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Ester Industries Limited

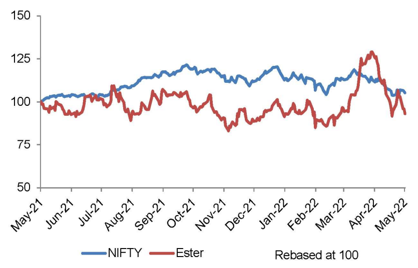
26 May 2022

Margin-accretive EP divestment justifies re-rating

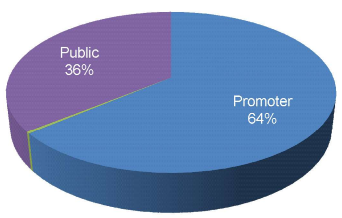
BUY

Sector	: Plastics
Target Price	: Rs 200
Last Closing Price	: Rs 131
Market Cap	: Rs 1,094 crore
52-week High/Low	: Rs 188/110
Daily Avg Vol (12M)	: 3,28,454
Face Value	: Rs 5
Beta	: 0.99
Pledged Shares	: 6.0%
Year End	: March
BSE Scrip Code	: 500136
NSE Scrip Code	: ESTER
Bloomberg Code	: ESTR IN
Reuters Code	: ESTR.NS
Nifty	: 16,170
BSE Sensex	: 54,253
Analyst	: Research Team

Price Performance



Shareholding Pattern



4Q FY22 Update

Results Analysis

- Ester reported robust growth in 4Q FY22 and FY22, driven by strong performances across segments. Operating revenues increased by 30.7% y-o-y and 41.7% over 4Q FY22 and FY22, respectively.
- EBITDA growth of 10.2% y-o-y and 4.2% in 4Q FY22 and FY22, respectively was lower than the topline growth with margins declining, as a fall in Film margins more than offset the higher margins in Speciality Polymers (SP) and Engineering Plastics (EP) segments. Film margins were lower due to higher raw material cost.
- PAT was broadly flat on a y-o-y basis during the quarter as well as the full financial year due to higher interest expenses and higher tax.
- The net proceeds from the divestment of the EP business are expected to be approximately Rs 225 crore.

Outlook & Valuation

We view the sale of the EP business as a value-unlocking event. While EP delivered robust margins in FY22, those levels are not sustainable in the long run with inevitable normalisation, according to management. Going forward, we expect continued robust export-driven growth in SP, and healthy growth in Film, driven by capacity expansion. The new film facility in Telengana, comprising 48,000 MTPA of BOPET film capacity and 8,333 MTPA of metallised BOPET film capacity, which is expected to come on-stream by October 2022, will boost 2H FY23 revenues, with its full impact expected to be seen from FY24 onwards. The Ester stock has appreciated 77% since we initiated coverage on the company on 30 September 2020. The EP divestment and a higher share of SP / value-added films will lead to margin-accretion and margin-stability, i.e. improved earnings quality, going forward. Consequently we increase our target multiple to 8.0x (from 7.0x) FY24E EPS to arrive at a price target of Rs 200, reiterating a BUY with an upside of 52%.

Key Financial Metrics (Consolidated)

₹ crore	FY19A	FY20A	FY21A	FY22A	FY23E*	FY24E*
Operating revenue	1,028.1	1,038.7	991.8	1,405.7	1,291.9	1,648.3
Growth		*1.0%*	*-4.5%*	*41.7%*	*-8.1%*	*27.6%*
EBITDA	108.0	189.4	231.2	240.9	295.6	392.9
EBITDA margin	*10.5%*	*18.2%*	*23.3%*	*17.1%*	*22.9%*	*23.8%*
PAT	31.1	99.5	137.5	136.7	157.1	208.3
PAT margin	*3.0%*	*9.6%*	*13.9%*	*9.7%*	*12.2%*	*12.6%*
Diluted EPS (₹)	3.73	11.93	16.49	16.39	18.84	24.98

**Pro forma financials excluding the divested EP business*
Source: Company data, Khambatta Research

Financial Performance (Consolidated)

₹ crore	4Q FY21	3Q FY22	4Q FY22	Y-o-Y	Q-o-Q	FY21	FY22	Y-o-Y
Operating revenue	297.0	365.6	388.1	30.7%	6.2%	991.8	1,405.7	41.7%
EBITDA	57.3	60.9	63.2	10.2%	3.7%	231.2	240.9	4.2%
EBITDA margin	*19.3%*	*16.7%*	*16.3%*	*-302 bps*	*-38 bps*	*23.3%*	*17.1%*	*-617 bps*
PAT	32.4	34.5	32.9	1.6%	-4.6%	137.5	136.7	-0.6%
PAT margin	*10.9%*	*9.4%*	*8.5%*	*-242 bps*	*-96 bps*	*13.9%*	*9.7%*	*-414 bps*
Diluted EPS (₹)	3.89	4.14	3.95	1.6%	-4.6%	16.49	16.39	-0.6%

Source: Company data, Khambatta Research

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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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