

# ESSEL PROPACK

## Europe revival on the radar

India Equity Research | Miscellaneous

Essel Propack (EPL) reported lower-than-estimated Q4FY18 performance with revenue, at INR6.3bn, growing mere 3% YoY (net of GST); constant currency (CC) growth too came in at paltry 2% YoY (FY18: 8%). Key highlights were: 1) India continued to be impacted by the GST rate change in November'17; 2) as per management, oral care concerns in EAP seem to have stabilised; 3) Americas reported strong margin uptick, driven by operating efficiencies while Europe remained weak. Even as this year Americas improved performance, in FY19 key driver and monitorable for EPL will be improvement in Europe operations, which has been a drag and long overdue. We value the stock at 9.0x FY20E EV/EBITDA, yielding TP of INR314 (INR317 earlier). Maintain 'BUY'.

### India: GST continues to hurt; EAP: Flat, oral care revival visible

AMESA grew 5.9% YoY in CC terms (FY18: 7%). In India, despite low base, revenue growth was muted at 6% (net of taxes) due to sluggish off-take in Beauty & Cosmetics and Pharma categories which were impacted by the GST rate change in Nov'17. Egypt extended strong show, growing 36% YoY in CC terms. EAP grew only 2.4% in CC terms (FY18: 7%) with non-oral growing 13% YoY. EPL mentioned oral care revenue has stabilised after prolonged decline due to customer's market share loss.

### Americas stable; Europe still under the cloud

Americas revenue grew 6.5% in CC terms for Q4FY18 (FY18: 4.5%), helped by strong performance in USA and Mexico. However, the region reported strong EBIT margin expansion of ~150bps on operating efficiencies. While performance of the Colombian unit has been volatile it saw margins improve this quarter. Europe continued to be impacted and in CC terms revenue fell 9% YoY (FY18: +12% due to consolidation of EDG). Even on margin front, EBIT margin dipped by 390bps YoY.

### Outlook and valuations: Europe revival key; maintain 'BUY'

This year, Americas saw improvement in margins driven by operating efficiencies and partial stabilisation of Colombia unit. Key driver and monitorable for EPL in FY19 will be improvement in Europe operations, which has been a drag and long overdue. As such, EPL is focusing on improving efficiencies in EDG and increasing non-oral share in Poland to drive this. We value the stock at 9.0x FY20E EV/EBITDA, yielding TP of INR314 (INR317 earlier). Maintain 'BUY'. Delays in turn-around of Europe could make us revisit our recommendation.

#### Financials

(INR mn)

Year to March	Q4FY18	Q4FY17	YoY (%)	Q3FY18	QoQ (%)	FY18	FY19E	FY20E
Net Revenues	6,284	6,126	2.6	5,951	5.6	24,239	26,579	29,168
EBITDA	1,162	1,204	(3.5)	1,143	1.7	4,648	5,287	5,889
Adjusted Profit	448	520	(13.8)	434	3.3	1,749	2,408	2,846
Diluted EPS (INR)	2.8	3.3	(13.9)	2.8	3.3	11.1	15.3	18.1
Diluted P/E (x)						23.7	17.2	14.6
EV/EBITDA (x)						10.1	8.6	7.4
ROAE (%)						15.4	18.1	18.6

#### EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

#### MARKET DATA (R: ESSL.BO, B: ESEL IN)

CMP	: INR 265
Target Price	: INR 314
52-week range (INR)	: 317 / 233
Share in issue (mn)	: 157.2
M cap (INR bn/USD mn)	: 42 / 633
Avg. Daily Vol. BSE/NSE ('000)	: 77.3

#### SHARE HOLDING PATTERN (%)

	Current	Q3FY18	Q2FY18
Promoters *	57.2	57.2	57.2
MF's, FI's & BKs	5.0	5.1	5.3
FII's	15.4	15.5	14.5
Others	22.4	22.3	23.0
* Promoters pledged shares (% of share in issue)	:	NIL	

#### PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	5.3	10.5	5.2
3 months	(2.6)	(2.5)	0.2
12 months	13.6	4.0	(9.7)

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### Q4FY18 con-call highlights:

- **Raw material:**
  - There has been a mere 3% YoY increase in polymer prices. Polymer prices have not moved in line with changes in oil
  - Polymer prices have not shown to impact volume growth
- **India:**
  - Revision of rates in November'17 impacted performance, especially in Beauty & Cosmetic segment
  - Expect double digit growth driven by lower base and new business acquisition in Pharma segment
- **EAP (China)**
  - Performance of oral care customers have stabilised
  - Non-oral continues to post growth; stands at 27% of EAP revenues
  - Company has won certain local customers
  - Last year, China's toothpaste market contracted by 1%
  - New brands coming on Ecommerce platform are also impacting established players
  - For EPL, Non-oral grew 2.7% in FY18, for Q4FY18 it was 13.4%
- **Europe:**
  - Europe looks poised to post growth
  - Germany: Was the main dampener in Europe
  - Looking at double digit growth in Europe
- **Americas:**
  - Don't expect any impact from the 'Global Trade War' scenario prevailing in the US
- **Capex"**
  - Company spent INR1.2bn as capex this year
  - Most of the spending has been on brown-field expansion
  - Expansion in Wada, injection molding in Vapi and couple of tuning lines
  - Some spend in US on decoration capability
  - India was ~60% of the spend
  - In FY19, EPL will be undertaking two strategic projects: a) Expansion of lamination in Vasind which can serve 1bn tubes; b) Further expansion in Wada
  - Approx INR2bn will be spent in FY19 due to these strategic projects

Chart 1: Region-wise revenue mix was stable YoY

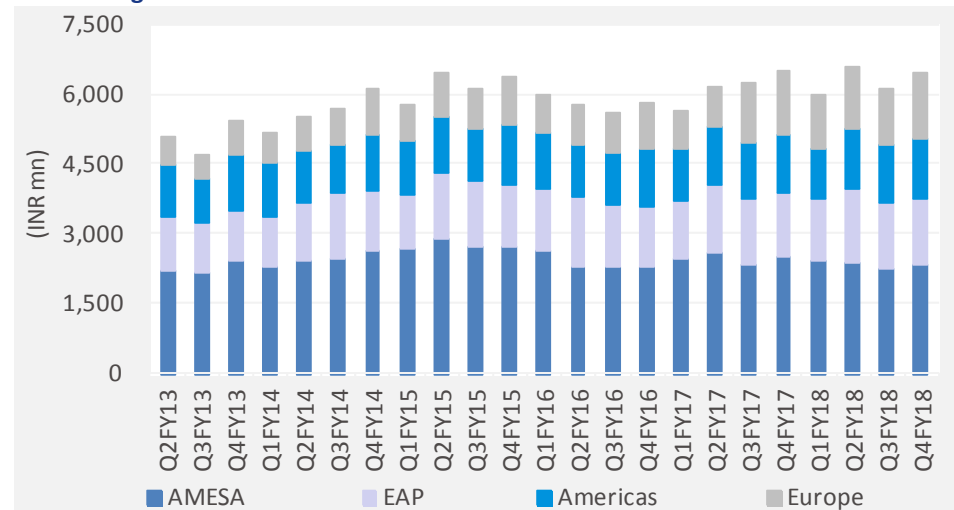


Chart 2: Margins improved in AMESA and Americas

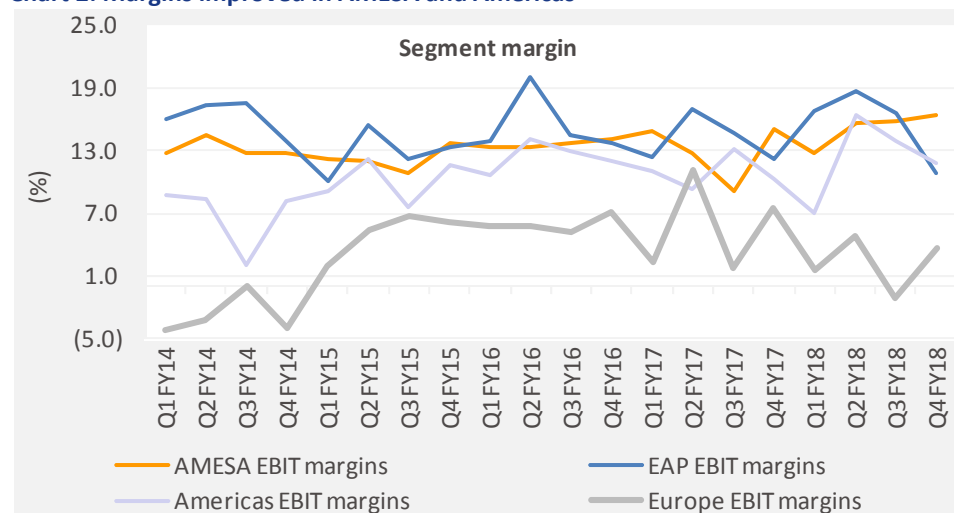
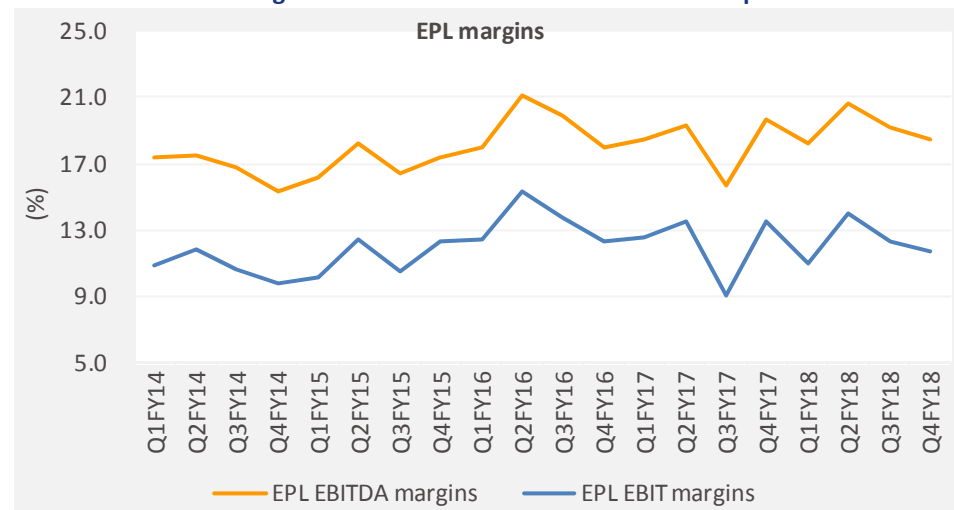


Chart 3: but overall margins were down due to contraction in Europe



Source: Company, Edelweiss research

**Table 1: Target price at INR314 on 9.0x FY20E EV/EBITDA**

<b>Particulars</b>	
EV/EBITDA (x)	9.0
FY20E EBITDA (INR mn)	5,889
FY19E Target EV (INR mn)	53,003
FY19E Debt (INR mn)	5,569
FY19E Cash (INR mn)	1,910
FY19E Minority Interest adjustment (INR mn)	79
FY19E Investment (INR mn)	131
FY19E Target Equity Value (INR mn)	49,396
Number of shares (mn)	157
<b>Mar '19 Target Price (INR/share)</b>	<b>314</b>

Source: Edelweiss research

## Financial snapshot

(INR mn)

Year to March	Q4FY18	Q4FY17	% change	Q3FY18	% change	FY18	FY19E	FY20E
Net revenues	6,284	6,126	2.6	5,951	5.6	24,239	26,579	29,168
Staff costs	1,087	1,012	7.5	1,095	(0.7)	4,339	4,618	4,891
Direct costs	2,742	2,690	2.0	2,509	9.3	10,366	11,316	12,507
Other expenses	1,293	1,220	5.9	1,203	7.4	4,886	5,358	5,880
EBITDA	1,162	1,204	(3.5)	1,143	1.7	4,648	5,287	5,889
Depreciation	430	379	13.4	414	3.8	1,671	1,716	1,830
EBIT	732	825	(11.3)	729	0.5	2,977	3,571	4,059
Other income	89	56	58.8	67	31.8	264	275	310
Interest	136	157	(13.6)	140	(3.5)	549	452	359
Add: Exceptional items		(83)	(100.0)	(50)	(100.0)	(50)		
Profit before tax	686	642	6.8	606	13.1	2,642	3,394	4,010
Provision for taxes	211	186	13.4	202	4.6	889	950	1,123
Minority interest	7	-		7	(5.6)	26	36	41
Associate profit share	(20)	6	NA	3	NA	(10)	-	-
Profit- Discontinued Ops								
Reported net profit	448	461	(2.8)	400	11.9	1,716	2,408	2,846
Adjusted Profit	448	520	(13.8)	434	3.3	1,749	2,408	2,846
Diluted shares (mn)	157	157		157		157	157	157
Adjusted Diluted EPS	2.8	3.3	(13.9)	2.8	3.3	11.1	15.3	18.1
Diluted P/E (x)	-	-		-		23.7	17.2	14.6
EV/EBITDA (x)	-	-		-		10.1	8.6	7.4
ROAE (%)	-	-		-		15.4	18.1	18.6

## As % of net revenues

Direct costs	43.6	43.9		42.2		42.8	42.6	42.9
Employee cost	17.3	16.5		18.4		17.9	17.4	16.8
Other expenses	20.6	19.9		20.2		20.2	20.2	20.2
EBITDA	18.5	19.7		19.2		19.2	19.9	20.2
Reported net profit	7.1	8.5		7.3		7.2	9.1	9.8
Tax rate	30.8	29.0		33.3		33.7	28.0	28.0

### Company Description

EPL, earlier known as Essel Packaging, was incorporated in 1982 and is a part of the Essel Group. The company is one of the largest specialty packaging players globally manufacturing laminated plastic tubes, extruded plastic tubes, caps & closures and flexible laminates. Its products are extensively used in packaging of oral care products, cosmetics, food and pharmaceuticals. EPL sells over 6bn tubes to over 400 clients globally. The company's clientele includes the world's biggest oral and non-oral care players such as Colgate, Unilever, P&G and GSK. It has manufacturing operations at 25 facilities in 12 countries across the world.

### Investment Theme

#### **Innovation DNA spurring market share gains:**

The packaging industry has been innovation driven. EPL has enhanced its laminated tubes market share from ~28% in CY02 to ~34% currently, a feat it accomplished owing to sizeable investments in innovation. R&D and innovations have been the company's unequivocal hallmarks, enabling it to pioneer the paradigm shift in packaging, redefining the market and unlocking growth potential.

#### **RoE kickers: Non-oral care focus, turn around in subsidiaries**

To propel growth, EPL has set sights on the global 22bn tubes non-oral market. We expect strong growth in non-oral revenues, riding conversions in US & Europe and growth in cosmetics, foods & pharma in China & India. Oral care is anticipated to remain the cash cow and log stable revenue growth. Earlier, losses in Americas and Europe had hammered EPL's performance. However, these subsidiaries are now turning around.

### Key Risks

#### **Sustained rise in crude prices**

EPL's raw materials are crude oil based polymers, which are highly correlated to the movement in crude prices ( $r=0.78$ ). Though there is a pass through mechanism in its contracts, there is a lag period for the same. In the past too, a significant increase in crude/polymer prices had resulted in contraction in margins.

#### **Pace of adoption/conversion to laminated packaging in non-oral segments**

EPL's growth will be driven by the non-oral segment, particularly in China and India. Though the overall non-oral market (food, cosmetics and pharma) is expected to grow at 8% plus levels, the company's higher growth will be dependent on increase in penetration/adoption of laminated packaging.

## Financial Statements

### Key Assumptions

Year to March	FY17	FY18	FY19E	FY20E
<b>Macro</b>				
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.6	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
USD/INR (Avg)	67.1	64.5	66.0	66.0
<b>Company</b>				
Rev. growth - AMESA (%)	1.9	(4.7)	12.9	11.3
Revenue growth - EAP (%)	1.3	3.9	8.5	9.3
Rev. growth -Americas(%)	2.3	1.2	6.4	7.6
Rev. growth - Europe (%)	25.3	17.1	8.3	9.3
EBIT margins - AMESA (%)	13.1	15.1	15.7	16.2
EBIT margins - EAP (%)	14.1	15.8	16.6	16.8
EBIT margins-Americas(%)	10.9	12.5	12.7	13.0
EBIT margins -Europe(%)	5.6	2.4	4.6	5.2
Capex (INR mn)	2,305	1,403	1,544	1,697
Debtor days	56	63	64	62
Inventory days	64	75	77	77
Payable days	50	59	63	62

### Income statement

(INR mn)

Year to March	FY17	FY18	FY19E	FY20E
Net revenue	23,023	24,239	26,579	29,168
Materials costs	10,079	10,366	11,316	12,507
Gross profit	12,944	13,873	15,263	16,660
Employee costs	4,058	4,339	4,618	4,891
Other Expenses	4,673	4,886	5,358	5,880
EBITDA	4,213	4,648	5,287	5,889
Depreciation	1,415	1,671	1,716	1,830
EBIT	2,798	2,977	3,571	4,059
Add: Other income	353	264	275	310
Less: Interest Expense	575	549	452	359
Add: Exceptional items	157	(50)	-	-
Profit Before Tax	2,732	2,642	3,394	4,010
Less: Provision for Tax	787	889	950	1,123
Less: Minority Interest	53	26	36	41
Associate profit share	11	(10)	-	-
Reported Profit	1,903	1,716	2,408	2,846
Exceptional Items	111	(33)	-	-
Adjusted Profit	1,792	1,749	2,408	2,846
Shares o /s (mn)	157	157	157	157
Adjusted Basic EPS	11.4	11.1	15.3	18.1
Diluted shares o/s (mn)	157	157	157	157
Adjusted Diluted EPS	11.4	11.1	15.3	18.1
Adjusted Cash EPS	20.9	21.6	26.0	29.5
Dividend per share (DPS)	2.4	2.6	3.6	4.4
Dividend Payout Ratio(%)	(21.8)	23.4	23.4	24.6

### Common size metrics

Year to March	FY17	FY18	FY19E	FY20E
Operating expenses	81.7	80.8	80.1	79.8
Materials costs	43.8	42.8	42.6	42.9
Staff costs	17.6	17.9	17.4	16.8
S G & A expenses	20.3	20.2	20.2	20.2
Depreciation	6.1	6.9	6.5	6.3
Interest Expense	2.5	2.3	1.7	1.2
EBITDA margins	18.3	19.2	19.9	20.2
Net Profit margins	8.0	7.3	9.2	9.9

### Growth ratios (%)

Year to March	FY17	FY18	FY19E	FY20E
Revenues	8.2	5.3	9.7	9.7
EBITDA	4.3	10.3	13.8	11.4
PBT	11.1	(3.3)	28.5	18.2
Adjusted Profit	6.3	(2.4)	37.7	18.2
EPS	6.3	(2.4)	37.7	18.2

Balance sheet (INR mn)				
As on 31st March	FY17	FY18	FY19E	FY20E
Share capital	314	315	315	315
Reserves & Surplus	10,076	12,191	14,036	16,183
Shareholders' funds	10,390	12,506	14,350	16,497
Minority Interest	57	43	79	120
Short term borrowings	1,934	2,851	2,569	2,684
Long term borrowings	6,050	4,492	3,000	2,000
Total Borrowings	7,984	7,343	5,569	4,684
Long Term Liabilities	233	236	250	250
Def. Tax Liability (net)	317	302	272	237
<b>Sources of funds</b>	<b>18,981</b>	<b>20,430</b>	<b>20,520</b>	<b>21,789</b>
Gross Block	15,007	16,410	17,955	19,652
Net Block	11,167	11,234	11,063	10,930
Capital work in progress	114	321	321	321
Intangible Assets	707	703	703	703
Total Fixed Assets	11,988	12,258	12,087	11,954
Non current investments	153	131	131	131
Cash and Equivalents	1,028	1,736	1,910	2,922
Inventories	2,460	2,864	3,126	3,456
Sundry Debtors	3,766	4,590	4,733	5,194
Loans & Advances	1,140	1,152	1,152	1,152
Other Current Assets	1,962	1,761	1,777	1,950
Total current assets	9,328	10,367	10,788	11,752
Trade payable	1,473	1,884	2,015	2,227
Other Current Liab	2,043	2,178	2,380	2,743
Total Current Liab	3,516	4,062	4,395	4,970
Net current assets	5,812	6,305	6,393	6,782
<b>Uses of funds</b>	<b>18,981</b>	<b>20,430</b>	<b>20,520</b>	<b>21,789</b>
BVPS (INR)	66.1	79.5	91.3	104.9
Contingent Liability	782.6	782.6	782.6	782.6

Free cash flow (INR mn)				
Year to March	FY17	FY18	FY19E	FY20E
Reported Profit	1,903	1,716	2,408	2,846
Add: Depreciation	1,415	1,671	1,716	1,830
Interest (Net of Tax)	410	364	325	258
Others	(41)	(111)	(217)	(592)
Less: Changes in WC	(479)	490	74	389
Operating cash flow	3,687	3,640	4,232	4,342
Less: Capex	2,305	1,627	1,544	1,697
<b>Free Cash Flow</b>	<b>1,861</b>	<b>1,523</b>	<b>2,614</b>	<b>2,256</b>

Cash flow metrics				
Year to March	FY17	FY18	FY19E	FY20E
Operating cash flow	3,687	3,640	4,232	4,342
Investing cash flow	(3,010)	(1,341)	(1,269)	(1,387)
Financing cash flow	(762)	(1,591)	(2,789)	(1,943)
Net cash Flow	(85)	707	174	1,012
Capex	(2,305)	(1,627)	(1,544)	(1,697)
Dividend paid	(414)	(402)	(563)	(699)

Profitability and efficiency ratios				
Year to March	FY17	FY18	FY19E	FY20E
ROAE (%)	18.3	15.4	18.1	18.6
ROACE (%)	17.9	16.9	19.3	21.2
Debtors Days	56	63	64	62
Payable Days	50	59	63	62
Cash Conversion Cycle	71	79	78	77
Current Ratio	2.9	3.0	2.9	3.0
Gross Debt/EBITDA	1.9	1.6	1.1	0.8
Gross Debt/Equity	0.8	0.6	0.4	0.3
Adjusted Debt/Equity	0.8	0.6	0.4	0.3
Net Debt/Equity	0.7	0.4	0.3	0.1
Interest Coverage Ratio	4.9	5.4	7.9	11.3

Operating ratios				
Year to March	FY17	FY18	FY19E	FY20E
Total Asset Turnover	1.3	1.2	1.3	1.4
Fixed Asset Turnover	2.2	2.0	2.2	2.5
Equity Turnover	2.3	1.7	1.5	1.4

Valuation parameters				
Year to March	FY17	FY18	FY19E	FY20E
Adj. Diluted EPS (INR)	11.4	11.1	15.3	18.1
Y-o-Y growth (%)	6.3	(2.4)	37.7	18.2
Adjusted Cash EPS (INR)	20.9	21.6	26.0	29.5
Diluted P/E (x)	23.2	23.8	17.3	14.6
P/B (x)	4.0	3.3	2.9	2.5
EV / Sales (x)	2.1	1.9	1.7	1.5
EV / EBITDA (x)	11.5	10.2	8.6	7.4
Dividend Yield (%)	0.9	1.0	1.4	1.7

## Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Essel Propack	633	17.3	14.6	8.6	7.4	18.1	18.6
AptarGroup	-	22.2	19.4	11.1	10.4	18.5	20.5
Bemis Co Inc.	-	14.1	12.8	9.1	8.9	19.3	17.6
Median	-	17.3	14.6	9.1	8.9	18.5	18.6
AVERAGE	-	17.8	15.6	9.6	8.9	18.6	18.9

Source: Edelweiss research



## Additional Data

### Directors Data

Dr. Subhash Chandra	Non- Executive Chairman	Ashok Goel	Vice Chairman & MD
Atul Goel	Director	Boman Moradian	Independent Director
Mukund Chitale	Independent Director	Radhika Pereira	Independent Director

Auditors - MGB & Co LLP

*\*as per last available data*

### Holding - Top10

	Perc. Holding		Perc. Holding
NT Asian Discovery Master Fund	3.35	Norges Bank	1.35
Clareville Cap Opp Mstr Fd	3.04	DSP Blackrock Investment Manager	1.33
FIL Limited	2.48	Shamyak Invest	1.32
Gagandeep Credit Capital	2.21	Dimensional Fund Advisors LP	1.32
Government Pension Fund - Global	1.35	UTI Asset Management	1.21

*\*as per last available data*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

*\*as per last available data*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
29 Aug 2017	Ashok Goel Trust	Buy	100000.00
18 Aug 2017	Ashok Goel Trust	Buy	100000.00

*\*as per last available data*

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### Coverage group(s) of stocks by primary analyst(s): Miscellaneous

AIA Engineering, Apar Industries Ltd, Aarti Industries, Agro Tech Foods, Balkrishna Industries, CCL Products India, Essel Propack, Orient Refractories, Supreme Industries, Solar Industries, SRF, Vesuvius India, VIP Industries

#### Recent Research

Date	Company	Title	Price (INR)	Recos
26-Apr-18	<b>Supreme Industries</b>	Margin surprises positively; <i>Result Update</i>	1,309	Buy
12-Apr-18	<b>AIA Engineering</b>	Strong volume visibility; <i>Visit Note</i>	1,418	Buy
05-Apr-18	<b>Balkrishna Industries</b>	Bhuj: Reinforces competitive positioning; <i>Visit Note</i>	1,178	Buy

#### Distribution of Ratings / Market Cap

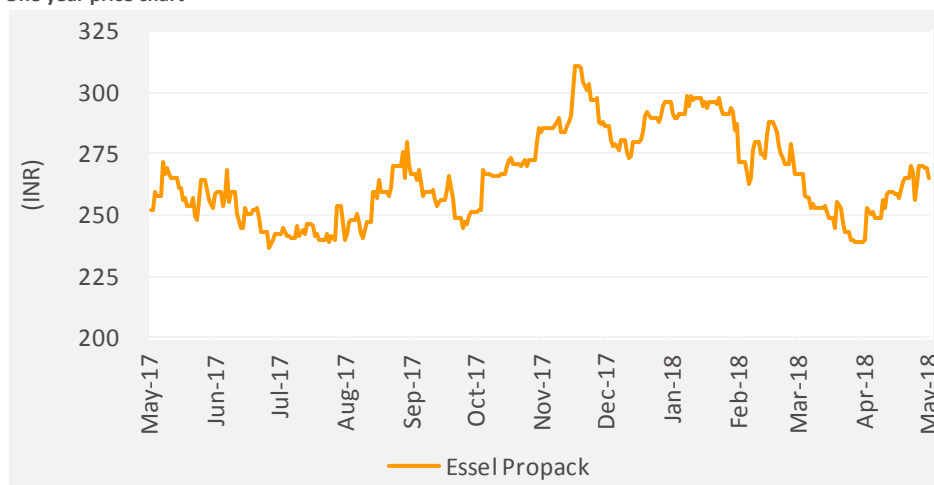
##### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

#### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

One year price chart



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