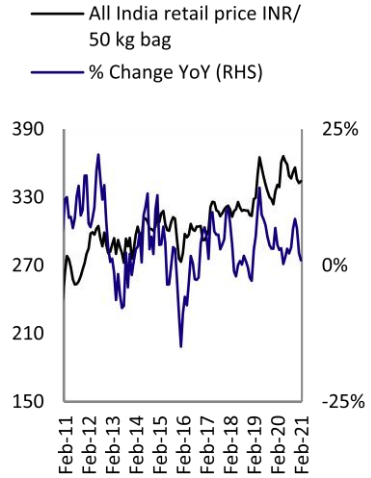
Cement

Demand has improved, but pricing remains muted

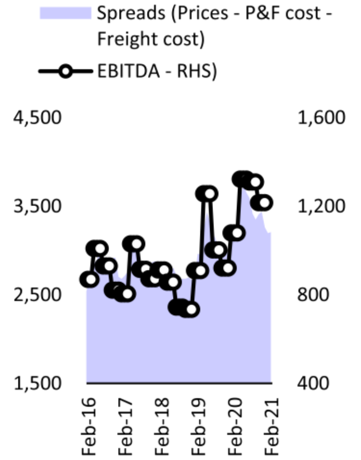
North and West see hikes, but South and East on the decline

Our channel checks indicate the seasonal uptick in demand is playing out, with volumes bouncing back strongly from the weakness seen in the first few weeks of Jan. While prices have improved 1–2% MoM in North and West, average pan-India price is down 2% QoQ thus far in 4QFY21 (+1% YoY). Cost inflation is also a concern in the near term as petcoke, coal, and diesel prices are up 71%, 4%, and 26% YoY, respectively. Therefore, we expect margins to decline sequentially for the industry, but they should still be higher YoY. We expect our coverage EBITDA to grow >20% YoY in 4QFY21, driven by ~18% YoY growth in volumes.

All-India price up only 1% YoY



Cement spreads have softened



Volumes remain strong; peak season demand kicks in

- Following ~10% YoY growth reported in volumes in 3QFY21, we expect volumes to grow 18–20% YoY in 4QFY21 (supported by the low base of 4QFY20 – volumes declined 13% YoY on government-mandated lockdown in March).
- Demand has been strong in February (+8–10% YoY), led by continued strong demand in East, North, and Central and revival in West. Although, demand remains weak in South.
- Demand in East has been particularly strong (>10% YoY), supported by pre-election spending in West Bengal and strong industrial/infra demand in Odisha.
- Demand in North and Central has also improved in February – supported by a receding winter season, which has improved the pace of construction work.
- Demand in West has rebounded strongly, led by recovery in urban real estate and construction. Maharashtra volumes are now on the rise for the first time since the pandemic.
- Demand in South has remained weak on a YoY basis, but improved sequentially, driven by a strong uptick in Andhra Pradesh and Telangana.

South – price down 1% MoM, but still up 9% YoY

- The Cement industry in South has exhibited a strong production discipline in the past year, in the face of weak volumes.
- Prices in South are still up ~INR30/bag (or 9%) YoY to INR371/bag in Feb'21, led by hikes taken over Apr–May'20. Prices are up 11%/12%/12%/3% YoY in Andhra Pradesh / Tamil Nadu / Karnataka / Kerala.
- On a MoM basis, though, price is down 1% on account of 3% MoM decline in Tamil Nadu, while it is flat across other states in South.

North and Central – strong demand supporting price hikes

- In North and Central, demand has picked up, led by a receding winter and the end of the harvest season, enabling workers to return to construction sites.
- Prices in North are up ~2% MoM (flat YoY) to INR378/bag, led by an INR5–10/bag hike across the region, supported by high plant utilization (>90%).
- Prices in Central, however, have been flat MoM at INR349/bag (up 3% YoY).

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West – demand improving; prices up 1% MoM / 3% YoY

- Demand in West has rebounded strongly, led by recovery in urban real estate and construction. Maharashtra volumes are now growing for the first time since the pandemic. Demand in Gujarat has also been strong at 5–10% YoY.
- In February, price is up +1% MoM / +3% YoY to INR345/bag in Mumbai, and up +1% MoM / +3% YoY to INR355/bag in Ahmedabad. Price in West, on average, is up 1% MoM to INR350/bag (+3% YoY).

East – demand strong, but price down 11% YoY

- Demand in East has been the strongest among the regions at 10–15% YoY, supported by government spending (particularly in West Bengal, Assam, and Odisha) and strong rural demand.
- However, on account of aggressive expansion undertaken by various players, East has seen the weakest pricing among the regions in the past three years – current prices are the lowest in three years. The rest of the country, meanwhile, has seen an over 10% increase in prices in the past three years.
- Price in East has declined ~INR50/bag or 15% since May'20. In February, while West Bengal witnessed a price increase of INR5/bag, price has been flat in other states. Average price in East is down 11% YoY to INR273/bag (flat MoM).

Costs – higher energy cost to be partly offset by operating leverage

- Lower petcoke price had been a tailwind for the Cement sector up to 2QFY21. However, this is now set to reverse as petcoke price has risen substantially (up 71% YoY to USD117/t). To mitigate the impact of higher petcoke price, cement producers have increased the use of imported coal – which is up only 4% YoY (but up 29% from Nov'20). We estimate power and fuel cost to increase by INR50–70/t QoQ (5–7%) in 4QFY21 and INR120–150/t in total by 1QFY22.
- Diesel price is also up 26% YoY in Feb'21, driven by higher duties levied by the government, which would result in higher freight cost in 4QFY21.
- We expect a total variable cost increase of INR70–90/t QoQ in 4QFY21, which should be partly neutralized by seasonally lower maintenance cost and better fixed cost absorption (on seasonally higher volumes). Thus, we expect industry EBITDA/t to remain strong at >INR1,100/t in 4QFY21 (but lower QoQ).

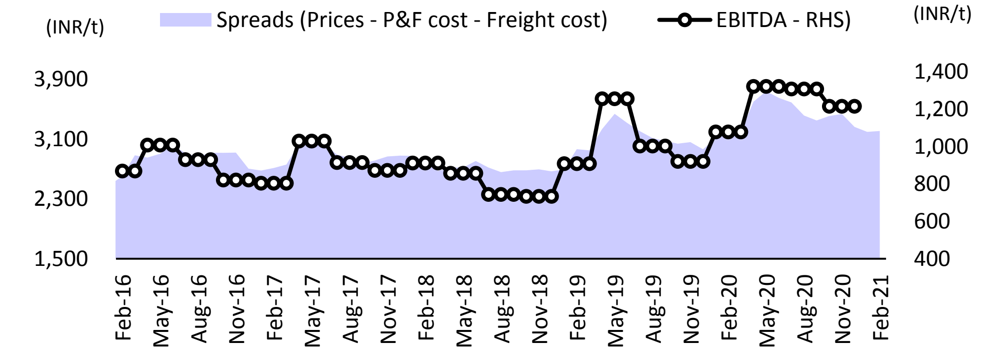
Top picks – UltraTech, Dalmia Bharat, and ACC

- While we are structurally positive on the industry outlook; we prefer North and Central as these markets have a higher clinker utilization of over 80%.
- We adopt a bottom-up stock-picking approach and prefer companies that: a) are moving down the cost curve, b) have the potential to gain market share, and c) provide valuation comfort.
- UltraTech is our top large-cap pick, while Dalmia Bharat is our top mid-cap pick. We also like ACC as a value pick, but do not see much upside in Shree, Ramco, and Ambuja, whose potential market share gains are already priced in.

Cement: Valuation summary

	Mcap (USD b)	CMP (INR)	Rating	P/E (x)		EV/EBITDA (x)		EV/t (x)		P/BV	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
UTCEM	25.4	6,419	Buy	28.5	23.1	15.3	12.8	223	190	3.5	3.2
SRCM	14.0	28,269	Neutral	40.2	36.0	20.6	17.9	267	240	5.9	5.1
ACEM	7.8	287	Neutral	22.9	19.0	13.1	11.0	160	155	1.8	1.7
ACC	4.7	1,820	Buy	19.6	18.5	9.2	8.1	105	98	2.4	2.2
DALBHARA	3.8	1,455	Buy	32.3	21.8	10.7	8.5	111	97	2.3	2.1
TRCL	3.2	979	Neutral	30.1	25.3	16.3	13.8	162	150	3.7	3.3
JKCE	2.9	2,751	Buy	27.3	22.2	12.6	10.8	171	171	5.1	4.2
BCORP	0.9	890	Buy	11.2	9.5	7.0	5.6	77	69	1.2	1.1
ICEM	0.7	169	Neutral	32.8	23.5	11.1	9.7	70	69	0.9	0.9
JKLC	0.6	376	Buy	14.4	11.5	6.4	5.6	49	48	1.9	1.7

Exhibit 1: Cement spreads have softened in 4QFY21



Source: MOFSL; EBITDA/t is actual reported for our coverage

Estimate 11% EBITDA CAGR for our Coverage Universe over FY21–23E

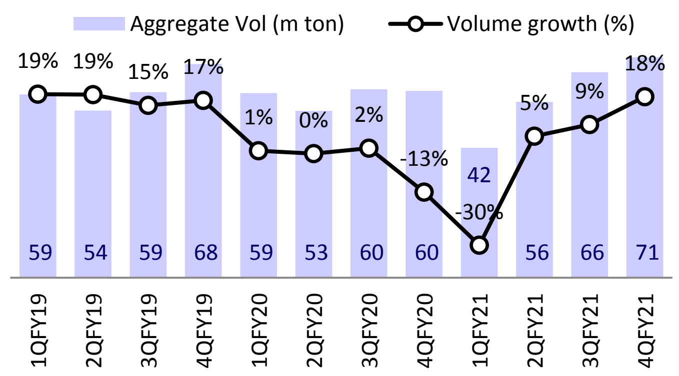
We expect EBITDA for our Coverage Universe to rise 18%/8%/14% YoY in FY21E/FY22E/FY23E, implying an 11% CAGR over FY21–23E. PAT should also grow at a 16% CAGR over FY21–23E, supported by strong cash flows, improving other income, and reducing interest cost. While EBITDA growth in FY21 has been led by higher margins, growth in FY22E/FY23E is expected to be driven largely by volumes. After come in nearly flat over FY19–21E, we expect volumes to grow 14% in FY22 and 9% YoY in FY23, implying an 11% CAGR over FY21–23E.

Exhibit 2: Expect 11% EBITDA CAGR over FY21–23E, driven by 11% volume CAGR

	EBITDA (INR b)			FY21–23E	Volume (mt)			FY21–23E	EBITDA/t (INR)		
	FY21E	FY22E	FY23E	CAGR (%)	FY21E	FY22E	FY23E	CAGR (%)	FY21E	FY22E	FY23E
UTCEM	111.8	122.9	140.8	12	84.3	94.3	101.6	10	1,327	1,303	1,386
SRCM	40.4	43.8	49.3	11	26.9	29.8	32.8	10	1,487	1,460	1,494
ACEM	27.0	27.8	32.3	9	22.5	25.4	27.6	11	1,199	1,094	1,169
ACC	24.8	28.3	29.9	10	25.5	29.5	30.4	9	972	962	985
TRCL	15.2	15.7	18.0	9	9.9	11.9	13.8	18	1,545	1,315	1,300
DALBHARA	27.3	27.2	32.0	8	20.9	24.5	27.8	15	1,309	1,108	1,154
JKCE	15.1	16.7	19.6	14	11.4	13.2	14.3	12	1,319	1,266	1,372
BCORP	13.4	15.4	17.4	14	13.1	15.0	17.1	14	1,029	1,026	1,018
ICEM	7.9	7.3	8.2	2	8.6	10.3	11.3	15	924	712	724
JKLC	7.2	7.5	8.4	8	9.9	10.6	11.1	6	726	709	756
Sum/average	**290.2**	**312.7**	**355.9**	**11**	**232.9**	**264.6**	**287.8**	**11**	**1,244**	**1,181**	**1,236**
YoY growth (%)	18	8	14		(1)	14	9		19	(5)	5

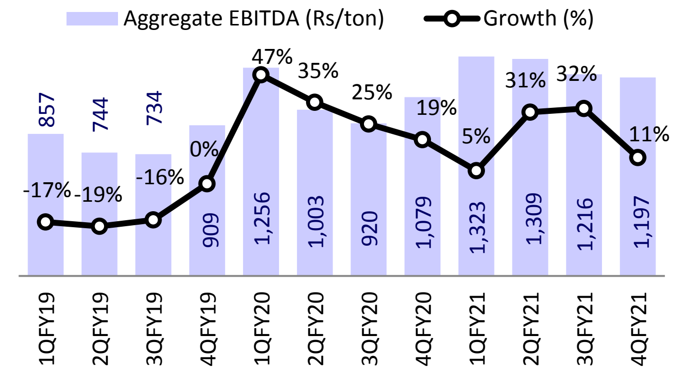
Source: MOFSL, Company

Exhibit 3: Volumes to be 18% YoY higher in 4QFY21E



Source: Company, MOSL

Exhibit 4: EBITDA/t to be 11% higher YoY in 4QFY21E



Source: Company, MOSL

Top picks – UltraTech, Dalmia Bharat, ACC, JK Cement

UltraTech (UTCEM)

UTCEM has a strong pan-India distribution network and preferred supplier status for key infrastructure projects. As a result, it is well-positioned to tap into expected growth in both retail and institutional (non-trade) cement demand in India. The company is ramping up its under-utilized acquired capacities (Binani, Century Cement). It also has a strong pipeline of projects and brownfield expansion potential, which offer visibility on long-term growth. We estimate a 14%/28% CAGR in consolidated EBITDA/PAT over FY20–23E, driven by a 7% CAGR in volumes and lower operating / interest costs. The valuation is reasonable at 12.8x FY23E EV/EBITDA and USD190/t capacity. The stock is also trading ~20% cheaper than peer SRCM and against the historical average of 10%. We value UTCEM at 14x Dec'22 EV/EBITDA.

Dalmia Bharat (DBL)

With its recent clinker expansion in East, DBL is well-placed to gain market share in this region. We estimate a 15% volume CAGR over FY21–23E, far higher than the industry growth rate, which would result in a ~22% EPS CAGR (over FY21–23E). The company should continue to generate strong FCF and reduce its net debt further from ~INR14b currently. It trades at a reasonable valuation of 8.5x FY23E EV/EBITDA and USD97/t EV/capacity. We value the stock at 9x Dec'22 EV/EBITDA.

ACC

ACC trades at a 30–50% discount to peers SRCM, UTCEM, and TRCL. Such a large valuation discount is excessive as: a) ACC has arrested its market share losses since CY17, b) the proportion of inefficient assets would decline and profitability would improve with planned capacity expansions in CY22/CY23, and c) the company has a strong net-cash balance sheet (17% of mcap) – allowing room for a special dividend (similar to parent ACEM). We value ACC at 10x CY22E EV/EBITDA (~10% discount to its past five-year average of 11x) to arrive at TP of INR2,100. This implies target EV/t of USD103 and target P/E of 21x on CY22E earnings. Reiterate **Buy**.

JK Cement (JKCE)

We expect JKCE to deliver a higher-than-industry EBITDA CAGR of 14% over FY21–23E – driven by a 12% volume CAGR – on account of its new capacity in North. The expansion further improves its regional mix in favor of North and Central. Furthermore, the company is moving down the cost curve by increasing its share of newer cost-efficient capacities. We value the White Cement business at 13x Dec'22 EV/EBITDA and Grey Cement business at 10x Dec'22 EV/EBITDA.

Story in charts

Exhibit 5: All-India prices flat MoM / up 1% YoY

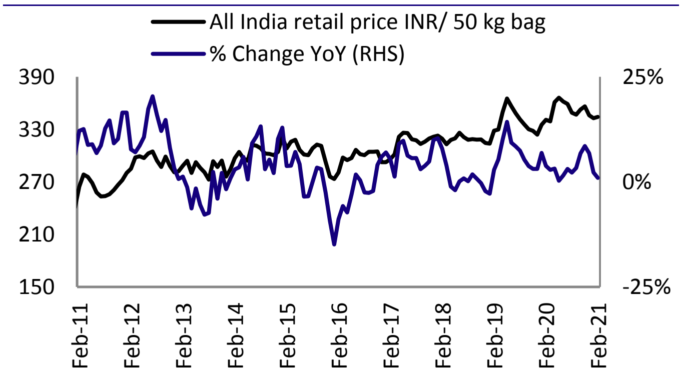


Exhibit 6: Prices in North up 1% MoM / flat YoY

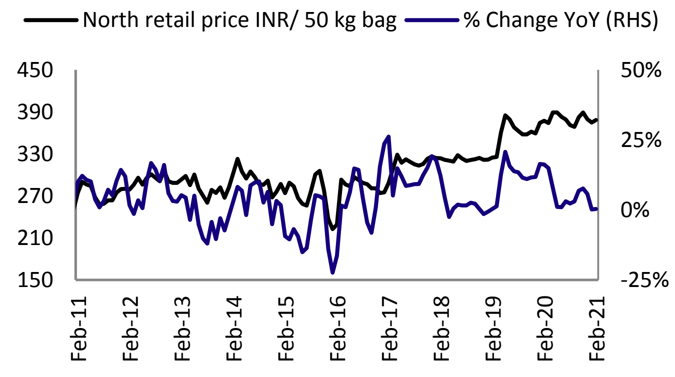
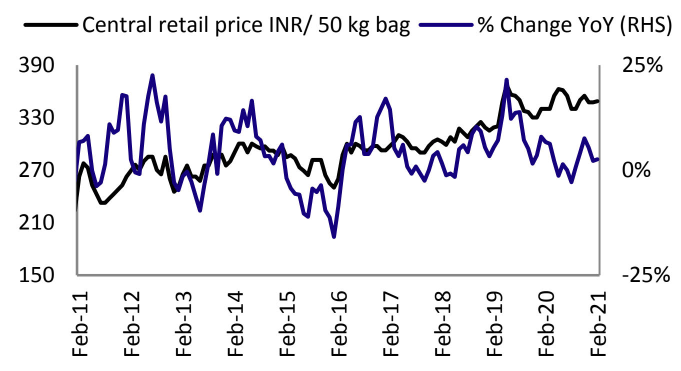
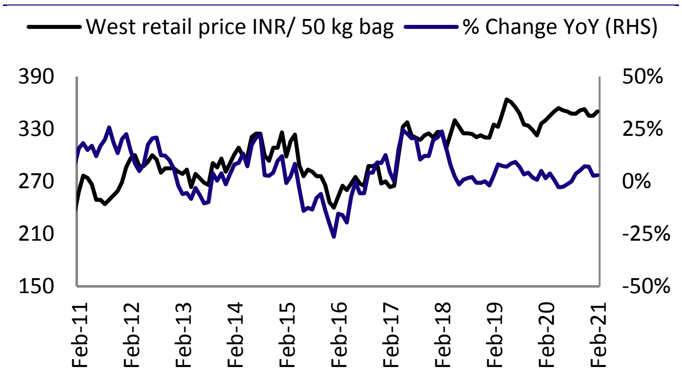


Exhibit 7: Prices in Central flat MoM / up 3% YoY



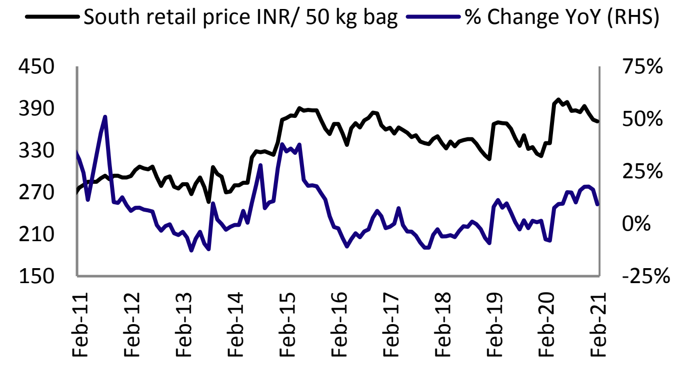
Source: MOFSL

Exhibit 8: Prices in West up 1% MoM / 3% YoY



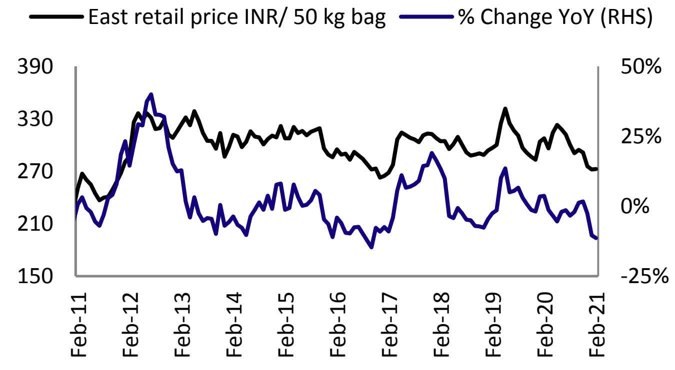
Source: MOFSL

Exhibit 9: Prices in South down 1% MoM / up 9% YoY



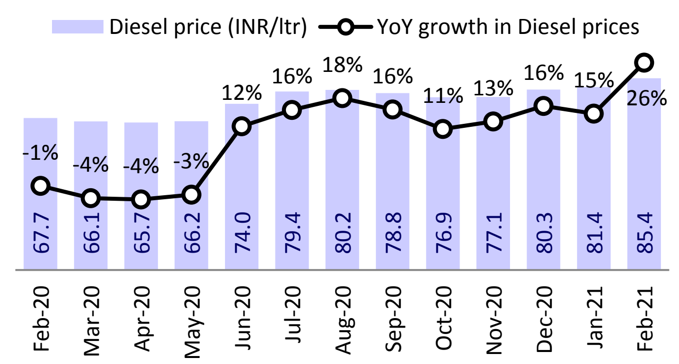
Source: MOFSL

Exhibit 10: Prices in East flat MoM / down 11% YoY



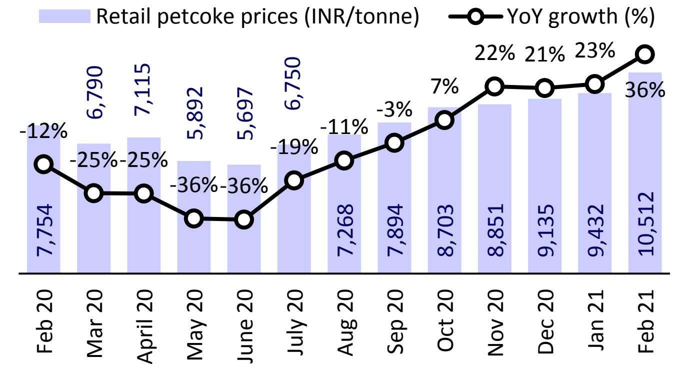
Source: MOFSL

Exhibit 11: Diesel prices up 26% YoY in Feb'21



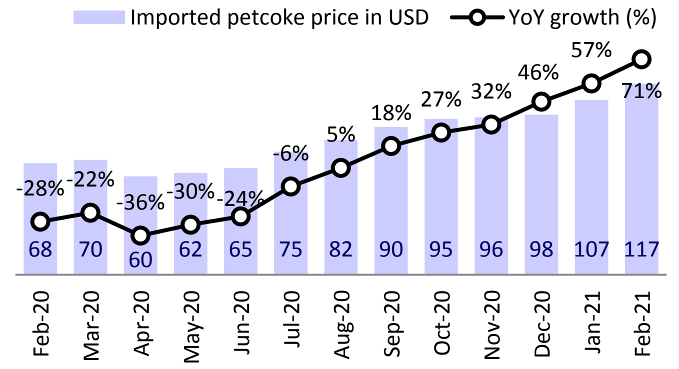
Source: Industry

Exhibit 12: Domestic petcoke prices up 36% YoY in Feb'21



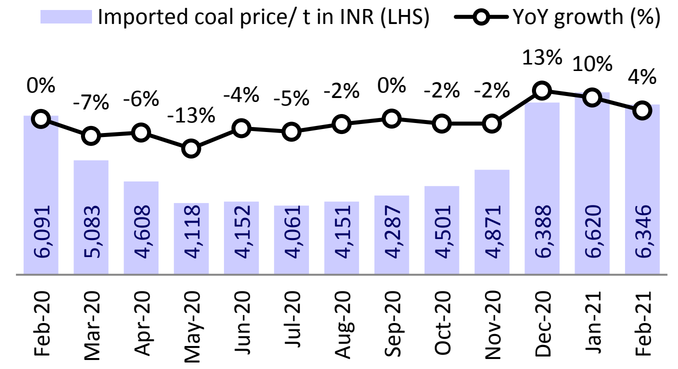
Source: Industry

Exhibit 13: Imported petcoke prices up 71% YoY in Feb'21



Source: Industry

Exhibit 14: Imported coal prices up 4% YoY in Feb'21



Source: Industry

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UNDER REVIEW	Rating may undergo a change
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