CEMENT

AMBIT
Acumen at work

June 2015

North country blues

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North country blues

The times, they are a-changing. A confluence of growth impediments—slowdown in rural sales, weak demand for organised housing and elusive infrastructure recovery—have further deteriorated cement demand/pricing in north India (the largest Indian cement market). North India's large share in major infrastructure projects exudes hopes of demand upcycle, but we believe it will take until FY18 for a meaningful recovery. Moreover, low utilisation and changing demand mix (more infrastructure) will curtail unitary EBITDA growth. Consensus expectations of lofty earnings growth in FY16-17 for expensive large-cap players (11-13x one-year forward EBITDA) will require cuts to account for volume/pricing disappointments; inexpensive (35% discount to large-caps) and efficient regional players make for better recovery plays.

North India: Several tailwinds ensured strong growth in last decade

North India, India's largest cement market, accounts for 31% of cement sold in India. Demand here expanded at 7.6% CAGR in the last decade, as it benefitted from industrialisation, public infra spending and rising urban agglomerations, leading to increased commercial/residential real estate construction. Despite high capacity utilisation (84% over FY05-15 vs India's average of 75%), pricing has been volatile, with rising competition from regional players/new entrants.

FY16: Light at the end of the tunnel or an approaching freight train?

Whilst FY16 was mooted to be a recovery year, demand has worsened, as rural sales decline sharply, real estate inventory has hit all-time high, and infrastructure recovery remains elusive with weak government tendering. The increasing prominence of regional manufacturers (51% capacity share in FY15 vs 45% in FY07) in a market with limited logistic challenges (largely roads) has led to price wars; now prices in north India are at a 35% discount to south India.

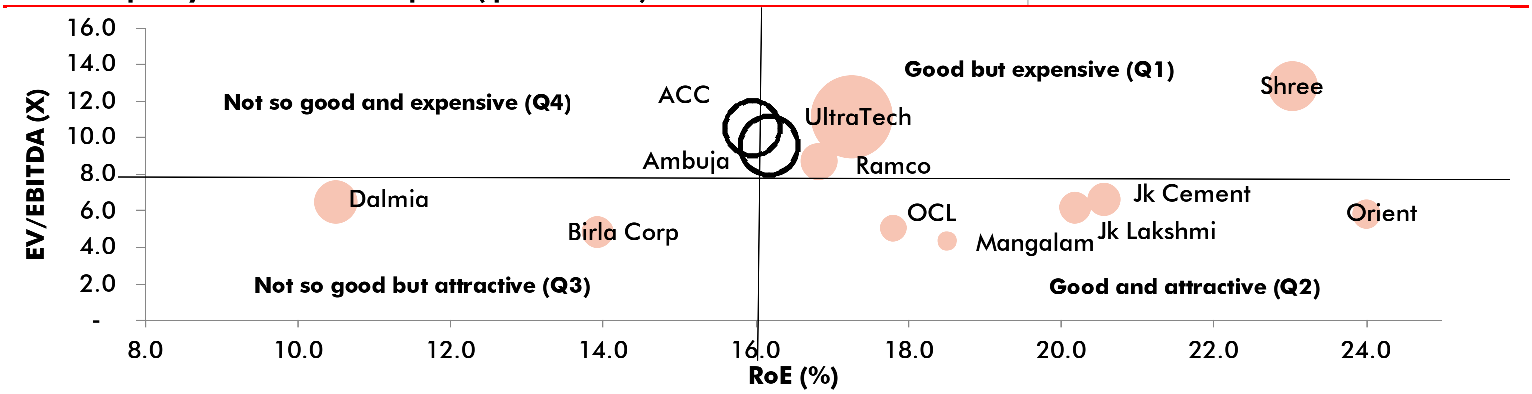
Mr. Super-cycle, when will you return?

North India will be a key beneficiary of infrastructure execution ramp-up in India, given a majority share in large infrastructure projects (roads, DFC, DMIC). However, a strong and sustained volume growth will take till FY18 as retail demand will recover with a few quarters lag to infra demand. However, low capacity utilisation, rising institutional share and OPC mix, will restrict profitability growth in this **demand super-cycle (as compared to FY05-09).**

Scale begets scale but efficiency begets RoCEs

Regional manufacturers with scale and cost efficiencies will benefit the most in an infra-led cement demand recovery. Pan-India players trade at rich valuations, run earnings downgrade risks (we have cut FY16 EBITDA by 6-20%) and do not have the best cost/capital efficiency to meaningfully improve RoCEs, as volumes might grow but chances of a sharp pricing recovery are scanty.

Invest in quality at a reasonable price (quadrant #2)



Source: Bloomberg, Company, Ambit Capital research

Key Recommendations

UltraTech	**SELL**
Target Price: ₹2,337	Downside: 16%
Ambuja	**SELL**
Target Price: ₹208	Downside: 7%
ACC	**SELL**
Target Price: ₹1,241	Downside: 12%
Shree Cement	**SELL**
Target Price: ₹9,157	Downside: 15%

Midcap valuation vs large-cap

Source: Ambit Capital research

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Coverage summary

Exhibit 1: Ambit cement coverage valuation summary

	CMP	TP	Upside/ Downside	Rating	MCap	MCap	EV/EBITDA (X)			EV/Tonne (X)			Target EV/EBITDA (X)		
	(₹)	(₹)	(%)		(₹ bn)	(US$ mn)	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E
UltraTech	2,788	2,337	(16.2)	SELL	754	11,943	18.0	14.5	11.6	12,051	12,037	11,345	15.6	12.7	10.1
Ambuja	222	208	(6.8)	SELL	353	5,363	15.3	13.2	11.5	10,469	10,027	9,106	14.5	12.4	10.8
ACC	1,414	1,241	(12.2)	SELL	265	4,122	16.6	14.3	10.8	8,223	7,105	6,797	14.6	12.5	9.4
Ramco	324	288	(11.1)	SELL	78	1,164	12.5	9.4	8.0	5,997	5,997	5,824	12.0	9.1	7.7
Shree	10,711	9,157	(14.5)	SELL	322	5,757	28.7	19.5	14.2	17,908	15,806	14,567	23.2	16.0	11.6
Orient	165	213	29.1	BUY	35	529	15.7	10.4	7.9	9,829	6,506	6,112	17.9	11.2	8.9

Source: Company, Ambit Capital research

Exhibit 2: Ambit cement unitary metrics summary

	Cement despatches (mn tonnes)			Utilisation			Realisation (₹/tonne)			Cost/tonne			EBITDA (₹/tonne)		
	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E
UltraTech	44.8	48.9	54.7	75	76	81	5,053	5,366	5,683	4,204	4,319	4,507	911	1,112	1,244
Ambuja	21.7	22.1	23.2	77	77	75	4,551	4,746	4,843	3,696	3,768	3,857	891	1,016	1,115
ACC	24.2	24.5	25.7	81	77	76	4,477	4,587	5,184	4,220	4,422	4,452	667	846	1,126
Ramco	7.7	8.1	8.6	48	49	51	4,612	4,935	5,231	3,808	3,902	4,072	973	1,202	1,325
Shree	16.2	18.4	21.5	87	81	86	4,044	4,206	4,458	3,091	3,109	3,111	817	1,056	1,244
Orient	4.4	5.6	6.7	87	69	74	3,752	4,089	4,416	3,048	3,197	3,382	704	893	1,034

Source: Company, Ambit Capital research

Exhibit 3: Ambit cement financial summary

	Revenues (₹ bn)			EBITDA (₹ bn)			EBITDA margin			PAT (₹ bn)			EPS		
	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E
UltraTech	229.4	265.4	315.4	41.9	54.3	68.2	18.3	20.5	21.6	20.1	26.9	35.8	73.3	98.2	130.6
Ambuja	99.8	106.2	123.8	19.3	22.5	25.9	19.4	21.2	20.9	12.9	14.5	16.5	8.4	9.4	10.7
ACC	117.4	125.4	136.0	14.9	16.4	21.7	12.7	13.1	16.0	9.0	11.7	9.0	44.7	46.7	65.2
Ramco	37.2	42.1	47.7	7.9	10.5	12.4	21.3	24.9	26.0	2.4	3.8	5.1	10.2	16.0	21.4
Shree	63.2	76.5	93.4	13.2	19.4	26.7	20.9	25.4	28.6	4.2	10.1	13.5	119.6	290.8	388.7
Orient	16.5	22.8	29.7	3.1	5.0	7.0	19.1	22.0	23.6	1.7	2.0	3.0	8.4	9.6	14.4

Source: Company, Ambit Capital research

Exhibit 4: Ambit cement financial ratios

	RoCE (%)			RoE (%)			Revenue growth (%)			EBITDA growth (%)			PAT growth (%)		
	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E
UltraTech	9.1	10.5	12.4	11.2	13.5	15.9	13.1	15.7	18.8	9.9	29.5	25.5	(6.3)	34.1	33.0
Ambuja	12.3	12.8	13.5	13.0	13.5	14.2	9.0	6.4	16.6	17.1	16.3	15.2	24.9	12.8	13.6
ACC	7.6	10.3	13.3	10.6	10.3	13.3	5.1	6.9	8.5	(4.2)	10.3	32.3	(6.8)	4.4	39.8
Ramco	7.1	8.0	9.5	9.5	13.5	15.8	1.1	13.1	13.4	40.7	32.4	18.3	76.0	57.0	33.8
Shree	8.7	17.2	19.7	8.5	18.5	21.0	7.4	21.1	22.0	(5.0)	46.9	37.5	(52.0)	143.2	33.7
Orient	21.4	16.2	15.3	19.2	18.7	23.5	14.4	38.3	30.3	46.0	59.9	39.4	70.9	14.2	49.8

Source: Ambit Capital research, Company

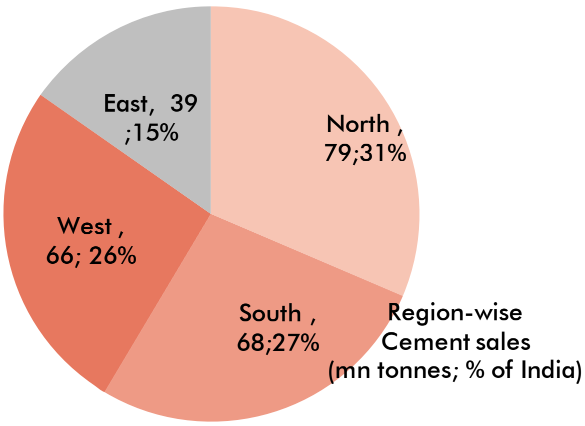
North India: A large and unique market

North India (including UP) is the largest cement market in India (31% of India's consumption in FY15). It has historically been a well-balanced cement market with high capacity utilisation, low fragmentation and little inward dispatch threat from other manufacturing regions. Whilst a large proportion of the market is dependent on rural/retail sales, the strong growth of manufacturing and services industry led to rising commercial and residential real estate construction in the last decade. The region is facing growth challenges, as: (1) infrastructure recovery remains elusive and (2) rural demand has deteriorated significantly in the last one year, owing to poor rainfall, low subsidies, wage growth and paltry MSP hikes. Alongside real estate business is facing liquidity constraints due to the government's clamp-down on black money.

North India is a large market facing growth challenges as infra recovery is elusive and rural/retail demand has deteriorated

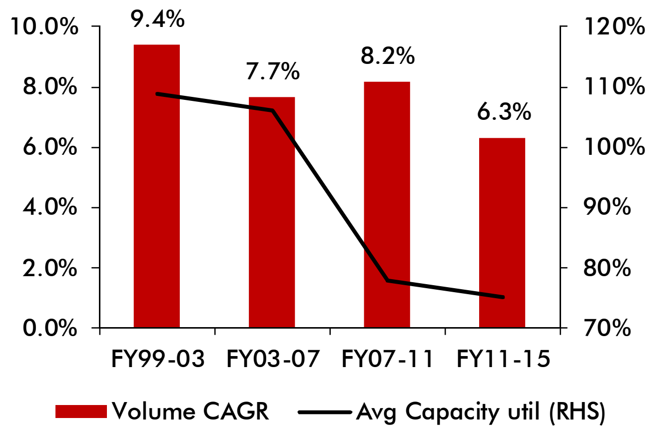
Shree Cement (19% capacity share) is the largest cement manufacturer in north India, followed by UltraTech (16% capacity share). Ambuja and ACC were the erstwhile leaders but their market share has dropped significantly, as the extant regional manufacturers and new entrants significantly added capacities.

Exhibit 5: North India is the largest cement market in India



Source: Company, Ambit Capital research

Exhibit 6: Volume growth has decelerated and capacity utilisation has dropped over FY11-15



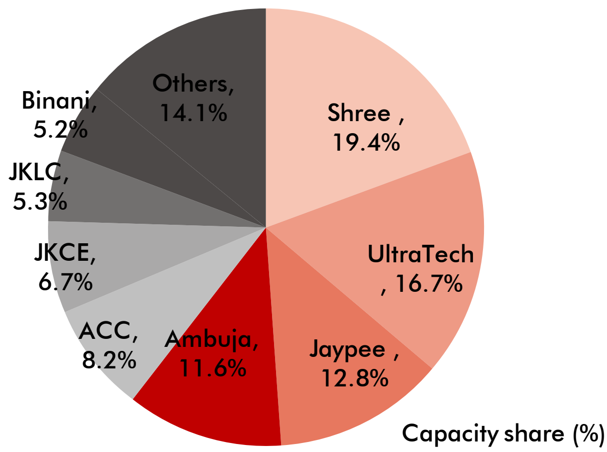
Source: Company, Ambit Capital research

Exhibit 7: UP, UTC and Rajasthan account for 60% of cement sales in north India

State	Size mn tonnes	% of North	CAGR (FY05-10)	CAGR (FY10-15)
UP+UTC	33	41.4%	9%	6%
Rajasthan	15	19.5%	10%	6%
Haryana	10	13.2%	14%	5%
Punjab	10	12.9%	6%	8%
Delhi	5	6.7%	7%	0%
Himachal Pradesh	3	4.2%	8%	9%
Jammu & Kashmir	1	1.6%	4%	2%
Chandigarh	0	0.4%	14%	3%
Total	**79**	**100.0%**	**9%**	**6%**

Source: Company, Ambit Capital research

Exhibit 8: Capacity share - North India (overall capacity at 100mn tonnes)



Source: Company, Ambit Capital research, Please note that the chart is based on grinding capacity

Evolution of north India cement market

North India is not only the largest market (79mn tonnes; 31% of India's cement consumption) but also a unique cement market (wherein retail and institutional cement demand have high prominence; also, despite its relatively better capacity utilisation, pricing is lower than other Indian regions). Cement sales in the region expanded at a 7.5% CAGR over the last decade, in line with the overall volume growth in India.

The exhibit below shows the evolution of the north India cement market, wherein we have divided the last 15 years into four distinct phases:

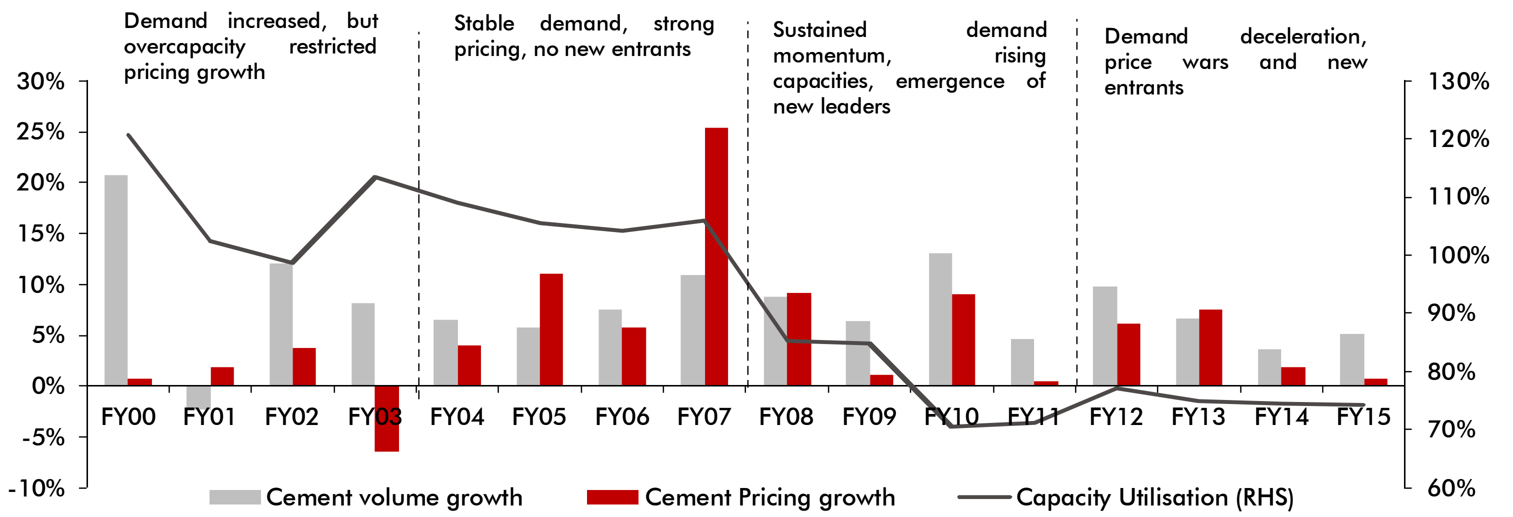
(1) FY01-03: Demand increased but overcapacity restricted pricing growth

(2) FY04-07: Stable demand, strong pricing, no new entrants

(3) FY08-11: Sustained demand momentum, rising capacities, emergence of new leaders

(4) FY12-15: Demand deceleration, price wars and new entrants

Exhibit 9: The evolution of the north India cement industry



Source: CMA, Ambit Capital research

(1) FY01-03: Demand increased but overcapacity restricted pricing growth

Demand growth was in high single digits but prices remained flat as new capacities were commissioned

Cement demand expanded at a 9.4% CAGR (the strongest four-year growth phase in the last 15 years), yet prices remained flat. Shree Cement in its FY2000 Annual Report highlighted that despite strong demand, prices failed to grow, as new capacities were commissioned.

The interesting aspect to note in FY01 was that it was the second year of the NDA Government at the Centre and contrary to popular belief infrastructure demand failed to increase

From JK Lakshmi's (then known as JK Corp) FY2000 Annual Report: *"Growth in demand fell far short of the capacity created in the industry. This overhang resulted in fierce price war which in turn lowered the net sales realisation to levels not seen since 1992-93."*
Whilst volume growth was strong in FY2000, we highlight that volumes dropped by -2.2% in FY01 (the only year of a volume decline in the last 15 years). The interesting aspect to note in FY01 was that it was the second year of the NDA Government at the Centre, and contrary to popular belief, infrastructure demand failed to increase (**Shree Cement mentioned the reasons for the poor sales in its FY01 Annual Report**: *"The inability of the government to translate large infrastructure projects into reality and drought and erratic rainfall in certain areas"*).

However, an important thing to note is that volumes increased sharply in FY02 and FY03, as implementation of government projects gathered steam, alongside rising focus on housing projects and an excellent monsoon season.

(2) FY04-07: Stable demand, strong pricing, no new entrants

Strongest demand and pricing growth phase as new capacities were limited and the industry operated at >100% utilisation level

Cement volumes expanded at an 8% CAGR; however, prices expanded at 11% CAGR over FY03-07, as average capacity utilisation in the region was at 108% and no major new companies entered the market. Sharp growth in Industrial GDP drove industrial capex and rising services GDP, drove real estate construction. Alongside, government ramped up investments in power, road, ports, railway and airport.

Shree Cement highlighted in its FY06 Annual Report: *"The north India cement market has recorded a marked improvement in cement demand with current year demand growing at over 11.5% against 6.1% achieved last year. Following the higher demand in North India, there has been an improvement in price realisations."*

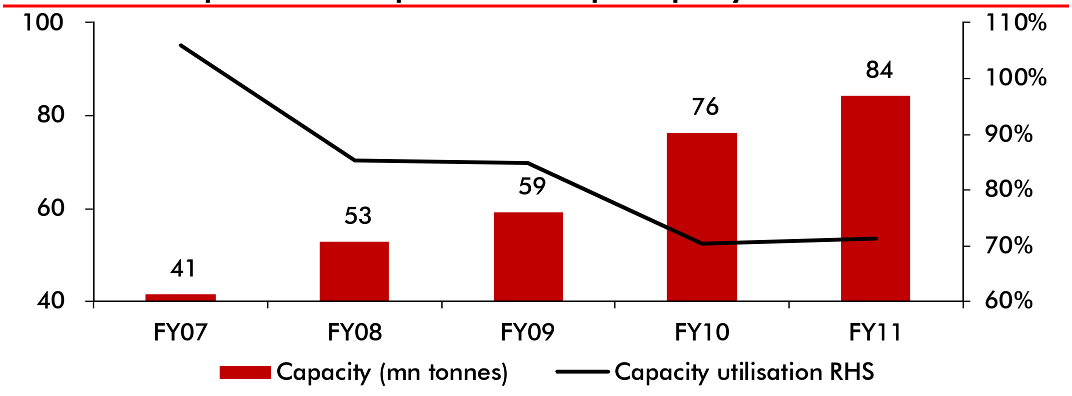
Shree Cement highlighted in its FY07 Annual Report: *"The demand in North India, where the Company operates, has also recorded a double digit growth consecutively for the second year."*

(3) FY08-11: Sustained demand momentum, rising capacities, emergence of new leaders

Refer to pages 29-32 for a detailed discussion on the FY05-09 period - The Super-cycle

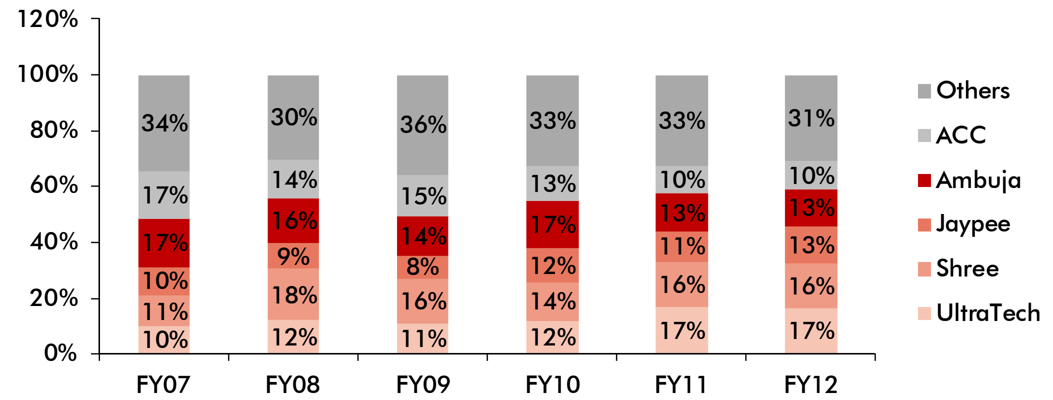
Demand remained strong in north India over FY08-11 (8.2% CAGR); however, average capacity utilisation dropped to 78% vs 108% over FY04-07, as multiple players ramped up capacities. Capacities increased at 19% CAGR over FY07-11 (17mn tonnes were commissioned in FY10 alone; 29% YoY capacity increase). Moreover, a key shift that took place in the market was that the share of two of the most influential brands in the north, ACC and Ambuja, dropped significantly, and the following companies reported an increase in market share: UltraTech (from 10% in FY07 to 17% in FY12), Shree (from 10% in FY07 to 16% in FY12) and Jaypee (from 10% in FY07 to 13% in FY12). Although UltraTech was focused on pricing, Shree chose to grow volumes, given its cost advantages and ability to sell at low prices yet at highest RoCEs; simultaneously Jaypee entered into price wars to gain market share and establish its brand.

Exhibit 10: Sharp increase in capacities and drop in capacity utilisation



Source: CMA, Ambit Capital research

Exhibit 11: Rising capacity share of UltraTech, Shree and Jaypee



Source: CMA, Ambit Capital research

(4) FY11-15: Demand deceleration, price wars and new entrants

Demand decelerated as infra demand declined and recently rural dropped owing to low farm income

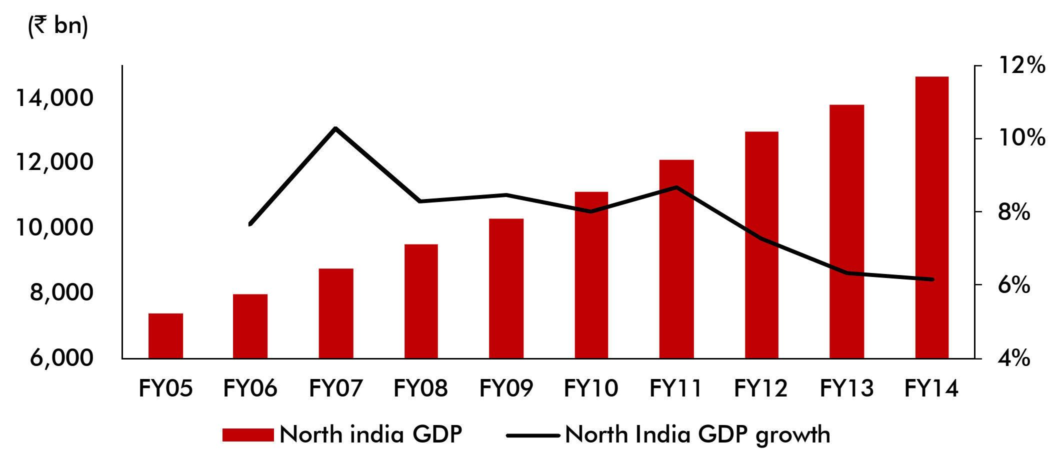
North India's GDP growth decelerated over FY11-14 (to 6.6% CAGR vs 8.6% CAGR over FY05-06). The slowdown was primarily on account of industrial GDP (evident from a deceleration in growth to 3-4% in FY13-14 vs 4-9% over FY09-12). Slowdown in industrial output and construction led to a sharp deceleration in institutional cement sales; however, sharp rural income growth and rising housing construction in tier II/III/IV cities helped sustain mid-single-digit cement volume growth (6.3% volume CAGR over FY11-15) in the region. Alongside, capacities increased further to 100mn tonnes in FY15 vs 84mn tonnes in FY14 and new entrants such as Wonder Cement (3.5mnn tonnes) and Lafarge (2.5mn tonnes) entered the north India market.

GSDP growth in north Indian states

State	CAGR FY05-14	% of North GDP
UP	6.6%	31.7%
Rajasthan	8.1%	17.6%
Delhi	10.0%	16.1%
Haryana	8.5%	13.6%
Punjab	6.7%	11.8%
Uttarakhand	12.4%	4.8%
Himachal Pradesh	7.8%	3.2%
Chandigarh	7.0%	1.1%
North India	7.9%	100.0%

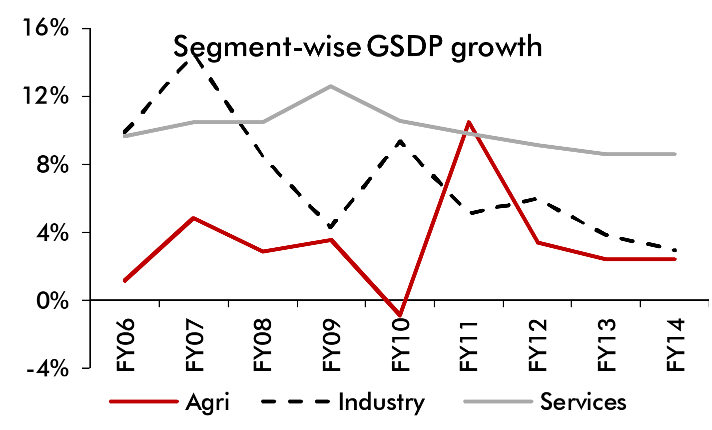
Source: MOSPI

Exhibit 12: North India GDP growth has decelerated in recent years



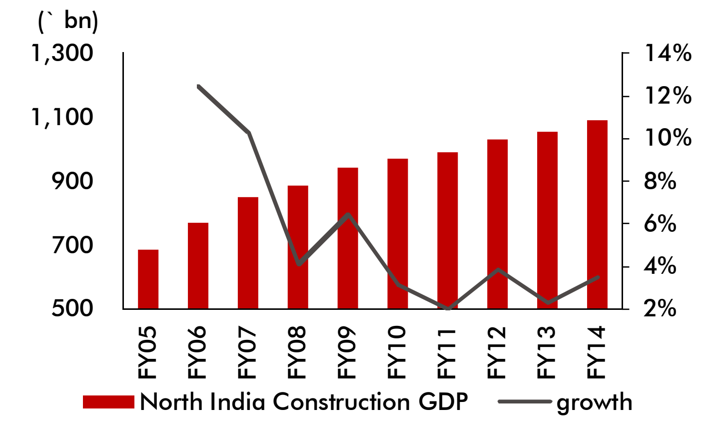
Source: Company, Ambit Capital research, Note: North India GDP includes Uttar Pradesh

Exhibit 13: Industrial GDP growth dragged overall GDP growth in north India in the last three years



Source: Data.Gov.in, Ambit Capital research

Exhibit 14: Construction GDP growth decelerated significantly, leading to slowdown in infra cement sales



Source: Data.Gov.in, Ambit Capital research

Understanding north India

Ranking the Indian regions

To ascertain the relative positioning of Indian regions, we have ranked them based on: (a) cement market size and pricing dynamics, (b) macro-economic parameters, and (c) state finances and infrastructure.

North India ranks second (after south India), mainly on account of weak pricing in the region and lower ranking on macro-economic parameters such as regional GSDP/construction growth. The region ranks the best on size of the cement market and state infrastructure/central budgetary allocation.

Exhibit 15: Ranking Indian regions to determine the relevance in the Indian cement industry; South region is the best

	Cement market and pricing					Macro-Economic parameters								State infrastructure			
Region	Size	FY09-15	per 50kg/bag	4-yr price CAGR	Rank	GDP Share	GDP CAGR FY05-14	Agri GDP share	Agri GDP CAGR (FY09-14)	Cons. GDP share	Cons. GDP CAGR FY09-14	Average PCI	Rank	Allocation from Centre	NH length	Rank	Overall Rank
South	2	4	1	2	1	1	2	2	4	1	2	1	1	3	2	2	1
North	1	2	4	3	2	1	3	1	2	2	4	3	3	1	1	1	2
East	4	1	2	2	3	4	4	4	3	4	1	4	4	2	3	3	3
West	3	3	3	4	4	1	1	3	1	3	3	2	2	4	4	4	4

Source: CMA, Company, MOSPI, Ambit Capital research. Note: We have incorporated UP in north India and MP in west India for our analysis

Cement market and pricing dynamics (North India - Rank #2): North India ranks higher than the other regions on market size, given that it is the largest cement market in India (80mn tonnes; 30% of India's cement sales); the region posted the second-highest growth over the last six years. South ranks second on market size, despite reporting the lowest growth in the last six years, owing to its market size.

North India's low rank on pricing can be explained by the lowest cement price amongst Indian regions (despite the highest utilisation) and low pricing growth in the last four years. We explain this in detail in a later section. East India ranks the best owing to its high and relatively stable cement prices (although this might change with the influx of multiple players in the region). South India ranks second, due to strong pricing discipline in the last one year and the highest pricing amongst Indian regions.

North India ranks second on our regional ranking framework

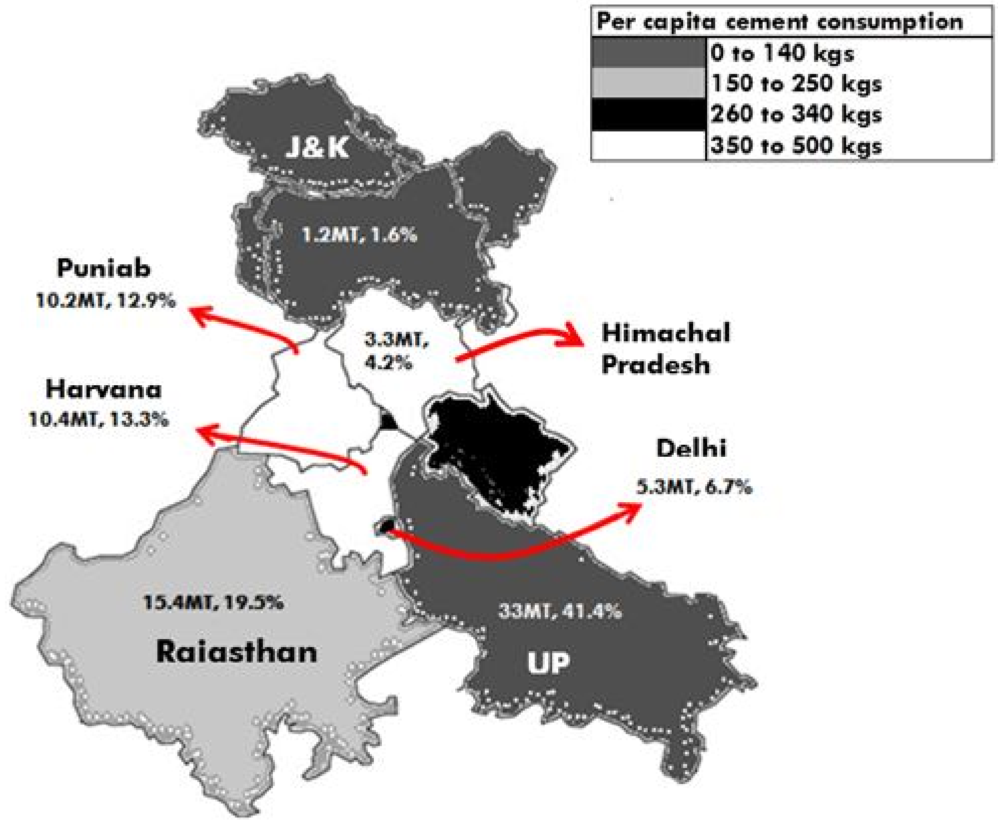
Macro-economic parameters (North India – Rank #3): North India ranks third on the macro-economic parameter, despite a similar GSDP scale as compared to west and south India, owing to lower GSDP and construction GSDP growth over the last five years. Moreover, per capita income in north India is the third lowest in the north. South India ranks the best, due to the large scale of its economy, reasonable growth and the highest per capita income.

State infrastructure/Central allocation (North India – Rank #1): North India's superior rank here is due to high national highway density (30% of overall national highways in India) and better state-rural connectivity. Moreover, the allocation from the Central government is the highest in north India.

A profile of the north Indian states

We include nine states in north India, out of which only two states are a part of the top-10 states in India (Rajasthan and Uttar Pradesh), three states are of a reasonable size (Delhi, Haryana and Punjab, each account for 3-4% of India's GDP), and the other four states are relatively small and account for ~1% of India's GDP. Note that per capita cement consumption is low across north India, barring Punjab, Haryana and Himachal Pradesh.

Exhibit 16: Per capita consumption is weak across north India



Source: Company, Ambit Capital research; Note: In each respective state, the first number signifies the consumption in million tonnes and the second number signifies the consumption % of each respective state to total consumption in north India.

Exhibit 17: Capacities in north India

North Indian States	GDP		GDP - Construction		GDP – Agriculture		PCI (in ₹)	PCCC (in Kgs)	Consumption as a % of N.I.
	Contribution to N.I. GDP	GDP CAGR (09-10)	Contribution to N.I. GDP	CAGR (09-10)	Contribution to N.I. GDP	CAGR (09-10)			
Haryana	11.71%	16.4%	15.34%	16.6%	12.91%	12.2%	132,089	390	13%
Himachal Pradesh	2.16%	14.4%	4.01%	5.2%	1.76%	12.6%	92,300	460	4%
Jammu & Kashmir	2.36%	15.6%	4.06%	5.6%	2.93%	19.3%	58,593	90	2%
Punjab	9.60%	13.3%	8.92%	9.3%	14.55%	9.1%	92,638	350	13%
Uttar Pradesh	26.26%	15.0%	30.60%	11.3%	41.34%	14.9%	37,630	140	41%
Uttarakhand	18.73%	14.9%	4.90%	19.1%	2.16%	16.9%	103,349	280	
Chandigarh	0.85%	13.1%	0.70%	9.5%	0.02%	1.9%	156,951	270	0.4%
Delhi	13.05%	17.0%	10.42%	8.0%	0.66%	23.2%	219,979	300	7%
Rajasthan	15.28%	17.6%	21.05%	12.1%	23.67%	23.0%	65,098	210	20%

Source: RBI, Ambit Capital research; Note: N.I. = North India, PCI= Per Capital Income, PCCC = Per Capital Cement Consumption

Below, we summarise the characteristics of each of the states: **60% of the demand is constituted by UP and Rajasthan and 26% by Punjab and Haryana.** The key demand drivers are: (a) real estate construction in the National Capital Region (Delhi and fringes of Haryana and Uttar Pradesh), (b) rural demand in Punjab/Haryana (large agricultural producers), and (c) urbanisation-led housing demand in tier II/III cities. Alongside, significant investments were made in roads and highways and urban infrastructure.

Exhibit 18: Profile of the key cement-consuming states in north India

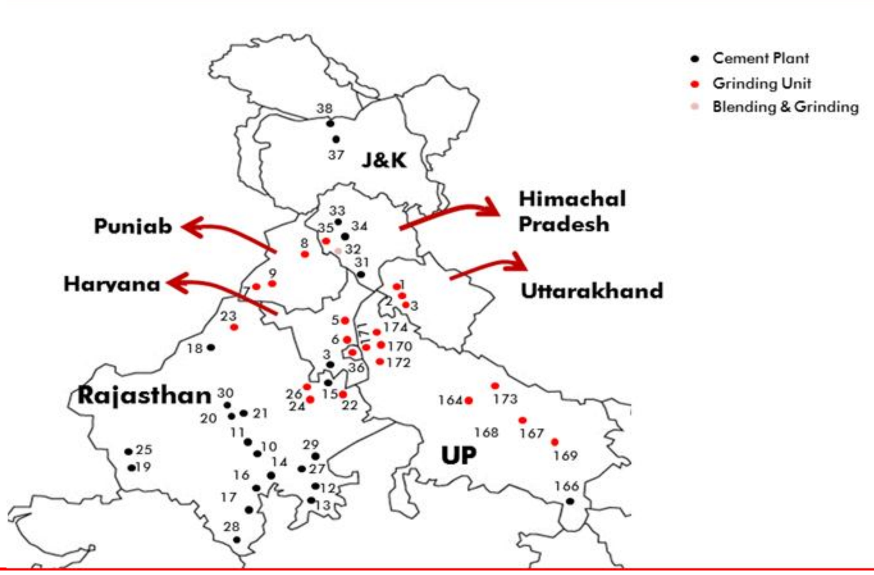
State	Size of the market (mn tonnes)	% of North	Demand drivers
Rajasthan	**15.5**	**19.5%**	**Cement consumption in Rajasthan is largely driven by housing in tier II/III towns.** Rajasthan is also the most industrialised state in north and accounts for the largest industrial output. Rajasthan State Industrial and Investment Corporation (RIICO), a State government agency, has developed 322 industrial areas in Rajasthan and four Agro Food Parks in Kota, Jodhpur, Sriganganagar and Alwar. Major MNCs like Daikin and Mikuni have set up their manufacturing facilities in the State, owing to the increasing number of Inland Container Depots at Jaipur, Jodhpur, Bhiwadi, Kota and Bhilwara. Concor (Container Corporation of India Ltd.), that already operates three of these terminals is coming up with another one near Udaipur. The State has 20 National Highways, totalling 5,722 km pass through the State. The upcoming dedicated freight corridor has a sizable presence in Rajasthan.
Punjab and Haryana	**20.6**	**26.1%**	The state is **primarily an agrarian economy with a lower industrial output as compared to other states of north India**. Industrial production in Punjab is through its small-sized industrial units. There are nearly 194,000 small-scale industrial units in the state and 586 large and medium units. **Rural income is the key driver of cement in Punjab and hence cement sells at a relative premium to other north India states**. **Real estate demand in Haryana due to development of the NCR was the key cement growth driver in the last 4-5 years**.
Uttar Pradesh and Uttarakhand	**32.7**	**41.4%**	Cement consumption growth in the past was primarily driven by industrial development in western UP, which was an offshoot of growth in the neighbouring regions. Rising investments in industries resulted into development of housing and commercial real estate growth in cities like Ghaziabad and Noida. These markets emerged as a preferred destination for several IT companies given its proximity and good connectivity with Delhi through several expressways and the Metro rail. Also, given the mid ticket-size construction, the vacancy level is much lower than other areas in the NCR (according to Knight Frank). **Our recent channel checks suggest that UP is the best-performing north India state in the last two years, owing to execution of state-sponsored infrastructure projects.** Uttarakhand is largely an agri-driven market; however, in the last decade, the state saw significant industrial investments with the Central and state governments offering multiple SOPs to drive growth in the state.
Delhi	**5.3**	**6.7%**	Delhi is the largest commercial centre in northern India. **Key service industries are information technology, telecommunications, hotels, banking, media and tourism, which led to strong growth in commercial and residential real estate in the last decade. Volumes have been declining in Delhi.** The Amritsar Delhi Kolkata Industrial Corridor encompasses one of the most densely populated regions in the world and houses about 40% of India's population.
Himachal Pradesh	**3.3**	**4.2%**	Lack of means of dependable transport and poor accessibility are the major hindrances to industrial development in HP. **Demand is driven primarily through agriculture, as about 93% of the population depends directly upon agriculture.**
Market Size	**77.4**	**100%**	

Source: Various state governments, Ambit Capital research

Production centralised around Rajasthan

North India accounts for one-fourth of the cement manufactured in India (87mn tonne installed capacity as on end-FY15); Rajasthan accounts for 54% (and almost the entire clinker capacity) and UP accounts for 14% of the overall capacity. Shree Cement is the market share leader, followed by UltraTech, Jaypee and Ambuja. Other relatively large manufacturers are Binani Cement, JK Cement and JK Lakshmi.

Exhibit 19: Capacities in north India



Source: Company, Ambit Capital research, Note: Please refer to the table below for information about a particular capacity

Exhibit 20: Capacities in north India

Sr. No	Company	Installed Cap. (Mn. T)	Sr. No	Company	Installed Cap. (Mn. T)	Sr. No	Company	Installed capacity (Mn. T)
1	Jaypee	1.2	20	Shree	3	39	Birla	0.63
2	Shree Cement	1.8	21	Shree	5	40	Heidelberg	0.5
3	Ambuja	1	22	Shree	3	41	Jaypee	0.5
4	CCI	0.17	23	Shree	1.2	42	Jaypee	2.5
5	Jaypee	1.5	24	Shree	1.5	43	Jaypee	0.6
6	UltraTech	1.3	25	Binani	4.85	44	Jaypee	1
7	UltraTech	1.75	26	Binani	1.4	45	Jaypee	1
8	Ambuja	2.5	27	Shriram	0.4	46	UltraTech	1.3
9	Ambuja	0.6	28	Indian Cement	1.8	47	UltraTech	1.3
10	Birla	2	29	ACC	1.5	48	ACC	2.31
11	Chanderia		30	Ambuja		49	Ambuja	1.5
12	Mangalam	3	31	CCI	0.2	50	Wonder	3.8
13	Neer Shree		32	Jaypee		51	Lafarge	1.5
14	UltraTech	5	33	ACC	4.4	52	Lafarge	1.5
15	UltraTech	3.1	34	Ambuja	2	53	UltraTech	2.9
16	J K Cement	3.3	35	Ambuja	1.5	54	Shree	2
17	J K Cement	0.75	36	CCI	0.5	55	Ambuja	0.5
18	J K Cement	1.07	37	J K Cement	0.2			
19	J K Lakshmi	5.3	38	Khyber Indus	0.33			

Source: Company, Ambit Capital research

Exhibit 21: Shree has the largest capacity share in north India

(mn tonnes unless specified)	Raj.	UP	HP	Punjab/Har	Uttarakhand	Total	Capacity share-Company
Shree	**16.5**		**-**	**1.5**	**1.5**	**19.5**	19%
UltraTech	11	2.6	-	3.1	-	**16.7**	16%
Jaypee		5.6	3.5		1.5	**10.6**	10%
Ambuja	2	1.5	4	3.1	1	**11.6**	11%
ACC	1.5	2.3	4.4	-	-	**8.2**	8%
JK Cement	6		-	1.5	-	**7.5**	7%
Binani	6.2		-	-	-	**6.2**	6%
JK Lakshmi	4.5		-	0.7	-	**5.2**	5%
Mangalam Cement	3		-	-	-	**3**	3%
Birla Corp	2	0.6	-	-	-	**2.6**	3%
Heidelberg		2				**2**	2%
India Cement	1.8		-	-	-	**1.8**	2%
Wonder Cement					3.5	**3.5**	3%
Lafarge					3	**3**	3%
Total	54.5	14.6	11.9	9.9	10.5	**101.4**	100%
Capacity share- State	**54%**	**14%**	**12%**	**10%**	**10%**	**100%**	

Source: Company, Ambit Capital Research

Inter-regional despatches are low from north India, as most of the cement is consumed. Rajasthan despatches ~20% of its production in west India; no other state despatches more than 2-3% of cement produced in the other regions.

Exhibit 22: State-wise despatch mix

	Installed Capacity (MT)	Capacity Utilisation (FY15)	UP	Delhi	Haryana	Punjab	Rajasthan	HP	Gujarat	Maharashtra	Others
Rajasthan	54.4	79%	16%	9%	16%	5%	34%	0%	11%	7%	2%
UP	14.3	82%	90%	7%	0%	0%	0%	0%	0%	0%	3%
HP	11.9	77%	8%	0%	6%	60%	0%	25%	0%	0%	3%
Punjab	9.9	75%	0%	3%	5%	85%	0%	2%	0%	0%	3%

Source: Company, Ambit Capital research

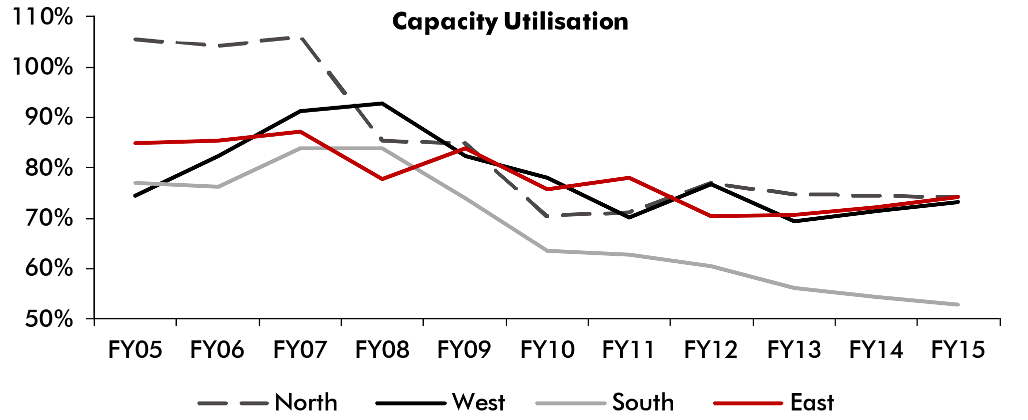
The pricing dichotomy

Highest capacity utilisation amongst Indian regions…

North India operates at nearly the highest capacity utilisation amongst Indian regions

Despite the recent drop in utilisation level of north India, capacity utilisation in the region is higher than other Indian regions, as the pace of capacity additions has been low. Moreover, a key advantage for north India is that inward movement of cement is limited, given that the other producing regions (west India and MP) are located far away from the key consumption locations; hence, a demand-supply mismatch in the other regions has a lower impact on north India.

Exhibit 23: North India's capacity utilisation has been higher than the other regions in India

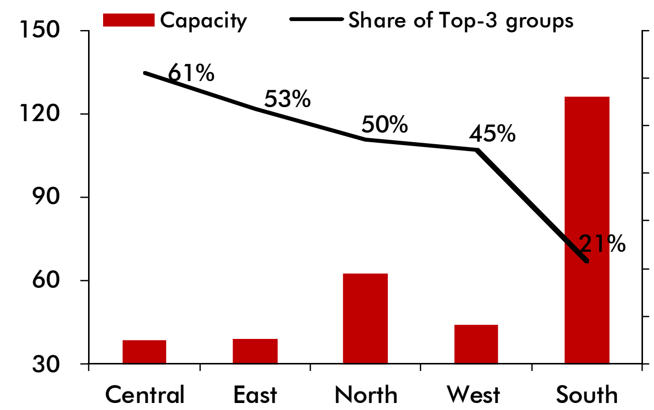


Source: CMA, Ambit Capital research

…50% of the capacities controlled by the top-3 players…

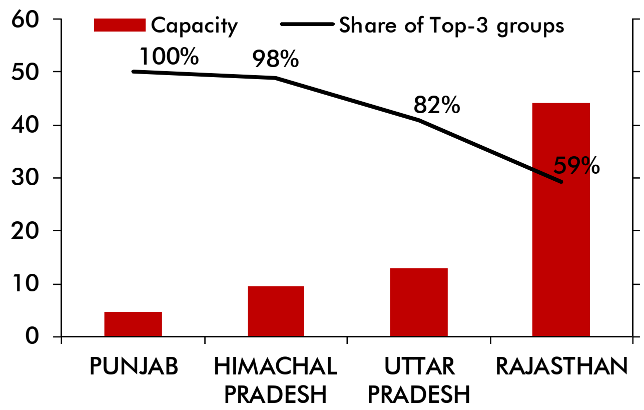
Alongside high capacity utilisation, the fragmentation level is relatively low in north India, with 50% of the capacities controlled by the top-3 groups (i.e. Shree, UltraTech and Ambuja). Although Rajasthan is relatively more fragmented (only 58% of capacities controlled by the top-3 groups, owing to several mid-sized players like JK Cement, JK Lakshmi Binani and Wonder Cement), the other producer states have extremely low fragmentation levels. ACC, Ambuja and UltraTech control most of the capacities in Punjab and Himachal Pradesh (HP).

Exhibit 24: The fragmentation level is fairly low in north India



Source: Company, Ambit Capital research

Exhibit 25: Barring Rajasthan, >75% of capacities are controlled by the top-3 groups

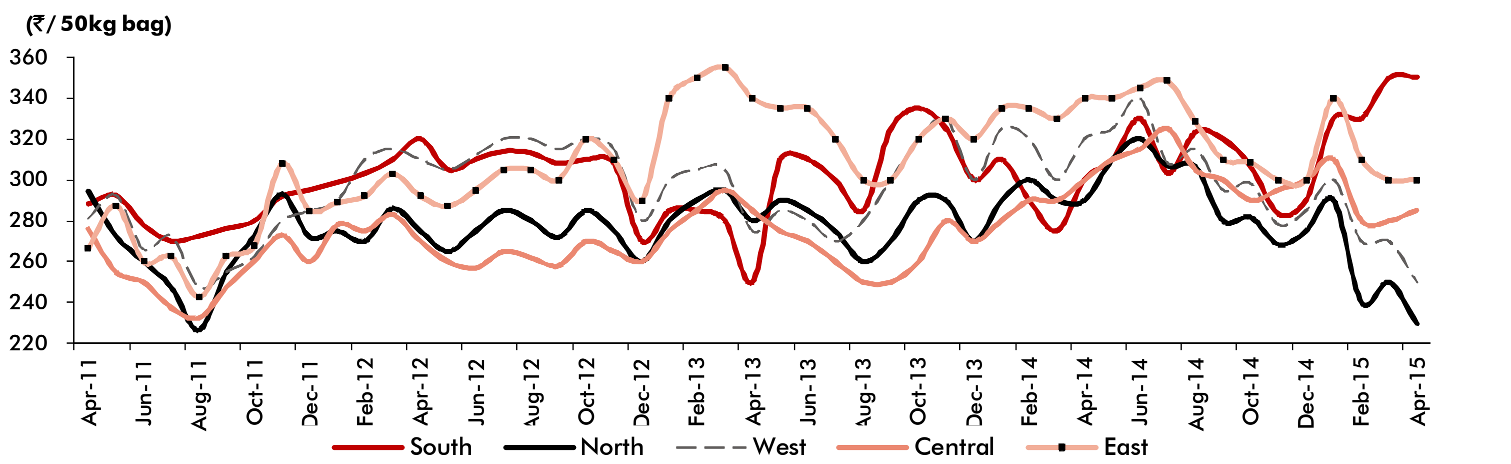


Source: Company, Ambit Capital research

...yet prices are the lowest...

Cement prices in north India have been volatile in the last 2-3 years, as capacity utilisation dropped (to 74% in FY15 vs 85% in FY10) alongside significant capacity additions from regional manufacturers (such as Shree Cement and JK Lakshmi) and the entry of new manufacturers (such as Wonder Cement and Lafarge). As shown in the exhibit below, in the last few months, prices in north India have dropped sharply and the gap with average prices in other Indian regions has widened significantly, as manufacturers cut prices led by demand deterioration.

Exhibit 26: Prices have dropped significantly in north India in recent months



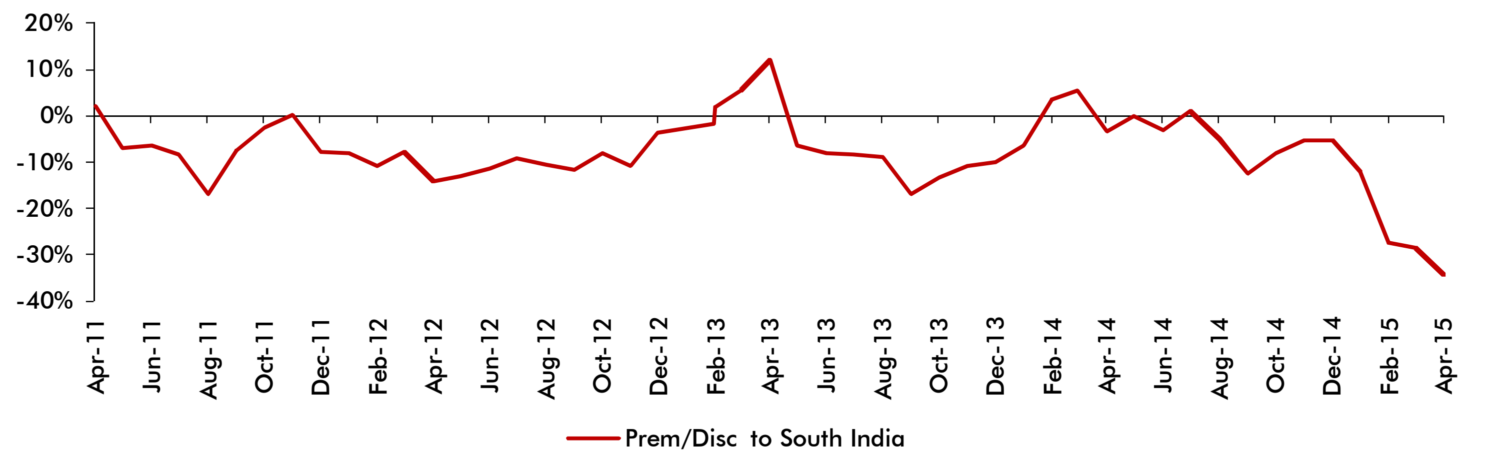
Source: Company, Ambit Capital research

...and are now at a 35% discount to south India!

Post the sharp price cuts is north India in the last 3-4 months (₹240/50kg bag in June 2015 vs ₹300/50kg bag in January 2015), prices are at a 35-40% discount to south India. The discount to south India seems counter-intuitive, given that north India operates at a significantly higher utilisation rate (80% vs 50% for south India). Our checks suggest that the quality of competition determines pricing in the north; large manufacturers have well-established cost efficiencies (Shree and JK Lakshmi) and recent entrants (Wonder Cement, Nirma Cement) vie for market share.

The significant discount to south India can be explained by quality of competition, demand and logistics dynamics

Exhibit 27: Cement price in north India is the lowest amongst all Indian regions



Source: Company, Ambit Capital research

What explains this dichotomy?

Our discussions with industry participants suggest that the above dichotomy can be explained by:

North-based players make much higher RoCEs than south-based players

(a) **Quality of competition:** As shown in the exhibit below, there is a significant gulf between the balance sheet strength and profitability of the north and south Indian cement manufacturers (north-based players being significantly better across parameters such as debt/equity, interest coverage and RoCEs). Hence, they can sustain lower prices to operate at higher utilisation levels. On the flipside, the south-India-based manufacturers have little option but to maintain pricing if they have to even service their interest burden, especially during times of weak demand. Hence, south-India-based manufacturers are holding on to price hikes, whereas prices have corrected sharply in north India.

Exhibit 28: Balance sheet health of the south India manufacturers is way inferior than their north India peers

Particulars	Debt/Equity (FY15)	Interest/EBITDA (FY15)	RoCE (FY15)
Pan-India	**0.2**	**6.5%**	**14.4%**
ACC	0.0	5.9%	17.0%
Ambuja Cem.	0.0	3.2%	16.1%
UltraTech Cem.	0.4	8.3%	12.9%
North	**0.7**	**11.4%**	**10.5%**
Mangalam Cement	0.7	14.4%	4.1%
Saurashtra Cem.	0.7	25.9%	12.8%
Shree Cement	0.3	8.6%	17.5%
JK Lakshmi Cem.	1.3	23.6%	6.7%
Sanghi Inds.	0.6	6.8%	3.7%
J K Cements	1.6	38.1%	7.0%
South	**1.0**	**46%**	**5%**
Andhra Cements	2.9	-71%	-1.5%
Chettinad Cement	0.7	16%	8.5%
India Cements	1.0	84%	4.6%
K C P	0.8	31%	10.7%
Ramco Cement	1.2	30%	6.1%
Orient Cement	0.4	6%	16.3%
Dalmia	1.0	53%	4.7%
JSW Cement	3.4	1117%	-4.2%

Source: Company, Ambit Capital research

North India has a higher mix of institutional demand

(b) **Quality of demand:** The institutional demand component is fairly high in north India, with significant investments in real estate construction in NCR and investments in public and urban infrastructure; institutional clients are brand-agnostic and price-conscious, and hence price hikes are difficult to push in north India. We highlight that even in the tier II/III cities in north India, the residential pattern is shifting from unorganised individual housing construction to organised mid-sized real estate construction, which is in turn is reducing the bargaining power of the manufacturers.

North India is largely a roads market

(c) **Logistics dynamics:** North India is largely a road logistics market, wherein 79% of the cement is transported by road given better road infrastructure than other Indian regions. Hence, there is no logistics competitive advantage (barring Shree Cement which has grinding locations much closer to the target markets) to manufacturers in terms of reaching the market. As shown in the exhibit below, 100% of the cement transported within north India is through roads. In most other regions, the rail:road split is significantly higher (64:36 in south) and players with established infrastructure (railway sidings, bulk terminals, etc) reach the market relatively quicker than the other competitors and hence command pricing power.

Exhibit 29: Road despatches are prevalent in north India

Region (as on FY12*)	% despatch mix			
	Rail	Road	Sea	Total
Northern Railway	0%	100%	0%	100%
North Western Railway	27%	73%	0%	100%
North Central Railway	32%	68%	0%	100%
Total North	**21%**	**79%**	**0%**	**100%**
Southern Railway	17%	83%	0%	100%
South Eastern Railway	67%	33%	0%	100%
South East Central Railway	62%	38%	0%	100%
South Western Railway	4%	96%	0%	100%
South Central Railway	36%	64%	0%	100%
Total South	**36%**	**64%**	**0%**	**100%**

*Source: CMA, Ambit Capital research. Note: * The above data was last available as on FY12; CMA stopped sharing this data post that*

Why is logistics so important?

Freight accounts for ~30% of the overall cost of cement companies and is a key determinant of cost competitiveness and ability to gain market share at lower prices than peers (Shree Cement has mastered this). Whilst large companies serving west and south India have built their logistics infrastructure, such as railway sidings, bulk terminals and jetties and hence have a logistics advantage in these markets, despatches in north India's micro markets are relatively easier, given the dependence on roads; hence, multiple brands compete in each micro market. Whilst there is no major competitive advantage in terms of infrastructure, Shree Cement managed to build its moat by following split grinding and hence being closer to the markets (~200-300kms of each key market). Ambuja and ACC have built moats by setting up capacities in difficult to reach markets such as Himachal Pradesh.

Dealer checks – Not enthusing

Demand has further deteriorated

Demand in north India has suffered on multiple fronts: (a) **slowdown in rural cement sales:** Almost 60% of the cement sales in north India is directly/indirectly impacted by rural income, which has suffered significantly owing to low Kharif output and unseasonal rain hampering the Rabi output; alongside, wage growth moderated significantly; (b) **real estate inventory remains high** (12 quarters to sale) and new launches are few owing to the high inventory build-up; and (c) **lack of government tenders** post the Union Elections and change in state governments in Rajasthan and Haryana.

Price wars – Jaypee has been leading the price wars; now larger players have started participating

Dealers highlight that Jaypee has been the first to always cut prices, and indulge in price wars with other players in this region. UltraTech's 2.4mn tonne expansion in Rajasthan was commissioned recently, and in the last few quarters, they have been leading price cuts in north India to gain market share. Moreover, given weak rural sales and rising institutional sales mix, established brands such as Ambuja have also started to compete on prices

Uttar Pradesh – The lone performer

Uttar Pradesh has been the only reasonably well-performing market in north India, as the state government has been awarding infrastructure projects and execution has remained strong. Rajasthan was growing at 8-10% for the last three years, but volume growth dropped significantly post the election of the new state government.

Exhibit 30: Dealer commentary on the top brands in north India

Company	Capacity (mn tonnes)	Capacity share in North	%of Company's total capacity	Dealer commentary
Shree	19.5	19%	83%	The largest manufacturer with the best-in-class logistics and quickest deliveries in north India. The company is not price-focussed and sells cement at a 5-10% discount to the pan-India players. In weak markets, the company gains market share through sharp price cuts. A large proportion of its sales is in the institutional segment as it can supply large quantities at competitive prices.
UltraTech	16.8	17%	27%	The company has built scale in recent years and is a tier I brand, although it sells at a slight discount to Ambuja. The company has recently been very aggressive in pursuing volume growth and hence cutting prices sharply.
Ambuja	11.6	12%	40%	The most established brand in north India and commands a premium over other cement brands. The company has been losing sheen and despatches have been patchy in recent years. The company's focus has always been to maintain pricing premium but in recent months Ambuja has been leading price cuts in north India.
ACC	8.2	8%	27%	The company has a strong presence in HP as it has the highest capacity in the state, a market which is difficult to reach for most players. In other markets, the company has been losing market share to regional players given better margins and terms. Dealers highlight that ACC has the most inflexible dealer terms and hence its relatively easier for the new entrants to break into their channel partners
JK Lakshmi	6.8	7%	65%	Dealers in Rajasthan highlighted that JK Lakshmi had several advantages in the region, such as quicker delivery, better dealer support and a perception of higher quality because of their intensive advertising in the region. This is largely because of their large manufacturing facility in the region, and better customer perception in the region. However, dealers outside Rajasthan did not highlight JKLC amongst the preferred brands. Whilst JKLC has a decent brand with a good brand name, it did not have any substantial benefits to offer (barring lower price) when compared with the other large players.

Source: Company, Ambit Capital research

What is ailing north India?

Cement demand has deteriorated significantly in north India, evident from the sharp drop in cement volumes reported by the regional manufacturers in 4QFY15. Demand in north India has suffered on multiple fronts: (a) **slowdown in rural cement sales**: ~60% of the cement sales in north India is directly/indirectly impacted by rural income, which has suffered significantly owing to low Kharif output and unseasonal rain hampering the Rabi output; alongside, wage growth moderated significantly; (b) **real estate inventory remains high** (12 quarters to sale) and new launches are few owing to the high inventory build-up; and (c**) lack of government tenders** post the Union Elections and change in state governments in Rajasthan and Haryana.

As highlighted in the section above, both retail and institutional demand have nearly equal significance in north India. We highlight three main demand facets which are facing headwinds due to unique issues that unfolded in the last one year.

Issue #1: Slowdown in rural demand

North India accounts for >25% of production across crops in India barring cotton (74% of wheat, 30% of rice, and 46% of food grains and sugar cane). Hence, it is evident that rural income forms a significant driver of discretionary spending in north India. Rural income suffered significantly in FY15 due to the following:

(a**) Weak monsoons** and hence weak Kharif output; monsoons were deficient in North India which led to 3% drop in Kharif output (see Exhibit 32),

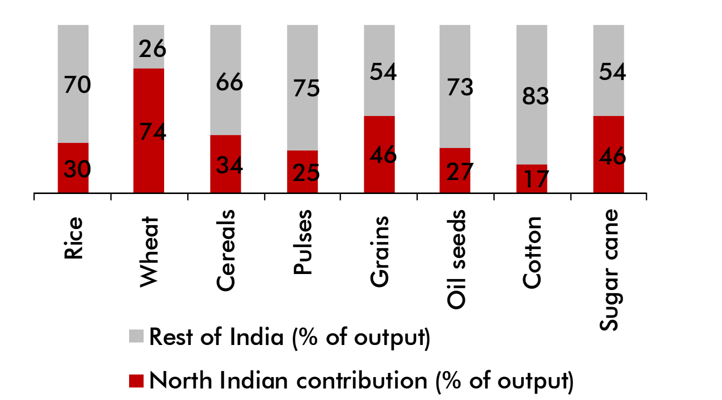
(b) **Low MSP growth:** The NDA Government has curtailed MSP growth in FY15 and recent checks suggest that MSP growth will be tepid in FY16 as well, which alongside weak output will hurt rural income.

North India has a large share in major crops; hence poor rainfall impacts agri income and in turn rural cement demand

(c) **Unseasonal rainfall** in February 2015 spoilt the Rabi crop which will impact rural income; this has dampened the rural consumer sentiment to spend for housing construction. A media article (Source: Livemint) suggests that unseasonal rains at the end of February and March damaged crops in 11 million hectares (ha) spread over Rajasthan, Uttar Pradesh, Haryana, Madhya Pradesh, Maharashtra and Punjab, according to a 26 March ministry estimate. An estimated **6 million ha of wheat crop, nearly one-fifth of the sown area has been damaged.** Note that north India accounts for 70% of wheat production in India which is the key Rabi crop.

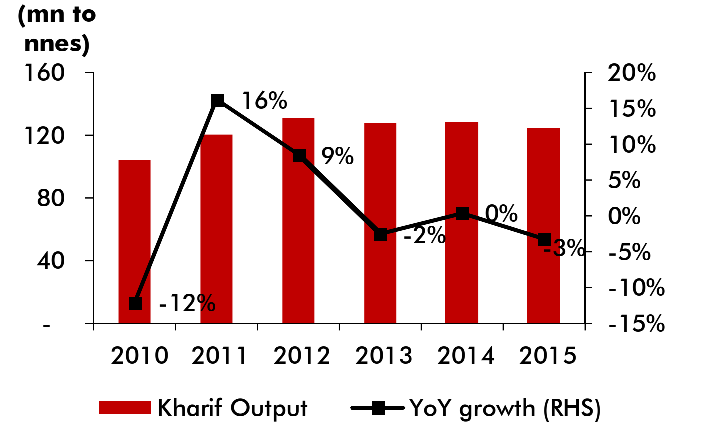
(d) **Rural wage growth in India fell to decadal lows** owing to lower allocation to welfare schemes (such as MNREGA), low MSPs and hence lower inflationary-led wage increase and lastly owing to a slowdown in construction and hence surplus labour availability.

Exhibit 31: North India has a large share across crop categories



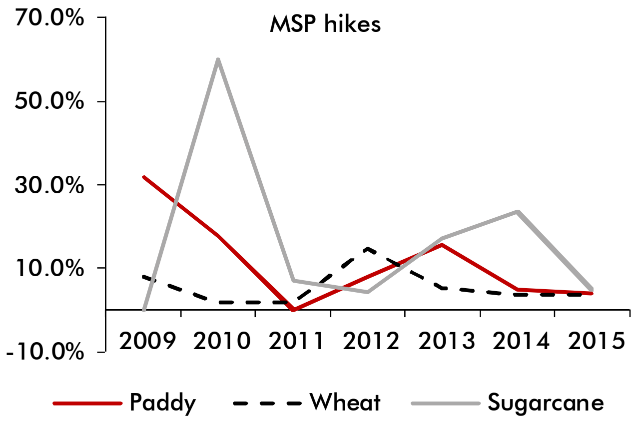
Source: Planning Commission, Ambit Capital research

Exhibit 32: Kharif output dropped by 3% in FY15, over and above weak growth in the last two years



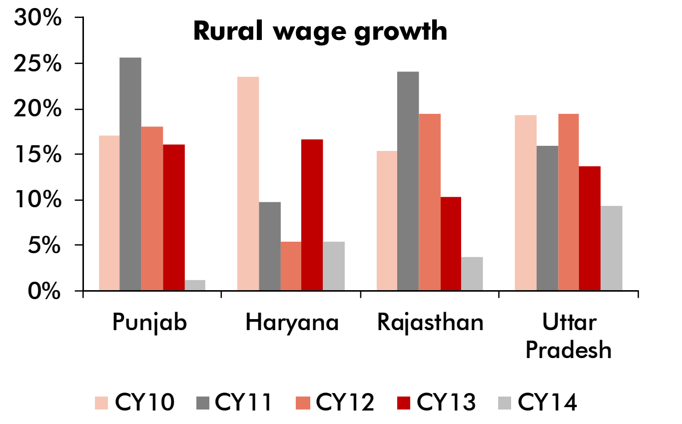
Source: Planning Commission, Ambit Capital research

Exhibit 33: MSP hikes have dropped significantly across major crop categories



Source: RBI database, Ambit Capital research

Exhibit 34: Rural wage growth has declined sharply in north Indian states



Source: RBI Database, Ambit Capital research

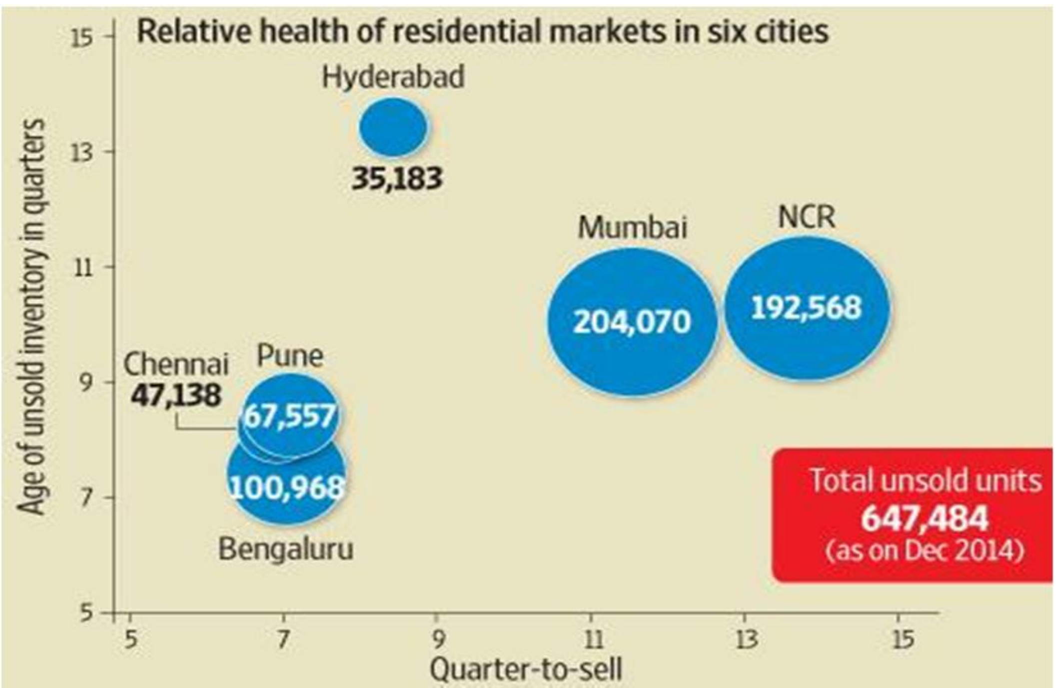
Issue #2: Real estate crackdown

Real estate inventory is the highest in NCR

North India saw high levels of investments in real estate in the last decade, and to a large extent, this was fuelled by generation of black money. Not only did this lead to a significant growth in real estate units but alongside it led to a sharp increase in land prices due to which the fragmented land owners received surplus cash which in turn led to investments in individual house construction. However, we see the following seminal shifts in the real estate landscape in the past 12 months:

- **Increase in real estate inventory:** As per a research paper published by Knight Frank, the unsold real estate inventory rose to ~192,000 units in FY15 which implies 14 quarters of unsold inventory (QTS), basis the current absorption rate. Note that the QTS is the highest in NCR, amongst the six top real-estate markets in India.

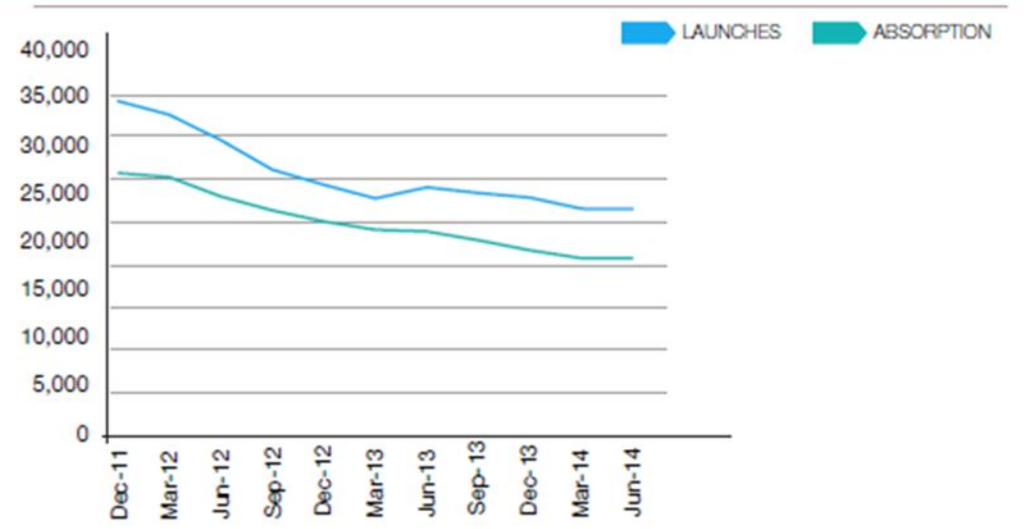
Exhibit 35: NCR has 14 QTS of unsold inventory



Source: Ambit Capital research, Knight Frank

- **Reduction in new launches:** New launches dropped to 16,000/month in June 2014 as against 35,000/month in December 2011, owing to weak end-consumer demand and poor liquidity of builders. Our checks with real estate agents in NCR suggest weak consumer sentiment and low level of enquiries, which could suppress new launches for the next 3-4 quarters.

Exhibit 36: Sharp reduction in new launches



Source: Ambit Capital research, Knight Frank

- **Black money squeeze:** The size of India's black economy expanded materially under the erstwhile government and given that black money finds high acceptance in physical assets such as real estate, majority of these funds were channelized in real estate. However, we believe that the NDA Government will engineer a clamp-down on the black money prevalence in India. The FY16 Union Budget explicitly aimed to disincentivise the black economy and curb the demand for physical assets. The Black Money Bill was recently passed in the Parliament recently and the Union Cabinet widened its reach to regulate the real estate sector and curb undeclared black money.

Takeaways from speaking to a leading real estate consultant

Inventory at its peak: Real estate inventory is at its peak in NCR (14-16 quarters to sell), largely in the mainstream markets such as Delhi, Gurgaon and Noida, wherein launches have reduced significantly. The only regions doing relatively better are the outskirts of NCR, driven mainly by low-cost housing (₹2700-3000/sq feet).

Land prices have stagnated/reduced: In the last 18 months, land prices have stagnated or reduced on two accounts: (a) the dearth of land transactions in primary real estate markets; developers fund land purchase from debt and given extremely low demand, they do not want to commit interest burden right now; and (b) the change of the Haryana Government led to a complete halt of new land licences.

Price correction is inevitable: Whilst stated prices remain elevated, the transaction prices have already reduced by 8-12% and the consultants highlight that further correction is a must for inventory liquidation. Discounts have increased significantly in the secondary transactions (sales from financial investors to end-users as against sales from developers directly).

Black money impact is largely on small unorganised projects: The large builders' sales are largely on cash and the clamp down on black money does not have a significant impact on them. The key impact is on the smaller unorganised and fragmented units, built by unorganised developers, which was fuelled by black money generation.

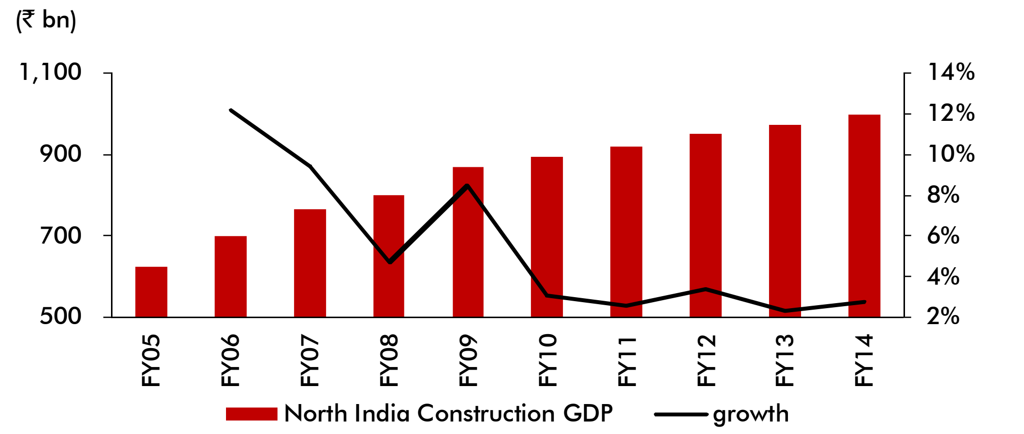
Commercial real estate: Commercial real estate continues to do well in NCR, primarily on account of increased leasing by the services industry (mainly IT/ITes). The size of the commercial market is ~52mn sq feet and 22mn sq feet are under construction (to be commissioned in the next 2-3 years). Whilst the average vacancy rate is high (28%), the vacancy in prime locations is significantly lower (single digits or early teens).

Issue #3: Failure of infrastructure demand recovery

Whilst the infrastructure segment was expected to drive cement consumption from FY15 onwards, weak order awards and tepid execution led to continued slowdown from this segment. Our checks in recent months suggest that usually government tenders increase in 4Q; however, in FY15, government tenders dropped to abysmally low levels which led to a sharp deterioration in cement sales. As shown in the exhibit below, the construction GSDP continued to languish in FY14 (2.8% growth over 2.4% growth posted in FY13) and we understand that FY15 has been worse, since after the state elections and change in government in Rajasthan (November 2013) and Haryana (October 2014), infrastructure construction activity has receded significantly in these states which are fairly large cement consumers.

Exhibit 37: Construction continues to languish in north India

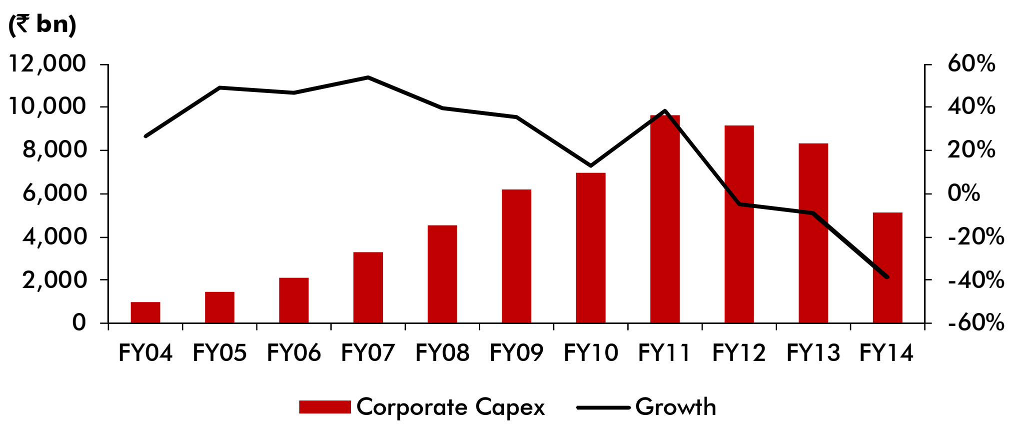
Infra recovery remains elusive, with little visibility of a near-term recovery



Source: Ambit Capital research, MOSPI

Moreover, corporate capex has dropped materially (declining for the last three years), as companies refrained from committing capex in an adverse macro-economic environment.

Exhibit 38: Sharp decline in corporate capex since FY12



Source: Ambit Capital research, Capitaline (sum of capex of listed and unlisted companies)

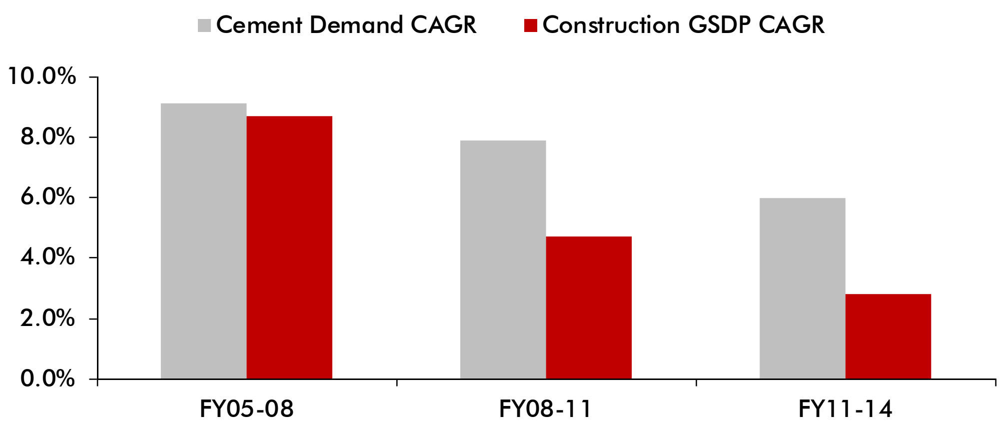
Infra needs to fire to rekindle demand

North India has a high intensity of infrastructure construction, and some of the largest upcoming infrastructure projects in India will pass through the region (Dedicated Freight Corridor and Delhi-Mumbai Industrial Corridor to name a few). Moreover, road construction in north Indian states is also a fairly large opportunity.

Industrial capex and government's infrastructure expenditure are the main drivers of infrastructure cement demand. In the section below, we try to dissect which segments could drive the cement demand recovery in north India.

Given the paucity of data, it is difficult (and often futile) to gauge the exact quantum of cement demand that infrastructure can drive; however, the table below highlights that periods of high construction GSDP growth also leads to high cement demand growth. This is understandable as infrastructure construction drives cement consumption directly (for execution of the projects) and also indirectly through ancillary infrastructure and improved connectivity drives housing construction in low-density towns/villages.

Exhibit 39: Construction continues to languish in north India



Source: Ambit Capital research, MOSPI

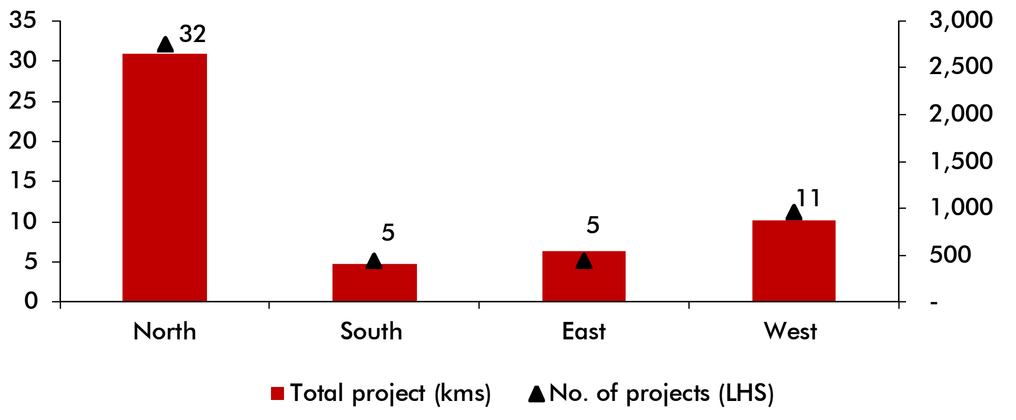
Possible volume drivers in north India

<u>Roads – Green shoots emerging</u>

59% of the road projects awarded in the last 24 months pass through north India

North India is manufacturing and freight-intensive, due to which road investments in the region have always been the highest amongst Indian regions. Note that 30% of the national highways are located in north India and 59% of the road projects awarded in the last 24 months pass through north India. Road is one of the few infrastructure sectors in India wherein order momentum has increased significantly in recent months, and we expect the momentum to remain strong for the next 1-2 years at least. North India will continue to have a dominant share in road orders, which in turn will drive cement consumption in the region. Whilst the Roads Ministry has outlined an aggressive ₹5 trillion investment in roads over FY16-20, even if we were to assume half of that, it would result into ~25,000kms of road construction, implying average of 13kms construction per day (vs the FY13-15 average of 10kms a day). The table below shows that if road construction continues at a reasonable pace for the next five years, it could contribute ~4-6 tonnes to cement demand (1-2% increase in the overall cement demand in north India).

Exhibit 40: 59% of the road projects awarded in the last two years pass through north India



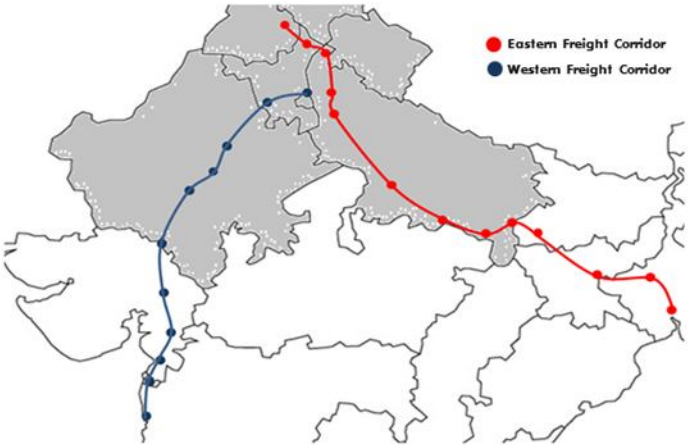
Source: NHAI, Ambit Capital research

Dedicated Freight Corridor (DFC) – North has a majority share

70% of DFC passes through north India

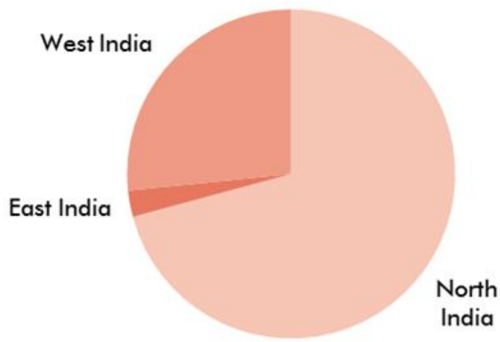
The DFC is an ambitious programme of the Indian railways to promote seamless movement of rail freight traffic in the country. The project involves construction of two corridors: the Eastern Corridor from Ludhiana to Dankuni (length of 1,839 km) and the Western Corridor from Dadri to Jawaharlal Nehru Port, Mumbai (length of 1,499 km). The DFC network will pass through 9 states (4 of which are in north India) and 61 districts. On the Eastern Corridor, the network will pass through the states of West Bengal, Bihar, Jharkhand, Uttar Pradesh, Haryana and Punjab. The Western Corridor will traverse the distance from Dadri in Uttar Pradesh, via Haryana, Rajasthan, and Gujarat to JNPT in Maharashtra.

Exhibit 41: The DFC passes through different regions in India



Source: DFCCIL, Ambit Capital research; Note: The shaded portion represents north Indian states

Exhibit 42: Almost 70% of the DFC passes through north India



Source: DFCCIL, Ambit Capital research

Key highlights of the project

The two corridors are likely to cost ~₹800bn. As on 31 March 2014, ~₹103bn has already been incurred towards execution of various projects. A major portion of the remaining expenditure is to be incurred in North Indian States.

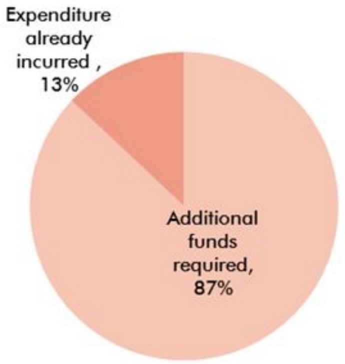
- JICA will fund 80% of the estimated cost of the Western corridor; World Bank will fund 67% of the estimated cost of Eastern corridor
- L&T-Sojitz consortium was awarded a contract worth ₹67bn to build a 626km double track corridor from Haryana to Gujarat

- GMR was recently awarded ₹50bn EPC contract for construction of 417km long double track railway line for the Eastern Dedicated freight corridor
- L&T and Sojitz recently won a contract worth ₹26bn for electrification of a 915 km section of the Western Freight Corridor
- Our checks suggest that the Western DFC will likely be commissioned by FY18-19, whereas the Eastern DFC could be commissioned by FY20-21

Status

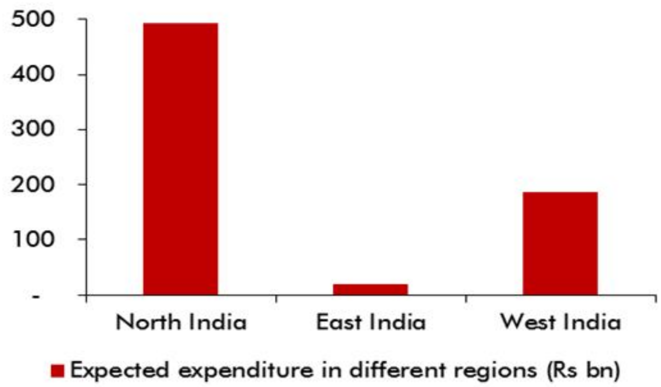
As per our checks with the DFC authorities and basis recent media articles, the main hindrance to the DFC was the alignment of the JNPT to Dahanu stretch, due to technical difficulties as well as environment challenges, such as the SGNP and mangroves along the Dahanu coast. The clearances have now been achieved, and the work on the JNPT-Vaitarna stretch should begin by next year. After the monsoon this year, work on the Vaitarna-Vadodara stretch will begin.

Exhibit 43: Only 13% of the project cost has been incurred until date



Source: DFCCIL, Ambit Capital research

Exhibit 44: North Indian will benefit from the highest network from DFC



Source: DFCCIL, Ambit Capital research

Excerpts from an interview with the MD of DFCCIL, Mr Adesh Sharma

On the pace of execution: *"The pace of work has accelerated manifold in the last six months in both corridors. Earlier, in the Khurja-Kanpur stretch of the Eastern corridor, we used to spend about ₹30 crore a month. Now, this is up to ₹100 crore a month. Between Rewari and Palanpur (625-km), work is in full swing. We have started daily monitoring of projects. When I started, earthwork progress was 5,000 cubic metres a day, now it is 80,000 cubic metres a day. Today, on earthwork and concreting, they have more than 100 excavators working in each corridor, about 500-700 tippers per contract, 16 mobile batching plants, 80 transit mixers. About 800 technical skilled labourers for bar-bending and shuttering are deployed."*

Completion schedule: *"Based on the land acquisition status and the contracts position,* ***both the corridors will be completed by December 2019.*** *The Minister has directed phase commissioning of DFC, which has been accordingly planned.*

So, ***the Khurja-Kanpur stretch will be operational by March 2018; Durgawati-Sasaram during the current fiscal, Mughalsarai-Sonnagar by December 2017 and Kanpur to Mughlsarai by December 2018.*** *In the Western corridor,* ***Rewari-Iqbalgarh will be done by June 2018, Iqbalgarh-Vadodara by March 2019. By December 2019, every portion of DFCCIL will be complete.****"*

Delhi-Mumbai Industrial Corridor (DMIC) - Large project but low visibility

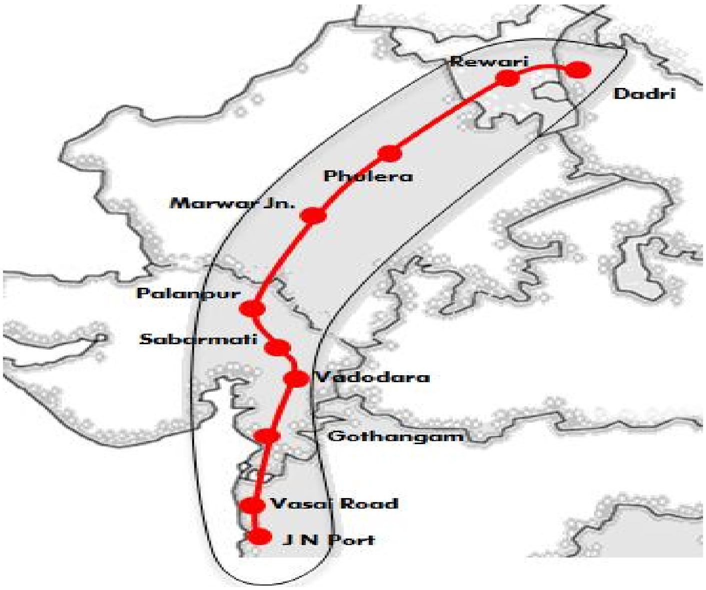
Delhi-Mumbai Industrial Corridor is a mega infrastructure project of US$90bn covering an overall length of 1483 kms between Delhi and Mumbai. The objective of the project is to expand India's manufacturing and services base and develop a "Global Manufacturing and Trading Hub". The entire DMIC project, over two phases, is to be spread over 24 cities and cover 5,500 sq km. The Japanese government has promised an initial US$4.5 billion for the first phase of the project

DMIC – Rajasthan and Gujarat comprise ~77% of the project

The DMIC network will pass through six States: UP, NCR of Delhi, Haryana, Rajasthan, Gujarat and Maharashtra, with end terminals at Dadri, NCR and JNPT, Mumbai. It is proposed that Rajasthan (39%) and Gujarat (38%) together will comprise 77% of the total length of freight corridor. The project proposes to incorporate 9 Mega Industrial zones of about 200-250 sq. km.; high-speed freight line, three ports, and six airports; a six-lane intersection-free expressway connecting Mumbai & Delhi; and a 4000 MW power plant.

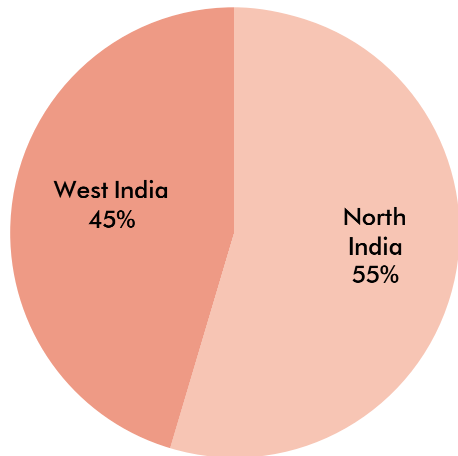
77% of DMIC passes through Rajasthan and Gujarat

Exhibit 45: DMIC network in different states in India



Source: DMIC, Ambit Capital research; Note: The shaded portion represents the proposed area of investment around the DMIC network

Exhibit 46: Almost 55% of the network to be a part of north Indian states



Source: DFCCIL, Ambit Capital research

Status: The project entails large investments in north India; however, it appears that execution will still take some time to begin at a reasonable pace. After several years of delay, it appears that the initial work has begun on the DMIC with the bids for building trunk infrastructure in Vikram Udyogpuri near Ujjain in Madhya Pradesh. Whilst there is little clarity yet on the commissioning time-lines of the project, given the scale of the project, the execution commencement will require significant cement consumption in north India.

Metros planned in multiple cities

Development of upcoming metros and expansion of current projects could be another key driver of demand in north India. Metros consume significant cement volumes; for instance, a single phase of metro construction entails consumption of ~1.5-2.5 million tonnes of cement. The Union Urban Development Ministry has also approved proposals for metros in tier-II cities in north India, Kanpur, Jaipur and Lucknow to name a few.

Exhibit 47: Snapshot of Metro-oriented activity in north India

Location	Proposed Outlay (₹ mn)	Status
Delhi	350,000	The success of the Delhi Metro set the benchmark for further metro activity in the country. Phase III and Phase IV are scheduled for completion in 2016 and 2021, respectively. Work on Phase III started in 2011 whilst planning for Phase IV has begun. The ex-chief of DMRC hinted that by the time Phase IV is completed, the city will need Phase V to cope with rising population and transport needs.
Jaipur	135,430	Phase-I of the Jaipur Metro has been completed, and Phase-II is scheduled for completion in 2021. Phase-I was completed in 4 years, making the Jaipur Metros one of the most efficiently constructed metros.
Lucknow	125,000	Construction of Phase-I of the Lucknow Metro has begun since September, 2014. Phase 2 will be started in 2018. Lucknow being the largest city in Uttar Pradesh has an urban population of more than 5 million in 2015.
Chandigarh	113,750	The Chandigarh Metro Project is currently under construction and expected to commence operations by 2018, with 30 stations in the first phase.
Kanpur	87,500	Phase-I of the Kanpur Metro is likely to be completed by FY20, given that construction has already begun in FY15. A 25 km corridor has been planned, in order to connect the most densely populated parts of the country.
Gurgaon	41,000	Phase-II of the Gurgaon project would be completed by 2015, and would add seven additional stations. There are plans to add 12 more stations in Phase-III which would be completed by 2021.

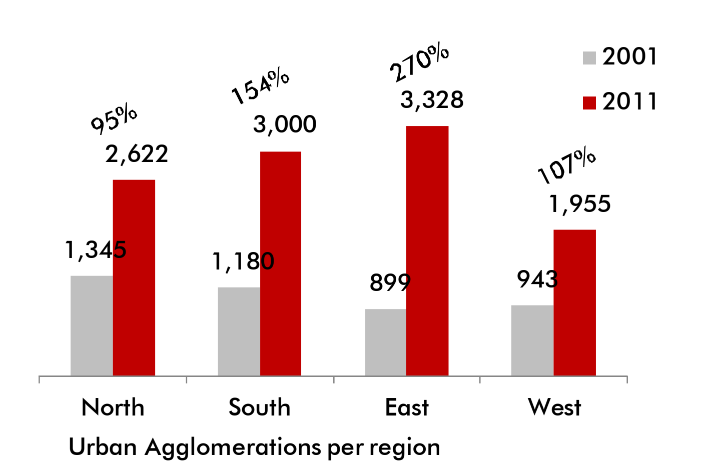
Source: Ambit Capital research

Urbanisation yet to increase majorly in north India

Urbanisation level in north India is low relative to other Indian regions

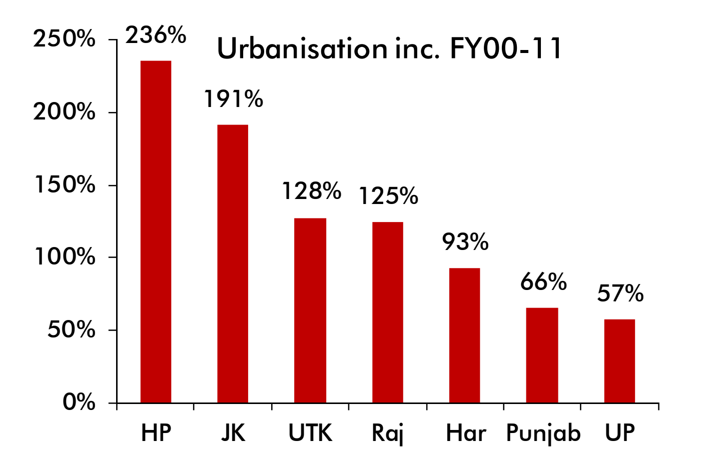
Whilst development of fringe cities around NCR drove urbanization led residential housing growth in North India, we highlight that the shift for the region as a whole has been significantly lower than other Indian regions. **Poor development in UP is a key reason for the lower rate of urbanisation in north India from 2001 to 2010**, which leaves that much room for the region to grow, if the government's agenda of infrastructure development and housing for all is implemented.

Exhibit 48: Urbanisation growth was the lower in North India over FY00-11…



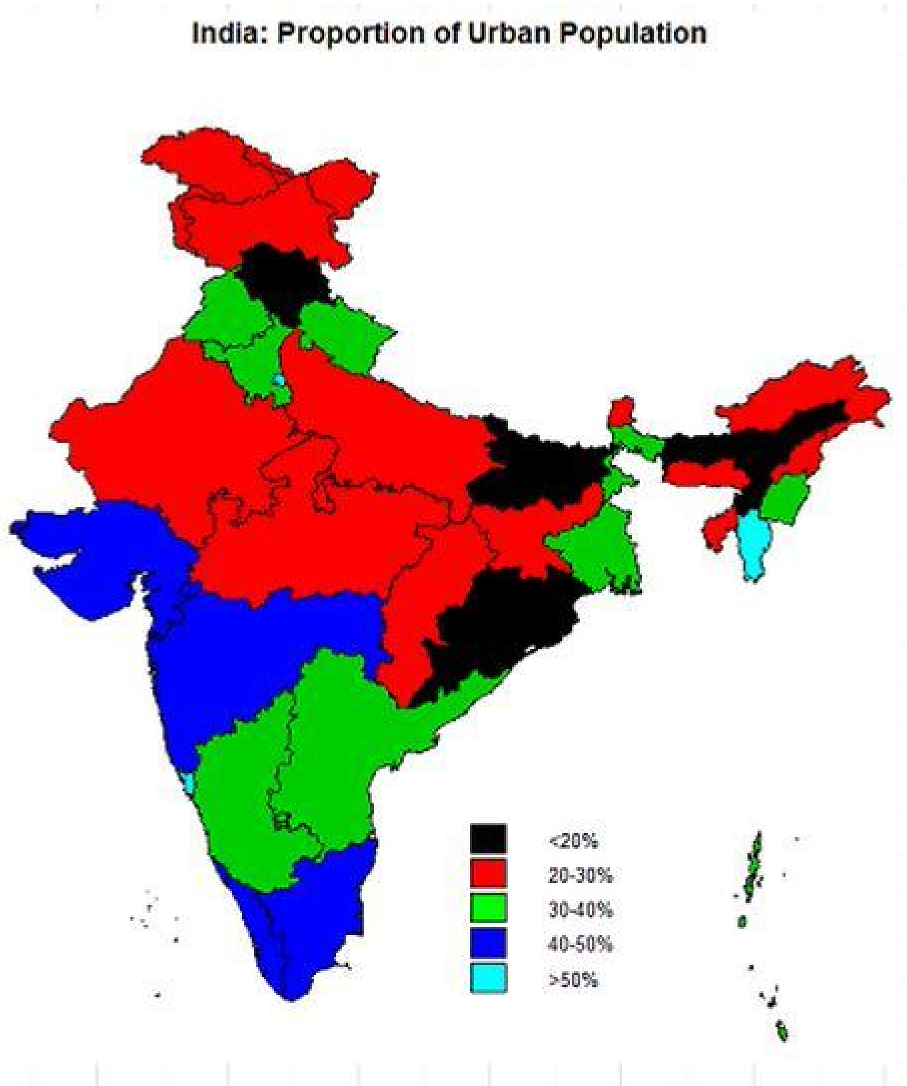
Source: Census, Ambit Capital research. Figures above the bar chart signify growth between 2001 and 2011

Exhibit 49: Urbanisation increase was the lowest in UP and Punjab over FY00-11



Source: Census, Ambit Capital research. Figures above the bar chart signify growth between 2001 and 2011

Exhibit 50: Urbanisation level is low in large parts of north India



Source: Census, Ambit Capital research

Near-term outlook for north India

North India is amongst the worst-affected regions in India currently, as not only has demand deteriorated significantly but prices have corrected in seasonally strong months, with little visibility of a near-term improvement. Our thoughts on the north India market over the next few years are as follows:

FY16 will be a very tough year: FY16 will be a tough year for north India, with both retail and institutional demand struggling to grow. Our discussion with industry participants suggests that the seasonally strong Apr-Jun quarter has been poor, and given the lack of government tenders, the scope of a meaningful improvement in the remaining part of the year is limited. Hence, we do not envisage a volume growth **in excess of 3-4%**, which itself is dependent on higher execution of infrastructure projects.

Will FY17 be any different? Whilst an increase in infrastructure spending will catalyze cement demand, the timing of the recovery is the key uncertainty. We highlight that the north India cement industry faced a similar situation in FY01, when infrastructure projects failed to increase, leading to a decline in cement consumption. Interestingly, cement demand expanded at a 9% CAGR for the next three years. Given north India's relevance in the infra landscape of India alongside a majority share in large infrastructure projects, we believe that the volume growth rates can increase significantly once execution gathers momentum. We expect the cement sales in the region to expand by 8-10% in FY17; however, our assumption hinges on an increase in infrastructure construction from the abysmally low base in FY16.

Volume improvement in FY17 hinges on recovery in infrastructure projects

Pricing will take a few more quarters to find support: With retail demand languishing, price increases will be difficult to pass through, as the regional manufacturers compete on prices to garner the maximum volumes from the institutional clients.

Limited announced expansions and fewer clinker capacity additions

Pace of capacity expansions will slowdown in north India; based on the announced expansion plans, only 14mn tonnes of cement capacity (best case) will be commissioned in north India. Note that the 4.5mn tonne plant of Ambuja Cement has stalled and there is little clarity on when the commissioning will be complete. Wonder cement recently announced further capacity expansion of 3.25mn tonnes over the next five years.

Exhibit 51: Upcoming capacities in north India

Company	State	Region	Capacity (mn tonnes)			Comments
			FY15	FY16	FY17	
JK Lakshmi	Haryana	North	0.5			Grinding unit
JK Lakshmi	Rajasthan	North			1.7	Reviving the Udaipur cement works
JK Cement	Haryana	North	1.5			Brownfield expansion at integrated plant
JK Cement	Rajasthan	North	1.5			Brownfield expansion at integrated plant
Birla Corp	Rajasthan	North	1.5			Brownfield expansion at integrated plant
UltraTech Cement	Rajasthan	North		2.9		Brownfield expansion at integrated plant
Ambuja Cement	Rajasthan	North			4.5	Greenfield Integrated unit; no visibility as the company has stalled expansion plans
Shree Cement	Uttar Pradesh	North		2.0		Grinding Unit
Wonder Cement				3.5		Brownfield expansion
Total			**5.0**	**8.4**	**6.2**	
% of installed capacity			**4.8%**	**7.7%**	**5.3%**	

Source: Company, Ambit Capital research

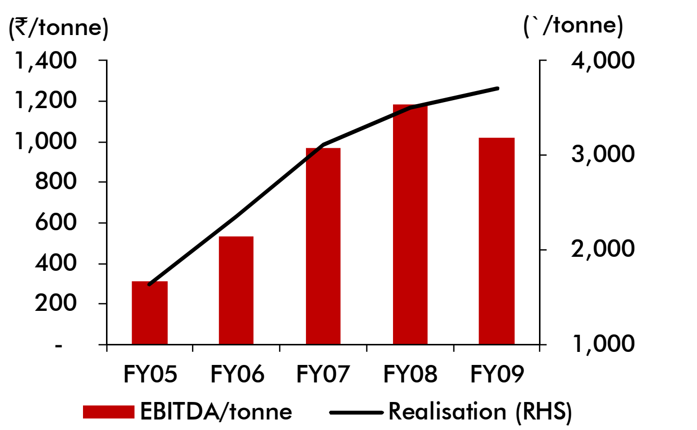
Mr. Super-cycle, when will you return?

Cement being a cyclical sector, investor decision of investing in cement stocks is usually on the hope of a recovering cycle and then culminating into a 'super-cycle', wherein volumes grows sharply and capacity utilisation improves, driving sharp price hikes, which in turn leads to significant increase in unitary EBITDA, RoCEs and free cash generation of cement companies.

A sneak peek at the last super-cycle

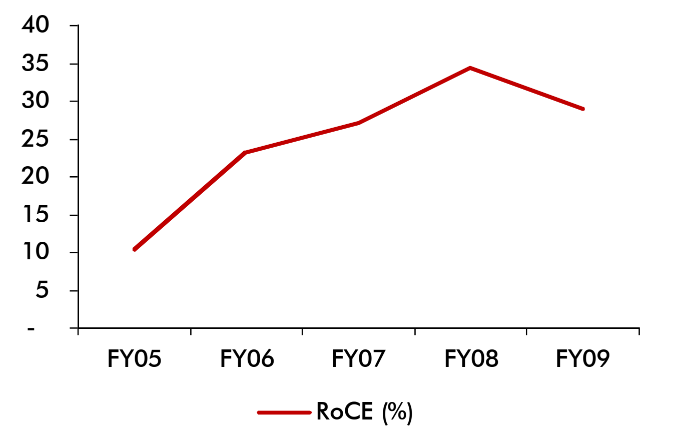
The last super-cycle started in FY05 and lasted until FY10. An analysis of four north-India-based cement manufacturers (Shree, JK Lakshmi, JK Cement and Mangalam) shows that realisation for the four companies more than doubled and hence EBITDA/tonne grew sharply throughout the cycle.

Exhibit 52: Realisations more than doubled, leading to sharp increase in unitary EBITDA and…



Source: Company, Ambit Capital research

Exhibit 53: …significant increase in RoCEs



Source: Company, Ambit Capital research

Interesting observations from Shree's annual reports over FY05-09

FY05: *"Over the years, cement production in North India has increased because of more effective capacity utilisation in manufacturing units stationed here.* ***There has been no greenfield capacity addition, over the last few years to account for the growth****. With installed capacity of 27 MT, the cement manufacturers here produced 26.6 MT during 2004-05.* ***As is clear from the high production levels, capacity utilisation across the industry has inched close to its best possible****. Thus, there is very little scope of servicing extra demand through this route. Added to the internal consumption of 24.2 MT is the inter-state movement (net) of over 2 MT. All this makes for current demand that is at par with supply. Given that demand is estimated to rise at 8% per annum and taking into account announcements of new capacity addition of players in the region,* ***production is expected to fall short of demand by 2 MT every year in the medium term. Manufacturers with new capacities stand to reap a windfall."***

The last super-cycle had multiple things working in favour of the north India manufacturers: strong demand, high utilisation and sharp price hikes

FY06: *"A look at the regional breakdown shows that the northern region of India, where Shree's plants are located, is witnessing a favourable rise in year-on-year consumption.* ***Following the higher demand in North India, there has been an improvement in price realisations.*** *The North India cement market has recorded a marked improvement in cement demand with current year demand growing at over 11.5% against 6.1% achieved last year.* ***North India is likely to witness new capacity addition over next three years increasing the supply in the market and bring down the prices."*** *(Ambit comment: but in the meantime prices would continue to rise!)*

FY07: *"Cement demand in the north is expected to enjoy an extended run because of proximity to the National Capital Region (NCR), which is attracting a lot of investment in office complexes, commercial real estate and housing, perhaps more than any other region."*

FY08: *"We believe that the drivers of cement demand viz., Housing, Infrastructure and Industrial activity all are intact. Cement demand can be expected to maintain its 10% growth rate in the near to medium term. Cement demand in North India clocked a strong growth of 12.2% on top of double digits growth in the last two years. The commonwealth games, the upcoming US$ 90 Billion Delhi Mumbai Industrial Corridor (DMIC) and the 1483 kilometer high speed Dedicated Freight Corridor (DFC) project will boost the demand for cement in North India."*

FY09: *"Several new projects have come up and many are expected to go upstream in the coming year. Some of them with big capacity have come up in the northern region where your company operates. This may led to increase in supply which may adversely affect prices and market share. However we feel that the demand is also expected to grow at reasonable levels which may set off negative impacts of new supplies."*

Our understanding of the situation during FY05-10 is that the steady demand in housing for multiples reasons (better subsidies for farmers, improving road connectivity, leakages in subsidies) kept pricing power steady; however, towards FY07/08 public infrastructure/institutional real estate demand construction fueled demand further which led to shortage of cement and hence limited bargaining power with infra cement buyers. Continuing momentum in housing and belief that the economic slowdown was temporary plus the lag impact from earlier infra creation improved housing demand further which did not let prices cool off.

Two years to go before a strong demand recovery

Public infrastructure projects will kick-start the demand recovery, but the percolation of infra spending into residential and retail consumer demand usually has a lag of 3-4 quarters. Whilst demand might grow by 7-8% in FY17 on a low base of FY16 with the execution of infra projects, **we believe that a strong and sustained volume growth of high single-digit or early teens will take time at least until mid-FY18.**

Then and now - Things aren't the way they were before!

Whilst the cement demand recovery will certainly uplift volume growth, we do think that this demand upcycle will be as lucrative for cement companies as the FY05-08 period.

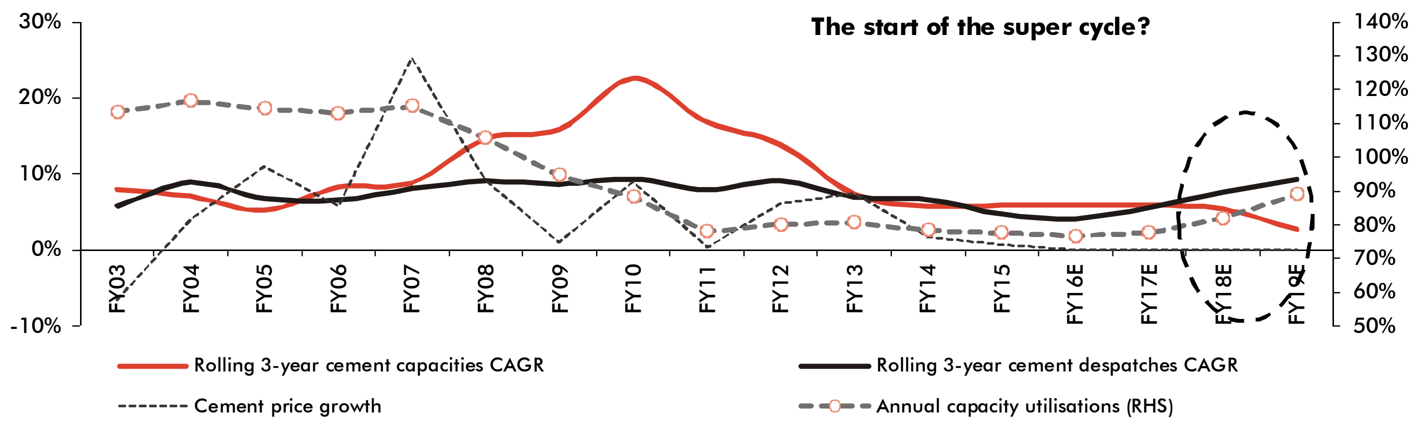
The following reasons make us believe that the next cyclical demand recovery will not be as lucrative:

The next super-cycle will not be as lucrative as the previous one owing to: (1) low utilisation, (2) increasing institutional sales, (3) rising OPC mix amid available capacities, and (4) limited efficiency improvement levers

(1) Gone are the days of 100% capacity utilisation

As shown in the exhibit below, the sharp cement price growth in FY06-07 (the dotted line) was on account of high capacity utilisation and no major capacity additions. Low utilisation and increasing capacities have led to muted price increases for the last few years, which is likely to continue for the next 2-3 years until utilisation ramps up.

Exhibit 54: Price hikes require slowdown in capacity addition and high utilisation level



Source: CMA, Ambit Capital research

The chart above highlights that assuming a 5% volume growth in FY16, 7% in FY17% and 10% in FY18 and FY19 each, utilization reaches 90% in FY19-end, which possibly will improve the pricing power of the cement companies.

North India's utilisation level was at 74% in FY15 and could move up to 83-84% in FY18, assuming a 9-10% volume growth in both years over a low 4% growth in FY16. Even after factoring in limited capacity expansions, we do not think that utilisation will hit the peaks seen earlier, and hence we see low likelihood of pricing growth to be as strong as the previous upcycle

Exhibit 55: Capacity utilisation in north India – Scenario analysis

		Volume growth (FY18)				
		6%	**7%**	**8%**	**9%**	**10%**
Volume growth (FY17)	**6%**	78%	79%	80%	80%	81%
	7%	79%	80%	80%	81%	82%
	8%	80%	80%	81%	82%	83%
	9%	80%	81%	82%	83%	83%
	10%	81%	82%	83%	83%	84%

Source: Company, Ambit Capital research

(2) Shifting consumption patterns: We believe that steadily the cement consumption pattern in India will shift from retail/channel sales to institutional sales with growth in infrastructure construction and rising organised housing construction. Given that institutional clients are bulk purchasers of cement, we do not think that pricing growth will be as strong as the last cycle.

(3) Use of OPC set to increase: Our recent checks with cement companies suggests that OPC penetration is rising in north India and is likely to rise further, as infrastructure demand increases (infra projects largely consume OPC cement). Although the realisation of OPC is similar or at best 2% higher than PPC, the unitary EBITDA is ~30% lower, since in PPC cement fly ash replaces cement up to 25%, wherein cost is ₹750/tonne vs clinker cost of ₹2,000/tonne. Rising OPC sales mix will drag overall unitary EBITDA and companies will try to offset this loss by raising prices of PPC cement.

A quote from a media article in 2010:

"As infrastructure projects in North India gather pace, cement makers dependent on this market are tweaking their product strategy. ***They are switching from portland pozzolana cement (PPC) to ordinary portland cement (OPC) to sustain growth.***

OPC is used in infrastructure projects while PPC is used for real estate development. OPC is used for making concrete for structural works that require high compressive strength, such as roads, bridges and dams. Shree Cement, which runs the largest single-location integrated cement factory in northern India, is concentrating on manufacturing OPC. Shree Cement managing director HM Bangur told ET: "Our contribution to PPC will gradually come down as we have decided to raise OPC production by 20% over the next few quarters." The demand for OPC has almost doubled in the northern region because of construction works for the Commonwealth Games," said Binani group managing director Vinod Juneja."

Exhibit 56: EBITDA/tonne in OPC is 30% lower than PPC

Particulars (₹/tonne)	Cost/tonne	PPC		OPC	
		% used	per tonne	% used	per tonne
Realisation			4,100		4,182
Manufacturing cost (A) + (B)			1,625		2,000
Clinker (A)	2,000	70%	1,400	100%	2,000
Fly ash (B)	750	30%	225	0	0
Freight and other costs			1,500		1,500
EBITDA/tonne			975		682
Change in EBITDA/tonne					**-30%**

Source: Company, Ambit Capital research

(4) Few levers to further efficiency improvement

We highlight that in the last upcycle, cement companies not only benefitted from rising demand but also increase efficiencies, leading to cost savings. A shift to petcoke and increased blending mix led to a sharp increase in PPC cement sales (replacement of clinker with fly ash).

Investment implications

Ranking the players in north India

Shree Cement ranks the best in our framework of ranking north India cement companies: Shree's best rank can be explained by: (a) the largest market share alongside fastest growth and (b) lowest cost to reach the market and the second lowest cost of manufacturing (as a percentage of sales). The company ranks low in pricing comparison, given lower realisation than pan-India peers. JK Lakshmi ranks fourth owing to reasonable market share and lowest manufacturing and selling costs after Shree, UltraTech and Ambuja

Exhibit 57: Shree Cement ranks the best on our ranking framework

Companies	Pricing	Cost of production	Cost of Sales	market share	Overall Ranking
Shree	5	3	1	1	1
Ambuja	1	1	2	4	2
UltraTech	3	2	6	2	3
JK Lakshmi	4	4	4	3	4
ACC	2	6	3	6	5
JK Cement	7	5	5	4	6
Mangalam	6	7	7	7	7

Source: Ambit Capital research, Company

Exhibit 58: The numbers behind our ranking

Companies	Realisation (₹/tonne)		Cost of production as a % of sales		Cost of sales as a % of sales		Market share	
	FY15	CAGR (FY09-15)	FY15	Avg (FY09-15)	FY15	Avg (FY09-15)	Capacity (mn tonnes)	volume CAGR (FY09-15)
Shree	3,642	2%	52.7%	53.9%	26.4%	23.0%	19.5	5.7%
Ambuja	4,576	4%	54.8%	53.8%	20.7%	19.5%	8.9	2.6%
UltraTech	4,122	3%	52.9%	54.4%	27.7%	24.1%	13.5	3.6%
JK Lakshmi	3,877	4%	63.3%	57.3%	30.0%	26.6%	6.0	13.0%
ACC	4,848	6%	55.7%	53.1%	25.9%	23.4%	6.0	5.2%
JK Cement	5,053	6%	56.1%	56.8%	26.0%	24.3%	4.5	6.7%
Mangalam	3,817	3%	48.4%	54.5%	31.4%	28.5%	3.0	11.1%

Source: Company, Ambit Capital research

Limitations to our analysis

a) UltraTech's, Ambuja's and ACC's numbers include the performance for all the Indian operations and they cannot be segregated for south India.

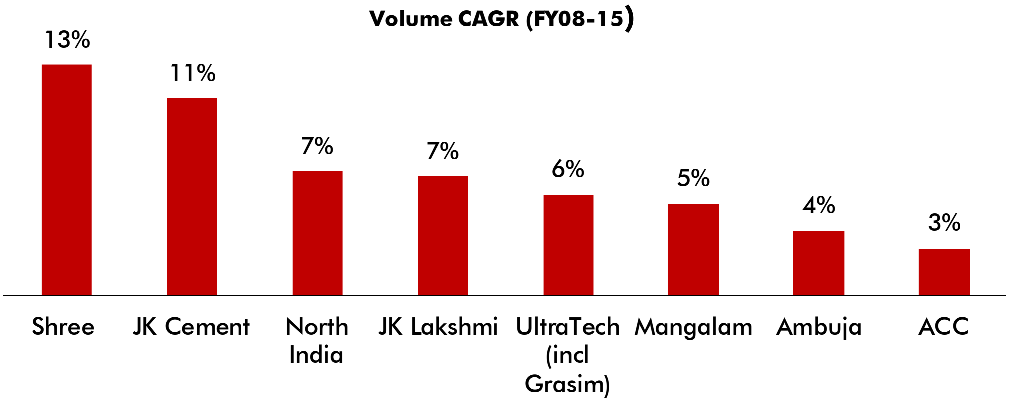
b) Our competitive mapping exercise considers that ~60% of the capacities are in south India, as the requisite details are not publicly available for the others.

c) We have included miscellaneous expenditure as a part of the cost of production, as the nature of the cost item is not determinable.

Regional peers will continue to gain market share

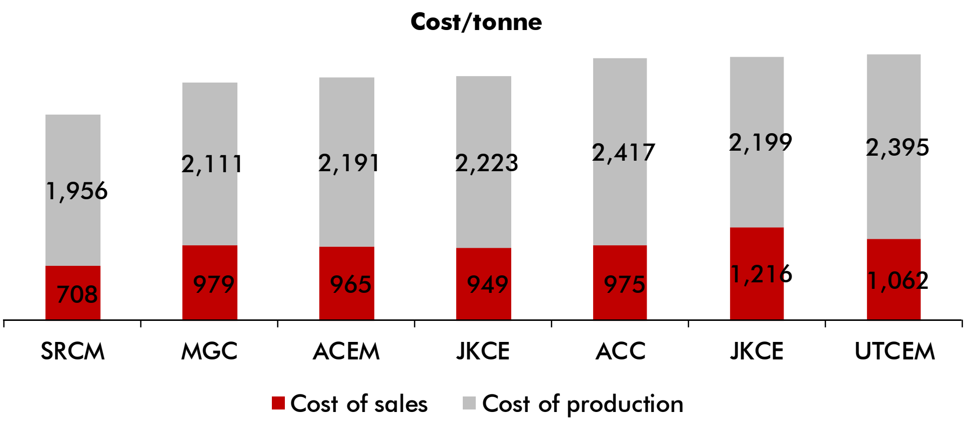
As shown in the exhibit below, the regional manufacturers have grown significantly higher than the pan-India peers over FY08-15, as these manufacturers added capacities significantly, built retail reach gradually given weak infra/institutional demand over FY11-15 thus improved their competitive positioning in north India. We believe that the pace of market share expansion will further accentuate the regional manufacturers such as Shree Cement, JK Lakshmi and JK Cement led by: (a) **continuous capacity additions:** regional players have significantly increased capacities and will fight for market share gains and (b) **rising institutional sales mix:** mix of institutional sales is set to increase in north India as a large proportion of cement demand in the region will be driven by infrastructure spending. Given that institutional consumers are not brand-conscious but price-conscious, the regional manufacturers will be larger beneficiaries of the demand recovery.

Exhibit 59: Regional peers have grown faster than pan-India peers



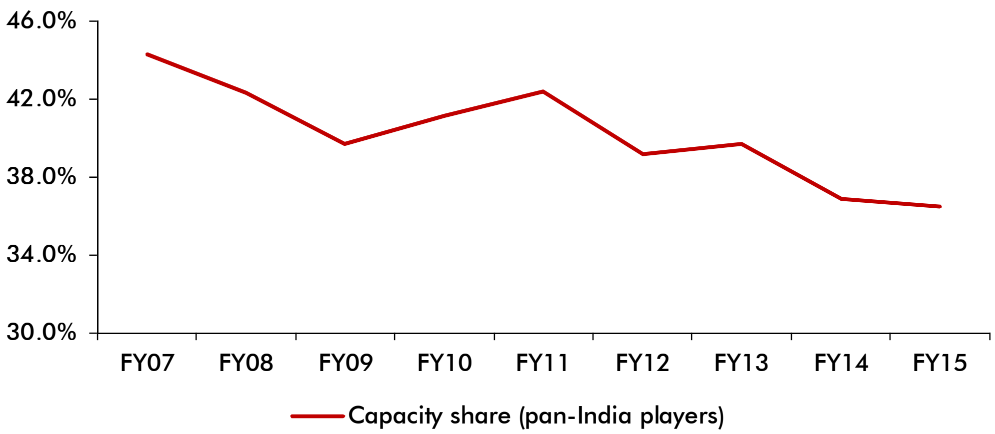
Source: Company, Ambit Capital research Note: JK Cement volume growth numbers include South India volumes as well.

Exhibit 60: Regional players are fairly competitive on costs



Source: Company, Ambit Capital research

Exhibit 61: Pan-India players' capacity share has fallen in last few years



Source: Company, Ambit Capital research

Choosing the right player in north India

We continue to prefer cost efficiency and ability to service institutional demand over brand supremacy in north India. Whilst **Shree Cement** ticks all the right boxes, we find its valuations expensive and hence despite its suitable positioning, we do not see scope for any significant investment returns. **UltraTech** has the scale but will have to compromise on profitability to service institutional demand (as it does not have the best cost efficiencies); moreover, the stock is expensive. **Ambuja and ACC** are largely retail-focused and it will continue to lose market share to the regional peers, given lack of capacities and shift in sales mix in favour of institutional consumers. The regional players in the north which could benefit and post the recent de-rating are available at reasonable valuations are **JK Lakshmi, JK Cement and Mangalam Cement.**

Regional players with enhanced capacities and well-established efficiencies are better recovery plays

Comparing the regional manufacturers on key parameters:

Logistics efficiency: Shree Cement's logistics cost is significantly lower than other regional peers, which is on account of grinding units located close to the demand centres and better terms with road developers, given reverse auctioning. JK Lakshmi is the second best, followed by JK Cement and Mangalam Cement.

Exhibit 62: Shree is significantly better than peers on logistics

Freight Costs (₹/tonne)	FY10	FY11	FY12	FY13	FY14	FY15	FY10-14
North India (aggregate of the below)	**616**	**637**	**668**	**722**	**821**	**792**	5.2%
Shree	492	473	508	520	663	618	7.7%
JK Cement	835	893	844	924	985	1,024	4.2%
JK Lakshmi Cement	607	678	785	925	987	868	12.9%
Mangalam Cement	714	804	941	975	1,039	1,077	9.8%

Source: Company, Ambit Capital research

Power and fuel efficiency: Shree Cement's unitary power cost is the lowest amongst the four companies compared below, followed by JK Lakshmi. Note in the exhibit below that Shree's and JK Lakshmi's power production cost and electricity needed per tonne are significantly lower than other manufacturers in north India.

Exhibit 63: Shree and JK Lakshmi are superior than other peers

Power and Fuel (₹/tonne)	FY10	FY11	FY12	FY13	FY14	FY15	FY10-14
North India (aggregate of the below)	**728**	**915**	**934**	**858**	**825**	**811**	2.2%
Shree	606	809	824	705	682	631	0.8%
JK Cement	910	1,027	1,133	1,100	1,048	1,107	4.0%
JK Lakshmi Cement	699	1,008	980	891	912	832	3.5%
Mangalam Cement	955	1,010	1,006	1,091	954	1,086	2.6%

Source: Company, Ambit Capital research

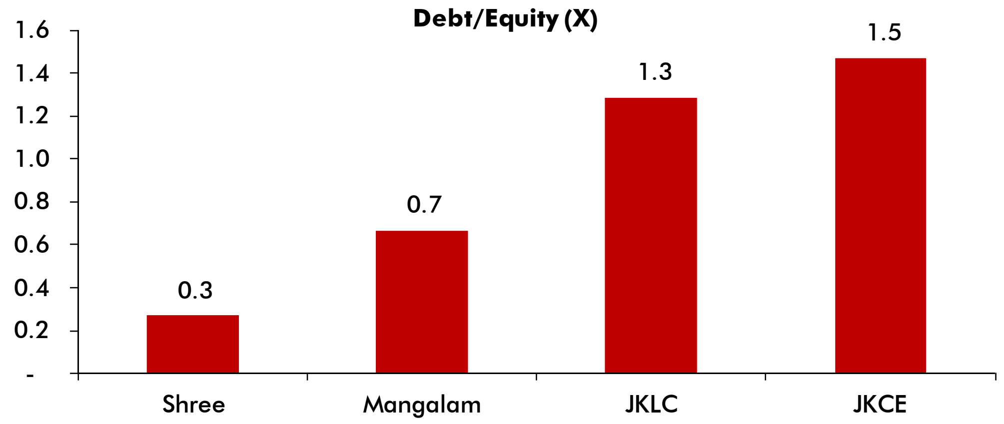
Exhibit 64: Shree and JK Lakshmi are the most efficient on power production cost

Company	Power Cost/Unit (₹)		Electricity needed (Kwh/tonne)	
	FY13	FY14	FY13	FY14
Shree	2.4	2.3	78	75
JK Lakshmi	2.4	2.2	75	73
JK Cement	3.6	3.2	89	86
Mangalam	4.6	5.5	71	75

Source: Company, Ambit Capital research

Balance sheet strength: We ascertain balance sheet strength through debt/equity and ability of the company to absorb demand shocks without significant stress on the balance sheet. Shree Cement has the lowest leverage (which also is largely working capital related), followed by Mangalam Cement. The debt of JK Lakshmi and JK Cement has risen significantly owing to recent expansions.

Exhibit 65: Shree and Mangalam have superior balance sheet strength



Source: Company, Ambit Capital research

To understand the company's ability to withstand demand shocks, we assume a 10% interest rate on the outstanding debt amount as on March 2015 and ascertain the interest coverage ratio, basis 5%/10%/15% lower EBITDA. As shown in the exhibit below, Shree and Mangalam Cement run the lowest risk of EBITDA erosion due to adverse demand/pricing. JK Lakshmi's and JK Cement's 36-40% EBITDA could be wiped off to service interest if consensus EBITDA is 15% lower than expected in FY16.

Exhibit 66: JK Lakshmi and JK Cement run the highest interest burden risk

Company	Debt-Mar-15	Interest cost (FY16)	Consensus EBITDA (FY16)	Interest/EBITDA			
				Consensus	-5%	-10%	-15%
Shree	13,379	1,338	22,057	6.1%	6.4%	6.7%	7.1%
Mangalam	3,447	345	1,518	22.7%	23.9%	25.2%	26.7%
JK Lakshmi	17,202	1,720	5,553	31.0%	32.6%	34.4%	36.4%
JK Cement	24,222	2,422	7,320	33.1%	34.8%	36.8%	38.9%

Source: Company, Ambit Capital research

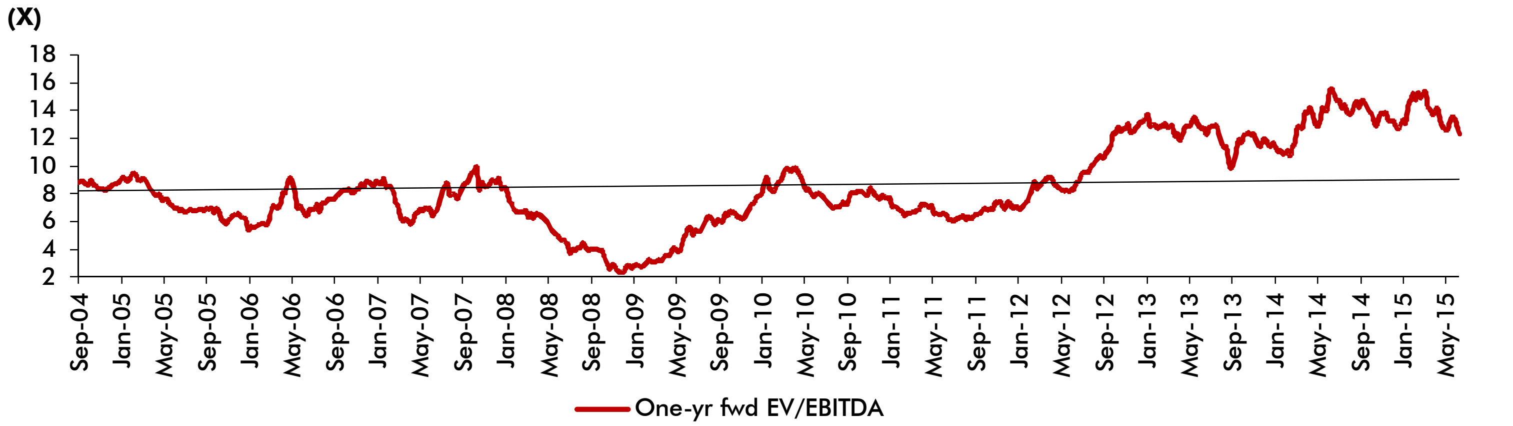
Valuation – Always hopeful to never acknowledge reality

Valuations of cement companies re-rated sharply in the last one year, as the election of the NDA Government raised hopes of an infra-demand-led cement recovery. However, demand deteriorated sharply from 2HFY15 and we see little chances of a demand recovery in FY16. Our economy team contends that the NDA Government will administer resets to the Indian economy, such as curtailing subsidies, clamp-down on black money and disrupt crony capitalism. We believe that these measures will impact cement consumption in the interim (mainly from housing segment and corporate capex) and it will require a strong infrastructure demand recovery for volume growth to improve. Alongside, a poor crop season and low MSP hikes has impacted rural income which contributes to 40% of overall cement demand in India.

Cement stocks continue to trade at rich multiples (43% premium to 5-year average EV/EBITDA) and not only does RoCE fail to justify the rich valuations but we believe that consensus earnings growth expectations will require downgrades for a prolonged demand recovery

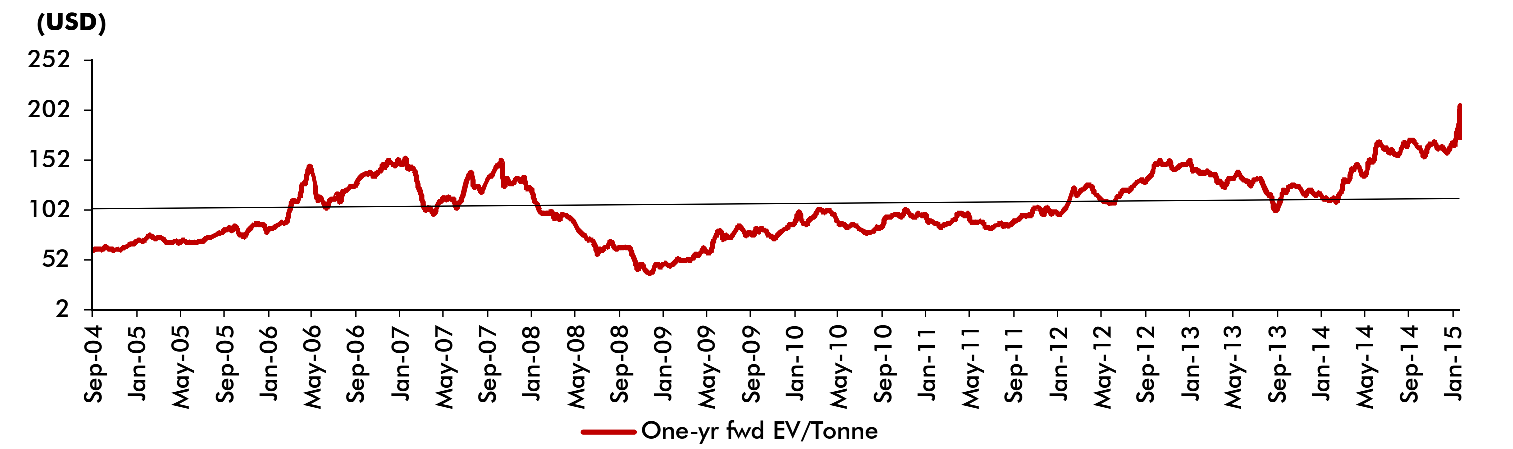
Against this backdrop, we believe that the industry volume growth in FY16 will at best be 5-6% and that too back-ended from 2H; cement stocks continue to trade at rich multiples (43% premium to 5-year average EV/EBITDA) and not only does RoCE fail to justify the rich valuations but we believe that consensus earnings growth expectations will require downgrades for a prolonged demand recovery. We reiterate SELL on UltraTech (16% downside), Ambuja (7% downside), ACC (12% downside), Shree (15% downside) and Ramco Cement (13% downside). Orient Cement is our only BUY recommendation in the cement space, as we expect its key markets such as AP to recover ahead of most other Indian regions; moreover, the company has well-established cost efficiencies and has added scale to effectively service demand from the institutional segment; however, Orient's reducing cost benefits from the rising cost of linkage coal will lead us to cut our EBITDA estimates and valuations by ~10%.

Exhibit 67: Top-5 cement companies trade at a 43% premium to long-term average EV/EBITDA...



Source: Company, Bloomberg, Ambit Capital research

Exhibit 68: ...and 62% premium to long-term average EV/Tonne

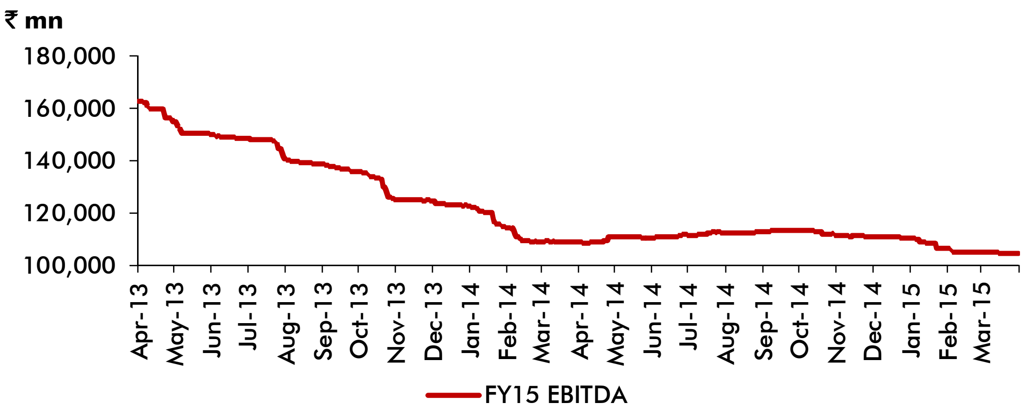


Source: Company, Bloomberg, Ambit Capital research

Consensus expectations will undergo cuts (again!)

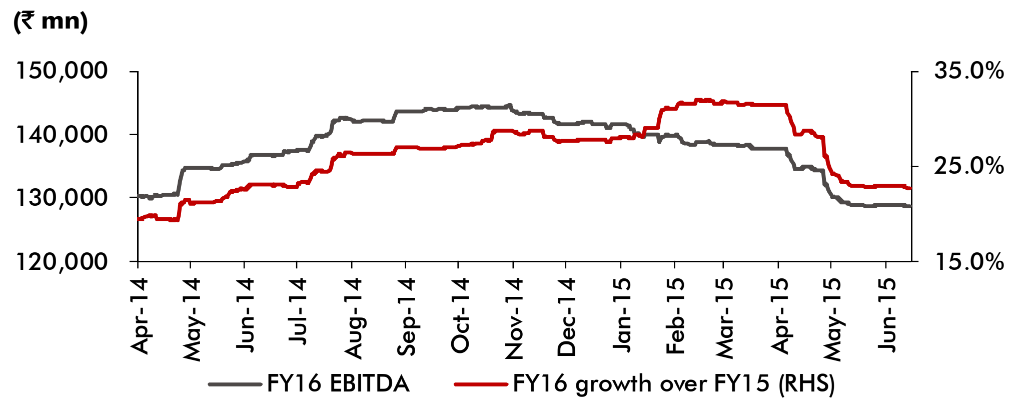
Consensus EBITDA estimates for FY15 (for top-5 cement companies) were cut by 35% over FY14-15, as disappointments on volumes and pricing continued; however, downward revisions in FY15 EBITDA estimates were followed by upward revisions in FY16 EBITDA growth estimates to justify the rich valuations (note that FY16 EBITDA growth over FY16 increased to 32% by March 2015 vs 19% in April 2014). Consensus EBITDA estimates for FY16 have been cut by 1% over the last 15 months but by 11% over the last nine months. We expect further cuts, as weak volumes and volatile pricing will lead to earnings disappointments.

Exhibit 69: Consensus FY15 EBITDA estimates (for top-5 companies) have been reduced by 35% over FY14-15…



Source: Bloomberg, Ambit Capital research

Exhibit 70: ….FY16 EBITDA estimates (for top-5 companies) have been cut by 11% in the last nine months; further cuts are likely



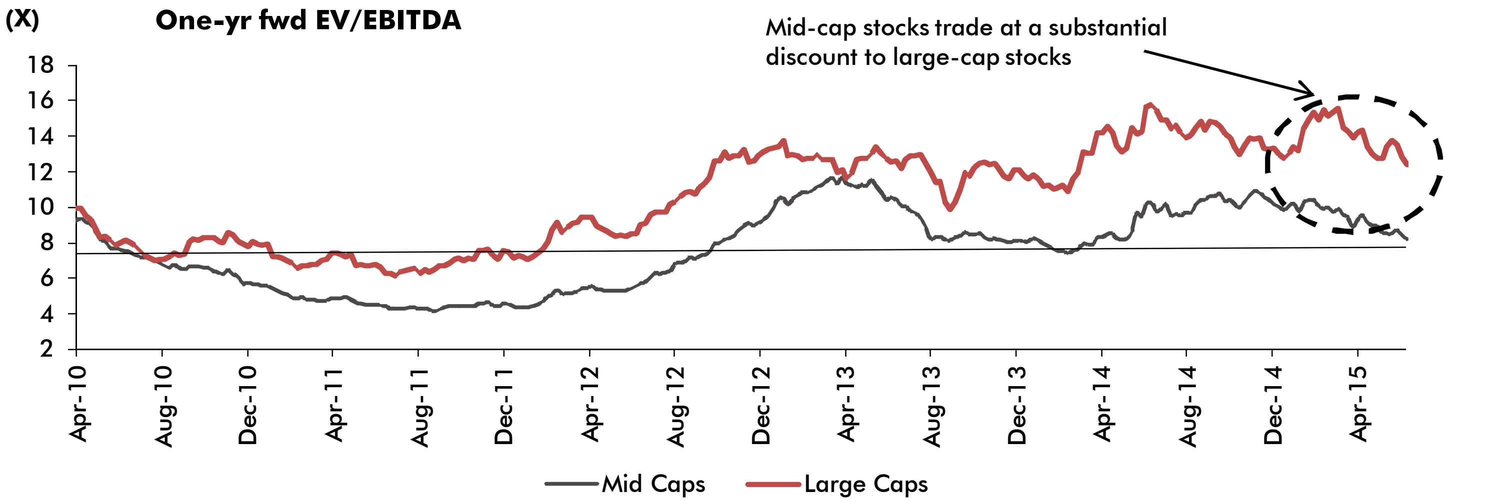
Source: Bloomberg, Ambit Capital research

Valuation comparison: Large-caps vs Mid-caps

Mid-cap cement stocks now trade at a significant discount to the large-cap peers

The mid-cap cement companies trade at a 34% discount to the large-cap peers as against a 10-25% discount in the last five years. We believe that the discount will narrow as the profitability of the mid-sized players improves and free cash generation helps them to de-lever their balance sheet. Moreover, we expect the regional manufacturers to grow faster than the pan-India players, owing to market share gains as infrastructure demand recovers; over the last few years, lack of infrastructure/institutional demand led to many of the regional players building their retail reach. Now, recovery of infra demand along with a relatively better retail standing vs a few years back makes them a better bet in the coming cycle. Hence, we prefer cost-efficient regional cement manufacturers over the large-cap peers. Owning large-cap cement names at expensive valuations, due to their large scale is not a valid argument, as we expect the mid-caps to grow faster and report higher profitability that their large-cap peers.

Exhibit 71: Mid-cap valuation gap to large-cap cement companies has narrowed



Source: Company, Bloomberg, Ambit Capital research. Note: Large-caps include UltraTech, ACC, Ambuja and Shree. Mid-caps include Ramco, JK Lakshmi, JK Cement and India Cement

Look for quality at a reasonable price

Whilst the large-sized companies would be amongst the major beneficiaries of a demand/pricing revival, we believe the valuations are too rich to generate investment returns. Therefore, investors could consider investing in high-quality mid-cap cement names, with high RoE expectation and available at reasonable valuations. We build a four quadrant matrix to ascertain valuations in light of RoE and size of the company (see Exhibit 72).

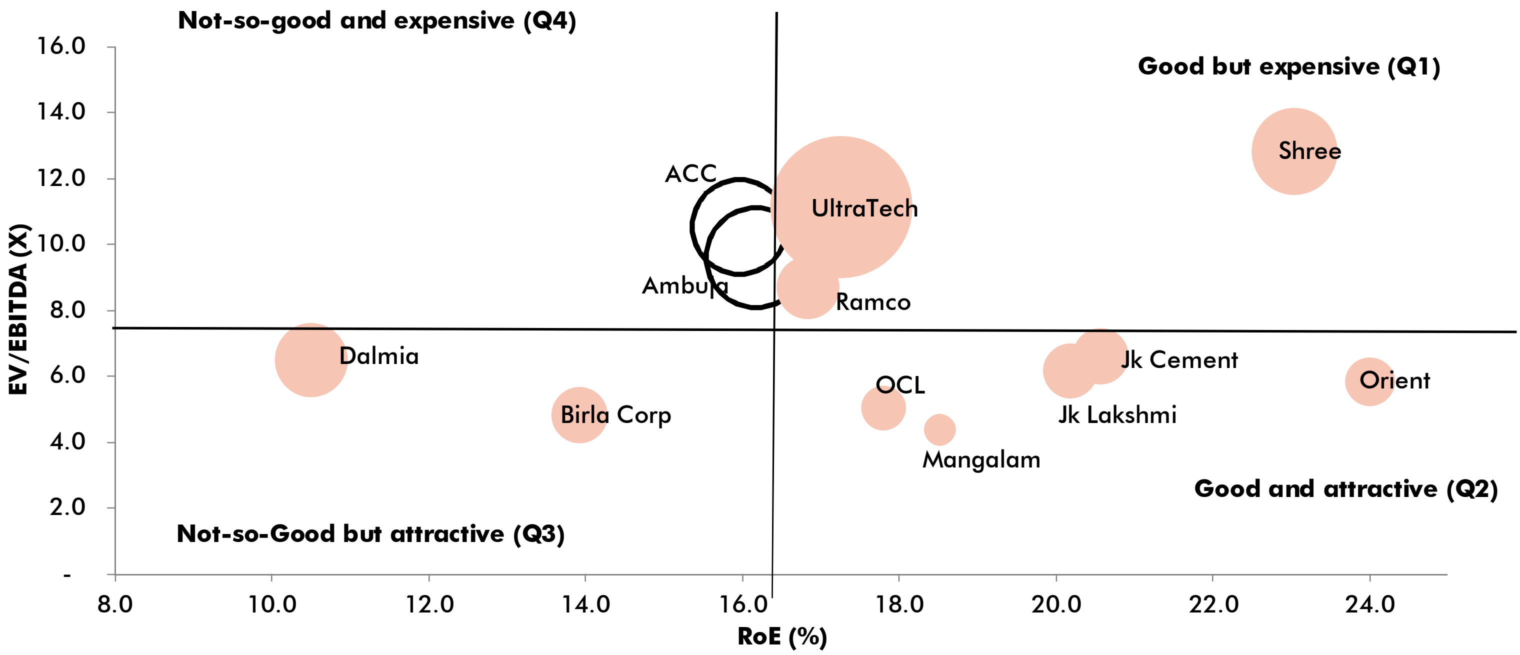
Quadrant #1 - Good but expensive: UltraTech, Shree and Ramco fall in this quadrant. We believe if investors are ready to invest in expensive stocks, then the best option is Shree, as it offers the maximum RoE and long-term superlative growth visibility. UltraTech has the highest scale but low profitability given high cost capacity expansions and lower utilisation as compared to Shree.

Quadrant #2 - Good and attractive: We believe this quadrant is the *"sweet spot,"* as it constitutes companies with high profitability at reasonable valuations. We suggest investing in companies with high-quality managements, relatively large scale alongside superior RoEs. **Orient Cement would be our top pick in this matrix, followed by JK Lakshmi and Mangalam Cement.**

Quadrant #3 - Not-so-good but attractive: The companies falling in this quadrant are not the best in terms of RoEs but are available at discounted valuations. We believe investors preferring to invest in this quadrant should look at management quality keenly as despite reasonable size, low multiples could be a function of structural concerns.

Quadrant #4 - Not-so-good and expensive: ACC and Ambuja fall in this quadrant, given relatively low RoEs but rich valuations. Whilst the premium could be on account of the quality of the franchise and hopes of a disproportionate growth beyond FY16, we believe that negative shocks like lower pricing could have a magnified impact on stocks in this quadrant. Moreover, these companies do not have surplus capacities to benefit from an infrastructure-led cement demand recovery.

Exhibit 72: Invest in quality at a reasonable price (quadrant #2)



Source: Ambit Capital research, Company, Bloomberg; Note: Size of the Bubble indicates capacity as on end-FY15

Relative valuation

Exhibit 73: Relative valuation summary

	Capacity			Rating	Mcap		Advt 6m	EV/EBITDA			P/E			EV/tonne			CAGR (FY15-17E)			ROE	
	(mn tonnes)				(₹ bn)	US$ mn	US$ mn	(x)			(x)			US$			(%)			(%)	
	FY15	FY16E	FY17E					FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E	Sales	EBITDA	EPS	FY16E	FY17E
Large-cap																					
UltraTech	62.0	67.0	72.0	SELL	697	11,614	14.2	19.4	14.4	11.1	37	25	18	205	190	177	19	32	43	15	17
Ambuja*	28.0	30.0	31.0	SELL	314	5,225	6.6	14.9	12.9	10.5	22	23	18	161	151	146	11	19	11	14	16
Grasim ^	NA	NA	NA	NR	288	4,805	4.5	8.6	6.7	5.2	18	13	9	NA	NA	NA	15	28	38	9	12
ACC*	30.1	33.6	33.6	SELL	241	4,017	9.7	16.0	12.4	9.6	22	22	17	125	112	112	12	29	16	13	16
Shree Cement **	21.0	25.0	28.0	SELL	342	5,705	5.4	24.5	16.7	12.8	57	32	22	274	230	206	22	38	62	19	23
JPA #	23.4	23.4	23.4	SELL	27	446	10.7	31.2	24.5	22.2	(3)	(9)	22	456	456	456	9	19	NA	-1	0
Total / Average	**164**	**179**	**188**		**318**	**5,302**	**8.5**	**19**	**15**	**12**	**26**	**17**	**18**	**244**	**228**	**219**	**15**	**27**	**34**	**11**	**14**
Mid-cap																					
Ramco Cements **	12.5	13.0	14.5	SELL	70	1,169	0.9	12.3	11.0	8.7	31	20	14	122	117	105	16	19	50	14	17
Jk Lakshmi Cement	9.0	10.0	11.0	NR	34	572	1.5	14.5	9.2	6.2	36	22	11	90	81	73	28	53	82	12	20
Century Tex#	12.8	12.8	12.8	NR	58	974	16.2	16.1	12.3	NA	370	134	NA	136	136	136	NA	NA	NA	2	NA
JK Cement	10.8	10.8	10.8	NR	38	641	0.5	15.2	9.2	6.6	29	19	10	98	98	98	24	51	73	12	21
Birla Corp #	10.5	10.5	10.5	NR	30	494	0.2	9.7	6.8	4.8	18	11	7	45	45	45	14	42	56	11	14
India Cements	18.5	18.5	18.5	NR	22	361	4.4	6.8	5.8	4.8	(1,982)	11	6	46	46	46	11	19	NA	5	9
Total / Average	**82**	**84**	**86**		**44**	**726**	**3.6**	**14**	**10**	**6.5**	**102**	**35**	**10**	**98**	**96**	**93**	**18**	**41**	**65**	**10**	**18**
Small-Cap																					
Dalmia Bharat #@	13.7	18.0	18.0	NR	44	735	0.5	18.7	8.4	6.5	1,526	28	12	130	99	99	58	70	NA	5	11
Orient Cement	5.0	8.0	9.0	BUY	31	519	0.6	12.4	8.5	5.8	17	17	10	125	78	69	34	46	28	19	25
OCL India	6.7	6.7	6.7	NR	26	427	1.7	8.0	6.6	5.0	24	17	10	66	66	66	16	26	50	12	18
Mangalam Cement	3.5	3.5	3.5	NR	6	97	0.3	10.4	6.2	4.4	35	10	6	42	42	42	21	54	149	11	19
Sagar Cement	2.5	3.5	3.5	NR	6	101	0.1	NA	NA	NA	2	1	NA	40	28	28	NA	NA	NA	18	NA
Total / Average	**31**	**40**	**41**		**23**	**376**	**0.6**	**12**	**7**	**5**	**321**	**15**	**10**	**81**	**63**	**61**	**32**	**49**	**76**	**13**	**18**

Source: Bloomberg consensus, Ambit Capital research,

Note: We use Bloomberg reported EV as of today for calculation of EV/tonne. We take EV/EBITDA as reported by Bloomberg

** indicates December ending (CY09=FY10)*

^ Grasim owns 61% in Ultratech

 # We have not adjusted the numbers of these companies for the value of the non-cement business

*** Shree Cements: We value power assets of 400 MW (of the 560 MW) at ₹45 mn/MW adjust the same in the EV*

*** Madras Cements: We value windmill assets of 160MWat ₹35 mn/MW adjust the same in the EV*

@ Dalmia has acquired Adhunik Cement (Cap: 1.5mtpa) and Calcom (Cap: 1.3mtpa) during FY13. Our capacity number includes both

Assumptions Summary

Exhibit 74: Assumption summary

Particulars	CY14/FY15						CY15/FY16						CY16/FY17					
	ACC	Ambuja	UltraTech	Ramco	Shree	Orient	ACC	Ambuja	UltraTech	Ramco	Shree	Orient	ACC	Ambuja	UltraTech	Ramco	Shree	Orient
Capacity utilisation (%)	80.5	77	75.2	47.9	87.4	87.4	77.5	76.5	76.3	48.8	80.8	69.4	75.9	74.5	81	51.4	85.8	74.4
Cement despatches (mn tonnes)	24.2	21.7	44.8	7.7	16.2	4.4	24.5	22.1	48.9	8.1	18.4	5.6	25.7	23.2	54.7	8.6	21.5	6.7
Cement Realisation (₹/tonne)	4,649	4,551	4,122	4,612	4,044	3,752	4,882	4,746	4,369	4,935	4,206	4,089	5,175	4,843	4,653	5,231	4,458	4,416
EBITDA (₹/tonne)	608	891	911	973	727	704	667	1,016	1,112	1,202	995	893	846	1,115	1,244	1,325	1,171	1,034
Net Revenue (₹ mn)	117,382	99,821	229,371	35,365	63,209	16,456	125,435	106,195	265,438	39,732	76,539	22,755	136,037	123,832	315,374	45,065	93,406	29,651
EBITDA (₹ mn)	14,896	19,323	41,950	7,920	13,208	3,136	16,432	22,474	54,327	10,488	19,404	5,013	21,734	25,891	68,200	12,404	26,680	6,990
EBITDA margin (%)	12.7	19.4	18.3	22.4	20.9	19.1	13.1	21.2	20.5	26.4	25.4	22	16	20.9	21.6	27.5	28.6	23.6
Adj PAT (₹ mn)	8,414	12,855	20,087	2,424	4,165	1,726	8,780	14,498	26,939	3,806	10,130	1,972	12,278	16,467	35,822	5,091	13,541	2,954
RoIC (%)	14.2	21.9	11.3	7.9	18.8	8.4	12.7	21.2	12.4	9.3	32.7	9.6	15.5	21.6	14.4	11.6	32.5	14.4
RoCE (%)	10.6	12.3	9.1	7.1	8.7	21.4	10.3	12.8	10.5	8	17.2	16.2	13.3	13.5	12.4	9.5	19.7	15.3
YoY change																		
Capacity utilisation (bps)	1.2	1.3	0.2	-16.3	-11	6	-3.8	-0.6	1.5	1.8	-7.6	-20.6	-1.4	-0.8	69.1	-41.2	-1.9	-3.9
Cement despatches (%)	1.2	3	8.7	-10.7	13.5	4.1	1	2	9	5	13.6	27	18.4	-48.2	613.9	-46.7	390.7	-72.6
Cement Realisation (%)	10.6	8.2	4.1	11.1	-2.1	10.2	5	4.3	6	7	4	9	13.7	17.5	0.9	29.3	18.8	-9.5
Unitary EBITDA (%)	-5.7	13.6	-1.5	64.3	-14.6	37.7	9.6	14	22	23.6	36.8	26.8	-5	22.4	27.8	82.2	66.4	55.2
Net Revenue (%)	5.1	9	13.1	-0.8	7.4	14.4	6.9	6.4	15.7	12.4	21.1	38.3	36.3	-46	791.8	-28.7	467.6	-76.4
EBITDA (%)	-4.2	17.1	9.9	40.7	-5	46	10.3	16.3	29.5	32.4	46.9	59.9	12.5	-38.3	761.1	-6.1	750.9	-57.5
EBITDA margin (bps)	-124	134	-54	660	-271	413	41	181	218	400	446	298	-338	262	-77	663	951	1,048
PAT (%)	-6.8	24.9	-6.3	76	-52	70.9	4.4	12.8	34.1	57	143.2	14.2	-4.5	-18	1,378.00	22.2	684.5	-66.4
RoIC (pps)	-18	8	-100	23	-53	71	-10	-3	9	18	74	14	-29	91	81	-38	285	14
RoCE (bps)	-12	12	-100	10	-52	78	-3	5	15	14	96	-24	8	49	75	8	-8	48

Source: Ambit Capital research

UltraTech

An expensive proxy to an elusive recovery

(UTCEM IN, mcap US$11.9bn, SELL, TP ₹2,337, 16% downside)

UltraTech is viewed as a proxy play to the cement demand recovery in India, as it is the only pan-India player which has the scale, surplus capacities and exposure to the institutional segment to benefit from the cement volume uptick. Prima-facie, it appears to be a reasonable assumption, but despite all these things working, UltraTech's poor capital discipline in pursuance of expansions will keep RoCEs suppressed for the next 2-3 years even if recovery was to sharp and swift. Despite continued expansions, UltraTech's volume growth has lagged industry average and regional peers for the last three years—4% vs 10%/8% for Shree/Orient. Despite focusing on improving fuel mix, new capacities and network expansion, its unitary costs are one of the highest in the industry, and more importantly the highest amongst large players. Its FY09-14 cross-cycle EBITDA average of ₹1,060/tonne is similar to large peers average and lower than Shree. Its capacity expansion cost has been amongst the highest in the industry over the last ten years: ₹6,864/tonne vs ₹5,400-₹5,900 for Shree, ACC and Ambuja. Continued high cost expansions and acquisitions will establish industry-leading scale but at low (sub-15%) incremental RoCEs.

Changes to assumptions

We reduce our FY16 and FY17 volume growth estimate by 6% and 3%, respectively (still building in 9%/12% volume growth in FY16/FY17), as demand has further deteriorated in India and we see little visibility of a near-term improvement. Moreover, we reduce our realisation growth assumption marginally (by 1-2%) and now build in 6-6.5% realisation growth in FY16-17. Our EBITDA/tonne estimate stands reduced by 1-2% and EBITDA by 5-6% over FY16-17E. Our estimates imply 21%/35% unitary EBITDA/EBITDA CAGR over FY15-18E.

Exhibit 75: Change in estimates

₹ mn unless mentioned	New Estimates		Old Estimates		Change		Comments
	FY16E	FY17E	FY16E	FY17E	FY16E	FY17E	
Utilisation (%)	76.3	81.0	81.2	85	(486)	(363)	We reduce our volume growth estimate in both FY16 and FY17 as demand has further deteriorated in India and we see little visibility of significant volume improvement in the next 12-18 months
Despatches (mn tonnes)	48.9	54.7	52.0	57.2	(6.0)	(4.3)	
Realisation (₹/tonne)	5,366	5,683	5,404	5,735	(0.7)	(0.9)	We marginally cut realisation estimate owing to weak pricing across India (barring south)
EBITDA (₹/tonne)	1,112	1,244	1,120	1,266.1	(0.8)	(1.8)	Decrease in EBITDA/tonne is largely on account of reduction of realisation estimates
Revenues (₹ mn)	265,438	315,374	284,352	332,565	(6.7)	(5.2)	Decrease in revenue is a function of marginal decrease realisations
EBITDA (₹ mn)	54,327	68,200	57,490	72,552	(5.5)	(6.0)	Lower volume and realisation estimate leading to cut in EBITDA estimates
PBT	37,942	50,453	41,225	54,997	(8.0)	(8.3)	
PAT (₹ mn)	26,939	35,822	29,270	39,048	(8.0)	(8.3)	Lower PAT is on account of reduction in EBITDA estimates
EPS (₹ mn)	98	131	107	142	(8.0)	(8.3)	Lower PAT is on account of reduction in EBITDA estimates
RoIC (%)	12.2	14.2	12.7	15	(51)	(95)	Reduction in profitability ratios is on account of reduction in unitary EBITDA
RoCE (%)	10.5	12.4	11.5	14	(101)	(116)	
RoE (%)	13.5	15.9	14.6	17	(115)	(124)	
Target Price		2,337		2,337		0.0%	Target price remains unchanged due to roll-over of estimates and increase in FY18 growth rates owing to prolonged cement demand recovery

Source: Company, Ambit Capital research

Valuation – Leadership at an expensive price

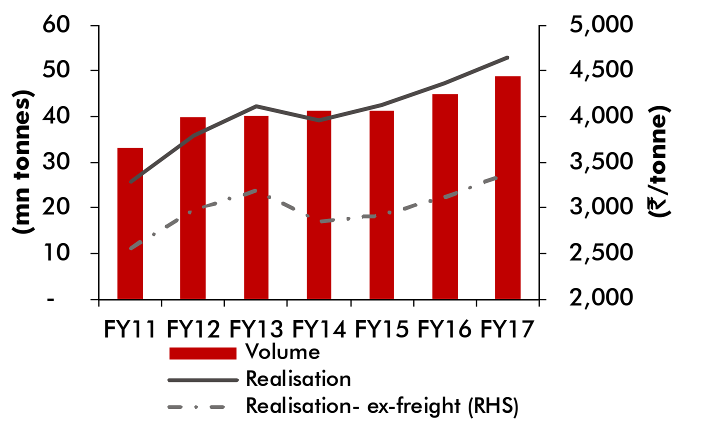
The stock is trading at 13.8x one-year EBITDA (a 40% premium to its last five-year average). Given its low efficiency and poor capital discipline (and hence low RoCEs), we believe the expensive valuations are not justified; our DCF-based target price of ₹2,337 implies 10.1x FY17E exit EBITDA.

Exhibit 76: Ambit vs consensus

	Consensus	Ambit	Divergence	Comments
Revenue (₹ mn)				
FY16	272,251	265,438	-3%	Our estimates are marginally higher than consensus as we expect sharp volume growth and better pricing
FY17	322,754	315,374	-2%	
EBITDA (₹ mn)				
FY16	56,539	54,327	-4%	Higher than consensus EBITDA in FY16 is on account of higher realisation estimates
FY17	72,955	68,200	-7%	
PAT (₹ mn)				
FY16	29,508	26,939	-9%	**Higher EBITDA leads to our PAT being higher than consensus**
FY17	40,200	35,822	-11%	

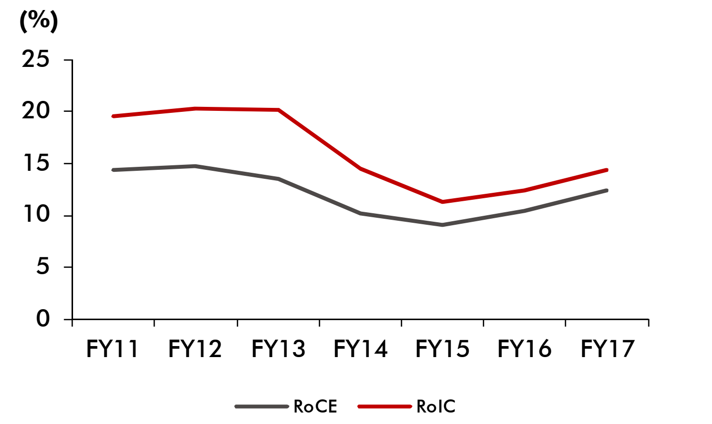
Source: Company, Ambit Capital research

Exhibit 77: Building in 9%/12% volume growth in FY16/FY17



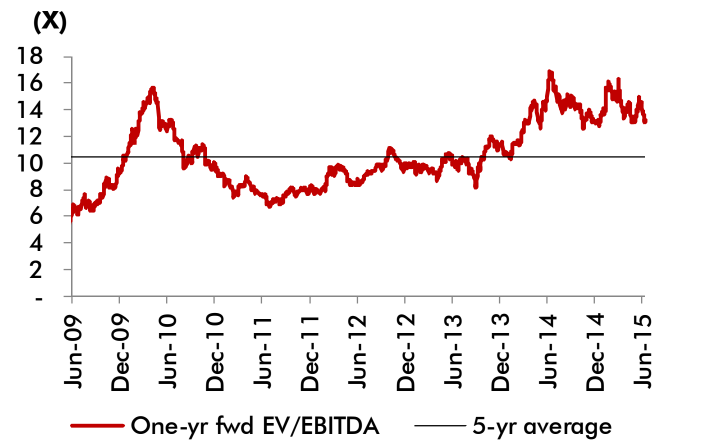
Source: Company, Ambit Capital research

Exhibit 78: RoCE expansion will be gradual and much below previous highs



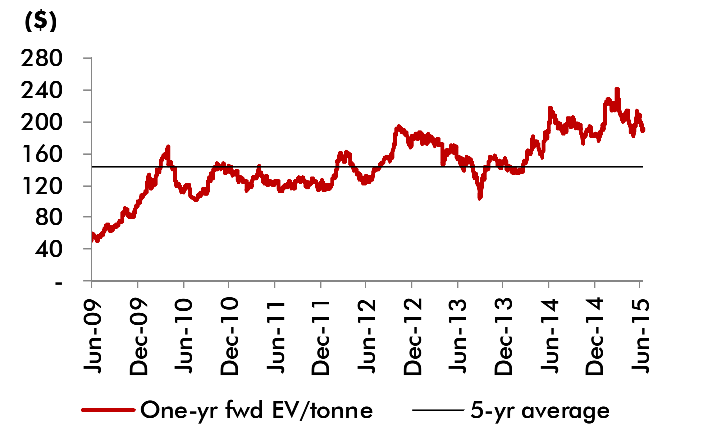
Source: Company, Ambit Capital research

Exhibit 79: UltraTech is trading at a 35% premium to five-year average EV/EBITDA...



Source: Company, Ambit Capital research

Exhibit 80: ...and 30% premium to five-year average EV/tonne



Source: Company, Ambit Capital research

Balance sheet

Year to March (₹ mn)	FY14	FY15E	FY16E	FY17E
Networth	170,975	188,570	210,881	240,548
Loans	51,993	74,140	75,140	72,140
Sources of funds	**245,926**	**290,630**	**313,941**	**340,608**
Net block	158,718	209,787	232,518	243,597
Capital work-in-progress	20,416	20,416	20,416	20,416
Investments	53,917	52,087	52,087	52,087
Current Assets	64,489	69,850	67,659	93,666
Current liabilities and provisions	51,613	61,511	58,740	69,158
Net current assets	12,875	8,339	8,919	24,508
Application of funds	**245,927**	**290,629**	**313,941**	**340,608**

Source: Company, Ambit Capital research

Income statement

Year to March (₹ mn)	FY14	FY15E	FY16E	FY17E
Revenue	202,798	229,371	265,438	315,374
Total expenses	164,619	187,421	211,112	247,174
EBITDA	38,179	41,950	54,327	68,200
Net depreciation / amortisation	10,523	11,331	13,247	14,847
EBIT	27,656	30,619	41,080	53,353
PBT	27,755	28,802	37,942	50,453
Adjusted PAT	21,445	20,087	26,939	35,822
EPS diluted (₹)	78.2	73.3	98.2	130.6

Source: Company, Ambit Capital research

Cash flow statement

Year to March (₹ mn)	FY14	FY15E	FY16E	FY17E
PBT	27,755	28,802	37,942	50,453
Change in working capital	685	600	(5,410)	(4,120)
Direct taxes paid	(6,584)	(3,754)	(11,003)	(14,631)
CFO	32,416	38,796	39,090	50,974
Net capex	(22,187)	(62,400)	(35,977)	(25,926)
CFI	(22,096)	(46,618)	(32,398)	(22,198)
Proceeds from borrowings	(2,092)	22,147	1,000	(3,000)
CFF	(8,973)	7,187	(10,346)	(15,782)
Net increase in cash	**1,347**	**(635)**	**(3,653)**	**12,994**
FCF	**10,229**	**(23,604)**	**3,113**	**25,049**

Source: Company, Ambit Capital research. Note: The cash flow statement of FY14 is based on our estimates, as the company has not reported the numbers.

Ratio analysis / Valuation parameters

Year to March	FY14	FY15E	FY16E	FY17E
EBITDA margin	18.8	18.3	20.5	21.6
RoCE	10.1	9.1	10.5	12.4
RoE	13.3	11.2	13.5	15.9
P/E (x)	34.6	37.0	27.6	20.7
Debt/Equity(x)	0.3	0.4	0.4	0.3
EV/EBITDA(x)	19.7	18.0	14.5	11.6
EV/tonne(₹)	13,283	12,051	12,037	11,345

Source: Company, Ambit Capital research

Ambuja Cement

Not so premium anymore

(ACEM IN, mcap US$5.4bn, SELL, TP ₹207, 7% downside)

Ambuja, a cement behemoth of the past, is losing its sheen, as limited expansion is dragging market share and volume growth. Recently, the company has started undercutting pricing (its key competitive advantage) to grow volumes in key markets. The company's market share dropped to 8.4% in CY14 vs 10.1% in CY07 and it has grown slower than the industry continuously for the last 6 years (3.5% volume CAGR over CY09-14 vs 7% industry volume CAGR). Significant increase in industry-wide capacities (up 40% over CY09-14) amidst Ambuja's minimal additions (up 12%) would lead to continued loss of market share and lower growth than industry for at least the next two years. Moreover, significant retail client dependence at a time when institutional demand would be a major demand growth constituent would also hinder growth rates. Alongside, little clarity on the timeline and terms for the Indian entities of the global Holcim-Lafarge merger is an added risk.

Changes to assumptions

We reduce our CY15 and CY16 volume growth estimate by 5% and 3%, respectively, given the sharp volume decline in 1Q and continued demand challenges in north and west India. We currently build in 2%/5% volume growth in CY15/CY16. We assume 6% realisation growth both in CY15 and CY16. Our EBITDA/tonne estimate is ₹1,016/1,1115 over CY15/CY16. Our estimates imply 17%/14% unitary EBITDA/EBITDA CAGR over FY15-18.

Exhibit 81: Change in estimates

₹ mn unless mentioned	New Estimates		Old Estimates		Change (%)		Comments
	CY15E	CY16E	CY15E	CY16E	CY15E	CY16E	
Utilisation (%)	76.5	74.5	80.9	81	(436)	(650)	We reduce our volume estimates for Ambuja, as our recent channel checks suggest extremely weak volumes in north and west India
Despatches (mn tonnes)	22.2	25.4	23.5	26.0	(5.4)	(2.3)	
Realisation (₹/tonne)	4,833	5,123	4,833	5,123	-	-	We reduce our realisation estimates on account of weak pricing discipline in recent months
EBITDA (₹/tonne)	1,016	1,115	1,036	1,202	(1.9)	(7.3)	Although we reduce realisations, we increase unitary EBITDA due to reduction in power and fuel and freight costs
Revenues (₹ mn)	106,195	123,832	111,389	129,903	(4.7)	(4.7)	Reduction in revenue is on account of lower volumes and realisations
EBITDA (₹ mn)	22,474	25,891	24,205	30,351	(7.1)	(14.7)	Reduction in EBITDA has been on account of lower volumes
PBT (₹ mn)	20,711	23,693	22,473	28,328	(7.8)	(16.4)	
PAT (₹ mn)	14,498	16,467	15,731	19,688	(7.8)	(16.4)	Reduction in PAT is on account of lower EBITDA
EPS(₹)	9.4	10.7	10.2	12.8	(7.8)	(16.4)	Reduction in PAT is on account of lower EBITDA
RoIC (%)	21.2	21.6	23.0	26	(177)	(424)	
RoCE (%)	12.8	13.5	13.9	16	(105)	(244)	Reduction in profitability is a function of reduction in EBITDA/tonne
RoE (%)	13.5	14.2	14.6	17	(110)	(254)	
Target Price		208		208		0.0%	

Source: Company, Ambit Capital research

Valuation – Paying a premium for a weakening franchise

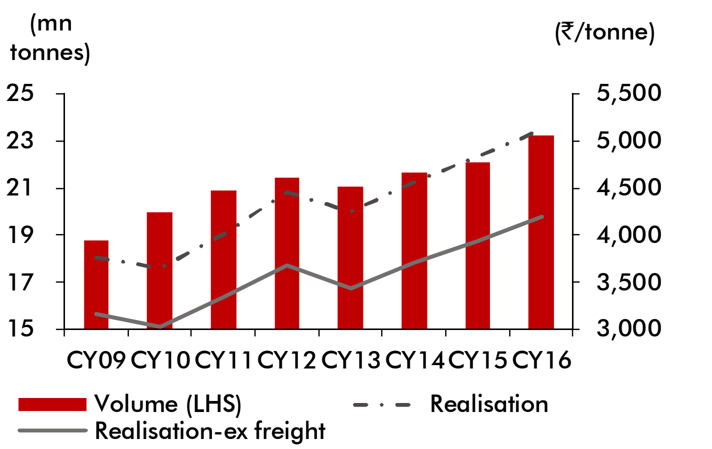
Ambuja is trading at 12.4x one-year forward EBITDA, a 40% premium to its five-year average. We find the valuations rich; we build in an optimistic 17% EBITDA CAGR over CY14-16, yet RoCEs will remain low at 13.8-14.5% vs five-year average of 16.5% and previous peaks of 25-28% over CY06-09. Our target price of ₹208 implies a rich 10.7x CY16E EBITDA.

Exhibit 82: Ambit vs consensus

	Consensus	Ambit	Divergence	Comments
Revenue (₹ mn)				
FY16	272,251	265,438	-3%	Our estimates are marginally higher than consensus, as we expect sharp volume growth and better pricing
FY17	322,754	315,374	-2%	
EBITDA (₹ mn)				
FY16	56,539	54,327	-4%	Higher than consensus EBITDA in FY16 is on account of higher realisation estimates
FY17	72,955	68,200	-7%	
PAT (₹ mn)				
FY16	29,508	26,939	-9%	Higher EBITDA leads to our PAT being higher than consensus
FY17	40,200	35,822	-11%	

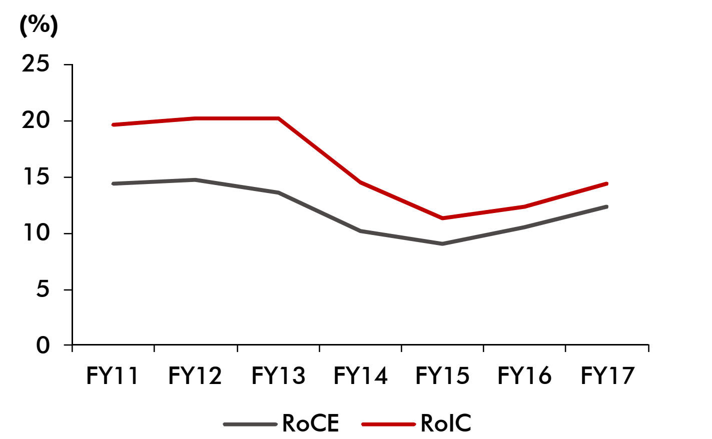
Source: Company, Ambit Capital research

Exhibit 83: Volume growth to remain in low single digits



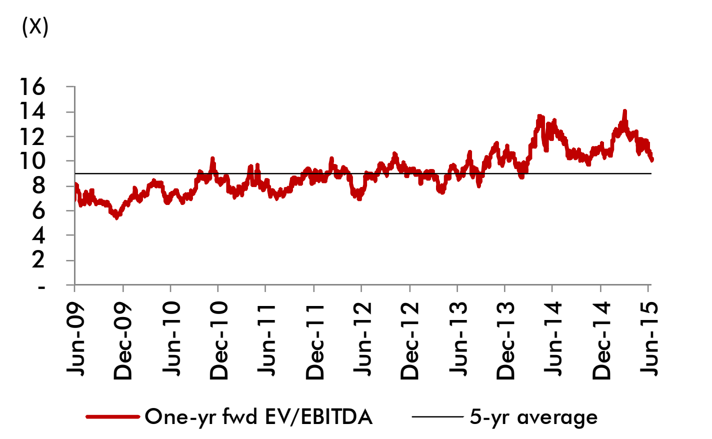
Source: Company, Ambit Capital research

Exhibit 84: RoCE will remain suppressed



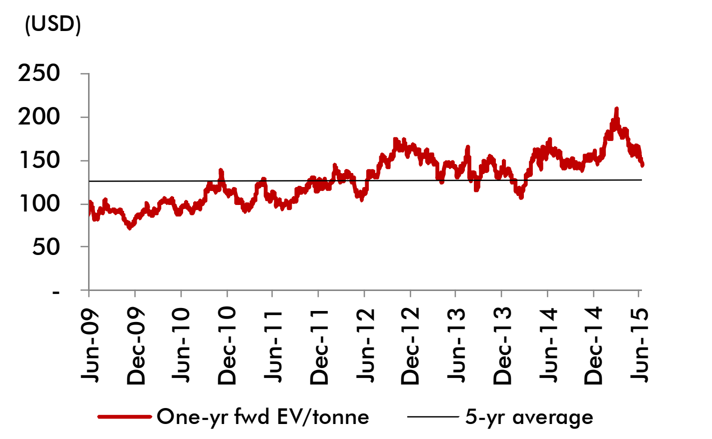
Source: Company, Ambit Capital research

Exhibit 85: Ambuja is trading a 15% premium to five-year average consensus EV/EBITDA…



Source: Bloomberg ,Company, Ambit Capital research

Exhibit 86: …and a 10% premium of five-year average EV/tonne



Source: Bloomberg ,Company, Ambit Capital research

Balance sheet

Year to December (₹ mn)	CY13	CY14	CY15E	CY16E
Total Networth	**94,855**	**102,852**	**111,538**	**120,461**
Sources of funds	**100,904**	**108,496**	**117,182**	**126,106**
Net block	60,625	72,532	84,271	88,631
Investments	17,885	17,885	17,885	17,885
Cash and bank balances	23,411	23,455	20,849	26,070
Total Current Assets	44,438	44,787	43,543	52,533
Current liabilities and provisions	28,994	33,658	35,467	39,893
Net current assets	15,444	11,129	8,076	12,639
Application of funds	**100,904**	**108,496**	**117,182**	**126,105**

Source: Company, Ambit Capital research

Income statement

Year to December (₹ mn)	CY13	CY14	CY15E	CY16E
Revenue	91,604	99,821	106,195	123,832
Total expenses	75,096	80,497	83,720	97,941
EBITDA	16,507	19,323	22,474	25,891
Net depreciation / amortisation	4,901	5,258	5,770	6,377
EBIT	11,607	14,065	16,705	19,513
PBT	15,140	18,364	20,711	23,693
Adjusted PAT	10,289	12,855	14,498	16,467
EPS diluted (₹)	6.7	8.4	9.4	10.7

Source: Company, Ambit Capital research

Cash flow statement

Year to December (₹ mn)	CY13	CY14	CY15E	CY16E
PBT	15,141	18,364	20,711	23,693
Change in working capital	446	3,481	(507)	(1,075)
Direct taxes paid	(5,101)	(5,509)	(6,213)	(7,226)
CFO	**12,003**	**17,295**	**15,755**	**17,589**
Capex	(6,884)	(17,165)	(17,509)	(10,737)
CFI	**(4,736)**	**(12,867)**	**(13,502)**	**(6,558)**
Dividends paid	(6,467)	(4,858)	(5,811)	(7,544)
CFF	**(6,258)**	**(5,263)**	**(5,811)**	**(7,544)**
Net increase in cash	**1,010**	**(835)**	**(3,559)**	**3,488**
FCF	**5,120**	**130**	**(1,754)**	**6,852**

Source: Company, Ambit Capital research. Note: The cash flow statement of FY14 is based on our estimates, as the company has not reported the numbers.

Ratio analysis / Valuation parameters

	CY13	CY14	CY15E	CY16E
EBITDA margin	18.0	19.4	21.2	20.9
RoCE	11.0	12.3	12.8	13.5
RoE	14.2	13.0	13.5	14.2
P/E (x)	33.2	26.5	23.5	20.7
P/B (x)	3.6	3.3	3.1	2.8
EV/EBITDA (x)	17.9	15.3	13.2	11.5
EV/tonne (₹)	10,485	10,469	10,027	9,106

Source: Company, Ambit Capital research

ACC

No respite from growth challenges

(ACC IN, mcap US$4.1bn, SELL, TP ₹1,241, 12% downside)

ACC has the lowest EBITDA/tonne amongst the top-4 cement manufacturers (9-14% lower over FY10-15) and expectations of efficiency-led cost savings have failed to yield tangible results yet (12% increase in unitary operating costs in CY14). Alongside, lack of capacity expansions and high retail exposure will restrict ACC's volume growth especially in an infrastructure-spending-driven cement demand recovery. Rising competition from regional manufacturers in north and west India and rising threat from new entrants in east India will lead to continued market share loss and restrict unitary EBITDA and RoCE growth.

Change in assumptions

We reduce our volume growth estimate to 1%/5% in CY15/CY16 vs 6%/8% estimated earlier, given a sharp decline in 1Q volumes and poor visibility of a near-term demand improvement. We build in 5%/6% realisation increase in CY15/CY16 which also hinges on pricing discipline. Our estimates imply 17% unitary EBITDA CAGR and 21% EBITDA CAGR over CY14-16E. We expect EBITDA/tonne to improve to ₹667 in CY15 and ₹846 in CY16 and RoCE of 8-10% in CY15-16 vs 7.5% in CY14.

Exhibit 87: Change in estimates

₹ mn unless mentioned	New Estimates		Old Estimates		Change (%)		Comments
	CY15E	CY16E	CY15E	CY16E	CY15E	CY16E	
Utilisation (%)	77.5	75.9	81.3	82.0			We cut our volume growth estimate to account for weaker-than-expected demand across India.
Despatches (mn tonnes)	24.5	25.7	25.7	27.7	-4.7%	-7.4%	
Realisation (₹/tonne)	4,587	5,184	4,809	5,097	-4.6%	1.7%	Reduce realisation assumptions given poor pricing discipline in recent months.
EBITDA (₹/tonne)	667	846	795	860	-16%	-2%	Reduction in EBITDA/tonne largely a function of lower realisation than earlier anticipated.
Revenues (₹ mn)	125,435	136,037	133,279	153,115	-6%	-11%	Reduction in revenue is on account of lower volume and realisation estimates.
EBITDA (₹ mn)	16,432	21,734	20,565	25,287	-20.1%	-14.1%	Decline in EBITDA is on account of cut in EBITDA/tonne and volumes.
PBT (₹ mn)	12,888	17,920	16,617	20,880	-22.4%	-14.2%	
PAT (₹ mn)	8,780	12,278	11,549	14,512	-24%	-15%	Decrease in PAT is on account of lower EBITDA.
EPS	46.8	65.4	62	77	-24%	-15%	
RoIC (%)	12.6	15.4	17.4	18.2	(475)	(278)	
RoCE (%)	8.3	10.8	10.9	12.8	(262)	(202)	Reduction in EBITDA estimates has led to drop in profitability ratios.
RoE (%)	10.3	13.3	13.5	15.4	(323)	(214)	
TP	1,241		1,241		0.0%		

Source: Company, Ambit Capital research

Valuation – Premium valuation despite low profitability

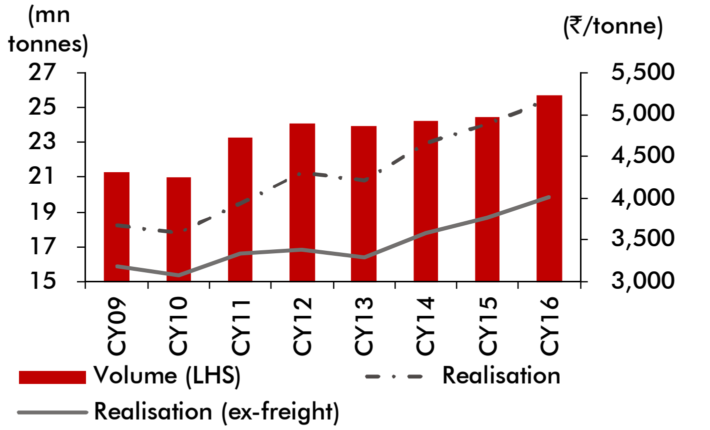
ACC's RoCE declined to 7.5% in CY14 vs 9% in CY13 and its five-year average of 17%. We expect only a marginal improvement to 8-10% in CY14/CY15. ACC is currently trading at 12.4x one-year forward EBITDA (a 35% premium to five-year average), despite materially lower RoCE than historical averages. We build in favourable volume and realisation growth and sharp rebound in EBITDA/tonne for the next two years and an 18% CFO CAGR over CY15-24. Despite such optimistic assumptions, our DCF model fails to justify the currently rich valuations. Our fair valuation of ₹1,241 implies 9.5x CY16E EBITDA.

Exhibit 88: Ambit vs consensus

	Consensus	Ambit	Divergence	Comments
Revenue (₹ mn)				
CY15	125,734	125,435	0%	Our estimates are lower than consensus on revenues, as we expect a prolonged demand recovery and poor pricing growth
CY16	143,297	136,037	-5%	
EBITDA (₹ mn)				
CY15	18,492	16,432	-11%	Lower realisation growth assumptions lead to lower than consensus EBITDA assumptions
CY16	22,482	21,734	-3%	
PAT (₹ mn)				
CY15	11,744	8,780	-25%	Lower EBITDA leads to lower PAT estimates
CY16	15,454	12,278	-21%	

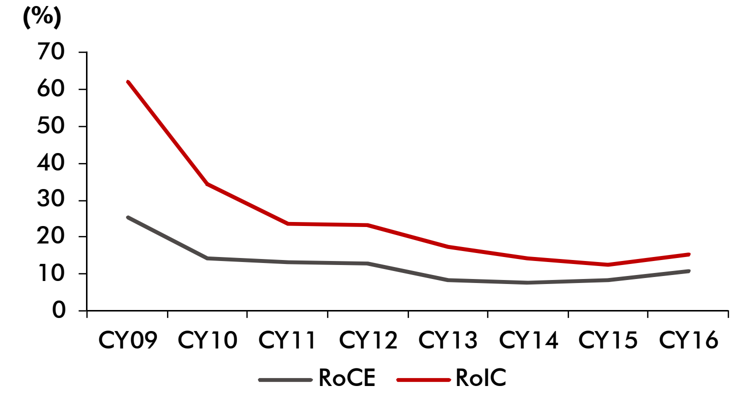
Source: Company, Ambit Capital research

Exhibit 89: Expect only marginal volume growth in CY15 and 5% volume growth in CY16



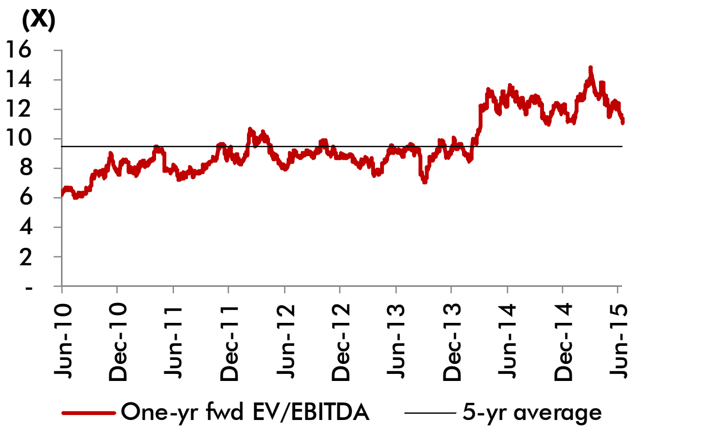
Source: Company, Ambit Capital research

Exhibit 90: RoCE continues to slide



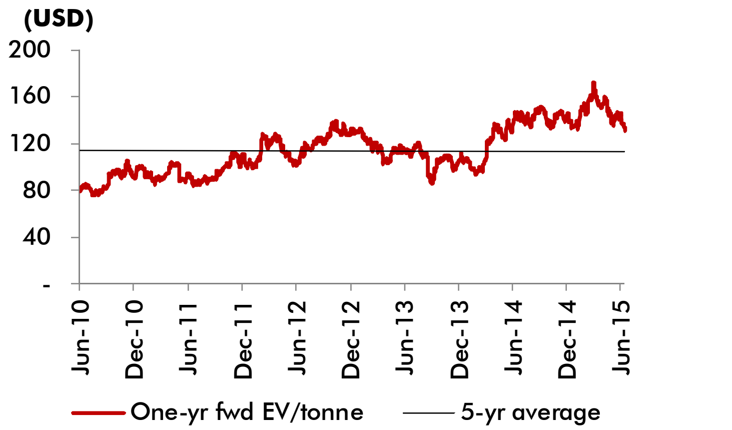
Source: Company, Ambit Capital research

Exhibit 91: ACC trades at 15% premium to five-year average consensus EV/EBITDA…



Source: Bloomberg, Company, Ambit Capital research

Exhibit 92: …and 12% premium on five-year average EV/tonne



Source: Bloomberg, Company, Ambit Capital research

Balance sheet

Year to December (₹ mn)	CY13	CY14	CY15E	CY16E
Total Networth	**76,446**	**82,356**	**88,005**	**95,731**
Sources of funds	**84,245**	**87,712**	**93,344**	**101,070**
Net block	61,671	55,984	75,915	79,712
Capital work-in-progress	10,000	19,146	5,000	7,000
Investments	25,535	15,730	15,909	15,909
Total Current Assets	30,062	35,853	26,061	30,917
Current liabilities and provisions	41,121	39,002	29,542	32,468
Net current assets	(11,060)	(3,148)	(3,481)	(1,551)
Application of funds	**84,245**	**87,712**	**93,344**	**101,070**

Source: Company, Ambit Capital research

Income statement

Year to December (₹ mn)	CY13	CY14	CY15E	CY16E
Revenue	111,689	117,382	125,435	136,037
Total expenses	96,135	102,486	109,003	114,303
EBITDA	15,555	14,896	16,432	21,734
Net depreciation / amortisation	5,646	5,576	5,500	6,299
EBIT	9,909	9,320	10,932	15,434
PBT	11,745	11,352	12,451	17,029
Adjusted PAT	9,025	8,414	8,477	11,658
EPS basic (₹)	48.1	44.8	45.2	62.1

Source: Company, Ambit Capital research

Cash flow statement

Year to December (₹ mn)	CY13	CY14	CY15E	CY16E
PBT	11,745	11,352	12,274	16,852
Change in working capital	6,140	417	(362)	922
Direct taxes paid	(2,690)	(2,354)	(3,815)	(5,194)
CFO	19,004	13,317	12,432	17,638
Capex	(15,566)	(15,244)	(11,285)	(12,096)
CFI	(13,328)	(14,367)	(9,943)	(10,677)
Dividends paid	(6,407)	(7,530)	(3,004)	(4,109)
CFF	(5,839)	(8,371)	(3,184)	(4,109)
Net increase in cash	(162)	(9,421)	(695)	2,852
FCF	**3,439**	**(1,927)**	**1,146**	**5,543**

Source: Company, Ambit Capital research.

Ratio analysis / Valuation parameters

	CY13	CY14	CY15E	CY16E
EBITDA margin	13.9	12.7	13.1	16.0
RoCE	8.4	7.6	8.4	11.0
RoE	12.0	10.6	10.0	12.7
P/E (x)	29.2	31.3	31.1	22.6
P/B (x)	3.4	3.2	3.0	2.7
EV/EBITDA (x)	15.1	16.6	15.1	11.4
EV/tonne (₹)	7,786	8,223	7,498	7,173

Source: Company, Ambit Capital research

Shree Cement

Where is the margin of safety?

(SRCM IN, mcap US$5.8bn, SELL, TP ₹9,157, 15% downside)

Shree Cement is undeniably the strongest cement franchise in north India, and given its cost efficiency, it will be the main beneficiary of an infrastructure-led cement demand revival in north India. However, consensus expectation of a strong and sustained EBITDA growth faces risks such as delayed infrastructure execution, slowdown in retail sales and poor pricing discipline in north India. Whilst Shree is certainly equipped to grow volumes ahead of the industry, as infrastructure demand increases in north India, we believe that increase in institutional sales will suppress realisation growth to 5-6% at best.

Changes to our assumptions

We reduce our volume growth estimate by 8%/5% in FY16/FY17, as demand remains extremely poor in north India. Despite the cut in our volume growth estimates, we build in a fairly high 14%/17% volume growth in FY16/FY17 (significantly higher than the industry and other peers). We reduce our realisation growth estimate over FY16-17 to 4-6% vs 6-8% estimated earlier.

Our estimates imply 27% unitary EBITDA CAGR and 42% EBITDA CAGR over FY15-17E. We expect EBITDA/tonne to improve to ₹995 in FY16E and ₹1,171 in FY17E. We expect RoCE to increase to 17-19% in FY16-17E vs 9% in FY15 (low due to high depreciation charge).

Exhibit 93: Change in estimates

₹ mn unless specified	Assumptions (new)		Assumptions (old)		Change (%)		Comments
	FY16E	FY17E	FY16E	FY17E	FY16E	FY17E	
Cement sales	18.4	21.5	20.0	22.5	-7.9%	-4.8%	We reduce our FY16 and FY17 volume growth estimate to account for weaker-than-expected demand in north India.
Capacity utilisation (%)	80.8	85.8	87.7	91.9	-692 bps	-614 bps	
Cement Realisation	3,741	3,973	3,988	4,271	-6.2%	-7.0%	Reduction in realisation assumption is on account of poor pricing discipline and low realisation growth in the last two quarters.
Operating costs	2,716	2,756	2,881	2,981	-5.7%	-7.5%	Reduce operating cost estimates owing to lower power and fuel cost.
EBITDA	995	1,171	1,081	1,250	-7.9%	-6.3%	Change in unitary EBITDA is largely driven by downward revision of realisation estimates.
Financials (₹ mn unless specified)							
Net Revenues	76,539	93,406	86,828	107,824	-11.9%	-13.4%	
EBITDA	19,404	26,680	24,708	33,888	-21.5%	-21.3%	Lower cement EBITDA is a function of downward revision in realisations.
EBITDA margin (%)	25.4	28.6	28.5	31.4	-310 bps	-287 bps	
Adjusted PBT	12,991	18,063	18,487	25,987	-29.7%	-30.5%	Reduction in PBT estimates is on account of lower cement EBITDA.
Adjusted PAT	10,133	13,547	14,420	19,490	-29.7%	-30.5%	Change in PAT is in line with PBT change.
Gross Block turnover	0.9	0.9	1.0	1.1	-12 bps	-16 bps	Keep capex estimate unchanged; however, lower CFO generation impacts FCF generation negatively.
RoCE	17.2	19.7	22.9	23.8	-575 bps	-408 bps	
Target price	9,157		9157		0%		Our target price remains unchanged despite change in earnings assumptions due to roll-over of our target price and increase in future growth estimates

Source: Company, Ambit Capital research

Valuation – Problem of plenty; upside possibilities scanty

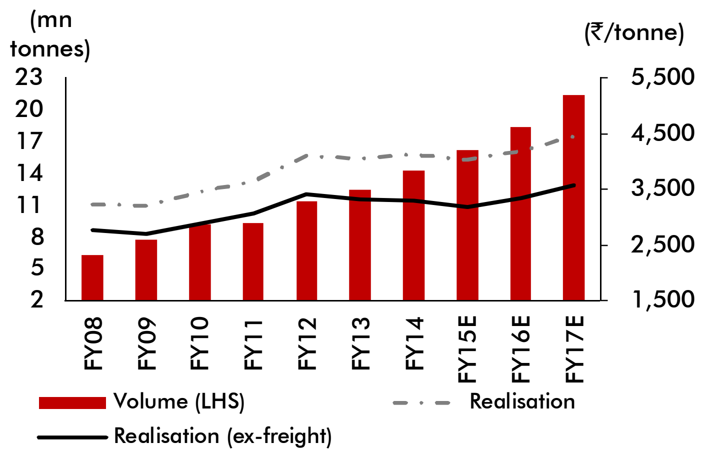
Shree is trading at industry-leading valuation (17.5x one-year forward EBITDA on our sub-consensus numbers) and it is amongst the most-expensive cement stocks in the world at US$240/tonne. Whilst Shree delivered strong earnings growth and profitability historically, as it graduates from a mid-sized to a large-sized entity, its logistic cost advantage of a single location could fade and RoCEs could stagnate (as the company deploys surplus cash in greenfield expansion). Against this backdrop and alongside rich valuations, we see little upside possibilities presently.

Exhibit 94: Ambit vs consensus

	Consensus	Ambit	Divergence	Comments
Revenue (₹ mn)				
FY16	82,666	76,539	-7%	Our estimates are lower than consensus on revenues, as we expect a prolonged demand recovery and poor pricing growth
FY17	98,565	93,406	-5%	
EBITDA (₹ mn)				
FY16	22,057	19,404	-12%	Lower realisation growth assumptions lead to lower than consensus EBITDA assumptions.
FY17	28,730	26,680	-7%	
PAT (₹ mn)				
FY16	11,486	10,130	-12%	Lower EBITDA leads to lower PAT estimates.
FY17	16,860	13,541	-20%	

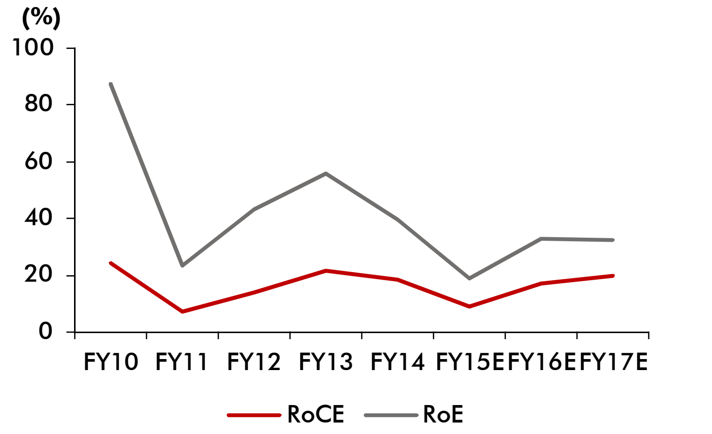
Source: Company, Ambit Capital research

Exhibit 95: Shree will continue to report strong volume growth owing to upcoming capacities



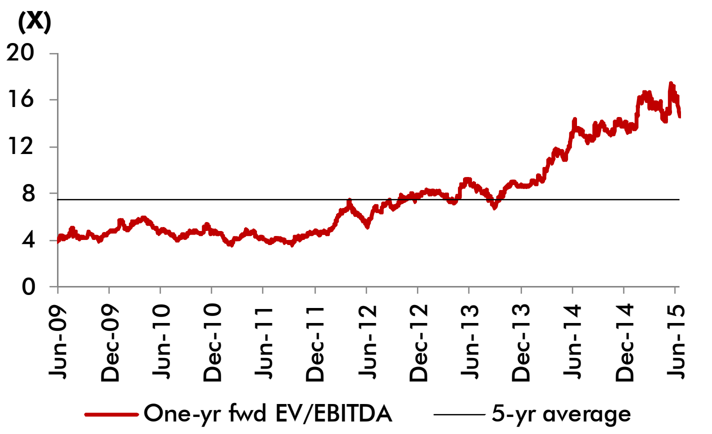
Source: Company, Ambit Capital research

Exhibit 96: RoCE improvement will be driven by rising utilisation of recently added capacities



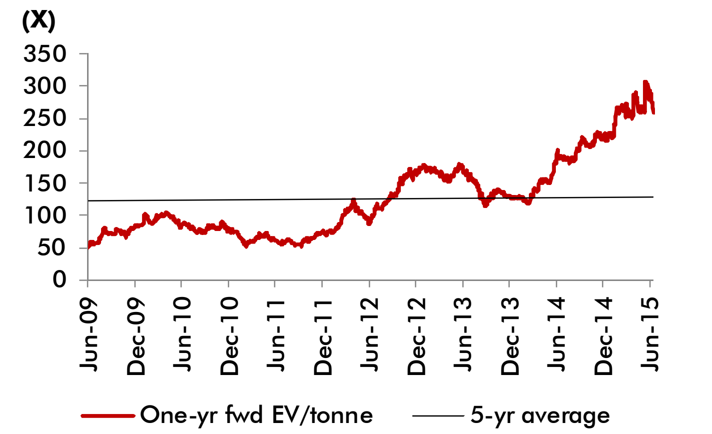
Source: Company, Ambit Capital research

Exhibit 97: Shree is trading at a significant premium to its five-year average consensus EV/EBITDA…



Source: Bloomberg, Company, Ambit Capital research

Exhibit 98: ..and five-year average EV/tonne



Source: Bloomberg, Company, Ambit Capital research

Balance sheet

Year to June (₹ mn)	FY14	FY15E	FY16E	FY17E
Total Networth	**47,109**	**50,693**	**59,056**	**69,765**
Deferred tax liability (net)	(1,429)	(1,429)	(1,429)	(1,429)
Sources of funds	**57,679**	**60,263**	**67,627**	**77,335**
Net block	21,938	24,056	33,247	42,214
Cash and bank balances	1,593	(2,161)	(4,641)	(3,579)
Total Current Assets	19,548	14,637	15,700	21,244
Current liabilities and provisions	13,408	12,442	14,816	17,820
Net current assets	6,140	2,195	884	3,424
Application of funds	**57,679**	**60,263**	**67,627**	**77,335**

Source: Company, Ambit Capital research

Income statement

Year to June (₹ mn)	FY14	FY15E	FY16E	FY17E
Revenue	58,873	63,209	76,539	93,406
Total expenses	44,975	50,001	57,135	66,726
EBITDA	13,898	13,208	19,404	26,680
Net depreciation	5,499	8,107	6,367	8,385
EBIT	8,399	5,101	13,037	18,295
Adj PBT	8,957	5,207	12,987	18,055
Consolidated adj PAT	8,678	4,165	10,130	13,541
EPS basic (₹)	249.1	119.6	290.8	388.7

Source: Company, Ambit Capital research

Cash flow statement

Year to December (₹ mn)	FY14	FY15E	FY16E	FY17E
PBT	8,152	5,207	12,987	18,055
Change in working capital	1,187	192	(1,169)	(1,479)
Direct taxes paid	(556)	(1,041)	(2,857)	(4,514)
CFO	**14,007**	**13,701**	**16,418**	**21,433**
Capex	(15,829)	(14,636)	(15,042)	(15,552)
CFI	**(12,340)**	**(14,636)**	**(15,042)**	**(15,552)**
Dividends paid	(895)	(581)	(1,766)	(2,833)
CFF	**(1,558)**	**(2,818)**	**(3,856)**	**(4,819)**
Net increase in cash	**109**	**(3,753)**	**(2,480)**	**1,062**
FCF	**(1,822)**	**(935)**	**1,376**	**5,881**

Source: Company, Ambit Capital research.

Ratio analysis / Valuation parameters

	FY14	FY15E	FY16E	FY17E
EBITDA margin	23.6	20.9	25.4	28.6
RoCE	18.3	8.7	17.2	19.7
RoE	20.3	8.5	18.5	21.0
P/E (x)	33.1	22.3	38.3	28.7
P/B (x)	8.2	7.7	6.6	5.6
EV/EBITDA (x)	27.1	28.7	19.5	14.2
EV/tonne (₹)	17,908	17,908	15,806	14,567

Source: Company, Ambit Capital research

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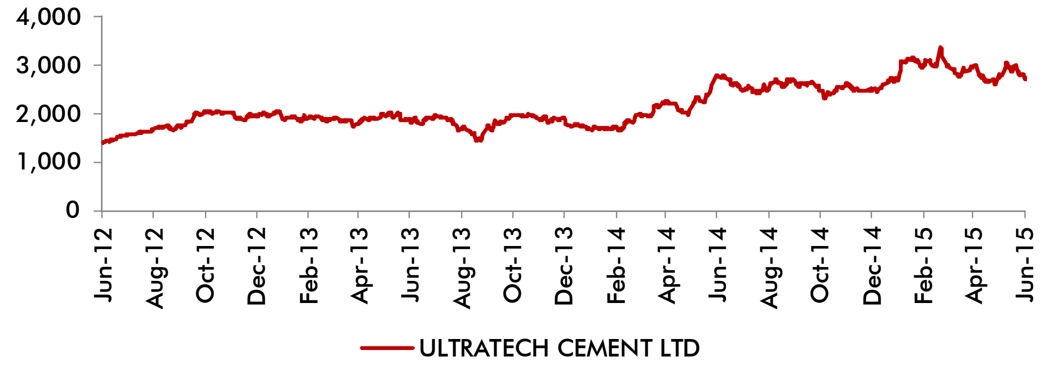
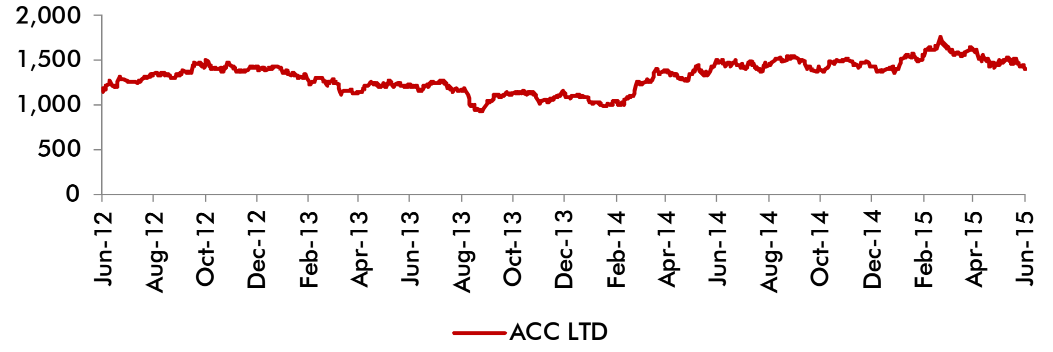
E&C = Engineering & Construction

Ultratech Cement Ltd (UTCEM IN, SELL)



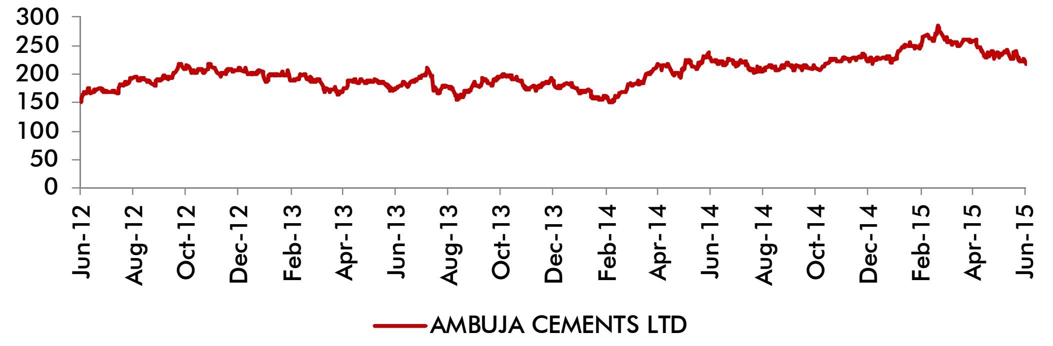
Source: Bloomberg, Ambit Capital research

ACC Ltd (ACC IN, SELL)



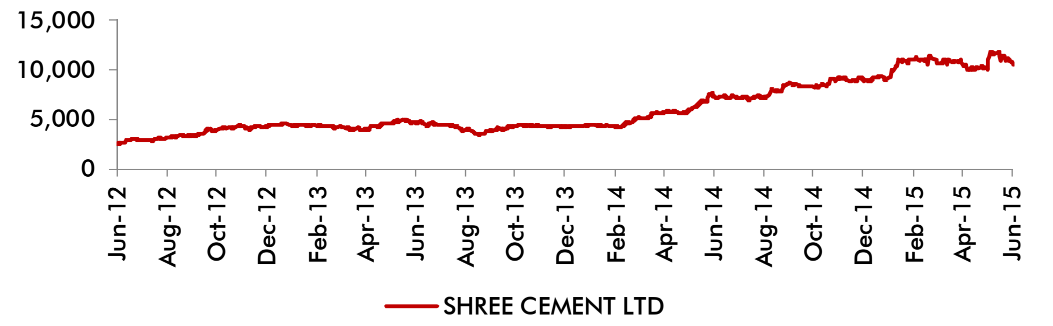
Source: Bloomberg, Ambit Capital research

Ambuja Cements Ltd (ACEM IN, SELL)



Source: Bloomberg, Ambit Capital research

Shree Cement Ltd (SRCM IN, SELL)



Source: Bloomberg, Ambit Capital research

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SELL	$\leq$10%
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UNDER REVIEW	We will revisit our recommendation, valuation and estimates on the stock following recent events
NOT RATED	We do not have any forward looking estimates, valuation or recommendation for the stock

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