The Ramco Cements

# Laying the ground

## While volumes are expected to revive, cost benefits may not continue

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The Ramco Cements is among the best plays in the southern cement market with its high operating margin and signs of volume pick-up.

However, profitability could come under pressure due to price competition or rise in pet coke prices. The stock's valuation is also much above the replacement value. While fresh exposure can be avoided, investors can hold the stock as the cement industry seems to be at the revival stage currently.

### High valuations

The stock price has run-up 43 per cent in the last six months and the current valuation looks expensive. At ₹659, on an enterprise value per tonne basis ($204 per tonne), the stock quotes at a 30-35 per cent premium to its replacement value. Its peers JK Lakshmi Cement ($106) and JK Cement ($132) quote at much lower valuations.

The company has production capacity of 12.5 million tonnes (mt). During 2015-16, its revenue was ₹3,595 crore — marginally lower than in the previous year — while its net profit was up 129 per cent to ₹558 crore.

Profits went up sharply on the back of huge cost savings made by the company, even as its sales volumes fell. However, going forward, cost savings might not be sustainable, given that pet coke prices are inching up.

### Operational efficiency

Operating margin has nearly doubled over the last two years on the back of reduction in operational costs as well as higher realisations. Its operating margin was 32 per cent in 2015-16 as against 22.1 per cent and 17 per cent in 2014-15 and 2013-14 respectively.

For the first quarter of 2016-17, operating margin at 32.5 per cent was at about the same level as that of the last year. Power and fuel costs were down 25.1 per cent during 2015-16. With fall in pet coke prices, the company plans to increase the fuel mix of pet coke from 50 per cent in 2015-16 to 70 per cent in 2016-17.

Also, transportation and handling costs were down 15.6 per cent during the year, thanks to fall in diesel prices. Cost of raw material, including limestone and gypsum, was also down 11.9 per cent in 2015-16.

The company has been de-leveraging its balance sheet. Last year, it reduced debt to the extent of ₹510 crore; its interest payment was down 6.7 per cent during that period. It managed to reduce its debt-to-equity ratio to 0.56 times as of March 2016 from 0.78 times a year back.

### Poor capacity utilisation

However, cement volumes have not picked up in southern India due to lack of demand. Sales volumes for The Ramco Cements have been down for the last two consecutive financial years by 10.5 per cent and 6 per cent, respectively. Cement volumes were 7.2 mt in 2015-16 as irregular monsoon, falling industrial production as well as delay in infrastructure investments played spoilsport.

The overall cement market in 2015-16 was down 4 per cent in value terms in the southern states as against 6 per cent growth witnessed on a pan-India basis.

Southern players have a low level of capacity utilisation — 55 per cent as against 75 per cent for the rest of the country. The Ramco Cements capacity utilisation was 58 per cent in 2015-16.

However, there are signs of volume pick-up. For the June quarter of 2016-17, the company's sales volumes were up 15 per cent, offsetting decrease in realisations. With the economic recovery, volumes should eventually pick up for the southern markets.

While the price run-up (about 5 per cent) of 2015-16 helped hold up revenue, there is now the risk of price competition among existing players, given lower levels of capacity utilisation. Moreover, there seems to be little scope to cut costs further from the current levels.

HOLD

**Why**

- Recent run-up in stock price
- Sales volume showing signs of pick-up
- Less scope for further cost savings