INDIA

HOLD

Orient Refractories

CENTRUM

Metals

Company Update 11 September 2018

On solid growth trajectory, maintain Hold

Our detailed interaction with Orient Refractories (ORL) & RHI Magnesita management on the side-lines of ORL AGM pointed towards i) increased focus of the group in transitioning to a bigger entity in India with substantial market share, ii) addition of production capability for meeting both domestic and export demand and iii) reduction in margins from a high base of FY18 at both ORL and RHI India led by RM cost inflation. Revenue growth is expected to remain solid but earnings growth would be lower due to normalisation of margins. Though we remain structurally positive on ORL led by best in class capital as well as operational costs, strong local management, MNC parentage and strong return ratios but recent sharp re-rating caps upside. Maintain Hold with an unchanged TP of Rs230.

- **Strong topline growth to be maintained:** Our discussion with ORL management indicated that revenue growth momentum remains very strong in FY19 and ORL is expected to easily clock 15-20% revenue growth in FY19 led by both volumes and price increase. Recent ISO product expansion has ramped up well and is operating at production run-rate above rated capacity of 200 tonnes/mth. Revenue growth is also strong at RHI India and RHI Clasil in FY19. ORL is expected to start investments in ISO phase 2 (2400 tpa) at a capex of Rs80mn and longer size slide gate plates at a capex of Rs50mn. These investments should get completed within 12 months and contribute from H2FY20.
- **Margins expected to soften from high base of FY18:** Margins at ORL remain under pressure due to sharp increase in RM costs which is difficult to pass on a regular basis (recent increase in alumina costs, carbon costs, weak rupee and high magnesita costs have played spoilsport). Management guidance on ORL margins remains at 17-18% range (which is well below 19.5-20% range seen in FY17/18). RHI India margins in FY18 were favourably impacted by sharp increase in product prices in the wake of RM cost increase but long term stable margin range is expected at 10-11%. Recent rupee depreciation is expected to soften the margins of RHI India going forward as the imported supplies would cost higher.
- **Merged entity to focus on market share gains and have solid growth opportunities:** Our discussion with RHI Magnesita management on growth plans for the Indian entity pointed towards increased focus of parent on i) adding production capabilities in India, ii) gaining market share in both domestic and exports markets and iii) enhancing product and customer basket with strong intent of growing much faster than the underline steel market. We expect the merged entity to have solid growth opportunities with wide range of product basket and two manufacturing locations. We expect import trading business to grow at 12% CAGR while manufacturing business (domestic + exports) to grow at 15% CAGR for merged entity during FY19-21E. We expect EBITDA/PAT CAGR of 9.4%/12.4% over FY18-21E for the merged entity resulting in EBITDA/PAT of Rs3bn/Rs2bn in FY21E.
- **Valuation and risk – Upside capped, maintain hold:** We remain structurally positive on the merger of ORL with RHI entities but have recently turned neutral on the stock in terms of our recommendation as we see margins at both ORL and RHI India softening from a very high base of FY18. This is expected to keep earnings growth muted despite strong topline growth. Additionally, recent sharp re-rating in ORL stock caps upside in our view as the stock is trading at 21x FY21E EPS on our estimates for the merged entity. We believe that upside from current levels would be factor of earnings surprise above our estimates and/or higher multiple ascribed by the market to the combined entity. We retain our TP of Rs230 and maintain hold. Key upside risk is faster growth and better margins led by synergies while downside risk is higher volatility in earnings & margins due to increased inter-company business on both imports & exports.

Target Price	Rs230
CMP*	Rs250.8
Downside	*8.3%*
Previous Target	Rs230
Previous Rating	Buy

Price Performance (%)*

	1M	6M	1Yr
ORIENT IN	*9.6*	*62.3*	*61.8*
NIFTY	*(0.2)*	*11.5*	*14.0*

Key Data	
Bloomberg Code	ORIENT IN
Curr Shares O/S (mn)	120.1
Diluted Shares O/S(mn)	120.1
Mkt Cap (Rsbn/USDmn)	30.1/406.1
52 Wk H / L (Rs)	280.1/136.6
5 Year H / L (Rs)	280.1/24.5
Daily Vol. (3M NSE Avg.)	236426

**as on 10 September 2018; Source: Bloomberg, Centrum Research*

Shareholding pattern *(%)**

	Jun-18	Mar-18	Dec-17	Sep-17
Promoter	*69.6*	*69.6*	*69.6*	*69.6*
FIIs	*5.1*	*5.1*	*4.9*	*5.3*
Dom. Inst.	*5.5*	*5.2*	*5.1*	*5.1*
Public & Others	*19.8*	*20.0*	*20.3*	*20.0*

*Source: BSE, *as on 10 September 2018*

Earnings Revision

Particulars (Rs mn)	FY19E			FY20E		
	New	Old	*Chg (%)*	New	Old	*Chg (%)*
Sales	7,238	7,268	*(0.4)*	8,331	8,374	*(0.5)*
EBITDA	1,395	1,407	*(0.8)*	1,620	1,635	*(1.0)*
EBITDA Margin (%)	*19.3*	*19.4*		*19.4*	*19.5*	
PAT	982	990	*(0.8)*	1,119	1,136	*(1.5)*

Source: Centrum Research Estimates

Centrum vs. Bloomberg Consensus*

Particulars (Rsmn)	FY19E			FY20E		
	Centrum	BBG	*Var (%)*	Centrum	BBG	*Var (%)*
Net Sales	7,238	7,317	*(1.1)*	8,331	8,656	*(3.8)*
EBITDA	1,395	1,473	*(5.3)*	1,620	1,739	*(6.8)*
PAT	982	1,025	*(4.2)*	1,119	1,229	*(9.0)*

Bloomberg Consensus				Centrum Target Price (Rs)	*Variance (%)*
BUY	SELL	*HOLD*	Target Price (Rs)		
5	0	2	274	230	*(15.9)*

**as on 10 September 2018; Source: Bloomberg, Centrum Research Estimates*

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Y/E Mar(Rs mn)	Rev	*YoY (%)*	EBITDA	*EBITDA (%)*	PAT	*YoY (%)*	EPS (Rs)	*RoE (%)*	*RoCE (%)*	P/E (x)	EV/EBITDA (x)
FY16	4,589	*1.7*	852	*18.6*	558	*5.6*	4.6	*28.2*	*24.9*	17.9	10.9
FY17	5,194	*13.2*	1,034	*19.9*	689	*23.5*	5.7	*27.6*	*24.7*	17.8	10.8
FY18	6,268	*20.7*	1,270	*20.3*	858	*24.6*	7.1	*28.8*	*25.8*	21.3	13.4
FY19E	7,238	*15.5*	1,395	*19.3*	982	*14.4*	8.2	*27.9*	*24.2*	30.7	20.4
FY20E	8,331	*15.1*	1,620	*19.4*	1,119	*13.9*	9.3	*27.0*	*23.9*	26.9	17.3

Source: Company, Centrum Research Estimates; All ratios based on average mcap for year

AGM Takeaways

We attended the Orient Refractories (ORL) AGM yesterday in Mumbai and met with the senior management and foreign directors on the side-lines. Below are the key takeaways:-

Highlights of discussion with MD & CFO of ORL (Mr. Parmod Sagar & Mr. Sanjeev Bhardwaj)

- Revenue growth momentum remains very strong in FY19 and ORL is expected to easily clock 15-20% revenue growth in FY19 led by both volumes and price increase.
- Recent ISO product expansion has ramped up well and is operating at above rated capacity with production run-rate of more than 200 tonne/month.
- Margins remain under pressure due to sharp increase in RM costs which is difficult to pass on a regular basis (recent increase in alumina costs, carbon costs, weak rupee and high magnesita costs have played spoilsport).
- Management guidance on ORL margins remains at 17-18% range (which is well below 19.5-20% range seen in FY17/18). We believe that management has guided conservatively on this but at the same time it might be difficult for them to achieve 19%+ margins in FY19.
- ORL is currently on the lookout for attractive M&A opportunities in India and may be interested in acquiring small facilities with good scale-up potential.
- ORL is expected to start investments in ISO phase 2 (2400 tpa) at a capex of Rs80mn and longer size slide gate plates at a capex of Rs50mn. These investments should get completed within 12 months and contribute from H2FY20.
- Sharp rupee depreciation is not expected to impact ORL significantly due to natural hedge by way of both imports and exports. However, exports are generally higher than imports.
- Q2FY19 revenue growth has been strong but margins are not expected to be materially different from those seen in Q1FY19.

Highlights of discussion with RHI Magnesita Directors & Management (Mr. Erwin Jankovits & Mr. Arthur Jakopin)

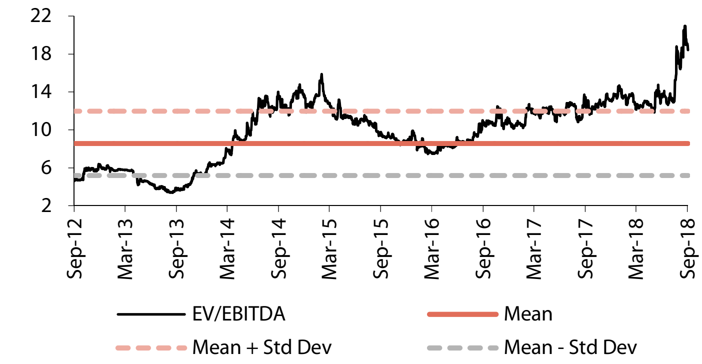
- RHI Magnesita has a clear goal in mind of being near to the customer and near to the raw materials as a global strategy. Indian operations are expected to be in high growth phase being closer to the customer as India is expected to be the highest growth market.
- The merger of Indian entities of the group has allowed the crucial expansion of product and customer basket and brought the whole operations on same footing thereby creating stronger base for growth. This is expected to help the company target customers better with full product basket.
- RHI directors mentioned that more products would be added in due course in India as manufacturing capability and that the production would be increased significantly in India which should ultimately reduce dependence on imported supplies in India from RHI.
- Continuous investments would be made in upgrading the facilities in India and adding production. Production enhancement is to be targeted for both local and export markets.
- Focus on market share gains to remain high.
- The group would strive very hard to grow substantially higher than the underline steel production growth in India.
- RHI India margins in FY18 were favourably impacted by sharp increase in product prices in the wake of RM cost increase but long term stable margin range is expected at 10-11%. Recent rupee depreciation is expected to soften the margins of RHI India going forward as the imported supplies would cost higher and subsequent price in the domestic market remains fixed.
- Exports share for the merged entity is expected to gradually increase over the coming years as the export potential is huge.

Sensitivity Analysis (FY19E)

1% change	*% Chg in EBITDA*	*% Chg in PAT*
Realizations	*1.2*	*1.1*
Volumes	*1.1*	*1.1*

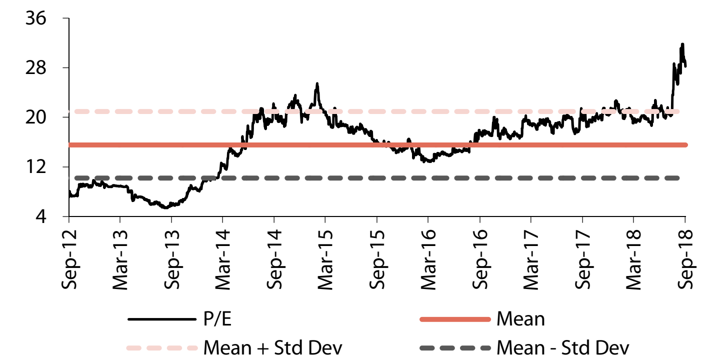
Source: Company, Centrum Research Estimates

Exhibit 1: 1 year forward EV/EBITDA chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 2: 1 year forward P/E chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 3: Valuation – Peer comparison

Company	Mkt. Cap (US$ mn)	CAGR CY17-CY19E (%)			EBITDA Margin (%)			P/E (x)			EV/EBITDA (x)			RoE (%)			Div Yield (%)		
		Rev.	EBITDA	PAT	CY17	CY18E	CY19E	CY17	CY18E	CY19E	CY17	CY18E	CY19E	CY17	CY18E	CY19E	CY17	CY18E	CY19E
Orient Refractories*#	**406**	**15.3**	**12.9**	**14.2**	**20.3**	**19.3**	**19.4**	**21.3**	**30.7**	**26.9**	**13.4**	**20.4**	**17.3**	**28.8**	**27.9**	**27.0**	**1.6**	**1.1**	**1.3**
Vesuvius India	323	*9.9*	*8.9*	*12.1*	*18.2*	*17.5*	*17.9*	26.1	22.2	18.8	13.5	11.3	9.3	*16.6*	*14.9*	*15.6*	*0.5*	*0.7*	*0.8*
IFGL Refractories Ltd	129	*9.3*	*14.4*	*17.1*	*12.7*	*13.8*	*13.9*	18.6	16.7	14.5	8.5	7.0	6.1	*6.6*	*7.2*	*7.8*	*0.8*	*0.9*	*1.0*
Global Peers																			
Rhi Magnesita NV	2,829	24.6	*234.5*		*2.4*	*18.1*	*17.6*		*10.0*	*9.9*	*59.3*	*6.0*	*5.9*	*(3.3)*	*29.8*	*27.6*		*1.5*	*1.6*
Vesuvius PLC	2,156	4.2	*20.9*	*89.8*	*10.3*	*13.3*	*13.8*	*40.6*	*13.1*	*11.9*	*10.6*	*8.0*	*7.8*	*3.6*	*11.7*	*11.8*	*3.1*	*3.1*	*3.3*
Cie de St-Gobain	23,049	3.5	*13.3*	*11.7*	*9.0*	*10.5*	*10.8*	*16.9*	*11.1*	*9.8*	*8.8*	*6.1*	*6.2*	*8.4*	*9.6*	*9.6*	*2.7*	*3.8*	*4.1*

Source: Bloomberg consensus estimates, Centrum Research Estimates, #CY17=FY18 and so on for Orient, IFGL. All ratios based on average mcap for year*

Exhibit 4: Quarterly Financials

Y/E Mar (Rs mn)	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19
Net sales	**1,322**	**1,281**	**1,278**	**1,417**	**1,484**	**1,578**	**1,789**	**1,741**
Other Operating Income	0	0	0	0	0	0	0	0
Total Income	**1,322**	**1,281**	**1,278**	**1,417**	**1,484**	**1,578**	**1,789**	**1,741**
Accretion to Stocks in trade & work in progress	(40)	(71)	(7)	13	57	(44)	(2)	(0)
Cost of Raw Materials consumed	535	490	501	537	554	637	685	724
Purchase of traded goods	231	285	235	256	221	258	298	302
Staff Cost	106	117	100	122	114	118	119	134
Other Operational expenses	239	206	186	250	247	278	279	296
Operating Profit (Core EBITDA)	**252**	**254**	**263**	**238**	**292**	**331**	**409**	**285**
Depreciation	16	17	15	16	17	17	17	20
EBIT	**236**	**237**	**248**	**222**	**275**	**314**	**392**	**266**
Interest	0	0	0	0	0	0	0	0
Other Revenue/Income	22	20	22	25	30	21	29	65
Exceptional items	0	0	0	0	0	0	0	0
Profit Before Tax	**258**	**256**	**269**	**247**	**305**	**335**	**421**	**331**
Tax	89	89	92	84	104	115	147	112
Profit After Tax	**169**	**167**	**177**	**163**	**201**	**220**	**275**	**219**
Growth (YoY %)								
Revenue	*19.8*	*11.9*	*4.1*	*7.4*	*12.2*	*23.2*	*39.9*	*22.9*
EBITDA	*31.9*	*12.7*	*3.4*	*(9.4)*	*16.0*	*30.3*	*55.6*	*19.7*
PAT	*33.8*	*12.0*	*8.5*	*(6.6)*	*18.9*	*31.6*	*55.1*	*34.3*
Margin (%)								
EBITDA	*19.0*	*19.8*	*20.6*	*16.8*	*19.7*	*21.0*	*22.9*	*16.4*
EBIT	*17.9*	*18.5*	*19.4*	*15.7*	*18.5*	*19.9*	*21.9*	*15.3*
PAT	*12.8*	*13.0*	*13.8*	*11.5*	*13.5*	*13.9*	*15.4*	*12.6*

Source: Company, Centrum Research

Financials

Exhibit 5: Income Statement

Y/E Mar(Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Revenues	**4,589**	**5,194**	**6,268**	**7,238**	**8,331**
Materials cost	2,539	2,906	3,471	4,069	4,687
% of revenues	*55.3*	*56.0*	*55.4*	*56.2*	*56.3*
Employee cost	394	425	473	543	625
% of revenues	*8.6*	*8.2*	*7.5*	*7.5*	*7.5*
Others	804	829	1,054	1,230	1,400
% of revenues	*17.5*	*16.0*	*16.8*	*17.0*	*16.8*
EBITDA	**852**	**1,034**	**1,270**	**1,395**	**1,620**
EBITDA margin (%)	*18.6*	*19.9*	*20.3*	*19.3*	*19.4*
Depreciation & Amortisation	59	63	68	78	92
EBIT	**793**	**971**	**1,202**	**1,317**	**1,527**
Interest expenses	0	-	-	-	-
PBT from operations	**793**	**971**	**1,202**	**1,317**	**1,527**
Other income	54	83	106	171	168
PBT	**847**	**1,053**	**1,308**	**1,488**	**1,695**
Taxes	288	364	450	506	576
Effective tax rate (%)	*34.1*	*34.6*	*34.4*	*34.0*	*34.0*
Rep. PAT	**558**	**689**	**858**	**982**	**1,119**
Adj. PAT	**558**	**689**	**858**	**982**	**1,119**

Source: Company data, Centrum Research Estimates

Exhibit 6: Key Ratios

Y/E Mar	FY16	FY17	FY18	FY19E	FY20E
Growth Ratio (%)					
Revenue	*1.7*	*13.2*	*20.7*	*15.5*	*15.1*
EBITDA	*5.8*	*21.3*	*22.9*	*9.8*	*16.1*
Adjusted PAT	*5.6*	*23.5*	*24.6*	*14.4*	*13.9*
Margin Ratios (%)					
EBITDA	*18.6*	*19.9*	*20.3*	*19.3*	*19.4*
PBT from operations	*17.3*	*18.7*	*19.2*	*18.2*	*18.3*
Adjusted PAT	*12.2*	*13.3*	*13.7*	*13.6*	*13.4*
Return Ratios (%)					
ROE	*28.2*	*27.6*	*28.8*	*27.9*	*27.0*
ROCE	*24.9*	*24.7*	*25.8*	*24.2*	*23.9*
ROIC	*35.0*	*39.1*	*39.0*	*41.6*	*42.5*
Turnover Ratios (days)					
Gross block turnover ratio (x)	9.5	13.3	13.0	12.3	11.7
Debtors	94	80	93	80	80
Inventory	51	57	53	55	55
Creditors	57	55	61	54	54
Cash conversion cycle	88	83	85	81	81
Solvency Ratio (x)					
Net debt-equity	(0.3)	(0.4)	(0.4)	(0.5)	(0.5)
Debt-equity	-	-	-	-	-
Interest coverage ratio	0.0	-	-	-	-
Gross debt/EBITDA	-	-	-	-	-
Current Ratio	3.3	3.6	3.1	3.5	3.6
Per share Ratios (Rs)					
Adjusted EPS	4.6	5.7	7.1	8.2	9.3
BVPS	18.8	22.7	26.9	31.7	37.2
CEPS	5.1	6.3	7.7	8.8	10.1
DPS	1.5	2.5	2.5	2.9	3.3
Dividend payout %	*31*	*44*	*35*	*35*	*35*
Valuation (x)*					
P/E (adjusted)	17.9	17.8	21.3	30.7	26.9
P/BV	4.4	4.5	5.7	7.9	6.7
EV/EBITDA	10.9	10.8	13.4	20.4	17.3
Dividend yield %	*1.7*	*2.5*	*1.6*	*1.1*	*1.3*
5 Yr Avg AOCF/EV yield %	*4.5*	*4.3*	*3.1*	*2.3*	*2.6*

*Source: Company data, Centrum Research Estimates; *All ratios based on average mcap for year*

Exhibit 7: Balance Sheet

Y/E Mar(Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Equity Share Capital	120	120	120	120	120
Reserves & surplus	2,136	2,613	3,108	3,688	4,349
Shareholders' fund	2,256	2,733	3,228	3,808	4,469
Total Debt	-	-	-	-	-
Def. tax liability(net)	-	-	-	-	-
Minority interest	-	-	-	-	-
Total Liabilities	**2,256**	**2,733**	**3,228**	**3,808**	**4,469**
Gross Block	346	435	530	650	770
Less: Acc. Depreciation	-	62	128	206	298
Net Block	346	373	402	444	471
Capital WIP	16	47	140	170	200
Net Fixed Assets	362	419	542	614	671
Investments	0	0	1,077	1,077	1,077
Inventories	642	814	911	1,091	1,255
Sundry debtors	1,185	1,140	1,594	1,586	1,826
Cash	765	1,108	127	639	1,022
Loans & Advances	57	66	104	52	59
Other assets	49	55	133	64	72
Total Current Asset	2,698	3,183	2,869	3,432	4,234
Trade payables	719	776	1,046	1,071	1,233
Other current Liab.	53	57	148	115	132
Provisions	32	37	66	129	148
Net Current Assets	1,894	2,314	1,610	2,118	2,721
Total Assets	**2,256**	**2,733**	**3,228**	**3,808**	**4,469**

Source: Company data, Centrum Research Estimates

Exhibit 8: Cash Flow

Y/E Mar(Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Operating profit bef working capital changes	886	1,054	1,333	1,395	1,620
Changes in working capital	192	(79)	(320)	4	(221)
Cash flow from operations	**802**	**604**	**572**	**893**	**822**
Adj. OCF (OCF - Interest)	802	604	572	893	822
Net Capex	88	115	195	150	150
Adj. FCF	714	490	378	743	672
Cash flow from investments	**(42)**	**(62)**	**(1,210)**	**21**	**18**
Cash flow from financing	**(250)**	**(205)**	**(353)**	**(402)**	**(458)**
Net change in cash	**511**	**337**	**(990)**	**512**	**382**

Source: Company data, Centrum Research Estimates

Appendix A

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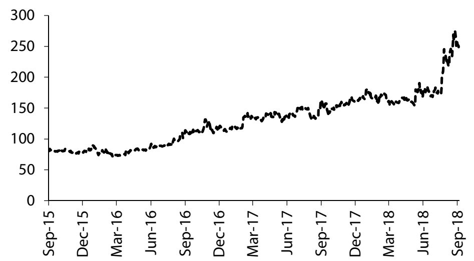
Orient Refractories price chart



Source: Bloomberg, Centrum Research

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Hold	Upside between -20% to +20%	Upside between -15% to +15%	Upside between -10% to +10%
Sell	Downside > 20%	Downside > 15%	Downside > 10%

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