

March 20, 2006

Industry View  
Attractive

## India Cement

### Pricing On Track for Blowout

#### Volumes up 16.4% YoY, prices up 6.3% MoM.

February saw a return to market share losses on a regional basis. The top regional players lost market share in three of the four regions (shares were stable in the North). The losses were accompanied by pricing gains MoM in all four regions. More important, in our view, pricing (Rs171 per bag) moved up a strong 6.3% MoM from last month's 5-year high, reflecting the strength of this cycle. We continue to expect slower volume growth and stronger pricing in F2007 across all regions.

**Northern region's recovery gains strength.** The Northern market gained on volume growth in February albeit from a smaller base a year ago. Despite the market share of the top four players in the region remaining at January levels, pricing moved up MoM. Volumes jumped 17.1% YoY (though from a low base), while pricing moved up a strong 9% MoM. We continue to believe that, given the high capacity utilization in the region (90% in February 2006), pricing growth should continue in the next few months.

**Southern recovery continued:** The recovery in the Southern region continued, with YoY volume growth at 28.2% in February (despite a slightly larger base in February). Prices also continued their upward trend, rising 1.5% MoM (YoY prices were up 4.1%). We believe that volume growth will slow (more in line with the rest of India) over the next couple of quarters as the low base effect stops having an impact on the region. We also expect pricing to strengthen further in the region.

#### MSCI Country: India

|  |      |
|--|------|
| Asia Strategist's Recommended Weight   | 4.1% |
| MSCI Asia/Pac All Country Ex Jp Weight | 5.4% |

#### Companies Featured

| Company             | Rating     |
|---------------------|------------|
| ACC (Rs759.05)      | Overweight |
| Grasim (Rs1,924.25) | Overweight |
| Gujarat (Rs97.8)    | Overweight |
| Ultratech (Rs630.8) | Overweight |

Source: Morgan Stanley Research:

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## Investment Case

### Summary & Conclusions

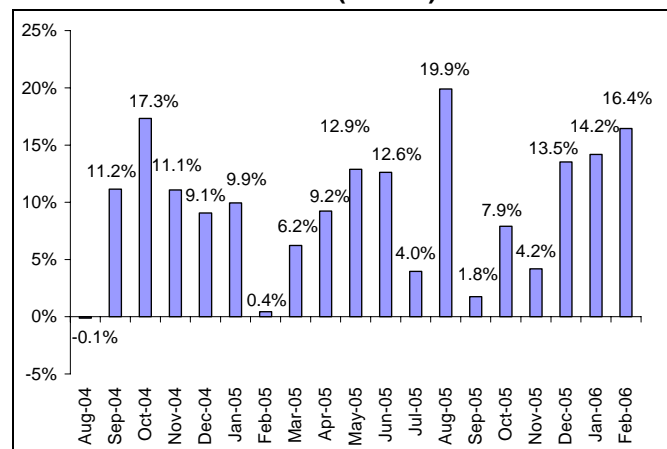
Volume growth remained strong at 16.4% YoY in February albeit on a weak base in February 2005. Helped by market share losses of the top regional players in three of the four regions (the North being the exception), prices jumped 6.3% MoM to Rs171 per bag of cement. This growth comes on top of pricing hitting a five-year high last month, and we expect strong pricing and pricing discipline among the top players to continue. We maintain our expectation of a pricing blowout in F2007.

The recovery in the Northern market that started in October 2005 gained further strength in February, with growth of 33% YoY in value terms (vs. 29% in January). We suspect that the low base might be the main reason for the strong jump in volumes (YoY), while high utilizations (90%) coupled with the lack of market share gains by the top players resulted in the MoM pricing uptrend. Given the high capacity utilization in the region, we expect the region's recovery to strengthen, especially on the pricing front. The Southern region's pricing continued its upward trajectory with a rise of 1.5% MoM, and continued to deliver on volumes with a strong 28.2% YoY growth in the month.

We continue to believe that ACC is best positioned in the industry in the short term, given its higher leverage to cement prices and a volume recovery in the Southern region, coupled with the change in management. Grasim and Ultratech also have significant exposure to the South and could benefit.

Exhibit 1

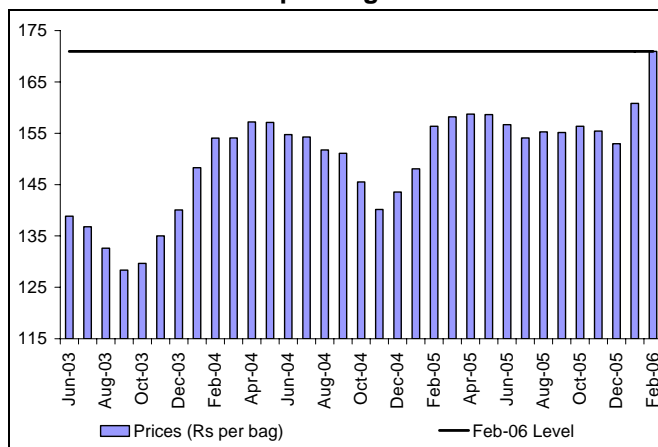
### All India Demand Growth (% YoY)



Source: CMA, Morgan Stanley Research

Exhibit 2

### India Cement: Prices per Bag



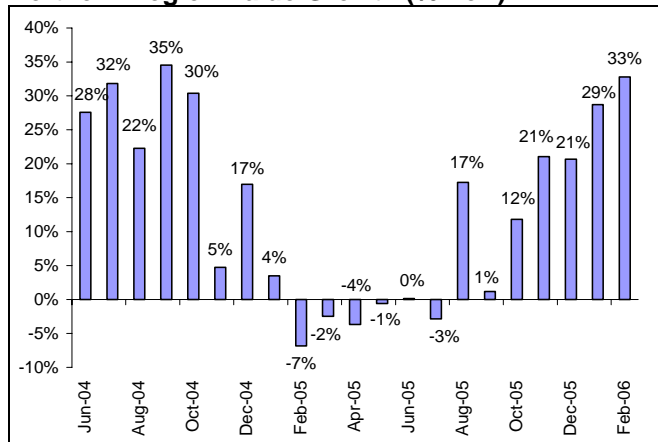
Source: CMA, Morgan Stanley Research

### February 2006 Developments

**Northern market recovery strengthens.** The recovery that resumed in October 2005 continued to move into higher gear in February, with value growth accelerating to 33% YoY. While volumes jumped 17.1% YoY, pricing increased 13.4% YoY to the highest levels in the last five years (up 900 bps MoM.) Given the high capacity utilization in the region (90% in February 2006), we expect the region's recovery to continue for the next couple of quarters. The low base effect over the next two quarters should push growth to higher levels relative to the rest of India. With prices in Delhi at Rs190 a bag, the Northern region seems the closest to a pricing blowout.

Exhibit 3

### Northern Region Value Growth (% YoY)

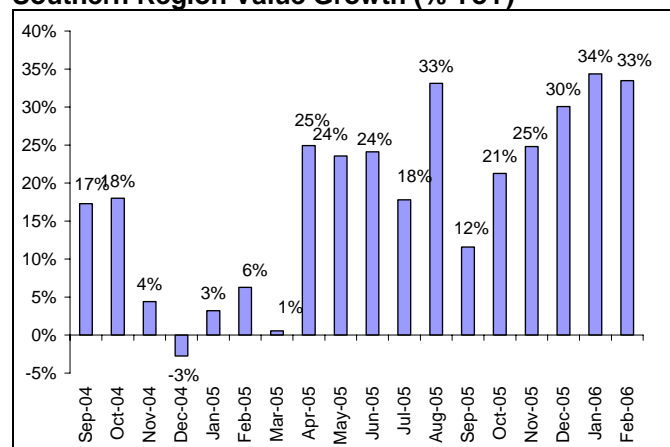


Source: CMA, Morgan Stanley Research

**Southern pricing and volumes up in line with expectations.** The region's volumes continued to grow strongly in February, rising 28.2% YoY. Pricing continued its uptrend, which resumed in January, moving up 150 bps MoM on market share losses among the top four players in the region. We expect the volume growth trend to continue in March as the base effect strengthens. YoY growth in value terms was 33.5% (Exhibit 4) in February (the strongest in the last 40 months with the exception of January). The main beneficiaries of the Southern recovery, in our view, would be UltraTech and ACC, which depend heavily on that region. We expect volume growth to move down in F2007, as the larger (more normalized) base comes into play from April 2005.

Exhibit 4

**India Cement:  
Southern Region Value Growth (% YoY)**



Source: CMA, Morgan Stanley Research

**Pricing: Strong on Market Share Losses**

**East.** In February, for the third straight month, the trend in the Eastern region continued to reflect the negative relationship between the market share of the top four players and price per bag of cement. While the top players' market share dipped 120 bps MoM to 60.6%, prices moved up by 620 bps MoM in February.

**West.** Prices in the region moved up 8.2% MoM in February on the MoM drop of 60 bps in market share of the top four producers to 57.6%, mainly as a result of market share losses

in Madhya Pradesh. The strength in pricing was also due to the high capacity utilization of 97% in the month (versus 90% for India.)

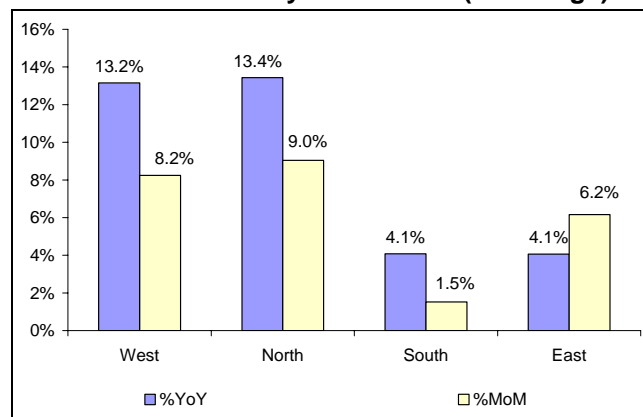
**North.** Prices per bag moved up by 9% MoM to Rs178 in the face of an insignificant gain of 2 bps in market share of the top four players (52.5% vs. 52.5% in January 2006).

**South.** Market share among the top four players in this region registered a marginal decline of 10 bps in February to 47.2% from 47.3% in January. With the downtick in market share, prices registered a 1.5% MoM increase to Rs161 per bag.

**All India.** Pricing reverted to its typical trend, with the top four companies losing market share in three of the four regions (the North being the exception). The negative relationship between market share and pricing was reflected in the month except in the Northern region where pricing increased even though there were no market share losses. All other regions showed pricing increases on the back of the market share losses. On a YoY basis, prices rose 9.3% (a significant acceleration from 4.6% YTD to January 2006). We believe prices are on track to meet our 5% growth estimate in F2006. Exhibits 6–9 show market shares and pricing for the four regions.

Exhibit 5

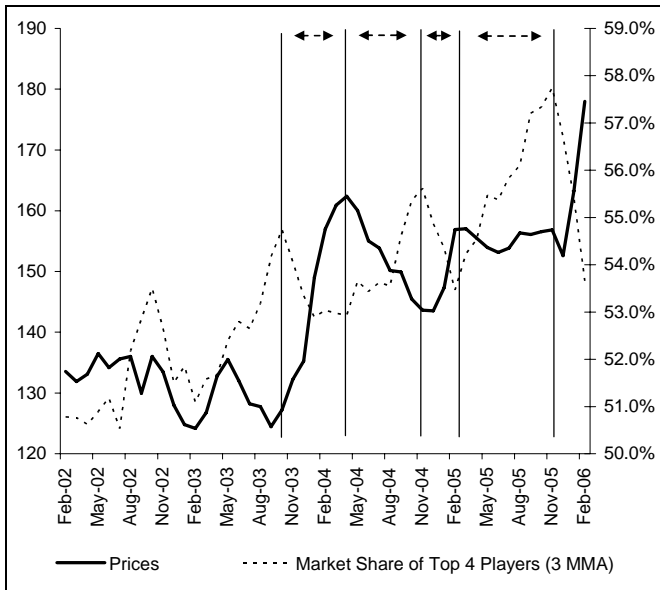
**India Cement: February 2006 Prices (% Change)**



Source: CMA, Morgan Stanley Research

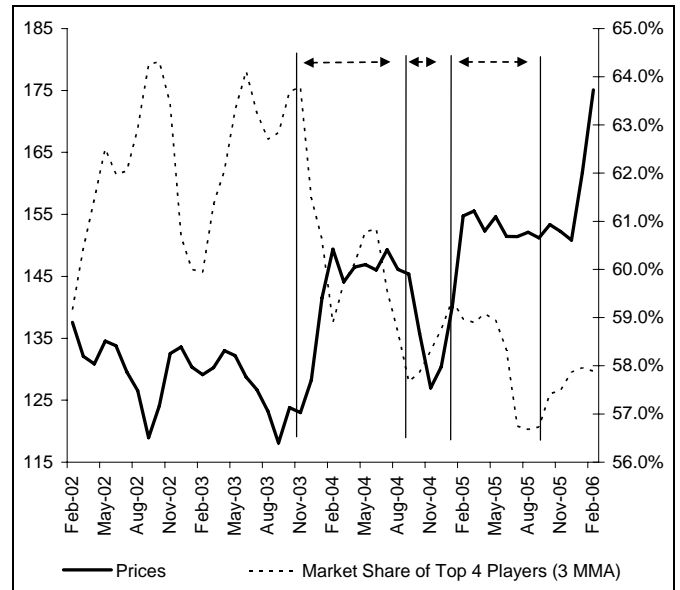
## Pricing Discipline in the Current Uptrend

Exhibit 6  
**India Cement: Northern Region**



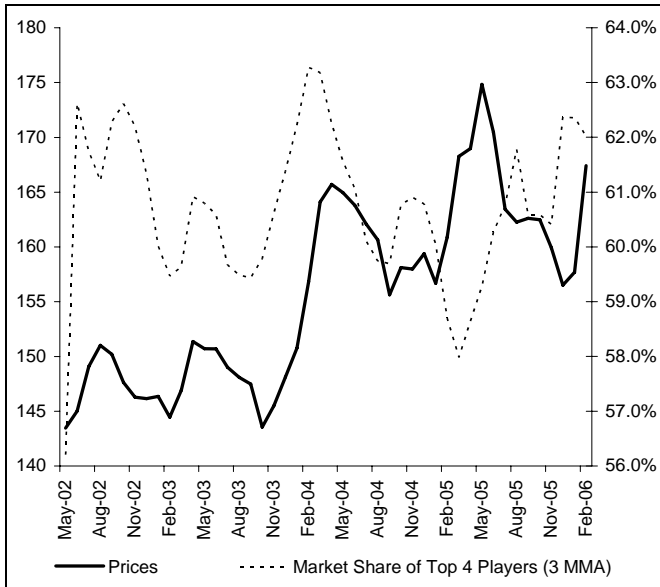
Source: CMA, Morgan Stanley Research

Exhibit 8  
**India Cement: Western Region**



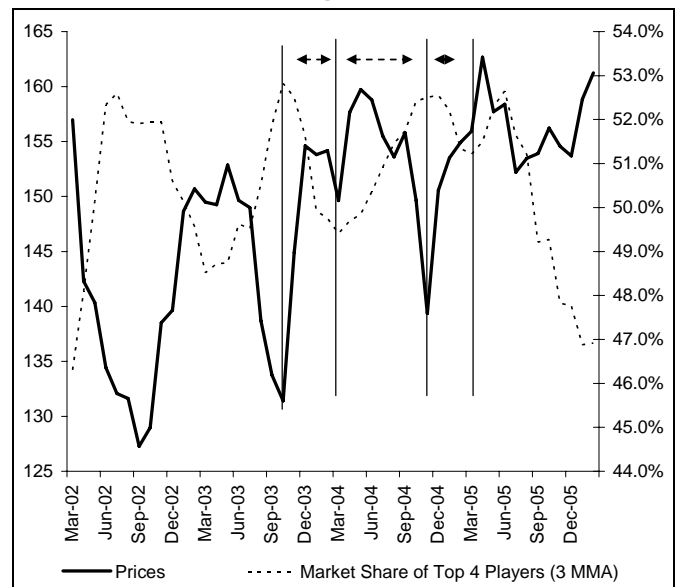
Source: CMA, Morgan Stanley Research

Exhibit 7  
**India Cement: Eastern Region**



Source: CMA, Morgan Stanley Research

Exhibit 9  
**India Cement: Southern Region**



Source: CMA, Morgan Stanley Research

**Demand Growth: Stronger than Expectations**

**East.** With the lower base of February 2005, volume growth moved up slightly to 1.9% YoY, with volumes rising to 1.7 million tons in February 2006 (Exhibit 10). We expect similar volume growth in March on a higher base a year ago.

**West.** With a smaller base in February 2005, the region showed a pickup from the 8.1% volume growth in January to 13.2% in February 2006, with overall consumption moving up to 3.3 million tons (Exhibits 11 and 12). The pickup was mainly due to the 34% jump in volumes in Gujarat.

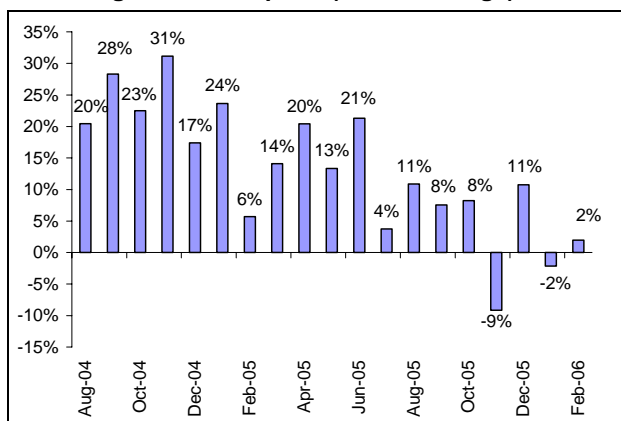
**North.** The recovery strengthened on a low base with a volume increase of 17.1% for February 2006 to 3.5 million tons (Exhibit 13). With a small base in March 2005 too, we expect strong growth to continue (though slower than in February.)

**South.** The strong recovery of the Southern region continued on a low base as volume growth clocked 28.2% YoY (Exhibit 14). Consumption for the region in February 2006 stood at 3.3 million tons. We expect the recovery to abate over the next two quarters as the higher base catches up with the region's volume growth.

**All India.** Demand growth accelerated from 14.2% in January 2006 to 16.4% YoY in February 2006 (on the lower base in February 2005), helped by the loss in market share among the top producers in three of the four regions. Pricing jumped 6.3% MoM, while YoY growth strengthened to 9.3%. We believe the top players will have to continue to take market share cuts by dropping dispatches to move prices higher over the next 12 months.

Exhibit 10

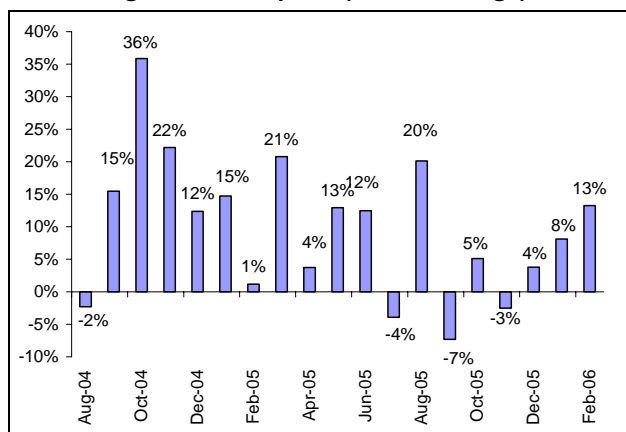
**India Cement: Eastern Region Consumption (YoY % Change)**



Source: CMA, Morgan Stanley Research

Exhibit 11

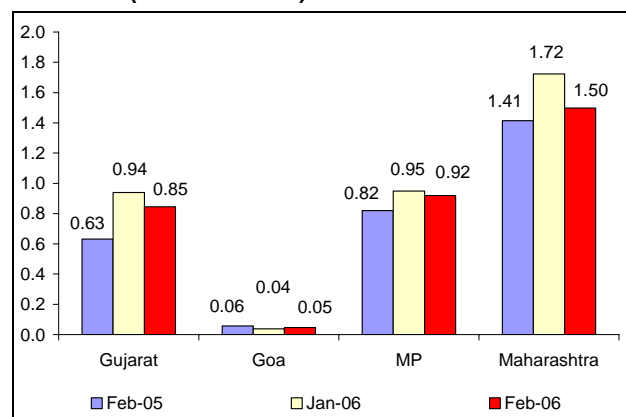
**India Cement: Western Region Consumption (YoY % Change)**



Source: CMA, Morgan Stanley Research

Exhibit 12

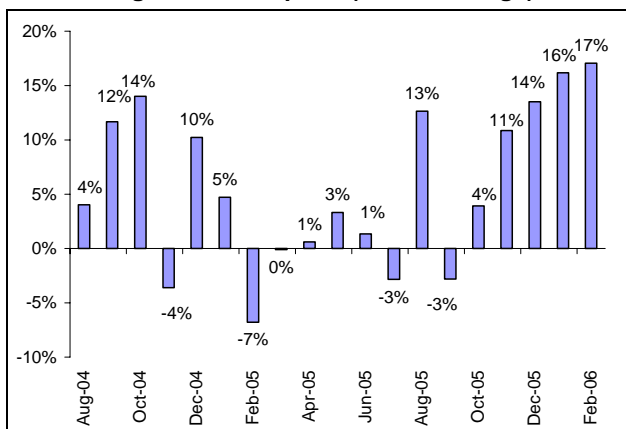
**India Cement: Western Region Consumption Breakdown (million tonnes)**



Source: CMA, Morgan Stanley Research

Exhibit 13

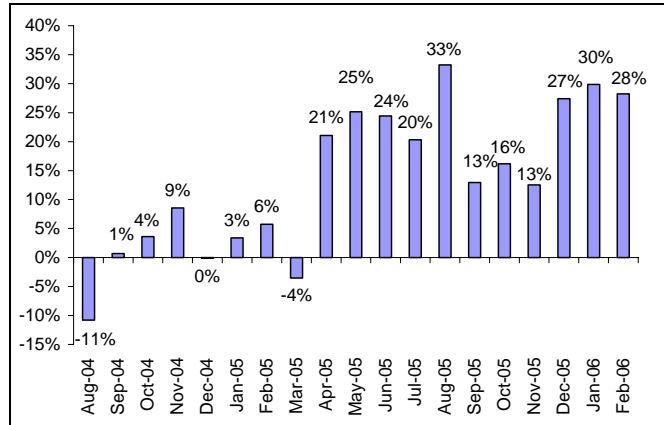
**India Cement: Northern Region Consumption (YoY % Change)**



Source: CMA, Morgan Stanley Research

Exhibit 14

**India Cement: Southern Region Consumption (YoY % Change)**



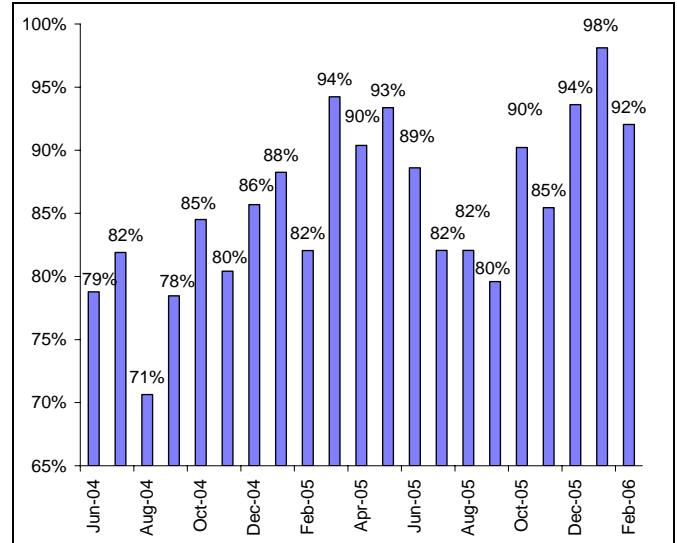
Source: CMA, Morgan Stanley Research

**Utilization**

With only 6.7 million tons of capacity being added in the last 12 months (Exhibit 15), the increase in demand outstripped the increase in capacity, leading to higher utilization at 92% in February 2006 versus 82% in February 2005. However, the utilization rate did slip slightly from the five-year high of 98% in January 2006 (Exhibit 16).

Exhibit 16

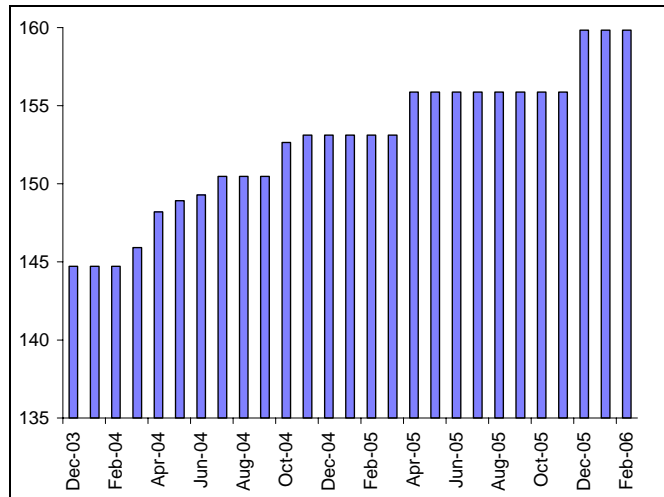
**India Cement: Utilization (%)**



Source: CMA, Morgan Stanley Research

Exhibit 15

**India Cement: Annual Capacity (mn tons)**



Source: CMA, Morgan Stanley Research

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(as of February 28, 2006)

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| Stock Rating Category | Coverage Universe |            | Investment Banking Clients (IBC) |                |                      |
|-----------------------|-------------------|------------|----------------------------------|----------------|----------------------|
|                       | Count             | % of Total | Count                            | % of Total IBC | % of Rating Category |
| Overweight/Buy        | 744               | 36%        | 276                              | 40%            | 37%                  |
| Equal-weight/Hold     | 937               | 45%        | 323                              | 47%            | 34%                  |
| Underweight/Sell      | 400               | 19%        | 95                               | 14%            | 24%                  |
| Total                 | 2,081             |            | 694                              |                |                      |

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Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Underweight (U or Under) - The stock's total return is expected to be below the total return of the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months.

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Unless otherwise specified, the time frame for price targets included in this report is 12 to 18 months.

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Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

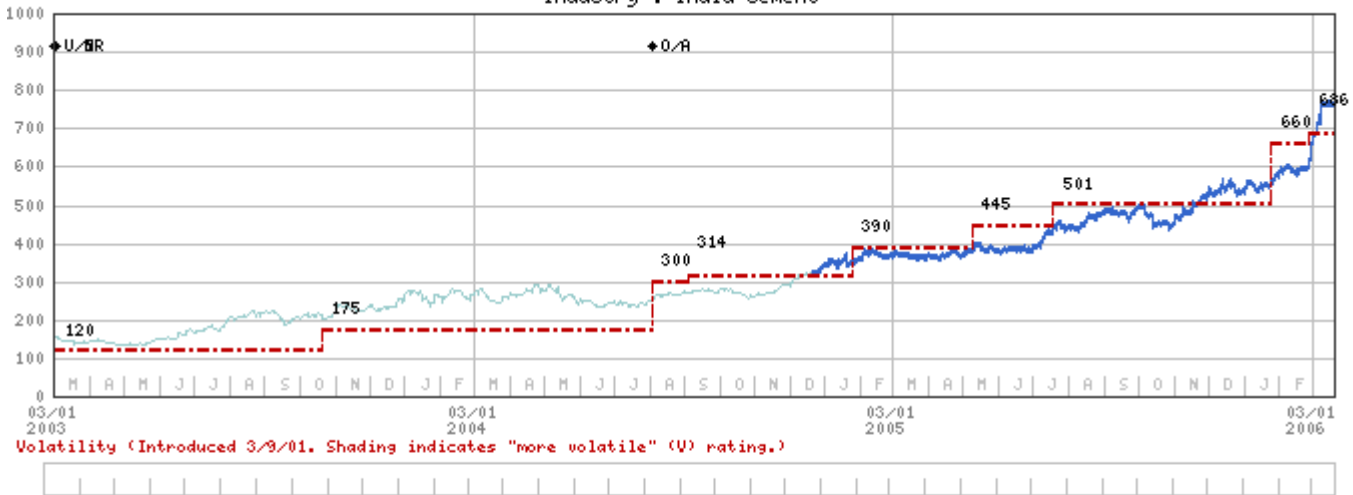
Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.



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**Stock Price, Price Target and Rating History (See Rating Definitions)**

Associated Cement Cos. (ACC.BO) - As of 3/19/06 in INR  
 Industry : India Cement

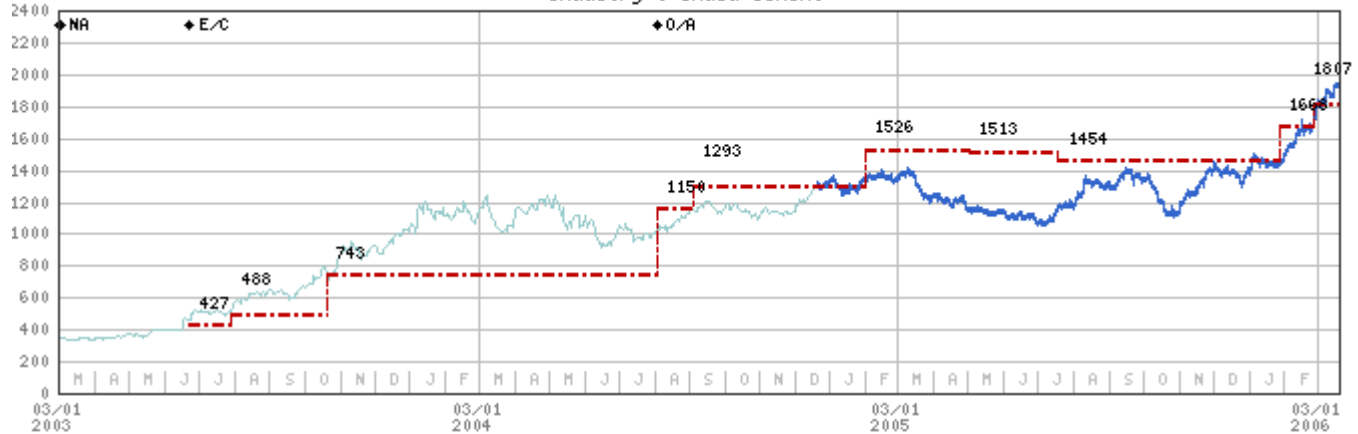


Stock Rating History: 8/7/02 : U/NR; 3/2/03 : U/C; 8/3/04 : O/A

Price Target History: 11/5/02 : 120; 10/20/03 : 175; 8/3/04 : 300; 9/3/04 : 314; 1/24/05 : 390; 5/9/05 : 445; 7/18/05 : 501; 1/25/06 : 660; 2/27/06 : 686

Source: Morgan Stanley Research      Date Format : MM/DD/YY      Price Target ---      No Price Target Assigned (NA)  
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■  
 Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) ♦  
 Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAU)  
 Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAU)  
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

Grasim Industries (GRAS.BO) - As of 3/19/06 in INR  
Industry : India Cement



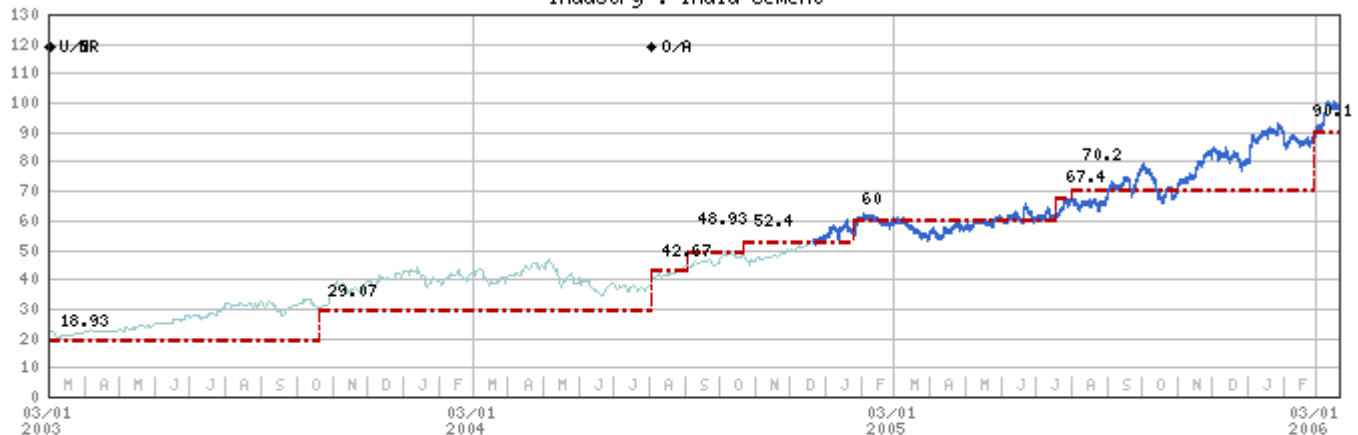
Volatility (Introduced 3/9/01. Shading indicates "more volatile" (V) rating.)

Stock Rating History: 10/14/02 : NA; 3/2/03 : NA; 6/23/03 : E/C; 8/3/04 : O/A

Price Target History: 10/14/02 : NA; 6/23/03 : 427; 7/29/03 : 488; 10/20/03 : 743; 8/3/04 : 1150; 9/3/04 : 1293; 1/31/05 : 1526; 5/2/05 : 1513; 7/18/05 : 1454; 1/27/06 : 1668; 2/27/06 : 1807

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)  
 Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ■  
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Gujarat Ambuja Cements (GACM.BO) - As of 3/19/06 in INR  
Industry : India Cement

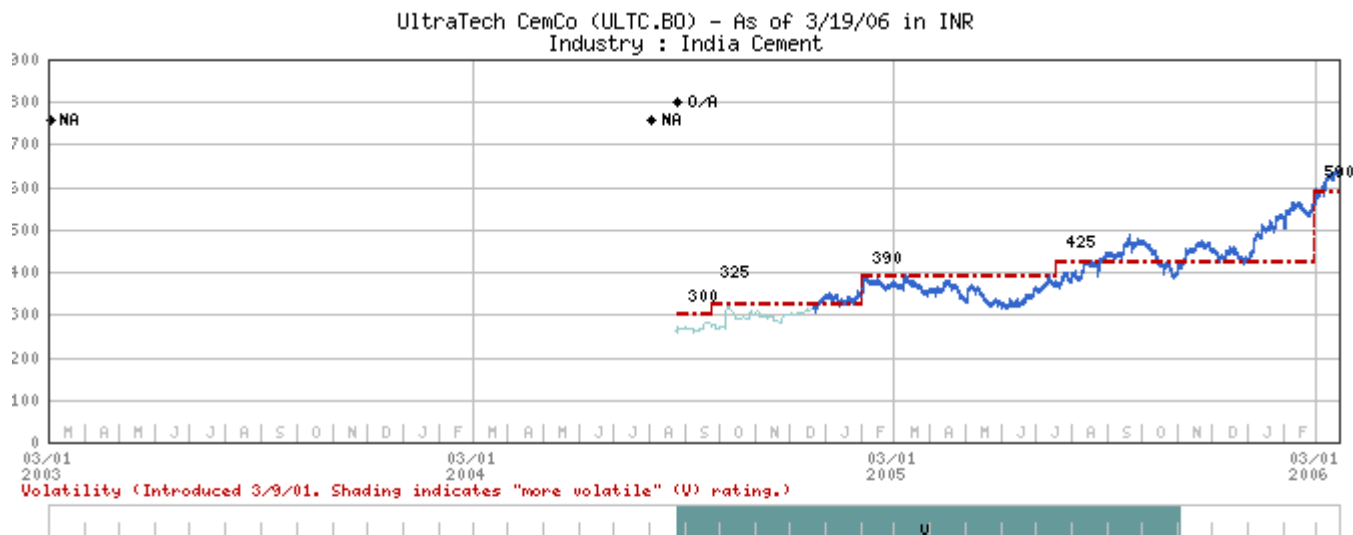


Volatility (Introduced 3/9/01. Shading indicates "more volatile" (V) rating.)

Stock Rating History: 10/30/02 : U/NR; 3/2/03 : U/C; 8/3/04 : O/A

Price Target History: 10/30/02 : 18.93; 10/20/03 : 29.07; 8/3/04 : 42.67; 9/3/04 : 48.93; 10/21/04 : 52.4; 1/24/05 : 60; 7/18/05 : 67.4; 8/1/05 : 70.2; 2/27/06 : 90.1

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)  
 Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ■  
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 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)



Stock Rating History: 3/2/03 : NA; 8/3/04 : NA; 8/25/04 : O/A  
 Price Target History: 8/25/04 : 300; 9/23/04 : 325; 1/31/05 : 390; 7/18/05 : 425; 2/27/06 : 590

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)  
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 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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**Industry Coverage: India Cement**

| <b>Company (Ticker)</b>             | <b>Rating (as of)</b> | <b>Price (03/17/2006)</b> |
|-------------------------------------|-----------------------|---------------------------|
| <b>Akshay Soni</b>                  |                       |                           |
| Associated Cement Cos.<br>(ACC.BO)  | O (08/03/2004)        | Rs759.60                  |
| Grasim Industries (GRAS.BO)         | O (08/03/2004)        | Rs1929.00                 |
| Gujarat Ambuja Cements<br>(GACM.BO) | O (08/03/2004)        | Rs98.00                   |
| UltraTech CemCo (ULTC.BO)           | O (08/25/2004)        | Rs632.75                  |

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