

Initiating Coverage Essel Propack Ltd.

21-September-2020



Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Packaging	Rs 251.90	Buy at LTP and add on dips in 225 - 228 band	Rs. 291	Rs. 312	2 quarters

HDFC Scrip Code	ESSPAC
BSE Code	500135
NSE Code	ESSELPACK
Bloomberg	ESEL IN
CMP Sept. 18, 2020	251.90
Equity Capital (cr)	63.1
Face Value (Rs)	2
Eq- Share O/S(cr)	31.5
Market Cap (Rscr)	7949
Book Value (Rs)	49
Avg.52 Wk Volume	606371
52 Week High	318.75
52 Week Low	102.10

Share holding Pattern % (19 Sept)**	
Promoters	52.00
Institutions	30.25
Non Institutions	17.75
Total	100.0

**Post promoter stake sell

Fundamental Research Analyst

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Our Take:

Essel Propack is the global leader in the manufacturing of laminated plastic tubes and laminates with ~37% share. The products of the company are the key integrals of packaging for FMCG and Pharma industry. Essel Propack has marquee clientele across the globe. Essel Propack had a management overhaul in FY2020, when Blackstone group acquired majority stake from the erstwhile promoters. With this stake sale, there have been significant changes in the top level management. Recently company hired Mr. Sudhanshu Vats as new MD and CEO to strengthen the corporate governance, prudent capital allocation and consistent earnings growth. We believe company operates in a segment where COVID-19 impact is expected to be minimal. Essel Propack leading market position in laminated tubes coupled with the management overhaul post Blackstone entry and sustainable and diversified revenues across the globe gives us confidence in the company. The company has huge prospects of growth across the globe with European facilities being key growth driver in the recent times.

Valuations & Recommendation:

In FY20, Blackstone group acquired majority stake in the company and since then has made significant changes in the top level management to improve corporate governance standards. The company has adopted more prudent capital allocation across regions and also aims at consistent earnings growth. The European region is likely to be key growth driver for the company given better utilization levels along with diversification across categories and robust order pipeline. Amidst the COVID-19 crisis, company has identified an extra source of revenue through introduction of hand sanitizer tube and in a very short span of time the company has become a leading supplier of hand sanitizer tubes. We expect Revenues/EBITDA/PAT CAGR of 10%/15%/27% respectively over FY20-22E factoring in the impact of COVID-19 crisis and post crisis pick up of volumes across the geographies. The stock is currently trading at ~23x FY22E earnings. **We feel investors can buy the stocks at current price and add the stock on dips at band of Rs. 225-228 (~21x FY22E earnings). We have arrived at base case fair value of Rs. 291 (~27x FY22E earnings) and bull case fair value of Rs. 312 (~29x FY22E earnings).**

Financial Summary

Rs in Cr	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	FY19	FY20	FY21E	FY22E
Net Revenues	741	630	17.7	689	7.6	2707	2760	3008	3366
EBITDA	147	109	35.0	138	5.9	499	557	653	741
Depreciation	58	57	1.8	57	1.8	186	230	242	255
Other Income	5	7	-22.3	1	586.7	29	13	15	17
Tax	16	15	3.7	20	-19.5	93	64	103	126
APAT	46	40	14.0	50	-8.7	190	212	280	340
EPS (Rs)	1.41	1.24		1.54		6.2	6.7	8.9	10.8

(Source: Company, HDFC sec.)

Recent Developments

The current promoter of company - Blackstone through its entity Epsilon Bidco sold a total of 7,25,80,090 shares totaling to 23% stake on Sept 18, 2020. The shares were acquired by marquee domestic and overseas funds such as Axis Mutual Fund, Franklin Templeton Mutual Fund, DSP Mutual Fund, Morgan Stanley, Neuberger Berman, Nomura etc. Post the sale, Blackstone holding has come down to 52% from 75%. The increase in free float will help in attracting higher weight in indices and more fund flows.

Despite the pandemic, Essel Propack Q1FY21 results were quite good where its consolidated revenues increased by 18% YoY to Rs. 741 crore while EBITDA increased by 47% YoY to Rs. 147 crore. EBITDA margins also expanded to 20% from 17%. Consolidated PAT increased by 14% YoY to Rs. 46 crore. The improvement in EBITDA margins was on the back of better product mix and operating leverage including optimized operating costs.

During Q1FY21, AMESA/EAP/Europe/Americas contributed 28/26/26/20% to the revenues respectively. The EBIT contribution across AMESA/EAP/Europe/Americas was 17/47/19/17% respectively. Company witnessed robust growth in EAP (46% YoY) and Europe (30% YoY) regions which led to higher contribution of total revenue in these regions. Company continues to witness strong business pipeline and momentum.

Company amidst the COVID-19 crisis has find new business opportunity in hand sanitizers. The company has launched hand sanitizer tubes and it has become a leading hand sanitizer tube supplier globally, with a robust order pipeline. This new category alone has the potential to scale up the business by further additional 150 mn tubes.

Company received approval for Platina which is a recyclable tube in the USA, Europe and India, and other geographies. This segment is expected to provide good growth opportunities in the coming years as many companies are inclined towards green initiatives.

Long term Triggers

Leader in niche business

Essel Propack is the leader in manufacture of laminated plastic tubes and its operations are spread across the globe in 11 countries and 20 manufacturing units. The tubes industry is predominantly concentrated between few global players like ALBEA S.A., CCL industries and Essel. The company is a market leader in oral care segment with global share of ~37% and caters to companies like Unilever, Colgate, P&G etc. In the Personal care market, its share stands at ~8% showing a vast scope of growth for Essel. The company is engaged in a very niche business considering its products are an integral part of the FMCG and Pharma space with packaging being one of the four key P's of marketing mix that underpin the success of any brand. The opportunity in the business is quite huge evident by the fact that opportunity for oral care tubes is 14bn pa while for beauty & cosmetics is 12bn pa and pharmaceuticals is 10bn pa. Essel Propack sells ~8bn tubes annually.

Essel's integrated and vast operations make it a preferred one stop solution for its big clients who form long term partnership with Essel. Its existing capacity can meet 2x the current demand and hence need for large capex is ruled out for the near term.

Replacement of aluminium/plastic tubes by laminated tubes continues at a good pace across the globe due to better aesthetics, lower cost, higher plastic-barrier properties, product and design flexibility and higher sustainability.

Diversified revenues across geographies

Essel has global footprints with revenue coming in from Americas (USA, Mexico and Colombia), Europe (UK, Germany, Poland and Russia), AMESA (Africa, Middle East & South Asia), EAP (East Asia Pacific).

Americas (USA, Mexico and Colombia)

The company has a strong presence in both North and South America, through its wholly owned subsidiaries in USA, Mexico and Colombia. The region's revenue growth is contributed by robust Personal Care category growth of 17.1% in FY20. The share of Personal Care category improved by 240 bps. Americas contributed 22% of company's revenues and 20% to EBITDA in FY20. The region is showing good traction as company has been able to manage new customer wins across categories and cross selling Personal Care products to existing oral care customers.

Europe

The company has units in Poland, Russia and Germany, from where laminated tubes and extruded plastic tubes are manufactured and sold. Europe is the largest tube market in the world and continues to be the focus market for Essel (24% of FY20 revenues). The company sells both laminated tubes and extruded plastic tubes in Europe. In Europe, company have seen a robust pipeline for Germany and Poland where new business are coming in. Going forward, this region is likely to continue growth trajectory coupled with margin improvement on the back of better utilization levels and diversification across categories. Essel serves all the major Oral care players in Europe. Current EBITDA margins of 13% show a large potential for improvement.

AMESA (Africa, Middle East and South Asia)

This region is serviced by the company from its six units in India and its subsidiary in Egypt. AMESA regions contributed 33% to total revenues and 38% to EBITDA in FY20 (EBITDA margin healthy at 22%). This region also includes Essel's India operations. India contributed 86% of AMESA revenues in FY20. This region saw a tough year in FY20 on the back of weak macroeconomic conditions in India, however this was partially offset by strong revenue growth in Egypt. We expect strong growth momentum to continue in Egypt while India's operations will also see recovery post pandemic.

EAP (East Asia Pacific)

The company operates in this region through 5 units in China and 1 unit in Philippines. EAP contributed 22% to total revenues and 25% to EBITDA in FY20 (EBITDA margin healthy at 23%). The revenues in this region are dominated by China as it shares 95% of EAP revenues. The recovery in China was significant post the peak of pandemic in China. We believe the region's margins can be improved on the back of cost optimization measures, improved revenue mix and productivity improvement across the plants. On the other hand, Philippines continued to grow consistently with large part of its revenues arising from personal care.

Management overhaul post Blackstone entry

The company had a management overhaul in FY20, where Blackstone Group acquired majority stake in the company from the erstwhile promoter at Rs 134 per share valuing the deal at USD 310mn. Subsequently, through an open offer the group further acquired 26% at Rs 139 per share. Blackstone has stated its mission to deliver “capital efficient consistent earnings growth”. With the entry of Blackstone, the group has made significant changes in the top level management to improve the corporate governance. Recently, the company has hired Mr. Sudhanshu Vats as CEO and MD of the company who has more than 28+ years of industry experience across the FMCG and Media sectors and has worked with companies like Viacom 18 and Unilever.

Growth in personal care to be continued

Personal care and pharmaceuticals are two categories where immense value along with accretive margins can be created which is evident by the fact that opportunity is thrice the value of the oral care market. In FY20, Essel derived 45% of total revenues from personal care segment. Beauty & Cosmetics and Pharma categories have been key drivers of personal care. Average realization of tubes sold for beauty & cosmetics and pharmaceuticals is 1.5-3x times of oral care because of higher pricing of these products. This segment is expected to show strong growth momentum coupled with superior margins on the back of robust business pipeline, new launches and new customer wins. In FY20, company converted a leading Indian anti-fungal ointment brand to laminate tubes compared to erstwhile usage of aluminium tubes.

Launch of Phoenix project to cut costs and boost margins

Under Phase-I of project Phoenix, Essel managed to increase EBITDA margin by 180bp YoY to 20.2% in FY20. The Phase-II of project Phoenix, aims to expand margins further by virtue of cost management and rationalization. Essel’s margins that are already the best in class are expected to improve further.

What could go wrong

Volatility in raw material prices as they are highly correlated to the movement in crude prices. The principal raw material consumed is polymer granules which is a derivative of crude oil and is highly sensitive to any volatility in crude oil prices. The recent rise in margins could be partly attributed to fall in crude prices. Reversal of this could lead to softer margins for the company.

As company has operations across the globe, it is exposed to foreign exchange fluctuation risk and translation risks.

Due to unprecedented event of COVID-19, economic slowdown is expected across the globe which could have an adverse impact on the company as revenue contribution comes from across the globe. Also demand for Beauty and cosmetics has been impacted in COVID times.

Volume growth in the global oral care market is 3-4% p.a. Globally, toothpaste is a consolidated segment with 77% of market share held by top four brands with Colgate holding 42% share. This could mean slow growth in oral care segment and lower bargaining power with customers in case capacity increase happens in laminated packaging segment.

Globally, regulations require that all packaging materials have to be recyclable by 2025 (for India it is 2022). The regulation requires packaging materials to be sustainable, which means packaging companies / reusers should be able to recycle the product without doing any intermediate process and it should go into a recycling chain 100% without any alterations. This could present challenges and opportunities for Essel.

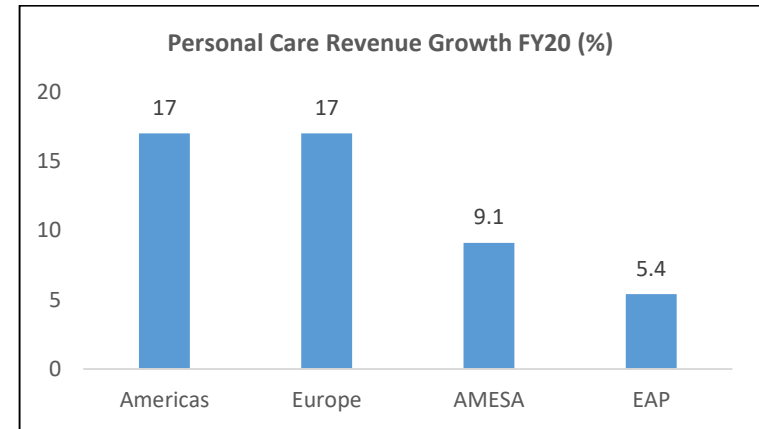
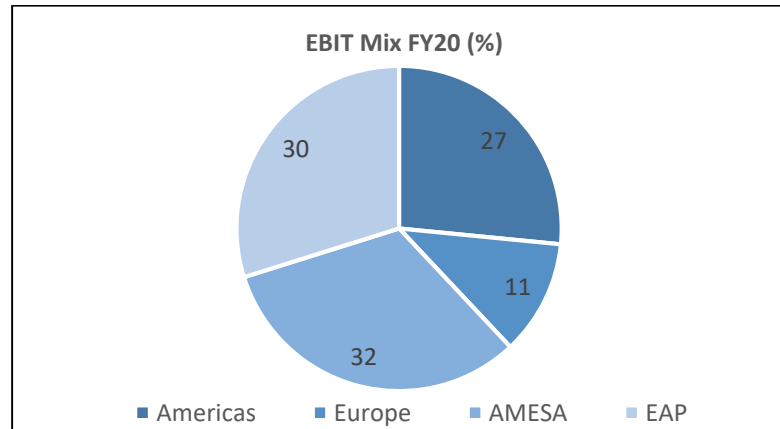
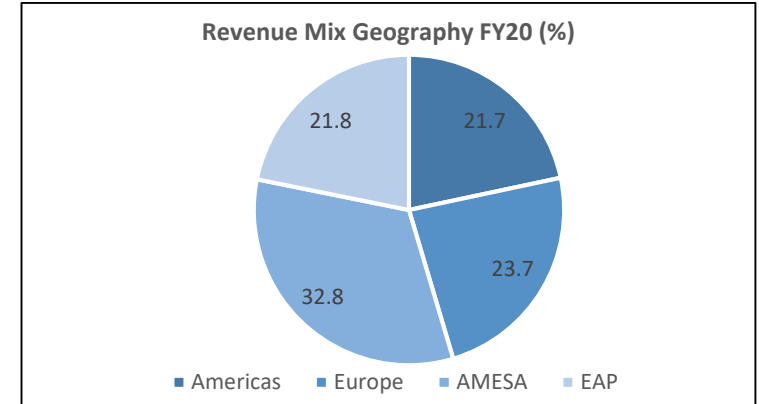
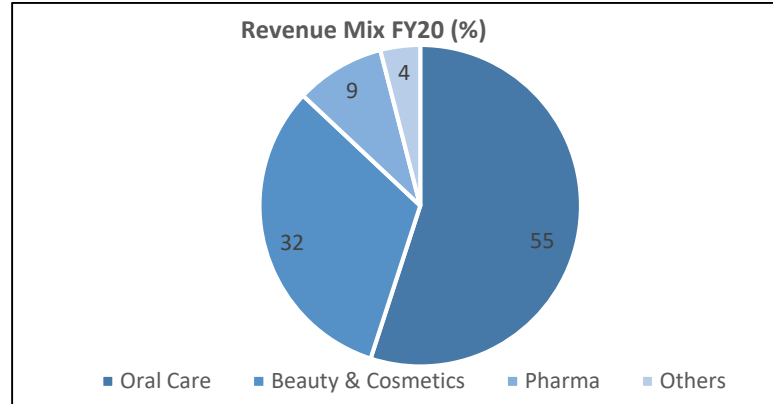
In FY20, Essel's Platina 250 and Green GML 300 laminated tubes were recognized by the US-based Association of Plastic Recyclers (APR) as meeting or exceeding the strict APR HDPE critical guidance criteria, of being 100% recyclable. This should help global take-off in demand for Platina when Essel fully commercializes it.

About the company

Essel Propack Limited (EPL) is the largest global specialty packaging company, manufacturing laminated plastic tubes, catering to the FMCG and Pharma space. Essel operates in all the three tube segments i.e. oral care, beauty and cosmetics and pharma with capabilities of entire value chain from manufacturing laminates to printing and tubing. Essel Propack has units operating in countries such as USA, Colombia, Mexico, Poland, Germany, Egypt, Russia, China, Philippines and India.

In FY20, Blackstone Group bought majority stake of 51% in Essel from the erstwhile promoter at Rs 134 per share valuing deal at USD 310 mn. This was followed by a trigger of a mandatory open offer, according to regulations, requiring further 26% acquisition which happened at Rs 139 per share. Recently The promoter of company - Blackstone through its entity Epsilon Bidco sold a total of 7,25,80,090 shares totaling to 23% stake. The shares were acquired by marquee domestic and overseas funds such as Axis Mutual Fund, Franklin Templeton Mutual Fund, DSP Mutual Fund, Morgan Stanley, Neuberger Berman, Nomura etc. Post the sale, Blackstone holding has come down to 52% from 75%.

Charts



(Source: Company, HDFC sec.)

Financials

Income Statement

Particulars (Rs. cr)	FY19	FY20	FY21E	FY22E
Income from operations	2707	2760	3008	3366
Material Cost	1165	1157	1249	1397
Employee Cost	501	531	557	619
Other expenses	542	515	551	609
Total expenses	2208	2203	2356	2626
EBITDA	499	557	653	741
Depreciation	186	230	242	255
EBIT	313	328	411	486
Other Income	29	13	15	17
Interest	61	56	43	37
Profit before tax	283	276	383	466
Tax Expenses	93	64	103	126
Profit After Tax	190	212	280	340
Adj. PAT	195	212	279	339
EPS	6.2	6.7	8.9	10.8

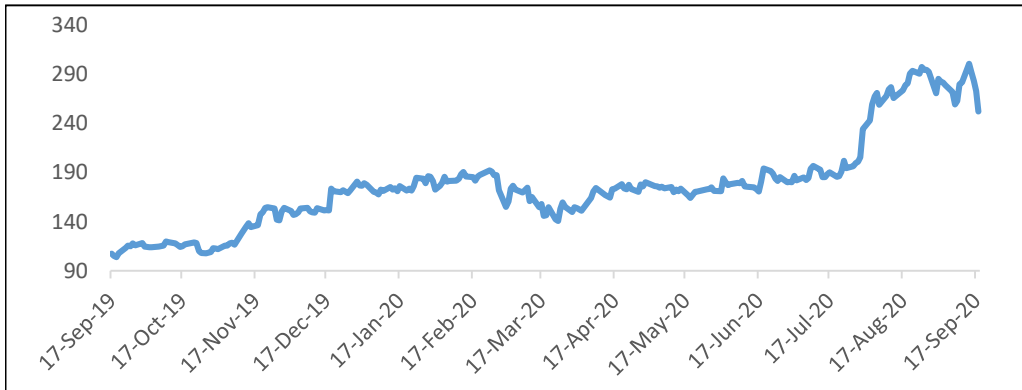
Balance Sheet

Particulars (Rs. cr)	FY19	FY20	FY21E	FY22E
EQUITY AND LIABILITIES				
Share Capital	63.1	63.1	63.1	63.1
Reserves and Surplus	1325	1470	1619	1830
Shareholders' Funds	1388	1533	1682	1893
Minority Interest	5	9	9	9
Long Term borrowings	469	330	300	260
Deferred Tax Liabilities (Net)	36	29	29	29
Other Long Term Liabilities	13	77	72	74
Long Term Provisions	20	21	22	25
Non-current Liabilities	538	456	423	387
Short Term Borrowings	113	196	146	96
Trade Payables	207	245	243	277
Other Current Liabilities	236	334	339	378
Short Term Provisions	7	7	7	8
Current Liabilities	562	781	735	759
TOTAL	2494	2779	2849	3048
ASSETS				
Fixed Assets				
Gross Block	1976	2267	2421	2545
Less: Acc. Depreciation	723	960	1202	1457
Net Block	1253	1307	1219	1089
Goodwill	14	14	14	14
Capital work-in-progress	31	31	26	22
Intangible Assets	51	51	51	51
Non current Investments	17	16	16	16
Long-Term Loans and Advances	10	12	12	13
Other Non-current Assets	30	9	12	13
Non-current Assets	57	38	40	43
Inventories	323	367	372	424
Trade Receivables	493	490	551	618
Cash and Bank Balances	134	371	453	661
Short-Term Loans and Advances	24	6	7	6
Other Current Assets	113	104	115	120
Current Assets	1088	1338	1498	1828
TOTAL	2494	2779	2849	3048

Cash Flow Statement

Particulars (Rs. cr)	FY19	FY20	FY21E	FY22E
Profit Before Tax	288.6	276	383.2	465.9
Depreciation	186.1	229.8	242.1	254.5
Others	12.3	50	35.2	36
Change in working capital	-40.4	7.6	-72.8	-46.8
Tax expenses	-90.1	-75.3	-103.5	-125.8
CF from Operating activities	356.4	488	484.3	583.8
Net Capex	-304	-128.6	-150	-120
Other investing activities	116.2	4.7	-15	-15
CF from Investing activities	-187.9	-123.9	-165	-135
Proceeds from Eq Cap	5.3	1.3	0	0
Borrowings / (Repayments)	-102.4	13.1	-80	-90
Dividends paid	-45.4	-86.8	-94.6	-94.6
Interest paid	-48.5	-37.9	-42.5	-37
Other Adjustmets	-2.5	-32.4	-20	-20
CF from Financing activities	-193.5	-142.8	-237.1	-241.6
Net Cash Flow	-25	221.3	82.2	207.3

One Year Price Chart



(Source: BSE, HDFC sec.)

Key Ratios

Particulars	FY19	FY20	FY21E	FY22E
EPS (Rs)	6.2	6.7	8.9	10.8
Cash EPS (Rs)	12.1	14	16.5	18.8
BVPS (Rs)	44	49	53	60
PE (x)	40.6	37.5	28.4	23.4
P/BV (x)	5.7	5.2	4.7	4.2
Mcap/Sales (x)	2.9	2.9	2.6	2.4
EV/EBITDA (x)	16.8	14.5	12.2	10.3
EBITDAM (%)	18.4	20.2	21.7	22
EBITM (%)	11.6	11.9	13.7	14.4
PATM (%)	7.2	7.7	9.3	10.1
ROCE (%)	16.4	16.3	19.6	22.2
RONW (%)	14.8	14.5	17.4	19
Current Ratio (x)	1.9	1.7	2	2.4
Quick Ratio (x)	1.4	1.2	1.5	1.9
Debt-Equity (x)	0.4	0.3	0.3	0.2
Debtor days	64	65	63	63
Inventory days	41	46	45	43
Creditor days	27	30	30	28

(Source: Company, HDFC sec.)

Disclosure:

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