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Ultratech Cement Ltd.

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Better pricing offsets weak volume

UltraTech Cement Ltd. (UltraTech), a part of the Aditya Birla Group is the largest producer of grey cement, white cement and ready-mix concrete in India. It has an installed grey cement capacity of 69.3 MTPA. The company is also India's largest exporter of cement and clinker.

Investment Rationale

Weak volumes restrict revenue growth:

Ultratech Cement reported ~7% YoY growth in revenue on consolidated basis in Q1FY18 driven by strong growth in realisation which helped offset the impact of flat volumes. While the domestic cement volumes declined by 1% YoY in Q1FY18, the company witnessed 23% YoY increase in exports leading to flat volumes of 13.2 MT. The company reported weak cement volumes mainly due to a) Structural issues on account of scarcity of sand & water b) Challenging demand environment due to drought situation in certain parts of the country. Blended realisation during the quarter increased by 7% YoY. Capacity utilisation of the company during the quarter stood at 78%.

Higher realisation and operational efficiency aided margin:

In line with steady revenue growth, the company reported ~11% YoY increase in EBITDA leading to 80bps improvement in EBITDA margin to 23.2%. EBITDA/tonne increased by 11% YoY to Rs1,238 as raw material cost/tonne declined by 12% YoY coupled with strong growth in realisation and improvement in operational efficiency. This helped to offset increase in the energy and logistics costs. Power & fuel cost/tonne surged by 34% YoY on account of 2x rise in pet coke prices (pet coke mix stood at 71% of the overall fuel mix). Further, freight cost/tonne increased by 2% YoY due to sharp rise in diesel prices. In line with robust operating performance coupled with lower interest expense (down 21.7% YoY) and higher other income (9.9% YoY), the company reported 15% YoY improvement in net profit during the quarter under consideration.

Ramp up of Jaypee assets; key to watch:

The company has completed the acquisition of Jaiprakash Associates' assets in Q1FY18, thus further strengthening its leadership position in the cement industry. With the acquisition of cement plants in Madhya Pradesh, Uttar Pradesh, Himachal Pradesh, Uttarakhand and Andhra Pradesh, the overall capacity of the company increased by 21.2 MT to 93 MTPA. Currently the focus of Ultratech's management is to improve the operational efficiency and the utilisation level of the acquired assets (currently operating at utilization of less than 15%) to 60% over the next one year and 70% by FY19. We expect the company's focus on production ramp-up of the acquired assets and improvement in operational efficiency is long drawn process and will be earnings dilutive in the short run on account of integration of acquired assets (increase in interest and depreciation on its books).

Valuation: We expect revenue/PAT to grow at a CAGR of 21%/18% over FY17-19E owing to steady ramp up in capacities. Further with strong capacities in place, we believe the company is in a position to benefit from any cyclical demand recovery. Hence, we recommend 'Hold' with a target price of Rs. 4,514 (based on FY198E EV/EBITDA of 16x).

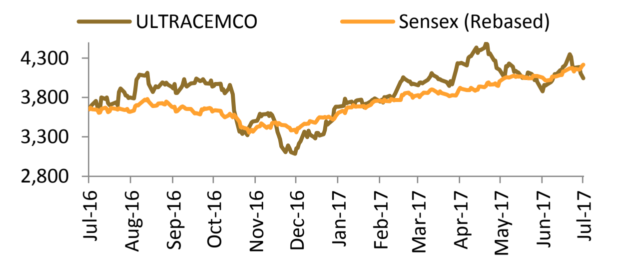
Market Data

Rating	**BUY**
CMP (Rs.)	4,024
Target (Rs.)	**4,514**
Potential Upside	12%
Duration	Long Term
Face Value (Rs.)	10
52 week H/L (Rs.)	4,531/3,052
Adj. all time High (Rs.)	4,531
Decline from 52WH (%)	11.2
Rise from 52WL (%)	31.8
Beta	0.5
Mkt. Cap (Rs.Cr)	110,436

Fiscal Year Ended

Y/E	FY16	FY17	FY18E	FY19E
Revenue (Rs.Cr)	25,153	25,375	30,514	37,391
Adj. Net profit (Rs.Cr)	2,478	2,715	2,580	3,780
Adj. EPS (Rs.)	90.3	98.9	94.0	137.7
Adj. P/E (x)	44.6	40.7	42.8	29.2
P/BV (x)	5.0	4.5	4.2	3.7
ROE (%)	12.1	11.7	10.1	13.4

One year Price Chart

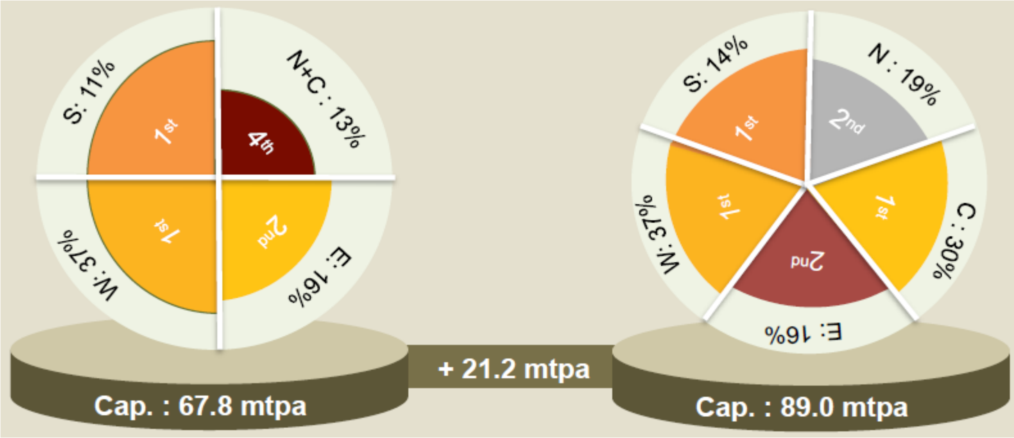


Shareholding Pattern	Jun-17	Mar-17	Chg.
Promoters	62.1	62.2	(0.1)
FII's	21.9	21.9	0.0
MFs/Insti	6.3	5.5	0.8
Public	5.7	6.4	(0.7)
Others	4.0	4.0	0.0

Ultratech Cement Ltd: Business overview

Ultratech Cement (Ultratech) is the largest manufacturer of grey cement in India and is also India's largest exporter of cement and clinker. Ultratech has operations in four countries – UAE, Bahrain, Bangladesh and Sri Lanka. It provides a range of products under grey cement that includes - Ordinary Portland Cement, Portland Blast Furnace Slag Cement and Portland Pozzalana Cement. The company is also India's largest producers of white cement with a and 2 WallCare putty plants. Ultratech markets its white cement under the brand name 'Birla White'. Additionally, with 100+ Ready Mix Concrete (RMC) plants, UltraTech is the largest manufacturer of concrete in India (under the brand name 'UltraTech Concrete'). Besides, the company also sells other construction materials viz; Aerated Autoclaved Concrete (AAC) blocks, waterproofing solutions, grouting solutions and plastering solutions under the name 'UltraTech Building Products'.

Ultratech's zonal capacity post Jaypee cement assets acquisition



Source: Company, In-house research

Quarterly Financials (Consolidated)

(Rs cr)	Q1FY18	Q1FY17	YoY Growth %	Q4FY17	QoQ Growth %
Sales	**7,035**	**6,587**	*6.8*	**7,020**	*0.2*
EBITDA	**1,632**	**1,475**	*10.6*	**1,336**	*22.2*
Margin (%)	23.2	22.4	*80bps*	19.0	*417bps*
Depreciation	330	323	*2.2*	356	*(7.3)*
EBIT	**1,302**	**1,153**	*13.0*	**981**	*32.8*
Interest	141	180	*(21.7)*	167	*(15.6)*
Other Income	166	151	*9.9*	241	*(31.1)*
Exceptional Items	(31)	-	-	-	-
PBT	**1,296**	**1,124**	*15.3*	**1,054**	*22.9*
Tax	398	344	*15.8*	328	*21.3*
PAT	**898**	**780**	*15.1*	**726**	*23.7*
MI/ Associates	1	(0)	*(413.8)*	0	*405.6*
Reported PAT	**897**	**780**	*15.0*	**726**	*23.6*
Adjustment	31	-	-	-	-
Adj PAT	**928**	**780**	*19.0*	**726**	*27.9*
No. of shares (cr)	27.5	27.4	*0.0*	27.5	*0.0*
EPS (Rs)	**33.8**	**28.4**	*19.0*	**26.4**	*27.9*

Per Tonne analysis

(Rs cr)	Q1FY18	Q1FY17	YoY Growth %	Q4FY17	QoQ Growth %
Overall Cement Volumes (MT)	13.2	13.2	*(0.2)*	13.7	*(4.0)*
Raw Materials	836	914	*(8.5)*	952	*(12.2)*
Employee Expenses	307	282	*8.8*	272	*13.1*
Power & Fuel	1,000	749	*33.6*	913	*9.5*
Freight	1,211	1,183	*2.4*	1,224	*(1.0)*
Other Expenses	744	744	*(0.0)*	776	*(4.2)*
Total Expenses	4,099	3,872	*5.9*	4,138	*(0.9)*
Realisation	5,337	4,990	*7.0*	5,111	*4.4*
EBITDA	1,238	1,118	*10.8*	973	*27.3*

Source: Company

Weak volumes restrict revenue growth

Ultratech Cement reported ~7% YoY growth in revenue on consolidated basis in Q1FY18 driven by strong growth in realisation which helped offset the impact of flat volumes. While the domestic cement volumes declined by 1% YoY in Q1FY18, the company witnessed 23% YoY increase in exports leading to flat volumes of 13.2 MT. The company reported weak cement volumes mainly due to a) Structural issues on account of scarcity of sand & water b) Challenging demand environment due to drought situation in certain parts of the country. Blended realisation during the quarter increased by 7% YoY. Capacity utilisation of the company during the quarter stood at 78%. We expect volumes to grow at 19% CAGR over FY17-19E led by steady ramp up of Jaypee assets and pickup in demand from housing and infrastructure sectors.

Higher realisation and operational efficiency aided margin

In line with steady revenue growth, the company reported ~11% YoY increase in EBITDA leading to 80bps improvement in EBITDA margin to 23.2%. EBITDA/tonne increased by 11% YoY to Rs1,238 as raw material cost/tonne declined by 12% YoY coupled with strong growth in realisation and improvement in operational efficiency. This helped to offset increase in the energy and logistics costs. Power & fuel cost/tonne surged by 34% YoY on account of 2x rise in pet coke prices (pet coke mix stood at 71% of the overall fuel mix). Further, freight cost/tonne increased by 2% YoY due to sharp rise in diesel prices. In line with robust operating performance coupled with lower interest expense (down 21.7% YoY) and higher other income (9.9% YoY), the company reported 15% YoY improvement in net profit during the quarter under consideration. Although, we expect the pace of EBITDA margin expansion to remain moderate in FY18E owing to integration of Jaiprakash Associates' cement assets, we factor a healthy 175bps YoY increase in margin in FY19E.

Ramp up of Jaypee assets; key to watch

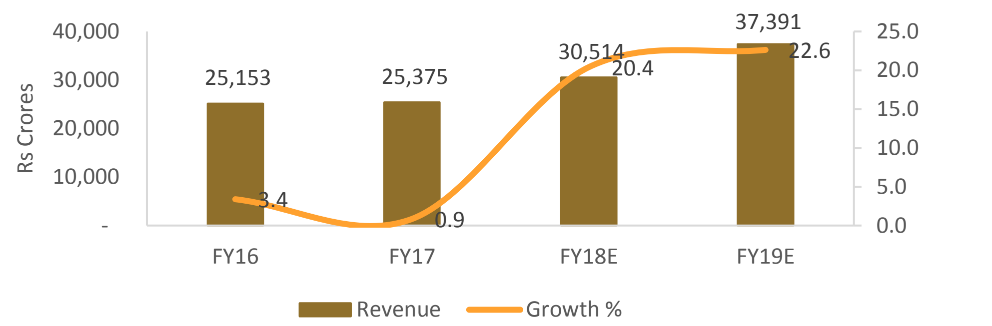
The company has completed the acquisition of Jaiprakash Associates' assets in Q1FY18, thus further strengthening its leadership position in the cement industry. With the acquisition of cement plants in Madhya Pradesh, Uttar Pradesh, Himachal Pradesh, Uttarakhand and Andhra Pradesh, the overall capacity of the company increased by 21.2 MT to 93 MTPA. Currently the focus of Ultratech's management is to improve the operational efficiency and the utilisation level of the acquired assets (currently operating at utilization of less than 15%) to 60% over the next one year and 70% by FY19. Further, the company expects to achieve cash breakeven for the acquired assets in the next 12 months.

We expect the company's focus on production ramp-up of the acquired assets and improvement in operational efficiency is long drawn process and will be earnings dilutive in the short run on account of integration of acquired assets (increase in interest and depreciation on its books).

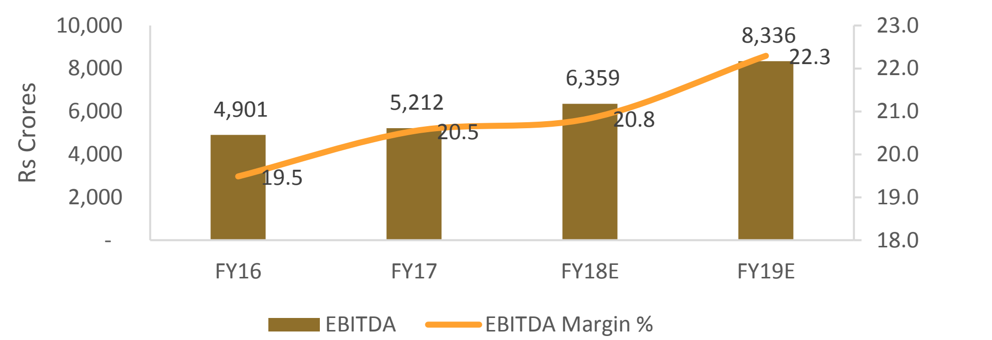
Valuation

We expect revenue/PAT to grow at a CAGR of 21%/18% over FY17-19E owing to steady ramp up in capacities. Further with strong capacities in place, we believe the company is in a position to benefit from any cyclical demand recovery. Hence, we recommend 'Hold' with a target price of Rs. 4,514 (based on FY198E EV/EBITDA of 16x).

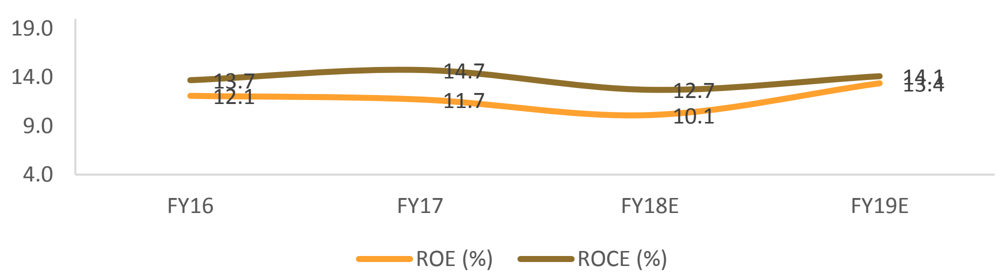
Revenue to grow at 21% CAGR over FY17-19E



Ebitda margin to improve by 175bps over FY17-19E



Return ratios trend



Source: Company, In-house research

Key risks:

- Sharp rise in fuel costs
- Slow pick up in infrastructure demand and delay in housing recovery
- Weak monsoons

Profit & Loss Account (Consolidated)

Y/E (Rs.Cr)	FY16	FY17	FY18E	FY19E
Total operating Income	**25,153**	**25,375**	**30,514**	**37,391**
Raw Material cost	4,418	4,493	4,997	6,006
Employee cost	1,445	1,522	1,798	2,141
Other operating expenses	14,390	14,148	17,360	20,908
EBITDA	**4,901**	**5,212**	**6,359**	**8,336**
Depreciation	1,377	1,348	1,759	2,027
EBIT	**3,524**	**3,864**	**4,600**	**6,309**
Interest cost	566	640	1,429	1,478
Other Income	464	648	511	563
Profit before tax	**3,421**	**3,872**	**3,682**	**5,394**
Tax	942	1,159	1,102	1,614
Profit after tax	**2,479**	**2,714**	**2,580**	**3,780**
Minority Interests	2	(1)	-	-
P/L from Associates	0	0	-	-
Adjusted PAT	**2,478**	**2,715**	**2,580**	**3,780**
E/o income / (Expense)	-	-	(31)	-
Reported PAT	**2,478**	**2,715**	**2,549**	**3,780**

Balance Sheet (Consolidated)

Y/E (Rs.Cr)	FY16	FY17	FY18E	FY19E
Paid up capital	274	275	274	274
Reserves and Surplus	21,671	24,117	26,334	29,620
Net worth	**21,946**	**24,392**	**26,608**	**29,894**
Minority Interest	15	10	10	10
Total Debt	7,372	7,450	21,950	18,950
Other non-current liabilities	286	335	335	335
Total Liabilities	**29,620**	**32,186**	**48,903**	**49,189**
Net fixed assets	24,203	24,819	37,982	38,655
Capital WIP	1,470	921	4,200	3,300
Goodwill	**1,106**	**1,085**	**1,085**	**1,085**
Investments	5,095	6,691	6,691	6,691
Net Current Assets	(974)	664	1,089	1,752
Deferred tax assets (Net)	(2,431)	(2,773)	(2,773)	(2,773)
Other non-current assets	1,151	779	629	479
Total Assets	**29,620**	**32,186**	**48,903**	**49,189**

Cash Flow Statement (Consolidated)

Y/E (Rs.Cr)	FY16	FY17	FY18E	FY19E
Pre tax profit	3,421	3,872	3,682	5,394
Depreciation	1,377	1,348	1,759	2,027
Chg in Working Capital	429	518	(84)	(156)
Others	149	(1)	918	915
Tax paid	(852)	(744)	(1,102)	(1,614)
Cash flow from operating activities	**4,526**	**4,993**	**5,173**	**6,566**
Capital expenditure	(2,150)	(1,386)	(18,200)	(1,800)
Chg in investments	(1,658)	(1,162)	-	-
Other investing cashflow	81	79	511	563
Cash flow from investing activities	**(3,727)**	**(2,469)**	**(17,689)**	**(1,237)**
Equity raised/(repaid)	4	7	(0)	-
Debt raised/(repaid)	46	(1,615)	14,500	(3,000)
Dividend paid	(297)	(312)	(363)	(494)
Other financing activities	(596)	(614)	(1,429)	(1,478)
Cash flow from financing activities	**(844)**	**(2,535)**	**12,707**	**(4,972)**
Net chg in cash	**(45)**	**(10)**	**192**	**357**

Key Ratios (Consolidated)

Y/E	FY16	FY17	FY18E	FY19E
Valuation(x)				
P/E	44.6	40.7	42.8	29.2
EV/EBITDA	23.6	22.2	20.4	15.2
EV/Net Sales	4.6	4.6	4.3	3.4
P/B	5.0	4.5	4.2	3.7
Per share data				
EPS	90.3	98.9	94.0	137.7
DPS	9.5	10.0	11.0	15.0
BVPS	799.7	888.6	969.4	1089.2
Growth (%)				
Net Sales	3.4	0.9	20.4	22.6
EBITDA	10.7	6.4	22.0	31.1
Net profit	18.1	9.6	-5.0	46.5
Operating Ratios				
EBITDA Margin (%)	19.5	20.5	20.8	22.3
EBIT Margin (%)	14.0	15.2	15.1	16.9
PAT Margin (%)	9.9	10.7	8.5	10.1
Return Ratios (%)				
RoE	12.1	11.7	10.1	13.4
RoCE	13.7	14.7	12.7	14.1
Turnover Ratios (x)				
Net Sales/GFA	0.8	0.9	0.9	0.8
Sales/Total Assets	0.6	0.6	0.6	0.6
Sales/Working Capital	-14.0	-10.4	-20.6	-30.9
Liquidity and Solvency Ratios (x)				
Current Ratio	0.9	1.1	1.1	1.2
Interest Coverage	6.2	6.0	3.2	4.3
Debt/Equity	0.3	0.3	0.8	0.6

Rating criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* Ultratech is a large cap company

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