



# **INDEPENDENT EQUITY RESEARCH**

**Sagar Cements Ltd**

**Initiating coverage**

**Enhancing investment decisions**

## Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade) The fundamental grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals) The valuation grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Fundamental Grade	Assessment	CRISIL Valuation Grade	Assessment
5/5	Excellent fundamentals	5/5	Strong upside (>25% from CMP)
4/5	Superior fundamentals	4/5	Upside (10-25% from CMP)
3/5	Good fundamentals	3/5	Align (+-10% from CMP)
2/5	Moderate fundamentals	2/5	Downside (negative 10-25% from CMP)
1/5	Poor fundamentals	1/5	Strong downside (<-25% from CMP)

### Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

### Additional Disclosure

This report has been sponsored by NSE - Investor Protection Fund Trust (NSEIPFT).

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# Sagar Cements Ltd

## Industry overcapacity eats into margins

Fundamental Grade	2/5 (Moderate fundamentals)
Valuation Grade	5/5 (CMP has strong upside)
Industry	Cement

Sagar Cements Ltd (Sagar) is an Andhra Pradesh-based cement manufacturer with a grinding capacity of 2.35 mtpa. In FY08, it entered into a joint venture (JV) with Vicat SA of France to set up a 5.5 mtpa fully-integrated cement plant in Karnataka. The company is expected to have low utilisation and EBITDA margins over the next two years on account of industry overcapacity. It is expected to log 4.4% revenue CAGR during FY10-12 with losses in FY11. We assign Sagar Cements a fundamental grade of '2/5', indicating that its fundamentals are 'moderate' relative to other listed securities in India.

### Industry overcapacity to impact profitability over the next two years

Despite operating in India's cement hub, Andhra Pradesh (AP), the overcapacity scenario is expected to keep operating rates lower than 60% during FY11-12 with EBITDA margins of 9-13%, lower than the 25% average maintained during FY08-10. Combined with high debt, the company is expected to make losses in FY11 (EPS of Rs -7.2) with marginal profits in FY12 (EPS of Rs 0.8). RoCE is expected to be 2% in FY11 and 6.6% in FY12, lower than the cost of capital.

### Recovery only post FY12

We expect the industry capacity utilisation to bottom out in FY11 at 72% with a marginal increase to 76% in FY12 along with Rs7-10/bag increase in cement prices. Recovery is expected in FY13 and FY14, with 84% and 91% industry capacity utilisation, respectively, with cement prices going back to the 2007-09 levels driven by strong demand. Accordingly, we expect Sagar to log EBITDA margin of 25%+ only after FY12.

### Vicat JV – value accretion at low cost

Sagar entered into a JV with Vicat SA for setting up a 5.5 mtpa cement plant at a capex of Rs 25 bn (70% debt funded) in Gulbarga, Karnataka. Sagar is expected to benefit significantly from this JV, particularly due to higher stake at lower cash infusion – Sagar is entitled for 47% stake with a 19.7% cash contribution to the total equity. This is on account of the local expertise that Sagar brings to the table and the premium paid by Vicat is an entry cost for expanding in India. The JV is expected to add significant shareholder value over FY13-15.

### Valuations - strong upside in the long run

We have valued Sagar on the sum-of-the-parts basis using the EV/tonne of US\$40 for the core business and its investment in Sagar-Vicat JV at 6x EV/EBITDA. We initiate coverage on Sagar with a fair value of Rs 202 per share (Rs 143 for core business and Rs 59 for JV), with a valuation grade of '5/5', indicating that the Rs 125 market price has a 'strong upside' from the current levels. However, since the cement industry is going through a downcycle, the stock may continue to trade below its fair value until the industry turns around.

## KEY FORECAST

(Rs mn)	FY08	FY09	FY10	FY11E	FY12E
Operating income	2,235	2,701	4,305	4,484	4,690
EBITDA	643	653	905	397	607
Adj Net income	331	189	202	(125)	14
Adj EPS-Rs	24.8	12.6	13.5	(7.2)	0.8
EPS growth (%)	6.1	(42.9)	6.7	n.m	n.m
PE (x)	3.9x	2.6x	10.0x	-18.8x	163.9x
P/BV (x)	1.1x	0.2x	0.9x	1.1x	1.1x
RoCE (%)	5.2x	4.4x	4.8x	11.2x	7.9x
RoE (%)	26.5	11.4	13.7	2.0	6.6
EV/EBITDA (x)	33.2	11.8	9.6	(5.8)	0.7

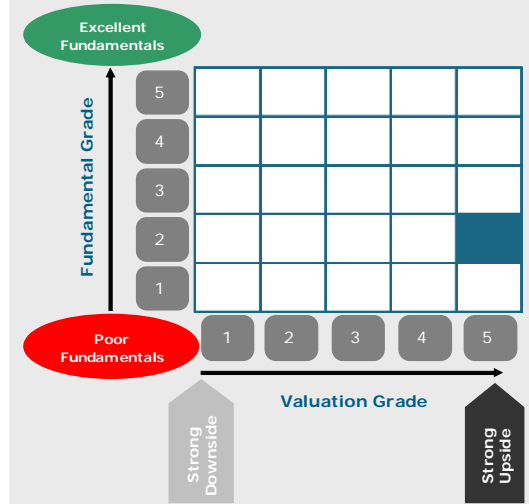
Source: Company, CRISIL Equities estimate

NM: Not meaningful; CMP: Current Market Price

December 01, 2010

Fair Value Rs 202  
CMP Rs 125

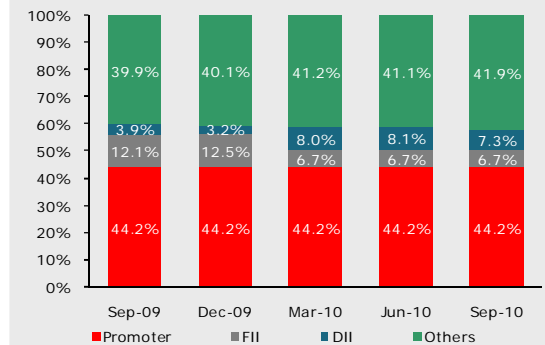
## CFV MATRIX



## KEY STOCK STATISTICS

NIFTY	5,852
NSE Ticker	SAGCEM
Face value (Rs per share)	10
Current market price (as on report date)	125
Shares outstanding (mn)	15
Market cap (Rs mn)/(US\$ mn)	1875/41
Enterprise value (Rs mn)	4,151
52-week range (Rs) (H/L)	225/117
P/E on EPS estimate (FY11E)	nm
Beta	1.04
Free float (%)	55
Average daily volumes (three months)	2,103
Avg daily value (30-days) (Rs mn)	0.3

## SHAREHOLDING PATTERN



## PERFORMANCE VIS-À-VIS MARKET

	Returns			
	1-m	3-m	6-m	12-m
Sagar	-3%	-11%	-25%	-26%
NIFTY	-3%	8%	15%	18%

## ANALYTICAL CONTACT

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**Table: 1 Sagar Cements: Business environment**

Parameter	Cement business
<b>Product / service offering</b>	Ordinary portland cement, pozzolona portland cement, sulphate resistant cement
<b>Geographic presence</b>	Southern India: Mainly caters to Andhra Pradesh. It has started selling in other southern states and Maharashtra New joint venture with Vicat of France in Karnataka; will again cater to southern region
<b>Market position</b>	Highly fragmented and regional industry, with top five players in South having slightly less than 50% market share. Sagar Cement has 2.35 mtpa out of total 67 mtpa capacity in the South
<b>Industry growth expectations</b>	10% for the next five years driven by growth in the IT/ITeS sector and government spending on different government schemes
<b>Sales growth (FY07-FY10 – 3-yr CAGR)</b>	28.9%
<b>Sales forecast (FY10-FY12 – 2-yr CAGR)</b>	4.4%
<b>Demand drivers</b>	<ul style="list-style-type: none"> <li>• Growth in the IT/ITeS sector and government spending on schemes like JNNURM, NREGA, IAS</li> </ul>
<b>Key competitors</b>	<ul style="list-style-type: none"> <li>• Regional players – India Cements, Madras Cements, Ultratech, ACC and Grasim Industries</li> <li>• Pan India players—Ambuja Cements, Shree Cements, Birla Corp, Binani Cement</li> </ul>

Source: Company, CRISIL Equities

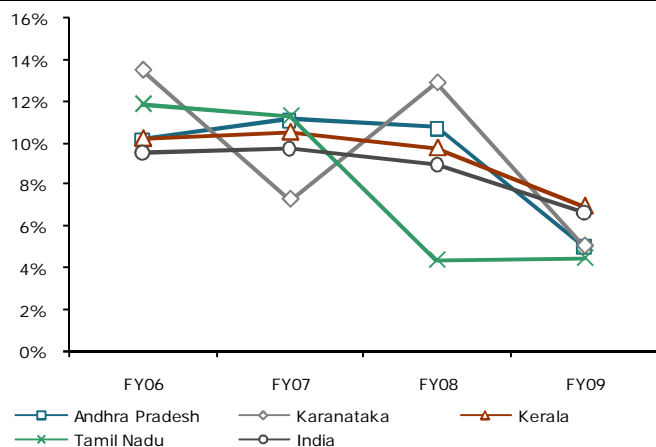
## Grading Rationale

### Focus on Andhra Pradesh, the cement hub of India

Sagar Cements, a small player with a capacity of 2.35mn tonnes, is based in Andhra Pradesh (AP), which leads in cement capacities and consumption in India. AP accounts for 16.3% of India's cement capacities, 14.5% of production and 10.5% of consumption. The average per capita cement consumption was 227 kgs in this state compared to an all-India level of 169 kg in FY08. AP has registered 20% CAGR in cement consumption over the past five years due to strong GDP growth and increased government spend on infrastructure activities.

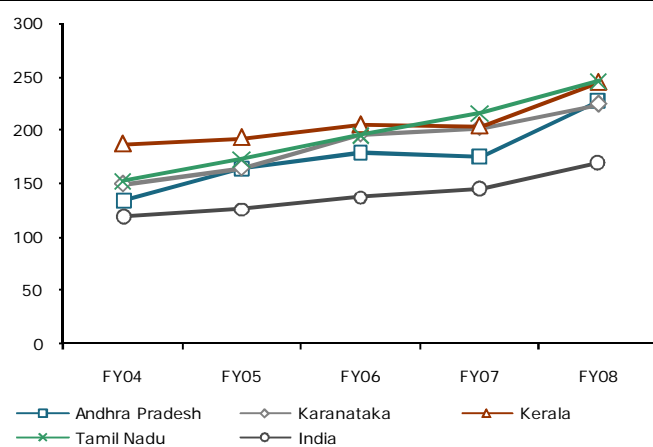
Sagar's production facilities are located in the Nalgonda cluster, central AP. Sagar derives over 80% of its sales from AP and the balance from Maharashtra (8%), Karnataka (4%), Orissa and Tamil Nadu. It is slowly trying to diversify into other markets.

**Figure 1 : Nominal GDP growth in southern states**



Source: CRISIL Equities

**Figure: 2 High per capita consumption in the South**



Source: CRISIL Equities

### Vicat JV – value accretion at low cost

Sagar entered into a JV with Vicat SA for setting up a 5.5 mtpa cement plant at a capex of Rs 25 bn (capex per tonne of US\$100 with Rs 45 to a US\$) in Gulbarga, Karnataka. The first phase of 2.75 mtpa is expected to come on stream by June 2012, with commercial production set to start by end-CY12. Sagar is expected to benefit significantly from this JV, particularly on account of higher stake at lower cash infusion – Sagar is entitled for a 47% stake with a mere 19.7% cash contribution to the total equity. Out of the total equity of Rs 5 bn, Sagar Cements is paying Rs 860 mn for a 47% stake. This is on account of the local expertise that Sagar brings to the table and the premium paid by Vicat is an entry cost for expanding in India.

Sagar has invested Rs 410 mn in the JV so far, and the debt funding has already achieved financial closure from International Finance Corporation.

**Table 2: Details of Sagar-Vicat JV**

	Phase I	Phase II	Total
Cement grinding capacity (mtpa)	2.75	2.75	5.5
Power plant (MW)	40	20	60
Plant commissioning	Jun-12	NA	
Capex (Rs mn)	16,000	9,000	25,000
Capex per tonne (Rs mn)	5,818	3,273	4,545
Capex per tonne (US\$ mn)	130	70	100
Funding			
Equity	5,000	2,400	7,400
- Sagar contribution	860	600	1,460
- Vicat contribution	4,140	1,800	5,940
Debt funding	11,000	6,600	17,600
Financial closure achieved	Yes	No	
Sagar stake (%)	47	47	47

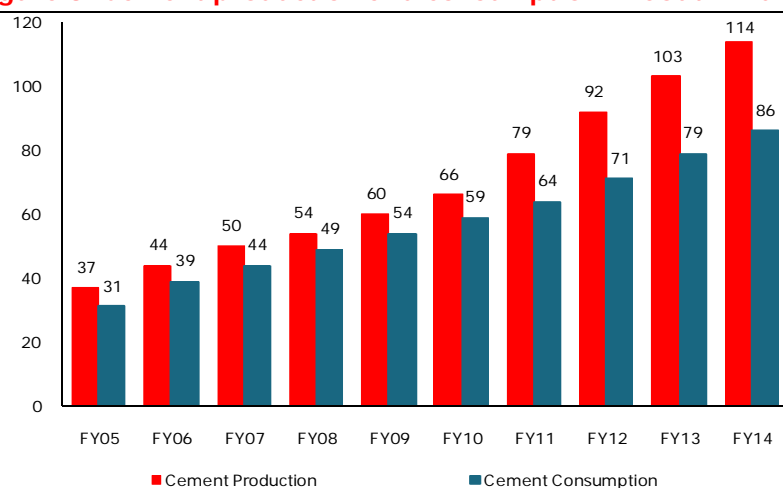
**Phase II plans are yet to be finalised**

**Debt funding for phase I is by International Finance Corporation and other multilateral agencies**

## Strong demand in cement industry in southern markets...

CRISIL Research expects demand for cement to grow at a CAGR of ~10% over the next five years. With an expected pick-up in the IT/ITeS sector, we believe there will be concurrent investments in the real estate sector in South India. Further, with most developed economies recovering from the economic slowdown, remittances are expected to gradually increase, thereby supporting demand for real estate. We also expect growth to be supported by infrastructure investments, especially in road projects and rural housing, supported by various government schemes like IAS, JNNURM, NREGS and others.

**Figure 3: Cement production and consumption in South India**

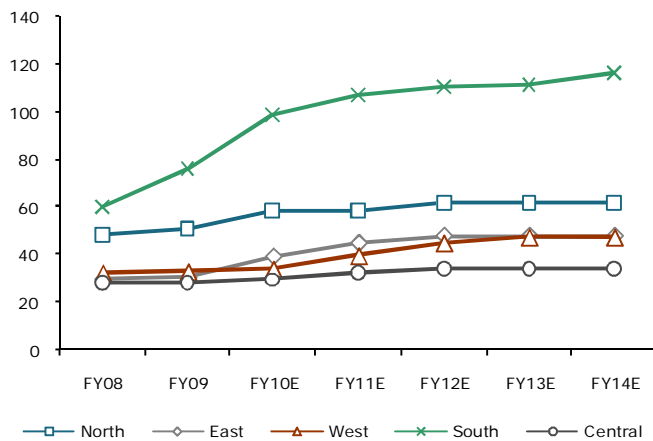


Source: CRISIL Research

## ... but overcapacity to keep operating rates in check

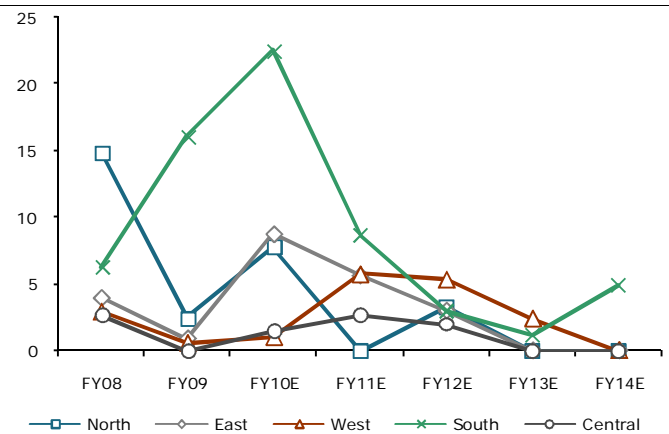
On a pan-India basis, 150 mtpa capacity is expected to be added in the next five years to the current capacity of 236 mtpa. Around 63 mtpa is expected to be added in South India during the next five years, as per CRISIL Research. This translates to a share of around 42% in total cement capacity addition. Within the South, over half of the capacity will be added in the Nalgonda (~30%) and Yerraguntalla (~70%) cement clusters in AP. The addition is higher than the incremental demand of 5 mtpa in the southern region, thus causing an oversupply situation, leading to a drop in operating rates. Sagar's operating rate for H1FY11 was <50%, lower than the 62% achieved in Q4FY10. We expect FY11 operating rate of 53% and FY12 operating rate of 60% for Sagar.

**Figure 4: South has maximum installed capacity**



Source: CRISIL Equities

**Figure 5: Maximum capacity additions in South during FY09-10**

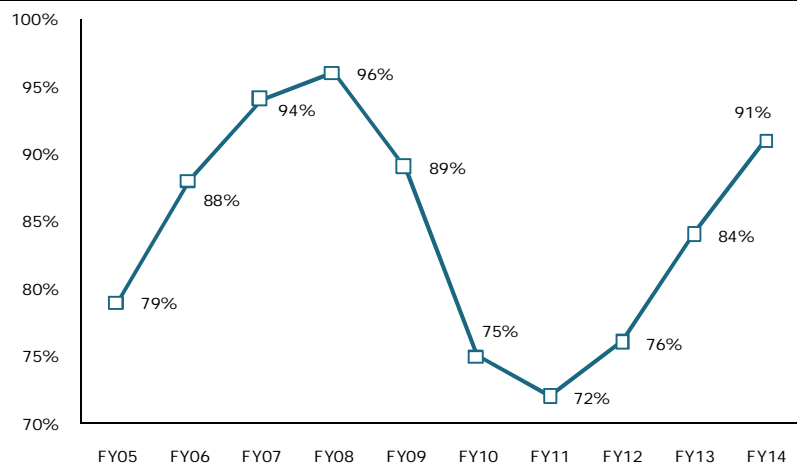


Source: CRISIL Equities

## Story changes post FY12: Rising demand to increase operating rates, realisations

We expect the full impact of capacity addition to be realised in FY11, with a bottoming out by then and a gradual recovery thereafter. In the southern region, while we expect a price increase of Rs 7-10 per bag in FY12, it is still not adequate to improve the profitability of the players significantly. As demand improves and capacity additions peak out in FY11-12, industry operating rates are expected to improve to 84% in FY13 and 91% in FY14. Accordingly, we expect Sagar to log EBITDA margin levels of 25%+ only after FY12.

**Figure 6: Operating rates in South to improve post FY12**



Source: CRISIL Research

## Overcapacity = lower prices and margins

CRISIL Research expects the southern region to see the highest correction in cement prices in FY11 (~7-8%) and a drop in margins, given the significant capacity surplus and the level of fragmentation. For Sagar, realisation for H1FY11 has already declined by 19.4% y-o-y to Rs 153.1; fall in 2QFY11 was 23% to Rs 141.3. Accordingly, the company's H1FY11 EBITDA and PAT margins have fallen to 8.92% (6.22% in Q2FY11) and -2.2% (-6.1% in Q2FY11), respectively. We expect EBITDA margins of 9.7% and 11.5% for FY10 and FY11, respectively.

**Table 3 Key assumptions for Sagar Cements**

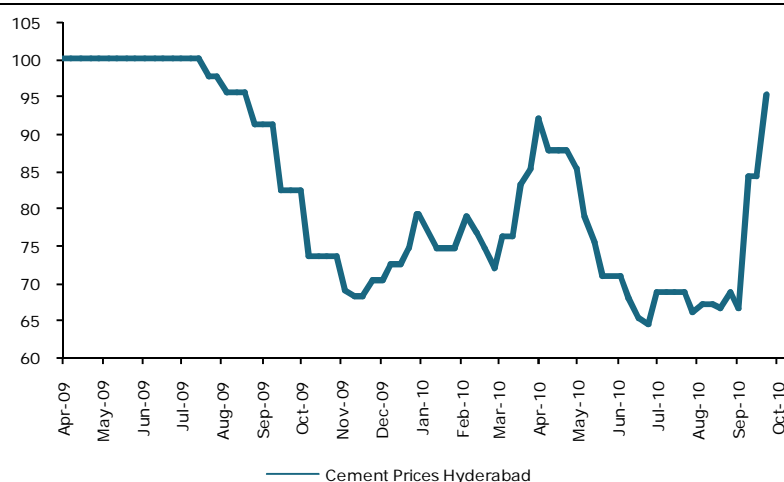
	FY09	FY10	FY11E	FY12E
Capacity (mtpa)	2,350,000	2,350,000	2,350,000	2,350,000
Capacity utilisation	18%	48%	53%	60%
Sales - Cement				
Total sales (mt)	641,485	1,334,827	1,449,108	1,615,066
Realisation (Rs/MT)	3,869	3,306	3,096	3,189
Realisation (Rs/bag)	193	165	155	159

Source: CRISIL Equities estimates

## Recent rise in cement prices unsustainable

Despite overcapacity, there was an increase in prices during end-September 2010 by Rs 50-100/bag in the southern region without a significant spurt in demand, which we believe is unsustainable. A similar price rise during April 2010 was short-lived and prices came back to the original levels.

**Figure 7: Cement price index in Hyderabad**



**The prices in Hyderabad are near peak levels, which are not sustainable given the industry overcapacity**

**Source: CRISIL Research**

Note: Prices indexed from Apr 2009

### **Savings in inward freight to be a long-term benefit**

The nearest railway station is 50kms away from the plant. The company imports nearly 300,000MT of coal for its clinker and currently incurs about Rs 100 mn additional costs on account of 50kms of road transport and handling charges for transfer of cargo from rail to road transport. The government is in the process of laying a railway track near Sagar's plant – the railway siding is expected to be operational by FY12. Accordingly, the company is expected to save about Rs 50 mn from FY13 onwards (~100bps improvement in margins).

Also, the company's average lead distance is about 450kms from its plant and 97% of the sales happen through road and railway sidings. The company can use the railways for about 25% of its despatches, which amounts to a saving of ~Rs 4 Omn. However, as per CRISIL Research, availability of wagons is an issue and hence we remain conservative on the outward freight cost saving.

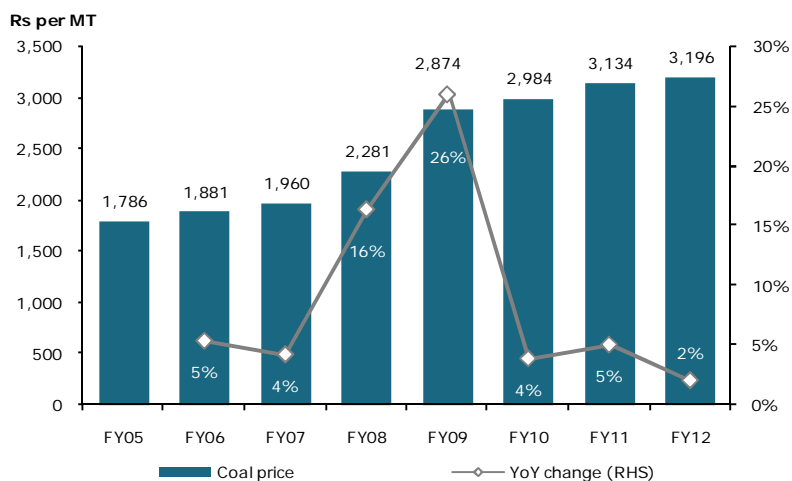
## Key risks / Monitorables

### Rise in coal prices

Coal is a key input in the cement manufacturing process. On an average, coal cost comprises 50-60% of power and fuel costs, and 20-25% of the total cost of sales. The average cost of imported coal increased from US\$55 per tonne in September 2009 to US\$94 per tonne in March 2010, and is ~10% lower currently. Sagar imports 40% of its coal requirement, and balance through coal linkages. The company is currently operating at lower than 50% operating capacity. With increasing production from FY12 onwards, the company is likely to rely more on imported coal and thereby increase its production costs.

Also, any increase in diesel price / deregulation is expected to increase transport costs.

**Figure 8: Sagar: Coal prices on the rise**



Source: Company, CRISIL Equities

### Telangana issue may impact demand and thereby operating rates

Production was stalled for 2-3 months in FY10 because of the Telegana agitation in Andhra Pradesh, combined with the floods situation. The problem may continue going forward and may exert further pressure on demand and operating rates.

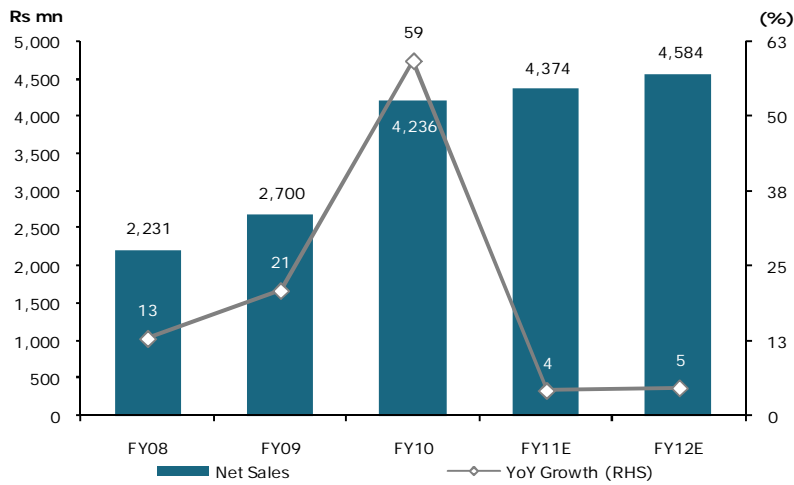
### Any slump in IT sector will affect demand adversely

Any slump in the IT/ITeS sector due to US government policies will affect demand adversely. If the US government passes the laws against outsourcing, the demand in IT-focused southern markets will take a major hit.

## Financial Outlook

Revenues to grow marginally, losses in FY11

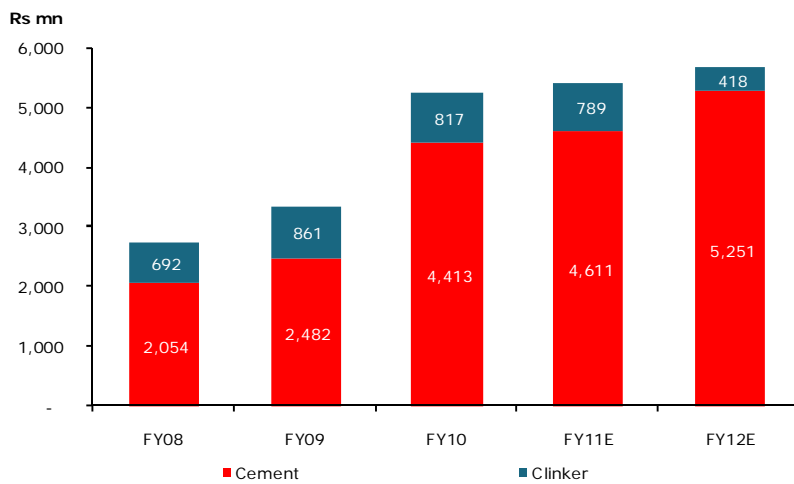
Figure 9: Revenues expected to grow at two-year CAGR of 4%



Source: Company, CRISIL Equities

Revenue growth impacted by industry overcapacity.

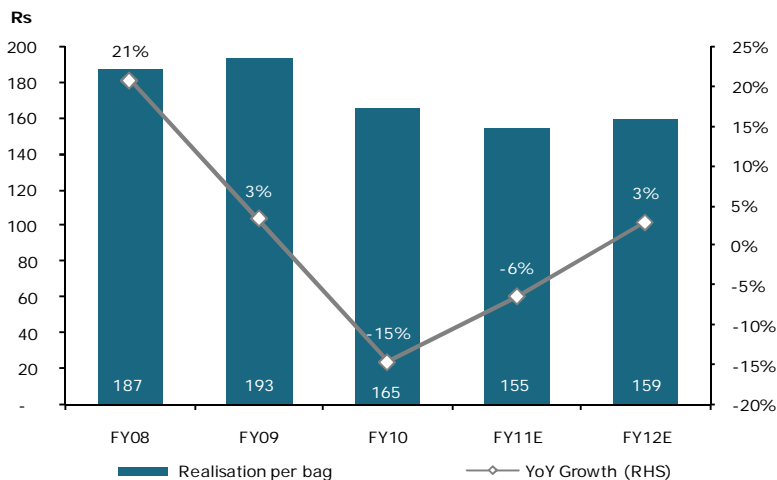
Figure 10: Gross sales mix: Cement sales dominate



Source: Company, CRISIL Equities

We expect clinker sales to decline beyond FY12 due to merger with Amareshwari

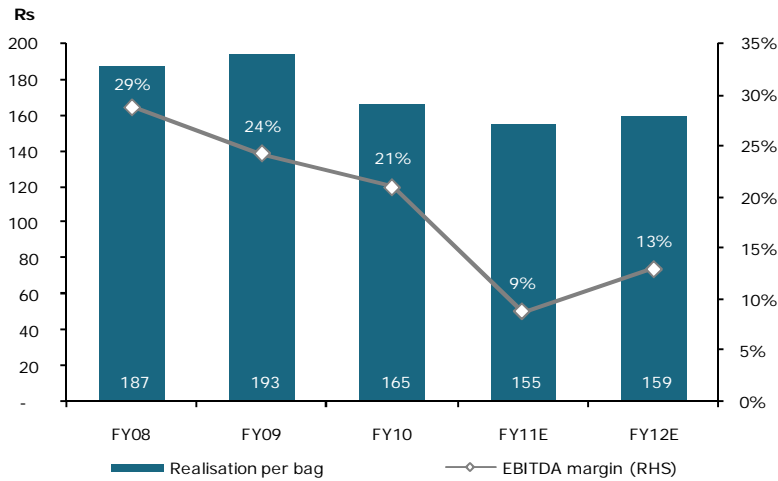
Figure 11: Trend in realisation per bag



Source: Company, CRISIL Equities

Realisation to decline by 6% in FY11, on the back of a 15% drop in FY10

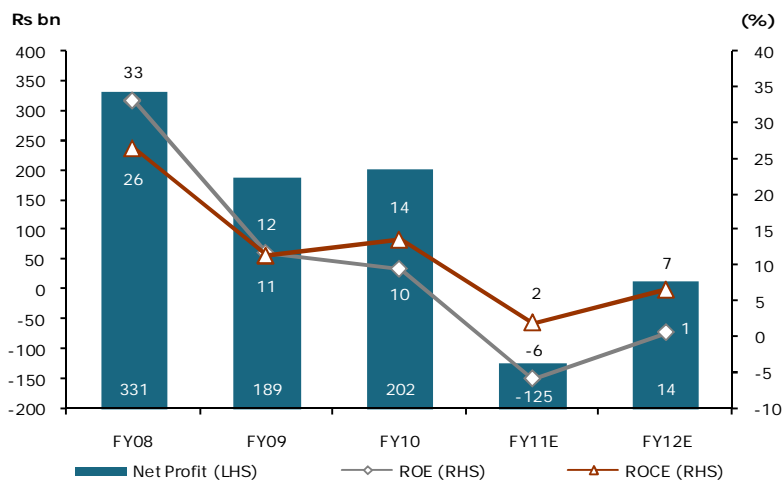
**Figure12: EBITDA margin trend**



Source: Company, CRISIL Equities

With rising input costs, EBITDA margins are set to decline to 10% in FY11 and 12% in FY12

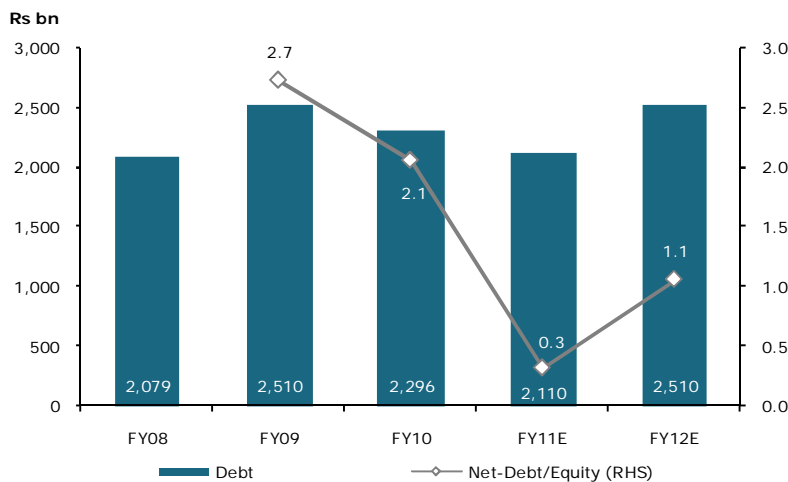
**Figure 13: PAT losses in FY11**



Source: Company, CRISIL Equities

With lower EBITDA margin and high debt servicing costs, we expect Sagar to incur losses in FY11. Return ratios are expected to be lower than cost of capital

**Figure 14: Debt and interest coverage**



Source: Company, CRISIL Equities

While debt is expected to remain largely constant, interest coverage is set to decline significantly in FY11

## Management Overview

CRISIL's fundamental grading methodology includes a broad assessment of management quality, apart from other key factors such as industry and business prospects, and financial performance.

### Highly qualified management with good industry experience

Sagar Cements has a highly qualified and experienced management headed by Mr S.Veera Reddy, CEO and Managing Director, who was the co-promoter of the Priyadarshini Group. He joined the board as Managing Director in 1991. Mr S.Veera Reddy is supported by S. Anand Reddy and S. Sreekanth Reddy, part of the promoter family. Mr. Sreekanth Reddy, whole-time promoter director of the company has a PG Diploma in Cement Technology and Mr. Anand Reddy, the executive director of the company, is an MBBS. They both have cement industry experience of more than 15 years.

### Management has expanded capacities on a slow pace until recently

Sagar's capacity was expanded slowly from .2 mtpa in 1992 to 0.3mtpa in FY08. However, in FY09, it expanded its capacity multi-fold to 2.35 MTPA. In FY08, management also signed a JV with VICAT SA to set up a 5.5 MTPA plant in Karnataka. This plant, once operational, will make the company one of the mid-sized players in South India.

### Second line of management

Based on our interactions, we believe the company's second line is reasonably experienced. Key managerial personnel have more than 10 years of experience in their respective fields.

## Corporate Governance

CRISIL's fundamental grading methodology includes a broad assessment of corporate governance and management quality, apart from other key factors such as industry and business prospects, and financial performance. In this context, CRISIL Equities analyses the shareholding structure, board composition, typical board processes, disclosure standards and related-party transactions. Any qualifications by regulators or auditors also serve as useful inputs while assessing a company's corporate governance.

Overall, corporate governance at Sagar Cements meets the regulatory requirements.

### Board composition

Sagar's board is headed by O.Swaminatha Reddy, an independent director and consists of nine members, of whom three are independent directors, which is in line with the requirements under Clause 49 of SEBI's listing guidelines.

### Disclosure levels and board's processes

The company's quality of disclosure can be considered good judged by the level of information and details furnished in the annual report websites and other publicly available data. The company also conducts analyst conference calls on a quarterly basis. The company has all the necessary committees – audit, remuneration, and investment and investor grievance - in place to support corporate governance practices. The audit committee is chaired by an independent director, O.Swaminatha Reddy, ex-chairman of Andhra Bank and AP State Finance Corporation. The committee meets at timely and regular intervals.

**Table 4: Group company transactions**

Group company	Nature of transaction	Comments
Amareswari Cements	Sale of Clinker and purchase of cement	Amareswari is expected to be merged with Sagar in FY11. It has a cement-grinding capacity of 0.35mn and 43mn tonnes of limestone reserves
Panchavati Polyfibres	Purchase of bags for packaging of cement	-

## Valuation

Grade: 2/5

We have valued Sagar on the sum-of-the-parts basis using EV/tonne for the core business and EV/EBITDA multiple for the investment in the Sagar-Vicat JV. We initiate coverage on Sagar with a fair value of Rs 202 per share (Rs 143 for the core business and Rs 59 for the JV). At the current market price of Rs 135, the stock has a “strong upside” from current levels. However, given that the cement industry is going through a downcycle, we believe that the stock may continue to trade below its fair value until the industry turns around.

### Valuation of core business

We value the core business at US\$40/tonne (Rs 1,720 mn), lower than the capex/tonne of US\$100 and arrive at a valuation of Rs 143/share for the core business. We believe that this is justified, given that (a) Sagar has a single-location plant; (b) it has one of the lowest sales/tonne and PAT/tonne amongst its peers; (c) Sagar’s EBITDA margins are inherently lower than the industry on account of lack of power plant and high freight costs; and (d) it is currently at the bottom-end of the cement cycle and is expected to incur losses for FY11 and marginal profits for FY12.

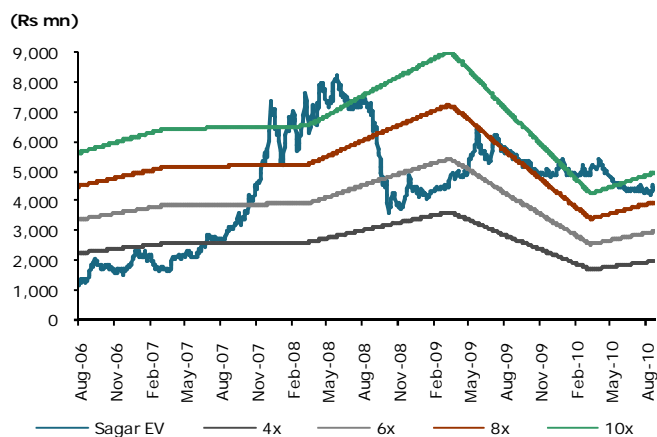
### Valuation of SAGAR-Vicat JV

Based on the pro forma P&L of Sagar-Vicat JV for FY14, and assigning a EV/EBITDA multiple of 6x to its FY14 EBITDA, we arrive at a equity valuation of Rs 3bn. We discount this by 18% to arrive at a value of Rs 2.2 bn valuation to arrive at the present value as at FY12. Accordingly, Sagar’s 47% stake is valued at Rs 59/share. Also, according to the JV, either party can sell its stake to the other party at an EV/EBITDA multiple of 6x.

Over the longer term, once the phase I production is on-stream and phase-II funding is tied up, we believe that the JV can add significant shareholder value over FY13-15.

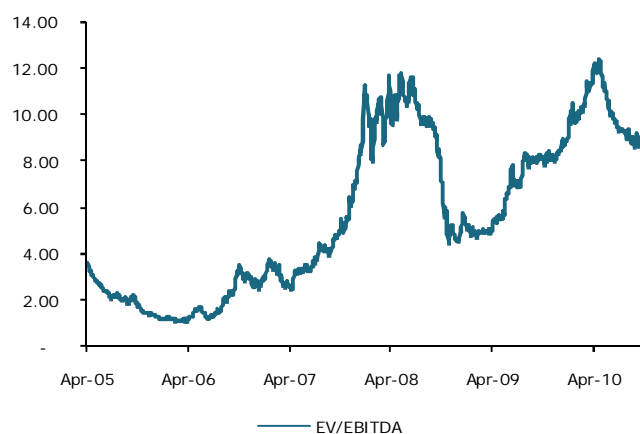
**Fair value estimate of Rs 202 based on EV/EBITDA; core business valued at Rs143/share and Vicat JV at Rs59/share**

Figure 15: Sagar Cements: EV/EBITDA Band chart



Source: CRISIL Equities

Figure 16: Sagar Cements: EV/EBITDA Movement chart



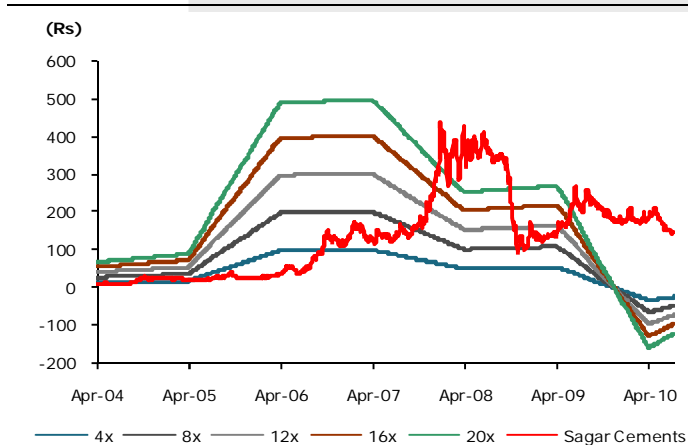
Source: CRISIL Equities

**Figure 17: Sagar Cements: EV/Ton chart**



Source: CRISIL Equities

**Figure 18: Sagar Cements: PE Band chart**



Source: CRISIL Equities

**Table 5: Sagar-Vicat pro forma profit and loss account (FY14)**

Capacity	2.75
Utilisation	90%
Production	2.48
Sales price/ton (Rs)	4,400
Sales per bag (Rs)	220
Gross sales	10,890
Net Sales	8,494
EBITDA margin	27.5%
EBITDA	2,336
Assigned EV/EBITDA multiple	6.0
EV	14,015
Less: debt	11,000
Equity Value	3,015
Cost of Equity	18%
Discounting Years	2.00
Present value of equity valuation	2,166
Sagar's stake	47%
Sagar share of Equity valuation	1,018
Number of shares	17.4
Rs/share	58.5

Source: CRISIL Equities

### Peer comparison – Sagar is placed lower than its peers

- Sagar cement is placed below its peer group on a sales/tonne. We believe that the company may be selling at prices lower than its peer on account of low competitive positioning and small size. Also, AP has one of the lowest realisations in India.
- Accordingly, Sagar also has one of the lowest EBITDA per tonne. Also, its costs are higher as its sales-freight mix is 97% towards road, while players like India Cements caters ~25% through rail.
- Due to low EBITDA per tonne and high interest cost, PAT per tonne is the lowest.

We factor in a 90% capacity utilisation and realisation of Rs 220 per bag for FY14, against CRISIL Research's FY12 estimates of Rs 247/bag in the west and Rs 228/bag in the south in FY12, the likely end-markets of the JV

Have assumed EBITDA margins of 27.5%, marginally higher than the 26.3% achieved by Sagar in FY07-09, as the JV has an integrated power plant.

Based on relatively conservative assumptions, we arrive at the present value of Sagar's share in the JV at Rs 1,018mn, against the equity investment of Rs 860mn

# Sagar Cements Ltd

**Table 6: Peer Comparison**

Regional Players	DEBT/TONNE (Capacity)				EBITDA/TONNE			
	FY07	FY08	FY09	FY10	FY07	FY08	FY09	FY10
<b>Sagar Cements</b>	277	885	1,024	968	877	1,173	995	683
India Cements Ltd	2,142	1,570	1,468	1,582	874	1,192	1,091	788
Ultratech Cement Ltd	600	824	479	(48)	997	1,182	1,136	1,152
Madras Cements Ltd	1,035	2,018	2,427	2,412	991	1,293	1,199	1,080
Shree Cement Ltd	1,008	310	242	929		1,378	1,229	1,609
ACC Ltd	(532)	(432)	(508)		1,007	865	1,220	

**Table 7: Peer Comparison**

Regional Players	Net Margin				PAT/TONNE			
	FY07	FY08	FY09	FY10	FY07	FY08	FY09	FY10
<b>Sagar Cements</b>	16%	15%	7%	5%	537	604	288	153
India Cements Ltd	23%	22%	12%	9%	629	744	461	339
Ultratech Cement Ltd	16%	18%	15%	15%	538	672	618	622
Madras Cements Ltd	20%	21%	15%	13%	544	700	558	441
Shree Cement Ltd	12%	14%	22%	20%		465	753	762
ACC Ltd	17%	13%	18%		596	490	730	

Source: Company, CRISIL Equities

**Table 8: Peer group comparison – Valuation metrics**

	Share Price (Rs)	Rs mn		P/E			P/B			EV/EBITDA			Cement Capacity - mtpa (FY12)	EV/Tonne (Rs)
		Mm cap	EV	FY10	FY11	FY12	FY10	FY11	FY12	FY10	FY11E	FY12E		
Sagar Cements Ltd	130	1,936.48	4,262	10.0	(18.8)	163.9	0.9	1.1	1.1	4.8	11.2	7.9	2.35	1,814
<b>Southern players</b>														
India Cements Ltd	113	34,726	56,975	9.3	21.2	14.2	0.9	0.8	0.8	8.49	9.72	7.47	14.05	4,055
Madras Cements Ltd	119	28,390	54,607	7.5						5.55			11.59	4,712
Heidelbergcement India Ltd	46	10,515	4,884	8.0	9.3	8.5	1.5	1.2	1.1	2.76	2.92	2.48	3.07	1,592
Chettinad Cement Corp Ltd	523	15,430	20,151	18.8						4.94			6.00	3,358
<b>Other Cement players</b>														
Ultratech Cement Ltd	1,103	302,111	300,973	12.5	16.6	15.0	3.0	2.5	2.4	7.20	12.58	11.38	40.90	7,359
Ambuja Cements Ltd	143	217,810	205,034	17.7	16.9	15.8	3.3	3.0	2.6	7.24	10.05	9.32	23.00	8,915
Birla Corp Ltd	391	30,070	33,762	5.5						4.61			7.87	4,289
Binani Cement Ltd	90	17,002	30,468	6.4						4.46	4.43		8.25	3,693
OCL India Ltd	131	7,451	10,720	4.5	4.6	2.8	0.9	0.7	0.6	2.95	2.24	1.16	5.35	2,004
ACC Ltd	1,014	190,355	188,144	12.2	14.6	15.4	3.2	2.8	2.6	5.12	8.70	8.94	29.17	6,450

**Table 9: Peer group comparison – Valuation metrics**

	ROE (%)			PAT margin			EBITDA margin		
	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E
Sagar Cements Ltd	9.57	(5.81)	0.68	4.7%	-2.8%	0.3%	21.0%	8.8%	13.0%
<b>Southern players</b>									
India Cements Ltd	9.28	3.90	7.20	9.4%	4.0%	6.3%	19.7%	16.5%	19.8%
Madras Cements Ltd	25.10			12.6%			31.0%		
Heidelbergcement India Ltd	20.11	12.95	12.90	14.3%	11.9%	11.7%	17.7%	20.1%	21.6%
Chettinad Cement Corp Ltd	17.69			7.9%			37.6%		
<b>Other Cement players</b>									
Ultratech Cement Ltd	26.61	16.95	15.77	15.3%	11.3%	11.6%	27.6%	31.5%	36.2%
Ambuja Cements Ltd	20.05	18.60	18.30	17.2%	16.9%	16.6%	28.5%	28.4%	29.2%
Birla Corp Ltd	36.16			25.8%			34.4%		
Binani Cement Ltd	48.62			12.9%			28.5%	30.8%	
OCL India Ltd	22.95	18.17	23.40	12.2%	10.7%	15.0%	30.3%	28.2%	33.8%
ACC Ltd	29.25	19.90	17.80	18.4%	15.3%	13.7%	34.7%	25.6%	25.0%

## Company Overview

Sagar Group is a Hyderabad-based group mainly into cement manufacturing. Sagar Cement Ltd, the flagship company of the group, was founded in 1981 by Mr. Muni Krishna, Mr. J. Rama Rao and Mr. Butchaiah as a mini cement plant in Andhra Pradesh with a clinker and cement capacity of 66000 tonnes per annum. It was then a part of the Priyadarshini Cement Group which is also the parent group for Rain Commodities. The present Sagar Group split from the Priyadarshini Group and became an individual group in 1992. After 1992, it gradually increased its capacity to the present 2.1 mtpa clinker and 2.35 mtpa cement capacity.

### Table 10: History and major developments

1981	Incorporated as Sagar Cements on 15 January
1992	Sagar Group split from Priyadarshini group.
2007	Blackstone group picked up stake in Sagar Cements
2008	VICAT Sagar Pvt Ltd, a 53:47 JV between Vicat SA and Sagar Cements finalized
2008	Expanded cement capacity to 2.35 mtpa
2008	Belgium-based Ackermans & Van Haaren (AvH) picked up 14.99% stake in Sagar Cements.

## Business

Sagar Cements is located in the Nalgonda cement cluster of Andhra Pradesh. The Nalgonda cluster is strategically located for producing cement. It has availability for limestone, coal and gypsum, the main raw materials required to produce cement. Sagar Cements has proven reserves of around 700 million tonnes of limestone. The company relies on the state grid for its power requirements. The company has not faced any power issues so far. As per CRISIL Research, AP's power deficit is expected to decline from 8% in FY11 to a surplus of 1% in FY15. Accordingly, the company is not expected to face any issue of unavailability of power.

As a part of the promoter-holding restructuring, Sagar Cement is merging Amareswari and divesting the power business. Sagar Power, a hydel and wind power company, with revenues of Rs 74 mn is expected to be divested during FY11.

## Amareswari merger

Sagar Cements has announced the merger of its group company Amareswari Cements with itself. Amareswari Cements, a sick company, was acquired by the promoters of Sagar Cements about five years ago. It has a grinding capacity of 0.35 mtpa and 43 MT of proven limestone reserves. Amareswari also has all necessary approvals for 1.5 MTPA capacity extension. As per the management, the merger of Amareswari Cements will add Rs 40-50 mn to the company's EBITDA. As per the valuation from Delloite and KPMG, the determined exchange ratio for the said merger is 10 equity shares of Rs. 10/- each of Sagar Cements for every 14 equity shares of Rs.10/- held in Amareswari Cements. After the extinguishment of 900000 shares of Sagar held by Amareswari, there will be a net addition of 2.3 mn shares in Sagar Cements. We have accounted for the merger to be effective from FY12 onwards.

## Annexure: Financials

### Income statement

(Rs mn)	FY08	FY09	FY10	FY11E	FY12E
<b>Operating income</b>	<b>2,235</b>	<b>2,701</b>	<b>4,305</b>	<b>4,484</b>	<b>4,690</b>
<b>EBITDA</b>	<b>643</b>	<b>653</b>	<b>905</b>	<b>397</b>	<b>607</b>
<b>EBITDA margin</b>	<b>28.8%</b>	<b>24.2%</b>	<b>21.0%</b>	<b>8.8%</b>	<b>13.0%</b>
Depreciation	63	207	287	308	314
<b>EBIT</b>	<b>581</b>	<b>447</b>	<b>618</b>	<b>89</b>	<b>294</b>
Interest	41	164	301	277	277
<b>Operating PBT</b>	<b>540</b>	<b>283</b>	<b>317</b>	<b>(188)</b>	<b>17</b>
Other income	(4)	4	3	2	5
Exceptional inc/(exp)	-	6	0	-	-
<b>PBT</b>	<b>536</b>	<b>293</b>	<b>321</b>	<b>(186)</b>	<b>21</b>
Tax provision	205	98	119	(61)	7
Minority interest	-	-	-	-	-
<b>PAT (Reported)</b>	<b>331</b>	<b>195</b>	<b>202</b>	<b>(125)</b>	<b>14</b>
Less: Exceptionals	-	6	0	-	-
<b>Adjusted PAT</b>	<b>331</b>	<b>189</b>	<b>202</b>	<b>(125)</b>	<b>14</b>

### Ratios

	FY08	FY09	FY10	FY11E	FY12E
<b>Growth</b>					
Operating income (%)	12.9	20.9	59.4	4.2	4.6
EBITDA (%)	26.1	1.6	38.5	(56.2)	53.2
Adj PAT (%)	6.1	(42.9)	6.7	(161.6)	(111.5)
Adj EPS (%)	1.0	(49.2)	6.7	(153.2)	111.5
<b>Profitability</b>					
EBITDA margin (%)	28.8	24.2	21.0	8.8	13.0
Adj PAT Margin (%)	14.8	7.0	4.7	(2.8)	0.3
RoE (%)	33.2	11.8	9.6	(5.8)	0.7
RoCE (%)	26.5	11.4	13.7	2.0	6.6
RoIC (%)	17.7	9.6	12.1	3.9	7.9
<b>Valuations</b>					
Price-earnings (x)	3.9	2.6	9.3	(17.4)	151.8
Price-book (x)	1.1	0.2	0.9	1.0	1.0
EV/EBITDA (x)	5.2	4.4	4.6	10.8	7.6
EV/Sales (x)	1.5	1.1	1.0	1.0	1.0
Dividend payout ratio (%)	15.8	35.1	27.1	-	-
Dividend yield (%)	4.0	14.0	2.9	-	-
<b>B/S ratios</b>					
Inventory days	21	88	66	60	63
Creditors days	78	109	81	72	73
Debtor days	12	38	34	34	34
Working capital days	16	36	39	37	37
Gross asset turnover (x)	1.5	0.8	0.9	0.9	0.9
Net asset turnover (x)	2.7	1.1	1.1	1.2	1.3
Sales/operating assets	1.1	0.8	1.1	1.2	1.3
Current ratio (x)	1.4	1.8	1.6	1.5	1.6
Debt-equity (x)	1.8	1.2	1.1	1.0	1.2
Net debt/equity (x)	1.7	1.2	1.0	1.0	1.1
Interest coverage	14.3	2.7	2.1	0.3	1.1

### Per share

	FY08	FY09	FY10	FY11E	FY12E
Adj EPS (Rs)	24.8	12.6	13.5	(7.2)	0.8
CEPS	29.5	26.4	32.6	10.5	18.9
Book value	87.1	135.8	145.9	121.0	121.8
Dividend (Rs)	3.9	4.6	3.7	-	-
Actual o/s shares (mn)	13.3	15.0	15.0	17.4	17.4

### Balance Sheet

(Rs mn)	FY08	FY09	FY10	FY11E	FY12E
<b>Liabilities</b>					
Equity share capital	133	150	150	174	174
Reserves	1,029	1,888	2,038	1,929	1,944
Minorities	-	-	-	-	-
<b>Net worth</b>	<b>1,162</b>	<b>2,038</b>	<b>2,188</b>	<b>2,103</b>	<b>2,118</b>
Convertible debt	-	-	-	-	-
Other debt	2,089	2,520	2,306	2,120	2,520
<b>Total debt</b>	<b>2,089</b>	<b>2,520</b>	<b>2,306</b>	<b>2,120</b>	<b>2,520</b>
Deffered tax liability (net)	74	159	271	271	271
<b>Total liabilities</b>	<b>3,325</b>	<b>4,717</b>	<b>4,765</b>	<b>4,494</b>	<b>4,908</b>
<b>Assets</b>					
Net fixed assets	1,099	3,822	3,782	3,629	3,416
Capital WIP	2,062	183	103	23	23
<b>Total fixed assets</b>	<b>3,161</b>	<b>4,005</b>	<b>3,885</b>	<b>3,652</b>	<b>3,439</b>
<b>Investments</b>	<b>0</b>	<b>150</b>	<b>381</b>	<b>381</b>	<b>881</b>
<b>Current assets</b>					
Inventory	80	430	493	514	537
Sundry debtors	54	249	418	436	456
Loans and advances	332	468	387	403	422
Cash & bank balance	71	115	31	14	92
Marketable securities	-	-	-	-	-
<b>Total current assets</b>	<b>537</b>	<b>1,261</b>	<b>1,330</b>	<b>1,367</b>	<b>1,507</b>
<b>Total current liabilities</b>	<b>374</b>	<b>700</b>	<b>831</b>	<b>907</b>	<b>919</b>
<b>Net current assets</b>	<b>164</b>	<b>562</b>	<b>499</b>	<b>460</b>	<b>588</b>
<b>Intangibles/Misc. expenditure</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total assets</b>	<b>3,325</b>	<b>4,717</b>	<b>4,765</b>	<b>4,494</b>	<b>4,908</b>

### Cash flow

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Pre-tax profit	536	287	321	(186)	21
Total tax paid	(178)	(13)	(7)	61	(7)
Depreciation	63	207	287	308	314
Working capital changes	10	(354)	(21)	22	(50)
<b>Net cash from operations</b>	<b>431</b>	<b>127</b>	<b>580</b>	<b>205</b>	<b>278</b>
<b>Cash from investments</b>					
Capital expenditure	(2,307)	(1,050)	(167)	(75)	(100)
Investments and others	(0)	(150)	(231)	-	(500)
<b>Net cash from investments</b>	<b>(2,307)</b>	<b>(1,200)</b>	<b>(398)</b>	<b>(75)</b>	<b>(600)</b>
<b>Cash from financing</b>					
Equity raised/(repaid)	609	198	-	24	-
Debt raised/(repaid)	1,790	431	(214)	(186)	400
Dividend (incl. tax)	(52)	(68)	(55)	-	-
Others (incl extraordinary)	(562)	557	3	16	(0)
<b>Net cash from financing</b>	<b>1,785</b>	<b>1,117</b>	<b>(265)</b>	<b>(147)</b>	<b>400</b>
Change in cash position	(91)	44	(84)	(17)	78
Closing cash	71	115	31	14	92

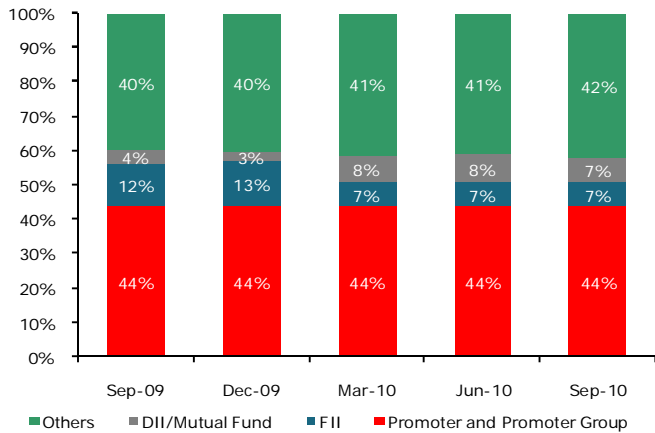
### Quarterly financials

(Rs mn)	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11
<b>Net sales</b>	<b>1,281</b>	<b>895</b>	<b>1,236</b>	<b>1,305</b>	<b>864</b>
Change (q-o-q)	NM	-30%	38%	6%	-34%
<b>EBITDA</b>	<b>317</b>	<b>24</b>	<b>101</b>	<b>127</b>	<b>54</b>
Change (q-o-q)	NM	-92%	324%	26%	-58%
<b>EBITDA margin</b>	<b>24.7%</b>	<b>2.7%</b>	<b>8.2%</b>	<b>9.8%</b>	<b>6.2%</b>
PAT	112	(65)	3	5	(53)
<b>Adj PAT</b>	<b>112</b>	<b>(65)</b>	<b>3</b>	<b>5</b>	<b>(53)</b>
Change (q-o-q)	NM	-158%	-104%	112%	-1098%
<b>Adj PAT margin</b>	<b>10.3%</b>	<b>8.8%</b>	<b>-7.3%</b>	<b>0.2%</b>	<b>0.4%</b>
<b>Adj EPS</b>	<b>7.5</b>	<b>(4.4)</b>	<b>0.2</b>	<b>0.4</b>	<b>(3.5)</b>

Source: Company, CRISIL Equities estimate

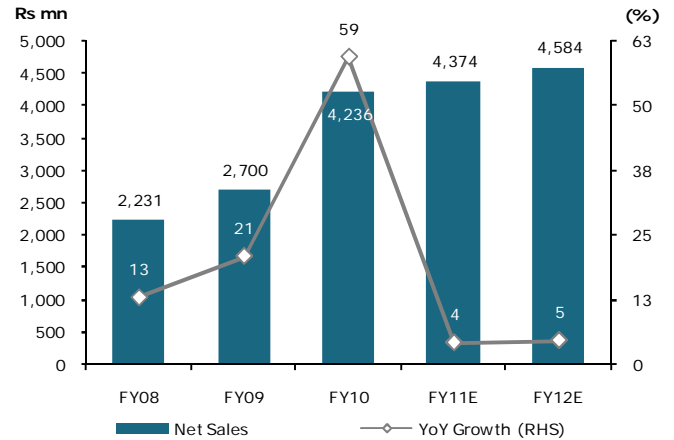
## Focus Charts

### Historical share-holding pattern



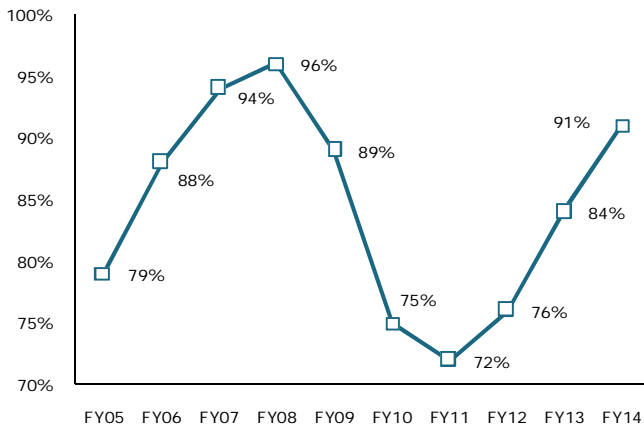
Source: NSE

### Revenues expected to grow at two-year CAGR of 4%



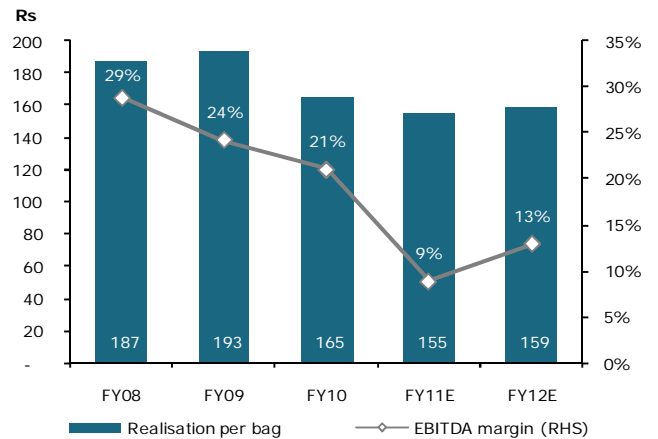
Source: Company

### Overcapacity to keep operating rates low



Source: Company, CRISIL Equities

### Realisation growth to remain subdued



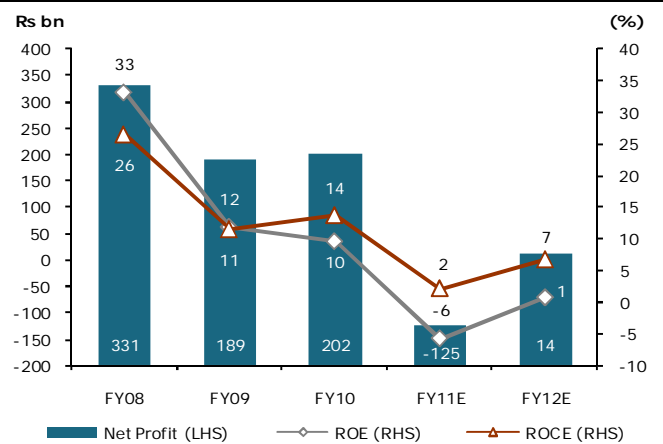
Source: Company, CRISIL Equities

### The recent cement price rise unsustainable



Source: Company, CRISIL Equities

### ROCE to be lower than cost of capital



Source: Company, CRISIL Equities

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