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UPDATE

BSE-30: 38,961

Price euphoria beginning to reverse, more cuts to come. Our channel checks with dealers suggest that cement price hikes, which started in April, have failed to sustain and started softening. All-India cement prices in June 2019 have corrected by 2% mom (Rs7/bag), reversing the hike taken in May. Nonetheless, with sharp 7-8% hike in April, 1QFY20E still promises to be a strong quarter despite stagnant demand. However, a seasonally weak monsoon and sluggish demand suggest price moderation should continue and margins likely to peak in 1QFY20E. We remain cautious on the sector.

Cement prices—May gains reversed in June; 1QFY20E looks strong but likely to peak

Our channel checks suggest all-India cement prices have declined by 2% mom to Rs361/bag in June 2019 versus Rs368/bag in May. With sharp 8% mom hike pan-India in April, average trade prices for 1QFY20E are +11% qoq. However, we note that higher price discounts in the trade segment and sharper reversal in the non-trade segment during the quarter would partially drag average realizations in 1QFY20E.

Region-wise price trends. Price cuts in June were mainly led by South and West with Rs8-11/bag mom correction. For 1QFY20, pan-India trade prices were up Rs35/bag (+11% qoq) where North and East witnessed Rs30-50/bag (+11-16% qoq) hike whereas West and Central regions saw Rs30-35/bag (10-12% qoq) hike. While South prices were up Rs26/bag (8% qoq) in 1QFY20, prices hikes taken in April were rolled back and exit prices in June were back to 4QFY19 exit prices.

Demand stays sluggish—April registers 1% yoy rise while May-June fail to show any recovery

As per DIPP data, industry volumes increased by 1% yoy to 28.7 mn tons in April 2019 after registering 12% yoy growth in 4QFY19 and 13% yoy growth in FY2019. The strong growth in FY2019 was led by the government's housing schemes and infrastructure demand. We note the three-year CAGR of 5% (with pre-demonetization year as base year, i.e. FY2016).

Our channel checks suggest 1QFY20 demand has been stagnant (0-5% decline) on a pan-India basis (DIPP data will be available with a lag). Sharp increase in prices, slowdown in government projects pre-election, shortage of labor due to excessive heat in the North, general elections, and water shortage in a few states have all contributed to weak demand. With a high FY2019 base and seasonally weak monsoon, we expect demand to recover only in 2HFY20E.

Cost respite provides support to lower volumes

Prices of key commodities, which drive the variable costs for cement companies (power, fuel and freight costs), remain range-bound and should keep variable costs stable in 1QFY20E. With flat diesel prices and benefits of higher axle load norms being factored in 4QFY19 costs, freight costs should remain stable in 1QFY20E. Imported pet-coke remains in US\$95-100/ton range whereas domestic pet coke price at Rs7,600/ton is down 13% qoq in 1QFY20. Further, domestic thermal coal availability has improved post restocking at power plants while international thermal coal prices are down 21% qoq.

Maintain cautious stance on expensive valuations

We see 1QFY20E cement prices and margins at near-term peak and expect price moderation to continue. Stable costs should improve sector margins in FY2020E; however, margin expansion is well factored in our and consensus expectations. We believe large capacity addition will keep industry utilizations low (<72%) over the next two years and will restrict sustainable improvement in margins. We maintain cautious stance on the cement sector on expensive valuations of large-cap cement names at 12-16X FY2021E EV/EBITDA. We see better risk-reward in mid-caps (JKC, DBEL, and ORCM) over large caps (UTCEM, SRCM, ACC, ACEM).

QUICK NUMBERS

- Cement price hikes, which started in April, have failed to sustain and started softening
- With sharp hike in April, 1QFY20E still promises to be a strong quarter but should not extrapolate
- Seasonality and sluggish demand should keep prices under pressure

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Exhibit 1: All-India prices declined by 2% in June pan-India rolling back gains of May 2019

Monthly cement prices across regions in India, June 2018-19 (Rs per 50 kg bag)

	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19
North	296	309	302	302	300	303	301	304	308	306	343	363	358
Central	325	344	331	328	331	329	327	333	339	328	362	372	367
East	336	343	346	335	327	331	331	330	326	332	357	372	365
West	321	322	315	309	311	302	304	302	316	314	340	356	345
South	347	339	344	340	340	328	320	316	357	365	381	372	364
All India average	328	332	330	325	324	320	317	317	334	335	360	368	361
Change per bag (% mom)													
North	-0.2	4.6	-2.4	0.0	-0.7	1.1	-0.5	0.8	1.3	-0.6	12.0	5.9	-1.4
Central	1.5	5.9	-3.7	-1.0	1.0	-0.7	-0.3	1.7	1.7	-3.1	10.3	2.6	-1.1
East	-0.1	1.9	0.9	-3.1	-2.2	1.2	-0.2	-0.3	-1.4	1.9	7.8	4.0	-1.8
West	-1.1	0.5	-2.2	-2.0	0.6	-2.7	0.6	-0.7	4.6	-0.4	8.1	4.5	-3.0
South	-2.8	-2.3	1.6	-1.2	-0.1	-3.5	-2.2	-1.3	12.7	2.4	4.3	-2.3	-2.1
All India average	-1	1	-1	-1	0	-1	-1	0	5	0	8	2	-2
Change per bag (% yoy)													
North	-7.3	-3.0	-3.9	-2.0	-1.8	-0.5	-5.9	-1.6	-0.4	1.0	14.3	22.5	21.0
Central	1.4	8.8	4.4	4.0	5.6	4.6	2.4	4.1	3.5	3.1	12.2	16.2	13.2
East	-4.3	0.5	-1.2	-2.0	1.0	0.3	-0.4	-0.5	-3.4	-1.7	6.3	10.4	8.6
West	-4.3	-2.6	-1.9	0.0	0.1	0.0	1.6	-1.5	2.8	3.9	9.5	9.6	7.5
South	-5.8	-9.6	-6.9	-6.4	-2.3	-1.3	-3.8	-10.2	1.0	8.5	10.0	4.2	5.0
All India average	-4	-3	-3	-2	0	0	-2	-3	1	4	11	11	10

Source: Industry, Kotak Institutional Equities estimates

Region-wise cement price trend for June 2019

- ▶ **North—prices declined by Rs5/bag.** Cement prices in the North declined by Rs5/bag to Rs358/bag in June 2019—prices have declined post a sharp increase in April and May. Prices declined by Rs5-10 per bag in Rajasthan, Punjab, Haryana and Delhi but were flat in Himachal Pradesh and Jammu & Kashmir. Channel checks suggest extremely poor demand during the months of May-June and widening of the price gap between trade and non-trade prices.
- ▶ **Central—prices declined by Rs5/bag.** Cement prices in the Central region declined by Rs5/bag mom to Rs367/bag. Per our channel checks, prices declined by Rs5/bag in Uttar Pradesh and Madhya Pradesh. Demand remains sluggish with dealers beginning to undercut each other to push volumes. Dealers suggest flat to marginal decline in sales.
- ▶ **West—prices declined by Rs11/bag.** Cement prices declined in the West region during the month by Rs11/bag to Rs345/bag. The region has not been able to sustain the price hike witnessed in the month of May due to poor demand and concerns on the upcoming lean monsoon season. Per our channel checks, prices declined by close to Rs15/bag in Maharashtra while in Gujarat prices moderated by Rs5/bag. Demand appears stable in cities such as Ahmedabad, Baroda and Surat while demand declined sharply in Maharashtra.
- ▶ **South—prices declined by Rs8/bag.** Cement prices declined by Rs8/bag on an average in the South region to Rs364/bag. This highlights the issue of excess supply in the region as the companies are not able to sustain the price hikes taken in March-April 2019. Prices declined by Rs8/bag in Andhra Pradesh and Tamil Nadu and Karnataka by Rs10/bag.
- ▶ **East—prices declined by Rs7/bag.** Cement prices in the East declined by Rs7/bag to Rs365/bag in June 2019. Our channel checks indicate that companies have not been able to sustain the price increases of May due to poor demand on account of elections in the regions along with problems of labor supply. Prices declined by Rs20/bag in West Bengal and by Rs5/bag in Odisha but increased by Rs5/bag in North-Eastern states. North-Eastern states continue to show high demand on account of strong construction activity.

Exhibit 2: The current price trends suggest ~11% qoq increase in 1QFY20E realization

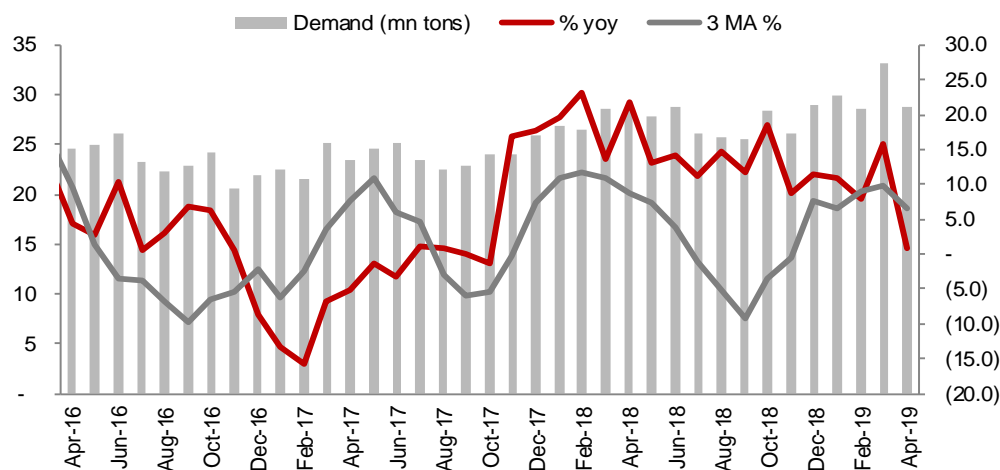
Quarterly trend in cement prices in India across geographies, 1QFY18-1QFY20E (Rs per 50 kg bag)

	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	FY2019	CY2018	CY2019
North	327	314	310	307	297	304	301	306	355	302	302	330
Central	328	316	316	322	322	334	329	333	367	330	327	350
East	347	344	329	335	336	341	330	329	365	334	336	347
West	325	320	304	306	319	316	306	311	347	313	311	329
South	376	369	338	347	350	341	329	346	372	342	342	359
All India average	346	338	322	327	328	329	320	328	363	327	326	346
Change per bag (% qoq)												
North	7	(4)	(1)	(1)	(3)	2	(1)	2	16			
Central	8	(4)	(0)	2	0	4	(2)	1	10			
East	8	(1)	(4)	2	0	1	(3)	(0)	11			
West	15	(1)	(5)	0	4	(1)	(3)	2	12			
South	8	(2)	(9)	3	1	(3)	(3)	5	8			
All India average	9	(2)	(5)	2	1	0	(3)	2	11			
Change per bag (% yoy)												
North	7	(1)	2	1	(9)	(3)	(3)	(0)	19			
Central	9	(0)	3	6	(2)	6	4	4	14			
East	5	4	1	5	(3)	(1)	0	(2)	8			
West	14	13	0	8	(2)	(1)	1	2	9			
South	10	4	(6)	(0)	(7)	(8)	(2)	(0)	6			
All India average	9	4	(1)	3	(5)	(3)	(0)	0	11			

Source: Industry, Kotak Institutional Equities estimates

Exhibit 3: As per DIPP, cement volumes increased 1% yoy in April 2019

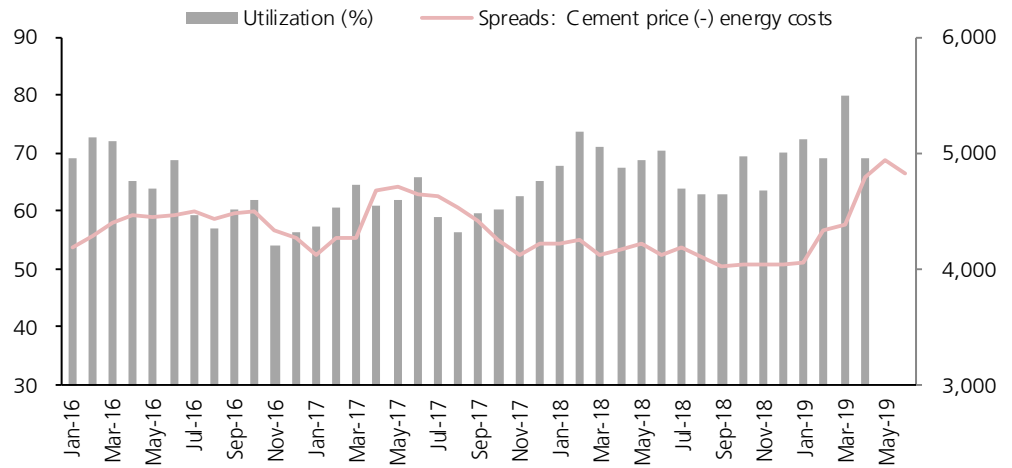
Monthly cement production volumes in India, 2016-19 ('000 tons, %)



Source: DIPP, Kotak Institutional Equities estimates

Exhibit 4: Spreads for companies have increased by 14% qoq in 1QFY20 aided by higher pan-India prices and lower fuel costs

Spreads (cement prices less energy costs) and EBITDA/ton for Indian cement companies, 2016-19 (Rs/ton)

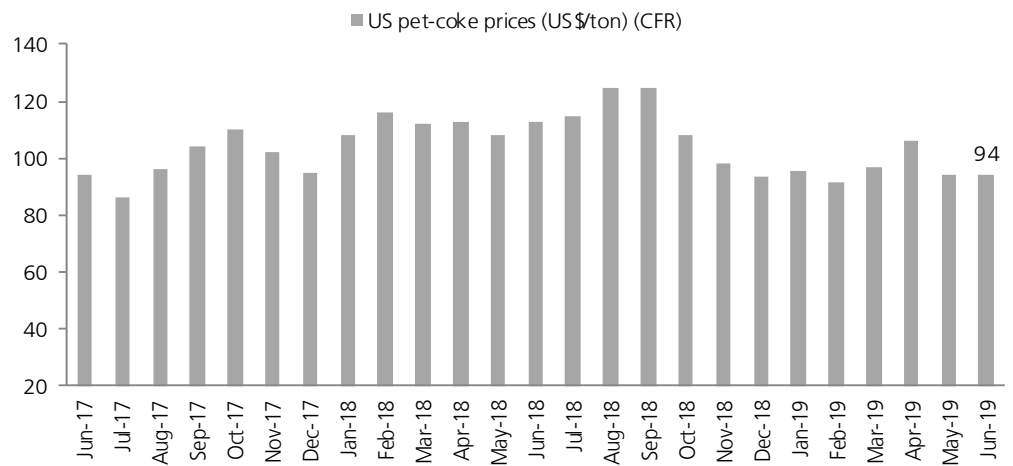


Notes:

(1) EBITDA/ton computation is based on average reported by companies under our coverage till 4QFY19.

Source: Bloomberg, Company, Kotak Institutional Equities estimates

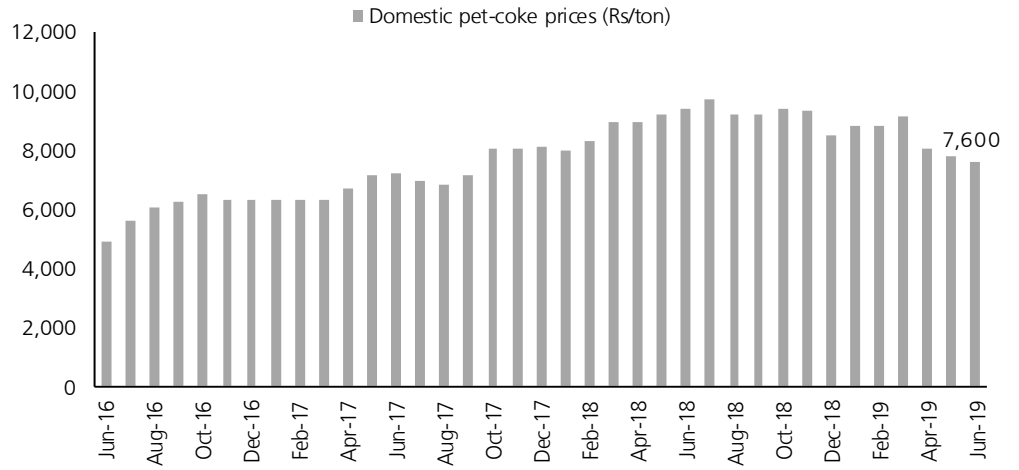
Exhibit 5: International pet-coke prices have remained stable mom but increased 4% qoq in 1QFY20
US pet coke prices (CFR basis), 2016-19 (US\$/ton)



Source: Industry, Kotak Institutional Equities estimates

Exhibit 6: Domestic pet-coke prices declined 13% qoq in 1QFY20E following a decline in international prices

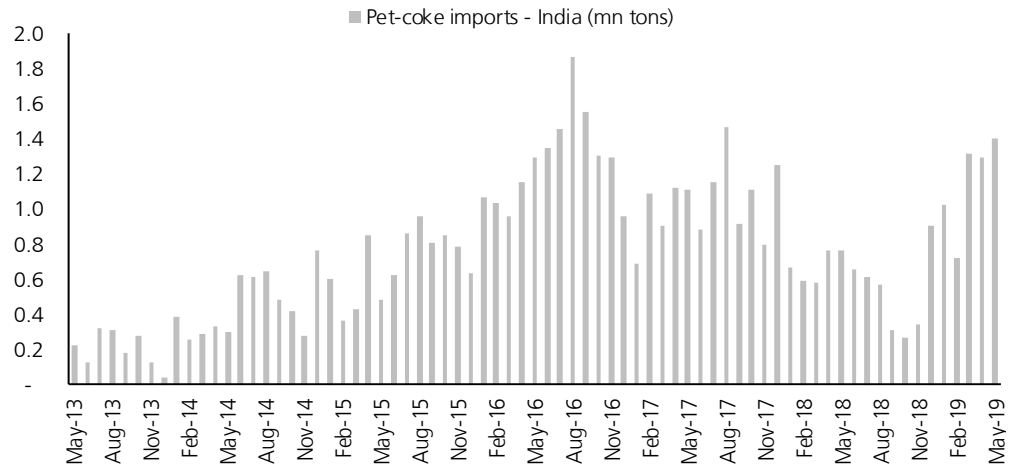
Domestic pet-coke prices, 2016-19 (Rs/ton)



Source: Industry, Kotak Institutional Equities estimates

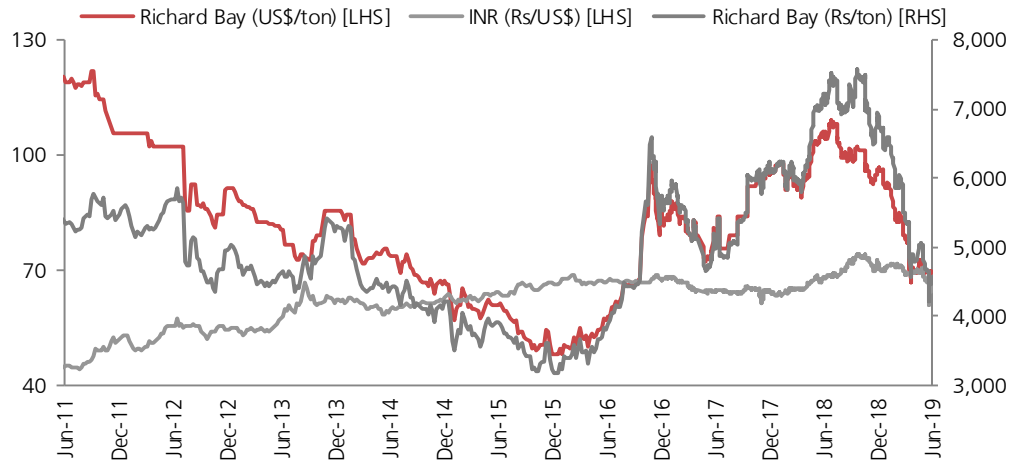
Exhibit 7: Pet-coke imports by Indian companies increased 9% in May 2019 due to higher domestic prices

Pet-coke imports by India, May 2013-19



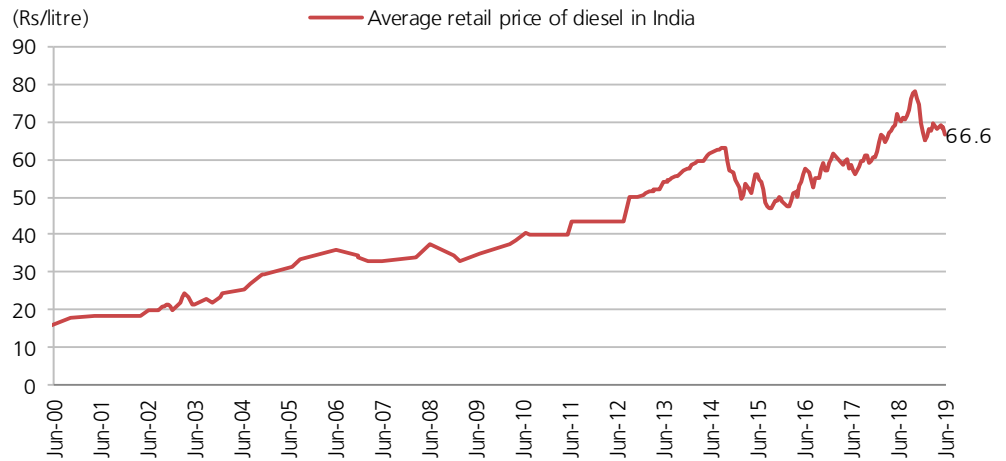
Source: Industry, Kotak Institutional Equities estimates

Exhibit 8: Imported coal cost has declined by 21% qoq in 1QFY20E
 Coal prices at Richard Bay (US\$/ton, Rs/ton), 2011-19



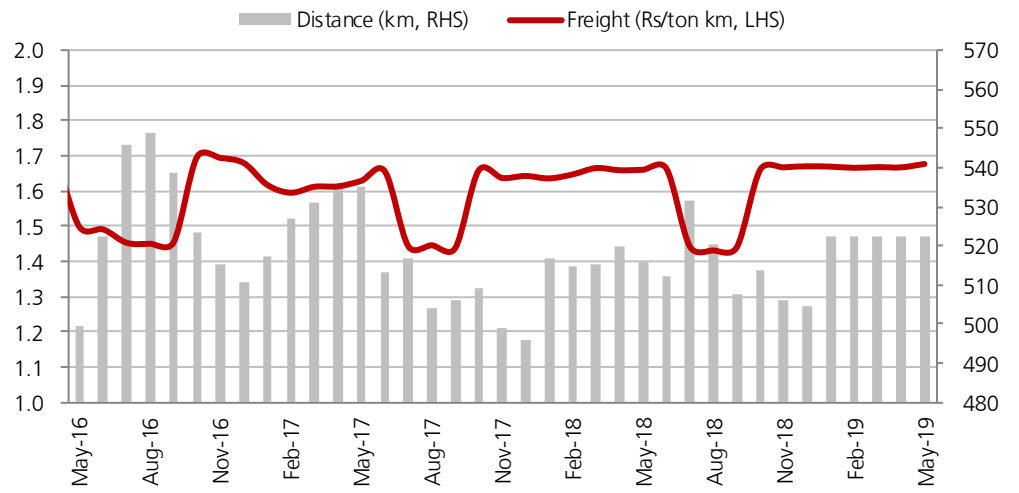
Source: Bloomberg, Kotak Institutional Equities estimates

Exhibit 9: Retail diesel prices in India remained stable mom in June 2019
 Average retail price of diesel in major cities in India (Rs/litre)



Source: Company, Kotak Institutional Equities estimates

Exhibit 10: Railway freights have remained stable due to levy of busy season surcharge
 Lead distance of cement transportation by railways and average freight rates (km, Rs/ton km)



Source: Indian Railways, Kotak Institutional Equities estimates

Exhibit 11: We expect EBITDA/ton for cement companies to increase by 10-70% in FY2020 due to increase in prices, declining costs

Realization/ton, costs/ton, EBITDA/ton and volumes (Rs/ton, mn tons)

	FY2017	FY2018	FY2019	FY2020E	FY2021E	yoy growth (%)		
						FY2019	FY2020E	FY2021E
Realisation/Ton								
ACC	4,684	4,934	5,098	5,266	5,421	3	3	3
Ambuja	4,267	4,462	4,540	4,744	4,910	2	4	3
Ultratech	4,706	4,737	4,980	5,226	5,395	5	5	3
Shree Cement	4,263	4,106	4,223	4,497	4,654	3	6	3
JK Cement	5,562	4,898	5,008	5,273	5,417	2	5	3
JK Lakshmi Cement	3,546	3,969	3,957	4,232	4,368	(0)	7	3
India Cement	4,601	4,781	4,524	4,796	4,939	(5)	6	3
Dalmia Cement	4,391	4,793	4,973	5,272	5,456	4	6	3
Orient Cement	3,377	3,868	3,933	4,208	4,377	2	7	4
Average	4,377	4,505	4,582	4,835	4,993	2	6	3
Costs/Ton								
ACC	4,139	4,340	4,494	4,601	4,708	4	2	2
Ambuja	3,520	3,712	3,915	3,915	4,010	5	0	2
Ultratech	3,775	3,788	4,070	4,148	4,259	7	2	3
Shree Cement	3,118	3,022	3,268	3,280	3,358	8	0	2
JK Cement	4,682	4,130	4,246	4,272	4,371	3	1	2
JK Lakshmi Cement	3,097	3,511	3,541	3,527	3,612	1	(0)	2
India Cement	3,821	4,161	4,011	4,038	4,181	(4)	1	4
Dalmia Cement	3,186	3,857	4,116	4,129	4,222	7	0	2
Orient Cement	3,057	3,337	3,446	3,529	3,616	3	2	2
Average	3,599	3,762	3,901	3,938	4,038	4	1	3
EBITDA/Ton								
ACC	544	593	604	665	713	2	10	7
Ambuja	747	750	625	829	900	(17)	33	8
Ultratech	931	949	909	1,078	1,136	(4)	19	5
Shree Cement	1,145	1,084	955	1,217	1,296	(12)	27	7
JK Cement	881	768	761	1,000	1,045	(1)	31	5
JK Lakshmi Cement	449	457	416	704	755	(9)	69	7
India Cement	780	620	513	758	758	(17)	48	0
Dalmia Cement	1,205	936	857	1,143	1,234	(8)	33	8
Orient Cement	321	531	487	679	761	(8)	39	12
Average	778	743	681	897	955	(8)	32	7
Volumes								
ACC	23	26	28	30	31	8	5	3
Ambuja	21	23	24	26	27	5	7	6
Ultratech	49	61	70	76	81	16	9	6
Shree Cement	20	22	25	28	32	13	14	13
JK Cement	7	8	9	10	11	6	12	15
JK Lakshmi Cement	8	9	11	11	12	15	4	3
India Cement	11	11	12	13	14	11	7	5
Dalmia Cement	6	17	19	20	22	10	7	8
Orient Cement	6	6	6	7	7	12	7	7
Average	17	20	23	25	26	12	8	7

Source: Companies, Kotak Institutional Equities estimates

Exhibit 12: Cement comparative valuation

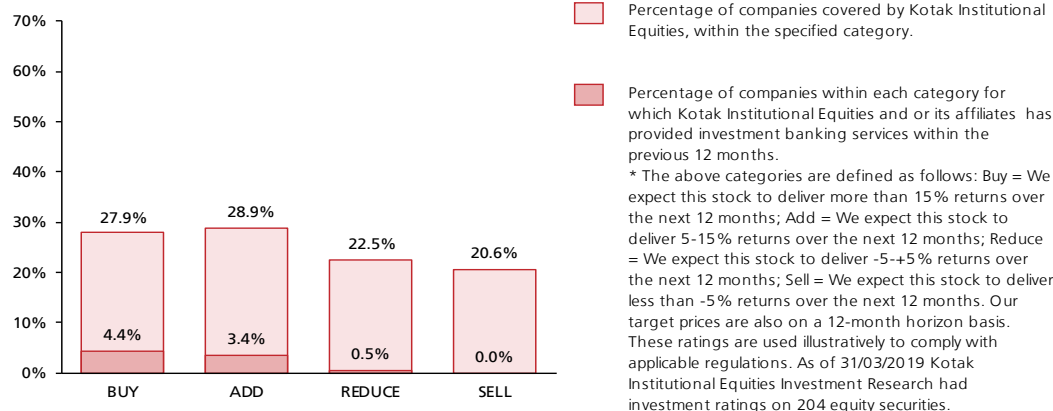
Company	Market cap. (US\$ mn)	CMP (Rs) 17-Jun	Target price (Rs)	Rating	EPS (Rs)				P/E (X)			
					2018	2019	2020E	2021E	2018	2019	2020E	2021E
Large-cap. stocks												
ACC	4,039	1,509	1,400	SELL	49	80	65	73	31	19	23	21
Ambuja Cements	5,810	206	192	REDUCE	7	7	10	11	28	28	21	18
Grasim Industries	5,735	879	1,020	ADD	46	63	81	104	19	14	11	8
Shree Cement	9,907	19,992	14,750	SELL	397	323	465	602	50	62	43	33
UltraTech Cement	17,368	4,455	2,960	SELL	89	89	133	166	50	50	33	27
Mid-cap. stocks												
Dalmia Bharat	1,277	1,106	1,170	ADD	14	14	32	43	80	77	35	25
India Cements	406	93	116	REDUCE	3.3	2.2	8.6	9.7	28	41	11	10
JK Cement	982	987	1,100	ADD	43.2	34.1	73.9	83.8	23	29	13	12
JK Lakshmi Cement	593	354	432	ADD	5.7	4.1	26.2	33.2	63	87	13	11
Orient Cement	329	113	106	ADD	2.2	2.3	7.7	10.8	52	NM	15	10
Company	EV/EBITDA (X)				EV/ton of capacity (US\$)				P/B (X)			
	2018	2019	2020E	2021E	2018	2019	2020E	2021E	2018	2019	2020E	2021E
Large-cap. stocks												
ACC	16.5	14.8	12.4	11.0	109	108	104	102	3.0	2.7	2.5	2.3
Ambuja Cements	14.4	15.2	11.3	9.8	110	110	109	106	2.0	1.8	1.7	1.6
Grasim Industries	24.3	21.5	13.3	11.2	NA	NA	NA	NA	1.0	1.0	1.0	0.9
Shree Cement	27.3	25.5	17.8	14.5	275	235	219	187	7.8	7.3	6.4	5.4
UltraTech Cement	22.8	21.2	16.0	13.8	225	222	208	200	4.7	4.4	3.9	3.5
Mid-cap. stocks												
Dalmia Bharat	12.2	12.7	10.5	9.0	97	95	96	93	2.1	2.0	1.9	1.8
India Cements	8.4	9.8	5.7	5.3	53	57	53	52	0.6	0.5	0.5	0.5
JK Cement	12.9	12.3	9.0	7.1	118	117	106	86	2.8	2.4	2.0	1.7
JK Lakshmi Cement	13.8	13.0	6.8	5.8	68	67	63	59	2.9	2.8	2.4	2.0
Orient Cement	11.6	11.3	7.3	6.2	63	62	60	62	2.3	2.2	2.0	1.7

Source: Company, Kotak Institutional Equities estimates

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