Graphite India

Performance Highlights

Y/E March (₹ cr)	3QFY11	2QFY11	% chg (qoq)	3QFY11	% chg (yoy)
Net sales	337	324	4.2	279	21.0
EBITDA	73	84	(13.3)	103	(28.7)
EBITDA (%)	21.7	26.1		36.8	
PAT	44	49	(10.1)	63	(29.8)

Source: Company, Angel Research

For 3QFY2011, Graphite India (GIL) posted top-line growth of 21.0% yoy to ₹337cr (₹279cr), which was below our estimates of ₹354cr. However, PAT declined by 29.8% to ₹44cr (₹63cr), mainly because of margin contraction. OPM came in at 21.7% (36.8%), much below our expectations of 24.8%. The main reasons for lower-than-expected OPM were a one-time dearness bonus, high input costs and higher electricity consumption. Going ahead, we expect OPM to improve from the current levels and the top line to post strong growth. **We maintain our Buy recommendation on the stock.**

Disappointment on the top-line and OPM front: For 3QFY2011, GIL reported below-expectation top-line growth mainly due to price pressures in the domestic market. OPM also witnessed a decline because of high input costs, dearness bonus and high electricity consumption due to relatively more graphitisation of electrodes during the quarter. However, going ahead, OPM is set to improve on the back of electrode price increases announced by SGL Carbon recently.

Outlook and valuation: Going ahead, we expect volumes to remain robust on account of high demand for graphite electrodes, with prices also strengthening from current levels. The company's expansion plan places it well to capture the boom in demand. Overall, we expect the company to post a 17.6% CAGR in sales and a 5.9% CAGR in PAT over FY2010–12E. Owing to lower-than-expected margins, we have revised our margin estimates for FY2011 and FY2012 downwards to 23.2% and 23.5% from 24.4% and 24.2%. Currently, the stock is trading at 1.1x and 1.0x its FY2011E and FY2012E BV. We maintain Buy on the stock with a revised Target Price of ₹114 (₹117).

Key financials (Consolidated)

Y/E March (₹ cr)	FY2009	FY2010	FY2011E	FY2012E
Net sales	1,498	1,347	1,570	1,864
% chg	12.6	(10.1)	16.5	18.7
Net profit	234	235	227	264
% chg	64.5	0.3	(3.4)	16.5
EBITDA (%)	24.2	29.5	23.7	23.9
EPS (₹)	11.4	10.7	11.6	13.5
P/E (x)	7.7	8.2	7.8	6.7
P/BV (x)	1.3	1.2	1.1	1.0
RoE (%)	25.0	19.6	16.0	16.1
RoCE (%)	20.2	20.5	18.6	19.6
EV/Sales (x)	1.0	1.1	1.2	1.0
EV/EBITDA (x)	4.3	3.8	5.1	4.1

Source: Company, Angel Research

BUY

CMP	₹88
Target Price	₹114
Investment Period	12 Months

Stock Info	
Sector	Capital Goods
Market Cap (₹ cr)	1,718
Beta	1.1
52 Week High / Low	112/76
Avg. Daily Volume	151,693
Face Value (Rs)	2
BSE Sensex	18,008
Nifty	5,396
Reuters Code	GRPH.BO
Bloomberg Code	GRIL@IN

Shareholding Pattern (%)	
Promoters	57.2
MF / Banks / Indian FIs	16.2
FII / NRIs / OCBs	15.7
Indian Public / Others	10.9

Abs. (%)	3m	1yr	3yr
Sensex	(13.8)	11.0	(3.5)
Graphite India	(6.1)	1.3	49.4

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Exhibit 1: 3QFY2011 performance

Y/E March (₹ cr)	3QFY2011	3QFY2011	% chg (qoq)	3QFY2010	% chg (yoy)	9MFY2011	9MFY2010	% chg
Net Sales	**337**	**324**	*4.2*	**279**	*21.0*	**920**	**793**	*16.0*
Consumption of RM	172	160	*8.1*	117	*47.9*	364	276	*32.1*
(% of Sales)	51.1	49.3		41.8		39.6	34.8	
Staff Costs	24	19	*24.0*	19	*28.5*	63	55	*15.0*
(% of Sales)	7.1	6.0		6.7		6.8	6.9	
Other Expenses	68	61	*12.0*	41	*65.6*	275	182	*51.6*
(% of Sales)	20.1	18.7		14.7		30.0	22.9	
Total Expenditure	**264**	**239**	*10.4*	**176**	*50.0*	**702**	**512**	*37.2*
Operating Profit	**73**	**84**	*(13.3)*	**103**	*(28.7)*	**217**	**281**	*(22.6)*
OPM	**21.7**	**26.1**		**36.8**		**23.6**	**35.4**	
Interest	1	1	*3.5*	2	*(48.8)*	2	9	*(74.0)*
Depreciation	10	10	*0.3*	10	*1.2*	30	29	*0.9*
Other Income	4	14	*(72.8)*	6	*(37.1)*	20	28	*(28.7)*
PBT (excl. Extr. Items)	66	87	*(24.3)*	97	*(31.9)*	206	271	*(24.2)*
Extr. Income/(Expense)	-	(13)		-		(13)	-	
PBT (incl. Extr. Items)	**66**	**75**	*(11.4)*	**97**	*(31.9)*	**193**	**271**	*(28.9)*
(% of Sales)	**19.6**	**23.1**		**34.8**		**21.0**	**34.2**	
Provision for Taxation	22	26	*(13.9)*	34	*(35.7)*	65	94	*(31.2)*
(% of PBT)	33.2	34.1		35.2		33.7	34.8	
Reported PAT	**44**	**49**	*(10.1)*	**63**	*(29.8)*	**128**	**177**	*(27.6)*
PATM	**13.1**	**15.2**		**22.6**		**13.9**	**22.3**	
Equity shares (cr)	19.5	19.5		17.1		19.5	17.1	
EPS (₹)	2.3	2.5	*(10.1)*	3.7	*(38.6)*	6.5	10.3	*(36.7)*
Adjusted PAT	**44**	**62**	*(28.6)*	**63**	-	**141**	**177**	*(20.4)*

Source: Company, Angel Research

Segment-wise performance

The graphite and carbon segment posted revenue growth of 21.2% yoy to ₹294cr (₹242cr), due to 34.0% growth in electrode sales volumes. However, EBIT margins for the division fell by 1,589bp yoy and 104bp qoq to 18.6%, mainly on account of rising input costs and moderating electrode prices. However, going ahead, the outlook is more optimistic, with SGL Carbon announcing a 9–10% increase in electrode prices.

The power segment posted a 6.4% yoy decline in sales to ₹9cr. EBIT for the segment came in at ₹7cr, which implied an EBIT margin of 81.0%, up 485bp yoy from 76.2% in 3QFY2010.

The steel segment maintained its strong growth momentum in this quarter as well, growing by 49.9% to ₹26cr (₹17cr). EBIT margins for the segment came in at 3.1%, as against loss of 2.1% in 3QFY2010.

Revenue of the others segment declined by 5.7% yoy to ₹21cr (₹23cr). However, EBIT margins expanded by 477bp to 29.1% (24.3%).

Exhibit 2: Segment-wise performance

Y/E March (₹ cr)	3QFY11	2QFY11	3QFY10	% chg (qoq)	% chg (yoy)
Total Revenue					
A) Graphite and carbon	294	275	242	6.9	21.2
B) Power	9	8	9	4.9	(6.4)
C) Steel	26	23	17	10.9	49.9
D) Others	21	28	23	(23.7)	(5.7)
Total	349	334	291	4.6	19.9
Less: Inter-segmental revenue	12	10	12	16.0	(3.5)
Net Sales	337	324	279	4.2	21.0
EBIT Margin (%)					
A) Graphite and carbon	18.6	19.6	34.4	(104bp)	(1,589bp)
B) Power	81.0	91.0	76.2	(991bp)	485bp
C) Steel	3.1	0.7	(2.1)	241bp	518bp
D) Others	29.1	28.6	24.3	50bp	477bp

Source: Company, Angel Research

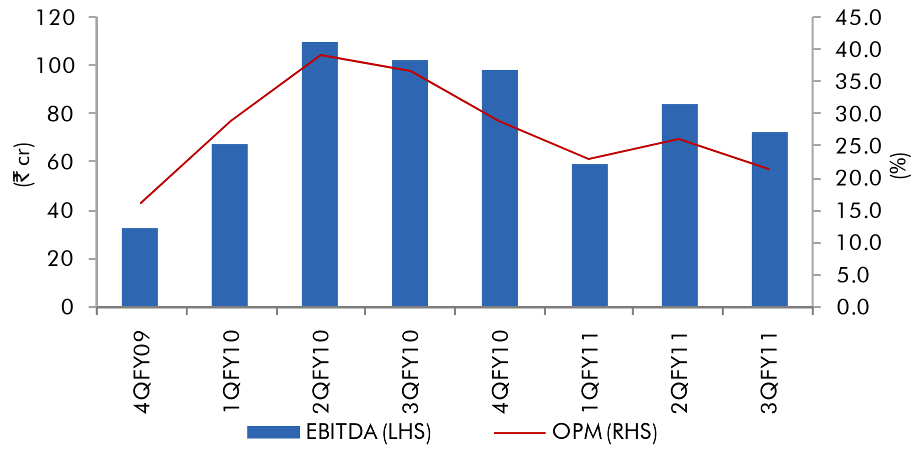
Sales maintain growth momentum: GIL has maintained a robust sales growth rate over the past few quarters, after witnessing a slump during the crisis of 2009. During this quarter also, sales growth came in at healthy 21.0%. Going ahead, we expect growth to remain at decent levels, backed by an improvement in the company's business outlook.

Exhibit 3: Sales growth trend

Source: Company, Angel Research

OPM fell to 21.7%: OPM came in at 21.7% during the quarter, falling from the higher levels in the past few quarters. In FY2010, the company had posted exceptionally high OPMs, post which they have returned to normal levels. However, going ahead, we expect OPM to improve from 21.7% currently.

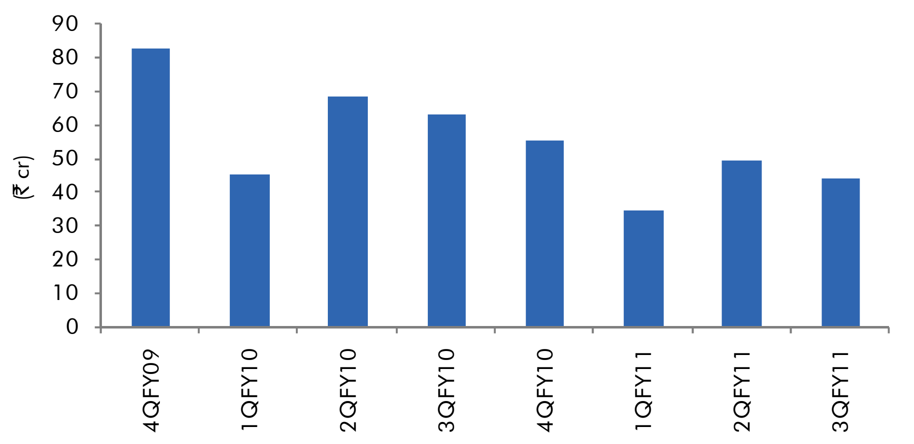
Exhibit 4: OPM trend



Source: Company, Angel Research

Fall in OPM leads to a decline in PAT: PAT declined to ₹44cr in 3QFY2011 from ₹63cr in 3QFY2010, mainly on account of margin correction. During 3QFY2010, the company reported extraordinarily high OPM of 36.8%. Overall, going ahead, we expect PAT to grow at a much lesser pace compared to the top line.

Exhibit 5: PAT trend



Source: Company, Angel Research

Management Call – Key Takeaways

- In 3QFY2011, prices corrected in the domestic market because of aggressive selling by global majors in India. However, exports markets saw stable prices. Going ahead, prices are expected to strengthen.
- Capacity utilisation for 3QFY2011 was ~84.0%, owing to high demand from steel manufacturers. Electrode sales volumes grew by 34.0% yoy, while prices declined as compared to the last year.
- OPM was hit due to one-time wage expenses, high electricity consumption in the graphitisation of electrodes, high input costs and subdued realisations. However, most of these factors are expected to reverse in the quarters to come.

- Expansion at the Durgapur plant to add 20,000MT of capacity is on track and the plant is expected to be commissioned in 3QFY2012.

Investment arguments

GIL set to ride on the industry's rebound: The graphite electrodes industry is expected to grow faster, compared to EAF steel production over the next few years, as the de-stocking of graphite electrodes inventory on steel manufacturers' end is expected to reverse. Consequently, we expect volumes of graphite electrodes to grow at a 17.2% CAGR over CY2009–11E. GIL, with its capacity expanding to 98,000mt/year by FY2012E from 78,000mt/year currently, is well poised to reap the benefits of this growth. We expect GIL's market share to increase to 9.0% by FY2012E and the top line to grow at a 17.6% CAGR over FY2010–12E on the back of this expansion.

Strong labour cost advantage: GIL has strong labour cost advantages compared to its global peers, as the other companies have their plants in locations where labour costs are significantly higher compared to India. The largest global player, SGL Carbon, has plants located mainly across Europe and North America. GrafTech Ltd., the world's second largest player, has plants located in France, Spain, South Africa, Brazil and Mexico. In FY2009, GIL's employee cost was 9% of sales, whereas it was almost 23% (CY2008) for SGL Carbon. Historically, GIL has passed on a part of this advantage in order to gain market share. However, with the rate of market share addition expected to slow down, we expect GIL to retain a larger part of this cost advantage and, thereby, improve its margins over historical average levels.

Strong entry barriers: The global graphite electrodes industry is characterised by high level of consolidation, with the top six players accounting for over 70% of the world's total installed capacity. The balance capacity is owned by motley of small players. The highly consolidated nature of the industry is due to the entry barriers for new entrants. For instance, only the top global players have the technology to manufacture high-quality ultra high power (UHP) graphite electrodes. The industry is marked by a relationship and referral-based model. A new entrant has to prove the quality of its products by supplying to a steel manufacturer and then get referral and word-of-mouth publicity for the products from the manufacturer. Another barrier for the new as well as some of the existing players is the high cost of setting up a greenfield graphite electrodes manufacturing facility.

Outlook and valuation

We maintain our positive stance on GIL on account of revival in the global steel production industry. Global steel production reached 1.4bn tonnes in CY2010, an increase of 15.0% over CY2009. Graphite electrode volumes have also shown substantial improvement. GIL reported a 34.0% yoy increase in volumes in 3QFY2011. However, the fall in electrode prices has been more than anticipated. Therefore, we have revised our top-line estimates for FY2011 and FY2012 downwards by 2.4% each to ₹1,570cr and ₹1,864cr, respectively, and PAT estimates by 8.2% and 6.2% to ₹220cr and ₹258cr, respectively. At the CMP, the stock is trading at 1.1x and 1.0x its FY2011E and FY2012E BV. **We maintain Buy on the stock with a revised Target Price of ₹114 (₹117).**

Exhibit 6: 3QFY2011 results: Actual v/s Estimated

	Actual	Estimated	*Difference (%)*
Sales (₹ cr)	337	354	*(4.6)*
EBITDA (₹ cr)	73	88	*(16.5)*
OPM (%)	21.7	24.8	*(311)bp*
PAT (₹ cr)	44	54	*(18.8)*

Source: Company, Angel Research

Exhibit 7: Revised estimates

(₹ cr)	Old		New		% chg	
	FY2011E	FY2012E	FY2011E	FY2012E	FY2011E	FY2012E
Sales	1,608	1,909	1,570	1,864	*(2.4)*	*(2.4)*
EBITDA	392	461	365	439	*(6.9)*	*(4.9)*
EBITDA (%)	24.4	24.2	23.2	23.5		
PAT	240	275	220	258	*(8.2)*	*(6.2)*
EPS (₹)	12.3	14.0	11.3	13.2	*(8.2)*	*(6.2)*

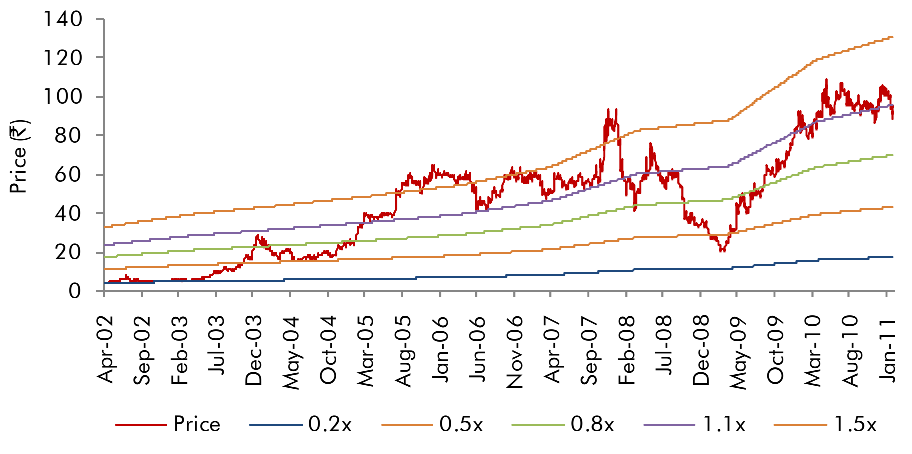
Source: Angel Research

Exhibit 8: Key assumptions

	FY2011E	FY2012E	Remarks
% of steel produced through EAF method	30.7	30.9	Increasing share of EAF route
World graphite electrode production (MT)	695,637	723,709	Volumes to improve on the back of improving steel volumes
GIL volumes (MT)	57,329	65,471	Capacity expansion to result in improved market share
OPM (%)	23.7	23.9	OPM to strengthen as realisations improve

Source: Angel Research

Exhibit 9: One-year forward P/BV band



Source: Company, Bloomberg, Angel Research

Profit and loss statement (Consolidated)

Y/E March (₹ cr)	FY07	FY08	FY09	FY10	FY11E	FY12E
Gross sales	1,171	1,388	1,558	1,394	1,653	1,961
Less: Excise duty	53.2	57.1	59.5	47.0	82.8	96.8
Net Sales	1,118	1,331	1,498	1,347	1,570	1,864
Total operating income	**1,118**	**1,331**	**1,498**	**1,347**	**1,570**	**1,864**
% chg	*45.2*	*19.1*	*12.6*	*(10.1)*	*16.5*	*18.7*
Total Expenditure	893	1,054	1,135	950	1,205	1,425
Net Raw Materials	358	468	487	480	518	608
Other Mfg costs	301	321	381	243	371	440
Personnel	117	130	135	122	154	186
Other	117	134	132	105	162	191
EBITDA	**225**	**278**	**363**	**397**	**365**	**439**
% chg	*63.2*	*23.5*	*30.8*	*9.3*	*(8.0)*	*20.2*
(% of Net Sales)	*20.1*	*20.9*	*24.2*	*29.5*	*23.2*	*23.5*
Depreciation& Amortisation	38	41	44	50	51	64
EBIT	**187**	**237**	**319**	**347**	**314**	**374**
% chg	*77.1*	*26.4*	*34.9*	*8.7*	*(9.5)*	*19.3*
(% of Net Sales)	*16.7*	*17.8*	*21.3*	*25.7*	*20.0*	*20.1*
Interest & other Charges	37	43	35	14	17	22
Other Income	131	29	25	32	32	32
(% of PBT)	46.7	13.2	8.2	8.8	9.8	8.4
Recurring PBT	**281**	**223**	**309**	**365**	**329**	**385**
% chg	*182.4*	*(20.7)*	*38.6*	*17.9*	*(9.8)*	*16.9*
Extraordinary Expense/(Inc.)	-	-	57	-	-	-
PBT (reported)	**281**	**223**	**253**	**365**	**329**	**385**
Tax	59	81	18	129	109	127
(% of PBT)	*20.9*	*36.2*	*7.2*	*35.4*	*33.0*	*33.0*
PAT (reported)	**223**	**142**	**234**	**236**	**220**	**258**
Prior period items	75	(0)	(1)	-	-	-
PAT after MI (reported)	**223**	**142**	**234**	**236**	**220**	**258**
ADJ. PAT	**147**	**143**	**236**	**236**	**220**	**258**
% chg	*118.4*	*(3.3)*	*65.5*	*(0.1)*	*(6.5)*	*16.9*
(% of Net Sales)	*13.2*	*10.7*	*15.7*	*17.5*	*14.0*	*13.8*
Basic EPS (₹)	**15.1**	**9.6**	**15.1**	**13.7**	**11.3**	**13.2**
Fully Diluted EPS (₹)	**12.5**	**8.0**	**11.4**	**10.7**	**11.3**	**13.2**
% chg	*168.2*	*(36.2)*	*43.7*	*(6.6)*	*5.3*	*16.9*

Balance sheet (Consolidated)

Y/E March (₹ cr)	FY07	FY08	FY09	FY10	FY11E	FY12E
SOURCES OF FUNDS						
Equity Share Capital	29	30	34	34	39	39
Reserves& Surplus	614	725	1,085	1,249	1,506	1,672
Shareholders' Funds	**643**	**755**	**1,119**	**1,283**	**1,545**	**1,712**
Total Loans	706	619	528	324	170	320
Deferred Tax Liability (Net)	64	70	62	74	74	74
Total Liabilities	**1,413**	**1,444**	**1,709**	**1,681**	**1,789**	**2,106**
APPLICATION OF FUNDS						
Gross Block	815	834	995	1,010	1,030	1,535
Less: Acc. Depreciation	262	303	435	485	536	601
Net Block	**553**	**531**	**559**	**524**	**493**	**934**
Capital Work-in-Progress	8	9	14	20	257	15
Investments	**111**	**106**	**101**	**187**	**100**	**100**
Current Assets	993	1,133	1,336	1,230	1,310	1,478
Cash	92	66	177	80	84	25
Loans & Advances	118	108	132	119	138	164
Inventories	439	534	695	729	628	746
Debtors	344	412	318	291	449	533
Other	-	13	14	11	11	11
Current liabilities	252	335	301	281	372	422
Net Current Assets	**741**	**798**	**1,035**	**949**	**939**	**1,056**
Total Assets	**1,413**	**1,444**	**1,709**	**1,681**	**1,789**	**2,106**

Cash flow statement (Consolidated)

Y/E March	FY07	FY08	FY09	FY10	FY11E	FY12E
Profit before tax	281	223	251	364	329	385
Depreciation	38	41	44	50	51	64
(Inc.)/ Dec. in Working Capital	(166)	(92)	(103)	(23)	34	(151)
Less: Other income	131	29	25	32	32	32
Direct taxes paid	59	81	18	129	109	127
Cash Flow from Operations	(38)	62	148	229	273	139
(Inc.)/ Dec. in Fixed Assets	(76)	(21)	(165)	(21)	(257)	(263)
(Inc.)/ Dec. in Investments	(98)	5	5	(86)	87	-
(Inc.)/ Dec. in loans and advances	(29)	10	(24)	13	(20)	(26)
Other income	131	29	25	32	32	32
Cash Flow from Investing	(72)	23	(158)	(62)	(157)	(257)
Issue of Equity	-	23	4	3	133	-
Inc./(Dec.) in loans	89	(86)	(91)	(204)	(154)	150
Dividend Paid (Incl. Tax)	51	53	60	70	92	92
Others	11	6	267.17	7.73	1.18	-
Cash Flow from Financing	49	(111)	120	(264)	(111)	58
Inc./(Dec.) in Cash	(60)	(25)	111	(97)	4	(60)
Opening Cash balances	152	92	66	177	80	84
Closing Cash balances	92	66	177	80	84	25

Key ratios

Y/E March	FY07	FY08	FY09	FY10	FY11E	FY12E
Valuation Ratio (x)						
P/E (on FDEPS)	7.0	11.0	7.7	8.2	7.8	6.7
P/E (on basic, reported EPS)	5.8	9.1	5.8	6.4	7.8	6.7
P/CEPS	5.0	7.2	5.4	5.3	6.3	5.3
P/BV	2.0	1.8	1.3	1.2	1.1	1.0
Dividend yield (%)	3.4	3.4	3.4	4.0	4.5	4.5
Market cap. / Sales	1.2	1.0	1.0	1.1	1.1	0.9
EV/Sales	1.6	1.2	1.0	1.1	1.2	1.0
EV/EBITDA	7.7	5.7	4.3	3.8	5.2	4.2
EV / Total Assets	1.2	1.1	0.9	0.9	1.1	0.9
Per Share Data (₹)						
EPS (Basic)	15.1	9.6	15.1	13.7	11.3	13.2
EPS (fully diluted)	12.5	8.0	11.4	10.7	11.3	13.2
Cash EPS	17.7	12.1	16.2	16.6	13.9	16.5
DPS	3.0	3.0	3.0	3.5	4.0	4.0
Book Value	36.1	42.2	55.0	58.4	79.0	87.5
ROE Decomposition (%)						
EBIT margin	16.7	17.8	21.3	25.7	20.0	20.1
Tax retention ratio	79.1	63.8	92.7	64.5	67.0	67.0
ROCE (Post Tax)	12.2	11.9	20.7	15.8	13.1	12.7
Cost of Debt (Post Tax)	4.4	4.1	5.7	2.2	4.7	6.0
Leverage (x)	0.7	0.6	0.3	0.1	0.0	0.1
Operating ROE	18.0	16.7	25.3	17.5	13.2	13.0
Returns (%)						
ROCE (Pre-tax)	14.7	16.6	20.2	20.5	18.1	19.2
Angel ROIC	15.6	18.7	22.5	24.9	23.3	19.0
ROE	26.3	20.4	25.0	19.6	15.6	15.8
Turnover ratios (x)						
Asset Turnover (Gross Block)	1.5	1.6	1.6	1.3	1.5	1.5
Asset Turnover (Net Block)	2.1	2.5	2.7	2.5	3.1	2.6
Operating Income / Invested Capital	0.9	1.1	1.1	1.0	1.2	0.9
Inventory / Sales (days)	125	133	150	193	158	134
Receivables (days)	96	104	89	83	86	96
Payables (days)	79	82	77	79	67	69
Working capital cycle (ex-cash) (days)	180	189	194	234	200	185
Solvency ratios (x)						
Gross debt to equity	1.1	0.8	0.5	0.3	0.1	0.2
Net debt to equity	0.8	0.6	0.2	0.0	-	0.1
Net debt to EBITDA	2.2	1.6	0.7	0.1	-	0.4
Interest Coverage (EBIT / Interest)	5.1	5.5	9.1	24.0	18.1	17.0

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DISCLAIMER

Disclosure of Interest Statement	**Graphite India**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Returns):	*Buy (> 15%)*	*Accumulate (5% to 15%)*	*Neutral (-5 to 5%)*
	Reduce (-5% to 15%)	Sell (< -15%)	