The views expressed are personal

Not an invitation to invest

May have personal and / or professional position

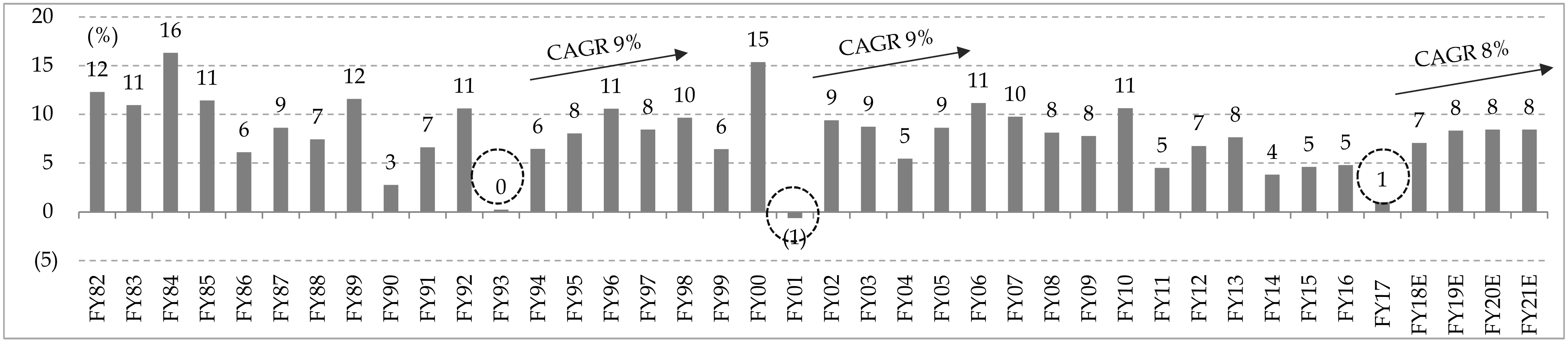
Cement Sector – *Sort of consensus optimism…*

What is our view?

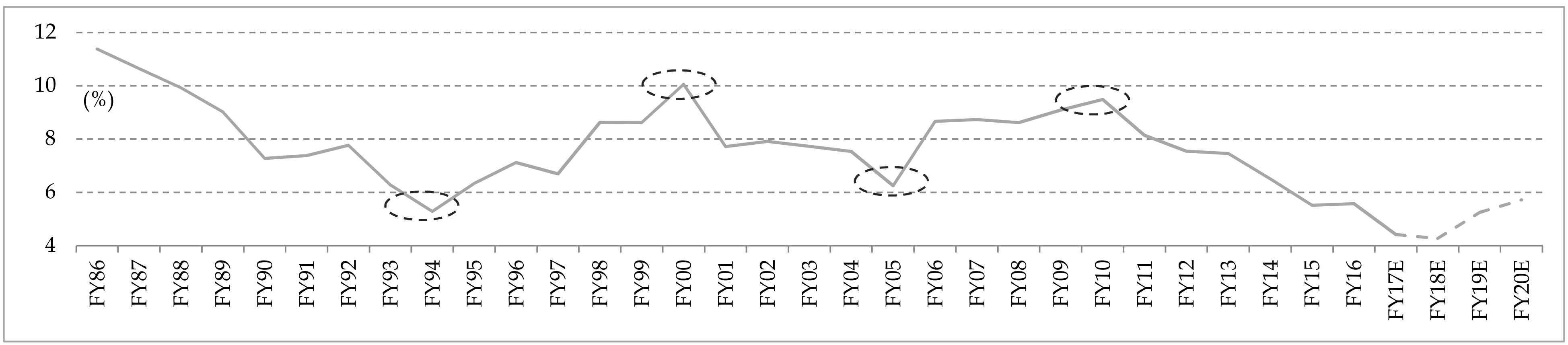
Sunil Singhania

Positive traction in demand

Distinct possibility of demand growth to outstrip supply growth (3-4% annually till FY21)

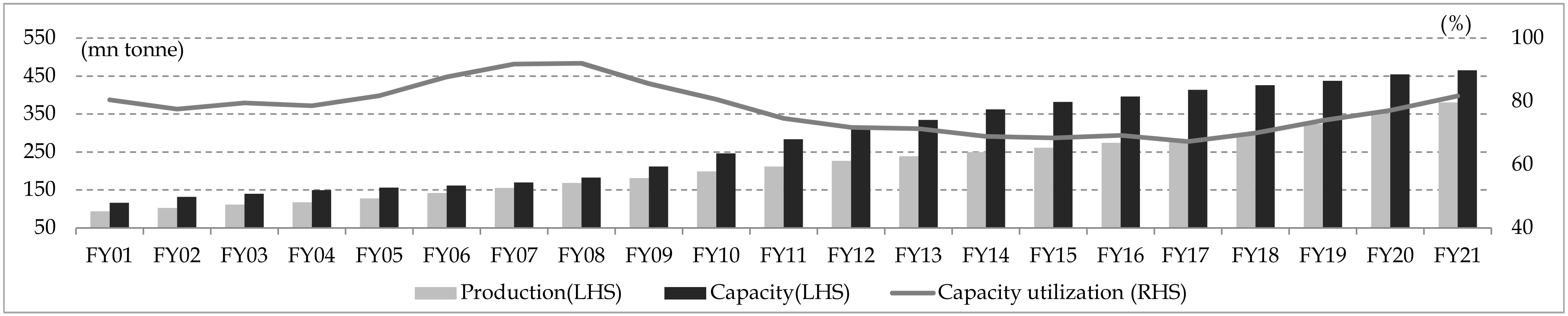


Moving 5 year demand CAGR slow downs to ~5% in mid of the decade

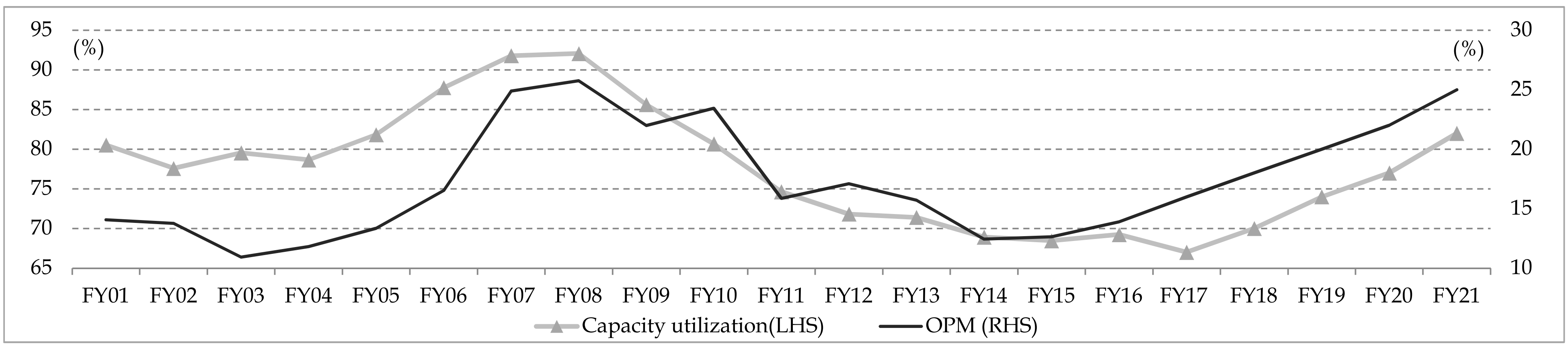


Increasing demand to lead to higher utilizations

All India capacity utilization to bottom out in FY17…



… which in turn should resonate on EBIDTA margins of the industry too



Demand might surprise on the upside

Proposed spending in Housing & Infra can add 720bps of incremental annual addition to demand over FY18-21

	Market size (MT)	Housing for all		Infra	
		Annual incremental demand*	Gr (%)	Annual incremental demand*	Gr (%)
East	48.0	3.5	7.2	0.6	1.2
Central	43.0	2.5	5.8	0.3	0.6
South	65.0	3.6	5.5	1.1	1.6
West	47.0	1.3	2.7	0.2	0.4
North	54.0	0.8	1.4	0.2	0.3
Northeast	8.0	0.1	1.0	-	-
Center Spending				4.2	1.5
Delta to All India growth	265.0	11.7	4.7	7.5	2.5

Note: *Housing demand estimated at 50% of target while infrastructure spending rate taken at 5% lower than the ratio of last year target v/s actual spending

Dynamics of setting up a new cement plant

Significant changes in operating dynamics over the past few years should enable established, sizeable players to command a large premium over the average sector valuation metrics

Pre 2016	Post 2016
Mining leases were given on first come first serve basis. Limestone mines could be acquired without the end use assets	Limestone mine allocation only through auctions. Acquisition of mines allowed only when there is a attached cement plant to it; mine transfer to attract transfer fees
Land acquisition at nominal prices	Scarcity of contiguous, optimally priced land around mining leases has become the most stiff barrier courtesy the New Land Acquisition, R&R Act
New players had a free run to foray in the sector via M&As	Majority of the stressed capacities sold to stronger hands, handful of value accretive assets left for sale
No major challenge relating to availability of key inputs barring coal and rake availability in very few cases	Availability issues around Slag and Fly ash have started emerging; new contracts for Slag not available in some regions
Greenfield projects used to yield 12-15% RoCE even in the down cycle, for a moderately efficient player	Current cement prices/profitability make Greenfield projects economically unviable
Operating cost per tonne – INR 3,400 (5 yrs avg.) Replacement cost per tonne – USD 90-100	Operating cost per tonne – INR 3,600 Replacement cost per tonne – USD 120-135

However, stocks have run up too much too fast

Absolute Return (%)

	6 months	1 year	2 year	3 year
UltraTech Cement Ltd	18	30	46	73
Ambuja Cements Ltd	17	5	4	8
ACC Ltd	24	8	11	19
Shree Cement Ltd	19	34	59	162
Dalmia Bharat Ltd	52	163	303	543
Ramco Cements Ltd/The	21	48	120	170
India Cements Ltd/The	78	122	147	103
Birla Corp Ltd	34	117	116	143
Century Textiles & Industries Ltd	36	72	68	114
JK Lakshmi Cement Ltd	26	41	41	155
JK Cement Ltd	52	90	81	218
Orient Cement Ltd	14	(6)	(16)	94
Prism Cement Ltd	31	28	8	93
Kesoram Industries Ltd	2	28	64	83
Heidelberg Cement India Ltd	16	27	94	129

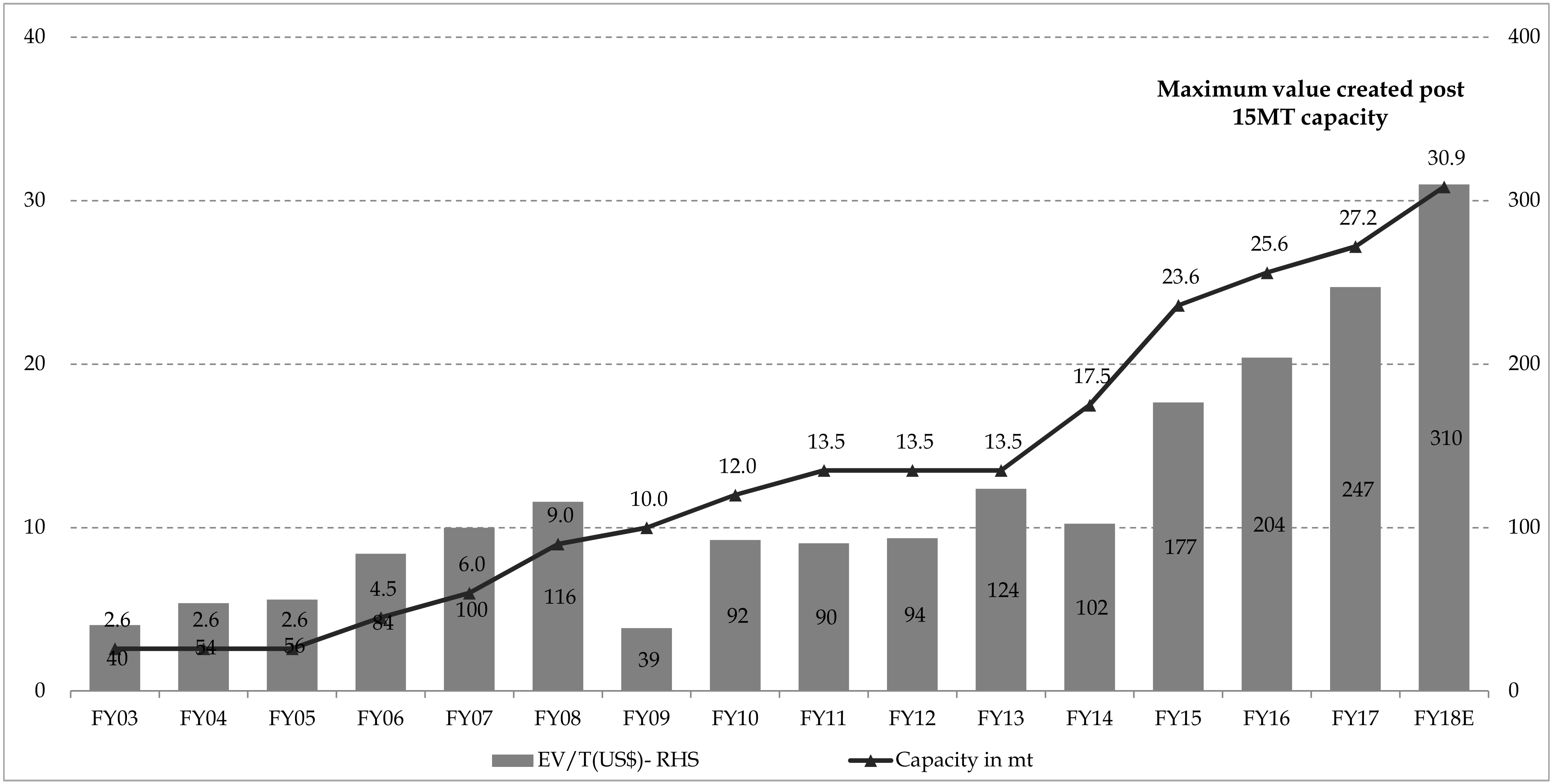
Lets see how companies have grown

First 15MT is very difficult, thereafter cement companies have demonstrated a remarkable compression in future expansion time and delivered more consistent & superior returns

	Year Of Incorporation	15MT (Year)	25MT (Year)	Current Capacity (MT) (31 Mar'17)
Ultratech	1983	2003	2004	92.0
Market Cap (INR bn)		*32*	*33*	*1094*
Ambuja	1983	2006	2010	29.6
Market Cap (INR bn)		*140*	*183*	*470*
ACC	1936	2002	2010	33.1
Market Cap (INR bn)		*26*	*179*	*272*
Shree	1979	2013	2016	27.2
Market Cap (INR bn)		*141*	*433*	*595*
Dalmia	1939	2010	2015	25.0
Market Cap (INR bn)		*20*	*35*	*175*
Average time spent b/w phases (yrs)		**43**	**4**	
Annualized return b/w phases (%)			**35%**	**60%**

Case Study: The most expensive cement stock

Market gives value to Growth & Consistency: Valuation re-rating with expansion and consistent profit delivery



Sector is good, but valuations expensive. Is there a way to play this sector?

The most expensive cement stock Vs the rest

	Capacity (MT)	M. Cap (INR bn)*	EV/ton (x)
Shree Cement	**27.2**	**625**	**357**
The Ramco Cements	16.5	172	170
India Cements	15.6	63	90
Birla Corporation	15.4	65	101
Century Textiles Inds***	13.3	118	95
J K Lakshmi	13.0	58	91
J K Cement	10.5	78	115
Orient Cement**	12.2	30	75
Prism Cement	8.0	59	115
Kesoram Industries***	7.3	17	79
Heidelberg Cement India	5.4	30	106
Grand Total (ex. Shree)	**117.0**	**689**	**104**

Note: *M Cap as on 31st May, 2017 **Calculations asume JPA's capacities acquisition ***EV/ton calculated considering only the cement business debt and estimated M. Cap

Our recommendation. There is a big opportunity, returns though shall be stock specific

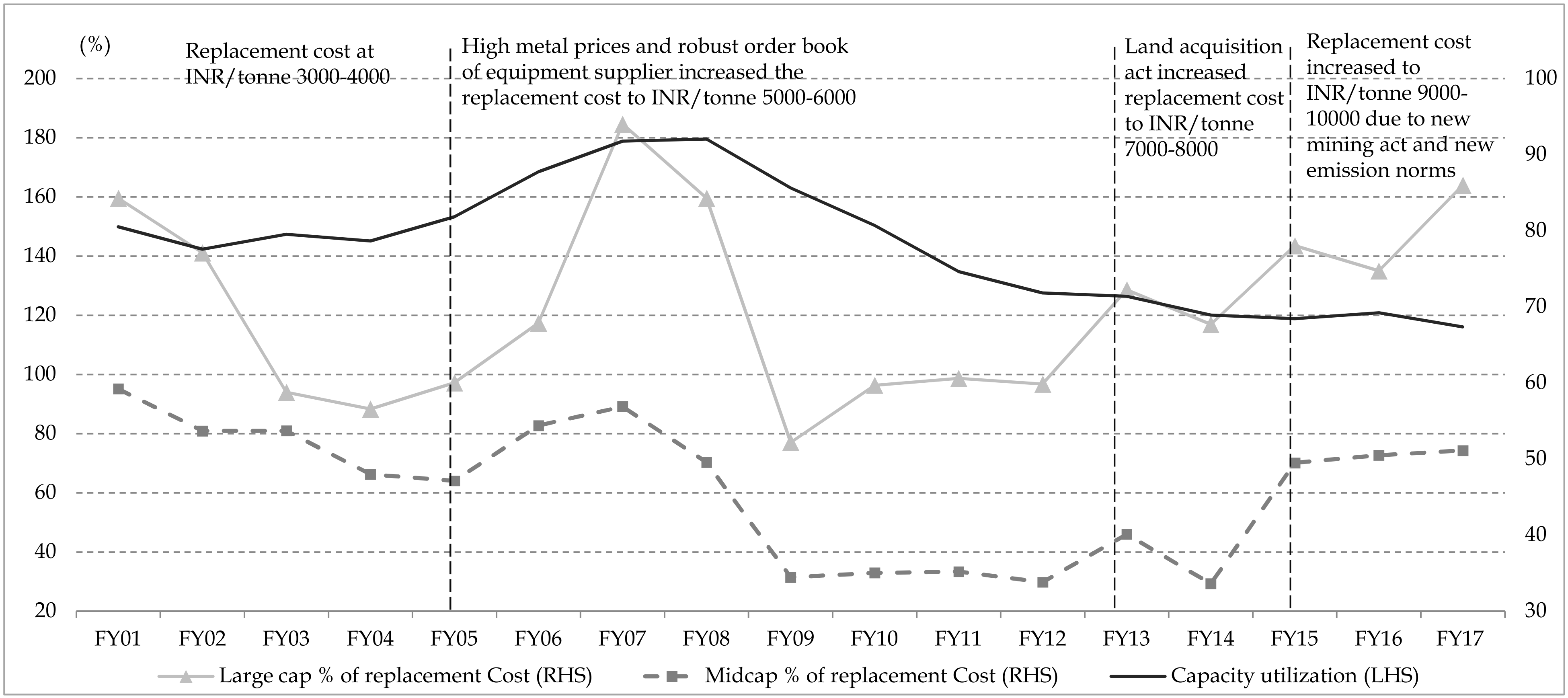
We would back 15MT capacity companies which can scale up to 25MT

BUY two 15MT companies. One in North/Central India, other in South, thereby creating a quasi All India play

FY17	Company 1	Company 2
Current Capacity (MT)	15.5	15.5
Market Cap. (INR bn)	63	65
EBIDTA (INR mn)	8,775	6,776
EV (INR bn)	91	101
EBIDTA per ton (INR)	795	678
EV/EBIDTA (x)	10.3	14.9
EV/tonne (USD)	90	100

Large caps trade at 2x of replacement in up cycle

Midcaps have traded at 50% discount to large caps (15MT+) and at par with replacement cost in an up cycle. However, with increase in size, improvement in operating efficiency and leaner balance sheets, this valuation gap should started reducing significantly



Scenario 2021

FY21E	Company 1	Company 2
Capacity visibility (MT)	20	20
EBIDTA (INR mn)	16,500	22,000
EBIDTA per ton (INR)	1,100	1,400
EV (INR bn)	85	95
EV/EBIDTA (x)	5.1	4.4
EV/tonne (USD)	65	73
Possible EV (@200 per ton, INR bn)	260	260
Possible Market Cap (INR bn)	238	231
Upside Potential (times)	3.8x	3.5x

THANK YOU