

## Gujarat Ambuja Cements

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,849	GAMB IN
	REUTERS CODE
S&P CNX: 2.975	GACM.BO

30 January 2006

Neutral

*Previous Recommendation: Buy*

Rs90

		YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	1,352.1	06/05A	26,058	4,682	3.5	54.4	26.1	5.6	22.4	18.3	4.5	16.0
52-Week Range	98/49	06/06E	30,100	5,303	3.9	13.3	23.1	5.1	23.2	23.4	3.8	12.5
1,6,12 Rel. Perf. (%)	9/11/1	06/07E	33,430	6,808	5.0	28.4	18.0	4.5	26.5	28.8	3.3	10.1
M.Cap. (Rs b)	122.3											
M.Cap. (US\$ b)	2.8											

GACL's cement volumes have gone up by just 2.4% YoY in 2QFY06 to 3.42m ton. However, realizations grew 21.8% YoY to Rs113/bag, driving up EBITDA by 48.5% YoY to Rs2b. EBITDA margins expanded by 420bp YoY to 26.1% while EBITDA per ton increased by Rs184 to Rs590. Recurring PAT remained flat at Rs879m, as effective tax rate increased from 16.5% in 2QFY05 to 25% in 2QFY06. The company expects effective tax rate to remain at 25%, going forward.

Holcim has acquired 14.8% stake in GACL from existing promoters at a price of Rs105/share (which includes a non compete fee of Rs15/share). It would be making an open offer for another 20% stake at Rs90/share once it gets approval from regulatory bodies. The total investment that Holcim would be making to acquire 34.8% stake in GACL translates into an EV of US\$186/ton.

GACL's 2QFY06 numbers were lower than our expectations. While volume growth is constrained, as its plants are already operating at full capacity, we believe the scope for realization growth too is limited. Based on FY06 estimates, GACL trades at a P/E of 23.1x and EV/EBITDA of 12.5x. On FY07 estimates, the stock trades at a P/E of 18x and EV/EBITDA of 10.1x. We believe these valuations are expensive. While the immediate downside in the stock may be limited due to the open offer, upside too is limited due to sector fundamentals and stiff valuations. We downgrade GACL from **Buy** to **Neutral**.

**STANDALONE QUARTERLY PERFORMANCE**

Y/E JUNE	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales Volume (m ton)	2.94	3.34	3.18	3.28	2.94	3.42	3.52	3.52	12.74	13.40
YoY Change (%)	31.3	31.1	14.8	13.5	0.0	2.4	10.7	7.3	22.0	5.2
Realization (Rs/ton)	2,037	1,856	2,099	2,197	2,227	2,261	2,333	2,161	2,046	2,246
YoY Change (%)	20.6	8.5	3.9	6.7	9.4	21.8	11.2	-1.6	8.3	9.8
QoQ Change (%)	-1	-8.9	13	5	6.1	1.5	3	-7		
<b>Net Sales</b>	<b>5,989</b>	<b>6,198</b>	<b>6,674</b>	<b>7,205</b>	<b>6,549</b>	<b>7,732</b>	<b>8,213</b>	<b>7,608</b>	<b>26,066</b>	<b>30,100</b>
YoY Change (%)	58.4	42.3	19.3	21.1	9.4	24.7	23.0	5.6	32.4	15.5
<b>EBITDA</b>	<b>1,667</b>	<b>1,360</b>	<b>1,991</b>	<b>2,219</b>	<b>1,703</b>	<b>2,021</b>	<b>2,717</b>	<b>2,750</b>	<b>7,236</b>	<b>9,191</b>
Margins (%)	27.8	21.9	29.8	30.8	26.0	26.1	33.1	36.1	27.8	30.5
Depreciation	-503	-493	-492	-466	-490	-502	-500	-438	-1,954	-1,930
Interest	-210	-203	-208	-226	-216	-197	-175	-152	-848	-740
Other Income	122	408	85	131	13	-76	220	393	746	550
<b>PBT after EO Exp/(Inc)</b>	<b>1,076</b>	<b>1,072</b>	<b>1,376</b>	<b>1,657</b>	<b>1,010</b>	<b>1,246</b>	<b>2,262</b>	<b>2,552</b>	<b>5,181</b>	<b>7,070</b>
Tax	176	177	-56	206	258	367	566	638	503	1,768
Rate (%)	16.4	16.5	-4.0	12.4	25.5	29.5	25.0	25.0	9.7	25.0
<b>Adj PAT</b>	<b>900</b>	<b>895</b>	<b>1,431</b>	<b>1,452</b>	<b>753</b>	<b>879</b>	<b>1,697</b>	<b>1,914</b>	<b>4,678</b>	<b>5,303</b>
YoY Change (%)	858.4	158.2	-1.6	22.4	-16.3	-1.9	18.6	31.9	61.2	177.0

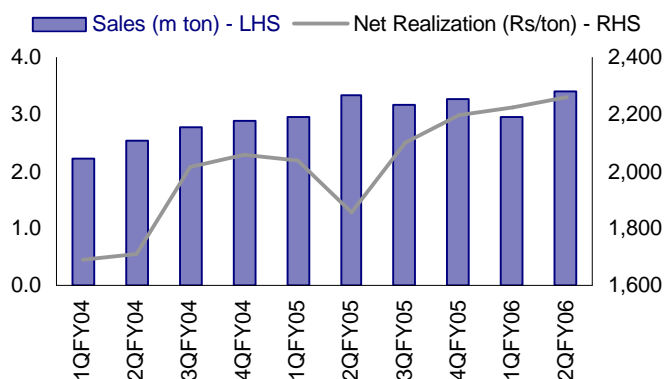
E: MOSSt Estimates; Note: Quarterly results don't add up with full year results due to restating of past quarter results

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### Firm cement prices drive revenue growth

Net sales for 2QFY06 grew 24.7% YoY to Rs.7.7b, mainly driven by realization growth. Volumes grew just 2.4% YoY to 3.42m ton – GACL's plants are operating at 100% capacity utilization and there is limited scope for volume growth without increase in capacity. Realizations grew 21.8% YoY from Rs92.8/bag to Rs113/bag. On a QoQ basis, however, realizations increased by just Rs1.7/bag. We believe that the scope for a further increase in GACL's cement realizations is limited.

TREND IN DISPATCHES (M TON) & REALIZATIONS (RS/TON)

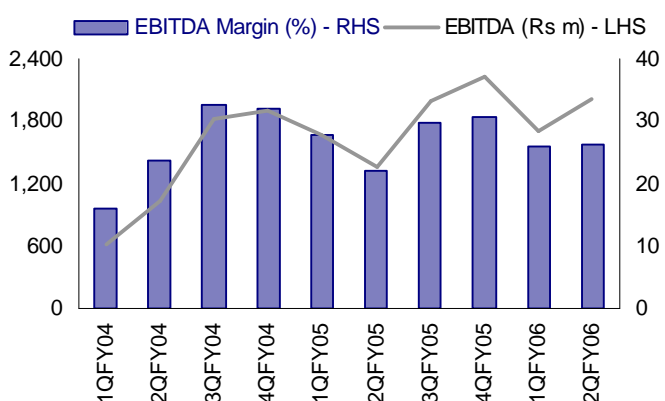


Source: Company/ Motilal Oswal Securities

### Higher realizations push up margins

Higher realizations pushed up both GACL's operating profit and EBITDA margins. Operating profit for 2QFY06 moved up 48.5% YoY to Rs2b. EBITDA per ton increased by Rs184 YoY (and by Rs11 QoQ) to Rs590. EBITDA margins expanded by 420bp YoY (and by 10bp QoQ) to 26.1%.

TREND IN EBITDA (RS M) AND EBITDA MARGINS (%)



Source: Company/ Motilal Oswal Securities

### Higher freight drives up operating cost

Operating cost moved up 15.3% YoY from Rs72.4/bag to Rs83.5/bag, driven mainly by higher freight cost (up 18% YoY) and other expenditure (up 36% YoY).

INCOME STATEMENT (RS/TON)

	2QFY06	YOY (%)	QOQ (%)
<b>Net Selling Price</b>	<b>2,261</b>	<b>21.8</b>	<b>1.4</b>
Raw Material	119	-2.6	2.1
Staff Cost	94	28.4	-3.3
Power & Fuel	540	1.1	-8.1
Freight	409	18.4	4.9
Other Expenditure	507	35.9	11.1
<b>Total Cost per ton</b>	<b>1,670</b>	<b>15.3</b>	<b>1.3</b>
<b>EBITDA</b>	<b>591</b>	<b>45.1</b>	<b>2.0</b>

Source: Company/ Motilal Oswal Securities

### Holcim acquiring 14.8% stake in GACL

Holcim has acquired 14.8% stake in GACL from existing promoters at a price of Rs105/share (which includes a non compete fee of Rs15/share). The existing promoters would continue to hold 8.8% of GACL's equity.

For Holcim, the initial investment outlay for 14.8% stake acquisition would be US\$477m. Further, it would be making an open offer for another 20% stake at Rs90/share once it gets approval from regulatory bodies. Holcim has already earmarked a maximum of US\$560m for this open offer, which would take its total investment for 34.8% stake in GACL to US\$1.04b.

**Valuation:** The total investment that Holcim would be making to acquire 34.8% stake in GACL translates into an EV of US\$186/ton. Considering the quality of GACL's assets, premium valuations were expected. However, the extent of premium exceeds our expectations by a wide margin. The deal has been concluded at the highest valuation for any stake acquisition in the Indian cement sector.

**Key takeaways from Holcim conference call**

Holcim sees substantial potential in India as an emerging market. It expects cement consumption in India (estimated at 136m ton in CY05) to grow at 8-9% in the coming years.

Taking a combined view on its two acquisitions in India, the company believes that the overall price paid by it is reasonable. It has stated that based on FY06 estimates, the three companies (ACC, ACIL and GACL) have been acquired at an EV of US\$130/ton and EV/EBITDA of 9x. On FY07 estimates, the valuations work out to US\$115/ton and EV/EBITDA of 8x.

Post the GACL acquisition, Holcim would have 35.2m ton of capacity under control, making it the single largest cement entity in India. It is planning to increase GACL's capacity by another 5m ton by FY07 through debottlenecking, brownfield expansion, blending and greenfield expansion but has not yet disclosed the details of the expansion plan.

**Valuation and view**

GACL's 2QFY06 numbers were lower than our expectations. While volume growth is constrained, as its plants are already operating at full capacity, we believe the scope for realization growth too is limited. Based on FY06 estimates, GACL trades at a P/E of 23.1x and EV/EBITDA of 12.5x. On FY07 estimates, the stock trades at a P/E of 18x and EV/EBITDA of 10.1x. We believe these valuations are expensive. While the immediate downside in the stock may be limited due to the open offer, upside too is limited due to sector fundamentals and stiff valuations. We downgrade GACL from **Buy** to **Neutral**.

## Gujarat Ambuja Cements: an investment profile

### Company description

Gujarat Ambuja is the third largest cement company in India with total capacity of 14.9m ton under its control. It is one of the lowest cost producers of cement with focus on structurally sound markets of North, West and East. It is also the largest exporter of cement from India.

### Key investment arguments

- Best positioned geographically (#1 & #2 in North and West, respectively) to benefit from current upturn in cement prices.
- Geographical location gives flexibility to choose between domestic and export market.
- Financially well placed (zero net debt) to drive further consolidation in the industry.

### Key investment risks

- Exhausting sales tax benefit in Gujarat, coupled with implementation of VAT, could impact margins adversely.
- Any downturn in the export market would result in over-supply in the domestic market, resulting in pressure on prices in the key market of Gujarat.

### Recent developments

- Holcim has acquired 14.8% stake from the existing promoters at Rs105/share (including Rs15/share non-compete fee).
- Holcim would be making an open offer to acquire 20% stake in GACL at Rs90/share post the approval from regulatory bodies.

### Valuation and view

- Leadership position in the key markets of Northern and Western India would augur well for the company.
- However, volume growth is constrained, as its plants are already operating at full capacity. We believe the scope for realization growth too is limited.
- The stock quotes at a P/E of 23.1x and EV/EBITDA of 12.5x FY06E. We downgrade the stock from **Buy** to **Neutral**.

### Sector view

- Volume expected to grow by 8%, driven by continuous momentum in housing and infrastructure projects.
- Improved demand supply dynamics due to limited capacity addition in previous years. However, greenfield capacity addition can disturb the tight demand supply scenario envisaged by us.

#### COMPARATIVE VALUATIONS

		GACL	ACC	ULTRA-CEM
P/E (x)	FY06E	23.1	18.8	43.9
	FY07E	18.0	15.0	20.0
P/BV (x)	FY06E	5.1	4.3	6.1
	FY07E	4.5	3.7	4.9
EV/Sales (x)	FY06E	3.8	2.2	2.3
	FY07E	3.3	2.0	1.9
EV/EBITDA (x)	FY06E	12.5	11.9	14.5
	FY07E	10.1	9.1	9.5

#### SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	23.8	23.6	23.7
Domestic Institutions	17.8	17.8	19.2
FII's/FDIs	42.9	43.3	42.4
Others	15.5	15.4	14.7

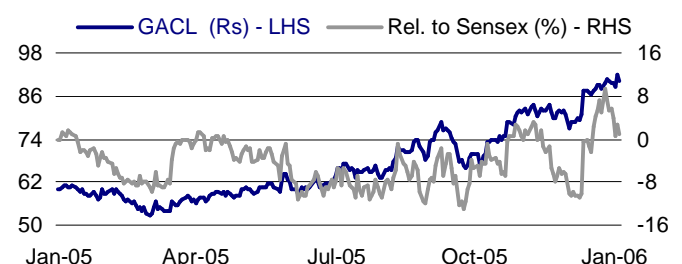
#### EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	3.9	4.1	-3.7
FY07	5.0	4.9	3.1

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
90	-	-	Neutral

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E JUNE	2004	2005	2006E	2007E	2008E	
<b>Net Sales</b>	<b>19,681</b>	<b>26,058</b>	<b>30,100</b>	<b>33,430</b>	<b>33,760</b>	
Change (%)	13.4	32.4	15.5	11.1	1.0	
Total Expenditure	14,283	18,818	20,910	22,527	24,179	
<b>EBITDA</b>	<b>5,399</b>	<b>7,240</b>	<b>9,191</b>	<b>10,903</b>	<b>9,581</b>	
Margin (%)	27.4	27.8	30.5	32.6	28.4	
Depreciation	1,686	1,954	1,930	1,966	2,042	
EBIT	3,713	5,286	7,261	8,937	7,540	
Int. and Finance Charges	784	848	740	534	276	
Other Income - Rec.	505	746	550	675	675	
PBT before EO expense	3,433	5,184	7,070	9,078	7,939	
Extra Ordinary Expense/(Inco)	-430	0	0	0	0	
PBT after EO expense	3,863	5,184	7,070	9,078	7,939	
Current Tax	203	399	1,273	1,634	1,429	
Deferred Tax	264	104	495	635	556	
Tax Rate (%)	12.1	9.7	25.0	25.0	25.0	
<b>Reported PAT</b>	<b>3,396</b>	<b>4,682</b>	<b>5,303</b>	<b>6,808</b>	<b>5,954</b>	
<b>PAT Adj for EO items</b>	<b>3,018</b>	<b>4,682</b>	<b>5,303</b>	<b>6,808</b>	<b>5,954</b>	
Change (%)	36.0	55.1	13.3	28.4	-12.6	
Margin (%)	15.3	18.0	17.6	20.4	17.6	

BALANCE SHEET		(Rs Million)				
Y/E JUNE	2004	2005	2006E	2007E	2008E	
<b>Net Worth</b>	<b>20,129</b>	<b>21,720</b>	<b>23,972</b>	<b>27,425</b>	<b>29,566</b>	
Deferred liabilities	3,707	3,811	4,306	4,941	5,497	
Total Loans	12,697	11,275	9,882	5,379	2,512	
<b>Capital Employed</b>	<b>36,533</b>	<b>36,805</b>	<b>38,159</b>	<b>37,744</b>	<b>37,574</b>	
Gross Block	36,581	37,092	38,592	39,592	41,592	
Less: Accum. Deprn.	12,841	14,639	16,569	18,536	20,577	
<b>Net Fixed Assets</b>	<b>23,739</b>	<b>22,452</b>	<b>22,022</b>	<b>21,056</b>	<b>21,014</b>	
Capital WIP	1,243	1,181	1,500	1,500	1,500	
Investments	10,110	11,251	11,251	11,251	11,251	
<b>Curr. Assets</b>	<b>4,914</b>	<b>5,878</b>	<b>7,946</b>	<b>8,897</b>	<b>9,063</b>	
Inventory	2,543	3,170	4,207	4,710	4,798	
Account Receivables	427	458	748	837	853	
Cash and Bank Balance	688	865	1,122	1,256	1,279	
Others	1,255	1,385	1,870	2,093	2,132	
<b>Curr. Liability &amp; Prov.</b>	<b>3,473</b>	<b>3,958</b>	<b>4,559</b>	<b>4,959</b>	<b>5,254</b>	
Account Payables	2,760	2,890	3,437	3,703	3,975	
Provisions	713	1,068	1,122	1,256	1,279	
<b>Net Current Assets</b>	<b>1,441</b>	<b>1,921</b>	<b>3,387</b>	<b>3,938</b>	<b>3,809</b>	
<b>Appl. of Funds</b>	<b>36,533</b>	<b>36,805</b>	<b>38,160</b>	<b>37,745</b>	<b>37,574</b>	

E: MOST Estimates

RATIOS		(Rs Million)				
Y/E JUNE	2004	2005	2006E	2007E	2008E	
<b>Basic (Rs)</b>						
<b>EPS</b>	<b>2.2</b>	<b>3.5</b>	<b>3.9</b>	<b>5.0</b>	<b>4.4</b>	
Cash EPS	3.5	4.9	5.3	6.5	5.9	
BV/Share	15.0	16.1	17.7	20.3	21.9	
DPS	16	18	2.0	2.2	2.5	
Payout (%)	47.2	46.0	57.5	49.3	64.0	
<b>Valuation (x)</b>						
P/E		26.1	23.1	18.0	20.5	
Cash P/E		18.4	16.9	13.9	15.3	
P/BV		5.6	5.1	4.5	4.1	
EV/Sales		4.5	3.8	3.3	3.2	
EV/EBITDA		16.0	12.5	10.1	11.2	
Dividend Yield (%)		2.0	2.2	2.4	2.8	
<b>Return Ratios (%)</b>						
RoE	16.7	22.4	23.2	26.5	20.9	
RoCE	12.7	18.3	23.4	28.8	25.3	
<b>Working Capital Ratios</b>						
Asset Turnover (x)	0.5	0.7	0.8	0.9	0.9	
Debtor (Days)	7	6	8	8	8	
<b>Leverage Ratio (x)</b>						
Current Ratio	1	1	2	2	2	
Debt/Equity	0.6	0.5	0.4	0.2	0.1	

CASH FLOW STATEMENT		(Rs Million)				
Y/E JUNE	2004	2005	2006E	2007E	2008E	
Oper. Profit/(Loss) before Ta	5,399	7,240	9,191	10,903	9,581	
Interest/Dividends Recd.	505	746	550	675	675	
Direct Taxes Paid	-467	-503	-1,768	-2,269	-1,985	
(Inc)/Dec in WC	4,489	-303	-1,209	-417	153	
<b>CF from Operations</b>	<b>9,925</b>	<b>7,180</b>	<b>6,764</b>	<b>8,892</b>	<b>8,424</b>	
EO expense	-430	0	0	0	0	
<b>CF from Op. incl EO Exp</b>	<b>10,356</b>	<b>7,180</b>	<b>6,764</b>	<b>8,892</b>	<b>8,424</b>	
(inc)/dec in FA	-6,549	-605	-1,819	-1,000	-2,000	
(Pur)/Sale of Investments	907	-1,141	0	0	0	
<b>CF from Investments</b>	<b>-5,641</b>	<b>-1,746</b>	<b>-1,819</b>	<b>-1,000</b>	<b>-2,000</b>	
Issue of Shares	2,216	-939	0	0	0	
(Inc)/Dec in Debt	-4,162	-1,319	-898	-3,867	-2,311	
Interest Paid	-784	-848	-740	-534	-276	
Dividend Paid	-1,604	-2,152	-3,050	-3,355	-3,813	
<b>CF from Fin. Activity</b>	<b>-4,335</b>	<b>-5,257</b>	<b>-4,689</b>	<b>-7,757</b>	<b>-6,400</b>	
<b>Inc/Dec of Cash</b>	<b>380</b>	<b>177</b>	<b>256</b>	<b>135</b>	<b>24</b>	
Add: Beginning Balance	309	688	865	1,122	1,256	
<b>Closing Balance</b>	<b>688</b>	<b>865</b>	<b>1,121</b>	<b>1,257</b>	<b>1,280</b>	



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**Gujarat Ambuja Cements**

- |  |    |
|--|----|
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| 3. Broking relationship with company covered | No |

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