

## Phillips Carbon Black Ltd.

### CMP

Rs. 197

### TARGET PRICE

Rs. 330

## Result Review

### POTENTIAL UPSIDE

60-70%

### TIME FRAME

6 Months

Phillips Carbon Black, the **largest producer of carbon black in India**, with **market share of more than 40%** plans to **expand its carbon black manufacturing facilities by more than 46% and power capacities by more than 300%**.

The company has re-negotiated the pricing formula and aligned with the material cost. The company has also developed alternate supplier for its feedstock. It has also maximized its yield and capacity utilization. Owing to these arrangements, the company has been able to improve its operating margins from 6.24% to 15.4%, over the last six quarters.

Further, due to higher compliance costs, the company plans to shift its capacities from USA, European Union and Japan to emerging markets.

We recommend BUY on PCBL with a price target of Rs. 330 in 6 months.

### Strengthening its leadership position

Buoyed by increasing demand from tyre replacement market, domestic carbon black industry is expected to grow at a CAGR of 8-9% over the next five years. To meet the growing demand, PCBL plans to spend Rs. 250 crore, to expand its capacity by 125000 mtpa to 395000 mtpa by FY2009E. Due to higher emission compliance cost in USA and European Union, PCBL is shifting its tyre capacity to low cost emerging markets.

### Improving Operating Margins

Over the last six quarters, PCBL has witnessed improved margins from 6.24% to 15.4%. Going forward, on the back of price escalation clause in the new contracts, we expect margins to improve further.

### De-risking business model

PCBL generates power through waste gas where the cost of producing power is very low and margins 85-90%. Company will spend Rs. 215 crore to increase its power capacity from 18.5 MW to 74.5 MW by FY 2009E. The company will be able to sell 40-45 MW of power to GEB, CESC and other customers at Rs. 2 per unit. This will not only improve its margins but also de-risk the business model.

### Bottom line surges 1314%

During the quarter ended September 2007, PCBL witnessed a meager 2.84% growth in sales. However, on the back of lower total expenditure, interest expenses and depreciation, bottomline grew by whopping 1314% to Rs. 240.4 million against Rs. 17 million in the corresponding quarter last year.

During the quarter, OPM improved by almost 800 basis points to 15.4% and NPM improved by 900 basis points to 9.64%. Diluted EPS stood at Rs. 9.43.

### Valuations

Buoyed by increasing demand from tyre replacement market, domestic carbon black industry is expected to grow at a CAGR of 8-9% over the next five years. PCBL is expected to be a major beneficiary of the robust tyre replacement demand.

FY08 EPS is estimated at Rs 33 that translates into a target price of Rs 330 taking a conservative PE of 10.

### Concerns

- **De-growth in the Automobile sector:** The automobile sector has been witnessing de-growth on account of which the company could be adversely impacted. But, it may be noted that the company derives maximum demand from the tyre replacement segment. Also, the company's brownfield venture is targeting the exports market.

- **Rising crude oil prices could impact OPMs:** In the past, the company was not able to pass on the rise in raw material costs (primarily CBFS prices) to its customers. But, now with the escalation clause built into the contract, we believe, the company has passed on the risk, to some extent, to the buyers.
- **Delay in implementation of power project:** The power project is the main driver for margin improvement as it has EBITDA margins of 85-90%. Hence, delays in implementation of the power plant would impact overall margins significantly. However, we have factored in one-two months delay in the implementation of the project.

## Key financials

(Rs. million)

Description	30-Sep-07 (3 months)	30-Sep-06 (3 months)	Y-o-Y Growth	30-Jun-07 (3 months)	Q-o-Q Growth
<b>Net Sales / Interest Earned / Operating Income</b>	<b>2,494.50</b>	<b>2,425.70</b>	<b>2.84</b>	<b>2,348.10</b>	<b>6.23</b>
Other Income	42.5	2	2025.00	4.4	865.91
<b>Total Income</b>	<b>2,537.00</b>	<b>2,427.70</b>	<b>4.50</b>	<b>2,352.50</b>	<b>7.84</b>
Expenditure	2,153.70	2,248.30	-4.21	2,004.20	7.46
<b>Operating Profit</b>	<b>383.3</b>	<b>179.4</b>	<b>113.66</b>	<b>348.3</b>	<b>10.05</b>
Interest	45.5	92.2	-50.65	47.4	-4.01
<b>Profit Before Depreciation and Tax</b>	<b>337.8</b>	<b>87.2</b>	<b>287.39</b>	<b>300.9</b>	<b>12.26</b>
Depreciation	51.1	51.2	-0.20	50.5	1.19
<b>Profit before Tax</b>	<b>286.7</b>	<b>36</b>	<b>696.39</b>	<b>250.4</b>	<b>14.50</b>
Tax	46.3	19	143.68	31.1	48.87
<b>Net Profit</b>	<b>240.4</b>	<b>17</b>	<b>1314.12</b>	<b>219.3</b>	<b>9.62</b>
Basic And Diluted EPS after Extraordinary item	-	0.96		8.68	
Basic EPS after Extraordinary items	9.52	-		-	
Diluted EPS after Extraordinary items	9.43	-		-	
Operating Profit Margin	15.37	7.4		14.83	
Net Profit Margin	9.64	0.7		9.34	
Cash EPS	11.54	-		-	

## Rating

Out performer	Large cap	10% or more
	Mid Cap	20% or more
	Small cap	30% or more
Performer	Large cap	Between 5 to 10%
	Mid Cap	Between 10 to 15%
	Small cap	Between 15 to 20%
Under performer	Large cap	-10 %or more
	Mid Cap	-15 %or more
	Small cap	-20% or more

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