February 4, 2019

Oriental Carbon (ORICAR)

₹ 1200

Firmly placed, next leg of capex on the anvil…

- Oriental Carbon & Chemicals (OCCL) reported a robust operational performance in Q3FY19 led by volume growth in its base business (insoluble sulphur) and operating leverage benefits arising out of brownfield nature of capacity expansion (11,000 tonne- two phases)
- Net sales in Q3FY19 came in at ₹ 94.5 crore, up 9.6%YoY. EBITDA in Q3FY19 was at ₹ 34.5 crore with corresponding EBITDA margins at 36.5%. Reported margins look unusually high as it includes forex gains, adjusted for same, the normalised margins stood at ~33%.
- Consequent PAT for Q3FY19 came in at ₹ 20.7 crore, up 35.3% YoY
- In the past, OCCL has successfully commissioned Phase 2 of expansion (5500 tonne) and is progressing well to reach peak utilisation in FY20E, thereby triggering the next level of capex in the similar business domain (insoluble sulphur)
- Currently, OCCL is also executing a buyback plan wherein the company intends to spend ~₹ 35 crore on buyback of shares from open market at a price not exceeding ₹ 1150/share. It intends to buy ~3.04 lakh shares (~3% of share capital). As on date (February 1), it has already completed ~57% of intended buyback (1.74 lakh shares)

Insoluble sulphur volumes to grow at ~11% CAGR in FY18-20E

OCCL is a speciality chemical company manufacturing insoluble sulphur, a critical vulcanisation agent for manufacturing tyres. It has successfully commissioned the Phase 2 of expansion (5500 tonne) in July 2018 and is progressing well to attain double digit volume growth in FY18-20E. With present installed capacity of 34,000 tonne; OCCL is well poised to clock insoluble sulphur sales volume of ~32,000 tonne in FY20E vs. ~26,000 tonne in FY18; implying a volume CAGR of ~11%. Sales volume in FY19E is expected at ~30,000 tonne. Initially for the last year, the company was scouting for opportunities for growth beyond FY20E in similar or different business profiles. However, the management commentary suggests an expansion in the insoluble sulphur segment with next leg of growth to be of similar magnitude i.e. ~11,000 tonne in two phases. We believe this will provide sustainable growth prospects given it is a critical raw material for manufacturing tyres, which has no threat of obsolesce due to upcoming electric/unmanned vehicle technology.

Low asset turns to limit expansion in return ratios, steady play, HOLD!

OCCL manufactures insoluble sulphur and is one of the three credible players worldwide. It operates in a closely guarded technology space with small industry size (~₹ 3500 crore) and low asset turnovers (~1x). This limit the competition in the marketplace. Therefore, given the impressive utilisation of the expanded capacity, the next leg of capex is on the anvil for OCCL. However, with low asset turns (~1x) and B2B nature of business profile, we expect limited scope RoCE expansion from the current levels, which will limit the valuation multiple expansion, going forward. From a fundamental perspective OCCL remains a steady business model wherein asset turnover is ~1x, EBITDA margins is ~30% and net working capital cycle is ~75 days with consequent RoCE at ~20%. Going forward, over FY18-20E, expect sales, PAT to grow at a CAGR of 12.3%, 19.7%, respectively, wherein we build in 230 bps expansion in EBITDA margins to 32.2% in FY20E. We value OCCL at ₹ 1300 i.e. 16x P/E on FY20E EPS of ₹ 81.2/share and assign a **HOLD** rating to the stock. We draw comfort from healthy cash flow generation at OCCL with present CFO yield at ~8%. We also build in successful closure of buyback amounting to ~₹ 35 crore in FY19E.

Rating matrix

Rating	:	Hold
Target	:	₹ 1300
Target Period	:	12-18 months
Potential Upside	:	8%

What's changed?

Target	Unchanged
EPS FY19E	Changed from ₹ 71.2 to ₹ 72.0
EPS FY20E	Changed from ₹ 81.1 to ₹ 81.2
Rating	Changed from Buy to Hold

Key financials

₹ crore	FY17	FY18	FY19E	FY20E
Net Sales	297.5	328.2	381.7	414.0
EBITDA	87.3	98.2	122.4	133.3
Net Profit	53.4	56.8	72.1	81.3
EPS	51.8	55.1	72.0	81.2

Valuation summary

	FY17	FY18	FY19E	FY20E
P/E	23.2	21.8	16.7	14.8
Target P/E	25.1	23.6	18.0	16.0
EV / EBITDA	14.8	13.0	10.4	9.0
P/BV	3.7	3.2	2.9	2.5
RoNW	15.9	14.6	17.6	17.1
RoCE	15.3	15.5	19.0	22.4
ROIC	17.3	19.9	22.3	24.5

Stock data

Stock Data	₹ crore
Market Capitalization	1237.2
Total Debt (FY18)	112.0
Cash and Cash Equivalent (FY18)	68.4
Enterprise Value	1280.8
52 week H/L	1418 / 901
Equity Capital	10.3
Face Value	₹ 10
MF Holding (%)	23.6
FII Holding (%)	0.4

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Company Analysis

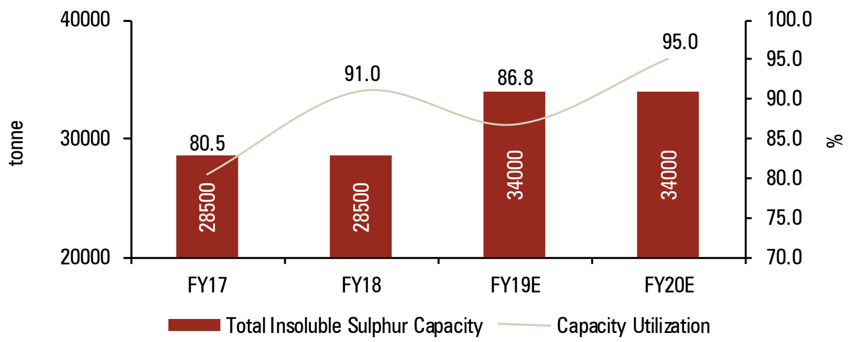
OCCL is a JP Goenka Group company manufacturing insoluble sulphur under the brand "Diamond Sulf". The company was established in 1978 while it commenced manufacturing insoluble sulphur in 1994 with an installed capacity of 3,000 TPA. The company has a current capacity to manufacture 23,000 tonne of insoluble sulphur annually. It has two plants in India viz. Dharuhera, Haryana (12,000 tonne capacity) and Mundra SEZ, Gujarat (11,000 tonne capacity). In 2015, OCCL further commenced a brownfield expansion of 11,000 TPA at the existing Mundra facility of which both phases (of 5500 tonne each) have been successfully commissioned. The capex is estimated to cost ~₹ 159 crore with expected project IRR of ~20%+ and payback period of about four years.

Capacity expansion in place; impressive ramp-up bodes well!

Capacity utilisations levels peaked in FY16 with utilisations levels at ~90%. Sensing the constraints, the company executed a brownfield expansion with Phase 1 commissioned by end of FY17 and Phase 2 in Q2FY19. With robust demand, we expect a quick ramp up of capacities with capacity utilisation inching to ~95% in FY20E vs. ~91% in FY18.

The new capacity is expected to be absorbed quickly as OCCL has a strong relationship with its customers amid healthy product demand

Exhibit 1: Capacity utilisation levels trend



Source: Company, ICICI Direct Research

We expect insoluble sulphur sales volume to grow at a CAGR of ~11% to ~32 KT by FY20E.

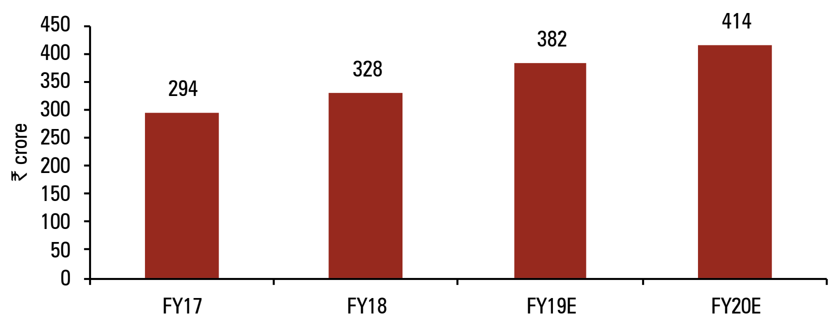
Net sales to be robust; tracking capacity expansion

With incremental capacities in place and steady realisations, we expect healthy volume led growth to led to 12.3% CAGR in sales in FY18-20E.

This is largely volume led growth with pricing expected to be stable amid stabilising crude oil prices and OCCL possessing a good bargaining power by virtue of it being a player in the oligopolistic market

Sales volumes are tilted more in the favour of exports vs. domestic. Exports share in total sales volume mix remains largely in the range of 65-70%

Exhibit 2: Net sales trend

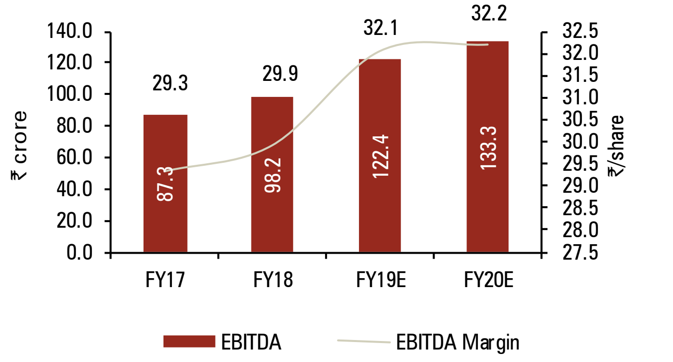


Source: Company, ICICI Direct Research

Healthy EBITDA & PAT growth, going forward

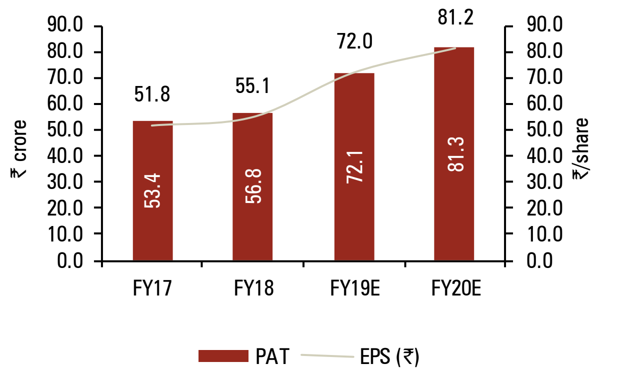
EBITDA is expected to grow at a CAGR of 16.5% in FY18-20E to ₹ 133.3 crore in FY20E. This is largely a result of sales volume growth (~11% CAGR) coupled with 230 bps expansion in EBITDA margins. EBITDA margins are expected to expand as the capex is brownfield in nature. This may result in sharing of overhead costs on expanded base.

Exhibit 3: EBITDA & EBITDA margins trend



Source: Company, ICICI Direct Research

Exhibit 4: PAT & EPS trend



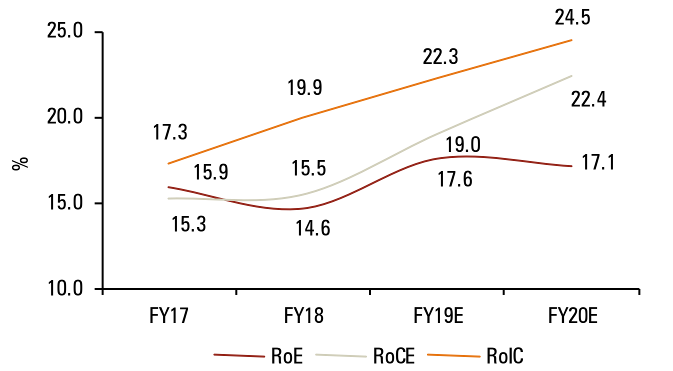
Source: Company, ICICI Direct Research

In FY18-20E, on account of sales volume growth (12.3% CAGR), expansion in EBITDA margins (230 bps) and decline in interest costs (due to repayment of debt), we expect PAT to grow at a CAGR of 19.7% over FY18-20E to ₹ 81.3 core in FY20E. Corresponding EPS is expected at ₹ 72.0 in FY19E & ₹ 81.2 in FY20E.

Increasing profitability to result in improved return ratio profile

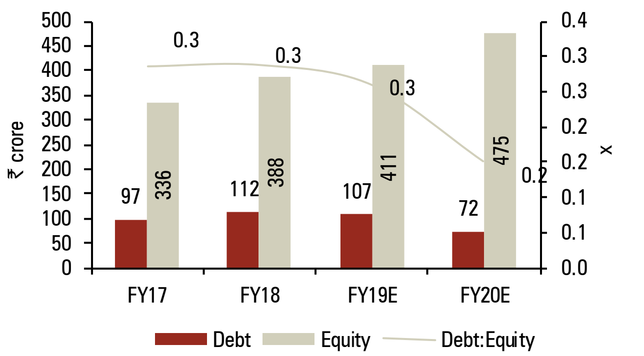
Post the blip in FY17, return ratios are expected to improve with RoE & RoCE expected to perk up to ~17% & ~22%, respectively, by FY20E. Return ratios are also suppressed due to surplus cash with the company, which it intends to spend on future growth opportunities for growth beyond FY20E.

Exhibit 5: Return ratios profile



Source: Company, ICICI Direct Research

Exhibit 6: Debt: equity trend



Source: Company, ICICI Direct Research

Low planned capex, healthy cash flows improve debt gearing!

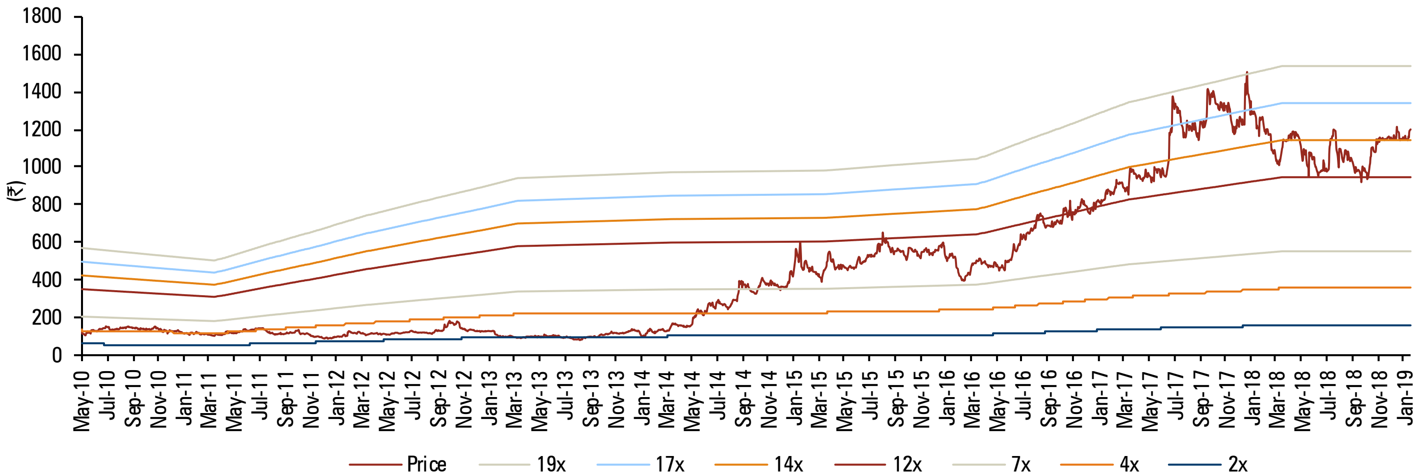
OCCL has a healthy balance sheet with gross debt of ₹ 112 crore as of FY18 with consequent debt: equity at 0.3x. We expect the debt gearing to be controlled due to healthy generation of cash from operations. OCCL is expected to generate average CFO of ~₹ 95 crore/year in FY18-20E with debt: equity expected to reduce further to ~0.2x in the aforesaid period. The company has also a controlled working capital cycle with net working capital days of ~73 days in FY18.

Outlook and valuation

Oriental Carbon & Chemicals (OCCL) is a speciality chemical company manufacturing insoluble sulphur, a critical vulcanisation agent for manufacturing tyres. With limited competition and a unique product profile, OCCL has a strong presence in the domestic (~50% market share) as well as export markets. With the robust auto sector outlook, increasing share of radialisation in India's CV segment and operational efficiencies, OCCL is on a strong footing with robust prospects, going forward.

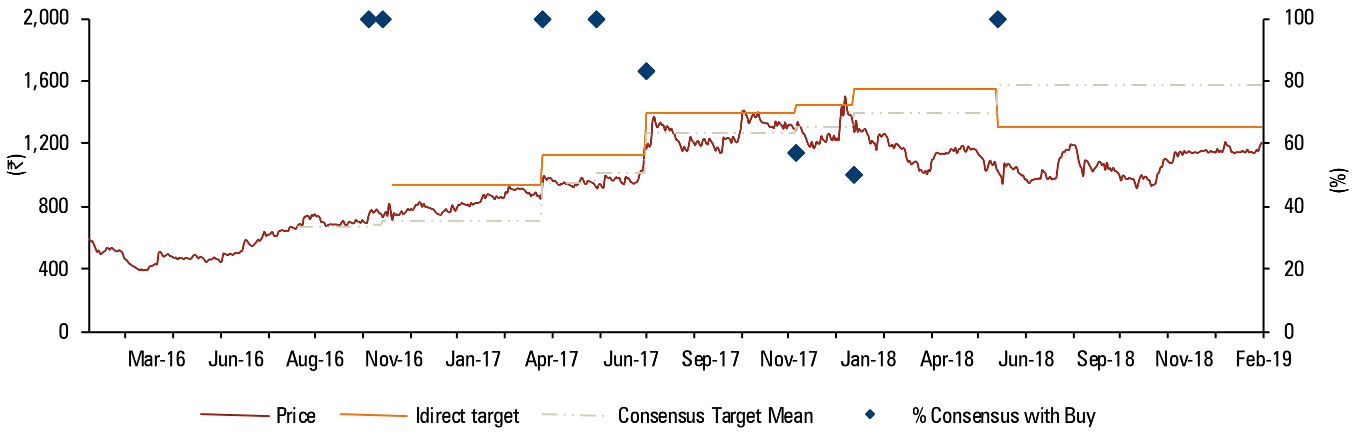
OCCL manufactures insoluble sulphur and is one of the three credible players worldwide. It operates in a closely guarded technology space with small industry size (~₹ 3500 crore) and low asset turnovers (~1x) which limit the competition in the market place. Therefore, given the impressive utilisation of the expanded capacity, the next leg of capex is on the anvil for OCCL. However, with low asset turns (~1x) and B2B nature of business profile we expect limited scope RoCE expansion from current levels, which will limit the valuation multiple expansion, going forward. From a fundamental perspective, OCCL remains a steady business model wherein asset turnover is ~1x, EBITDA margins is ~30% and net working capital cycle is ~75 days with consequent RoCE at ~20%. It can certainly be held in one's portfolio from a long term investment horizon perspective. Going forward, over FY18-20E, expect sales, PAT to grow at a CAGR of 12.3% & 19.7%, respectively, wherein we build in 230 bps expansion in EBITDA margins to 32.2% in FY20E. We value OCCL at ₹ 1300 i.e. 16x P/E on FY20E EPS of ₹ 81.2/share with a **HOLD** rating on the stock. We draw comfort from healthy cash flow generation with present CFO yield at ~8%. We also build in successful closure of buyback amounting to ~₹ 35 crore in FY19E.

Exhibit 7: Two year forward P/E (OCCL currently trading at 14.8x)



Source: Reuters, 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
2004	OCCL sets up second line of insoluble sulphur increasing its capacity in Dharuera by 4000 metric tonne (MT)
2010	The company increases insoluble sulphur capacity to 12000 MT through debottlenecking
2011	OCCL reports net sales of ₹ 158.2 cr (up 25.9% YoY) and net profit of ₹ 37.4 cr (up 27.2% YoY) on the back of robust global demand and capacity expansion through debottlenecking. Major tyre manufacturers identify OCCL as a strategic supplier
2012	The company commissions Phase I at the Mundra SEZ Plant (5500 MT) in August 2011 taking the total capacity to 17500 MT. Robust demand and product validation and approvals by major tyre manufacturers augurs well for the company thereby fastracking the capacity utilisation levels at OCCL
2013	OCCL fully commissions Phase II at the Mundra SEZ Plant (5500 MT) in May 2012 taking the total insoluble sulphur capacity to 23000 MT. OCCL was impacted by the global slowdown of insoluble sulphur demand as tyre companies took production cuts. OCCL acquires 50% stake in Schrader Duncan Ltd
2014	Domestic sales of insoluble sulphur grow 12% while export sales grow 14%. With existing land availability at Mundra facility and tyre industry steadily getting out of recession OCCL plans another expansion of 11000 MT over two phases
2015	In FY15, OCCL's gross revenue from insoluble sulphur increased 5% YoY. Export sales quantity increases 10% YoY on account of increased off take by existing customers and addition of some new customers. The growth rate in domestic volumes is only 6% as the tyre industry in India is in the grip of a slowdown and demand picks up late in the second half of the year
2016	OCCL executing brownfield expansion (11000 tonne in two phases with each phase of 5500 tonne) in Mundra. The first phase of capacity expansion is expected to be commissioned ahead of schedule by the end of FY17E against the initial guidance of April 2017
2017	OCCL successfully commissions Phase 1 (5500 tonne) facility in December 2017 at Mundra. The company expects to fully ramp up the facility within a year. OCCL is confident of tying up additional quantities in American and Chinese market, where it has begun to establish its presence
2018	OCCL has commenced trail runs from Phase 2 (5500 tonne) of brownfield expansion and expects it to commission soon. For full year FY18, Net sales stood at ₹ 328.2 crore (up 10.3% YoY), EBITDA stood at ₹ 98.2 crore (EBITDA margins at 29.9%, up 60 bps YoY) and PAT at ₹ 56.8 crore, up 6.4% YoY.

Source: Company, ICICI Direct Research

Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Cosmopolitan Investments, Ltd.	30-Sep-18	19	1.9	0.0
2	New India Investment Corporation, Ltd.	30-Sep-18	12	1.2	0.0
3	Duncan International (India) Ltd.	30-Sep-18	10	1.0	0.0
4	HDFC Asset Management Co., Ltd.	30-Sep-18	9	0.9	0.0
5	L&T Investment Management Limited	30-Sep-18	7	0.7	0.1
6	Haldia Investment Co., Ltd.	30-Sep-18	6	0.6	0.0
7	Life Insurance Corporation of India	30-Sep-18	4	0.4	0.0
8	General Insurance Corporation of India	30-Sep-18	3	0.3	0.0
9	Goenka (Aparna)	30-Sep-18	2	0.2	0.0
10	DSP Investment Managers Pvt. Ltd.	30-Sep-18	1	0.1	0.0

Source: Reuters, ICICI Direct Research

Shareholding Pattern

(in %)	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Promoter	49.8	49.8	49.8	50.0	50.7
FII	1.2	1.4	1.0	0.4	0.4
DII	21.0	21.1	21.2	22.6	23.6
Others	28.0	27.8	28.0	26.9	25.3

Recent Activity

Buys			Sells		
Investor name	Value (US$M)	Shares(M)	Investor name	Value (US$M)	Shares(M)
L&T Investment Management Limited	2.0	0.1			
HSBC Global Asset Management (India) Pvt Ltd	0.8	0.0			

Source: Reuters, ICICI Direct Research

Financial summary (Standalone)

Profit and loss statement (₹ Crore)

(Year-end March)	FY17	FY18	FY19E	FY20E
Net Sales	294.5	328.2	381.7	414.0
Other Operating Income	3.0	0.0	0.0	0.0
Total Operating Income	297.5	328.2	381.7	414.0
Growth (%)	8.3	10.3	16.3	8.4
Raw Material Expenses	70.7	76.1	94.9	102.3
Employee Expenses	38.2	39.4	45.1	48.9
Power & Fuel Expenses	36.1	39.4	43.9	47.6
Other Operating Expense	65.1	75.2	75.4	82.0
Total Operating Expenditure	210.2	230.0	259.4	280.7
EBITDA	87.3	98.2	122.4	133.3
Growth (%)	7.7	12.6	24.6	8.9
Depreciation	15.2	16.3	18.8	20.3
Interest	5.1	7.9	8.2	6.4
Other Income	6.6	5.5	5.6	7.0
PBT	73.6	79.6	100.9	113.7
Exceptional Item	0.0	0.0	0.0	0.0
Total Tax	20.2	22.8	28.9	32.4
PAT	53.4	56.8	72.1	81.3
Growth (%)	0.9	6.2	27.0	12.8
EPS (₹)	51.8	55.1	72.0	81.2

Source: Company, ICICI Direct Research

Cash flow statement (₹ Crore)

(Year-end March)	FY17	FY18	FY19E	FY20E
Profit after Tax	53.4	56.8	72.1	81.3
Add: Depreciation	15.2	16.3	18.8	20.3
(Inc)/dec in Current Assets	9.7	12.4	-19.3	-12.8
Inc/(dec) in CL and Provisions	12.2	2.8	11.2	5.3
Others	5.1	7.9	8.2	6.4
CF from operating activities	95.6	96.1	91.0	100.4
(Inc)/dec in Investments	-14.6	-22.7	0.0	-25.0
(Inc)/dec in Fixed Assets	-101.3	-56.2	-25.0	-10.0
Others	8.5	-17.4	0.0	0.0
CF from investing activities	-107.4	-96.3	-25.0	-35.0
Issue/(Buy back) of Equity	0.0	0.0	-0.3	0.0
Inc/(dec) in loan funds	24.1	15.5	-5.0	-35.0
Dividend paid & dividend tax	-12.4	-12.4	-14.4	-16.8
Inc/(dec) in Share Cap	0.0	0.0	0.0	0.0
Others	3.6	-0.8	-42.9	-6.4
CF from financing activities	15.3	2.4	-62.6	-58.2
Net Cash flow	3.5	2.3	3.4	7.3
Opening Cash	9.9	13.4	15.6	19.0
Closing Cash	13.4	15.6	19.0	26.3

Source: Company, ICICI Direct Research

Balance sheet (₹ Crore)

(Year-end March)	FY17	FY18	FY19E	FY20E
Liabilities				
Equity Capital	10.3	10.3	10.0	10.0
Reserve and Surplus	326.0	377.5	400.5	465.0
Total Shareholders funds	336.3	387.8	410.5	475.0
Total Debt	96.5	112.0	107.0	72.0
Deferred Tax Liability & Others	29.6	20.6	20.6	20.6
Total Liabilities	462.4	520.4	538.1	567.6
Assets				
Gross Block	421.3	439.6	502.4	512.4
Less: Acc Depreciation	115.2	131.6	150.4	170.7
Net Block	306.1	308.0	352.0	341.7
Capital WIP	2.4	40.4	2.5	2.5
Total Fixed Assets	308.5	348.4	354.5	344.2
Liquid Investments	30.1	52.8	52.8	77.8
Other Investments	14.7	23.0	23.0	23.0
Inventory	32.2	38.6	47.1	51.0
Debtors	72.6	75.6	88.9	96.4
Loans and Advances	34.3	17.8	15.3	16.6
Other Current Assets	6.0	0.7	0.8	0.8
Cash	13.4	15.6	19.0	26.3
Total Current Assets	158.4	148.3	171.0	191.2
Creditors	46.9	49.0	57.5	62.4
Provisions	2.4	3.1	5.8	6.2
Current Liabilities & Prov	49.3	52.1	63.3	68.6
Net Current Assets	109.1	96.2	107.8	122.5
Application of Funds	462.4	520.4	538.1	567.6

Source: Company, ICICI Direct Research

Key ratios

(Year-end March)	FY17	FY18	FY19E	FY20E
Per share data (₹)				
EPS	51.8	55.1	72.0	81.2
Cash EPS	66.5	70.9	90.8	101.5
BV	326.2	376.2	410.3	474.7
DPS	10.0	10.0	12.0	14.0
Cash Per Share (Incl Invst)	42.1	66.4	71.8	104.1
Operating Ratios (%)				
EBITDA Margin	29.3	29.9	32.1	32.2
PBT / Total Op. income	24.7	24.2	26.4	27.5
PAT Margin	18.0	17.3	18.9	19.6
Inventory days	39.9	42.9	45.0	45.0
Debtor days	89.9	84.1	85.0	85.0
Creditor days	58.1	54.5	55.0	55.0
Return Ratios (%)				
RoE	15.9	14.6	17.6	17.1
RoCE	15.3	15.5	19.0	22.4
RoIC	17.3	19.9	22.3	24.5
Valuation Ratios (x)				
P/E	23.2	21.8	16.7	14.8
EV / EBITDA	14.8	13.0	10.4	9.0
EV / Net Sales	4.4	3.9	3.3	2.9
Market Cap / Sales	4.2	3.8	3.2	3.0
Price to Book Value	3.7	3.2	2.9	2.5
Solvency Ratios				
Debt/EBITDA	1.1	1.1	0.9	0.5
Debt / Equity	0.3	0.3	0.3	0.2
Current Ratio	2.9	2.5	2.4	2.4
Quick Ratio	2.3	1.8	1.7	1.7

Source: Company, ICICI Direct Research

RATING RATIONALE

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Buy: >10%/15% for large caps/midcaps, respectively;
Hold: Up to +/-10%;
Sell: -10% or more;

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