4 May 2007 | 16 pages

Ambuja Cements (GACM.BO)

Downgrading to Sell: Expensive in the Current Scenario

Rating change ☑
Target price change ☑
Estimate change ☑

- **Target price cut** — We have reduced our target price to Rs103, derived from 7.5x CY08E EV/EBITDA – a 10% discount to ACL's 7-year average of 8.4x. This equates to an EV/tonne of US$180 and P/E of 12.4x for CY08E. We believe the stock is expensive, given that earnings should decline in CY08E due to unfavorable government measures and expected capacity hikes.

- **Price expected to decline 7% in CY08E** — Our new forecasts are 3.7% higher for CY07E, incorporating the recent strong pricing trends (+8% yoy) and higher other income from cash flows on sale of land (Rs3.3bn) and investment in ACIL (Rs10.6bn). CY08 forecasts incorporate a 9% yoy price decline based on large capacities coming up in early CY08 in North India — 38% of ACL's sales.

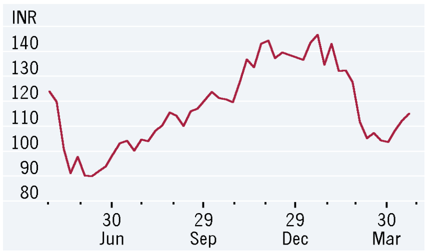
- **India's largest cement exporter at risk** — Export prices are currently strong (US$51/t), but we have assumed declines in both export prices and volumes due to massive capacity coming on stream in the Middle East. The oversupply could be worse than we expect, which would hit profits.

- **Volume growth, captive power do not protect margins** — Volume growth will be limited to around 7% yoy in CY07E and CY08E, as the bulk of the volume increase is coming from blended cement. New clinker capacity is expected only in 1H CY09. Despite cost savings from 178MW of captive power coming up in stages in CY07 and CY08, lower prices would hurt CY08E margins.

- **Upside risks** — (1) Further delays in new capacity; (2) higher-than-expected demand growth; and (3) change in the duty/tax regime in favour of producers.

Sell/Medium Risk	**3M**
from Hold/Medium Risk	
Price (30 Apr 07)	Rs117.95
Target price	Rs103.00
from Rs158.00	
Expected share price return	-12.7%
Expected dividend yield	2.3%
Expected total return	**-10.3%**
Market Cap	Rs179,367M
	US$4,370M

Price Performance (RIC: GACM.BO, BB: GAMB IN)



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

Figure 1. Ambuja Cements — 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$)
FY04	Jun-04	19,653	3,368	5,370	2.2	14	54.3	28.1	363
FY05	Jun-05	26,000	4,683	7,241	3.5	59	34.1	20.7	294
CY06 (18m)	Dec-06	62,683	15,033	21,331	9.9	91	17.9	11.2	247
CY07	Dec-07	56,258	15,875	23,131	10.4	58	11.3	6.8	215
CY08	Dec-08	55,319	12,639	19,395	8.3	-20	14.2	8.7	213
CY09	Dec-09	60,097	10,401	17,316	6.8	-18	17.2	9.9	186

Source: Company Reports and Citigroup Investment Research estimates

*Annualized. Rs/US$ rate at 42 for the forecasts.

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Fiscal year end 31-Dec	Jul04-Jun05	Jul05-Dec06	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	34.1	17.9	11.3	14.2	17.2
EV/EBITDA adjusted (x)	11.0	9.6	7.1	8.3	9.5
P/BV (x)	7.4	5.1	3.5	2.9	2.7
Dividend yield (%)	1.8	1.4	2.3	2.3	2.5
Per Share Data (Rs)					
EPS adjusted	3.46	9.91	10.44	8.31	6.84
EPS reported	3.46	9.91	14.08	9.84	6.84
BVPS	16.04	22.97	34.11	40.80	44.22
DPS	2.10	2.50	2.75	2.75	3.00
Profit & Loss (RsM)					
Net sales	26,000	62,683	56,258	55,319	60,097
Operating expenses	-19,896	-43,135	-34,762	-38,042	-45,925
EBIT	**6,103**	**19,548**	**21,495**	**17,278**	**14,172**
Net interest expense	-918	-1,132	-772	-755	-845
Non-operating/exceptionals	0	0	0	0	1
Pre-tax profit	**5,185**	**18,416**	**20,723**	**16,522**	**13,327**
Tax	-503	-3,384	-4,848	-3,883	-2,925
Extraord./Min.Int./Pref.div.	0	0	5,540	2,319	0
Reported net income	**4,683**	**15,033**	**21,416**	**14,959**	**10,402**
Adjusted earnings	4,683	15,033	15,875	12,639	10,402
Adjusted EBITDA	8,057	22,810	24,181	20,395	18,291
Growth Rates (%)					
Sales	32.1	60.7	34.6	-1.7	8.6
EBIT adjusted	34.2	113.5	64.9	-19.6	-18.0
EBITDA adjusted	29.3	88.7	59.0	-15.7	-10.3
EPS adjusted	39.0	90.7	58.0	-20.4	-17.7
Cash Flow (RsM)					
Operating cash flow	**6,399**	**17,962**	**18,783**	**14,513**	**12,407**
Depreciation/amortization	1,954	3,261	2,685	3,117	4,120
Net working capital	-791	463	-335	-526	-1,509
Investing cash flow	**-2,531**	**-6,272**	**2,776**	**-14,517**	**-9,033**
Capital expenditure	-1,709	-7,564	-7,742	-20,694	-10,008
Acquisitions/disposals	-1,141	131	9,469	5,177	0
Financing cash flow	**-3,691**	**-8,889**	**-2,763**	**-5,733**	**-3,623**
Borrowings	-1,140	-3,402	-1,000	-200	2,000
Dividends paid	-1,841	-4,801	-1,384	-4,778	-4,778
Change in cash	**177**	**2,802**	**18,796**	**-5,737**	**-249**
Balance Sheet (RsM)					
Total assets	**40,730**	**54,348**	**74,670**	**84,611**	**92,675**
Cash & cash equivalent	865	3,781	22,577	16,840	16,590
Accounts receivable	458	900	1,151	1,212	1,482
Net fixed assets	23,633	31,241	38,084	55,660	61,549
Total liabilities	**19,043**	**19,508**	**22,799**	**22,560**	**25,435**
Accounts payable	2,223	4,417	4,431	4,815	5,681
Total Debt	11,275	8,654	7,654	7,454	9,454
Shareholders' funds	**21,687**	**34,840**	**51,871**	**62,051**	**67,240**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	31.0	36.4	43.0	36.9	30.4
ROE adjusted	22.4	35.5	49.4	22.2	16.1
ROIC adjusted	21.6	36.4	44.7	26.9	18.0
Net debt to equity	48.0	14.0	-28.8	-15.1	-10.6
Total debt to capital	34.2	19.9	12.9	10.7	12.3

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Downgraded to Sell

Although ACL's premium valuations may continue due to higher profitability relative to domestic peers, we believe the stock is expensive and deserves a lower target multiple

We downgrade Ambuja Cements Ltd (ACL) to Sell/Medium Risk (3M), with a target price of Rs103. Our target price is derived from 7.5x CY08E EV/EBITDA, a 10% discount to its 7-year average EV/EBITDA multiple of 8.4x. The target multiple is lower than the 10.5x we used previously based on CY07E earnings. Although ACL's premium valuations may continue due to higher profitability relative to domestic peers, we believe the stock is expensive and deserves a lower target multiple because of the following: (1) a lack of visibility on cement pricing upside caused by the uncertainties created by the government measures in CY07; (2) a 20% yoy decline in CY08E earnings due to large domestic capacities (particularly in North India); and (3) risk to exports due to the new capacities expected in the Middle East (ACL is India's largest cement exporter). The cost savings from a 178MW captive power plant and higher production of low-cost blended cement will not offset the EBITDA decline in CY08E, based on our analysis.

Estimate revisions

Figure 2. Ambuja Cements — Estimate Changes, CY07-08E

	CY07E			CY08E		
	Old	New	% change	Old	New	% change
Net sales (Rs bn)	54.2	56.3	4	54.4	55.3	2
EBITDA (Rs bn)	22.1	23.1	4	20.0	19.4	-3
Net profit (Rs bn)-adj	15.3	15.9	4	13.6	12.6	-7
EPS (Rs)	10.1	10.4	3	9.0	8.3	-7

Source: Citigroup Investment Research estimates

Valuation framework

Valuations have been adversely impacted by recent government measures to control cement prices

The robust pricing trends seen in cement have led to a substantial improvement in profitability, with ACL's EBITDA/tonne jumping from Rs569 in FY05 to Rs1,296 in the quarter ended March 2007. Cement stocks were strongly re-rated in anticipation of improved pricing. Valuations have been adversely impacted by recent government measures to control cement prices. In the light of this we expect limited cement pricing upside in CY07, and expect a decline in cement prices in CY08 due to a steady stream of new capacities. This should prevent further upside in stock valuations. We use EV/EBITDA as our primary valuation measure, which is supported by EV/tonne and P/E to value ACL.

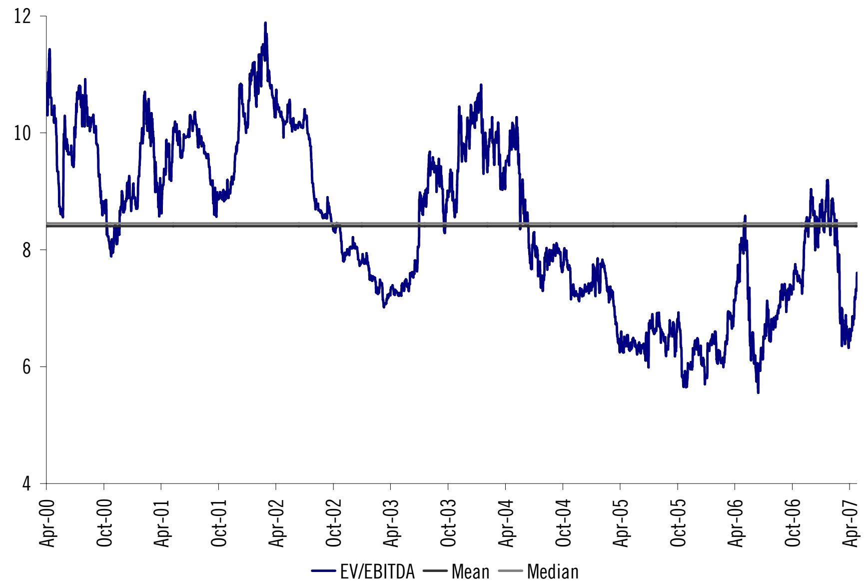
Primary valuation tool — EV/EBITDA

We value ACL on 7.5x CY08E EV/EBITDA

As the exhibit below shows, ACL's mean and median one-year forward EV/EBITDA over the past seven years have averaged 8.4x. During this period, the stock has generally reached a high of 11-12x EV/EBITDA for short periods in bullish times, and has fallen to as low as 5x in bear phases. The stock recently came off to a level of 7x due to concerns on cement pricing. We expect near-term pricing to be firm but see pricing coming off in early 2008 due to new capacities, particularly in North India. In such a scenario, we do not expect ACL's share price to cross its seven-year mean valuations decisively. We have set our target price at Rs103, based on a 10% discount to the average valuation of the past seven years — giving us an EV/EBITDA of 7.5x. At our target price

ACL would be valued at an EV/tonne of US$180 for CY08E. The premium valuation to the rest of the cement majors is justified in our view because of ACL's higher margins and efficiency.

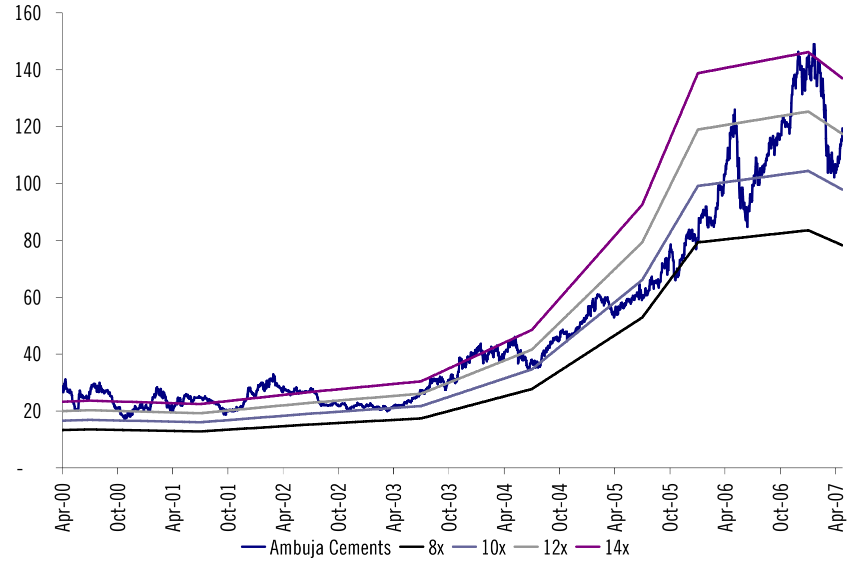
Figure 3. Ambuja Cements — Rolling Forward EV/EBITDA Chart



Source: DataStream, Company Reports and Citigroup Investment Research

We use P/E to supplement our EV/EBITDA valuation. As seen in the exhibit below, since late 2000, ACL's P/E has largely traded in a range of 10-14x depending on the cement price outlook at the time. In 2H CY06 the stock was re-rated up from a P/E of 8-10x to over 14x. The stock has come off to a range of 10-12x since January 2007. Although the uptrend in cement stock prices may continue over the next few months on the back of better results and some price upside, we are cautious from a one-year perspective. At our target price of Rs103, the stock would trade at P/Es of 9.9x for CY07E and 12.4x for CY08E.

Figure 4. Ambuja Cements — Rolling P/E Band Chart



Source: DataStream, Company Reports and Citigroup Investment Research

Update on expansion plans

Figure 5. Capacity Expansion Schedule

Location	Additional Grinding Capacity (m tpa)	Commissioning Schedule
Farakka (WB)	1.0	1Q CY07
Roorkee (Uttaranchal)	1.0	2Q CY07
Surat (Guj)	1.0	3Q CY07
Dadri (UP)	1.5	1Q CY09
Panipat (Har)	1.5	2Q CY09
Total	**6.0**	

Source: Company Reports

- ACL will be increasing its cement grinding capacity by 3m tpa in CY07 and a further 3m tpa in CY09. This will take its capacity from 16.3m tpa to 22.3m tpa by CY09. The total capex for this is Rs9.5bn.

- Clinker capacity is also being upgraded in stages. Clinker capacity at Rabriyawas (Rajasthan) will be enhanced by 0.5m tpa by 3Q CY07. ACL expects to commission 2.3m tpa of clinker capacity by 1Q CY09 in Bhatapara (Chattisgarh) and 1.8m tpa by 2Q CY09 in Rauri (Himachal Pradesh). The capex for these clinker capacities is expected to be Rs15.8bn.

Figure 6. Captive Power Capacity Expansion Schedule

Location	Capacity Addition MW	Commissioning Schedule
Ambujanagar (Guj)	60 (2x30)	1QCY07 / 2QCY07
Ambujanagar (Guj)	30	Q4CY08
Bhatapara (Ctg)	15+33	2QCY08 / 4QCY08
Rabriyawas (Raj)	19	1QCY08
Chandrapur (Mah)	15	1QCY08
Ropar (Pun)	6	2QCY07
Total	**178**	

Source: Company Reports

- Captive power capacity is also being increased as shown in the table above. Of the 178MW of captive power being set up during CY07 and CY08, 60MW of capacity being commissioned in Gujarat is solid fuel captive power to replace the existing 60MW of liquid fuel power. The capex for these power capacities is Rs8.3bn.

Financial summary

Figure 7. Financial Results at a Glance post ACEL Merger

(Rs m)	YE Dec 2006 (12months)	YE Dec 2005 (12months)	Growth (%)
Sales (net of excise)	48,479	32,964	47%
PBIT	18,807	9,516	98%
Interest	377	880	-57%
Gross Profit	18,430	8,636	113%
Depreciation	2,269	2,197	3%
PBT	16,160	6,440	151%
Tax	2,760	1,323	109%
PAT	13,401	5,117	162%

Source: Company Reports

Figure 8. Ambuja Cements — Operating Statistics

	FY04 Jun-04 (12m)	FY05 Jun-05 (12m)	CY06 Dec-06 (18m)	CY07E Dec-07 (12m)	CY08E Dec-08 (12m)	CY09E Dec-09 (12m)
Operating Data						
Clinker capacity (m tonnes)	9.86	10.10	11.30	11.30	11.30	11.30
Effective cement capacity (m tonnes)	12.86	13.30	16.30	19.30	19.30	22.30
Cement production (m tonnes)	10.37	12.80	22.63	17.50	18.85	21.90
Sales						
Cement (m tonnes)	10.44	12.72	22.60	17.50	18.85	21.90
Domestic sales (m tonnes)	8.69	10.96	20.10	15.90	17.45	20.60
Export sales (m tonnes)	1.73	1.76	2.50	1.60	1.40	1.30
Average Exchange Rate (Rs/US$)	**45.5**	**44.6**	**45.1**	**41.8**	**40.0**	**39.0**

Source: Company Reports and Citigroup Investment Research estimates

Figure 9. Ambuja Cements — Profit and Loss Account (Rs in Millions)

	FY04 Jun-04 (12m)	FY05 Jun-05 (12m)	CY06 Dec-06 (18m)	CY07E Dec-07 (12m)	CY08E Dec-08 (12m)	CY09E Dec-09 (12m)
Sales breakdown						
Domestic cement sales (Rs m)	17,387	23,180	57,537	52,851	52,799	57,967
Exported cement sales (Rs m)	2,266	2,796	5,146	3,407	2,520	2,129
Clinker sales (Rs m)	0	23	0	0	0	0
Net sales	**19,653**	**26,000**	**62,683**	**56,258**	**55,319**	**60,097**
Operating expenses	14,283	18,758	41,352	33,127	35,924	42,781
Operating profit	**5,370**	**7,241**	**21,331**	**23,131**	**19,395**	**17,316**
Op. profit/tonne (Rs)	514	569	944	1,321	1,029	791
Op. profit/tonne (US$)	11.3	12.8	20.9	31.5	24.5	18.8
Other income	863	816	1,479	1,050	1,000	975
EBITDA	**6,233**	**8,057**	**22,810**	**24,181**	**20,395**	**18,291**
EBITDA margin %	32%	31%	36%	43%	37%	30%
EBITDA/tonne (Rs)	597	633	1,009	1,381	1,082	835
EBITDA/tonne (US$)	13.1	14.2	22.4	32.9	25.8	19.9
Depreciation	1,686	1,954	3,261	2,685	3,117	4,120
% of avg gross block	5.1%	5.3%	7.9%	5.4%	5.4%	5.4%
EBIT	**4,547**	**6,103**	**19,548**	**21,495**	**17,278**	**14,172**
EBIT/tonne (Rs)	436	480	865	1,228	916	647
EBIT/tonne (US$)	9.6	10.7	19.2	29.2	21.8	15.4
Interest	1,142	918	1,132	772	755	845
PBT	**3,405**	**5,185**	**18,416**	**20,723**	**16,522**	**13,326**
Total Tax	467	503	3,384	4,848	3,883	2,925
Eff.tax rate %	13.7%	9.7%	18.4%	23.4%	23.5%	22.0%
PAT	**2,938**	**4,683**	**15,033**	**15,875**	**12,639**	**10,401**
Prior period/extraordinary items	430	0	0	5,540	2,319	0
Net profit as reported	**3,368**	**4,683**	**15,033**	**21,416**	**14,959**	**10,401**
Net profit/ tonne (Rs)	323	368	665	1,223	793	475
Net profit/ tonne (US$)	7.1	8.2	14.8	29.1	18.9	11.3

Source: Company Reports and Citigroup Investment Research estimates

Figure 10. Ambuja Cements — Balance Sheet (Rs in Millions)

	FY04 Jun-04 (12m)	FY05 Jun-05 (12m)	CY06 Dec-06 (18m)	CY07E Dec-07 (12m)	CY08E Dec-08 (12m)	CY09E Dec-09 (12m)
Fixed Assets	**24,982**	**23,633**	**31,241**	**38,084**	**55,660**	**61,549**
Gross Block	36,581	37,092	45,425	54,962	61,574	91,004
Acc. Depreciation	-12,841	-14,639	-20,533	-23,219	-26,336	-30,455
Net Block	23,739	22,452	24,892	31,743	35,238	60,549
CWIP	1,243	1,181	6,349	6,340	20,422	1,000
Investments	**10,110**	**11,251**	**11,331**	**5,617**	**2,760**	**2,760**
Liquid investments	546	1,687	1,174	1,174	1,174	1,174
Current Assets	**4,914**	**5,846**	**11,776**	**30,969**	**26,191**	**28,367**
Stocks + WIP	2,543	3,170	4,088	3,966	4,539	6,170
Sundry debtors	427	458	900	1,151	1,212	1,482
Other current assets	7	18	50	75	100	125
Loans and advances	1,248	1,334	2,957	3,200	3,500	4,000
Cash/bank	688	865	3,781	22,577	16,840	16,590
Current Liabilities and provisions	**3,473**	**3,958**	**7,016**	**11,266**	**11,193**	**12,041**
Sundry creditors	2,155	2,223	4,417	4,431	4,815	5,681
Taxation	5	13	13	806	300	-202
Proposed dividends (eq+pref)	609	925	1,384	4,778	4,778	5,212
Other creditors/liabilities	704	797	1,202	1,250	1,300	1,350
Overall Capital employed	**36,533**	**36,772**	**47,333**	**63,404**	**73,418**	**80,634**
Shareholders Funds	**20,129**	**21,687**	**34,840**	**51,871**	**62,051**	**67,240**
Share capital	1,794	2,704	3,034	3,041	3,041	3,041
ESOP outstanding	1	0	11	11	11	11
Other reserves	18,334	18,983	31,796	48,818	58,999	64,188
Deferred tax liability	**3,707**	**3,811**	**3,839**	**3,880**	**3,913**	**3,940**
Loan Funds	**12,697**	**11,275**	**8,654**	**7,654**	**7,454**	**9,454**
Secured loans	6,498	5,493	3,178	3,178	3,178	3,178
Unsecured loans	6,199	5,781	5,476	4,476	4,276	6,276
Total sources of Funds	**36,533**	**36,772**	**47,333**	**63,404**	**73,418**	**80,634**

Source: Company Reports and Citigroup Investment Research estimates

Figure 11. Ambuja Cements — Cash Flow Statement, Stock Metrics and Ratios

	FY04 Jun-04 (12m)	FY05 Jun-05 (12m)	CY06 Dec-06 (18m)	CY07E Dec-07 (12m)	CY08E Dec-08 (12m)	CY09E Dec-09 (12m)
Cash flow statement (Rs m)						
PBT	3,835	5,185	18,416	20,723	16,522	13,326
Add: Depreciation	1,686	1,954	3,261	2,685	3,117	4,120
Add: Interest	784	848	790	772	755	845
Less: Other income	-130	-429	-401	-1,050	-1,000	-975
Changes in working capital	532	-791	463	-335	-526	-1,509
Less: tax	-202	-384	-4,503	-4,013	-4,356	-3,400
Others	-433	16	-64	0	0	0
Cash from operating activities	**6,072**	**6,399**	**17,962**	**18,783**	**14,513**	**12,407**
Purchase of fixed assets	-2,516	-1,709	-7,564	-7,742	-20,694	-10,008
Investment purchased	-351	-1,141	131	9,469	5,177	0
Other income	415	64	357	1,050	1,000	975
Others	28	254	804	0	0	0
Cash used in investing activities	**-2,424**	**-2,531**	**-6,272**	**2,776**	**-14,517**	**-9,033**
Proceeds from issue of share capital	-43	124	481	393	0	0
Repayment/proceeds of borrowings	-384	-1,140	-3,402	-1,000	-200	2,000
Interest paid	-1,142	-918	-1,132	-772	-755	-845
Dividend paid	-1,697	-1,841	-4,801	-1,384	-4,778	-4,778
Others	-176	83	-35	0	0	0
Cash flow from financing	**-3,441**	**-3,691**	**-8,889**	**-2,763**	**-5,733**	**-3,623**
Net cash flow	**208**	**177**	**2,802**	**18,796**	**-5,737**	**-249**
Stock Metrics						
No. of shares (m)	1,352	1,352	1,517	1,521	1,521	1,521
Book value per share (Rs)	14.9	16.0	23.0	34.1	40.8	44.2
EPS (Rs)	2.2	3.5	9.9	10.4	8.3	6.8
CFPS (Rs)	3.4	4.9	12.1	12.2	10.4	9.5
Net Debt/EBITDA (x)	1.8	1.1	0.2	-0.7	-0.5	-0.5
Total debt/Tangible net worth (x)	0.6	0.5	0.2	0.1	0.1	0.1
Net debt/equity (x)	0.6	0.4	0.1	-0.3	-0.2	-0.1
ROE (%)	16%	22%	53%	37%	22%	16%
RoCE (%)	12%	17%	46%	39%	25%	18%
Total dividend (Rs mn)	1,604	2,157	5,259	4,778	4,778	5,212
DPS (Rs)	1.60	2.10	2.50	2.75	2.75	3.00
Dividend payout (%)	48%	46%	35%	22%	32%	50%
Ratios						
Current ratio	1.4	1.5	1.7	2.7	2.3	2.4
Interest coverage	4.0	6.7	17.3	27.8	22.9	16.8
Days in inventory	91	80	72	80	85	100
Days receivable	8	6	7	8	8	10
Debtors turnover	46.0	56.7	69.7	48.9	45.6	40.6
Days payable	71	55	77	60	60	60

Source: Company Reports and Citigroup Investment Research estimates

1Q CY07 Results

Figure 12. Ambuja Cements — 1Q CY07 Results

(Rs m)	1Q CY07	1Q CY06	% chg
Net sales	**14,338**	**10,740**	**34%**
Total expenditure	8,708	7,041	24%
EBITDA	**5,631**	**3,700**	**52%**
EBITDA per tonne	1,296	885	46%
% margin	39.3	34.4	14%
Other income	257	213	21%
Interest (net)	18	110	-84%
Depreciation	598	566	6%
Extraordinary items	2408	358	
PBT	**7,679**	**3,594**	**114%**
Tax	1,772	-534	-432%
Effective tax rate (%)	23	-15	
PAT as reported	**5,907**	**4,128**	**43%**
PBT excluding extraordinaries	5,271	3,236	63%
Tax on rec profit	1,216	-481	-353%
Tax rate (%)	23.1	-14.9	-255%
Adjusted PAT	**4,055**	**3,716**	**9%**

Source: Citigroup Investment Research

Net sales grew 34% yoy (in line) to Rs14.3bn, driven by a price jump of 28% yoy

Net sales grew 34% yoy (in line) to Rs14.3bn, driven by a price jump of 28% yoy. Reported PAT grew 43% yoy to Rs5.9bn, but adjusted for sale of investments came in at Rs4.1bn (+9% yoy) and was in line with expectations. Volumes grew only 4% yoy to 4.34m tonnes due to last year's high base, and the lack of spare capacity. Prices were subdued on a sequential basis due to government measures. ACL did well during the quarter with EBITDA growing 52% yoy to Rs5.6bn. EBITDA margins grew 500bps to 39.3% and EBITDA/tonne reached a high of Rs1,300. Expenses were largely in line with forecasts and grew 19% yoy. Interest costs were substantially lower YoY due to the company's net cash position. ACL is on track to raise capacity by 3m tpa during CY07, which would take capacity to 19.3m tpa. The company's property at Kalina in Mumbai has received a high bid of Rs3.3bn. As the formalities are not yet complete, no effect has been seen in the 1Q CY07 results.

Ambuja Cements

Company description

Ambuja Cements (ACL) is one of India's lowest-cost cement producers and enjoys relatively high EBITDA margins due to its focus on the retail cement market (giving higher realizations), modern plants with low power and fuel consumption, and use of sea transport. Its largest markets are North India (38% of sales volumes) and West India (33%). Its merger with Ambuja Cement Eastern (ACEL) gives it a presence in the eastern market (13% of sales). Holcim holds a 28% stake in ACL, of which 10% is through its 78% subsidiary company Ambuja Cement India. Both ACC and ACL give the Holcim Group a total capacity of 36m tpa in India, which is expected to rise to about 50m tpa by 2009E.

Investment thesis

We rate ACL as Sell/Medium Risk (3M) with a target price of Rs103. Although ACL is likely to trade at a premium to domestic peers, due to higher EBITDA margins, we believe the stock is expensive for the following reasons: (1) limited visibility on cement pricing moving up as a result of uncertainties arising from unfavorable government measures in CY07; (2) a 20% yoy expected decline in CY08E earnings as large capacities are expected domestically, particularly in North India; and (3) the risk to exports, as substantial new cement capacity is coming up in the Middle East, which would convert the current deficit in that region into a surplus. ACL is one of India's largest cement exporters (10% of sales), supplying mainly to the Middle East and Sri Lanka. We have factored in a slowdown in export volumes and pricing already, however, these could be greater than we forecast. ACL should benefit from cost savings from an additional 178MW of captive power (vs. around 200MW currently) and higher production of low-cost blended cement. But these savings are unlikely to offset the EBITDA fall expected in CY08E due to the forecast 9% yoy price decline.

Valuation

We use EV/EBITDA to value ACL, a common metric used for cement companies. We have set our target price at Rs103 based on a 10% discount to the historical seven-year average of 8.4x, which gives us an EV/EBITDA of 7.5x for CY08E. At our target price ACL would be valued at an EV/tonne of US$180 for CY08E. The 10% discount to the seven-year average is due to the unfavorable government measures that attempt to take away the last leg of pricing upside. In recognition of ACL's higher margins and efficiency, we use only a 10% discount to the seven-year average, rather than the 15% applied for ACC.

Risks

We rate ACL as Medium Risk, based on our quantitative risk-rating system that tracks 260-day historical share price volatility. The key upside risks to our target price include: (1) further delays in industry capacity; (2) better-than-expected domestic demand growth; (3) a depreciation of the rupee versus the US$; we have assumed an appreciating rupee; and (4) changes in the duty/tax regime in favor of producers.

ACC (ACC.BO, 3M, Rs838.85)

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 will take 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

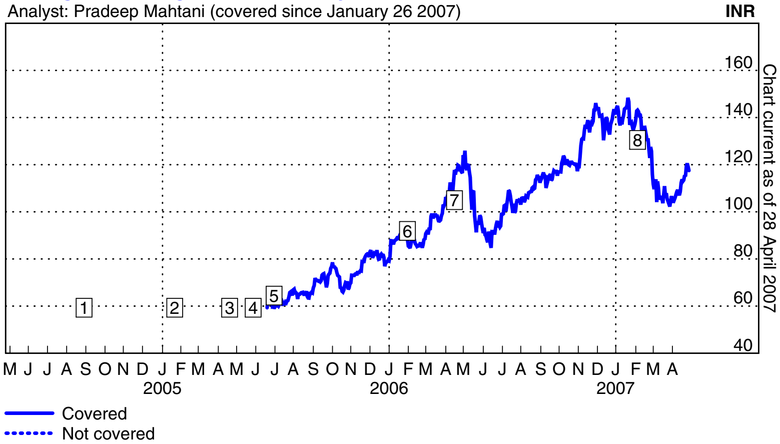
I, Pradeep Mahtani, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be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

IMPORTANT DISCLOSURES

Ambuja Cements (GACM.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Pradeep Mahtani (covered since January 26 2007)



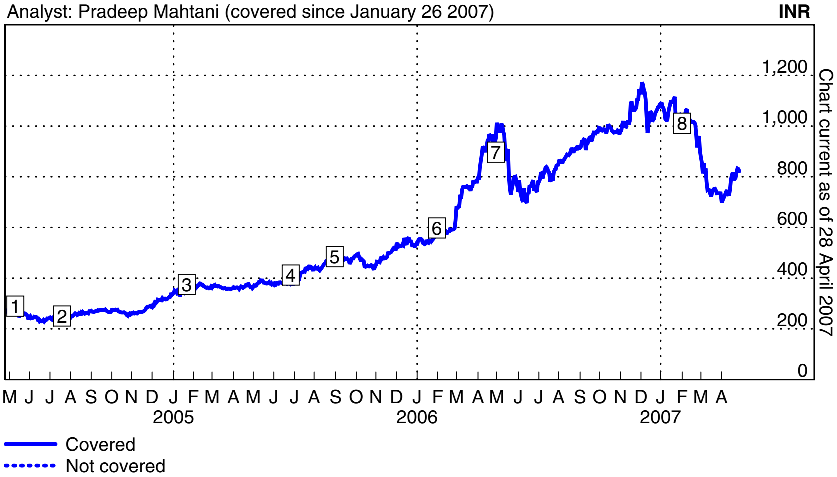
#	Date	Rating	Target Price	Closing Price
1:	30 Aug 04	*2M	*49.07	NA
2:	21 Jan 05	2M	*60.00	NA
3:	20 Apr 05	2M	*61.33	NA
4:	27 May 05	*2L	61.33	NA
5:	30 Jun 05	2L	*64.00	59.00
6:	31 Jan 06	*3L	*92.00	88.50
7:	17 Apr 06	3L	*96.00	117.75
8:	5 Feb 07	*2M	*158.00	143.15

*Indicates change.

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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