# HeidelbergCement India Ltd.

Research report as on 28-10-2022

CMP: 206.75 INR

Market Capitalisation : 4690 Cr

PEE AAR SECURITIES LTD.

BY: HIMANSHI KHOSLA
(FUNDAMENTAL RESEARCH ANALYST)

# Leadership of the parent company

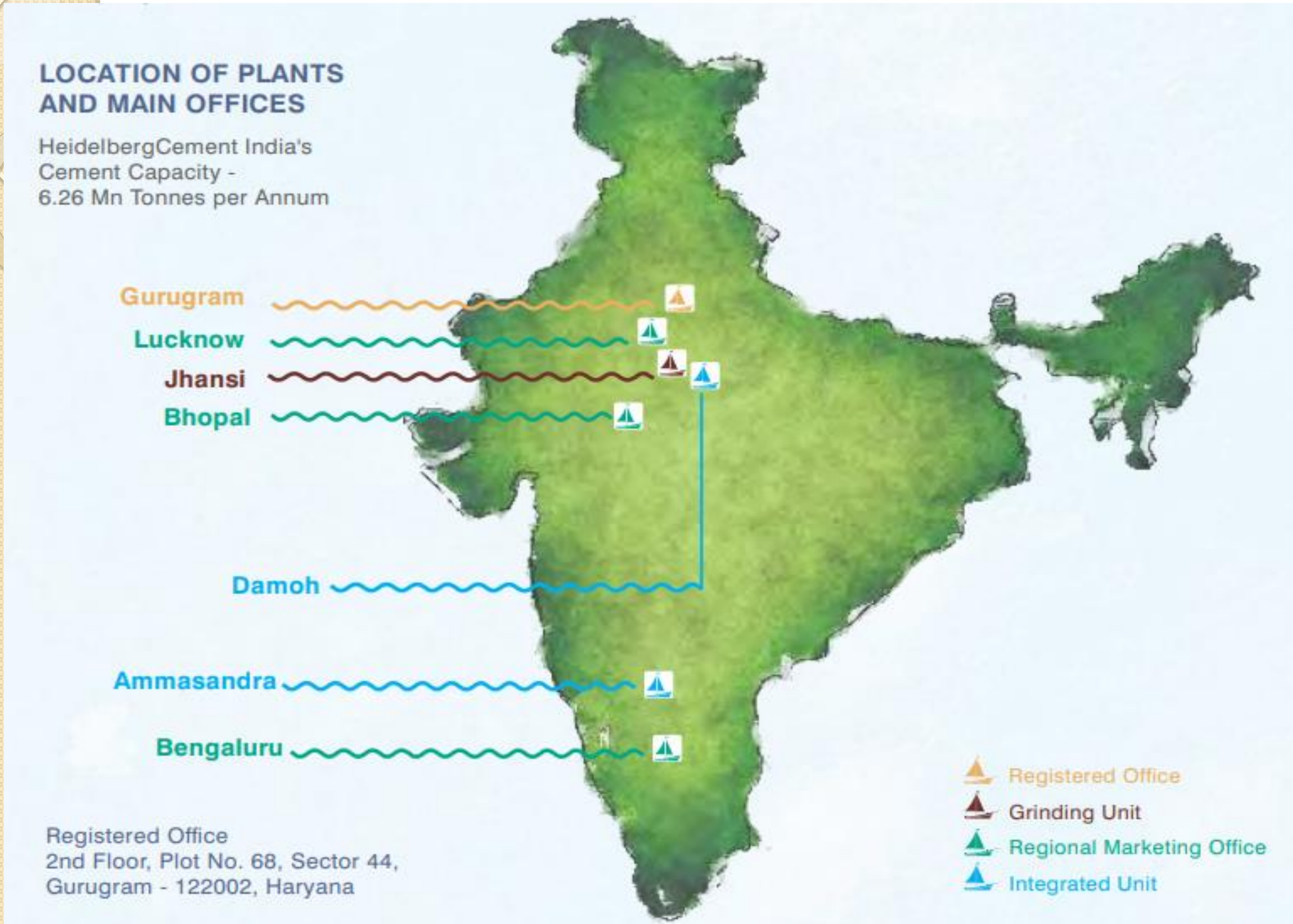
- The parent MNC (HeidelbergCement AG) is one of the top four cement companies by market share globally with a presence in over 50 countries generating global revenue of over 17 billion euros.
- HeidelbergCement is one of the world's largest building material Group. Post the acquisition of the Italian cement producer Italcementi, HeidelbergCement repositioned itself as number 1 in aggregates production, number 2 in cement, and number 3 in ready mix concrete.
- The group also has another cement company in India, Zuari Cement. That company focuses its operations in Southern India. Zuari has a capacity of 7.75 MTPA.

# Introduction

- Heidelberg Cement India is the Indian subsidiary of HeidelbergCement Group, Germany. The Company has its operations in Central India at Damoh (Madhya Pradesh), Jhansi (Uttar Pradesh), and in Southern India at Ammasandra (Karnataka).
- Heidelberg Cement India Ltd. key Products/Revenue Segments include Cement, Other Operating Revenue, Scrap, Sale of services and Clinker.
- The company sells under the MyCem and MyCem Power brand.
- The capacity utilization has been 99.6% at their Jhansi plant and 94.5% at their Imlai plant.
- Debottlenecking activities in last quarter of FY20 increased the grinding capacity at Imlai and Jhansi plants by 0.5 MTPA and 0.55 MTPA respectively. The aggregate cement grinding capacity of the Company stood at 6.26 MTPA.
- Limestone is the primary raw material for manufacturing cement. The company has mining rights in Patheria Mines (MP). The transportation from the mines is done via a 21 km long conveyor belt.
- It installed a waste heat recovery plant at the same facility in MP and made a 25 years' solar power agreement for another facility in Karnataka; thereby, saving significantly on power cost.

# Company History

- Company was originally incorporated as Mysore Cements Ltd. in 1958 by S.K. Birla.
- HeidelbergCement Group made its foray into India in early 2006. The move was motivated by its pursuit for growth which emanated from the opportunities available in the growing markets of developing countries. As a part of its growth strategy, the Group acquired controlling stake in Mysore Cements Limited as well as Indorama Cement Limited Joint Venture, which in 2008 was converted into a complete acquisition.
- Company undertook a brownfield capacity expansion in Central India to increase its cement manufacturing capacity from 2.1 million tonnes per annum (MTPA) to 5.4 MTPA.
- 2016: the company acquired Italcementi and the current capacity stands at 6.2MT.
- 2017: the company installed India's longest overland conveyor belt to transport limestone from its mines to the facility at Narsingh, Damoh. It significantly reduced transport costs and time.

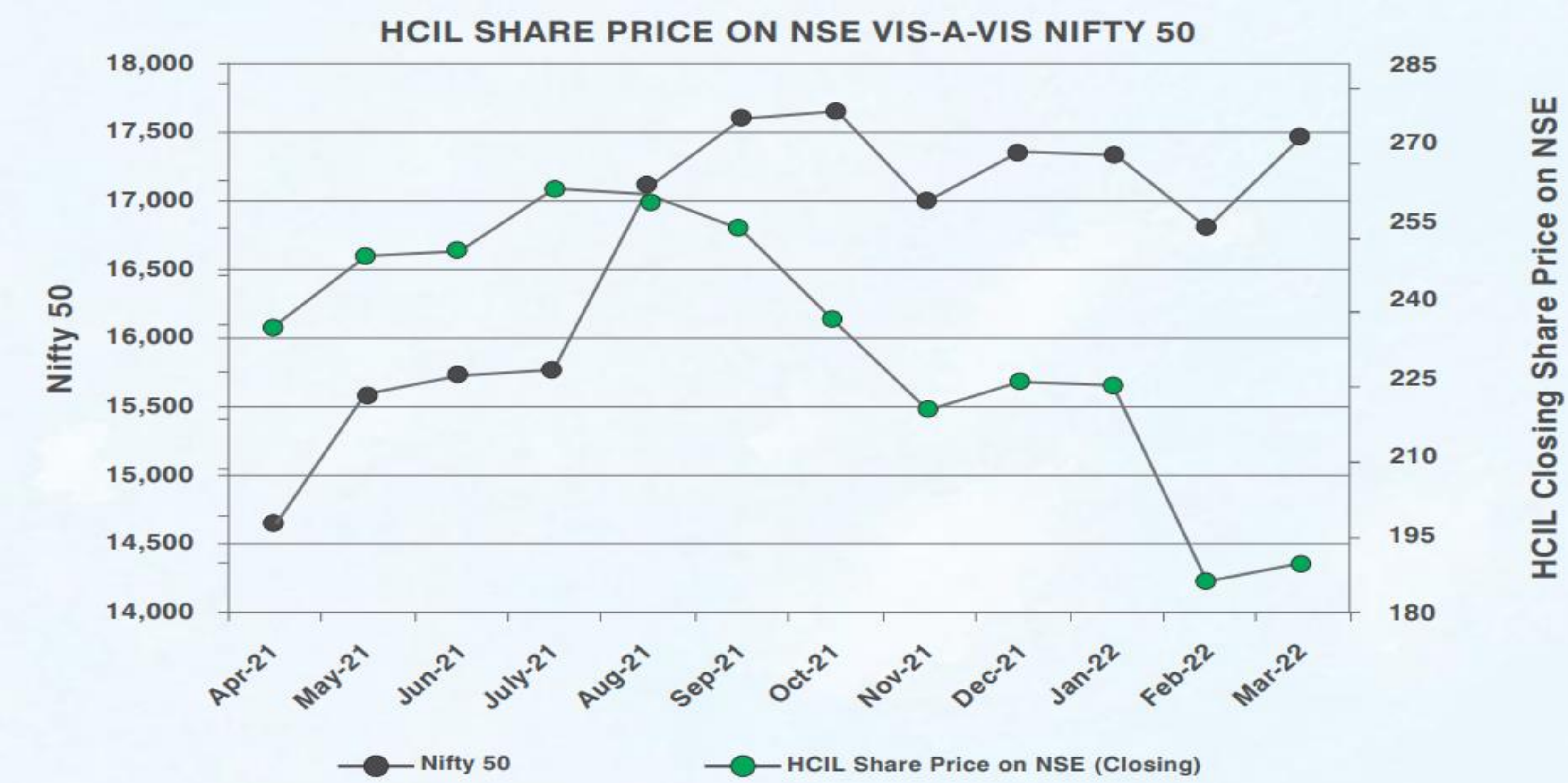

LOCATION OF PLANTS AND MAIN OFFICES
HeidelbergCement India's Cement Capacity - 6.26 Mn Tonnes per Annum
Gurugram
Lucknow
Jhansi
Bhopal
Damoh
Ammasandra
Bengaluru
Registered Office
2nd Floor, Plot No. 68, Sector 44, Gurugram - 122002, Haryana
Registered Office
Grinding Unit
Regional Marketing Office
Integrated Unit

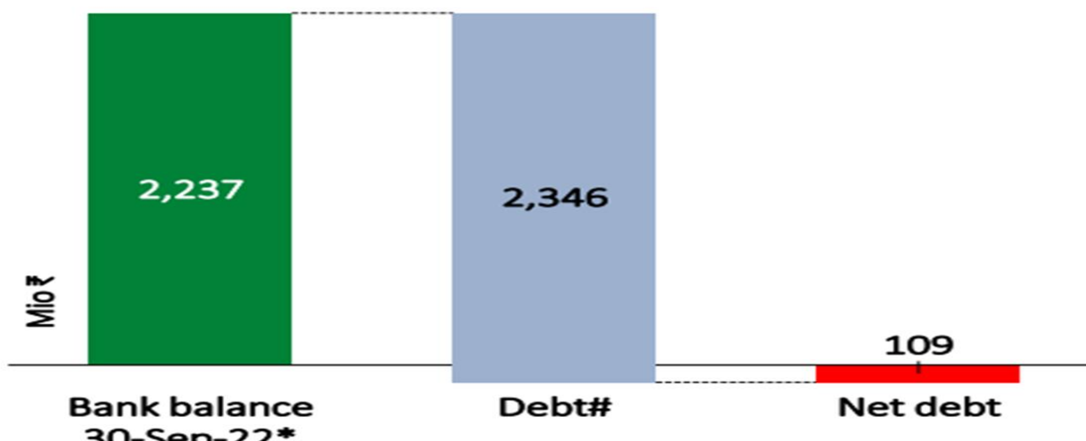
# Cement Industry

- The main characteristics of this industry is that it is <u>highly fragmented, regional, cyclical and capital intensive.</u>
- The cement industry faces intense competition because it is highly fragmented with many suppliers who have created an overcapacity i.e. supply of cement is more than its demand.
- In addition, the industry is cyclical because its demand is impacted by factors like monsoon. Good monsoon leads to a rise in agricultural income, thereby leading to higher demand from the rural area. However, lesser rains or draught decreases the demand for cement. Similarly, higher rains lead to floods, crop damage, and in addition, difficulty in constructing houses. Therefore, both lesser and excessive rains lead to lower demand.

# Russia-Ukraine War caused havoc on Indian cement companies

- The rising fuel prices in the wake of Russia-Ukraine tensions will hurt Indian cement makers, which are already reeling under rising costs of raw material and energy. The price of Brent crude jumped 3.08% a barrel. Fuel prices will also affect the logistics costs of companies, which are struggling with lower demand.
- According to a Crisil report, after rising to Rs 390 per bag over the past 12 months at an all-India level, domestic cement prices are set to climb another Rs 25-50 across regions as manufacturers start to pass on rising costs.
- Coal and pet coke are the most important elements of clinker, which is a critical raw material used in the cement manufacturing industry. Apart from the ever-increasing price of coal and pet coke, the cost of petroleum products like petrol and diesel prices is also increasing in the national and international markets, which very badly impacts the cost of production of raw materials of cement, Packaging materials, production, transportation and distribution cost of cement.


HCIL SHARE PRICE ON NSE VIS-A-VIS NIFTY 50
Nifty 50
18,000
17,500
17,000
16,500
16,000
15,500
15,000
14,500
14,000
HCIL Closing Share Price on NSE
285
270
255
240
225
210
195
180
Apr-21
May-21
Jun-21
July-21
Aug-21
Sep-21
Oct-21
Nov-21
Dec-21
Jan-22
Feb-22
Mar-22
Nifty 50
HCIL Share Price on NSE (Closing)


Mio ₹
2,237
2,346
109
Bank balance 30-Sep-22*
Debt#
Net debt

# Growth Prospects

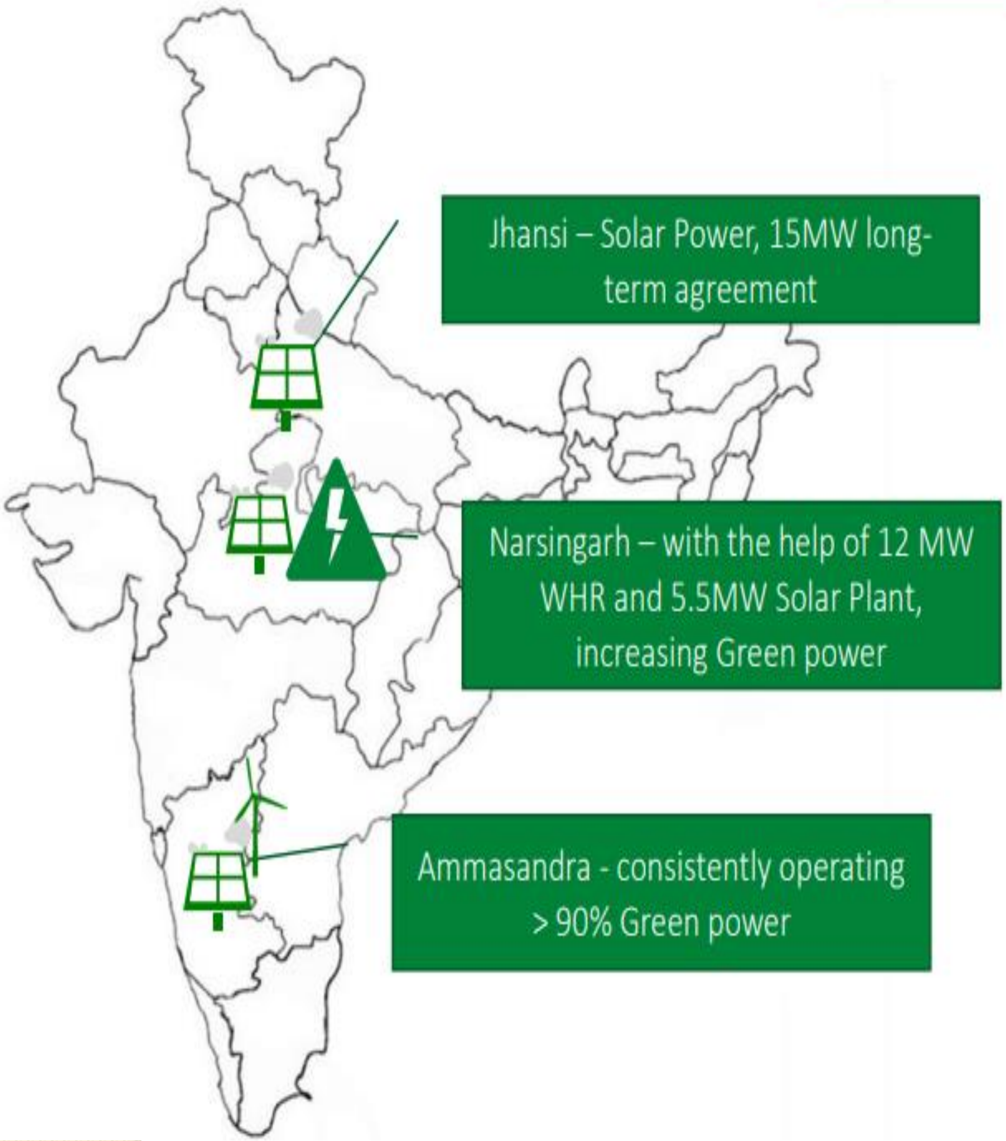
Demand for the industry can be attributed to three main sectors viz.

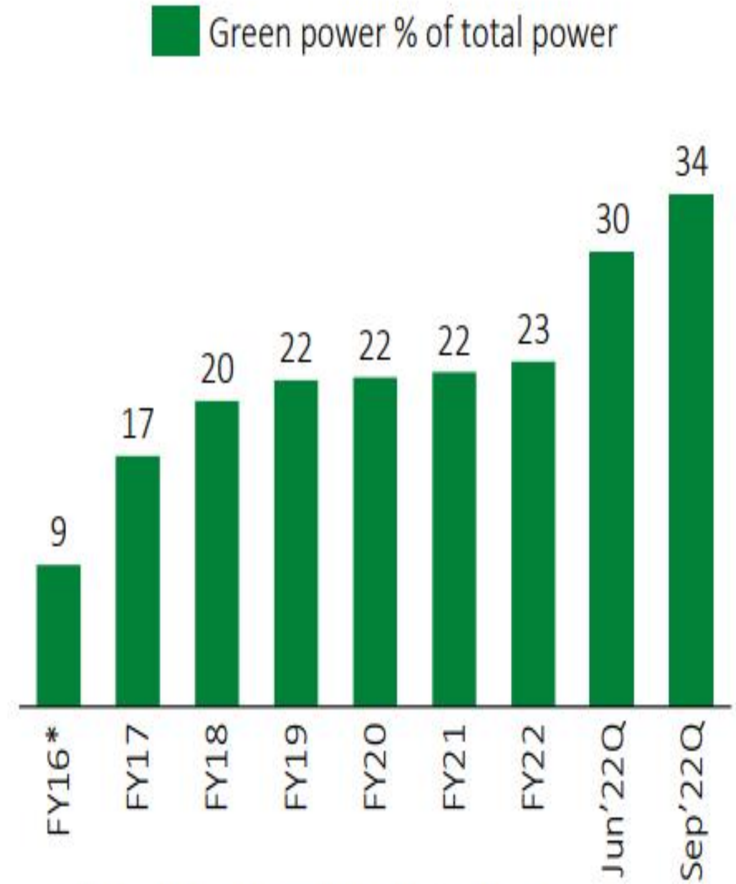
- **Housing & Real Estate:** Around 8 million units to be built under Pradhan Mantri Awas Yojna in FY23, initiatives to increase farmer's income, higher budgetary allocation for agriculture and irrigation facilities combined with a healthy rabi crop should assist demand from rural housing.

- **Public Infrastructure:** INR 1991 billion sanctioned for the development of 25000 km expressways. PM Gatishakti Yojana in ports, roads, rail, waterways, airways, mass transport system, logistics cargo terminals will form the backbone of Indian supply chain. River linking projects that will benefit 0.9 million hectares of agricultural land, INR15 billion allocated for infrastructure push in north - east states of India, developing villages in border areas are some of the programs that will increase cement demand.

- **Industrial Development:** INR 195 billion allocated for solar power, INR 87 million for drinking water schemes, opening of defense sector for private participation with government of India, announcement regarding procurement of 68% of defense equipment from Indian manufacturers, investments in low carbon technology, 280 GW solar power generation by 2030. All these investments are expected to promote indigenous manufacturing and ancillary facilities that will not only increase demand for cement but also generate employment raising the consumer spending.

# Increasing green power share consistently




*Damoh WHRS was commissioned in Mar'16Q

- Increased green power consumption across all plants, share of green power increased to > 34%. Company's power and fuel costs peaked out in Q1. It is looking to scale up its alternative fuel/green power usage over the next 2-3 years.
- Continues to produce 100% blended cement.
- HEIM has migrated to lower tax rate of 25.2% from FY23. HEIM has started an online initiative of buy cement through WhatsApp. It expects to improve volume.
- It is also undertaking 0.3/0.5mn MT clinker/grinding expansion by FY24E. The Gujarat greenfield IU expansion (3- 3.5mn MT cement and 2mn MT clinker costing INR 25bn) is expected in FY26 (SEZ clearance and mining lease are obtained).

# Key Risks

- **Intense competition and lower barriers to entry.** Cement companies usually have large suppliers with huge bargaining power and customers with many choices to buy. Therefore, such companies tend to face tough business phases and have to take a hit on their profit margins during business down phases.
- This demand supply mismatch put pressure on prices. *This lead to* decline in the capacity utilization *throughout the industry.*
- When an industry has periods of alternate high and low demand and in addition, it has too many players (fragmented industry), who have created an oversupply situation, then an investor would appreciate the negotiating, pricing or bargaining power of the cement manufacturers would remain low.
- **Mounting inflationary pressure on key raw materials** Significant rise in costs, especially the price of coal, petroleum products, power and freight cost further eroded the profitability. *Decrease in Sep'22Q EBITDA/t mainly due to increase in fuel cost.* The increased cost of Coal and Petroleum products has increased the cost of production, distribution, and other inputs cost that has ultimately increased our cement production cost

# Subdued profitability due to a significant increase in fuel costs

Mio ₹

| Particulars | Quarter ended | | Change | 6 months ended | | Change |
|---|---|---|---|---|---|---|
| | 30-Sep-22 | 30-Sep-21 | | 30-Sep-22 | 30-Sep-21 | |
| **Revenue** | **5,060** | **5,765** | ***-12.2%*** | **10,959** | **11,324** | ***-3.2%*** |
| Operating Expenses | 4,585 | 4,600 | *-0.3%* | 9,533 | 8,849 | *7.7%* |
| **EBITDA** | **476** | **1,165** | ***-59.2%*** | **1,426** | **2,476** | ***-42.4%*** |
| Depreciation/amortization | 281 | 282 | *-0.2%* | 561 | 558 | *0.6%* |
| Other income | 110 | 139 | *-20.6%* | 213 | 244 | *-12.7%* |
| **EBIT** | **305** | **1,021** | ***-70.2%*** | **1,078** | **2,162** | ***-50.1%*** |
| Interest and financial charges* | 207 | 112 | *84.3%* | 287 | 214 | *34.0%* |
| **Profit Before Tax** | **98** | **909** | ***-89.2%*** | **791** | **1,948** | ***-59.4%*** |
| Tax Expenses | 28 | 314 | *-91.1%* | 205 | 666 | *-69.2%* |
| **Profit After Tax** | **70** | **596** | ***-88.2%*** | **586** | **1,282** | ***-54.3%*** |
| | | | | | | |
| **KPIs** | | | | | | |
| Sales voulme (Mio T) | 1.00 | 1.23 | *-18.8%* | 2.11 | 2.42 | *-12.6%* |
| Gross realisation (INR/t) | 5,063 | 4,683 | *8.1%* | 5,191 | 4,689 | *10.7%* |
| Total cost (INR/t) | 4,587 | 3,737 | *22.8%* | 4,515 | 3,664 | *23.2%* |
| EBITDA (INR/t) | 476 | 946 | *-49.7%* | 676 | 1,025 | *-34.1%* |
| *EBITDA% of revenue* | *9.4%* | *20.2%* | *-1080 bps* | *13.0%* | *21.9%* | *-885 bps* |
| *PAT% of revenue* | *1.4%* | *10.3%* | *-895 bps* | *5.3%* | *11.3%* | *-597 bps* |

# Financial Results (Q1,Q2 FY2023)

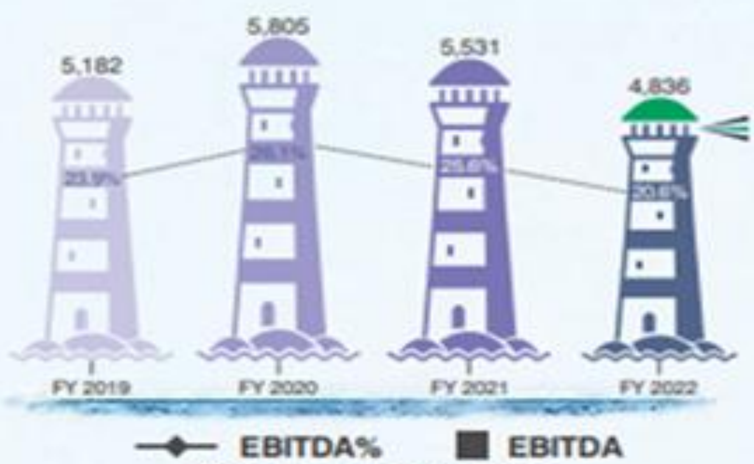
- HeidelbergCement India Ltd reported a decline of 88.23 per cent in its net profit to 7.01 crore in the second quarter ended September 30, 2022, citing lower sales volume.
- The company had reported a net profit of 59.56 crore in the year-ago period, HeidelbergCement India said in a BSE filing.
- Its total revenue from operation was down 12.21 per cent to 506.05 crore during the quarter under review against 576.47 crore in the corresponding quarter of the previous fiscal.
- Revenue decreased by 12 per cent y-o-y driven by a decrease in volume by 19 per cent and was partially offset by an increase in price by 8 per cent.
- The company reported total income of Rs. 600.15 crores during the period ended June 30, 2022 as compared to Rs.566.45 crores during the period ended June 30, 2021.
- The company posted net profit / (loss) of Rs.51.61 crores for the period ended June 30, 2022 as against net profit / (loss) of Rs.68.65 crores for the period ended June 30, 2021.

## Sales Volume ('000 Tonnes)


## Total Revenue (Rs. Million)


Note: Revenue including other income

## EBITDA (Rs. Million and % of Total Revenue)




Note: EBITDA including other income

## PAT (Rs. Million)

# Key Ratios

| Ratio | Numerator | Denominator | 31-Mar-22 | 31-Mar-21 | %change |
|---|---|---|---|---|---|
| Current ratio (in times) | Current Assets | Current Liabilities | 1.42 | 1.09 | 30.4% |
| Debt- Equity Ratio (in times) | Total Debt | Shareholder's Equity | 0.12 | 0.20 | -38.4% |
| Debt Service Coverage ratio (in times) | Earnings before Depreciation, Finance cost and Tax | Interest on long term debt + Principal repayment within next 12 months | 8.31 | 3.54 | 134.6% |
| Return on Equity ratio (%) | Net Profits after taxes – Preference Dividend | Average Shareholder's Equity | 16.5% | 22.4% | -5.9% |
| Inventory Turnover ratio (in days) | Cost of goods sold | Average Inventory | 8.09 | 8.08 | 0.1% |
| Trade Receivable Turnover Ratio (in days) | Revenue from operation (incl. GST) | Average Trade Receivable | 4.66 | 4.02 | 16.0% |
| Trade Payable Turnover Ratio (in days) | Total Operating Cost (incl. GST) | Average Trade Payables | 41.46 | 47.00 | -11.8% |
| Net Capital Turnover Ratio (in times) | Net sales = Total sales - sales return | Working capital = Current assets - Current liabilities | 6.45 | 26.76 | -75.9% |
| Net Profit ratio (%) | Net Profit | Net sales = Total sales - sales return | 11.25% | 15.05% | -3.8% |
| Return on Capital Employed (%) | Earnings before interest and taxes | Capital Employed = Tangible Net Worth + Total Debt + Deferred Tax Liability | 18.8% | 22.2% | -3.4% |
| Return on Investment (%) | Interest (Finance Income) | Investment = Loan + Interest bearing security deposit | 7.1% | 7.2% | -0.2% |

# Key Ratios Analysis

- The company has delivered a poor sales growth of 5.99% over past five years. Volume decreased by 19% y/y, 10% q/q in a seasonally weak quarter i.e., sept 2022.
- ROCE is a measure of a company's yearly pre-tax profit (its return), relative to the capital employed in the business. **HeidelbergCement India has an ROCE of 18.8%.** In absolute terms, that's a satisfactory return, but compared to the Basic Materials industry average of 10% it's much better.
- Continue to operate on **negative net operating working capital**
- Its dividend payout ratio is 81% of profit, which means the company is paying out a majority of its earnings. The relatively limited profit reinvestment could slow the rate of future earnings growth. It could become a concern if earnings started to decline.
- Company has reduced debt. Net debt is ₹ 109 million
- **EBITDA** of ₹ 476 per tonne, c. **-50%** y/y

# Conclusion

**Hold**

- In FY23, cement volume growth will be stable at 5-7 per cent, driven by affordable housing demand from tier-2 and tier-3 cities, along with infrastructure. However, high construction costs will limit the demand uptick.
- But such kind of fluctuating performance of sales revenue and profitability indicates that the business performance of Heidelberg Cement India Ltd is exposed to cyclical factors. Rising inflation leading to hardening interest rates policy, and a decrease in consumer sentiments, may reduce/defer discretionary spending.
- India being a developing country remains one of the fastest growing markets for construction industry. There's huge scope of growth if entered when Cement demand from Govt. projects and household increases. Also, cement and steel industry can be proxy investment to benefit from construction in Ukraine as and when it happens.
- Cement industry follows the GDP trajectory. It has been estimated by IMF that the GDP rates in FY22 and FY23 would be around 8.2% and 6.9% respectively. We are therefore taking a conservative approach of 6-7% growth in FY23