

14 November 2018

Star Cement

Shutdown impacts performance; retaining Buy

Rating: **Buy**

Target Price: ₹126

Share Price: ₹100

Its rationalised 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. Its Q2 was bruised by a huge rise in raw material and freight costs on the shutdown of its clinker plant and expiration of its transport subsidy. Further, it will benefit from the boost to infrastructure spending in the north-east. We are upbeat about its prospects and retain our Buy rating the stock, with a target of ₹126.

Its strong hold on the market persists. On the capacity additions, its commanding ~23% in its key market together with premium pricing in the north-east, would boost its performance. Its high, ~83%, share in retail markets would further aid realisations.

Soaring operational costs. In Q2 FY19, its raw material and freight costs increased on the shuttering of its clinker plant and its transport subsidy expiring. This led to the huge, 30% y/y, fall in quarterly EBITDA/ton, to ₹1,109. Ahead, various measures implemented in optimising costs and rationalising freight would lead to better operational performance. We expect its EBITDA over FY18-20 to register a 4% CAGR.

Optimising freight costs. During the quarter, freight costs soared to 55% y/y on the expiration of its entire freight subsidy and the shutting of its clinker plant for more than ~65 days. Further, to trim logistics costs, it is planning a railway sliding, expected to come by Jan-Feb'19. This would help reduce its lead distance and improve EBITDA-per-ton.

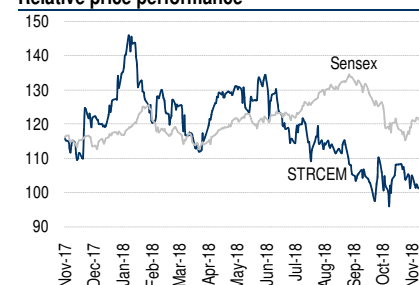
Valuations. With shrinking debt through subsidy receipts and a good pick-up in volume growth and infrastructure activity, we lower our target price to ₹126 and maintain our Buy recommendation on the stock, which quotes at an FY20e EV/EBITDA of 10x. **Risk.** Rising operational costs.

Key data	STRCEM IN
52-week high / low	₹152 / 80
Sensex / Nifty	35142 / 10576
3-m average volume	\$0.3m
Market cap	₹42bn / \$575.4m
Shares outstanding	419m

Shareholding pattern (%)	Sep'18	Jun'18	Mar'18
Promoters	68.9	68.9	68.9
- of which, Pledged	29.0	42.8	42.8
Free float	31.1	31.1	31.1
- Foreign institutions	1.0	2.2	1.9
- Domestic institutions	8.4	7.3	7.3
- Public	21.7	21.6	21.9

Estimates revision (%)	FY19e	FY20e
Sales	(12.8)	(12.2)
EBITDA	(13.0)	(12.0)
PAT	(13.1)	(10.9)

Relative price performance



Source: Bloomberg

Key Financials (YE Mar)	FY16	FY17	FY18	FY19e	FY20e
Sales (₹ m)	17,095	15,215	16,064	17,738	21,349
Net profit (₹ m)	1,346	1,947	3,307	2,327	3,144
EPS (₹)	3.2	4.6	7.9	5.5	7.5
PE (x)	35.7	30.2	14.7	18.0	13.3
EV / EBITDA (x)	14.5	16.6	10.2	9.5	7.4
EV / ton (\$)	214.9	250.0	197.4	158.8	110.6
RoE (%)	17.1	19.2	25.6	15.3	17.9
RoCE (%)	12.9	15.1	21.7	15.4	18.9
Dividend yield (%)	0.5	-	0.9	0.9	1.2
Net debt / equity (x)	1.0	0.7	0.3	0.0	-0.0

Source: Company, Anand Rathi Research

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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	2.8	3.2
Net revenues	17,095	15,215	16,064	17,738	21,349
<i>Growth (%)</i>	19.8	-11.0	5.6	10.4	20.4
Direct costs	3,455	3,403	2,697	2,916	3,529
SG&A	9,701	7,792	8,235	10,350	12,238
EBITDA	3,938	4,021	5,132	4,473	5,582
<i>EBITDA margins (%)</i>	23.0	26.4	31.9	25.2	26.1
- Depreciation	1,715	1,179	1,207	1,100	1,250
Other income	69	87	125	62	62
Interest expenses	834	781	525	239	109
PBT	1,458	2,148	3,526	3,195	4,285
<i>Effective tax rate (%)</i>	4.1	6.5	4.6	25.0	25.0
+ Associates / (minorities)	53	62	55	70	70
Net income	1,340	1,947	3,307	2,327	3,144
Adjusted income	1,346	1,947	3,307	2,327	3,144
WANS	419	419	419	419	419
FDEPS (₹ / sh)	3.2	4.6	7.9	5.5	7.5
<i>FDEPS growth (%)</i>	-14.5	44.7	69.8	-29.6	35.1

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
PBT	1,458	2,148	3,526	3,195	4,285
+ Non-cash items	1,715	1,179	1,207	1,100	1,250
Oper. prof. before WC	3,173	3,327	4,733	4,295	5,535
- Incr. / (decr.) in WC	2,651	898	91	-2,110	517
Others incl. taxes	29	418	733	799	1,071
Operating cash-flow	493	2,011	3,909	5,607	3,946
- Capex (tang. + intang.)	707	679	231	1,500	2,500
Free cash-flow	-213	1,332	3,678	4,107	1,446
Acquisitions					
- Div. (incl. buyback & taxes)	222	-	505	433	580
+ Equity raised	197	-	0	-0	-
+ Debt raised	593	-1,383	-3,683	-2,468	-629
- Fin investments	-	-1	-0	3	-
- Misc. (CFI + CFF)	321	-6	-506	-	0
Net cash-flow	34	-43	-3	1,204	236

Source: Company, Anand Rathi Research

Fig 5 – Price movement


Source: Bloomberg

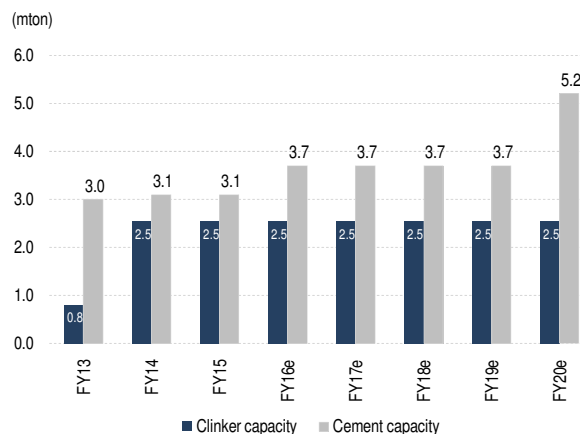
Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
Share capital	419	419	419	419	419
Net worth	9,512	11,460	14,764	16,657	19,220
Debt	9,390	8,007	4,324	1,857	1,227
Minority interest	504	566	621	691	761
DTL / (Assets)	-1,492	-1,765	-2,329	-2,329	-2,329
Capital employed	17,914	18,268	17,380	16,876	18,880
Net tangible assets	9,189	8,631	7,845	8,103	9,753
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)	13,212	13,641	14,311	11,761	13,277
Cash	245	201	198	1,402	1,638
Current liabilities	5,238	4,769	5,348	4,908	5,908
Working capital	7,974	8,872	8,963	6,852	7,370
Capital deployed	17,914	18,268	17,380	16,876	18,880
Contingent liabilities	-	299	-	-	-

Fig 4 – Ratio analysis

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
P/E (x)	35.7	30.2	14.7	18.0	13.3
EV / EBITDA (x)	14.5	16.6	10.2	9.5	7.4
EV / sales (x)	3.3	4.4	3.3	2.4	1.9
P/B (x)	5.1	5.1	3.3	2.5	2.2
RoE (%)	17.1	19.2	25.6	15.3	17.9
RoCE (%) - after tax	12.9	15.1	21.7	15.4	18.9
DPS (₹ / sh)	0.5	-	1.0	0.9	1.1
Dividend payout (%) - incl. DDT	16.5	-	15.3	18.6	18.5
Net debt / equity (x)	1.0	0.7	0.3	0.0	-0.0
WC days	171	202	203	163	122
EV / ton (\$)	214.9	250.0	197.4	158.8	110.6
NSR / ton (₹)	4,538	7,235	8,372	7,786	7,941
EBITDA / ton (₹)	1,498	1,467	2,138	1,614	1,751
Volumes (m tons)	2.6	2.7	2.4	2.8	3.2
CFO : PAT (%)	36.7	103.3	118.2	241.0	125.5

Source: Company, Anand Rathi Research

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


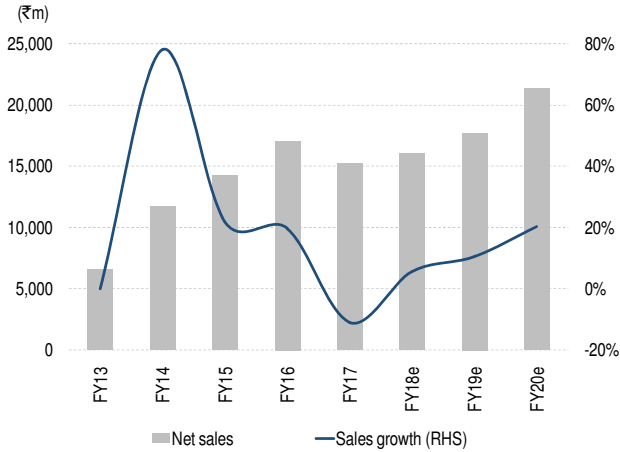
Source: Company

Other key highlights

Revenue growth

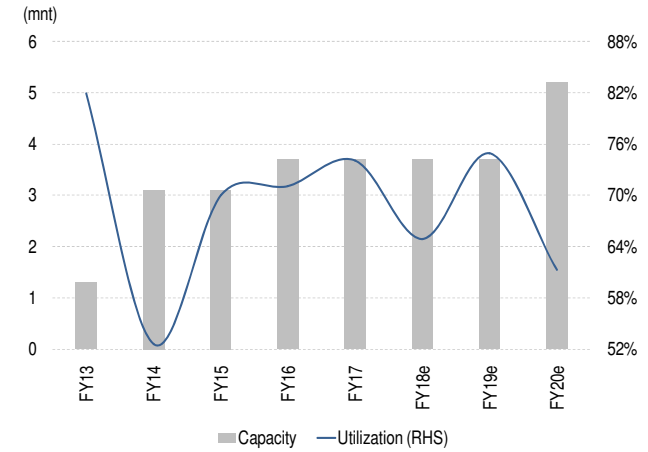
A decent, 25%, rise in volumes to 0.55m tons, and a pick-up in demand led to revenue growing 30% y/y to ₹3.6bn. Also, the better pricing scenario in the north-east led to realisation during the quarter rising 10% y/y to ₹6,509. As the company expects 15% growth in volumes and demand in FY19, we expect a 15% CAGR in revenue over FY18-20, boosted by a 15% CAGR in volumes.

Fig 7 – Revenue and Revenue growth



Source: Company, Anand Rathi Research

Fig 8 – Capacity and Utilisation

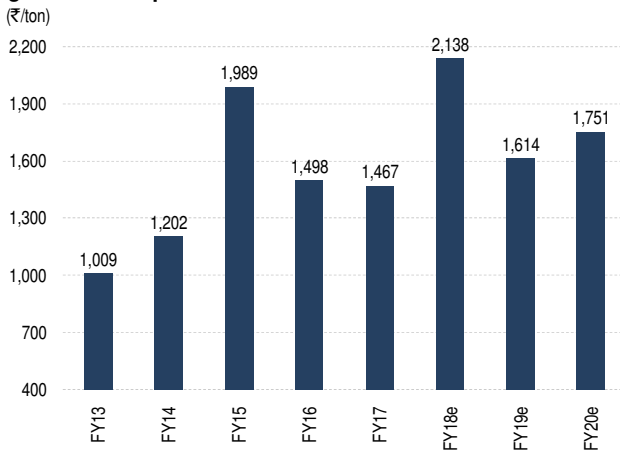


Source: Company, Anand Rathi Research

Operating performance

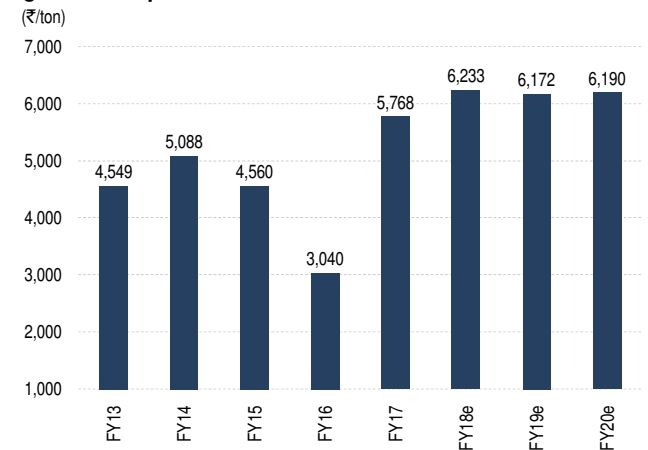
The Q2 FY19 EBITDA/ton dipped 30% y/y to ₹1,109. This was largely due to higher raw material and freight costs, respectively 119% and 55% y/y. This stemmed chiefly from the shutdown of its clinker plant for more than 65 days, when the company had purchase 30,000 tons of clinker. The huge decline in interest and the tax, respectively 77% and 83% y/y, led to a 41% y/y rise in PAT, to ₹364m.

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)

	Q2 FY19	Q1 FY19	Q4 FY18	Q3 FY18	Q2 FY18	FY18	FY19e	FY20e
Sales	3,623	5,179	5,274	3,774	2,810	16,064	17,738	21,349
EBITDA	687	1,317	1,444	1,413	770	5,132	4,473	5,582
EBITDA margins (%)	19	25	27	37	27	32	25	26
EBITDA per ton (₹)	1,109	1,724	1,851	2,142	1,592	2,138	1,614	1,751
Interest	33	54	89	137	141	525	239	109
Depreciation	271	283	241	337	326	1,207	1,100	1,250
Other income	7	3	28	2	9	125	62	62
PBT	390	983	1,143	942	311	3,526	3,195	4,285
Tax	8	68	54	28	49	164	799	1,071
PAT	382	915	1,088	914	263	3,362	2,397	3,214

Source: Anand Rathi Research

Fig 12 – Per-ton analysis

(₹ per ton)	Q2 FY19	Q1 FY19	Q4 FY18	Q3 FY18	Q2 FY18	FY18	FY19e	FY20e
Realisations	6,509	7,980	8,087	5,484	5,902	8,372	7,786	7,941
EBITDA	1,109	1,724	1,851	2,142	1,592	2,138	1,614	1,751
Sales volumes (m tons)	0.5	0.7	0.7	0.6	0.4	2.4	2.8	3.2
Costs								
Raw material	1,405	1,327	1,162	862	798	885	1,088	1,138
Purchase of traded goods	364	282	220	199	223	207	-	-
Staff cost	585	376	331	443	610	447	371	388
Other expenses	2,709	3,369	3,450	2,551	2,386	2,984	3,364	3,450

Source: Anand Rathi Research

Change in estimates

The higher costs in Q2 FY19 drive us to lower our FY19e and FY20e revenue, respectively 12.8% and 12.2%. We also lower our FY19e and FY20e EBITDA 13% and 12% respectively, and PAT 13.1% and 10.9%. With better volume growth expected in coming years and deleveraging, 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	17,738	21,349	20,341	24,318	(12.8)	(12.2)
EBITDA	4,473	5,582	5,140	6,345	(13.0)	(12.0)
PAT	2,327	3,144	2,677	3,528	(13.1)	(10.9)

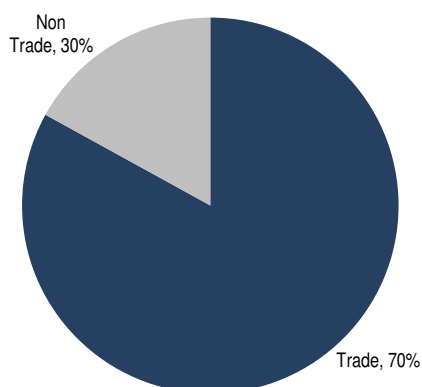
Source: Anand Rathi Research

Concall Highlights

Operational and Financial highlights

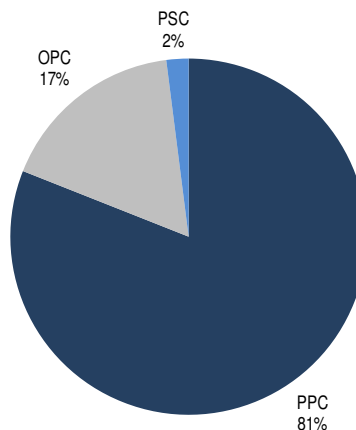
- Sales volumes in the north-east were 0.42m tons, increasing 27% y/y. Outside the north-east, it was 0.12m tons, increasing 20% y/y
- Transport subsidies of ₹300-350/ton expired in Jan 2018 and a plant was shuttered for 65 days in Q2 FY19 (40 days in Q2 FY18).
- The trade and non-trade sales-mix for the quarter was 83:17.

Fig 14 – Sales mix (%)



Source: Company

Fig 15 – OPC-PPC-PSC mix



Source: Anand Rathi Research

- Freight cost for the quarter increased 54.6% y/y to ₹630m; power and fuel cost increased 22.16% y/y to ₹370m.
- The PPC-OPC-PSC cement mix in Q2 FY19 was 81:17:2.
- Capacity utilised during the quarter was 65-70%.

Subsidies

- The ₹4bn government subsidy would be in phases: ₹1.5bn in FY19, the rest in FY20.
- For its 2m-ton plant the company will receive subsidy up to 2023; for its 1.8m-ton plant, up to 2027.

Capex / Capacity expansion

- The company expects commissioning of its Siligudi 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 is ₹180m for a railway siding and ₹150-200m for de-bottlenecking in FY19. For its Siligudi plant capex planned is ₹4bn: ₹1.5bn in FY19, the rest in FY20.

Others

- The company expects ₹1,700-1,800 EBITDA/ton for FY19.
- For the coming quarter ~13-15% growth in demand is expected

Valuations

At the ruling price, the stock trades at an EV/EBITDA of 7.4x and an EV/ton of \$110.7. We maintain our Buy recommendation on it, with a lowered price target of ₹126.

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	100	17.5	13.0	9.5	7.4	159	111
Birla Corp.	610	24.6	16.2	9.2	7.9	64	67
Dalmia Bharat	2,126	29.4	22.2	9.5	8.1	122	111
Deccan Cement	379	11.3	9.2	5.3	4.1	32.4	29.3
Heidelberg Cement	153	16.3	13.1	8.1	6.9	95	89
India Cement	90	16.2	9.0	7.4	5.8	51	50
JK Cement	694	17.1	15.0	9.9	9.3	83	69
JK Lakshmi	267	20.8	11.7	9.9	7.2	63	59
Mangalam Cement	210	NM	70.8	11.7	8.9	37	35
NCL Industries	130	16.0	8.8	7.0	5.0	39	35
Orient Cement	85	50.8	19.1	10.5	7.9	50	57
Ramco Cement	611	29.8	22.6	17.1	13.3	174	174
Sagar Cement	655	43.3	14.2	11.8	7.2	50	44
Sanghi Industries	62	16.5	11.3	10.0	9.4	86	100

Source: Bloomberg

Risk

- Increasing operational costs.

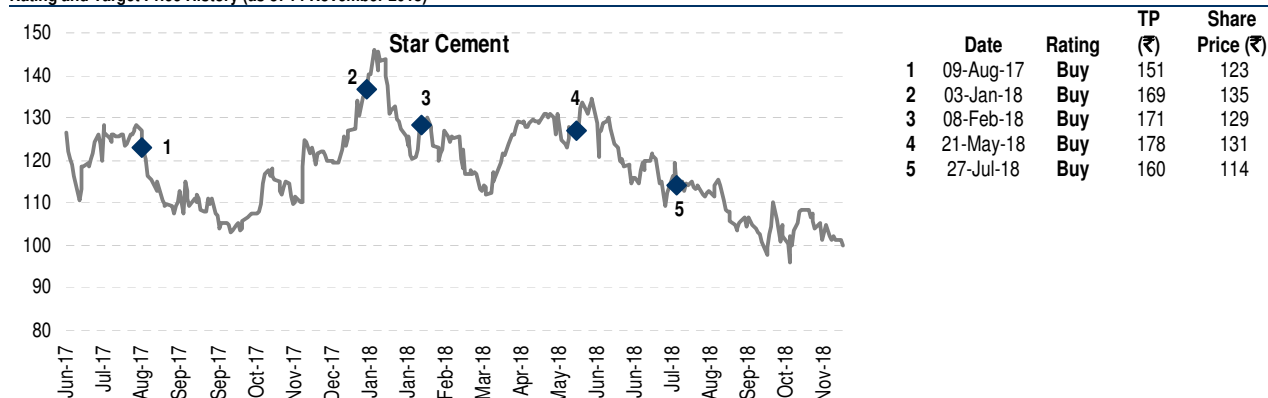
Appendix

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