

ESSEL PROPACK

INR 77

*Growth engines in place*

BUY

Essel Propack posted revenues of INR 2.9 bn at a Y-o-Y growth of 28.0%, in line with expectations. For the full year CY06, revenues grew 23.7% to INR 10.1 bn. The growth was driven by growth in lamitubes in USA and Europe, and contributions from the newly acquired medical devices and specialty packaging businesses. Since the new businesses have lower EBITDA margins compared to the base tubes business, the EBITDA margins declined slightly because of the changing revenue mix. Another factor for decline was expenses related to capacity expansion currently underway in USA, Poland and India.

We continue to remain positive on the long term outlook of Essel Propack. It is the market leader in laminated tubes and had ventured into plastic tubes through acquisition of Arista. In order to reduce dependence on tubes market, it has recently diversified into medical devices and specialty packaging business. This strategy of diversifying its revenue streams provides comfort on the growth outlook of the company. We expect revenues and net profits to grow at CAGR of 23% and 20%, respectively over CY06-08E. The stock trades at attractive valuation of 10.6x CY07E and 8.5x CY08E on a P/E basis. We maintain our 'BUY' recommendation.

Key highlights

- ◆ Revenue for the quarter grew 28.0% Y-o-Y and 4.5% Q-o-Q to INR 2.9 bn, in line with our expectations. For the full year CY06, revenues grew 23.7% to INR 10.1 bn.
 - This impressive growth over last year was partly due to the contributions made by the recently acquired medical devices business of Avalon and Tacpro, and the specialty packaging business of Packaging India Pvt. Ltd (PIPL). These businesses are being consolidated with Essel Propack's numbers effective April 1, 2006 and September 1, 2006, respectively.
 - For the full year CY06, 89% of revenues came from the tubes business, 7% from the medical devices business and the remaining 4% from the specialty packaging business.
- ◆ EBITDA margins for the quarter stood at 20.1% while for the full year, EBITDA margins stood at 22.7%.
 - The recently acquired business of PIPL has lower EBITDA margins of about 12-13% as compared to ~ 20% EBITDA margins for the medical devices business and ~ 26% EBITDA margins for the tubes business. As a result of the revenue mix changing in favor of specialty packaging and medical devices, the EBITDA margins have declined.

Financials

Year to December	Q4CY06	Q4CY05	% change	Q3CY06	% change	CY06	CY07E
Revenues (INR mn)	2,893	2,261	28.0	2,769	4.5	10,099	12,725
EBITDA (INR mn)	582	503	15.7	654	(11.0)	2,290	2,850
Net profit (INR mn)	301	273	10	267	13	985	1,137
EPS (INR)	1.9	1.7		1.7		6.3	7.3
PE (x)						12.2	10.6
EV/EBITDA (x)						7.7	6.2

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Reuters : ESSL.BO
Bloomberg : ESEL IN

Market Data

52-week range (INR) : 97 / 61
Share in issue (mn) : 157.0
M cap (INR bn/USD mn) : 12.0 / 272.5
Avg. Daily Vol. BSE ('000) : 71.3

Share Holding Pattern (%)

Promoters : 58.9
MFs, FIs & Banks : 12.0
FIs : 4.8
Others : 24.3

- Another reason for decline in margins was the investments made on capacity expansions currently underway in USA, Poland and India. The company has already started incurring expenses on additional manpower, facilities and trial runs while fresh orders are yet to materialize.
- In addition, as per the management, while the units of Telcon and Mexico have turned profitable, the units of Arista in UK and the greenfield venture in Russia continue to make losses. However, these units are expected to turnaround in the second half of CY07.
- ♦ While the net profit margins for the quarter improved by 80 bps sequentially, there was a decline of 167 bps on a Y-o-Y basis. This was largely on account of higher interest expense.

Other highlights

* Outlook remains positive

We continue to remain positive on Essel Propack. It has close to a third of the global lamitube market share. In order to reduce its exposure to the dentrifice market and diversify its revenue stream, the company ventured into plastic tubes through acquisition of Arista. The company has now identified plastic tubes as a thrust area and has put capacities in India and USA in addition to UK. It has big plans to grow as OEM of medical devices by expanding into non-cardiac applications of catheters and also entering other specialties like orthopedics. The recent acquisition of PIPL has given Essel Propack the vehicle to address the specialty and pharmaceutical packaging market.

* Revenues and PAT to grow at 23% and 20%, CAGR respectively over CY06-08E

We expect revenues to grow at a CAGR of 23% over CY06-08E. While we expect the laminated tubes business to grow at a nominal 10%, the growth will be primarily driven by 40%+ growth in plastic tubes segment and 20-25% growth in the medical devices category. In addition, the specialty packaging business will also have its full year impact in CY07 as against only four months of consolidation in CY06. We expect this segment to grow at 20-25% thereafter, large part of the growth coming from pharmaceutical packaging, going forward. On account of the changing revenue mix and continued capex, we expect the margins in CY07 to remain soft but expect an improvement thereafter in CY08. However, we expect the ROCEs to improve as the new businesses have higher asset turnover ratio.

* Attractive valuations. Maintain 'BUY'

We estimate that Essel Propack will PAT of INR 1.14 bn in CY07 and INR 1.42 in CY08. This translates into EPS of INR 7.3 and INR 9.1 in CY07 and CY08, respectively. The stock trades at 10.6x CY07E and 8.5x CY08E. We maintain our 'BUY' recommendation on the stock.

Financial snapshot										(INR mn)
Year to December	Q4CY06	Q4CY05	% change	Q3CY06	% change	CY05	CY06	% change	CY07E	CY08E
Revenues	2,893	2,261	28.0	2,769	4.5	8,166	10,099	23.7	12,725	15,314
Raw material	1,322	946	39.7	1,173	12.7	3,738	4,318	15.5	5,535	6,662
Staff costs	514	366	40.4	478	7.5	1,337	1,794	34.2	2,303	2,703
Others	475	446	6.5	464	2.4	1,154	1,697	47.0	2,036	2,450
Total expenditure	2,311	1,758	31.5	2,115	9.3	6,229	7,809	25.4	9,875	11,815
EBITDA	582	503	15.7	654	(11.0)	1,937	2,290	18.2	2,850	3,498
Interest	83	43	93.0	79	5.1	132	279	111.4	315	315
Depreciation	296	219	35.2	221	33.9	766	937	22.3	1,250	1,416
Other income	163	66	147.0	35	365.7	178	225	26.4	206	141
PBT	366	307	19.2	389	(5.9)	1,217	1,299	6.7	1,491	1,908
Tax	65	34	91.2	110	(40.9)	308	302	(1.9)	340	473
Adjusted net profit	301	273	10.3	279	7.9	909	997	9.7	1,152	1,435
Minority interest	-	-		-		7	-		15	18
Recurring net profit	301	273	10.3	279	7.9	902	997	10.6	1,137	1,417
Extraordinary items	-	-		(12)		-	(12)		-	-
Reported net profit	301	273	10.3	267	12.7	902	985	9.3	1,137	1,417
Equity capital (FV INR 2)	313	313		313		313	313		313	313
No. of shares (mn)	157	157		157		157	157		157	157
EPS (INR)	1.9	1.7		1.7		5.8	6.3		7.3	9.1
PE (x)						13.3	12.2		10.6	8.5
as % of net revenues										
Direct costs	45.7	41.8		42.4		45.8	42.8		43.5	43.5
Employee expenses	17.8	16.2		17.3		16.4	17.8		18.1	17.7
Other expenses	16.4	19.7		16.8		14.1	16.8		16.0	16.0
EBITDA	20.1	22.2		23.6		23.7	22.7		22.4	22.8
Net profit	10.4	12.1		9.6		11.0	9.8		8.9	9.3

Company description

Essel Propack manufactures laminated tubes, plastic tubes, medical devices and specialty packaging materials. The company provides tube packaging solutions to toothpaste, pharmaceuticals, cosmetics, toiletries, food and industrial sectors all over the world. In Medical Devices, the company manufactures cardio-vascular catheters and delivery systems. The specialty packaging materials of the company currently caters to the food and pharmaceutical industry. The company has state-of-the-art manufacturing facilities in 13 countries with 24 plants across the globe.

Investment rationale

Essel Propack has close to a third of the global lamitube market share. In order to reduce its exposure to the dentrifice market and diversify its revenue stream, the company ventured into plastic tubes through acquisition of Arista. The company has now identified plastic tubes as a thrust area and has put capacities in India and USA in addition to UK. It has big plans to grow as OEM of medical devices by expanding into non-cardiac applications of catheters and also entering other specialties like orthopedics. The recent acquisition of PIPL has given Essel Propack the vehicle to address the specialty and pharmaceutical packaging market. We expect revenues and net profits of the company to grow at CAGR of 23% and 20%, respectively over CY06-08E.

Risks to recommendation

Slowdown in demand of oral care products can impact the growth of lamitubes business which formed close to 77% of the revenues in CY07. In addition, low capacity utilizations in the new capacities can result in lower profitability. The other key risks are increase in raw material prices, further hardening of interest rates leading to higher financing costs or loss of contract of any major customer.

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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