Investor's guide

Which to Pick and What to Skip
A look at the laggards, gainers and the runaway winners. We go beyond the boring stats to bring you up to speed with the Street
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Robust growth in user industries has put the packaging sector on a strong wicket. Despite sound fundamentals, most companies appear to be undervalued at the moment. High debt-equity ratio is a concern in many companies, but this is justified by their expansion plans, say **Kiran Kabtta Somvanshi** & **Crystal Barretto** of ET Intelligence Group

Making Money By Thinking 'IN THE BOX'

When larger wheels in a machine start rotating, the smaller ones automatically gain momentum. The same's true of the Indian packaging sector too. Strong growth in sectors like fast moving consumer goods, pharmaceuticals, liquor, cosmetics etc. has had a positive rub off on the packaging industry. Growth in consumer goods and organised retailing mainly drives demand for packaging.

There is a variety of packaging available. This includes traditional rigid packaging through glass, wood, metal etc. and flexible packaging through paper, plastic, film, metal foil etc. Flexible packaging contains multi-layered laminated sheets of plastic, paper or aluminium. This type of packaging is more easy to use, and has found wide application across most product categories. Metal packaging growth is driven by urban consumption of beverages, carbonated drinks, canned food etc. Glass packaging continues to be driven by growth in the key, traditional category of alcoholic drinks.

More than 80% of the packaging in India is still rigid. As the economy grows and the Indian consumer comes of age, the share of flexible packaging is likely to go up from 20% now.

For an investor, the packaging sector offers promising growth and high returns. With consumerism gaining strength, it is growing at 14-15% annually according to an industry report. India Inc's quarterly earnings have taken a knock due to the sharp rise in commodity and fuel prices. The upward interest rate cycle has also dampened business environment. Though these factors are cause for concern, they have a relatively less impact on demand for food and beverages, FMCG and pharmaceutical products, compared with demand in core sectors like steel, capital goods, infrastructure and automobiles which remain under pressure.

Two key valuation parameters — price to earnings and market capitalisation to sales — show that most of the packaging companies are fairly undervalued as their strong fundamentals are not reflected in current market prices. One key concern is the relatively high debt-equity ratio and weak cash flow of most companies. However, given that this is a capital intensive industry and many companies are expanding operations through the organic route or acquisitions, this is justified.

Here's a pick of the most investment-worthy stocks across various types of packaging with a potential to grow.

FLEXIBLE PACKAGING

Essel Propack and **Uflex** are among the larger players in this segment. Other promising companies include Cosmo Films, Polyplex Corporation and Jindal Poly Films.

Essel Propack, the largest producer of laminated tubes for the oral care industry, has recovered from the slowdown in business during FY08 and FY09. The company has restructured itself and is reducing its debt. It now supplies to the non-oral care sectors too. The company has a manufacturing presence in China and Poland. This is helping to boost cash flows.

Uflex, a producer of flexible packages, is in expansion mode. However, high debt is a key concern. Unconfirmed reports that chemical major Dupont India is likely to acquire a substantial stake in the company have sparked buying interest in the stock recently.

Polyplex Corporation is a leading multinational manufacturer of thin polyester packaging films. Higher capacity utilisation, start of a new plant in Turkey, favourable market conditions and good demand have enabled the company to report robust growth in recent quarters. However, a change in the demand cycle for films may impact margins.

Jindal Poly Films is a leading producer of flexible packaging films. The steep rise in PET (polyethylene terephthalate) film prices has brought a windfall for film manufacturers. Any correction in the uptrend is likely to adversely impact the profitability of companies in this segment. The BC Jindal group company is in expansion mode. This, along with a good cash flow and a strong balance sheet are factors favourable for the company.

Cosmo Films, one of the largest exporters of BOPP (biaxially-oriented polypropylene) films, has been growing steadily. The company has sound fundamentals, and has consolidated its position through timely capacity expansions. However, competition from Chinese manufacturers remains a concern for the company.

The largest cost component for flexible packaging companies is raw materials. The BOPET (biaxially-oriented polyethylene terephthalate) chips used to make BOPET film as well as the polymers that are used to produce BOPP film are derived from petroleum. With crude oil prices remaining volatile, raw material cost is the deciding factor for these companies' bottom line. The growth of the BOPET film business is export-driven. Companies in Asia are benefiting from a decline in capacities in the developed world.

METALS PACKAGING

The metals packaging segment is fragmented with a few large players. Two companies that stand out are **Tinplate Company of India** and Hindustan Tin Works. Both have grown at 13% over the past five years, piggy backing on the need for improved packing solutions in the food and beverage, FMCG and pharmaceutical sectors. Anticipating further growth in user industries, Tinplate has expanded capacities while **Hindustan Tin Works** has invested heavily on technology upgradation and modernisation of equipment.

Raw material costs, which make up 55-70% of sales for these companies, have gone up sharply over the past few quarters, eroding operating profit margins. Hindustan Tin Works, the smaller of the two companies based on sales and market cap, has done a better job at maintaining margins as well as EPS growth.

FOILS

Within the metals packaging segment, there is growing demand for aluminium foils. These foils, in the form of micro thin sheets, are used by pharmaceutical companies and by processed foods manufacturers. **Ess Dee Aluminium** is one of the biggest players in the organised aluminium packaging segment in India with a market share of 10%. It recently acquired India Foils to increase its foothold.

Among others, smaller companies like **PG Foils**, **Gujarat Foils** and **Parekh Aluminex** deserve mention. These companies make foil sheets which are used by retail consumers to wrap fresh food. They also make foil containers for retail users as well as airlines, railways and other providers of read-to-eat packaged food. With a turnover of ₹900 crore for the year ended March 2011, Parekh Aluminex is the largest company by sales in the foils segment and is relatively undervalued. Its market cap is one-third of sales, and the market price (₹291) is only six times its earnings, making it the cheapest amongst peers.

GLASS PACKAGING

Hindusthan National Glass (HNGL) and **Hindustan Sanitaryware & Industries (HSIL)** are the two major players in the container glass segment. The user industries for the container glass business like liquor, beer, food and beverage, pharmaceuticals and cosmetics are expected to grow at 10-12%

While Kolkata-based HNGL is the largest player with around 60% share of the organised market, HSIL is the No. 2 player with a 17% share. Both the companies are in growth phase forging organic and inorganic expansion.

In its first overseas acquisition, HNGL bought a German container glass manufacturing company for over ₹320 crore last month. This acquisition will enable the company to make inroads into the international container glass market. The company has earmarked ₹2,500 crore towards doubling its capacity in the domestic market over the next three years.

For HSIL, container glass makes up half of its business. The company recently acquired Garden Polymers, a maker of PET bottles, caps and closures, in a ₹90-crore deal. This acquisition will enable HSIL to widen its portfolio of packaging products.

MISCELLANEOUS PACKAGING

Manaksia manufactures bottle caps and crowns for companies like Dabur India, Jyothy Laboratories, Eveready Industries and McDowell Group. The packaging division, which contributes 15% to the company's total revenues, has been growing at a compounded annual rate of 5% over the past five years.

Paper Products is one of the leading players in consumer packaging. It offers packaging solutions like flexible packaging, labelling and specialised cartons. It is the Indian arm of Finland-based Huhtamaki Group — one of the world's top ten consumer packaging multinationals. Paper Products has strong fundamentals, a growth-oriented business and high dividend yield.

Bilcare is a leading packaging solutions provider to pharma companies globally. The company's acquisition of Swiss company Ineos Films last year has helped it to supply to companies like Pfizer, Novartis and J&J. Ineos is the leading rigid film producer in the world. Bilcare's consolidated revenues also received a fillip from the latest overseas acquisition.

Hitech Plast manufactures innovative polymer packaging products for companies in the paints, personal care, agro chemicals and confectionary industries. It is a market leader in the paints packaging segment with a market share of over 35% catering to clients like Asian Paints and ICI.

The company has been expanding operations through the inorganic route. As a result, its net sales have grown at 18% over the past four years. While growth prospects are very strong, the company's dependence on the paints industry is a concern owing to the steep rise in crude oil prices.

Integrated packaging solutions provider, **Manjushree Technopack** makes PET preforms, jars and bottles. This Bangalore-based company is a leader in the rigid packaging segment and caters to clients like Coca Cola, Pepsi and Heinz. To meet the growing demand in the food and beverages industry — its key users — the company has increased its capacity by 10,500 MTPA, taking its total capacity to 40,000 MTPA. Sales have grown at 25% over the past five years and operating profit margins have also increased consistently. The company's debt is 7.8 times its equity, but this is justified given its expansion plans.

NON-CORE PACKAGING UNITS

There are several large companies like ITC, Bajaj Hindusthan, Hindalco, Balmer Lawrie and Max India that have a significant presence in the packaging industry. However, the packaging business is only a small portion of their total operations. ITC is the largest player in the country in paperboard packaging. But it earns only 13.6% of revenues from this business. Bajaj Hindusthan is a leading player in the corrugated packaging material (made from bagasse) but this contributes only 4% to the company's consolidated top line. Max India earns only 4% of its revenues from the division that manufactures plastic packaging films and sheets.

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Recent Acquisitions

MAY 2011
Hind Nat Glass
ACQUIRED: Agenda Glas AG
DEAL SIZE: ₹321 Cr

MAY 2011
Hind. Sanitaryware
ACQUIRED: Garden Poly
DEAL SIZE: ₹90 Cr

AUG 2010
Time Technoplast
ACQUIRED: Plastic products division of Solutia Inc
DEAL SIZE: Undisclosed

AUG 2009
Cosmo Films
ACQUIRED: GBC Commercial Print Finishing
DEAL SIZE: Undisclosed

ALL PACKED UP AND READY TO GROW

COMPANY NAME	P/E	NET SALES YOY(%)	OPERATING MARGIN	RAW MATERIAL SALES (%)	NET PROFIT YOY (%)
Essel Propack	15.6	-15.9	16.9	47.1	-23.1
Uflex	2.2	47.9	31.6	48.6	261.3
HSIL	12.5	34.0	18.8	33.3	79.0
Tinplate Co	18.1	0.8	10.8	54.4	-46.7
Cosmo Films	6.0	17.6	8.5	62.1	-45.2
Paper Products	10.1	21.6	10.5	70.8	28.7
Hind Nat Glass	20.7	12.2	15.3	27.2	-61.9
Polyplex Corpn	0.9	99.5	36.6	45.6	1023.1
Hitech Plast	8.5	31.1	13.6	64.4	-3.5
PG Foils	6.1	-1.8	7.8	80.7	251.4
Bilcare	6.5	121.9	15.9	57.3	25.4
Hind Tin Works	6.3	3.5	9.8	74.9	-3.3
Gujarat Foils	19.7	71.9	10.0	86.9	86.3
Parekh Aluminex	5.3	42.1	17.6	75.1	36.7
Ess Dee Alumin	11.5	15.7	25.1	66.5	165.4
Time Technoplast	11.9	26.1	18.5	67.4	22.2
Manaksia	3.8	10.2	15.1	66.1	-13.8
Manjushree Tech	7.2	45.1	22.0	55.1	39.9
Jindal Poly Films	2.7	9.8	24.0	62.0	19.1

Figures have been calculated on latest available data;
M-Cap, Net Sales, Net Profit are in ₹crore

Source: ETIG Database