

# Rain Industries

BUY

Strong Carbon segment margins; Outlook positive

## Summary

- Rain Industries reported significantly better than expected profitability in Q3CY17 results with EBITDA 43.5% above our estimate on the back of stronger than expected profitability in Carbon Products.
- Carbon Products EBITDA grew to Rs6.3 bn (+83.3% YoY, +58.3% QoQ). Segment EBITDA/tonne grew to Rs7,863/tonne (+83.3% YoY, +58.3% QoQ).
- In light of significantly better than expected Carbon Products profitability and anticipated higher spreads for CPC/ CTP, we raise our CY17/18 margin estimates.
- We maintain our Buy rating on the stock with a revised target price to Rs418.

## Key Highlights and Investment Rationale

- **Carbon Products reports stellar profitability:** Carbon Products volumes grew 15.7% YoY to 0.8 mn tonnes. However, the segment profitability surprised us with strong growth in EBITDA/tonne at Rs7,863/tonne (+52.1% QoQ, +86.2% YoY). Segment EBITDA grew to Rs6,336 mn(+83.3% YoY, +58.3% QoQ).
- **Chemical segment profitability falls:** Chemicals EBITDA fell 70.5% YoY to Rs133 mn on higher costs and some minor Fire accident in the Netherlands plant. Nevertheless, Cement EBITDA increased 58.2% YoY to Rs269 mn on improved cost performance.
- **Net debt increase slightly:** Net debt increased modestly (+2.5% QoQ to \$976 mn) due to exchange rate changes and higher working capital needs (higher volumes and product prices).
- **Raise CY17-18 estimates on improved outlook:** CPC and CTP demand has continued to improve in the last six months which is also evident from Carbon Products margin improvement during 9MCY17. We raise our CY17-18 Carbon Products EBITDA estimates sharply for CY17/CY18 on rising demand. With higher spreads, we expect the company's ROE to be in 24%/26% for CY17/18, respectively. With higher return ratios, we raise our valuation multiples in our SOTP valuation. **We raise our target price to Rs418 (previous Rs144); Maintain BUY.**

## Q3CY17 Result Review

|                             |       |
|-----------------------------|-------|
| TP                          | Rs418 |
| CMP                         | Rs340 |
| Potential upside / downside | +23%  |
| Previous Rating             | BUY   |

### V/s Consensus

| EPS (Rs)     | CY17E | FY18E |
|--------------|-------|-------|
| IDBI Capital | 23.9  | 31.9  |
| Consensus    | 16.1  | 19.6  |
| % difference | 48.3  | 62.4  |

### Shareholding Pattern (%)

|           |      |
|-----------|------|
| Promoters | 41.1 |
| FII       | 17.4 |
| DII       | 2.9  |
| Public    | 38.4 |

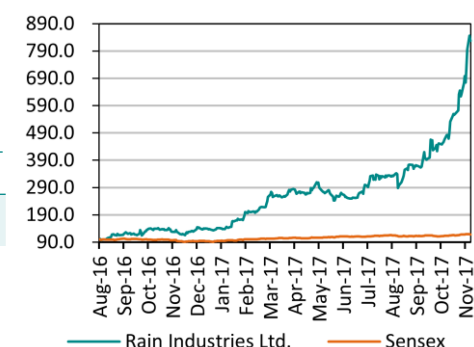
### Price Performance (%)

|               | -1m  | -3m   | -12m  |
|---------------|------|-------|-------|
| Absolute      | 77.4 | 142.3 | 546.6 |
| Rel to Sensex | 72.6 | 138.9 | 525.1 |

### Key Stock Data

|                                 |                  |
|---------------------------------|------------------|
| Bloomberg / Reuters             | RINDL IN/RAID.BO |
| Sector                          | Midcap           |
| Shares o/s (mn)                 | 336              |
| Market cap. (Rs mn)             | 114,341          |
| Market cap. (US\$ mn)           | 1,759            |
| 3-m daily average value (Rs mn) | 321              |
| 52-week high / low              | Rs345 / 41       |
| Sensex / Nifty                  | 33,219 / 10,303  |

### Relative to Sensex (%)



### Financial snapshot

| Year               | CY2014  | CY2015  | CY2016 | CY2017E | CY2018E |
|--------------------|---------|---------|--------|---------|---------|
| Revenue            | 119,370 | 102,185 | 93,164 | 114,593 | 129,252 |
| EBITDA             | 12,145  | 13,492  | 13,537 | 23,781  | 26,840  |
| EBITDA (%)         | 10.2    | 13.2    | 14.5   | 20.8    | 20.8    |
| Adj. PAT           | 3,464   | 3,301   | 3,234  | 8,038   | 10,746  |
| EPS (Rs)           | 10.3    | 9.8     | 9.6    | 23.9    | 31.9    |
| EPS Growth (%)     | (10.2)  | (4.7)   | (2.0)  | 148.5   | 33.7    |
| PE (x)             | 33.0    | 34.6    | 35.4   | 14.2    | 10.6    |
| Dividend Yield (%) | 0.3     | 0.4     | 0.4    | 0.7     | 0.7     |
| EV/EBITDA (x)      | 14.6    | 13.1    | 12.8   | 7.1     | 6.0     |
| RoE (%)            | 11.2    | 11.2    | 10.9   | 24.3    | 26.2    |
| RoCE (%)           | 7.3     | 9.0     | 9.0    | 16.2    | 18.4    |

Source: Company; IDBI Capital Research

**Table 1: Quarterly Snapshot**

(Rs mn)

| Financial snapshot           | Q3CY17        | Q2CY17        | QoQ (%)       | Q3CY16        | YoY (%)       |
|------------------------------|---------------|---------------|---------------|---------------|---------------|
| <b>Net sales</b>             | <b>30,764</b> | <b>27,641</b> | <b>11.3</b>   | <b>22,541</b> | <b>36.5</b>   |
| Expenditure                  | 23,770        | 22,488        | 5.7           | 17,808        | 33.5          |
| <b>EBITDA</b>                | <b>6,994</b>  | <b>5,153</b>  | <b>35.7</b>   | <b>4,732</b>  | <b>47.8</b>   |
| <i>EBITDA margin (%)</i>     | <i>22.7</i>   | <i>18.6</i>   | <i>409bps</i> | <i>21.0</i>   | <i>174bps</i> |
| Interest                     | 1,463         | 1,483         | (1.4)         | 1,515         | (3.4)         |
| Depreciation                 | 1,336         | 1,295         | 3.2           | 1,293         | 3.3           |
| <b>PBT</b>                   | <b>4,196</b>  | <b>2,375</b>  | <b>76.6</b>   | <b>1,663</b>  | <b>152.4</b>  |
| Tax                          | 1,662         | 819           | 102.9         | 352           | 372.5         |
| <b>PAT</b>                   | <b>2,534</b>  | <b>1,556</b>  | <b>62.8</b>   | <b>1,311</b>  | <b>93.3</b>   |
| <b>Adj. PAT</b>              | <b>2,456</b>  | <b>1,515</b>  | <b>62.1</b>   | <b>1,530</b>  | <b>60.6</b>   |
| <b>Adj. diluted EPS (Rs)</b> | <b>7.30</b>   | <b>4.51</b>   | <b>62.0</b>   | <b>4.55</b>   | <b>60.5</b>   |

Source: Company; IDBI Capital Research

**Table 2: Actual vs. Estimates**

(Rs mn)

|                              | Q3CY17E      | Q3CY17       | Variance (%)  |
|------------------------------|--------------|--------------|---------------|
| Net sales                    | 27,901       | 30,764       | 10.3          |
| EBTIDA                       | 4,873        | 6,994        | 43.5          |
| <i>Margin (%)</i>            | <i>17.5</i>  | <i>22.7</i>  | <i>523bps</i> |
| <b>Adj. PAT</b>              | <b>1,436</b> | <b>2,456</b> | <b>71.1</b>   |
| <b>Adj. diluted EPS (Rs)</b> | <b>4.27</b>  | <b>7.30</b>  | <b>71.1</b>   |

Source: Company; IDBI Capital Research

### Key highlights from the earnings con-call:

- Chinese government remains serious on controlling pollution; aluminium production curbs in China remain strong although difficult to quantify the extent of these curtailments.
- Aluminium demand remains positive with prices rising alongside lower inventories. Some western world smelters likely to restart smelters which will further improve demand for CPC and CTP.
- During November- March, several CPC and CTP plants in China are likely to remain shut due to pollution concerns.
- Strong demand driving improvement in EBITDA margins for Carbon Products.
- Capacity utilization likely to improve further in Carbon Products segment. CPC prices have risen sharply since Q4CY16. The company is seeing strong demand for its Carbon Products from Electrode manufacturers.

**Table 3: Sales volumes**

(mn tonnes)

|                 | Q3CY17 | Q2CY17 | QoQ (%) | Q3CY16 | YoY (%) |
|-----------------|--------|--------|---------|--------|---------|
| Carbon Products | 0.83   | 0.76   | 9.5     | 0.74   | 12.2    |
| Chemicals       | 0.05   | 0.06   | (10.0)  | 0.07   | (21.7)  |
| Cement          | 0.51   | 0.56   | (9.2)   | 0.48   | 4.8     |

Source: Company; IDBI Capital Research

**Table 4: Segment Revenues**

(Rs mn)

|                          | Q3CY17        | Q2CY17        | QoQ (%)     | Q3CY16        | YoY (%)     |
|--------------------------|---------------|---------------|-------------|---------------|-------------|
| Carbon Products          | 25,368        | 21,039        | 20.6        | 17,371        | 46.0        |
| Chemicals                | 5,258         | 5,442         | (3.4)       | 5,009         | 5.0         |
| Cement                   | 2,192         | 2,823         | (22.4)      | 2,102         | 4.3         |
| <b>Total Revenues</b>    | <b>32,818</b> | <b>29,304</b> | <b>12.0</b> | <b>24,482</b> | <b>34.0</b> |
| less: intersegment sales | 2,309         | 2,138         | 8.0         | 2,187         | 5.6         |
| <b>Net revenues</b>      | <b>30,508</b> | <b>27,166</b> | <b>12.3</b> | <b>22,295</b> | <b>36.8</b> |

Source: Company; IDBI Capital Research

**Table 5: Segmental adj. EBITDA**

(Rs mn)

|                 | Q3CY17 | Q2CY17 | QoQ (%) | Q3CY16 | YoY (%) |
|-----------------|--------|--------|---------|--------|---------|
| Carbon Products | 6,336  | 4,002  | 58.3    | 3,456  | 83.3    |
| Chemicals       | 133    | 465    | (71.4)  | 451    | (70.5)  |
| Cement          | 269    | 211    | 27.5    | 170    | 58.2    |

Source: Company; IDBI Capital Research

CPC and CTP demand has continued to improve in the last six months which is also evident from Carbon Products margin improvement during 9MCY17. We raise our CY17/18 margin estimates to account for strong improvement in CPC and CTP spreads. Hence, our CY17/18 FY18/19 EBITDA and net profit estimates are revised upwards.

**Table 6: Change in estimates**

|                    | CY17E   |         |         | CY18E   |         |         |
|--------------------|---------|---------|---------|---------|---------|---------|
|                    | Old     | New     | (%) Chg | Old     | New     | (%) Chg |
| Revenue (Rs mn)    | 101,769 | 114,593 | 12.6    | 111,167 | 129,252 | 16.3    |
| EBITDA (Rs mn)     | 18,769  | 23,781  | 26.7    | 19,328  | 26,840  | 38.9    |
| EBITDA margin (%)  | 18.4    | 20.8    | 235bps  | 17.4    | 20.8    | 337bps  |
| Net profit (Rs mn) | 5,276   | 8,038   | 52.4    | 6,080   | 10,746  | 76.7    |
| EPS (Rs)           | 15.7    | 23.9    | 52.2    | 18.1    | 31.9    | 76.5    |

Source: Company; IDBI Capital Research

In light of strong demand visibility of carbon products (CPC and CTP), we now expect Carbon Products and Chemicals segment to trade in-line with other commodity companies (EV/EBITDA of 6.5-7.0x) with industry tailwinds. Hence, we raise our EV/EBITDA multiple to 6.5x for both Carbon Products and Chemicals segments (earlier 4.5x). Further, the company's return ratios are likely to improve significantly with our revised estimates which warrant a re-rating.

**Table 7: Valuation**

(Rs mn)

|                             | Method    | CY18 EBITDA | Multiple (x) | Value          |
|-----------------------------|-----------|-------------|--------------|----------------|
| Carbon                      | EV/EBITDA | 24,134      | 6.5          | 156,874        |
| Chemicals                   | EV/EBITDA | 1,714       | 6.5          | 11,138         |
| Cement (@ \$90 EV/tonne)    |           |             |              | 21,105         |
| <b>Total EBITDA</b>         |           |             |              | <b>189,117</b> |
| Total EV (Rs mn)            |           |             |              | 48,401         |
| Net debt (Rs mn)            |           |             |              | 140,716        |
| <b>Value per share (Rs)</b> |           |             |              | <b>418</b>     |
| CMP (Rs)                    |           |             |              | 340            |
| <i>Upside potential (%)</i> |           |             |              | 23             |

Source: Company; IDBI Capital Research

## Financial Summary

**Profit & Loss Account**

(Rs mn)

| Year-end: June                | CY15           | CY16          | CY17E          | CY18E          |
|-------------------------------|----------------|---------------|----------------|----------------|
| <b>Net sales</b>              | <b>102,185</b> | <b>93,164</b> | <b>114,593</b> | <b>129,252</b> |
| <i>Growth (%)</i>             | <i>(14.4)</i>  | <i>(8.8)</i>  | <i>23.0</i>    | <i>12.8</i>    |
| Operating expenses            | (88,693)       | (79,627)      | (90,813)       | (102,411)      |
| <b>EBITDA</b>                 | <b>13,492</b>  | <b>13,537</b> | <b>23,781</b>  | <b>26,840</b>  |
| <i>Growth (%)</i>             | <i>11.1</i>    | <i>0.3</i>    | <i>75.7</i>    | <i>12.9</i>    |
| Depreciation                  | (3,278)        | (3,461)       | (5,332)        | (5,306)        |
| <b>EBIT</b>                   | <b>10,214</b>  | <b>10,076</b> | <b>18,448</b>  | <b>21,535</b>  |
| Interest paid                 | (5,964)        | (5,867)       | (5,940)        | (5,195)        |
| Other income                  | 796            | 737           | -              | -              |
| <b>Pre-tax profit</b>         | <b>4,985</b>   | <b>3,576</b>  | <b>11,838</b>  | <b>16,339</b>  |
| Tax                           | (1,962)        | (1,648)       | (4,273)        | (5,392)        |
| <i>Effective tax rate (%)</i> | <i>39.4</i>    | <i>46.1</i>   | <i>36.1</i>    | <i>33.0</i>    |
| Minority Interest             | 217.1          | (63.8)        | (196.3)        | (201.2)        |
| <b>Net profit</b>             | <b>3,240</b>   | <b>1,864</b>  | <b>7,368</b>   | <b>10,746</b>  |
| Exceptional items             | (61)           | (1,370)       | (670)          | -              |
| <b>Adjusted net profit</b>    | <b>3,301</b>   | <b>3,234</b>  | <b>8,038</b>   | <b>10,746</b>  |
| <i>Growth (%)</i>             | <i>(4.7)</i>   | <i>(2.0)</i>  | <i>148.5</i>   | <i>33.7</i>    |
| <i>Shares o/s (mn nos)</i>    | <i>336</i>     | <i>336</i>    | <i>336</i>     | <i>336</i>     |

**Cash Flow Statement**

(Rs mn)

| Year-end: June                       | CY15           | CY16           | CY17E          | CY18E          |
|--------------------------------------|----------------|----------------|----------------|----------------|
| Pre-tax profit                       | 4,985          | 3,576          | 11,838         | 16,339         |
| Depreciation                         | 3,278          | (6)            | 5,332          | 5,306          |
| Tax paid                             | (3,102)        | (2,031)        | (4,273)        | (5,392)        |
| Chg in working capital               | 94             | 2,495          | (3,339)        | (1,696)        |
| Other operating activities           | -              | -              | -              | -              |
| <b>Cash flow from operations (a)</b> | <b>5,255</b>   | <b>4,033</b>   | <b>9,557</b>   | <b>14,557</b>  |
| Capital expenditure                  | (2,976)        | (1,960)        | (5,710)        | (5,250)        |
| Chg in investments                   | 10             | (40)           | -              | -              |
| Other investing activities           | -              | -              | -              | -              |
| <b>Cash flow from investing (b)</b>  | <b>(2,907)</b> | <b>(1,865)</b> | <b>(5,710)</b> | <b>(5,250)</b> |
| Equity raised/(repaid)               | -              | -              | -              | -              |
| Debt raised/(repaid)                 | (355)          | (1,567)        | (4,793)        | (7,000)        |
| Dividend (incl. tax)                 | (405)          | (506)          | (810)          | (810)          |
| Chg in minorities                    | 25             | 628            | -              | -              |
| <b>Cash flow from financing (c)</b>  | <b>(735)</b>   | <b>(1,445)</b> | <b>(5,603)</b> | <b>(7,810)</b> |
| <b>Net chg in cash (a+b+c)</b>       | <b>1,613</b>   | <b>723</b>     | <b>(1,755)</b> | <b>1,497</b>   |

## Balance Sheet

(Rs mn)

| Year-end: June                        | CY15           | CY16           | CY17E          | CY18E          |
|---------------------------------------|----------------|----------------|----------------|----------------|
| Net fixed assets                      | 89,506         | 91,473         | 91,850         | 91,795         |
| Investments                           | 59             | 99             | 99             | 99             |
| Other non-curr assets                 | 4,344          | 2,844          | 2,844          | 2,844          |
| <b>Current assets</b>                 | <b>39,321</b>  | <b>35,863</b>  | <b>43,820</b>  | <b>50,926</b>  |
| Inventories                           | 16,210         | 12,678         | 17,766         | 20,039         |
| Sundry Debtors                        | 11,968         | 10,637         | 13,902         | 15,681         |
| Cash and Bank                         | 8,605          | 10,491         | 9,440          | 12,156         |
| Loans and advances                    | 2,313          | 1,997          | 2,651          | 2,990          |
| <b>Total assets</b>                   | <b>133,230</b> | <b>130,279</b> | <b>138,614</b> | <b>145,664</b> |
| <b>Shareholders' funds</b>            | <b>29,375</b>  | <b>30,144</b>  | <b>36,094</b>  | <b>46,031</b>  |
| Share capital                         | 673            | 673            | 673            | 673            |
| Reserves & surplus                    | 28,702         | 29,471         | 35,421         | 45,358         |
| <b>Total Debt</b>                     | <b>71,323</b>  | <b>69,756</b>  | <b>64,963</b>  | <b>57,963</b>  |
| Secured loans                         | 71,323         | 69,756         | 64,963         | 57,963         |
| Other liabilities                     | 11,836         | 11,676         | 12,988         | 14,207         |
| <b>Curr Liab &amp; prov</b>           | <b>20,672</b>  | <b>17,988</b>  | <b>23,656</b>  | <b>26,351</b>  |
| Current liabilities                   | 19,146         | 16,626         | 21,880         | 24,347         |
| Provisions                            | 1,526          | 1,362          | 1,776          | 2,003          |
| <b>Total liabilities</b>              | <b>103,831</b> | <b>99,420</b>  | <b>101,608</b> | <b>98,521</b>  |
| <b>Total equity &amp; liabilities</b> | <b>133,230</b> | <b>130,279</b> | <b>138,614</b> | <b>145,664</b> |
| <b>Book Value (Rs)</b>                | <b>87</b>      | <b>90</b>      | <b>107</b>     | <b>137</b>     |

Source: Company; IDBI Capital Research

## Financial Ratios

| Year-end: June                               | CY15  | CY16  | CY17E | CY18E |
|--|-------|-------|-------|-------|
| Adj EPS (Rs)                                 | 9.8   | 9.6   | 23.9  | 31.9  |
| Adj EPS growth (%)                           | (4.7) | (2.0) | 148.5 | 33.7  |
| EBITDA margin (%)                            | 13.2  | 14.5  | 20.8  | 20.8  |
| Pre-tax margin (%)                           | 4.9   | 3.8   | 10.3  | 12.6  |
| ROE (%)                                      | 11.2  | 10.9  | 24.3  | 26.2  |
| ROCE (%)                                     | 9.0   | 9.0   | 16.2  | 18.4  |
| <b>Turnover &amp; Leverage ratios (x)</b>    |       |       |       |       |
| Asset turnover (x)                           | 0.8   | 0.7   | 0.9   | 0.9   |
| Leverage factor (x)                          | 4.6   | 4.4   | 4.1   | 3.5   |
| Net margin (%)                               | 3.2   | 3.5   | 7.0   | 8.3   |
| Net Debt/Equity (x)                          | 2.1   | 2.0   | 1.5   | 1.0   |
| <b>Working Capital &amp; Liquidity ratio</b> |       |       |       |       |
| Inventory days                               | 58    | 50    | 57    | 57    |
| Receivable days                              | 43    | 42    | 44    | 44    |
| Payable days                                 | 42    | 36    | 45    | 45    |

## Valuation

| Year-end: March        | CY15 | CY16 | CY17E | CY18E |
|------------------------|------|------|-------|-------|
| PER (x)                | 34.6 | 35.4 | 14.2  | 10.6  |
| Price / Book value (x) | 3.9  | 3.8  | 3.2   | 2.5   |
| PCE (x)                | 17.4 | 17.1 | 8.6   | 7.1   |
| EV / Net sales (x)     | 1.7  | 1.9  | 1.5   | 1.2   |
| EV / EBITDA (x)        | 13.1 | 12.8 | 7.1   | 6.0   |
| Dividend Yield (%)     | 0.4  | 0.4  | 0.7   | 0.7   |

# Notes

|         |                   |                         |
|---------|-------------------|-------------------------|
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|---------|-------------------|-------------------------|

## Key to Ratings Stocks:

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

**IDBI Capital Markets & Securities Ltd.** (Formerly known as “IDBI Capital Market Services Ltd.”)

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