JK Paper Ltd: Q4FY18 Result Update

Strong Q4FY18 result; healthy B/S to support future capex plan

CMP INR: 138
Rating: BUY
Target Price INR: 195
Upside: 41%

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Bloomberg:	JKPAPER:IN
52-week range (INR):	169.90 / 88.70
Share in issue (cr):	17.82
M cap (INR cr):	2,468
Avg. Daily Vol. BSE/NSE :('000):	60/479
Promoter Holding (%)	49.17

Date: 16th May, 2018

JK Paper Ltd (JKP) reported PAT in Q4FY18 came 14.6% ahead of our estimate due to better than expected improvement in operating margin (+243 bps) and sharper than expected reduction in interest cost (-10.7%). However, the improvement in performance was largely in-line with the industry. We believe the performance of the company to remain strong over the next 2-3 years due to favourable pricing environment in the global market and sharp rupee depreciation in the past few months whereas raw-material cost is expected to remain well under control. We maintain our 'Tactical Buy' rating on JKP with a target price of INR 195 per share. Our target price is based on a 6x multiple to arrive of FY20 EBITDA estimates, which is relatively in-line with the 15-year historical average multiple of 5.8x.

Strong operating performance on higher realization and lower RM/employee cost

JKP's operating income grew by 7.6% y-o-y to INR 752 crore in Q4FY18 driven by higher sales volumes (+5%) and improved realization (+2.5%). However, operating income came 5.1% below our estimate due to lower than expected sales volume on the back of lower trading activities and maintenance shutdown for 10 days in Q4FY18 for Odisha unit. EBITDA margin improved from 20.4% in Q4FY17 to 22.3% in Q4FY18 (vs our estimate of 19.9%) due to a) higher realization vis-à-vis stable raw-material cost, b) narrowing of difference in domestic and export realization from 8-10% to ~3% due to rising paper prices in the global market, and c) lower employee cost. Higher operating profit and lower interest expense resulted in sharp improvement in PAT (+30.7% y-o-y) in Q4FY18.

Strong cash profit and healthy debt protection metrics to support proposed capex plan

JKP has announced its capex plan to set up a 160 ktpa pulp facility and 200 ktpa packaging board facility at Unit CPM, Gujarat at a cost of INR 1,450 crore. Given the strong cash generation (cash profit improved from INR 302 crore in FY17 to INR 422 crore in FY18) & improved debt protection metrics (net debt/EBITDA is the lowest in the past 15 years at 1.70x in FY18), we believe JKP should be comfortably able to fund the capex without resorting to any equity dilution in the future. Even after the company raises the entire debt (assumed debt equity ratio of 55:45) for its proposed packaging board facility, net debt/EBITDA is projected to remain at healthy levels (at 1.51x in FY20 and 1.59x in FY21) in the future. The management expects the project to be completed within 18-24 months from the date of receipt of environmental clearance. We have assumed the project to get commissioned by March 2021.

Outlook and valuations: 'Tactical BUY'

We maintain our 'Tactical Buy' rating on JKP with a TP of INR 195 per share. Our target price is based on a 6x multiple of FY20 EBITDA estimates, which is relatively in-line with the 15-year historical average multiple of 5.8x. We believe JKP is the best placed among its major peers to reap benefits of positive domestic industry fundamental; b) sharp rise in global pulp prices due to nil reliance on imported hardwood pulp vis-a-vis relatively stable price outlook for domestic wood; and c) sharp rupee appreciation in the past few months.

Year to March	Q4FY18	Q4FY17	% chg	Q3FY18	% chg	FY18	FY19E	FY20E
Net sales (INR cr)	752	699	7.6%	791	-4.9%	2,844	2,979	3,125
Growth (%)						*8.2%*	*4.7%*	*4.9%*
EBITDA (INR cr)	168	143	17.5%	154	8.9%	613	638	662
Adj PAT (INR cr)	74	56	30.7%	70	5.4%	260	290	320
Growth (%)						*59.8%*	*11.6%*	*10.3%*
Dil. EPS (INR)						14.6	16.3	18.0
Diluted P/E (x)						9.5	8.5	7.7
EV/EBITDA (x)						5.6	4.9	4.2
ROAE (%)						17.5	16.5	16.0

Q4FY18 Result Highlights

Particulars (INR crore)	Q4FY18	Q4FY17	% change	Q3FY18	% change	FY18	FY17	% change
Operating income	752	699	7.6%	791	-4.9%	2844	2629	8.2%
Cost of goods sold	407	383	6.3%	450	-9.7%	1528	1486	2.8%
Employee expenses	58	64	-9.3%	60	-3.0%	232	218	6.3%
Other expenses	120	109	9.2%	127	-5.6%	471	412	14.3%
Total operating expenses	585	556	5.1%	637	-8.2%	2231	2116	5.4%
EBITDA	168	143	17.5%	154	8.9%	613	512	19.7%
Depreciation and amortization	30	29	3.4%	31	-0.9%	121	120	1.1%
EBIT	137	113	21.2%	123	11.3%	492	393	25.3%
Interest expenses	33	43	-23.6%	37	-10.7%	143	188	-23.8%
Other income	7	9	-21.4%	6	17.1%	26	26	-2.6%
PBT	111	79	41.0%	92	20.5%	375	232	61.9%
Provision for tax	38	23	66.5%	22	67.4%	115	69	67.0%
Core profit	74	56	30.7%	70	5.4%	260	163	59.8%
Extraordinary items	-	-	-	-	-	0	-7	NM
Adjusted net profit	74	56	30.7%	70	5.4%	260	156	67.3%
No. of shares (Cr)	17.8	17.8	0.0%	17.8	0.0%	17.8	17.8	0.0%
Diluted EPS (INR)	4.1	3.2	30.7%	3.9	5.4%	14.6	8.7	67.3%
Ratio								
EBITDA margin	22.3%	20.4%	188 bps	19.5%	282 bps	21.6%	19.5%	207 bps
Tax Rate	33.8%	28.6%		24.4%		30.7%	29.7%	
PAT margin	9.7%	8.0%	174 bps	8.8%	93 bps	9.1%	6.1%	293 bps
Interest coverage	5.1	3.3		4.2		4.3	2.7	
Net Debt/Equity						0.63	1.08	
Net Debt/EBITDA						1.68	2.79	
Debtor days						14	15	
Inventory days						51	53	
Creditor days						33	32	
Operating Cycle						32	36	

Valuation Analysis

Target Price Based on EV/EBITDA Methodology	Amount (INR crore)
FY20 EBITDA estimate	662
EBITDA multiple	6
EV	3970
Less: Net Debt of FY20	-1141
Add: Capital Work in Progress	650
Equity Value	3479
No. of shares	18
Target Price	**195**

Conference call highlights:

- **Update on status of inorganic growth opportunities -** JKP is the only bidder of Sirpur Paper Mill (SPM), which is available for sale under NCLT. SPM has a nameplate capacity of printing & writing paper of 130 ktpa (but can produce upto 100 ktpa in the initial period of operations). The cost of the asset is estimated to be around INR 600-700 crore, which is proposed to be funded out of internal accrual of INR 150 crore and the remaining through debt. Further, the company would have to incur capex of INR 200 crore for modernization/debottlenecking in the second year of operation. It would roughly take 4-6 months to start the operation and the capacity can be ramped up to 80% level (on 100 ktpa capacity) by the end of first year of operations. SPM will be able to repay the debt obligation from its own cash accrual. We view the materialization of SPM acquisition as structurally positive for JKP due to diversification of its presence to Southern India and 30% enhancement in capacity in a favourable market condition.

- **Update on capex plan of packaging board plant in Gujarat** – The capex cost of proposed integrated packaging board unit (pulp capacity of 160 ktpa + paperboard capacity of 200 ktpa) is estimated to be INR 1450 crore, which is proposed to be funded out of debt of around INR 1000 crore and the remaining through internal accrual. The project cost is significantly lower than the capex cost of non-integrated unit of TNPL (which commissioned similar size paperboard facility without any pulp mill at a cost of ~INR 1400 crore in May 2016) due to brownfield nature of operations and usage of refurbished existing pulp mill. Currently, JKP is generating operating margin of around 10-12% for its packaging segment due to reliance on imported pulp. However, the company plans to earn around 18-20% margin on proposed packaging board facility due to integrated nature of operations with almost negligible reliance on imported pulp. Further, the management expects the segment demand supply fundamental to significantly improve by the time the proposed capacity will come into the market. The project is expected to be completed within 24-30 months from the date of receipt of environmental clearance. Overall, the management plans to maintain net debt/EBITDA below 3x in the future.

- **Price hike** – JKP has taken a price hike of 2-4% across various paper segments – Maplitho (2-3%); Copier (1.5-2%) and Coated paper (2-4%) in April and May 2018.

Business Overview:

JKP was incorporated in 1960 by a leading business conglomerate, the JK Group. JKP has an installed capacities of pulp (276,000 tpa), P&W paper (346,000 tpa), paperboard (90,000 tpa) and power (77 MW) at two locations: Songadh, Gujarat and Rayagadh, Odisha.

JKP to benefit most from tight domestic supplies and sharp rise in global pulp prices

The global pulp prices are likely to remain firm over the medium-term on expectation of a) improved global demand; and b) limited global pulp capacity expansion plan during CY2019 to CY2021. Meanwhile, domestic wood prices are expected to remain weak on improved wood availability due to captive farm forestry program. Furthermore, the change in bamboo reclassification from forest produce to non-forest produce in November 2017 would keep a check on wood prices in the future. Among domestic paper manufacturers, JKP is expected to benefit the most from the strong domestic industry fundamentals and a sharp rise in global pulp prices as it has almost nil reliance on hardwood pulp for its P&W segment.

Healthy return ratios and strong debt protection metrics

JKP's operating ROCE is projected to improve from 15.0% in FY18 to 16.5% in FY20 due to healthy cash flow from operations and sharp reduction in interest cost (from INR 143 crore in FY17 to INR 90 crore in FY20) following a gradual repayment of its existing term debt. Despite debt laden capex plan of the company, the net debt/EBITDA is projected to remain at healthy level in the future (from 1.70x in FY18 to 1.59x in FY20). We have captured the packaging board capex in our projection and have not considered the proposed acquisition of Sirpur Paper Mills as it is not yet materialized.

JKP market share to grow on strong execution capability & weak peer positions

JKP has a proven strong execution capabilities as: a) it has expanded operations at the 2nd fastest pace in the industry (after TNPL); b) increased market share in the high-value segment by gradually moving away from low-value to high-value P&W products and successfully ventured into the packaging board segment in 2007, c) weaned off its reliance on imported hardwood for its paper manufacturing operations, and d) cultivated high operating efficiencies in terms of low consumption of pulp, energy and water vis-à-vis its peers Given the limited capex plan of strong domestic paper producers and the weak balance sheet positions of major paper manufacturers (such as BILT, TNPL), we believe JKP could further increase its market share by growing organically or inorganically over the medium-term.

Diversified product portfolio and multi locations

JKP has a diversified product portfolio with a presence in high-quality paper segments (coated paper, uncoated paper and packaging board). It leads in the copier paper segment and is the 2nd second largest in coated paper and the 5th largest in packaging board. Further, JKP is less vulnerable to a poor monsoon (pulp & paper manufacturing is a water-intensive operations) as it has manufacturing facilities in two states – Gujarat (145 ktpa) and Odisha (291 ktpa). Meanwhile, most of the major paper companies have a presence in one state and rely heavily on the monsoon for efficient operations.

Inorganic growth opportunities or imposition of ADD poses potential upside risk

JKP has shown interest in acquiring weak assets (Sirpur Paper Mills) available for sale under NCLT. We believe this is an opportune time to acquire the sick assets at an attractive price due to a) favourable domestic industry fundamentals; and b) limited competition for distressed assets because of weak balance sheets of key players (BILT, TNPL) and the unwillingness of a few strong players to move to a different state. Furthermore, the government has initiated an investigation of imposition of anti-dumping duty (ADD) on imported coated & uncoated paper from South-east Asian countries. A decision is expected within another 3-6 months period. As JKP is one of the largest players in both coated and uncoated paper segments, it would be the major beneficiary of any favourable outcome of the investigation, but we have not factored this into our estimates.

Key Risks

- Sharp rupee appreciation
- Slowdown in global economy
- Sharp increase in agricultural commodity prices may result in shifting in cultivation from wood to other crops
- Unfavorable changes in government regulation

Financials

Income statement					(INR cr)
Year to March	FY16	FY17	FY18	FY19E	FY20E
Income from operations	2,437	2,629	2,844	2,979	3,125
Total operating expenses	2,046	2,116	2,231	2,341	2,463
EBITDA	391	512	613	638	662
Depreciation and amortisation	117	120	121	125	128
EBIT	274	393	492	512	534
Interest expenses	195	188	143	107	90
Profit before tax	89	232	375	419	462
Provision for tax	28	69	115	128	142
Core profit	61	163	260	290	320
Extraordinary items	0	-7	0	0	0
Profit after tax	61	156	260	290	320
Adjusted net profit	61	156	260	290	320
Equity shares outstanding (mn)	15	16	18	18	18
EPS (INR) basic	4.3	10.3	14.8	16.3	18.0
Diluted shares (Cr)	17.8	17.8	17.8	17.8	17.8
EPS (INR) fully diluted	4.1	9.1	14.6	16.3	18.0
Dividend per share	0.5	1.5	2.5	3.0	3.5
Dividend payout (%)	12.2	16.4	17.1	18.4	19.5

Common size metrics- as % of net revenues					
Year to March	FY16	FY17	FY18	FY19E	FY20E
Operating expenses	84.0	80.5	78.4	78.6	78.8
Depreciation	4.8	4.5	4.3	4.2	4.1
Interest expenditure	8.0	7.1	5.0	3.6	2.9
EBITDA margins	16.0	19.5	21.6	21.4	21.2
Net profit margins	2.5	5.9	9.1	9.7	10.3

Growth metrics (%)					
Year to March	FY16	FY17	FY18	FY19E	FY20E
Revenues	12.9	7.9	8.2	4.7	4.9
EBITDA	53.8	31.0	19.7	4.0	3.8
PBT	NM	159.7	61.9	11.6	10.3
Net profit	NM	167.5	59.8	11.6	10.3
EPS	NM	122.2	59.9	11.6	10.3

Ratios					
Year to March	FY16	FY17	FY18	FY19E	FY20E
ROAE (%)	5.8	13.4	17.5	16.5	16.0
ROACE (%)	8.5	12.0	14.8	14.4	13.7
Debtors (days)	21	15	14	14	14
Current ratio	0.7	0.7	0.9	1.2	1.0
Debt/Equity	1.7	1.3	0.8	0.7	0.7
Inventory (days)	50	53	51	51	51
Payable (days)	28	32	33	33	33
Cash conversion cycle (days)	43	36	32	32	32
Debt/EBITDA	4.8	3.3	2.1	2.0	2.1
Adjusted debt/Equity	1.7	1.1	0.6	0.5	0.5

Valuation parameters					
Year to March	FY16	FY17	FY18	FY19E	FY20E
Diluted EPS (INR)	4.1	9.1	14.6	16.3	18.0
Y-o-Y growth (%)	*NM*	*122.2*	*59.9*	*11.6*	*10.3*
CEPS (INR)	12.0	18.1	21.7	23.3	25.2
Diluted P/E (x)	33.7	15.2	9.5	8.5	7.7
Price/BV(x)	1.9	1.6	1.5	1.3	1.2
EV/Sales (x)	1.0	1.1	1.2	1.2	1.1
EV/EBITDA (x)	6.3	5.6	5.6	4.9	4.2
Diluted shares O/S	14.9	15.6	17.6	17.8	17.8
Basic EPS	4.1	9.1	14.6	16.3	18.0
Basic PE (x)	33.7	15.2	9.5	8.5	7.7
Dividend yield (%)	0.0	0.0	1.8	2.2	2.5

Balance sheet					(INR cr)
As on 31st March	FY16	FY17	FY18	FY19E	FY20E
Equity share capital	149	156	176	178	178
Preference Share Capital	0	0	0	0	0
Reserves & surplus	963	1,166	1,470	1,696	1,941
Shareholders funds	1,111	1,322	1,646	1,874	2,119
Total Debt	1,892	1,698	1,308	1,261	1,381
Borrowings	1,892	1,698	1,308	1,261	1,381
Sources of funds	**3,003**	**3,019**	**2,953**	**3,135**	**3,501**
Gross block	2,866	2,812	2,900	2,950	3,000
Depreciation	115	177	297	425	553
Net block	2,751	2,636	2,603	2,525	2,447
Capital work in progress	20	16	34	300	750
Total fixed assets	2,771	2,651	2,637	2,825	3,197
Investments	41	271	181	37	37
Other non-current assets	17	15	6	6	6
Inventories	335	383	394	413	433
Sundry debtors	139	111	109	114	120
Cash and equivalents	15	27	122	300	330
Loans and advances	61	57	53	53	53
Other current assets	108	79	105	107	117
Total current assets	658	657	784	987	1,053
Sundry creditors and others	396	463	503	527	553
Provisions	9	14	12	13	13
Total CL & provisions	405	477	515	539	566
Net current assets	253	180	268	448	488
Net Deferred tax	-78	-98	-139	-181	-227
Uses of funds	**3,003**	**3,019**	**2,953**	**3,135**	**3,501**
Book value per share (INR)	75	85	94	105	119

Cash flow statement					
Year to March	FY16	FY17	FY18	FY19E	FY20E
Net profit	61	163	260	290	320
Add: Depreciation	117	120	121	125	128
Add: Deferred tax	4	20	41	42	46
Gross cash flow	182	302	422	458	494
Less: Changes in W. C.	-32	-87	-15	2	10
Operating cash flow	214	390	437	456	485
Less: Capex	96	0	107	314	500
Free cash flow	**118**	**390**	**330**	**142**	**-15**

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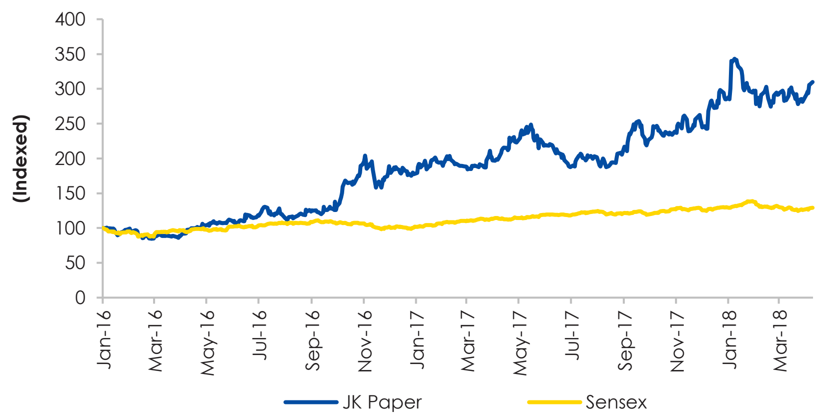
Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate between 5-15% over a 12-month period
Reduce	Return below 5% over a 12-month period



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