

8 November 2019

Star Cement

Higher one-off costs; outlook intact; retaining a Buy

Rating: **Buy**

Target Price: ₹122

Share Price: ₹96

Higher costs (due to the plant shutdown and to imported coal) hit Star's operating performance. However, greater demand in the NE, high trade sales, lower debt and high other income resulted in revenue and PAT growing respectively 6% and 23% y/y. A better demand outlook, stable prices and continuous cost rationalisations along with net cash despite capex would boost its performance. We are upbeat about Star's prospects and retain our Buy rating on it, with a lower target of ₹122 (earlier ₹132).

Healthy demand outlook. Its market-leading position in the NE and high trade sales (~82%) drove volumes 9% y/y with the NE growing 6%. Further, the 10% y/y rise in realisation pushed up cement revenue 20% y/y. The pent-up demand (due to the floods) and likely higher prices (as the festival season has ended) along with the Siligudi plant commissioning would further aid realisations and volumes. We expect an 11% revenue CAGR over FY19-21, backed by an 11% volume CAGR and the rise in realisation.

Opex to rationalise. The use of imported coal and the plant shutdown led to overall costs increasing, which management said was a one-off. The high cost resulted in EBITDA declining 6% y/y, and EBITDA/ton by 14% to ₹1,067. Management said that the use of imported coal would lead to the cost of production for the year rising by ₹7.5-10/bag. We expect EBITDA/ton of ₹1,705 by FY21 with the measures to optimize costs (use of pet-coke, a WHRS) and higher realisations.

Outlook, Valuation. On 5th Nov, the company completed its buyback of 6.8m shares at ~₹1bn. De-bottlenecking was completed during the quarter and management said the Siligudi plant would be commissioned in Q4 FY20. The environment clearance for a 2m-ton clinker plant is expected to be received by Q3. With capex funded from internal accruals, the balance sheet is expected to be net cash, with a net D/E of 0.2x in FY21. We expect a 7% PAT CAGR over FY19-21, aided by the falling interest cost and the cost-saving measures. We retain our Buy rating, with a lower target price of ₹122 (9x FY21e EV/EBITDA). **Risk:** Rising operational costs.

Key data	STRCEM IN
52-week high / low	₹140 / 85
Sensex / Nifty	40324 / 11908
3-m average volume	\$0.2m
Market cap	₹40bn / \$563.4m
Shares outstanding	419m

Shareholding pattern (%)	Sept-19	Jun-19	Mar-19
Promoters	67.9	67.9	68.0
- of which, Pledged	-	-	0.2
Free float	32.1	32.1	32.0
- Foreign institutions	0.8	1.1	1.2
- Domestic institutions	9.3	9.2	8.7
- Public	22.1	21.8	22.1

Estimates revision (%)	FY20e	FY21e
Sales	(2.3)	(3.2)
EBITDA	(9.1)	(2.2)
PAT	(3.4)	(2.3)

Relative price performance



Source: Bloomberg

Key Financials (YE Mar)	FY17	FY18	FY19	FY20e	FY21e
Sales (₹ m)	15,215	16,064	18,310	19,673	22,649
Net profit (₹ m)	1,947	3,307	2,988	2,831	3,390
EPS (₹)	4.6	7.9	7.1	6.9	8.2
PE (x)	30.2	14.7	13.5	14.0	11.7
EV / EBITDA (x)	16.6	10.2	8.7	8.6	7.1
EV / ton (\$)	268.7	212.1	156.8	103.7	104.6
RoE (%)	19.2	25.6	19.1	16.2	17.4
RoCE (%)	15.1	21.7	19.6	17.5	19.3
Dividend yield (%)	-	0.9	0.9	1.1	1.3
Net debt / equity (x)	0.6	0.3	-0.1	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	FY17	FY18	FY19	FY20e	FY21e
Sales volumes (m tons)	2.7	2.4	2.7	3.0	3.3
Net revenues	15,215	16,064	18,310	19,673	22,649
Growth (%)	-11.0	5.6	14.0	7.4	15.1
Direct costs	3,403	3,025	4,367	3,244	3,750
SG&A	7,792	7,907	9,451	11,847	13,263
EBITDA	4,021	5,132	4,492	4,581	5,635
EBITDA margins (%)	26.4	31.9	24.5	23.3	24.9
- Depreciation	1,179	1,207	1,056	1,100	1,300
Other income	87	125	55	205	50
Interest expenses	781	525	144	60	60
PBT	2,148	3,526	3,346	3,626	4,325
Effective tax rates (%)	6.47	4.65	8.86	20.00	20.00
+ Associates / (Minorities)	62	55	62	70	70
Net income	1,947	3,307	2,988	2,831	3,390
Adjusted income	1,947	3,307	2,988	2,831	3,390
WANS	419	419	419	412	412
FDEPS (₹/ sh)	4.6	7.9	7.1	6.9	8.2
FDEPS growth (%)	44.7	69.8	-9.6	-3.7	19.8

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
PBT	2,148	3,526	3,346	3,626	4,325
+ Non-cash items	1,179	1,207	1,056	1,100	1,300
Oper. prof. before WC	3,327	4,733	4,403	4,726	5,625
- Incr. / (decr.) in WC	898	91	-3,112	-137	864
Others incl. taxes	418	733	683	725	865
Operating cash-flow	2,011	3,909	6,832	4,138	3,896
- Capex (tang. + intang.)	679	231	818	4,000	3,600
Free cash-flow	1,332	3,678	6,014	138	296
Acquisitions					
- Div. (incl. buyback & taxes)	-	505	458	1,544	625
+ Equity raised	-	0	-0	-	-
+ Debt raised	-1,383	-3,683	-3,586	-	-
- Fin investments	0	-0	3	-3	-
- Misc. (CFI + CFF)	-6	-506	52	-	0
Net cash-flow	-44	-3	1,915	-1,403	-329

Source: Company, Anand Rathi Research

Fig 5 – Price movement


Source: Bloomberg

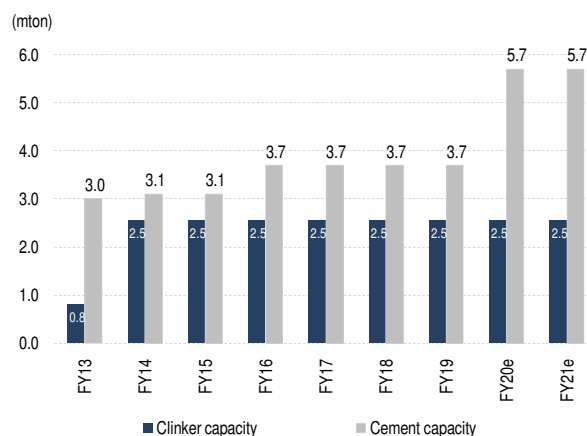
Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Share capital	419	419	419	412	412
Net worth	11,460	14,764	17,237	18,524	21,289
Debt	8,007	4,324	738	738	738
Minority interest	566	621	683	753	823
DTL / (Assets)	-1,765	-2,329	-2,710	-2,710	-2,710
Capital employed	18,268	17,380	15,947	17,305	20,140
Net tangible assets	8,631	7,845	7,221	9,862	10,162
Net intangible assets	2	2	2	2	2
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	549	357	743	1,000	3,000
Investments (strategic)	15	14	17	17	17
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	13,641	14,311	10,161	11,157	12,845
Cash	201	198	2,113	710	382
Current liabilities	4,769	5,348	4,311	5,444	6,267
Working capital	8,872	8,963	5,851	5,713	6,577
Capital deployed	18,268	17,380	15,947	17,305	20,140
Contingent liabilities	566	545	712	-	-

Fig 4 – Ratio analysis

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
P/E (x)	30.2	14.7	13.5	14.0	11.7
EV / EBITDA (x)	16.6	10.2	8.7	8.6	7.1
EV / Sales (x)	4.4	3.3	2.1	2.0	1.8
P/B (x)	5.1	3.3	2.3	2.1	1.9
RoE (%)	19.2	25.6	19.1	16.2	17.4
RoCE (%) - after tax	15.1	21.7	19.6	17.5	19.3
DPS (₹ / sh)	-	1.0	0.9	1.1	1.3
Dividend payout (%) - incl. DDT	-	15.3	15.3	18.5	18.4
Net debt / equity (x)	0.6	0.3	-0.1	0.0	0.02
WC days	202	203	148	107	99
EV / ton (\$)	268.7	212.1	156.8	103.7	104.6
NSR / ton (₹)	7,235	7,681	7,979	8,150	8,350
EBITDA / ton (₹)	1,467	1,970	1,572	1,527	1,705
Volumes (m tons)	2.7	2.4	2.7	3.0	3.3
CFO : PAT (%)	103.3	118.2	228.7	146.2	114.9

Source: Company, Anand Rathi Research

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


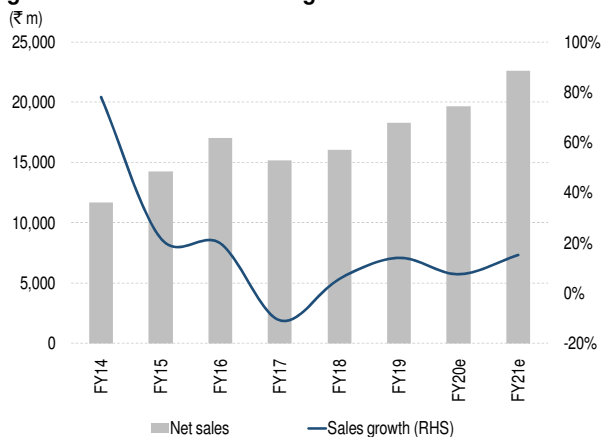
Source: Company

Other key highlights

Revenue growth

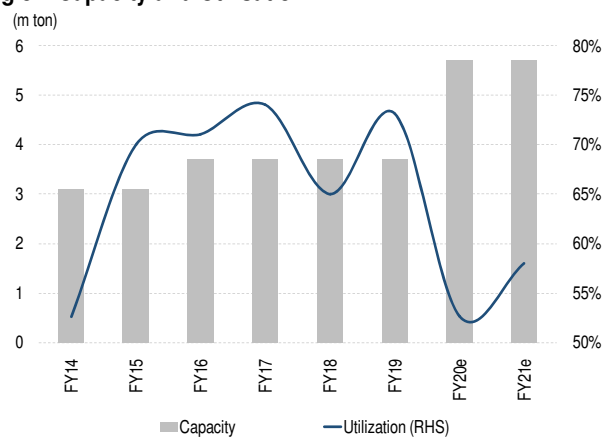
Cement revenue increased 20% y/y; overall revenue, 6%, to ₹3.8bn on higher inter-segment sales. With the north-east region’s 6% growth, cement volumes grew 9% y/y to 0.599m tons. With stable prices in the north-east and some decline in prices in the east, gross realisations rose 10% y/y (down 2.5% q/q) to ₹8,105 a ton. We expect an 11% revenue CAGR over FY19-21.

Fig 7 – Revenue and Revenue growth



Source: Company, Anand Rathi Research

Fig 8 – Capacity and Utilisation

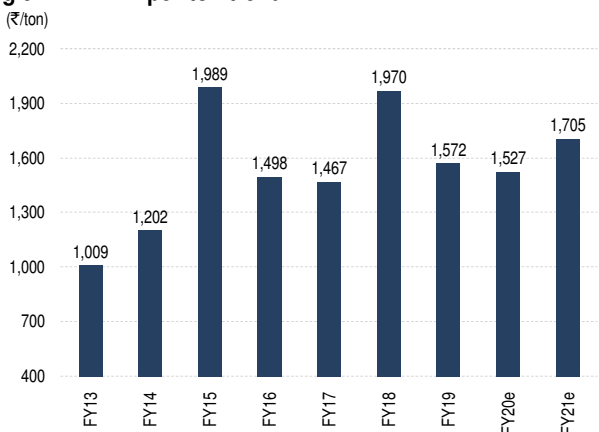


Source: Company, Anand Rathi Research

Operating performance

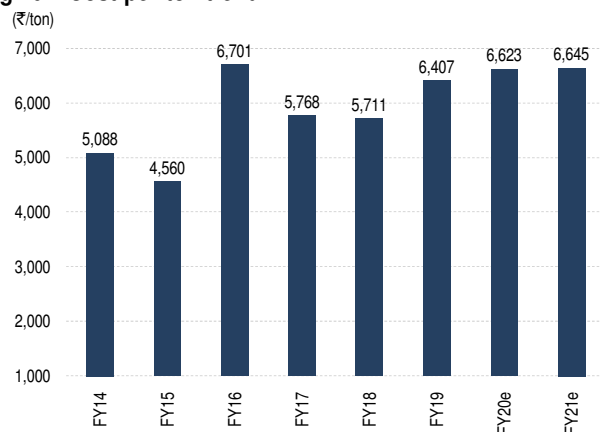
The Q2 FY20 EBITDA/ton dipped 14% y/y to ₹1,067. This was largely due to the subdued operating performance on account of use of 100% imported coal and the some shutdown in the quarter. Adj. PAT came at ₹446m, up 23% y/y due to the better topline, fall in interest expense (down 77% y/y), depreciation expense (down 17% y/y) and increase in other income to ₹77m (₹7m in Q2 FY19).

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)	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	% Y/Y	%Q/Q
Sales	4,792	4,287	2,810	3,774	5,274	5,179	3,623	4,164	5,344	4,609	3,825	5.6	(17.0)
EBITDA	1,693	1,586	770	1,413	1,444	1,317	687	1,219	1,269	1,121	644	(6.3)	(42.6)
EBITDA margins (%)	35	37	27	37	27	25	19	29	24	24	17	-214bps	-750bps
EBITDA per ton (₹)	2,135	2,415	1,592	2,360	1,799	1,632	1,236	1,861	1,510	1,542	1,067	(13.6)	(30.8)
Interest	184	157	141	137	89	54	33	26	31	28	8	(76.5)	(72.3)
Depreciation	122	303	326	337	241	283	271	264	238	222	225	(16.9)	1.6
Other income	20	4	9	2	28	3	7	10	34	74	77	1,069.4	4.5
PBT	1,407	1,130	311	942	1,143	983	390	939	1,034	945	487	25.0	(48.4)
Tax	127	33	49	28	54	68	8	102	118	106	34	322.0	(67.8)
PAT	1,280	1,097	263	914	1,088	915	382	837	916	839	453	18.7	(46.0)

Source: Anand Rathi Research

Fig 12 – Per-ton analysis

(₹ per ton)	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	% Y/Y	%Q/Q
Realisations	5,870	8,911	5,902	7,269	8,148	7,980	7,352	8,099	8,298	8,312	8,105	10.2	(2.5)
EBITDA	2,135	2,415	1,592	2,360	1,799	1,632	1,236	1,861	1,510	1,542	1,067	(13.6)	(30.8)
Sales volumes (m tons)	0.8	0.6	0.4	0.6	0.7	0.7	0.5	0.6	0.8	0.7	0.6	9.3	(16.7)
Costs													
Raw material	1,005	1,107	798	949	1,162	1,327	1,405	1,294	1,184	1,166	1,213	(13.6)	4.0
Purchase of traded goods	240	253	223	318	220	282	364	243	255	311	228	(37.3)	(26.6)
Staff cost	384	459	610	488	331	376	585	469	341	415	490	(16.3)	18.0
Other expenses	2,545	2,606	2,386	2,710	3,450	3,369	2,709	3,085	3,011	3,088	3,306	22.0	7.1

Source: Anand Rathi Research

Change in estimates

Factoring in the H1 FY20 performance, we lower our FY20e and FY21e revenue 2.3% and 3.2% respectively, EBITDA 9.1% and 2.2%, and PAT 3.4% and 2.3%.

Fig 13 – Change in estimates

(₹ m)	New		Old		Variance	
	FY20e	FY21e	FY20e	FY21e	% chg	% chg
Sales	19,673	22,649	20,145	23,408	(2.3)	(3.2)
EBITDA	4,581	5,635	5,043	5,764	(9.1)	(2.2)
PAT	2,831	3,390	2,930	3,471	(3.4)	(2.3)

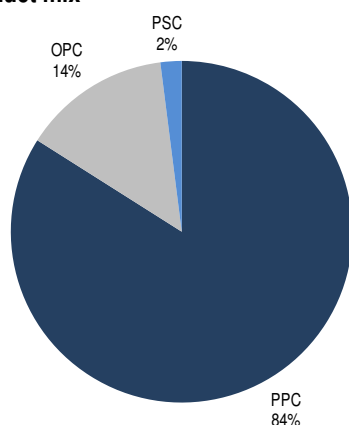
Source: Anand Rathi Research

Concall Highlights

Operational and Financial highlights

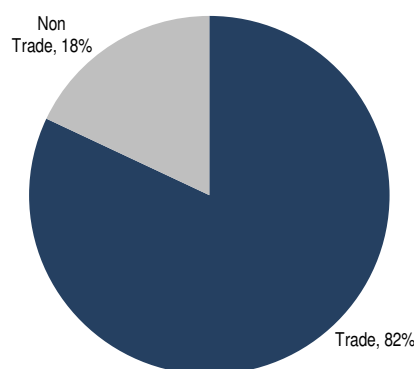
- Cement sales volumes in Q2 FY20 were 0.599m tons, up 0.9% y/y. In the north-east, sales volumes were 0.46m tons, increasing 9% y/y. Outside the north-east, they were 0.139m tons, up 9% y/y. However, clinker sales declined to 0.04m tons (0.08m tons a year ago) mainly due to heavy rainfall.
- The trade and non-trade sales-mix was 82:18.
- Freight cost was ₹689.5m, and power and fuel cost came at ₹827.1m.
- The PPC-OPC-PSC cement mix was 84:14:2.
- Buyback: On 5th Nov'19, the buyback of 6.8m equity shares was completed at ~₹1bn.

Fig 14 – Product mix



Source: Company, Anand Rathi Research

Fig 15 – Sales mix



Source: Company, Anand Rathi Research

- The company used 100% imported coal (instead of local coal) to study its effects on the kiln and other equipment. This resulted in power & fuel costs increasing q/q. Management said this would lead to a ₹7.5-10/bag increase in prices for the full year.

Capex / Capacity expansion

- The Siligudi plant is expected to be completed by Q4 FY20.
- Capex estimated by the company for FY20 is ₹3.5bn. By Q2 FY20, the company had already incurred ₹2.25bn.
- The de-bottlenecking exercise of 0.2m tons was completed at capex of ~₹70m during the shutdown.
- The company is in the process of obtaining environmental clearance for the clinker capacity expansion of 2m tons at the Meghalaya plant. This is expected to be received by Q3 FY20. The estimated timeline for completion is 24-30 months from the date of commencing construction. The company has estimated capex of ₹8bn for the clinker plant and ~₹1.25bn for the WHRS, expected to commence in the next 18-24 months. Capex would be funded through internal accruals.

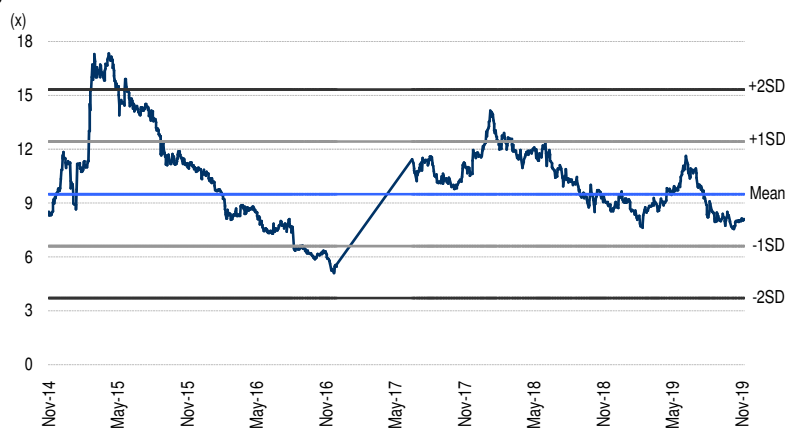
Others

- The north-east market grew 6% in Q2 FY20 whereas the east declined 2% (9% in Q1 FY20). Management expects ~4-5% growth in the east, and ~8-9% in the north-east, benefitting from pent-up demand due to floods in the region and the end of the festival season, from greater sand availability and improving demand in the trade segment.
- In Oct, prices in the north-east declined by ₹7-9 a bag; in the east they fell by ₹10 a bag. With demand improving, management does not expect a further decline in prices.
- The company expects double-digit volume growth in FY20.
- Management said 30% of profit would continue to be distributed to shareholders.

Valuations

At the ruling price, the stock quotes at an EV/EBITDA of 7.1x and an EV/ton of \$105. We maintain our Buy recommendation on it, with a lower target price of ₹122 (earlier ₹132) based on 9x FY21e EV/EBITDA.

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 (\$)	
		FY20e	FY21e	FY20e	FY21e	FY20e	FY21e
Star Cement	96	13.6	11.4	8.6	7.1	104	105
Birla Corp.	635	10.2	10.6	6.1	5.9	66	66
Dalmia Bharat	827	33.6	29.1	7.7	6.9	101	71
Deccan Cement	350	7.6	6.2	4.1	3.0	31	27
Heidelberg Cement	197	15.1	13.0	8.0	6.8	120	109
India Cement	85	12.9	10.9	6.9	6.6	53	54
JK Cement	1,167	19.4	17.0	11.8	9.8	109	106
JK Lakshmi	308	18.9	11.3	8.8	6.3	61	55
Mangalam Cement	321	15.4	10.3	7.3	5.4	49	46
NCL Indus	92	6.0	4.5	3.6	2.7	31	27
Orient Cement	80	17.5	10.4	7.2	6.3	53	59
Prism Johnson	74	22.7	16.1	9.4	7.7	78	73
Ramco Cement	802	25.3	20.0	15.6	12.5	190	157
Sagar Cement	575	17.8	12.7	8.3	7.3	52	40
Sanghi Industries	44	14.7	12.6	10.9	8.0	79	40

Source: Bloomberg

Risk

- Mounting operational costs.

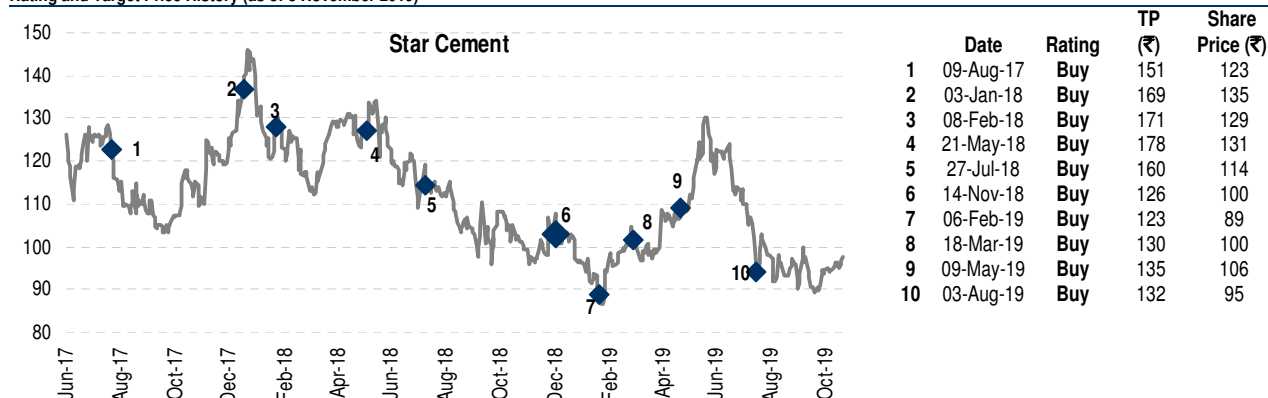
Appendix

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