

14 May 2014

Graphite India

Cash generation accelerates; Buy

Rating: **Buy**

Target Price: ₹119

Share Price: ₹85

Key takeaways

Revenues driven by greater volumes. Graphite India's 4QFY14 sales volumes increased 4% yoy, offset by lower price realization. Export volumes were subdued while strong domestic volume growth sustained the growth rates. With 83% capacity utilization to 16,600 tonnes, production rose 7% yoy. Management has guided to a ~70% utilization rate at the consolidated level in FY15 but we believe the guidance would be surpassed by the upswing in steel volumes in developed countries and the brightening Indian outlook.

EBITDA margin sustained. EBITDA increased 10.3% yoy and the margin expanded 185bps to 13.9% due to greater export incentives. Management has been focusing on production rationalisation in order to maintain the margin profile. PAT increased 22.2% yoy due to higher other income and lower finance costs.

Cash generation accelerates adding to balance-sheet strength. Post-capex, ₹5bn in cash was generated, turning the standalone balance sheet net cash positive, and dividend of ₹3.5 a share was declared for FY14. From the consolidated results, it could be inferred that the German subsidiary suffered an EBITDA loss of ₹343m as volumes declined ~30%, but recovery in demand is progressing as the management expects better volumes in FY15.

Our take. Graphite India has scale in the global league of graphite electrode operators, with annual production capacity of 98,000 tonnes; ~65% of the production is exported to 30 countries. Strong product knowledge has been built since 1960. Sturdy operating margins driven by operational efficiency, productivity, technology, and access to low-cost sources of power would sustain cash generation during the cycle. At the CMP, the stock trades at 3x FY16e EV/EBITDA and we maintain a Buy on it, with a price target of ₹119 based on 4.5x FY16e EV/EBITDA. **Risks.** Adverse currency movements and sharp raw-material price volatility.

| Key data | GRIL IN / GRPH.BO |
|--------------------|-------------------|
| 52-week high / low | ₹95/₹57 |
| Sensex / Nifty | 23871/7109 |
| 3-m average volume | US\$0.1m |
| Market cap | ₹17bn/US\$0.3bn |
| Shares outstanding | 195m |

| Shareholding pattern (%) | Mar'14 | Dec'13 | Sep'13 |
|--------------------------|--------|--------|--------|
| Promoters | 65.0 | 64.5 | 63.9 |
| - of which, Pledged | - | - | - |
| Free Float | 35.1 | 35.5 | 36.1 |
| - Foreign Institutions | 15.7 | 15.5 | 15.2 |
| - Domestic Institutions | 3.5 | 4.0 | 4.8 |
| - Public | 15.8 | 16.0 | 16.2 |

| Estimates revision (%) | FY15e | FY16e |
|------------------------|-------|-------|
| Revenues | (3.0) | (4.0) |
| EBITDA | (0.8) | (2.4) |
| PAT | 1.7 | 1.4 |

| Financials (YE Mar) | FY15e | FY16e |
|---------------------|--------|--------|
| Revenues (₹m) | 18,471 | 21,033 |
| EBITDA (₹m) | 3,407 | 4,383 |
| EBITDA margin (%) | 18.4 | 20.8 |
| PAT (₹m) | 2,080 | 2,818 |
| EPS (₹) | 10.6 | 14.4 |
| EPS growth (%) | 21.7 | 35.5 |
| P/E (x) | 8.0 | 5.9 |
| P/BV (x) | 0.9 | 0.8 |
| EV/EBITDA (x) | 4.3 | 3.0 |
| ROAE (%) | 11.6 | 14.7 |

Source: Anand Rathi Research

| Quarterly results (YE Mar) | 4QFY13 | 4QFY14 | YoY(%) | FY13 | FY14 | YoY(%) |
|----------------------------|--------|--------|----------|--------|--------|--------|
| Sales (₹m) | 5,112 | 4,890 | (4.3) | 17,649 | 17,681 | 0.2 |
| EBITDA (₹m) | 618 | 682 | 10.3 | 2,789 | 2,843 | 1.9 |
| EBITDA margin (%) | 12.1 | 13.9 | 185bps | 15.8 | 16.1 | 28bps |
| Interest (₹m) | 71 | 39 | (44.5) | 221 | 170 | (23.4) |
| Depreciation (₹m) | 137 | 134 | (1.8) | 500 | 536 | 7.1 |
| Other income (₹m) | 98 | 159 | 62.0 | 264 | 402 | 52.4 |
| PBT (₹m) | 509 | 667 | 31.1 | 2,331 | 2,539 | 8.9 |
| Tax (₹m) | 93 | 218 | 133.9 | 700 | 830 | 18.6 |
| Tax rate (%) | 18.3 | 32.6 | 1,433bps | 30.0 | 32.7 | 266bps |
| PAT (₹m) | 416 | 449 | 8.1 | 1,631 | 1,709 | 4.8 |

Source: Company

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

| Year-end: Mar | FY12 | FY13 | FY14e | FY15e | FY16e |
|-------------------------|--------------|--------------|--------------|--------------|--------------|
| Net revenues | 16,708 | 17,649 | 17,681 | 18,471 | 21,033 |
| Revenue growth (%) | 36.3 | 5.6 | 0.2 | 4.5 | 13.9 |
| - Oper. expenses | 13,596 | 14,860 | 14,838 | 15,063 | 16,650 |
| EBIDTA | 3,112 | 2,789 | 2,843 | 3,407 | 4,383 |
| EBITDA margin (%) | 18.6 | 15.8 | 16.1 | 18.4 | 20.8 |
| - Interest expenses | 144 | 221 | 170 | 175 | 115 |
| - Depreciation | 404 | 500 | 536 | 569 | 593 |
| + Other income | 346 | 264 | 402 | 440 | 531 |
| - Tax | 828 | 700 | 830 | 1,024 | 1,388 |
| Effective tax rate (%) | 25.8 | 30.0 | 32.7 | 33.0 | 33.0 |
| Reported PAT | 2,379 | 1,631 | 1,709 | 2,080 | 2,818 |
| +/- Extraordinary items | 296 | - | - | - | - |
| +/- Minority interest | - | - | - | - | - |
| Adjusted PAT | 2,379 | 1,631 | 1,709 | 2,080 | 2,818 |
| Adj. FDEPS (₹/sh) | 12.2 | 8.3 | 8.7 | 10.6 | 14.4 |
| Adj. FDEPS growth (%) | 38.1 | (31.4) | 4.8 | 21.7 | 35.5 |

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

| Year-end: Mar | FY12 | FY13 | FY14e | FY15e | FY16e |
|-------------------------|---------------|---------------|---------------|---------------|---------------|
| Share capital | 391 | 391 | 391 | 391 | 391 |
| Reserves & surplus | 15,228 | 16,059 | 16,968 | 18,075 | 19,409 |
| Net worth | 15,619 | 16,450 | 17,359 | 18,465 | 19,800 |
| Minority interest | - | - | - | - | - |
| Total debt | 4,617 | 5,676 | 3,410 | 2,410 | 1,410 |
| Def. tax liab. (net) | 708 | 950 | 897 | 897 | 897 |
| Capital employed | 20,945 | 23,077 | 21,666 | 21,772 | 22,107 |
| Net fixed assets | 6,700 | 6,626 | 6,415 | 6,646 | 6,353 |
| Investments | 2,051 | 1,093 | 1,576 | 1,576 | 1,576 |
| - of which, Liquid | - | - | - | - | - |
| Net working capital | 12,850 | 14,026 | 10,009 | 9,126 | 9,171 |
| Cash and bank balance | 1,395 | 2,424 | 3,666 | 4,425 | 5,007 |
| Capital deployed | 20,945 | 23,077 | 21,666 | 21,772 | 22,107 |
| Net debt | 3,222 | 3,252 | (256) | (2,015) | (3,598) |
| WC days | 281 | 290 | 207 | 180 | 159 |
| Book value (₹/sh) | 64.0 | 78.3 | 97.4 | 118.7 | 119.7 |

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

| Year-end: Mar | FY12 | FY13 | FY14e | FY15e | FY16e |
|-------------------------|---------|-------|---------|---------|---------|
| PAT | 2,379 | 1,631 | 1,709 | 2,080 | 2,818 |
| + Non-cash items | 404 | 500 | 536 | 569 | 593 |
| Cash profit | 2,783 | 2,131 | 2,245 | 2,648 | 3,411 |
| - Incr./Decr. in WC | 2,101 | 2,349 | (2,924) | (884) | 46 |
| + Net finance exp | 168 | 253 | 572 | 615 | 646 |
| - Misc | 564 | (69) | 804 | 880 | 1,062 |
| Operating cash-flow | 286 | 104 | 4,937 | 3,267 | 2,949 |
| - Capex | 1,321 | 408 | 325 | 800 | 300 |
| Free cash-flow | (1,035) | (305) | 4,612 | 2,467 | 2,649 |
| - Dividend and interest | 947 | 1,024 | 970 | 1,148 | 1,598 |
| + Equity raised | - | - | 0 | - | - |
| + Debt raised | 1,752 | 1,241 | (2,266) | (1,000) | (1,000) |
| - Investments | (4) | 3 | - | - | - |
| + Other income and misc | (33) | (41) | (402) | (440) | (531) |
| Net cash-flow | (193) | (49) | 1,778 | 759 | 582 |

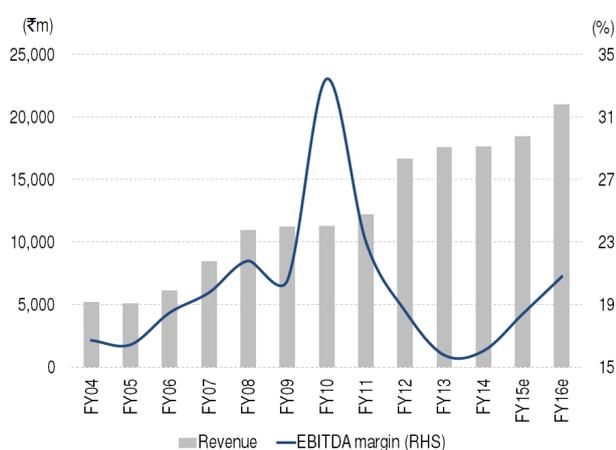
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹85

| Year-end: Mar | FY12 | FY13 | FY14e | FY15e | FY16e |
|---------------------|------|--------|-------|-------|-------|
| P/E (x) | 6.0 | 8.7 | 9.2 | 8.0 | 5.9 |
| P/B (x) | 0.9 | 0.9 | 0.8 | 0.9 | 0.8 |
| P/CF (x) | 5.1 | 6.7 | 6.8 | 6.3 | 4.9 |
| EV/Sales (x) | 1.0 | 1.0 | 0.8 | 0.8 | 0.6 |
| EV/EBITDA (x) | 5.6 | 6.3 | 5.0 | 4.3 | 3.0 |
| Dividend yield (%) | 4.8 | 4.8 | 3.3 | 5.0 | 7.6 |
| Dividend payout (%) | 28.7 | 41.9 | 30.0 | 40.0 | 45.0 |
| RoAE (%) | 16.0 | 10.2 | 9.2 | 11.6 | 14.7 |
| RoACE (%) | 16.0 | 11.6 | 11.0 | 15.1 | 19.7 |
| Net Debt/Equity (x) | 0.3 | 0.3 | 0.3 | 0.1 | 0.1 |
| EBIT/Interest (x) | 18.8 | 10.3 | 8.2 | 16.3 | 33.1 |
| EBITDA growth (%) | 10.1 | (10.4) | 3.5 | 19.9 | 28.6 |
| EBITDA margin (%) | 18.6 | 15.8 | 17.0 | 18.4 | 20.8 |
| EBIT margin (%) | 16.2 | 13.0 | 13.8 | 15.4 | 18.0 |
| PAT margin (%) | 14.2 | 9.2 | 9.1 | 11.3 | 13.4 |

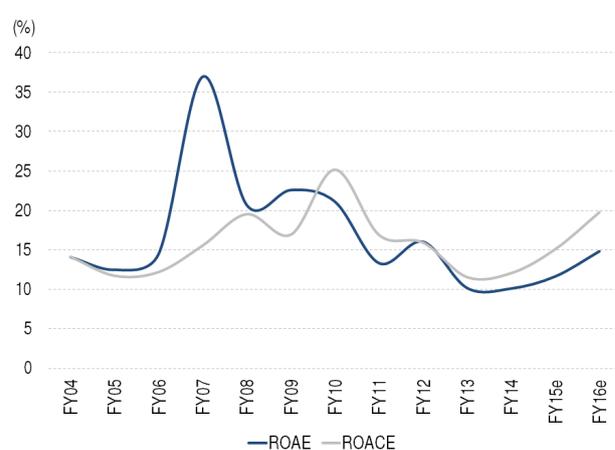
Source: Company, Anand Rathi Research

Fig 5 – Earnings driven by EBITDA margin



Source: Company, Anand Rathi Research

Fig 6 – Stabilizing returns



Source: Company, Anand Rathi Research

Result Highlights

Fig 7 – Results vs Estimates

| (₹ m) | 4QFY14 | 4QFY14e | Var% | 4QFY13 | YoY% | 3QFY14 | QoQ% |
|-------------------|--------|---------|-------|--------|-------|--------|-------|
| Revenues | 4,890 | 4,202 | 16.4 | 5,112 | (4.3) | 4,345 | 12.5 |
| EBITDA | 682 | 726 | (6.1) | 618 | 10.3 | 685 | (0.5) |
| EBITDA Margin (%) | 13.9 | 17.3 | (334) | 12.1 | 185 | 15.8 | (183) |
| PAT | 449 | 441 | 1.9 | 416 | 8.1 | 422 | 6.6 |

Source: Company, Anand Rathi Research

With strong sequential volume growth, Graphite India's 4QFY14 results were surprising as the guidance and global peer performance suggested otherwise. 4QFY14 utilisation, at 83%, saw sales volume growth of 4% yoy (16.6k tonnes) after almost six quarters. 4QFY14 realizations declined ~16% yoy pressured by weak demand and lower raw material costs. Sequential realizations are expected to stabilize at current levels. The dollar realization has stabilized sequentially and is expected to hold at similar levels (US\$4,918 a tonne). Average capacity utilization for FY14 was 72%/66% for the Indian/consolidated operations.

The management focus on inventory reduction in graphite electrodes (as evident from high volumes vs margins) would continue to see accelerated cash release over the next 3-6 quarters (~₹1.7bn in working capital reduction in FY14). Due to lower interest expenses and higher other income, PAT grew 8% yoy to ₹441.

We expect the management to surpass its guidance of 70% consolidated utilization in FY15 as domestic demand for graphite electrodes is strong and European steel volumes are picking up (2-3% growth expected in CY14 vs a decline since 2008). The lagged inventory impact would see a strong, 25%, CAGR in EBITDA over FY14-FY16e as lower raw material prices flow through.

We have finetuned our estimates to factor in the USD-INR rate at 60 (earlier at 63) but higher other income has cushioned the impact on the bottom line.

Fig 8 – Standalone details

| | 1QFY13 | 2QFY13 | 3QFY13 | 4QFY13 | 1QFY14 | 2QFY14 | 3QFY14 | 4QFY14 |
|------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Capacity (tonnes) | 60,000 | 60,000 | 60,000 | 60,000 | 80,000 | 80,000 | 80,000 | 80,000 |
| Capacity utilisation (%) | 89 | 91 | 96 | 103 | 67 | 66 | 70 | 83 |
| Production (tonnes) | 13,350 | 13,650 | 14,400 | 15,450 | 13,400 | 13,200 | 14,000 | 16,600 |
| Chg YoY (%) | | 2.2 | 5.5 | 7.3 | (13.3) | (1.5) | 6.1 | 18.6 |
| Realization (USD) | 5,055 | 4,972 | 4,788 | 5,671 | 4,957 | 5,023 | 4,776 | 4,281 |
| Chg YoY (%) | | (1.7) | (3.7) | 18.4 | (12.6) | 1.3 | (4.9) | (10.4) |
| Revenues (₹m) | | | | | | | | |
| Graphite & Carbon | 3,657 | 3,745 | 3,733 | 4,746 | 3,717 | 4,111 | 4,146 | 4,391 |
| Steel | 241 | 86 | 245 | 215 | 191 | 182 | 149 | 165 |
| Others | 338 | 285 | 359 | 151 | 130 | 118 | 50 | 334 |
| EBIT (₹m) | | | | | | | | |
| Graphite & Carbon | 747 | 544 | 700 | 618 | 778 | 874 | 626 | 663 |
| Steel | 4 | (6) | 14 | 77 | 36 | 6 | (2) | 80 |
| Others | 44 | 77 | (5) | (36) | (8) | (6) | (4) | (4) |
| Capital Employed (₹m) | | | | | | | | |
| Graphite & Carbon | 16,828 | 17,356 | 19,377 | 19,729 | 18,306 | 17,991 | 17,660 | 16,379 |
| Steel | 1,859 | 1,814 | 1,863 | 1,942 | 1,970 | 1,980 | 1,975 | 2,044 |
| Others | 1,048 | 1,005 | 1,017 | 486 | 444 | 459 | 296 | 446 |

Source: Company, Anand Rathi Research

Valuations

Graphite India has scale in the global league of graphite electrode operators, with annual production capacity of 98,000 tonnes; ~65% of the production is exported to 30 countries. Strong product knowledge has been built since 1960. Sturdy operating margins driven by operational efficiency, productivity, technology, and access to low-cost sources of power would sustain cash generation during the cycle. At the CMP, the stock trades at 3x FY15e EV/EBITDA and we maintain a Buy on it, with a price target of ₹119 based on 4.5x FY16e EV/EBITDA.

Risks

- Adverse currency movements.
- Sharp raw-material price volatility.

Fig 9 – Valuations

| ₹ m | FY16e |
|----------------------------|------------|
| FY16e EBITDA | 4,383 |
| Multiple (x) | 4.5 |
| EV | 19,724 |
| Net debt | (3,597) |
| MCAP | 23,322 |
| Value per share (₹) | 119 |

Source: Anand Rathi Research

Fig 10 – Business model

| | FY08 | FY09 | FY10 | FY11 | FY12 | FY13 | FY14 | FY15e | FY16e |
|--------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Capacity (tonnes) | 55,000 | 55,000 | 55,000 | 55,000 | 60,000 | 60,000 | 80,000 | 80,000 | 80,000 |
| Chg YoY (%) | 0.0 | 0.0 | 0.0 | 0.0 | 9.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Capacity utilisation (%) | 132.5 | 120.4 | 73.7 | 102.9 | 95.4 | 94.8 | 71.5 | 75.0 | 85.0 |
| Chg YoY (%) | 10.0 | (9.1) | (38.8) | 39.6 | (7.3) | (0.7) | (24.5) | 4.9 | 13.3 |
| Production (tonnes) | 72,874 | 66,208 | 40,529 | 56,593 | 57,241 | 56,850 | 57,200 | 60,000 | 68,000 |
| Chg YoY (%) | 10.0 | (9.1) | (38.8) | 39.6 | 1.1 | (0.7) | 0.6 | 4.9 | 13.3 |
| Realization (USD/tonne) | 3,240 | 3,233 | 4,680 | 4,014 | 5,190 | 5,348 | 4,731 | 4,542 | 4,633 |
| Chg YoY (%) | 30.7 | (0.2) | 44.7 | (14.2) | 29.3 | 3.1 | (11.5) | (4.0) | 2.0 |
| Expenses (USD/tonne) | 2,928 | 2,947 | 3,916 | 3,657 | 4,954 | 4,803 | 4,290 | 4,045 | 4,032 |
| Chg YoY (%) | 28.7 | 0.6 | 32.9 | (6.6) | 35.5 | (3.0) | (10.7) | (5.7) | (0.3) |
| EBITDA (USD/tonne) | 735 | 861 | 1,970 | 1,096 | 1,134 | 901 | 822 | 946 | 1,001 |
| Chg YoY (%) | (6.4) | 17.2 | 128.8 | (44.3) | 3.4 | (20.5) | (8.8) | 15.2 | 5.7 |

Source: Company, Anand Rathi Research

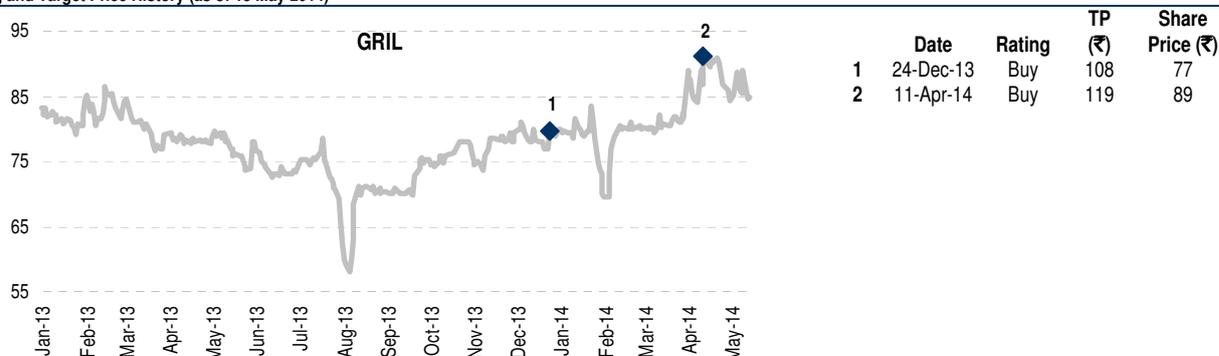
Appendix

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