

MANAGEMENT VISIT NOTE

Phillips Carbon Black

Business in a sweet spot

NOT RATED

Analyst

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Nifty: 9,607; Sensex: 31,103

CMP Rs479
Outlook Positive

Key Stock Data

Sector	Chemicals
Bloomberg / Reuters	PHCB IN / PHIL.BO
Shares o/s (mn)	34
Market cap. (Rsmn)	16,505
Market cap. (US\$ mn)	256

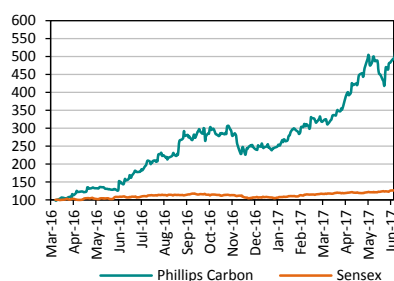
Price Performance

52-week high/low	Rs485/129		
	-1m	-3m	-12m
Absolute (%)	8	70	259
Rel to Sensex (%)	4	63	242

Shareholding Pattern (%)

Promoters	53.6
Institutions	10.9
Non-Institutions	35.5

Relative to Sensex



Source: Capitaline

Summary

- We met the management of Phillips Carbon Black (PCB) to get insights on its business and future plans.
- PCB is the largest manufacturer of carbon black in India (46% market share by capacity) and seventh largest in the world.
- It is expanding carbon black capacity by 42k tonnes via brownfield expansion (current capacity - 472k tonnes) with a modest capex of Rs1,400 mn.
- Value added products forms 9% of its volumes and 20% of EBITDA currently. The company aims to raise share of value added products to 20% of volumes and 40% of EBITDA by FY20.
- The company's net debt is likely to decline in the coming two years as it does not have any major capex plans. We have a positive view but do not have any rating on the stock.

Key takeaways from the meet

- **Brownfield capacity expansion with modest capex**
PCB is expanding carbon black capacity by 42k tonnes via brownfield expansion (current capacity - 472k tonnes) with a modest capex of Rs1,400 mn. Currently, it is the only one expanding carbon black capacity in India and has the ability to produce 56 different grades of carbon black. Further, PCB is doubling its specialty grade carbon to 24k tonnes with a capex of Rs700 mn. Specialty grade FY15/FY16/FY17 volumes stood at 2.5k/4.7k/8.0k tonnes, respectively.
- **Margins likely to increase with higher volumes of non-rubber portfolio**
The company's EBITDA/tonne has gone up sharply over the past few quarters due to improved efficiencies, operating leverage and better product mix. Value added products (non-rubber) forms 9% of volumes but contributes 20% to EBITDA currently. The company targets non-rubber (including specialty) volumes to contribute 20% of total volumes and contribute 40% to EBITDA by FY20. These products enjoy very high margins (EBITDA/tonne are higher by 3-5x compared to carbon black).
- **Low crude prices makes Indian carbon black players competitive internationally**
Carbon black can be manufactured using either coal tar (by product of the coking process) or carbon black feed stock (crude derivative). Post a decline in crude prices in 2014-15, Indian companies have become competitive in the international markets as prices of carbon black feed stock have come off sharply. Hence, PCB, seventh largest globally, has been able to increase exports over FY15-17. In the domestic market, carbon black players enjoy protection as there is an anti-dumping duty on import of carbon black from China of ~\$400/tonne till November 2020.
- **Outlook**
We believe PCB is in a sweet spot currently given rising tyre demand in India, competitive position in the international markets and improving product mix with rising sales of specialty products. The company's credit profile is also likely to strengthen with higher free cash flows, modest capex plans and declining debt. We have a positive view but do not have any rating on the stock.

Table: Financial snapshot

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY14	22,770	1,550	6.8	(866)	(25.1)	nm	9.3	(15.9)	(2.5)
FY15	24,850	2,100	8.5	126	3.7	42.6	20.6	2.5	5.6
FY16	19,080	2,150	11.3	150	4.3	15.3	10.5	4.4	7.1
FY17	19,470	3,080	15.8	730	21.1	16.8	9.8	13.8	16.5

Source: Company; Bloomberg; IDBI Capital Research

Other highlights

- The company is a sweet spot currently as realizations of carbon black are higher in international markets and is gaining market share.
- The company generally prices its products to OEMs based on formula which is linked to its raw materials. Hence, efficiency gains are EBITDA accretive.
- The working capital cycle is generally in the range of 80-90 days.
- The company is likely to step up dividends payments with rising profits; leverage to decline given no major capex plans.
- GST is unlikely to have any meaningful change in taxes on carbon black industry.
- The company has a vacant land in Chennai which can be used to set-up a greenfield carbon black manufacturing capacity in the future.

Company overview

Incorporated in 1960, PCB is a part of the RP-Sanjiv Goenka Group. It is the largest carbon black producer in India (seventh largest globally) with a total capacity of 472k tonnes. Carbon black is a critical component in tyre manufacturing and forms ~25% by volume of the tyre weight and ~10% by value of tyre costs. PCB also has integrated power plants at all of its plant locations (total capacity - 76 MW). The company also manufactures speciality grade carbon material (capacity - 12k tonnes). It operates four plants which are located in: West Bengal (147k tonnes), Mundra- Gujarat (140k tonnes), Palej- Gujarat (95k tonnes) and Kerala (90k tonnes).

Operating and financial matrix

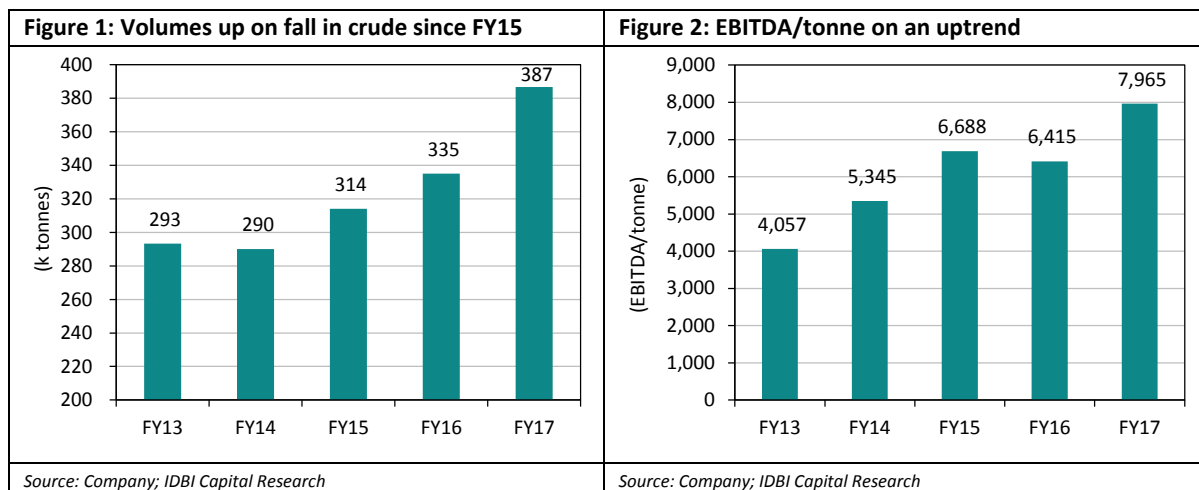
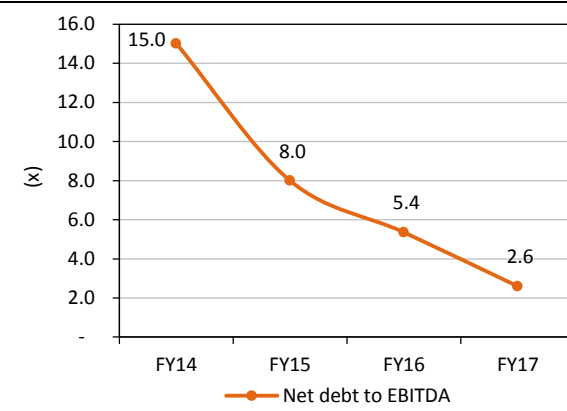
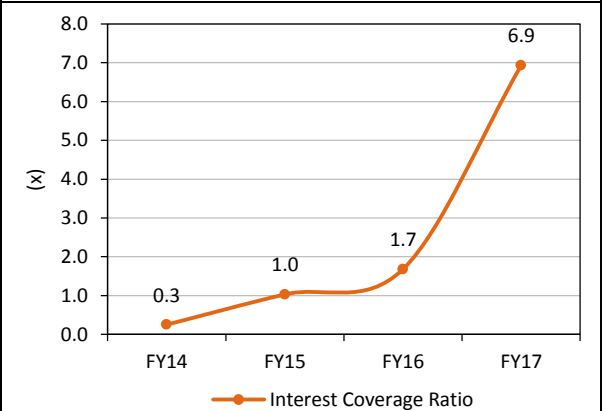


Figure 3: Improving net debt to EBITDA ratio



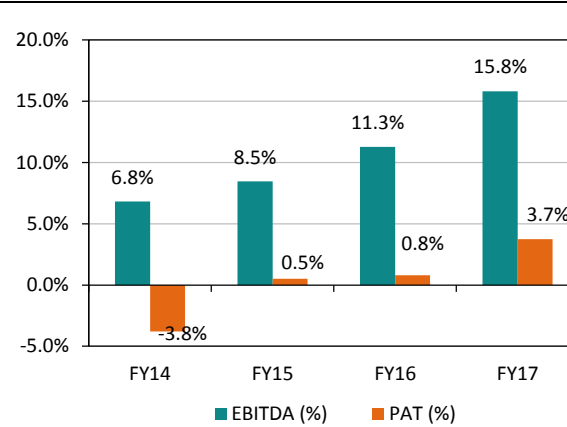
Source: Company; IDBI Capital Research

Figure 4: Interest coverage improved in FY17



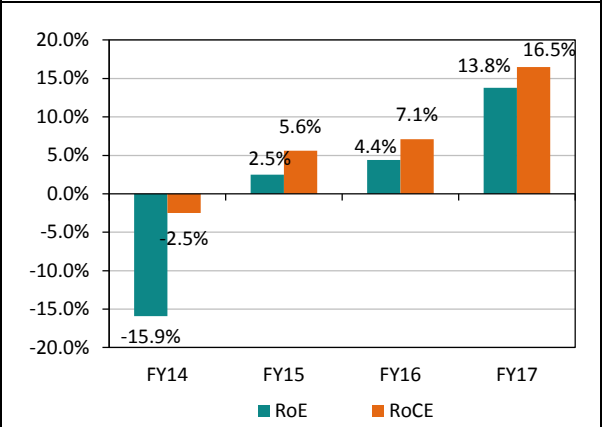
Source: Company; IDBI Capital Research

Figure 5: Margins expanded steadily



Source: Company; IDBI Capital Research

Figure 6: Return ratios continue to improve



Source: Company; IDBI Capital Research



Notes

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Key to Ratings**Stocks:**

BUY: Absolute return of 15% and above; **ACCUMULATE:** 5% to 15%; **HOLD:** Upto ±5%; **REDUCE:** -5% to -15%; **SELL:** -15% and below.

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