

Initiating Coverage



PLYWOOD & LAMINATES Greenply Industries

CMP: Rs152

Price Target: Rs246

BUY

Reuters: GRPL BO

Bloomberg: MTLMIN

06th July, 2007

Sensex: 14,862

Nifty: 4,354

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Greenply Industries

Buy

Price

Rs152

Target Price %upside
Rs246 62↑

Market Capitalisation
Rs2499mn (US\$62mn)

52 week range H/L (Rs) 172/82

Shares o/s (mn) **Daily vol (mn shares)**
16.45 0.02

Reuters **Bloomberg**
GRPL.BO MTLM IN

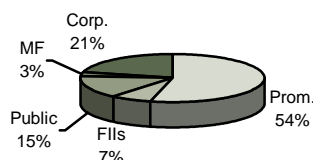
Performance (%)

	1M	3M	12M	YTD
Absolute	18.7	37.7	66.6	54.8
Rel. to Sensex	13.9	19.1	20.7	43.6

BSE Sensex **Nifty**
14,862 4,354

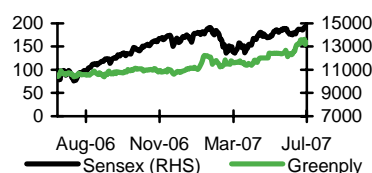
Source: Bloomberg

Shareholding pattern (%)



Source: Capitaline

Price performance



Source: Capitaline

Key financials

YE Mar (Rs mn)	FY08E	FY09E	FY10E
Sales	5,444	6,267	7,044
% change	26.8	15.1	12.4
EBIDTA	624	774	888
EBIDTA mgn (%)	11.5	12.4	12.6
Net profit	282	381	478
Diluted EPS (Rs)	16.6	22.4	28.1
% change	20.2	35.2	25.3
RoE (%)	27.8	30.8	31.2
Net D/E (x)	1.1	0.8	0.6
P/E (x)	9.2	6.8	5.4
P/BV (x)	1.8	1.5	1.2
EV/EBIDTA (x)	5.9	4.8	4.2
EV/Sales (x)	0.7	0.6	0.5

Source: Company, Ambit Capital Research estimates

Greenply Industries (GIL) has been operating in the plywood and laminate industry since 1984 and has achieved leadership in both the segments. Products manufactured by the company include plywood, particle board, decorative laminate, block board and decorative veneer. We believe that as a leader in the industry, the company is fundamentally well placed to benefit from the favorable trend in the construction sector.

Key investment arguments

Market leader in plywood and laminate – Greenply Industries is the market leader in both plywood and laminate segments, having the highest share of the organized market. The company is growing at a CAGR of 35% for the last four years, well above the industry growth rate of 15%. The unorganized sector constitutes nearly 85% of the plywood & laminate market. This strengthens our belief of higher shareholder value creation when the industry moves from unorganized to organized segment.

Favorable Regulations – The plywood industry, though largely unorganized, is heavily regulated by the Govt. because of environmental concerns. The govt. has started banning all units that started after the year 2002 and don't have a valid license. It has also put stringent norms for new units. This will help in limiting the share of unorganized sector and will also check oversupply. The Govt. has cut down excise duty from 16% to 8% in FY07. This will help in reducing the gap between organized and unorganized sector's prices.

Boost from the current construction boom – The laminate and plywood industry is a direct beneficiary of the boom in demand for office space and housing units. The industry tracks construction sector's growth cycle with a lag of 18-24 months. According to Crisil Research, demand for the housing and commercial space is expected to grow at a CAGR of 12.6% and 23.6% respectively, over the next five years. We believe that the construction boom will sustain strong demand for the plywood and laminate industry.

Capacity expansion coupled with increasing utilization levels – The company just finished capacity addition in the plywood and particle board divisions, with a new plant in Utrakhnad. It plans to add 30% more to the current capacity of laminate division in FY08. We believe that increasing demand would lead to better utilization levels. And on higher capacity levels, we expect improvement in EBITDA margins from the current 10.9% to 12.6% in FY10.

Strategic plant locations – Timber is a major raw material for plywood. The Govt. has put strong restrictions on the use of timber for commercial production. However, GIL's Nagaland plant (capacity of 4.5 mn sqmt) is exempt from these restrictions since Nagaland is not covered under National Forest Policy, 1998. This gives the company the strategic advantage of access to key raw material. Moreover, the plant in Utrakhnad is eligible for corporate tax and excise duty waiver.

Attractive valuations

We expect the company to exhibit a CAGR growth of 18% in sales and 28.5% in net profit over the period FY07-FY10E. Given its track record of consistent and robust growth over the period FY03-FY07 and strong fundamentals, we expect a re-rating of the stock. At the CMP of Rs152, the stock is currently trading at a P/E of 9.2x and 6.8x our FY08E and FY09E EPS estimates. Our DCF-based valuation yields a target price of Rs246 over a 12-month horizon. We initiate coverage on the stock with a **BUY** recommendation and a target price of Rs246 over a 12-month horizon, indicating an upside of 62% from the current levels.

Balance sheet

Year to Mar (Rs mn)	FY06	FY07	FY08E	FY09E	FY10E
Shareholders' equity	99	82	85	85	85
Reserves & surpluses (incl. Reval reserve)	562	1,005	1,285	1,616	2,044
Total networth	660	1,087	1,370	1,701	2,129
Interest bearing debt	1,238	1,466	1,500	1,400	1,200
Total liabilities	1,898	2,553	2,870	3,101	3,329
Fixed Assets	680	1,350	1,498	1,512	1,473
Investments	1	11	11	11	11
Inventory	845	1,129	1,326	1,525	1,678
Cash & equivalents	62	148	278	324	460
Debtors	681	984	1,180	1,358	1,493
Other assets	332	129	0	0	0
Current Liabilities	654	1,139	1,366	1,571	1,729
Other Liabilities	49	58	58	58	58
Total assets	1,898	2,553	2,870	3,101	3,329
Net working capital	885	1,063	1,360	1,578	1,845
Net debt/ (Cash)	1,176	1,318	1,222	1,076	740

Profit & loss statement

Year to Mar (Rs mn)	FY06	FY07	FY08E	FY09E	FY10E
Total revenues	2,796	4,292	5,444	6,267	7,044
% growth	61.9	53.5	26.8	15.1	12.4
Cost of Sales	2,490	3,823	4,821	5,493	6,155
EBITDA	306	469	624	774	888
% growth	69.7	53.7	32.9	24.2	14.7
Depreciation	63	87	102	136	150
EBIT	242	383	522	639	739
Net interest/ (income)	76	117	178	174	156
Pre-tax profit	166	265	344	465	583
Tax	25	40	62	84	105
Net profit	141	225	282	381	478
% growth	167.6	59.4	25.3	35.2	25.3

Cash flow

Year to Mar (Rs mn)	FY06	FY07	FY08E	FY09E	FY10E
EBIT	242	383	522	639	739
Depreciation and amortization	63	87	102	136	150
Direct taxes paid	(25)	(40)	(62)	(84)	(105)
Interest expenditure	(76)	(117)	(178)	(174)	(156)
Operating profit prior to wkg cap changes	205	312	384	517	627
Working capital changes	(96)	(93)	(167)	(171)	(131)
Misc expenses	(0)	(0)	0	0	0
Net cash flow from operating activities	109	219	217	346	496
Inc/(Dec) in fixed assets (capital expenditure)	654	553	121	150	111
Inc/(Dec) in investments	0	10	0	0	0
Net cash flow from investing activities	(654)	(563)	(121)	(150)	(111)
Issue / dilution of equity	153	244	50	0	(0)
Increase (decr) in debt	463	228	34	(100)	(200)
Dividend Paid (Equity & Pref)	(28)	(41)	(50)	(50)	(50)
Net cash flow from financing activities	587	430	35	(150)	(250)
Net Increase in cash or cash equivalents	42	85	131	46	136
Add: Opening cash balance	20	62	148	278	324
Closing cash balance	62	148	278	324	460

Ratio analysis

(%)	FY06	FY07	FY08E	FY09E	FY10E
EBIDTA margin	10.9	10.9	11.5	12.4	12.6
Net profit margin	5.1	5.2	5.2	6.1	6.8
Return on equity	26.8	29.5	27.8	30.8	31.2
RoCE	18.4	18.1	20.9	23.8	26.1
Net debt to equity (x)	1.9	1.3	1.1	0.8	0.6
Current ratio (x)	2.3	1.9	2.0	2.0	2.0

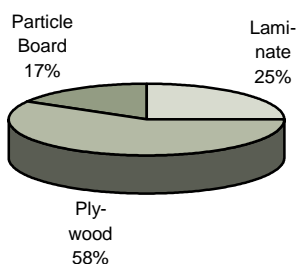
Valuation parameters

	FY06	FY07	FY08E	FY09E	FY10E
Diluted EPS (Rs)	10.3	13.8	16.6	22.4	28.1
BV/share (Rs)	49.1	66.1	83.3	103.4	129.4
P/E (x)	14.7	11.0	9.2	6.8	5.4
P/BV (x)	3.1	2.3	1.8	1.5	1.2
EV/EBIDTA (x)	12.1	7.9	5.9	4.8	4.2
EV/Sales(x)	1.3	0.9	0.7	0.6	0.5

Source: Company, Ambit Capital Research estimates

Industry overview

Industry size (Rs120bn)



Source: Company

The laminate and plywood industry is estimated to be Rs120bn in size and is growing at 15% per annum on an average. This industry lags the housing and commercial sector cycle by 18-24 months. The unorganized sector dominates the industry with more than 85% of the market share. The main reason for this is cash purchases by the customers which helps the unorganized players in tax evasion. This allows the unorganized players in keeping the prices low, thus appealing to the price conscious customers. The chart on the side shows the breakup of industry into its main segments.

Plywood

The plywood sector is estimated to be around Rs70bn in size and is growing at 15% per annum. The size of organized sector in this segment is very low at around 15%, mainly because of low brand perception and price sensitive nature of purchases, which are often done by the carpenters. However, it is growing at a faster rate of 25% to 30% per annum on account of entry of organized players in the construction industry.

The demand for plywood is increasing mainly because of its superior qualities over substitutes like wood, e.g. water and termite resistant, high strength to weight ratio, long life, easy to transport and low maintenance cost etc. It is increasingly replacing aluminum and steel as an interior construction material. Timber is major raw material for plywood, constituting around 60% of the total production cost, followed by chemicals like phenol.

It is because of the use of timber in this industry, it is heavily regulated by the government. The government controls 97% of the forest area, while more than 90% of the timber production is in private sector. Greenfield projects are very closely scrutinized by the Central Empowered Committee appointed by the Government of India for issuing licenses. Timber purchase is allowed only from states having more than 40% of total area under forest cover.

Laminate

Laminate is a complementary product to plywood. It is superior to paint in terms of surface smoothness, quality, and aesthetic appeal. The laminate market is comparatively more organized, with fewer players and around 50% of the market in the organized segment. The market size for laminate is estimated to be Rs30bn, and is growing at 10% to 15% per annum.

The main raw material for laminate is paper and chemicals like phenol. Paper constitutes more than 40% of the cost of production, while the cost of phenol constitutes around 25%. The cost of phenol are highly volatile as it is derived from crude oil. In India, currently both the major raw materials are imported.

Demand for laminate is expected to increase along with increase in demand for plywood and increasing use in new areas like walls, train compartments, circuit boards etc.

Particle board

The particle board segment is estimated to be around Rs20bn currently and is growing at 20% per annum. The present demand for particle board is higher than the supply. India currently imports around 50% of its particle board requirements. The reason for low capacity in this segment is higher capex requirements. Having particle board unit alone is not viable because of economies of scale and scope. Moreover, raw material for particle

board is mainly wood powder and small wood pieces, which is a by-product of plywood production. Hence, only large integrated players can feasibly operate in this segment.

Outlook for the industry

The construction industry, which is the end-user of plywood and laminate is currently experiencing strong growth in both commercial and residential segments. Strong growth in IT/ITES and organized retail is expected to create huge demand for additional office space by 2011. Similarly, growing per capita income, nuclear families, under penetration of housing in India etc. will result in high growth for additional residential space. This favourable trend in the construction industry will boost demand for plywood and laminate products in the coming years.

Investment in housing and commercial space			
	2001-02 to 2005-06	2006-07 to 2010-11	CAGR (%)
Housing	9,810	17,338	12.1
Commercial real estate	408	1,179	23.6
Total	10,218	18,517	36

Source: CRISIL Research

Company brief

Greenply Industries (GIL) is an integrated manufacturer of laminate, plywood and allied products. The company is the market leader in both of the segments, growing at more than 50% in revenues for the last two years viz. 15% growth in the industry. Products manufactured by the company included plywood, particle board, decorative laminate, block board, and veneer. It operates 4 plants in Rajasthan, West Bengal, Nagaland and Uttarakhand. It operates through a pan India sales and distribution network, comprising 7100 dealers and 24 sales offices.

Segment-wise details

Plywood & allied

Plant wise capacity as at FY07

Plywood (mn sqmt)	
Nagaland	4.50
Uttarakhand	7.50
Kolkata	6.00
Laminate (mn sheets)	
Rajasthan	3.96

Source: Company

With a total capacity of 18 mn sqmt in plywood production, GIL is the market leader in this segment. It accounts for 25% market share in organized segment. Plywood contributed Rs2,246mn in revenues, a jump of 65% from last year. Its market leadership along with focused brand building has enabled GIL to register an increase of 57% in volume growth along with 20% growth in price realization. It has finished a 7.5 mn sqmt capacity addition in Uttarakhand. Going further, we expect capacity utilization to increase to 95% in FY09 from the current 71%.

The plant in Uttarakhand has the benefit of being close to a key raw material source and it also enjoys tax benefits. The company's Nagaland plant gives it strategic advantage in terms of access to key raw material. The Indian Forest Act limits the amount of timber-fell to be used by wood manufacturer. However, this Act is not applicable in Nagaland because of Article 371(A). This gives the company an advantage to buy timber from local tribals who own around 88% of the forest area. Also, the company has the option of importing timber from Myanmar.

GIL also manufactures decorative veneer which is a high value added product, with high price realization and healthy margins. It has a capacity of 2 mn sqmt in decowood. The company is going thorough a product rationalization exercise, which will increase share of high value products like decowood in the total sales.

Brands - Plywood & allied

- Greenply
- Green Club
- Decowood
- Green Laminated

Source: Company

Laminate

Brands - Laminate

- Greenlam
- Green Gloss
- Green Touch
- Greenlam Supertuf
- New Mika

Source: Company

The company is the market leader in this segment as well, with 15% of organized market share. Laminate contributed around Rs1,822mn to total revenues this year, up 32% from last year. Total installed capacity in laminate is 3.96mn sheets. Capacity utilization was 115% this year. The division managed to increase volumes by 22% while increasing realization by 11% at the same time. The company is further increasing its capacity during FY08 by another 35%, in view of the increased demand.

Particle board

The particle board division is a recent addition to the current product portfolio. This division would help the company in import substitution of particle board, since around 50% of the current domestic demand is imported. It should be noted that the 50% of the raw material for particle board comes from the by-products of plywood production, thus providing the company production synergies. Currently the plant capacity is at 2 mn sqmt. Going forward, we expect that the capacity utilization to increase from 54% (annualized) at present to 70% in over the next three years

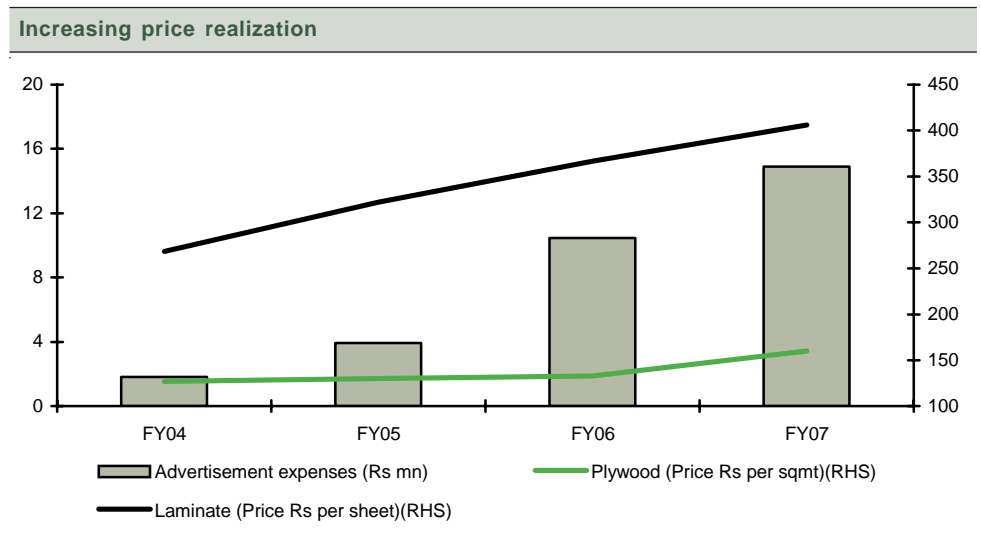
Greenply: Fundamentally well placed

Greenply is present in a high growth industry with a lot of potential. But, the industry is also characterized with a dominant unorganized sector. This keeps the pressure on product price growth. Greenply has adopted the strategy of focused brand building in order to differentiate its products from those of unorganized sector. In the residential construction segment, its target segment is middle and upper middle class, which is quality conscious, wants value added products and is not highly price sensitive. With increasing per capita income and housing demand, customers are becoming more and more aware of brands, look and feel, and quality of products.

Focus on branding and marketing

GIL's strategy is to cater to this segment with a focus on product quality and range of offerings. It has been investing in brand building in the last four years and now has a good brand recall, with a product portfolio of 3 brands and 14 products in plywood and 5 brands in laminate. It is planning to increase penetration in the market with its large distribution network. It has 24 sales offices and 7100 dealers at present, giving it a pan India presence.

Increased advertising expenses resulting in high price realisation - a successful strategy



Source: Company,

The strategy has paid well and the company has been able to register high price realization in all the product categories.

Its thrust on quality and brand value has enabled it to get orders from corporate majors also. The corporate client list, as indicated below is quite impressive.

Major clients

Godrej	Indian Airlines	Hutch and Airtel
BlowPlast	Bharat Petroleum	SBI and ICICI
Featherlite	Barista	Larsen & Toubro
Infosys, Wipro	Tata Consultancy Services	Life Insurance Corp.

Source: Company

We have tried to analyze the competitive advantage of GIL and came out quite convinced that the strategies adopted by the company are further looking.

GIL's strategy	
Threat	GILs' Response
Low Brand Perception	<ul style="list-style-type: none"> ■ Aggressive ad campaign (advertisement/sales 3% per year) ■ Targeting quality conscious customer ■ Introduction of new products
Low Penetration	<ul style="list-style-type: none"> ■ Pan India sales distribution network ■ 24 sales office, presence in tier II and tier III cities ■ 7100 dealers
High timber Cost	<ul style="list-style-type: none"> ■ Plants in Nagaland and Uttrakhand helping in local purchase and imports
Margins	<ul style="list-style-type: none"> ■ Increase in plant utilization ■ Strengthening rupee bringing cost of laminate raw material down
Unorganized segment	<ul style="list-style-type: none"> ■ Sales tax and excise duty cut, introduction of VAT narrowing price gap ■ Entry of organized players in construction industry

Source: Company, Ambit Capital Research

Financials

The company has exhibited a CAGR growth of over 33% in sales over the period FY03-FY07. Going forward, we estimate the sales to grow at a CAGR of 18% for the coming 3 years. This will be the result of volume and realization CAGR of around 12% and 8% respectively. EBITDA and PAT margins are estimated to improve from the current levels mainly due to higher capacity utilization, which will reduce the share of fixed and semi-fixed costs in the total cost. The result of all these factors will be seen in the profits of the company, which will grow at a CAGR of 28.5% during the same period.

Key financials

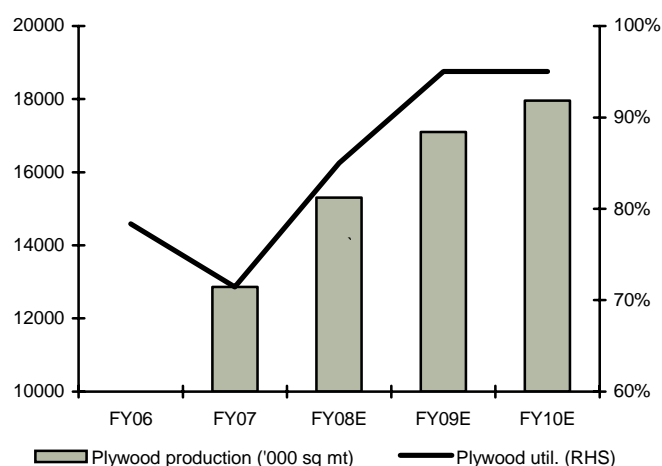
Year to Mar (Rs mn)	FY06	FY07	FY08E	FY09E	FY10E
Sales	2,796	4,292	5,444	6,267	7,044
Sales growth rate (%)	61.9	53.5	26.8	15.1	12.4
EBITDA	306	469	624	774	888
EBITDA margin (%)	10.9	10.9	11.5	12.4	12.6
PAT	141	225	282	381	478
PAT margin (%)	5.1	5.2	5.2	6.1	6.8
RoCE (%)	18.4	18.1	20.9	23.8	26.1
RoE (%)	26.8	29.5	27.8	30.8	31.2
Debt	1,238	1,466	1,500	1,400	1,200
Networth	660	1,087	1,370	1,701	2,129

Source: Company, Ambit Capital Research estimates

Increasing capacity along with capacity utilization resulting in higher volumes

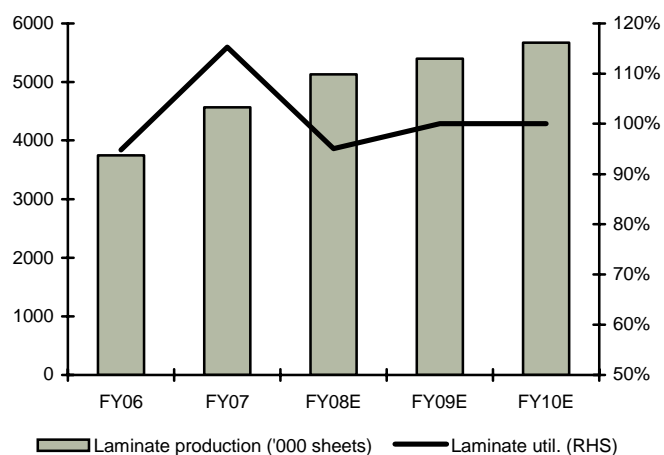
The company has set up a new plywood plant with a capacity of 7.5 mn sqmt and particle board plant with 2 mn sqmt. Capacity utilization in the case of plywood was 71% and 115% in the case of laminate. This has resulted in a jump of 39% in the plywood volumes and 22% in the laminate volumes. We expect higher capacity utilization for all the divisions in the coming three years on the back of robust demand outlook.

Plywood division



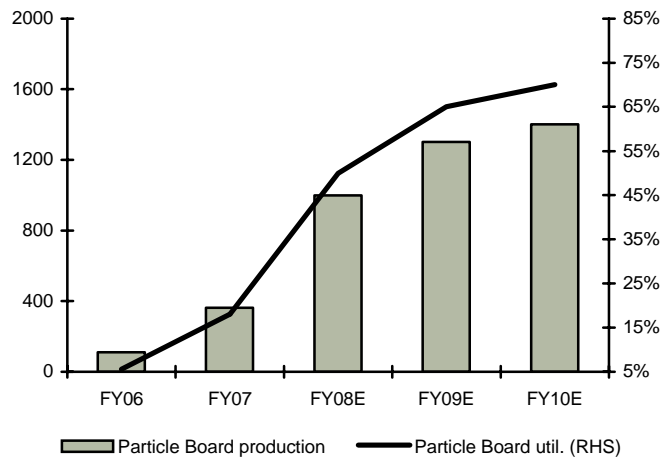
Source: Company, Ambit Capital Research estimates

Laminate division



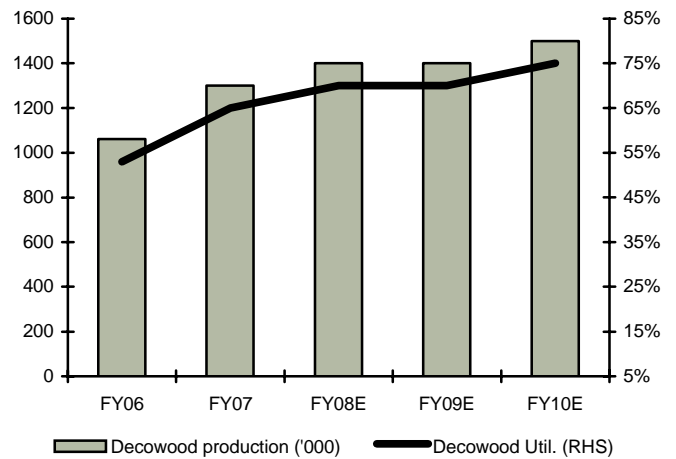
Source: Company, Ambit Capital Research estimates

Particle board



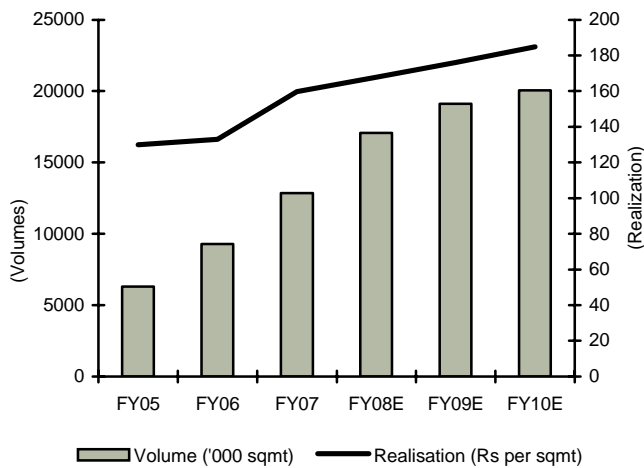
Source: Company, Ambit Capital Research estimates

Decorative veneer



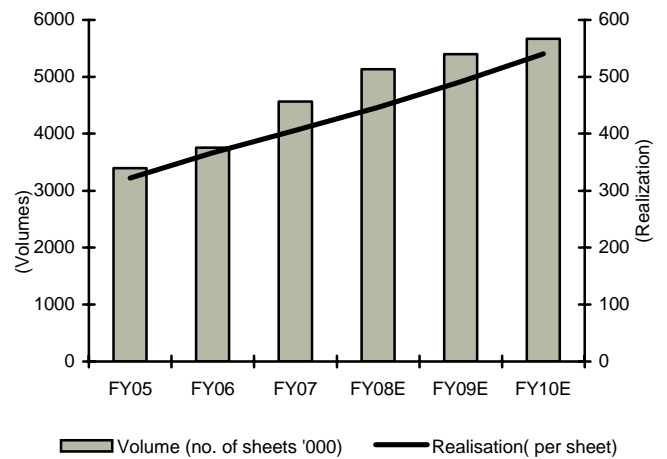
Source: Company, Ambit Capital Research estimates

Plywood production and realization



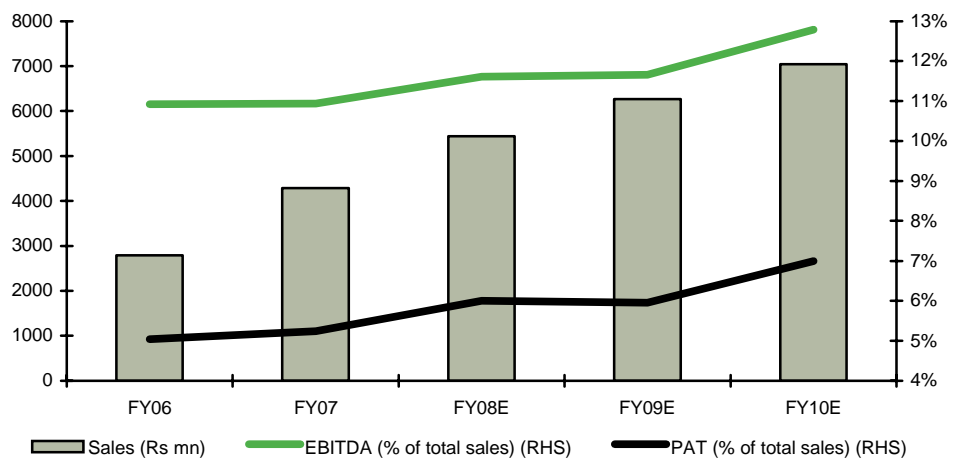
Source: Company, Ambit Capital Research estimates

Laminate production and realization



Source: Company, Ambit Capital Research estimates

Revenue, EBITDA and PAT growth



Source: Company, Ambit Capital Research estimates

We expect the company to exhibit a CAGR growth of 18% in sales and 28.5% in net profit over the period FY07-FY10E. Given its track record of consistent and robust growth over the period FY03-FY07 and strong fundamentals, we expect a re-rating of the stock. At the CMP of Rs152, the stock is currently trading at a P/E of 9.2x and 6.8x our FY08E and FY09E EPS estimates.

We value the company based on DCF estimates as

- The industry is not a commodity and cyclicity is less
- Cash flows capture growth of the company

Our DCF-based valuation yields a target price of Rs246 over a 12-month horizon. We initiate coverage on the stock with a BUY recommendation and a target price of Rs246 over a 12-month horizon, indicating an upside of 62% from current levels.

Key ratio comparison with peers - FY07

	EBITDA (%)	PAT (%)	EPS (Rs)	Mkt. Cap (Rs mn)	P/E(x)	EV/EBITDA(x)	EV/Sales(x)	P/BV(x)
Century Plyboard	10.6	4.8	10.3	5,866	28.7	14.3	1.5	5.0
Greenply	10.9	5.2	13.8	2,500	11.0	7.8	0.9	2.5

Source: Capitaline; Ambit Capital Research estimates

While comparing with its peer Centuryply, we find that Greenply has done well on all the operational parameters but still trades at a discount to Centuryply on all of the valuation parameters. We observe an unrealistic valuation gap between Centuryply and Greenply, and expect the gap to narrow down from the current levels. At our fair value of Rs235, the stock now trades at a P/E of 9.2 and 6.8 based on FY08 and FY09 earnings respectively.

DCF assumptions (%)

Tax rate upto FY10	18.0
Rf	8.0
Rm - Rf	6.0
Adj Beta	0.87
kE	13.2
kD	9.8
WACC	12.2
Transition period growth	10.0
Terminal growth	3.0
Long term tax rate	35.0
Transition period kD	7.8
Transition period WACC	11.6

Source: Ambit Capital Research estimates

DCF valuation

(Rs mn)	FY06	FY07	FY08E	FY09E	FY10E
EBIT* (1-t)	199	314	428	524	606
EBIT growth rate (%)	74.9	58.1	36.3	22.5	15.6
Depreciation	63	87	102	136	150
Delta working capital	96	93	167	171	131
Capital expenditure	712	508	121	150	150
Free cash flow to firm	(546)	(200)	242	338	475
Discounted value			229	285	356
Total Discounted value		2,177			
Terminal value (Rs mn)		2,772			
Total value (Rs mn)		4,949			
Debt (Rs mn)		1,500			
Cash (Rs mn)		278			
Total shareholders' value (Rs mn)		3,728			
No. of shares (post dilution) (mn)		17			
Present fair value, Rs		219			
1-yr forward value per share (Rs)		246			
Upside (%)		62.0			

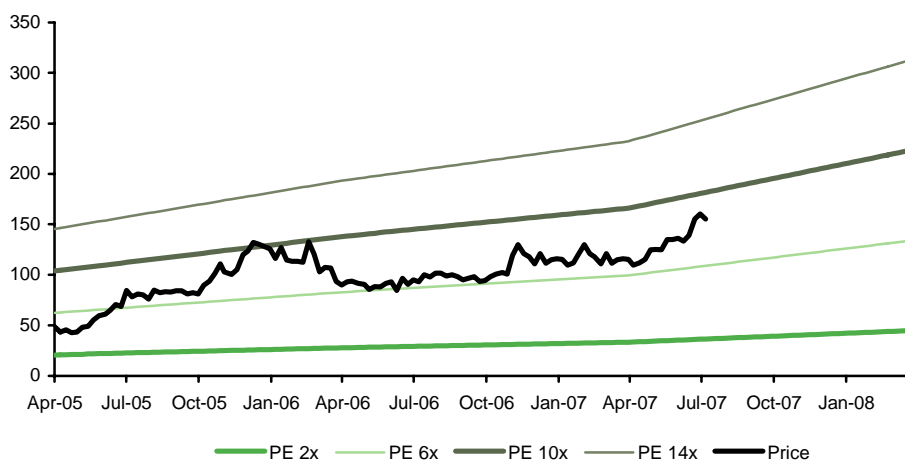
Source: Ambit Capital Research estimates

Key concerns

The dominant unorganized sector can hamper the price realization growth, thus hurting company's EBITDA and PAT margins.

Timber, a key raw material for plywood is a scarce resource. The same is the case with phenol, a key chemical used in laminate. Both registered a sharp increase in prices in FY07. Continuation of this trend can hurt the company's margins, if it is unable to pass on the increase in the costs.

Rising interest rates can lead to a slowdown in the housing units and commercial space demand. This can limit company's revenue growth rate.

1-year forward P/E band

Source: Ambit Capital Research estimates

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