India I Equities

Cement

Visit Note

17 March 2015

Star Ferro and Cement

"Star" performer

Rating: **NR**
Target Price: NA
Share Price: ₹160

A leading cement player in the north-east with consolidated capacities of 3.5m tons (cement) and 2.5m tons (clinker), Star Ferro and Cement also has a captive 51 MW plant and a small division of ferro alloys. (This it plans to hive off.) It is one of the biggest beneficiaries of the fiscal benefits from the north-east region's governments.

Regional dominance. With a 23% market share, "STAR" cement is the largest selling and a decade-old, leading cement brand in the north-east region (NER). Because of this, it commands a premium there. Its established leading market position and deeper penetration in the trade segment (85% from retail users) makes it a high operating-leverage play.

Strong operating performance. Under the NEIIPP policy in the region, it enjoys vast concessions. Backed by huge government grants and the subsidies it enjoys, its EBITDA/ton (9M FY15) came at ~₹1,800. The value of such fiscal benefits to the overall EBITDA/ton of cement is around ₹500-600. Even on the operating front, its EBITDA/ton is higher than leading operators in the industry, buoyed up by higher prices in the NER.

Strong balance sheet to fund expansion. Its present net gearing is 1.3x. This, the company believes, is likely to slide to 0.1x in FY17 given its repayment of debt from the subsidies, strong internal accruals and no major capex planned. Further, it intends to expand capacity to 4m tons by FY17. Most organic/inorganic growth is likely to be funded through internal accruals.

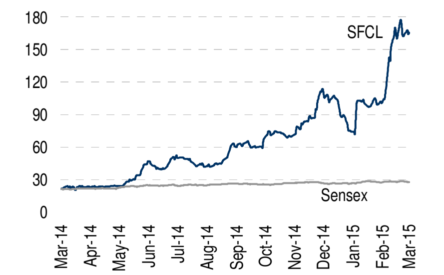
In the right place. Star Ferro's operating performance is one of the best in the region. Given the Central government's regional demand trend and the opportunities for growth, the company expects its volumes in the next two years to rise ~20% yoy. The new government's focus on the development of the NER is likely to generate huge demand for cement in the region. The company is in a sweet spot to benefit from such a scenario.

Valuation. At the ruling price, the stock trades at an EV/EBITDA of 17.9x FY14 consolidated figures. **Risks.** A sharp spike in coal prices, drop in cement prices.

Key data	SFCL IN / CNTY.BO
52-week high / low	₹189 / ₹20
Sensex / Nifty	28735 / 8720
3-m average volume	US$0.47m
Market cap	₹36.6bn / US$611m
Shares outstanding	222.17m

Shareholding pattern (%)	Dec '14	Sep '14	Jun '14
Promoters	67.0	67.0	68.9
- of which, Pledged	*2.02*	*2.02*	*1.96*
Free Float	33.0	33.0	31.1
- Foreign Institutions	0.34	0.34	0.35
- Domestic Institutions	0.0	0.0	0.0
- Public	32.6	32.7	30.7

Relative price performance



Source: Bloomberg

Year-end: Mar	FY13	FY14	9MFY15
Sales (₹ m)	6,573	11,714	10,074
Net profit (₹ m)	374	58	377
EPS (₹)	498.4	0.3	1.7
Growth (%)	-	(0.8)	NA
PE (x)	0.2	616.8	-
EV/EBITDA (x)	7.8	17.9	-
EV/Ton ($)	52.9	264.1	-
RoE (%)	5.4	0.8	-
RoCE (%)	4.0	5.5	-
Net gearing (x)	1.3	1.4	-

Source: Company, Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY13	FY14
Net revenues	6,573	11,714
Revenue growth (%)	-	78.2
- Oper. expenses	5,412	9,184
EBIDTA	1,161	2,530
EBITDA margin (%)	17.7	21.6
- Interest expenses	285	872
- Depreciation	503	1,616
+ Other income	38	43
- Tax	37	27
Effective tax rate (%)	9.0	35.6
Reported PAT	374	58
+/- Extraordinary items	(2)	9
+/- Minority interest	127	(12)
Adjusted PAT	249	61
Adj. FDEPS (₹/sh)	748	0
Adj. FDEPS growth (%)	-	(84.6)

Source: Company

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY13	FY14
Share capital	1	222
Reserves & surplus	6,927	6,641
Net worth	6,927	6,863
Minority interest	2,538	2,529
Total Debt	9,292	9,917
Def. tax liab. (net)	41	45
Capital employed	**18,798**	**19,354**
Net fixed assets	12,937	12,717
Investments	15	15
- of which, Liquid	-	1
Net working capital	5,575	6,495
Cash and bank balance	271	126
Capital deployed	**18,798**	**19,354**
Net debt	9,021	9,790
WC days	310	188
Book value (₹/sh)	13,854	31

Source: Company

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY13	FY14
PAT	249	61
+Non-cash items	544	1,620
Cash profit	793	1,681
- Incr./(Decr.) in WC	-	921
Operating cash-flow	793	761
-Capex	-	1,397
Free cash-flow	793	(636)
-Dividend	-	122
+ Equity raised	-	(3)
+ Debt raised	-	625
-Investments	-	-
-Misc. items	522	-
Net cash-flow	271	(145)
+Op. cash & bank bal.	-	271
Cl. cash & bank bal.	271	126

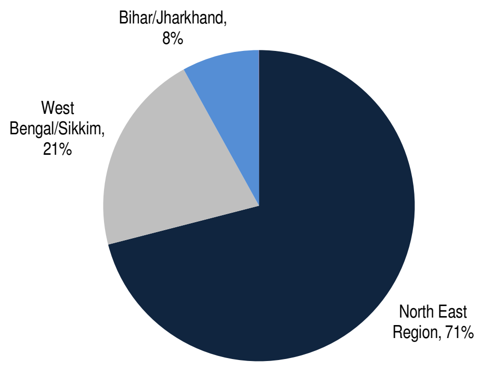
Source: Company

Fig 4 – Ratio analysis @ ₹160

Year-end: Mar	FY13	FY14
P/E (x)	0.2	616.8
P/B (x)	0.0	5.2
P/CEPS (x)	0.1	21.2
EV/EBITDA (x)	7.8	17.9
EV/Ton ($)	52.9	264.1
RoE (%)	5.4	0.8
RoCE (%)	4.0	5.5
Net Debt / Equity (x)	1.3	1.4
Interest Coverage (x)	2.3	1.0
DPS (`)	-	0.5
Dividend yield (%)	-	0.3
Dividend payout (%)	-	213.3
Cement & Clinker- NSR/ton (₹)	5,554	5,855
Cement- EBITDA/ton (₹)	1,014	1,212
Cement- Volumes (m tons)	1.1	1.6

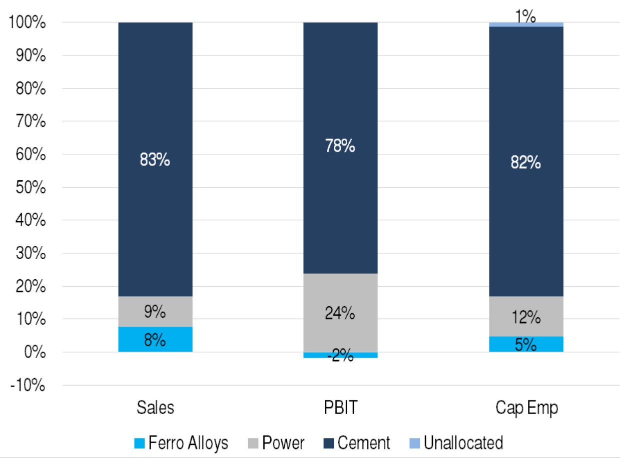
Source: Company

Fig 5 – Regional sales-mix (9M FY15)



Source: Company

Fig 6 – Share of various segments in 9M FY15



Source: Company, Anand Rathi Research

Expansions to drive growth

Star Ferro and Cement is a leading cement manufacturer in the NER, with consolidated cement capacity of 3.5m tons and clinker capacity of 2.5m tons. It also has a 51 MW plant and a small division of ferro alloys (which it plans to hive off). It is one of the biggest beneficiaries of the fiscal benefits of the NER's governments.

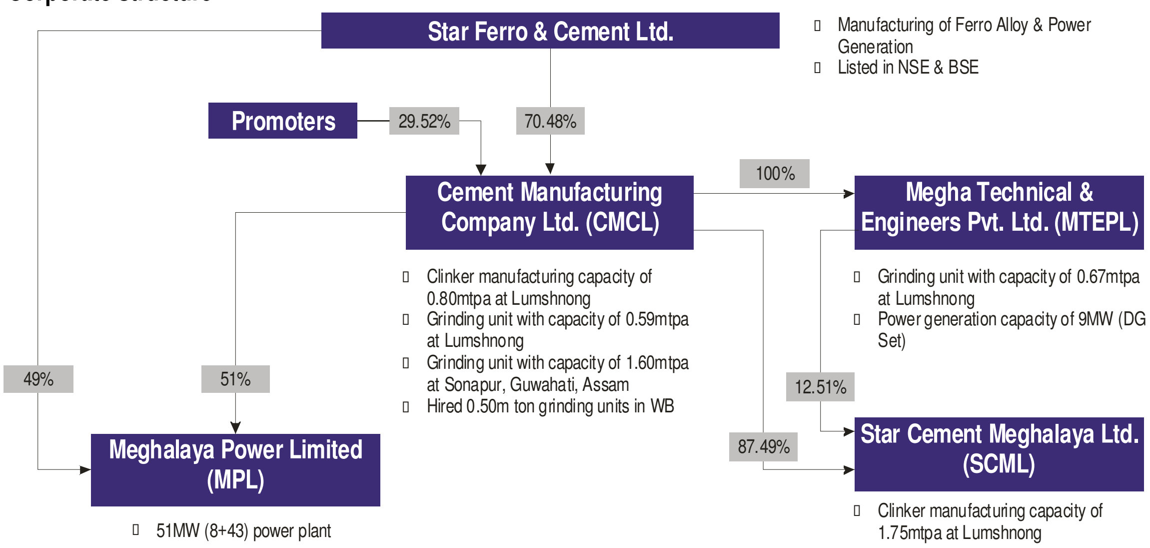
Cement business profile

The cement business is handled by its 70.48% subsidiary, the Cement Manufacturing Co.. (CMC), the largest cement manufacturer in the NER, with a market share of about 23%. It manufactures both OPC (20%) and PPC (80%).

Its plants enjoy significant advantages such as proximity to quality raw material, strong infrastructure and a comprehensive package of fiscal benefits offered by the governments there. This makes NER one of the most attractive regions for the cement business. The company enjoys one of the highest EBITDA/tons in India (₹1,800).

A subsidiary, Meghalaya Power, is into power generation, operating a 51-MW plant in Meghalaya. The plant is mainly used for captive purpose, the surplus sold to the grid.

Fig 7 – Corporate structure



Source: Company, Anand Rathi Research

Cement manufacturing facilities

CMC, along with its subsidiaries, has five manufacturing plants strategically located across eastern India with capacity of 3.1m tons. It has hired facilities in West Bengal of 0.4m-ton capacity, taking its total capacity to 3.5m tons. It is emerging as a one of the strong operators in West Bengal, Bihar and Jharkhand.

It is further planning to expand capacities to 4m tons by FY17, (through a mix of organic and inorganic growth) in a phased manner, to be funded through internal accruals. The company has adequate linkage which, on current clinker capacity, could last for 80 years.

Fig 8 – Capacity details

Capacity		Location
Cement (m tons)	3.1	Guwahati, Meghalaya
Cement (m tons) hired grinding units	0.4	West Bengal
Clinker (m tons)	2.55	Meghalaya
Power (MW)	51	Meghalaya

Source: Company, Anand Rathi Research

Sufficient limestone reserves

Limestone is one of the most critical elements in cement manufacturing. Star Ferro has the best limestone, with substantial reserves to ensure uninterrupted production for more than 80 years. It has its own mines of quality limestone, with calcium-oxide content of more than 49%. All its mines are located within 2—3km of its plant sites. Also, it has its own power plant for the supply of fly ash.

Good marketing reach and brand awareness

The company also enjoys a robust marketing network as it was the first to start direct distribution, i.e., through dealers rather than C&F agents, in the NER. At present, its network of more than 2,000 dealers covers the NER, West Bengal, Bihar and Jharkhand. Its major competitors in the region are Dalmia Cement (capacity: 3.2m tons) and Meghalaya Cement (capacity: 1.2m tons). It has positioned itself as a Grade 'A' brand and hence commands one of the highest prices in the region along with all-India operators such as UltraTech and Ambuja.

Strong brand

"STAR" cement is the largest-selling cement brand in the NER with a leading, 23%, market share. It spends ~₹450m a year on advertising and brand promotion (~4% of revenue). Its strong brand commands a premium to its peers in the NER, with an established market leadership and deeper penetration in the trade segment (retail users), which accounts for 85% of its revenue.

Fig 10 – 'Star' Brand

Source: Company

Effective capacity utilisation

The company operates at 62% (capacity utilisation). The expanded capacities would enhance its ability to cater to a wider area, and bring in economies of scale. It has the highest sales volume in the NER, which does not have adequate capacity to meet demand in the region. This being a high-realisation market leads to inflows of cement from neighbouring states. Given the regional demand trend and the growth opportunities, the company expects ~20% yoy growth in volumes over the next two years.

Fig 11 – Operating parameters

₹ per ton analysis	FY13	FY14	% yoy	9M FY14	9M FY15	% change
Realization	5,554	5,855	5.4	5,805	5,896	1.6
EBITDA	1,130	1,349	19.4	1,050	1,808	72.2
Sales Volumes (m tons)	1.07	1.75	63.6	1.19	1.56	31.1

Source: Company, Anand Rathi Research

Ideally placed in the region to capitalise on growth opportunities

With its better operating performance due to its pricing power, backward integration, fiscal benefits and higher realisations, the company can well capitalise on the growth opportunities. It has great advantages in the region mainly due to

- Proximity to high-quality coal ("A" grade in Meghalaya at a reasonable price) and limestone reserves.
- Proximity to key markets in the region
- Per-capita consumption in the NER (142kg per annum) is the lowest in the industry; the national average is 185kg. Per-capita consumption in eastern India (West Bengal, Bihar, Jharkhand) is even lower, at 115kg a year.
- Demand for cement in the north-east is expected to grow at high single digits.
- The new government's focus on the development of the NER is likely to generate huge cement demand there.
- SFC and two others control ~60% of the NER cement market, leading to it commanding strong pricing power.

Fig 12 – Peer comparison (operating performances)

	Capacity (m tons)		EBITDA/ton			EBITDA margin		
	FY13	FY14	FY13	FY14	9M FY15	FY13	FY14	9M FY15
SFC	**3.1**	**3.1**	**1,130**	**1,349**	**1808**	**18%**	**22%**	**29%**
JK Cement	8.2	8.6	872	585	542	19%	13%	12%
JK Lakshmi	5.3	6.7	819	536	632	21%	15%	16%
Mangalam Cement	2.0	2.0	643	246	359	18%	7%	9%
Ramco Cement	12.5	12.5	1,068	533	648	25%	14%	16%
Orient Cement	5.0	5.0	779	511	668	22%	15%	18%
Dalmia Cement	11.8	12.6	855	336	352	22%	11%	11%
OCL	5.3	6.7	1,156	791	873	23%	15%	15%
Heidelberg (CY)	6.0	5.3	239	539	560	6%	14%	15%
Sagar Cement	2.8	2.8	266	100	140	8%	3%	4%

Source: Anand Rathi Research

Large beneficiary of government grants and subsidies

The company receives a huge amount in grants and subsidies. Such fiscal benefits contribute to the overall EBITDA/ton in cement, at around ₹500—600. It also enjoys concessions under the NEIIPP policy for the region.

Star Ferro receives a capital investment subsidy of 30% of investment in plant and machinery for all newly commissioned plants. This benefit translates to ~₹2bn receivable on account of the capital subsidy for investments made in the company's new plant. Also, the company expects to receive a freight subsidy of ~₹2bn. On the receipt of these benefits, it expects to repay debt of ₹4bn in FY16. Other tax benefits are:

- Income-tax benefit – 100% exemption (subject to MAT and carry forward) under section 80 IE (balance exemption period: two plants – eight years, one plant – two years, one plant – nil)
- CST and VAT exemption for newly commissioned plants for another five years
- Exemption on excise duty (balance exemption period: two plants – eight years, two plants – two years)
- Freight (transport) subsidy (balance exemption period: two plants – three years, two plants –nil)

Hence, the combination of untapped natural resources and the favourable policy framework would attract huge industrial and infrastructure investment. In turn, this is expected to fuel cement demand growth in the region. (It would also lead to higher EBITDA/ton in the industry, at around ₹1,800.) The company is likely to pay off its debt and turn debt free (at the net level) in 1—2 years due to strong cash flows from operations. Also, the hiving off of the ferro alloys and power businesses would simplify its holding structure.

Ferro alloys business

The company manufactures ferro-silicon and silicon-manganese at its Meghalaya unit, where raw material is abundantly available. Ferro alloys mainly cater to the steel industry; in the manufacture of steel, they are used as additives and de-oxidising agents. Ferro-alloy production is highly power intensive (power cost constitutes almost 40% of the total cost per ton of manufacturing ferro alloys). Hence, and for uninterrupted production, the company set up a 13.8-MW plant for its own use.

In addition, it enjoys fiscal incentives such as refund of excise, transport subsidies and a tax holiday according to the North-East policy of the governments. However, it is planning to hive off its ferro-alloys business, after which it would simplify its holding structure.

Financials

Revenues have risen from ₹4.9bn in FY11 to ₹10.28bn in FY14, a 28% CAGR. This strong growth was fuelled by sturdy realisation growth; along with volumes, the margin too has improved. This indicates that the company has got its act together on branding and pricing. The greater capacity utilisation would lead, in coming years, to a rise in its EBITDA margin. The EBITDA margin for 9M FY15 came at 30.6%, and is likely to be maintained.

Fig 13 – Financials (cement division)

Consolidated Financials (₹ m)	FY11	FY12	FY13	FY14	9MFY15
Gross sales	5,080	5,974	6,254	10,290	9,520
Net sales	4,903	5,650	5,950	10,280	9,230
EBITDA	1,532	1,385	1,200	2,355	2,830
PBT	1,173	910	490	(48)	520
PAT	1,206	898	430	(42)	420

Source: Company

The better operating performance, low gearing and rising capacity utilisation would help it improve return ratios. The present net gearing is 1.3x, likely to slide to 0.2x in FY17, given the debt repayment from subsidies, strong internal accruals and no major capex plan. It further plans to expand capacity to 4m tons by FY17 and 7m in the next five years.

Most of its organic/inorganic growth is likely to be funded through internal accruals.

Fig 14 – Segment-wise finance

	FY13	FY14	% yoy	9MFY14	9MFY15	% yoy
Net revenue, by segment						
-Ferro Alloys	646	1,455	125.3	995	858	(13.8)
-Power	7	-	NA	1,139	1,023	(10.2)
-Cement	5,921	10,260	73.3	6,915	9,210	33.2
Total	**6,573**	**11,714**	**78.2**	**9,049**	**11,090**	**22.6**
Less: Inter-segment	788	1,219	54.7	1,139	1,016	(10.8)
Net Sales	**5,785**	**10,495**	**81.4**	**7,910**	**10,074**	**27.4**
PBIT, by segment						
-Ferro Alloys	(109)	164	NA	19	(24)	NA
% of revenue	-17	11		2	-3	
-Power	106	123	16.2	230	305	32.6
% of revenue	1,548	NA		20	30	
-Cement	725	682	(6.0)	(72)	1,001	NA
% of revenue	12	7		-1	11	
Total	**722**	**969**	34.1	**177**	**1,283**	623.9
Less: Interest	285	872	205.8	661	696	5.4
Add Other unalloc.net inc.	(23)	(21)	11.1	(19)	(14)	28.3
PBT (before extraord.)	**414**	**76**	(81.6)	**(502)**	**573**	NA

Source: Company, Anand Rathi Research

Fig 14 – Peer comparison (valuations)

			EV/ton (US$)		EV/EBITDA	
	CMP (₹)	Mkt Cap (₹ bn)	FY13	FY14	FY13	FY14
SFC	**165**	**36.6**	**53**	**264**	**7.8**	**17.9**
JK Cement	685	47.9	123	137	10.9	19.5
JK Lakshmi	380	44.7	170	143	12.6	18.9
Mangalam Cement	292	7.8	71	88	6.9	23.0
Ramco Cement	332	79.0	142	146	11.1	21.4
Orient Cement	177	36.3	132	138	12.4	19.3
Dalmia Cement	455	36.9	84	88	10.8	22.2
OCL	446	25.4	59	47	5.2	7.6
Heidelberg*	79	17.9	87	92	35.9	13.0
Sagar	336	5.8	47	47	18.5	55.1

*Source: Company, Anand Rathi Research * year-ending Dec'14*

Company Background & Management

Split off from its parent Century Plyboards (India), to its present avatar of Star Ferro and Cement. The Cement Manufacturing Co. and its subsidiaries (Star Cement Meghalaya, Meghalaya Power, Megha Technical & Engineers Pvt. Ltd. and NE Hills Hydro) have, w.e.f. 1st Apr'12, become subsidiaries of Star Ferro & Cement.

"STAR" cement is the largest brand in the NER. It is a brand-name retail play on the building-material segment, with a 23% market share in the region. Star Ferro's promoters have 15—45 years of industry experience and strong local ties in the NER. These have been crucial factors in the success of Star Ferro.

Statutory auditor: Kailash B. Goel & Co.

Fig 15 – Star Ferro: Promoters and Key Management Personnel

Name	Position
Mr Sajjan Bhajanka	Promoter Director and Chairman
Mr Hari Prasad Agarwal	Promoter Director
Mr Sanjay Agarwal	Promoter Director
Mr Sanjay Kumar Gupta	Chief Executive Officer
Mr Dilip Kumar Agarwal	Chief Financial Officer
Mr Manindranath Banerjee	Non-Executive Independent Director
Mr Shantanu Ray	Non-Executive Independent Director
Mr Mangilal Jain	Non-Executive Independent Director
Mrs Pristina Dkhar	Non-Executive Independent Director

Source: Company

Appendix

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