

PCBL (Phillips Carbon Black Ltd)

Pain seems abating, Long term growth story intact

PCBL reported a strong show on per unit gross spreads despite weakness in demand but a poor show on volume front. Volumes have declined by 7% & 19% QoQ in domestic & exports market because of inventory destocking at customers end leading to slow offtake of volumes. This is expected to rebound from the next quarter as supply channel inventory is minimal & demand is seen improving. Over the longer term, growth is expected to be robust led by expansion in normal and speciality grade CB and rising exports. Also, volatility in crude oil & CBFS prices is expected to subside thereby supporting gross spreads per kg but incremental supply addition of CB in domestic market would keep the realization of CB players in check. With speciality grade CB ramp up over the next few years, the gross spreads are expected to remain robust. Near term pain is largely factored in the price and the company's long term outlook is bullish considering the capex announced by tyre players which bodes well for carbon black players. We reiterate BUY rating (valuing 12x FY25E EPS) with target price of Rs 163 per share.

Despite steeper volume decline, per unit spreads declined, increase in product mix to help stabilize margins

- Revenue grew by 18% YoY & declined by 16% QoQ in Q3FY23. The decline is led by 10% de-growth in volumes & 6% de-growth in realization. The decline in realizations is because of pass on of raw material prices, which is linked to crude and has sequentially declined. On YoY basis realizations are up by 35%.
- Despite volumes declining by 10% QoQ, blended gross spreads declined by mere 3% QoQ to Rs 31.5 per kg. This increases our confidence in the company to maintain its per unit economics in difficult times. Also, the volume decline in the quarter is largely because of inventory destocking at the customers end which has now completed and channel inventory is now at minimum and hence we expect volumes will pick up traction from the coming quarters.
- Demand environment has started to show green shoots with uncertainties abating, hence we feel coming quarters will show improvement in overall numbers. The long term outlook is bullish as PCBL is a proxy play on volume recovery in the tyre sector which is set to grow at 7-9% from FY22-25E.
- Also, as speciality carbon black contribution will inch upwards in overall volumes it would provide higher spreads and stability in the overall margin and spreads profile.

Expansion to lead robust growth in volumes, competitive intensity to increase in near term

- The expansion of normal grade carbon black at Chennai plant of 1,47,000 tonnes is completed and expected commercialization by Q1FY24 and speciality carbon black (20,000 tonnes phase 1 & 20,000 tonnes phase 2) is set to commission by Q4FY23 and FY24E respectively.
- Post expansion we expect the company to be a dominant player in the domestic industry and to report robust volume growth of 7.6% in normal grade CB over FY23E-25E vs 2.2% from FY17-22 & speciality grade CB volume growth is expected to be 17% CAGR over FY22-25E.
- Majority part of its capex programme of Rs~11.7bn (Rs6.5bn for CB capacity, Rs3.2bn for speciality CB & Rs3.2bn for power capacity & Rs0.5bn in R&D) is completed except for 2nd phase of speciality CB capacity of Rs1.6bn which will be incurred in FY24E. We expect peak utilization to be achieved in 2-3 years' timeframe considering the competitive intensity in the carbon black space.

Valuation

- Currently, the stock is trading at inexpensive valuation on FY25E P/E of ~9x. We feel increasing share of speciality business, rising exports & strong tyre growth are the key triggers going ahead. We roll forward our target multiples to FY25E and value the stock on forward P/E multiple of 12x (earlier 12.5x) and, thereby, arrive at target price of Rs 163 per share which offers upside of 36% from current valuations.
- Therefore, we maintain **BUY** rating on the stock.

Y/E Mar (Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Net sales	13,633	11,561	17.9	16,279	-16.2
Operating costs	12,000	9,881	21.4	14,393	-16.6
EBITDA	1,634	1,680	-2.8	1,886	-13.4
EBITDA Margin (%)	12.0	14.5	(255) bps	11.6	40 bps
Depreciation	330	308	7.1	327	0.9
Interest	150	69	116.2	110	36.6
Other income	85	90	-4.9	38	125.1
PBT	1,239	1,392	-11.0	1,487	-16.6
Provision for tax	268	277	-3.5	322	-16.9
Reported PAT	971	1,115	-12.9	1,165	-16.6
Non-Controlling interest	-1	-1	33.3	-1	50.0
Consolidated PAT	970	1,114	-12.9	1,164	-16.6

Source: Company, SMIFS Research

Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Adj EPS	RoE (%)	RoCE (%)	Adj P/E (x)	EV/EBITDA (x)
FY21	26,595	-18.0	5,180	19.5	3,144	9.0	8.3	17.2	13.5	7.4	5.0
FY22	44,464	67.2	6,530	14.7	4,267	35.7	11.3	18.7	14.8	9.7	6.4
FY23E	56,442	26.9	6,839	12.1	4,113	-3.6	10.9	15.1	12.4	11.0	7.4
FY24E	60,404	7.0	7,408	12.3	4,501	9.4	11.9	15.3	12.6	10.1	6.6
FY25E	64,405	6.6	8,330	12.9	5,137	14.1	13.6	16.1	13.6	8.8	5.5

Source: Company, SMIFS Research Estimates



Rating: **BUY** Upside: **36%**
 Current Price: **120** Target Price: **163**

| Earlier recommendation

Previous Rating: Buy
 Previous Target Price: 183

| Market data

Bloomberg: PHCB: IN
 52-week H/L (Rs): 154/89
 Mcap (Rs bn/USD bn): 45.4/0.56
 Shares outstanding (mn): 377.5
 Free float: 31.6%
 Daily vol. (3M Avg.): 1.57mn
 Face Value (Rs): 1

Source: Bloomberg, SMIFS Research

| Shareholding pattern (%)

	Dec-22	Sept-22	Jun-22	Mar-22
Promoter	51.4	51.4	51.4	51.4
FII	8.6	10.9	10.2	9.5
DII	8.4	6.5	7.3	6.4
Public/others	31.6	31.2	31.1	32.8

| Pro. Pledging

Pledging 0.0 0.0 0.0 0.0

Source: BSE

| Price performance (%)*

	1M	3M	12M	36M
NIFTY 50	-3.2	-2.6	-1.0	51.1
NIFTY 500	-4.4	-4.3	-3.0	54.5
PCBL	-9.1	-4.4	5.0	99.8

*as on 2nd Nov 2022; Source: AceEquity, SMIFS Research

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Analyst Call Highlights

- **Demand outlook:** The company's major end user industries in the domestic market like tyres, plastics, printing inks, tones, paper etc are witnessing good demand. However, exports market was particularly weak led by inventory destocking which also impacted PCBL with its export volumes declining by 27% YoY & 19% QoQ. The same is expected to improve in the coming quarters. Domestic demand is still strong despite global headwinds and management foresees this to continue going ahead.
- **Newly commissioned chennai plant:** The company has almost completed commissioning of 1.47 lakh tonnes capacity of Chennai plant dividing into 3 units out of which 1st unit which contributes 40% of overall chennai plant is completed and remaining 2 units will start once customer approvals are finalized. Full commercialization of volumes will start to witness in Q1FY24. Management expects chennai plant to fully utilize in about 2 years timeframe.
- **Remaining expansion plans timeline:** The phase 1 speciality carbon black capacity of 20,000 tonnes is expected to commission by Q4FY23 and remaining phase 2 capacity of 20,000 tonnes is expected to be commissioned by Q4FY24. On power business, incremental capacity addition of 7MW in Kochi is completed along with 24MW in Chennai will be added by the end of FY23E.
- Incremental capacity of 0.5 million tonnes is being added by PCBL & its competitors in domestic market which can probably increase the competitive intensity in the exports & domestic market.
- **Production volume:** The company reported volume decline of 13% YoY & 11% QoQ to 1,01,492 tonnes in Q3FY23. The domestic volumes stood at 72,394 tonnes & exports volumes stood at 29,098 tonnes. The speciality volumes declined by 9% YoY & 10% QoQ to 8998 tonnes.
- In speciality carbon black, exports constituted 70-75% of the sales volume.
- The company's export mix is 75-80% in SE Asia, 15-16% in Europe, 3-4% in North America & remaining in RoW.
- Export freight rates have corrected by nearly 40-50% from the highs and this has benefitted the company in Q3FY23 with other expenses witnessed declining by ~18% QoQ.
- **Dividend:** The company has declared interim dividend of Rs 5.5 per share (4.6% dividend yield)

Valuation and Recommendations

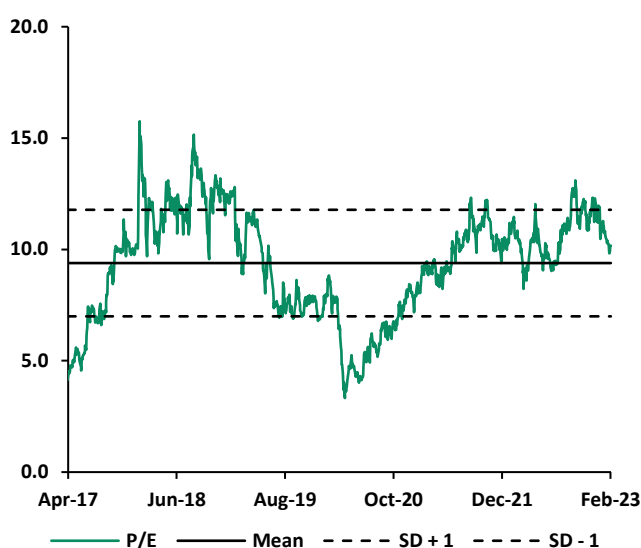
Currently, the stock is trading at inexpensive valuation on FY25E P/E of ~9x.

We value the stock on forward P/E multiple of 12x (downgrading from earlier 12.5x) factoring in slightly higher competitive intensity in exports business but we feel increasing share of speciality business & robust tyre growth are the positives to watch on and, thereby, arrive at target price of Rs 163 per share which offers strong upside of 36% from current valuations.

Therefore, we maintain **BUY** rating on the stock.

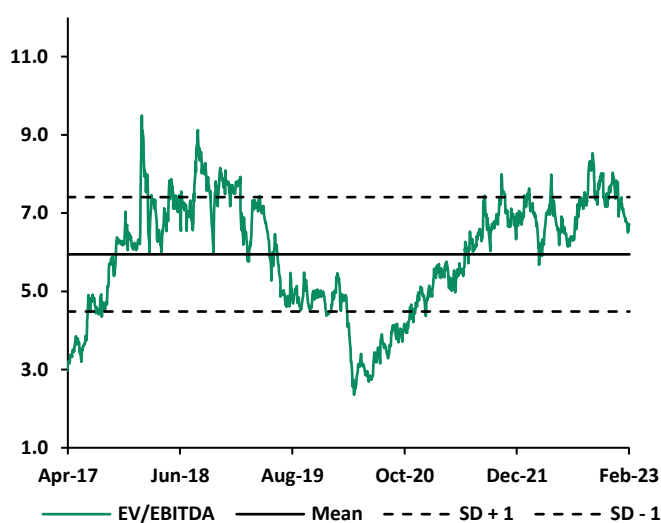
Risk to our call is unforeseen impact on the demand and sharp decline in spread.

Fig 1: 1-year forward P/E



Source: AceEquity, SMIFS Research

Fig 2: 1-year forward EV/EBITDA



Source: AceEquity, SMIFS Research

Key Performance Indicators

Operational Metrics	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Effective CB capacity (in MT)*	476427	499469	539469	539469	737000	757000	757000
Normal Grade CB volumes (In MT)	391287	388683	360818	421484	390225	419250	451500
YoY Change (%)	1.5	-0.7	-7.2	16.8	-7.4	7.4	7.7
Speciality Grade CB volumes (In MT)	19501	19378	23967	35000	38640	47040	58240
YoY Change (%)	19	-1	24	46	10	22	24
Blended Gross spread per kg	30.0	25.8	27.3	28.8	32.1	32.6	33.6

Source: Company, SMIFS Research Estimates, Note: * indicates Effective capacity includes normal CB plus speciality grade CB capacity

Quarterly financials, operating metrics and key performance indicators

Fig 3: Quarterly Financials

Y/E March (Rs mn)	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Net Sales	8,667	10,039	10,676	11,561	12,188	14,091	16,279	13,633
Raw Materials	5,127	6,719	7,173	8,403	9,042	10,257	12,587	10,437
Employee Costs	347	361	412	398	418	472	488	478
Other Expenditure	1,333	1,323	1,220	1,080	1,385	1,408	1,318	1,085
EBITDA	1,860	1,636	1,870	1,680	1,343	1,955	1,886	1,634
Depreciation	280	292	304	308	305	375	327	330
Interest	81	76	77	69	69	89	110	150
Other Income	112	38	37	90	121	117	38	85
PBT	1,612	1,306	1,527	1,392	1,091	1,608	1,487	1,239
Tax	334	261	306	277	208	346	322	268
Tax rate (%)	21	20	20	20	19	21	22	22
Reported PAT	1,278	1,045	1,221	1,115	883	1,263	1,165	971
Minority Interest	-1	-1	-1	-1	-1	-1	-1	-1
Adjusted PAT	1,277	1,044	1,220	1,114	882	1,262	1,164	970
YoY Growth (%)								
Revenue	23.8	179.2	60.8	50.3	40.6	40.4	52.5	17.9
EBITDA	87.5	325.2	77.6	-10.7	-27.8	19.5	0.8	-2.8
PAT	75.5	4092.4	110.5	-11.2	-31.0	20.9	-4.6	-12.9
QoQ Growth (%)								
Revenue	12.7	15.8	6.4	8.3	5.4	15.6	15.5	-16.2
EBITDA	-1.2	-12.1	14.3	-10.1	-20.0	45.5	-3.5	-13.4
Adj. PAT	1.8	-18.3	16.9	-8.7	-20.9	43.1	-7.8	-16.6
Margin (%)								
Gross	40.8	33.1	32.8	27.3	25.8	27.2	22.7	23.4
EBITDA	21.5	16.3	17.5	14.5	11.0	13.9	11.6	12.0
Adj PAT	14.7	10.4	11.4	9.6	7.2	9.0	7.1	7.1
Employee cost as % of sales	4.0	3.6	3.9	3.4	3.4	3.3	3.0	3.5
Other expenses as % of sales	15.4	13.2	11.4	9.3	11.4	10.0	8.1	8.0
Operational Metrics								
Overall CB volumes	113022	109424	115717	116594	112452	109377	113859	101492
CB Realization per kg	75.1	90.3	90.3	96.8	106.0	125.6	139.8	131.2
Blended CB Gross spread Per kg	29.7	28.9	28.3	24.7	25.6	31.8	32.4	31.5
Blended EBITDA spread per kg	16.5	15.0	16.2	14.4	11.9	17.9	16.6	16.1

Source: Company, SMIFS Research

Fig 4: Change in Estimates

	New Estimates		Old Estimates		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Revenue	60,404	64,405	65969	71019	-8%	-9%
EBITDA	7,408	8,330	8269	9009	-10%	-8%
EBITDA Margin	12.3%	12.9%	12.5%	12.7%	(27) bps	25 bps
PAT	4,501	5,137	5019	5531	-10%	-7%
EPS (Rs)	11.9	13.6	13.3	14.6	-10%	-7%

Source: Company, SMIFS Research Estimates

Financial Statements

Income Statement					
YE March (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Revenues	26,595	44,464	56,442	60,404	64,405
Raw Materials	16,089	31,338	42,654	45,208	47,262
% of sales	60	70	76	75	73
Personnel	1,324	1,589	1,911	2,081	2,246
% of sales	5	4	3	3	3
Other Expenses	4,002	5,008	5,038	5,706	6,567
% of sales	15	11	9	9	10
EBITDA	5,180	6,530	6,839	7,408	8,330
Other Income	180	286	270	294	318
Depreciation	1,101	1,209	1,665	1,800	1,852
EBIT	4,259	5,607	5,444	5,902	6,797
Finance cost	339	291	379	395	416
Core PBT	3,740	5,030	4,794	5,213	6,063
PBT	3,920	5,316	5,065	5,507	6,381
Tax-Total	781	1,052	955	1,010	1,248
Tax Rate (%) - Total	20	20	19	18	20
Reported PAT	3,140	4,263	4,110	4,497	5,133
Minority Interest	4	3	3	3	4
Adjusted PAT	3,144	4,267	4,113	4,501	5,137

Source: Company, SMIFS Research Estimates

Key Ratios					
YE March	FY21	FY22	FY23E	FY24E	FY25E
Growth Ratio (%)					
Revenue	-18.0	67.2	26.9	7.0	6.6
EBITDA	11.6	26.0	4.7	8.3	12.4
Adjusted PAT	9.0	35.7	-3.6	9.4	14.1
Margin Ratios (%)					
Gross Profit	39.5	29.5	24.4	25.2	26.6
EBITDA	19.5	14.7	12.1	12.3	12.9
EBIT	16.0	12.6	9.6	9.8	10.6
Core PBT	14.1	11.3	8.5	8.6	9.4
Adjusted PAT	11.8	9.6	7.3	7.5	8.0
Return Ratios (%)					
ROE	17.2	18.7	15.1	15.3	16.1
ROCE	13.5	14.8	12.4	12.6	13.6
Turnover Ratios (days)					
Gross block turn ratio (x)	1.2	1.7	1.7	1.6	1.7
Adj OCF / Adj PAT (%)	101.8	53.6	118.3	115.4	112.2
Inventory	101	70	55	55	55
Debtors	97	91	85	85	85
Creditors	134	106	85	85	85
Cash conversion cycle	64	55	55	55	55
Solvency Ratio (x)					
Debt-equity	0.4	0.3	0.3	0.3	0.2
Net debt/equity	0.1	0.0	0.2	0.1	0.0
Gross debt/EBITDA	1.4	1.2	1.3	1.1	1.0
Current Ratio	2.0	2.3	1.8	1.9	2.1
Interest coverage ratio	13	19	14	15	16
Dividend					
DPS	3.2	5.0	5.5	6.0	6.5
Dividend yield (%)	4.7	4.4	4.6	5.0	5.4
Dividend Payout (%)	38.5	44.3	50.6	50.4	47.8
Per Share (Rs.)					
Basic EPS (reported)	9.1	11.8	10.9	11.9	13.6
Adj EPS	8.3	11.3	10.9	11.9	13.6
CEPS	11.2	14.5	15.3	16.7	18.5
BV	51.5	69.5	74.9	80.9	88.0
Valuation					
Adj P/E	7.4	9.7	11.0	10.1	8.8
P/BV	1.2	1.6	1.6	1.5	1.4
EV/EBITDA	5.0	6.4	7.4	6.6	5.5
EV/Sales	0.9	0.9	0.8	0.7	0.7
Adj Mcap / Core PBT	5.5	7.2	9.2	8.3	6.8
Adj Mcap / Adj OCF	6.5	15.9	9.1	8.3	7.1

Source: Company, SMIFS Research Estimates

Balance Sheet					
YE March (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Source of funds					
Share Capital	345	378	378	378	378
Reserves & Surplus	19,085	25,845	27,914	30,151	32,836
Shareholders' Funds	19,430	26,222	28,291	30,529	33,213
Total Loan Funds	7,054	7,669	8,892	8,216	7,790
Other Liabilities	2,812	2,848	3,665	3,923	4,183
Total Liabilities	29,296	36,739	40,848	42,667	45,186
Application of funds					
Gross Block	21,900	25,574	33,932	37,040	38,650
Net Block	17,424	19,341	25,437	26,150	25,310
Capital WIP	2,668	1,753	1,717	674	521
Investments	1,963	5,880	2,938	3,029	3,069
Other Non-Current Assets	512	1,466	1,987	2,417	2,849
Inventories	4,448	6,039	6,427	6,812	7,122
Sundry Debtors	7,085	11,051	13,144	14,067	14,998
Cash and bank balances	2,644	1,591	905	1,824	4,061
Other current assets	517	727	974	1,188	1,411
Total Current Assets	14,694	19,408	21,450	23,891	27,592
Sundry Creditors	5,916	9,111	9,933	10,528	11,006
Other current liabilities	2,048	1,997	2,746	2,966	3,149
Total Current Liabilities	7,964	11,109	12,680	13,493	14,155
Net Current Assets	6,730	8,299	8,771	10,397	13,437
Total Assets	29,296	36,739	40,848	42,667	45,186

Source: Company, SMIFS Research Estimates

Cash Flow					
YE March (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Operating profit before WC changes	5,134	6,584	6,835	7,405	8,327
Net changes in working capital	-624	-2,644	-637	-807	-900
Tax Paid	-660	-1,036	-955	-1,010	-1,248
Cash flow from operating activities	3,850	2,904	5,244	5,588	6,178
Adj. OCF	3,199	2,287	4,864	5,193	5,762
Capital expenditure	-1,141	-3,062	-7,725	-1,471	-858
Adj FCF	2,058	-775	-2,861	3,722	4,904
Cash flow from investing activities	-2,027	-5,407	-4,513	-1,268	-581
Debt	63	770	1,000	-750	-500
Dividend	-1,206	-1,887	-2,076	-2,265	-2,454
Interest and Lease	-652	-617	-379	-395	-416
Cash flow from financing activities	-1,795	2,167	-1,417	-3,402	-3,361
Net change in cash	28	-336	-685	919	2,237

Source: Company, SMIFS Research Estimates

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