Cement

Sector at cross roads; competitive intensity to rise going forward

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The Indian cement sector is at the cross roads. With the entry of large conglomerate Adani Group in this space, market participants are divided about the way forward on the sector dynamics. Based on our industry interactions, we simulate two scenarios which are likely to pan out as a result of the Adani's entry – i) Aggressive capacity addition to increase competitive intensity and keep sector profitability muted and ii) Profitability to be prioritised over volumes, thus keeping realisations steady or better. While industry participants favour scenario 2, we believe scenario 1 is the most likely one to pan out. The larger players are expected to experience a tug of war for the market share and the push on volumes will drive a demand CAGR of 9% over FY22-24E. However, volume growth will be accompanied by decline in the profitability as the players undercut each other. The smaller players are expected to witness a deterioration in the fundamentals – cash flows and return ratios, thereby derailing their capacity expansion plans. Further, with the deterioration in the fundamentals, smaller players could become acquisition with strong regional presence. In terms of valuations, current trading multiple of the sector is higher than the long term median multiple. We continue to remain positive on large caps – Ultratech and Shree continue to be preferred picks. We also prefer ACC owing to the benign valuations.

- **Scenario 1 – Volume push by the players will lead to higher competitive intensity:** With the entry of Adani, we believe the competitive intensity will rise and the larger players will continue to struggle for market and capacity share. The large players will push volumes at the cost of pricing thereby impacting profitability of the sector. As a result, the volumes are expected to report strong volume growth at 9% CAGR over FY22-24E on the back of demand from infrastructure and housing segments. Additionally, infrastructure spending in FY24 (pre-election year) will drive the volume growth during the period. While EBITDA/t is expected to decline by INR 300//t over the same period driving the deterioration in the fundamentals of the sector – return ratio profile and cash flow to deteriorate. While larger players will keep adding capacity to the tune of 25-30MTPA annually, deterioration in the cash flows of smaller players will impact their capacity addition plans. Current trading multiples are at or higher than the long term median multiples for the sector. Additionally, deteriorating fundamentals will also lead to smaller players being target for the acquisition by the larger players. Our preference in this scenario is towards large cap players. Our top pick for the sector will be Ultratech (market leader) and Shree cement (cost leader with market leadership in North). Further, ACC is also a preferred pick on the back of benign valuations.

- **Scenario 2 – Profitability takes precedence over volumes:** Given the high price paid by Adani to buy the stakes in ACC and Ambuja, few participants believe that sector will prioritise profitability and return ratios over volumes. As a result, the volumes are estimated to remain stable over FY22-24E accompanied by the strong price uptick driving the improvement in the EBITDA/t by INR 100/t over the same period. Despite the rising profitability, RoEs and RoICs are expected to decline marginally over FY22-24E from 14.5% to 14.7% to 11.6% and 13.5% respectively. Additionally, the capacity addition speed is expected to moderate and the current capacity pipeline will be delayed as the players focus on improving utilisation at operational plants. We believe, the smaller players will benefit more in this scenario driving the improvement in return ratio profile, cash flows and capacity addition pipeline. The trading multiples are below the long term median multiples for the sector. Our preference in this scenario will be towards small and mid sized players – JK Cement, Orient Cement and Sagar Cement, which may re-rate.

- **Scenario 1 is most likely – Ultratech, Shree and ACC are the top picks:** We believe with the entry of Adani Cement in the Indian cement sector, the competitive intensity will rise. The struggle for the market share will lead to deterioration in the profitability and fundamentals of the sector. As a result, we continue to remain positive on the large caps. Our top picks for the sector remains Ultratech and Shree owing to their leadership position in the market. We also prefer ACC owing to the benign valuations.

Cement stock performance

- Overall, the stocks under coverage have corrected by 25-40% (except Ambuja and ACC) over last 6 months driven by muted pricing environment in a cost inflationary environment.
- Further, rising rates is expected to lead to demand slowdown putting the dampener on the pre-election period spending.

Exhibit 1. Price performance of the coverage companies

Period	Ultratech	Shree	ACC	Ambuja	Dalmia Bharat	Ramco	JK Cement	JK Lakshmi	Orient	Sagar	Heidelberg
1M	-6%	-13%	-3%	-2%	-6%	-8%	-11%	-5%	-8%	-20%	-8%
3M	-16%	-23%	-1%	19%	-16%	-18%	-17%	-10%	-22%	-32%	-13%
6M	-26%	-30%	-4%	-4%	-31%	-37%	-38%	-27%	-27%	-36%	-25%
1Yr	-16%	-30%	6%	7%	-32%	-37%	-26%	-28%	-15%	-22%	-32%

Source: Company, JM Financial, Bloomberg

Simulating scenarios

We have simulated scenarios with varying capacity addition, competitive intensity and their impact on profitability and volume growth

Exhibit 2. Scenarios

	Scenario 1	Scenario 2
Capacity addition	25-30MTPA annually	Capacity addition to be moderate
Volumes	Strong growth of 9% CAGR over FY22-24E	Stable volume trend
Realisations	Price decline to drive realisation downtick of c.INR 100/t	Prices to remain upbeat with realisation uptick of c.INR 250-300/t
Costs	Rise of INR 200/t in the total costs	Rise of INR 150/t in total costs
EBITDA/t	To decline by INR 300/t	To rise by INR 100/t

Source: Company, JM Financial

Scenario 1 – Volume push with strong competitive intensity

- With the entry of new player and consolidation driving the higher capacity share with the larger players, we expect the larger players to push volumes to sustain market share. However, the industry is also expected to report strong growth over next two years led by demand from infrastructure and housing segments. Further, FY24 being pre-election year, the industry will see strong demand.
- With increased competitive intensity, we expect the realisation to remain subdued even as the costs continue to rise. This will lead to material correction in the EBITDA/t over next two years.
  - **Volumes -** Volume **growth of 7-9%** YoY
  - **Realisations and profitability –** Muted realisations and decline in EBITDA/t expected over next two years.
  - We are **estimating around INR 300/t EBITDA** decline over next two years coupled with volume growth of 9% for the coverage companies
  - Additionally, players will keep **adding capacities to the tune of 25-30MTPA** to maintain or gain capacity share

- **Key takeaways** – In scenario 1, the sector seems to be trading at significantly high multiple. Overall, the weighted average **EV/EBITDA multiple for the sector stands at 15x on FY24 basis**. The companies on the EBITDA estimates are **trading at or higher than the long term median multiples**.
- Return ratio profile of the sector is expected to decline with declining profitability. **Average RoEs and RoICs** for the sector is expected to **decline from 14.5% and 14.7% to 8% and 9%** respectively over FY22 to FY24E.
- We expect this is a **most likely scenario** which is expected to pan out over next two years.
- Small players are expected to be impacted to a greater extent than larger players. Prefer large caps to small or mid caps – **Top picks are Ultratech and Shree**

Exhibit 3. Scenario 1 – Strong competitive intensity

Company	Volumes (mnT)			Realisations (INR/t)			Costs (INR/t)			EBITDA/t (INR/t)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Ultratech	88.0	97.4	106.5	5,149	5,135	5,044	3,907	4,039	4,102	1,242	1,096	942
Shree	27.6	30.2	33.1	4,742	4,671	4,649	3,418	3,495	3,626	1,324	1,176	1,023
Ambuja	55.9	58.8	63.9	5,105	5,105	5,054	3,994	4,186	4,204	1,111	919	850
ACC	28.9	30.1	33.7	5,112	5,124	5,073	4,074	4,281	4,298	1,038	843	774
Dalmia Bharat	22.2	24.4	27.1	5,084	5,033	4,982	3,991	4,128	4,190	1,093	905	791
Ramco	11.1	12.5	13.8	5,258	5,239	5,137	4,091	4,227	4,278	1,167	1,012	860
JK Cement	12.1	13.1	15.2	5,532	5,507	5,439	4,309	4,454	4,557	1,222	1,053	882
JK Lakshmi	10.6	11.2	11.4	4,601	4,587	4,516	3,844	4,005	4,076	757	583	439
Heidelberg	4.8	5.1	5.5	4,808	4,754	4,707	3,899	4,007	4,104	910	747	603
Orient	5.5	6.0	6.4	4,970	4,960	4,861	3,891	4,090	4,086	1,079	871	775
Sagar	3.6	4.9	5.5	4,431	4,353	4,327	3,666	3,796	3,866	765	557	461
Cov. Comp	**270.2**	**293.8**	**322.1**	**5,070**	**5,049**	**4,985**	**3,919**	**4,067**	**4,125**	**1,151**	**982**	**861**

Source: Company, JM Financial, Industry

Exhibit 4. Scenario - 1

Company	EV/EBITDA			5 year avg EV/E multiple	10 year avg EV/E multiple	ROE (%)			ROCE (%)		
	FY22	FY23E	FY24E			FY22	FY23E	FY24E	FY22	FY23E	FY24E
Ultratech	15.3	15.3	15.6	15.4	14.9	15.3	11.4	9.4	14.6	11.3	10.3
Shree	16.9	17.2	17.6	19.2	17.5	14.6	10.5	8.9	23.1	15.8	13.6
Ambuja	15.0	16.6	17.0	11.2	13.7	14.6	11.6	11.0	16.4	13.6	12.6
ACC	11.1	13.2	12.5	10.0	11.0	14.2	10.2	9.6	25.1	17.4	16.1
Dalmia Bharat	9.7	11.3	12.2	11.2	8.5	8.0	3.9	3.2	5.2	3.3	2.6
Ramco	14.1	13.9	14.6	15	12.4	14.3	8.6	7.3	9.4	5.8	5.1
JK Cement	13.1	14.0	14.8	9.5	9.0	19.1	15.0	12.5	11.3	8.7	7.5
JK Lakshmi	5.7	7.0	8.6	7.5	7.7	19.8	12.7	8.2	18.3	12.2	7.6
Heidelberg	8.5	8.7	9.3	9.4	10.7	16.5	13.3	10.0	20.6	17.8	15.5
Orient	4.4	6.0	8.1	8.1	12.1	18.6	13.1	8.8	13.3	10.3	7.5
Sagar	10.9	10.1	10.4	7.8	9.7	4.7	1.6	1.1	4.2	4.7	4.4
Cov. Comp	**13.8**	**14.7**	**15.1**			**14.5**	**10.2**	**8.2**	**14.7**	**11.0**	**9.3**

Source: Company, JM Financial, Industry

Scenario 2 – Profitability takes precedence over volumes

- Secnario 2 assumes that given the high price paid by Adani to buy the stakes in ACC and Ambuja, the companies are expected to prioritise profitability over volumes. As a result, the players will not push volumes in the market. This will lead to muted volume growth over next two years. The cement prices will remain upbeat driving the improvement in the profitability going forward.
- With prices being prioritised, we expect the volumes to remain subdued. This will lead to growth in the EBITDA/t over next two years.
  - **Volumes –** Volumes **to remain flat YoY** over next two years
  - **Realisations and profitability** – Realisations to improve driving **the EBITDA/t improvement of c.INR 100/t over next two years**.
  - **Capacities in pipeline are expected to be delayed** as the players look to improve utilisations.
- **Key takeaways** – In scenario 2, the sector seems to be trading at around 12x FY24 EBITDA. The companies are trading at a discount to their long term median multiples.
- Despite growing EBITDA/t, return ratio profile of the sector is expected to decline **– RoEs and RoICs** are expected to go **down from 14.5% and 14.7% to 11.6% and 13.5% respectively over FY22 to FY24E**.
- Smaller players are expected to benefit to a greater extent than the larger players. As a result, our preference in this case would be towards smaller and mid-sized players. Top picks will be **JK Cement, Orient and Sagar cement**.

Exhibit 5. Scenario 2 – Profitability takes precedence

Company	Volumes (mnT)			Realisations (INR/t)			Costs (INR/t)			EBITDA/t (INR/t)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Ultratech	88.0	88.0	88.0	5,149	5,252	5,305	3,907	3,949	3,955	1,242	1,303	1,350
Shree	27.6	27.6	27.6	4,742	4,884	4,996	3,418	3,455	3,571	1,324	1,429	1,425
Ambuja	55.9	55.9	55.9	5,105	5,324	5,404	3,994	4,162	4,242	1,111	1,162	1,162
ACC	28.9	28.9	28.9	5,112	5,303	5,420	4,074	4,188	4,267	1,038	1,115	1,153
Dalmia Bharat	22.2	22.2	22.2	5,084	5,226	5,383	3,991	4,085	4,192	1,093	1,142	1,192
Ramco	11.1	11.1	11.1	5,258	5,439	5,539	4,091	4,223	4,269	1,167	1,216	1,270
JK Cement	12.1	12.1	12.1	5,532	5,681	5,834	4,309	4,410	4,502	1,222	1,270	1,332
JK Lakshmi	10.6	10.6	10.6	4,601	4,786	4,894	3,844	3,967	4,033	757	819	861
Heidelberg	4.8	4.8	4.8	4,808	4,946	5,087	3,899	3,992	4,090	910	953	997
Orient	5.5	5.5	5.5	4,970	5,164	5,267	3,891	4,028	4,078	1,079	1,136	1,189
Sagar	3.6	3.6	3.6	4,431	4,590	4,730	3,666	3,774	3,863	765	816	868
Cov. Comp	**270.2**	**270.2**	**270.2**	**5,070**	**5,226**	**5,318**	**3,919**	**4,012**	**4,072**	**1,151**	**1,213**	**1,246**

Source: Company, JM Financial, Industry

Exhibit 6. Scenario - 2

Company	EV/EBITDA			5 year avg EV/E multiple	10 year avg EV/E multiple	ROE (%)			ROCE (%)		
	FY22	FY23E	FY24E			FY22	FY23E	FY24E	FY22	FY23E	FY24E
Ultratech	15.3	14.2	13.0	15.4	14.9	15.3	12.5	11.6	14.6	12.4	12.8
Shree	16.9	15.4	15.0	19.2	17.5	14.6	12.1	10.8	23.1	18.5	17.2
Ambuja	15.0	13.6	13.6	11.2	13.7	14.6	14.4	13.4	16.4	17.2	15.9
ACC	11.1	10.3	9.6	10	11	14.2	13.4	12.5	25.1	23.9	21.8
Dalmia Bharat	9.7	9.8	9.6	11.2	8.5	8.0	5.3	5.2	5.2	4.6	4.4
Ramco	14.1	13.1	12.2	15	12.4	14.3	9.4	9.4	9.4	6.3	6.5
JK Cement	13.1	12.5	12.1	9.5	9	19.1	17.2	15.7	11.3	10.0	9.5
JK Lakshmi	5.7	5.2	4.3	7.5	7.7	19.8	18.4	17.6	18.3	17.9	18.2
Heidelberg	8.5	7.2	6.2	9.4	10.7	16.5	16.3	14.8	20.6	22.5	25.6
Orient	4.4	4.9	5.9	8.1	12.1	18.6	16.8	13.4	13.3	13.4	11.1
Sagar	10.9	9.2	8.2	7.8	9.7	4.7	2.4	3.2	4.2	5.2	5.9
Cov. Comp	13.8	12.8	12.2			14.5	12.6	11.6	14.7	13.8	13.5

Source: Company, JM Financial, Industry

APPENDIX I

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