Company In-Depth

4 May 2007 | 13 pages

ACC (ACC.BO)

Downgrading to Sell: Lower Pricing to Hit Profits

Rating change ☑
Target price change ☑
Estimate change ☑

- Target price cut — Our target price has been cut to Rs730, which equates to 7.5x EV/EBITDA, an EV/tonne of US$123 and a P/E of 11.8x for CY08E. Our target EV/EBITDA is at a 15% discount to the stock's seven-year average due to the uncertainty caused by government measures, a lack of visibility on cement price upside, and the increased threat of imports.

- Lower pricing expected — Our profit forecasts for CY07 and CY08 have been reduced by 8% and 19%, respectively. The key reason for the estimate cuts is a lower base price, on which we continue to assume a 7.3% yoy price increase in CY07E and now assume a 7% yoy fall in CY08E, versus a decline of 5% yoy assumed previously.

- Delays in capacity, higher costs — ACC is seeing a delay in new capacities by about 6 months. Around 1m tpa was expected by September 2006 and 2m tpa by December 2006. These are now due for completion in April and September 2007, respectively, marginally impacting our previous volume forecasts. An increase in costs (notably coal) and lower other income have impacted profits.

- Planned capacity increases — In addition to the above, ACC plans to further expand capacity by 1.4m tpa (6%) in CY08E and 3m tpa (12%) in CY09E. This would include 80MW of captive power, increasing captive power usage from 70% in CY06 to 85% in CY09E.

- Upside risks — (1) Further delay in industry capacity; (2) higher-than-expected demand growth; and (3) changes in the duty/tax regime in favor of producers.

Sell/Medium Risk	**3M**
from Buy/Medium Risk	
Price (30 Apr 07)	Rs838.85
Target price	Rs730.00
from Rs1,260.00	
Expected share price return	-13.0%
Expected dividend yield	2.0%
Expected total return	**-10.9%**
Market Cap	Rs157,179M
	US$3,829M

Price Performance (RIC: ACC.BO, BB: ACC IN)

See Appendix A-1 for Analyst Certification and important disclosures.

Figure 1. ACC — Statistical Abstract

		Revenue (Rs m)	Net Profit (Rs m)	EBITDA (Rs m)	EPS^ (Rs)	EPS growth* (%)	P/E* (x)	EV/EBITDA* (x)	EV/tonne* (US$)
FY05	31-Mar	38,874	3,784	6,186	19.6	151	42.7	26.7	212
CY05 (9 m)	31-Dec	31,775	5,442	5,357	15.3	4	41.2	23.0	143
CY06	31-Dec	57,170	12,318	16,232	56.7	178	14.8	9.6	168
CY07E	31-Dec	67,211	14,705	21,624	78.1	38	10.7	6.9	149
CY08E	31-Dec	68,155	11,607	17,694	61.6	-21	13.6	8.6	143
CY09E	31-Dec	69,970	7,963	13,406	42.3	-31	19.8	11.3	126

Source: Company Reports and Citigroup Investment Research estimates

* Annualized. Priced as of April 30. Rs/US$1 rate at 42 for the forecast years. ^Adj for extraordinaries

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Fiscal year end 31-Dec	Apr04-Mar05	Apr-Dec/05	2006	2007E	2008E	2009E
Valuation Ratios						
P/E adjusted (x)	39.7	21.5	12.8	10.7	13.6	19.8
EV/EBITDA adjusted (x)	12.8	11.2	9.6	6.8	8.2	10.8
P/BV (x)	9.4	7.3	5.0	3.7	3.1	2.9
Dividend yield (%)	0.8	1.3	1.8	2.0	2.0	1.8
Per Share Data (Rs)						
EPS adjusted	21.11	29.33	65.61	78.10	61.65	42.30
EPS reported	21.11	29.33	65.61	78.10	61.65	42.30
BVPS	89.14	114.82	167.34	225.38	267.40	292.38
DPS	7.00	8.00	15.00	17.00	17.00	15.00
Profit & Loss (RsM)						
Net sales	38,874	31,775	57,170	67,211	68,155	69,970
Operating expenses	-33,861	-27,570	-42,655	-47,090	-52,273	-58,970
EBIT	**5,013**	**4,205**	**14,515**	**20,121**	**15,882**	**11,000**
Net interest expense	-882	-638	-520	-250	-196	-382
Non-operating/exceptionals	0	0	0	0	0	0
Pre-tax profit	**4,131**	**3,568**	**13,995**	**19,871**	**15,686**	**10,618**
Tax	-657	-1,399	-3,877	-5,166	-4,078	-2,654
Extraord./Min.Int./Pref.div.	310	3,274	2,200	0	0	0
Reported net income	**3,784**	**5,442**	**12,318**	**14,705**	**11,607**	**7,963**
Adjusted earnings	3,784	5,442	12,318	14,705	11,607	7,963
Adjusted EBITDA	6,881	5,849	17,058	22,883	18,883	14,435
Growth Rates (%)						
Sales	18.8	9.0	34.9	17.6	1.4	2.7
EBIT adjusted	86.0	11.9	158.9	38.6	-21.1	-30.7
EBITDA adjusted	54.2	13.3	118.7	34.2	-17.5	-23.6
EPS adjusted	87.6	85.2	67.8	19.0	-21.1	-31.4
Cash Flow (RsM)						
Operating cash flow	**5,980**	**6,438**	**14,217**	**15,424**	**13,240**	**10,717**
Depreciation/amortization	1,869	1,644	2,543	2,762	3,002	3,435
Net working capital	-1,247	561	319	-1,836	-532	-141
Investing cash flow	**-5,186**	**-1,812**	**-4,827**	**-7,227**	**-14,180**	**-8,346**
Capital expenditure	-5,843	-670	-4,454	-6,486	-13,370	-7,375
Acquisitions/disposals	520	-1,311	-2,098	-2,000	-2,000	-2,000
Financing cash flow	**-870**	**-4,190**	**-4,234**	**-4,696**	**-4,791**	**-977**
Borrowings	650	-2,102	-2,602	-1,248	-900	3,100
Dividends paid	-800	-1,425	-1,683	-3,203	-3,695	-3,695
Change in cash	**-76**	**436**	**5,156**	**3,501**	**-5,732**	**1,394**
Balance Sheet (RsM)						
Total assets	**44,246**	**48,369**	**59,057**	**70,766**	**79,172**	**88,155**
Cash & cash equivalent	573	1,028	6,202	9,703	3,971	5,365
Accounts receivable	1,905	1,992	2,140	2,947	3,549	3,835
Net fixed assets	28,635	31,220	33,959	37,683	48,051	51,991
Total liabilities	**28,269**	**27,066**	**27,637**	**28,332**	**28,825**	**33,106**
Accounts payable	6,347	7,712	8,545	8,919	9,956	11,264
Total Debt	15,091	11,762	9,160	7,912	7,012	10,112
Shareholders' funds	**15,977**	**21,303**	**31,420**	**42,434**	**50,346**	**55,049**
Profitability/Solvency Ratios (%)						
EBITDA margin adjusted	17.7	18.4	29.8	34.0	27.7	20.6
ROE adjusted	23.7	38.9	31.2	39.8	25.0	15.1
ROIC adjusted	15.6	11.9	31.1	38.4	25.0	15.3
Net debt to equity	90.9	50.4	9.4	-4.2	6.0	8.6
Total debt to capital	48.6	35.6	22.6	15.7	12.2	15.5

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Downgraded to Sell/Medium Risk

We have cut our target multiple to reflect the lack of visibility on cement pricing upside caused by the uncertainties triggered by government measures in CY07

We downgrade ACC to Sell/Medium Risk (3M), with a target price of Rs730. Our target price is derived from 7.5x CY08E EV/EBITDA, lower than the 10x we used previously based on CY07E earnings. We have lowered our target multiple to reflect the lack of visibility on cement pricing upside caused by the uncertainties triggered by government measures in CY07. Although capacities have been delayed, we expect a steady stream of new supply in CY08E that will make it difficult for producers to raise or maintain prices. There is also a greater threat of imports, but a surge is not expected in the near future.

Estimate revisions

Figure 2. ACC — Estimate Changes, CY07E-08E

	CY07E			CY08E		
	Old	New	% change	Old	New	% change
Net sales (Rs bn)	67.1	67.2	0	70.4	68.2	-3
EBITDA (Rs bn)	22.5	21.6	-4	20.4	17.7	-13
Net profit (Rs bn)-adj	15.9	14.7	-8	14.3	11.6	-19
EPS (Rs)	84.5	78.1	-8	75.7	61.6	-19

Source: Citigroup Investment Research estimates

Valuation framework

We value ACC at a CY08E EV/EBITDA of 7.5x

We have used EV/EBITDA to value ACC, which is supported by EV/tonne especially in relation to EBITDA margins and EBITDA per tonne. P/E, in our view, is a less useful measure for ACC as the company has incurred net losses in some years. Our target price of Rs730 is derived from a CY08E EV/EBITDA of 7.5x, which equates to an EV/tonne of US$123.

Primary valuation tool — EV/EBITDA

Target EV/EBITA multiple based on a 15% discount to the stock's seven-year average

As the exhibit below shows, ACC's rolling forward EV/EBITDA has largely traded in a band of 8x to 12x since 2000. It has been driven by trends in ACC's EBITDA margins for each year. In good years such as FY02, the EV/EBITDA has reached as high as 14-15x. The sharp fall in EV/EBITDA to 6x around December 2005 was largely driven by sluggish cement pricing trends. In the past two years, ACC's EV/EBITDA has been in a range of 7-10x. In recent months its EV/EBITDA has fallen to around 6.5x amid uncertainties surrounding the sector at a time when the industry has a lot of pricing power. Some of the upside in cement prices has already been taken away by the government, and imports have become much cheaper. While the stock could in the short term continue its bounce from current levels — CY08E EV/EBITDA is 8.6x and EV/tonne is US$143 — the upside in our view will be limited given the higher risks facing the sector. Our target multiple is based on a 15% discount to the average EV/EBITDA of 9x of the past seven years, which we round down to 7.5x for FY08E — the lower end of the trading band over the past two years. This equates to an EV/tonne valuation of US$123.

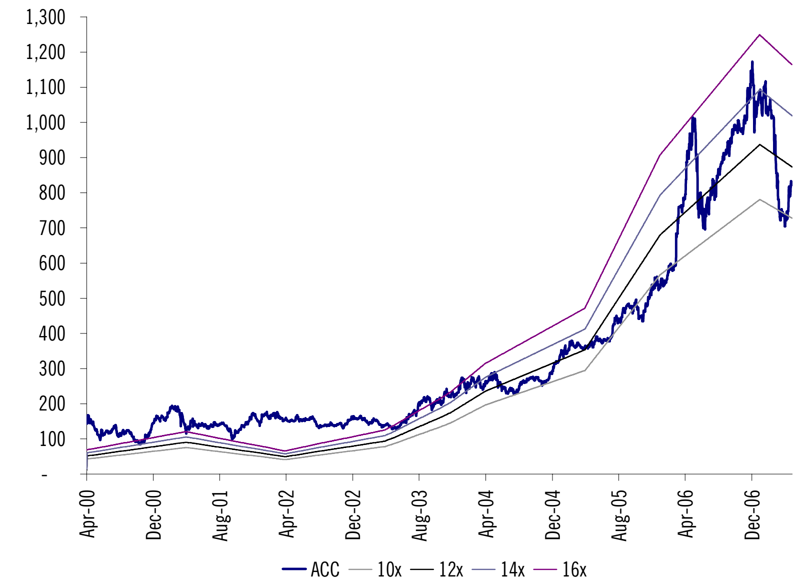
Figure 3. ACC — Rolling EV/EBITDA Chart

Source: DataStream, Company Reports and Citigroup Investment Research

ACC's P/E over the past 7 years has fluctuated in a wide range

As shown in the exhibit below, ACC's P/E over the past 7 years has fluctuated in a wide range — from a low of 10x to more than 25x. Over the past year or so the stock has largely traded in a band of 12x to 16x. It was recently rerated to a P/E of around 12x. At our target price of Rs730, the stock would trade at a P/E of 11.8x — slightly below the low end of the trading range, largely because we see few triggers to justify an upward re-rating in the current scenario.

Figure 4. ACC — Forward P/E Band Chart



Source: DataStream, Company reports, Citigroup Investment Research estimates

Update on expansion plans

- ACC's capacity increased by 0.9m tpa in CY06 to 19.9m tpa due to expansions in Gagal (Himachal Pradesh).

- We expect capacity to expand 3.3m tpa (+17%) in CY07. Of this, 0.9m tpa capacity at Lakheri (Rajasthan) is in the process of being commissioned. The balance capacity is due to be commissioned by September 2007 in locations such as Tikaria (UP, 0.3m tpa), Kymore (MP, 0.5m tpa), Wadi (Karnataka, 1.0m tpa) and Sindri (Jharkhand, 0.4m tpa). Most of these capacities are being set up at a low capex cost of US$15-20/tonne. These capacities have been delayed by about 6 months. The expansions at Lakheri and Kymore will include the commissioning of 50MW of captive power (25MW each).

- In CY08, capacity is expected to increase by 1.4m tpa (6%). This expansion is expected at Madukkarai (Tamil Nadu, 0.22mtpa) and Bargarh (Orissa, 1.18m tpa). In addition, 30MW of captive power is being commissioned at Bargarh and the total capex at Bargarh is around Rs5.4bn.

- Another 3m tpa of capacity is expected to be commissioned in CY09E at Wadi (Karnataka), together with a captive power plant of 50MW. The total capital outlay for the project is expected to be ~Rs14.9bn.

Financial summary

Figure 5. ACC — Operating Statistics

	FY04 31-Mar	FY05 31-Mar	CY05 (9 m) 31-Dec	CY06 31-Dec	CY07E 31-Dec	CY08E 31-Dec	CY09E 31-Dec
Operating Data							
Cement capacity (m tonnes)	16.15	16.80	19.03	19.91	23.06	24.46	27.46
Cement production (m tonnes)	14.65	15.32	12.93	18.73	20.09	21.66	23.63
Capacity utilization	91%	91%	91%	94%	87%	89%	86%
Sales							
Cement (m tonnes)	14.83	15.20	12.74	18.67	20.09	21.66	23.63
Purch cement & other products	629,000	1,051,000	74,000	101,000	100,000	100,000	100,000
Ready mix concrete (cu metres)	613,000	887,000	735,000	1,119,000	1,398,750	1,678,500	2,014,200
Refractories & refractory prod	80,000	113,000	62,000	0	0	0	0
Average Exchange Rate (Rs/US$)	**45.9**	**44.9**	**44.2**	**45.3**	**43.2**	**42.0**	**41.5**

Source: Company data and Citigroup Investment Research estimates

Figure 6. ACC — Profit and Loss Account (Rs in Millions)

	FY04 31-Mar	FY05 31-Mar	CY05 (9 m) 31-Dec	CY06 31-Dec	CY07E 31-Dec	CY08E 31-Dec	CY09E 31-Dec
Cement	27,263	30,852	28,018	53,672	61,941	62,113	63,036
Purchased cement and other products	2,132	3,464	424	380	383	364	346
Ready mix concrete	1,286	1,833	1,713	2,998	3,823	4,496	5,287
Refractories and refractory products	1,318	1,790	1,083	0	0	0	0
Consultancy services	539	620	581	766	842	926	1,019
Erection, fabrication & contracts	286	445	383	219	241	277	304
Miscellaneous/inter segment	20	17	7	1	1	1	1
Total sales	**32,845**	**39,021**	**32,207**	**58,035**	**67,231**	**68,177**	**69,994**
Net sales	**32,733**	**38,874**	**31,775**	**57,170**	**67,211**	**68,155**	**69,970**
Operating expenses	28,991	32,835	26,850	41,803	45,607	50,483	56,588
Operating profit	**3,854**	**6,186**	**5,357**	**16,232**	**21,624**	**17,694**	**13,406**
Op. profit/tonne (Rs)	249	381	418	865	1,071	813	565
Op. profit/tonne (US$)	5.4	8.5	9.4	19.1	24.1	18.3	12.7
Other income	610	696	492	826	1,259	1,190	1,029
Extraordinary items	876	315	487	503	0	0	0
EBITDA (excl extraordinary items)	**4,464**	**6,881**	**5,849**	**17,058**	**22,883**	**18,883**	**14,435**
EBITDA margin %	14%	18%	18%	30%	34%	28%	21%
EBITDA/tonne (Rs)	289	423	456	909	1,134	868	608
EBITDA/tonne (US$)	6.3	9.4	10.3	20.0	25.5	19.5	13.7
Depreciation	1,769	1,869	1,644	2,543	2,762	3,002	3,435
% of avg gross block	4.7%	4.6%	3.6%	5.3%	5.1%	4.9%	4.5%
EBIT (excl extraordinary items)	**2,695**	**5,013**	**4,205**	**14,515**	**20,121**	**15,882**	**11,000**
Interest	929	882	638	520	250	196	382
Extraordinary items	-103	-5	2,787	1,697	0	0	0
PBT	**2,539**	**4,441**	**6,841**	**16,195**	**19,871**	**15,686**	**10,618**
Total Tax	536	657	1,399	3,877	5,166	4,078	2,654
Eff.tax rate %	21.1%	14.8%	20.5%	23.9%	26.0%	26.0%	25.0%
PAT (incl extraordinary items)	2,002	3,784	5,442	12,318	14,705	11,607	7,963
Net profit (excl extraordinary items)	**1,393**	**3,520**	**2,838**	**10,645**	**14,705**	**11,607**	**7,963**
Net profit/ tonne (Rs)	90	217	221	567	728	534	336
Net profit/ tonne (US$)	2.0	4.8	5.0	12.5	16.4	12.0	7.5

Source: Company Reports and Citigroup Investment Research estimates

Figure 7. ACC — Balance Sheet (Rs in Millions)

	FY04	FY05	CY05 (9 m)	CY06	CY07E	CY08E	CY09E
	31-Mar	**31-Mar**	**31-Dec**	**31-Dec**	**31-Dec**	**31-Dec**	**31-Dec**
Fixed Assets	**24,721**	**28,635**	**31,220**	**33,959**	**37,683**	**48,051**	**51,991**
Gross Block	37,898	40,749	46,286	48,163	53,883	60,753	77,128
Acc.Depreciation	-14,141	-15,657	-17,223	-18,938	-21,700	-24,702	-28,137
Net Block	23,756	25,092	29,064	29,225	32,183	36,051	48,991
CWIP	965	3,543	2,157	4,734	5,500	12,000	3,000
Investments	**3,757**	**3,267**	**2,938**	**5,035**	**7,035**	**9,035**	**11,035**
Liquid investments	491	0	2,497	4,677	6,677	8,677	10,677
Current Assets	**10,130**	**12,137**	**14,212**	**20,062**	**26,048**	**22,085**	**25,129**
Stocks + WIP	3,780	5,424	6,010	6,241	7,223	7,965	8,903
Sundry debtors	1,824	1,905	1,992	2,140	2,947	3,549	3,835
Loans and advances	4,097	4,191	4,868	5,319	5,800	6,200	6,600
Other current assets	34	251	315	161	375	400	425
Cash/bank	395	573	1,028	6,202	9,703	3,971	5,365
Current Liabilities and provisions	**8,495**	**10,224**	**12,301**	**15,270**	**17,014**	**18,251**	**19,325**
Sundry creditors	5,327	6,347	7,712	8,545	8,919	9,956	11,264
Taxation	0	129	393	397	1,000	1,000	1,000
Proposed dividends (eq+pref)	800	1,425	1,683	3,203	3,695	3,695	3,261
Other creditors/liabilities	2,369	2,323	2,513	3,125	3,400	3,600	3,800
Overall Capital employed	**30,113**	**34,022**	**36,069**	**43,787**	**53,752**	**60,921**	**68,830**
Shareholders Funds	**13,188**	**15,977**	**21,303**	**31,420**	**42,434**	**50,346**	**55,049**
Share capital	1,779	1,792	1,855	1,878	1,883	1,883	1,883
Revaluation reserves	0	0	0	0	0	0	0
Other reserves	11,409	14,185	19,448	29,542	40,551	48,464	53,166
Deferred tax liability	**2,752**	**2,955**	**3,004**	**3,207**	**3,406**	**3,563**	**3,669**
Loan Funds	**14,173**	**15,091**	**11,762**	**9,160**	**7,912**	**7,012**	**10,112**
Secured loans	10,401	11,411	9,501	7,210	6,210	5,210	8,210
Unsecured loans	2,871	2,667	1,213	502	502	502	502
Stockists' deposits (Unsecured)	900	1,013	1,048	1,448	1,200	1,300	1,400
Cash credit	0	0	0	0	0	0	0
Total sources of Funds	**30,113**	**34,022**	**36,069**	**43,787**	**53,752**	**60,921**	**68,830**

Source: Company Reports and Citigroup Investment Research estimates

Figure 8. ACC — Cash Flow Statement, Stock Metrics and Ratios

	FY04 31-Mar	FY05 31-Mar	CY05 (9 m) 31-Dec	CY06 31-Dec	CY07E 31-Dec	CY08E 31-Dec	CY09E 31-Dec
Cash flow statement (Rs m)							
PBT	1,766	4,131	3,568	13,995	19,871	15,686	10,618
Depreciation	1,769	1,869	1,644	2,543	2,762	3,002	3,435
Interest	929	882	638	520	250	196	382
Other income	-610	-696	-492	-826	-1,259	-1,190	-1,029
Changes in working capital	-23	-1,247	561	319	-1,836	-532	-141
Taxes paid	-388	-285	-463	-3,925	-4,364	-3,921	-2,548
Others	1,339	1,326	983	1,591	0	0	0
Net cash from operations	**4,783**	**5,980**	**6,438**	**14,217**	**15,424**	**13,240**	**10,717**
Purchase of fixed assets	-2,265	-5,843	-670	-4,454	-6,486	-13,370	-7,375
Purchase of investments	-2,480	520	-1,311	-2,098	-2,000	-2,000	-2,000
Other income	610	696	492	826	1,259	1,190	1,029
Others	-20	-559	-324	899	0	0	0
Net cash used in investment activities	**-4,155**	**-5,186**	**-1,812**	**-4,827**	**-7,227**	**-14,180**	**-8,346**
Interest paid	-929	-882	-638	-520	-250	-196	-382
Proceeds from issue of share capital	1,585	290	144	190	5	0	0
Repayment/proceeds of borrowings	-250	650	-2,102	-2,602	-1,248	-900	3,100
Dividend paid	-482	-800	-1,425	-1,683	-3,203	-3,695	-3,695
Others	-251	-129	-170	381	0	0	0
Net cash from financing activities	**-327**	**-870**	**-4,190**	**-4,234**	**-4,696**	**-4,791**	**-977**
Net cash flow	**301**	**-76**	**436**	**5,156**	**3,501**	**-5,732**	**1,394**
Opening cash balance	348	650	573	1,028	6,202	9,703	3,971
Amalgamation adjustment	0	0	19	18	0	0	0
Closing cash balance	650	573	1,028	6,202	9,703	3,971	5,365
Stock Metrics							
No. of shares (mn)	177.9	179.2	185.5	187.8	188.3	188.3	188.3
Book value per share (Rs)	74	89	115	167	225	267	292
EPS (Rs)*	7.8	19.6	15.3	56.7	78.1	61.6	42.3
CFPS (Rs)	21.2	31.5	38.2	79.1	92.8	77.6	60.5
Net Debt/EBITDA (x)	2.5	2.0	1.3	-0.1	-0.4	-0.3	-0.4
Total debt/Tangible net worth (x)	1.1	0.9	0.6	0.3	0.2	0.1	0.2
Net debt/equity (x)	1.0	0.9	0.4	-0.1	-0.2	-0.1	-0.1
ROE (%)	12%	24%	15%	40%	40%	25%	15%
ROCE (%)	9%	16%	12%	36%	41%	28%	17%
Total dividend (Rs mn)	800	1425	1683	3203	3695	3695	3261
DPS (Rs)	4.0	7.0	8.0	15.0	17.0	17.0	15.0
Dividend payout (%)	40%	38%	31%	26%	25%	32%	41%
Ratios							
Current ratio	1.2	1.2	1.2	1.3	1.5	1.2	1.3
Interest coverage	3.7	6.0	11.7	32.1	80.5	81.0	28.8
Days in inventory	68	86	94	87	90	90	90
Days receivable	20	17	17	13	16	19	20
Debtors turnover	18.0	20.5	16.2	27.1	22.8	19.2	18.3
Days payable	126	127	158	165	150	150	150

Source: Company Reports and Citigroup Investment Research estimates *Adjusted for extraordinaries

1Q CY07 results

Figure 9. ACC — 1Q CY07 results

(Rs m)	1Q CY07	1Q CY06	% chg
Sales	**16,748**	**13,424**	**25%**
Expenditure	11,677	10,159	15%
EBITDA	**5,071**	**3,266**	**55%**
EBITDA per tonne	1,028	646	59%
% margin	30.3	24.3	24%
Other income—recurring	284	333	-15%
Interest	40	194	-79%
Depreciation	621	597	4%
Extraordinary items	200	91	119%
PBT (as reported)	**4,894**	**2,900**	**69%**
Tax	1,256	545	130%
% tax rate	26	19	
PAT as reported	**3,638**	**2,354**	**55%**
PBT (excl non recurring/extraordinaries)	4,694	2,809	67%
Tax	1,205	528	128%
Tax rate (%)	26	19	
Adjusted PAT	**3,489**	**2,280**	**53%**

Source: Citigroup Investment Research

1Q CY07 net sales grew 25% yoy to Rs16.7bn, in line with our expectations

1Q CY07 net sales grew 25% yoy to Rs16.7bn, in line with our expectations. However, both EBITDA and PAT came in about 10% below expectations at Rs5.1bn (+55% yoy) and Rs3.6bn (+55% yoy) due to higher costs than anticipated. Sales volumes declined 2% yoy to 4.9m tonnes. Net realization increased 30% yoy to Rs3,242/tonne (in line with expectations). The QoQ increase was around 3%. Sales volume declined 2% due to planned stoppages on account of certain technical modifications carried out at 3 plants in February. Operating expenses came in 7% higher than expected at Rs11.7bn (+15% yoy). This is largely on account of a 32% surge in freight costs to Rs524/tonne (+14% qoq). The company has indicated that this was due to an increase in lead distances covered for the transport of cement for strategic reasons. These costs are expected to decline in future. ACC expects to add more than 7m tpa of capacity with 3.1m expected in CY07, 1.4m in CY08 and the balance 3m tpa in CY09. Around 130MW of captive power is also being added. ACC's board has approved the transfer of its Ready Mix business (sales Rs3bn in CY06) to a new wholly owned subsidiary.

ACC

Company description

ACC is India's largest cement company with a capacity of 20m tpa and a market share of about 13% in FY06. This will be increased to around 27m tpa by CY09E. ACC is located in all the major markets but hardly exports any cement. Holcim holds a 35.2% stake in ACC (through its 78% subsidiary company Ambuja Cement India). Adding on the market presence of Holcim's other group company in India (Ambuja Cements) gives Holcim a total capacity of 36m tpa in India and a significant presence in several key markets. In the past few years, ACC has focused on cost-cutting, selling unviable cement capacity and exiting non-cement businesses. ACC has been a pioneer of blended cement and has the highest proportion of blended cement sales (83%) among the domestic cement majors.

Investment thesis

We rate ACC as Sell/Medium Risk (3M), with a target price of Rs730. Our rating is predicated on the lack of visibility on cement pricing upside, created by the uncertainties following the government measures in CY07. Although cement capacities have been delayed, we expect a steady stream of new supply in India in CY08E — making it difficult for producers to raise or maintain prices. There is also a greater threat of imports, but we do not expect a surge in the near future.

Valuation

We rate ACC on EV/EBITDA, a common metric used to value cement companies. Our target multiple is based on a 15% discount to the stock’s average EV/EBITDA of 9x of the past seven years, which we round down to 7.5x for FY08E — the lower end of its trading band over the past two years and equates to an EV/tonne valuation of US$123. We use a discount to reflect our fear that the recent government measures are taking away the last leg of pricing upside for cement companies.

Risks

We rate ACC as Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. The rating reflects the higher relative valuations of cement companies compared with both past cycles as well as regional peers. The main upside risks to our target price include: (1) further delays in industry capacity; (2) higher-than-expected domestic demand growth; and (3) changes in the duty/tax regime in favor of the producers.

Appendix A-1

Analyst Certification

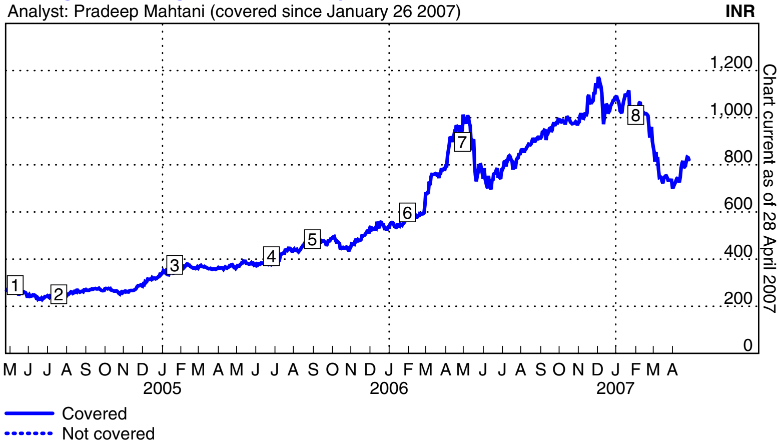
I, Pradeep Mahtani, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

ACC (ACC.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Pradeep Mahtani (covered since January 26 2007)



#	Date	Rating	Target Price	Closing Price
1:	11 May 04	*1M	*336.00	267.55
2:	20 Jul 04	1M	*305.00	232.70
3:	21 Jan 05	1M	*414.00	NA
4:	27 Jun 05	*1L	*453.00	377.30
5:	31 Aug 05	1L	*540.00	478.45
6:	31 Jan 06	1L	*660.00	573.00
7:	28 Apr 06	*2L	*1,050.00	951.95
8:	1 Feb 07	*1M	*1,260.00	1,034.95

*Indicates change.

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