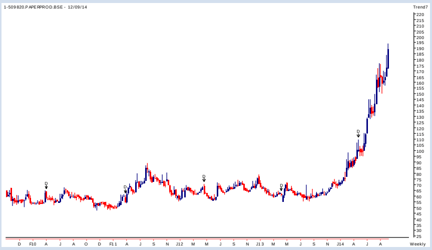
Huhtamaki PPL Ltd. (erstwhile Paper Products)

STOCK NOTE

Scrip Code	Industry	CMP	Recommendation	Target	Time Horizon
HUHPPLEQNR	Flexible Packaging	Rs. 183.3	Buy at CMP and add on dips to Rs. 151-160	Rs. 245	2-3 quarters

Price Chart



Stock Details	
BSE Code	500163
NSE Code	PAPERPROD
Bloomberg	HPPL.IN
Price (Rs) on Sept 15, 2014	183.3
Equity Capital (Rs. Mn)	145.4
Face Value (Rs)	2
Eq. Shares O/s (mn)	72.7
Market Cap (Rs Mn.)	11,939.2
Book Value (Rs)	121.6
Avg. Volume (52 Week)	41,155
52 wk H/L (Rs)	194.0/59.5
Shareholding Pattern	
(As on June 30, 2014)	**% Holding**
Promoters	63.8
FII	0.1
Institutions	6.2
Others (incl. body corporate)	29.9
Total	**100.0**

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We expect HPPL's consolidated net sales to grow by 41.8% on CAGR basis over CY13-16, which is likely to be driven by consolidation of PPIL, capacity expansion & improving demand for flexible packaging (due to revival in FMCG industry). Capacity Expansion, NASP initiatives would enable HPPL to improve its volume growth and boost its revenues & profits.

The acquisition of PPIL (Positive Packaging) would almost double HPPL's turnover and is likely to be EPS accretive. It would enable HPPL gain further bargaining power with its customers, to extend its customer network and would also help synergies in sourcing of inputs and up-gradation in technology. In our view, the structure of the deal seems to be positive for the minority shareholders of HPPL. The acquisition reflects parent company's increasing interest in Indian operations.

We expect HPPL's operating & PAT margins and return ratios to decline in CY14 & CY15 on the back of lower operating margins of PPIL and significant rise expected in the interest cost (due to PPIL's debt of Rs. 270 cr & NCDs likely to be raised to fund acquisition of PPIL). However, they are expected to improve in CY16 with improved profitability & repayment of debt.

The hike in holding by Huhtamaki in HPPL since Feb 2014 from 60.8% to 68.8% (till date), change in the name of the company recently from Paper Products to Huhtamaki PPL and the fact that Huhtamaki has complete control over almost all its other subsidiaries point towards HPPL being a probable candidate for de-listing over the medium to long term. While this event is unlikely to happen in near term, any progress on that front in the medium to long term could be a big positive trigger.

HPPL would continue to command premium valuations over its peers like Uflex due to its superior Technology & servicing capability, MNC Tag, diverse product basket and strategic acquisition of competitor. We feel the stock is capable of trading at 13xCY16E EPS, which gives a price target of Rs. 245. We feel investors could buy this stock at CMP and average it on dips to Rs. 151-160 (8-8.5xCY16E EPS) band for our price target over the next two to three quarters.

Consolidated Particulars (Rs. in Mn)	CY11	CY12	CY13	CY14E	CY15E	CY16E
Net Sales	7973.0	8931.7	10748.0	13987.1	26507.1	30610.3
% Growth y-o-y	9.9	12.0	20.3	30.1	89.5	15.5
Operating Profit	861.5	911.0	1167.7	1450.6	2655.6	3244.5
% Growth y-o-y	24.4	5.7	28.2	24.2	83.1	22.2
PAT (Adjusted)	496.5	450.7	512.2	638.8	944.8	1368.0
% Growth y-o-y	39.3	-9.2	13.6	24.7	47.9	44.8
EPS (Fully Diluted)	7.9	7.2	8.2	8.8	13.0	18.8
PE	23.1	25.5	22.4	20.9	14.1	9.7

(Source: Company, HDFC sec Research)

Company Overview

Incorporated in 1950, Huhtamaki PPL Ltd. (HPPL) [erstwhile Paper Products Ltd.], is India's leading manufacturer of primary consumer packaging. Since 1999, PPL is majority owned by global packaging major, Huhtamaki Oyj, Finland (one of the world's top ten consumer packaging multinationals), which holds about 68.8% of the equity capital. With an employee strength of 1496 (as on Dec 31, 2013), HPPL is a pioneer and technology and market leader in flexible packaging in India with market share of ~9% in the organized market (market size of US$2bn in FY13) and manufacturing facilities at Thane, Silvassa, Hyderabad and Rudrapur. The current installed capacity of paper & films is ~52000 MT and the company is operating at 75-80% capacity utilization rate. The company meets the packaging needs of almost the entire range of FMCG segments including personal products, personal wash, laundry, foods, sauces, beverages, bakery products, spices, chocolates and confectionery, dairy and also for seeds, specialized chemicals, automotive lubes, electronics, healthcare and many other specific specialized uses including anti-spurious packaging.

The Package Protection and Decoration products range includes latest leading edge technologies (labelling) - shrink sleeves, wrap-arounds, heat transfers, pressure sensitives and metallised paper labels. Manufacturing of specialized cartons and cartoning systems, manufacture of poly films, specialized barrier metallising and high-end application extrusion coating are also part of HPPL's product offerings. The company's packaging machines division offers complete packaging solutions to customers. Further HPPL is amongst select few companies worldwide having expertise in holographic images in packaging medium. This makes the packaging look attractive, thus enhancing the product visibility for premium positioning. Holograms are also popular as a deterrent against counterfeits for product protection. Flexible Packaging & Labelling is done at all facilities of HPPL, while Cartons are produced only at Hyderabad facility & Tube Laminates are produced only at Silvassa.

HPPL derives almost 96-98% of its revenues from the FMCG industry. The company mainly caters to the premium segment of packaging and its major clients include Britannia, Cadbury, Castrol, Coca Cola, Dabur, Emami, Eveready, GSK, Godrej, Hindustan Unilever, ITC, Marico, Nestle, Pepsi, Perfetti, P&G, Tata Tea, TTK-LIG, Wipro etc. The top ten clients of HPPL account for ~60% of the company's revenues. Product-wise, Laminates and Converted, Coated / Uncoated Paper and Films category accounts for a major portion of HPPL's total revenues (>90%).

HPPL derives around 80% of its revenues from the domestic market, while exports account for the balance 20%. Consolidating its position as India's most prominent packaging institution, HPPL expanded its business into promising overseas markets with a view to benchmark itself with the global competition. Overseas, HPPL has presence across 4 continents (South Asia, Africa, Middle East, Europe and Central America) & provides service to over 50 customers worldwide.

Huhtamaki group acquired 1.88mn shares or 3% stake from Mr. Suresh Gupta, Chairman of HPPL, at a consideration of Rs. 358.2 mn in February '14, thus increasing its stake from 60.8% to 63.8%. The price paid to Mr. Gupta (Rs190/share) was at a significant premium to the PPL's market price. Further, 10.02 mn equity shares were allotted to Huhtamaki group @ Rs.134.08 in August 2014, thereby increasing its stake to 68.8%.

Subsidiary Details

As on Dec 31, 2013, HPPL had one 51% subsidiary based in India viz; Webtech Labels Pvt. Ltd., which was acquired in Nov 2012 for a consideration of Rs377mn, in an all cash deal. Webtech Labels is specialized in manufacturing high-end pressure sensitive labels, especially to pharmaceutical customers. The company reported Net Sales of Rs. 789.9 mn in CY13 which represents over 10% growth in comparable operating levels v/s 2012.

Further in July 2014, HPPL acquired 100% Indian business of Positive Packaging Industries Ltd. (PPIL) for an enterprise value of Rs. 818 cr inclusive of debt and subject to closing adjustments. The transaction is expected to close in Q4CY14. PPIL offers packaging solutions like flexible packaging, labeling, high-quality printing and metalizing (using metalized films) across sectors including food and beverages, fast-moving consumer goods, pharmaceuticals, and industrial & agro products. PPIL's turnover in FY14 stood at Rs. 1014 cr and PAT stood at Rs. 14 cr.

HPPL's parent profile

Huhtamaki Oyj is a one of the top 10 consumer packaging companies in the world. Being a market leader in several product categories, the company has a turnover of Euro 2.34 bn with operations across the globe (in 31 countries). Huhtamaki has 61 manufacturing units & employs over 14308 people. The company has evolved from a multi-industry company into a consumer packaging specialist through a series of almost 200 company acquisitions and divestments since 1980. Sub-brands of the company include retail brands, Chinet, Bibo and Lily as well as the BioWare family of compostable tableware and packaging.

The company has a large presence in Europe & US. Its business is categorized into 5 segments viz; Flexible Packaging (Strong market position in Tube Laminates & petfood worldwide, Biscuits & Confectionery in India, Coffee in Thailand & Vietnam, Chocolate in Europe), Films (Global leader in Release films, North America (shaped containers for frozen desserts, premium branded tableware), Food Service E-A-O [Europe-Asia-Oceania] (Cups and lids to quick service, vending and catering) & Molded Fibre (Recycled fiber packaging - egg packaging, fruit trays). Foodservice Disposals account & Flexible Packaging account for 58% & 25% of the total revenues (contribution from Indian operations in Flexible Packaging is ~22%), while the balance 17% comes from Films & Molded Fibre segments (8% & 9% respectively).

Some of the major customers of Huhtamaki include Costco, Kraft, McDonald's, Nestle, Unilever etc. The Group has strong position in fast growing emerging markets and has plans to strengthen this further. In 2013, 26% of the Group's net sales and 46% of its employees were in emerging markets. In 2013, net sales growth in emerging markets (in constant currencies) was 8% with Russia, India and the Czech Republic being the most important growth countries.

While HPPL recently acquired Indian business of PPIL, its foreign parent acquired Positive Packaging Group, UAE and the various sales offices in South Africa, Ghana, Kenya, etc. The overall turnover of Positive Packaging Group (including Indian operations) in FY14 stood ~Rs. 1750 cr. or a little more than that, about 220 mn Euros.

Equity Dilution

In order to part fund the acquisition of PPIL, HPPL allotted 10.02 mn equity shares of FV of Rs. 2 each to Huhtamaki group in Aug 2014. This has increased HPPL's equity capital from Rs. 125.4 mn as on June 30, 2014 to Rs. 145.4 mn.

Investment Rationale

Likely to benefit from growth revival in FMCG industry

The company meets the packaging needs of almost the entire range of FMCG segments including personal products, personal wash, laundry, foods, sauces, beverages, bakery products, spices, chocolates and confectionery, dairy and also for seeds, specialized chemicals, electronics, healthcare and many other specific specialized uses including anti-spurious packaging. The company mainly caters to the premium segment of packaging and its major clients include Britannia, Cadbury, Castrol, Coca Cola, Dabur, Emami, Eveready, GSK, Godrej, HUL, ITC, Marico, Nestle, Pepsi, Perfetti, P&G, Tata Tea, TTK-LIG, Wipro etc. PPL derives 96-98% of its revenues from the FMCG industry. Hence the company's growth is largely linked to the growth of FMCG industry. Economic growth and rising personal disposable income are growth drivers for the consumer goods sector, which in turn improves the demand for packaging.

The FMCG industry has been witnessing slowdown in growth over the last few quarters (muted volume growth) due to economic slowdown in FY14. Slowing consumer due to high CPI inflation has resulted in reduced demand for certain discretionary and premium products and the premiumisation trend has slowed down in most of the segments over the last three to four quarters. This has impacted demand for flexible packaging. In CY13, FMCG sector growth slowed down to ~10.3% (from ~17% in CY12). However, HPPL managed to grow at a better rate by 12.8% (standalone operations). The slowdown in the sector continued in H1CY14 and is likely to improve only marginally in H2CY14. However, we expect a material revival in the FMCG industry in CY15, since we expect the economic growth and spending power to improve.

Flexible packaging industry continues to maintain its relatively stable growth outlook. The industry is expected to grow around 10-12% CAGR in the medium term. Growing rural demand, retail push, planned investments by large MNCs in the FMCG business and strong fundamentals of the Indian economy support the view that FMCG and consequently growth for Flexible Packaging would remain strong. As per IBEF (Indian Brand Equity Federation), FMCG industry in India is expected to grow at a CAGR of 14.7% between 2012 and 2020, which will help the growth of the packaging industry.

Increasing penetration in the rural & semi-urban areas aided by Government initiatives to boost the rural infrastructure is likely to improve the demand for FMCG products. This in turn would benefit specialized flexible packaging players like PPL, which offer value addition in the form of both product specific (like high speeds on product filling lines, insulation from heat & moisture, high strength for supporting long distance transportation, holographic images etc.) & custom designed packaging solutions (like brand image protection, protection from counterfeit and cost effectiveness). The management has indicated that certain trends like - use of plastic tubes instead of metal tubes and PET bottles instead of glass bottles are / would drive its addressable markets. Recent trend of using pouches instead of rigid packs for hair/edible oils is also / would expand its market size.

Competitive Advantage due to Superior Technology & servicing capability, MNC Tag, diverse product basket and strategic acquisition of competitor

In the Flexible Packaging business, HPPL faces competition from Uflex, PIPL (Packaging India Pvt. Ltd. - part of Essel Propack group) and from some unlisted players like Positive Packaging (which has now been acquired by HPPL), Uma Polymers, Umax Packaging & Parikh Packaging. At CMP, HPPL is trading at a significant premium to Uflex. This is despite Uflex having a larger business size & higher operating margins. Even on Market Cap / Sales and P / BV basis, HPPL is relatively expensive than Uflex. This could be possibly due to competitive advantage that HPPL has vis-à-vis Uflex (and other unlisted peers as well) on the back of strong parental support (MNC Tag), geographical spread, superior technology & servicing capability and diverse product basket. Further HPPL's debt-equity ratio in CY13 stood at only 0.1x (almost debt free company) as compared to Uflex, which has Debt-Equity ratio of 0.9x (in FY14). Also Uflex does not have MNC support & unlike HPPL, which is India focused, Uflex has manufacturing presence in Mexico, Egypt, Poland, Dubai & US. This exposes it to forex translation risks & its business growth is linked not only to growth of Indian economy but also to growth of other overseas economies.

HPPL is not a commodity BOPET (Biaxially-oriented polyethylene terephthalate) or BOPP (Biaxially-Oriented Polypropylene) film producer. In case of Uflex, a large portion of its revenues comes from commodity plastic films. For HPPL, like many other inputs, BOPP or BOPET films are just another input. The company offers value addition in the form of both product specific (like high speeds on product filling lines, insulation from heat & moisture, high strength for supporting long distance transportation, holographic images etc.) & custom designed packaging solutions (like brand image protection, protection from counterfeit and cost effectiveness). This distinguishes the company from other flexible packaging players & gives it a competitive edge over them. The company's fortune is more linked with the growth in FMCG companies instead of huge fluctuations in BOPP or BOPET film prices.

The acquisition of Indian competitor company 'positive packaging' would almost double HPPL's turnover and would enable HPPL gain further bargaining power with its customers, to extend its customer network and would also help synergies in sourcing of inputs and up-gradation in technology.

Due to all these reasons, we feel that PPL could continue to command premium valuations vis-à-vis its peers going forward.

Strong Parental Support

Post being a part of Huhtamaki (which holds 68.8% stake in PPL), PPL has been able to strengthen its export presence by getting access to countries, where it did not have presence. PPL also exports its products to countries where Huhtamaki does not find products from its local units cost effective. With its parental support, PPL has also been able to introduce new product segments in India like Tube laminates, which is growing at a decent rate. There is increasing confidence that the focus on PPL's India flexible packaging business & enhancing the export presence would continue to remain going forward. At present, PPL's export business contributes ~20% to the total turnover (South Asia, Africa, Middle East, Europe and Central America) & provides service to over 50 customers worldwide. With the parental support, PPL expects its export share & overseas client base to increase going forward.

The Group continues to actively explore acquisition opportunities that support its growth targets. In developed markets, acquisitions are expected to bring synergy benefits. In emerging markets, acquisitions are expected to boost the Group's growth targets. India remains one of the key focus markets for Huhtamaki group, as evident from the increase in stake in HPPL over the last few months.

With the parental support there is a possibility (over the medium to long term) of PPL bringing in new product segments from its parent's product basket (like Tube Laminates in the past) in India. This would enable PPL to widen its product portfolio.

The parent or its group companies does not receive any substantial amount from HPPL (except for commission expenses Rs. 7.7 mn on sale to South African Group Company). This indicates minimal transfer of profits from the Indian operations to the parent company, which is beneficial for the minority shareholders of HPPL.

Probable candidate for de-listing over the medium to long term

Huhtamaki has 100% stake in almost all its subsidiaries. Besides HPPL, the subsidiaries in which Huhtamaki holds less than 100% equity include Huhtamaki Egypt LLC (75:25 JV), Dixie Cup (Hong Kong) Ltd (54%) and Shandong GreenGood Eco-Tech Co (86.8%). Huhtamaki manages its empire through 78 direct and indirect subsidiaries. The hike in holding by Huhtamaki in HPPL since Feb 2014 from 60.8% to 68.8%, change in the name of the company recently from Paper Products to Huhtamaki PPL and the fact that Huhtamaki has complete control over almost all its subsidiaries point towards HPPL being a probable candidate for de-listing over the medium to long term. The possibility cannot be ruled out considering the significant jump in open offers from MNCs to increase their equity stake in Indian units.

India is among the strategically important markets for Huhtamaki. In CY13, the company's sales growth in emerging markets was 8%, with Russia, India and the Czech Republic being the most important growth countries. In CY13, the growth was strongest in India. On an aggregate basis, India is at the third place along with China by employee count. The countries with the largest number of employees are the US (24%), Germany (13%), India (12%) and China (12%). India was the third largest contributor to Huhtamaki's turnover in CY13, with contribution of 6% and sales of Euro 136.6mn. Overall, Huhtamaki is facing stagnation in revenue at Euro 2.34bn in CY13 as against Euro 2.32bn in CY12. That could be the reason Huhtamaki wants to put greater emphasis on its Indian operations, which is growing at a faster rate and has bright future prospects. The hefty price of Rs 190.1 paid to Mr. Gupta in Feb 2014 (at a significant premium to market price during that time) by Huhtamaki to acquire 3% stake in February indicates Huhtamaki's increasing interest in Indian operations.

While we don't expect this event to happen in the near term, any announcement on that front in future could be a huge positive trigger.

Acquisition of positive packaging – a strategic move

In July 2014, HPPL acquired 100% stake in the Indian business of Positive Packaging Industries Ltd. (PPIL) for an enterprise value of Rs. 818 cr inclusive of debt (Rs. 270 cr) and subject to closing adjustments. The transaction is expected to close in Q4CY14 and is likely to be funded through a mix of internal accruals, equity allotment (already done – 10.02 mn shares allotted to Huhtamaki group at Rs. 134.08 including premium of Rs. 132.08 aggregating to Rs. 134.4 cr), issue of NCDs (could be raised in the range of Rs. 420-450 cr – to parent company; maturity is likely to be 5 years and upper cap in the interest rate is likely to be 10.5%).

PPIL offers packaging solutions like flexible packaging, labeling, high-quality printing and metalizing (using metalized films) across sectors including food and beverages, fast-moving consumer goods, pharmaceuticals, and industrial & agro products. With an employee strength of 1600, the company has 6 facilities in India (2 in Bangalore, 2 in Ambarnath, 1 each in Taloja & Khopoli), which has been taken over by HPPL (and 3 overseas facilities, which has been taken over by the parent company). The current total installed capacity of PPIL in India is ~45000 TPA. The company exports 35% of the total output. PPIL's turnover in FY14 stood at Rs. 1014 cr and PAT stood at Rs. 14 cr.

With the acquisition of its competitor positive packaging, HPPL is set to become market leader in the space. The acquisition would almost double HPPL's turnover and is likely to be EPS accretive from the first year of acquisition. Though the acquisition would result in a few common clients & few overlapping products, it would enable HPPL gain further bargaining power with its customers, to achieve better economies of scale, to extend its customer network and would also help synergies in sourcing of inputs and up-gradation in technology.

In our view, the structure of the deal seems to be positive for the minority shareholders of HPPL. The acquisition reflects parent company's increasing interest in Indian operations, since it has been made through its Indian subsidiary and is likely to be funded fully by the parent. While the acquisition would increase the debt-equity of HPPL to 0.8x in CY14 (from 0.1x in CY13), we expect the company to gradually repay its debt out of the strong cash flow generation expected over the next few years.

Though PPIL's turnover growth has been robust (from Rs.684 cr in FY12 to Rs.1014 cr in FY14), its net profits have been declining consistently over the last three years (from Rs.32.4 cr in FY12 to Rs.14.2 cr in FY14). However, post acquisition, we expect HPPL to turnaround PPIL at the net level over the next few years, while revenues would continue to grow at a robust rate. The payback period is expected to be 4-5 years. The company aims to improve PPIL's margins (operating & net) near to HPPL's levels over the next few years.

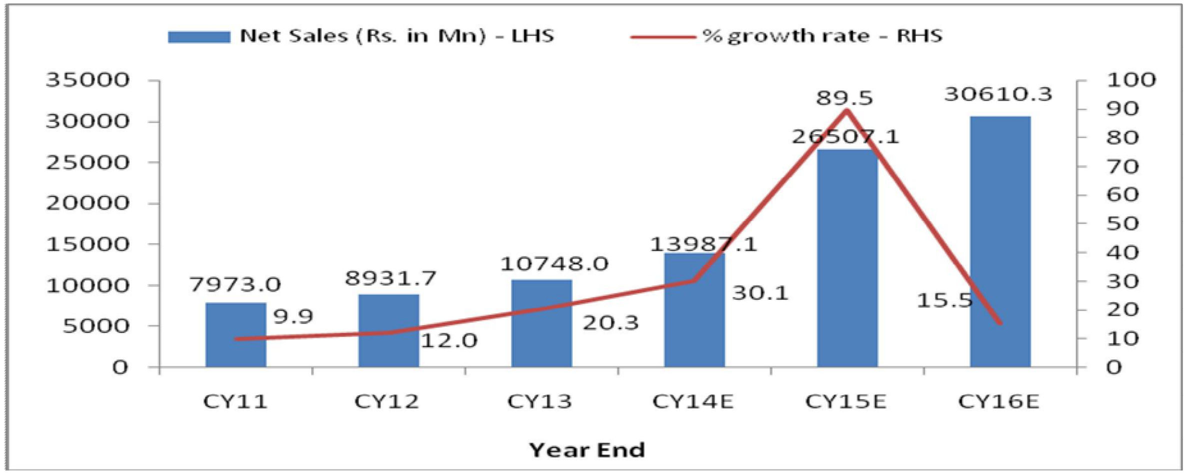
Capacity Expansion, NASP initiatives to boost the revenue & profit growth

The current installed capacity of paper & films is ~52000 TPA and the company is operating at 75-80% capacity utilization rate. In order to maintain its growth momentum and meet the demand, PPL is expanding its capacity by ~8000 TPA to 60,000 TPA (in Hyderabad & Silvassa). The Capex for this expansion is estimated to be ~Rs. 750 mn and it is expected to go on stream in phases starting from Q4CY14 onwards. The timely ramp up of the expanded capacity could enable the company to improve its volume growth. Further, PPIL has done a lot of CAPEX over the last three years. We expect higher utilization & higher revenues from PPIL going forward.

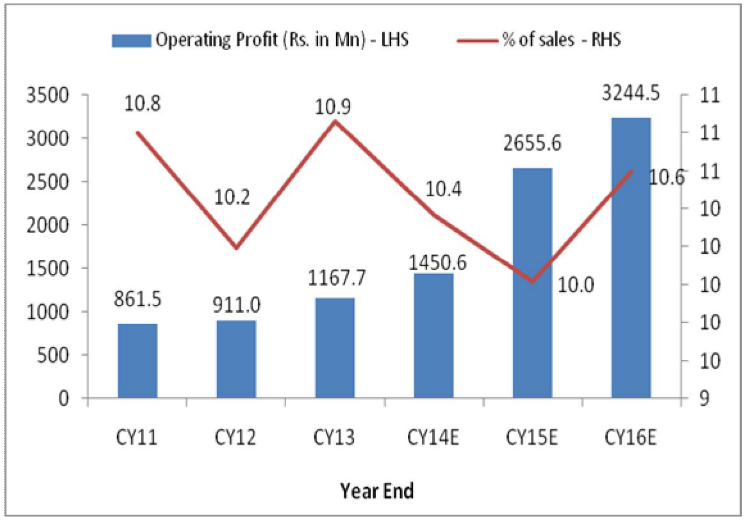
The NASP (New Applications, Structures and Products/ Processes program), which is focused towards development of new products and improvisation of existing products has enabled the company to add new customers and improve its sales growth. In 2013, NASP initiatives contributed to 30% of the company's turnover and it added 50 new customers. We expect these initiatives to continue to benefit the company going forward.

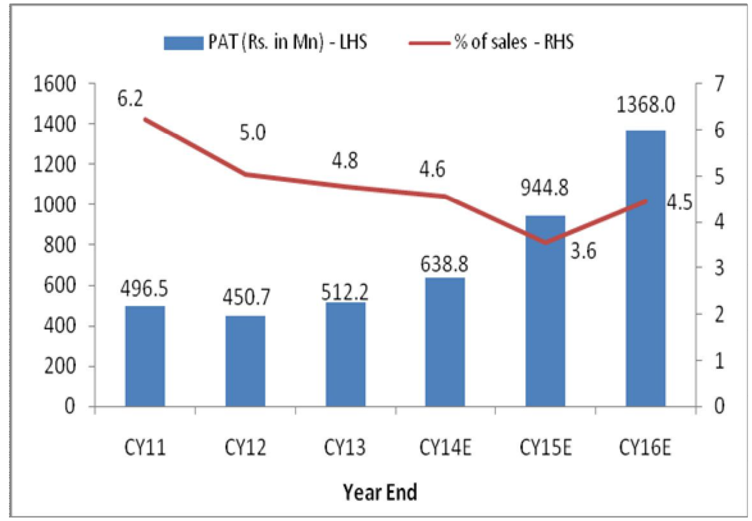
Consolidated Net Sales & PAT to grow by 41.8% & 38.7% over CY13-16

We expect HPPL's consolidated net sales to grow by 41.8% on CAGR basis over CY13-16, which is likely to be driven by consolidation of PPIL (expected from Nov 2014), capacity expansion & improving demand for flexible packaging (due to revival expected in FMCG industry, aided by improved economic growth and spending power). The full benefits of consolidation would be visible in CY15, while the growth in CY16 would be fully organic in nature.



HPPL's operating profit is estimated to grow marginally slower than in line with sales growth at 40.6% over CY13-16 on the back of lower operating margins of PPIL. OPM is expected to reduce from 10.9% in CY13 to 10.4% in CY14 and further to 10% in CY15. However, it is expected to improve again to 10.6% in CY16, as we expect PPIL to turnaround materially at operating level from CY16. Consolidated PAT is estimated to grow by 38.7% over CY13-16. PAT margin is likely to fall from 4.8% in CY13 to 3.6% in CY15 on the back of significant rise in the interest cost (as the company is likely to raise NCDs worth Rs. 420-450 cr and PPIL has debt of Rs. 270 cr in its book) and higher tax rate in CY15, but is expected to improve to 4.5% in CY16, as we expect HPPL to repay some portion of its debt & PPIL's debt & also to re-negotiate PPIL's remaining debt at lower interest rate.





Risks & Concerns

- PPL's key raw materials include films, inks, adhesives & solvents. Films (BOPP film, PET Film & PVC Film) account for more than 50% of the total input cost, while inks, adhesives & solvents contribute ~20%. The prices of all these inputs are linked to crude oil prices. Any sharp increase in the crude oil prices or huge fluctuations in the INR-USD exchange rate could lead to an upsurge in PPL's input prices (though they might not increase in the same proportion) & impact the company margins going forward in the event of company's failure to pass on the input price hikes completely to its customers. At present, material cost constitutes 71.5% of PPL's revenues.
- PPL derives around 96-98% of its revenues from the FMCG industry. The FMCG industry has slowed down recently due to economic slowdown in FY14, thus affecting volume growth of many FMCG players. Hence any continued sharp slowdown in this industry due to slowdown in India's economic growth is likely to impact the demand for flexible packaging & could erode the pricing power, which PPL enjoys at present due to its strong presence in premium packaging.

- PPL's top ten customers account for around 60% of its revenues. Further, PPL does not have any long-term supply contract with them. Thus in the event of slowdown in the business of any of its customers or in case of any dispute arising with them in future, PPL's growth prospects could be hampered.
- Flexible Packaging industry is highly competitive & around 60-65% of the market is unorganised. PPL faces competition from listed flexible packaging companies like Uflex, PIPL (Packaging India Pvt. Ltd. - part of Essel Propack group) and from some unlisted players like Positive Packaging India (now acquired by PPL), Paharpur & Multiflex. Despite PPL's superior technology, diverse product basket & better servicing capability, if the competition intensifies from organised & unorganised flexible packaging players beyond a certain point & the user industries witness a slowdown, then it could lead to pricing pressure & impact the company's margins going forward.
- PPL is in the process of expanding its capacities in Hyderabad and Silvassa by 8000 TPA. Any delay in the ramp up could impact the revenue & profit growth, since PPL is already operating at above 80% utilisation.
- PPL's exports currently account for 20% of its total net sales and could strengthen going forward. This exposes the company to forex fluctuations.
- While the acquisition of Positive Packaging seems to be a strategic move by PPL, integration & synergy benefits could take longer than expected.
- Dividend payouts might not increase in line with the profit growth, since HPPL's first priority would be to re-pay its loan taken for funding the acquisition of Positive Packaging.
- Goodwill would be created in books in consolidated accounts and would be checked for impairment every year. There is a risk of impairment of goodwill, if the company is unable to turnaround PPIL successfully in the coming years.
- The tax rates could increase going forward (from 22% in H1CY14 to 28.5% in CY16) on the back of higher profits from taxable units and lower benefits from backward areas. This could put pressure on net profits.
- The company faces the risk of delay or denial of approval for takeover of PPIL from the Competition Commission.

Conclusion

We expect HPPL's consolidated net sales to grow by 41.8% on CAGR basis over CY13-16, which is likely to be driven by consolidation of PPIL (expected from Nov 2014), capacity expansion & improving demand for flexible packaging (due to revival expected in FMCG industry, aided by improved economic growth and spending power). The full benefits of consolidation would be visible in CY15, while the growth in CY16 would be fully organic in nature. Capacity Expansion, NASP initiatives would enable the company to improve its volume growth and boost its revenue growth & profits.

The acquisition of PPIL is a strategic move. It would almost double HPPL's turnover and is likely to be EPS accretive from the first year of acquisition. It would enable HPPL gain further bargaining power with its customers, to extend its customer network and would also help synergies in sourcing of inputs and up-gradation in technology. In our view, the structure of the deal seems to be positive for the minority shareholders of HPPL. The acquisition reflects parent company's increasing interest in Indian operations, since it has been made through its Indian subsidiary and is likely to be funded fully by the parent. The company aims to bring PPIL's margins in line with HPPL over the next few years.

We expect the operating & PAT margins to decline in CY14 & CY15 on the back of lower operating margins of PPIL and significant rise expected in the interest cost (due to PPIL's debt of Rs. 270 cr & NCDs likely to be raised to fund acquisition of PPIL). However, we expect the margins to improve in CY16 and thereon, as we expect HPPL to repay some portion of its debt & PPIL's debt & also to re-negotiate PPIL's remaining debt at lower interest rate.

While the acquisition would lower the return ratios of HPPL (ROCE & ROE expected to decline from 12.4% & 9.9% in CY15), we expect them to improve in CY16 with improved profitability in repayment of debt.

The hike in holding by Huhtamaki in HPPL since Feb 2014 from 60.8% to 68.8%, change in the name of the company recently from Paper Products to Huhtamaki PPL and the fact that Huhtamaki has complete control over almost all its subsidiaries point towards HPPL being a probable candidate for de-listing over the medium to long term. While this event is unlikely to happen in near term, any progress on that front in the medium to long term could be a big positive trigger.

The company would continue to command premium valuations over its peers like Uflex on the back of its Superior Technology & servicing capability, MNC Tag, diverse product basket and strategic acquisition of competitor. With the parental support there is a possibility (over the medium to long term) of PPL bringing in new product segments from its parent's product basket (like Tube Laminates in the past) in India. This would enable PPL to widen its product portfolio.

We feel the stock is capable of trading at 13xCY16E EPS, which gives a price target of Rs. 245. We feel investors could buy this stock at CMP and average it on dips to Rs. 151-160 (8-8.5xCY16E EPS) band for our price target over the next 2-3 quarters.

Quarterly Financials (Consolidated)

Particulars (Rs. In Mn)	Q2CY14	Q2CY13	VAR [%]	Q1CY14	VAR [%]	Q4CY13	Q3CY13
Net Sales	3066.3	2757.4	11.2	2890.3	6.1	2790.2	2653.1
Other Operating Income	26.4	20.4	29.4	25.5	3.5	24.5	41.3
Other Income	47.5	7.8	509.0	20.3	134.0	76.7	-3.9
Total Income	3140.2	2785.6	12.7	2936.1	7.0	2891.4	2690.5
Total Expenditure	2778.5	2454.4	13.2	2595.6	7.0	2541.5	2434.4
Raw Material Consumed	2221.2	1932.9	14.9	2120.7	4.7	1948.3	1843.6
Stock Adjustment	-14	-27.4	-48.9	-69.4	-79.8	51.5	30
Employee Expenses	228.3	220.5	3.5	211	8.2	189.8	228.9
Other Expenses	343	328.4	4.4	333.3	2.9	351.9	331.9
PBIDT	361.7	331.2	9.2	340.5	6.2	349.9	256.1
Interest	7.2	9.5	-24.2	7.6	-5.3	9.3	9.9
PBDT	354.5	321.7	10.2	332.9	6.5	340.6	246.2
Depreciation	109.1	103.9	5.0	109.3	-0.2	107.7	106
PBT	245.4	217.8	12.7	223.6	9.7	232.9	140.2

Tax (incl. DT & FBT)	52.9	67.1	-21.2	50.1	5.6	59.4	47.8
PAT	192.5	150.7	27.7	173.5	11.0	173.5	92.4
Minority Interest	5.8	3.0	93.3	4.3	34.9	6.9	0.9
Reported PAT	186.7	147.7	26.4	169.2	10.3	166.6	91.5
Extra-ordinary Items	26.4	0.0	-	12.5	111.2	51.3	0.0
Adjusted PAT	160.3	147.7	8.5	156.7	2.3	115.3	91.5
EPS (Rs.)	2.6	2.4	8.5	2.5	2.3	1.8	1.5
Equity	125.4	125.4	0.0	125.4	0.0	125.4	125.4
Face Value	2.0	2.0	0.0	2.0	0.0	2.0	2.0
OPM (%)	10.2	11.7	-12.6	11.1	-7.5	9.8	9.8
PATM (%)	5.2	5.4	-2.4	5.4	-3.6	4.1	3.4

(Source: Company, HDFC Sec)

Note: Against an insurance claim for fire at Silvassa plant during CY13, an advance payment of Rs. 60 mn has been received during H1CY14pending final settlement, surplus of Rs. 26.4 mn & Rs. 38.9 mn has been recognized during Q2CY14 & H1CY14 respectively.

Financial Estimates (Consolidated)

Profit & Loss A/c

YE March (Rs. In Mn)	CY11	CY12	CY13	CY14E	CY15E	CY16E
Net Sales	7973.0	8931.7	10748.0	13987.1	26507.1	30610.3
Other Operating Income	58.6	74.1	107.0	133.8	200.6	230.7
Total Operating Income	8031.6	9005.8	10855.0	14120.8	26707.7	30841.1
Material Cost	5574.4	6249.1	7523.0	10000.8	18965.8	21855.8
Employee Benefits Expenses	639.3	709.8	841.0	1049.0	2001.3	2265.2
Conversion & Other Related charges	0.0	0.0	0.0	0.0	0.0	0.0
Advertisement & Sales Promotion	0.0	0.0	0.0	0.0	0.0	0.0
Other Expenditure	956.4	1135.9	1323.3	1620.4	3085.0	3475.6
Total Operating Expenses	7170.1	8094.8	9687.3	12670.2	24052.1	27596.6
Operating Profit	861.5	911.0	1167.7	1450.6	2655.6	3244.5
Other Income	113.4	68.6	97.5	112.0	128.8	150.0
EBITDA	974.9	979.6	1265.2	1562.6	2784.3	3394.5
Interest	0.4	5.9	37.5	147.1	666.8	579.0
Depreciation	320.5	356.5	420.2	496.7	787.5	863.8
PBT	654.0	617.2	807.5	918.8	1330.1	1951.7
Tax (including FBT & DT)	128.1	166.1	229.3	220.0	361.0	555.7
PAT (before minority interest	525.9	451.1	578.2	698.8	969.1	1395.9
Minority Interest	29.4	0.4	16.1	21.1	24.3	27.9
Reported PAT	496.5	450.7	562.1	677.7	944.8	1368.0

Extra-ordinary Items	0.0	0.0	49.9	38.9	0.0	0.0
Adjusted PAT	496.5	450.7	512.2	638.8	944.8	1368.0

(Source: Company, HDFC Sec Estimates

Note: i) We have assumed consolidation of PPIL in HPPL's books from Nov 2014 onwards
ii) Exceptional income in CY13 comprises gain on sale of office property at Nariman point, Mumbai during Q4CY13 of Rs. 70.3, which has been adjusted net of tax .

Balance Sheet

YE March (Rs. In Mn)	CY11	CY12	CY13	CY14E	CY15E	CY16E
Equity & Liabilities						
Shareholders' Funds	**3288.3**	**3549.6**	**3908.1**	**8839.6**	**9521.5**	**9951.9**
Share Capital	125.4	125.4	125.4	145.4	145.4	145.4
Warrant Allotment	0.0	0.0	0.0	0.0	0.0	0.0
Reserves & Surplus	3162.9	3424.2	3782.7	8694.1	9376.1	10463.8
Share application money pending allotment	0.0	0.0	0.0	0.0	0.0	0.0
Non-Current Liabilities	**249.1**	**549.8**	**623.3**	**7872.1**	**7233.3**	**6336.3**
Minority Interest	0.0	185.2	201.3	222.4	246.6	274.5
Long Term borrowings	215.9	342.6	399.1	7300.0	6600.0	5600.0
Deferred Tax Liabilities (Net)	25.2	6.8	10.2	30.6	34.9	40.5
Other Long Term Liabilities	0.0	0.0	0.0	200.0	220.0	264.0
Long Term Provisions	7.9	15.2	12.7	119.1	131.8	157.3
Current Liabilities	**1645.2**	**1939.7**	**2093.9**	**4817.9**	**5641.6**	**6801.1**
Short Term Borrowings	0.0	140.6	5.9	0.0	0.0	0.0
Trade Payables	1144.2	1282.5	1485.5	3445.4	4005.9	4819.2
Other Current Liabilities	209.0	232.1	299.6	784.6	916.5	1088.3
Short Term Provisions	291.9	284.5	303.0	587.8	719.2	893.5
Total Equity & Liabilities	**5182.5**	**6039.0**	**6625.3**	**21529.5**	**22396.4**	**23089.3**
Assets						
Non-Current Assets	**2009.8**	**2633.1**	**2638.4**	**12628.5**	**12512.3**	**12288.4**
Fixed Assets	**1823.1**	**2474.4**	**2428.0**	**6706.7**	**6538.7**	**6263.3**
Gross Block	4533.6	5177.4	5421.3	11771.3	12471.3	13071.3
Depreciation	2858.5	3169.0	3485.4	5633.8	6421.3	7285.1
Net Block (Tangible Assets)	1675.1	2008.5	1935.9	6137.5	6050.0	5786.2
Intangible Assets	64.1	225.6	186.6	246.6	207.3	174.9
Capital Work-in-Progress	81.4	44.7	109.8	126.8	85.7	106.6

Goodwill On Consolidation	2.4	195.7	195.7	2475.7	2475.7	2475.7
Non Current Investments	0.1	0.0	0.0	0.0	0.0	0.0
Deferred Tax Asset	0.0	0.0	0.3	0.0	0.0	0.0
Long -term Loans and Advances	157.6	115.5	167.6	359.8	400.7	440.8
Other Non-Current Assets (including Deferred Tax Asset)	29.1	43.2	42.8	82.1	92.8	104.2
Current Assets	**3172.7**	**3405.9**	**3986.6**	**8901.0**	**9884.1**	**10800.9**
Current Investments	633.7	603.8	547.9	1080.1	942.9	575.5
Inventories	843.7	886.2	934.8	2445.2	2794.8	3214.0
Trade Receivables	1248.5	1588.7	2086.9	4328.6	4946.0	5687.8
Cash & Cash Equivalents	222.7	147.6	158.0	336.6	370.3	398.3
Short Term Loans & Advances	106.5	85.4	120.6	374.8	441.1	497.2
Other Current Assets	117.5	94.3	138.4	335.6	389.2	428.1
Total Assets	**5182.5**	**6039.0**	**6625.0**	**21529.5**	**22396.4**	**23089.3**

(Source: Company, HDFC Sec Estimates)

Key Ratios

YE March	CY11	CY12	CY13	CY14E	CY15E	CY16E
FD EPS (Rs.)	7.9	7.2	8.2	8.8	13.0	18.8
PE (x)	23.1	25.5	22.4	20.9	14.1	9.7
Book Value (Rs.)	52.5	56.6	62.3	121.6	130.9	136.9
P/BV (x)	3.5	3.2	2.9	1.5	1.4	1.3
OPM (%)	10.8	10.2	10.9	10.4	10.0	10.6
PBT (%)	8.2	6.9	7.5	6.6	5.0	6.4
NPM (%)	6.2	5.0	4.8	4.6	3.6	4.5
ROCE (%)	18.7	15.5	19.6	6.6	12.4	16.3
RONW (%)	15.1	12.7	13.1	7.2	9.9	13.7
Debt-Equity (x)	0.1	0.1	0.1	0.8	0.7	0.6
Current Ratio (x)	0.4	1.8	1.9	1.8	1.8	1.6
Mkt. Cap / Sales (x)	1.4	1.3	1.1	1.0	0.5	0.4
EV/EBITDA (x)	11.0	11.5	8.8	12.3	6.7	5.3

(Source: Company, HDFC Sec Estimates)

Cash Flow

YE March	CY11	CY12	CY13	CY14E	CY15E	CY16E
Profit Before Tax	654.0	617.2	807.5	918.8	1330.1	1951.7
Net Opt Cash Flow	848.4	625.3	509.1	-110.8	2140.3	2547.7
Net Cash from Investing Activities	-330.8	-539.4	-215.7	-9470.7	-534.0	-472.5
Net Cash from Financing Activities	-164.5	-162.9	-284.6	9760.1	-1572.7	-2047.2
Cash & Cash Equivalents	106.5	147.6	158.0	336.6	370.3	398.3
Net Inc/(Dec) in Cash	353.1	-77.0	8.8	178.6	33.7	28.0

(Source: Company, HDFC Sec Estimates)

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