INDIA

HOLD

Graphite India

CENTRUM

Metals

Result Update 06 August 2018

Riding the golden wave of GE, 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/21E. 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. GIL reported another record earnings performance in Q1 which was well above expectations. We continue to value the stock on our conservative 5 year cash flow methodology to arrive at a revised fair value of Rs1165. Maintain Hold.

- **Capacity utilisation remains high, realisation continues to race ahead:** Capacity utilisation for Q1 stood at 98%/88% at standalone/consolidated level and management guided towards improvement in utilisations at German operations going forward. Realisations jumped to ~US$12800/t at standalone level (vs US$8644/t QoQ) and further improvements in coming quarters could still be expected as pricing in new contracts remain favorable.
- **EBITDA/t expands to another record level:** EBITDA rose 94% QoQ to Rs13bn led by higher realisations & best ever gross profit/t. EBITDA margins stood at a robust 73.2% and EBITDA/t stood at ~US$9900/t (based on production derived from capacity utilisations) led by high gross margins supported by lag impact of needle coke price hikes. GIL reported quarterly consolidated financials for the first time and Cons. EBITDA/t stood at US$9926/t which was best ever.
- **Outlook remains strong, sensitivity to spreads to remain high:** Though we have continued to expect the strongest upcyle of last few decades in store for electrode industry but the intensity of the same has exceeded our expectations till now and we now expect consolidated EBITDA/t of US$8126/$6182 in FY19E/20E for GIL. Despite a large upward revision in our estimates, we continue to build lower EBITDA/t on full year basis v/s the current run-rate. 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 ~Rs38bn 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 ~700% since our IC dated 20 June 2017. 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 Rs1165. 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 - Std (Rs mn)	Q1FY19	Q1FY18	YoY%	Q4FY18	QoQ%	Q1FY19E	Chg %
Net sales	**17,770**	**3,510**	**406.2**	**12,122**	**46.6**	**16,836**	**5.5**
Total RM consumed	2,340	1,240	88.8	2,877	(18.7)	3,570	(34.4)
Employee costs	470	411	14.2	450	4.4	475	(1.1)
Other expenses	680	451	50.8	748	(9.1)	684	(0.6)
EBITDA	**13,000**	**355**	**3560.9**	**6,686**	**94.4**	**10,858**	**19.7**
EBITDA margin (%)	**73.2**	**10.1**		**55.2**		**64.5**	
Depreciation	110	120	(8.6)	111	(1.0)	120	(8.3)
Other income	280	211	32.5	370	(24.4)	300	(6.7)
PBT	**13,160**	**436**	**2914.9**	**6,925**	**90.0**	**11,018**	**19.4**
Tax	4,580	142		2,388	91.8	3,746	22.3
PAT	**8580**	**294**	**2813.4**	**4,537**	**89.1**	**7,272**	**18.0**

Source: Company, Centrum Research

Target Price	Rs1,165
CMP*	Rs1,063
Upside	9.6%
Previous Target	825
Previous Rating	Hold

Key Data	
Bloomberg Code	GRIL IN
Curr Shares O/S (mn)	195.4
Diluted Shares O/S(mn)	195.4
Mkt Cap (Rsbn/USDbn)	207.7/3
52 Wk H / L (Rs)	1094.8/222
5 Year H / L (Rs)	1094.8/57
Daily Vol. (3M NSE Avg.)	1890413

Price Performance (%)*

	1M	6M	1Yr
GRIL IN	12.9	72.0	385.1
NIFTY	5.7	8.5	13.1

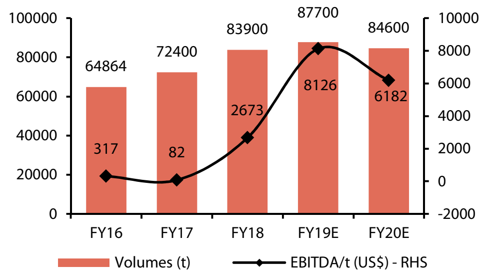
**as on 6 August 2017; Source: Bloomberg, Centrum Research*

Shareholding pattern (%)*

	Jun-18	Mar-18	Dec-17	Sep-17
Promoter	65.2	65.2	65.2	65.2
FIIs	6.0	4.6	5.9	4.7
Dom. Inst.	8.7	8.5	8.8	9.1
Public & Others	20.1	21.7	20.1	20.9

*Source: BSE, *as on 6 August 2017*

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	80,404	68,947	16.6	66,478	51,045	30.2
EBITDA	47,749	31,867	49.8	35,042	18,432	90.1
EBITDA Margin (%)	59.4	46.2		52.7	36.1	
PAT-adj.	31,802	21,615	47.1	24,086	13,309	81.0

Source: Centrum Research Estimates

Centrum vs. Bloomberg Consensus*

Particulars (Rs bn)	FY19E			FY20E		
	Centrum	BBG	Var (%)	Centrum	BBG	Var (%)
Net Sales	80,404	71,403	12.6	66,478	69,833	(4.8)
EBITDA	47,749	37,368	27.8	35,042	34,201	2.5
PAT	31,802	25,692	23.8	24,086	24,060	0.1

Bloomberg Consensus*				Centrum Target Price (Rs)	Variance (%)
BUY	SELL	HOLD	Target Price (Rs)		
5	1	1	1,063	1,165	9.6

**as on 6 August 2018, Source: Bloomberg, Centrum Research Estimates*

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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	45.0	33.5	7.9	4.9
FY19E	80,404	146.2	47,749	59.4	31,802	208.2	162.8	82.4	60.1	6.5	4.0
FY20E	66,478	(17.3)	35,042	52.7	24,086	(24.3)	126.4	41.2	75.6	8.6	4.8

Source: Company, Centrum Research Estimates

In the interest of timeliness, this document is not edited

Earnings revised higher to factor in higher spreads

We revise our earnings estimates higher significantly as we factor in higher realisations in line with the current trend and build in higher spreads as continuation of favorable demand-supply dynamics and sustenance of global steel prices have led to sustenance of higher realisations and spreads in the GE business. 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 upcyle of last few decades in store for electrode industry and expect consolidated EBITDA/t of GIL to expand materially to US$8126/$6182 in FY19E/20E. We expect EBITDA of Rs47.7bn/Rs35bn and PAT of Rs31.8bn/Rs24.1bn in FY19E/20E.

Exhibit 1: Earnings Revision

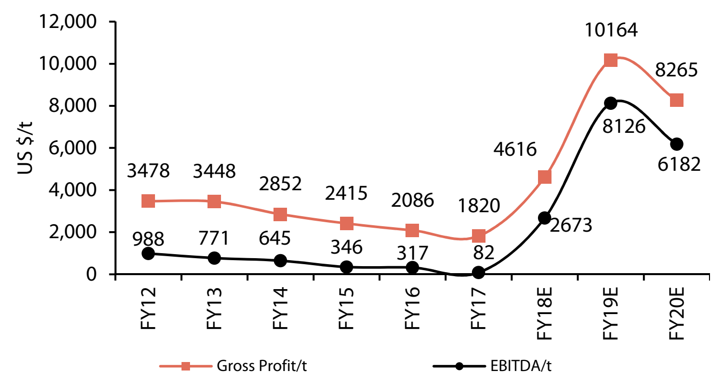
	FY19E			FY20E		
	Revised	**Previous**	***% Chg***	**Revised**	**Previous**	***% Chg***
Net Sales (Rsmn)	80,404	68,947	*16.6*	66,478	51,045	*30.2*
EBITDA (Rsmn)	47,749	31,867	*49.8*	35,042	18,432	*90.1*
EBITDA %	*59.4*	*46.2*		*52.7*	*36.1*	
PAT (Rsmn)	31,802	21,615	*47.1*	24,086	13,309	*81.0*

Source: Company, Centrum Research Estimates

Sharp improvement in spreads, earnings remain highly sensitive to spreads

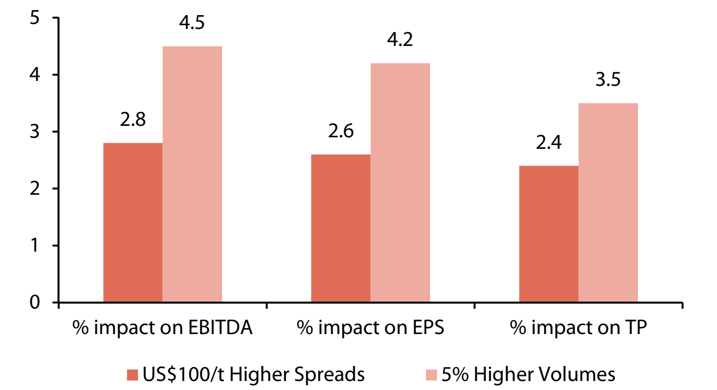
We expect sharp improvements in spreads to ~US$10100/t in FY19E before coming down to ~US$8300/t in FY20E. This is expected to be driven by current attractive price contracts which are executed with a pass through for needle coke price increases and hence ensures higher & sustainable spreads. However, the pricing contracts have become more short term in nature (quarterly negotiation etc) and hence could see volatility going forward. 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 Rs1165. 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)	11.7
Ascribed AOCF/EV yield - % (50% premium)	5.9
Ascribed EV/AOCF Multiple (x)	17.1
Avg. AOCF (Rs mn) - FY16-20	11,103
EV (Rs mn)	1,89,591
Add: Net Cash (FY20E)	37,838
Fair value mkt cap	2,27,430
No. of shares (mn)	195.4
Fair Value/share (Rs)	**1165**

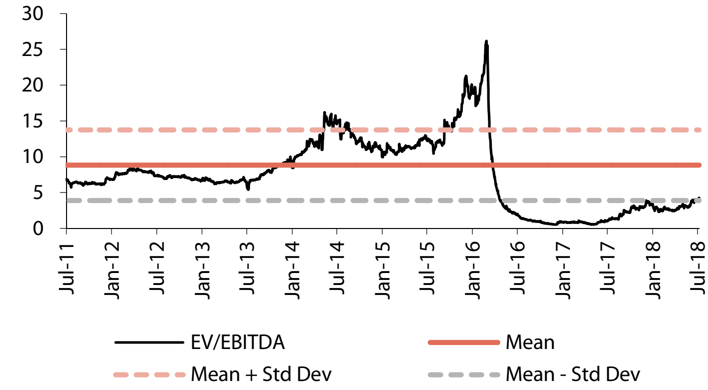
Source: Company, Centrum Research Estimates

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*

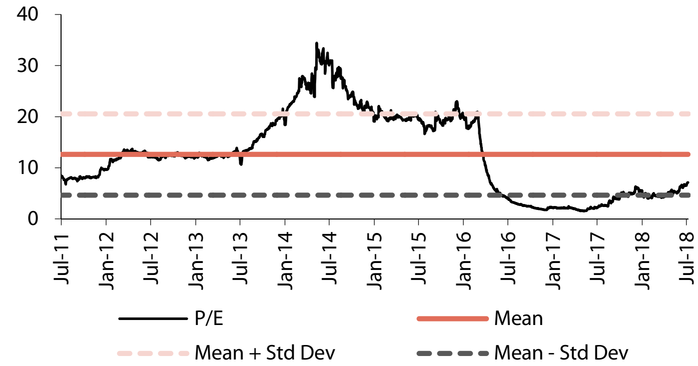
Source: Company, Centrum Research Estimates

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	**2,07,538**	***42.7***	***55.8***	***52.8***	***44.2***	***59.4***	***52.7***	**7.9**	**6.5**	**8.6**	**4.9**	**4.0**	**4.8**	***45.0***	***82.4***	***41.2***	***4.1***	***3.8***	***2.9***
HEG	1,67,411	*61.6*	*61.6*	*67.8*	*54.9*	*58.1*	*55.0*	6.7	7.2	7.5	4.1	4.7	5.1	*62.3*	*79.9*	*49.8*	*3.8*	*4.1*	*3.7*
Vesuvius India#	26,180	*13.1*	*15.8*	*18.1*	*18.2*	*18.6*	*19.1*	26.1	23.2	19.1	13.5	11.9	9.5	*16.6*	*16.3*	*17.0*	*0.5*	*0.6*	*0.8*
Orient Refractories	28,539	*15.6*	*13.5*	*15.0*	*20.3*	*19.4*	*19.5*	21.3	28.7	25.0	13.5	19.0	16.1	*28.7*	*28*	*27.3*	*1.6*	*1.2*	*1.4*
International#(US$ mn)																			
Tokai Carbon Co	4,368	*63.3*	*130.5*	*120.7*	*17.5*	*38.5*	*34.9*	18.6	7.6	8.0	12.1		4.8	*10.0*	*40.4*	*28.6*	*1.2*	*1.3*	*1.9*
Showa Denko KK	7,134	*15.7*	*40.9*	*89.7*	*14.9*	*21.4*	*22.1*	14.9	7.5	6.5	7.2	4.9	4.6	*10.4*	*28.3*	*25.0*	*2.3*	*1.8*	*2.1*
Nippon Carbon Co	690	*34.6*	*101.5*	*86.1*	*14.8*	*33.2*	*33.1*	16.0	8.4	7.0	12.9		5.0	*11.0*			*1.2*	*1.5*	*1.5*

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 (standalone)

Particulars (Rs mn)	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19
Net sales	**3,146**	**3,308**	**3,734**	**3,510**	**4,619**	**9,331**	**12,122**	**17,770**
Other Operating Income	50.6	67.7	0	0	0	0	0	0
Total Income	**3,196**	**3,376**	**3,734**	**3,510**	**4,619**	**9,331**	**12,122**	**17,770**
Accretion to Stocks in trade & work in progress	(4.9)	(79.9)	359.0	(42.3)	(160.3)	33.2	301.2	(1,350.0)
Cost of Raw Materials consumed	1,350	1,261	1,260	1,282	1,470	1,787	2,576	3,690
Consumption of Stores & Spares	300	320	352	344	346	430	486	480
Power & Fuel	599	625	633	709	729	797	758	800
Staff Cost	371	388	411	411	450	446	450	470
Other Operational expenses	440	499	573	451	485	651	748	680
Operating Profit (Core EBITDA)	**141**	**364**	**147**	**355**	**1,299**	**5,186**	**6,686**	**13,000**
Depreciation	97	96	126	120	120	113	111	110
EBIT	**44**	**268**	**20**	**235**	**1,179**	**5,073**	**6,575**	**12,890**
Interest	18	21	11	10	15	17	20	10
Other Revenue/Income	220	129	312	211	192	115	370	280
Profit Before Tax	**246**	**375**	**321**	**436**	**1,356**	**5,170**	**6,925**	**13,160**
Tax	87	142	(144)	142	457	1,765	2,388	4,580
Profit After Tax	**159**	**234**	**620**	**294**	**899**	**3,405**	**4,537**	**8,580**
Growth (%)								
Revenue	*0.8*	*(5.0)*	*9.3*	*27.6*	*46.8*	*182.1*	*224.7*	*284.7*
EBITDA	*(69.6)*	*(14.8)*	*(54.4)*	*237.9*	*822.1*	*1,326.5*	*4,463.5*	*900.6*
PAT	*(42.5)*	*1.9*	*233.0*	*168.0*	*464.2*	*1,356.5*	*632.2*	*854.1*
Margin (%)								
EBITDA	*4.4*	*10.8*	*3.9*	*10.1*	*28.1*	*55.6*	*55.2*	*73.2*
EBIT	*1.4*	*7.9*	*0.5*	*6.7*	*25.5*	*54.4*	*54.2*	*72.5*
PAT	*5.0*	*6.9*	*16.6*	*8.4*	*19.5*	*36.5*	*37.4*	*48.3*
Key Drivers								
Average Capacity Utilization (Electrodes - standalone) %	*75%*	*85%*	*89%*	*95%*	*89%*	*95%*	*100%*	*98%*
EBITDA/t (US$)	140	317	123	290	1135	4218	5199	9885

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$/t)*	3,052	2,455	5,500	13,000	11,000
Needle Coke (US$/t)*	900	700	1,000	3,500	3,400
USD/INR	65.5	67.0	64.4	67.0	67.0

*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**	**80,404**	**66,478**
Materials cost	6,461	5,851	7,719	20,678	19,633
% of revenues	*42.2*	*39.9*	*23.6*	*25.7*	*29.5*
Employee cost	2,012	2,225	2,521	3,031	3,216
% of revenues	*13.1*	*15.2*	*7.7*	*3.8*	*4.8*
Others	5,504	6,206	7,978	8,945	8,587
% of revenues	*35.9*	*42.3*	*24.4*	*11.1*	*12.9*
EBITDA	**1,346**	**396**	**14,442**	**47,749**	**35,042**
EBITDA margin (%)	*8.8*	*2.7*	*44.2*	*59.4*	*52.7*
Depreciation & Amortisation	492	464	516	550	604
EBIT	**854**	**(68)**	**13,925**	**47,199**	**34,438**
Interest expenses	95	79	81	89	69
PBT from operations	**759**	**(147)**	**13,845**	**47,110**	**34,369**
Other income	494	865	885	1,075	2,125
Exceptional items	0	0	0	0	0
PBT	**1,254**	**718**	**14,730**	**48,185**	**36,494**
Taxes	426	13	4,410	16,383	12,408
Effective tax rate (%)	*33.9*	*1.8*	*29.9*	*34.0*	*34.0*
Reported PAT	**828**	**705**	**10,320**	**31,802**	**24,086**
Adjusted PAT	**828**	**705**	**10,320**	**31,802**	**24,086**

Source: Company, Centrum Research Estimates

Exhibit 12: Key Ratios

Y/E March	FY16	FY17	FY18	FY19E	FY20E
Growth Ratio (%)					
Revenue	*(10.4)*	*(4.2)*	*122.5*	*146.2*	*(17.3)*
EBITDA	*(1.6)*	*(70.6)*	*3,551.5*	*230.6*	*(26.6)*
Adjusted PAT	*31.1*	*(14.9)*	*1,364.7*	*208.2*	*(24.3)*
Margin Ratios (%)					
EBITDA	*8.8*	*2.7*	*44.2*	*59.4*	*52.7*
PBT from operations	*5.0*	*(1.0)*	*42.4*	*58.6*	*51.7*
Adjusted PAT	*5.4*	*4.8*	*31.6*	*39.6*	*36.2*
Return Ratios (%)					
ROE	4.6	3.9	45.0	82.4	41.2
ROCE	*4.1*	*3.6*	*33.5*	*60.1*	*34.7*
ROIC	*3.4*	*-0.4*	*53.2*	*90.3*	*75.6*
Turnover Ratios (days)					
Gross block turnover ratio (x)	1.1	1.3	4.1	9.1	6.9
Debtors	113	110	92	80	80
Inventory	178	150	88	100	100
Creditors	41	54	46	45	45
Cash conversion cycle	250	206	134	135	135
Solvency Ratio (x)					
Net debt-equity	(0.1)	(0.2)	(0.4)	(0.3)	(0.6)
Debt-equity	0.2	0.1	0.1	0.0	0.0
Interest coverage ratio	0.1	(1.2)	0.0	0.0	0.0
Gross debt/EBITDA	2.2	6.6	0.2	0.0	0.0
Current Ratio	2.8	2.9	3.0	3.2	4.8
Per share Ratios (Rs)					
Adjusted EPS	4.2	3.6	52.8	162.8	123.3
BVPS	91.5	95.1	139.8	255.2	342.7
CEPS	6.8	6.0	55.5	165.6	126.4
DPS	2.0	2.0	17.0	40.7	30.8
Dividend payout %	*47.2*	*55.5*	*32.2*	*25.0*	*25.0*
Valuation (x)* Avg MCap					
P/E (adjusted)	18.0	22.8	7.9	6.5	8.6
P/BV	0.8	0.9	3.0	4.2	3.1
EV/EBITDA	9.6	29.8	4.9	4.0	4.8
Dividend yield %	*2.6*	*2.4*	*4.1*	*3.8*	*2.9*
5 Yr Avg AOCF/EV yield %	*14.5*	*21.0*	*5.6*	*3.1*	*6.5*

Source: Company, Centrum Research Estimates

Exhibit 13: Balance Sheet

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Equity Share Capital	391	391	391	391	391
Reserves & surplus	17,489	18,185	26,927	49,483	66,566
Shareholders' fund	17,880	18,576	27,318	49,874	66,957
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**	**30,985**	**53,041**	**69,624**
Gross Block	14,165	7,624	8,493	9,168	10,068
Less: Acc. Depreciation	8,253	950	1,478	2,028	2,632
Net Block	5,912	6,674	7,016	7,141	7,437
Capital WIP	655	321	81	156	256
Net Fixed Assets	6,567	6,995	7,097	7,297	7,693
Investments	4,751	6,310	12,078	12,078	12,078
Inventories	7,485	6,021	7,864	22,028	18,213
Sundry debtors	4,742	4,415	8,235	17,623	14,571
Cash	211	515	556	6,460	27,482
Loans & Advances	357	116	114	661	546
Other assets	957	1,232	1,858	3,446	2,732
Total Current Asset	13,752	12,299	18,628	50,218	63,544
Trade payables	1,724	2,166	4,119	9,913	8,196
Other current Liab.	1,378	1,078	2,359	5,507	4,554
Provisions	201	370	340	1,132	941
Net Current Assets	10,448	8,684	11,810	33,666	49,853
Total Assets	**21,766**	**21,989**	**30,985**	**53,041**	**69,624**

Source: Company, Centrum Research Estimates

Exhibit 14: Cash Flow

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Operating profit before WC	1,735	731	14,661	47,749	35,042
Changes in working capital	1,626	2,296	(2,658)	(15,952)	4,835
Cash flow from operations	**2,846**	**2,602**	**7,596**	**15,415**	**27,469**
Adj. OCF (OCF - Interest)	2,751	2,523	7,515	15,326	27,400
Net Capex	550	864	574	750	1,000
Adj. FCF	2,201	1,659	6,941	14,576	26,400
Cash flow from investments	**(871)**	**(2,255)**	**(5,541)**	**325**	**1,125**
Cash flow from financing	**(1,911)**	**(392)**	**(1,789)**	**(9,835)**	**(7,572)**
Net change in cash	**64**	**(44)**	**266**	**5,904**	**21,022**

Source: Company, Centrum Research Estimates

Appendix A

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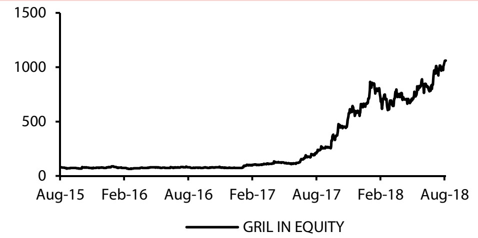

Source: Bloomberg, Centrum Research

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