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CONSTRUCTION MATERIALS

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EQUITY RESEARCH

Profitability beats estimates on cost control

First Look

February 9, 2012

Rating Remains	**Neutral**
Target price Remains	INR 1155
Closing price February 9, 2012	INR 1389

A revival in demand in South India, where ACC has the highest exposure, in Nov. and Dec. '11 along with higher available capacity vs. 4QCY10 enabled ACC to achieve growth of 6% in dispatch volumes in 4QCY11 and also helped it to take price hikes of 20% YoY and 10% QoQ. Overall the 4QCY11 results were better than our estimates, helped by higher realizations and a tax provision write-back with profitability turning out 8% ahead of estimate.

Demand in the cement sector has picked up since Nov. '11 after a dismal FY11 and 1HFY12; prices are currently at peak levels while cost pressures are unlikely to be high in the short term. This should allow profitability of cement companies to be boosted further in the next couple of quarters in line with our view in our anchor report of Dec 8, 2011 *(India Cement – Rock Solid).* Price hikes in South India though may be limited from here for the short term as they are at their peak levels and companies are conscious of inviting government intervention with rapid hikes.

We use an EV/ton to replacement cost/ton valuation methodology and continue to value ACC at a 4.7% discount to its replacement cost of INR6,250/ton based on its 10-year historical average and expected mid-cycle level ROCE to arrive at our target price. At present though the stock is trading at a 24% premium to the replacement cost, which is unattractive, in our view.

Key result highlights:

- Realizations at INR4,223/ton in 4QCY11 rose 20% YoY and 10% QoQ above our estimate of INR4,132/ton, while volumes as reported earlier at 5.9mnT were up 6% YoY
- This helped net sales at INR24.9bn rise 27% YoY against our estimate of a 24% increase.
- Raw material cost per ton (INR666/ton) was up 32% YoY in line with our estimate.
- Power and fuel cost per ton (INR991/ton) was up 23% YoY again in line with our estimate, driven primarily by higher coal prices.
- Freight cost per ton at INR639/ton was up 24% YoY slightly above our estimate of INR615/ton.
- Like Ambuja Cements (ACEM IN), other operating expenses per ton (INR1,028/ton) surprised on the upside against our estimate of INR950/ton, rising 10% QoQ.
- Overall ACC has controlled costs well unlike Ambuja Cements and its profitability in terms of EBITDA/ton turned out at INR635/ton, up 70% YoY and 62% QoQ, ahead of our estimate of INR588/ton.
- For CY11, EBITDA/ton was at INR718/ton down from INR734/ton in CY10.
- Below the EBITDA level, the company reported a large reversal of tax provision related to earlier years of INR2.3 bn, which related to

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negative tax cost of INR1.3 bn for 4QCY11. Even in 4QCY10 there was a reversal of tax provision though much smaller in amount.

- Adjusting for this, PAT in 4QCY11 would have beaten our estimate by 8.7%.
- The company believes investment in infrastructure will boost cement demand in CY12, although cost pressures could continue through higher raw material, fuel & power and freight costs.

Fig. 1: P&L statement and per ton analysis

Standalone (INR mn)	Dec-10	Sep-11	Dec-11	(y-y)%	(q-q)%	Dec-11F	CY10	CY11
Net Sales	19,576	21,500	24,875	27%	16%	24,340	77,173	94,387
Other Operating Income	1,312	987	677	-48%	-31%	643	2,584	2,216
Total Income	**20,889**	**22,487**	**25,552**	**22%**	**14%**	**24,983**	**79,758**	**96,603**
Total expenses	**17,488**	**19,295**	**21,134**	**21%**	**10%**	**20,878**	**61,634**	**77,396**
Total Raw Material cost	2,822	3,840	3,924	39%	2%	4,298	11,842	15,034
Staff Cost	1,486	1,382	1,555	5%	12%	1,473	4,619	5,257
Power & Fuel Cost	4,513	5,524	5,836	29%	6%	5,890	15,987	21,832
Freight Cost	2,995	3,329	3,764	26%	13%	3,622	10,703	14,017
Depreciation	1,119	1,199	1,271	14%	6%	1,225	3,927	4,753
Other Operating expenses	5,673	5,221	6,055	7%	16%	5,596	18,482	21,256
EBITDA	**3,401**	**3,191**	**4,418**	**30%**	**38%**	**4,104**	**18,124**	**19,207**
Other Income	242	574	458	89%	-20%	523	985	1,919
Operating profit	**3,643**	**3,765**	**4,876**	**34%**	**29%**	**4,627**	**19,109**	**21,126**
Depreciation	1,119	1,199	1,271	14%	6%	1,225	3,927	4,753
EBIT	**2,524**	**2,566**	**3,605**	**43%**	**40%**	**3,402**	**15,182**	**16,373**
Interest	**137**	**253**	**192**	**40%**	**-24%**	**262**	**568**	**969**
PBT (after exceptional items)	**2,386**	**2,313**	**3,413**	**43%**	**48%**	**3,140**	**14,615**	**15,404**
Tax	(173)	637	(1,291)			911	3,414	2,152
PAT	**2,559**	**1,676**	**4,704**	**84%**	**181%**	**2,229**	**11,200**	**13,253**
Per tonne analysis (INR)								
Volumes	5.6	5.6	5.9	6%	5%	5.9	21.2	23.7
Realisation / tonne	3,508	3,832	4,223	20%	10%	4,132	3,645	3,986
Cost / tonne	3,134	3,439	3,588	14%	4%	3,545	2,911	3,268
EBITDA / tonne	374	393	635	70%	62%	588	734	718
RM / tonne	506	684	666	32%	-3%	669	559	635
Staff Cost / tonne	266	246	264	-1%	7%	250	218	222
Power & Fuel Costs / tonne	809	985	991	23%	1%	1,000	755	922
Freight Costs / tonne	537	593	639	24%	8%	615	506	592
Depreciation / tonne	201	214	216	11%	1%	208	185	201
Other operating expenses / tonne	1,017	931	1,028	2%	10%	950	873	898

Source: Company data, Nomura estimates

Appendix A-1

Analyst Certification

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Mentioned companies

Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
ACC	ACC IN	INR 1389	09-Feb-2012	Neutral	Not rated	4

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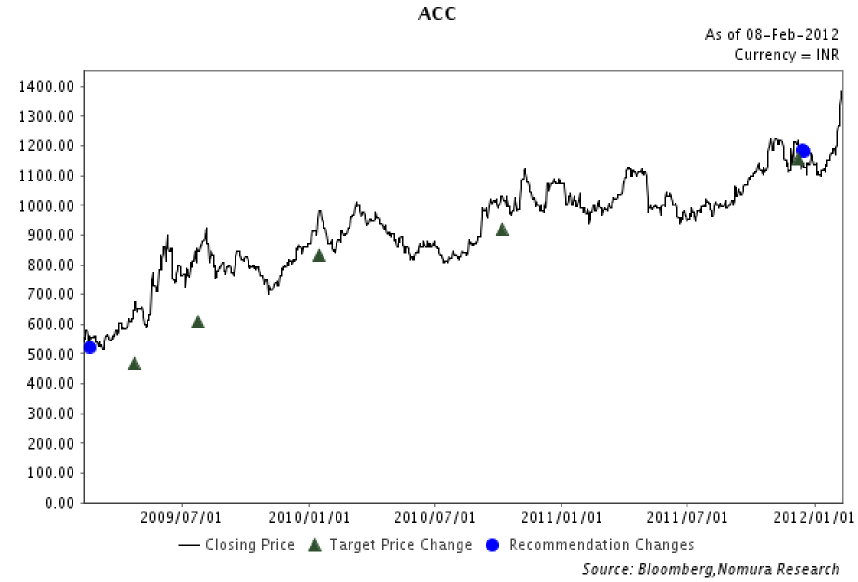
Issuer name	Previous Rating	Date of change
ACC	Not Rated	08-Dec-2011

ACC (ACC IN) **INR 1389 (09-Feb-2012)** Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
08-Dec-11	Neutral		1,202.70
08-Dec-11		1,155.00	1,202.70
05-Dec-11	Not Rated		1,204.25
06-Oct-10		917.00	1,031.25
15-Jan-10		830.00	980.80
24-Jul-09		609.00	845.30
23-Apr-09		466.00	647.90
10-Feb-09	Reduce		543.45

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Given mid-cycle ROCE over the next two years we believe ACC should also trade at a mid-cycle multiple to the replacement cost in terms of EV/ton. We adjust this mid-cycle multiple by the ratio of the one year forward ROCE to the mid-cycle ROCE of the company to arrive at a more accurate multiple. ACC's EV/ton to replacement cost mid-cycle multiple over the last 10 years has been a very small 1% discount. We expect a ROCE of 20.2% in CY12F vs. a mid-cycle ROCE of 20.9% in the last 10 years, a discount of 3.7%. Thus our target multiple to the replacement cost per ton for ACC of INR6,250/ton (USD121/ton at INR-USD rate of INR51.7) would be a discount of 4.7% or an EV/ton of INR5,959/ton (USD115/ton). We multiply this with ACC's current capacity of 30.6mnT to arrive at our target EV and TP of INR1155.

Risks that may impede the achievement of the target price Risks to upside: 1)Higher than expected volume growth, 2) Lower than expected capacity additions,3) Fall in coal prices and 4) higher than expected GDP growth Risks to downside: 1)Slower growth continuing for longer than expected, 2) Breakdown in production discipline resulting in lower pricing, 3)higher interest rates in India resulting in slower GDP growth, 4) higher than expected capacity additions and 5) sharp increase in costs

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