Star Ferro & Cement (SFCL IN)

From a North-East major to an emerging East-India cement manufacturer...

INDIA | CEMENT | MANAGEMENT MEET UPDATE

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Star Ferro & Cement (Star) is amongst the leading cement manufacturers in North-East India. It commenced its commercial operations in 2005 and currently enjoys more than 20% market share in North-East India. Star continues to remain a highly ambitious and determined North-East cement manufacturer and as we understand, we may expect Star to expand its footprints materially to more regions of the country. With an EBITDA of Rs1,850/tonne and debt expected to be wiped off by end of FY17, given raw material support Star has the potential of doubling its capacity and can be an exciting story. We recently met up with the Management to understand the strategy and outlook at Star.

Brief: Star is the current flagship company of the group and a listed entity. This company came into existence as a result of divestment of cement subsidiary stake by Century Ply in early 2011. Star operates its cement business through its operating subsidiary (~70% stake) "Cement Manufacturing Company Ltd. (CMCL)". CMCL commenced cement operations in 2005 with an initial clinker and cement capacity at 0.40mtpa each. Since FY05 its cement and clinker capacities have grown at a CAGR of +27% and 20% and currently stands at 3.40mtpa and 2.6mtpa, respectively. CMCL's integrated capacity set up is based in Lumshnong, Meghalaya (~1.4mtpa cement & 2.6mtpa clinker capacity) with support of split grinding of 1.6mtpa at Guwahati, Assam. CMCL has also hired a grinding unit in West Bengal with capacity of 0.40 mtpa. Currently, CMCL is amongst the leading cement manufacturer of North-East India and its closest competitors are Dalmia Bharat & Meghalaya Cement.

Ambitious for growth; looking forward to increase its strategic presence: In current scenario, Star seems to be the most ambitious players in North-East India. The company has recently debuted in States of Bihar & West Bengal and is looking forward to expand its foot print to East India with setup of a grinding unit of 1mtpa in West Bengal. We also understand from the Management that the group may unfold further aggressive expansion plans into East India in foreseeable future. Management sounds ambitious and seems confident of adding up material capacities in East/North-East India. Its potential, in our opinion is to double from current levels.

Moving smart to capitalize on absence of any major competition in North-East: North-East has an installed capacity of ~11mtpa of which only 8-8.5mtpa is operational. Of the operational capacities – Star, Dalmia Bharat & Meghalaya Cement owns the major chunk (~7mtpa) and the rest is scattered amongst the other smaller manufacturers. Star seems to be quick enough to identify this advantage and is spending enormously on brand building activities in North-East / East India. Annual brand promotion / advertising spends at Star Cement in FY15 were at +3% of revenue at Rs462mn. To put this into perspective, cement majors absolute spends on advertising ranges from Rs1-2bn and less than 1% of revenues. Given that Star operates a much lower capacity than any comparables or industry majors – numbers clearly suggest Star Cement is moving ahead on the curve to capitalize on brand building exercise.

EBITDA/tonne at Rs1,850/- much higher than industry: Star's EBITDA/tonne in FY15 was reported at Rs1,850/tonne which is materially (124%) higher than the industry average. Though one may argue that this is largely on account o subsidies in North-East region – even if one removes for subsidies (~Rs800/tonne), EBITDA/tonne in FY15 was higher by +25% vis-à-vis industry's average. Highest EBITDA coupled with zero debt by end FY17 could be a key trigger and comfort zone for Management to announce aggressive capex / growth plans.

Confident of delivering much higher volume growth vs. Industry: Star's volume in last reported quarter +30% YoY vs. negative volume growth for the industry. Star remains confident of delivering much better volume growth vis-à-vis industry and its peers in North-East / East India. Management has guided for +20% volume growth over coming years and expect to ramp up its plants to full utilisations by end of FY17. Star's volumes in FY15 were at ~2.2mn tns. Current capacity of 3.4 will suffice Star for double digit volume growth till end of FY17. New capex in West Bengal (18-24 months from now) will be the added support for volume growth from FY17 and onwards. Also, as said earlier - one may expect further aggressive capex announcements at Star.

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COMPANY DATA

O/S SHARES (MN) :	222
MARKET CAP (RSBN) :	34
MARKET CAP (USDBN) :	0.5
52 - WK HI/LO (RS) :	189 / 39
LIQUIDITY 3M (USDMN) :	0.2
PAR VALUE (RS) :	1

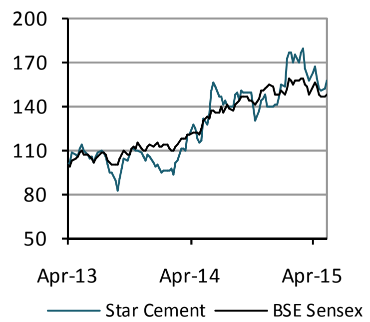
SHARE HOLDING PATTERN, %

PROMOTERS :	66.5
FII / NRI :	0.14
NON PROMOTER CORP. HOLDINGS :	9.32
PUBLIC & OTHERS :	24.08

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-5.9	-4.6	290.1
REL TO BSE	-6.8	-3.8	279.9

PRICE VS. SENSEX



Source: Phillip Capital India Research

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Some more takeaways from our meeting:

North-East growth to remain buoyant – Star remains unworried for volume growth: Management remains extremely positive on continuation of robust cement consumption in North-East India. Few growth triggers in North-East as highlighted by Management in our meeting are:

Star remains unconcerned about volume growth. Believes volume at Star will continue to outperform industry and will grow at robust double digits.

- **Thrust of Central Government to create road infrastructure in North-East:** Under the Special Accelerated Road Development Programme – North-East (SARDP-NE) - Rs340bn worth of road projects (~10,000kms of roads) is proposed across North-East India. Of this work on projects worth Rs120bn is already on (~4,000 kms) while rest will be awarded in the due course of time. In normal circumstances – assuming all these roads are 2 lane roads, this has the potential of consuming additional 10-12mn tns of cement. However, given the terrain of North-East, the consumption parameters here are much higher than the ballpark numbers. Building of civil infrastructure for arrest of land-slides in hilly areas such as North-East consumes large quantities of cement. Hence one may easily expect incremental +8-10mn tns (on the conservative side) of cement demand to be consumed just from road projects in North-East over the next few years. Moreover, as highlighted by the Management to us – Mr. Nitin Gadkari (Minister of Road Transport and Highways of India) has recently promised another Rs150bn spend on road projects in North-East.
- **Spends on Railway Infrastructure in North-East:** Government has mega plans to spend +Rs400bn on railway infrastructure in North-East. These spends will be done on gauge conversion (Rs99bn – 1,439kms of rail network), new railway lines (Rs330bn for 1,157kms of rail network) and doubling the existing network (Rs21bn – 1,400kms). Moreover, the defence ministry has announced spends of Rs1,400bn on creating a 1,400 kms of railway network in State of Arunachal Pradesh in and around the borders of Republic of China. Though this may take almost a decade to be built, this will result in huge capital investment in North-East India. Given the complex terrain of North-East, creation of such infrastructure by railways is also likely to trigger cement demand in material numbers (similar to road infrastructure).
- **Development of hydro power projects in North-East:** There is a pipeline to develop 60,000MWs of hydro power plants in North-East (especially State of Arunachal Pradesh). Every 1,000MW of hydro-power has the potential to generate cement demand of ~1-1.2mn tns. Hence this itself will mean incremental cement demand of 60-70mn tns in the longer term.
- **Shift to concrete houses in North-East:** ~75% of houses in North-East are believed to be temporary houses with asbestos roofs. With changing lifestyles in North-East, the population here is shifting to concrete houses and this is likely to be the key and long term sustainable demand driver for North-East India.

Star sells its brand and not just cement: We found Star to be very focussed on branding. The management consistently reiterated its efforts and focus on creating a brand recall for Star in North-East & East India. In our opinion, this is a rare characteristic and in-line with strategy of majors such as UltraTech Cement, Ambuja Cement, ACC Ltd. & Dalmia Bharat. We have got a similar feedback from channel partners in East India about branding focus at Star and we have also personally witnessed aggressive branding activities in Kolkata by Star. Star is also acting differently by focussing itself on creating a brand recall through surrogate branding (branding at outlets which are visited by end users such as pan shops, groceries etc).

Focus on creation of a brand recall at Star, to us, seems similar to strategies of majors such as UltraTech Cement, Ambuja Cement, ACC Ltd. and Dalmia Bharat.

Zero debt by end of FY17 gives Star a comfort zone to announce aggressive capex: Star is currently at a debt of ~Rs7bn and is likely to be a zero debt company by end of FY17. They are due to receive subsidy benefits to the tune of Rs4bn from government (Rs2bn of capital subsidy & Rs2bn of freight subsidies). The whole proceeds will be utilised towards reducing debt. Besides this, Star also makes a quarterly repayment of Rs450mn towards its debt. In this scenario, Star will be a zero debt company by end of FY17. Given the robust EBITDA generation at Star (Rs1,850/tonne in FY15), Star will have a very strong balance sheet support to announce aggressive and material capex. Notably, subsidy benefits (in case of most subsidies) is still due for another 3-8 years.

Financials – Cement Subsidiary

Rs In Mn	2010-11	2011-12	2012-13	2013-14	2014-15
Gross Sales	5,040	5,970	6,250	11,230	14,730
Net sales	4,860	5,650	5,950	10,280	14,300
EBITDA	1,520	1,450	1,200	2,340	4,370
EBITDA margin (%)	31%	26%	20%	23%	31%
Cash Profit	1,510	1,240	880	1,540	3,450
EBIT	1,270	1,170	760	770	2,130
PBT	1,180	910	490	(40)	1,260
PAT	1,250	900	430	(40)	1,190
PAT margin (%)	26%	16%	7%	0%	8%
Net Fixed Asset	5,430	9,870	12,590	12,420	10,690
Total Capital Employed	9,320	13,920	18,810	19,270	19,350
Long Term Debt	2,750	5,990	8,270	7,940	6,910
Share Capital	420	420	420	420	420
Net Worth	5,140	6,040	8,590	8,430	9,210
RoE (%)	24%	15%	5%	0%	13%
RoCE (%)	14%	8%	4%	4%	11%
Debt- Equity Ratio	0.54	0.99	0.96	0.94	0.75
EPS	28.77	21.43	10.24	(1.00)	28.30

With an EBITDA of Rs1,850 and debt likely to be wiped off by end of FY17 – in our opinion, in the current scenario Star has the potential of doubling its capacity with no material stress to its financials.

Financials – Star Ferro & Cement Ltd.

Rs In Mn	2012-13	2013-14	2014-15
Gross Sales	6,940	11,710	14,730
Net sales	6,600	11,730	14,300
EBITDA	1,200	2,570	4,360
EBITDA margin (%)	18%	22%	30%
Cash Profit	880	1,670	3,440
EBIT	700	960	2,120
PBT	410	80	1,250
PAT	250	60	830
PAT margin (%)	4%	1%	6%
Net Fixed Asset	12,940	12,720	10,690
Total Capital Employed	18,840	18,580	19,690
Long Term Debt	7,650	6,570	6,910
Share Capital	0.05	22	22
Net Worth	6,930	6,860	6,800
RoE (%)	4%	1%	12%
RoCE (%)	4%	5%	11%
Debt- Equity Ratio	1.10	0.96	1.02
EPS	498.40	0.28	3.76

Source: Company

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