27 June 2024

Himadri Specialty Chemicals

Rating: **Not Rated**

Share Price: Rs.390

Profit to double in three years, with better margins, RoCE

Positive about its battery chemicals' business, Himadri Specialty Chemicals intends to double profit in three years to ~Rs8bn, thanks to its specialty carbon black capacity expansion, liquid coal-tar pitch (CTP) exports commencing, debottlenecking 20% of CTP capacity and the rising share of value-added products (eg, oils). It expects no huge revenue growth in FY25 owing to lower realisations. Volume growth, however, is likely to be good. For its lithium-iron phosphate (LFP) expansion, it expects to receive land by Q3 FY25, with commercialisation in FY27. Besides, it is coming up with a pilot plant for LFP. It is revamping the recently acquired assets of Birla Tyres, which would contribute considerably to revenue from FY26 (the plant is expected to re-start in Dec'24).

Focus areas. The company is focusing on CTP exports to Australia and the Mid-East (where CTP commands a higher premium), increasing specialty-oil volumes (which enjoy better margins) and improving efficiency and utilisation, which would then reflect in margins. Further, it is adding specialty carbon black capacity to fortify its position and margin profile.

Birla Tyres. With Dalmia Bharat Refractories as a resolution applicant, the company jointly acquired Birla Tyres for Rs3bn. By levering its carbon-black expertise, it is on track to develop tyres for CVs and PVs. It intends to tap the replacement market and use the Birla brand and incentives to drive the business and hit target margins. It would become forward-integrated and lever its global and domestic network once the ramp-up is complete. The plant is expected to re-start by Dec'24, with signal contribution likely from FY26.

Making a foray into battery chemicals. The company is entering battery chemicals—manufacturing LFP cathode active material, catering to 100GWh of lithium-ion batteries in phases (5-6 years), 200,000 tonnes needing Rs48bn capex. Phase 1 of 40,000 tonnes requires Rs11.3bn capex. The company has now completed R&D stage trials and setting up a pilot plant. It is acquiring land to set up a commercial plant. Besides, it acquired stakes in Sicona Battery Technologies (12.79%) and in Invati Creations (40%) to produce quality anode materials and li-ion battery materials.

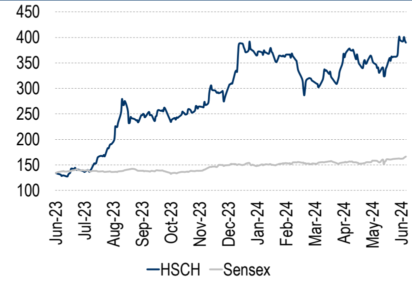
Guidance. The company intends to maintain its net-debt-to-EBITDA ratio at 1:1, with profit doubling by FY27 primarily from the present business, better margins and more sales of, and revenue from, value-added products. Further, it is not looking for any dilution or raising debt in the near term. Its focus is on projects driving RoCE growth and on reaching mid-30s RoCE.

Valuation. At the Rs390 ruling price, the stock trades at 47x FY24 EPS.

Key data	HSCH IN / HIMD BO
52-week high / low	Rs419 / 126
Sensex / Nifty	79243 / 24045
3-m average volume	$3.9m
Market cap	Rs192bn / $2300m
Shares outstanding	493m

Shareholding pattern (%)	Mar'24	Dec'23	Sep'23
Promoters	50.3	44.8	44.9
- of which, Pledged			
Free float	49.7	55.2	55.1
- Foreign institutions	5.1	5.4	5.1
- Domestic institutions	2.1	0.6	0.5
- Public	42.5	49.2	49.5

Relative price performance



Source: Bloomberg

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Research Analyst

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Quick Glance – Financials & Valuations (consolidated)

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23	FY24
Net revenue	18,058	16,795	27,913	41,718	41,849
Growth (%)	*-25.5*	*-7.0*	*66.2*	*49.5*	*0.3*
Direct costs	12,238	12,339	22,449	32,544	30,303
SG&A	3,017	3,146	3,904	5,183	5,096
EBITDA	**2,803**	**1,309**	**1,561**	**3,992**	**6,451**
EBITDA margins (%)	*15.5*	*7.8*	*5.6*	*9.6*	*15.4*
- Depreciation	392	470	495	508	499
Other income	80	140	72	280	425
Interest expenses	549	334	356	661	639
PBT	1,941	646	781	3,103	5,739
Effective tax rates (%)	*-5.8*	*26.8*	*27.0*	*23.0*	*28.4*
+ Associates / (Minorities)	(1)	(2)	(19)	1	1
Net income	2,055	475	409	2,157	4,106
Adjusted income	2,055	475	656	2,457	4,106
WANS	419	419	419	433	493
FDEPS (Rs)	4.9	1.1	1.6	5.7	8.3
FDEPS growth (%)	-36.7	-76.9	38.2	262.7	46.8
Gross margins (%)	*32.2*	*26.5*	*19.6*	*22.0*	*27.6*

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23	FY24
Share capital	419	419	419	433	493
Net worth	17,342	17,929	18,676	22,805	30,456
Debt	3,370	6,783	5,390	7,910	6,004
Minority interest	-5	-7	-27	-28	-28
DTL / (Assets)	520	618	732	940	1,691
Capital employed	**21,226**	**25,323**	**24,771**	**31,627**	**38,123**
Net tangible assets	14,732	14,664	15,449	15,145	15,332
Net intangible assets	18	13	7	7	8
Investments	-	-	-	-	-
Other non-current assets	1,584	1,596	766	935	665
Inventory	467	661	1,133	1,319	4,767
Accounts receivable	-	-	-	-	8
Invst. (incl. bank balance)	10,699	12,060	17,134	16,201	16,393
Cash	466	1,377	2,650	6,248	7,314
Other current assets	6,739	5,048	12,367	8,228	6,365
Current liabilities	3,960	7,012	4,767	7,973	10,029
Capital deployed	**21,226**	**25,323**	**24,771**	**31,627**	**38,123**

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23	FY24
PBT after OI and Interest	2,411	839	1,065	3,483	5,952
+ Non-cash items	392	470	495	508	499
Oper. profit before WC changes	2,803	1,309	1,561	3,992	6,451
- Incr. / (decr.) in WC	(2,585)	3,052	(2,245)	3,206	2,056
Others, incl. taxes	347	118	139	478	1,011
Operating cash-flow	5,041	(1,861)	3,667	308	3,384
- Capex (tangible + intangible)	3,689	409	443	374	417
Free cash-flow	1,352	(2,271)	3,224	(67)	2,967
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	76	84	105	108	246
+ Equity raised	-	-	-	14	60
+ Debt raised	(930)	3,414	(1,393)	2,520	(1,906)
- Financial investments	(1,326)	194	473	186	3,456
- Misc. items (CFI + CFF) (OI & int.)	1,717	(46)	(20)	(1,425)	(3,648)
Net cash-flow	(45)	911	1,273	3,598	1,066

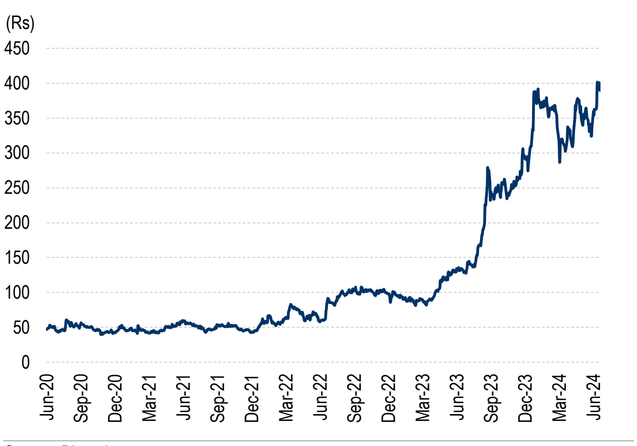
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY20	FY21	FY22	FY23	FY24
P/E (x)	79.5	344.2	249.1	68.7	46.8
EV / EBITDA (x)	69.6	150.9	124.9	48.5	29.6
EV / Sales (x)	10.8	11.8	7.0	4.6	4.6
P/B (x)	11.1	10.7	10.3	8.4	6.3
RoE (%)	11.6	4.2	4.5	13.3	18.3
RoCE (%) -after tax	12.2	3.1	3.3	10.3	13.1
RoIC – after tax	12.5	3.2	3.6	12.2	16.2
DPS (Rs)	0.2	0.2	0.3	0.3	0.5
Dividend yield (%)	0.0	0.1	0.1	0.1	0.1
Dividend payout (%) - incl. DDT	3.1	17.7	25.6	5.0	6.0
Net debt / equity (x)	0.2	0.3	0.1	0.1	(0.0)
Receivables (days)	60.6	100.3	66.0	44.2	57.2
Inventory (days)	81.9	73.8	100.9	47.6	61.3
Payables (days)	46.4	33.2	101.8	30.2	49.7
CFO : PAT (%)	245.3	(392.1)	559.0	12.5	82.4

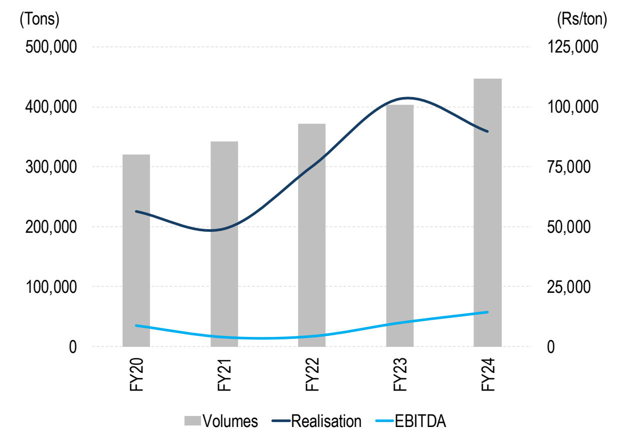
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Volume growth



Source: Company, Anand Rathi Research

Meeting highlights

To understand the present industry dynamics and obtain updates on acquisitions and initiatives, and other processes and operations, we attended the company's analyst meet in Mumbai. CMD & CEO Anurag Choudhary, CFO Kamlesh Kumar Agarwal and Executive VP (CTD and Strategy) Somesh Satnalika provided comprehensive updates regarding the company's operations and the outlook for it.

Coal tar pitch

Himadri is the largest manufacturer of CTP, >60% share in its home market. CTP is a complex chemical generated by distilling coal tar and a crucial raw material for various industries, including aluminium smelting, graphite electrode production, surface coatings of industrial materials and chemical products. At present, the aluminium industry relies solely on CTP as the primary binder to produce carbon anodes. It is widely used as the pre-eminent binder in anode production, primarily due to its effective interaction with coke particles during the mixing phase. It can wet the surface of coke particles and permeate their open pores, thereby facilitating the transformation of dry particles into a malleable paste conducive to shaping it as desired.

CTP is not a commodity for management, which provides customised solutions to customers. The pitch's quality directly affects power consumption and carbon consumption in electrolysis. Besides, it changes the purity of the metal, rendering it critical in the process (especially for high value-added products). CTP is supplied in liquid form at 250^{o} Celsius in specially made trucks; this requirement obviates the threat from major domestic and Chinese competitors. Further, it cannot be imported as all smelters in India are distant from ports and require special trucks.

Past margins were feeble due to contractual arrangements with customers, where prices over FY19-22 were linked to the global index. The premium on carbon black feedstock went up to 50% of value and the company was hard hit in pricing and margins.

Management expects demand to be strong as India is a major global producer of aluminium, with substantial demand for CTP, used to make high-technology products like carbon fibre, anodes for lithium-ion batteries, and more. Further, CTP is a foundational material in coatings and paints and is applied in roofings and pavings, as a binder in various tar products. CTP is feedstock in producing various chemicals, incl. naphthalene, phenol and creosote. These chemicals are used in diverse industries such as pharmaceuticals, textiles and wood preservation.

Further, the company plans to export liquid CTP to the Mid-East and Australia. It has set up a liquid-pitch terminal at Haldia, with audits having commenced and trials to be approved. To address rising demand, it will raise capacity 20% via de-bottlenecking.

Carbon black

Carbon black, a variant of elemental carbon, synthesised through the controlled vapour-phase pyrolysis of hydrocarbons and tight control of the manufacturing process, delivers a range of features including reinforcement, conductivity, pigmentation, rheology control and many other properties. As a result, carbon black is used to manufacture tyres, plastics, coatings, printing inks, paints, batteries, rubber compounds, conductive packaging, film and fibres. Recognised for its cost-effectiveness, versatility and durability, carbon black extends the performance of tyres, reinforces rubber goods, is a colorant in coatings, provides conductivity in plastics and delivers many other benefits across a range of applications.

Specialty carbon black

Specialty carbon black is an engineered particle providing added features beyond ASTM commodity carbon black such as superior aesthetics in terms of colour, higher UV stability and conductivity and other benefits, while being easier to process with fewer defects. Specialty blacks are tailored to specific industry applications to help end-users achieve greater production performance. In addition to plastics, coatings, printing inks, paints, specialised tyres, conductive packaging film and fibres, specialty blacks are also used in belts, hoses, boots, fascia, gaskets, grommets, diaphragms, air springs, conveyor wheels and vibration-isolation devices.

To address growing demand, the company will add 70,000 tonnes at Rs2.2bn to increase specialty carbon-black capacity to 130,000 tonnes, expected to be commissioned by H1 FY26. With this, it will have the world’s largest speciality carbon-black capacity at a single site.

Naphthalene

Naphthalene is produced by distilling coal tar or fractioning petroleum. It is a white, volatile, fragrant and crystalline substance, extracted from petroleum or coal tar, primarily used to produce phthalic anhydride, insecticides, low-volatile solvents, naphthalene sulfonates and moth repellents. It is an essential intermediary in manufacturing dyes, resins, insect repellents and plasticisers. India’s largest producer (and of its purest form), the company meets 70% of the requirements of its US customers.

Specialty oils

The company produces several oils that cater to the specific requirements of various industries. These oils are by-products of the company's advanced multi-stage coal-tar distillation. The company’s state-of-the-art coal tar distillation plants employ a sophisticated multi-phase technique, ensuring the extraction of different types of oils. Levering a continuous distillation approach, the company achieves consistent cuts of distillates using a series of fractional distillation columns throughout the operation. This method facilitates the separation of oils into distinct grades based on their boiling ranges. Subsequently, the different grades of oils are meticulously blended in precise proportions through the company's operational processes to meet the exact demands of various industries.

Foray into battery chemicals

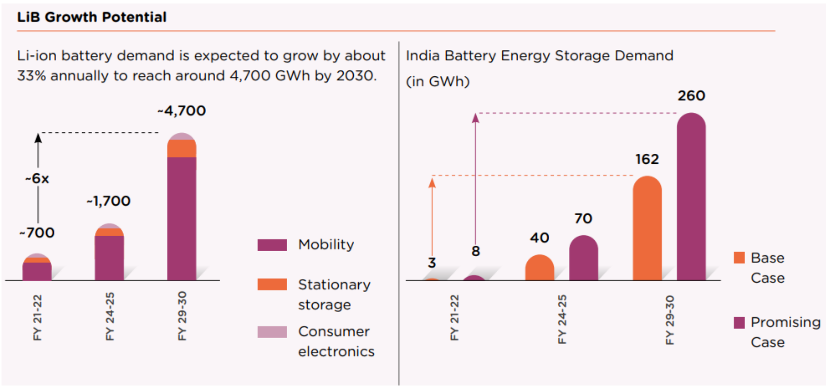
The company is entering battery chemicals, manufacturing LFP cathode active material, catering to 100GWh of li-ion batteries, in phases (5-6 years). Per management, this will be the first commercial plant for LFP cathode active material in India, to cater to domestic and global markets.

In lithium-ion batteries, cathodes plays a vital role in determining the battery's performance and characteristics. One commonly used cathode material is LFP, which is paired with a graphite electrode with a metallic backing serving as the anode. Unlike several other cathode materials, LFP exhibits a unique atomic arrangement, forming a crystalline structure that results in a three-dimensional network of lithium ions. This distinctive structure enhances electrical conductivity compared to other cathode materials such as nickel, manganese and cobalt, which typically feature two-dimensional slabs.

At present, the company has completed R&D-stage trials and is setting up a pilot plant. It is acquiring land to set up a commercial plant. It intends to add 200,000 tonnes in phases (5-6 years) at Rs48bn capex. Phase 1 of 40,000 tonnes requires Rs11.3bn capex and will focus on meeting domestic and global demand. Land is expected to be acquired by Oct'24 and production to start in FY27. Per management, basic engineering was completed and detailed engineering has begun. The company believes it has an edge in costing as raw material is generally 73% of costs (the company's RM cost was ~69-70% due to formulation and technology benefits). The company does not expect any challenges in sourcing key raw materials like lithium carbonate and ion phosphate.

With the expansion, the company aims to cater to 100GWh of li-ion battery demand. This plant would widen its offerings into the rapidly growing EV and energy-storage segment.

Fig 7 – Expected demand for lithium-ion batteries



Source: Company, Annual report FY24

Updates on recent acquisitions

Birla Tyres

Along with Dalmia Bharat Refractories (resolution applicant), the company participated in the corporate insolvency resolution process of Birla Tyres and jointly acquired it for Rs3.06bn, funded by internal accruals and debt. Management says that, apart from strategic forward integration, Birla Tyres offers other economic and strategic advantages.

- The cost of building such a plant would have been ~Rs34bn.
- Building the asset organically would have taken 36 months.
- Eligibility for investment-related incentives under the state government policy.
- Sufficient land available for future expansion.

Birla Tyres has 400tpd capacity to manufacture tyres for buses, trucks, agri and passenger vehicles. The company expects to re-start the plant by Dec'24. Management says it will invest Rs5bn-6bn over 3-4 years to strengthen its product range and manufacture more high-value added products.

Sicona Battery Technologies

The company acquired a 12.79% stake in Sicona Battery Technologies, an innovative Australian start-up specialising in high-capacity silicon anode technology for lithium-ion batteries.

It intends to produce high-quality anode materials and reinforces the commitment to exploring innovative technologies in battery materials.

Invati Creations

The company acquired a 40% stake in Invati, founded by alumni of IIM Kolkata and IIT Kharagpur, for Rs452m. Invati has a sharp focus on engineering lithium-ion electrode materials for efficient energy storage, with higher energy density and longer battery lives, using groundbreaking nano-technology biosciences to provide real-world solutions.

It also engages in R&D of various molecules and nanotech solutions, addressing challenges in the life-science vertical, designing technology for diverse industries such as agrochemicals, animal health and energy storage.

Invati holds many patented and patentable technologies for novel molecule inventions spanning various applications, incl. developing the first broad-spectrum antiviral drug molecule.

Appendix

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