

22 November 2019

## Graphite, India

*Despite attractive valuations, a bleak future; maintaining a Sell*

Rating: **Sell**

Target Price: ₹318

Share Price: ₹303

Subdued steel production and huge inventories in the pipeline led to Graphite India's Q2 revenue sliding 63% y/y to ₹8.8bn. Standalone EBITDA/tonne plunged to \$1,175, from \$9,573 a year ago. The double whammy of rising needle-coke prices and falling realisations led to such a steep fall. Despite talk of needle-coke prices stabilising at the same or lower prices, uncertainty persists. Though the valuation and balance sheet are favourable, sluggish prospects drive us to retain our Sell, with a TP of ₹318 (2x FY21e EV/EBITDA), earlier ₹300.

**Subdued demand:** With the steel market turning tough, and the resulting fall in demand for electrodes together with excess inventory in the system, sales dropped and prices stabilised. Graphite's Q2 FY20 production declined by 6,200 tonnes; capacity utilisation slipped to 71%. Also, over-capacities in the industry led to tightly squeezed realisations for all. Graphite India's realisation slipped to \$8,633 a tonne, \$5,141 lower than a year ago.

**Pressure on margins.** The double whammy of higher costs and lower realisations added to the squeeze on profitability. Several headwinds from the steel industry led to Q2 standalone EBITDA/tonne falling to \$1,175 a tonne. We expect this downward trend to persist at the present low levels.

**Surprise in needle-coke prices.** In a few days, prices of needle-coke for FY21 will be set. Experts expect some drop in prices as demand for needle coke has contracted. In the long run, though, supply of needle coke is expected to be tight due to rising demand in electrodes and competing demand from lithium-ion batteries.

**Valuation.** Against the backdrop of the steel demand slowdown, globally, volume pressure would continue. We expect it would take a couple of quarters for demand to pick up. Despite valuations looking attractive, no turnaround in the near future can be expected. Thus, we maintain our Sell rating. **Risk:** Rise in realisations and steel production.

Key data	GRIL IN / GRPH.BO
52-week high / low	₹985 / 255
Sensex / Nifty	40575 / 11968
3-m average volume	\$10.7m
Market cap	₹59bn / \$822.8m
Shares outstanding	195m

Shareholding pattern (%)	Sep-19	Jun-19	Mar-19
Promoters	65.4	65.4	64.3
- of which, Pledged	-	-	-
Free float	34.8	34.8	35.7
- Foreign institutions	7.7	7.7	7.1
- Domestic institutions	5.2	5.2	7.7
- Public	21.9	21.9	20.9

Estimates revision (%)	FY 20e	FY 21e
Sales	-1.7	0.6
EBITDA	16.1	12.0
PAT	26.5	22.3

### Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY17	FY18	FY19	FY20e	FY21e
Sales (₹ m)	14,678	32,660	78,579	38,807	42,422
Net profit (₹ m)	705	10,320	33,956	9,037	10,214
EPS (₹)	3.6	52.8	176.8	46.4	52.4
PE (x)	31.1	13.7	2.5	6.5	5.8
EV / EBITDA (x)	46.3	9.3	1.3	2.5	1.8
PBV (x)	1.2	5.2	1.6	1.0	0.9
RoE (%)	3.9	45.0	85.4	15.9	16.0
RoCE (%)	3.6	55.8	115.8	19.1	19.5
Dividend yield (%)	1.8	2.3	12.3	4.8	5.4
Net debt / equity (x)	-0.2	-0.3	-0.4	-0.6	-0.6

Source: Company, Anand Rathi Research

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## Quick Glance – Financials and Valuations (consolidated)

**Fig 1 – Income statement (₹ m)**

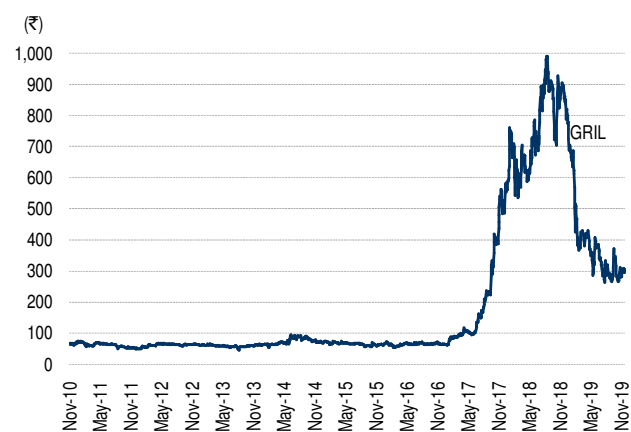
Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Volumes (tonnes)	72,520	83,300	84,770	65,660	69,580
Net revenues	14,678	32,660	78,579	38,807	42,422
Growth (%)	-4.2	122.5	140.6	-50.6	9.3
Material cost	5,851	7,719	14,854	18,628	20,530
Employee & other exp.	8,431	10,500	13,493	11,264	12,603
<b>EBITDA</b>	<b>396</b>	<b>14,442</b>	<b>50,233</b>	<b>8,914</b>	<b>9,288</b>
EBITDA margins (%)	2.7	44.2	63.9	23.0	21.9
- Depreciation	464	516	625	616	627
Other income	865	885	2,097	3,223	4,228
Interest expenses	79	81	116	116	116
PBT	718	14,730	51,589	11,405	12,773
Effective tax rate (%)	1.8	29.9	33.1	20.8	20.0
+ Associates / (Minorities)	-	-	-30	-	-
Net income	705	10,320	33,956	9,037	10,214
Adjusted income	705	10,320	34,504	9,037	10,214
WANS	195	195	195	195	195
FDEPS (₹ / sh)	3.6	52.8	176.8	46.4	52.4
EPS growth (%)	-14.9	1,364.6	234.8	-73.8	13.0

**Fig 3 – Cash-flow statement (₹ m)**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
PBT	718	14,730	51,040	11,405	12,773
+ Non-cash items	14	-69	3	733	743
Oper. prof. before WC	731	14,661	51,044	12,137	13,516
- Incr. / (decr.) in WC	-2,067	2,571	10,630	-10,753	1,589
Others incl. taxes	197	4,494	17,188	2,367	2,734
Operating cash-flow	2,602	7,596	23,226	20,523	9,194
- Capex (tang. + intang.)	-891	-619	-335	-1,475	-747
Free cash-flow	1,711	6,977	22,891	19,048	8,447
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	470	3,321	10,732	2,808	3,174
+ Equity raised	-	-	-1	-	-
+ Debt raised	-431	130	874	-2,539	-
- Fin investments	1,559	5,768	13,817	16,093	4,592
- Misc. (CFI + CFF)	-1,053	-2,023	-4,307	-397	-254
Net cash-flow	304	40	3,523	-1,995	935

Source: Company, Anand Rathi Research

**Fig 5 – Price movement**



Source: Bloomberg

**Fig 2 – Balance sheet (₹ m)**

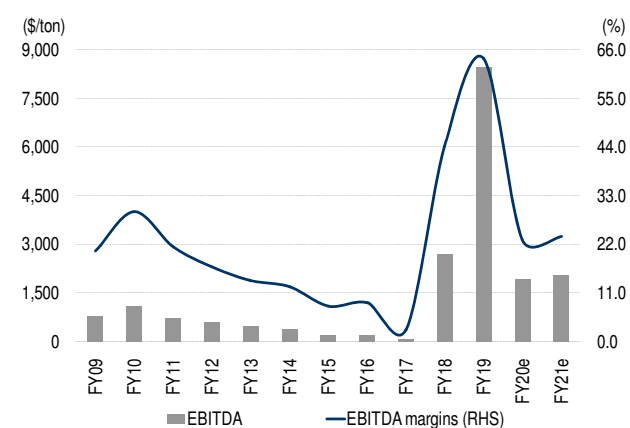
Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Share capital	391	391	390	390	390
Net worth	18,576	27,318	53,505	60,124	67,555
Debt	2,592	2,722	3,596	1,057	1,057
Minority interest	-	-	-	-	-
DTL / (Assets)	821	451	1,092	1,092	918
<b>Capital employed</b>	<b>21,989</b>	<b>30,491</b>	<b>58,193</b>	<b>62,274</b>	<b>69,530</b>
Net tangible assets	6,655	7,002	6,620	7,596	7,717
Net Intangible assets	19	16	19	19	18
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	321	79	168	50	50
Investments (strategic)	656	1,750	5,980	6,080	6,280
Investments (financial)	5,654	10,328	19,915	35,908	40,300
Current assets (ex cash)	11,586	17,578	32,235	15,881	17,988
Cash	515	556	4,079	2,084	3,018
Current liabilities	3,418	6,818	10,822	5,345	5,842
Working capital	8,169	10,760	21,413	10,536	12,145
<b>Capital deployed</b>	<b>21,989</b>	<b>30,491</b>	<b>58,193</b>	<b>62,274</b>	<b>69,530</b>
Contingent liabilities	896	852	1,216	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
P/E (x)	31.1	13.7	2.5	6.5	5.8
EV / EBITDA (x)	46.3	9.3	1.3	2.5	1.8
EV / Sales (x)	1.2	4.1	0.8	0.6	0.4
P/B (x)	1.2	5.2	1.6	1.0	0.9
RoE (%)	3.9	45.0	85.4	15.9	16.0
RoCE (%) - after tax	3.6	55.8	115.8	19.1	19.5
RoIC (%) - after tax	4.9	61.7	148.3	39.2	53.9
DPS (₹ / sh)	2.0	17.0	55.0	14.4	16.3
Dividend yield (%)	1.8	2.3	12.3	4.8	5.4
Dividend payout (%) - incl. DDT	66.7	32.2	31.6	31.1	31.1
Receivables (days)	110	92	40	40	42
Inventory (days)	150	88	100	100	102
Payables (days)	54	46	30	30	30
Sales (\$ / tonne)	2,459	5,347	12,201	8,000	8,250
EBITDA (\$ / tonne)	54	2,685	8,453	1,920	2,000

Source: Company, Anand Rathi Research

**Fig 6 – Gross spread will continue under pressure**



Source: Company

## Result Highlights

**Fig 7 – Segment-wise details**

(₹ m)	Q2 FY20	Q2 FY19	Y/Y (%)	H1 FY20	H1 FY19	Y/Y (%)
<b>Sales</b>						
Graphite and Carbon	8,600	19,670	(56.3)	17,230	36,920	(53.3)
GRP pipes	220	410	(46.3)	560	930	(39.8)
Unallocated	-	-		-	-	
<b>Total</b>	<b>8,820</b>	<b>20,080</b>	<b>(56.1)</b>	<b>17,790</b>	<b>37,850</b>	<b>(53.0)</b>
<b>EBIT</b>						
Graphite and Carbon	1550	13710	(88.7)	4,260	26,750	(84.1)
GRP pipes	-20	40		30	80	(62.5)
Unallocated	0	0		-	-	
<b>Total</b>	<b>1530</b>	<b>13750</b>	<b>(88.9)</b>	<b>4,290</b>	<b>26,830</b>	<b>(84.0)</b>
<b>EBIT margins (%)</b>						
Graphite and Carbon	18.0	69.7		24.7	72.5	
GRP pipes	(9.1)	9.8		5.4	8.6	

Source: Company

**Fig 8 – Sales and realisation trends (standalone)**

	FY17				FY18				FY19				FY20		Y/Y (%)
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	
Sales (₹ m)	2,752	3,196	3,376	3,734	3,510	4,619	9,331	12,122	17,770	20,080	15,620	13,900	8,970	8,330	(58.5)
Graphite electrodes (tonnes)	13,600	15,000	17,000	17,800	19,000	17,800	19,000	20,000	19,600	20,400	17,200	18,400	16,800	14,200	(30.4)
Graphite electrode realisations (\$ / tonne)	2,897	2,981	2,954	3,001	2,869	3,776	7,322	8,997	13,155	13,775	12,480	10,403	7,388	8,633	(37.3)
EBITDA (₹ m)	105	141	364	147	355	1,299	5,186	6,686	13,000	13,670	8,680	6,710	2,600	1,170	(91.4)
EBITDA margin (%)	3.8	4.4	10.8	3.9	10.1	28.1	55.6	55.2	73.2	68.1	55.6	48.3	29.0	14.0	
EBITDA (\$ / ton)	116	141	320	122	290	1,116	4,264	5,223	9,914	9,573	7,108	5,136	2,226	1,175	(87.7)

Source: Company

## Valuations

In the poor demand-supply context, competition would keep realisations compressed, leading to profitability being pared. As excess inventories in graphite electrodes are used up, fresh demand should arise. However, such a situation is unlikely in the next 1-2 years. Therefore, despite the valuation looking attractive, we maintain our Sell rating, with a higher TP of ₹318 (2x FY21e EV/EBITDA), earlier ₹300.

### Change in estimates

In a few days, needle-coke prices for FY21 will be set. Competition as well as the management expects some drop due to shrunken demand for needle coke. Thus, we raise our FY20e and FY21e EBITDA 16% and 12% respectively. Besides, the shift to the new tax regime would lead to a 27% EPS revision in FY20, and 22% in FY21.

**Fig 9 – Change in estimates**

₹ m)	Old		Revised		%Change	
	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e
Revenue	39,460	42,152	38,807	42,422	-1.7	0.6
EBITDA	7,678	8,291	8,914	9,288	16.1	12.0
EPS (₹)	36.7	42.9	46.4	52.4	26.5	22.3

Source: Anand Rathi Research

**Fig 10 – One-year-forward PER**



Source: Company, Anand Rathi Research

**Fig 11 – One-year-forward EV/EBITDA**



Source: Company, Anand Rathi Research

### Key risks

- Sluggishness in the user, the steel industry, would cut into volume growth.
- Needle coke is the key raw material. An increase in its prices would eat into profitability.

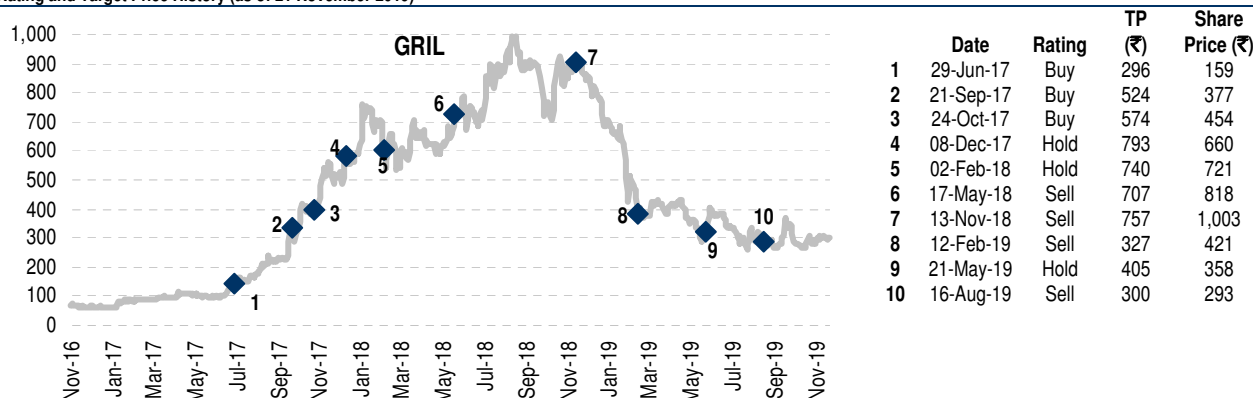
## Appendix

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