

8 February 2017

## Star Cement

*Subsidy receipt, a key positive; retaining our Buy rating*

Enjoying a strong, 25%, market share in the north-east, and adding capacities outside this region would help Star Cement gain through diversification and the forthcoming infrastructure emphasis in the NE. Receipt of subsidy dues and its strong operating performance are other key positives. We are upbeat about the company's prospects and retain our Buy rating on the stock, with a price target of ₹171.

**Enhanced market share.** Already a well-known brand with a ~25% market-share in the north-eastern region, the company is adding capacities in east India, and benefiting from premium pricing there. Approx. 76% of its sales are in the retail segment, Star Cement is already a high operating-leverage player. Besides, it is trying to increase its institutional reach.

**Better profitability expected.** A sturdy rise in realisations and benefits from subsidies led Star Cements Q3 FY18 EBITDA/ton to shoot up 83.2% y/y, to ₹2,142. We expect the strong profitability to endure on account of estimated 10% volume growth by FY18, given the special infrastructure boost to the north-eastern states. However, the transport subsidy being discontinued from Jan'18 would impact EBITDA/ton by ₹200 a ton (adjusting for freight-rationalisation benefits).

**Subsidy dues at peak.** The company has so far received ₹2.3bn toward capital and freight subsidies. It expects to receive another ₹1bn-1.5bn in FY18 of the balance of ₹6.8bn. It has planned ₹4bn capex and the remaining amount will be used to repay debt.

**Valuations.** The stock trades at an EV/EBITDA of 9.1x and an EV/ton of \$162 on FY20e. We revise our price target to ₹171 and maintain our Buy recommendation on the stock. **Risk.** Rising coal prices, falling volumes.

Key Financials (YE Mar)	FY16	FY17	FY18e	FY19e	FY20e
Sales (₹ m)	17,095	17,217	15,854	22,340	26,502
Net profit (₹ m)	1,340	1,716	2,292	2,547	3,130
EPS (₹)	3.2	4.1	5.5	6.1	7.5
PE (x)	34.4	33.1	23.1	20.8	17.0
EV / EBITDA (x)	14.5	16.5	11.7	10.4	9.1
EV / ton (\$)	231.0	268.4	226.2	163.3	162.2
RoE (%)	16.1	15.5	17.8	17.2	18.3
RoCE (%)	11.9	12.0	14.5	15.4	17.2
Dividend yield (%)	0.5	-	0.6	0.7	0.9
Net debt / equity (x)	0.9	0.6	0.1	0.2	0.1

Source: Company, Anand Rathi Research

Rating: **Buy**

Target Price: ₹171

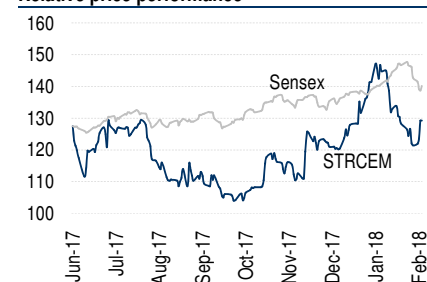
Share Price: ₹129

Key data	STRCEM IN
52-week high / low	₹152 / 102
Sensex / Nifty	34413 / 10577
3-m average volume	\$1.5m
Market cap	₹54bn / \$843m
Shares outstanding	419m

Shareholding pattern (%)	Dec'17	Sep'17	June'17
Promoters	73.3	74.6	74.9
- of which, Pledged	-	-	-
Free float	26.8	25.4	25.1
- Foreign institutions	2.0	0.4	0.1
- Domestic institutions	2.7	1.6	1.2
- Public	22.1	23.4	23.8

Estimates revision (%)	FY18e	FY19e	FY20e
Sales	(11.5)	5.4	(3.6)
EBITDA	5.5	8.6	(1.7)
PAT	17.4	14.1	(2.9)

### Relative price performance



Source: Bloomberg

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## Quick Glance – Financials and Valuations

**Fig 1 – Income statement (₹ m)**

Year-end: Mar	FY16	FY17	FY18e	FY19e	FY20e
Sales Volume (m tons)	2.6	2.8	2.4	3.3	3.8
Net revenues	17,095	17,217	15,854	22,340	26,502
Growth (%)	19.8	0.7	-7.9	40.9	18.6
Direct costs	3,455	4,144	2,595	3,698	4,405
SG&A	9,701	9,049	8,465	13,125	15,852
<b>EBITDA</b>	<b>3,938</b>	<b>4,025</b>	<b>4,795</b>	<b>5,517</b>	<b>6,244</b>
EBITDA margins (%)	23.0	23.4	30.2	24.7	23.6
- Depreciation	1,715	1,412	1,400	1,500	1,500
Other income	69	85	62	62	62
Interest Exp	834	780	689	589	539
PBT	1,458	1,918	2,767	3,490	4,267
Effective tax rate (%)	4.10	7.44	15.00	25.00	25.00
+ Associates / (minorities)	53	59	60	70	70
Net income	1,340	1,716	2,292	2,547	3,130
Adjusted income	1,346	1,716	2,292	2,547	3,130
WANS	419	419	419	419	419
FDEPS (₹ / sh)	3.2	4.1	5.5	6.1	7.5
FDEPS growth (%)	-14.5	27.5	33.6	11.1	22.9

**Fig 3 – Cash-flow statement (₹ m)**

Year-end: Mar	FY16	FY17	FY18e	FY19e	FY20e
PBT	1,458	1,918	2,767	3,490	4,267
+ Non-cash items	1,745	1,458	1,400	1,500	1,500
Oper. prof. before WC	3,203	3,376	4,167	4,990	5,767
- Incr. / (decr.) in WC	2,651	918	-3,460	2,711	2,018
Others incl. taxes	60	143	415	872	1,067
Operating cash-flow	493	2,315	7,212	1,407	2,682
- Capex (tang. + intang.)	707	912	947	1,750	1,750
Free cash-flow	-213	1,403	6,265	-343	932
Acquisitions					
- Div. (incl. buyback & taxes)	222	-	413	460	562
+ Equity raised	197	-	0	-	-
+ Debt raised	593	-1,449	-2,801	-2,000	-328
- Fin investments	-	1	-	-	-
- Misc. (CFI + CFF)	321	-10	-0	-	0
Net cash-flow	34	-37	3,051	-2,803	43

Source: Company, Anand Rathi Research

**Fig 5 – Price movement**


Source: Bloomberg

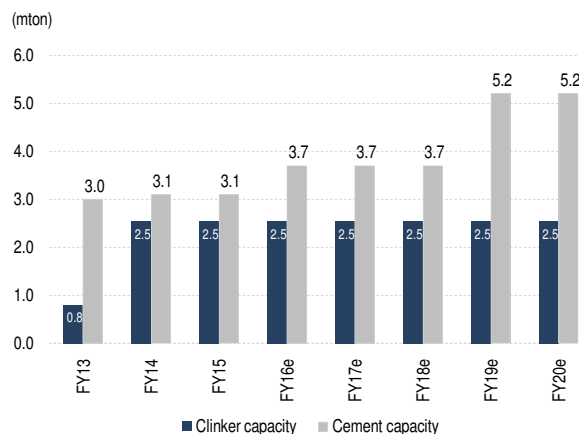
**Fig 2 – Balance sheet (₹ m)**

Year-end: Mar	FY16	FY17	FY18e	FY19e	FY20e
Share capital	419	419	419	419	419
Net worth	10,553	12,280	14,159	16,247	18,815
Total debt	9,398	7,949	5,148	3,148	2,821
Minority interest	530	589	649	719	789
DTL / (assets)	117	163	163	163	163
<b>Capital employed</b>	<b>20,599</b>	<b>20,981</b>	<b>20,120</b>	<b>20,277</b>	<b>22,588</b>
Net tangible assets	9,190	8,631	8,626	8,876	9,126
Net intangible assets	2	2	2	2	2
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	490	549	100	100	100
Investments (strategic)	15	17	17	17	17
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	14,725	15,345	11,728	15,914	18,878
Cash	238	201	3,252	449	492
Current liabilities	4,060	3,763	3,605	5,080	6,026
Working capital	10,665	11,583	8,123	10,833	12,851
<b>Capital deployed</b>	<b>20,599</b>	<b>20,981</b>	<b>20,120</b>	<b>20,277</b>	<b>22,588</b>
Contingent liabilities	191	299	-	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY16	FY17	FY18e	FY19e	FY20e
P/E (x)	34.4	33.1	23.1	20.8	17.0
EV / EBITDA (x)	14.5	16.5	11.7	10.4	9.1
EV / sales (x)	3.3	3.9	3.5	2.5	2.1
P/B (x)	4.6	4.8	3.8	3.3	2.9
RoE (%)	16.1	15.5	17.8	17.2	18.3
RoCE (%) - after tax	11.9	12.0	14.5	15.4	17.2
DPS (₹ / sh)	0.5	-	0.8	0.9	1.1
Dividend payout (%) - Inc. DDT	16.5	-	18.0	18.0	18.0
Net debt / equity (x)	0.9	0.6	0.1	0.2	0.1
WC days	199	236	227	155	163
EV / ton (\$)	231.0	268.4	226.2	163.3	162.2
NSR / ton (₹)	6,018	6,123	6,490	6,685	6,885
EBITDA / ton (₹)	1,386	1,432	2,061	1,487	1,561
Volumes (m tons)	2.6	2.8	2.4	3.3	3.8
CFO: PAT (%)	36.7	134.9	314.6	55.2	85.7

Source: Company, Anand Rathi Research

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


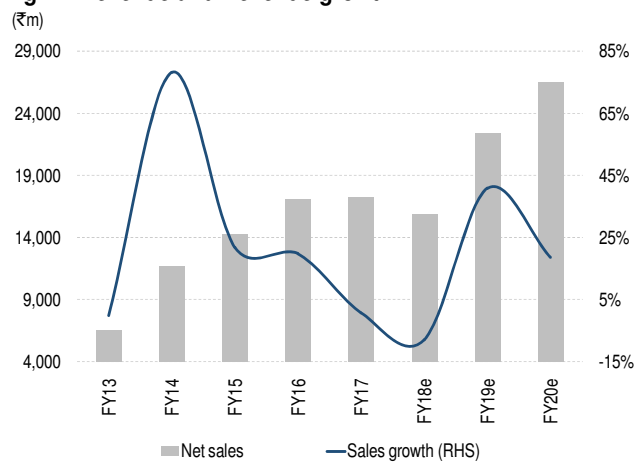
Source: Company

## Other key highlights

### Revenue growth

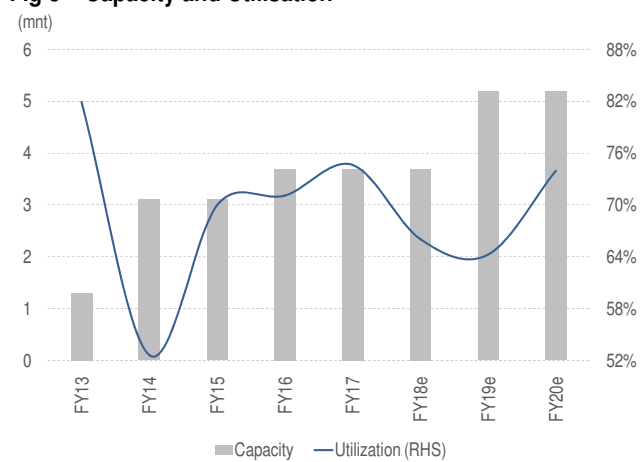
Sluggish demand in the north-east led to Q3 FY18 volumes falling 6% y/y to 0.62m tons. Revenue declined 4% y/y to ₹3.7bn, bruised chiefly by volumes dropping. Realisation in the quarter, though, was slightly up, 0.39% y/y. We expect a 15% CAGR in revenue over FY17-20, boosted by a 12% CAGR in volumes, which are likely to pick up in the coming quarter due to the expected increase in demand growth bolstered by the government’s infrastructure push for the north-eastern region.

**Fig 7 – Revenue and Revenue growth**



Source: Company, Anand Rathi Research

**Fig 8 – Capacity and Utilisation**

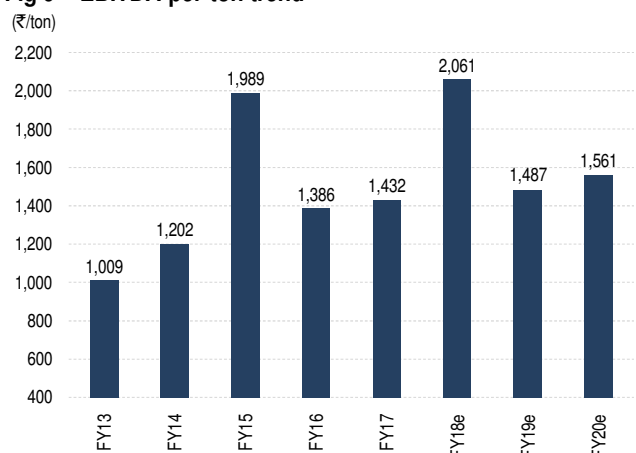


Source: Company, Anand Rathi Research

### Operating performance

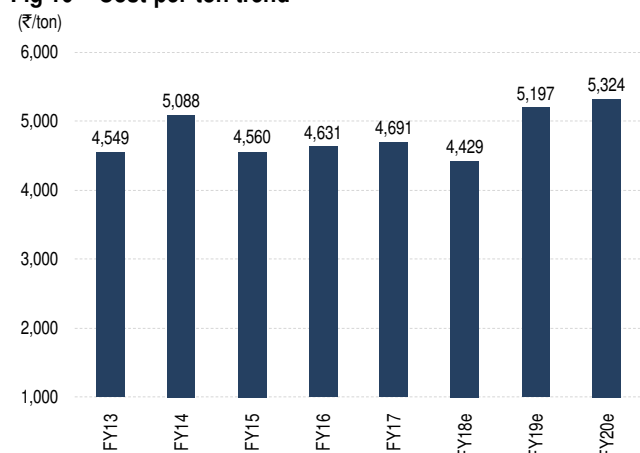
The low base helped EBITDA/ton for the quarter shoot up 96% y/y. The 3.3% y/y drop in raw material consumption and 4.6% y/y drop in other expenses, to ₹2,358. The outstanding bottom-line performance stemmed from the huge fall in interest costs and other income by respectively 26.3% and 77.6% y/y, rocketing PAT ~179% y/y, to ₹914m.

**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)

	FY18			FY17		FY18e	FY19e	FY20e
	Q3	Q2	Q1	Q4	Q3			
Sales	3,774	2,810	4,287	5,167	3,927	15,854	22,340	26,502
EBITDA	1,413	770	1,586	1,676	870	4,795	5,517	6,244
EBITDA margins (%)	37	27	37	32	22	30	25	24
EBITDA per ton (₹)	2,142	1,629	2,415	2,098	1,169	2,061	1,487	1,561
Interest	137	141	157	186	186	689	589	539
Depreciation	337	326	303	355	356	1,400	1,500	1,500
Other income	3	9	4	39	12	62	62	62
PBT	942	311	1,130	1,177	334	2,767	3,490	4,267
Tax	28	49	33	124	0	415	872	1,067
PAT	914	262	1,097	1,050	339	2,352	2,617	3,200

Source: Anand Rathi Research

Fig 12 – Per-ton analysis

(₹ per ton)	FY18			FY17		FY18e	FY19e	FY20e
	Q3	Q2	Q1	Q4	Q3			
Realization	5,484	6,029	7,234	6,884	5,808	6,490	6,685	6,885
EBITDA	2,142	1,629	2,415	2,098	1,169	2,061	1,487	1,561
Sales volumes (m tons)	0.6	0.4	0.6	0.8	0.7	2.4	3.3	3.8
<b>Costs</b>								
Raw material	862	817	1,107	1,005	842	1,104	1,137	1,171
Purchase of traded goods	199	126	253	471	597	-	-	-
Power & Fuel	-	-	-	-	-	-	-	-
Staff cost	443	624	459	380	439	377	388	399
Trans., C&F charges	-	-	-	-	-	-	-	-
Other expenses	2,551	2,543	2,606	2,807	2,528	3,090	3,541	3,720

Source: Anand Rathi Research

### Change in estimates

Factoring in the Q3 FY18 performance, we lower our FY18 and FY20 estimates: revenue by 11.5% and 3.6% respectively and increased FY19e sales by 5.4%. We increased our FY18e & FY19e EBITDA by 5.5% and 8.6% & PAT by 17.4% and 14.1% respectively. The FY20 EBITDA & PAT estimates, however, we lowered, by 1.7%/2.9%, due to the change in ownership structure. We expect Star Cement to continue to fare well, based on a better operating performance and boosted by higher cement prices.

Fig 13 – Change in estimates

	New			Old			Variance		
	FY18e	FY19e	FY20e	FY18e	FY19e	FY20e	% chg	% chg	% chg
Sales (₹ m)	15,854	22,340	26,502	17,915	21,192	27,488	(11.5)	5.4	(3.6)
EBITDA (₹ m)	4,795	5,517	6,244	4,545	5,081	6,352	5.5	8.6	(1.7)
PAT (₹ m)	2,292.2	2,547.3	3,130.2	1,952	2,233	3,223	17.4	14.1	(2.9)

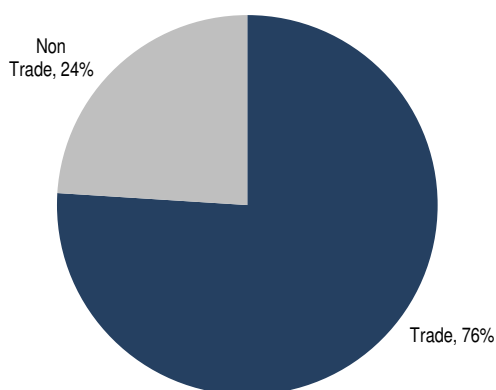
Source: Anand Rathi Research

## Concall Highlights

### Operational and Financial highlights

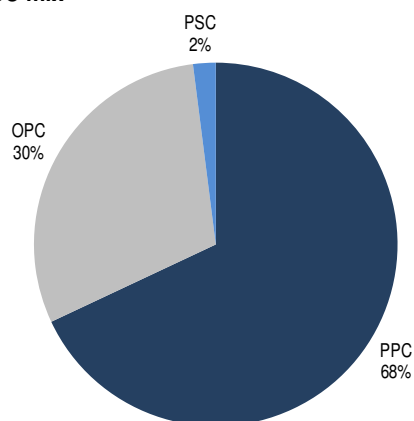
- Q3 FY18 volumes in the north-east rose 2% y/y, to 0.42m tons (0.41m a year ago).
- The company sold 57,000 tons of clinker in the quarter (20,000 a year ago).
- EBITDA/ton for the coming quarter might be hit to the extent of ₹300-350 a ton by the discontinuance of the freight subsidy. However, on a re-alignment of dispatches within and outside the NE market, the company expects to save ₹100-150 a ton.
- The trade and non-trade sales-mix for the quarter was 76:24.
- The PPC-OPC-PSC cement mix in Q3 FY18 was 68:30:2.

Fig 14 – Sales mix (%)



Source: Company

Fig 15 – OPC-PPC-PSC mix



Source: Anand Rathi Research

**Subsidy**

- Management is expecting to receive total subsidies of ₹6.8bn in FY18/19; of this, it expects to receive a further subsidy of ₹1bn-1.5bn in FY18 (received so far: ₹2.3bn).
- By Dec'17, it had already received ₹2.3bn of total subsidy, including ₹1.6bn in Q3.

**Capex / Capacity expansion**

- The company plans expansion at Silligudi with total capacity of 1.5m-2m tons in the next fifteen months at ₹3bn-3.5bn capex.
- Its clinker capacity in the north-east is being de-bottlenecked, expected to be complete by Q2 FY19, after which capacity would increase to 3m tons, from 2.6m tons now, at an estimated ₹500m.
- Capex estimated by the company for FY19 and FY20 is ₹4bn.

**Volumes, Demand and Capacity utilisation**

- The company expects volume growth to be flat in FY18.
- The volume mix for FY17 would be north east: 70%, others: 30%.
- Capacity utilised by the company in north east was 65-70%; in the east 75%.

**Other**

- The company expects to receive excise subsidy for one unit till 2023, and for the other unit till 2027.
- Demand growth of 7-8% is expected for the coming quarter and 10% for FY18.
- The company plans clinker and grinding unit expansion in the next five years.

## Valuations

At the ruling price, the stock trades at an EV/EBITDA of 9.1x and an EV/ton of \$162. We maintain our Buy recommendation on it, with a revised price target of ₹171.

**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 (\$)	
	(₹)	FY19e	FY20e	FY19e	FY20e	FY19e	FY20e
Birla Corp.	1,029	20.9	18.4	9.8	9.0	103	100
Dalmia Bharat	2,705	24.2	20.0	11.2	9.6	148	137
Deccan Cement	547	10.5	9.0	5.1	4.0	46.1	40.9
Heidelberg Cement	150	16.5	13.0	8.5	6.7	97	90
India Cement	153	15.5	10.8	7.0	5.7	71	68
JK Cement	1,030	20.5	18.4	10.4	9.4	113	108
JK Lakshmi	406	18.2	13.7	9.5	8.0	83	80
Mangalam Cement	349	11.9	8.2	6.5	5.1	49	49
Orient Cement	151	22.1	18.4	9.3	8.2	80	79
Ramco Cement	727	26.1	22.0	15.5	13.0	202	195
Sagar Cement	901	17.8	10.2	9.1	5.6	77	49
Star Cement	129	20.7	16.9	10.3	9.1	163	162
Sanghi Industries	117	20.0	13.7	10.6	9.7	121.6	133.9

Source: Bloomberg

### Risks

- Increasing coal prices.
- Fall in volumes mainly due to single-region exposure.

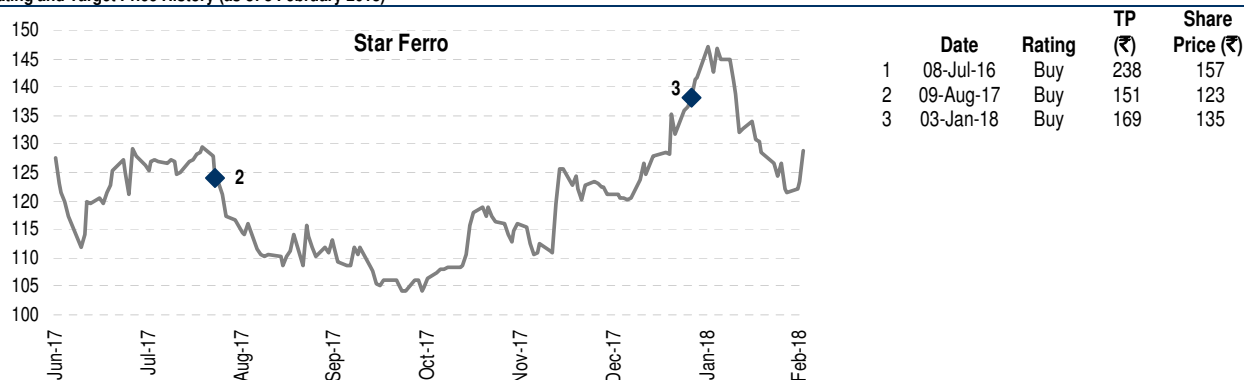
## Appendix

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