

Expect worst to be over- upgrade to ACCUMULATE

October 21, 2010

Reco	Previous Reco
Accumulate	Hold
CMP	Target Price
Rs983	Rs1,035
EPS change FY11E/12E (%)	8.0/5.9
Target Price change (%)	18.3
Nifty	6101
Sensex	20261

Price Performance

(%)	1M	3M	6M	12M
Absolute	(5)	20	4	24
Rel. to Nifty	(5)	7	(9)	6

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Cement
Bloomberg	ACC@IN
Equity Capital (Rs mn)	1877
Face Value(Rs)	10
No of shares o/s (mn)	188
52 Week H/L	1,049/686
Market Cap (Rs bn/USD mn)	182/4,101
Daily Avg Volume (No of sh)	501006
Daily Avg Turnover (US\$m)	10.5

Shareholding Pattern (%)

	J'10	M'10	D'09
Promoters	46.2	46.2	46.2
FII/NRI	15.4	13.2	13.0
Institutions	18.1	20.1	19.8
Private Corp	4.8	4.7	5.0
Public	15.4	15.9	16.0

Source: Capitaline

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- **APAT at Rs0.9bn (-79.3%yoy) sharply below estimates led by lower realizations. Revenue decline of 16.9% yoy - volumes decline 3.6%yoy, realizations down 13.8%**
- **Costs increases drag EBITDA to Rs 1.69bn by 74.6%yoy. RM cost/t up 16%yoy due to outside clinker purchases & increase in fly ash prices. EBITDA/t at Rs3512 (-73.6%yoy)**
- **Downgrade our earnings by 8% for CY10 & 5.9% for CY11. With recent cement prices hikes and pick up in volumes, we expect the worst phase of profitability to be over for ACC**
- **We upgrade our target price to Rs1050 by upgrading our valuation to EV/ton of USD 130 (earlier USD110/ton) and rolling over to CY11 nos. Upgrade to ACCUMULATE**

Revenue decline of 16.9% yoy- realizations down 13.8%

Q3CY11 revenues at Rs16.37bn have declined by 16.9% yoy led by 3.6% yoy decline in volumes (4.83 mt) and 13.8% yoy decline in realisations (Rs3390/t). Volumes declined mainly due to a) Wadi II kiln shutdown for major part of Q3 for expansion hook-up b) Chanda operations suffering monsoon & floods & c) North operations getting affected on account of flood & fly ash availability constraints.

Increasing costs drag EBIDTA down by 74.6%

Due to decline in realizations & significant increase in costs ACC's EBIDTA at Rs 1.7bn (our estimates Rs3.3 bn) fell sharply by 74.6%yoy and 69.3%qoq. RM costs at Rs516/t increased 16.6% yoy on account of higher purchase of clinker & increase in slag & fly ash prices. Power and fuel costs have increased by 4.3% yoy to Rs 749/t. These costs could have been higher but lower clinker production volumes and captive power generation. Other expenses increased 13.8%yoy due to increase in royalty, provision for inventory obsolescence. Total costs/t at Rs3038/t saw an increase of 16.9%yoy and 9.1%qoq.

EBIDTA/t at Rs352 down 74% yoy

With sharp fall in realisation and higher costs, ACC's EBIDTA/t at Rs352 declined by 73.6% yoy and 66.5% qoq with EBIDTA margins contracting by 2354bps yoy to 10.4%. These levels of profitability were last seen in CY2005 with EBIDTA/t of Rs368. However with the recent price hikes (led by increasing producer discipline) we expect that the worst to be behind as far as profitability is concerned.

Net profit at Rs0.9bn down 77% yoy

Interest expenses for Q3CY10 increased by 19.3%yoy, while depreciation charges increased 14.4%yoy taking ACC's pre-exceptional net profit to Rs0.9bn, decline of 79.3% yoy and 75%qoq. Reported profits at Rs1 bn include Rs100 mn as profit on sale of business (Air pollution control activity)

Consolidated Financial Snapshot

Rs Mn

(Rs mn)	Net sales	EBIDTA (Rs m)	PAT (%)	EPS (Rs m)	EPS (Rs)	EPS growth (%)	ROE (%)	PE (x)	EV/EBIDTA	EV/Tonne (USD)
Y/E Dec										
CY08	72,829	17,332	23.8	11,639	64.6	-15.7	25.6	15.9	10.5	168.0
CY09	80,272	24,797	30.9	16,067	85.5	32.4	29.4	12.0	7.3	146.0
CY10E	77,788	18,289	23.5	11,493	61.2	-28.5	18.0	16.8	9.8	123.4
CY11E	86,424	21,527	24.9	13,386	71.2	16.5	18.7	14.4	7.7	113.8

Result Table

Rs mn	Q3CY09	Q4CY09	Q1CY10	Q2CY10	Q3CY10	YoY (%)	QoQ (%)	YTD CY10	YTD CY09	YoY (%)
Revenue	19,694	19,215	21,018	20,207	16,372	-16.9	-19.0	57,597	61,057	-5.7
Expenditure	13,015	14,315	14,796	14,677	14,673	12.7	0.0	44,146	40,561	8.8
<i>as % of sales</i>	<i>66.1</i>	<i>74.5</i>	<i>70.4</i>	<i>72.6</i>	<i>89.6</i>			<i>76.6</i>	<i>66.4</i>	
Consumption of RM	2,219	2,354	2,481	2,829	2,493	12.4	-11.9	7,803	6,561	18.9
<i>as % of sales</i>	<i>11.3</i>	<i>12.3</i>	<i>11.8</i>	<i>14.0</i>	<i>15.2</i>			<i>13.5</i>	<i>10.7</i>	
Stocks	-347.9	-425.0	320.9	-483.3	560.6	-261.2	-216.0	398	138	189.4
<i>as % of sales</i>	<i>(1.8)</i>	<i>(2.2)</i>	<i>1.5</i>	<i>(2.4)</i>	<i>3.4</i>			<i>0.7</i>	<i>0.2</i>	
Employee Cost	998	917	896	1063	1174	17.7	10.4	3,133	2,760	13.5
<i>as % of sales</i>	<i>5.1</i>	<i>4.8</i>	<i>4.3</i>	<i>5.3</i>	<i>7.2</i>			<i>5.4</i>	<i>4.5</i>	
Power & Fuel	3,595	3,950	3,926	3,934	3,615	0.6	-8.1	11,474	11,447	0.2
<i>as % of sales</i>	<i>18.3</i>	<i>20.6</i>	<i>18.7</i>	<i>19.5</i>	<i>22.1</i>			<i>19.9</i>	<i>18.7</i>	
Cost of traded cement	212	219	266	296	258	21.4	-12.8	819	712	15.0
<i>as % of sales</i>	<i>1.1</i>	<i>1.1</i>	<i>1.3</i>	<i>1.5</i>	<i>1.6</i>			<i>1.4</i>	<i>1.2</i>	
Freight	2,548	2,672	2,753	2,700	2,255	-11.5	-16.5	7,708	7,872	-2.1
<i>as % of sales</i>	<i>12.9</i>	<i>13.9</i>	<i>13.1</i>	<i>13.4</i>	<i>13.8</i>			<i>13.4</i>	<i>12.9</i>	
Other expenditure	3791	4628	4154	4339	4316	13.8	-0.5	12,810	11,070	15.7
<i>as % of sales</i>	<i>19.3</i>	<i>24.1</i>	<i>19.8</i>	<i>21.5</i>	<i>26.4</i>			<i>22.2</i>	<i>18.1</i>	
EBITDA	6,679	4,900	6,222	5,530	1,699	-74.6	-69.3	13,451	20,497	-34.4
Depreciation	796	1052	935	962	911	14.4	-5.3	2,807	2,369	18.5
EBIT	5883	3848	5287	4568	789	-86.6	-82.7	10,644	18,128	-41.3
Other Income	509	833	609	597	709	39.4	18.7	1,915	1,580	21.2
Interest	136	180	127	141	162	19.3	15.3	431	439	-2.0
PBT	6256	4502	5769	5024	1335	-78.7	-73.4	12,128	19,268	-37.1
Total Tax	1900	1092	1717	1435	435	-77.1	-69.7	3,587	5,785	-38.0
Adjusted PAT	4355	3410	4051	3589	900	-79.3	-74.9	8,541	13,484	-36.7
(Profit)/loss from JV's/Ass/MI										
PAT after MI	4355	3410	4051	3589	900	-79.3	-74.9	8,541	13,484	-36.7
Extra ordinary items	-	-	-	-	-	-	-	-	224	
Reported PAT	4355	2810	4051	3589	1000	-77.0	-72.1	8,641	13,260	-34.8
Reported EPS	23.2	18.2	21.6	19.1	4.8	-79.3	-74.9	45.5	71.9	-36.7

Margins (%)						(bps)	(bps)				(bps)
EBIDTA	33.9	25.5	29.6	27.4	10.4	-2354	-1699	23.4	33.6	-1022	
EBIT	29.9	20.0	25.2	22.6	4.8	-2506	-1779	18.5	29.7	-1121	
EBT	31.8	23.4	27.4	24.9	8.2	-2361	-1671	21.1	31.6	-1050	
PAT	22.1	17.7	19.3	17.8	5.5	-1662	-1226	14.8	22.1	-725	
Effective Tax rate	30.4	24.3	29.8	28.6	32.6	219	400	29.6	30.0	-44	

Per tonne analysis

Rs/t	Q3CY09	Q4CY09	Q1CY10	Q2CY10	Q3CY10	YoY (%)	QoQ (%)	YTD CY10	YTD CY09	YoY (%)
Cement volumes	5.01	5.36	5.58	5.27	4.83	-3.6	-8.3	15.68	16.16	-3.0
Raw Material	443	439	445	537	516	16.6	-3.8	498	406	22.6
Stocks	-69	-79	58	-92	116	-267.2	-226.6	25	9	198.2
Staff cost	199	171	161	202	243	22.1	20.5	200	171	17.0
Power & Fuel	718	737	703	746	748	4.3	0.3	732	708	3.3
Cost of traded cement	42	41	48	56	53	25.9	-4.8	52	44	18.5
Freight	509	498	493	512	467	-8.2	-8.9	492	487	0.9
Other expenses	757	863	745	823	894	18.1	8.5	817	685	19.3
Total Cost Per tonne	2598	2671	2652	2785	3038	16.9	9.1	2815	2510	12.2
EBIDTA/Ton	1333	914	1115	1049	352	-73.6	-66.5	858	1268	-32.4
Realization	3931	3585	3767	3834	3390	-13.8	-11.6	3673	3778	-2.8
Variable cost	1711	1715	1689	1852	1785	4.3	-3.6	1773	1646	7.8
Fixed cost	956	1035	905	1025	1137	18.9	10.9	1017	856	18.8

Capex plans update

Wadi II plant commissioned - Chanda expansion nearing completion

The Lighting up of Wadi II kiln was completed this quarter and it will ramp up as per plan. The major expansion project at Chanda in the state of Maharashtra, which will add 3 mtpa cement capacity is nearing completion and will be commissioned in the next quarter. Post the completion of this project ACC will have a capacity of 30.4 mtpa. And the 25 MW captive power plant at Chanda was commissioned in this quarter.

Downgrade Earnings

On account of lower than expected quarterly numbers we are downgrading our earnings estimates for ACC by 8% for CY10 (EPS of Rs61.2) and 5.9% for CY11 (EPS of Rs71.2).

CY10 earnings downgraded by 8%

	CY10			CY11		
	Earlier	Revised	change	Earlier	Revised	change
Sales	81084	77788	-4.1%	90406	86424	-4.4%
EBIDTA	19660	18289	-7.0%	22660	21527	-5.0%
EBIDTA (%)	24.2	23.5		25.1	24.9	
Net Profit	12488	11493	-8.0%	14233	13386.3	-5.9%
EPS	66.4	61.2	-8.0%	75.7	71.2	-5.9%

Expect worst to be over for ACC...

As mentioned earlier ACC's Q3CY10 EBIDTA/t of Rs352/t is lowest levels of profitability since CY2005. However we believe that the worst is over as far as profitability is concerned. Our view is based on following factors

1. Pace of capacity addition to recede– average quarterly additions to drop 50% over next 6 quarter

Close to 65 mt of new capacity has been added over last 6 quarter (Q1FY10-Q2FY11), i.e. an average addition of close to 11 mt every quarter. We estimate close to 33 mt of new capacity additions over next 6 quarter, resulting in an average addition of 5.5 mt. These average additions over next 6 quarters are 50% lower additions done in past 6 quarter.

2. Increasing pricing discipline - Recent cement price hike to restrict downgrade

With the sector profitability reaching levels of CY05 we have seen emergence of producers understanding and pricing discipline. This is has to cement prices being hiked by Rs15-35/bag across various regions. With recent price taken by cement producer across country, we estimate average cement prices have reached ~Rs235-237/bag. Our CY11E numbers for ACC (EPS of Rs71.3) are model at Rs241/bag. Hence with further price hike of Rs5-6/bag, led by pick up in demand and receding capacity additions, the cement prices can touch our estimates.

3. Landed International coal prices down ~ 10% from recent peaks

International coal prices (Richard bay South Africa) are currently ruling at USD88 down 6% from recent peaks. Adjusted for appreciation in INR against USD, the price are down 10% from recent peaks. With this and pick in volumes (leverage fixed costs) we expect cost pressure to recede.

... upgrade to ACCUMULATE

Driven by above mentioned factors we are upgrading our recommendation on ACC from HOLD to ACCUMULATE and target price to Rs1035 as compared to Rs875. We have valued ACC at an EV/ton of USD 130 (USD 120 earlier) and PER of 13X (as compared to 12X earlier). The increase in our TP on ACC is driven by rollover of valuation to CY11 numbers and moderate increase in valuation multiples.

Valuation at EV/EBIDTA of 7.1X and EV/ton of 109 remain reasonable considering ~25% RoCE

At current levels the stock is trading at PER of 13.6X (11.8X ex cash of Rs1131/share in CY10) and EV/EBIDTA of 7.1X for CY11. On EV/ton basis the stock trades USD 109 for its CY11 capacity. We believe these valuations; though not cheap are reasonable considering that ACC's would still generate CY11E RoCE of ~25% (close to 1.5X cost of capital).

Financials

Income Statement

Y/E, Dec (Rs. mn)	CY08	CY09	CY10E	CY11E
Net Sales	72,829	80,272	77,788	86,424
Growth (%)	4.2	10.2	(3.1)	11.1
Total Expenditure	55,497	55,475	59,499	64,897
Raw Materials Cost	7,991	8,915	9,317	10,879
Employee expenses	4,163	3,677	4,008	4,249
Power & Fuel cost	15,990	15,397	16,240	17,317
Freight	11,786	12,241	12,978	14,295
Others	15,567	15,246	16,956	18,157
EBIDTA	17,332	24,797	18,289	21,527
Growth (%)	(9.7)	43.1	(26.2)	17.7
EBIDTA %	23.8	30.9	23.5	24.9
Depreciation	2,942	3,421	3,801	4,338
EBIT	14,390	21,376	14,489	17,189
EBIT Margin (%)	19.8	26.6	18.6	19.9
Other income	2,887	2,411	2,493	2,493
Interest	400	843	564	558
EBT	16,877	22,944	16,418	19,123
Tax	5,238	6,877	4,925	5,737
Effective tax rate (%)	31.0	30.0	30.0	30.0
Adjusted PAT	11,639	16,067	11,493	13,386
Growth (%)	(5.0)	38.0	(28.5)	16.5
Net Margin (%)	16.0	20.0	14.8	15.5
(Profit)/loss from JV's/Ass/MI				
Adjusted PAT After JVs/Ass/MI	11,639	16,067	11,493	13,386
E/O items	489	0	0	0
Reported PAT	12,128	16,067	11,493	13,386
Growth (%)	(15.7)	32.5	(28.5)	16.5

Cash Flow

Y/E, Dec (Rs. mn)	CY08	CY09	CY10E	CY11E
PBT (Ex-Other income)	13,990	20,533	13,925	16,630
Depreciation	2,942	3,421	3,801	4,338
Interest Provided	400	843	564	558
Other Non-Cash items				
Chg in working cap	-672	4,859	-224	1,159
Tax paid	5,238	6,877	4,925	5,737
Operating Cashflow	14,398	24,347	15,070	18,884
Capital expenditure	-13,253	-15,440	-8,438	-1,000
Free Cash Flow	2,803	942	6,632	17,884
Other income	2,887	2,411	2,493	2,493
Investments	1,657	-7,966	0	0
Investing Cashflow	-11,595	-23,405	-8,438	-1,000
Equity Capital Raised	0	0	0	0
Loans Taken / (Repaid)	1,756	849	231	-3,000
Interest Paid	-400	-843	-564	-558
Dividend paid (incl tax)	-4,391	-5,051	-4,398	-4,398
Income from investments				
Others				
Financing Cashflow	-2,635	-4,203	-4,167	-7,398
Net chg in cash	168	-3,261	2,465	10,486
Opening cash position	7,435	9,842	7,464	9,929
Closing cash position	9,842	7,464	9,929	20,415

Balance Sheet

Y/E, Dec (Rs. mn)	CY08	CY09	CY10E	CY11E
Equity share capital	1,879	1,879	1,879	1,879
Reserves & surplus	47,398	58,282	65,377	74,365
Shareholders Funds	49,277	60,161	67,256	76,245
Minority Interest				
Secured Loans	4,500	5,500	5,500	2,500
Unsecured Loans	320	169	400	400
Loan Funds	4,820	5,669	5,900	2,900
Net Deferred Taxes	3,358	3,493	3,493	3,493
Total Liabilities	57,455	69,323	76,649	82,637
Gross Block	58,357	68,263	83,763	89,763
Less: Acc Depreciation	23,660	26,680	30,480	34,819
Net block	34,697	41,583	53,282	54,944
Capital WIP	16,029	21,562	14,500	9,500
Investment	6,791	14,756	14,756	14,756
Current Assets	27,596	22,945	24,996	36,539
Inventories	7,933	7,790	7,549	8,387
Sundry Debtors	3,102	2,037	1,974	2,193
Cash and Bank	9,842	7,464	9,929	20,415
Loans and Advances	6,513	5,544	5,544	5,544
Other current assets	206.7	109.9	0	0
Current Liab & Prov	27,657	31,522	30,885	33,101
Current liabilities	18,018	20,603	19,966	22,182
Provisions	9,639	10,919	10,919	10,919
Net current assets	-61	-8,578	(5,889)	3,438
Miscellaneous Exps	0	0	0	0
Total Assets	57,456	69,324	76,650	82,638

Key Ratios

Y/E, Dec	CY08	CY09	CY10E	CY11E
Profitability (%)				
EBITDA Margin	23.8	30.9	23.5	24.9
Net Margin	16.0	20.0	14.8	15.5
ROCE	32.8	37.5	23.3	24.7
ROE	25.6	29.4	18.0	18.7
RoIC	57.2	84.9	46.0	45.6
Per Share Data (Rs)				
EPS	64.6	85.5	61.2	71.2
CEPS	80.2	103.7	81.4	94.3
BVPS	262.3	320.1	357.9	405.7
DPS	20.0	23.0	20.0	20.0
Valuations (x)				
PER	15.9	12.0	16.8	14.4
P/CEPS	12.8	9.9	12.6	10.9
P/BV	3.9	3.2	2.9	2.5
EV / Sales	2.5	2.3	2.3	1.9
EV / EBITDA	10.5	7.3	9.8	7.7
Dividend Yield (%)	1.9	2.2	1.9	1.9
Gearing Ratio (x)				
Net Debt/ Equity	-0.2	-0.3	-0.3	-0.4
Net Debt/EBIDTA	-0.3	-0.1	-0.2	-0.8
Working Cap Cycle (days)	-35.0	-49.0	-49.0	-49.0

Recommendation History: ACC – ACC IN

Date	Reports	Reco	CMP	Target
22/07/2010	ACC Q2CY10 Result Update	Hold	825	875
22/04/2010	ACC Q1CY2010 Result Update	Reduce	919	875
05/02/2010	ACC Q4CY2009 Result Update	Accumulate	882	930
28/10/2009	ACC Q3CY2009 Result Update	Buy	758	930

Recent Research Reports

Date	Reports	Reco	CMP	Target
08/09/2010	Cement Sector Update			
17/08/2010	Shree Cement Q1FY11 Result Update	Accumulate	1,805	2,200
03/08/2010	Madras Cement Q1FY11 Result Update	Reduce	100	101
02/08/2010	India cements Q1FY11 Result Update	Sell	105	98

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