

Star Cement

Refer to important disclosures at the end of this report

Compelling valuations still make it an attractive play

CMP	Target Price
Rs 91 as of (February 4, 2019)	Rs 150 (▼) 12 months
Rating	Upside
BUY (■)	64.9 %

- Star Cement's Q3FY19 operating results came in above our estimates, with EBITDA at Rs1.2bn (est: Rs1.1bn) and EBITDA/ton at Rs1,864 (est: Rs1,600), mainly due to lower-than-expected opex/ton. OPM stood at 29.3% vs. our estimate of 24.8%.
- Excluding clinker sales, cement sales volumes were up 13.5% yoy (total volumes were up 5.5% yoy). Sales in the North East markets were 77.6% of total volumes vs. 74.1% in Q3FY18. EBITDA/ton was Rs1,864 vs. Rs2,280/Rs1,236 in Q3FY18/Q2FY19.
- Management expects demand growth in the NE markets to remain strong and believes that smaller players are operating close to their peak utilization rates. Consequently, incremental volume growth in the region should benefit large players. The grinding unit in Siliguri, West Bengal is expected to get commissioned in Q3FY20.
- We maintain our FY19 EBITDA estimates, while reducing FY20/FY21 estimates by 4.4%/8.3%. We prefer Star Cement due to its higher profitability, return ratios, and its presence in a lucrative market. Valuation at 6.3x/5.6x FY20/FY21E EV/EBITDA appears to be attractive. Maintain Buy, with a revised TP of Rs150.

Strong volumes; higher opex drags profits down

Star Cement's results came in above our estimates, with EBITDA at Rs1.2bn vs. our estimate of Rs1.1bn and OPM at 29.3% vs. our estimate of 24.8%, supported by lower costs. Cement and clinker sales volumes stood at 0.65mt, up 5.5% yoy. Excluding clinker sales, cement sales volumes improved 13.5% yoy. Sales volume growth was primarily led by higher sales in the NE markets, up 18.9% yoy. Realization was up 4.6% yoy, but down 2.3% qoq. We believe that the sequential decline in realizations was led by: 1) higher clinker sales (0.015mt vs. 0.08mt in Q2FY19); and 2) lower trade sales of 79% vs. 83% in Q2FY19. Opex/ton rose 18.3% yoy due to higher RM costs (up 28.1% yoy), energy costs (up 17.5% yoy), and freight costs (up 26.3% yoy). Higher opex led to a 8.2pp yoy decline in OPM to 29.3%, while EBITDA/ton declined 18.2% yoy. EBITDA was down 13.8% yoy. The sequential improvement in profitability was driven by: 1) an absence of purchased clinker; 2) better efficiency in energy consumption; and 3) lower maintenance expenses. Profit was down 8.1% yoy.

Reduce FY20/21 estimates; valuations compelling

We maintain FY19 EBITDA estimates but cutting FY20/FY21 estimates by 4.4%/8.3% on energy costs. We prefer Star Cement due to its presence in the North East region that offers better growth opportunities, strong margin profile, and superior return ratios. The North East region is a lucrative market characterized by oligopolistic nature where just two players are controlling 50% of the total capacity. It has consistently delivered more than 2x EBITDA/ton vs. the average of others in our coverage universe. Valuations at 6.3x/5.6x FY20/21E EV/EBITDA appear attractive. We maintain our Buy rating, with a target price of Rs150, valuing it at 10x FY21E EV/EBITDA. In the near term, the key risk is any adverse ruling by the Supreme Court regarding the coal mining ban in Meghalaya (hearing is scheduled on 19th Feb).

Financial Snapshot (Consolidated)

(Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Revenue	15,278	16,227	18,847	21,583	23,710
EBITDA	3,962	5,295	4,625	5,267	5,674
EBITDA Margin (%)	25.9	32.6	24.5	24.4	23.9
APAT	1,826	3,388	3,107	3,792	3,850
EPS (Rs)	4.4	8.1	7.4	9.0	9.2
EPS (% chg)	35.7	85.5	(8.3)	22.1	1.5
ROE (%)	16.6	25.8	19.3	20.1	17.7
P/E (x)	20.8	11.2	12.3	10.0	9.9
EV/EBITDA (x)	11.6	8.0	8.2	6.3	5.6
P/BV (x)	3.3	2.6	2.2	1.9	1.7

Source: Company, Emkay Research

Change in Estimates

EPS Chg FY19E/FY20E (%)	4/(4)
Target Price change (%)	(10.3)
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

EPS Estimates		
	FY19E	FY20E
Emkay	7.4	9.0
Consensus	7.1	9.4
Mean Consensus TP (12M)	Rs 144	

Stock Details

Bloomberg Code	STRCEM IN
Face Value (Rs)	1
Shares outstanding (mn)	419
52 Week H/L	137 / 80
M Cap (Rs bn/USD bn)	38 / 0.53
Daily Avg Volume (nos.)	70,998
Daily Avg Turnover (US\$ mn)	0.1

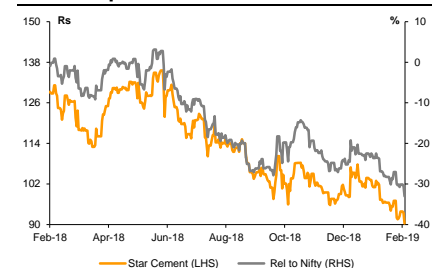
Shareholding Pattern Dec '18

Promoters	68.9%
FIIIs	1.2%
DIIIs	8.7%
Public and Others	21.2%

Price Performance

(%)	1M	3M	6M	12M
Absolute	(10)	(11)	(20)	(26)
Rel. to Nifty	(12)	(15)	(17)	(27)

Relative price chart



Source: Bloomberg

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Exhibit 1: Actual vs. Estimates (Q3FY19)

(Rs mn)	Actual	Estimate		% variation		Comment
		Emkay	Consensus	Emkay	Consensus	
Sales	4,164	4,359	4,308	-4.5	-3.3	Impacted by lower sales volume and realization
EBITDA	1,219	1,081	1,055	12.8	15.5	Impact of lower RM and other expenses
EBITDA margin (%)	29.3	24.8	24.5	447bps	478bps	
Adj. PAT	823	733	609	12.2	35.0	led by higher operating profit

Source: Company, Emkay Research, Bloomberg

Exhibit 2: Quarterly Results

Rs mn	Q3FY18	Q2FY19	Q3FY19	YoY (%)	QoQ (%)	YTDFY18	YTDFY19	YoY (%)
Revenue	3,774	3,623	4,164	10.3%	15.0%	10,871	12,966	19.3%
Expenditure	2,361	2,935	2,945	24.8%	0.3%	7,102	9,743	37.2%
as % of sales	63%	81%	71%					
Consumption of RM	382	930	515	35.1%	-44.6%	1,649	2,437	47.8%
as % of sales	10%	26%	12%					
Employee Expenses	275	321	300	9.3%	-6.4%	828	889	7.4%
as % of sales	7%	9%	7%					
Other Expenses	1,705	1,684	2,130	24.9%	26.4%	4,625	6,417	38.7%
as % of sales	45%	46%	51%					
EBITDA	1,413	687	1,219	-13.8%	77.4%	3,769	3,223	-14.5%
Depreciation	337	271	264	-21.4%	-2.5%	966	818	-15.2%
EBIT	1,077	416	955	-11.4%	129.5%	2,804	2,405	-14.2%
Other Income	2	7	10	323.0%	59.5%	15	20	34.8%
Interest	137	33	26	-81.0%	-20.6%	436	113	-74.1%
PBT	942	390	939	-0.3%	140.9%	2,383	2,312	-3.0%
Total Tax	28	8	102	259.4%	1161.3%	110	178	62.3%
Adjusted PAT	914	382	837	-8.4%	119.2%	2,273	2,134	-6.1%
Extra ordinary items	-	-	-			-	-	
Reported PAT	914	382	837	-8.4%	119.2%	2,273	2,134	-6.1%
(Profit)/loss from JV's/Ass/MI	18	18	14	-22.9%	-20.2%	46	44	-4.0%
PAT after MI	895	364	823	-8.1%	126.0%	2,227	2,090	-6.2%
Adjusted EPS	2.1	0.9	2.0	-8.1%	126.0%	5.3	5.0	-6.2%

Margins (%)				(bps)	(bps)			(bps)
EBIDTA	37.4	19.0	29.3	(818)	1,030	34.7	24.9	(981)
EBIT	28.5	11.5	22.9	(561)	1,144	25.8	18.5	(724)
EBT	25.0	10.8	22.6	(242)	1,179	21.9	17.8	(409)
PAT	24.2	10.5	20.1	(412)	956	20.9	16.5	(445)
Effective Tax rate	3.0	2.1	10.9	786	880	4.6	7.7	310

Source: Company, Emkay Research

Exhibit 3: Operating cost analysis on a per-ton basis

Rs	Q3FY18	Q2FY19	Q3FY19	YoY (%)	QoQ (%)	YTDFY18	YTDFY19	YoY (%)
Sales volume (mt)	0.62	0.56	0.65	5.5%	17.6%	1.80	2.02	12.1%
Raw Material	616	1,674	788	28.1%	-52.9%	2,850	3,690	29.5%
Employee Expense	443	577	459	3.6%	-20.4%	1,415	1,368	-3.3%
Other Expense	2,749	3,029	3,256	18.4%	7.5%	7,688	9,511	23.7%
Total Cost	3,808	5,280	4,504	18.3%	-14.7%	11,953	14,569	21.9%
Realization	6,088	6,516	6,367	4.6%	-2.3%	6,039	6,428	6.4%
EBIDTA	2,280	1,236	1,864	-18.2%	50.8%	2,094	1,598	-23.7%

Source: Company, Emkay Research

Changes in Estimates

We keep our FY19 EBITDA estimates intact but reduce FY20/21 EBITDA estimates by 4.4%/8.4% due to higher coal costs. Coal costs have increased by Rs500/ton and are expected to remain at similar levels in FY20. EPS estimates are being downgraded by 4.2%/8.3% for FY20/FY21E.

Exhibit 4: Changes in Estimates

Rs mn	FY19E			FY20E			FY21E		
	Earlier	Revised	Chg (%)	Earlier	Revised	Chg (%)	Earlier	Introducing	Chg (%)
Sales vol (mt)	2.9	2.9	0.0%	3.2	3.2	0.0%	3.39	3.39	0.0%
Realization (Rs/tn)	6,520	6,520	0.0%	6,846	6,716	-1.9%	7,189	6,984	-2.8%
Sales	18,847	18,847	0.0%	22,002	21,583	-1.9%	24,403	23,710	-2.8%
EBIDTA	4,625	4,625	0.0%	5,510	5,267	-4.4%	6,196	5,674	-8.4%
EBIDTA (%)	24.5	24.5	0	25.0	24.4	-64	25.4	23.9	-146
Net Profit	2,994	3,107	3.8%	3,959	3,792	-4.2%	4,198	3,850	-8.3%
EPS (Rs)	7.1	7.4	3.8%	9.4	9.0	-4.2%	10.0	9.2	-8.3%

Source: Company, Emkay Research

Exhibit 5: Key Assumptions

Key Assumptions	FY17	FY18	FY19	FY20E	FY21E
Sales volume (mt)	2.8	2.6	2.9	3.2	3.4
Realization (Rs/tn)	5,425	6,210	6,520	6,716	6,984
Raw material (Rs/tn)	1,208	1,037	1,193	1,229	1,266
Employee cost (Rs/tn)	421	413	394	390	391
Freight cost (Rs/mt)	958	1,240	1,540	1,587	1,666
Other Expense (Rs/tn)	1,387	1,514	1,793	1,872	1,991
Opex (Rs/tn)	3,975	4,205	4,920	5,077	5,313
EBITDA (Rs/tn)	1,450	2,005	1,600	1,639	1,671

Source: Company, Emkay Research

Con-call highlights

- **Volume details:** Clinker production was 0.60mt vs. 0.59mt in Q3FY18. Cement production from own plants stood at 0.59mt vs. 0.51mt in Q3FY18. Cement/Clinker sales volumes stood at 0.64mt/0.015mt vs. 0.56mt/0.057mt in Q3FY18. Cement volumes in the North East market stood at 0.50mt vs. 0.42mt in Q3FY18. OPC/PPC/PSC mix stood at 22%/76%/2%.
- **North East market dynamics:** Demand in the North East market is expected to increase by about 10% yoy to 9mt in FY19E. Installed capacities in the region are 11-11.5mt. However, effective installed capacity is ~9-9.5mt as smaller plants do not have limestone capacities. Clinker capacity in the region is only 7.5mt, which can help achieve production of ~9-9.5mt; hence, demand-supply dynamics is expected to remain favorable. Management believes that smaller players in the region are operating near their peak utilization rates. As a result, incremental volume would benefit players like Star Cement and Dalmia Bharat who have surplus capacities.
- **Update on Coal prices and Coal mining:** Average coal price for the company has increased by Rs500/ton to Rs5,500/ton. Coal supply issues in Meghalaya have not yet affected Star substantially, as it is also sourcing coal from Nagaland and Eastern Coal Fields. Although management expects coal issues to normalize in the state, it believes that any adverse ruling by the Supreme Court may lead to a Rs100-150/ton increase in operating costs as coal from outside costs Rs8,000/ton.
- **Outstanding subsidies:** The company received Rs253mn in subsidies in Q2FY19, post which outstanding subsidies stand at ~Rs4bn. It expects to receive Rs1.5bn more in Q4FY19 and rest in FY20.
- **Capex plans:** The company will install a 2mt grinding unit in Siliguri, West Bengal, for which equipment has been ordered. This project is expected to get commissioned by Q3FY20 and the related capex is pegged at Rs2-2.5bn. This unit will be eligible for VAT subsidies (75% exemption) under West Bengal Industrial Policy. It has completed first phase of clinker debottlenecking post which clinker production capacity has increased to 2.8mt. The second phase of the clinker debottlenecking program will be completed in Q2FY20 which should further lead to a 0.2mt increase in clinker capacity. The company has applied for environmental clearance for the 2mt clinker capacity in Meghalaya.
- **Trade: Non-Trade Mix:** Trade sales volumes stood at 79% vs. 76% in Q3FY18 and 83% in Q2FY19.

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Revenue	15,278	16,227	18,847	21,583	23,710
Expenditure	11,316	10,932	14,222	16,316	18,036
EBITDA	3,962	5,295	4,625	5,267	5,674
Depreciation	1,179	1,207	1,107	1,158	1,383
EBIT	2,783	4,088	3,517	4,108	4,291
Other Income	24	44	48	68	81
Interest expenses	781	525	139	13	6
PBT	2,027	3,608	3,426	4,163	4,367
Tax	139	164	240	291	437
Extraordinary Items	0	0	0	0	0
Minority Int./Income from Assoc.	(62)	(55)	(80)	(80)	(80)
Reported Net Income	1,826	3,388	3,107	3,792	3,850
Adjusted PAT	1,826	3,388	3,107	3,792	3,850

Balance Sheet

Y/E Mar (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Equity share capital	419	419	419	419	419
Reserves & surplus	11,040	14,344	16,957	20,008	22,625
Net worth	11,459	14,763	17,376	20,428	23,044
Minority Interest	566	621	701	781	861
Loan Funds	8,007	4,324	317	103	83
Net deferred tax liability	(1,765)	(2,329)	(2,898)	(3,466)	(4,035)
Total Liabilities	18,267	17,379	15,497	17,846	19,953
Net block	8,632	7,847	7,340	6,582	9,199
Investment	15	14	14	14	14
Current Assets	13,842	14,509	11,813	13,937	15,849
Cash & bank balance	201	198	409	4,870	6,125
Other Current Assets	0	0	0	0	0
Current liabilities & Provision	4,770	5,349	6,028	6,687	7,109
Net current assets	9,072	9,160	5,785	7,250	8,739
Misc. exp	0	0	0	0	0
Total Assets	18,267	17,379	15,497	17,846	19,953

Cash Flow

Y/E Mar (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
PBT (Ex-Other income) (NI+Dep)	2,148	3,526	3,426	4,163	4,367
Other Non-Cash items	701	527	139	13	6
Chg in working cap	(722)	(345)	3,586	2,997	(235)
Operating Cashflow	3,000	4,206	7,402	7,403	4,434
Capital expenditure	(890)	(324)	(2,600)	(2,043)	(2,000)
Free Cash Flow	2,110	3,882	4,802	5,361	2,434
Investments	(30)	26	0	0	0
Other Investing Cash Flow	0	0	0	0	0
Investing Cashflow	(894)	(253)	(2,552)	(1,975)	(1,919)
Equity Capital Raised	0	0	0	0	0
Loans Taken / (Repaid)	(1,402)	(3,407)	(4,007)	(214)	(21)
Dividend paid (incl tax)	0	0	(493)	(740)	(1,234)
Other Financing Cash Flow	0	0	0	0	0
Financing Cashflow	(2,181)	(3,929)	(4,640)	(967)	(1,260)
Net chg in cash	(75)	24	211	4,462	1,255
Opening cash position	245	201	198	409	4,870
Closing cash position	170	224	409	4,870	6,125

Source: Company, Emkay Research

Key Ratios

Profitability (%)	FY17	FY18	FY19E	FY20E	FY21E
EBITDA Margin	25.9	32.6	24.5	24.4	23.9
EBIT Margin	18.2	25.2	18.7	19.0	18.1
Effective Tax Rate	6.9	4.5	7.0	7.0	10.0
Net Margin	12.4	21.2	16.9	17.9	16.6
ROCE	14.4	23.2	21.7	25.0	23.1
ROE	16.6	25.8	19.3	20.1	17.7
RoIC	14.9	23.8	23.8	37.9	41.3

Per Share Data (Rs)	FY17	FY18	FY19E	FY20E	FY21E
EPS	4.4	8.1	7.4	9.0	9.2
CEPS	7.2	11.0	10.1	11.8	12.5
BVPS	27.3	35.2	41.4	48.7	55.0
DPS	0.0	0.0	1.0	1.5	2.5

Valuations (x)	FY17	FY18	FY19E	FY20E	FY21E
PER	20.8	11.2	12.3	10.0	9.9
P/CEPS	12.7	8.3	9.0	7.7	7.3
P/BV	3.3	2.6	2.2	1.9	1.7
EV / Sales	3.0	2.6	2.0	1.5	1.4
EV / EBITDA	11.6	8.0	8.2	6.3	5.6
Dividend Yield (%)	0.0	0.0	1.1	1.7	2.8

Gearing Ratio (x)	FY17	FY18	FY19E	FY20E	FY21E
Net Debt/ Equity	0.7	0.3	0.0	(0.2)	(0.3)
Net Debt/EBIDTA	2.0	0.8	0.0	(0.9)	(1.1)
Working Cap Cycle (days)	211.9	201.6	104.1	40.2	40.2

Growth (%)	FY17	FY18	FY19E	FY20E	FY21E
Revenue	(10.9)	6.2	16.1	14.5	9.9
EBITDA	(0.8)	33.6	(12.7)	13.9	7.7
EBIT	22.1	46.9	(14.0)	16.8	4.5
PAT	36.3	85.5	(8.3)	22.1	1.5

Quarterly (Rs mn)	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Revenue	3,774	5,274	5,179	3,623	4,164
EBITDA	1,413	1,444	1,317	687	1,219
EBITDA Margin (%)	37.4	27.4	25.4	19.0	29.3
PAT	895	1,079	903	364	823
EPS (Rs)	2.1	2.6	2.2	0.9	2.0

Source: Company, Emkay Research

Shareholding Pattern (%)	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Promoters	73.3	68.9	68.9	68.9	68.9
FIs	2.0	1.9	2.2	1.0	1.2
DIs	2.7	7.3	7.3	8.4	8.7
Public and Others	22.1	21.9	21.6	21.7	21.2

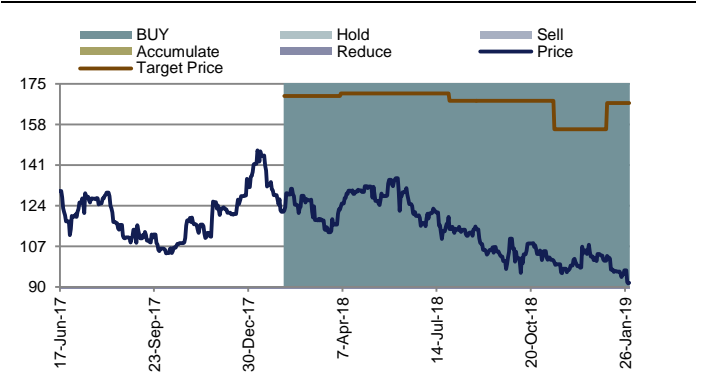
Source: Capitaline

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
7-Jan-19	103	167	12m	Buy	Sanjeev Kumar Singh
13-Nov-18	100	156	12m	Buy	Sanjeev Kumar Singh
27-Jul-18	114	168	12m	Buy	Sanjeev Kumar Singh
18-May-18	128	171	12m	Buy	Sanjeev Kumar Singh
5-Apr-18	124	171	12m	Buy	Sanjeev Kumar Singh
5-Feb-18	122	170	12m	Buy	Sanjeev Kumar Singh

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

Emkay Rating Distribution

BUY	Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
HOLD	Expected total return (%) (Stock price appreciation and dividend yield) of upto 10% within the next 12-18 months.
REDUCE	Expected total return (%) (Stock price depreciation) of upto (-) 10% within the next 12-18 months.
SELL	The stock is believed to underperform the broad market indices or its related universe within the next 12-18 months.

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Sources for all charts and tables are Emkay Research unless otherwise specified.

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