

## INDIA

# Indian cement sector

28 August 2007

### Indian cement sector

Company	Ticker	Rec	Current (Rs)	Target (Rs)	Upside (%)
ACC	ACC IN	OP	1,037	1,230	18.6
Ambuja Cement	ACEM IN	OP	133	168	26.1
Ultratech Cement	UTCEM IN	OP	905	1,325	46.4
Grasim Ind.	GRASIM IN	OP	2,828	3,600	27.3
India Cement	ICEM IN	OP	238	264	10.7

Source: Bloomberg, Macquarie Research, August 2007

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## Cement – fundamentally strong

### Event

- **Further price increases possible:** While it is raining hard and now is the lean season for cement demand, we have examined the vital parameters of the industry and find it to be in a healthy state for price increases.

### Impact

- **Inventories still at historical lows:** Clinker stocks have recovered slightly at 4.28m tonnes in July, since hitting a historical low of 3.84m tonnes in June 2007. However, at 12 days of consumption and with roughly just a month to go before the peak season, stocks are well below the average historical levels of 18–20 days, which indicates a chronic tightness in the market.
- **Clinker production growth on decline:** Growth of clinker production (12-month moving average) has dropped from roughly 10% in FY03 to roughly 4% currently, and is falling short of meeting the 10% cement demand growth.
- **Blending on a new high:** The blending ratio has jumped to a new high of 1.37 as the last remaining bastions of ordinary cement (OPC) – Maharashtra, Gujarat and Rajasthan – are aggressively converting to blended cement markets. We believe any further growth from here would be muted, as ordinary cement commands a premium of Rs20/bag over blended cement. Also, sourcing of fly-ash for blending is becoming increasingly more costly.
- **Exports have dwindled:** Cement and clinker exports have declined from an average of 1mtpa to roughly 0.8mtpa and should continue to shrink as domestic prices remain more lucrative.
- **Imports likely – but not a threat:** Some Pakistan cement companies have applied for BIS approval and Lucky Cement (LUCK PA, Not rated) is the first one to have obtained approval. Our industry sources indicate that 2,000 tonnes of bagged cement have arrived in a container at JNPT port near Mumbai. The estimated selling price is approximately Rs207/bag against domestic prices of Rs240/bag. We believe it might be possible to import 0.5m tonnes of cement from Pakistan into the country over the next 12 months. However, with a forecast 5m tonne shortage of cement in the country, we believe imports will not be able to effect a reduction in cement prices.

### Outlook

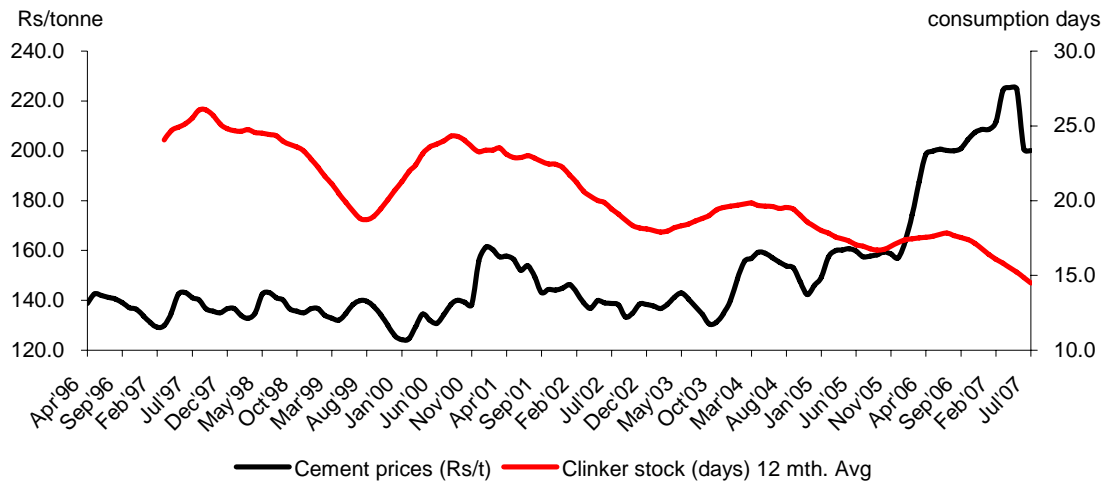
- **Rising prices will be a key trigger:** We expect cement prices to increase after the monsoon, leading to earnings upgrades for both FY3/08 and FY3/09.
- **Valuations compelling:** Cement stocks are trading at an average PER of 10.5x and EV/EBITDA of 6.7x based on 1 yr forward estimates, which are well near historical averages and are not reflecting the higher-for-longer cement price scenario.
- Our top picks remain Grasim Industries (GRASIM IN, Rs2,828, Outperform, TP: Rs3,600) and Ambuja Cements (ACEM IN, Rs133, Outperform, TP: Rs168).

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### Indian cement industry: Pointing toward a price rise

Clinker stocks have recovered slightly at 4.28m tonnes in July, since hitting their historical low of 3.84m tonnes in June 2007. However, at 12 days of consumption and with roughly just a month to go before the peak season, stocks are well below the average historical levels of 18–20 days, which indicates a chronic tightness in the market.

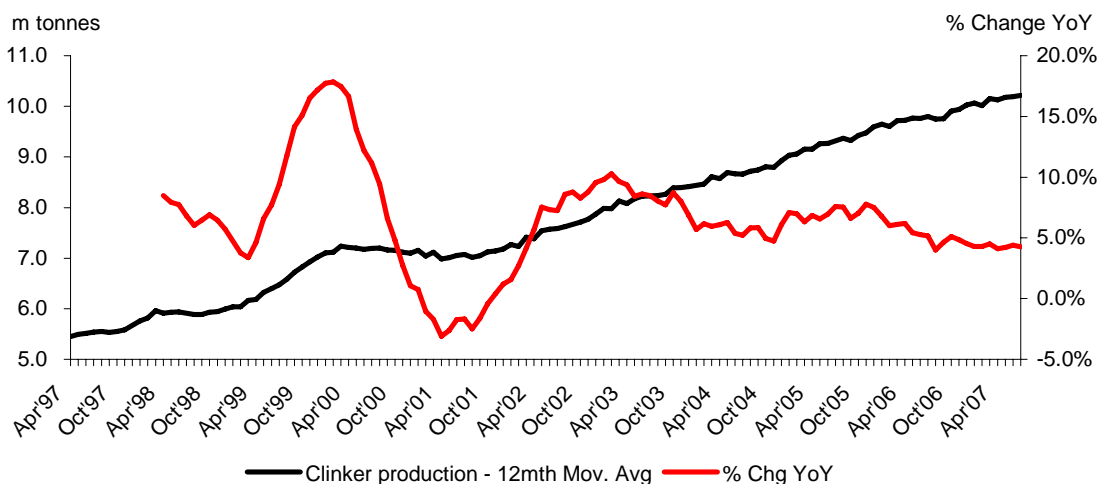
**Fig 1 Clinker stocks (consumption days) still at industry lows**



Source: Cement Manufacturers Association, Macquarie Research, August 2007

We examined clinker production growth over the past ten years. Growth has slowed from a peak of approximately 10% in FY03 to less than 4% currently. With 10% growth in demand, clinker production is falling short of meeting requirements.

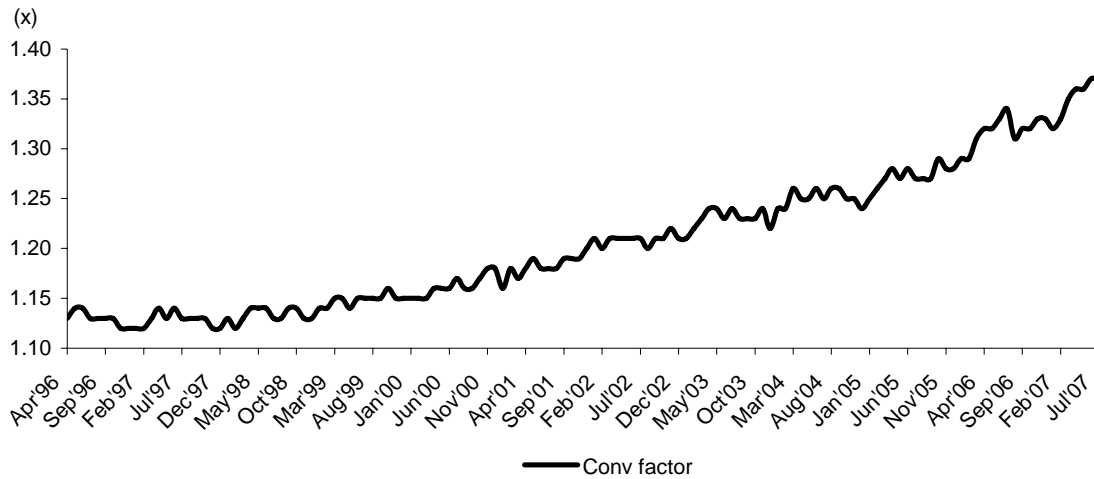
**Fig 2 Clinker production growth is slowing**



Source: Macquarie Research, August 2007

The blending ratio has jumped to a new high of 1.37, as the last remaining bastion of ordinary cement (OPC) – Maharashtra, Gujarat and Rajasthan – are aggressively converting to blended cement markets. We believe any further growth from here would be muted, as ordinary cement commands a premium of Rs20/bag over blended cement.

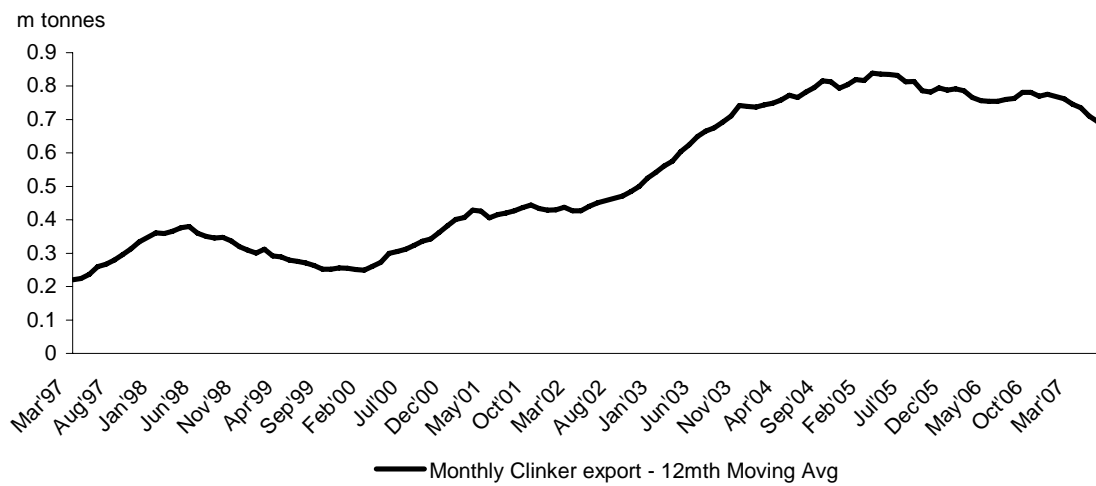
**Fig 3 Industry conversion ratio at a new high**



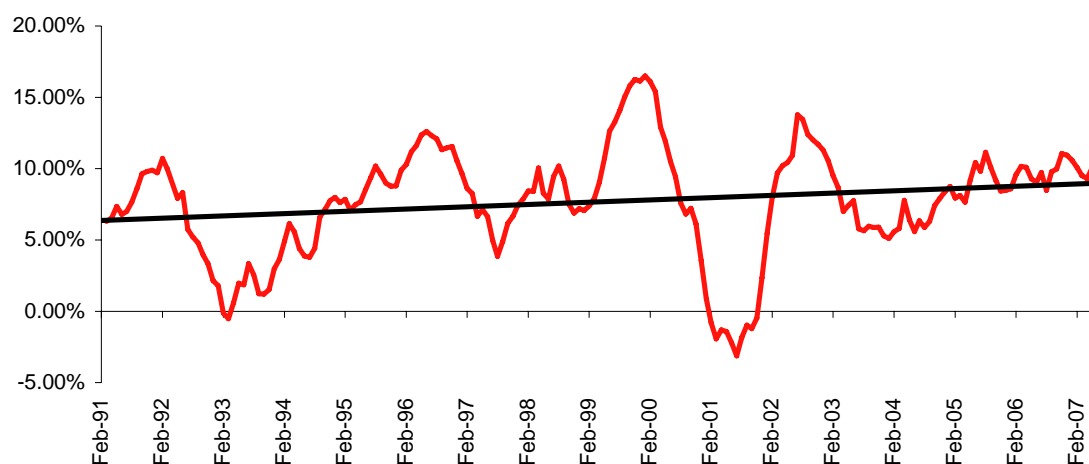
Source: Cement Manufacturers Association, Macquarie Research, August 2007

Cement and clinker exports have declined from an average of 10mtpa to roughly 8mtpa and will continue to shrink as domestic prices remain more lucrative.

**Fig 4 Clinker exports declining**



Source: Cement Manufacturers Association, Macquarie Research, August 2007

**Fig 5 All India - 12month moving average demand growth rate**

Source: Cement Manufacturers Association, Macquarie Research, August 2007

**Indian cement sector valuations****Fig 6 Indian cement sector: Recommendations and Target prices**

Company	Ticker	Rec	Current price	Target	Upside%
ACC	ACC IN	Outperform	1,037	1,230	18.6%
Ambuja Cement	ACEM IN	Outperform	133	168	26.1%
Ultratech Cement	UTCEM IN	Outperform	905	1,325	46.4%
Grasim Industries	GRASIM IN	Outperform	2,828	3,600	27.3%
India Cement	ICEM IN	Outperform	238	264	10.7%

Source: Bloomberg, Macquarie Research, August 2007

**Fig 7 Indian cement valuations**

(Rs m)	ACC		Ambuja		Grasim		Ultratech		India Cements	
	CY07E	CY08E	CY07E	CY08E	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
Net Sales	72,656	81,139	57,116	65,069	157,321	169,093	57,892	60,359	28,340	30,794
EBITDA	25,169	27,341	22,844	25,594	51,667	53,736	19,213	20,608	10,808	10,533
EPS (Rs)	88.2	102.1	11.3	12.5	277.8	284.1	90.6	97.4	26.5	23.9
P/E (x)	11.8x	10.2x	11.8x	10.7x	10.2x	10.0x	10.0x	9.3x	9.0x	10.0x
EV/EBIDTA (x)	7.3x	6.2x	7.4x	6.3x	5.7x	5.5x	6.5x	6.1x	7.0x	6.8x
EV/Ton (US\$) - Reported	208	177	204	195	298	258	176	177	187	161
Real EV / ton (US\$) - Adj.	195	164	162	154	179	182	121	122	163	141

Source: Bloomberg, Macquarie Research, August 2007

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## Recommendation definitions

## Macquarie Australia/New Zealand

Outperform – return >5% in excess of benchmark return (>2.5% in excess for listed property trusts)  
 Neutral – return within 5% of benchmark return (within 2.5% for listed property trusts)  
 Underperform – return >5% below benchmark return (>2.5% below for listed property trusts)

## Macquarie Asia

Outperform – expected return >+10%  
 Neutral – expected return from -10% to +10%  
 Underperform – expected return <-10%

## Macquarie First South Securities (South Africa)

Outperform – expected return >+5%  
 Neutral – expected return from -5% to +5%  
 Underperform – expected return <-5%

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

## Recommendation proportions

	AU/NZ	Asia	RSA
Outperform	46.81%	61.36%	45.30%
Neutral	39.01%	18.67%	35.80%
Underperform	14.18%	19.97%	18.90%

For quarter ending 30 June 2007

## Volatility index definition\*

This is calculated from the volatility of historic price movements.

**Very high–highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low–medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.

\* Applicable to Australian/NZ stocks only

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All "Adjusted" data items have had the following adjustments made:  
 Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense  
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa\*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

\*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

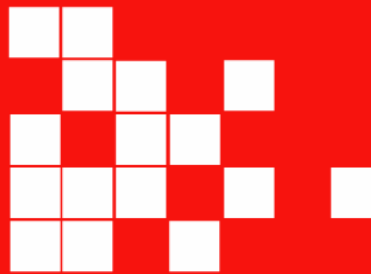
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