Stock Pointer

VENTURA
Kyon ki bhaiya, sabse bada rupaiya.

Oriental Carbon & Chemicals Ltd. CMP Rs 125.0 PE 2.2x FY2013E BUY

Oriental Carbon & Chemicals Ltd. (OCCL) is the only producer of insoluble sulphur (IS) in India which is used in the manufacture of tyres and hence is a proxy play on the Indian tyre industry. With increased radialization of the tyre industry and India gradually becoming a hub for global manufacturing, the prospects of OCCL could never have been better. We initiate a STRONG BUY with an 18 month Price Objective of Rs 280 (target PE of 5x for FY2013). At CMP of Rs 125.0, the stock is trading at 3.4x and 2.2x its FY2012E & FY2013E earnings respectively, representing a potential upside of 124.0%. In addition the stock carries an attractive dividend yield of 3.2%.

PRICE TARGET Rs 280/- (18 Months)

Index Details

Sensex	18,420
Nifty	5,532
BSE 500	7,188
Industry	Other Non Ferrous Metals

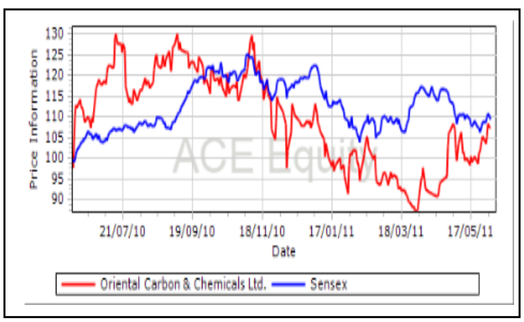
Scrip Details

Mkt Cap (Rs in crore)	128.0
Book Value (Rs)	121.7
Eq Shares O/s (Cr)	1.0
Avg Vol (Lacs)	0.1
52 Week H/L	161/100
Dividend Yield (%)	3.2
Face Value (Rs)	10.0
BSE Code	506579
NSE Code	-

Shareholding Pattern (31st Mar, 2011)

Shareholders	% holding
Promoters	56.1
Indian Institutions	11.3
FII's	-
Non Promoter Corporate	7.1
Public	25.5
Total	100.0

OCCL vs. Sensex



Capacity expansion at Mundra to cater to global markets

OCCL is undertaking a capacity expansion in two stages at Mundra SEZ, which will nearly double its capacities to 23,000 tpa from the current 12,000 tpa and cater 100% to its export requirements. The first stage of the Rs 75 crore expansion (5,500 tpa) is expected to be operational by July 2011 while the second stage for another 5500 tpa is expected to be commissioned in FY13 at an incremental capex of ~ Rs 35 - 40 crore. We believe that the Mundra SEZ apart from providing fiscal benefits would result in significant savings in freight in servicing the export orders. Post commissioning, we expect revenues to grow at a CAGR of 32.3% to Rs 283.0 crore in FY13E from Rs 161.5 crore clocked in FY11.

New quarterly pricing contracts to help lower volatility

IS price trends have remained quite volatile over the last two years in line with volatility in the prices of major raw material (80% constituent) Sulphur. With the company moving to a quarterly price contracting system (from its erstwhile annual contracts), OCCL has witnessed better pricing leading to reduced volatility in margins thus resulting in improved visibility of profitability.

Increased radialization and value added IS products to improve revenue and profitability

The Indian CV market has a very poor market share of radials compared to the western world and presents a huge opportunity. With most tyre manufacturers enhanced capacities being only for radial tyres, the market share of the latter is only set to grow. Further, in order to move away from the commoditized nature of the product, OCCL has ventured into premium grades of IS, namely AS and HD grades which enjoys a premium (as high as 5-40%) over conventional grades in the international markets. Both these measures are value accretive and should help earnings grow at a CAGR of 24.2% to Rs 57.7 crore over the forecast period.

Debt increase not to impact profitability significantly

For funding the two stage expansion at the Mundra SEZ facility, OCCL would be spending cumulatively ~ Rs 115 over the period FY11-13. Compared to the size of operations of the company this is huge. However since the business is extremely profitable having high RoE and ROCE, the payback of the business expansion is around two years. Hence servicing of the debt and its repayment would not a major issue, in our view.

Key Financials (Rs in Cr)

Y/E Mar (Rs Crore)	Net Revenue	EBITDA	PAT	EPS	EPS Growth (%)	RONW (%)	ROCE (%)	P/E (X)	EV/ EBITDA(X)
2010	127.7	40.1	29.5	28.7	-	31.8	29.9	4.4	4.4
2011	161.5	50.8	37.4	36.3	26.6	29.8	24.0	3.4	3.5
2012E	184.9	58.3	37.7	36.6	0.8	23.8	19.6	3.4	3.0
2013E	283.0	89.5	57.7	56.0	53.1	27.3	25.8	2.2	2.0

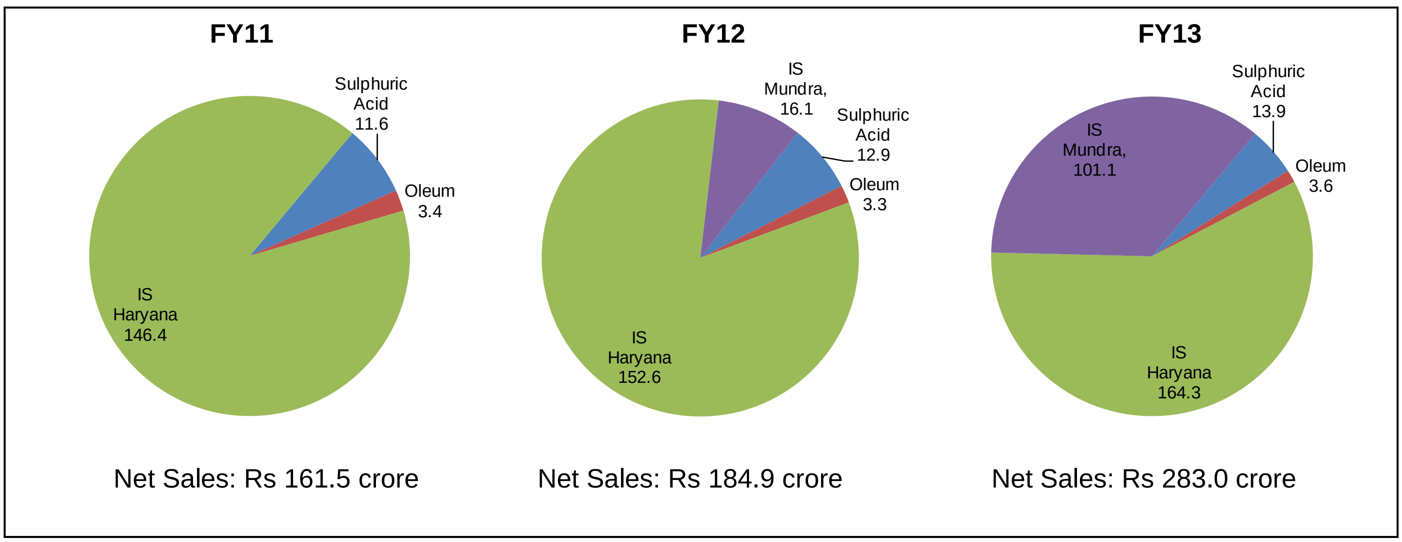
Company Background

Oriental Carbon and Chemicals Ltd. (OCCL), a J P Goenka group, has been in business for more than 25 years and forayed into production of Insoluble Sulphur (IS) in 1994. Prior to 2000, OCCL was engaged in the production of carbon black which was hived off to Continental Carbon Limited in 2000. The business relationships developed over the years with the tyre companies has helped OCCL emerge as India's leading insoluble sulphur (IS) manufacturer. Today insoluble sulphur constitutes over 80% of its turnover with sulphuric acid and oleum (being supplied to local customers) constituting the balance 20% of its turnover.

Key Investment highlights

Capacity expansion at Mundra to cater to global markets

OCCL is undertaking a capacity expansion in two stages at Mundra SEZ, which will nearly double its capacities to 23,000 tpa from the current 12,000 tpa and cater 100% to its export requirements. The first stage of the Rs 75 crore expansion (5,500 tpa) is expected to be operational by July 2011 while the second stage for another 5500 tpa is expected to be commissioned in FY13 at an incremental capex of ~ Rs 35 - 40 crore. We believe that the Mundra SEZ apart from providing fiscal benefits would result in significant savings in freight in servicing the export orders. Post commissioning, we expect revenues to grow at a CAGR of 32.3% to Rs 283.0 crore in FY13E from Rs 161.5 crore clocked in FY11.

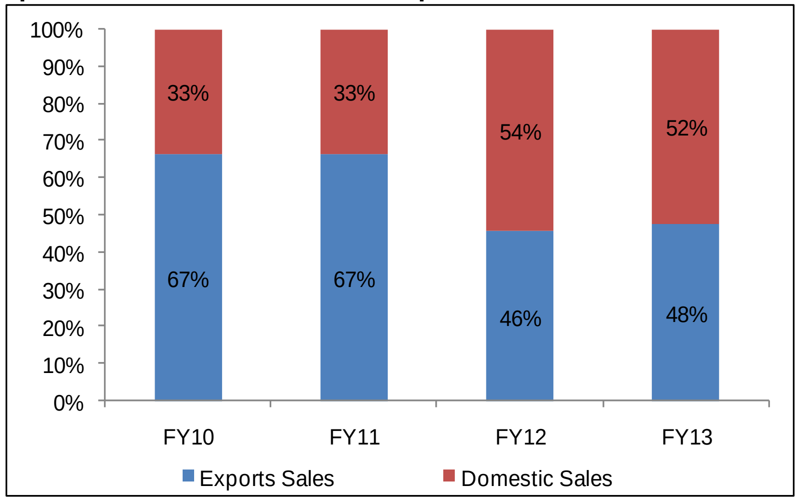


Source:OCCL, Ventura

Capacity expansion to boost share in global markets

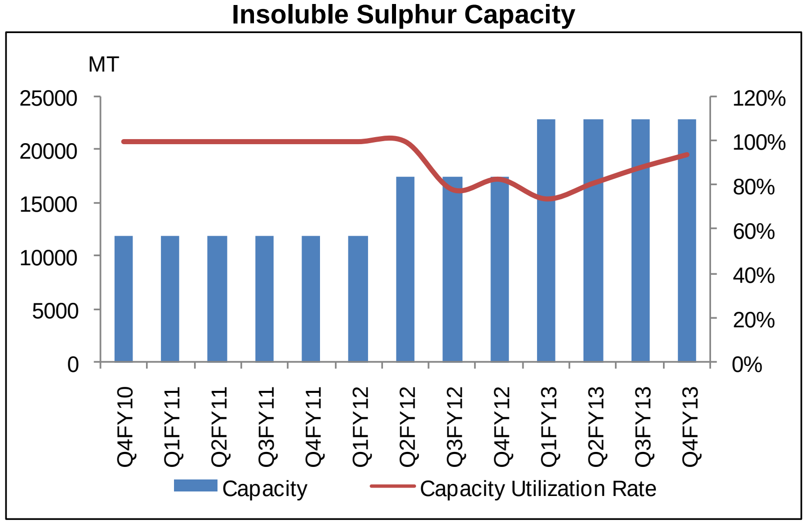
OCCL is India's only homegrown IS manufacturer with over 10,000 TPA of installed capacity which in FY2011 was expanded to 12,000 TPA through a de-bottlenecking exercise. With quality standards meeting international benchmarks, OCCL has emerged as the "second alternate supplier" to world leader Flexsys (reported to command 85-90% market share in the western world). Today it boasts of a customer base comprising major tyre companies in the world like Continental AG, Goodyear, Bridgestone, Kumho Tyres etc. for exports and Apollo Tyres, Bridgestone, J K Tyres, MRF Tyres, Ceat Tyres, Goodyear India, Birla Tyres etc in the domestic market. Further closely guarded technology, capital intensive nature of the business and long time required for getting approvals from the tyre companies act as the entry barriers for competition.

Exports turnover to increase with peak utilization of Mundra SEZ



Source:OCCL, Ventura

Insoluble Sulphur Capacity

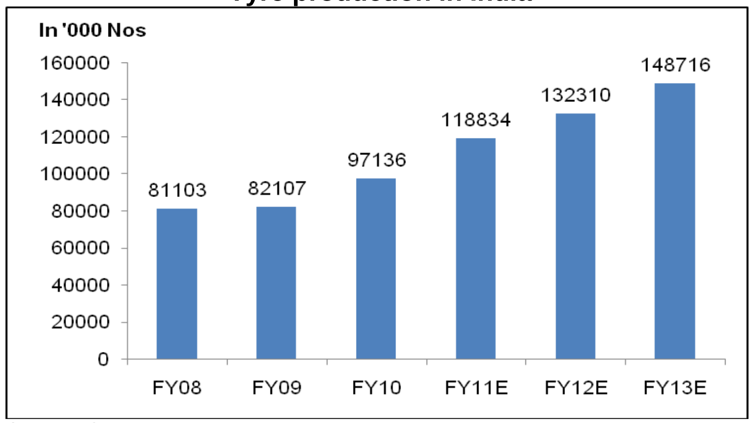


Source:OCCL, Ventura

Strong growth in domestic tyre production and increased radialization opportunity has landed the company in a sweet spot.

As per CMIE, tyre production is expected to grow at a 12% CAGR over FY11-13 on the back of strong OEM demand (12%-14% CAGR), huge replacement growth (10-12% CAGR) and surge in exports (13.5% CAGR). With Michelin and Bridgestone making India a hub for radial tyre manufacture and local companies like Ceat and Balkrishna Tyre looking to increase exports, the demand for the export market never looked so good. In addition with the Bureau of Indian Standards (BIS) issuing stricter regulations on quality standards there is expected to be a slow down in tyre imports by as much as 30-40% which would providing a phillip to domestic tyre manufacturers.

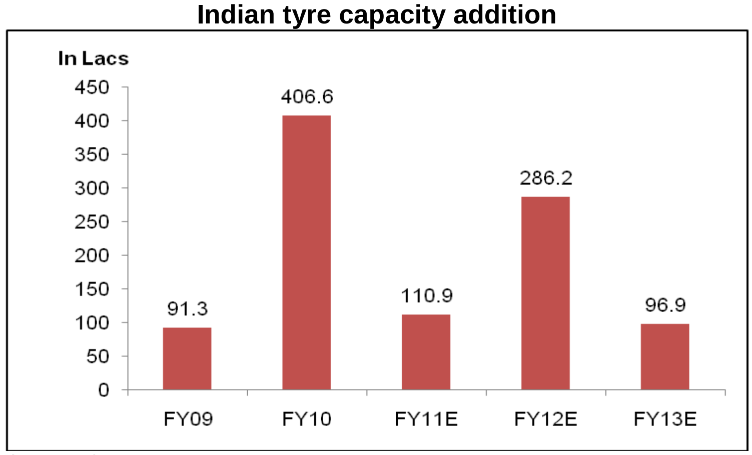
Tyre production in India



Source: CMIE

Further most of the capacities that are being set up are for radial tyres and hence this should provide a strong boost to IS consumption. While the passenger car market has witnessed almost 98% radialization, in the commercial segment it is only to the tune of 12% and is expected to reach 25% in the next 3-4 years. Also with the life of CV radial tyres being only about 12-15 months maximum, a steady source of demand for IS consumption would be triggered due to the replacement market.

Indian tyre capacity addition



Source: CMIE

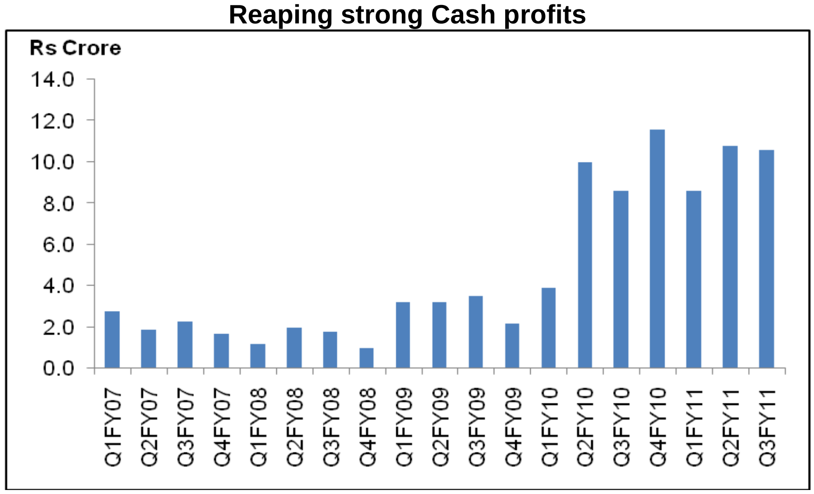
The domestic demand for insoluble sulphur is growing at a robust pace and this trend is expected to continue in the coming years as new tyre capacities are added. With increasing radialization the domestic demand for IS is expected to grow at 2x the 12% CAGR of tyre demand over FY2011-2013. This is in stark contrast to the international IS market which is growing at 4% per annum. With international tyre companies such as Michelin also setting up plants in India and consumption of IS in China being nearly five times that of India, there is an ample scope for demand increase in India.

❑ New quarterly pricing contracts to help lower volatility

IS price trends have remained quite volatile over the last two years in line with volatility in the prices of major raw material (80% constituent) Sulphur. With the company moving to a quarterly price contracting system (from its erstwhile annual contracts), OCCL has witnessed better pricing leading to reduced volatility in margins thus resulting in improved visibility of profitability.

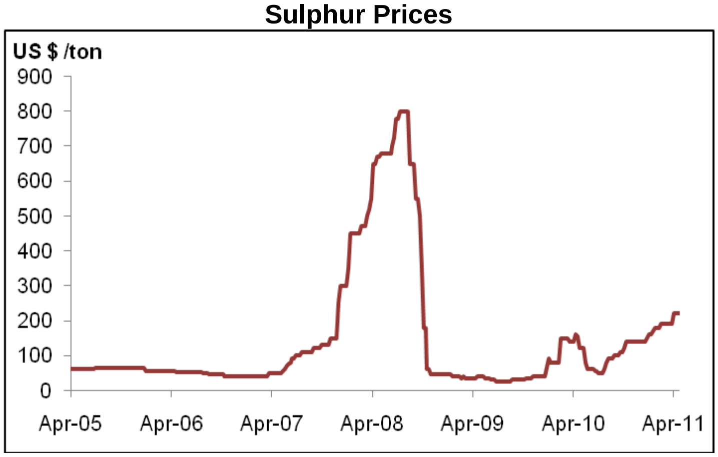
The volatility in the prices of Sulphur had negatively impacted the performance of OCCL in 2007-08 due to its inability to pass the raw material price rise to the customers in a timely manner. However even during this period when the sulphur priced had scaled a peak of $ 800 per tonne and later crashed to $ 50 per tonne, OCCL continued to reap cash profits. This is testament to its strong pricing power and efficiency of operations.

Reaping strong Cash profits



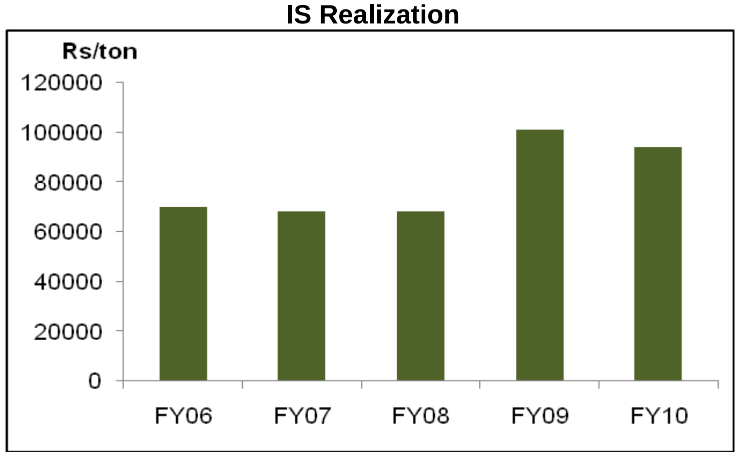
Source:OCCL

Sulphur Prices



Source: Bloomberg

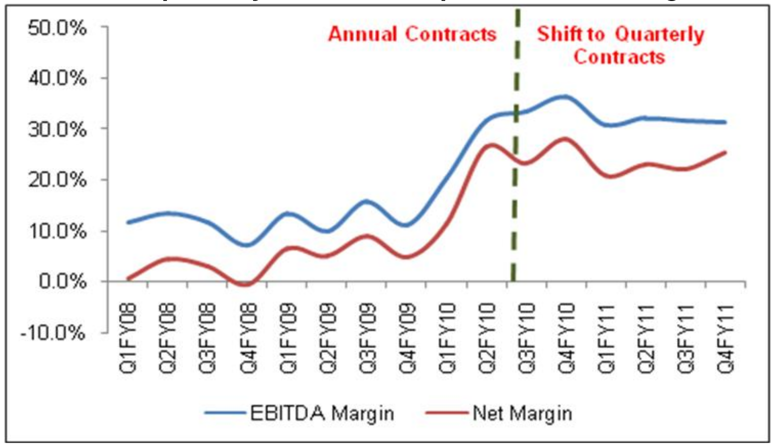
IS Realization



Source:OCCL

Since mid-FY09, the company has entered into quarterly contracts instead of annual contracts providing itself the flexibility of passing on the raw material price increase while maintaining margins. This new contract pricing mechanism has resulted in significant improvement in the profitability of the company over the last six quarters and better control over the procurement cost of sulphur.

Shift to quarterly contracts helps statabilize margins



Source:OCCL

❑ Increased radialization and value added IS products to improve revenue and profitability

The Indian CV market has a very poor market share of radials compared to the western world and presents a huge opportunity. With most tyre manufacturers enhanced capacities being only for radial tyres, the market share of the latter is only set to grow. Further, in order to move away from the commoditized nature of the product, OCCL has ventured into premium grades of IS, namely AS and HD grades which enjoys a premium (as high as 5-40%) over conventional grades in the international markets. Both these measures are value accretive and should help earnings grow at a CAGR of 24.2% to Rs 57.7 crore over the forecast period.

Different grades of IS and their properties

	Regular			High Stable			Special Grade		
QUALITY PARAMETERS	**DS - OT - 10**	**DS - OT - 20**	**DS - OT - 33**	**DS - OT - 10 (HS)**	**DS - OT - 20 (HS)**	**DS - OT - 33 (HS)**	**DS - 90**	**DS - OT - 25 (AS)**	**DS - OT - 20 (HD)**
Elemental Sulphur %	90±1	80±1	67±1	90±1	80±1	67±1	99.5±0.5	67±1	80±1.5
Insoluble Sulphur (Min)% (On Total S)	90	90	90	90	90	90	90	90	90
Oil hinder %	10±1	20±1	33±1	10±1	20±1	33±1	-	25±1.5	20±1.5
Acidity(as H2SO4)(Max)%	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Ash Content (Max)%	0.05	0.05	0.05	0.05	0.05	0.05	0.1	8±1	0.01
Heat Loss (Max) %	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Fineness Retention on (Wet Screen)									
100 Mesh (Max)%	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
200 Mesh (Max)%	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Thermal Stability Heating at 105°C for 15 min. (In Liquid Paraffin) (Min) %	-	-	-	80	80	80	-	75	75

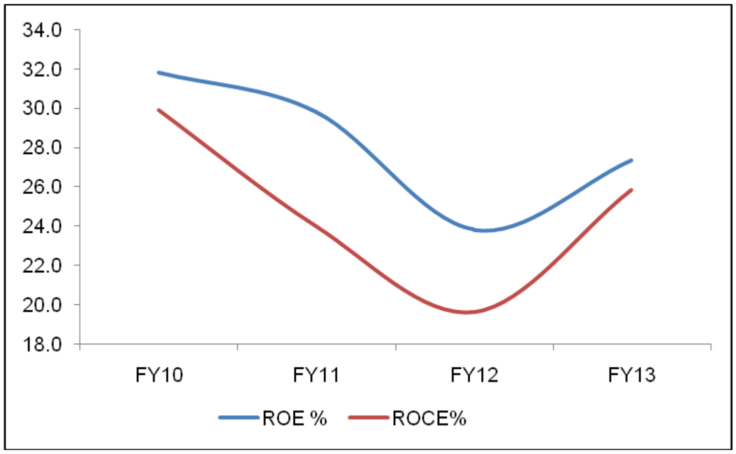
Source: OCCL

Inelastic nature of demand to help in pass through of price hikes

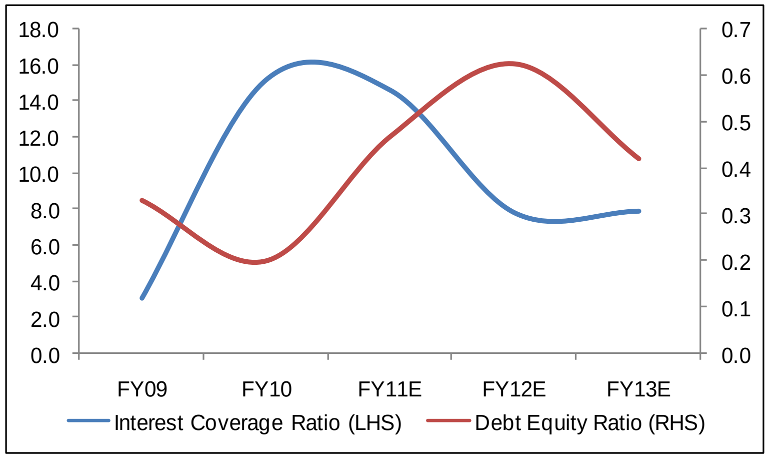
IS costs are an insignificant percentage of the total cost of raw material used in tyre manufacture and hence any significant price rise is unlikely to be met with resistance from tyre manufacturers. In addition, being a vital element ensures that demand for IS would always be sustained.

❑ Debt increase not to impact profitability significantly

For funding the two stage expansion at the Mundra SEZ facility, OCCL would be spending cumulatively ~ Rs 115 crore over the period FY11-13. Compared to the size of operations of the company this is huge. However since the business is extremely profitable having high RoE and ROCE, the payback of the business expansion is around two years. Hence servicing of the debt and its repayment would not a major issue, in our view.



Source:OCCL, Ventura



Source:OCCL, Ventura

❑ Key Concerns

Vulnerable to rise in raw material prices

IS price trends have remained quite volatile over the last two years in line with volatility in the prices of major raw material (80% constituent) Sulphur. The volatility in the prices of Sulphur had negatively impacted the performance of OCCL in 2007-08 due to its inability to pass raw material price rise to the customers in a timely manner. However even during this period when the sulphur priced had scaled a peak of $ 800 per tonne and later crashed to $ 50 per tonne, OCCL continued to reap cash profits. This is testament to its strong pricing power and efficiency of operations.

Slowdown in Automobile industry

As majority of IS is consumed for tyre production, the demand for IS is entirely dependent on boom in global automobile industry. Slowdown or recession in the global economy may affect international demand for automobile products which in turn can severely impact business and profitability of the company.

Exposed to currency risks

OCCL derives roughly 67% of revenues in foreign currency and stands exposed to currency fluctuations. Any unfavorable currency trends in the future can severely dent the profitability of the company.

❑ Financial Performance

Owing to improved realizations OCCL posted a 17.0% rise in Q4FY11 Net Sales to Rs 43.7 crore. As the company was not able to pass on the entire increased RM cost, EBITDA margin for the current quarter declined by 460 bps to 31.2% for Q4FY11. Meanwhile, Net profit margin for the quarter stood at 25.4% (-240 bps YoY).

Net sales for FY11 grew by 30.3% YoY to Rs 117.9 crore due to improved realizations. Both EBITDA and Net margins for FY11 were maintained at 31.4% and 23.1%, respectively.

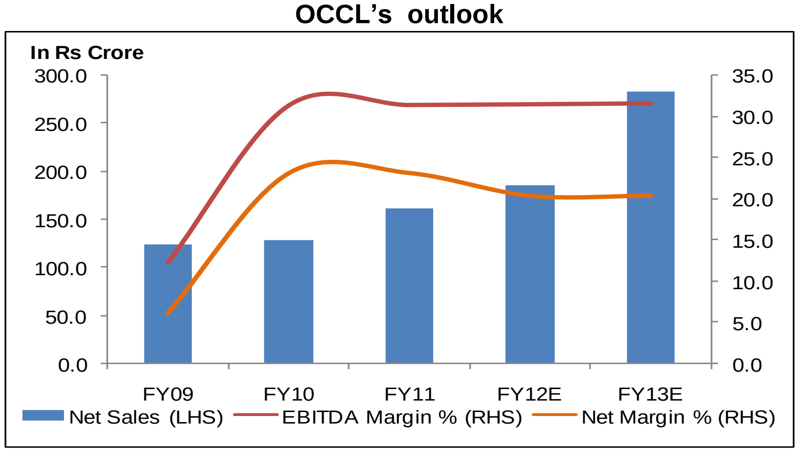
RESULTS Q4FY11				
PARTICULARS	**Q4FY11**	**Q4FY10**	**FY11**	**FY10**
Net Sales	43.7	37.3	161.5	127.7
Growth %	*17.0*		*26.5*	
Expenditure	30.1	23.6	110.8	87.7
EBITDA	13.6	13.7	50.8	40.1
Margin %	*31.2*	*36.8*	*31.4*	*31.4*
Depreciation	1.3	1.2	5.0	4.7
EBIT (EX OI)	12.3	12.5	45.8	35.4
Other Income	0.4	0.4	1.0	1.4
EBIT	12.8	12.9	46.8	36.7
Margin %	*29.2*	*34.6*	*28.9*	*28.8*
Interest	0.0	0.6	3.2	2.4
PBT	12.7	12.3	43.6	34.3
Margin %	*29.1*	*32.9*	*27.0*	*26.9*
PAT	11.1	10.4	37.4	29.5
Margin %	*25.4*	*27.8*	*23.1*	*23.1*

Source:OCCL, Ventura

❑ Financial Outlook

On the back of enhanced capacities from the current 12000 tpa to 23000 tpa by FY13, increased production of value added IS products, thrust on exports (67% of total FY10 revenues), increased radialization of the Indian tyre industry and inelastic nature of demand should see revenues grow at a CAGR of 32.3 % to Rs 283.0 crore by FY13 from the Rs 161.5 crore clocked in FY10. Further as the company has moved to quarterly contracting system stabilization of pricing due to reduced volatility with help improve visibility of margins leading to improved profitability.

OCCL's outlook

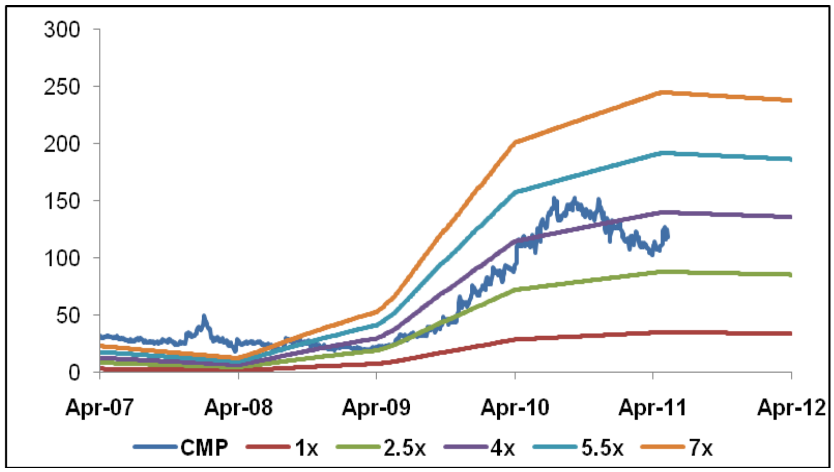


Source:OCCL, Ventura

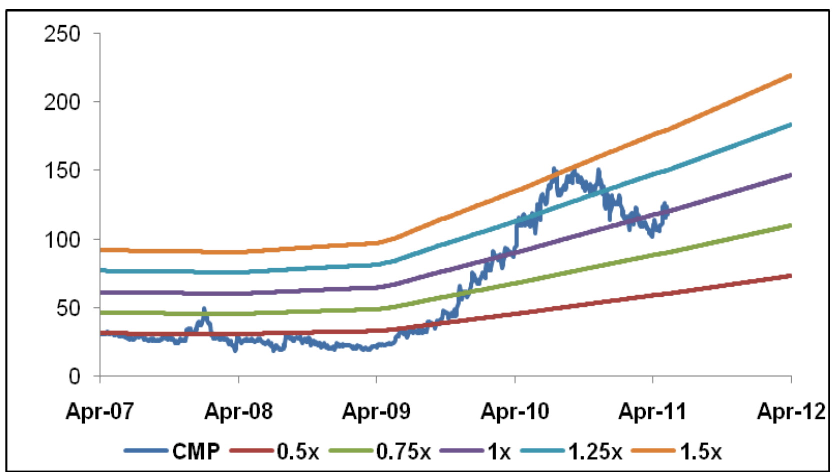
❑ Valuation

OCCL is a strong play on the global IS market and increasing radialization of the Indian tyre industry. With technological upgradations and production of higher value added varieties of IS, margins are only expected to expand. We initiate a STRONG BUY with an 18 month Price Objective of Rs 280 (target PE of 5x for FY2013). At CMP of Rs 125.0, the stock is trading at 3.4x and 2.2x its FY2012E & FY2013E earnings respectively, representing a potential upside of 124.0%. In addition the stock carries an attractive dividend yield of 3.2%.

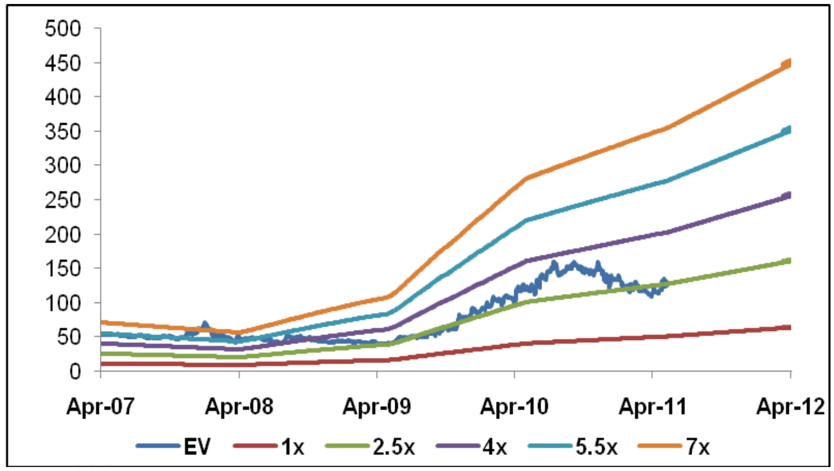
P/E bands



P/BV bands



EV EBITDA bands



Source: OCCL, Ventura

Exhibit 01: Financials and Projections

Profit & Loss Statement

Y/E March, Fig in Rs. Cr	FY2010	FY2011e	FY2012e	FY2013e
Net Sales	**127.7**	**161.5**	**184.9**	**283.0**
% Chg.	*3.0*	*26.5*	*14.4*	*53.1*
Total Expenditure	**87.7**	**110.8**	**126.6**	**193.5**
% Chg.	*-19.5*	*26.3*	*14.3*	*52.8*
EBDITA	**40.1**	**50.8**	**58.3**	**89.5**
EBDITA Margin %	*31.4*	*31.4*	*31.5*	*31.6*
Other Income	1.4	1.0	0.9	1.3
PBDIT	**41.4**	**51.8**	**59.2**	**90.8**
Depreciation	4.7	5.0	6.6	10.3
Interest	2.4	3.2	6.7	10.2
Exceptional items	-	-	-	-
PBT	34.3	43.6	45.9	70.3
Tax Provisions	4.8	6.2	8.3	12.7
Reported PAT	**29.5**	**37.4**	**37.7**	**57.7**
PAT Margin (%)	*23.1*	*23.1*	*20.4*	*20.4*
Raw Materials / Sales (%)	*27.3*	*30.0*	*28.6*	*28.4*
Employee Exp / Sales (%)	*7.5*	*8.1*	*9.5*	*10.1*
Other Mfr. Exp / Sales (%)	*33.9*	*30.5*	*30.4*	*29.9*
Tax Rate (%)	*14.0*	*14.2*	*18.0*	*18.0*

Key Ratios

Y/E March, Fig in Rs. Cr	FY2010	FY2011e	FY2012e	FY2013e
Per Share Data (Rs)				
EPS	28.7	36.3	36.6	56.0
Cash EPS	33.2	41.2	42.9	66.0
DPS	4.0	4.0	4.0	4.0
Book Value	90.1	121.7	153.6	204.9
Capital, Liquidity, Returns Ratio				
Debt / Equity (x)	0.2	0.5	0.6	0.4
Current Ratio (x)	4.3	4.3	4.4	4.7
ROE (%)	31.8	29.8	23.8	27.3
ROCE (%)	29.9	24.0	19.6	25.8
Dividend Yield (%)	3.2	3.2	3.2	3.2
Valuation Ratio (x)				
P/E	4.4	3.4	3.4	2.2
P/BV	1.4	1.0	0.8	0.6
EV/Sales	1.4	1.1	1.0	0.6
EV/EBIDTA	4.4	3.5	3.0	2.0
Efficiency Ratio (x)				
Inventory (days)	37.7	39.6	39.6	39.6
Debtors (days)	54.0	55.8	55.8	55.8
Creditors (days)	30.7	30.6	30.6	30.6

Balance Sheet

Y/E March, Fig in Rs. Cr	FY2010	FY2011e	FY2012e	FY2013e
Share Capital	10.3	10.3	10.3	10.3
Reserves & Surplus	82.5	115.0	147.8	200.7
Minority Interest	-	-	-	-
Total Loans	18.6	58.6	98.6	88.6
Deferred Tax Liability	6.9	6.9	6.9	6.9
Total Liabilities	**118.3**	**190.8**	**263.6**	**306.5**
Gross Block	113.5	121.7	196.7	251.7
Less: Acc. Depreciation	48.5	53.5	60.0	70.4
Net Block	**65.0**	**68.2**	**136.7**	**181.4**
Capital Work in Progress	8.3	65.9	59.6	15.0
Investments	0.5	0.5	0.5	0.5
Net Current Assets	**44.5**	**56.2**	**66.8**	**109.6**
Deferred Tax Assets	-	-	-	-
Total Assets	**118.3**	**190.8**	**263.6**	**306.5**

Cash Flow Statement

Y/E March, Fig in Rs. Cr	FY2010	FY2011e	FY2012e	FY2013e
Profit After Tax	29.5	37.4	37.7	57.7
Depreciation	4.7	5.0	6.6	10.3
Working Capital Changes	0.6	-11.4	-6.5	-27.4
Others	0.2	-	-	-
Operating Cash Flow	**35.0**	**31.0**	**37.7**	**40.6**
Capital Expenditure	-20.7	-65.9	-68.8	-10.4
Change in Investment	-0.1	0.0	0.0	0.0
Cash Flow from Investing	-20.8	-65.9	-68.8	-10.4
Proceeds from equity issue	-	-	-	-
Inc/(Dec) in Debt	-3.9	40.0	40.0	-10.0
Dividend Paid	-4.8	-4.8	-4.8	-4.8
Cash Flow from Financing	**-8.7**	**35.2**	**35.2**	**-14.8**
Net Change in Cash	5.4	0.3	4.1	15.4
Opening Cash Balance	5.3	10.8	11.1	15.3
Closing Cash Balance	10.8	11.1	15.3	30.6

Ventura Securities Limited

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