

April, 7th, 2017

Orion Engineered Carbons S.A: OEC

Marion HORRY

Sector: Basic Materials

Industry: Specialty Chemicals

Current Price: \$20.30

Target Price: \$27.33

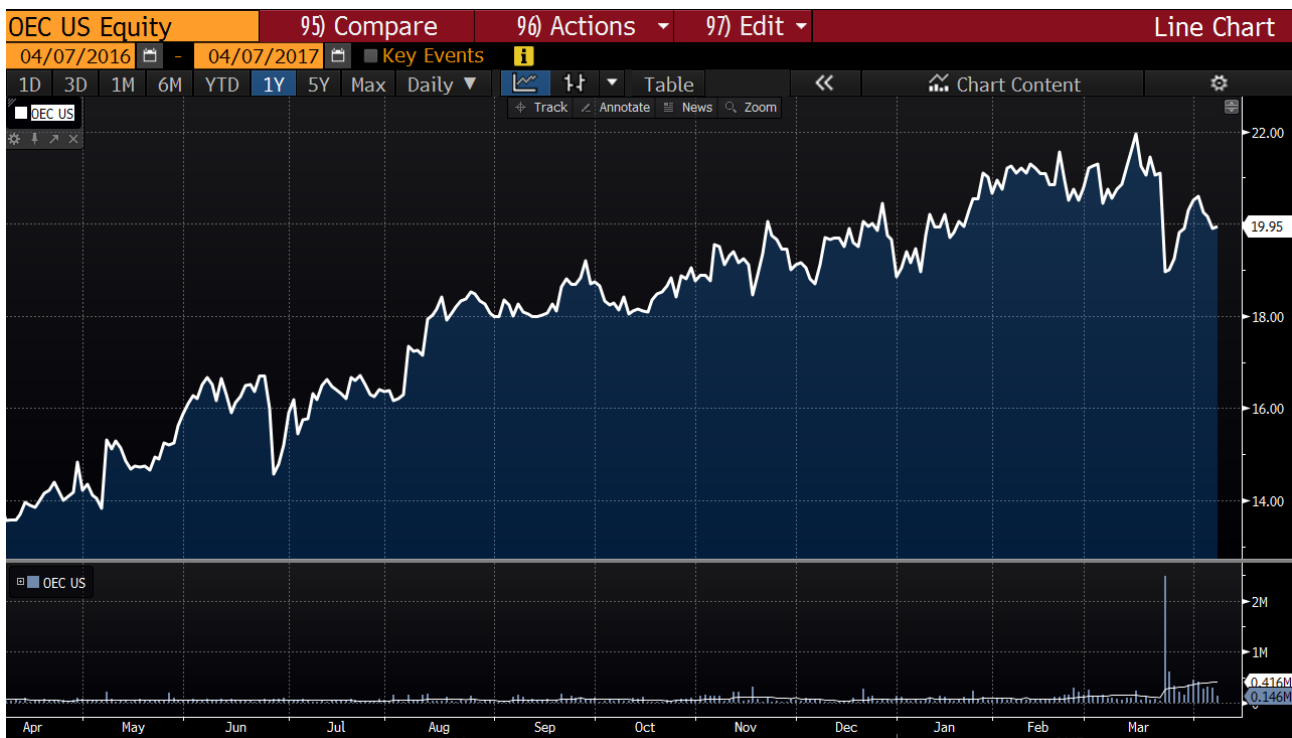
OEC is producing and selling carbon product internationally. More particularly, it sells its product in Germany, United States, South Korea, Brazil, and South Africa, in Europe and in the rest of the world. The two major's product of the company is the rubber carbon black and the specialty carbon black.

BUY

Current Price: \$20.30

Target Price: \$27.33

Market Cap: 1.18B



Thesis:

OEC is one of the leader within its industry. It provided high quality carbon products to customers. They offer 2 types of products the rubber carbon blacks and the specialty carbon blacks. This will ensure its revenue and they will keep put in place profitability strategy in order to keep increasing their margin. This will give them a competitive advantage, and it will increase its free cash flow through the time. I advise to buy OEC because it stock price is currently undervalued. I expect the price of the stock to rise in the future from \$20.30 to \$27.33.

Catalysts:

- **Short Term(within the year):**

The next earning is on May 04, 2017. This can increase the volatility of the stock and help to reach the target price.

- **Mid Term(1-2 years):**

Their strategy to focus on its profitability should continue to give them a competitive advantage.

- **Long Term(3+):**

Between 2016 and 2021, the oil price range should stay between \$50per barrel and \$75/ barrel.

Rubber Carbon Blacks:

OEC is producing carbon black since 1862. To produce it, the company is using Furnace Black Process. This process is basically the injection of liquid hydrocarbon into a flame which permits to the feedstock to decompose and to create carbon black particles. They also used other methods such as Lamp Black Process and Degussa Gas Black Process.

The company produce different types of carbon black such Hard Blacks, Soft Black, Thermal black and Gas Black. All of this type of carbon black have different characteristics.

OEC is selling its Rubber Carbon Blacks under different trademarks: CORAX, ECORAK, CORAX HP BLACKS, CORAX N990, PUREX, SABLE, DUREX 0, and CK 3.

CORAX trademark is offering to customer's different range of standard grades of Furnace Blacks. The ECORAX and CORAX HP BLACK is responding to a large demand in ultra-high performance car tires and fuel-efficient truck tires. On the other side, CORAX HP BLACK is responding to the growing demand for racing and motorcycle tires. DUREX 0 is producing thanks to the Lamp Black Process, this allows the company to guarantee excellent stability of the product. CK 3 is produced using Degussa Gas Black Process to provide high quality product to customers.

Rubber carbon Black is helpful for 2 major's applications:

Tires:

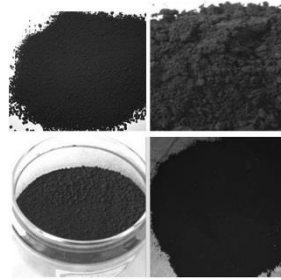
The market is the largest consumers and buyers of Rubber Carbons are Automotive and truck tires. It provides high quality rubber carbon black in order to generated fuel economy, to improve the life of the tires.

Mechanicals Rubber Goods:

The other application of the Rubber are tubes and hoses, belts, extruded profiles, molded products, seals, gaskets, anti-vibration engine mounts, wiper blades, rubber flooring and footwear. By providing high quality rubber carbon, it allows its customers to optimize their production process and to improve their final products.

Since 2013 to 2016, the revenue generated from this product has been between 60% and 70%. In 2016, the revenue generated by this product was 62.5% of OEC total revenue, \$644.2 million. By looking at the gross

profit of the Rubber Carbon block it is possible to see that between 2013 and 2016, the range of the gross profit is 47.6% to 56.4%. Actually, the gross profit on this product is at 47.6%. The gross profit for this period is lower than before because the company had experienced a decrease in their sales of Rubber Carbon Black and an increase in its other products.



Specialty Carbon Black:

OEC is the leader within the industry for the specialty carbon blacks. The raw material is useful for the production of plastic, adhesives for examples.

The company is offering this product under different brands.

Major Brands for Specialty Carbon Blacks

AROSPERSER®	LAMP BLACK	RUSSDISPERSION
COLCOLOR®	NEROX®	RUSSPASTE
COLOUR BLACK	NIPex®	SPECIAL BLACK
CORASOL®	PANTHER	TACK®
DERUSSOL®	PBR	VOSSEN-BLAU®
HIBLACK®	PRINTEX®	XPB

There are 5 majors application for this raw material:

- Printing System,
- Coating System,
- Polymer System,
- Energy Systems,
- Special Applications.

This segment is generating between 29.1% and 37.5% of the total revenue. In 2016, this segment generated \$ 385.9 million of revenue, 37.5%. The revenue growth between 2015 and 2016 is at 1.20%, which represents a change of sale in volume of 12.10%. The gross profit for this segment is between 56.45 and 47.6%. In 2016, the gross profit is at the lowest level at 37.5% because of an increase in cost of revenue during the same period.

Profitability:

Overview								Comp Sheets		Markets		EPS Preview		Ownership		Credit		Custom	
Create Template																			
Add Column								9) Fields		19) Save As									
Name (BI Peers)		Ticker	Mkt Cap (USD)	GM LF	OPM LF	EBITDA to Net Sales LF		NI Mrgn Adj LF											
Median			6.25B	28.36%	14.24%	19.96%		5.78%											
100)	ORION ENGINEERED CARB...	OEC US	1.19B	31.50%	13.28%	19.96%		6.86%											
101)	SAUDI KAYAN PETROCHE...	KAYAN AB	3.24B	18.58%	14.24%	40.75%		--											
102)	YANBU NATIONAL PETRO...	YANSAB AB	9.11B	36.60%	33.45%	48.55%		--											
103)	SAUDI INTERNATIONAL P...	SIPCHEM AB	1.72B	23.36%	14.69%	42.04%		--											
104)	ARKEMA	AKE FP	7.67B	--	6.86%	16.25%		4.54%											
105)	LANXESS AG	LXS GR	6.25B	19.32%	1.83%	8.46%		1.17%											
106)	BASF SE	BAS GR	90.66B	30.95%	11.17%	19.61%		4.69%											
107)	SAUDI BASIC INDUSTRIE...	SABIC AB	80.70B	31.11%	23.32%	37.02%		--											

OEC is producing raw materials of carbon for other company that transform it in a final products. The process of creating the rubber carbon black and specialty carbon are complicated and sophisticated. Thus, OEC has a good competitive advantage compare to its competitors since it has a higher gross profit margin. It means that OEC has lower cost of revenue compare to its competitors. OEC has more money left compare to its competitors after paying the cost of goods sold. It is possible to argue that the margin will continue to be stable through the next periods.

The operating profit margin of OEC shows that they are under the median value than its competitors. It means that the company has less money after paying all of its expenses compare to its competitors. The EBITDA margin shows that OEC is at the median among its competitors. Thus, it doesn't make him more or less profitable than its competitors on this ratio. Finally, by looking at the net income margin, it is possible to see that OEC is generating more net income than its competitors.

Globally, OEC is more profitable than its competitors except on the EBITDA margin were they are at the median value. It is important to notice that the company was able to compensate the rising in oil price in order to keep a good profitability performance.

OEC is actually working on strategy that will provide high margin per segment and also to improve its productions performance.

Capital Allocation:

The ROIC of OEC shows that it has an efficient way to allocate its capital by choosing profitable investment. Thus, its means that the company is invested money that will later on generates returns. By compare the ROIC of OEC to its competitors, it is possible to see that they are allocating their capital on more profitable investment. In fact the competitors of OEC have a ROIC of 0.9% compare to the ROIC of OEC for 15.8%.

	ROIC (NOPAT/IC)	
	<i>History</i>	<i>LTM</i>
OEC	12.9%	15.8%
Competitors	15.4%	0.9%

By looking at the WACC, it is possible to notice that OEC has a higher WACC compare to its competitors. In 2016, OEC has 613.7million of debt. OEC has 15.8 of ROIC and a WACC at 8.8% which means that they are creating value. Finally, OEC is creating \$0.07 for every \$1 invested in capital. Its competitors are destroying \$0.076 for every \$1 dollars invested in capital.

	WACC	
	<i>History</i>	<i>LTM</i>
OEC	8.8%	8.8%
Competitors	8.6%	8.5%

Conclusion:

In conclusion, it is important to notice that OEC is providing to customer's high quality product that they can easily transform into final products. Moreover, OEC is continually working toward progress in order to always improve the quality of their products. Actually, OEC is having a good profitability compare to its competitors, and give them a competitive advantage. Lululemon Athletica Inc. has and will continue to gain more competitive advantage. This competitive advantage will be obtain by its long term strategy to work toward a higher profitability and higher and better operation efficiency. By increasing their margin, the company will be able to create more value.

Orion Engineered Carbons,
S.A. (OEC)

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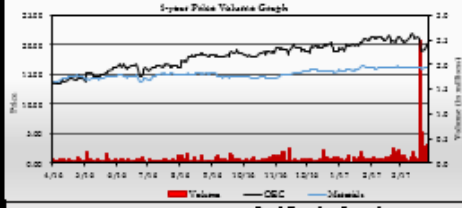
BULLISH

Analyst: **Marion HOBBY**
4/7/2017

Current Price: **\$29.38**
Dividend Yield: **2.7%**

Intrinsic Value: **\$26.88**
Target Price: **\$27.33**

Target 1 year Return: **37.2%**
Probability of Price Increase: **9%**

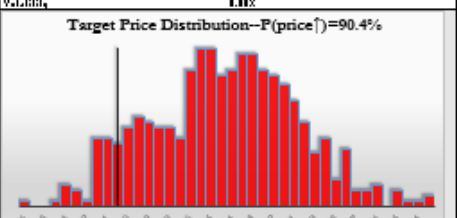


Description	
Orion Engineered Carbons S.A., together with its subsidiaries, produces and sells various black products in Germany, the United States, South Korea, Brazil, South Africa, the rest of Europe, and internationally.	
General Information	
Symbol	Materials
Industry	Chemicals
Listed Exchange	NYSE
First public offering date	May 4, 2017
Estimated Country Risk Premium	2.5%
Effective Tax rate	5%
Effective Operating Tax rate	5%

Market Data	
Market Capitalization	\$1,222.81
Daily volume (mil)	8.16
Shares outstanding (mil)	59.32
Diluted shares outstanding (mil)	58.55
X shares held by institutional	74%
X shares held by insiders	1%
X shares held by hedge funds	1%
X shares held by insiders	2.87%
Short interest	0.87%
Days to cover short interest	0.24
52 week high	\$22.28
52 week low	\$15.52
Levered Beta	1.54
Volatility	0.8%

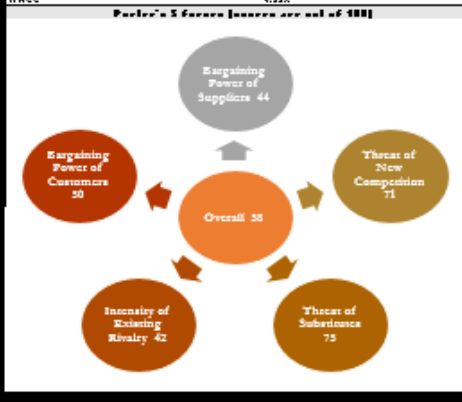
Quarter ending		Revenue		EBITDA	
12/31/2015	-5.3%	2.3%	2.3%		
3/31/2016	-14.2%	-1.8%	-1.8%		
6/30/2016	-8.4%	-1.3%	-1.3%		
9/30/2016	-5.1%	-1.2%	-1.2%		
12/31/2016	2.3%	2.3%	2.3%		
Mean	-6.8%	-1.6%	-1.6%		
Standard error	2.8%	2.8%	2.8%		

Management		Position		Total compensation year		Total return to shareholders	
Chair, Jack	Group Chief Executive Officer	N/M		N/M		N/M	
Managing Director, Charles	Group Chief Financial Officer	N/M		N/M		N/M	
Deputy CEO, Robert	Chief Revenue Officer and	N/M		N/M		N/M	
Executive, Christian	Chief Compliance Officer, Ho	N/M		N/M		N/M	
Managing Director, Jeffrey	Senior Vice President of Op	N/M		N/M		N/M	
Chair, Erik	Senior Vice President of Res	N/M		N/M		N/M	



Profitability		OEC (LTM)		OEC (5 years historical as industry (LTM))	
ROIC	14.4%	31.8%	12.6%	12.6%	
NOPAT Margin	12%	7.2%	12.2%	12.2%	
Revised/Revised Capital	1.1%	1.1%	1.1%	1.1%	
ROE	18.7%	45.7%	15.3%	15.3%	
Adjusted margin	18%	5.3%	18.5%	18.5%	
Revised/Adjusted Book Value	4.2%	15.2%	1.4%	1.4%	
Financial Ratios		OEC (LTM)		OEC (5 years historical as industry (LTM))	
Total Cash/Total Capital	7.4%	7.4%	1%	1%	
Estimated Operating Cash/Total Capital	4.3%	5.2%	N/A	N/A	
Non-recurring Capital/Total Capital	11.3%	17.4%	1%	1%	
Levered Capital/Total Capital	14.3%	75.6%	8%	8%	
Capital Structure		OEC (LTM)		OEC (5 years historical as industry (LTM))	
Total Debt/Common Equity (LTM)	1.52	1.42	1.2%	1.2%	
Cost of Existing Debt	5.5%	5.5%	3.7%	3.7%	
Estimated Cost of new Borrowing	5.8%	5.8%	3.7%	3.7%	
COFC Risk Rating	C	C	C	C	
Unlevered Beta (LTM)	1.33	1.31	1.8%	1.8%	
WACC	4.55%	4.1%	5.1%	5.1%	

Sensitivity Attribution Analysis	
Revenue	22.0%
Operating Expense	27.2%
Dividends	0.2%
NPV	0.3%
CAPEX	21.0%
Operating Cash	0.0%



Period		Revenue growth		Valuation	
Year Year					
12/31/2017	-7.3%	12.8%			
12/31/2018	-15.1%	18.5%			
12/31/2019	-19.2%	18.5%			
12/31/2020	-14.3%	18.7%			
12/31/2021	-9.3%	18.8%			
12/31/2022	-7.4%	18.2%			
12/31/2023	-5.2%	14.2%			
12/31/2024	-6.6%	14.4%			
12/31/2025	-1.7%	14.6%			
12/31/2026	8.2%	14.8%			
12/31/2026	2.4%	12.1%			
Collapsing Period	4.1%	12.4%			

Period		Invested Capital		Net Claims		Price per share	
Year Year							
12/31/2017	\$178.35	\$178.35	\$26.54				
12/31/2018	\$184.87	\$184.87	\$27.72				
12/31/2019	\$178.67	\$178.67	\$28.37				
12/31/2020	\$182.36	\$182.36	\$28.25				
12/31/2021	\$182.27	\$182.27	\$28.57				
12/31/2022	\$187.84	\$187.84	\$27.32				
12/31/2023	\$183.53	\$183.53	\$24.33				
12/31/2024	\$185.45	\$185.45	\$25.88				
12/31/2025	\$176.38	\$176.38	\$27.35				
12/31/2026	\$178.32	\$178.32	\$28.33				
12/31/2026	\$176.33	\$176.33	\$28.72				
Collapsing Period							