

3 August 2019

## Star Cement

*Weak volumes; capex to drive growth; retaining a Buy*Rating: **Buy**

Target Price: ₹132

Share Price: ₹95

Better realisations continue to drive Star Cement's performance, though profitability suffered from lower volumes and higher costs. Its continuous efforts on cost rationalisation, government subsidies, uplift of the ban on coal mining and better demand outlook would bolster its performance. Despite capex for coming expansions, the company would still hold to a net cash position in FY21. We are upbeat about its prospects and retain our Buy rating, with a lower target of ₹132.

**Lower volumes.** Cement revenue declined 6.2% y/y mainly on a decline in volumes to 0.73m tons (10% y/y) on lower clinker sales. However, it was set off with 4.2% y/y increase in gross realisations to ₹8,312. Demand in its key north-eastern market was subdued due to government expenditure contracting though it is likely to revive in coming quarters. The premium pricing in the north-east and the company's high, ~82%, share in retail markets would further aid realisations and boost performance. We expect a 13% revenue CAGR over FY19-21 shored up by capex at Siligudi (2m tons).

**Operating performance to improve.** In Q1 FY20, EBITDA/ton declined 5.5% y/y, to ₹1,542, but increased 2.1% q/q, chiefly on higher fuel costs (~₹100/ton). The lifting of the ban on coal mining would reduce pressure on fuel costs, with benefits in coming quarters. Ahead, various measures (to optimise costs and rationalise freight) to counter the impact of the ceased transport subsidy would lead to a better operational performance. We expect an FY21 EBITDA/ton of ₹1,685.

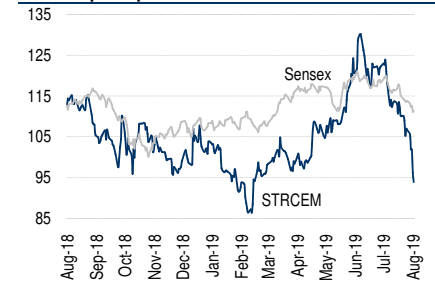
**Outlook, Valuation.** Despite the planned capex, subsidies would lead to a net-debt-to-equity of ~-0.1x in FY21. The company estimates FY20 capex of ₹3.5bn. The Siligudi plant is expected to be commissioned by Q3 FY20, and de-bottlenecking has been pushed forward to the next shutdown. We expect an 8% PAT CAGR over FY19-21. With demand to pick up in coming quarters, likely stable realisations and cost-savings measures, we believe, operational performance will improve. We retain our Buy rating, with a target price of ₹132 (9x FY21e EV/EBITDA). **Risk:** Rising operational costs.

Key data	STRCEM IN
52-week high / low	₹140 / 80
Sensex / Nifty	37118 / 10997
3-m average volume	\$0.3m
Market cap	₹39bn / \$566.2m
Shares outstanding	419m

Shareholding pattern (%)	Jun-19	Mar-19	Dec'18
Promoters	67.9	68.0	68.9
- of which, Pledged	-	0.2	0.1
Free float	32.1	32.0	31.1
- Foreign institutions	1.2	1.2	1.2
- Domestic institutions	8.7	8.7	8.7
- Public	22.1	22.1	21.2

Estimates revision (%)	FY20e	FY21e
Sales	(0.7)	(1.8)
EBITDA	(5.5)	(5.9)
PAT	(7.8)	(8.1)

### Relative price performance



Source: Bloomberg

Key Financials (YE Mar)	FY17	FY18	FY19	FY20e	FY21e
Sales (₹m)	15,215	16,064	18,310	20,145	23,408
Net profit (₹m)	1,947	3,307	2,988	2,930	3,471
EPS (₹)	4.6	7.9	7.1	7.0	8.3
PE (x)	30.2	14.7	13.3	13.6	11.5
EV / EBITDA (x)	16.6	10.2	8.5	7.2	6.3
EV / ton (\$)	268.7	212.1	154.2	95.7	95.3
RoE (%)	19.2	25.6	19.1	16.3	16.8
RoCE (%)	15.1	21.7	18.1	16.0	16.6
Dividend yield (%)	-	0.9	1.1	1.1	1.3
Net debt / equity (x)	0.6	0.3	-0.1	-0.2	-0.1

Source: Company, Anand Rathi Research

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## Quick Glance – Financials and Valuations

**Fig 1 – Income statement (₹m)**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Sales volumes (m tons)	2.7	2.4	2.7	3.1	3.4
Net revenues	15,215	16,064	18,310	20,145	23,408
Growth (%)	-11.0	5.6	14.0	10.0	16.2
Direct costs	3,403	3,025	4,367	3,325	3,879
SG&A	7,792	7,907	9,451	11,778	13,765
<b>EBITDA</b>	<b>4,021</b>	<b>5,132</b>	<b>4,492</b>	<b>5,043</b>	<b>5,764</b>
EBITDA margins (%)	26.4	31.9	24.5	25.0	24.6
- Depreciation	1,179	1,207	1,056	1,250	1,300
Other income	87	125	55	32	32
Interest expenses	781	525	144	75	70
PBT	2,148	3,526	3,346	3,750	4,426
Effective tax rates (%)	6.47	4.65	8.86	20.00	20.00
+ Associates / (Minorities)	62	55	62	70	70
Net income	1,947	3,307	2,988	2,930	3,471
Adjusted income	1,947	3,307	2,988	2,930	3,471
WANS	419	419	419	419	419
FDEPS (₹/ sh)	4.6	7.9	7.1	7.0	8.3
FDEPS growth (%)	44.7	69.8	-9.6	-1.9	18.5

**Fig 3 – Cash-flow statement (₹m)**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
PBT	2,148	3,526	3,346	3,750	4,426
+ Non-cash items	1,179	1,207	1,056	1,250	1,300
Oper. prof. before WC	3,327	4,733	4,403	5,000	5,726
- Incr./ (decr.) in WC	898	91	-626	-2,486	948
Others incl. taxes	418	733	296	750	885
Operating cash-flow	2,011	3,909	4,733	6,736	3,893
- Capex (tang. +intang.)	679	231	818	4,500	3,100
Free cash-flow	1,332	3,678	3,915	2,236	793
Acquisitions					
- Div. (incl. buyback & taxes)	-	505	551	542	639
+ Equity raised	-	0	-0	-	-
+ Debt raised	-1,383	-3,683	-3,811	-	-
- Fin investments	0	-0	3	-3	-
- Misc. (CFI + CFF)	-6	-506	-2,365	-	-
Net cash-flow	-44	-3	1,915	1,697	154

Source: Company, AnandRathi Research

**Fig 5 – Price movement**


Source: Bloomberg

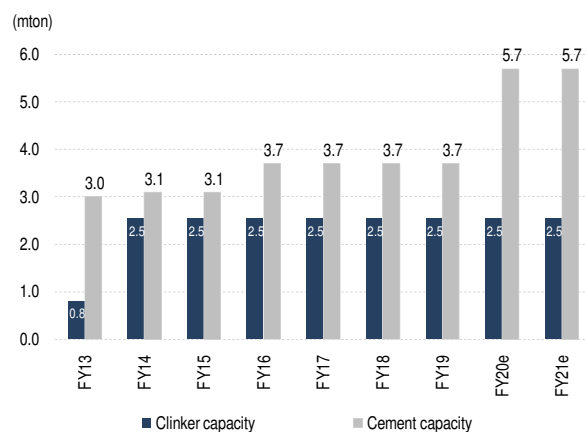
**Fig 2 – Balance sheet (₹ m)**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Share capital	419	419	419	419	419
Net worth	11,460	14,764	17,237	19,625	22,456
Debt	8,007	4,324	513	513	513
Minority interest	566	621	683	753	823
DTL/(Assets)	-1,765	-2,329	-	-	-
<b>Capital employed</b>	<b>18,268</b>	<b>17,380</b>	<b>18,433</b>	<b>20,891</b>	<b>23,792</b>
Net tangible assets	8,631	7,845	7,221	10,212	10,012
Net intangible assets	2	2	2	2	2
Goodwill	-	-	-	-	-
CWIP (tang. &intang.)	549	357	743	1,000	3,000
Investments (strategic)	15	14	17	17	17
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	13,641	14,311	12,872	11,425	13,275
Cash	201	198	2,113	3,810	3,964
Current liabilities	4,769	5,348	4,536	5,574	6,477
Working capital	8,872	8,963	8,336	5,850	6,798
<b>Capital deployed</b>	<b>18,268</b>	<b>17,380</b>	<b>18,433</b>	<b>20,891</b>	<b>23,793</b>
Contingent liabilities	566	545	-	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
P/E (x)	30.2	14.7	13.3	13.6	11.5
EV / EBITDA (x)	16.6	10.2	8.5	7.2	6.3
EV / Sales (x)	4.4	3.3	2.1	1.8	1.6
P/B (x)	5.1	3.3	2.3	2.0	1.8
RoE (%)	19.2	25.6	19.1	16.3	16.8
RoCE (%) - after tax	15.1	21.7	18.1	16.0	16.6
DPS (₹ / sh)	-	1.0	1.1	1.1	1.3
Dividend payout (%) - incl. DDT	-	15.3	18.4	18.5	18.4
Net debt / equity (x)	0.6	0.3	-0.1	-0.2	-0.15
WC days	202	203	172	129	99
EV / ton (\$)	268.7	212.1	154.2	95.7	95.3
NSR / ton (₹)	7,235	7,681	7,979	8,100	8,250
EBITDA / ton (₹)	1,467	1,970	1,572	1,647	1,685
Volumes (m tons)	2.7	2.4	2.7	3.1	3.4
CFO : PAT (%)	103.3	118.2	158.4	229.9	112.2

Source: Company, AnandRathi Research

**Fig 6 – Cement (incl. hired) and clinker capacity**


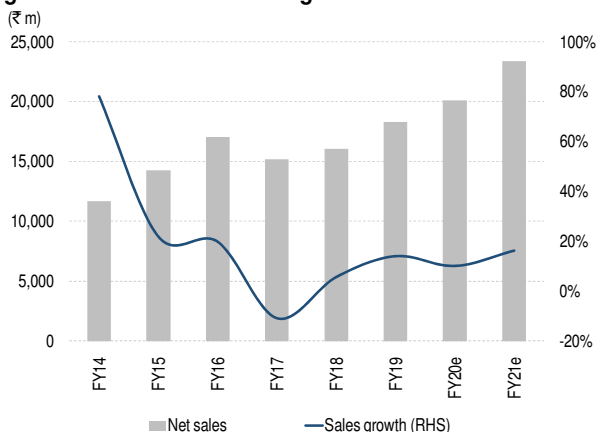
Source: Company

## Other key highlights

### Revenue growth

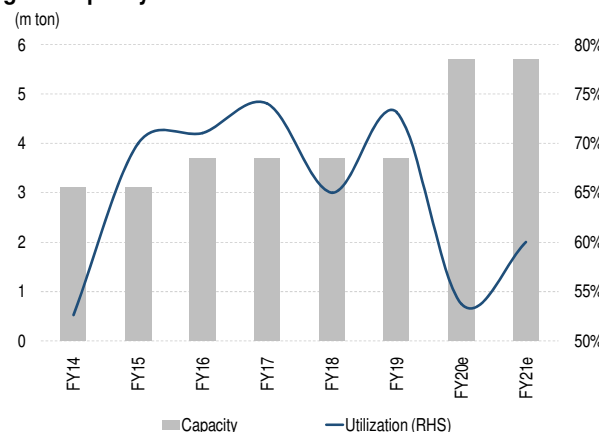
Cement revenue declined 6.2% y/y and overall revenue, 11% y/y to ₹4.61bn due to higher inter-segment sales. The slowdown in demand due to the elections led to a 10% drop in cement volumes to 0.73m tons. Favourable pricing in the north-east led to gross realisations increasing 4.2% y/y to ₹8,312 a ton, thus contributing to revenue. We expect a 13% CAGR in revenue over FY19-21.

Fig 7 – Revenue and Revenue growth



Source: Company, Anand Rathi Research

Fig 8 – Capacity and Utilisation

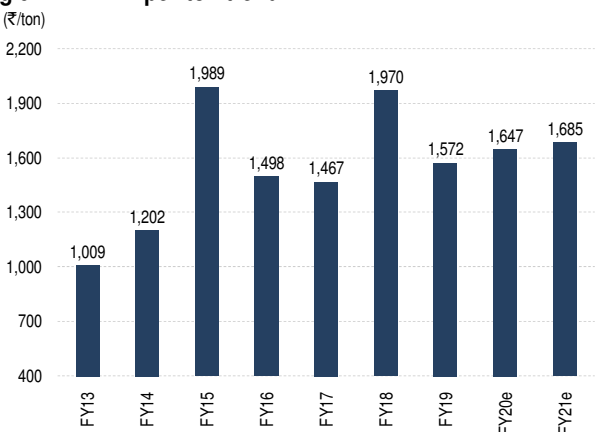


Source: Company, Anand Rathi Research

### Operating performance

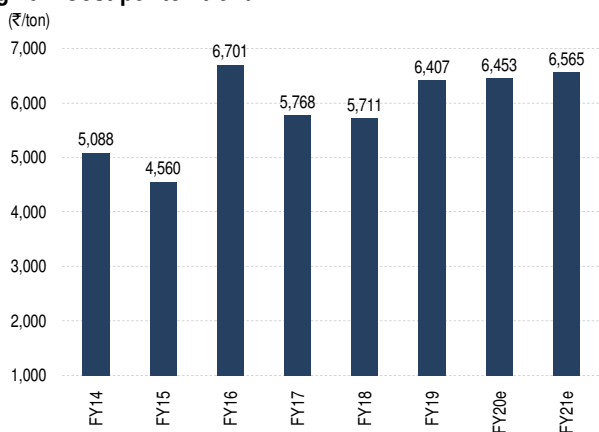
The Q1FY20 EBITDA/ton dipped 5.5% y/y, but rose only 2.1% q/q to ₹1,542. This was largely due to the subdued operating performance on account of lower volumes and higher per-ton cost, which was up a marginal 1% y/y. Adj. PAT came at ₹839m, down 7% y/y due to the restrained operating performance and higher tax expenses. This was partially offset by the 49% y/y decline in interest, and 21.5% y/y in depreciation.

Fig 9 – EBITDA-per-ton trend



Source: Company, Anand Rathi Research

Fig 10 – Cost-per-ton trend



Source: Company, Anand Rathi Research

## Result Highlights

**Fig 11 – Quarterly performance**

(₹ m)	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	% Y/Y	%Q/Q
Sales	3,927	4,792	4,287	2,810	3,774	5,274	5,179	3,623	4,164	5,344	4,609	(11.0)	(13.8)
EBITDA	870	1,693	1,586	770	1,413	1,444	1,317	687	1,219	1,269	1,121	(14.9)	(11.6)
EBITDA margins (%)	22	35	37	27	37	27	25	19	29	24	24	-110bps	59bps
EBITDA per ton (₹)	1,169	2,135	2,415	1,592	2,360	1,799	1,632	1,094	1,861	1,510	1,542	(5.5)	2.1
Interest	186	184	157	141	137	89	54	33	26	31	28	(49.0)	(9.8)
Depreciation	356	122	303	326	337	241	283	271	264	238	222	(21.5)	(6.8)
Other income	12	20	4	9	2	28	3	7	10	34	74	2,087.2	114.4
PBT	334	1,407	1,130	311	942	1,143	983	390	939	1,034	945	(3.9)	(8.6)
Tax	0	127	33	49	28	54	68	8	102	118	106	56.0	(10.2)
PAT	339	1,280	1,097	263	914	1,088	915	382	837	916	839	(8.3)	(8.4)

Source: Anand Rathi Research

**Fig 12 – Per-ton analysis**

(₹ per ton)	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	% Y/Y	%Q/Q
Realisations	5,808	5,870	8,911	5,902	7,269	8,148	7,980	6,509	8,099	8,298	8,312	4.2	0.2
EBITDA	1,169	2,135	2,415	1,592	2,360	1,799	1,632	1,094	1,861	1,510	1,542	(5.5)	2.1
Sales volumes (m tons)	0.7	0.8	0.6	0.4	0.6	0.7	0.8	0.5	0.6	0.8	0.7	(9.9)	(9.8)
<b>Costs</b>													
Raw material	842	1,005	1,107	798	949	1,162	1,327	1,405	1,294	1,184	1,166	(12.1)	(1.5)
Purchase of traded goods	597	240	253	223	318	220	282	364	243	255	311	10.2	21.8
Staff cost	439	384	459	610	488	331	376	585	469	341	415	10.5	21.6
Other expenses	2,528	2,545	2,606	2,386	2,710	3,450	3,369	2,709	3,085	3,011	3,088	(8.3)	2.6

Source: Anand Rathi Research

### Change in estimates

Factoring in the Q1 FY20 performance, we lower our FY20e and FY21e revenue, respectively 0.7% and 1.8%. We also lower our FY20e and FY21e EBITDA 5.5% and 5.9% respectively, and PAT 7.8% and 8.1%. With better volume growth expected in coming years and the delevering, we expect Star Cement to post a better operating performance.

**Fig 13 – Change in estimates**

(₹m)	New		Old		Variance	
	FY20e	FY21e	FY20e	FY21e	% chg	% chg
Sales	20,145	23,408	20,283	23,835	(0.7)	(1.8)
EBITDA	5,043	5,764	5,334	6,123	(5.5)	(5.9)
PAT	2,930	3,471	3,176	3,778	(7.8)	(8.1)

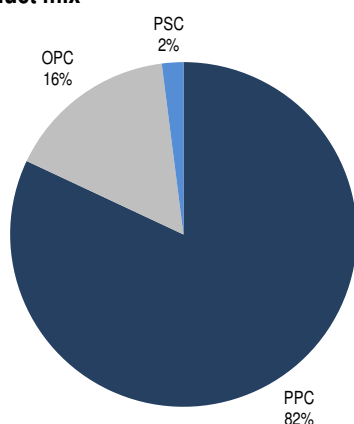
Source: Anand Rathi Research

## Concall Highlights

### Operational and Financial highlights

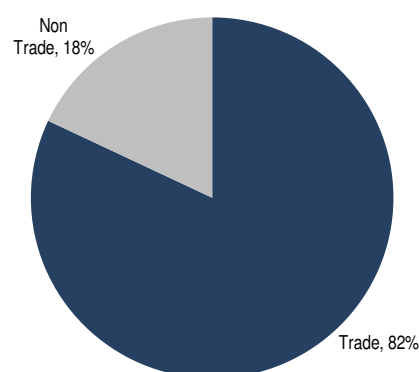
- Cement sales volumes in Q1FY20 were 0.719m tons, up 0.84% y/y. In the north-east, sales volumes were 0.53m tons, increasing 3.3% y/y. Outside the north-east, they were 0.19m tons, flat y/y. However, clinker sales declined to 0.01m tons (0.09m tons a year ago) mainly due to heavy rainfall in June.
- The trade and non-trade sales-mix was 82:18.
- Freight cost was ₹884m, and power and fuel cost came at ₹814.9m.
- The PPC-OPC-PSC cement mix was 82:16:2.

Fig 14 – Product mix



Source: Company, Anand Rathi Research

Fig 15 – Sales mix



Source: Company, Anand Rathi Research

- The Supreme Court allowed over-the-ground coal extraction in the north-east, earlier banned. Other agencies have been asked to get the coal auctioned; this would take 1-2 months. Thus, the impact on EBITDA of ~₹100-150 a ton will come down from Q3FY20. Available coal would suffice for 3–3.5 years.

### Subsidies

- Outstanding government subsidies amount to ₹520m, expected to be received in FY20.

### Capex / Capacity expansion

- The Siligudi plant is expected to be completed on schedule, by Q3FY20.
- On 31<sup>st</sup> Jun'19, the company had a net-cash position of ₹3.5bn.
- Capex estimated by the company for FY20 is ₹3.5bn.
- The de-bottlenecking exercise of 0.2m tons has been postponed to the next shutdown as management is still awaiting the equipment ordered.
- The company is in the process of obtaining environmental clearance of the clinker capacity expansion of 2m tons at the Meghalaya plant, expected to be received by end-Q2FY20. The estimated timeline for completion is 24-30 months from the date of commencing construction.

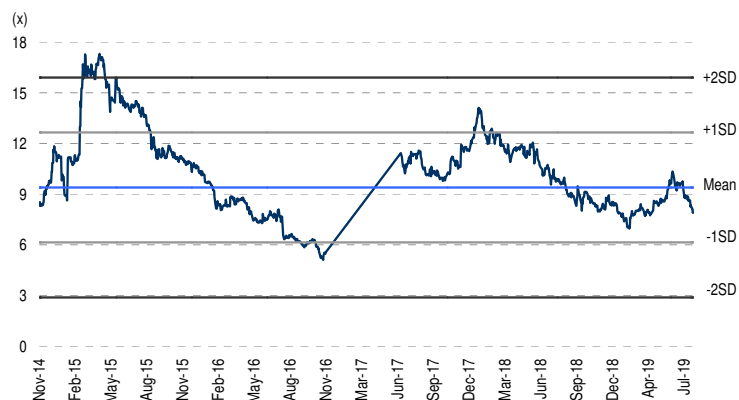
**Others**

- The company expects ~15% volume growth in FY20.
- It said prices would dip slightly in Q2FY20 due to not-so-encouraging demand. Prices in the north east are relatively stable and declines are on account of the ₹3-5/bag discounts. Outside the north-east, prices in July declined ₹10-15/bag.
- Demand has been constrained by the good monsoon and shrinking government expenditure. The company expects demand to be flat in Q2FY20, and demand and prices to pick up from Q3FY20. It expects 4-5% demand growth in FY20.

## Valuations

At the ruling price, the stock quotes at an EV/EBITDA of 6.3x and an EV/ton of \$95.3. We maintain our Buy recommendation on it, with a lower target price of ₹132 (earlier ₹135) based on 9x FY21e EV/EBITDA.

**Fig 16 – 12-month-forward EV/EBITDA: Mean and Standard deviation**



Source: Bloomberg

**Fig 17 – Peer comparison - Valuations**

	CMP (₹)	P/E		EV/EBITDA		EV/ton(\$)	
		FY20e	FY21e	FY20e	FY21e	FY20e	FY21e
Star Cement	95	13.3	11.2	7.2	6.3	96	95
Birla Corp.	531	14.7	13.4	7.5	7.2	64	64
Dalmia Bharat	909	36.7	31.4	9.2	8.2	115	84
Deccan Cement	352	8.1	6.8	3.7	2.7	27	22
Heidelberg Cement	188	14.7	12.6	7.8	6.9	115	105
India Cement	86	13.9	10.7	7.1	6.6	54	55
JK Cement	960	19.1	17.0	11.2	9.3	93	89
JK Lakshmi	334	21.9	13.9	9.7	7.2	62	56
Mangalam Cement	210	32.2	9.9	9.7	6.1	39	37
NCL Indus	104	6.2	4.9	3.8	3.0	34	30
Orient Cement	94	13.1	10.4	6.7	6.2	61	66
Prism Johnson	91	20.9	17.6	9.9	8.6	89	83
Ramco Cement	731	25.0	18.0	15.1	11.3	174	144
Sagar Cement	567	13.7	10.9	7.2	6.7	51	39

Source: Bloomberg

### Risk

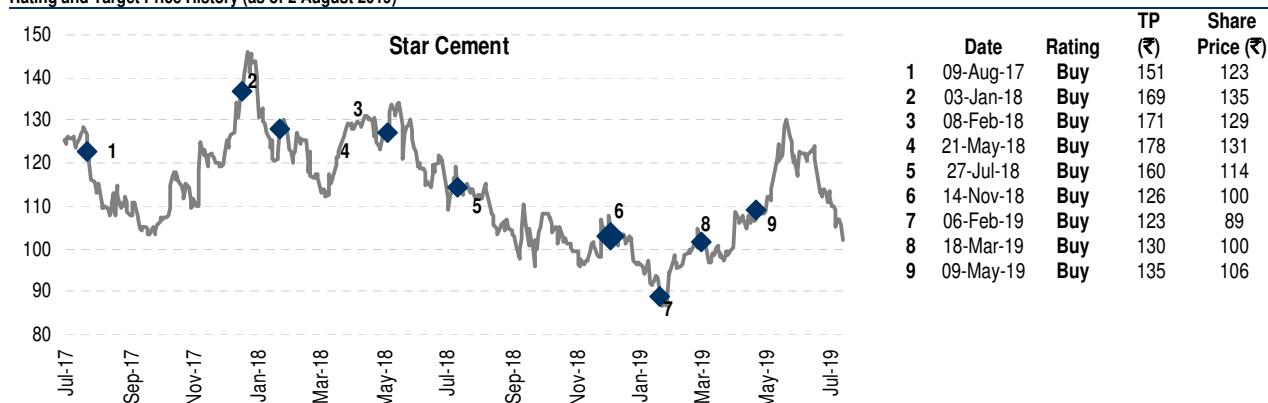
- Mounting operational costs.

## Appendix

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#### Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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