

March 11, 2011

Recommendation	Not Rated
CMP	404
Target	NA
Stock Return	NA

Nifty	5,494
Sensex	18,328

Key Stock Data

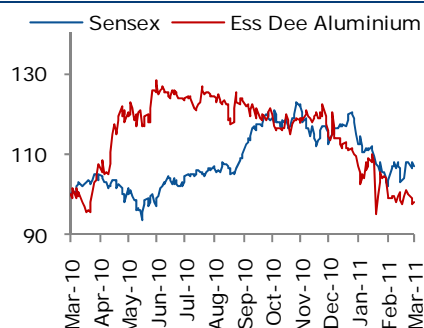
Sector	Packaging
Reuters Code	ESDA.BO
BLOOMBERG Code	EDA IN
No. of Shares (mn)	32
Market Cap (Rs bn)	13
Market Cap (\$ mn)	286
6 mth avg traded value (Rs. mn)	21

Stock Performance (%)

52 - Week high / low	Rs 537/361		
	3M	6M	12M
Absolute (%)	(13.7)	(20.7)	(1.3)
Relative (%)	(7.6)	(18.2)	(8.1)

Shareholding Pattern (%)

Promoters	59.50
FIs & Local MFs	10.64
FIIIs	21.42
Public & Others	8.44

Source: Company
Sensex and Stock Movement

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We met with Ess Dee Aluminium, a leading manufacturer of aluminium foil based packaging for pharmaceuticals, food and FMCG products. The company is well poised to reap in good earnings growth in the next three years based on a) High growth in end-user market and Ess Dee's unique position to cater to those b) Significant capacity addition of Ess Dee c) Stable margin business model. The stock currently trades at an FY12 EV/EBITDA (consensus) of 5.4x on consensus FY12EBITDA of Rs.2.9b. We believe these valuations are at attractive levels given the company's potential EBITDA growth from its volume expansion. High debtor days are our main concern.

High growth in end-use markets

The main customer of Ess Dee aluminium is pharmaceuticals sector; we see this market growing at more than 15% in the next three years. Ess Dee aluminium is uniquely placed to cater to the high end pharma companies which are export oriented, since it is one of the very few US-FDA approved packaging solutions company in India. We learn that this particular high end segment has very high entry barriers due to a) significant capital requirement b) long timeframe (of 4-5 years) to get all necessary regulatory approvals and technology procurement. Ess Dee doesn't see any significant competition in the near future. The other main customers are food and FMCG, both of which we believe would see significant growth of more than 20% over the next three years.

Significant capacity addition till FY13-14

Ess Dee Aluminium expects to increase its production capacity from the current 26kt to 37kt in FY12 (FY11 exit capacity) and 52kt by FY14-15. It operates out of its three plants – Daman, Kamarhati and Hoera. The Daman plant of Ess Dee has 18kt of capacity and is in full production. The additional 11kt of capacity in Kamarhati (acquired through India Foil Limited) has started commercial production and another 8kt at Hoera will be in production by end of FY11. The 15kt of additional capacity coming online post FY13 is a Greenfield initiative. The management is confident of operating at very high utilization rates due to the inherent demand. That said, the biggest hurdle for the capacity addition is the availability of skilled labour required to operate the machines. Currently the management recruits graduate students and train them to operate these highly complex machines. Post 52kt, the management doesn't have any immediate plans for capacity expansions. The management guides to a capex of Rs4.3b (Rs0.8-0.9b of maintenance capex and Rs.3.6b of expansionary capex) in FY11-FY13 period.

Stable margin business

Ess Dee aluminium passes through input cost increase to the customers. Due to the unique position of having US-FDA approval, the customers aiming at exporting to US depends on Ess Dee for their packaging requirement. Ess Dee therefore commands very high bargaining power. The management guides to a stable 28-30% EBITDA margin since their pricing is based on a fixed multiples of LME price of Aluminium with escalator and de-escalator clauses. The LME prices are transferred to Ess Dee by the foil stock suppliers, which in turn gets passed on to Ess Dee's customers.

High debtor ratio key concern

Ess Dee currently has very high debtor days: 170-190 days in the past two years. The management attributes this to the after effect of IFL acquisition. During the acquisition the management received post dated cheques running up to 36 months, which have contributed to high accounts receivables. The management however guides on bringing it down to 150 days by FY11 end and further reducing it to 120 days by FY12 end. This is being accomplished through a) Active clearance of IFL cheques b) Charging interest on outstanding payments of clients who do not pay within 120 days.

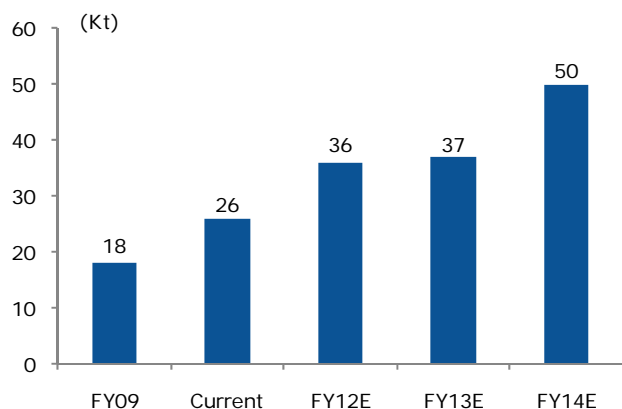
Valuation

The stock currently trades at an FY12 EV/EBITDA (Consensus) of 5.4x on consensus FY12EBITDA of Rs.2.9b. We believe these valuations are at attractive levels given the company's potential EBITDA growth from its volume expansion. We however do not see any significant growth in margins due to the business model.

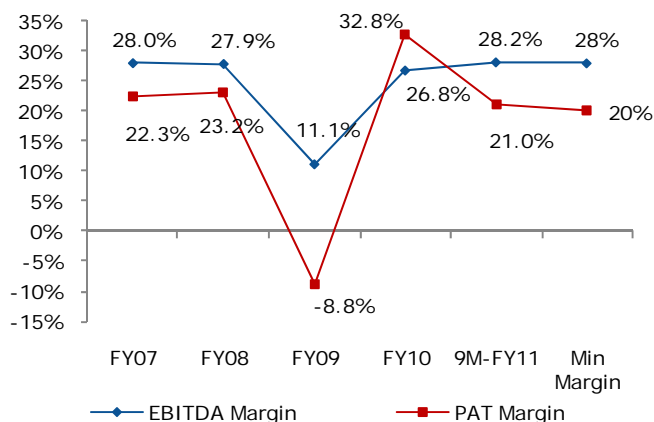
Table 1: Financial Summary

(Rsm)	FY07	FY08	FY09	FY10
Net sales	1673.72	3169.44	4515.19	5885.58
Growth YoY		89.4%	42.5%	30.4%
EBITDA	469.29	884.28	500.39	1577.18
EBITDA Margin	28%	28%	11%	27%
Net profit	372.8	734.47	-397.65	1933
Net profit Margin	22.3%	23.2%	-8.8%	32.8%
P/E	15.44	19.59	-13.41	4.70
P/B	3.27	3.99	1.26	2.22
EV/EBITDA	15.79	17.73	13.04	8.24

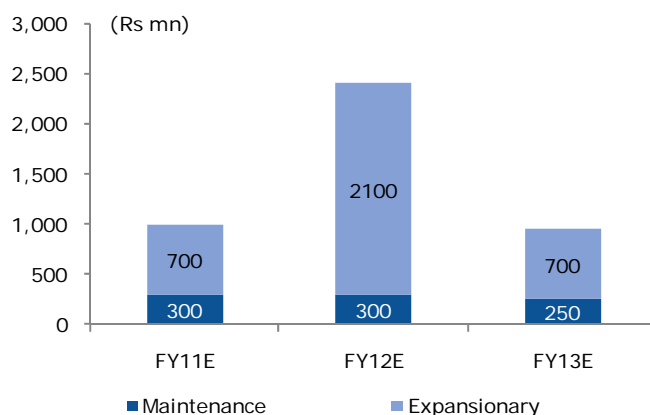
Source: Company Data, Bloomberg, HDFC Sec Institutional Research

Chart 1: Capacity additions (FY09-FY14E)


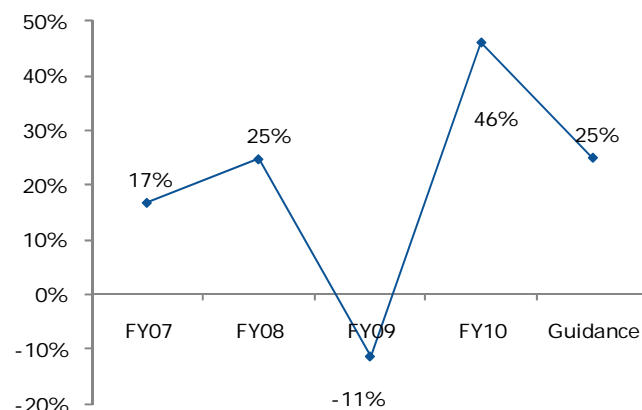
Source: Company, HDFC Securities Institutional Research

Chart 3: EBITDA and PAT Margin FY09 – Impacted due to IFL loss


Source: Company, HDFC Securities Institutional Research

Chart 2: Capex guidance – maintenance vs. expansionary


Source: Company, HDFC Securities Institutional Research

Chart 4: Return on Equity Management guides to a sustainable ROE > 25%


Source: Company, HDFC Securities Institutional Research

Table 2: Income Statement

(Rsm)	FY07	FY08	FY09	FY10
Sales	1,785	3,403	4,756	6,146
Less Excise Duty	112	233	241	261
Net Sales	1,674	3,169	4,515	5,886
Material Cost	1,014	2,006	2,831	3,534
Manufacturing Expenses	57	72	175	254
Employee cost	63	98	147	244
SG&A	70	109	862	277
EBITDA	469	884	500	1,577
Depreciation	12	35	104	174
Impairment of Assets	-	-	429	(16)
EBIT	457	849	(32)	1,419
Net Finance Charges	64	76	153	200
Other income	32	80	44	140
Profit before Tax	425	853	(141)	1,359
Provision for Tax	52	118	256	(574)
Profit after Tax	373	734	(398)	1,933

Table 3: Balance Sheet

(Rsm)	FY07	FY08	FY09	FY10
SOURCES OF FUNDS				
Shareholders' Funds				
Share capital	264	278	278	278
Share capital Suspense Account	-	-	-	1,513
Reserves and Surplus	1,962	3,441	3,050	3,276
Total Shareholders' Fund	2,226	3,719	3,328	5,067
Loan Funds				
Secured Loans	505	999	1,267	1,787
Unsecured Loans	1	1	1	-
Total Debt	506	1,000	1,268	1,787
Minority Interest			1,255	-
Deferred Tax Liability (Net)	20	45	89	(742)
Deferred Sales Tax Liability			210	210
Total	2,753	4,764	6,151	6,322
APPLICATION OF FUNDS				
Fixed assets				
Gross Block	371	1,003	6,013	4,035
Less: Depreciation	27	63	3,397	1,339
Net Block	344	941	2,616	2,696
Capital WIP	371	618	-	1,088
Total Fixed assets	715	1,559	2,616	3,784
Investments	516	319	0	0
Goodwill on consolidation			1,385	-
Current assets, Loans and Advances	1,831	3,396	3,988	5,160
Inventories	319	416	436	546
Sundry Debtors	758	1,476	2,744	3,501
Cash and Bank Balances	570	194	124	158
Loans and Advances	184	1,309	684	955
Current Liabilities and Provisions	309	509	1,838	2,623
Sundry Creditors	179	304	742	1,280
Provisions	130	205	1,096	1,343
Net current assets	1,522	2,887	2,150	2,538
Total	2,753	4,764	6,151	6,322

Source : Company, HDFC Securities Institutional Research

Table 4: Cash Flow Statement

(Rsm)	FY07	FY08	FY09	FY10
Profit before tax	425	853	(141)	1,359
Adjustments for: Depreciation	12	35	104	174
Goodwill on consolidation	-	-	(1,385)	1,385
Minority Interest	-	-	1,255	(1,255)
Other Misc Adjustments	65	77	976	(648)
Changes in working capital	(612)	(1,806)	732	(353)
Cash Generated from Operations	(110)	(841)	1,539	663
Tax paid	(47)	(93)	(213)	(257)
Cash (used in)/ generated from Operating Activities	(157)	(934)	1,326	406
(Purchase)/ sale of Fixed Assets	(479)	(879)	(4,391)	(1,324)
Depreciation on consolidation of Subsidiary	-	-	2,663	(2)
(Purchase)/ sale of Investments	(515)	197	318	-
Effect of M&A of Subsidiary	-	-	(37)	(801)
Cash (used in)/ generated from Investing Activities	(995)	(681)	(1,447)	(2,127)
Share Capital/ Share Capital Suspense Account	1,669	823	-	1,513
Debt raised/ (repaid)	75	493	269	518
Interest paid	(64)	(76)	(153)	(200)
Dividend Paid	-	-	(65)	(75)
Cash (used in)/ generated from Financing Activities	1,680	1,240	50	1,757
Net increase/ (decrease in cash and cash equivalents	528	(375)	(71)	36
Opening balance of cash and cash equivalents	42	570	194	124
Closing balance of cash and cash equivalents	570	194	124	159

Source : Company, HDFC Securities Institutional Research

Table 5: Ratios

	FY07	FY08	FY09	FY10
Margin (%)				
EBITDA	28.0	27.9	11.1	26.8
EBIT	27.3	26.8	(0.7)	24.1
PAT	22.3	23.2	(8.8)	32.8
Turnover Ratios				
Working Capital Turnover (x)	0.9	0.7	0.6	0.4
Fixed Assets Turnover (x)	0.2	0.3	0.6	0.5
Return Ratios (%)				
ROACE	24	21	(6)	36
ROAE	30	25	(11)	46
Working Capital Ratios				
Inventory Days	115	67	55	51
Debtor Days	165	129	171	194
Creditor Days	65	44	67	104
Leverage Ratios				
Debt/ Equity	0.2	0.3	0.4	0.4
Debt/ EBITDA	1.1	1.1	2.5	1.1

Source : Company, HDFC Securities Institutional Research

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