

## Transition to speciality some time away...

Himadri Speciality Chemicals (HSCL) is a carbon product manufacturer manufacturing coal tar pitch (CTP) used in aluminium, graphite electrode industry and carbon black, which is used in the tyre industry. Both its products are industrial in nature and quite essential in their user industries. However, this is a steady state business with limited competitive edge and minimal excitement for investors. However, HSCL has in the past laid out a strategy to venture into new age technological products like speciality carbon black that is to be used in paints, plastics, etc. and advance carbon material, which is to be used in electric cells/ lithium-ion battery. Both these products were supposed to earn very high margins and consequent return ratios matrix, thereby putting HSCL into a new orbit of speciality products manufacturer. Both projects, however, were delayed with extensions time and again. Speciality carbon black project finally came on stream at the end of January 2020 (vs. initial indication of early FY20E commissioning) and is yet to produce the desired grades. Advance carbon material is yet to be commissioned (initial indication of early FY20E commissioning in phases). This inordinate delay has led to a sharp de-rating of the HSCL stock with the company now commanding a valuation multiple in tandem with its commoditised nature of business. We believe this will likely continue before any meaningful contribution from the new age technology products.

## Margins fall sharply in sync with muted demand prospects

By virtue of HSCL supplying essential compound for user industries like aluminium, graphite electrode and tyres (automobile), margins were on an uptrend tracking robust demand prospects in user industries amid limited competition domestically. EBITDA margins expanded from 12.3% in FY16 to 22.6% in FY19 with corresponding EBITDA/tonne improving from ~₹ 4,800/tonne in FY16 to ~₹ 14,800 in FY19. However, with current muted demand prospects in user industries along with incremental capacities in market place, margins are under pressure with EBITDA/tonne dropping to ~₹ 9,300 in FY20E with corresponding EBITDA margins at 16.5%. With the commissioning of new products, which are margin accretive in nature, we expect the EBITDA/tonne to improve to ~ ₹ 10,700/tonne in FY22E with consequent EBITDA margins at 18.2% in FY22E.

## Valuation & Outlook

Building in the prevailing muted demand prospects both domestically as well as globally in its base business and delay in commissioning of new projects, we expect HSCL to clock sales, PAT CAGR of 7.0%, 14.3%, respectively, in FY20E-22E. With a decline in margin profile, return ratios matrix has reduced to ~10% RoE, which significantly limits our ability to assign a higher valuation multiple to HSCL. Consequently, we value HSCL at ₹ 50 i.e. 10x P/E on FY22E EPS of ₹ 5.0. We derive some comfort from consistent CFO generation with controlled leverage on B/S (debt: equity at ~0.3x). We downgrade the stock from BUY to **HOLD**.

### Key Financial Summary

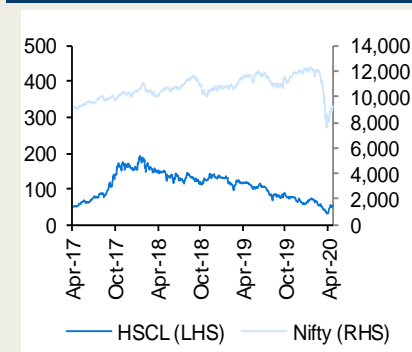
| Key Financials     | FY18  | FY19  | FY20E | FY21E | FY22E | CAGR (FY20E-22E) |
|--------------------|-------|-------|-------|-------|-------|------------------|
| Net Sales          | 1971  | 2377  | 1802  | 1581  | 2062  | 7.0%             |
| EBITDA             | 450   | 537   | 297   | 281   | 375   | 12.4%            |
| EBITDA Margins (%) | 22.8% | 22.6% | 16.5% | 17.8% | 18.2% |                  |
| Net Profit         | 243   | 307   | 161   | 139   | 210   | 14.3%            |
| EPS (₹)            | 5.8   | 7.3   | 3.8   | 3.3   | 5.0   |                  |
| P/E                | 8.3   | 6.5   | 12.5  | 14.5  | 9.6   |                  |
| RoNW (%)           | 16.7  | 18.3  | 8.8   | 7.1   | 9.7   |                  |
| RoCE (%)           | 18.2  | 22.7  | 11.0  | 9.6   | 12.4  |                  |



### Particulars

| Stock Data                      | ₹ crore  |
|---------------------------------|----------|
| Market Capitalization           | 2008     |
| Total Debt (FY19)               | 458      |
| Cash and Cash Equivalent (FY19) | 47       |
| Enterprise Value                | 2420     |
| 52 week H/L                     | 117 / 27 |
| Equity Capital                  | 41.9     |
| Face Value                      | ₹ 1      |

### Price Chart



### Research Analyst

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## Financial Summary

| Exhibit 1: Profit and loss statement   crore |               |               |               |               |
|--|---------------|---------------|---------------|---------------|
| (Year-end March)                             | FY19          | FY20E         | FY21E         | FY22E         |
| Net Sales                                    | 2376.6        | 1802.5        | 1580.6        | 2062.0        |
| Other Operating Income                       | 0.0           | 0.0           | 0.0           | 0.0           |
| <b>Total Operating Income</b>                | <b>2376.6</b> | <b>1802.5</b> | <b>1580.6</b> | <b>2062.0</b> |
| Growth (%)                                   | 20.6          | -24.2         | -12.3         | 30.5          |
| Raw Material Expenses                        | 1,587.8       | 1,219.2       | 1,051.1       | 1,360.9       |
| Employee Expenses                            | 58.1          | 72.6          | 74.8          | 78.4          |
| Other Operating Expense                      | 193.3         | 213.9         | 174.1         | 247.4         |
| Total Operating Expenditure                  | 1,839.2       | 1,505.6       | 1,299.9       | 1,686.7       |
| <b>EBITDA</b>                                | <b>537.4</b>  | <b>296.8</b>  | <b>280.6</b>  | <b>375.3</b>  |
| Growth (%)                                   | 19.4          | -44.8         | -5.5          | 33.7          |
| Depreciation                                 | 32.5          | 36.4          | 51.1          | 55.7          |
| Interest                                     | 70.6          | 53.2          | 51.8          | 44.9          |
| Other Income                                 | 10.7          | 12.3          | 12.6          | 13.2          |
| <b>PBT</b>                                   | <b>445.0</b>  | <b>219.6</b>  | <b>190.3</b>  | <b>287.8</b>  |
| Exceptional Item                             | 0.0           | 0.0           | 0.0           | 0.0           |
| Total Tax                                    | 137.7         | 58.7          | 51.4          | 77.7          |
| <b>PAT</b>                                   | <b>307.3</b>  | <b>160.9</b>  | <b>138.9</b>  | <b>210.1</b>  |
| Growth (%)                                   | 26.7          | -47.6         | -13.7         | 51.3          |
| <b>EPS (₹)</b>                               | <b>7.3</b>    | <b>3.8</b>    | <b>3.3</b>    | <b>5.0</b>    |

Source: Company, ICICI Direct Research

| Exhibit 2: Cash flow statement   crore |               |               |               |               |
|--|---------------|---------------|---------------|---------------|
| (Year-end March)                       | FY19          | FY20E         | FY21E         | FY22E         |
| Profit after Tax                       | 307.3         | 160.9         | 138.9         | 210.1         |
| Add: Depreciation                      | 32.5          | 36.4          | 51.1          | 55.7          |
| (Inc)/dec in Current Assets            | -282.0        | 143.7         | 106.2         | -222.6        |
| Inc/(dec) in CL and Provisior          | 284.7         | -129.9        | -34.4         | 74.7          |
| Others                                 | 70.6          | 53.2          | 51.8          | 44.9          |
| <b>CF from operating activitie</b>     | <b>413.0</b>  | <b>264.2</b>  | <b>313.6</b>  | <b>162.9</b>  |
| (Inc)/dec in Investments               | 94.0          | 80.0          | 10.0          | 0.0           |
| (Inc)/dec in Fixed Assets              | -132.1        | -330.0        | -180.0        | -50.0         |
| Others                                 | -37.3         | 0.0           | 0.0           | 0.0           |
| <b>CF from investing activitie</b>     | <b>-75.4</b>  | <b>-250.0</b> | <b>-170.0</b> | <b>-50.0</b>  |
| Issue/(Buy back) of Equity             | 0.0           | 0.0           | 0.0           | 0.0           |
| Inc/(dec) in loan funds                | -165.5        | 50.0          | -75.0         | -50.0         |
| Interest & Dividend paid               | -78.1         | -63.2         | -60.2         | -53.3         |
| Inc/(dec) in Share Cap                 | 0.0           | 0.0           | 0.0           | 0.0           |
| Others                                 | -78.9         | 0.0           | 0.0           | 0.0           |
| <b>CF from financing activitie</b>     | <b>-322.5</b> | <b>-13.2</b>  | <b>-135.2</b> | <b>-103.3</b> |
| Net Cash flow                          | 15.2          | 1.0           | 8.4           | 9.6           |
| Opening Cash                           | 31.4          | 46.6          | 47.6          | 56.0          |
| <b>Closing Cash</b>                    | <b>46.6</b>   | <b>47.6</b>   | <b>56.0</b>   | <b>65.6</b>   |

Source: Company, ICICI Direct Research

| Exhibit 3: Balance Sheet   crore |               |               |               |               |
|----------------------------------|---------------|---------------|---------------|---------------|
| (Year-end March)                 | FY19          | FY20E         | FY21E         | FY22E         |
| <b>Liabilities</b>               |               |               |               |               |
| Equity Capital                   | 41.9          | 41.9          | 41.9          | 41.9          |
| Reserve and Surplus              | 1,635.4       | 1,786.2       | 1,916.7       | 2,118.5       |
| <b>Total Shareholders funds</b>  | <b>1677.2</b> | <b>1828.1</b> | <b>1958.6</b> | <b>2160.3</b> |
| <b>Total Debt</b>                | <b>458.4</b>  | <b>508.4</b>  | <b>433.4</b>  | <b>383.4</b>  |
| Deferred Tax Liability           | 130.8         | 130.8         | 130.8         | 130.8         |
| Minority Interest / Others       | 4.0           | 4.0           | 4.0           | 4.0           |
| <b>Total Liabilities</b>         | <b>2270.4</b> | <b>2471.3</b> | <b>2526.8</b> | <b>2678.6</b> |
| <b>Assets</b>                    |               |               |               |               |
| Gross Block                      | 1,577.9       | 1,884.3       | 2,204.3       | 2,254.3       |
| Less: Acc Depreciation           | 487.8         | 524.1         | 575.2         | 631.0         |
| <b>Net Block</b>                 | <b>1090.1</b> | <b>1360.2</b> | <b>1629.1</b> | <b>1623.3</b> |
| Capital WIP                      | 126.4         | 150.0         | 10.0          | 10.0          |
| Total Fixed Assets               | 1,216.5       | 1,510.2       | 1,639.1       | 1,633.3       |
| Investments                      | 259.2         | 179.2         | 169.2         | 169.2         |
| Inventory                        | 538.9         | 493.8         | 433.0         | 564.9         |
| Debtors                          | 374.0         | 296.3         | 259.8         | 339.0         |
| Loans and Advances               | 54.2          | 39.7          | 31.6          | 41.2          |
| Other Current Assets             | 168.3         | 161.9         | 161.0         | 163.0         |
| <b>Cash</b>                      | <b>46.6</b>   | <b>47.6</b>   | <b>56.0</b>   | <b>65.6</b>   |
| Total Current Assets             | 1,182.1       | 1,039.3       | 941.5         | 1,173.7       |
| Current Liabilities              | 513.0         | 375.4         | 342.0         | 414.5         |
| Provisions                       | 0.6           | 8.1           | 7.1           | 9.3           |
| Current Liabilities & Prov       | 513.5         | 383.6         | 349.1         | 423.9         |
| <b>Net Current Assets</b>        | <b>668.5</b>  | <b>655.7</b>  | <b>592.4</b>  | <b>749.8</b>  |
| Others Assets                    | 126.2         | 126.2         | 126.2         | 126.2         |
| <b>Application of Funds</b>      | <b>2270.4</b> | <b>2471.3</b> | <b>2526.8</b> | <b>2678.6</b> |

Source: Company, ICICI Direct Research

| Exhibit 4: Key ratios       |            |            |            |            |
|-----------------------------|------------|------------|------------|------------|
| (Year-end March)            | FY19       | FY20E      | FY21E      | FY22E      |
| <b>Per share data (₹)</b>   |            |            |            |            |
| EPS                         | 7.3        | 3.8        | 3.3        | 5.0        |
| Cash EPS                    | 8.1        | 4.7        | 4.5        | 6.4        |
| BV                          | 40.1       | 43.7       | 46.8       | 51.6       |
| DPS                         | 0.2        | 0.2        | 0.2        | 0.2        |
| Cash Per Share (Incl Invst) | 7.3        | 5.4        | 5.4        | 5.6        |
| <b>Operating Ratios (%)</b> |            |            |            |            |
| EBITDA Margin               | 22.6       | 16.5       | 17.8       | 18.2       |
| PAT Margin                  | 12.9       | 8.9        | 8.8        | 10.2       |
| Inventory days              | 82.8       | 100.0      | 100.0      | 100.0      |
| Debtor days                 | 57.4       | 60.0       | 60.0       | 60.0       |
| Creditor days               | 62.8       | 55.0       | 55.0       | 55.0       |
| <b>Return Ratios (%)</b>    |            |            |            |            |
| RoE                         | 18.3       | 8.8        | 7.1        | 9.7        |
| RoCE                        | 22.7       | 11.0       | 9.6        | 12.4       |
| RoIC                        | 29.0       | 13.0       | 10.5       | 13.7       |
| <b>Valuation Ratios (x)</b> |            |            |            |            |
| P/E                         | 6.5        | 12.5       | 14.5       | 9.6        |
| EV / EBITDA                 | 4.5        | 8.3        | 8.5        | 6.2        |
| EV / Net Sales              | 1.0        | 1.4        | 1.5        | 1.1        |
| Market Cap / Sales          | 0.8        | 1.1        | 1.3        | 1.0        |
| Price to Book Value         | 1.2        | 1.1        | 1.0        | 0.9        |
| <b>Solvency Ratios</b>      |            |            |            |            |
| Debt/EBITDA                 | 0.9        | 1.7        | 1.5        | 1.0        |
| Debt/Equity                 | 0.3        | 0.3        | 0.2        | 0.2        |
| Current Ratio               | 2.4        | 3.0        | 3.0        | 3.0        |
| <b>Quick Ratio</b>          | <b>1.1</b> | <b>1.2</b> | <b>1.2</b> | <b>1.2</b> |

Source: Company, ICICI Direct Research

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