

Strong near-term, but highly vulnerable

Bank of America 
Merrill Lynch

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Strong YoY volume growth helped 3Q CY11 results

ACC's 3Q CY11 EBITDA grew 44% YoY backed by strong volume growth. The Co's 18% volume growth in 3Q CY11 compares with ~6% growth for the industry, and mostly reflects ACC's market share gains in south India. EBITDA margin in 3Q CY11 was up ~100bps YoY adjusting for non-recurring employee payout during the quarter. Margin performance was below consensus and our expectations due to higher than expected energy and overhead costs.

Cement prices up again in October; pain seems postponed

Our feedback from dealers indicates that current cement prices are up ~10% vs 4Q CY10 and up 6% MoM for ACC. We see the industry's rational pricing behaviour as a short-term postponement of pain given steep overcapacity & downside risk to demand expectations. Price sustainability appears most challenging in south India given JPA's large expansion.

CY12E profit cut; coal cost may rise; volume growth to ease

Post 3Q results, we have cut CY12 EBITDA forecast by ~9% while CY11 EBITDA stays largely unchanged (+2%). ACC sources nearly 40% of its coal requirement from e-auctions. Continued ring-fencing of e-auction coal for the power sector is likely to exert upward pressure on energy costs for ACC. On the volume front, ACC's strong outperformance vs the industry should ease in CY12E as the Co's large capacity expansions are already factored into recent market share gains.

Maintain underperform as risk-reward seems unfavorable

ACC is trading at an EV/capacity of ~US\$134/ton i.e. ~10% premium to replacement cost. Upside potential appears capped at ~US\$150/ton assuming rational pricing sustains while downside could be steeper at ~US\$95/ton if demand recovery fails to materialize or rational industry behavior falls apart.

Estimates (Dec)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	15,640	10,130	11,148	9,753	11,687
EPS	83.28	53.94	59.36	51.93	62.23
EPS Change (YoY)	48.0%	-35.2%	10.0%	-12.5%	19.8%
Dividend / Share	23.00	30.50	23.00	23.00	27.56
Free Cash Flow / Share	45.78	62.81	31.38	81.55	96.97

Valuation (Dec)

	2009A	2010A	2011E	2012E	2013E
P/E	14.22x	21.95x	19.95x	22.80x	19.03x
Dividend Yield	1.94%	2.58%	1.94%	1.94%	2.33%
EV / EBITDA*	8.44x	13.50x	11.39x	12.81x	11.51x
Free Cash Flow Yield*	3.86%	5.30%	2.65%	6.88%	8.18%

* For full definitions of *iQmethod*SM measures, see page 7.

Stock Data

Price	Rs1,184
Price Objective	Rs900.00
Date Established	28-Jul-2011
Investment Opinion	C-3-7
Volatility Risk	HIGH
52-Week Range	Rs915.48-Rs1,237
Mkt Val / Shares Out (mn)	US\$4,517 / 187.9
Market Value (mn)	Rs222,556
Average Daily Volume	323,416
BofAML Ticker / Exchange	ADCLF / BSE
Bloomberg / Reuters	ACC IN / ACC.BO
ROE (2011E)	16.9%
Net Dbt to Eqty (Dec-2010A)	-30.0%
Est. 5-Yr EPS / DPS Growth	10.0% / 10.0%
Free Float	49.7%

Key Changes

(Rs)	Previous	Current
2011E EPS	57.08	59.36
2012E EPS	60.24	51.93
2013E EPS	72.66	62.23
2011E EBITDA (m)	17,868.0	18,246.5
2012E EBITDA (m)	17,764.2	16,230.8
2013E EBITDA (m)	19,981.7	18,056.9

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Refer to important disclosures on page 8 to 10. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5. Link to Definitions on page 5. 11104549

iQprofileSM Associated Cement Companies

Key Income Statement Data (Dec)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Sales	84,796	82,588	99,079	106,058	119,911
Gross Profit	24,624	15,405	18,246	16,231	18,057
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	20,892	11,127	13,195	10,605	12,249
Net Interest & Other Income	1,583	2,382	2,682	3,278	4,397
Associates	NA	NA	NA	NA	NA
Pretax Income	22,476	13,509	15,876	13,883	16,646
Tax (expense) / Benefit	(6,868)	(3,414)	(4,763)	(4,165)	(4,994)
Net Income (Adjusted)	15,640	10,130	11,148	9,753	11,687
Average Fully Diluted Shares Outstanding	188	188	188	188	188

Key Cash Flow Statement Data

Net Income	15,640	10,130	11,148	9,753	11,687
Depreciation & Amortization	3,731	4,277	5,052	5,626	5,808
Change in Working Capital	5,590	5,004	(9,542)	868	1,730
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	1	0	1,345	1,222	1,193
Cash Flow from Operations	24,962	19,412	8,004	17,469	20,418
Capital Expenditure	(16,372)	(7,626)	(2,115)	(2,167)	(2,222)
(Acquisition) / Disposal of Investments	(5)	(365)	0	0	0
Other Cash Inflow / (Outflow)	(5)	813	0	0	0
Cash Flow from Investing	(16,383)	(7,178)	(2,115)	(2,167)	(2,222)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(5,051)	(6,709)	(5,060)	(5,060)	(6,063)
Cash Flow from Financing	(4,202)	(7,139)	(5,142)	(5,060)	(6,063)
Free Cash Flow	8,590	11,786	5,889	15,301	18,196
Net Debt	(13,330)	(18,854)	(19,684)	(29,926)	(42,060)
Change in Net Debt	(3,528)	(5,524)	(829)	(10,242)	(12,133)

Key Balance Sheet Data

Property, Plant & Equipment	65,359	68,708	65,771	62,312	58,726
Other Non-Current Assets	466	830	830	830	830
Trade Receivables	2,739	2,494	2,993	3,203	3,622
Cash & Equivalents	18,999	24,094	24,841	35,083	47,217
Other Current Assets	13,018	14,281	17,138	18,342	20,741
Total Assets	100,582	110,407	111,573	119,771	131,137
Long-Term Debt	5,669	5,240	5,157	5,157	5,157
Other Non-Current Liabilities	3,546	3,668	5,014	6,236	7,429
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	32,653	38,674	32,489	34,770	39,320
Total Liabilities	41,868	47,582	42,659	46,164	51,906
Total Equity	58,714	62,825	68,914	73,607	79,232
Total Equity & Liabilities	100,582	110,407	111,573	119,771	131,137

iQmethodSM - Bus Performance*

Return On Capital Employed	25.1%	14.5%	15.0%	12.1%	13.5%
Return On Equity	29.3%	16.7%	16.9%	13.7%	15.3%
Operating Margin	24.6%	13.5%	13.3%	10.0%	10.2%
EBITDA Margin	29.0%	18.7%	18.4%	15.3%	15.1%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.6x	1.9x	0.7x	1.8x	1.7x
Asset Replacement Ratio	4.4x	1.8x	0.4x	0.4x	0.4x
Tax Rate (Reported)	30.6%	25.3%	30.0%	30.0%	30.0%
Net Debt-to-Equity Ratio	-22.7%	-30.0%	-28.6%	-40.7%	-53.1%
Interest Cover	8.6x	3.7x	3.8x	2.6x	2.3x

Key Metrics

* For full definitions of iQmethodSM measures, see page 7.

Company Description

ACC is one of India's largest cement producers, with cement capacity of about 30mtpa by Dec '11. The company has a nationwide presence with plants located across all major regions of India. Holcim, a global cement major, is the controlling shareholder of ACC.

Investment Thesis

Our Underperform rating on ACC reflects 1) forecast weak outlook for cement prices in CY12 and 2) potential downside to CY12 volumes if demand recovery fails to materialise and 3) unfavorable risk-reward on stock valuations.

Stock Data

Price to Book Value 3.2x

Table 1: 3Q CY11 results summary

Yr to 31 Dec	Jul - Sep '10	Apr-Jun '11	Jul - Sep '11*	YoY chng	QoQ chng
Cement sales (mn tons)	4.8	5.9	5.7	18%	-4%
Rs mn					
Net Turnover	17,592	25,390	22,834	30%	-10%
Operating costs	15,941	19,915	20,455	28%	3%
EBDIT	1,651	5,475	2,379	44%	-57%
<i>EBDIT margin</i>	9.4%	21.6%	10.4%		
Depreciation	1,002	1,247	1,289	29%	3%
Operating profit	649	4,228	1,091	68%	-74%
Other income	690	597	953	38%	60%
EBIT	1,339	4,825	2,044	53%	-58%
Interest	164	271	253	54%	-7%
Profit before tax	1,175	4,554.3	1,790.4	52%	-61%
Provision for Tax	437	1,478	638	46%	-57%
Share of Earnings of Associates	(3)	28.8	23.3		
Recurring net profit	735	3,105	1,176	60%	-62%
Non-recurring inc/(exp)	128	176	417		
Reported net profit	863	3,281	1,593	85%	-51%

Source: Company

* Adjusted for one-time costs & prior period writebacks

Table 2: Industry supply demand scenario

As on 31 March (mn tpa)	FY09	FY10	FY11	FY12E	FY13E
Reported cement capacity	216	256	300	330	353
Effective cement capacity	202	234	274	310	330
Effective clinker capacity	167	197	236	271	289
Capacity growth	20%	18%	20%	15%	7%
Cement demand	181	200	209	217	237
Demand growth	8.0%	10.3%	4.7%	4.0%	9.0%
Domestic consumption	178	197	207	215	235
Growth in domestic consumption	8%	11%	5%	4%	9%
Cement exports	3.2	2.2	2.0	2.0	2.0
Export growth	-12%	-31%	-9%	0%	0%
Cement - capacity utilization	90%	85%	76%	70%	72%
Cement/clinker ratio	1.37	1.36	1.37	1.37	1.37
Blended cement as % of total production	75%	75%	75%	75%	75%
Clinker - capacity utilisation (incl. exports)	81%	76%	66%	59%	61%
Clinker - capacity utilisation (excl. exports)	79%	74%	65%	59%	60%

Source: BofA Merrill Lynch Global Research estimates

Table 3: Valuation comparison of Indian cement majors

	Share Price	Market Cap (US\$ mn)	BofAML Rating
ACC	1186	4562	C-3-7/UNDERPERFORM
Grasim	2479	4667	C-2-7/NEUTRAL
Ambuja Cements	155	4828	C-3-7/UNDERPERFORM
Ultratech Cement	1,152	6483	C-3-7/UNDERPERFORM
Shree Cement	1929	1380	C-2-7/NEUTRAL
India Cements	79	498	C-3-7/UNDERPERFORM
BSE30	17481		
Yr to 31 March/Dec	2010/FY11	2011E/FY12E	2012E/FY13E
EV/Capacity (US\$/ton)			
ACC	179	138	134
Grasim-Cement business	68	79	77
Ambuja Cements	179	164	150
Ultratech Cement	137	139	139
Shree Cement	94	98	90
India Cements	57	59	57
Replacement cost benchmark-India (US\$/ton)	120-125	120-125	120-125
RoE (%)			
ACC	17	17	14
Grasim	17	17	13
Ambuja Cements	18	16	17
Ultratech Cement	20	19	13
Shree Cement	10	8	9
India Cements	1	6	6
Local Market RoE	19	18	18
P/E (x)			
ACC	22.0	20.0	22.8
Grasim	10.0	8.4	9.8
Ambuja Cements	19.1	19.0	16.4
Ultratech Cement	20.3	14.2	18.8
Shree Cement	33.7	39.2	33.4
India Cements	51.6	9.8	10.0
Local Market PE	18.0	15.5	13.6
EV/EBITDA (x)			
ACC	13.4	11.2	12.2
Grasim - Cement business	5.5	5.0	6.0
Ambuja Cements	12.0	10.6	9.1
Ultratech Cement	10.6	8.5	10.5
Shree Cement	7.8	7.3	6.1
India Cements	11.2	6.6	6.3
Local Market EV/EBITDA	10.1	9.0	7.9

Source: BofA Merrill Lynch Global Research estimates

Price objective basis & risk

Assoc. Cement (ADCLF)

We have a price objective of Rs900/sh for ACC. We value the company at CY12E EV/capacity of around US\$95-100/ton based on a 20-25% discount to the industry's current replacement cost of US\$120-125/ton. Trough discount vs replacement cost was steeper at 40-45% in the previous cycle but structurally improved RoEs and significantly healthier balance sheets may warrant lower discount in current cycle. The 20-25% discount is in line with the average (rather than trough) discount witnessed through the previous downturn (1997-2002). Upside risks to our outlook stem from 1) renewed rational pricing behaviour by cement producers across the industry, 2) sharp easing in energy prices and 3) stronger than expected demand recovery. Downside risks stem from further demand weakness and unforeseen rise in energy prices.

Link to Definitions

Industrials

Click [here](#) for definitions of commonly used terms.

Analyst Certification

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India - General Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Aditya Birla Nu	ADYAF	ABNL IN	Reena Verma Bhasin, CFA
	Anant Raj Industries Ltd	XNRJF	ARCP IN	Gagan Agarwal
	Brigade Enterprises	XBDGF	BRGD IN	Gagan Agarwal
	Chambal Fertilisers & Chemicals	CHBZF	CHMB IN	Prasad Deshmukh
	DLF Limited	XVDUF	DLFU IN	Abhishek Kiran Gupta
	Exide Indus Ltd	XEDRF	EXID IN	Sanjaya Satapathy
	Havells	HVLIF	HAVL IN	Sanjaya Satapathy
	Indiabulls Real Estate Ltd	IBELF	IBREL IN	Abhishek Kiran Gupta
	Motherson Sumi	XMSUF	MSS IN	Sanjaya Satapathy
	Oberoi Realty Ltd	XRXOF	OBER IN	Abhishek Kiran Gupta
	Opto Circuits	OPOCF	OPTC IN	Sanjaya Satapathy
	Renuka Sugars	SRNKF	SHRS IN	Sanjaya Satapathy
	SINTEX INDUSTRIES LTD	SIXDF	SINT IN	Prasad Deshmukh
NEUTRAL				
	Coromandel International Ltd	CMDFF	CRIN IN	Prasad Deshmukh
	Grasim	GRSJF	GRASIM IN	Reena Verma Bhasin, CFA
	Grasim -G	GRSJY	GRAS LX	Reena Verma Bhasin, CFA
	Jain Irrigation Systems Ltd	JNIDF	JI IN	Prasad Deshmukh
	Shree Cements	SREEF	SRCM IN	Reena Verma Bhasin, CFA
	Unitech Ltd	UTKIF	UT IN	Abhishek Kiran Gupta
UNDERPERFORM				
	Ambuja Cements	AMBUF	ACEM IN	Reena Verma Bhasin, CFA
	Assoc. Cement	ADCLF	ACC IN	Reena Verma Bhasin, CFA
	Bajaj Hindusthan	BJJHF	BJH IN	Sanjaya Satapathy
	Bairampur Chini	BMPRF	BRCM IN	Sanjaya Satapathy
	Container Corp	CIDFF	CCRI IN	Sanjaya Satapathy
	Cummins India	CUIDF	KKC IN	Sanjaya Satapathy
	Housing Development and Infrastructure	XGHSF	HDIL IN	Gagan Agarwal
	India Cements	INIAF	ICEM IN	Reena Verma Bhasin, CFA
	India Cements -G	IAMUY	ICEM LX	Reena Verma Bhasin, CFA
	Jaypee Infratech	XJAYF	JPIN IN	Gagan Agarwal
	Jet Airways	JTAIF	JETIN IN	Anand Kumar
	Jindal Saw	SWPFF	JSAW IN	Sanjaya Satapathy
	Omaxe Limited	XOMXF	OAXE IN	Gagan Agarwal
	Puravankara Projects Ltd	XPJVF	PVKP IN	Gagan Agarwal
	Sobha Developers	SBDRF	SOBHA IN	Gagan Agarwal
	SpiceJet Ltd	MDLFF	SJET IN	Anand Kumar
	Tata Chemicals Ltd	TTCXF	TTCH IN	Prasad Deshmukh
	UltraTech Cemen	XDJNF	UTCEM IN	Reena Verma Bhasin, CFA
	Voltas	VTSJF	VOLT IN	Sanjaya Satapathy
	Welspun Corp Ltd	XUQRF	WLCO IN	Sanjaya Satapathy
RSTR				
	Nagarjuna Fertilizers & Chemicals Ltd	NFACF	NFCL IN	Prasad Deshmukh
RVW				
	Fortis Healthcare Limited	XFFTf	FORH IN	Prasad Deshmukh

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

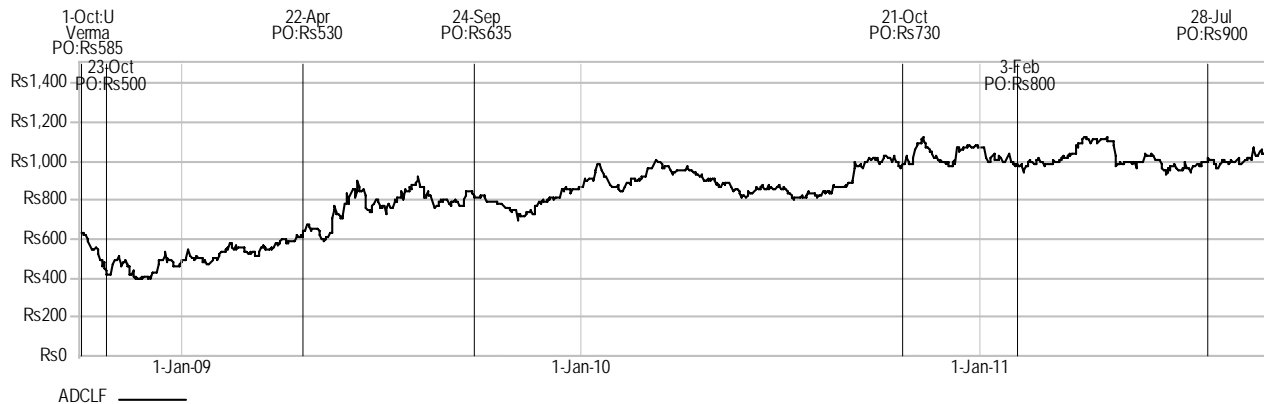
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ADCLF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [September 30, 2011] or such later date as indicated.

Investment Rating Distribution: Building Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	61	60.40%	Buy	15	26.32%
Neutral	21	20.79%	Neutral	9	47.37%
Sell	19	18.81%	Sell	5	27.78%

Investment Rating Distribution: Global Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2073	54.13%	Buy	923	49.12%
Neutral	961	25.09%	Neutral	460	52.57%
Sell	796	20.78%	Sell	287	38.32%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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