Industry In-Depth

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Indian Cement Sector

No Big Relief – Sell Into Current Strength

- Downgrading sector outlook — The government measures of 3 May could boost earnings by 4-6%. But we are negative on the sector: (1) the previous measures of the past few months erode pricing upside in FY08E, and increase the threat of imports; (2) A steady stream of large capacities in FY09E; and (3) Diminishing exports because of a capacity surge in the Middle East. We downgrade ACC, Grasim, UltraTech and Ambuja to Sell/Medium Risk (3M).

- Surplus despite delays — We recently met several major cement companies and the large cement machinery manufacturers. Capacity is likely to increase by 50% (85m tpa) in the next three years. Despite higher demand growth of 12% yoy in FY09E, and even assuming 6-month delays in new supply, there is a small surplus.

- A surge in regional capacity — Our report includes discussions with producers in Pakistan and details from a recent Middle East cement conference. An unprecedented 210m tpa (globally, excl China) was ordered in the last two years. Of the orders in 2006, 54% were from India and the Middle East.

- We advise Selling — We cut our target EV/EBITDA multiples from a premium to a discount to seven-year average valuations due to (1) recent policy changes, (2) increased import threat, (3) reduced earnings, and (4) negative earnings growth. Our new valuations give an EV/EBITDA range of 6.5-7.5x and EV/t of US$110-180, indicating a 10% downside for most stocks under coverage.

- Upside risk factors — (1) Delay in capacities beyond six months; (2) Higher-than-estimated demand growth; (3) Changes in duty/tax regime in favor of producers.

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Figure 1. Indian Cement Sector — Valuation Snapshot

	Ticker	Current Price (LC)	Mkt Cap (US$ m)	Rating		Target Price		P/E*	EV/EBITDA*	EV/tonne*
				Old	New	Old (LC)	New (LC)	CY08 FY09	CY08 FY09	CY08 FY09
ACC	ACC.BO	839	3,852	1M	3M	1,260	730	13.6	8.6	143
Ambuja Cements	GACM.BO	118	4,396	2M	3M	158	103	14.2	8.7	213
Grasim	GRAS.BO	2,448	5,488	1L	3M	3,460	2,390	11.3	6.6	121
UltraTech	ULTC.BO	820	2,501	1M	3M	1,290	730	12.9	7.8	124

*Annualized. Prices as on April 30. Rs/US$ rate at 42 for the forecasts

Source: Citigroup Investment Research estimates

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

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Downgrading Cement Sector Outlook

This report incorporates our recent meetings with several major cement companies across India, large cement machinery manufacturers, and discussions with producers in Pakistan. We also incorporate details from a recent cement conference in the Middle East.

We downgrade our sector view based on the following:

- Recent government measures attempting to take away the last leg of pricing upside in FY08 and increasing the threat of imports.
- Capacities expected likely to create a surplus in FY09E, even after we assume delays of six months for capacities, and a higher demand growth rate of ~12%.
- Diminishing exports due to a surge in capacities in the Middle East (accounts for 50-60% of India's exports), thereby adding to the domestic supply.

Some pricing power in FY08E, but we advise investors to Sell into current strength; the announcement of 3 May may provide further selling opportunities

The cement sector is likely to enjoy some level of pricing power in the next few months, as there is currently a domestic cement shortage. Cement stock prices could continue their uptrend in the near term on the back of this. Based on the above concerns, however, we believe the uptrend is likely to be short-lived and advise investors to Sell from a 12-month perspective.

We cut our forecasts by 7-19% for CY08E/FY09E and expect negative earnings growth of 8-21% yoy

Our earlier target prices were based on premiums to historical averages. Based on the above concerns, however, we cut our CY08E/FY09E forecasts by 7-19%. We expect negative earnings growth of 8-21% yoy, which is more pronounced than the decline we expected earlier. We now use a discount to historical (7-year) average valuations giving an EV/EBITDA target range of 6.5-7.5x and EV/t of US$110-180. Thus, even though FY08E valuations have declined, we do not see major stock price upside from here.

On 3 May 2007, the government announced a change, wherein the excise duty would be charged on an ad valorem basis at 12% on cement sold above Rs190 per 50kg bag versus Rs600/tonne proposed in the budget.

While we believe that this announcement is positive for the cement producers and could, at first glance, impact our earnings estimates upwards by 4-6%, we are not incorporating this in our forecasts until we have more clarity on how the producers react, and the extent to which the benefits are passed on to consumers. We advise Selling into the current strength.

Reason 1: Government Pressures

In the last three months, the government has announced several measures that have adversely impacted the cement industry:

1. On 23 January 2007, the basic import duty on cement was cut from 12.5% to nil;

2. The budget changed the excise duty on cement from Rs408/t (Rs20 per 50 kg bag) to: a) Rs361/t if the retail price does not exceed Rs190/ bag, or b) Rs618/t (Rs31/bag) if prices exceed Rs190/bag;

3. On 3 April 2007, the government reduced countervailing duty (CVD) from Rs618/Rs361 per tonne to nil and additional customs duty from 4% to nil on imported cement.

4. On 3 May 2007, the government announced excise duty to be charged on an ad valorem basis at 12% on cement sold above Rs190 per bag (Rs600/tonne proposed previously). This measure should provide some relief to the cement producers against the above mentioned measures.

Figure 2. Landed Cost of Cement Imports

	Including import duty +CVD+SAD	Including CVD+SAD	No duties
FOB price (US$/t)	30	30	30
Freight cost to India (US$/t)	35	35	35
CIF (US$/t)	**65**	**65**	**65**
Exchange rate (Rs/US$)	42	42	42
(Rs/tonne)			
CIF	2,730	2,730	2,730
Import duty	341	0	0
Countervailing duty (CVD)	618	618	0
Assessable value	3,689	3,348	2,730
Additional customs duty (SAD)	148	134	0
Octroi	109	109	109
Port handling	300	300	300
Local transport	500	500	500
Warehousing	100	100	100
Congestion charges	300	300	300
Total landed price per tonne	**5,146**	**4,791**	**4,039**
Total landed price per bag	**257**	**240**	**202**

Source: Citigroup Investment Research

Government measures reduce landed cost of imported cement to ~Rs200/bag

The measures specified in points 1 and 3 above, effectively reduced the theoretical landed cost of imported cement from Rs260/bag to Rs200/bag (see figure 2). The recent changes in the basic and additional import duties may force the producers to reduce prices in coastal markets such as Mumbai, where prices are currently Rs230-240 per 50 kg bag. These prices are particularly vulnerable if Pakistan is able to export cement into India at a landed cost of Rs210-220/bag, especially if it is possible to send it in small quantities.

Government is indicating to companies to reduce cement prices

While the industry was able to pass on the higher excise duty specified in point 2, this has taken away some of the pricing upside that would have gone to the bottom lines of cement companies. Additionally, as seen in several press reports, the government has indicated to the cement companies on several occasions that they should try to find ways to reduce cement prices. All these factors continue to act as impediments to the last leg of pricing upside before the next large batch of cement capacities comes in FY09E.

Imported Cement – Constrained by Infrastructure

Constraints on imports of bulk cement

Though imported cement will become more attractive with the new duty regime, the biggest constraint for cement imports into India is the lack of infrastructural facilities at the ports to handle bulk cement. Although capex on such infrastructure is not prohibitive (approximately US$30m excluding land cost), the key is in finding a site with access to deep water facilities. This latter point is the key block in establishing cement terminals along the coast.

Bagged cement imports now more likely, though modest

It is possible to import bagged cement into India

While it will be difficult to import bulk cement into India, it is possible to import bagged cement. This will add to the existing supply, particularly in markets where the landed cost is cheaper than domestic prices. We expect the existing and future oversupply in the neighboring countries to worsen in the coming quarters, increasing the threat from imports. The key issues preventing a near-term surge in imports into India are: (1) Certification by the Bureau of Indian Standards (BIS) leading to delays, resulting in the first batch of cement imports only becoming available only during or after the monsoon months, (2) limited number of major ports through which imports are possible, (3) bagged cement more prone to damage resulting in losses of 5-7%, (4) most users use small quantities (3,000 tonnes per month) while an economical ship load is around 25,000 tonnes.

Reason 2: Demand Can't Absorb Supply Despite Delays

Demand outlook – still robust

Demand growth currently at 10% and expected to accelerate to ~12%

India's cement demand grew by a CAGR of 8.1% over the past 10 years. The growth has accelerated to a higher level of 10% in the past two years, mainly on strong demand from the housing sector and recent demand from IT-related spending and infrastructure. We expect domestic cement demand to grow by 10% in FY08E and 12% in FY09E.

With the rise in interest rates we expect some slack in housing-related demand in FY08 but expect some demand kicking in from the Special Economic Zones (SEZs), which have just received formal approval to go ahead by the government, to offset part of this. Please see Rohini Malkani's note *SEZ Update – Positives outweigh the negatives* dated 10 April 2007 for further details. https://www.citigroupgeo.com/pdf/SAP04287.pdf

We expect the demand growth rate to accelerate to 12% yoy in FY09E based on further demand from the SEZs and infrastructure creation. The increase in growth rate is largely due to additional demand from the 63 notified and 234 formally approved SEZs, which together will cover 417 sq km.

SEZs expected to consume an additional 5-6m tonnes of cement every year

We assume that 50% of these would go ahead as scheduled in the light of the lower attractiveness due to the new regulations, which have reduced the flexibility of land use. Further we assume that 50% of the area will be built up, and using an FSI of 1x, our calculations show that an additional 5-6m tonnes of cement would be consumed every year. Since some of the SEZ development is likely to replace existing demand for office space and industry development, we have added half of this to our demand assumption for FY09E, which takes the YoY growth rate from 10% to 12%.

Figure 3. SEZ Land — Quick Facts

	Number	Land area (sq km)
Notified SEZ	63	67
Formally Approved SEZ	234	350
In-Principle Approvals SEZ	162	1400
Total SEZ land area (formally approved + in- principle)		1750
India's Total land area		2,973,190 (3mn)
India's Total agri land area (51% of Total)		1,534,166 (1.5mn)
SEZs as % of agri land		0.1%

Source: SEZ India

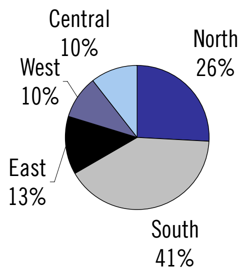
New domestic supply — some delays but still coming

85-90m tonnes of capacity is expected in the next three years

We recently met the large cement machinery manufacturers and also several large cement companies across India. Based on orders already placed there is about 85-90m tpa of capacity expected in the next three years. Most of the orders have come through in 2006, particularly in the 2H. Some orders have also come in the first two months of 2007 and although orders have dried up in March 2007, the cement machinery manufacturers expect orders for around 10m tpa of capacity in the next few months.

Our discussions with the above companies showed that new capacity creation is delayed in many cases. This is due to a variety of reasons such as non-availability of civil contractors, land clearance delays, environmental delays, equipment supply backlogs and difficulty in coal linkages. As a result of this, while we expected around 15m tpa of capacity in FY07, only about 10m tpa has actually been completed. Keeping such delays in mind, we estimate that almost all the future capacities in FY09 and FY10 are likely to be commissioned with a delay of six months from the dates provided to us by the cement machinery manufacturers and estimates given by the companies. To estimate production for the year, we adjust for the anticipated completion date and assume a utilization level of 75% in year one and 90-95% in year two of commissioning. Even after assuming these delays and assuming a higher rate of growth of 12%, we expect a marginal oversupply in FY09E.

Figure 4. India — Capacity Addition by Region (FY08-10E)



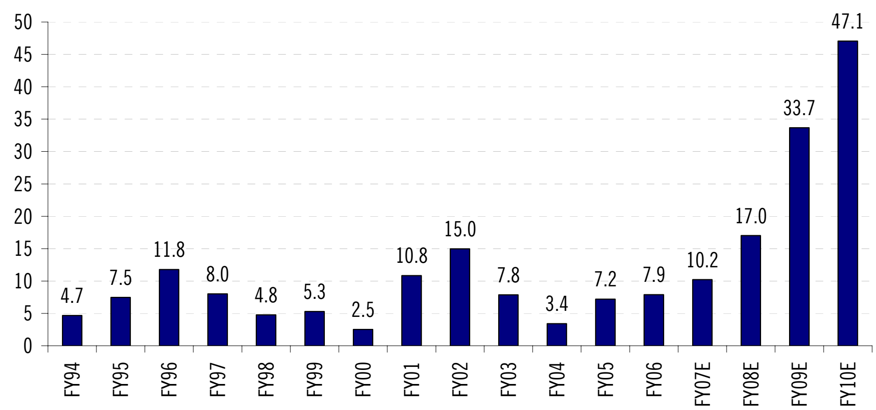
Source: Cement Manufacturers' Association, Company Reports, Citigroup Investment Research

Figure 5. India — Domestic Cement Demand-Supply

	Capacity m tpa	Prod m tpa	Capacity utilization (%)	Domestic Dispatches m tpa	Dom demand gr (%)	Cement exports m tpa	Clinker exports m tpa	Surplus/ deficit m tpa
FY2000	106.9	94.0	87.9	91.9	15.2	2.0	1.2	0.18
FY2001	117.7	93.4	79.4	90.2	-1.9	3.1	2.0	0.12
FY2002	132.7	102.4	77.2	99.0	9.8	3.4	1.8	0.00
FY2003	140.6	111.4	79.2	107.6	8.7	3.5	3.5	0.28
FY2004	144.0	117.5	81.6	113.9	5.8	3.4	5.6	0.27
FY2005	151.2	127.6	84.4	123.1	8.1	4.1	6.0	0.42
FY2006	159.1	141.8	89.1	135.6	10.1	6.0	3.2	0.24
FY2007E	169.3	152.8	90.2	149.0	9.9	5.9	3.3	-2.07
FY2008E	186.3	166.5	89.4	163.9	10.0	4.0	3.0	-1.35
FY2009E	**220.0**	**187.5**	**85.2**	**183.5**	**12.0**	**1.5**	**1.5**	**2.49**
FY2010E	**267.0**	**227.6**	**85.2**	**205.6**	**12.0**	**1.5**	**1.5**	**20.55**

Source: Cement Manufacturers' Association, Company Reports, Citigroup Investment Research estimates

Figure 6. India — Yearly Capacity Addition (m tpa)

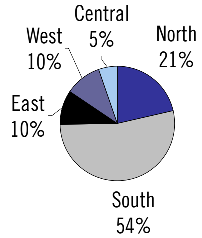


Source: Cement Manufacturers' Association and Citigroup Investment Research estimates

As illustrated, most of the capacity creation in FY08 is in north and central India. The total supply of 17m tpa is largely made up of small plants

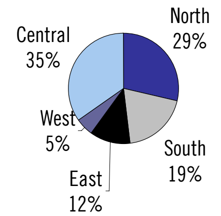
In FY09, the situation gets much worse. At 34m tpa the capacity is twice that of FY08, but also in larger chunks and half of that is expected in north India, causing serious oversupply in the region

Figure 7. Regional Capacity Addition — FY07E (10m tpa)



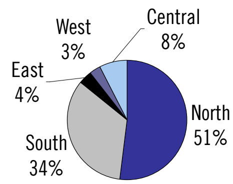
Source: Company Reports, CMA, CIR

Figure 8. Regional Capacity Addition — FY08E (17m tpa)



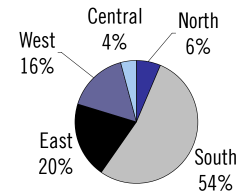
Source: Company Reports, CMA, CIR

Figure 9. Regional Capacity Addition — FY09E (34m tpa)



Source: Company Reports, CMA, CIR

Figure 10. Regional Capacity Addition — FY10E (47m tpa)



Source: Company Reports, CMA, CIR

FY08E pricing impacted due to governmental pressures and FY09E pricing to be impacted due to expected oversupply

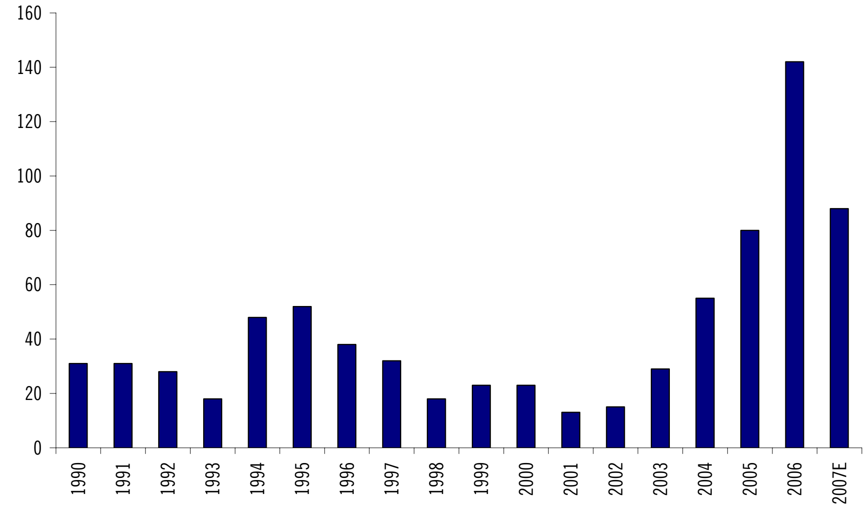
As we show in the tables above, FY08E will in our view be a good year for the industry based on the likely deficit. This changes in FY09E, when we expect a marginal oversupply. However, in both cases there is an adverse impact on pricing power. In FY08E (as explained above) it is due to governmental pressures and in FY09E it would be due to the likely advent of imports and slower exports (as explained below). Additionally, pricing will also be impacted in FY09E as new capacity coming in will be double the level in FY08E and in larger and regular doses, making it difficult to push through and maintain price increases.

Reason 3: Unprecedented Levels of Global Capacity

In addition to the large capacities coming in India, there are also huge capacities coming up globally, with the largest chunk (66%) of the orders coming in from the Middle East, India and other Asian countries. As the section below shows, the impact is likely to be quite serious in the coming years.

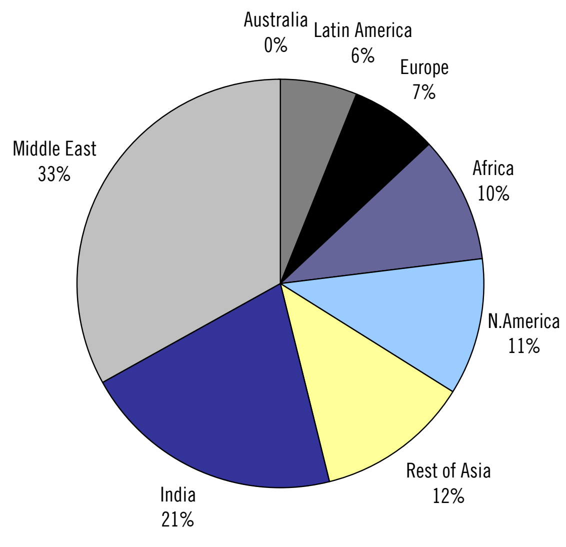
The historical average kiln capacity ordered between 1990-2005 was 33m tpa (global ex China). In contrast around 210m tpa of capacity has been ordered in 2005 and 2006 alone

Figure 11. Global Contracted Cement Kiln Capacity (excl. China) (m tpa)



Source: FLSmidth

Figure 12. Geographical Distribution of Contracted New Kiln Capacity in 2006 (excl. China)



Source: FLSmidth

Pakistan — already in oversupply

Pakistan has 7-8m tonnes of oversupply; some being targeted at India

We also spoke to a few producers in Pakistan such as Lucky Cement and D.G. Khan Cement. Both these companies have recently completed expansions and are also adding on some more cement capacity. They are already exporting cement to countries such as Afghanistan, Iraq and Dubai and are looking to export more to these countries. In Pakistan, there is already about 7-8m tpa of oversupply some of which is being targeted towards India.

Figure 13. Pakistan's Cement Demand-Supply dynamics

	2002	2003	2004	2005	2006	2007E	2008E	2009E	2010E
Production Capacity (m tpa)	-	-	-	18.0	21.0	30.0	30.0	30.0	30.0
Total Production (m tpa)	-	-	-	16.3	18.3	21.7	25.1	29.0	33.4
Consumption (m tpa)	9.8	10.9	12.5	14.8	16.8	19.7	22.6	26.0	29.9
Growth % (YOY)	-	*11*	*15*	*18*	*14*	*17*	*15*	*15*	*15*
Exports (m tpa)	0.1	0.4	1.2	1.6	1.5	2.0	2.4	2.9	3.5
Growth % (YOY)	-	*353*	*169*	*34*	*-3*	*35*	*20*	*20*	*20*
Imports (m tpa)	0	0	0	0	0	0	0	0	0
Domestic Utilization (%)	-	-	-	82	80	66	75	87	100
Total Utilization (%)	-	-	-	91	87	72	84	97	111

Source: Lucky Cement Limited and Citigroup Investment Research

Pakistan plans to sell cement to India at an FOB price of US$65/t

D.G. Khan Cement confirmed that it has already delivered 1,500 tonnes of sulphate resistant cement to Mundhra port. Lucky Cement is the largest cement producer and has the largest presence in southern Pakistan. Of its total capacity of 6.5m tpa, 2.5m tpa is in the south, near Karachi port. Lucky Cement plans to sell cement at an FOB price of US$65/t and with a freight cost of about US$5-10/t the delivered cost is likely to be around Rs210-220 per 50kg bag in Mumbai city. It has submitted samples to the cement for Bureau of Indian Standards (BIS) evaluation and is awaiting approval. It is also planning to send cement to India in small quantities in containers of 25 tonnes each containing 500 bags.

Figure 14. Landed Cost of Cement Imports from Pakistan

	Pakistan Freight = $5	Pakistan Freight = $10
FOB price (US$/t)	65	65
Freight cost to India (US$/t)	5	10
CIF (US$/t)	**70**	**75**
Exchange rate (Rs/US$)	42	42
(Rs/tonne)		
CIF	2,940	3,150
Import duty	0	0
Countervailing duty (CVD)	0	0
Assessable value	2,940	3,150
Additional customs duty (SAD)	0	0
Octroi	118	126
Port handling	300	300
Local transport	500	500
Warehousing	100	100
Congestion charges	200	200
Total landed price per tonne	**4,158**	**4,376**
Total landed price per bag	**208**	**219**

Source: Citigroup Investment Research

A surge in Middle Eastern cement capacity

About 50-60m tonnes of capacity is coming up in the Middle East in the next three years. We estimate that the deficit of ~15m tpa will be converted into a surplus of about 40m tpa by 2010

Our colleagues from London, Clyde Lewis and Aynsley Lammin, recently visited cement companies in Dubai to get a better sense of the demand growth and supply creation in the region. In addition, our colleague Dari Al-Bader attended the Cemtech conference in Abu Dhabi. According to information gathered by them, there is about 50-60m tpa of capacity coming in the next three years in the Middle East, mainly in Saudi Arabia, Iran and the UAE. Of this, about 5-6m tpa is due to enter commission in the next 3–6 months in the UAE alone. There is a view that a large part of the new capacity in Iran and Saudi Arabia in particular is being earmarked for exports. Given the low fuel and power costs, cement exports are effectively an alternative way of exporting oil, albeit in a powdered form.

There is some uncertainty on oversupply in Saudi Arabia as some capacities may not come through and demand growth could be stronger than we expect

Figure 15. Regional Market Status

	2005			2010E		
Country	Cons (m tpa)	Per capita cons (kg)	Demand-supply balance	Cons (m tpa)	Per capita cons (kg)	Demand-supply balance
Iran	**34**	**482**	**2**	**60**	**812**	**15**
Iraq	11	382	-9	18	560	-11
Jordan	4	655	0	5	788	2
Kuwait	5	1,885	-2	8	2,601	-3
Lebanon	3	684	2	3	778	2
Oman	3	1,167	0	4	1,694	1
Qatar	2	2,875	-1	4	4,138	-1
Saudi Arabia	**27**	**1,085**	**0**	**38**	**1,393**	**22**
Syria	7	380	-2	11	517	1
UAE	13	2,761	0	21	4,027	15
Yemen	4	188	-2	5	222	1
Afghanistan	3	104	-3	4	117	-4
Pakistan	18	113	0	30	169	0
Total	**133**	**355**	**-15**	**210**	**511**	**39**

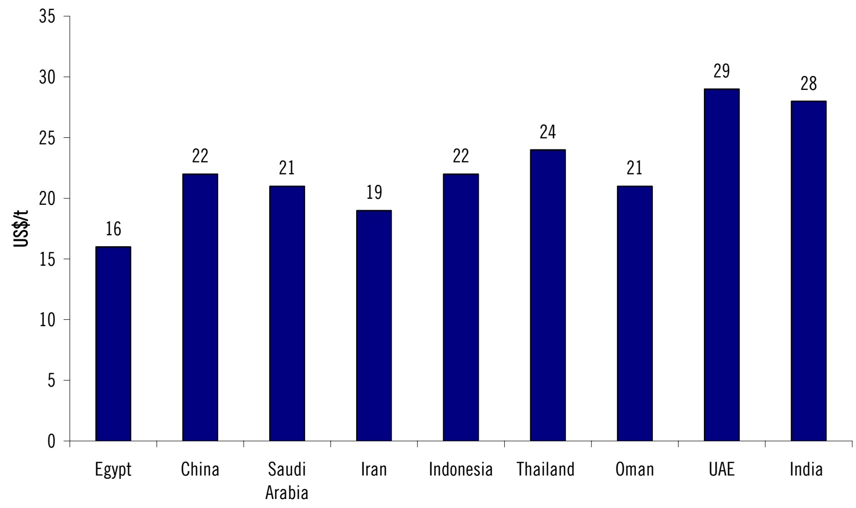
Source: CIDCO, Iran and Citigroup Investment Research estimates

Figure 16. Planned Cement Capacity Expansions

Country	2005 Capacity – m tpa	2010E Capacity – m tpa	% chg
Iran	35	75	114%
Iraq	3	7	180%
Jordan	4	7	63%
Kuwait	3	5	67%
Lebanon	5	5	0%
Oman	2	5	125%
Qatar	2	3	73%
Saudi Arabia	27	60	124%
Syria	5	11	104%
UAE	13	35	167%
Yemen	2	6	300%
Afghanistan	0	1	150%
Pakistan	18	30	67%
Total	**118**	**249**	**110%**

Source: Citigroup Investment Research estimates

Figure 17. Cash Costs of Production – Bulk OPC



Source: A Presentation by Holtec Consulting, India

India exports mainly to the Middle East

More than 60% of India's cement exports are to the Middle East

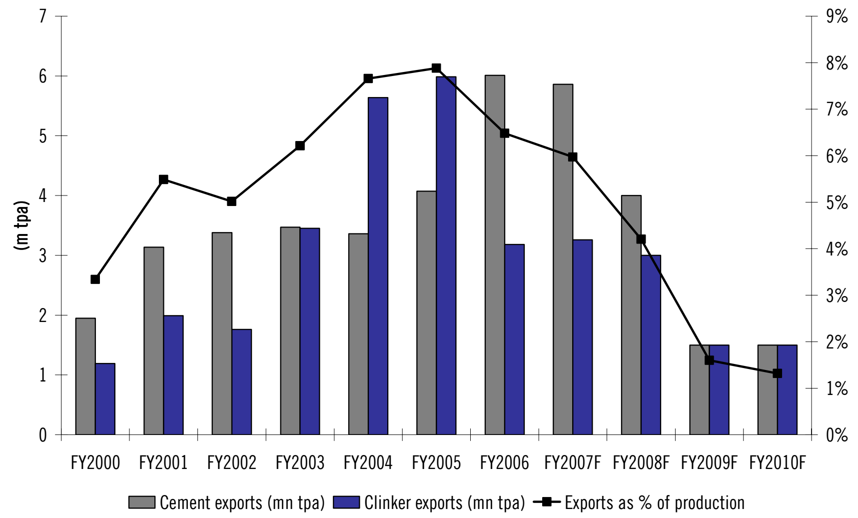
As we see from figure 15, the deficit of about 15m tpa in 2005 for the Middle Eastern region is likely to turn into a surplus of around 40m tpa by 2010. This is not good news for India. Cement exports from India rose in the past few years. Total exports of cement and clinker combined rose from a level of 5m tonnes per annum in FY01 to about 9.2mn tonnes combined in FY07. India's key export markets are the Middle East, Nepal, Sri Lanka and Bangladesh. Industry sources indicate that more than 60% of cement exports and around 50% of clinker exports are sent to the Middle East.

Some slowdown in exports in recent months

We see cement exports from India declining and estimate that the total exports of cement and clinker combined are likely to reach 3m tpa by FY09E, from a level of 9m tpa combined in FY07

An analysis of the monthly data trends reported by the Cement Manufacturers' Association indicates some slowdown in cement exports. From an average of 540,000m tonnes per month of cement exports in 1H FY07 (which includes the monsoon months), this decelerated to 430,000 tonnes per month during October 2006 to February 2007. Some of the slack has been filled up by clinker exports. In the light of the large levels of capacity creation in the Middle East in the coming months, we expect cement exports from India to decline and estimate that the total exports of cement and clinker are likely to reach 3m tpa by FY09. This could adversely impact export pricing and volumes, but could also adversely impact domestic prices, particularly for plants based in western India, which account for a disproportionate share of India's cement and clinker exports.

Figure 18. India — Yearly Cement and Clinker Exports (m tpa) and Exports as a % of Total Production



Source: Cement Manufacturers' Association, Citigroup Investment Research estimates

Valuations not compelling enough in changed scenario

As we have seen in the previous sections, the scenario for the cement industry has altered substantially in the past few months. This has reduced the pricing flexibility in the near term at a time when the industry was preparing to enjoy the best demand supply dynamics in favour of pricing after a long stretch. The pricing power will likely reduce substantially in FY09E as new chunks of capacity begin to come on stream at regular intervals and it will be difficult for producers to increase or even maintain prices.

We reduce target multiples to a range of 6.5x to 7.5x for CY08E/FY09E

Based on this changed outlook for the industry and updates from cement plant manufacturers and sources in the Middle East, we reduce our target multiples for the cement majors from a range of 8.5x to 10.5x EV/EBITDA for CY07E/FY08E to a level of 6.5x to 7.5x for CY08E/FY09E. We believe the lower valuations are justified keeping in mind the lower YoY prices we expect in FY09. These will result in lower EBITDA/tonne from historical highs likely to be earned in the current year, lower EBITDA margins and ROEs. Despite coming off from their highs of US$160-260, EV/tonne valuations are still quite high in the range of US$120-210/tonne, especially considering replacement costs in the range of US$90-100/tonne.

We downgrade our recommendations on ACC, Grasim and UltraTech from Buy to Sell/Medium. On Ambuja Cements we go from Hold to Sell/Medium. While our earlier target multiples valued the stocks at a premium to historical averages, we now value them lower than their average valuations for the past seven years, except for Grasim. We have used discounts of around 15% for ACC and UltraTech to their average EV/EBITDA multiples for the past 7 years. For Ambuja Cements, we have used a lower discount rate of ~10% because of its relatively higher margins and efficiency levels. For Grasim, we have used a 10% premium to its mean to incorporate the growth in EBITDA of its other divisions. As these valuations fall in a range for CY08E/FY09E EV/EBITDA of 6.5-7.5x and EV/t of US$110-180, there is little room for share price upside, in our view.

Figure 19. Global Cement Sector – Valuation Comparatives

	Ticker	Rating	Current Price (LC)	Target Price (LC)	Mkt Cap (US$ m)	EPS (LC)		P/E		EV/EBITDA		EV/tonne (US$/tonne)	
						CY07E FY08E	CY08E FY09E	CY07E FY08E	CY08E FY09E	CY07E FY08E	CY08E FY09E	CY07E FY08E	CY08E FY09E
ACC	ACC.BO	3M	822	730	3,786	78.1	61.6	11	13	7	8	146	140
Ambuja Cements	GACM.BO	3M	118	103	4,393	10.4	8.3	11	14	7	9	214	212
Grasim	GRAS.BO	3M	2,424	2,390	5,441	239.2	216.2	10	11	6	7	149	120
UltraTech	ULTC.BO	3M	803	730	2,447	69.0	63.8	12	13	7	8	154	122
Anhui Conch Cement	0914.HK	3M	32	31	5,935	1.5	2.1	20	15	12	9	87	73
China National Building Material	3323.HK	1M	9	10	2,252	0.4	0.6	22	14	13	10	71	54
Siam Cement	SCC.BK	1L	234	264	8,736	22.7	25.8	10	9	7	7	na	na
Siam City	SCCC.BK	3L	278	228	2,162	17.8	19.2	16	15	11	10	132	132
TPI Polene	TPIP.BK	1H	13	17	798	0.9	1.1	15	11	7	6	120	115
Taiwan Cement	1101.TW	1L	30	33	2,928	2.4	2.5	13	12	15	14	74	62
Asia Cement	1102.TW	2L	35	36	2,643	3.1	3.3	11	11	12	10	77	69
Indocement	INTP.JK	3L	5,900	5,000	2,393	232.0	307.0	25	19	12	10	159	148
Holcim Indonesia	SMCB.JK	3M	720	540	608	0.0	14.0	-	52	20	16	125	122
Semen Gresik	SMGR.JK	1L	38,200	47,000	2,497	2513.0	2748.0	15	14	8	7	145	139
Holcim	HOLN.VX	1M	129	143	27,292	9	10	14	13	7	7	250	230
Lafarge SA	LAFP.PA	1M	117	135	28,186	9	10	13	11	7	7	207	181
Heidelberg Cement	HEIG.DE	2M	118	115	18,585	8	9	15	14	8	7	167	146

Prices as of April 27

Source: DataCentral, Company Reports and Citigroup Investment Research estimates

Companies

ACC (ACC.BO)

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)

Downgrading to Sell: Lower Pricing to Hit Profits

- 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.

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

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.

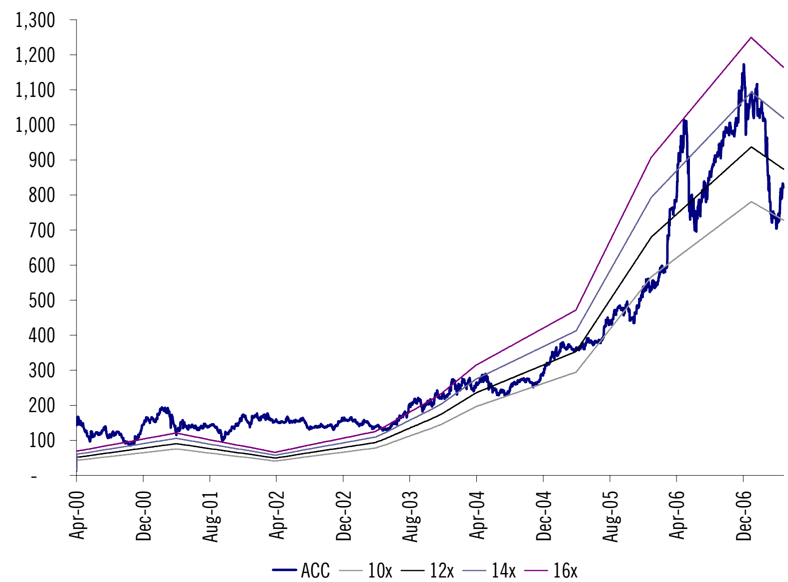
Figure 3. ACC — Rolling EV/EBITDA Chart

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	FY05	CY05 (9 m)	CY06	CY07E	CY08E	CY09E
	31-Mar	31-Mar	31-Dec	31-Dec	31-Dec	31-Dec	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	FY05	CY05 (9 m)	CY06	CY07E	CY08E	CY09E
	31-Mar	31-Mar	31-Dec	31-Dec	31-Dec	31-Dec	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.

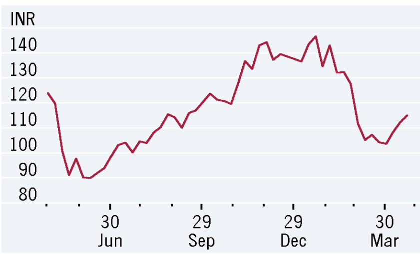
Risks

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.

Ambuja Cements (GACM.BO)

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)



Downgrading to Sell: Expensive in the Current Scenario

- 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.

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.

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

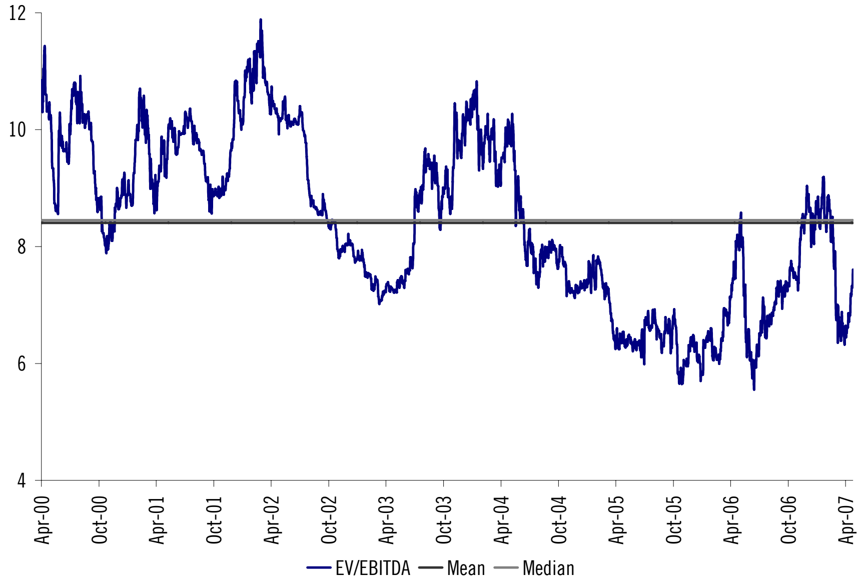
The robust pricing trends seen in cement have led to a substantial improvement in profitability, with ACL's EBITDA/tonne jumping from Rs569 in FY05 to Rs1,296 in the quarter ended March 2007. Cement stocks were strongly re-rated in anticipation of improved pricing. Valuations have been adversely impacted 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.

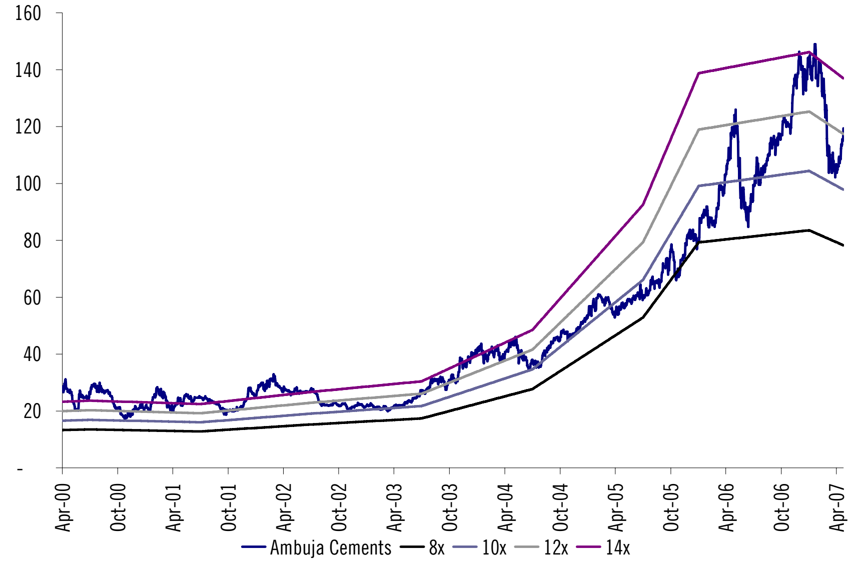
Figure 3. Ambuja Cements — Rolling Forward EV/EBITDA Chart



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.

Grasim Industries (GRAS.BO)

Downgrading to Sell: Growth in Other Divisions Offset by Cement

Sell/Medium Risk	3M
from Buy/Low Risk	
Price (30 Apr 07)	Rs2,442.35
Target price	Rs2,390.00
from Rs3,460.00	
Expected share price return	-2.1%
Expected dividend yield	1.2%
Expected total return	-0.9%
Market Cap	Rs223,900M
	US$5,455M

Price Performance (RIC: GRAS.BO, BB: GRASIM IN)

- **Target price cut** — Our new target price of Rs2,390 equates to 6.5x EV/EBITDA, an adjusted EV/tonne of US$110 and a P/E of 11.1x for FY09E. The downturn in cement in FY09E is expected to be partly offset by other businesses, which should perform well in FY09E-10E. We therefore use a 10% premium to the stock's 7-year mean of 5.9x.

- **Lower cement volumes expected; pricing pressures** — Volumes were lower than expected in FY07, and we have cut volume forecasts for FY08-09. We estimate prices to rise 7% yoy in FY08E and fall 9% in FY09E, as several large capacities (including Grasim's) are expected in North India in FY09. Our cement EBITDA rises 19% yoy in FY08E but falls 6% in FY09E and 8% in FY10E.

- **Growth in Viscose Staple Fibre** — We expect the division to benefit from both pricing and volume growth in FY08E-09E. EBITDA margins should remain in the 28-30% range as higher costs will likely be passed on amid growing demand. Grasim is expanding its VSF capacity by 95,000 tpa (35%) to 365,000 tpa by FY10, which should help volumes grow 17% in FY10E.

- **Other divisions doing well** — While cement and VSF together account for 85% of sales and 89% of EBITDA, Grasim's other divisions are doing reasonably well. Sponge iron should do better on the back of better pricing and improved availability of natural gas from end-FY08 onwards.

- **Upside risks** — (1) Further delays in cement capacity; (2) higher international VSF prices; and (3) better scrap prices/cheaper gas could help sponge iron.

Figure 1. Grasim — Statistical Abstract

Yr to Mar	Net Profit (Rs m)	EPS (Rs)	EPS cons (Rs)	EPS cons growth (%)	P/E cons (x)	EV/EBITDA cons (x)	EV/tonne cons (US$)
FY05	8,857	103	96	19%	25.5	12.7	160
FY06	8,632	89	114	18%	21.6	13.4	179
FY07E	15,358	163	215	89%	11.4	7.1	147
FY08E	17,188	188	239	11%	10.2	6.4	151
FY09E	15,385	168	216	-10%	11.3	6.6	121
FY10E	14,342	156	200	-8%	12.3	6.6	93

Source: Company Reports and Citigroup Investment Research estimates

Note: Rs/US$ rate at 42 for the forecast years.

Other Per Share Data	
NAV	na
Discount to NAV	na

Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	23.7	27.5	14.9	13.0	14.6
P/BV (x)	5.2	4.5	3.6	2.9	2.5
Dividend yield (%)	0.7	0.8	1.1	1.2	1.3
Payout Ratio (%)	15.5	22.5	16.8	16.0	19.4
Per Share Data (Rs)					
EPS adjusted	102.91	88.76	163.49	187.50	167.83
EPS reported	96.62	94.17	167.54	187.50	167.83
BVPS	472.17	543.48	675.62	828.83	959.51
DPS	16.00	20.00	27.50	30.00	32.50
Profit & Loss (RsM)					
Net sales	62,293	66,205	86,757	96,164	105,583
Operating expenses	-47,291	-53,667	-63,746	-69,833	-81,896
EBIT	**15,001**	**12,538**	**23,011**	**26,331**	**23,688**
Net interest expense	-1,388	-973	-1,118	-1,420	-2,320
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**13,614**	**11,565**	**21,893**	**24,911**	**21,368**
Tax	-4,180	-3,428	-6,906	-7,722	-5,983
Extraord./Min.Int./Pref.div.	-577	495	371	0	0
Reported net income	**8,857**	**8,632**	**15,358**	**17,188**	**15,385**
Adjusted earnings	9,434	8,137	14,987	17,188	15,385
Adjusted EBIT	15,001	12,538	23,011	26,331	23,688
Growth Rates (%)					
Sales	na	6.3	31.0	10.8	9.8
EBIT adjusted	na	-16.4	83.5	14.4	-10.0
EPS adjusted	na	-13.7	84.2	14.7	-10.5
Cash Flow (RsM)					
Operating cash flow	**10,505**	**10,364**	**16,724**	**15,885**	**19,295**
Depreciation/amortization	2,846	2,916	3,179	3,600	4,865
Net working capital	-2,047	421	49	-4,208	-1,391
Investing cash flow	**-8,684**	**-7,066**	**-24,187**	**-17,361**	**-11,724**
Capital expenditure	-2,672	-3,658	-14,984	-19,228	-13,393
Acquisitions/disposals	-6,835	-4,997	-11,300	0	0
Financing cash flow	**-3,228**	**-2,610**	**6,491**	**1,405**	**-5,463**
Borrowings	-569	-287	9,700	5,700	0
Dividends paid	-1,448	-1,675	-2,091	-2,875	-3,143
Change in cash	**-1,408**	**688**	**-972**	**-71**	**2,108**
Balance Sheet (RsM)					
Total assets	**80,445**	**88,195**	**111,588**	**130,793**	**144,644**
Cash & cash equivalent	867	1,556	584	513	2,621
Accounts receivable	5,220	4,135	4,754	5,796	6,364
Net fixed assets	32,085	33,110	44,915	60,543	69,071
Total liabilities	**37,161**	**38,374**	**49,654**	**54,814**	**56,686**
Accounts payable	5,975	7,410	8,248	7,880	9,120
Total Debt	20,083	19,797	29,497	35,197	35,197
Shareholders' funds	**43,283**	**49,821**	**61,933**	**75,978**	**87,958**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	24.1	18.9	26.5	27.4	22.4
ROE adjusted	na	17.5	26.8	24.9	18.8
ROA adjusted	na	9.7	15.0	14.2	11.2
Net debt to equity	44.4	36.6	46.7	45.6	37.0
Total debt to capital	31.7	28.4	32.3	31.7	28.6

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Estimate revisions

Figure 2. Grasim — Estimate Changes, FY08E-09E

	FY08E			FY09E		
	Old	New	% change	Old	New	% change
Net sales (Rs bn)	92.5	96.2	4%	104.2	105.6	1%
EBITDA (Rs bn)	28.3	28.1	-1%	27.8	26.9	-3%
Net profit (Rs bn)-adj	17.2	17.2	0%	17.9	15.4	-14%
EPS - Standalone (Rs)	188	188	0%	195	168	-14%
EPS - Consolidated (Rs)	252	239	-5%	254	216	-15%

Source: Citigroup Investment Research estimates

Valuation framework

Our main valuation tool to value Grasim is EV/EBITDA, which is supported by P/E and EV/tonne.

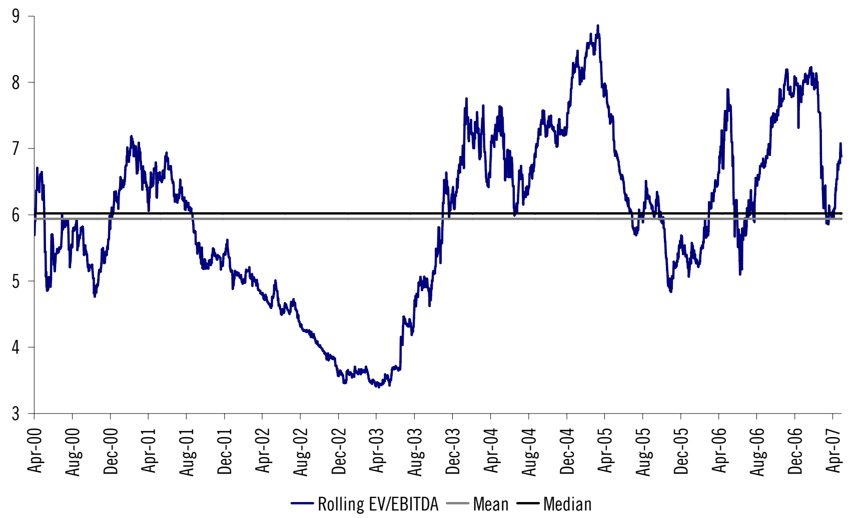
Primary valuation tool — EV/EBITDA

Grasim's EV/EBITDA has moved in a wide range since April 1995. The stock traded below its 7-year mean of 5.9x from April 2000 to April 2003. This was because of its diversified business mix. The stock was re-rated from April 2003 onward largely due to the completion of a substantial reorganization, which, among other things, involved closure of loss-making and non-core businesses and investments. This resulted in some streamlining of its business mix.

Our target price of Rs2,390 is derived from a consolidated EV/EBITDA of 6.5x for FY09E

Grasim also enjoyed a re-rating as its main businesses improved profitability from FY04. Cement and sponge iron did well in FY04 and FY05, and VSF had three good years during FY03-05. In FY06 cement did well but there was a downturn in VSF. In FY07 we saw both VSF and cement recover, and we expect this trend to continue in FY08 as well, in both cases due to better volumes and firm pricing. The downturn we expect in FY09 in cement is expected to be partly offset by strong growth in the other divisions in FY09E-10E. Our target multiple is therefore at a premium of 10% to the seven-year mean to incorporate growth in EBITDA of the other divisions. Our target price of Rs2,390 is derived from a consolidated EV/EBITDA of 6.5x for FY09E (versus 8.5x used earlier for FY08E). We use a lower multiple to reflect the unfavorable government measures that are taking away the last leg of pricing upside.

Figure 3. Grasim — Rolling EV/EBITDA

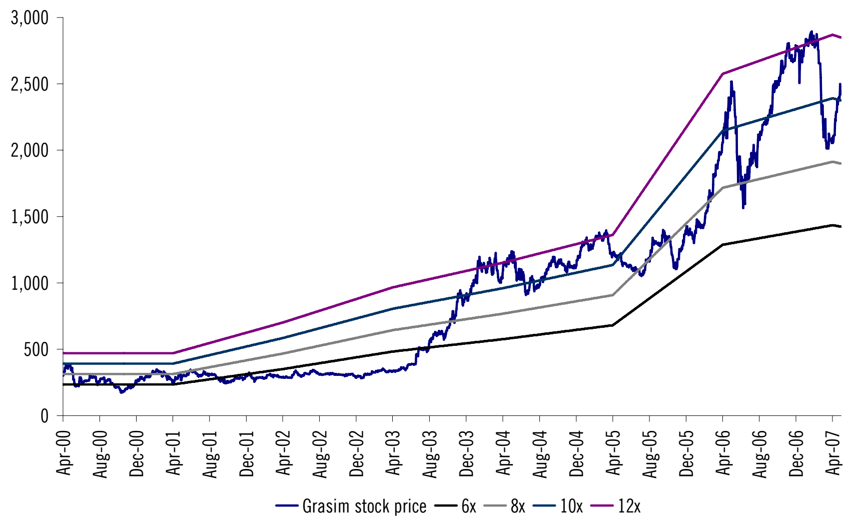


Source: DataStream, Company Reports, Citigroup Investment Research

At our target price of Rs2,390, the stock would trade at a P/E of 11.1x FY09E earnings

Grasim's forward P/E band chart also shows the re-rating since April 2003. For much of the period since April 2000, the stock has traded below 8x. The restructuring and better divisional performance took the P/E to a range of 10-12x until a difficult period for VSF and lackluster cement pricing led to the P/E falling once again to the 6-8x range. With a substantial improvement in cement profitability and also better divisional profits for VS, P/E is back in the range of 10-12x. While the strong performance of the non-cement divisions is expected to sustain, we expect a downturn in cement in FY09. At our target price of Rs2,390, the stock would trade at a P/E of 11.1x FY09E earnings.

Figure 4. Grasim — Forward P/E Bands



Source: DataStream, Company Reports, Citigroup Investment Research

At our target price the consolidated EV/tonne for Grasim equates to US$110

As Grasim is a diversified company we have made adjustments to arrive at its cement EV/tonne. At our target price the consolidated EV/tonne for Grasim equates to US$110. This is worked out by stripping out the non-cement businesses by valuing VSF at 8x EV/EBITDA and others such as chemicals, sponge iron and textile businesses at 5-6x EV/EBITDA.

Financial summary

Figure 5. Grasim — Operating Statistics

Year to 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
Operating Data						
Cement capacity (m tonnes)	13.1	13.1	13.1	14.6	22.6	22.6
VSF capacity (m tonnes)	0.25	0.26	0.27	0.27	0.37	0.37
Sponge Iron capacity (m tonnes)	0.90	0.90	0.90	0.90	0.90	0.90
Sales						
Cement (m tonnes)	12.6	14.0	14.5	15.3	19.1	22.5
VSF (m tonnes)	0.23	0.24	0.25	0.26	0.27	0.32
Sponge Iron (m tonnes)	0.77	0.48	0.57	0.62	0.71	0.82
Average Exchange Rate (Rs/US$)	**44.9**	**44.3**	**45.3**	**41.8**	**40.0**	**39.0**

Source: Company Reports and Citigroup Investment Research estimates

Figure 6. Grasim — Profit and Loss Account (Rs m)

Year to 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
Viscose staple fibre	19,564	19,354	23,276	24,821	25,985	30,663
Wood pulp/chemicals	3,518	3,872	3,190	3,339	3,537	3,774
Cement	27,980	36,076	51,727	57,986	64,360	69,884
Sponge iron	10,214	6,336	7,511	8,919	10,401	11,331
Textiles	1,017	568	1,053	1,099	1,300	1,516
Net sales	**62,293**	**66,205**	**86,757**	**96,164**	**105,583**	**117,168**
Operating expenses	46,318	52,339	62,663	68,100	78,700	91,000
Operating profit	**15,975**	**13,866**	**24,094**	**28,064**	**26,883**	**26,168**
Operating profit margin %	26%	21%	28%	29%	25%	22%
Other income	1,872	1,589	2,097	1,867	1,669	1,778
EBITDA	**17,847**	**15,455**	**26,190**	**29,930**	**28,552**	**27,946**
EBITDA margin %	29%	23%	30%	31%	27%	24%
Depreciation	2,846	2,916	3,179	3,600	4,865	5,679
% of avg gross block	4.9%	4.9%	4.9%	5.1%	5.5%	5.1%
EBIT	**15001**	**12538**	**23011**	**26331**	**23688**	**22267**
Interest	1,388	973	1,118	1,420	2,320	2,620
PBT	13,614	11,565	21,893	24,911	21,368	19,647
Total Tax	4,180	3,428	6,906	7,722	5,983	5,305
Eff.tax rate %	31%	30%	32%	31%	28%	27%
PAT	**9,434**	**8,137**	**14,987**	**17,188**	**15,385**	**14,342**
Extraordinary items	-577	495	371	0	0	0
Net profit	**8,857**	**8,632**	**15,358**	**17,188**	**15,385**	**14,342**
Profit from subsidiaries						
UltraTech	15	1,148	3,990	4,379	4,051	3,641
Shee Digvijay Cements	-61	180	287	314	344	269
Others	-7	446	40	41	42	42
Consolidated profit	**8,803**	**10,406**	**19,675**	**21,923**	**19,821**	**18,294**
Consolidated EBITDA/tonne (Rs)	354	534	1,000	1,108	869	687
Consolidated EBITDA/tonne (US$)	7.9	12.0	22.1	26.4	20.7	16.4

Source: Company Reports and Citigroup Investment Research estimates

Figure 7. Grasim — Balance Sheet (Rs m)

As at 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
Fixed Assets	**32,085**	**33,110**	**44,915**	**60,543**	**69,071**	**74,392**
Gross Block	58,970	61,141	68,654	72,541	103,681	120,681
Acc.Depreciation	28,482	31,095	34,274	37,874	42,738	48,417
Net Block	30,489	30,046	34,380	34,668	60,943	72,264
CWIP	1,597	3,064	10,535	25,875	8,128	2,128
Investments	**29,820**	**34,817**	**46,117**	**46,117**	**46,117**	**46,117**
Liquid investments	5,740	10,001	20,001	20,001	20,001	20,001
Current Assets	**18,539**	**20,268**	**20,556**	**24,133**	**29,456**	**37,176**
Stocks + WIP	6,786	7,507	7,331	8,208	9,913	11,649
Sundry debtors	5,220	4,135	4,754	5,796	6,364	7,062
Loans and advances	5,666	7,070	7,887	9,616	10,558	11,717
Cash/bank	867	1,556	584	513	2,621	6,748
Current Liabilities and provisions	**11,083**	**12,734**	**14,332**	**14,041**	**16,126**	**18,688**
Sundry creditors	5,975	7,410	8,248	7,880	9,120	10,717
Taxation	720	495	0	0	0	0
Proposed dividends	1,676	2,091	2,875	3,143	3,405	3,667
Other creditors/liabilities	2,712	2,738	3,210	3,018	3,601	4,305
Overall Capital employed	**69,362**	**75,461**	**97,256**	**116,752**	**128,517**	**138,996**
Shareholders Funds	**43,283**	**49,821**	**61,933**	**75,978**	**87,958**	**98,633**
Share capital	917	917	917	917	917	917
Reserves and Surplus	42,367	48,904	61,017	75,062	87,041	97,716
Deferred tax liability	**5,995**	**5,844**	**5,826**	**5,576**	**5,363**	**5,166**
Total debt	**20,083**	**19,797**	**29,497**	**35,197**	**35,197**	**35,197**
Total sources of Funds	**69,362**	**75,461**	**97,256**	**116,752**	**128,517**	**138,996**

Source: Company Reports and Citigroup Investment Research estimates

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

Year to 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
Cash flow statement (Rs m)						
PBIT	15,001	12,538	23,011	26,331	23,688	22,267
Depreciation	2,846	2,916	3,179	3,600	4,865	5,679
Other income	-1,872	-1,589	-2,097	-1,867	-1,669	-1,778
Changes in working capital	-2,047	421	49	-4,208	-1,391	-1,292
Tax	-3,802	-3,923	-7,419	-7,971	-6,197	-5,501
Others	378	0	0	0	0	0
Net cash from operations	**10,505**	**10,364**	**16,724**	**15,885**	**19,295**	**19,374**
Purchase of fixed assets	-2,672	-3,658	-14,984	-19,228	-13,393	-11,000
Purchase of investments	-6,835	-4,997	-11,300	0	0	0
Other income	1,137	1,589	2,097	1,867	1,669	1,778
Others	-314	0	0	0	0	0
Net cash used in investment activities	**-8,684**	**-7,066**	**-24,187**	**-17,361**	**-11,724**	**-9,222**
Shares issued	0	0	0	0	0	0
Debt	-569	-287	9,700	5,700	0	0
Interest paid	-1,388	-973	-1,118	-1,420	-2,320	-2,620
Dividend paid	-1,448	-1,675	-2,091	-2,875	-3,143	-3,405
Others	176	325	0	0	0	0
Net cash from financing activities	**-3,228**	**-2,610**	**6,491**	**1,405**	**-5,463**	**-6,025**
Net cash flow	**-1,408**	**688**	**-972**	**-71**	**2,108**	**4,127**
Opening cash balance	2,275	867	1,556	584	513	2,621
Closing cash balance	867	1,556	584	513	2,621	6,748
Stock Metrics						
No. of shares (m)	91.7	91.7	91.7	91.7	91.7	91.7
Book value per share (Rs)	472	543	676	829	960	1076
EPS (Rs) - Standalone	103	89	163	188	168	156
EPS (Rs) - Consolidated	96	114	215	239	216	200
CFPS (Rs)- Standalone	134	121	198	227	221	218
Net Debt/EBITDA (x)	0.8	0.5	0.3	0.5	0.4	0.3
Total debt/Tangible net worth (x)	0.5	0.4	0.5	0.5	0.4	0.4
Net debt/equity (x)	0.3	0.2	0.1	0.2	0.1	0.1
ROE (%)	24%	17%	27%	25%	19%	15%
ROCE (%)	23%	17%	27%	25%	19%	17%
Total dividend (Rs m)	1676	2090	2875	3143	3405	3667
DPS (Rs)	16.0	20.0	27.5	30.0	32.5	35.0
Dividend payout (%)	19%	20%	15%	14%	17%	20%
Ratios						
Current ratio	1.7	1.6	1.4	1.7	1.8	2.0
Interest coverage	10.8	12.9	20.6	18.5	10.2	8.5
Days in inventory	132	150	120	125	125	125
Days receivable	31	23	20	22	22	22
Days payable	116	148	135	120	115	115

Source: Company Reports and Citigroup Investment Research estimates

4Q FY07 results

Figure 9. Grasim — 4Q FY07 Results

Rs m	4Q FY07	4Q FY06	% chg
Net sales	**24,938**	**18,298**	**36**
Total Expenses	17,995	14,221	27
EBITDA	**6,942**	**4,077**	**70**
EBITDA (%)	28	22	
Interest	366	248	48
Depreciation	876	759	15
Other income	776	575	35
Pre-tax profit	**6,476**	**3,645**	**78**
Tax	2102	1059	98
Tax rate (%)	33	29	
Net profit before exceptionals	**4,374**	**2,586**	**69**
Less: Extraordinary items	371	41	798
PAT reported	**4,745**	**2,627**	**81**

Source: Company Reports

4Q FY07 was driven by better performance from cement and sponge iron

4Q FY07 was driven by better performance from cement and sponge iron. VSF volumes beat expectations, but both EBITDA margins and prices for the division fell sequentially and YoY. Overall, Grasim reported sales growth of 36% yoy to Rs24.9bn, EBITDA growth of 70% yoy to Rs6.9 bn, and adjusted PAT growth of 69% yoy to Rs4.4bn. EBITDA and adjusted PAT for the quarter were about 10% below expectations. Divisional performance: (1) Cement (59% of sales, 34.3% EBITDA margin) continued to do well. Divisional EBITDA grew 77% yoy and 12% qoq largely on the back of better prices, 35% higher from the low levels last year and 2% higher sequentially. Sales volumes were flat with only 1.4% yoy growth. EBITDA margins rose from 26.1% in 4Q FY06 despite higher fuel and freight costs. (2) VSF (26% of sales, 31% EBITDA margin) did not perform as well as expected as Grasim gave higher rebates due to higher sales volumes in 4Q leading to lower average realizations. EBITDA margins were in line with last year despite a 15% yoy price rise and a 13% yoy rise in volumes, due to a rise in pulp and labour costs. Grasim expects demand growth to be buoyant and margins to be maintained as most cost increases should be passed on. (3) Sponge iron (8% of sales, 15.5% EBITDA margin) did well in 4Q FY07 due to better pricing (up 24% yoy) as a result of higher prices of substitute products. The higher prices allowed the use of alternative fuels, which helped hike production and sales (by 79% yoy). Grasim expects sponge iron profitability to sustain with better prices in the near term, and improve in the long term with better availability of natural gas.

Grasim Industries

Company description

Grasim is a diversified company with five main divisions — cement, viscose staple fibre (VSF), sponge iron, chemicals and textiles. Cement (13m tpa) is its largest division, accounting for 60% of sales and 60-65% of EBITDA. VSF is the other core business. The two core businesses account for around 85% of sales and around 90% of EBITDA. It has two subsidiaries — UltraTech (52% equity, holding) which has a capacity of 17m tpa; and Shree Digvijay Cement (54% holding), which has a capacity of 1.1m tpa. This takes the current group capacity to 31m tpa, which is expected to rise to 45m tpa by June 2008. Grasim's domestic markets are well spread across regions, and it does not export cement.

Investment thesis

We rate Grasim as Sell/Medium Risk (3M) with a target price of Rs2,390. Despite its diversification, cement has the biggest impact on Grasim's revenues and profits. The expected downturn in cement will offset the upside seen in other divisions, based on our analysis. We expect the recent uncertainty caused by government measures, and the increased threat of cement supplies from imports as well as domestic sources to hurt the cement division's profits. The cement division's EBITDA will rise 19% yoy in FY08 but fall 6% yoy in FY09 and 8% yoy in FY10, based on our estimates. In VSF (26% of sales and EBITDA) we expect the division to benefit from both pricing and volume growth in FY08-09. We forecast EBITDA margins at 28-30% as higher costs are passed on amid growing demand. Grasim's other divisions are doing reasonably well. Sponge iron (8% of sales and 3% of EBITDA) should do better on the back of better pricing and improved availability of natural gas from end-FY08E onward.

Valuation

We value Grasim on EV/EBITDA, a common metric used for cement companies. Our target price of Rs2,390 is based on a 10% premium to the stock's seven-year mean of 5.9x. The downturn in cement in FY09E is expected to be partly offset by other businesses, which should perform well in FY09E-10E. We therefore use a premium to value the stock. At our target price the consolidated EV/tonne for Grasim equates to US$110/tonne and a consolidated P/E of 11.1x for FY09E.

Risks

Grasim is rated as Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. The key upside risks to our target price include: (1) further delays in industry capacity; (2) higher than expected domestic cement demand growth; (3) changes in the duty/tax regime in favor of producers; (4) higher international prices or rise in prices of competing fibres, both of which will positively impact VSF prices; and (5) better prices for scrap and cheaper natural gas than we anticipate, leading to better sponge iron margins than expected.

UltraTech Cement (ULTC.BO)

Sell/Medium Risk	3M
from Buy/Medium Risk	
Price (30 Apr 07)	Rs820.30
Target price	Rs730.00
from Rs1,290.00	
Expected share price return	-11.0%
Expected dividend yield	0.5%
Expected total return	**-10.5%**
Market Cap	Rs102,044M
	US$2,486M

Price Performance (RIC: ULTC.BO, BB: UTCEM IN)

Downgrading to Sell: Vulnerable to Pricing Downside

- Target price cut — We cut our target price to Rs730, which equates to 7.0x FY09E EV/EBITDA, an EV/tonne of US$110 and a P/E of 11.4x for FY09E. ULTC would be vulnerable to any export slowdown, as it exports ~20% of its total volumes. Although captive power should help it cut costs in FY09E, ULTC's profits would likely be hit by an export slowdown and new capacities.

- Lackluster performance in 4Q FY07 — ULTC performed well on the sales front in 4Q FY07; but despite its presence in the southern markets, its realizations were flat sequentially in 4Q. Higher freight and coal costs led to a sequential decline of 180bps in EBITDA margin — rare in these good times.

- Limited volume growth, export worries — ULTC is running at full utilization, and we expect only 4% yoy volume growth in FY08. It is one of India's largest exporters of clinker, and would face pricing pressure as capacity in the Middle East goes on stream. Volume growth will likely be better at 12% yoy in FY09E, but it would be accompanied with large domestic capacity expansion.

- Captive power only in FY09E — ULTC's Gujarat plant accounts for about 30% of capacity but has only naphtha-based power capacity. Its high costs have forced UltraTech to switch to power from the state grid. The ongoing capex for 192MW of captive power includes 92MW of captive power at Gujarat, which will help reduce costs substantially but will only be available in FY09E.

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

Figure 1. UltraTech — Statistical Abstract

Yr to 31 Mar	Revenue (Rs m)	Net Profit (Rs m)	EBITDA (Rs m)	EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)	EV/tonne (US$)
FY05	26,069	797	3,508	6.4	105	128.1	33.3	168
FY06	32,995	2,298	5,543	18.5	188	44.4	20.9	154
FY07E	47,284	7,823	14,178	62.8	241	13.1	7.9	157
FY08E	50,739	8,587	15,643	69.0	10	11.9	7.4	157
FY09E	53,163	7,943	14,475	63.8	-8	12.9	7.8	124
FY10E	59,054	7,137	13,728	57.3	-10	14.3	7.6	110

Source: Company Reports and Citigroup Investment Research estimates

Note: Rs/US$ rate at 42 for the forecast years.

Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	nm	46.9	13.1	11.9	12.9
EV/EBITDA adjusted (x)	31.1	19.4	7.6	7.0	7.5
P/BV (x)	9.6	9.8	5.8	4.0	3.1
Dividend yield (%)	0.1	0.2	0.5	0.5	0.5
Per Share Data (Rs)					
EPS adjusted	0.23	17.47	62.84	68.98	63.80
EPS reported	6.41	18.46	62.84	68.98	63.80
BVPS	85.78	83.40	141.69	206.11	265.35
DPS	0.75	1.75	4.00	4.00	4.00
Profit & Loss (RsM)					
Net sales	26,069	32,995	47,284	50,739	53,163
Operating expenses	-24,568	-29,242	-34,754	-37,159	-41,357
EBIT	**1,501**	**3,752**	**12,530**	**13,580**	**11,806**
Net interest expense	-1,069	-896	-868	-879	-937
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**432**	**2,856**	**11,662**	**12,702**	**10,868**
Tax	365	-558	-3,840	-4,115	-2,926
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**797**	**2,298**	**7,822**	**8,587**	**7,943**
Adjusted earnings	28	2,175	7,822	8,587	7,943
Adjusted EBITDA	3,719	5,913	14,793	16,193	14,925
Growth Rates (%)					
Sales	15.8	26.6	43.3	7.3	4.8
EBIT adjusted	-8.6	150.0	233.9	8.4	-13.1
EBITDA adjusted	-1.8	59.0	150.2	9.5	-7.8
EPS adjusted	-92.7	nm	259.6	9.8	-7.5
Cash Flow (RsM)					
Operating cash flow	**3,374**	**5,516**	**9,913**	**11,616**	**11,671**
Depreciation/amortization	2,218	2,160	2,263	2,612	3,119
Net working capital	-370	340	-483	62	34
Investing cash flow	**-872**	**-3,572**	**-5,115**	**-12,874**	**-7,326**
Capital expenditure	-689	-2,162	-5,840	-13,650	-8,120
Acquisitions/disposals	-235	-1,479	0	0	0
Financing cash flow	**-2,358**	**-1,891**	**-2,116**	**-1,446**	**-2,505**
Borrowings	-1,201	-880	-1,000	0	-1,000
Dividends paid	-70	-106	-248	-568	-568
Change in cash	**144**	**53**	**2,681**	**-2,704**	**1,841**
Balance Sheet (RsM)					
Total assets	**36,195**	**36,231**	**43,691**	**52,389**	**59,812**
Cash & cash equivalent	563	616	3,297	593	2,434
Accounts receivable	1,720	1,726	2,332	2,363	2,476
Net fixed assets	25,971	26,782	30,359	41,396	46,397
Total liabilities	**25,524**	**25,848**	**26,052**	**26,731**	**26,779**
Accounts payable	4,154	5,169	5,865	6,275	6,868
Total Debt	15,314	14,518	13,518	13,518	12,518
Shareholders' funds	**10,671**	**10,383**	**17,638**	**25,658**	**33,033**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	14.3	17.9	31.3	31.9	28.1
ROE adjusted	0.3	20.7	55.8	39.7	27.1
ROIC adjusted	6.2	10.9	28.2	24.7	19.2
Net debt to equity	138.2	133.9	57.9	50.4	30.5
Total debt to capital	58.9	58.3	43.4	34.5	27.5

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Estimate revisions

Figure 2. UltraTech — Estimate Changes, FY08E-09E

	FY08E			FY09E		
	Old	New	% change	Old	New	% change
Net sales (Rs bn)	54.7	50.7	-7	58.0	53.2	-8
EBITDA (Rs bn)	17.7	15.6	-12	16.3	14.5	-11
Net profit (Rs bn)	10.2	8.6	-16	9.4	7.9	-15
EPS (Rs)	81.8	69.0	-16	75.4	63.8	-15

Source: Citigroup Investment Research estimates

Valuation framework

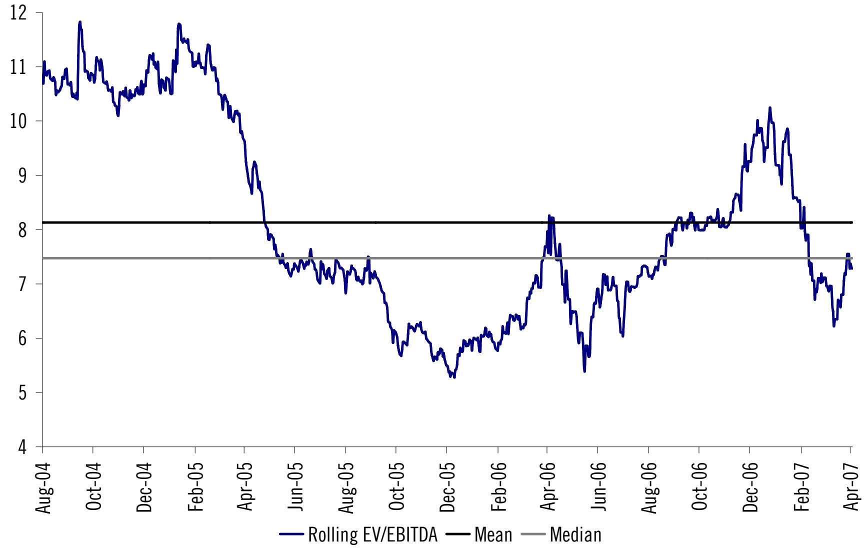
UltraTech (ULTC) has a short valuation history relative to other cement majors. It was listed only in August 2004, after its de-merger from Larsen & Toubro. In our view EV/EBITDA is more useful than P/E based on the fact that the company's profits are low relative to its size, and due to the several adjustments that need to be made to headline profit numbers given the write-offs and one-time adjustments since the takeover of the company by the Aditya Birla Group.

Primary valuation tool — relative EV/EBITDA

Valued at a small discount to ACC and Ambuja Cements

The rolling forward EV/EBITDA exhibit below shows that ULTC's valuations have been quite volatile since its listing in August 2004. Its EV/EBITDA has seen highs of 11-12x and lows of 5x, depending on the pricing trend and the profit outlook. The average EV/EBITDA since listing has been 8.1x. Our target multiple of 7.0x EV/EBITDA for FY09E, versus 9.5x EV/EBITDA for FY08E used earlier, is derived from a small discount to major peers ACC and Ambuja Cements. The target multiple has been lowered in reaction to the government measures for the industry. ULTC's EBITDA/tonne improved from about Rs400/tonne in FY06 to about Rs850/tonne in 4Q FY07, but is lower than those for peers such as ACC and Ambuja Cements. Hence, on a relative basis our target EV/EBITDA for ULTC of 7.0x for FY08E is at a discount to ACC's and Ambuja's 7.5x EV/EBITDA for CY08E, as both ACC and Ambuja enjoy comparatively higher EBITDA/tonne than ULTC. Our EV/EBITDA target equates to a discount of about 15% to ULTC's average since its listing. At our target price of Rs730, the stock would trade at an EV/tonne of US$110.

Figure 3. UltraTech — Rolling EV/EBITDA Chart

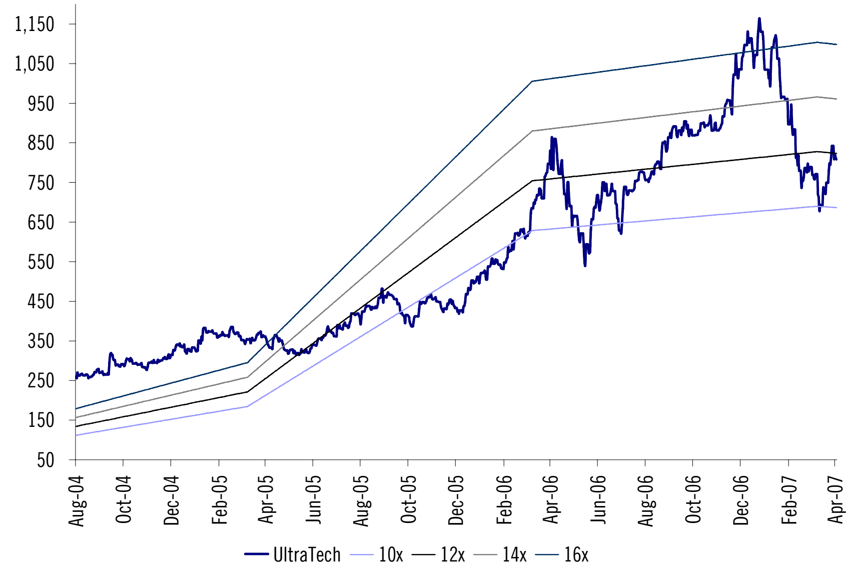


Source: DataStream, Company Reports and Citigroup Investment Research

The historical P/E range for ULTC has been quite wide

Like EV/EBITDA, the historical P/E range for ULTC has been quite wide. Since April 2005, the stock has largely traded in a range of 8-12x. The recent sharp improvement in profitability has resulted in the band going up to 12-14x. The recent uncertainties have led to a de-rating in the valuations once again to a range of 10-12x. There is no near-term trigger for re-rating the stock, in our view. At our target price, the stock would trade at an FY09E P/E of 11.4x.

Figure 4. UltraTech — Rolling P/E Band Chart



Source: DataStream, Company Reports and Citigroup Investment Research

Financial summary

Figure 5. UltraTech — Operating Statistics

Year to 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
Operating Data						
Cement capacity (m tonnes)	15.5	17.0	17.0	17.5	21.5	22.5
Cement production (m tonnes)	12.1	13.7	14.6	14.9	17.4	20.1
Clinker production (m tonnes)	12.4	13.4	14.2	14.3	15.9	18.9
Sales						
Cement (m tonnes)	12.5	14.2	14.6	14.9	17.4	20.1
Clinker (m tonnes)	2.6	1.3	2.5	2.8	2.5	3.2
Average Exchange Rate (Rs/US$)	**44.9**	**44.3**	**45.3**	**41.8**	**40.0**	**39.0**

Source: Company Reports, Citigroup Investment Research estimates

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

Year to 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
Cement	22,505	30,913	42,894	46,272	49,602	54,798
Clinker	3,564	2,081	4,075	3,868	2,760	3,256
Adjustments	0	0	315	600	800	1,000
Net sales	**26,069**	**32,995**	**47,284**	**50,739**	**53,163**	**59,054**
Operating expenses	22,561	27,452	33,106	35,097	38,688	45,326
Operating profit	**3,508**	**5,543**	**14,178**	**15,643**	**14,475**	**13,728**
Op. profit/tonne (Rs)	231	356	828	885	729	588
Op. profit/tonne (US$)	5.2	8.0	18.6	19.9	16.4	13.2
Other income	211	370	615	550	450	400
EBITDA	**3,719**	**5,913**	**14,793**	**16,193**	**14,925**	**14,128**
EBITDA margin %	14%	18%	31%	32%	28%	24%
EBITDA/tonne (Rs)	245	380	864	916	752	605
EBITDA/tonne (US$)	5.5	8.6	19.4	20.6	16.9	13.6
Depreciation	2,218	2,160	2,263	2,612	3,119	3,446
% of avg gross block	9%	8%	7%	6%	7%	8%
EBIT	**1,501**	**3,752**	**12,530**	**13,580**	**11,806**	**10,682**
Interest	1,069	896	868	879	937	901
PBT	**432**	**2,856**	**11,662**	**12,702**	**10,868**	**9,781**
Total Tax	-365	558	3,840	4,115	2,926	2,643
Eff.tax rate %	-84%	20%	33%	32%	27%	27%
PAT	**797**	**2,298**	**7,823**	**8,587**	**7,943**	**7,137**
Net profit/ tonne (Rs)	53	148	457	486	400	306
Net profit/ tonne (US$)	1.2	3.3	10.3	10.9	9.0	6.9
Non-recurring items	-768.4	-122.3	0.0	0.0	0.0	0.0
Net profit	**28**	**2,175**	**7,823**	**8,587**	**7,943**	**7,137**
Profit from subsidiaries	-562	76	26	28	29	31
Consolidated PAT	**-534**	**2,251**	**7,849**	**8,615**	**7,972**	**7,168**

Source: Company Reports and Citigroup Investment Research estimates

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

As at 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
Fixed Assets	**25,971**	**26,782**	**30,359**	**41,396**	**46,397**	**45,452**
Gross Block	43,043	46,054	50,054	52,354	74,074	76,574
Acc.Depreciation	17,554	20,682	22,945	25,557	28,677	32,122
Net Block	25,489	25,372	27,109	26,796	45,397	44,452
CWIP	482	1,410	3,250	14,600	1,000	1,000
Investments	**1,848**	**1,724**	**1,724**	**1,724**	**1,724**	**1,724**
Current Assets	**8,377**	**7,725**	**11,608**	**9,269**	**11,691**	**19,737**
Cash and Bank Balance	563	616	3,297	593	2,434	9,235
Loans and Advances	3,257	1,588	1,838	2,088	2,338	2,588
Sundry Debtors	1,720	1,726	2,332	2,363	2,476	2,750
Inventories	2,837	3,796	4,141	4,225	4,443	5,164
Current Liabilities and provisions	**4,393**	**5,560**	**6,598**	**7,022**	**7,636**	**8,775**
Current Liabilities	4,154	5,169	5,865	6,275	6,868	8,007
Provision for dividend	106	248	568	568	568	568
Other provisions	132	143	165	180	200	200
Overall Capital Employed	**31,802**	**30,671**	**37,093**	**45,367**	**52,176**	**58,138**
Shareholders Funds	**10,671**	**10,383**	**17,638**	**25,658**	**33,033**	**39,604**
Share capital	1,244	1,245	1,245	1,245	1,245	1,245
Reserves and surplus	9,427	9,138	16,393	24,413	31,788	38,359
Deferred tax liability	5,817	5,770	5,936	6,190	6,625	7,016
Loan Funds	**15,314**	**14,518**	**13,518**	**13,518**	**12,518**	**11,518**
Secured loans	12,534	12,219	11,219	11,219	10,219	9,219
Unsecured loans	2,780	2,299	2,299	2,299	2,299	2,299
Total Sources of Funds	**31,802**	**30,671**	**37,093**	**45,367**	**52,176**	**58,138**

Source: Company Reports and Citigroup Investment Research estimates

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

Year to 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
Cash flow statement (Rs m)						
PBT	432	2,856	11,662	12,702	10,868	9,781
Depreciation	2,218	2,160	2,263	2,612	3,119	3,446
Interest	1,069	896	868	879	937	901
Other income	-211	-370	-615	-550	-450	-400
Changes in working capital	-370	340	-483	62	34	-104
Taxes paid	-316	-606	-4,006	-4,369	-3,361	-3,035
Others	551	239	224	280	523	523
Net cash from operations	**3,374**	**5,516**	**9,913**	**11,616**	**11,671**	**11,112**
Purchase of fixed assets	-689	-2,162	-5,840	-13,650	-8,120	-2,500
Purchase of investments	-235	-1,479	0	0	0	0
Interest received	211	370	615	550	450	400
Others	-159	-301	110	226	344	257
Net cash used in investment activities	**-872**	**-3,572**	**-5,115**	**-12,874**	**-7,326**	**-1,843**
Proceeds from issue of share capital	-5	1	0	0	0	0
Repayment/proceeds of borrowings	-1,201	-880	-1,000	0	-1,000	-1,000
Interest paid	-1,069	-896	-868	-879	-937	-901
Dividend paid	-70	-106	-248	-568	-568	-568
Others	-13	-8	0	0	0	0
Net cash from financing activities	**-2,358**	**-1,891**	**-2,116**	**-1,446**	**-2,505**	**-2,469**
Net cash flow	**144**	**53**	**2,681**	**-2,704**	**1,841**	**6,800**
Opening cash balance	418	563	616	3,297	593	2,434
Closing cash balance	563	616	3,297	593	2,434	9,235
Stock Metrics						
No. of shares (m)	124.4	124.5	124.5	124.5	124.5	124.5
Book value per share (Rs)	85.8	83.4	141.7	206.1	265.4	318.1
EPS (Rs)	6.4	18.5	62.8	69.0	63.8	57.3
CFPS (Rs)	24.2	35.8	81.0	90.0	88.9	85.0
Net Debt/EBITDA (x)	4.0	2.4	0.7	0.8	0.7	0.2
Total debt/Tangible net worth (x)	1.4	1.4	0.8	0.5	0.4	0.3
Net debt/equity (x)	1.4	1.3	0.6	0.5	0.3	0.1
ROE (%)	7%	22%	56%	40%	27%	20%
ROCE (%)	6%	15%	40%	35%	26%	21%
Total dividend (Rs m)	106.4	248.5	567.7	567.7	567.7	567.7
DPS (Rs)	0.8	1.8	4.0	4.0	4.0	4.0
Dividend payout (%)	13%	11%	7%	7%	7%	8%
Ratios						
Current ratio	1.9	1.4	1.8	1.3	1.5	2.2
Interest coverage	1.7	3.6	10.0	10.8	9.5	8.9
Days in inventory	76	89	80	78	78	78
Days receivable	24	19	18	17	17	17
Days payable	69	70	65	65	65	65

Source: Company Reports and Citigroup Investment Research estimates

4Q FY07 results

Figure 9. UltraTech — 4Q FY07 Results

Rs m	4Q FY07	4Q FY06	% chg
Net sales	**13,820**	**9,934**	**39**
Total expenses	9,735	7,788	25
EBITDA	**4,085**	**2,146**	**90**
EBITDA (%)	30	22	
EBITDA/tonne (Rs)	849	492	73
Interest	203	223	-9
Depreciation	601	599	0
Other income	195	105	86
PBT	**3,476**	**1,429**	**143**
Total Tax	1,161	108	979
% Tax Rate	33	8	
Net profit for the period	**2,315**	**1,321**	**75**

Source: Company Reports

Net sales in 4Q FY07 grew 39% yoy to Rs13.8bn, driven by a 27% yoy increase in prices and a 10% rise in volumes

Net sales in 4Q FY07 grew 39% yoy to Rs13.8bn, driven by a 27% yoy increase in prices and a 10% rise in volumes (total of cement and clinker). PAT came in at Rs2.3bn, +75% yoy, but about 16% below our forecast. Unlike most other domestic majors, ULTC's domestic cement realizations were flat QoQ, despite its presence in South India — which had a disproportionate price hike from a low base. Export realizations for cement were US$50/tonne and for clinker US$39/tonne, flat sequentially but about 14% and 7% higher YoY respectively, in 4Q FY07. The company expects export prices to soften from mid-2007. Freight per tonne rose 12% yoy due to higher sales in the domestic market and coal costs rose due to higher cost of domestic and imported coal. Both these factors resulted in a sequential fall in EBITDA margin by 180bps, even though margins were 800bps higher YoY. ULTC was one of few major companies that reported a sequential fall in EBITDA margins in 4Q. Interest costs fell 9% yoy during the quarter due to debt restructuring. ULTC will be increasing capacity by 0.5m tpa to 17.5m tpa in FY08 and a further 4m tpa by FY09. It is also setting up 192MW of captive power at three locations — Gujarat (92MW), Chattisgarh (50MW) and Andhra Pradesh (50MW) — along with the new plant.

UltraTech Cement

Company description

UltraTech Cement (ULTC) is India's second-largest cement company with a capacity of 17m tpa. Its markets are well spread out. Based on its plant locations, its main markets are in west, south and east India. It exports around 10% of its cement volumes and 22% of its total volumes (17.1m tpa in FY07 including clinker), and has no presence in the northern markets. Along with Grasim (which holds a 52% stake), ULTC is working toward rationalizing markets, cutting costs and improving average realizations. ULTC has been known for the consistent high quality of its cement, and manages to earn a premium price over other cement brands in most markets. The group companies (ULTC, Grasim and Shree Digvijay Cement) have a total capacity of 31m tpa, which is expected to rise to about 45m tpa by June 2008.

Investment thesis

We rate ULTC as Sell/Medium Risk (3M) with a target price of Rs730. ULTC has been hard hit by higher costs recently, particularly for coal and freight. It has benefited less than other cement companies from the pricing upside, particularly in the quarter ended March 2007, despite its presence in the attractive markets such as South India (24% of sales) that enjoyed disproportionate price hikes. ULTC is running at full utilization, and we expect only 4% yoy volume growth in FY08. It is one of India's largest exporters of clinker, which will likely face pricing pressure as capacity comes on stream in the Middle East. We expect volume growth of 12% yoy in FY09, but will likely come with substantial increases in domestic cement capacity — creating oversupply and pricing declines in FY09E. ULTC should benefit from lower costs due to the captive power capacity due by FY09, but this is unlikely to help compensate for the 8% yoy price decline. We expect a yoy profit decline in FY09.

Valuation

ULTC has a short valuation history relative to other cement majors. It was listed only in August 2004, after its de-merger from L&T. We therefore base our target price on relative valuations versus majors such as ACC and Ambuja Cements. Although ULTC's EBITDA/tonne improved from about Rs400/tonne in FY06 to Rs850/tonne in 4Q FY07, it is still lower than the EBITDA/tonne of ACC and Ambuja Cements. Our target EV/EBITDA multiple for ULTC is 7.0x for FY09E, at a discount to ACC's and Ambuja's 7.5x EV/EBITDA for CY08E. At our target price of Rs730, ULTC would trade at an FY09E P/E of 11.4x and EV/tonne of US$110.

Risks

We rate ULTC as Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. The key upside risks to our target price include: (1) further delays in industry capacity; (2) a higher level of domestic demand growth than we expect; (3) a depreciation of the rupee, versus our assumption of an appreciation; and (4) changes in the duty/tax regime in favor of producers.

Appendix A-1

Analyst Certification

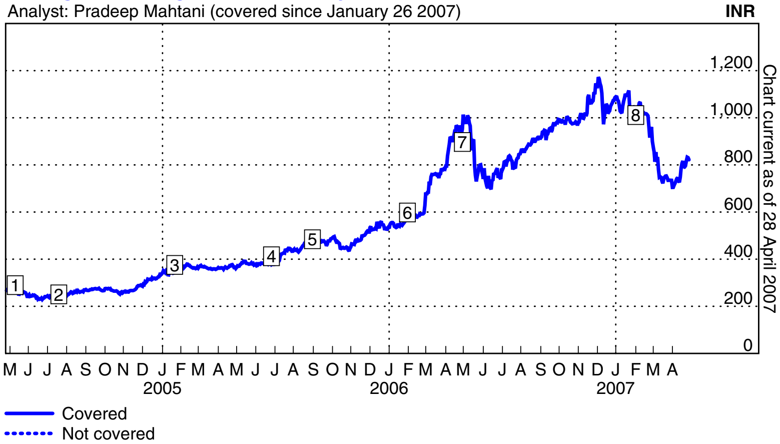
I, Pradeep Mahtani, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be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



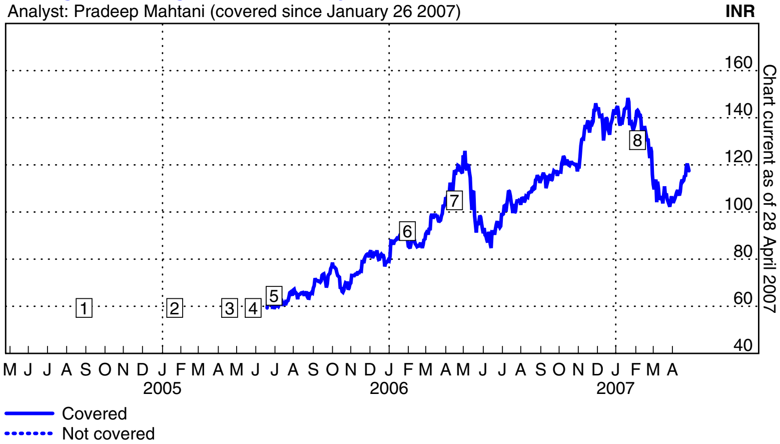
#	Date	Rating	Target Price	Closing Price
1:	11 May 04	*1M	*336.00	267.55
2:	20 Jul 04	1M	*305.00	232.70
3:	21 Jan 05	1M	*414.00	NA
4:	27 Jun 05	*1L	*453.00	377.30
5:	31 Aug 05	1L	*540.00	478.45
6:	31 Jan 06	1L	*660.00	573.00
7:	28 Apr 06	*2L	*1,050.00	951.95
8:	1 Feb 07	*1M	*1,260.00	1,034.95

*Indicates change.

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.

Grasim Industries (GRAS.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Pradeep Mahtani (covered since January 26 2007)

#	Date	Rating	Target Price	Closing Price
1:	30 Apr 04	1L	*1,481.00	1,236.30
2:	28 Sep 04	1L	*1,541.00	1,121.05
3:	31 Jan 05	1L	*1,581.00	1,328.20
4:	2 May 05	1L	*1,538.00	1,140.00
5:	26 Mar 06	1L	*2,367.00	1,980.45
6:	1 May 06	1L	*2,760.00	2,517.10

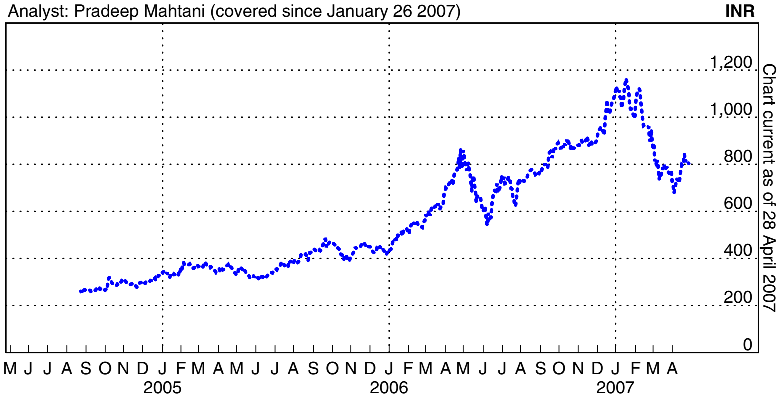
*Indicates change.

Covered
Not covered

UltraTech Cement (ULTC.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Pradeep Mahtani (covered since January 26 2007)



#	Date	Rating	Target Price	Closing Price

*Indicates change.

Covered
Not covered

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% of companies in each rating category that are investment banking clients	56%	20%	0%
China -- Asia Pacific (88)	72%	15%	14%
% of companies in each rating category that are investment banking clients	44%	46%	42%
India -- Asia Pacific (130)	58%	14%	28%
% of companies in each rating category that are investment banking clients	42%	50%	42%
Indonesia -- Asia Pacific (22)	50%	9%	41%
% of companies in each rating category that are investment banking clients	64%	100%	22%
Taiwan -- Asia Pacific (91)	66%	20%	14%
% of companies in each rating category that are investment banking clients	17%	6%	23%
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