December 29, 2015

Nano Nivesh

Key risks to investing in Nano stocks

- Nano stocks may not be in the limelight and inherently being micro cap in nature will have a high risk return profile

- We advise clients to be disciplined in investing at all times. Allocate only a small proportion of your investible income to these stocks and diversify well

- Try to diversify your exposure within the Nano stocks as well by investing equal proportions in several picks

- These stocks may have low volumes and trade infrequently

- Micro cap stocks the world over are, to a large extent, affected by the "Pump and Dump" phenomenon of inflated price buying and depressed price selling

- As explained above, the clients should be patient and trade only through limit orders on any side of the trade.

- The risk of volatility remains in such micro cap stocks as they can move up or down with large buy/sell orders

- The fair value of Nano stocks are subject to expected growth potential in the future. Though due diligence has been done to a fair extent, the actualisation of growth still has a degree of uncertainty attached to it

Nano stocks report tries to highlight companies with good and scaleable business models, dependable management and sound financials. However, these stocks may not be in the limelight and have a high risk high return potential. Please watch out for the following factors before investing in these stocks:

Allocate a small proportion of your investible income to these stocks and diversify well. If you choose to invest in these stocks, most of your assets allocated towards equity should remain in more stable investments like stocks of large companies. Moreover, try to diversify your exposure within the nano stocks as well by investing equal proportions in several picks. This will help you avoid losing too much of your total wealth if the investments do not turn out well. When you invest in micro-cap stocks there is a higher risk of impairment.

These stocks may have low volumes and trade infrequently. This can create a situation in which you may not be able to find any willing buyers for your stocks when you wish to sell. We advise our clients to be patient and trade only though limit orders to avoid volatile fluctuations, both while putting a buy and sell order in these stocks.

December 29, 2015

Sagar Cement (SAGCEM)

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Sagar Cements (SCL) has got transformed from a mini cement plant in Andhra Pradesh (AP) with a capacity of 0.06 MT to a major cement plant with a capacity of 2.75 MT (3.75 MT including BMM). SCL's plant is located in Nalgonda (Telangana) and sells cement in Telangana, AP, Tamil Nadu, Karnataka, Maharashtra and Odisha. With the demand revival in the south and a sharp rise in cement prices coupled with synergy benefits with BMM, we expect sales and PAT to grow at a CAGR of 25% and 60%, respectively, in FY15-18E.

Price

₹ 426

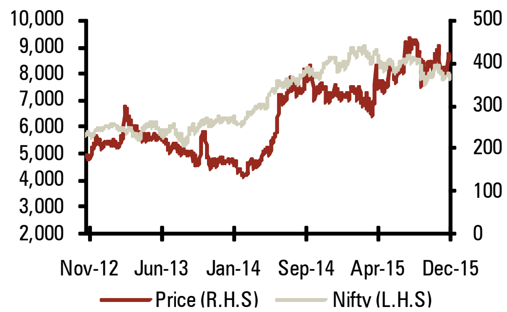
Recommendation

Buy

Fair value

₹ 550-600

Price performance



Highlights

- **SCL key beneficiary of demand revival:** SCL's key markets are on the verge of a turnaround led by creation of Telangana and political stability in Andhra Pradesh. Both governments of Andhra Pradesh & Telangana are planning to invest heavily in infrastructure projects. Telangana has ~₹ 24,000 crore of infra projects under construction. Further, the government has cleared lift irrigation projects worth ~₹ 35,250 crore. Andhra Pradesh government has proposed to invest ₹ 20,000 crore to develop its new capital Amravati. SCL's cement plant is in close proximity to these infra projects, which would make it a key beneficiary of cement demand emerging from the region. In light of these factors, we expect revenues to grow at 25% CAGR in FY15-18E
- **Acquisition of BMM, railway siding to aid margin growth**: The BMM plant is strategically located near the Karnataka border, which will help SCL reduce the lead distance to serve its existing markets of Karnataka and Tamil Nadu. This market swap from SCL to BMM will help in reducing freight cost by ~₹ 100-140/tonne. SCL transports 100% of cement through road. To improve the road to rail mix, the company has laid down railway siding near its Mattampally plant. Railway siding is expected to reduce freight cost by ~₹ 12-15 crore annually led by improved road: rail mix
- **Strong financial performance, compelling valuation**: With the recovery in the southern region, we expect sales and EBITDA to grow at a CAGR of 25% and 60%, respectively, in FY15-18E. The EBITDA growth is expected to be driven by healthy realisation and lower freight cost. SCL is currently trading at an EV/EBITDA of 6x in FY17E and 5x in FY18E. With anticipated improvement in financial performance, we have assigned an EV/EBITDA multiple of 6-6.5x in FY18E, arriving at a target price of ₹ 550-600/share

Key risks-

Business specific

Weak production discipline/delay in demand recovery: Over the past year, the southern region has seen a significant improvement in cement prices primarily led by production discipline. Going forward, cement prices are expected to be driven by production discipline. As a result, weak production discipline would adversely impact south based cement players. Southern players have been witnessing a demand slowdown over the past few years. However, we expect demand to improve in coming quarters led by political stability, formation of new capital, higher government spending on infrastructure and housing related projects. Any delay in demand recovery would adversely impact south based cement players.

Company specific

Rise in power & fuel cost: The company sources power from state grid and power exchanges. The electricity cost per unit has increased at a CAGR of 20% in FY10-14 to ₹ 7.2 per unit led by power shortages in the state. However, during FY15, the company managed to reduce its electricity cost per unit to ₹ 5.7 per unit. Any increase in power cost would negatively impact the company's profitability. The company sources coal from domestic linkages and imported coal. Imported coal price has fallen sharply over the past year. Any significant increase in imported coal price or rise in domestic coal price (led by auctioning of linkage coal) will adversely impact the company's profitability.

Description

Sagar Cements (SCL) started its operation with a cement capacity of 0.06 MT. The company has gradually increased it to 2.75 MT (3.75 MT including BMM). SCL manufactures various varieties of cement like ordinary Portland cement (OPC), Portland Pozzalona cement (PPC), and Portland slag cement (PSC). SCL's plant is located in Nalgonda (Telangana) and sells cement in Telangana and Andhra Pradesh (39% of volumes), Tamil Nadu (16% of volumes), Karnataka (15% of volumes), Maharashtra (20% of volumes) and others (10% of volumes).

History and track record

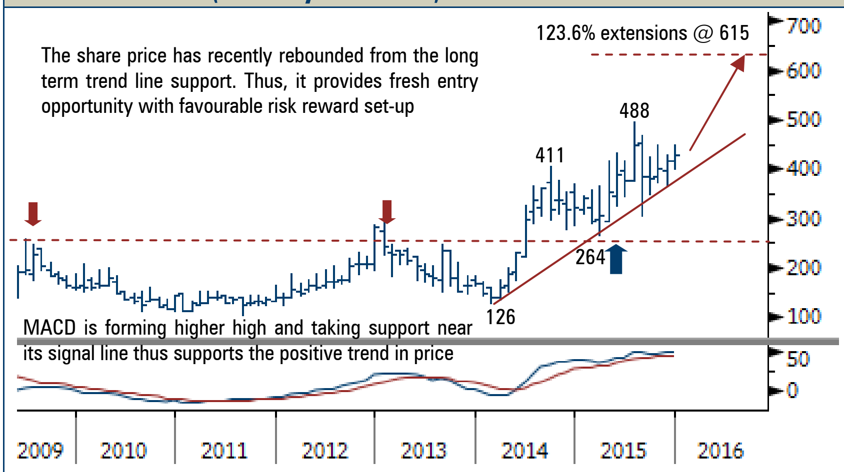
- The company was founded in 1981 by Muni Krishna, J Rama Rao and Mr Butchaiah. It was then a part of the Priyadarshini Cement group, which is also the parent group for Rain Commodities. In 1992, SCL separated from the Priyadarshini group and became an individual group headed by Sammidi Veera Reddy and Sammidi Anand Reddy
- Since its inception, the company has increased its capacity six times (from 0.06 MT at inception to 3.75 MT in FY15)
- In 2008, Belgium-based Ackermans & Van Haaren (AvH) picked up a 14.99% stake in SCL. Since then, it has increased its stake to 18.55%
- In 2008, the company entered into a JV with Vicat SA. The company invested ₹ 86 crore in the JV and exited at ₹ 435 crore in FY14
- In FY15, SCL acquired BMM Cements for EV of ₹ 540 crore. BMM is located in Anantpur district, Andhra Pradesh, close to important markets of Karnataka, Tamil Nadu. BMM owns 1 MT cement unit and captive power plant (coal based) of 25 MW
- Apart from SCL, the management has significant influence over Sagar Power, RV consulting (provides turnkey solution to cement industry) and Panchavati Polyfibres Ltd.

Earning estimates

₹ crore	FY14	FY15	FY16E	FY17E	FY18E
Sales	488.9	575.6	820.2	990.7	1135.6
EBITDA	1.3	56.4	128.3	191.3	231.0
EBITDA margin (%)	0.3	9.8	15.6	19.3	20.3
Adjusted PAT	-25.6	22.8	53.9	62.2	92.7
Adjusted EPS	-14.7	13.1	31.0	35.8	53.3

Source: Company, ICICIdirect.com Research

Technical Chart (Monthly Bar chart)



Source: Bloomberg, ICICIdirect.com Research

Stock data

Market Capitalisation (₹ crore)	739.5
52 week High / Low (₹)	498 / 275
Promoter Holding (%)	56.9
FII Holding (%)	2.3
DII Holding (%)	6.4
Dividend Yeild (%)	1.2
12M / 6M stock return (%)	23.1 / 9.7
Debt (₹ crore) (FY15)	245.0
Cash and Cash Equivalent (₹ crore) (FY15)	180.5
Enterprise Value (₹ crore)	804.0
5 Year Revenue CAGR (%) (FY10-15)	3.7
5 Year EBITDA CAGR (%) (FY10-15)	-6.7
5 Year PAT CAGR (%) (FY10-15)	3.6

Valuation

(X)	FY14	FY15	FY16E	FY17E	FY18E
P/E (Adjusted)	-	32.4	13.7	11.9	8.0
Target PE	-	45.7	19.4	16.8	11.3
EV / EBITDA	761.5	14.3	9.5	6.2	4.8
P/BV	3.1	1.5	1.2	1.1	1.0
RoIC(%)	(4.2)	5.1	8.0	11.4	14.1
RoCE(%)	(5.1)	4.6	8.4	11.8	14.8

Source: ICICIdirect.com Research

Quarterly performance

₹ crore	Q3FY15	Q4FY15	Q1FY16	Q2FY16
Sales	124.4	190.7	194.7	180.9
EBITDA	5.9	41.4	38.2	17.6
EBITDA Margin (%)	4.7	21.7	19.6	9.7
Depreciation	5.6	5.9	5.6	4.0
Interest	4.7	4.8	3.4	6.4
Other income	6.0	5.5	7.3	5.2
Adjusted PAT	1.1	21.7	22.7	8.4
Adjusted EPS (₹)	0.7	12.5	13.1	5.0

Source: ICICIdirect.com Research

Shareholding trend (%)

Key Shareholders	Q3FY15	Q4FY15	Q1FY16	Q2FY16
Promoter group	56.9	56.9	56.9	56.9
FII	2.2	2.2	2.2	2.3
DII	7.2	7.2	7.1	6.4
Corporate bodies	25.3	25.3	25.2	25.1
Public	8.4	8.4	8.6	9.3

Source: ICICIdirect.com Research

Technical View

The stock has been in a strong uptrend since the February 2014 low of ₹ 126. During the entire up move, the stock has constantly been taking support at the long term trend line joining the major lows indicating buying support at regular interval and at elevated levels. The stock has recently rebounded taking support at the long term trend line support. Thus, it provides a fresh entry opportunity.

The long term price chart highlights the stock has registered a rounding pattern breakout in mid 2014 and rallied to 411 levels by September 2014. A subsequent pullback has seen the stock testing the breakout area in March 2015. A sharp rally from the support area indicates a bullish price structure on the long term chart.

We expect the stock to head towards ₹ 615 over the medium-term as it is the 123.6% extensions of the previous major up move from ₹ 126 to ₹ 411, as projected from the 2015 low of ₹ 264, projects upside towards ₹ 615 in the medium term.

What's the story?

Company's key market on verge of turnaround

The company's key markets witnessed an oversupply situation over the past few years on account of political instability in Andhra Pradesh (key cement-consuming state in south) and general slowdown in the economy. Cement consumption in AP has come down from 24 MT in FY11 to 16 MT in FY15 led by a decline in government consumption of cement from 10 MT in FY11 to 2 MT in FY15. However, going forward, we expect demand to revive in Andhra Pradesh and Telangana led by creation of Telangana and political stability in Andhra Pradesh. In 2015-16, the Andhra and Telangana governments are expected to procure from local manufacturers over 3.2 MT of cement. In Karnataka, cement demand is expected to improve driven by demand from urban housing and government spend on infra. In light of these factors, we expect demand in the south to pick up post Q3FY16E, after remaining broadly flat for almost five years.

SCL to benefit most from incremental investment in Andhra Pradesh!

Post the bifurcation of Andhra Pradesh, both governments of Andhra Pradesh and Telangana are planning to invest heavily in infrastructure projects. Telangana has ~₹ 24,000 crore of infra projects under construction. Further, the government has cleared lift irrigation project worth ~₹ 35,250 crore in three districts Mahabubnagar, Nalgonda and Ranga Reddy. In addition, the Andhra Pradesh government has proposed to develop its new capital named Amaravathi and the government is working with Singapore government to make it a world class city. The Andhra government aims to invest ₹ 20,000 crore for the development of the capital city, which would include a central business district, commercial zones and industrial parks. SCL's cement plant is in close proximity to these infra projects, which would make the company a key beneficiary of the cement demand emerging from the region. Further, due to close proximity, SCL would enjoy the benefit of lower lead distance resulting in higher profitability.

SCL location advantage

Andhra Pradesh	Average distance from SCL plant
New capital at Amravathi and development of smart cities near Vijaywada and Guntur	<200 KM
Manufacturing Zones in Chittoor and Prakasam districts	300-600 KM
Visakhapatnam Kakinada Petroleum, Chemicals and Petrochemicals Investment Region (PCPIR)	500-600 KM
Metro rail projects at three locations Visakhapatnam, Guntur and Vijayawada	200-600 KM
Telangana	**Average distance from SCL plant**
Pharma city near Hyderabad	<100 KM
Rail and road connectivity from Hyderabad to the new capital of Andhra Pradesh	100-200 KM
Metro rail project in Hyderabad	<100 KM
Two new airports in Hyderabad, near Shamirpet, JawaharNagar and Ghatkesar	<100 KM
New rail lines: Manoharabad-Kothapalli and Peddapalli-Nizamabad	100-300KM
Industrial corridor between Hyderabad and Warangal	100-200 KM
Integrated Textiles Parks; in Warangal and in Sircilla, Karimnagar district	125-250 KM

Source: Company, ICICIdirect.com Research

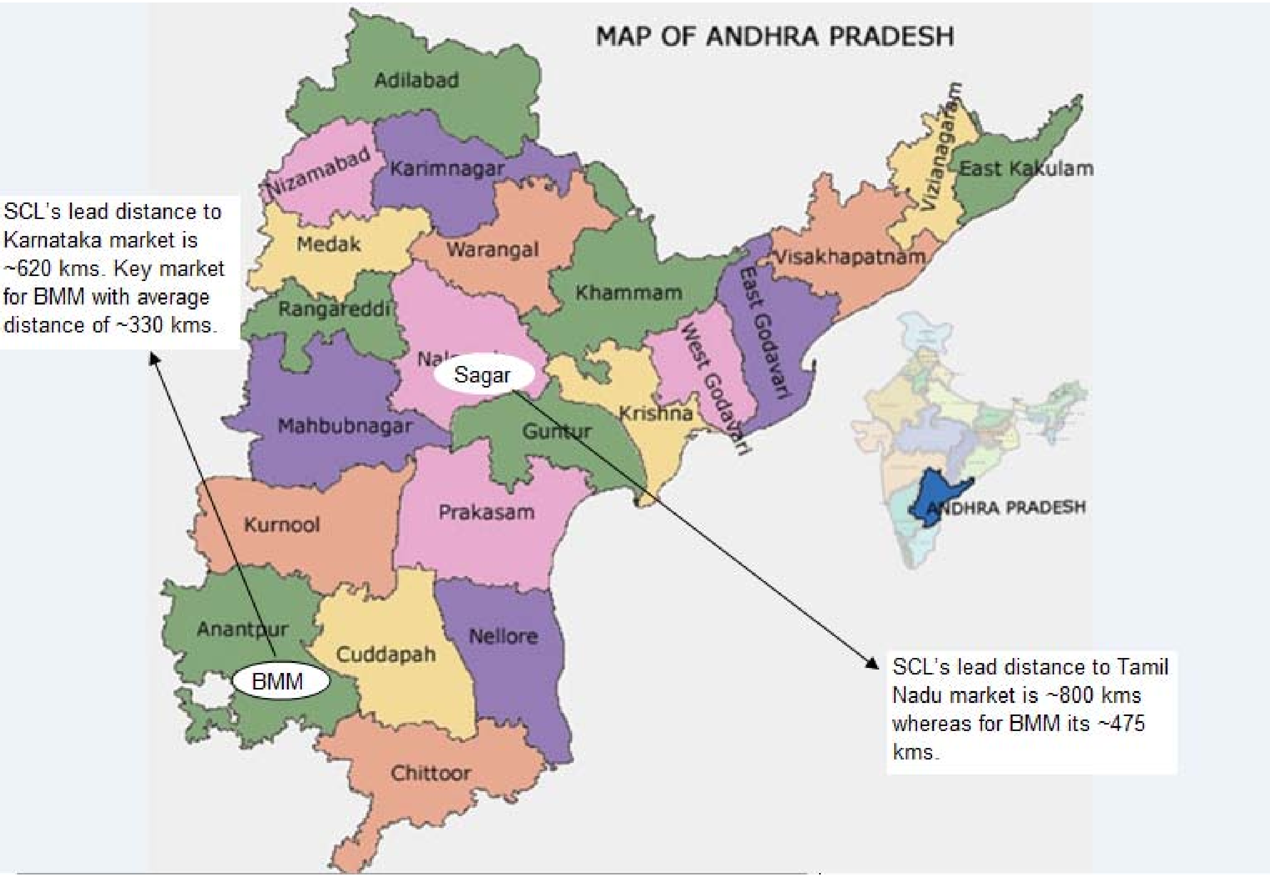
Railway siding to reduce freight cost!

Currently, SCL transports 100% of cement through road. High dependence on road transport has adversely impacted the company's freight cost. In order to the improve road: rail mix, the company has laid railway siding near its Mattampally plant. The railway siding is expected to be commissioned in H2FY16E. This will enable the company to 1) improve volume growth by deepening presence in the markets with longer distance 2) decline in freight cost due to lower dependence on road transport. Railway siding is expected to reduce freight cost by ~₹ 12-15 crore annually led by improved road: rail mix.

Strategic acquisition of BMM to boost volume, margins!!!

SCL has acquired 1 MT cement plant of BMM group for ₹ 540 crore (US$90/tonne) located in the Anantpur district of Andhra Pradesh. BMM has 25 MW captive power plant and 155 MT of limestone reserves. The BMM plant is strategically located near the Karnataka border, which will help SCL in reducing lead distance to serving its existing markets of Karnataka and Tamil Nadu. The average lead distance from SCL's plant to Karnataka and Tamil Nadu is ~600-800 km while the lead distance from BMM to Karnataka and Tamil Nadu is ~350-500 km. This market swap from SCL to BMM will help in reducing freight cost by ~100-140/tonne. Apart from this, the incremental capacity and strategic location will help SCL boost its volumes and its presence in Karnataka and Tamil Nadu.

BMM location advantage



Source: Company, ICICIdirect.com Research

Sale of Vicat JV to help fund acquisition and capex!!!

In 2008, the company entered into a JV with Vicat SA to set up a 2.75 MT cement plant. Out of the total investment of ₹ 1,600 crore, ₹ 1,100 crore was funded by debt and the remaining ₹ 500 crore equity was funded by SCL (₹ 86 crore) and Vicat SA (₹ 414 crore). SCL exited the JV at ₹ 435 crore in FY14 and earned a CAGR return of 31.0% over FY08-14. The fund received has been utilised for equity infusion in BMM (₹ 153 crore) and for internal capex (₹ 25 crore) with the remaining as cash. Thus, despite the acquisition of BMM, we expect the company to maintain healthy balance sheet metrics.

Financial summary

Profit and loss statement					₹ Crore
(Year-end March)	FY14	FY15	FY16E	FY17E	FY18E
Total operating Income	488.9	575.6	820.2	990.7	1,135.6
Growth (%)		17.7	42.5	20.8	14.6
Raw material cost	53.6	57.3	130.4	153.0	175.7
Power & fuel	198.3	210.2	264.9	324.0	363.0
Freight cost	105.9	108.6	130.0	156.9	189.1
Others	129.9	143.1	166.7	165.4	176.9
Total Operating Exp.	487.6	519.2	691.9	799.4	904.6
EBITDA	1.3	56.4	128.3	191.3	231.0
Growth (%)		4,194.5	127.4	49.2	20.8
Depreciation	26.9	21.5	32.1	49.2	53.1
Interest	29.5	23.1	34.8	60.5	51.4
Other Income	17.8	366.3	17.9	9.9	9.9
PBT	-37.4	378.1	79.3	91.5	136.4
Total Tax	-11.8	81.4	25.4	29.3	43.6
PAT	-25.6	296.7	53.9	62.2	92.7
PAT margin	NA	51.5	6.6	6.3	8.2
Adjusted PAT	-25.6	22.8	53.9	62.2	92.7
Growth (%)		-189.2	136.4	15.4	49.1
Adjusted EPS (₹)	-14.7	13.1	31.0	35.8	53.3

Source: Company, ICICIdirect.com Research

Cash flow statement					₹ Crore
(Year-end March)	FY14	FY15	FY16E	FY17E	FY18E
Profit after Tax	-25.6	296.7	53.9	62.2	92.7
Add: Depreciation	26.9	21.5	32.1	49.2	53.1
(Inc)/dec in Current Assets	18.4	-128.5	38.4	-60.6	-51.6
Inc/(dec) in CL and Provisions	-3.0	37.6	2.0	19.9	16.9
CF from operating activities	46.3	250.4	161.1	131.1	162.6
(Inc)/dec in Investments	0.0	86.0	0.0	0.0	0.0
(Inc)/dec in Fixed Assets	-40.0	-91.9	-600.0	-40.0	-40.0
Others	8.5	6.0	12.0	12.0	12.0
CF from investing activities	-31.5	0.1	-588.0	-28.0	-28.0
Issue/(Buy back) of Equity	0.0	0.0	97.0	0.0	0.0
Inc/(dec) in loan funds	-5.3	-20.0	290.0	0.0	-80.0
Dividend paid & dividend tax	0.0	-15.3	-9.2	-10.2	-10.2
Interest paid	-29.5	-23.1	-34.8	-60.5	-51.4
Others	-0.1	-16.1	-35.9	0.0	0.0
CF from financing activities	-34.9	-74.4	307.1	-70.6	-141.6
Net Cash flow	-20.1	176.0	-119.7	32.5	-7.0
Opening Cash	24.6	4.5	180.5	60.7	93.2
Closing Cash	4.5	180.5	60.7	93.2	86.2

Source: Company, ICICIdirect.com Research

Balance sheet					₹ Crore
(Year-end March)	FY14	FY15	FY16E	FY17E	FY18E
Liabilities					
Share Capital	17.4	17.4	17.4	17.4	17.4
Quasi equity			97.0	97.0	97.0
Reserve and Surplus	223.4	488.6	497.4	549.5	632.0
Total Shareholders funds	240.8	506.0	611.8	663.8	746.4
Total Debt	265.0	245.0	535.0	535.0	455.0
Deferred Tax Liability	32.2	47.5	59.5	71.5	83.5
Minority Interest / Others	73.4	64.1	64.1	64.1	64.1
Total Liabilities	611.4	862.6	1,270.4	1,334.5	1,349.0
Assets					
Gross Block	534.6	554.8	1,154.8	1,307.0	1,347.0
Less: Acc Depreciation	199.5	221.4	253.5	302.7	355.8
Net Block	335.1	333.4	901.3	1,004.3	991.2
Capital WIP	40.1	112.2	112.2	0.0	0.0
Total Fixed Assets	375.2	445.6	1,013.5	1,004.3	991.2
Investments	86.0	0.0	0.0	0.0	0.0
Inventory	41.8	62.3	96.6	116.7	133.8
Debtors	48.5	58.1	96.6	116.7	133.8
Loans and Advances	72.3	194.3	82.0	99.1	113.6
Other Current Assets	39.0	15.3	16.4	19.8	22.7
Cash	4.5	180.5	60.7	93.2	86.2
Total Current Assets	206.1	510.5	352.4	445.5	490.0
Creditors	35.5	51.3	56.2	67.9	77.8
Provisions	20.4	42.2	39.3	47.5	54.4
Total Current Liabilities	55.9	93.5	95.5	115.4	132.2
Net Current Assets	150.2	417.1	256.9	330.2	357.8
Others Assets	0.0	0.0	0.0	0.0	0.0
Application of Funds	611.4	862.7	1,270.5	1,334.5	1,349.1

Source: Company, ICICIdirect.com Research,

Key ratios					
(Year-end March)	FY14	FY15	FY16E	FY17E	FY18E
Per share data (₹)					
Adjusted EPS	-14.7	13.1	31.0	35.8	53.3
Cash EPS	0.8	183.0	49.4	64.0	83.8
BV	138.4	291.0	351.6	381.5	429.0
DPS	0.0	7.5	4.5	5.0	5.0
Cash Per Share	2.6	103.8	34.9	53.6	49.5
Operating Ratios (%)					
EBITDA Margin	0.3	9.8	15.6	19.3	20.3
PAT / Total Operating income	-5.2	0.6	8.7	14.5	20.2
Adjusted PAT Margin	-5.2	4.0	6.6	6.3	8.2
Inventory days	31.2	39.5	43.0	43.0	43.0
Debtor days	36.2	36.8	43.0	43.0	43.0
Creditor days	26.5	32.5	25.0	25.0	25.0
Return Ratios (%)					
RoE	-10.6	58.6	8.8	9.4	12.4
RoCE	-5.1	4.6	8.4	11.8	14.8
RoIC	-4.2	5.1	8.0	11.4	14.1
Valuation Ratios (x)					
P/E (adjusted)	0.0	32.4	13.7	11.9	8.0
EV / EBITDA	761.5	14.3	9.5	6.2	4.8
EV / Net Sales	2.0	1.4	1.5	1.2	1.0
Market Cap / Sales	1.5	1.3	0.9	0.7	0.7
Price to Book Value	3.1	1.5	1.2	1.1	1.0
Solvency Ratios					
Debt/EBITDA	201.8	4.3	4.2	2.8	2.0
Debt / Equity	1.1	0.5	0.9	0.8	0.6
Current Ratio	3.7	5.5	3.7	3.9	3.7
Quick Ratio	2.9	4.8	2.7	2.9	2.7

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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Strong Buy: >15%/20% for large caps/midcaps, respectively, with high conviction;
Buy: >10%/15% for large caps/midcaps, respectively;
Hold: Up to +/-10%;
Sell: -10% or more;

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