

27th August, 2007

REDUCE

Price	Target Price
Rs135	Rs100
Sensex	14,425

Price Performance

(%)	1M	3M	6M	12M
Absolute	5	18	10	19
Rel. to Sensex	15	16	4	(5)

Source: Capitaline

Stock Details

Sector	Cement
Reuters	GACM.BO
Bloomberg	ACEM @IN
Equity Capital (Rs mn)	3041
Face Value (Rs)	2
52 Week H/L	150/100
Market Cap (Rs bn)	5396501
Daily Avg Vol. (No of shares)	5396501
Daily Avg Turnover (US\$m)	16.3

Shareholding Pattern (%)

(30 June '07)

Promoters	37.1
FII/NRI	32.3
Institutions	17.3
Private Corp.	1.8
Public	11.5

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Ambuja Cements

Holcim consolidates further

Event
Update

Swiss cement major Holcim, in a bid to further consolidates its holding in Ambuja Cement Ltd (ACL), has bought an additional 60 million shares (or 3.94% of the currently equity capital) from erstwhile promoters Sekhsaria and Neotia. The deal has been concluded at Rs154 per share of ACL. Subsequently Holcim Mauritius is making and open offer for further acquiring 20% at the price Rs154 per share. The deal values ACL at whopping USD 268 for its CY2007 capacity, 17.2X its CY2007 earnings and 10.1X its CY2007 EBIDTA. We believe the price offered is very attractive and at significant premium to its fair value. We believe such a huge premium is being paid by Holcim, primarily because of strategic value and not much because of future profitability. If we assume that because of sheer future profitability of ACL Holcim is paying such a huge premium, it implies that cement prices in next 1-2 years should be more than Rs320. Considering that cement industry is about to add significant 70 million tonne in next 2 years, such expectation looks unreasonable.

Holcim consolidates its holding in Ambuja cements – makes open offer @ Rs154

Swiss cement major Holcim, in a bid to further consolidate its holding in Ambuja Cement Ltd (ACL), has bought an additional 60 million shares (or 3.94% of the currently equity capital) from erstwhile promoters Sekhsaria and Neotia. The deal has been concluded at Rs154 per share of ACL. Subsequent to the deal and taking into consideration SEBI takeover code, Holcim Mauritius is making an open offer for further acquiring 306.5 million equity share of ACL (representing 20% of the equity capital) at the price Rs154 per share. Assuming 100% success of the open offer, Holcim stake in ACL would go upto 56%.

Is there an arbitrage opportunity?

At CMP of Rs133 and acceptance ratio of 30%, the arbitrage opportunity (considering 0.7% impact cost and no opportunity cost) presents a return of 4%. However if LIC and GIC do not offer their cumulative stake of 12% in ACL the acceptance ratio jumps to 39% which means an arbitrage return of more than 6%.

	Acceptance Ratio		
	30%	40%	50%
CMP (Rs)	133	133	133
No. of shares purchased	100	100	100
Total Investment	13300	13300	13300
Shares accepted (nos)	30	40	50
Shares rejected (nos)	70	60	50
Open offer price (Rs)	154	154	154
Return from open offer (Rs)	4620	6160	7700
Return from remaining shares (Rs)	9310	7980	6650
Total Returns	13930	14140	14350
Profit	630	840	1050
Profit (%)	4.7%	6.3%	7.9%

Deal values ACL at a whopping EV/ton of USD268 for CY2007 capacity

The deal between Holcim and the erstwhile promoters values ACL at whopping USD 268 for its CY2007 capacity, 17.2X its CY2007 earnings and 10.1X its CY2007 EBIDTA. We believe the price offered is very attractive and at significant premium to its fair value.

What is ACL fair value?

We value cement stock on what is known as enterprise value of the firm. This method takes into consideration the capital cost of setting up a cement plant and the present value of cash flows one would be enjoying in the gestation period of setting up that cement plant. Further we also attribute some value to the competitive advantage a firm enjoys on account of its distribution network, brand and also pricing power in a region. Based on these calculations we arrive at ACL fair value which is shown in the following exhibit.

Fair Value workings for ACL

	Rs billion
Cost of setting up a new cement plant (USD)	75
ACL's Capacity (CY2009)	22.0
Cost of setting up a plant	74.25
PV of Free Cash (opportunity loss for 5 years)*	59.98
Plant Replacement Cost (5 years)	134.23
Competitive Advantage	1440
Enterprise replacement value	14863
EV/Tonne	150

*Note: cash profit per ton of Rs1040 and discounting rate of 12% is considered.

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Premium Holcim is paying for ACL

	Premium				
	-10%	-5%	0%	25%	50%
EV/ton	135	143	150	188	225
Fair value per share	91	96	100	125	150

What signal is this open offer sending?

We believe Holcim taking erstwhile promoters stake and the subsequent open offer for further 20% stake in ACL @Rs154 per share is most probably culmination of the long drawn process of consolidation of Holcim stake in the company. We do not think this act of Holcim's sends its aggressive or bullish view of the Indian Cement industry. Hence we do not believe that this open offers necessarily an event, which is likely to result in re-rating of valuation of cement stocks.

What does it mean for ACC?

Holcim interest in Indian cement industry is driven by the stake it has in two industry giants i.e. Ambuja Cement (36% stake) and ACC (43% stake – assuming Holcim 100% stake in ACCIL). Holcim has already accelerated the process of consolidating its stake in ACL through buying stakes of erstwhile promoters, creeping acquisition as well as the recent open offer. While if we look at ACC, it already holds 43% and hence we believe, Holcim will continue to increase its stake in ACC through creeping acquisition from market rather than make an open offer. Also at CMP of Rs975, ACC trades at EV/ton USD 179 and EV/EBIDTA of 9.2X, which is lower valuation as compared to what Holcim is ready to pay for ACC.

We believe current valuation for ACL are expensive keeping in mind significant capacity additions of 70 million tonnes lined up by the industry over next two year. The capacity addition we believe would disturb the demand supply equation and would weaken pricing power of cement producers. However because of an buoyant cement demand in FY2008 and high cement prices, cement stocks like Ambuja cement are likely to do well in the sort term.

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