

Nilkamal Plastics

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,374	NILKIN
	REUTERS CODE
S&P CNX: 2,851	NLKP.BO

13 January 2006

Not Rated

Rs225

Equity Shares (m)	8.6
52-Week H/L (Rs)	240/52
1,6,12 Rel. Perf. (%)	42/53/190
M.Cap. (Rs b)	1.9
Avg. Daily Vol. ('000)	93.9

YEAR END	NET SALES	PAT (Rs M)	EPS (Rs)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES (X)	EV/ EBITDA (X)
3/05A	3,266.6	128.9	15.0	-17.3	15.0	1.6	10.6	9.3	0.8	8.4
3/06E	3,522.6	69.5	8.1	-46.1	27.7	1.5	5.4	9.1	0.8	9.3
3/07E	4,279.6	113.7	13.3	63.4	17.0	1.4	8.1	10.8	0.7	7.1
3/08E	5,298.8	193.8	22.6	70.5	9.9	1.2	12.1	10.4	0.6	5.2

From Commodity Product to Retail Brand

We recently had a meeting with the management of Nilkamal Plastics Ltd to understand its current business and its new venture into Home Furnishing under the brand - '@home'.

Introduction

Promoted by the Parekh family, Nilkamal Plastics is the largest manufacturers of material handling plastic crates and moulded furniture in India. Its products include chairs, sofas, tables and other plastic furnitures.

The company enjoys a PAN India presence with its five manufacturing units located across the country. Further the company has presence beyond India through its subsidiaries in Sri Lanka and Bangladesh. The total installed capacity for moulded furniture stands at 43,996 ton per annum spread across its plants at Pondicherry, Silvassa, Noida, Barjora (W.B.), Sinar.

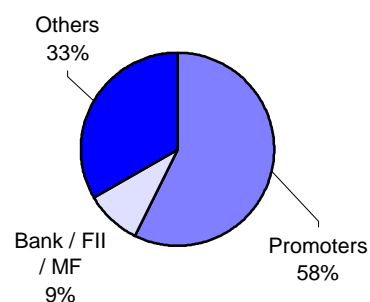
From a plastic moulded furniture company, Nilkamal is transforming its self into home furnishing company.

Key investment arguments

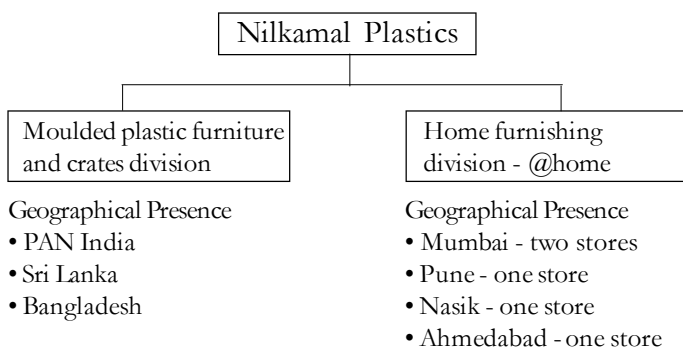
- Transforming from a commodity product company to branded home furnishing company - '@home'.
- Huge demand in the housing sector to act as a catalyst for growth in its retail home furnishing.
- With five @home stores already operational and 48 more stores (including 28 franchise) to be added by FY08, the company is well placed to take advantage of the exponential growth in the organized retailing.
- Strong presence in moulded plastic furniture through its 350 distributors and 5,000 retailers spread across the country.
- We believe that once the retail business of the company achieves breakeven, the PE of the company would be re-rated. The company is expected to post an EPS of Rs13.3 in FY07E and Rs22.6 in FY08E. At CMP the stock discounts FY07E EPS by 17x and FY08E EPS by 9.9x.



SHAREHOLDING PATTERN



Business Model



Future lies here: @home - Home furnishing

Realising the low growth potential in its existing moulded plastic business, the company has identified huge opportunity in the home furnishing business. To tap the same, it is setting up retail stores across various cities within India. This initiative will help the company to transform itself from a commodity product company to a consumer product company.

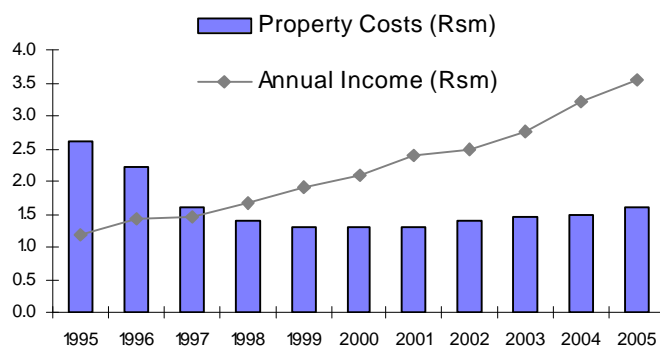
Huge opportunity backed by housing sector boom.

Over the past two years there has been a huge growth in the residential complex. The growth is triggered by fast growing urban population, growth in nuclear families and lower interest rates for home loans.

The urban population in India is growing at 2.3% p.a. as against the population growth of 1.1%. Also, there has been an increase in number of nuclear families. The number of new homes to be added per annum is likely to be c.4.5m.

The demographic change with an expected 60% population in age of 15-54 years by 2010 is one of the highest in the world. Indians are not only earning more but are also spending more. In the recent past there has been a change in the spending patterns of Indians. Increasing disposable income and changing attitudes has resulted in a decline in the average age of the home owner from 40 years to 27-28 years.

INCREASING ANNUAL INCOME



Source: HDFC

We believe the ongoing housing boom would continue and the demand for home furniture which accounts for 10% of the total cost of home would rise.

Huge Opportunity

Line	Products	Rs billion
Plumbing Products	Bathroom Products	50
	PVC Pipes	12
	Marble	15
Painting Products	Paints	67
Carpentry Products	Glass	30
	Furniture*	60
	Locks	13
	Brass Hardware	25
Electrical Products	Lighting	80
	Wires & Cables	25
	Modular Plate switches	10
	Switchgear	10
Total		397

Note: * @home product Source: Company/Motilal Oswal Securities

@home - On its way to get a share of the huge opportunity in home furnishing.

Having identified the opportunity in the readymade home furniture, Nilkamal has taken steps towards getting its share. The company has set up a separate division - @home, tied up with a Malaysian company to provide the readymade furniture and setup five retail outlets in the western region of India. It has entered into a 3 year contract with the Malaysian company for exclusive designs which can not be sold to any other retailer in India.

The company has plans to operate various exclusive home stores in more than 20 different locations across the country in phased manner. The cost of setting up one retail outlet is ~Rs28m (on lease basis). Currently it has five stores in the western region of India - Pune-1, Nasik-1, Mumbai-2, Ahemdabad-1.

Particulars	FY06	FY07	FY08
Capex	150	250	300
Additional No. of Stores	5	9	11

Source: Company / Motilal Oswal Securities

Each store is spread over a 20,000sq.feet of retail space which includes furniture products for bed room, living room, dinning room, kids' room and other home decorative products. The total cost of Rs700m expansion would be funded through debt / internal accruals.

Key differentiator

■ At each of its outlets a customer is assisted by a trained architect who with the help of a software provides a three-dimension look of the furniture once the same is placed at the customers' home. This helps the customer to make quick decision of purchase resulting into higher conversion rate.

■ The company has set up a team of three people who are responsible to come up with new designs which are then sent to Malaysia for its manufacturing. Currently, the company is selling the products designed by the Malaysian company. It has entered into a three year contract with the Malaysian company for not selling its designs to any other retailer in India.

■ As the retail venture would be a new business model for the company much different from its current business, the company has brought in Mr. Raghu Pillai as a CEO of its Home Solutions Retail. This would bring in the professionalism in its venture as Mr. Pillai has a rich experience in retail business. He was associated with RPG as President and CEO of Retail Sector.

Business Model

Own Stores:

The company plans to set up 25 own stores by FY08. The total capex on the same would be Rs700m. It will enter into a nine years lease contract for each store.

The lease rental on a 20000 sq feet store would be ~Rs12m/store p.a. Addition to the lease rental, the company would be incurring cost on its interiors at ~Rs16m/store. This totals to Rs28m/store which also includes security deposit equivalent to six month rentals. Taking the current cost structure the company would breakeven at sales of ~Rs46m/per store (Rs1,27,000/day)

Currently, the company's average revenue per store is at Rs1lakh per store per day from its existing five retail outlets. We expect this to increase going forward to Rs1.75lakh per store per day by FY08 when it will have 25 owned outlets. We believe that by FY08 the division should start making profits.

Franchise Model:

Going forward the company plans to put a franchise model for its @home. It expects to open 28 franchises by the end of FY08. In the first phase, it plans to open 12 franchises by FY07 and the remaining 16 franchise by FY08. We believe that this will help the company to increase its penetration. Setting up of a franchise model would not only provide the company with fixed revenue as royalty income (@15% on per sale of furniture at its franchise outlet) but will also reduce the risk associated to managing a store.

Financials - @home

Particulars	FY06E	FY07E	FY08E
Number of stores	5	14	25
Revenues (Rs m)	60	540	1260
Per store revenue Rs(m)	12	39	50
PAT (Rs m)	-60	-32	75
Net margins	N.A.	N.A.	6.0

Source: Company / Motilal Oswal Securities

Steady existing business - Moulded Plastic

PAN India presence in Moulded Plastic:

Nilkamal has been in manufacturing and marketing of the moulded plastic articles since 1986 and this has remained its main business. Over the years the company has created its brand name by offering wide range of quality products in the plastic furniture segment, which include products like plastic chairs, crates, tables, sofas which are mainly used in marriages and other festive events.

The Rs10b moulded plastic industry continues to be highly fragmented with 30% of the market being addressed by the regional players. However, Nilkamal with its PAN India presence has a largest market share of c.30% of the total Rs10b market. The company has strong network of 350 distributors and 5,000 retailers spread across India. Moreover, with its five plants the company is able to meet the demand arising from all the four regions of the country thereby eliminating the transportation overheads.

Further, the company has set up two subsidiaries in Sri Lanka with 76% interest namely, Nilkamal Eswaran Plastic Private Ltd (NEPPL) and Nilkamal Eswaran Marketing Private Ltd (NEMPL). It also has subsidiary at Bangladesh namely, Nilkamal Padma Plastics Private Ltd.

Moulded Plastic: - A commoditized product

■ Although the company has made its mark in this segment, it has been facing stiff competition due to the presence of unorganized players. This has resulted in the products getting commoditized.

■ Raw material (Polymers) prices have gone which has impacted the operating margins for the company.

■ Moreover, the products design which is the key differentiator can be copied easily by the unorganized player with a time lag of three-six months

Outlook - Moulded plastic

We believe that the stiff competition and inability of the players to pass on the cost push to the customers has resulted in stagnancy within the industry. However, there is a possibility of consolidation taking place with few players exiting the moulded plastic business which could be a positive for the company. The company aims at retaining its leadership position in the area of injection moulded plastic article.

Financials - Moulded plastic division

Over the last two years, the stagnation in the industry and the inability of the company to pass on the cost push due to higher raw material price is evident from its the financial performance.

Rs Million

Particulars	FY04	FY05	FY06E	FY07E	FY08E
Net Sales	3140	3267	3463	3740	4039
Growth	15.9	4.0	6.0	8.0	8.0
EBITDA	378	317	325	357	384
EBITDA					
Margins (%)	12.0	9.7	9.4	9.6	9.5
Adjusted PAT	155	124	117	147	174

Source: Company / Motilal Oswal Securities

Investment Concern

In spite of the huge opportunity available in the retail industry, execution of these retail outlets would be the key factor impacting our projections.

By FY08 the company would be managing 25 stores as against current five stores; at this scale the key factors would be managing the inventory levels and supply chain.

Company does not have a first mover advantage in this segment and faces competition from other players like Durian, Living room, Tangent, Life Style and other unorganized player. With Pantaloon Retail also planning to fore into this segment, we expect the margins could remain under pressure.

Valuation - on a consolidated basis

As the company is venturing into the new business the financial for FY06E would not be comparable to that of FY05. For FY06E, we expect the company to post net sales of Rs3.5b and a PAT of Rs70m which is expected to increase to Rs5.3b and Rs194m respectively by FY08.

We believe that once the retail business of the company achieves breakeven the PE of the company would be re-rated. The company is expected to post an EPS of Rs22.6 in FY08E. At CMP the stock discounts FY07E EPS by 17x and FY08E EPS by 9.9x.

Particulars	FY04	FY05	FY06E	FY07E	FY08E
Net Sales	3,140	3,267	3,523	4,280	5,299
Growth (%)	15.9	4.0	7.8	21.5	23.8
Adjusted PAT	156	129	70	114	194
Margins	5.0	3.9	2.0	2.7	3.7
Equity	85.7	85.7	85.7	85.7	85.7
EPS	18.2	15.0	8.1	13.3	22.6
PE	12.4	15.0	27.7	17.0	9.9



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