Sharekhan by BNP PARIBAS

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Stock Update

Greenpanel Industries Ltd

Healthy growth outlook amidst global turmoil

Building materials	Sharekhan code: GREENPANEL

Reco/View: Buy ↔	CMP: Rs. 439	Price Target: Rs. 563 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

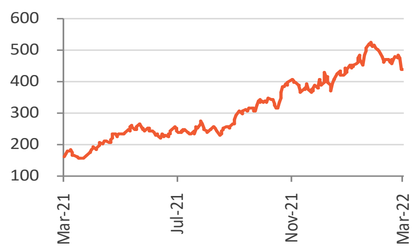
Company details

Market cap:	Rs. 5,380 cr
52-week high/low:	Rs. 538/150
NSE volume: (No of shares)	4.70 lakh
BSE code:	542857
NSE code:	GREENPANEL
Free float: (No of shares)	5.8 cr

Shareholding (%)

Promoters	53.1
FII	3.7
DII	22.9
Others	20.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-12.8	7.8	49.8	169.7
Relative to Sensex	-4.2	16.9	58.2	165.0

Sharekhan Research, Bloomberg

Summary

- We retain our Buy rating on Greenpanel Industries Limited (Greenpanel) with an unchanged PT of Rs. 563, considering a strong earnings growth outlook.
- MDF demand and pricing environment are expected to remain favourable in Q4FY2022 along with healthy volume growth expectation for FY2023.
- The company may undertake 1,80,000 cubic metres brownfield expansion at Andhra Pradesh at ~Rs. 400 crore capex, which would retain its leadership position in MDF in FY2024. We factor dip in realisation in FY2024, led by capacity additions by major players.
- The company's focus on increasing retail sales vis-à-vis OEM and domestic sales vis-à-vis exports would aid in maximising profitability from existing units.

We interacted with the management of Greenpanel Industries Limited (Greenpanel). The meeting highlighted favourable demand and pricing environment continuing for MDF in Q4FY2022 along with healthy volume growth expectation for FY2023. The company has yet not finalised capacity expansion plans but may zero in on 1,80,000 cubic metres brownfield expansion in MDF at Andhra Pradesh plant with a roughly calculated Rs. 400 capex. Incremental capacity, which is likely by FY2024 end, would aid in retaining its leadership position post Century's and Greenply's expansions getting completed during FY2024. However, large capacity additions during FY2024 may lead to lower operating profit margin (OPM) (200-250bps lower) during FY2024 and FY2025 before reverting to normal levels from FY2026, as incremental capacities get absorbed. The company's focus on increasing retail sales vis-à-vis original equipment manufacturers (OEM) and domestic sales vis-à-vis exports would aid in maximising profitability from its existing capacities in MDF.

- **Favourable demand and pricing environment:** Demand environment remained strong during the second half of January and February during Q4FY2022 till date, compensating for weakness in the first halves of each month. Management expects 29% y-o-y volume growth for FY2022, while it expects 15% y-o-y volume growth for FY2023 in MDF. Plywood volumes are expected to grow at 6-8% in FY2023. Post 17% price hike taken during Q3FY2022 in MDF, it has not taken any further price hike as raw-material prices especially Formaldehyde and Melamine remained stable. The benefit of price hikes undertaken in Q3FY2022, Uttarakhand plant resuming operations, and lower export sales would lead to better OPM sequentially for Q4FY2022.
- **MDF expansion on an anvil to retain MDF leadership by FY2024 end:** Post brownfield expansions at both northern and southern plants in November 2021 and January 2022 getting completed, its MDF capacity has increased from 5,40,000 cubic meters to 6,60,000 cubic meters. It may go ahead with 1,80,000 cubic metre brownfield expansion at Andhra Pradesh plant at a ~Rs. 400 crore capex (D/E of 80:20 or 75:20), which may get operational by FY2024 end. It would take its MDF capacity to 8,40,000 cubic metres, maintaining its leadership positioning followed by Century Plyboards (5,58,000 cubic metres) and Action (5,11,000 cubic metres). As per management, OPM for the industry may get impacted by 200-250 bps during FY2024 and FY2025 before reverting to normalcy in FY2026 as incremental capacities get absorbed.
- **Focus on retail and domestic sales to achieve maximum profitability:** The company would be focusing on increasing retail sales vis-a-vis OEM to de-risk itself from lower realisations, higher capital requirements in OEM, and achieve maximum profitability from its existing capacities in MDF. Further, the company would majorly be completing its EPCG commitments by FY2022 end with respect to exports (10% discount versus domestic prices), which should lead to higher domestic sales share in FY2023, aiding higher realisation and OPM. Overall, we believe the company is undertaking optimum measures to improve its profitability in MDF.

Revision in estimates – We have fine tuned our estimates for FY2022E-FY2023E, while we have lowered our estimates for FY2024, factoring dip in MDF realisation, led by capacity additions coming on-stream by major players.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 563: Greenpanel has strong structural growth drivers along with favourable environment, led by weak imports owing to changing global sourcing, led by anti-China sentiments. Strong demand helped the company to pass on a steep rise in raw-material costs, which has shielded gross margins. The company's brownfield expansion and another anticipated round of capacity expansions would lead to healthy growth going forward. The company's limited capex requirement towards brownfield expansions, strong operating cash flow generation, tight working capital management, and reducing leverage would propel its return ratios over FY2021-FY2024E. The stock trades at a P/E of 18x its FY2024E earnings, which we believe is quite attractive considering over 60% CAGR in net earnings expected over FY2021-FY2024E. Hence, we retain our Buy rating with an unchanged price target (PT) of Rs. 563.

Key Risks

Weak macroeconomic environment leading to a lull in industry growth trend.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	1,020.8	1,568.3	1,837.0	1,934.4
OPM (%)	19.9	25.3	25.3	25.3
Adjusted PAT	68.8	218.9	269.9	305.9
% Y-o-Y growth	172.0	218.2	23.3	13.3
Adjusted EPS (Rs.)	5.6	17.9	22.0	24.9
P/E (x)	78.2	24.6	19.9	17.6
P/B (x)	7.2	5.7	4.6	3.7
EV/EBIDTA (x)	27.9	14.3	12.2	11.6
RoNW (%)	9.9	26.3	25.7	23.5
RoCE (%)	8.5	20.3	22.6	22.0

Source: Company; Sharekhan estimates

Key Management Interaction Takeaways

- **Guidance:** For MDF, the company targets 29% y-o-y volume growth for FY2022 at 4,90,000 cubic metres, while FY2023 is expected to see 15% y-o-y volume growth. In plywood, it is targeting to grow its volume by 6-8% y-o-y for FY2023.
- **Capacity expansion:** The company completed Uttarakhand de-bottlenecking in November 2021, increasing its capacity to 2,16,000 cubic metres from 180,000 cubic metres and Andhra Pradesh in January 2022 increasing it to 4,44,000 cubic metres from 3,60,000 cubic metres. Overall, MDF capacity has increased to 6,60,000 cubic metres from 5,40,000 cubic metres. The company is yet to finalise its capacity expansion plans. However, it may go for 1,80,000 cubic metre brownfield MDF expansion at Andhra Pradesh at a rough capex cost of Rs. 400 crore (to be funded through D/E of 75:25 or 80:20). In the MDF industry, Century Plyboards would be adding 1,30,000 cubic metres in FY2023 and 2,30,000 in FY2024, while Greenply's 2,40,000 cubic metres capacity is slated to come in FY2024, along with Greenpanel's by FY2024 end. Capacity additions during FY2024 may lead to lower OPM for the industry during FY2024 and FY2025, reverting back to normal levels in FY2026.
- **Demand environment:** The company has seen MDF volumes picking up in the second half of each of January and February 2022, compensating for weaker first halves. Volumes in Q4FY2022 have been affected by the impact of price hikes, elections in few states, and COVID impact in January 2022.
- **Pricing environment:** MDF prices have remained stable post Q3FY2022, where it had taken 17% price hike in MDF. Realisations would be higher in Q4FY2022 versus Q3FY2022.
- **Raw material:** The company sources formaldehyde from domestic MSME manufacturers and melamine from GSFC (sole domestic manufacturer). In case GSFC does plant shutdown, it buys melamine from traders (imported). Pre-covid, raw materials such as wood and chemicals comprised 65% and 35%, respectively, of total raw-material costs (40% of sales). Currently, wood and chemicals comprise 51% and 49%, respectively, owing to sharp run-up in chemical prices. Wood prices generally rise 2-3% p.a. although as of Q3FY2022, they are up 10% in North and 5% in South. Melamine price increased from Rs. 85/kg to a peak of Rs. 280/kg and are currently at Rs. 165/kg.
- **Exports:** Export prices are at 10% discount to domestic prices. The company would complete most of the EPCG requirement by March 2022, which would lead to lower export share in FY2023 (15% exports, 85% domestic). The company has to do six times customs duty saved as exports over a six-year period. Exports incentives would form 15.5% in FY2022 and 1.5% in FY2023. MDF exports invoiced during March 2021 was $190 per cubic metres, which is currently at $275/cubic metres. In the past, global MDF prices were at 30-35% discount, which is now at 10%. Vietnam and Indonesia have been significantly exporting US and European countries due to anti-China sentiments, which led to lower imports to India. There is no price difference in higher than 5mm thickness MDF in exports and domestic prices, while in thin MDF, it is 10%. The company does not expect imports to affect domestic market owing to currency risks, 4-4.5% hedging spends, and two and half to three months inventory costs.
- **Forex exposure:** The company has Euro 22 million (~Rs. 190 crore) overseas loan from Germany, which is to be repaid in 10 half yearly installments from April 2022. It does not expect any currency loss in Q4FY2022. However, it has un-hedged loan and faced risk of currency fluctuations. Interest cost of the loan is only 0.5% with an annual cost of 7% p.a.
- **OEM versus retail sales:** The OEM share comprised 30%, which is now 15% of domestic volume as it had reduced discount to OEM bringing at par to retail prices. The company is de-risking business through reducing OEM exposure, which has lower realisation and higher working capital. The company will be drawing up plans for retail expansion.

Outlook and Valuation

■ Sector view - Expect faster recovery in operations

The building materials industry was severely affected by COVID-19 led lockdown during Q1FY2021, which had affected its peak sales period of the year. Additionally, its high fixed cost structure had affected OPM, dragging down its net earnings. However, from June, the sector has been one of the fastest to recover, with easing of lockdowns domestically. The sector witnessed resumption of dealer and distribution networks and a sharp improvement in capacity utilisation levels. Most players have begun to see demand and revenue run-rates reaching 80-90% as compared to pre-COVID levels. Scaling up of revenue is also expected to lead to better absorption of fixed costs going ahead, aiding net earnings recovery. The industry is expected to rebound with strong growth in FY2022.

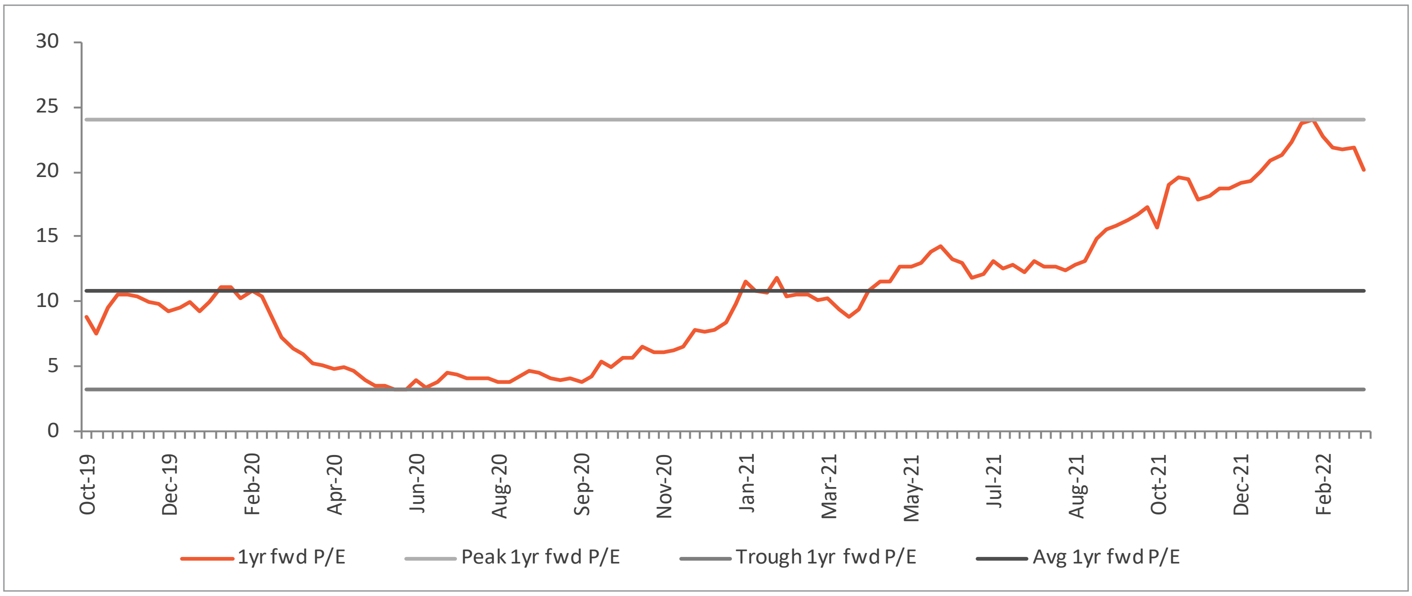
■ Company outlook - Structural triggers to drive growth

GRPL holds a leadership position in the high-growth MDF segment of the wood panel industry. GRPL is expected to ride on strong growth being envisaged for the wooden furniture industry, which is expected to post a 12% CAGR over 2020-2023. Rising incomes, urbanisation, real estate development, Housing for All, etc., are key growth drivers. The company's dominant positioning in the MDF segment (a 79% revenue share in FY2021) gives it an edge in the wood panel industry as MDF demand is expected to grow at 15-20% per annum over the next two years. Its plywood division is also expected to see double-digit volume growth as demand from plywood has resurrected from Q3FY2021 and is expected to maintain growth trajectory going ahead.

■ Valuation - Maintain Buy with an unchanged PT of Rs. 563

Greenpanel has strong structural growth drivers along with favourable environment, led by weak imports owing to changing global sourcing, led by anti-China sentiments. Strong demand helped the company to pass on a steep rise in raw-material costs, which has shielded gross margins. The company's brownfield expansion and another anticipated round of capacity expansions would lead to healthy growth going forward. The company's limited capex requirement towards brownfield expansions, strong operating cash flow generation, tight working capital management, and reducing leverage would propel its return ratios over FY2021-FY2024E. The stock trades at a P/E of 18x its FY2024E earnings, which we believe is quite attractive considering over 60% CAGR in net earnings expected over FY2021-FY2024E. Hence, we retain our Buy rating with an unchanged PT of Rs. 563.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Company	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Greenlam Industries	27.0	20.9	16.1	13.3	6.2	5.3	24.5	27.7
Greenpanel Industries	19.9	17.6	12.2	11.6	4.6	3.7	25.7	23.5
Century Plyboards	30.0	25.4	19.9	16.5	6.6	5.3	24.4	23.1

Source: Sharekhan Research

About company

Greenpanel is India's largest MDF manufacturer with plants at Uttarakhand and Andhra Pradesh (with a combined MDF capacity of 5,40,000 cubic metres/annum; plywood capacity at 10.5 million sqm). The company's product portfolio also comprises block boards, veneers, wood floors, and doors. The company is also the third largest MDF manufacturer in Asia and the fifth largest MDF manufacturer in the world. It has 1,400 of distributors, 7,000 retailers, and serviced by 15 branches for pan-India distribution.

Investment theme

Greenpanel has strong structural growth drivers along with the government's favourable measures such as likely anti-dumping duty on thin MDF and CVD on any imported MDF, which is likely to aid in strong double-digit revenue growth for its MDF vertical. Further, strong revival in demand for plywood seen in Q3FY2021 is expected to sustain momentum going ahead. The company's limited capex requirement towards brownfield expansions, strong operating cash flow generation, tight working capital management, and reducing leverage would propel its return ratios over FY2021-FY2024E.

Key Risks

- A slowdown in macro-economy, leading to weak realty market.
- High concentration in the MDF industry.

Additional Data

Key management personnel

Mr. Shiv Prakash Mittal	Executive Chairman
Mr. Shobhan Mittal	Managing Director & CEO
Mr. V. Venkatramani	Chief Financial Officer
Mr. Lawkush Prasad	Company Secretary & Compliance Officer

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SM Management	25.79
2	Prime Holdings	10.87
3	Mittal Shobhan	8.63
4	HDFC Asset Management Company	5.82
5	IDFC Mutual Fund	4.38
6	Tata Asset Management	4.12
7	Vanashree Properties	2.54
8	Mittal Rajesh	2.51
9	SBI Funds Management	1.41
10	Mauryan First	1.29

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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