3C CAPITALS

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Game Changer

OCCL

Oriental Carbon & Chemicals Ltd

A Consistent Compounding Machine

Date: 9th March, 2021

Inside the Report

Slow & Steady, Builds Wealth

In behavioral finance, herd mentality bias refers to investors' tendency to follow and copy what other investors are doing. They are largely influenced by emotion and instinct, rather than by their own independent analysis.

This particular mentality is prominent when there is a lot of excitement and speculation in the market and everyone seems to be getting rich fast.

These are the times, investors have to hold their ground and focus on accumulating wealth in the slow and steady fashion. Most investors shun this approach because they see investing as a pursuit of returns. Instead one should perceive investing as a pursuit of accumulating capital. Reinvesting returns and building resources that can be put to work will enable investors to exploit the awesome power of compounding in order to grow serious wealth.

One other problem that people who go after quick gains face is that they forget to protect their downside. Any long term investor, experienced or novice, should keep in mind that in long-term investing, the focus should not be on making money, but protecting the capital that one already have. Investing is one area where inaction pays more than action.

'Preservation of Capital' is closely related to the concept of 'Economic Moats'.. Investing in companies with an economic moat will not only help create wealth but also preserves the capital that one has already invested.

Our latest Game Changer recommendation, **Oriental Carbon & Chemicals Ltd (OCCL)**, fits perfectly into these group of steady compounders. OCCL is a medium growing stalwarts' type of business per Peter Lynch's definition of businesses.

While its end-user industries have grown in single digits over the years, the company has consistently earned 15% for the last five years, and the capital employed within the business has risen 87% in that time. Since 15% is a moderate ROCE though, it is good to see that a business can continue to reinvest at these decent rates of returns. Over long periods of time, returns like these might not be too exciting, but with consistency they can pay off in terms of share price returns.

The inherent entry barriers in the industry coupled with the second preferred supplier status to all the major tire manufacturers in the world, makes OCCL a perfect candidate in your portfolio. The company is led by a management that have always walked the talk and is clearly looking to take the company to newer heights.

Company Snapshot

Total Weightage % in Portfolio = 6% (CMP 900, 9th Mar'21)

Two Phase Buying Strategy = Buy 6% between Rs 900-1000 (for this stock ONLY buying 6% in one phase is advised)

Price Target = Around Rs 2600-3000 (~200% Upside) in next 12-18 months. It can deliver 30% CAGR over next 4-6 years.

Market Cap	₹ 893 Cr.	Current Price	₹ 894	High / Low	₹ 1,020 / 470
Stock P/E	12.9	Book Value	₹ 482	Dividend Yield	1.12 %
ROCE	15.6 %	ROE	16.5 %	Face Value	₹ 10.0
Promoter holding	51.8 %	Dividend yield	1.12 %	Change in Prom Hold	0.00 %
Chg in Prom Hold 3Yr	1.93 %	Unpledged Prom Hold	51.8 %	CF Financing	₹ -9.83 Cr.

Business : Oriental Carbon & Chemicals Ltd belong to the JP Goenka group of companies. The company was incorporated as Dharuhera Chemicals Ltd in 1978. After hiving off its carbon black business, OCCL has concentrated and grown into one of the major players of Insoluble Sulphur (IS) in the world and the only player in India.

Management : OCCL is managed by the Goenka group of companies who have earned a big name as an industrialist over the last 3 decades. They have shown a consistent track record of executing successful projects from 1994 to 2020. Mr. Arvind Goenka, the key personnel behind OCCL's success is still the man in charge and he is gearing up his son, Akshat Goenka to lead the future growth.

Valuation : OCCL is a focused player on IS production unlike the rest of its competitors or other rubber chemical manufacturers. The company is available at a PE of 12.9 near its median PE of 13.2. However, we still believe the company will be able to further grow at a rate faster than the industry fueled by demand in domestic as well as international markets and further innovation in its products..

Risks : Product Concentration, further slowdown in auto sector, volatility in forex rates and project execution risks.

Price Chart Pattern

History

1978 Incorporated as Dharuhera Chemicals Ltd to manufacture Sulphuric Acid, Commenced Sulphuric Acid production	**1984** Merged with Oriental Carbon Ltd to form Oriental Carbon & Chemicals Ltd	**1994** Commenced Insoluble Sulphur production	**2000** Divested the carbon black business
2005 Doubled Insoluble Sulfur capacity by adding 2nd line(100% EOU) at Dharuhera	**2009** Embarked on a greenfield investment of 11000 Mtpa for Insoluble Sulphur at the Mundra plant	**2011** Commissioned the first expansion phase of the Mundra plant with a capacity of 5500 MTPA	**2012** Acquired 50% equity share in Schrader Duncan Ltd; commissioned the second phase of the Mundra plant with 5500 MTPA
2016 Kickstarted a brownfield expansion of 11,000TPA of Insoluble Sulphur capacity at Mundra in two phases.	**2017** Commissioned the first phase of the next round of Insoluble Sulphur expansion of 5500 TPA at Mundra	**2018** Commissioned the second phase of the Insoluble Sulphur expansion of 5500 TPA at Mundra	**2019** Kick-started the brownfield expansion with an additional 11000 MTPA of Insoluble Sulphur capacity at Dharuhera

Investment Rationale

Tailwinds

Capacity Expansion by Tire Manufacturers

Continuous shift towards Radial Tires

Continued Domestic Market Dominance

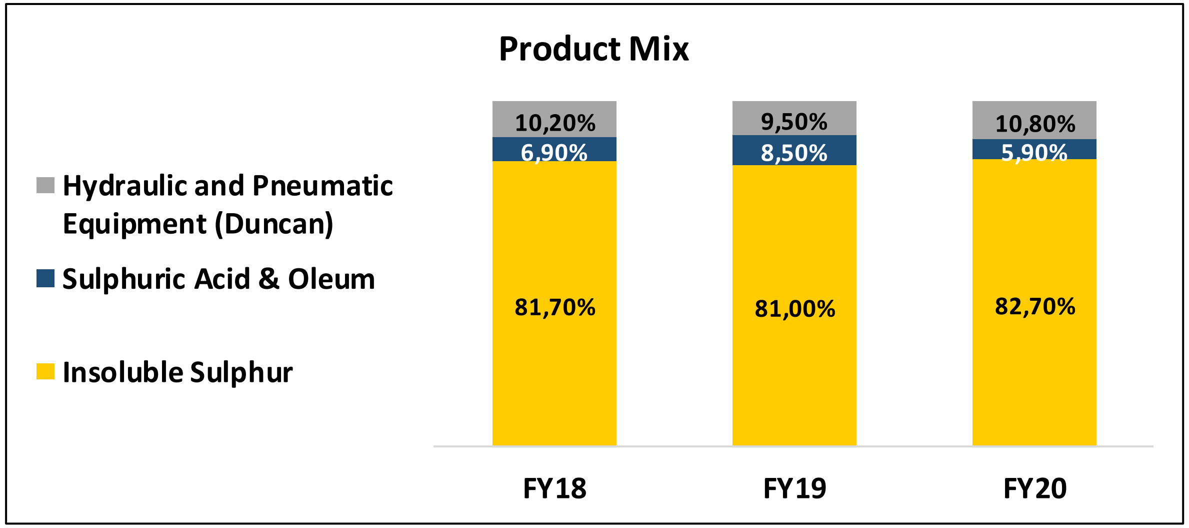
“Second Supplier” status among customers around the world

High Entry Barriers in the form of long approval periods and guarded technology

Stable Margins & Positive Cash Flows

Diversified Clientele

Business Overview



OCCL is one of the market leader in the production of Insoluble Sulphur

Domestic market share of ~60% | Global market share of ~10-12%

Credit Rating: AA- (it was BBB in 2008)

Referred to as a "Secondary Supplier"

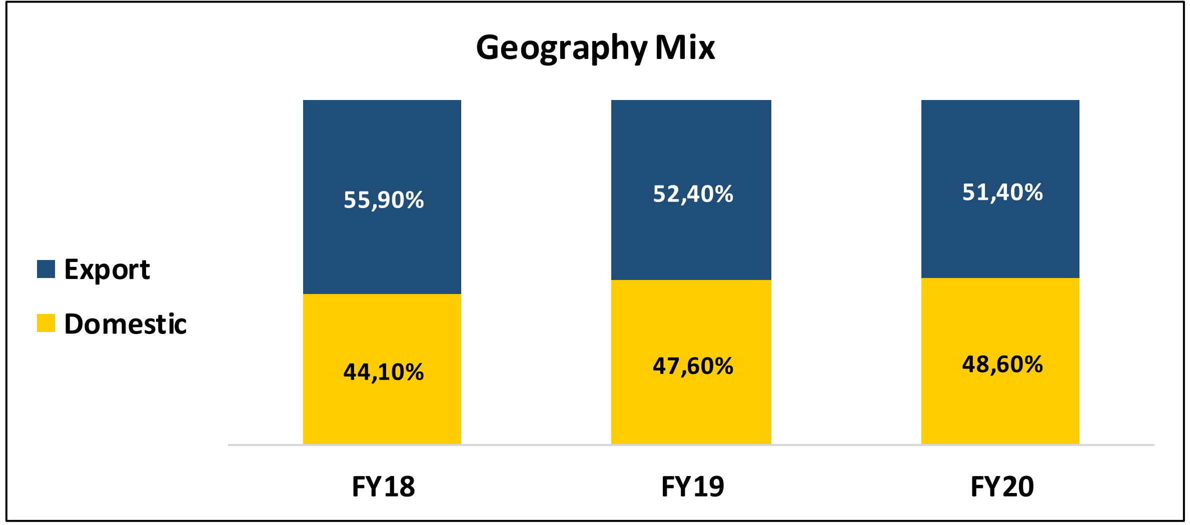
Increased its global market share from 3% in 2006 to 10% by 2020

OCCL has one subsidiary, Duncan Engineering Ltd (formerly known as Schrader Duncan Limited).

Duncan produces Industrial Pneumatics and Off-Highway Tire (OTR) valves and accessories.

The company turned profitable in FY19. They registered a gross turnover of INR 44,38.97 lakhs during FY20 against INR 45,12.24 lakhs during FY19.

Profit reported was INR 3,26.30 lakhs in FY20 against previous year profit of INR 277.93 lakhs.



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Product Profile

Insoluble Sulphur is sold under the brand "DIAMOND SULF"

Application: Used as vulcanizing agent in application where Sulphur loading levels are required above the Sulphur solubility rating of particular elastomers

DIAMOND SULF is offered in various grades to satisfy diverse compounding requirements majorly for Tire industry

- High Dispersion Grades: These are particularly suitable for use in compounds where sulphur loading levels are very high.
- High Stability Grades: This grade possesses a high level of thermal stability. It ensures consistent vulcanising properties and allows storage at relatively higher ambient temperatures
- Special Grades: These are customised around specific requirements. These grades have been progressively enhanced, customised in line with demanding downstream requirements.

Recently the company launched Diamix - Pre dispersed Sulphur, which is a different form of vulcanisation agent in the form of solid pellets. These are customised insoluble products intended for specialised applications.

Manufactures both Commercial Grade and Battery Grade Sulphuric Acid and Oleum

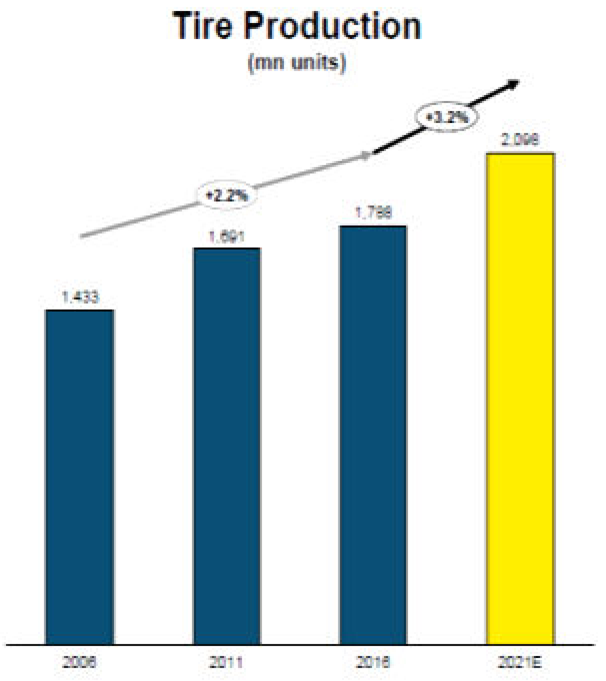
Application: Dehydrating agent, catalyst, active reactant in chemical processes, solvent, detergents and absorbent

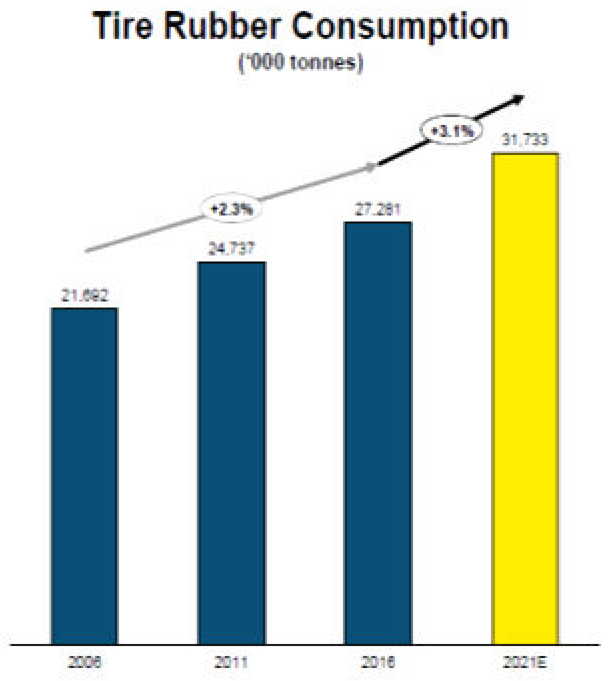
Offered in following Grades

- Grades of exact purity Storage battery, rayon, dye, Detergent and pharmaceutical industries
- Grades of less specifications Steel, heavy chemical and superphosphate industries

Capacity Expansion by Tire Industry

- According to a various market research reports, the global demand for tires is projected to grow further in the forecast period of 2021-2026 at a CAGR of 4%.
- Majority of the tire manufacturers of the world are undergoing capacity expansion over the past couple of years.
- Post the reopening of the economy the tire industry has witnessed strong demand growth in replacement segment driven by multiple factors like pent-up demand, shift towards personal mobility and increasing vehicle utilization trends.





Source: Notch Report

Balkrishna Industries' fresh capex of ₹1,900 cr makes investors jittery

New tire factory marks Apollo Tyres expansion

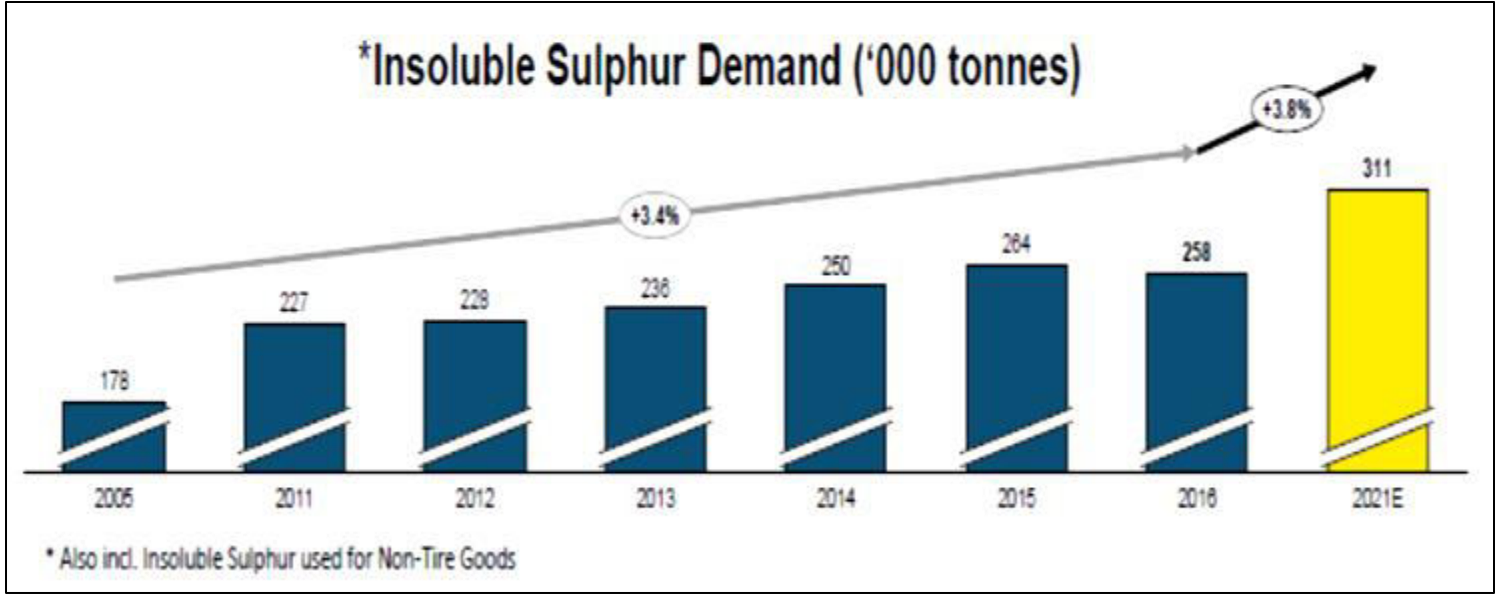
With factories running full, Ceat hikes FY22 capex by 40%

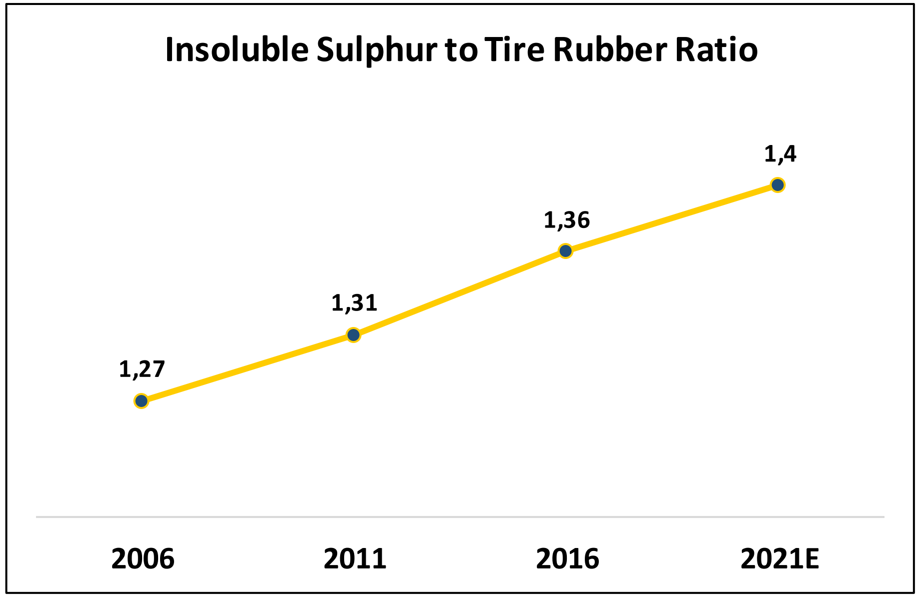
Yokohama Sets Big Goals to Grow Through 2023

Continental expands truck tyre manufacturing capacity at Modipuram plant

Radialisation Effect

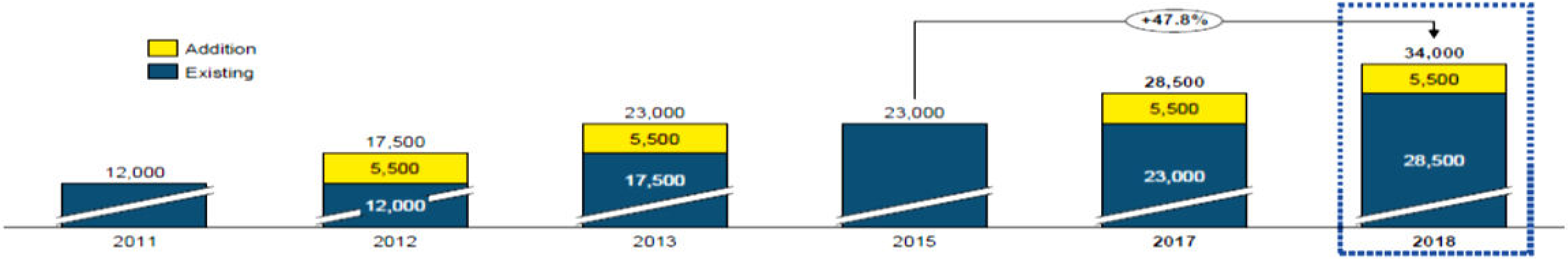
- **Growing emphasis on lowering emission levels and reliance of fuel efficiency vehicles has accelerated the trend towards more efficient radial tires as against traditional bias tires.**
- **Increase in Automation in Tire Industry and Higher Performance Expectation from Tires will also drive the demand of Insoluble Sulphur**
- North America is the largest market for Insoluble Sulphur with potential for growth to increase share.
- Insoluble Sulphur requirement is increasing at a fast pace in Asia which is a High Growth Market.
- **The Indian market for Insoluble Sulphur is growing more than the growth rate for the tire industry due to increasing share of radial tire in commercial vehicles which consume more Insoluble Sulphur.**
- The passenger car tire segment has radialisation of over 98%, while its only 35% in truck and bus segment and 40% in light commercial vehicles tires.





Source: Notch Report

Continuous Capacity Expansion to meet demand



Product Name	Annual Capacity (MT)	Location	No of lines
Insoluble Sulphur	12,000	Dharuhera (Haryana)	2
Insoluble Sulphur	22,000	SEZ Mundra (Gujarat)	4
Sulphuric Acid/Oleum	46,000	Dharuhera (Haryana)	1

Product Name	Upcoming Capacity Expansion
Insoluble Sulphur	▪ Expansion of Insoluble Sulphur Capacity by 11,000 MT ▪ Expansion in 2 phases of 5,500 MT each
Sulphuric Acid	▪ Expansion of Sulphuric Acid Capacity by 42,000 MT ▪ Total Capacity of Sulphuric Acid would become 88,000 MT

- Capital investment would be of ~INR 216 Cr. including Working Capital of INR 7.5 Cr.
- The Project is proposed to be funded by a mix of Loans and Internal accruals with a debt equity ratio of 2:1

Competitive Landscape

- There are only 4 major players in the world who command 90% of the global market share.
- Eastman chemicals, USA has 70% of the global market share, OCCL, and Shikoku chemicals, Japan share 10% market share each.
- There is an upcoming player, China Sunshine who serves domestic Chinese market and has not been approved by tire manufacturers outside China.
- **While there is no significant differentiation in the products of these companies, OCCL bets on the fact that they provide customers and geographies an alternate supplier. Usually customers need 1-2 suppliers ready to avoid any supply chain issues in production.**
- Insoluble Sulphur is comparatively smaller percentage of revenue for other players than OCCL.

High Entry Barriers

- Niche business with guarded technology.
- Exhaustive approval process: It would take at least 2 years of R&D, plant set up and another 24 months of gestation period to get approval from customers.
- Customers usually need 1-2 suppliers ready to avoid any supply chain issues in production.

- Capacity addition at global level is seen only from China Sunshine and OCCL. Cumulative capacity of OCCL and Chinese company would add around 12-13% to the overall global capacity.
- No new/ fresh capacity expansion for IS has been announced by competition. Capex projects which are already announced are continuing.
- The overall pie is merely growing at 3-4%. Entry of any new player will reduce the returns for all the market participants in the industry which deters new entrants from entering this business.
- **OCCL mostly caters to existing customer's increased demand by taking a share of the growing pie and not by taking anybody else's share. OCCL has increased its global market share from 3% in 2006 to 10% by 2020.**
- **The management is eyeing to gain foothold/market share in the markets where it has no/ low presence and aim for reasonable market share. OCCL has ample scope for growth as it has no/low presence in around 35%-40% of the global markets.**

Diversified Clientele

Services over 40+ Customers having presence in 21 countries across the globe

Nearly 80% of the revenue is derived from clients of over 5 years and more.

Financial Analysis (1/2)

	FY11	FY12	FY13*	FY14*	FY15*	FY16*	FY17*	FY18*	FY19*	FY20*
Operating Revenue (INR Cr.)	159.00	218.00	287.00	331.00	347.00	311.00	332.00	369.00	432.00	387.00
Operating Profit (INR Cr.)	47.78	55.75	56.50	68.92	68.19	77.91	87.58	102.00	123.00	105.00
Operating Margin (%)	32.28	27.51	21.67	22.35	23.60	26.87	27.84	28.94	31.17	29.83
Profit after Tax	37.38	31.46	27.63	40.49	48.29	49.52	51.23	56.82	75.13	73.14
Net Margin (%)	23.51	14.44	9.61	12.24	13.93	15.92	15.45	15.41	17.39	18.91
Cash From Operating Activities (INR Cr.)	29.28	29.91	32.31	52.71	70.34	69.59	81.52	93.74	93.33	115.00
Debt to Equity	0.45	0.79	0.77	0.58	0.44	0.30	0.33	0.32	0.32	0.32

* - Consolidated Values

- Revenues of the company have been growing at a **CAGR of 10.39% from FY11 – 20, more than twice the overall industry growth.**
- Operating profits and net profits have grown at a CAGR of 9.14% and 7.74%.
- While the company has not been able to grow its profits at a higher rate than its revenues, both operating and net profit margins have been stable.
- **Operating and net profit margins have been above 25% and 15% in each of the last five years.** This is a testament to the company's pricing power.
- OCCL has been able to pass on its volatile raw material costs to its customers through quarterly contracts. This has been one of the major factors behind the company's stable and high margins.
- **Cumulative operating cash flows for last 9 years are INR 667.73 Cr. while net profits are INR 491.09 Cr. only.** The net profits have been getting converted into cash flows which shows no accounting gimmicks.
- The company has a healthy balance sheet with a debt to equity of 0.32. We expect the ongoing capex to put a stress on its margins and increase the debt to equity of the company.

Financial Analysis (2/2)

	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Cash EPS (INR)	36.30	30.55	26.84	39.32	46.90	48.1	49.76	55.19	75.21	73.21
ROCE (%)	26.55	22.11	17.21	19.62	20.09	19.64	17.70	18.37	21.96	15.61
ROE (%)	29.84	20.88	15.79	19.57	19.77	17.49	15.22	14.89	18.39	15.74
ROIC (%)	24.76	16.07	12.96	17.06	16.11	17.10	12.40	12.99	14.95	17.91
Inventory Days	35.76	37.95	60.49	52.33	51.27	57.59	47.86	42.70	42.64	45.43
Receivable Days	53.21	60.20	67.79	63.31	65.99	71.26	75.82	80.64	71.89	75.73
Receivables as a % of sales	18.20	20.78	19.73	19.53	19.48	19.59	25.35	21.95	20.64	18.43
Asset Turnover	0.76	0.71	0.74	0.82	0.79	0.69	0.63	0.63	0.68	0.55
Return on Assets (%)	17.88	10.29	7.15	9.99	10.99	10.97	9.72	9.65	11.90	10.49

* - Consolidated Values

- The company has been able to **grow its earnings per share on a CAGR of 8.11% over the past 9 years.**
- The return ratios have been volatile owing to the continuous capex and slowdown in auto sector. However, one should note that ROCE has never gone down below 15% which shows the efficiency of its business model.
- **Inventory days have been declining and has been in the range on 42 – 47 days. Receivable days have been in the range of 50 - 80 days. Receivables as a % of sales have been witnessing a declining trend over the past four years.**
- We expect the asset turnover to improve once the ongoing capex and de-bottlenecking measures are completed.
- OCCL's plant performance has been healthy over past few years with healthy capacity utilisation levels. Capacity utilisation post capacity additions have also been healthy.
- While currently the capacity utilisation has moderated given the auto sector slowdown, the same is expected to pickup gradually.

Q3 FY21 Update

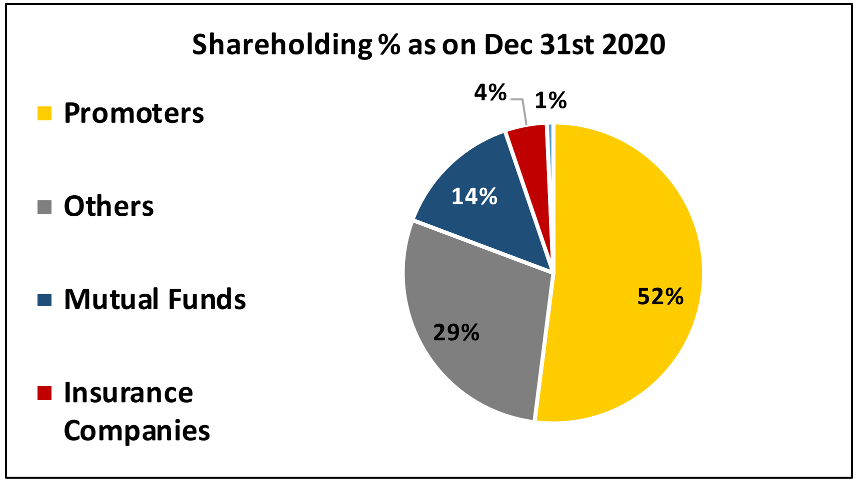
	Q3 FY20	Q2 FY21	Q3 FY21	Q-o-Q (%)	Y-o-Y (%)
Revenue (INR Cr.)	90.18	90.50	117.00	29.28	29.74
Operating Profit (INR Cr.)	23.97	32.49	40.81	25.60	70.25
Operating Profit Margins (%)	26.58	35.90	34.92	-	-
Net Profits (INR Cr.)	16.79	22.06	29.57	34.04	76.11
Net Profit Margins (%)	18.61	24.37	25.31	-	-

- **The management expects the phase one of the 5,500 tonnes per annum insoluble sulfur line and the 42,000 tonnes per annum sulfuric acid line in Dharuhera to be commissioned by July 2021.**
- INR 100 Cr. have been spend so far from phase 1 capex. Out of which INR 55 Cr. was debt. Cost of debt is in the range on ~7-7.5%.
- Capacity utilization for the quarter was 90%.
- 60% of the revenue was from export and the remaining 40% was from domestic market.
- The total borrowing stands at about INR 163 Crores as on December 31, 2020, this includes working capital borrowing of ~ INR 40 crores. and the total investment would be around INR 150 Crores. This includes cash as well.
- The management aspires to have ~10% market share in North America in 2-3 years from less than 5% now.
- Self- sufficiency of steam, captive solar power in Daruhera plant and usage of gas in Mundra plant would further help drive down the power and fuel costs.
- Since power and fuel happens to be around 9-10% of the sales, power cost optimization to aid margin improvement.

Management Analysis & Shareholding %

OCCL is led by Mr. Arvind Goenka who has transformed the company into a global supplier of Insoluble sulphur and a domestic leader in this product category. Under his leadership, the management has made proactive investments to evolve, innovate and enhance product stability and performance.

Mr. Akshat Goenka, son of Arvind Goenka, joined OCCL in May 2010. He is spearheading OCCL's transformation into a future ready, high-performance organization. He led the expansion at Mundra and ensured successful completion of the project in record time. He is actively involved in making the product portfolio robust and capable to meet future requirements of the customers. He was also responsible for turning around the subsidiary in less than 3 years and made it profitable.



Promoter Shareholding : Current shareholding of promoters in the company is 51.8% (December 31st, 2020). Promoter shareholding has increased by 2% in the past two years.

Management compensation: Management compensation has been in line with the ceiling limits of 10% of net profits. Both the managing directors have been taking 7% of net profits in last 5 years.

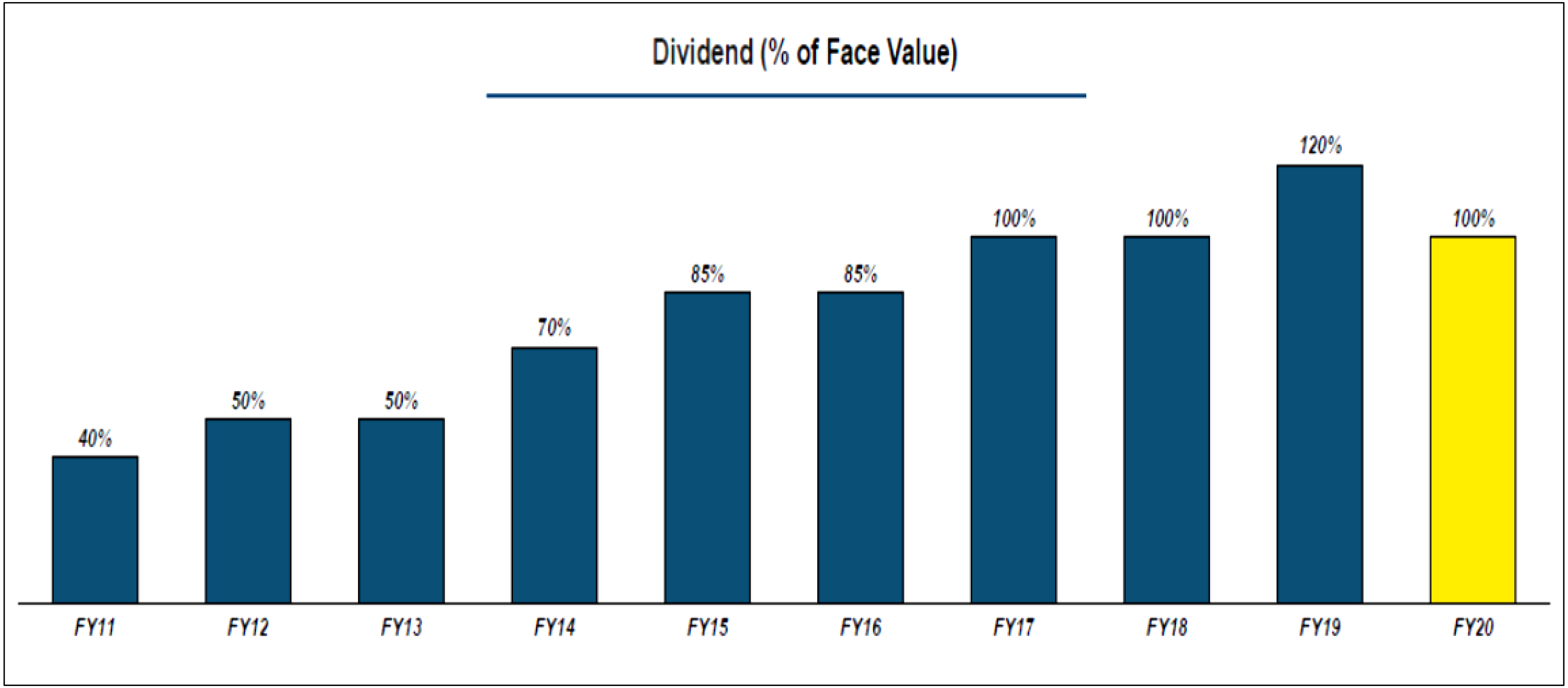
Capital allocation record: The management has a consistent track record of executing successful projects from 1994 to 2020. Few of the projects have been executed ahead of schedule and under budget. Management has been prudent in not going after other specialty chemicals because every specialty chemical needs to have its separate supply chain and offers very few financial synergies which reduce overall returns on capital. OCCL has been lending money (5-6 Cr) to its subsidiary Schrader Duncan Ltd as they were trying to make it profitable, but these are not interest-free loans. Duncan has paid back all the outstanding loans to OCCL with interest as of March 2019 and the company has become profitable.

Shareholder communication: Adequate

Pledged Shares: Nil

Consistent Dividend

The Board of Directors has declared an Interim Dividend for the Financial Year 2020 2021 of INR 4/ per equity share of Rs.10/each (40% of FV)



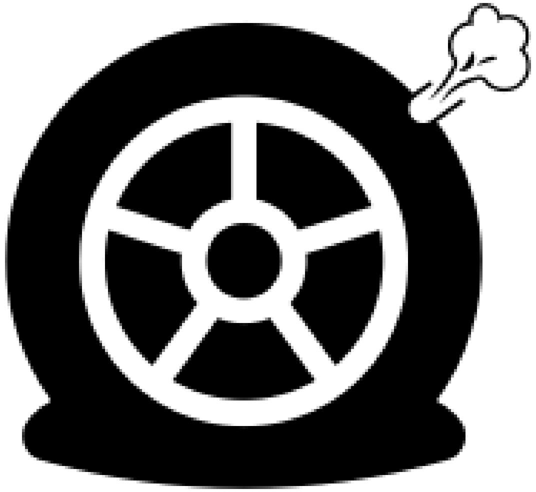
Sources of Risks

Product Concentration

Nearly 82% of OCCL's revenue is derived from the sale of insoluble sulphur which results in high reliance of the company on a single product. Additionally, the majority of demand for insoluble sulphur is derived from the automotive tires, resulting in significant reliance on a single sector for demand.

Volatility in forex rates movements

OCCL derives significant share of revenues from export sales thus exposing the company to foreign exchange fluctuations. However, the risk is partially mitigated as the company has a policy to hedge nearly 75% of its net exposure for the forward 6 months using forward contracts.



Further slowdown in Auto Sector

The automotive sector and as a result the tire sector has witnessed significant headwinds due to the macroeconomic slowdown in FY2020 with the same being compounded by the Covid-19 led restrictions and subdued economy. The domestic and the global tire industry witnessed contraction in sales volume in FY2020 and the trend is expected to continue in FY2021 as well.

Project Execution Risk

OCCL is undertaking an INR 216 Cr. capacity expansion project for increasing it's IS capacity. There is a delay in the project execution owing to the slowdown in the automotive sector and the Covid-19 led lockdowns, though no cost over runs are envisaged. The project being large, exposes the company to project execution risks

Future Outlook

Let’s assume we are in March, 2022, with OCCL operating with optimum capacity utilization of 90% plus in its existing business coupled with revenue of INR 60-70 Cr. due to Phase 1 capex commissioned by July 2021. Operating margins will improve to 28-32% due to operating leverage.

Revenue in FY22 is expected to be around INR 538 Cr. (468+70) with operating profit of INR 172 Cr. and net profit of around INR 129 Cr. With equity capital of just INR 10 Cr. (only 1 Cr. shares, FV = 10); net profit of 129 Cr.; EPS of FY22 will be around 129; current stock price is 900, OCCL will be trading at a PE of 7.7 which is grossly undervalued compared to industry PE of 21.

2017 was a peak year for auto industry. 2018 and 2019 was a downturn and 2020 was the year of Covid-19. 2021 is showing recovery in auto cycle. Auto cycle normally lasts for 4 years. We believe we are at the start of another uptrend in auto cycle. One of the major reason why we have recommended and included some auto ancillary companies like Suprajit Engineering, Precision Camshafts and Minda Industries in our Game Changer portfolio.

In India, there are two key players operating in the tire chemical industry – NOCIL & OCCL. Even though NOCIL has a diversified product portfolio, they face intense competition from Korean and Chinese players. Its profitability is dependent on dumping duty rules by the government. If anti-dumping duties are taken off, NOCIL will face huge pressure on its margins.

OCCL operates in a unique product category and has a guarded technology. With its new capacity to be commissioned by next financial year, the company stands to exploit the opportunity in front of them especially in high growth markets like North America and Asia.

The improvement of the credit rating of the company from BBB in 2008 to AA- in 2020, serves as a piece of vital evidence that the company has been performing well financially & operationally.

Shift towards utilization of radial tires and stable demand for rubber are the main drivers of growth. Tire manufacturing is being shifted to developing countries like India and China as major tire manufacturers are trying to cut the costs. Moreover, there is anti-dumping duty for Chinese tires in India. Thus, OCCL is strategically placed to capture the growing pie of the global market as well as India. Management is also innovating different grades of Insoluble Sulphur to augur the future growth opportunities.

We believe OCCL will continue to be a compounding machine.

Statutory Disclosure

SEBI Research Analyst Registration No. : INH200006451

1. At the time of writing this article, **the analyst have no position in the stock** covered by this report.
2. The analyst has not traded in the recommended stock in the last 30 days.
3. The research analyst does not have any material conflict of interest at the time of publication of the research report.
4. The research analyst has not received any compensation from the subject company in the past twelve months.
5. The research analyst or its associates has not managed or co-managed public offering of securities, has not received any compensation for investment banking or merchant banking or brokerage services nor received any third party compensation. The subject company was not a client during twelve months preceding the date of distribution of the research report.
6. The research analyst has not served as an officer, director or employee of the subject company.
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8. The research analyst or research entity or its associates or relatives does not have actual/beneficial ownership of one per cent or more in the securities of the subject company, at the end of the month immediately preceding the date of publication of the research report or date of the public appearance.
9. The analyst does not own more than 1% equity in the said company.