

7 September 2010

Sell

Target price
Rs98.54 (from Rs93.34)

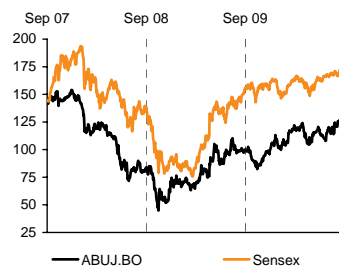
Price
Rs136.05

Short term (0-60 days)
n/a

Market view
Underweight

Price performance

	(1M)	(3M)	(12M)
Price (Rs)	114.9	115.5	101.3
Absolute (%)	18.4	17.8	34.3
Rel market (%)	15.7	8.6	13.5
Rel sector (%)	13.2	2.6	10.4



Market capitalisation
Rs207.12bn (US\$4.46bn)

Average (12M) daily turnover
Rs301.77m (US\$6.46m)

Sector: BBG AP Construction
RIC: ABUJ.BO, ACEM IN
Priced Rs136.05 at close 7 Sep 2010.
Source: Bloomberg

Researched by

**RBS Equities (India) Limited
Institutional Team**

Mafatlal Chambers – C Wing, Ground Floor, N.M. Joshi Marg, Lower Parel (E), Mumbai 400 013, India. Tel : +91 022 6754 8411 Fax : +91 022 6754 8420

www.rbs.in/broking

Ambuja Cements

Sharp margin correction imminent

We are now seeing signs of surplus-induced price falls spreading beyond south India. Cement prices in Gujarat (ACEM has 18% exposure) in the west have fallen 20% in last few weeks. Completion of Commonwealth Games capex should slow demand in the north. We expect margin erosion from 3Q10. Reiterate Sell.

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue (Rsm)	62,348	70,765	73,649	77,730	86,268
EBITDA (Rsm)	17,781	18,667	20,924	19,126	21,884
Reported net profit (Rsm)	14,024	12,182	13,024	11,701	13,009
Normalised net profit (Rsm) ¹	10,941	12,182	13,024	11,701	13,009
Normalised EPS (Rs)	7.19	8.00	8.55	7.68	8.54
Dividend per share (Rs)	2.20	2.40	2.20	2.20	2.20
Dividend yield (%)	1.62	1.76	1.62	1.62	1.62
Normalised PE (x)	18.90	17.00	15.90	17.70	15.90
EV/EBITDA (x)	10.70	9.85	8.16	8.69	8.13
Price/book value (x)	3.65	3.20	2.81	2.53	2.28
ROIC (%)	20.90	18.60	17.20	13.70	15.30

1. Post-goodwill amortisation and pre-exceptional items

Accounting standard: Local GAAP

Source: Company data, RBS forecasts

year to Dec, fully diluted

Gujarat cement prices fall as competition intensifies; south India price crash spreads

Cement prices in Gujarat fell to Rs180/bag in August (about Rs150/bag for small players) on rising competition, as JP Associates' newly commissioned 2.7MTPA capacity in the state despatched more than 100K tonnes per month in last four months. Also, with prices in south India still low (Rs150/bag), companies there have been shipping more to the neighbouring markets in west India. We expect Ambuja Cements (ACEM), with 18% exposure to the Gujarat market, to face earnings pressure in the coming quarters.

Other costs pressures to mitigate savings in material costs

The commissioning of the clinkerisation capacity is positive for input costs, but we expect other cost pressures. ACEM's production cost per tonne went up 4.2% qoq in 2Q10 despite 65% savings in raw material costs, on higher power costs and other expenses. We expect ACEM's average imported coal cost to rise to US\$105/mt in 3Q10 (from US\$90/mt in 1H10).

Margins to come under pressure from 3Q10 onwards

We expect cement prices in north India (ACEM has about 44% exposure) to come under pressure after the completion of Commonwealth Games-related capex. We believe the pressure on cement realisations will accelerate, as the demand-supply gap in the cement industry widens (we expect end-FY11 capacity of 285MTPA vs demand of 220mmt). As a result, we expect sharp margin erosion starting 3Q10 and lasting for four to six quarters. We forecast ACEM's margin will fall to Rs863/mt in 2H10, from Rs1,155/mt in 1H10.

We retain our estimates; reiterate Sell

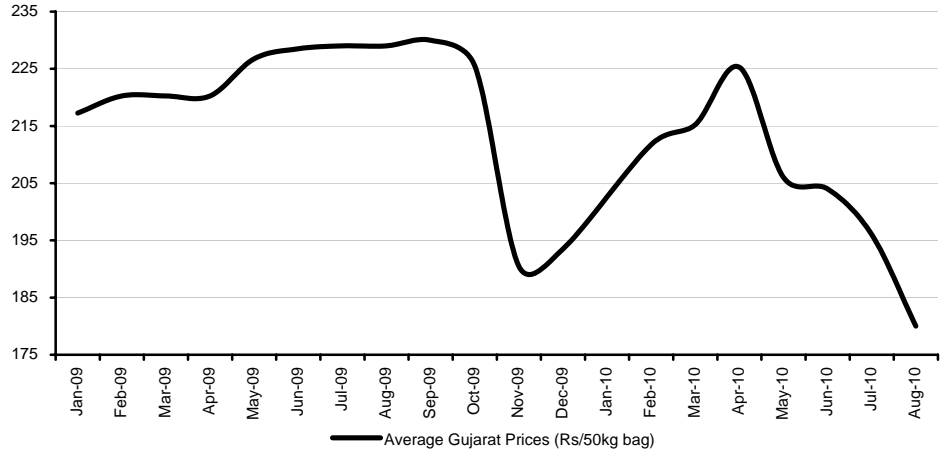
We retain our estimates and fine-tune our DCF model to adjust for the change in time value. We raise our invested capital growth assumption marginally (to 10.5%, vs 10% earlier), which raises our target price to Rs98.54 (from Rs93.34). We remain below consensus (1-16% lower for FY10-12), as we expect the demand-supply imbalance to continue for the next 4-6 quarters. ACEM trades at US\$144 EV/mt, a 30% premium to replacement cost. Reiterate Sell.

Important disclosures can be found in the Disclosures Appendix.

Price competition spreads beyond south India

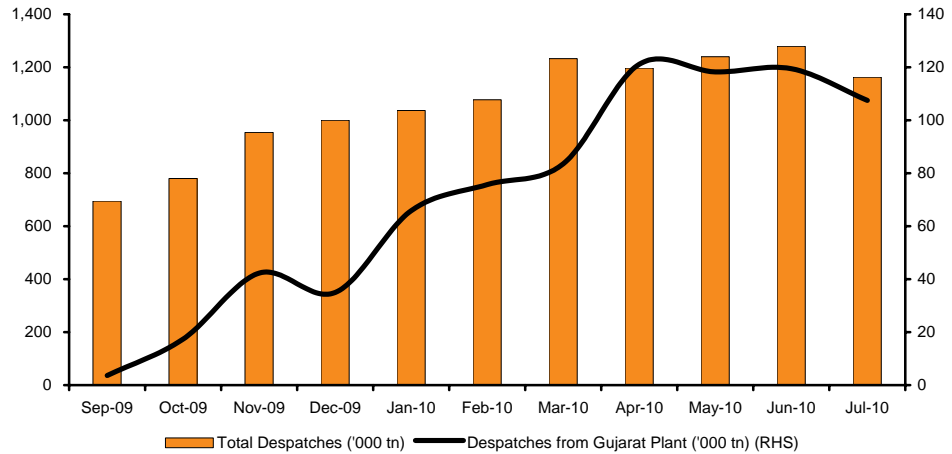
Prices have declined sharply in the western State of Gujarat, where top brands such as Ambuja and Ultratech are selling at Rs180/bag, while cheaper brands are selling at even lower prices, at Rs150-160/bag. This price decline has been induced by JP Associates' production ramp-up in Gujarat. With the cement industry operating at around 79% capacity utilisation, we expect price competition to spread to the markets in north India as well.

Chart 1 : Average cement prices in Gujarat



Source: Cement Manufacturer's Association (CMA)

Chart 2 : Jaiprakash Associates – total and Gujarat plant despatches



Source: CMA

Table 1 : Ambuja Cement – RBS estimates vs consensus

	Sales (Rs m)			EBITDA (Rs m)			PAT (Rs m)		
	FY10F	FY11F	FY12F	FY10F	FY11F	FY12F	FY10F	FY11F	FY12F
RBS	73,649	77,730	86,268	20,924	19,126	21,884	13,024	11,701	13,009
Bloomberg consensus	75,378	82,153	90,785	20,751	21,877	25,442	13,222	13,587	15,498
RBS vs consensus	-2%	-5%	-5%	1%	-13%	-14%	-1%	-14%	-16%

Source: Bloomberg, RBS estimates

Income statement

Rsm	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue	62348	70765	73649	77730	86268
Cost of sales	-6113	-9644	-5350	-5604	-5833
Operating costs	-38454	-42454	-47376	-53000	-58551
EBITDA	17781	18667	20924	19126	21884
DDA & Impairment (ex gw)	-2598	-2970	-4423	-4415	-4728
EBITA	15183	15697	16500	14712	17156
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	15183	15697	16500	14712	17156
Net interest	-320.6	-223.8	-195.6	-184.8	-194.5
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	1754	2558	2849	2680	2170
Reported PTP	16617	18031	19154	17207	19132
Taxation	-5676	-5849	-6129	-5506	-6122
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	3083	0.00	0.00	0.00	0.00
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	14024	12182	13024	11701	13009
Normalised Items Excl. GW	3083	0.00	0.00	0.00	0.00
Normalised net profit	10941	12182	13024	11701	13009

Source: Company data, RBS forecasts

year to Dec

Balance sheet

Rsm	FY08A	FY09A	FY10F	FY11F	FY12F
Cash & market secs (1)	8518	8807	10000	15000	9000
Other current assets	14876	10987	11526	12206	13413
Tangible fixed assets	51400	61545	56977	63562	76835
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	3324	7270	17270	12270	12270
Total assets	78118	88608	95773	103039	111518
Short term debt (2)	1887	0.00	0.00	0.00	0.00
Trade & oth current liab	14738	17411	16121	15014	14663
Long term debt (3)	2887	1657	892.3	1369	993.8
Oth non-current liab	3808	4858	4858	4858	4858
Total liabilities	21432	23926	21871	21241	20515
Total equity (incl min)	56686	64682	73902	81798	91002
Total liab & sh equity	78118	88608	95773	103039	111518
Net debt	-5632	-7150	-9108	-13631	-8006

Source: Company data, RBS forecasts

year ended Dec

Cash flow statement

Rsm	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA	17781	18667	20924	19126	21884
Change in working capital	-2484	4712	-1829	-1787	-1557
Net interest (pd) / rec	-506.6	-202.7	-195.6	-184.8	-194.5
Taxes paid	-5924	-3055	-6129	-5506	-6122
Other oper cash items	304.1	967.7	0.00	0.00	0.00
Cash flow from ops (1)	9171	21089	12769	11648	14010
Capex (2)	-16614	-13475	144.3	-11000	-18000
Disposals/(acquisitions)	199.1	114.4	0.00	0.00	0.00
Other investing cash flow	7109	1400	-7151	7680	2170
Cash flow from invest (3)	-9306	-11961	-7007	-3320	-15830
Incr / (decr) in equity	12.4	73.8	0.00	0.00	0.00
Incr / (decr) in debt	-326.9	-637.0	-764.7	476.5	-374.9
Ordinary dividend paid	-3902	-3900	-3352	-3352	-3352
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	-4.80	-0.30	-648.1	-637.3	-647.0
Cash flow from fin (5)	-4222	-4464	-4765	-3513	-4374
Forex & disc ops (6)	6450	-4375	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	2093	288.4	997.6	4815	-6194
Equity FCF (1+2+4)	-7444	7613	12914	648.2	-3990

Lines in bold can be derived from the immediately preceding lines.
Source: Company data, RBS forecasts

year to Dec

Standard ratios

	Ambuja Cements					ACC Ltd			India Cements		
Performance	FY08A	FY09A	FY10F	FY11F	FY12F	FY10F	FY11F	FY12F	FY10F	FY11F	FY12F
Sales growth (%)	10.7	13.5	4.08	5.54	11.0	3.87	6.14	13.0	9.35	14.4	6.77
EBITDA growth (%)	-13.1	4.98	12.1	-8.59	14.4	-12.2	-8.38	15.6	-10.9	17.4	-8.24
EBIT growth (%)	-16.1	3.38	5.12	-10.8	16.6	-17.6	-10.5	16.8	-18.1	8.27	-11.8
Normalised EPS growth (%)	-22.2	11.3	6.92	-10.2	11.2	-17.9	-12.3	14.7	-24.6	4.23	-11.2
EBITDA margin (%)	28.5	26.4	28.4	24.6	25.4	24.6	21.2	21.7	23.1	23.7	20.3
EBIT margin (%)	24.4	22.2	22.4	18.9	19.9	19.5	16.5	17.0	16.6	15.7	12.9
Net profit margin (%)	17.5	17.2	17.7	15.1	15.1	14.6	12.1	12.2	9.88	9.01	7.50
Return on avg assets (%)	15.5	14.8	14.3	11.9	12.2	12.9	10.8	11.1	6.15	6.07	5.16
Return on avg equity (%)	21.2	20.1	18.8	15.0	15.1	20.3	15.8	16.2	11.4	10.4	8.25
ROIC (%)	20.9	18.6	17.2	13.7	15.3	18.5	15.4	16.4	4.05	4.04	3.27
ROIC - WACC (%)	9.27	6.96	5.56	2.09	3.64	7.34	4.19	5.26	0.00	0.00	0.00
	year to Dec					year to Dec			year to Mar		
Valuation											
EV/sales (x)	3.04	2.60	2.32	2.14	2.06	1.85	1.73	1.54	1.48	1.28	1.17
EV/EBITDA (x)	10.7	9.85	8.16	8.69	8.13	7.55	8.15	7.09	6.41	5.41	5.76
EV/EBITDA @ tgt price (x)	7.45	6.79	5.43	5.71	5.52	5.97	6.43	5.60	8.22	6.95	7.44
EV/EBIT (x)	12.5	11.7	10.3	11.3	10.4	9.49	10.5	9.03	8.93	8.16	9.04
EV/invested capital (x)	3.46	2.95	2.45	2.28	2.02	2.51	2.27	2.00	0.95	0.87	0.82
Price/book value (x)	3.65	3.20	2.81	2.53	2.28	2.51	2.26	2.02	0.99	0.85	0.79
Equity FCF yield (%)	-3.59	3.67	6.23	0.31	-1.92	1.25	6.08	2.74	-4.56	-4.60	18.2
Normalised PE (x)	18.9	17.0	15.9	17.7	15.9	13.2	15.0	13.1	9.19	8.82	9.92
Norm PE @tgt price (x)	13.7	12.3	11.5	12.8	11.5	10.5	12.0	10.5	13.4	12.9	14.5
Dividend yield (%)	1.62	1.76	1.62	1.62	1.62	2.33	2.21	2.21	1.89	1.89	1.89
	year to Dec					year to Dec			year to Mar		
Per share data						Solvency					
Tot adj dil sh, ave (m)	1523	1524	1524	1524	1524	Net debt to equity (%)	-9.93	-11.1	-12.3	-16.7	-8.80
Reported EPS (INR)	9.21	8.00	8.55	7.68	8.54	Net debt to tot ass (%)	-7.21	-8.07	-9.51	-13.2	-7.18
Normalised EPS (INR)	7.19	8.00	8.55	7.68	8.54	Net debt to EBITDA	-0.32	-0.38	-0.44	-0.71	-0.37
Dividend per share (INR)	2.20	2.40	2.20	2.20	2.20	Current ratio (x)	1.59	1.14	1.34	1.81	1.53
Equity FCF per share (INR)	-4.89	5.00	8.48	0.43	-2.62	Operating CF int cov (x)	30.8	120.1	97.6	93.8	104.5
Book value per sh (INR)	37.2	42.5	48.5	53.7	59.7	Dividend cover (x)	3.27	3.33	3.89	3.49	3.88
	year to Dec					year to Dec					

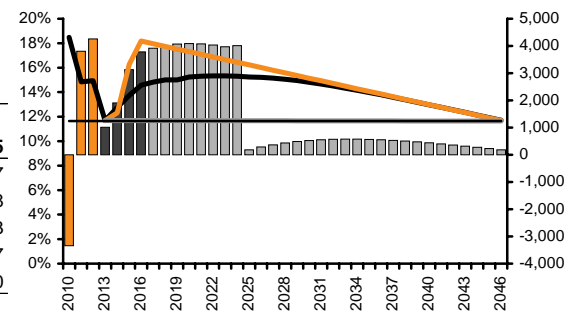
Priced as follows: ABUJ.BO - Rs136.05; ACC.BO - Rs902.95; ICMN.BO - Rs106.00
Source: Company data, RBS forecasts

Valuation methodology

Economic Profit Valuation			Discounted Cash Flow Valuation		
	Rs m	%		Rs m	%
Adjusted Opening Invested Capital	90869.8	61	Value of Phase 1: Explicit (2010 to 2012)	4715.2	8
NPV of Economic Profit During Explicit Period	2214.1	1	Value of Phase 2: Value Driver (2013 to 2016)	9823.0	17
NPV of Econ Profit of Remaining Business (1, 2)	284.0	0	Value of Phase 3: Fade (2017 to 2046.24)	41799.6	74
NPV of Econ Profit of Net Inv (Grth Business) (1, 3)	56664.1	38	Terminal Value	0.0	0
Enterprise Value	150032.1	100	Enterprise Value	56337.8	100
Plus: Other Assets	0.0	0	FCF Grth Rate at end of Phs 1 implied by DCF Valuation		8.5
Less: Minorities	0.0	0	FCF Grth Rate at end of Phs 1 implied by Current Price		1043.8
Less: Net Debt (as at 07 Sep 2010)	0.0	0			
Equity Value	150032.1	100			
No. Shares (millions)	1522.6				
Per Share Equity Value	98.54				
Current Share Price	136.05				

Sensitivity Table	No of Years in Fade Period				
	15	18	20	23	25
WACC 9.6%	115.35	127.65	136.54	150.97	161.37
WACC 10.6%	92.94	100.15	105.31	113.59	119.48
WACC 11.6%	75.86	79.75	82.55	87.04	90.23
WACC 12.6%	62.59	64.33	65.64	67.81	69.37
WACC 13.6%	52.10	52.45	52.83	53.59	54.20

Returns, WACC and NPV of Free Cash Flow



Performance Summary	2010	2011	2012	Phase 2 Avg (2013 - 2016)
Invested Capital Growth (%)	11.9	10.5	10.0	10.3
Operating Margin (%)	28.4	24.6	25.4	21.0
Capital Turnover (x)	0.9	0.9	0.9	0.8

Source: Company data, RBS forecasts

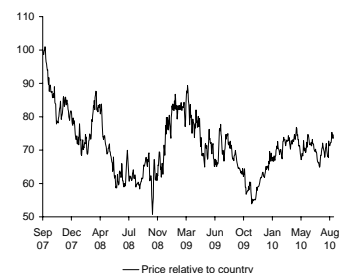
- In periods following the Explicit Period i.e. Phase 2 and Phase 3
- Remaining Business is defined as Capital as at the end of Phase 1 and capex = depreciation thereafter
- Net Investment is defined as capex over and above depreciation after Phase 1

Company description

Ambuja Cements is now fully controlled by global cement giant Holcim, which owns a 48% equity stake in the company. The company has a presence in western India, northern India and eastern India, but none in southern India. It has been among India's most efficiently run cement companies and a pioneer in cost-saver in transport, power and fuel. The company is in the process of raising its cement capacity to 27mmt by end 2010 by expanding in northern and eastern India.

Sell

Price relative to country



Strategic analysis

Average SWOT company score: 3

Sales volume split (FY09)

Strengths

ACEM has been one of most innovative cement companies in India in terms of managing logistics and production costs. Holcim's entry into Ambuja management should further improve this aspect of the company.

4

Weaknesses

ACEM has relatively lopsided exposure to India's northern and western markets, which makes its vulnerable to price fluctuations in these areas.

2

Opportunities

ACEM could look at strategic acquisitions in key markets to drive further growth, given its excellent track record in turning around acquired cement companies.

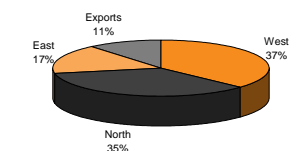
3

Threats

Any significant slowdown in the export market could impact pricing in the state of Gujarat, as a major portion of the surplus in that state is exported.

2

Scoring range is 1-5 (high score is good)



Source: Company data

Market data

Headquarters

P.O Ambuja Nagar, Taluka Kodinar, Dist. Junagadh, Gujarat-362715

Website

www.gujaratambuja.com

Shares in issue

1522.4m

Freefloat

65%

Majority shareholders

FIIS (32%), Holcim (23%), Founder Promoters (8%)

Country view: India

The macro picture for India has been constructive recently, with GDP and industrial production tracking in line with expectations, while portfolio allocators continue to favour the market for its domestic consumption orientation. However, these positives have already been priced in and we believe risks are rising from the increasing double deficit, demanding valuations and tightening liquidity.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Country rel to Asia Pacific



Competitive position

Average competitive score: 3-

Broker recommendations

Supplier power

ACEM's scale of operations means it can swing better terms of trade with suppliers of raw materials and with freight operators.

3-

Barriers to entry

Cement is a commodity business with no entry barriers. ACEM has strong brand equity in the retail market, which helps it make a higher proportion of its sales to this lucrative market.

3-

Customer power

ACEM's strong brand equity in the retail market allows it to command a price premium of 3-4% for its cement compared with smaller players.

3-

Substitute products

There is no substitute for cement in civil construction. There exist threats from imports in coastal locations like Gujarat and Maharashtra, but is limited given India's port infrastructure.

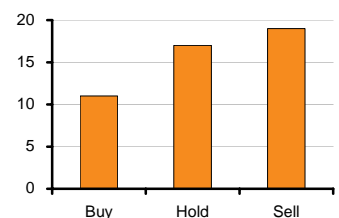
3-

Rivalry

The top end of the Indian cement industry is well consolidated with five players accounting for 60%, but there are 40+ small players that could lead to price competition in many markets.

3-

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg

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