Shree Cement

BSE Sensex	S&P CNX
32,159	10,093

CMP: INR18,800 **TP: INR22,360 (+19%)** **Buy**

Mr H M Bangur
MD and CEO
Shree Cements

SHREE CEMENT LIMITED

Financials Snapshot (INR b)

Y/E Mar	2017	2018E	2019E
Net Sales	84.3	98.9	123.0
EBITDA	23.7	25.0	31.9
Net Profit	13.4	16.0	19.1
EPS (INR)	384.4	460.4	547.8
EPS Gr.(%)	5.4	19.8	19.0
BV/Sh. (INR)	2,210	2,622	3,121
RoE (%)	18.4	19.1	19.1
RoCE (%)	17.5	17.7	18.0
P/E (x)	48.9	40.8	34.3
P/BV (x)	8.5	7.2	6.0
EV/EBITDA(x)	26.5	24.4	18.7
EV/Ton(USD)	314	257	224

Slowing capacity addition to drive utilization improvement

Takeaways from CEO track; limestone resources – a constraint

We hosted Mr H M Bangur, MD and CEO of Shree Cement (SRCM), as part of 'CEO Track' at our annual conference. Key takeaways:

- **Capacity addition will likely slow down from 5% over FY12-17 to sub-2% in the next five years. This, coupled with stable demand, should drive utilization improvement in the next 3-4 years.**
- **Per capita cement consumption in India continues to be among the lowest in the world, the improvement in which could drive structural growth in India's cement industry.**
- **Limestone reserves in India are scarce and can support demand only for the next 6-7 years before getting fully utilized.**
- **Import of cement does not pose a major threat for India due to the relatively cheap price of delivered cement.**
- **The company is likely to report growth at 1.5-2x that of industry average, led by capacity addition ahead of industry.**
- **SRCM will continue enjoying cost efficiency due to its capability to put up cement plants at 30-40% lower cost than industry. Hence, it will not bid for any expensive acquisition.**
- **Given its relatively healthy balance sheet, the company is likely to reward investors with a dividend payout.**

Pace of capacity addition slowing down

Management expects capacity addition of ~50mt over the next five years, lesser than +85-90mt over FY12-17. This translates into a capacity addition rate of 2% over FY17-22, as against 5% over FY12-17. Demand growth over FY12-17 was sub-5% due to weak demand from the housing and rural segments. This, coupled with higher supply addition, led to flat utilization during that period.

With slowing supply addition and increasing demand, we expect industry utilization to increase meaningfully over the next 3-4 years.

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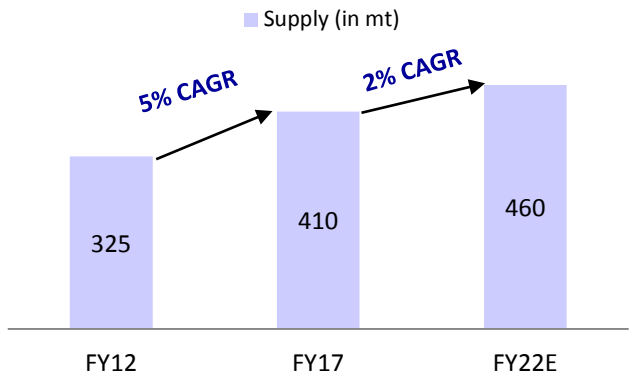
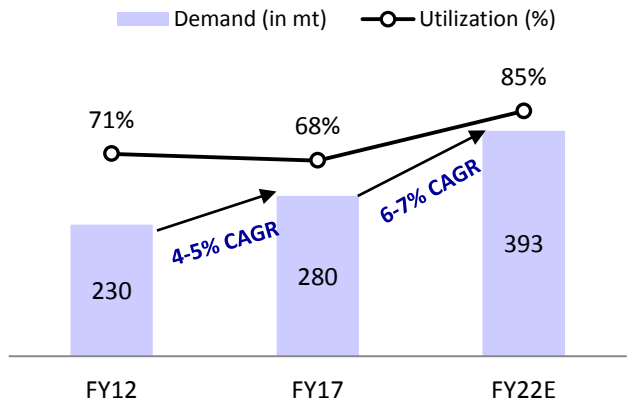
Exhibit 1: Supply grew at a CAGR of 5% from FY12-17, while it is expected to grow at only 2% CAGR from FY17-22E



Source: MOSL, Company

Exhibit 2: Demand CAGR was 4-5% over FY12-17, while it is expected to be 6-7% over FY17-22E, leading to utilization improvement



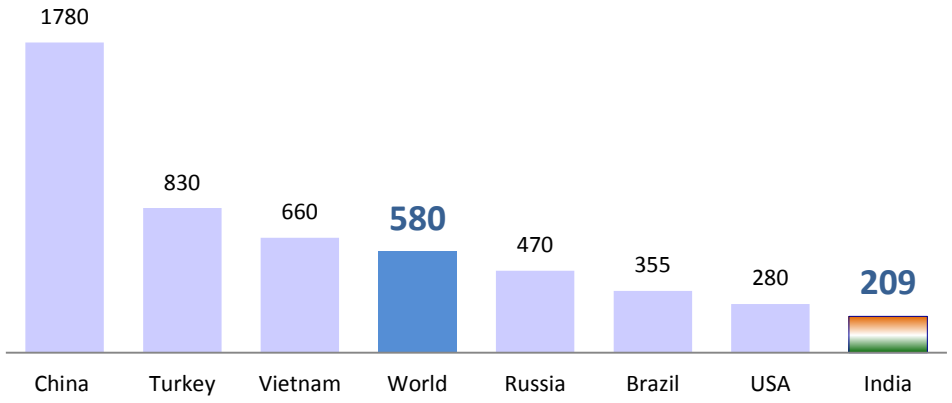
Source: MOSL, DIPP

Per capita cement consumption continues to increase

Management expects demand over the medium-to-long term to be driven by an increase in per capita consumption, which is substantially lower in India compared to most other countries. According to industry reports, per capita consumption of cement in India at ~200kg is significantly behind world average of 580kg. China and Turkey lead, with per capita consumption of 1,780kg and 830kg, respectively.

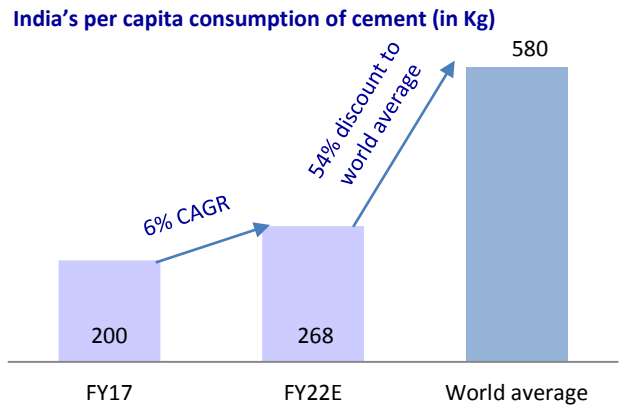
The industry expects population to increase at a CAGR of 1-1.2% over the next few years. This implies that if cement demand grows at 6-7% over the next five years, then per capita consumption should also grow at a similar pace. Per capita consumption of cement is likely to be 268kg/281kg if it grows at a CAGR of 6%/7%, which would still be lower than the world average by 54%/51%. Hence, we do not expect demand growth in India to saturate over the medium term. Instead, it would continue growing sustainably at 5%+.

Exhibit 3: Per capita consumption in India is low compared to other countries and world average (in kg)



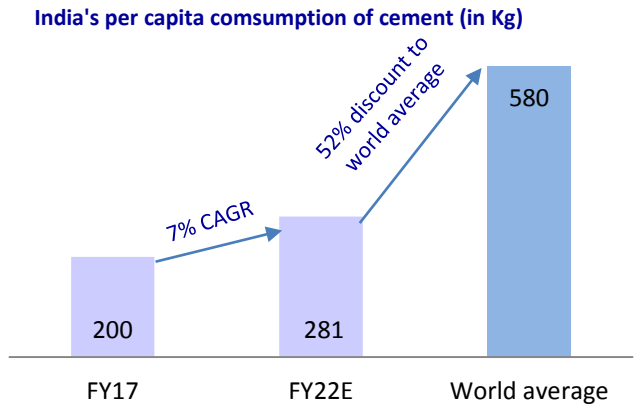
Source: MOSL, Company

Exhibit 4: 6% CAGR in per capita consumption for cement in India would result in 54% discount to world average



Source: MOSL, Company

Exhibit 5: 7% CAGR in per capita consumption for cement in India would result in 52% discount to world average

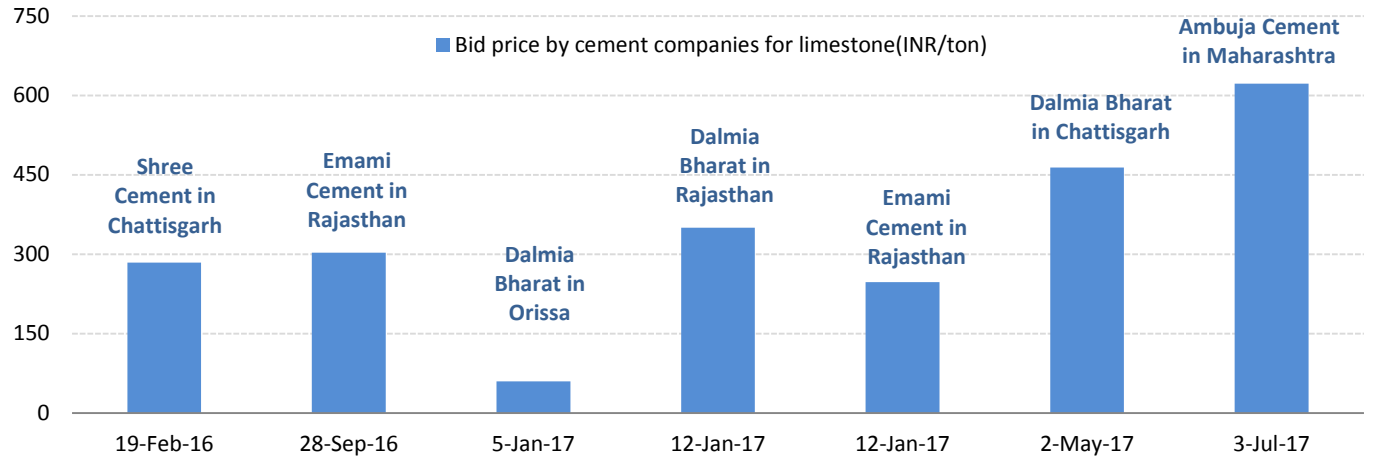


Source: MOSL, Company

Limestone resources – a constraint; existing players at advantage

- According to management, current limestone resources are expected to get fully utilized over the next 6-7 years. To have access to higher limestone reserves, the environment norms would have to be relaxed. Hence, players with large limestone reserves with ability to meet growing demand are likely to be the key beneficiaries.
- The cost of bidding for new limestone mines has been increasing constantly, putting new capacities at cost advantage compared to legacy assets. To justify incremental flow of capital into these new capacities, pricing has to improve. This will ensure that profitability of the existing players improves substantially.

Exhibit 6: Limestone bid prices on a rise



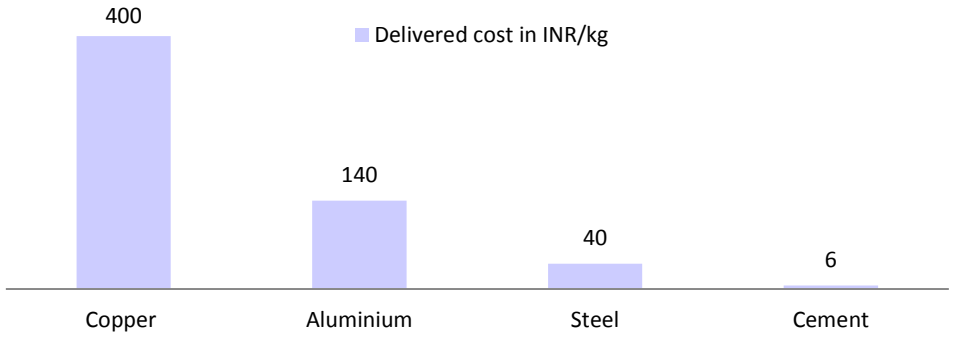
Source: Company, MOSL

No threats from cement imports

- Management does not expect any form of threat from cement imports as the cost of delivered cement works out to be INR6/kg, which is at a significant discount to other imported commodities (e.g. delivered cost is INR40/kg for steel, INR400/kg for aluminum and INR140/kg for copper).

- The scalability of cement imports is another challenge. This is because adjusted for freight; the logistics for delivering cement to land-locked areas is extremely difficult. Thus, while it may be a far possibility in coast-bound areas, it is extremely difficult in land-locked areas due to the issues related to logistics.

Exhibit 7: Delivered cost of cement much lower than other commodities

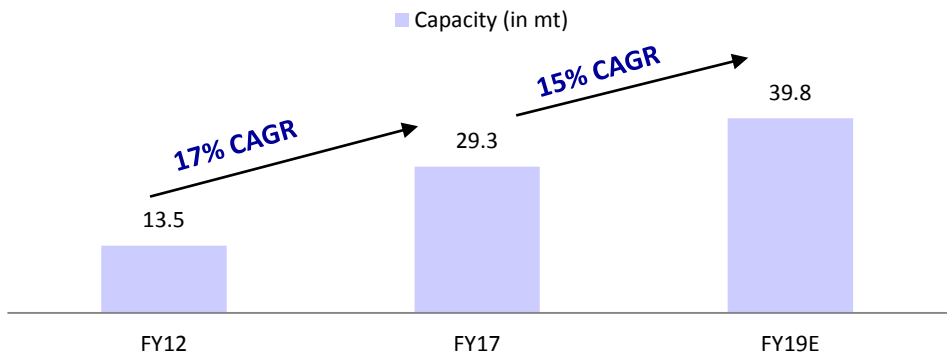


Source: MOSL, Company

SRCM to outperform industry growth led by significant capacity addition

- Management expects SRCM's volumes to grow at 1.5-2x that of industry over the next few years, led by its better capacity addition.
- SRCM is likely to increase capacity from 29.3mt at end-FY17 to ~39.8mt by end-FY19 while diversifying into the newer markets of south India. The company is expected to add capacity at a 15% CAGR over FY17-19, far higher than industry, which will likely result in market share gains.
- Over FY13-17, the company exhibited volumes CAGR of 13% v/s industry average of 5%, led by doubling of capacity. The trend is likely to continue as it plans to increase capacity by ~34% over FY17-19.

Exhibit 8: SRCM's capacity to grow at CAGR of 15% over FY17-19



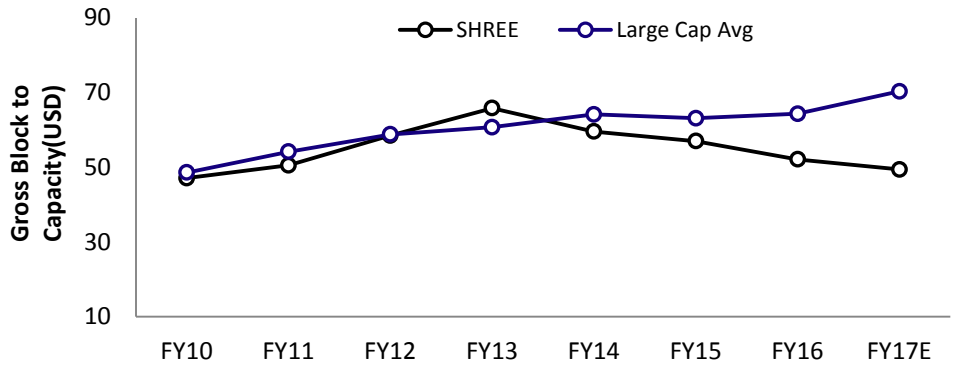
Source: MOSL, Company

Continues to create capacities at 30-40% discount

- Management believes that it is unlikely to acquire capacity at replacement cost, as the company has the capability to put up cement plants at 30-40% lower cost than industry. The cost efficiency of 30-40% emanates from its superior project execution capabilities and standardization of plants. This trend is likely to continue, going forward.
- SRCM is the most cost-efficient player in the industry. Its superior execution capability enables it to achieve RoIC of over ~50% (FY19E). The company's gross-

block-to-capacity (GB/capacity) – currently at ~USD53/tonne – has been structurally trending downward, as the proportion of brownfield expansion has increased. Its GB/capacity is at 28% discount to peers, which is also reflected in its superior RoCE profile.

Exhibit 9: Gross block to capacity of SRCM much lesser than large-cap average

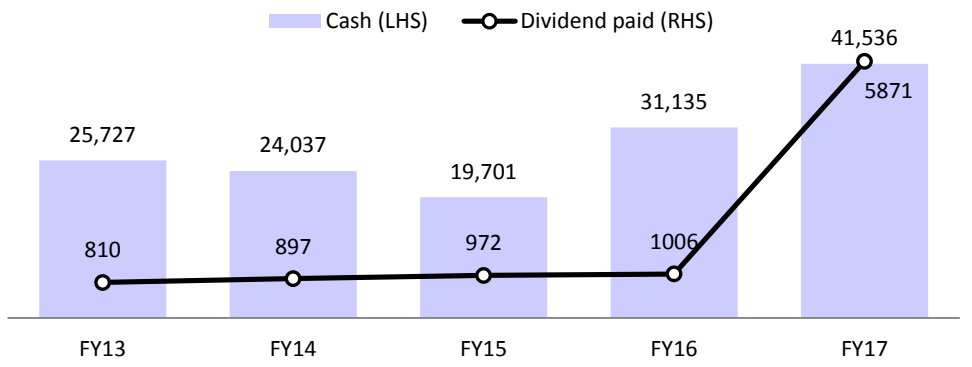


Source: MOSL, Company

Strong cash generation to result in higher payouts

- Given the stable cash flow generation potential over the next few years, management believes that incremental cash generation could be returned to shareholders in form of higher dividend payout. SRCM has cash of INR40b in its books at end-FY17, which is likely to further increase to INR50b+ in FY19.

Exhibit 10: Healthy balance sheet ensures higher payouts to shareholders (INR m)



Source: MOSL, Company

Valuation and view

- SRCM is the most cost-efficient cement producer in India. Its superior execution capability enables it to achieve RoIC of over ~50% (FY19E). SRCM's gross-block-to-capacity (GB/capacity) – currently at ~USD53/tonne – has been structurally trending downward, as the proportion of brownfield expansion has increased. Its GB/capacity is at 28% discount to peers, which is also reflected in its superior RoCE. We believe SRCM deserves to trade at premium valuations; we value the cement business at 15x FY20E EV/EBITDA to arrive at a target price of INR22,360. Maintain **Buy**.

Financials and Valuations

Income Statement (INR Million)

Y/E Mar	2013	2014	2015	2016	2017	2018E	2019E	2020E
Net Sales	**55,671**	**58,759**	**64,399**	**72,382**	**84,292**	**98,950**	**122,966**	**149,818**
Change (%)	16.5	5.5	9.6	12.4	16.5	17.4	24.3	21.8
Total Expenditure	40,293	44,975	51,097	54,746	60,619	73,905	91,041	109,391
% of Sales	72.4	76.5	79.3	75.6	71.9	74.7	74.0	73.0
EBITDA	**15,378**	**13,784**	**13,302**	**17,637**	**23,672**	**25,045**	**31,925**	**40,428**
Margin (%)	27.6	23.5	20.7	24.4	28.1	25.3	26.0	27.0
Depriciation	4,356	5,499	9,248	10,658	12,147	10,678	15,961	15,512
EBIT	**11,022**	**8,285**	**4,054**	**6,979**	**11,525**	**14,366**	**15,964**	**24,916**
Int. and Finance Charges	1,931	1,292	1,206	1,021	1,294	1,318	1,108	706
Other Income - Rec.	2,114	1,964	1,515	7,119	5,077	7,000	9,000	11,000
PBT before EO Expense	**11,205**	**8,957**	**4,363**	**13,076**	**15,308**	**20,048**	**23,856**	**35,210**
EO Expense/(Income)	11	-154	355	240	0	0	0	0
PBT after EO Expense	11,194	9,111	4,008	12,837	15,308	20,048	23,856	35,210
Tax	1,155	1,238	-255	364	1,917	4,010	4,771	7,042
Tax Rate (%)	10.3	13.6	-6.4	2.8	12.5	20.0	20.0	20.0
Reported PAT	**10,040**	**7,872**	**4,263**	**12,472**	**13,391**	**16,039**	**19,085**	**28,168**
Adj PAT for EO items	**10,049**	**7,739**	**4,640**	**12,705**	**13,391**	**16,039**	**19,085**	**28,168**
Change (%)	77.2	-23.0	-40.0	173.8	5.4	19.8	19.0	47.6
Margin (%)	18.1	13.2	7.2	17.6	15.9	16.2	15.5	18.8

Balance Sheet (INR Million)

Y/E Mar	2013	2014	2015	2016	2017	2018E	2019E	2020E
Equity Share Capital	348	348	348	348	348	348	348	348
Other Reserves	38,088	46,760	52,416	68,107	76,633	90,994	108,402	134,892
Total Reserves	38,088	46,760	52,416	68,107	76,633	90,994	108,402	134,892
Net Worth	**38,436**	**47,109**	**52,764**	**68,455**	**76,981**	**91,343**	**108,750**	**135,241**
Deferred Liabilities	-938	-1429	-1952	-3718	-5077	-5277	-5516	-5868
Secured Loan	11,274	10,783	8,200	7,265	12,925	11,425	9,925	8,425
Unsecured Laon	0	0	0	0	0	0	0	0
Total Loans	11,274	10,783	8,200	7,265	12,925	11,425	9,925	8,425
Capital Employed	**48,773**	**56,463**	**59,012**	**72,002**	**84,829**	**97,490**	**113,159**	**137,798**
Gross Block	56,895	66,764	85,764	38,689	46,297	55,401	75,401	98,401
Less: Accum. Deprn.	40,242	45,741	54,989	8,187	20,306	30,984	46,945	62,457
Net Fixed Assets	**16,653**	**21,023**	**29,154**	**29,647**	**25,991**	**24,417**	**28,456**	**35,944**
Capital WIP	2,500	8,500	6,000	3,500	7,104	10,000	10,000	4,000
Investments	22,033	22,444	16,626	30,305	40,426	40,426	40,426	40,426
Curr. Assets	**19,478**	**19,892**	**26,246**	**27,463**	**33,063**	**46,868**	**65,935**	**93,677**
Inventory	5,305	8,098	9,189	8,152	13,145	14,910	18,529	22,575
Account Receivables	3,147	2,966	4,764	3,286	3,351	5,422	5,727	6,978
Cash and Bank Balance	3,694	1,593	3,075	830	1,110	15,149	28,203	48,526
Others	7,333	7,236	9,219	15,195	15,456	11,386	13,476	15,598
Curr. Liability & Prov.	**11,891**	**15,396**	**19,015**	**18,913**	**21,755**	**24,221**	**31,658**	**36,250**
Account Payables	10,841	14,209	18,135	18,835	21,674	23,043	30,320	34,889
Provisions	1,050	1,186	880	78	81	1,177	1,337	1,361
Net Current Assets	**7,587**	**4,496**	**7,231**	**8,551**	**11,308**	**22,647**	**34,277**	**57,427**
Appl. of Funds	**48,773**	**56,463**	**59,012**	**72,002**	**84,829**	**97,490**	**113,159**	**137,798**

Financials and Valuations

Ratios								
Y/E Mar	**2013**	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Basic (INR)								
EPS	**288.5**	**222.2**	**133.2**	**364.7**	**384.4**	**460.4**	**547.8**	**808.5**
Cash EPS	441.3	427.5	541.3	863.8	974.0	942.0	1,282.3	1,490.2
BV/Share	1,103.3	1,352.3	1,514.6	1,965.0	2,209.6	2,621.8	3,121.4	3,881.8
DPS	20.0	22.0	24.0	24.0	140.0	40.0	40.0	40.0
Payout (%)	8.1	11.4	22.8	8.1	43.8	10.5	8.8	6.0
Valuation (x)								
P/E				51.5	48.9	40.8	34.3	23.3
Cash P/E				21.8	19.3	20.0	14.7	12.6
P/BV				9.6	8.5	7.2	6.0	4.8
EV/Sales				9.1	7.9	6.6	5.2	4.1
EV/EBITDA				35.8	26.5	24.4	18.7	14.2
EV (US$)				9,281	9,189	8,935	8,722	8,490
EV/ton (USD-Cap)				364	314	257	224	194
Dividend Yield (%)				0.1	0.7	0.2	0.2	0.2
Return Ratios (%)								
RoIC	61.1	32.2	15.1	19.2	27.4	33.8	38.4	50.2
RoE	30.6	18.1	9.3	21.0	18.4	19.1	19.1	23.1
RoCE	25.2	16.5	10.0	20.0	17.5	17.7	18.0	21.9
Normalized RoE	33.5	22.0	19.2	32.1	30.0	26.3	28.7	29.8
Working Capital Ratios								
Inventory (Days)	35	50	52	41	57	55	55	55
Debtor (Days)	19	17	24	15	13	18	15	15
Creditor (Days)	71	88	103	95	94	85	90	85
Working Capital Turnover (Days)	50	28	41	43	49	84	102	140
Leverage Ratio (x)								
Current Ratio	1.6	1.3	1.4	1.5	1.5	1.9	2.1	2.6
Debt/Equity	0.3	0.2	0.2	0.1	0.2	0.1	0.1	0.1

Cash Flow Statement								(INR Million)
Y/E Mar	**2013**	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Oper. P/L before Tax	15,368	13,938	12,947	13,701	23,672	25,045	31,925	40,428
Interest/Dividends Recd.	2,114	1,964	1,515	6,675	5,077	7,000	9,000	11,000
Direct Taxes Paid	-2,198	-1,729	-268	-1,221	-3,241	-4,210	-5,010	-7,394
(Inc)/Dec in WC	-5,957	990	-1,253	-3,384	-2,477	2,700	1,423	-2,827
CF from Operations	**9,326**	**15,162**	**12,942**	**15,770**	**23,031**	**30,535**	**37,339**	**41,207**
(inc)/dec in FA	-7,331	-15,869	-14,879	-6,268	12,096	12,000	-20,000	-17,000
Free Cash Flow	**1,995**	**-707**	**-1,938**	**9,502**	**10,935**	**18,535**	**17,339**	**24,207**
(Pur)/Sale of Investments	3,319	-411	5,818	-13,679	10,121	0	0	0
CF from investments	**-4,012**	**-16,280**	**-9,062**	**-19,947**	**22,217**	**12,000**	**-20,000**	**-17,000**
Issue of Shares	1,867	1,697	2,364	5,266	1,006	0	0	0
(Inc)/Dec in Debt	-5,337	-491	-2,583	-935	5,660	-1,500	-1,500	-1,500
Interest Paid	-1,931	-1,292	-1,206	-758	-1,294	-1,318	-1,108	-706
Dividend Paid	-810	-897	-972	-1,006	-5,871	-1,677	-1,677	-1,677
CF from Fin. Activity	**-6,211**	**-983**	**-2,398**	**2,568**	**-499**	**-4,495**	**-4,285**	**-3,883**
Inc/Dec of Cash	**-896**	**-2,101**	**1,482**	**-1,609**	**314**	**14,039**	**13,053**	**20,324**
Add: Beginning Balance	4,590	3,694	1,593	3,075	830	1,110	15,149	28,203
Closing Balance	**3,693**	**1,592**	**3,075**	**1,706**	**1,145**	**15,149**	**28,203**	**48,526**

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