Batlivala & Karani

B&K SECURITIES
WE UNDERSTAND MONEY

SECTOR UPDATE

12 April 2010

Cement

Pricing to soften in mid term...Lighten exposure in mid term...Long-term story intact

Approaching monsoon period, easing of supply chain bottlenecks and seasonal dip in utilisation rates during a high increased supply situation is bound to bring **prices under pressure in the medium term.** Channel interactions suggest that prices are likely to correct from the sharp reversals seen in the past four months, as utilisations dip during monsoons. Softer prices and increasing cost pressures will mean EBITDA per tonne will come under pressure (but unlikely to be much below the December 2009 quarter levels). Given this scenario and the outperformance (refer Chart 3) to the broader markets, since our report dated 14 January 2010, we believe ~15% correction is likely from current levels.

However, contrary to consensus, in the **longer term** (12+ month view), as outlined in our sector report dated 14 January 2010, we believe the **incremental demand is higher than incremental supply.** Despatches growth in the past two months has been soft at ~4% and ~8.5% respectively largely on account of the supply chain issues. We expect ~10% growth in FY11E demand. Our Banking team forecasts a credit growth of ~20% for FY11E which should spur this demand growth. Utilisation rates inching up post monsoons and supply chain bottlenecks likely to resurface in December 2010, will push prices up once again from December 2010. **Long only investors should use the opportunity in the next six months to increase exposure** to the cement basket.

What do we like on relative valuation basis?

Large Caps – Ambuja Cements

Mid Caps – India Cements, Kesoram Industries and Century Textiles

Companies not under coverage – Orient Paper and JK Cement

What are trading at premium valuations on relative basis

Large Caps – UltraTech, ACC

Mid Caps – Prism Cement, Madras Cements

Company not under coverage – Heidelberg Cement

Read on for detailed analysis...

Chockalingam Narayanan, FRM
chockalingam.n@bksec.com
+91-22-4031 7105

Milind Raginwar
milind.raginwar@bksec.com
+91-22-4031 7117

Varun Bisht
varun.bisht@bksec.com
+91-22-4031 7111

Prices had reversed sharply on the back of strong demand, lower wagon availability and pass-through of cost push

Increased supply and availability of wagons made long inter-regional movements possible and allowed prices to correct steeply in the December 2009 quarter. Seasonal wagon availability issues cropping up in early March 2010 quarter (as they seasonally do) during a strong demand period allowed prices to move up strongly from the depressed levels. However, with the seasonal supply chain issues likely to ease off and high supply continuing in the market, we believe inter-regional movement will once again start and prices are likely to ease off marginally from the current levels. We believe the all-India average retail price per 50 kg bag is likely to see a Rs 15-20 per bag correction from the current level of Rs 247 per 50 kg bag in the coming six months. However, they are unlikely to breach the lows seen in early December 2009.

Chart 1: Rail as a % of despatches

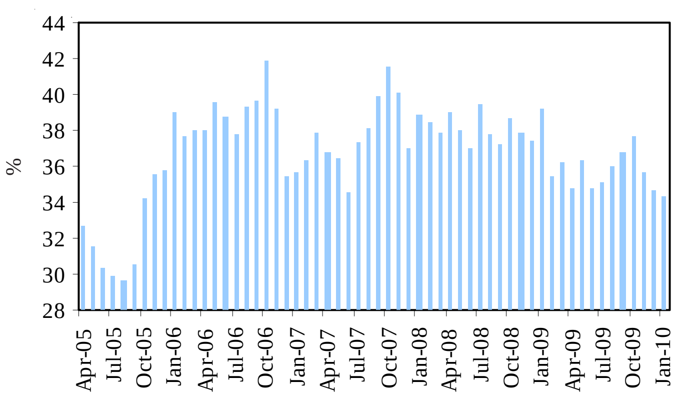
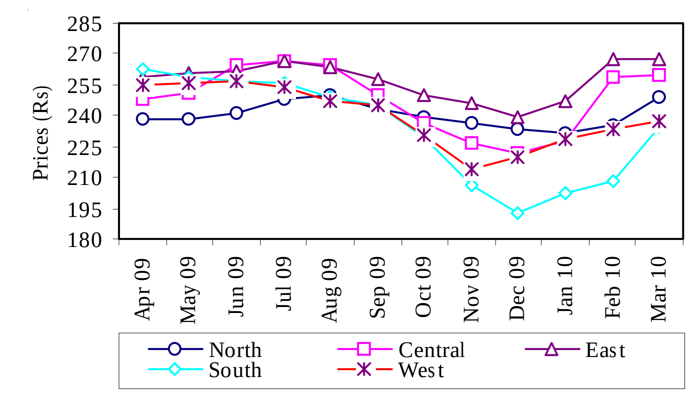
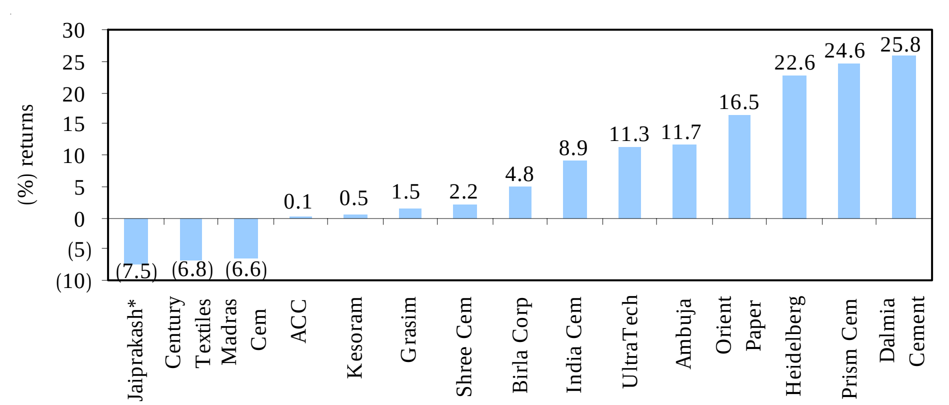


Chart 2: Region-wise retail prices



Source: CMA, Industry, B&K Research

Chart 3: Stocks have outperformed the broader markets since our 14 January 2010 report



Source: B&K Research

EBITDA per tonne will come under pressure in the coming six months

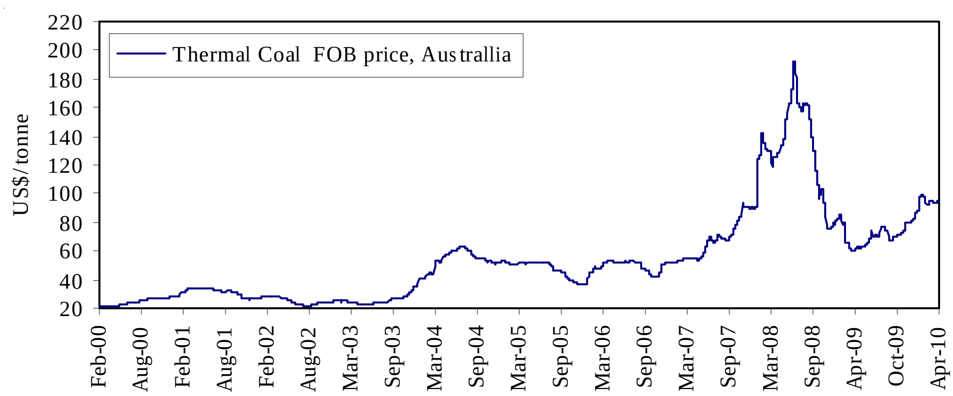
EBITDA per tonne had collapsed for most players in the December 2009 quarter on the back of the steep correction in prices. However, the correction was not fully reflected, as prices in early part of that quarter were better. In the March quarter, we expect the EBITDA per tonne to be only marginally better than the December quarter levels (despite the sharp reversal as base at the start of the quarter was low). It is expected to be marginally better in June 2010 quarter but September 2010 and December 2010 quarters will be soft as cost push is also being felt.

Table 1: EBITDA / tonne (Rs) Quarterly movement

	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09	Dec 09	Mar 10E	FY10E	FY11E
ACC	871	782	883	766	1,095	1,357	1,312	859	1,067	1,217	967
Ambuja	1,075	1,084	990	862	1,017	999	1,018	924	1,180	973	899
Birla Corp	796	1,005	746	807	882	1,322	1,255	992	1,138	1,271	1,036
Century	781	747	571	577	1,061	1,390	1,257	939	1,093	1,184	831
Grasim	1,078	1,183	981	966	1,273	1,466	1,438	1,225	1,175	1,361	1,047
India Cement	1,051	1,227	1,241	921	1,010	1,126	1,054	430	547	697	550
Jaiprakash Asso.	1,077	953	787	809	983	1,255	1,001	865	1,145	967	766
Kesoram Industries	1,162	1,206	1,037	971	1,143	1,268	1,152	667	781	1,025	897
Madras Cement	1,190	1,238	1,193	991	1,102	1,392	1,363	597	637	1,187	883
Prism Cement	1,162	1,050	441	668	1,028	1,572	965	940	1,171	1,237	1,015
Shree Cement	1,233	1,097	861	1,003	1,301	1,668	1,645	1,309	1,387	1,346	1,153
UltraTech	1,007	1,047	798	957	1,052	1,355	1,149	796	774	938	679

Source: Companies, B&K Research. **Note:** Full year figures for ACC and Ambuja Cement are for CY09 and CY10E.

Chart 4: Coal prices on the rise

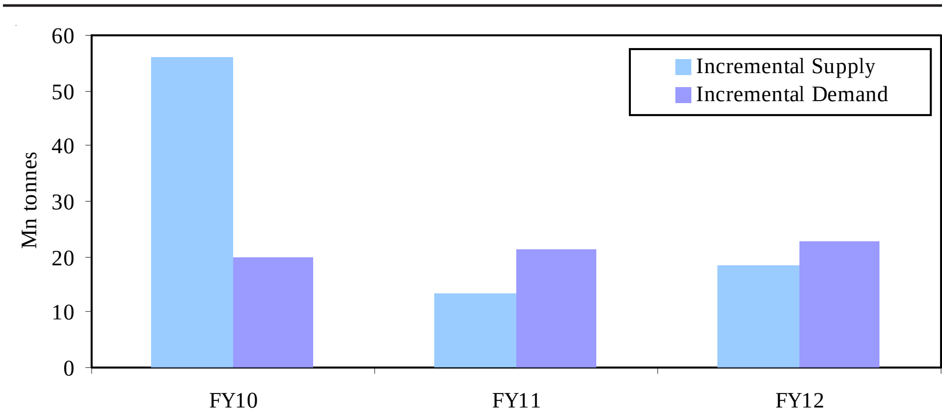


Source: Bloomberg, B&K Research

However...Long-term story remains intact

Demand growth has been strong and is expected to sustain at these levels. Credit offtake, as per our Banking team, is likely to be ~20% in FY11E and this is likely to sustain double digit growth in demand. Moreover, the incremental demand is likely to be higher at these levels than the incremental supply. (Supply as per most on the street as well as CMA is understated.

Chart 5: Incremental demand versus Incremental supply



Source: Industry, B&K Research

Capacities pending for commissioning, hence, are much lower than current street estimates. Please refer our report dated 14 January 2010 for details on the same).

Utilisation levels will improve and supply side infrastructure bottlenecks will resurface during peak months unless a more permanent solution is found (like what is being suggested by Mr Sumit Banerjee, Managing Director, ACC). This, we believe, will allow prices to surpass the previous peaks in prices over a 12-month period.

> *"We expect these problems to remain at least this month," Banerjee said. "There is no short-term solution to this problem, but if we can have a PPP (public private partnership) model in wagons, it can also help to increase investments in an area where there have been none for years."*
>
> *Mr Sumit Banerjee, MD – ACC at the sidelines of the AGM on 08 April 2010*
>
> Source: Mint

Valuations are not expensive from a longer term perspective. Long only investors should use the opportunity to add positions in dips

We believe the valuations are not expensive even at these levels from a longer term perspective. The majority of the industry generated an RoCE in excess of WACC even in the worst of the periods. Return ratios will only improve from here, as prices and capacity utilisation rates improve from these levels.

Table 2: RoCE in December 2009 quarter

Company	December 2009 EBIT / tonne (Rs)	RoCE
ACC	816	24.7
Ambuja Cements	862	23.0
Birla Corp	929	26.9
Century	822	42.2
Grasim	1,025	28.9
India Cements	256	5.3
Jaiprakash Associates	865	8.1
Kesoram Industries	524	19.4
Madras Cements	427	11.8
Prism Cement	835	21.5
Shree Cement	517	16.6
UltraTech	625	18.4

Source: Companies, B&K Research

Premium to replacement cost for larger names is only ~20% and given far healthier balance sheets, we believe the delta can be large over the long-term from these levels. We recommend Long only investors to buy in the dips. Our 18-month target prices on the stocks remain the same as in our report dated 14 January 2010.

Table 3: Valuation matrix

Company	Price	EPS (Rs)		PER (x)		EV/EBITDA (x)		EV/tonne (US$)		6MAD	Target^	Reco
	(Rs)	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	(US$ mn)	price (Rs)	
ACC	956	85.5	68.2	11.2	14.0	6.3	7.4	134	117	10.5	920	UP@
Ambuja	120	8.0	7.5	15.0	15.9	8.6	7.8	147	136	7.5	120	OP
Birla Corp	407	76.1	72.1	5.3	5.6	3.2	3.1	69	63	0.7	388	UP@
Century	533	50.3	40.1	10.6	13.3	3.2	5.2	84	101	11.5	657	BUY
Grasim#	2,884	301.2	258.0	9.6	11.2	5.3	5.7	109	99	12.9	3,165	OP
India Cem	140	13.0	9.0	10.8	15.5	5.4	6.6	84	80	5.5	145	OP
Jaiprakash Asso.*	152	5.2	5.1	29.2	29.7	7.9	8.7	110	99	54.5	147	UP
Kesoram Ind.	408	57.0	62.6	7.2	6.5	5.8	6.0	117	119	0.9	435	OP
Madras Cement	124	15.0	9.3	8.3	13.4	5.1	6.0	101	99	1.2	114	UP@
Prism Cement	64	7.7	5.6	8.3	11.5	5.9	8.0	76	85	2.1	45	UP@
Shree Cement	2,312	279.3	237.2	8.3	9.7	5.9	4.9	146	129	0.9	1,944	UP@
UltraTech	1,160	83.9	62.9	13.8	18.4	7.8	9.1	137	128	5.8	1,132	UP@

Note: ACC and Ambuja numbers are CY09 and CY10E numbers. **Note:** @UP – Downgrade to Underperformer. UP – Underperformer, OP – Outperformer. #Consolidated, *Standalone, ^9 month target price.

B&K Securities is the trading name of Batlivala & Karani Securities India Pvt. Ltd.

B&K Investment Ratings:

1. **BUY:** Potential upside of > +25% (absolute returns)
2. **OUTPERFORMER:** 0 to +25%
3. **UNDERPERFORMER:** 0 to -25%
4. **SELL:** Potential downside of < -25% (absolute returns)

The information contained herein is confidential and is intended solely for the addressee(s). Any unauthorized access, use, reproduction, disclosure or dissemination is prohibited. This information does not constitute or form part of and should not be construed as, any offer for sale or subscription of or any invitation to offer to buy or subscribe for any securities. The information and opinions on which this communication is based have been complied or arrived at from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to their accuracy, correctness and are subject to change without notice. Batlivala & Karani Securities India P Ltd and/ or its clients may have positions in or options on the securities mentioned in this report or any related investments, may effect transactions or may buy, sell or offer to buy or sell such securities or any related investments. Recipient/s should consider this report only for secondary market investments and as only a single factor in making their investment decision. The information enclosed in the report has not been vetted by the compliance department due to the time sensitivity of the information/document. Some investments discussed in this report have a high level of volatility. High volatility investments may experience sudden and large falls in their value causing losses when the investment is realized. Those losses may equal your original investment. Some investments may not be readily realizable and it may be difficult to sell or realize those investments, similarly it may prove difficult for you to obtain reliable information about the value, risks to which such an investment is exposed. Neither B&K Securities nor any of its affiliates shall assume any legal liability or responsibility for any incorrect, misleading or altered information contained herein.

Analyst Declaration: We, Chockalingam Narayanan, Milind Raginwar & Varun Bisht, hereby certify that the views expressed in this report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendation or view expressed in this report.

B & K SECURITIES INDIA PRIVATE LTD.
Equity Research Division: City Ice Bldg., 298, Ground/1st Floor, Perin Nariman Street, Behind RBI, Fort, Mumbai - 400 001, India. Tel.: 91-22-4031 7000, Fax: 91-22-2263 5020/30.
Registered Office: Room No. 3/4, 7 Lyons Range, Kolkata - 700 001. Tel.: 91-33-2243 7902.

B&K Research is also available on Bloomberg <BNKI>, Thomson First Call & Investext.