

Market Watch

SENSEX

04:04 PM | 28 Jul

25,991.23  -135.52

NIFTY

7,748.70  -41.75

Gold (MCX) (Rs/10g.)

27,910.0  -28.0

USD/INR

60.14  0.03VIEW MARKET DASHBOARD 

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Cement stocks poised for a turnaround; should you invest?

Sanjay Kumar Singh, ET Bureau Jul 28, 2014, 08.00AM IST

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Since the Budget, Aditya Kumar, 44, a Mumbai-based government servant, has been wondering how he can profit from the government's focus on infrastructure and housing. Kumar has been closely studying cement stocks, since they would benefit from an upsurge in construction.

Tough times

The last couple of years have been challenging for the sector. In 2013-14, cement consumption rose by only 3.5%, compared to 5.3% in 2012-13 and 6.7% in 2011-12, according to a report from CARE Ratings. The slowdown in project execution in infrastructure, industry and real estate took a toll on demand. The sector also had to bear the brunt of higher input costs. Due to limited indigenous availability, manufacturers had to import coal, coke and gypsum. The weakening of the rupee compounded their woes.



(*With the current government...)

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Freight costs rose due to rise in the price of diesel, which caused the Railways to revise freight rates. All these factors drove the sector's return on equity (RoE) to single digit.

Turnaround on the anvil

The cement sector's prospects are expected to improve in the future. "With a stable government coming to power, and given its focus on infrastructure and housing development, I expect demand growth to improve to 6-10% in the future," says J Radhakrishnan, AVP, IIFL Institutional Equities. Generally, cement demand grows at 1.2 times GDP, so an economic turnaround should have a positive effect.

The rupee's appreciation to around 60 visa-vis the dollar means that imports will pinch cement manufacturers less in the future. The government's efforts to improve coal availability are also expected to reduce the dependence on imports. With demand remaining low in the past two years, capacity addition has slowed down. As demand growth outpaces capacity addition in future, cement companies will gain pricing power.

At present the southern region has a low level of utilisation of around 60% compared to the all-India average of around 76-77%. "Now that Telangana has achieved statehood, there won't be further agitations that have affected sentiment and led to low cement demand. The two new governments' focus on infrastructure should also lead to higher demand," says Radhakrishnan.

SPOTLIGHT

Monsoon Watch



Rainfall below normal in the past three days

The monsoon has weakened again, delivering scanty showers for three days after the season's wettest week that helped farmers plant crops.

- Govt must invest in building a modern system of irrigation
- IMD website, weather apps gain on deficient rains



Valuations appear stretched

While the deterioration in profit margins halted in the fourth quarter of 2013-14, earnings have yet to improve considerably. Meanwhile, **stocks** have shot up in anticipation of an upturn. Says Daljeet Kohli, head of research, India Nivesh Securities: "Valuations of most large-cap stocks have got stretched. Small-cap stocks still offer prospects for appreciation." According to Radhakrishnan, large caps are currently trading at around 1.5 times replacement cost, based on enterprise value per tonne (EV/t). In the previous upcycle, their valuations had risen as high as four times. "These stocks may still have a lot of upside, but that will come about only if utilisation levels rise to 90-95%," he says.

What you should do

If you have already invested in cement stocks, this is a good time to book at least partial profits in them. **Shree Cement** is the best-in-class performer on fundamentals while **Ultratech** commands the largest market cap. Both have capacity expansion plans that will enable them to benefit from rising demand. Keep them on your watch list and invest when valuations come closer to long-term averages.

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Both Shree Cement and Ultratech have capacity expansion plans that will enable them to benefit from the rise in demand for cement in the coming months.

COMPANY NAME	CMF (₹)	MARKET CAP (₹)	REVENUE (₹)	REVENUE-5 YR CAGR (%)	PAT (₹)	PAT-5 YR CAGR (%)	NPM (%)	ROE (%)	FCF/share-5 yr CAGR (%)	Debt/equity ratio	PE	PE-5 yr avg
Shree Cement	7,104.85	25,100.57	5,682.04	20.24	1,003.97	27.91	18.04	30.53	12.86	0.34	31.59	25.07
Ultratech Cement	2,452.85	69,221.35	21,652.20	26.96	2,212.78	17.70	9.08	13.66	6.32	0.43	33.00	19.42

Data from Axis Equity as on 23 July, 2014. FCF stands for free cash flow.

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28 Jul, 2014 08:39 PM

already both the stocks are at their peak

TRKN (Toronto)

28 Jul, 2014 07:01 PM

Cement demand is bound to pick up with the thrust in infrastructure creation.

S K (Unknown)

28 Jul, 2014 02:16 PM

The cement stocks are good bet on dips

TRKN (Toronto) replies to S K

28 Jul, 2014 07:03 PM

Going forward, cement demand will pick up as the monsoon gets over.