

ESSEL PROPACK

INR 71

*Result in line, outlook positive*

BUY

Essel Propack posted revenues of INR 2.8 bn at a Y-o-Y growth of 33.2%, in line with expectations. 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 9.9x CY07E and 7.8x CY08E on a P/E basis. We maintain our 'BUY' recommendation.

Key highlights

- Consolidated revenues for the quarter grew 33.2% Y-o-Y to INR 2.8 bn, in line with our expectations.
 - The results are not strictly comparable because it added the medical devices business (through acquisition of Avalon and Tacpro) and specialty packaging business (through acquisition of Packaging India Pvt Ltd) after Q1CY06.
 - These two businesses have contributed approximately INR 226 mn and INR 311 mn, respectively to this quarter's topline. After removing the effect of these, the topline for the tubes business grew by ~ 8% Y-o-Y.
- EBITDA margins for the quarter stood at 19.7% compared to 24.1% EBITDA margins last year. This is on account of changing revenue mix and investments made in capacity expansions and new product development.
 - The medical devices business and specialty packaging business have EBITDA margins of 20% and 13%, respectively compared to ~25% EBITDA margins for the lamitubes business. Change in revenue mix because of higher contribution from these businesses is one reason for the decline in EBITDA margins.
 - Another reason for the decline was INR 41 mn of expense related to new product development initiative that has been charged off in this quarters P&L.

Financials

Year to December	Q1CY07	Q1CY06	% change	Q4CY06	% change	CY06	CY07E
Revenues (INR mn)	2,825	2,121	33.2	2,893	(2.4)	10,099	12,725
EBITDA (INR mn)	556	511	8.8	582	(4.5)	2,290	2,799
Net profit (INR mn)	206	186	10.5	301	(31.6)	997	1,141
EPS (INR)	1.2	1.2		1.9		6.3	7.2
PE (x)						11.3	9.9
EV/EBITDA (x)						7.0	5.7

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Market Data

52-week range (INR) : 97 / 61
Share in issue (mn) : 157.0
M cap (INR bn/USD mn) : 11.1 / 264.4
Avg. Daily Vol. BSE ('000) : 76.1

Share Holding Pattern (%)

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

- In addition, the company has been investing in expanding plastic tubes capacities in USA and Poland and specialty packaging capacities in India which has also pulled down the margins a bit. The company has already started incurring expenses on additional manpower, facilities and trial runs while fresh orders are yet to materialize.
- ♦ The company posted PAT of INR 206 mn compared to INR 186 mn in Q1CY06. There is an extra-ordinary charge of INR 11 mn related to closure of an overseas unit. After adjusting for that, the reported PAT stood at INR 195 mn.

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 in consolidated revenues 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 ROCE and ROE to improve as the new businesses have higher asset turnover ratio.

* Attractive valuations. Maintain 'BUY'

We estimate that Essel Propack will PAT of INR 1.13 bn in CY07 and INR 1.42 in CY08. This translates into EPS of INR 7.2 and INR 9.1 in CY07 and CY08, respectively. The stock trades at attractive valuations of 9.9x CY07E and 7.8x CY08E. We maintain our 'BUY' recommendation on the stock.

(INR mn)

Financial Snapshot								
Year to December	Q1CY07	Q1CY06	% change	Q4CY06	% change	CY06	CY07E	CY08E
Revenues	2,825	2,121	33.2	2,893	(2.4)	10,099	12,725	15,314
Raw material	1,265	902	40.2	1,322	(4.3)	4,318	5,535	6,662
Staff costs	500	360	38.9	514	(2.7)	1,794	2,240	2,692
Others	504	348	44.8	475	6.1	1,697	2,151	2,459
Total expenditure	2,269	1,610	40.9	2,311	(1.8)	7,809	9,926	11,813
EBITDA	556	511	8.8	582	(4.5)	2,290	2,799	3,501
Interest	88	46	91.3	83	6.0	279	392	360
Depreciation	234	208	12.5	296	(20.9)	937	1,101	1,416
Other income	36	1	2,365.8	163	(77.9)	225	191	188
PBT	270	258	4.5	366	(26.2)	1,299	1,497	1,913
Tax	64	72	(11.1)	65	(1.5)	302	341	474
Adjusted net profit	206	186	10.5	301	(31.6)	997	1,156	1,439
Minority interest	-	-		-		-	15	18
Recurring net profit	206	186	10.5	301	(31.6)	997	1,141	1,421
Extraordinary items	(11)	-		-		(12)	(11)	-
Reported net profit	195	186	4.6	301	(35.2)	985	1,130	1,421
Equity capital (FV INR 2)	313	313		313		313	313	313
No. of shares (mn)	157	157		157		157	157	157
EPS (INR)	1.2	1.2		1.9		6.3	7.2	9.1
PE (x)						11.3	9.9	7.8
as % of net revenues								
Direct costs	44.8	42.5		45.7		42.8	43.5	43.5
Employee expenses	17.7	17.0		17.8		17.8	17.6	17.6
Other expenses	17.8	16.4		16.4		16.8	16.9	16.1
EBITDA	19.7	24.1		20.1		22.7	22.0	22.9
Net profit	6.9	8.8		10.4		9.8	8.9	9.3

Company description

Essel Propack manufactures laminated tubes, plastic tubes, medical devices and specialty packaging materials. It 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 CY06. 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.

Financial Statements

Income statement					(INR mn)
Year to December	CY04	CY05	CY06	CY07E	CY08E
Net revenues	6,699	8,166	10,099	12,725	15,314
Raw materials	3,117	3,738	4,317	5,535	6,662
Employee expenses	879	1,337	1,794	2,240	2,692
S G & A expenses	887	1,154	1,699	2,151	2,459
Total expenditure	4,883	6,229	7,810	9,926	27,126
EBIDTA	1,816	1,937	2,289	2,799	3,501
Depreciation	641	766	937	1,101	1,416
Interest expenditure	60	132	279	392	360
Other income	87	178	238	191	188
Profit before tax	1,202	1,217	1,311	1,497	1,913
Provision for taxation	366	308	302	341	474
Minority interest	8	7	13	15	18
Profit after tax	828	902	996	1,141	1,421
Recurring net profit	828	902	996	1,141	1,421
Extraordinary items	(20)	-	(12)	(11)	-
Reported profit	809	902	984	1,130	1,421
EPS (INR) fully diluted	5.2	5.8	6.3	7.2	9.1
CEPS (Rs.) fully diluted	9.3	10.7	12.4	14.3	18.2
Dividend per share	9.0	22.0	2.0	2.5	2.8
Dividend payout ratio (%)	34.9	76.4	31.8	34.6	30.9

Common size metrics- as % of net revenues

Year to December	CY04	CY05	CY06	CY07E	CY08E
Raw material expenses	46.5	45.8	42.7	43.5	43.5
Employee expenses	13.1	16.4	17.8	17.6	17.6
S G & A expenses	13.2	14.1	16.8	16.9	16.1
Depreciation	9.6	9.4	9.3	8.6	9.2
Interest expenditure	0.9	1.6	2.8	3.1	2.3
EBIDTA margin	27.1	23.7	22.7	22.0	22.9
EBIT margin	17.5	14.3	13.4	13.3	13.6
Net profit margin	12.4	11.0	9.9	9.0	9.3

Growth metrics

Year to December	CY04	CY05	CY06	CY07E	CY08E
Net revenues	16.1	21.9	23.7	26.0	20.3
EBITDA	11.7	6.7	18.2	22.3	25.1
EBIT	17.8	(0.4)	15.5	25.6	22.7
Net profit	14.6	11.5	9.1	14.9	25.7
EPS	14.6	11.5	9.1	14.9	25.7

Balance sheet					(INR mn)
As on 31st December	CY04	CY05	CY06E	CY07E	CY08E
Share capital	313	313	313	313	313
Reserves	6,631	6,722	7,354	8,044	8,971
Shareholders funds	6,944	7,035	7,667	8,357	9,285
Minority Interest	53	56	69	84	102
Secured loans	3,299	4,030	5,300	5,280	5,300
Deferred tax liability	246	235	235	240	245
Sources of funds	10,542	11,356	13,271	13,961	14,931
Gross assets	8,896	10,893	13,013	14,163	15,963
Less depreciation	4,063	5,209	6,146	7,247	8,663
Capital WIP	277	209	210	215	220
Net fixed assets	5,109	5,892	7,076	7,131	7,520
Goodwill	2,947	3,043	3,043	3,043	3,043
Investments	414	420	420	430	440
Current assets	3,497	4,039	4,737	5,880	6,931
Debtors	991	1,031	1,383	1,708	2,014
Cash & bank balance	368	427	299	323	285
Inventory	953	1,168	1,439	1,813	2,182
Advances	1,184	1,413	1,616	2,036	2,450
Current liabilities	1,498	2,102	2,070	2,587	3,067
Creditors	1,121	1,233	1,688	2,127	2,559
Other liabilities	47	69	69	69	69
Provisions	331	800	313	391	438
Working capital	1,999	1,937	2,667	3,293	3,864
Misc expenditure	73	65	65	65	65
Uses of funds	10,542	11,356	13,271	13,961	14,931
BV (INR)	219.4	222.6	48.6	53.0	58.9

Cash flow statement					(INR mn)
Year to December	CY04	CY05	CY06E	CY07E	CY08E
Cash flow from operations	1483	1666	1934	2246	2855
Cash for working capital	(372)	121	(858)	(602)	(609)
Net operating cash flow (A)	1,111	1,788	1,076	1,644	2,246
Net purchase of fixed assets	(1,207)	(1,645)	(2,121)	(1,155)	(1,805)
Net purchase of investments	202	89	-	(10)	(10)
Net cash flow from investing (B)	(1,005)	(1,555)	(2,121)	(1,165)	(1,815)
Proceeds from LTB/STB	486	720	1,270	(15)	25
Dividend payments	(317)	(775)	(352)	(440)	(493)
Net cash flow from financing	169	(55)	917	(455)	(468)
Free cash flow (A-B)	(96)	143	(1,045)	489	441

Ratios

Year to December	CY04	CY05	CY06E	CY07E	CY08E
ROE	11.8	12.9	12.9	13.6	15.4
ROCE	8.4	9.2	9.7	11.1	12.1
Debtor (days)	54	46	50	49	48
Inventory (days)	52	52	52	52	52
Fixed assets (T/o)	0.8	0.9	1.0	1.3	1.4
Debt/Equity	0.5	0.6	0.7	0.7	0.6
Interest coverage	19.5	8.9	4.8	4.3	5.8

Valuations parameters

Year to December	CY04	CY05	CY06E	CY07E	CY08E
EPS (diluted) (INR)	25.8	28.8	6.3	7.2	9.1
<i>Y-o-Y growth (%)</i>	<i>14.2</i>	<i>11.5</i>	<i>(78.2)</i>	<i>14.9</i>	<i>25.7</i>
CEPS	9.3	10.7	12.4	14.3	18.2
PE (x)	13.8	12.4	11.3	9.9	7.8
FCFPS (INR)	(3.1)	4.6	(6.7)	3.1	2.8
<i>Y-o-Y growth (%)</i>		<i>249.5</i>	<i>(246.3)</i>	<i>(146.8)</i>	<i>(9.8)</i>
FCFPE (x)		15.6	(10.7)	22.8	25.3
Price/BV	0.3	0.3	1.5	1.3	1.2
Market cap/FCF		2,442.1	(1,669.6)	3,570.1	3,958.5
EV/Sales	2.2	1.8	1.6	1.3	1.0
EV/EBITDA	8.1	7.5	7.0	5.7	4.6

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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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