Not Rated

Visit Note: Star Ferro & Cement Ltd.

Regional STAR

CMP INR 155

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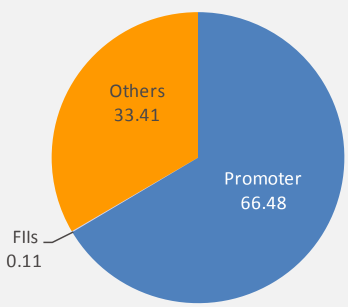
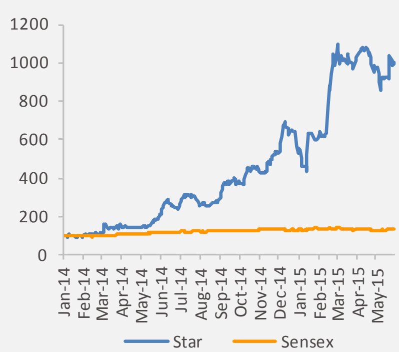
Bloomberg:	SFCL:IN
52-week range (INR):	185 / 41
Share in issue (Crs):	22.2
M cap (INR Crs):	3,477
Avg. Daily Vol. BSE/NSE ('000):	154

SHARE HOLDING PATTERN (%)





Date: 8th July 2015

Star Ferro & Cement Ltd. (SFCL) operates in the lucrative North East region (NE), a niche market with only a few players and premium pricing due to its geographical complexity. SFCL is a leading cement player in this region with a market share of 23%. With the Government's increased thrust on bringing infrastructure in this region on par with the rest of the country, SFCL expects the cement demand to be higher than other regions. We believe that the company's focus on brand building and recent capacity expansion puts it in a sweet spot to capitalise on the incremental demand. SFCL expects to be debt free by FY17E on account of (a) 20% CAGR growth in volumes and (b) capital & freight subsidies.

North East region offers tremendous opportunity

The North Eastern region (NE) remains one of the most underpenetrated parts of the country in terms of cement demand. Despite the region (particularly Meghalaya) having superior quality limestone reserves, few cement companies have been able to set up local manufacturing units due to regulatory hurdles, geographical complexity and political instability in these states. SFCL has been one of the earliest players to establish a local presence in NE. Not only that, its strategy of focusing on brand building has enabled it to become a leader in this region with a 23% market share v/s 15% for Dalmia Bharat.

Diversifying into the lucrative eastern region

SFCL has hired 2 units in West Bengal (WB) with a grinding capacity of 0.4 MT, where it's strategic location enables it to cater to both WB and Bihar markets. Given the fact that the eastern region remains one of the most lucrative cement markets, the company intends to expand its presence with a 1.0 MT grinding unit in West Bengal. Going forward, SFCL expects eastern markets to grow at a CAGR of ~10% on the back of the Government's focus on infrastructure development to boost GDP growth through increased allocations for housing, infrastructure and commercial real estate segments.

Regional complexity leads to higher profitability

With an EBITDA/ton of INR 1825/- (~2x the industry average), SFCL is currently the most profitable cement manufacturer in India. The EBITDA/ton also includes subsidies that the company is eligible to receive from central & state governments under various incentive schemes. In FY15, ~40% of the company's EBITDA/ton was on account of government subsidies. Even after excluding the subsidies from the EBITDA/ton, SFCL continues to remain among the most profitable cement players with an adjusted EBTIDA/ton of ~INR 1075/- on account of access to high-quality coal and limestone at lower prices and its captive power plant.

Valuations

SFCL currently trades at EV/EBITDA of 8.5x & 7.0x FY16E & FY17E consensus estimates, respectively. While the current valuation seems fair, the company has carved a niche for itself in a commoditised market, which would help it to sustain its profitability going forward. As a result, the stock is expected to trade at a premium to industry peers even in the future.

Year to March	FY13	FY14	FY15
Revenue	660	1,173	1,430
Revenue Growth (%)	N/A	77.9%	21.9%
EBITDA	118	255	435
Net Profit	38	5	120
Profit Growth (%)	N/A	-68.7%	961.3%
Shares Outstanding (crs.)	22	22	22
Diluted EPS (INR)	1.1	0.4	3.8
EPS Growth (%)	N/A	-68.7%	961.5%
Diluted P/E (x)	134.5	429.6	40.5
EV/EBITDA (x)	36.8	17.4	9.5
RoE (%)	5.4%	0.7%	17.6%

North East region offers tremendous opportunity

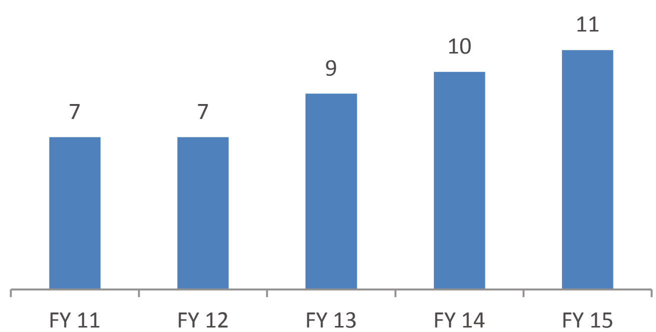
NE remains one of the most underpenetrated parts of the country in terms of cement demand. Per capita consumption of cement in NE stands at 142 kg/person v/s an all-India average of 210 kg/person. Despite the region (particularly Meghalaya) having superior quality limestone reserves, few cement companies have been able to set up local manufacturing units due to regulatory hurdles, geographical complexity and political instability. Currently, the top 3 players account for ~70% of the region's capacity.

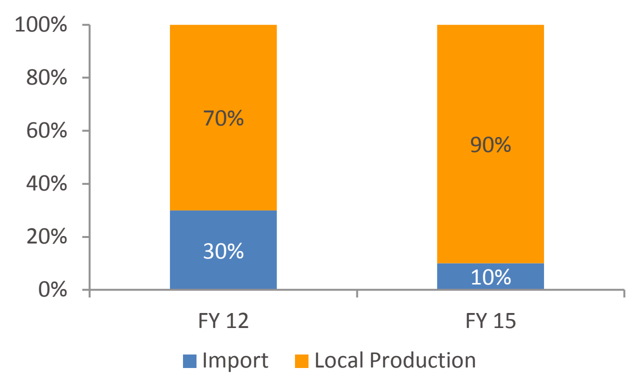
Player	Capacity (mn MT)	CPP
Dalmia Bharat	3.6	25 MW
SFCL Cement	3.0	51 MW
Meghalaya Cement	1.3	10 MW
Others	3.1	N/A
Total NE	**11**	

Source: Company, Edel Invest Research.

All these factors have contributed to a demand-supply mismatch in NE, causing cement to be imported from the mainland, thereby increasing the landed cost of cement. However, with the Central/State Governments offering various incentives to set up manufacturing units in NE, there has been a substantial ramp-up in capacities from 7 mn MT in FY11 to 11 mn MT in FY15 led primarily by the existing players. Accordingly, import of cement from other states declined from 30% in FY12 to 10% in FY15, while prices continue to remain at a premium to the Eastern region owing to the long lead distances.

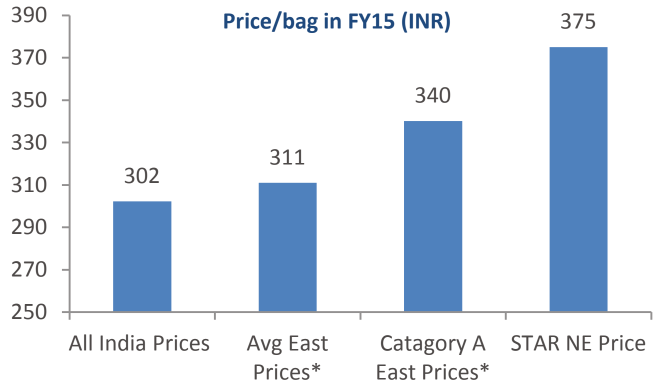
NE Cement Capacity (Mn MT)





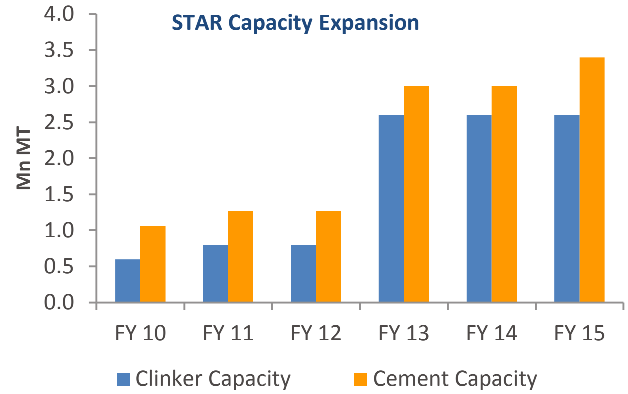
Source: Company, Edel Invest Research.

SFCL has been one of the earliest players to establish a local presence in NE with 0.4 mn MT capacity in Meghalaya. During FY05-FY15, the company increased its capacity manifold to 3.4 mn MT in FY15. Approximately 3 mn MT of this capacity is in NE, accounting for ~27% of the regions' installed capacity and making it the 2nd largest player in terms of capacity after Dalmia Bharat (3.6 mn MT). However, SFCL's strategy of focusing on strong brand building, coupled with its ability to price its product at a premium has enabled it to become a leader in NE with a 23% market share v/s 15% for Dalmia Bharat. Currently, SFCL prices its cement at INR ~375/bag, which is at a 10-12% premium to Category A prices in the East (~ INR 340/bag).

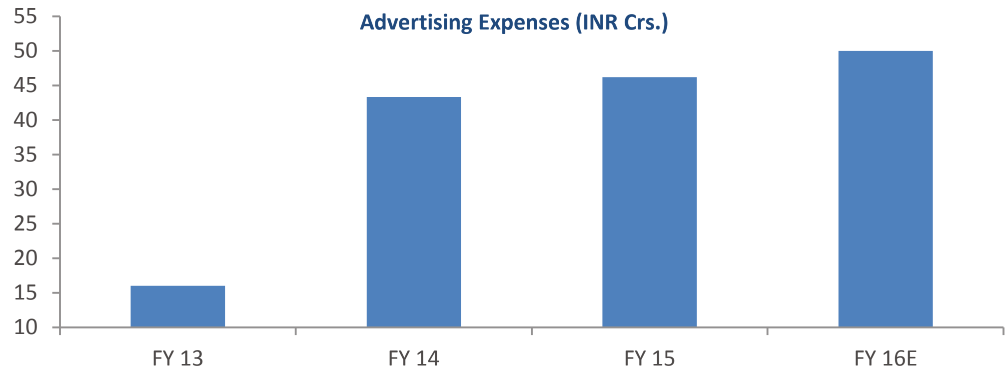


*WB and Bihar prices

Source:, Edel Invest Research.



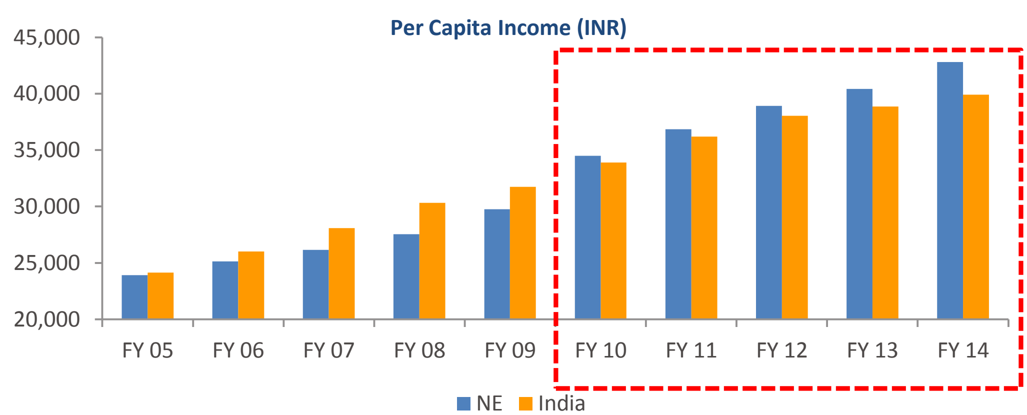
Source: Company, Edel Invest Research.



Source: Company, Edel Invest Research.

Huge potential for cement demand growth in NE

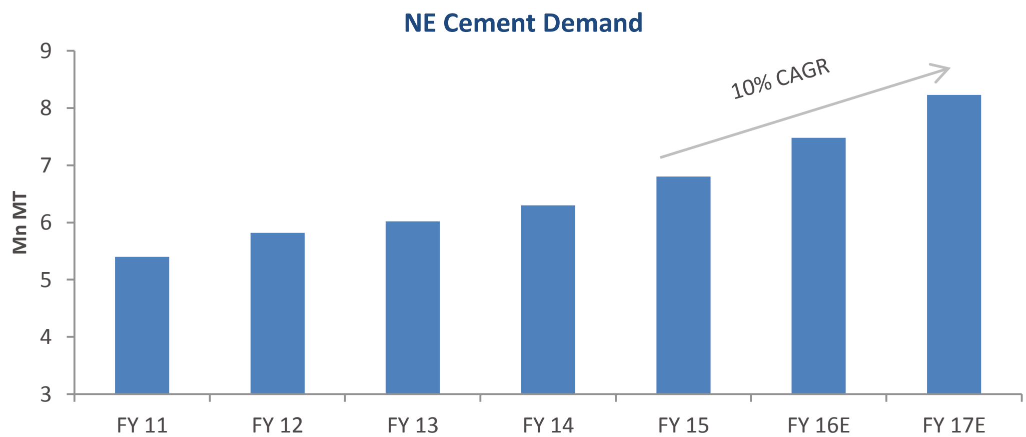
Historically, NE has not received as much Government attention as some of the other regions of the country, leading to slower development in this region v/s the rest of India. In a bid to stimulate growth in NE, the Government introduced a variety of incentive packages to boost manufacturing and infrastructure development in these states, most notably the 'North East Industrial & Investment Promotion Policy (NEIIPP), 2007 and "Special Accelerated Road Development Programme in North East (SARDP-NE)". Accordingly, growth in NE has accelerated in the last few years, as can be seen in the increase in per capita income during FY10-FY14.



Source: Edel Invest Research.

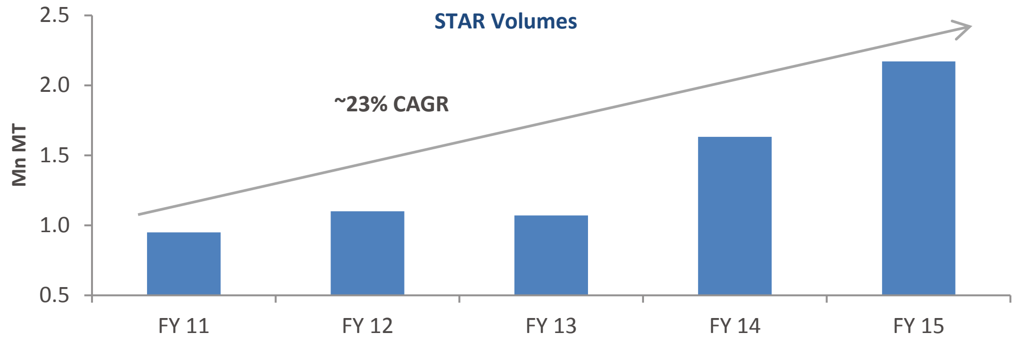
In line with the GDP growth of NE, the region has witnessed burgeoning demand for cement. Consumption of cement has increased at a CAGR of 5.9% in NE during FY11-15, while that of the industry as a whole has increased at a CAGR of 4.9%. Going forward, SFCL anticipates the cement demand to grow at a CAGR of 10% over the next few years led by the Government's thrust on infrastructure development in NE. Some of these projects include:-

- SARDP-NE, under which INR 33752 Cr has been allocated to upgrade national highways to 2/4 lanes and improve connectivity of NE for a total length of 10141 km. As of FY14, 1359 km of road has been completed at an expenditure of INR 8956 Cr. The project is targeted to be completed by March 2017
- Allocation of INR 38360 Cr for railway projects, including 20 new lines, gauge conversion and double line projects
- INR 5000 Cr of investment in the next 10 years on airports, of which 5 have been sanctioned and 8 are in the pipeline
- NE has the highest hydropower potential in India. Approximately 63000 MW of Hydro Power capacities have been identified, of which 14000 MW has been allotted to private players already. This is expected to generate ~14 mn MT of cement demand.



Source: Company, Edel Invest Research.

In a bid to capitalise on the surge in cement demand in NE, the company undertook significant capacity expansion over the last 5 years, leading to a volume CAGR of ~23% over FY11-15. With trade sales contributing ~76% of SFCL's revenues, the volume growth was primarily led by strong demand from the housing sector, which witnessed significant traction as per capita income in NE catapulted above national average. NE is expected to sustain high growth rates going forward as well. The company has enough land bank to double its capacity from the current level and still have limestone reserves that could last ~80 years.



Source: Company, Edel Invest Research.

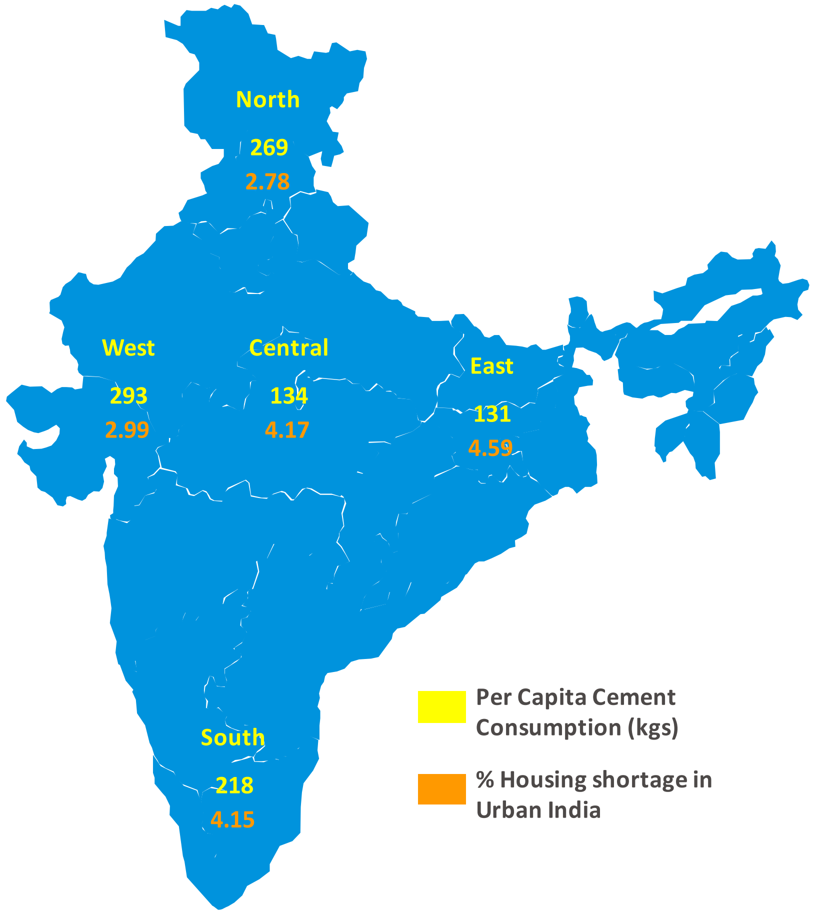
Diversifying into other lucrative eastern regions

In a bid to diversify its geographical presence, the company entered into an arrangement to operate 2 units in West Bengal (WB) with a grinding capacity of 0.4 MT where it's strategic location enables it to cater to both WB and Bihar markets. Eastern region historically has been a high price market on account of higher than industry growth rates in 6 out of the last 7 years, which has led to higher capacity utilization of 84% vs 76% for the industry.

East	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
Installed capacity at the year end	43.7	47.0	49.6	54.7	64.0	67.9	70.4
Operative Effective capacity	38.2	43.1	46.4	50.9	57.1	64.4	67.6
Consumption	38.7	41.1	42.8	45.7	49.4	54.4	59.8
% change YoY	3.1%	6.0%	4.2%	6.8%	8.2%	10.0%	10.0%
Surplus/(Deficit)	**(6.3)**	**(4.7)**	**(3.8)**	**(3.0)**	**(1.5)**	**(0.2)**	**(1.7)**
Cement production	32.4	36.4	39.0	42.7	47.9	54.1	58.1
Capacity utilisation	84.8%	84.5%	84.0%	84.0%	84.0%	84.0%	86.0%

Source: Edel Invest Research.

Going forward, eastern markets for cement are expected to grow at a CAGR of ~10% on the back of the Government's focus on infrastructure development to boost NE economic growth through increased allocations for housing, infrastructure and commercial real estate segments. Further, the eastern region continues to be highly underpenetrated with the per capita cement consumption being the lowest at INR 131 kg/person vis-a-vis an all-India average of 210 kg/person. In addition, the Eastern region contributes 15% to the total housing shortage in urban India, implying immense potential for strong cement demand.



Source: Company, Edel Invest Research.

SFCL forayed into the eastern region recently and currently generates 30% of its volumes from WB and Bihar markets. Given the fact that the eastern region remains one of the most lucrative cement markets in the country, the company intends to expand its presence with a 1.0 MT grinding unit in WB. The new unit is expected to come on-stream in H2FY17E at a total cost of INR 180 Cr and it is expected to cut down the lead distance significantly to 250-300 kms vis-a-vis 1000-1500 kms for its peers. The company has already finalized the land and obtained all the requisite clearances for the same. SFCL continues to follow its brand building strategy in the eastern region as well and is pricing its products at par with the category A players in the region.

Source: Company, Edel Invest Research.

Regional complexity leads to higher profitability

With an EBITDA/ton of INR 1825/- (~2x the industry average), SFCL is currently the most profitable cement manufacturer in India. The EBITDA/ton includes subsidies that the company is eligible to receive from central & state governments under their incentive schemes. In FY15, ~40% of the company's EBITDA/ton came on the back of government subsidies. The company is eligible for Excise (received monthly), Freight (received with a lag of 12-18 months) and capital subsidy (one-time) with these incentives being applicable for the next 5-8 years (for new plants) & 2 years (for old plant). In FY16E, the company is expecting to receive INR 400 Cr on account of subsidies (INR 200 Cr for freight & INR 200 Cr for capital subsidy).

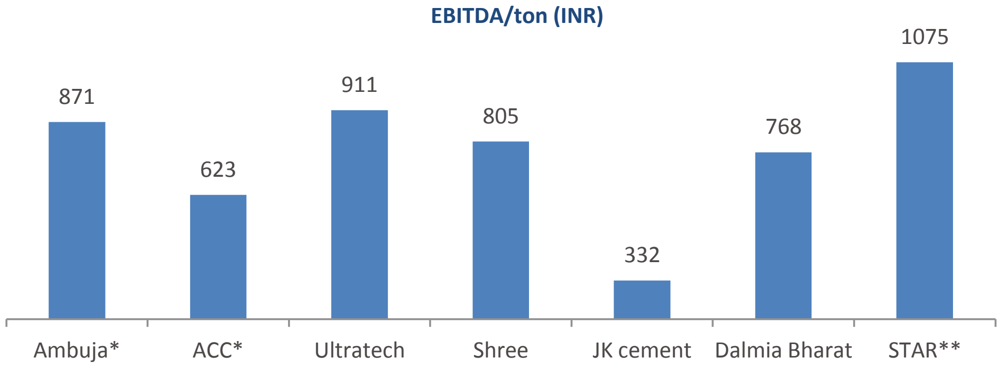
	Exemption	Balance Exemption period			
		SCML	CMCL-GGU	CMCL-LMS	MTEPL
Income Tax	100% under Section 80 IE subject to MAT	8 years	8 years	–	2 years
Excise Duty on					
Clinker	75%	8 years	–	2 years	–
Cement	75%/36%^	–	^8 years	2 years	^2 years
Central Sales Tax	99%	5 years	–	–	–
VAT	99%^^	5 years	275Crs/5 years	–	–
Freight Subsidy					
Inward					
Within NER*	90%	–	–	–	–
Outside NER	90%	–	–	–	–
Outward		3 years	3 years	–	–
Within NER*	50%	–	–	–	–
Outside NER	90%	–	–	–	–
Capital Investment Subsidy	30% of Investment in Plant & Machinery	One time	One time	–	–

^^At GGU unit, VAT exemption is 99% upto 200% of FCI ^ 75% for integrated units and 36% for standalone grinding units
*Freight subsidies are not available for intra-state movements

Source: Company, Edel Invest Research.

Even after excluding the subsidies from the EBITDA/ton, SFCL continues to remain among the most profitable cement players with an adjusted EBTIDA/ton of ~INR 1075/-. This is on account of:-

- Access to high quality coal which the company sources from local mines at a cost lower than its peers.
- Captive power plant (51 MW) which is sufficient to meet SFCL current energy requirements. The CPP is currently operating at 55-60% utilization, which will be sufficient for any future expansion as well.
- Fly ash generated in its CPP is used internally for its Meghalaya plant, thus saving on freight cost.



*CY14

** Adj for Subsidies

Source: Edel Invest Research.

Other Highlights

- SFCL expects volume growth (including WB and Bihar) at 20% CAGR over FY15-FY17E.
- The current gross debt stands at ~INR 700 Cr as on FY15. The company has a scheduled repayment of INR 180 Cr per annum. Moreover, the company is expecting another INR 400 Cr of subsidy in FY16E (Capital + Freight subsidy), which is expected to bring the debt down substantially.
- SFCL expects to be debt free (long-term) by the end of FY16E or 1HFY17E.
- SFCL paid out ~30% of its earnings as dividend in FY15.

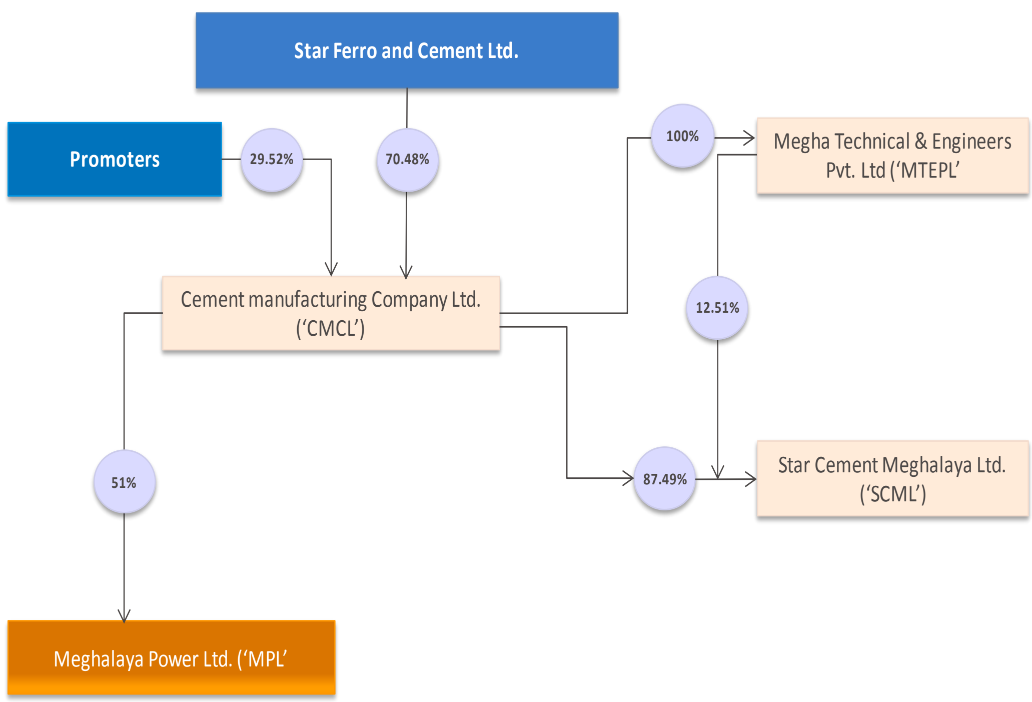
Company Background

Star Ferro and Cement Ltd. (SFCL) (formerly a division of Century Plyboards India Ltd) was incorporated as a separate company in 2011, with the demerger coming in effect from 1st April, 2012.

The company was engaged in the manufacture of cement as well as ferro alloys, contributing 88% and 12%, respectively to revenues in FY14. With effect from 1st April, 2014, the ferro alloy division has been demerged into Shyam Century Ferrous Ltd at a demerger ratio of 1:1.

SFCL is primarily focused on the North East region, where it is the market leader with a 23% market share. The company has an installed capacity of ~3.4 mn tons, with 2.6 mn tons of clinker capacity and ~1.4 mn tons of grinding capacity in Meghalaya, 1.6 mn tons of grinding capacity in Assam and 0.4 mn tons of hired grinding units in West Bengal. Further, the company is planning to expand its footprint in the East with a 1 mn ton grinding unit in WB, which is expected to come on stream by FY17E. SFCL also has 51 MW power plant in Meghalaya and its limestone mines are located within 2-3 kms of the plants, leading to uninterrupted supply of raw material.

Approximately 70% of the company's sales are in NE while WB and Bihar account for the rest. Around 20-25% of the company's cement sales are OPC while the rest are PPC with a fly ash ratio of 25-30%. SFCL derives 76% of its revenues from trade sales and has a rail road ratio of 20:80. The company also has an extensive dealer network of 5000+ retailers and 2000+ dealers across 11 states.



Source: Company, Edel Invest Research.

Income Statement			(INR Cr)
Year to March	**FY13**	**FY14**	**FY15**
Net revenue	660	1,173	1,430
Materials costs	95	202	230
Gross profit	565	972	1,201
EBITDA	118	255	435
Depreciation & Amortization	50	162	224
EBIT	68	94	211
Other income	2	3	1
Extraordinary Items	(0)	(2)	(0)
EBIT incl. other income	70	94	212
Interest expenses	29	87	87
Profit before tax	41	7	125
Provision for tax	4	2	5
Net profit	38	5	120
Minority Interest	13	(1)	37
Adj Net Profit	25	8	83
Basic shares outstanding (crs)	22	22	22
EPS (Rs.)	1.1	0.4	3.8
Dividend per share (Rs.)	-	0.5	1.2
Dividend payout (%)	0.0%	N/A	31.1%

Common Size			
Year to March	**FY13**	**FY14**	**FY15**
Materials costs	14.4%	17.2%	16.0%
Depreciation	7.6%	13.8%	15.6%
EBITDA margins	18.0%	21.7%	30.4%
EBIT margins	10.3%	8.0%	14.8%
Net profit margins	5.7%	0.4%	8.4%

Growth Ratios			
Year to March	**FY13**	**FY14**	**FY15**
Revenues	N/A	77.9%	21.9%
EBITDA	N/A	115.4%	70.5%
PBT	N/A	-82.5%	1632.0%
Net profit	N/A	-68.7%	961.3%

Balance Sheet

As on 31st March	FY13	FY14	FY15E
Equity capital	22	22	22
Reserves & surplus	671	664	658
Borrowings	1,009	1,065	775
Deferred Tax Liabilities (Net)	4	4	9
Minority Interest	254	253	323
Sources of funds	**1,960**	**2,008**	**1,787**
Net Fixed Assets	1,294	1,272	1,069
Investments	2	2	2
Inventories	150	175	109
Sundry debtors	43	110	310
Cash & Bank Balances	27	13	20
Other Current assets	227	213	0
Loans and advances	318	423	680
Total current assets	765	934	1,120
Sundry creditors and others	98	197	393
Provisions	2	2	10
Total current liabilities & provisions	100	199	403
Net current assets	665	735	717
Uses of funds	**1,960**	**2,008**	**1,787**

Free cash flow

Year to March	FY13	FY14	FY15E
Net profit	38	5	120
Add : Depreciation	50	162	224
Others	18	88	87
Gross cash flow	106	254	430
Less: Changes in WC	(205)	(94)	26
Operating cash flow	(99)	160	456
Less: Capex	(239)	(117)	(141)
Free cash flow	(338)	43	316

CasH Flow Statement

Year to March	FY13	FY14	FY15E
Cash flow from operations	(99)	160	456
Cash Flow from investing activities	1	(117)	(140)
Cash Flow from financing activities	124	(59)	(306)
Capex	(239)	(117)	(141)
Dividends	-	-	(22)

Profitability & Efficiency Ratios

Year to March	FY13	FY14	FY15E
ROAE (%)	5.4%	0.7%	17.6%
ROACE (%)	4.1%	5.5%	13.2%
ROIC (%)	3.6%	4.8%	11.2%
Inventory day	24	24	54
Debtors days	83	51	36
Payable days	54	46	75
Cash conversion cycle (days)	52	28	15
Current ratio	7.6	4.7	2.8
Debt/Equity	1.5	1.6	1.1

Turnover Ratios

Year to March	FY13	FY14	FY15E
Total asset turnover	0.3	0.5	0.7
Fixed asset turnover	0.5	0.8	0.9
Equity turnover	1.0	1.7	2.1

Du Pont Analysis

Year to March	FY13	FY14	FY15E
NP margin (%)	6%	0%	8%
Total assets turnover	0.3	0.5	0.7
Leverage multiplier	3.0	3.1	3.2
ROAE (%)	5.4%	0.7%	17.6%

Valuation Parameters

Year to March	FY13	FY14	FY15E
Diluted EPS (Rs.)	1.1	0.4	3.8
Y-o-Y growth (%)	N/A	-68.7%	961.5%
Diluted PE (x)	134.5	429.6	40.5
Price/BV (x)	4.9	4.9	5.0
EV/Sales (x)	6.6	3.8	2.9
EV/ton (USD/tonne)	266.6	244.0	199.2
EV/EBITDA (x)	36.8	17.4	9.5
EBITDA/ton	1,117.7	1,338.1	1,825.0
Dividend yield (%)	0.0%	0.3%	0.8%

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