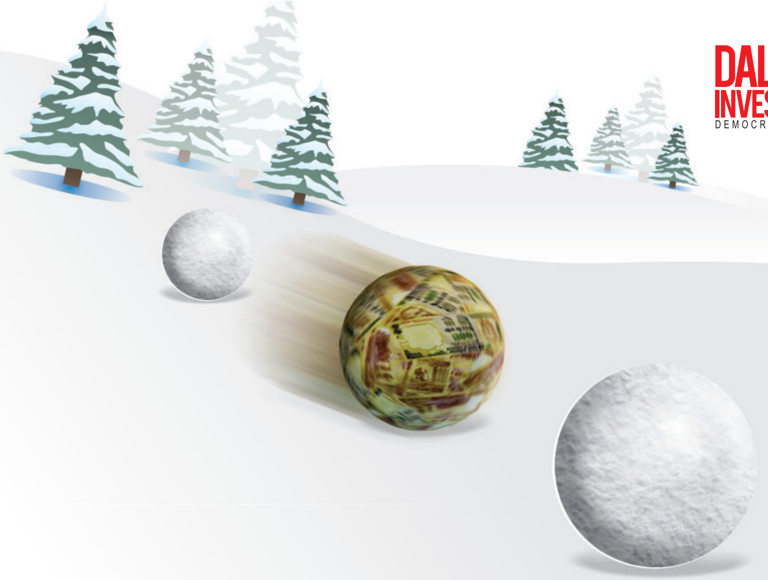

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DEMOCRATIZING WEALTH CREATION

MID BRIDGE
THE MIDCAP MARVEL

October 2018

COMPANY NAME	:	**Phillips Carbon Black**
BSE Code	:	**506590**
Time Duration	:	**1 year**
CMP	:	**₹218.30 (as on 17 Oct., 2018)**
Target Price	:	**₹282**

The Mid Bridge for the month of October is Phillips Carbon Black Limited. The group is primarily engaged in the business of manufacturing and sale of carbon black and sale of power. The company majorly operates in two segments, namely, carbon black and power. Carbon black is manufactured in four manufacturing units located at Durgapur, Kochi, Vadodara and Mundra. The company's power business segment is engaged in generation of electricity for the purpose of captive consumption as well as distribution of surplus to outsiders. It has manufacturing facilities at four locations in India with an aggregate installed carbon black capacity of 5,15,000 MT and co-generation power plant (CPP) capacity of 76 MW.

Much of the success of the carbon black industry has hinged on the subtle balance between global demand and supply. Most global and Indian capacities are already operating at optimal levels. Carbon black demand is expected to grow globally, but faster in India as 46 per cent of world's investments in tyre over the next 3-4 years is planned in Asia. The supply, on the other hand, is likely to remain constrained as no new major capacities are coming up and China is facing shortage of the raw material. This will keep the carbon black prices firm in the foreseeable future. This, coupled with 50 per cent CAGR in specialty carbon black volumes over the next three years (grown by 100 per cent CAGR for the last three years), where the absolute EBITDA/tonne is 3-4x rubber carbon black, savings in opex costs on new brownfield capacities, yield improvements and no further borrowings will cause the bottomline (~50 per cent CAGR) to grow faster than the topline (20-22 per cent CAGR).

Benefits from cost competition over raw material with China

At the start of 2016, stricter environmental norms were enforced in China, which led to a squeeze in steel production, thereby resulting in compression in coal tar (CT) and carbon black production. The consumption of coal tar, on the other hand, increased as the demand from the automobile sector increased. This caused the prices of coal tar to move up, thus making India more cost-competitive. Along with this, China's trend towards using electric furnace reduced availability of residue, which is the main component of carbon black. This resulted in higher cost from Chinese coal tar. This helped India to garner more market share through cost competitiveness.

This has resulted in higher capacity utilisation in India and has encouraged the Indian manufacturers to expand capacities. Along with that, imposition of of anti-dumping duty also helped Indian companies to match lower cost of production.

Demand supply gap - Domestically and globally

Currently, the global demand for CB is pegged at 13 MTPA and supply at 13.5 MTPA. There has not been much capacity addition since December 2016. Hence, the demand exceeds production, which will keep prices firm in near future. According to the industry forecast analysis, by 2021, the demand is expected grow to 14.8mn tonnes, surpassing the supply at 14.5 mn tonnes, largely driven by the automobile and tyre sectors. On the domestic front also, the demand is already higher than the supply. Looking at the expansion plans within the industry, only PCBL and Himadari are expanding capacities, while many other small players are opting out of it.

Demand in Auto industry

Rubber Carbon Black (RCB) is very important constituent for the tyre industry, which acts as a reinforcing agent and accounts for 10-12 per cent of the raw material cost. The demand movement of this is linked with the growth in the automobile and tyre industry. Now, looking at the forecast regarding the automobile industry by Society of Indian Automobile Manufacturers, the demand is rising in passenger vehicles by 8 per cent, commercial vehicle by 20 per cent, 3-wheeler by 24 per cent and two-wheeler by 15 per cent. This will boost the tyre industry, which is the main revenue generation source for the company. This may give positive push to the revenues in FY19-20.

Strong Client Base

The company has very strong clients who are not just big players in the tyre industry, but are also in strong growth phase which is very positive for Philip Carbon. Its clients include leading tyre companies across the globe such as Bridgestone, Goodyear, Michelin, Continental, Loadstar, Yokohama, TVS, Nexen, CEAT, MRF, JK, Sumitomo, Apollo, Balkrishna Tyres and Kumho. The company's association with some of them go back to over 15 years. PCBL enjoys the status of preferred supplier to some of these. In FY18, 92 per cent of the sales were from repeat clients.

Capacity Expansion

The company plans to invest Rs 900 crore towards capex by 2020. According to Sanjiv Goenka, Group Chairman, around Rs

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600 crore will go towards a greenfield plant in Tamil Nadu that is expected to be operational around September 2020. The company is setting up brownfield capacities at Mundra and Palej of 56,000 MTPA and 32,000 MTPA at a cost of Rs 300 crore, to be operational by Q3FY19 and Q2FY20, respectively. Overall, the expansion plans on execution will increase total capacity to 7 lakh tonnes from current 4.7 lakh tonnes.

The company exports to over 30 nations, with its exports accounting for 23 per cent of its revenues.

Specialty carbon black or non-rubber black

Specialty carbon black is an advanced technology-driven product which acts a pigment used in plastic, inks, batteries and paints and toners. It constitutes 7% of global CB demand. PCBL forayed into the specialty carbon black (SCB) segment three years ago and has already established itself as the leader in this segment. In FY18, this segment accounted for 9% of PCBL's volumes and 12% in value terms. Over the past 3 years, the company has been growing SCB volumes at 100% CAGR, which along with operational efficiencies, has added to an overall improvement in EBITDA margins from 8.7% in FY16 to 14.8% in FY18. The management is focusing on increasing penetration in this segment. It is ramping up its portfolio to reduce India's dependence on imports. It is more than doubling its capacity from 24,000 MTPA to 56,000 MTPA.

Financial Performance

Looking at company from the financial front, it posted revenue of Rs. 781 crore as against Rs. 641.78 crore in first quarter when compared YoY in FY19. The total revenue showed almost 95 per cent revenue coming from its major business of carbon black, while remaining came from the power business. Taking its segment-wise performance into account, carbon black sales stood at Rs. 754.54 crore, which was Rs. 619.04 crore during corresponding period last year. This shows a growth of 22 per cent in major revenues. On the operating front, the company posted further robust results with EBITDA at Rs. 160.67 crore as against Rs. 94.06 crore. The EBITDA margin stood at 20 per cent as compared to 15 per cent for the same period last year. It is notable that the company imports its 85 per cent raw material, which is directly exposed to currency volatility. But still, the company was able to achieve higher EBITDA margins mostly due to enhanced operational efficiency. During FY18, the company achieved 95 per cent capacity utilisation across the board. Its net profit during the period rose drastically to more than double when compared to last year's numbers. The PAT stood at Rs. 97.54 crore as compared to Rs. 48.16 crore YoY. Such high rise in net profit was on account of better operating management, inventory management and tax management.

Valuation

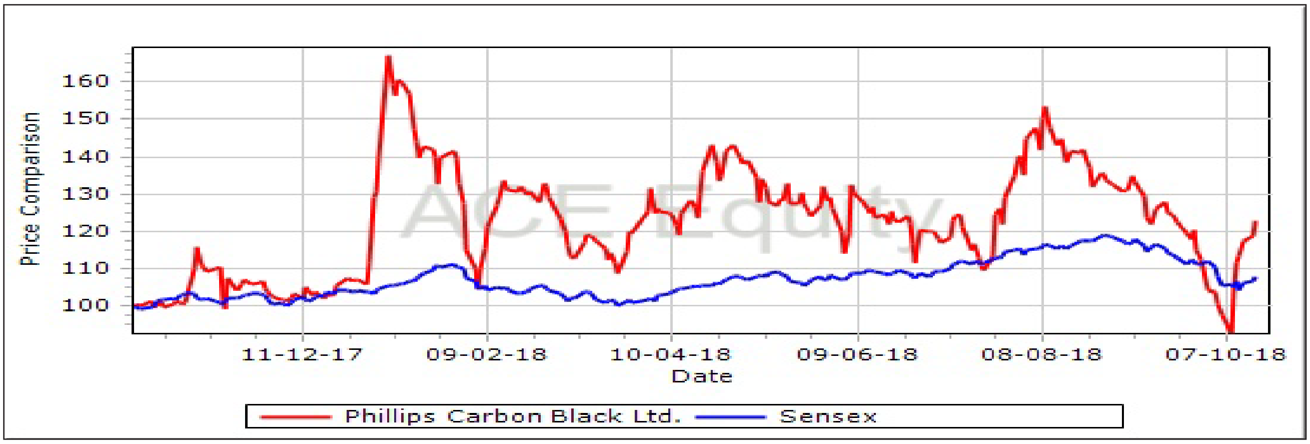
For FY18, the company posted ROE of 18.39 per cent, while it traded at PE of 12.56x. The company had debt-to-equity ratio of 0.52, which is on the higher side as it increased short-term borrowings in FY18 to meet the rising working capital requirement. The company uses its power business for its internal usage, which reduces outflow of cash. Also, it expects to increase its capacity utilisation further, which will further increase its operating profit. Also, during FY19, the company has plans to reduce debt significantly. These two factors will improve its EV/EBITDA ratio. We see potential upside of 29% with target price of Rs 282 over a period of one year. We urge investors to make investment in three tranches.

Inc/Exp Statement(Standalone) (Rs in Crore)

Description	201803	201703	201603	201503	201403
Net Sales	2546.98	1926.95	1894.10	2470.19	2277.46
Total Income	2584.15	1964.57	1932.13	2484.61	2297.98
Total Expenditure	2178.37	1686.99	1749.49	2317.95	2251.91
PBIDT	405.79	277.59	182.65	166.66	46.06
PAT	229.79	69.52	16.91	12.64	-86.60
Dividend %	120.00	60.00	25.00	10.00	
Adj. EPS(Rs)	13.33	4.03	0.98	0.73	-5.02

Quarter On Quarter (Standalone) (Rs in Crore)

Particulars	201806	201803	Q on Q Var%	201706	Y on Y Var%
Net Sales	781.42	753.01	3.77	640.24	22.05
Total Expenditure	624.43	651.05	-4.09	547.72	14.01
PBIDT (Excl OI)	156.99	101.96	53.97	92.52	69.68
PAT	97.54	74.25	31.37	48.16	102.53
PBIDTM% (Excl OI)	20.09	13.54	48.38	14.45	39.03
PBIDTM%	20.50	15.00	36.67	14.69	39.55
PATM%	12.48	9.86	26.57	7.52	65.96
Adj. EPS(Rs)	5.66	0.86	558.14	2.79	102.87


160
150
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Price Comparison
11-12-17
09-02-18
10-04-18
09-06-18
08-08-18
07-10-18
Date
Phillips Carbon Black Ltd.
Sensex
ACE Equity