

4 August 2016

Star Ferro and Cement

Strong volumes; prices to improve from H2; Buy

Rating: **Buy**

Target Price: ₹144

Share Price: ₹114

Following weak pricing in the north-east, Star Ferro's operating performance came lower than we estimated. Volume growth, however, was a strong 22%. With cement prices expected to improve from H2 FY17 as well as volume growth in the region, we are upbeat about the company's prospects and maintain a Buy rating on the stock, with a price target of ₹144.

Volumes rise, realisations subdued. In Q1 FY17 Star Ferro's cement volumes rose 22% yoy (down 15% qoq) to 0.8m tons driven by capacity expansion and strong demand in the north-east. Realizations slipped 10% yoy, to ₹5,934 a ton, due to weak pricing in the regions where it operates.

EBITDA/ton declined. EBITDA/ton, at ₹1,042 (less than our ₹1,298 estimate), plunged 41% yoy (17% qoq) primarily due to the lower realisations. Also, the lower EBITDA, higher interest cost (up 4% yoy) and lower other income (down 26% yoy) led to PAT declining 40% yoy, to ₹362m. We expect cement prices to bounce back from H2 FY17 as the construction season takes off.

Reverse merger: The Board has approved a scheme of amalgamation of Star Ferro (the transferor company) with Star Cement (formerly The Cement Manufacturing Co., the transferee company) w.e.f. 1st Apr'16. Earlier, Star Cement was a 70.48% subsidiary of Star Ferro. Under this reverse merger Star Cement would issue 1.33 shares for every one of Star Ferro. The merger is expected to be complete in six months from now.

Valuation. The stock trades at an EV/EBITDA of 7.7x and an EV/ton of \$146 on FY18e. We value it at 9x FY18e EBITDA. The target EV/EBITDA multiple is higher than its peers as the company operates in a high-growth market and commands superior margins. We maintain our Buy recommendation. **Risk.** Delay in receiving government subsidies.

Key data	SFCL IN / STRF.BO
52-week high / low	₹159 / ₹95
Sensex / Nifty	27714 / 8551
3-m average volume	\$0.4m
Market cap	₹25bn / \$375m
Shares outstanding	222m

Shareholding pattern (%)	Jun '16	Mar '16	Dec '15
Promoters	66.7	66.6	66.4
- of which, Pledged	-	1.4	1.4
Free Float	33.4	33.4	33.6
- Foreign Institutions	0.1	0.1	0.0
- Domestic Institutions	0.0	0.0	0.1
- Public	33.2	33.3	33.5

Estimates revision (%)	FY17e	FY18e
Sales	(0.8)	(1.0)
EBITDA	(4.7)	(0.6)
PAT	(9.9)	(1.1)

Financials (YE: Mar)	FY17e	FY18e
Sales (₹ m)	20,959	22,754
Net profit (₹ m)	1,186	1,605
EPS (Rs)	5.3	7.2
Growth (%)	0.2	0.4
PE (x)	15.1	11.1
EV / EBITDA (x)	10.2	7.7
EV / ton (\$)	209.6	146.1
RoE (%)	21.3	25.8
RoCE (%)	17.0	22.0
Net gearing (x)	1.0	0.5

Source: Anand Rathi Research *Consolidated

Quarterly results (YE: Mar)	1QFY16	1QFY17	% yoy	FY15	FY16	% yoy
Sales (₹ m)	4,084	4,480	9.7	14,270	17,095	19.8
EBITDA (₹ m)	1,211	905	(25.2)	4,316	3,923	(9.1)
EBITDA margin (%)	29.6	20.2	(944)bps	30.2	23.0	(730)bps
EBITDA per ton (₹)	1,766	1,042	(41.0)	1,759	1,296	(26.3)
Interest (₹ m)	202	210	3.7	874	834	(4.6)
Depreciation (₹ m)	417	342	(18.0)	2,237	1,715	(23.4)
Other income (₹ m)	19	14	(26.0)	42	70	64.4
PBT (₹ m)	611	367	(39.8)	1,247	1,445	15.8
Tax (₹ m)	5	5	1.6	48	55	14.8
Adj. PAT (₹ m)	605	362	(40.2)	1,199	1,389	15.9

Source: Company, Anand Rathi Research *Consolidated

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16	FY17e	FY18e
Net revenues	11,714	14,270	17,095	20,959	22,754
Revenue growth (%)	78.2	21.8	19.8	22.6	8.6
- Oper. expenses	9,184	9,954	13,171	16,276	17,179
EBIDTA	2,530	4,316	3,923	4,682	5,575
EBITDA margins (%)	21.6	30.2	23.0	22.3	24.5
- Interest	872	874	834	839	689
- Depreciation	1,616	2,237	1,715	1,800	2,100
+ Other income	43	42	70	60	60
- Tax	27	48	55	421	569
Effective tax rate (%)	35.6	3.9	3.8	20.0	20.0
+ Assoc. / (minorities)	(12)	365	464	496	672
Adjusted PAT	70	834	925	1,186	1,605
+ Extraordinary items	9	0	5	-	-
Reported PAT	49	1,199	1,384	1,683	2,277
Adj. FDEPS (₹ / sh)	0.3	5.4	6.3	7.6	10.2
Adj. FDEPS growth (%)	(84.6)	1,980.9	15.9	21.1	35.3

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16	FY17e	FY18e
Share capital	222	222	222	222	222
Reserves & surplus	6,641	6,578	7,276	8,068	9,140
Net worth	6,863	6,800	7,498	8,290	9,362
Total debt	9,917	8,805	9,398	8,425	5,325
Minority interest	2,529	3,231	3,596	4,093	4,764
Def. tax liab. (net)	45	87	112	112	112
Capital employed	19,354	18,922	20,604	20,921	19,565
Net fixed assets	12,714	10,688	9,680	8,630	7,280
Intangible assets	3.1	1.5	1.5	1.5	1.5
Investments	15	15	15	15	15
- of which, Liquid	-	-	-	-	-
Working capital	6,495	8,014	10,663	12,173	11,969
Cash	126	204	245	101	299
Capital deployed	19,354	18,922	20,604	20,921	19,565
Working capital (days)	188	186	199	199	194
Book value (₹ / sh)	31	31	34	37	42

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16	FY17e	FY18e
PAT	70	834	925	1,186	1,605
+Non-cash items	1,620	2,279	1,741	1,800	2,100
Cash profit	1,690	3,113	2,666	2,986	3,705
- Incr. / (decr.) in WC	921	1,519	2,649	1,511	(204)
Operating cash-flow	770	1,595	17	1,476	3,910
-Capex	1,397	209	707	750	750
Free cash-flow	(627)	1,385	(690)	726	3,160
-Dividend	122	67	-	394	533
+ Equity raised	222	-	-	-	-
+ Debt raised	625	(1,112)	593	(972)	(3,100)
-Investments	-	-	-	-	-
-Misc. items	243	128	(138)	(496)	(672)
Net cash-flow	(145)	78	41	(144)	198
+Op. cash & bank bal.	271	126	204	245	101
Cl. cash & bank bal.	126	204	245	101	299

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹114

Year-end: Mar	FY14	FY15	FY16	FY17e	FY18e
P/E (x)	439.5	21.1	18.2	15.1	11.1
P/B (x)	3.7	3.7	3.4	3.1	2.7
P / CEPS (x)	15.1	7.4	8.2	7.3	5.8
EV / EBITDA (x)	19.7	11.2	12.5	10.2	7.7
EV / ton (\$)	239.9	231.8	235.5	209.6	146.1
RoE (%)	0.8	17.6	19.4	21.3	25.8
RoCE (%)	5.5	12.8	13.5	17.0	22.0
Net debt / equity (x)	1.4	1.3	1.3	1.0	0.6
Interest coverage (x)	1.0	2.4	2.6	3.4	5.0
DPS (₹)	0.5	-	-	1.5	2.0
Dividend yield (%)	0.4	-	-	1.3	1.8
Dividend payout (%)	213.3	-	-	20.0	20.0
NSR / ton (₹)	6,290	6,549	6,433	6,614	6,812
EBITDA / ton (₹)	1,214	1,759	1,296	1,341	1,503
Volumes (m tons)	1.6	2.2	2.7	3.2	3.3

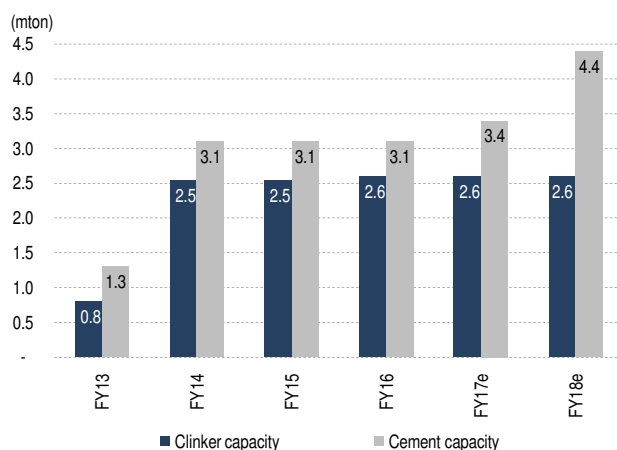
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg, Anand Rathi Research

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



Source: Company, Anand Rathi Research

Result Highlights

Fig 7 – Q1 FY17 Results vs Expectations

(₹ m)	Q1 FY17	Q1 FY17e	% Var	Q1 FY16	% yoy	Q4 FY16	% qoq
Sales	4,480	4,947	(9.4)	4,084	9.7	5,616	(20.2)
EBITDA	905	1,211	(25.3)	1,211	(25.2)	1,252	(27.7)
EBITDA margin (%)	20.2	24.5	428	29.6	(944)	22.3	(208)
EBITDA per ton (₹)	1,042	1,298	(19.8)	1,766	(41.0)	1,257	(17.1)
Interest	210	220	(4.7)	202	3.7	216	(3.0)
Depreciation	342	440	(22.1)	417	(18.0)	440	(22.1)
Other income	14	19	(26.0)	19	(26.0)	18	(20.0)
PBT	367	571	(35.7)	611	(39.8)	614	(40.2)
Tax	5	114	(95.2)	5	1.6	26	(79.0)
PAT	362	457	(20.8)	605	(40.2)	588	(38.4)

Source: Company, Anand Rathi Research

Fig 8 – Change in estimates

	Old		New		Variance	
	FY17e	FY18e	FY17e	FY18e	% chg	% chg
Sales (₹m)	21,119	22,977	20,959	22,754	(0.8)	(1.0)
EBITDA (₹m)	4,914	5,608	4,682	5,575	(4.7)	(0.6)
PAT (₹m)	1,317	1,623	1,186	1,605	(9.9)	(1.1)

Source: Anand Rathi Research

Change in estimates

We have lowered our FY17/18 revenue and EBITDA estimates by respectively 0.8%/1% and 4.7%/0.6% primarily to factor in the Q1 FY17 performance. The FY17/18 PAT estimates have also been reduced, by 9.9%/1.1%. We expect Star Ferro's good performance to continue, based on a better operating performance from H2 FY17 following higher cement prices.

Concall Highlights

- **Strong volumes:** Star Ferro's Q1 FY17 cement sales volumes were 0.75m tons (0.62m a year earlier). Clinker production was 0.65m tons (0.583m a year earlier). Of the sales volumes, 61% was to the north-east, 39% elsewhere. In the quarter the company operated at 74% capacity.
- **Capacity expansion:** Star has 4m-ton capacity (including 0.7m tons of a hired unit in West Bengal). Last year it de-bottlenecked its grinding unit (~0.3m tons) and is planning another de-bottlenecking, of the 0.3m ton clinkerisation unit. It plans to set up a 1m-ton plant at Siligudi, after which, by end-FY18, capacity would be 5m tons. However, the company is faced with issues regarding land, which it expects to clear by Sep'16. Capex plans ahead, for FY17 and part of FY18, would amount to ~₹1.5bn, chiefly for the Siligudi plant.
- **Subsidies receivable:** Under the North-East Industrial and Investment Promotion Policy, 2007, the company enjoys various subsidies. Total subsidies receivable as of end-Jun'16 were ~₹7bn. Although all subsidies have been sanctioned, disbursements from the Central government are awaited. During Q1 FY17 the company received the first tranche of a subsidy, amounting to ₹250m. The company has received an extension on the subsidy for its old plant, up to Jul'20, expected to expire in 2017.
- **Reverse merger:** The Board has approved a scheme of amalgamation of Star Ferro (the transferor company) with Star Cement (formerly The Cement Manufacturing Co., the transferee company) w.e.f. 1st Apr'16. Earlier, Star Cement. was a 70.48% subsidiary of Star Ferro. Under this reverse merger Star Cement will issue 1.33 shares for every one of Star Ferro. The merger is expected to be completed within six months from now.

Valuations

We value the stock at 9x FY18e EBITDA. The target EV/EBITDA multiple is higher than its peers as the company operates in a high-growth market and commands superior margins. The stock trades at an EV/EBITDA of 7.7x and an EV/ton of \$146 on FY18e.

Fig 9 – EV/EBITDA band



Source: Company, Anand Rathi Research

Fig 10 – Valuations

	Basis of Valuation	Driver Value (₹ m)	Multiple (x)	Value (₹ m)
Cement Business	EV/EBITDA Mar'18	5,575	9.0	50,179
Less Net debt				5,011
Stake in the cement business %				70.48
Target market cap of its cement division				31,834
Diluted number. of shares (m)				222
Fair value (per share)				144

Source: Anand Rathi Research

Risks

- Single-region exposure.
- Delay in obtaining government subsidies.

Appendix

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