Uflex

Global Markets Research

Packaging profits

Strong foothold in packaging market

Uflex is the largest flexible packaging company as well as the lowest cost producer of packaging products in India with a 19% share of the organized market. The company operates as a converter of packaging products with a presence in both the plastic film and flexible packaging business. The unique strength of Uflex is its vertically integrated operations, offering 'end to end' packaging solutions to marquee FMCG companies like Unilever, Nestle, P&G, Britannia and Fritolay among others. Thus it captures margins across the value chain – from plastic film production to flexi-pack conversion and to the final packing of a variety of FMCG products.

Ambitious expansion plans to become a global player

The company is planning to aggressively grow over FY10-12E with an investment of over USD250mn. Uflex will setup plastic film plants in Egypt, Mexico and Dubai and a flexi-pack plant in the state of J&K. This would enable it to increase capacity by nearly 65% in the plastic business and over 50% in the flexi-pack vertical. We expect the top line and the bottom-line to grow at a CAGR of 22% and 27% respectively, over FY10-13E. The company plans to raise INR2bn by way of right issue in the current year and over INR8bn of debt. We expect net debt levels to reduce to 0.5x by FY13E from current 1.2x.

Steep cost efficiencies, changing business mix to widen margins

The company's cost efficient raw material conversion play has been the biggest differentiator vis-à-vis peers. It's conversion price, after attaching profit margins, remains the conversion cost of other global peers. Considering an equal EBITDA margin, Uflex price per kg is nearly 25% lower than international peers, leaving a significant headroom for it to attract large global clients. The company strategy to hike the contribution from flexi-packs to total revenues and to tap the high margin world markets will play a key role in augmenting EBITDA margins by about 100bps.

Rating : Buy

Target Price : INR190

Upside : 73%

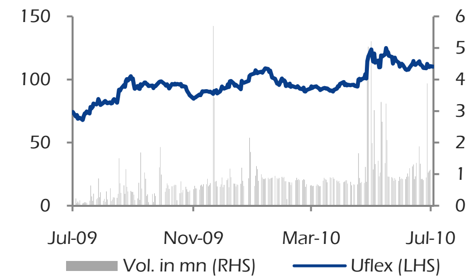
CMP : INR110 (as on 5 July 2010)

Key data

Bloomberg /Reuters Code	UFLX IN/UFLX.BO
Current /Dil. Shares O/S (mn)	65.0/72.3
Mkt Cap (INRbn/US$mn)	7.2/152.9
Daily Vol. (3M NSE Avg.)	877,957
Face Value (INR)	10
1 US$= INR46.8	

Source: Bloomberg ; * As on 5 July 2010

Price & volume



Source: Bloomberg

Share holding (%)	Q1FY10	Q2FY10	Q3FY10	Q4FY10
Promoter	42.9	43.0	43.0	43.0
Institutional Investors	8.3	8.2	7.1	9.9
Other Investors	36.7	35.0	27.6	24.3
General Public	12.1	13.9	22.4	22.9

Source: Bloomberg

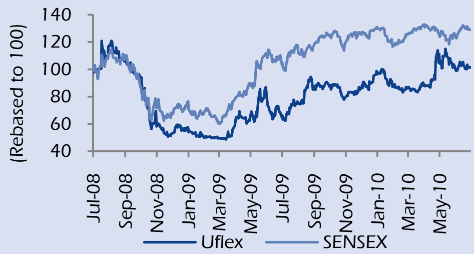
Price performance (%)	3M	6M	12M
Sensex	(2.8)	(1.4)	17.0
Uflex	12.3	2.7	48.5
Jindal Poly	4.7	12.4	47.5
Essel Propack	4.8	(10.5)	83.5

Source: Bloomberg

Valuation

At the CMP, Uflex trades at a P/E of 4.5x and 3.5x FY11E and FY12E earnings respectively. We believe the stock will undergo a significant P/E expansion on account of its strong foothold in the packaging market, aggressive growth plans and expectation of improving margins. We have assigned Uflex a target multiple of 6x on its FY12E earnings of INR31.6 per share that derives a per share value of INR190. **We initiate the coverage with a BUY rating and a target price of INR190 per share, providing an upside potential of 73% from the current market price.**

Price performance



Source: Bloomberg

Key Financials

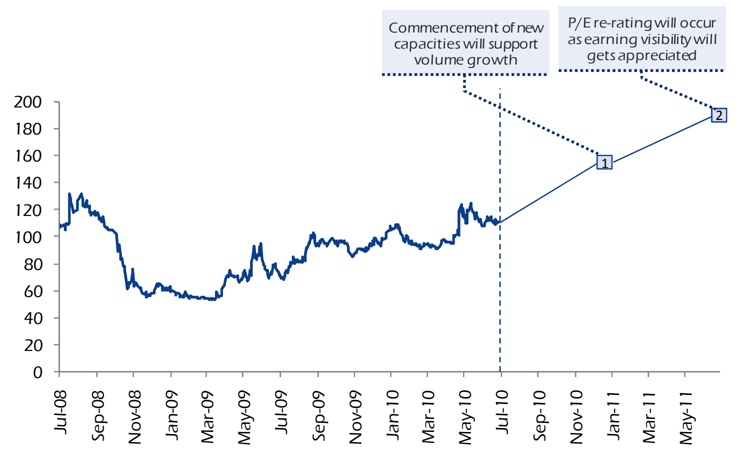
Y/E Mar (INR mn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Rep PAT	YoY (%)	Fully DEPS	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY08	16,389	17.7	1,658	10.1	1,098	42.0	13.6	14.2	9.0	10.0	12.0
FY09	21,730	32.6	3,854	17.7	1,865	69.8	23.0	21.2	12.2	2.4	3.7
FY10E	24,010	10.5	4,422	18.4	1,927	3.3	26.4	17.9	12.8	4.2	4.6
FY11E	28,488	18.7	5,295	18.6	2,114	9.7	24.2	14.6	10.9	4.5	3.8
FY12E	34,825	22.2	6,505	18.7	2,530	19.7	31.6	15.2	12.0	3.5	3.1

Source: Company, Elara Securities Estimate

Aliasgar Shakir • aliasgar.shakir@elaracapital.com • +91 22 4062 6816

Elara Securities (India) Private Limited

Valuation trigger



Source: Bloomberg, Elara Securities Estimates

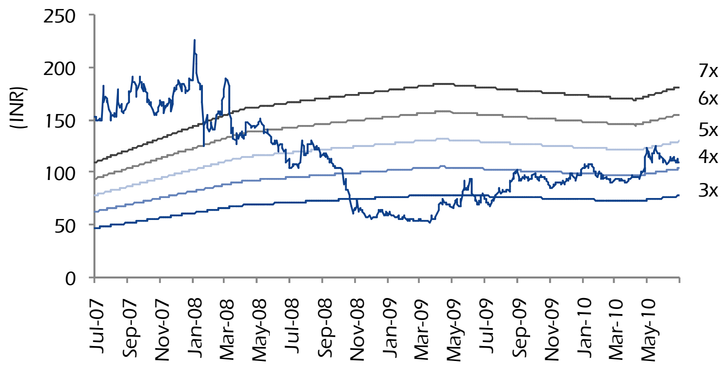
Valuation overview

Valuation	FY 2012E
Net Profits	2,530
Diluted no of shares	80.0
EPS FY11E	31.6
Target Multiple (x)	6.0
Fair Value per share	190
CMP	110
Upside (%)	73

Figs in INR mn (unless explicitly mentioned)

Source: Elara Securities Estimates

Valuation driver - P/E Band



Source: Elara Securities Research

Investment summary

- Market leader in flexi-pack business with 19% market share and 2nd largest player in the plastic film business
- Rising per capita consumption of packaging in India standing at mere USD15, against the world average of USD100
- Marquee client list including MNCs like Unilever, P&G, Nestle, ITC to provide earning visibility

Valuation trigger

1. Commencement of new capacities will support volume growth
2. P/E re-rating will occur as earning visibility will gets appreciated

Key risks

- Extensive delay in executing the expansion plan.
- Inability to raise funds for expansion.
- Steep rise in crude prices may escalate end product prices; taper demand.
- Reduction in use of plastic globally.

Our assumptions

- Global expansion to support top line and bottom line CAGR growth of 22% and 27% respectively over FY10-13E.
- Improvement in business mix from international sales and higher margin flexi-pack business to support margin expansion.
- Factoring a quarter's delay in executing expansion plan.

Financials

Income Statement (INR mn)	FY09	FY10	FY11E	FY12E
Net Revenues	21,730	24,010	28,488	34,825
EBITDA	**3,854**	**4,422**	**5,295**	**6,505**
Add:- Non operating Income	-	206	-	-
OPBIDTA	3,854	4,628	5,295	6,505
Less :- Depreciation & Amortization	1,003	1,190	1,277	1,627
EBIT	**2,851**	**3,438**	**4,017**	**4,877**
Less:- Interest Expenses	981	1223	1440	1753
PBT	**1,871**	**2,215**	**2,578**	**3,124**
Less :- Taxes	(335)	(331)	(464)	(594)
Adjusted PAT	**1,535**	**1,884**	**2,114**	**2,530**
Add/Less: - Extra-ordinaries	330	43	-	-
Reported PAT	**1,865**	**1,927**	**2,114**	**2,530**

Balance Sheet (INR mn)	FY09	FY10E	FY11E	FY12E
Share Capital	650	650	800	800
Reserves	8,145	10,137	13,726	15,882
Minority Interest	88	98	98	98
Borrowings	13,694	14,942	21,054	22,782
Deferred Tax (Net)	878	1,016	1,016	1,016
Total Liabilities	**23,455**	**26,842**	**36,693**	**40,577**
Gross Block	22,447	25,550	32,550	36,580
Less:- Accumulated Depreciation	7,929	9,051	10,329	11,956
Net Block	14,518	16,498	22,221	24,623
Add:- Capital work in progress	592	592	592	592
Investments	974	764	764	764
Net Working Capital	7,370	8,987	13,116	14,597
Other Assets	0	-	-	-
Total Assets	**23,455**	**26,842**	**36,693**	**40,577**

Cash Flow Statement (INR mn)	FY09	FY10E	FY11E	FY12E
Cash profit adjusted for non cash items	3,877	3,557	4,665	5,746
Add/Less : Working Capital Changes	(2,545)	(520)	604	290
Operating Cash Flow	1,332	3,037	5,269	6,036
Less:- Capex	(3,030)	(3,103)	(7,000)	(4,030)
Free Cash Flow	(1,698)	(66)	(1,731)	2,006
Financing Cash Flow	(1,762)	280	6,368	(400)
Investing Cash Flow	(842)	(2,947)	(6,834)	(3,864)
Net change in Cash	**(1,272)**	**371**	**4,803**	**1,772**

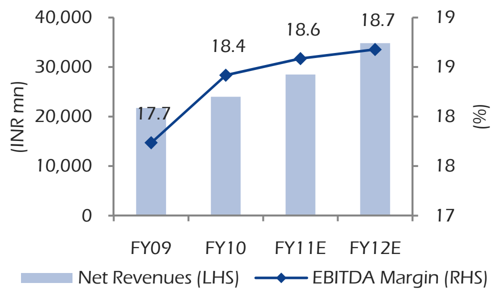
Ratio Analysis	FY09	FY10E	FY11E	FY12E
Income Statement Ratios(%)				
Revenue Growth	32.6	10.5	18.7	22.2
EBITDA Growth	132.5	14.7	19.7	22.9
PAT Growth	39.8	22.7	12.2	19.7
EBITDA Margin	17.7	18.4	18.6	18.7
Net Margin	7.1	7.8	7.4	7.3
Return & Liquidity Ratios (%)				
Net Debt/Equity (x)	1.4	1.2	1.0	0.9
ROE (%)	21.2	17.9	14.6	15.2
ROCE (%)	12.2	12.8	10.9	12.0
Per Share data & Valuation Ratios				
Diluted EPS (INR/Share)	23.0	26.4	24.2	31.6
EPS Growth (%)	69.9	14.4	(8.1)	30.6
DPS (INR/Share)	4.0	4.0	4.0	4.0
P/E Ratio (x)	2.4	4.2	4.5	3.5
EV/EBITDA (x)	3.7	4.6	3.8	3.1
EV/Sales (x)	0.7	0.8	0.7	0.6
Price/Book (x)	0.5	0.7	0.6	0.5
Dividend Yield (%)	7.1	3.6	3.6	3.6

Source: Company, Elara Securities Estimates

New capacities to increase operating cash flow, reduce net debt levels

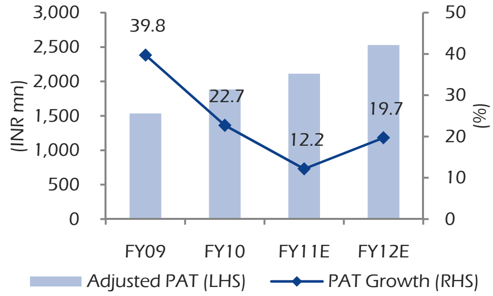
FCF positive by FY12E and improving ROE will trigger P/E expansion

Revenue & margins growth trend



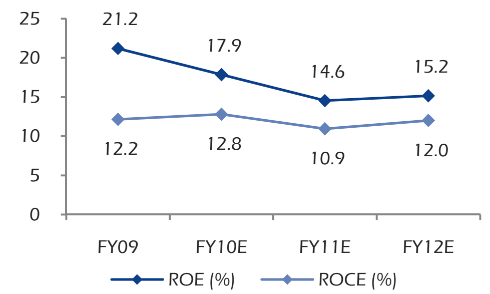
Source: Company, Elara Securities Estimates

Adjusted profits growth trend



Source: Company, Elara Securities Estimates

Return ratios



Source: Company, Elara Securities Estimates

Investment Rationale

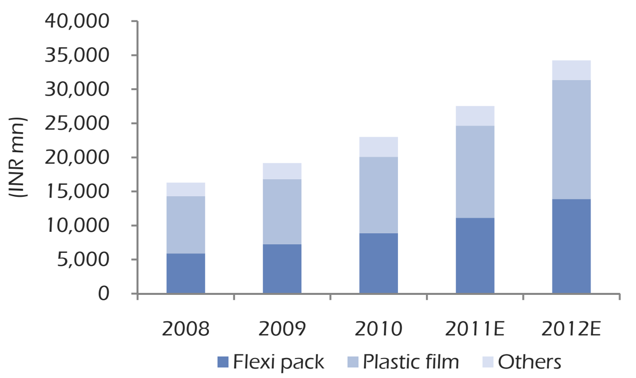
- **Strong foothold in plastic packaging market**
- **All the world is a stage: Ambitious global expansion on the anvil**
- **Significant cost efficiencies, changing business mix to expand margins**

Firm footing in packaging sector

Uflex is the largest flexible packaging company and the lowest cost producer of packaging products in India. The company operates as a converter of packaging products with a presence in both the plastic film as well as flexible packaging business. Evidently, this makes revenues largely delinked from raw material prices in absolute terms as any price rise is promptly shifted on to the customer. The unique strength of Uflex is its vertically integrated operations, offering 'end to end' packaging solutions. Thus it captures margins across the value chain – from plastic film production to flexi-pack conversion and the final packing of variety of FMCG products. The flexi-pack business derives 80% of revenues from FMCG companies, leading to a stable business environment with limited risks to the top line.

Currently about 37% of the revenues are being derived from the flexible packaging, which is a customized product catering to marquee clients, commanding a superior EBITDA margin. The Uflexstrategy remains to improve its revenue mix by increasing the flexible packaging revenue share to nearly equal to the size of plastic film business. This will enable the company to command a better return on capital. Additionally, plans to diversify the plastic film business to other geographies and set up plants in Mexico and Egypt over the next two fiscals will also lead to a stronger hold in the global plastic film market.

Exhibit 1: Focus on hiking revenue from flexi-pack



Source: Company Filings, Elara Securities Estimates

On the plastic film business side, the company markets BOPP (Bi-axally Oriented Poly Propylene film), BOPET (Bi-axally Oriented Polyester) and CPP (Cast Poly Propylene) films globally to over 100 countries including US, Canada, UK, Russia, CIS, South Africa, South Asia and the Middle East region catering to large flexible packaging companies. We believe the company is presently well placed to grow the top line by a CAGR of 22% over FY10-13E and the bottom line by a CAGR of 27% led by the widening margin bracket. This would be supported by 25% growth in the flexi-pack business and over 20% growth in the plastic business.

Flexible packaging business

The company is the largest player in the flexible packaging segment with over 19% share of the organized market in India, catering to all marquee clients in the FMCG and food sector. Over 80% of company's production is consumed by food and FMCG industry, which gives a strong revenue visibility. The major advantage of the company is its strong long term relations with the big FMCG brands viz., Unilever, Nestle, P&G, Britannia and Fritolay who source nearly one-third of their flexible packaging needs from Uflex. The company plans to launch two or three new products every year to fuel the business growth. It is scheduled to launch a new product in Q3 FY11E, and has also plans to launch another couple of products in the next calendar year. Being the market leader and the preferred choice of supplier, this enables Uflex to retain long term customers.

Typically, on an average, the packaging cost remains in the range of 5% of the product hence more emphasis would be bestowed on the quality of the packaging than its cost. The company's emphasis on product innovations like zip pouches, 3D packaging and unit packs like sachets as well as the quality enhancement has enabled it to attract wide customer needs and help retain long term clients. Additionally, this also leads to a shift in the business from rigid to flexible packaging that will increase the target market for the company. The company has over 1000 customer with about 500-600 active clients in the flexi-pack business. The top 20 clients contribute about 40% revenues, implying an average of 2% per client. Thus the client base does not remain very concentrated.

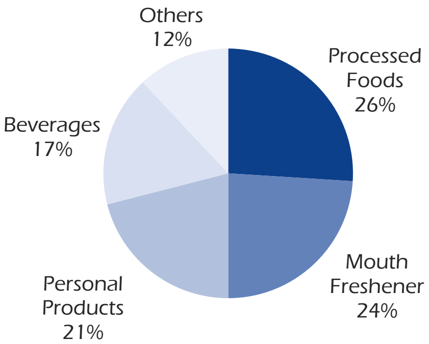
FMCG companies have relatively stable business volumes as well as a growth profile. Thus, once a major FMCG customer is signed up, the business volumes tend to be relatively stable. The time required to sign up a FMCG customer is 12-18 months with a relatively longer sales cycle. This is on account of the sensitive nature of products packaged, putting higher emphasis on the quality of packaging material. Thus, lower customer attrition and the absence of business seasonality render a stable capacity utilization and lower earnings risk.

In order to maintain the growth trajectory, Uflex is eying clients in wider geographies. The company is leveraging its strong relations with the existing companies to supply for its overseas markets. It has made giant inroads into south east Asia and the US to service large FMCG clients like P&G, Nestle and Unilever (that are already among its clientele in India). As of FY10, about 27% of the flexi-pack segment caters to the international market while the company targets the international revenue contribution to reach about 40% in the next two-three fiscals. We believe that Uflex is an established player and should have limited trouble in penetrating these markets. Additionally, the company's cost competencies vis-à-vis other foreign peers are significant which will enable it to attract more clients and garner healthy margins.

Domestic flexi-pack industry on a growth trajectory

The Indian packaging market is in a high-growth phase on account of the robust volume spiral in the FMCG industry. The USD14bn industry comprises about 80% of rigid packaging that includes bottles, cans and others. The flexible packaging market holds the remaining 20% of the overall packaging market with a size of approx USD3bn. The end user flexi-pack market is largely concentrated around the FMCG sector which remains a recession profit industry, and has recorded a CAGR of 14% in the past six years as per the AC Neilson data. This has helped the flexi-pack market to grow at 22%-25% annually as per industry sources, and is further expected to continue its accelerated growth in the coming fiscals.

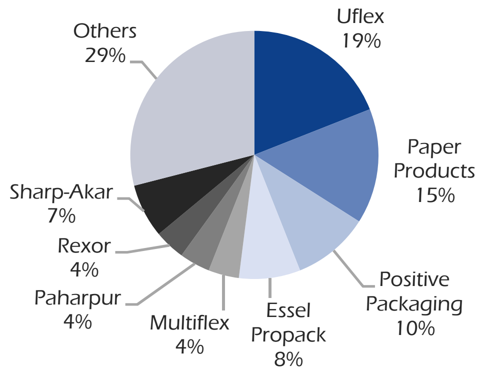
Exhibit 2: FMCG – The largest flexi-pack end user



Source: Company Filings

The large growing middle class and the organized retail sector are the key catalysts to growth in packaging industry. At present, only 15-20% of the total consumption comes in packaged form as the per capita consumption of packaging in India is still very low at around USD15, against the world average of USD100. Thus, the shift from unpacked to packaged products will increase the packaging consumption and propel a significant volume growth. Further, the plastic packaging is the most cost effective packaging mode with others - paper, glass and metal cans - costing nearly 15-25% more. Subsequently, there is a shift from rigid to plastic packaging that will add to the flexi-pack market size and also increase the target market.

Exhibit 3: Uflex dominates flexi-pack market



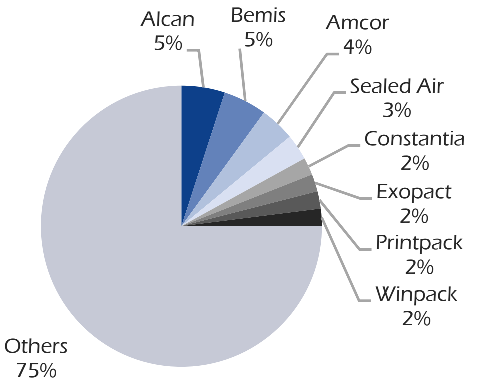
Source: Company Filings

The Indian flexi-pack market is dominated (nearly two-third) by the unorganized market. Uflex is the leader with about 19% market share of the organized flexi-pack market. Typically, in the FMCG market, large MNCs have about three suppliers to source packaging, and Uflex has been among the top supplier of several large FMCG companies, ensuring strong sales visibility and a stable revenue base.

Vast prospects in global flexi-pack market

Globally, the flexi-pack sector is around USD160bn with the large organized markets viz., US and UK holding the maximum share of nearly 30% each. Global flexible packaging industry is growing at 6-7% annually and is expected to maintain the growth rate going forward. The market is highly fragmented with no major player holding over 5% market share. The current trend validates the shift to Asian suppliers due to the low cost advantage hence India is fast becoming the preferred hub for sourcing packaging. However the quality remains an important criterion in the packaging industry due to the presence of big brands.

Exhibit 4: Global flexi-pack market



Source: Company Filings

Globally, Indian companies are not considered producers of high quality packaging materials therefore the acceptability of Indian products has been historically low. Uflex already has major FMCG companies under its belt and this should enable it to increase its international presence.

Plastic film business

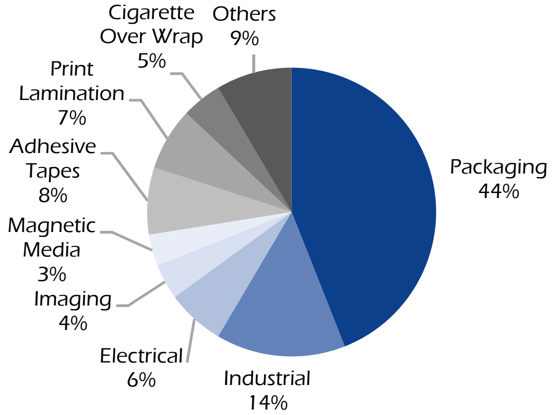
The company makes BOPP, BOPET and CPP films with nearly 63% of the overall revenues coming from the plastic film business. Uflex is the 2nd largest producer in the Indian plastic film market, known for its excess supply hence the company wants a larger international push. Uflex with sales in over 100 countries gets around 51% of its revenue from international operations. As the global expansion takes place, we expect the company's international sales in the plastic film segment to contribute over 60% by FY13E.

Domestic plastic film market

The plastic film business is a pure commoditized one with no product differentiator. The Indian market is categorized with excess capacities thus, depressing the pricing for a while now. The Indian BOPP and BOPET market together stand at USD590mn, growing at about 17-18% CAGR over the last five years as per industry sources. Uflex holds about 20% of the market share while the other major player Jindal Poly holds nearly 35% market share, dominating the domestic plastic film market. Since economies of scale drive the business viability, the plant is generally operated at full capacity to gain complete operating leverage.

Nearly 50% of the plastic film demand depends on the flexi-pack business internationally and this is even higher in the domestic market. Thus, the low per capita consumption of flexible packaging remains the key driver with a healthy double digit growth expectation. Yet the capacity has outpaced the demand and a number of companies have entered the international market.

Exhibit 5: Global plastic end user market



*Includes only BOPP and BOPET

Source: Company Filings

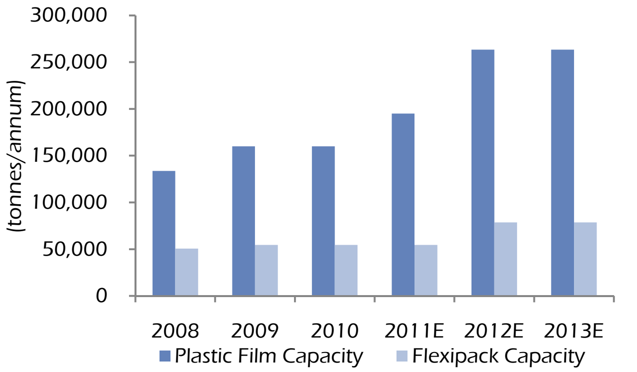
The global plastic film market stands at USD12.8bn, with low cost producers like China accounting for about 40% of it. Due to the huge scale of international market and cost competencies, local players dump excess supply in the international market. Uflex is expanding in the international arena, and setting up plants closer to customer locations in Europe and the US. Customers will have better access to visit and inspect these facilities. Uflex's lower production costs will help the company scale up its operations better in the global arena and attract a higher market share.

Ambitious global expansion plan

The company is planning an aggressive growth strategy over the next two fiscals with an investment of more than USD250mn that would enable it to increase the installed capacity by nearly 65% in the plastic business and over 50% in the flexi-pack vertical. As nearly half of the plastic film revenues come from international business, the company plans to create a base in strategic overseas locations to cut cost and cater to the global market more efficiently. Management plans to increase the share of international sales from the current 43% to 60% by 2013.

Historically, Uflex has always been able to book the sales of the new capacity before its implementation. This has also been the case in the recently set up facilities in Dubai and Mexico during 2007 and 2009 respectively. The company's wide distribution network with sales in more 100 countries has enabled it to gained strong traction. We believe the expansion plan will enable the company to support robust volume growth.

Exhibit 6: Aggressive expansion plan



Source: Company Filings, Elara Securities Estimates

Overseas expansion of plastic film biz

Exhibit 7: Mexico expansion

Particulars	Phase I (July 2009)	Phase II (July 2011)	Total
Product	PET film	PET film	PET film
Capacity (TPA)	26,400	26,400	52,800
Total investment (USD mn)	54	55	109

Note: 1 US$= INR46

Source: Company Filings

The company plans to establish bases in, Egypt and expand the facility in Mexico, to take advantage of the regional treaties that lessen custom duty burden. The company currently has a capacity of 26,700 tonnes per annum (TPA) of polyester film, in Mexico started in FY10. It now plans to scale up this facility by setting up a second line of PET films with a capacity of 26,400 TPA involving an additional capital outlay of USD 55mn. This would aggregate the total capacity to 52,800 TPA in Mexico. The average time to set up a plant is about 12-18 months. However, Uflex has been able to set up all its plants under one year. The company has initiated the process of setting up the plant, and is expected to complete it in the Q1FY11-12. Yet, we have factored in a quarter's delay in the implementation and expect the plant to start production from H2FY12E.

Typically, the plant operates at 75% utilization levels for two quarters and it should be able to scale up to full capacity from thereon. Thus Uflex would be able to produce over 90% from FY13E onwards. The Mexico plant would contribute about 9% of revenues in FY12E and scale up to nearly 13% by FY13E.

Exhibit 8: Egypt expansion

Particulars	Phase I (July 2010)	Phase II (Dec 2011)	Total
Product	BOPP film	CPP + PET film	PP + PET film
Capacity (TPA)	35,000	42,000	77,000
Total investment (USD mn)	52	83	135

Note: 1 US$= INR46

Source: Company Filings

The company is also setting up a poly propylene and polyester (PET) film project in Egypt. It has outlined a 35,000 TPA of BOPP film project in the 1st phase and a 30,000 TPA of PET and 12,000 TPA of CPP project in the 2nd phase, involving a total investment of USD135mn. The 1st phase of the Egypt project is expected to commence in the current month and the 2nd phase should be commissioned by the Q3FY 2011-12. This is expected to contribute about 12% of revenues in FY12E and will scale up to nearly 18% in FY13E.

At present the company utilizes the Indian facility in Noida for international sales. The new overseas facilities will enable the company to service international business through foreign facilities. The Indian plastic film facility will be used to source inputs for the captive flexi-pack operations as well as sales in Indian market. However, the Indian plastic film industry currently has excess supply, and thus we believe the company will have to reach out international market to operate at full capacity.

With the completion of Phase II of the Mexico project by July 2011, and the Phase I and II of the Egyptian facility by June 2010 and December 2011, respectively, we expect the overall share of international sales revenue to go up from the current 43% to over 60% by 2013.

The move is primarily to counter the anti dumping measures unfavorable to exports of films from India. Overseas facilities fall under international trade pacts that provide access to large and profitable developed markets. The Mexico facility is a part of North America Free Trade Agreement (NAFTA) and gives Uflex access to North American markets. The Egypt facility has trade pacts with GCC nations, Southern Europe, Africa, the Middle East, West Asia and CIS nations. Thus it would enable the company to save significant customs and freight duties of about nearly 17-18 cents per kg on about USD2.25/kg of plastic film realization rates. Additionally, the labor cost in both Mexico and Egypt is relatively lower compared to developed nations like the US and Europe. Thus there could be a mere 3-4 cents of escalation in the local costs. Yet on a net basis, the company would save at least about 12-13 cents per kg equivalent to about INR6 per kg on a realization rate of about INR100-110 on plastic film products. This implies a gain of nearly 5% EBITDA margin on international business. Thus as the company increases its reach in the global market, it would witness a significant improvement in margins. We expect the company's blended EBITDA margins to improve by about 100bps by FY13E.

Domestic flexi-pack business also to expand

Apart from the overseas projects, Uflex is also expanding its Indian capacities for its flexible packaging products, involving a total investment of around USD60mn during the current and next financial years. Currently the flexi-pack business is operating at a utilization rate of nearly 70%.

Exhibit 9: Jammu expansion

	Phase I (Jan 2011)	Phase II (May 2011)	Total
Product	Flexi-pack	Flexi-pack	Flexi-pack
Capacity (TPA)	12,000	12,000	24,000
Total investment (USD mn)	**30**	**30**	**60**

Note: 1 US$= INR46

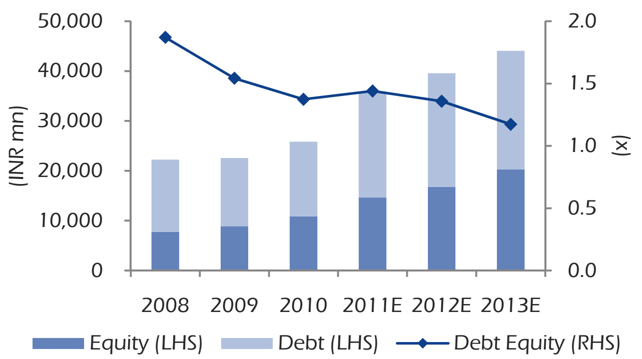
Source: Company Filings

With increased foreign sales, and rigorous growth measures, the flexi-pack business is expected to grow by about 25% reaching utilization rates of about 80%, which would be the peak level in the business. The expansion is expected to be fully commissioned by Q1FY12E and would support the company's international growth opportunities in the flexi-pack business.

Funding aimed at favorable debt equity ratio

Uflex plans to target to maintain a 1x:1 debt equity ratio from the current 1.4x:1 at gross levels. The entire USD250mn investment will be partly funded by debt and partly through internal accruals.

Exhibit 10: Reducing leverage position



Source: Company Filings, Elara Securities Estimates

For Egypt, out of the total USD135mn investment, the company has already infused USD35mn through internal accruals in FY10. For the remaining, the company plans to fund through a debt of USD88 mn, out of which USD 55 mn has already been tied up.

For Phase II in Mexico, out of the total USD55mn, USD45mn will be funded through debt. The company has already made arrangements for the same. The USD10mn equity will be provided through accruals.

Exhibit 11: Funding plan

Particulars (USDmn)	Egypt Phase I &II	Mexico Phase II	Jammu	Total
Equity	47	10	10	67
Debt	88	45	50	183
Total	**135**	**55**	**60**	**250**

Note: 1 US$= INR46

Source: Company Filings

The Jammu plant will be funded two thirds by debt and the remaining through equity. The company plans to raise about INR2,000mn in the current year through a right issue and we believe this would enable the company to improve the leverage position. Management is not keen to issue the rights at a deep discount , thus there could be limited dilution from current levels.

Uflex is expected to generate cumulative operating cash flows of INR18.5bn over FY11-13E led by robust business growth. This will enable the company to fund the INR12bn capex plans over FY10-13E. By FY13E, Uflex's debt equity position at gross levels should be 1.17x:1 and a mere 0.5x:1 at net levels. This should enable Uflex to maintain reasonable levels of leverage and liquidity position.

Cost efficiencies, diversified business mix to enhance margins

Cost efficiency plays a key role

Uflex's cost efficient raw material conversion play has been the biggest differentiator vis-à-vis its peers. The company has a strong advantage in the global market on account of its low cost production. Management vouches for it's nearly half the conversion cost vis-à-vis global peers. This has also led to the shift of facilities to Asia and other low cost producer. In the past five years there has been no new capacity added in the US and UK. Older machinery and lower operating levels have increased the operating cost, leading to higher conversion cost.

Uflex has significant cost advantages led by a high operating leverage and low labor costs. The company is able to convert raw material at a mere INR73/kg and attach a profit margin of INR65/kg, implying a conversion price of INR138/kg. Global peers such as Sonoco & Bemis on the contrary bear conversion cost of INR138/kg. In effect the Uflex conversion price after attaching its profit margins remains the conversion cost of global peers. Uflex's low conversion cost is on account of its low labor cost, newer machineries with efficient processes and high operating levels. The company's low operating cost has enabled it to reduce its conversion cost. This leaves no profit head room for global players to compete against Uflex's low cost production.

Exhibit 12: Potential cost competency of Uflex

Uflex's Cost Efficiency	Flexi-pack		Plastic Film	
Particulars	Uflex	Global	Uflex	Global
Revenues	320	402	100	123
Raw Material Cost	183	183	60	60
Conversion Cost	73	138	21	40
EBITDA (Conversion margin)	65	81	19	23
Conversion Price	**138**	**219**	**40**	**63**

Rates per kg

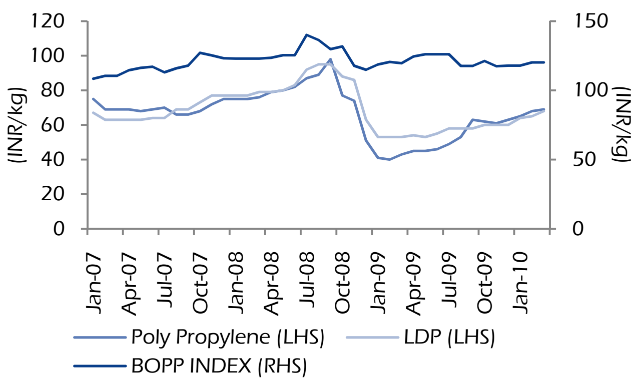
Source: Company Filings, Elara Securities Estimates

Considering the fixed raw material cost and Uflex's cost efficiency, if the global peers maintain the same EBITDA margin, the conversion price works out to be significantly higher than Uflex. Uflex's flexi-pack price at INR320/kg remains nearly 20% lower than its global peers. This leaves it with significant headroom to attract large global clients. The company's operating margin hovers around 14% in comparison to its global peer, Sonoco & Bemis's 8%. Uflex has already serviced large MNCs in the domestic FMCG market hence would not find it tough to penetrate the foreign markets and gain any significant market share.

Similarly in the global plastic film business, the Uflex conversion price of INR40/kg - comprising a conversion cost of 21/kg and an EBITDA of 19/kg - remains the conversion cost for global peers. This patently is the reason more number of Indian companies expanding globally in the plastic film business which is a pure conversion play with no product differentiation. Its over INR18 EBITDA/kg is also the optimum in the domestic industry vis-à-vis lesser than INR18 EBITDA/kg of other players.

Low risk to margins from costlier inputs

Exhibit 13: Shift in raw material prices passed on



Source: Bloomberg

The core raw material of the plastic film industry is crude derivates, prices of which are highly volatile and uncertain. However, this holds a limited threat to the company's business since it operates as a mere raw material converter and transfers any changes in raw material prices to the realization rates. The company charges a conversion price to the client which remains constant. Thus while the EBITDA margin may vary on account of the crude price variation, the absolute EBITDA per tonne remains constant. Subsequently, the EPS does not witness any impact of the variation.

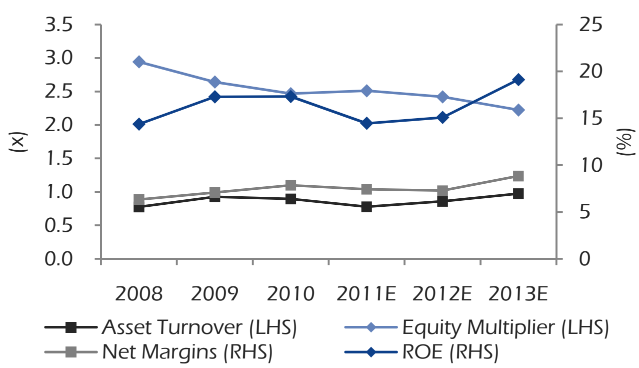
Changing business mix

The company has scaled up from the EBITDA margins of 16% to the incumbent 18% in the past 3-4 years. Going forward, the Uflex strategy of improving the contribution of flexi pack to the total revenues and also to tap the high margin international market will play a key role in augmenting the margins. The flexible packaging business is a customized product market and provides superior margins. The company's focus remains to increase the revenue share of flexible packaging business which currently contributes about 37% of overall revenues. This would be fueled by both domestic as well as global expansion. The company plans to increase the flexi-pack international revenues from the current 27% to nearly 40% in the next two-three fiscals. Owing to better realization rates, this should enable it to command superior margins. Thus the blended EBITDA margin will move up due to shift in product mix.

Return ratios to advance

The company is currently in the expansion mode which is expected to keep significant portion of asset underutilized over the next two fiscals. By FY13E, the company will be operating at a full capacity of nearly 95% utilization which will enable it to command superior turnover ratios of about 1x. Additionally, the changing business mix will also improve margins and lead to superior return ratios. We believe that the company will be able to improve its return on equity to 19% even after factoring delay in execution by a quarter. This is significantly better than its peers in an industry that overall commands ROEs in the range of 12-15%

Exhibit 14: Improving return ratios



Source: Company Filings, Elara Securities Estimates

Packaging

Valuation & Recommendation

- **Growing revenue scale, aggressive international foray to provide earning visibility**
- **Being free cash flows positive by FY12E to enhance liquidity, reduce net debt levels**
- **Expect major re-rating due to deep undervaluation, better return ratios**

Initiating coverage with a Buy recommendation

We have assigned Uflex a target multiple of 6x on its FY12E earnings which seems justified on account of its strong foothold in the market, aggressive growth plans and likelihood of improving margins. At CMP, Uflex trades at a P/E of 4.5x and 3.5x FY11E and FY12E earnings respectively. At TTM basis, the stock is trading at a P/E of 4.2x, while an EV/EBITDA of 4.9x. Thus we believe, Uflex remains a good value pick at present levels. While competition could cut margin significantly as well as risk the expansion plan. However, we believe all these risks are more than factored in the current price. Majority of the earnings comes from FMCG companies that provide a strong earning visibility. By FY13E, the company would post an improved ROCE of 15% from the current 12%. Further if the management is able to timely execute its expansion strategy, it would expand the capacity by about 60% recording topline CAGR of 22% over FY10-13E. Thus it holds a significant scope for expansion in valuation multiples.

Deep discount vs peers

Uflex is the only player that operates in both the plastic film and flexi-pack business with presence across the value chain. This enables it to attain a better margin vis-à-vis other players. This is evident from its superior net margin as well as return ratios. Yet Uflex trades at significant discount to its peers across geographies in the plastic film as well as the flexi-pack business. We believe the company's robust revenue growth prospects and an improvement in its return ratios will attract better investor interest and valuation multiple.

In terms of book value, the company is trading at P/BV of 0.7x as per FY10 numbers. Considering the balance sheet is at historical values, the current prices look highly lucrative in terms of the book value of the company. The company has about 60 acres of land in the premium location of Noida which can be valued above the current market cap. While the debt equity position remains marginally stretched at a ratio of 1.4x, we expect this to come down to reasonable levels of 1.1x by FY13E. The company has credit lines available that should have a limited impact on the capex funding plans. Additionally the interest coverage at about 3x looks reasonable considering the company's stable form of revenues. **We initiate the coverage on Uflex with a BUY rating and target price of INR190 per share, providing an upside potential of 73% from the current market price.**

Exhibit 15: Valuation overview

Valuation	FY 2012E
Net Profits	2,530
Diluted no of shares	80.0
EPS FY11E	31.6
Target Multiple (x)	6.0
Fair Value per share	**190**
CMP	110
Upside (%)	73

Figs in INR mn (unless explicitly mentioned)

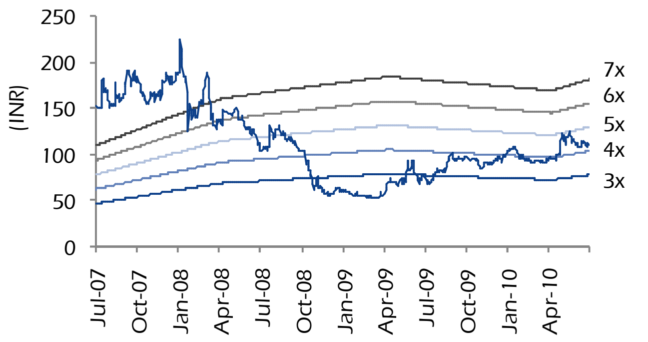
Source: Elara Securities Estimates

Exhibit 16: Peer comparison

	Rev mn	Net Margin (%)	TTM P/E (x)	P/B (x)	ROCE (%)	ROE (%)
Uflex (INR)	24,010	7.8	4.0	0.7	12.8	17.9
Essel Propack (INR)	16,568	3.6	12.2	1.0	9.2	8.0
Jindal Polyfilms (INR)	15,519	6.8	10.6	1.1	9.0	11.3
Bemis (USD)	1,022	4.2	14.2	1.7	6.9	9.4
Sonoco (USD)	3,514	4.2	15.3	2.2	9.6	12.0

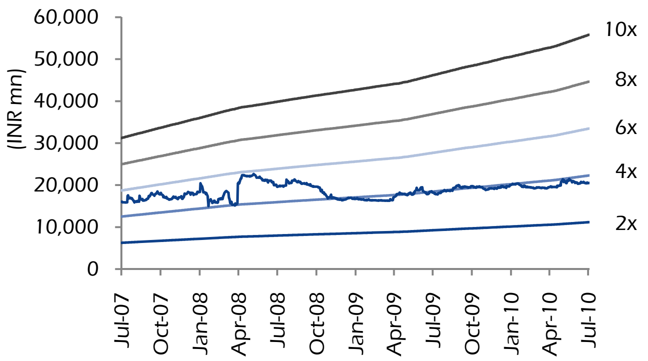
Source: Bloomberg, Elara Securities Research

Exhibit 17: P/E band



Source: Bloomberg, Elara Securities Research

Exhibit 18: EV/EBITDA band

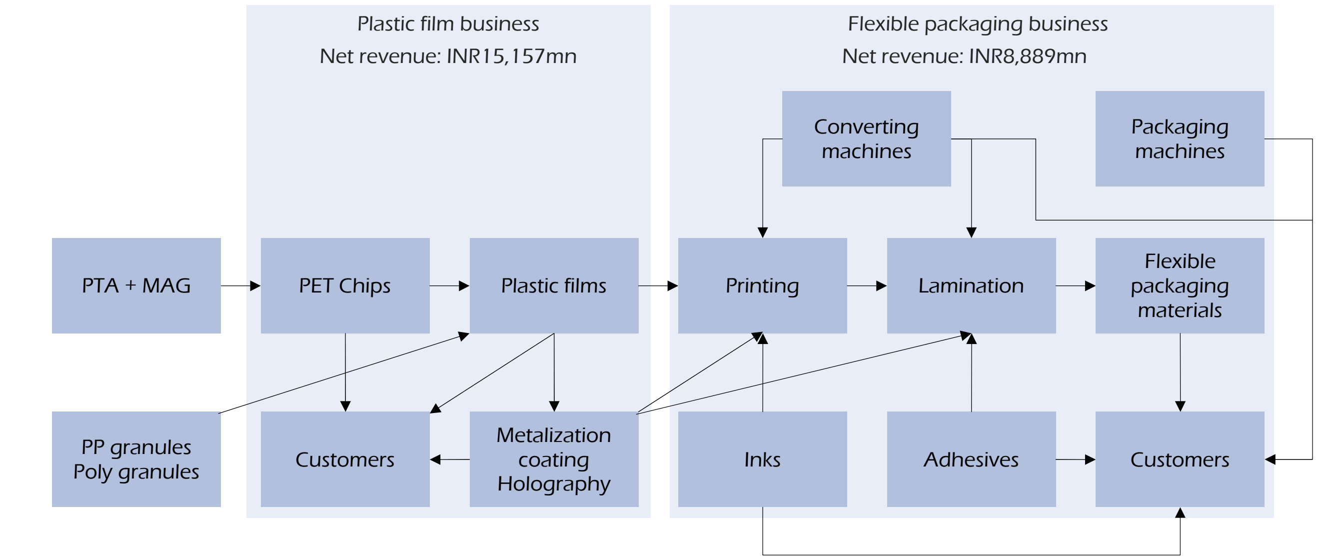


Source: Bloomberg, Elara Securities Research

Company Description

Uflex Limited is engaged in the packaging business. The plastic film business contributes 63% of topline with products ranging from polyester films, bi-axially oriented poly propylene (BOPP) films, metalized and specialized films, and polyester chips. The flexible packaging business contributes 37% of the revenues selling laminates made with various combinations of polyester, metalized polyester, aluminum foil, paper, BOPP, manufacture of rotogravure cylinders for various types of rotogravure printing and others. The wholly owned subsidiaries of the Company include Flex America Inc., Flex Middle East FZE, Flex Europe Pvt. Ltd., Uflex Packaging Inc., and Upet Holding Ltd. through which it operates in various geographic locations.

Uflex's business value chain



Board of Directors & Management

Ashok Chaturvedi – Chairman

Ashok Chaturvedi is a first generation entrepreneur and founder promoter of the group. He has created a leadership position for Uflex in the flexible packaging industry with his innovative and developmental approach over the last 25 years. Under his leadership, Uflex has transformed from a small business to a global enterprise.

Pradeep Tyle – Senior President (Film Business)

Pradeep Tyle is a Chemical Engineer and associated with the group since its inception. He has vast experience in the field of flexible packaging and polymers business and serves as Director on a number of group companies. His managerial skill and technical expertise greatly helped in instituting need based operational measures, which supported the company to become low cost producer of plastic films. He primarily controls the sales and marketing of the film business on a global basis.

RK Jain – President (Corporate Finance and Strategies)

RK Jain is Chartered Accountant and associated with the group for more than two decades. He has worked for corporate houses like HCL Group, Samtel Group and currently serves as Director on several group companies. Jain has experience in Corporate Finance, Taxation, Corporate Laws and Corporate Business Strategies.

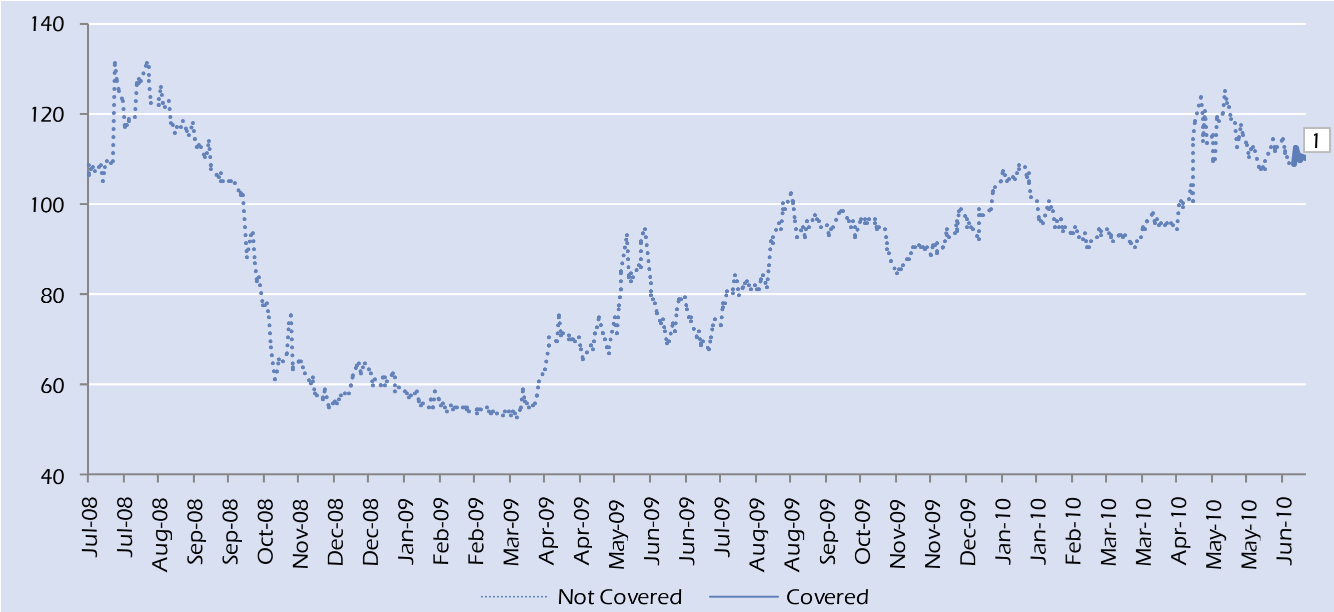
PL Sirsamkar – President (Film)

PL Sirsamkar is an instrumentation and electronics engineer and associated with the group for more than 15 years. He has worked for several reputed organizations like Garware, Polyplex and as experience of more than 27 years in plastic films business. He had been actively involved in setting up all the plastic film lines in Uflex, and successful operations of the same.

Amitava Ray – President (Packaging Business)

Amitava Ray is a Post graduate in Management and associated with the group for last eight years. Prior to Uflex, he was Managing Director and CEO of India Foils Ltd. His managerial skill and business management expertise has greatly helped in introducing newer packaging concepts to add values to the business. At Uflex, his responsibilities include introduction and marketing of need based and innovative packaging concepts.

Coverage History



	Date	Rating	Target Price	Closing Price
1	5-Jul-2010	Buy	INR190	INR110

Guide to Research Rating

BUY	Absolute Return >+20%
ACCUMULATE	Absolute Return +5% to +20%
REDUCE	Absolute Return -5% to +5%
SELL	Absolute Return < -5%

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Elara Securities (India) Private Limited

ElaraCapital

India	Europe	USA	Asia / Pacific
Kalpataru Synergy, 6th Level, East Wing, Opp Grand Hyatt, Santacruz East, Mumbai – 400 055, India Tel : +91 22 4062 6868	29 Marylebone Road, London NW1 5JX, United Kingdom Tel : +44 20 7486 9733	535 Fifth Avenue 29th Floor New York, NY 10017 Tel : 646-884-7130	20, RAFFLES PLACE, # 14-02 OCEAN TOWERS, Singapore 048620 Tel : +65 6536 6267

Harendra Kumar	Head - Institutional Equities & Global Research		harendra.kumar@elaracapital.com	+91 22 4062 6871
Sales				
Joseph K. Mammen	Global Head Sales & Trading			
	London	+44 78 5057 7329	joseph.mammen@elaracapital.com	+44 20 7467 5578
Jonathan Camissar	London	+44 79 1208 7272	jonathan.camissar@elaracapital.com	+44 20 7299 2575
Vishal Pattani	London	+44 77 0220 1384	vishal.pattani@elaracapital.com	+44 20 7467 5452
David Somekh	US	+44 75 9527 9712	david.somekh@elaracapital.com	+44 20 7299 2577
Prashin Lalvani	India	+91 98334 77685	prashin.lalvani@elaracapital.com	+91 22 4062 6844
Koushik Vasudevan	India	+91 98676 96668	koushik.vasudevan@elaracapital.com	+91 22 4062 6841
Amit Mamgain	India	+91 98676 96661	amit.mamgain@elaracapital.com	+91 22 4062 6843
Sales Trading & Dealing				
Ananthanarayan Iyer	India	+91 98334 99217	ananthanarayan.iyer@elaracapital.com	+91 22 4062 6856
Vishal Thakkar	India	+91 98694 07973	vishal.thakker@elaracapital.com	+91 22 4062 6857
Manoj Murarka	India	+91 99675 31422	manoj.murarka@elaracapital.com	+91 22 4062 6851
Research				
Abhinav Bhandari	Analyst	Construction, Infrastructure	abhinav.bhandari@elaracapital.com	+91 22 4062 6807
Aliasgar Shakir	Analyst	Mid caps	aliasgar.shakir@elaracapital.com	+91 22 4062 6816
Alok Deshpande	Analyst	Oil & Gas	alok.deshpande@elaracapital.com	+91 22 4062 6804
Amol Bhutada	Analyst	Auto & Auto Ancillaries	amol.bhutada@elaracapital.com	+91 22 4062 6806
Himani Singh	Analyst	FMCG, Hotels, Hospitals	himani.singh@elaracapital.com	+91 22 4062 6801
Mohan Lal	Analyst	Media & Retail	mohan.lal@elaracapital.com	+91 22 4062 6802
Pralay Das	Analyst	Information Technology	pralay.das@elaracapital.com	+91 22 4062 6808
Ravindra Deshpande	Analyst	Metals & Cement	ravindra.deshpande@elaracapital.com	+91 22 4062 6805
Ravi Sodah	Analyst	Cement	ravi.sodah@elaracapital.com	+91 22 4062 6817
Satyender Khatter	Analyst	Banking & Telecom	satyender.khatter@elaracapital.com	+91 22 4062 6809
Sumant Kumar	Analyst	FMCG	sumant.kumar@elaracapital.com	+91 22 4062 6803
Surajit Pal	Analyst	Pharmaceuticals, Real Estate	surajit.pal@elaracapital.com	+91 22 4062 6810
Kavitha Rajan	Associate	Telecom	kavitha.rajan@elaracapital.com	+91 22 4062 6814
Pooja Sharma	Associate		pooja.sharma@elaracapital.com	+91 22 4062 6819
Saira Ansari	Associate	Pharmaceuticals, Real Estate	saira.ansari@elaracapital.com	+91 22 4062 6812
Sreevalsan Menon	Editor		sreevalsan.menon@elaracapital.com	+91 22 4062 6813
Gurunath Parab	Production		gurunath.parab@elaracapital.com	+91 22 4062 6815

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