

Mid Cap
Construction Materials
Equity – India

India Cement Sector

High dispatch growth an aberration to the trend

- ▶ **High 8% dispatch growth in January primarily due to low base effect and strong growth in the north**
- ▶ **January dispatch growth in south and west at 4-year lows; strong short-term growth likely, long-term outlook sluggish**
- ▶ **Remain cautious on the sector; our key Underweight (V) stocks are ACC, Ambuja Cements and India Cements**

Low comparison base effect. High dispatch growth in January was due to a low y-o-y comparison (5% growth in January 2008). The figure was low last year as a severe winter slowed down construction activity. This year growth was driven by north India, which recorded 20% y-o-y growth.

South and west India dispatch growth at 4-year lows. South India saw 3% y-o-y growth, the lowest figure in January in four years, and west India posted a 3% decline – the first decline in January in four years.

Expect high growth in the short term. We expect dispatch growth to remain strong in the short term as construction traditionally picks up during February-May. Demand also got a boost from government spending on low-cost housing and infrastructure projects, including irrigation.

Long-term growth sluggish. The long-term outlook should remain difficult, given the deteriorating macro outlook and expectation of softening GDP.

We remain cautious on the sector. Our key Underweight (V) stocks are ACC, Ambuja Cements, Madras Cements and India Cements. We are Overweight (V) on Shree Cements.

16 February 2009

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Cement companies peer valuation

Company	Ticker	Current price Cap (USD (INR))	Market Rating (USD m)	PE (x)			EV/EBITDA (x)			EV/Tonne (USD)		
				FY09e	FY10e	FY11e	FY09e	FY10e	FY11e	FY09e	FY10e	FY11e
ACC	ACC IN	577	2,226 UW(V)	8.9	11.4	12.7	6.0	7.0	7.4	92	78	79
Ambuja Cements	ACEM IN	73	2,295 UW(V)	10.0	12.0	12.9	6.0	7.4	7.7	119	97	94
Shree Cements	SRCM IN	567	406 OW(V)	5.3	5.9	6.1	3.0	3.3	3.0	59	56	51
India Cements	ICEM IN	109	635 UW(V)	4.7	6.5	7.9	3.9	5.0	5.5	68	75	79
Madras Cements	MC IN	67	326 UW(V)	3.3	4.2	4.9	3.4	3.9	4.3	63	56	56

For ACC and Ambuja Cements, FY09e, FY10e and FY11e are CY08e, CY09e and CY10e respectively
Source: HSBC estimates

Valuations and risks

ACC: TP INR431, Underweight (V)

As oversupply should limit cement companies' pricing power, we value ACC at 5.5x EV/EBITDA. Our target EV/EBITDA implies an EV/tonne of USD60, which is in line with its historical trough valuation between 2000 and 2004. Our target price is INR431 and we rate the stock Underweight (V). The key upside risk to our valuation is a lower decline in prices than our estimates, which could boost margins.

Ambuja Cements: TP INR50, Underweight (V)

Given the deteriorating macro outlook that has slowed demand and potential oversupply that should limit pricing power, we value Ambuja Cements at a target 2010e EV/EBITDA of 5.5x, which is at a discount to its historical trading range of 7-10x and in line with its industry peers. It has historically traded at a premium to industry valuations, given its superior operational advantages. However, we do not believe Ambuja Cements warrants its historical premium, given the fact that other Indian cement majors have improved their operational parameters. Hence we value Ambuja Cements in line with ACC, which we believe is its closest comparable. Our target price is INR50 and we have an Underweight (V) rating on the stock. The key upside risk to our valuation is significant delay in capacity addition slated to commission next year, which could reduce oversupply.

Madras Cements: TP INR60, Underweight (V)

With a worsening macro outlook and expected oversupply limiting cement companies' ability to raise prices, we value Madras Cements at 4x EV/EBITDA. Over the past 10 years, Madras Cements has traded at an EV/tonne of USD28-194; the average EV/tonne in the last downcycle (2000-04) was cUSD55. So our valuation metric for Madras Cements of 4x one-year forward EV/EBITDA corresponds to the average trough EV/tonne of cUSD55/tonne in the previous downturn. Our target price is INR60 and we have an Underweight (V) rating on the stock. The key upside risk to our valuation is significant delay in capacity addition slated for commissioning for next year, which could reduce oversupply and may result in a lower price decline than our estimates.

India Cements: TP INR80, Underweight (V)

With a worsening macro outlook and likely oversupply in 2009, we value India Cements at 4.5x 2010e EV/EBITDA, which is at a discount to its historical trading range of 5.5x-8.5x. Over the past 10 years, India Cements has traded on a EV/tonne between USD50-USD220; the average EV/tonne in the last down cycle (2000-04) was cUSD65. Hence our valuation metric of 4.5x one-year forward EV/EBITDA corresponds to the average trough EV/tonne of cUSD65 in the previous downturn. Our target price is INR80, and we have an Underweight (V) rating on the stock. The key upside risk to our valuation is a lower price decline than our estimates, which could result in EBITDA margin higher than our estimates.

Shree Cements: TP INR602, Overweight (V)

The stock has traded in a narrow EV/EBITDA band of 4-6x in the last two years. We value Shree Cements at a multiple of 3.5x as we expect pressure on prices to cap the margin. Also, a concentration of the company's operations in northern India could make it more vulnerable to potential oversupply in 2009; we therefore value it at the lower band of its EV/EBITDA range, i.e. 3.5x. This is in line with its trough EV/EBITDA multiple. Our valuation multiple is also in line with the average EV/tonne valuation

of cUSD55. Our target price on the stock is INR602 and we have an Overweight (V) rating on it. The key downside risks to our valuation are a sharper decline in prices than we estimate and any significant increase in pet coke prices, which could reduce our margin estimates.

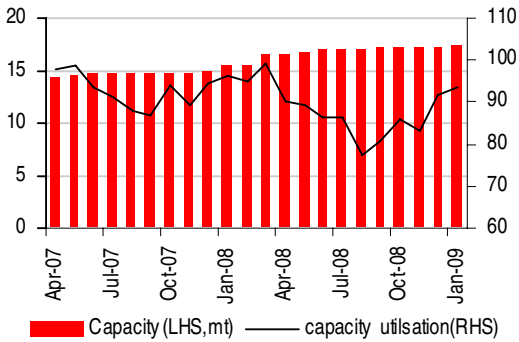
Key indicators

Dispatch growth for Indian cement companies (mt)

Company	Jan-09	Jan-08	y-o-y	YTD Jan-09	YTD Jan-08	y-o-y
ACC	1.86	1.66	12%	17.25	16.43	5%
Birla Corp	0.51	0.49	4%	4.26	4.34	-2%
Century Textiles	0.69	0.62	11%	5.86	5.59	5%
Chettinad Cement	0.23	0.24	-4%	2.53	2.37	7%
Grasim Industries	1.50	1.46	2%	13.10	13.16	0%
Ambuja Cements	1.63	1.55	5%	14.63	14.09	4%
India Cements	0.71	0.75	-6%	7.53	7.51	0%
Jaypee Group	0.73	0.62	17%	6.17	5.45	13%
Kesoram Industries	0.48	0.44	11%	4.45	3.64	22%
Lafarge	0.47	0.46	3%	4.29	4.04	6%
Madras Cements	0.50	0.47	6%	5.19	4.58	13%
Mangalam Cement	0.16	0.13	22%	1.39	1.24	12%
Orient Paper	0.25	0.23	10%	2.41	1.99	21%
Penna	0.32	0.22	41%	2.75	2.32	19%
Ultratech Cement	1.48	1.40	6%	12.77	12.22	5%
Shree Cements	0.75	0.58	30%	6.18	4.93	25%
Prism Cement	0.22	0.21	9%	2.08	1.99	4%
Dalmia Cement	0.25	0.26	-3%	2.75	2.70	2%
OCL India Ltd	0.26	0.19	42%	2.17	1.59	36%
Total	16.13	14.90	8%	146.77	136.46	8%

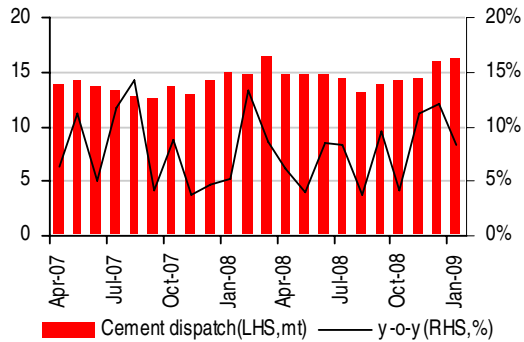
Source: CMA

All-India capacity utilisation picked up in recent months, but y-t-d rate is still low at 86% compared to 96% in FY08



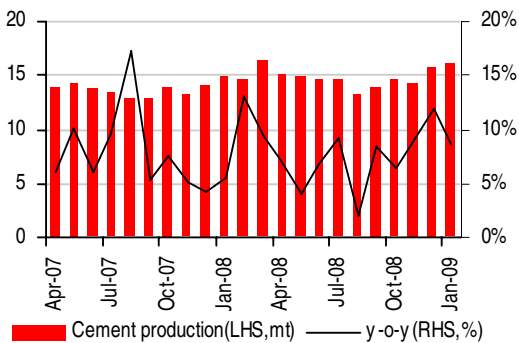
Source: CMA

All-India dispatch growth high in recent months due to low base effect



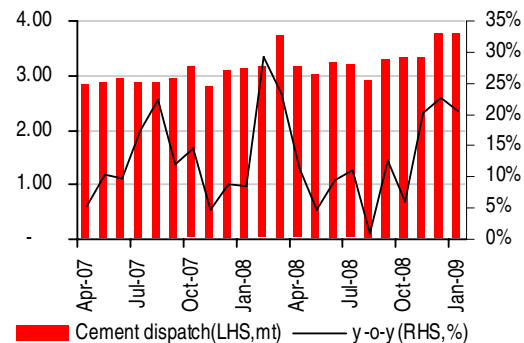
Source: CMA

All India production up 9% y-o-y in January 2009



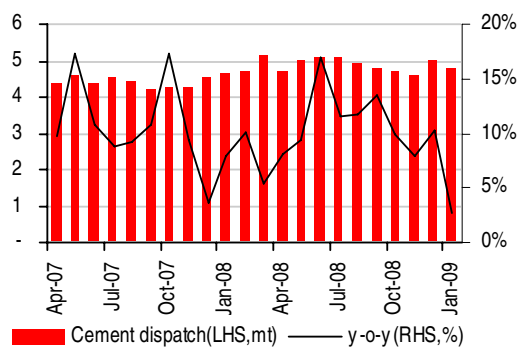
Source: CMA

North India dispatch growth strong at 20%, primarily due to low base effect



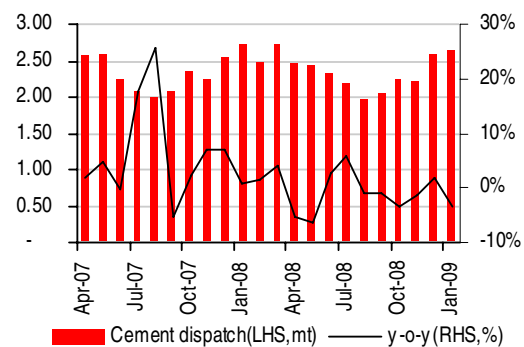
Source: CMA

South India dispatch growth declined significantly to 3%, lowest in the last 4 years



Source: CMA

West India dispatch growth declined by 3%, the first decline in January in the last four years



Source: CMA

Disclosure appendix

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*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

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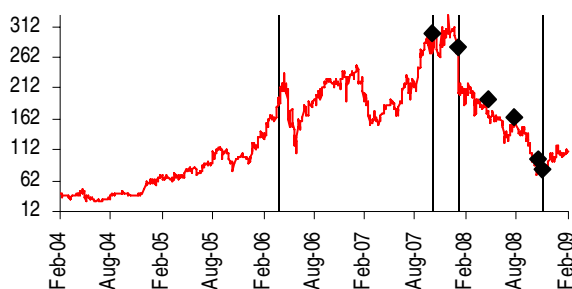
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As of 16 February 2009, the distribution of all ratings published is as follows:

Overweight (Buy)	39%	(30% of these provided with Investment Banking Services)
Neutral (Hold)	38%	(32% of these provided with Investment Banking Services)
Underweight (Sell)	23%	(23% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

India Cements (ICMN.BO) Share Price performance INR Vs HSBC rating history



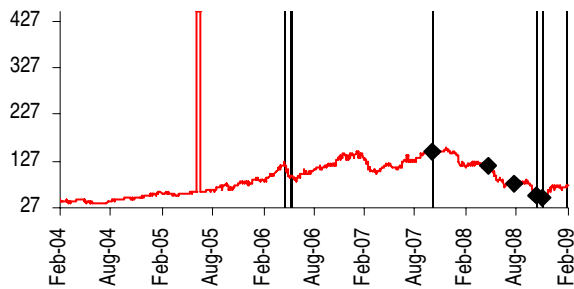
Source: HSBC

Recommendation & price target history

From	To	Date
Add	N/A	12 April 2006
N/A	Underweight (V)	18 October 2007
Underweight (V)	Neutral (V)	17 January 2008
Neutral (V)	Underweight (V)	12 November 2008
Target Price	Value	Date
Price 1	N/A	26 May 2006
Price 2	300.00	18 October 2007
Price 3	279.00	17 January 2008
Price 4	195.00	02 May 2008
Price 5	166.00	03 August 2008
Price 6	97.00	03 November 2008
Price 7	80.00	12 November 2008

Source: HSBC

Ambuja Cements Ltd (ABUJ.BO) Share Price performance INR Vs HSBC rating history



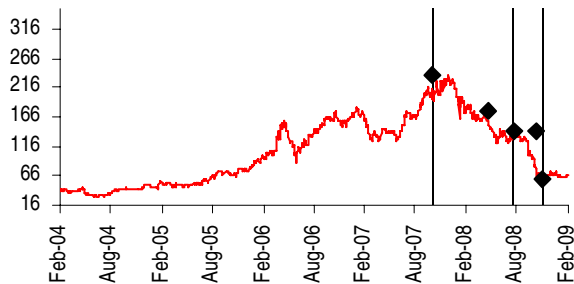
Source: HSBC

Recommendation & price target history

From	To	Date
Neutral	Underweight	03 May 2006
Underweight	N/A	24 May 2006
N/A	Underweight	18 October 2007
Underweight	Neutral	24 October 2008
Neutral	Underweight	12 November 2008
Underweight	Underweight (V)	09 February 2009
Target Price	Value	Date
Price 1	N/A	24 May 2006
Price 2	146.00	18 October 2007
Price 3	116.00	02 May 2008
Price 4	78.00	03 August 2008
Price 5	52.00	24 October 2008
Price 6	50.00	12 November 2008

Source: HSBC

Madras Cements (MSCM.BO) Share Price performance INR Vs HSBC rating history



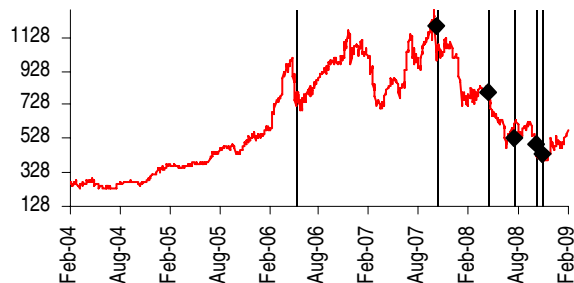
Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Neutral	18 October 2007
Neutral	Neutral (V)	03 August 2008
Neutral (V)	Underweight (V)	12 November 2008
Target Price	Value	Date
Price 1	N/A	26 May 2006
Price 2	239.57	18 October 2007
Price 3	174.97	02 May 2008
Price 4	140.90	03 August 2008
Price 5	141.45	22 October 2008
Price 6	60.00	12 November 2008

Source: HSBC

ACC (ACC.BO) Share Price performance INR Vs HSBC rating history



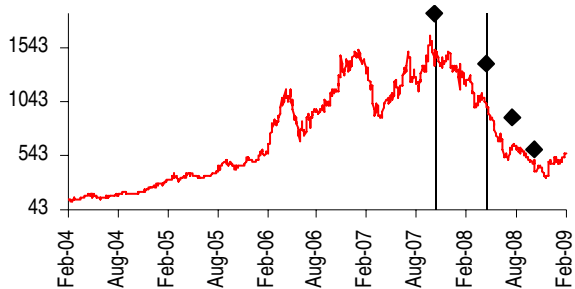
Source: HSBC

Recommendation & price target history

From	To	Date
Neutral	N/A	24 May 2006
N/A	Underweight	18 October 2007
Underweight	Neutral (V)	02 May 2008
Neutral (V)	Underweight (V)	03 August 2008
Underweight (V)	Neutral (V)	24 October 2008
Neutral (V)	Underweight (V)	12 November 2008
Target Price	Value	Date
Price 1	N/A	24 May 2006
Price 2	1190.00	18 October 2007
Price 3	802.00	02 May 2008
Price 4	537.00	03 August 2008
Price 5	496.00	24 October 2008
Price 6	431.00	12 November 2008

Source: HSBC

Shree Cements (SHCM.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight	18 October 2007
Overweight	Overweight (V)	02 May 2008
Target Price	Value	Date
Price 1	N/A	26 May 2006
Price 2	1850.00	18 October 2007
Price 3	1390.00	02 May 2008
Price 4	883.00	03 August 2008
Price 5	602.00	21 October 2008

Source: HSBC

HSBC & Analyst disclosures

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Company	Ticker	Recent price	Price Date	Disclosure
INDIA CEMENTS	ICMN.BO	109.55	13-Feb-2009	4

Source: HSBC

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