

January 4, 2018

Rating matrix	
Rating	: Buy
Target	: ₹ 1700
Target Period	: 12-18 months
Potential Upside	: 36%

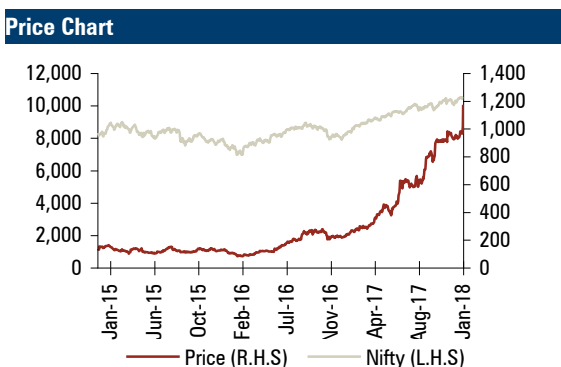
What's changed?	
Target	Changed from ₹ 1100 to ₹ 1700
EPS FY18E	Changed from ₹ 61.0 to ₹ 70.1
EPS FY19E	Changed from ₹ 73.4 to ₹ 84.4
EPS FY20E	Introduced at ₹ 97.2
Rating	Unchanged

Key financials				
₹ crore	FY17	FY18E	FY19E	FY20E
Net Sales	1927.1	2723.5	2983.4	3127.1
EBITDA	260.2	428.8	487.3	522.0
Net Profit	72.8	241.5	290.7	334.9
EPS	21.1	70.1	84.4	97.2

Valuation summary				
	FY17	FY18E	FY19E	FY20E
P/E	59.2	17.8	14.8	12.9
Target P/E	80.5	24.3	20.1	17.5
EV / EBITDA	18.7	11.2	9.8	8.6
P/BV	4.2	3.4	2.8	2.4
RoNW*	13.8	31.3	28.7	26.1
RoCE*	16.5	26.3	26.6	24.9
ROIC*	16.1	27.1	25.6	26.7

\* Return ratios adjusted for revaluation reserve amounting to ~₹500 crore

Stock data	
Stock Data	₹ crore
Market Capitalization	4308
Total Debt (FY17)	677
Cash and Cash Equivalent (FY17)	115.6
Enterprise Value	4868.9
52 week H/L (₹)	1326 / 226
Equity Capital	34.5
Face Value	₹ 10
MF Holding (%)	1.8
FII Holding (%)	13.2



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## Phillips Carbon Black (PHICAR)

₹ 1250

### In different orbit; re-rating to continue...

- Phillips Carbon Black (PCBL) is the largest manufacturer of carbon black (market share ~40%), which is used as a reinforcement material in manufacturing tyres (constitutes ~23% by volume)
- PCBL has successfully turned around its operations & is now clocking healthy ~16% EBITDA margin with core return ratios (RoE, RoCE) in excess of 25% (FY18E-20E), thereby traversing into a different orbit altogether vs. perception of a commodity play in the past
- Demand prospects for carbon black are also robust amid healthy demand growth in automobile and, consequently, tyre industry space and supply constraints from China (largest player globally)
- The commentary of two leading carbon black manufacturers globally (Orion Carbon & Cabot Corp), suggests the good times will sustain for the carbon black industry for an elongated time period
- The recent rise in coking coal price globally and consequent rise in coal tar price is expected to limit the production from China. It is likely to result in further tightness of the demand & supply situation in favour of carbon black manufacturers, including PCBL

### Volume led growth to drive earnings in FY18-20E

PCBL, is currently executing a de-bottlenecking exercise, which coupled with brownfield expansion will augment its capacity by ~80,000 tonne (411,000 tonne currently), with likely commissioning in FY18E-19E. This will ensure volume led growth sustains at PCBL. We expect PCBL to report sales volume of ~440 KT in FY19E and ~ 460 KT in FY20E, implying a volume CAGR of 6.0% in FY18E-20E. This coupled with increasing share of specialty grade carbon black & operational efficiencies on account of better sweating of assets will result in ~100 bps expansion in EBITDA margins. We expect PCBL to report EBITDA margins of 16.7% in FY20E vs. 15.7% in FY18E. Corresponding EBITDA/tonne is expected at ₹ 11325/tonne in FY20E vs. ₹ 10627/tonne in FY18E. Consequently, we expect PCBL to stage impressive 17.5% PAT growth in FY18-20E, with a base revision in the current fiscal of FY18E. We expect PCBL to report PAT of ₹ 241 crore in FY18E vs. ₹ 73 crore in FY17. Going forward, PAT is expected at ₹ 291 crore in FY19E and ₹ 335 crore in FY20E.

### Improving return ratios, financial matrix; deserves better valuation!

PCBL has promptly de-risked its business model from the fluctuations of commodity price viz. crude with the company incorporating full variable cost pass through in contracts with all its key customers. This protects the company from fluctuating profitability as witnessed in the past and adds strength/moat to its business profile. Therefore, profitability of PCBL is not a determinant of crude price and is more sustainable in nature thereby ensuring robust profitability trend continues, going forward. On the balance sheet front, PCBL has reduced its debt in FY17 to the tune of ~₹ 350 crore with consequent debt: equity at 0.7x. On the back of robust profitability amid increasing carbon black demand and operational efficiencies, PCBL has successfully achieved a quality driven business profile with core RoE & RoCE in excess of 25% in FY18E-20E and commands better valuation. Given the current tightness in the carbon black market and positive commentary by industry players, we revise upward our estimates. We now value PCBL at ₹ 1700 i.e. 17.5x P/E (1x PEG) on FY20E EPS of ₹ 97.2 with a **BUY** recommendation on the stock. We have largely captured the stock rally since initiation (July 2016) with recorded returns of 630%. We still believe there is more upside leg room for healthy price appreciation in the counter.

## Financial summary

Profit and loss statement		₹ Crore			
(Year-end March)	FY17	FY18E	FY19E	FY20E	
Net Sales	1924.8	2723.5	2983.4	3127.1	
Other Operating Income	2.2	0.0	0.0	0.0	
<b>Total Operating Income</b>	<b>1927.1</b>	<b>2723.5</b>	<b>2983.4</b>	<b>3127.1</b>	
Growth (%)	1.7	41.3	9.5	4.8	
Raw Material Expenses	1,236.6	1,776.7	1,939.2	2,026.4	
Employee Expenses	81.7	94.3	101.0	113.4	
Selling Expense	77.2	108.9	118.8	124.5	
Other Operating Expense	271.4	314.8	337.1	340.9	
<b>Total Operating Expenditure</b>	<b>1,666.9</b>	<b>2,294.7</b>	<b>2,496.2</b>	<b>2,605.1</b>	
<b>EBITDA</b>	<b>260.2</b>	<b>428.8</b>	<b>487.3</b>	<b>522.0</b>	
Growth (%)	57.7	64.8	13.6	7.1	
Depreciation	60.7	61.0	67.9	76.0	
Interest	51.4	48.9	44.8	38.1	
Other Income	20.2	14.1	13.1	21.6	
PBT	168.3	333.0	387.6	429.4	
Exceptional Item	0.0	0.0	0.0	0.0	
Total Tax	95.5	91.5	96.9	94.5	
<b>PAT</b>	<b>72.8</b>	<b>241.5</b>	<b>290.7</b>	<b>334.9</b>	
Growth (%)	220.1	231.9	20.4	15.2	
EPS (₹)	21.1	70.1	84.4	97.2	

Source: Company, ICICIdirect.com Research

Balance sheet		₹ Crore			
(Year-end March)	FY17	FY18E	FY19E	FY20E	
<b>Liabilities</b>					
Equity Capital	34.5	34.5	34.5	34.5	
Reserve and Surplus	994.0	1,236.4	1,477.5	1,750.4	
<b>Total Shareholders funds</b>	<b>1,028.5</b>	<b>1,270.9</b>	<b>1,512.0</b>	<b>1,784.9</b>	
Total Debt	677.0	627.0	567.0	507.0	
Deferred Tax Liability	205.2	205.2	205.2	205.2	
Minority Interest / Others	0.0	0.0	0.0	0.0	
<b>Total Liabilities</b>	<b>1,910.7</b>	<b>2,103.1</b>	<b>2,284.2</b>	<b>2,497.1</b>	
<b>Assets</b>					
Gross Block	1,974.1	1,997.9	2,287.9	2,367.9	
Less: Acc Depreciation	586.6	647.6	715.5	791.5	
Net Block	1,387.5	1,350.3	1,572.4	1,576.4	
Capital WIP	73.8	150.0	70.0	20.0	
<b>Total Fixed Assets</b>	<b>1,461.3</b>	<b>1,500.3</b>	<b>1,642.4</b>	<b>1,596.4</b>	
Investments	155.8	140.8	110.8	335.8	
Inventory	243.5	298.5	326.9	342.7	
Debtors	465.7	656.6	694.8	728.2	
Loans and Advances	22.9	54.5	59.7	62.5	
Other Current Assets	34.0	54.5	59.7	62.5	
Cash	20.6	31.4	40.0	49.4	
<b>Total Current Assets</b>	<b>786.7</b>	<b>1,095.4</b>	<b>1,181.0</b>	<b>1,245.4</b>	
Current Liabilities	463.8	596.9	613.0	642.6	
Provisions	10.6	17.9	18.4	19.3	
Current Liabilities & Prov	474.4	614.8	631.4	661.8	
Net Current Assets	312.2	480.6	549.6	583.5	
Others Assets	-18.6	-18.6	-18.6	-18.6	
<b>Application of Funds</b>	<b>1,910.7</b>	<b>2,103.1</b>	<b>2,284.2</b>	<b>2,497.1</b>	

Source: Company, ICICIdirect.com Research

Cash flow statement		₹ Crore			
(Year-end March)	FY17	FY18E	FY19E	FY20E	
Profit after Tax	72.8	241.5	290.7	334.9	
Add: Depreciation	60.7	61.0	67.9	76.0	
(Inc)/dec in Current Assets	14.8	-298.0	-77.0	-55.0	
Inc/(dec) in CL and Provisions	158.4	140.4	16.6	30.4	
Others	51.4	48.9	44.8	38.1	
<b>CF from operating activities</b>	<b>357.9</b>	<b>193.8</b>	<b>343.0</b>	<b>424.5</b>	
(Inc)/dec in Investments	14.5	15.0	30.0	-225.0	
(Inc)/dec in Fixed Assets	-49.2	-100.0	-210.0	-30.0	
Others	109.4	0.0	0.0	0.0	
<b>CF from investing activities</b>	<b>74.8</b>	<b>-85.0</b>	<b>-180.0</b>	<b>-255.0</b>	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
Inc/(dec) in loan funds	-344.4	-50.0	-60.0	-60.0	
Interest & Dividend paid	-76.2	-90.3	-94.4	-100.2	
Inc/(dec) in Share Cap	0.0	0.0	0.0	0.0	
Others	-42.2	42.2	0.0	0.0	
<b>CF from financing activities</b>	<b>-462.8</b>	<b>-98.1</b>	<b>-154.4</b>	<b>-160.2</b>	
Net Cash flow	-30.1	10.8	8.6	9.4	
Opening Cash	50.6	20.6	31.4	40.0	
<b>Closing Cash</b>	<b>20.6</b>	<b>31.4</b>	<b>40.0</b>	<b>49.4</b>	

Source: Company, ICICIdirect.com Research

Key ratios					
(Year-end March)	FY17	FY18E	FY19E	FY20E	
<b>Per share data (₹)</b>					
EPS	21.1	70.1	84.4	97.2	
Cash EPS	38.7	87.8	104.1	119.3	
BV	298.5	368.8	438.8	518.0	
DPS	6.0	10.0	12.0	15.0	
Cash Per Share (Incl Invst)	51.2	50.0	43.8	111.8	
<b>Operating Ratios (%)</b>					
EBITDA Margin	13.5	15.7	16.3	16.7	
PAT Margin	3.8	8.9	9.7	10.7	
Inventory days	46.2	40.0	40.0	40.0	
Debtor days	88.3	88.0	85.0	85.0	
Creditor days	87.9	80.0	75.0	75.0	
<b>Return Ratios (%)</b>					
RoE*	13.8	31.3	28.7	26.1	
RoCE*	16.5	26.3	26.6	24.9	
RoIC*	16.1	27.1	25.6	26.7	
<b>Valuation Ratios (x)</b>					
P/E	59.2	17.8	14.8	12.9	
EV / EBITDA	18.7	11.2	9.8	8.6	
EV / Net Sales	2.5	1.8	1.6	1.4	
Market Cap / Sales	2.2	1.6	1.4	1.4	
Price to Book Value	4.2	3.4	2.8	2.4	
<b>Solvency Ratios</b>					
Debt/EBITDA	2.6	1.5	1.2	1.0	
Debt / Equity	0.7	0.5	0.4	0.3	
Current Ratio	1.6	1.7	1.8	1.8	
Quick Ratio	1.1	1.2	1.3	1.3	

Source: Company, ICICIdirect.com Research

\* Return ratios adjusted for revaluation reserve amounting to ~₹500 crore

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Buy: > 10%/15% for large caps/midcaps, respectively;  
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