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Paper Sector

Industry on the Cusp of a Turnaround

Sector Update

January 3, 2014

Recommendation summary

Co. Name	CMP	Reco.	Target
BILT	13	Accumulate	23
JK Paper	31	Sell	30
TNPL	122	Buy	168

- **Industry has been on capex mode for the last 4-5 years, leading to higher competitive intensity and lower pricing power in the hands of the manufacturers**
- **Capacity additions have been funded through a mix of debt and internal cash generation, which have led to a rise in debt**
- **Intensity of capacity additions has been higher than the previous cycle. Players analyzed by us have reported a 1.7x increase in capacity over FY08-14 compared with 1.2x during FY03-08**
- **Increase in raw material prices, due to limited availability and inflexible supply, has impacted EBITDA margins. EBITDA margins for the peer set analyzed by us shrunk from 23.4% in FY08 to 15.9% in FY13**
- **Capacity addition intensity is expected to decline significantly in the next 2-3 years, as no new large capacity additions are expected**
- **Reducing competitive intensity and continued absorption of excess capacity have helped players significantly pass on cost-push pressures in CY13**
- **Structural growth factors supporting domestic consumption remain intact, as the industry is expected to benefit from increasing per capita consumption in the medium term and higher demand due to general elections in the near term**
- **High operating leverage to lead to direct flow of benefit of higher average realizations to the bottom-line, improving cashflow generation, improved margins and de-leveraging of the balance sheet**
- **TNPL to benefit the most due to cost leadership, along with BILT, which is likely to benefit from higher operating leverage**
- **Valuations for TNPL (40% discunt to book value) and BILT (60% discount to BV) are close to the down-cycle troughs. Strong dividend yield at 4-5% coushins the downside risk**
- **Further increase in paper prices will lead to earnings upgrade going forward as we have not modeled for further price increase in FY15**

Exhibit 1: Valuation table

Company Name	Net Sales FY14E	EPS CAGR FY13-15E	P/B		P/E		RoE	
			FY14E	FY15E	FY14E	FY15E	FY14E	FY15E
BILT	53,412	35%	0.4	0.4	11.0	6.3	3.1	5.6
JK Paper	18,460	0%	0.4	0.4	n.a.	17.4	0.2	2.4
TNPL	20,402	46%	0.7	0.6	4.6	4.0	15.2	15.7

Source: Company, Emkay Research

Industry has been on capex-intensive mode

Indian paper industry is expected to grow at a CAGR of 5%-6% between FY11-27 according to the 12th Five Year Plan projections

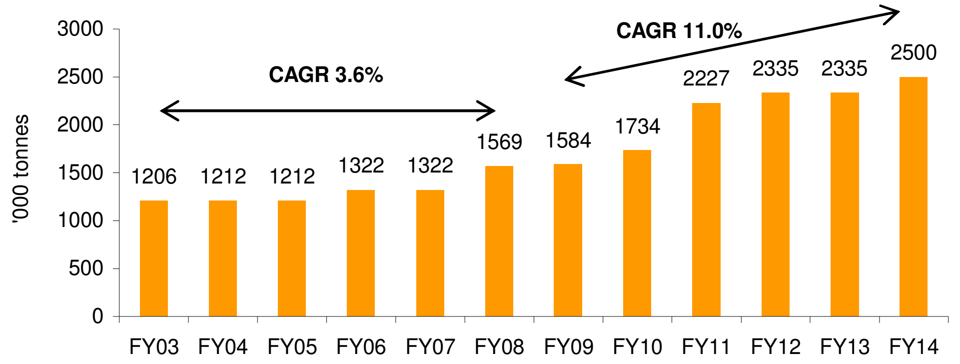
In the last decade, the Indian paper industry has grown at a CAGR of 7-8%. Given the country's low per capita consumption of paper, it is expected that the industry will continue to grow at a similar pace going forward. According to the 12th Plan report of the Planning Commission, the paper consumption in India, as per baseline projections, is expected to increase from 10.1mn tons in FY11 to 23.5mn tons in FY27.

In view of the steady growth expectation, paper millers in the country have been on capacity expansion mode since FY09. The industry has always remained cyclical in nature, with capacity expansions becoming imperative every 2-3 years in order to cope with incremental demand.

Industry has thus been on a capex mode in the last 4-5 years. Capex intensity in the current expansion was higher than the previous capex cycle

According to estimates, the industry has added close to 1mn ton of new capacities during FY14. However, the capex intensity has been higher in the recent past compared with earlier cycles on the expectation of sustained steady growth in paper demand. In order to understand the intensity of capacity additions, we have conducted a detailed analysis of large Indian paper millers for a period of 10 years. As shown below, the capacity expansion intensity for the peer set analyzed by us stood higher at 1.7x over FY08-14 compared with 1.2x during FY03-08.

Exhibit 2: Aggregate capacity of peer set



Source: Company, Emkay Research

Capacity additions by the industry grew at a CAGR of 3.6% between FY03 and FY08, while it increased at a CAGR of 11% between FY09 and FY14. As a result of the increase in capacities across the board, the competitive intensity within the sector has increased.

Increased capex puts pressure on input costs

Wood based capacities contribute to the highest share in inputs for writing/printing segment while packaging segment in dependent on RCF and waste paper for its raw material requirement

The Indian paper industry relies on three broad categories of raw materials, wood-based, agro-based and RCF/waste paper-based materials, to meet its requirements. The wood-based material constitutes 31.5% of the industry's total raw material requirement. It is the dominant raw material for the writing and printing segment with a 60% share. The agro-based material accounts for 22%, and RCF/waste-based material for 46.5%. The RCF/waste paper has a dominant share of 58% of the total input requirements of the packaging segment.

Exhibit 3: Share of raw material

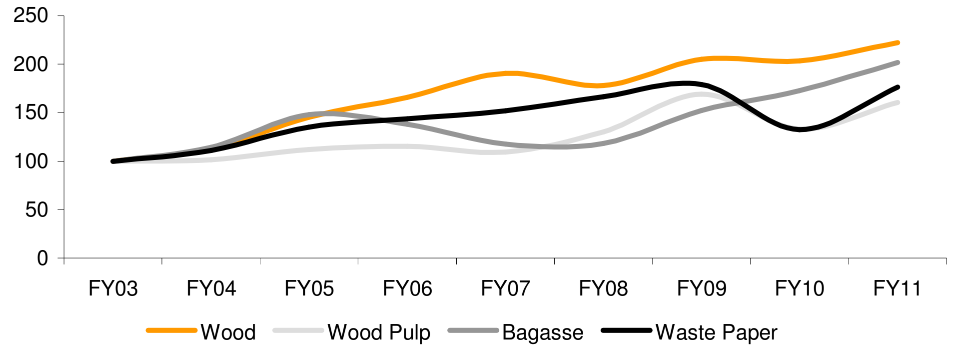
Variety of Paper	Wood-based	Agro-based	RCF/Waste paper- based	Total
Writing/printing	2.36	0.73	0.81	3.9
Packaging	0.77	1.5	3.15	5.42
Newsprint	0.03	0	0.76	0.79
Grand Total	**3.16**	**2.23**	**4.72**	**10.11**

Source: Company, Emkay Research

Clustered capacity expansion has put pressure on wood chip demand. Inflexible supplies led to sharp increase in raw material costs

In view of the fact that wood-based raw material accounts for a dominant share of the writing and printing paper segment, the rise in capacities of this segment needs to match the increase in availability of raw material. Since the supply of wood-based raw material is inelastic in nature, the increased capacity additions have put pressure on the input cost of wood and wood-based raw material. As shown below, an analysis of the average cost of various raw materials between FY03 and FY11 reveals that wood prices, on an average, have risen at a CAGR of 10% during the period under analysis compared with a CAGR of 6% and 7% for wood pulp and waste paper, respectively.

Exhibit 4: Average re-based cost index by raw material



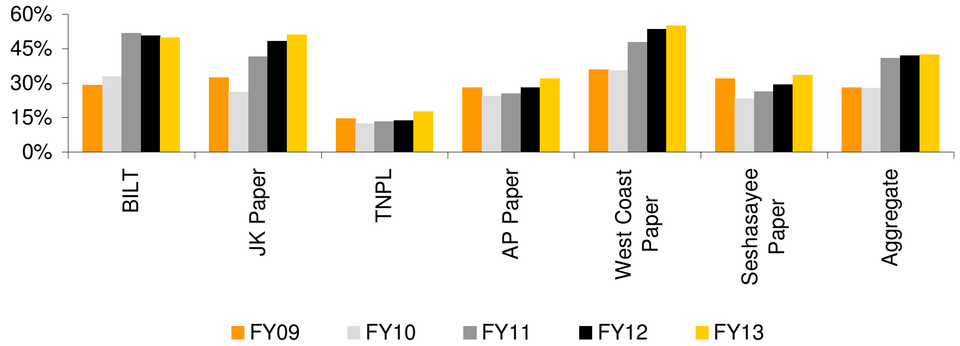
Source: Company, Emkay Research

Raw material costs increased significantly over FY09-12

Raw material as a percentage of sales thus increased significantly from 28% in FY09 to 42% in FY13

Our analysis of large paper millers in the country reveals that the raw material pressure was palpable across the board. Between FY10 and FY12, the raw material cost, as a percentage of sales, increased from 28% to 42% at the aggregate level for the companies analyzed by us. For instance, BILT witnessed the highest increase in raw material costs, while the rise in TNPL remained muted. Raw material costs after peaking in FY12 moderated marginally in FY13.

Exhibit 5: Raw material costs as a percentage of sales



Source: Company, Emkay Research

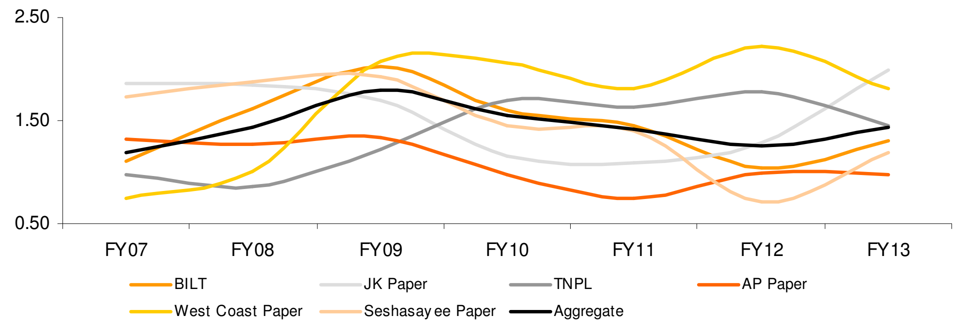
Increase in leverage due to higher capex

Capex expenditures have been funded with a mix of debt and internal accruals thereby leading to increase in leverage

Increase in capex expenditure was funded through a mix of both debt and internal cashflow generation. As a result of the higher capex, at the aggregate level, the gross block, including capital WIP for the analyzed peer set, increased 2x between FY08 and FY13. Of the companies analyzed by us, the capex intensity between FY08 and FY13 was highest for West Coast Paper, while it was the lowest for AP Paper.

As a result of the increase in capex, the balance-sheet leverage continued to remain elevated. Hence, the total debt-to-equity ratio remained elevated between FY08 and FY13. As a result, the interest outgo has continued to remain elevated.

Exhibit 6: Total debt-to-equity ratio



Source: Company, Emkay Research

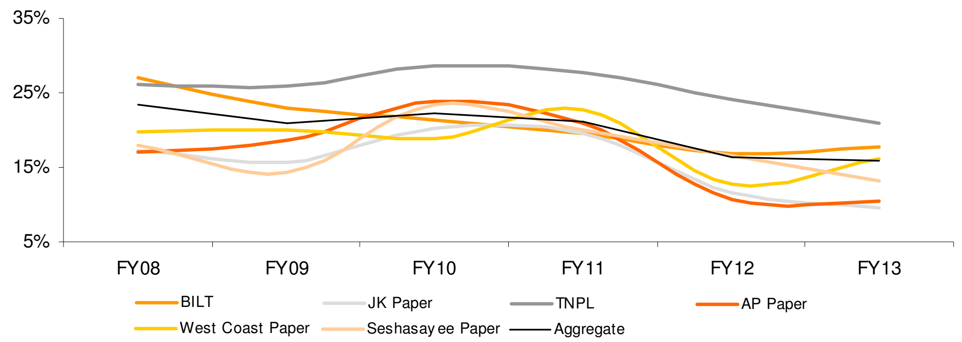
Lower average realizations, higher cost and higher interest outflows impact profitability

Given the increased capex intensity within the sector, the competitive intensity continued to scale up. As a result, average realizations remained subdued. The inability of the players to pass on cost pressures led to a significant impact on EBITDA margins.

High competitive intensity due to commissioning of capacities and higher raw material costs impacted EBITDA margins significantly in the current down cycle

The EBITDA margins expanded from 19.3% in FY05 (the peak of the last capex cycle) to 23.4% in FY08. However, with the build-up in competitive intensity due to both moderation in demand during the crisis years and capacity expansions thereafter, the EBITDA margins once again contracted from 23.4% in FY08 to 15.9% in FY13. Although the margin contraction has been broad-based, TNPL saw the least contraction.

Exhibit 7: EBITDA margins



Source: Emkay Research, Company

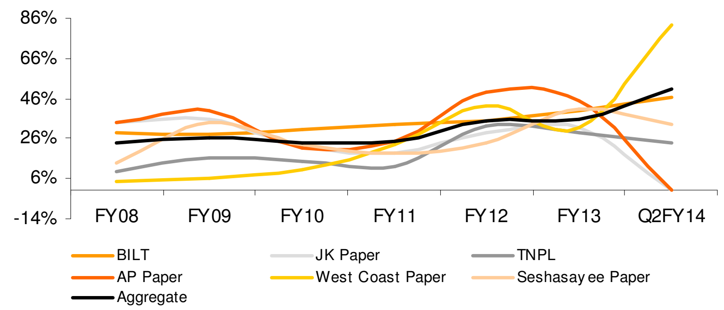
Increase in debt servicing cost to affect bottomline

Net profit margins impacted due to higher interest servicing costs. Interest as a percentage of EBITDA thus increase from 23% in FY08 to 51% in Q2FY14

On the other hand, net profit margins have been further impacted by higher interest servicing costs due to higher leverage. Interest, as a percentage of EBITDA after bottoming out in FY07, continued to increase throughout FY08-13. Interest as a percentage of EBITDA increased from 23% in FY08 to 36% in FY13. It further remained elevated even in Q2FY14 inching higher to 51% in Q2FY14 due to negative EBITDA reported by JK Paper and AP Paper. Tamil Nadu Newsprint by far remained the most comfortable out of the peer set in terms of debt servicing.

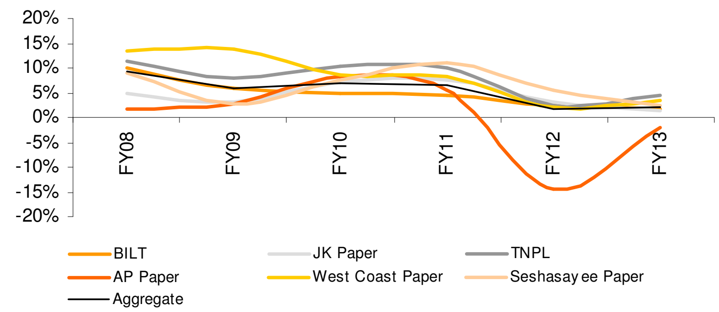
As a result of higher interest outgo, the net profit margin contracted from 9.2% in FY08 to 2% in FY13, which was at 10-year low.

Exhibit 8: Interest as a percentage of EBITDA



Source: Company, Emkay Research

Exhibit 9: Net profit margin



Source: Company, Emkay Research

Industry on the cusp of a turnaround

Earnings could bottom out, as excess supply gets absorbed

Demand supply mismatch to continue improving as capex intensity has reduced

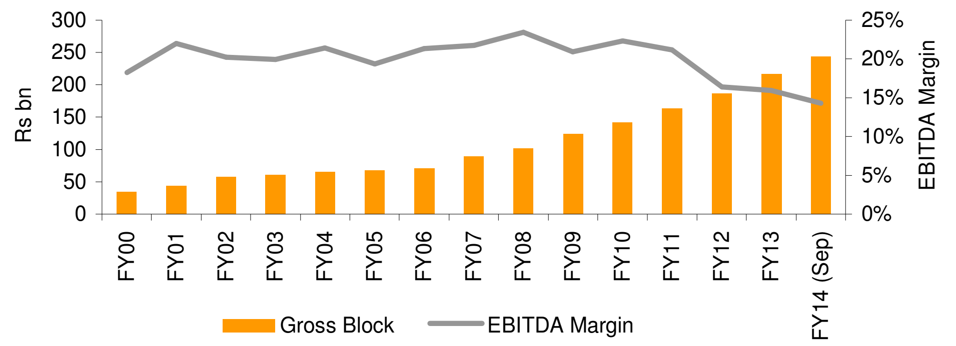
Given the annual growth rate of 5-6%, the incremental demand each year is estimated at 0.5-0.6mn tons. Since the capex intensity is expected to slow down going forward, with no new large capex being announced, the demand-supply mismatch would gradually reduce, as incremental demand absorbs excess supply.

Sector margins are close to historical down-cycle lows

EBITDA margins have contracted and reached down cycle lows. The pressure has been acute in the current capex cycle due to pressure on average realizations and increase in raw material costs

Our analysis of major listed players reveals that EBITDA margins are currently at down-cycle lows. The industry witnessed three bouts of capital expenditure during FY01-03, FY07-09 and FY12-14E. The gross block in these three phases increased at a CAGR of 17.7%, 17.5% and 14.3%, respectively. During these three phases, EBITDA margins contracted from the peak of 22% to 20%, 21.8% to 20.9% and 22.3% to 15.9%, respectively, at the aggregate level for the peer set analyzed by us. The significant drop in margins in the latest capex cycle can be attributed to a significant increase in raw material costs, which have risen from 28% of sales in FY10 to 42% of sales in FY12.

Exhibit 10: Gross block and EBITDA margins



Source: Company, Emkay Research

Structural demand levers remain intact

Structural demand levers for the sector remains intact in the medium term with demand expected to grow at a CAGR of 5-6% (12th Five Year Plan projections) between FY11-27. Further, in the near term, with forthcoming elections, demand for paper is expected to remain firm.

Currency depreciation hurt imports and creates opportunity for exports

Currency depreciation has helped shield the industry from import pressures while opening up export opportunities for the sector

Paper industry does not faces severe competition from imports due to fragmented nature of the industry and customized products requirement except coated paper segment. Coated paper segment has been facing pressure on realization due to imports. However recent currency depreciation has given cost advantage to the domestic manufacturers in coated segment. Players like BILT and JK paper have taken it as an opportunity to increase the prices in coated paper segment.

We expect the currency depreciation to help increasing export opportunity. Companies like TNPL have seen significant increase in export volume and realizations. Though domestic realizations remain lucrative compared to exports, we believe that there may be an opportunity going forward in this segment.

Absorption of supply boost realisations

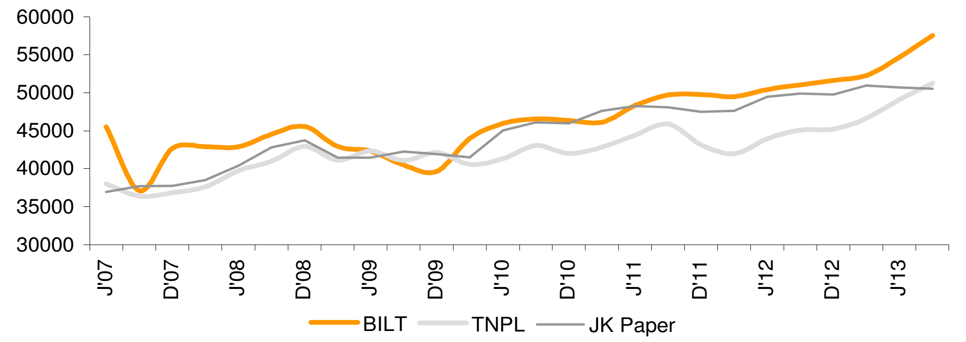
Steady demand has helped absorb incremental capacities thereby helping millers to take price increases

The easing of competitive intensity within the industry has helped restore the bargaining power to some extent in favor of the suppliers. The reduced competitive intensity has helped paper millers to pass on the burden of higher costs to some degree in the last few quarters.

Paper companies have taken price increase of 12-15% in CY13 as against average price increase of 6-10% between CY10-12. The price increase taken in current year is an indicator of increased pricing power in the hand of the industry players. We expect that the momentum may continue in CY14 also as there is not much capacity in plan in near future.

Increase in paper prices in CY13 by 12-14% is the most in last 3 years

Exhibit 11: Average realisation (per MT)

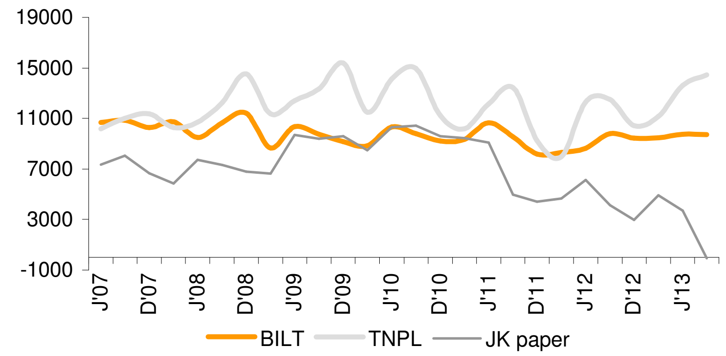


Source: Company, Emkay Research

Higher operating leverage to help achieve margin improvement

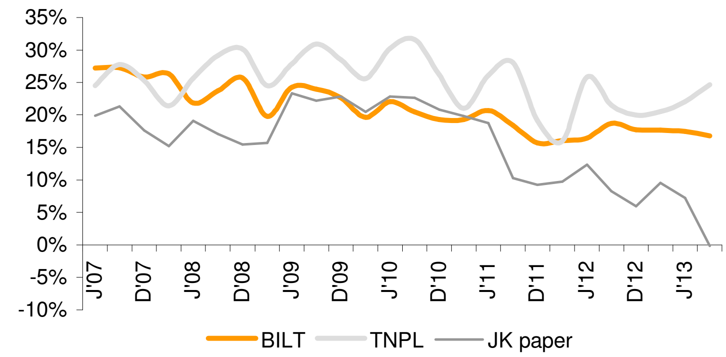
The higher operating leverage (improved capacity utilization) along with increase in realizations to help the companies improved its bottomline. Given the commodity nature of the industry, higher realizations have direct impact on companies' bottomline.

Exhibit 12: EBITDA (Rs/MT)



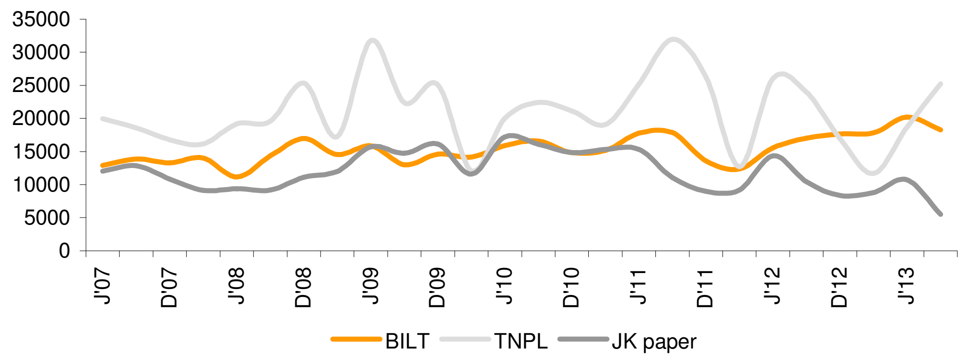
Source: Company, Emkay Research

Exhibit 13: EBITDA margin (%)



Source: Company, Emkay Research

Exhibit 14: Contribution/MT

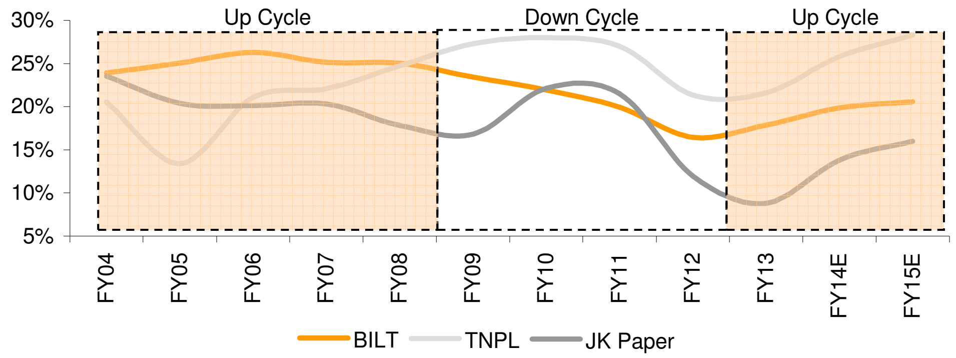


Source: Company, Emkay Research

Return ratios to improve with margin expansion

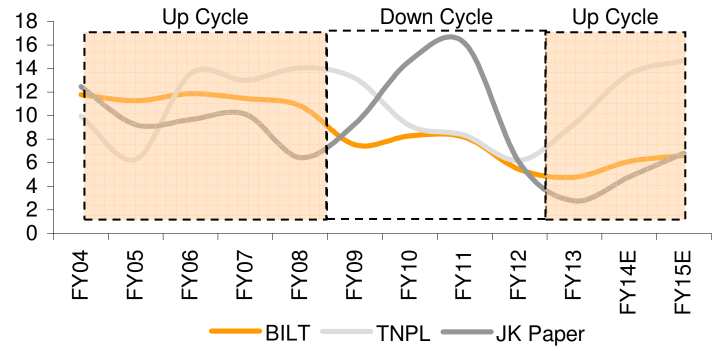
We believe that improvement in profit margins will finally have positive impact on companies' return rations. With industry facing downward pressure, RoCE / RoE have dropped to low single digit in FY11-13. An improvement in profit margins will take RoCE / RoE of the industry players to their previous level of 12-16%.

Exhibit 15: EBITDA Margins



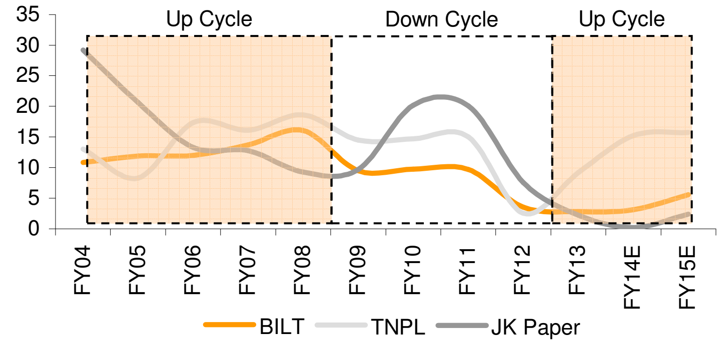
Source: Company, Emkay Research

Exhibit 16: RoCE (%)



Source: Company, Emkay Research

Exhibit 17: RoE (%)



Source: Company, Emkay Research

Cost push to moderate going forward

On the input cost front, we expect some moderation to kick in going forward, as availability of raw material improves. JK Paper, West Coast Paper, TNPL, and AP Paper have cumulatively planted 50,920 hectares of land with saplings (increase of 17% yoy in FY13) in continuation of the earlier initiatives undertaken by the companies. The total land under cultivation by these four companies across various programmes stood at 315,127 hectares at the end of FY13. The benefits of these initiatives are likely to accrue going forward, which will help moderate cost-push pressures.

Exhibit 18: Land under cultivation (hectares)

Plantation	Land under cultivation FY13	Incremental in FY13	Land under cultivation FY12	Incremental in FY12	Land under cultivation FY11	Incremental in FY11	Land under cultivation FY10
JK Paper	101500	11500	90000	8500	81500	6500	75000
TNPL	37114	3920	33194	6242	26952	6224	20728
West Coast Paper	17622	5330	12292	3423	8869	2313	6556
AP Paper	158891	26131	132760	16827	115933	15933	100000
Aggregate	315127	46881	268246	34992	233254	30970	202284
Growth yoy	17%		15%		15%		

Source: Company, Emkay Research

Higher cash generation to help reduce leverage

Improvement in average realizations to help improve cash generation thereby reducing leverage

With a stable-to-positive outlook on average realizations, coupled with operating leverage at play, we expect the benefits of incremental average realizations to flow directly to the bottom-line. This will help increase cashflow generation, which is likely to be primarily used to de-leverage the balance sheet. With no new large capex expected in the coming 2-3 years, cash generation is expected to improve over the next couple of years.

The up–cycle, which is expected to follow, is likely to help reduce the financial strains in the balance sheet of respective companies.

Low cost and leverage players to benefit the most due to changing industry dynamics

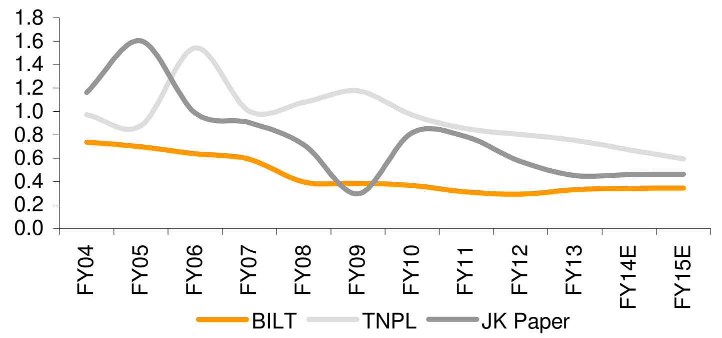
The changing industry dynamics of moving from over-supply to equilibrium is likely to result in pricing power moving back in favour of the manufacturers. As average realizations improve, the companies that are most likely to benefit are low-cost players and operating leverage plays.

Valuations at down-cycle lows

Valuations remain close to down cycle lows while reduction in capex intensity to help improve average realizations and margins

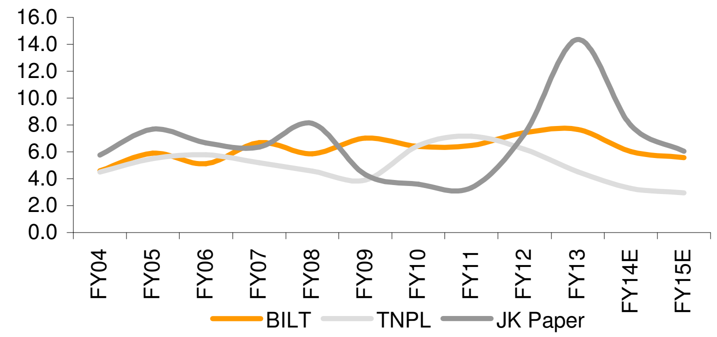
The paper stocks under our coverage are currently trading at valuations that are closer to down-cycle lows. The reduction in capex intensity has resulted in pricing power shifting back in favour of the paper companies. As a result, we have seen a sharp rise in average realizations, which is expected to continue going forward. This is likely to result in improvement in margins, thereby leading to cash generation and improved earnings. The increased cash generation will be used to de-leverage balance sheets, which will help improve valuations of these companies going forward.

Exhibit 19: P/B



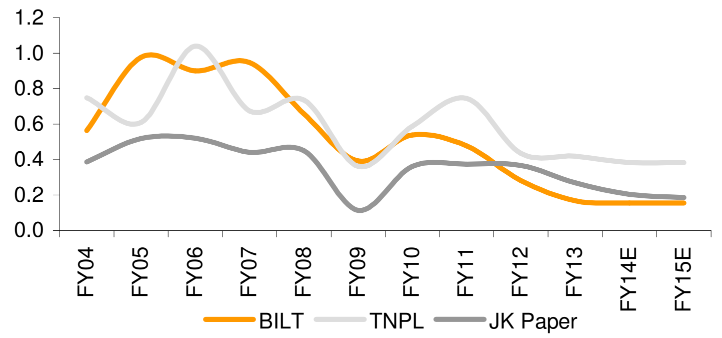
Source: Company, Emkay Research

Exhibit 20: EV/EBITDA



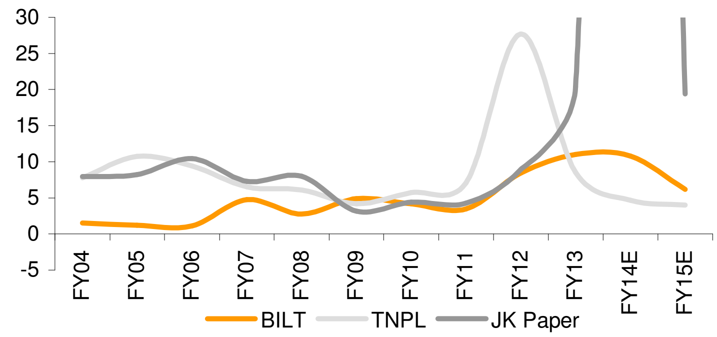
Source: Company, Emkay Research

Exhibit 21: MCap/Sales



Source: Company, Emkay Research

Exhibit 22: P/E



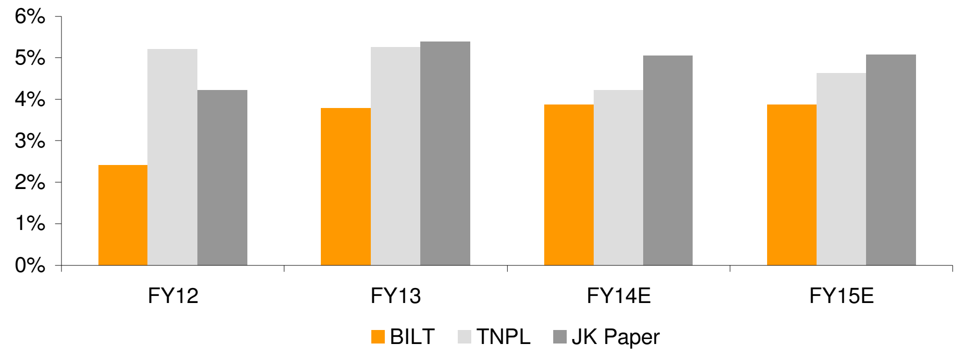
Source: Company, Emkay Research

Strong dividend yield cushions downside risk

Dividend yield of 4-5% remains attractive and provides cushion to downside risk

At current level, companies provide lucrative dividend yield of 4-5% and supports downside risk. Bilt 4%, TNPL 5% and JK paper 5%

Exhibit 23: Dividend Yield (%)



Source: Company, Emkay Research

TNPL remains our top pick followed by BILT

TNPL remains our top pick due to low cost advantage, higher visibility on margins and earnings growth

TNPL continues to remain our top-pick in the sector, due to its low-cost advantage. We expect the company's EPS to grow at a CAGR of 45.6% over FY13-15E, driven by an improvement in the EBITDA margin from 21.6% in FY13 to 28.3% in FY15E. We have a Buy rating on the stock, with a target price of Rs168.

For BILT, we expect the improvement in cash generation to translate into a reduction in debt, thereby helping the company to reduce the balance sheet leverage. We have an Accumulate rating on the stock, with a target price of Rs23.

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Ballarpur Inds

De-leveraging play

Company Update

January 3, 2014

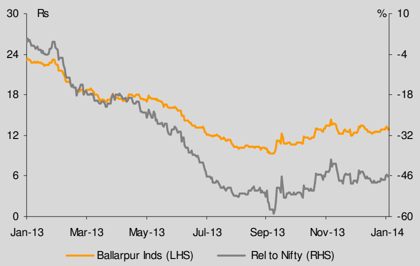
Rating	Previous Reco
Accumulate	Accumulate
CMP	**Target Price**
Rs13	Rs23
EPS Chg FY14E/FY15E (%)	NA/NA
Target Price change (%)	NA
Nifty	6,211
Sensex	20,851

Price Performance

(%)	1M	3M	6M	12M
Absolute	2	18	3	-45
Rel. to Nifty	2	13	-5	-47

Source: *Bloomberg*

Relative price chart



Source: Bloomberg

Stock Details

Sector	Paper
Bloomberg	BILT IB
Equity Capital (Rs mn)	1,311
Face Value(Rs)	2
No of shares o/s (mn)	656
52 Week H/L	24/ 8
Market Cap (Rs bn/USD mn)	8/ 136
Daily Avg Volume (No of sh)	1,329,046
Daily Avg Turnover (US$mn)	0.3

Shareholding Pattern (%)

	Sep'13	Mar'13	Dec'12
Promoters	49.4	49.4	49.4
FII/NRI	17.0	18.2	17.9
Institutions	16.7	17.4	17.5
Private Corp	4.7	4.4	4.3
Public	12.1	10.6	10.9

Source: Bloomberg

- **BILT's RGP (Rayon Grade Pulp) and its global operations at Malaysian subsidiary has been putting pressure on company's profitability along with increase in input cost**
- **Highly leveraged balance sheet (2.3x assuming perpetual equity as debt) and significantly higher outgo as interest payment (~45% of EBIDTA) has wiped out its profitability**
- **Industry turnaround is likely to boost domestic margins in paper business and improve profitability with EBIDTA and PAT CAGR (FY13-15) of 12% and 33% respectively**
- **BILT is a de-leveraging play in the sector as improved cash flows will reduce debt. Maintain our Accumulate rating with price target of Rs 23 (based on 0.6x FY14 book value)**

RGP and Sabah business drags profitability

The rayon grade pulp (RGP) business (contributed 30% of EBIT in FY12 and 8% in FY13) continues to drag company's profitability in FY14 as RGP realization are under pressure. Its subsidiary at Sabah, Malaysia (comprises 20% of capacity) is going through losses due to lower capacity utilization and unremunarative global realizations. We believe that these factors will keep BILT's profitability under pressure in near term.

Improvement in average realizations to drive revenue growth

The reduction in capex intensity has helped flip the bargaining power back in favor of the industry players. BILT too has taken price increases in line with the increase in average realization for the industry and we expect average realizations to increase by 10% between FY13 to FY14E. The increase in average realizations will translate into revenue CAGR of ~5% between FY13-15E for the paper segment. The overall revenues are thus expected to grow at a CAGR of 4.5% between FY13-15E.

EBITDA margins may have bottomed out

BILT's EBITDA margins deteriorated from 27% in FY08 to 18% in FY13 due to cost pressure. With increase in average realizations, EBITDA margins pressures may have bottomed out. The increase in average realizations is likely to lead to an improvement in both profitability and cashflow going forward. We expect EBITDA margins to improve from 18% in FY13 to 20.6% in FY15E while expect net debt to equity ratio to improve steadily from 2.1x in FY13 to 1.9x in FY15E.

Highly leveraged balance sheet remains a key risk, asset monetization and debt repayment may trigger the stock price

BILT's highly leveraged balance sheet with 2.3x D/E assuming perpetual equity as debt and 1.2x otherwise is a key concern. Since ~45% of EBIDTA goes in debt servicing, the debt repayment is likely to remain under pressure. However improved realisation and end of capex cycle is likely to boost cash flows and will help debt repayment. Any asset monetization initiative will boost cash flows and may trigger stock price. Maintain Accumulate rating with price target price of Rs 23 (based on 0.6x FY14 book value).

Financial Snapshot (Consolidated) **(Rsmn)**

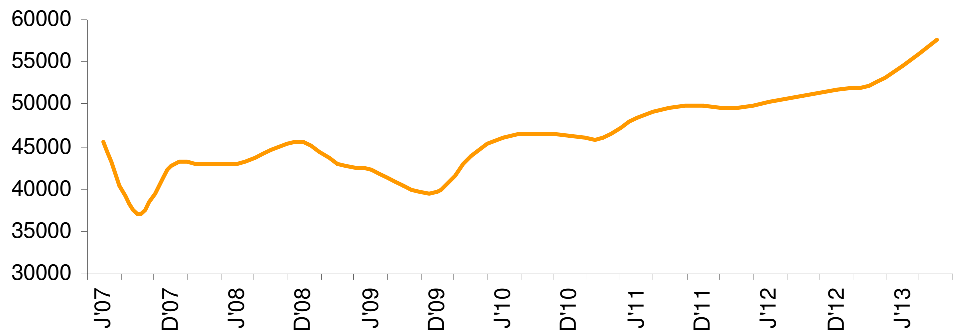
YE-Mar	Net Sales	EBITDA (Core)	(%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
FY12A	48,214	7,936	16.5	977	1.5	-58.7	3.6	8.7	5.8	0.3
FY13A	48,979	8,759	17.9	749	1.1	-23.3	2.8	11.3	6.9	0.3
FY14E	53,412	10,600	19.8	766	1.2	2.3	3.1	11.0	5.4	0.4
FY15E	53,460	11,003	20.6	1,335	2.0	74.2	5.6	6.3	4.9	0.4

Improvement in average realizations to drive revenue growth

Increase in average realization to the tune of of 10% to help drive revenue

The improvement in average realizations to the tune of 10% is likely to help drive revenue and profit growth going forward. Average realizations have witnessed a sharp increase in CY13 primarily due to reduction in competitive intensity. The average realizations per mt for BILT have increased by ~10%yoy YTD. Going forward, we expect average realizations to continue to improve steadily from here on there by leading to sales growth of 4.5% CAGR between FY13-15E.

Exhibit 24: Average paper realizations/mt



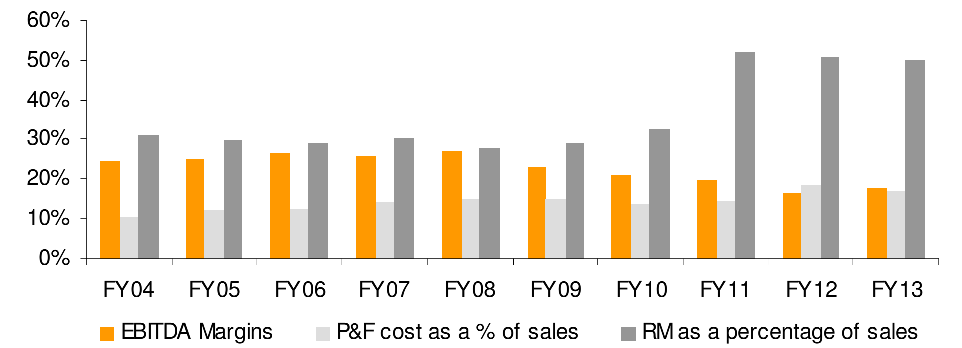
Source: Company, Emkay Research

EBITDA margins may have bottomed out

Raw material costs put pressure on margins, which may have bottomed out

Ballarpur Industries' EBITDA margins came under severe pressure due to its inability to pass on cost pressures. As a result, EBITDA margins deteriorated from 27% in FY08 to 18% in FY13. The drop in EBITDA margins was primarily driven by an increase in raw material costs. Raw material costs, as a percentage of sales, increased from a low of 27.6% in FY08 to 50% in FY13. They likely have peaked in FY12, as we have witnessed some moderation due to the ability of the company to pass on the same in the form of increase in average realizations.

Exhibit 25: EBITDA, RM, P&F and PAT as a percentage of sales



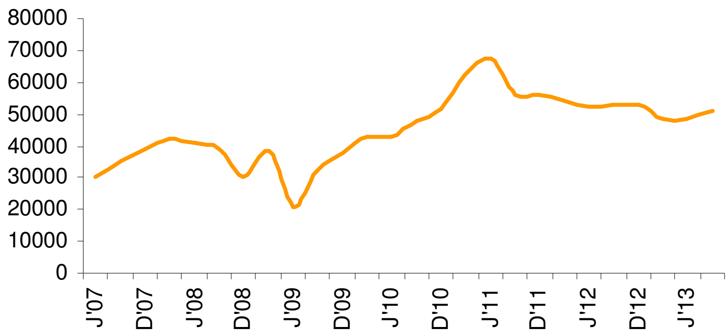
Source: Company, Emkay Research, Capita line

RGP business continues to remain under pressure

Lower realizations and higher costs put pressure on RGP and Sabah operations

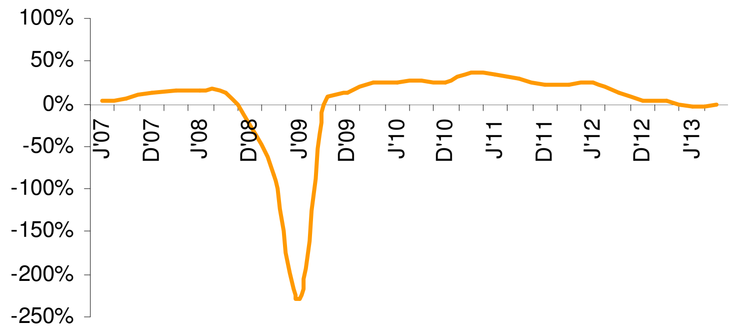
The rayon grade pulp business of the company though continues to remain under pressure due to lower average realizations and higher cost pressures. As a result, the EBIT margin has dropped from 25% in FY12 to 4% in FY13 while it has been reporting a loss at the EBIT level in the last two quarters. Going forward, we expect some improvement in the RGP business though, the pain is likely to continue. Further, the Sabah operations of the company are also under pressure due to lower average realizations and higher cost pressures. We expect the pain to continue for some more time thereby depressing overall margins.

Exhibit 26: RGP Average realizations/mt



Source: Company, Emkay Research

Exhibit 27: RGP EBIT margins

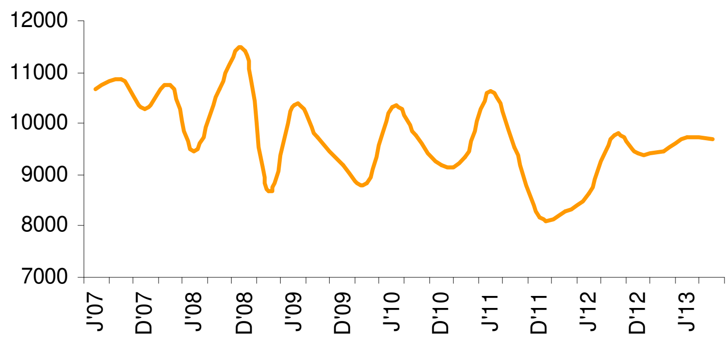


Source: Company, Emkay Research

Increase in average realizations to help improve profitability; reduce leverage

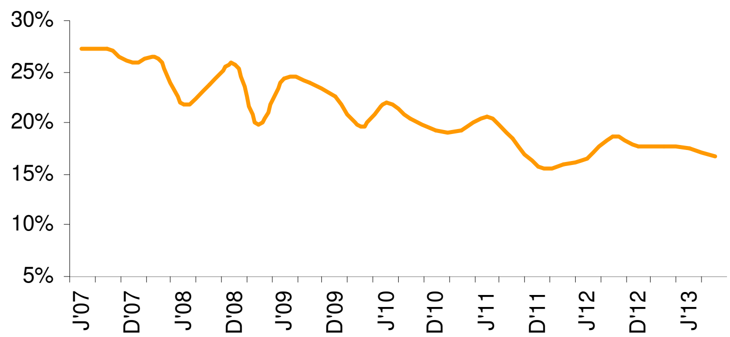
The increase in average realizations is likely to lead to an improvement in both profitability and cashflow going forward. The company has been in capex mode in the last 5 years. As a result, the gross block, including capital WIP, rose 2x between FY08 and FY13, increasing at a CAGR of 15%. A large part of this capex was financed through debt and, as a result, interest costs, as a percentage of EBITA, increased from 19% in FY07 to 40% in FY13. This had a direct impact on the PAT margin, which deteriorated from 11% in FY07 to 2% in FY13. Going forward, with pricing power returning to paper millers, thanks to the decreasing intensity of capacity expansions and absorption of excess supply, we expect cashflow, margins and balance-sheet strength to improve in the next couple of years.

Exhibit 28: Consolidated EBITDA/mt



Source: Company, Emkay Research

Exhibit 29: Consolidated EBITDA margin



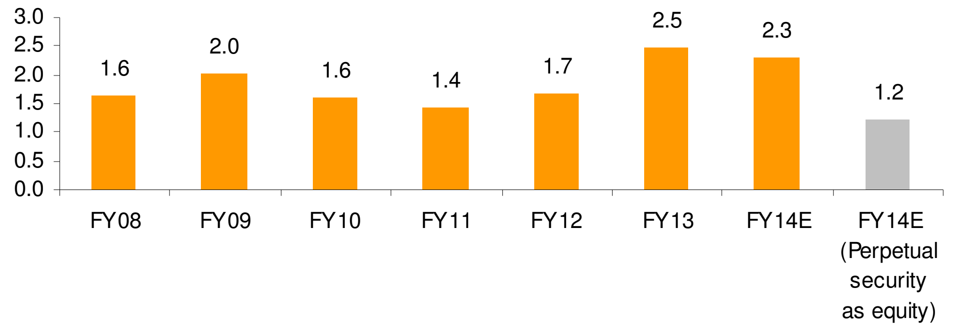
Source: Company, Emkay Research

Highly leveraged balance sheet remains a key risk

High leverage and debt servicing impacts cash flow and remains a key concern

BILT's highly leveraged balance sheet with 2.3x D/E assuming perpetual equity as debt and 1.2x otherwise is a key concern. The perpetual debt amounts to Rs 11.9bn with a coupon of 9.75%. Since ~45% of EBIDTA goes in debt servicing, the debt repayment is likely to remain under pressure. However with improved realisation and end of capex cycle is likely to boost cash flows and will help debt repayment.

Exhibit 30: Debt to Equity Ratio



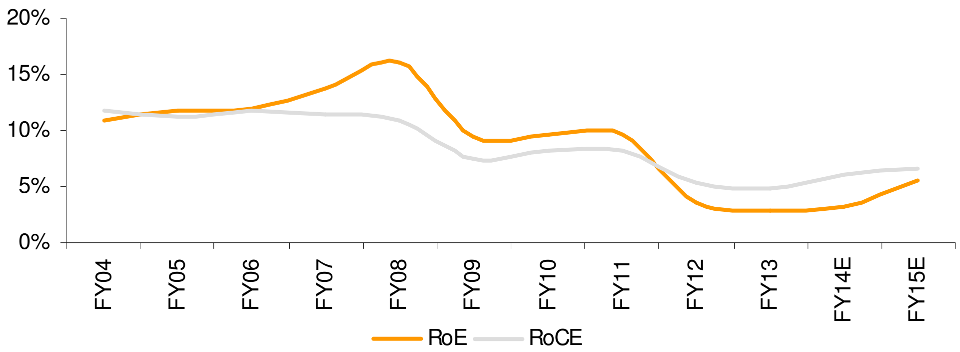
Source: Company, Emkay Research

Up-cycle to help de-leverage balance sheet, maintain accumulate

Up-cycle to help de-leverage balance sheet, valuations remain close to down cycle lows

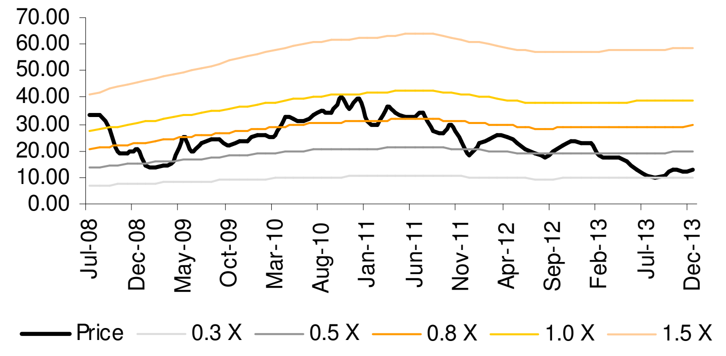
The improvement in cashflow generation is likely to help de-leverage the balance sheet going forward. Few key pain points though still persist: poor performance of the RGP business and the lower profitability of international operations. However, with average realizations increasing steadily, we expect the company to be able to de-leverage its balance sheet. Thus, we maintain our Accumulate rating on the stock with a target price of Rs 23 (based on 0.6x FY14E P/B).

Exhibit 31: RoE and RoCE (%)



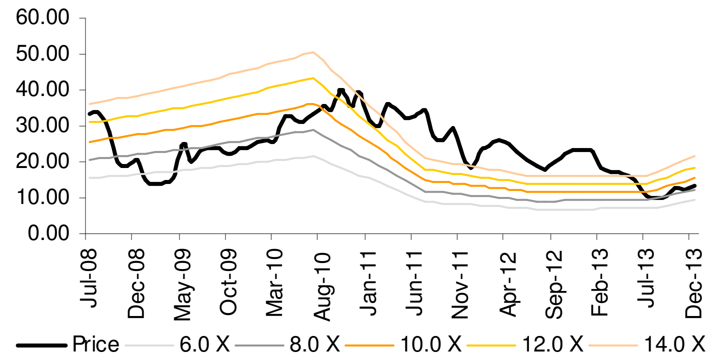
Source: Company, Emkay Research

Exhibit 32: 1 year forward PB Band



Source: Company, Emkay Research

Exhibit 33: 1 year forward PE Band



Source: Company, Emkay Research

Key Financials (Consolidated)

Income Statement

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
Net Sales	**48,214**	**48,979**	**53,412**	**53,460**
Growth (%)	*6.8*	*1.6*	*9.1*	*0.1*
Expenditure	**40,278**	**40,219**	**42,812**	**42,457**
Raw Materials	16,462	16,438	17,498	17,353
Employee Cost	2,989	2,984	3,177	3,150
Other Exp	20,827	20,797	22,137	21,954
EBITDA	**7,936**	**8,759**	**10,600**	**11,003**
Growth (%)	*-11.8*	*10.4*	*21.0*	*3.8*
EBITDA margin (%)	***16.5***	***17.9***	***19.8***	***20.6***
Depreciation	3,638	4,517	5,050	5,200
EBIT	**4,299**	**4,243**	**5,550**	**5,803**
EBIT margin (%)	***8.9***	***8.7***	***10.4***	***10.9***
Other Income	0	0	0	0
Interest expenses	2,882	3,480	4,450	4,000
PBT	**1,417**	**763**	**1,100**	**1,803**
Tax	**122**	**-164**	**154**	**288**
Effective tax rate (%)	*8.6*	*-21.5*	*14.0*	*16.0*
Adjusted PAT	**1,295**	**927**	**946**	**1,515**
Growth (%)	*-55.3*	*-28.4*	*2.1*	*60.1*
Net Margin (%)	***2.7***	***1.9***	***1.8***	***2.8***
(Profit)/loss from JVs/Ass/MI	-318	-178	-180	-180
Adj. PAT After JVs/Ass/MI	**977**	**749**	**766**	**1,335**
E/O items	0	0	0	0
Reported PAT	**977**	**749**	**766**	**1,335**
PAT after MI	**977**	**749**	**766**	**1,335**
Growth (%)	-58.7	-23.3	2.3	74.2

Balance Sheet

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
Equity share capital	1,311	1,311	1,311	1,311
Reserves & surplus	26,761	23,546	22,762	22,547
Net worth	**28,073**	**24,857**	**24,073**	**23,858**
Minority Interest	**7,574**	**5,932**	**6,112**	**6,292**
Secured Loans	35,872	45,595	42,095	39,095
Unsecured Loans	11,589	15,706	15,706	15,706
Loan Funds	**47,462**	**61,301**	**57,801**	**54,801**
Net deferred tax liability	1,661	1,272	1,272	1,272
Total Liabilities	**84,769**	**93,361**	**89,258**	**86,222**
Gross Block	94,914	111,841	122,841	124,841
Less: Depreciation	32,761	37,278	42,328	47,528
Net block	**62,153**	**74,563**	**80,513**	**77,313**
Capital work in progress	10,453	11,000	2,000	2,000
Investment	**9,812**	**9,208**	**9,208**	**9,208**
Current Assets	**24,953**	**23,260**	**23,221**	**22,572**
Inventories	10,445	11,915	11,945	11,717
Sundry debtors	4,334	4,533	4,974	5,126
Cash & bank balance	879	796	713	134
Loans & advances	9,051	5,767	5,341	5,346
Other current assets	245	248	248	248
Current lia & Prov	**22,602**	**24,670**	**25,685**	**24,871**
Current liabilities	21,980	23,943	24,958	24,145
Provisions	622	727	727	727
Net current assets	**2,351**	**-1,410**	**-2,464**	**-2,299**
Misc. exp	0	0	0	0
Total Assets	**84,769**	**93,361**	**89,258**	**86,222**

Cash Flow

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
PBT (Ex-Other income)	**1,417**	**763**	**1,100**	**1,803**
Depreciation	3,638	4,517	5,050	5,200
Interest Provided	2,882	3,480	4,450	4,000
Other Non-Cash items	0	0	0	0
Chg in working cap	7,113	3,291	970	-743
Tax paid	-122	164	-154	-288
Operating Cashflow	**14,927**	**12,214**	**11,416**	**9,971**
Capital expenditure	-12,511	-17,474	-2,000	-2,000
Free Cash Flow	**2,416**	**-5,261**	**9,416**	**7,971**
Other income	0	0	0	0
Investments	-9,406	604	0	0
Investing Cashflow	**-21,183**	**-22,276**	**-2,000**	**-2,000**
Equity Capital Raised	0	0	0	0
Loans Taken / (Repaid)	9,140	13,839	-3,500	-3,000
Interest Paid	-2,882	-3,480	-4,450	-4,000
Dividend paid (incl tax)	-380	-380	-380	-380
Income from investments	0	0	0	0
Others	0	0	-1,170	-1,170
Financing Cashflow	**5,878**	**9,980**	**-9,500**	**-8,550**
Net chg in cash	**-378**	**-82**	**-84**	**-579**
Opening cash position	1,257	879	796	713
Closing cash position	**879**	**796**	**713**	**134**

Key Ratios

Y/E Mar	FY12A	FY13A	FY14E	FY15E
Profitability (%)				
EBITDA Margin	16.5	17.9	19.8	20.6
Net Margin	2.7	1.9	1.8	2.8
ROCE	5.4	4.8	6.1	6.6
ROE	3.6	2.8	3.1	5.6
RoIC	7.0	6.2	7.4	7.6
Per Share Data (Rs)				
EPS	1.5	1.1	1.2	2.0
CEPS	7.0	8.0	8.9	10.0
BVPS	42.8	37.9	36.7	36.4
DPS	0.5	0.5	0.5	0.5
Valuations (x)				
PER	8.7	11.3	11.0	6.3
P/CEPS	1.8	1.6	1.5	1.3
P/BV	0.3	0.3	0.4	0.4
EV / Sales	0.9	1.2	1.1	1.0
EV / EBITDA	5.8	6.9	5.4	4.9
Dividend Yield (%)	3.9	3.9	3.9	3.9
Gearing Ratio (x)				
Net Debt/ Equity	1.3	2.1	2.0	1.9
Net Debt/EBIDTA	4.7	5.9	4.6	4.2
Working Cap Cycle (days)	11.1	-16.4	-21.7	-16.6

Your success is our success

JK Paper

Under stabilization phase

Company Update

January 3, 2014

Rating	Previous Reco
Sell	Sell
CMP	**Target Price**
Rs31	Rs30

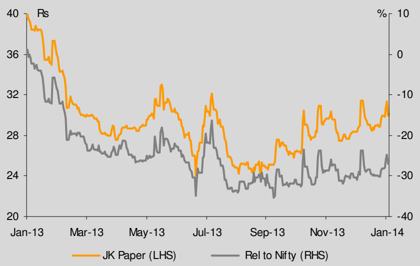
EPS Chg FY14E/FY15E (%)	NA
Target Price change (%)	NA
Nifty	6,211
Sensex	20,851

Price Performance

(%)	1M	3M	6M	12M
Absolute	5	13	1	-24
Rel. to Nifty	5	8	-7	-28

Source: *Bloomberg*

Relative price chart



Source: *Bloomberg*

Stock Details

Sector	Agri Input & Chemicals
Bloomberg	CPM IB
Equity Capital (Rs mn)	1,366
Face Value(Rs)	10
No of shares o/s (mn)	137
52 Week H/L	41/ 23
Market Cap (Rs bn/USD mn)	4/ 66
Daily Avg Volume (No of sh)	118,375
Daily Avg Turnover (US$mn)	0.1

Shareholding Pattern (%)

	Sep'13	Mar'13	Dec'12
Promoters	53.8	51.8	51.0
FII/NRI	N/A	0.1	0.1
Institutions	10.9	10.9	10.9
Private Corp	6.2	7.9	8.6
Public	29.0	29.3	29.4

Source: *Bloomberg*

- **Recently commissioned capacity to drive topline growth with revenue CAGR of 20% over FY13-15 while margins continue to remain under pressure**
- **Company to witness margin expansion on back of increase in realization however higher interest cost keep PAT growth under pressure**
- **Highly leveraged balance sheet (D/E 2.1x) and initial issues in commissioning remain our key concerns**
- **We maintain our sell recommendation on the stock and will review it once its operations get stabilised**

Ongoing capex affected the profitability

The company has been in the capacity expansion mode in the last 3 years and has commissioned a new pulp mill, paper machine and power plant in Q2FY14. With the commissioning of the new plant, the overall paper and board capacity has increased from 290,000 tpa to 455,000 tpa. This augmented capacity is likely to drive revenue growth going forward as volumes from the new 165,000 tpa plant ramp up steadily through H2FY14E and FY15E. Further, with the reduction in competitive intensity, the increase in average realizatios will also aid in driving revenues.

Higher cost and new capex continue to put pressure on margins

JK paper's performance is expected to remain under pressure primarily due to two key factors (i) higher raw material costs and (ii) commissioning of new capacities recently (Q2FY14). The EBITDA margins have been under pressure for the last 6-8 quarters due to increase in raw material costs and limited pricing power due to higher competitive intensity. The competitive intensity has reduced steadily as most of the earlier announced capex by the larger industry players has already been commissioned thereby helping flip the bargaining power back in favor of the paper millers. Hence, going forward, we expect EBITDA margins to improve only once the volumes from new capacities start ramping up. In the near term though, the profitability margins could remain under pressure due to higher depreciation and interest expense.

Return ratios to remain under pressure

Return ratios are expected to remain under pressure in FY14E and FY15E driven by higher leverage and commissioning of new capex, which is expected to ramp up steadily. The RoE is expected to remain subdued at 2.4% in FY15E vs 2.2% in FY13 while the RoCE is expected to improve to 6.8% in FY15E vs 2.8% in FY13 as volume ramps up from the newly commissioned capacity. The balance sheet on the other hand continues to remain stretched with net debt to equity ratio remaining high at 2.1x in FY15E while interest coverage ratio remains under pressure at 0.9x in FY15E as compared to 0.8x in FY13. We continue to maintain our sell rating on the stock as the company continues to remain highly leveraged with subdued return ratios and will review it once its operations get stabilized.

Financial Snapshot (Standalone) **(Rsmn)**

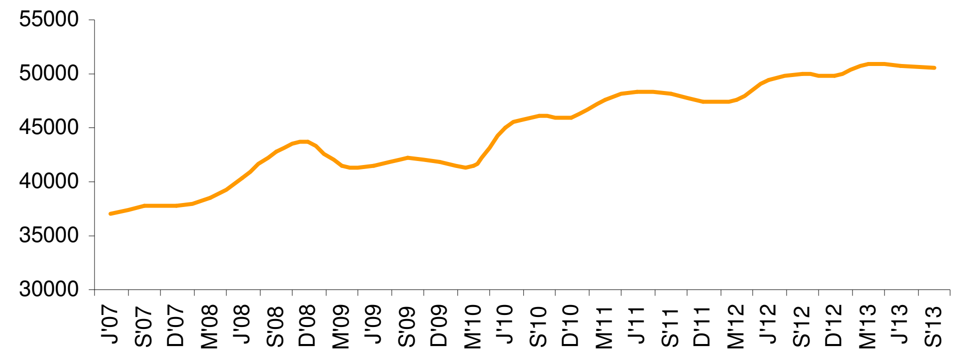
YE-Mar	Net Sales	EBITDA (Core)	(%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
FY12A	13,305	1,590	12.0	547	4.0	-71.1	7.6	6.3	7.5	0.4
FY13A	14,207	1,255	8.8	189	1.4	-65.5	2.2	18.2	16.4	0.4
FY14E	18,460	2,552	13.8	16	0.1	-91.3	0.2	209.9	8.3	0.4
FY15E	20,274	3,244	16.0	198	1.4	1,107.2	2.4	17.4	6.3	0.4

Volume ramp up and increase in average realizations to drive growth

Commissioning of the new 165,000 tpa plant to drive volume and revenue growth. Full benefits though to be visible only in FY15E

JK Paper has been on the capex mode for the last three years leading to an expansion in paper and board capacity from 290,000 tpa to 455,000 tpa. The additional capacity of 165,000 tpa has been commissioned in the end of Q2FY14. With the commissioning of the new capacity (which includes a 215,000 tpa new pulp mill), we expect the company to achieve revenue growth driven by both volumes and increase in average realizations. The new capacity is expected to steadily ramp up going forward through H2FY14E. The full benefit of the augmented capacity will be visible in the FY15E. Further, with the reduction in competitive intensity within the sector, revenue growth will be aided by an increase in average realizations. The average realizations for JK Paper have increased by 3% through FY13 to H1FY14. We expect average realizations to steadily inch higher which through H2FY14E which will further aid in revenue growth. We expect the company to register revenue CAGR of 19.5% between FY13-15E.

Exhibit 34: Average realizations/mt



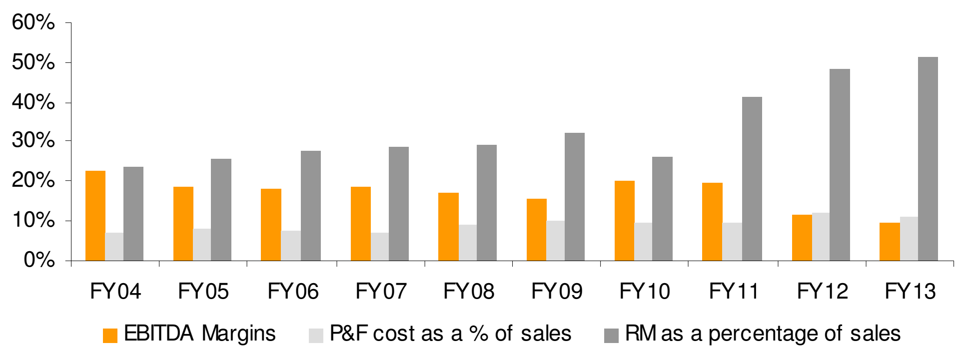
Source: Company, Emkay Research

EBITDA margins though to improve with a lag

High input cost pressures depress margins

The EBITDA margins have come under severe pressure in the last 6-7 quarters primarily due to higher cost pressures across the board. The company was unable to pass the full impact of the higher costs due to high competitive intensity within the industry as new capacities were getting commissioned. Together, this led to a sharp drop in EBITDA margins.

Exhibit 35: EBITDA, RM and P&F cost as a percentage of sales



Source: Company, Emkay Research

Margins to improve steadily driven by ramp up in volumes of the newly commissioned plant. PAT and PBT margins to remain depressed with commissioning of new capacities

The improvement in EBITDA margins though are expected to improve steadily driven by ramp up in volumes of the newly commissioned plant. Further, the PBT and PAT margins are expected to remain under pressure due to higher interest and depreciation on account of commissioning of the new capacity. The improvement in profitability ratios will thus be visible in FY15E driven by higher volumes and higher average realizations which will help improve EBITDA margins.

High leverage to continue to impact net profit margins and free cash flow generation

High leverage to impact cash flow generation thereby delaying de-leveraging of the balance sheet

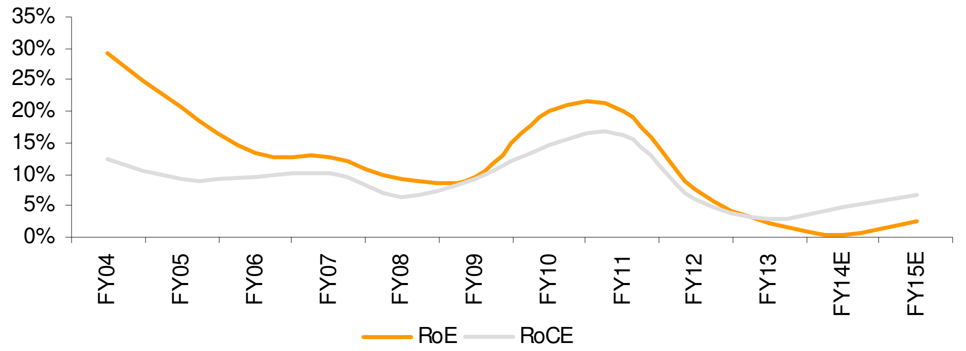
The net profit margin too is expected to remain under pressure at 1% due to higher interest obligations on account of high leverage. The capex expansion undertaken by the company has led to increase in leverage with net debt to equity remaining elevated at 2.1x in FY15E. This is likely to impact the overall cash flow generation going forward. With the commissioning of new capacities, EBT as a result is expected to grow at a CAGR of 29.3% between FY13-15E, due to lower base while PAT is expected to grow at a CAGR of 2.3% in the same period. Cash flow generation though is expected to remain under pressure going forward which will not lead to a meaningful de-leveraging of the balance sheet.

Return ratios to remain under pressure, maintain sell

Return ratios to remain under pressure due to high raw material cost and higher leverage

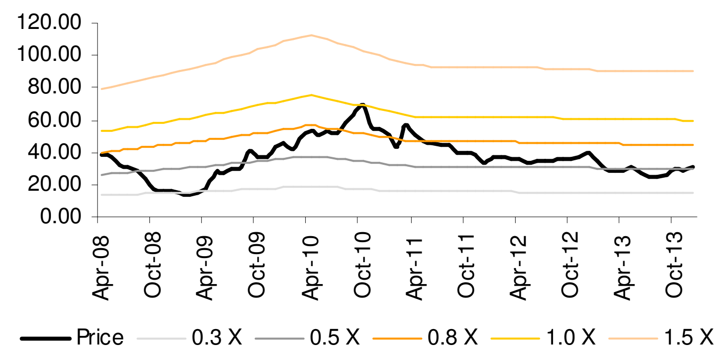
The RoE and RoCE as a result are expected to remain subdued. RoE is expected to remain subdued at 2.4% in FY15 The RoE is expected to remain subdued at 2.4% in FY15E vs 2.2% in FY13 while the RoCE is expected to improve to 6.8% in FY15E vs 2.8% in FY13 as volume ramps up from the newly commissioned capacity. The balance sheet on the other hand continues to remain stretched with net debt to equity ratio remaining high at 2.1x in FY15E while interest coverage ratio remains under pressure at 0.9x in FY15E as compared to 0.8x in FY13. We continue to maintain our sell rating on the stock as the company continues to remain highly leveraged with subdued return ratios.

Exhibit 36: RoE and RoCE (%)



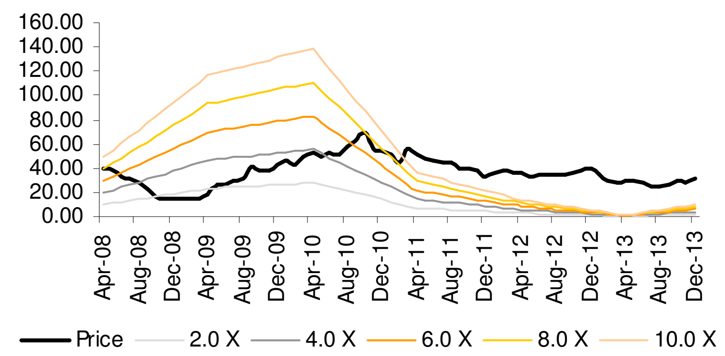
Source: Company, Emkay Research

Exhibit 37: 1 year forward PB



Source: Company, Emkay Research

Exhibit 38: 1 year forward PE



Source: Company, Emkay Research

Key Financials (Standalone)

Income Statement

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
Net Sales	**13,305**	**14,207**	**18,460**	**20,274**
Growth (%)	*7.9*	*6.8*	*29.9*	*9.8*
Expenditure	**11,715**	**12,952**	**15,908**	**17,030**
Raw Materials	5,627	5,317	5,317	5,317
Employee Cost	1,261	1,325	1,326	1,327
Other Exp	4,827	6,310	9,265	10,386
EBITDA	**1,590**	**1,255**	**2,552**	**3,244**
Growth (%)	*-40.0*	*-21.1*	*103.3*	*27.1*
EBITDA margin (%)	***12.0***	***8.8***	***13.8***	***16.0***
Depreciation	729	732	1,250	1,400
EBIT	**861**	**523**	**1,302**	**1,844**
EBIT margin (%)	***6.5***	***3.7***	***7.1***	***9.1***
Other Income	105	135	20	20
Interest expenses	444	501	1,300	1,600
PBT	**521**	**158**	**22**	**264**
Tax	**28**	**-31**	**5**	**66**
Effective tax rate (%)	*5.4*	*-19.9*	*25.0*	*25.0*
Adjusted PAT	**547**	**189**	**16**	**198**
Growth (%)	*-49.6*	*-65.4*	*-91.3*	*1,107.2*
Net Margin (%)	***4.1***	***1.3***	***0.1***	***1.0***
(Profit)/loss from JVs/Ass/MI	0	0	0	0
Adj. PAT After JVs/Ass/MI	**547**	**189**	**16**	**198**
E/O items	54	0	0	0
Reported PAT	**493**	**189**	**16**	**198**
PAT after MI	**547**	**189**	**16**	**198**
Growth (%)	-49.6	-65.4	-91.3	1,107.2

Balance Sheet

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
Equity share capital	1,367	1,369	1,369	1,369
Reserves & surplus	7,148	7,095	6,868	6,821
Net worth	**8,515**	**8,463**	**8,236**	**8,189**
Minority Interest	**0**	**0**	**0**	**0**
Secured Loans	8,456	16,464	16,464	16,464
Unsecured Loans	1,563	1,563	1,563	1,563
Loan Funds	**10,019**	**18,027**	**18,027**	**18,027**
Net deferred tax liability	1,218	1,218	1,218	1,218
Total Liabilities	**19,752**	**27,709**	**27,481**	**27,434**
Gross Block	16,025	20,762	30,499	30,649
Less: Depreciation	6,854	7,586	8,836	10,236
Net block	**9,171**	**13,177**	**21,663**	**20,413**
Capital work in progress	5,214	10,214	628	628
Investment	**730**	**730**	**730**	**730**
Current Assets	**8,714**	**8,023**	**9,508**	**11,092**
Inventories	1,642	1,869	2,903	3,055
Sundry debtors	1,442	1,591	2,529	2,777
Cash & bank balance	1,477	925	298	1,118
Loans & advances	4,067	3,552	3,692	4,055
Other current assets	87	87	87	87
Current lia & Prov	**4,078**	**4,435**	**5,047**	**5,428**
Current liabilities	3,817	4,174	4,785	5,167
Provisions	261	261	261	261
Net current assets	**4,636**	**3,588**	**4,461**	**5,664**
Misc. exp	0	0	0	0
Total Assets	**19,752**	**27,709**	**27,481**	**27,434**

Cash Flow

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
PBT (Ex-Other income)	**417**	**23**	**2**	**244**
Depreciation	729	732	1,250	1,400
Interest Provided	444	501	1,300	1,600
Other Non-Cash items	-2,378	0	0	0
Chg in working cap	-1,623	496	-1,500	-382
Tax paid	-28	31	-5	-66
Operating Cashflow	**-2,438**	**1,782**	**1,046**	**2,796**
Capital expenditure	-5,214	-9,737	-150	-150
Free Cash Flow	**-7,652**	**-7,954**	**896**	**2,646**
Other income	105	135	20	20
Investments	7	0	0	0
Investing Cashflow	**-938**	**-9,602**	**-130**	**-130**
Equity Capital Raised	584	2	0	0
Loans Taken / (Repaid)	4,635	8,008	0	0
Interest Paid	-444	-501	-1,300	-1,600
Dividend paid (incl tax)	-242	-242	-244	-245
Income from investments	0	0	0	0
Others	0	0	0	0
Financing Cashflow	**4,533**	**7,267**	**-1,544**	**-1,845**
Net chg in cash	**1,157**	**-552**	**-628**	**821**
Opening cash position	320	1,477	925	298
Closing cash position	**1,477**	**925**	**298**	**1,118**

Key Ratios

Y/E Mar	FY12A	FY13A	FY14E	FY15E
Profitability (%)				
EBITDA Margin	12.0	8.8	13.8	16.0
Net Margin	4.1	1.3	0.1	1.0
ROCE	6.0	2.8	4.8	6.8
ROE	7.6	2.2	0.2	2.4
RoIC	7.5	3.7	6.2	7.3
Per Share Data (Rs)				
EPS	4.0	1.4	0.1	1.4
CEPS	9.3	6.7	9.3	11.7
BVPS	62.3	61.8	60.2	59.8
DPS	1.5	1.5	1.5	1.5
Valuations (x)				
PER	6.3	18.2	209.9	17.4
P/CEPS	2.7	3.7	2.7	2.2
P/BV	0.4	0.4	0.4	0.4
EV / Sales	0.9	1.4	1.1	1.0
EV / EBITDA	7.5	16.4	8.3	6.3
Dividend Yield (%)	6.0	6.0	6.0	6.1
Gearing Ratio (x)				
Net Debt/ Equity	1.0	2.0	2.2	2.1
Net Debt/EBIDTA	5.4	13.6	6.9	5.2
Working Cap Cycle (days)	86.7	68.4	82.3	81.8

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Tamilnadu Newsprint

Benefits of low-cost producer

Company Update

January 3, 2014

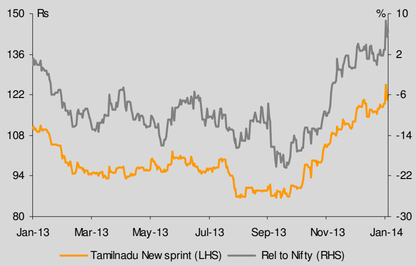
Rating	Previous Reco
Buy	Buy
CMP	**Target Price**
Rs122	Rs168
EPS Chg FY14E/FY15E (%)	NA/NA
Target Price change (%)	NA
Nifty	6,211
Sensex	20,851

Price Performance

(%)	1M	3M	6M	12M
Absolute	4	36	26	10
Rel. to Nifty	4	30	16	5

Source: *Bloomberg*

Relative price chart



Source: Bloomberg

Stock Details

Sector	Paper
Bloomberg	TNNP IB
Equity Capital (Rs mn)	692
Face Value(Rs)	10
No of shares o/s (mn)	69
52 Week H/L	129/ 78
Market Cap (Rs bn/USD mn)	8/ 136
Daily Avg Volume (No of sh)	90,176
Daily Avg Turnover (US$mn)	0.2

Shareholding Pattern (%)

	Sep'13	Mar'13	Dec'12
Promoters	35.3	35.3	35.3
FII/NRI	7.6	5.4	5.3
Institutions	31.6	35.6	35.9
Private Corp	7.9	7.3	8.4
Public	17.6	16.3	15.1

Source: Bloomberg

- **TNPL's low cost advantage due to use of bagasse as raw material supports its 300-500bps higher EBIDTA margins over the industry average**
- **Recently commissioned de-inking pulp facility will further boost its cost efficiency and reduce the dependency on imported pulp**
- **Company has further chalked down greenfield capex plan of Rs 12bn to put capacity of packaging board which is expected to be completed by the end of FY16**
- **TNPL remains our top pick due to its distinct cost advantage and compelling valuations at EV/EBIDTA of 3x, 40% discount to book value with 5% dividend yield**

Lowest cost advantage supports higher margins

TNPL benefits from the low input cost due to use of bagasse as a key raw material. Bagasse base pulp contributes ~50% of its total pulp requirement and supports cost savings of Rs 2000/- mt. This distinct and unique cost advantage has been excelled by the company over a period of time and is difficult to be replicated by any other large integrated player in the industry due to lack of access to baggasse and technical issues. Apart from that company has taken various initiatives which support its cost efficiency and boost margins. Recently commissioned de-inking pulp facility will further add to its cost advantage.

Expect earnings growth of 45% CAGR, return ratios to improve

We expect TNPL's earnings to grow at CAGR of 46% to Rs 1.95bn by FY15 from Rs 0.9bn in FY13. The earnings growth to be driven by increase in EBIDTA margins from 21.6% to 28.3% over the same period while topline growth is likely to remain muted at 4.7% due to minimal volume growth. We continue to believe that paper prices are likely to remain firm in next two years which will lead to various earnings upgrade going forward as we have not factored in any price increase in our assumption in FY15.

TNPL remains our top pick in the sector, reiterate BUY

We believe that TNPL will be the biggest beneficiary of industry turn around driven by increase in realization. Company's low cost advantage will support it's higher than the industry margins and return ratios. Capex plans to get into packaging board will support its long term growth and with strong cash generation and strong balance sheet, company will be easily able to fund its capex plan. Compelling valuations with 40% discount to book value, EV/EBIDTA 3x and P/E of 4x along with strong dividend yield of 5% makes TNPL our top pick in the sector. We retain our BUY recommendation with target price of Rs 168 based on 1x FY14 book value.

Financial Snapshot (Standalone) **(Rsmn)**

YE-Mar	Net Sales	EBITDA (Core)	(%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
FY12A	15,303	3,269	21.4	241	3.5	-81.3	2.6	32.0	6.7	0.8
FY13A	18,613	4,021	21.6	915	13.2	280.0	9.1	8.4	4.7	0.7
FY14E	20,402	5,265	25.8	1,667	24.0	82.3	15.2	4.6	3.4	0.7
FY15E	20,384	5,771	28.3	1,946	28.0	16.7	15.7	4.0	3.0	0.6

Baggase based pulp contributes 50% of total pulp while the new de-inking capacity to contribute another 25% going forward

Use of bagasse as a raw material leads to cost advantage by Rs 2000/- mt

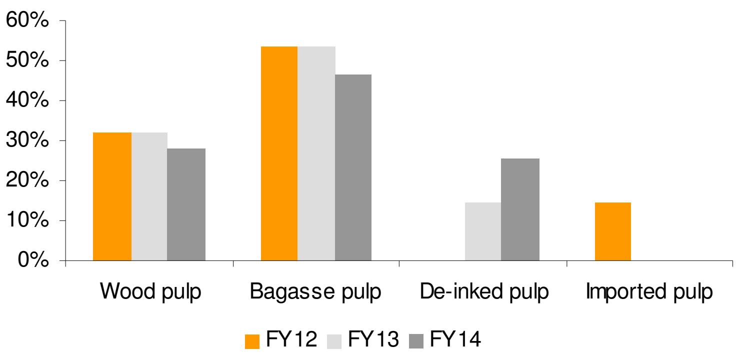
TNPL has perfected the technology of manufacturing newsprint & printing and writing paper from bagasse, a waste product of the sugar industry. This has been an outstanding innovation and leads to cost advantage to the company.

Use of bagasse as a raw material leads to cost advantage due to lower bagasse cost as compared to wood / bamboo. Bagasse based pulp contributes to 50% of the total pulp capacity where company enjoys the cost advantage of approx Rs 2000/- mt. 30% of its pulp capacity is based on wood while balance 20% is imported pulp.

Commissioning of de-inked pulp facility to further boost the cost advantage

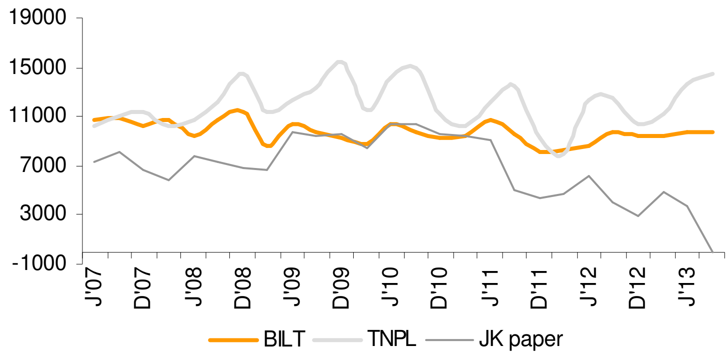
TNPL has recently commissioned its de-inking based pulp facility with capacity of 300tpd. Company's ability to blend cheaper cost raw material has helped the company to enjoy least cost producer advantage. Commissioning of this de-inked pulp facility will further reduce its cost by replacing imported pulp. We expect a cost advantage of approximately Rs 4000-5000 / mt.

Exhibit 39: Pulping capacity break up (%)



Source: Company, Emkay Research

Exhibit 40: EBITDA/mt



Source: Company, Emkay Research

Surplus pulp from de-inking facility to support future expansion plans

Commissioning of de-inking pulp facility with capacity of 300tpd will lead to surplus pulp of 50-60 thousand mt at full utilization. TNPL has plans to sell this surplus pulp in open market which will further add too its margins. This surplus pulp can also be utilized for captive purpose post the commissioning of its packaging board plant.

Other factors contributing to TNPL's cost efficiency

Bio-methation, surplus power from captive power plant and renewable energy certificates provided additional benefits

Bio methane plant

Company has installed two bio-methanation plants which has helped it generation of methane gas and has replaced high cost furnace oil. This has given a cost savings of approximately Rs 240mn previous year.

Captive power plant / surplus power generation leads to surplus revenues

Power requirement is met through captive power plants. Surplus power is exported to the grid. Energy conservation measures have brought savings in steam and power consumption.

Renewable Energy Certificates (REC) benefits

TNPL also uses agro fuel such as saw dust, paddy husk, coir pith and coconut shells. The black liquor solid (generated as waste) is now recognized as bio-mass. Power generated from the steam produced in the recovery boiler is eligible for Renewable Energy Certificates (RECs). TNPL has received 136738 RECs upto 31.3.2013. TNPL is the first company in the Paper Industry to have been awarded this benefit.

Cement plant for better waste management

TNPL has set up a 600 tpd cement plant for converting mill wastes such as lime sludge and fly ash into high grade cement is also an innovative step implemented for the first time in the country. We expect this project to add approx Rs 100mn per year at bottomline.

Tissue culture research centre improves raw material availability

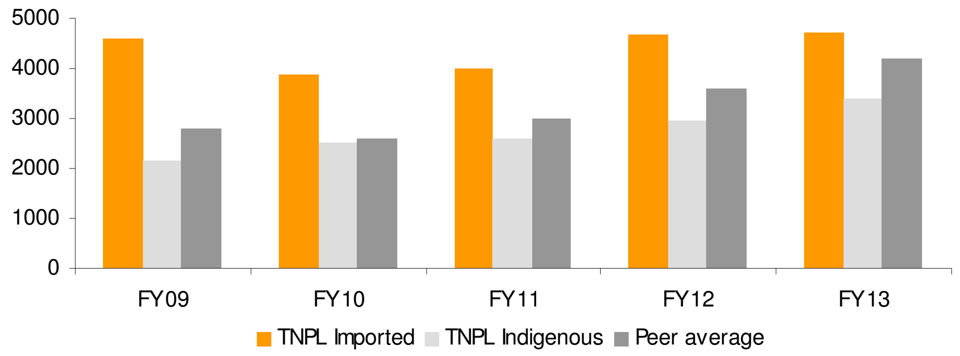
TNPL has established a separate bio-technology and bio-energy research centre to develop tissue culture seedlings to be used as mother plants in the farm forestry and captive plantation schemes. This helps the company to improve the availability of bamboo / raw material in its catchment area.

TNPL's dependence on imported coal leads to stable coal cost

Cost of imported coal has remained steady while domestic coal costs continue to rise

TNPL uses imported coal due to proximity of the port as against other manufacturers who are dependent on domestic coal. Domestic coal prices have witnessed sharp up move in last two years due to lower linkages, increased unavailability and higher transportation cost. However imported coal cost has relatively remained stable for TNPL despite currency depreciation.

Exhibit 41: Coal cost (Rs/mt)



Source: Company, Emkay Research

Increase in exports to work as natural hedge for the company

Export revenues increased from Rs 1.7bn to Rs 3bn between FY10-13 thereby providing a natural hedge to foreign exchange outflow

With recent increase in paper capacity, TNPL's export has increased as company has entered in to many other locations to push additional production. The increase in exports to Rs 3bn in FY13 as against Rs 1.7 bn in FY10 is likely to provide natural hedge against its imports of coal.

Exhibit 42: Total value of imports and exports (Rs mn)

Source: Company, Emkay Research

Green field expansion of setting up additional 200,000 mtpa double coated plant to entail an outflow of Rs 12bn which will be funded largely through internal accruals and debt

TNPL entering into high end packaging boards with capex of Rs 12bn

TNPL has firmed up plans to set up a state-of the-art multilayer double coated board plant with a capacity of 2,00,000 mtpa with capital cost of Rs 12bn in at Trichy District, Tamilnadu. This greenfield project will be funded through internal accruals and debt and is expected to be completed by the end of FY16. Though the land acquisition work has already started and company expects to spend approx Rs 3bn in current year, the larger expenditure will occur only in FY16.

The total market for packaging board is estimated at 2.4mn mt. About 50% of the market relates to grey back boards and the remaining 50% relates to white coated back high end varieties. The demand growth in the higher segments is expected to hover at 12-13% per annum and the segment is primarily dominated by key players like ITC, BILT and JK Paper.

TNPL to benefit from industry turn around

We believe that TNPL will benefit from the turn around of the industry cycle. Company has increased paper prices by approx Rs 5000/- mt in current year which is expected boost its margins and support earnings growth.

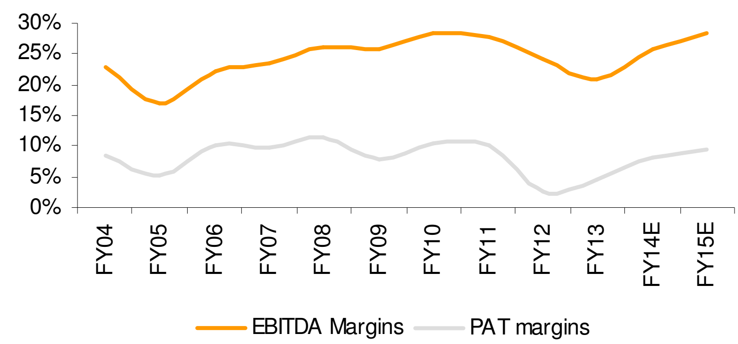
FY13-15 earnings CAGR at 46% will be driven by margin expansion

Earnings growth to be driven by increase in average realizations leading to improved margins and return ratios

At present level, TNPL has already achieved a capacity utilization of 100% (in Q2FY14) and we do not expect further increase in production. As a result, we believe topline growth is likely to remain muted over this period. Growth in topline will be largely driven by further increase in realization. We have not taken any further increase in realization (assumed Rs 52,000/- mt realization for FY15), However we remain confident about firming up paper prices going forward.

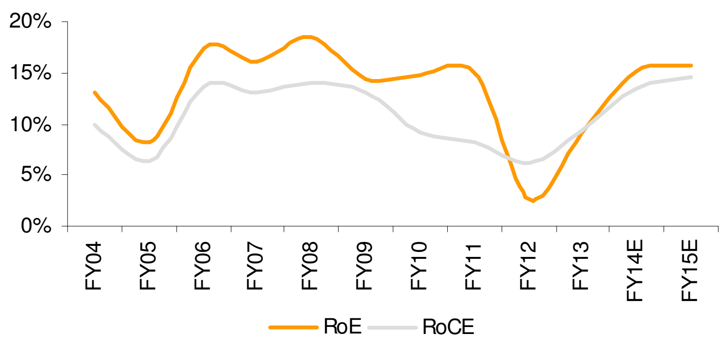
We expect company's earnings to grow at a CAGR of 46% to Rs 24 in FY14E and Rs 28 in FY15E.

Exhibit 43: EBITDA and PAT Margin (%)



Source: Company, Emkay Research

Exhibit 44: RoE and RoCE (%)



Source: Company, Emkay Research

1000/- Rs increase in realization, increases EPS by 15%

We estimate that an increase of Rs 1000/- mt in average realization will increase company's EPS by 15%. We are confident about further upgrades in our earnings estimate driven by increase in realisatons.

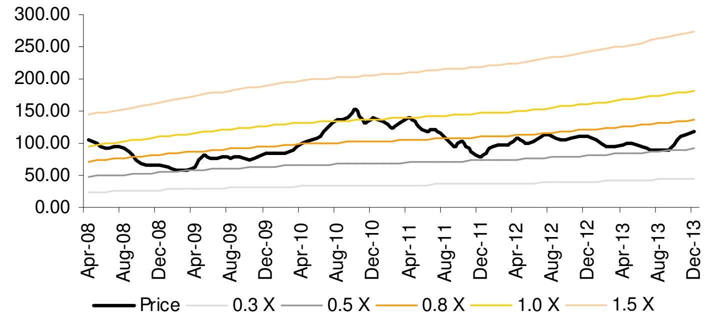
Return ratios to strengthen with improvement in margins

Improvement in margins will lead to improvement in return ratios. We expect RoE to improve from 9.1% in FY13 to 15.7% in FY15E, while RoCE is likely to increase from 9.3% in FY13 to 14.7% in FY15E.

Valuations close to down-cycle lows, remains our top pick in the sector

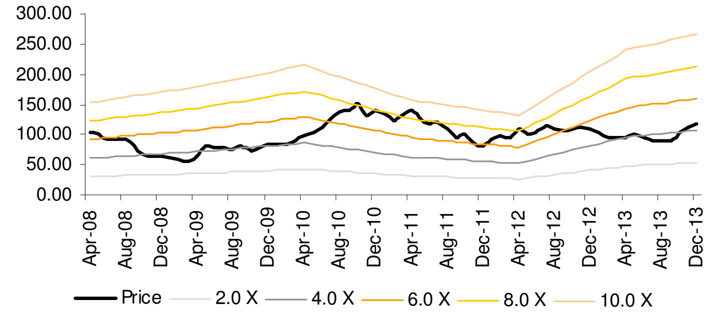
On the valuation front, the stock is currently trading at a P/B of 0.6x FY15E and EV/EBITDA of 3x FY15E, which is close to the down- cycle lows. With the paper cycle now turning the corner, we believe TNPL is likely to be the biggest beneficiary. We maintain our Buy rating on the stock, valuing it at 1x P/B FY14E, with a target price of Rs168.

Exhibit 45: 1 year forward PB



Source: Company, Emkay Research

Exhibit 46: 1 year forward PE



Source: Company, Emkay Research

Key Financials (Standalone)

Income Statement

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
Net Sales	**15,303**	**18,613**	**20,402**	**20,384**
Growth (%)	*25.2*	*21.6*	*9.6*	*-0.1*
Expenditure	**12,034**	**14,591**	**15,137**	**14,613**
Raw Materials	3,644	4,418	4,584	4,425
Employee Cost	1,262	1,530	1,587	1,532
Other Exp	7,128	8,643	8,967	8,656
EBITDA	**3,269**	**4,021**	**5,265**	**5,771**
Growth (%)	*-1.0*	*23.0*	*30.9*	*9.6*
EBITDA margin (%)	***21.4***	***21.6***	***25.8***	***28.3***
Depreciation	1,691	1,750	1,956	2,000
EBIT	**1,579**	**2,272**	**3,309**	**3,771**
EBIT margin (%)	***10.3***	***12.2***	***16.2***	***18.5***
Other Income	87	199	152	90
Interest expenses	1,413	1,210	1,142	1,000
PBT	**253**	**1,261**	**2,320**	**2,861**
Tax	**12**	**346**	**652**	**916**
Effective tax rate (%)	*4.7*	*27.5*	*28.1*	*32.0*
Adjusted PAT	**241**	**915**	**1,667**	**1,946**
Growth (%)	*-81.3*	*280.0*	*82.3*	*16.7*
Net Margin (%)	***1.6***	***4.9***	***8.2***	***9.5***
(Profit)/loss from JVs/Ass/MI	0	0	0	0
Adj. PAT After JVs/Ass/MI	**241**	**915**	**1,667**	**1,946**
E/O items	849	0	0	0
Reported PAT	**1,090**	**915**	**1,667**	**1,946**
PAT after MI	**241**	**915**	**1,667**	**1,946**
Growth (%)	-81.3	280.0	82.3	16.7

Balance Sheet

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
Equity share capital	694	694	694	694
Reserves & surplus	9,013	9,661	10,922	12,421
Net worth	**9,707**	**10,355**	**11,616**	**13,115**
Minority Interest	**0**	**0**	**0**	**0**
Secured Loans	8,508	6,573	4,773	4,773
Unsecured Loans	5,834	4,959	5,459	5,459
Loan Funds	**14,342**	**11,532**	**10,232**	**10,232**
Net deferred tax liability	3,441	3,744	3,744	3,744
Total Liabilities	**27,490**	**25,630**	**25,592**	**27,091**
Gross Block	35,355	39,056	40,556	41,556
Less: Depreciation	13,396	15,146	17,102	19,102
Net block	**21,959**	**23,910**	**23,454**	**22,454**
Capital work in progress	3,180	1,712	1,212	3,212
Investment	**11**	**11**	**11**	**11**
Current Assets	**10,399**	**9,177**	**10,178**	**10,719**
Inventories	3,277	2,644	3,299	3,351
Sundry debtors	3,639	2,769	3,431	3,351
Cash & bank balance	198	245	171	742
Loans & advances	3,109	3,300	3,060	3,058
Other current assets	177	218	218	218
Current lia & Prov	**8,059**	**9,180**	**9,264**	**9,305**
Current liabilities	7,516	8,611	8,695	8,736
Provisions	543	569	569	569
Net current assets	**2,341**	**-3**	**915**	**1,414**
Misc. exp	0	0	0	0
Total Assets	**27,490**	**25,630**	**25,592**	**27,091**

Cash Flow

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
PBT (Ex-Other income)	**166**	**1,062**	**2,167**	**2,771**
Depreciation	1,691	1,750	1,956	2,000
Interest Provided	1,413	1,210	1,142	1,000
Other Non-Cash items	0	0	0	0
Chg in working cap	1,828	2,694	-992	73
Tax paid	-12	-346	-652	-916
Operating Cashflow	**5,085**	**6,369**	**3,621**	**4,928**
Capital expenditure	-3,453	-2,233	-1,000	-3,000
Free Cash Flow	**1,632**	**4,136**	**2,621**	**1,928**
Other income	87	199	152	90
Investments	0	0	0	0
Investing Cashflow	**-2,653**	**-1,895**	**-848**	**-2,910**
Equity Capital Raised	0	0	0	0
Loans Taken / (Repaid)	-539	-2,811	-1,300	0
Interest Paid	-1,413	-1,210	-1,142	-1,000
Dividend paid (incl tax)	-406	-406	-406	-446
Income from investments	0	0	0	0
Others	0	0	0	0
Financing Cashflow	**-2,357**	**-4,426**	**-2,848**	**-1,446**
Net chg in cash	**75**	**48**	**-75**	**572**
Opening cash position	122	197	246	171
Closing cash position	**197**	**246**	**171**	**742**

Key Ratios

Y/E Mar	FY12A	FY13A	FY14E	FY15E
Profitability (%)				
EBITDA Margin	21.4	21.6	25.8	28.3
Net Margin	1.6	4.9	8.2	9.5
ROCE	6.2	9.3	13.5	14.7
ROE	2.6	9.1	15.2	15.7
RoIC	6.4	9.5	13.8	15.9
Per Share Data (Rs)				
EPS	3.5	13.2	24.0	28.0
CEPS	27.8	38.4	52.2	56.9
BVPS	139.9	149.3	167.4	189.0
DPS	5.0	5.0	5.0	5.5
Valuations (x)				
PER	32.0	8.4	4.6	4.0
P/CEPS	4.0	2.9	2.1	2.0
P/BV	0.8	0.7	0.7	0.6
EV / Sales	1.4	1.0	0.9	0.8
EV / EBITDA	6.7	4.7	3.4	3.0
Dividend Yield (%)	4.5	4.5	4.5	5.0
Gearing Ratio (x)				
Net Debt/ Equity	1.5	1.1	0.9	0.7
Net Debt/EBIDTA	4.3	2.8	1.9	1.6
Working Cap Cycle (days)	51.1	-4.9	13.3	12.0

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