

Gujarat Ambuja

STOCK INFO. BLOOMBERG
BSE Sensex: 7,971 GAMB IN
REUTERS CODE
S&P CNX: 2,412 GACM.BO

19 October 2005

Buy

Rs66

Previous Recommendation: Buy

		YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	1,352.1	06/05E	26,058	4,682	3.5	54.4	19.0	4.1	22.4	18.3	3.2	11.4
52-Week Range	79/44	06/06E	30,755	5,557	4.1	18.7	16.0	3.7	24.2	24.3	2.7	8.7
1,6,12 Rel. Perf. (%)	-2/-11/-3	06/07E	34,310	7,125	5.3	28.2	12.5	3.2	27.3	30.0	2.2	6.8
M.Cap. (Rs b)	89.2											
M.Cap. (US\$ b)	2.0											

Gujarat Ambuja Cements (GACL) reported disappointing 1QFY06 results as cost pressures hurt EBITDA margins despite higher realizations. The company reported EBITDA of Rs1.7b against our expectation of Rs1.9b. Recurring PAT of Rs0.8b was much lower than our expectation of Rs1.2b, mainly on account of higher tax rate and lower other income.

- ✍ Volumes remained flat YoY at 2.9m ton. Realization per bag was up 9.3% from Rs101.9 to Rs111.4. Operating cost per bag moved up by 12% YoY from Rs73.5 to Rs82.4 per bag.
- ✍ EBITDA moved up by 2% YoY to Rs1.7b. Despite increase in cement realizations, EBITDA margins declined by 190bp to 26% YoY. EBITDA per ton increased marginally by Rs11 to Rs579 per ton.
- ✍ Recurring PAT declined by 17% to Rs0.8b as effective tax rate increased from 16% to 25.5% in 1QFY06. GACL expects tax rate to remain at current level of 25% which is much higher than our FY06 assumption of 12%.
- ✍ On account of higher than expected cost push, we are marginally downgrading FY06 EBITDA estimate from Rs9.6b to Rs9.4b. Also, on account of sharp increase in tax rate (from our assumption of 12% to company's guidance of 25%), we have downgraded our FY06 EPS estimate by 18% from Rs5 to Rs4.1 per share.

GACL trades at an FY06 PER of 16x and EV/EBITDA of 8.7x. GACL's valuations are not cheap per se. However, considering that its valuations are the most reasonable among cement majors and given its lowest cost producer status, we maintain it as our most preferred pick among large cap cement stocks.

STANDALONE QUARTERLY PERFORMANCE

Y/E JUNE	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Sales Volume (m ton)	2.94	3.34	3.18	3.28	2.94	3.61	3.46	3.75	12.74	13.75
YoY Change (%)	31.3	31.1	14.8	13.5	0.0	8.0	8.7	14.3	22.0	7.9
Realization (Rs/ton)	2,037	1,856	2,099	2,197	2,227	2,272	2,322	2,129	2,046	2,236
YoY Change (%)	20.6	8.5	3.9	6.7	9.4	22.4	10.6	-3.1	8.3	9.3
QoQ Change (%)	-1	-9	13	5	6	2	2	-8		
Net Sales	5,989	6,198	6,674	7,205	6,549	8,196	8,026	7,985	26,066	30,755
YoY Change (%)	58.4	42.3	19.3	21.1	9.4	32.2	20.2	10.8	32.4	18.0
EBITDA	1,667	1,360	1,991	2,219	1,703	2,392	2,660	2,643	7,236	9,398
Margins (%)	27.8	21.9	29.8	30.8	26.0	29.2	33.1	33.1	27.8	30.6
Depreciation	-503	-493	-492	-466	-490	-462	-500	-478	-1,954	-1,930
Interest	-210	-203	-208	-226	-216	-195	-175	-148	-848	-734
Other Income	122	408	85	131	13	150	220	292	746	675
PBT after EO Exp/(Inc)	1,076	1,072	1,376	1,657	1,010	1,885	2,205	2,309	5,181	7,410
Tax	176	177	-56	206	258	471	551	577	503	1,852
Rate (%)	16.4	16.5	-4.0	12.4	25.5	25.0	25.0	25.0	9.7	25.0
Adj PAT	900	895	1,431	1,452	753	1,414	1,654	1,732	4,678	5,557
YoY Change (%)	858.4	158.2	-1.6	22.4	-16.3	57.9	15.6	19.3	61.2	220.9

E: Inquire Estimates; Note: Quarterly results don't add up with full year results due to restating of past quarter results

Nirbhay Mahawar (Nirbhay@MotilalOswal.com); Tel: +91 22 39825412/ Jinesh Gandhi (Jinesh@MotilalOswal.com); Tel: +91 22 39825416

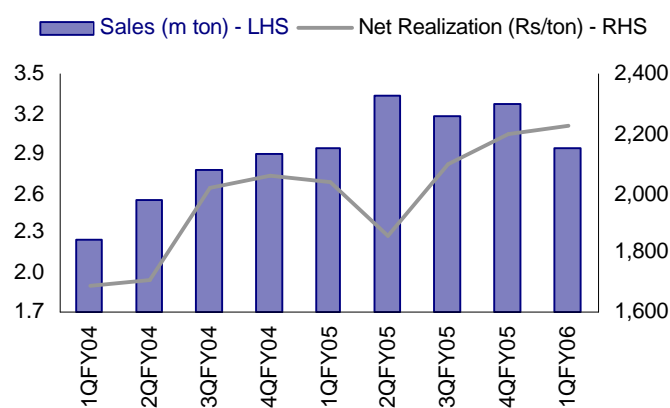
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Revenue growth driven by firm cement prices

Net sales for 1QFY06 grew by 9.4% to Rs6.5b, mainly driven by realization growth as volumes remained flat at 2.94m ton. Even with impressive growth in industry volumes, the company reported flat volumes mainly because of poor export volumes as well as regional players gaining market share in the domestic market.

TREND IN DESPATCHES (M TON) AND REALIZATIONS (RS/TON)



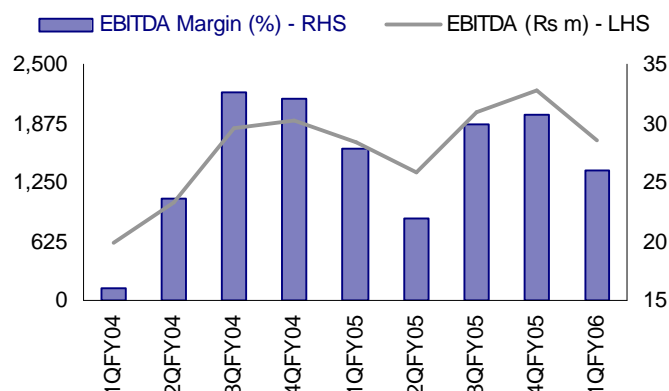
Source: Company/Motilal Oswal Securities

YoY realization moved up by 9.4% to Rs2,227 per ton, which was near its all time high. Increase in realization was driven by firm cement prices in the domestic market as well as firm export realization (\$45 per ton FoB). Realization increase is also enhanced by change in accounting policy of cement producers in which post the implementation of VAT producers have started including some component of freight bill also in its realization.

EBITDA impacted due to cost push

GACL's operating profit moved up by 2% to Rs1.7b. In spite of significant improvement in realization, EBITDA per ton moved up by Rs12 per ton to Rs579/ton. Due to significant cost push operating margins declined by 190bp to 26%.

EBITDA MARGIN DECLINES



Source: Company/Motilal Oswal Securities

Operating cost per ton for GACL moved up by 12% to Rs1,648 per ton. Operating cost push was mainly on account of higher fuel cost which went up significantly. Operating cost per ton also went up because of some aberration in the quarter i.e heavy rains caused some disruptions in operation etc.

HIGHER COST PUSH IMPACTS MARGINS (RS/TON)

	1QFY06	YOY (%)	QOQ (%)
Net Selling Price	2,227	9.4	1.4
Raw Material	117	67.6	7.2
Staff Cost	97	21.3	26.9
Power & Fuel	588	8.2	10.8
Freight	390	7.4	-0.7
Other Expenditure	457	10.4	11.0
Total Cost per ton	1,648	12.1	8.4
EBITDA	579	2.1	-14.4

Source: Company/Motilal Oswal Securities

Higher tax provisioning as well as lower other income resulted in disappointing PAT numbers

GACL reported a 17% decline in PAT to Rs8b which was much lower than our as well as consensus expectation. In spite of a 2% increase in operating profit, PBT declined by 6% mainly on account of lower other income of Rs13m against last years income of Rs122m. Decline in PAT was

much higher (17% to Rs8b) than PBT decline as tax rate for the company moved up from 16% to 25% with tax-breaks enjoyed by the company slowly going away. The company has also mentioned that the tax rate will remain at the current level of 25% till they do not make any acquisitions. Acquisition of a loss making company can bring down the tax rate again.

Downgrading earnings estimates to factor in cost push

We are downgrading our FY06 and FY07 earnings estimates to factor in significant increase in tax rate as well as higher than anticipated cost push. We have raised our tax rate assumptions from 12% for FY06 and 17% for FY07 to 25% for both year. We have also reduced operating profit numbers marginally from Rs9.6b to Rs9.4b in FY06 and from Rs11.7b to Rs11.4b in FY07. Accordingly, we have downgraded our FY06E EPS by 18% to Rs4.1 and FY07E EPS by 14% to Rs5.3.

Near term outlook on price remains positive

With the monsoon season getting over, cement prices are likely to firm up further from November onwards. GACL,

being the largest exporter of cement, will also get benefited from higher realization in export market (around US\$46-48 per ton). However, sequentially we do not see sharp expansion in operating margins as cement prices are already at an all time high and do not leave much scope for realization driven margin expansion.

Valuations and view

GACL's revenues and earnings are expected to witness a CAGR of 15% and 23% over FY05-07E, respectively. Being the market leader in its key markets of northern and western India, it would be one of the biggest beneficiaries of any uptrend in prices in these regions due to tight demand supply in these regions. Also, cement prices in the export markets are firming up as current contracts are booked in the range of US\$46-48/ton FoB auguring well for the company as it derives around 16% of its volume from exports. Although on the valuation front, at 16x FY06E earnings and 8.7x EV/EBITDA the stock does not look cheap, considering the extremely stretched earning multiple of its peers and its lowest cost status, we maintain GACL as our most preferred pick in the cement sector.

Gujarat Ambuja: an investment profile

Company description

Gujarat Ambuja is the third largest cement company in India with total capacity of 14.9m ton under its control. It is one of the lowest cost producers of cement with focus on structurally sound markets of North, West and East. It is also the largest exporter of cement from India.

Key investment arguments

- Best positioned geographically (#1 & #2 in North and West, respectively) to benefit from current upturn in cement prices.
- Geographical location gives flexibility to choose between domestic and export market.
- Financially well placed (zero net debt) to drive further consolidation in the industry.

Key investment risks

- Exhausting sales tax benefit in Gujarat, coupled with implementation of VAT, could impact margins adversely.
- Any downturn in the export market would result in over-supply in the domestic market, resulting in pressure on prices in the key market of Gujarat.

Valuation and view

- Adjusted standalone PAT is expect to grow by 23% CAGR between FY05-07E, driven by higher realizations both in domestic and export markets.
- Leadership position in key markets of Northern and Western region would augur well for the company.
- The stock quotes at 16x and 12.5x our FY06E and FY07E EPS estimates. We recommend **Buy** with a price target of Rs74 (~14x FY07E EPS).

Sector view

- Volume expected to grow by 8%, driven by continuous momentum in housing and infrastructure projects.
- Improved demand supply dynamics due to limited capacity addition in previous years. However, greenfield capacity addition can disturb the tight demand supply scenario envisaged by us.
- Near term outlook for the sector remains positive but longer-term prospects will be determined by the sector's allocation of cash flow.

COMPARATIVE VALUATIONS

		GACL	ACC	ULTRA-CEM
P/E (x)	FY06E	16.0	18.8	24.1
	FY07E	12.5	15.0	13.5
P/BV (x)	FY06E	3.7	4.3	4.5
	FY07E	3.2	3.7	3.6
EV/Sales (x)	FY06E	2.7	2.2	1.9
	FY07E	2.2	2.0	1.5
EV/EBITDA (x)	FY06E	8.7	11.9	9.9
	FY07E	6.8	9.2	6.8

SHAREHOLDING PATTERN (%)

	SEP.05	JUN.05	SEP.04
Promoters	23.6	23.6	23.8
Domestic Institutions	17.8	17.8	22.9
FII's/FDIs	43.3	43.0	37.2
Others	15.4	15.6	16.1

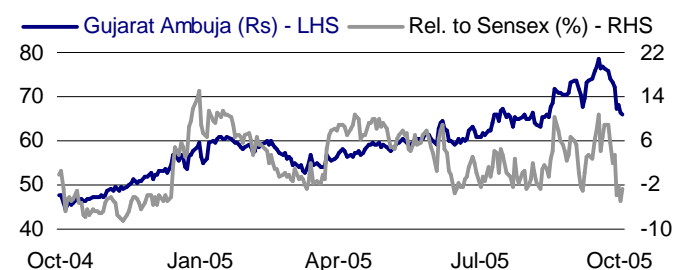
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	4.1	4.3	-4.9
FY07	5.3	5.1	5.0

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
66	74	12.1	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)			
Y/E JUNE	2004	2005	2006 E	2007 E	
Net Sales	19,681	26,058	30,755	34,310	
Change (%)	13.4	32.4	18.0	11.6	
Total Expenditure	14,283	18,818	21,357	23,010	
EBITDA	5,399	7,240	9,398	11,301	
Margin (%)	27.4	27.8	30.6	32.9	
Depreciation	1,686	1,954	1,930	1,966	
EBIT	3,713	5,286	7,468	9,334	
Int. and Finance Charges	784	848	734	510	
Other Income - Rec.	505	746	675	675	
PBT before EO expense	3,433	5,184	7,410	9,500	
Extra Ordinary Expense/(Income)	-430	0	0	0	
PBT after EO expense	3,863	5,184	7,410	9,500	
Current Tax	203	399	1,334	1,710	
Deferred Tax	264	104	519	665	
Tax Rate (%)	12.1	9.7	25.0	25.0	
Reported PAT	3,396	4,682	5,557	7,125	
PAT Adj for EO items	3,018	4,682	5,557	7,125	
Change (%)	36.0	55.1	18.7	28.2	
Margin (%)	15.3	18.0	18.1	20.8	

BALANCE SHEET		(Rs Million)			
Y/E JUNE	2004	2005	2006 E	2007 E	
Equity Share Capital	1,795	2,704	2,704	2,704	
Total Reserves	18,334	19,015	21,522	25,292	
Net Worth	20,129	21,720	24,227	27,996	
Deferred liabilities	3,707	3,811	4,330	4,995	
Total Loans	12,697	11,275	9,683	4,877	
Capital Employed	36,533	36,805	38,239	37,867	
Gross Block	36,581	37,092	38,592	39,592	
Less: Accum. Deprn.	12,841	14,639	16,569	18,536	
Net Fixed Assets	23,739	22,452	22,022	21,056	
Capital WIP	1,243	1,181	1,500	1,500	
Investments	10,110	11,251	11,251	11,251	
Curr. Assets	4,914	5,878	8,123	9,132	
Inventory	2,543	3,170	4,300	4,834	
Account Receivables	427	458	765	859	
Cash and Bank Balance	688	865	1,147	1,289	
Others	1,255	1,385	1,911	2,149	
Curr. Liability & Prov.	3,473	3,958	4,658	5,072	
Account Payables	2,760	2,890	3,511	3,782	
Provisions	713	1,068	1,147	1,289	
Net Current Assets	1,441	1,921	3,465	4,060	
Appl. of Funds	36,533	36,805	38,239	37,867	

E: MOf Estimates

RATIOS		(Rs Million)			
Y/E JUNE	2004	2005 E	2006 E	2007 E	
Basic (Rs)					
EPS	2.2	3.5	4.1	5.3	
Cash EPS	3.5	4.9	5.5	6.7	
BV/Share	15.0	16.1	17.9	20.7	
DPS	16	18	2.0	2.2	
Payout (%)	47.2	46.0	54.9	47.1	
Valuation (x)					
P/E	29.4	19.0	16.0	12.5	
Cash P/E	18.9	13.4	11.9	9.8	
P/BV	4.4	4.1	3.7	3.2	
EV/Sales	2.8	3.2	2.7	2.2	
EV/EBITDA	10.1	11.4	8.7	6.8	
EV/Ton (Cap) - US\$	94.0	143.0	136.5	128.2	
Dividend Yield (%)	2.4	2.7	3.0	3.3	
Return Ratios (%)					
RoE	16.7	22.4	24.2	27.3	
RoCE	12.7	18.3	24.3	30.0	
Working Capital Ratios					
Asset Turnover (x)	0.5	0.7	0.8	0.9	
Debtor (Days)	7	6	8	8	
Leverage Ratio (x)					
Current Ratio	1	1	2	2	
Debt/Equity	0.6	0.5	0.4	0.2	

CASH FLOW STATEMENT		(Rs Million)			
Y/E JUNE	2004	2005 E	2006 E	2007 E	
Oper. Profit/(Loss) before Tax	5,399	7,240	9,398	11,301	
Interest/Dividends Recd.	505	746	675	675	
Direct Taxes Paid	-467	-503	-1,852	-2,375	
(Inc)/Dec in WC	4,489	-303	-1,263	-452	
CF from Operations	9,925	7,180	6,958	9,149	
EO expense	-430	0	0	0	
CF from Oper incl EO Exp	10,356	7,180	6,958	9,149	
(inc)/dec in FA	-6,549	-605	-1,819	-1,000	
(Pur)/Sale of Investments	907	-1,141	0	0	
CF from Investments	-5,641	-1,746	-1,819	-1,000	
Issue of Shares	2,216	-939	0	0	
(Inc)/Dec in Debt	-4,162	-1,319	-1,073	-4,141	
Interest Paid	-784	-848	-734	-510	
Dividend Paid	-1,604	-2,152	-3,050	-3,355	
CF from Fin. Activity	-4,335	-5,257	-4,857	-8,005	
Inc/Dec of Cash	380	177	282	143	
Add: Beginning Balance	309	688	865	1,147	
Closing Balance	688	865	1,147	1,290	

For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 56575200 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

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| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |

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