

India Cement Sector

Valuations factoring strong pick up in H2

Equities

India
Building Materials

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Cement prices decline

Our dealer check indicates MoM cement price decline of Rs5/bag and Rs15/bag in North and Central region (though still up 27% and 13% from Mid Feb'16 levels respectively). Cement prices in South remained unchanged whereas prices in West declined by Rs10/bag. East was the only region to register price hike, though mild at Rs5/bag. Most companies/ dealers remain optimistic of strong uptick in cement volume post-monsoon. Consensus estimates factor 6-7% volume growth for ACC and Ambuja in 2HCY16 and 11-12% for UltraTech for rest of FY17.

Q1 – delivered on profitability though volume growth was muted

Q1FY17 for our covered companies was the best on profitability margins in last 12 quarters as 1) price hike was more than compensating for weak volume growth and 2) tailwinds from low cost environment. Government print of cement volumes indicates a 6% YoY growth in Q1FY17, though 3% sequential de-growth. Our covered companies registered 2% YoY volume growth in Q1, with only UltraTech matching the industry growth rate. ACC and Ambuja both registered a YoY decline of 1%/2%. We see sequential decline in volume in Q2 as construction activities moderate during monsoon.

Rising costs could dampen the coming quarters

Recent bounce back in fuel prices could result in downside risk to FY17 estimates as consensus incorporates a benign fuel price environment. Reliance petcoke prices have increased 74% YTD (see figure 10) leading to increase in procurement cost of domestic petcoke. Most large cement firms are carrying inventory of imported petcoke that should deplete by end of Q2. Rising fuel and freight costs would negatively impact margins of cement companies. We expect cement companies to partly cushion this with efficiency measures. Cement companies are optimising supply chain with closer-to-market grinding terminals leading to a shorter lead distances and lower freight costs.

Valuations at higher end, relative preference for UltraTech

Cement sector stocks have rallied strongly in 2016 resulting in them trading close to all-time-high valuations. Post the recent rally, ACC and Ambuja are trading close to UltraTech's valuations (based on consensus numbers). We prefer UltraTech as it has better growth prospects among the three. While we continue to like the sector on a medium to long-term perspective, near-term gains look capped. A sustained increase in realisations is likely once utilisation rates move beyond 75%. Weak monsoons and delays in the execution of government programmes are the key risk factors.

Figure 1: Valuation comparison

Company	Share Price	Market cap	Rating	Price target		EPS (Rs)		EPS CAGR	EV/EBITDA (x)		EBITDA CAGR	RoIC (%)
	(Rs)			(Rs)	Upside	FY18E	FY18E		FY17E	FY18E	FY16-18E	FY18E
ACC	1,685	4,733	Neutral	1,690	0%	78.3	21.5	41%	14.6	11.4	32%	21%
Ambuja	271	6,281	Sell	244	-10%	10.5	25.8	42%	18.4	14.2	29%	34%
UltraTech	3,802	15,607	Neutral	3,755	-1%	164.8	23.1	44%	17.6	13.5	26%	30%
Sector								43%	17.3	13.3	28%	29%

Note: Prices as of 09-August-2016, FY18E refers to 2017 for ACC and Ambuja.

Source: Bloomberg, company data, UBS estimates

India Cement Sector

UBS Research THESIS MAP MOST FAVORED

UltraTech

LEAST FAVORED

Ambuja

PIVOTAL QUESTIONS

Q: Can demand growth absorb the overcapacity in the Indian cement industry over the next two years?

We expect the overcapacity issue to get resolved over the next two to three years, translating to better pricing power. Our review of capacity addition plans of 70+ cement companies, including some mini-cement plants, suggests an overall nameplate capacity of 443mtpa by FY18E. We believe supply additions are likely to slow from FY17E onwards and we see less than 10mtpa of cement capacity addition in FY18E and FY19E.

[Stronger pricing power with improving utilisation →](#)

Q: Can government spend on infrastructure sector offset slowing private spend?

We do not think a pick-up in infrastructure alone can drive cement demand as it comprises only 20% of volumes consumed in India. We expect recovery in rural demand in FY17 assuming a normalization of monsoons following two bad years. The mix of government spending has been improving, with a focus on creating capital assets, though fiscal constraint limits the overall spend.

[Demand could benefit from an improving mix of government spending →](#)

Q: Is reduction in fuel and logistics costs enough to offset weaker pricing power?

Yes. We expect a reduction in energy and freight costs to help companies maintain operating margins (Ebtida/t) despite a weak demand/pricing environment in the near term. Over the next 2-3 years, we expect a gradual pick-up in demand, as well as seeing better price discipline boosting margins, thereby translating into an improvement in return ratios.

[Moderating costs to aid margins →](#)

WHAT'S PRICED IN?

We believe stock prices of cement majors are factoring a strong demand recovery on back of strong monthly numbers seen in early 2016. We do not expect a material pick-up in demand considering limited leeway for the government to enhance spending. We believe upside surprise can only come once utilization improves over the next two years and cement prices start to sustainably move up.

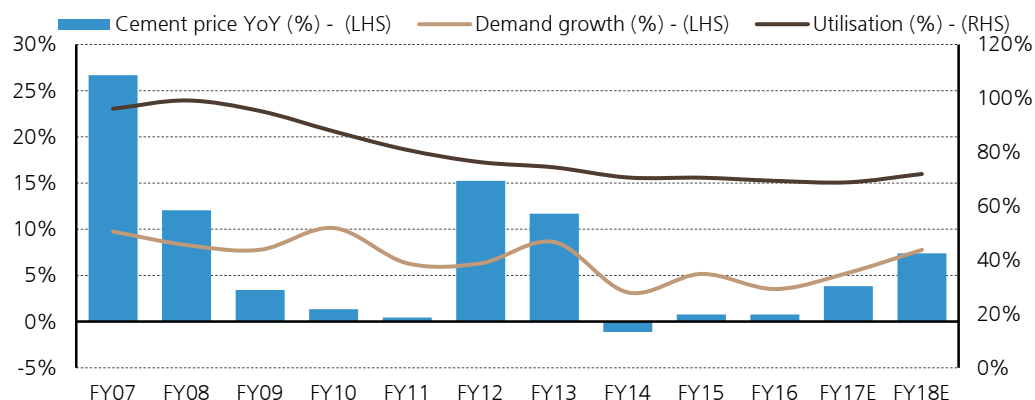
UBS VIEW

We think limited incremental capacity additions, rising capital costs to set up capacity, and M&A should help bring much needed price discipline to India's cement sector over the next two years. We assume cement demand growth in India will rise from 4% on average over the last two years to 5-8% over the next three years, driven by an improving mix of government spending.

EVIDENCE

Based on our extensive analysis of 70+ companies' (around 98% of India's total cement industry capacity) capex plans, we expect limited capacity additions over the next three years. We believe pricing could start to improve from FY17E onwards as capacity utilization levels inch up, and there may be greater upside by FY18E and FY19E as utilization rates could reach 72% and 75%, respectively.

YoY price increase versus utilization and despatch (%)



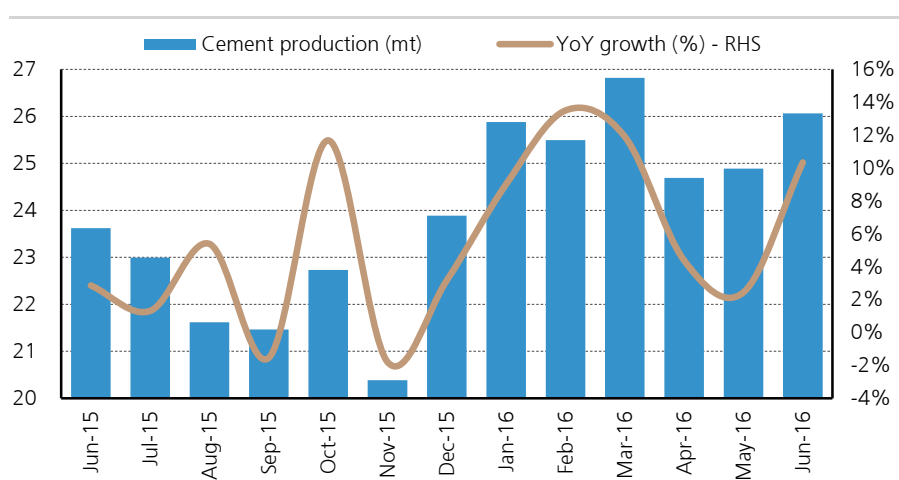
Source: CMA, Crisil, company data, UBS estimates

Figure 2: Current cement price in major Indian cities

	Current indicative cement prices (Rs/bag)	Current price vs. avg. Jul'16 price
Bhopal	300	decrease of Rs15/ bag
Chennai	390	no change
Delhi	305	decrease of Rs5/ bag
Hyderabad	260	Decrease of Rs15/ bag
Kolkata	345	increase of Rs5/ bag
Mumbai	290	decrease of Rs10/ bag

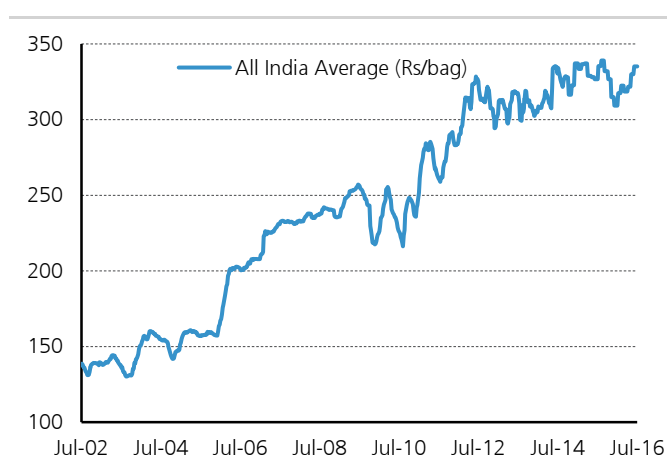
Note: one bag is 50kg; retail prices; Source: UBS Research

Figure 3: Monthly cement production



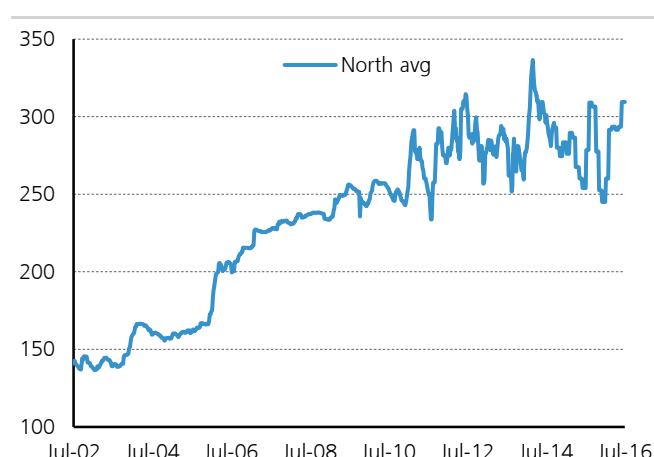
Source: Ministry of Commerce & Industry, Govt. of India

Figure 4: All-India average cement prices (Rs/bag)



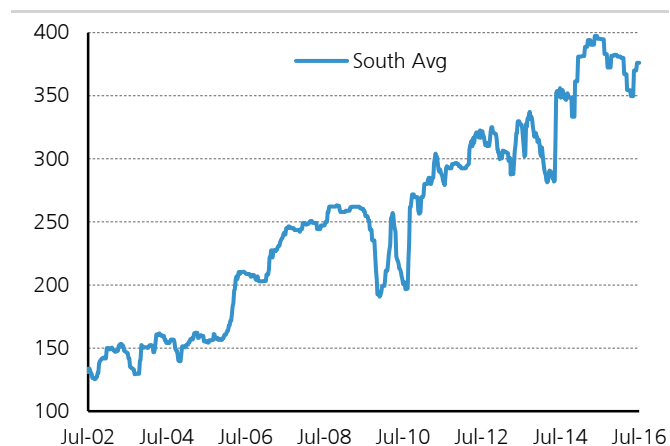
Source: CMA, Crisil, company data

Figure 5: North India average cement prices (Rs/bag)



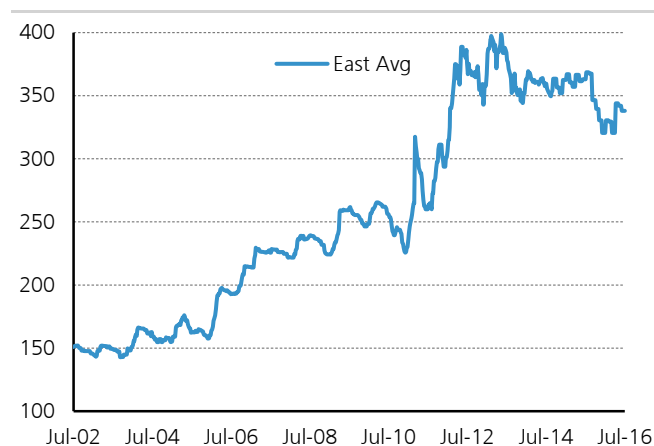
Source: CMA, Crisil, company data

Figure 6: South India average cement prices (Rs/bag)



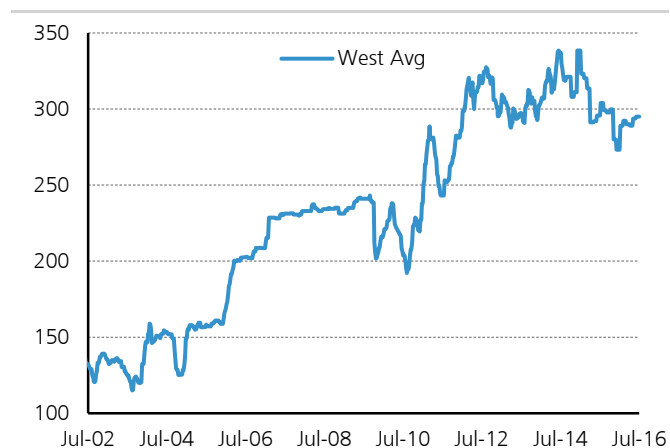
Source: CMA, Crisil, company data

Figure 7: East India average cement prices (Rs/bag)



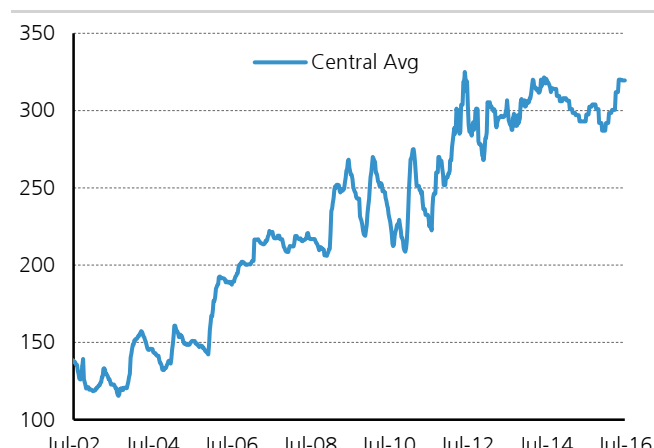
Source: CMA, Crisil, company data

Figure 8: West India average cement prices (Rs/bag)



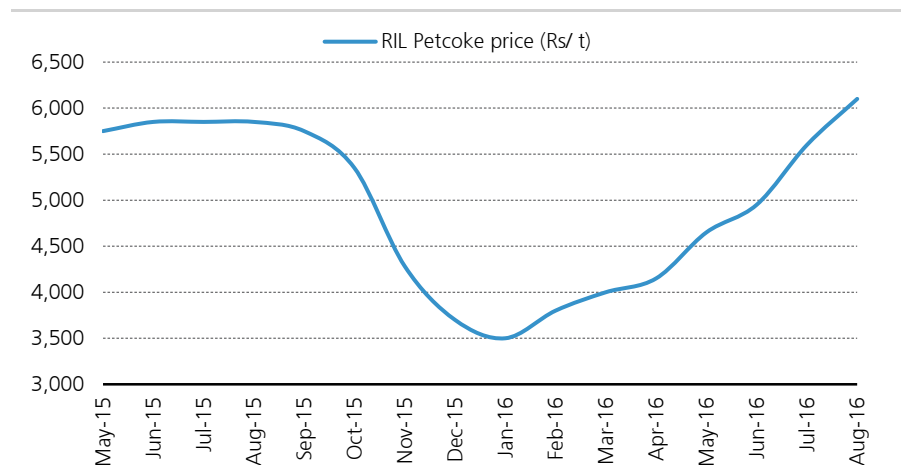
Source: CMA, Crisil, company data

Figure 9: Central India average cement prices (Rs/bag)



Source: CMA, Crisil, company data

Figure 10: RIL petcoke price trend



Source: India Coal Market Watch, UBS Research

Reliance petcoke prices have bottomed out and increase 74% from the bottom

Figure 11: Q1FY17 – results performance

Company (Rs m)	Revenues			EBITDA			PAT		
	Jun-15	Jun-16	%YoY	Jun-15	Jun-16	%YoY	Jun-15	Jun-16	%YoY
Ambuja	25,083	25,607	2%	3,838	6,009	57%	2,264	3,995	77%
ACC	30,153	29,172	-3%	3,335	4,566	37%	1,314	2,378	81%
UltraTech	60,975	62,325	2%	11,519	14,225	23%	5,908	7,749	31%

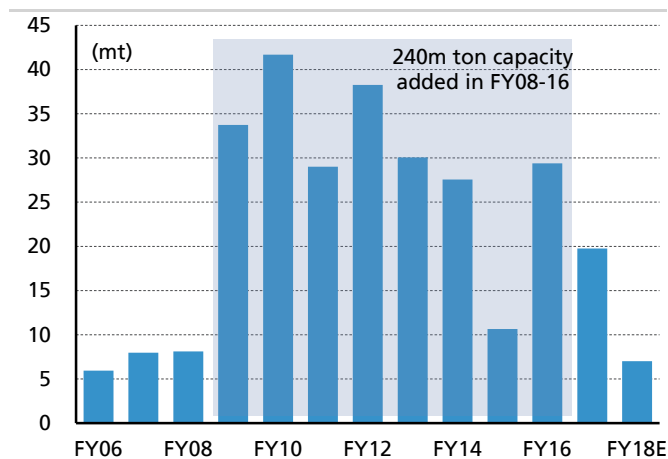
Source: Company data

Figure 12: Q1FY17 – KPIs

Company	Volume (MT)			Realisation (Rs/ t)			EBITDA/ t (Rs)		
	Jun-15	Jun-16	%YoY	Jun-15	Jun-16	%YoY	Jun-15	Jun-16	%YoY
Ambuja	5.9	5.8	-2%	4,266	4,446	4%	653	1,043	60%
ACC	6.2	6.1	-1%	4,863	4,767	-2%	538	746	39%
UltraTech	11.9	12.6	6%	5,011	4,850	-3%	968	1,132	17%

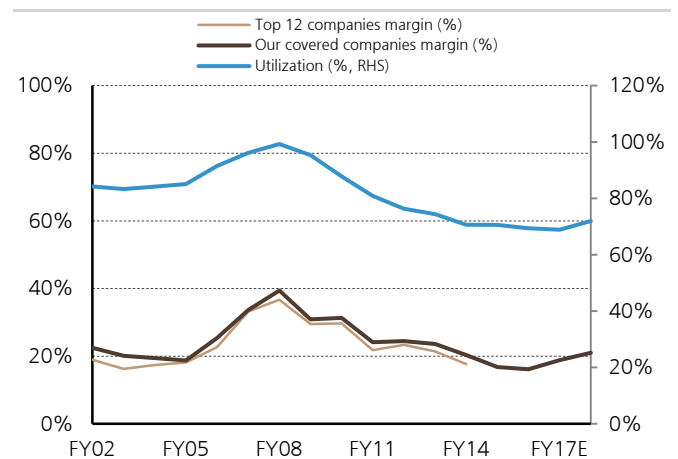
Source: Company data

Figure 13: Capacity additions (mt)



Source: CMA, company data, Crisil, UBS estimates

Figure 14: Utilisation rates versus EBITDA margins



Source: CMA, company data, Crisil, UBS estimates

Figure 15: All-India cement demand/ supply model

(year ending 31 March)	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E
Year end capacity (mtpa)	209	251	280	318	348	376	386	416	436	443	450
Despatches (mtpa)	183	202	215	228	248	256	269	278	293	316	335
Capacity utilization (%)	95%	88%	81%	76%	74%	71%	71%	69%	69%	72%	75%
Change in capacity (mtpa)	34	42	29	38	30	28	11	29	20	7	8
YoY total capacity (%)	12%	20%	15%	13%	11%	9%	5%	5%	6%	3%	2%
YoY total despatches (%)	8%	10%	6%	6%	9%	3%	5%	4%	5%	8%	6%
Prices (Rs/bag)	239	242	243	280	313	310	312	314	326	351	365
YoY price change (%)	3%	1%	0%	15%	12%	-1%	1%	1%	4%	7%	4%

Source: Cement Manufacturers Association (CMA), company data, UBS estimates

Figure 16: Cement capacity additions by major players

	FY17E	FY18E	FY19E
North region			
Ambuja Cement - Marwar, Rajasthan	-	-	4.0
Siddhivinayak cements	2.0	-	-
Mangalam Cement - Aligarh, Uttar Pradesh	0.5	-	-
Total capacity (m ton)	2.5	-	4.0
East region			
ACC - Jamul, Chattisgarh	1.1	-	-
ACC - Sindri, Jharkhand	1.4	-	-
UltraTech - Pataliputra, Bihar	1.6	-	-
JK Lakshmi Cement - Kishanganj, Bihar	1.6	-	-
JK Lakshmi Cement - Cuttack, Odisha	-	1.0	-
Shree Cement - Aurangabad, Bihar	1.6	-	-
Shree Cement – Saria Kale Karasawa, Jharkhand	-	-	2.0
Emami Cement - Baloda Bazar, Chhattisgarh	1.5	-	-
Emami Cement - Durgapur, Burdwan, WB	2.0	-	-
Emami Cement - Baigunea, Odisha	1.5	-	-
Total capacity (m ton)	13.3	1.0	2.0-
South region			
Zuari - Krishna nagar	3.0	-	-
KCP Ltd., Muktyala, Andhra Pradesh	-	-	1.7
Total capacity (m ton)	3.0	-	1.7
West region			
JK Lakshmi - Surat, Gujarat	1.0	-	-
Orient Cement,	-	2.0	-
Sanghi Industries	-	4.0	-
Total capacity (m ton)	1.0	6.0	-

Source: Company data, UBS Research

Figure 17: Recent capacity additions and expected over the coming quarters

Date	Company	Capacity (mtpa)	Location
May-16	Ambuja	0.9	Sankrail, West Bengal
Jun-16	Shree Cement	1.6	Aurangabad, Bihar
Major additions over coming quarters			
Q2FY17	J K Lakshmi	1.0	Surat, Gujarat
Q2FY17	ACC Cement	1.1	Jamul, Chhattisgarh
Q2FY17	ACC Cement	1.4	Sindri, Jharkhand
Q3FY17	J K Lakshmi	1.0	Cuttack, Odisha

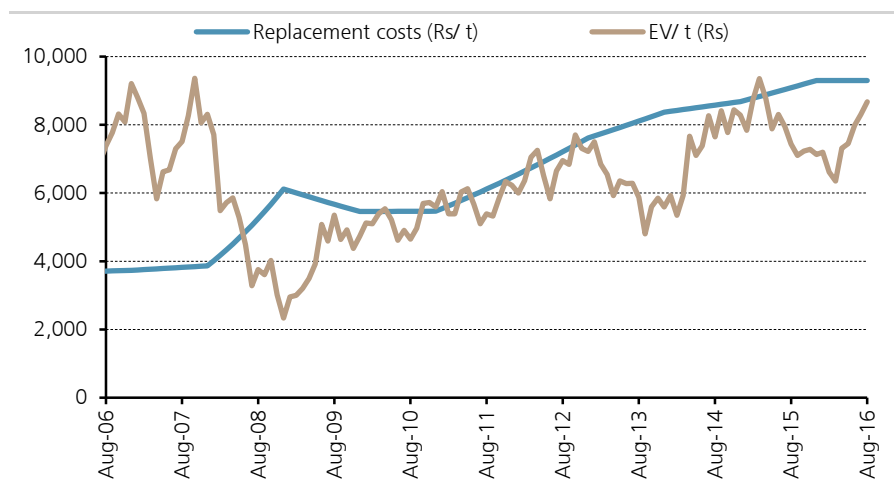
Source: Company filings

Figure 18: Valuation comparisons

Company	Price	Mkt cap	Rating	Price target		EPS (Rs)	PE (x)	EPS CAGR	EV/EBITDA (x)		EBITDA CAGR	RoIC (%)
	(Rs)	(US\$ m)		(Rs)	Upside	FY18E	FY18E	FY16-18E	FY17E	FY18E	FY16-18E	FY18E
ACC	1,685	4,733	Neutral	1,690	0%	78.3	21.5	41%	14.6	11.4	32%	21%
Ambuja	271	6,281	Sell	244	-10%	10.5	25.8	42%	18.4	14.2	29%	34%
UltraTech	3,802	15,607	Neutral	3,755	-1%	164.8	23.1	44%	17.6	13.5	26%	30%
Shree Cement	17,135	8,941	Not Rated	NA	NA	502.4	34.1	96%	23.6	18.6	52%	
JK Lakshmi Cement	441	777	Not Rated	NA	NA	24.8	17.7	342%	13.4	9.4	62%	
JK Cement	748	783	Not Rated	NA	NA	53.2	14.1	142%	10.5	8.3	26%	
Prism Cement	110	831	Not Rated	NA	NA	5.6	19.7	794%	13.9	9.7	36%	
Dalmia Cement	1,437	1,911	Not Rated	NA	NA	68.8	20.9	72%	7.2	6.1	16%	
Ramco Cement	561	2,001	Not Rated	NA	NA	32.3	17.4	17%	12.9	11.2	11%	

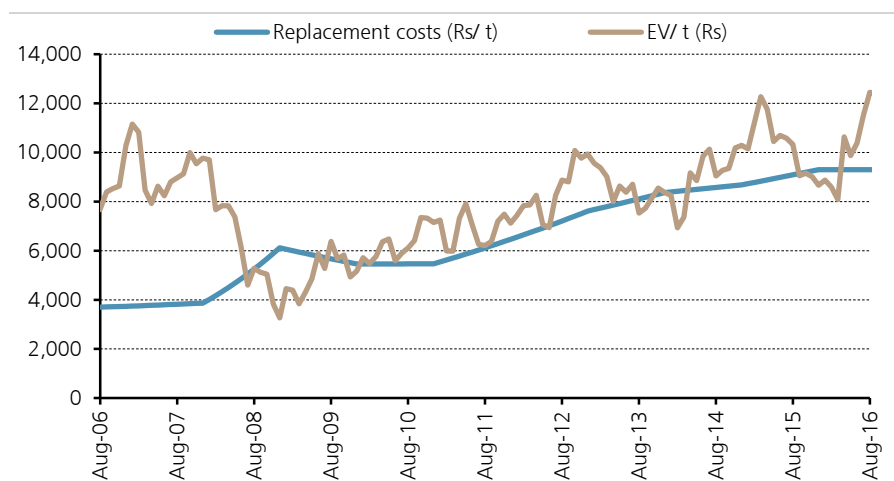
Note: Above data as of 9-August-2016. We use Bloomberg estimates for companies that are not rated. FY18E refers to 2017 for ACC and Ambuja;
Source: Bloomberg, UBS estimates

Figure 19: ACC EV/ t versus replacement cost profile (Rs)



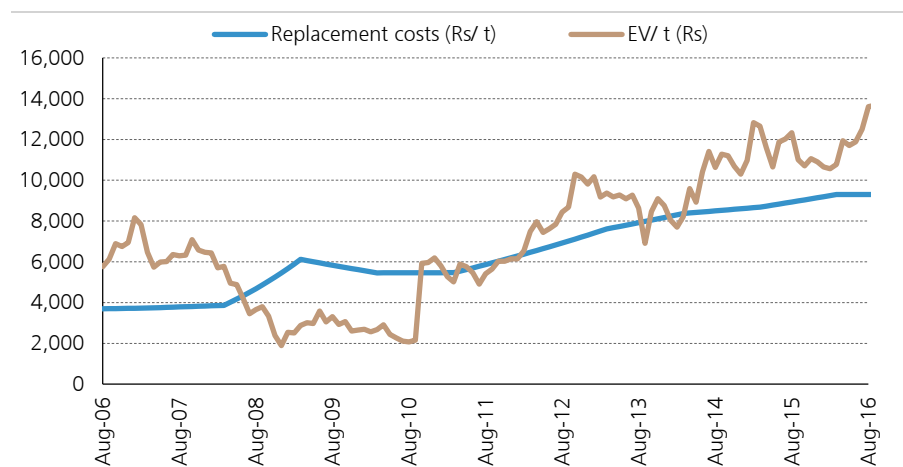
Source: Company data, UBS estimates

Figure 20: Ambuja EV/ t versus replacement cost profile (Rs)



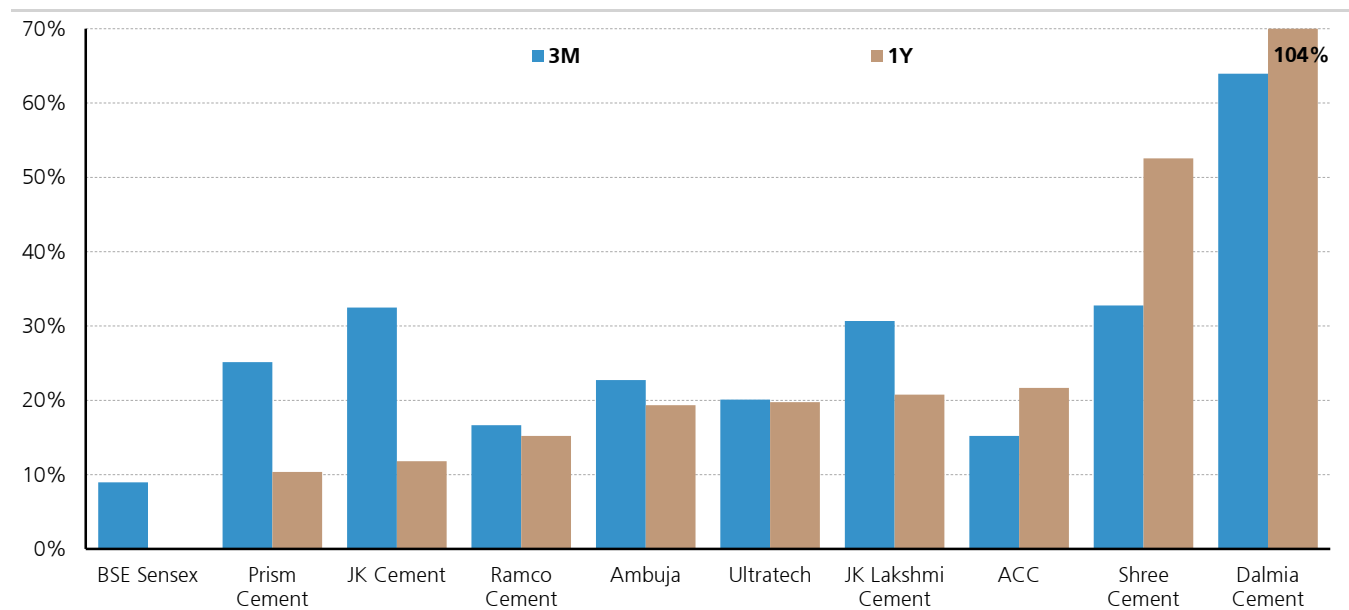
Source: Company data, UBS estimates

Figure 21: UltraTech EV/ t versus replacement cost profile (Rs)



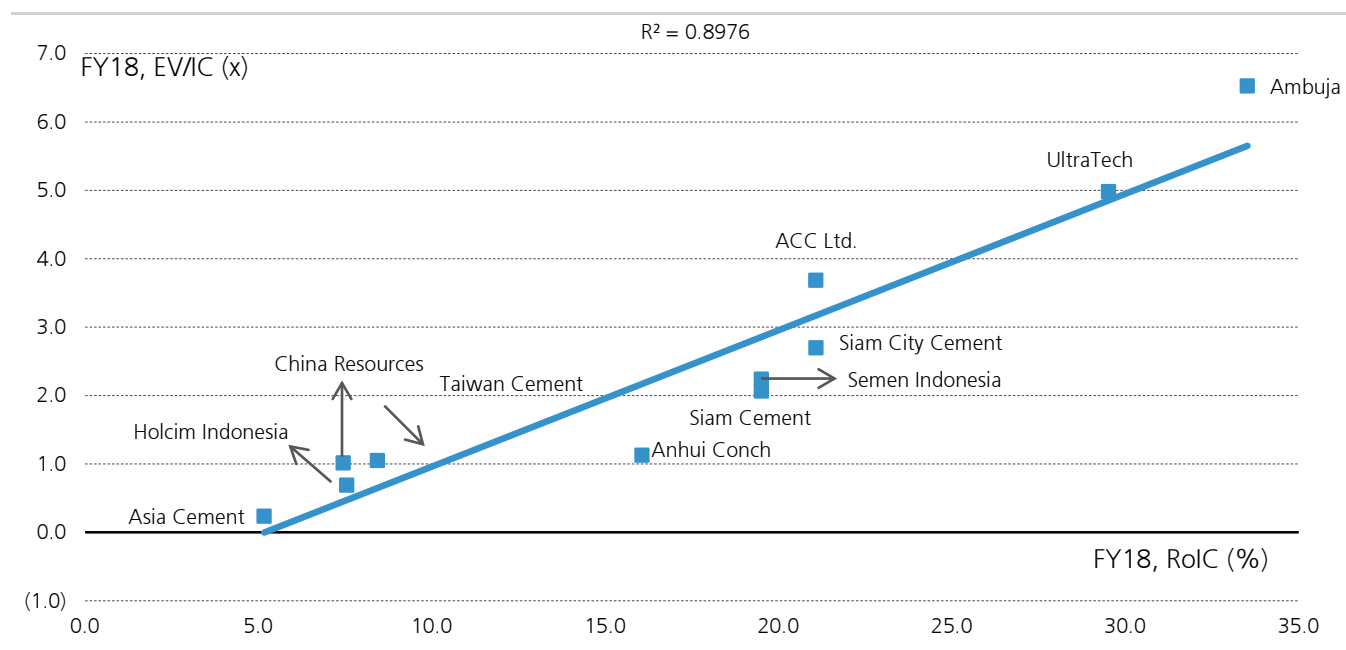
Source: Company data, UBS estimates

Figure 22: Cement stocks performance



Note: Above data as of 09 August 2016; Source: Bloomberg

Figure 23: EV/IC versus RoIC scatter plot



Source: Reuters, UBS estimates

We would like to thank Ankit Dubey, our support service professional, for assistance in preparing this research report.

Valuation Method and Risk Statement

We value Indian cement stocks based on EV/ Ebitda multiples.

We believe the key risks to our sector outlook are an unexpected drop in cement prices, and an increase in input costs such as those for coal or freight. Other risks include: 1) deteriorating GDP growth, investment cycle and inflation as these will adversely affect the cement demand outlook; 2) negative sentiment following the national elections; 3) a significant increase in coal and diesel prices or raw material availability issues; and 4) delays in efficiency initiatives.

We believe the key risks for ACC are: 1) delays in its new capacity expansion and efficiency improvements; and 2) inorganic growth at higher-than-expected valuations.

We believe the key risks for Ambuja are: 1) clinker capacity and medium-term volume constraints; and 2) delays in targeted synergies from group restructuring.

We believe the key risks for UltraTech are: 1) delays in new capacity expansion; and 2) inorganic growth at expensive valuations.

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Buy	FSR is > 6% above the MRA.	47%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	25%
Sell	FSR is > 6% below the MRA.	15%	21%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 30 June 2016.

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

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4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

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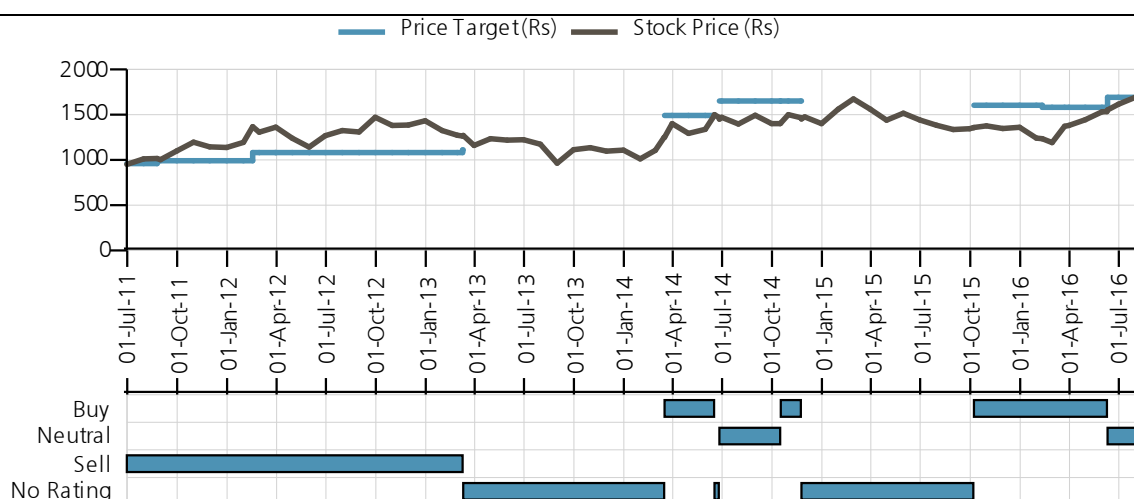
Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
ACC Limited	ACC.BO	Neutral	N/A	Rs1,684.85	09 Aug 2016
Ambuja Cements	ABUJ.BO	Sell	N/A	Rs270.55	09 Aug 2016
UltraTech Cement	ULTC.BO	Neutral	N/A	Rs3,801.80	09 Aug 2016

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

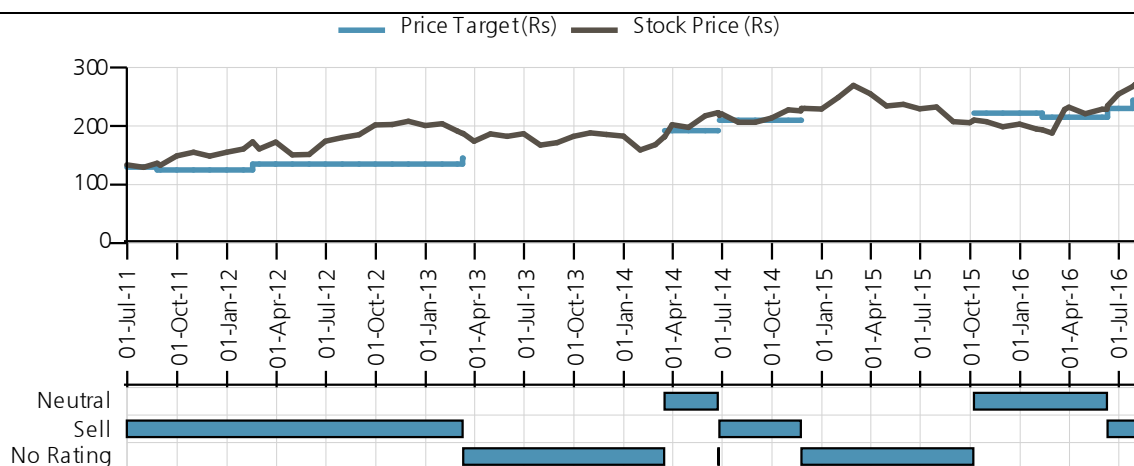
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ACC Limited (Rs)



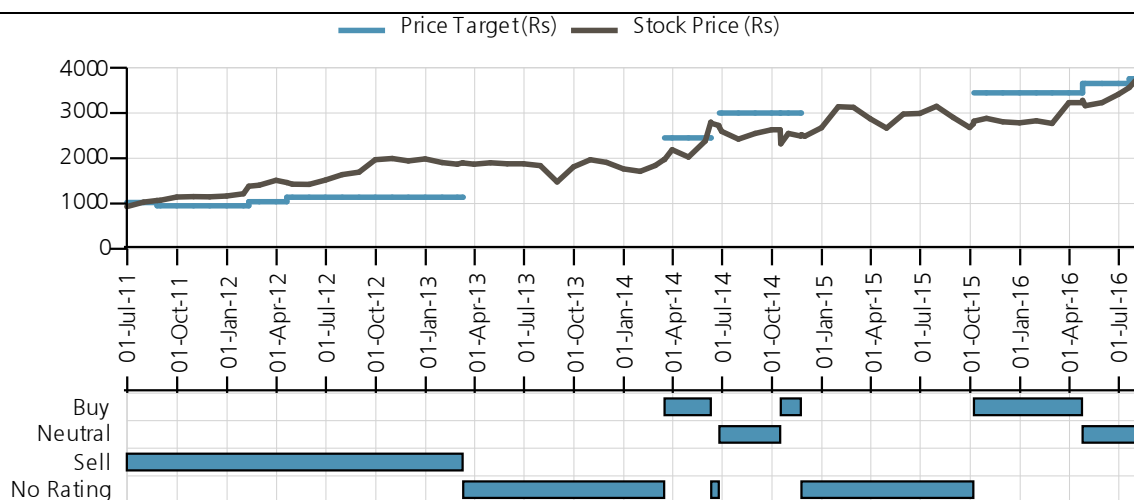
Source: UBS; as of 09 Aug 2016

Ambuja Cements (Rs)



Source: UBS; as of 09 Aug 2016

UltraTech Cement (Rs)



Source: UBS; as of 09 Aug 2016

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