Madras Cements

Recommendation	:	**Outperformer**
CMP	:	Rs 113
Target	:	**Rs 146**
Upside Potential	:	29.2%

Sector	:	**Cement**
Sensex	:	17198
Bloomberg code	:	MC IN
Reuters Code	:	MSCM.BO

AT A GLANCE

Issued Equity Capital (Cr. Shrs)	:	23.80
Mkt. Cap (Rs. in Crs)	:	2689.40
Major Shareholders		
Promoters (%)	:	42.01%
Free Float (%)	:	57.99%
Avg. Daily Vol. ('000)	:	235.22

Background: Madras Cements Ltd (MCL) is the flag ship company of Ramco Group. The company was incorporated in the year 1957 and is primarily engaged in manufacturing and marketing of cement. It is the sixth largest cement producer in the country and the second largest player in South India. MCL also produces ready mix concrete and dry mortar products. MCL has installed coal based captive power plants totaling 72 MW at Jayanthipuram in Andhra Pradesh and Alathiyur in Tamilnadu. The company's power generation segment has a total capacity to generate 181.59 MW from Wind Energy Farms.

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Light at the end of the tunnel…

Strong offtake in major markets...

The housing sector acts as the principal growth driver for cement demand. However, considering the pace at which infrastructural activity is taking place in recent times, industrial and infrastructure sectors have also emerged as strong demand drivers for cement. Cement manufacturers have also lined up expansion plans accordingly. In the Southern region, Andhra Pradesh has the highest cement capacity followed by Tamilnadu and Karnataka. These three states together, account for about 99% of the total regional capacity. Kerala does not have enough capacity and hence most of the cement demand for the state is met through supply from Tamilnadu and the Western region of India.

Madras Cements sells a majority of its produce in Tamilnadu and Kerala, where demand has continued to remain buoyant. Though demand from Andhra Pradesh has remained subdued offlate, it is expected to pick up in the forthcoming quarters. Madras Cements is best placed to benefit from the growth in Southern market and is ready for increased cement offtake through its recent capacity expansion to 10 MTPA.

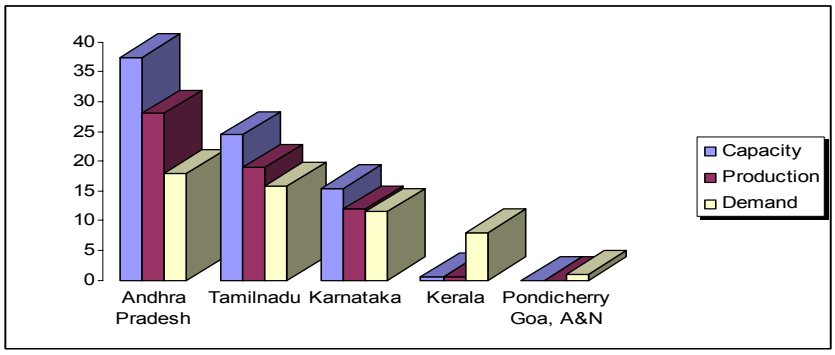
Expect coal costs to ease

Smooth supply of state grid power is another problem. To ensure smooth functioning of plants and lower costs, the cement industry has opted to set up captive power plants based on coal. This has resulted in increase in demand for coal. But coal linkages for the industry are poor.

FY March (Rs Crore)	Turnover	EBITDA	PBT	Net Profit	EPS (Rs)	BVPS (Rs)	PE (X)	Net Div Yield (%)	EV/EBITDA (X)	ROE (%)
2009A	2530.90	778.81	545.41	363.51	15.27	52.95	7.4	1.77	6.52	28.84%
2010E	2931.25	1072.00	741.50	496.81	20.87	71.82	5.41	1.77	4.77	29.06%
2011E	3288.13	1067.93	731.48	490.09	20.59	90.42	5.48	1.77	4.48	22.77%

However, coal and pet coke prices have declined from their peak late last year. Inline with this, Madras Cements also has exhausted the high cost coal inventory and has started reaping benefits from the fall in prices. The company has entered into long term contracts for coal supply. This shall help Madras Cements to benefit from lower power and fuel cost.

South India Cement – Capacity, Production, Demand (in million tons)

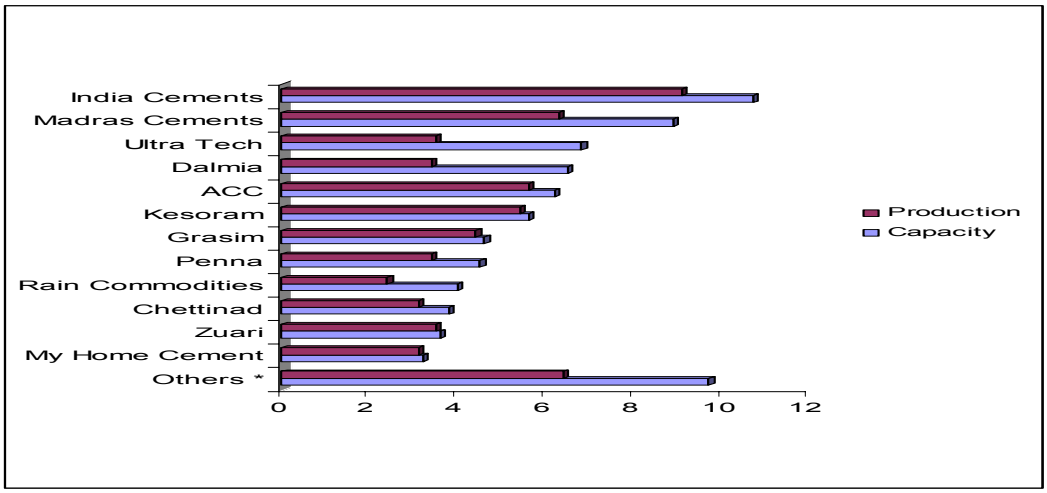


Source: CMA, DCSEC Research

Captive power

Madras Cements like most other industries was faced with significant power shortages and irregular power supply. In order to tide over this, the company embarked on a plan to make it fully self reliant for its power requirements. Madras Cements is setting up 65 MW coal-based captive power plants at two of its cement plants production facilities. Both these plants are expected to get commissioned in 18 months. These new power capacities, along with its existing 70 MW, will make Madras Cements 10 MTPA cement capacity self-sufficient in power.

South India Cement –Capacity, Production in Million Tons



Source: CMA, DCSEC Research

About the Company

Madras Cements Ltd (MCL) is the flag ship company of Ramco Group. The company was incorporated in the year 1957 and is primarily engaged in manufacturing and marketing of cement. It is the sixth largest cement producer in the country and the second largest player in South India. MCL also produces ready mix concrete and dry mortar products. Additionally, the company operates wind energy farms.

MCL operates through two reportable segments: cement and power generation. The company's cement segment primarily manufactures portland cement through the five production facilities spread over South India. These plants have a total capacity of 10 million tons per annum (MTPA): R R Nagar, Tamilnadu(1.2 MTPA), Jayanthipuram, Andra Pradesh (3.6 MTPA), Alathiyur, Tamilnadu(3.0 MTPA), Ariyalur, Tamilnadu(2.0 MTPA), Mathod, Karnataka (0.2 MTPA). MCL is a major player in the blended cement category and enjoys good recall for its “Ramco Super Steel” and “Ramco Super Grade” brand of cements. The cement segment also operates ready mix concrete plant, situated in Medavakkam, a suburb of Chennai and its capacity is 56 cubic meter per hour. Additionally, the segment operates a production facility for dry mix products near Sriperumpudur, Tamilnadu. The plant produces dry mortar, tile fixing compound and cement based putty. Additionally, MCL has earmarked on setting up a grinding mill at Kolaghat in Midnapore, West Bengal.

MCL has installed coal based captive power plants totaling 72 MW at Jayanthipuram in Andhra Pradesh and Alathiyur in Tamilnadu. The company’s power generation segment generates power from Wind Farms comprising of 257 Wind Energy generators totaling 181.59 MW. The Wind Farm is situated at Muppandal, Poolavadi, Oothumalai and Mathodu.

Risks and concerns

The southern region always had excess capacity in the past owing to abundant availability of limestone. This region has witnessed highest capacity addition during the past five years registering a CAGR of 12.5%. As a result, the region has witnessed a substantial decline in the operating rate from a high of 93% in FY07 to 77% in FY09. We expect the Southern region to witness substantial bunching up of capacities and expect another 14 million tons to come on stream in FY10. This is bound to create an oversupply situation and exert pressure on the cement prices. Cement prices have corrected from their peaks and we expect prices to stabilize around current levels. However, any major downfall from these levels could negatively affect the profitability of cement manufacturers, thereby altering our outlook for the company.

Outlook

Madras Cements is best placed to benefit from the growth in Southern regional cement market given the strong demand outlook. Though, we expect cement prices to correct marginally in the medium term; the company could continue to benefit from increased volume offtake. On the cost front, Madras Cements could also benefit from lower power and fuel costs due to decline in international coal prices. Additionally, the company's Wind Energy Farms is expected to substantially add to its topline. Investors with a long term perspective of 12 to 18 months can take exposure in the stock. The company is trading at a discount to its replacement cost for installed capacity. We initiate coverage on Madras Cements with an OUTPERFORMER rating on the stock with a target price of Rs.146.

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STOCK RATING: Outperformer: > 20% upside over the next 12 months; Marketperformer: trade within a +/-20% range over the next 12 months; Underperformer: > 20% downside over the next 12 months.