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Informed Investor

A retail investor's take on the Indian stock markets

Ghost of Inflation Hovers Over India

The RBI has warned of inflation breaching the 5 per cent mark this financial year. Private analysts expect it to touch 7 per cent as capital goods and commodity prices begin to surge.

Food prices are already up and some items like sugar are quoting 50 per cent higher than last year. As the country's food stocks run out as a consequence to the poor monsoons, imports will become necessary.

Crude prices are ruling above US$ 70 and poised to go higher unless the global markets correct.

The apex bank is worried about rising prices and is waiting to tighten monetary policy. In other words interest rates are poised to move upwards.

Debt held by companies and interest outgoings need closer look before investing.

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Investment Idea

Ess Dee Aluminium

'Simplified' Code Taxing Investors

The draft Direct Tax Code unveiled by the government last week has caused confusion among investors even as the prospects of lower income tax rates have been welcomed across the board.

Among the salient features of the Code that concerns the average investor is the proposal to remove the distinction between short and long term capital gains from equities.

So far, short-term capital gains from equities were taxed at 15 per cent while long-term capital gains on equities held for more than a year were not taxed at all. However the proposed code would remove all such differentiation.

This is a big negative for long-term investors who stay invested in companies across market cycles. Moreover the proposed measures would encourage investors in equities and mutual fund companies to 'churn' their portfolios and add to the volatility in the equity markets.

This would benefit only brokerages and purveyors of financial products and not an investor who spends time and money studying companies and markets before committing funds in equities.

Worldwide, governments encourage long-term investors and penalize via taxation those who indulge in reckless speculation by flitting in and out of stocks regularly.

In the US, short-term capital gains from shares sold within a year are clubbed to the investor's annual income and taxed accordingly. Long-term capital gains are taxed at 15 per cent though investors in the lower tax brackets are liable to pay just 5 per cent on their gains.

Similar concessions to small investors are also given by other governments. In the United Kingdom capital gains up to a million pounds are exempt from capital gains tax for certain categories of investors.

Experts quoted by the media have come up with conflicting interpretations of tax on capital gains proposed under the new code. Several insisted that capital gains from equity would be added to the tax payer's income.

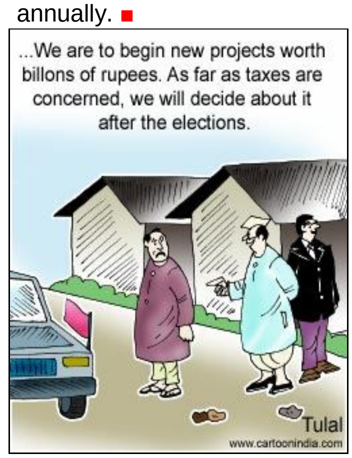
In that case at the highest income bracket, the tax would go up to 30 per cent. The investor might as well have to shell out more given the penchant by successive governments to impose surcharges on income tax.

Such measures, if it comes about, will act as a major disincentive for honest investors who take on risk in order to bring about capital generation in an economy that is starved of it.

Considering the huge up move by the markets following the unveiling of the draft code, it appears that investors are expecting the government to soften the tax blow on capital gains.

A government keen on pressing ahead with disinvestment in PSUs will hopefully desist from hurting investors with excessive taxes. Much will then depend on final Direct Tax Code Act passed by parliament.

The draft code's other proposal to bring in equity and other financial products within the ambit of wealth tax would have negligible impact on retail investors. Only holdings at a cost above Rs 50 cr. will be taxed at 0.25 per cent annually. ■



ESS DEE ALUMINIUM LTD.

BSE: 532787
NSE: ESSDEE
CMP (BSE): Rs 273.20
Market Cap (Rs Cr.): 760

P/E (TTM): 11.40
ROCE: 25
ROE: 25
Dividend Yield (%): 0.7
52Wk H/L(Rs) 389.40/110.60
Debt/Equity: 0.22
3 Yr CAGR Sales (%): 225
3 Yr CAGR Profit (%): …

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Packing Some Punch

The growth of organized retailing has spawned a booming industry in packaging. From the old method of plastics, aluminium foil has emerged as a major component of packaging with FMCGs, pharma, etc switching over entirely to this method of packaging mainly due to the possibilities of optimization it affords.

With the Indian pharma, food and retail sectors growing exponentially there exists tremendous potential for the packaging industry which caters to them. Among the more aggressive players in this sector happens to be Ess Dee Aluminium Ltd. (EDAL) which specializes in providing tailor made aluminium foil based flexible packaging laminates and PVC based thermoforming solutions to a number of Indian and transnational players.

EDAL recently took over India Foils Ltd, a sick unit, and is in the process of restoring it to profitability. IFL has an installed capacity of about 19000 TPA of state-of-the-art foil rolling mills backed by the latest technology in foil conversion.

It also exports to 35 countries globally. With this acquisition EDAL has emerged as India's largest pharmaceuticals foil company.

EDAL has now set its sights on a foreign acquisition. According to Sudip Dutta, Chairman and Managing Director, EDAL, the company is looking at acquiring distressed assets in Europe which would enable it to enter the global markets.

At present EDAL's range of products include aluminium strip pack foil, lid foil for blister packs, PVC film and PVdC coated PVC film all of which have found use in the booming pharma sector.

EDAL has established a countrywide network which allows it to meet the requirements of a client within six hours of an order being placed. The company

Investor-Analysis

has three rolling units, one PVC unit, five printing units under its subsidiary Flexart. The IFL acquisition gives it two more rolling units,

The company's facilities are spread over Daman, Vasai near Mumbai, Goa, Baddi in Himachal Pradesh and Sikkim. The IFL acquisition gives the company a reach in Eastern India. Moreover its installed capacity will rise from from 18000 mtpa to 37000 mtpa by the end of this year.

Investment Rationale

EDAL now operates across the value chain converting aluminium ingots to foil which is then rolled, printed and delivered to the final customer. The management expects substantial value addition from the India Foils acquisition which is likely to turn around in the current financial year.

EDAL also stands to benefit from high entry barriers to new entrants in the business. New entrants will also need to obtain approvals from regulatory bodies just like pharma companies.

EDAL has also improved quality control by become the first Indian Company to follow the CGMP (Current Good Manufacturing Practice) norms..

EDAL has strongly established connections with its clients who are big names in the pharma industry. Management expects that EDAL's long ties would enable it to expand its offerings to other brands of the pharma companies that are not in its basket yet.

With a 45 per cent market share in flexible packaging, domestically, EDAL is all set to benefit from the boom in the FMCG sector. It has developed new products like Tri laminate forcold forming, Bi/ Tri child resist laminate, four/ three ply extruded structures, multi ply laminates, and bi laminates.

Risks and Concerns

Higher raw material prices and the acquisition cost of India Foils has affected EDAL's performance.

Its operating margins have fallen from 30 per cent to 19 per cent. Its interest cost also rose to 12.75 per cent in FY09 from 7 per cent the previous year. EDAL will also have to absorb India Foils' contingent liabilities of Rs 108 cr. that will have to be written off.

However management expects to benefit from the economies of scale following the acquisition. Gains are expected to show from FY10.

An aggressive growth story, it remains to be seen how EDAL successfully integrates its acquisitions with itself. ■