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Sanghi Industries Ltd.

BUY

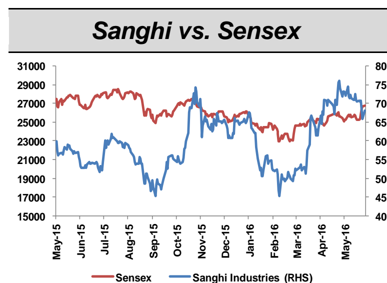
Target Price ₹107	CMP ₹69	FY19E EV/EBITDA 5.6x

Index Details	
Sensex	27,009
Nifty	8,266
BSE 100	8,372
Industry	Cement

Scrip Details	
Mkt Cap (₹cr)	1,519
BVPS (₹)	41.5
O/s Shares (Cr)	22.0
Av Vol (Lacs)	0.3
52 Week H/L	79.2/44
Div Yield (%)	0.0
FVPS (₹)	10.0

Shareholding Pattern	
Shareholders	%
Promoters	74.98
Public	25.02
Total	100.0

Sanghi vs. Sensex



Sanghi Industries Ltd. (Sanghi) is a cement manufacturer with a dominant presence in Gujarat, West India. We believe that the cement industry is on an up-turn and expect Sanghi to be a key beneficiary given its lucrative location and operating efficiencies.

We are positive on the company given that:

i) Cement industry is on the verge of a turn-around:

After two years of subdued performance, the domestic cement sector is expected to witness a revival. We expect cement dispatches to clock a CAGR of ~8% from FY15-FY18. Over a period of 15 years, the cement industry, on an average, has grown at 1x India's real GDP. However, cement volume dispatches have grown at ~1.1-1.2x during periods of economic recovery. We anticipate cement dispatches to grow at 1.1x GDP over FY16-18 as the economy is all set to stage a recovery driven by:

- **Forecast of above normal monsoon for the current year**
- **Government's thrust on rural economy development.**
- **Pick up in infra activity – Several projects which were stalled due to slow pace of approvals from the government have now been cleared.**

With rural and urban housing constituting 65% of the total domestic cement demand, there are many green-shoots for the cement industry:

- **According to a KPMG report, in order to achieve the Government's vision of 'Housing for All' by 2022, 11 crore houses will have to be constructed at an investment of USD 2 tn (Rs 13,600 bn).**

STOCK POINTER

Key Financials (₹ in Cr)

Y/E Mar	Net Sales	EBITDA	Adj PAT	EPS (Rs)	EPS Growth (%)	RONW (%)	ROCE (%)	P/E (x)	EV/EBITDA (x)
2016*	777	141	2	3.2	130.4	3.2	3.5	19.2	13.5
2017E	1,198	236	70	3.2	0.0	0.2	5.6	21.4	8.0
2018E	1,309	287	59	2.7	-15.8	7.2	8.4	25.4	7.9
2019E	1,434	328	79	3.6	33.0	5.7	6.5	19.1	6.5

**** FY16 fiscal year changed from June to March; hence it's a 9 month fiscal and YoY numbers are not comparable***

Note: All CAGR calculations have been made annualizing FY16 numbers

Wednesday 8th June, 2016

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- **Based on our interactions, cement players have indicated that activity in the road sector has picked up at a significant pace. For instance, there has been a 69% increase in project awards by NHAI during the first eight months of FY16 to 2,649 km from 1,572 km in the same period of the previous fiscal.**
- **NITI Ayog, Smart Cities Mission, and Make in India are expected to boost industrial and commercial construction.**

ii) Sanghi derives ~85% of its sales from Gujarat, which has witnessed a GDP growth rate of 14-15% in the past three years and is expected to maintain a similar growth rate going forward.

iii) Sanghi aims to double its existing cement capacity of 4.1 mtpa in the next five years. Capacity expansion coupled with favorable industry dynamics is expected to translate to a volume CAGR of 5.5% from FY16-19. We expect revenues to grow at a CAGR of 11.5% during the same period.

iv) Sanghi derives operating efficiencies through its captive power plant, adequate limestone reserves with mining rights upto 2046, rain water harvesting facilities and captive jetties/port berths at key locations.

v) Higher sales of PPC cement, subdued coal prices, construction of a captive port in Surat and a waste heat recovery plant are triggers for EBITDA margin expansion. We expect EBITDA margins to expand from ~18% in FY16 to ~23% by FY19.

We initiate coverage on Sanghi as a BUY with a Price Objective of ₹107, representing a potential upside of 56% over a period of 18 months. We have arrived at our target price by assigning an EV/EBITDA multiple of 9x to FY19E EBITDA of Rs 328 crores.

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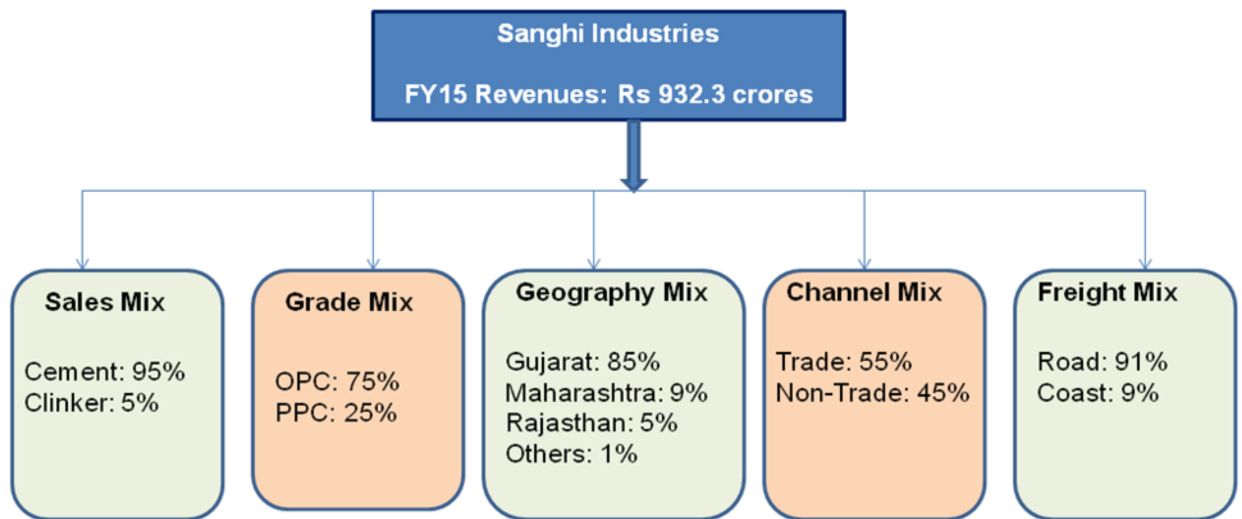
➢ Company Background

Incorporated in 1985, Sanghi is a dominant cement manufacturer in Gujarat. As of FY16, it has a grinding capacity of 4.1 mn tones and a clinker capacity of 3.3 mn tones. It also has a 63 MW captive thermal power plant, a water de-salination facility, and captive port in Kutch which can handle 1 MMTPA of cargo. Its brand, 'Sanghi Cement' enjoys high recall in the markets in which it operates viz. Gujarat and Maharashtra. Sanghi has a dealership strength of ~1500.

Sanghi Industries – Snapshot



Source: Sanghi, Ventura Research

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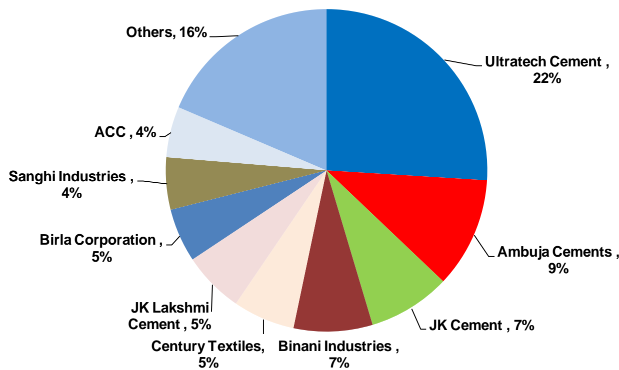
❖ Key Investment Highlights

➢ Strategic location provides inherent advantage

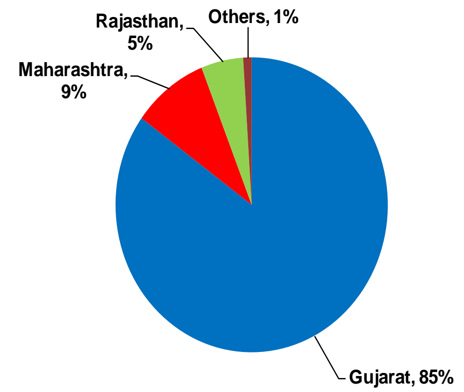
Sanghi, with a manufacturing plant located in Kutch, is a dominant player in Western India. It has a 4% market share in West India, with Ultratech dominating this region. According to the management, Sanghi has the third highest market share in Gujarat, after Ultratech and Ambuja Cements.

Competitive landscape in the West



Source: Ventura Research

Sanghi Sales mix



Source: Ventura Research

West India has witnessed a robust cement demand growth of 7.7% CAGR during FY11-FY15 led by high industrial activity in Gujarat. Going forward, we expect demand to grow at a CAGR of 7.3% during FY16-18. With capacity additions limited at 1.1% CAGR during the same period, cement prices in this region are expected to remain firm.

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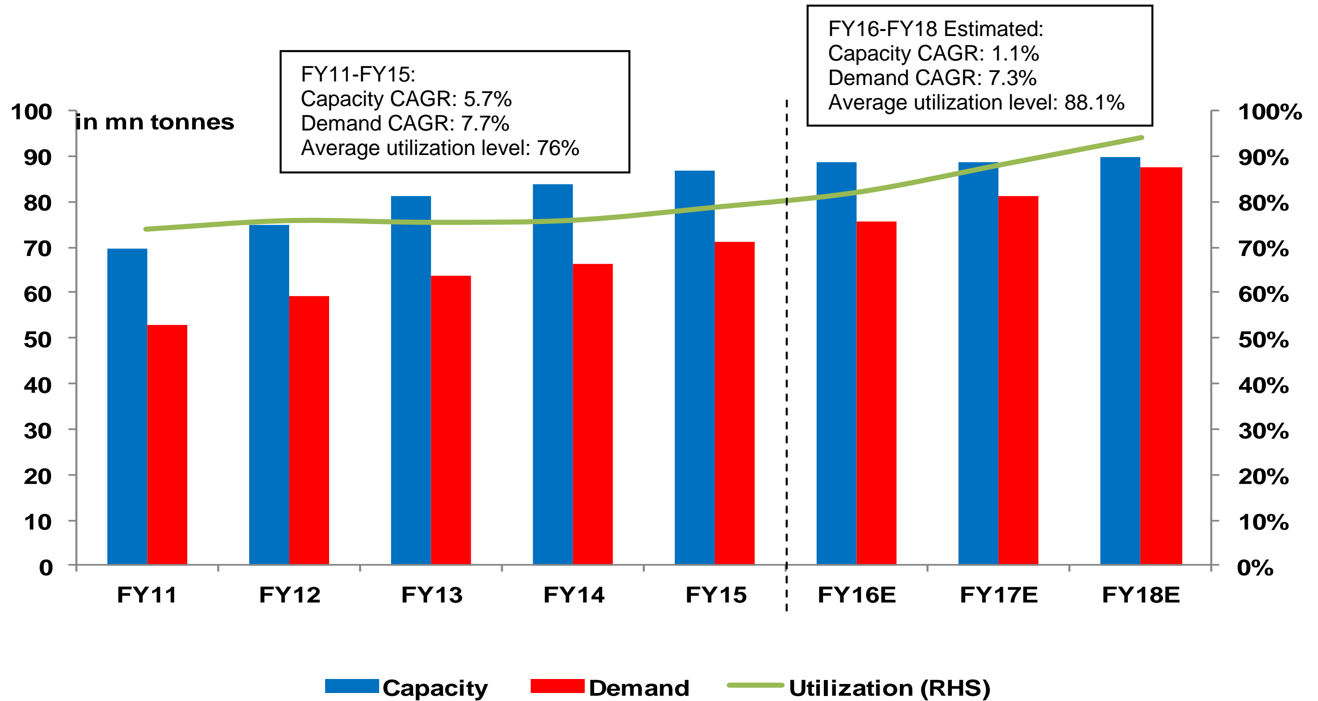
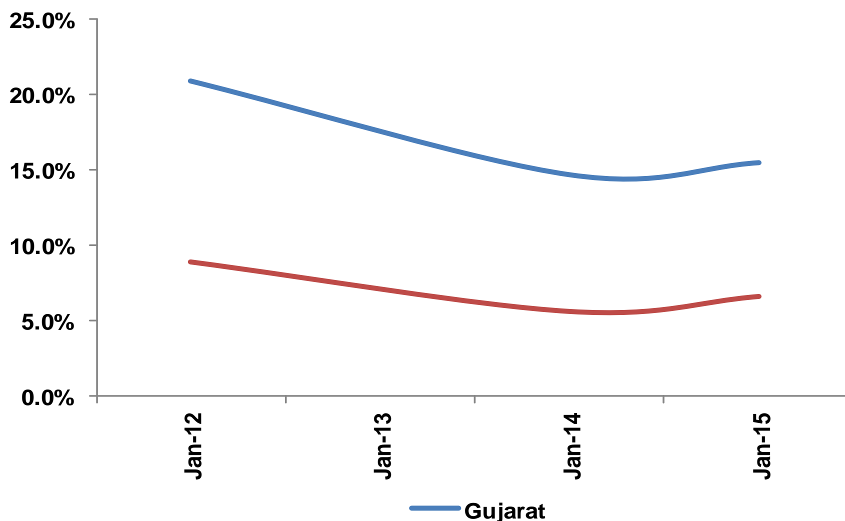
West: Demand has outpaced capacity growth; utilization levels are highest in the industry



Source: Ventura Research

Gujarat has consistently out-performed India's average GDP growth rate



Source: Ventura Research

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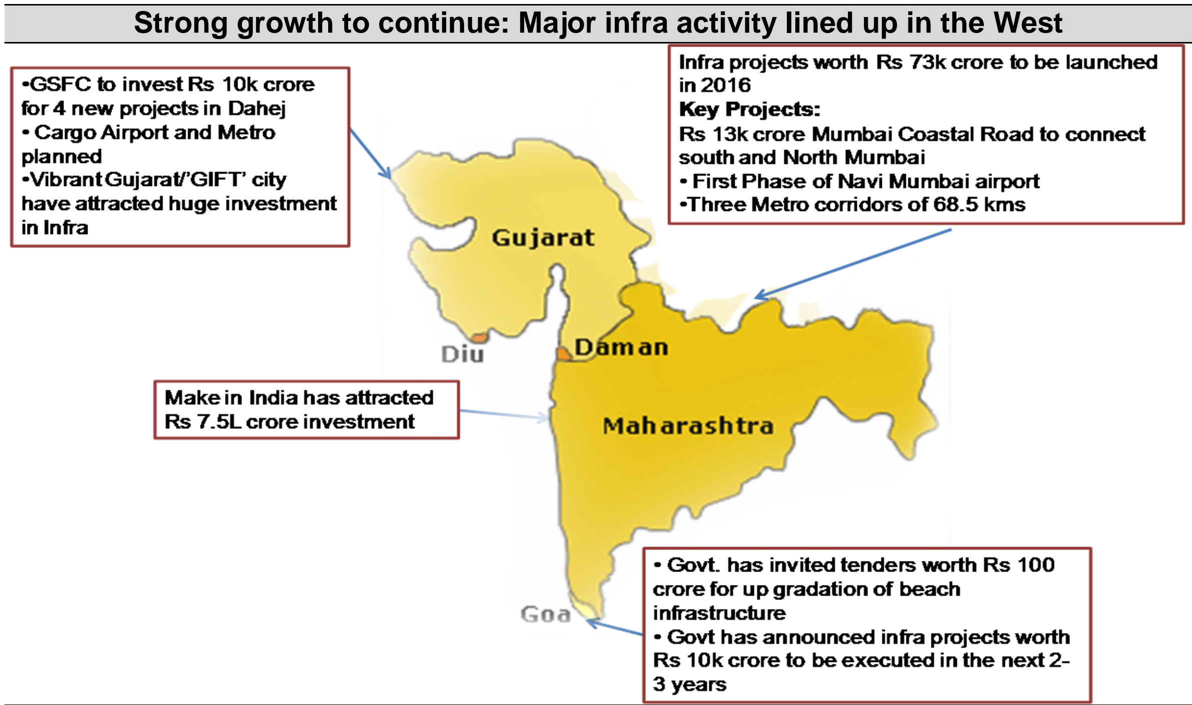
Strong growth to continue: Major infra activity lined up in the West



Source: Ventura Research

➢ Capacity expansion to fuel top-line growth

We expect Sanghi's revenues to grow at a 3 year CAGR of 11.5% to Rs 1434 crore in FY19E on the back of an improved demand scenario supported by capacity expansion.

Sanghi has a grinding capacity of 4.1 mtpa supported by clinker capacity of 3.3. mtpa as of FY16. While capacity has grown at a moderate pace of 8% CAGR during FY10-16, the management has drawn up plans to double the existing capacity by FY22.

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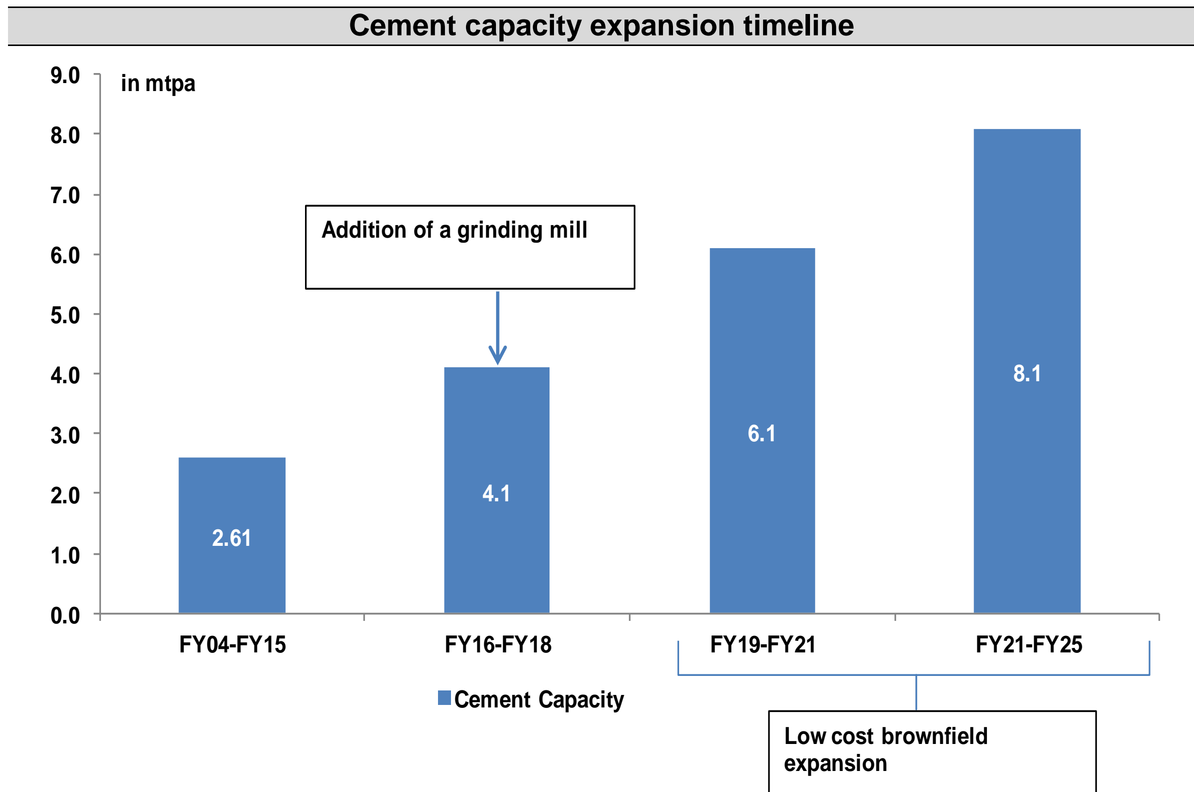
Cement capacity expansion timeline



Source: Ventura Research

Phase 1:

- The 1.2 mtpa grinding mill has been commissioned in H1FY16; the full benefit of this addition will be witnessed from FY17 onwards.
- The existing clinker capacity of 3.3 mtpa will be able to service the incremental capacity
- It is an exclusive PPC manufacturing plant
- Capex for the project was ~Rs 50 crores, funded through internal accruals

Phase 2:

- The 4 mtpa grinding plant, supported by a clinker plant of 3.3 mtpa, is expected to commission in two phases of 2 mtpa each. The management has stated that it will take 24 months from the date of financial closure to set up the first phase of the 2 mtpa plant. They have also indicated that the financial closure is round the corner and hence, we have assumed the 2 mtpa plant to be set-up by H2FY19.
- The total cost of the project is ~ Rs 1200 crores, of which Rs 800 crores will be funded through debt at an estimated cost of 10.5%-11%. The capital cost works out to be ~$45 per ton, significantly lower than the industry replacement cost of ~$110-120 per ton on account of the following:
  i) Only 1/3rd of the existing factory land is occupied, hence there are no additional land requirements

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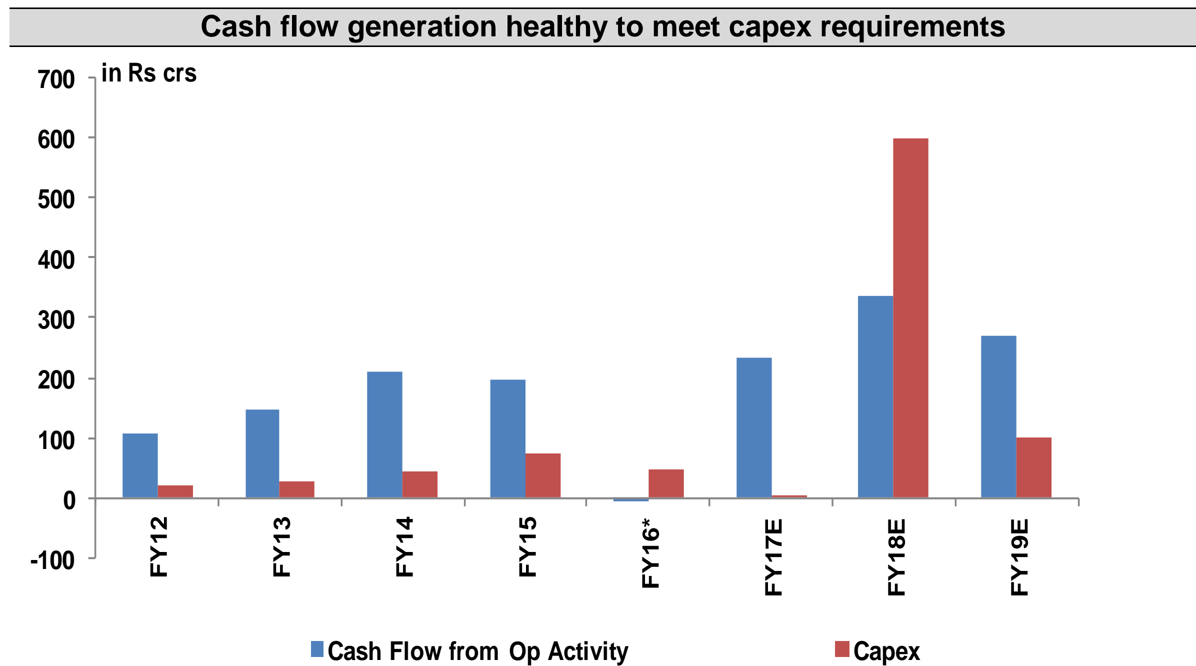
ii) The power plant shed has an empty space to incorporate an additional genset; power transmission lines can service the requirements of the incremental capacity
iii) There are adequate limestone reserves to service the incremental capacity, and
iv) Common logistic and other infrastructural faculties

Given the healthy balance sheet of the company, with a D/E of 0.5x as on September 2015 and the steady cash flow generation of Rs 150-200 crores from operations, the company is well placed to raise the additional debt and service it in a timely manner. In order to repay existing loan, the company has raised NCDs worth Rs 256 crores at an interest cost of 15.5%; Piramal Group has invested in these NCDs.

Cash flow generation healthy to meet capex requirements



Source: Ventura Research

Expect volume growth of 5.5% CAGR from FY16-19

Sanghi, during FY12-15, reported a volume growth of only ~1% CAGR owing to subdued demand conditions. However, going forward, volumes are expected to grow at a steady 2 year CAGR of 5.5% during FY16-19 given that Sanghi is on an expansion spree, especially at a time when industry dynamics have turned favorable.

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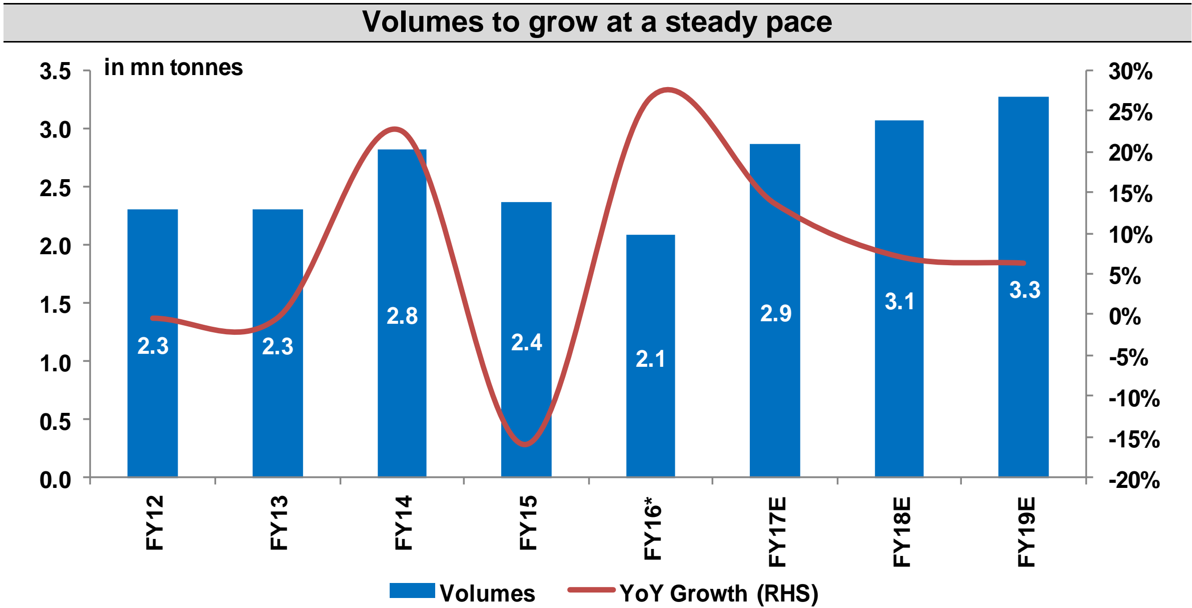
Volumes to grow at a steady pace



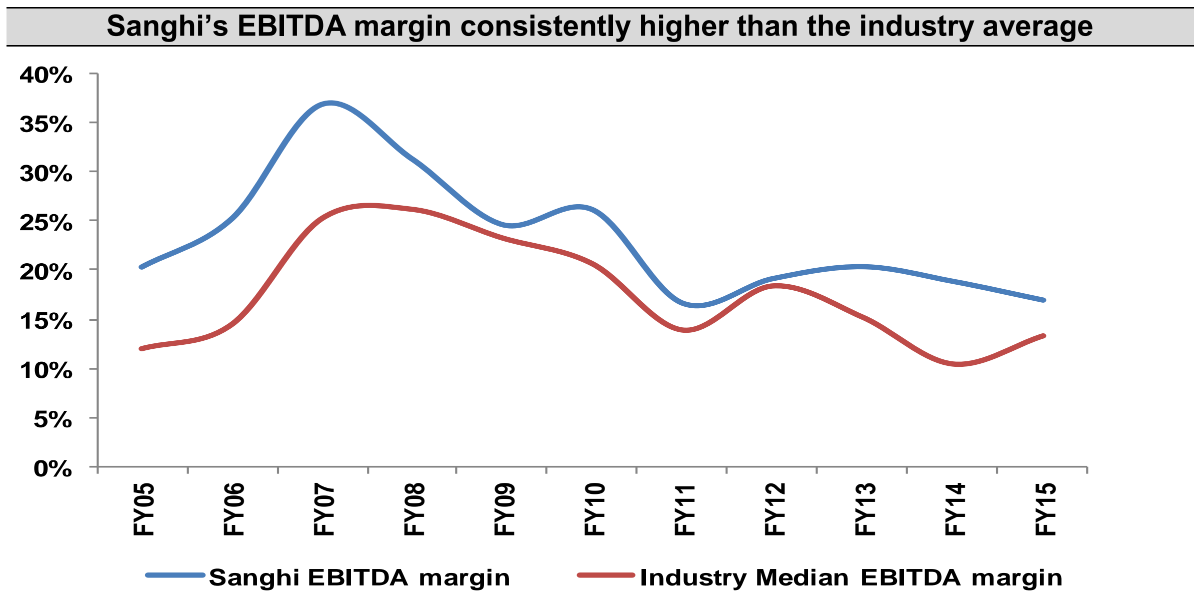
*FY16 is a 9 month fiscal year

Source: Ventura Research

➢ Operational efficiencies provide the extra edge

Sanghi's 5 year average EBITDA margin stood at 18.7%, nearly 350 bps higher than the industry average during the same period. This out-performance can be attributed to the operating efficiency that Sanghi derives from its captive power plant, adequate limestone reserves, rain water harvesting, and captive port and jetty.

Sanghi's EBITDA margin consistently higher than the industry average



Source: Ventura Research

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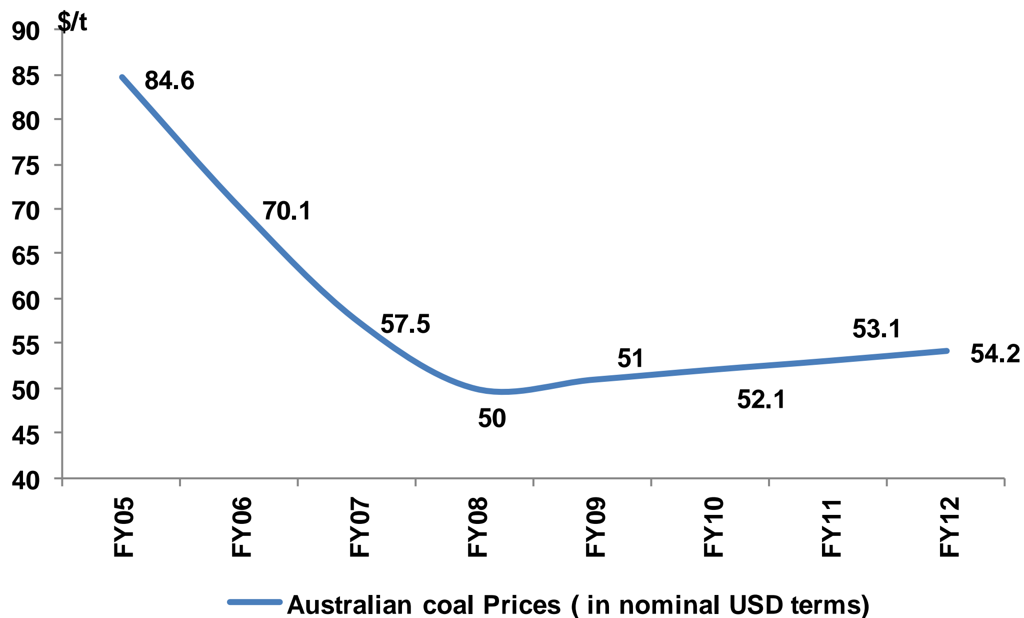
Captive thermal based power plant = fuel savings

Sanghi's power & fuel cost has ranged at ~25% of revenues for the past three years; power cost per ton has averaged at Rs 1100-Rs 1200 per ton (similar to the industry average) before dropping to ~Rs 900 per ton in FY16 on account of fall in coal prices and higher usage of low cost pet coke.

Sanghi has a 63 MW captive thermal power plant, with peak power requirement of 42 MW, this translates to surplus power of 20 MW. The government has now constructed a sub-station near the company's plant which enables it to sell a part of the surplus power to the grid. Further, the power plant is a multi fuel one which can be operated on pet coke, lignite or coal depending on the price competitiveness of these fuels. So far, the company has used lignite and coal in their operations. Lignite is procured from GMDC's plant which is at a distance of 40 kms from the plant, while coal is majorly imported via its captive jetty. Given the emphasis on clean energy, industry forecasts suggest that coal prices are unlikely to rebound to a great extent, spelling fuel savings for companies such as Sanghi.

Coal prices expected to remain range-bound in the coming years



Source: Knoema, Ventura Research

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Adequate limestone reserves ensure scalability

Limestone is the key ingredient used in the manufacture of clinker. Sanghi's limestone mine has estimated reserves of close to 1000 MM valid upto 2046. These reserves are capable of servicing requirements of a 10 mtpa plant for 60-65 years. Hence, even post the second phase of expansion, Sanghi has enough limestone reserves to undertake expansions and scale up its business.

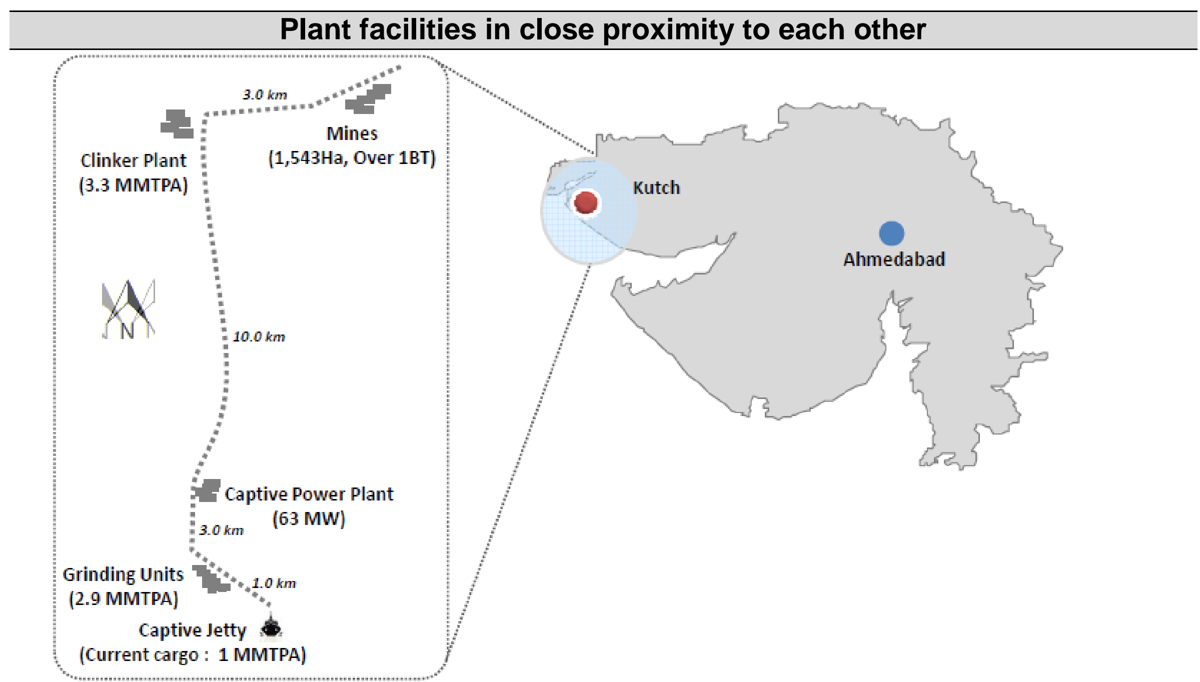
Further, the mine is situated just 3 kms away from the clinker plant, implying negligible transportation cost. Also, given the fact that the plant is located near the coast, the limestone reserves are soft and do not require extensive mining operations, thereby reducing the cost of limestone extraction. Accordingly, Sanghi's raw material cost per tone is ~Rs 250/tone, as compared to the industry average of Rs 700-800 per tone.

…However, freight costs high due to high lead distance

Sanghi's freight cost is Rs ~1200/ton, higher than the industry average of Rs 800 per ton due to a high lead distance. Further, majority of the key markets are serviced through road, which is a relatively expensive mode of transport.

Raw Material:
Sanghi's limestone reserves, clinker plant and grinding unit are within a distance of 10 kms from each other.

Plant facilities in close proximity to each other



Source: Sanghi Industries, Ventura Research

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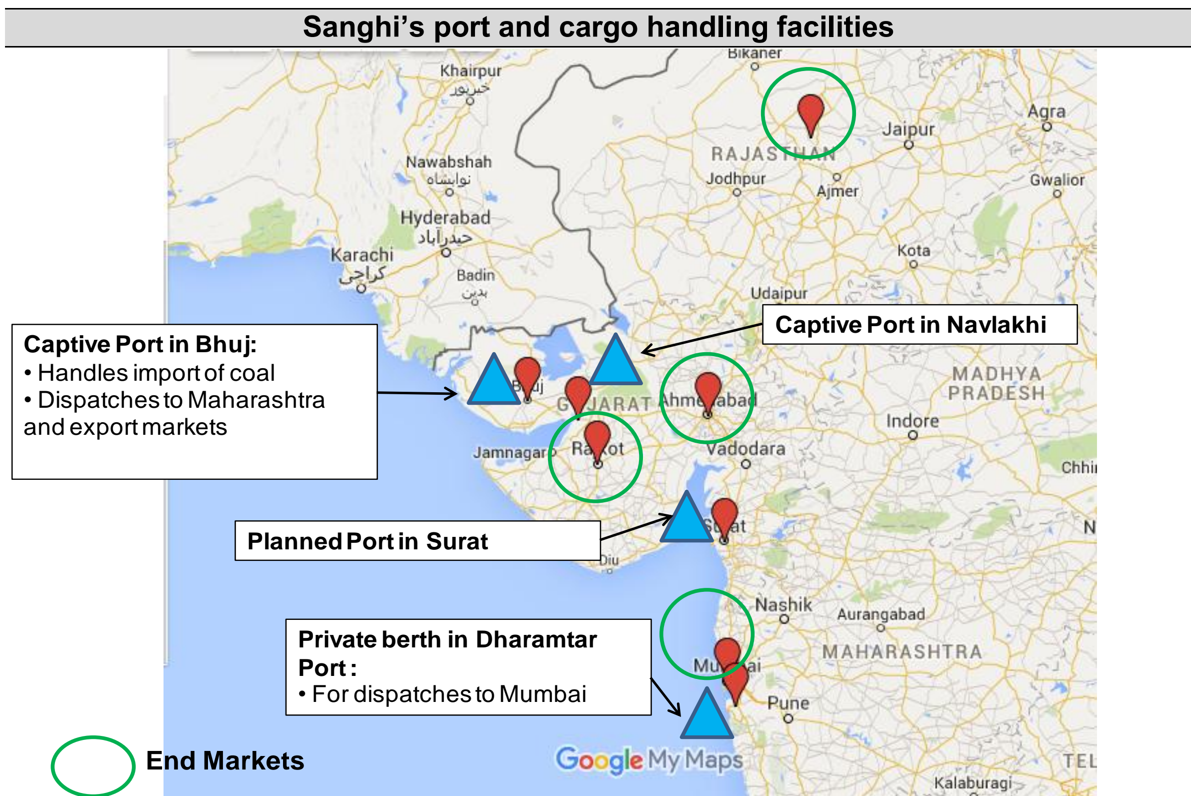
Cement dispatches:

However, Sanghi's lead distance for cement dispatches range from 150 kms to 650 kms since cement is dispatched to places as far as Ahmendabad and Surat via road. The company uses the coastal route for dispatches to Maharashtra through the Dharmatar port in Raigad. In order to optimize freight costs, the company plans to develop a captive port in Surat, which will serve as a hub for supplies to Surat and Baroda markets. This arrangement will be similar to the existing captive port that the company has built in Navlakhi for supplies to Saurashtra and Rajkot markets.

Sanghi's port and cargo handling facilities



Source: Sanghi Industries, Ventura Research

The sea route is the cheapest mode of freight transport, followed by rail and road. Higher proportion of dispatches through the sea route, post the commissioning of the port in Surat, will help Sanghi to reduce freight cost.

Sea-route the cheapest logistical option for cement companies

Mode of transport	Cost of transport (per tonne per km)
Road	Rs 1.5
Railway	Re 1
Sea	50-70 paise

Source: Ventura Research

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➢ Multiple triggers for operating margin expansion

Sanghi's EBITDA margin has expanded from 16.9% in FY15 to 19.4% in 9MFY16 on account of lower raw material and operating expenses. We believe margins can expand further from here-on, on the back of:

i) Higher proportion of PPC cement:
The standard Ordinary Portland Cement (OPC) contains 95% clinker, while PPC (Portland Pozzolana Cement) grade contains ~70% clinker, with a mix of fly ash and slag constituting the remaining. Since fly ash and slag are available at 1/4th the cost of clinker, savings on manufacture of PPC grade cement can go up to Rs 250-275/tone.

The existing plant of Sanghi can manufacture OPC cement. However with certain modifications, the company has started manufacturing PPC grade cement from the existing set-up. It now manufactures 0.5mtpa of PPC from the existing set-up. Also, the additional 1.2 mtpa line set-up in 2015 is a PPC manufacturing set-up. The management aims to improve the OPC:PPC sales ratio which is currently at 75:25, to 40:60 in the coming two years.

ii) Subdued coal prices: As illustrated earlier, coal prices are expected to remain subdued in the near term, resulting in savings in fuel costs for players in the cement industry in the near term.

Long-Term triggers:

i) Sanghi will be able to save on freight costs post the commissioning of the **captive port in Surat,** as mentioned earlier.

ii) Sanghi has plans to set-up a **Waste heat recovery plant in the next 1-2 years:** Waste Heat recovery plants, which entail a capex of ~Rs 40-50 crores, trap heat emitted from the clinkerisation process and re-cycle it for further use. They can yield 30-35% savings in power costs.

Accordingly, we anticipate the company to clock a EBITDA growth of 11% CAGR during FY16-19 to Rs 328 crores by FY19, and EBITDA margin to expand to ~23% by FY19E, from ~18% in FY16.

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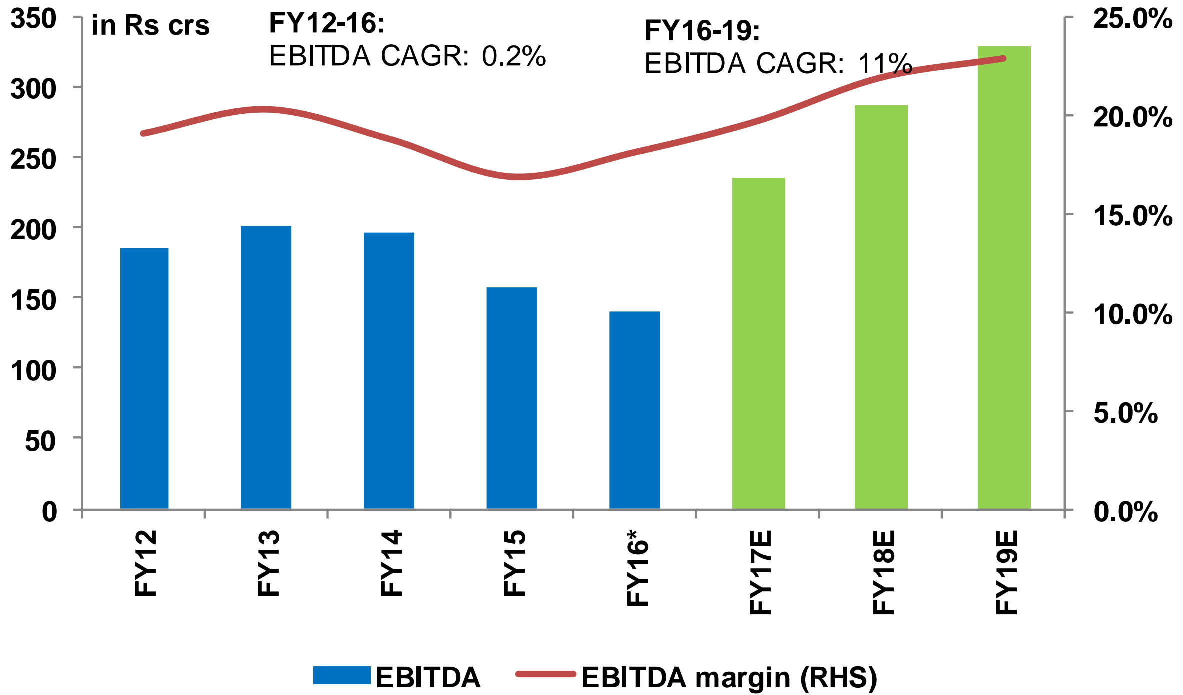
EBITDA and operating margins set to recover from FY16 onwards



Source: Ventura Research

Key Risks:

- **Lower than anticipated rainfall:** While the Met department has forecast above normal monsoons for this year, any deviation will hurt the rural economy to a great extent. This will adversely impact all underlying sectors, including cement.

- **Delay in capacity expansion:** Any delay in financial closures will delay the phase 2 of the expansion plan as a result of which, the company will not be able to capitalize on the demand uptick expected.

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Financial Performance

In Q4FY16, Sanghi reported a robust revenue growth of 22% YoY to Rs 303 crores backed by volume expansion due to the gradual ramp-up of the expanded capacity. EBITDA margin remained flat YoY at 20.7%. The company incurred a one-time expense of Rs 60.4 crores related to CDR lenders settlement. It reported an Adj PAT of Rs 33 crores, which marked a increase of 51% YoY.

Quarterly Financial Performance *(₹ in crore)*

Particulars	Q4FY16	Q4FY15	FY15	FY16*
Net Sales	303.3	248.2	932.3	776.7
Growth %	*22.2*			*9.3%*
Total Expenditure	240.6	195.7	774.9	636.0
EBIDTA	62.7	52.5	157.4	140.8
EBDITA Margin %	*20.7*	*21.2*	*16.9*	*18.1*
Depreciation	18.8	24.4	106.4	54.1
EBIT (EX OI)	43.8	28.1	51.0	86.7
Other Income	1.2	1.16	7.1	2.8
EBIT	45.1	29.3	58.1	89.5
Margin %	*14.9*	*11.8*	*6.2*	*11.5*
Interest	11.8	7.6	27.5	27.2
Exceptional items	-60.39	0	0.0	-60.4
PBT	**-27.1**	**21.7**	**30.6**	**1.9**
Margin %	*-8.9*	*8.8*	*3.3*	*0.2*
Provision for Tax	0.4	0.0	0.0	0.4
PAT	**-27.5**	**21.7**	**30.6**	**1.5**
PAT Margin (%)	*-9.1*	*8.8*	*3.3*	*0.2*

** FY16 is a 9 month fiscal, YoY growth is over 9M FY15*
Source: Sanghi, Ventura Research

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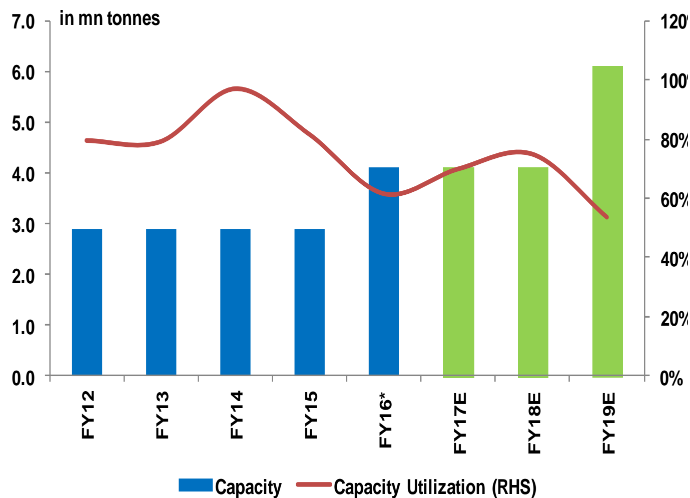
Financial Outlook

➢ Revenues expected to grow at a CAGR of 11.5%

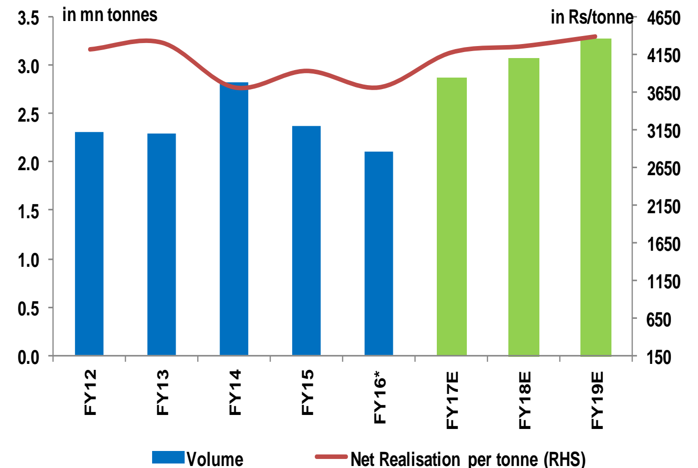
We expect Sanghi's revenues to grow at a 3 year CAGR of 11.5% to Rs 1434 crore in FY19E on the back of an improved demand scenario and capacity expansion. Utilization is expected to moderate to ~50% levels in the initial years post the commissioning of the capacity and then increase going forward. Volumes are expected to grow at a steady 5.5% CAGR during FY16-19 to 3.3 mn tones by FY19. We expect net realizations to increase at a 5.7% year CAGR to Rs 4386 per tonne by FY19. Prices are expected to recover in FY17 and remain firm in the next couple of years.

Capacity expansion in FY16 and FY19…



Source: Ventura Research

…coupled with improvement in realisations



Source: Ventura Research

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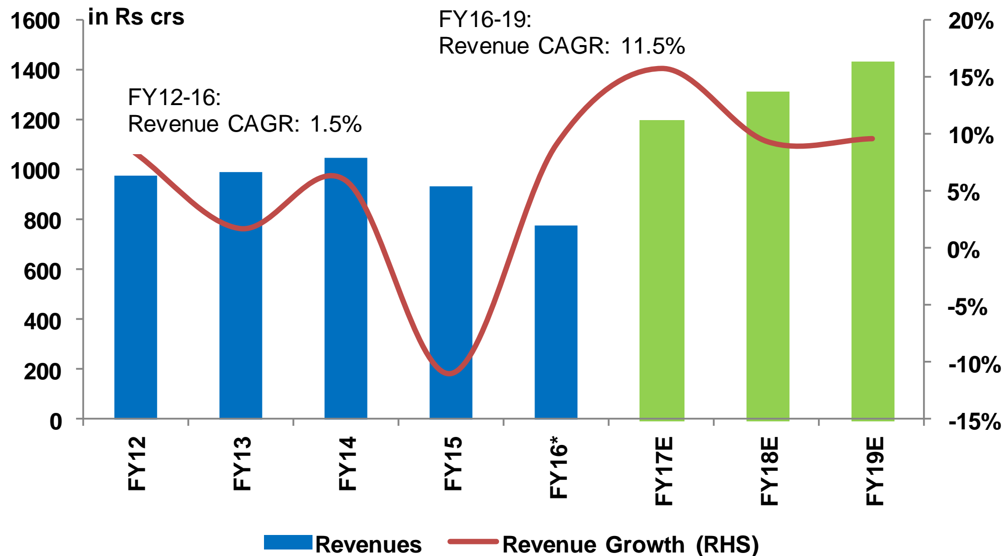
To lead to a revenue growth of 11.5% CAGR from FY16-19

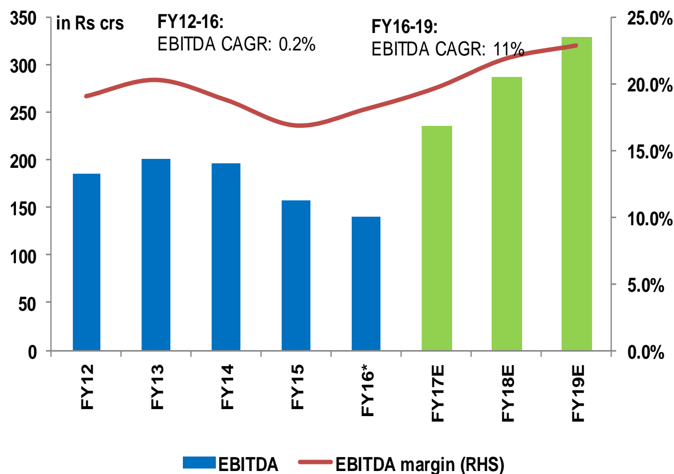


Source: Ventura Research

➢ EBITDA and PAT to grow at a steady pace

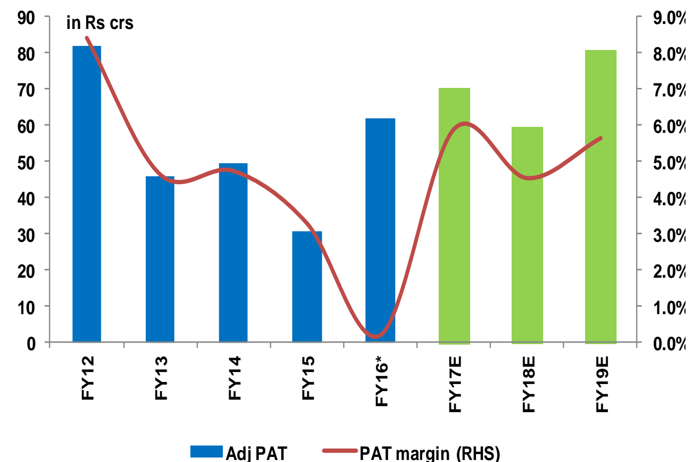
EBITDA is expected to grow at a 3 year CAGR of 20% to Rs 328 crore by FY19 on the back of higher PPC sales and subdued coal costs. Accordingly EBITDA margin is expected to expand from ~18% in FY16 to ~23% by FY19. We expect the company to report a PAT of Rs 79 crores and EPS of Rs 3.6 in FY19.

EBITDA margin set to expand



Source: Ventura Research

PAT to grow at a robust pace



Source: Ventura Research

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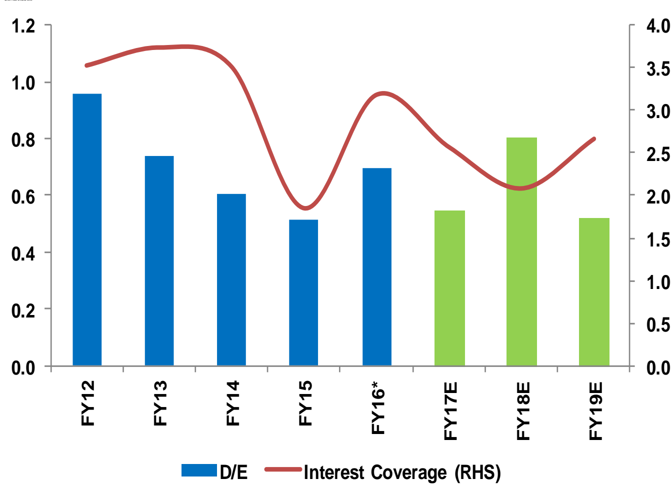
Exit from CDR mechanism

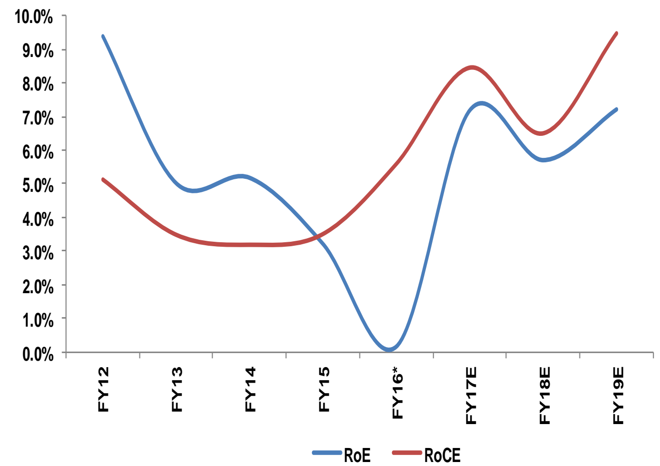
In 2006, Sanghi had to opt for the CDR mechanism as it was unable to service its debt obligations owing to delay in capacity expansion. After a one-time payment to CDR lenders, the company has completely exited the CDR mechanism in Q3FY16.

Balance sheet strength intact post expansion



Source: *Ventura Research*

Return ratios to improve



Source: *Ventura Research*

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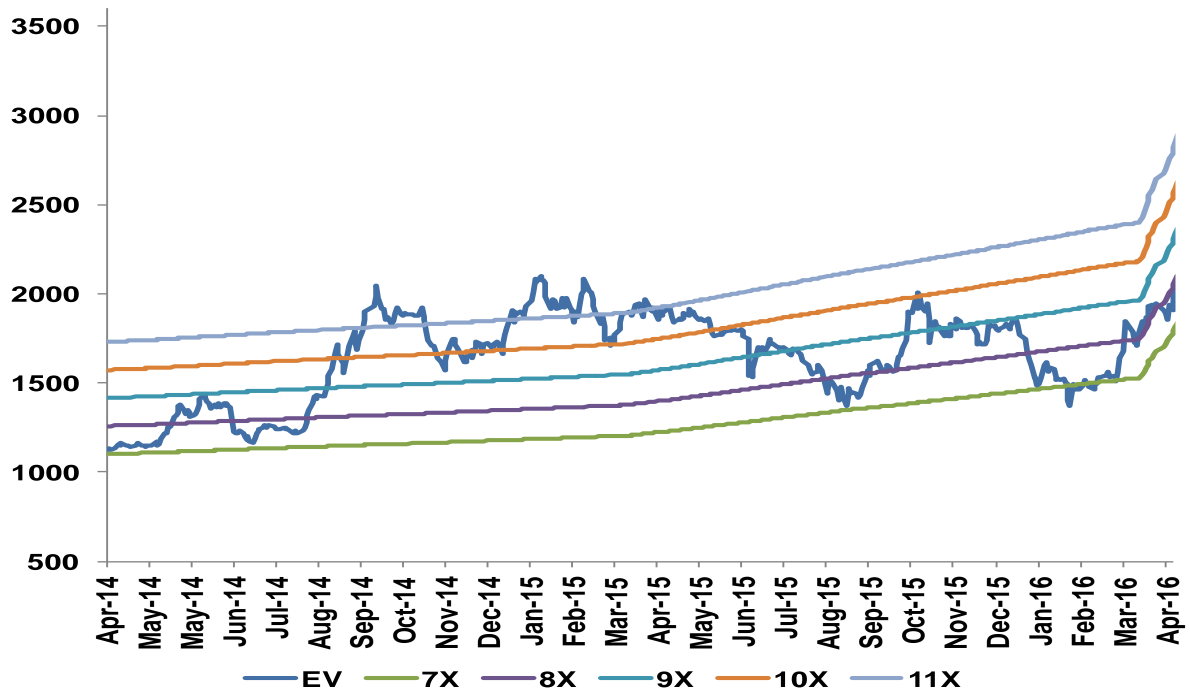
➢ Valuation

We initiate coverage on Sanghi as a BUY with a Price Objective of ₹107, representing a potential upside of 56% over a period of 18 months. We have arrived at our target price by assigning an EV/EBITDA multiple of 9x to FY19E EBITDA estimate of Rs 328 crores. We have assigned a premium of 20% to Sanghi's three year median EV/EBITDA multiple of ~7.5x. We believe Sanghi is a good play in the boom of the cement cycle given its expansion plans, operating efficiencies, lucrative location and strong balance sheet strength. The assigned valuation implies a EV/Tonne of $71, which is in-line with similar sized peers.

Sanghi's EV/EBITDA multiple trend



Source: Ventura Research

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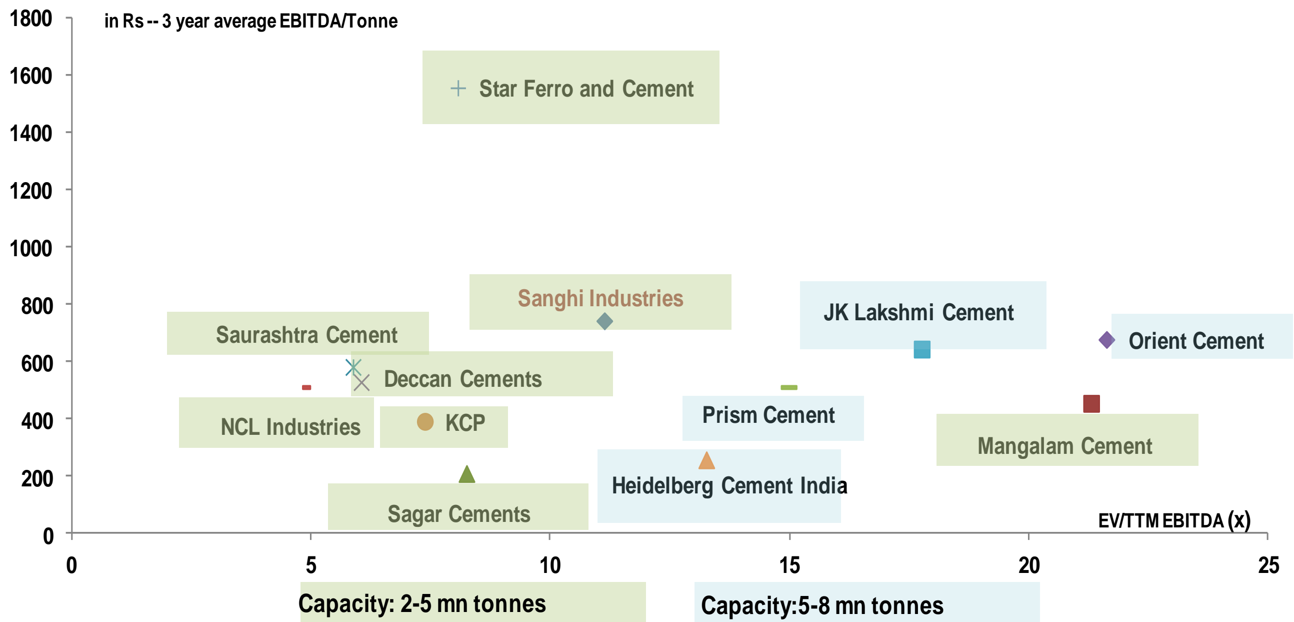
EBITDA/Tonne V/S EV/TTM EBITDA -- Sanghi attractively placed vis-a vis peers



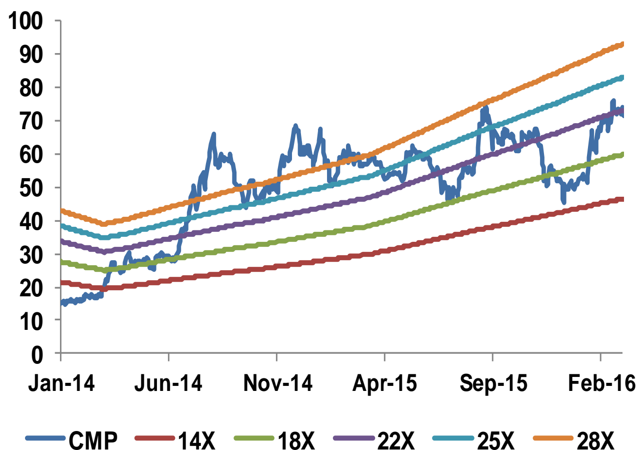
Source: Ventura Research

Capacity-wise buckets and the EV/Tonne trading range

Capacity	$EV/Tonne (FY19 capacity)
Less than 2 mn tonnes	35
2-5 mn tonnes	45
5-8 mn tonnes	70
8-12 mn tonnes	90
Above 12 mn tonnes	120

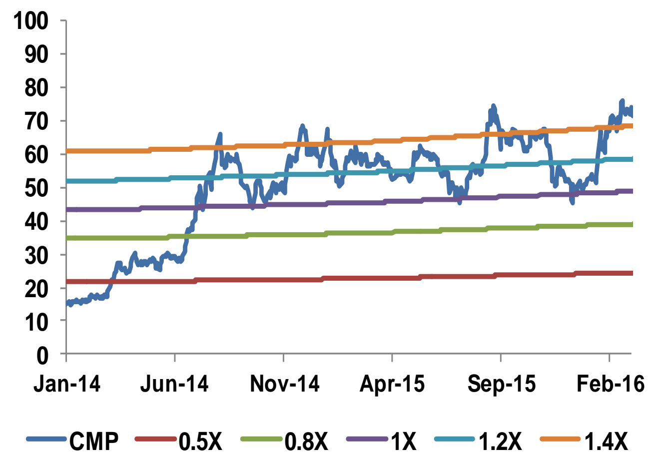
Source: Ventura Research

P/E trend



Source: Ventura Research

P/Bv trend



Source: Ventura Research

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Financials and Projections

Y/E March, Fig in ₹ Cr	FY16*	FY17E	FY18E	FY19E
Profit & Loss Statement				
Net Sales	**776.7**	**1198.1**	**1309.4**	**1434.2**
% Chg.	*-16.7*	*54.2*	*68.6*	*19.7*
Total Expenditure	636.0	961.9	1022.4	1105.8
% Chg.	*-17.9*	*51.2*	*60.8*	*15.0*
EBDITA	141	236	287	328
EBDITA Margin %	*18.1*	*19.7*	*21.9*	*22.9*
Other Income	2.8	9.6	10.5	11.5
PBDIT	**143.6**	**245.8**	**297.4**	**339.8**
Depreciation	54.1	107.7	164.6	167.1
Interest	27.2	50.0	58.6	63.1
Exceptional items	-60.4	0.0	0.0	0.0
PBT	**1.9**	**88.1**	**74.2**	**109.6**
Tax Provisions	0.4	17.6	14.8	30.7
Reported PAT	**1.5**	**70.5**	**59.3**	**78.9**
Minority Interest	0.0	0.0	0.0	0.0
Share of Associate	0.0	0.0	0.0	0.0
PAT	**1.5**	**70.5**	**59.3**	**78.9**
PAT Margin (%)	*0.2*	*5.9*	*4.5*	*5.5*
Power/ Sales (%)	*20.7*	*26.3*	*24.7*	*25.1*
Balance Sheet				
Share Capital	220.0	220.0	220.0	220.0
Reserves & Surplus	692.4	762.9	822.2	901.1
Minority Interest				
Long Term Borrowings	476.3	403.5	643.5	487.5
Deferred Tax Liability	-58.5	-58.2	-59.3	-58.5
Other Non Current Liabilities	101.7	102.6	109.8	117.7
Total Liabilities	**1432**	**1431**	**1737**	**1668**
Gross Block	**2308.3**	**2393.3**	**2993.3**	**3038.3**
Less: Acc. Depreciation	1103.3	1211.0	1375.6	1542.7
Net Block	1205.0	1182.3	1617.7	1495.6
Capital Work in Progress	82.4	0.0	0.0	55.0
Other Non Current Assets				
Net Current Assets	125.0	247.8	119.0	116.9
Long term Loans & Advances	19.5			
Total Assets	**1432**	**1431**	**1737**	**1668**

Y/E March, Fig in ₹ Cr	FY16*	FY17E	FY18E	FY19E
Per Share Data (Rs)				
Adj. EPS	3.2	3.2	2.7	3.6
Cash EPS	2.5	8.1	10.2	11.2
DPS				
Book Value	41.5	44.7	47.4	51.0
Capital, Liquidity, Returns Ratio				
Debt / Equity (x)	0.7	0.5	0.8	0.6
Current Ratio (x)	1.4	1.6	1.3	1.3
ROE (%)	3.2	0.2	7.2	5.7
ROCE (%)	3.5	5.6	8.4	6.5
Dividend Yield (%)	0.0	0.0	0.0	0.0
Valuation Ratio (x)				
P/E	19.2	21.4	25.4	19.1
P/BV	1.7	1.6	1.5	1.4
EV/Sales	2.5	1.6	1.7	1.5
EV/EBIDTA	13.5	8.0	7.9	6.5
Efficiency Ratio (x)				
Inventory (days)	77	76	74	69
Debtors (days)	9	8	8	8
Creditors (days)	68	45	40	40
Cash Flow Statement				
Profit Before Tax	**62.3**	**88.1**	**74.2**	**109.6**
Depreciation	54.1	107.7	164.6	167.1
Working Capital Changes	-163.3	-15.7	46.3	-46.1
Others	39.9	52.7	51.0	40.3
Operating Cash Flow	**-7.0**	**232.8**	**336.1**	**270.9**
Capital Expenditure	-47.0	-2.7	-600.0	-100.0
Other Investment Activities	0.0	0.0	0.0	0.0
Cash Flow from Investing	**-47.0**	**-2.7**	**-600.0**	**-100.0**
Changes in Share Capital	0.0	0.0	0.0	0.0
Changes in Borrowings	206.5	-102.8	240.0	-156.0
Dividend and Interest	-69.9	-50.0	-58.6	-63.1
Cash Flow from Financing	**137**	**-153**	**181**	**-219**
Net Change in Cash	**83**	**77**	**-82**	**-48**
Opening Cash Balance	**0**	**83**	**160**	**78**
Closing Cash Balance	**83**	**160**	**78**	**30**

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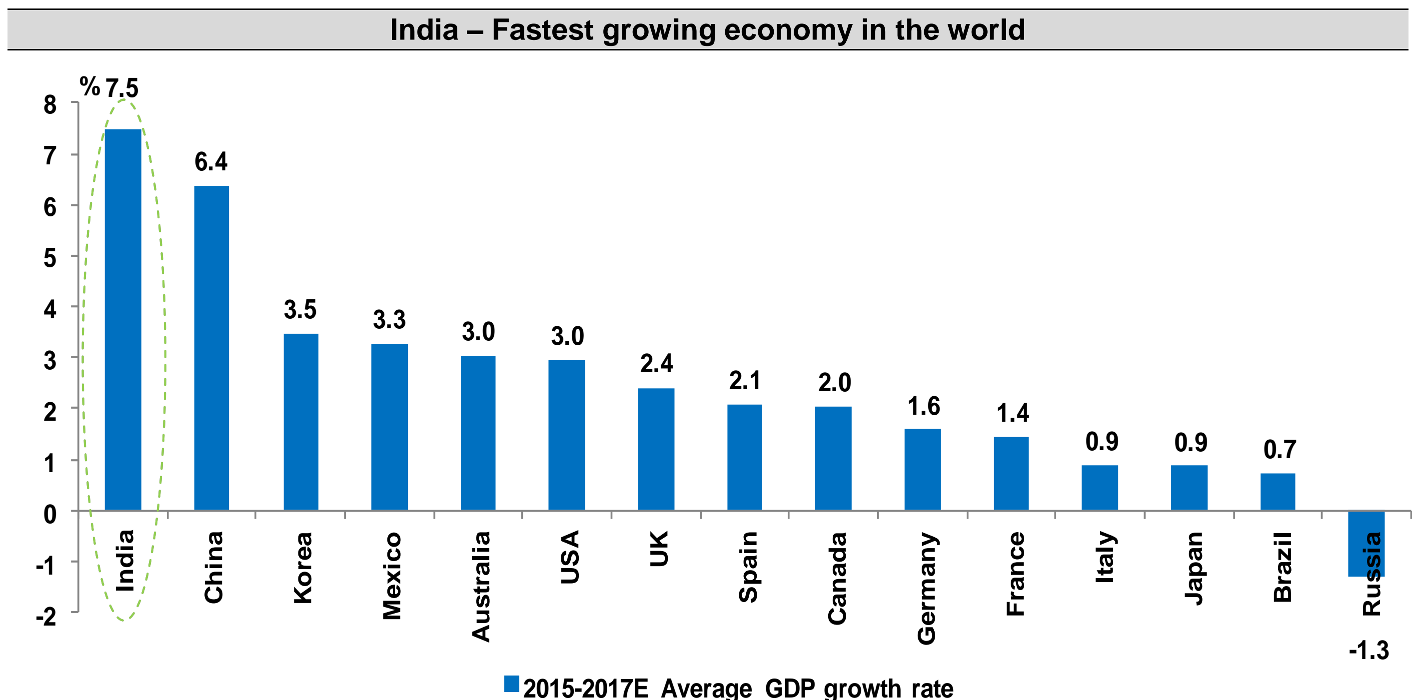
Cement Stocks – A Compelling Investment Story

We believe that the cement industry is on the threshold of a recovery given that:

➢ India is the fastest growing economy

After a sustained period of high inflation, policy logjam and slow growth, the Indian economy is all set to stage a recovery. According to IMF estimates, India's real GDP is set to accelerate by ~100 bps from an average of 6.4% during 2012-14, to 7.5% from 2015-17. These estimates pip India as the fastest growing economy over the next two years.

India – Fastest growing economy in the world



Source: IMF

➢ During the period of high growth, cement industry has grown at ~1.2x real GDP

Over a period of 15 years, the cement industry, on an average, has grown at 1x India's real GDP. However, cement volume dispatches have grown at ~1.1-1.2x during periods of economic recovery. We anticipate cement dispatches to grow at 1.1x GDP over FY16-18 as the economy is all set to stage a recovery driven by:

- Forecast of above normal monsoon for the current year
- Government's thrust on rural economy development. Several measures taken to double rural income in the coming five years which include higher allocations for MNREGA, building irrigation and soil testing capabilities, emphasis on organic farming, crop insurance schemes, interest subvention on farmer loans etc. Uptick in rural economy could kick-start growth in the entire economy
- Pick up in infra activity – Several projects which were stalled due to slow pace of approvals from the government have now been cleared. Further, our interactions with industry players reveal that road construction activity has picked up at a robust pace under the Modi Government – from 3kms a day to 13 kms a day.

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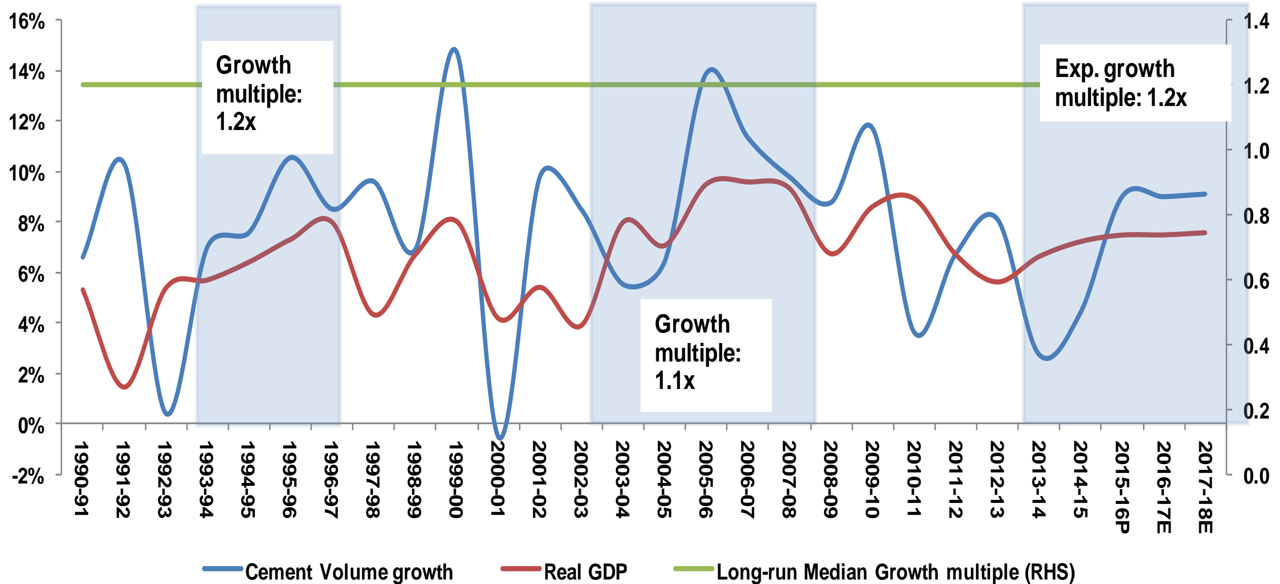
Accordingly, we anticipate cement dispatches to increase from 258 mn tones in FY15 to ~320 mn tones in FY18 at CAGR of 7.6%.

Cement sector has outpaced GDP growth – long run median growth multiple is 1.2x

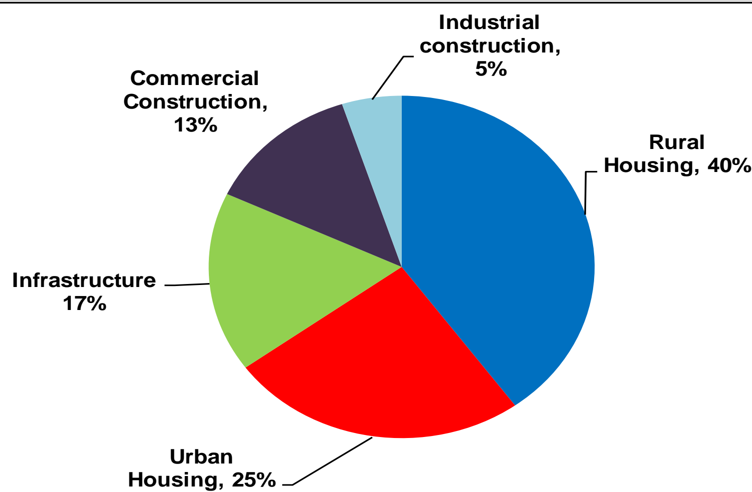


Source: CMIE, Ventura Research

➢ Government's impetus on revival of key demand sectors a boon

Housing constitutes 65% of the total cement demand in India, with a 40% share stemming from rural housing alone.

Cement sector demand break-up



Source: Industry

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Housing:

According to a KPMG report, in order to achieve the Government's vision of 'Housing for All' by 2022, 11 crore houses will have to be constructed at an investment of USD 2 tn (Rs 13,600 bn).

Housing: Current situation and Future Requirements

Particulars (in crore units)	Urban	Rural	Total
Current housing shortage	1.9	4	5.9
Required housing units by 2022	2.6-2.9	2.3-2.5	4.9-5.4
Total Need	4.4-4.8	6.3-6.5	10.7-11.3

Source: KPMG

While our industry interactions suggest that the housing activity, both in the urban and rural areas is yet to pick up, we believe there are enough green-shoots in the sector which may result in a revival sooner than later. These include:

i) There is a shortage of nearly 4 crore units in rural areas, which is more than double than that of urban areas. In order to give an impetus to rural housing, the government has proposed financial assistance of up to Rs.1.30 lakh for the construction of 2.95 crore pucca houses in rural areas by 2022. Also, above normal monsoon would be a great relief to the farm economy which has seen two consecutive years of drought like situation and low MSPs. Improvement in farm income could kick-start spending and construction activity in the rural areas.

ii) Urban housing is also expected to receive a boost under the government's Smart City development initiative. An investment of Rs 50,800 crores has been allocated for the development of 20 smart cities in the first phase.

iii) The government has also introduced various tax exemptions to builders for construction of affordable housing, constituting ~90% of the total demand for homes and additional home loan interest deductions to buyers on loan upto Rs 35L, where the purchase cost does not exceed Rs 50L.

Infrastructure and Construction:

Based on our interactions, cement players have indicated that activity in the road sector has picked up at a significant pace. For instance, there has been a 69% increase in project awards by NHAI during the first eight months of FY16 to 2,649 km from 1,572 km in the same period of the previous fiscal. Also, the pace of execution has increased 45% to 4.96/km a day during April-Nov 2015, from 3.41/km a day in the same period previous year. This can be attributed to government's efforts on quick resolution of stalled projects, delegation of power to local registries to grant forest clearances, and award of project only after 80% of the land has been secured. According to ICRA, at this pace, execution during FY2016 will exceed 1,800 km, higher than the FY14 and FY15 levels. Such a spurt in road construction augurs well for demand revival of the cement industry.

Industrial and commercial construction is expected to follow suit on the back of:
i) NITI Ayog: As per NITI Ayog's directional framework, the government plans to focus on 5 major areas of investments:

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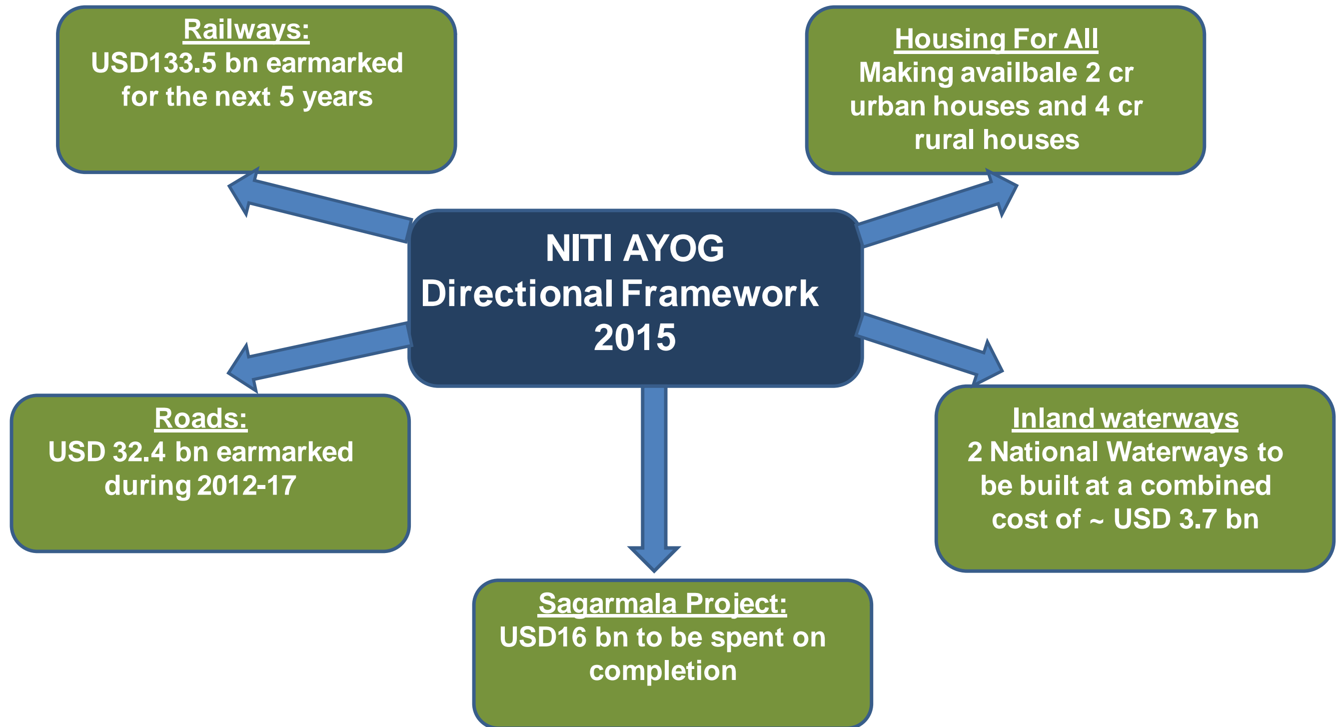
Infrastructure Investments planned as per the NITI Ayog framework



Source: Ventura Research

ii) Make in India – Launched with the aim to boost industrial growth

iii) Smart Cities Mission – Enable local area development and create multiple hubs across the country to foster economic development

iv) Launched Atal Mission for Rejuvenation and Urban Transformation (AMRUT) with a three-fold objective: a) Ensure access of tap water in every household. b) Construct greenery and open spaces in cities and c) Switching to public transport or construction of non-motorised transport.

The cement sector will be the foremost beneficiary of revival in housing, infrastructure and construction activity estimated on the back of the initiatives of the Government and an improving demand scenario.

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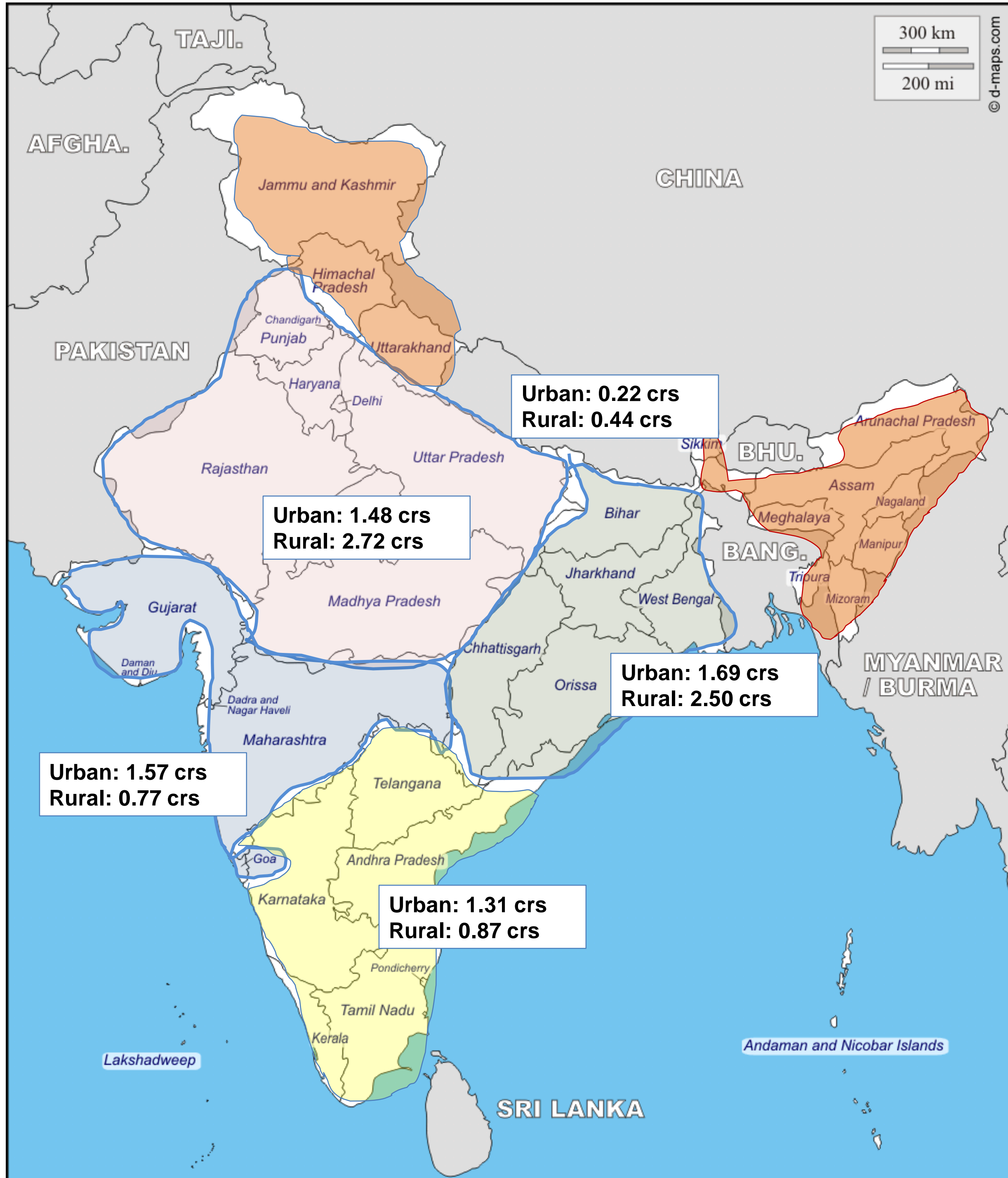
➢ **Pockets of High Infrastructure Activity in India:**

Housing for All: Housing requirements by 2022; North and East have the highest requirements



Source: Ventura Research

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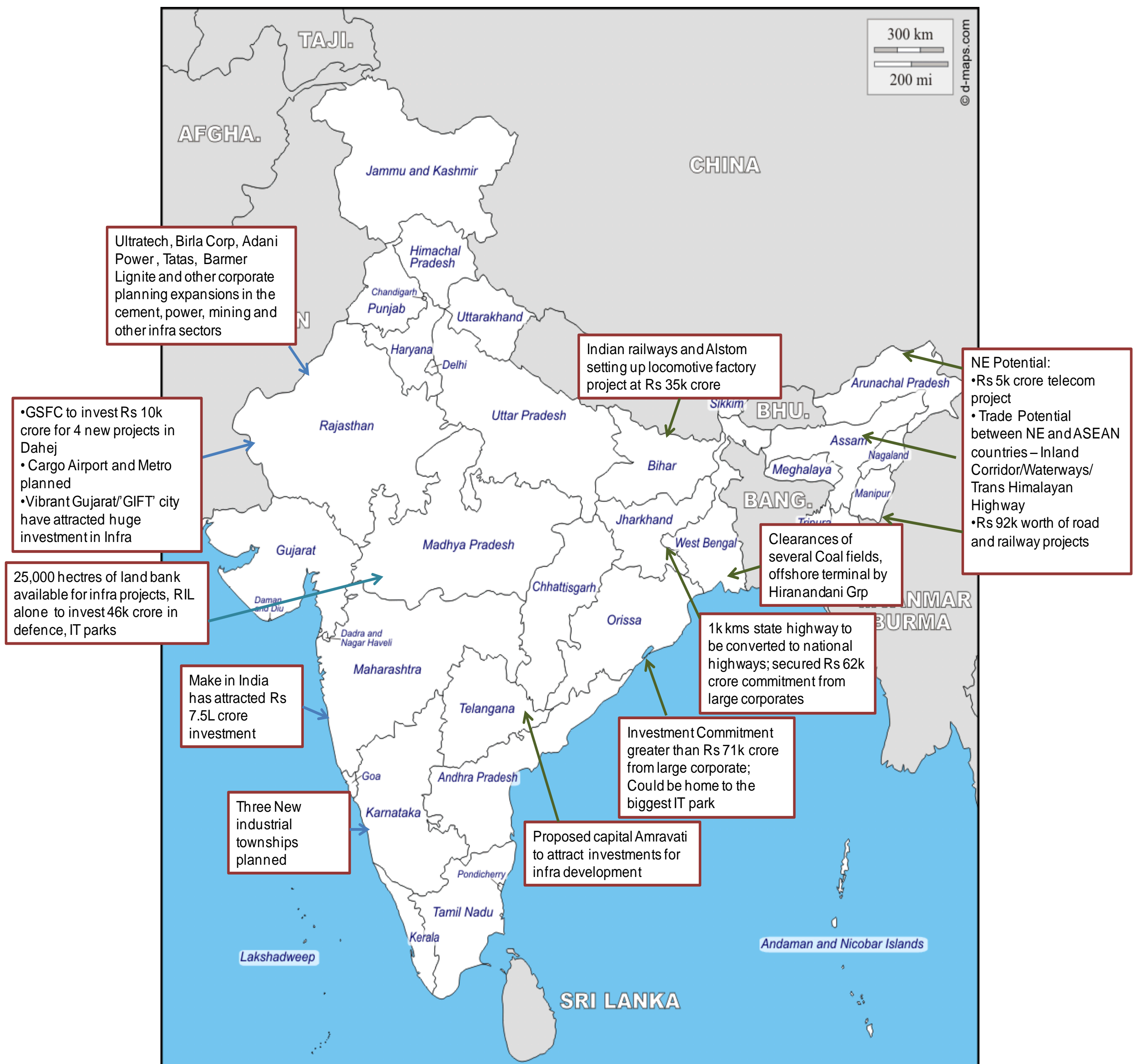
State-wise infrastructure investment potential; prospects look bright



Source: Ventura Research

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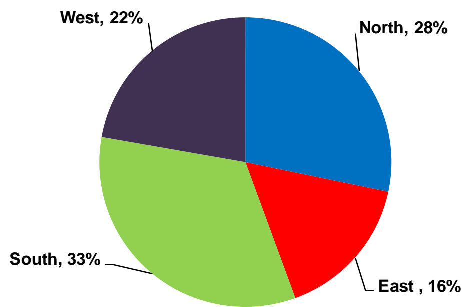
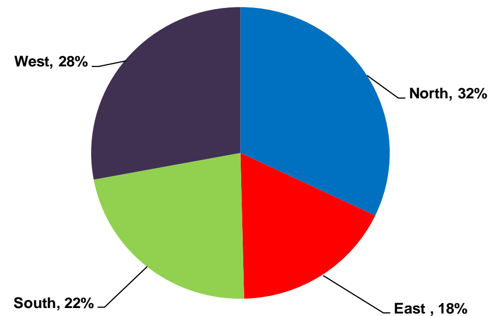
Political resolution in the South a relief

South constitutes nearly 35% of the total cement capacity in India due to abundant availability of limestone reserves, the key raw material used in the manufacturing of cement. However, over the years, capacity built up exceeded the demand leading to the low operating utilization levels and distressed financials for South based players. The political turmoil over the creation of a separate state, Telangana, only added to the woes.

South has largest chunk of the capacity…	…but a relatively low demand share





Source: Ventura Research

However, with political resolution in 2014 and with the creation of a new state, construction activity in the South is likely to get a boost. With limited capacity additions in this region coupled with improvement in prices, the fortunes of South based players could well turn around from here on. Thus, the period of over-hang of South based players on the overall performance of the industry could be over.

Consolidation to lead to pricing stability

Since 2013, the cement industry has witnessed a number of M&A transactions, wherein reasonably sized players have chosen the inorganic route to expand capacities and diversify geographic presence. Since 2013, nearly 90 mn ton of capacity (23% of current capacity) has been consolidated through the M&A route. Consolidation augurs well for the cement industry as it leads to relatively lower price wars and exit of distressed players bringing in pricing stability. The increase in M&A activity also reflects that large players are upbeat of the demand prospects in the coming years. Some part of the M&A activity can be attributed to large mergers at the global level (Holcim-Lafarge) which necessitate them to divest certain part of the assets so as to comply with the competition guidelines. As can be seen from the below table, majority of the consolidation has taken place in Central and North India, regions most likely to benefit through pricing stability.

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M&A activity in the cement sector since 2013

Year	Acquirer	Acquired Company	Location	Capacity (in mnt)	Investment (Rs crs)	EV/Tn ($)	Particulars
2013	Barrings	Lafarge	Central & East India	8.4	1456	160	Lafarge divested 14% stake in its assets
2013	Blackstone	Sree Jayajothi	AP	3.2	550	150-160	Acquires 53% stake from Shriram group
2013	Ambuja	ACC	Across India	30.5	3500	110	Holcim sold its stake in ACC to Ambuja
2013	Ultratech	JPA's Gujarat assets	Gujarat	4.8	3800	124	3.6MT clinker, 90 years of limestone reserves, captive jetty, 57.5 MW of power capacity
2014	Vicat Group	Sagar's stake in JV	Karnataka	2.75	435	150	Vicat acquires 47% stake in Sagar, plant has access to 300 MT of limestone reserves and operational captive power capacity 30MW, approvals for expansion also in place
2014	Sagar Cements	BMM	AP	1	540	90	Captive thermal power plant, limestone reserves of 155 MT
2014	Shree Cement	JP's North Assets	Haryana	1.5	360	36	JP's Panipat Grinding Unit
2014	Dalmia Cement	JPA's Bokaro JV	Jharkhand	2.1	690	90	Plant has 30 year contract for clinker and slag
2014	Ultratech	JP's MP assets	MP (Satna cluster)	4.9	5400	140	5.2 clinker capacity and 180 MW power plant
2015	Birla Corp	Lafarge	Chattisgarh	5.5	5000	150	As a part of the CCI for Holcim Lafarge merger
2016	Biral Corp	Reliance Cements	MP and UP	5.5	4800	130	Sufficient limestone resevers, captive power plant
2016	Ultratech	JPA Cement assets	MP UP AP, Uttarakhand	22.4	16970	110	Limestone reserves available but MMDRA regulations on mine transfer fee awaited

Source: Industry, Ventura Research

➢ Limited capacity additions to lead to improvement in utilization levels

The industry is unlikely to witness large capacity additions in the coming two years. We anticipate a 1.8% CAGR in capacity additions over FY15-8 given that:
i) Majority of new capex has commissioned in 2015-16
ii) Large players are looking to expand through the inorganic route
iii) Fresh announcements of capacity expansion would mean that the incremental capacities would only be commissioned in 2018-19.
iv) The industry operated at ~69% utilization levels in FY16 – these levels do not warrant fresh capacity additions. Infact, at these levels, new additions would be economically unviable.

Further, with demand expected to revive in the coming years and clock a CAGR of 8-8.5%, utilization levels are expected to improve to ~79%-80% in FY18E.

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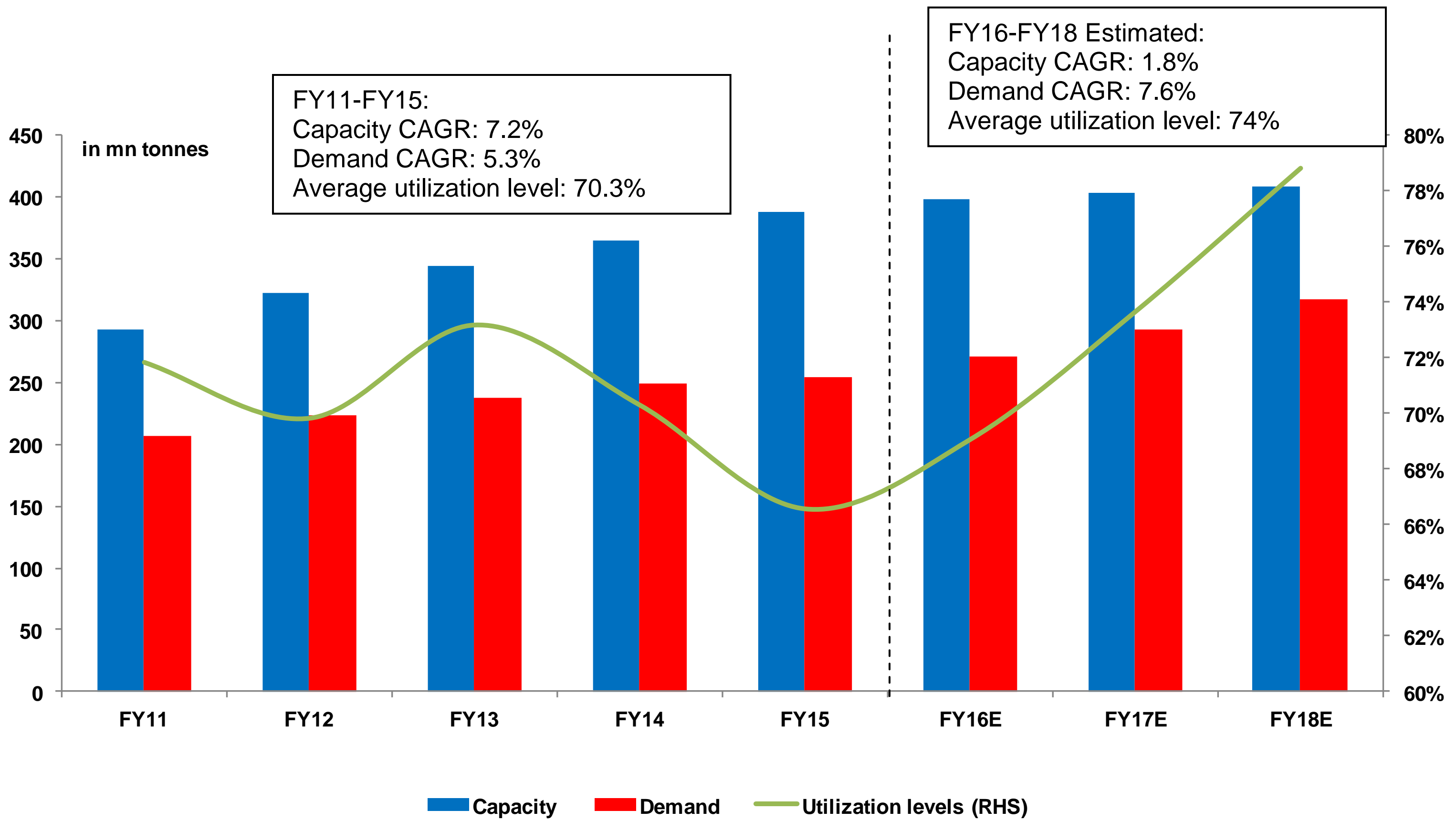
Limited additions + Demand revival = Higher utilization levels



Source: Ventura Research

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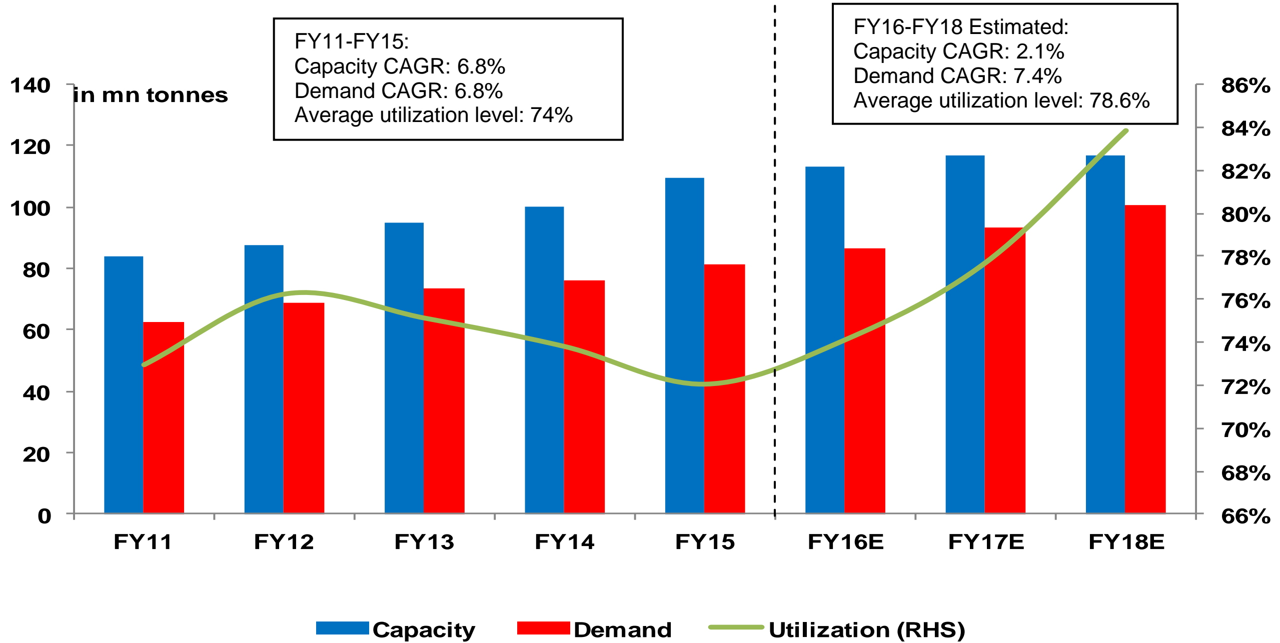
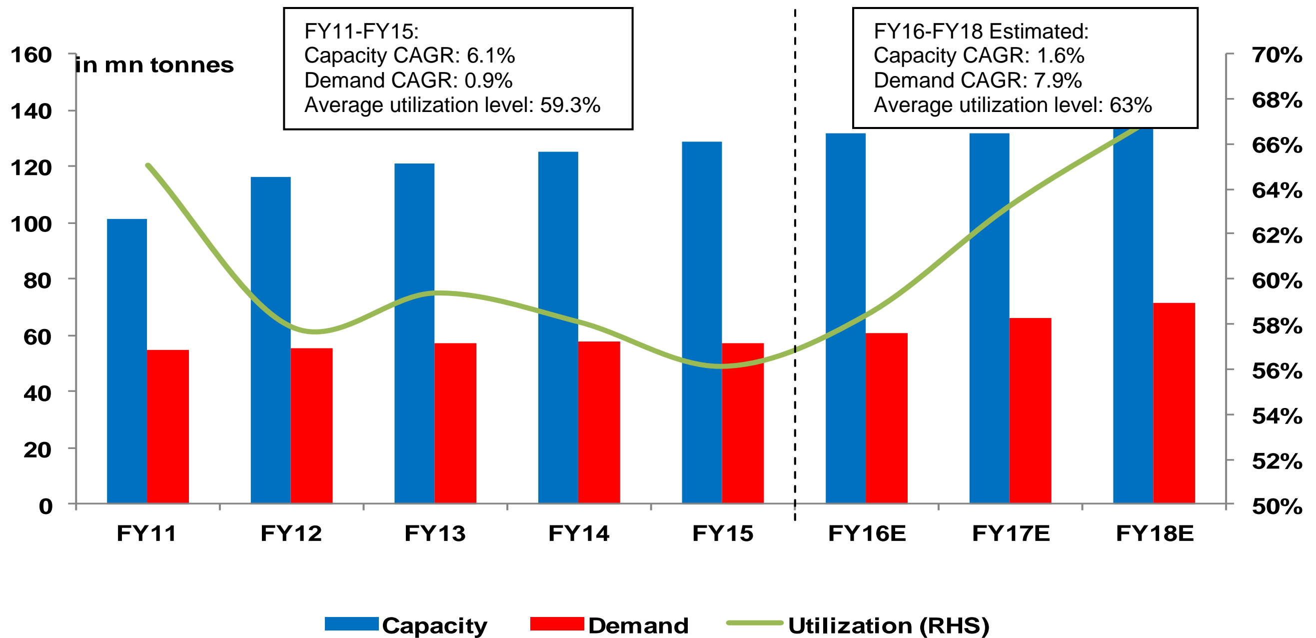
Regional Dynamics

North: Surplus capacity of ~20 mnt, limited additions to ensure improvement in utilizations



Source: Ventura Research

South: Demand likely to revive after a subdued period of 5 years, utilizations to cross 60%



Source: Ventura Research

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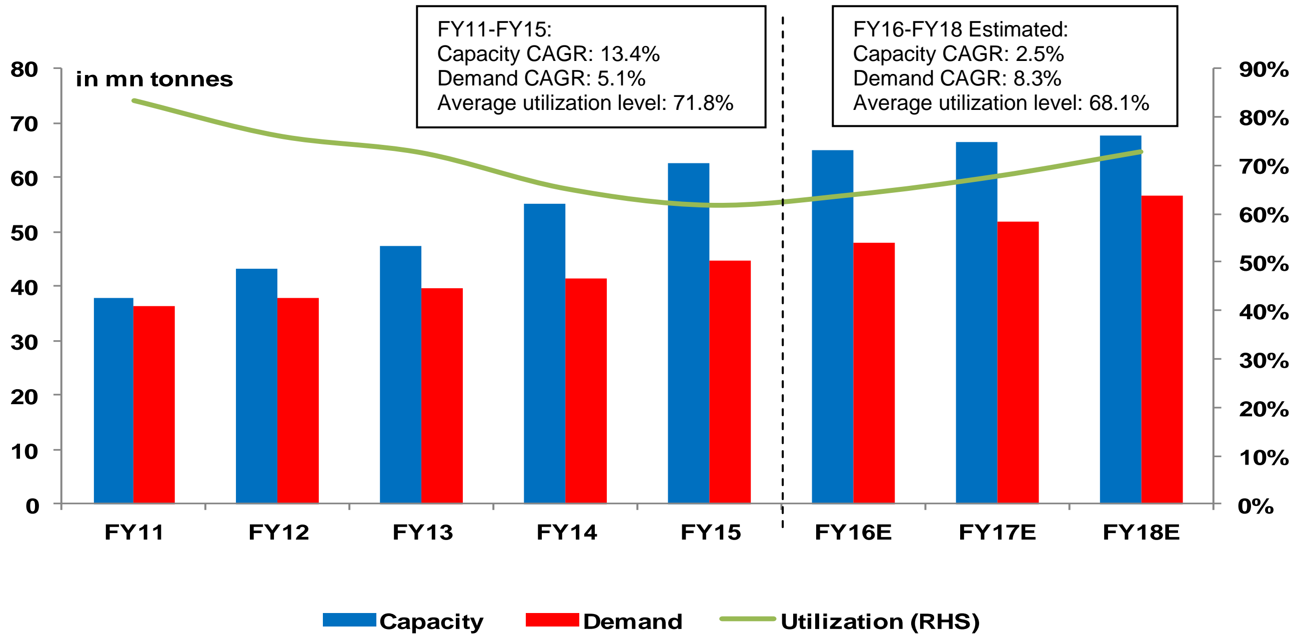
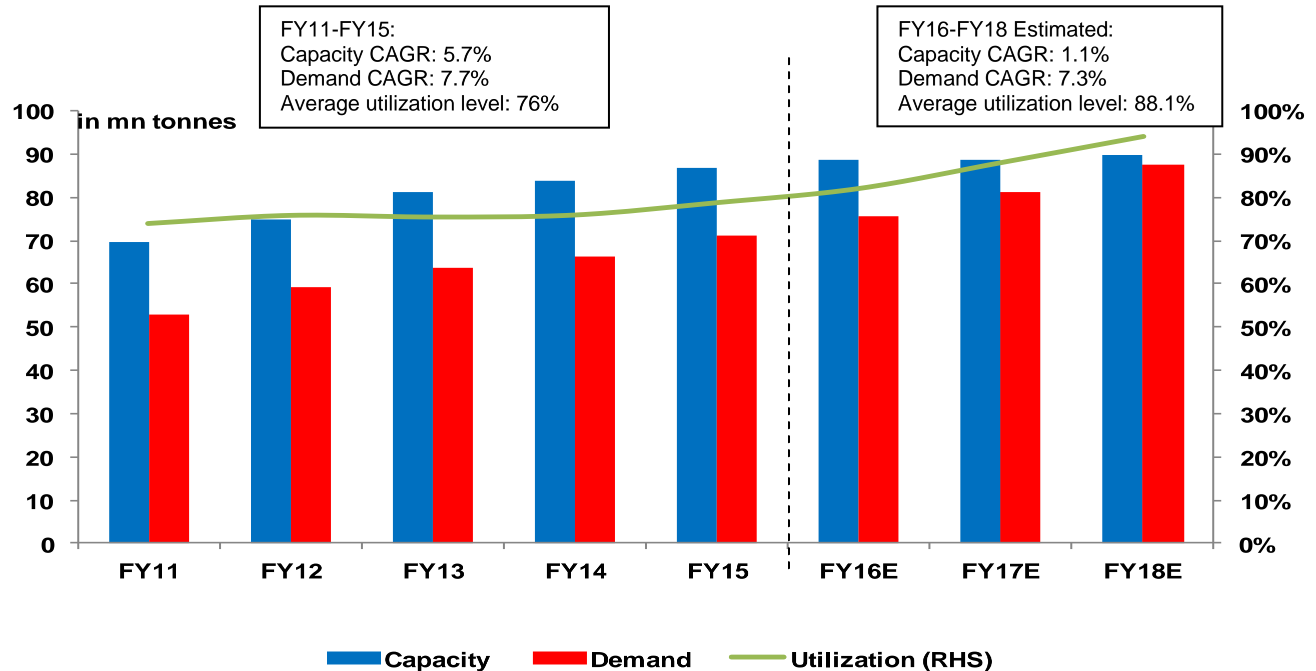
East: Spree of capacity additions has bought down utilizations, demand remains robust



Source: Ventura Research

West: Demand growth has outpaced capacity growth; utilization levels the highest



Source: Ventura Research

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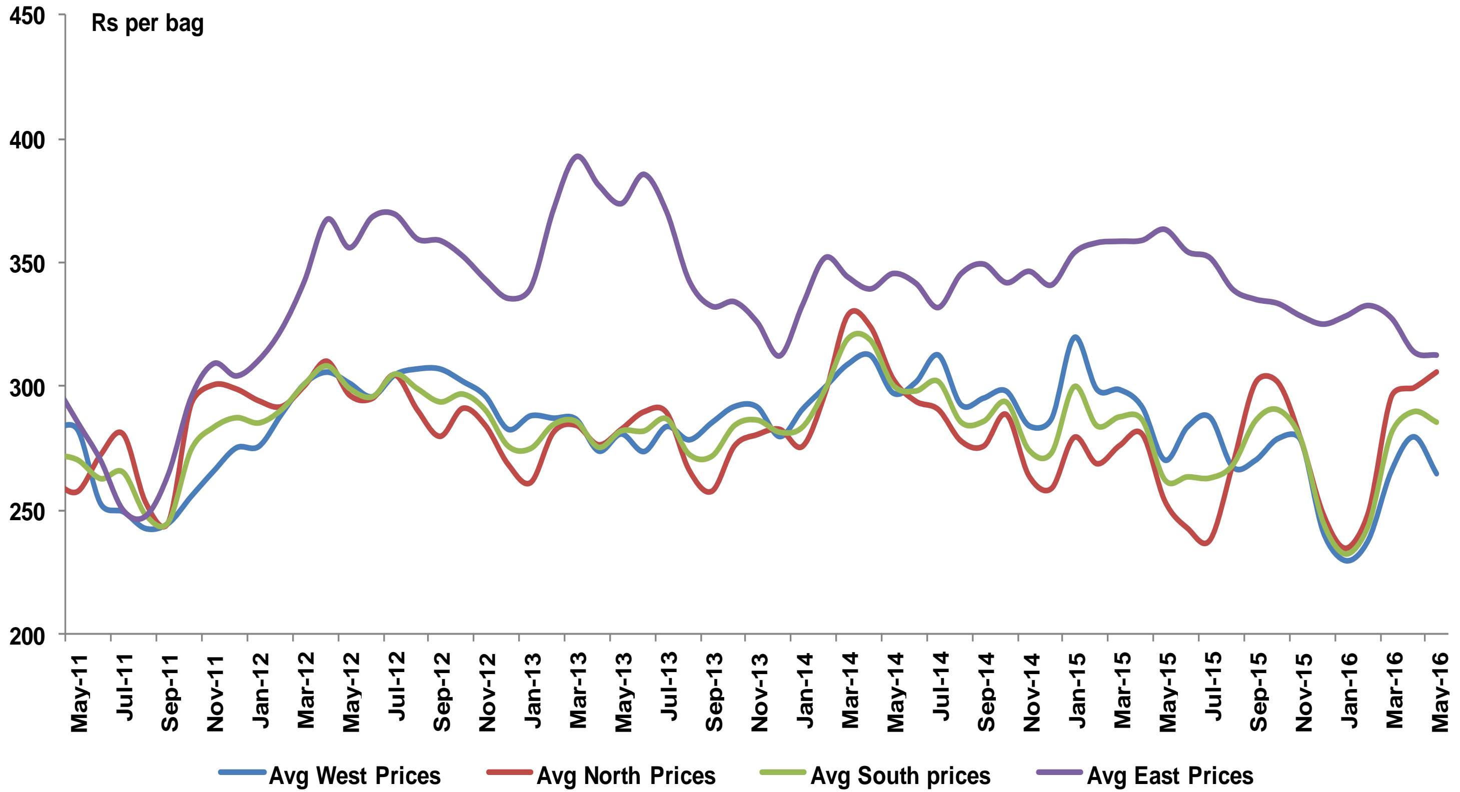
Pricing Trends:

As can be seen from the following chart, prices in the Eastern region have consistently been higher than in the other regions due to favourable demand-supply dynamics. Further, prices continue to be volatile since April 2011 in the absence of a structural demand improvement. However, capacity consolidation and demand revival across key sectors is likely to lead to pricing stability and improvement in operating margins.

Prices in Eastern region consistently higher; pricing volatility persists in the absence of structural demand improvement



Source: Ventura Research

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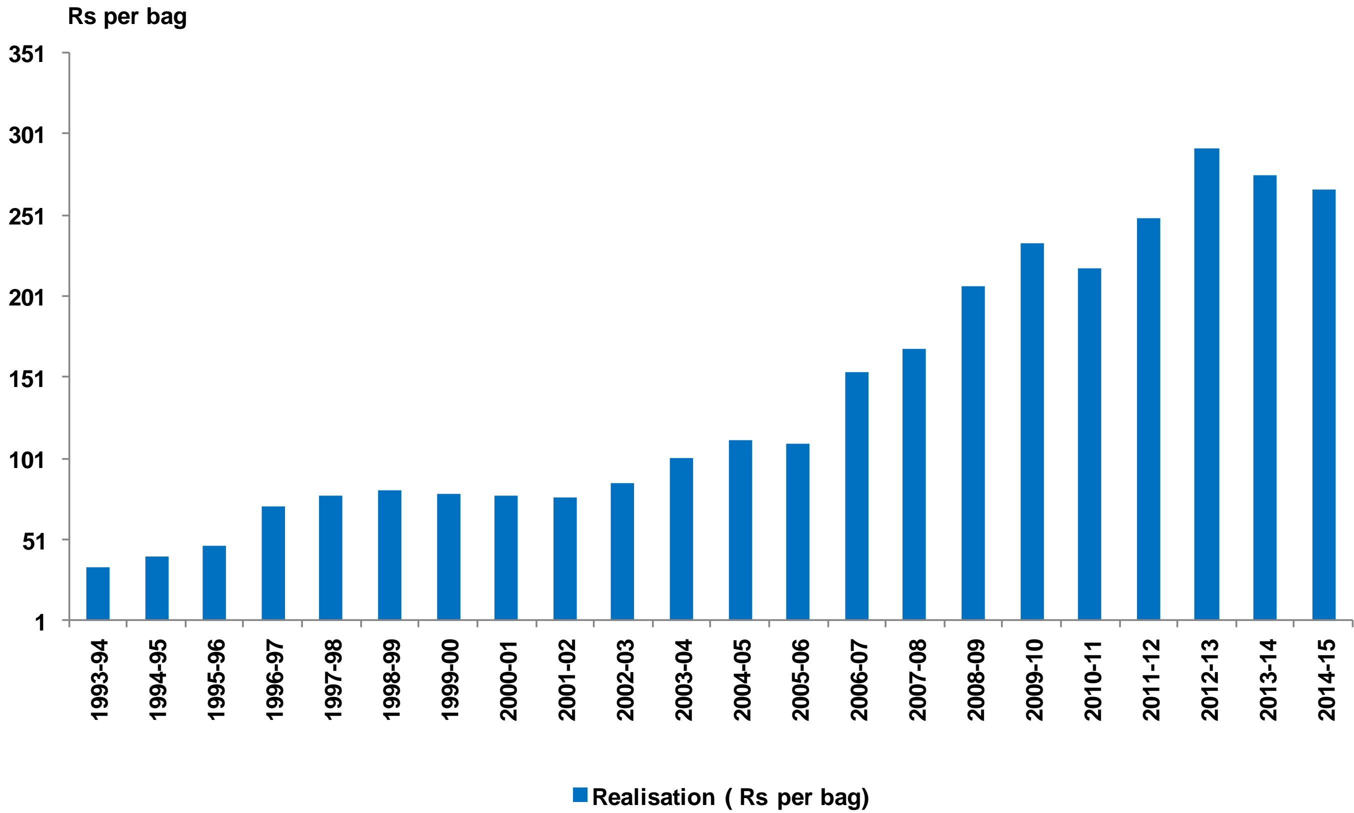
Avg. cement realizations/bag have increased at a CAGR of 10.4% to Rs 266 in FY15, compared to avg CPI of 7.5% from FY1994-FY15



Source: Ventura Research

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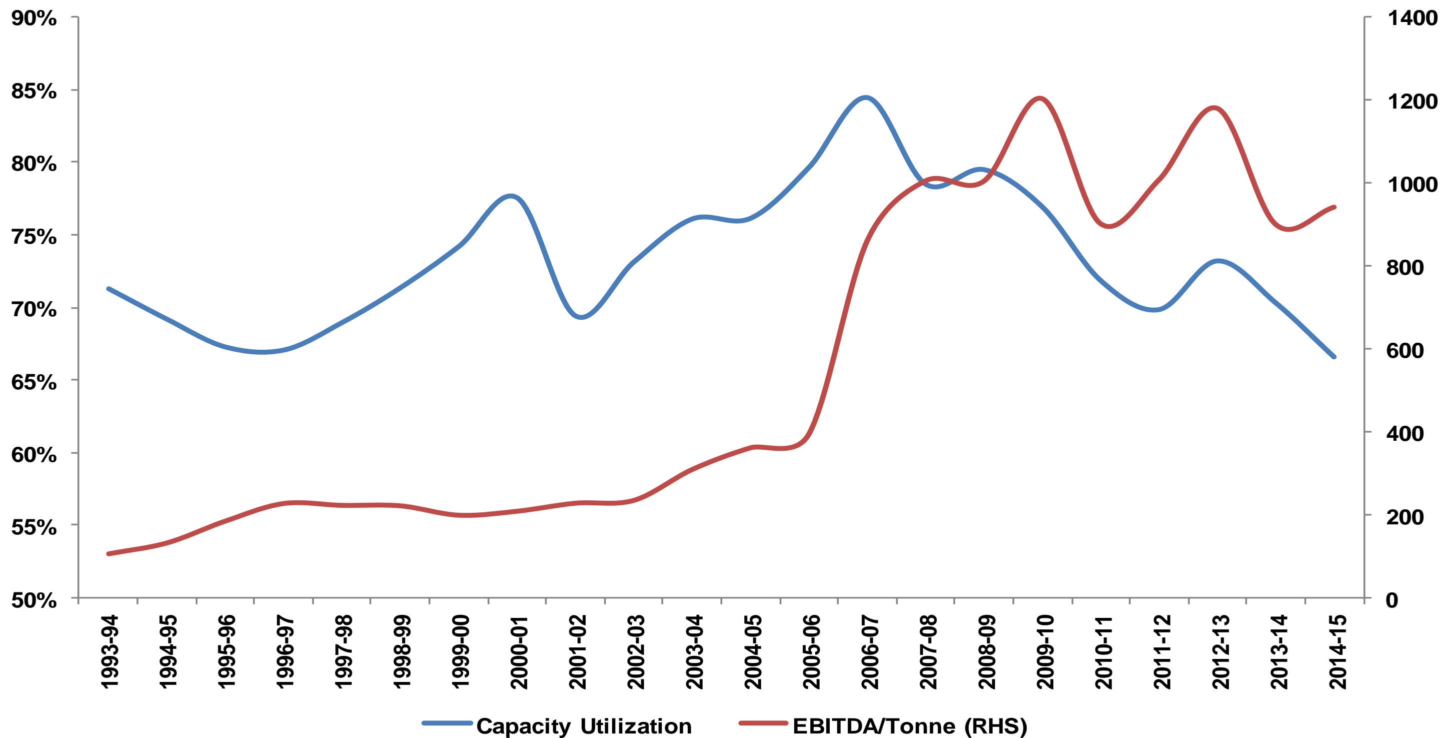
Ample levers to enhance EBITDA/Tonne

Over the past decade, companies have undertaken various cost reduction and operational efficiency measures to enhance EBITDA/tone from Rs 108/tone in FY94 to Rs 943/tone in FY15, a CAGR of 11%. The peak EBITDA per tone of Rs 1200 was reported in FY10.

At similar levels of utilizations, EBITDA/tone of cement players (listed + unlisted) has increased manifold



Source: CMIE, Ventura Research

This has been possible because of multiple factors:

- **Raw material costs saving through alteration of cement grade:**

  The standard Ordinary Portland Cement (OPC) contains 95% clinker, while PPC (Portland Pozzolana Cement) grade contains only 60-65% clinker, with a mix of fly ash and slag constituting the remaining. Since fly ash and slag are available at 1/4th the cost of clinker, savings on manufacture of PPC grade cement can go up to Rs 250-275/tone, as per our industry interactions. Accordingly, many manufacturers are producing such blended varieties of cement grade to save raw material costs. Nevertheless, due to increasing loyalties/taxes on limestone mining, raw material cost per tone has increased at a CAGR of 10.9% (FY1994-FY15) to Rs 1030 in FY15, with raw material constituting an average 21-13% of the total expenditure.

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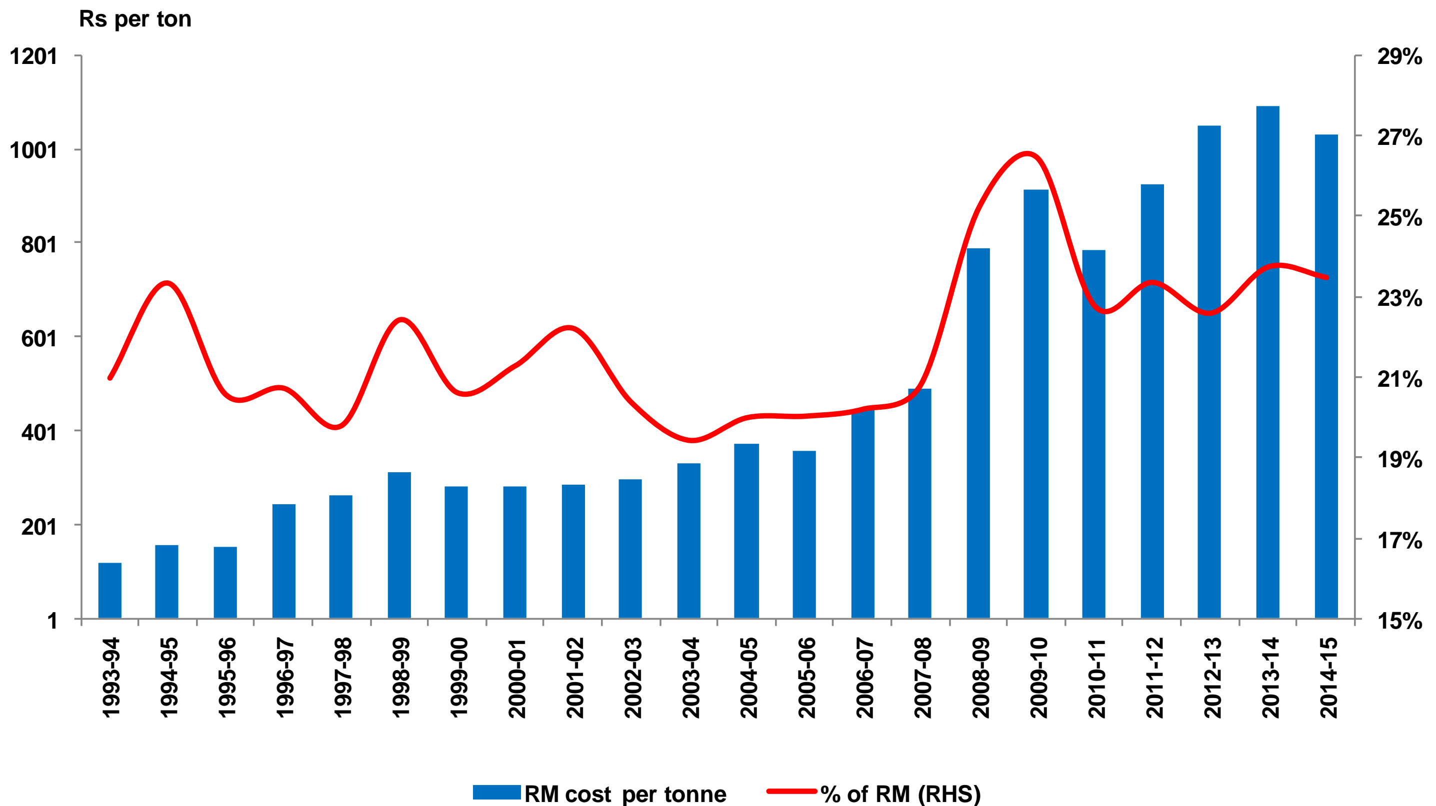
Blended cement production has helped reduce RM expenditure % in the recent years



- **Captive power, multi-fuel plants drive power cost savings:**

  i) Majority cement companies have installed captive power plants to save on fuel costs, which constitute 1/4th of the total expenditure. According to industry sources, a 1 mnt power plant requires about 16MW of power, entailing a capex of about Rs 80- 100 crores. A captive power plant has multi fold benefits including:

  a) Substantial savings (Rs 1-1.5 per unit) in power cost than buying from grid, wherein cost increases happen at periodic levels.
  b) Ensures uninterrupted power supply
  c) Surplus power can be sold to the grid

  ii) Companies are also building multi-fuel power generating systems, which can use a combination of coal, pet coke and lignite depending on prevailing prices to optimize costs.

  iii) Waste Heat recovery plants, entailing capex of ~Rs 40-50 crores, trap heat emitted from the clinkerisation process and re-cycle them for further use -- they can yield 30-35% savings in power costs.

  These measures have helped power costs increase to be restricted to a CAGR of 9.9% from Rs 146.8 per ton in FY1994 to Rs 1065 per ton in FY15, with the power % expenditure coming down to 24% from 26% during the same period.

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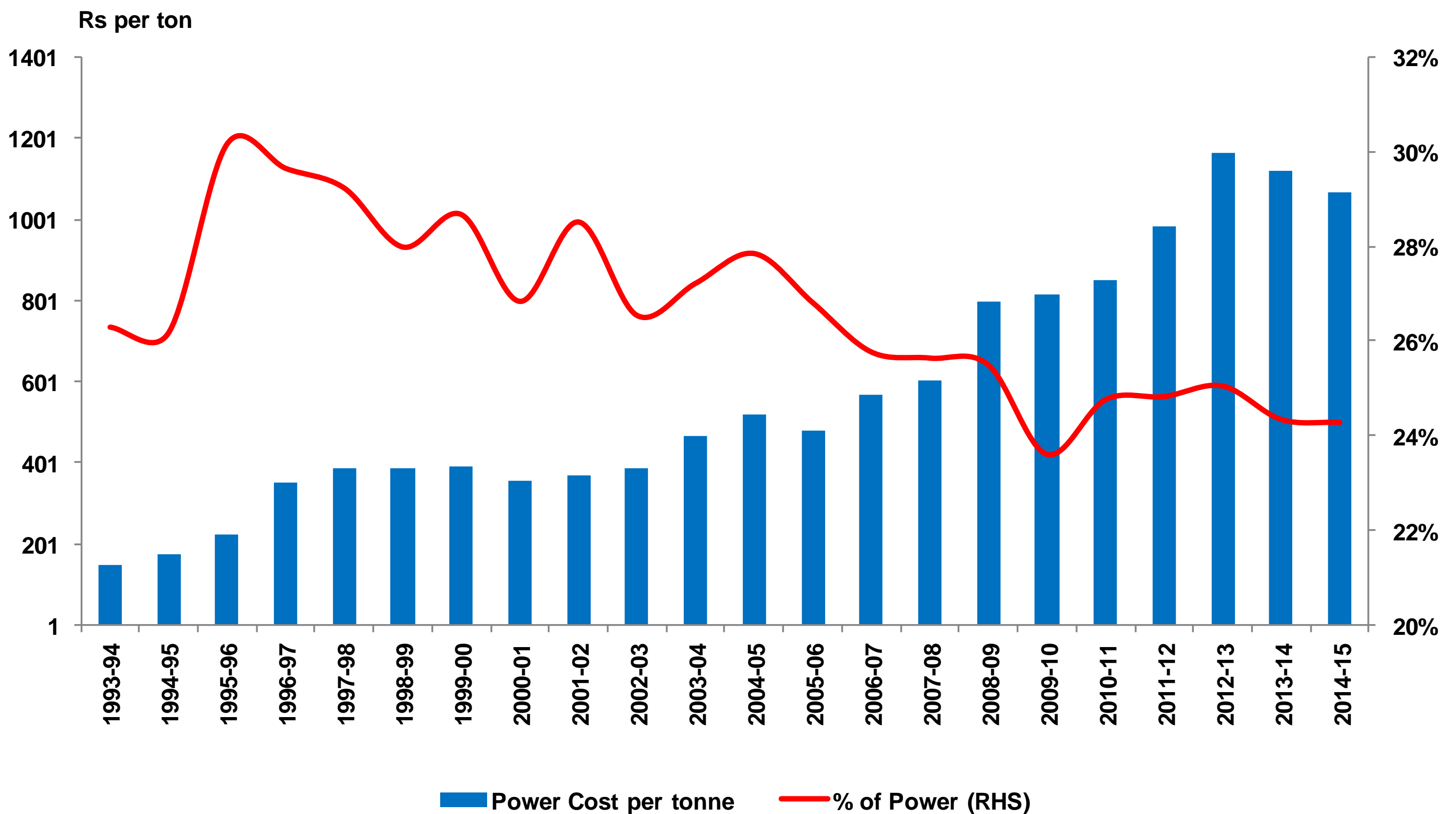
Operational efficiencies and new technologies have driven savings in power costs



Source: CMIE, Ventura research

- **<u>Higher lead distance and increasing diesel costs have increased freight costs</u>:**

  Logistics continue to remain a challenge for cement companies; freight cost per ton has increased from Rs 71 per tone in FY1994 to Rs 830 per ton, a CAGR of 12.4%. As a % of total expenditure, freight cost has increased from 13% to 19% during the same period.

  The increase can be attributed to:

  i) In a bid to capture newer geographies and market share, companies have resorted to higher lead distance sales, thereby increasing transportation costs.
  ii) Out of the three primary logistical modes, railways and sea-way are relatively cheaper than roadways. However, according to industry sources, only 40% of the total logistics is carried out through the railways. Many companies are thus, tweaking their rail-road mix and optimizing lead distances to reduce costs.

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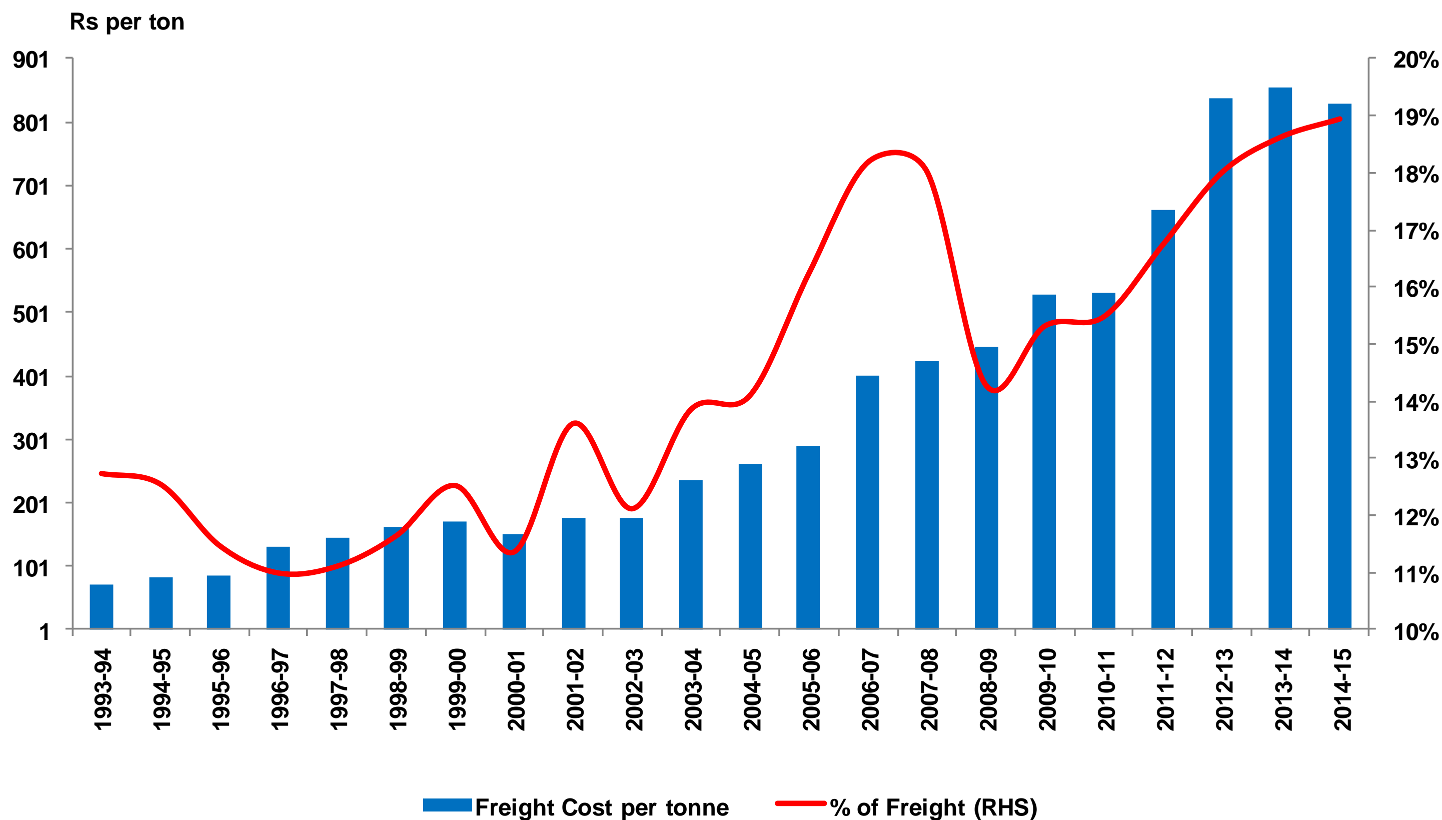
Sea-route the cheapest logistical option for cement companies

Mode of transport	Cost of transport (per tonne per km)
Road	Rs 1.5
Railway	Re 1
Sea	50-70 paise

Source: CMIE, Ventura research

Freight costs % on an uptrend



Source: CMIE, Ventura research

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