

January 31, 2018

## Graphite India (CAREVE)

₹ 785

### Stellar performance on all fronts...

- Graphite India (GIL) reported a stellar Q3FY18 performance. On the back of higher-than-expected realisations, the performance was significantly higher on all fronts. The company reported a capacity utilisation of ~95% in line with our estimates. Income from operations were at ₹ 933.1 crore (up 176.4% YoY, 102% QoQ), higher than our estimate of ₹ 556.3 crore
- EBITDA for the quarter was at ₹ 518.6 crore, significantly higher than our estimate of ₹ 227.5 crore. Subsequent EBITDA margin was at 55.6% (Q3FY17: 10.8%, Q2FY18: 28.1%, our estimate of 40.9%)
- Other income came in at ₹ 11.5 crore (our estimate: ₹ 20.2 crore), depreciation of ₹ 11.3 crore (our estimate: ₹ 12 crore) while the interest expense came in at ₹ 1.7 crore (our estimate: ₹ 1.0 crore). The ensuing PAT was at ₹ 340.5 crore (our estimate: ₹ 157.2 crore)

### Multiple triggers, capacity cuts by China affirm positive outlook...

A sustained positive outlook on the global graphite electrode segment coupled with healthy realisations of both global, domestic manufacturers has driven the strong rally. Key triggers have been: 1) consolidation of graphite electrode market globally, 2) ~20% of the global graphite electrode capacity (ex-China) shutting down in the last three years, 3) increase in steel production through EAF route (outside China) coupled with an increase in global steel prices. Furthermore, closure of steel and graphite electrode capacity in China on account of environmental concerns led to lower exports from the region improving the market balance, auguring well for both steel and graphite electrode prices.

### Polluting steel furnaces likely to be replaced by EAF...

While China is shutting down the inefficient induction furnaces and highly polluting blast furnaces, the same is expected to be replaced by environment friendly electric arc furnace (EAF) route supported by increased scrap availability. Over a longer term horizon, any increase in steel production through EAF route (especially in China) will boost the demand for graphite electrodes.

### Capacity utilisation level to remain healthy...

On a standalone basis, we model capacity utilisation of 94% for FY18E (upward revised from 91% earlier), 85% for FY19E and FY20E. On a consolidated basis, we model capacity utilisation of 87% for FY18E (upward revised from 84% earlier) and 79% for FY19E and FY20E. We tone down capacity utilisation levels for FY19E, FY20E factoring in the current scarce availability of needle coke (a key raw material). Any increase in availability of needle coke presents an upside risk in terms of capacity utilisation.

### Higher price contracts boost performance, maintain BUY...

GIL reported a stellar Q3FY18 performance driven by higher-than-expected realisations. The benefits of higher price contracts have started to flow in directly to the EBITDA from Q2FY18 onward. For 9MFY18, the standalone topline grew 87% YoY to ₹ 1746 crore while standalone EBITDA margins expanded ~3260 bps to 39.2% (vs. 6.5% in 9MFY17). We expect the company to continue to report a robust performance, going forward. We value the company at 10x FY19E EV/EBITDA. Hence, we arrive at a target price of ₹ 1000. We maintain our **BUY** recommendation on the stock.

#### Rating matrix

Rating	: Buy
Target	: ₹ 1000
Target Period	: 15-18 months
Potential Upside	: 27%

#### What's Changed?

Target	Unchanged
EPS FY18E	Changed from ₹ 30.2 to ₹ 46.7
EPS FY19E	Changed from ₹ 52.7 to ₹ 55.4
EPS FY20E	Changed from ₹ 68.7 to ₹ 69.7
Rating	Unchanged

#### Quarterly Performance (Standalone)

	Q3FY18	Q3FY17	YoY (%)	Q2FY18	QoQ (%)
Revenue	933.1	337.6	176.4	461.9	102.0
EBITDA	518.6	36.3	1328.5	129.9	299.2
EBITDA (%)	55.6	10.8	4482 bps	28.1	2745 bps
PAT	340.5	23.3	1361.5	89.9	278.8

#### Key Financials

(₹ Crore)	FY17	FY18E	FY19E	FY20E
Total Operating Income	1467.8	3132.2	4568.7	5170.0
EBITDA	39.6	1362.5	1563.9	1816.4
Net Profit	70.5	912.4	1082.0	1362.3
EPS	3.6	46.7	55.4	69.7

#### Valuation summary

	FY17	FY18E	FY19E	FY20E
PE (x)	217.7	16.8	14.2	11.3
Target PE (x)	277.3	21.4	18.1	14.3
EV/EBITDA (x)	377.1	10.8	9.1	7.7
P/BV (x)	8.3	7.8	6.4	5.4
RoNW (%)	3.8	46.6	45.2	47.8
RoCE (%)	-0.3	60.4	62.2	62.7

#### Stock data

Particular	Amount
Market Capitalisation (₹ crore)	₹ 15339
Debt (FY17) (₹ crore)	₹ 259
Cash & Cash Equivalent (FY17) (₹ crore)	₹ 683
EV (₹ crore)	₹ 14915.1
52 week H/L	906 / 94
Equity capital (₹ crore)	₹ 39.1
Face value	₹ 2

#### Price performance (%)

Return %	1M	3M	6M	12M
HEG	22.2	79.5	533.0	1,516.5
Graphite India	11.9	68.0	310.3	719.6

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### Variance analysis

	Q3FY18	Q3FY18E	Q3FY17	YoY (%)	Q2FY18	QoQ (%)	
Revenue	933.1	556.3	337.6	176.4	461.9	102.0	Higher realisations boosted topline, which came in higher than our estimates
Other Income	11.5	20.2	12.9	-11.0	19.2	-40.2	
Employee Expense	44.6	35.6	38.8	15.1	45.0	-0.8	
Raw Material Expense	225.1	210.5	150.1	50.0	131.0	71.8	
Power & Fuel Expense	79.7	47.5	62.5	27.4	72.9	9.3	
Other operating expenses	65.1	35.2	49.9	30.5	83.1	-21.6	
EBITDA	518.6	227.5	36.3	1,328.5	129.9	299.2	EBITDA came in significantly higher than our estimates
EBITDA Margin (%)	55.6	40.9	10.8	4482 bps	28.1	2745 bps	The EBITDA margin came in significantly higher than our estimates
Depreciation	11.3	12.0	9.6	17.5	12.0	-6.0	
Interest	1.7	1.0	2.1	-18.6	1.5	14.0	
Exceptional Items	0.0	0.0	0.0	NA	0.0	NA	
PBT	517.0	234.6	37.5	1278.8	135.6	281.3	
Tax Outgo	176.5	77.4	14.2	1,143.0	45.7	286.2	
PAT	340.5	157.2	23.3	1361.5	89.9	278.8	PAT came in higher than our estimates
Key Metrics							
Capacity Utilisation Level (%) ; Domestic Operations	95%	95%	85%		89%		Standalone capacity utilisation came in-line with our estimates

Source: Company, ICICIdirect.com Research

### Change in estimates

(₹ Crore)	FY18E			FY19E			FY20E			Comments
	Old	New	% Change	Old	New	% Change	Old	New	% Change	
Revenue	2793	3132	12.2	4328.2	4,569	5.6	5049.8	5170.0	2.4	Upward revised estimates on all parameters
EBITDA	804	1363	69.4	1,397.2	1,564	11.9	1,762.2	1,816.4	3.1	
EBITDA Margin (%)	28.8	43.5	1470 bps	32.3	34.2	195 bps	34.9	35.1	24 bps	The increasing prices of the key raw material (needle coke) is likely to have a bearing on the EBITDA margins, going forward.
PAT	590	912	54.6	1,030.1	1,082	5.0	1,342.1	1,362.3	1.5	
EPS (₹)	30.2	46.7	54.6	52.7	55.4	5.1	68.7	69.7	1.5	

Source: Company, ICICIdirect.com Research

### Assumptions

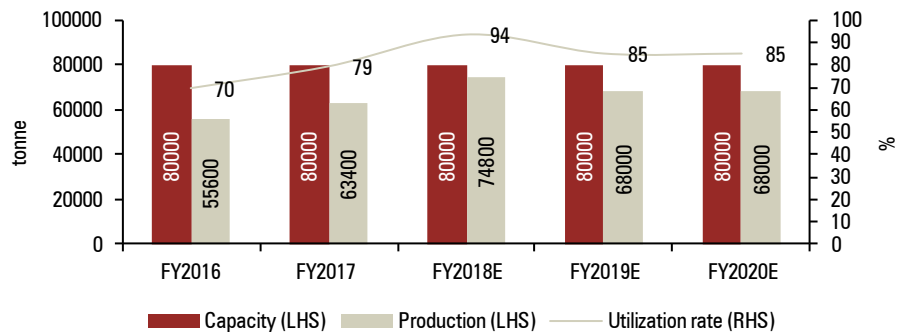
	Current			Earlier			Comments
	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	
Consolidated capacity utilisation	87	79	79	84	79	79	Upward revised consolidated capacity utilisation for FY18E, maintained estimates for FY19E, FY20E

Source: Company, ICICIdirect.com Research

## Company Analysis

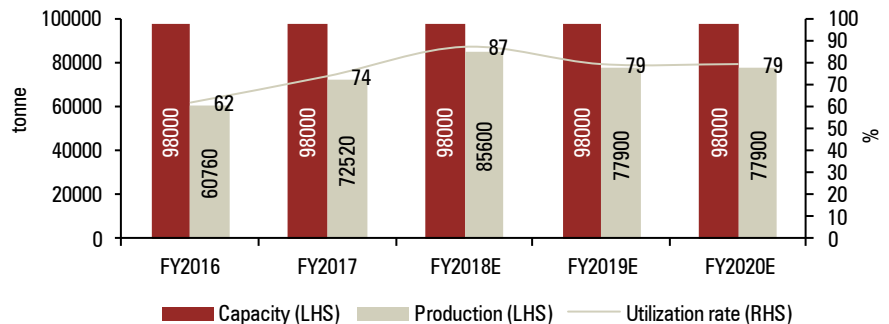
The company is a leading manufacturer of graphite electrode with an installed capacity of 98,000 tonne per annum (TPA). The installed capacity in India is 80,000 tonne of which 54,000 tonne is in Durgapur, 13,000 tonne in Nashik and 13,000 tonne in Bengaluru. GIL also owns a plant in Nuremberg (Germany) with an installed capacity of 18,000 tonne. The company commissioned its last capacity expansion in Q1FY14 wherein it installed a capacity of 20,000 tonne at its Durgapur plant while incurring a capex of ₹ 255 crore.

**Exhibit 1: Graphite electrode capacity production & utilisation rate (standalone basis)**



Source: Company, ICICIdirect.com Research

**Exhibit 2: Capacity & utilisation rates (Consolidated basis)**

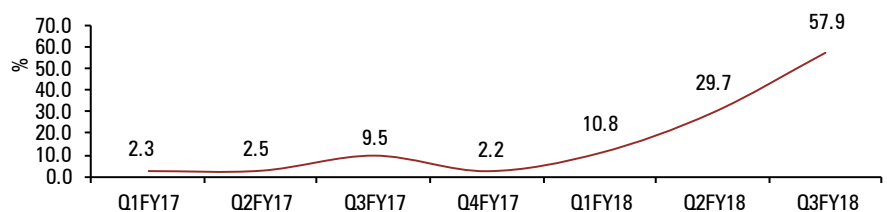


Source: Company, ICICIdirect.com Research

### Segmental performance

Apart from operating the graphite electrode facility, the company also operates a carbon paste facility, calcined petroleum coke facility and some graphite equipment facility. GIL also possesses a high speed steel and alloy steel facility.

**Exhibit 3: Graphite electrode segment EBIT performance**



Source: Company, ICICIdirect.com Research

On a standalone basis, we expect capacity utilisation of 94% in FY18E and 85% in FY19E and FY20E. We have toned down the capacity utilisation level for FY19E, FY20E factoring in the current scarce availability of needle coke (a key raw material)

On a consolidated basis, we expect the company to report capacity utilisation of 87% in FY18E and 79% in FY19E, FY20E each. We have toned down the capacity utilisation level for FY19E, FY20E factoring in the current scarce availability of needle coke (a key raw material)

For standalone operations in Q3FY18, EBIT margins of graphite electrodes segment improved notably to 57.9% as compared to 9.5% in Q3FY17 and 29.7% in Q2FY18

## Outlook and valuation

Graphite India reported a stellar Q3FY18 performance driven by higher-than-expected realisations. The benefits of higher price contracts have started to flow in directly to the EBITDA from Q2FY18 onward. For 9MFY18, the standalone topline grew 87% YoY to ₹ 1746 crore while standalone EBITDA margins expanded ~3260 bps to 39.2% (vs. 6.5% in 9MFY17). We expect the company to continue to report a robust performance, going forward.

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We value the company at 10x FY19E EV/EBITDA thereby arriving at a target price of ₹ 1000. We value the company at 10x EV/EBITDA thereby arriving at a target price of ₹ 1000. We maintain our **BUY** recommendation on the stock.

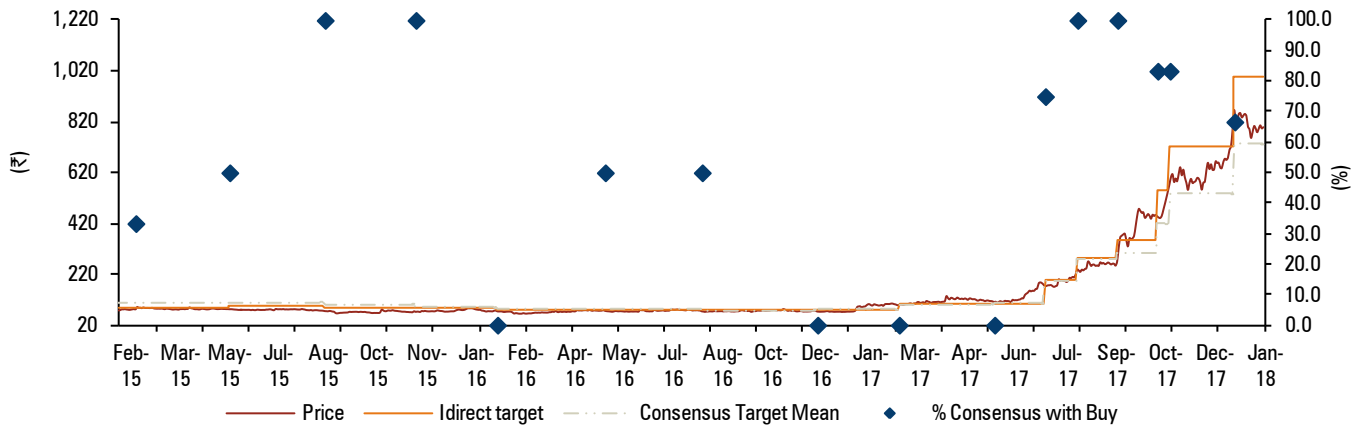
Graphite India has a robust balance sheet, net cash status and healthy cash flow generation, which augurs well for the company.

**Exhibit 4: Valuation matrix**

	Revenue (₹ Cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
FY15	1710.7	-14.9	2.9	-55.7	266.3	111.9	3.3	4.4
FY16	1532.3	-10.4	4.2	43.8	185.3	113.0	4.7	4.2
FY17	1467.8	-4.2	3.6	-14.9	217.7	377.1	3.8	-0.3
FY18E	3132.2	113.4	46.7	1194.9	16.8	10.8	46.6	60.4
FY19E	4568.7	45.9	55.4	18.6	14.2	9.1	45.2	62.2
FY20E	5170.0	13.2	69.7	25.9	11.3	7.7	47.8	62.7

Source: Company, ICICIdirect.com Research

### Recommendation history vs. consensus estimate



Source: Bloomberg, Company, ICICIdirect.com Research

### Key events

Date	Event
Mar-10	Converts bonds into shares. Sets bond conversion price at ₹ 55.3
Dec-10	European Union renews tariffs on graphite electrodes from India (tariff at 9.4%)
Mar-11	GIL declares lockout at Titlagarh unit post labour unrest at its plant site
Jun-11	Titlagarh unit resumes production post settlement with labour unions including increase in wages & other benefits
Mar-12	GIL sells its entire stake in its subsidiary Carbon International (engaged in trading activities only) for €4.6 million (₹ 30 crore)
Jul-12	Karnataka State Pollution Control Board orders the company to shut operations in its Bangalore plant till further orders, citing environmental pollution
Aug-12	GIL resumes operations at its Bangalore plant after obtaining stay on the pollution control board order for closure of its plant at Bangalore
Sep-12	The company's international peer Graftech expected to hike electrode prices for 2013 contracts
Nov-13	Global players announce production cuts to support graphite electrode prices
Feb-15	Gol imposes antidumping duty on graphite electrodes (all diameters) originating in or exported from China. The amount of anti-dumping duty ranges from US\$278.19 per MT to US\$922.03 per MT, depending on the Chinese producer/exporter
Mar-16	Board declares interim dividend of ₹ 2.0/share
Jun-17	Board declares dividend of ₹ 2.0/share for FY17

Source: Company, ICICIdirect.com Research

### Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position	Change
1	Emerald Co., Ltd.	30-Sep-2017	61.2	119.6M	0
2	SBI Funds Management Pvt. Ltd.	30-Jun-2017	2.8	5.5M	-2.0M
3	GKN PLC	30-Sep-2017	2.0	4.0M	0
4	Life Insurance Corporation of India	30-Sep-2017	1.9	3.7M	0
5	The New India Assurance Co. Ltd.	30-Sep-2017	1.2	2.4M	-0.3M
6	Global IVY Ventures L.L.P.	30-Sep-2017	1.2	2.4M	0
7	Goldman Sachs Asset Management International	30-Sep-2017	1.2	2.3M	0
8	L&T Investment Management Limited	30-Sep-2017	1.1	2.2M	-1.8M
9	Bangur (Krishna Kumar)	30-Sep-2017	0.8	1.7M	-0.0M
10	Dimensional Fund Advisors, L.P.	31-Dec-2017	0.7	1.5M	-0.4M

Source: Reuters, ICICIdirect.com Research

### Shareholding Pattern

(in %)	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Promoter	65.2	65.2	65.2	65.2	65.2
FII	12.5	12.6	10.3	4.7	5.9
DII	7.4	8.4	8.1	9.1	8.8
Others	14.9	13.8	16.4	21.0	20.1

### Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
HSBC Global Asset Management (Hong Kong) Limited	5.9M	0.6M	Fidelity Management & Research Company	-91.2M	-8.2M
Sophus Capital	1.7M	0.2M	SBI Funds Management Pvt. Ltd.	-5.1M	-2.0M
Russell Investments Limited	1.0M	0.1M	L&T Investment Management Limited	-10.1M	-1.8M
ABN AMRO Investment Solutions (AAIS)	0.4M	0.1M	State Street Global Advisors Ltd. (Canada)	-3.2M	-0.6M
Principal PNB Asset Management Company Ltd.	0.3M	0.0M	Dimensional Fund Advisors, L.P.	-4.0M	-0.4M

Source: Reuters, ICICIdirect.com Research

## Financial summary

Profit and loss statement (₹ crore)				
(Year-end March)	FY17	FY18E	FY19E	FY20E
Total Operating Income	1467.8	3132.2	4568.7	5170.0
Growth (%)	-4.2	113.4	45.9	13.2
Raw Material Expenses	585.1	772.6	1,512.4	1,793.5
Employee Expenses	222.5	222.5	408.8	421.8
Other expenses	620.6	774.5	1,083.6	1,138.3
Total Operating Expenditure	1,428.2	1,769.7	3,004.8	3,353.6
EBITDA	39.6	1362.5	1563.9	1816.4
Growth (%)	-70.6	3,345.1	14.8	16.1
Depreciation	46.4	54.6	55.8	28.1
Interest	7.9	7.0	3.5	0.5
Other Income	86.5	60.9	110.4	245.5
PBT	71.8	1,361.8	1,615.0	2,033.4
Exceptional Item	0.0	0.0	0.0	0.0
Total Tax	1.3	449.4	532.9	671.0
PAT	70.5	912.4	1082.0	1362.3
Growth (%)	-14.9	1,194.9	18.6	25.9
EPS (₹)	3.6	46.7	55.4	69.7

Source: Company, ICICIdirect.com Research

Cash flow statement (₹ crore)				
(Year-end March)	FY17	FY18E	FY19E	FY20E
Profit after Tax	70.5	912.4	1,082.0	1,362.3
Add: Depreciation	46.4	54.6	55.8	28.1
(Inc)/dec in Current Asset	204.0	-84.0	-82.5	-949.6
Inc/(dec) in CL & Provision	11.6	151.0	35.2	808.9
Others	9.3	2.9	0.0	0.0
CF from operating activities	341.7	1,037.0	1,090.5	1,249.7
(Inc)/dec in Investments	-215.1	-50.0	-100.0	-200.0
(Inc)/dec in Fixed Assets	-89.1	-15.0	-25.0	-25.0
Others	0.0	0.0	0.0	0.0
CF from investing activities	-304.2	-65.0	-125.0	-225.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-43.1	-54.0	-175.0	-30.2
Dividend paid & div. tax	-47.0	-704.9	-650.0	-900.3
Inc/(dec) in Share Cap	83.0	-106.4	1.7	-1.7
Others	0.0	0.0	0.0	0.0
CF from financing activities	-7.1	-865.3	-823.3	-932.2
Net Cash flow	30.4	106.7	142.2	92.5
Opening Cash	21.0	51.5	158.2	300.4
Closing Cash	51.5	158.2	300.4	392.9

Source: Company, ICICIdirect.com Research

Balance sheet (₹ crore)				
(Year-end March)	FY17	FY18E	FY19E	FY20E
Liabilities				
Equity Capital	39.1	39.1	39.1	39.1
Reserve and Surplus	1,818.5	1,919.6	2,353.4	2,813.7
Total Shareholders funds	1,857.6	1,958.7	2,392.5	2,852.8
Total Debt	259.2	205.2	30.2	0.0
Deferred Tax Liability	85.0	85.0	85.0	85.0
Minority Interest / Others	0.0	0.0	0.0	0.0
Total Liabilities	2,201.8	2,249.0	2,507.7	2,937.8
Assets				
Gross Block	1,539.1	1,583.1	1,608.1	1,633.1
Less: Acc Depreciation	871.7	926.3	982.2	1,010.3
Net Block	667.4	656.8	625.9	622.8
Capital WIP	32.1	3.1	3.1	3.1
Total Fixed Assets	699.5	659.8	629.0	625.8
Investments	631.0	681.0	781.0	981.0
Inventory	602.1	613.7	598.0	1,062.3
Debtors	441.5	454.6	622.9	1,133.2
Loans and Advances	11.7	95.8	50.8	50.8
Other Current Assets	103.5	78.5	53.5	28.5
Cash	51.5	158.2	300.4	392.9
Total Current Assets	1,210.1	1,400.8	1,625.6	2,667.7
Current Liabilities	316.0	409.1	398.7	708.2
Provisions	25.7	83.5	129.2	628.5
Current Liabilities & Prov	341.7	492.7	527.9	1,336.7
Net Current Assets	868.4	908.1	1,097.7	1,331.0
Others Assets	2.9	0.0	0.0	0.0
Application of Funds	2,201.8	2,249.0	2,507.7	2,937.8

Source: Company, ICICIdirect.com Research

Key ratios				
(Year-end March)	FY17	FY18E	FY19E	FY20E
Per share data (₹)				
EPS	3.6	46.7	55.4	69.7
Cash EPS	6.0	49.5	58.2	71.2
BV	95.1	100.2	122.4	146.0
DPS	2.0	30.0	27.7	38.3
Cash Per Share	2.6	8.1	15.4	20.1
Operating Ratios (%)				
EBITDA Margin	2.7	43.5	34.2	35.1
PBT / Total Operating income	4.9	43.5	35.3	39.3
PAT Margin	4.8	29.1	23.7	26.4
Inventory days	149.7	135.0	120.0	75.0
Debtor days	109.8	100.0	125.0	80.0
Creditor days	78.6	90.0	80.0	50.0
Return Ratios (%)				
RoE	3.8	46.6	45.2	47.8
RoCE	-0.3	60.4	62.2	62.7
RoIC	-0.3	65.2	71.1	72.7
Valuation Ratios (x)				
P/E	217.7	16.8	14.2	11.3
EV / EBITDA	377.1	10.8	9.1	7.7
EV / Net Sales	10.2	4.7	3.1	2.7
Market Cap / Sales	10.5	4.9	3.4	3.0
Price to Book Value	8.3	7.8	6.4	5.4
Solvency Ratios				
Debt/EBITDA	6.6	0.2	0.0	0.0
Debt / Equity	0.1	0.1	0.0	0.0
Current Ratio	3.5	2.8	3.1	2.0
Quick Ratio	1.8	1.6	1.9	1.2

Source: Company, ICICIdirect.com Research



## ICICIdirect.com coverage universe (Graphite Electrodes)

Company	CMP		Rating	M Cap		EPS (₹)			P/E (x)			EV/EBITDA (x)			ROCE(%)			ROE(%)		
	(₹)	TP (₹)		(₹ Cr)		FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Graphite India	785	1,000	Buy	15,339		46.7	55.4	69.7	16.8	14.2	11.3	217.7	16.8	14.2	-0.3	60.4	62.2	3.8	46.6	45.2
HEG	2650	3200	Buy	10,600		-12.5	116.0	196.1	NA	22.8	13.5	139.7	14.2	8.6	0.9	37.9	48.7	-5.7	34.7	37.0

Source: Company, ICICIdirect.com Research

#### **RATING RATIONALE**

ICICIdirect.com endeavours to provide objective opinions and recommendations. ICICIdirect.com assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Strong Buy, Buy, Hold and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock.

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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## ANALYST CERTIFICATION

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