Quarterly Results and Conference Call

14th Nov, 2019

Rain Industries Limited

(Formerly Rain Commodities Limited)

KeyData	
Industry:	Metal
CMP:	Rs.105.6
MarketCap(Cr):	Rs. 3551
52-Weekhigh/low:	Rs.197/77
InvestmentHorizon:	2-3years
Outlook:	Positive

Shareholding Pattern	
Promoters:	41.10%
FII:	14.01%
Mutual Funds:	0.93%
Public:	43.96%

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The previous quarter results did provide us with signs of business recovery. This quarterly result did corroborate the view and further recouped our confidence in the business.

After listening to so many conference calls of Rain Industries Ltd. since the time of initiating coverage (2016), today was one of those times which gave us a sense of comfort and assurance from the management that the business is expected to perform well in the coming quarters. Mr. Jagan Mohan Reddy sounded very confident on the two new expansion projects and given his conservative nature it gave us a lot of assurance and makes us believe that all problems are behind for the company. Going forward, with no major Capex on line, the path seems to be much clearer now with more positives than negatives for the company and huge cash piles expected to be accumulated on the Balance Sheet to pay off the debtand also earnings increases to improve the Debt to EBITDA ratios

The results exhibited:

i. **Margins and EBITDA of Carbon Segment** improved significantly and beyond our expectations. The margins improved from 12.6% in Q2 2019 to 18.7% in Q3 2019. The management guided it to be sustainable and expected to improve.

ii. There was a **one-time expense** of Rs.107 crores towards closure of Netherlands plant as also highlighted in the previous update. This actually dragged down the bottom line. If one excludes that then the Adjusted Net Profit rose by 24% qoq to 175cr

iii. **Strong Cash Flows:**In the current scenario also, the company managed to generate healthy cash flow, which is expected to continue in coming quarters too. There is a reduction in prices across all products. This has resulted in reduction in working capital requirements and increased cash flow from operations.

iv. The **margins of Advanced Carbon Material** got impacted because of weakness in pricing and demand from end user industries.

Decrease in Sales Volume:

The decrease in sales happened mainly due to delay in few shipment timings and reduction in selling price of carbon products especially CPC. The important point to note here is that being a convertor of raw materials, decrease in selling price doesn't affect Rain until the convertor margins are intact. Due to sharp reduction in raw material prices, we are seeing the margins returning to normal levels. Hence, reduction in sales is not a concern to the extent that it does not mean reduction in demand.The results show thatEBITDA and margins improved significantly and cash flows remained steady. Rain supplies to top notch aluminum players globally. So, even if aluminium cycle isn't performing well, Rain's volume wouldn't get impacted much because it is expected that bigger players would producealuminium at steady rate and this is depicted in the below table:

	Q3 2019	Q2 2019	Q3 2018
Norsk Hydro (kmt)	522	486	497
Alcoa (mmt)	0.7	0.7	0.9
Century Aluminium (tonnes)	198543	203380	182926
Rio Tinto (kt)	789	804.78	812.67
	Q2 2020	**Q1 2020**	**Q2 2019**
Hindalco (kt)	328	320	326

Addressing the Supreme Court Ban

Another concern during the current quarter was that the Supreme Court dismissed the case about allocation of GPC to the new plant in SEZ. In a situation like this, when competitors are perplexed on how to go ahead and whether to expand or not, Rain has announced that in order to run the plant efficiently, the company has developed an alternate and patented new raw material called ACP which has no import restrictions and received all environment clearances. The company plans to set up two plants of ACP, one in India and the other in the US. Further, it would process ACP to make CCP which would be used by aluminium smelters. The product is said to be very cost competitive along with quality assurance. The raw material dynamics of ACP is more favourable than GPC as guided by management. It's more of a customized product and offers unique advantage to anode producers such as less power requirement. The development of this product is happening since 2011, has been tested extensively and the management is of the view that this product could prove to be a real differentiator in the long run for the company.

Profitable when others are losing money

There is no second thought on the fact that only market leaders have the ability to retain margins during downtime. The results of Goa Carbon and Rain Industries CPC division actually support the view that market leaders retain margins when the competitors lose money.

Rain Industries Ltd. (CPC Division)

(Rs. in crores)	Sep (2019)	June(2019)	Mar (2019)
Revenue	681.2	873.6	872.7
Estimated EBITDA/tonne (in $)	54	38	40.8
Estimated EBITDA (in Rs.)	127.99	109.94	102.15
EBITDA Margins	19%	13%	12%

Goa Carbon Ltd.

(Rs. in crores)	Sep (2019)	June(2019)	Mar (2019)
Revenue	101.49	138.86	129.09
EBITDA	-9.65	-2.36	-9.20
PAT	-13.77	-5.02	-8.79

Conference Call and Result Highlights

The management highlighted the following in the conference call:

1. **Carbon Segment**

   i. **CPC:**

   - **Volumes and Margins**

The CPC volumes and per ton realization declined in the current quarter. With decrease in revenue, EBITDA increased due to improvement in margins. The margin spread expanded in the current quarter after a prolonged overhang of high cost raw material inventory that was dragging the bottom line. The CPC spread increased to ~$54 per tonne from estimated ~$38/tonne in the previous quarter.

   - **New Expansion Update: Vertical Shaft CPC**

The cost of setting up this plant has increased from the planned ~$66 million to ~$71 million This is on account of superior technology. It is setting up ammonia scrubbing technology which is 3 times more costly than traditional lime scrubbing technology. This technology actually produces liquid ammonia sulphate which can be used by farmers as fertilizer. The company would be setting up two New facilities for making ACP (the alternate raw material), one in India and other in US at a combined cost of ~$27 million

Pay Back Period: Even with increase in cost, the management guided that payback period remains the same at 3.5-4 years. The plant would commence in Q2 2020.

Cost: The product would be very cost competitive and offer advantages to anode producers. Basically, they would use refineries bottom to produce ACP. For the Indian plant, they would source it locally and don't have to be dependent on anode grade coke. They use other alternative raw materials.

ii. CTP

CTP volumes increased in the current quarter on account of increased demand in North America and sale to non-traditional markets.

Going forward, ramp up in aluminium smelters in North America and increased demand in Russia would further increase CTP volumes.

2. Advanced Carbon Materials Segment

- **Volumes and Margins**

  There was overall increase in volume qoq but the margins got impacted due to weakness in prices and demand in end user industries. The speciality binders cater to steel industry and downstream markets of steel and graphite. There was a slowdown in these industries.

- **New Expansion Update: HHCR Plant in Germany**

  Delay in Commencement: The plant was expected to commence in Q3 2019. The project got delayed on account of arrival of equipments and also on construction side.

  Pay Back Period: With increase in capex, the payback period is expected to remain same at 4.5-5 years on account of premium quality and ready acceptance of the product as per management guidelines.

  Margins: On comparing similar products sold by Eastman chemicals(USA) and data from other wholesale channels indicate the margins on these resins in range of 22-28%

Quality: It's a highest quality product in the market and the company has been closely working with customers. It's the cleanest white water resin of superior quality with lower cost of production.

Capacity Utilisation: The company would start with utilization rate of 50% and slowly ramp up to 70% and then 90%.

3. Cement Segment

- **Volumes and Margins**
  There was a decrease in volumes and realization in this segment on account of monsoon.

  Going forward, owing to good monsoons this year and bumper harvest, demand from rural areas is expected to increase.

4. Other key guidelines

- The total capex for both plants is ~$164 million out of which $105 million is already incurred. The remaining capex amounts to ~Rs. 600 crores which would be funded through internal accruals.
- The company provided interim dividend of Rupee 1.

5. Financials:

(Rs. In Cr.)	Sept-19	June-19	Sept-18
Revenue	2992.27	3341.5	3492.5
Adj. EBITDA	471.9	450.9	550.7
EBITDA Margin	15.8%	13.5%	15.8%
Profit before Exceptional Items and Taxes	108.5	202.7	280.7
Exceptional Items	-	-	-
Profit Before Tax	108.5	202.7	280.7
Tax Expense	7.6	55.9	91
Net Profit	100.8	146.7	189.6
Adjusted Net Profit	174.9	141.3	197.8
Adjusted EPS	5.2	4.20	5.88

*Adj. Net Profit excludes the one-time expenses.

Going forward, the company is expected to perform well on account of sustainable improved margins and the two new plants coming up next year.

6. Expected Results Going Forward:

(Rs. in crores)	CY 18 (A)	CY 19 (E)	CY 20 (E)	CY 21 (E)
Revenue from Existing Business				
CPC	4574.6	3223	3250	3350
CTP & Other Carbon Products	4993.5	5032	4800	4900
Advance Carbon Materials	3484.4	3257	3400	3400
Cement	908.3	1074	1000	1100
Revenue from New Capex				
New HHCR Plant	0	0	300	400
New Vertical Shaft Calcination Plant	0	0	550	650
Other Income	88.2	69	-	-
Total Revenue	**14049**	**12655**	**13300**	**13800**
Adjusted EBITDA (Existing Business)				
CPC	-	-	600	620
CTP & Other Carbon Products	-	-	1000	1000
Total Carbon Segment	1667.5	1215	1600	1620
Advance Carbon Materials	402.2	363	350	370
Cement	71.4	179	80	90
EBITDA (New Capex)				
New HHCR Plant	0		75	100
New Vertical Shaft Calcination Plant	0	0	100	120
Total EBITDA	**2141**	**1757**	**2205**	**2300**
PBT	995	721	1120	1245
PAT	**581.7**	**466.6**	**760**	**846**
Add – Depreciation			625	625
MaintenanceCapex			-500	-500
Free Cash Flow			885	971

Hence, the stock is now trading at just 4x of the Free Cash flows of CY2020. The above numbers haven't factored in a very high growth in sales and are based on conservative sales growth but still the amount of cash being generated is pretty good. With the major Capex cycle behind us and also based on post management guidance,we believe that there is a high probability that the additional cash would go in reducing the US dollar denominated debt as that has a high rate of 7.25% compared to the Euro loan of close to 3%. This can lead to rerating of the stock by a lot of fund houses. We have already seen a major fund house, ICICI AMC already buying the shares of the company since last few months now.

Overall, we maintain a positive outlook on the company.