Industry Flash

16 August 2007 | 9 pages

Indian Cement Sector

Import Threat Looms Closer

- **Imports more viable** — Recent developments have brought forward the likelihood of cement imports into the country. (1) The government has directed Minerals and Metals Trading Corp (MMTC) to import cement from companies even where Bureau of Indian Standards (BIS) certification is pending. (2) We spoke to the BIS and some Pakistan cement companies. Certification for a few companies is expected in a few weeks, and the first consignment soon after.

- **MMTC can make life easier for smaller users** — The permission to MMTC is a move by the government to increase domestic cement availability and moderate prices. Imports were difficult earlier as most users required small quantities (3,000 tonnes per month) whereas an economical shipload is around 25,000 tonnes. Now smaller users can source their import requirements through MMTC, though port constraints remain.

- **Pakistan in surplus** — Our conversations with a few Pakistan-based producers awaiting BIS certification indicated that imports could be expected by early September at a delivered cost of ~Rs200 per 50 kg bag, and that 1.5-2m tonnes could be sent on an annualized basis. Cement capacity in Pakistan is around 35m tpa while consumption for the y/e June 2007 is expected to reach 21m tpa.

- **Reiterate Sell** — While imports are difficult to quantify, we expect them to have a dampening effect on sentiment and prices. The pricing upside for the rest of FY08 may be limited due to such government measures, despite a supply deficit. In FY09 we expect pricing pressure due to a supply surplus and maintain our Sell on the sector.

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Figure 1. Indian Cement Sector – Valuation Snapshot

	Ticker	Rating	Current Price (Rs)	Mkt Cap (US$ m)	Target Price (Rs)	P/E (x) CY07 FY08	P/E (x) CY08 FY09	EV/EBITDA (x) CY07 FY08	EV/EBITDA (x) CY08 FY09	EV/tonne (US$/t) CY07 FY08	EV/tonne (US$/t) CY08 FY09
ACC	ACC.BO	3M	980	4,526	730	12.5	15.9	8.1	10.1	181	173
Ambuja Cem	GACM.BO	3M	127	4,761	103	12.2	15.3	7.4	9.4	239	236
Grasim	GRAS.BO	3M	2,793	6,312	2,390	11.7	12.9	7.2	7.5	185	150
UltraTech	ULTC.BO	3M	871	2,672	730	12.6	13.7	7.8	8.2	169	134

Source: DataCentral, Citigroup Investment Research estimates. Prices as on August 16. Rs/US$ rate at Rs41 for forecasts.

See Appendix A-1 for Analyst Certification and important disclosures.

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Valuation and Risks – Stocks Mentioned

ACC (ACC.BO – Rs979.55; 3M)

Valuation

We rate ACC on EV/EBITDA, a common metric used to value cement companies. Our target multiple is based on a 15% discount to the average EV/EBITDA of 9x of the past seven years, which we round down to 7.5x for CY08E - the lower end of its trading band over the past two years and equates to an EV/tonne valuation of US$123. We use a discount to reflect our fear that the recent government measures are taking away the last leg of pricing upside for cement companies.

Risks

We rate ACC as Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. The rating reflects the higher relative valuations of cement companies compared with both past cycles as well as regional peers. The main upside risks to our target price include: (1) further delays in industry capacity; (2) higher-than-expected domestic demand growth; and (3) changes in the duty/tax regime in favor of the producers.

Ambuja Cements (GACM.BO – Rs126.90; 3M)

Valuation

We use EV/EBITDA to value ACL, a common metric used for cement companies. We have set our target price at Rs103 based on a 10% discount to the historical seven-year average of 8.4x, which gives us an EV/EBITDA of 7.5x based on CY08E. At our target price ACL would be valued at an EV/tonne of US$180 for CY08E. The 10% discount to the seven-year average is due to the unfavorable government measures that attempt to take away the last leg of pricing upside. In recognition of ACL's higher margins and efficiency, we use only a 10% discount to the seven-year average, rather than the 15% applied for ACC.

Risks

We rate ACL as Medium Risk, based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. The key upside risks to our target price include: (1) further delays in industry capacity; (2) better-than-expected domestic demand growth; (3) a depreciation of the rupee versus the US$; we have assumed an appreciating rupee; and (4) changes in the duty/tax regime in favor of producers.

Grasim Industries (GRAS.BO – Rs2792.55; 3M)

Valuation

We value Grasim on EV/EBITDA, a common metric used for cement companies. Our target price of Rs2,390 is based on a 10% premium to the stock's seven-year mean of 5.9x. The downturn in cement in FY09E is expected to be partly offset by other businesses, which should perform well in FY09E-10E. We therefore use a premium to value the stock. At our target price the consolidated EV/tonne for Grasim equates to US$110/tonne and a consolidated P/E of 11.1x for FY09E.

Risks

Grasim is rated as Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. The key upside risks to our target price include: (1) further delays in industry capacity; (2) higher than expected domestic cement demand growth; (3) changes in the duty/tax regime in favor of producers; (4) higher international prices or rise in prices of competing fibres, both of which will positively impact VSF prices; and (5) better prices for scrap and cheaper natural gas than we anticipate, leading to better sponge iron margins than expected.

UltraTech Cement (ULTC.BO – Rs871.20; 3M)

Valuation

ULTC has a short valuation history relative to other cement majors. It was listed only in August 2004, after its de-merger from L&T. We therefore base our target price on relative valuations versus majors such as ACC and Ambuja Cements. Although ULTC's EBITDA/tonne improved from about Rs400/tonne in FY06 to Rs850/tonne in 4Q FY07, it is still lower than the EBITDA/tonne of ACC and Ambuja Cements. Our target EV/EBITDA multiple for ULTC is 7.0x for FY09E, at a discount to ACC's and Ambuja's 7.5x EV/EBITDA for CY08E. At our target price of Rs730, ULTC would trade at an FY09E P/E of 11.4x and EV/tonne of US$110.

Risks

We rate ULTC as Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. The key upside risks to our target price include: (1) further delays in industry capacity; (2) a higher level of domestic demand growth than we expect; (3) a depreciation of the rupee, versus our assumption of an appreciation; and (4) changes in the duty/tax regime in favor of producers.

Appendix A-1

Analyst Certification

I, Pradeep Mahtani, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

ACC (ACC.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Pradeep Mahtani (covered since January 26 2007)

Covered
Not covered

#	Date	Rating	Target Price	Closing Price
1:	21 Jan 05	1M	*414.00	NA
2:	27 Jun 05	*1L	*453.00	377.30
3:	31 Aug 05	1L	*540.00	478.45
4:	31 Jan 06	1L	*660.00	573.00
5:	28 Apr 06	*2L	*1,050.00	951.95
6:	1 Feb 07	*1M	*1,260.00	1,034.95
7:	3 May 07	*3M	*730.00	852.25

*Indicates change.

Ambuja Cements (GACM.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Pradeep Mahtani (covered since January 26 2007)

Covered
Not covered

#	Date	Rating	Target Price	Closing Price
1:	30 Aug 04	*2M	*49.07	NA
2:	21 Jan 05	2M	*60.00	NA
3:	20 Apr 05	2M	*61.33	NA
4:	27 May 05	*2L	61.33	NA
5:	30 Jun 05	2L	*64.00	59.00
6:	31 Jan 06	*3L	*92.00	88.50
7:	17 Apr 06	3L	*96.00	117.75
8:	5 Feb 07	*2M	*158.00	143.15
9:	3 May 07	*3M	*103.00	121.65

*Indicates change.

Grasim Industries (GRAS.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Pradeep Mahtani (covered since January 26 2007)

Covered
Not covered

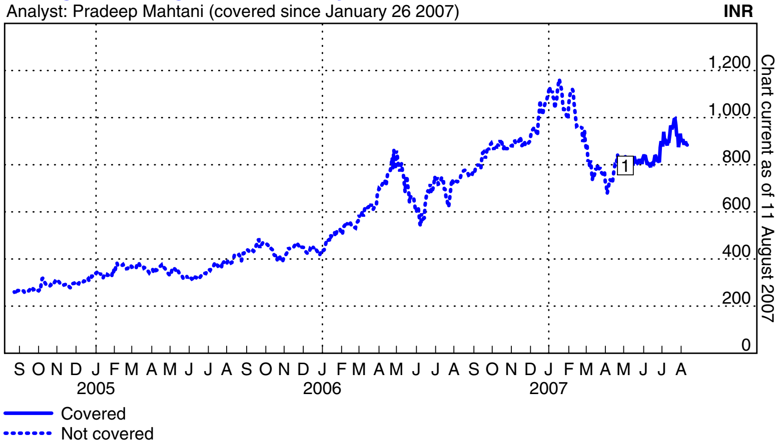
#	Date	Rating	Target Price	Closing Price
1:	28 Sep 04	1L	*1,541.00	1,121.05
2:	31 Jan 05	1L	*1,581.00	1,328.20
3:	2 May 05	1L	*1,538.00	1,140.00
4:	26 Mar 06	1L	*2,367.00	1,980.45
5:	1 May 06	1L	*2,760.00	2,517.10
6:	3 May 07	*3M	*2,390.00	2,492.55

*Indicates change.

UltraTech Cement (ULTC.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Pradeep Mahtani (covered since January 26 2007)



#	Date	Rating	Target Price	Closing Price
1:	3 May 07	3M	730.00	833.95

*Indicates change.

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