

27 July 2018

## Star Cement

### Rationalising costs; retaining our Buy call

Rationalising freight & power and fuel costs and good volume growth with a strong, ~23%, market share in its key north-east region would drive Star Cement's performance. Further, it is expected to gain from adding capacity outside this region, the boost in infrastructure spending in the north-east and diversification. We are upbeat about the company's prospects and retain our Buy rating on the stock, with a price target of ₹160.

**Maintaining its market share.** With a well-known brand, a strong ~23% market-share and premium pricing in the north-east, we anticipate the company to benefit from the addition of capacities in east India. It has a high share (~70%) in retail markets, which helps it secure better realisations.

**Improvement in operations.** Increasing coal prices and FoR dispatches, reflected in the high fuel and freight costs, led to the 29% y/y fall in quarterly EBITDA/ton, to ₹1,724. Given the measures taken by the company in optimising costs and rationalising freight, we expect a better operational performance. We expect EBITDA registering an 11% CAGR over FY18-20.

**Trimming the lead distance.** On completion of the entire freight subsidy, the company would cut down its overall operational cost. It has begun to rationalise its lead distance. This would help lower its lead distance and improve EBITDA-per-ton.

**Valuations.** With good volume growth and downsizing debt through subsidy receipts, we revise our target price to ₹160 and maintain our Buy recommendation on the stock, which quotes at an FY20e EV/EBITDA of 7.5x and an EV/ton of \$136. **Risk.** Rising operational costs.

Key Financials (YE Mar)	FY16	FY17	FY18	FY19e	FY20e
Sales (₹ m)	17,095	15,215	16,064	20,341	24,318
Net profit (₹ m)	1,346	1,947	3,307	2,677	3,528
EPS (₹)	3.2	4.6	7.9	6.4	8.4
PE (x)	35.7	30.2	14.7	17.9	13.5
EV / EBITDA (x)	14.5	16.6	10.2	9.6	7.5
EV / ton (\$)	230.9	268.7	212.1	198.7	135.9
RoE (%)	17.1	19.2	25.6	17.3	19.6
RoCE (%)	12.9	15.1	21.7	17.3	20.7
Dividend yield (%)	0.5	-	0.9	0.9	1.1
Net debt / equity (x)	0.9	0.7	0.3	0.1	-0.0

Source: Company, Anand Rathi Research

Rating: **Buy**

Target Price: ₹160

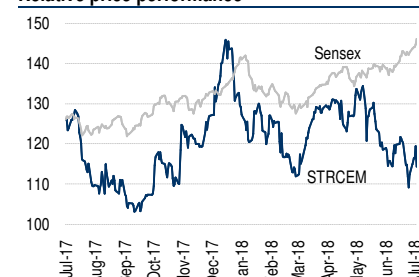
Share Price: ₹114

Key data	STRCEM IN
52-week high / low	₹152 / 102
Sensex / Nifty	37337 / 11278
3-m average volume	\$0.2m
Market cap	₹48bn / \$697.9m
Shares outstanding	419m

Shareholding pattern (%)	June'18	Mar'18	Dec'17
Promoters	68.9	68.9	73.3
- of which, Pledged	42.8	42.8	40.3
Free float	31.1	31.1	26.8
- Foreign institutions	2.2	1.9	2.0
- Domestic institutions	7.3	7.3	2.7
- Public	21.6	21.9	22.1

Estimates revision (%)	FY19e	FY20e
Sales	2.1	(1.8)
EBITDA	(6.7)	(1.7)
PAT	5.3	7.3

### Relative price performance



Source: Bloomberg

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## Quick Glance – Financials and Valuations

**Fig 1 – Income statement (₹ m)**

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
Sales volumes (m tons)	2.6	2.7	2.4	2.6	3.0
Net revenues	17,095	15,215	16,064	20,341	24,318
Growth (%)	19.8	-11.0	5.6	26.6	19.5
Direct costs	3,455	3,403	2,697	3,358	4,034
SG&A	9,701	7,792	8,235	11,844	13,939
<b>EBITDA</b>	<b>3,938</b>	<b>4,021</b>	<b>5,132</b>	<b>5,140</b>	<b>6,345</b>
EBITDA margins (%)	23.0	26.4	31.9	25.3	26.1
- Depreciation	1,715	1,179	1,207	1,300	1,500
Other income	69	87	125	62	62
Interest expenses	834	781	525	239	109
PBT	1,458	2,148	3,526	3,663	4,798
Effective tax rate (%)	4.10	6.47	4.65	25.00	25.00
+ Associates / (minorities)	53	62	55	70	70
Net income	1,340	1,947	3,307	2,677	3,528
Adjusted income	1,346	1,947	3,307	2,677	3,528
WANS	419	419	419	419	419
FDEPS (₹ / sh)	3.2	4.6	7.9	6.4	8.4
FDEPS growth (%)	-14.5	44.7	69.8	-19.0	31.8

**Fig 3 – Cash-flow statement (₹ m)**

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
PBT	1,458	2,148	3,526	3,663	4,798
+ Non-cash items	1,715	1,179	1,207	1,300	1,500
Oper. prof. before WC	3,173	3,327	4,733	4,963	6,298
- Incr. / (decr.) in WC	2,651	898	91	-1,105	537
Others incl. taxes	29	418	733	916	1,199
Operating cash-flow	493	2,011	3,909	5,152	4,562
- Capex (tang. + intang.)	707	679	231	2,000	2,000
Free cash-flow	-213	1,332	3,678	3,152	2,562
Acquisitions					
- Div. (incl. buyback & taxes)	222	-	505	496	650
+ Equity raised	197	-	0	-0	-
+ Debt raised	593	-1,383	-3,683	-2,468	-629
- Fin investments	-	0	-0	-	-
- Misc. (CFI + CFF)	321	-6	-506	-	-
Net cash-flow	34	-44	-3	188	1,283

Source: Company, Anand Rathi Research

**Fig 5 – Price movement**


Source: Bloomberg

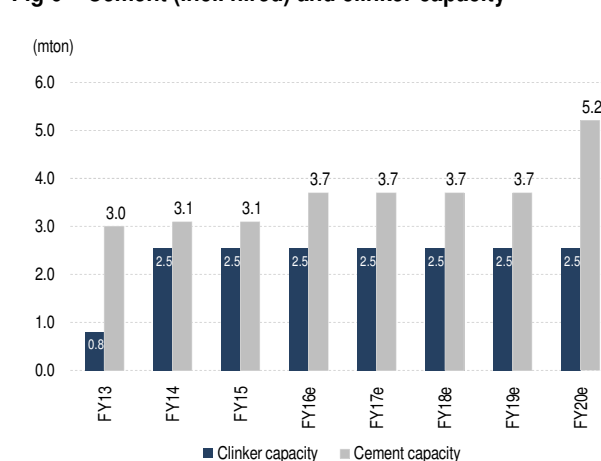
**Fig 2 – Balance sheet (₹ m)**

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
Share capital	419	419	419	419	419
Net worth	10,553	11,460	14,764	16,944	19,823
Total debt	9,398	8,007	4,324	1,857	1,227
Minority interest	530	566	621	691	761
DTL / (assets)	117	-1,765	-2,329	-2,329	-2,329
<b>Capital employed</b>	<b>20,599</b>	<b>18,268</b>	<b>17,380</b>	<b>17,163</b>	<b>19,482</b>
Net tangible assets	9,190	8,631	7,845	8,403	9,303
Net intangible assets	2	2	2	2	2
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	490	549	357	500	100
Investments (strategic)	15	15	14	17	17
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	14,725	13,641	14,311	13,487	15,124
Cash	238	201	198	386	1,668
Current liabilities	4,060	4,769	5,348	5,629	6,729
Working capital	10,665	8,872	8,963	7,858	8,395
<b>Capital deployed</b>	<b>20,599</b>	<b>18,268</b>	<b>17,380</b>	<b>17,165</b>	<b>19,485</b>
Contingent liabilities	-	299	-	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
P/E (x)	35.7	30.2	14.7	17.9	13.5
EV / EBITDA (x)	14.5	16.6	10.2	9.6	7.5
EV / sales (x)	3.3	4.4	3.3	2.4	1.9
P/B (x)	5.1	5.1	3.3	2.8	2.4
RoE (%)	17.1	19.2	25.6	17.3	19.6
RoCE (%) - after tax	12.9	15.1	21.7	17.3	20.7
DPS (₹ / sh)	0.5	-	1.0	1.0	1.3
Dividend payout (%) - incl. DDT	16.5	-	15.3	18.5	18.4
Net debt / equity (x)	0.9	0.7	0.3	0.1	-0.0
WC days	219	202	203	151	122
EV / ton (\$)	230.9	268.7	212.1	198.7	135.9
NSR / ton (₹)	7,588	7,126	8,828	9,269	9,733
EBITDA / ton (₹)	1,386	1,445	2,255	1,871	2,051
Volumes (m tons)	2.6	2.7	2.4	2.6	3.0
CFO : PAT (%)	36.7	103.3	118.2	192.4	129.3

Source: Company, Anand Rathi Research

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


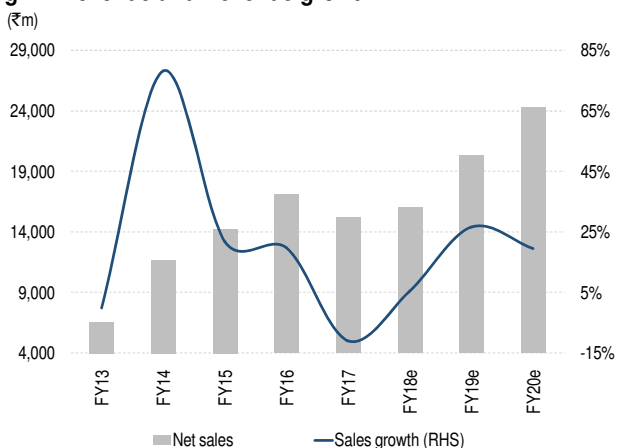
Source: Company

## Other key highlights

### Revenue growth

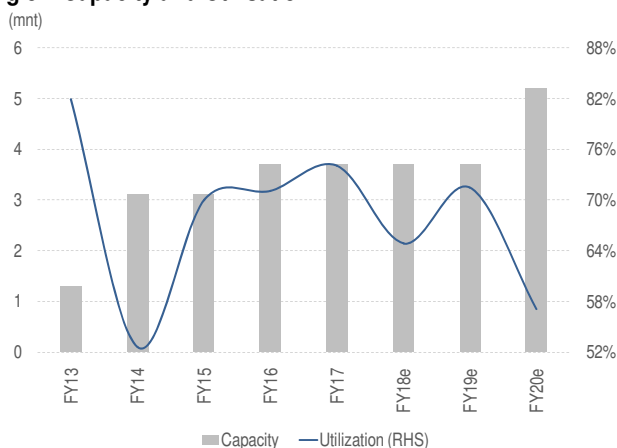
A good 15% growth in the volumes to 0.71m tons, along with a pickup in demand led to achieve revenue growth by 21% y/y to ₹5.17bn. Whereas due to low pricing scenario in the north east markets, realization during the quarter decline by 10% y/y to ₹7,980. We expect a 23% CAGR in revenue over FY18-20, boosted by a 11% CAGR in volumes, as the company expects an 10% growth in volumes and demand in FY19.

**Fig 7 – Revenue and Revenue growth**



Source: Company, Anand Rathi Research

**Fig 8 – Capacity and Utilisation**

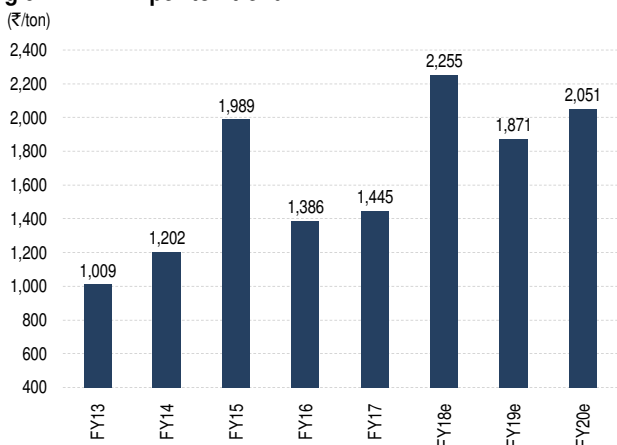


Source: Company, Anand Rathi Research

### Operating performance

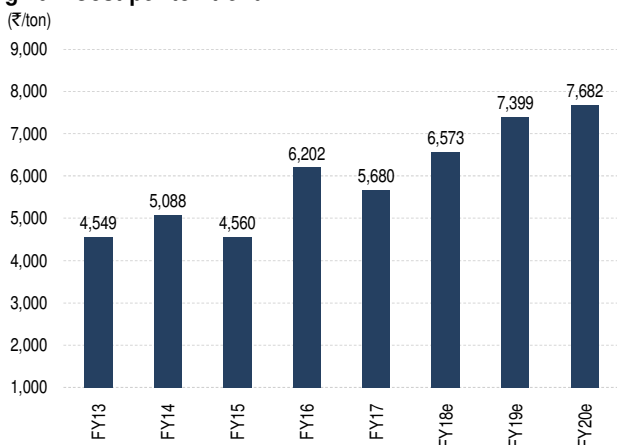
Q1FY19, EBITDA/ton saw a huge dip by 29% y/y at ₹1,724. This was largely due to increasing other expenses by 35% y/y and raw material costs by 20% y/y. However during the quarter power & fuel cost was ₹948/ton and freight cost ₹1592/ton. The huge increase in tax by 108% y/y along with inefficient operational performance led to a 18% y/y fall in PAT, 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)

	FY19		FY18			FY18	FY19e	FY20e
	Q1	Q4	Q3	Q2	Q1			
Sales	5,179	5,274	3,774	2,810	4,287	16,064	20,341	24,318
EBITDA	1,317	1,444	1,413	770	1,586	5,132	5,140	6,345
EBITDA margins (%)	25	27	37	27	37	32	25	26
EBITDA per ton (₹)	1,724	1,851	2,142	1,629	2,415	2,255	1,871	2,051
Interest	54	89	137	141	157	525	239	109
Depreciation	283	241	337	326	303	1,207	1,300	1,500
Other income	3	28	2	9	4	125	62	62
PBT	983	1,143	942	311	1,130	3,526	3,663	4,798
Tax	68	54	28	49	33	164	916	1,199
PAT	915	1,088	914	262	1,097	3,362	2,747	3,598

Source: Anand Rathi Research

Fig 12 – Per-ton analysis

(₹ per ton)	FY19		FY18			FY18	FY19e	FY20e
	Q1	Q4	Q3	Q2	Q1			
Realisations	7,980	8,087	5,484	6,029	8,911	8,828	9,269	9,733
EBITDA	1,724	1,851	2,142	1,629	2,415	2,255	1,871	2,051
Sales volumes (m tons)	0.7	0.7	0.6	0.4	0.6	2.4	2.6	3.0
<b>Costs</b>								
Raw material	1,327	1,162	862	817	1,107	885	1,307	1,391
Purchase of traded goods	124	220	199	126	253	207	-	-
Staff cost	-	-	-	-	-	-	-	-
Other expenses	376	331	443	624	459	447	446	475

Source: Anand Rathi Research

### Change in estimates

Owing to the Q1 FY19 performance, we have raised our FY19e revenue 2.1% and lowered those for FY20 by 1.8%. We lower our FY19e/20e EBITDA 6.7% and 1.7% respectively and increase PAT 5.3% and 7.3%. With better volume growth expected in coming years and deleveraging to happen, we expect Star Cement to post a better operating performance.

Fig 13 – Change in estimates

(₹ m)	New		Old		Variance	
	FY19e	FY20e	FY19e	FY20e	% chg	% chg
Sales	20,341	24,318	19,920	24,756	2.1	(1.8)
EBITDA	5,140	6,345	5,511	6,454	(6.7)	(1.7)
PAT	2,676.9	3,528.3	2,543	3,288	5.3	7.3

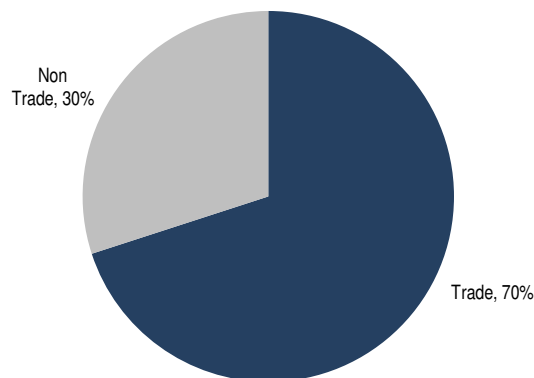
Source: Anand Rathi Research

## Concall Highlights

### Operational and Financial highlights

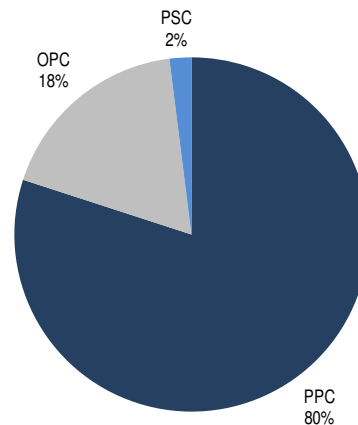
- Sales volumes in the north-east were 0.54m tons, climbing 16% y/y.
- It sold 94,000 tons of clinker in the quarter.
- The trade and non-trade sales-mix for the quarter was 70:30.
- The PPC-OPC-PSC cement mix in Q1 FY19 was 80:18:2.

Fig 14 – Sales mix (%)



Source: Company

Fig 15 – OPC-PPC-PSC mix



Source: Anand Rathi Research

### Subsidies

- Management expects ₹4.3bn GST subsidy in FY19/20.
- It expects to receive ₹1.5bn by end-Sep or Dec'18 and the balance the next year.
- It is expected to receive subsidy up to 2023 for its 2m-ton plant and up to 2027 for its 1.8m-ton plant.

### Capex / Capacity expansion

- The company expects commissioning of its Silligudi plant by Dec'20.
- Its clinker capacity in the north-east is being de-bottlenecked,

increasing capacity to 3m tons (from 2.6m), expected to be complete by Q2 FY19.

- Capex estimated by the company for FY19 and FY20 is ₹4.5bn, where ₹1.5bn-2bn is expected to be spent in FY19 and the balance in FY20.

#### **Volumes, demand and capacity utilisation**

- The company expects ~8-10% volume growth in FY19.
- Capacity utilised during the quarter was 93%.

#### **Others**

- For the coming quarter, ~10% growth in demand is expected.
- Coal prices during the quarter were ~₹5,300-5,500 a ton.

## Valuations

At the ruling price, the stock trades at an EV/EBITDA of 7.5x and an EV/ton of \$136. We maintain our Buy recommendation on it, with a revised price target of ₹160.

**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
Star Cement	114	17.4	13.3	9.6	7.5	199	136
Birla Corp.	775	26.8	18.8	9.0	7.7	89	85
Dalmia Bharat	2,692	33.2	24.8	11.4	8.8	153	124
Deccan Cement	460	13.3	10.4	6.3	4.8	39.8	36.5
Heidelberg Cement	155	18.4	15.0	9.4	8.0	104	99
India Cement	119	15.3	11.1	7.1	6.1	61	60
JK Cement	800	15.4	14.9	8.9	8.9	101	82
JK Lakshmi	338	21.4	12.5	10.2	7.4	72	67
Mangalam Cement	244	17.2	11.7	8.3	6.0	39	35
NCL Indus	170	10.0	7.1	5.7	4.3	50	44
Orient Cement	128	22.9	17.1	9.2	7.9	73	73
Ramco Cement	720	26.2	22.0	15.6	13.1	201	202
Sagar Cement	797	24.3	12.2	10.0	6.5	57	49
Sanghi Industries	94	20.1	14.3	11.8	10.7	111	124

Source: Bloomberg

### Risk

- Rising operational costs

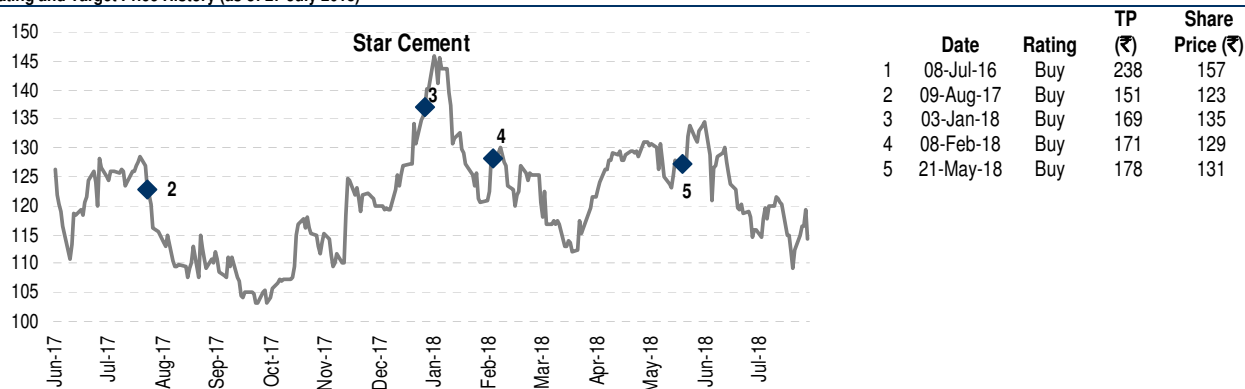
## Appendix

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