Equity Research

October 15, 2009

BSE Sensex: 17231

INDIA

Cement sector

Bonding strength

Reason for report: Reinitiating coverage

We reinitiate coverage on cement sector with a positive bias. We believe that continued strong demand buoyed by economic recovery and lower-than-expected supply will ensure prices to remain within a narrow band. Also, the quantum and period of oversupply would be less than Street expectations. Supply seems to have been 'managed' and coupled with higher consolidation has led to greater pricing discipline by producers. Cement prices have declined in the past few months owing to seasonal monsoon and floods, especially in the South. However, our channel checks indicate that prices will likely firm up as demand picks up after November '09. Our FY11-12E earnings estimates stand at 1-14%, ahead of consensus. Cement companies are trading below their mid-cycle, long-term historical average on all parameters (EV/E, EV/te, P/E) despite strong free cashflow (FCF) generation and healthy margins. All companies are trading below their replacement cost. We reinitiate coverage on four large-caps – Grasim, ACC, Ambuja Cement (ACEM) and UltraTech Cement (UTCL) – with BUY rating.

- **Supply 'management'.** We believe capacity utilisation is unlikely to fall below 82% in FY11E. Most of the incremental capacity is staggered/delayed and new capacities generally take 6-12 months for production to stabilise implying lower output. We expect supply CAGR of 12.8% through FY09-12E.
- **Prices may move within narrow band.** We expect prices to remain stable/soft in H2FY10 and pricing pressure to build in H1FY11 as new capacities commence in a seasonally weak demand period; thereafter, we expect prices to inch up with pick up in demand. We factor in 5.3% drop in average realisations in FY11E. Companies have become financially stronger with high FCF generation and increased cost efficiencies and are geared even for the next expansion phase, indicating that supply/demand mismatch, if any, would not result in disruptive prices.
- **Demand to be robust over next 3-5 years.** With initial signs of economic recovery, the housing sector is witnessing improved demand from all segments – rural, semi-urban and urban. Coupled with increased thrust on government infrastructure spend, we expect demand CAGR of 9.5% over FY09-12E.
- **Top picks – Grasim and ACEM.** We prefer North-based companies as well as players with capacity addition in the North as these would see better incremental realisations (Grasim and ACEM), early capacity additions (Grasim and UTCL) and higher cost savings (Grasim, UTCL and ACEM). Also, we recommend BUY on UTCL (on reduction in valuation discount post proposed restructuring) and ACC (on attractive valuations and diversified presence).

ACC (Buy)
Target price Rs910

Ambuja Cement (Buy)
Target price Rs113

Grasim (Buy)
Target price Rs2,935

UltraTech Cement (Buy)
Target price Rs975

Company	Market cap (US$bn)	Reco	CMP (Rs)	TP (Rs)	P/E (x)		EV/EBITDA (x)		P/B (x)	
					FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
ACC	3.2	BUY	790	910	10.7	10.1	5.7	5.1	2.2	1.9
ACEM	3.1	BUY	94	113	11.3	10.3	6.5	5.8	1.9	1.7
Grasim	4.7	BUY	2,405	2,935	9.1	8.3	4.9	4.3	1.4	1.2
UltraTech	2.2	BUY	811	975	10.0	9.5	5.5	5.0	1.8	1.5

Note: Year end for ACC and ACEM is December; hence, FY11E & FY12E mean CY10E & CY11E respectively

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Prices and Sensex as on October 14, '09

Investment rationale

Supply seems to be ‘managed’; capacity utilisation may not fall below 82%

We believe investor concern about oversupply is reasonable, given huge capacity additions planned for the next 12-18 months. Cement companies made huge profit over FY04-07 and embarked on massive expansion plans owing to growth potential of the sector. Based on our interaction with cement companies and other channel checks, ~80mnte cement capacity is expected over the next three years, of which 35-40mnte may come in FY10E itself.

However, factoring in: i) 3-6 month delay in commissioning of the plant, ii) *pro-rata* availability based on period of commissioning, iii) 3-6 months for stabilisation of production at the plant and iv) 60-65% utilisation for the newly commenced plant, we estimate ~33mnte incremental capacity in FY10E. We believe supply has been staggered over a longer period of time. At the same time, demand has picked up thus lowering the quantum of oversupply. Overall, we do not expect average utilisation to fall below 86% in FY10E (87% in H1FY10) from 92% in FY09E. Further, we believe utilisation will not fall below ~82% in FY11E and would thereafter inch up to ~84% in FY12E. We expect supply & demand CAGRs of 12.8% & 9.5% respectively over FY09-12E.

Table 1: Cement supply/demand outlook

	FY08	FY09	FY10E	FY11E	FY12E
Year-end installed capacity	198	224	263	288	304
Effective capacity	178	205	237	272	292
Capacity not in production	4	4	4	4	4
Actual- effective capacity	174	201	233	268	288
Domestic consumption	164	178	196	215	236
Export (cement + clinker)	6	6	5	5	6
Domestic consumption + exports	170	184	201	220	242
Surplus / (Deficit)	**4**	**17**	**32**	**48**	**46**
% surplus - wrt effective capacity	2	8	14	18	16
Capacity utilisations	98	92	86	82	84
Average price	231	238	249	236	238
Change in average price (%)	12.1	3.0	4.6	(5.3)	0.9
Capacity growth (%)	10.0	15.3	16.2	14.8	7.4
Domestic growth (%)	10.1	8.5	10.0	9.8	9.8
Domestic + exports growth (%)	9.8	8.3	9.1	9.7	9.7

Source: I-Sec Research

Table 2: Capacity addition – Schedule

(mnte)

Company	CoD	Region	Year-end Installed capacity				Incremental effective capacity			
			FY09	FY10	FY11	FY12	FY09	FY10	FY11	FY12
ACC	Dec-09	East		1.4				-	1.0	0.3
ACC	Dec-09	South		1.2				-	0.9	0.3
ACC	Jun-10	South			1.8				0.9	0.9
ACC	Dec-10	West			3.0	-			-	2.3
ACEM	Dec-09	East		2.2				-	1.7	0.6
ACEM	Jun-10	North			2.2				1.1	1.1
Andhra Cements	Dec-09	South		1.0				0.3	0.8	
Bhavya Cement	Dec-10	South			1.3				0.3	1.0
Binani Cements	Dec-11	West				2.6				0.7
Birla Corp	Sep-09	Central		0.3				0.2	0.1	
Birla Corp	Apr-10	North			1.5				1.1	0.4
Chettinad - Ariyalur	Feb-09	South	2.0				0.3	1.7		
Chettinad	Apr-09	South		1.0				0.8	0.3	
Dalmia	Dec-08	South	0.5				0.1	0.4		
Dalmia - Kadapa	Mar-09	South	2.5					1.9	0.6	
Dalmia - Ariyalur	Jun-09	South		2.5				1.3	1.3	
Deccan Cement	Dec-09	South		1.1				0.3	0.8	
Grasim	Mar-09	North	1.6					1.6		
Grasim	Jun-09	North		1.6				1.2	0.4	
Grasim	Dec-09	North		3.1				0.8	2.3	
Italicementi	Apr-10	South			2.2				1.7	0.6
India Cements	Aug-08	South	1.1				0.6	0.6		
India Cements	Sep-09	South		2.1				1.1	1.1	
India Cements	Apr-09	West		1.1				0.8	0.3	
India Cements	Sep-10	North			1.3				0.7	0.7
Jaiprakash - Dalla	Mar-09	Central	2.5					1.3	1.3	
Jaiprakash - Sidhi	Mar-09	Central	2.0					1.0	1.0	
Jaiprakash - GACL SP-1	Jun-09	West		1.2				0.9	0.3	
Jaiprakash -Baga (HP)	Dec-09	North		1.5				0.4	1.1	
Jaiprakash -Bagheri (HP)	Dec-09	North		2.0				0.5	1.5	
Jaiprakash -Wanakbori 1	Sep-10	West			1.2				0.3	0.9
Jaiprakash- Roorke	Sep-10	North			1.2				0.3	0.9
Jaiprakash- SAIL JV Bhilai	Mar-11	East			2.0	-	-	-	-	1.5
Jaiprakash- GACL SP-2	Dec-11	West				1.2				0.3
Jaiprakash -Wanakbori 2	Dec-11	West				1.2				0.3
Jaiprakash- SAIL JV Bokaro	Dec-11	East				2.1				0.5
Jaiprakash - Balaji	Mar-12	South				3.5				-
JK Cement - Gotan	Sep-08	North	0.4				0.2	0.2		
JK Cement	Dec-09	South		2.5				0.6	1.4	1.1
KCP Cements	Sep-11	South				1.8				0.9
Kesoram	Nov-08	South	0.3				0.1	0.2		
Kesoram	Sep-09	South		1.5				0.8	0.8	
Lafarge	Mar-09	East	1.0				0.1	0.9		
Lafarge	Mar-09	East	0.4				0.0	0.4		
Lafarge - Sonadi	Sep-09	East		1.1				0.6	0.6	
My Home Indus	Jun-08	South	0.4				0.3	0.1		
Madras Cement	Apr-08	South	0.6				0.6			
Madras Cement	Mar-09	South	2.0				0.2	1.8		
Madras Cement	Dec-09	East		1.0	-	-	-	0.3	0.7	-
Mangalam Cement	Sep-08	North	0.5				0.3	0.3		
Murali Agro	Sep-09	West		1.3				0.7	0.7	
Murali Agro	Jun-10	West			1.3				0.7	0.7
NCL	Apr-10	South			1.5				1.1	0.4
OCL India - Kapilas	May-08	East	1.4				0.9	0.5		
OCL Rajgangpur	Apr-09	East		2.2				1.7	0.6	
Orient Cement	Dec-09	South		1.6				0.4	1.2	
Orient Cement	Apr-11	West				1.0				1.0
Prism Cements	Dec-11	Central				3.0				0.8
Rain Commodities	Jun-08	South	0.5				0.4	0.1		
Rain Commodities	Jun-08	South	2.0				1.5	0.5		
Raghuram Cement	Apr-10	South			2.0				1.5	0.5
Raghuram Cement	Dec-10	South			2.0				0.5	1.5
Shree Cements	Dec-10	North		1.5	-	-	-	0.8	0.8	-
Shriram Cements	Apr-09	North		0.2				0.2		
UTCL	Sep-08	South	1.3				0.7	0.7		
UTCL	Mar-09	South	2.4				0.2	2.2		

Cont'd…

Capacity addition – Schedule (cont'd)

(mnte)

Company	CoD	Region	Year-end Installed capacity FY09	FY10	FY11	FY12	Incremental effective capacity FY09	FY10	FY11	FY12
UTCL	May-09	South		1.2				1.0	0.2	
Vasvadatta Cements	Apr-08	South	0.5				0.5			
Zuari Industries	Sep-09	South		2.4				1.2	1.2	
Total			**25.8**	**39.8**	**24.5**	**16.4**	**6.8**	**32.6**	**34.6**	**19.8**

Source: Company data, I-Sec Research

Table 3: Regional capacity additions

(mnte)

	FY09	FY10	FY11	FY12	FY09	FY10	FY11	FY12
	Incremental capacity (mnte)				Incremental effective capacity (mnte)			
Region								
North	2.5	9.9	6.2	-	0.4	5.8	9.3	3.0
Central	4.5	0.3	-	3.0	-	2.5	2.3	0.8
East	2.8	7.9	2.0	2.1	1.0	4.3	4.4	2.9
West	-	3.6	5.5	6.0	-	2.4	2.2	6.1
South	16.1	18.1	10.8	5.3	5.4	17.6	16.4	7.1
Total	**25.8**	**39.8**	**24.5**	**16.4**	**6.8**	**32.6**	**34.6**	**19.8**
	Capacity additions (%)				Incremental capacity additions (%)			
North	9.6	24.9	25.3	-	6.4	17.9	26.8	15.2
Central	17.4	0.8	-	18.3	-	7.6	6.7	3.8
East	10.7	19.7	8.2	12.8	14.9	13.1	12.8	14.7
West	-	9.1	22.4	36.5	-	7.3	6.3	30.5
South	62.3	45.5	44.1	32.4	78.8	54.1	47.4	35.8
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: I-Sec Research

Continued delay in commissioning of capacities

Most of the new capacities have been delayed 6-9 months, with some for over a year. In H1FY09, lower demand, credit crunch, shortage in supply of equipment etc resulted in delay in commissioning of the plant. Currently, delay in civil construction, shortage of skilled/unskilled labour and simultaneously managing larger capacities have led to the delay. Thus, most of the incremental supply seems to have been postponed.

Lower capacity utilisation of newly commenced plants

Our analysis of capacities added over the past 18 months indicates that average utilisation of some plants is ~44%. Based on our interaction with companies, we believe newer capacities would take 6-12 months before normal production at 80-90% utilisation.

Table 4: Lower capacity utilisation of newly commenced plants

(mn te)

Company/Name of plant	Location	Region	CoD	Additional installation	August utilisation (%)	April-August utilisation (%)
Rain Comdt. Unit-II Line 2	Racheria, AP	South	Jun-08	2.0	39.0	48.2
UTCL - Ginigera (G)	Ginigera, KAR	South	Sep-08	1.3	57.4	57.9
Dalmia - Kapada	Jammalamadugudu, AP	South	Mar-09	2.5	29.0	27.0
Madras Cements - Ariyalur	Govindapuram, TN	South	Mar-09	2.0	81.8	64.1
Chettinad - Ariyalur	Keelapaluvur, TN	South	Mar-09	2.0	70.0	65.0
India Cements - Parli (G)	Parli, MAH	West	Apr-09	1.1	40.8	24.3
Dalmia - Ariyalur	Thamaraikulam, TN	South	Jun-09	2.5	11.6	7.9
Madras - Uthiramerur (G)	Uthiramerur, TN	South	Jul-09	0.6	50.6	43.9
OCL India - Rajgangpur	Rajgangpur, Orissa	East	Apr-09	2.2	45.0	52.0

Source: Company data, I-Sec Research

Cement companies financially stronger and more efficient

Most cement companies made bumper profit over FY05-08, generated huge operating cashflows and are financially stronger at present. Our analysis indicates that the top-4 cement companies generate Rs217bn operating cashflows and Rs78bn FCF cumulatively over FY10E-12E. Hence, we believe cement companies would not engage in a price war. In fact, companies are geared up for the next expansion phase, implying that a supply/demand mismatch, if any, would not result in disruptive prices.

Table 5: Key financials – I-Sec Cement universe

(Rsmn)

	FY09	FY10E	FY11E	FY12E
ACEM				
Net Sales	62,347	70,060	73,648	80,976
EBITDA	17,779	19,926	20,991	23,016
Recurring Net Income	10,939	12,312	12,708	13,949
Operating Cash Flow	9,258	16,031	14,137	15,046
Free Cash Flow	(5,148)	1,754	6,920	5,156
ACC				
Net Sales	77,197	85,430	87,995	96,560
EBITDA	16,624	25,197	23,743	25,618
Recurring Net Income	10,571	15,507	13,819	14,628
Operating Cash Flow	16,186	18,844	18,272	20,790
Free Cash Flow	563	2,787	4,343	7,043
Grasim				
Net Sales	184,039	191,559	201,386	214,241
EBITDA	43,296	56,022	53,334	57,109
Recurring Net Income	21,867	25,536	24,299	26,624
Operating Cash Flow	26,395	36,985	35,463	39,321
Free Cash Flow	8,571	15,085	13,178	20,144
UTCL				
Net Sales	63,831	71,595	73,614	79,719
EBITDA	17,064	22,854	19,968	20,795
Recurring Net Income	9,770	12,421	10,236	10,729
Operating Cash Flow	12,575	14,891	12,833	14,157
Free Cash Flow	4,339	6,868	2,347	5,219

Source: Company data, I-Sec Research

Companies have become more efficient

Cement companies have not only become financially stronger, but also more efficient. Power & fuel costs constitute 18-22% of cement companies' revenues. Indian cement companies largely depend on domestic coal, imported coal and pet coke as a source of fuel. Fuel is primarily used in kilns and captive power plants (CPPs). Companies have started setting up CPPs, thus reducing dependence on expensive/irregular external power supply. Most companies in I-Sec coverage would source 80-85% of their power requirement via CPPs by FY11E.

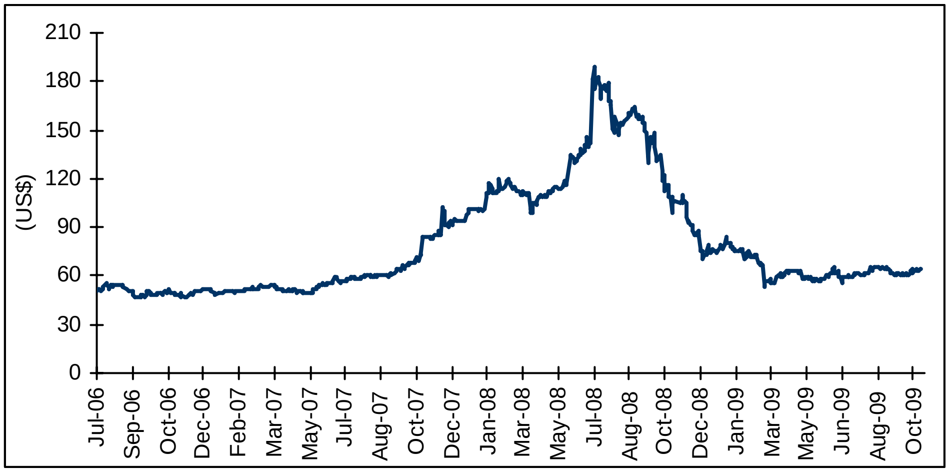
Table 6: Current coal mix

(%)

Company	Linkage coal	e-auctions	Imports	Total
ACC	65	20	15	100
ACEM	55	10	35	100
Grasim	30	40	30	100
UTCL	40	15	45	100

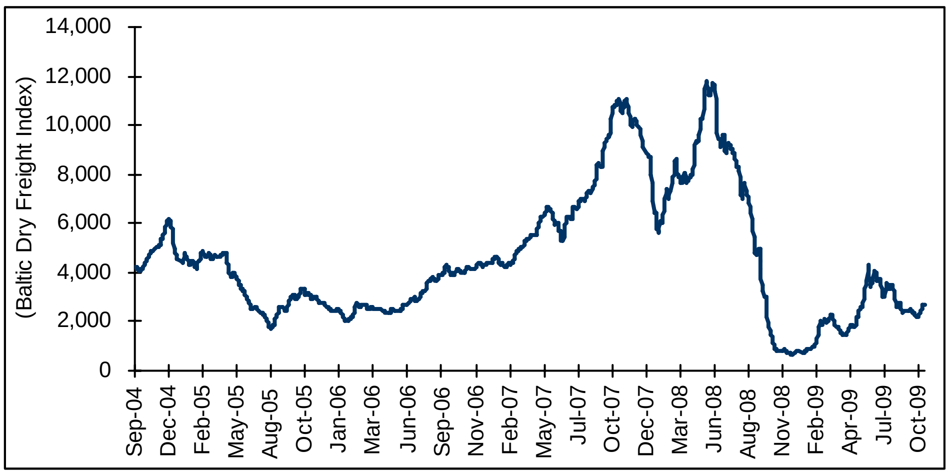
Source: Company data

Chart 1: International coal price movement



Source: Bloomberg

Chart 2: Baltic dry freight index



Source: Bloomberg

Freight costs constitute 12-18% of cement companies' revenues and depend on lead distance to the market, freight mix between road, rail & sea as well as proximity to source of raw material such as fly ash. Freight costs have also seen a rising trend on account of rising diesel prices. However, companies are planning to split grinding units located closer to key markets or to fly ash sources to reduce impact of higher freight costs.

Table 7: Freight mix

(%)

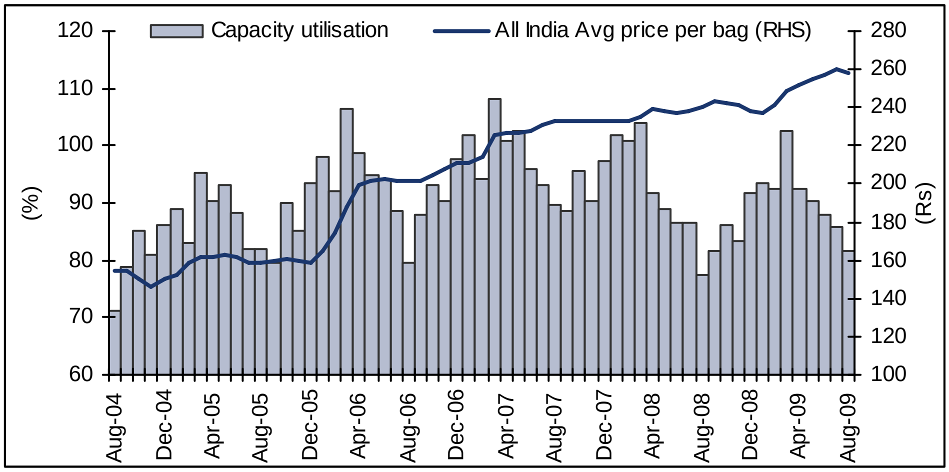
	Rail	Road	Sea
ACC	50	50	-
Grasim	47	53	-
ACEM	23	60	17
UTCL	37	52	11

Source: CMA, I-Sec Research

Besides the aforementioned, G&A costs have been rationalised and the companies are getting benefit of scale of operations. Thus, we believe that even if prices see a decline, companies are geared against margin erosion. Even after factoring in a 5.3%

decline in average realisations in FY11E, EBITDA margins of companies in I-Sec cement universe will remain within 26-28%.

Chart 3: Utilisation versus cement prices



Source: CMA, I-Sec Research

Higher degree of consolidation in most regions

Top-2 cement groups (Holcim and Aditya Birla Group) have ~40% market share, while the next five companies have ~20% market share. Even our region-wise analysis indicates higher degree of consolidation in most markets, except the South (which is more fragmented and would see ~46% incremental capacity over FY09-12E). Thus, we believe the South is the most vulnerable market in terms of pricing. Hence, we prefer companies which are adding capacity in the northern region, thereby leading to better net incremental realisations.

Table 8: Consolidation – Region-wise

Region	No. of Players	Market Share (%)
North	Top 5	74
South	Top 5	50
East	Top 5	67
West	Top 5	60
Central	Top 6	72

Source: CMA, I-Sec Research

Table 9: Historic M&A transactions

Year	Acquirer	Target	Shareholding (%)	Capacity (mnte)	EV/te (US$)
Nov-99	Lafarge	Tisco	100	2.0	58
Dec-99	ACEM	ACC	14	12.0	144
Apr-00	Lafarge	Raymond	100	2.2	80
May-00	Ciments Francais	Zil	50	1.8	84
Jan-02	Zuari	Sri Vishnu	95	1.2	66
Dec-03	ACC	Idcol	87	1.0	65
Jun-04	Grasim	L&T cement	52	17.0	80
Jan-05	ACEM	ACC	36	18.2	99
Jan-06	Holcim	Guj Ambuja	15	14.0	200
May-06	Ciments Francais	Zuari	50	3.2	100
Jul-06	Heidelberg Cement	Mysore	50	2.6	117
Dec-07	Holcim	ACEM	13	21.0	277
Dec-07	Cimphor	Sri Digvijay	74	1.1	162
Mar-08	CRH	My Home Industries	50	3.2	235
Jun-08	Vicat	Sagar	7	2.5	100

Source: Company data, I-Sec Research

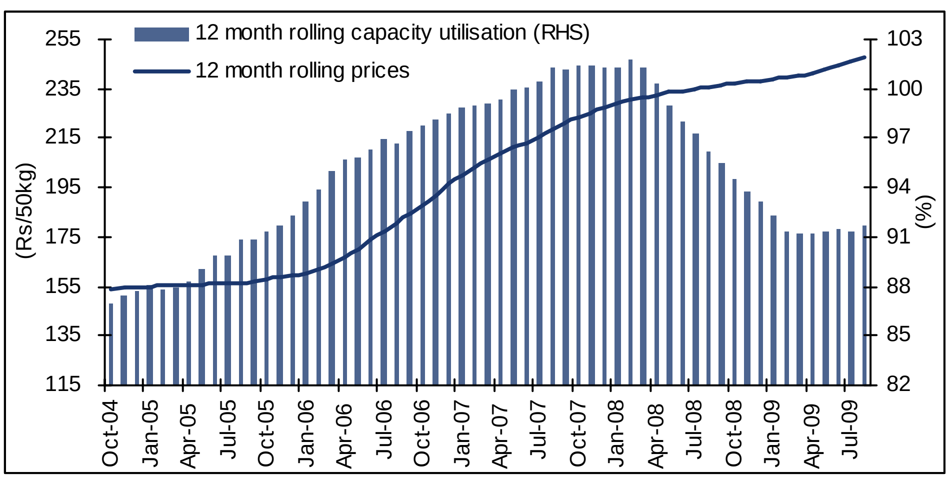
Prices may move within narrow band over FY09-12

Cement prices have shown great resilience YTDFY10 on the back of strong housing demand and higher infrastructure spend. All-India trailing 12-month average prices are up 5.2%, whereas those for the North, Central, East, South and West have moved up 4.9%, 8.1%, 4.4%, 7.3% and 2% respectively. We expect trailing 12-month average prices of All-India, North, Central, East, South and West regions to increase 5.5%, 7.1%, 10.9%, 8.5%, (0.6)% and 1.1% respectively in FY10E.

With bunching up of capacities over the next 12 months, we expect FY11E average prices to fall 5.3%. We expect the North, Central, East, South and West to witness 4.3%, 2.8%, 3.2%, 6% and 3.5% fall respectively in FY11E. We believe prices would start correcting in H1FY11 in a seasonally weak demand period and thereafter gradually inch up in H2FY11. We do not expect average utilisation to fall below 82% in FY11E and believe it would thereafter increase to 84% in FY12E. Further, in FY12E, we expect average prices to start moving up as oversupply may reduce to 17% from 19% in FY11E. We believe average prices would move up 0.9% while those in the North, Central, East, South and West would increase 1.5%, 1.8%, 1.2%, 0.7% and 1.1% respectively in FY12E. Thus, we expect average prices to move within a narrow band over FY09-12E.

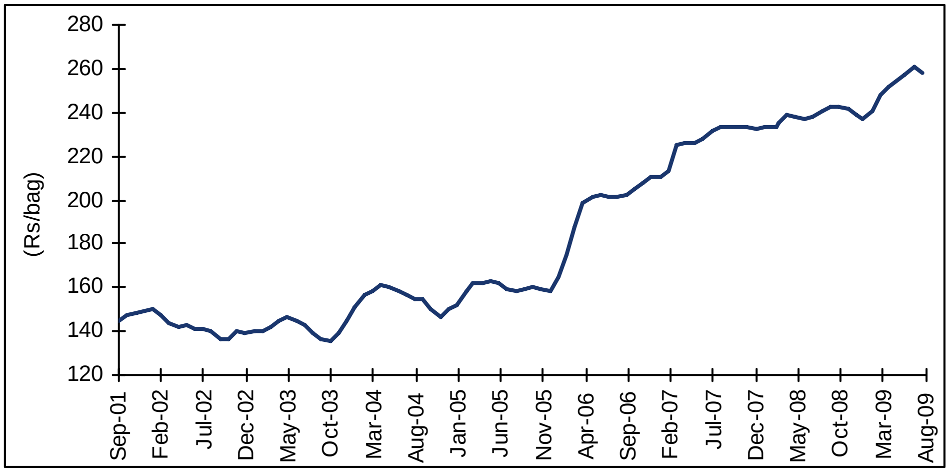
Historically, over FY96-04, when oversupply ranged over 7-19%, cement prices have moved within the narrow band of Rs138-Rs148/ 50Kg bag for almost eight years. Following the trend, we estimate oversupply to be within the 8-19% range and average prices to move within a narrow band over FY09-12E.

Chart 4: Rising utilisation levels and prices



Source: CMA, I-Sec Research

Chart 5: All-India average cement price trend



Source: Cement Manufacturers Association (CMA), I-Sec Research

Region-wise utilisation

We believe that accounting for region-wise supply/demand mismatch, the South would be the worst impacted in terms of pricing. ~46% of capacity would be added in the South over FY09-12E. Rolling 12-month utilisation in the South is expected to fall to 77% by March '10 and further to 70% in FY11E before moving up to 72-73% by FY12E. As regards other regions, we believe supply/demand mismatch would be more of a temporary phenomenon and utilisation would start moving up post FY11E.

Table 10: Region-wise demand drivers

Region	Demand drivers
North	Low cost housing, rural housing, infrastructure, Common wealth game, metro
Central	Rural housing, low cost housing, infrastructure
East	Infrastructure - power, industrial, low cost housing
South	Infrastructure - irrigation projects, roads, commercials-SEZs, housing
West	Recovery in urban housing, roads, infrastructure

Source: I-Sec Research

Table 11: Region-wise realisation growth

(%)

	North	East	South	West	Central	All India
FY09	3.4	2.7	7.7	1.8	0.2	3.8
FY10E	7.1	8.5	(0.6)	1.1	10.9	5.5
FY11E	(4.3)	(3.2)	(6.0)	(3.5)	(2.8)	(5.3)
FY12E	1.5	1.2	0.7	1.1	1.8	0.9

Source: I-Sec Research

Table 12: Company-wise realisation growth

(%)

	ACC	ACEM	UTCL	Grasim
FY09	3.7	2.2	4.5	4.1
FY10E	6.0	4.6	2.2	4.0
FY11E	(5.0)	(4.0)	(6.0)	(4.5)
FY12E	0.5	0.8	0.4	0.7

Source: I-Sec Research

Table 13: Region-wise utilisation

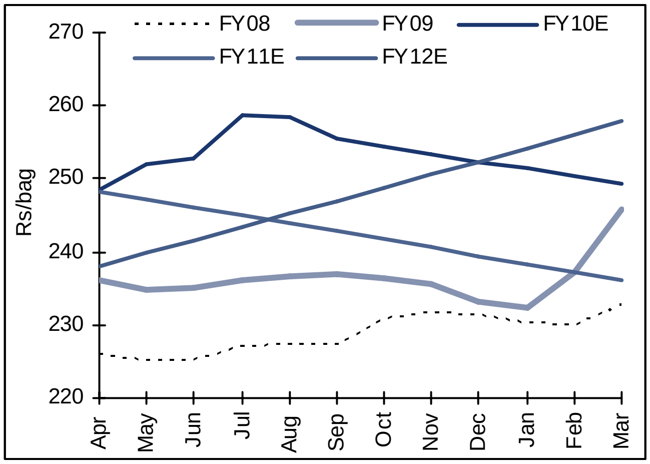
(mn te)

	FY08	FY09	FY10E	FY11E	FY12E
North					
Effective Capacity	36.6	48.0	53.8	63.1	66.1
Production	36.5	41.2	46.1	50.8	55.8
Utilisation (%)	99.6	85.8	85.8	80.5	84.5
Despatches	36.5	41.1	46.1	50.8	55.8
YoY change (%)		12.8	12.2	10.0	10.0
Central					
Effective Capacity	25.8	28.2	30.6	33.0	33.7
Production	25.0	26.0	28.8	31.6	34.5
Utilisation (%)	97.0	92.5	94.0	95.8	102.3
Despatches	24.5	25.7	28.8	31.6	34.5
YoY change (%)		4.7	12.1	9.6	9.2
East					
Effective Capacity	27.3	29.8	34.1	38.5	41.4
Production	23.8	26.0	28.8	31.7	35.0
Utilisation (%)	87.4	87.2	84.5	82.2	84.5
Despatches	23.2	26.0	28.8	31.7	35.0
YoY change (%)		12.2	10.7	10.0	10.5
South					
Effective Capacity	56.6	67.5	85.1	101.5	108.6
Production	54.2	59.7	65.0	71.4	78.1
Utilisation (%)	95.8	88.6	76.4	70.3	71.9
Despatches	54.1	59.7	65.0	71.4	78.1
YoY change (%)		10.3	8.8	9.8	9.5
West					
Effective Capacity	29.3	31.9	34.3	36.5	42.5
Production	28.8	28.5	30.2	32.5	35.1
Utilisation (%)	98.0	89.1	88.1	89.1	82.5
Despatches	28.7	28.4	30.2	32.5	35.1
YoY change (%)		(0.7)	6.3	7.5	8.0

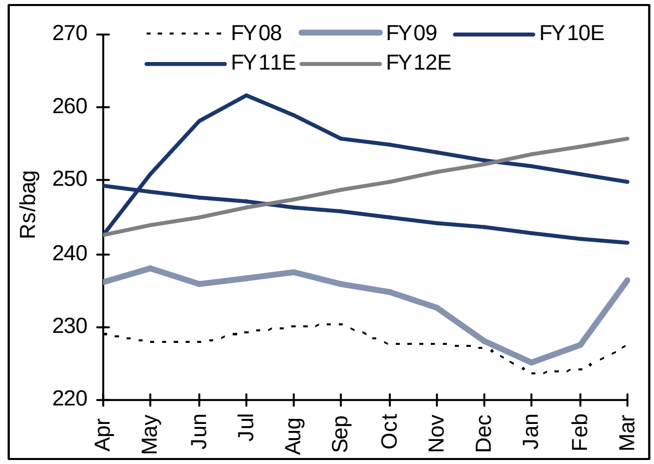
Source: CMA, I-Sec Research

Chart 6: Cement price chart – Region-wise

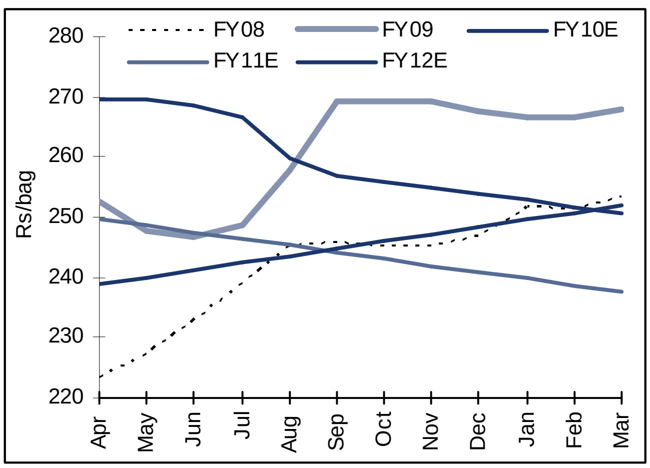
North – Price movements



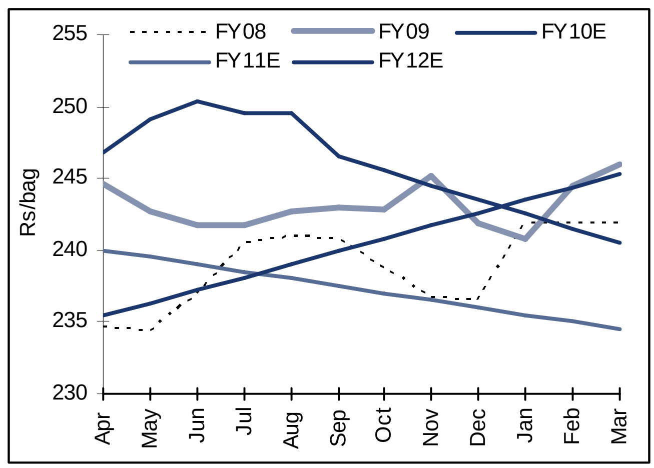
East – Price movements



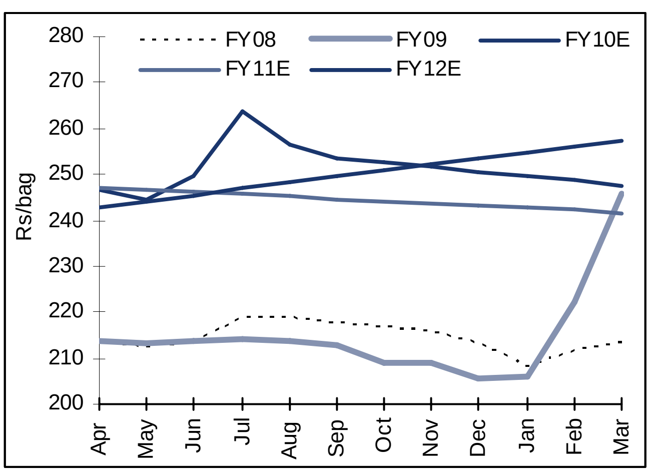
South – Price movements



West – Price movements



Central – Price movements



Source: CMA, I-Sec Research

Sensitivity analysis

Table 14: Sensitivity analysis (% change) on CY10/FY11 EPS

	Grasim	ACEM	UTCL	ACC
1% change in realisations from base assumption	2.8	4.0	4.5	3.9
1% change in raw material costs from base assumption	1	1.2	0.6	0.7
1% change in power and fuel cost from base assumption	0.7	0.8	0.9	0.7
1% change in freight cost from base assumption	0.5	0.6	0.8	0.5

Source: I-Sec Research

Our estimates ahead of consensus

Table 15: Our estimates ahead of consensus

(Rs mn)

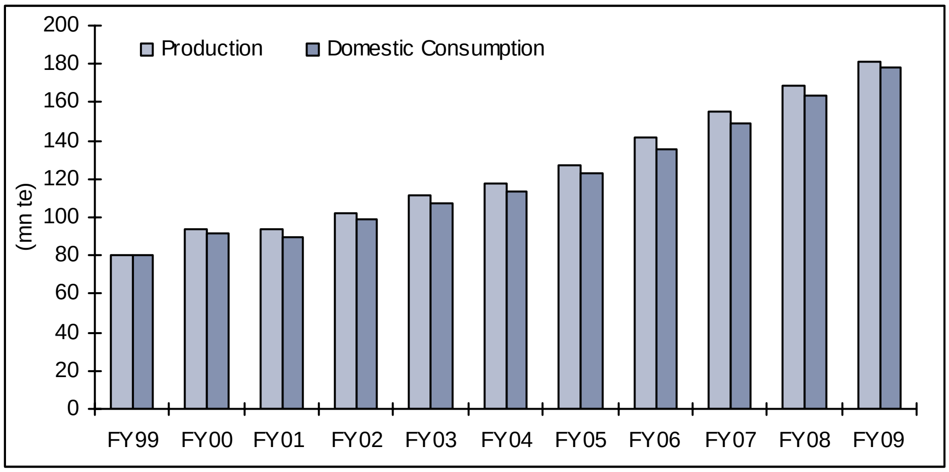
	PAT			EBITDA			Sales		
	FY10E	**FY11E**	**FY12E**	**FY10E**	**FY11E**	**FY12E**	**FY10E**	**FY11E**	**FY12E**
ACC									
Consensus estimates	15,487	13,176	12,783	24,504	23,403	22,855	83,946	86,733	91,487
I-Sec estimates	15,507	13,819	14,628	25,197	23,743	25,618	85,430	87,995	96,560
Variations (%)	0.1	4.9	14.4	2.8	1.5	12.1	1.8	1.5	5.5
ACEM									
Consensus estimates	12,117	11,459	12,579	19,725	19,570	21,601	68,675	71,168	72,302
I-Sec estimates	12,312	12,708	13,949	19,926	20,991	23,016	70,060	73,648	80,976
Variations (%)	1.6	10.9	10.9	1.0	7.3	6.6	2.0	3.5	12.0
Grasim									
Consensus estimates	25,406	22,713	25,165	53,876	49,397	53,688	190,298	197,217	212,253
I-Sec estimates	25,536	24,299	26,624	56,022	53,334	57,109	191,559	201,386	214,241
Variations (%)	0.5	7.0	5.8	4.0	8.0	6.4	0.7	2.1	0.9
UTCL									
Consensus estimates	11,990	9,663	10,015	21,407	18,306	19,634	71,860	73,181	75,625
I-Sec estimates	12,421	10,236	10,729	22,854	19,968	20,795	71,595	73,614	79,719
Variations (%)	3.6	5.9	7.1	6.8	9.1	5.9	(0.4)	0.6	5.4

Source: Bloomberg, I-Sec Research

Robust demand over next 3-5 years

Cement demand in India has registered ~8-9% CAGR in the past 10 years. Housing continues to be the main driver, constituting ~60% of overall demand. However, we believe that with government thrust on infrastructure, the cement sector could see increase in share of overall demand in the next 3-5 years.

Chart 7: Production and consumption trend



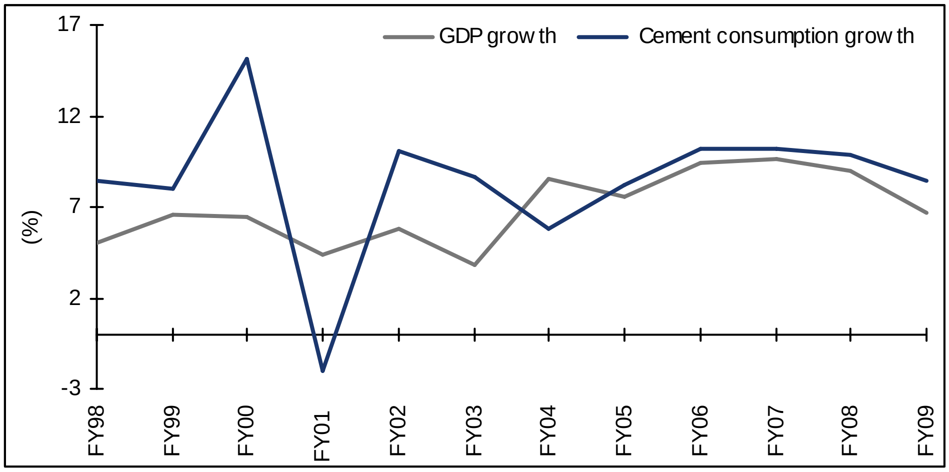
Source: CMA, I-Sec Research

Cement demand – Highly correlated with GDP

Cement demand is highly dependant on economic growth. Since infrastructure investments and construction activity (the main drivers of cement demand) are key components of GDP, cement demand growth has high correlation to GDP growth. Further, housing (both rural and urban), also a determinant for cement demand, depends on agricultural productivity and income levels, which are key components of GDP.

Based on the past 10-year data (FY00-09) on cement consumption growth versus GDP growth, cement-to-GDP stands at 1.3x. With planned investment in infrastructure to more-than-double in the XI FYP vis-à-vis X FYP, we may see improvement in the cement-to-GDP. Consequently, with GDP expected to grow 7-7.5% going forward, we believe cement demand would grow ~9-10% till FY12E. We expect housing, infrastructure, corporate capex, commercial construction and SEZs to be key demand drivers going forward.

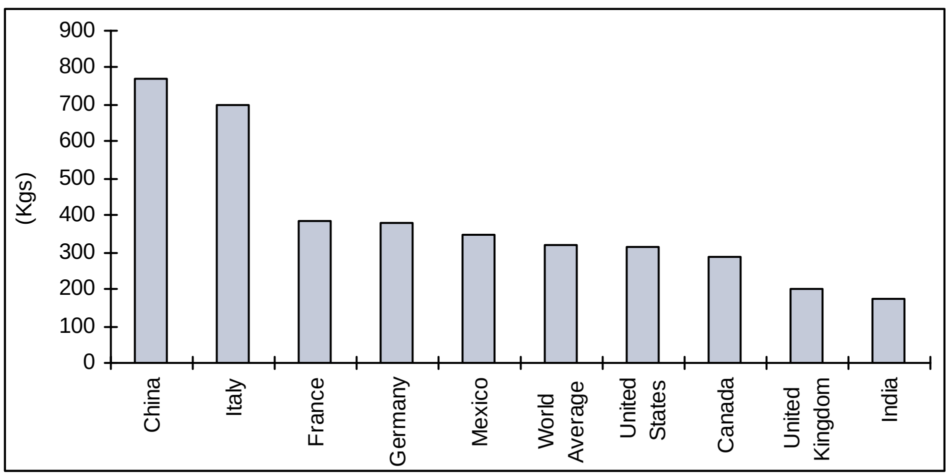
Chart 8: GDP versus cement demand growth



Source: CMA, Bloomberg

India is amongst the world's lowest per-capita consumers of cement. This reflects potential for growth of the cement industry in the country.

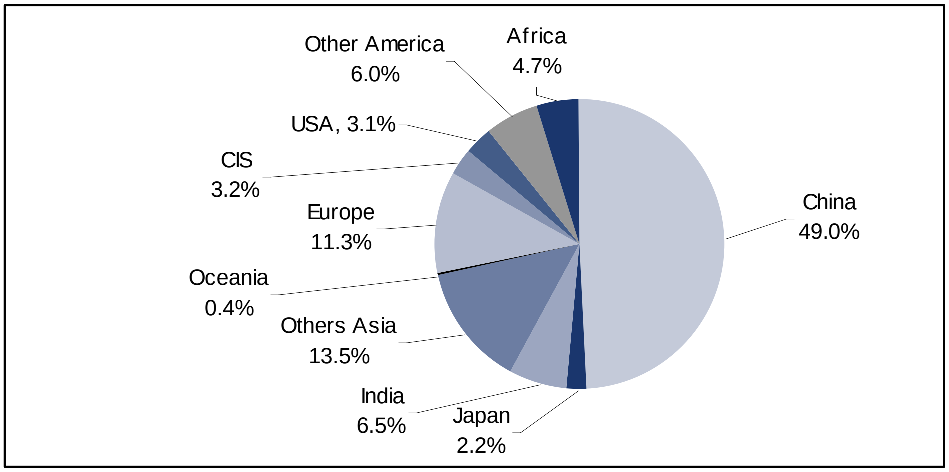
Chart 9: Per capita cement consumption



Source: Cembureau, I-Sec Research

India is the second-largest producer of cement in the world after China. It has production capacity of ~230mnte at present, which is expected to rise to 250-260mnte by end-FY10 (20-30mnte addition expected in the next six months). This implies ~6.5% of overall global production.

Chart 10: Break-up of global cement production in '08



Source: Cembureau, I-Sec Research

Table 16: Major cement producers globally

Country	Production[#] (mnte)						
	2002	2003	2004	2005	2006	2007	2008
China	725.1	862.5	967.8	1079.6	1253.5	1377.8	1368.4*
India	117.5	126.7	136.9	146.8	162	172.9	185.9
USA (excl. Puerto Rico)	89.8	92.9	97.4	99.4	98.2	95.5	87.8[e]
Japan	76.4	73.8	72.4	72.7	73.2	71.4	67.6
Korea, Rep. of	56.4	59.7	55.8	49.1	51.4	54.4	55.1
Russian Federation	38.1	41.4	46.2	49.5	55.2	60.1	53.6
Turkey	37.2	38.1	41.3	45.6	49	50.8	53.4
Brazil	38.2	34.2	36.4	39.2	42.4	47.2	52.2
Iran	28.8	30.5	32.3	32.7	35.3	40*	44.4*
Spain	42.5	44.8	46.6	50.3	54	54.7	43
Italy	41.5	43.5	46.1	46.4	47.9	47.5	43
Egypt	26.3	32.5	35	37	38.1	40.1	43[e]
Indonesia	35.1	34.9	37.9	36.1	38.1	39.9	41.8
Mexico	33.6	33.6	35.2	38.1	40.8	41.6	40.1*
Thailand	38.8	35.6	36.7	37.9	41.3	43.2	39.5
Vietnam	21.1	24.1	26.2	30.8	32.7	35.6	36.7*
Germany	31.5	33.6	32.7	31.9	34.3	34.4	34.7
Saudi Arabia	24.3	24.4	25.5	26.1	27.1	33.7	32.9*
Pakistan	9.9	11.3	14.8	15.8	18.3	26.3	28.7[e]
France	20	20.4	21.5	21.7	22.3	22.3	21.7

[#] Production including exported clinker; * Excluding exported clinker; e – Estimated
Source: Cembureau, I-Sec Research

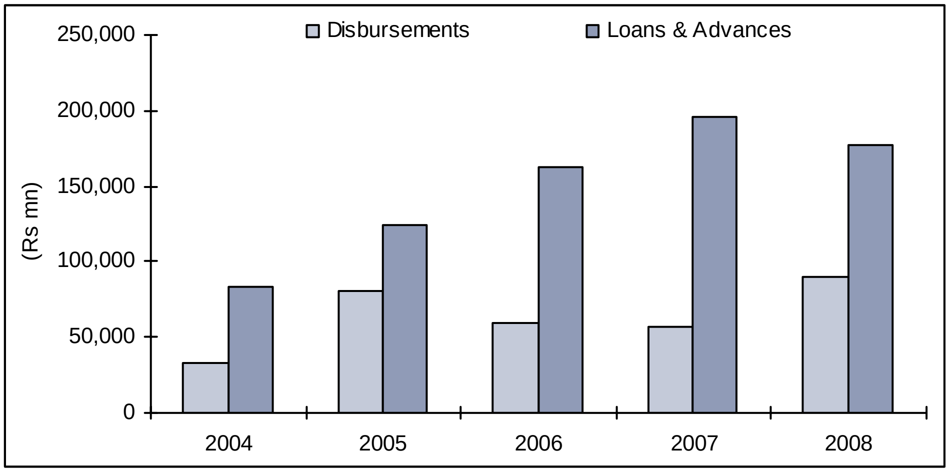
Housing to remain largest demand contributor

Housing is likely to continue fuelling cement demand growth going forward. Although over the past few years, increasing real-estate requirement in urban India has contributed the most to cement demand, we believe the next demand wave would be driven by semi-urban and rural housing needs – e.g., according to the XI FYP, total rural housing shortage during FY08-12E is expected to be 47.43mn houses.

As per the XI FYP ('08-12), housing requirement of ~74mn units in India is expected. Coupled with this, rising affordability of the middle class owing to rising income levels and rapid urbanisation (expected to grow to 37.2% in '25 from 28.7% in '05, as per a UN World Urbanisation Prospects report) would lead to rise in cement demand. Also, according to the UN report, number of cities with population of over 1mn would grow from 33 in '05 to 56 in '25.

The housing finance industry has also substantially grown over the past few years, given increase in disbursements (Rs33bn in FY04 to Rs90bn in FY08).

Chart 11: Loans and disbursements



Source: National Housing Bank, I-Sec Research

Main factors driving housing demand are:

- rise in disposable income levels and ease in availability of finance, enabling households to migrate from non-*pucca* houses to urban *pucca* housing and resulting in increase in demand for larger houses, thereby raising average size of dwelling units
- continued growth in population and change in population profile. As per the census of India '01 report, ~27.7% of India's population in '01 that was in the 25-44-year age group (typical age of home purchaser) is likely to increase to ~32% in '26, which implies annual addition of ~6.5mn people to the age bracket
- changing demographics (migration from rural to urban areas)
- decrease in number of people per household (average size of household) with breakdown of the joint family system into nuclear families
- fiscal incentives provided by the government and easy availability of finance.

Table 17: Housing demand projection

	FY08	FY09	FY10E	FY11E	FY12E
Estimated housing stock (mn)	133.8	138.3	142.9	147.8	152.8
Housing stock (bn sqft)	90.3	94.8	99.4	104.3	109.5
Average size (sqft)	675	685	696	706	717
Incremental demand (bn sqft)	4.2	4.4	4.7	4.9	5.1
Cement demand (mnte)	105.9	111.2	116.6	122.4	128.4

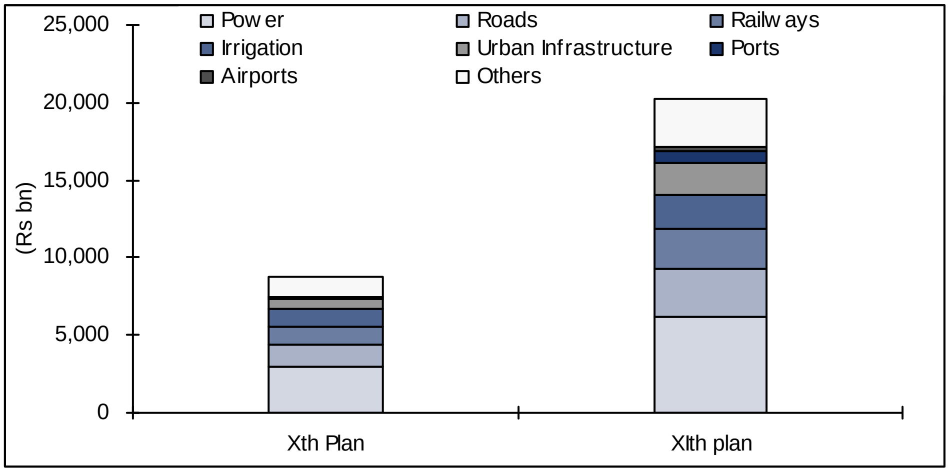
Source: Industry, I-Sec Research

As per industry sources, housing stock is expected to post 3.4% CAGR over the next five years. Further, housing stock in terms of area (sqft) is expected to rise at a higher 4.9% CAGR over the same period, given the expected increase in average size of dwelling units. Hence, we expect ~584mnte cement to be consumed by the housing sector over the next five years.

Infrastructure share to rise

The Planning Commission has projected Rs20,271bn investment in infrastructure for the XI FYP, 2.3x higher than infrastructure investment anticipated in the X FYP. Main sectors that would drive cement demand are roads, power, ports, airports, irrigation and urban infrastructure.

Chart 12: Infrastructure spending in X & XI FYPs



Source: Planning Commission

Road projects. Various road projects under the National Highway Development Programme (NHDP) that include phases II-VII are expected to generate cement demand of ~47.5mnte till end XI FYP.

Table 18: Road projects under NHDP

Project	Details	Date of completion	Cement consumption (mnte)
NHDP Phase II	NSEW Corridor	Dec, 2009	8.8
NHDP Phase III	Four-laning of 10,000Kms of high density National Highways	Mar, 2010	12.8
NHDP Phase IV	Up gradation of existing 20,000 Highways to two lane	Mar, 2012	18
NHDP Phase V	Six laning of GQ and other high density highways 5,000Kms	Mar, 2012	3.5
NHDP Phase VI	1,000Kms of expressways	Mar, 2012	4.5
Total			**47.5**

*Cement demand, assuming 25% of roads made of concrete
Source: National Highway Authority of India (NHAI), Committee on Infrastructure, I-Sec Research

Additionally, various state governments have undertaken road projects including repair and upgradation of existing roads. Total investment in such projects is expected to be ~Rs1,000bn, with ~18mnte demand expected over the next five years. Further, investment of ~Rs790bn in rural roads is likely to generate further demand of 14mnte. Overall, we expect ~80mnte demand from Central, state and rural road projects over the next five years.

Power projects. The XI FYP envisages total capacity addition of ~78,577MW, of which 16,500MW would be hydro projects where cement consumption is significantly higher than other projects. We expect ~46mnte of cement consumption for power generation projects over the next five years.

Table 19: Demand from power projects

	Capacity (MW)	Construction component (%)	Demand (mnte)
Thermal coal	54,355	20	14.3
Thermal gas	4,289	10	0.4
Hydro	16,553	70	29.4
Nuclear	3,380	30	2.3
Total	**78,577**		**46.4**

Source: Central Electricity Authority (CEA), National Institute for Construction Management & Research (NICMAR), I-Sec Research

Based on investments projected in the XI FYP, we estimate total cement requirement of 248mnte over the next five years. Further, we expect share of cement demand from infrastructure to rise to ~23% in the XI FYP from ~17% of total demand in the X FYP.

Table 20: Demand from infrastructure

	X FYP	XI FYP	Construction component (%)	Demand (mnte)
Power	2,919	6,165		46.4
Roads	1,449	3,118		80.0
Railways	1,197	2,580	42	31.0
Irrigation	1,115	2,231	60	38.3
Urban Infrastructure	648	1,991	60	34.1
Ports	41	739	50	10.6
Airports	68	347	42	4.2
Others	1,369	3,099	10	8.9
Total	**8,805**	**20,272**		**253.4**

Source: NHAI, CEA, NICMAR, Planning Commission, I-Sec Research

Industrial sector

Backed by healthy growth of the Indian economy, most industries are operating at peak utilisation. With demand expected to remain firm from various sectors, most industries have announced large capacity expansion plans. As per industry sources, an investment of ~Rs6,900bn is estimated over the next five years for various industrial projects. Hence, we expect cement demand of ~69mnte for these projects.

Commercial construction

Commercial construction includes malls, multiplexes, office space, hotels, hospitals etc. Demand for office space is largely driven by the IT/ITES industry, which comprises 75-80% of commercial demand at present. The sector is showing initial signs of recovery and is expected to grow ~15% annually over the next few years post the demand recovery and would be the key driver of commercial demand.

We expect aggregate cement demand of 1.08bnte over the next five years, implying over 10% CAGR over FY08-12E.

Table 21: Sector-wise projected cement demand (FY08-12E)

	Demand (mnte)	Share (%)
Housing	585	54.0
Infrastructure	253	22.9
Commercial, SEZ, Defence etc	160	14.8
Industrial capex	69	6.4
Exports	21	1.9
Total	**1,083**	**100.0**

Source: I-Sec Research

Key risks

Adverse supply/demand mismatch

In case large number of capacities get commissioned before schedule, an oversupply could result in pricing pressure from FY10E itself. Further, with housing and infrastructure being key demand drivers, significant slowdown in either housing or infrastructure project implementation could affect demand estimates.

Increased pricing pressure

Sector performance, to a large extent, is dependent on pricing movements. We have factored in 5% dip in average realisations through FY11E. Any further decline would pose a downside risk to our estimates.

Government interference

In the past, the Government has resorted to measures such as ban on exports, increasing duty, different duty structure for different levels of cement prices etc, which could affect the growth of the sector and pose downside risks to our estimates.

Input cost pressure

Historically, cement companies were able to pass on the rise in input cost to end consumers. However, in a scenario of oversupply, we believe the company may not be able to do so. Substantial increase in international coal price, domestic coal price and crude oil can pose downside risks to our estimates.

Valuations

We believe EV/EBITDA adjusted for cycle is a relatively stable and appropriate measure for cyclicals such as cement. Thus, we value cement companies in our coverage on target EV/EBITDA. Also, we compare this value with the current replacement cost.

Table 22: Valuations of cement companies worldwide

Company	Currency	Year End	Mkt. Cap	P/E (x) FY11	P/E (x) FY12	EV/EBITDA (x) FY11	EV/EBITDA (x) FY12	P/S (x) FY11	P/S (x) FY12
EUROPE									
Holcim	CHF	12/2008	23,387	15.8	13.0	7.6	6.8	1.0	0.9
Lafarge	EUR	12/2008	18,231	14.3	11.8	8.5	7.7	1.0	1.0
Buzzi Unicem	EUR	03/2009	2,373	11.5	8.9	5.2	4.6	0.8	0.8
Italcementi	EUR	12/2008	2,520	13.5	10.9	5.1	4.7	0.5	0.4
Ciments Francais	EUR	12/2008	2,976	11.9	9.1	5.0	4.5	0.7	0.6
Titan Cement	EUR	12/2008	2,070	13.2	10.7	8.5	7.4	1.3	1.3
Vicat	EUR	12/2008	2,570	11.8	9.5	6.4	5.4	1.3	1.2
Dyckerhoff	EUR	12/2008	1,773	14.1	12.7	6.2	5.7	1.2	1.1
Heidelberg Cement	EUR	12/2008	8,582	14.0	9.5	8.2	7.1	0.7	0.6
Average				**13.3**	**10.7**	**6.7**	**6.0**	**0.9**	**0.9**
ASIA									
Holcim Indonesia	IDR	12/2008	12,567,160	16.7	12.7	9.4	8.0	2.2	2.0
Lafarge Malayan Cement	MYR	12/2008	5,268	13.1	12.4	8.9	8.5	2.0	1.9
Anhui Conch Cement	HKD	12/2008	91,177	19.7	16.7	11.3	9.5	2.8	2.4
Indocement	IDR	12/2008	43,622,600	15.8	13.1	10.1	8.6	3.8	3.3
Siam Cement	THB	12/2008	270,000	11.0	9.5	8.0	7.1	0.9	0.8
Tangshan Jidong Cement	CNY	12/2008	17,779	14.6	12.3	8.6	7.1	1.9	1.5
Average				**15.2**	**12.8**	**9.4**	**8.1**	**2.3**	**2.0**
AUSTRALIA									
Boral Ltd.	AUD	06/2009	3,572	17.1	11.5	8.0	6.4	0.7	0.6
James Hardie	AUD	03/2009	3,325	26.4	16.0	11.2	8.4	2.5	2.0
Average				**21.7**	**13.8**	**9.6**	**7.4**	**1.6**	**1.3**

Source: Bloomberg, I-Sec Research

Most stocks under the I-Sec cement universe are trading at FY12E EV/EBITDA of 4.5-6x, much lower than Asian peers' average of FY12E EV/EBITDA of 8.1x. All stocks are trading below current replacement cost, which is ~US$120/te.

We take ACEM's EV/EBITDA as the base since it has been more stable than peers across different cycles. ACEM's average EV/EBITDA over the past eight years ('02-09) and the past 15 years (1994-09) has been ~8.5x.

However, it is important to look at valuations through the various industry cycles. ACEM traded at an average of 6.5x 1-year forward EV/EBITDA in the previous period of stable prices ('02-05). During a downturn, ACEM traded at 8.4x 1-year forward EV/EBITDA in 1997-00 and at 7.2x in FY03 (down from 8.2x in FY02). It is currently trading at CY11E EV/EBITDA of 5.8x. Similarly, cement companies usually trade at a discount (of 30-40%) to replacement cost during a downturn while enjoying similar premium in an upturn. Given the shorter period of supply/demand mismatch, higher degree of consolidation in various regions and a relatively stable price environment, we believe cement stocks are not expensive at current valuations.

We believe valuations should also factor in FCF generation capacity and operating margins. Companies in our coverage would generate OCF of Rs217bn and FCF of Rs78bn over FY10E-12E cumulatively. Similarly, we expect healthy EBITDA margin of 26-32% for all stocks in I-Sec cement universe for FY10E-12E.

We take mid-cycle EV/ EBITDA as the base as we expect prices to remain within a narrow band.

For ACEM, we expect the highest EBITDA margin in CY10 and CY11 vis-à-vis peers in our coverage; also, it is a zero-debt company with strong FCF and has demonstrated consistent performance. Hence, we assign a higher multiple to value ACEM vis-à-vis peers. We value ACEM at one-year forward EV/EBITDA of 7x. Similarly, backed by higher volume growth, better margins and diversified geographic presence, besides being a holding company for India's largest cement company, we value Grasim at 7-8% discount to ACEM's target multiple and value at 1-year forward EV/EBITDA of 6.5x. We apply ~15% discount to ACEM's target multiple and value ACC (due to deteriorating volumes and margins) and UTCL (due to high concentration in the South and the West that are more prone to pricing pressure) at 1-year forward EV/EBITDA of 6x.

Table 23: Valuation summary

Company	Reco	CMP (Rs)	TP (Rs)	P/E (x)		EV/EBITDA (x)		P/B (x)	
				FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
ACC	BUY	790	910	10.7	10.1	5.7	5.1	2.2	1.9
ACEM	BUY	94	113	11.3	10.3	6.5	5.8	1.9	1.7
Grasim	BUY	2,405	2,935	9.0	8.1	5.0	4.5	1.4	1.2
UTCL	BUY	811	975	10.0	9.5	5.5	5.0	1.8	1.5

Source: I-Sec Research

Table 24: Key operating data – I-Sec Cement universe

	FY09	FY10E	FY11E	FY12E
Realisation/te (Rs)				
ACC	3,705	3,943	3,750	3,762
ACEM	3,545	3,722	3,573	3,604
Grasim	3,936	4,093	3,909	3,936
UTCL	3,511	3,567	3,362	3,355
EBITDA/te (Rs)				
ACC	798	1,163	1,012	998
ACEM	1,011	1,059	1,018	1,024
Grasim	1,056	1,299	1,103	1,099
UTCL	939	1,139	912	875
Volumes (mnte)				
ACC	20.8	21.7	23.5	25.7
ACEM	17.8	18.8	20.6	22.5
Grasim	16.2	19.6	21.7	23.9
UTCL- cement and clinker	18.2	20.1	21.9	23.8
Utilisation (%)				
ACC	92.1	90.4	87.0	85.6
ACEM	80.7	85.6	83.3	85.1
Grasim	83.0	86.8	84.7	93.2
UTCL	83.0	86.9	94.8	102.8

Source: Company data, I-Sec Research

Table 25: Key financial data – I-Sec Cement universe

(%)

	FY09	FY10E	FY11E	FY12E
ACEM				
EBITDA Margins	28.5	28.4	28.5	28.4
Return on Capital Employed	19.1	18.6	17.0	16.6
Return on Equity	21.2	20.2	18.3	17.7
Sales Growth	9.3	12.4	5.1	9.9
EBITDA Growth	(13.1)	12.1	5.3	9.6
Recurring Net Income Growth	(17.2)	12.5	3.2	9.8
P/E (x)	13.1	11.6	11.3	10.3
EV/EBITDA (x)	7.8	7.0	6.5	5.8
ACC				
EBITDA Margins	21.5	29.5	27.0	26.5
Return on Capital Employed	20.4	25.8	19.9	18.7
Return on Equity	23.6	28.9	21.8	20.2
Sales Growth	10.2	10.7	3.0	9.7
EBITDA Growth	(13.3)	51.6	(5.8)	7.9
Recurring Net Income Growth	(13.7)	46.7	(10.9)	5.9
P/E (x)	14.0	9.6	10.7	10.1
EV/EBITDA (x)	8.3	5.5	5.7	5.1
Grasim				
EBITDA Margins	23.5	29.2	26.5	26.7
Return on Capital Employed	20.7	23.1	19.8	19.6
Return on Equity	21.2	20.1	16.3	15.5
Sales Growth	8.4	4.1	5.1	6.4
EBITDA Growth	(12.7)	29.4	(4.8)	7.1
Recurring Net Income Growth	(16.2)	16.8	(4.8)	9.6
P/E (x)	10.1	8.6	9.1	8.3
EV/EBITDA (x)	6.4	4.7	4.9	4.3
UTCL				
EBITDA Margins	26.7	31.9	27.1	26.1
Return on Capital Employed	16.5	18.2	13.7	12.9
Return on Equity	31.0	29.7	19.6	17.3
Sales Growth	15.9	12.2	2.8	8.3
EBITDA Growth	(0.8)	33.9	(12.6)	4.1
Recurring Net Income Growth	(3.0)	27.1	(17.6)	4.8
P/E (x)	10.5	8.2	10.0	9.5
EV/EBITDA (x)	7.0	4.9	5.5	5.0

Source: Company data, I-Sec Research

Grasim (BUY) – Target price Rs2,935

Post the proposed merger of Grasim's cement division (Samruddhi) and UTCL, Grasim would house India's largest pure play cement company, which would enjoy better financing options to fund the next phase of organic/inorganic expansion. Adding capacity, ahead of competition, would ensure highest growth in the industry and increased captive power consumption would reduce costs. Its viscose stable fibre (VSF) division is showing signs of improvement, both in terms of volume and realisations. After factoring in 15% holding company discount to the entire cement business, our sum-of-the-parts (SOTP) target price is Rs2,935/share. We believe the proposed restructuring would unlock significant value for shareholders. We reinitiate coverage on Grasim with BUY; it is our top pick in the sector besides ACEM.

Table 26: Grasim – SOTP valuation based on FY12

	Target EV/ E (x)	**(Rs mn)**
Cement business after applying 15% holding company discount	6.5	145,136
VSF	4	35,688
Chemicals	3	4,650
Target EV		185,474
Less: Net debt / (cash)		(7,185)
Target equity value (Rsmn)		192,659
No. of shares (mn)		91.69
Target price per share (Rs)		2,101
Target valuation for UTCL (Rs mn)		122,801
Proportionate value for 55% stake after 15% holding company discount (Rs mn)		57,138
Target price per share (Rs)		623
Value of other quoted investments after 30% discount (Rs mn)		19,297
Target price per share (Rs)		210
Target price per share (Rs)		**2,935**

Source: Company data, I-Sec Research

Ambuja Cement (BUY) – Target price Rs113

ACEM underperformed peers in the past 12-15 months due to capacity constraint and higher clinker purchase. With 4.4mnte clinker capacity expected to be commissioned in the next 6-9 months augmented by 5.5mnte grinding capacity, we expect ACEM to grow in line with the industry. Further, no presence in South (high pricing pressure) and all capacity addition in North and East (lower pricing pressure) would ensure better realisations. With absence of clinker purchase and increased power from captive power plant post CY09, ACEM is better placed to defend margin erosion, if any, caused by pricing pressure. We expect 8.6% EPS CAGR and Rs45bn operating cashflows over CY08-11E. We reinitiate coverage on ACEM with BUY and 12-month target price of Rs113/share. ACEM is among our top picks in the sector besides Grasim.

Table 27: ACEM – Valuations based on CY11

Target EV/ EBITDA multiple (x)	7
Target EV (Rsmn)	161,114
Net debt / (cash) (Rsmn)	(10,331)
Target value (Rsmn)	171,445
No. of shares (mn)	1522.6
Target price per share (Rs)	113

Source: I-Sec Research

UltraTech Cement (BUY) – Target price Rs975

UTCL, post the proposed restructuring of Grasim, is likely to emerge as India's largest pure play on cement with ~49mnte capacity and strong free cashflow generation. Also, its market mix, which was earlier skewed towards West and South, would become more diversified with pan-India presence. Capacity addition, ahead of competition, would ensure better-than-industry volume growth and market share rise. Having completed the first phase of expansion, we believe UTCL would soon announce its next capacity expansion. Besides volume growth, UTCL would post significant cost savings from commissioning of 192MW captive power plant in FY09. We believe the valuation discount to peers would disappear and UTCL would trade in line with ACC. We reinitiate coverage with BUY and Rs975/share target price (FY12E EV/E of 6x).

Table 28: UTCL – Valuations based on FY12

Target EV/ EBITDA (x)	6
Target EV (Rsmn)	124,773
Net debt / (cash) (Rsmn)	1,972
Target value (Rsmn)	122,801
No. of shares (mn)	126.17
Target price per share (Rs)	**975**

Source: I-Sec Research

ACC (BUY) – Target price Rs910

ACC has witnessed muted volume growth in the past 12-15 months due to capacity constraint and has lagged peers. However, in the next 15 months, we expect ACC to add 7.35mnte capacity and match industry growth. We do not expect effective utilisation to fall below 85% for ACC over CY09E-11E. With increased cost efficiencies and increasing power sourcing from captive power plant, ACC would be able to restrict margin erosion. We believe valuations at CY11E EV/EBITDA of 5.2x are not expensive for ACC, the industry leader given its pan-India diversified presence, net cash of Rs10bn, healthy return ratios and expected strong operating cashflows of Rs58bn over CY09E-11E. We initiate coverage on ACC with BUY and 12-month target price of Rs910/share (CY11E EV/EBITDA of 6x).

Table 29: ACC – Valuations based on CY11

Target EV/ EBITDA (x)	6
Target EV (Rsmn)	153,708
Net debt / (cash) (Rsmn)	(17,381)
Target value (Rsmn)	171,088
No. of shares (mn)	187.88
Target price per share (Rs)	910

Source: I-Sec Research

Top picks – Grasim and ACEM. We prefer North-based companies as well as players with capacity addition in the North as these would see better incremental realisations (Grasim and ACEM), early capacity additions (Grasim and UTCL) and higher cost savings (Grasim, UTCL and ACEM). Also, we recommend BUY on UTCL (on reduction in valuation discount post proposed restructuring) and ACC (on attractive valuations and diversified presence).

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Charts

Equity Research
October 15, 2009
BSE Sensex: 17231

INDIA

Grasim

BUY

Choicest pick

Rs2,405

Reason for report: Reinitiating coverage

Cement

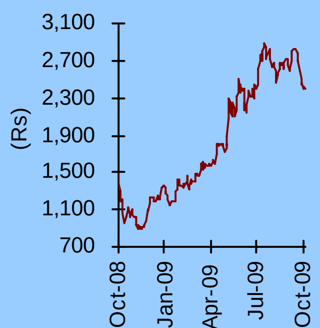
Target price Rs2,935

Shareholding pattern

	Dec '08	Mar '09	Jun '09
Promoters	**25.2**	**25.2**	**25.2**
Institutional investors	**43.0**	**44.1**	**43.7**
MFs and UTI	6.0	4.8	4.7
Insurance Cos.	16.4	16.1	15.8
FIIs	20.6	23.2	23.2
Others	**31.9**	**30.8**	**31.2**

Source: CMIE

Price chart



Post the proposed merger of Grasim's cement division (Samruddhi) and UltraTech Cement (UTCL), Grasim would house India's largest pure play cement company, which would enjoy better financing options to fund the next phase of organic/inorganic expansion. Adding capacity, ahead of competition, would ensure the highest growth in industry and increased captive power consumption would reduce costs. Its viscose stable fibre (VSF) division is showing signs of improvement, both in terms of volume and realisations. After factoring in 15% holding company discount to the entire cement business, our sum-of-the-parts (SOTP) target price is Rs2,935/share. We believe the proposed restructuring would unlock significant value for shareholders. We reinitiate coverage on Grasim with BUY; it is our top pick in the sector besides Ambuja Cements.

- **Proposed restructuring to benefit.** We believe the proposed restructuring protects economic interests of all stakeholders and would enable significant value unlocking when Samruddhi is merged with UTCL. Grasim's shareholders would directly own ~17% in the merged entity, besides Grasim owning ~60% stake.
- **Cement – Increasing market share.** Grasim's standalone cement volumes rose 25% YoY in H1FY10 aided by timely capacity addition. We estimate 21% volume growth in FY10E, followed by ~10%+ in FY11E-12E. Grasim's well diversified exposure would ensure better realisations. This coupled with commissioning of CPP would restrain EBITDA margin at ~27% over FY11E-12E.
- **Visible improvement in VSF.** With recovery in the economy, demand for VSF has increased, both domestically and internationally. Demand is expected to sustain on account of fall in global cotton production. Even the VSF price has improved from a low of Rs85/Kg in February '09 to ~Rs105/Kg at present. Recently, Grasim announced setting up Rs10bn VSF plant, which would increase capacity 25%.
- **Reinitiate with BUY, target price Rs2,935.** Grasim is expected to generate free cashflow (FCF) of Rs35bn on standalone basis over FY10E-12E. Hence, D/E is likely to decline to 0.2x in FY12E. Consolidated operating cashflows are in excess of Rs110bn through FY10E-12E. At FY11E & FY12E EV/E of 4.9x & 4.3x, Grasim's valuations are inexpensive. Even after factoring in 15% holding company discount to the entire cement business, our SOTP target price is Rs2,935. Grasim is our top pick in the sector. We reinitiate coverage with BUY.

Market Cap	Rs220.5bn/US$4.7bn
Reuters/Bloomberg	GRASIM.BO/GRASIM IN
Shares Outstanding (mn)	91.7
52-week Range (Rs)	2940/824
Free Float (%)	74.8
FII (%)	23.2
Daily Volume (US$'000)	12,850
Absolute Return 3m (%)	(8.3)
Absolute Return 12m (%)	60.9
Sensex Return 3m (%)	20.9
Sensex Return 12m (%)	59.4

Year to March	FY09	FY10E	FY11E	FY12E
Revenue (Rs mn)	184,039	191,559	201,386	214,241
Net Income (Rs mn)	21,867	25,536	24,299	26,624
EPS (Rs)	238.5	278.5	265.0	290.4
% Chg YoY	(16.2)	16.8	(4.8)	9.6
P/E (x)	10.1	8.6	9.1	8.3
CEPS (Rs)	332.9	385.8	388.5	422.4
EV/E (x)	6.4	4.7	4.9	4.3
Dividend Yield	1.5	1.7	1.6	1.6
RoCE (%)	20.7	23.1	19.8	19.6
RoE (%)	21.2	20.1	16.3	15.5

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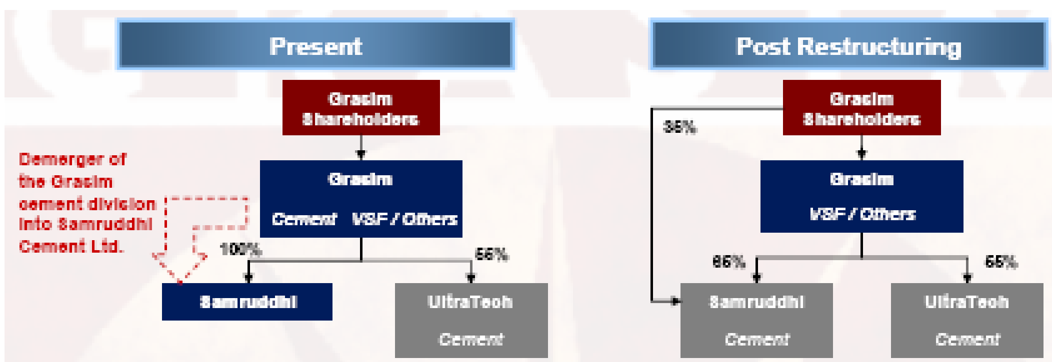
Proposed restructuring to benefit

Grasim recently announced a scheme of restructuring, wherein the cement division/business would be de-merged effective October 1, '09 into a separate company known as Samruddhi, a wholly-owned subsidiary of Grasim. Grasim's shareholders would receive one equity share of Samruddhi for one equity share held in Grasim. Grasim's shareholders would own 35% in Samruddhi and the balance would be owned by Grasim. Upon effectiveness of the de-merger, Samruddhi is proposed to be listed and ultimately Samruddhi and UTCL would be merged into a single pure play cement company. The swap ratio is expected within few weeks. The whole process is expected to take 8-10 months.

This means that Grasim, on a standalone basis, would only own VSF and Chemicals businesses and would be a holding company for India's largest pure play cement entity and thus, may attract a holding company discount. However, we believe loss, if any, caused by the above holding structure would be more than compensated by shares of Samruddhi.

We believe the proposed restructuring protects the economic interests of all stakeholders and would enable significant value unlocking when Samruddhi is merged with UTCL. Grasim's shareholders would directly own ~17% in the merged entity, besides Grasim having ~60% stake. We believe the swap ratio would not be detrimental to Grasim's shareholders.

Chart 1: Scheme of restructuring



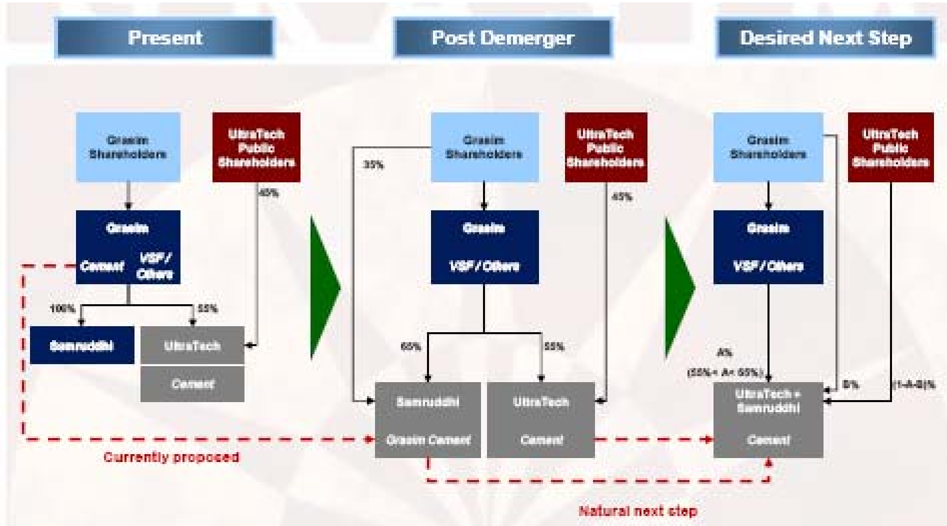
Source: Company data, I-Sec Research

Table 1: Assets moving to Samruddhi

Grey Cement	Capacity - 25.7mtpa (including grinding mills of 3.1mtpa to be operational in Q3FY10)
White Cement	Capacity - 0.6mtpa
Ready-mix concrete	36 plants - 6.8mn cubic metres
Thermal Power Plants	268 MW
Investments	Harish Cement - 100% Bhaskarpara Coal company - 47%
Limestone mining leases	Including under development mines
Exclusion	Investment in UTCL

Source: Company data, I-Sec Research

Chart 2: Consolidation into a single entity



Source: Company data, I-Sec Research

Table 2: Key financials (standalone) as on September 30, ’09

(Rs mn)

	As at 30-Jun-09			As at 30-Sep-09 (Provisional)
	Grasim (Pre-demerger)	VSF & Others	Cement Division	Cement Division
Net Fixed Assets	82,060	16,620	65,440	65,930
Investments	-	-	-	-
- UTCL	25,510	25,510	-	-
- Other Strategic Investments	9,640	9,640	1	7
- Liquid Investments	25,610	25,610	-	-
Net Working Capital	2,210	850	1,360	2,980
Capital Employed	145,030	78,230	66,800	68,920
Less: Debt	32,120	9,440	22,680	21,250
Less: Deferred Tax	9,460	2,270	7,190	7,850
Shareholders Funds	103,450	66,520	36,930	39,820

Source: Company data, I-Sec Research

Swap ratio the key, likely to be announced soon

We expect the swap ratio to be ~1:1.9 i.e. one share of UTCL for 1.9 shares of Samruddhi based on the following assumptions:

Table 3: Swap ratio calculation

	Samruddhi	UTCL
Based on FY10E data		
Target EV/ EBITDA multiple (x)	6.5	6
Target EV (Rsmn)	165,363	137,126
Net debt / (cash) (Rsmn)	29,100	14,238
Target value (Rsmn)	136,263	122,888
No. of shares (mn)	262	126
Target price per share (Rs)	521	974
Swap Ratio	1.9	1.0

Source: Company data, I-Sec Research

On a consolidated basis, post the proposed restructuring Grasim would be the holding company of the largest domestic entity in the cement industry with pan-India presence. The merged cement entity would rank tenth globally. The company is also the largest VSF manufacturer in India, enjoying near-monopoly with 12% global market share.

Cement – Increasing market share

Grasim is much ahead of competition in terms of capacity addition. The company had decided to expand its cement manufacturing capacity from 13.12mnte as of end-FY07 to 22.4mnte at an estimated capex of Rs55-60bn. The capacity expansion plan involved debottlenecking, greenfield expansion and addition of captive power plants. Grasim's cement capacity rose from 13.12mnte to 16.75mnte in FY08, which included 2.4mnte increase due to debottlenecking; the rest was due to grinding addition of 1.3mnte.

One of the two cement mills at Shambhupura (Rajasthan) was commissioned in Q4FY09. The company also added a grinding unit at Dadri (capacity of 1.3mnte) during FY09. The second cement mill at Shambhupura and the split grinding unit at Aligarh (Uttar Pradesh) got commissioned in Q1FY10. The 3.3mnte clinker unit at Kotputli (Rajasthan) was commissioned in March '09, while the grinding facility is expected to go on stream by Q3FY10. Grasim's current capacities are well diversified with North forming 33%, South 23%, Central 22% and East & West together 22%. All the additional capacities (8.9mnte) are being added in North.

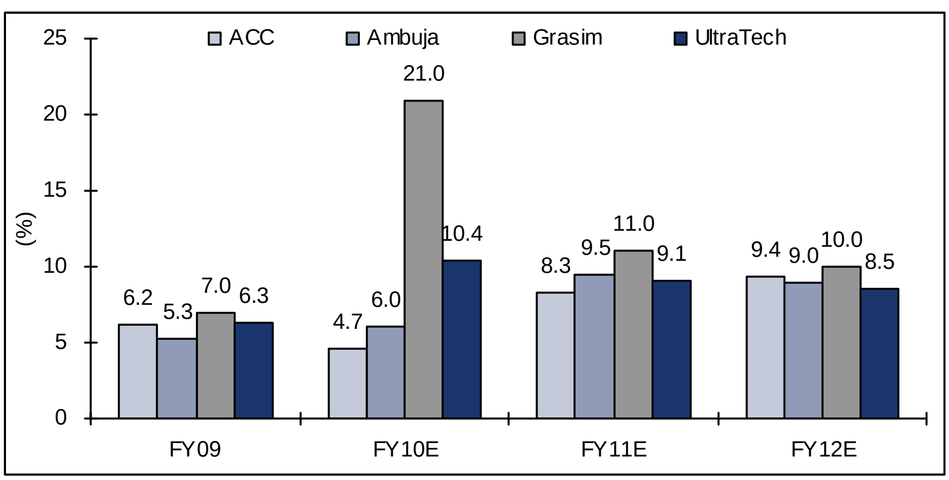
We believe capacity addition, ahead of competition, would enable Grasim to grow faster than the industry and increase its market share. Grasim's standalone cement volumes rose 25% YoY in H1FY10 aided by timely capacity addition. We estimate 21% volume growth for FY10E, followed by ~10%+ growth in FY11E-12E.

Table 4: Capacity addition plans

			Incremental effective capacity		
Company	**CoD**	**Region**	**FY10**	**FY11**	**FY12**
Grasim - Shambhupura	Mar-09	North	1.6		
Grasim - Shambhupura	Jun-09	North	1.2	0.4	
Grasim - Kotputli	Dec-09	North	0.8	2.3	

Source: Company data, I-Sec Research

Chart 3: Volume growth comparison



Source: Company

Table 5: Increasing market share versus peers

(%)

	FY09	FY10E	FY11E	FY12E
ACC	11.3	10.8	10.7	10.6
ACEM	9.6	9.4	9.4	9.3
Grasim	8.8	9.8	9.9	9.9
UTCL	9.9	10.0	9.9	9.8

Source: Company data, I-Sec Research

Table 6: Capacity break-down in terms of region

%	FY09	FY10E	FY11E	FY12E
North	24.0	43.2	49.1	49.1
Central	24.0	18.5	16.6	16.6
East	13.0	10.8	9.6	9.6
South	27.0	19.8	17.7	17.7
West	12.0	7.8	6.9	6.9
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company data, I-Sec Research

Table 7: Key markets and market share

	Market share (%)	% of total despatches	9-yr consumption CAGR (%)	Share of total consumption (%)
North				
Uttar Pradesh & Uttaranchal	6.9	4.4	8.9	12.2
Rajasthan	17.0	5.4	9.9	6.1
Punjab	17.9	4.1	6.0	4.4
Haryana	18.0	3.5	12.2	3.8
West				
Gujarat	38.6	10.9	4.5	6.8
Maharashtra	34.9	21.2	7.2	12.2
South				
Tamil Nadu	14.0	6.3	7.4	8.6
Karnataka	29.9	11.6	11.2	7.5
Kerala	8.9	2.2	6.8	4.7
Andhra Pradesh	9.9	4.2	8.5	8.2
East				
West Bengal	24.1	5.8	6.7	4.6
Bihar & Jharkhand	11.8	2.9	10.1	4.8
Orissa	26.4	4.1	10.9	3.0
Central				
Madhya Pradesh & Chhattisgarh	26.0	9.5	9.6	7.0
Total	**20.0**	**100.0**	**8.1**	**100.0**

Source: Cement Manufacturers Association (CMA), I-Sec Research

Better realisation versus peers due to diversified pan-India presence

Since the acquisition of UTCL, Grasim has become the largest player in India on consolidated basis, with installed capacity base of ~49mnte and market share of ~20%. Grasim and UTCL are market leaders in Orissa (26.4%), Gujarat (38.6%), Goa (52.5%), Maharashtra (34.9%), Madhya Pradesh (21.7%), Chhattisgarh (33.2%) and Karnataka (30%). Grasim's well diversified exposure would ensure better realisations. Also, most of its capacity addition is in North, thus enabling better incremental net realisations. We expect FY11E realisations expected to dip ~4.5% due to bunching of capacities, and then improve 0.7% in FY12E. We expect utilisation to improve from the current 87% to 93% in FY12E.

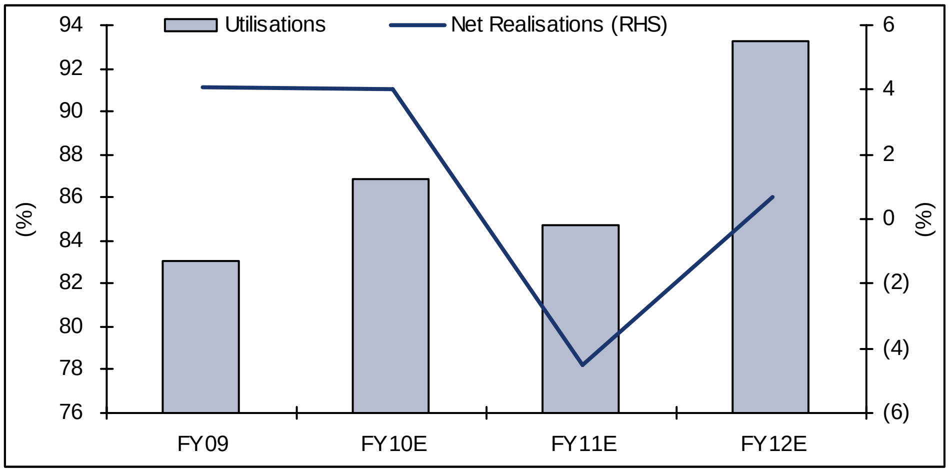
Table 8: Realisations growth among peers

(%)

	All India	ACC	ACEM	UTCL	Grasim
FY09	3.8	3.7	2.2	4.5	4.1
FY10E	5.5	6.0	4.6	2.2	4.0
FY11E	(5.3)	(5.0)	(4.0)	(6.0)	(4.5)
FY12E	0.9	0.5	0.8	0.4	0.7

Source: Company data, I-Sec Research

Chart 4: Utilisation and realisation growth

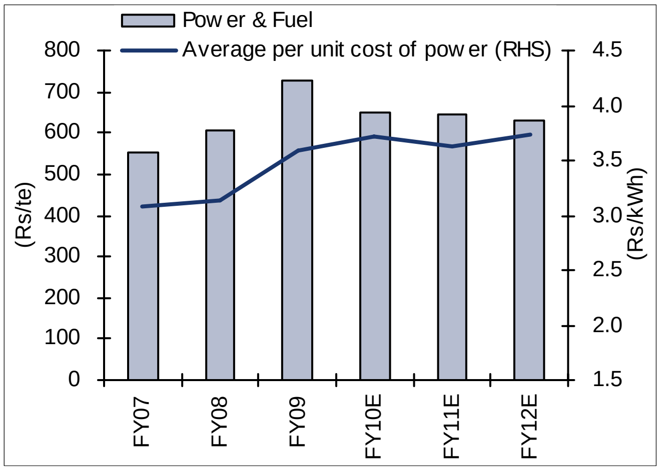


Source: Company data, I-Sec Research

Captive power to contain margin erosion

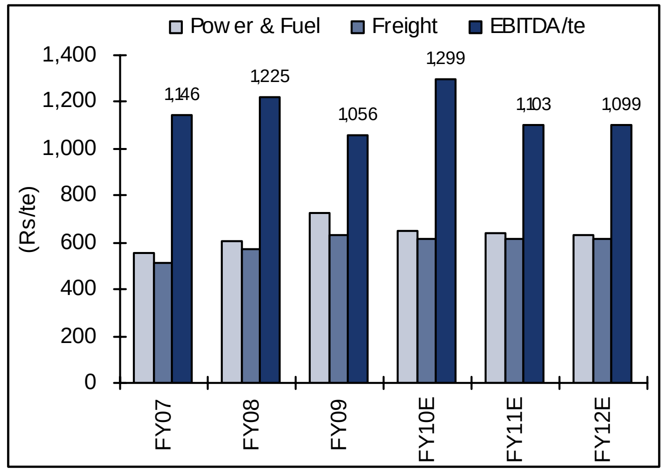
Grasim increased its captive power generation capacity from 123MW as of end FY08 to 268MW as of end FY09 by commissioning 144MW at four different locations. Thus, we believe Grasim would be able to source 80% of its power requirement from CPP after these new capacity additions. Power and fuel cost has reduced 25-30% over the past three quarters.

Chart 5: Power and fuel costs trend



Source: Company data, I-Sec Research

Chart 6: Key cost trends



Source: Company data, I-Sec Research

Better logistics and freight cost savings

Grasim has set up another 1.3mnte grinding unit at Dadri in Uttar Pradesh. The grinding units at Panipat and Dadri will help the company source cheaper fly ash and would reduce the lead distances to the markets, aiding savings in freight costs.

Thus, we believe Grasim would be able to maintain its EBITDA margin close to 27% in FY11-12E.

Visible improvement at VSF

VSF's performance suffered in FY09 due to slowdown and recession – its revenues dipped 12% and average realisation was down 7%. With initial signs of recovery in the global economy, demand for VSF has improved, both globally and domestically. VSF demand is likely to remain firm going forward due to: i) shift in textile manufacturing hubs to the East, ii) rising consumer preference for natural comfort fabrics due to global warming, iii) availability of advanced spinning technologies aiding the use of VSF and iv) slowdown in cotton production worldwide.

Table 9: Global cotton production and consumption

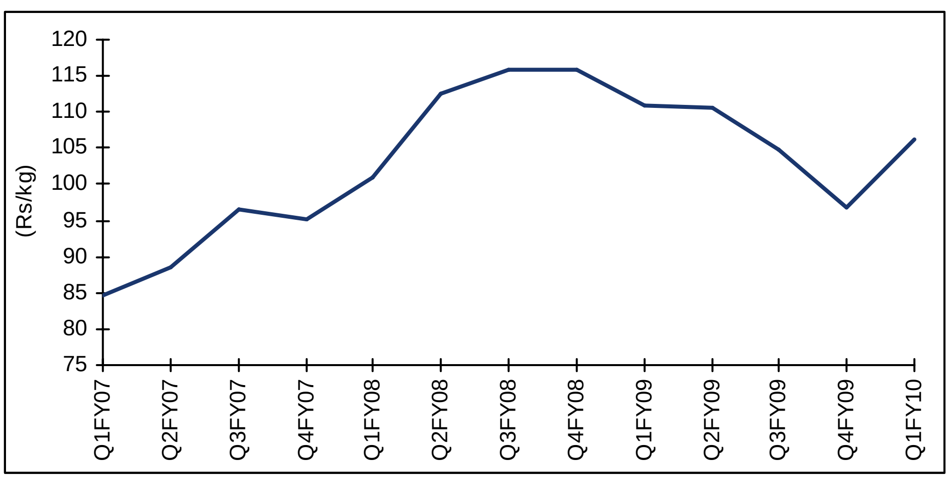
(mn tonnes)

	FY07	FY08	FY09	FY10E	FY11E
Beginning Stock	12.31	12.71	12.13	12.37	12.03
Production	26.72	26.04	23.37	23.25	22.98
Consumption	26.36	26.38	23.09	23.59	23.93
Exports	8.10	8.36	6.5	6.8	7.04
Imports	8.14	8.32	6.46	6.8	7.04
Ending Stock	12.71	12.13	12.37	12.03	11.08

Note: Year Beginning August
Source: International Cotton Advisory Committee

In Q1FY10, sales volumes rose 19% YoY, while realisation, though down 4% YoY, also increased 12% QoQ. The management has indicated that run-rate has increased to ~780tpd in Q2FY10 from 600tpd in Q4FY09 and 750tpd in Q1FY10. However, the management is cautious that the current run-rate may not sustain post Q2FY10. The company is focussed on cost reduction measures, moving up the value chain and enlargement of product mix. Also, aided by lower input costs and better realisations, margin may improve in short term.

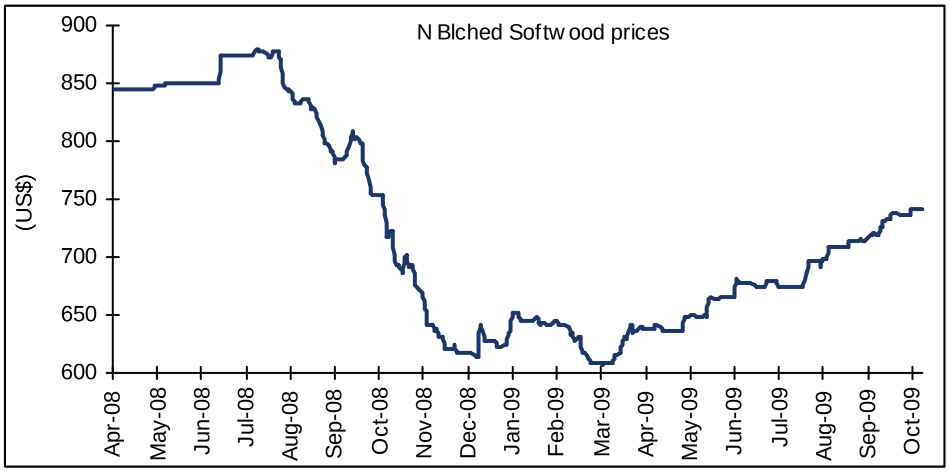
Chart 7: VSF – Quarterly realisation trend



Source: Company data

To strengthen its position in the global market, Grasim has announced setting up greenfield project at Vilayat, Gujarat at Rs10bn, which would increase capacity 25%. Thus, we believe the company is geared not only to grow its cement business alone but also to grow its VSF business. In the past, VSF has funded the growth for cement and provided stability to overall financials; this will continue even after the proposed restructuring. We expect VSF to post revenue and EBITDA CAGR of 9.2% and 19.9% over FY09-12E and EBITDA margin to remain close to 27%.

Chart 8: International pulp prices



Source: Bloomberg

Sale of sponge iron – To focus on cement and VSF

To focus on its core business of cement and VSF, Grasim sold its sponge iron business on May 22, '09 for Rs10.3bn (1x FY09 sales, 8x FY09 EV/E). EBITDA margin from the sponge iron division was among the lowest in the standalone entity (~13%) compared with standalone margin of 23%. Thus, the sale of the sponge iron division would be EBITDA-accretive in FY10.

Chemicals – Small but profitable

The chemicals division, which accounts for ~3% of Grasim's revenues, enjoys stable and better margins of 30%. Demand for caustic soda is likely to be subdued due to slowdown in growth from the alumina segment in international markets, according to the management and hence, even realisations may remain under strain in the short term. We expect revenue CAGR of 17% over FY09-12E.

Consolidated EBITDA CAGR of 9.7% over FY09-12E

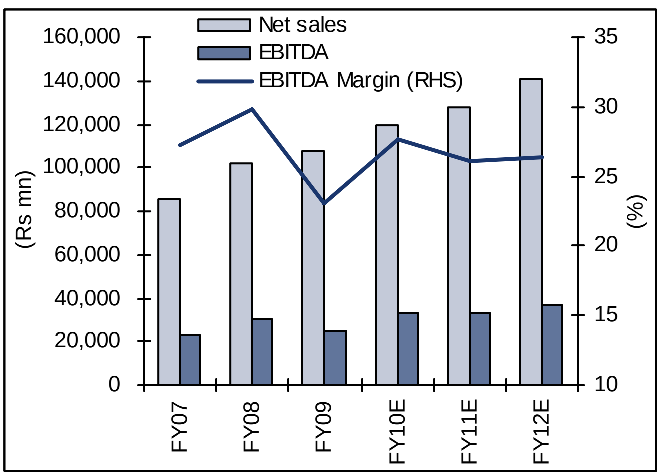
Table 10: Performance trend and forecast assumptions

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Cement						
Capacity ('000 te)	13,115	16,750	19,650	22,550	25,650	25,650
Production ('000te)	14,418	15,364	16,318	19,582	21,736	23,910
Capacity Utilisation (%)	110	92	83	87	85	93
Sales ('000 te)	14,849	15,129	16,189	19,582	21,736	23,910
Growth (%)	3.6	1.9	7.0	21.0	11.0	10.0
Realisation (Rs/te)	3,385	3,782	3,936	4,093	3,909	3,936
Growth (%)	34.6	11.7	4.1	4.0	(4.5)	0.7
VSF						
Capacity (te)	270,100	333,975	333,975	333,975	333,975	333,975
Production (te)	246,833	279,901	232,745	250,481	267,180	283,879
Capacity Utilisation	91	84	70	75	80	85
Sales (te)	246540	266801	236920	249361	265986	282610
Growth (%)	1.7	8.2	(11.2)	5.3	6.7	6.3
Realisation (Rs/te)	91,795	112,973	102,646	105,725	108,897	112,164
Growth (%)	14.2	23.1	(9.1)	3.0	3.0	3.0

Source: I-Sec Research

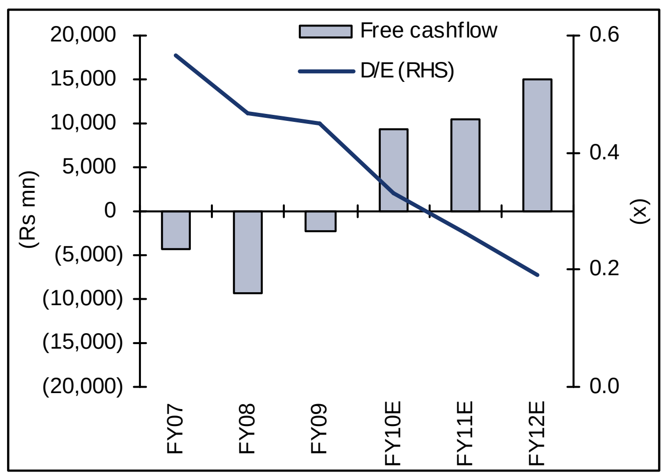
On a standalone basis, we expect revenue, EBITDA and PAT CAGR of 9.2%, 14.2% and 9.9% over FY09-12E. On a consolidated basis, we expect revenue, EBITDA and PAT CAGR to be 5.2%, 9.7% and 7.5% over FY09-12E.

Chart 9: Sales, EBITDA and EBITDA margin movement



Source: Company data, I-Sec Research

Chart 10: FCF and D/E



Source: I-Sec Research

Grasim had planned significant capex since '06, which included 8.9mnte cement capacity and ~64,000te VSF capacity. With most of its expansion nearing completion, Grasim is geared for the next phase of expansion. As per recent announcements, Grasim will need to set up 25mnte capacity over the next five years at a cost of US$3bn to maintain market share and grow faster than the industry. We believe the proposed new structure would help Grasim find better financing options, including dilution in the merged entity (Grasim would hold ~60% stake in the merged entity). Grasim is expected to generate free cashflow of Rs35bn on standalone basis over FY10E-12E. Consequently, D/E is likely to decline to 0.2x in FY12E. Consolidated operating cashflows are in excess of Rs110bn.

Table 11: Sensitivity analysis (% change) on CY10 EPS

1% change in realizations from base assumption	2.8
1% change in raw material costs from base assumption	1
1% change in power and fuel cost from base assumption	0.7
1% change in freight cost from base assumption	0.5

Source: I-Sec Research

Table 12: Consensus versus I-Sec estimates

(Rs mn)

	PAT			EBITDA			Sales		
	FY10E	**FY11E**	**FY12E**	**FY10E**	**FY11E**	**FY12E**	**FY10E**	**FY11E**	**FY12E**
Consensus estimates	25,406	22,713	25,165	53,876	49,397	53,688	190,298	197,217	212,253
I-Sec estimates	25,536	24,299	26,624	56,022	53,334	57,109	191,559	201,386	214,241
Variations (%)	0.5	7.0	5.8	4.0	8.0	6.4	0.7	2.1	0.9

Source: Bloomberg, I-Sec Research

Key risks

Adverse supply/demand mismatch

In case large number of capacities get commissioned before schedule, an oversupply could result in pricing pressure from FY10E itself. Further, with housing and infrastructure being key demand drivers, significant slowdown in either housing or infrastructure project implementation could affect demand estimates.

Increased pricing pressure

Sector performance, to a large extent, is dependent on pricing movements. We have factored in 5% dip in average realisations through FY11E. Any further decline would pose a downside risk to our estimates.

Government interference

In the past, the Government has resorted to measures such as ban on exports, increasing duty, different duty structure for different levels of cement prices etc, which could affect the growth of the sector and pose downside risks to our estimates.

Input cost pressure

Historically, cement companies were able to pass on the rise in input cost to end consumers. However, in a scenario of oversupply, we believe the company may not be able to do so. Substantial increase in international coal price, domestic coal price and crude oil can pose downside risks to our estimates.

Adverse swap ratio

In the proposed scheme of restructuring, any adverse swap ratio, say less than one share of UTCL for every 1.9 share in Samruddhi, would be detrimental for Grasim's shareholders.

VSF demand/realisations

Lower-than-expected VSF volumes/realisations due to continued subdued environment may downside to our estimates.

Grasim (Buy) – Target price Rs2,935

Attractive valuations

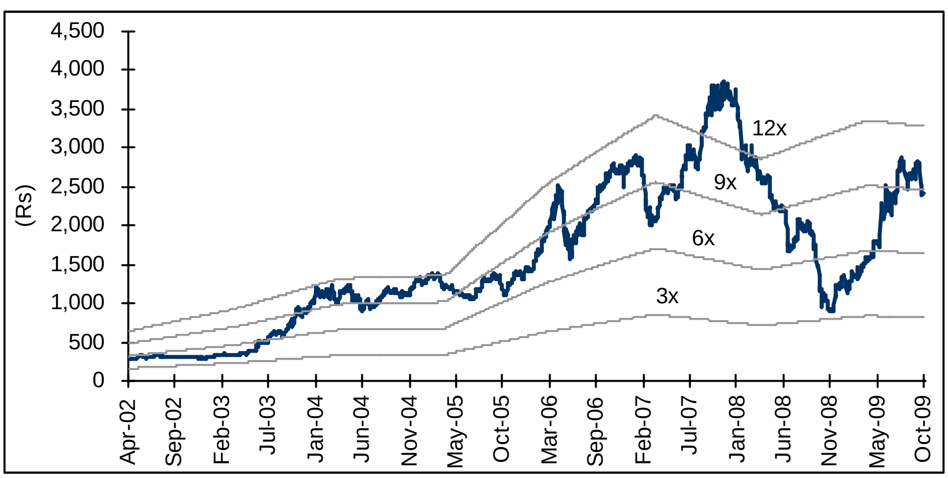
Historically, Grasim has traded at a significant discount to peers due to its diversified business. However, with 70% of its revenues coming from the cement division (post the acquisition of UTCL) and its exit from non-core business of textiles and sponge iron, we believe a re-rating is imminent. At FY11E & FY12E EV/E of 4.9 & 4.3x, Grasim's valuations are inexpensive. Even after factoring in 15% holding company discount to the entire cement business, our SOTP target price is Rs2,935. Grasim is our top pick in the sector. We reinitiate coverage with BUY.

Table 13: SOTP valuation based on FY12

	Target EV/ E (x)	(Rs mn)
Cement business after applying 15% holding company discount	6.5	145,136
VSF	4	35,688
Chemicals	3	4,650
Target EV		185,474
Less: Net debt / (cash)		(7,185)
Target equity value (Rs mn)		192,659
No. of shares (mn)		91.69
Target price per share (Rs)		2,101
Target valuation for UltraTech (Rs mn)		122,801
Proportionate value for 55% stake after 15% holding company discount (Rs mn)		57,138
Target price per share (Rs)		623
Value of other quoted investments after 30% discount (Rs mn)		19,297
Target price per share (Rs)		210
Target price per share (Rs)		**2,935**

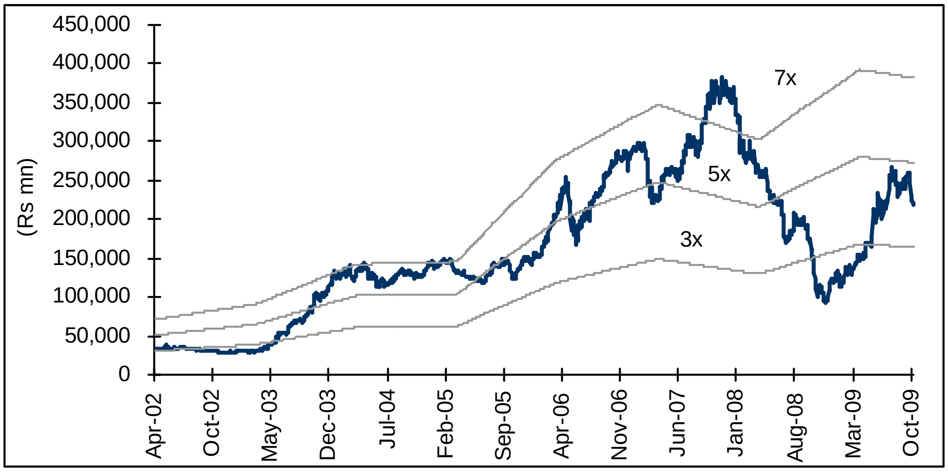
Source: Company data, I-Sec Research

Chart 11: Rolling P/E bands



Source: Bloomberg, I-Sec Research

Chart 12: Rolling EV/E bands



Source: Bloomberg, I-Sec Research

Financial summary (consolidated)

Table 14: Profit and Loss Statement

(Rs mn, year ending March 31)

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Gross Sales	**156,738**	**191,128**	**204,323**	**210,895**	**221,692**	**235,911**
Less: Excise Duty	16,043	21,388	20,283	19,335	20,305	21,669
Net Sales	**140,695**	**169,739**	**184,039**	**191,559**	**201,386**	**214,241**
of which Export Sales	*9,442*	*8,092*	*8,992*	*8,779*	*9,777*	*10,154*
of which Domestic Sales	*131,253*	*161,648*	*175,048*	*182,780*	*191,609*	*204,087*
Total Operating Income	**140,695**	**169,739**	**184,039**	**191,559**	**201,386**	**214,241**
Less:						
Raw Material Consumed	28,589	35,297	39,774	38,045	40,509	43,590
Other Manufacturing Expenses	14,143	16,224	19,130	16,438	18,346	19,520
Power and Fuel	24,724	29,074	37,406	33,947	37,721	39,902
Personnel Expenses	6,722	8,493	9,513	9,349	10,214	10,907
Selling and Distribution Expenses	4,230	5,696	5,921	5,978	6,517	6,789
Other Expenses	3,762	4,460	5,299	5,206	5,347	5,415
Freight	18,803	20,897	23,700	26,574	29,399	31,010
Less Amounts Capitalised						
Total Operating Expenses	**100,972**	**120,142**	**140,743**	**135,538**	**148,052**	**157,133**
EBITDA	**39,723**	**49,598**	**43,296**	**56,022**	**53,334**	**57,109**
Depreciation & Amortisation	6,100	6,703	8,658	9,837	11,323	12,109
Other Income	3,177	4,623	4,532	3,596	4,308	4,747
EBIT	**36,800**	**47,517**	**39,170**	**49,781**	**46,319**	**49,746**
Less: Gross Interest	2,286	2,221	3,105	3,553	3,436	3,088
PBIT	**34,514**	**45,296**	**36,066**	**46,228**	**42,883**	**46,659**
Recurring Pre-tax Income	**34,514**	**45,296**	**36,066**	**46,228**	**42,883**	**46,659**
Add: Share of earnings of associate						
Add: Extraordinary Income		2,824				
Less: Extraordinary Expenses						
Less: Taxation	10,922	14,658	9,914	14,978	13,875	15,327
--Current Tax	10,971	14,728	5,507	14,423	13,370	14,773
--Deferred Tax	(50)	(70)	4,407	555	505	554
Net Income (Reported)	**23,593**	**33,462**	**26,152**	**31,249**	**29,008**	**31,332**
Recurring Net Income	**23,593**	**30,639**	**26,152**	**31,249**	**29,008**	**31,332**
Minority Interest	(3,919)	(4,548)	(4,286)	(5,714)	(4,709)	(4,709)
Recurring Net Income	**19,674**	**26,091**	**21,867**	**25,536**	**24,299**	**26,624**

Source: Company data, I-Sec Research

Table 15: Balance Sheet

(Rs mn, year ending March 31)

	FY07	FY08	FY09	FY10E	FY11E	FY12E
ASSETS						
Current Assets, Loans & Advances						
Cash & Bank balance	3,692	2,903	2,270	3,189	2,512	5,980
Inventory	13,581	17,443	22,210	22,979	25,024	27,526
Sundry Debtors	8,252	10,185	8,239	9,447	10,822	12,253
Loans and Advances	7,487	12,054	12,625	14,911	14,674	14,792
Total Current Assets	**33,011**	**42,585**	**45,343**	**50,525**	**53,032**	**60,551**
Current Liabilities & Provisions						
Current Liabilities	**22,358**	**30,350**	**29,123**	**31,404**	**33,220**	**36,293**
Sundry Creditors	15,097	21,272	20,313	22,715	24,184	26,896
Other Current Liabilities	7,261	9,077	8,810	8,689	9,035	9,397
Provisions	**2,070**	**6,433**	**6,562**	**8,359**	**8,662**	**9,177**
Total Current Liabilities and Provisions	**24,429**	**36,783**	**35,685**	**39,763**	**41,882**	**45,470**
Net Current Assets	**8,583**	**5,802**	**9,659**	**10,762**	**11,150**	**15,080**
Miscellaneous Expenses						
Investments						
Strategic & Group Investments						
Other Marketable Investments	22,719	16,607	35,626	38,155	46,850	56,324
Total Investments	**22,719**	**16,607**	**35,626**	**38,155**	**46,850**	**56,324**
Goodwill	**18,442**	**19,913**	**20,010**	**20,010**	**20,010**	**20,010**
Fixed Assets	10,425	12,108	53,373	25,887	24,845	21,285
Gross Block	125,133	137,241	190,613	216,500	241,344	262,630
Less Accumulated Depreciation	60,125	63,397	68,254	77,216	88,539	101,183
Net Block	65,008	73,844	122,359	139,284	152,806	161,447
Add: Capital Work in Progress	19,716	55,379	19,830	15,845	13,285	11,177
Less: Revaluation Reserve						
Total Fixed Assets	**84,724**	**129,223**	**142,190**	**155,129**	**166,091**	**172,624**
Total Assets	**134,467**	**171,544**	**207,484**	**224,055**	**244,101**	**264,038**
of which cash and cash equivalents	26,411	19,510	37,897	41,344	49,363	62,304
LIABILITIES AND SHAREHOLDERS' EQUITY						
Borrowings						
Short Term Debt	11,623	17,133	22,236	18,695	16,332	12,850
Non-Convertible Preference Shares	63	98	181	181	181	181
Long Term Debt	37,107	38,836	37,197	28,808	25,808	20,808
Total Borrowings	**48,793**	**56,067**	**59,615**	**47,684**	**42,321**	**33,839**
Deferred Tax Liability	**11,526**	**11,575**	**15,919**	**16,410**	**16,907**	**17,422**
Minority Interest	**8,587**	**12,760**	**16,704**	**20,840**	**25,124**	**29,614**
Share Capital						
Paid up Equity Share Capital	917	917	917	917	917	917
No. of Shares outstanding (mn)	*92*	*92*	*92*	*92*	*92*	*92*
Face Value per share (Rs)	*10*	*10*	*10*	*10*	*10*	*10*
Preference Share Capital (convertible)						
Reserves & Surplus						
Share Premium	9,443	9,660	8,351	8,351	8,351	8,351
General & Other Reserve	55,200	80,565	105,978	129,853	150,481	173,894
Less: Misc. Exp. not written off						
Less: Revaluation Reserve						
Net Worth	**65,560**	**91,142**	**115,246**	**139,121**	**159,749**	**183,162**
Total Liabilities & Shareholders' Equity	**134,467**	**171,544**	**207,484**	**224,055**	**244,101**	**264,038**

Source: Company data, I-Sec Research

Table 16: Cash Flow Statement

(Rs mn, year ending March 31)

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Cash Flow from Operating Activities						
Reported Net Income	23,593	33,462	26,152	31,249	29,008	31,332
Add:						
Depreciation & Amortisation	4,965	3,272	4,857	8,962	11,323	12,644
Provisions	(1,207)	4,363	129	1,798	303	515
Deferred Taxes	(50)	(70)	4,407	555	505	554
Less:						
Other Income	3,177	4,623	4,532	3,596	4,308	4,747
Net Extra-ordinary income	0	2824	0	0	0	0
Operating Cash Flow before Working Capital change (a)	**24,124**	**33,581**	**31,013**	**38,968**	**36,831**	**40,299**
Changes in Working Capital						
(Increase) / Decrease in Inventories	(1,935)	(3,862)	(4,768)	(768)	(2,045)	(2,502)
(Increase) / Decrease in Sundry Debtors	(2,344)	(1,933)	1,947	(1,209)	(1,375)	(1,431)
(Increase) / Decrease in Operational Loans & Adv.	(1,228)	(4,567)	(571)	(2,286)	237	(118)
(Increase) / Decrease in Other Current Assets	0	0	0	0	0	0
Increase / (Decrease) in Sundry Creditors	3,715	6,175	(959)	2,403	1,469	2,712
Increase / (Decrease) in Other Current Liabilities	2,258	1,816	(267)	(122)	347	361
Working Capital Inflow / (Outflow) (b)	465	(2,371)	(4,618)	(1,982)	(1,368)	(978)
Net Cash flow from Operating Activities (a) + (b)	**24,589**	**31,210**	**26,395**	**36,985**	**35,463**	**39,321**
as a % of Operating Cash Flow						
Cash Flow from Capital commitments						
Purchase of Fixed Assets	(25,533)	(47,772)	(17,824)	(21,901)	(22,285)	(19,177)
Purchase of Investments						
Consideration paid for acquisition of undertaking						
Cash Inflow/(outflow) from capital commitments (c)	**(25,533)**	**(47,772)**	**(17,824)**	**(21,901)**	**(22,285)**	**(19,177)**
Free Cash flow after capital commitments (a) + (b) + (c)	**(943)**	**(16,562)**	**8,571**	**15,085**	**13,178**	**20,144**
Cash Flow from Investing Activities						
Purchase of Marketable Investments	(9,198)	6,112	(19,020)	(2,529)	(8,695)	(9,473)
(Increase) / Decrease in Other Loans & Advances	-	-	-	-	-	-
Sale of Fixed Assets						
Sale of Investments						
Consideration received for sale of undertaking/division						
Other Income	3,177	4,623	4,532	3,596	4,308	4,747
Net Cash flow from Investing Activities (d)	**(6,021)**	**10,735**	**(14,488)**	**1,067**	**(4,387)**	**(4,727)**
Cash Flow from Financing Activities						
Issue of Share Capital during the year	-	-	-	-	-	-
Borrowings	11,532	7,273	3,548	(11,931)	(5,363)	(8,482)
Buyback of Shares	-	(0)	-	-	-	-
Dividend paid including tax	(3,442)	(3,893)	(3,892)	(4,198)	(4,095)	(4,165)
Others	193	(1,167)	5,627	896	(9)	698
Net Cash flow from Financing Activities (e)	**8,283**	**2,214**	**5,283**	**(15,233)**	**(9,467)**	**(11,950)**
Net Extra-ordinary Income (f)	**-**	**2,824**	**-**	**-**	**-**	**-**
Total Increase / (Decrease) in Cash (a) + (b) + (c) + (d)+ (e) + (f)	**1,318**	**(789)**	**(633)**	**919**	**(677)**	**3,467**
Opening Cash and Bank balance	**2,374**	**3,692**	**2,903**	**2,270**	**3,189**	**2,512**
Closing Cash and Bank balance	**3,692**	**2,903**	**2,270**	**3,189**	**2,512**	**5,980**
Increase/(Decrease) in Cash and Bank balance	**1,318**	**(789)**	**(633)**	**919**	**(677)**	**3,467**

Source: Company data, I-Sec Research

Table 17: Key Ratios

(Rs mn, year ending March 31)

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Per Share Data (Rs)						
Diluted Recurring Earning per share (DEPS)	214.6	284.6	238.5	278.5	265.0	290.4
Diluted Earnings per share	214.6	284.6	238.5	278.5	265.0	290.4
Recurring Cash Earnings per share (CEPS)	281.1	357.7	332.9	385.8	388.5	422.4
Free Cashflow per share (FCPS-post capex)	(10.3)	(180.6)	93.5	164.5	143.7	219.7
Reported Book Value (BV)	715.0	994.0	1,256.9	1,517.3	1,742.3	1,997.6
Adjusted Book Value (ABV)	715.0	994.0	1,256.9	1,517.3	1,742.3	1,997.6
Dividend per share	32.9	36.8	36.8	39.9	38.9	39.6
Valuation Ratios (x)						
Diluted Price Earning Ratio	11.2	8.5	10.1	8.6	9.1	8.3
Price to Recurring Cash Earnings per share	8.6	6.7	7.2	6.2	6.2	5.7
Price to Book Value	3.4	2.4	1.9	1.6	1.4	1.2
Price to Adjusted Book Value	3.4	2.4	1.9	1.6	1.4	1.2
Price to Sales Ratio	1.6	1.3	1.2	1.2	1.1	1.0
EV / EBITDA	6.7	5.5	6.4	4.7	4.9	4.3
EV / Total Operating Income	1.9	1.6	1.5	1.4	1.3	1.2
EV / Operating Free Cash Flow (Pre-Capex)	10.8	8.8	10.5	7.2	7.3	6.3
EV / Net Operating Free Cash Flow (Post-Capex)	(281.6)	(16.5)	32.4	17.6	19.8	12.3
Dividend Yield (%)	1.4	1.5	1.5	1.7	1.6	1.6
Growth Ratios (% YoY)						
Diluted Recurring EPS Growth	89.8	32.6	(16.2)	16.8	(4.8)	9.6
Diluted Recurring CEPS Growth	61.1	27.2	(6.9)	15.9	0.7	8.7
Total Operating Income Growth	38.0	20.6	8.4	4.1	5.1	6.4
EBITDA Growth	91.2	24.9	(12.7)	29.4	(4.8)	7.1
Recurring Net Income Growth	89.8	32.6	(16.2)	16.8	(4.8)	9.6
Operating Ratios (%)						
EBITDA Margins	28.2	29.2	23.5	29.2	26.5	26.7
EBIT Margins	26.2	28.0	21.3	26.0	23.0	23.2
Recurring Pre-tax Income Margins	24.0	26.0	19.1	23.7	20.8	21.3
Recurring Net Income Margins	13.7	15.0	11.6	13.1	11.8	12.2
Raw Material Consumed / Sales	20.3	20.8	21.6	19.9	20.1	20.3
SGA Expenses / Sales	3.0	3.4	3.2	3.1	3.2	3.2
Other Income / Pre-tax Income	9.2	10.2	12.6	7.8	10.0	10.2
Other Operating Income / EBITDA	-	-	-	-	-	-
Effective Tax Rate	31.6	30.5	27.5	32.4	32.4	32.8
Return / Profitability Ratios (%)						
Return on Capital Employed (RoCE)-Overall	31.1	31.1	20.7	23.1	19.8	19.6
Return on Invested Capital (RoIC)	34.5	33.1	23.2	26.3	23.1	22.9
Return on Net Worth (RoNW)	34.7	33.3	21.2	20.1	16.3	15.5
Dividend Payout Ratio	15.3	12.9	15.4	14.3	14.7	13.6
	21.3	21.6	15.0	15.6	13.4	13.1
Solvency Ratios / Liquidity Ratios (%)						
Debt Equity Ratio (D/E) (X)	0.9	0.7	0.7	0.5	0.4	0.3
Long Term Debt / Total Debt	80.6	74.5	70.3	70.6	72.1	74.6
Net Working Capital / Total Assets	3.6	1.7	3.6	3.4	3.5	3.5
Interest Coverage Ratio-based on EBIT	16.1	21.4	12.6	14.0	13.5	16.1
Debt Servicing Capacity Ratio (DSCR)	(2.1)	(0.7)	(1.5)	(2.5)	(2.7)	(2.5)
Current Ratio	0.7	0.6	0.6	0.6	0.7	0.8
Cash and cash equivalents / Total Assets	2.7	1.7	1.1	1.4	1.0	2.3
Turnover Ratios						
Inventory Turnover Ratio (x)	5.8	5.6	5.3	4.3	4.5	4.4
Assets Turnover Ratio (x)	1.2	1.1	1.0	0.9	0.9	0.9
Working Capital Cycle (days)	1.8	(5.5)	(9.1)	(6.8)	(7.0)	(2.8)
Average Collection Period (days)	16.5	17.6	16.5	15.3	16.7	17.9
Average Payment Period (days)	47.9	55.2	53.9	57.9	57.8	59.3

Source: Company data, I-Sec Research

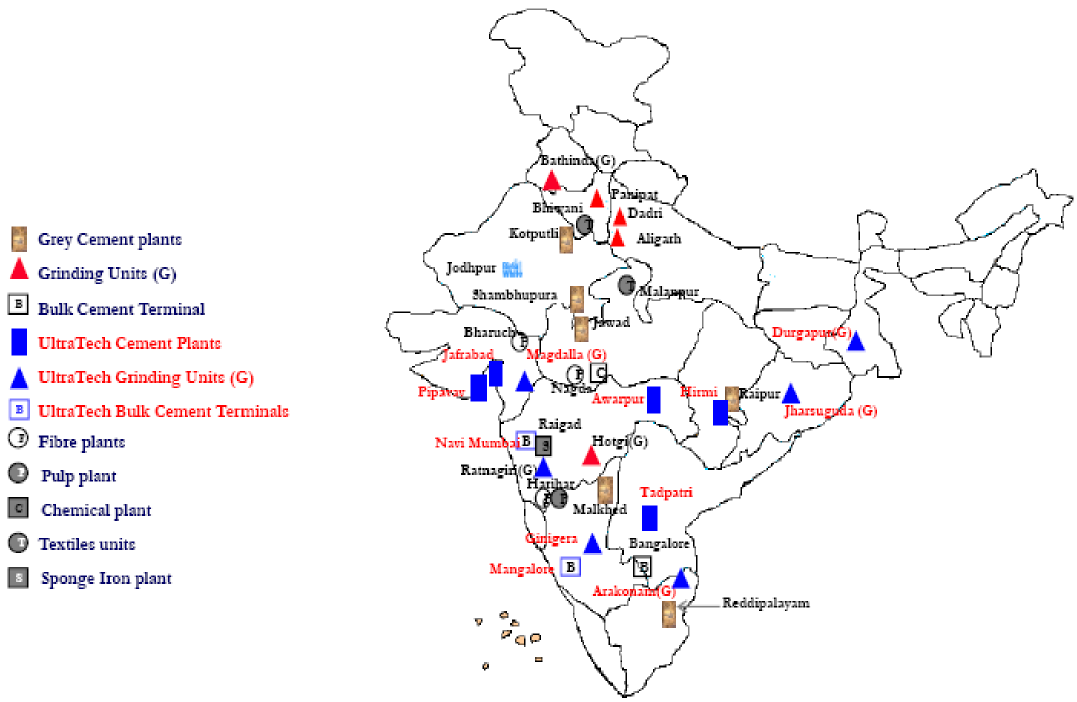
Company overview

Grasim Industries, an Aditya Birla Group company, is one of the leading cement manufacturers in India, with ~9% of market share on a standalone basis and ~19% market share on a consolidated basis. The company has significant presence in North and West. Cement accounts for ~70%, while VSF ~25% of total revenues.

Grasim's subsidiaries include UTCL, Dakshin Cements, UltraTech Ceylinco (Private), Grasim Bhiwani Textiles, Harish Cement, Samruddhi Swastik Trading and Investments and Sun God Trading and Investments.

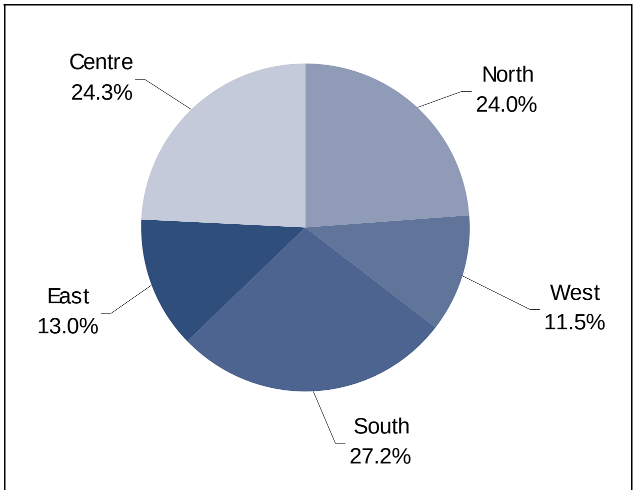
Recently, Grasim has proposed to demerge its cement division into a separate arm, Samruddhi and later merge it with UTCL to create India's largest cement company.

Chart 13: Grasim's plants



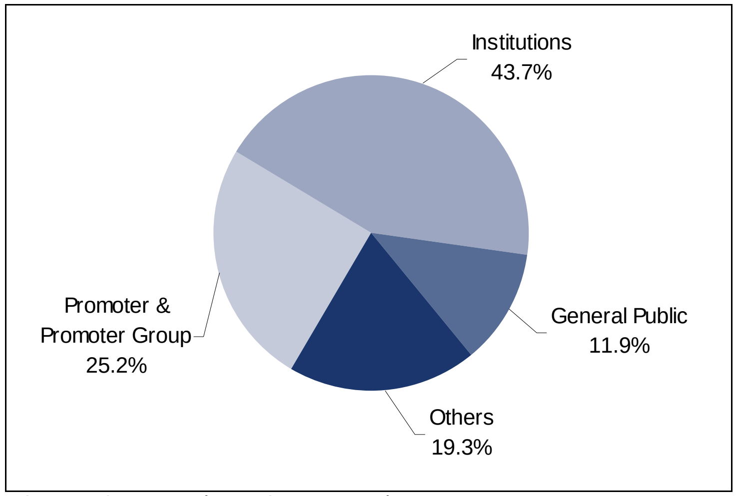
Source: Company data

Chart 14: Regional cement despatches



Source: Company data, I-Sec Research

Chart 15: Ownership structure



Source: Company data, I-Sec Research

Table 18: Management overview

Name	Designation	Qualification & experience
Mr. Kumar Mangalam Birla	Chairman	MBA - London Business School, CA Serves as the Chairman of Aditya Birla Management Corp.
Mr. Saurabh Misra	Business Head - Cement	Earlier served in various other leadership roles in Aditya Birla Group Companies prior to his role as Manager - UTCL ('04-06)
Mr. Shailendra K. Jain	Business Head - VSF	Post Graduate from MIT, USA Also Director on Board of Grasim Industries, A.V.Cell Inc., Indo Bharat Rayon and Thai Rayon
Mr. K.K. Maheshwari	Business Head - Chemicals	Masters degree in Commerce, Fellow member of The Institute of Chartered Accountants of India Has been with the Aditya Birla Group for more than 23 years.
Mr. Pranab Barua	Business Head - Textile	He also serves as the whole time Director of A.B. Nuvo
Mr. Adesh Gupta	CFO	Previously held positions of CFO and President at A.B. Nuvo and served in various other leadership roles in Aditya Birla Group Companies

Source: Company data, I-Sec Research

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Charts

Equity Research

October 15, 2009

BSE Sensex: 17231

Cement

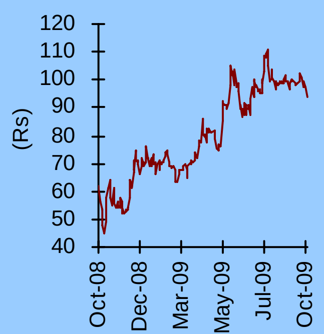
Target price Rs113

Shareholding pattern

	Dec '08	Mar '09	Jun '09
Promoters	**46.5**	**46.5**	**46.5**
Institutional investors	**37.9**	**38.5**	**38.9**
MFs and UTI	0.5	0.9	1.0
Insurance Cos.	15.4	16.2	15.8
FIIs	22.0	21.4	22.1
Others	**15.6**	**15.1**	**14.7**

Source: CMIE

Price chart



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INDIA

Ambuja Cement

BUY

Regaining strength

Rs94

Reason for report: Reinitiating coverage

Ambuja Cement (ACEM) underperformed peers in the past 12-15 months due to capacity constraint and higher clinker purchase. With 4.4mnte clinker capacity expected to be commissioned in the next 6-9 months augmented by 5.5mnte grinding capacity, we expect ACEM to grow in line with the industry. Further, capacity addition in North and East (lower pricing pressure), and no presence in South (high pricing pressure) would ensure better realisations. With absence of clinker purchase and increased power from captive power plant post CY09, ACEM is better placed to defend margin erosion, if any, caused by pricing pressure. We expect 8.6% EPS CAGR and Rs45bn operating cashflows over CY08-11E. We reinitiate coverage on ACEM with BUY and 12-month target price of Rs113/share. ACEM is among our top picks in the sector besides Grasim.

- **Volumes to grow in line with industry.** ACEM's expansions in Bhatapara, Chhattisgarh (East India) and Rauri, Himachal Pradesh (North India) at 2.2mnte each, after being delayed by almost a year, are expected to be operational by December '09 and June '10 respectively. Post expansion, North, West and East would contribute 40%, 40% and 20% to revenues, implying better realisation. We expect CY10E & CY11E volumes to grow 9.5% & 9% respectively.
- **Cost deflation to contain margin erosion.** We expect savings of Rs190/te due to in-sourcing of clinker from CY10E. Also, ACEM is adding 90MW captive power by end-CY09, which would aid power cost rationalisation. Thus, ACEM is better placed to withstand pricing pressure and contain margin erosion.
- **Strong operating cashflows and balance sheet.** With net cash of Rs4bn as on December '08, ACEM would generate Rs45bn operating cashflows over CY09E-11E, which is more than sufficient to meet all capex requirements (~Rs30bn) over CY09E-11E. We expect ACEM to announce its next round of expansions soon.
- **Reinitiate with BUY & Rs113 target price.** Based on better geographic presence, superior realisations & consistent margins, improving financial performance and strong cashflow & balance sheet, we expect ACEM to continue to enjoy premium valuations versus peers. We reinitiate coverage with BUY and 12-month target price of Rs113/share (7x CY11E EV/E).

Market Cap	Rs143.1bn/US$3.1bn
Reuters/Bloomberg	ABUJ.BO/ACEM IN
Shares Outstanding (mn)	1,523
52-week Range (Rs)	112/43
Free Float (%)	53.5
FII (%)	22.1
Daily Volume (US$'000)	8,590
Absolute Return 3m (%)	(5.0)
Absolute Return 12m (%)	51.3
Sensex Return 3m (%)	20.9
Sensex Return 12m (%)	59.4

Year to Dec	CY08	CY09E	CY10E	CY11E
Revenue (Rs mn)	62,347	70,060	73,648	80,976
Net Income (Rs mn)	10,939	12,312	12,708	13,949
EPS (Rs)	7.2	8.1	8.3	9.2
% Chg YoY	(17.2)	12.5	3.2	9.8
P/E (x)	13.1	11.6	11.3	10.3
CEPS (Rs)	8.9	10.0	10.8	11.9
EV/E (x)	7.8	7.0	6.5	5.8
Dividend Yield	2.3	2.3	2.3	2.3
RoCE (%)	19.1	18.6	17.0	16.6
RoE (%)	21.2	20.2	18.3	17.7

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Volumes to grow in line with industry

ACEM's volumes grew only 5.3% in CY08 and we expect it to grow ~6% in CY09E, lower than the industry average of ~9%, due to delay in commissioning of its new capacities. We expect 2.2mnte plant at Bhatapara, Chhattisgarh (East) to be operational by December '09 and 2.2mnte plant at Rauri, Himachal Pradesh (North) to be operational by June '10. Thus, we expect ACEM to register volume growth of 9.5% to 18.8mnte and 9% to 20.6mnte in CY10E and CY11E respectively, broadly in line with the industry. We expect effective utilisations to dip from 86% at present to 83% in CY10E and then inch up to 85% in CY11E.

ACEM would add 5.5mnte grinding capacity over the next 12 months, in alignment with the new clinker capacity. Its two 1.5mnte grinding unit at Dadri and Nalagarh in the North is expected to be commissioned by December '09 and June '10 respectively. However, the company has deferred the introduction of its Sanand, Ahmedabad grinding unit and has suspended its Barh grinding unit.

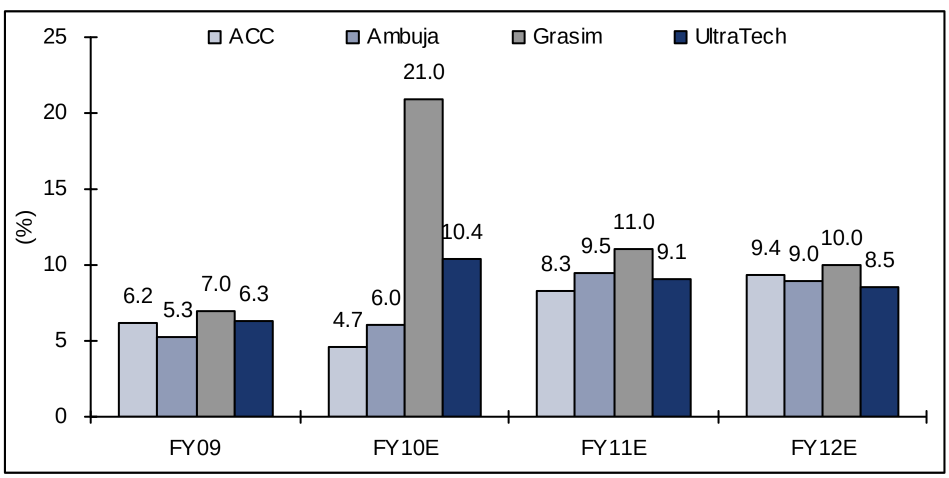
In order to maintain its market share in the interim, ACEM has resorted to aggressive clinker purchase, resulting in significant margin erosion (200-250bps). Thus, any further delay in commissioning of new capacities would pose downside risk to our estimates.

Table 1: Capacity addition plans

			Incremental effective capacity		
Company	**CoD**	**Region**	**CY09E**	**CY10E**	**CY11E**
ACEM	Dec-09	East	-	1.65	0.55
ACEM	Jun-10	North		1.10	1.10

Source: Company data, I-Sec Research

Chart 1: Volume growth comparison



Source: Company

At present, ACEM derives 46%, 39% and 15% from West, North and East respectively. Post the expansion of Bhatapara and Rauri capacities it would derive 40%, 40% and 20% from West, North and East respectively. As explained earlier, we believe North and East would continue to generate better demand and hence, realisations. ACEM has no presence in South, which is expected to face higher pricing pressure. ACEM is also setting up a bulk cement terminal at Kochi, which would give access to the South via cost effective sea transportation.

Table 2: Capacity break-down in terms of region

%	CY08	CY09E	CY10E	CY11E
North	38.5	38.5	38.7	40.6
Central	-	-	-	-
East	15.2	15.4	20.9	21.8
South	-	-	-	-
West	46.3	46.2	40.4	37.7
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company data, I-Sec Research

Table 3: Key markets and market share

	Market share (%)	% of total despatches	9-yr consumption CAGR (%)	Share of total consumption (%)
North				
Uttar Pradesh & Uttaranchal	3.5	5.0	8.9	12.2
Rajasthan	14.0	8.7	9.9	6.1
Punjab	28.7	12.7	6.0	4.4
Haryana	14.1	5.3	12.2	3.8
Himachal Pradesh	48.3	6.1	14.4	1.3
Chandigarh (UT)	20.6	0.5		0.2
Madhya Pradesh and Chhattisgarh	8.9	6.3	9.6	7.0
West				
Gujarat	19.7	13.5	4.5	6.8
Maharashtra	19.7	24.4	7.2	12.2
East				
West Bengal	19.2	9.0	6.7	4.64
Assam	8.1	0.6	7.4	0.70
Orissa	3.8	1.2	10.9	2.99
Total	**9.88**	**93.2**	**8.1**	**100.0**

Source: CMA, I-Sec Research

Table 4: Market share to stabilise at ~9.4%

(%)

	FY09	FY10E	FY11E	FY12E
ACC	11.3	10.8	10.7	10.6
ACEM	9.6	9.4	9.4	9.3
Grasim	8.8	9.8	9.9	9.9
UTCL	9.9	10.0	9.9	9.8

Source: Company data, I-Sec Research

We believe ACEM's market share would fall from 10.3% in CY07 to 9.4% in CY09E and would remain at 9.4% over CY10E-11E.

CY10E realisation to dip 4% and then firm up 0.8% in CY11E

Based on the geographic mix of revenues, we expect ACEM's realisations to dip 4% in CY10E and then firm up 0.8% in CY11E. We expect revenues to grow 5.1% and 9.9% in CY10E and CY11E respectively.

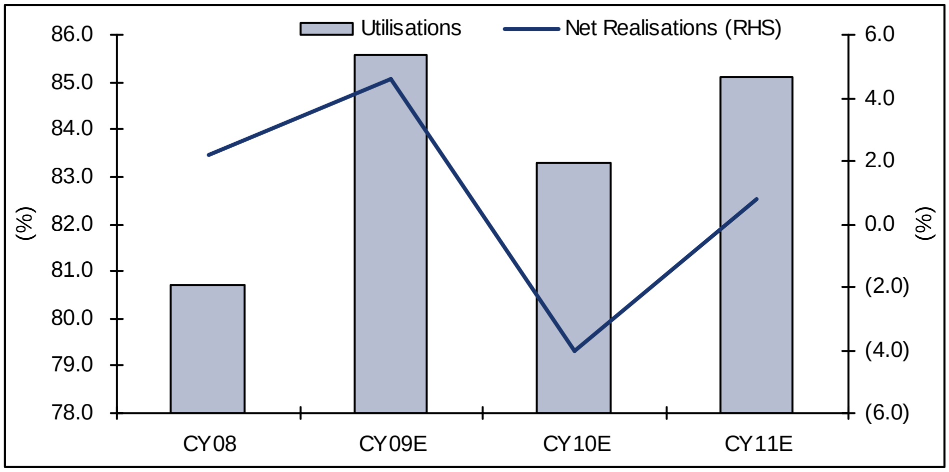
Table 5: Realisation growth among peers

(%)

	All India	ACC	ACEM	UTCL	Grasim
FY09	3.8	3.7	2.2	4.5	4.1
FY10E	5.5	6.0	4.6	2.2	4.0
FY11E	(5.3)	(5.0)	(4.0)	(6.0)	(4.5)
FY12E	0.9	0.5	0.8	0.4	0.7

Source: Company data, I-Sec Research

Chart 2: Utilisation and realisation growth



Source: Company data, I-Sec Research

Cost deflation to contain margin erosion

Historically, ACEM has enjoyed among the highest EBITDA margin in the industry as it was an early mover in setting up captive power plants with lower freight cost from sea transport and cost efficient in managing its resources/expenses. However, higher cost of clinker purchase and higher cost of imported coal resulted in ~700bps decline in EBITDA margin in CY08. To maintain its market share, ACEM has resorted to aggressive clinker purchase. Similarly, the company had entered into contract that locked the coal price at US$110-120/te. Both the above factors impacted H1CY09 margin.

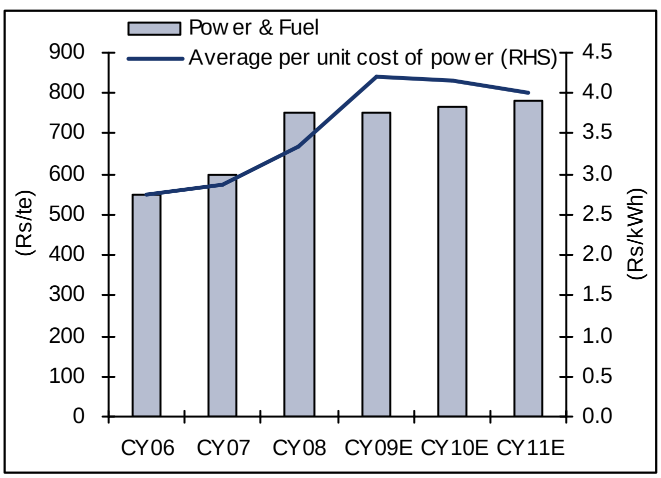
In-sourcing of clinker to result in savings of ~Rs190/te

The new clinker capacity at Bhatapara and Rauri are expected by December '09 and June '10. Thus, clinker purchase would reduce in H2CY09 compared with H1CY09 levels, and there would not be any clinker purchase from CY10, as per the management. We estimate savings of ~Rs190/te in CY10E due to in-sourcing of clinker.

Lower coal cost and rise in captive power plant to reduce power and fuel costs

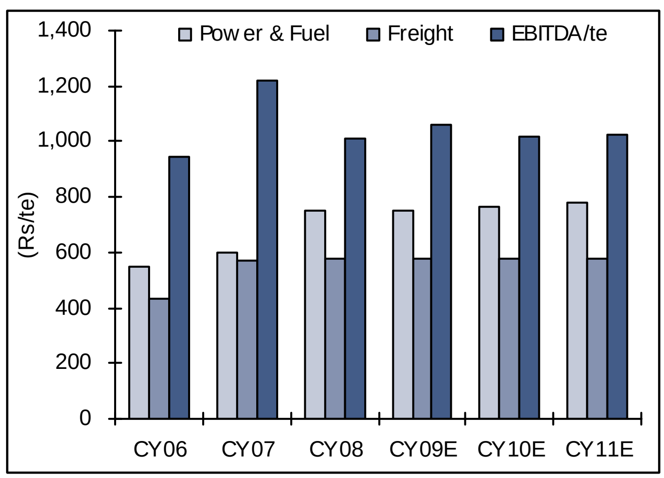
ACEM is setting up captive power plants at Ambujanagar, Bhatapara and Maratha, which will add ~90MW capacity, taking the total to 400MW by '09. However, the clinker unit at Rauri will not rely on captive power plant (CPP). The company has tied up coal supply for these units and thus, the proportion of imported coal is expected to decline from 30% at present to 20% in '10. Its captive power consumption would rise from the current 63% to 80-82% by CY10E. Besides, the impact of high-priced coal, which was seen in H1CY09, would come down as such inventories are consumed.

Chart 3: Power and fuel costs trend



Source: Company data, I-Sec Research

Chart 4: Key cost trends



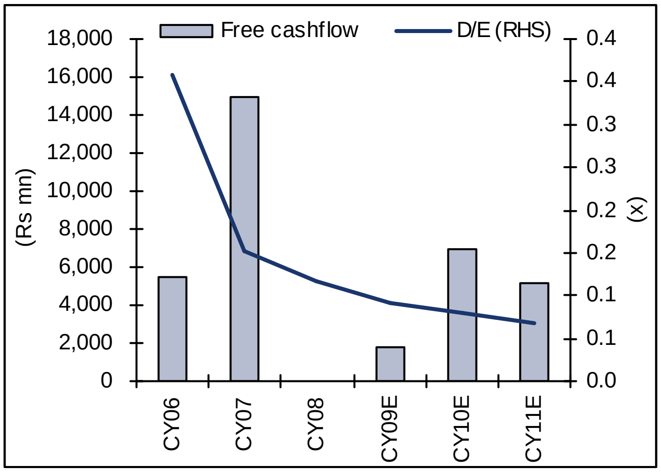
Source: Company data, I-Sec Research

We expect EBITDA margin to move close to 28.5% over CY08-11E.

Strong operating cashflows and balance sheet

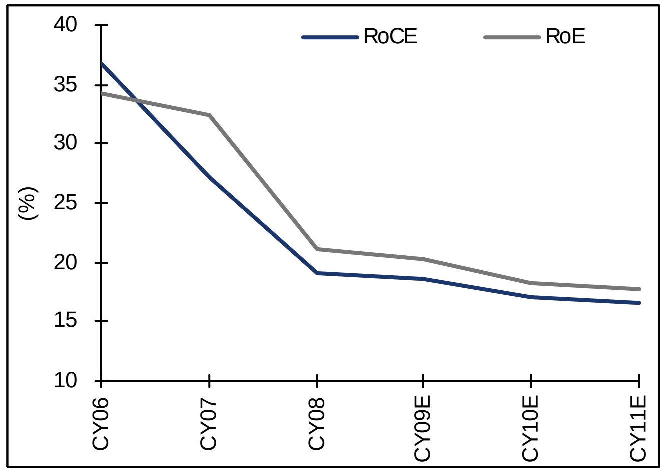
With net cash of Rs4bn as on December '08, we expect ACEM to generate Rs45bn operating cashflows over CY09E-11E, more than sufficient to meet all its capex requirements (~Rs30bn) over CY09E-11E. Hence, despite the current capex plan, the company is likely to generate FCFs of ~Rs15bn+ in the next two years and would remain net cash positive. We expect ACEM to announce its next round of expansions in the next 6-9 months.

Chart 5: FCF and D/E



Source: Company data, I-Sec Research

Chart 6: RoCE and RoE trends



Source: Company data, I-Sec Research

ACEM's D/E, which was as low as 0.12x in CY08, would further decline to 0.09x in CY09E.

ACEM's return ratios are expected to decline, mainly due to significant capex, the benefits of which can be expected only after commissioning of such capacities.

Better performer versus peers

Table 6: Performance trend and forecast assumptions

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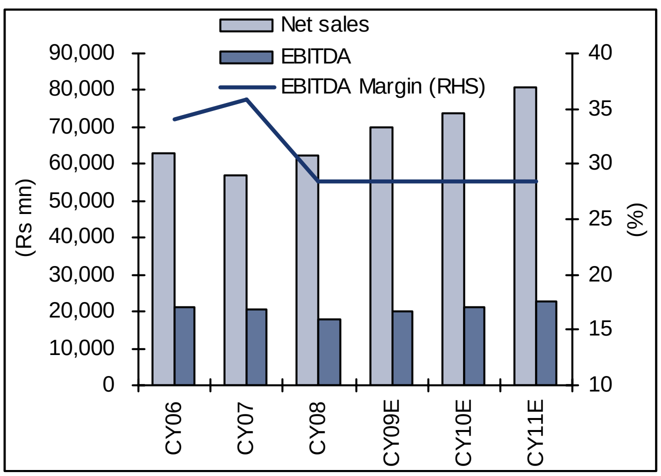
	CY06	CY07	CY08	CY09E	CY10E	CY11E
Capacity	23,450	18,500	22,000	22,000	24,750	26,400
Production	22,633	16,861	17,758	18,823	20,611	22,466
Capacity utilisation (%)	96.5	91.1	80.7	85.6	83.3	85.1
Sales	22,602	16,771	17,586	18,823	20,611	22,466
Growth (%)	77.7	(25.8)	4.9	7.0	9.5	9.0
Realisations (Rs/te)	3,102	3,849	4,023	4,046	3,884	3,918
Growth (%)	30.5	24.1	4.5	0.6	(4.0)	0.9
Exports	2,503	1,335	832	847	948	1,056
Growth (%)	42.6	(46.7)	(37.7)	1.8	11.9	11.4

Source: I-Sec Research

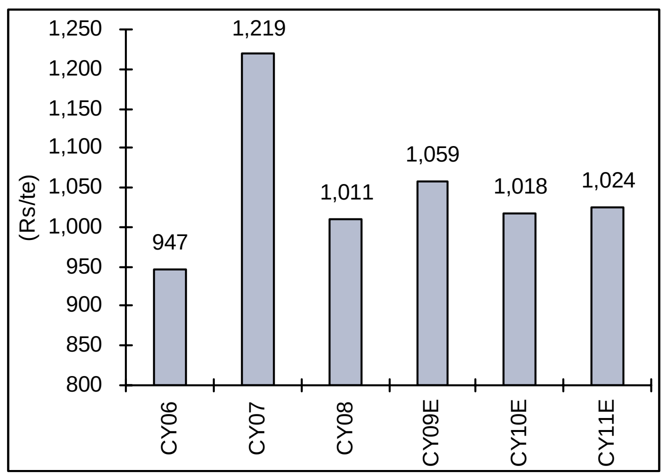
We expect ACEM to post CY10E & CY11E volume growth of 9.5% to 18.8mnte and 9% to 20.6mnte respectively, broadly in line with the industry. Realisations may dip 4% in CY10E and then firm up 0.8% in CY11E. We expect CY10E & CY11E revenues to grow 5.1% and 9.9% respectively. We expect EBITDA margin to move close to 28.5% over CY08-11E. Overall, we expect revenue, EBITDA and PAT CAGR of 8.9%, 9.1% and 8.4% over CY08-11E.

Chart 7: Sales, EBITDA and EBITDA margin movement



Source: Company data, I-Sec Research

Chart 8: EBITDA/te



Source: I-Sec Research

Table 7: Per ton analysis

(Rs/tonne)

	CY06	CY07	CY08	CY09E	CY10E	CY11E
Net Sales	**2,776**	**3,402**	**3,545**	**3,722**	**3,573**	**3,604**
Raw Material Consumed	259	334	431	573	437	442
Power and Fuel	549	599	754	751	766	780
Freight	433	569	576	577	576	576
Others	589	680	774	762	776	782
Total Operating Expenses	**1,830**	**2,182**	**2,534**	**2,663**	**2,555**	**2,580**
EBITDA/tonne	**947**	**1,219**	**1,011**	**1,059**	**1,018**	**1,024**

Source: Company data, I-Sec Research

Table 8: Sensitivity analysis (% change) on CY10 EPS

1% change in realizations from base assumption	4.0
1% change in raw material costs from base assumption	1.2
1% change in power and fuel cost from base assumption	0.8
1% change in freight cost from base assumption	0.6

Source: I-Sec Research

Table 9: Consensus versus I-Sec estimates

(Rs mn)

	PAT			EBITDA			Sales		
	FY10E	**FY11E**	**FY12E**	**FY10E**	**FY11E**	**FY12E**	**FY10E**	**FY11E**	**FY12E**
Consensus estimates	12,117	11,459	12,579	19,725	19,570	21,601	68,675	71,168	72,302
I-Sec estimates	12,312	12,708	13,949	19,926	20,991	23,016	70,060	73,648	80,976
Variations (%)	1.6	10.9	10.9	1.0	7.3	6.6	2.0	3.5	12.0

Source: Bloomberg, I-Sec Research

Key risks

Adverse supply/demand mismatch

In case large number of capacities get commissioned before schedule, an oversupply could result in pricing pressure from FY10E itself. Further, with housing and infrastructure being key demand drivers, significant slowdown in either housing or infrastructure project implementation could affect demand estimates.

Increased pricing pressure

Sector performance, to a large extent, is dependent on pricing movements. We have factored in 5% dip in average realisations through FY11E. Any further decline would pose a downside risk to our estimates.

Government interference

In the past, the Government has resorted to measures such as ban on exports, increasing duty, different duty structure for different levels of cement prices etc, which could affect the growth of the sector and pose downside risks to our estimates.

Input cost pressure

Historically, cement companies were able to pass on the rise in input cost to end consumers. However, in a scenario of oversupply, we believe the company may not be able to do so. Substantial increase in international coal price, domestic coal price and crude oil can pose downside risks to our estimates.

Delay in clinker capacity addition

We have assumed that Bhatapara and Rauri clinker units will go on stream latest by December ’09 and June ’10 respectively and have factored in no clinker purchase from CY10. Any delay in commissioning of the same would affect our revenue and earnings estimates.

ACEM (Buy) – Target price Rs113

Valuation premium to sustain

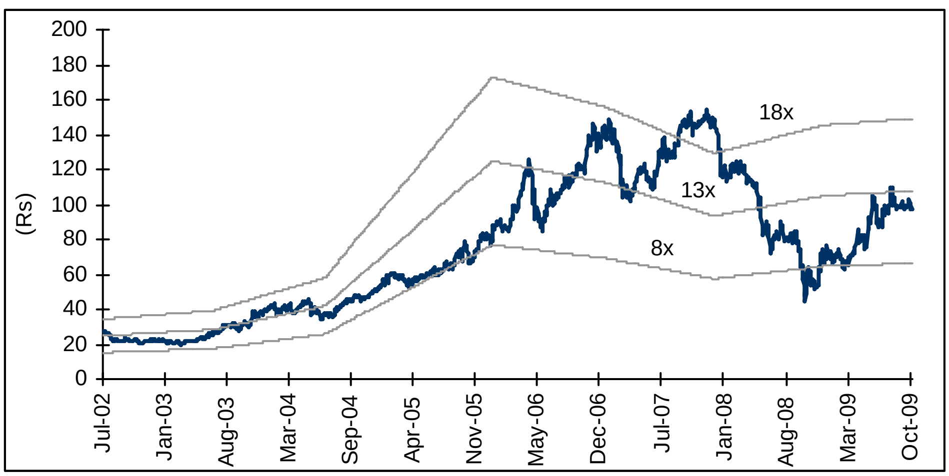
At the current market price, ACEM is trading at CY10E & CY11E P/E of 11.3x & 10.3x and EV/E of 6.5x and 5.8x respectively. Based on better geographic presence, superior realisations & consistent margins, improving financial performance and strong cashflow & balance sheet, we expect ACEM to continue to enjoy premium valuations versus peers. We reinitiate coverage with BUY and 12-month target price of Rs113/share (7x CY11E EV/E). ACEM is among our top picks in the sector besides Grasim.

Table 10: Valuations based on CY11

Target EV/ EBITDA multiple (x)	7
Target EV (Rsmn)	161,114
Net debt / (cash) (Rsmn)	(10,331)
Target value (Rsmn)	171,445
No. of shares (mn)	1522.6
Target price per share (Rs)	113

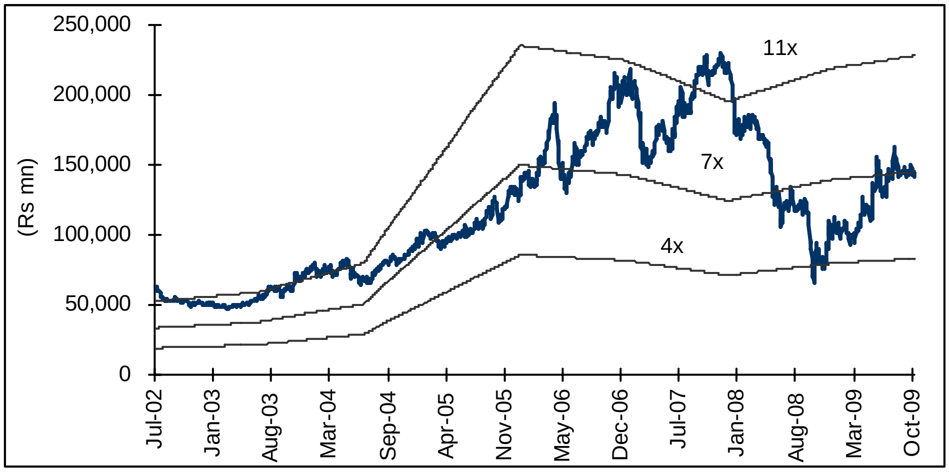
Source: I-Sec Research

Chart 9: Rolling P/E bands



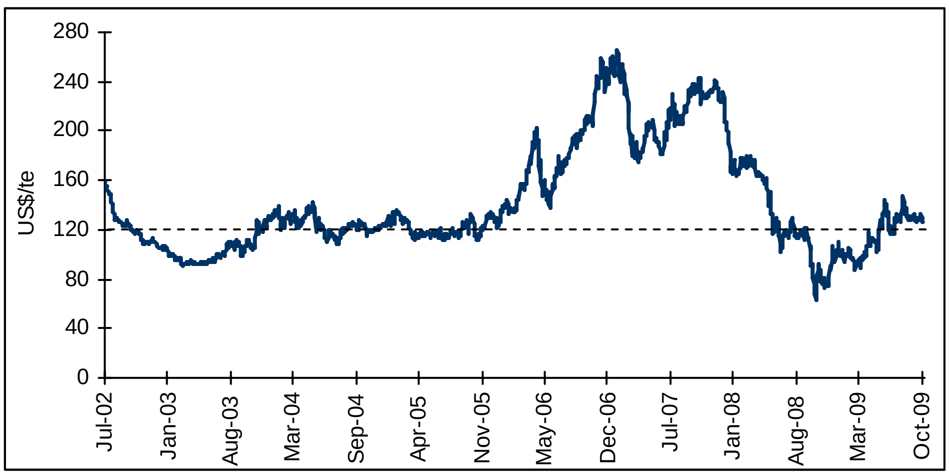
Source: Bloomberg, I-Sec Research

Chart 10: Rolling EV/E bands



Source: Bloomberg, I-Sec Research

Chart 11: Rolling EV/te



Source: Bloomberg, I-Sec Research

Financial summary (standalone)

Table 11: Profit and Loss Statement

(Rs mn, year ending Dec 31)

	CY06	CY07	CY08	CY09E	CY10E	CY11E
Gross Sales	**70,167**	**64,697**	**70,899**	**76,153**	**80,052**	**88,017**
Less: Excise Duty	7,422	7,648	8,552	6,092	6,404	7,041
Net Sales	**62,745**	**57,048**	**62,347**	**70,060**	**73,648**	**80,976**
of which Export Sales	*5,219*	*2,856*	*2,318*	*1,842*	*2,019*	*2,200*
of which Domestic Sales	*57,526*	*54,193*	*60,028*	*68,218*	*71,629*	*78,775*
Total Operating Income	**62,745**	**57,048**	**62,347**	**70,060**	**73,648**	**80,976**
Less:						
Raw Material Consumed	5,865	5,606	7,579	10,795	9,008	9,937
Other Manufacturing Expenses	6,351	4,790	6,059	6,503	7,447	8,432
Power and Fuel	12,399	10,042	13,257	14,131	15,785	17,529
Personnel Expenses	2,331	2,086	2,661	2,714	2,958	3,195
Selling and Distribution Expenses	2,095	2,336	1,751	1,839	2,023	2,124
Other Expenses	2,526	2,189	3,139	3,296	3,559	3,809
Freight	9,786	9,548	10,122	10,857	11,877	12,933
Total Operating Expenses	**41,352**	**36,597**	**44,567**	**50,135**	**52,657**	**57,959**
EBITDA	**21,393**	**20,451**	**17,779**	**19,926**	**20,991**	**23,016**
Depreciation & Amortisation	3,261	2,363	2,598	2,889	3,679	4,228
Other Income	941	1,935	1,754	1,434	1,583	1,917
EBIT	**19,073**	**20,023**	**16,936**	**18,471**	**18,895**	**20,705**
Less: Gross Interest	1,132	759	321	233	206	192
Recurring Pre-tax Income	**17,941**	**19,265**	**16,615**	**18,237**	**18,688**	**20,513**
Add: Extraordinary Income	475	8,154	3,142			
Less: Extraordinary Expenses		3,671	59			
Less: Taxation	3,384	6,057	5,676	5,925	5,980	6,564
--Current Tax	3,353	6,066	5,652	5,743	5,793	6,359
--Deferred Tax	31	(9)	24	182	187	205
Add: Share in income of associates						
Net Income (Reported)	**15,033**	**17,691**	**14,023**	**12,312**	**12,708**	**13,949**
Recurring Net Income	**14,557.3**	**13,207**	**10,939**	**12,312**	**12,708**	**13,949**

Source: Company data, I-Sec Research

Table 12: Balance Sheet

(Rs mn, year ending Dec 31)

	CY06	CY07	CY08	CY09E	CY10E	CY11E
ASSETS						
Current Assets, Loans & Advances						
Cash & Bank balance	3,781	6,426	8,518	6,681	9,749	7,512
Inventory	4,088	5,816	9,398	9,895	10,618	12,176
Sundry Debtors	900	1,457	2,246	3,029	3,502	4,236
Loans and Advances	2,957	2,054	2,999	3,299	3,628	3,991
Other Current Assets	50	121	234	257	283	311
Total Current Assets	**11,776**	**15,873**	**23,395**	**23,161**	**27,781**	**28,227**
Current Liabilities & Provisions						
Current Liabilities	**5,329**	**6,755**	**10,032**	**11,257**	**11,891**	**13,087**
Sundry Creditors	4,417	5,740	8,802	9,904	10,402	11,450
Other Current Liabilities	912	1,016	1,230	1,353	1,488	1,637
Provisions	**1,687**	**4,936**	**4,706**	**7,166**	**7,231**	**7,297**
Total Current Liabilities and Provisions	**7,016**	**11,691**	**14,738**	**18,423**	**19,121**	**20,384**
Net Current Assets	**4,760**	**4,182**	**8,657**	**4,738**	**8,660**	**7,843**
Investments						
Strategic & Group Investments	9,861	4,107	1,250	1,250	1,250	1,250
Other Marketable Investments	1,470	8,783	2,074	2,282	3,423	8,556
Total Investments	**11,331**	**12,889**	**3,324**	**3,531**	**4,672**	**9,806**
Fixed Assets						
Gross Block	45,425	52,311	57,069	74,267	83,967	95,967
Less Accumulated Depreciation	20,533	22,712	25,142	28,031	31,710	35,939
Net Block	24,892	29,599	31,928	46,236	52,257	60,029
Add: Capital Work in Progress	6,349	6,968	19,472	16,551	14,069	11,958
Less: Revaluation Reserve						
Total Fixed Assets	**31,241**	**36,567**	**51,400**	**62,787**	**66,326**	**71,987**
of which intangibles	-	-	-	-	-	-
Total Assets	**47,333**	**53,638**	**63,380**	**71,057**	**79,658**	**89,636**
of which cash and cash equivalents	5,251	15,209	10,593	8,963	13,172	16,069
LIABILITIES AND SHAREHOLDERS' EQUITY						
	12,125	11,740	11,740	11,741	11,742	11,742
Borrowings						
Short Term Debt	-	-	-	-	-	-
Non-Convertible Preference Shares						
Long Term Debt	8,654	3,304	2,887	2,132	1,906	1,815
Total Borrowings	**8,654**	**3,304**	**2,887**	**2,132**	**1,906**	**1,815**
Deferred Tax Liability	**3,839**	**3,784**	**3,808**	**3,846**	**3,884**	**3,923**
Share Capital						
Paid up Equity Share Capital	3,034	3,045	3,045	3,045	3,045	3,045
No. of Shares outstanding (mn)	*1,517*	*1,522*	*1,523*	*1,523*	*1,523*	*1,523*
No. of Warrants outstanding (mn)*						
Face Value per share (Rs)	*2*	*2*	*2*	*2*	*2*	*2*
Preference Share Capital (convertible)						
Reserves & Surplus						
Share Premium	11,544	11,864	11,876	11,876	11,876	11,876
General & Other Reserve	20,339	31,704	41,808	50,201	58,990	69,020
Less: Misc. Exp. not written off	77	62	43	43	43	43
Less: Revaluation Reserve						
Net Worth	**34,840**	**46,550**	**56,686**	**65,079**	**73,868**	**83,898**
Total Liabilities & Shareholders' Equity	**47,333**	**53,638**	**63,380**	**71,057**	**79,658**	**89,636**

Source: Company data, I-Sec Research

Table 13: Cash Flow Statement

(Rs mn, year ending Dec 31)

	CY06	CY07	CY08	CY09E	CY10E	CY11E
Cash Flow from Operating Activities						
Reported Net Income	15,033	17,691	14,023	12,312	12,708	13,949
Add:						
Depreciation & Amortisation	5,894	2,179	2,430	2,889	3,679	4,228
Provisions	619	3,249	(230)	2,460	65	66
Deferred Taxes	31	(9)	24	182	187	205
Less:						
Other Income	941	1,935	1,754	1,434	1,583	1,917
Net Extra-ordinary income	475	4,484	3,083	-	-	-
Operating Cash Flow before Working Capital change (a)	**20,160**	**16,691**	**11,409**	**16,410**	**15,056**	**16,532**
Changes in Working Capital						
(Increase) / Decrease in Inventories	(918)	(1,728)	(3,582)	(498)	(723)	(1,558)
(Increase) / Decrease in Sundry Debtors	(441)	(557)	(789)	(783)	(473)	(734)
(Increase) / Decrease in Operational Loans & Adv.	(1,590)	904	(945)	(300)	(330)	(363)
(Increase) / Decrease in Other Current Assets	(32)	(71)	(113)	(23)	(26)	(28)
Increase / (Decrease) in Sundry Creditors	2,194	1,323	3,063	1,102	498	1,047
Increase / (Decrease) in Other Current Liabilities	245	104	214	123	135	149
Working Capital Inflow / (Outflow) (b)	(543)	(26)	(2,152)	(379)	(919)	(1,486)
Net Cash flow from Operating Activities (a) + (b)	**19,617**	**16,664**	**9,258**	**16,031**	**14,137**	**15,046**
as a % of Operating Cash Flow						
Cash Flow from Capital commitments						
Purchase of Fixed Assets	(13,502)	(7,504)	(17,263)	(14,277)	(7,217)	(9,890)
Purchase of Investments	(593)	5,754	2,857	-	-	-
Consideration paid for acquisition of undertaking						
Cash Inflow/(outflow) from capital commitments (c)	**(14,095)**	**(1,750)**	**(14,406)**	**(14,277)**	**(7,217)**	**(9,890)**
Free Cash flow after capital commitments (a) + (b) + (c)	**5,522**	**14,914**	**(5,148)**	**1,754**	**6,920**	**5,156**
Cash Flow from Investing Activities						
Purchase of Marketable Investments	**513**	**(7,312)**	**6,708**	**(207)**	**(1,141)**	**(5,134)**
(Increase) / Decrease in Other Loans & Advances	-	-	-	-	-	-
Sale of Fixed Assets						
Sale of Investments						
Consideration received for sale of undertaking/division						
Other Income	941	1,935	1,754	1,434	1,583	1,917
Net Cash flow from Investing Activities (d)	**1,454**	**(5,377)**	**8,462**	**1,227**	**442**	**(3,217)**
Cash Flow from Financing Activities						
Issue of Share Capital during the year	330	11	0	-	-	-
Proceeds from fresh borrowings	(2,621)	(5,350)	(417)	(755)	(226)	(91)
Repayment of Borrowings						
Buyback of Shares	-	-	-	-	-	-
Dividend paid including tax	(5,259)	(6,232)	(3,919)	(3,919)	(3,919)	(3,919)
Others	3,014	195	31	(144)	(148)	(166)
Net Cash flow from Financing Activities (e)	**(4,536)**	**(11,376)**	**(4,305)**	**(4,818)**	**(4,294)**	**(4,176)**
Net Extra-ordinary Income (f)	**475**	**4,484**	**3,083**	**-**	**-**	**-**
Total Increase / (Decrease) in Cash (a) + (b) + (c) + (d)+ (e) + (f)	**2,916**	**2,645**	**2,093**	**(1,837)**	**3,068**	**(2,237)**
Opening Cash and Bank balance	**865**	**3,781**	**6,426**	**8,518**	**6,681**	**9,749**
Closing Cash and Bank balance	**3,781**	**6,426**	**8,518**	**6,681**	**9,749**	**7,512**
Increase/(Decrease) in Cash and Bank balance	**2,916**	**2,645**	**2,093**	**(1,837)**	**3,068**	**(2,237)**

Source: Company data, I-Sec Research

Table 14: Key Ratios

(Year ending Dec 31)

	CY06	CY07	CY08	CY09E	CY10E	CY11E
Per Share Data (Rs)						
Diluted Recurring Earning per share (DEPS)	9.6	8.7	7.2	8.1	8.3	9.2
Diluted Earnings per share	9.9	11.6	9.2	8.1	8.3	9.2
Recurring Cash Earnings per share (CEPS)	11.7	10.2	8.9	10.0	10.8	11.9
Free Cashflow per share (FCPS-post capex)	3.6	9.8	(3.4)	1.2	4.5	3.4
Reported Book Value (BV)	23.0	30.6	37.2	42.7	48.5	55.1
Adjusted Book Value (ABV)	23.0	30.6	37.2	42.7	48.5	55.1
Dividend per share	3.0	3.5	2.2	2.2	2.2	2.2
Valuation Ratios (x)						
Diluted Price Earning Ratio	9.8	10.8	13.1	11.6	11.3	10.3
Price to Recurring Cash Earnings per share	8.0	9.2	10.6	9.4	8.7	7.9
Price to Book Value	4.1	3.1	2.5	2.2	1.9	1.7
Price to Adjusted Book Value	4.1	3.1	2.5	2.2	1.9	1.7
Price to Sales Ratio	2.3	2.5	2.3	2.0	1.9	1.8
EV / EBITDA	7.0	6.6	7.8	7.0	6.5	5.8
EV / Total Operating Income	2.4	2.4	2.2	2.0	1.8	1.6
EV / Operating Free Cash Flow (Pre-Capex)	7.6	8.1	15.0	8.7	9.6	8.8
EV / Net Operating Free Cash Flow (Post-Capex)	27.1	9.1	(27.0)	79.9	19.6	25.8
Dividend Yield (%)	3.2	3.7	2.3	2.3	2.3	2.3
Growth Ratios (% YoY)						
Diluted Recurring EPS Growth	197.7	(9.6)	(17.2)	12.5	3.2	9.8
Diluted Recurring CEPS Growth	151.6	(12.9)	(13.1)	12.3	7.8	10.9
Total Operating Income Growth	140.8	(9.1)	9.3	12.4	5.1	9.9
EBITDA Growth	195.4	(4.4)	(13.1)	12.1	5.3	9.6
Recurring Net Income Growth	234.1	(9.3)	(17.2)	12.5	3.2	9.8
Operating Ratios (%)						
EBITDA Margins	34.1	35.8	28.5	28.4	28.5	28.4
EBIT Margins	30.4	35.1	27.2	26.4	25.7	25.6
Recurring Pre-tax Income Margins	28.2	32.7	25.9	25.5	24.8	24.7
Recurring Net Income Margins	22.9	22.4	17.1	17.2	16.9	16.8
Raw Material Consumed / Sales	9.3	9.8	12.2	15.4	12.2	12.3
SGA Expenses / Sales	3.3	4.1	2.8	2.6	2.7	2.6
Other Income / Pre-tax Income	5.2	10.0	10.6	7.9	8.5	9.3
Effective Tax Rate	18.9	31.4	34.2	32.5	32.0	32.0
Return / Profitability Ratios (%)						
Return on Capital Employed (RoCE)-Overall	36.8	27.2	19.1	18.6	17.0	16.6
Return on Invested Capital (RoIC)	36.6	29.1	21.4	20.7	18.9	18.3
Return on Net Worth (RoNW)	34.3	32.5	21.2	20.2	18.3	17.7
Dividend Payout Ratio	31.7	40.3	30.6	27.2	26.4	24.0
Solvency Ratios / Liquidity Ratios (x)						
Debt Equity Ratio (D/E)	0.4	0.2	0.1	0.1	0.1	0.1
Long Term Debt / Total Debt	1.0	1.0	1.0	1.0	1.0	1.0
Net Working Capital / Total Assets	-	-	-	-	-	-
Interest Coverage Ratio-based on EBIT	16.8	26.4	52.8	79.2	91.6	107.9
Debt Servicing Capacity Ratio (DSCR)	0.9	(1.9)	26.8	59.1	77.4	97.9
Current Ratio	1.3	1.2	1.4	1.1	1.3	1.2
Cash and cash equivalents / Total Assets	11.1	28.4	16.7	12.6	16.5	17.9
Turnover Ratios						
Inventory Turnover Ratio (x)	7.7	4.6	3.9	3.6	3.5	3.5
Assets Turnover Ratio (x)	1.5	1.2	1.1	1.1	1.0	1.0
Working Capital Cycle (days)	6.9	12.6	22.8	18.5	16.0	20.0
Average Collection Period (days)	3.5	6.7	9.5	12.6	14.9	16.0
Average Payment Period (days)	29.3	50.7	59.6	68.1	70.4	68.8

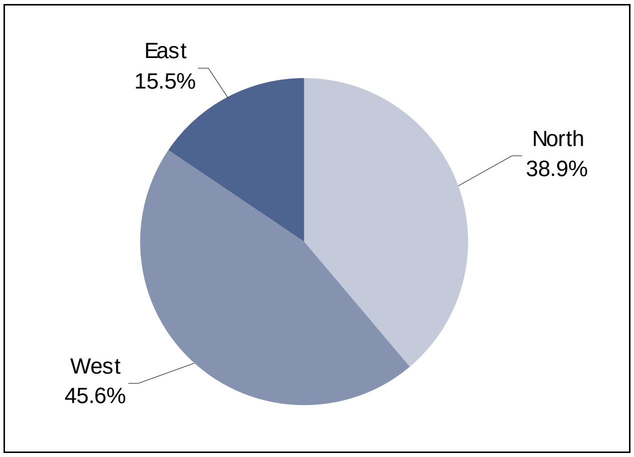
Source: Company data, I-Sec Research

Company overview

ACEM, formerly known as Gujarat Ambuja, is a leading cement manufacturing company in India with a market share of ~9.5%. The company has installed cement capacities in North and West. Its subsidiaries include M.G.T Cements Private, Kakinada Cements and Chemical Limes Mundwa Private. In '08, ACEM sold its shareholding in Ceylon Ambuja Cements Private.

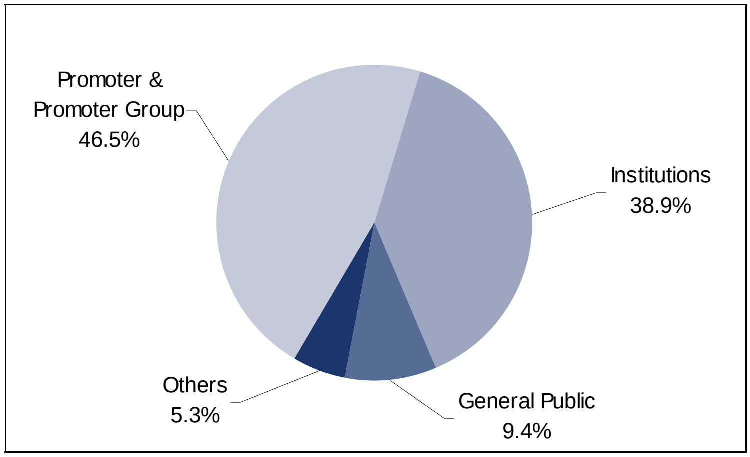
At present, ACEM has an installed capacity base of 22mnte. As per the management, two other expansion projects are underway – Bhatapara in Chhattisgarh and Rauri in Himachal Pradesh – expected to be completed by October and December '09, increasing ACEM's clinker capacity by 4.4mnte per annum.

Chart 12: Regional cement despatches



Source: Company data, I-Sec Research

Chart 13: Ownership structure



Source: Company data, I-Sec Research

Table 15: Management overview

Name	Designation	Qualification & experience
Mr. A.L.Kapur	Managing Director	Chartered Accountant, Cost Accountant, Graduate in Arts. Assumed the role of Managing Director of ACEM on May 1, '07 and has been associated with the cement industry for more than 20 years. Previously served as the whole time Director from May 1999-April 2007.
Mr. David Atkinson	CFO	FCMA, B.A. (Hons.) Served as the Regional Controller of Holcim prior to joining ACEM (on January 1, '07)
Mr. R.P. Sharma	V.P. Operations	B.Tech - Chemical Engineering Previously served as Senior Chemical Engineer at Satna Cement Works and has over 27 years of experience.

Source: Company data, I-Sec Research

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Charts

Equity Research

October 15, 2009

BSE Sensex: 17231

INDIA

UltraTech Cement

BUY

In big league

Rs811

Reason for report: Reinitiating coverage

Cement

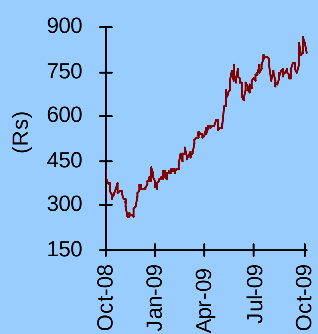
Target price Rs975

Shareholding pattern

	Dec '08	Mar '09	Jun '09
Promoters	**54.8**	**54.8**	**54.8**
Institutional investors	**11.4**	**11.2**	**20.7**
MFs and UTI	1.7	1.6	6.0
Insurance Cos.	7.5	7.4	8.9
FIIs	2.2	2.3	5.8
Others	**33.9**	**34.0**	**24.6**

Source: CMIE

Price chart



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UltraTech Cement (UTCL), post the proposed restructuring of Grasim, is likely to emerge as India's largest pure play on cement with ~49mnte capacity and strong free cashflow generation. Also, its market mix, which was earlier skewed towards West and South, would become more diversified with pan-India presence. Capacity addition, ahead of competition, would ensure better-than-industry volume growth and market share rise. Having completed the first phase of expansion, we believe UTCL would soon announce its next capacity expansion. Besides volume growth, UTCL would post significant cost savings from commissioning of 192MW captive power plant in FY09. We believe the valuation discount to peers would disappear and UTCL would trade in line with ACC. We reinitiate coverage with BUY and Rs975/share target price (FY12E EV/E of 6x).

- **To emerge as India's largest pure play on cement** post the proposed restructuring of Grasim. UTCL, with low leverage and strong cashflow generation, is gearing for the next level of organic/inorganic growth. Besides, UTCL would enjoy pan-India presence, which would result in narrowing of discount versus peers.

- **Capacity addition ahead of competition** would ensure that UTCL posts FY10E & FY11E volume growth of 10.4% & 9.1% respectively, ahead of the industry average.

- **Increased captive power & cost efficiencies to offset margin erosion.** UTCL would source 80% of its power requirement captively post the commissioning of additional 192MW power plant from the current 20%. Increased captive power consumption and fall in price of imported coal would lead to Rs200/te savings in FY10E. Thus, despite factoring in 6% dip in average realisations through FY11E, EBITDA margin is expected to fall 500bps to 27.5%.

- **Valuation discount to diminish.** We expect UTCL to generate operating cashflows of Rs42bn over FY10E-12E, resulting in D/E declining to 0.3x from the current 0.8x. UTCL is currently trading at attractive FY11E & FY12E EV/E of 5.5x and 5.0x respectively. We believe the valuation discount to peers would diminish post the proposed restructuring of Grasim and UTCL would trade in line with ACC. We reinitiate coverage with BUY and target price of Rs975/share (FY12E EV/E of 6x).

Market Cap	Rs102.3bn/US$2.2bn
Reuters/Bloomberg	ULTC.BO/UTCEM IN
Shares Outstanding (mn)	126
52-week Range (Rs)	920/245
Free Float (%)	45.2
FII (%)	5.8
Daily Volume (US$'000)	5,180
Absolute Return 3m (%)	9.8
Absolute Return 12m (%)	90.6
Sensex Return 3m (%)	20.9
Sensex Return 12m (%)	59.4

Year to March	FY09	FY10E	FY11E	FY12E
Revenue (Rs mn)	63,831	71,595	73,614	79,719
Net Income (Rs mn)	9,770	12,421	10,236	10,729
EPS (Rs)	77.4	98.4	81.1	85.0
% Chg YoY	(3.7)	27.1	(17.6)	4.8
P/E (x)	10.5	8.2	10.0	9.5
CEPS (Rs)	103.0	130.1	117.5	125.7
EV/E (x)	7.0	4.9	5.5	5.0
Dividend Yield	0.6	0.7	0.6	0.6
RoCE (%)	16.5	18.2	13.7	12.9
RoE (%)	31.0	29.7	19.6	17.3

TABLE OF CONTENT

To emerge as India's largest pure play on cement

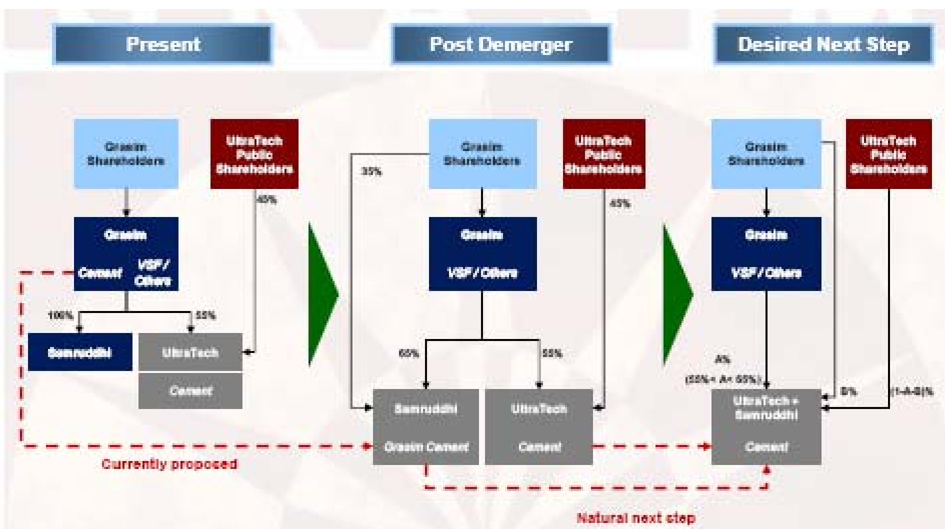
UTCL, post the proposed restructuring of Grasim, is likely to emerge as India's largest pure play on cement with capacity of ~49mnte and strong free cashflow generation. Having completed the first phase of expansion, we believe UTCL would be better geared for organic expansion/inorganic initiatives. At present, the company derives ~50% of its revenue from West and ~35% from South. Post the proposed restructuring UTCL would become more diversified with pan-India presence. Hence, the discount currently attributed to UTCL for its positioning in West/South (prone to more pricing pressure) would diminish.

Table 1: Capacity of the proposed merged entity

	Grasim		UTCL		Grasim + UTCL	
	Capacity (mnte)	Market Share (%)	Capacity (mnte)	Market Share (%)	Capacity (mnte)	Market Share (%)
North	12.4	18			12.4	18
East			4.1	11	4.1	11
South	6.1	7	8	10	14.1	16
West	7.2	10	11.0	18	18.2	28
Total	**25.7**		**23.1**		**48.8**	**20**

Source: Company data, I-Sec Research

Chart 1: Consolidation into a single entity



Source: Company data, I-Sec Research

Capacity addition ahead of peers

Post Grasim's acquisition of UTCL in '03, the latter was initially focusing on improving overall efficiencies, maximising existing volume potential through debottlenecking and improving its balance sheet. Thereafter, helped by higher cement prices, consequent cash generation and improvement in operational efficiency levels, the company embarked on a 4.9mnte brownfield capacity expansion along with 50MW captive TPP in Tadpatri, Andhra Pradesh in mid '06 at an estimated capex of Rs40bn.

The Tadpatri plant commenced clinker production in Q2FY09. However, the grinding capacity got deferred to Q4FY09. UTCL has also planned a split grinding facility at Ginigera, which became operational in Q3FY09. With the grinding capacity coming on stream during May '09 at Tadpatri, UTCL's effective capacity increased to 23.1mnte.

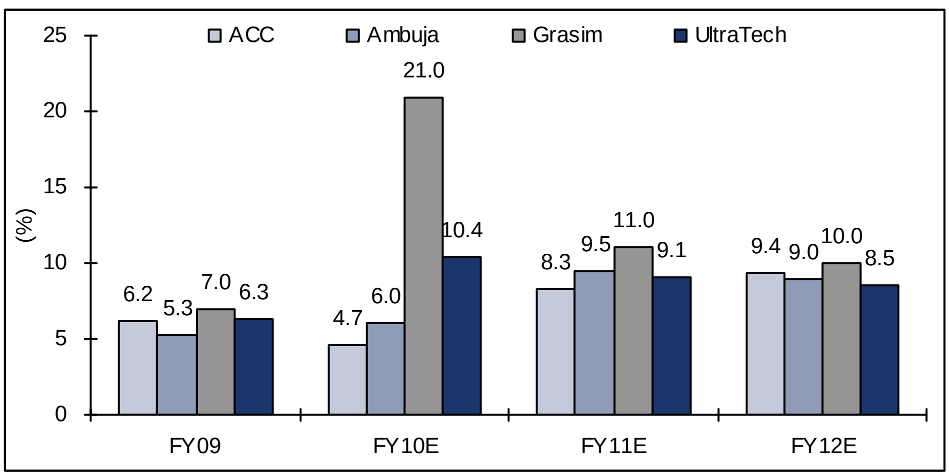
Capacity addition ahead of competition would ensure that UTCL posts volume growth of 10.4% and 9.5% in FY10E and FY11E, ahead of the industry average.

Table 2: Capacity addition plans

			Incremental effective capacity		
Company	**CoD**	**Region**	**FY10E**	**FY11E**	**FY12E**
UTCL - Tadpatri	Sep-08	South	0.7		
UTCL - Tadpatri	Mar-09	South	2.2		
UTCL - Tadpatri	May-09	South	1.0	0.2	

Source: Company data, I-Sec Research

Chart 2: Volume growth comparison



Source: Company data, I-Sec Research

Table 3: Capacity breakdown region-wise in terms of percentage

%	FY09	FY10E	FY11E	FY12E
North	-	-	-	-
Central	-	-	-	-
East	24.8	15.9	15.8	15.8
South	22.1	41.4	41.8	41.8
West	53.1	42.7	42.4	42.4
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company data, I-Sec Research

Market leader in key markets

Table 4: Key markets and market share

	Market share (%)	% of total despatches	8-year consumption CAGR (%)	Share of total consumption (%)
West				
Gujarat	29.6	16.6	4.5	6.8
Maharashtra	21.9	27.9	7.2	12.2
South				
Tamil Nadu	7.2	6.9	7.4	8.6
Karnataka	12.0	10.0	11.2	7.5
Kerala	4.6	2.4	6.8	4.7
Andhra Pradesh	7.1	6.5	8.5	8.2
East				
West Bengal	18.0	9.3	6.7	4.6
Bihar & Jharkhand	6.4	3.4	10.1	4.8
Orissa	20.3	6.7	10.9	3.0
Assam	17.3	1.3	7.4	0.7
Central				
Madhya Pradesh and Chhattisgarh	9.3	7.3	9.6	7.0
Total	**9.7**	**98.3**	**8.1**	**100**

Source: Cement Manufacturers Association (CMA), I-Sec Research

UTCL is also expanding its grinding and jetty capacity at Pipavav and a bulk terminal in Mumbai in FY09 at an estimated capex of Rs4.7bn, thus improving export capability. The company will add 17 RMC plants at the beginning of FY09 with 3.3m cubic meters capacity at an estimated capex of Rs1.4bn.

In FY09, UTCL added 15 RMC plants at an estimated capex of Rs0.86bn. The company will add two more RMC plants in FY10, with an additional capacity of 5L cubic meters. UTCL is modernising and upgrading its existing facilities to enhance efficiency at an estimated capex of Rs4.5bn. The company had planned to spend Rs33bn on the entire capacity expansion. It has already spent Rs18.5bn or 50% of the total planned capex up to Q4FY09, and will spend Rs9.2bn and Rs11bn in FY10 & FY11 respectively. The remaining capex will be entirely funded via internal accruals.

FY11E realisations to dip 6% and then inch up 0.4% in FY12E

We expect utilisation to increase from the current 83% to 95% by FY11E as no new organic capacities are expected in the next 12-18 months. We factor in 6% drop and a slight 0.4% rise in net realisations in FY11E and FY12E respectively as incremental capacities are added in the South, which is more prone to pricing pressure. We expect revenues to grow 2.8% and 8.3% in FY11E and FY12E respectively.

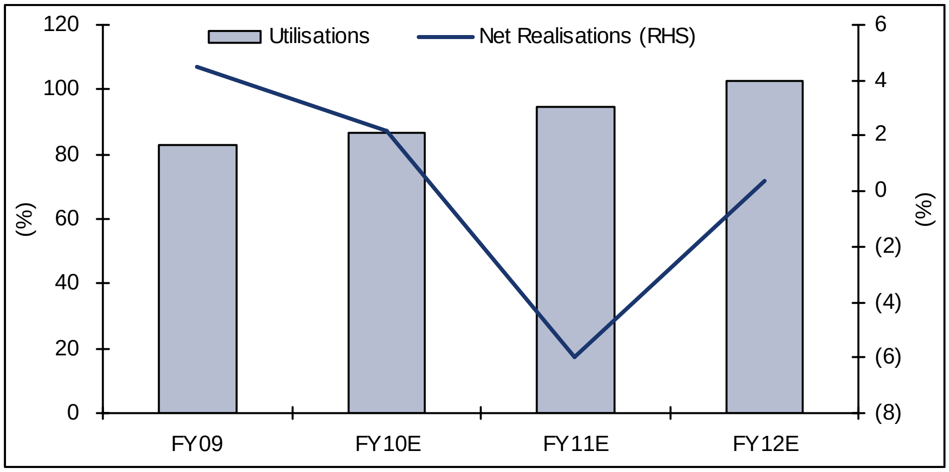
Table 5: Realisation growth among peers

(%)

	All India	ACC	ACEM	UTCL	Grasim
FY09	3.8	3.7	2.2	4.5	4.1
FY10E	5.5	6.0	4.6	2.2	4.0
FY11E	(5.3)	(5.0)	(4.0)	(6.0)	(4.5)
FY12E	0.9	0.5	0.8	0.4	0.7

Source: Company data, I-Sec Research

Chart 3: Utilisation and realisation growth



Source: Company data, I-Sec Research

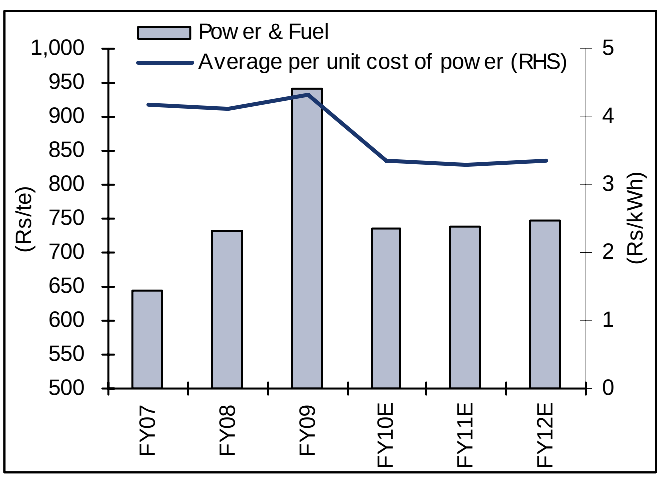
Increased captive power & cost efficiencies to offset margin erosion

UTCL has consistently focussed on higher efficiencies and modernisation. Initial investments were aimed at achieving rated capacity (historically, UTCL has operated at very low utilisation due to production bottlenecks). Post that, the company has invested heavily in captive power generation, with power plant capacity addition of 192MW in FY09. UTCL would source 80% of its power requirement captively post commissioning of additional 192MW power plant from the current 20%. It plans to bring the remaining 33MW capacity on stream in FY10. UTCL should benefit from these investments as cost per unit of purchases from the grid is higher 40-50%. The company has already started witnessing benefits of increased captive power generation as its power & fuel costs declined from Rs1,154/te in Q3FY09 to Rs719 in Q1FY10.

UTCL uses a mix of domestic and imported coal. It does not have any long-term fixed price supply contract for both domestic and imported coal and is required to buy at spot rates. This makes the company vulnerable to coal prices increase. All its plants in Gujarat use imported coal due to their proximity to the port at Pipavav. Imported coal is sourced primarily from South Africa since the Pipavav port is on the west coast and hence, the landed cost from South Africa is cheaper than Indonesian or Australian coal. UTCL's plants outside Gujarat procure most of their coal requirements through linkages (70-75%), while the remaining is purchased from the spot market. At present, UTCL imports ~30% of its coal requirement. We expect the proportion to decline to ~20% as the new 4.9mnte capacity at Tadpatri will run on linkage coal.

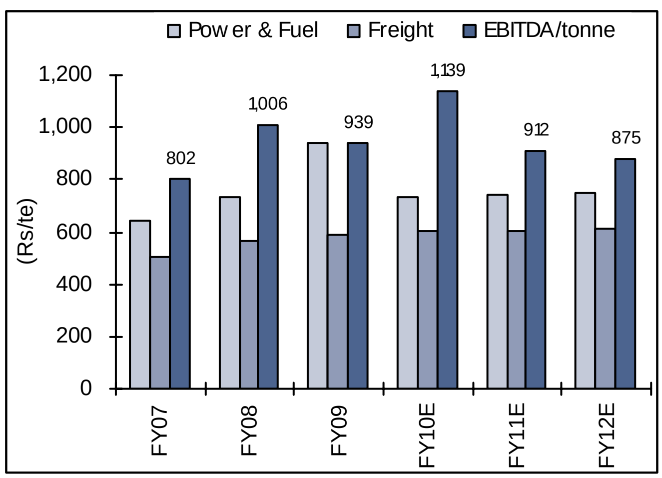
Increased captive power consumption and fall in price of imported coal would lead to savings of Rs200/te in FY10E. Thus, despite factoring in 6% dip in average realisations in FY11E, EBITDA margin is expected to fall 500bps to 27.5%.

Chart 4: Power & fuel costs and average unit cost of power



Source: Company data, I-Sec Research

Chart 5: Key cost and EBITDA/te

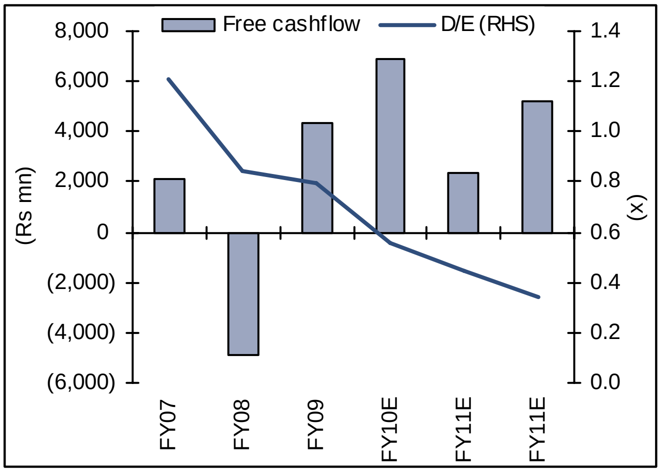


Source: Company data, I-Sec Research

Strong free cashflow generation

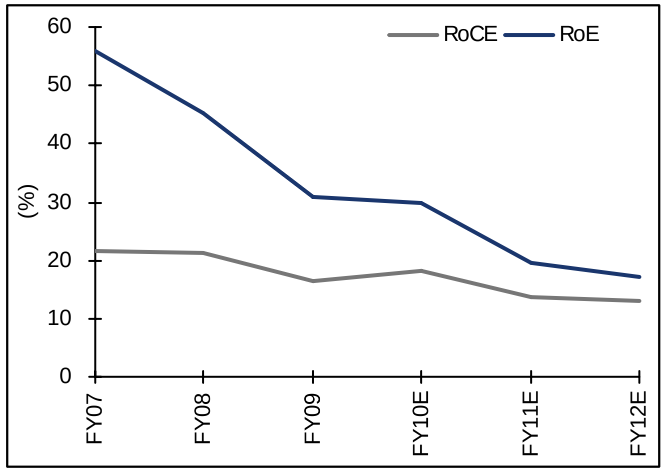
We expect UTCL to generate operating cashflows of Rs42bn and FCF of Rs14bn over FY10E-12E, resulting in D/E declining to 0.3x from the current 0.8x. We believe UTCL will be able to fund its future expansions via internal accruals.

Chart 6: FCF and D/E



Source: I-Sec Research

Chart 7: RoCE and RoE trends



Source: I-Sec Research

Revenue CAGR of 7.7% over FY09-12E

Table 6: Performance trend and forecast assumptions

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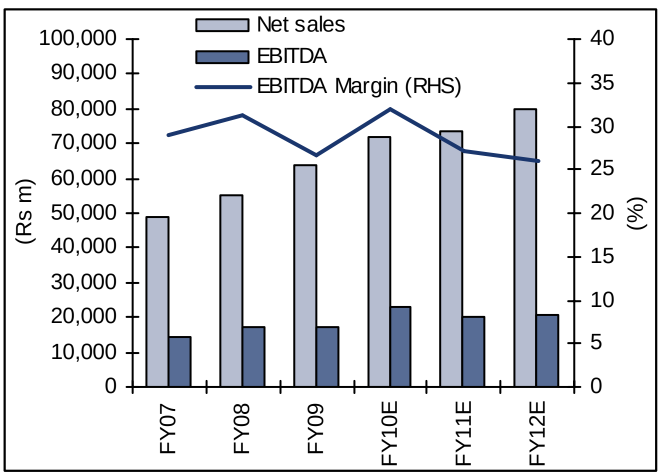
	FY07	FY08	FY09	FY10E	FY11E	FY12E
Capacity	17,000	18,200	21,900	23,100	23,100	23,100
Cement Production	14,635	15,069	15,864	17,264	18,864	20,486
Capacity Utilisation (%)	86	83	72	75	82	89
Cement and Clinker Sales	17,669	17,106	18,179	20,069	21,893	23,758
Growth (%)	13.6	(3.2)	6.3	10.4	9.1	8.5
Realisation (Rs/te)	3,318	3,739	3,907	3,993	3,753	3,768
Growth (%)	32.0	12.7	4.5	2.2	(6.0)	0.4

Source: I-Sec Research

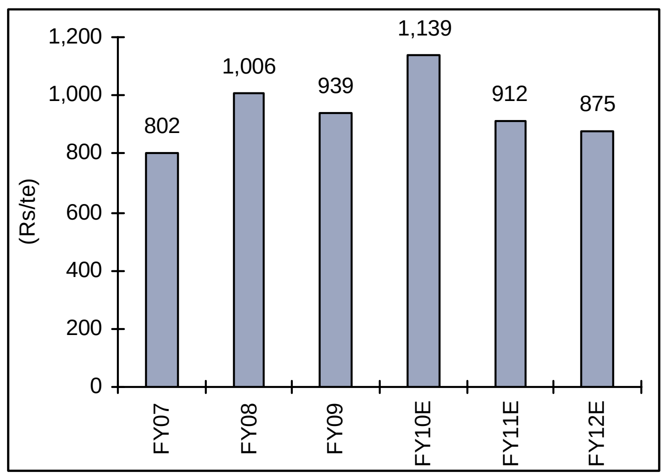
Capacity addition ahead of competition would ensure that UTCL posts FY10E & FY11E volume growth of 10.4% & 9.1% respectively, ahead of the industry average. We factor in 6% drop and a slight 0.4% rise in net realisations in FY11E and FY12E respectively as incremental capacities are added in South, which is more prone to pricing pressure. We expect FY11E & FY12E revenues to grow 2.8% & 8.3% respectively. We estimate FY10E EBITDA margin to increase a significant 6% to 32.2% and then dip ~6% to 26.5% by FY12E. Overall, we expect revenue, EBITDA and PAT CAGR of 7.7%, 7.4% and 5.4% over FY09-12E.

Chart 8: Sales, EBITDA and EBITDA margin movement



Source: Company data, I-Sec Research

Chart 9: EBITDA/te



Source: I-Sec Research

Table 7: Per ton analysis

(Rs/tonne)

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Net Sales	**2,779**	**3,221**	**3,511**	**3,567**	**3,362**	**3,355**
Raw Material Consumed	312	370	414	455	466	475
Power and Fuel	644	733	942	735	738	748
Freight	502	567	589	601	607	613
Others	519	545	627	637	640	644
Total Operating Expenses	**1,977**	**2,215**	**2,573**	**2,429**	**2,450**	**2,480**
EBITDA/tonne	**802**	**1,006**	**939**	**1,139**	**912**	**875**

Source: Company data, I-Sec Research

Table 8: Sensitivity analysis (% change) on CY10 EPS

1% change in realisations from base assumption	4.5
1% change in raw material costs from base assumption	0.6
1% change in power and fuel cost from base assumption	0.9
1% change in freight cost from base assumption	0.8

Source: I-Sec Research

Table 9: Consensus versus I-Sec estimates

(Rs mn)

	PAT			EBITDA			Sales		
	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E
Consensus estimates	11,990	9,663	10,015	21,407	18,306	19,634	71,860	73,181	75,625
I-Sec estimates	12,421	10,236	10,729	22,854	19,968	20,795	71,595	73,614	79,719
Variations (%)	3.6	5.9	7.1	6.8	9.1	5.9	(0.4)	0.6	5.4

Source: Bloomberg, I-Sec Research

Key risks

Adverse supply/demand mismatch

In case large number of capacities get commissioned before schedule, an oversupply could result in pricing pressure from FY10E itself. Further, with housing and infrastructure being key demand drivers, significant slowdown in either housing or infrastructure project implementation could affect demand estimates.

Increased pricing pressure

Sector performance, to a large extent, is dependent on pricing movements. We have factored in 5% dip in average realisations through FY11E. Any further decline would pose a downside risk to our estimates.

Government interference

In the past, the Government has resorted to measures such as ban on exports, increasing duty, different duty structure for different levels of cement prices etc, which could affect the growth of the sector and pose downside risks to our estimates.

Input cost pressure

Historically, cement companies were able to pass on the rise in input cost to end consumers. However, in a scenario of oversupply, we believe the company may not be able to do so. Substantial increase in international coal price, domestic coal price and crude oil can pose downside risks to our estimates.

Adverse swap ratio

In the proposed scheme of restructuring, any adverse swap ratio, say more than one shares of UTCL for every 1.9 shares of Samruddhi would be detrimental for UTCL's shareholders.

UTCL (Buy) – Target price Rs975

Valuation discount to diminish

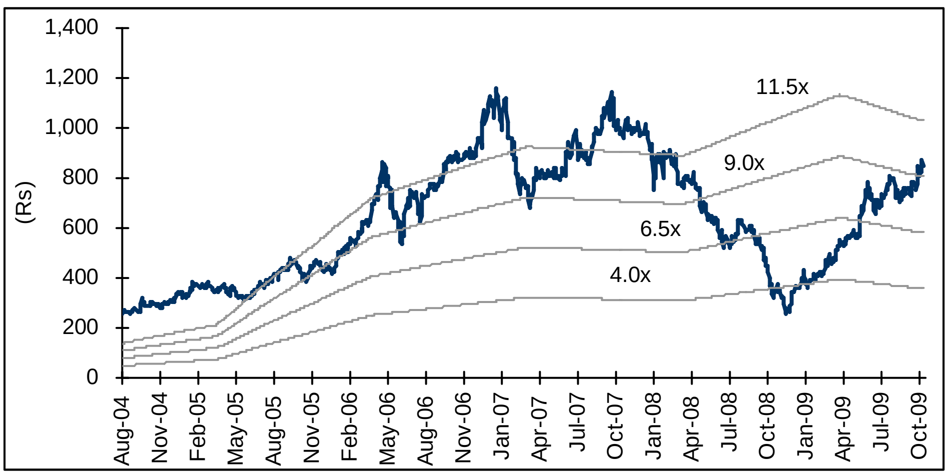
We expect UTCL to generate operating cashflows of Rs42bn over FY10E-12E, resulting in D/E declining to 0.3x from 0.8x at present. UTCL is currently trading at attractive FY11E & FY12E EV/E of 5.5x and 5.0x respectively. We believe the valuation discount to peers would disappear post the proposed restructuring of Grasim and UTCL would trade in line with ACC. We reinitiate coverage with BUY and target price of Rs975/share (FY12E EV/EBITDA of 6x).

Table 10: Valuations based on FY12

Target EV/ EBITDA multiple (x)	6
Target EV (Rsmn)	124,773
Net debt / (cash) (Rsmn)	1,972
Target value (Rsmn)	122,801
No. of shares (mn)	126.17
Target price per share (Rs)	**975**

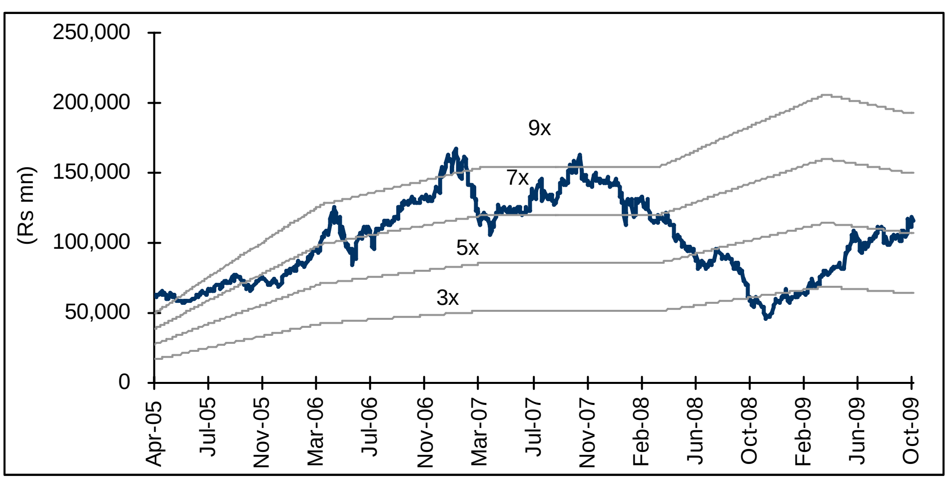
Source: I-Sec Research

Chart 10: Rolling P/E bands



Source: Bloomberg, I-Sec Research

Chart 11: Rolling EV/E bands



Source: Bloomberg, I-Sec Research

Chart 12: Rolling EV/te

Source: Bloomberg, I-Sec Research

Financial summary (consolidated)

Table 11: Profit and Loss Statement

(Rs mn, year ending March 31)

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Gross Sales	**54,844**	**62,862**	**71,604**	**79,210**	**81,459**	**88,251**
Less: Excise Duty	5,735	7,770	7,773	7,615	7,846	8,532
Net Sales	**49,108**	**55,092**	**63,831**	**71,595**	**73,614**	**79,719**
of which Export Sales	*6,928*	*5,096*	*5,823*	*5,261*	*6,030*	*6,606*
of which Domestic Sales	*42,180*	*49,996*	*58,008*	*66,334*	*67,583*	*73,113*
YoY growth in net sales	48.8	12.2	15.9	12.2	2.8	8.3
Less:						
Raw Material Consumed	5,507	6,337	7,531	9,132	10,198	11,288
Other Manufacturing Expenses	5,627	4,517	5,638	6,406	7,233	8,097
Power and Fuel	11,383	12,533	17,130	14,759	16,153	17,770
Personnel Expenses	1,172	1,716	2,177	2,351	2,515	2,666
Selling and Distribution Expenses	1,256	1,706	1,830	2,159	2,310	2,472
Other Expenses	1,116	1,392	1,751	1,873	1,948	2,065
Freight	8,869	9,693	10,711	12,061	13,289	14,565
Total Operating Expenses	**34,930**	**37,892**	**46,767**	**48,741**	**53,646**	**58,924**
EBITDA	**14,178**	**17,201**	**17,064**	**22,854**	**19,968**	**20,795**
EBITDA margins (%)	28.9	31.2	26.7	31.9	27.1	26.1
YoY growth in EBITDA	155.8	21.3	(0.8)	33.9	(12.6)	4.1
Depreciation & Amortisation	2,263	2,372	3,230	3,996	4,589	5,125
Other Income	615	999	1,036	1,215	1,472	1,697
EBIT	**12,530**	**15,827**	**14,870**	**20,073**	**16,850**	**17,368**
Less: Gross Interest	868	757	1,255	1,534	1,573	1,353
Recurring Pre-tax Income	**11,662**	**15,070**	**13,615**	**18,539**	**15,278**	**16,014**
Add: Extraordinary Income						
Less: Extraordinary Expenses						
Less: Taxation	3,839	4,994	3,844	6,118	5,042	5,285
--Current Tax	4,006	5,161.1	2,039	5,840	4,813	5,044
--Deferred Tax	(167)	(167.1)	1,806	278	229	240
Net Income (Reported)	**7,823**	**10,076**	**9,770**	**12,421**	**10,236**	**10,729**
Recurring Net Income	**7,823**	**10,076**	**9,770**	**12,421**	**10,236**	**10,729**

Source: Company data, I-Sec Research

Table 12: Balance Sheet

(Rs mn, year ending March 31)

	FY07	FY08	FY09	FY10E	FY11E	FY12E
ASSETS						
Current Assets, Loans & Advances						
Cash & Bank balance	896	1,007	1,045	1,776	1,420	2,149
Inventory	4,336	6,098	6,920	8,069	8,978	9,980
Sundry Debtors	1,835	2,166	1,862	2,158	2,420	2,621
Loans and Advances	2,535	3,768	3,790	3,979	4,178	4,387
Total Current Assets	**9,602**	**13,039**	**13,616**	**15,982**	**16,996**	**19,136**
Current Liabilities & Provisions						
Current Liabilities	7,367	11,530	11,209	12,074	12,805	13,895
Sundry Creditors	4,640	7,768	7,231	7,976	8,585	9,548
Other Current Liabilities	2,727	3,762	3,978	4,098	4,221	4,347
Provisions	185	1,256	1,218	1,398	1,288	1,368
Total Current Liabilities and Provisions	**7,552**	**12,786**	**12,427**	**13,472**	**14,093**	**15,263**
Net Current Assets	2,050	253	1,189	2,509	2,903	3,873
Investments						
Strategic & Group Investments	242	442	453	453	453	453
Other Marketable Investments	4,592	1,267	9,895	13,895	15,895	18,895
Total Investments	**4,835**	**1,709**	**10,348**	**14,348**	**16,348**	**19,348**
Goodwill						
Fixed Assets						
Gross Block	47,847	49,726	74,010	82,710	93,806	103,292
Less Accumulated Depreciation	22,674	24,721	27,653	31,650	36,239	41,364
Net Block	25,173	25,005	46,357	51,061	57,567	61,928
Add: Capital Work in Progress	6,970	22,832	6,773	6,096	5,486	4,937
Less: Revaluation Reserve						
Total Fixed Assets	**32,142**	**47,836**	**53,130**	**57,156**	**63,053**	**66,865**
of which intangibles	-	-	-	-	-	-
Total Assets	**39,027**	**49,798**	**64,667**	**74,014**	**82,304**	**90,086**
of which cash and cash equivalent	5,488	2,274	10,940	15,671	17,314	21,044
LIABILITIES AND SHAREHOLDERS' EQUITY						
Borrowings						
Short Term Debt	2,744	6,380	9,658	9,175	8,717	8,281
Non-Convertible Preference Shares						
Long Term Debt	13,042	11,025	11,758	9,758	8,758	6,758
Total Borrowings	15,786	17,405	21,416	18,933	17,475	15,039
Deferred Tax Liability	5,603	5,424	7,229	7,507	7,737	7,977
Share Capital						
Paid up Equity Share Capital	1,245	1,253	1,262	1,262	1,262	1,262
No. of Shares outstanding (mn)	124	125	126	126	126	126
No. of Warrants outstanding* (mn)						
Face Value per share (Rs)	10	10	10	10	10	10
Preference Share Capital (convertible)						
Reserves & Surplus						
Share Premium						
General & Other Reserve	16,393	25,717	34,759	46,311	55,831	65,809
Less: Misc. Exp. not written off						
Less: Revaluation Reserve						
Net Worth	17,638	26,970	36,021	47,573	57,092	67,071
Total Liabilities & Shareholders' Equity	**39,027**	**49,798**	**64,667**	**74,014**	**82,304**	**90,086**

Source: Company data, I-Sec Research

Table 13: Cash Flow Statement

(Rs mn, year ending March 31)

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Cash Flow from Operating Activities						
Reported Net Income	7,823	10,076	9,770	12,421	10,236	10,729
Add:						
Depreciation & Amortisation	1,992	2,047	2,932	3,996	4,589	5,125
Provisions	(207)	1,071	(38)	180	(111)	80
Deferred Taxes	(167)	(167)	1,806	278	229	240
Less:						
Other Income	615	999	1,036	1,215	1,472	1,697
Net Extra-ordinary income	-	-	-	-	-	-
Operating Cash Flow before Working Capital change (a)	8,826	12,028	13,435	15,661	13,472	14,478
Changes in Working Capital						
(Increase) / Decrease in Inventories	(540)	(1,762)	(822)	(1,149)	(909)	(1,001)
(Increase) / Decrease in Sundry Debtors	(110)	(331)	304	(296)	(263)	(201)
(Increase) / Decrease in Operational Loans & Adv.	(947)	(1,233)	(21)	(189)	(199)	(209)
(Increase) / Decrease in Other Current Assets	-	-	-	-	-	-
Increase / (Decrease) in Sundry Creditors	1,459	3,128	(537)	745	609	963
Increase / (Decrease) in Other Current Liabilities	740	1,035	216	119	123	127
Working Capital Inflow / (Outflow) (b)	602	837	(860)	(770)	(639)	(321)
Net Cash flow from Operating Activities (a) + (b)	**9,428**	**12,865**	**12,575**	**14,891**	**12,833**	**14,157**
Cash Flow from Capital commitments						
Purchase of Fixed Assets	(7,352)	(17,741)	(8,226)	(8,023)	(10,486)	(8,937)
Purchase of Investments	-	(200)	(11)	-	-	-
Consideration paid for acquisition of undertaking						
Cash Inflow/(outflow) from capital commitments (c)	(7,352)	(17,941)	(8,236)	(8,023)	(10,486)	(8,937)
Free Cash flow after capital commitments (a) + (b) + (c)	**2,076**	**(5,076)**	**4,339**	**6,868**	**2,347**	**5,219**
Cash Flow from Investing Activities						
Purchase of Marketable Investments	(3,111)	3,326	(8,628)	(4,000)	(2,000)	(3,000)
(Increase) / Decrease in Other Loans & Advances	-	-	-	-	-	-
Sale of Fixed Assets						
Sale of Investments						
Consideration received for sale of undertaking/division						
Other Income	615	999	1,036	1,215	1,472	1,697
Net Cash flow from Investing Activities (d)	(2,496)	4,324	(7,593)	(2,785)	(528)	(1,303)
Cash Flow from Financing Activities						
Issue of Share Capital during the year	1	8	9	-	-	-
Proceeds from fresh borrowings	1,268	1,619	4,011	(2,483)	(1,459)	(2,436)
Repayment of Borrowings						
Buyback of Shares	-	-	-	-	-	-
Dividend paid including tax	(568)	(731)	(709)	(869)	(717)	(751)
Others	(1)	(32)	(19)	(0)	0	(0)
Net Cash flow from Financing Activities (e)	700	863	3,292	(3,352)	(2,175)	(3,187)
Net Extra-ordinary Income (f)	-	-	-	-	-	-
Total Increase / (Decrease) in Cash (a) + (b) + (c) + (d)+ (e) + (f)	280	111	38	731	(356)	729
Opening Cash and Bank balance	**616**	**896**	**1,007**	**1,045**	**1,776**	**1,420**
Closing Cash and Bank balance	**896**	**1,007**	**1,045**	**1,776**	**1,420**	**2,149**
Increase/(Decrease) in Cash and Bank balance	**280**	**111**	**38**	**731**	**(356)**	**729**

Source: Company data, I-Sec Research

Table 14: Key Ratios

(Rs mn, year ending March 31)

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Per Share Data (Rs)						
Diluted Recurring Earning per share (DEPS)	62.8	80.4	77.4	98.4	81.1	85.0
Diluted Earnings per share	62.8	80.4	77.4	98.4	81.1	85.0
Recurring Cash Earnings per share (CEPS)	81.0	99.4	103.0	130.1	117.5	125.7
Free Cashflow per share (FCPS-post capex)	16.7	(40.5)	34.4	54.4	18.6	41.4
Reported Book Value (BV)	141.7	215.3	285.5	377.1	452.5	531.6
Adjusted Book Value (ABV)	141.7	215.3	285.5	377.1	452.5	531.6
Dividend per share	4.0	5.0	4.9	6.0	5.0	5.2
Valuation Ratios (x)						
Diluted Price Earning Ratio	12.9	10.1	10.5	8.2	10.0	9.5
Price to Recurring Cash Earnings per share	10.0	8.2	7.9	6.2	6.9	6.4
Price to Book Value	5.7	3.8	2.8	2.1	1.8	1.5
Price to Adjusted Book Value	5.7	3.8	2.8	2.1	1.8	1.5
Price to Sales Ratio	2.1	1.8	1.6	1.4	1.4	1.3
EV / EBITDA	8.2	7.1	7.0	4.9	5.5	5.0
EV / Total Operating Income	2.4	2.2	1.9	1.6	1.5	1.3
EV / Operating Free Cash Flow (Pre-Capex)	12.4	9.5	9.5	7.6	8.6	7.4
EV / Net Operating Free Cash Flow (Post-Capex)	56.2	(24.0)	27.6	16.4	46.9	20.0
Dividend Yield (%)	0.49	0.61	0.61	0.75	0.62	0.65
Growth Ratios (% YoY)						
Diluted Recurring EPS Growth	240.3	28.0	(3.7)	27.1	(17.6)	4.8
Diluted Recurring CEPS Growth	126.1	22.7	3.7	26.3	(9.7)	6.9
Total Operating Income Growth	48.8	12.2	15.9	12.2	2.8	8.3
EBITDA Growth	155.8	21.3	(0.8)	33.9	(12.6)	4.1
Recurring Net Income Growth	240.5	28.8	(3.0)	27.1	(17.6)	4.8
Operating Ratios (%)						
EBITDA Margins	28.9	31.2	26.7	31.9	27.1	26.1
EBIT Margins	25.5	28.7	23.3	28.0	22.9	21.8
Recurring Pre-tax Income Margins	23.5	26.9	21.0	25.5	20.3	19.7
Recurring Net Income Margins	15.7	18.0	15.1	17.1	13.6	13.2
Raw Material Consumed / Sales	11.2	11.5	11.8	12.8	13.9	14.2
SGA Expenses / Sales	2.6	3.1	2.9	3.0	3.1	3.1
Other Income / Pre-tax Income	5.3	6.6	7.6	6.6	9.6	10.6
Effective Tax Rate	32.9	33.1	28.2	33.0	33.0	33.0
Return / Profitability Ratios (%)						
Return on Capital Employed (RoCE)-Overall	21.5	21.2	16.5	18.2	13.7	12.9
Return on Invested Capital (RoIC)	22.9	23.2	17.4	18.3	13.4	12.7
Return on Net Worth (RoNW)	55.8	45.2	31.0	29.7	19.6	17.3
Dividend Payout Ratio	6.4	6.2	6.4	6.1	6.1	6.1
	24.1	23.8	18.6	19.4	14.4	13.5
Solvency Ratios / Liquidity Ratios (%)						
Debt Equity Ratio (D/E)	1.2	0.8	0.8	0.6	0.4	0.3
Long Term Debt / Total Debt	0.9	0.7	0.7	0.7	0.7	0.6
Net Working Capital / Total Assets	0.0	(0.0)	0.0	0.0	0.0	0.0
Interest Coverage Ratio-based on EBIT	14.4	20.9	11.8	13.1	10.7	12.8
Debt Servicing Capacity Ratio (DSCR)	4.0	2.5	1.6	2.2	2.0	2.3
Current Ratio	0.7	0.5	0.4	0.5	0.6	0.6
Cash and cash equivalents / Total Assets	14.1	4.6	16.9	21.2	21.0	23.4
Turnover Ratios						
Inventory Turnover Ratio (x)	6.1	4.9	5.2	4.6	4.5	4.5
Assets Turnover Ratio (x)	1.4	1.3	1.1	1.1	1.0	0.9
Working Capital Cycle (days)	0.3	(13.3)	(17.5)	(10.4)	(6.8)	(4.1)
Average Collection Period (days)	11.8	11.6	10.3	9.3	10.3	10.4
Average Payment Period (days)	40.9	59.8	58.5	56.9	56.3	56.2

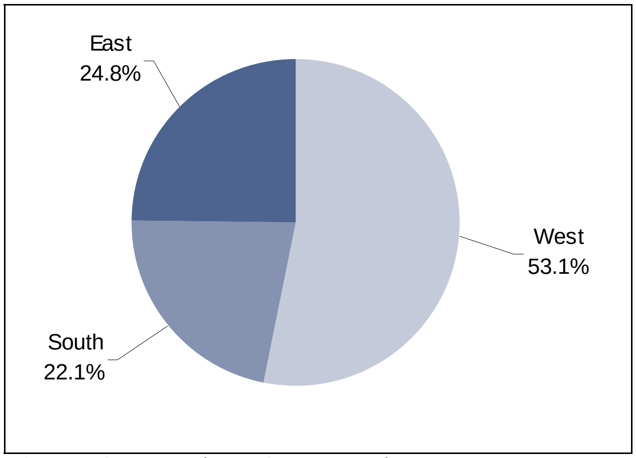
Source: Company data, I-Sec Research

Company overview

UTCL manufactures and markets Ordinary Portland Cement, Portland Blast Furnace Slag Cement and Portland Pozzalana Cement; it also manufactures Ready Mix Concrete (RMC). The company has five integrated plants, six grinding units and three terminals — two in India and one in Sri Lanka. The company's cement manufacturing capacity is 23.1mnte per annum.

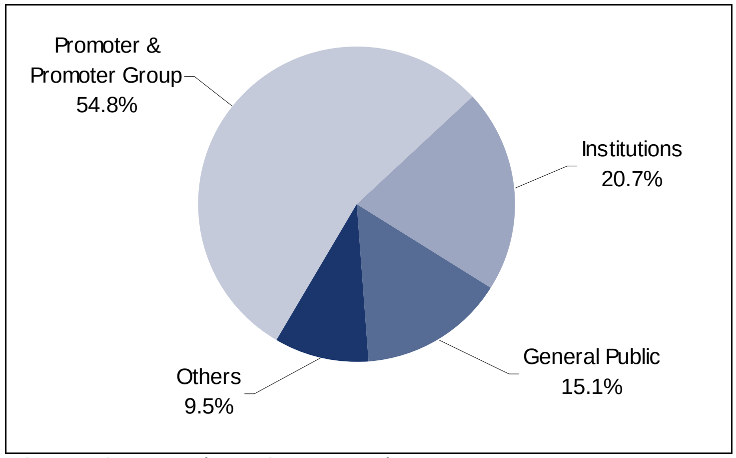
UTCL is India's largest exporter of cement clinker. Its export market comprises countries around the Indian Ocean, Africa, Europe and the Middle East. UTCL's subsidiaries include Dakshin Cement and UltraTech Ceylinco (P).

Chart 13: Regional cement despatches



Source: Company data, I-Sec Research

Chart 14: Ownership structure



Source: Company data, I-Sec Research

Table 15: Management overview

Name	Designation	Qualification & experience
Mr. S.Misra	Managing Director	Assumed the role of Managing Director from October '06 after serving as the CEO of UTCL. Has more than 35 years of experience at various leadership positions.
Mr. K.C. Birla	Executive President & CFO	FCA, CA, B.Com Also serves as the President of Cement Division (South) of Grasim Industries
Mr. O.P. Puranmalka	Chief Marketing Officer	Bachelors degree, Calcutta University Also serves as the Group Executive President and Chief Marketing Officer of Cement Division, Grasim Industries

Source: Company data, I-Sec Research

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Tables

Charts

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Equity Research

October 15, 2009
BSE Sensex: 17231

Cement

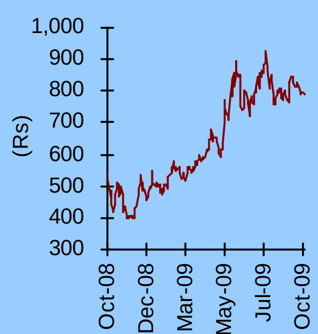
Target price Rs910

Shareholding pattern

	Mar '09	Jun '09	Sep '09
Promoters	**46.2**	**46.2**	**46.2**
Institutional investors	**32.4**	**31.9**	**31.5**
MFs and UTI	2.7	2.5	2.6
Insurance Cos.	19.5	19.1	19.3
FIIs	10.3	10.3	9.7
Others	**21.4**	**21.9**	**22.3**

Source: CMIE

Price chart



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INDIA

ACC

BUY

Attractive on valuations

Rs790

Reason for report: Reinitiating coverage

ACC has witnessed muted volume growth in the past 12-15 months due to capacity constraint and has lagged peers. However, in the next 15 months, we expect ACC to add 7.35mnte capacity and match industry growth. We do not expect effective utilisation to fall below 85% for ACC over CY09E-11E. With increased cost efficiencies and increasing power sourcing from captive power plant, ACC would be able to restrict margin erosion. We believe valuations at CY11E EV/EBITDA of 5.1x are not expensive for ACC, the industry leader, given its pan-India diversified presence, net cash of Rs10bn, healthy return ratios and expected strong operating cashflows of Rs58bn over CY09E-11E. We reinitiate coverage on ACC with BUY and 12-month target price of Rs910/share (CY11E EV/EBITDA of 6x).

- **Volumes to revive and match industry growth.** Even after factoring in ongoing delays in commissioning of new capacities, we expect 1.35mnte Bargarh (East region) and 1.2mnte Wadi (South region) units to be operational by December '09. We expect additional 1.8mnte Wadi and 3mnte Chanda (West region) to be operational by June '10 and December '10. ACC should be able to match industry growth. We expect CY10E & CY11E volume growth to be 8.3% and 9.4% respectively. Diversified pan-India presence would ensure overall lower drop in ACC's average realisations.
- **Limited margin erosion.** We factor in 5% drop in net realisation in CY10E for ACC as incremental capacities are added in South and West. However, with better cost control initiatives and increased sourcing of power from CPP, we estimate margin drop to be restricted to 250-300bps and margin to be stable at ~27% in CY10E-11E.
- **Strong balance sheet to fund expansions.** With net cash of Rs10bn, expected operating cashflows of Rs58bn and FCF of Rs14bn over CY09E-11E, we believe ACC would be able to fund its next phase of expansion via internal accruals.
- **Attractive valuations.** Valuations at CY11E EV/EBITDA of 5.1x are not expensive in our view for ACC, the industry leader, given its pan-India diversified presence and healthy return ratios, far exceeding the cost of capital. We reinitiate coverage on ACC with BUY and 12-month target price of Rs910/share.

Market Cap	Rs148.5bn/US$3.2bn
Reuters/Bloomberg	ACC.BO/ACC IN
Shares Outstanding (mn)	188
52-week Range (Rs)	929/365
Free Float (%)	53.8
FII (%)	9.7
Daily Volume (US$'000)	13,640
Absolute Return 3m (%)	(2.4)
Absolute Return 12m (%)	43.6
Sensex Return 3m (%)	20.9
Sensex Return 12m (%)	59.4

Year to Dec	CY08	CY09E	CY10E	CY11E
Revenue (Rs mn)	77,197	85,430	87,995	96,560
Net Income (Rs mn)	10,571	15,507	13,819	14,628
EPS (Rs)	56.3	82.5	73.6	77.9
% Chg YoY	(13.7)	46.7	(10.9)	5.9
P/E (x)	14.0	9.6	10.7	10.1
CEPS (Rs)	73.3	101.9	98.9	108.7
EV/E (x)	8.3	5.5	5.7	5.1
Dividend Yield	2.5	2.7	2.9	3.2
RoCE (%)	20.4	25.8	19.9	18.7
RoE (%)	23.6	28.9	21.8	20.2

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Volumes to revive and match industry growth

ACC's volume grew only 4.6% in CY08 and we expect it to grow ~4% in CY09E, at lower-than-industry average of ~9%, due to delay in commissioning of its new capacities. However, over the next 15 months, we expect ACC to add 7.35mnte capacity and match industry growth rate.

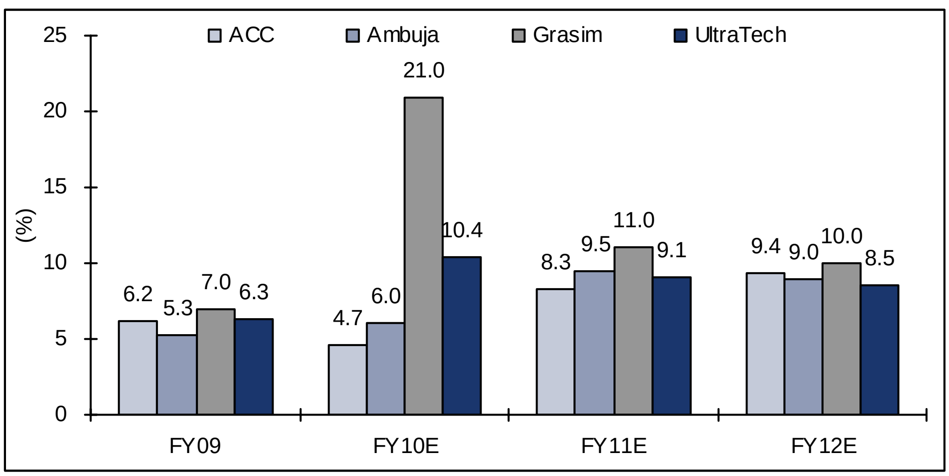
Even after factoring in ongoing delays in commissioning of new capacities, we expect 1.35mnte Bargarh (East region) and 1.2mnte Wadi (South region) unit to be operational by December '09. We expect additional 1.8mnte Wadi and 3mnte Chanda (West region) to be operational by June '10 and December '10 and thus, ACC should be able to match industry growth rate. We expect CY10E & CY11E volume growth to be 8.3% and 9.4% respectively.

Table 1: Capacity addition plans

			Incremental effective capacity		
Company	**CoD**	**Region**	**CY09E**	**CY10E**	**CY11E**
ACC - Bargarh	Dec-09	East	-	1.4	
ACC - Wadi	Dec-09	South		1.2	-
ACC - Wadi	Jun-10	South		0.9	0.9
ACC - Chanda	Dec-10	West		-	3.0

Source: Company data, I-Sec Research

Chart 1: Volume growth comparison



Source: Company data, I-Sec Research

Table 2: Capacity breakdown region-wise in terms of percentage

%	CY08	CY09E	CY10E	CY11E
North	24.9	26.1	23.2	20.4
Central	22.0	19.9	17.7	15.6
East	21.4	21.4	23.0	20.3
South	26.3	28.1	32.1	32.4
West	5.4	4.4	3.9	11.2
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company data, I-Sec Research

ACC continues to be the largest player in India

Table 3: Key markets and market share

	Market share (%)	% of total despatches	9-yr consumption CAGR (%)	Share of total consumption (%)
North				
Uttar Pradesh & Uttaranchal	20.2	19.8	8.9	12.2
Rajasthan	1.9	1.0	9.9	6.1
Punjab	30.9	10.9	6.0	4.4
Haryana	6.50	2.0	12.2	3.8
Himachal Pradesh	45.7	4.6	14.4	1.3
West				
Goa	35.8	0.8	0.7	6.8
Maharashtra	14.0	13.7	7.2	12.2
South				
Tamil Nadu	2.6	1.8	7.4	8.6
Karnataka	16.0	9.6	11.2	7.5
Kerala	11.9	4.5	6.8	4.7
Andhra Pradesh	4.7	3.1	8.5	8.2
East				
West Bengal	15.9	5.9	6.7	4.6
Bihar & Jharkhand	20.5	7.9	10.1	4.8
Orissa	18.9	4.5	10.9	3.0
Central				
Madhya Pradesh and Chhattisgarh	11.0	6.2	9.6	7.0
Total	**12.4**	**96.3**	**8.1**	**100.0**

Source: Cement Manufacturers Association (CMA), I-Sec Research

Table 4: Market share to stabilise at 10.6%

(%)

	CY08	CY09E	CY10E	CY11E
ACC	11.3	10.8	10.7	10.6
ACEM	9.6	9.4	9.4	9.3
Grasim	8.8	9.8	9.9	9.9
UTCL	9.9	10.0	9.9	9.8

Source: Company data, I-Sec Research

Realisations to dip 5% in CY10E and then inch up 0.5% in CY11E

ACC remains the largest cement player with pan-India presence. This helps insulate the company from regional variations in demand and prices. We do not expect utilisations to fall below 85% for ACC over CY09E-11E. We factor in 5% drop and a marginal 0.5% rise in net realisations in CY10E and CY11E respectively for ACC as incremental capacities are added in South and West. We expect CY10E & CY11E revenues to grow 3% and 9.7% respectively.

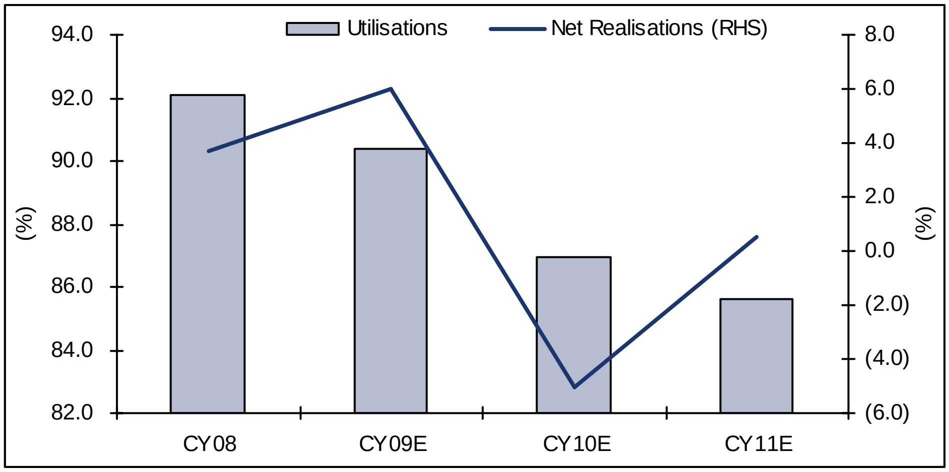
Table 5: Realisation growth among peers

(%)

	All India	ACC	ACEM	UTCL	Grasim
FY09	3.8	3.7	2.2	4.5	4.1
FY10E	5.5	6.0	4.6	2.2	4.0
FY11E	(5.3)	(5.0)	(4.0)	(6.0)	(4.5)
FY12E	0.9	0.5	0.8	0.4	0.7

Source: Company data, I-Sec Research

Chart 2: Utilisation and realisation growth



Source: Company data, I-Sec Research

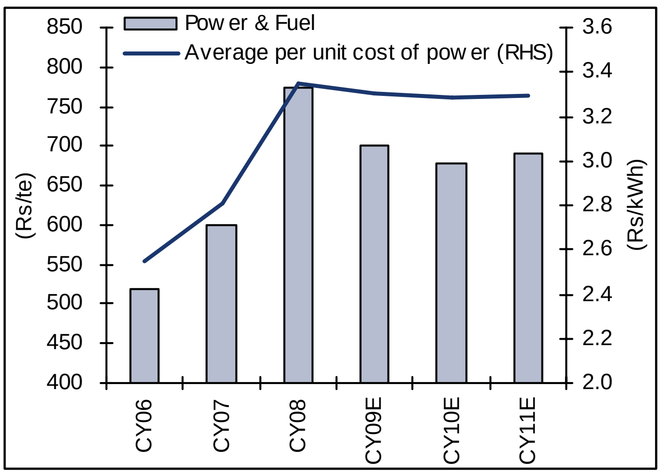
Margin erosion could be restricted

About 85% of ACC's coal requirements are sourced domestically. Imported coal is primarily used at ACC's 1mnte plant in Tamil Nadu. Further, of the total domestic coal consumed, ~20-25% has to be sourced from open markets (due to shortage of domestic coal), where prices are ~25-30% higher than CIL rates. This exposes the company to significant variations in coal cost, depending on the share of coal purchased from open markets. However, we believe ACC's fuel costs are going to be lower than most of its peers who use larger proportion of imported coal or pet coke.

Savings of Rs100/te in power costs over CY08-10E

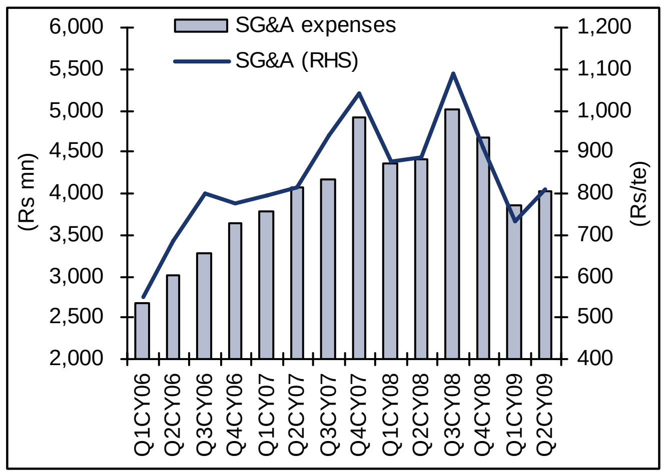
At present, ~70% of ACC's power requirements are met captively. ACC has 241MW captive thermal power capacity and has invested heavily to add another 110MW in CY09. ACC would continue to purchase power from the grid for its Himachal Pradesh plant as it is inexpensive hydro power. We believe ACC would be able to save Rs100/te post the commissioning of new capacities and meet ~85% of its power requirement captively.

Chart 3: Power and fuel costs trend



Source: Company data, I-Sec Research

Chart 4: SG&A expenses



Source: Company data

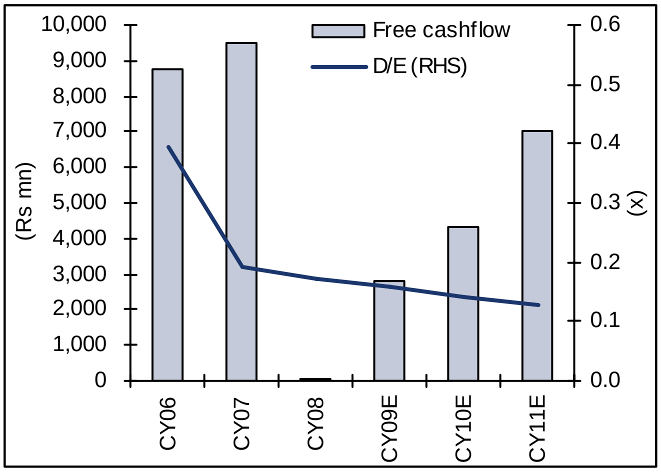
SG&A and other expenses could come down Rs60/te

With increased cost efficiencies and benefit of scale operation, we expect SG&A and other expenses to come down by Rs60/te over CY08-10E. In fact, staff cost and other expenses have come down from Rs1,060/te in H1CY08 to Rs950/te in H1CY09.

Strong balance sheet to fund expansions

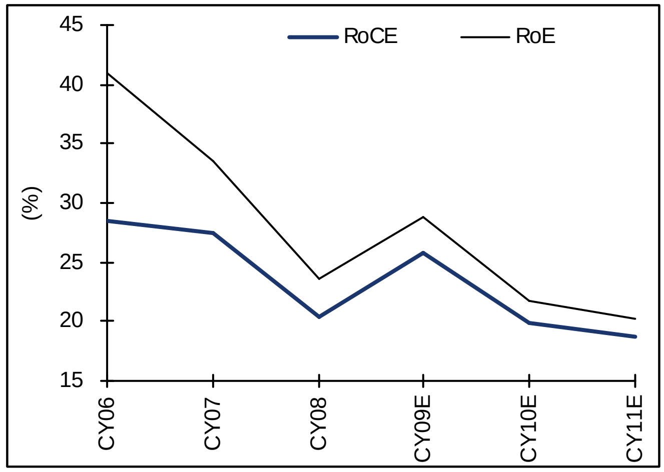
With net cash of Rs10bn, expected operating cashflows of Rs58bn and FCF of Rs14bn over CY09E-11E, we believe ACC would be able to fund its next phase of expansion (likely to be announced soon) via internal accruals.

Chart 5: FCF and D/E



Source: Company data, I-Sec Research

Chart 6: RoCE and RoE trends



Source: Company data, I-Sec Research

ACC is likely to generate FCF of Rs14bn in the next two years despite substantial capex of ~Rs30bn for Wadi (3mnte) and Chanda (3mnte). Therefore, we expect ACC's D/E to remain lower at 0.14x & 0.13x in CY10E & CY11E respectively.

ACC's return ratios are expected to witness a declining trend, mainly owing to slowdown in earnings growth and large capex plan (6mnte), the returns from which are only expected post the commissioning of these capacities.

Earnings CAGR 10.6% through CY08-11E

Table 6: Performance trend and forecast assumptions

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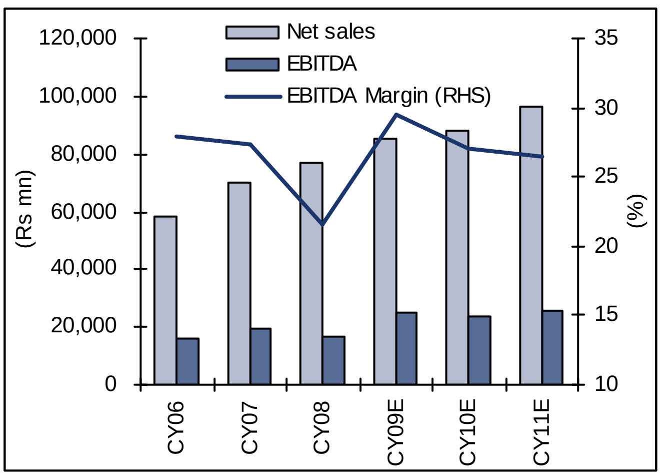
	CY06	CY07	CY08	CY09E	CY10E	CY11E
Capacity	19,909	22,409	22,629	23,979	26,979	29,979
Production	18,733	19,921	20,836	21,666	23,466	25,666
Capacity utilisation (%)	94.1	88.9	92.1	90.4	87.0	85.6
Sales	18,357	19,498	20,702	21,666	23,466	25,666
Growth (%)	45.4	6.2	6.2	4.7	8.3	9.4
Realisations (Rs/te)	2,893	3,282	3,405	3,609	3,429	3,446
Growth (%)	32.1	13.5	3.7	6.0	(5.0)	0.5

Source: I-Sec Research

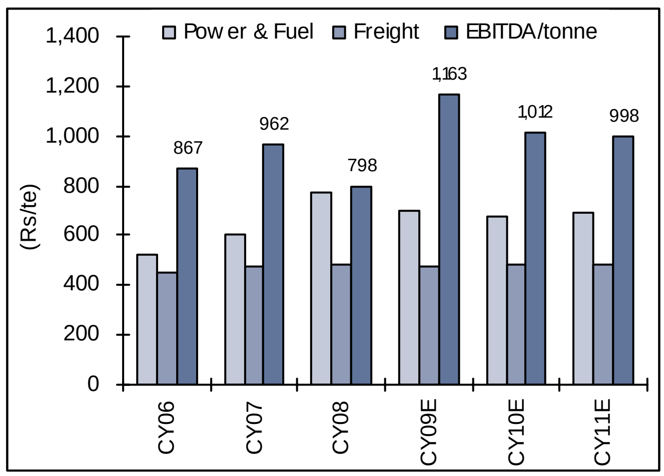
We expect ACC to post CY10E & CY11E volume growth of 8.3% to 23.5mnte and 9.4% to 25.7mnte respectively, broadly in line with the industry. Realisations may dip 5% in CY10E and then firm up 0.5% in CY11E. We expect CY10E & CY11E revenues to grow 3% and 9.7% respectively. We estimate EBITDA margin to move close to 27% through CY09E-11E. Overall, we expect revenue, EBITDA and PAT CAGR of 7.7%, 15.5% and 10.6% over CY08-11E.

Chart 7: Sales, EBITDA and EBITDA margin movement



Source: Company data, I-Sec Research

Chart 8: Key costs and EBITDA/te



Source: I-Sec Research

Table 7: Per ton analysis

(Rs/tonne)

	CY06	CY07	CY08	CY09E	CY10E	CY11E
Net Sales	**3,098**	**3,517**	**3,705**	**3,943**	**3,750**	**3,762**
Raw Material Consumed	478	536	636	632	622	628
Power and Fuel	519	600	774	701	679	692
Freight	451	474	479	478	480	482
Others	782	946	1,019	970	957	963
Total Operating Expenses	**2,231**	**2,555**	**2,907**	**2,780**	**2,738**	**2,764**
EBITDA/tonne	**867**	**962**	**798**	**1,163**	**1,012**	**998**

Source: Company data, I-Sec Research

Table 8: Sensitivity analysis (% change) on CY10 EPS

1% change in realisations from base assumption	3.9
1% change in raw material costs from base assumption	0.7
1% change in power and fuel cost from base assumption	0.7
1% change in freight cost from base assumption	0.5

Source: I-Sec Research

Table 9: Consensus versus I-Sec estimates

(Rs mn)

	PAT			EBITDA			Sales		
	FY10E	**FY11E**	**FY12E**	**FY10E**	**FY11E**	**FY12E**	**FY10E**	**FY11E**	**FY12E**
Consensus estimates	15,487	13,176	12,783	24,504	23,403	22,855	83,946	86,733	91,487
I-Sec estimates	15,507	13,819	14,628	25,197	23,743	25,618	85,430	87,995	96,560
Variations (%)	0.1	4.9	14.4	2.8	1.5	12.1	1.8	1.5	5.5

Source: Bloomberg, I-Sec Research

Key risks

Adverse supply/demand mismatch

In case large number of capacities get commissioned before schedule, an oversupply could result in pricing pressure from FY10E itself. Further, with housing and infrastructure being key demand drivers, significant slowdown in either housing or infrastructure project implementation could affect demand estimates.

Increased pricing pressure

Sector performance, to a large extent, is dependent on pricing movements. We have factored in 5% dip in average realisations through FY11E. Any further decline would pose a downside risk to our estimates.

Government interference

In the past, the Government has resorted to measures such as ban on exports, increasing duty, different duty structure for different levels of cement prices etc, which could affect the growth of the sector and pose downside risks to our estimates.

Input cost pressure

Historically, cement companies were able to pass on the rise in input cost to end consumers. However, in a scenario of oversupply, we believe the company may not be able to do so. Substantial increase in international coal price, domestic coal price and crude oil can pose downside risks to our estimates.

ACC (Buy) – Target price Rs910

Valuations attractive

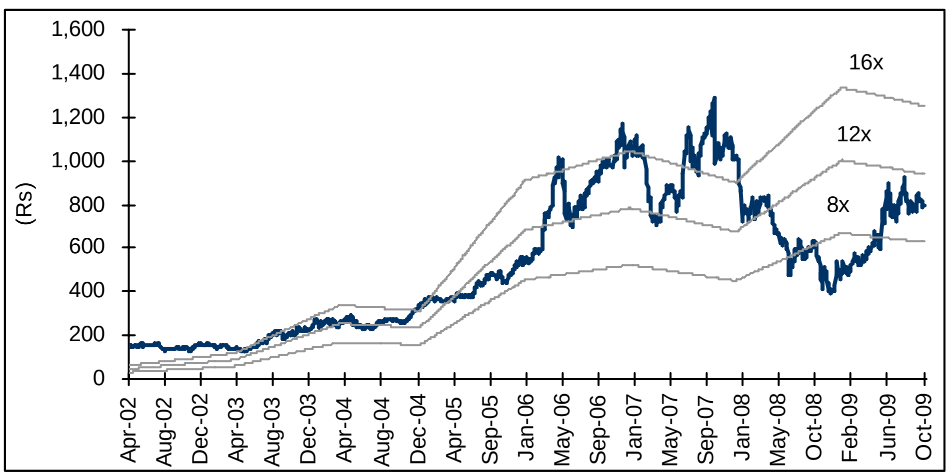
At the current market price, ACC is valued at CY10E & CY11E P/E of 10.7x and 10.1x and EV/E of 5.7x & 5.1x respectively. On EV/te, the company is valued at US$102, which, we believe, is not expensive for the industry leader given its pan-India diversified presence and healthy return ratios, far exceeding cost of capital. We reinitiate coverage on ACC with BUY and 12-month target price of Rs910/share (6x CY11E EV/EBITDA). With deteriorating earnings profile over the next two years, we expect it to trade at a discount to ACEM.

Table 10: Valuations based on CY11

Target EV/ EBITDA multiple (x)	6
Target EV (Rsmn)	153,708
Net debt / (cash) (Rsmn)	(17,381)
Target value (Rsmn)	171,088
No. of shares (mn)	187.88
Target price per share (Rs)	910

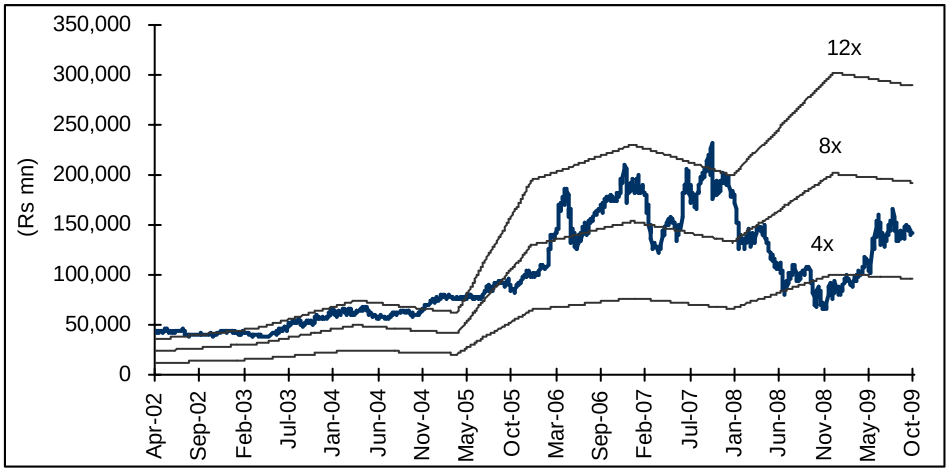
Source: I-Sec Research

Chart 9: Rolling P/E bands



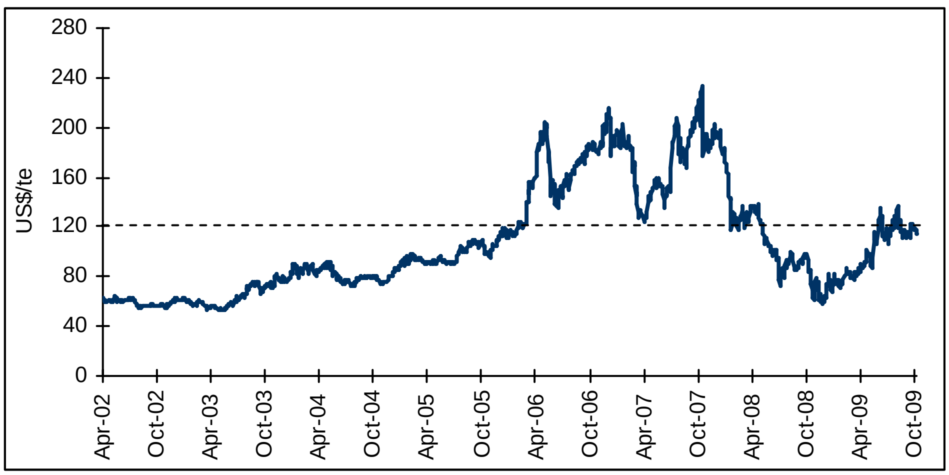
Source: Bloomberg, I-Sec Research

Chart 10: Rolling EV/E bands



Source: Bloomberg, I-Sec Research

Chart 11: Rolling EV/te



Source: Bloomberg, I-Sec Research

Financial summary (consolidated)

Table 11: Profit and Loss Statement

(Rs mn, year ending Dec 31)

	CY06	CY07	CY08	CY09E	CY10E	CY11E
Gross Sales	**64,531**	**78,483**	**86,594.1**	**92,862**	**95,651**	**104,961**
Less: Excise Duty	6,496	8,412	9,397	7,432	7,656	8,401
Net Sales	**58,035**	**70,072**	**77,197**	**85,430**	**87,995**	**96,560**
of which Export Sales						
of which Domestic Sales	*58,035*	*70,072*	*77,197*	*85,430*	*87,995*	*96,560*
Total Operating Income	**58,035**	**70,072**	**77,197**	**85,430**	**87,995**	**96,560**
Less:						
Raw Material Consumed	8,962	10,670	13,248	13,686	14,599	16,109
Other Manufacturing Expenses	8,863	12,253	13,461	13,663	14,570	16,125
Power and Fuel	9,727	11,946	16,118	15,183	15,925	17,754
Personnel Expenses	3,282	3,581	4,464	3,928	4,242	4,624
Selling and Distribution Expenses	2,511	3,005	3,308	3,417	3,652	3,959
Freight	8,458	9,442	9,975	10,356	11,264	12,371
Total Operating Expenses	**41,803**	**50,898**	**60,573**	**60,233**	**64,252**	**70,943**
EBITDA	**16,232**	**19,174**	**16,624**	**25,197**	**23,743**	**25,618**
EBITDA (%)	28.0	27.4	21.5	29.5	27.0	26.5
Depreciation & Amortisation	2,543	3,051	3,205	3,639	4,757	5,798
Other Income	1,560	1,787	2,779	2,450	2,660	3,024
EBIT	**15,250**	**17,911**	**16,198**	**24,008**	**21,645**	**22,844**
Less: Gross Interest	752	739	400	922	1,075	1,068
Recurring Pre-tax Income	**14,498**	**17,172**	**15,822**	**23,111**	**20,595**	**21,800**
Add: Extraordinary Income /Profit from discontinuing operations	1,697	2131	426			
Less: Extraordinary Expenses	189					
Profit from discontinuing operations(Net of Tax)						
Less: Taxation	3,688	4,917	5,252	7,603	6,776	7,172
--Current Tax	3,740	4,767	5,215	7,557	6,735	7,129
--Deferred Tax	(52)	150	37	46	41	44
Net Income (Reported)	**12,318**	**14,386**	**10,996**	**15,507**	**13,819**	**14,628**
Share of Earnings of Associates			24	24	24	24
Minority Interest			0	0	0	0
Recurring Net Income	**10,810**	**12,255**	**10,571**	**15,507**	**13,819**	**14,628**

Source: Company data, I-Sec Research

Table 12: Balance Sheet

(Rs mn, year ending Dec 31)

	CY06	CY07	CY08	CY09E	CY10E	CY11E
ASSETS						
Current Assets, Loans & Advances						
Cash & Bank balance	6,202	7,435	9,915	9,788	10,236	11,666
Inventory	6,241	7,309	7,993	7,913	8,369	8,509
Sundry Debtors	2,140	2,893	3,579	3,960	4,079	4,476
Loans and Advances	4,939	4,205	5,321	5,635	5,726	5,825
Other Current Assets	161	189	220	200	200	200
Total Current Assets	**19,683**	**22,030**	**27,028**	**27,496**	**28,610**	**30,676**
Current Liabilities & Provisions						
Current Liabilities	**10,247**	**13,922**	**18,763**	**20,121**	**21,574**	**23,809**
Sundry Creditors	8,545	12,075	15,339	16,355	17,431	19,252
Other Current Liabilities	1,703	1,847	3,424	3,766	4,143	4,557
Provisions	**4,643**	**6,663**	**9,655**	**10,994**	**12,522**	**14,267**
Total Current Liabilities and Provisions	**14,890**	**20,585**	**28,418**	**31,115**	**34,096**	**38,076**
Net Current Assets	**4,792**	**1,445**	**(1,390)**	**(3,619)**	**(5,486)**	**(7,400)**
Investments						
Strategic & Group Investments	789	958	461	461	461	461
Other Marketable Investments	4,247	7,490	4,708	6,591	8,239	11,535
Total Investments	**5,035**	**8,448**	**5,169**	**7,052**	**8,700**	**11,996**
Goodwill						
Fixed Assets						
Gross Block	48,163	54,641	61,140	78,809	94,189	109,241
Less Accumulated Depreciation	18,938	21,494	24,536	28,175	32,932	38,730
Net Block	29,225	33,147	36,604	50,634	61,257	70,511
Add: Capital Work in Progress	4,734	6,492	16,114	14,503	13,052	11,747
Less: Revaluation Reserve						
Total Fixed Assets	**33,959**	**39,639**	**52,718**	**65,137**	**74,309**	**82,258**
of which intangibles	*-*	*-*	*893*	*224*	*-*	*-*
Total Assets	**43,787**	**49,533**	**56,497**	**68,570**	**77,523**	**86,854**
of which cash and cash equivalents	10,448	14,925	14,623	16,379	18,475	23,201
LIABILITIES AND SHAREHOLDERS' EQUITY						
Borrowings						
Short Term Debt	1,719	1,787	-	-	-	-
Non-Convertible Preference Shares						
Long Term Debt	7,441	2,904	4,820	5,820	5,820	5,820
Total Borrowings	**9,160**	**4,691**	**4,820**	**5,820**	**5,820**	**5,820**
Deferred Tax Liability	**3,207**	**3,315**	**3,421**	**3,592**	**3,771**	**3,960**
Share Capital						
Paid up Equity Share Capital	1,878	1,879	1,879	1,879	1,879	1,879
No. of Shares outstanding (mn)	*188*	*188*	*188*	*188*	*188*	*188*
No. of Warrants outstanding (mn)*						
Face Value per share (Rs)	*10*	*10*	*10*	*10*	*10*	*10*
Preference Share Capital (convertible)						
Reserves & Surplus						
Share Premium	8,312	8,415	8,429	8,429	8,429	8,429
General & Other Reserve	21,240	31,233	37,934	48,826	57,589	66,722
Less: Misc. Exp. not written off	9	-	11	8	6	5
Less: Revaluation Reserve						
Net Worth	**31,420**	**41,527**	**48,231**	**59,125**	**67,891**	**77,025**
Minority Interest			**25**	**33**	**41**	**49**
Total Liabilities & Shareholders' Equity	**43,787**	**49,533**	**56,497**	**68,570**	**77,523**	**86,854**

Source: Company data, I-Sec Research

Table 13: Cash Flow Statement

(Rs mn, year ending Dec 31)

	CY06	CY07	CY08	CY09E	CY10E	CY11E
Cash Flow from Operating Activities						
Reported Net Income	12,318	14,386	10,996	15,507	13,819	14,628
Add:						
Depreciation & Amortisation	1,715	2,556	3,043	3,639	4,757	5,798
Provisions	1,831	2,020	2,992	1,338	1,528	1,745
Deferred Taxes	(52)	150	37	46	41	44
Less:						
Other Income	1,560	1,787	2,779	2,450	2,660	3,024
Net Extra-ordinary income	1,508	2,131	426	-	-	-
Operating Cash Flow before Working Capital change (a)	**12,744**	**15,193**	**13,864**	**18,081**	**17,486**	**19,191**
Changes in Working Capital						
(Increase) / Decrease in Inventories	(232)	(1,067)	(685)	81	(456)	(140)
(Increase) / Decrease in Sundry Debtors	(148)	(753)	(686)	(382)	(119)	(397)
(Increase) / Decrease in Operational Loans & Adv.	(427)	733	(1,116)	(313)	(91)	(99)
(Increase) / Decrease in Other Current Assets	154	(27)	(31)	20	-	-
Increase / (Decrease) in Sundry Creditors	832	3,530	3,264	1,016	1,076	1,821
Increase / (Decrease) in Other Current Liabilities	282	145	1,577	342	377	414
Working Capital Inflow / (Outflow) (b)	461	2,560	2,323	764	786	1,600
Net Cash flow from Operating Activities (a) + (b)	**13,205**	**17,754**	**16,186**	**18,844**	**18,272**	**20,790**
as a % of Operating Cash Flow						
Cash Flow from Capital commitments						
Purchase of Fixed Assets	(4,454)	(8,236)	(16,121)	(16,058)	(13,930)	(13,747)
Purchase of Investments	96	(169)	498	-	-	-
Consideration paid for acquisition of undertaking						
Cash Inflow/(outflow) from capital commitments (c)	**(4,358)**	**(8,405)**	**(15,624)**	**(16,058)**	**(13,930)**	**(13,747)**
Free Cash flow after capital commitments (a) + (b) + (c)	**8,848**	**9,348**	**563**	**2,787**	**4,343**	**7,043**
Cash Flow from Investing Activities						
Purchase of Marketable Investments	**(2,194)**	**(3,243)**	**2,782**	**(1,883)**	**(1,648)**	**(3,296)**
(Increase) / Decrease in Other Loans & Advances	-	-	-	-	-	-
Sale of Fixed Assets						
Sale of Investments						
Consideration received for sale of undertaking/division						
Other Income	1,560	1,787	2,779	2,450	2,660	3,024
Net Cash flow from Investing Activities (d)	**(633)**	**(1,456)**	**5,561**	**567**	**1,012**	**(272)**
Cash Flow from Financing Activities						
Issue of Share Capital during the year	22	2	-	-	-	-
Proceeds from fresh borrowings	(2,602)	(4,469)	129	1,000	-	-
Repayment of Borrowings						
Buyback of Shares	-	-	(1)	-	-	-
Dividend paid including tax	(3,203)	(4,388)	(4,391)	(4,616)	(5,056)	(5,495)
Others	1,234	65	193	136	149	155
Net Cash flow from Financing Activities (e)	**(4,549)**	**(8,790)**	**(4,069)**	**(3,480)**	**(4,907)**	**(5,341)**
Net Extra-ordinary Income (f)	**1,508**	**2,131**	**426**	**-**	**-**	**-**
Total Increase / (Decrease) in Cash (a) + (b) + (c) + (d)+ (e) + (f)	**5,174**	**1,233**	**2,480**	**(127)**	**448**	**1,431**
Opening Cash and Bank balance	**1,028**	**6,202**	**7,435**	**9,915**	**9,788**	**10,236**
Closing Cash and Bank balance	**6,202**	**7,435**	**9,915**	**9,788**	**10,236**	**11,666**
Increase/(Decrease) in Cash and Bank balance	**5,174**	**1,233**	**2,480**	**(127)**	**448**	**1,431**

Source: Company data, I-Sec Research

Table 14: Key Ratios

(Year ending Dec 31)

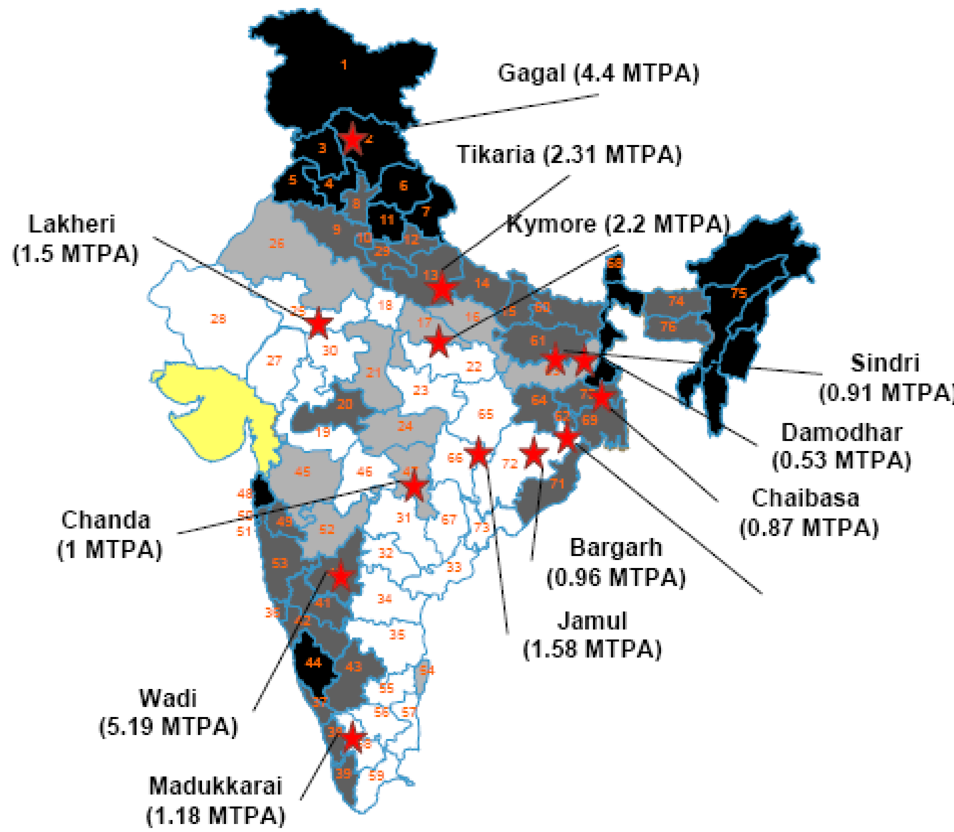
	CY06	CY07	CY08	CY09E	CY10E	CY11E
Per Share Data (Rs)						
Diluted Recurring Earning per share (DEPS)	56.9	65.2	56.3	82.5	73.6	77.9
Diluted Earnings per share	65.6	76.5	58.5	82.5	73.6	77.9
Recurring Cash Earnings per share (CEPS)	71.1	81.4	73.3	101.9	98.9	108.7
Free Cashflow per share (FCPS-post capex)	47.1	49.7	3.0	14.8	23.1	37.5
Reported Book Value (BV)	167.3	221.0	256.7	314.7	361.4	410.0
Adjusted Book Value (ABV)	167.3	221.0	256.7	314.7	361.4	410.0
Dividend per share	15.0	20.0	20.0	21.0	23.0	25.0
Valuation Ratios (x)						
Diluted Price Earning Ratio	13.9	12.1	14.0	9.6	10.7	10.1
Price to Recurring Cash Earnings per share	11.1	9.7	10.8	7.8	8.0	7.3
Price to Book Value	4.7	3.6	3.1	2.5	2.2	1.9
Price to Adjusted Book Value	4.7	3.6	3.1	2.5	2.2	1.9
Price to Sales Ratio	2.6	2.1	1.9	1.7	1.7	1.5
EV / EBITDA	9.3	7.2	8.3	5.5	5.7	5.1
EV / Total Operating Income	2.6	2.0	1.8	1.6	1.5	1.4
EV / Operating Free Cash Flow (Pre-Capex)	11.4	7.8	8.6	7.3	7.4	6.3
EV / Net Operating Free Cash Flow (Post-Capex)	17.0	14.8	246.4	15.8	14.3	7.2
Dividend Yield (%)	1.9	2.5	2.5	2.7	2.9	3.2
Growth Ratios (% YoY)						
Diluted Recurring EPS Growth	190.0	14.5	(13.7)	46.7	(10.9)	5.9
Diluted Recurring CEPS Growth	201.6	14.5	(10.0)	39.0	(3.0)	10.0
Total Operating Income Growth	81.2	20.7	10.2	10.7	3.0	9.7
EBITDA Growth	213.1	18.1	(13.3)	51.6	(5.8)	7.9
Recurring Net Income Growth	295.7	13.4	(13.7)	46.7	(10.9)	5.9
Operating Ratios (%)						
EBITDA Margins	28.0	27.4	21.5	29.5	27.0	26.5
EBIT Margins	26.3	25.6	21.0	28.1	24.6	23.7
Recurring Pre-tax Income Margins	24.3	23.9	19.8	26.3	22.7	21.9
Recurring Net Income Margins	18.1	17.1	13.2	17.6	15.2	14.7
Raw Material Consumed / Sales	15.4	15.2	17.2	16.0	16.6	16.7
SGA Expenses / Sales	4.3	4.3	4.3	4.0	4.2	4.1
Other Income / Pre-tax Income	10.8	10.4	17.6	10.6	12.9	13.9
Effective Tax Rate	22.8	25.5	32.3	32.9	32.9	32.9
Return / Profitability Ratios (%)						
Return on Capital Employed (RoCE)-Overall	28.5	27.4	20.4	25.8	19.9	18.7
Return on Invested Capital (RoIC)	29.8	30.8	23.8	29.4	21.9	20.5
Return on Net Worth (RoNW)	41.0	33.6	23.6	28.9	21.8	20.2
Dividend Payout Ratio	26.3	30.6	35.5	25.4	31.3	32.1
Post tax ROCE	29.5	28.6	20.7	25.8	19.9	18.7
Solvency Ratios / Liquidity Ratios (%)						
Debt Equity Ratio (D/E) (x)	0.4	0.2	0.2	0.2	0.1	0.1
Long Term Debt / Total Debt	0.9	0.8	1.0	1.0	1.0	1.0
Net Working Capital / Total Assets	(0.0)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)
Interest Coverage Ratio-based on EBIT	20.3	24.3	40.5	26.0	20.1	21.4
Debt Servicing Capacity Ratio (DSCR)	7.1	8.2	48.3	29.7	24.3	26.5
Current Ratio	0.9	0.8	0.8	0.7	0.7	0.7
Cash and cash equivalents / Total Assets	23.9	30.1	25.9	23.9	23.8	26.7
Turnover Ratios						
Inventory Turnover Ratio (x)	4.9	5.6	6.0	5.8	6.1	6.6
Assets Turnover Ratio (x)	1.5	1.5	1.5	1.4	1.2	1.2
Working Capital Cycle (days)	(8.6)	(7.6)	(22.4)	(34.1)	(42.5)	(46.2)
Average Collection Period (days)	11.7	11.7	13.6	14.8	15.3	14.9
Average Payment Period (days)	71.0	73.9	82.6	96.0	96.0	94.4

Source: Company data, I-Sec Research

Company overview

ACC is a leading manufacturer of cement and enjoys a pan-India presence. The company has a total cement capacity of 22.63mnte spread across all the five regions –North, East, West, South and Central. The company markets cement through a network of 19 sales units, 54 area offices, and 194 warehouses, which is backed by a countrywide network of over 9,000 dealers who, in turn, are assisted by their sub-dealers. Chart 11 shows the list of cement plants across the country and their capacities.

Chart 12: ACC's cement capacities

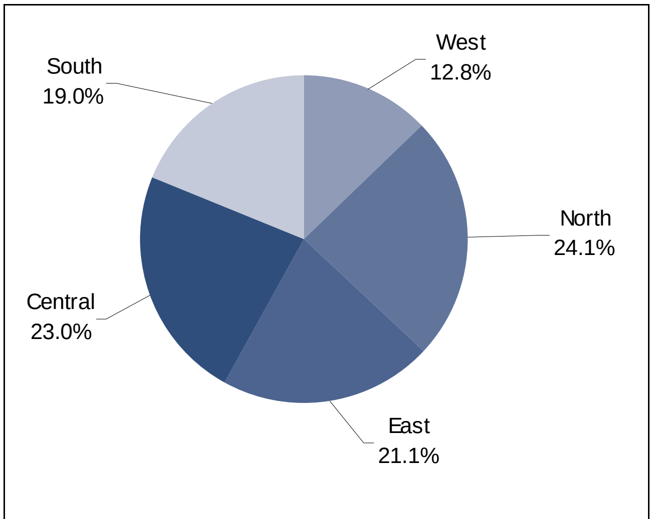


Source: Company data, I-Sec Research

ACC has a fair share of installed capacities in all regions, except in the West where it has a comparatively smaller installed capacity base (5% of the industry in CY08). More than two-thirds of the company's cement despatches are made in the central (23% market share in CY08), northern (24% market share in CY08) and eastern regions (21% market share in CY08).

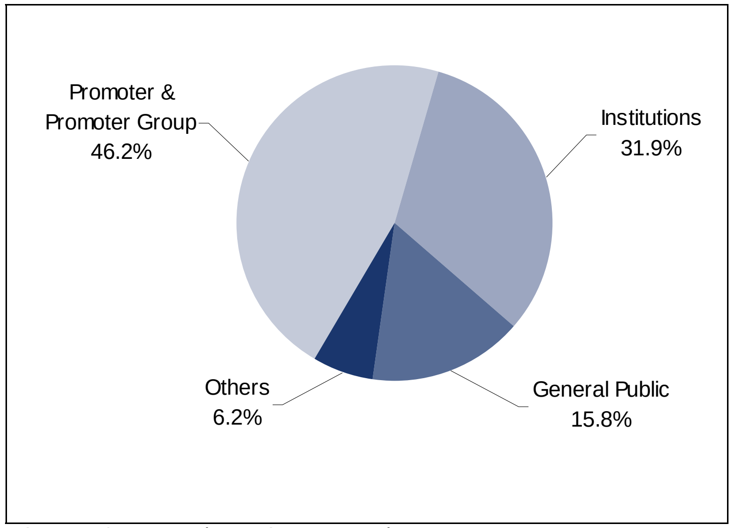
ACC's subsidiaries and associates include ACC Concrete, ACC Mineral Resources, Bulk Cement Corporation (India), Lucky Minmat, and National Limestone Company Private.

Chart 13: Regional cement despatches



Source: Company data, I-Sec Research

Chart 14: Ownership structure



Source: Company data, I-Sec Research

Table 15: Management overview

Name	Designation	Qualification & experience
Mr NS Sekhsaria	Chairman	B.Tech - Chemical Engineering - University of Bombay Assumed the role of Chairman in '06 and is also the founder-promoter of ACEM and is currently serving as the Vice Chairman.
Mr Paul Hugentobler	Deputy Chairman	Degree in Economics Science - University of St. Gallen, Degree in Civil Engg. - ETH, Zurich He has previously served as the CEO of Siam City Cement, Bangkok and also as the Area Manager for Holcim. He has been a Member of Executive Committee since January '02 and is responsible for South Asia and ASEAN, ex-Philippines.
Mr Sumit Banerjee	Managing Director	B.Tech - Mechanical Engg. - IIT Kharagpur He has served earlier as Managing Director of Tube Investments of India and also with Indal and Hindalco group at various leadership positions.
Mr Sunil Nayak	CFO	FCS, FCA, AICWA, Degree in LLB and B.Com Earlier worked with Clariant Chemicals (India)

Source: Company data, I-Sec Research

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I-Sec investment ratings (all ratings relative to Sensex over next 12 months)
BUY: +10% outperformance; **HOLD**: -10% to +10% relative performance; **SELL**: +10% underperformance

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