Batlivala & Karani

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INITIATING COVERAGE

Ess Dee Aluminium (BUY)

08 June 2010

MID CAP

Share Data

Market Cap.	Rs 14.4 bn (US$ 309 mn)
Price	Rs 519
Target Price	Rs 652
BSE Sensex	16,781
Reuters	ESDA.BO
Bloomberg	EDS IN
6M avg. daily turnover (US$ mn)	1.2
52-week High/Low (Rs)	522/245
Issued Shares	27.8 mn

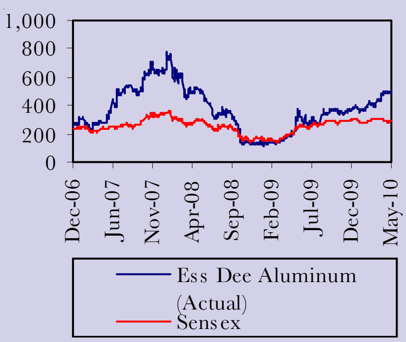
Valuation Ratios

Yr to 31 Mar	FY11E	FY12E
EPS (Rs)	47.3	72.3
+/- (%)	28.9	52.7
PER (x)	11.0	7.2
PBV (x)	2.8	2.1
Dividend/Yield (%)	0.5	0.8
EV/Sales (x)	2.1	1.5
EV/EBITDA (x)	7.5	5.2

Shareholding Pattern (%)

Promoters	59
FIIs	14
MFs/FIs	15
Public & Others	12

Relative Performance



Packing a punch

Ess Dee Aluminium (EDA) is one of India's largest manufacturers of aluminium foils following the acquisition of India Foils Ltd. (IFL). EDA provides packaging solutions for pharmaceutical and FMCG industries and has been able to leverage its market dominance to record 93% revenue CAGR over FY06-09. Given IFL's incremental capacity and upbeat prospects of major user industries – pharma and FMCG, EDA's top line is expected to grow at 41% CAGR over FY10-12.

Year to March	FY09	FY10	FY11E	FY12E	CAGR (%)
P&L Data (Rs mn)					**FY09-12E**
Revenues	4,515	5,885	8,216	11,669	37.2
EBITDA	476	1,576	2,291	3,316	91.0
Adjusted Net Profit	(240)	1,022	1,438	2,195	NA
Margins (%)					
EBITDA	10.5	26.8	27.9	28.4	–
Net Profit	(5.3)	17.4	17.5	18.8	–
Balance Sheet (Rs mn)					
Total Assets	7,989	10,330	10,706	13,810	20.0
Shareholders' Funds	3,328	4,296	5,671	7,724	32.4
Per Share Data (Rs)					
EPS	(8.6)	36.7	47.3	72.3	NA
CEPS	10.5	43.0	53.8	79.8	96.5
Returns (%)					
RoCE	(0.2)	22.5	28.0	36.3	–
RoE	(5.8)	20.2	25.6	32.8	–

**FY09 figures include the impact of consolidation of IFL which reported net losses of Rs 1.6 bn. IFL has reported a marginal profit at the EBITDA level and a marginal loss at the net level for FY10.*

- EDA benefits from strong demand from major user industries. Further, with IFL's incremental capacity coming on board, we believe it is poised to record a strong top-line CAGR of 37% over FY09-12E.
- EBITDA margin expansion has been significant. EDA's presence in a sellers' market has enabled it to pass on input price increases comfortably. Given strong demand outlook and expected softness in raw material prices, we believe margin outlook will remain bright for EDA.
- We expect bottom-line growth to remain healthy, mirroring the EBITDA trend. If the High Court approves EDA's proposal to merge with IFL, we can expect ~8% dilution in the company's equity base.
- We initiate coverage on EDA with a Buy rating and a target price of Rs 652 (26% upside), based on EV/EBITDA multiple of 9.3x FY11E.

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Analyst Declaration: We, Kaustav Kakati & Pritam Lala, hereby certify that the views expressed in this report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendation or view expressed in this report.

B&K Research is also available on Bloomberg <BNKI>, Thomson First Call & Investext.

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B&K Securities is the trading name of Batlivala & Karani Securities India Pvt. Ltd.

B&K Investment Ratings:

1. **BUY:** Potential upside of > +25% (absolute returns)
2. **OUTPERFORMER:** 0 to +25%
3. **UNDERPERFORMER:** 0 to -25%
4. **SELL:** Potential downside of < -25% (absolute returns)

Investment argument

Ess Dee Aluminium is one of the largest Indian integrated aluminium packaging players. The company offers an entire range of pharmaceutical packaging solutions. This diversity has enabled the company to capitalise on the demand supply mismatch in the Indian packaging industry to rapidly achieve top-line CAGR of 93% over FY06-09.

Strong demand to continue from user industries

Good growth in user industries to drive demand

EDA's key user industries, pharmaceuticals, FMCG, and organised retail, have been growing at 15-16% annually. Increasing applications in personal care products (FMCG), pharmaceutical formulations and processed foods are key growth drivers. India is evolving as a vibrant market for pharmaceuticals, especially generic. The country's consumption story appears attractive. EDA is well equipped to benefit from the growth of these sectors.

Approvals from major pharma manufacturers strengthen competitive positioning

Product approvals from top pharma companies

Pharmaceutical companies have stringent packaging norms and seeking approval from pharma majors is indeed a formidable task. EDA obtained approvals from top Indian pharmaceutical companies such as Ranbaxy, Dr Reddy's, Cadila, Cipla, Glenmark, and Lupin, which endorses its high quality and its standing with these clients. EDA also obtained approvals from companies manufacturing latex contraceptives such as TTK and Hindustan Latex.

Long gestation cycles act as entry barriers

Manufacturing gestation period acts as entry barrier

Manufacturing of high quality, customised packaging products involves long gestation periods. It takes nearly 18-24 months to assemble machinery, which is fabricated as per the packager's customised requirements and is generally imported from either Germany or Italy. Further, drug trials and packaging approvals by pharma companies take almost three years. From setting up of machinery to the final sale of the product, the entire processing cycle for a packaging company takes 4.5–5 years. This acts as a major entry barrier for incumbents since new entrants and marginal players would find it difficult to sustain such long gestation cycles and survive long enough to cope with the rigor of the industry and ramp up capacity.

Advantage of being in a sellers' market

Favourable demand-supply scenario

Total Indian imports of aluminium packaging foil in FY09 were ~350,000 tons. EDA alone supplies ~22,000 TPA. A few FMCG majors such as HUL and Dabur have the financial muscle to import their packaging requirements directly from global players such as Alcan. However, a number of companies (including some of the prominent pharmaceutical companies) depend on domestic suppliers for quality supplies. EDA, one of the largest Indian players, with a strong track record for quality, is one of the biggest beneficiaries of this.

Unmatched capacity and range lend strength

Will be able to achieve further economies of scale due to size

With the acquisition of India Foils Ltd, EDA has emerged the largest aluminium foil manufacturer in India with a combined capacity of 37,000 TPA. The company is using only 22,000 TPA capacity (18,000 TPA of EDA + 4,000 TPA of IFL) now. EDA plans to ramp up capacity to 37,000 TPA by FY12, which will make it the largest player in the pharmaceutical packaging industry in the country. This leadership would give it the power to edge out imports and strengthen its business. Moreover, EDA also caters to the requirements of poly vinyl chloride (PVC) and poly vinylidene chloride (PVdC) users through its packaging unit at Goa that has a capacity of 4,200 TPA. Thus, EDA offers a diverse range of packaging solutions for the pharmaceutical and FMCG sectors, a strength which smaller players would find difficult to replicate.

New products add value

First mover advantage in alu-alu packaging in India

EDA is the first company in India to manufacture dedicated high-end pharma packaging products such as cold form blister (alu-alu) and child-resistant-blister packaging products. These value-added products find use in packaging of sensitive products. Imports from South Korea and Europe met almost all cold form blister packaging requirements until EDA ventured into this space. This represents a good opportunity for EDA since it has a clear first-mover advantage.

Cost advantages make India a preferred packaging export hub

India- preferred export hub

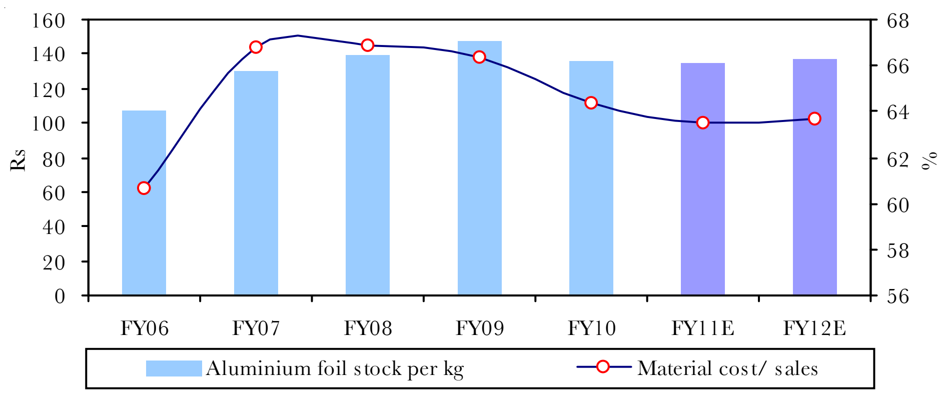
The Indian packaging industry has made a mark with exports of printed sheets and components, plastic film laminates, craft paper, paper board and packaging machinery. Due to lower manufacturing costs, India is fast emerging a preferred hub for the global packaging industry. EDA would again be a clear beneficiary of this trend. The company has already has been able to extend its reach to Europe, the US and South East Asia.

Robust operating profitability trend to continue

EDA's standalone EBITDA growth was 183% in the past five years (FY05-10). Its margins surged from 9% in FY05 to ~27% in FY10. Strong demand and market dominance allow EDA to pass on increase in raw material prices to customers. The company books its raw materials on a back-to-back basis. We expect gradual margin expansion, given strong demand for the company's products and an expected softness in raw material prices.

Able to pass on raw material price inflation

Material costs as percentage of sales vis-à-vis raw material price trend



Source: Company, B&K Research

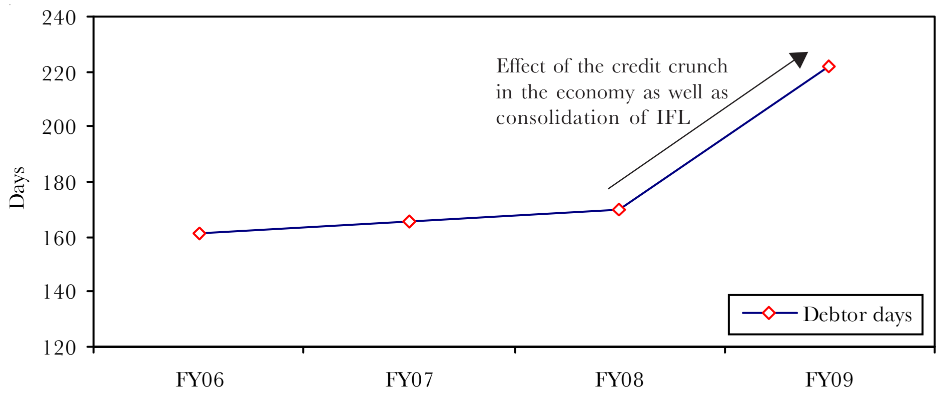
The figure above shows how the company has been able to rein in material costs as percentage of sales since FY07.

Investment Concerns

Macro economic risk

Inordinate delays in payments from customers during credit crunches could lead to debtor days shooting up. For instance, debtors' days surged from 170 in FY08 to 222 in FY09, as shown in the chart below.

Impact on receivable days



Source: Company, B&K Research

Competition

Bilcare- the main competitor

- **From domestic companies**: At home, EDA's strongest competitor is Bilcare, which has an annual lamination film capacity of 30,000 MTPA. However, majority of Bilcare's packaging foils are PVdC based and it is believed to be the market leader in India in this category. Caprihans India is another major player with an annual capacity of 25,860 TPA of Rigid & Flexible PVC sheets. EDA's strategy is to increase its focus gradually on alu-alu packaging, which the management believes, will gradually replace the PVdC based packaging market.
- **From imports**: In cold blister form packaging (alu-alu packaging), China, represents the strongest competition for EDA. However, with quality becoming a greater differentiator, the company is confident of acquiring a substantial share of the market from Chinese competitors.

Limited negotiating power with raw material supplier

Gulf Aluminum Rolling Mill Company (GARMCO), Bahrain is the sole supplier of raw material (aluminium sheet) to EDA. Although the company enjoys a strong relationship with the vendor, its negotiating power gets limited to a certain extent. Domestic supplies of aluminium sheet have failed to meet the desired quality required by EDA. The alternative to GARMCO is a European supplier called Amcor. However, importing from Amcor will lead to an increase in freight costs which could end up hurting margins. EDA is also looking at making operational the caster units of IFL which could be used to produce aluminum sheets in-house.

Exposed to foreign exchange fluctuations

The company imports most of its raw material requirement. Since it does not have any well defined hedging strategy in place, it is exposed to risks in foreign exchange fluctuation, especially in case of rupee depreciation. Although EDA has been in a position to pass on increases in raw material costs to its customers, sharp fluctuations can lead to pressure on its margins since the company may find it difficult to pass on the full impact of forex fluctuation.

IFL's profitability a concern

India Foils profitability concerns

IFL had been making losses for the past ten years. IFL was unable to combat the effect of rising input costs since it could not pass on higher input costs and increase realizations. Following IFL's acquisition by EDA in FY09, its profitability has improved considerably. Net losses for FY10 have come down to Rs 18 mn compared with Rs 1.6 bn in the previous year. EDA's consolidated profit growth depends on the time taken by IFL to turn around completely and start making steady profits. This would be a key challenge for EDA.

Equity base would be diluted following the IFL merger

8% dilution of equity base from the proposed merger

EDA has proposed merging IFL with itself. It will be issuing 2.6 mn equity shares with a swap ratio of 1 share of EDA for every 1,285 shares of IFL as well as equity shares of EDA of face value Rs 10 at a premium of Rs 540 per equity share, for non-cumulative preference shares of Rs 100 per share of IFL (2.5 mn equity shares). Thus, the company's equity base would dilute by ~8% following the merger with India Foils.

Outlook and Valuation

The Indian pharmaceutical packaging industry is expected to grow at 15% CAGR. The demand-supply mismatch in the Indian packaging industry provides ample scope for growth for EDA, especially with incremental capacities coming on board following the acquisition of IFL. We expect EDA to achieve 37% top-line CAGR over FY09-12. EDA has benefitted from being in a sellers' market and has been able to pass on input inflation to customers. Hence, we believe EDA's margin outlook would be favourable. We believe EDA will leverage its deep-rooted understanding of the packaging industry and it strong business capabilities and track record to improve IFL's profitability.

Following the acquisition of IFL, EDA has become the largest player in the aluminium foil packaging industry with Bilcare being its nearest competitor with an annual capacity of 30,000 TPA. Caprihans India is another major player in the pharma packaging sector with a capacity of 25,860 TPA. However, Caprihans India's major capacity is in rigid PVC packaging, similar to that of Bilcare. Globally, Alcan Packaging is the largest packaging player with a capacity of 75,000 TPA.

Extensive product range and complete focus on packaging solutions

Although Bilcare appears to be cheaper on relative valuation, its focus is changing from being primarily a packaging supplier to an integrated pharma R&D provider, which includes services such as clinical trials, material support, anti-counterfeiting, and brand protection. In such a scenario, EDA is set to emerge the strongest player in the pharma packaging industry, which would provide premium valuations vis-à-vis peers. Moreover, considering that the company's earnings are expected to be healthy at 47% CAGR over FY10-12E, we believe the current market price is a good entry point for this scrip.

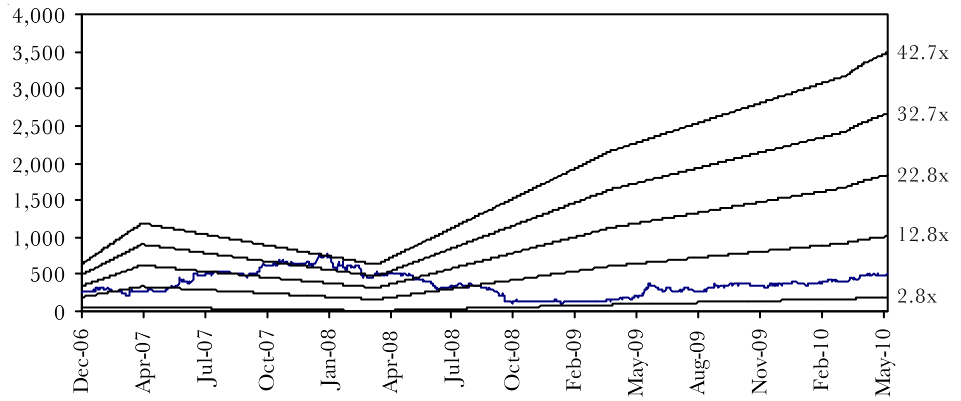
For our target price calculation, we have considered EV/EBITDA multiple of 9.3x FY11E of the merged entity to arrive at a price of Rs 652, which gives us 26% upside from the current level. **We initiate coverage on the stock with a BUY rating.**

Peer comparison

Company	CMP (Rs)	M.Cap (Rs mn)	EBITDA margin (%)		PAT margin (%)		EPS (Rs)		P/E (x)		EV/EBITDA (x)		RoE (%)	
			FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Ess Dee	**519**	**14,445**	**27.9**	**28.4**	**17.5**	**18.8**	**47.3**	**72.3**	**11.0**	**7.2**	**7.5**	**5.2**	**25.6**	**32.8**
Bilcare	448	10,170	23.7	25.1	12.0	14.3	71.6	105.2	6.3	4.3	4.9	3.6	18.2	21.7

Source: B&K Research, Bloomberg

EV/EBITDA Band



Source: xxxxxxx

Business Overview

Background

Ess Dee Aluminium Ltd. (EDA) is one of the leading suppliers of primary packaging materials in India. Incorporated as Ess Dee Aluminium Pvt. Ltd. in 2004, the company converted to a public limited company and changed its name to Ess Dee Aluminium Ltd. in 2006. Mr Sudip Dutta, a first-generation entrepreneur, promoted EDA. The company manufactures and markets aluminium foils and polyvinyl film-based packaging products for the pharmaceuticals and FMCG industries. It is the first in India to manufacture dedicated high-end pharma-packaging products such as cold form blister and child-resistant-blister packaging. The company's manufacturing facilities are at Daman and Goa.

The company completed the construction of its first factory at Daman for manufacturing aluminium foil based packaging products with an initial capacity of 3,600 MTPA. It subsequently increased capacity to 18,000 MTPA. EDA also has another plant in Goa with a capacity of 4,200 MTPA. The company entered the FMCG and organised retail space during FY08 and now its extended product portfolio includes specialised packaging for food items and FMCG products.

History

Year	Event
1993	Established Flex Art Foil Pvt. Ltd. engaged in the process of printing the aluminium foils
2004	Established EDA with the first rolling plant having an initial capacity of 3,500 TPA at Daman
2006	Came up with a public issue, raising Rs 1.6 bn from the issue at a price of Rs 225 per share, which included a premium of Rs 215 per share.
2006	Atlanta Vinyl Pvt. Ltd. was amalgamated with the company, thereby adding an additional unit for manufacturing polyvinyl films-based packaging products at Goa with a capacity of 4,200 TPA. Also, the company acquired the entire paid up capital of Flex Art Foil Pvt Ltd which is engaged in the business of printing aluminium foil based packaging products
2006	Commissioned the second cold rolling mill which enhanced the capacity from 3,600 TPA to 9,100 TPA. The company set up and commissioned PVdC coating line for barrier sensitive high end pharmaceutical products.
2008	Increased the capacity of cold rolling from 9,100 TPA to 18,000 TPA which enabled the company to cater to light gauge and ultra light gauge foil suitable for the food and FMCG sectors. The company forayed into the FMCG and retail spaces during the year, extending its product portfolio by including specialised packaging for the food and FMCG sectors
2008	Acquired an 89% in India Foils Ltd. for a consideration of Rs 1.3 bn

Source: Company, B&K Research

Management

The management of EDA has considerable experience in aluminium packaging as highlighted in the table below:

Key personnel

Name	Designation	Experience
Mr. Sudip Dutta	CMD	A first generation entrepreneur and the founder of EDA, Mr. Dutta spearheads the company's strategic growth. He has more than 20 years of experience in the pharmaceutical and packaging industry.
Mr. Soumitra Barari	Director	Mr. Barari brings 30 years of experience in technology and he oversees EDA's R&D and commercial execution. He is entrusted with new technology innovation, commercial trial and final execution at the floor level. He is a postgraduate in Packaging and Printing Technology from Jadavpur University
Mr. Debdeep Bhattacharya	Director	Mr. Bhattacharya is an Economics Graduate from Presidency College, Kolkata. He has experience of two decades in sales and marketing in the packaging industry. He heads revenue strategy and its execution through a team of sales and marketing professionals to augment top-line growth. He is also entrusted with client and Investor Relationship management and corporate communication
Mr. Prasenjit Dutta	Whole Time Director	Mr. Dutta is a metallurgist from IIT with a post graduate qualification in management from XLRI. He has been a lead assessor for ISO 9001 systems with RBA-UK. He has close to two decades of manufacturing experience in the aluminium foil industry. He spearheads EDA's aluminium related initiatives and developments.
Mr. Abhijit Bose	Director	Mr. Bose brings more than two decades of experience in formulation of business strategy and execution to ensure organic and inorganic growth through brand building, international business development and effective collaborations. He is a graduate in Chemical Engineering from Jadavpur University, Kolkata and is an alumnus of Indian Institute of Management, Kolkata

Source: Company, B&K Research

Acquisition and subsequent merger of India Foils Limited

Helping turn around IFL

In 2008, EDA, along with Madras Aluminium Ltd (MALCO), agreed to revive the failing India Foils Ltd (IFL) through a rehabilitation scheme, subject to BIFR approvals. Under the rehabilitation scheme, EDA and MALCO infused Rs 2.6 bn in IFL in the form of equity and preference shares to repay IFL's existing lenders of IFL, making the company debt free. EDA acquired 147 mn equity shares of Re 1 each, constituting an 89% stake in IFL, making it a subsidiary. The company also subscribed to 1.25 mn optionally convertible non-cumulative preference shares as well as 9.6 mn non-convertible non-cumulative preference shares of Rs 100 each. The closed foil stock and rolling plant of IFL at Hoera in West Bengal has been restarted using the funds infused.

EDA is now merging the 89% subsidiary IFL with itself. It will be issuing 2.6 mn equity shares in this regard with a swap ratio of one equity share of EDA for every 1,285 shares held in IFL as well as equity shares of EDA of face value Rs 10, at a premium of Rs 540 per equity share, for non-cumulative preference shares of IFL of Rs 100 per share. The total equity dilution resulting from the merger would be ~8%.

Equity share capital

The company's Initial Public Offering (IPO) in December 2006 mobilized Rs 1.6 bn at a price of Rs 225 per share with a premium of Rs 215 per share. The company subsequently issued 1.4 mn shares on a preferential basis to Morgan Stanley India Investment Fund and Morgan Stanley Mutual Fund at a premium of Rs 565 per share. Further dilution of ~8% is expected if the High Court accepts the proposed merger with IFL. The table below charts out the equity history of the company.

Equity history

Date	Equity Capital	Reason	Premium per share (Rs)	Ratio
20/12/2006	264.1	Public Issue	215	
15/09/2007	278.2	Preferential Issue Of Shares	565	
Upon the approval of the merger of IFL				
	278.4	Merger of IFL (1 equity share of EDA for 1,285 equity shares of IFL numbering 13,557)		1:1,285
	303.8	Merger of IFL (Non-cumulative, redeemable, non-convertible preference shares of Rs 100 each of IFL, worth Rs 1.4 bn, to be exchanged for equity shares of EDA, each valued at Rs 550)	540	1:5.5

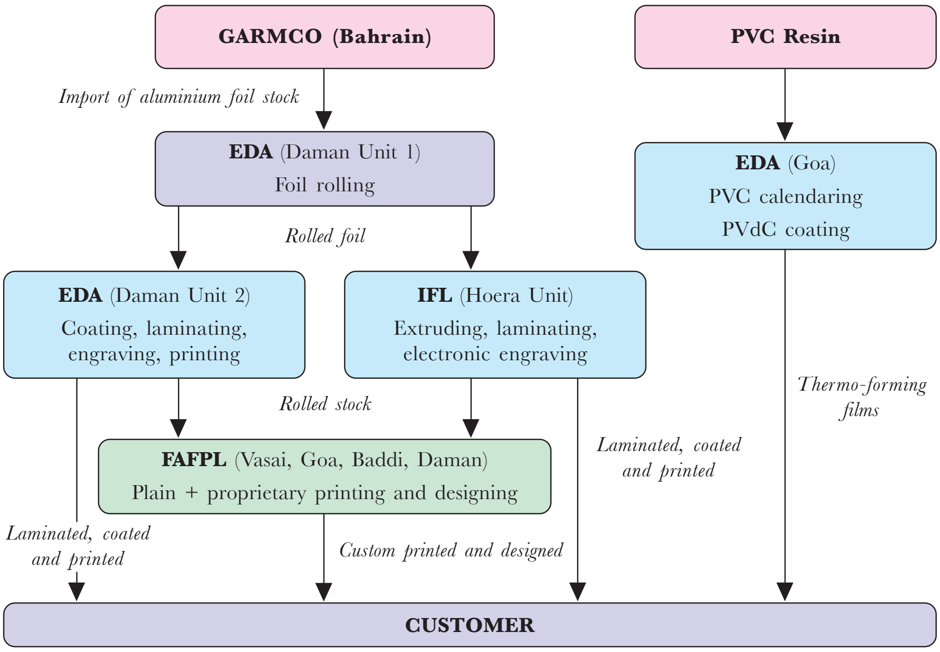
Source: Capitaline, B&K Research

Business Model

Integrated business model

EDA's objective is to provide packaging solutions to pharmaceutical end users. The company is engaged in the business of cold rolling of aluminium foil stock to aluminium foil, which is further converted into 'printers stock' through lamination for strip pack or coating for blister pack. It also manufactures thermoforming poly vinyl chloride films (Rigid PVC films) as well as PVdC coated PVC barrier thermoforming films for blister packaging. Its wholly-owned subsidiary, Flex Art Foil Private Limited, engages in subsequent conversion of printers stock to customized size and printing to proprietary designs.

Business model flow chart



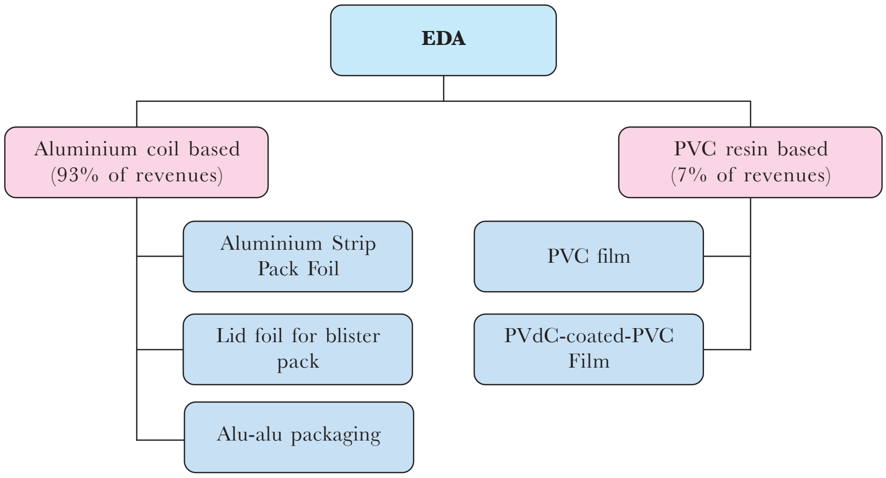
Source: Company, B&K Research

EDA - Ess Dee Aluminium Ltd. **IFL -** India Foils Ltd. **FAFPL -** Flex Art Foils Pvt Ltd.

Product line

EDA's products can be broadly divided under two categories – aluminium based and synthetic resin based. The aluminum-based product category includes aluminum strip pack foil, cold form blister (alu-alu) and normal lid foil for blister packaging. EDA has an aluminium-based product capacity of 22,000 TPA (which includes 4,000 TPA of IFL).

Product mix



Source: Company, B&K Research

Inclined more towards aluminium-based packaging

Aluminium-based products

The company manufactures aluminium based packaging products at its Daman facility which has a capacity of 18,000 TPA

- **Aluminium Strip Pack Foil** – soft aluminium foils laminated to low density polyethylene (LDPE), when sealed at an appropriate temperature, pressure and dwell time, do not allow moisture, odour and gases to penetrate.
- **Lid foil for blister pack** - hard aluminium foils coated with heat seal lacquer- when sealed at an appropriate temperature, pressure and dwell time, they reduce the risk of reaction, spillage, and leakage. They also protect the drugs until the prescribed shelf life. The lidding material consists of support material such as aluminium that has a printed primer on one side and a sealing agent such as a heat-sealing lacquer on the other side. The sealing agent faces the product and the forming films.
- **Cold form blister (alu-alu) packaging** - an aluminum-based laminate film pressed into a mould by means of a stamp. The principal advantage of cold form foil blisters is that they offer a near complete barrier against water and oxygen, allowing an extended product expiry date.

PVC resin-based products

The company manufactures PVC resin-based products at the Goa plant, which has a capacity of 4,200 TPA. EDA acquired the Goa plant in 2006 from its former parent company Atlanta Vinyl Pvt Ltd.

- **PVC film** – PVC film scores high on properties like thermoforming, shape retention and sealing. PVC is also an excellent thermoforming material that provides good dimensional stability. When used as a forming film, it is called rigid PVC because it is almost free of softening agents. Rigid PVC is used for packing stable products
- **PVdC-coated-PVC Film** – This is a primary packaging material for pharmaceutical applications for high moisture and oxygen-sensitive products such as capsules and vitamin tablets. Primary packaging products come in direct contact with the actual goods as in the

case of pharmaceuticals, tablets and capsules. PVdC-coated-PVC film has good barrier properties against moisture, water vapour and is used for packaging sensitive products.

In terms of product thickness

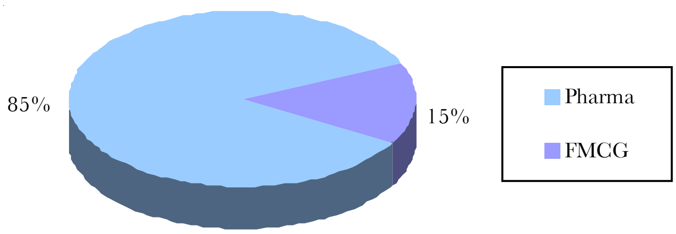
Product thickness	End use
Light to ultra light gauge foils (6-12 microns)	• Child resistant packs for pharmaceuticals • Food and FMCG applications such as confectionery, chocolates, beverages contraceptives, lifestyle products, frozen desserts, culinary, dairy whiteners, cereals, oral re-hydration salts, cough lozenges and personal products.
Medium gauge foils (18-45 microns)	• Pharma strip pack foil • Lid foil for blister pack • Cold forming alu-alu and tropical laminates • Lids for casseroles for in flight catering services • Lids for jams, yogurts, mineral mater, juices, • Laminates for induction wads
Heavy gauge foil	• Suppositories for pharmaceutical including veterinary applications

Source: Company, B&K Research

User industries

EDA caters to packaging requirements of players in two sectors – pharmaceuticals and FMCG. The company started out as a packaging supplier for pharmaceutical companies and hence the revenue mix to date is skewed in favour of the pharma sector as the pie chart below illustrates

Revenue break-up in terms of user industries



Source: Company, B&K Research

EDA's client list includes prestigious domestic pharma companies such as GSK, Ranbaxy, Dr Reddy's, Cipla, Lupin, Pfizer and manufacturers of contraceptives such as TTK and Hindustan Latex. The company made inroads in the FMCG space and is trying to increase its presence in the packaged food and organised retail industries.

Key clientele

All major pharma companies among its client list

Pharmaceuticals	FMCG
Cadila Pharmaceuticals	Pidilite Industries
Cipla	Reckitt Benckiser
Dr Reddy's Laboratories	Cadbury's
GSK Ltd	Nestle
Glenmark Pharmaceuticals	Perfetti Van Melle
Lupin	
Pfizer	
Ranbaxy	
Sun Pharmaceuticals	
Torrent Pharmaceuticals	
Wockhardt	
Zydus Cadila	

Source: Company, B&K Research

Industry Outlook

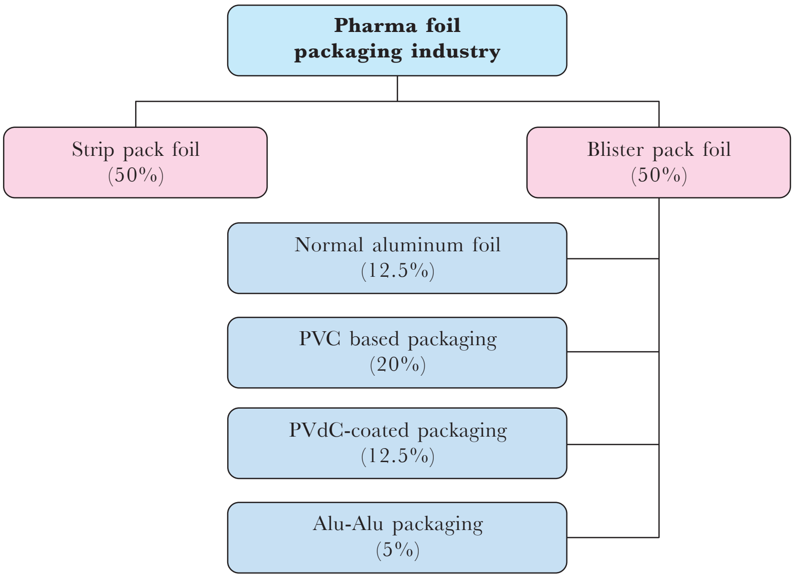
Industry Overview

Opportunity to scale up

The size of the Indian pharma packaging industry (excluding bottles) is estimated at ~Rs 80 bn. It is a fragmented sector, characterised by numerous small-sized players, with just a few recording more than Rs 1 bn top line. Aluminium foil capacity is pegged at ~250,000 TPA. The industry changed significantly in the past few years. From loose packing, strip packing and blister packing to alu-alu packing, a wide range of packaging options are available now in plastic, glass, aluminium, PET bottles or paper. Packaging is now considered an initial stage in the development of a drug and not merely a final stage in manufacturing. The blister packaging segment is expected to grow substantially owing to higher use of unit dose packaging.

The global pharmaceutical packaging market was valued at $42 bn in 2008. The market is forecast to grow at 7% CAGR from 2008 to 2015 and reach a size of $68 billion by 2015. The global pharmaceutical industry is currently expanding rapidly, with advances in manufacturing processes, technology innovation and integration being the driving force. Growth is likely to be higher in emerging economies such as India and China, primarily due to generics and contract manufacturing.

Pharma packaging industry structure in India



Source: Company

India, being a low-cost destination, has benefitted from the complex nature of clinical trials across the globe, as pharmaceutical companies have increasingly started outsourcing their clinical trial activities to low-cost destinations. To achieve major cost savings, MNC pharmaceutical companies are focusing on reducing the number of suppliers they work with. In this environment, it becomes important for companies to be preferred vendors to pharmaceutical companies for their clinical trial services.

Apart from pharmaceutical packaging, FMCG is the other focus area where EDA is making inroads. The FMCG packaging industry is worth ~Rs 120 bn and is fragmented, characterised by a great number of small manufacturers. Purchasing power in India is growing, although it is relatively lower compared with western nations. The key focus area in the consumption sector is the rural market. This focus has prompted a number of consumer companies to offer products in smaller-than-standard sizes to appeal to the affordability of the rural Indian consumer. Not many companies have the flexibility to manufacture products of different shapes and sizes, to establish a stronghold on the market. Hence, innovative packaging solutions would be in demand to ensure steady volume growth.

Financials Earnings and Outlook

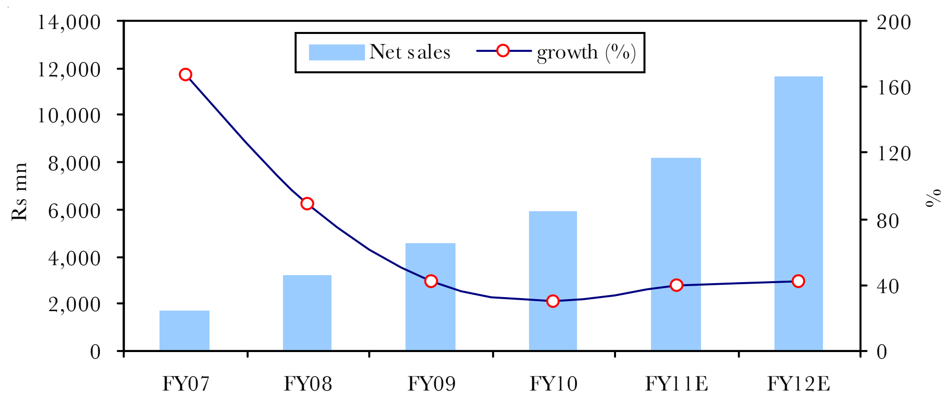
The company will benefit from the strong demand from user industries. Being the only major player with a presence across the entire gamut of foil packaging (aluminium and PVC based) for the pharma industry, EDA is all set to deliver strong top-line and bottom-line growth. We have considered the merged financials from FY11E onward as re-grouped historical numbers would be difficult to ascertain and might not be in line with the re-grouping of the company.

Net sales and growth

The company's net sales grew at a robust pace of 93% annually during FY06-09, albeit on a low base. The growth was driven primarily by strong demand from pharmaceuticals, the major user industry. Strong demand from pharma and FMCG sectors, along with incremental capacities from IFL, should engender solid top-line growth. The addition of the IFL capacities would be in three phases- 4,000 TPA in FY10, 8,000 TPA in FY11 and the remaining 7,000 TPA in FY12. Correspondingly, top-line growth expected is 40% for FY11E and 42% for FY12E, leading to 41% CAGR over FY10-12E.

Strong demand and incremental capacities from IFL to drive growth

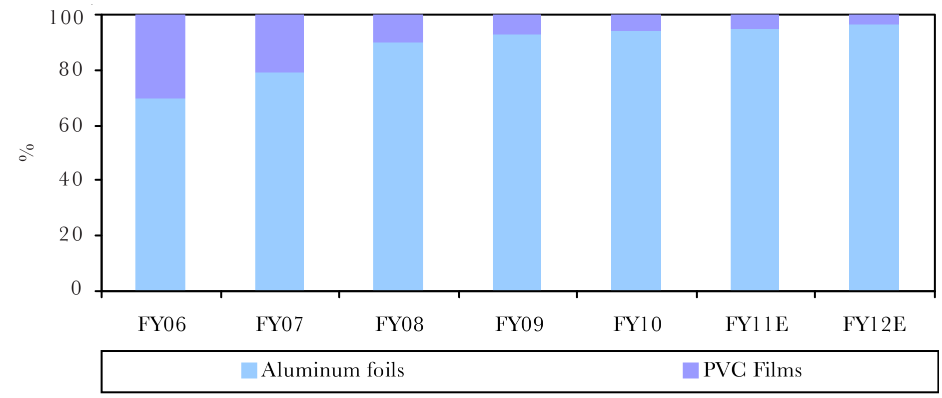
Net sales and growth



Source: Company, B&K Research

The revenue mix between aluminium-based and PVC resin-based products has been constantly tilting in favour of aluminium-based products. EDA has been increasing its focus on the more recent alu-alu packaging and cold form blister packaging, which it believes will gradually replace PVC- resin products. Hence, the company has reduced focus on PVC-based products, which is evident in the steadily declining volumes in this segment. We expect the trend to continue in the near future and the company to become more specialised, offering custom-made products to clients.

Changing revenue mix



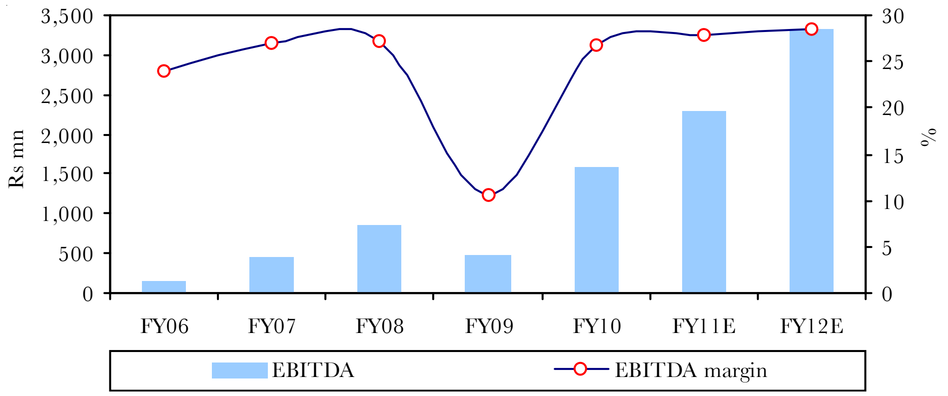
Source: Company, B&K Research

EBITDA and margin

Margin expansion has been significant as EDA has benefitted from being in a sellers' market, which has given it the ability to pass on raw material price inflation. The fact that the aluminium foil stock prices have remained ~8% lower than the previous year, has helped EDA to shore up margins in FY10. With aluminium foil stock prices expected to remain soft, we expect margins to expand further in the next couple of years.

Margin expansion to continue

EBITDA and margin



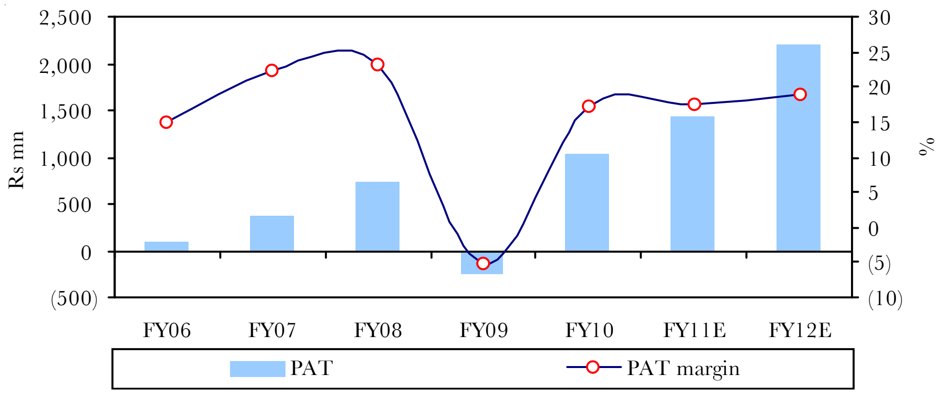
Source: Company, B&K Research

FY09 figures include the impact of consolidation of IFL which had net losses to the tune of Rs 1.6 bn. IFL has reported a marginal profit at the EBITDA level and a marginal loss at the net level for FY10-

PAT and margin

EDA's bottom line is expected to mirror the strong growth at the EBITDA level. The blip in FY09 was a result of the consolidation of IFL which carried steep losses on its books. EDA's PAT margin is expected at 17-20% for FY10-12E as the company does not have a highly leveraged balance sheet.

PAT and margin



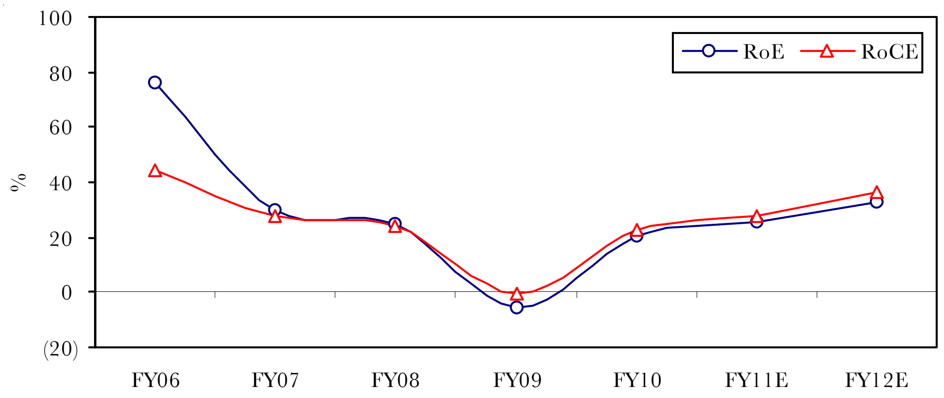
Source: Company, B&K Research

FY09 figures include the impact of consolidation of IFL which had net losses to the tune of Rs 1.6 bn. IFL has reported a marginal profit at the EBITDA level and a marginal loss at the net level for FY10.

Return ratios

EDA's return ratios had also dipped significantly in FY09 in line with the PAT margin trend owing to consolidation of the loss-making IFL. Given EDA's minimum capex requirements, low debt, strong earnings growth and expected turnaround in bottom line profitability of IFL, RoCE and RoE are expected to increase to 38% and 33% respectively by FY12.

RoCE and RoE



Source: Company, B&K Research

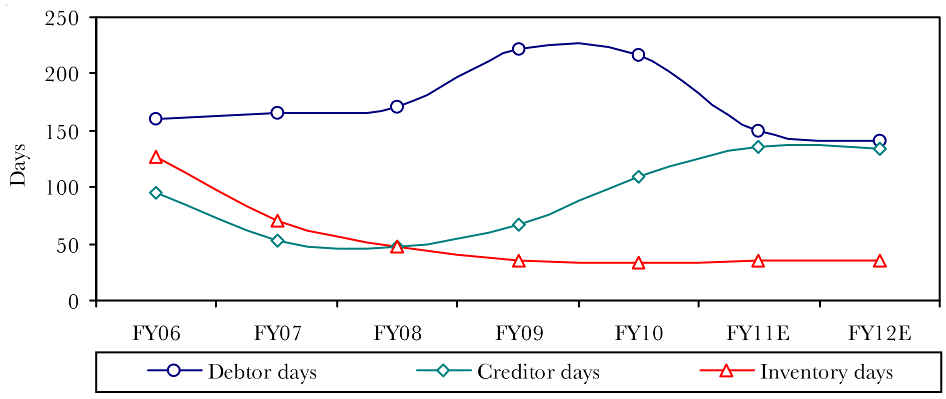
FY09 figures include the impact of consolidation of IFL which had net losses to the tune of Rs 1.6 bn. IFL has reported a marginal profit at the EBITDA level and a marginal loss at the net level for FY10

Working capital management

The company had skewed working capital with debtors amounting to 222 days of sales in FY09 as a result of the combined effect of IFL consolidation and global credit crunch. However, with the economy recovering, the company is hopeful of bringing down debtor days significantly Debtor days are expected at ~150 days by end of FY11. Having a single supplier of raw material lowers EDA's negotiating power, leading to payable days being consistently low. However, increased raw material volumes are expected once incremental capacities from IFL come on board. Thus, we believe EDA would be able to improve payable days and reduce the gap between debtor and creditor days.

Gap between debtor days and creditor days to reduce

Working capital trends



Source: Company, B&K Research

Detailed Financials

Income Statement

Yr end 31 Mar (Rs mn)	FY07	FY08	FY09	FY10	FY11E	FY12E
Net sales	**1,674**	**3,169**	**4,515**	**5,885**	**8,216**	**11,669**
Operating expenses	(1,222)	(2,306)	(4,039)	(4,308)	(5,924)	(8,353)
- Material cost	(1,014)	(2,006)	(2,831)	(3,788)	(5,145)	(7,111)
- Staff cost	(63)	(98)	(147)	(244)	(288)	(385)
- Others	(145)	(202)	(1,062)	(277)	(491)	(857)
Operating profit/EBITDA	**451**	**864**	**476**	**1,576**	**2,291**	**3,316**
Depreciation	(12)	(35)	(532)	(174)	(196)	(228)
Other income	32	80	44	156	53	59
EBIT	**471**	**908**	**(12)**	**1,558**	**2,149**	**3,147**
Interest paid	(46)	(56)	(129)	(200)	(232)	(219)
Pre-tax profit before non-recurring items	425	853	(141)	1,358	1,917	2,927
Pre-tax profit after non-recurring items	425	853	(141)	1,358	1,917	2,927
Tax (current+deferred)	(52)	(118)	(256)	(338)	(479)	(732)
Net profit	373	734	(398)	1,020	1,438	2,195
Adjusted Net Profit	**373**	**734**	**(240)**	**1,022**	**1,438**	**2,195**

FY09 figures include the impact of consolidation of IFL which reported net losses of Rs 1.6 bn. IFL has reported a marginal profit at the EBITDA level and a marginal loss at the net level for FY10.

Balance Sheet

Yr end 31 Mar (Rs mn)	FY07	FY08	FY09	FY10P	FY11E	FY12E
Current assets	**1,831**	**3,396**	**3,988**	**5,160**	**5,540**	**7,620**
Cash & bank	570	194	124	158	251	268
Debtors	758	1,476	2,744	3,501	3,376	4,476
Inventory	319	416	436	546	787	1,118
Loans and advances	184	1,309	684	955	1,125	1,758
Non-current assets	1,231	1,877	4,001	5,169	5,166	6,189
Fixed assets (Net block)	715	1,559	4,001	5,169	5,166	6,189
Gross block	371	1,003	7,398	7,704	7,465	8,616
Less: Depreciation	(27)	(63)	(3,397)	(3,623)	(3,199)	(3,427)
Add: Capital WIP	371	618	0	1,088	900	1,000
Investments	516	319	0	0	0	0
Total assets	**3,062**	**5,273**	**7,989**	**10,330**	**10,706**	**13,810**
Current liabilities	309	509	1,838	2,640	3,032	4,132
Creditors	179	304	742	1,280	2,214	3,058
Other current liabilities	130	205	1,096	1,361	818	1,074
Non-current liabilities	527	1,045	1,568	2,140	2,003	1,953
Total debt	506	1,000	1,268	1,787	1,650	1,600
Other non-current liabilities	20	45	299	353	353	353
Total liabilities	**836**	**1,554**	**3,406**	**4,780**	**5,035**	**6,086**
Total shareholder's fund	2,226	3,719	4,583	5,549	5,671	7,724
Paid up capital	264	278	278	278	304	304
Reserves and surplus	1,963	3,441	3,050	4,018	5,367	7,420
Less: Misc. expenditure	(0)	0	0	0	0	0
Total equity and liabilities	**3,062**	**5,273**	**7,989**	**10,330**	**10,706**	**13,810**

FY09 figures include the impact of consolidation of IFL which reported net losses of Rs 1.6 bn. IFL has reported a marginal profit at the EBITDA level and a marginal loss at the net level for FY10.

Cash Flow

Yr end 31 Mar (Rs mn)	FY07	FY08	FY09	FY10P	FY11E	FY12E
Pre-tax profit	425	853	(141)	1,358	1,917	2,927
Depreciation	12	35	3,334	226	(424)	228
Change in working capital	(640)	(1,832)	10	(429)	701	(1,268)
Total tax paid	(19)	(5)	654	(190)	(1,100)	(479)
Cash flow from operations (a)	**(222)**	**(949)**	**3,857**	**965**	**1,094**	**1,407**
Capital expenditure	(479)	(879)	(5,777)	(1,394)	427	(1,251)
Others	(385)	548	9	13	0	0
Cash flow from investing (b)	**(864)**	**(331)**	**(5,767)**	**(1,381)**	**427**	**(1,251)**
Free cash flow (a+b)	**(1,086)**	**(1,280)**	**(1,910)**	**(416)**	**1,521**	**156**
Equity raised/(repaid)	1,764	811	0	(0)	26	0
Debt raised/(repaid)	75	493	269	518	(137)	(50)
Dividend (incl. tax)	0	(62)	(65)	(65)	(65)	(89)
Other financing activities	(226)	(338)	223	(2)	(0)	(0)
Cash flow fron financing (c)	**1,614**	**905**	**1,840**	**451**	**(1,429)**	**(139)**
Net chg in cash (a+b+c)	**528**	**(375)**	**(71)**	**35**	**92**	**18**

FY09 figures include the impact of consolidation of IFL which reported net losses of Rs 1.6 bn. IFL has reported a marginal profit at the EBITDA level and a marginal loss at the net level for FY10.

Income Statement

Yr end 31 Mar (Rs mn)	FY09	FY10	FY11E	FY12E
Net sales	**4,515**	**5,885**	**8,216**	**11,669**
Growth (%)	*42.5*	*30.3*	*39.6*	*42.0*
Operating expenses	(4,039)	(4,308)	(5,924)	(8,353)
Operating profit	476	1,576	2,291	3,316
EBITDA	**476**	**1,576**	**2,291**	**3,316**
Growth (%)	(44.9)	231.1	45.4	44.7
Depreciation	(532)	(174)	(196)	(228)
Other income	44	156	53	59
EBIT	**(12)**	**1,558**	**2,149**	**3,147**
Interest paid	(129)	(200)	(232)	(219)
Pre-tax profit (before non-recurring items)	(141)	1,358	1,917	2,927
Pre-tax profit (after non-recurring items)	(141)	1,358	1,917	2,927
Tax (current + deferred)	(256)	(338)	(479)	(732)
Net profit (before Minority Interest, Pref Dividend, etc.)	(398)	1,020	1,438	2,195
Reported PAT	**(240)**	**1,022**	**1,438**	**2,195**
Minority interests	158	2	0	0
Adjusted net profit	**(240)**	**1,022**	**1,438**	**2,195**
Growth (%)	*(132.7)*	*NA*	*40.7*	*52.7*

Balance Sheet

Yr end 31 Mar (Rs mn)	FY09	FY10P	FY11E	FY12E
Cash & marketable securities	124	158	251	268
Other current assets	3,864	5,002	5,289	7,352
Net fixed assets	4,001	5,169	5,166	6,189
Total assets	**7,989**	**10,330**	**10,706**	**13,810**
Current liabilities	1,838	2,640	3,032	4,132
Total debt	1,268	1,787	1,650	1,600
Other non-current liabilities	299	353	353	353
Total liabilities	**3,406**	**4,780**	**5,035**	**6,086**
Share capital	278	278	304	304
Reserves & surplus	3,050	4,018	5,367	7,420
Shareholders' funds	**3,328**	**4,296**	**5,671**	**7,724**
Minorities interests	1,255	1,253	0	0
Total equity & liabilities	**7,989**	**10,330**	**10,706**	**13,810**
Capital employed	**6,151**	**7,689**	**7,674**	**9,678**

Cash Flow Statement

Yr end 31 Mar (Rs mn)	FY09	FY10P	FY11E	FY12E
Pre-tax profit	(141)	1,358	1,917	2,927
Depreciation	3,334	226	(424)	228
Chg in working capital	10	(429)	701	(1,268)
Total tax paid	654	(190)	(1,100)	(479)
Cash flow from oper. (a)	**3,857**	**965**	**1,094**	**1,407**
Capital expenditure	(5,777)	(1,394)	427	(1,251)
Chg in investments	318	0	0	0
Other investing activities	(309)	13	0	0
Cash flow from inv. (b)	**(5,767)**	**(1,381)**	**427**	**(1,251)**
Free cash flow (a+b)	**(1,910)**	**(416)**	**1,521**	**156**
Equity raised/(repaid)	0	0	26	0
Chg in minorities	1,413	0	(1,253)	0
Debt raised/(repaid)	269	518	(137)	(50)
Dividend (incl. tax)	(65)	(65)	(65)	(89)
Other financing activities	223	(2)	0	0
Cash flow from fin. (c)	**1,840**	**451**	**(1,429)**	**(139)**
Net chg in cash (a+b+c)	**(71)**	**35**	**92**	**18**

Key Ratios

Yr end 31 Mar (%)	FY09	FY10P	FY11E	FY12E
EPS (Rs)	(8.6)	36.7	47.3	72.3
EPS growth	(131.8)	NA	28.9	52.7
Book NAV/ share (Rs)	161.5	196.2	183.7	251.3
Dividend/ share (Rs)	2.0	2.0	2.5	4.0
Dividend payout ratio	(27.1)	6.4	6.2	6.5
Tax	(181.6)	24.9	25.0	25.0
EBITDA margin	10.5	26.8	27.9	28.4
EBIT margin	(0.3)	26.5	26.2	27.0
RoCE	(0.2)	22.5	28.0	36.3
Net debt/Equity	25.0	29.3	24.7	17.2

Valuations

Yr end 31 Mar (x)	FY09	FY10P	FY11E	FY12E
PER	NA	14.1	11.0	7.2
PCE	49.4	12.1	9.7	6.5
Price/Book	3.2	2.6	2.8	2.1
Yield (%)	0.4	0.4	0.5	0.8
EV/Net sales	3.7	3.0	2.1	1.5
EV/EBITDA	35.5	11.0	7.5	5.2

Du Pont Analysis – ROE

Yr end 31 Mar (x)	FY09	FY10P	FY11E	FY12E
Net margin (%)	(5.3)	17.4	17.5	18.8
Asset turnover	0.7	0.6	0.8	1.0
Leverage factor	1.6	1.8	1.9	1.8
Return on equity (%)	(5.8)	20.2	25.6	32.8

FY09 figures include the impact of consolidation of IFL which reported net losses of Rs 1.6 bn.