January 17, 2019

Rating matrix

Rating	:	Buy
Target	:	₹ 250
Target Period	:	12-18 months
Potential Upside	:	20%

What's changed?

Target	Changed from ₹ 360 to ₹ 250
EPS FY19E	Changed from ₹ 18.0 to ₹ 24.5
EPS FY20E	Changed from ₹ 21.2 to ₹ 25.0
Rating	Unchanged

Key financials

₹ crore	FY17	FY18	FY19E	FY20E
Net Sales	1927.0	2546.9	3435.3	3258.7
EBITDA	258.6	386.0	684.7	710.4
Net Profit	69.5	229.8	423.0	430.8
EPS	4.0	13.3	24.5	25.0

Valuation summary

	FY17	FY18	FY19E	FY20E
P/E	51.6	15.6	8.5	8.3
Target P/E	62.0	18.8	10.2	10.0
EV / EBITDA	16.3	10.8	6.1	5.9
P/BV	3.2	2.6	2.1	1.8
RoNW	6.2	16.7	24.7	21.1
RoCE	10.5	15.6	24.9	22.5
ROIC	10.3	15.1	24.8	23.0

Stock data

Stock Data	₹ crore
Market Capitalization	3584
Total Debt (FY18)	721
Cash and Cash Equivalent (FY18)	139
Enterprise Value	4166
52 week H/L (₹)	287 / 157
Equity Capital	34.5
Face Value	₹ 2
MF Holding (%)	2.8
FII Holding (%)	11.0

Stock data

	1M	3M	6M	12M
Phillips Carbon Black	-0.6	-6.2	-8.1	-29.0
Oriental Carbon (OCCL)	-0.4	16.7	17.5	-14.1

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Phillips Carbon Black (PHICAR) ₹ 208

Steady business model; in consolidation mode

- Phillips Carbon Black (PCBL) reported a steady Q3FY19 performance
- Net sales in Q3FY19 were at ₹ 945.9 crore, up 54% YoY, primarily led by realisations that came in at ₹ 90/kg vs. ₹ 59/kg in base quarter (Q3FY18). Realisations were driven by an increase in crude price and consequent CBFS price amid rupee depreciation on a YoY basis
- Sales volume of carbon black in Q3FY19 were at 102 KT, up 1% YoY
- EBITDA in Q3FY19 was at ₹ 178.8 crore with corresponding EBITDA margins at 18.9%. EBITDA/tonne in Q3FY19 was at ₹ 17,543/tonne
- The management commentary indicated softness in demand and consequent carbon black prices in the international spot markets that will limit the exponential growth witnessed by PCBL in the past. With some delay in commissioning of new capacities, we expect earnings to consolidate post its re-basing in FY19E

Volume growth to rebound in FY20E, post muted growth in FY19E

Carbon black is essentially a chemical compound used to manufacture tyres and comprises ~26% of tyre by volume. PCBL is the largest carbon black manufacturer domestically with market share at ~35%. It has successfully commissioned incremental capacity to the tune of 90,000 tonnes in recent past on a base of 411,000 tonnes as of FY17. Over and above this, PCBL is well poised to commission another 20,000 tonne of speciality grade carbon black line in FY20E thereby taking its total installed capacity to 521,000 tonnes. However, it could not ramp up its existing capacities due to wear & tear as well as shutdowns thereby impacting its volumes in FY19E. Going forward, with no major capacity addition by other CB players domestically & globally, we expect incremental capacity to be well absorbed in FY20E leading to rebound in volume growth. We expect CB volumes of 440,000 in FY20E, up 7% YoY.

Speciality carbon black, niche segment, increasing share-margin accretive

Speciality grade carbon black (SGCB) is a refined carbon black compound with application in paints, plastics, inks, etc, and is a value added product being sold at ~1.5x normal rubber grade carbon black (realisation) but fetches ~4-5x EBITDA/tonne vs. the usual rubber grade carbon black. Incrementally, PCBL is focussing more in this domain with capacity addition skewed in favour of SGCB out of the total expansion of 110,000 tonnes. Going forward, we expect the overall share of SGCB to increase from ~4% in FY18 to ~7% in FY20E. This will aid an improvement in EBITDA margins & structural uptick in earnings, going forward.

On high base in FY19E, earnings to consolidate in FY20E, retain BUY

Global demand/supply situation is balanced, favouring CB players with no meaningful capacity addition in sight. Commentary of all major CB players indicate the good times will sustain for a longer time with Chinese players losing their competitive advantage. Going forward, we expect PCBL to report 4.7% CAGR in sales volume with consequent sales & PAT expected to grow at a CAGR of 13.1% & 36.9%, respectively, in FY18-20E. EBITDA/tonne is expected to improve to ₹ 16,665/tonne in FY19E and then consolidate to ₹ 16,136 tonne in FY20E vs. ₹ 9,615/tonne in FY18. EBITDA/tonne numbers in FY20E incorporate softness in spot market prices amid increasing share of SGCB in the sales pie. We value PCBL at ₹ 250 i.e. 10x P/E on FY20E EPS of ₹ 25/share. We derive comfort from healthy cash flow generation with CFO yield at 10%, robust return ratios (RoCE>20%) & sound management practices thereby de-risking the business model from fluctuations of commodity and currency.

Company Analysis

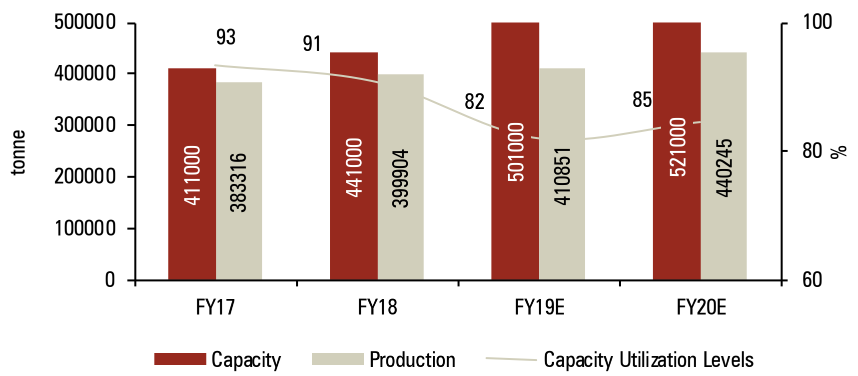
Phillips Carbon Black (PCBL) is an RP Sanjiv Goenka group (CESC promoter group) company manufacturing carbon black domestically. PCBL was incorporated in 1960 in collaboration with Phillips Petroleum Company, US. In 1988, PCBL entered into a technical collaboration with Columbian Chemicals Company, US. PCBL's first plant for manufacturing carbon black was set up in Durgapur (West Bengal) with an installed capacity of 14 KT. It commenced production in 1962. As of FY16, PCB has four plants across India manufacturing carbon black with an associated waster heat recovery power plants; Durgapur, WB (147 KT, 30 MW); Mundra, Gujarat (140 KT, 30 MW); Palej, Gujarat (95 KT, 12 MW); Kochi, Kerela (90 KT, 10 MW). Producing power from waste gases makes PCBL a carbon neutral company.

Carbon black – increasing capacity to aid volume growth!!

PCBL has an effective installed capacity of 411 kilo tonne (KT) for carbon black (name plate capacity at 472 KT) as of FY17. On this, it clocked sales volume of ~401 KT in FY18, implying capacity utilisation in excess of 95%. With the de-bottlenecking exercise (30,000 tonne) complete at the end of FY18, its effective capacity has increased to 441 KT as of FY18 end. PCBL is further augmenting its capacity by 80 KT through the brownfield route, which will take its total capacity of 521 KT by end of FY20E. This is likely to lead volume growth to rebound with CB sales volume CAGR at 4.7% in FY18-20E.

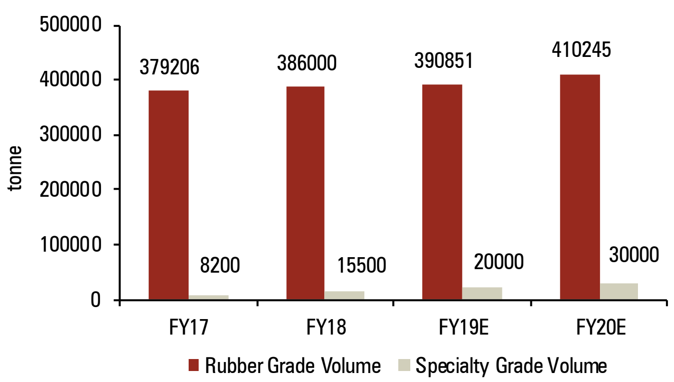
PCBL also sells high margin speciality grade carbon black, which finds application in plastics, inks, etc. Its volume in FY18 was at ~16 KT (8.2 KT in FY17). Going forward, with increased capacity addition in the speciality grade carbon black domain we expect speciality grade carbon black sales volume at ~ 20 KT in FY19E & ~ 30 KT in FY20E

Exhibit 1: Capacity, production & capacity utilisation levels



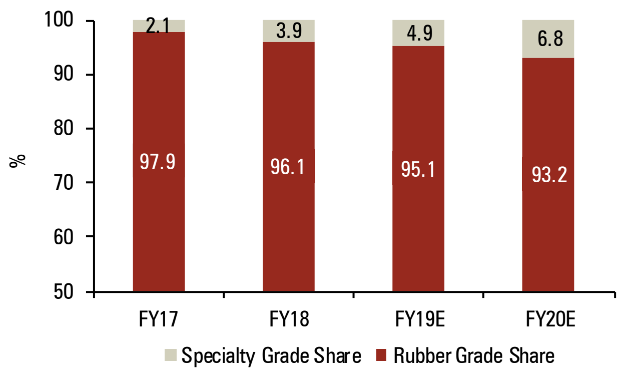
Source: Company, ICICI Direct Research

Exhibit 2: Rubber grade and speciality grade CB Volumes



Source: Company, ICICI Direct Research

Exhibit 3: Rubber grade to speciality grade CB sales mix



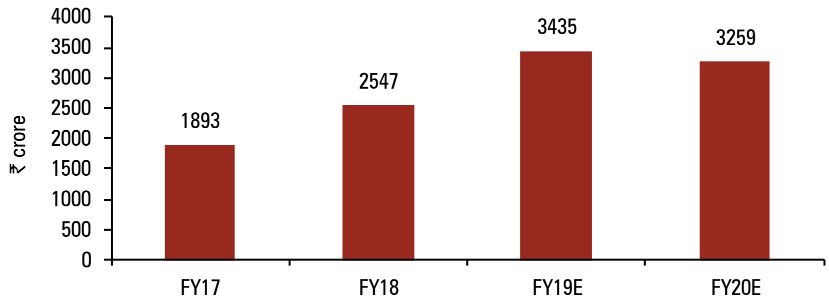
Source: Company, ICICI Direct Research

Net sales to grow at CAGR of 13.1% in FY18-20E

We expect sales to grow at a CAGR of 13.1% in FY18-20E largely tracking 4.7% CAGR in volumes and 8.0% CAGR improvement in realisations. A drop in net sales in FY20E is not a cause for concern as it tracks correction in crude price amid a rebound in volumes.

We expect PCBL to record net sales of ₹ 3435 crore in FY19E & ₹ 3259 crore in FY20E

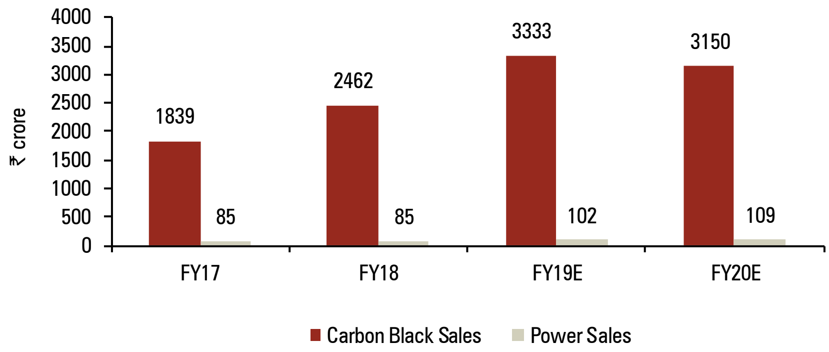
Exhibit 4: Net sales trend



Source: Company, ICICI Direct Research

PCBL generates power out of the waste gases generated during the manufacturing of carbon black. On an average, it generates ~1100 units of electricity per tonne of carbon black produced. Its captive consumption is ~350 units with the rest ~750 units being sold to the external grid. This surplus power sales contributed a steady ~3% of total sales and drives operational efficiencies at PCBL

Exhibit 5: Sales break-up



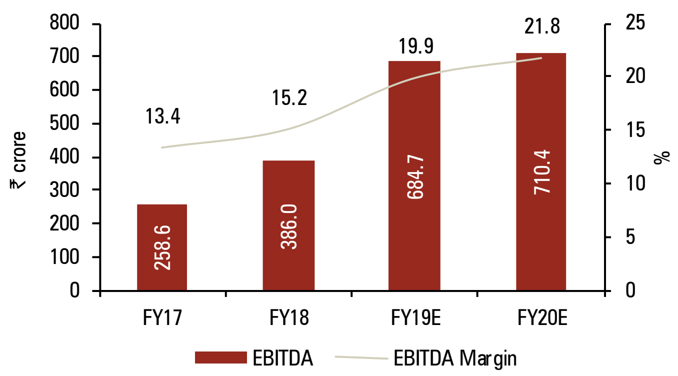
Source: Company, ICICI Direct Research

Margin expansion to drive EBITDA & PAT, going forward

Operating leverage benefits on account of brownfield nature of expansion and increasing share of speciality grade CB is expected to lead to EBITDA margin expansion over FY18-20E. We expect PCBL to clock EBITDA margins of 21.8% in FY20E vs. 15.2% in FY18.

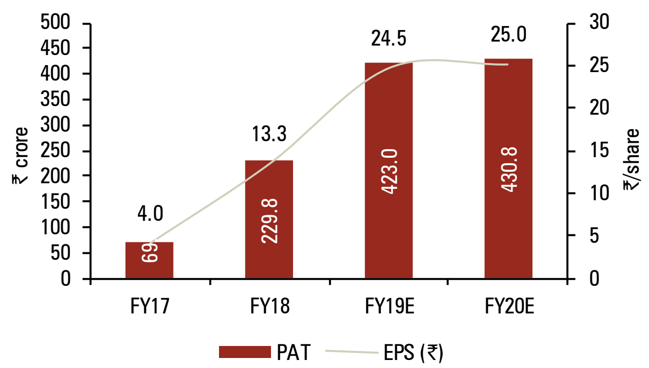
EBITDA/tonne (including hedging costs) is expected at ₹ 16,665/tonne in FY19E & ₹ 16,136 in FY20E (₹ 9615/tonne in FY18)

Exhibit 6: EBITDA & EBITDA margins trend



Source: Company, ICICI Direct Research

Exhibit 7: PAT & EPS trend



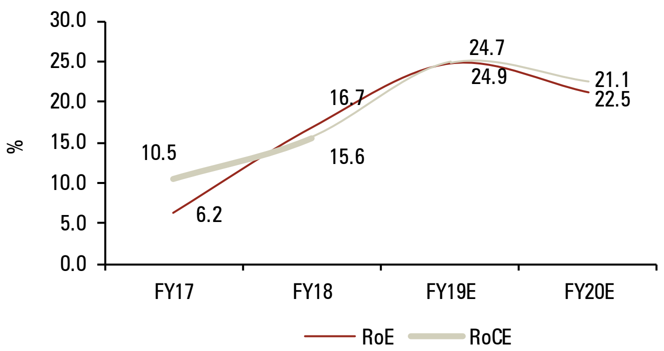
Source: Company, ICICI Direct Research

The re-basing of earnings is being witnessed in FY19E. We expect earnings to consolidate over this high base In FY18-20E, on account of sales volume growth and expansion in EBITDA margins, we expect PCBL to stage an impressive PAT CAGR of 36.9% in FY18-20E. We expect PCBL to report PAT of ₹ 423 crore in FY19E & ₹ 431 crore in FY20E vs. ₹ 230 crore in FY18.

Increasing profitability to result in improved return ratio profile

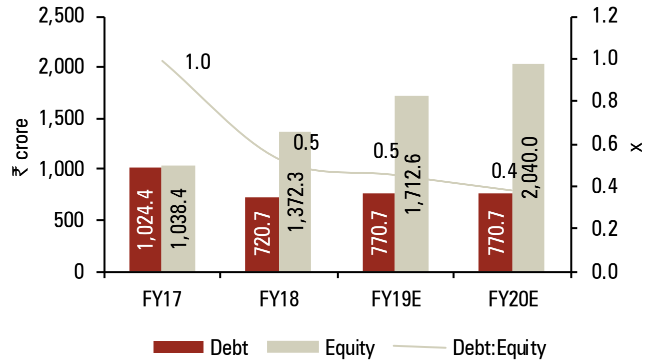
Return ratios were subdued in the past due to subdued profitability. However, with the robust performance, the same has improved with RoE & RoCE expected at ~20% over FY18-20E.

Exhibit 8: Return ratios profile



Source: Company, ICICI Direct Research

Exhibit 9: Debt: Equity trend



Source: Company, ICICI Direct Research

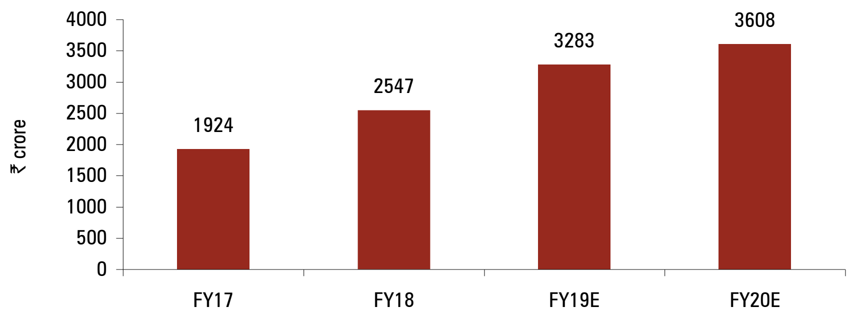
Absolute debt to remain, debt gearing set to improve!!

By virtue of declining profitability and an elongated working capital cycle PCBL has accumulated huge debt with peak debt at ₹ 1220 crore as of FY15. However, with enhanced profitability and working capital controls the debt has been reduced to ₹ 721 crore as of FY18 end. Going forward, however, with impressive brownfield expansion underway and greenfield expansion on the anvil, we expect absolute debt to slightly increase over FY18-20E. However, debt gearing is expected to decline with consequent debt: equity at 0.4x in FY20E vs. 0.5x as of FY18.

Greenfield expansion

At one of its board meetings, PCBL has also approved a greenfield expansion to the tune of ~₹ 500 crore with incremental capacity of ~120 KT (effective capacity, rated capacity at 150 KT). However, the company has still not finalised the plant location consequent to which we do not expect any volume from the said project in FY20E with likely commissioning only in FY21E end.

Exhibit 10: Capacity addition trend



Source: Company, ICICI Direct Research

Outlook and valuation

Carbon black is essentially a chemical compound used to manufacture tyres and comprises ~26% of tyre by volume. PCBL is the largest carbon black manufacturer domestically, with market share at ~35%. The company has successfully commissioned incremental capacity to the tune of 90,000 tonnes in the recent past on a base of 411,000 tonnes as of FY17. Over and above this, PCBL is well poised to commission another 20,000 tonne of speciality grade carbon black line in FY20E thereby taking its total installed capacity to 521,000 tonnes. It, however, could not ramp up its existing capacities due to wear & tear as well as shutdowns thereby impacting its volumes in FY19E. Going forward, with no major capacity addition by other CB players domestically & globally, we expect the incremental capacities to be well absorbed in FY20E leading to a rebound in volume growth. We expect CB volumes of 440,000 in FY20E, up 7% YoY.

The global demand/supply situation is balanced, favouring CB players with no meaningful capacity addition in sight. Commentary of all major CB players indicates the good times are expected to sustain for a longer time with Chinese players losing their competitive advantage. Going forward, we expect PCBL to report 4.7% CAGR in sales volume with consequent sales & PAT expected to grow at a CAGR of 13.1% & 36.9%, respectively, in FY18-20E. EBITDA/tonne is expected to improve to ₹ 16,665/tonne in FY19E and then consolidate to ₹ 16,136 tonne in FY20E vs. ₹ 9,615/tonne in FY18. EBITDA/tonne numbers in FY20E incorporate softness in spot market prices amid increasing share of SGCB in the sales pie. We value PCBL at ₹ 250 i.e. 10x P/E on FY20E EPS of ₹ 25/share. We derive comfort from healthy cash flow generation with CFO yield at 10%, robust return ratios (RoCE>20%) & sound management practices thereby de-risking the business model from fluctuations of commodity and currency.

Exhibit 11: What's changed?

Particulars	FY19E			FY20E		
	Old	New	% Change	Old	New	% Change
Revenue	3,283.1	3435.3	4.6	3,607.6	3258.7	(9.7)
EBITDA	510.9	684.7	34.0	587.3	710.4	21.0
EBITDA Margin %	15.6	19.9	437 bps	16.3	21.8	552 bps
PAT	309.5	423.0	36.7	364.7	430.8	18.1
EPS	18.0	24.5	36.7	21.2	25.0	18.1

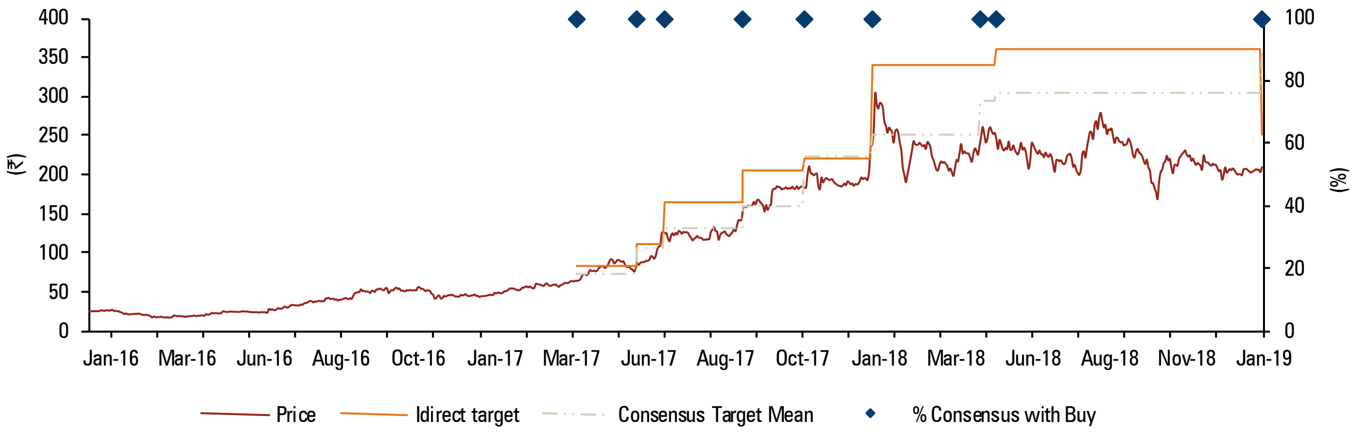
Source: Company, ICICI Direct Research

Exhibit 12: Valuation Summary

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY17	1924.1	1.7	4.0	205.7	51.6	16.3	6.2	10.5
FY18	2546.9	32.4	13.3	230.6	15.6	10.8	16.7	15.6
FY19E	3435.3	34.9	24.5	84.1	8.5	6.1	24.7	24.9
FY20E	3258.7	-5.1	25.0	1.8	8.3	5.9	21.1	22.5

Source: Company, ICICI Direct Research

Recommendation history vs. consensus estimate



*Source: Bloomberg, Company, ICICI Direct Research; *I-direct coverage on Phillips Carbon Black was initiated on July 2016*

Key events

Date/Year	Event
2003	PCBL increases its carbon black capacity in Durgapur to 1,35,000 metric tonne (MT) taking total Carbon Black Capacity to 2,00,000 MT
2007	The company enters into a MOU for a carbon black plant in Vietnam
2009	PCBL commences production of carbon black from the greenfield capacity at Mundra with capacity of 90,000 MT (Total Carbon Black Capacity: 3,60,000 MT). PCBL witnesses difficult market conditions with PCBL reporting loss at the PAT level in FY09
2010	PCBL completes 50 years in operation. Golden jubilee year
2012	PCBL further augments its carbon black capacity at Mundra & Durgapur. Commences 50,000 MT carbon black plant at Mundra (Total Carbon Black Capacity: 4,10,000 MT); Commences 8 MW co-generation power plant at Mundra, Gujarat (Total Power Capacity: 76 MW). Commences 12,000 MT carbon black plant at Durgapur (Total Carbon Black Capacity: 4,22,000 MT)
2014	PCBL commences 50,000 MT carbon black plant at Kochi (Total Carbon Black Capacity: 4,72,000 MT)
2015	PCBL records highest lifetime turnover of ₹ 2470 crore in FY15. Consequent EBITDA & PAT stood at ₹ 152 crore and ₹ 13 crore respectively.
2016	As of FY16, PCBL has four plants across India manufacturing carbon black with associated waster heat recovery power plants; Durgapur, West Bengal (147 KT, 30 MW); Mundra, Gujarat (140 KT, 30 MW); Palej, Gujarat (95 KT, 12 MW); Kochi, Kerela (90 KT, 10 MW). It is currently headed by Sanjiv Goenka (Chairman), CEO – Kaushik Roy and CFO – Raj Kumar Gupta. In FY16, PCB distributed dividend of ₹ 2.5/share (EPS - ₹ 6.6/share)
2017	PCBL successfully turns around its operations with operational efficiencies and economies of scale resulting in ~400 bps improvement in EBITDA margins to 13.0% in FY17E vs. 8.7% in FY16. PCBL has recently concluded an interim dividend of ₹ 6/share
2018	PCBL has successfully commissioned 30,000 incremental capacity as part of its de-bottlenecking exercise and is well poised for another 80,000 capacity addition as part of its brownfield expansion. Board of PCBL has also approved a greenfield project amounting to ~₹ 500 crore , involving a capacity expansion of 120 KT (effective capacity) with likely commissioning by FY21E

Source: Company, ICICI Direct Research

Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Position Change (m)
1	RPG Ventures	30-Sep-18	50.2	86.5	0.0
2	Fidelity International	31-Oct-18	3.7	6.4	1.8
3	Dotex Merchandise Pvt. Ltd.	30-Sep-18	3.1	5.3	0.0
4	Fidelity International Asset Management Cor	30-Sep-18	2.0	3.4	0.0
5	FIL Investment Management (Singapore) Ltd	31-Mar-18	2.0	3.4	-1.2
6	Wellington Management Company, LLP	30-Sep-18	1.9	3.2	-0.3
7	Kerala State Industrial Development Co., Ltd.	30-Sep-18	1.4	2.3	0.0
8	Principal Asset Management Private Limited	30-Sep-18	1.2	2.1	0.0
9	L&T Investment Management Limited	30-Sep-18	1.1	1.9	0.0
10	Dimensional Fund Advisors, L.P.	30-Nov-18	0.9	1.5	0.0

Source: Reuters, ICICI Direct Research

Shareholding Pattern

(in %)	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
Promoter	53.6	53.6	53.6	53.6	53.6
FII	11.5	14.1	11.0	10.8	11.0
DII	1.7	3.1	3.1	3.4	2.8
Others	33.3	29.2	32.4	32.3	32.6

Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
Fidelity International	+5.6M	+1.8M	Fiera Capital Corporation	-2.0M	-0.6M
Lazard Asset Management, L.L.C.	+2.0M	+0.6M	Wellington Management Company, LLP	-0.9M	-0.3M
Credit Suisse Asset Management	+0.4M	+0.1M	APG Asset Management	-0.6M	-0.2M
Candriam Belgium S.A.	+0.2M	+0.1M	Royce & Associates, LP	-0.1M	-0.0M
Nuveen LLC	+0.1M	+0.0M	Dimensional Fund Advisors, L.P.	-0.1	0.0

Source: Reuters, ICICI Direct Research

Financial summary (Standalone)

Profit and loss statement				₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E
Net Sales	1924.1	2546.9	3435.3	3258.7
Other Operating Income	2.9	0.0	0.0	0.0
Total Operating Income	1927.0	2546.9	3435.3	3258.7
Growth (%)	1.7	34.4	34.9	-5.1
Raw Material Expenses	1,236.6	1,659.3	2,203.0	2,036.7
Employee Expenses	81.8	97.2	114.2	120.6
Selling Expense	78.6	101.9	137.4	130.3
Other Operating Expense	271.4	302.5	296.0	260.7
Total Operating Expenditure	1,668.4	2,160.9	2,750.6	2,548.3
EBITDA	258.6	386.0	684.7	710.4
Growth (%)	69.9	134.0	77.4	3.8
Depreciation	60.6	60.5	66.6	77.1
Interest	51.4	41.4	41.0	46.2
Other Income	18.9	19.7	15.2	15.4
PBT	165.6	303.8	592.3	602.5
Exceptional Item	0.0	0.0	0.0	0.0
Total Tax	96.1	74.0	169.3	171.7
PAT	69.5	229.8	423.0	430.8
Growth (%)	205.7	230.6	84.1	1.8
EPS (₹)	4.0	13.3	24.5	25.0

Source: Company, ICICI Direct Research

Cash flow statement				₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E
Profit after Tax	69.5	229.8	423.0	430.8
Add: Depreciation	60.6	60.5	66.6	77.1
(Inc)/dec in Current Assets	12.9	-151.5	-301.7	-26.6
Inc/(dec) in CL and Provisions	105.5	57.1	149.3	-33.4
Others	51.4	41.4	41.0	46.2
CF from operating activities	299.9	237.2	378.2	494.1
(Inc)/dec in Investments	-60.4	-28.4	0.0	0.0
(Inc)/dec in Fixed Assets	-32.8	-65.2	-290.0	-330.0
Others	57.6	32.8	0.0	0.0
CF from investing activities	-35.6	-60.8	-290.0	-330.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-265.1	-38.6	50.0	0.0
Interest & Dividend paid	-76.5	-91.1	-123.7	-149.6
Inc/(dec) in Share Cap	0.0	0.0	0.0	0.0
Others	43.2	66.3	0.0	0.0
CF from financing activities	-298.4	-63.4	-73.7	-149.6
Net Cash flow	-34.2	113.0	14.5	14.5
Opening Cash	60.2	26.0	139.0	153.5
Closing Cash	26.0	139.0	153.5	168.0

Source: Company, ICICI Direct Research

Balance sheet				₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E
Liabilities				
Equity Capital	34.5	34.5	34.5	34.5
Reserve and Surplus	1,091.5	1,337.9	1,678.2	2,005.6
Total Shareholders funds	1,126.0	1,372.3	1,712.6	2,040.0
Total Debt	759.3	720.7	770.7	770.7
Deferred Tax Liability	202.6	239.4	239.4	239.4
Minority Interest / Others	0.0	0.0	0.0	0.0
Total Liabilities	2,087.9	2,332.4	2,722.6	3,050.1
Assets				
Gross Block	1,509.7	1,579.5	1,836.4	2,116.4
Less: Acc Depreciation	122.1	180.3	246.9	324.0
Net Block	1,387.6	1,399.2	1,589.4	1,792.4
Capital WIP	73.8	66.8	100.0	150.0
Total Fixed Assets	1,461.4	1,466.0	1,689.4	1,942.4
Investments	309.0	337.4	337.4	337.4
Inventory	243.5	309.9	423.5	446.4
Debtors	465.7	522.0	705.9	714.2
Loans and Advances	51.9	65.5	68.7	65.2
Other Current Assets	4.5	19.7	20.6	19.6
Cash	26.0	139.0	153.5	168.0
Total Current Assets	791.6	1,056.0	1,372.2	1,413.3
Current Liabilities	442.9	422.9	564.7	535.7
Provisions	10.6	77.2	84.7	80.4
Current Liabilities & Prov	453.5	500.1	649.4	616.0
Net Current Assets	338.0	555.9	722.8	797.3
Others Assets	-20.5	-26.9	-26.9	-26.9
Application of Funds	2,087.9	2,332.4	2,722.6	3,050.1

Source: Company, ICICI Direct Research

Key ratios				
(Year-end March)	FY17	FY18	FY19E	FY20E
Per share data (₹)				
EPS	4.0	13.3	24.5	25.0
Cash EPS	7.6	16.8	28.4	29.5
BV	65.3	79.6	99.4	118.4
DPS	1.2	2.4	4.0	5.0
Cash Per Share (Incl Invst)	19.4	27.6	28.5	29.3
Operating Ratios (%)				
EBITDA Margin	13.4	15.2	19.9	21.8
PAT Margin	3.6	9.0	12.3	13.2
Inventory days	46.2	44.4	45.0	50.0
Debtor days	88.3	74.8	75.0	80.0
Creditor days	84.0	60.6	60.0	60.0
Return Ratios (%)				
RoE	6.2	16.7	24.7	21.1
RoCE	10.5	15.6	24.9	22.5
RoIC	10.3	15.1	24.8	23.0
Valuation Ratios (x)				
P/E	51.6	15.6	8.5	8.3
EV / EBITDA	16.3	10.8	6.1	5.9
EV / Net Sales	2.2	1.6	1.2	1.3
Market Cap / Sales	1.9	1.4	1.0	1.1
Price to Book Value	3.2	2.6	2.1	1.8
Solvency Ratios				
Debt/EBITDA	2.9	1.9	1.1	1.1
Debt / Equity	0.7	0.5	0.5	0.4
Current Ratio	1.7	1.8	1.9	2.0
Quick Ratio	1.2	1.2	1.2	1.3

Source: Company, ICICI Direct Research

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