Saurashtra Cement Ltd

HDFC securities

Stock Note | **Smallcap - Medium risk** | **September 21, 2012**

HDFC Sec Scrip code	Industry	CMP (Rs.)	Recommended Action	Sequential Price Targets (Rs.)	Time Horizon
SAUCEMEQNR	Cement	19.40	Buy at CMP	29.4 and 34.3	2-3 quarters

Price Chart

Stock Details

BSE Code	502175
Bloomberg	SRC IN
Price (Rs) Sept. 20, 2012	19.40
Equity Capital (Rs Cr)	51.19
Face Value (Rs)	10.0
Eq. Shares O/s (cr)	5.11
Market Cap (Rs Cr.)	99.31
Book Value (Rs)	-8.87
Avg daily volume (52 Wk)	4508.0
52 wk H/L	23.55/ 8.40

Shareholding Pattern

(As on June 30, 2012)	
Institutions	3.5
Non Promoter Corp Hold	3.8
Foreign	20.3
Promoters	64.4
Public & Others	8.0
Total	100.0

Background

Saurashtra Cement (SCL) is a Porbandar (Gujarat) based Cement Company belonging to Mehta group (Uganda). SCL has a 1.5-mn tonne clinkerisation and grinding plant set up in stages between 1963 and 1984. Apart from SCL, the group also has interest in Gujarat Sidhee Cement (1.2 mn tonne clinkerisation and grinding plant at Junagadh) where Gujarat Govt is a minority partner (~6% stake). While SCL sells cement under "Hathi" brand, Gujarat Sidhee sells cement under "Sidhee" brand. Hathi brand sells at close to the highest price in the region and state.

What went wrong: The earthquake in Gujarat (Apr 2006), high power costs, setting up of additional capacities by Sanghi Inds and the consequent price war to capture market share resulted in SCL and most Gujarat cement players going into red in 2007-2008. While setting up of Thermal power plant of 25 MW helped control power costs, competitive scenario has eased a bit over the last few quarters. In the process the debt situation of SCL worsened, and the interest payments shot up. Further SCL also could not pay sales tax, electricity duty etc to the state Govt in time. As part of one time settlement with the Gujarat Govt, SCL was asked to deposit Rs.70 cr with Gujarat State Financial Services Ltd in 2008. In the interim SCL had two accounting years stretching into 18 months and 15 months respectively (June 2007 to Dec 2008 and Jan 2009 to Mar 2010). To come over these difficulties and fund the thermal power plant (costing Rs.125 cr) SCL had raised Rs. 26 cr by way of convertible debentures from Mauritius Debt Management Ltd (converted into equity shares in Aug 2007 @ Rs.35 each – resulting in a stake of 14.55% held by them). In addition an amount of Rs. 5.12 cr was raised from International Debt Management (IDM) by way of 13% optionally convertible cumulative preference shares (which are now not convertible) and Rs.208 cr loans from IDM. As on Mar 2012 a sum of Rs.140.07 cr was due to International Debt management Ltd.

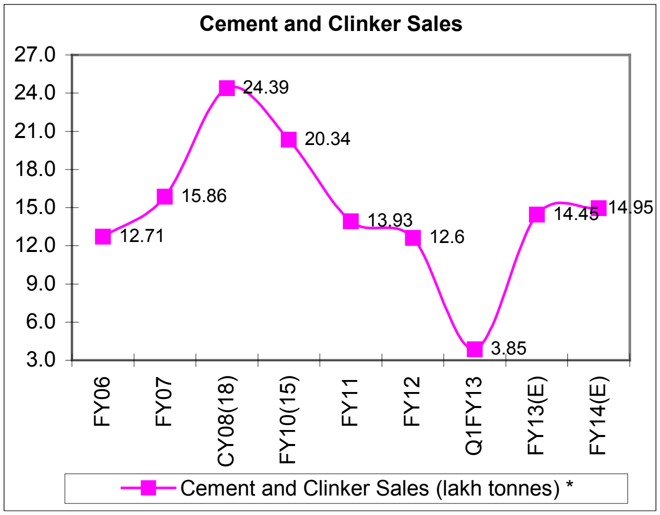
Triggers

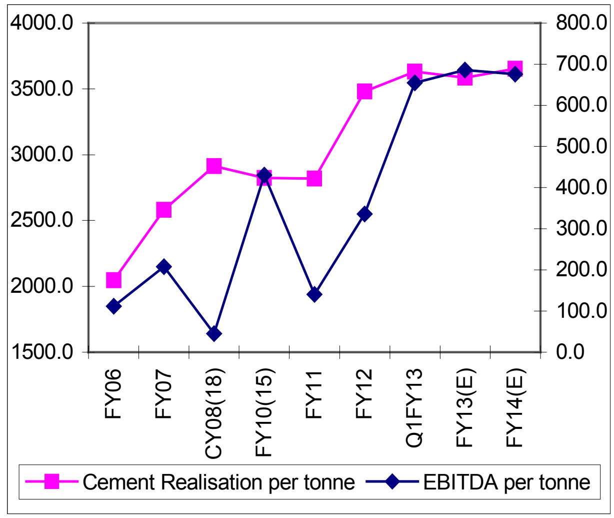
- In the results for June 2012, SCL has written back a sum of Rs.160 cr as exceptional items that include credit for (a) Reversal of provision of Rs 12007.27 lacs for interest and penalty on outstanding dues of sales tax, electricity duty and royalty as per One Tine Settlement (OTS) during the quarter with the Government of Gujarat (GOG) under the Scheme for relief to the sick industrial companies registered with BIFR (b) Reversal of interest of Rs. 1414 84 lacs payable to a lender as per Rehabilitation Scheme sanctioned by Honble BIFR; and (c) Interest of Rs 2605.39 lacs for the period from 2007 to June 30,2012 on deposit placed on account of an earlier OTS Scheme of GOG. As a result SCL got a refund of Rs.18 cr out of the deposit of Rs.70 cr placed with the Gujarat Govt earlier.

- SCL had a debt of Rs.403 cr as on Mar 2012. Out of this a sum of Rs.134 has been written back and another Rs.50 cr has been repaid post Mar 2012. This has resulted in a reduction of debt by almost 50% to Rs.219 cr. This repayment has been made possible by healthy cash generation due to buoyant cement prices. In FY12, SCL suffered a loss because cement prices dropped sharply in Q2FY12 after the onset of monsoon. Effect of this was also felt in Q3FY12. However in FY13, cement prices have remained high in Q1FY13 and have continued to remain high in Q2FY13. This could mean that the financial results of SCL in the near term could remain good as long as the cement realizations in Gujarat do not fall majorly.

- Networth of SCL which had turned negative in FY12 (minus 91.46 cr including debit balance of P&L account Rs.291.4 cr) has now turned positive post Q1FY13 results. However the debit balance in the P&L account may take another 3-4 years to become positive.

- SCL is enjoying rising realizations since the last few quarters and is on a steady path of capacity utilization (close to 100%). This has resulted into return to profitability which situation could continue for some more time. This is apparent from the quarterly results pasted at the end of this report and the chart pasted hereunder:





*= Includes traded cement and clinker

Source: Capitaline, Company

Risks and concerns

- SCL's financial results are susceptible to fluctuation in cement prices in the Gujarat region. This is turn would depend on demand growth in the state and new capacities being added. Hence turnaround in the fortunes of the company is dependent on continued buoyancy in cement prices over the foreseeable future.

- SCL had imported a plant in 2006 for expanding its capacity. However as the funding line was discontinued by IFCI due to SCL's losses and IFCI's own issues, the equipment continues to be shown as part of CWIP (Rs.77.3 cr) with occasional impairment. This equipment has been mothballed well and SCL would have to spend another ~Rs.250 cr for setting up the incremental 1.2 mn tonne capacity. This would be much lower than the cost of setting up a new brownfield plant of similar capacity. However any action on this could be taken only after the loans to IDM have been repaid (which could take upto 3 years). Till then SCL may not witness any organic growth in capacities or volumes. In case of any further delay in the imported plant being put to use or due to technology changes, SCL may in future have to impair a part or full of the equipment lying in CWIP.

- 99.3% of promoter's stake has been pledged to IDM as collateral for loans obtained from them. This creates risk of sharp sell-off in share prices if the promoters are not able to pay the MTM in case of adverse movement in share prices.

- SCL imported Rs. 81 cr worth of coal for its thermal power plant in FY12 from South Africa/Indonesia. Though it takes forward cover, it could create a risk in case of sharp depreciation in value of Rupee before the imports are covered.

- There is a possibility of some restructuring within the group (two companies in the same region manufacturing cement) at some point in future after the debt on SCL's books are paid off. It is difficult to estimate the impact of such restructuring on SCL's shareholders.

- SCL has six subsidiaries out of which 4 have invested in Gujarat Sidhee Cements Ltd, one is inactive and one is in logistics business (loss making). Though in FY12 subsidiaries together reported a loss of Rs.1.4 cr, impact of operations of subsidiaries on the parent is difficult to estimate at the moment.

- SCL would be liable to pay MAT @18.5% + surcharge in FY14.

Conclusion & Recommendation:

SCL is on the turnaround path. It has seen a reduction in debt by a large proportion and its profitability has improved sharply over the past few quarters aided by buoyant cement prices in Gujarat.

Based on FY14E estimates (FY13 has an extraordinary debit by way of write off of deferred tax asset of Rs.32.04 cr), SCL at the CMP of Rs.19.4 is quoting at 2xFY14E EPS earnings. Further on an FY14 EV/EBITDA basis too the stock is cheap at 2.2 times while EV to tonne is an attractive $27.1 based on FY14E numbers.

We think the stock can be bought at the CMP of Rs.19.4 for sequential targets of Rs.29.4 and Rs.34.3 (3 and 3.5 times FY14E EPS). At this prices the FY14 EV/EBITDA would work out to 2.7 and 2.9 respectively and its FY14 EV/Tonne would work out to $33.4 and $36.5 respectively.

Quarterly Financial Performance: (Standalone)

(Rs. In Crore)

Particulars	Q1FY13	Q1FY12	% Chg	Q4FY12	% Chg	Q3FY12	Q2FY12
Gross Sales	154.8	131.7	17.5%	138.4	11.9%	101.9	103.5
Excise Duty	15.0	11.8	26.9%	13.3	12.8%	9.4	8.3
Net Sales	139.8	119.9	16.6%	125.1	11.8%	92.5	95.1
Other Operating Income	1.8	1.4	29.5%	0.7	146.7%	2.9	1.4
Total Income	141.6	121.3	16.8%	125.8	12.6%	95.5	96.5
Expenditure							
Raw Material Consumed	9.3	6.8	36.9%	10.7	-13.7%	7.7	8.2
Stock Adjustment	5.4	3.9	37.8%	-9.8	-155.1%	8.0	0.4
Purchase of Finished Goods	10.4	7.1	45.7%	0.0	-48074.2%	0.9	8.0
Employee Expenses	6.6	5.9	12.6%	6.0	10.1%	6.5	6.4
Power & Fuel	38.9	41.3	-6.0%	48.0	-19.0%	30.4	39.6
Other Expenses	39.3	39.4	-0.2%	40.0	-1.7%	42.1	38.8
Total Expenditure	109.9	104.4	5.2%	94.9	15.7%	95.5	101.5
EBIDTA	**31.8**	**16.9**	88.4%	**30.9**	2.9%	**-0.1**	**-5.0**
EBIDTA Margin%	*22.7%*	*14.1%*		*24.7%*		*-0.1%*	*-5.3%*
Other Income	161.4	0.8	20289.5%	2.8	5616.6%	1.1	0.0
Interest	7.4	10.5	-30.1%	11.1	-33.6%	11.0	11.9
Depreciation	5.4	6.1	-12.6%	5.4	0.1%	5.4	5.0
PBT	180.5	1.0	18121.1%	17.3	945.5%	-15.3	-22.0
PBTM%	*129.1%*	*0.8%*		*13.8%*		*-16.6%*	*-23.1%*
Tax	32.0	0.0		23.3	37.4%	0.0	0.0
Effective Tax Rate%	*17.8%*	*0.0%*		*135.1%*	-86.9%	*0.0%*	*0.0%*
Reported Profit After Tax	148.4	1.0	14885.3%	-6.1	-2550.1%	-15.3	-22.0
PAT Net of Minority Interest	**148.4**	**1.0**	14885.3%	**-6.1**	-2550.1%	**-15.3**	**-22.0**
Exceptional Items	131.8	0.0		0.0		0.0	**0.0**
Adjusted PAT	**16.6**	**1.0**	1575.6%	**-6.1**	-374.0%	**-15.3**	**-22.0**
NPM%	*106.2%*	*0.8%*		*-4.8%*		*-16.6%*	*-23.1%*
EPS	**3.2**	**0.2**	1575.6%	**-1.2**	-374.0%	**-3.0**	**-4.3**
Equity	51.2	51.2		51.2		51.2	51.2
Face Value	10	10		10		10	10

(Source: Company, HDFC Sec)

Annual Financial Performance:

(Rs. In Crore)

Particulars	FY11	FY12	% Chg	FY13 (E)	FY14 (E)
Net Sales	389.1	431.8	11.0%	518	546
EBIDTA	**26.5**	**42.3**	59.9%	99.2	101.0
Other Income	4.6	5.3	13.7%	165.3	6.0
Interest	42.8	44.7	4.5%	24.9	24.9
Depreciation	30.4	22.0	-27.7%	22.6	22.1
Tax	15.0	0.0	-100.0%	32.0	10.0
Reported Profit After Tax	-57.1	-19.1	-66.5%	185.0	50.0
PAT Net of Minority Interest	**-57.1**	**-19.1**	-66.5%	**185.0**	**50.0**
Exceptional Items post tax	**-0.2**	**0.0**		160.3	0
Adjusted PAT	**-56.9**	**-19.1**	-66.5%	**24.7**	**50.0**
EPS	**-11.1**	**-3.7**	-66.4%	**36.1**	**9.8**
Equity	51.2	51.2		51.2	51.2
Face Value	10	10		10	10

(Source: Company, HDFC Sec)

Balance Sheet (Rs. In Crore)

Balance Sheet		
YE March (Rs. Cr.)	**FY11**	**FY12**
EQUITY AND LIABILITIES		
Shareholder's Funds		
Share Capital	58.1	58.1
Reserves & Surpuls	-70.6	-93.3
Total Shareholders Funds	**-12.5**	**-35.2**
Minority Interest	0.0	0.0
Non-current liabilities		
Long-term borrowings	121.3	102.7
Other long-term liabilities	6.3	6.3
Long-term provisions	5.9	7.3
	133.5	**116.3**
Current Liabilities		
Short-term borrowings	7.9	5.4
Trade payables	45.3	43.3
Other current liabilities	295.4	323.1
Short-term provisions	3.0	2.3
	351.7	**374.0**
Total	**472.7**	**455.0**
ASSETS		
Non-current Assets		
Fixed Assets		
Tangible assets	239.9	218.7
Intangible assets	0.6	0.4
Capital work-in-progress	76.4	77.3
Non-current investments	15.0	15.0
Deferred Tax Assets	32.0	32.0
Long-term loans and advances	13.5	13.5
Other non-current assets	3.8	4.2
	381.2	**361.2**
Current Assets		
Inventories	45.2	54.5
Trade Receivables	25.0	18.2
Cash and bank balances	8.1	5.9
Short-term loans and advances	12.2	14.7
Other current assets	0.9	0.6
	91.4	**93.8**
Total	**472.7**	**455.0**

(Source: Company, HDFC Sec)

Quick Estimates (Rs. In Crore)

Particulars	FY11	FY12	FY13 (E)	FY14 (E)
Net Sales	389.1	431.8	518.0	546.0
EBIDTA	26.5	42.3	99.2	101.0
EBIDTA (%)	6.8%	9.8%	19.2%	18.5%
Reported PAT	-19.1	-56.9	24.7	50.0
PAT (%)	-4.9%	-13.2%	4.8%	9.2%
Equity Capital	51.2	51.2	51.2	51.2
Face value Rs.	10.0	10.0	10.0	10.0
EPS Rs.	-3.7	-11.1	4.8	9.8
P/E	-4.4	-1.4	4.0	2.0
EV	468.1	484.3	269.3	219.3
Installed Capacity	0.15	0.15	0.15	0.15
EV/EBITDA	17.7	11.4	2.7	2.2
EV/Tonne US$	69.9	63.1	33.2	27.1
CMP (Rs.)	16.6	16.0	19.4	19.4

(Source: Company, HDFC Sec)

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