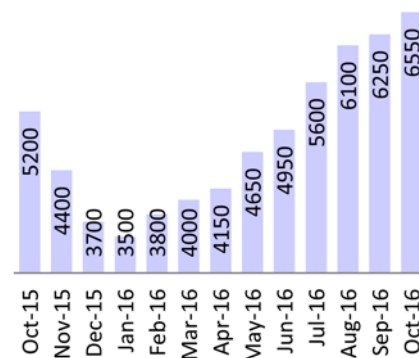


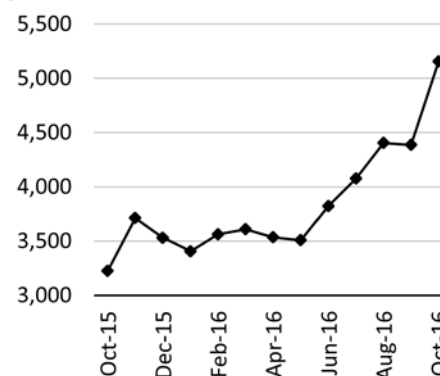


the whistleblower series

Retail petcoke prices (INR/tonne)



Imported coal prices (INR/tonne)



Fuel prices flaring up

Cement price hikes imperative to retain profitability

- Average petcoke and imported coal prices have increased by 42-43% from 1QFY17 levels.
- This is likely to result in an INR91-145/tonne or 10-37% increase in power and fuel cost for cement companies from 1QFY17 levels for the remaining half of FY17.
- Cement companies would have to take price hikes of 2-4% from 1QFY17 levels to retain profitability.

Fuel prices on an upward trend

Average fuel prices in October (both imported coal and domestic petcoke) have increased by 43% from the 1QFY17 average. The firmness in global fuel prices is due to lower production in China since March 2016. Imported coal prices have increased by 17% MoM in October while domestic petcoke prices have increased by 5% MoM. As domestic refiners rebase their prices only at the start of the month, we expect INR400-500/tonne hike in petcoke prices in November. Petcoke demand is expected to be elevated with the commissioning of Reliance Industries' (RIL) petcoke gasifiers.

Expect 10-37% increase in power and fuel cost per tonne of cement

Domestic petcoke prices are 87% higher than the lows of January 2016. We expect power and fuel (P&F) cost for our Cement Universe to increase by INR91-145/ton (10-37% increase) from 1QFY17 levels for the remaining half of FY17. We gather that cement producers have built up some proportion of low cost inventory, which would keep their P&F cost hedged for most of 2QFY17 (In its 2QFY17 results commentary, UltraTech mentioned that the full impact would be visible in 4QFY17).

Price hikes inevitable to retain profitability

To retain profitability, cement companies have to take price hikes of 2-4% from 1QFY17 levels. We note that unlike previous years, cement prices have been firm this monsoon season, with all-India average realization for 2QFY17 increasing marginally QoQ. While we do not expect meaningful price hikes in the month of October due to subdued demand on account of ongoing festival season, price hikes in November/December would be imperative for cement companies to maintain their profitability.

Abhishek Ghosh (Abhishek.Ghosh@MotilalOswal.com); +91 22 3982 5436

Varun Gadia (Varun.Gadia@MotilalOswal.com); +91 22 3982 5446

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Domestic petcoke prices to remain firm in the short term

India consumes ~18m tonnes of petcoke per year, of which 12m tonnes is produced domestically (RIL, Essar, OMCs). RIL's petcoke-based gassifiers are expected to be commissioned by the end of FY17. The first of its eight gassifiers is likely to get commissioned by January 2017. Once all of its gassifiers are commissioned, RIL would consume 8.5m tonnes of petcoke per year, resulting in limited supply of petcoke by RIL. Given this backdrop, we believe it is important for cement companies with higher petcoke consumption (especially those that depend on domestic sources) to tie up with US and Middle East refiners for procuring petcoke.

Thermal coal prices, which have been on an uptrend since China reduced its production in March 2016, could see some softness. Media articles suggest that China has started to relax some policies pertaining to supply restrictions to reduce prices of thermal coal.

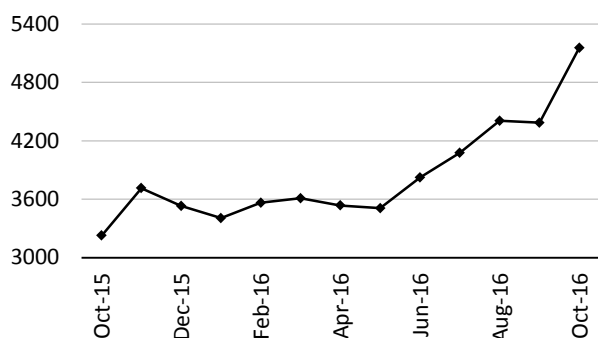
Sector view

We note that cost push in the last 2-3 months could impact profitability of cement companies in the short term if adequate price hikes are not taken post the festive season. We expect the pricing power of cement companies to strengthen meaningfully in FY18, as supply addition reduces. While we acknowledge the possibility of a short-term profitability hit, we maintain our positive stance on the sector. Industry dynamics are turning favorable due to slowing capacity addition and expected demand recovery, particularly for the North and Central markets. Earnings could surprise positively, led by better-than-estimated price improvements in these regions. UltraTech, Dalmia Cement and JK Lakshmi Cement remain our preferred picks.

Fuel prices hardening

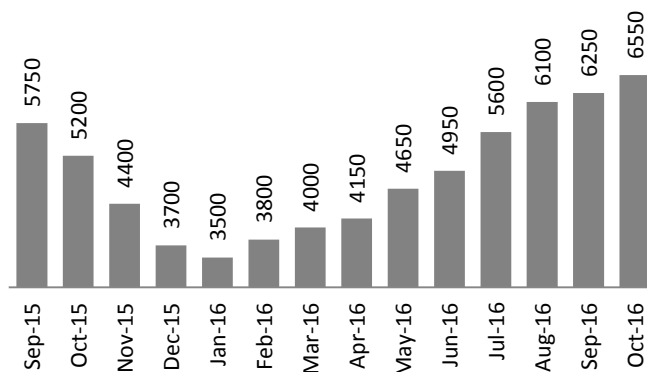
Reliance Industries’ (RIL) domestic petcoke prices have increased by 87% from the lows of January 2016. We expect RIL to further increase prices for November loading by INR400-500/tonne, given the firmness in imported coal prices. Domestic demand for petcoke is likely to increase further, as RIL’s petcoke-based gassifiers come online in a phased manner over FY17. Incrementally, imported coal prices have also hardened due to higher imports by China, which cut production following a policy change in March 2016. However, media articles indicate that China is relaxing its policy on restricted production to address the issue of rising coal prices.

Exhibit 1: Imported coal prices (INR/tonne)



Source : MOSL, ICMW, Richards Bay

Exhibit 2: Retail petcoke prices (INR/tonne)



Source : MOSL, ICMW, Richards Bay

In October 2016, average domestic fuel prices increased by 43% QoQ.

Exhibit 3: Quarterly fuel prices (INR/tonne)

Retail petcoke prices (INR/tonne)				
4QFY16	1QFY17	2QFY17	Oct-16	Change from 1QFY17 levels
3767	4583	5983	6550	1967
Imported coal prices (Richards bay 6000 kcal)(INR/tonne)				
4QFY16	1QFY17	2QFY17	Oct-16	Change from 1QFY17 levels
3526	3622	4289	5155	1533

Source: MOSL, ICMW, Richards Bay

Expect 10-37% increase in power and fuel cost per ton of cement

The sharp increase in fuel prices is likely to result in an INR91-145/tonne or 10-37% increase in power and fuel (P&F) cost for cement companies from 1QFY17 levels. During the monsoon season, the number of shipments is considerably lower and cement companies are currently using low cost inventory. The impact of higher P&F cost should be evident in subsequent quarters, depending upon the inventory situation of individual companies.

Exhibit 4: Impact of increasing petcoke prices on P&F cost/tonne of cement

	Unit	Value
Calorific value of petcoke	kcal	7,900
Kcals/ ton of clinker	kcal	750
Increase in cost/ ton of petcoke	INR/ton	1,967
increase in cost/ton of clinker	INR/ton	187
Blending ratio		1.3
Increase in P&F cost/ton of cement	INR/ton	144

Source: MOSL, Company *Assuming 100% petcoke as fuel

Exhibit 5: Impact of increasing imported coal prices on P&F cost/tonne of cement

	Unit	Value
Calorific value of imported coal	kcal	6,000
Kcals/ ton of clinker	kcal	750
Increase in cost/ ton of imported coal	INR/ton	1,533
increase in cost/ton of clinker	INR/ton	192
Blending ratio		1.3
Increase in cost/ton of cement	INR/ton	147

Source: MOSL, Company *Assuming 100% imported coal as fuel

Exhibit 6: Impact of increasing fuel prices on individual companies' P&F cost/tonne

Companies	Imported coal in fuel mixl (%)	Impact(INR/ton) on P&F cost	Petcoke in fuel mix (%)	Impact(INR/ton) on P&F cost	Total impact(INR/ton) on P&F cost
ACC	12	18	60	86	104
ACEM	12	18	60	86	104
UTCEM	20	29	70	101	130
Shree	0	0	100	144	144
DBEL	17	25	83	119	144
ICEM	40	59	60	86	145
JKCE	5	7	75	108	115
JKLC	0	0	86	124	124
RAMCO	30	44	70	101	145
ORNTCMT	18	27	45	65	91
PRISM	30	44	70	101	145

Source: MOSL, Company

Exhibit 7: Increase in realization to offset the impact of higher fuel prices

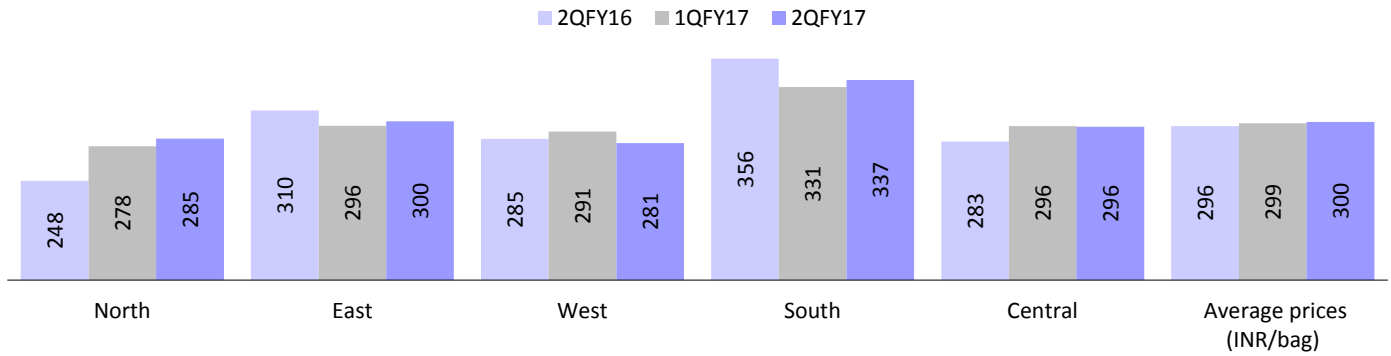
Companies	Total impact(INR/ton) on P&F cost	Realizations (INR/ton) in 1QFY17	% Inc. in realization to offset the impact
ACC	104	4,267	2.4
ACEM	104	4,344	2.4
UTCEM	130	4,687	2.8
Shree	144	3,885	3.7
DBEL	144	4,586	3.1
ICEM	145	4,505	3.2
JKCE	115	4,703	2.4
JKLC	124	3,649	3.4
RAMCO	145	4,426	3.3
ORNTCMT	91	3,126	2.9
PRISM	145	4,111	3.5

Source: MOSL, Company

Price hikes inevitable to retain profitability

To negate the impact of higher P&F cost on EBITDA/tonne, 2-4% increase in realization is required. Unlike previous monsoons, cement prices have been firm this time around, with all-India price realization up marginally QoQ in 2QFY17. While we expect prices to be soft in October due to festive season, we note that price hikes in November/December would be crucial for cement companies to retain profitability.

Exhibit 8: Prices remain firm in July and August despite monsoon (INR/bag)

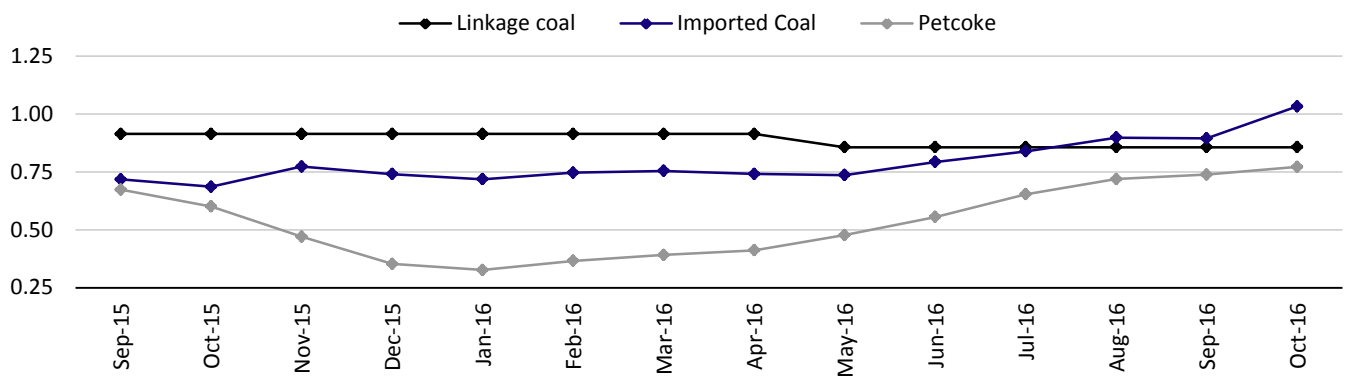


Source : MOSL, Company

Petcoke still the preferred fuel

The cost differential between linkage coal and petcoke on per kcal basis has narrowed to 15-20% at spot prices as against 40-45% earlier, given the strong surge in petcoke prices. Our industry checks suggest that while some companies with linkage coal would shift back to linkage coal, freight would act as a major decisive factor for fuel mix, given current cost dynamics.

Exhibit 9: Trend in fuel cost ex-freight/kcal for different sources (INR/kcal)



Source : MOSL, ICMW, Richards Bay

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Varun Kumar
Varun.kumar@motilaloswal.com
Contact : (+65) 68189232
Office Address: 21 (Suite 31), 16 Collyer Quay, Singapore 04931

Kadambari Balachandran
kadambari.balachandran@motilaloswal.com
(+65) 68189233 / 65249115



Motilal Oswal Securities Ltd

Motilal Oswal Tower, Level 9, Sayani Road, Prabhadevi, Mumbai 400 025
Phone: +91 22 3982 5500 E-mail: reports@motilaloswal.com