STALLION ASSET
CREATING ALPHA

2016

SAGAR CEMENT/RAMCO CEMENT

BUY SAGAR CEMENT

CMP: Rs. 386.60

BUY RAMCO CEMENT

CMP: Rs. 400.45

Thesis: South Cement Story in Play

1. **Changing Fundamentals**
2. **Location Advantage**
3. **Operating Leverage to ensure profitability**
4. **Long term Technical Breakout**

With infrastructure sector taking off, the cement industry will be a direct beneficiary as the major raw material required for building infrastructure is cement.

Moreover, there are many factors on which the performance of a cement company is dependent like location, fuel cost, capacity and demand. Since all these factors are favouring the industry in a positive way, the cement companies have started performing well on operational basis.

If we talk about the south cement companies in specific, we need to know that unlike north it is highly fragmented market with lot of small companies operating at 55% utilization levels. Andhra Pradesh and Telengana are the two southern states which has seen the maximum demand lately due to development of new smart cities and infrastructure (as announced by their governments).

Since the transportation cost of cement is very high, nearer the factor plant to the construction site, better it is! Sagar Cement and Ramco Cement are not only located in favourable locations but will also enjoy operating leverage as they do not have to incur any capex (due to overcapacity) for next 2 years atleast.

Sagar and Ramco Cement has technically given a long term breakout clearly indicating that the stock price is going to head upwards backed by the strong upcoming quarterly numbers we expect due to increase in volume growth in cement and revivel in prices.

Current Scenario:

India’s cement story has not looked pretty for a while now. If manufacturing capacities have been installed in anticipation of high economic growth sustaining, it has only been turned out to be an ill-timed bet with demand not matching up. This has obviously caused severe heartburn to many cement manufacturers who are now saddled with high levels of debt and a serious difficulty in servicing it.

In the condition, where the product is commodity like with no differentiation whatsoever, overcapacity due to huge demand-supply mismatch and slowing real estate what makes this industry look attractive for investment??

The Indian cement industry is directly related to the growth of infrastructure industry. With infrastructure sector taking off , the cement industry will be a direct beneficiary as the major raw material required for building infrastructure is cement.

South India today accounts for 139 million tonne per annum (MTPA), which is 37% of the national capacity of 373 MTPA. Here, utilisation levels were 48% for FY15, which was down from 61% in FY11. By contrast, national utilisation levels stand at 68%, with the other four regions — north, east, west and central — well in excess of 80%. High prices orchestrated through low production have ensured that there is enough money to be made.

Cement Industry in South India is highly fragmented with many small players unlike north India hence with strong demand coming up all will be in a win win situation.

This situation in the south is expected to last only as long as demand remains tepid. Hence growth will be seen until the demand doesn’t get dried up.(Factor on which our investment horizon is largely dependent)

Govt’s infra push is a boon for cement firms

Government’s decision of making Amaravati as the new capital in Andhra Pradesh and major developments happening in the states of Andhra Pradesh and Telegana is the major growth driver of the cement industry in the south.

Though new projects from the Government side are yet to begin, industry outlook is bright with the projected procurement plans. The new capital of AP will also bring in some demand. Things are good for the cement makers in Kadapa (AP) and Nalgonda (Telananga) belts.

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Industry Triggers:

For an investment decision to be correct, the invested company should be profitably with good growth visibility. A cement company's efficiency and profitability is dependent on the following points and should be closely considered.

1. Location
2. Capacity
3. Fuel Cost

Plan of smart city Amaravati-New Capital of Andhra Pradesh

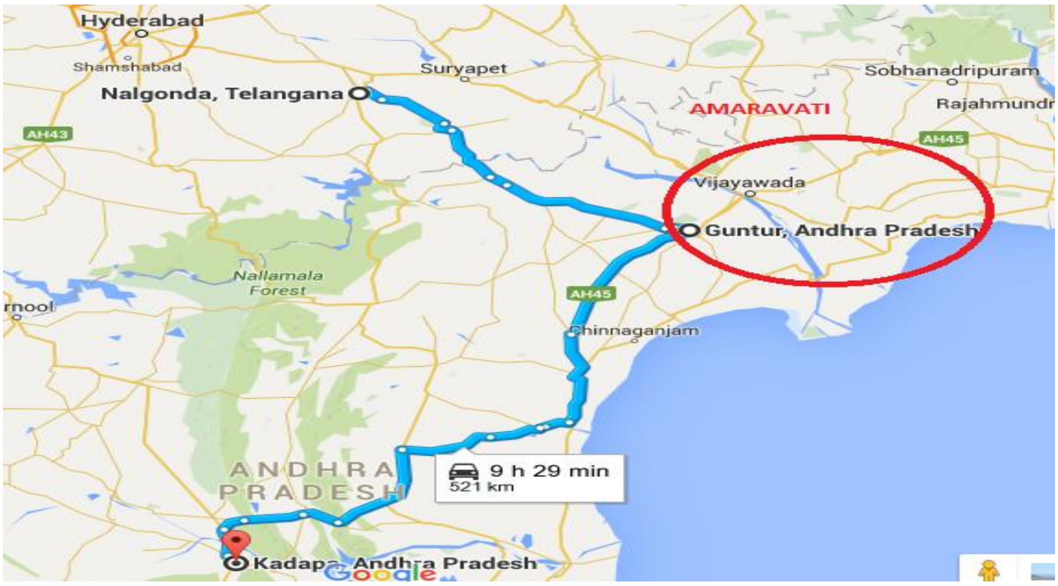
Location:

Location forms the most important factor. Closer the factory plant to the place of construction better it is! Transporting cement is very expensive and hence infrastructure companies will order cement for only those players who are located nearby and provide competitive prices (not much pricing power with a single player since it's a commodity type product).

With the infra boom which has just started in the two states of Andhra and telegana, the companies located in places like Guntur District, Nalagonda District and Kaddappa, Krishna district will benefit the most as it is very nearby to the place where Amravati City is going to come (less than 200 km) and so will the plants located near Chennai (restructuring demand due to Chennai floods).

	Plant Location
Sagar Cement	Nalagonda District
Ramco Cement	Virudhu Nagar,Ariyalur, Krishna District in Tamil Nadu, Chitradurga district in Karnataka

30% of the Ramco Cements capacity is in Krishna district which is closer to Amravati and 50% of its capacity is in Ariyalur district which is closer to Chennai (250 km approx).



Capacity:

Due to lack of demand, cement industry were running at low capacity utilization till last year. But this year the scenario will change as demand is going to increase considerably this year. The company with lowest capacity utilization will benefit the most as it will be able to sell more cement at good prices!

Increasing capacity at this juncture is useless as a lot of capex will be required and in turn it will also increase their debt. Also, the gestation period to make the plant is too long and hence the company may miss on the current demand story.

Many companies like deccan cement, kcp, sagar etc are running at 50-60% capacity hence company will require no further capex to grow. There will be operating leverage at play i.e. even if the demand of cement goes up 10% keeping pricing at similar levels there will be a large impact on profits as fixed cost (overheads) remain the same.

	Capacity (FY15)
Sagar Cement	3.7 MTPA (57%)
Ramco Cement	12.49 MPTA (61%)

Fuel Cost:

Fuel cost is the most important cost in cement producing process and hence cannot be ignored. The prices of fuel keep on fluctuating hence it affects the cost structure considerably.

On an average 61% of the total fuel cost comprise of coal. Hence it is important to know at what price the company is acquiring coal. Imported coal now is cheaper than Indian Coal.

About Sagar Cement

Sagar Cement is a small sized south based company based in Nalgonda district which acquired BMM for enterprise value of 540 Cr last year. The acquisition was primarily funded by proceeds of sale of the 47% stake in Vicat Sagar Cement Private Limited in September 2014 to its French partner Vicat Group for Rs. 435 Cr.

The total capacity of Sagar is 2.75 million tonnes and one million tonnes of BMM totalling to 3.75 MTPA.BMM also has proven limestone reserves for 100 years (1000 MT). The BMM capacity is helping them to meet the demand growth along with their existing capacity.

As we have highlighted in the report above the capacity utilization of cement companies in the south is low. Any volume growth with have a massive impact to the profit numbers. Sagar Cement has 60% of its total cost as variable and 40% of it is fixed i.e. if volume grows by 10% operating margin will increase by 400 bps(assuming prices stay the same). There is large scope of operating leverage as these companies are well below their long term capacity utilization levels. Currently Sagar has an operating margin of 9% in 2015 and we believe that there will be strong uptick in the volume growth as the infra projects by both the Andhra Pradesh Govt. and Central Govt. has risen.

About Ramco Cement

The Ramco Cements Limited (Formerly Madras Cements Ltd) is the flagship company of the Ramco Group, a well-known business group of South India. It is headquartered at Chennai. The main product of the company is Portland cement, manufactured in eight state-of-the art production facilities with total capacity of 12.49 MTPA and sales of 3645 crores in FY15.

Ramco cement has its presence in extreme south of Tamil Nadu thus a major beneficiary of the demand pick up in the flood affected region.

Changing Fundamentals: Quarterly Numbers

Quarterly numbers itself says that the growth prospects in the industry have changed. The industry has lately shown a robust growth in volume of cement as companies are reporting extraordinary growth numbers on quarterly basis.

The monthly numbers suggest that Andhra Pradesh and Telengana have reported maximum growth among others. Companies are encashing this opportunity.

Sagar cement grew its topline by 44.5% in Q2,2015 but registered a decline of 3% in Q3 2015 . Inspite of a marginal decline in the sales growth last quarter, the profit did not decline with a yoy growth of 171.2%. We expect growth to be volatile but the direction will be north.

Ramco cement sales growth for the last quarter remained flattish but there was a tremendous profit growth.The operating margins of the company were at 30% levels. Company has not seen such margins since a long time.

Particulars	SAGAR		RAMCO	
	2015	**2014**	**2015**	**2014**
Total Capacity(MT)	3700000	2700000	1249000	1249000
Capacity Produced(MT)	1551598	1419943	7696266	6539471
Units sold (MT)	1550076	1419857	7668000	8597000
Sales (Rs. In crores)	575.54	489.00	3731	3684

PEER COMPARISION

Company	Market Cap	Debt	Cash	Enterprise Value (Rs in crores)	Total Capacity (MTPA)	EV per ton
Deccan	409	159	26	542	2.3	2357
Sagar	**680**	**184**	**196**	**668**	**3.7**	**1805**
KCP	1030	359	33	1356	2.1	6457
NCL	333	156	6	483	2	9660
Ramco	**9568**	**2281**	**63**	**11786**	**12.49**	**9436**

*Debt as per FY 2015 Annual Report *Market cap 28th march.

Operating Profit Margin

Company	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Deccan	12.96%	13.02%	15.14%	23.22%	19.74%	24.97%	35.26%	36.53%	27.59%	11.76%
Sagar	**8.80%**	**0.25%**	**6.59%**	**16.56%**	**14.88%**	**16.61%**	**19.26%**	**22.51%**	**19.07%**	**5.08%**
KCP	14.23%	12.15%	9.49%	18.95%	20.81%	25.40%	25.37%	27.72%	28.79%	18.26%
NCL	11.75%	6.13%	12.13%	23.88%	24.14%	23.54%	24.13%	35.44%	29.73%	16.40%
Ramco	**21.44%**	**17.21%**	**27.04%**	**29.78%**	**24.85%**	**30.62%**	**31.74%**	**37.43%**	**35.36%**	**21.01%**

All the companies are operating at rock-bottom margins due to many unfavourable factors prevailing in the industry. Ramco cement has been the best performer so far. Infact Ramco enjoys the best operating margins as compared to its peers, mainly because of high operational efficiency i.e. lowest fuel cost among all.

Financials: Sagar and Ramco Cement

Sagar Cement	Mar'15	Mar'14	Mar'13	Mar'12	Mar'11
Return on Capital Employed (%)	11.60%	-1.22%	5.99%	15.45%	7.66%
Net Sales (Rs. Cr.)	650	559	641	680	487
Y-o-Y Gr. Rt.	16.40%	-12.80%	-5.80%	39.60%	1.60%
Adjusted EPS (Rs.)	30.33	-15.18	3.33	25.37	8.25
Y-o-Y Gr. Rt.	NA	-5.559	-0.869	2.075	-0.353
Book Value per Share (Rs.)	299.82	138.52	153.24	149.36	146.15
Adjusted Net Profit	52.7	-26.4	5.8	44.1	12.4
Net Op. Cash Flow (Rs. Cr.)	27	47.5	34.4	81.6	31.6
Debt to Cash Flow from Ops	8.17	4.32	6.53	1.93	7.65
Return on Equity (%)	13.84	-10.4	2.2	18.33	5.77
Operating Profit Margin (%)	8.8	0.25	6.59	16.56	14.88
Net Profit Margin (%)	8.11	-4.72	0.9	6.48	2.54
Debt to Equity	0.42	0.85	0.84	0.61	1.1
Working Capital Days	132	122	112	95	102
Cash Conversion Cycle	23	29	29	23	23

Ramco Cement	Mar'15	Mar'14	Mar'13	Mar'12	Mar'11
Return on Capital Employed	6.25%	4.43%	10.74%	10.84%	7.14%
Net Sales (Rs. Cr.)	3645	3684	3831	3224	2616
Y-o-Y Gr. Rt.	-1.10%	-3.80%	18.80%	23.20%	-6.60%
Adjusted EPS (Rs.)	8.4	4.15	16.83	16.46	8.8
Y-o-Y Gr. Rt.	1.024	-0.753	0.023	0.871	-0.408
Book Value per Share (Rs.)	111.1	104.29	99.61	86.15	72.88
Adjusted Net Profit	200	98.7	400	392	209
Net Op. Cash Flow (Rs. Cr.)	942	479	701	864	619
Debt to Cash Flow from Ops	2.88	6.08	3.8	3.14	4.51
Return on Equity (%)	7.8	4.07	18.11	20.7	12.72
Operating Profit Margin (%)	19.59	15.38	26.42	29.4	24.06
Net Profit Margin (%)	5.49	2.68	10.45	12.15	8
Debt to Equity	1.03	1.17	1.13	1.32	1.61
Working Capital Days	134	127	104	108	133
Cash Conversion Cycle	59	64	52	46	44

Conclusion

We believe that the downside from these levels in earnings is limited as things cannot go worse. The volume growth in Tamil Nadu and Andhra Pradesh is set to improve but the major growth is expected to come in coming quarters.

Sagar cement has a market cap of Rs 680 crores with EV per ton of Rs 1805.Ramco cement has a market cap of Rs 9568 with EV per ton of Rs.9436.

Ramco Cement is the market Leader in the south industry with operating margins of 30%.

Last quarter sales growth slowed down mainly due to no infra activity happening in monsoon. As the infra activity has already picked up, the growth is bound to happen in such cement companies. In the last 3 months prices have fallen by 20-25Rupees in the south but we expect prices to remain stable going forward. Additionally, the low-cost housing and irrigation projects of Andra Pradesh and Telangana will only be positive triggers for demand. We believe that at these levels Sagar cement has low downside with high margin of safety and Rambo should be a compounder.

Disclosure – No Position

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