# ACC

| BSE Sensex | S&P CNX |
|---|---|
| 28,797 | 8,867 |

**CMP: INR1,653 TP: INR1,833 (+11%) Neutral**

## Attractive valuations could be illusory

**Profitability to lag industry leaders; prefer to wait and watch**

- **ACC is perceived as the most sensitive large cap Cement stock to play price recovery, with high scope for margin expansion. The stock currently trades at a 42% discount to peers in terms of EV/ton (FY18E), making it appear attractively valued.**
- **While we are reasonably confident of an impending upturn in the industry, we do not expect sharp margin improvement for ACC. Its profitability is unlikely to catch up with peers, given its inefficient operations.**
- **Capacity constraints in growing markets would result in sustained market share loss.**
- **We retain our Neutral rating and our target price for now.**

### Profitability unlikely to catch up with peers

ACC's profitability has lagged peers' since the last peak cycle in CY08, when it was almost at par with them. Its EBITDA/ton is now at 24-43% below its peers', despite higher profitability from southern operations, which contribute ~15% of its volumes. This is largely because of its relatively high cost of production in an era of tepid cement prices. While rising prices would result in profitability improvement, it would be limited due to higher proportion of inefficient operations, which is not likely to change in the near term. When it would be able to realize the synergy benefits from the restructuring of ACC-Ambuja is uncertain. Also, the returns generated from the recently-commissioned Jamul capacity depend on how effectively ACC uses its excess clinker. If it does not put up its own grinding unit to process the excess clinker, the pre-tax RoCE from the Jamul project could be sub-7%. We are reasonably confident of an impending upturn in the industry, but we see ACC's profitability gap with more efficient peers persisting.

### Market share loss to continue

ACC has been consistently losing market share. Over CY11-15, its market share has declined 180bp, as it is capacity constrained in key markets like the North and the West. Utilizations for its North and West operations are 85% and 80%, respectively, and it has not added any capacity in these regions in the last 5-6 years, leaving limited scope for raising production. While it has spare capacity in the South, where its plants are running at 50-55% utilization, and it is adding capacity in the East, we believe this does not give ACC the ability to arrest the decline in its market share.

### Valuation gap to persist; maintain Neutral

With new growth avenues (Jamul plant) and improving industry dynamics, we expect ACC to deliver a better 2HCY16. However, medium-term concerns on cost structure and efficient utilization of excess clinker from its new plant in Jamul remain. Even in an upturn, ACC's operating margins would lag industry due to its inefficient operations. Its capacity constraints would result in sustained market share loss. The stock currently trades at a 42% discount to peers in terms of EV/ton (FY18E). We believe the valuation gap with its more efficient peers would persist. We retain our **Neutral** rating for now.

### Stock Info

| | |
|---|---|
| Bloomberg | ACC IN |
| Equity Shares (m) | 188.0 |
| 52-Week Range (INR) | 1,738/1,173 |
| 1, 6, 12 Rel. Per (%) | -4/20/11 |
| M.Cap. (INR b) | 310.8 |
| M.Cap. (USD b) | 4.7 |
| Avg Val, INR m | 395 |
| Free float (%) | 49.7 |

### Financial Snapshot (INR b)

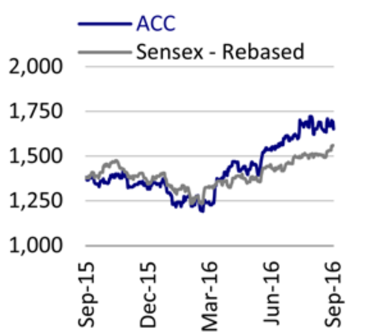
| Y/E Dec | 2015 | 2016E | 2017E |
|---|---|---|---|
| Sales | 114.3 | 116.9 | 137.2 |
| EBITDA | 11.7 | 15.6 | 24.3 |
| NP | 6.0 | 8.7 | 15.5 |
| Adj. EPS (INR) | 32.0 | 46.4 | 82.2 |
| EPS Gr. (%) | -30.3 | 45.2 | 77.2 |
| BV/Sh (INR) | 449.3 | 465.6 | 493.6 |
| RoE (%) | 7.2 | 10.1 | 17.1 |
| RoCE (%) | 7.4 | 10.2 | 16.7 |
| P/E (x) | 51.7 | 35.6 | 20.1 |
| P/BV (x) | 3.7 | 3.6 | 3.3 |

### Shareholding pattern (%)

| As on | Jun-16 | Mar-16 | Jun-15 |
|---|---|---|---|
| Promoter | 50.3 | 50.3 | 50.3 |
| DII | 17.9 | 18.5 | 16.7 |
| FII | 15.7 | 14.8 | 14.4 |
| Others | 16.1 | 16.3 | 18.7 |

Note: FII includes depository receipts

### Relative to Index

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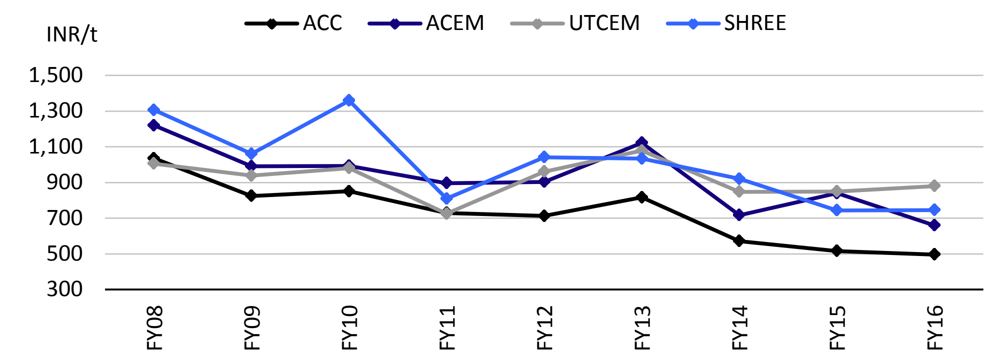
## Profitability unlikely to catch up with peers

ACC's profitability has lagged peers' since the last peak cycle in CY08, when it was almost at par with them. Among the reasons for this are (a) old inefficient plants, (b) lack of efforts to modernize / adopt newer methods of production, and (c) recent implementation of higher safety standards by the Holcim group. ACC's EBITDA/ton is now 24-43% below its peers', despite higher profitability from southern operations, which contribute ~15% of its volumes.

**Exhibit 1: ACC's EBITDA/ton has lagged peers**




Source: MOSL, Company

While we are reasonably confident of an impending upturn in the industry, we believe ACC's profitability is unlikely to catch up with peers given that leaders have already started investing in the next phase of cost reduction initiatives: (1) waste heat recovery systems, (2) higher transportation by sea . Among the other reasons for profitability gap are:

- **Higher proportion of inefficient assets**

~50% of ACC's capacity is over 30 years old and one of its units in Bargarh has weaker profitability due to technical issues. Also, some of its plants have not undergone any modernization for over a decade. Relative to its peers, whose plants are newer, ACC is an inefficient cement producer.

**Exhibit 2: ACC's capacities and year of commission**

| Plant | State | Capacity (MT) | % of total capacity | Remarks |
|---|---|---|---|---|
| Lakheri | RAJ | 1.5 | 4.6 | 1916(oldest) |
| Chaibasa | JHK | 0.9 | 2.7 | 1947(modernization in FY05) |
| Kymore | MP | 2.2 | 6.8 | Pre 1980 |
| Madukkarai | TN | 1.0 | 2.9 | Pre 1990 |
| Sindri | JHK | 0.9 | 2.8 | Pre1960 |
| Chanda | MAH | 4.0 | 12.3 | 1969 |
| Jamul-I | CTG | 1.6 | 4.9 | 1965 |
| Khudithini/THDBH | KAR | 2.6 | 7.9 | 2010 |
| Gagal | HP | 2.0 | 6.1 | 1984-Phase-I |
| Gagal | HP | 2.4 | 7.4 | 1984-Phase-I |
| Damodhar | WB | 1.0 | 3.2 | Post 1990 |
| Tikaria | UP | 2.3 | 7.1 | 0.6mtpa in 1998 |
| Wadi | KAR | 5.8 | 17.2 | 1982(1MT kiln) 2.6mtpa in 2001 |
| Bargarh | Orissa | 2.2 | 6.6 | Up gradation required |
| Jamul-II | CTG | 2.5 | 7.5 | Recently commissioned |
| Total - ACC | | 32.8 | 100 | |

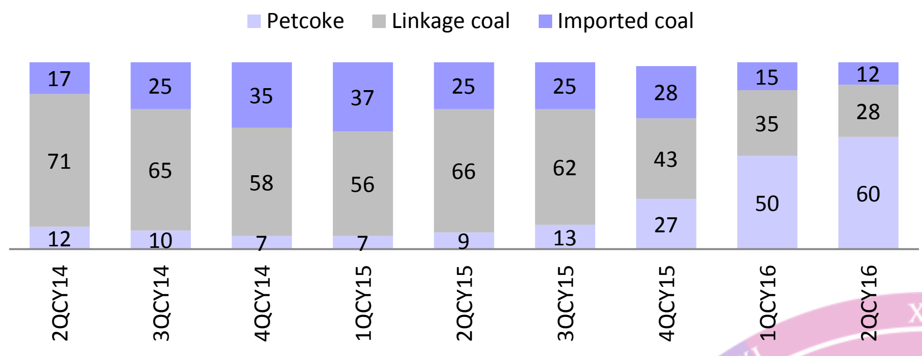
Source: Company, MOSL

- **Lack of efforts to modernize / adopt newer methods of production**

ACC did not shift to low cost pet coke for a sustained period of time. Until 3QCY15, pet coke constituted less than 10% in its fuel mix. It is only in 2QCY16, that the share of pet coke in its fuel mix has increased to ~60%, in line with industry consumption norms.

ACC has had the advantage of low cost linkage coal, which constitutes ~28% of its fuel mix (as at the end of 2QCY16). This advantage would soon cease to exist – most of its fuel supply agreements (FSAs) are due for renewal in CY17. The absence of low cost linkage coal could impact its EBITDA by INR1.5b-1.7b (INR80/ton).

**Exhibit 3: Fuel mix (%)**



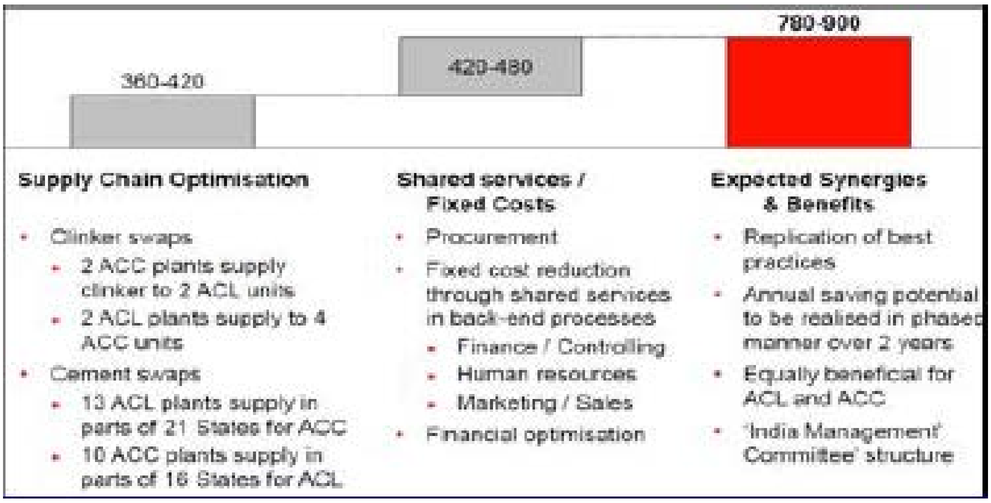

Source: Company, MOSL

ACC's freight and logistics costs are at elevated, as it has lower proportion of split grinding units (~11% of total capacity). Split units enable production of cement closer to consumption centers, thus reducing the overall distance over which cement is transported.

- **Implementation of synergy benefits a tough proposition**

The management had announced synergy benefits of INR9b during the restructuring of ACC and Ambuja in July 2013. Yet, it has not made much progress on this front. We understand that less than INR1b of synergies have actually been realized thus far. In addition, decisions like shifting production to the more efficient entity may be put off until the eventual merger of the two entities. This is because of the differential impact of such decisions on the minority shareholders of the individual companies.

**Exhibit 4: Potential benefits from ACC-Ambuja restructuring (INR cr)**




Source: MOSL, Company

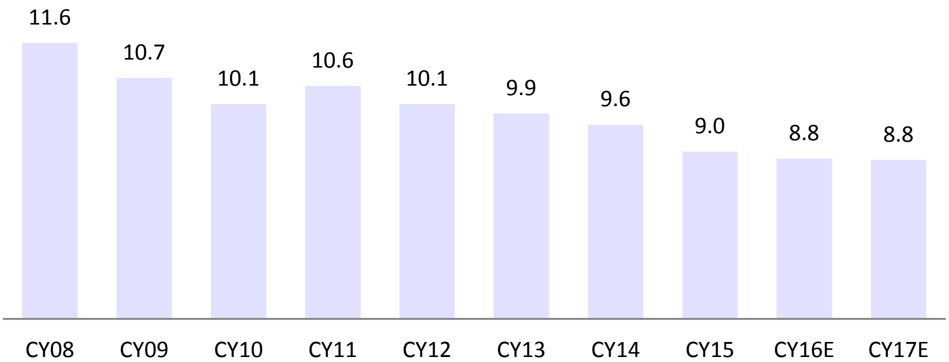
- **Implementation of global standards to keep costs elevated**

The implementation of global operating standards by promoter group, Holcim in the last 12-18 months for a localized business like cement production will continue to reduce ACC's competitiveness relative to other more-efficient domestic players.

## Market share loss to continue

ACC has been consistently losing market share. Over CY11-15, its market share has declined 180bp, as it is capacity constrained in key markets like the North and the West. Utilizations for its North and West operations are 85% and 80%, respectively, and it has not added any capacity in these regions in the last 5-6 years, leaving limited scope for raising production. While it has spare capacity in the South, where its plants are running at 50-55% utilization and it is adding capacity in the East, we believe this does not give ACC the ability to arrest the decline in its market share.

**Exhibit 5: Losing market share (%)**

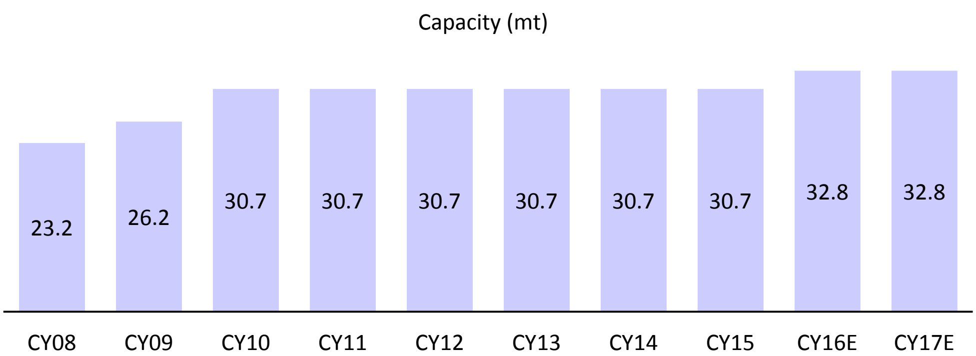



Source: Company, MOSL

- **Capacity constraints remain**

ACC's loss in market share is on account of capacity constraints. It has recently commissioned clinker capacity of 2.79m tons at Jamul and associated grinding units of 2.45m tons in Jamul and Sindri, which would result in some uptick in volume growth in CY17. However, this does not give ACC the ability to arrest the decline in its market share.

**Exhibit 6: Annual capacity build-up**




Source: Company, MOSL

## Valuation gap to persist; maintain Neutral

ACC's profitability was most impacted over CY11-15, when industry dynamics were not favorable. Net profit declined at a compounded annual rate of 15%. We expect improvement in profits over CY15-17, led by better pricing, leading to 740bp margin expansion. However, margins would be still be inferior to efficient players. ACC would continue to trade at discount. The stock trades at an EV of 18.6x CY16E and 11.6x CY17E EBITDA, and at USD131/ton. We believe the upside is limited. We maintain **Neutral**, with a target price of INR1,833 (EV of 13.5x CY17E EBITDA).

- **Decision on excess clinker in Jamul to be decisive for returns**

ACC has recently commissioned clinker capacity of 2.79m tons, with associated grinding capacity of 2.45m tons at Jamul and Sindri. The decision to put up another grinding unit to utilize excess clinker would be critical in generating healthy return ratios from the Jamul expansion. Our calculations suggest that if ACC does not put up its own grinding unit to process the excess clinker, the pre-tax RoCE from the project could be sub-7%.

**Exhibit 7: RoCE on Jamul project**

| Plant | Unit | Capacity |
|---|---|---|
| Jamul | mt | 2.79 |
| Jamul (Grinding unit) | mt | 1.35 |
| Sindri ( Grinding unit) | mt | 1.1 |
| Total cement capacity | mt | 2.45 |
| Post stabilization utilization of GU's | % | 85% |
| Expected EBITDA/t | INR/t | 1000 |
| Estimated EBITDA | INR m | 2082 |
| Total Capex | INR m | 18000 |
| Depreciation | INR m | 900 |
| EBIT | INR m | 1182 |
| Pre Tax ROCE | % | 6.6% |

Source: MOSL, Company

# Financials and Valuations

**Income Statement** (INR Million)

| Y/E December | CY11 | CY12 | CY13 | CY14 | CY15 | CY16E | CY17E |
|---|---|---|---|---|---|---|---|
| **Net Sales** | **94,296** | **111,305** | **109,084** | **114,811** | **114,328** | **116,927** | **137,206** |
| Change (%) | 22.2 | 18.0 | -2.0 | 5.2 | -0.4 | 2.3 | 17.3 |
| Total Expenditure | 77,396 | 91,624 | 95,402 | 102,310 | 102,597 | 101,323 | 112,947 |
| **EBITDA** | **16,901** | **19,681** | **13,683** | **12,501** | **11,731** | **15,605** | **24,259** |
| Change (%) | 8.8 | 16.4 | -30.5 | -8.6 | -6.2 | 33.0 | 55.5 |
| Margin (%) | 17.9 | 17.7 | 12.5 | 10.9 | 10.3 | 13.3 | 17.7 |
| Depreciation | -4,753 | -5,589 | -5,740 | -5,576 | -6,521 | -6,407 | -7,674 |
| Int. and Fin. Charges | -969 | -1,147 | -517 | -828 | -673 | -750 | -700 |
| Other Income - Rec. | 4,226 | 4,923 | 4,573 | 4,561 | 3,437 | 3,500 | 5,000 |
| **PBT Before EO Item** | **15,404** | **17,869** | **12,000** | **10,658** | **7,974** | **11,948** | **20,885** |
| EO Income/(Expense) | 2,280 | -3,354 | 2,437 | 3,786 | -123 | 0 | 0 |
| **PBT After EO Item** | **17,684** | **14,515** | **14,437** | **14,444** | **7,852** | **11,948** | **20,885** |
| Tax | 4,431 | 3,903 | 3,479 | 2,761 | 1,936 | 3,226 | 5,430 |
| Tax Rate (%) | 25.1 | 26.9 | 24.1 | 19.1 | 24.7 | 27.0 | 26.0 |
| **Reported PAT** | **13,253** | **10,612** | **10,958** | **11,683** | **5,916** | **8,722** | **15,455** |
| **Adjusted PAT** | **11,544** | **12,918** | **9,108** | **8,621** | **6,008** | **8,722** | **15,455** |
| Change (%) | 13.9 | 11.9 | -29.5 | -5.3 | -30.3 | 45.2 | 77.2 |
| Margin (%) | 12.2 | 11.6 | 8.3 | 7.5 | 5.3 | 7.5 | 11.3 |

**Balance Sheet** (INR Million)

| Y/E December | CY11 | CY12 | CY13 | CY14 | CY15 | CY16E | CY17E |
|---|---|---|---|---|---|---|---|
| Share Capital | 1,879 | 1,880 | 1,880 | 1,880 | 1,880 | 1,880 | 1,880 |
| Reserves | 70,043 | 71,949 | 76,369 | 80,477 | 82,551 | 85,611 | 90,874 |
| **Net Worth** | **71,923** | **73,828** | **78,248** | **82,356** | **84,430** | **87,490** | **92,754** |
| Loans | 5,061 | 850 | 0 | 0 | 355 | 355 | 355 |
| Deferred Tax Liability | 5,184 | 5,169 | 5,073 | 5,356 | 4,692 | 4,871 | 5,184 |
| **Capital Employed** | **82,167** | **79,848** | **83,321** | **87,712** | **89,477** | **92,716** | **98,293** |
| | | | | | | | |
| Gross Block | 95,757 | 101,600 | 103,996 | 109,507 | 123,603 | 140,603 | 143,603 |
| Less: Accum. Depn. | 34,378 | 42,961 | 48,956 | 53,523 | 60,044 | 66,451 | 74,124 |
| **Net Fixed Assets** | **61,378** | **58,639** | **55,040** | **55,984** | **63,559** | **74,152** | **69,479** |
| Capital WIP | 4,353 | 3,113 | 8,196 | 19,146 | 13,000 | 3,000 | 4,000 |
| Investments | 16,250 | 25,536 | 21,940 | 15,730 | 14,757 | 12,410 | 19,854 |
| | | | | | | | |
| **Curr. Assets, Loans&Adv.** | **37,912** | **31,975** | **35,760** | **35,853** | **37,092** | **40,634** | **45,558** |
| Inventory | 10,995 | 11,336 | 11,215 | 12,556 | 11,886 | 11,836 | 13,513 |
| Account Receivables | 1,877 | 3,035 | 3,972 | 4,107 | 4,844 | 4,633 | 5,061 |
| Cash and Bank Balance | 16,526 | 6,784 | 5,034 | 3,043 | 916 | 5,446 | 6,390 |
| Others | 8,513 | 10,821 | 15,539 | 16,147 | 19,446 | 18,719 | 20,594 |
| | | | | | | | |
| **Curr. Liab. and Prov.** | **37,726** | **39,415** | **37,615** | **39,002** | **38,931** | **37,481** | **40,598** |
| Account Payables | 22,273 | 21,763 | 21,849 | 24,469 | 31,339 | 25,628 | 28,193 |
| Other Liabilities | 3,723 | 3,811 | 4,068 | 4,000 | 0 | 4,165 | 4,887 |
| Provisions | 11,730 | 13,841 | 11,698 | 10,532 | 7,592 | 7,688 | 7,518 |
| **Net Current Assets** | **186** | **-7,440** | **-1,855** | **-3,148** | **-1,839** | **3,154** | **4,960** |
| | | | | | | | |
| **Application of Funds** | **82,167** | **79,848** | **83,321** | **87,712** | **89,477** | **92,716** | **98,293** |

E: MOSL Estimates

## Financials and Valuations

**Ratios**

| Y/E December | CY11 | CY12 | CY13 | CY14 | CY15 | CY16E | CY17E |
|---|---|---|---|---|---|---|---|
| **Basic (INR)** | | | | | | | |
| **EPS** | **61.4** | **68.7** | **48.5** | **45.9** | **32.0** | **46.4** | **82.2** |
| Cash EPS | 86.7 | 98.5 | 79.0 | 75.5 | 66.7 | 80.5 | 123.1 |
| BV/Share | 382.7 | 392.9 | 416.4 | 438.2 | 449.3 | 465.6 | 493.6 |
| DPS | 28.0 | 30.0 | 30.0 | 34.0 | 17.0 | 25.0 | 45.0 |
| Payout (%) | 46.0 | 61.8 | 60.2 | 63.6 | 65.1 | 64.9 | 65.9 |
| **Valuation (x)** | | | | | | | |
| P/E | | | | 36.0 | 51.7 | 35.6 | 20.1 |
| Cash P/E | | | | 21.9 | 24.8 | 20.5 | 13.4 |
| EV/Sales | | | | 2.4 | 2.5 | 2.5 | 2.0 |
| EV/EBITDA | | | | 21.8 | 24.1 | 18.6 | 11.6 |
| P/BV | | | | 3.8 | 3.7 | 3.6 | 3.3 |
| Dividend Yield | | | | 2.1 | 1.0 | 1.5 | 2.7 |
| EV/ton (USD-Cap) | | | | 133 | 138 | 131 | 127 |
| **Return Ratios (%)** | | | | | | | |
| RoE | 16.9 | 17.7 | 12.0 | 10.7 | 7.2 | 10.1 | 17.1 |
| RoCE | 15.8 | 17.2 | 11.6 | 10.9 | 7.4 | 10.2 | 16.7 |
| RoIC | 24.2 | 23.0 | 13.0 | 11.4 | 7.1 | 10.1 | 17.5 |
| **Working Capital Ratios** | | | | | | | |
| Debtor (Days) | 7 | 10 | 13 | 13 | 15 | 14 | 13 |
| Asset Turnover (x) | 0.9 | 0.7 | 1 | 1 | 0.8 | 0.8 | 0.7 |
| **Leverage Ratio** | | | | | | | |
| Debt/Equity (x) | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

* EPS numbers are annualized.

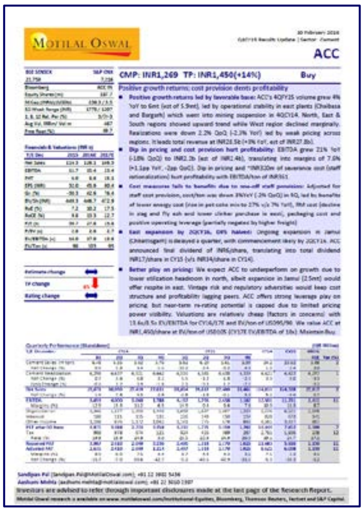
**Cash Flow Statement** (INR Million)

| Y/E December | CY11 | CY12 | CY13 | CY14 | CY15 | CY16E | CY17E |
|---|---|---|---|---|---|---|---|
| OP/(Loss) before Tax | 16,901 | 19,681 | 13,683 | 12,501 | 11,731 | 15,605 | 24,259 |
| Interest/Dividends Recd. | 4,226 | 4,923 | 4,573 | 4,561 | 3,437 | 3,500 | 5,000 |
| Direct Taxes Paid | -2,863 | -3,917 | -3,576 | -2,478 | -2,600 | -3,047 | -5,117 |
| (Inc)/Dec in WC | -4,391 | -2,116 | -7,335 | -697 | -3,436 | -463 | -862 |
| **CF from Operations** | **13,872** | **18,570** | **7,345** | **13,886** | **9,133** | **15,595** | **23,280** |
| EO Income/(Expense) | 2,280 | -3,354 | 2,437 | 3,786 | -123 | 0 | 0 |
| **CF from Op. incl EO Exp.** | **16,152** | **15,217** | **9,782** | **17,672** | **9,010** | **15,595** | **23,280** |
| (inc)/dec in FA | -4,032 | -1,609 | -7,224 | -17,470 | -7,950 | -7,000 | -4,000 |
| **Free Cash Flow** | **9,840** | **16,962** | **121** | **-3,584** | **1,183** | **8,595** | **19,280** |
| (Pur)/Sale of Investments | 777 | -9,286 | 3,595 | 6,210 | 973 | 2,347 | -7,444 |
| **CF from Investments** | **-3,255** | **-10,895** | **-3,628** | **-11,260** | **-6,977** | **-4,653** | **-11,444** |
| Issue of Shares | 70 | -2,153 | 60 | -148 | 9 | 0 | 0 |
| (Inc)/Dec in Debt | -177 | -4,211 | -850 | 0 | 355 | 0 | 0 |
| Interest Paid | -969 | -1,147 | -517 | -828 | -673 | -750 | -700 |
| Dividend Paid | -6,095 | -6,553 | -6,597 | -7,427 | -3,850 | -5,662 | -10,192 |
| **CF from Fin. Activity** | **-7,171** | **-14,064** | **-7,904** | **-8,403** | **-4,160** | **-6,412** | **-10,892** |
| **Inc/Dec of Cash** | **5,725** | **-9,742** | **-1,750** | **-1,991** | **-2,127** | **4,530** | **944** |
| Add: Beginning Balance | 10,800 | 16,526 | 6,784 | 5,034 | 3,043 | 916 | 5,446 |
| **Closing Balance** | **16,526** | **6,784** | **5,034** | **3,043** | **916** | **5,446** | **6,390** |

E: MOSL Estimates

## Our recent reports on ACC



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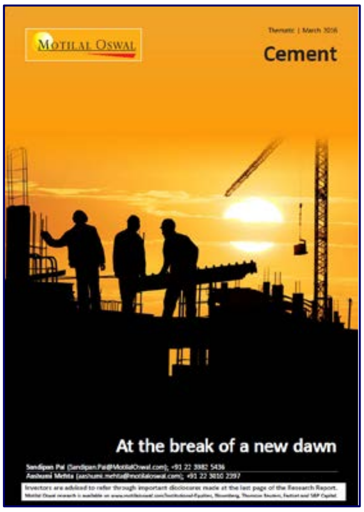


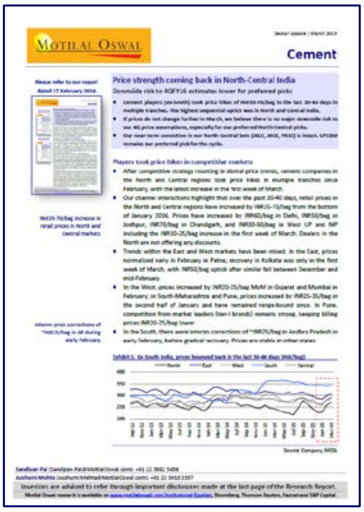


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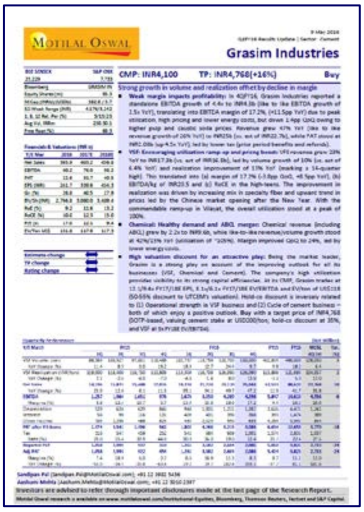


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