

Phillips Carbon Black (PHICAR)

CMP: ₹ 118

Target: ₹ 150 (27%)

Target Period: 12 months

August 9, 2019

BUY

One-offs behind, healthy EBITDA margins to prevail...

Phillips Carbon Black (PCBL) reported a healthy Q1FY20 performance adjusted for one-off line item in other expenses. Carbon black (CB) sales volume for the quarter was at 107 KT, up 8.1% YoY supported by 37% YoY volume growth in export markets (28 KT). Consequent net sales were at ₹ 912 crore. EBITDA in Q1FY20 was at ₹ 114 crore with corresponding EBITDA margins at 12.4%, EBITDA/tonne at ₹ 10,600/tonne. Adjusting for one off, EBITDA was at ₹ 149 crore with EBITDA margin at 16.3% & EBITDA/tonne at ₹ 13,900/tonne. Consequent PAT in Q1FY20 was at ₹ 65 crore.

Higher share of replacement demand in tyre to protect volumes

Carbon black is used as a reinforcing agent in manufacturing tyres and constitutes ~26% of tyre by volume. Tyres industry by virtue of having higher share of replacement demand (~60% of sales) vs. the OEM sales (~30% of sales) is somewhat insulated from the prevailing slump in vehicle sales domestically and is expected to steadily grow at a CAGR of 7%+. **This ensures healthy carbon black demand with PCBL as a natural beneficiary which is a market leader domestically with a market share of ~35%.** Moreover, in the disruptive Electric Vehicle Technology, major changes will happen on the engine front, with tyres again insulated from change in technology landscape; thereby proving longevity to carbon black demand. With incremental capacities in place as well as no meaningful capacity addition in the international markets, we expect volumes at PCBL to grow at a CAGR of 4.5% over FY19-21E to 440 KT in FY21E (403 KT in FY19).

Health of earnings set to improve, going big in speciality grade!

Tyre constitute bulk of Carbon black demand at ~73% with non-tyre usage at ~20% and speciality carbon black usage at ~7%. Speciality grade CB is a technology advanced product, which finds application in paints, plastics, etc. It has ~1.5-2.0x normal CB realisation but clocks ~3-4x EBITDA/tonne leading to disproportionate increase in profitability as the share of specialty grade increases. Though years of indigenous research in this domain, PCBL has made a mark for itself in the global markets and is set to venture out big with share of speciality grade CB set to improve to ~9% of sales in FY21. Recently commissioned R&D centre is a progressive step in this direction.

Valuation & Outlook

FY19 was a superlative year for PCBL with EBITA margins inching up to 20%, primarily driven by tight demand-supply situation in domestic market. With demand situation now normalised and with one-offs behind it, we expect normalcy in earnings to prevail from Q2FY19 onwards with EBITDA margin expectation of ~16% vs. 12.4% clocked in Q1FY20. We value PCBL at ₹ 150 i.e. 5x EV/EBITDA on FY21E numbers and assign a **BUY** rating to stock. We drive comfort from healthy CFO yield (> 15%) & return ratios profile (> 15%).

Key Financial Summary

Key Financials	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Net Sales	1,924.1	2,546.9	3,528.6	3,588.7	3,712.5	2.6%
EBITDA	258.6	386.0	622.8	544.0	603.3	-1.6%
EBITDA Margins (%)	13.4	15.2	17.6	15.2	16.3	
Net Profit	69.5	229.8	388.5	321.8	350.0	-5.1%
EPS (₹)	4.0	13.3	22.5	18.7	20.3	
P/E	29.3	8.8	5.2	6.3	5.8	
RoNW (%)	6.2	16.7	23.6	17.0	16.2	
RoCE (%)	10.5	15.6	22.8	17.5	18.8	

Source: ICICI Direct Research, Company



Particulars

Stock Data	₹ crore
Market Capitalization	2033
Total Debt (FY19)	796
Cash and Cash Equivalent (FY19)	185
Enterprise Value	2645
52 week H/L (₹)	287 / 106
Equity Capital	34.5
Face Value	₹ 2

Key Highlights

- Adjusting for one-offs, PCBL reported healthy performance in Q1FY20 with carbon black volumes at 107 KT, up 8% YoY
- With one-offs behind, incremental capacities in place, we expect PCBL to clock healthy earnings, going forward
- CB volume expected to grow at a CAGR of 4.5% over FY19-21. Share of speciality grade CB on a rise (9% in FY21E).
- Maintain BUY with revised target price of ₹ 150. PCBL trades at 4.0x EV/EBITDA, 6x P/E and 1x P/B on FY21E numbers

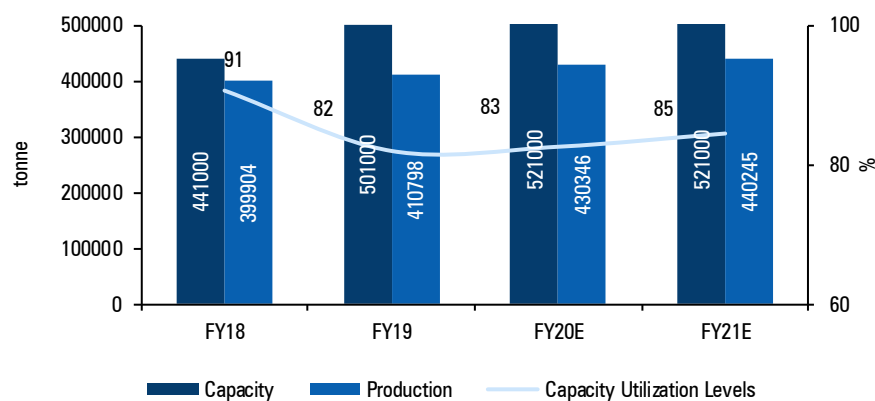
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Financial story in charts

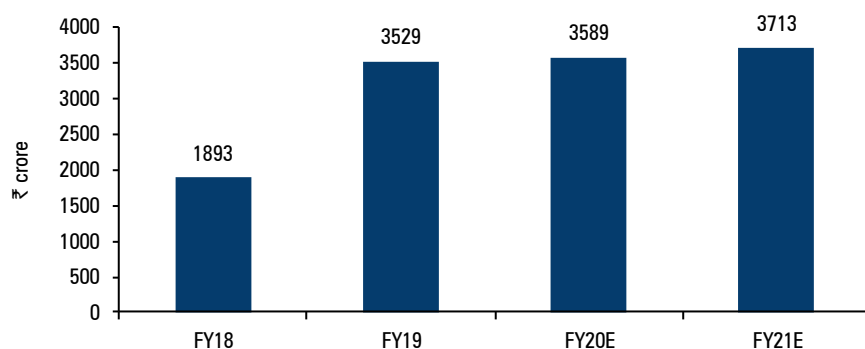
Exhibit 1: Effective capacity, production and utilisation levels



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

Source: Company, ICICI Direct Research

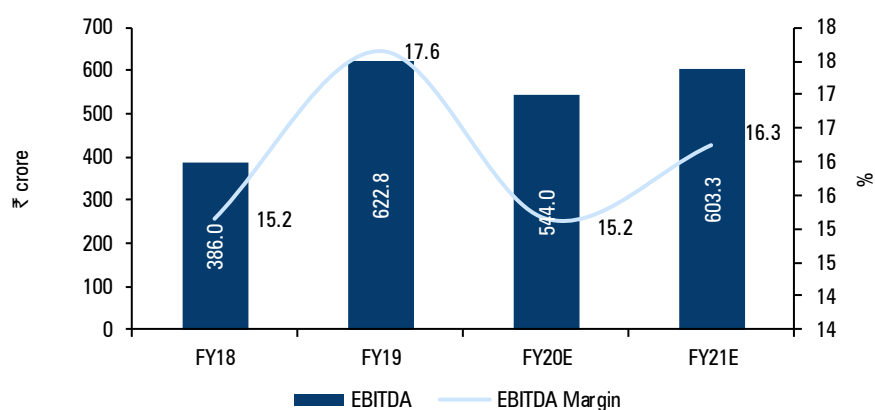
Exhibit 2: Topline trend



We expect sales to grow at a CAGR of 2.6% over FY19-21E, which includes a volume growth of 4.5% CAGR in the aforesaid period. Realisations are expected to be softer given Benin outlook on crude price

Source: Company, ICICI Direct Research

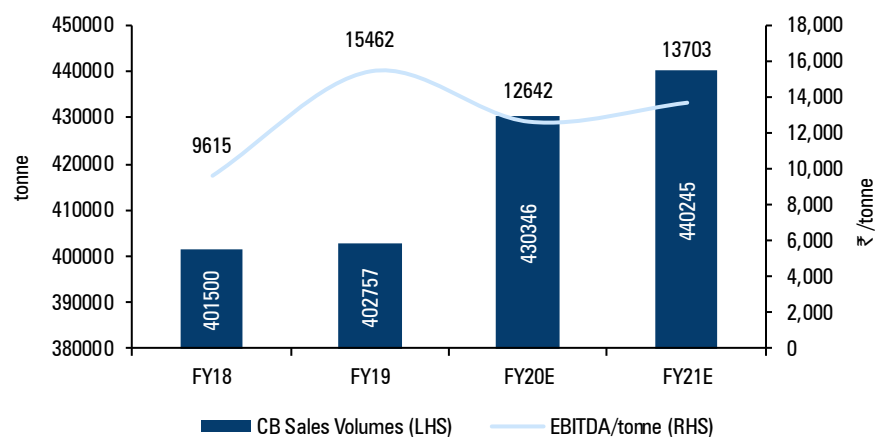
Exhibit 3: EBITDA and EBITDA margin trend



Given the high base in FY19, we expect EBITDA margins to taper to 16.3% in FY21E

Source: Company, ICICI Direct Research

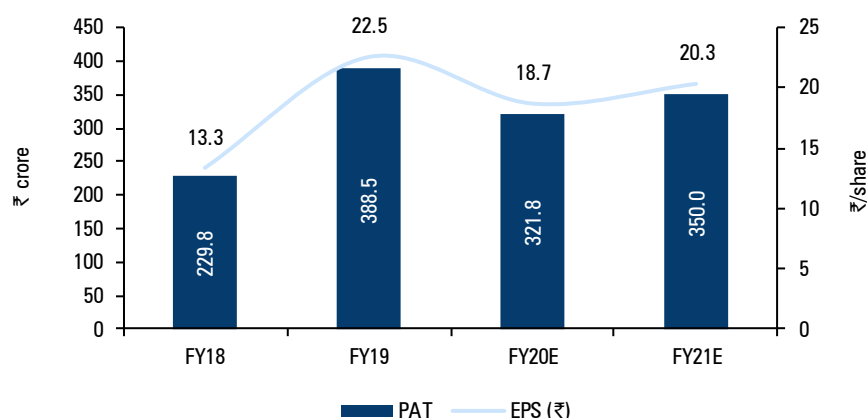
Exhibit 4: Sales volume and EBITDA/tonne trend



Source: Company, ICICI Direct Research

EBITDA/tonne is expected to improve to ₹ 12,642/tonne in FY20E & ₹ 13,703/tonne in FY21E

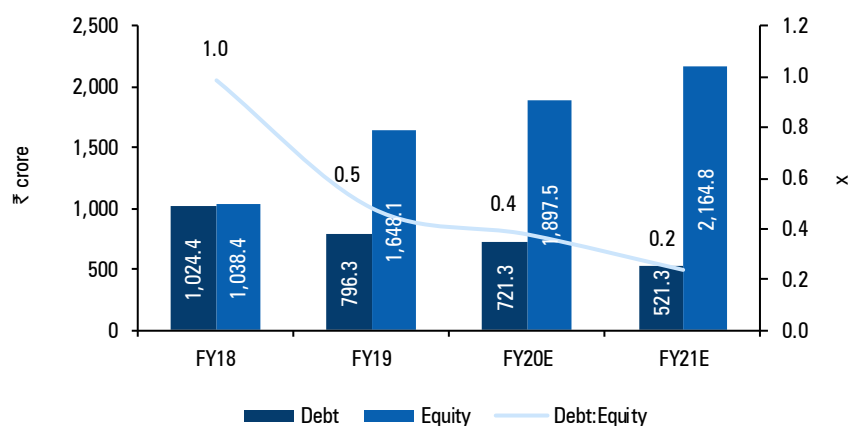
Exhibit 5: PAT & EPS trend



Source: Company, ICICI Direct Research

Earnings CAGR is negative tracking high base

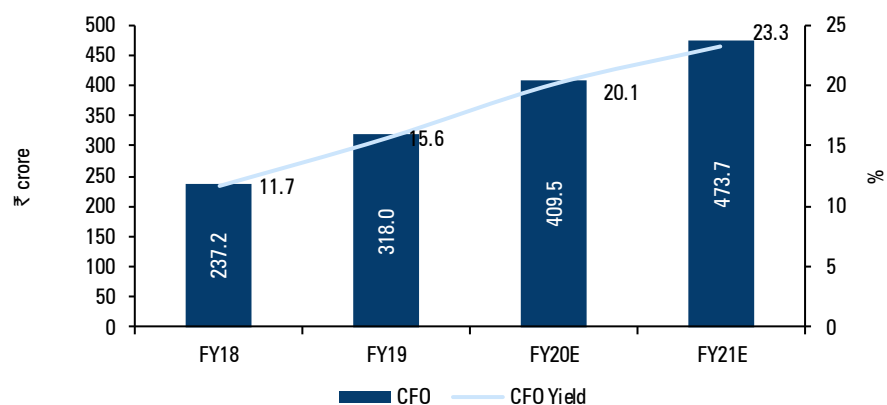
Exhibit 6: Debt leverage profile



Source: Company, ICICI Direct Research

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

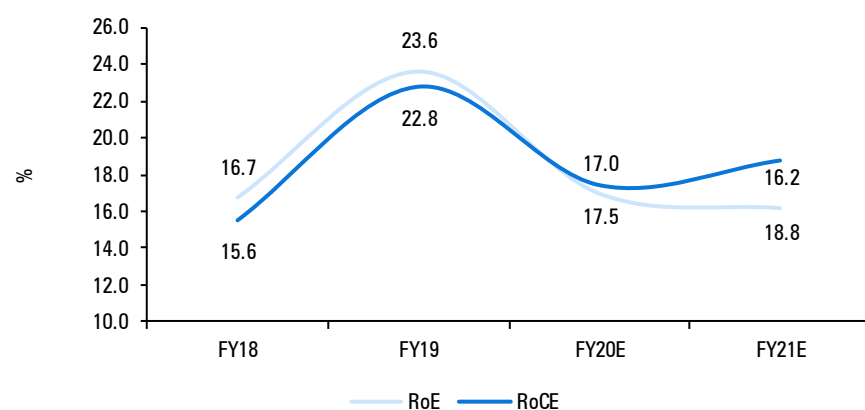
Exhibit 7: Healthy CFO generation



CFO generation is robust with average CFO generation of ~₹ 400 crore in FY19-21E vs. the MCap of ~₹ 2000 crore offering a healthy CFO yield of ~20%

Source: Company, ICICI Direct Research

Exhibit 8: Return ratio trend



Return ratio profile is healthy with RoCE comfortably placed at ~18%

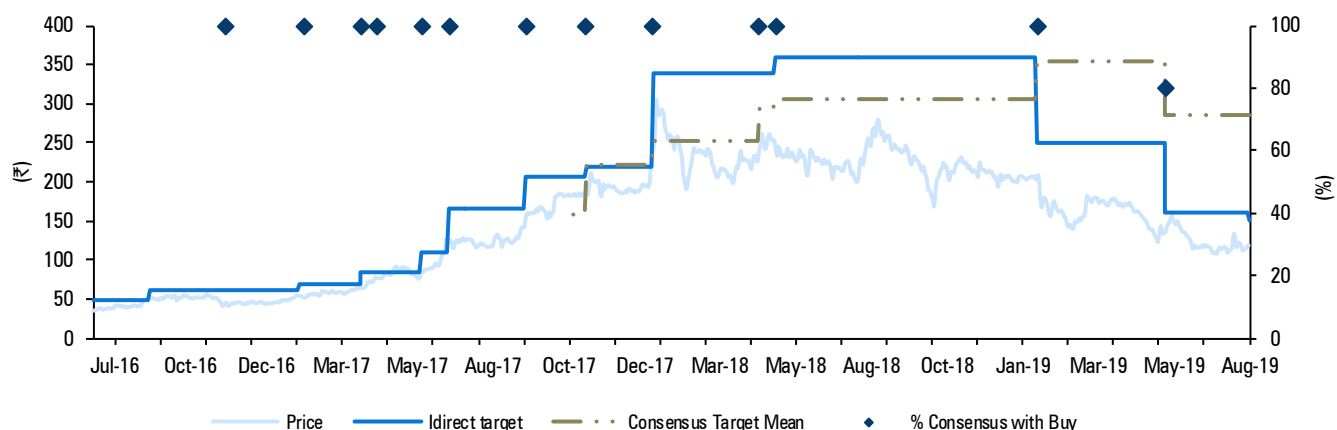
Source: Company, ICICI Direct Research

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	8.8	6.8	16.7	15.6
FY19	3528.6	38.5	22.5	69.1	5.2	4.2	23.6	22.8
FY20E	3588.7	1.7	18.7	-17.2	6.3	4.9	17.0	17.5
FY21E	3712.5	3.4	20.3	8.8	5.8	4.0	16.2	18.8

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	30-Jun-19	50.2	86.5	0.0
2	Dotex Merchandise Pvt. Ltd.	30-Jun-19	3.1	5.3	0.0
3	Kerala State Industrial Development Co.,	30-Jun-19	1.4	2.3	0.0
4	Fidelity Management & Research Comp	30-Jun-19	1.2	2.0	2.0
5	Fidelity International	31-Mar-19	1.2	2.0	-1.4
6	Dimensional Fund Advisors, L.P.	30-Jun-19	1.1	1.9	0.0
7	Wellington Management Company, LLP	30-Jun-19	1.1	1.9	-4.1
8	L&T Investment Management Limited	31-Mar-19	1.1	1.8	0.0
9	FIL Investment Management (Singapore)	31-Mar-19	1.0	1.7	-1.7
10	BlackRock Institutional Trust Company, I	31-Jul-19	0.4	0.7	0.0

Source: Reuters, ICICI Direct Research

Exhibit 12: Recent activity

Buys			Sells		
Investor name	Value (\$mn)	Shares(mn)	Investor name	Value (\$mn)	Shares(mn)
Fidelity Management & Research Company	+3.4M	+2.0M	Wellington Management Company, LLP	-6.9M	-4.1M
BlackRock Institutional Trust Company, N.A.	+0.0M	+0.0M	FIL Investment Management (Singapore) Ltd.	-4.4M	-1.7M
Mellon Investments Corporation	+0.0M	+0.0M	Fidelity International	-3.5M	-1.4M
			Lazard Asset Management, L.L.C.	-1.6M	-0.6M
			Copper Rock Capital Partners LLC	-0.8	-0.4

Source: Reuters, ICICI Direct Research

Exhibit 13: Shareholding pattern

(in %)	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Promoter	53.6	53.6	53.6	53.6	53.6
FII	10.8	11.0	11.4	10.3	9.8
DII	3.4	2.8	2.8	2.1	0.4
Others	32.3	32.6	32.3	34.1	36.2

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	3588.7	3712.5
Other Operating Income	0.0	0.0	0.0	0.0
Total Operating Income	2546.9	3528.6	3588.7	3712.5
Growth (%)	32.0	38.5	1.7	3.4
Raw Material Expenses	1,659.3	2,296.6	2,424.5	2,468.8
Employee Expenses	97.2	110.9	121.8	131.8
Selling Expense	101.9	141.1	143.5	148.5
Other Operating Expense	302.5	357.2	354.8	360.1
Total Operating Expenditure	2,160.9	2,905.8	3,044.7	3,109.2
EBITDA	386.0	622.8	544.0	603.3
Growth (%)	49.0	61.3	-12.6	10.9
Depreciation	60.5	66.4	87.0	98.8
Interest	41.4	36.4	53.1	46.6
Other Income	19.7	18.8	22.0	18.3
PBT	303.8	538.8	425.9	476.2
Exceptional Item	0.0	0.0	0.0	0.0
Total Tax	74.0	150.3	104.1	126.2
PAT	229.8	388.5	321.8	350.0
Growth (%)	231.0	69.1	-17.2	8.8
EPS (₹)	13.3	22.5	18.7	20.3

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	321.8	350.0
Add: Depreciation	60.5	66.4	87.0	98.8
(Inc)/dec in Current Assets	-151.5	-319.0	-73.0	-45.2
Inc/(dec) in CL and Provisions	57.1	145.7	20.6	23.4
Others	41.4	36.4	53.1	46.6
CF from operating activities	237.2	318.0	409.5	473.7
(Inc)/dec in Investments	-28.4	-46.4	75.1	-40.0
(Inc)/dec in Fixed Assets	-65.2	-275.8	-275.0	-100.0
Others	32.8	18.3	0.0	0.0
CF from investing activities	-60.8	-303.9	-199.9	-140.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-38.6	75.6	-75.0	-200.0
Interest & Dividend paid	-91.1	-108.8	-125.5	-129.3
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	-73.5	-200.5	-329.3
Net Cash flow	113.0	-59.4	9.1	4.4
Opening Cash	26.0	139.0	79.6	88.7
Closing Cash	139.0	79.6	88.7	93.1

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	1,863.0	2,130.3
Total Shareholders funds	1372.3	1648.1	1897.5	2164.8
Total Debt	720.7	796.3	721.3	521.3
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	2701.9	2876.4	2943.6
Assets				
Gross Block	1579.5	1746.5	2121.5	2271.5
Less: Acc Depreciation	180.3	246.1	333.2	432.0
Net Block	1399.2	1500.3	1788.3	1839.5
Capital WIP	66.8	175.0	75.0	25.0
Total Fixed Assets	1,466.0	1,675.4	1,863.4	1,864.5
Investments	337.4	383.8	308.7	348.7
Inventory	309.9	460.3	491.6	508.6
Debtors	522.0	652.7	688.2	712.0
Loans and Advances	65.5	102.3	107.7	111.4
Other Current Assets	19.7	20.8	21.5	22.3
Cash	139.0	79.6	88.7	93.1
Total Current Assets	1,056.0	1,315.6	1,397.8	1,447.3
Current Liabilities	422.9	573.3	589.9	610.3
Provisions	77.2	84.5	88.5	91.5
Current Liabilities & Prov	500.1	657.8	678.4	701.8
Net Current Assets	555.9	657.8	719.3	745.5
Others Assets	-26.9	-15.0	-15.0	-15.0
Application of Funds	2332.4	2701.9	2876.4	2943.6

Source: Company, ICICI Direct Research

Exhibit 17: Key ratios				
(Year-end March)	FY18	FY19	FY20E	FY21E
Per share data (₹)				
EPS	13.3	22.5	18.7	20.3
Cash EPS	16.8	26.4	23.7	26.0
BV	79.6	95.7	110.1	125.6
DPS	2.4	3.5	3.5	4.0
Cash Per Share (Incl Invst)	27.6	26.9	23.1	25.6
Operating Ratios (%)				
EBITDA Margin	15.2	17.6	15.2	16.3
PAT Margin	9.0	11.0	9.0	9.4
Inventory days	44.4	47.6	50.0	50.0
Debtor days	74.8	67.5	70.0	70.0
Creditor days	60.6	59.3	60.0	60.0
Return Ratios (%)				
RoE	16.7	23.6	17.0	16.2
RoCE	15.6	22.8	17.5	18.8
RoIC	15.1	23.6	16.8	17.9
Valuation Ratios (x)				
P/E	8.8	5.2	6.3	5.8
EV / EBITDA	6.8	4.2	4.9	4.0
EV / Net Sales	1.0	0.7	0.7	0.7
Market Cap / Sales	0.8	0.6	0.6	0.5
Price to Book Value	1.5	1.2	1.1	0.9
Solvency Ratios				
Debt/EBITDA	1.9	1.3	1.3	0.9
Debt / Equity	0.5	0.5	0.4	0.2
Current Ratio	1.8	1.9	1.9	1.9
Quick Ratio	1.2	1.2	1.2	1.2

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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