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Paper Products Ltd

EQUITY REPORT

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Paper Products Ltd (PPL), a leading manufacturer of primary consumer packaging and labelling materials in India is well poised to benefit from the projected growth rate of 15% in the flexible packaging industry. Further, its consistent emphasis on improving the NASP initiative will also improve its contribution to the overall revenue generation in the coming fiscals.

Investor's Rationale

- PPL witnessed 13.9% QoQ & 19.9% YoY growth in its Q2CY12 net sales, supported by healthy demand from clients as well as the phased expansion coming on stream at the end of Q1CY12. Further, PPL's throughputs and efficiencies in the various plants are likely to witness significant growth in EBITDA to cross ₹1,250 million mark by CY13E.

- PPL'S plants are strategically located near its customer base manufacturing proving advantages for both the parties. With the growing demand, and with green-field & brownfield capacity expansion, PPL's revenues are likely to enhance in the coming years. Further, on account of continuous upgradation of technology in line with international trends and innovative packaging solutions, PPL is a preferred supplier to all major brands like HUL, Britannia, Cadbury, Dabur etc.

- PPL commands a 65% market share in the high-end flexible packaging industry in India, through reputed clientele like HLL, Colgate and Nestle etc. With the constant and increasing demand in the packaging industry, a wide spread of customers & a distributed product portfolio, PPL is quite confident to gain advantage from the projected growth rate of 15% p.a. in the flexible packaging industry.

- The company continuously updates its technology base by replacing old equipment's with contemporary technology with major improvements in product quality, reduce waste and high throughputs. This provides the end customer with superior flexible packaging solutions and thus in return augments its growth.

- The capacity enhancement expansion program of PPL will improve its overall throughput and operating efficiencies, which in turn will improve the top-line of the company. Further, its intended organizational measures to accelerate the NASP efforts will boost its overall profitability.

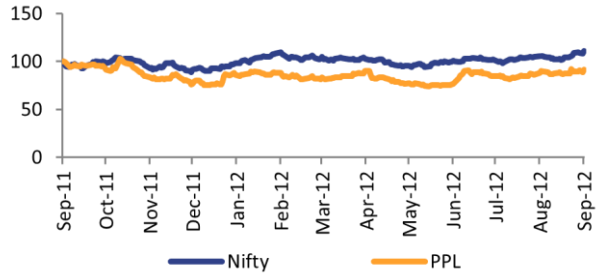
Market Data

Rating	**BUY**
CMP (₹)	72
Target (₹)	**92**
Potential Upside	~28%
Duration	Long Term
52 week H/L (₹)	85.0/58.0
All time High (₹)	99.8
Decline from 52WH (%)	15.2
Rise from 52WL (%)	24.3
Beta	0.3
Mkt. Cap (₹ bn)	4.5
Enterprise Value (₹ bn)	4.5

Fiscal Year Ended

C/Y Dec	CY10A	CY11A	FY12E	FY13E
Revenue (₹mn)	7,123.3	8,109.8	9,227.4	10,546.7
Net Profit(₹mn)	481.2	526.0	604.4	722.5
Share Capital	125.4	125.4	125.4	125.4
EPS (₹)	7.7	8.4	9.6	11.5
P/E (x)	9.4	8.6	7.5	6.2
P/BV (x)	1.5	1.4	1.2	1.0
EV/EBITDA (x)	5.8	4.7	4.1	3.5
ROE (%)	16.4	16.0	16.2	16.8
ROCE (%)	14.6	17.8	19.1	20.2

One year Price Chart



Shareholding Pattern	Jun'12	Mar'12	Diff.
Promoters	63.70	63.70	-
FII	0.11	0.11	-
DII	5.84	5.73	0.11
Others	30.35	30.46	(0.11)

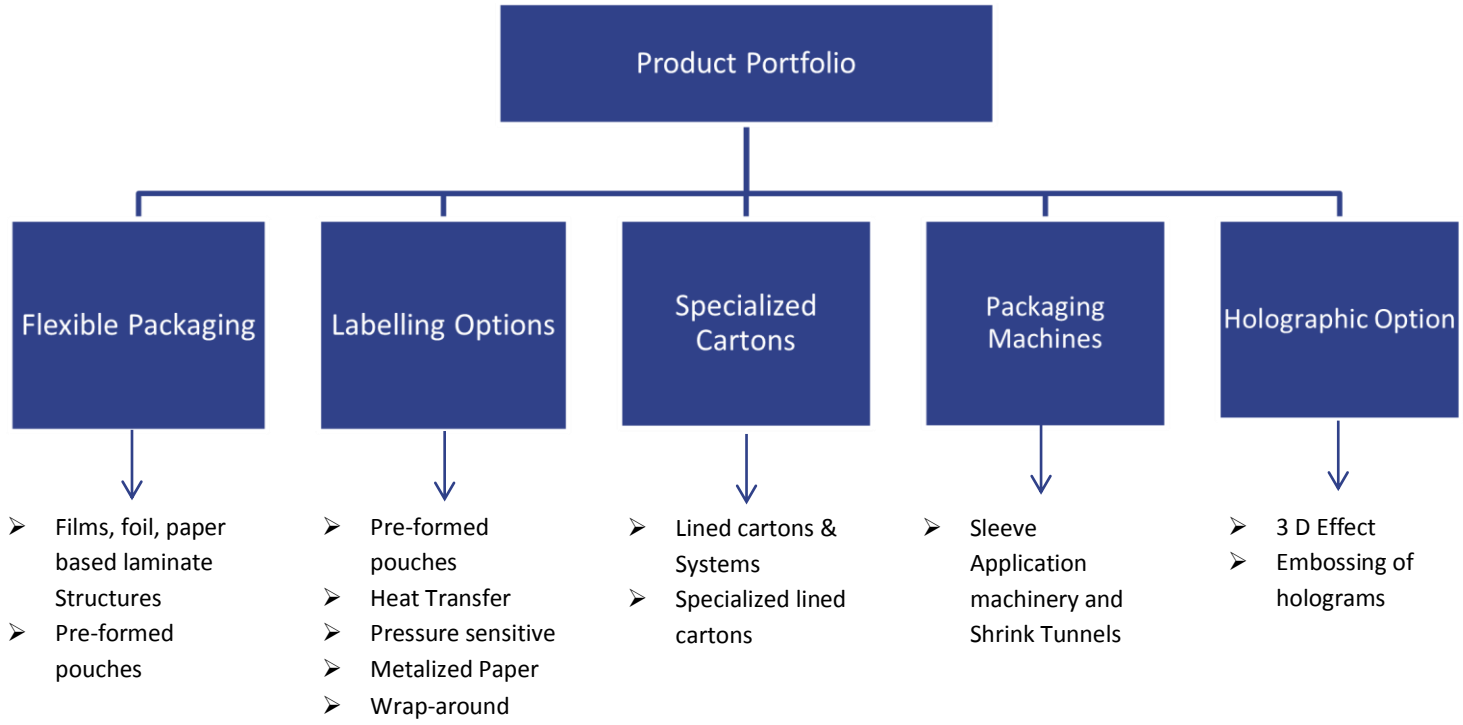
Paper Products Ltd ~ 65% market share in the high-end flexible packaging industry in India

Since 1999, PPL is a joint venture with the global packaging major, Huhtamaki Oyj, Finland who holds 60.8% of the equity capital. Huhtamaki is one of the world's top ten consumer packaging multinationals.

Paper Products Ltd (PPL), incorporated in 1950, is a leading manufacturer of primary consumer packaging and labeling materials in India. PPL is a member of Huhtamaki Packaging Worldwide and is a leading manufacturer of flexible packaging materials in India. In CY11, Huhtamaki Oyj has increased its shareholding in the company from 58.9% to 60.8%, demonstrating Huhtamaki's confidence in and support to Indian operations. The company, known for its dominance in the consumer packaging industry for the past 7 decades, offers a wide range of packaging solutions that include Flexible Packaging, Labeling Technologies and Specialized Cartons. The company has four fully integrated manufacturing units at Thane, Silvassa, Hyderabad and Rudrapur to meet the packaging needs of almost the entire range of FMCG segments including personal products, personal wash, laundry, foods, healthcare and many other specific specialized uses including anti-spurious packaging. The company commands around 65% market share in the high end flexible packaging in India and caters to a high profile clientele including HLL, Colgate, Nestle etc. PPL is a preferred supplier to all major brands due to its superior quality and innovative packaging solutions at competitive prices.

The growth in the packaging industry in India is mainly driven by the food and the pharmaceutical packaging sectors. The increasing penetration of organized retail such as supermarkets and hypermarkets and increasing preference for branded products has also fuelled the demand for flexible packaging solution. Further, the introduction of foreign direct investment (FDI) in to the Indian retail market will create a platform for the packaging sector to record a sustained growth in the coming years.

PPL's wide range of packaging solution

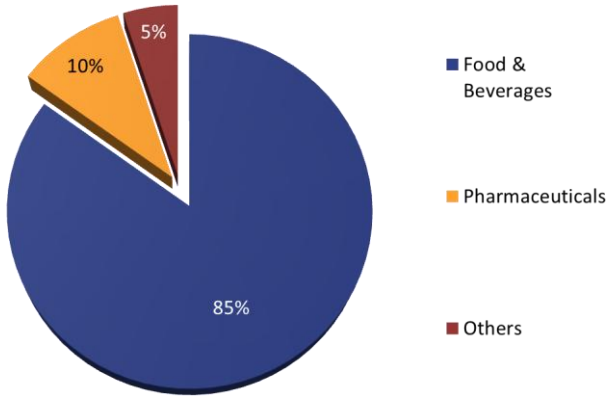


Strong demand in Indian packaging industry to remain resilent

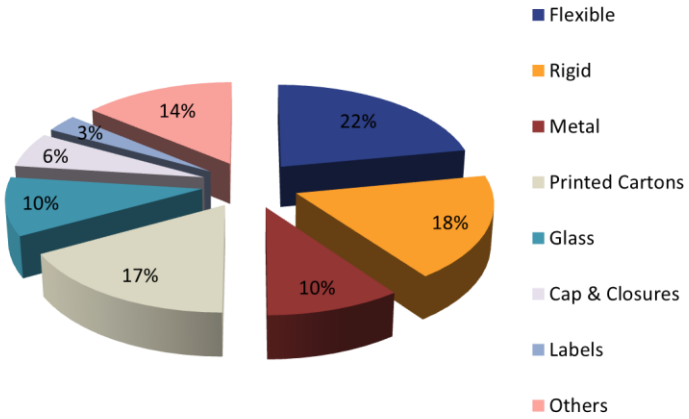
The Indian packaging industry is growing at the rate of more than 15% p.a. and expected to touch €15 billion in the present FY13E.

The Indian packaging industry is growing at the rate of more than 15% p.a. and expected to touch €15 billion in the present FY13E. Further, the growth is expected to double in the coming two years, one of the reasons being the thriving retail sector in India. The growth of the packaging industry in India can be seen mostly in the second-tier cities where packaging plays an important role in the launch of new products. Big giants like Hindustan Unilever Ltd, Nestle India Ltd, ITC Ltd, Procter & Gamble India Ltd, PepsiCo India Ltd, Coca-Cola India Ltd and Dabur India Ltd have also become quiet aggressive in this form of advertisement. Also, the growth in the packaging industry in India is attributed to the increase in the number of joint ventures and partnerships with foreign companies. At present, rigid and metallic food packaging materials account for around 28% of the total packaging material market, while printed cartons, glass, Labels, Cap & Closures and other packaging segments together represent 50% of the total packaging market. Flexible materials such as food packaging laminates, flexible packaging foils, cookies packaging etc. constitute close to 22% of the overall packaging material market, followed by rigid food packaging material segment.

Sector-wise product offerings of the industry



Contribution of different packaging solution



The increasing penetration of organized retail such as supermarkets and hypermarkets and increasing preference for branded products has also fuelled the demand for flexible packaging solution, elevating the role of packaging to an important marketing tool to influence the purchasing decisions in-stores.

PPL commands a 65% market share in the high-end flexible packaging industry in India as it is light, uses less material, and is an efficient packaging format for transportation. It can -- in selective cases -- be made in re-closable format which is easy to store and dispose. Besides, it can protect the product from moisture and contamination, retain aroma and lend gloss and graphic appeal to the consumer. Thus, through reputed clientele like HLL, Colgate and Nestle etc., PPL is well placed to benefit from the projected growth rate of 15% p.a. for the flexible packaging industry.

Focus on NASP to pace the top-line growth

PPL has a partnership with global packaging major, Huhtamaki Oyj of Finland, which holds 60.8% stake in the company. Over a decade, PPL's strong in-house research and development initiatives coupled with those of Huhtamaki have enabled the former to continue its product development

The company aims to put additional thrust on its innovative initiative called NASP, will increase the overall profitability in the years to come

program. For 2012 and the years to come, the company aims to put additional thrust on its innovative initiative called NASP (New Application, Structure and Products). The first objective of NASP is to create new business through finding new applications and markets for existing products and the second objective is to introduce new packaging products and structures not only for new applications and markets, but also to offer new technologically superior solutions which offer cost advantage and add value to the brands being packaged. During 2011, the company made key organizational changes to further strengthen the process, sought newer materials, explored alternate processes and is working on new structures and packaging formats with major customers. It is also working on numerous projects with customers with a global footprint with active help and support from the Global NPD team.

With the company's intended organizational measures to further accelerate the NASP efforts; its overall profitability likely to increase. Besides, the company aims to drive the revenue contribution from the higher margin value-added segments by focusing on innovative and newer products and exploring new markets for profitable growth.

Technological up-gradation support the growth

PPL continuously updates its technology base by replacing old equipment's with contemporary technology with major improvements in product quality, reduce waste and high throughputs.

PPL is doing continuous technological up-gradation aimed at providing the end customer with superior flexible packaging solutions. This helps various large and small FMCG manufacturers to continuously evaluate their packaging solutions that help them reach their products to the end consumer in a wholesome manner. Other initiatives taken by the company includes regular studies on shelf life, impact of material changes in the flexible laminations on barrier and performance characteristics, evaluation of alternate structures etc. which ensures customers in developing appropriate packaging solutions. The company continuously updates its technology base by replacing old equipment's with contemporary technology with major improvements in product quality, reduce waste and high throughputs.

During CY11, new high speed printers and laminators with multiple capabilities were installed into the operations and absorbed successfully. The Company also concentrated on new Coating technologies for sealing, enhancing barriers and improving the performance of the laminations in general. Special laminate structures were successfully developed and supplied for the most sensitive applications i.e. for wet dairy products. New materials like special grades in extrusion lamination, films with lower densities and thicknesses to meet the sustainability objectives of large customers, new pouching formats for improved convenience of the end user, new concepts in reclosable packaging, extension of cold seal applications to bakery products and a wider range of confectionery products were some of the prominent innovations it developed and implemented. The above initiatives enhanced the competitive position of the company and it enjoys a strong reputation regarding quality and technology for their products and services.

Full benefit of expanded capacity will be visible from CY12E

PPL has 4 plant locations namely Thane, Silvassa, Hyderabad, and Rudrapur from where it operates with a combined capacity of 40,990 MT Laminated & Coated Paper, 5000 MT Cartons, 5,400 MT Polyethylene Films and 1000 Films-Metallized. PPL's plants are strategically located near its customer base manufacturing proving advantages for both the parties. In CY11, PPL has raised its installed capacity of laminate/films by 5,600 tonnes (up 15.2% YoY) to 40,990 tonnes. Out 5,600 tonnes, the company has added 2,000 tonnes capacity in CY11 in a brownfield expansion at its Hyderabad plant, due to growing demand from the Southern region, with capital oultay capex of

₹640 million and commercial production commenced in Q2CY11. The remaining 3600 tonnes capacity was added at Rudrapur plant in a green-field expansion with total capex of around ₹380 million. The government's decision to extend the concessional benefits to expansions has encouraged the Company to invest further in Rudrapur. With the additional capacity coming on stream, the overall sales from Rudrapur plant will be higher resulting in a lower overall tax rate for the company during CY'12, as it comes under tax incentive zone with profits exempt from tax for the first five years of operations and only 50% of profits getting taxed in the subsequent five years. Thus, the full benefit of expanded capacity will be visible in CY12.

Installed capacity during CY11

Installed Capacity	CY11 (tonnes)	CY10 (tonnes)
Laminates and Converted, Coated / Uncoated Paper and Films	40,990	35,590
Cartons	5,000	11,000
Metalized Films	1,000	1,000
Polyethylene Films	5,400	5,400

Region-wise Plant Capacity

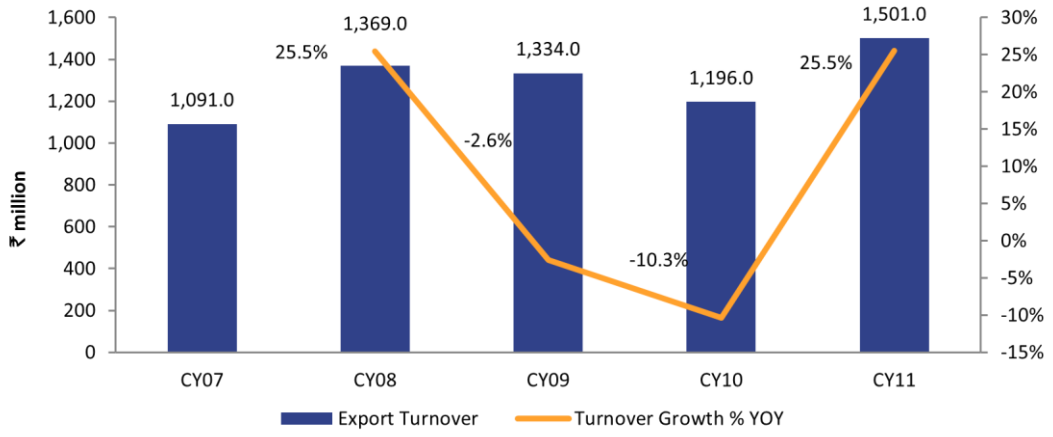
Location	Total CY11 Capacity (tonnes)	Capacity added CY11 (tonnes)	Commercialization started in
Thane	~7,000	-	
Silvassa	~11,500	-	
Hyderabad	~11,500	~2,000	Q2CY11
Rudrapur	~10,990	~3,600	Q1CY11
Total	**~40,900**	**~5,600**	

Expanded business into favourable overseas markets

Exports have increased from ₹1.1 billion in CY07 to ₹1.5 billion in CY11, at a CAGR growth of 13.5%

Consolidating its position as India's most prominent packaging institution, PPL expanded its business into promising overseas markets with a view to benchmark itself with the global competition. The company strongly believes in developing and sustaining long-term relationships with its business partners. Therefore, PPL exports account for around 20% of its revenues. Its International Business Division is set up as a separate group servicing large MNC accounts across 4 continents & over 50 customers worldwide. PPL has customers across Asia, Africa, Middle East, Europe & America. India is a potential source for packaging requirements globally & regionally Development work in this area continues, both directly & with the synergy available as a member of the Huhtamaki group. PPL is a 61% subsidiary of European packaging major Huhtamaki, which is one of the top 10 consumers packaging MNC with a turnover of €2 billion.

Strong export growth across varied geographies



Decent June quarter 2012 performance backed by increased volume growth and healthy demand from the clients

The decent top-line performance of the company in Q2CY12, the earnings at the end of CY12 is likely to exhibit significant improvement.

India's leading manufacturer of primary consumer packaging, Paper Products Ltd. reported sterling numbers for quarter ended June'12 with 19.9% YoY and 13.9% QoQ rise in its net sales at ₹2,680 million. PPL witnessed strong growth in net sales due to 14% volume growth and 5-6% value growth, which is led by combination of improvement in product mix and price hikes. The topline growth was supported by healthy demand from clients as well as the phased expansion coming on stream from the end of Q1CY12. The company is witnessing strong demand growth for packaging coming in from beverages, food processing & personal care manufacturers. On the export front, PPL's International Business Division is set up as a separate group servicing large MNC accounts across 4 continents & over 50 customers worldwide. Its exports, which constitute 17 to 17.5% of the topline continued to grow by more than 20%, on strong demand from South Africa and Middle East and there is bit of slowdown in US and Europe. However, PAT declined by 11.8% YoY while on sequential basis pat grew marginally by 3.5% to ₹134 million, mainly on account high inflationary pressure. PPL has a very strong B/S with almost zero debt and surplus Net Cash. It has very strong operating cash flows. PPL has a history of high dividend payouts of 30%+ which thus gives us dividend yield of +4%.

During CY11, PPL's net sales increased by 13.3% to ₹7,973 million, due to 19% volume growth in export while volumes in domestic flexible laminates and tube Laminates remained static while labeling volumes grew by 25%. The operating profit has inclined by 20% to ₹951.1 million, which in turn led the operating profit margin (OPM) to expand by 67 basis points to 11.9% due to fall in overall expenditure. Further, due to 201% YoY rise in other income and a forex gain of ₹60 million, resulted in 35% YoY growth in profit before taxation (PBT) at ₹624.6 million.

Further, with enhanced focus of PPL on improving its operating efficiencies, expanding the supplier base for critical items, introducing alternate materials, improving equipment reliability etc, PPL's throughputs and efficiencies in the various plants are likely to witness significant improvement, fuelling up bottom-line growth in the coming months.

Balance Sheet

C/Y Dec (₹million)	CY10A	CY11A	CY12E	CY13E
Share Capital	125.4	125.4	125.4	125.4
Reserve and surplus	2,811.2	3,162.9	3,616.8	4,182.6
Net Worth	**2,936.6**	**3,288.3**	**3,742.2**	**4,308.0**
Loan funds	225.3	221.5	218.4	211.8
Deferred Tax Liabilities	52.6	25.2	25.2	25.2
Capital Employed	**3,214.6**	**3,534.9**	**3,985.8**	**4,545.0**
Fixed Assets	1,753.0	1,739.3	1,868.2	2,130.1
CWIP	33.9	158.4	158.4	158.4
Investment	394.5	633.8	747.8	897.4
Net Current Assets	1,033.2	1,003.5	1,211.4	1,359.2
Capital Deployed	**3,214.6**	**3,534.9**	**3,985.8**	**4,545.0**

Profit & Loss Account

C/Y Dec (₹million)	CY10A	CY11A	CY12E	CY13E
Total Operating Income	**7,123.3**	**8,109.8**	**9,227.4**	**10,546.7**
Expenses	6,330.7	7,158.7	8,125.8	9,272.8
EBITDA	**792.6**	**951.1**	**1,101.6**	**1,273.9**
Depreciation	324.0	320.5	339.4	356.3
EBIT	**468.7**	**630.6**	**762.2**	**917.6**
Interest	6.0	5.9	5.7	5.6
Exceptional Item	122.8	0.0	0.0	0.0
Profit Before Tax	**585.5**	**624.6**	**756.5**	**912.0**
Tax	134.8	128.1	181.6	218.9
Extraordinary Item	30.5	29.4	29.4	29.4
Net Profit	**481.2**	**526.0**	**604.4**	**722.5**

Key Ratios

C/Y Dec	CY10A	CY11A	CY12E	CY13E
EBITDA Margin (%)	11.3	11.9	12.1	12.2
EBIT Margin (%)	6.7	7.9	8.4	8.8
NPM (%)	6.4	6.2	6.3	6.7
ROCE (%)	14.6	17.8	19.1	20.2
ROE (%)	16.4	16.0	16.2	16.8
EPS (₹)	7.7	8.4	9.6	11.5
P/E (x)	9.4	8.6	7.5	6.3
BVPS (₹)	46.8	52.5	59.7	68.7
P/BVPS (x)	1.5	1.4	1.2	1.0
EV/Operating Income (x)	0.7	0.6	0.5	0.4
EV/EBITDA (x)	5.8	4.7	4.1	3.5
EV/EBIT (x)	9.9	7.2	5.9	4.9

Valuation and view

PPL is the dominant player in the consumer packaging industry for the past 7 decades with four fully integrated manufacturing units. The company is well placed to benefit from the projected growth rate of 15% in the flexible packaging industry. The decent top-line performance of the company in Q2CY12, the earnings at the end of CY12 is likely to exhibit significant improvement. Besides, the capacity enhancement expansion program of the company will improve its overall throughput and operating efficiencies, which in turn will improve the top-line of the company. At a current CMP of ₹72, PPL is attractively placed at P/E of ~6.3x CY13E. Considering the above aspects, we rate the stock as 'BUY' with a price objective of ₹92 based on P/E multiple of 8x of its CY'13E EPS of ₹11.5, implying potential upside of ~28% for the coming 12 months.

Indbank Merchant Banking Services Ltd.
I Floor, Khiviraj Complex I,
No.480, Anna Salai, Nandanam, Chennai 600035
Telephone No: 044 – 24313094 - 97
Fax No: 044 – 24313093
www.indbankonline.com

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