



Star Ferro and Cement

View: Positive

Play on a key profitable niche region

CMP: Rs160

Key points

- An established brand image in niche north eastern region:** Star Ferro and Cement Ltd (SFCL) is the largest player in the north eastern region of India, commanding nearly a 23% market share (with a capacity of 3.6 million tonne). The company's plants located in Meghalaya and Assam caters to the key states in the north eastern belt. It is one of the most profitable cement companies due to higher realisation (limited competition in the Northeast), the subsidy that it gets on freight cost, tax benefits on excise duty & VAT, and its limestone mines along with a committed supply of coal and other raw materials like fly ash. Thus, the company posted an EBITDA per tonne of Rs1,808 as against an all-India average of Rs827 per tonne in M9FY2015.
- Infrastructure-led investments and untapped housing needs to improve capacity utilisation:** The north eastern region of the country is one of the lowest cement consuming region with a per capita cement consumption of 131 kilogram (kg; against the national average of 210kg) thus underling a huge potential for growth. The government's focus on infrastructure (ie 10% of the total revenue granted to every ministry by the central government have to spend in the Northeast) and conversion of kutcha house in rural areas to pukka house are the key drivers of cement demand. The central government is planning for big-ticket projects in the north eastern region (10,141km roads, 13 airports and 14,000MW hydro power) which will drive the cement demand over the coming years. The cement demand in the eastern region (~11 million tonne) has grown at a CAGR of 9.7% in the last five years and it is expected to grow at a CAGR of 10-12% over the next five years. The company is expanding its grinding capacity by 1 million tonne to meet the growth demand.
- Demerger of the ferro alloy and power businesses:** The company has completed the demerger of its ferro alloy and power businesses into a separate company, Shyam Century Ferrous Ltd, with effect from April 2014. The demerger ratio is 1:1 which means that the shareholder holding one share of SFCL will get one share of Shyam Century Ferrous Ltd with a record date of April 25, 2015. After the restructuring we believe that the management would be able to focus on the core business of cement in the company.
- Premium valuation to sustain; Positive view:** SFCL is in a different league commanding a relatively high valuation among other cement players on account of a regional advantage and robust demand outlook. At the current price, the stock is trading at an EV/EBITDA of 9.4x its FY2016E and 6.8x its FY2017E earnings. We have a positive view on the stock and expect a 20-25% upside potential from the current level.

Valuations*

Particulars	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Net sales (Rs cr)	657	1,171	1,554	1,801	2,398
<i>Growth (%)</i>		78.3	32.8	15.9	33.1
EBITDA (Rs cr)	115	252	386	430	568
EBITDA margin (%)	17.6	21.5	24.8	23.9	23.7
Adjusted PAT (Rs cr)	34	2	82	121	231
<i>Growth (%)</i>		-92.7	-	46.2	91.6
EPS diluted (Rs)	1.6	0.1	3.7	5.4	10.4
PE (x)	102.9	-	43.1	29.5	15.4
P/BV (x)	5.1	5.2	4.6	4.0	3.2
EV/EBITDA (x)	38.5	18.0	11.0	9.4	6.8
EV/sales (x)	6.8	3.9	2.7	2.2	1.6
RoE (%)	10.0	0.4	11.3	14.5	23.0
RoCE (%)	6.6	2.4	7.9	9.3	15.3

* Financial numbers before demerger of Ferro alloy and power divisions

About the company

SFCL is the largest cement player in the Northeast region of India with over 23% market share. The company has expanded its capacity from 1.5 million tonne (MT) in FY2013 to 3.6MT in FY2015. The unit uses a state-of-the-art dry process rotary kiln technology and manufactures high-grade ordinary Portland cement (OPC), Portland Pozzolana Cement (PPC) and other specialty grades required for infrastructure projects. SFCL sells its cement under the brand name of *Star Cement*. This, in turn, has helped the company to gain a market share in the north eastern region. Its plants located in Meghalaya and Assam caters to the key states in the north eastern belt. With nearly 4,000+ retailers and 2,000 dealers spread across 11 states, the company enjoys a strong brand recall in the Northeast and also has a deep customer base. It also enjoys the advantage of having its own captive limestone mines, situated at roughly around 25km from the plant and has mining reserves of 300MT, which is enough to meet all its raw material requirements for the next 90-100 years.

Subsidy benefits by central and state government

SFCL has commissioned a new plant of 1.8MT in FY2013 which will lead the company to receive the central and state government incentives till FY2018-23. The total installed capacity of the company is 2.4MT.

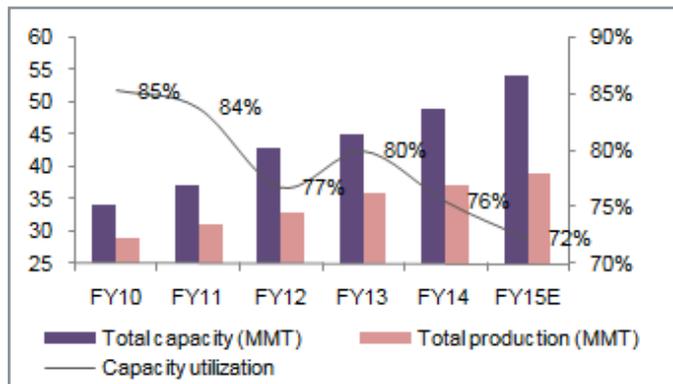
Particulars	Balance exemption period				Benefits per tonne
	SCML	CMCL-GGU	CMCL-LMS	MTEPL	
Excise duty	8	8	8	8	100-150
VAT	5	Rs294/5 years	0	0	150-200
Freight subsidy	3	3	0	0	200-250
Capital investment	1 time	1 time	0	0	
Total					450

Cement demand to grow at 10% CAGR over the next five years in Eastern India

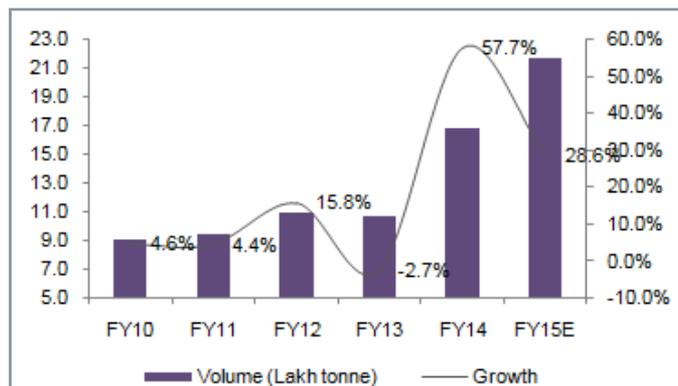
The cement production in the East region has grown at a compounded annual growth rate (CAGR) of 9.7% per annum and is further expected to grow at a CAGR of over 10% in the next five years. The per capita consumption in the East at 131kg is among the lowest as compared with the national average of 210kg per year which underlines a huge growth potential. The government’s increased focus on the development of infrastructure in the Northeast region in segments like roads (SARDP-NE and NHDP for 10,141km), airports (five sanctioned and eight in pipeline), railways (Rs38,360-crore projects underway), hydro power (63,000MW capacity identified) and focus

on rural & semi-urban housing projects is expected to maintain a double-digit cement demand for regional players. SFCL is likely to be the beneficiary with no major capacities in the pipeline in the region.

East India capacity, production and utilisation trend



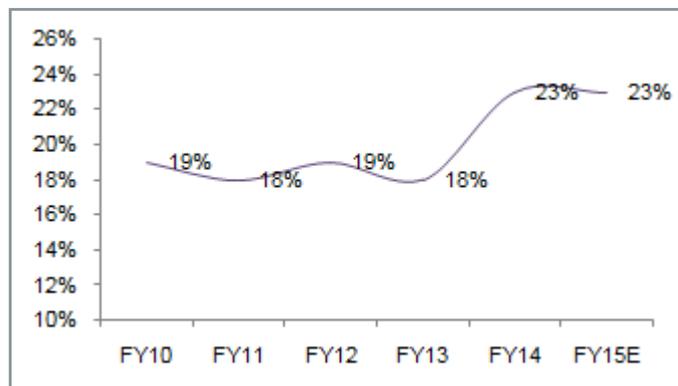
SFCL volume trend



Opportunity galore

SFCL enjoys a leadership position in the Northeast with a 23% market share through a strong distribution network of over 4,000 retailers and 2,000 dealers which is spread across 11 states. The company’s strategically located plants catering to the eastern and north eastern regions are a major entry barrier for mainland players. Additionally, a close proximity to coal and limestone captive mines gives an added advantage in containing the cost of production for the regional player.

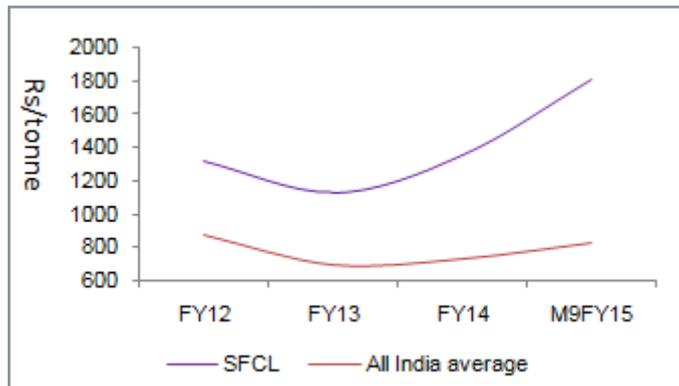
SFCL market share



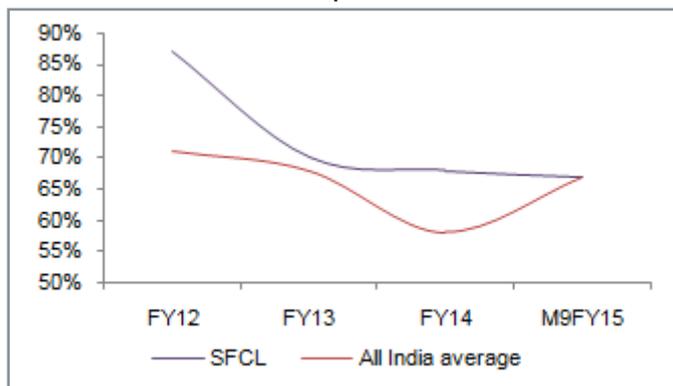
Highest EBITDA per tonne

SFCL through its extensive distribution reach has higher proportion of trade sales (80%) resulting in a higher cement realisation per tonne. Further, the company's capacity utilisation being at par with the industry's utilisation rates has led to a much higher earnings before interest, tax, depreciation and amortisation (EBITDA) per tonne as compared with an all-India average.

Cement EBITDA/tonne comparison



Cement utilisation rates comparison



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