

India Research

Star Ferro and Cement

VISIT NOTE

 Bloomberg: SFCL IN
 Reuters: STRF.BO

NOT RATED

Star player of "North-East"

We recently met Star Ferro & Cement (SFC). The company, being the leader in North-East, enjoys superior operating margins (EBITDA at Rs1776/t vs. industry average of ~Rs 800/t) led by higher realisations in the region. Capacity expansion in FY13 has resulted into strong volume growth during FY14-15 (50% CAGR). Further ramp-up & demand pick-up in East & North-East would drive volumes during FY15-17E (~15% CAGR). We expect strong earnings growth (87% CAGR over this period) led by better volumes, improvement in operating margins (EBITDA/t expected to improve to Rs 1988/t by FY17E from Rs 1776/t in FY15) & decline in interest cost. The stock is trading at 10-20% discount to the mid-cap peers.

Further ramp-up of new capacities & pick-up in demand to drive volume: SFC expanded its cement capacity to 3.12 mt in FY13 (from 0.62 mt in FY12) through a 1.8 mt grinding unit in Assam and 0.7 mt brownfield expansion in Meghalaya. This expansion coupled with better demand in N-E and increase in exposure in East has helped the company's volume to grow by 50% CAGR during FY14-15. We expect the volume to grow by ~15% CAGR during FY15-17E led by pick-up in demand, further ramp-up of new capacities and expansion of 1 mt in WB.

Higher margins expected to improve further: SFC enjoys superior operating margins on account of higher pricing in North-East & East regions where it sells ~70% & ~30% of its volumes respectively. We expect the cement EBITDA/ton to improve to Rs 1988/t by FY17E from Rs 1776/t in FY15 led by improvement in realisations (2% CAGR) and operating leverage benefits. The improvement in operating margins coupled with strong volume growth would result into healthy EBITDA growth during FY15-17E (~22% CAGR).

Outlook: We expect strong operating cash flow generation during FY15-17E on account of sharp improvement in earnings and decline in interest cost. Net debt/equity has peaked out at 1.4x in FY14 and expected to come down to 0.2x by FY17E. The stock trades at 7.5x/5.8x EV/EBITDA on FY16E and FY17E (10-20% discount to the mid-cap peers).

Key Financials

Rs Mn	FY13	FY14	FY15	FY16E	FY17E
Net Sales	6,573	11,714	14,270	16,820	19,623
EBITDA	1,161	2,530	4,316	5,293	6,417
EBITDA margin (%)	17.7	21.6	30.2	31.5	32.7
PAT	249	61	834	1,997	2,917
EPS (Rs)	1.1	0.3	3.8	9.0	13.1
RoE (%)	3.6	0.9	12.3	23.3	25.4
RoCE (%)	3.7	4.9	11.2	17.8	20.6
P/E (x)	138.2	562.3	41.3	17.2	11.8
EV/EBITDA (x)	37.4	17.5	10.0	7.5	5.8
EV/Tonne (\$)	225	229	194	181	130

Source: Company, Karvy Stock Broking

Recommendation

CMP (as on 19 June 2015):	Rs154
Target Price:	Not Rated

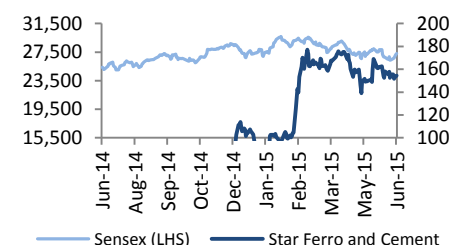
Stock Information

Market Cap. (Rs bn / US\$ mn)	35/546
52-week High/Low (Rs)	189/39
3m ADV (Rs mn /US\$ mn)	15/0.2
Beta	0.0
Sensex/ Nifty	27,459/8,276
Share outstanding (mn)	222

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	(7.6)	(4.1)	284.4	76.4
Rel. to Sensex	(6)	(1.3)	251.4	76.7

Performance



Source: Bloomberg

Analysts Contact

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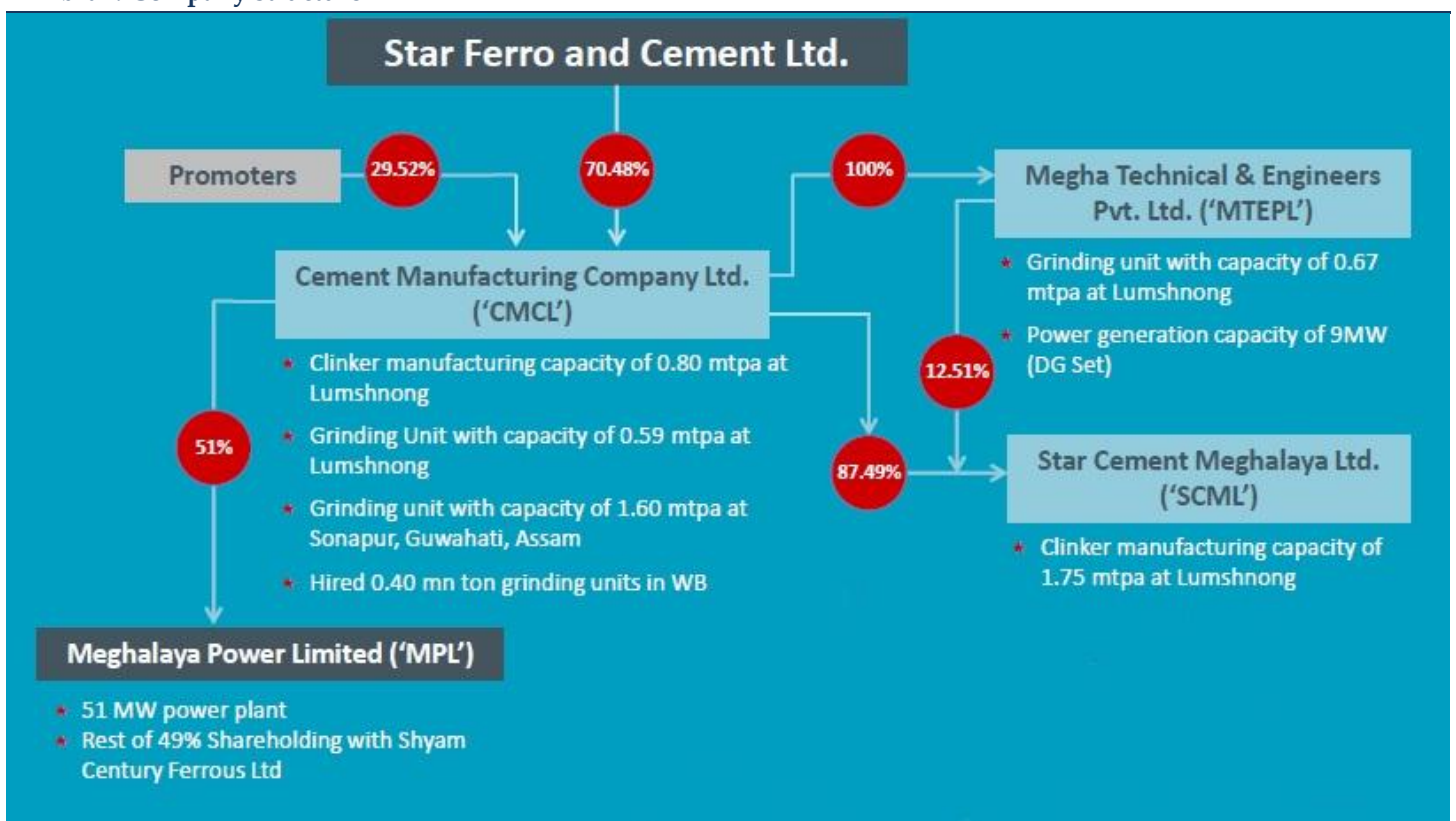
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Company structure

Star Ferro & Cement Ltd. (SFCL) holds 70.5% in Cement Manufacturing Company Ltd. (CMCL). The other 29.5% stake in CMCL is directly held by promoters. CMCL has a clinker capacity of 0.8 mt at Lumshnong (Meghalaya) with grinding capacity of 2.2 mt (0.6 mt at Lumshnong and 1.6 mt at Guwahati, Assam). One grinding unit of 0.4 mt in West Bengal is also hired recently by CMCL.

CMCL holds 100% in Megha Technical & Engineers Pvt. Ltd (MTEPL) which has a grinding capacity of 0.67 mt at Lumshnong (Meghalaya). It also holds 87.5% in Star Cement Meghalaya Ltd. (SMCL) which has a clinker capacity of 1.75 mt at Lumshnong (Meghalaya). The other 12.5% stake in SCML is held by MTEPL.

Exhibit 1: Company structure



Source: Karvy Stock Broking, Company

Star Ferro and Cement
Cement capacity expanded by ~5x in FY13

Star Ferro & Cement (SFC) expanded its cement capacity from 0.62 mt in FY12 to 3.12 mt in FY13 through a 1.8 mt grinding unit in Assam and an addition of 0.7 mt at Meghalaya. Both these units were commissioned in Q4FY13. The cement capacity in Meghalaya now stands at 1.32 mt. Consequently, the clinker capacity has been expanded to 2.6 mt (commissioned in Q4FY13) from 0.8 mt in FY12.

The company has also hired one grinding unit recently in Q3FY15 with a capacity of 0.46 mt in West Bengal to utilize its extra clinker production. Moreover, it is setting up a grinding unit of 1 mt at Siliguri (WB) which is expected to be commissioned by Q3FY17. Post this, the total cement capacity will reach to 4.58 mt by FY17.

Exhibit 2: Clinker and Cement capacity details

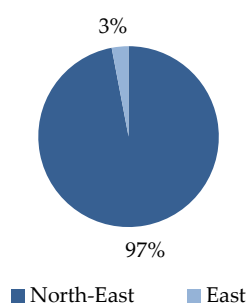
mn tonnes	FY12	FY13	FY14	FY15	FY16E	FY17E
Clinker Capacity (Meghalaya)	0.80	2.60	2.60	2.60	2.60	2.60
Cement Capacity	0.62	3.12	3.12	3.58	3.58	4.58
Meghalaya	0.62	1.32	1.32	1.32	1.32	1.32
Assam	0.00	1.80	1.80	1.80	1.80	1.80
Siliguri (WB)	0.00	0.00	0.00	0.00	0.00	1.00
WB (on lease)	0	0	0	0.46	0.46	0.46

Source: Company, Karvy Stock Broking

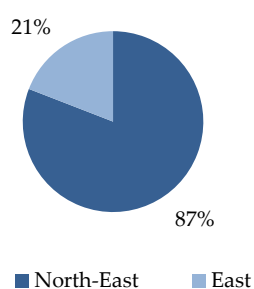
Major presence in North-East & Eastern markets

The company sells ~70% of its cement output in the markets of North-East region. Eastern region markets account for the rest ~30%. Assam is the major selling market for the company in North-East where it dispatches ~42% of its cement volumes (~60% of N-E volumes) while West Bengal is the major market in East region (accounts for ~20% of the volumes). The other selling markets in these two regions are Arunachal Pradesh, Meghalaya, Manipur, Mizoram, Tripura, Sikkim, Jharkhand and Bihar.

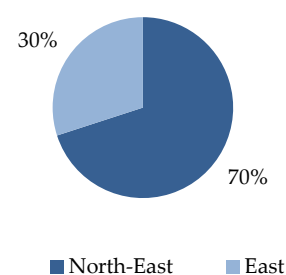
In East region, the company has increased its exposure in the last 2 years (from 3% of the total volumes in FY13 to ~30% in FY15) on account of ramp-up of the new plants at Assam and Meghalaya which commissioned in FY13 end.

Exhibit 3: Market mix (FY13)


Source: Karvy Stock Broking, Company

Exhibit 4: Market mix (FY14)


Source: Karvy Stock Broking, Company

Exhibit 5: Market mix (FY15)


Source: Karvy Stock Broking, Company

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Exhibit 6: Star Ferro & Cement’s plants and market presence

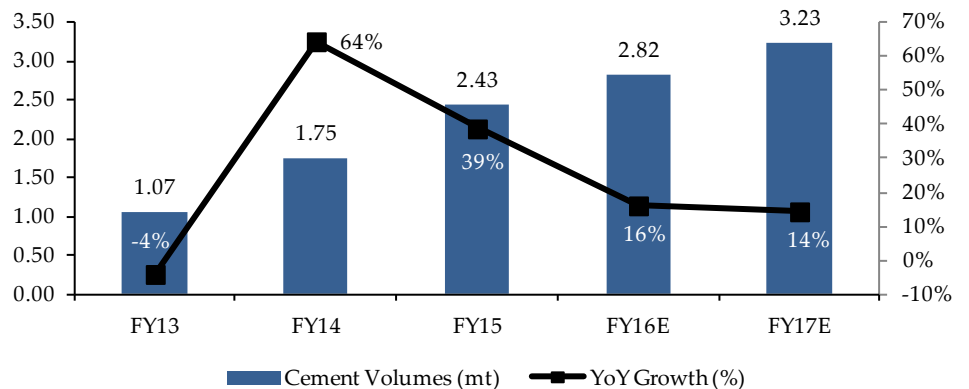


Source: Karvy Stock Broking, Company

Cement volumes expected to grow at ~15% CAGR over FY15-17E

The cement volumes grew by ~64% in FY14 and ~39% in FY15 on account of capacity expansion and increase in demand in North-East & East regions. The average cement capacity utilisation stood at ~70% in FY15 as against ~53% in FY14. We expect the cement volumes to grow at ~15% CAGR during FY15-17E led by further ramp-up of new plants.

Exhibit 7: Cement volumes expected to grow ~15% CAGR during FY15-17E



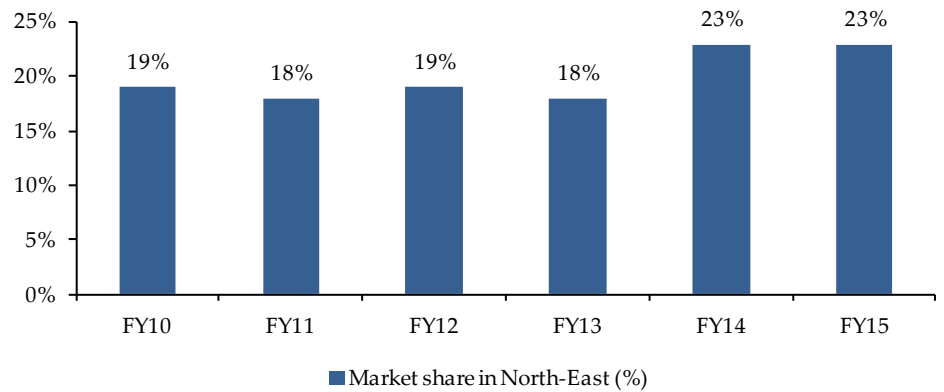
Source: Company, Karvy Stock Broking

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Leadership position in “high-growth” North-East region with 23% market share

Star Ferro & Cement, a second largest cement player in North-East region with cement capacity of 3.12 mt, enjoys a leadership position in the region with ~23% market share (which increased significantly from 18% in FY13). This was on account of gradual ramp-up of new plants, better demand in N-E region, increasing exposure in East region (West Bengal, Bihar and Jharkhand) through expanding distribution network. The other major player in the region is Dalmia Cement with a capacity of 3.2 mt which made its presence through acquisition of Adhunik Cement (Meghalaya) and Calcom cement (Assam).

Exhibit 8: Market share in North-East region

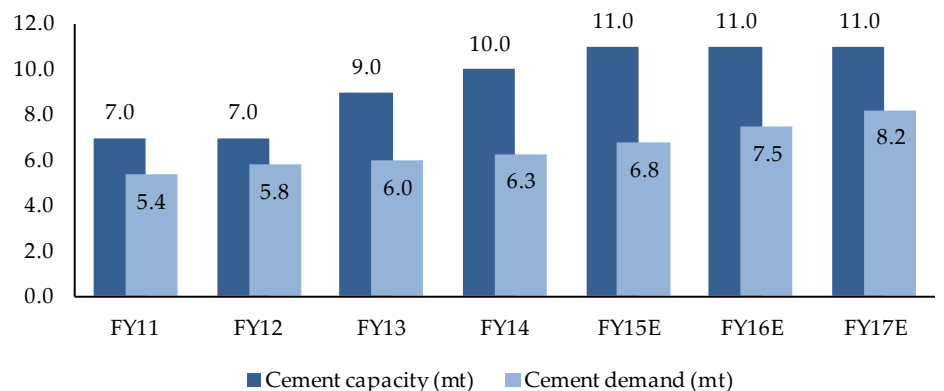


Source: Karvy Stock Broking, Company

Cement demand outlook looks promising in North-East

Cement demand in North-East region, which accounts for ~70% of the company’s sales volumes, is expected to increase in the medium to long term on account of expected increase in construction activities led by Infrastructure development and conversion of kuccha houses to pukka houses. The cement capacity of the region is ~11 mt at present while demand is ~7 mt. However, most of the small players in the region are running at very low capacity utilisation (on account of working capital issues) which has reduced the effective supply in the region (even lower than demand).

Exhibit 9: Cement capacity and demand in North-East region



Source: Karvy Stock Broking, Company

Star Ferro and Cement
Central government's thrust on Infrastructure development & Housing in North-East region to drive cement demand

- Road Projects by Special Accelerated Road Development for North-East (SARDP-NE) and National Highway Development Programmes (NHDP) in N-E region for 10,141 kms at an estimated cost of Rs 335 bn.
- Investments worth Rs 50 bn is expected in Airports in the next 10 years (5 Airports sanctioned and 8 are in pipeline).
- Railway projects worth Rs 384 bn are being executed (20 ongoing new lines and double line projects).
- N-E region is seen as a largest hydro power potential market with 98% still untapped. 63000 MW of Hydro power capacity is identified with 14000 MW already allotted to Pvt. Players. This is expected to result in 14 mt of cement demand.
- Conversion of kuccha wooden houses into pucca concrete houses would be a major demand driver in N-E region.
- Cement demand expected to grow ~10% CAGR in N-E in the next 5 years as compared to ~7% CAGR in the last 5 years. The per capita consumption of cement is 142 kgs in the region as compared to an average of 185 kgs which shows a huge potential for growth.

East region too shows huge untapped potential

- East region, which accounts for ~30% of the company's sales volume, has an effective supply is ~54 mt at present. Cement consumption in the region is ~50 mt and has been growing at ~7% CAGR (last 3 years). We expect the demand to grow by 8-10% CAGR in the next 5 years led by Govt. focus on Infrastructure (increased allocation in housing, Infra and commercial real estate segments with special focus on rural/semi-urban areas).
- Though we expect the effective capacity utilisation to decline in FY16E to ~77% from ~82% in FY14 (on account of capacity additions of ~15 mt as against incremental demand expected at ~12 mt), it is expected to improve to ~77% again by FY17E led by improvement of demand in the region.

Exhibit 10: East region demand-supply scenario

Mn tonnes	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E
Effective Supply	35.4	38.9	42.7	47.9	54.2	61.1	64.5
Production/Despatch	31.1	33.9	37.0	39.1	41.5	44.5	49.9
Utilisation (%)	88%	87%	87%	82%	77%	73%	77%
Consumption	36.9	39.9	44.6	47.2	50.5	54.5	58.9
YoY Growth	6.6%	8.9%	11.7%	5.8%	7.0%	8.0%	8.0%
Inter-region transfer	(5.8)	(6.0)	(7.6)	(8.0)	(9.0)	(10.0)	(9.0)
Net Surplus	4.3	5.0	5.7	8.8	12.7	16.6	14.7
Surplus as % of effective	12%	13%	13%	18%	23%	27%	23%

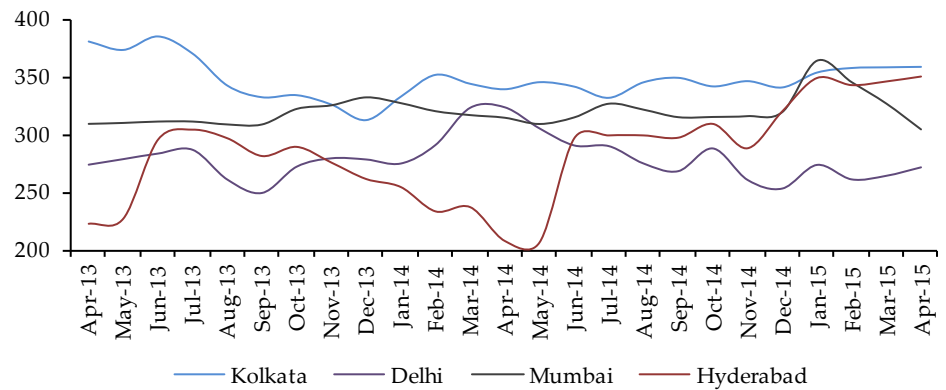
Source: Company, Karvy Stock Broking

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Star Ferro & Cement’s EBITDA/tonne is ~2x of Industry’s average

SFCL benefits from its higher operating margin which is on account of higher cement realisations. The presence in Eastern region & North-East markets has been benefiting the company as the cement prices in these regions remain better than the other regions. Exhibit 11 shows that cement prices in Kolkata has been higher by ~15% as compared to the Country’s average.

Exhibit 11: Cement prices trend (Rs/bag); Kolkata prices remain higher



Source: Company, Karvy Stock Broking Note: 1 bag=50 kgs

SFCL also enjoys the benefits from its plant locations (limestone mines are located within 2-3 kms of the clinker units which helps in providing easy accessibility and uninterrupted supply of the raw material). Coal is also available in close proximity leading to energy cost efficiencies. The company’s plants in North-East also enjoy many fiscal benefits granted by Central/state Govt. (like exemption on excise duty & VAT amounting to Rs 250-350/t and transport subsidy of Rs 250-300/t).

The company’s net cement realisation at Rs 5872/tonne in FY15 is ~18% higher than the industry’s average. The higher realisation and cost benefits clearly reflects in EBITDA/ton which is at Rs 1776/ton (almost double compared to industry’s average of ~Rs 800/t). We expect the net realisation to improve moderately by ~2% CAGR over the next two years led by gradual improvement in utilisation rates. EBITDA/ton is expected to increase by ~6% CAGR during FY15-17E to Rs 1988/ton by FY17E.

Exhibit 12: FY15 EBITDA/ton (Rs/t) of cement companies

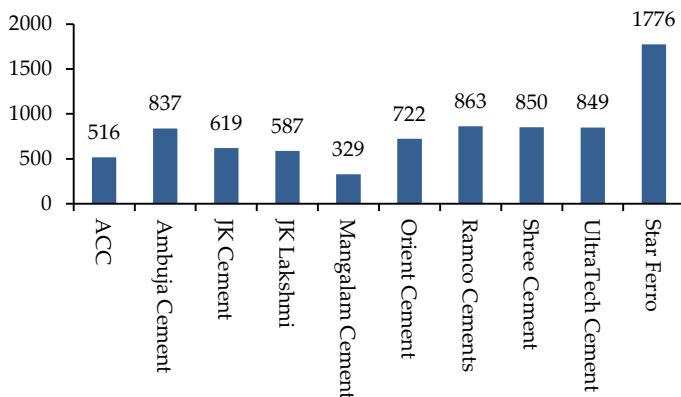
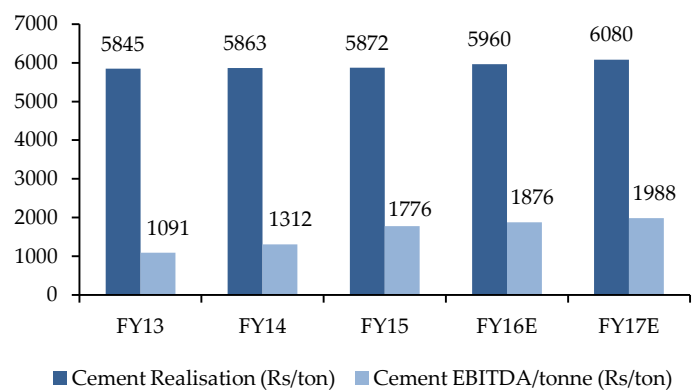


Exhibit 13: EBITDA/ton to improve to Rs 1988/t by FY17E



Source: Company, Karvy Stock Broking

Source: Company, Karvy Stock Broking

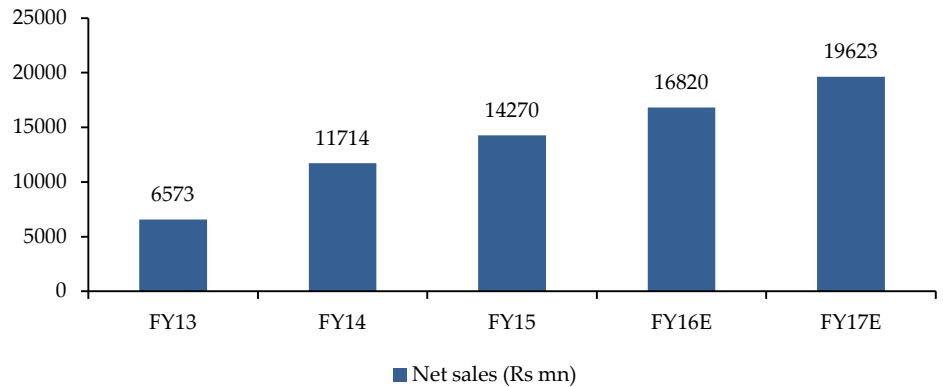
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Financial Analysis

Revenues expected to grow ~17% CAGR during FY15-17E

The net revenue of the company is expected to grow at a CAGR of 17% over FY15-17 on the back of ~15% CAGR in sales volume and ~2% CAGR in net realization.

Exhibit 14: Net sales expected to grow at ~17% CAGR over FY15-17E



Sharp improvement in profitability expected over FY15-17E

We expect EBITDA growth at ~22% CAGR over FY15-FY17E, driven by realization improvement, moderation in operating cost and operating leverage benefits. Net profit is expected to jump by ~3.5x over the period FY15-17E on account of significant improvement in operating profit and decline in interest cost (on account of reduction in debt).

Exhibit 15: EBITDA set to grow 22% CAGR over FY15-17E

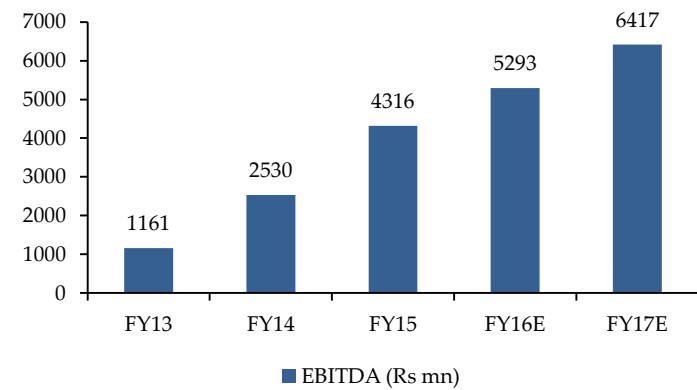
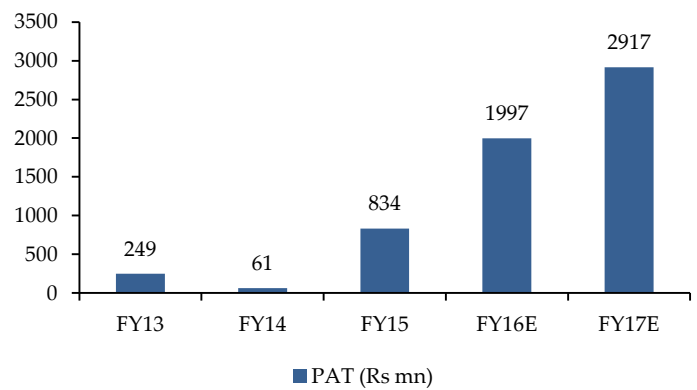


Exhibit 16: PAT expected to grow 3.5x over FY15-17E



Source: Company, Karvy Stock Broking

Source: Company, Karvy Stock Broking

Star Ferro and Cement

Free cash flow positive from FY15

The free cash flow (FCF) was negative in FY14 due to high capex of ~Rs 14.8 bn during the period FY13-14 for the Meghalaya and Assam expansion. In FY15, the FCF came into positive as the majority of the capex was spent in FY13-14. Going ahead, the capex is expected to be at ~Rs 2bn during FY16-17E related to maintenance and Siliguri (WB) expansion. Given the sharp improvement in profitability, we expect the FCF to remain positive during the period.

Exhibit 17: Capex estimated at Rs 2.1 bn over FY16-17E

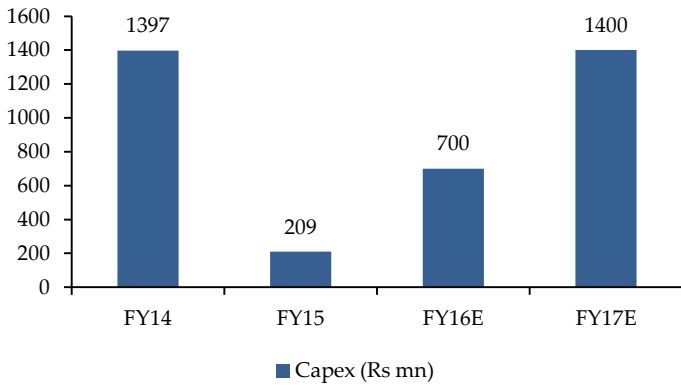
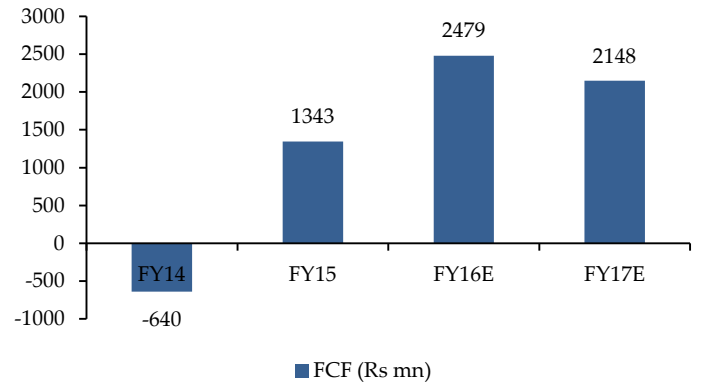


Exhibit 18: FCF to remain positive



Source: Company, Karvy Stock Broking

Source: Company, Karvy Stock Broking

Net D/E to improve going forward; Return ratios to improve significantly

Net debt of the company, which increased to Rs 9.7 bn in FY14 from Rs 9 bn in FY13 primarily to fund capacity expansion, has declined to Rs 8.5 bn. We expect Net debt to decline sharply going forward to Rs 2.7bn in FY17E. Net D/E is likely to have peaked out in FY14 at 1.4x. It is expected to come down gradually to 0.2x by FY17E.

The return ratios, which declined in FY14, is expected to improve sharply over FY15-17E led by increase in profitability. RoE is expected to improve to ~25% by FY17 as against ~5% in FY14. RoCE is expected to improve to ~21% by FY17E as against ~1% in FY14.

Exhibit 19: Net debt peaked out in FY14

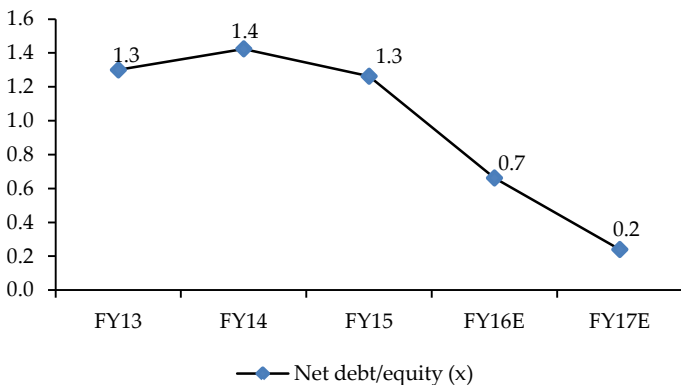
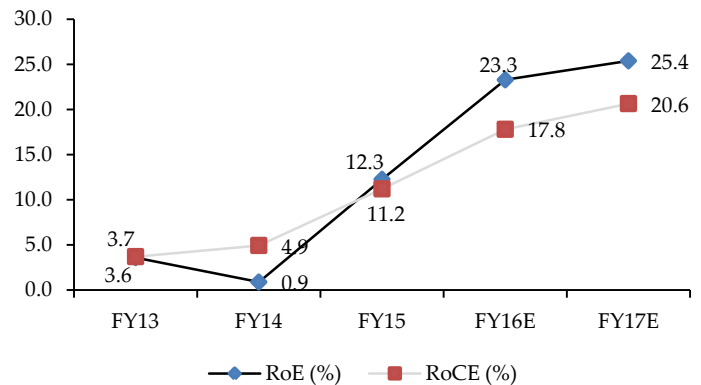


Exhibit 20: Return ratios to improve



Source: Karvy Stock Broking, Company

Source: Karvy Stock Broking, Company

Star Ferro and Cement
Exhibit 21: Profit & Loss Statement (Consolidated)

Y/E Mar Rs mn	FY13	FY14	FY15	FY16E	FY17E
Revenue	6,573	11,714	14,270	16,820	19,623
% growth		78.2	21.8	17.9	16.7
Operating expenditure	5,412	9,184	9,954	11,527	13,206
EBITDA	1,161	2,530	4,316	5,293	6,417
% growth		117.9	70.6	22.6	21.2
Other Income	38	43	42	45	47
Depreciation	503	1,616	2,237	1,908	2,095
EBIT	696	957	2,121	3,430	4,369
Interest	285	872	874	725	544
Exceptional Items	(2)	(9)	(0)	-	-
PBT	413	76	1,247	2,705	3,826
Tax	37	27	48	271	383
Reported PAT	376	49	1,199	2,435	3,443
Minority Interest	127	(12)	365	438	526
Adjusted PAT	249	61	834	1,997	2,917
% growth		(75)	1,262	139	46

Source: Karvy Stock Broking, Company

Exhibit 22: Balance Sheet (Consolidated)

Y/E Mar Rs mn	FY13	FY14	FY15	FY16E	FY17E
Cash & Cash equivalents	271	126	204	1,030	2,154
Trade receivables	427	1,097	3,098	3,594	4,193
Inventories	1,500	1,755	1,091	1,290	1,505
Loans & Advances	5,449	6,361	6,807	7,373	8,602
Investments	15	15	15	15	15
Fixed Assets	12,937	12,717	10,689	9,482	8,787
Total Assets	20,599	22,072	21,905	22,785	25,256
Current Liabilities & Provisions	1,802	2,718	2,982	3,518	4,097
Debt	9,292	9,917	8,805	6,725	4,925
Deferred tax assets (Liabilities)	41	45	87	87	87
Total Liabilities	11,134	12,680	11,874	10,330	9,108
Shareholder's equity	222	222	222	222	222
Reserves & Surplus	6,705	6,641	6,578	8,356	11,274
Shareholder's funds	6,927	6,863	6,800	8,578	11,496
Minority Interest	2,538	2,529	3,231	3,877	4,652
Total Equity & Liabilities	20,599	22,072	21,905	22,785	25,256

Source: Company, Karvy Stock Broking

Star Ferro and Cement
Exhibit 23: Cash Flow Statement (Consolidated)

Y/E Mar Rs mn	FY13	FY14	FY15	FY16E	FY17E
PAT	249	61	834	1,997	2,917
Add: Depn	503	1,616	2,237	1,908	2,095
Change in WC	(5,575)	(921)	(1,519)	(726)	(1,464)
Cash Flow from operations	(4,822)	757	1,553	3,179	3,548
Capex	(13,440)	(1,397)	(209)	(700)	(1,400)
Change in Investments	(15)	-	-	-	-
Deffered Tax Liability	41	4	42	-	-
Cash Flow from Investing	(13,414)	(1,393)	(168)	(700)	(1,400)
Change in equity	222	-	-	-	-
Change in debt	9,292	625	(1,112)	(2,080)	(1,800)
Dividend paid	-	(122)	-	(260)	(260)
Others	8,994	(12)	(195)	687	1,035
Cash flow from financing	18,507	491	(1,307)	(1,652)	(1,025)
Net cash Flow	270	(145)	78	827	1,123
cash at the beginning	0	271	126	204	1,030
Cash at the end	271	126	204	1,030	2,154

Source: Karvy Stock Broking, Company

Exhibit 24: Ratios

Y/E Mar %	FY13	FY14	FY15	FY16E	FY17E
EBITDA margin	17.7	21.6	30.2	31.5	32.7
EBIT margin	10.6	8.2	14.9	20.4	22.3
Net profit margin	3.8	0.5	5.8	11.9	14.9
Dividend payout ratio	0.0	170.2	0.0	11.1	7.6
Net debt/equity (x)	1.3	1.4	1.3	0.7	0.2
Interest/EBIT (x)	0.4	0.9	0.4	0.2	0.1
RoCE	3.7	4.9	11.2	17.8	20.6
RoE	3.6	0.9	12.3	23.3	25.4

Source: Company, Karvy Stock Broking

Exhibit 25: Valuation

Y/E Mar	FY13	FY14	FY15	FY16E	FY17E
EPS (Rs)	1.1	0.3	3.8	9.0	13.1
DPS (Rs)	0.0	0.5	0.0	1.0	1.0
BVPS (Rs)	31.2	30.9	30.6	38.6	51.7
P/E (x)	138.2	562.3	41.3	17.2	11.8
EV/EBITDA (x)	37.4	17.5	10.0	7.5	5.8
P/BV (x)	5.0	5.0	5.1	4.0	3.0
EV/Tonne (USD)	225	229	194	181	130

Source: Company, Karvy Stock Broking

Stock Ratings		Absolute Returns
Buy	:	> 15%
Hold	:	5-15%
Sell	:	< 5%

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Disclosures Appendix

Analyst certification

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