

Sagar Cement Ltd.

4 December 2020

Reuters: SGRC.NS; Bloomberg: SGC:IN

Conference call KTAs – higher margins here to stay

We hosted Sagar Cements (SGC) management for a call to understand the company's future prospects and industry dynamics in the near to medium term. We retain our positive stance on the company as we believe that stable pricing and gradually improving demand will keep margins higher despite rising operating costs. We like SGC's low cost business operations and lower than industry investments for capex. We maintain our BUY recommendation on the stock with a target price (TP) of Rs1,040. Please find the key takeaways of our call below.

Gradual recovery post COVID: For SGC, April'20 was a complete washout and the company lit up first kiln on 3rd May 2020 even though the government had given orders to open up a week earlier. While plant operations were smooth, the company faced logistics issues initially in May'20. However, it soon started clocking 170-180k mt every month. The demand started coming back to normalcy from June onwards and improved every month thereafter. In 1QFY21, the company's volume was down 70% YoY whereas the same in 2QFY21 was down 5% YoY due to the low base of last year. YTD till November, overall volume is down by ~8% YoY and the company expects to end FY21 with 5-10% lower volume.

Cement prices stable for 8 months after a long time: Despite weak volume, pricing has been supportive for the industry. Realisations in the SGC's markets were up by 25-30% on YoY basis. Last year, except for 1Q, prices were extremely low and had reached decadal low on inflation adjusted basis. Prices have remained stable with Rs5-10/bag change over the past 7-8 months, which has happened after a long time. There has been some seasonal correction but it has been minimal.

Lower operating costs also helped achieve good margins: Another factor for good margins in 1H FY21 has been operating costs, which were also benign. Petcoke cost in 1H FY21 was lower by ~15% YoY. Various cost reduction measures undertaken by the company like WHRS, ramping up of GU in Vizag and change in cooler in one of the unit helped it to reduce costs further. SGC is one of the lowest cost producers of cement in India despite having lower blending ratio compared to peers and having lower operating ratio as the utilisation of the plants are lower compared to the all-India average. SGC's blending ratio is 45% whereas industry utilisation rates are lower at ~55%. The SGC management also mentioned that its asset quality is phenomenal despite few plants being more than 40 years old. Another factor which resulted in lower costs was lower advertising, travel and marketing costs in the last few months although they are expected to rise in the near future.

Fuel costs moving up: Petcoke prices have started rising again and have gone up from US\$60/mt to US\$100/mt over the past 4 months. SGC was using 100% petcoke till last quarter and still has low cost inventory till January 2021. The company has a policy of maintaining 6 months of fuel inventory and has started buying Australian coal. The average price of Australian coal is ~US\$53-54/mt. Currently, imported coal is more economical than domestic coal and petcoke, which are currently trading at Rs1.2/Kcal. Freight costs have also started rising from July'20 due to rising diesel costs.

Spending by AP and Telangana governments improving: AP and Telangana demand can reach FY18 level in FY21, which is close to 22mn mt despite a sharp cut in 1H FY21. Positive factors are: government demand is buoyant as purchases from both AP and Telangana governments have been higher. Each month, the government is procuring close to 400k mt of cement, which will go to 500k soon. The overall demand is growing on MoM basis. Another positive factor is that payments from the government are happening within 30 days and there is no delay. Recently, Telangana demand has slowed but AP demand is still strong. The government also agreed for a price hike of Rs10/bag in 3 coastal districts where SGC has good presence.

Additional supply in East not a concern from pricing perspective: Eastern market is consistently growing by 10% YoY and is the fastest growing cement market in India. Lot of infrastructure work along with low cost housing is major demand driver there. Pricing has always been poor in that market and as clinker has to travel close to 600kms in that region, scope for further reduction in prices is low. The region has supply problems as 15mn mt to 20mn mt capacity is coming up in that region. As a result, operating rates are expected to fall by 10% for existing players but pricing is not likely to be affected much. Current players, which operate at close to 85-90% utilisation rates, may see it falling to 70-75% as new players ramp up. SGC is setting up 1.5mn mt plant in Odisha by Sept'2021 and expects to operate at 70% in the first year of operations. The return ratios on the investment will be better even if they get Rs450-500/mt/EBITDA.

BUY

Sector: Cement

CMP: Rs711

Target Price: Rs1,040

Upside: 46%

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Key Data

Current Shares O/S (man)	23.5
Mkt Cap (Rsbn/US\$mn)	16.7/226
52 Wk H / L (Rs)	829/236
Daily Vol. (3M NSE Avg.)	61,795

Price Performance (%)

	1 M	6 M	1 Yr
Sagar Cement	(0.9)	117.0	34.5
Nifty Index	11.2	30.5	9.5

Source: Bloomberg

Exhibit 1: Key Financial Summary

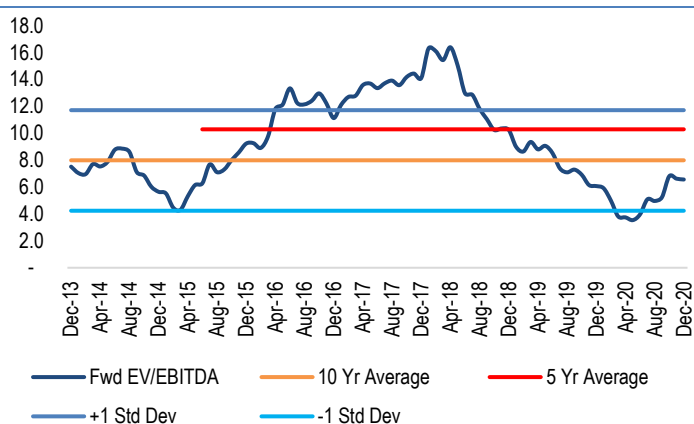
Y/E March (Rsmm)	FY19	FY20	FY21E	FY22E	FY23E
Revenues	12,176	11,752	12,361	16,350	22,125
YoY (%)	17.3	(3.5)	5.2	32.3	35.3
EBITDA	1,468	1,855	2,972	3,309	4,438
EBITDA (%)	12.1	15.8	24.0	20.2	20.1
Adj. PAT	136	265	1,143	1,246	1,985
YoY (%)	(48.2)	95.2	330.7	9.0	59.3
EPS (Rs)	6.7	11.9	51.3	55.9	89.1
ROE (%)	1.7	2.9	11.2	10.9	15.3
EV/EBITDA	13.1	9.0	6.9	6.1	4.3
EV/mt (\$)	47.9	41.1	32.7	32.5	31.0
P/E (x)	111.1	47.5	13.7	12.3	7.6

Source: Company, Nirmal Bang Institutional Equities Research

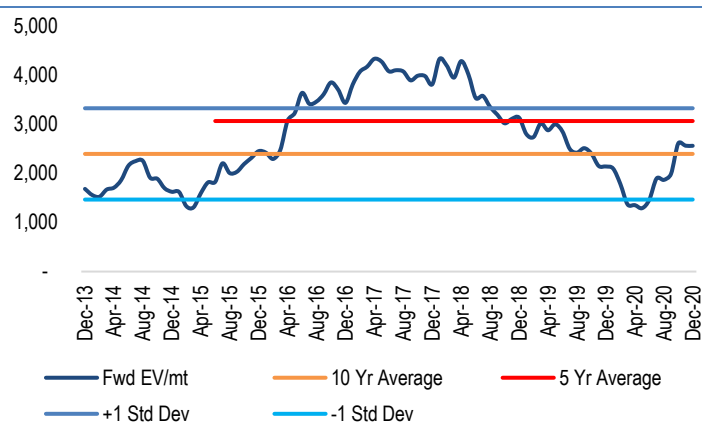
Exhibit 2: Valuation summary

Particulars	(Rs)
Sep 22 EBITDA	3,874
Target multiple (x)	7.0
Enterprise value	27,116
Less: Net debt	3,934
Equity value	23,182
No of shares (mn)	22.3
Value per share (Rs)	1,040
CMP (Rs)	711
Upside / (downside) %	46%

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Rolling valuation charts


Source: Company, Nirmal Bang Institutional Equities Research



Source: Company, Nirmal Bang Institutional Equities Research

Financial statement

Exhibit 4: Income statement

YE March, Rsmn	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	12,176	11,752	12,361	16,350	22,125
Raw Material Consumed	2,388	2,273	2,141	3,132	4,423
Power & Fuel Cost	3,628	3,092	3,040	4,240	5,734
Employee Cost	588	649	642	741	850
Freight and Forwarding	2,525	2,238	2,109	2,934	3,970
Other expenses	1,580	1,646	1,458	1,994	2,711
Total Expenditure	10,707	9,897	9,389	13,040	17,687
Operating profit	1,468	1,855	2,972	3,309	4,438
Operating profit margin (%)	12%	16%	24%	20%	20%
Other Income	55	40	40	40	40
Interest	634	610	634	702	688
Depreciation	657	789	854	930	1,001
PBT	232	497	1,524	1,718	2,789
Exceptional items	-	-	-	-	-
PBT post exc items	232	497	1,524	1,718	2,789
Tax	96	231	371	432	704
Tax rate (%)	41%	47%	24%	25%	25%
PAT	136	265	1,153	1,286	2,085
EPS (Rs)	6.7	11.9	51.7	57.7	93.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

YE March	FY19	FY20	FY21E	FY22E	FY23E
Growth (%)					
Sales	17.3	(3.5)	5.2	32.3	35.3
Operating Profits	(1.0)	26.3	60.2	11.4	34.1
Net Profits	(48.2)	95.2	334.5	11.6	62.1
Leverage (x)					
Net Debt: Equity	0.49	0.43	0.42	0.37	0.25
Interest Cover(x)	2.32	3.04	4.69	4.72	6.45
Total Debt/EBITDA	3.03	2.31	1.96	1.79	1.27
Profitability (%)					
OPM	12.1	15.8	24.0	20.2	20.1
NPM	1.1	2.3	9.3	7.9	9.4
ROE	1.7	2.9	11.3	11.3	15.9
ROCE	7.4	9.9	15.8	15.6	20.4
Turnover ratios (x)					
GFAT	0.8	0.7	0.6	0.8	1.0
Debtors Turnover(x)	28	56	17	12	12
WC days	88	81	111	127	125
Valuation (x)					
P/E	111.1	47.5	13.7	12.3	7.6
P/B	1.8	1.3	1.5	1.3	1.1
EV/EBIDTA	13.1	9.0	6.9	6.1	4.3
EV/mt (\$)	47.9	41.1	32.7	32.5	31.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Balance Sheet

YE March, Rsmn	FY19	FY20	FY21E	FY22E	FY23E
Equity Capital	770	223	223	223	223
Reserves and Surplus	7,669	9,444	10,570	11,829	13,888
Networth	8,438	9,667	10,793	12,052	14,111
Total Debt	4,447	4,279	5,836	5,936	5,636
Deferred tax liability	83	439	439	439	439
Other non-current liabilities	642	822	541	597	680
Trade Payables	2,038	2,230	2,106	2,929	3,986
Other Current Liabilities	1,635	1,387	1,291	1,213	1,151
Total Current Liabilities	5,062	5,023	4,803	5,548	6,543
Total liabilities	17,283	19,388	21,570	23,730	26,566
Net Block	12,442	13,306	14,172	14,913	15,433
CWIP	1,101	1,080	1,132	1,132	1,132
Investment	-	-	-	-	-
Other non-current assets	353	1,296	1,303	1,310	1,318
Inventories	1,450	1,158	1,102	1,513	2,034
Sundry Debtors	1,156	1,368	1,438	1,887	2,538
Cash and Bank	295	128	1,311	1,525	2,178
Other current assets	486	519	580	916	1,401
Total Current Assets	3,388	3,172	4,431	5,842	8,151
Total Assets	17,283	19,388	21,570	23,730	26,566

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Cash flow statement

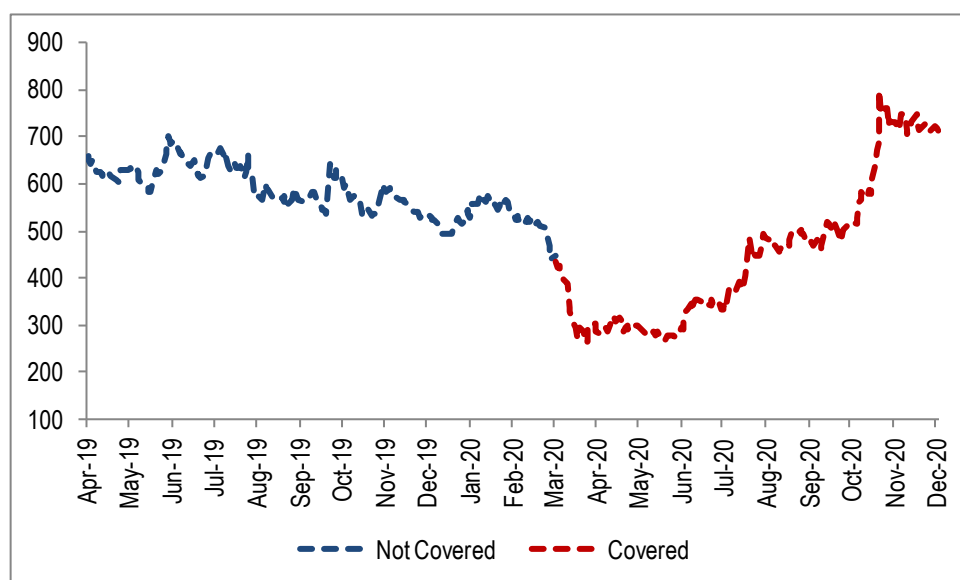
YE March, Rsmn	FY19	FY20	FY21E	FY22E	FY23E
Profit before tax	232	497	1,524	1,718	2,789
Add: Depreciation	657	789	854	930	1,001
Add: Interest Exp	634	610	634	702	688
CFO b4 WC	1,523	1,895	3,012	3,350	4,479
Net change in Working capital	366	59	(295)	(452)	(661)
Tax paid	(96)	(231)	(371)	(432)	(704)
Net cash from operations	1,793	1,723	2,345	2,465	3,114
Capital expenditure	(2,420)	(2,166)	(1,771)	(1,671)	(1,521)
Sale of investments	-	-	-	-	-
Net cash from investing	(2,081)	(3,109)	(1,778)	(1,678)	(1,529)
Issue of shares	566	(547)	-	-	-
Increase in debt	(3)	(168)	1,557	100	(300)
Dividends paid incl. tax	(37)	(62)	(62)	(62)	(62)
Interest paid	(634)	(610)	(634)	(702)	(688)
Net cash from financing	2	1,218	616	(573)	(931)
Net Cash	(286)	(167)	1,183	214	654
Opening Cash	581	295	128	1,311	1,525
Closing Cash	295	128	1,311	1,525	2,178

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
3 March 2020	BUY	439	801
13 April 2020	BUY	288	567
2 June 2020	BUY	292	567
17 July 2020	BUY	380	520
31 July 2020	ACCUMULATE	489	520
16 October 2020	BUY	577	801
23 October 2020	BUY	789	1,040
4 December 2020	BUY	711	1,040

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

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