



# JOINDRE CAPITAL SERVICES LTD.

SEBI REGN NO. INH000002061 / INZ 000174034

## RESEARCH REPORT

21<sup>st</sup> Jan 2019

### ORIENT PAPER INDUSTRIES LTD

**BSE : ORIENTPPR**

**Sector: SPECIALITY PAPER**

**BSE: 502420**

#### View - BUY

CMP : Rs. 41

Target Price: Rs 60(In next 12 to 15 mths)

#### BUSINESS BACKGROUND

OPIL, incorporated in 1936, belongs to a leading business conglomerate, the CK Birla Group. OPIL is an integrated paper manufacturer with capacities of 72,500 MTPA of pulp, 55,000 MTPA of P&W paper, 50,000 MTPA of tissue paper and 55 MW of power in Amlai. It also has 36,000 MTPA capacity of Caustic Soda, contributing 18% to revenue. Vide a process of sequential demergers its erstwhile cement and consumer durables businesses are now parts of two separate listed entities,

OPIL is a fully integrated paper player and has low reliance on market pulp for its paper operations. Going ahead OPIL intends to expand operation in the tissue paper segment only in the future

#### INVESTMENT HIGHLIGHTS

##### Strong Financial Performance in H1 FY19 –

OPIL reported a strong set of Q2FY19 numbers with net sales at Rs 186.73 crs with EBIDTA placed at Rs 40.04 crs from Rs 30.99 crs up by 29% YoY with the PAT placed at Rs 29.69 crs from Rs 14.74 crs up by 101% YoY.

During Q2FY19, net sales were driven by higher sales volumes due to effective utilisation of the new tissue paper line and better realization. Realization improved by 3.5-4% mainly due to buoyant demand, weakening Rupee and high global pulp prices For FY18 OPIL reported Sales of Rs 661.36 crs, a EBIDTA of Rs 111.87 crs with PAT at Rs 49.28 crs from Rs 10.87 crs last year. OPIL declared a dividend of 100% for FY18.

##### OPIL is a strong player in the domestic tissue paper segment –

With a capacity of 50,000 MTPA and market share of 30%, OPIL is the largest player of domestic tissue paper segment. In FY18 the company's tissue paper export of total tissue paper sales volume was 50% of total production. The segment has higher sales realizations compared to other segments and hence volume uptick as well as better realizations bodes well for future earnings growth

In the tissue paper segment OPIL enjoys higher realisations and margins. With the recent capacity expansion of 25,000MT done with a capex of Rs 80 crs it is now India's largest producer and exporter of tissue paper.

Its state-of-the-art plant can produce premium-grade tissue papers of better softness and higher bulk, making it possible for the company to cater to the higher-realisation market. The new capacity will also allow it to address a larger market – in terms of both domestic and exports – and to segments such as facial and toilet-grade tissues

#### KEY DATA

FACE VALUE	Rs	1.00
DIVID YIELD %		2.43
52 WK HI/LOW		53/26
NSE CODE		ORIENTPPR
BSE CODE		ORIENTPPR
MARKET CAP	RS	885 CRS

#### SHAREHOLDING PATTERN

PROMOTERS	-	39%
BANKS, MFs & DIIs	-	17%
FIIIs	-	...%
PUBLIC	-	44%

#### KEY FUNDAMENTALS

YE	FY19	FY20	FY21
Rev Gr%	10	10	8
EBIDTA Gr%	34	21	12
PAT Gr%	78	20	14
EPS Gr%	78	20	14
EPS (Rs)	4.13	4.95	5.66
ROE %	6	7	8
ROCE %	5	6	6
P/E(x)		8	7

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**OPIL has adequate self-sufficiencies for major portion of its raw material and power requirements; to improve its cost structure –**

OPIL's dependence on open market pulp procurement has remained limited to around 30% of its total pulp requirements and a majority of its requirement is met through its own capacity and farm forestry sources,

OPIL is also self-reliant for majority of its power requirements and sources almost 90% of its power from captive sources. To eliminate its dependency on the more expensive market pulp the company has planned to increase its pulp capacity from 72,500 MTPA to 100,000 MTPA at a cost of Rs 45 crs. It is also setting up a new recovery boiler at a cost of Rs 1.65 bn and upgrading its pulp capacity at a cost of Rs 15 cr.

The proposed capex will be commissioned by Q3FY20 and will be funded majorly through internal accruals and marginal borrowings. Post expansion the enhanced pulp capacity will support paper production of 120,000-125,000 MTPA as against current paper capacity of 100,000 MTPA

The company expects new pulp capacity to be operational in 2HFY20E. Also, the company's thrust on promoting farm forestry will aid in consistent availability of wood pulp for pulp manufacturing. With higher pulp availability, OPIL paper will save on raw material front as well as capacity utilization will improve significantly.

**Indian Paper Industry Overview – Fragmented in size**

Indian paper industry is highly fragmented with 656 mills established across India. The large integrated players with above 100 MT per day capacity constitute only 32% of the total capacity, suggesting a highly competitive nature of the industry. The small mills which constitute for 34% of the installed capacity are largely present in lower end of the product segments such as kraft paper and news print.

The Indian paper industry can be broadly segregated into Writing and Printing Paper (WPP), Industrial Paper (IP), News Print (NP) and Speciality Paper (SP). Of these, IP segment accounts for 50% of the total paper demand. It is largely driven by the industrial demand for corrugated boxes made of kraft paper. WPP segment which constitute creamwove, maplitho, coated and branded paper account for 30% of the total demand.

As per the Associated Chambers of Commerce and Industry of India (ASSOCHAM) estimates, Indian paper industry witnessed a 10.6% growth in per capita consumption and reached 9.2kgs in FY15. Total volumes at the end of FY17 stood at 10.2 mn tonnes. On the supply side, at the end of FY17, paper production capacity in India was estimated to be at 9.7 mn tonnes with overall 90% capacity utilisation.

Fibre, the primary raw material in paper manufacturing accounts for 40% of the total cost. For fibre, industry is dependent on hard wood and bamboo (40% of the requirement), agro waste (30%) and wastepaper (30%).

Availability of fiber at reasonable cost is a concern for the industry as Indian laws do not permit leasing of land and deforestation. Though many large companies now either have shifted or shifting to contract farming, industry still imports 2 mn tonnes in the form of pulp and wastepaper or 25% of the total pulp requirement per annum.

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**Steady demand growth prospects for the paper industry to boost OPIL's prospects –**

The Indian paper industry has witnessed a Compounded Annual Growth Rate (CAGR) of around 9% over last four years which has been driven by a steady growth in per capita consumption by around 7.5% over this period. Given the low domestic per capita consumption at around 9.1 Kg, as against world average of around 58 Kg and other developing country like China of around 55 Kg; the demand growth potential is huge over medium to long term.

This is expected to be supported by increasing literacy levels, thrust on education sector and strong economic growth leading to increase in consumption from industrial and consumer goods.

**Tissue paper segment growth to outpace industry growth rate –**

India's tissue paper share is meager at 1% as compared to 8% global tissue paper segment contribution to total pie of paper and paper products. Increasing awareness of hygiene across developed/developing countries has led to robust growth of this segment in recent years. However, still 70% of the global population doesn't use tissue paper, leaving a huge scope for growth in future.

As per the industry trends, tissue paper will remain the fastest growing segment amongst the paper and paper product segments. From current size of 165,000MT, tissue paper segment is expected to grow at CAGR of 9.5% over FY18-21E to reach 217,000MT in FY21E. Rising population, increasing per capita income, focus on improving life style would be key catalysts for growth of domestic tissue paper segment.

The tissue paper industry in India is highly concentrated due to the necessity of setting up small-sized facilities and the intense efforts required in scaling up operations as tissue paper products are mainly consumed in small quantities. key domestic paper manufacturers (such as TNPL, JK Paper, WCPM, SSPB, IP APPM, Trident) are yet to enter this segment.

In the organized segment, the tissue paper market is mainly dominated by few players. OPIL is the largest player in tissue paper segment in India (5000 tpa capacity), followed by Century Textile & Industries Ltd (36000 tpa), ITC (36000 tpa) and Pudumjee Paper Products Ltd (22000 tpa)

**OPIL's presence in high growth product tissue paper segments to benefit it significantly –**

Within the overall paper industry, OPIL has a strong presence in tissue paper and writing segments. These products segments accounted for almost 98% of OPIL's total product mix in FY 18. Given the underlying demand drivers for these segments, they are expected to grow at a higher rate than overall industry average.

OPIL enjoys higher realisations and margins. With the recent capacity expansion of 25,000MT with a capex of Rs 80 crs it is now India's largest producer and exporter of tissues with a total capacity of 50,000MT

In this segment, OPIL has a strong presence in exports and is making inroads into newer markets such as South Africa, Australia, Zimbabwe, Tanzania, and Ghana. In the domestic market, we expect the tissue-paper industry's CAGR at 20% over the next 2-3 years because of an increase in consumption based on the changing lifestyles of India's vast middle class.



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### **OPIL is also present in the Writing and printing (WP) paper segment where demand is strong –**

In WP, OPIL has undertaken major cost optimisation over the last 2-3 years. Additionally, improvement in the demand- supply equation in the industry has resulted in improvement in volume growth and profitability. We expect demand for WP to remain firm in the near term as no major capacity additions are in sight in India.

Additionally, ban on low-grade waste-paper imports in China have resulted in a reduction in pulp supply from Chile, which led to an increase in world pulp and paper prices. We expect the current demand-supply mismatch to continue as a result of which pulp prices should remain strong for 2-3 years.

OPIL currently has a capacity of 55,000MT in WP paper (plants at AMLAI, Madhya Pradesh) operating at around 80% capacity utilisation. With improving demand from both the domestic and global markets, OPIL is in a strong position to take full advantage of growth opportunities.

OPIL has now established a strong self sustaining Business Model since the last 3 years which has been largely due to – Better product mix and moving up in the higher margin tissue segment, Strong cost control, and Improved demand-supply equation in paper.

OPIL has an edge over its peers due to its established presence in both the domestic & international markets. Furthermore, the company can generate ROCE of 17-18% for its new tissue paper facility due to the low capex on brownfield expansion, which is significantly better as compared to a greenfield capex where ROI is much lower.

In addition, the company has surplus power capacity (16-17 MW) and a huge land bank available at its existing plant in Madhya Pradesh. We believe the company could plan for enhancement in tissue paper capacity by 25000 tpa once the new line reaches to optimum level of production. The management expects to ramp up the capacity of new facility to 90% by the end of June 2019

### **OPIL enjoys a strong balance sheet and both Topline and Bottomline growth is likely to remain strong going ahead –**

Over the last few years, Orient Paper has deleveraged its balance sheet by repaying debt of Rs 1 bn. As of September 2018, total debt stands at Rs 33 crs against an expected operating cash flow of Rs 1.6-1.7 bn in FY19E & FY20E respectively, providing visibility to meet future capex requirements comfortably.

OPIL also holds investments worth Rs 2.30 bn in equity shares of Hyderabad Industries Ltd., as a part of the Promoter Group and Century Textiles & Industries Ltd., in which the management intends to liquidate stake going forward. It also holds 800 acres of land at its erstwhile plant at Brajrajnagar, closed since 1999, which, we believe, could be used for other purposes going forward

OPIL is expected to generate strong operating cashflows despite lower ROE levels which means that OPIL has the capability to sustain the robust financials performance given its strong order scenario, strong operating margins and strong cash flow generation expected over the next 2-3 years.

We expect that going ahead overall bottomline growth in the next 3 years starting FY19 onwards should easily increase at a CAGR of 25-28% and going ahead also we believe that net cash flows generated will remain healthy going ahead.

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**Business Outlook & Stock Valuation –**

On a rough cut basis, in FY19, Topline will see a steady rise wherein Topline is expected to touch Rs 727 crs in FY19E.

On the bottomline level we expect the company to record a PAT of Rs 87.50 crs in FY19E. Thus on a conservative basis, OPIL should record a EPS of Rs 4.13 for FY19E. For FY20E and FY21E our expectation is that earnings traction for OPIL would continue to be strong wherein we expect a EPS of Rs 5 and Rs 5.66 respectively.

OPIL has now established a strong self sustaining Business Model since the last 3 years which has been largely due to – Better product mix and moving up in the higher margin tissue segment, Strong cost control, and Improved demand-supply equation in paper.

OPIL has an edge over its peers due to its established presence in both the domestic & international markets. Furthermore, the company can generate ROCE of 17-18% for its new tissue paper facility due to the low capex on brownfield expansion, which is significantly better as compared to a greenfield capex where ROI is much lower.

Orient Paper has moved up the value chain which has higher growth potential and better realizations, leading to a self-sustained model backed by favourable demand-supply equilibrium and muted domestic wood prices. Additionally, with internal cost controls and effective management, this business is showing signs of improvement in utilization levels(asset turnover), healthy margins, and strong free cash flow generation, providing visibility to meet future capex requirements

More ever tissue paper will remain the fastest growing segment amongst the paper and paper product segments. From current size of 165,000 MT, tissue paper segment is expected to grow at CAGR of 9.5% over FY18-21E to reach 217,000 MT in FY21E. Rising population, increasing per capita income, focus on improving life style would be key catalysts for growth of domestic tissue paper segment.

With a capacity of 50,000 MTPA and market share of 30%, OPIL is the largest player of domestic tissue paper segment. This segment has higher sales realizations compared to other segments and hence volume uptick as well as better realizations bodes well for future earnings growth. We also expect the domestic paper cycle to remain buoyant as no major capacity additions are in sight and Rupee depreciation has made imports costlier, providing domestic manufacturers with significant pricing power

Hence we believe that the OPIL stock should be purchased at the current price for a price target of around Rs 60 over the next 15 months.



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## FINANCIALS

For the Year Ended March RsCrs	FY17A	FY18A	FY19E	FY20E	FY21
Net Sales	511.49	661.36	727.50	800.25	864.27
EBIDTA	31.53	111.87	150.30	182.40	204.00
EBIDTA %	6.16	16.92	20.66	22.79	23.60
Interest	20.6	14.60	15.2	13.00	12.00
Depreciation	25.18	28.30	33.1	39.00	44.00
Non Operational Other Income	19.97	11.23	23.00	12.00	12.00
Profit Before Tax	5.72	80.11	125.00	142.40	160.00
Profit After Tax	10.87	49.28	87.50	105.00	120.00
EPS (Rs)	0.51	2.32	4.13	4.95	5.66
Equity Capital	21.21	21.21	21.21	21.21	21.21
Reserves	1188.57	1296.46	1360.96	1440.96	542.47
Borrowings	168.22	69.89	80.00	68.00	65.00
Gross Block	1648.4	1747.16	1777.16	1803.16	1828.16
Investments	237.57	297.08	297.08	297.08	297.08

Source Company our Estimates

## KEY CONCERNS

Sharp increase in prices of agri commodities could impact raw materials costs to increase sharply and may hit the company's profitability

Government regulations and Unfavourable changes in duty structure, restrictions on water usage, etc may hit the domestic paper industry and the company's profitability





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