# Ambuja Cements – SELL

Management meeting

| ACEM IN | Rs108 | Cement | 18 May 2010 |
|---|---|---|---|

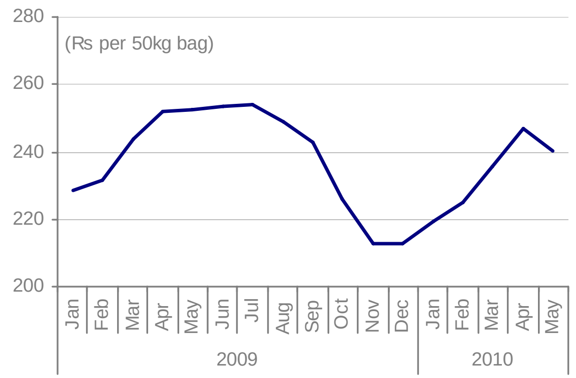
## Industry concerns overshadow improving efficiency

**In our recent meeting, Ambuja Cements's (ACL) management said cement prices are likely to be under pressure for the next two quarters, as construction activity slows down during the monsoon season, and supplies increase as new capacities stabilise. Among companies in our coverage, we believe ACL is best-placed to weather the adverse impact of falling cement prices. ACL's earnings resilience comes from reduced clinker purchases, increase in captive power capacity and superior volume growth with addition of new capacities. However, we retain SELL on the company, as we expect the sector to underperform the broader markets over the medium term, as demand growth trails the increase in supply. Key takeaways from the meeting:**

**Prices likely to be under pressure for the next two quarters:** Cement prices have declined by Rs5-7 per bag in the past one month. Sluggishness in demand growth has led to prices declining. Demand is likely to decline for the next few months on account of the monsoon and some major construction projects related to Commonwealth Games coming to an end. On the other hand, supplies are likely to increase, with stabilisation of new capacities commenced in the past few months. This is likely to put pressure on cement prices for the next two quarters.

**ACL's new plants stabilisation on track:** ACL's 2.2mtpa Bhatapara clinker plant, which went on stream in end-4QCY09, is currently running at 50% utilisation, and its 2.2mtpa Rauri clinker plant commenced in 1QCY10 is running at 30%. Its two grinding units at Dadri and Nalagarh (1.5mtpa each), started in 1QCY10, have stabilised, and a 1.5mtpa grinding capacity addition in Bhatapara is likely to be completed in October 2010. ACL has stopped purchasing clinker for its Farakka unit, with increased clinker production from its new Bhatapara plant. It does purchase some clinker for the Dadri grinding unit, as the Rauri clinker unit is yet to stabilise. ACL expects to clock ~12% YoY volume growth in the coming quarters as its production capacity increases.

**All-India average cement price trend**




Source: Industry, IIFL Research

**Financial Summary**

| Y/e 31 Dec | CY08A | CY09A | CY10ii | CY11ii | CY12ii |
|---|---|---|---|---|---|
| Revenues (Rs m) | 62,347 | 70,769 | 74,756 | 80,587 | 93,078 |
| EBITDA Margins (%) | 28.5 | 26.4 | 27.4 | 26.0 | 29.5 |
| Reported PAT (Rs m) | 14,023 | 12,184 | 13,949 | 13,906 | 18,753 |
| **EPS (Rs)** | **7.2** | **8.0** | **9.0** | **9.1** | **12.3** |
| Growth (%) | -7.7 | 11.5 | 12.8 | 1.1 | 34.9 |
| **PER (x)** | **15.1** | **13.5** | **12.0** | **11.8** | **8.8** |
| ROE (%) | 27.1 | 20.1 | 20.0 | 17.4 | 20.3 |
| **EV/EBITDA (x)** | **8.2** | **7.3** | **6.6** | **6.1** | **4.4** |
| Price/Book (x) | 2.9 | 2.5 | 2.2 | 1.9 | 1.6 |
| EV/ton | 186 | 164 | 140 | 134 | 124 |

Price as at close of business on 18 May 2010

| *6-mth TP* | *(Rs)96 (-11%)* |
|---|---|
| **Market cap (US$ m)** | **3,566** |
| 52Wk High/Low (Rs) | 126/74 |
| Diluted o/s shares (m) | 1524 |
| Daily volume (US$ m) | 7 |
| Dividend yield CY10ii (%) | 2.4 |
| Free float (%) | 53.6 |

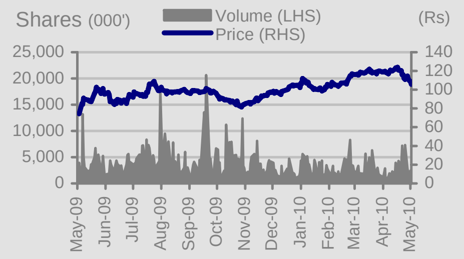
**Shareholding pattern (%)**

| | |
|---|---|
| Holcim | 46.4 |
| FIIs | 24.1 |
| DIIs | 16.5 |
| Others | 13.0 |

**Price performance (%)**

| | 1M | 3M | 1Y |
|---|---|---|---|
| Ambuja | -11.0 | -0.8 | 39.2 |
| Rel. to Sensex | -6.3 | -6.1 | -3.9 |
| ACC | -5.1 | 0.8 | 45.3 |
| Grasim Inds | -7.7 | -2.7 | 47.1 |
| UltraTech Cem | -17.5 | -6.2 | 63.7 |

**Stock movement**





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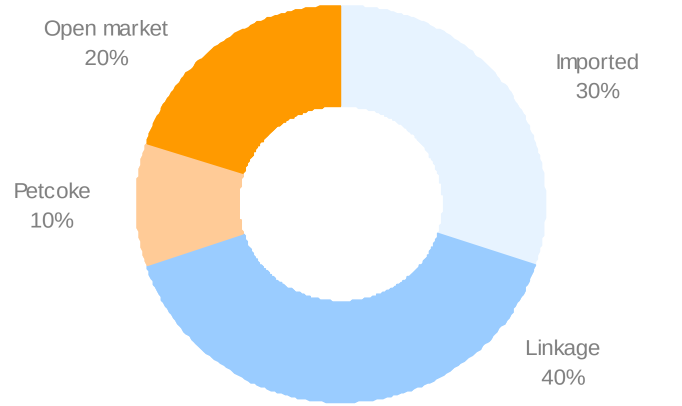
**Share of institutional segment sales to increase going forward:** In CY09, the institutional segment accounted for ~15% of ACL's volumes. With increase in capacity and increasing sales to infrastructure segment, sales volumes to the institutional segment are likely to increase to 25-30% of the total sales going forward. *We expect increasing share of institutional segment sales to result in a marginally higher fall in ACL's realisations, as typically, institutional segment sales fetch lower realisations compared to retail sales.*

**Low-cost coal to benefit till 2QCY10:** Power and fuel costs declined sharply in 1QCY10, as ACL benefited from low-cost imported coal inventory at US$90 per tonne. The low-cost coal inventory is likely to benefit in 2QCY10 as well, but cost will likely increase from 3QCY10, as the company is currently procuring imported coal at US$120 per tonne. The present fuel mix for ACL is 30% imported coal, 10% pet-coke, 40% linkage coal, and the rest through open-market purchases and e-auctions.

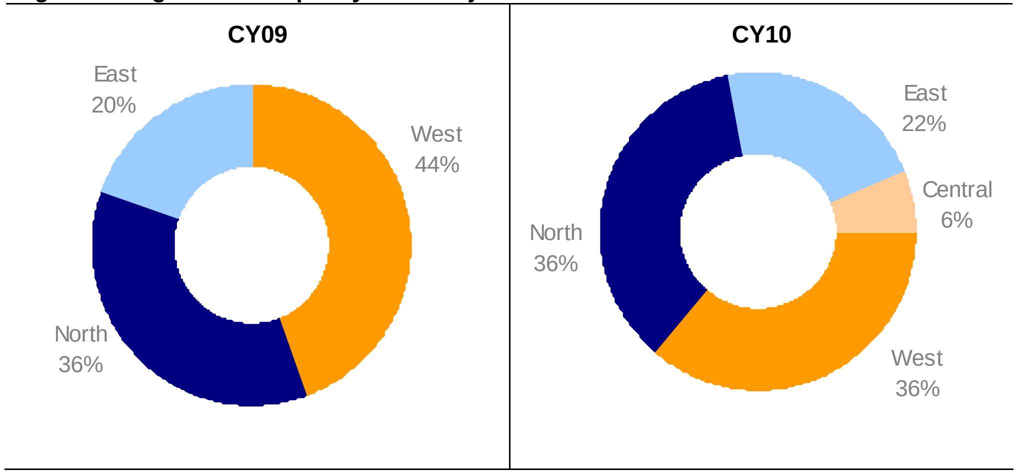
**Stabilisation of captive power capacities to reduce power costs:** ACL has commenced a 33MW CPP in Chattisgarh in 1QCY10, and a 30MW CPP in Gujarat will soon start; stabilisation of these CPPs will reduce power cost going forward.

**Figure 1: ACL's coal source mix**



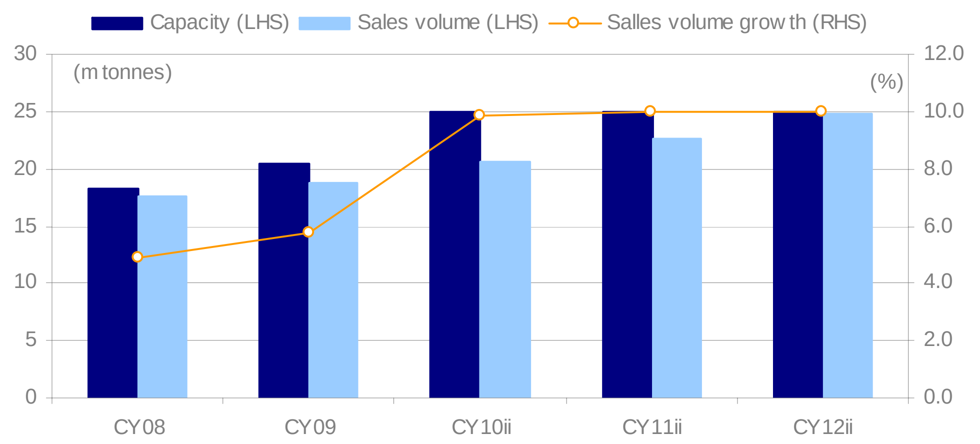

Source: Company

**Figure 2: Region-wise capacity of Ambuja Cements**




Source: Company

**Figure 3: Capacity expansions to boost Ambuja Cements's volume growth in CY10**




Source: Company, IIFL Research

# Financial summary

### Income statement summary (Rs m)

| Y/e 31 Dec | CY08A | CY09A | CY10ii | CY11ii | CY12ii |
|---|---|---|---|---|---|
| Revenue | 62,347 | 70,769 | 74,756 | 80,587 | 93,078 |
| EBIDTA | 17,779 | 18,669 | 20,518 | 20,926 | 27,451 |
| EBIT | 16,936 | 18,257 | 19,652 | 20,297 | 27,222 |
| Interest Expense | -321 | -224 | -431 | -431 | -431 |
| Depreciation | -2,598 | -2,970 | -3,256 | -3,419 | -3,419 |
| PBT | 16,615 | 18,033 | 19,221 | 19,866 | 26,791 |
| Taxes | -5,676 | -5,849 | -5,473 | -5,960 | -8,037 |
| Net Profit | 10,939 | 12,184 | 13,748 | 13,906 | 18,753 |
| PAT after EO | 14,023 | 12,184 | 13,949 | 13,906 | 18,753 |

### Cashflow summary (Rs m)

| Y/e 31 Dec | CY08A | CY09A | CY10ii | CY11ii | CY12ii |
|---|---|---|---|---|---|
| EBIT | 16,936 | 18,257 | 19,652 | 20,297 | 27,222 |
| Depr & Amortisation | 2,598 | 2,970 | 3,256 | 3,419 | 3,419 |
| Working capital Δ | -2,464 | 6,562 | -1,732 | 274 | 172 |
| Other operating items | -1,163 | -3,219 | 0 | 0 | 0 |
| Net Interest/ Tax/ Others | -6,245 | -3,279 | -5,905 | -6,391 | -8,468 |
| Operating Cash flow | 9,662 | 21,292 | 15,272 | 17,599 | 22,344 |
| Capital Expenditure | -16,614 | -13,475 | -7,500 | -7,500 | -7,500 |
| Disposal of Subsidiaries etc. | 5,893 | 0 | 0 | 0 | 0 |
| Free Cash Flow | -1,059 | 7,816 | 7,772 | 10,099 | 14,844 |
| Debt financing/disposal | -434 | 0 | 0 | 0 | 0 |
| Dividends paid | -3,902 | -3,900 | -3,855 | -3,855 | -3,855 |
| Other items | 4,549 | 0 | 201 | 0 | 0 |
| Net Change in cash | -847 | 3,916 | 4,118 | 6,244 | 10,989 |

Source: Company data, IIFL Research

### Balance sheet summary (Rs m)

| Y/e 31 Dec | CY08A | CY09A | CY10ii | CY11ii | CY12ii |
|---|---|---|---|---|---|
| Cash & Cash equivalents | 11,842 | 16,077 | 20,195 | 26,439 | 37,429 |
| Sundry Debtors | 2,246 | 1,522 | 1,608 | 1,733 | 2,002 |
| Inventories - trade | 9,398 | 6,832 | 7,113 | 7,824 | 8,606 |
| Other current assets | 234 | 102 | 102 | 102 | 102 |
| Fixed assets | 51,400 | 61,545 | 65,788 | 69,869 | 73,951 |
| Other term assets | 3,042 | 2,558 | 2,558 | 2,558 | 2,558 |
| Total assets | 78,161 | 88,635 | 97,363 | 108,525 | 124,647 |
| Short term debt | 4,706 | 6,740 | 4,937 | 4,937 | 4,938 |
| Sundry Creditors | 10,032 | 10,671 | 11,108 | 12,219 | 13,441 |
| Long term debt | 2,887 | 1,657 | 1,657 | 1,657 | 1,657 |
| Other long term liabilities | 3,808 | 4,858 | 4,858 | 4,858 | 4,858 |
| Networth | 56,729 | 64,709 | 74,803 | 84,854 | 99,752 |
| Total liability and equity | 78,161 | 88,635 | 97,363 | 108,525 | 124,647 |

### Ratio Analysis

| Y/e 31 Dec | CY08A | CY09A | CY10ii | CY11ii | CY12ii |
|---|---|---|---|---|---|
| Revenue growth (%) | 10.7 | 13.5 | 5.6 | 7.8 | 15.5 |
| Op EBIDTA growth (%) | -13.1 | 5.0 | 9.9 | 2.0 | 31.2 |
| Op EBIT growth (%) | -15.4 | 7.8 | 7.6 | 3.3 | 34.1 |
| Op EBIDTA margin (%) | 28.5 | 26.4 | 27.4 | 26.0 | 29.5 |
| Op EBIT margin (%) | 27.2 | 25.8 | 26.3 | 25.2 | 29.2 |
| Net Profit margin (%) | 17.5 | 17.2 | 18.4 | 17.3 | 20.1 |
| Dividend payout (%) | 35.2 | 32.0 | 28.0 | 27.7 | 20.6 |
| Tax rate (%) | 34.2 | 32.4 | 28.5 | 30.0 | 30.0 |
| Net Debt/Equity (%) | -9.1 | -14.8 | -18.3 | -23.5 | -31.0 |
| Net Debt/Op EBIDTA (x) | -0.3 | -0.5 | -0.7 | -1.0 | -1.1 |
| Return on Equity (%) | 27.1 | 20.1 | 20.0 | 17.4 | 20.3 |
| Return on Assets (%) | 22.6 | 17.4 | 17.7 | 15.7 | 18.1 |

Source: Company data, IIFL Research

**Key to our recommendation structure**

**BUY** - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
**SELL** - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

**Add** - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
**Reduce** - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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