Buy

# Star Ferro & Cement

Cement

**Result Update** 

12 May 2015

# Setting into a firmer grip

We maintain BUY on Star Ferro & Cement (SFCL) with a revised TP of Rs240. Its Q4FY15 profitability was in-line with our estimates driven by strong 44% YoY volume growth led by good demand in the North East region as well as by expanding presence in other eastern states. We expect SFCL to deliver 26% EBITDA CAGR over the next two years led by its capacity ramp-up and new expansion in the lucrative NE region, tier-1 brand positioning in the eastern region, longevity of NEIIPP incentive benefits and increasing cost efficiency.

- O Strong Q4FY15 results 44% YoY volume growth: SFCL delivered consolidated Net sales/ EBITDA/ adj PAT growth of 33% / 31%/ 51% YoY in Q4FY15. Adjusting for the demerged ferro alloy business, core cement revenues and EBITDA rose 50% and 43% YoY. SFCL's total cement & clinker sales (excluding clinker sales to on-lease grinding units (GU) for conversion to cement) volume rose 44% YoY and QoQ to 0.81 mn MT. Growth benefitted from demand up-tick in the NE region as well as sales expansion in the eastern region. Clinker sales to the on-lease grinding units in West Bengal accounted for 7% of total sales volume in Q4FY15 vs 3% in Q3FY15.
- O Cement EBITDA per MT up 7% YoY to Rs1913: SFCL's blended NSR dipped 0.4% QoQ and 2% YoY. The dip actually reflects (1) change in the market mix as SFCL has been increasing its sales away from the core NE region (67% sales in the NE region in Q4FY15 vs 87% in Q4FY14 and ~70% in Q3FY15) and (2) higher share of clinker sales QoQ (15% clinker sales in Q4 vs 11% in Q3). Clinker utilisation rose to 93% in Q4FY15 vs 85% in Q3FY15 and 65% in Q4FY14. Profitability benefited from increasing cost efficiency, capacity ramp-up and NEIIPP incentives thereby boosting EBITDA to Rs1913 per MT during the quarter.
- Capex to drive growth and efficiency: SFCL's current on-lease GUs and the own GU in WB (expected by end of FY16E) will lower cost of sales in the eastern region due to fly-ash transport cost reduction and also increase SFCL's sales flexibility in the region. SFCL is also looking for both organic and inorganic expansion opportunities in NE region, West Bengal and Bihar to drive its growth beyond FY17. Strong cash flow generation and capital subsidy cash expected in 1HFY16E should drive SFCL's expansion even as SFCL becomes a zero net debt company by the end of FY16E.
- O Valuation & Risks: We cut our EBITDA estimates for FY16E/17E by 4%/ 6% respectively mostly to eliminate Ferro business profitability post the demerger and trimmed EBITDA margins by 200bps each to factor in sales rise outside NE region. We maintain BUY on SFCL valuing its 70.5% holding in the cement business at 10x FY17E EBITDA leading to TP of Rs240 (earlier Rs250 including Ferro alloy valuations). The recent demerger of the Ferro business will increase business focus towards the cement business. Key downside risks are: lower than expected demand off-take, capacity expansion delays and sharp rise in input costs.

Y/E Mar (Rsmn)	Q4FY15	Q4FY14	YoY %	Q3FY15	QoQ %	Q4FY15 E	Var(%)
Net Sales	5,069	3,808	33.1	3,382	49.9	4,895	3.6
Op. cost	3,522	2,625	34.2	2,202	60.0	3,294	6.9
EBITDA	1,548	1,183	30.8	1,180	31.1	1,601	(3.3)
EBITDA margin (%)	30.5	31.1	20	34.9	66bps	32.7	(218) bps
Depreciation	600	407	47.3	551.5	8.7	560.0	7.1
Interest	201	212	(5.2)	233.9	(14.3)	237.0	(15.4)
PBT	738	561	31.6	402.8	83.2	809.0	(8.8)
Taxes Paid	(19)	43	n/m	29.3	(164.5)	30.0	(162.9)
Minority Int	210	155	35.0	128.9	62.6	196.3	6.8
Adjusted PAT	547	362	51.0	244.6	123.7	582.8	(6.1)

Source: Company, Centrum Research Estimates; Consolidated financials; Q4FY14 numbers includes Ferro alloy financials

Target Pric	e	R	s240	Key Data	
CMP*	CMP*		ls152	Bloomberg Code	SFCL IN
Upside	lpside 58%		Curr Shares O/S (mn)	222.2	
Previous Tar	Previous Target Rs250		Diluted Shares O/S(mn)	222.2	
Previous Rat	Previous Rating Buy		Mkt Cap (Rsbn/USDmn)	33.7/527.6	
Price Perfo	rmance	(%)*		52 Wk H / L (Rs)	189/23
	1M	6M	1Yr	5 Year H / L (Rs)	189/13.3
SFCL IN	(12.9)	111.4	537.2	Daily Vol. (3M NSE Avg.)	248565
NIFTY	(5.2)	(0.4)	21.4		

as on 11 May 2015; Source: Bloomberg, Centrum Research\* Stock performance affected by the demerger of Ferro Alloy business(ex-date

#### Shareholding pattern (%)\*

	Mar-15	Dec-14	Sep-14	Jun-14
Promoter	66.5	67.0	67.0	68.9
FIIs	0.1	0.3	0.3	0.4
Dom. Inst.	0.0	0.0	0.0	0.0
Public & Others	33.4	32.7	32.7	30.7
Source: BSE, *as on	11 May 2015			

#### Strong volume growth & margin expansion YoY

	Q4FY15	Q4FY14	YoY %	Q3FY15	QoQ %
Sales Vol					
Net sales (mn MT)	0.81	0.56	44.1	0.56	43.9
Gross sales (mn MT)	0.87	0.56	54.7	0.58	50.5
NSR (Rs/MT) ^^	5,836	5,959	(2.1)	5,857	(0.4)
Opes (Rs/MT) ^^	4,055	4,165	(2.6)	3,813	6.3
EBITDA (Rs/MT) **	1,913	1,794	6.7	2,098	(8.8)

Source: Company, Centrum Research

^^ NSR and Opex calculated on gross sales which include clinker sales to Onlease GU for conversion to cement

\*\* EBITDA per MT calculation on total external sales volume

#### **Earning Revisions summary**

Particulars		FY16	E	FY17E				
(Rs bn)	New	Old	Chg (%)	New	Old	Chg (%)		
Sales	17.3	17.0	2.1	21.0	21.1	(0.7)		
EBITDA	5.5	5.8	(4.0)	7.0	7.4	(6.2)		
Ebitda margin (%)	31.9	33.9	(203) bps	33.2	35.1	(196) bps		
Adj PAT	1.9	2.2	(12.4)	3.0	3.4	(11.6)		

Source: Centrum Research Estimates



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Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	APAT	YoY (%)	DEPS Rs.	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY14	11,734	<i>77.</i> 9	2,550	21.7	70	(71.7)	0.3	0.6	3.1	481.4	26.8
FY15P	14,304	21.9	4,351	30.4	834	1,091.9	3.8	12.3	10.6	40.4	13.7
FY16E	17,338	21.2	5,531	31.9	1,922	130.4	8.7	23.0	15.2	17.5	8.9
FY17E	20,958	20.9	6,955	33.2	3,037	58.0	13.7	29.1	20.2	11.1	5.9
FY18E	25,422	21.3	8,273	32.5	3,762	23.9	16.9	28.6	22.6	9.0	4.6

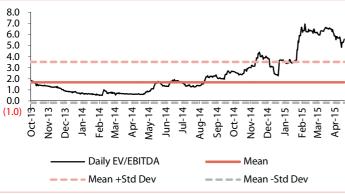
Source: Company, Centrum Research Estimates, Standalone Financials; FY14 Financials include the demerged Ferro alloy business.

# **Valuations & Key assumptions**

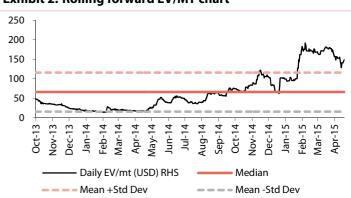
We cut our EBITDA estimates for FY16E/17E by 4%/ 6% respectively mostly to eliminate ferro business profitability post the demerger. As SFCL is increasing its sales volume in the eastern states outside its NE region, we factor in ~3-4% higher volume off-take for FY16E/17E and have concurrently lowered EBITDA per MT estimates for these years by ~4% each to factor in lower EBITDA per MT contribution from outside the NE region. Hence, we have trimmed our EBITDA margin estimates by ~200bps each. Subsequently, we expect SFCL to deliver 16% volume CAGR over the next two years which along with increasing cost efficiency should drive its 26% EBITDA CAGR. We have also factored in capex of Rs4 bn during FY17-18E towards organic and/or inorganic growth to drive growth beyond FY17E.

We value SFCL's 70.5% holding in the cement business at 10x its FY17E EBITDA thereby leading to TP of Rs 240. SFCL will continue to deliver industry leading return ratios driven by its leadership presence in lucrative NE region, tier-1 brand positioning in other eastern states and NEIPP incentives. These factors alongwith increase in focus towards cement business (as the non-core Ferro business has been demerged) should sustain SFCL' premium valuations.

**Exhibit 1: Rolling forward EV/EBITDA chart** 



**Exhibit 2: Rolling forward EV/MT chart** 



Source: Bloomberg, Company, Centrum Research Estimates

Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 3: Comparative Valuations – SFCL should continue to deliver industry leading return ratios

Mkt Caj		CAGR FY15-17E (%)			EBITDA margin (%)		RoCE (%)		RoE (%)		EV/EBITDA (x)		(x)	EV/MT(USD)					
Company	(Rs bn)	Rev.	EBITDA	PAT	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E
SFCL	33.7	21.0	26.4	90.8	30.4	31.9	33.2	10.6	15.2	20.2	12.3	23.0	29.1	13.7	8.9	5.9	321	266	168
UltraTech Cement	774.7	25.5	42.3	48.1	18.3	21.6	23.5	7.9	10.8	14.0	11.2	15.1	18.9	18.7	13.3	9.4	209	191	180
Shree Cement	358.2	25.6	42.9	118.0	21.5	25.1	27.8	6.4	17.6	24.4	8.7	22.0	28.5	24.9	16.8	11.4	239	215	205
Ambuja Cements	369.7	11.0	27.6	30.6	18.9	21.8	24.7	9.9	12.2	15.3	13.1	13.8	18.0	16.8	13.2	10.0	184	179	174
JK Lakshmi	40.6	27.5	46.2	44.6	16.3	18.7	21.5	6.8	8.3	12.7	12.8	12.8	21.8	13.7	9.3	6.3	104	92	83
Orient Cement	35.7	31.5	49.8	56.5	19.8	22.8	25.7	10.3	13.2	19.4	18.1	19.2	31.7	11.1	10.4	6.7	113	100	95

Source: Company, Centrum Research Estimates

**Exhibit 4: Key Operational Assumptions** 

Particulars	FY13	FY14	FY15	FY16E	FY17E	FY18E
Total Sales Volume (mn MT)	1.1	1.8	2.4	2.7	3.2	3.7
YoY change (%)	(3.6)	64.4	34.5	16.4	15.8	16.9
(Rs/ MT trend)						
NSR (1)	5,554	5,854	5,804	5,891	6,244	6,494
YoY change (%)	13.5	5.4	(0.9)	1.5	6.0	4.0
RM & Traded goods (2)	704	855	944	1,061	1,067	1,000
Power & Fuel (3)	1,017	941	707	649	706	779
Freight costs (4)	1,183	1,086	998	943	999	1,071
Employee cost (5)	368	419	375	357	360	370
Other expense (6)	1,131	1,270	1,069	1,003	1,041	1,160
Total Opex (7)= sum(2 thru 6)	4,403	4,570	4,093	4,012	4,172	4,381
YoY change (%)	23.3	3.8	(10.4)	(2.0)	4.0	5.0
Ex plant NSR (1-4)	4,371	4,768	4,806	4,948	5,245	5,422
Input cost (2+3)	1,721	1,795	1,651	1,709	1,772	1,779
Variable cost (2+3+4)	2,904	2,882	2,649	2,652	2,771	2,851
Fixed cost (5+6)	1,499	1,689	1,444	1,360	1,401	1,530
EBITDA per MT (1-7)	1,150	1,284	1,846	2,016	2,190	2,169
YoY change (%)	(13.0)	11.6	43.8	9.2	8.6	(1.0)

Source: Company, Centrum Research Estimates

**Exhibit 5: Quarterly financials trend** 

Y/E Mar (Rs mn)	Q1FY14	Q2FY14	Q3FY14	Q4FY14	Q1FY15	Q2FY15	Q3FY15	Q4FY15
Net Sales	2,347	2,225	3,353	3,808	3,561	2,922	3,382	5,069
Total Expenditure	1,965	2,156	2,439	2,625	2,384	2,370	2,202	3,522
Raw Materials	234	687	429	668	467	714	227	1,074
Employee	175	197	199	218	214	253	246	227
Others	1,555	1,272	1,811	1,739	1,704	1,403	1,728	2,221
EBITDA	383	69	915	1,183	1,177	552	1,180	1,548
Depreciation	395	405	409	407	557	557	552	600
EBIT	(12)	(336)	506	776	620	(5)	629	948
Interest	263	170	227	212	241	218	234	201
Other Income	16	4	7	(4)	7	2	8	(9)
PBT	(259)	(503)	286	561	386	(221)	403	738
Taxes	(25)	(14)	23	43	12	28	29	(19)
Adjusted PAT (before minority)	(234)	(489)	263	518	373	(249)	374	757
Exceptional expense/ (income)	(294)	260	8	17	0	(13)	8	3
Minority Interest	(135)	(86)	53	155	103	(87)	129	210
Reported PAT	(394)	(143)	218	380	270	(175)	253	550
Adjusted PAT	(100)	(403)	210	362	270	(161)	245	547
Adj EPS (Rs)	(0.4)	(1.8)	0.9	1.6	1.2	(0.7)	1.1	2.5
YoY Growth (%)								
Revenue	31.0	57.5	113.0	109.5	51.7	31.3	0.8	33.1
EBITDA	(18.3)	(75.9)	559.1	308.4	207.5	697.5	29.0	30.8
PBT	n/m	n/m	1,014.1	(519.4)	(248.7)	n/m	40.8	31.6
Adj PAT	n/m	n/m	n/m	n/m	n/m	n/m	16.4	51.0
Margins (%)								
EBITDA	16.3	3.1	27.3	31.1	33.0	18.9	34.9	30.5
EBIT	(0.5)	(15.1)	15.1	20.4	17.4	(0.2)	18.6	18.7
PBT	(11.1)	(22.6)	8.5	14.7	10.8	(7.6)	11.9	14.6
Adj PAT	(10.0)	(22.0)	7.8	13.6	10.5	(8.5)	11.0	14.9
Operational Trend								
Cement & clinker Sales Vol								
Gross sales volume (mn MT)	0.36	0.37	0.46	0.56	0.53	0.45	0.58	0.87
YoY growth (%)	27.4	32.9	93.3	110.0	47.8	23.7	24.2	54.7
Net sales volume (mn MT)	0.36	0.37	0.46	0.56	0.53	0.45	0.56	0.81
YoY growth (%)	27.4	32.9	93.3	110.0	47.8	23.7	21.0	44.1
NSR (Rs/MT)	5,576	5,343	6,346	5,959	6,020	5,809	5,857	5,836
Opex (Rs/MT)	4,412	5,336	4,581	4,165	3,940	4,662	3,813	4,055
EBITDA (Rs per MT)	1,164	6	1,764	1,794	2,080	1,147	2,098	1,913

Source: Company, Centrum Research

# **Financials - Consolidated**

#### **Exhibit 6: Income Statement**

Y/E Mar(Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
Net Sales	11,734	14,304	17,338	20,958	25,422
Raw Materials	2,018	1,798	1,786	2,305	3,178
as % of sales	17.2	12.6	10.3	11.0	12.5
Employee	786	913	1,050	1,207	1,449
as % of sales	6.7	6.4	6.1	5.8	5.7
Others	2,828	2,599	2,953	3,495	4,541
as % of sales	24.1	18.2	17.0	16.7	17.9
EBITDA	2,550	4,351	5,531	6,955	8,273
EBITDA margin (%)	21.7	30.4	31.9	33.2	32.5
Depreciation	1,616	2,237	2,168	2,355	2,557
EBIT	933	2,113	3,363	4,599	5,716
Interest	872	874	700	500	300
Other income	24	8	200	350	400
PBT	85	1,247	2,863	4,449	5,816
Tax	27	48	300	400	800
Tax rate (%)	32.0	3.8	10.5	9.0	13.8
Minority+ Associates	12	(365)	(641)	(1,012)	(1,254)
Adj PAT Pre-minority	58	1,199	2,563	4,049	5,016
Adj PAT (post minority)	70	834	1,922	3,037	3,762
EO items	(9)	-	-	-	-
Reported PAT (post minority)	61	834	1,922	3,037	3,762

Source: Company, Centrum Research Estimates

### **Exhibit 7: Key Ratios**

Y/E Mar	FY14	FY15P	FY16E	FY17E	FY18E
Growth Metrics (%)					
Net Sales	77.9	21.9	21.2	20.9	21.3
EBITDA	115.4	70.6	27.1	25.8	19.0
Adj PAT	(71.7)	1,091.9	130.4	58.0	23.9
Profitability Metrics (%)					
EBIT margin	8.0	14.8	19.4	21.9	22.5
PBT margin	0.7	8.7	16.5	21.2	22.9
Adj PAT margin	0.5	8.4	14.8	19.3	19.7
Return Ratios (%)					
RoE	0.6	12.3	23.0	29.1	28.6
RoCE	3.1	10.6	15.2	20.2	22.6
RoIC	3.2	10.7	18.4	29.2	33.4
Turnover ratios (No of days)					
Inventory period	55	28	33	37	42
Collection period	44	79	55	47	49
Creditors period	26	20	26	27	27
Cash conversion cycle	73	87	61	57	64
Solvency Ratio (x)					
D/E	1.1	0.9	0.6	0.3	0.1
Net D/E	1.0	0.9	0.1	(0.1)	(0.3)
Interest coverage	1.1	2.4	4.8	9.2	19.1
Current ratio	3.4	3.9	3.6	3.0	3.2
Dividend					
DPS (Rs)	0.3	0.0	1.3	2.7	4.2
Dividend yield (%)	0.2	0.0	0.9	1.8	2.8
Dividend pay-out (%)	119.2	0.0	17.7	23.5	29.4
Per share (Rs)					
Basic EPS- reported	0.3	3.8	8.7	13.7	16.9
Basis EPS- adjusted	0.3	3.8	8.7	13.7	16.9
FDEPS- reported	0.3	3.8	8.7	13.7	16.9
FDEPS- adjusted	0.3	3.8	8.7	13.7	16.9
CEPS	7.6	13.8	18.4	24.3	28.4
BVPS	30.9	30.6	37.7	48.2	60.1
Valuations Metrics (x)					
P/E	481.4	40.4	17.5	11.1	9.0
Price/Cash earnings	20.0	11.0	8.2	6.2	5.3
Price/BV	4.9	5.0	4.0	3.1	2.5
EV/EBITDA	26.8	13.7	8.9	5.9	4.6
EV/ton (USD \$)	325	321	266	168	136

Source: Company, Centrum Research Estimates

#### **Exhibit 8: Balance Sheet**

Y/E Mar(Rs mn)	FY14	FY15P	FY16E	FY17E	FY18E
Sources of Funds:					
Share Capital	222	222	222	222	222
Reserves	6,641	6,578	8,161	10,483	13,138
Shareholders Fund	6,863	6,800	8,383	10,705	13,360
Debt	9,917	8,918	7,918	4,918	2,418
Net deferred tax	45	87	287	487	687
Minority Int	2,529	3,231	3,872	4,884	6,138
Total Liabilities	19,354	19,035	20,459	20,993	22,602
Application of Funds:					
Gross Block	15,827	16,622	18,072	18,172	21,172
Accumulated Depn	4,105	6,342	8,510	10,865	13,422
Net Fixed Assets	11,722	10,280	9,562	7,306	7,749
Capital WIP	995	410	310	3,310	1,310
Investments	15	15	15	15	15
Inventories	1,755	1,091	1,560	2,096	2,923
Sundry Debtors	1,416	3,098	2,601	2,725	3,432
Cash & Liquid Investments	126	204	6,528	6,208	7,853
Loans & Advances	6,037	6,802	3,988	4,401	5,466
Other Current Assets	5	4	2	2	3
Total Current Assets	9,339	11,200	14,679	15,431	19,677
Sundry creditors	829	770	1,248	1,572	1,907
Other liabilities & provisions	1,889	2,099	2,859	3,497	4,242
Total Current Liabilities	2,718	2,869	4,107	5,069	6,149
Net Current Assets	6,621	8,331	10,572	10,362	13,528
Total Assets	19,354	19,035	20,459	20,993	22,602

Source: Company, Centrum Research Estimates

### **Exhibit 9: Cash Flow**

Y/E Mar(Rs mn)	FY14	FY15P	FY16E	FY17E	FY18E
PBT & extraord. Items	76	1,247	2,863	4,449	5,816
Add: Depreciation	1,616	2,237	2,168	2,355	2,557
Add: Interest	872	874	700	500	300
Add: Others	(24)	(8)	(200)	(350)	(400)
Operating profit before WC changes	2,541	4,351	5,531	6,955	8,273
Trade & other receivables	(1,606)	(2,446)	3,315	(538)	(1,772)
Inventories	(255)	663	(469)	(535)	(828)
Trade payables	919	151	1,237	962	1,080
Net change - WC	(941)	(1,632)	4,083	(111)	(1,520)
Direct taxes	-	(6)	(100)	(200)	(600)
Net cash from operating activities	1,599	2,713	9,514	6,644	6,152
Capital expenditure	(1,173)	(769)	(1,350)	(3,100)	(1,000)
Others	(1)	8	200	350	400
Net Cash from investing activities	(1,175)	(761)	(1,150)	(2,750)	(600)
Net free cash flows	425	1,951	8,364	3,894	5,552
Issue of share capital	-	-	-	-	-
Debt change	409	(999)	(1,000)	(3,000)	(2,500)
Dividend paid	(122)	-	(339)	(715)	(1,107)
Interest paid	(872)	(874)	(700)	(500)	(300)
Net cash from financing activities	(585)	(1,873)	(2,039)	(4,215)	(3,907)
Net change in cash	(160)	78	6,325	(321)	1,645

Source: Company, Centrum Research Estimates

## **Appendix A**

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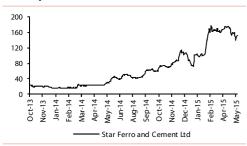
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#### SFCL price chart



Source: Bloomberg, Centrum Research

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