Ambuja Cements (ABUJ.BO)

3Q11: Better Pricing, But Downside Risk

- **3Q11 PAT exceeds estimates** — Ambuja Cements' 3Q adjusted PAT rose 26% yoy to Rs1.9bn, higher than our estimate of Rs1.2bn on better pricing and higher other income (sale of power). EBITDA margin (excl other income) at 17.3% was lower yoy (vs 18.1%) and also qoq (vs 26.8%). EBITDA/t was Rs664 (+2% yoy) vs. Rs1,100 in 2Q11. Net sales rose 15% yoy to Rs18.1bn mainly on account of an 8% increase in volumes and 7% increase in realizations yoy.
- **Volumes, prices rise** — Ambuja reported lower volume growth of 8% (to 4.7mt) relative to ACC at 18% but higher than UltraTech (2%). Ambuja's average realization rose 7% yoy to Rs3,850/t but fell 6% on a qoq basis. While 4Q11 margins (Oct-Dec11) are likely to benefit from better pricing (cement producers have raised prices in the past few weeks), we believe there is downside pricing risk.
- **Costs: a concern** — Ambuja did better than expected on the cost front with raw materials and power/fuel costs rising 3-4% (per tonne). It has been substituting purchased clinker with its own production at its two new 2.2mt clinker plants and has saved substantially on purchased clinker. Freight costs, however, rose 13% yoy (per tonne). Ambuja's EBITDA/t during the quarter at Rs664 was much better vs ACC (Rs387) and slightly higher than UltraTech at Rs628. We believe raw material, power/fuel and freight costs will be pressure points for Ambuja and hurt margins.
- **Expansion update** — The clinker and cement grinding units set up in 1H10 have led to Ambuja's cement capacity expanding to 25mtpa. The grinding unit at Bhatapara (1.1mt) was commissioned during 3Q. Additional grinding units at Bhatapara and Maratha will help take capacity to 27m tpa by 2011.
- **Maintain Sell** — We believe there is downside risk to cement prices on the back of capacity additions, India's sluggish demand (+3.4% in Apr-Aug11) and fragmented long tail of smaller producers. Ambuja looks expensive at US$166/t vs other cement majors.

Figure 1. Ambuja Cements – Statistical Abstract

YE 31 Dec	Revenue (Rs m)	Net Profit (Rs m)	EBITDA (Rs m)	EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)	EV/tonne (US$)
CY08	62,347	11,828	17,779	7.8	-16%	20.1	11.7	221
CY09	70,769	12,184	18,669	8.0	3%	19.5	10.5	216
CY10	73,902	12,434	18,236	8.2	2%	19.1	10.4	184
CY11E	82,246	11,423	18,528	7.5	-8%	20.8	10.1	169
CY12E	90,820	11,925	18,842	7.8	4%	19.9	9.7	166
CY13E	100,007	12,449	19,363	8.2	4%	19.1	9.1	161

Source: Citi Investment Research and Analysis estimates. Price as on 1 Nov 2011. Rs/US$ at 47.

■ Company Update

Sell	3
Price (02 Nov 11)	Rs155.90
Target price	Rs117.00
Expected share price return	-25.0%
Expected dividend yield	1.6%
Expected total return	**-23.3%**
Market Cap	Rs238,936M
	US$4,849M

Price Performance
(RIC: ABUJ.BO, BB: ACEM IN)

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Fiscal year end 31-Dec	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	19.5	19.1	20.8	19.9	19.1
EV/EBITDA adjusted (x)	10.9	11.0	10.5	10.2	9.6
P/BV (x)	3.7	3.2	3.0	2.7	2.5
Dividend yield (%)	1.5	1.7	1.7	1.6	1.6
Per Share Data (Rs)					
EPS adjusted	8.00	8.17	7.50	7.83	8.18
EPS reported	8.00	8.17	7.50	7.83	8.18
BVPS	42.49	48.15	52.61	57.50	62.74
DPS	2.40	2.60	2.60	2.50	2.50
Profit & Loss (RsM)					
Net sales	70,769	73,902	82,246	90,820	100,007
Operating expenses	-52,511	-57,062	-65,317	-73,714	-82,173
EBIT	**18,257**	**16,840**	**16,929**	**17,106**	**17,834**
Net interest expense	-224	-487	-595	-530	-530
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**18,033**	**16,353**	**16,334**	**16,576**	**17,304**
Tax	-5,849	-3,919	-4,910	-4,651	-4,855
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**12,184**	**12,434**	**11,423**	**11,925**	**12,449**
Adjusted earnings	12,184	12,434	11,423	11,925	12,449
Adjusted EBITDA	21,227	20,712	21,387	21,740	22,531
Growth Rates (%)					
Sales	13.5	4.4	11.3	10.4	10.1
EBIT adjusted	7.8	-7.8	0.5	1.0	4.3
EBITDA adjusted	8.7	-2.4	3.3	1.6	3.6
EPS adjusted	3.0	2.1	-8.1	4.4	4.4
Cash Flow (RsM)					
Operating cash flow	**21,292**	**18,743**	**6,527**	**13,123**	**14,653**
Depreciation/amortization	2,970	3,872	4,459	4,634	4,697
Net working capital	4,459	-219	-2,432	-1,234	-28
Investing cash flow	**-16,337**	**-5,332**	**-2,633**	**-3,102**	**-3,832**
Capital expenditure	-12,844	-7,710	-6,120	-6,000	-7,000
Acquisitions/disposals	-3,946	1,662	627	0	0
Financing cash flow	**-4,667**	**-4,735**	**-3,093**	**-5,161**	**-5,005**
Borrowings	-1,230	-1,007	0	0	0
Dividends paid	-3,919	-4,267	-2,498	-4,631	-4,475
Change in cash	**288**	**8,675**	**801**	**4,860**	**5,816**
Balance Sheet (RsM)					
Total assets	**88,608**	**103,197**	**107,656**	**116,823**	**126,747**
Cash & cash equivalent	8,807	17,482	18,283	23,142	28,958
Accounts receivable	1,522	1,282	2,019	2,737	3,014
Net fixed assets	61,545	65,585	67,246	68,611	70,914
Total liabilities	**23,926**	**29,901**	**27,567**	**29,285**	**31,234**
Accounts payable	9,223	11,063	11,214	12,722	14,298
Total Debt	1,657	650	650	650	650
Shareholders' funds	**64,682**	**73,296**	**80,089**	**87,538**	**95,512**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	30.0	28.0	26.0	23.9	22.5
ROE adjusted	20.1	18.0	14.9	14.2	13.6
ROIC adjusted	21.2	20.3	17.7	17.5	17.6
Net debt to equity	-11.1	-23.0	-22.0	-25.7	-29.6
Total debt to capital	2.5	0.9	0.8	0.7	0.7

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Figure 2. Ambuja Cements — 3Q results

(Rs m)	3Q11	3Q10	% chg	2Q11	% chg qoq
Net sales	18,051	15,640	15%	21,733	-17%
Total expenditure	14,936	12,809	17%	15,906	-6%
EBITDA	**3,115**	**2,832**	**10%**	**5,826**	**-47%**
EBITDA per tonne	**664**	**649**	**2%**	**1,101**	**-40%**
EBITDA margin (%)	**17.3%**	**18.1%**		**26.8%**	
Other income	857	495	73%	720	19%
Interest	138	89	54%	152	-9%
Depreciation	1,079	1,018	6%	1,074	0%
PBT	2,755	2,220	24%	5,320	-48%
Tax	834	699	19%	1,845	-55%
Effective tax rate (%)	30.3%	31.5%		34.7%	
Adjusted PAT	**1,921**	**1,521**	**26%**	**3,475**	**-45%**
Cement sales (mt)	4.69	4.36	8%	5.41	-13%
Net realization (Rs/tonne)	3,849	3,587	7%	4,108	-6%

Source: Company

Ambuja Cements

Company description

Ambuja Cements (ACL) is one of India's lowest-cost cement producers with relatively much higher EBITDA margins due to its focus on the retail cement market (giving higher realizations), modern plants with low power and fuel consumption, and use of sea transport. In recent times its EBITDA margins and EBITDA/tonne are only slightly higher or in line with its peers due to their continuing focus on reducing costs and Ambuja's reliance on imported coal (~30% of its requirements). Its capacity is currently 27m tpa and it is going ahead with plans to set up 2.2mtpa of clinker capacity in Rajasthan. Its largest markets are North India (40% of sales volumes) and West India (40%). East India accounts for 20% of its volumes. Holcim holds around 50% in ACL. Adding on the capacity of ACC gave the Holcim Group a total capacity of 57m tpa in India and a significant presence in several key markets.

Investment strategy

We rate ACL Sell with a target price of Rs117. This is based on expected pricing pressures due to the current industry oversupply and as the stock looks relatively expensive at an EV/t of US$156/t. Prices have recovered lost ground by 9-27% since Jul11 largely on the back of production cutbacks and despite sluggish demand trends. We expect EBITDA margins to decline yoy during CY11-13 largely due to sluggish price trends. ACL benefits from its captive power capacity of ~410MW which meets 80% of its power requirements. We expect domestic cement prices to rise 8.5% in CY11, and 1% in CY12 and 2% in CY13. We expect volumes to grow 4% in CY11, 9% in CY12 and 8% in CY13. Maintain Sell on relatively expensive valuations, expected price correction, and cost pressures.

Valuation

We use EV/tonne to value ACL, a common metric used to value cement companies. We set our target price at Rs117, in line with current trends in replacement cost of US$120/t. We value ACL in line with replacement costs (as against a discount used earlier) as long term demand growth is expected to be robust and new capacity creation is slowing down. Our target price of Rs117 equates to a Sep12 EV/EBITDA valuation of 7.0x and a PE of 15.2x.

Risks

Key upside risks to our target price include: (1) Continued price strength; (2) Delays in industry capacity; and (3) Better-than-expected domestic demand growth.

Appendix A-1

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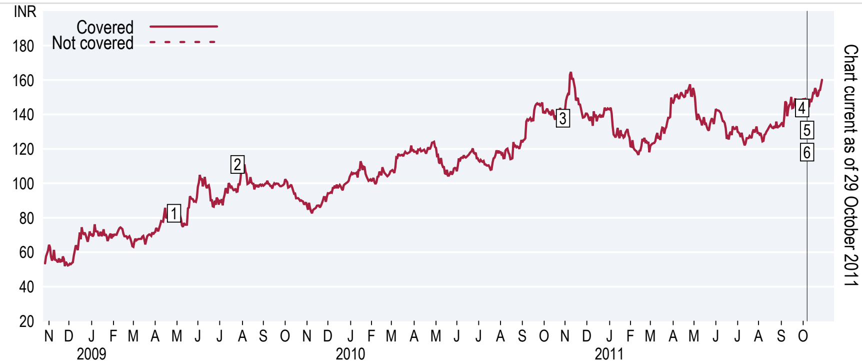
Ambuja Cements (ABUJ.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Pradeep Mahtani



	Date	Rating	Target Price	Closing Price
1	28-Apr-09	3M	*70.00	80.85
2	27-Jul-09	3M	*71.00	95.25
3	28-Oct-10	*3L	*108.00	140.95
4	30-Sep-11	3L	*117.00	148.60
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*3	117.00	145.15

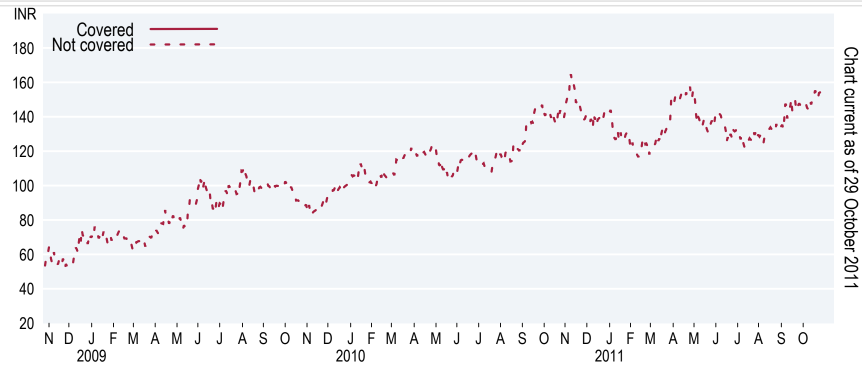
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Ambuja Cements (ABUJ.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Pradeep Mahtani



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