Q1FY13 Result Update

August 11, 2012

HDFC Sec Scrip code	Industry	CMP	Recommended Action	Target	Period
MADCEMEQNR	Cement	Rs.171.1	Fresh investors could buy at the CMP and add on dips between Rs.153-158	Rs.194	1 quarter

MCL recently reported its Q1FY13 results, which were above street estimates. Given below are some of the key highlights, which we came across while reviewing the results.

Quarter Financials - Consolidated:

(Rs. in Cr)

Particulars	Q1FY13	Q1FY12	% Chg	Q4FY12	% Chg	Remarks
Net Sales	989.3	764.2	29.5%	911.9	8.5%	Improved demand led to higher volumes and in turn better realisations. This aided sharp growth in revenue.
Other Operating Income	6.0	4.0	48.6%	28.4	-78.9%	
Total Income	995.3	768.2	29.6%	940.2	5.9%	
Expenditure						
Raw Material Consumed	142.7	95.3	49.8%	128.2	11.3%	
Stock Adjustment	-14.3	22.7	-162.7%	13.7	-203.8%	
Employee Expenses	44.9	41.6	8.1%	43.6	3.0%	
Power & Fuel	212.8	163.2	30.4%	205.7	3.5%	
Transportation & Handling	192.2	117.2	64.0%	185.7	3.5%	Freight costs rose sharply by led by ban on overloading of trucks between TN-Kerala, increased volumes to West Bengal & Orissa and Rail tariff hikes of ~22% in March 2012.
Other Expenses	104.2	79.9	30.4%	135.3	-23.0%	
Total Expenditure	682.6	519.8	31.3%	712.3	-4.2%	
EBIDTA	**312.7**	**248.4**	25.9%	**227.9**	37.2%	Lower than expected Power & Fuel cost aided in higher EBIDTA
EBIDTA Margin%	*31.6%*	*32.5%*		*25.0%*		
Other Income	1.8	1.8	-1.7%	3.1	-42.5%	
Interest	54.3	47.6	14.0%	31.0	75.3%	Increase in depreciation and interest costs was due to commissioning of Ariyalur line-2 capacity during this quarter.
Depreciation	78.1	64.2	21.8%	65.9	18.5%	
PBT	182.1	138.4	31.5%	134.1	35.7%	
PBTM%	*18.4%*	*18.1%*		*14.7%*		
Tax	59.1	40.1	47.2%	35.0	69.0%	
Effective Tax Rate%	*32.4%*	*29.0%*		*26.1%*		
Reported Profit After Tax	123.0	98.3	25.1%	99.2	24.0%	
Extra-ordinary Items	0.0	0.0	-	0.1	-100.0%	
Adjusted Net Profit	**123.0**	**98.3**	25.1%	**99.1**	24.1%	
NPM%	*12.4%*	*12.9%*		*10.9%*		
EPS	**5.2**	**4.1**	25.1%	**4.2**	24.1%	
Equity	23.8	23.8	0.0%	23.8	0.0%	
Face Value	1	1	0.0%	1	0.0%	

(Source: Company, HDFC Sec)

Segmental Financials:

(Rs. in Cr)

Particulars	Q1FY13	Q1FY12	% Chg	Q4FY12	% Chg
Segmental Revenue					
- Cement	948.3	732.1	29.5%	905.2	4.8%
- Windmills	41.0	32.1	27.6%	6.7	511.2%
Less: Inter Segment Revenue	4.5	6.3	-29.1%	5.5	-19.0%
Net Segment Revenue	984.8	757.9	29.9%	906.3	8.7%
Segmental Results					
- Cement	230.7	194.8	18.4%	233.2	-1.0%
- Windmills	24.8	15.1	64.5%	-14.2	-275.0%
Total	255.5	209.9	21.7%	219.0	16.7%
Less: Interest	54.3	47.6	14.0%	31.0	75.3%
Less: Unallocable expenditure net of unallocable income	19.2	23.9	-19.6%	53.9	-64.4%
PBT	**182.1**	**138.4**	31.5%	**134.1**	35.7%
Capital Employed					
- Cement	3798.9	3551.5	7.0%	3708.0	2.5%
- Windmills	683.6	693.3	-1.4%	666.9	2.5%
Less: Unallocated	2309.0	2412.0	-4.3%	2324.5	-0.7%
Total	2173.4	1832.8	18.6%	2050.4	6.0%

(Source: Company, HDFC Sec)

Some observations on Q1FY13 results:

- MCL's Q1FY13 volumes increased by a strong 21.2% y-o-y to 2.2 mt driven by improved demand in key states of Karnataka, Kerala, and Tamil Nadu, commissioning of Ariyalur line-2 and market share gains in key southern states. Realisations grew strongly to Rs.4,394/t, up 7% both on a y-o-y and q-o-q basis.

- Though costs increased by 31.3% y-o-y, the same declined by 4.2% q-o-q helped by lower than expected rise in Power & Fuel cost. P&F cost increased by just 3.5% q-o-q despite a 13-19% increase in electricity tariffs by the state of Andhra Pradesh and Tamil Nadu. The Power & Fuel cost increase was restricted on the back of 7% improvement in efficiency for electricity consumption seen in FY12 (78.1 KWH/t of cement vs 83.9 KWh/t in FY11). Strong volume growth with better cost structure helped EBIDTA to go up by 25.9% y-o-y and 37.2% q-o-q.

- MCL has locked its petcoke requirement for 5-6 months at lower price prevailing in Q4FY12. Further the recent decline in international coal prices could help MCL further improve its cost structure as imported petcoke/coal accounts for 75% of its requirement. Further the with commissioning of 25 MW captive power plant (CPP) at RR Nagar (TN) and 20 MW CPP at Ariyalur (TN), MCL would be able to de-link itself from expensive grid power in TN (per unit tariff of Rs.5.5-6/unit) and save at least 15% on per unit basis.

- During the quarter MCL commissioned its 2 mtpa cement line – II at Ariyalur thereby taking its cement capacity from 10.5 mtpa to 12.5 mtpa. The capitalisation of Unit – II led to 22% y-o-y increase in depreciation charge and 14% increase in interests cost to Rs.543 mn. Hence net profit at Rs1.23bn grew +25% y-o-y.

- Cement prices have been increased by Rs.20-30 per bag since mid-June to Rs.300-350 per bag, which has enabled all cement-makers to offset increase in freight and energy costs. Pricing power of the industry in the south (largest market and 60-65% utilisation) will be tested in next 6 months with the recently commissioned capacity's ramp-up in production.

- Windmill sales stood at 114 mn units at an average realisation of Rs.3.58/unit. Total receivables from TNEB stands at Rs.780 mn with collection cycle ranging between 9-12 months.

- Current gross debt stands at Rs.26.2 bn in Q1FY13 vs. Rs.27.1 bn in Q4FY12 with cash and cash equivalents balances at Rs.330 mn. With no major capex plans slated for the next two years, MCL would be keen to reduce the leverage with the strong free cash generation over FY13-14E. Hence there could be significant repayment of debt over the next 18 months.

Concerns

- Geographic concentration in the southern region could hurt MCL's earnings if there is any slump in the demand situation in the region.

- The proposed new mining tax could be another blow to cement companies as it would increase the limestone mining costs by Rs.75 to 80/ton. Further given Coal India's strong pricing power, there could be a price hike to compensate for the higher incidence of mining tax on Coal India. This could result in downside risks to the profitability of cement producers.

- MCL has invested in group companies, which is locked up and not available for use. However the market value of these investments is higher than the cost.

- The Competition Commission of India (CCI) has imposed a penalty of Rs.2.6 bn on MCL for alleged cartelisation with select cement manufacturers. Though there would not be any near term impact on the cash flows of company as it has appealed against the CCI order to Competition Appellate Tribunal (CAT), this would act as a sentiment dampener and may pressurise cement prices in the near future.

Conclusion & Recommendation

MCL reported better than expected Q1FY13 results. The quality of performance was far superior to its peers as the EBIDTA gains were driven by a extremely healthy volume growth of 21.2% y-o-y (2.2 mt) while realisation improved 7%.

Management expects a growth of 8% for FY13 due to the continued fillips given for the infrastructure projects. The Company expects to sustain and improve the output levels of all the units during the year. Also, MCL could have the benefit of increased production from its new projects, which could enable it to meet the increased market demand for cement. The management also continues to concentrate on cost reduction measures in all areas of production and distribution to protect and improve its profitability.

MCL's business concentration is high in the southern region, where surplus capacities (owing to large capacity additions in the recent past) have led to significant pricing and volume pressures over the last 2-3 years. Due to further capacity additions anticipated in the region over the medium term, realisations may remain under witness pressure while capacity utilisation is likely to remain subdued.

On positive front, cement industry is expected to benefit from the recent cost moderation due to correction in coal, crude and packaging cost. MCL has a competitive edge to its peers with respect to costs like coal, freight and power and fuel and is cheaper on EV/EBIDTA basis and EV/tonne basis (except for India Cements).

Its current accruals position is quite healthy (driven by the high proportion of blended cement, strong operating efficiencies and captive power utilisation) and its flexible financial profile supported by established presence of the Ramco Group. Further as large capex could come to an end by FY13, it could generate good free cashflows thereafter.

MCL posted FY12 numbers almost in line with our estimates except on the PBIDT margins, which were lower than estimated. We are revising upwards our FY13 estimates on the back of encouraging Q1FY13 results.

In our initiating coverage dated April 13, 2012, we had stated that the stock could be bought at CMP of Rs.144.95 and add on dips between Rs.126-134 for sequential targets of Rs.167 and Rs.184 over 1-2 quarters. Post the issue of the report, the stock made a low of Rs.133.15 on May 18, 2012 and consequently achieved first target of Rs.167 on August 1, 2012 and thereafter made a high of Rs.181.9 on August 2, 2012. At the CMP of Rs.171.1, the stock is trading at 9.2 FY13RE EPS of Rs.18.5.

We feel that existing investors could hold on to the stock for the target mentioned hereafter. Fresh investors could buy the stock at the CMP and add on dips between Rs.153-158 (8.25-8.5x FY13RE EPS) for a target of Rs.194 (10.5x FY13RE EPS) over the next quarter.

Financial Estimates:

Particulars (Rs in Crs)	FY09	FY10	FY11	FY12 (E)*	FY12 (A)*	FY13 (OE)*	FY13 (RE)*
Operating income	2456.2	2800.9	2604.9	3168.0	3236.1	3418.0	3770.0
PBIDT	786.2	869.8	684.6	977.8	960.3	1021.0	1123.5
PBIDTM (%)	32.0%	31.1%	26.3%	30.9%	29.7%	29.9%	29.8%
Profit after Tax	363.9	353.6	210.9	384.0	385.1	397.1	441.1
PATM (%)	14.8%	12.6%	8.1%	12.1%	11.9%	11.6%	11.7%
EPS	15.3	14.9	8.9	16.1	16.2	16.7	18.5
P/E (x)	11.2	11.5	19.3	10.6	10.6	10.3	9.2

* - Quick Estimates, A - Actuals, OE - Original Estimates, RE - Revised Estimates (**Source:** Annual Report, HDFC Sec Estimates)

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