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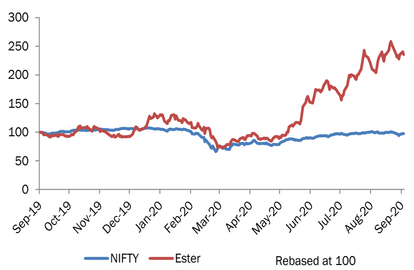
# Ester Industries Limited

30 September 2020

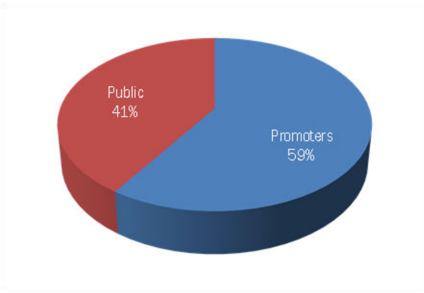
## High-end products to drive profitability and deliver solid earnings growth — BUY

| | |
|---|---|
| Sector | : Plastics |
| Target Price | : Rs 131 |
| Current Market Price | : Rs 74 |
| Market Cap | : Rs 618 crore |
| 52-week High/Low | : Rs 83/22 |
| Daily Avg Vol (12M) | : 1,60,756 |
| Face Value | : Rs 5 |
| Beta | : 1.01 |
| Pledged Shares | : 6% |
| Year End | : March |
| BSE Scrip Code | : 500136 |
| NSE Scrip Code | : ESTER |
| Bloomberg Code | : ESTR IN |
| Reuters Code | : ESTR.NS |
| Nifty | : 11,222 |
| BSE Sensex | : 37,973 |
| Analyst | : Ritwik Bhattacharjee |

**Price Performance**




**Shareholding Pattern**




## Introductory Note

### Investment Summary

- Ester operates in the high-growth flexible plastic packaging, engineering plastic, and high-end speciality polymer spaces. The company has grown at a CAGR of 10.% in the 10 years from FY10 to FY20, driven by capacity expansions and productivity improvements. The company plans to expand its polyester films capacity to cater to future growth in demand.
- Demand for polyester films is expected to remain buoyant, driven by the consumer stapes and pharma sectors. A young population, increasing urbanisation, and rise in disposable income coupled with changes in lifestyle such as higher consumption of packaged food and beverages will drive demand for flexible polyester packaging in India.
- Ester's management looks to generate ~30% of revenues from high-margin value-added and speciality films by the next 2 years compared to ~15% levels currently.
- Revival of auto demand, infrastructure projects and fiberisation of telecom infra (including 5G-related) will drive engineering plastics.
- The speciality polymers business has a high entry barrier as products are protected by intellectual property rights and it involves large investments towards research and product development.
- We expect an overall degrowth in FY21 sales due to the COVID-19 pandemic. We have modelled EBITDA margin expansion driven by improvements in product mix. We expect healthy topline growth in FY22 due to a revival in demand. Ester has consistently reduced its short-term borrowing requirement and had no long-term debt as of March 2020. The company is expected to raise debt (to the tune of Rs 350 crore) for expansion of polyester film capacity in FY22. At current levels, the Ester stock trades at an attractive forward P/E of 4.5x FY22E EPS. Assigning a target P/E multiple of 8.0x FY22E EPS of Rs 16.40, we value Ester at Rs 131 with an upside potential of 77% and informing a BUY rating.

### Key Financial Metrics

| Rs crore | FY18A | FY19A | FY20A | FY21E | FY22E |
|---|---|---|---|---|---|
| Operating revenue | 824.5 | 1,028.1 | 1,038.7 | 939.0 | 1,044.2 |
| *Growth* | | *24.7%* | *1.0%* | *-9.6%* | *11.2%* |
| EBITDA | 65.6 | 108.0 | 189.4 | 209.4 | 234.9 |
| *EBITDA margin* | *8.0%* | *10.5%* | *18.2%* | *22.3%* | *22.5%* |
| PAT | 5.3 | 31.1 | 99.5 | 123.9 | 136.8 |
| *PAT margin* | *0.6%* | *3.0%* | *9.6%* | *13.2%* | *13.1%* |
| Diluted EPS (Rs) | 0.63 | 3.73 | 11.93 | 14.86 | 16.40 |

*Source: Company data; Khambatta Research*

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### Company Profile

Ester Industries manufactures polyester films, specialty polymers and engineering plastic compounds. The company serves a variety of industries in packaging and other applications. Polyester films have applications in flexible packaging while specialty polymers are used in niche areas such as rigid packaging and textiles. Engineering plastics have utilisation in the automotive, electrical & electronics, appliances and telecom verticals.

Exports accounted for 23% of overall revenues in FY20

Ester supplies its products to 75 countries across the Indian sub-continent, the Americas, Europe, Africa, Asia Pacific (including the Far East), and the Middle East. Exports accounted for 23% of overall revenues in FY20.

Headquartered in Gurgaon in the National Capital Region (NCR), Ester's manufacturing facility is located at Khatima, Uttarakhand, about 300 kms north of New Delhi.

### Investment Thesis

**Ester has generated solid growth over the last 10 years with plans for capacity expansion to cater to growing demand.** Ester operates in the high-growth flexible plastic packaging, engineering plastic, and high-end speciality polymer spaces. The company has grown at a CAGR of 10.% in the 10 years from FY10 to FY20, driven by capacity expansions and productivity improvements. In FY20, Ester produced 69K MT of polyester chips, 69K MT of polyester films, 11.5K MT of engineering plastics and 2K MT of speciality polymers. A majority of chips produced was used as raw material for films. The company has planned capacity expansion of polyester films of additional 48K MTPA with a capital outlay of Rs 500 crore (Rs 150 crore equity + Rs 350 crore debt). The project will be undertaken through a new wholly-owned subsidiary of the company to benefit from the lower tax rate of 15% for new manufacturing units. The work for the expansion is expected to begin in FY22.

The Indian polyester films market is expected to grow by a CAGR of 10% to FY23, outperforming the world market and China

**Demand for polyester films is expected to remain buoyant, driven by the consumer stapes and pharma sectors.** Biaxially-oriented polyethylene terephthalate (BOPET) or polyester film is used in flexible packaging applications in the food & beverage (F&B), pharma, and other consumables industries. Polyester films is the largest revenue contributor for Ester, accounting for over three-fourths of total sales. Domestic demand for BOPET increased at a CAGR of 10%-12% over the past 5 years. Ester's operations were not affected due to the nationwide lockdown as polyester film is regarded as an essential commodity. According to a 2019 research report by Wood Mackenzie Chemicals, global BOPET demand will be led by Asia, particularly China and India, where the market growth is expected to outperform overall global demand. While the world market is forecast to grow by a CAGR of 5.6% to FY23, India and China are seen to expand at a faster rate with India expected to grow at significantly higher 10% compared to 6.6% for China. Flexible packaging accounts for approximately 60% of global consumption of BOPET films. The key end markets for flexible packaging includes F&B, home & personal care (HPC) and pharma. A young population, increasing urbanisation, and rise in disposable income coupled with changes in lifestyle such as higher consumption of packaged food and beverages will drive demand for flexible polyester packaging in India. Besides these end markets, the electrical and electronics market will also contribute to the demand growth for BOPET going forward.

Ester looks to increase the share of value-added and speciality films from ~15% to ~30% over the next 2 years

**Focus on value-added films will help Ester move up the value chain and help improve profitability.** Ester has been continuously working to improve its product mix by increasing the share of value-added products. The company's management looks to generate ~30% of revenues from value-added and speciality films by the next 2 years compared to ~15% levels currently. Incremental margins from decommoditisation of a higher proportion of the business will help improve the company's overall profitability.

**Revival of auto demand, infrastructure projects and fiberisation of telecom infra will drive demand for engineering plastics.** Due to their thermal, mechanical and dimensional stability properties, engineering plastics are suitable for applications in the automotive, electrical and electronics, construction, medical, consumer durables and telecommunication spaces. The product segment accounts for ~15% of Ester's overall revenues. The automotive sector is the largest end-use market for engineering plastics in India. The auto and auto components sectors were negatively affected by the BSVI transition and overall economic slowdown in FY20. From near-zero sales in April when it was severely affected by the COVID-19 outbreak and the ensuing lockdown, the auto industry is making a quicker-than-expected turnaround with major passenger vehicle (PV) and two-wheeler (2W) OEMs reporting y-o-y growth in August. This could be attributed to a revival in demand and realisation of postponed purchases. An expanding working age population coupled with increasing disposable income will drive PV and 2W sales in India in the medium-to-long term. Increasingly stringent norms for emission and fuel efficiency will drive demand for light-weight vehicles and, in turn, for engineering plastics in automotive applications globally. The electrical industry, which is the second largest end market for engineering plastics, is expected to benefit from increasing urbanisation and personal income growth. Further, fiberisation of data networks including network upgrades relating to 5G will drive demand for engineering plastics in the medium term.

Ester has 19 products in various stages of development with 7 of them patented

**Speciality polymers hold strong future potential.** The speciality polymer business has a long gestation period as the products are not commodities. With it based on development of specialised products, the business has a long gestation period. The speciality polymers business has a high entry barrier as products are protected by intellectual property (IP) rights and it involves large investments towards research and product development. Ester has 19 products in various stages of development with 7 of them having received patents. FY20 was one of the best years for Ester's speciality polymers business with revenues to the tune of Rs 73 crore coming from it

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(approximately 7% of overall revenues). With high operating margins (~35% EBIT margins vs 23% for polyester films and 5% for engineering plastics), the business presents a strong potential for the future.

### Valuation

Basis solid earnings growth expectation, at current levels the Ester stock trades at a very attractive forward P/E of 4.5x FY22E EPS

**At 8.0x FY22E EPS, we rate Ester a BUY with a target price of Rs 131 and an upside potential of 77%.** Ester reported a 33% decline in revenues in 1Q FY21, affected by a slowdown in demand due to the COVID-19 pandemic. We expect an overall degrowth in FY21 sales. We have modelled EBITDA margin expansion driven by improvements in product mix with a greater proportion of value-added products. Subsequently in FY22, we expect healthy topline growth due to a revival in demand. Ester has consistently reduced its short-term borrowing requirement, from Rs 236 crore in FY18 to Rs 167 crore in FY19 and Rs 77 crore in FY20. As of March 2020, the company had paid off all long-term debt. Going forward, the company is expected to raise debt (to the tune of Rs 350 crore) for the planned expansion of polyester film capacity for which the work will commence in FY22. Basis our expectation of solid earnings growth, at current levels the Ester stock trades at a very attractive forward P/E of 4.5x FY22E EPS. Assigning a target P/E multiple of 8.0x FY22E EPS of Rs 16.40, we value Ester at Rs 131 with an upside potential of 77% and informing a BUY rating.

**Abridged Profit & Loss Account**

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| *PAT margin* | *0.6%* | *3.0%* | *9.6%* | *13.2%* | *13.1%* |
| Diluted EPS (Rs) | 0.63 | 3.73 | 11.93 | 14.86 | 16.40 |

*Source: **Company data; Khambatta Research***

### Key Risks

- Our expectations of margin and earnings growth is based on Ester's ability to sustainably improve its product mix. An inability to increase the share of high-margin products will lead to underperformance of our estimates.
- While Ester's revenue base is not concentrated (largest client contributes ~10% of overall revenues), the loss of any important client(s) could make a dent in the company's topline.
- An extended economic downturn owing to / as a fallout of the COVID-19 pandemic may lead to underperformance of our forecasts.

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## Guide to Khambatta's research approach

### Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

*Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.*

### Stock ratings

*Buy recommendations* are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

*Hold recommendations* are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

*Sell recommendations* are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

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