Oriental Carbon & Chemicals Ltd

Bloomberg Code: OTCC IN

India Research - Stock Broking

BUY

Capacity Expansion Coupled with Growth in Tyre Industry to Drive Top Line

Increase in radialization of tyres in India will drive the demand for insoluble sulphur: Domestic demand for insoluble sulphur likely to go up with an increase in rate of Radialization across all the tyre segments in India. OCCL is well placed to grab the opportunities with its brownfield capacity expansion at Mundra port. Insoluble sulphur is contributing more than 90% of its total standalone revenue.

A desired supplier by the top tyre manufacturing companies: OCCL's products are tailor-made to satisfy diverse compounding requirements of its customers. Its products are widely accepted around the world as a preferred vendor by leading tyre manufacturers. It has a strong global sales network which is present in 21 countries across the world and has strong customer base which includes Continental, Bridgestone, JK Tyres, Pirelli, CEAT, Birla Tyres, Good year, Nokian Tyres, MRF, etc.

High entry barrier business, an advantage: A capital intensive business with high technology barrier coupled with long approval processes of tyre manufacturers acts as a deterrent for entry of new manufacturers. Minimum 24 months required for customers to approve & validate product from new supplier.

With the ramp-up at its Mundra Plant, revenue/ EBITDA are likely to post 7% CAGR, while lowering debt and finance cost, net profit would grow at 16% CAGR over FY13-FY18E. We further expect the company to post a substantial volume growth by exploring the international reach.

Valuation and Outlook

New additions of customer base coupled with approvals coming in from various international tyres companies will augur growth in the long run. We expect that the company to maintain its leadership position in insoluble sulphur cater to the growing needs of tyre industry in India, which in turn to drive revenue. At CMP of Rs. 466, OCCL is trading at 12.8x FY16E, 9.4x FY17E and 7.6x FY18E earnings. We initiate **'BUY'** with a target price of Rs.600, based on 1 year forward 10x PE multiple FY18E EPS representing an upside of 29% for the period of 9-12 months.

Key Risks

1) Slowdown in Tyre industry 2) Exposed to currency risks.

Exhibit 1: Valuation Summary

YE Mar (Rs. Mn)	FY14	FY15	FY16E	FY17E	FY18E
Net Sales	3308	3468	3460	3656	4081
EBITDA	691	682	569	740	900
EBITDA Margin (%)	20.9	19.7	16.5	20.2	22.1
Net Profit	407	483	374	512	635
EPS (Rs.)	39.5	46.9	36.4	49.8	61.7
RoE (%)	21.3	21.4	14.2	16.5	17.1
PE (x)	4.0	9.6	12.8	9.4	7.6

*Source: Company, Karvy Research, *Represents multiples for FY14 & FY15 are based on historic market price*

Recommendation (Rs.)

CMP *(as on Apr 28, 2016)*	466
Target Price	600
Upside (%)	29

Stock Information

Mkt Cap (Rs.mn/US$ mn)	4798 / 72
52-wk High/Low (Rs.)	675 / 385
3M Avg. daily volume (mn)	3046
Beta (x)	1.0
Sensex/Nifty	25603 / 7847
O/S Shares(mn)	10.3
Face Value (Rs.)	10.0

Shareholding Pattern (%)

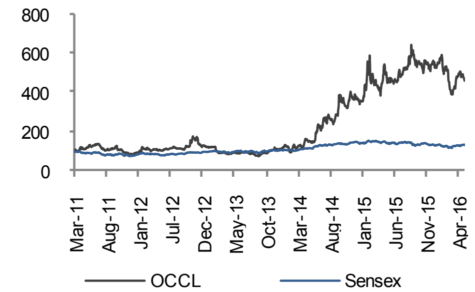
Promoters	51.0
FIIs	0.0
DIIs	13.2
Others	35.7

Stock Performance (%)

	1M	3M	6M	12M
Absolute	(5)	(13)	(17)	0
Relative to Sensex	(7)	(17)	(13)	7

Source: Bloomberg

Relative Performance*



*Source: Bloomberg; *Index 100*

Analyst Contact

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Company Financial Snapshot (Y/E Mar)

Profit & Loss (Rs. Mn)

	FY15	FY16E	FY17E	FY18E
Net sales	3468	3460	3656	4081
Optg. Exp (Adj for OI)	2786	2891	2916	3181
EBITDA	682	569	740	900
Depreciation	164	172	182	198
Interest	103	106	111	115
Other Income	136	139	156	170
PBT	551	431	603	756
Tax	98	86	121	151
PAT	483	374	512	635
Profit & Loss Ratios				
EBITDA margin (%)	19.7	16.5	20.2	22.1
Net margin (%)	13.9	10.8	14.0	15.6
P/E (x)	9.6	12.8	9.4	7.6
EV/EBITDA (x)	7.4	9.1	6.9	5.5
Dividend yield (%)	1.9	1.8	1.8	1.8

Source: Company, Karvy Research

Company Background

Oriental Carbon & Chemicals Ltd (OCCL), a Kolkata based Duncan JP Goenka Group company, engages in manufacturing and sales of Insoluble Sulphur under the brand "Diamond Sulf". Insoluble Sulphur is used in the tyre industry. Diamond Sulf is offered in various grades to satisfy diverse compounding requirements of leading tyre companies. It also manufactures Sulphuric Acid and Oleums used as sulphonating agent in manufacture of detergents and in other inorganic chemicals. OCCL has manufacturing plants at Dharuhera (Haryana) and Mundra (Gujarat). OCCL has one subsidiary company namely Schrader Duncan Limited which deals with manufacturing of automotive tyre valves and pneumatic products such as hydraulic and pneumatic cylinders, pneumatic valves and accessories.

Balance sheet (Rs. Mn)

	FY15	FY16E	FY17E	FY18E
Total Assets	**4393**	**4496**	**5118**	**5872**
Net Fixed assets	2178	2555	2603	2894
Current assets	1769	1769	2001	2256
Other assets	433	172	514	722
Total Liabilities	**4393**	**4496**	**5118**	**5872**
Networth	2442	2816	3379	4064
Debt	441	466	487	504
Current Liabilities	1136	844	881	927
Other Liabilities	374	369	371	377
Balance Sheet Ratios				
RoE (%)	21.4	14.2	16.5	17.1
RoCE (%)	21.6	15.7	17.8	18.5
Net Debt/Equity	0.2	0.2	0.1	0.1
Equity/Total Assets	0.6	0.6	0.7	0.7
P/BV (x)	1.9	1.7	1.4	1.2

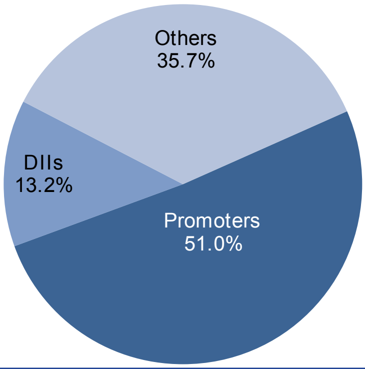
Source: Company, Karvy Research

Cash Flow (Rs. Mn)

	FY15	FY16E	FY17E	FY18E
Profit*	551	431	603	756
Depreciation	164	172	182	198
Interest (net)	104	106	111	115
Tax	(114)	(86)	(121)	(151)
Changes in WC	16	58	(50)	(109)
Others	(28)	(28)	(28)	(28)
CF from Operations	**692**	**653**	**698**	**782**
Capex	(185)	(260)	(210)	(320)
Investment	(154)	(126)	(134)	(131)
Others	10	10	10	10
CF from Investing	**(329)**	**(376)**	**(334)**	**(441)**
Change in Debt	(229)	25	21	17
Dividends & Others	(206)	(226)	(231)	(236)
CF from Financing	**(435)**	**(201)**	**(210)**	**(218)**
Change in Cash	54	76	154	123

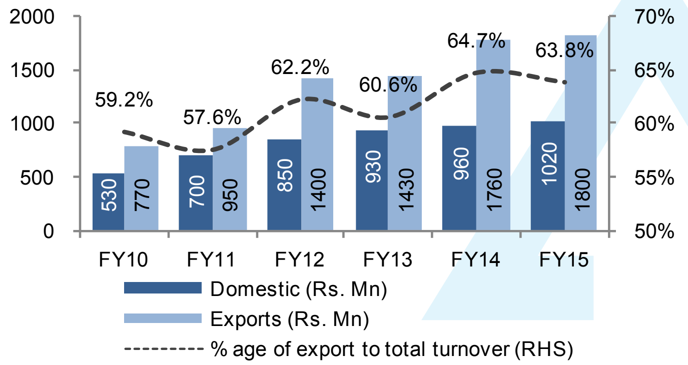
*Source: Company, Karvy Research, * Profit before tax & extra ordinary item*

Exhibit 2: Shareholding Pattern (%)



Source: BSE, Karvy Research

Exhibit 3: Geographical Revenue Segmentation (%)

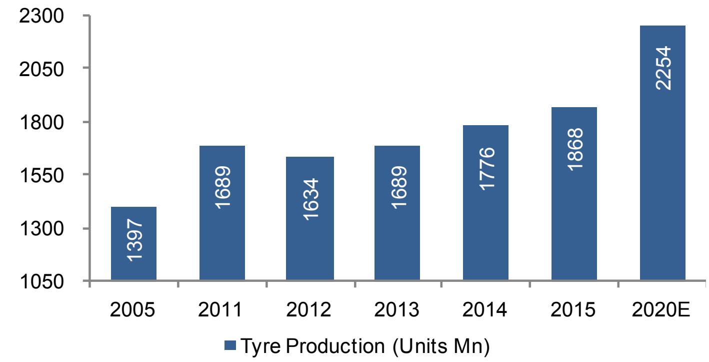


Source: Company, Karvy Research

Increase in radialization of tyres in India will drive the demand for insoluble sulphur:

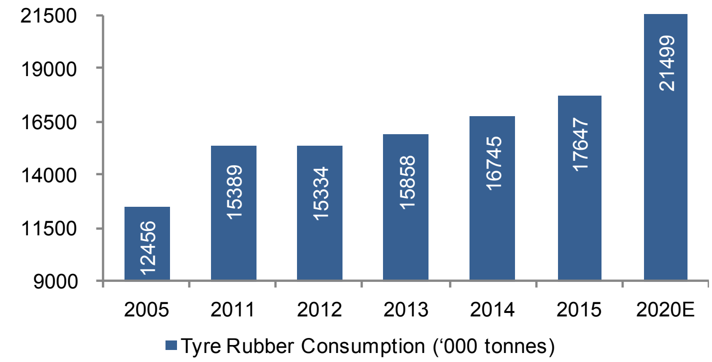
Domestic tyre industry is likely to witness double digits growth during the next few years on the back of growth in automotive demand. Coming to the radialization of tyres, growth is still subdued in India specially in commercial vehicle segment. Normally, radialization of tyres exhibits the eminence of roadways and road development. However, in India, road network is the mix of modern highways and narrow, unpaved roads. Gradually, the scenario is improving with growing connectivity between cities, towns and villages in the country. Likely target of laying out new roads in India will be increased to 150000 km per year from 2016 compared to existing 96000 km. Thus, it gives a positive outlook for the demand of insoluble sulphur in the Indian market for the next few years. OCCL is well placed to grab the opportunities with its brownfield capacity expansion at Mundra port. Insoluble sulphur is contributing to more than 90% of its total revenue.

Exhibit 4: Global Tyre Industry Production (Units Mn)



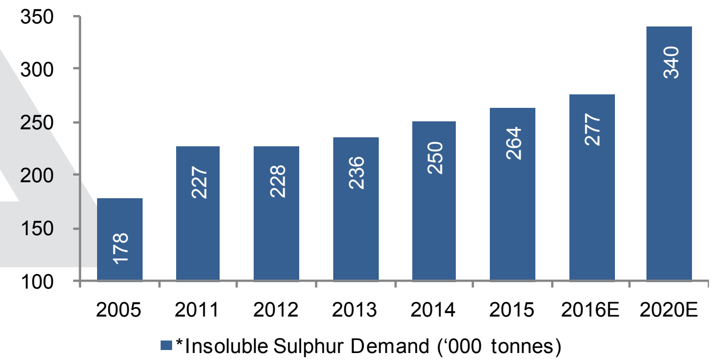
Source: Company Presentation, Karvy Research

Exhibit 5: Global Tyre Industry Rubber Consumption ('000 tonnes)



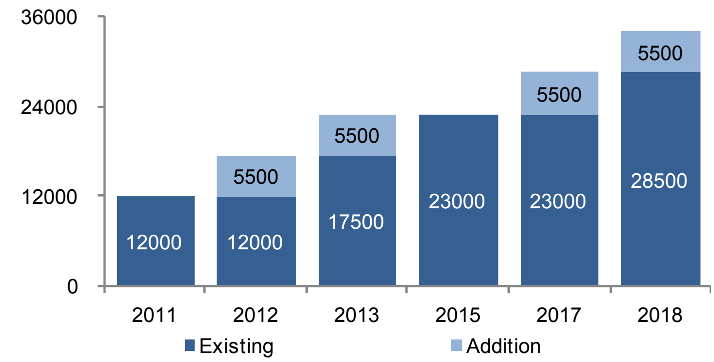
Source: Company Presentation, Karvy Research

Exhibit 6: Global Insoluble Sulphur Demand ('000 tonnes)*



Source: Company Presentation, Karvy Research,
** Also incl. Insoluble Sulphur used for Non-Tyre Goods*

Exhibit 7: Planned Capacity Expansion (Metric Tonne)



Source: Company, Karvy Research

A desired supplier by the top tyre manufacturing companies and entry into new markets to boost top line:

Globally, OCCL is a dominant player in insoluble sulphur enjoying ~10% market share. OCCL, through its penetration strategy, entered into North America where the demand is ~16% of the total global demand and in the China market. Even in Europe, OCCL is targeting other customers and trying to build its market presence more prominently. OCCL's products are tailor-made to satisfy diverse compounding requirements of its customers. Its products are widely accepted around the world as a preferred vendor by leading tyre manufacturers. It has a strong global sales network which is present in 21 countries across the world.

A capital intensive, high entry barrier business, an advantage:

OCCL's business is a capital intensive business model and gives an edge over the others with its Land & Common Infrastructure available for further expansion at Mundra. It can be raised with the demand of insoluble sulphur. Minimum 24 months required for customers to approve & validate product from new supplier which means the gestation period high, which might act as entry barrier for new entrants. Its closely held in-house technology coupled with in-house R&D works on a continuous basis to improve quality of product and its properties. It can also make tailor-made products to satisfy the diverse compounding requirements of leading tyre manufacturers and new grades to meet customer requirements. Its applied marketing mix makes it a key differentiator.

Robust in-house R&D likely to boost the demand and sales:

OCCL has an in-house R&D unit which has been recognised by Ministry of Science & Technology, Department of Scientific & Industrial Research. Thus, it can win the loyalty of the existing customers coupled with enlistment of new quality-conscious customers, value addition in products, edge over competitors and better control over qualitative deviations.

Robust Clientele:

OCCL is a preferred supplier for largest tyre manufacturing companies like Continental, Bridgestone, JK Tyres, Pirelli, CEAT, Birla Tyres, Good year, Nokian Tyres, MRF etc. It has tailor-made various grades of insoluble sulphur to satisfy diverse compounding requirements of leading tyre manufacturers which gives a positive outlook on a sustainable basis.

OCCL's cost optimization strategy augurs well to improve its bottom line:

During the last five years, 12.0% of the gross revenue is power and water cost. OCCL has lined up capex of Rs.150 Mn for Coal Fired Boiler expected to be operational during the current financial year resulting in savings in power & fuel cost at Mundra Plant.

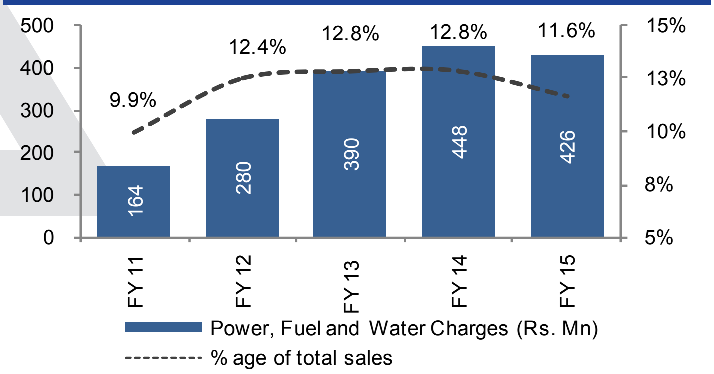
Key raw materials required to manufacture Insoluble Sulphur is sulphur and Naphthenic Oil which equal to 11% and 19% (average of last five financial years) respectively of the gross revenue. Sulphur is available easily due to ample supply and Naphthenic Oil is procured from domestic as well as international players. So, it is clear that procurement of raw material won't be a hindrance for manufacturing. These two are the major parts of the raw material consumed.

OCCL has its manufacturing facility at Mundra port which gives locational advantage of reduced logistics & freight cost as its ~65% of the sales constitutes exports.

There is expansion of capacity 5500 MT at Mundra and Dharuhera. With increase production at the plants operating leverage to play out. Expansion will result in reduced fixed costs per MT; and R&D cost and utilities will be also shared.

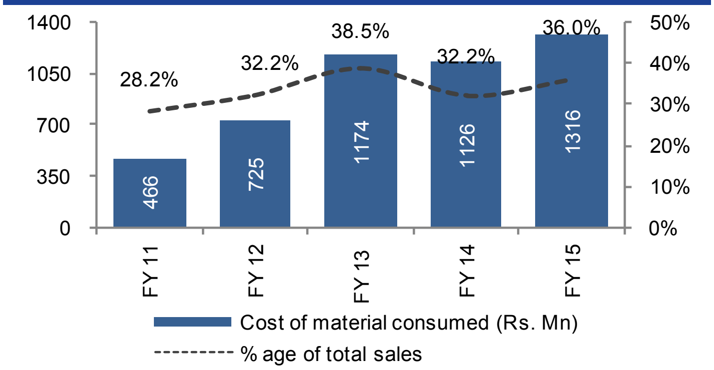
OCCL's Mundra plant is in Special Economic Zone (SEZ) location which will be benefited from various Income Tax exemption benefits and thus decrease the net tax rate.

Exhibit 8: Power, Fuel & Water Charges as % of sales



Source: Company, Karvy Research

Exhibit 9: Cost of material consumed as % of total sales



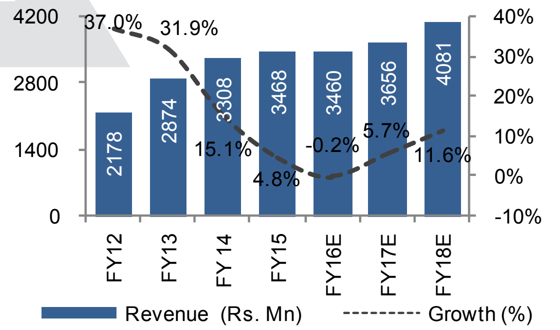
Source: Company, Karvy Research

Exhibit 10: Business Assumptions

Y/E Mar (Rs. Mn)	FY15	FY16E	FY17E	FY18E	Comments
Revenue	3468	3460	3656	4081	Revenue is likely to clock CAGR of 7% over a period of FY13-FY18E and likely to register a decent growth on YoY basis during FY17E and FY18E.
Revenue Growth (%)	4.8	(0.2)	5.7	11.6	
EBITDA	682	569	740	900	EBITDA is likely to register a CAGR of 10% and is likely to witness some margin expansion on the back of more utilization of the capacities vis-a-vis on the same cost, as R&D expenses, low logistics and freight charges and lower power cost because of self generation at its Mundra plant. Increase in capacity and utilization could be backed by high demand for commercial vehicle tyre radialization, overseas new customers and development business in new countries.
EBITDA Margins (%)	19.7	16.5	20.2	22.1	
PAT	483	374	512	635	PAT is likely to grow at 40% and 25% during FY17E and FY18E respectively on the back of growing demand of insoluble sulphur.
EPS (Rs.)	46.9	36.4	49.8	61.7	
Net CFO	704	653	698	782	Historically, it has decent cash flow from operations.
Capex	(185)	(260)	(210)	(320)	Capex for expansion of Mundra plant capacity.
Net Debt (Long Term)	441	466	487	504	Debt will increase, but at the same time there could be repayment of the existing debt. So, net effect won't be much to the debt equity ratio. OCCL is likely to raise debt of Rs. 1000 Mn for their expansion during the next few years.
Free Cash Flow	519	393	488	462	The asset base could increase on the back of expansion activities.

Source: Company, Karvy Research

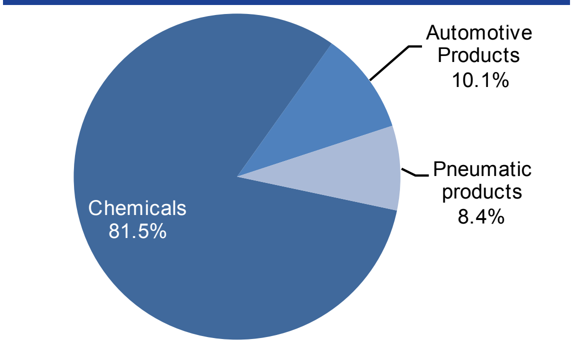
Exhibit 11: Revenue & Revenue Growth (%)



Source: Company, Karvy Research

We expect the revenue to grow at a CAGR of 7% during FY13-FY18E. We expect a muted growth during FY16E. Of late, it is expected that the increase in demand of insoluble sulphur could rise on the back of growth in the domestic tyre industry. Also, it is expected that OCCL's penetration strategy in new geographies, specially in North America where the demand is highest in the world for insoluble sulphur, which could able to add new customers.

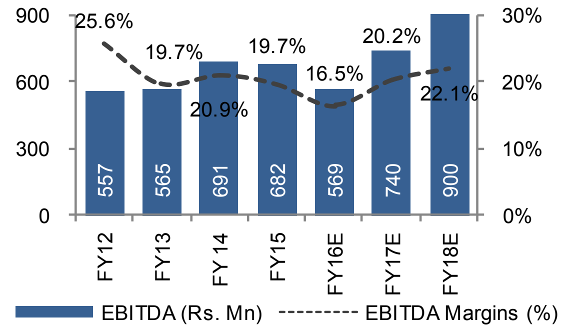
Exhibit 12: Consolidated Segmental revenue (%)



Source: Company, Karvy Research

Revenue contribution from OCCL's subsidiary company Schrader Duncan Limited is ~18.5%. It deals with manufacturing of automotive tyre valves and pneumatic products such as hydraulic and pneumatic cylinders, pneumatic valves and accessories. Rest 81.5% is coming from the chemical business, of which 90% is revenue contribution is from Insoluble sulphur.

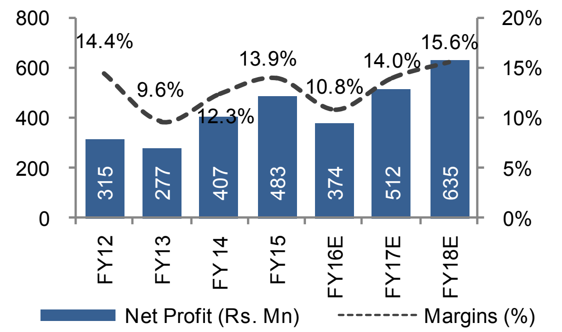
Exhibit 13: EBITDA & EBITDA Margins (%)



Source: Company, Karvy Research

Historically, OCCL has maintained a healthy EBITDA margin; and going forward, we expect that margin can improve on the back of lowering power and fuel cost on the commissioning of self developed coal fired boiler at Mundra plant. We expect the EBITDA to clock 10% CAGR during FY13-FY18E.

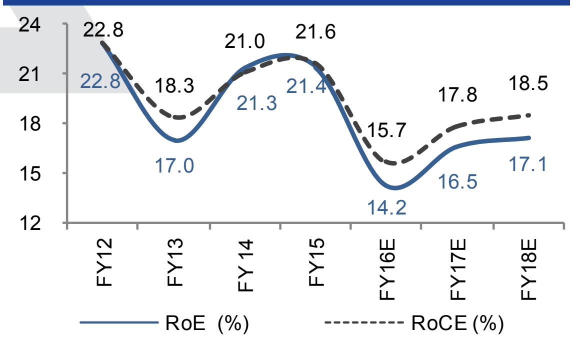
Exhibit 14: Net Profit & Net Profit Margins (%)



Source: Company, Karvy Research

During FY15, the company recorded net profit of Rs.483 mn registering a growth of 19% YoY. It is expected that the growth momentum to be carried during FY17E with expansion of net margin.

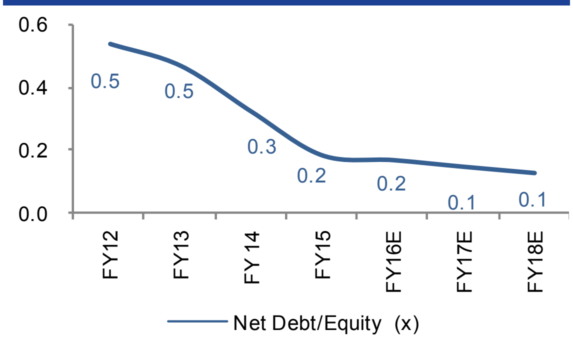
Exhibit 15: RoE & RoCE (%)



Source: Company, Karvy Research

OCCL's RoE and RoCE are likely to be around 16-17% and 17-19% during the next couple of years respectively. It has maintained a healthy RoE and RoCE.

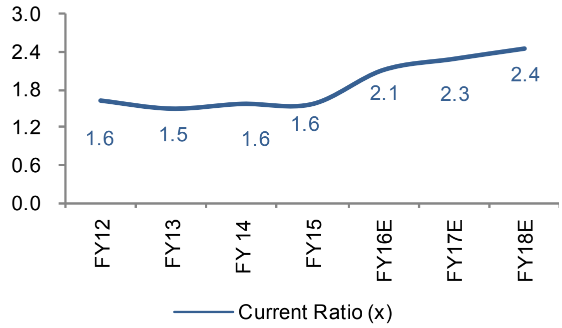
Exhibit 16: Net Debt/Equity (x)



Source: Company, Karvy Research

Capital investment would be of ~Rs.1590 Mn, funded with debt equity ratio of 2:1. Repayment of existing debt would keep the debt equity ratio under control.

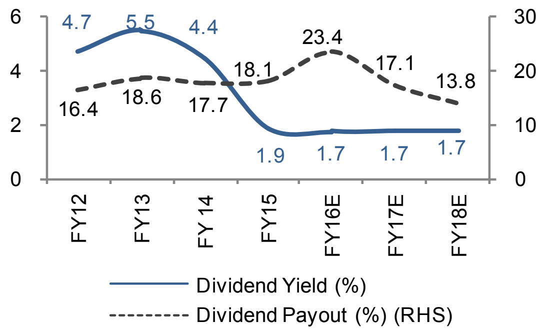
Exhibit 17: Current Ratio (x)



Source: Company, Karvy Research

OCCL has good working capital management, keeping current ratio multiple nearly 2x.

Exhibit 18: Dividend Yield & Payout (%)



Source: Company, Karvy Research

Over the years, OCCL has consistently distributed stable dividends with decent payout ratios. We believe that the company is likely to be a good proxy for dividend payout.

Exhibit 19: Company Snapshot (Ratings)

	Low				High
	1	2	3	4	5
Quality of Earnings		✓			
Domestic Sales	✓				
Exports				✓	
Net Debt/Equity				✓	
Working Capital Requirement					✓
Quality of Management					✓
Depth of Management				✓	
Promoter				✓	
Corporate Governance					✓

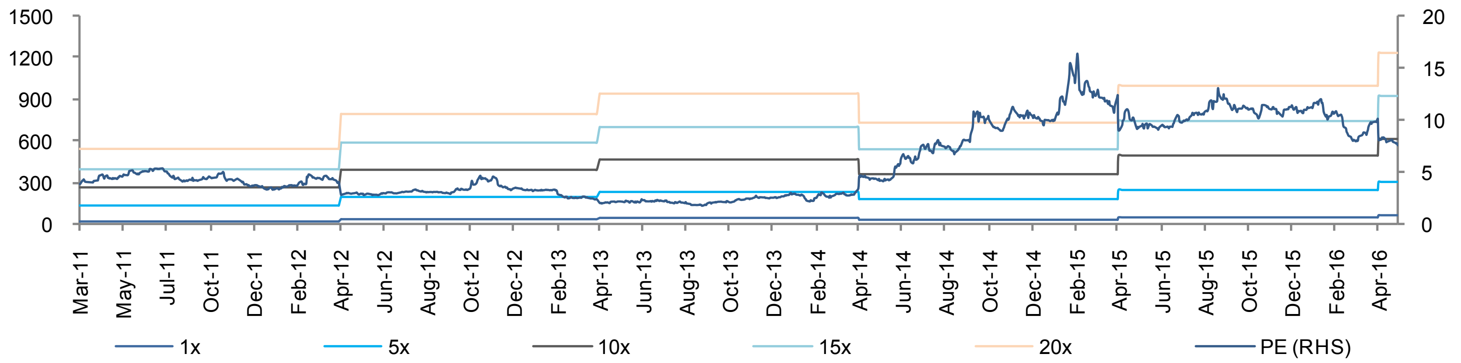
Source: Company, Karvy Research

- ~64% of OCCL's revenue is accrued from exports. Going forward, we expect that domestic demand of insoluble sulphur will pick up to boost its domestic sales and new customer base would develop in overseas to boost the exports.
- More than 90% of standalone revenue accrued from its one product, insoluble sulphur.
- Net Debt Equity ratio never crossed 1x during last 5 years.
- OCCL has good working capital management, keeping current ratio multiple nearly 2x.

Valuation & Outlook

New additions of customer base coupled with approvals coming in from various international tyres companies will augur growth in the long run. We expect that the company to maintain its leadership position in insoluble sulphur cater to the growing needs of tyre industry in India, which in turn to drive revenue. At CMP of Rs. 466, OCCL is trading at 12.8x FY16E, 9.4x FY17E and 7.6x FY18E earnings. We initiate **'BUY'** with a target price of Rs.600, based on 1 year forward 10x PE multiple FY18E EPS representing an upside of 29% for the period of 9-12 months

Exhibit 20: PE Band



Source: BSE, Karvy Research

Key Risks

- **Slowdown in Tyre industry:** More than 90% of the revenue is coming from insoluble sulphur and 65% from exports. Majority of insoluble sulphur consumed for tyre production. Demand of insoluble sulphur may shrink, in case if there is any slowdown or recession in the global economy which may affect demand for tyres, as it is an automobile industry dependent product.
- **Exposed to currency risks:** The profitability of OCCL is exposed to any unfavourable currency trends in the future as majority of its revenue comes from exports.

Financials

Exhibit 21: Income Statement

YE Mar (Rs. Mn)	FY14	FY15	FY16E	FY17E	FY18E
Revenues	3308	3468	3460	3656	4081
Growth (%)	15.1	4.8	(0.2)	5.7	11.6
Operating Expenses	2617	2786	2891	2916	3181
EBITDA	691	682	569	740	900
Growth (%)	22.3	(1.3)	(16.5)	30.0	21.6
Depreciation & Amortization	129	164	172	182	198
Other Income	50	136	139	156	170
EBIT	611	654	537	714	872
Interest Expenses	135	103	106	111	115
PBT	476	551	431	603	756
Tax	96	98	86	121	151
PAT	380	453	344	482	605
Growth (%)	45.9	11.2	(23.9)	40.1	25.4

Source: Company, Karvy Research

Exhibit 22: Balance Sheet

YE Mar (Rs. Mn)	FY14	FY15	FY16E	FY17E	FY18E
Cash & Cash Equivalents	124	183	202	356	479
Sundry Debtors	646	676	625	659	744
Inventory	497	530	441	469	515
Loans & Advances	387	500	232	579	787
Investments	115	268	394	402	399
Gross Block	3116	3178	3438	3648	3968
Net Block	2207	2135	2295	2393	2574
CWIP	23	43	260	210	320
Miscellaneous	43	45	48	51	54
Total Assets	**4056**	**4393**	**4496**	**5118**	**5872**
Current Liabilities & Provisions	948	1136	844	881	927
Debt	663	441	466	487	504
Other Liabilities	199	228	224	225	231
Total Liabilities	**1811**	**1805**	**1534**	**1593**	**1662**
Equity Share Capital	103	103	103	103	103
Reserves & Surplus	1966	2339	2713	3276	3961
Total Networth	**2069**	**2442**	**2816**	**3379**	**4064**
Minority Interest	176	146	146	146	146
Total Networth & Liabilities	**4056**	**4393**	**4496**	**5118**	**5872**

Source: Company, Karvy Research

Exhibit 23: Cash Flow Statement

YE Mar (Rs. Mn)	FY14	FY15	FY16E	FY17E	FY18E
PBT	502	551	431	603	756
Depreciation	129	164	172	182	198
Interest	135	104	106	111	115
Tax Paid	(111)	(114)	(86)	(121)	(151)
Inc/dec in Net WC	(84)	16	58	(50)	(109)
Other Income (Interest)	(12)	(14)	(14)	(14)	(14)
Other non cash items	(32)	(2)	(13)	(13)	(13)
Cash flow from operating activities	**527**	**704**	**653**	**698**	**782**
Inc/dec in capital expenditure	(237)	(185)	(260)	(210)	(320)
Inc/dec in investments	(109)	(154)	(126)	(134)	(131)
Others	136	27	10	10	10
Cash flow from investing activities	**(210)**	**(312)**	**(376)**	**(334)**	**(441)**
Inc/dec in borrowings	(142)	(132)	25	21	17
Dividend paid	(60)	(97)	(120)	(120)	(120)
Interest paid	(136)	(108)	(106)	(111)	(115)
Cash flow from financing activities	**(337)**	**(338)**	**(201)**	**(210)**	**(218)**
Net change in cash	(20)	54	76	154	123

Source: Company, Karvy Research

Exhibit 24: Key Ratios

YE Mar	FY14	FY15	FY16E	FY17E	FY18E
EBITDA Margin (%)	20.9	19.7	16.5	20.2	22.1
EBIT Margin (%)	18.5	18.9	15.5	19.5	21.4
Net Profit Margin (%)	12.3	13.9	10.8	14.0	15.6
Dividend Payout Ratio (%)	17.7	18.1	23.4	17.1	13.8
Net Debt/Equity (x)	0.3	0.2	0.2	0.1	0.1
RoE (%)	21.3	21.4	14.2	16.5	17.1
RoCE (%)	21.0	21.6	15.7	17.8	18.5

Source: Company, Karvy Research

Exhibit 25: Valuation Parameters

YE Mar	FY14	FY15	FY16E	FY17E	FY18E
EPS (Rs.)	39.5	46.9	36.4	49.8	61.7
DPS (Rs.)	7.0	8.5	8.5	8.5	8.5
BV (Rs.)	201	237	273	328	395
PE (x)	4.0	9.6	12.8	9.4	7.6
P/BV (x)	0.8	1.9	1.7	1.4	1.2
EV/EBITDA (x)	3.4	7.4	9.1	6.9	5.5
EV/Sales (x)	0.7	1.5	1.5	1.4	1.2

*Source: Company, Karvy Research; *Represents multiples for FY14 & FY15 are based on historic market price*

Appendix

Insoluble Sulphur (IS)
• Insoluble Sulphur is sold under the brand "DIAMOND SULF"
• **Application:** Used as vulcanising agent in application where sulphur loading levels are required above the sulphur solubility rating of particular elastomers.
• DIAMOND SULF is offered in various grades to satisfy diverse compounding requirements majorly for Tyre industry
1. High Dispersion Grades
2. High Stability Grades
3. Special Grades

Source: Company, Karvy Research

Sulphuric Acid
• Manufactures both Commercial Grade and Battery Grade Sulphuric Acid and Oleums.
• **Application:** Dehydrating agent, catalyst, active reactant in chemical processes, solvent, detergents and absorbent.
• Offered in following Grades.
1. **Grades of exact purity:** Storage battery, rayon, dye, Detergent and pharmaceutical industries
2. **Grades of less specifications:** Steel, heavy chemical and superphosphate industries

Source: Company, Karvy Research

Stock Ratings		Absolute Returns
Buy	:	> 15%
Hold	:	5-15%
Sell	:	<5%

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