Research

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It's Advice, Not Adventure

October 24, 2016

Nano Nivesh

Key risks to investing in Nano stocks

- Nano stocks may not be in the limelight and inherently being micro cap in nature will have a high risk return profile

- We advise clients to be disciplined in investing at all times. Allocate only a small proportion of your investible income to these stocks and diversify well

- Try to diversify your exposure within the Nano stocks as well by investing equal proportions in several picks

- These stocks may have low volumes and trade infrequently

- Micro cap stocks the world over are, to a large extent, affected by the "Pump and Dump" phenomenon of inflated price buying and depressed price selling

- As explained above, the clients should be patient and trade only through limit orders on any side of the trade.

- The risk of volatility remains in such micro cap stocks as they can move up or down with large buy/sell orders

- The fair value of Nano stocks are subject to expected growth potential in the future. Though due diligence has been done to a fair extent, the actualisation of growth still has a degree of uncertainty attached to it

Nano stocks report tries to highlight companies with good and scaleable business models, dependable management and sound financials. However, these stocks may not be in the limelight and have a high risk high return potential. Please watch out for the following factors before investing in these stocks:

Allocate a small proportion of your investible income to these stocks and diversify well. If you choose to invest in these stocks, most of your assets allocated towards equity should remain in more stable investments like stocks of large companies. Moreover, try to diversify your exposure within the nano stocks as well by investing equal proportions in several picks. This will help you avoid losing too much of your total wealth if the investments do not turn out well. When you invest in micro-cap stocks there is a higher risk of impairment.

These stocks may have low volumes and trade infrequently. This can create a situation in which you may not be able to find any willing buyers for your stocks when you wish to sell. We advise our clients to be patient and trade only though limit orders to avoid volatile fluctuations, both while putting a buy and sell order in these stocks.

October 24, 2016

Oriental Carbon & Chemicals (ORICAR)

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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 commissioning of the brownfield facility in early FY18E, we expect OCCL to report sales & PAT CAGR of 15.2% & 17.4%, respectively, in FY17E-19E. It is quoting at inexpensive valuation of 12.4x P/E on FY18E EPS of ₹ 56.4.

Buy Price

₹ 700

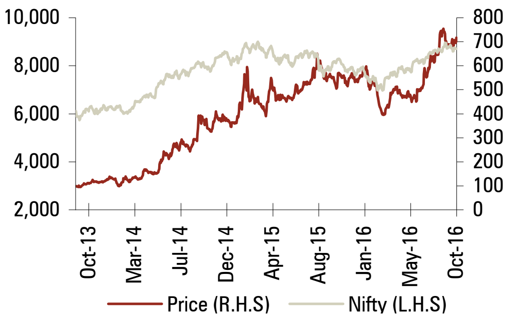
Recommendation

Buy

Fair value

₹ 870- 930

Price performance



Highlights

- **OCCL - prominent player in oligopolistic market:** As per industry estimates, total insoluble sulphur (IS) market globally as of CY15 is at ~264 KT dominated by three major players i.e. oligopolistic in nature. Eastman Chemicals (US) is the market leader with close to ~70% market share followed by Japanese Player Shikoku with ~15% market share. OCCL with total sales volume in the range of 20-22 KT is the third credible player with ~10% market share. Globally, demand for insoluble sulphur is expected to grow at 3-4% CAGR in the next few years with demand in India growing at a CAGR of 10%+ due to robust automobile demand & increasing radialisation of tyres in the CV segment (penetration at ~30%). Radialised tyres consume almost the double quantity of insoluble sulphur (per tonnage) vs. bias tyres
- **Capacity commissioning on track; volume growth to follow:** OCCL has a current capacity of 23000 tonne and is largely operating at ~90% utilisation level in FY16. Sensing the same, OCCL had launched an impressive expansion plan where it intends to increase its capacity (Brownfield) by 11000 tonne in two phases. The first phase of 5500 tonne is due to be commissioned in April 2017. With a strong relationship with customers and increasing product demand, we expect OCCL to report healthy volume led growth in FY17E-19E. We expect OCCL to report insoluble sulphur sales volume CAGR of 11.0% in FY17E-19E to ~30 KT in FY19E.
- **"Speciality chemical" company in true sense; warrants re-rating:** OCCL is indeed a speciality chemical company with a unique product profile, limited competition in the marketplace and consequent sustainable strong EBITDA margins (25%+) and return ratios (RoIC: 20%+). With commissioning of brown field capacity, we expect sales & PAT to grow at a CAGR of 15.2% & 17.4%, respectively in FY17E-19E. We value OCCL at ₹ 870-930 i.e. 14.5-15.5x P/E on FY18E & FY19E average EPS of ₹ 60

Key risks-

Business specific

Slowdown in overall automobile and consequent tyre demand; OCCL's product i.e. insoluble sulphur finds application in tyre manufacturing where it is used as a vulcanisation agent. Globally, demand for insoluble sulphur is projected to grow at a stable pace of 3-4% CAGR in CY15-20E. In India, demand for insoluble sulphur is expected to grow in excess of 10% primarily on the back two levers. Firstly, the automobile sector is witnessing robust demand due to a rise in discretionary spending and secondly the penetration of radialisation is on an uptrend in the CV segment, which contributes >50% of tyre demand in volumes. Therefore, any slowdown in demand for automobile demand both domestically as well as globally and ramp down in pace of radialization in the CV space (domestically) will hamper the growth prospects of OCCL with limited growth in profitability going forward.

Company specific

High share of exports; forex fluctuations: By virtue of OCCL realising ~70% of its sales volume in the export markets namely various parts of Europe, China, Thailand, Africa and now North America the company is exposed to foreign exchange fluctuations. It can lead to translational losses on its P&L account. OCCL is a net exporter. Hence, it is adversely impacted by the appreciation of the rupee. It realises windfall gains in case of depreciation of the rupee. Total exports in FY16 were at ₹ 163 crore out of the total sales of ₹ 275 crore with export share in value terms at 60% in FY16. Going forward, therefore, any steep appreciation of the rupee can adversely affect the financials and profitability. The company can try re-negotiating its contracts with its key customers but will eventually be able to execute the same with a quarterly lag.

Description

OCCL is JP Goenka Group company manufacturing insoluble sulphur under the brand "Diamond Sulf". The company has a current capacity to manufacture 23000 tonne of insoluble sulphur annually. It has two plants in India viz. Dharuhera, Haryana (12000 tonne capacity) and Mundra SEZ, Gujarat (11000 tonne capacity). OCCL operated at ~90% capacity utilisation as of FY16. It uses two key components as its raw material namely sulphur & coating oil. It also uses electricity amounting to ~1400 units per tonne of insoluble sulphur production. In FY16, on a standalone basis, net sales were at ₹ 274.7 crore with EBITDA at ₹ 81.1 crore (EBITDA margins at 29.5%). Standalone PAT in FY16 was at ₹ 53.0 crore with corresponding EPS at ₹ 51.4.

History and track record

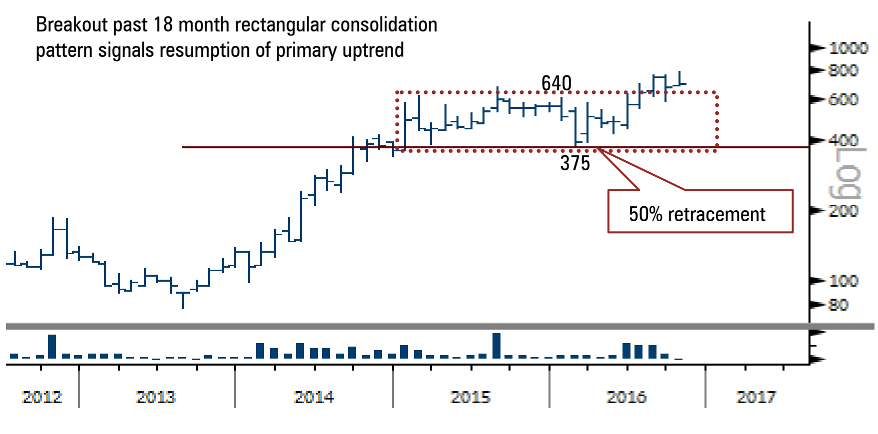
- OCCL was established in 1978 while it commenced manufacturing insoluble sulphur in 1994 with an installed capacity of 3000 TPA. Thereafter, through brownfield expansion and de-bottlenecking capacity expanded to 12000 TPA by 2008
- OCCL witnessed a turnaround in FY10 wherein EBITDA margins expanded from 10-15% in the past to 30%in FY10. This was largely on account of effective procurement of raw material (i.e. sulphur) and other operational efficiencies realised at the plant level
- In 2011-12, it commenced production of insoluble sulphur from a greenfield plant at Mundra with an installed capacity of 11000 TPA
- In FY13, OCCL acquired a controlling stake in Schrader Duncan Ltd, which is primarily engaged in manufacturing tyre valves and pneumatic & hydraulic systems and components for industrial use
- In 2015, OCCL further commenced a brownfield expansion wherein it is expanding its capacity by 11000 TPA at an estimated capex amounting to ~₹ 159 crore with expected project IRR of ~25%
- Its key clients include MRF, Ceat, JK Tyre, etc, in the domestic market and Bridgestone, Continental etc in the exports market
- OCCL is currently headed by Arvind Goenka (Managing Director), Akshat Goenka (Jt. Managing Director) and Anurag Jain (CFO)

Earnings estimates (Standalone)

₹ crore	FY15	FY16	FY17E	FY18E	FY19E
Net Sales	282.6	274.7	277.8	333.8	368.9
EBITDA	71.5	81.1	77.8	93.5	105.1
EBITDA Margins (%)	25.3	29.5	28.0	28.0	28.5
Net Profit	51.3	53.0	47.7	58.1	65.7
EPS	50.0	51.4	46.2	56.4	63.7

Source: Company, ICICIdirect.com Research

Technical Chart (Monthly Bar chart)



Source: Bloomberg, ICICIdirect.com Research

Stock data

Market Capitalization (₹ crore)	722.0
52 Week High / Low (₹)	764 / 375
Promoter Holding (%)	51.0
FII Holding (%)	1.0
DII Holding (%)	16.2
Dividend Yield (%)	1.2
12M / 6M stock return (%)	36 / 45
Debt (₹ crore)	72.0
Cash and Cash Equivalent (₹ crore)	25.4
Enterprise Value (₹ crore)	768.6
5 Year Revenue CAGR (%) (FY11-16)	11.7
5 Year EBITDA CAGR (%) (FY11-16)	11.3
5 Year PAT CAGR (%) (FY11-16)	7.2

Valuation

	FY16	FY17E	FY18E	FY19E
P/E	13.6	15.1	12.4	11.0
Target P/E	17.5	19.5	16.0	14.1
EV / EBITDA	9.5	9.9	8.4	7.0
P/BV	2.5	2.2	2.0	1.7
RoNW	18.5	14.7	15.7	15.6
RoCE	16.6	13.4	14.1	16.3
ROIC	20.8	20.3	19.3	18.5

Source: ICICIdirect.com Research

Quarterly performance

(₹ crore)	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Sales	70.7	62.6	69.4	75.5
EBITDA	23.0	17.7	19.1	22.1
EBITDA Margin (%)	32.5	28.3	27.6	29.2
Depreciation	4.2	3.4	3.4	3.7
Interest	1.4	1.6	1.8	1.2
Other Income	0.8	2.8	0.7	1.5
PAT	12.9	13.7	12.1	14.6
EPS (₹)	12.7	13.3	11.7	14.2

Source: ICICIdirect.com Research

Shareholding trend (%)

Key Shareholders	Q3FY16	Q4FY16	Q1FY17	Q2FY17
Promoter group	51.0	51.0	51.0	51.0
FII	0.0	0.0	0.4	1.0
DII	12.9	13.2	13.3	16.2
Non-institutional	36.1	35.7	35.3	31.8

Source: ICICIdirect.com Research

Technical View

The share price of Oriental Carbon has recently emerged out of a prolonged consolidation of over 18 months to signal end of secondary corrective phase and resumption of primary uptrend. The entire sideways price movement since February 2015 occurred in a well defined Rectangular consolidation pattern. The base of this consolidation is placed precisely at the 50% retracement of the 2013-2015 major bull rum (₹75 to ₹675).

The stock posted a decisive breakout past the 18 month rectangular consolidation pattern in July 2016. After the strong breakout rally, the sideways consolidation over the last three months above the breakout area of ₹640 highlights a higher base building process and provides good entry opportunity with a favourable reward/risk set-up

We expect the stock to head towards ₹900 levels over the medium term horizon as it is the measuring implication of the rectangular consolidation pattern (640-375=265 points) added to the breakout point of ₹640

What's the story?

Key player in oligopolistic industry; insoluble sulphur a critical component!

As per industry estimates, total tyre rubber consumption was globally at 17.6 million tonne (MT) in CY15, which translates to total insoluble sulphur demand of ~264 KT in CY15. This implies the input–output ratio of ~13 kg of insoluble sulphur for every 1 tonne of rubber consumption. It is a critical component in tyre manufacturing as it imparts the desired durability to tyres to withstand pressure and become sturdier in nature. Out of the total industry size of ~264 KT, ~225 KT is of high quality grade content, which is manufactured by OCCL. Eastman Chemicals (US) is the market leader with close to 70% market share followed by Japanese Player Shikoku with ~15% market share. OCCL with total sales volume in the range of 20-22 KT is the third credible player with ~10% market share globally. The technology for manufacturing insoluble sulphur is closely guarded with limited competition in the marketplace. Moreover, with limited market size globally (~₹ 3200 crore), an elongated customer approval process (~two years) and low asset turnovers (~<1x gross block) this place has witnessed no new entrants largely specifying the control of industry within three main players. Total demand for insoluble sulphur India as of FY16 was at 14500 TPA with OCCL's share of market in excess of 50%. OCCL being a prominent player in the marketplace coupled with its positioning as the next alternate supplier to Eastman Chemicals for the global tyre manufacturers augurs well for the company, going forward.

Impressive brownfield expansion augurs well; volume led growth to follow!

OCCL has a current capacity of 23000 tonne for manufacturing insoluble sulphur and is largely operating at ~90% utilisation level with sales volume of ~20-22 KT in FY16. With limited room for further volume lead growth, OCCL is currently executing an expansion plan where it intends to increase its capacity by 11000 tonne in two phases (5500 tonne each) with the first phase expected to be commissioned in April 2017 (early FY18E). The company intends to spend ₹ 159 crore on the entire brownfield expansion and expects the full capacity to be absorbed over three to four years. OCCL is expecting a project IRR in excess of 25% from the said project with a projected payback period of ~four years. At the prevailing product realisation, OCCL can realise a maximum topline of ~₹ 140 crore at peak capacity utilisation levels with margins in the range of 28-30% largely benefiting from the economies of scale and apportioning of fixed costs over a larger base (operating leverage). With a strong relationship with customers, focus on further penetration in the Chinese & North American markets and increasing product demand domestically, OCCL is on a strong footing with robust prospects going forward. We expect sales volume of insoluble sulphur to grow at a CAGR of 11.0% in FY17E-19E to~ 30 KT in FY19E.

Closing down loss making automotive valves division; consolidated financials to improve!

In FY13, OCCL acquired a controlling stake (50%) in Schrader Duncan (SDL) with an equity investment of ₹ 14.5 crore. SDL is primarily engaged in manufacturing of tyre valves and pneumatic & hydraulic systems and components for industrial use. In FY16, it realised total sales of ₹ 63.5 crore, EBITDA of ₹ 0.6 crore and Loss at the PAT level to the tune of ₹ 6.9 crore. It had an apportioned Loss of ₹ 3.5 crore for OCCL in FY16. The main dampener was the tyre valves business, which realised sales of ₹ 30.5 crore with corresponding EBIT loss of ₹ 3.2 crore. With a deteriorating performance in this segment and minimal likelihood of revival, OCCL has decided to close down this business and applied for approvals for the same from the requisite authorities. The same is expected to be closed down in FY17E resulting in better consolidated financials in FY18E-19E. We expect SDL to be marginally PAT positive in FY18E & FY19E. Eventually it is expected to augment the financial performance of the standalone business. We, however, have abstained from valuing the company on a consolidated basis primarily on the back of insignificant profitability at SDL. We also do not assign any value to OCCL's investment in SDL.

Speciality chemical company in true sense; robust earnings trajectory warrants re-rating!!!

OCCL is indeed a speciality chemical company with a unique product profile (insoluble sulphur), limited competition in the marketplace and consequent sustainable strong EBITDA margins (25-30%) and return ratios (RoIC>20%). OCCL has a healthy balance sheet profile with debt: equity at 0.3x as of FY16. OCCL also realises healthy CFO with average CFO over FY14-16 at ~₹ 60 crore with CFO yield of ~9%. FY17E would be largely a flat year for OCCL due to capacity constraints. However, with the commissioning of new capacity in FY18E we expect OCCL to report robust profitability in FY17E-19E. On a standalone basis, we expect sales to grow at a CAGR of 15.2% in FY17E-19E to ₹ 368.9 crore in FY19E (₹ 277.8 crore in FY17E). We expect PAT to grow at a CAGR of 17.4% CAGR in FY17E-19E to ₹ 65.7 crore in FY19E (₹ 47.7 crore in FY17E) with steady 28% EBITDA margin profile. On account of benefits associated with SEZ facility and available MAT credit entitlement, OCCL will continue to be a MAT paying company over FY16-19E. We value OCCL at ₹ 870-930 i.e. 14.5-15.5 x P/E (1x PEG) on FY18E & FY19E average EPS of ₹ 60.

Financial summary (Standalone)

Profit and loss statement				₹ Crore
(Year-end March)	FY16	FY17E	FY18E	FY19E
Net Sales	274.7	277.8	333.8	368.9
Other Operating Income	0.0	0.0	0.0	0.0
Total Operating Income	274.7	277.8	333.8	368.9
Growth (%)	-2.8	1.1	20.1	10.5
Raw Material Expenses	69.2	72.2	86.8	95.9
Employee Expenses	32.8	33.3	40.1	44.3
Power & Fuel Expenses	34.2	34.7	43.4	48.0
Other Operating Expense	57.4	59.7	70.1	75.6
Total Operating Expenditure	193.6	200.0	240.3	263.8
EBITDA	81.1	77.8	93.5	105.1
Growth (%)	14.1	-4.0	20.1	12.5
Depreciation	15.7	15.8	18.3	22.4
Interest	6.4	7.0	9.4	9.8
Other Income	5.7	4.6	6.9	9.2
PBT	64.8	59.6	72.6	82.1
Exceptional Item	0.0	0.0	0.0	0.0
Total Tax	11.8	11.9	14.5	16.4
PAT	53.0	47.7	58.1	65.7
Growth (%)	3.3	-10.0	21.9	13.0
EPS (₹)	51.4	46.2	56.4	63.7

Source: Company, ICICIdirect.com Research

Cash flow statement				₹ Crore
(Year-end March)	FY16	FY17E	FY18E	FY19E
Profit after Tax	53.0	47.7	58.1	65.7
Add: Depreciation	15.7	15.8	18.3	22.4
(Inc)/dec in Current Assets	-14.6	0.6	-24.4	-18.8
Inc/(dec) in CL and Provisions	0.6	-2.5	7.0	4.4
Others	6.4	7.0	9.4	9.8
CF from operating activities	61.0	68.6	68.4	83.4
(Inc)/dec in Investments	11.1	-25.0	-25.0	-25.0
(Inc)/dec in Fixed Assets	-46.2	-55.0	-55.0	-10.0
Others	0.0	0.0	0.0	0.0
CF from investing activities	-35.1	-80.0	-80.0	-35.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-16.8	30.0	30.0	-20.0
Dividend paid & dividend tax	-10.6	-10.5	-12.4	-14.8
Inc/(dec) in Share Cap	0.0	0.0	0.0	0.0
Others	-6.4	-6.9	-9.4	-9.8
CF from financing activities	-33.7	12.6	8.2	-44.6
Net Cash flow	-7.8	1.2	-3.4	3.8
Opening Cash	17.7	9.9	11.0	7.7
Closing Cash	9.9	11.0	7.7	11.5

Source: Company, ICICIdirect.com Research

Balance sheet				₹ Crore
(Year-end March)	FY16	FY17E	FY18E	FY19E
Liabilities				
Equity Capital	10.3	10.3	10.3	10.3
Reserve and Surplus	276.3	313.5	359.3	410.1
Total Shareholders funds	286.6	323.8	369.6	420.4
Total Debt	72.4	102.4	132.4	112.4
Deferred Tax Liability	21.1	21.1	21.1	21.1
Total Liabilities	380.1	447.3	523.1	553.9
Assets				
Gross Block	285.5	290.0	375.0	440.0
Less: Acc Depreciation	102.6	118.4	136.7	159.1
Net Block	182.9	171.5	238.3	280.8
Capital WIP	39.5	90.0	60.0	5.0
Total Fixed Assets	222.4	261.5	298.3	285.8
Liquid Investments	15.5	40.5	65.5	90.5
Other Investments	14.7	14.7	14.7	14.7
Inventory	38.7	38.1	45.7	50.5
Debtors	48.0	49.5	59.4	65.7
Loans and Advances	62.9	61.1	66.8	73.8
Other Current Assets	5.2	5.6	6.7	7.4
Cash	9.9	11.0	7.7	11.5
Total Current Assets	164.7	165.3	186.2	208.9
Creditors	28.5	26.6	32.0	35.4
Provisions	8.6	8.0	9.6	10.6
Current Liabilities & Prov	37.1	34.6	41.6	46.0
Net Current Assets	127.5	130.6	144.6	162.9
Application of Funds	380.1	447.3	523.1	553.9

Source: Company, ICICIdirect.com Research

Key ratios				
(Year-end March)	FY16	FY17E	FY18E	FY19E
Per share data (₹)				
EPS	51.4	46.2	56.4	63.7
Cash EPS	66.5	61.6	74.1	85.4
BV	278.0	314.1	358.5	407.8
DPS	8.5	8.5	10.0	12.0
Cash Per Share (Incl Invst)	24.6	50.0	71.0	98.9
Operating Ratios (%)				
EBITDA Margin	29.5	28.0	28.0	28.5
PBT / Total Op. income	23.6	21.4	21.8	22.3
PAT Margin	19.3	17.2	17.4	17.8
Inventory days	51.4	50.0	50.0	50.0
Debtor days	63.8	65.0	65.0	65.0
Creditor days	37.9	35.0	35.0	35.0
Return Ratios (%)				
RoE	18.5	14.7	15.7	15.6
RoCE	16.6	13.4	14.1	16.3
RoIC	20.8	20.3	19.3	18.5
Valuation Ratios (x)				
P/E	13.6	15.1	12.4	11.0
EV / EBITDA	9.5	9.9	8.4	7.0
EV / Net Sales	2.8	2.8	2.3	2.0
Market Cap / Sales	2.6	2.6	2.2	2.0
Price to Book Value	2.5	2.2	2.0	1.7
Solvency Ratios				
Debt/EBITDA	0.9	1.3	1.4	1.1
Debt / Equity	0.3	0.3	0.4	0.3
Current Ratio	4.2	4.5	4.3	4.3
Quick Ratio	3.1	3.4	3.2	3.2

Source: Company, ICICIdirect.com Research

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Strong Buy: >15%/20% for large caps/midcaps, respectively, with high conviction;
Buy: >10%/15% for large caps/midcaps, respectively;
Hold: Up to +/-10%;
Sell: -10% or more;

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