

Morgan Stanley India Company
Private Limited+

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August 25, 2008

Industry View
Cautious

India Cement

More Negatives Ahead; Assume With Cautious View

We assume coverage of the India Cement industry with a Cautious view. The Indian cement stocks have declined 14-24% in absolute terms in the past three months, but we believe this has just been a return to relative normality from historically high earnings multiples early this year. We think the stocks have further to decline. The industry faces multiple negative factors that should lead to lower earnings and keep stock performance in check. We are Underweight Ambuja, ACC, and Ultratech, and Equal-weight Grasim.

What's new: We expect significant supply in India's cement industry in F2010 to lower capacity utilization to below 80%. Realized cement prices have risen 50% in the past three years because of capacity constraints and strong demand. We expect this up-cycle to turn and prices to fall 12-15% over F2009-10, leading to lower margins. We expect the increase in cost pressures evident in 1H F2009 to continue, which, coupled with government intervention in prices, is a major negative for the cement industry.

Where we differ: Consensus assumptions are for flat cement prices over the next two years, whereas we assume a decline. So, our net income estimates are on average 20% below consensus for F2009.

What's next: Valuation multiples have come off recently, but we believe the stocks will still trade at or below their long-term averages, given the imminent decline in earnings. Consensus expectations do not appear to be factoring in such a decline. The stocks lack positive catalysts and the negatives are prominent. Therefore, we advise not owning the pure cement stocks. However, we have an Equal-weight rating on Grasim, given its diversified nature and higher cement growth volume.

Companies Featured

Company	Rating
ACC Ltd (ACC.BO, Rs559)	Underweight
Ambuja Cement Ltd (ABUJ.BO, Rs80)	Underweight
Grasim Industries Ltd (GRAS.BO, Rs1,962)	Equal-weight
Ultratech Ltd (ULTC.BO, Rs593)	Underweight

Prices as of August 25th, 2008. Source: Morgan Stanley Research

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Investment Case

- Assume coverage with a Cautious industry view
- UW Ambuja, ACC, and Ultratech; E-W Grasim.
- Our counter-consensus view is for cement prices to decline 12-15% over F2009-10.
- We expect all the input costs to rise.
- We expect record surplus capacity in India's cement industry in F2010 to weigh on prices.
- Most companies are in an investment phase, meaning higher depreciation/interest charges.
- Valuations have declined, but we do not expect a bounce, given the imminent earnings decline.

Why We Are Cautious

Up-cycle Over, Multiple Negatives Ahead

India's cement industry has been in a demand-driven bullish cycle for the past four years, in our view. In F2003-08, capacity growth was sluggish, at around 5% annually, and demand growth was buoyant, at around 8-10%.

The industry was recovering from the last down-cycle, during which most of the companies made losses and balance sheets were stretched. Therefore, no capacity was added. By F2007, cement prices had recovered sharply, reflecting buoyant demand and higher utilization. Many companies started announcing capacity expansion plans, supported by strong cash flows from higher cement prices. We believe that conditions will reverse with the situation similar to that in F2001-02 when utilization, at 79%, was at a trough and cement companies were not making money. We expect the ROE of all the companies that we cover in the industry to decline below the cost of capital in F2010. Demand remains buoyant, but we view the increase in supply as a problem.

We see multiple negative factors that could lead the industry into a cyclical downturn. These support our key counter-consensus assumption of lower cement prices:

- Aggressive capacity expansion by all firms, resulting in record surplus capacity in F2010.
- Increasing cost pressures from higher crude oil and related prices, coal costs, and raw material costs.
- Higher inflation, leading to government intervention.
- Possible supply overhang if power utilities start looking at cement manufacturing seriously.
- Exports slowing and imports becoming viable because of potential oversupply in the Gulf in 2010.

Cement Prices to Drop 12-15%; Consensus Flat

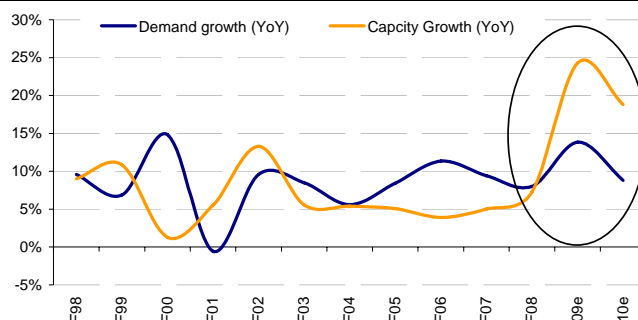
We believe impending capacity expansion, causing capacity growth to exceed demand growth, will lead to surplus capacity and put pressure on cement prices. We expect prices to decline 12-15% in F2009-10, following a peak in F2008. Consensus estimates are for flat cement prices in this period. Therefore, on average, our earnings estimates are 20% below consensus for F2009.

Valuations Have Declined, but We Don't Expect a Bounce

We value the Indian cement companies using DCF methodology. We also use valuation multiples to reaffirm our views. We use EV/EBITDA and EV/ton metrics for the cement stocks. Our price targets are based on intrinsic values derived from the DCF models. Based on our valuation, we believe Ambuja stock still has significant downside potential, as its relative valuations have not eased yet. For ACC and Ultratech, although asset valuations are trading at their long-term averages, we expect stock performances to be muted because of the decline in earnings leading to these stocks trading below replacement cost, as in the past. The stocks have underperformed the market by a good margin in the past 12 months. However, they lack positive catalysts, and we would view any bounce as a selling opportunity.

Exhibit 1

Capacity Growth Overtakes Demand Growth



E=Morgan Stanley Research estimates

Source: CMA, Company data, Morgan Stanley Research.

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Industry View: Cautious

India's cement industry, with 200mtpa of capacity, is second only to China's in terms of size. There has been four to five years of demand and price growth in the industry. However, we expect impending oversupply and government intervention to affect pricing negatively.

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Aggressive Capacity Expansion Leading to Price Declines

Exhibit 2

India Cement Industry Supply and Demand Model

Mn Tons	F2006	F2007	F2008	F2009E	F2010E
Effective Capacity	158	166	178	221	262
Capacity Growth (%)	3.9	5.0	7.3	24.3	18.8
Production	142	156	168	189	205
Utilization Rate (%)	90	94	95	86	78
Local Consumption	136	149	164	180	197
Exports	6	6	4	5	5
Total Demand	142	155	167	185	202
Demand growth (%)	11.3	9.4	8.0	10.6	9.0

E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research,

High growth in capacity expansion leading to surplus in F2010

Utilization rate to drop below 80%

Exports will be difficult from F2010, as there will be oversupply in the Gulf region

Pace and Extent of Capacity Addition Highest In Past 15 Years; To Add 48% to Existing Capacity

We expect more than 80mt of cement capacity to be set up in India in F2009-10. This translates to 48% of existing capacity. For the first time since F2002, we expect capacity growth to exceed demand growth comfortably (Exhibit 1).

Firm cement prices in the past two to three years, along with domestic demand, have strengthened the balance sheets of most cement companies in India. With high cash inflows and a conducive environment, most have started or announced capacity expansions, leading to a likely supply surplus. We expect the high utilization rates of the past two years, which have also supported cement prices, to decline.

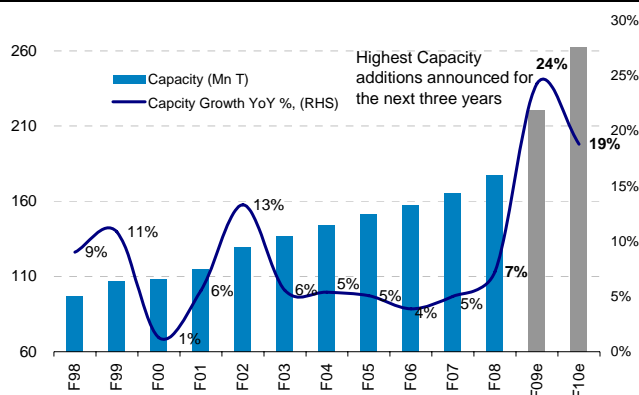
Capacity Utilization Rate to Drop Below 80%

Most cement companies in India currently operate at more than 100% capacity utilization. They have also resorted to higher blending ratios of cement to increase supply and overcome capacity constraint issues. There were no meaningful investments in capacity in F2003-05 because of stressed balance sheets and surplus capacity from earlier years.

In the past two years, the domestic growth rate for cement consumption has been above 9-10%, while cement prices have risen at a 13% CAGR in the past four years. This has resulted in most companies planning aggressive capacity expansion.

Exhibit 3

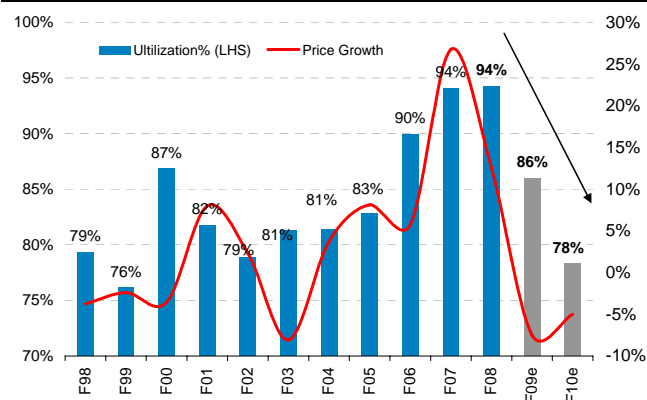
Highest Growth in Capacity Addition



E=Morgan Stanley Research estimates.
Source: CMA, company data, Morgan Stanley Research

Exhibit 4

Drop in Capacity Utilization to Take Prices Lower



E=Morgan Stanley Research estimates.
Source: CMA, company data, Morgan Stanley Research

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We believe the capacity addition will lead to utilization dropping below 80% from 94% currently. The cement companies' operating profit margins suffer badly whenever capacity utilization falls below 80%. This happened in the F2002 cycle, when most cement companies started making losses. During F2002 to F2004, when there was excess capacity, the operating profit margin declined to below 15% for most companies. After the situation eased from F2005, operating profit margins picked up to above 20%.

We believe the pace of capacity addition is very high compared with demand growth and will lead to a record surplus in F2010. This, in turn, would lower prices and margins.

Gross Cement Realized Prices to Fall 12-15% by F2010; Effect of Cyclical Downturn

Contrary to consensus, we believe cement prices will fall 12-15% by F2010 because of aggressive capacity expansion, increased government intervention as a result of inflationary pressure, and higher interest rates leading to a slowdown in housing activity. Cement prices have risen 50% in the past three years and cement companies' margins have peaked.

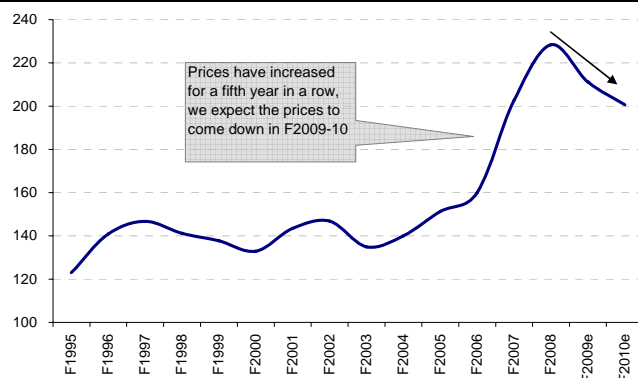
However, cement is a commodity and commodities are cyclical. Each cement company that has increased capacity will try to sell as much production as possible to increase utilization and market share, by reducing prices. Even though the industry is reasonably consolidated, regional and smaller firms may distort the pricing power of the big companies. Therefore, we expect prices to fall for the next two years.

This latest price cycle has been prolonged because of capacity constraints and strong demand. Lower interest rates boosting the housing sector, together with infrastructure and corporate capex, have supported this demand. Macro conditions have now changed, with higher interest rates and lower IIP and GDP growth rates. Still, we are conservative in our demand forecasts, as we have not factored in any slowdown in demand, but we expect rising supply to increase pressure on prices.

In the past, cement cycles have not lasted more than two to three years. However, the latest up-cycle has continued for more than four years. The rise in cement prices has been steep. We believe the situation will reverse as more supply comes on stream in the next few quarters.

Exhibit 5

We Expect Cement Prices to Decline in F2009-10



Source: Company data, Morgan Stanley Research E=Morgan Stanley Research estimates

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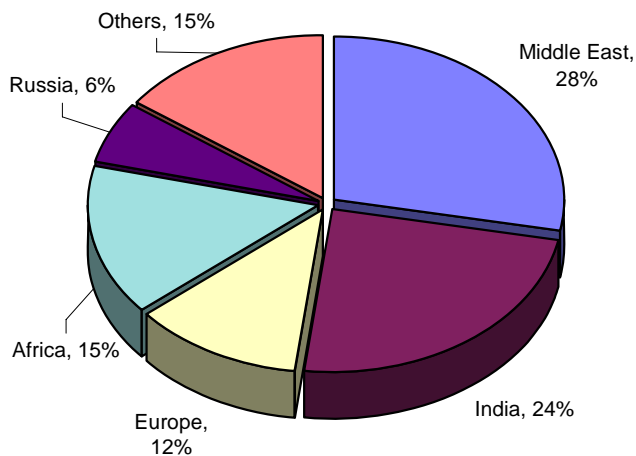
Capacity Additions Likely on Schedule

Market expectations are for delays in capacity additions, but we do not expect such delays, because of the following factors:

- Equipment suppliers' book-to-bill ratios are comfortable at 1.5-1.6x revenue.
- The cement manufacturers that have invested to build capacity are likely to avoid any delays in capacity commissioning to bring the new production to market as early as possible and thus take advantage of higher prices and improve their return on investment.
- FL Smidth, a major equipment manufacturer for the cement industry, has the highest market share in India. Its operations in India employ over 1,000 people and offer the full spectrum of required services, including operation and maintenance facilities, ensuring that projects start on time.

Exhibit 6

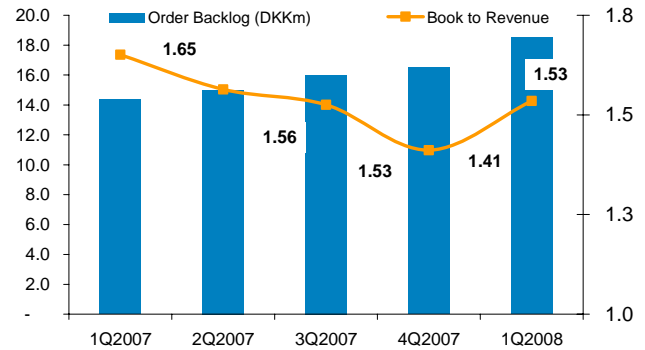
India and Middle East Dominate Global Contracted Cement Kiln Capacity, Excluding China



Source: FL Smidth, Morgan Stanley Research

Exhibit 7

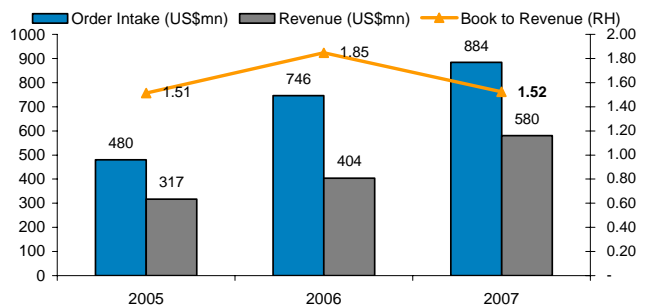
FL Smidth Order Backlog versus Book to Bill



Source: FL Smidth, Morgan Stanley Research

Exhibit 8

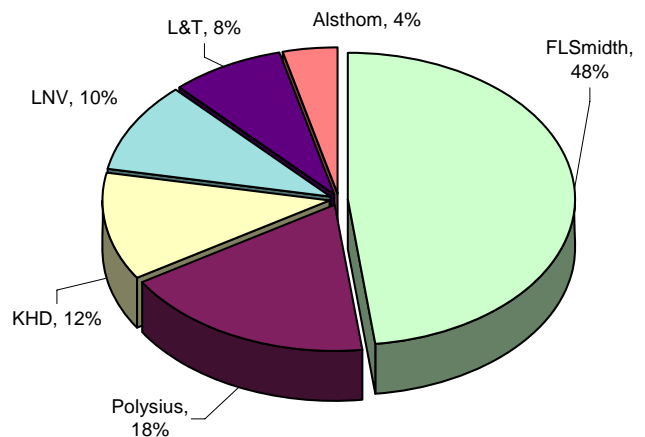
KHD Humboldt Book to Bill Still at 1.5x Despite Rise in Order Intake



Source: KHD Humboldt, Morgan Stanley Research

Exhibit 9

Market Share of Cement Industry Equipment Manufacturers in India



Source: FL Smidth, Company data, Morgan Stanley Research

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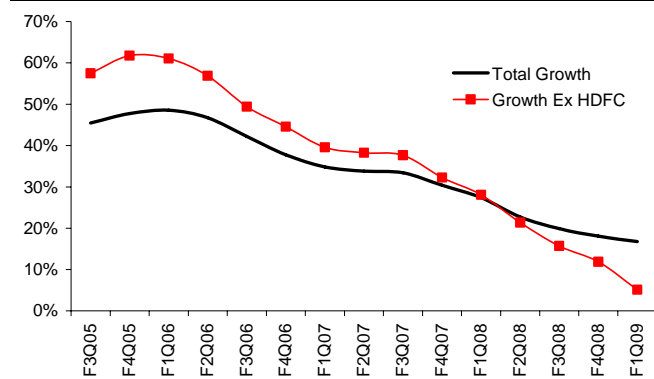
India Cement

Higher Infrastructure Demand to Mitigate Housing Slowdown

Although we believe the demand growth for cement will remain at 9-10% per annum over F2009-10, we do expect certain short-term barriers to demand growth. The housing market, which accounts for more than 60% of cement demand in India, is likely to slow because of higher interest rates. Housing loan growth, driven by very low interest rates, declined from 45% in 3Q F2006 to less than 20% in 1Q F2009. The YoY growth in housing loans granted by ICICI Bank (one of the largest mortgage banks in India) has been negative for the last five quarters, with a decline of more than 20% in four of the five quarters.

Exhibit 10

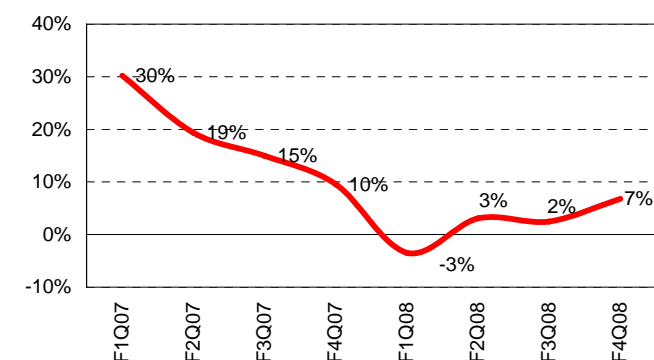
YoY Growth in Housing Loan Portfolio



Note: The data pertains to ICICI, SBI, HDFC and UTI Bank.
Source: Company data, Morgan Stanley Research

Exhibit 11

YoY Growth in New Housing Loans

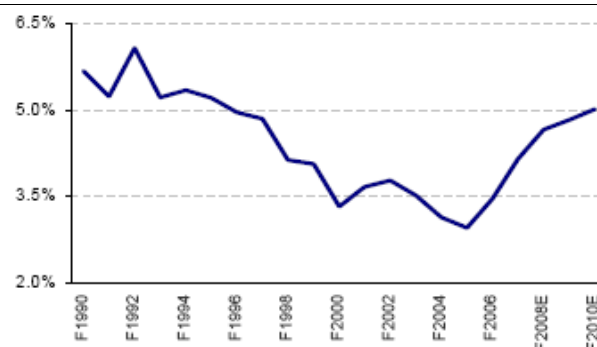


Note: This pertains to HDFC, ICICI Bank and LICHF
Source: Company data, Morgan Stanley Research

We believe higher demand from infrastructure investment and corporate capex would mitigate any fall in demand from the housing sector. India's infrastructure spend as a percentage of GDP, at around 4.5%, is still lower than China's 8.5%. To sustain higher economic growth, more investment is needed in infrastructure, which may lead to higher demand for cement. The lagging agriculture sector requires investment in irrigation, which could bode well for cement demand.

Exhibit 12

Infrastructure Investments as a Percentage of GDP



E=Morgan Stanley Research estimates. Source: CEIC, Morgan Stanley Research

Exhibit 13

Infrastructure Investments – India versus China

	India		China	
	US\$bn	% of GDP	US\$bn	% of GDP
F2007				
Transport	13.9	1.50%	144.2	4.20%
---Railways	5.1	0.60%	31.1	0.90%
---Roads	5.8	0.60%	90.7	2.60%
---Ports	1.4	0.20%	14.6	0.40%
---Airports	1.6	0.20%	7.8	0.20%
Communication	12.1	1.30%	23.6	0.70%
Electricity	11.2	1.20%	104	3.00%
Urban Infrastructure	0.9	0.10%	14.2	0.40%
Total	38.1	4.20%	286	8.30%

Source: Company data, Morgan Stanley Research

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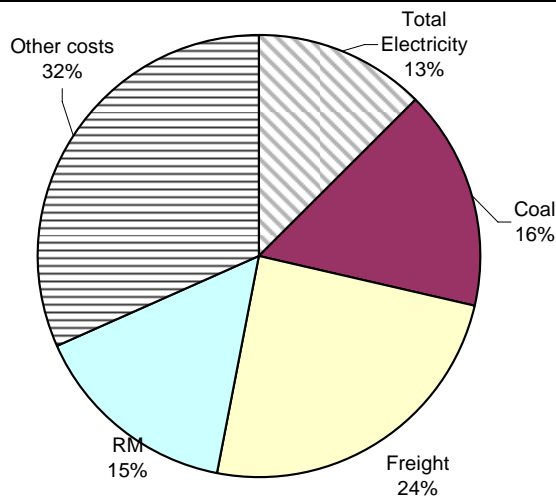
Greater Cost Pressures to Compress Margins

Key Input Costs Increasing on Rising Oil Prices

The key input costs for cement companies are electricity, fuel (coal), freight, and raw materials. These account for 40-45% of costs as a percentage of sales for India's cement companies. Some of these costs are directly or indirectly related to oil prices. With the crude oil price at around US\$120/bbl, these costs are all on the rise.

Exhibit 14

General Cost Breakdown for India's Cement Companies



Note: Data is for ACC, Ambuja, Ultratech, India Cement, Shree Cement, and Madras Cement. Data pertains to 2007 for ACC, Ambuja, and F2008 for others.
Source: Company data, Morgan Stanley Research

Coal

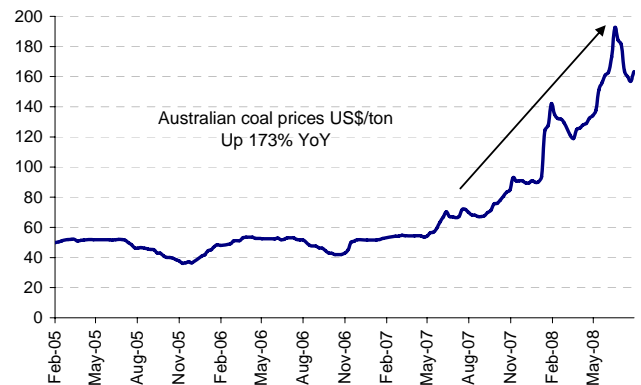
International coal prices increased from around US\$55 per ton at the start of 2007 to almost US\$120 per ton by the end of the year. Australian coal prices are now at around US\$160 per ton. India's cement companies are more reliant on imported coal than domestic coal, so we expect them to be vulnerable to coal price increases. The cost of freight for imported coal has also risen with the increase in the Baltic Dry Index. Coal costs (both for kiln operations and for generation of power) comprise roughly 20-25% of total costs for cement companies.

Coal is a key raw material in the cement manufacturing process and is used in kiln operations and for captive power plants. Although the cement companies receive coal linkages (long-term coal supply agreements with domestic government-controlled mining companies) from the government, often the supply is below the level permitted to them. The companies

have to either resort to government e-auctions, at which prices are 30-35% higher than from the linkages, or imported coal.

Exhibit 15

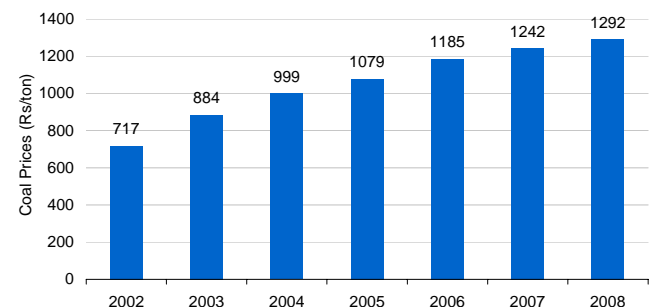
Coal Prices Have Risen Sharply



Source: Bloomberg, Morgan Stanley Research

Exhibit 16

Domestic Prices for Grade D Coal

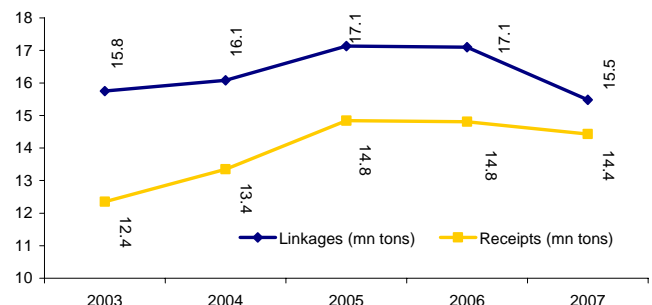


Source: Company data, Morgan Stanley Research

Note: The prices do not include taxes.

Exhibit 17

Coal Linkages versus Receipts



Source: CMA, Company data, Morgan Stanley Research

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Coal Prices to Remain Firm for the Next Couple of Years

In April 2008, Morgan Stanley materials analysts Wiktor Bielski and Craig Campbell increased their coal price forecasts for F2009 and F2010 to US\$140/ton. They expect coal prices to remain high with a higher probability of upside risk because of weather issues in China, flooding in Queensland, Australia, and infrastructure bottlenecks in Australia and South Africa.

Exhibit 18

Coal Price Forecast Changes

	Revised Forecast (US\$/ton)	Previous Forecast (US\$/ton)	Change (%)
2007	55.5	55.5	0%
2008e	125	105	19%
2009e	140	110	27%
2010e	140	110	27%
2011e	120	100	20%
2012e	100	95	5%
Long Term	60	60	0%

Source: Morgan Stanley Research E=Morgan Stanley Research estimates

Raw Materials

Raw material costs constitute 10-15% of sales and 16-20% of overall costs for India's cement companies. Raw material costs are rising as gypsum and fly ash prices rise. These increasing prices are denting margins. The fly ash requires transport, and the distance between the source and the cement plant affects the cost structure. We expect further pressure in terms of raw materials cost as new cement capacity comes on stream.

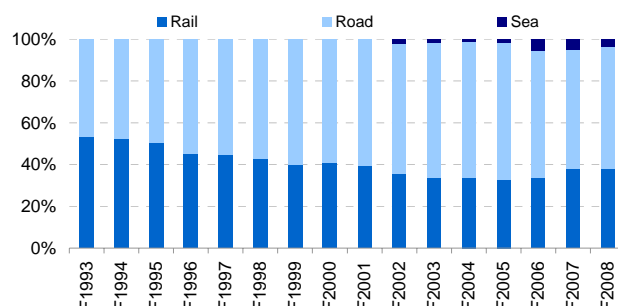
Freight Costs

The government's recent Rs3/litre hike in diesel prices can increase cement freight rates by 7-9% per kilometer. The proportion of cement freighted by road in India is on the decline, but we believe roads will always be the preferred mode of transport for distances below 350km.

Railway freight rates for cement have increased recently and the availability of wagons is an issue in the near term. The government's last rail budget set a target of moving 200mt of cement by rail annually by 2011-12. The government plans to increase investment along the ten cement clusters (regions with limestone deposits) in India by adding new lines and new bulk terminals. However, this may take time. As new capacity comes on stream, more cement will be transported by road in the near term, thereby increasing freight costs.

Exhibit 19

58% of Cement in India Is Transported by Road



Source: CMA, Company data, Morgan Stanley Research

Exhibit 20

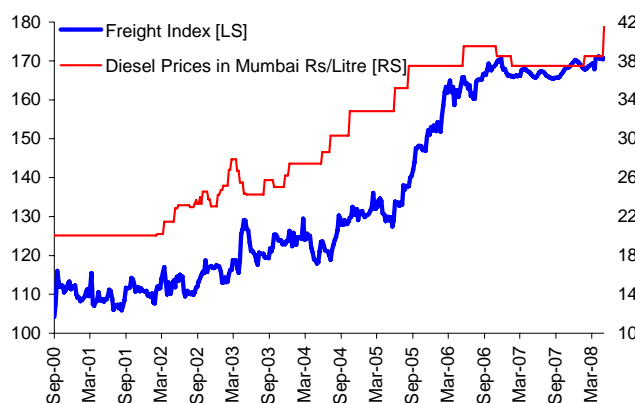
Road Is the Costliest Mode of Transport

	Average Lead (kms)	Rate (Rs/ton/km)
Rail	600-700	0.95
Road	300-400	1.50
Sea	>600	0.60

Source: Company data, Morgan Stanley Research

Exhibit 21

Diesel Prices in India Raised Rs3/litre



Source: Company data, Morgan Stanley Research

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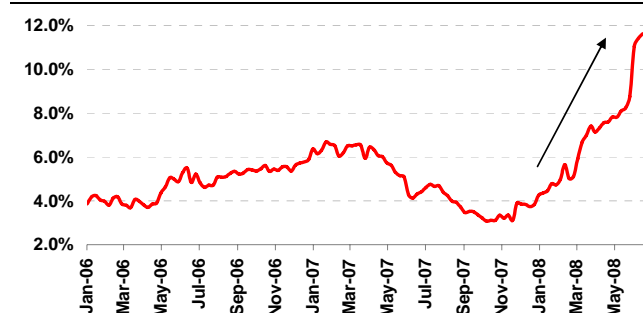
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Higher Inflation Equals More Government Intervention

Inflation in India is above the Reserve Bank of India's comfort level of 5.5%. The government is using many means to control the prices of most commodities. The cement and steel industries are two industries the government is targeting in which to lower prices. Cement is not a major contributor to inflation, but the state and central governments have indeed taken steps to control cement prices.

Exhibit 22

Inflation Is Rising



Source: Company data, Morgan Stanley Research

In the last two budgets, to control cement prices, the finance minister has introduced a differential duty structure and increased the excise on packaged cement, bulk cement, and clinker. He has also removed import duties on cement and banned cement exports. In addition, he has mentioned that there is 'cartelization' in the cement industry. We believe these measures have put serious pressure on cement companies to freeze price hikes.

The state governments have also put pressure on the cement companies. The most vocal have been the Andhra Pradesh

and Tamil Nadu governments. The Andhra Pradesh government recently urged the central government to delegate powers, including promulgation of an ordinance, to restrict the supply of cement to other states. The government has also asked cement companies to reduce the price to Rs200 per 50kg bag from the prevailing Rs240-250 per bag.

Exhibit 23

Government Stepping Up Pressure on Prices

Date	Measures Taken
	AP government urged the central government to delegate powers, including promulgation of an ordinance, to restrict movement of cement to other states from AP to control open market prices.
Apr-08	AP government asked cement companies to reduce the price to Rs200 per 50kg bag.
Apr-08	Finance Minister Chidambaram said "It is my view that cement manufactures and to some extent steel producers are behaving like a cartel".
Apr-08	Cement exports banned.
Mar-08	Hike in excise duty on bulk cement and clinkers.
Jan-08	Tamil Nadu state government threatens to take over the private companies if they fail to reduce prices.
	Specific excise duty on cement converted to ad valorem.
	Government asked cement companies to pass on the benefits to the consumers.
May-07	No additional customs duty and countervailing duty (CVD) on imported portland cement.
Apr-07	
Mar-07	Dual excise duty structure levied on cement..
Jan-07	Customs duty on cement cut.

Source: Company data, Morgan Stanley Research

Given this backdrop, we believe cement companies will remain cautious when it comes to raising prices. In the past quarter, cost increases at most cement companies have outpaced cement price increases, putting pressure on margins. This is evidence of their inability to pass on cost hikes through price increases.

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Possible Supply Overhang

Many power utility companies in India, including Reliance Power Ltd and NTPC, have shown an interest in building cement manufacturing units close to power plants. The idea is to better use the fly ash generated in thermal power plants. The disposal of fly ash is a big concern as it is hazardous to the environment. The power utilities are looking at alternative uses of the ash in the cement, brick, and fertilizer industries.

Reliance Power plans a 20mn ton cement plant in the vicinity of its 4000MW Sasan power plant. It has already secured the land and expects to start with a 5mn ton cement plant in the first stage when the first phase of its power plant is commissioned. The induction of Mr. Anil Singhvi (ex-managing director of Ambuja Cements) by Reliance Power emphasizes the fact that it is serious about its cement plans, in our view.

We believe the power utility companies could pose a threat to existing cement companies, as they will not have to incur transport costs for fly ash and most of them have interests in coalmines in Indonesia and Australia, which may give them an assured supply of quality coal.

Background

A great deal of power capacity is due to come on stream in India in the next ten years. The government's ultra mega power projects (UMPPs) planned at different locations in India would add 36,000 MW of power capacity in the country. According to the Planning Commission of India, addition of 68,900MW of power capacity is feasible during 11th five-year plan (F2007-12), of which 12,000MW is to be added in F2009. Most of the planned power plants are thermal plants (around 50,100MW of total), which use domestic or imported coal. The quality of domestic coal is very low, with a calorific value range of 1800-2300kcal/kg. This low calorific value and high ash content create a large amount of fly ash. The Mundra UMPP at Gujarat will use imported coal and generate 1.5mt of fly ash each year. Coal plants using domestic coal will generate almost five times as much fly ash as ones using imported coal. At present Indian power utility companies generate around 130mn tons of fly ash annually, and this could rise to 200mn tons by F2012. Therefore, there will be abundant supply of fly

ash, creating disposal issues. Fly ash is sold at no cost, and the only cost borne by the consumer is the freight cost, so it is essential for the cement units to be located close to the power plant to save on transportation costs. Hence, we expect more utility companies to look at cement production close to the power plants to better use fly ash.

Exhibit 24

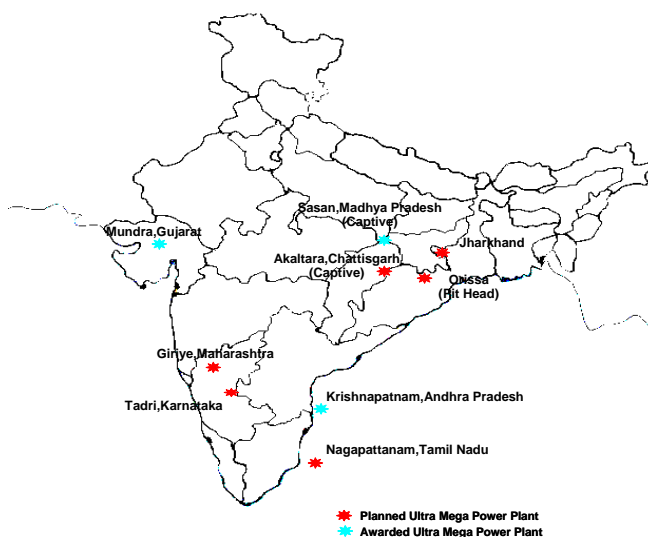
Potential Fly Ash Generation from UMPPs

Location	State	Capacity	Coal	Fly ash generated (mn tons)
Sasan	MP	4000	Domestic	7.5
Mundra	GJ	4000	Imported	1.5
Akaltara	CH	4000	Domestic	7.5
Giriy	MH	4000	Imported	1.5
Tadri	KN	4000	Imported	1.5
Krishnapatnam	AP	4000	Imported	1.5
Nagapatnam	TN	4000	Imported	1.5

Source: Company data, Morgan Stanley Research

Exhibit 25

Location of UMPPs



Source: Morgan Stanley Research

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Potential Cement Imports from the Gulf Region

In this section, we examine the dynamics of India's cement export potential. Recently, the government imposed a ban on cement exports, but then lifted the ban after 48 days. We believe India's cement export potential will be under threat by 2010, despite surplus capacity, for the following reasons:

- Most countries that receive cement exports from India will have surplus capacity by 2010. Those countries that will not have a surplus will receive supplies from neighboring countries with a surplus, rather than from India, in our view.
- The cost of production of cement in the Gulf countries is three times lower than in India. Even if we factor in high shipping costs, the landed price of cement will still be lower than in India because of government oil subsidies.

We believe cement prices will have to come off at least 25% from current levels, or that the Indian government will have to impose import duties again on cement, to avoid any inflow of cement into India's coastal states.

Exhibit 26

India's Key Cement Export Destinations Will Have Capacity Surpluses by 2010E

Country	Current Capacity	Current Demand	2010E capacity	2010E Demand	Capacity increase	Estimated surplus
Saudi Arabia	33	27	51	38	55%	13
UAE	23	18	40	28	74%	12
Qatar	3	5	5	5	50%	0
Kuwait	3	5	5	6	60%	-1
Oman	4	3	5	4	25%	1
Bahrain	1	2	2	2	300%	0
GCC Total	67	59	107	83	61%	25
Egypt	40	34	55	42	38%	13
Iran	51	39	65	49	27%	16
Iraq	17*	9	25	15	47%	10
Syria	6	7	15	10	150%	5
Total	181	148	267	198	48%	69

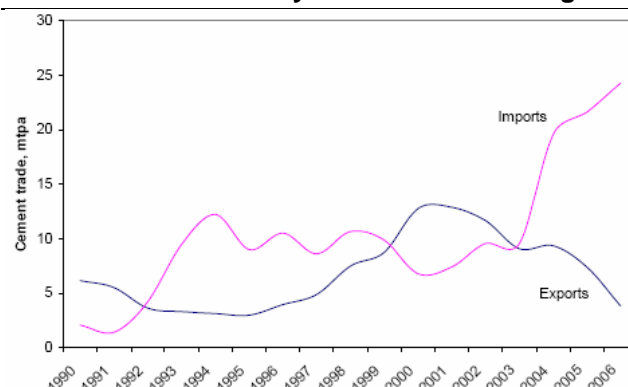
*Nominal Capacity – Actual Utilization low

E=Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 27

Gulf States Increased Reliance on Imports Because of Construction Activity and Cement Shortages

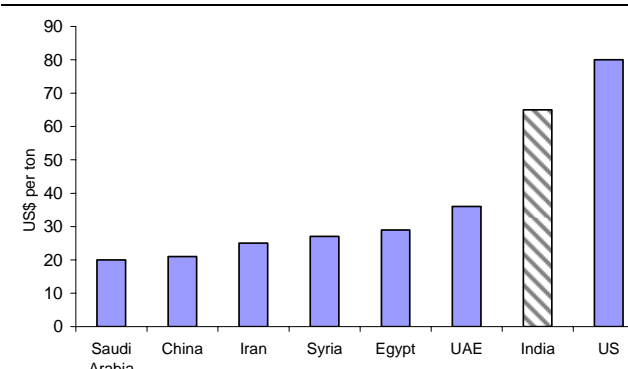


Source: ICR 2006, Morgan Stanley Research

Data pertains to Saudi Arabia, UAE, Qatar, Kuwait, Oman, Iraq, Iran, and Bahrain

Exhibit 28

Low-Cost Cement Production in the Gulf



Source: Industry data, Morgan Stanley Research

Exhibit 29

Imports from the Gulf Look Viable

Particulars

Cement ASP from Gulf (FOB US\$/ton)	37.5
Price in Rs per 50kg bag	79.7
Sea Freight per bag Rs/bag	31.4
CIF	111.1
Port charges (Handling)	10.0
Landed Cost	121.1
Transport from port	15.0
Warehousing	5.0
Distributor Margin & Packing costs	10.0
VAT @ 12.5%	18.9
Consumer Price Rs/bag	169.9
Current average coastal prices	230.0

Source: Company data, Morgan Stanley Research

Valuation – What's in the Price

Valuation Methodology

We believe DCF best captures the value of cement companies, as it takes into consideration cash outflows as well as earnings capability and leverage. We calculate the intrinsic value of the companies applying DCF to arrive at our price target. We then cross-check our values using EV/EBITDA and EV/ton multiples.

DCF Methodology

For our DCF we use our three years of projection in the first stage. In this stage, earnings have been compressed significantly, reflecting the cement down-cycle. However, in order to have a complete cement cycle before we extrapolate earnings, we assume an up-cycle for the next three to four years. This gives us six to seven years of earnings with a complete cycle. Then we normalize the earnings based on the company's long-term operating margins. Throughout this period, we assume capex whenever utilization exceeds 100%. Naturally with higher utilization we assume higher margins in that period. Then we discount the cash flows with WACC derived from the current cost of equity and the cross-cycle debt/equity ratio. We assume 4% terminal growth to calculate the terminal value at the end of year 20.

Exhibit 30

Valuation Summary

Company Name	DCF value	Price target	EV/EBITDA	EV/ton
ACC	527	527	9.0	110
Ambuja	68	68	10.7	145
Grasim	1919	1919	5.7	NA
Ultratech	533	533	8.6	91

Source: Company data, Morgan Stanley Research

To determine the assumptions factored into the current stock prices, we increase our pricing assumption for DCF to arrive at the current market price. We believe the markets are building in an 8-10% fall in cement prices, compared with our assumption of 12-15% over the next two years. Consensus is still bullish on cement price assumptions, factoring in just a 2-5% fall. We expect consensus estimates to decline as cement prices begin falling and stock performance should soon follow.

Exhibit 31

Consensus versus Morgan Stanley Estimates

Rs mn (Figures for F2009)	ACC	Ambuja	Grasim	Ultratech
MS Estimates				
Net Sales	71,215	61,288	155,457	58,752
Operating profit	16,158	16,720	37,170	12,947
OPM (%)	23	27	24	22
Net profit	9,551	10,715	21,928	6,531
Consensus Estimates				
Net Sales	73,483	62,442	182,743	63,685
Operating profit	19,528	19,491	49,838	18,488
OPM (%)	27	31	27	29
Net profit	12,485	13,195	25,546	10,017
Difference (%)				
Net Sales (%)	-3	-2	-15	-8
Operating profit (%)	-17	-14	-25	-30
OPM (%)	-15	-13	-12	-24
Net profit (%)	-24	-19	-14	-35

Source: Company data, Morgan Stanley Research Note: the year end for ACC and Ambuja is December and for Grasim and Ultratech it is March. E=Morgan Stanley Research estimates

ACC and Ultratech are the most sensitive to cement prices and that is why our estimates are on an average 20% below consensus. For Grasim, we assume price declines for the cement and viscose staple fiber (VSF) businesses, which take our revenue assumptions lower. We expect 5-10% cost increases per ton for the Indian cement companies under our coverage, in addition to the 12-15% cement price decline over the next two years.

Price Performance

Indian cement stocks have underperformed the market by a wide margin in the past year. We believe there is still room for further downside. ACC and Ambuja have underperformed the most; we believe Ultratech will soon follow suit.

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Exhibit 32

Price Performance: Short-term Bounce an Opportunity to Reduce Positions

	1M	3M	1Y
Absolute Performance			
ACC (%)	-0.9%	-17.8%	-41.3%
Ambuja (%)	-1.2%	-23.3%	-38.7%
Grasim (%)	9.6%	-16.1%	-29.25
Ultratech (%)	8.6%	-14.0%	-31.2%
Sensex (%)	2.1%	-14.8%	1.1%
Relative Performance			
ACC (%)	-3.0%	-3.0%	-42.4%
Ambuja (%)	-3.3%	-8.5%	-39.8%
Grasim (%)	7.5%	-1.3%	-30.3%
Ultratech (%)	6.5%	0.8%	-32.3%
Sensex (%)	0.0%	0.0%	0.0%

Source: Company data, Morgan Stanley Research

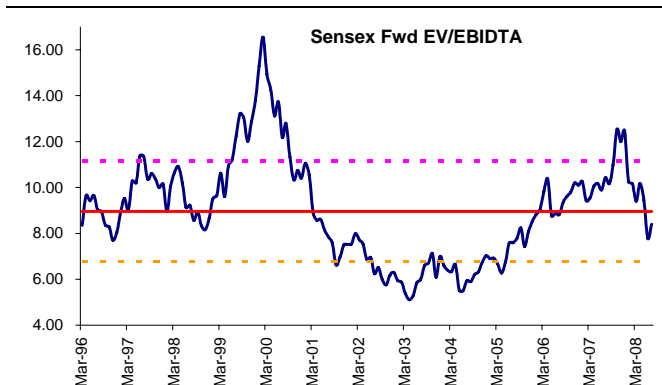
The valuation of India's cement companies is cyclical, with multiples shrinking in the up-cycle and expanding in the down-cycle. Various multiples can be used to value the cement companies, but each has its own limitations. We analyze the different options below.

The most commonly used multiples for cement are EV/EBITDA and EV/ton. EV/ton is an asset-based valuation method, which tends to neglect the stages of cement cycles. This tool can give abruptly higher values in a given year if the company announces capacity expansion, so tends to be less smooth than other valuation measures. We use EV/ton to understand the replacement value of a cement company and judge the potential downside support for the stock, a process for which other multiples lose their significance, generally when earnings decline sharply.

EV/EBITDA is a better tool to capture the operating, as well as the financial, efficiencies of the company. However it is difficult to assign a target multiple to a cement company because the average EV/EBITDA for the past 15 years would include cycles of different intensities and periods that may not be comparable to the current situation, thereby distorting the value. One reasonable way to overcome this problem is to assign the target multiple based on the state of the current cycle. Multiples relative to the benchmark Sensex index could be another way to look at the cement stocks.

Exhibit 33

Sensex 12M Forward EV/EBITDA



Source: Company data, Morgan Stanley Research

Exhibit 34

Valuation Snapshot

P/E				EV/EBITDA			
	2008	2009	2010		2008	2009	2010
ACC	12.6	25.3	27.3	ACC	7.5	12.3	11.5
Ambuja	12.8	22.5	23.5	Ambuja	8.3	11.9	11.9
Grasim	7.1	9.4	13.3	Grasim	5.3	6.5	6.9
Ultratech	6.8	11.6	15.0	Ultratech	5.0	7.0	7.1
P/B				EV/Ton (US\$/ton)			
	2008	2009	2010		2008	2009	2010
ACC	2.5	2.4	2.2	ACC	124	123	118
Ambuja	2.7	2.6	2.5	Ambuja	174	134	121
Grasim	2.3	1.9	1.7	Grasim	372	310	
Ultratech	2.5	2.2	2.0	Ultratech	106	93	

Source: Company data, E = Morgan Stanley Research Estimates, Note: Year end for ACC and Ambuja is December 31st and for Grasim and Ultratech it is March 31st

Macro Scenario Assumptions

In this section, we consider how different scenarios would influence changes to our base-case earnings. Since our call is based on macro changes in the industry, we elaborate how different magnitudes and intensities of these changes could affect the companies.

Base-case Assumptions

Our base case assumes the new announced capacity comes on stream according to the companies' timelines. We expect 10-15% volume growth based on the capacities added and the utilization levels. Our volume growth assumption for the companies is above the industry growth rate of 9-10%. We expect cement prices to decline 12-15% on the back of excess supply in the industry, and utilization to fall. We assume continuation of government intervention in market pricing of cement. We expect costs to increase at a 3-5% CAGR per ton. We expect a higher increase in freight and coal prices.

Bull-case Assumptions

Our bull case assumes capacity delays because of various factors, such as unavailability of contractors and delays in

land acquisition, although unlikely, to improve the demand/supply equation, resulting in less of a decline in cement prices than in our base case. The bull case assumes lower government intervention in cement prices because of lower inflation. It also assumes international coal prices will ease with lower international demand and removal of infrastructure bottlenecks. In this scenario, higher GDP growth leads to higher volume growth. As a result, operating profit margins are 4-6ppt wider than in the base case.

Bear-case Assumptions

In this scenario, lower cement demand, as a result of lower GDP growth, leads to higher surplus in the industry, thereby decreasing utilization and putting further downward pressure on prices. Input costs, such as for freight, raw materials, and electricity, continue their rising trend on the back of higher crude and coal prices. Government intervention in pricing intensifies through measures such as an export ban, differential excise etc. Therefore, the bear-case operating profit margin is 4-6ppt lower than in the base case.

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4Q F2008 Financials

The operating margins of most Indian cement companies declined in 4Q F2008. Volumes, rather than prices, were the predominant driver of the sales growth in the quarter. The industry's operating costs rose much faster than revenue growth, leading to an average 10% decline in operating margin. Among the industry companies we cover, Ambuja's operating profit margin narrowed the most, while Ultratech's improved. In March, international coal prices rose to US\$120 per ton from US\$60 a year before. We believe the full impact of this price increase will be felt in coming quarters when the companies enter new contracts. Also of note, all the companies stated during the quarter that their outlook is cautious.

ACC

ACC's sales rose more than expected, led by 9.5% volume growth and 3% higher prices. However, ACC's operating profit margin narrowed 540bp to 26.2% because of a higher increase in operating costs. For the first time, ACC management cautioned investors that the industry would face margin compression because of cost pressure.

Ambuja

Ambuja reported 19% sales growth and a 34% rise in operating costs. As a result, its operating profit was down 820bp YoY,

the worst decline in the past ten quarters. The cost increase outpaced the rise in prices for the fifth consecutive quarter. We expect potentially higher cost pressures for Ambuja, given that it uses a large amount of imported coal.

Grasim

Grasim's results were a negative surprise to us, as the VSF business performed poorly, as did the cement business. Revenue growth was just 15.3% YoY, compared with the 20.1% increase in operating costs. EBITDA declined 230bp in the cement segment and 290bp in the VSF segment. We expect average prices in both businesses to decline, leading to lower margins, as a result of the capacity increase for VSF and the effect of the macro downturn on the cement industry.

Ultratech

Ultratech was the only one of the four companies that was able to control its costs; its operating profit margin increased 260bp mainly because of higher prices. Its volumes declined 0.3% and its prices rose 9.5%, leading to a 9% increase in sales. Operating profit growth was higher at 20% because of cost controls. At the end of March, Ultratech commissioned its 3.3mn ton clinker plant in Karnataka and is due to commission a 1.6mn ton grinding unit in 1H F2009.

Exhibit 35

Quarterly Financials for Indian Cement Companies under Our Coverage

Rs bn	ACC			Ambuja			Grasim			Ultratech		
	Mar-08	Mar-07	YoY Growth	Mar-08	Mar-07	YoY Growth	Mar-08	Mar-07	YoY Growth	Mar-08	Mar-07	YoY Growth
Revenue	17.96	16.20	11%	18.89	15.92	19%	47.15	40.90	15%	16.02	14.66	9%
OP Exp	13.25	11.08	20%	13.73	10.26	34%	35.18	29.28	20%	11.13	10.57	5%
OP Profits	4.71	5.12	-8%	5.16	5.66	-9%	11.97	11.62	3%	4.89	4.09	20%
OPM (%)	26%	32%	-17%	27%	36%	-23%	25%	28%	-11%	30%	28%	9%
Net Profit	3.21	3.49	-8%	3.32	3.62	-8%	8.05	6.73	20%	2.83	2.32	22%
NPM (%)	18%	22%	-17%	18%	23%	-23%	17%	16%	4%	18%	16%	12%

Source: Company data, Morgan Stanley Research

ACC Ltd (ACC.BO, Rs559, UW, PT Rs527)

No Volume Growth, Prices Under pressure

- ACC plans no capacity addition in 2008. Its new capacity is coming in 2009 and 2010. We expect excess industry capacity by then.
- Very high exposure to northern markets, where we believe prices may face maximum pressure because of excess capacity.
- Earnings highly sensitive to cement prices. We expect the highest decline in earnings among the four Indian cement companies under our coverage in 2008-10.
- Multiple macro negatives for the industry.
- ACC is the market leader in northern and eastern India and has a 12% share of the national market.
- ACC plans to increase its capacity to 30mt. We believe this will help it maintain its market share.
- Current valuations for the stock look high at 8.5x 12-month forward EV/EBITDA and US\$100 EV/ton, given the deteriorating business environment.
- We have an Underweight rating on the stock with a price target of Rs527, 6% below the current level.

Earnings and Valuation

We expect ACC's earnings to decline a compound annual 38% over 2007-09. We expect an increase of just 3% in sales over the same period, driven by volumes. The major drivers for the earnings decline are lower cement prices and higher operating costs.

We believe that, even after the underperformance to the broader market, the stock lacks positive triggers and that the company's relatively low profitability does not warrant higher multiples.

Key reasons for our Underweight rating are lack of volume cushion in falling cement price scenario in C2008, higher operating costs per ton compared with peers, and higher exposure to Northern markets.

Company Description

Established in 1936, ACC Ltd is one of India's oldest cement manufacturing companies. Its current capacity is 22 mt. Swiss cement major Holcim – the second-largest cement producer in the world – has taken over control and management of ACC through ACIL. With its stakes in Ambuja Cement and ACC, Holcim has established a pan-India presence. It controls about 40 mt of cement capacity, around 20% of the country's capacity.

Investment Positives

- ✓ Market leader in India with 12% market share
- ✓ Capacity to reach 30mt in 2010
- ✓ Strong brand name
- ✓ Low gearing

Investment Concerns

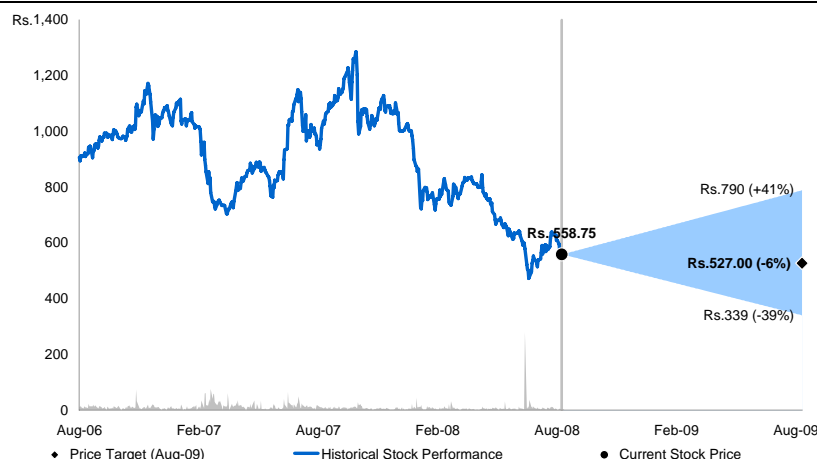
- ✗ Highest projected earnings decline
- ✗ Very high exposure to northern markets
- ✗ No meaningful capacity addition in 2008
- ✗ Increasing cost pressure

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India Cement

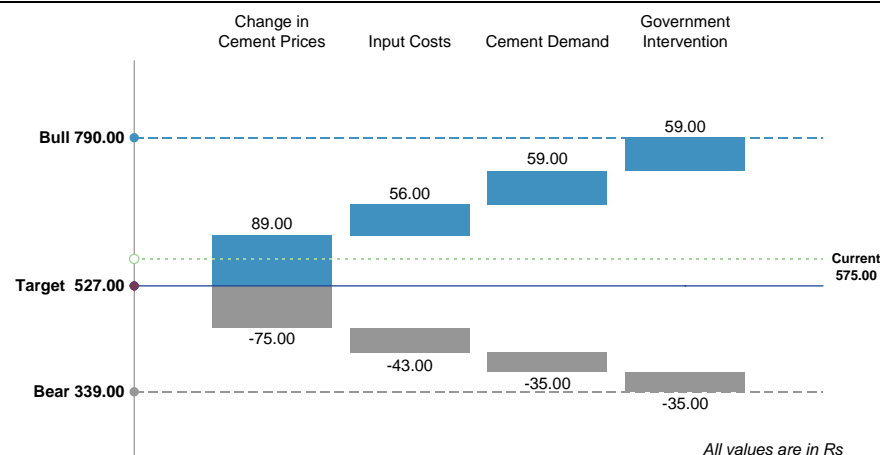
Risk-Reward Snapshot: ACC Ltd (ACC, Rs559, UW, PT Rs527)

Risk-Reward View: Cost Pressures and Lower Prices to Hurt



Price target Rs527		Derived from base-case scenario.
Bull case Rs790	7.4x one-yr fwd bull EV/EBITDA	Better supply/demand leads to lower fall in cement prices: Cement prices fall 10% in 2008-09. Input costs decline 3% in 2008-09. Cement demand rises 1-2%. As a result, operating profit margin rises to 19.1% in 2009.
Base case Rs527	7.6x one-yr fwd base EV/EBITDA	Capacity addition as scheduled; continued government intervention: 7.5% fall in cement prices in 2008 and in 2009. Capacity utilization drops from 90% to 85.6% in 2009. Operating profit margin at 15%.
Bear case Rs339	7.6x one-yr fwd bear EV/EBITDA	Less government intervention: 20% fall in cement prices across 2008-10. Input costs rise 3-4% over 2008-09. As a result, operating profit margin declines to 7.1% in 2009.

Bear to Bull: High Sensitivity to Cement Prices



Source: Morgan Stanley, Fact Set

Investment Thesis

- No capacity addition in 2008; ACC will not be able to benefit from the current high prices.
- High exposure to northern markets, where we expect prices to decline ahead of those in other regions.
- Increasing capacity to 30mt in 2009-10.
- We expect profit after tax to decline 77% to Rs2.8 billion in 2010 from Rs12.5 billion in 2007.
- Our net income estimates are 24% below consensus for 2008.

Key Value Drivers

- Cement prices, to which ACC's earnings are very sensitive.
- Input costs

Key Risks

- Delay in commissioning of planned industry capacity.
- Removal of government intervention in cement pricing.
- Higher GDP growth leading to higher cement demand.

August 25, 2008

India Cement

ACC: Financial Summary

INCOME STATEMENT (Rs mn)	C2006	C2007	C2008e	C2009e	C2010e
Gross Revenues	64,531	78,484	81,145	83,266	93,080
Less : Excise Duty	7,361	9,777	9,929	9,923	10,808
Net sales	57,170	68,707	71,215	73,343	82,271
Expenses					
Raw materials consumed	7,283	8,994	9,827	10,929	11,815
Power cost	9,727	11,376	12,961	14,266	15,787
Other Manufacturing Exp	7,147	8,445	9,150	10,041	10,980
Personnel costs	3,334	3,595	4,538	5,259	5,868
Selling and Admin Exp	12,978	16,586	18,581	21,603	25,274
Cost of goods sold	40,772	48,926	55,058	62,098	69,724
Operating profit	16,398	19,781	16,158	11,245	12,547
OPM	29%	29%	23%	15%	15%
Other income	826	1,164	937	903	946
Total interest paid	752	739	224	890	2,001
Interest earned	232	499	100	150	150
Depreciation	2,543	3,051	3,706	4,804	5,535
Pre-tax profit	14,161	17,655	13,265	6,604	6,107
Taxation	3,740	5,121	3,848	1,916	1,772
Effective tax rate %	26%	29%	29%	29%	29%
PAT before extraordinary	10,473	12,534	9,551	4,755	4,397
Extraordinary Items	1,846	1,852	0	0	0
PAT	12,318	14,386	9,551	4,755	4,397
EPS	66	77	51	25	23

BALANCE SHEET	C2006	C2007	C2008e	C2009e	C2010e
Equity share capital	1,878	1,878	1,878	1,878	1,878
Reserves & Surplus	29,552	39,648	46,022	48,659	51,996
Share premium	8,312	8,312	8,312	8,312	8,312
Other reserves	21,240	31,336	37,710	40,347	43,684
Net Worth	31,429	41,526	47,900	50,537	53,874
Debt	7,712	3,064	6,800	21,940	29,440
Net debt	1,510	(4,371)	1,936	18,691	24,217
Deferred Tax	3,207	3,317	3,183	3,116	3,055
Total Liabilities	42,348	47,907	57,883	75,593	86,369
Net block	29,225	33,147	47,969	69,875	65,965
Capital WIP	4,734	6,492	1,141	1,266	12,565
Total net fixed assets	33,959	39,639	49,110	71,141	78,530
Investments	5,431	8,449	5,392	3,392	2,394
Current Assets	20,062	22,030	23,330	21,606	26,733
Inventories	6,241	7,309	8,999	9,165	11,045
Receivables	2,301	3,082	2,762	3,059	3,426
Cash & cash equiv.	6,202	7,435	4,864	3,249	5,223
Loans & advances	5,319	4,205	6,705	6,132	7,040
Less : Current Liabilities	17,114	22,212	19,948	20,545	21,287
Liabilities	11,696	15,549	15,477	17,133	18,932
Provisions	2,215	4,468	1,294	1,294	1,296
Dividend Payable	3,203	2,195	3,177	2,118	1,059
Net Current Assets	2,949	(182)	3,382	1,062	5,446
Total Assets	42,348	47,907	57,883	75,594	86,369

CASH FLOW STATEMENT	C2006	C2007	C2008e	C2009e	C2010e
Profit after tax	12,267	14,386	9,417	4,688	4,336
Add : Depreciation	2,543	3,051	3,706	4,804	5,535
Cash flow from operations	14,809	17,437	13,123	9,493	9,871
Net Change in Work. Cap.	2,688	4,363	(6,134)	706	(2,411)
Change in inventory	(232)	(1,067)	(1,691)	(166)	(1,880)
Change in debtors	6	(781)	320	(298)	(367)
Change in other assets	(451)	1,113	(2,500)	572	(907)
Change in current liabilities	(3,365)	(5,098)	2,264	(597)	(743)
Extraordinary items	(593)	(287)	(359)	(359)	(359)
Net cash from operations	16,905	21,512	6,630	9,839	7,100
Capital expenditure	(4,399)	(8,227)	(12,818)	(26,475)	(12,565)
Sale of investments	(2,093)	(3,018)	3,058	2,000	998
Net cash from investing	(6,492)	(11,245)	(9,760)	(24,475)	(11,567)
Issue of shares	967	1	0	0	0
Increase in debt	(3,003)	(4,648)	3,736	15,140	7,500
Dividends	(3,203)	(4,388)	(3,177)	(2,118)	(1,060)
Net cash from financing	(5,239)	(9,034)	559	13,022	6,440
Net Change in Cash	5,174	1,233	(2,571)	(1,614)	1,974
Opening Cash	1,028	6,202	7,435	4,864	3,249
Closing Cash	6,202	7,435	4,864	3,249	5,223

RATIOS	C2006	C2007	C2008e	C2009e	C2010e
Growth (YoY)					
Sales	80%	20%	4%	3%	12%
Operating profit	203%	21%	-18%	-30%	12%
Net Profit	201%	20%	-25%	-50%	-8%
Total Assets	21%	13%	21%	31%	14%
Profitability					
OPM	29%	29%	23%	15%	15%
NPM	18%	18%	13%	6%	5%
ROE (BOP)	49%	40%	23%	10%	9%
ROE (Average Equity)	40%	34%	21%	10%	8%
ROCE	46%	49%	29%	11%	10%
Liquidity					
Debt/Equity	0.25	0.07	0.14	0.43	0.55
Net Debt/Equity	0.05	(0.11)	0.04	0.37	0.45
Valuation					
EV/EBIDTA	7.4	5.8	7.5	12.3	11.5
EV/Tonne (USD)	134	125	124	123	118
P/E	11.5	9.6	12.6	25.3	27.3
P/B	3.8	2.9	2.5	2.4	2.2
P/S	2.1	1.7	1.7	1.6	1.5

OTHER DATA	C2006	C2007	C2008e	C2009e	C2010e
Capacity	19.9	22.4	23.2	27.4	30.4
Sales	19	20	22	23	25
Utilization	94%	89%	93%	85%	83%
Per tonne Data					
Net Sales	3,062	3,440	3,302	3,149	3,240
Raw Materials	406	447	456	469	465
Power Costs	521	570	601	612	622
Other Manufacturing Exp	383	423	424	431	432
Employee Expenses	179	180	210	226	231
Selling and Admin exp	695	831	862	927	995
Operating Profit	878	991	749	483	494

Source: Company Data, Morgan Stanley Research E=Morgan Stanley Research estimates Note: Figures in Rs mn

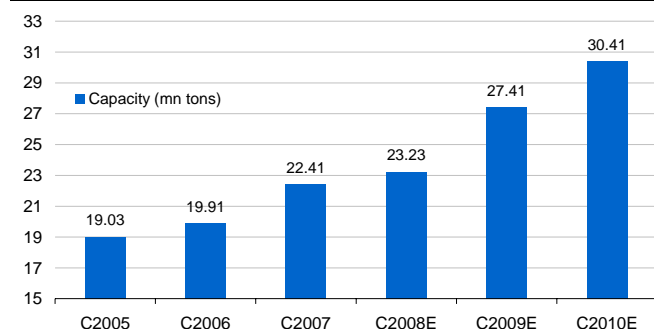
ACC: No Growth in Volumes; Prices Under Pressure

No Capacity Addition in 2008

ACC's major capacity addition at Chanda and New Wadi will start up after 1H09. The company's blending ratio is already high, so we believe there will be limited opportunity for volume growth in the near future. We expect ACC's cement prices to decline. With no volume growth to compensate for the fall in cement prices, earnings will decline faster.

Exhibit 36

ACC: New Capacity Expansion in 2009 and 2010



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Exhibit 37

ACC: Capacity Expansion Plans

Location	Capacity	Type	Timeline
Maddukkarai	0.22	Grinding Augmentation	2008
New Wadi	0.60	Grinding Augmentation	2008
Bargah	1.18	Expansion	2009
New Wadi	3.00	Expansion	End of 2009
Chanda	3.00	New line	2010

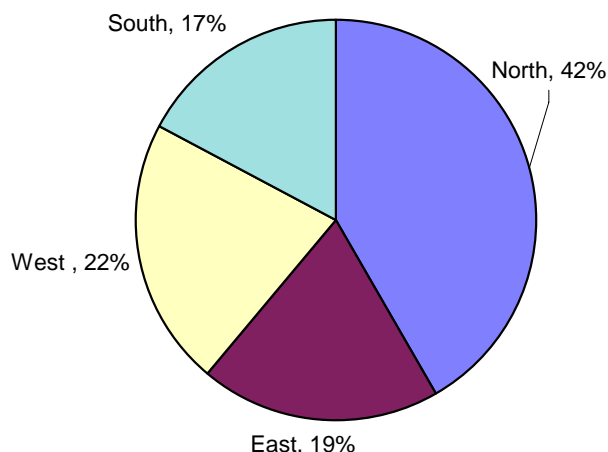
Source: Company data, Morgan Stanley Research

High Exposure to Northern Market

ACC's cement plants are spread across India, but the 40% exposure to the northern markets is a concern. We believe prices in the northern markets will decline earlier than in the rest of India because of high capacity additions in the region. Over the next 6-9 months, the northern region will see the addition of almost 15mn (mainly Grasim and Jaiprakash) tons of capacity, and we believe this will put significant pressure on cement prices.

Exhibit 38

ACC: Sales Breakdown by Region



Source: Company data, Morgan Stanley Research

Largest Projected Decline in Earnings in our Indian Cement Coverage

We expect ACC to report a 38% compound annual decline in profit after tax for 2007-09, primarily because of low volume growth and a decline in margins because of lower prices and higher cost pressure. Our earnings and sales estimates for ACC are 24% and 3% below consensus, respectively, for 2008 because the company's earnings are very sensitive to cement prices, as illustrated below.

Exhibit 39

Sensitivity to Cement Price Assumptions

Change in Price	2008E		2009E	
	Change in Revenue	Change in PAT	Change in Revenue	Change in PAT
-4%	-3.6%	-19.0%	-3.5%	-36.6%
-3%	-2.7%	-14.3%	-2.6%	-27.6%
-2%	-1.8%	-9.6%	-1.8%	-18.5%
-1%	-0.9%	-4.8%	-0.9%	-9.3%
0%	0.0%	0.0%	0.0%	0.0%
1%	0.9%	4.8%	0.9%	9.3%
2%	1.8%	9.7%	1.8%	18.7%
3%	2.7%	14.6%	2.7%	28.1%
4%	3.7%	19.5%	3.6%	37.7%

Source: Company data, E = Morgan Stanley Research Estimates

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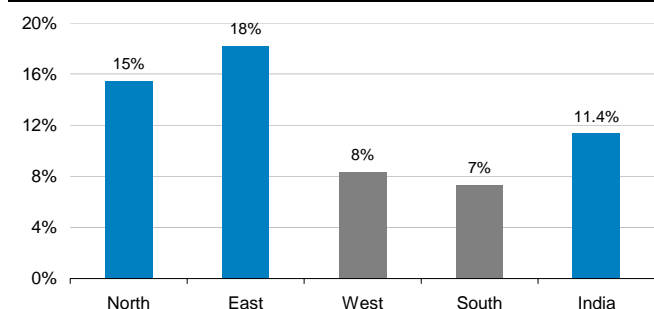
India Cement

Market Leader in North and East Markets

On the positive side, ACC is the market leader in India's northern and eastern markets, with market shares of 17% and 18%, respectively, in May 2008. Overall, ACC is the current nationwide market leader, with a 12% share. Its new large capacity in New Wadi and Chanda will ensure its sales distribution is diversified across the country, with its market shares in western and southern markets rising to similar levels as in the north and east.

Exhibit 40

ACC's Share of Different Markets



Source: Company data, Morgan Stanley Research

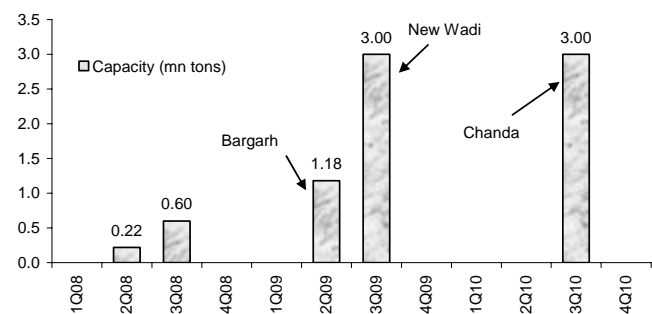
Capacity to Exceed 30mt

ACC plans to expand its capacity through brownfield expansion at its existing plants. In 2008, it will increase its grinding capacity marginally at Madukkarai and New Wadi. In 2009, it plans to implement a 1.18mn ton project at Bargarh

and a 3.0mt project at New Wadi. Thereafter, it plans a 3mt expansion at Chanda in Maharashtra state. ACC also plans two captive power plants of 55MW to cater for its increased power requirements. ACC's capacity should exceed 30mt in 2010 after these expansions.

Exhibit 41

ACC: Expansion Timelines



Source: Company data, Morgan Stanley Research

Largest Distribution Network and Best Brand

ACC has the widest distribution network of any cement company in India; it has 170 warehouses and over 8,000 dealers. It has established its pan-India network through its 15 plants across the country. ACC has developed its supporting businesses of ready mix concrete and bulk cement, which are simply the extension of the packaged cement business. ACC is an old and well-known brand in India, which helps the company charge a slight premium to the prices of local firms.

Valuation

As discussed in our industry note, we value ACC using a DCF methodology and then cross-check the value using various parameters, such as EV/ton and EV/EBITDA. We believe the stock looks expensive on these counts; hence, our Underweight rating. We base our price target of Rs527 on the DCF valuation, 6% below the current price.

Exhibit 42

ACC: Our Price Target

Particulars	Rs
CMP	559
DCF Value	527
Value using target EV/EBITDA	534
Our price target	527
Potential downside (%)	-6%

Source: Company data, Morgan Stanley Research

DCF Summary

We assume around 10% volume growth for ACC in 2008-10, with lower growth initially because of capacity constraints and higher growth in 2010 because of the new capacity. We estimate volume growth will taper down to around 5-6% in the next 20 years. We assume capacity additions whenever the capacity utilization rate exceeds 100% at around US\$85 per ton. We expect costs to increase at a steady rate of 3-4% annually. We assume 4% terminal growth, 15.0% cost of equity, an 9% risk free rate, and 6% ERP. We assume debt/equity ratio over a complete cycle instead of end of year ratio.

Exhibit 43

DCF Key Assumptions

Assumptions	
Risk free rate (%)	9.0%
Beta	1.0
Equity Risk Premium (%)	6.0%
Cost of Equity (%)	15.0%
Cost of debt (%)	8.0%
Debt: Equity	0.70
WACC (%)	12.1%

Source: Company data, Morgan Stanley Research

Exhibit 44

DCF Valuation Summary

Particulars	Rs mn
PV of Cash flow	45,160
Terminal Value	49,428
Terminal Growth (%)	4
Total Value	94,589
Net Debt	(4,371)
Value for Equity	98,959
No of shares	188
Value per Share	527

Source: Company data, Morgan Stanley Research

Exhibit 45

Valuation Using One Year Forward EV/EBITDA

Particulars	Rs mn
1Yr Fwd EBITDA	13,701
Multiple	7.0x
EV	95,909
Net Debt	(4,371)
Equity Value	100,280
No of shares	188
Value per share	534

Source: Company data, Morgan Stanley Research

Multiples Have Narrowed – Fundamentals Still Weak

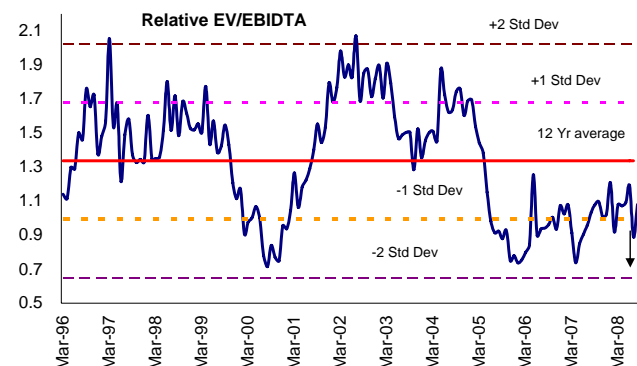
The stock looks expensive on an EV/ton of US\$100 and on relative EV/EBITDA measures. We believe the stock will trade below one standard deviation below the mean EV/EBITDA, as it has done in the past. We recommend investors avoid the stock until there is visibility on lower input costs or a greater-than-expected pick-up in demand. The stock has historically traded at a discount to the Sensex EV/EBITDA, except for during the past year. We believe that, with falling earnings, the stock will continue to trade at lower relative multiples, as it has done in the past, reflecting the fundamentals of the industry. EV/EBITDA and EV/ton have both reverted to mean or below and we expect these multiples to remain at the same levels until the cycle turns around or EBITDA declines to levels from where multiples expand.

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Exhibit 46

One-Year Forward Relative EV/EBITDA



Source: Company data, Morgan Stanley Research

EV/ton for ACC at US\$100 per ton is still above the replacement cost, which is US\$80-90 per ton. Most of the deals in the industry have been priced at around US\$100/ton, except for the Holcim/Ambuja transaction. We think the stock will trade at a discount to replacement cost, as it has done in the past, given the macro negatives going forward.

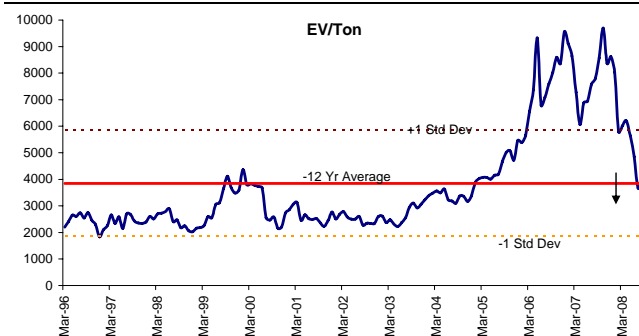
Bull and Bear Case Assumptions

Please refer to the *Macro Scenario Assumptions* section of this report for our macro scenario assumptions. Our bull case for ACC assumes less of a fall in cement prices because of a better-than-expected demand and supply scenario, delays in new capacity, and higher cement demand. It assumes an 8-10% fall in cement prices, compared with 12-15% in our base case. It also assumes cost pressures ease because of lower crude and coal prices, leading to an operating profit margin of 19.1% in 2009. Our bull case also assumes ACC faces less

government intervention because of lower inflation. Our bear case assumes timely capacity additions and lower cement demand because of lower GDP growth. Therefore, cement pricing for ACC declines 20% over 2007-09. Also, input costs rise 3-4% per ton, leading to an operating profit margin of 7.1%

Exhibit 47

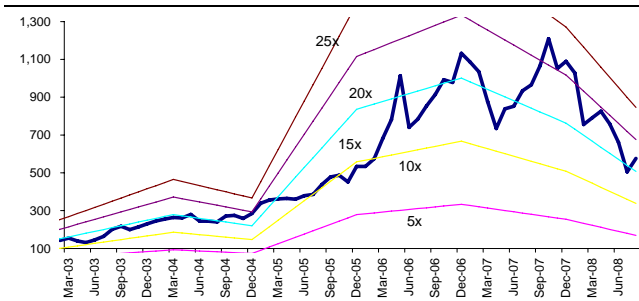
One-year Forward EV/Ton



Source: Company data, Morgan Stanley Research

Exhibit 48

P/E Bands



Source: Company data, Morgan Stanley Research

Exhibit 49

DCF – Detailed Table

Rs mn	2007	2008e	2009e	2010e	2011e	2012e	2013e	2014e	2015e	2028e
Capacity (tons)	22,409,000	23,229,000	27,409,000	30,409,000	30,409,000	30,409,000	30,409,000	35,409,000	35,409,000	58,909,000
Sales (tons)	19,970,000	21,567,600	23,293,008	25,389,379	27,166,635	29,068,300	30,812,398	32,661,142	34,620,810	55,983,828
Gross Cement Revenue	73,274	74,387	74,313	81,001	91,005	102,244	113,797	117,006	125,267	285,500
Other revenue	5,210	6,757	8,953	12,079	9,100	10,224	11,380	11,701	12,527	28,550
Total Revenue	78,484	81,145	83,266	93,080	100,105	112,468	125,177	128,707	137,794	314,050
Excise	9,777	9,929	9,923	10,808	11,624	13,060	14,535	14,945	16,000	36,467
Net Sales	68,707	71,215	73,343	82,271	88,481	99,408	110,642	113,762	121,793	277,582
Op Exp	48,926	55,058	62,098	69,724	76,097	83,053	89,796	97,088	104,971	219,583
Op Profit	19,781	16,158	11,245	12,547	12,384	16,356	20,845	16,674	16,822	58,000
EBIT*(1-t)	11,877	8,840	4,572	4,978	3,552	6,178	9,151	5,477	5,541	28,705
Depreciation	3,051	3,706	4,804	5,535	7,082	7,135	7,187	8,500	8,552	15,157
Capex	(8,227)	(12,818)	(26,475)	(12,565)	(750)	(750)	(750)	(18,750)	(750)	(750)
Change in working capital	(5,833)	(1,607)	(487)	(3,897)	(500)	(500)	(500)	(500)	(500)	(500)
Free Cash Flow	869	(1,878)	(17,586)	(5,949)	9,384	12,063	15,088	(5,274)	12,843	42,611
Period	0	1	2	3	4	5	6	7	8	21
Discount factor	1	1	1	1	1	1	1	0	0	0
PV of CF	869	(1,675)	(13,990)	(4,221)	5,939	6,809	7,596	(2,368)	5,144	3,858

Particulars	Rs mn
PV of Cash flow	45,160
Terminal Value	49,428
Terminal Growth	0
Total Value	94,589
Net Debt	(4,371)
Value for Equity	98,959
No of shares	188
Value per Share	527

Source: Company data, Morgan Stanley Research E = Morgan Stanley Estimates

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Earnings Outlook

Key Assumptions

We assume cement price declines of 5% in 2008 and 7.5% in 2009. We assume volume growth of 8.5% in the same period. We expect capacity utilization to fall to around 85% in 2010 from more than 90% currently. We assume marginal growth in operating costs per ton. Overall, we expect cost growth at a 12% CAGR in 2008-09 because of growth in volumes.

Our Below-consensus Estimates

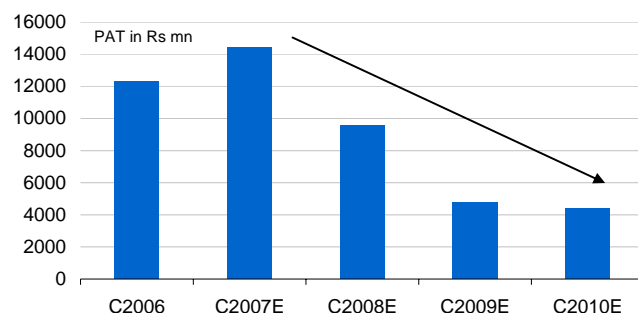
We expect ACC's net income to drop 25% in 2008 and 50% in 2009. This translates to around a 38% compound annual decline, driven by lower prices and increasing costs. We forecast sales growth of just 4% in 2008 and 3% in 2009. In 2008, we estimate net sales of Rs71.2 billion and profit after tax of Rs9.5 billion. Our estimates are significantly below consensus, mainly because of our assumptions for cement prices. As discussed, our estimates for ACC's earnings are highly sensitive to cement price assumptions. A 1% change in our cement price assumption alters our earnings estimates around 5%.

Sharp Earnings Decline Expected

We expect ACC's profit after tax to decline from Rs14.4 billion in 2007 to Rs4.8 billion in 2009. We expect greater price erosion in northern India, where ACC has a high market share, compared with in other parts of the country. Additional capacity is due in eastern India in mid-2009, and we believe prices there may also decline thereafter.

Exhibit 50

Steep Drop in PAT



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Operating Costs on the Rise

We expect ACC's operating costs to increase at a 14% CAGR in 2007-10, driven by increasing freight, energy, and labor costs. In 2007, ACC's operating costs increased 20% YoY. On a per ton basis, the increase was around 12%, driven by higher freight and raw material costs. We expect overall costs to increase 12% with higher volumes in 2009 and 2010. On a per ton basis, we expect costs to rise at around a 4% CAGR over the same period.

Capex and Funding

ACC will require Rs14 billion to expand capacity at its Chanda plant from 1mt to 4mt, and create a captive power plant of 25MW there. The 3mt expansion of the New Wadi plant will need Rs15 billion, while augmentation of grinding capacity at different locations requires Rs6.3 billion. Overall, we expect capex of around Rs36 billion for cement capacity, captive power plant, and ready mix concrete expansion. At the end of 2007, ACC had Rs7.5 billion in cash and Rs8.5 billion in investments. We expect its debt/equity ratio to increase from 0.07 currently to 0.5 by 2010.

Ambuja Cements Ltd. (ABUJ.BO, Rs80, UW, PT Rs68)

Highly Efficient, But Little Scope for Improvement

- We believe Ambuja's margins have peaked and that the company faces macro headwinds.
- Ambuja is highly efficient in terms of electricity consumption, freight cost control, captive power etc, leaving little room for further improvement.
- Ambuja is not adding capacity in 2008 and will face lower cement prices when capacity comes in 2009.
- Most of Ambuja's incremental capacity is coming in the northern region, which is already very competitive.
- Ambuja plans to add 11mt of capacity in the next two to three years.
- Ambuja sells 90% of its production in the western and northern markets. We believe supply in these markets will increase, partly because exports will be diverted to the domestic western markets as oversupply in the Gulf region limits India's cement export ability.
- Ambuja's freight costs are low because of the use of sea freight to transport cement to western and southern coastal states.
- We expect Ambuja's earnings to decline a compound annual 31% in 2007-10 because of lower cement prices and increasing cost pressures.
- Ambuja's valuations, at 9.3x 12-month forward EV/EBITDA and US\$126 12-month forward EV/ton, are ahead of the industry averages. Our intrinsic value is Rs68, 15% below the current share price.

Investment Positives

- ✓ Most efficient Indian cement company
- ✓ Low freight costs because of use of sea freight
- ✓ Low leverage

- ✓ Capacity to reach 30mt

Investment Concerns

- ✗ Margins at a peak
- ✗ No capacity addition in 2008
- ✗ High exposure to western India markets
- ✗ High reliance on costlier imported coal
- ✗ New capacity coming up in crowded northern region

Steep Valuation

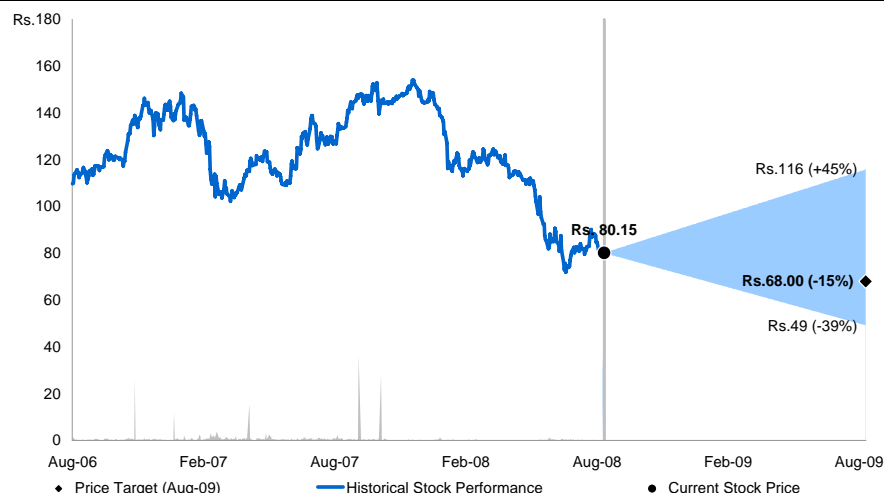
We believe Ambuja's 50% premium valuation to replacement cost is not warranted, given the outlook for cement prices, input cost pressure, and the weakness in the regions where Ambuja has a presence or is adding capacity. Ambuja's EV/EBITDA is higher than the Sensex 10-year average. We believe that, with multiple negatives ahead for the industry, the high valuations are not justified. We think these premium valuations could be a result of efficient manufacturing plants leading to higher operating profit margins than peers', corporate action with Holcim acquiring more Ambuja shares in the market, and the Holcim acquisition of Ambuja occurring at record valuations in excess of US\$200 per ton. We believe these high valuations may not be sustainable, hence our Underweight rating. Also, unlike in past down-cycles, we expect Ambuja to report ROEs lower than cost of capital this time around. At our DCF value of Rs68, the stock would be valued at an EV/ton of US\$105 and 7.7x 12-month forward EV/EBITDA.

Company Description

Ambuja Cements is arguably the lowest-cost cement producer in India. Its capacity in 2007 was 18.5mt. Swiss cement major Holcim – the second-largest cement producer in the world – is Ambuja's major shareholder. With its stakes in Ambuja Cement and ACC, Holcim has established a pan-India presence. It controls about 40mt of cement capacity, about 20% of the country's capacity.

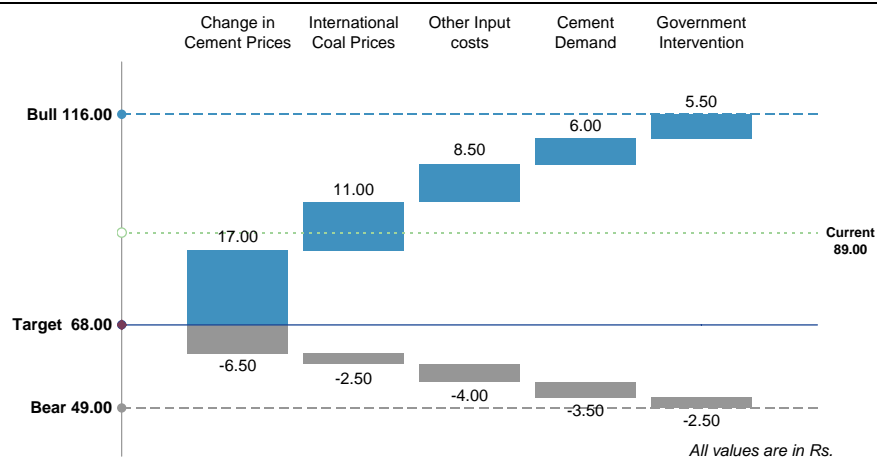
Risk-Reward Snapshot: Ambuja (ABUJ.BO, Rs80, UW, PT Rs68)

Risk-Reward View: Valuation to Decline With Earnings



Price target Rs68		Derived from base-case scenario.
Bull case Rs116	8.1x one-yr fwd bull EV/EBITDA	Lower international coal prices; more exports: 10% fall in cement prices over 2008-09. Input costs 3-4% lower than in the base case. Operating profit margin at 24.6%.
Base case Rs68	7.5x one-yr fwd base EV/EBITDA	Capacity addition as scheduled; continued government intervention: 7.5% fall in cement prices in each of 2008 and 2009. 12% annual growth in cement volumes in 2008-10. Increase of 3-4% in cost per ton of cement dispatched. Operating profit margin at 18% in 2009.
Bear case Rs49	7.3x one-yr fwd bear EV/EBITDA	Lower demand from lower GDP growth: 20% decline in cement prices over 2008-09. Input costs 3-4% higher than in base case. Operating profit margin at 13.3%.

Bear to Bull: Rising Costs and Inability to Raise Prices



Source: Morgan Stanley, Fact Set

Investment Thesis

- Ambuja's capacity expansion is coming in 2009 and 2010. We believe the industry will face oversupply by then, putting pressure on prices.
- High exposure to western India markets.
- Exports will become difficult by 2010 as the Gulf region faces oversupply.
- Ambuja relies on imported coal, which is more than twice as expensive as domestic coal.
- The capacity addition in northern India is a negative as the region is already facing a supply increase of 24% of existing capacity in 4Q F2009.
- We expect net income to fall 39% in 2008 and 43% in 2009.
- Our EPS estimates are 19% below consensus for 2008.

Key Value Drivers

- Cement prices
- Input costs

Key Risks

- Delay in commissioning of planned industry capacity.
- Less government intervention on cement pricing.
- Lower imported coal costs.
- Higher GDP growth leading to higher cement demand.

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Ambuja: Financial Summary

INCOME STATEMENT	C2006	C2007	C2008E	C2009E	C2010E
Gross Revenues	70,105	64,697	70,046	72,384	79,936
Less : Excise Duty	7,973	7,963	8,758	9,031	9,947
Net sales	62,132	56,734	61,288	63,353	69,989
Expenses					
Raw materials	3,724	4,453	5,232	5,837	6,487
Power cost	12,399	10,042	12,479	14,967	16,392
Other mfg exp	8,392	6,446	8,142	9,302	10,577
Personnel costs	2,127	2,086	2,644	3,146	3,721
Selling and admin exp	14,059	13,796	16,071	18,394	20,429
Cost of goods sold	40,801	36,255	44,568	51,646	57,606
Operating profit	21,331	20,479	16,720	11,706	12,383
OPM	34%	36%	27%	18%	18%
Other income	1,137	1,935	1,027	1,155	1,256
Interest (net)	1,132	1,519	537	741	1,194
Depreciation	3,261	2,363	3,034	3,657	4,231
Pre-tax profit	18,416	19,292	14,294	8,581	8,340
Taxation	3,353	9,442	3,574	2,489	2,502
Effective tax rate %	18%	35%	25%	29%	30%
Profit after Tax	15,033	17,701	10,715	6,089	5,835
EPS	9.91	11.63	7.04	4.00	3.83

BALANCE SHEET	C2006	C2007	C2008E	C2009E	C2010E
Equity share capital	3,034	3,045	3,045	3,045	3,045
Reserves & Surplus	31,872	43,564	48,637	49,519	51,014
Share premium	11,544	11,864	11,864	11,864	11,864
Other reserves	20,328	31,700	36,774	37,655	39,151
Net Worth	34,917	46,613	51,686	52,568	54,063
Debt	8,654	3,304	4,701	7,201	13,201
Net debt	4,873	(3,204)	1,048	2,699	10,737
Deferred Tax Liability	3,839	3,784	3,789	3,792	3,795
Retained earnings	9,773	12,059	5,073	882	1,495
Total Liabilities	47,410	53,701	60,176	63,561	71,059

Gross Block	45,425	52,311	63,589	74,404	85,219
Less : Depreciation	20,533	22,712	25,745	29,403	33,633
Net block	24,892	29,599	37,843	45,001	51,586
Capital WIP	5,419	5,100	500	500	500
Total net fixed assets	31,241	36,567	38,443	45,601	52,186
Investments	11,331	12,889	12,506	11,394	10,506
Current Assets	11,776	15,873	17,044	17,241	17,444
Inventories	4,088	5,816	5,348	6,198	6,913
Receivables	950	1,496	1,605	1,598	2,315
Cash & cash equiv.	3,781	6,508	3,653	4,502	2,464
Loans & advances	2,957	2,054	6,438	4,944	5,752
Less: Current liabilities	7,016	11,691	7,893	10,763	9,177
Liabilities	5,329	6,755	5,414	8,475	7,266
Provisions	303	3,154	5	5	6
Dividend Payable	1,384	1,781	2,474	2,284	1,904
Net Current Assets	4,760	4,182	9,151	6,478	8,267
Misc expenditure	77	62	75	88	100
Total Assets	47,410	53,701	60,176	63,561	71,059

CASH FLOW	C2006	C2007	C2008E	C2009E	C2010E
Profit after tax	15,033	17,701	10,715	6,089	5,835
Add : Depreciation	3,261	2,363	3,034	3,657	4,231
Cash flow from operations	18,294	20,064	13,749	9,747	10,065
Change in Working Cap	76	3,305	(7,824)	3,523	(3,828)
Extraordinary Items	778	(687)	(0)	0	(0)
Change in inventory	(918)	(1,728)	468	(849)	(715)
Change in debtors	(473)	(546)	(109)	7	(718)
Change in Other CA	(1,591)	904	(4,385)	1,495	(808)
Change in CL	(3,058)	(4,675)	3,798	(2,870)	1,587
Cash From Operations	19,176	22,628	5,931	13,272	6,241
Capital expenditure	(10,881)	(7,674)	(4,924)	(10,827)	(10,828)
Sale of investments	(81)	(1,558)	383	1,112	889
Cash from Investing	(10,962)	(9,232)	(4,541)	(9,715)	(9,939)
Issue of shares	2,582	323	0	0	0
Increase in debt	(2,621)	(5,350)	1,397	2,500	6,000
Dividends	(5,259)	(5,642)	(5,642)	(5,208)	(4,340)
Cash from Financing	(5,298)	(10,667)	(4,245)	(2,708)	1,661
Net Change in Cash	2,916	2,728	(2,855)	849	(2,037)
Opening Cash	865	3,781	6,508	3,653	4,502
Closing Cash	3,781	6,508	3,653	4,502	2,464

RATIOS	C2006	C2007	C2008E	C2009E	C2010E
Growth (YoY)					
Sales	139%	-9%	8%	3%	10%
Operating profit	198%	-4%	-18%	-30%	6%
Net Profit	212%	18%	-39%	-43%	-4%
Total Assets	29%	13%	12%	6%	12%
Profitability					
OPM	34%	36%	27%	18%	18%
NPM	24%	31%	17%	10%	8%
ROE (Average Equity)	53%	43%	22%	12%	11%
ROCE	46%	40%	26%	15%	14%
Liquidity					
Debt/Equity	0.25	0.07	0.09	0.14	0.24
Net Debt/Equity	0.14	(0.07)	0.02	0.05	0.20
Valuation					
EV/EBIDTA	6.3	6.5	8.3	11.9	11.9
EV/Tonne (USD)	208	170	174	134	121
P/E	8.6	7.7	12.8	22.5	23.5
P/B	3.7	2.9	2.7	2.6	2.5
P/S	2.1	2.4	2.2	2.2	2.0

OTHER DATA	C2006	C2007	C2008E	C2009E	C2010E
Capacity	15.3	18.8	18.9	24.8	29.1
Sales	23.5	16.9	18.9	21.2	23.4
Utilization	NA	90%	100%	86%	81%
Per tonne Data					
Net Sales	2,647	3,363	3,237	2,991	2,986
Raw Materials	163	230	276	276	277
Power Costs	528	595	659	707	699
Other Manufacturing Exp	358	382	430	439	451
Employee Expenses	91	124	140	148	159
Selling and Admin exp	599	818	849	868	872
Operating Profit	909	1,214	883	553	528

Source: Company Data, Morgan Stanley Research, E=Morgan Stanley Research estimates

Note: Figures in Rs mn

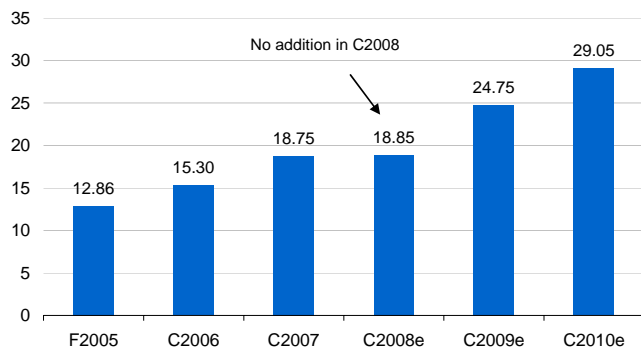
Ambuja: Little Room for Improvement

Adding 10mt of Capacity; But Only in 2009

Ambuja has plans to increase its capacity from 18.75mt in 2007 to 29mt by 2010. The volume growth may compensate for lower cement prices, but no capacity addition in the whole of 2008 is a problem, in our view. We assume cement prices decline 7.5% in 2008. We believe this will put significant pressure on Ambuja's operating margins.

Exhibit 51

Ambuja Year-end Capacity (mt)



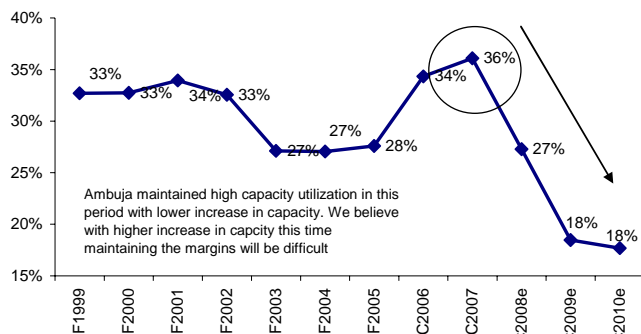
E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Margins Have Peaked

Ambuja's operating profit margin was 36% in 2007, the highest for the past 15 years. We believe the cement cycle will reverse, putting pressure on margins. We expect Ambuja's margins to drop to as low as 18% in 2010 because of lower cement prices, increasing cost pressure, and lower utilization.

Exhibit 52

Margin Peak in 2007



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Very High Exposure to Western markets

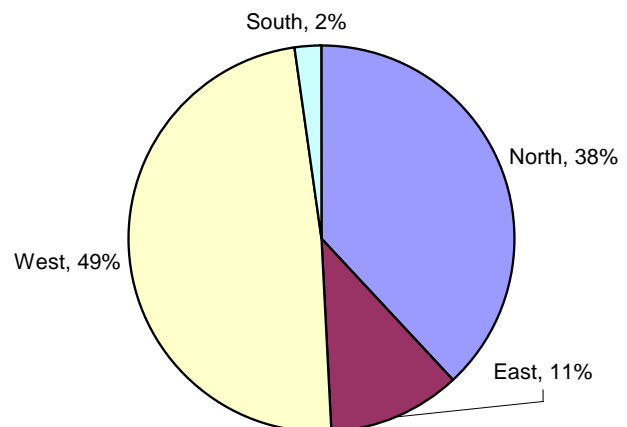
Ambuja sells 49% of its cement in western Indian markets. There was a supply glut in these markets when the government instituted the export ban, as most of the export volumes were

diverted to these markets. The export ban has been relaxed now, but we expect exports to continue to decline until 2010 because of excess supply in the Gulf region. Mumbai accounts for much of the cement consumption in western India and we expect higher interest rates and real estate prices to slow cement demand there. Even though demand will likely not slow considerably, increased supply will put pressure on prices.

Ambuja sells 87% of its cement in the western and northern regions. We believe prices in these regions will decline earlier than in the south and east because we expect earlier capacity increases in the west and north.

Exhibit 53

Ambuja Sells Almost 90% of its Cement in North and West India



Source: CMA, Company data, Morgan Stanley Research

Increasing Capacity in Crowded Northern Region

Ambuja is increasing its clinker capacity by 4.4mt and grinding capacity by 5.5mt. Almost 75% of this planned capacity addition is in the northern region. We expect oversupply there in coming months, so capacity addition could result in higher price risk.

Higher International Coal Prices a Major Concern

Ambuja relies more on imported coal than any other Indian cement company in our coverage. It derives almost 40% of its coal from overseas, and the rest through domestic coal linkages. The imported coal cost Ambuja 46% more than domestic coal did in 2007. International coal prices have more

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than doubled in the past five to six months. We believe this is a major concern for Ambuja because we expect coal prices to remain high for the next couple of years.

Highly Efficient in Terms of Costs and Technology

Ambuja is the most efficient Indian cement producer and has among the lowest costs. It has among the lowest electricity consumption per ton of cement produced. It sources around 80% of electricity required for production from captive power plants. Its labor and plant productivity have been increasing year after year. Ambuja uses sea freight to transport cement from its Gujarat factory to key markets in Mumbai and Surat. Mumbai consumes the most cement among all cities in India and Maharashtra the most among all states. Ambuja owns seven vessels and two port receiving terminals to facilitate transport of its cement. However, it is hard for Ambuja to improve on its already very low costs.

Hub and Spoke Model

Ambuja follows a strategy of grinding cement close to its markets. This optimizes logistics costs and helps the produce reach markets quickly and efficiently. Ambuja's plant in Rauri in northern India is supported by three grinding units at Nalagarh, Roorkee, and Dadri. In the western markets, it does not need the split grinding units, as it uses sea transport.

Strong Balance Sheet

Ambuja plans Rs35 billion capex. Its debt/equity ratio is low. Cash flow has been strong in the past couple of years. We expect its debt/equity to increase to 0.24 to fund capex.

Exhibit 54

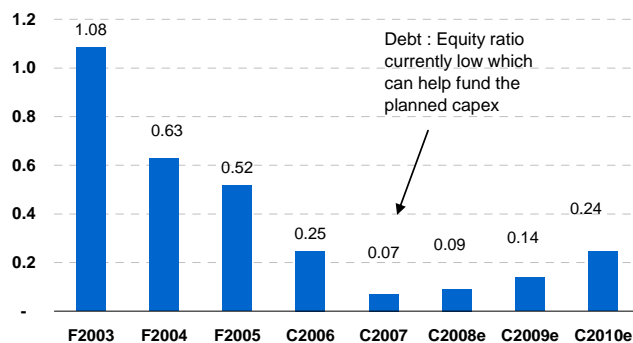
Use of Sea Freight to Optimize Logistics Costs



Source: Company data

Exhibit 55

Low Gearing



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

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Valuation

We base our price target of Rs68 on a DCF and it is 15% below the current price. The value using a target EV/EBITDA multiple is Rs70. At our price target, the stock would trade at 7.4x EV/EBITDA and US\$110 EV/ton. The EV/ton valuation of Ambuja is surprisingly high at Rs5,463 (US\$126) per ton. With cement prices falling and margins under pressure, we believe the multiples will normalize.

DCF – Key Assumptions

We assume 12% volume growth for Ambuja over 2008-10. We assume volume growth of 5-6% for the 20-year period, with higher growth earlier. We assume capacity expansion at US\$90 per ton whenever capacity utilization rate exceeds 100%. We assume 4% terminal growth and 15% cost of equity. We assume cross cycle average debt/equity ratio to calculate weighted average cost of capital.

Exhibit 56

Our Price Target

Particulars	Rs
CMP	80
DCF Value	68
Value using target EV/EBITDA	70
Our price target	68
Discount to DCF (%)	0
Potential downside (%)	-15%

Source: Company data, Morgan Stanley Research

Exhibit 57

DCF Summary

Particulars	Rs mn
PV of Cash flow	47,131
Terminal Value	53,270
Terminal Growth (%)	4
Total Value	100,400
Net Debt	(3,204)
Value for Equity	103,604
No of shares	1,522
Value per Share	68

Source: Company data, Morgan Stanley Research

Exhibit 58

Value Using One-year Forward EV/EBITDA

Particulars	Rs mn
1 Yr Fwd EBITDA	13,795
Multiple	7.5 x
EV	103,466
Net Debt	(3,204)
Equity Value	106,670
No of shares	1,522
Value per share	70

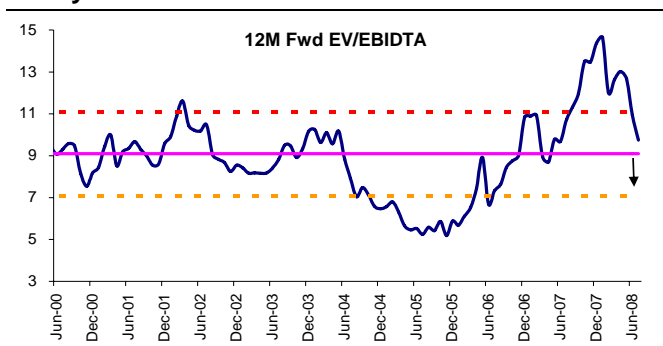
Source: Company data, Morgan Stanley Research

Multiples Still Significantly Above Industry Average

Ambuja is one of the most expensive stocks in the Indian cement industry in terms of asset valuation. It is trading at an EV/ton of US\$126. We believe this may be because of better-than-average efficiency and profitability. However, we believe this valuation is still on the high side, with replacement cost at US\$90 per ton and future profitability for the industry unclear. The stock is trading at 10x one-year forward EBITDA. This is above the 10-year average for the company and the Sensex EV/EBITDA valuation.

Exhibit 59

One-year Forward EV/EBITDA



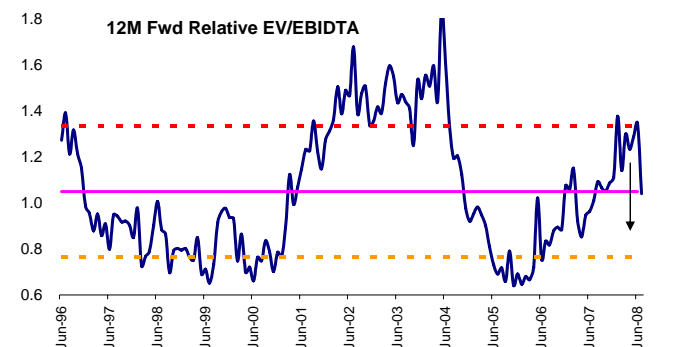
Source: Company data, Morgan Stanley Research

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Exhibit 60

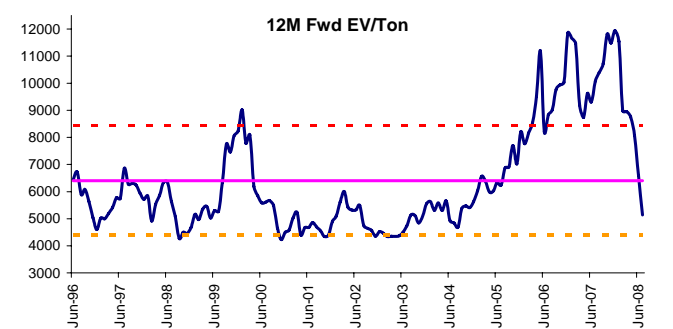
One-year Forward Relative EV/EBITDA Still High



Source: Company data, Morgan Stanley Research

Exhibit 61

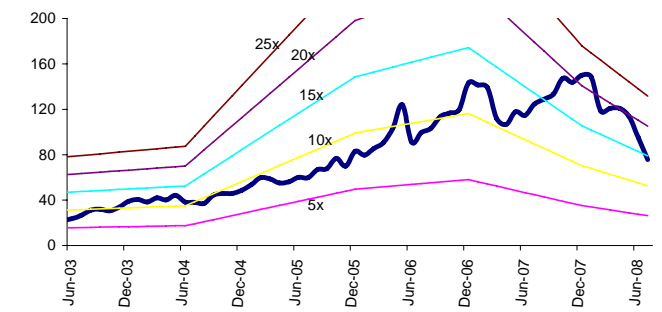
One-year Forward EV/ton Still High vs. Industry



Source: Company data, Morgan Stanley Research

Exhibit 62

P/E Bands



Source: Company data, Morgan Stanley Research

Bull and Bear Case Assumptions

Please refer to the *Macro Scenario Assumptions* section of this report for our macro scenario assumptions. In addition, our bull case for Ambuja expects the company to benefit from lower international coal prices and higher volumes because of exports. As a result, our bull case operating profit margin is 25% for 2009, compared with 18% in the base case. Similarly, in the bear case, we assume increasing coal costs leading to higher input cost pressures.

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Exhibit 63

DCF – Detailed Table

Rs mn	2007	2008e	2009e	2010e	2011e	2012e	2013e	2014e	2015e	2028e
Capacity (tons)	18,750,000	18,850,000	24,750,000	29,050,000	29,050,000	29,050,000	29,050,000	29,050,000	35,550,000	56,550,000
Sales (tons)	16,872,291	18,931,083	21,182,886	23,439,835	25,549,420	27,593,374	29,524,910	30,705,906	32,548,261	61,374,600
Gross Revenue	64,697	70,046	72,384	79,936	91,486	106,858	118,912	128,615	130,878	331,434
Excise	7,963	8,758	9,031	9,947	11,384	13,297	14,797	16,004	16,286	41,242
Net Sales	56,734	61,288	63,353	69,989	80,102	93,561	104,115	112,610	114,592	290,191
Op Exp	36,255	44,568	51,646	57,606	64,046	70,554	77,002	81,684	88,317	215,430
Op Profit	20,479	16,720	11,706	12,383	16,056	23,007	27,112	30,926	26,276	74,762
EBIT*(1-t)	11,816	10,265	5,715	5,707	7,906	12,547	15,281	17,820	13,930	43,755
Depreciation	2,363	3,034	3,657	4,231	4,255	4,280	4,305	4,330	5,484	9,455
Capex	(7,674)	(4,924)	(10,827)	(10,828)	(500)	(500)	(500)	(500)	(23,250)	(500)
Change in working capital	(6,045)	(228)	(2,218)	(654)	(500)	(500)	(500)	(500)	(500)	(500)
Free Cash Flow	(1,903)	5,113	(7,330)	(5,775)	6,906	11,547	14,281	16,820	(9,820)	42,755
Period	0	1	2	3	4	5	6	7	8	21
Discount factor	1	1	1	1	1	1	1	0	0	0
PV of CF	(1,903)	4,570	(5,855)	(4,123)	4,406	6,585	7,278	7,661	(3,998)	4,041

Particulars	Rs mn
PV of Cash flow	47,131
Terminal Value	53,270
Terminal Growth	0
Total Value	100,400
Net Debt	(3,204)
Value for Equity	103,604
No of shares	1,522
Value per Share	68

Source: Company data, Morgan Stanley Research E=Morgan Stanley Estimates

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Earnings Outlook

Less Optimistic than Consensus

For 2007-10, we estimate CAGRs of 7% for net sales and 12% for volume. We expect the operating margin to shrink from 36% in 2007 to 18% in 2010. As a result, we estimate operating profit and net profit will decline a compound annual 15% and 26%, respectively. Higher depreciation and interest charges because of new capacity will lead to a higher decline in net profits. We expect costs to rise at a 16.7% CAGR overall. However, on a per ton basis, we expect just a 4.6% increase, driven by higher power and freight costs.

For 2009, our estimates are 51% below consensus for earnings, 39% lower for operating profit, and 13% for sales. Contrary to market expectations of flat cement prices for the next couple of years, we expect higher capacity to result in lower prices and therefore narrower margins.

Key Assumptions

We expect cement prices to decline 12.5% in the next two years (C2008-09). We believe volume growth will continue at around 10-12%. However, we expect utilization to drop below 85% because of higher capacity. We expect a marginal increase in costs per ton, as most of the cost increase happened in 2007. With dwindling exports and a weak export outlook, Ambuja will have to divert its supply to local markets, so we believe freight costs may increase marginally. With new capacity coming in northern India, Ambuja will have to rely more on road and rail transport. Also, higher coal costs have an effect on manufacturing and power costs.

Balance Sheet

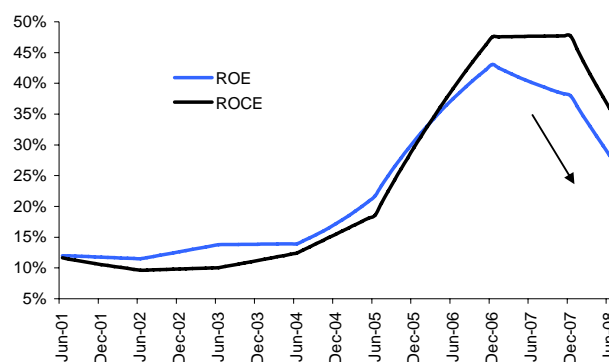
Ambuja plans Rs35 billion capex by 2010. It aims to fund this through internal accruals and debt. Its debt/equity ratio is low at 0.07. We expect this to rise marginally to 0.24. This would increase depreciation and interest charges.

Declining Returns

We expect ROE and ROCE to decline significantly. Ambuja's current ROE is an exceptionally high 32%, albeit off an earlier high of 40%. We expect this to decline below 15%. However, Ambuja's balance sheet is stronger than in previous cycles and we do not expect ROE to decline to the levels of 2001.

Exhibit 64

Returns Already Slowing



Source: Company data, Morgan Stanley Research

Grasim Industries Ltd. (GRAS.BO, Rs1,962, EW, PT Rs1,919)

Both Core Businesses in Cyclical Downturn

- We expect a simultaneous cyclical downturn in Grasim's two core businesses of cement and fiber.
- Margins are under pressure in both businesses as input costs are rising faster than prices.
- However, we believe higher volume growth in the cement and VSF businesses, as a result of increased capacity, will result in a less sharp earnings decline than at peers.
- Cement margins are likely to decline because of lower cement prices and higher fuel, freight, and raw material prices. We expect utilization to drop below 85% in F2010.
- Grasim is doubling its VSF capacity. We believe rising pulp and sulfur prices, and demand growth of just 3-4%, mean pricing will have to decline to increase utilization.
- Grasim's capacity additions are due before those of the competition. We expect Grasim to benefit from already higher prices. On the flip side, the capacity additions in northern India are a negative because competition in the region is already high.
- The stock is trading at 5.6x one-year forward EV/EBITDA on consolidated numbers.

Investment Positives

- ✓ Diversified play on cement and VSF
- ✓ Capacity addition in cement well timed
- ✓ Adding 58% of existing cement capacity
- ✓ Strong management
- ✓ Exiting non-core businesses

Investment Concerns

- ✗ Pricing environment unfavorable
- ✗ Pricing under pressure in both core businesses
- ✗ Input costs rising faster
- ✗ Adding cement capacity in already crowded northern region

Below Consensus Earnings and Fair Valuation

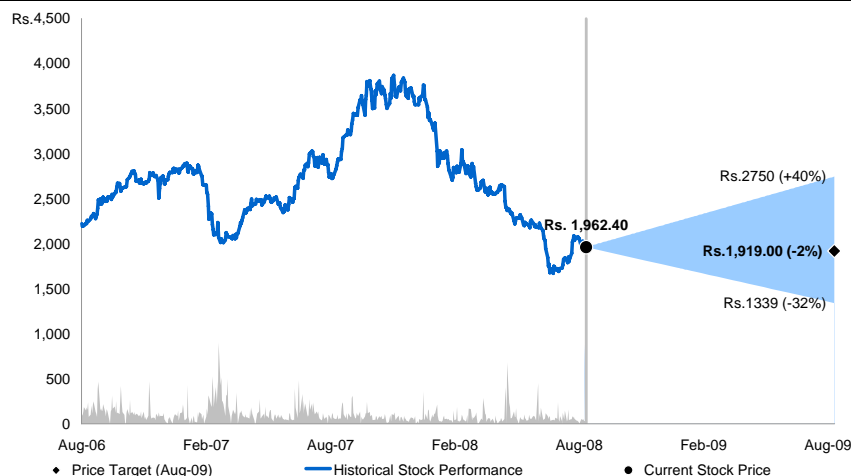
Our net income estimates for Grasim are 23% and 50% below consensus for F2009 and F2010, respectively. We believe Grasim will report a 23% drop in net profits and a 17% decline in operating profit over F2008-10 mainly because of lower cement prices and higher than industry cost pressures due to rising international coal prices. Our price target of Rs1,919, based on a DCF model, is 2% below the current price. At our price target, the stock would trade at 5.5x one-year forward EV/EBITDA on standalone numbers.

Company Description

Grasim is a flagship company of the Aditya Birla Group, with interests in cement, VSF, textiles, and chemicals businesses. Cement and VSF contribute more than two-thirds of EBITDA. Grasim along with its 51%-owned Ultratech is the second-largest cement producing group in India; it had a 20% market share in F2008. It is the largest VSF company in the world, with an 11% share of the global market.

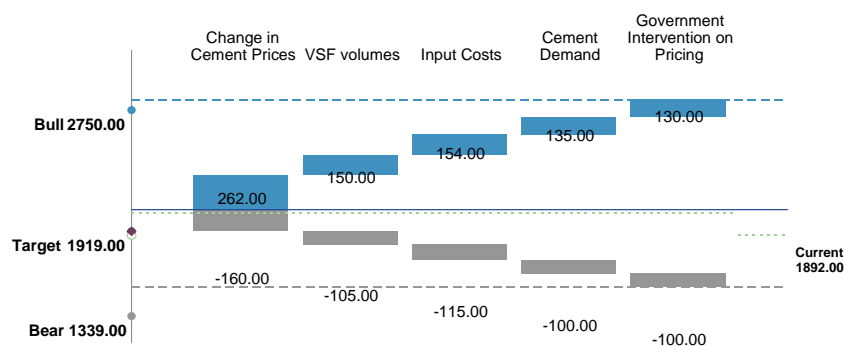
Risk-Reward Snapshot: Grasim (GRAS.BO, Rs1,962, EW, Rs1,919)

Risk-Reward View: Margin Pressure in Cement and VSF Businesses



Price target Rs1919			Derived from base-case scenario.
Bull case Rs2,750	5.7x one-yr fwd bull EV/EBITDA	Higher cement prices and moderate increase in input costs of freight, raw materials, and coal. Higher volumes with lower price cuts in the VSF business.	
Base case Rs1,919	5.4x one-yr fwd base EV/EBITDA	Capacity addition as scheduled; continued government intervention: Cement prices decline 15% over F2008-10. Cement utilization declines to 82% and VSF utilization declines to 85% in F2009. Operating profit margin declines to 21.8% in F2010 from 31.7% in F2008.	
Bear case Rs1,339	5.3x one-yr fwd bear EV/EBITDA	Lower demand from lower GDP growth: Cement prices decline 20%. Lower VSF volume growth despite price cuts. Input costs increase 5-8% over F2008-10. As a result, F2010 operating profit margin is 17.8%.	

Bear to Bull: Higher Volumes Compensate for Lower Prices



Source: Morgan Stanley, Fact Set

All values are in Rs

Why Equal-weight?

- Cement and VSF margin compression.
- Higher volumes to stave off earnings decline.
- The input costs for both businesses are rising and we expect prices to decline.
- We expect cement utilization to go below 85% in F2010.
- Expansion in northern India is negative as we expect early price erosion there.
- Grasim is doubling its VSF capacity and we expect prices to fall in this segment, as it tries to increase sales by cutting prices.
- Stock is fairly valued at 5.6x one year forward EV/EBITDA
- Our net income estimates are 13% below consensus for F2009.

Key Value Drivers

- Cement prices.
- Input costs in cement and VSF businesses.
- Higher utilization rates

Key Risks

- Delay in commissioning of planned capacity.
- Less government intervention in cement pricing.
- Higher volumes in the VSF business because of price cuts.

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Grasim: Financial Summary

INCOME STATEMENT	F2007	F2008	F2009E	F2010E	F2011E
Gross Sales	157,028	191,128	177,811	186,389	202,017
Less: Excise Duty	16,077	21,388	22,154	23,528	25,415
Net Sales	140,952	169,739	155,657	162,861	176,601
Expenses					
Raw Materials	28,547	35,297	32,289	34,763	37,380
Manufacturing Expenses	35,834	43,648	42,192	47,207	50,544
Personnel Exp	6,729	8,493	7,538	7,879	8,263
Selling and Admin Exp	29,371	31,961	35,009	38,828	41,598
COGS	101,228	121,049	117,710	129,154	138,119
OP	39,724	48,691	37,947	33,707	38,483
Interest and Dividend	1,065	1,648	2,104	2,191	2,282
Other Income	2,112	2,975	2,527	2,638	2,755
Interest	2,286	2,221	2,369	2,217	1,824
Depreciation	6,019	6,625	7,901	9,025	9,372
Total Expenditure	109,614	129,066	127,994	140,409	149,328
Profit before Tax	34,515	45,753	37,293	27,281	32,310
Total Tax	10,921	14,658	11,850	9,020	10,683
Tax Rate	32%	32%	32%	33%	33%
Profit after Tax	23,595	31,095	25,443	18,260	21,627
Less: Minority Interest	4,002	4,548	3,261	2,464	2,846
PAT	19,593	28,914	22,182	15,797	18,781
EPS	213.7	315.4	242.0	172.3	204.9

BALANCE SHEET	F2007	F2008	F2009E	F2010E	F2011E
Share Capital	917	917	917	917	917
Other share cap	63	296	296	296	296
P&L reserve	48,907	74,267	93,314	105,975	121,621
Other reserves	16,513	16,513	16,513	16,513	16,513
Reserves and Surplus	65,419	90,166	109,826	122,488	138,134
Minority Interest	8,587	12,760	15,912	17,563	19,583
Loan Funds					
Secured Loans	37,107	38,836	34,269	26,289	21,789
Unsecured Loans	11,623	16,935	17,053	15,553	14,053
Deferred Tax Liabilities	11,526	11,575	11,523	11,523	11,523
Total Liabilities	135,242	171,544	189,854	194,687	206,353

Gross Block	125,125	137,241	179,652	193,210	198,241
Less: Depreciation	60,125	63,397	68,345	77,370	86,742
Net Block	65,001	73,844	111,307	115,840	111,499
Capital Work-in-Progress	19,577	55,335	10,529	0	0
Investments	22,719	16,607	20,607	25,607	30,607
Goodwill	19,217	19,913	19,913	19,913	19,913
Current assets					
Inventories	13,581	17,443	15,566	16,588	17,735
Sundry Debtors	8,252	10,185	8,867	9,229	9,598
Cash and Bank Balances	3,692	2,900	16,432	21,991	32,363
Loans and Advances	7,684	12,047	16,758	18,434	19,587
Current Liabilities					
Liabilities	22,562	30,350	25,940	28,364	30,399
Provisions	2,070	6,430	4,232	4,598	4,598
Net Current Assets	8,585	5,802	27,458	33,287	44,293
Total Assets	135,242	171,544	189,854	194,687	206,353

CASH FLOW	F2007	F2008	F2009E	F2010E	F2011E
PAT	19,593	28,914	22,182	15,797	18,781
Add: Depreciation	6,019	6,625	7,901	9,025	9,372
Cash from Ops	25,611	35,540	30,083	24,822	28,153
Working Capital Changes					
Inventories	(1,935)	(3,862)	1,876	(1,022)	(1,148)
Receivables	(2,338)	(1,933)	1,318	(362)	(368)
Loans and advances	(1,440)	(4,363)	(4,712)	(1,676)	(1,153)
Current liabilities	6,176	7,788	(4,410)	2,424	2,036
Provisions	(1,207)	4,360	(2,198)	366	0
Change in working cap	(744)	1,991	(8,124)	(270)	(634)
Change in goodwill	(1,489)	(696)	0	0	0
Cash Flow from operation:	23,378	36,835	21,959	24,551	27,519

Capex	(26,584)	(51,127)	(555)	(3,029)	(5,031)
Investments	(9,198)	6,112	(4,000)	(5,000)	(5,000)
Cash flow from investing	(35,783)	(45,015)	(4,555)	(8,029)	(10,031)

Issue of shares	0	59	0	0	0
Increase in debt	11,532	7,273	(4,449)	(9,480)	(6,000)
Increase in Minority Interest	3,452	4,173	3,152	1,652	2,020
Increase in DTL	1,613	(563)	560	(0)	0
Dividends	(2,875)	(3,554)	(3,135)	(3,135)	(3,135)
Net cash from financing	13,723	7,387	(3,872)	(10,964)	(7,115)

Net Change in Cash	1,318	(792)	13,532	5,559	10,372
Opening Cash	2,374	3,692	2,900	16,432	21,991
Closing Cash	3,692	2,900	16,432	21,991	32,363

RATIOS	F2007	F2008	F2009E	F2010E	F2011E
Growth (YoY)					
Sales	34%	22%	-7%	5%	8%
Operating profit	92%	23%	-22%	-11%	14%
Net Profit	90%	48%	-23%	-29%	19%
Total Assets	33%	27%	11%	3%	6%
Profitability					
OPM	28%	29%	24%	21%	22%
NPM	14%	17%	14%	10%	11%
ROE (Average Equity)	34%	37%	22%	13%	14%
ROCE	28%	27%	17%	13%	15%
Liquidity					
Debt/Equity	0.73	0.61	0.46	0.34	0.26
Net Debt/Equity	0.68	0.58	0.31	0.16	0.02
Valuation					
EV/EBIDTA	6.6	4.8	5.7	5.9	4.8
P/E	11.0	6.2	8.1	11.4	-
P/B	3.3	2.0	1.6	1.5	1.3
P/S	1.5	1.1	1.2	1.1	1.0

NOTE: figures in Rs mn, March Year End

Source: Morgan Stanley Research, Company data E = Morgan Stanley Research

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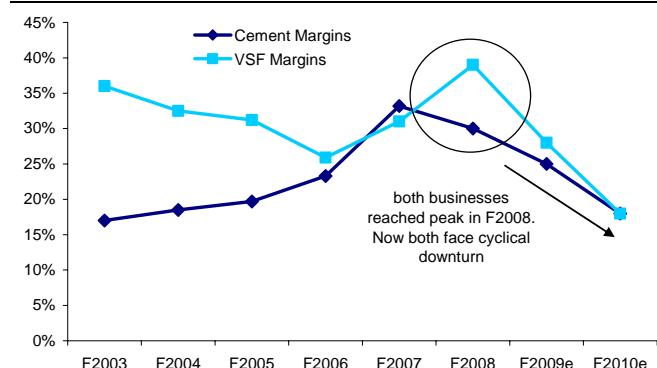
Grasim: Both Core Businesses in a Cyclical Downturn

Unfavorable Pricing Environment

We believe the biggest risk for Grasim is the pricing environment in its cement and VSF business. We expect impending surplus cement capacity to lower cement prices in the next couple of years. This, along with increased capacity in the VSF business, will ensure prices of Grasim's core products do not rise, in our view, thereby affecting margins negatively. Both businesses peaked in 2007 in terms of capacity utilization. We expect pricing pressure in both businesses as capacity increases.

Exhibit 65

Simultaneous Margin Decline in Core Businesses



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Cement Capacity Utilization to Decline

Grasim plans to add a large amount of cement capacity in F2009. We expect its cement production growth to exceed the industry average. However, we expect its cement utilization to drop from a high of 120% to 80-85% because the new capacity will take time to operate at maximum utilization and there is increasing supply in northern India.

Cement Pricing Pressure

As highlighted, the cement industry faces pricing pressure from the following factors:

- Addition of more than 100mt of capacity in the next three years, which will increase supply and lower utilization.
- Possible slowdown in construction because of high interest rates and lack of major government infrastructure initiatives.
- More government intervention because of high inflation.

We believe these factors will drive cement prices lower, leading to margin squeeze. We assume Grasim's cement prices fall 15% by F2010. As a result, we expect the cement contribution to EBIDTA to drop from 70% in F2007 to around 55% in F2009.

Input Costs Rising Fast in Core Businesses

Grasim's input costs are rising faster than sales growth. The prices of all the major inputs for cement, such as coal, fuel, and electricity, have risen significantly in the past couple of years. Imported coal prices have almost tripled in a year. Grasim uses other fuels, such as pet coke, a byproduct of oil refiners, in the cement manufacturing process. However, increasing crude oil prices have also raised the prices of pet coke, thereby boosting the costs. In the VSF business, prices of sulfur and pulp, the key raw materials, have increased by 60-70% in the past six months. Even though Grasim has adequate sourcing arrangements, lower demand for VSF results in a lack of pricing power, despite Grasim being the market leader in the segment. Labor costs in the nine months to December 2008 increased 25% YoY. We believe Grasim will find it difficult to pass on the cost increases, thereby squeezing margins further. We expect Grasim's standalone operating profit margins to narrow from 31% in F2008 to around 19% in F2010.

Adding Capacity in Already Crowded Northern India

Grasim plans two more cement plants and grinding units in northern India, where cement capacity was already at 55.4mt in F2008, up 35% YoY, with most of the addition coming in the final quarter. An additional 13mt of capacity is due to come on line in northern India by the end of F2009, implying a further 23% growth, putting pressure on the demand and supply situation in the region.

Exhibit 66

Significant Capacity Growth in Northern India

Period	Capacity Addition (Mn Tons)	
	Capacity Addition (Mn Tons)	Addition as % of existing
F1Q09e	4.0	7.2%
F2Q09e	7.0	12.6%
F3Q09e	-	0.0%
F4Q09e	2.0	3.6%
Total Addition	13.0	23.5%
Current Capacity	55.4	

Source: Company data, Morgan Stanley Research E=Morgan Stanley Estimates

As a result, we expect cement price declines in the northern region first. Grasim sells 37% of its production in the north. With the new capacity, this proportion will rise. We believe Grasim could be at risk of faster pricing decline because of its sales concentration in this region. However, Grasim's capacity

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additions are due earlier than those of competitors, so Grasim could benefit from higher prices for a few months.

Leadership in Cement and VSF business

In the VSF business, Grasim has around a 90% market share in India and 11% globally. The Aditya Birla group is one of the top two cement producers in India. With upcoming new capacity, it should become the leading cement company in India with capacity of 45mt by the end of 2008. Grasim has a 10% share of India's domestic cement sales market.

Well-timed Capacity Addition

We believe Grasim's capacity is coming on stream at the right time, before that of the competition. Grasim will be able to benefit from higher prices before prices fall as more additional capacity comes on line. We believe any capacity starting up in 2009 and 2010 will face pricing pressure as that is when most additional capacity is due.

Adding 58% of Existing Capacity

Grasim is adding almost 8.5mt of cement capacity to its existing 15mt. This is the largest capacity addition among major Indian cement companies as a percentage of existing capacity.

Exhibit 67

Highest Capacity Addition

Capacity	Last Reported	By C09	Addition	% Chg
ACC	22,409,000	27,409,000	5,000,000	22%
Ambuja	18,750,000	24,750,000	6,000,000	32%
Grasim	14,932,645	23,550,000	8,617,355	58%
Ultratech	18,200,000	25,100,000	6,900,000	38%

Source: Company data, Morgan Stanley Research

Strong Balance Sheet

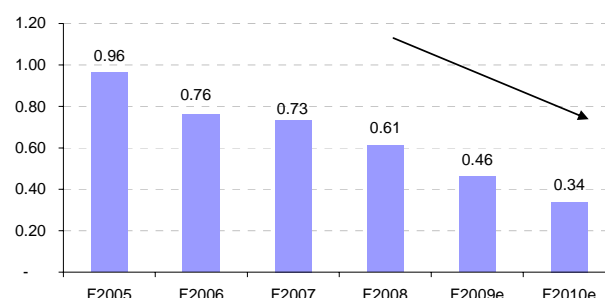
Grasim has favorable gearing despite high capex. It has funded most of its capex through internal accruals and we expect its debt/equity ratio to decline.

Freight Cost Rationalization

Grasim is setting up two plants in Rajasthan district, along with two split grinding units very close to the consumer market in the Northern Capital Region. We believe the split grinding units will reduce the average lead kilometers for cement transport, thereby lowering freight costs per ton. We expect the Kotputli plant to cater more to the northern region and the Jawad plant to supply cement to the central region.

Exhibit 68

Comfortable Gearing Ratio



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Captive Power

Grasim is adding 170MW of power capacity over the next two years. The two new plants at Shambhapura and Kotputli will have captive power aggregating 96MW. Grasim added a 26MW captive power plant in Jawad in 4Q F2008. It plans two thermal power plants at its existing plants to save on the purchased power costs. We believe these measures will take the use of captive power to 70-75% of requirements.

Recent Events

Grasim recently sold its sponge iron business to Welspun Steel and Power for Rs10.3 billion. We view this as a positive move because of the following factors.

- Margins were under pressure in the sponge iron business because of higher iron ore and natural gas prices.
- Competitors in the business are more efficient because most have captive iron ore and coal blocks.
- The valuation of the transaction was attractive, in our view, despite the issues above.

Grasim is increasingly focusing on the cement and VSF businesses. In April 2008, Grasim increased its stake in AV Cell to strengthen backward integration in the VSF business, AV Cell is a JV company based in Canada. It supplies raw materials, such as pulp, for the VSF business.

Strong Management Support

Grasim is the flagship company of the Aditya Birla group, one of the top business houses in India. The group's operations are spread over 20 countries with revenues of over US\$24 billion and market cap of US\$34 billion.

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Earnings Outlook

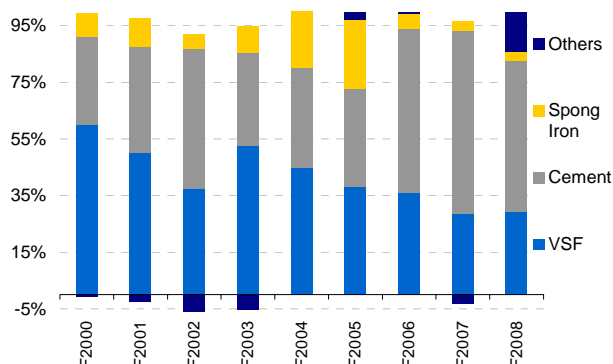
We estimate Rs162.3 billion in net sales and Rs15.36 billion in profit after tax in F2010. We expect net income to decline a compound annual 27% in F2008-10 because of a downturn in both core businesses. We calculate higher capacity will cover most of the decline in prices, leading to a flat top line.

Segmental Revenue and Profit

Grasim derives 53% of sales from the cement business and 23% from VSF. The rest comes from sponge iron, textiles, and chemicals. The EBITDA breakdown is similar: 52% from cement, 29% from VSF, and the rest from other businesses. We do not expect major changes to the revenue and profit distribution. We expect cement and VSF to contribute 55% and 23% of revenue and 51% and 21% of sales, respectively, in F2010. When one major segment has not performed well for Grasim, as in 2003-05 and 2006-07, as shown below, the other has made up for it. However, in the current cycle, both core businesses have been doing well until F2008 and we expect a downturn for both together.

Exhibit 69

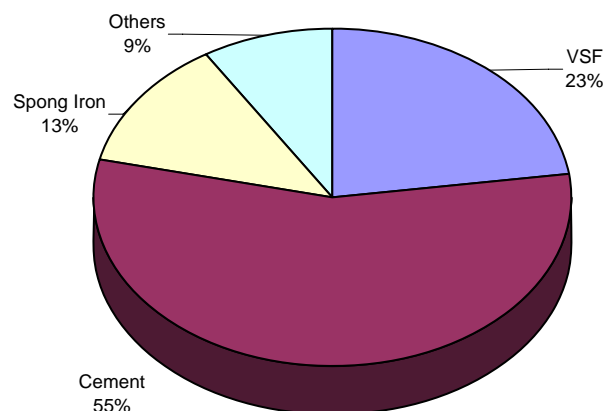
EBIDTA Contribution By Business



Source: Company data, Morgan Stanley Research

Exhibit 70

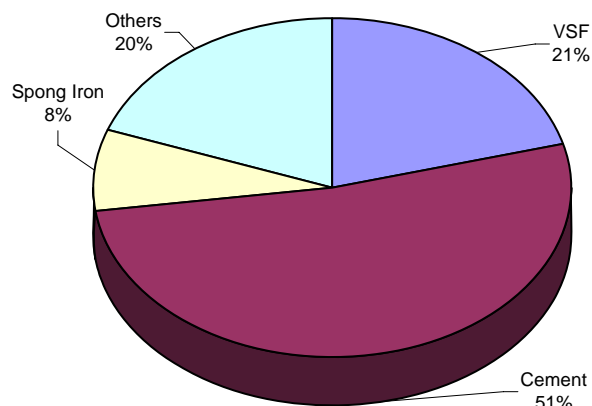
Revenue Breakdown, F2010E



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Exhibit 71

Operating Profit Breakdown, F2010E



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

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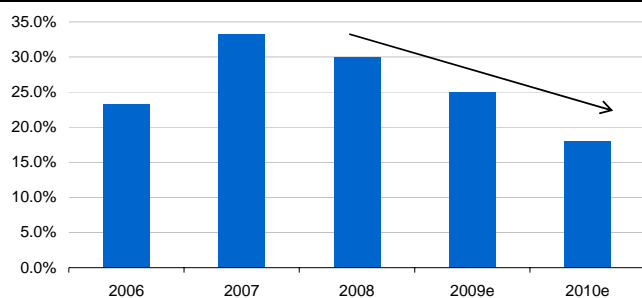
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Cement Business

We expect cement revenue to rise 3% driven by a 13% increase in volumes and a 15% decline in prices over F2008-10. Our estimate is for costs to rise 11% in the same period leading to fall in operating margins by almost 12ppt to 18%.

Exhibit 72

Declining Cement Operating Margins



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

VSF Business

In F2008, VSF prices rose 15% because of increases in prices of cotton and polyesters staple fibers. Grasim has plans to double its VSF capacity over F2008-10, whereas demand growth for VSF is stable at 3-4% annually. We believe Grasim will need to cut prices, as it did in 4Q F2008 to increase sales. We expect VSF prices to decline 10% in F2009 and 5% in F2010. We assume volume growth at 6%, against the historical average of 2.5%. We expect costs to rise much more quickly because of higher pulp and sulfur prices, leading to a decline in the operating profit margin.

Valuation

We value Grasim using a DCF method. We value the cement, fiber, and other businesses separately and then add the stake Grasim holds in Ultratech. We cross check our DCF value with one-year forward EV/EBITDA multiples relative to the Sensex. Our intrinsic value for Grasim using DCF is Rs1,919 per share.

Key Assumptions

We assume 9.0% risk-free rate, 6.0% equity risk premium, and a beta of 1.0 to derive our COE of 15%. We take the average debt/equity ratio in F2006-09E to calculate our WACC (hurdle rate). We assume the cement volume growth will come off highs of double-digit growth to around 5% by F2028. We assume capacity addition after the utilization rate exceeds 100%. We assume cyclical prices depending on utilization and also assume cyclical operating profit margin. We do the same exercise for the VSF business. We assume terminal growth of 4% for the cement business and 2% for the VSF business.

Exhibit 73

Key Assumptions

Risk Free Rate (%)	9.0%
Risk Premium (%)	6.0%
Beta	1.0
Cost of Equity (%)	15%
WACC (%)	12.8%

Source: Company data, Morgan Stanley Research

Exhibit 74

DCF Summary

Particulars	Rs mn
Value of Cement	114,881
Value of Fiber and pulp	26,152
Value of Other business	31,813
Total Value	172,846
Less: Net Debt	30,744
Total Equity Value	142,102
Value of Ultratech	33,800
Consolidated Value	175,902
No of shares	92
Value Per Share	1,919

Source: Company data, Morgan Stanley Research

Exhibit 75

Valuations Based on 12-month Forward EV/EBITDA

Particulars	Rs mn
12 Month Fwd EBITDA (Standalone)	24,142
Multiple	7.5 x
EV	181,063
Net Debt	30,744
Equity Value	150,319
Value of Ultratech	33,800
Total Value	184,119
No of shares	92
Value per share	2,008

Source: Company data, Morgan Stanley Research

Multiples

At the current price of Rs1,962, the stock trades at 5.6x one-year forward EBITDA on a consolidated basis, against the past 12-year average of 5.64x, making it look fairly valued, in our view. The stock has always traded at a discount to the Sensex.

We assign a target multiple of 7.5x to the 12-month forward standalone EBITDA. We add the value of Ultratech to the equity value of Grasim to calculate the value per share.

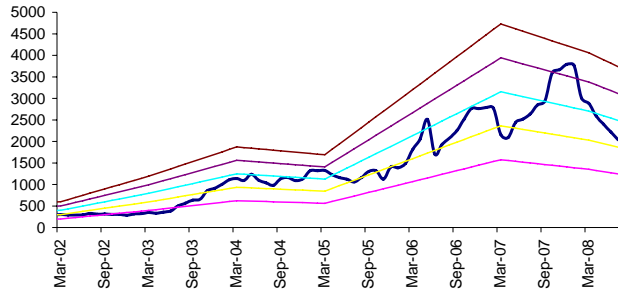
Bull and Bear Case Assumptions

Please refer to the *Macro Scenario Assumptions* section of this report for our macro scenario assumptions. In addition, higher blending with cotton fiber and higher substitution due to higher cotton prices may lead to higher-than-expected VSF volumes in our Bull Case without any steep price cuts. We also assume that lower prices of sulfur and pulp will increase the OPM in the VSF business. In our Bear Case, we assume lower VSF demand growth as cheap cotton prices lead customers to shift to cotton from VSF. In this case, the company would have to resort to steep price cuts to stimulate demand, especially given its expansion of capacity. As a result, our Bear-Case OPM is 5-6ppt lower than that in our Base Case.

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Exhibit 76

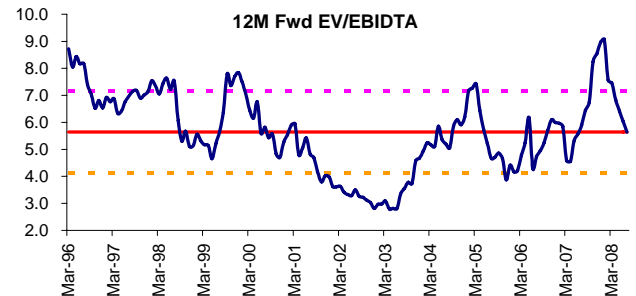
P/E Bands



Source: Company data, Morgan Stanley Research

Exhibit 78

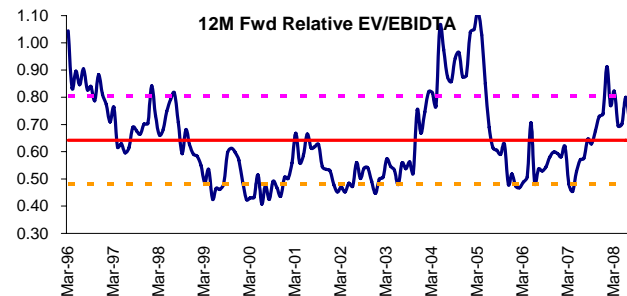
One-Year Forward EV/EBITDA



Source: Company data, Morgan Stanley Research

Exhibit 77

Grasim: One-Year Forward EV/EBITDA Against Sensex



Source: Company data, Morgan Stanley Research

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Exhibit 79

DCF – Detailed Table

CEMENT BUSINESS - GRASIM										
	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2028E
Capacity	13,120,000	16,750,000	22,250,000	23,550,000	23,550,000	23,550,000	23,550,000	28,550,000	28,550,000	50,550,000
Production	14,420,000	15,363,809	17,398,812	19,486,670	20,850,737	22,310,288	23,648,906	24,831,351	26,072,918	49,164,376
Sales (Qty)	14,520,000	15,129,402	17,398,812	19,486,670	20,850,737	22,310,288	23,648,906	24,831,351	26,072,918	49,164,376
Net Sales	47,056	51,914	55,167	58,338	65,258	74,016	83,164	83,830	85,381	221,189
EBIT	12,475	15,079	12,639	9,915	12,683	16,910	21,664	17,336	14,439	50,081
Depreciation	1,907	2,155	3,013	3,243	3,267	3,291	3,315	4,177	4,201	8,307
Capex	(11,228)	(19,671)	(3,262)	(1,400)	(500)	(500)	(500)	(18,000)	(500)	(500)
Change in working capital	(1,247)	621	(2,965)	(750)	(500)	(500)	(500)	(500)	(500)	(500)
Free Cash Flow	(1,962)	(6,637)	5,494	7,737	10,764	13,620	16,830	(2,708)	12,875	40,861
WACC	0	0	0	0	0	0	0	0	0	0
PV of CF	(1,962)	(6,637)	4,885	6,116	7,565	8,511	9,350	(1,337)	5,654	3,893
VSF BUSINESS										
	-	-	-	-	-	-	-	-	-	-
Capacity	270,100	333,975	397,975	430,000	500,000	500,000	500,000	500,000	500,000	600,000
Production	246,833	279,901	283,270	294,601	306,385	318,640	331,386	344,641	358,427	574,236
Sales (Qty)	250,725	269,781	283,270	294,601	306,385	318,640	331,386	344,641	358,427	574,236
Net Sales	19,497	26,769	25,261	24,773	22,188	23,999	25,708	27,538	28,639	47,113
EBIT	3,029	7,087	5,102	3,174	(309)	639	1,451	2,349	2,481	4,159
Depreciation	636	777	1,087	1,170	1,250	1,263	1,276	1,289	1,301	1,566
Capex	(1,604)	(2,810)	(466)	(200)	(1,545)	(250)	(250)	(250)	(250)	(250)
Change in working capital	(178)	89	(424)	(107)	(100)	(100)	(100)	(100)	(100)	(100)
Free Cash Flow	943	2,877	3,712	2,989	(602)	1,341	1,897	2,512	2,614	4,002
PV of CF	943	2,877	3,324	2,396	(432)	862	1,092	1,294	1,206	439
OTHER BUSINESS										
	-	-	-	-	-	-	-	-	-	-
Net Sales	19,116	23,468	16,477	16,847	18,026	19,288	20,638	21,876	22,970	38,615
EBIT	3,951	6,054	4,548	3,786	3,167	3,406	3,147	2,803	2,952	3,137
Depreciation	254	283	395	425	438	451	465	479	493	724
Capex	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)
Change in working capital	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)
Free Cash Flow	3,660	5,581	4,338	3,683	3,138	3,367	3,147	2,207	2,321	2,676
PV of CF	3,660	5,581	3,885	2,953	2,253	2,164	1,811	1,137	1,071	294
PV of all Cash Flows	116,505									
Terminal Value	56,378									
Total Value	172,882									
Less: Net Debt	30,744									
Total Equity Value	142,138									
Value of Ultratech	33,800									
Consolidated Value	175,939									
No of shares	92									
Value Per Share	1,919									

E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Ultratech Cement Ltd (ULTC.BO, Rs593, UW, PT Rs533)

High Price Sensitivity and Regional Concentration

- We believe high dependence on western India is a negative, as we expect higher price erosion there in the long term, as exports may be unviable because of oversupply in the Gulf region from F2010.
- Freight, fuel, and raw material costs are rising.
- We expect profit after tax to decline a compound annual 35% in F2008-10.
- Macro headwinds continue as the Indian cement industry faces surplus capacity.
- New capacity in southern India could be a marginal positive as price declines there are likely to come later than in the north and west.
- New captive power of 225MW will reduce power costs.
- Valuations have come down but the industry lacks positive triggers, and many negatives are looming large.

Investment Positives

- ✓ High capacity addition as a percentage of total capacity
- ✓ Addition well timed
- ✓ Power costs to decline with new capacity
- ✓ New capacity in southern India will reduce reliance on western region

Investment Concerns

- ✗ Very high exposure to western India market
- ✗ Sensitivity to cement price very high
- ✗ Input cost pressure

Earnings and Valuation

We expect Ultratech to report 6% sales growth and a 31% compound annual decline in profit after tax in F2008-10 because of lower cement prices and higher costs. We expect operating profit to decline a compound annual 19% in the same period from Rs17.1 billion to Rs11.3 billion. We expect operating profit per ton to decline faster, from Rs1,004 per ton in F2008 to Rs534 per ton in F2010.

We value Ultratech using a DCF method. Our price target of Rs533 is 10% below the current price. At our price target, the stock would trade at an EV/EBITDA of 7.5x and EV/ton of US\$84.

Company Description

Ultratech is one of the largest cement companies in India; in F2008 its capacity was 18.2mt. It also has interests in ready mix concrete business. Previously under Larsen & Toubro management, Ultratech is now part of the Aditya Birla Group; Grasim holds a 51% stake in Ultratech.

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Risk-Reward Snapshot: Ultratech Ltd (ULTC.BO, Rs593, UW, PT Rs533)

Risk-Reward View: Steep Earnings Decline Expected



Price target Rs533		Derived from base-case scenario.
Bull case Rs768	7.7x bull 2009E EV/EBITDA	Firmer cement prices because of less government intervention and delay in incremental supply. Easing international coal prices and lower freight costs lead to operating profit margin increasing to 32.5% in F2009.
Base case Rs533	7.5x base 2009E EV/EBITDA	Capacity addition as planned; continued government intervention: 15% decline in cement prices over F2008-10. Operating margin down from 31.2% in F2008 to 23.5% in F2010.
Bear case Rs338	7.0x bear 2009E EV/EBITDA	Cost rise 5% in F2009 and F2010 because of higher freight and power costs. Greater decline in cement prices in F2010. F2010 operating profit margin at 18.5%.

Why Underweight?

- Impending cement industry cyclical down-cycle as new supply comes on line over the next two years.
- We expect cement prices to drop 12.5% over F2008-10, resulting in margin compression.
- High dependence on western region is negative, as we expect price erosion there to follow that in the north of the country.
- We expect the net income to decline a compound annual 35% in F2008-10.
- Our net income estimates are 35% below consensus for F2009.

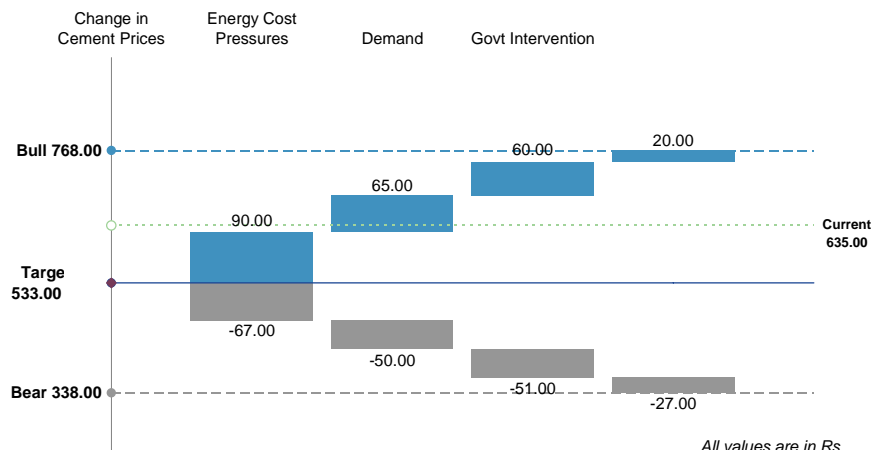
Key Value Drivers

- Cement prices.
- Input costs.

Key Risks

- Delay in commissioning of planned capacity.
- Less government intervention in cement pricing.

Bear to Bull: International Coal Prices to Affect Margins



Source: Morgan Stanley, Fact Set

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Ultratech: Financial Summary

INCOME STATEMENT					
	F2007	F2008	F2009e	F2010e	F2011e
Gross Sales	55,422	64,008	66,742	71,458	76,821
Less: Excise Duty	5,735	7,770	7,990	8,555	9,197
Net Sales	49,687	56,238	58,752	62,903	67,624
Total income	50,279	57,236	59,415	63,566	68,287
EXPENDITURE					
Raw Materials Consumed	4,534	6,227	6,405	7,509	8,051
Manufacturing Expenses	15,276	17,026	21,614	24,445	26,215
Purchase of FG	1,824	137	-	-	-
Employee Exp	1,190	1,745	1,927	2,156	2,425
Selling and Admin	12,547	14,194	15,860	17,511	18,597
COGS	35,370	39,064	45,805	51,621	55,288
OP	14,317	17,174	12,947	11,282	12,336
Depreciation	2,273	2,383	2,962	3,709	3,877
Interest	868	757	985	984	744
Profit before Tax	11,754	15,153	9,783	7,239	8,364
Total Tax	3,887	5,038	3,253	2,407	2,781
Tax Rate	33.1%	33.2%	33.2%	33.2%	33.2%
Profit After Tax	7,867	10,115	6,531	4,832	5,583
Less: Minority Interest	18	15	-	-	-
Profit After Minority Interest	7,850	10,101	6,531	4,832	5,583
EPS	63.1	81.1	52.5	38.8	44.8
CASH FLOW STATEMENT					
	F2007	F2008	F2009e	F2010e	F2011e
PAT	7,850	10,101	6,531	4,832	5,583
Add: Depreciation	2,273	2,383	2,962	3,709	3,877
	10,123	12,483	9,493	8,541	9,460
Working Capital Changes					
Inventories	(544)	(1,785)	342	(262)	(432)
Receivables	(118)	(287)	(87)	(149)	(170)
Loans and advances	(954)	(1,287)	(383)	(421)	(463)
Current liabilities	2,201	4,158	(381)	1,267	947
Provisions	(222)	1,078	(166)	366	-
Change in working cap	362	1,876	(675)	801	(118)
Change in Goodwill	14	14	-	-	-
Cash Flow from operations	10,498	14,381	8,818	9,342	9,342
Capex	(7,607)	(18,056)	(6,567)	(1,029)	(1,225)
Investments	(3,111)	3,126	500	-	-
Cash flow from investing	(10,718)	(14,930)	(6,067)	(1,029)	(1,225)
Issue of shares	-	-	-	-	-
Increase in debt	1,266	1,619	1,000	(4,000)	(4,000)
Increase in Minority Interests	6	4	-	-	-
Increase in DTL	(168)	(204)	0	-	-
Dividends Paid	(568)	(728)	(1,097)	(1,463)	(1,463)
Net cash from financing	537	691	(97)	(5,463)	(5,463)
Net Change in cash	317	142	2,654	2,850	2,654
Opening Cash	684	1,001	1,143	3,797	6,647
Closing Cash	1,001	1,143	3,797	6,647	9,301
OTHER DATA					
	F2007	F2008	F2009e	F2010e	F2011e
Capacity	17.00	18.20	25.10	25.10	25.10
Sales	17.67	17.11	18.90	21.14	22.65
Utilization	106%	100%	88%	87%	93%
Per tonne Data					
Net Sales	2,812	3,287	3,109	2,976	2,986
Raw Materials	239	364	339	355	356
Manufacturing Expenses	864	995	1,144	1,156	1,158
Employee Expenses	67	102	102	102	107
Selling and Admin exp	710	830	839	828	821
Operating Profit	810	1,004	685	534	545
BALANCE SHEET					
	F2007	F2008	F2009e	F2010e	F2011e
Sources of Funds					
Shareholders' Funds					
Share Capital	1,245	1,245	1,245	1,245	1,245
Reserves and Surplus	16,438	25,773	31,207	34,577	38,697
Loan Funds					
Secured Loans	11,513	9,827	9,827	7,327	4,827
Unsecured Loans	4,274	7,578	8,578	7,078	5,578
Minority Interest	53	57	57	57	57
Deferred Tax Liabilities (Net)	5,621	5,454	5,454	5,454	5,454
TOTAL	39,143	49,942	56,376	55,745	55,866
Application of Funds					
Gross Block	48,108	49,972	74,806	80,402	81,627
Less: Depreciation	22,742	24,795	27,757	31,465	35,343
Net Block	25,367	25,177	47,049	48,937	46,285
Capital Work-in-Progress	6,972	22,834	4,567	-	-
Net Worth	32,338	48,011	51,616	48,937	46,285
Goodwill on consolidation	91	78	78	78	78
Investments	4,592	1,467	967	967	967
Current Assets					
Inventories	4,412	6,197	5,855	6,117	6,549
Sundry Debtors	1,739	2,026	2,113	2,262	2,432
Cash and Bank Balances	1,001	1,143	3,797	6,647	9,301
Loans and Advances	2,543	3,830	4,213	4,634	5,097
Total Current Assets	9,694	13,196	15,977	19,660	23,379
Current Liabilities					
Current Liabilities	7,388	11,546	11,165	12,432	13,379
Provisions	186	1,264	1,097	1,463	1,463
	7,574	12,809	12,262	13,895	14,842
Net Current Assets	2,121	387	3,715	5,765	8,537
TOTAL	39,142	49,942	56,376	55,745	55,866
RATIOS					
	F2007	F2008	F2009e	F2010e	F2011e
Growth (YoY)					
Sales	43%	15%	4%	7%	8%
Operating profit	149%	20%	-25%	-13%	9%
Net Profit	249%	29%	-35%	-26%	16%
Total Assets	27%	28%	13%	-1%	0%
Profitability					
OPM	29%	31%	22%	18%	18%
NPM	16%	18%	11%	8%	8%
ROE (BOP)	75%	57%	24%	15%	16%
ROE (Average Equity)	56%	45%	22%	14%	15%
ROCE	36%	35%	20%	15%	16%
Liquidity					
Debt/Equity	0.9	0.6	0.6	0.4	0.3
Turnover					
Asset turnover	1.6	1.4	1.3	1.3	1.4
Inventory turnover	8.5	7.4	7.6	8.6	8.7
Receivables Turnover	33.0	34.0	32.2	32.7	32.7
Payables Turnover	5.6	4.1	4.0	4.4	4.3
Cash Conversion Cycle	10.2	9.8	10.2	9.9	9.8
Valuation					
EV/EBIDTA	8.36	4.96	6.45	6.79	5.67
EV/EBIDTA (1Yr Fwd)	6.96	6.57	7.54	-	-
EV/Tonne (USD)	175	107	94	-	-
P/E	13.36	6.82	10.54	14.25	-
P/E (1 Yr Fwd)	10.38	10.54	14.25	-	-
P/B	5.93	2.55	2.12	1.92	1.72
P/S	1.89	1.08	1.03	0.96	0.90

Source: Morgan Stanley Research, Company Data, E=Morgan Stanley Research estimates Note: March Years End, Figures in Rs mn

Ultratech: High Price Sensitivity and Regional Concentration

High Sensitivity to Cement Prices

We believe falling cement prices will put pressure on Ultratech's earnings, as illustrated by the sensitivity below.

Exhibit 80

Sensitivity of Change in Cement Prices to F2009E Revenue, Operating Profit, and Profit After Tax

Prices	Revenue	OP	PAT
-4%	-4%	-15%	-24%
-3%	-3%	-11%	-18%
-2%	-2%	-8%	-12%
-1%	-1%	-4%	-6%
0%	0%	0%	0%
1%	1%	4%	6%
2%	2%	8%	12%
3%	3%	12%	18%
4%	4%	16%	25%

Source: Company data, E = Morgan Stanley Research Estimates

Sales Heavily Skewed to Western India

Ultratech sells 59% of its cement in western India. Significant capacity addition there is not due until 4Q F2009, later than in the north and south. But, we expect most of the new capacity in the north and south to divert volumes to the western market.

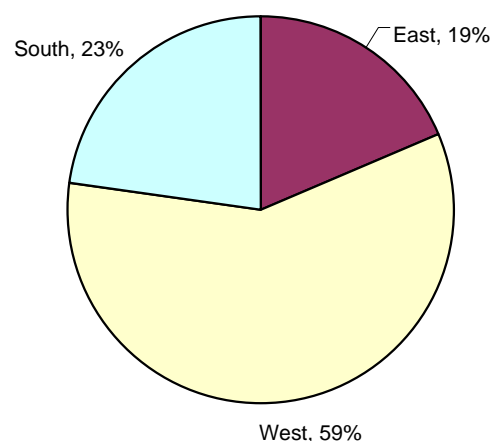
Maharashtra received 20% of its cement supplies from Karnataka and 9% from Andhra Pradesh in F2008. Gujarat, Maharashtra, and Madhya Pradesh together received 3.3mt, 13% of cement production in Rajasthan, in that year. We believe this trend will continue or even increase once there is oversupply in the north and south.

Export Ban Removed But No Respite From Falling Prices

The government's April 11, 2008 ban on exports affected Ultratech, which exported almost 10% of its cement volume in F2008. The government removed the ban on May 25, but we expect prices to remain under pressure. Also, we expect export volume to be diverted to western India when there is excess supply in the Gulf region from 2010.

Exhibit 81

Sales Breakdown, F2008



Source: Company data, Morgan Stanley Research

Rising Freight, Raw Material, and Fuel Costs

Ultratech's lead kilometers (average distance for cement deliveries) may increase as new capacity comes on line and the company may have to transport more material by road, increasing overall freight costs. Higher diesel prices will also increase freight costs, which Ultratech has controlled well until F2008. Higher imported coal prices and lower domestic coal supply will increase overall coal costs and electricity costs. Transport costs may also have an indirect effect on the price of coal or fly ash transported to the grinding units. We expect overall costs to increase much more quickly than sales rise, resulting in a lower margin. On the positive side, Ultratech will be able to control power costs by using more captive power and lignite as a substitute for coal.

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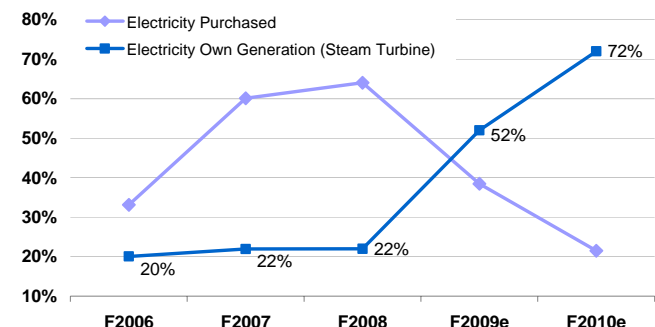
India Cement

Electricity Costs to be Controlled with New 225MW of Captive Power Capacity

Ultratech relies on state grid power for around 60% of its total requirement. The average cost of the grid purchased power for Ultratech is Rs4.8 per unit. We expect it will be able to source 80% of its total requirement in-house with the commissioning of new captive power capacity. The cost of power from captive power plants is Rs2.25 -2.5 per unit depending on the source of the purchased coal. As per the new coal policy, captive power plants are entitled to 100% coal linkages from Coal India Limited. However, this requirement is not fully met because of the lack of availability of coal for existing power plants. In this case, the companies have to rely on e-auctions by the government or imported coal. E-auction coal is 30% more expensive than domestic coal and imported coal is 60% more expensive. Still, despite this bottleneck, captive power plant power is cheaper than purchased power. Also, 92MW of the 225MW will be based on lignite, thereby decreasing cost. We expect Ultratech's power costs to decline 10-15% over the next couple of years.

Exhibit 82

Higher Use of Low-cost Captive Power



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Capacity Addition in Southern India

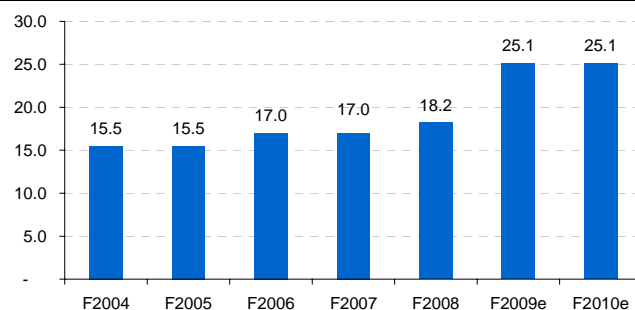
Ultratech sells 23% of its cement production in southern Indian. Ultratech's new capacity of 4.9mt at Tadpatri in Andhra Pradesh will increase its market share in the south. We believe the southern markets are well placed compared with those in the north. Demand growth in the south is strong and we expect production growth there to rise 10% in F2009. The southern region is adding 28% of existing cement capacity in the next couple of years. A large part of this is due to come on line by the end of 3Q F2009.

Ultratech's Capacity Addition

Ultratech is adding 38% of its existing capacity to take its capacity to 25.1mt. This is the second-highest planned percentage capacity addition of the four Indian cement companies under our coverage, after Grasim. We believe the volume growth will help stave off the decline in sales caused by lower cement prices.

Exhibit 83

Ultratech's Capacity to Rise 38% by F2010E



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

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India Cement

Earnings Outlook

We expect Ultratech to report a 5% increase in sales and around a 35% decline in profit after tax over F2008-10. It is expanding capacity, as discussed. However, we expect higher operating costs and lower cement prices to compress its margins, preventing earnings growth.

Key Assumptions

We expect cement prices for Ultratech to decline 7.5% in F2009 and 5% in F2010. We estimate sales of Rs59.4 billion and Rs6.5 billion profit after tax in F2009. We expect overall costs to rise 10% in F2008-10, driven by higher raw material and fuel costs. However, we expect a decline in power cost per ton because of the commissioning of 225MW of captive power.

Profitability

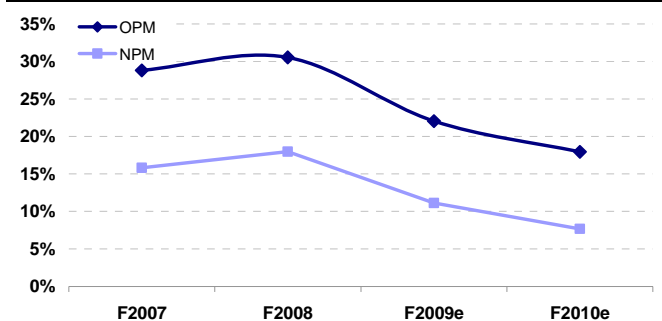
Ultratech has turned around its operations since it was transferred from Larson & Toubro to the Aditya Birla Group. This was aided by the cement up-cycle during that period. We expect Ultratech's operating profit margin to decline from 31.2% in F2008 to 17.4% in F2010 and the net profit margin to fall from 18.3% to 6.3%, respectively. We expect a sharp decline in ROE because of a higher capital base and lower earnings.

Lower Gearing Ratio Expected

Ultratech has already incurred the bulk of its planned significant capex. As a result, we expect its debt/equity ratio, and hence interest costs, to decline. However, depreciation should be higher from F2009, as this will be the first year of full depreciation on the new capacity.

Exhibit 84

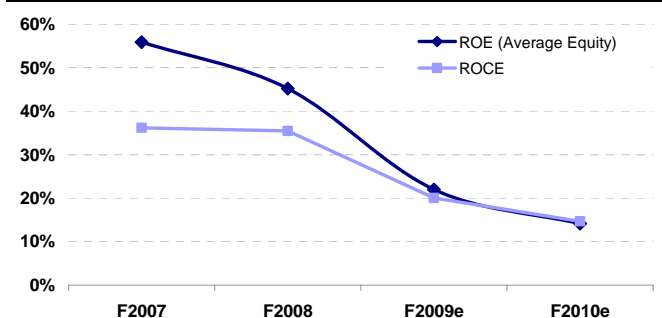
Decline in Profitability



Source: Company data, Morgan Stanley Research

Exhibit 85

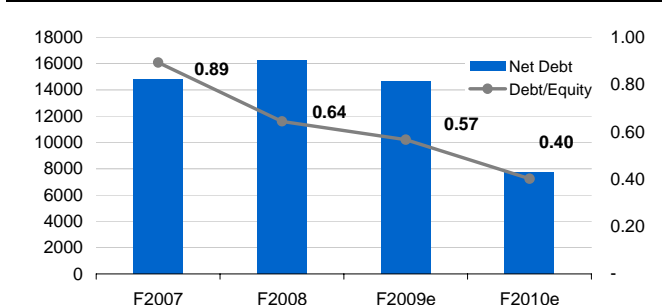
Sharp Decline in Return Ratios with Higher Capital Base and Lower Earnings



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Exhibit 86

Declining Debt/Equity Ratio



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

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India Cement

Valuation

We value the stock using a DCF method. Our key assumptions include 15% COE, 4% terminal growth, and around a 15-20% operating profit margin beyond the explicit horizon. We assume a 12.5% decline in cement prices over F2008-10 and 12-14% volume growth. We expect Ultratech's capacity utilization to decline to 85% by F2010.

Exhibit 87

Key Assumptions

Risk Free Rate (%)	9.0%
Risk Premium (%)	6.0%
Beta	1.0
Cost of Equity (%)	15.0%
WACC (%)	12.4%

Source: Company data, Morgan Stanley Research

Our DCF valuation comes to Rs66.3 billion, that is, Rs533 per share. At this price, the stock would trade at 7.4x F2009 EBITDA and around 8.5x F2010 EBITDA. This is close to current industry multiples and justified, in our view, given the expected earnings decline.

Exhibit 88

DCF Summary

Particulars	Rs mn
PV of Cash flow	45,669
Terminal Value	36,949
Terminal Growth (%)	4
Total Value	82,619
Net Debt	16,262
Value for Equity	66,357
No of shares	124
Value per Share	533

Source: Company data, Morgan Stanley Research

Ultratech made a loss in F2005, which distorts the trading history of the stock. Also, it was only listed in F2004. Therefore, we rely on industry multiples for any comparison.

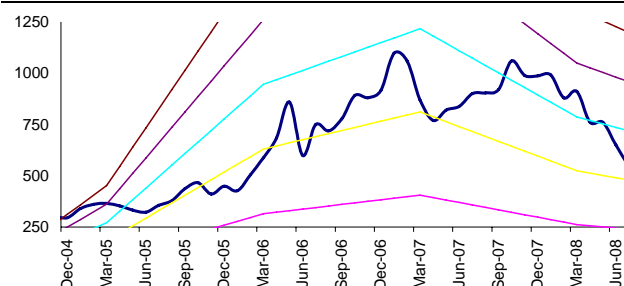
At the current market price, the stock is trading at an EV/EBITDA of 8.2x and EV/ton of US\$91. We believe it still faces downside potential and we would avoid exposure to the stock.

Bull and Bear Case Assumptions

Please refer to the *Macro Scenario Assumptions* section of this report for our macro scenario assumptions. Our Bull Case assumes a smaller decline in cement realizations in the southern region, where Ultratech's new capacity is coming on due to higher demand. We also expect Ultratech to lower its freight costs by reducing lead kilometers with the new capacity, and we look for lower international coal prices to drive up the OPM. Our Bear Case assumes timely capacity additions in the south and an unfavorable demand situation leading to a greater-than-expected fall in cement realizations.

Exhibit 89

PE Bands



Source: Company data, Morgan Stanley Research

Exhibit 90

Valuation Multiples

	F2007	F2008	F2009e
EV/EBITDA	8.4	5.0	6.4
EV/EBITDA (1Yr Fwd)	7.0	6.6	7.5
EV/Tonne (USD)	174.8	107.2	94.0
P/E	13.4	6.8	10.5
P/E (1 Yr Fwd)	10.4	10.5	14.2
P/B	5.9	2.5	2.1
P/S	1.9	1.1	1.0

E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Exhibit 91

DCF - Detailed Table

	F2007	F2008	F2009e	F2010e	F2011e	F2012e	F2013e	F2014e	F2015e	F2028e
Capacity (tons)	17,000,000	18,200,000	25,100,000	25,100,000	25,100,000	25,100,000	25,100,000	31,100,000	31,100,000	48,100,000
Sales (tons)	17,670,000	17,110,000	18,895,200	21,138,270	22,646,876	24,685,095	26,659,903	28,259,497	29,955,066	54,358,560
Total Revenue (Rs mn)	55,422	64,008	66,742	71,458	76,821	88,277	100,107	101,868	107,980	268,778
Excise	5,735	7,770	7,990	8,555	9,197	10,568	11,985	12,196	12,927	32,178
Net Sales	49,687	56,238	58,752	62,903	67,624	77,709	88,122	89,673	95,053	236,600
Op Exp	35,370	39,064	45,805	51,621	55,288	62,072	69,049	75,388	81,509	190,684
Op Profit	14,317	17,174	12,947	11,282	12,336	15,637	19,073	14,285	13,544	45,916
EBIT*(1-t)	8,061	9,874	6,665	5,056	5,646	7,834	10,112	6,234	5,724	25,241
Depreciation	2,273	2,383	2,962	3,709	3,877	3,901	3,925	4,946	4,970	8,104
Capex	(7,607)	(18,056)	(6,567)	(1,029)	(1,225)	(500)	(500)	(21,500)	(500)	(500)
Change in working capital	362	1,876	(675)	801	(118)	(100)	(100)	(100)	(100)	(100)
Free Cash Flow	3,090	(3,923)	2,385	8,536	8,180	11,135	13,437	(10,420)	10,093	32,745
Period	-	-	1	2	3	4	5	6	7	20
Discount factor	1	1	1	1	1	1	1	0	0	0
PV of CF	3,090	(3,923)	2,119	6,733	5,730	6,928	7,425	(5,114)	4,400	3,054

Particulars	Rs mn
PV of Cash flow	45,669
Terminal Value	36,949
Terminal Growth	0
Total Value	82,619
Net Debt	16,262
Value for Equity	66,357
No of shares	124
Value per Share	533

Source: Company data, Morgan Stanley Research E = Morgan Stanley Estimates

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India Cement

Appendix: Regional Analysis

Northern Region

Exhibit 92

North: Capacity, Demand, and Prices

mn tons	2004	2005	2006	2007
Capacity	31.85	34.96	38.00	39.92
		9.8%	8.7	5.1
Demand	36.26	38.37	41.26	45.78
		5.8%	7.5	10.9
Prices	152.4	154.7	193.1	217.7
		1.5%	24.8	12.8

Source: Company data, Morgan Stanley Research

Exhibit 93

ACC is Market Leader in the North, Followed by Ambuja – Top 5 Have 60% Market Share

Company Name	Market Share	Region as % of total
ACC (%)	16.6	44
Gujarat Ambuja (%)	13.4	39
Grasim (%)	12.3	38
JK (%)	10.4	77
Birla Corp (%)	6.8	72

Source: Company data, Morgan Stanley Research

Exhibit 94

North Adding 25% of Existing Capacity

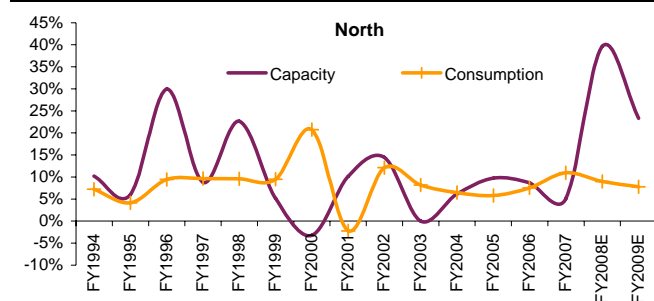
North Capacity addition as % of total

F1Q09E	8%
F2Q09E	13%
F3Q09E	0%
F4Q09E	4%
Total Addition	25%

Source: Company data, Morgan Stanley Research E=Morgan Stanley Estimates

Exhibit 95

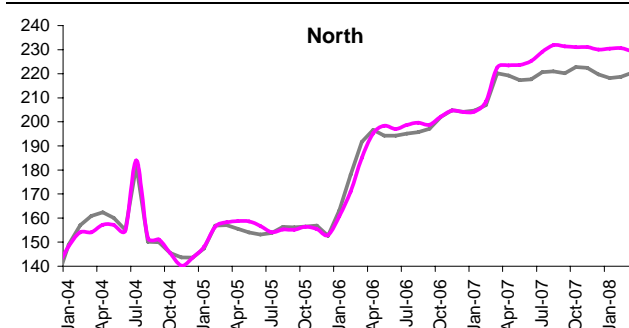
Capacity Growth to Outstrip Demand



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Exhibit 96

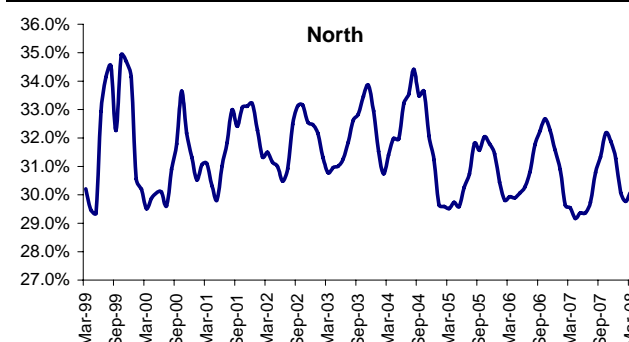
Prices in the North below National Average since 2007, Reflecting Fundamentals



Source: Company data, Morgan Stanley Research

Exhibit 97

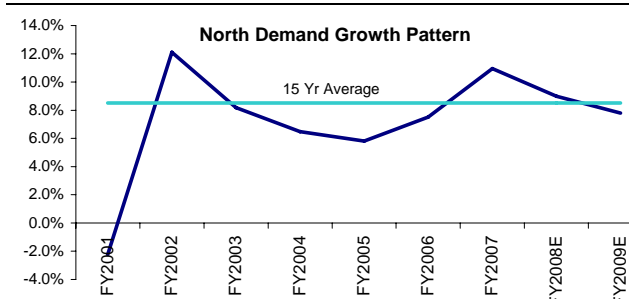
Cement Production in the North as Percentage of National Total



Source: Company data, Morgan Stanley Research

Exhibit 98

Demand Growth in North Stable at Around 8%; Above 10% in F2002 & F2007 on Base Effect



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

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India Cement

Western Region

Exhibit 99

West: Capacity, Demand, and Prices

mn tons	2004	2005	2006	2007
Capacity	54.36	57.45	57.45	57.95
		5.7%	0.0	0.9
Demand	31.54	30.75	38.88	44.02
		-2.5%	26.4	13.2
Prices	142.2	151.7	196.3	227.8
		6.7%	29.4	16.1

Source: Company data, Morgan Stanley Research

Exhibit 100

Ultratech Leads the Western Region Followed by Ambuja – Top 5 Constitute 62% Market Share

Company Name	Mkt. Share	Region as % of total
Ultratech (%)	18.0	57.8
Ambuja (%)	16.7	41.9
Grasim (%)	11.4	30.7
ACC (%)	9.4	21.3
Century (%)	6.9	49.2

Source: Company data, Morgan Stanley Research

Exhibit 101

Maximum Capacity coming in 4QF09

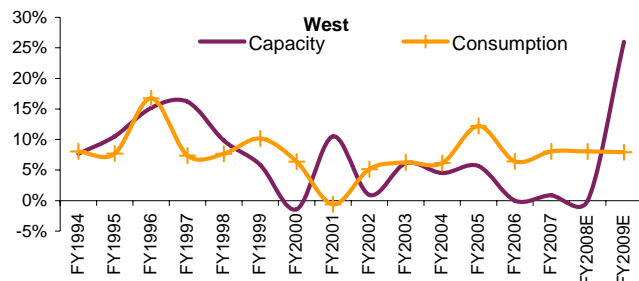
West Capacity addition as % of total

F1Q09E	4%
F2Q09E	0%
F3Q09E	3%
F4Q09E	15%
Total Addition (%)	22%

E = Morgan Stanley Estimates Source: Company data, Morgan Stanley Research

Exhibit 102

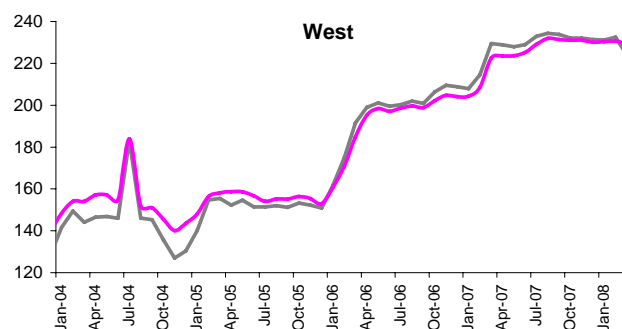
High Capacity Growth After Almost No Addition in 2006-08



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Exhibit 103

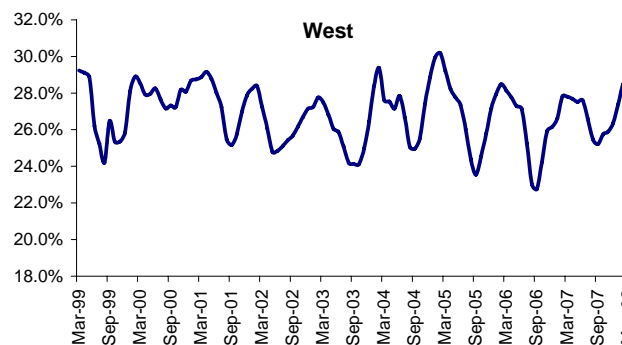
Cement Prices in the West Closely Mirror Average Prices in India



Source: Company data, Morgan Stanley Research

Exhibit 104

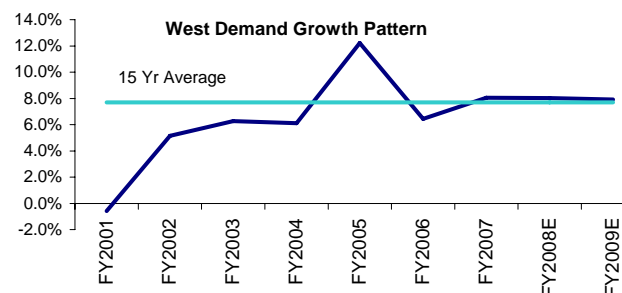
Cement Production in the West as Percentage of National Total



Source: Company data, Morgan Stanley Research

Exhibit 105

High Growth in F2005 Followed by Drop in F2006; Demand Stable at 8%



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

August 25, 2008

India Cement

Southern Region

Exhibit 106

South: Capacity, Demand, and Prices

mn tons	2004	2005	2006	2007
Capacity	46.17	47.10	50.96	53.48
		2.0%	8.2	4.9
Demand	31.54	30.75	38.88	44.02
		-2.5%	26.4	13.2
Prices	153.1	155.6	191.3	229.6
		1.7%	22.9	20.0

Source: Company data, Morgan Stanley Research

Exhibit 107

Dominated by Regional Firms, Top 5 Constitute Just 50% Market Share

Company Name	Mkt. Share	Region as % of total
India Cements (%)	17.4	90.5
Madras (%)	11.3	99.0
Grasim (%)	8.0	23.2
Ultratech (%)	7.6	26.1
Zuari (%)	6.6	96.0

Source: Company data, Morgan Stanley Research

Exhibit 108

Major Capacity Due in 3Q F2009; Adding 29% of Already High Capacity

South Capacity addition as % of total

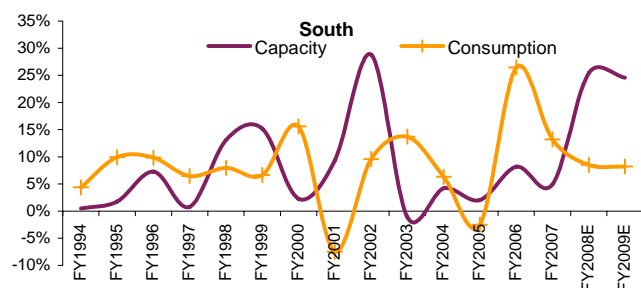
F1Q09E	3%
F2Q09E	6%
F3Q09E	10%
F4Q09E	7%

Total Addition **26%**

E = Morgan Stanley Estimates Source: Company data, Morgan Stanley Research

Exhibit 109

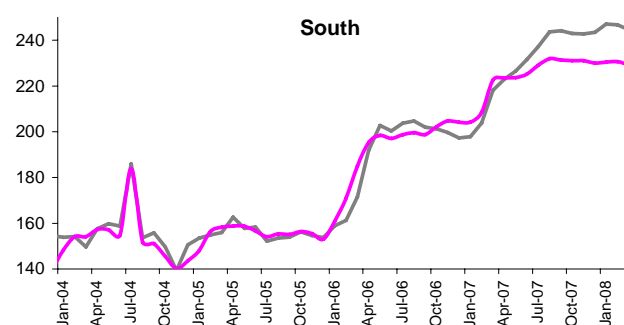
Higher Than Average Demand Growth and Capacity Due in Late F2009



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Exhibit 110

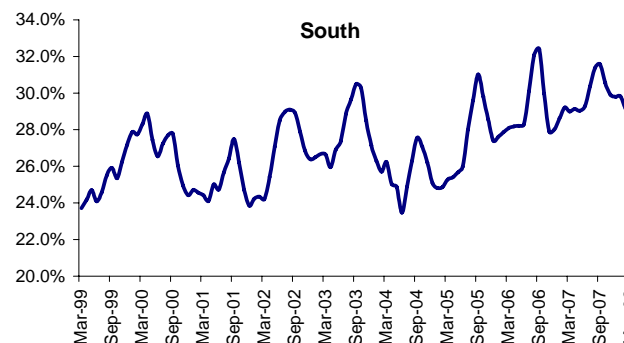
Prices Significantly Above Indian Average Reflecting Better Demand Scenario



Source: Company data, Morgan Stanley Research

Exhibit 111

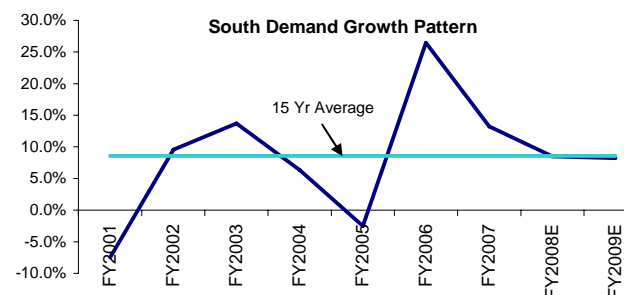
Cement Production in the South as Percentage of National Total



Source: Company data, Morgan Stanley Research

Exhibit 112

Demand Growth Higher Than Indian Average; But Difficult to Replicate F2006 Growth



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

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India Cement

Eastern Region

Exhibit 113

East: Capacity, Demand, and Prices

mn tons	2004	2005	2006	2007
Capacity	12.14	12.14	13.39	14.36
		0.0%	10.4	7.2
Demand	16.05	18.27	19.58	20.47
		13.8%	7.2	4.5
Prices	159.9	163.9	189.4	220.1
		2.5%	15.5	16.2

Source: Company data, Morgan Stanley Research

Exhibit 114

Top 5 Constitute 66% Market Share; Lafarge is Market Leader Followed by ACC

Company Name	Mkt. Share	Region as % of total
Lafarge (%)	18.9	82
ACC (%)	16.8	19
Gujarat Ambuja (%)	13.9	18
Ultratech (%)	9.6	15
Century (%)	7.2	26

Source: Company data, Morgan Stanley Research

Exhibit 115

No Capacity Addition Until 3Q F2009; Significant Additions in 4Q F2009

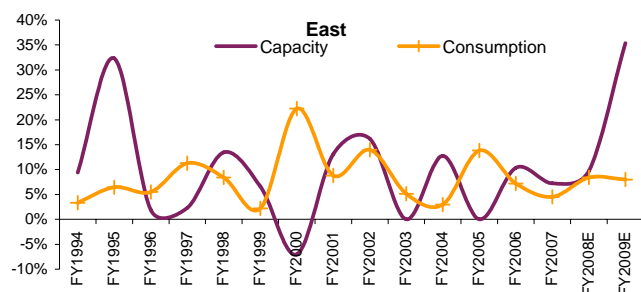
East Capacity addition as % of total

F1Q09E	0%
F2Q09E	0%
F3Q09E	12%
F4Q09E	24%

Total Addition (%) **36%**
E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Exhibit 116

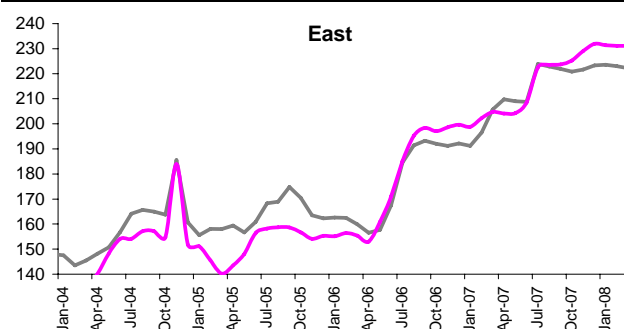
35% Capacity Growth Planned



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Exhibit 117

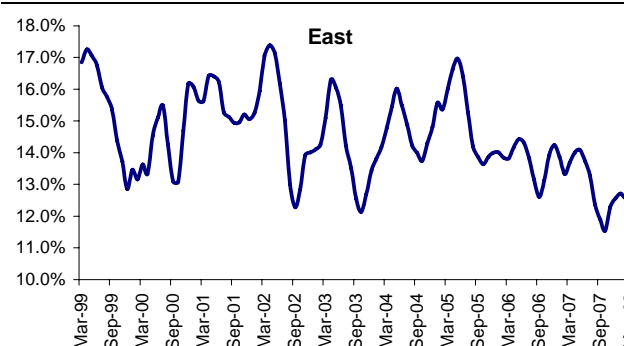
Prices Below National Average



Source: Company data, Morgan Stanley Research

Exhibit 118

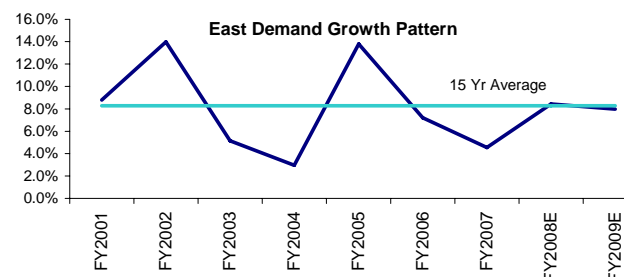
Cement Production in the East as Percentage of National Total



Source: Company data, Morgan Stanley Research

Exhibit 119

Demand Growth Fluctuates from 4% to 12% in Alternate Years



E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Disclosure Section

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Global Stock Ratings Distribution

(as of July 31, 2008)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	909	42%	290	45%	32%
Equal-weight/Hold	913	42%	270	42%	30%
Underweight/Sell	348	16%	83	13%	24%
Total	2,170		643		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Underweight (U or Under) - The stock's total return is expected to be below the total return of the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V) - We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

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Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

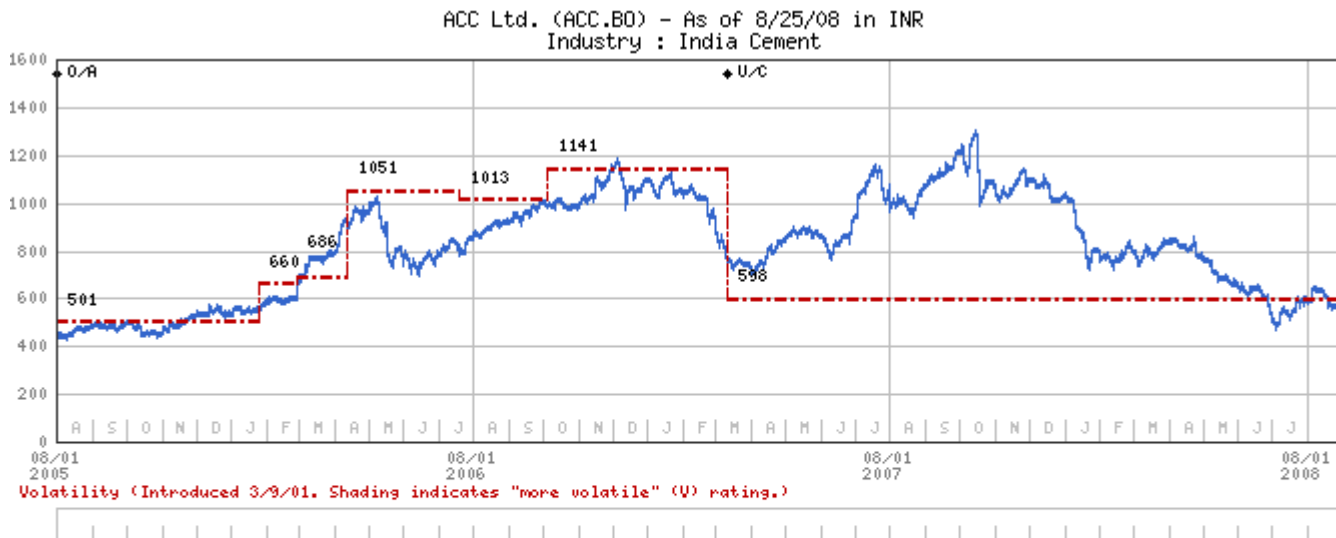
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

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India Cement

Stock Price, Price Target and Rating History (See Rating Definitions)



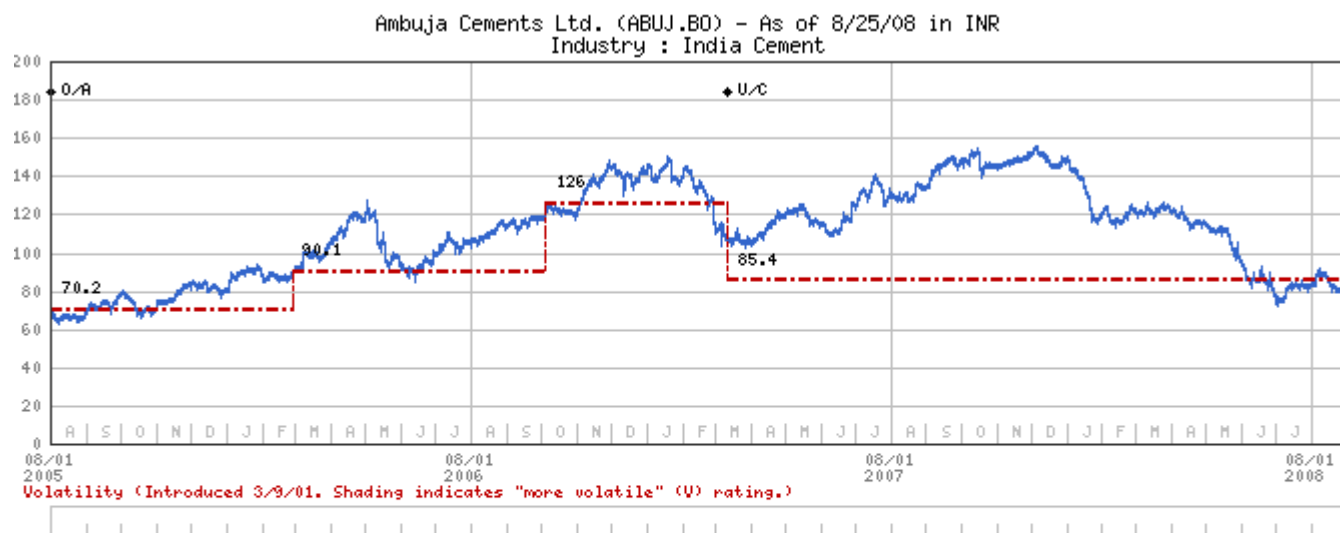
Stock Rating History: 8/1/05 : O/A; 3/12/07 : U/C

Price Target History: 7/18/05 : 501; 1/25/06 : 660; 2/27/06 : 686; 4/13/06 : 1051; 7/20/06 : 1013;
10/5/06 : 1141; 3/12/07 : 598

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ---
Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) ♦
Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (U) No Rating Available (NAU)
Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAU)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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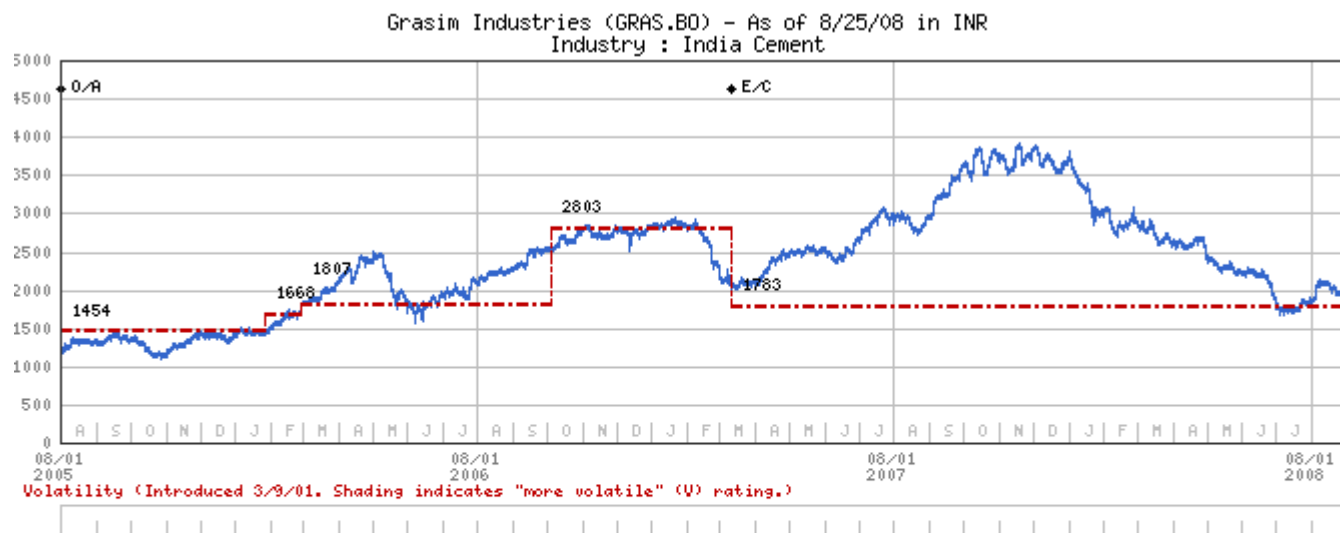
India Cement



Stock Rating History: 8/1/05 : O/A; 3/12/07 : U/C

Price Target History: 7/18/05 : 67.4; 8/1/05 : 70.2; 2/27/06 : 90.1; 10/5/06 : 126; 3/12/07 : 85.4

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —
 Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) ♦
 Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAU)
 Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAU)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)



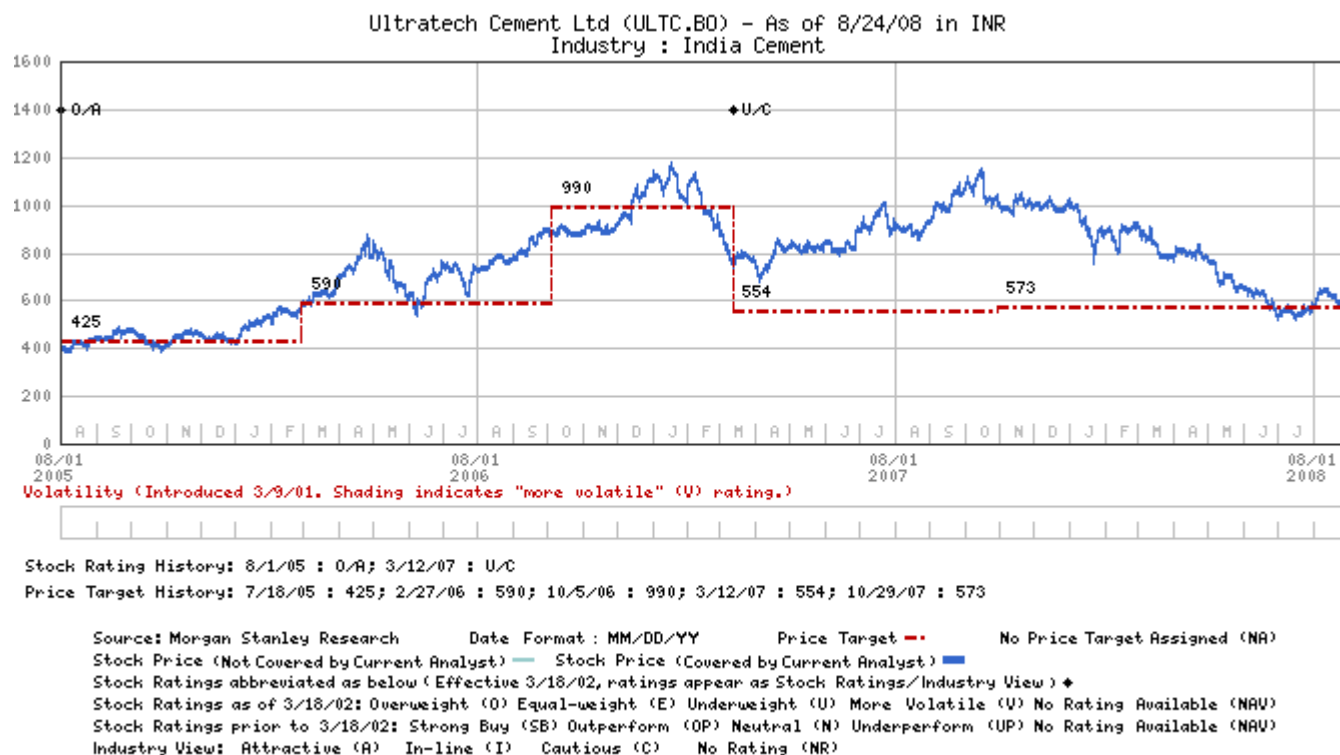
Stock Rating History: 8/1/05 : O/A; 3/12/07 : E/C

Price Target History: 7/18/05 : 1454; 1/27/06 : 1668; 2/27/06 : 1807; 10/5/06 : 2803; 3/12/07 : 1783

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —
 Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) ♦
 Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAU)
 Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAU)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage: India Cement

Company (Ticker)	Rating (as of)	Price (08/22/2008)
Mangesh Bhandang		
ACC Ltd. (ACC.BO)	U (03/12/2007)	Rs558.75
Ambuja Cements Ltd. (ABUJ.BO)	U (03/12/2007)	Rs80
Grasim Industries (GRAS.BO)	E (03/12/2007)	Rs1,929.1
Ultratech Cement Ltd (ULTC.BO)	U (03/12/2007)	Rs585

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