

Golden times continue getting better, retain Hold

We continue to remain positive on prospects of Graphite India (GIL) led by our view of electrode industry remaining in an upcycle for next few years as postulated in our recent [sector report](#). We continue to expect extremely strong earnings trajectory for GIL in next few years with peak earnings in FY19E and moderation kicking in from FY20E. GIL remains the best bet to play the electrode upcycle with healthy balance sheet, strong adj. FCF generation, high dividend payout and strong management pedigree. Q4 results were well above expectations and margins are expected to remain well above the long term average over the next few years but we continue to value the stock on our conservative 5 year cash flow methodology to arrive at a revised fair value of Rs825. Maintain Hold.

- **Capacity utilisation remains high, realisation continues to improve:** Capacity utilisation for Q4 stood at 100% and realisations jumped to ~US\$8650/t. Cons. capacity utilisation stood at 85% for FY18. GIL would see further realisation improvements in H1FY19 as it moves completely to new priced contracts.
- **EBITDA/t expands, overseas unit contributes materially in FY18:** EBITDA rose 29% QoQ to Rs6.7bn led by higher realisations. EBITDA margins stood at a robust 55.2% and EBITDA/t stood at ~US\$5200/t. Cons. EBITDA/t stood at US\$2673/t for FY18. Total dividend of Rs17/sh was announced for FY18 (32% of cons. PAT)
- **Outlook remains bright, sensitivity to spreads to remain high:** We expect strong expansion in GIL's gross profit/t in FY19E/20E led by better pricing aided by favorable demand-supply balance. We expect strongest upcycle of last few decades in store for electrode industry and expect consolidated EBITDA/t of US\$5590/\$3352 in FY19E/20E. We see earnings remaining highly sensitive to volumes and spreads and every US\$100/t additional spreads results in ~2.5% increase in EBITDA/EPs/TP while every 5% increase in volumes lead to ~4% increase in EBITDA/EPs/TP. We expect GIL's cash kitty to swell to ~Rs26bn by FY20E despite factoring in strong dividend (25% of PAT every year) and increased absolute working capital requirements. We believe that prudent cash management would be key and we would keep a close eye on the capital allocation decisions from hereon.
- **Valuation and risks:** The stock has seen a relentless up move and is up ~400% since our [IC](#) dated 20 June 2017. As postulated by us in our [sector view](#) earlier, we expect profitability to start moderating from FY20E albeit remaining higher than long term average and hence we believe that it would be prudent to value the company on 5 year average earnings. We continue to value GIL on our conservative AOCF/EV yield methodology using five year average adj. cash flows (FY16-20E) to arrive at our revised TP of Rs825. Maintain Hold. Key downside risk is margin pressure due to raw material volatility while upside risk is continuation of high spreads into FY20E/21E as that of FY19E.

Y/E Mar (Rs mn)	Q4FY18	Q4FY17	YoY(%)	Q3FY18	QoQ(%)	Q4FY18E	Var(%)
Net sales	12,122	3,734	224.7	9,331	29.9	9,963	21.7
Total RM consumed	2,877	1,619	77.6	1,821	58.0	1,944	48.0
Employee costs	450	411	9.5	446	0.8	450	0.0
Other expenses	748	573	30.7	651	14.9	750	(0.2)
EBITDA	6,686	147	4463.5	5,186	28.9	5,569	20.1
EBITDA margin (%)	55.2	3.9		55.6		55.9	
Depreciation	111	126	(11.8)	113	(1.5)	110	1.0
Other income	370	312	18.8	115	222.6	150	146.9
PBT	6,925	321	2056.0	5,170	33.9	5,599	23.7
Tax	2,388	(144)		1,765	35.3	1,904	25.4
PAT	4,537	620	632.2	3,405	33.2	3,695	22.8

Source: Company, Centrum Research

Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj. PAT	YoY (%)	EPS (Rs)	RoE (%)	RoCE (%)	PE (x)	EV/EBITDA(x)
FY16	15,323	(10.4)	1,346	8.8	828	31.1	4.2	4.6	4.1	18.0	9.6
FY17	14,678	(4.2)	396	2.7	705	(14.9)	3.6	3.9	3.6	22.8	29.8
FY18	32,660	122.5	14,442	44.2	10,320	1,364.7	52.8	47.3	36.2	7.9	5.1
FY19E	68,947	111.1	31,867	46.2	21,615	109.4	110.6	66.1	49.8	6.6	4.1
FY20E	51,045	(26.0)	18,432	36.1	13,309	(38.4)	71.3	29.5	48.1	10.7	6.3

Source: Company, Centrum Research Estimates

Target Price	Rs825	Key Data	
CMP*	Rs730	Bloomberg Code	GRIL IN
Upside	13%	Curr Shares O/S (mn)	195.4
Previous Target	780	Diluted Shares O/S(mn)	195.4
Previous Rating	Hold	Mkt Cap (Rsbn/USDbn)	142.6/2.1
Price Performance (%)*		52 Wk H / L (Rs)	908/102.5
	1M 6M 1Yr	5 Year H / L (Rs)	908/57
GRIL IN	3.3 24.4 519.9	Daily Vol. (3M NSE Avg.)	2437004
NIFTY	3.7 4.7 14.7		

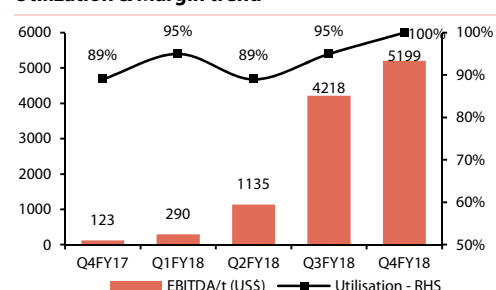
*as on 11 May 2017; Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Mar-18	Dec-17	Sep-17	Jun-17
Promoter	65.2	65.2	65.2	65.2
FII's	4.6	5.9	4.7	10.3
Dom. Inst.	8.5	8.8	9.1	8.1
Public & Others	21.7	20.1	20.9	16.4

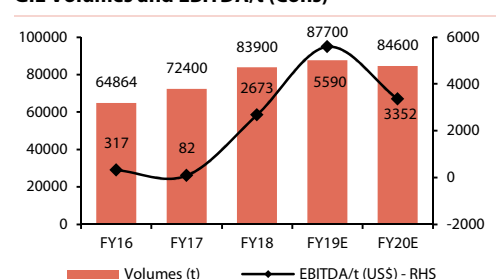
Source: BSE, *as on 11 May 2017

Utilization & Margin trend



Source: Company, Centrum Research Estimates

GIL Volumes and EBITDA/t (Cons)



Source: Company, Centrum Research Estimates

Earnings Revision

Particulars (Rs mn)	FY19E			FY20E		
	New	Old	Chg (%)	New	Old	Chg (%)
Sales	68,947	65,965	4.5	51,045	48,921	4.3
EBITDA	31,867	30,348	5.0	18,432	17,599	4.7
EBITDA Margin (%)	46.2	46.0		36.1	36.0	
PAT-adj.	21,615	20,512	5.4	13,309	12,691	4.9

Source: Centrum Research Estimates

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Earnings revised higher to factor in higher volumes

We revise our earnings estimates higher marginally as we factor in higher volumes while maintaining our realisations and EBITDA/t estimates. We expect strong expansion in GIL's gross profit/t in FY19E/20E led by better pricing aided by favorable demand-supply balance. We expect strongest upcycle of last few decades in store for electrode industry and expect consolidated EBITDA/t of GIL to expand materially to US\$5590/\$3350 in FY19E/20E. We expect EBITDA of Rs30.3bn/Rs17.6bn and PAT of Rs20.5bn/Rs12.7bn in FY19E/20E.

Exhibit 1: Earnings Revision

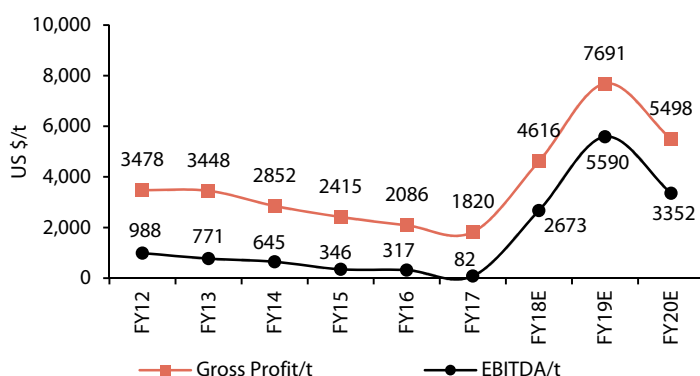
	FY19E			FY20E		
	Revised	Previous	% Chg	Revised	Previous	% Chg
Net Sales (Rsmn)	68,947	65,965	4.5	51,045	48,921	4.3
EBITDA (Rsmn)	31,867	30,348	5.0	18,432	17,599	4.7
EBITDA %	46.2	46.0		36.1	36.0	
PAT (Rsmn)	21,615	20,512	5.4	13,309	12,691	4.9

Source: Company, Centrum Research Estimates

Sharp improvement in spreads, earnings remain highly sensitive to spreads

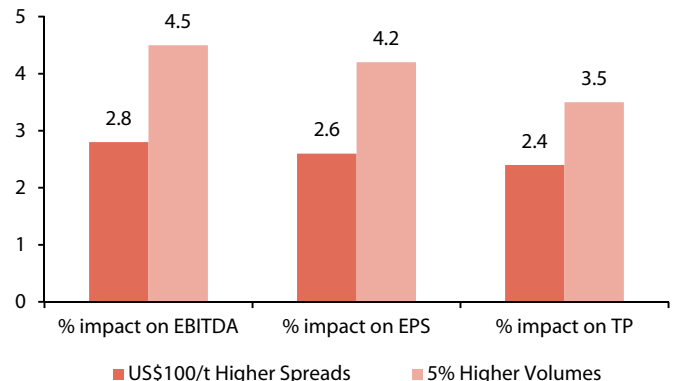
We expect sharp improvements in spreads to ~US\$7700/t in FY19E before coming down to ~US\$5500/t in FY20E. This is expected to be driven by new contracts which are expected to be executed with a pass through for needle coke price increases and hence ensures higher & sustainable spreads. We note that earnings remain highly sensitive to volumes and spreads and every US\$100/t additional spreads results in ~2.5% increase in EBITDA/EPs/TP while every 5% increase in volumes lead to ~4% increase in EBITDA/EPs/TP.

Exhibit 2: Spreads and EBITDA/t to reach all time high levels in FY19E



Source: Company, Centrum Research Estimates

Exhibit 3: Earnings sensitivity to volumes & spreads remain high



Source: Centrum Research Estimates

Valuation – Prudent to value on 5 year average earnings, Maintain Hold

We believe that investors need to look beyond FY19E's supernormal profitability and factor in the valuations on more sustainable earnings which would emerge from FY20E/21E. Since GIL's business is highly cyclical in nature and there have been several instances of significant renegotiation in contracts (both up and down), we believe that investors should look at average earnings and cash flows from a valuation perspective. We value GIL on our conservative AOCF/EV yield methodology using five year average adj. cash flows (FY16-20E) to arrive at our revised TP of Rs825. Maintain Hold. Key downside risk is margin pressure due to raw material volatility while upside risk is continuation of high spreads into FY20E/21E as that of FY19E.

Exhibit 4: Cash flow-based valuation

	Avg CF basis (FY16-20E)
5 Year avg. AOCF/EV Yield - % (FY14-18)	11.6
Ascribed AOCF/EV yield - % (50% premium)	5.8
Ascribed EV/AOCF Multiple (x)	17.2
Avg. AOCF (Rs mn) - FY16-20	7,830
EV (Rs mn)	1,35,055
Add: Net Cash (FY20E)	25,948
Fair value mkt cap	1,61,003
No. of shares (mn)	195.4
Fair Value/share (Rs)	825

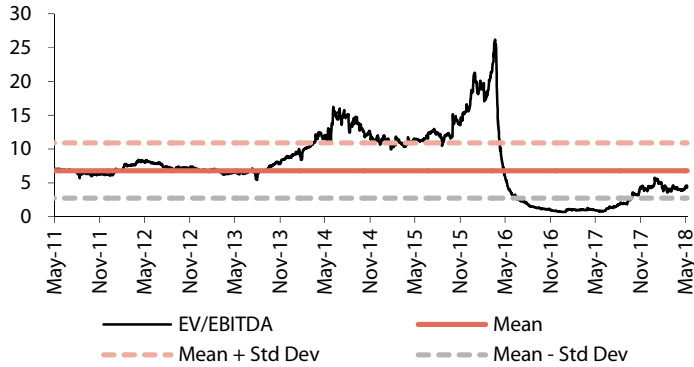
Source: Company, Centrum Research Estimates

Exhibit 5: Sensitivity Analysis (FY19E)

Sensitivity to key variables	% change	% impact on EBITDA	% impact on PAT
Electrode volume	1	0.9	0.9
Electrode Realization	1	2.7	2.5

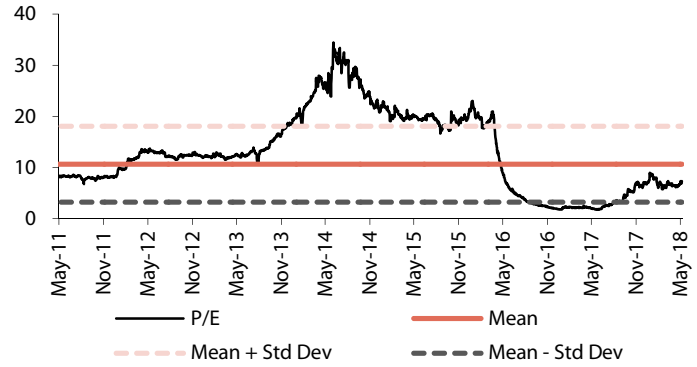
Source: Company, Centrum Research Estimates

Exhibit 6: 1 year forward EV/EBITDA chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 7: 1 year forward P/E chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 8: Valuation– Peer comparison

Company	Mkt. Cap	CAGR FY18-FY20E (%)			EBITDA Margin (%)			P/E (x)			EV/EBITDA (x)			RoE (%)			Div Yield (%)		
		Rev.	EBITDA	PAT	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
Domestic(Rs mn)																			
Graphite India	1,42,605	25.0	13.0	13.6	44.2	46.2	36.1	7.9	6.6	10.7	5.1	4.1	6.3	47.3	66.1	29.5	4.1	3.8	2.3
HEG	1,25,660	37.4	24.6	26.7	54.9	45.9	45.1	6.7	10.9	9.9	4.1	6.9	6.6	62.3	54.7	45.7	3.8	3.1	4.0
Vesuvius India#	26,452	11.3	13.2	18.0	18.2	18.4	18.9	28.1	23.5	20.1	16.0	14.4	10.8	15.2	16.2	16.6	0.5	0.6	0.8
Orient Refractories	18,994	16.3	16.3	18.5	19.8	19.9	19.8	22.6	20.0	16.6	15.4	13.6	11.3	25.7	25.0	25.8	1.6	1.9	2.1
International\$(US\$ mn)																			
Tokai Carbon Co	3,584	40.9	100.2	97.8	17.5	36.4	35.3	18.6	8.7	8.0	12.1		5.1	10.0	28.4	21.9	1.2	1.5	1.9
Showa Denko KK	5,836	12.5	29.4	70.2	14.9	20.2	19.7	14.9	7.4	6.5	7.2	4.6	4.6	10.4	23.1	19.5	2.3	1.6	2.1
Nippon Carbon Co	618	28.3	85.9	52.1	14.8	30.9	31.1	16.0	10.3	9.2	12.9		5.2	11.0			1.2	1.7	1.8

Source: Bloomberg Estimates, Centrum Research Estimates, #FY18=CY17 for Vesuvius India and global cos

Quarterly financials, operating metrics and key performance indicators

Exhibit 9: Quarterly Financials

Particulars (Rs mn)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Net sales	2,752	3,146	3,308	3,734	3,510	4,619	9,331	12,122
Other Operating Income	0	50.6	67.7	0	0	0	0	0
Total Income	2,752	3,196	3,376	3,734	3,510	4,619	9,331	12,122
Accretion to Stocks in trade & work in progress	(73.3)	(4.9)	(79.9)	359.0	(42.3)	(160.3)	33.2	301.2
Cost of Raw Materials consumed	1,302	1,350	1,261	1,260	1,282	1,470	1,787	2,576
Consumption of Stores & Spares	212	300	320	352	344	346	430	486
Power & Fuel	526	599	625	633	709	729	797	758
Staff Cost	351	371	388	411	411	450	446	450
Other Operational expenses	329	440	499	573	451	485	651	748
Operating Profit (Core EBITDA)	105	141	364	147	355	1,299	5,186	6,686
Depreciation	97	97	96	126	120	120	113	111
EBIT	8	44	268	20	235	1,179	5,073	6,575
Interest	14	18	21	11	10	15	17	20
Other Revenue/Income	178	220	129	312	211	192	115	370
Profit Before Tax	172	246	375	321	436	1,356	5,170	6,925
Tax	38	87	142	(144)	142	457	1,765	2,388
Profit After Tax	110	159	234	620	294	899	3,405	4,537
Growth (%)								
Revenue	(13.0)	0.8	(5.0)	9.3	27.6	46.8	182.1	224.7
EBITDA	(68.5)	(69.6)	(14.8)	(54.4)	237.9	822.1	1,326.5	4,463.5
PAT	(32.7)	(42.5)	1.9	233.0	168.0	464.2	1,356.5	632.2
Margin (%)								
EBITDA	3.8	4.4	10.8	3.9	10.1	28.1	55.6	55.2
EBIT	0.3	1.4	7.9	0.5	6.7	25.5	54.4	54.2
PAT	4.0	5.0	6.9	16.6	8.4	19.5	36.5	37.4
Key Drivers								
Average Capacity Utilization (Electrodes - standalone) %	68	75	85	89	95	89	95	100
EBITDA/t (US\$)	116	140	317	123	290	1135	4218	5199

Source: Company, Centrum Research

Exhibit 10: Key Assumptions

	FY16	FY17	FY18	FY19E	FY20E
Electrode Volumes (tonne)					
India Operations	55,600	63,400	75,800	76,000	72,000
Germany Operations	9,264	9,000	8,100	11,700	12,600
Total	64,864	72,400	83,900	87,700	84,600
Electrode Realisations (US\$/t)*	3,052	2,455	5,500	12,000	9,000
Needle Coke (US\$/t)*	900	700	1,000	4,500	3,750
USD/INR	65.5	67.0	64.4	65.0	65.0

Source: Company, Centrum Research Estimates; * Projected for FY16-18 as company doesn't report exact nos

Financials (Cons)

Exhibit 11: Income Statement

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Revenues	15,323	14,678	32,660	68,947	51,045
Materials cost	6,461	5,851	7,719	25,104	20,810
% of revenues	42.2	39.9	23.6	36.4	40.8
Employee cost	2,012	2,225	2,521	3,031	3,216
% of revenues	13.1	15.2	7.7	4.4	6.3
Others	5,504	6,206	7,978	8,945	8,587
% of revenues	35.9	42.3	24.4	13.0	16.8
EBITDA	1,346	396	14,442	31,867	18,432
EBITDA margin (%)	8.8	2.7	44.2	46.2	36.1
Depreciation & Amortisation	492	464	516	592	624
EBIT	854	-68	13,925	31,275	17,808
Interest expenses	95	79	81	89	69
PBT from operations	759	-147	13,845	31,186	17,740
Other income	494	865	885	1,075	2,125
Exceptional items	0	0	0	0	0
PBT	1,254	718	14,730	32,261	19,865
Taxes	426	13	4,410	10,646	6,555
Effective tax rate (%)	33.9	1.8	29.9	33.0	33.0
Reported PAT	828	705	10,320	21,615	13,309
Adjusted PAT	828	705	10,320	21,615	13,309

Source: Company, Centrum Research Estimates

Exhibit 12: Key Ratios

Y/E March	FY16	FY17	FY18P	FY19E	FY20E
Growth Ratio (%)					
Revenue	(10.4)	(4.2)	122.5	111.1	(26.0)
EBITDA	(1.6)	(70.6)	3,551.5	120.7	(42.2)
Adjusted PAT	31.1	(14.9)	1,364.7	109.4	(38.4)
Margin Ratios (%)					
EBITDA	8.8	2.7	44.2	46.2	36.1
PBT from operations	5.0	(1.0)	42.4	45.2	34.8
Adjusted PAT	5.4	4.8	31.6	31.3	26.1
Return Ratios (%)					
ROE	4.6	3.9	47.3	66.1	29.5
ROCE	4.1	3.6	36.2	49.8	25.5
ROIC	3.4	-0.4	53.2	68.5	48.1
Turnover Ratios (days)					
Gross block turnover ratio (x)	1.1	1.0	2.1	4.2	2.9
Debtors	113	110	92	80	80
Inventory	178	150	88	100	100
Creditors	41	54	46	45	45
Cash conversion cycle	250	205	134	135	135
Solvency Ratio (x)					
Net debt-equity	(0.1)	(0.2)	(0.3)	(0.3)	(0.5)
Debt-equity	0.2	0.1	0.1	0.1	0.0
Interest coverage ratio	0.1	(1.2)	0.0	0.0	0.0
Gross debt/EBITDA	2.2	6.6	0.2	0.1	0.1
Current Ratio	2.8	2.9	2.7	2.9	4.4
Per share Ratios (Rs)					
Adjusted EPS	4.2	3.6	52.8	110.6	68.1
BVPS	91.5	95.1	128.1	206.6	254.9
CEPS	6.8	6.0	55.5	113.6	71.3
DPS	3.9	2.0	17.0	27.7	17.0
Dividend payout %	112.4	64.5	37.4	29.1	29.1
Valuation (x)* Avg MCap					
P/E (adjusted)	18.0	22.8	7.9	6.6	10.7
P/BV	0.8	0.9	3.2	3.5	2.9
EV/EBITDA	9.6	29.8	5.1	4.1	6.3
Dividend yield %	5.2	2.4	4.1	3.8	2.3
5 Yr Avg AOCF/EV yield %	14.5	20.7	5.2	3.4	6.7

Source: Company, Centrum Research Estimates

Exhibit 13: Balance Sheet

Y/E March (Rs mn)	FY16	FY17	FY18P	FY19E	FY20E
Equity Share Capital	391	391	391	391	391
Reserves & surplus	17,489	18,185	24,642	39,972	49,411
Shareholders' fund	17,880	18,576	25,032	40,363	49,802
Total Debt	3,023	2,592	2,722	2,222	1,722
Def tax liab. (net)	863	821	945	945	945
Total Liabilities	21,766	21,989	28,699	43,529	52,469
Gross Block	14,165	15,394	16,249	16,924	17,824
Less: Acc. Depreciation	8,253	8,717	9,233	9,825	10,449
Net Block	5,912	6,677	7,016	7,099	7,375
Capital WIP	655	321	81	156	256
Net Fixed Assets	6,567	6,998	7,097	7,255	7,631
Investments	4,751	6,310	9,778	9,778	9,778
Inventories	7,485	6,021	7,864	18,889	13,985
Sundry debtors	4,742	4,415	8,235	15,112	11,188
Cash	211	515	572	3,154	17,892
Loans & Advances	357	116	114	567	420
Other assets	957	1,034	1,858	2,975	2,098
Total Current Asset	13,752	12,101	18,644	40,697	45,582
Trade payables	1,724	2,184	4,119	8,500	6,293
Other current Liab.	1,378	984	2,358	4,723	3,496
Provisions	201	249	340	975	730
Net Current Assets	10,448	8,684	11,826	26,499	35,062
Total Assets	21,766	21,989	28,699	43,529	52,469

Source: Company, Centrum Research Estimates

Exhibit 14: Cash Flow

Y/E March (Rs mn)	FY16	FY17	FY18P	FY19E	FY20E
Operating profit before WC	1,735	407	14,536	31,867	18,432
Changes in working capital	1,626	2,070	(3,057)	(12,091)	6,174
Cash flow from operations	2,846	2,464	7,070	9,130	18,051
Adj. OCF (OCF - Interest)	2,751	2,385	6,989	9,041	17,982
Net Capex	550	895	616	750	1,000
Adj. FCF	2,201	1,490	6,374	8,291	16,982
Cash flow from investments	(871)	(1,184)	(3,198)	325	1,125
Cash flow from financing	(1,911)	(964)	(3,815)	(6,873)	(4,439)
Net change in cash	64	315	57	2,581	14,738

Source: Company, Centrum Research Estimates

Appendix A

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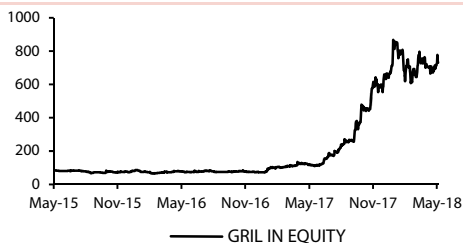
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Graphite India price chart



Source: Bloomberg, Centrum Research

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Sell	Downside > 20%	Downside > 15%	Downside > 10%

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