

Muted auto demand weighs, base valuation to prevail

Phillips Carbon Black (PCBL) reported a muted Q4FY19 performance. Carbon black (CB) sales volume for the quarter was at 102 KT with consequent net sales at ₹ 921 crore. EBITDA in Q4FY19 was at ₹ 112 crore with corresponding EBITDA margins at 12%, down 700 bps QoQ. EBITDA margins were marred by one-offs amounting to ~₹ 50 crore. Adjusting for this, EBITDA margins were at ~17.2%, down ~200 bps QoQ. Consequent PAT in Q4FY19 was at ₹ 74 crore vs. ₹ 109 crore in Q3FY19.

Volume growth to revive, exports at the rescue!

PCBL is a leading CB player with domestic market share at ~35%. It clocked CB sales volume of ~402 KT, flat YoY. As of FY18 end it had an effective capacity of ~441 KT. It operated at 90%+ utilisation levels and largely missed out on robust auto demand in H1FY19 due to lack of capacity. PCBL commissioned a brownfield expansion amount to ~56 KT in Q4FY19 and is well poised for volume led growth, going forward. With muted domestic auto demand prospects, PCBL is banking on exports to push volumes. We expect PCBL to report CB sales volume of 430 KT in FY20E and 440 KT in FY21E, implying volume CAGR of 4.6% in FY19-21E. With flat realisations (~₹ 85/kg), consequent sales growth is envisaged at 5.7% CAGR in FY19-21E.

Increasing share of speciality grade CB to aid profitability!

Speciality grade CB is a technology advanced product, which finds application in paints, plastics, etc. It has ~1.5x normal CB realisation but clocks ~4x EBITDA/tonne leading to disproportionate increase in profitability as the share of specialty grade increases. PCBL sold ~20 KT specialty grade CB in FY19, up 19% YoY and is well poised to clock ~ 30 KT in FY20E & ~48 KT in FY21E, which will augment its profitability and has more structural legs to it. With spot premiums eroding in the domestic market amid auto sector slowdown, the new base case for EBITDA/tonne at PCBL is ~₹ 13,500/tonne in FY20E. With increasing share of specialty grade CB, the same is expected at ~₹ 14,500/tonne in FY21E. However, given the high base of ~₹ 15,500/tonne in FY19, CAGR looks optically muted.

Valuation & Outlook

PCBL has moved up the ladder and is now a capital efficient player (RoCE ~20%) clocking EBITDA margins of 15%+ with controlled leverage (debt: equity at 0.5x) and prudent working capital cycle (< 60 days). Given the present transitory phase in the auto space and steady base case earnings at PCBL we change our valuation methodology from P/E to EV/EBITDA. We value PCBL at ₹ 160 i.e. 5x EV/EBITDA on FY21E numbers and assign a **BUY** rating on the stock. We also derive comfort from average CFO yield over FY19-21E at 16% & with limited capex spend, FCF yield placed at 5.5%.

Key Financial Summary

Key Financials	FY17	FY18	FY19P	FY20E	FY21E	CAGR (FY19P-21E)
Net Sales	1,924.1	2,546.9	3,528.6	3,830.1	3,940.4	5.7%
EBITDA	258.6	386.0	622.8	582.2	636.4	1.1%
EBITDA Margins (%)	13.4	15.2	17.6	15.2	16.2	
Net Profit	69.5	229.8	388.5	352.9	384.2	-0.6%
EPS (₹)	4.0	13.3	22.5	20.5	22.3	
P/E	33.5	10.1	6.0	6.6	6.1	
RoNW (%)	6.2	16.7	23.6	18.3	17.2	
RoCE (%)	10.5	15.6	23.1	19.0	20.0	

Source: ICICI Direct Research, Company



Particulars

Stock Data	₹ crore
Market Capitalization	2326
Total Debt (FY19P)	759
Cash and Cash Equivalent (FY19P)	185
Enterprise Value	2901
52 week H/L (₹)	287 / 122
Equity Capital	34.5
Face Value	₹ 2

Key Highlights

- PCBL commissioned brownfield expansion of 56,000 tonne with CB volumes expected to grow at a CAGR of 4.6% in FY19-21E
- Share of speciality grade CB is expected to increase from 4.9% in FY19 to 10.9% in FY21E, leading to structural improvement in earnings
- EPS growth is expected to be muted (largely flat) due to high base (FY19)
- Maintain BUY with a revised target price of ₹ 160

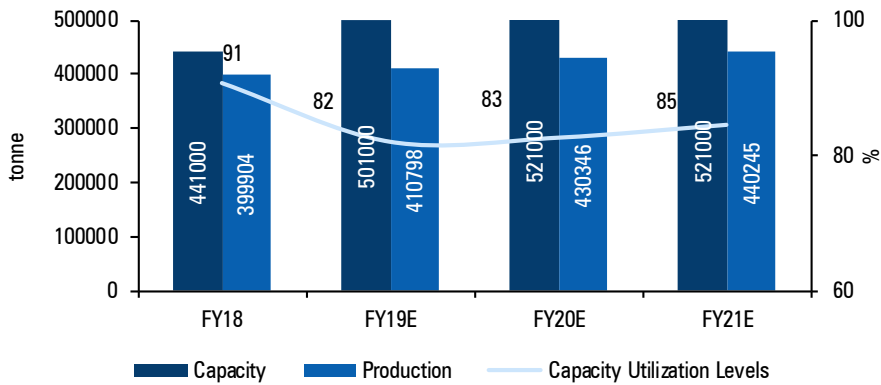
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Financial story in charts

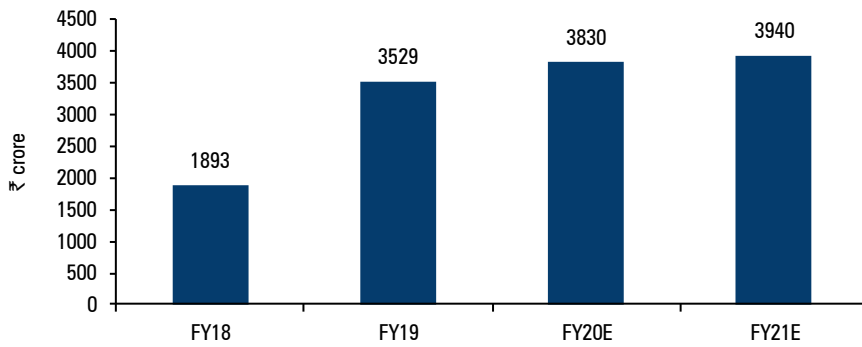
Exhibit 1: Effective capacity, production and utilisation levels



With incremental capacity in place, CB production is expected to perk up, going forward

Source: Company, ICICI Direct Research

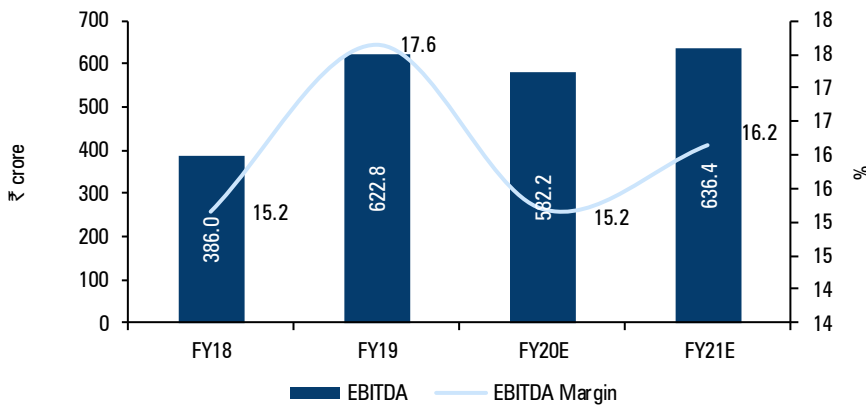
Exhibit 2: Topline trend



We expect sales to grow at a CAGR of 5.7% over FY19-21E, which includes a volume growth of 4.6% CAGR in the aforesaid period

Source: Company, ICICI Direct Research

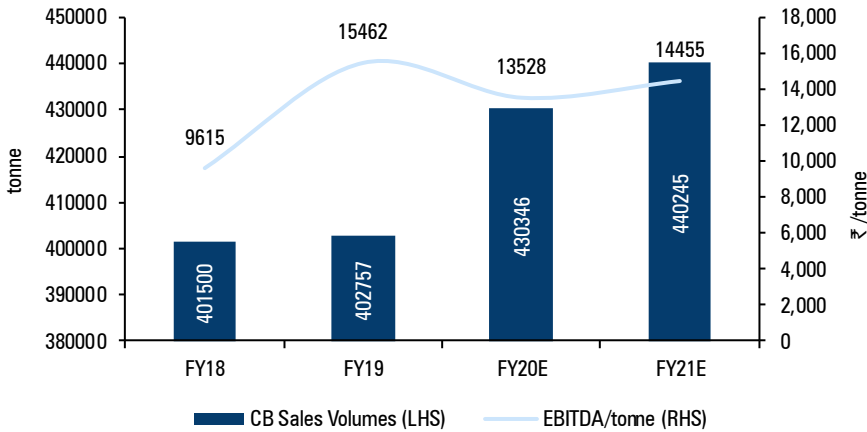
Exhibit 3: EBITDA and EBITDA margin trend



Given the high base in FY19, we expect EBITDA margins to taper to 16.2% in FY21E

Source: Company, ICICI Direct Research

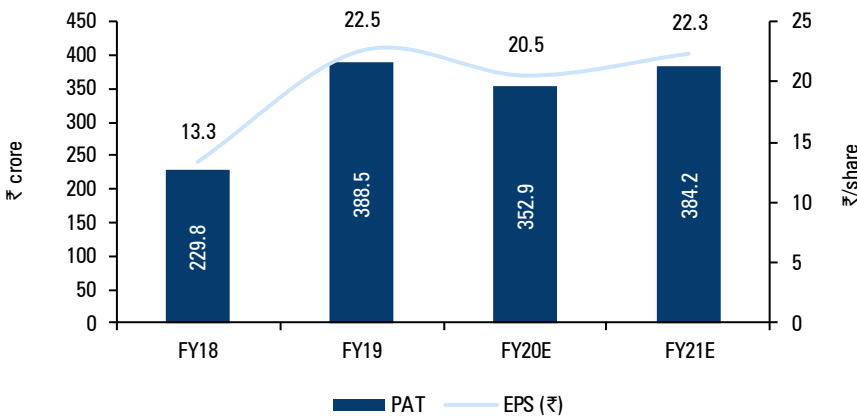
Exhibit 4: Sales volume and EBITDA/tonne trend



EBITDA/tonne is expected to improve to ~₹ 14,500/tonne in FY20E from a new base of ~₹ 13,500/tonne in FY21E

Source: Company, ICICI Direct Research

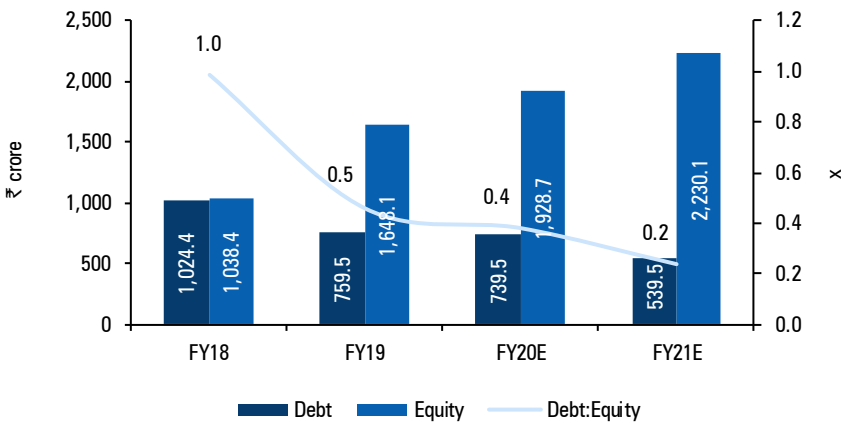
Exhibit 5: PAT & EPS trend



Earnings are expected to be largely flat over FY19-21E on absolute basis

Source: Company, ICICI Direct Research

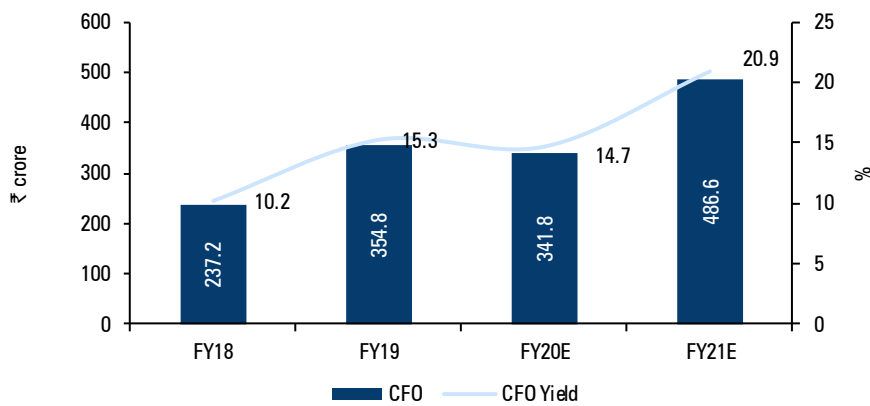
Exhibit 6: Debt leverage profile



Leverage is controlled with FY19 debt: equity at 0.5x, which is further expected to draw down to 0.2x in FY21E

Source: Company, ICICI Direct Research

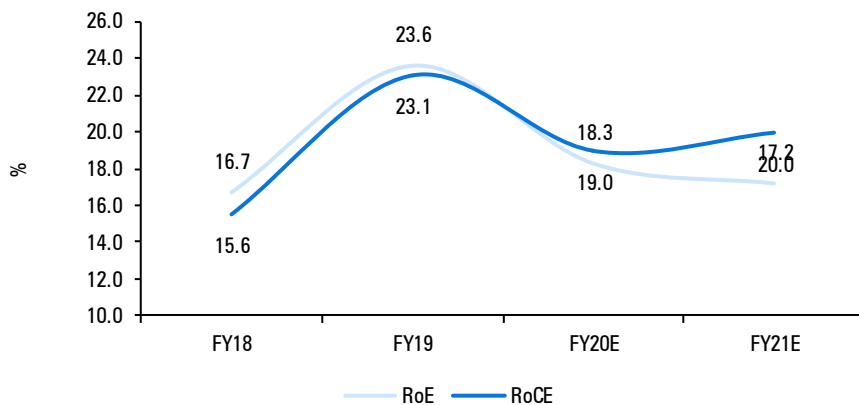
Exhibit 7: Healthy CFO generation



CFO generation is robust with average CFO generation of ~₹ 400 crore in FY19-21E vs. the MCap of ~₹ 2300 crore offering a healthy CFO yield of ~16%

Source: Company, ICICI Direct Research

Exhibit 8: Return ratio trend



Return ratio profile is healthy with RoCE comfortably placed at ~20%

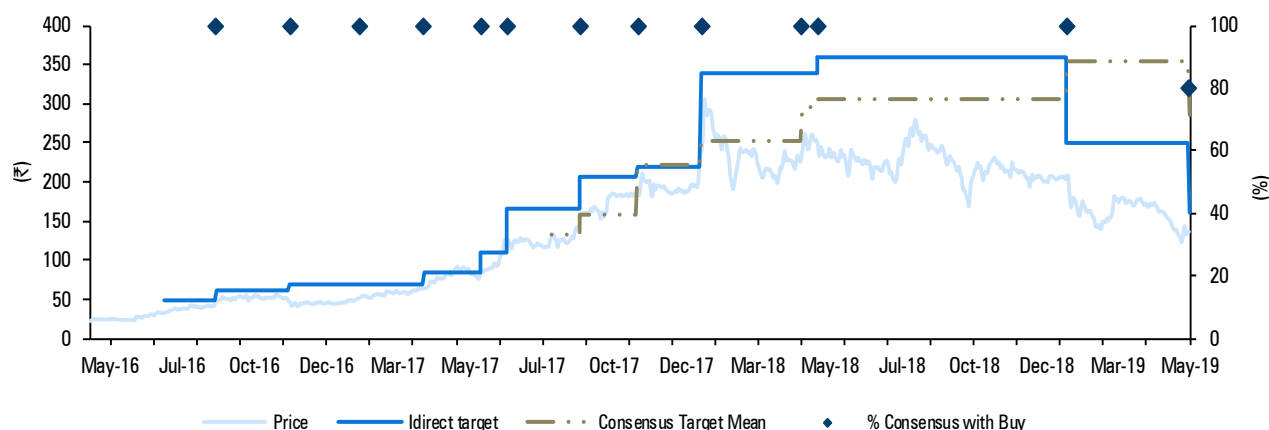
Source: Company, ICICI Direct Research

Exhibit 9: Key valuation metrics

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY18	2546.9	32.0	13.3	231.0	10.1	7.5	16.7	15.6
FY19	3528.6	38.5	22.5	69.1	6.0	4.7	23.6	23.1
FY20E	3830.1	8.5	20.5	-9.1	6.6	5.1	18.3	19.0
FY21E	3940.4	2.9	22.3	8.8	6.1	4.3	17.2	20.0

Source: Bloomberg, ICICI Direct Research

Exhibit 10: Recommendation history vs. consensus



Source: Reuters, ICICI Direct Research

Exhibit 11: Top 10 shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Position Change (m)
1	RPG Ventures	31-Mar-19	50.2	86.5	0.0
2	Wellington Management Company, LLP	31-Mar-19	3.5	6.0	2.8
3	Dotex Merchandise Pvt. Ltd.	31-Mar-19	3.1	5.3	0.0
4	FIL Investment Management (Singapore)	31-Dec-18	2.0	3.4	0.0
5	Principal Asset Management Private Lir	31-Dec-18	1.4	2.4	0.4
6	Kerala State Industrial Development Co.,	31-Mar-19	1.4	2.3	0.0
7	Fidelity International	31-Mar-19	1.2	2.0	-1.4
8	L&T Investment Management Limited	31-Mar-19	1.1	1.8	0.0
9	Dimensional Fund Advisors, L.P.	30-Apr-19	1.0	1.7	0.0
10	BlackRock Institutional Trust Company, I	30-Apr-19	0.3	0.5	0.0

Source: Reuters, ICICI Direct Research

Exhibit 12: Recent activity

Investor name	Buys		Sells	
	Value (\$mn)	Shares(mn)	Value (\$mn)	Shares(mn)
Wellington Management Company, LLP	+7.0M	+2.8M	Fidelity International	-3.5M -1.4M
Principal Asset Management Private Limited	+1.1M	+0.4M	Lazard Asset Management, L.L.C.	-1.6M -0.6M
Candriam Belgium S.A.	+0.2M	+0.1M	Reliance Nippon Life Asset Management Limited	-0.2M -0.1M
AQR Capital Management, LLC	+0.1M	+0.0M	Dimensional Fund Advisors, L.P.	-0.2M -0.1M
BlackRock Institutional Trust Company, N.A.	+0.1M	+0.0M	Mandarine Gestion	-0.2 -0.1

Source: Reuters, ICICI Direct Research

Exhibit 13: Shareholding pattern

(in %)	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Promoter	53.6	53.6	53.6	53.6	53.6
FII	11.0	10.8	11.0	11.4	10.3
DII	3.1	3.4	2.8	2.8	2.1
Others	32.4	32.3	32.6	32.3	34.1

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 14: Profit and loss statement				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Net Sales	2546.9	3528.6	3830.1	3940.4
Other Operating Income	0.0	0.0	0.0	0.0
Total Operating Income	2546.9	3528.6	3830.1	3940.4
Growth (%)	32.0	38.5	8.5	2.9
Raw Material Expenses	1,659.3	2,296.6	2,547.0	2,600.6
Employee Expenses	97.2	110.9	126.4	141.9
Selling Expense	101.9	141.1	153.2	157.6
Other Operating Expense	302.5	357.2	421.3	403.9
Total Operating Expenditure	2,160.9	2,905.8	3,247.9	3,304.0
EBITDA	386.0	622.8	582.2	636.4
Growth (%)	49.0	61.3	-6.5	9.3
Depreciation	60.5	66.4	75.4	83.5
Interest	41.4	36.4	45.0	38.4
Other Income	19.7	18.8	21.7	19.0
PBT	303.8	538.8	483.5	533.5
Exceptional Item	0.0	0.0	0.0	0.0
Total Tax	74.0	150.3	130.5	149.4
PAT	229.8	388.5	352.9	384.2
Growth (%)	231.0	69.1	-9.1	8.8
EPS (₹)	13.3	22.5	20.5	22.3

Source: Company, ICICI Direct Research

Exhibit 15: Cash flow statement				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Profit after Tax	229.8	388.5	352.9	384.2
Add: Depreciation	60.5	66.4	75.4	83.5
(Inc)/dec in Current Assets	-151.5	-319.0	-161.0	-40.2
Inc/(dec) in CL and Provisions	57.1	182.5	29.4	20.8
Others	41.4	36.4	45.0	38.4
CF from operating activities	237.2	354.8	341.8	486.6
(Inc)/dec in Investments	-28.4	-46.4	75.1	-60.0
(Inc)/dec in Fixed Assets	-65.2	-275.7	-275.0	-100.0
Others	32.8	18.3	0.0	0.0
CF from investing activities	-60.8	-303.8	-199.9	-160.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-38.6	38.8	-20.0	-200.0
Interest & Dividend paid	-91.1	-108.8	-117.3	-121.1
Inc/(dec) in Share Cap	0.0	0.0	0.0	0.0
Others	66.3	-40.4	0.0	0.0
CF from financing activities	-63.4	-110.3	-137.3	-321.1
Net Cash flow	113.0	-59.4	4.5	5.6
Opening Cash	26.0	139.0	79.6	84.1
Closing Cash	139.0	79.6	84.1	89.7

Source: Company, ICICI Direct Research

Exhibit 16: Balance Sheet				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Liabilities				
Equity Capital	34.5	34.5	34.5	34.5
Reserve and Surplus	1,337.9	1,613.6	1,894.2	2,195.6
Total Shareholders funds	1372.3	1648.1	1928.7	2230.1
Total Debt	720.7	759.5	739.5	539.5
Deferred Tax Liability	239.4	257.6	257.6	257.6
Minority Interest / Others	0.0	0.0	0.0	0.0
Total Liabilities	2332.4	2665.1	2925.7	3027.2
Assets				
Gross Block	1579.5	1747.0	2122.0	2272.0
Less: Acc Depreciation	180.3	246.7	322.2	405.7
Net Block	1399.2	1500.3	1799.8	1866.4
Capital WIP	66.8	175.0	75.0	25.0
Total Fixed Assets	1,466.0	1,675.3	1,874.9	1,891.4
Investments	337.4	383.8	308.7	368.7
Inventory	309.9	460.3	524.7	539.8
Debtors	522.0	652.7	734.5	755.7
Loans and Advances	65.5	102.3	114.9	118.2
Other Current Assets	19.7	20.8	23.0	23.6
Cash	139.0	79.6	84.1	89.7
Total Current Assets	1,056.0	1,315.7	1,481.2	1,527.0
Current Liabilities	422.9	610.1	629.6	647.7
Provisions	77.2	84.5	94.4	97.2
Current Liabilities & Prov	500.1	694.6	724.0	744.9
Net Current Assets	555.9	621.1	757.2	782.1
Others Assets	-26.9	-15.0	-15.0	-15.0
Application of Funds	2332.4	2665.1	2925.7	3027.2

Source: Company, ICICI Direct Research

Exhibit 17: Key ratios				
(Year-end March)	FY18	FY19	FY20E	FY21E
Per share data (₹)				
EPS	13.3	22.5	20.5	22.3
Cash EPS	16.8	26.4	24.9	27.1
BV	79.6	95.7	111.9	129.4
DPS	2.4	3.5	3.5	4.0
Cash Per Share (Incl Invst)	27.6	26.9	22.8	26.6
Operating Ratios (%)				
EBITDA Margin	15.2	17.6	15.2	16.2
PAT Margin	9.0	11.0	9.2	9.7
Inventory days	44.4	47.6	50.0	50.0
Debtor days	74.8	67.5	70.0	70.0
Creditor days	60.6	63.1	60.0	60.0
Return Ratios (%)				
RoE	16.7	23.6	18.3	17.2
RoCE	15.6	23.1	19.0	20.0
RoIC	15.1	24.0	18.3	19.2
Valuation Ratios (x)				
P/E	10.1	6.0	6.6	6.1
EV / EBITDA	7.5	4.7	5.1	4.3
EV / Net Sales	1.1	0.8	0.8	0.7
Market Cap / Sales	0.9	0.7	0.6	0.6
Price to Book Value	1.7	1.4	1.2	1.0
Solvency Ratios				
Debt/EBITDA	1.9	1.2	1.3	0.8
Debt / Equity	0.5	0.5	0.4	0.2
Current Ratio	1.8	1.8	1.9	1.9
Quick Ratio	1.2	1.1	1.2	1.2

Source: Company, ICICI Direct Research

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