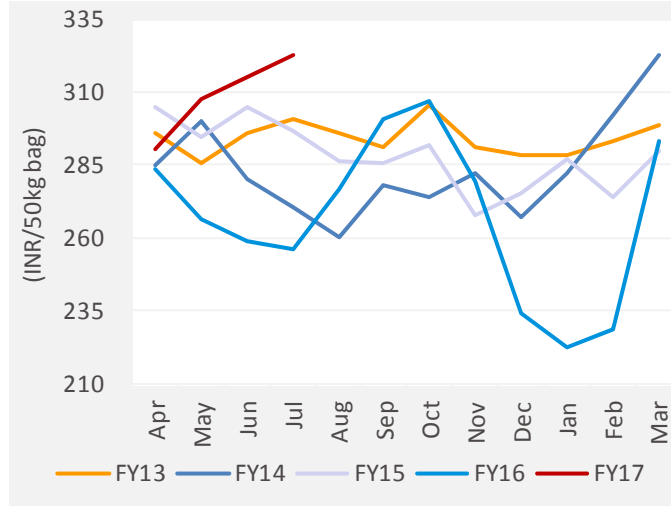


Chart 3: Central: Uttar Pradesh leads the pack

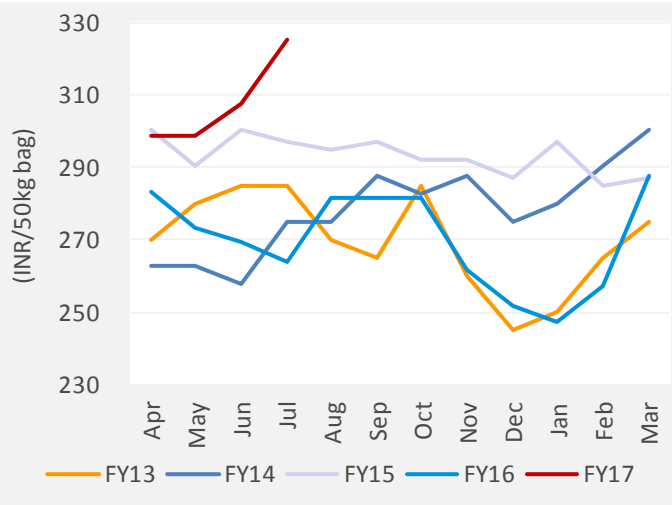


Chart 4: East: Marginal increase across the states

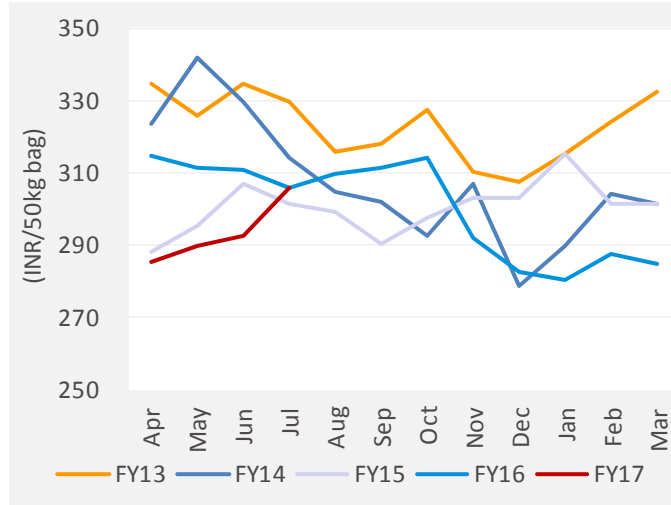


Chart 5: South: Flat over previous month

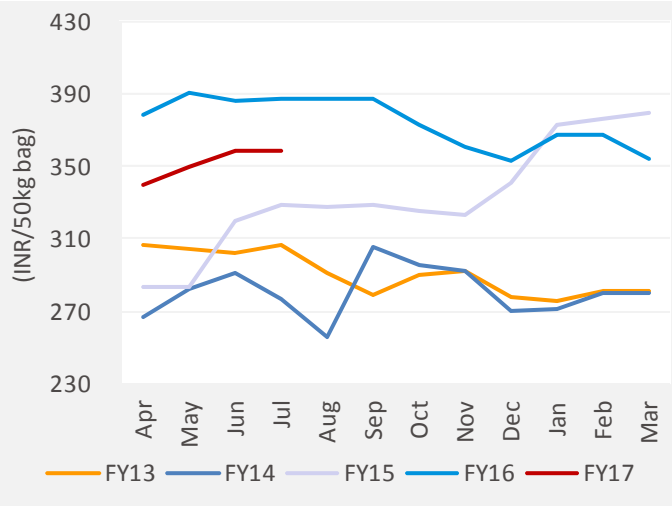
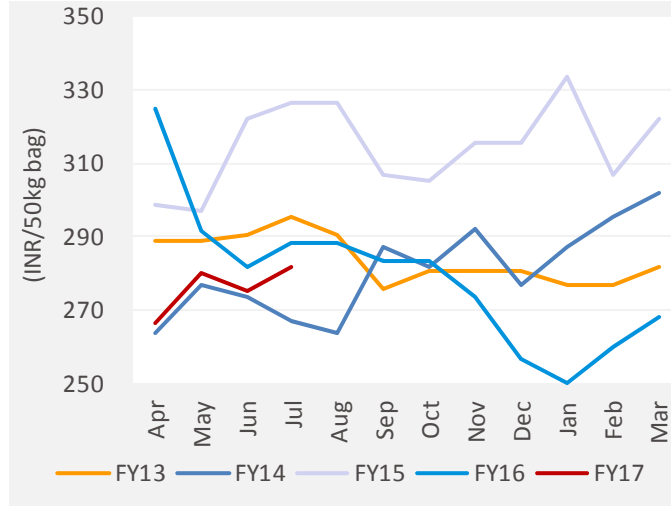


Chart 6: West: To remain at low levels during monsoon



Source: Company Distributors Data, Edelweiss research

Table 4: Indian cement stocks continue out-perform regional/global peer group

Company Name	FYE	Crncy	Price	Absolute (%)					Relative to BSE Sensex (%)				
				YTD (CY)	3M	6M	12M	3Y-Ann	YTD (CY)	3M	6M	12M	3Y-Ann
India (Coverage)													
Shree Cement	Mar	INR	16,075	39.8	26.9	60.5	46.8	54.0	32.2	17.5	45.8	46.9	39.9
UltraTech	Mar	INR	3,670	32.0	12.0	33.4	14.5	25.9	24.4	2.6	18.7	14.6	11.8
ACC	Dec	INR	1,676	23.2	17.8	34.6	18.9	14.1	15.6	8.4	19.8	19.0	0.0
Ambuja Cements	Dec	INR	269	32.5	20.4	36.6	12.0	18.4	24.9	11.0	21.8	12.1	4.3
India Cements	Mar	INR	117	20.9	32.0	34.3	38.4	32.1	13.3	22.6	19.6	38.5	18.0
Jk Cements Ltd	Mar	INR	702	21.7	15.2	37.8	12.1	51.3	14.2	5.8	23.0	12.1	37.2
Global													
LafargeHolcim	Dec	CHF	44.5	(8.4)	(3.6)	9.2	(31.9)	(9.7)					
Heidelberg Cement	Dec	EUR	71.5	(5.5)	(9.4)	8.3	(0.2)	10.0					
Cemex	Dec	USD	6.9	28.8	(2.1)	80.8	(10.6)	(12.6)					
China													
Anhui Conch	Dec	CNY	16.2	(5.1)	1.6	12.0	(19.9)	6.4					
CNBM	Dec	HKD	3.6	(2.7)	(11.9)	12.1	(42.5)	(19.7)					
Sinoma	Dec	HKD	1.9	25.7	(11.8)	39.8	(2.1)	5.0					
West China Cement	Dec	HKD	0.7	(54.4)	(55.2)	(53.8)	(51.7)	(13.3)					
Shanshui	Dec	HKD	6.3	-	-	-	-	25.7					
BBMG	Dec	HKD	2.9	11.6	5.4	32.4	(7.3)	6.8					
Indonesia													
Semen Gresik	Dec	IDR	9,400	(17.5)	(10.9)	(8.7)	(16.3)	(12.4)					
IndoCement	Dec	IDR	16,600	(25.6)	(16.8)	(15.1)	(24.6)	(5.0)					
Holcim Indonesia	Dec	IDR	1,095	10.1	(3.1)	19.0	(28.9)	(23.9)					
Lat Am													
Cementos Argos	Dec	COP	11,700	20.4	4.1	23.8	21.6	12.1					
Cemex LatAm	Dec	COP	12,400	20.4	(3.9)	22.8	(2.4)	(6.1)					
Taiwan													
Asia Cement	Dec	TWD	29.0	5.7	(1.0)	14.4	(18.1)	(2.5)					
Taiwan Cement	Dec	TWD	34.1	24.9	2.7	31.9	(7.3)	2.6					
Thailand													
Siam Cement	Dec	THB	510.0	10.9	6.7	21.4	(1.2)	8.7					

Source: Bloomberg, Edelweiss research

Table 5: Valuations

Company Name	Mkt Cap. (USD mn)	Ent. Val. (USD mn)	EV/EBITDA		P/E		P/CPS		EV/T
			FY17E	FY18E	FY17E	FY18E	FY17E	FY18E	FY18E
India (Coverage)									
Shree Cement	8,320	8,396	23.1	17.9	46.1	32.8	24.8	20.2	238.5
UltraTech	14,963	15,833	17.7	14.1	31.0	24.0	22.9	19.0	237.9
ACC	4,675	4,481	17.5	13.9	33.5	24.3	23.4	18.1	134.2
Ambuja Cements	6,202	5,460	19.0	16.0	33.5	25.7	19.2	16.0	184.2
India Cements	534	932	6.4	5.8	14.9	10.8	6.6	5.5	66.1
Jk Cements Ltd	730	1,122	10.7	8.1	23.6	12.7	12.9	8.7	91.8
Average			13.9	11.0	27.0	19.0	16.5	14.7	142.8

Source: Bloomberg, Edelweiss research

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Coverage group(s) of stocks by primary analyst(s): Cement

ACC, Ambuja Cement Ltd, Grasim Industries, India Cements, JK Cement, Shree Cements, UltraTech Cement

Recent Research

Date	Company	Title	Price (INR)	Recos
20-Jul-16	UltraTech Cement	Structurally positive result; <i>Result Update</i>	3,560	Buy
12-Jul-16	Cement	Not a time to run away from the party!!; <i>Monthly Update</i>		
04-Jul-16	UltraTech Cement	Renegotiation may appear as a dampener; <i>Company Update</i>	3,409	Buy

Distribution of Ratings / Market Cap

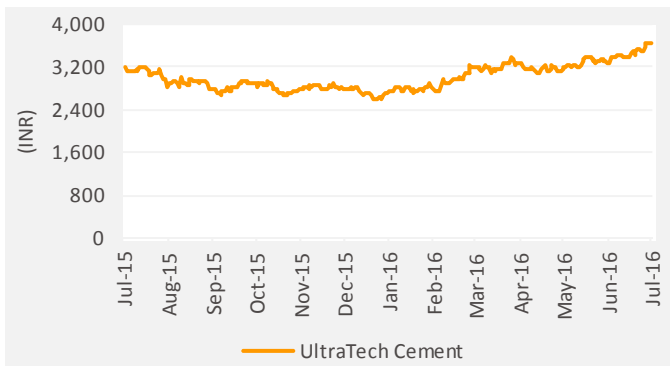
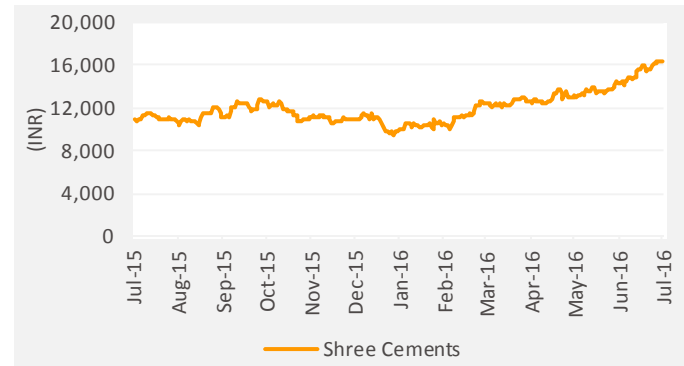
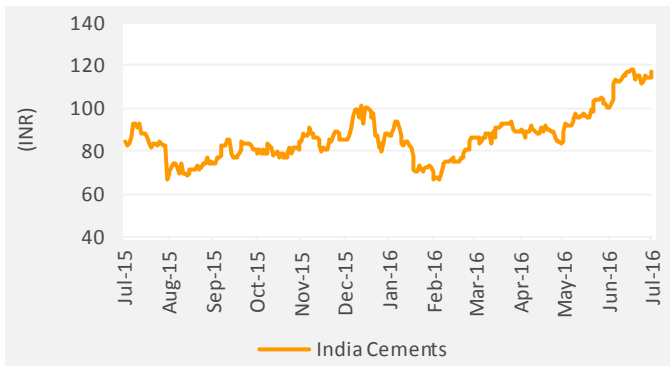
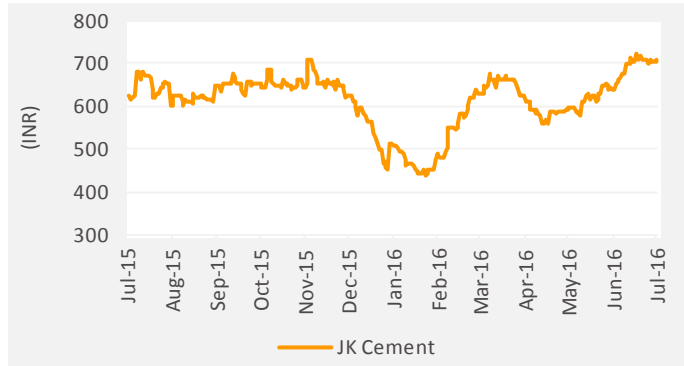
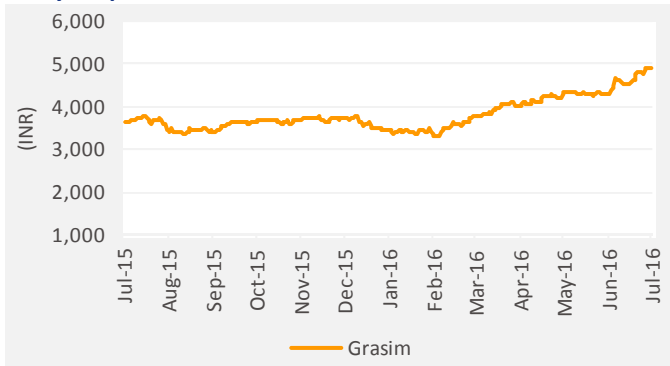
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	158	59	12	229
* - stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One-year price chart



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