



Farsight

## MORNING FARSIGHT

Wednesday, September 26, 2018

**JK PAPER**

**CMP:RS 167**

**TRGT:RS 200**

**TIME HORIZON: 1 YEAR**

JK Paper, the company which stands to benefit maximum from rising pulp prices globally (due to integrated pulp production), is now our pick in paper sector, with few company specific triggers, coupled with known industry developments. First, company's capacity utilization reached 104% in Q1FY19 and it has recently increased its paper capacity from 436,000 TPA to 471,000 TPA through de-bottlenecking. Second, company has acquired Sirpur Paper Mills having name plate capacity of 138,300 TPA, majorly in the writing printing segment) and plans to start production in 4QFY19, after completing the necessary refurbishments. Including modernization capex and benefit of capital subsidy, the SPM acquisition cost comes at Rs 671 cr (i.e. 371 cr cost of acquisition +300 cr refurbishment expenses) which is significantly below the Greenfield capex cost of Rs 1,400 cr for a similar facility. Further As part of the deal, the Telengana government has assured to provide raw-wood of certain quantity below the market rate for the first 10 years which can take care of the requirement of peak utilization of 55-60%. The government has also assured to provide degraded forest land for wood plantation under farm forestry program. SPM is expected to add around Rs 500 to Rs 600 cr of revenue to JKPL's annual consolidated revenue from FY20 i.e. more than 20% of current annual revenue. Third, the government of India has initiated an investigation of imposition of anti-dumping duty (ADD) on imported coated & uncoated paper from South-east Asian countries. In FY18 Annual Report, JKP has mentioned that the government has found prima facie evidence of dumping of uncoated paper from Indonesia, Thailand and Singapore. As JK Paper is one of the largest players in both coated and uncoated paper, it would be the major beneficiary of any favorable outcome of the investigation. Fourth, In Q1FY19, On a sequential basis. JK Paper witnessed 6.7% growth in sales, whereas most domestic paper manufacturers have reported almost flat sales revenue. Company's Q1FY19 earnings were as follows: Revenue Rs 795 cr (up 20% YoY), EBITDA Rs 206 a up 30% YoY, 16%QoQ (margin 25.9%) and PAT Rs 95 ct up 30% YoY. EPS 5.4. Fifth, Generally Q1 is considered as a seasonally weak quarter and Q4 as a seasonally strong quarter for paper industry, due to start of new school season in April-May and demand supply environment is set to remain favorable. Sixth, JK Paper has strong market presence with an installed capacity of pulp (276,000 TPA), P&W paper (381,000 TPA), paper board (90,000 TPA) and power (77 MW) at two locations: Songadh, Gujarat and Rayagadh, Odisha. Company is the market leader in the copier segment with a market share of 23%, second largest manufacturers of coated paper (market share of 12%), the 5th largest in packaging board segment with 11% market share and is among the top three players in the Indian paper industry, in terms of capacity. Company also has one of the best operating margin among key domestic paper producers, thanks to its negligible reliance on imported hardwood pulp for its manufacturing operations. and high operating efficiencies due to low consumption of pulp, energy and water vis-a-vis its peer. On an estimated EPS of Re. 22 for FY19 and EBITDA of Rs 800 cr, stock is trading at PE of 7.6x and EV/EBITDA of 4.7x without considering fresh Income and Debt from Sirpur Paper Mills. Further, even after addition of Rs 250 cr of Debt for FY19 and no income, EV/EBITDA comes at 5x, which is still lower than smaller peers as well. Company's RoE has risen from 13% in FY17 to 16% in FY18 and is set to rise to 21% In FY19, while EBITDA margin of over 22% is seen encouraging. Further, India ratings have also recently upgraded credit rating of the company. There is sectoral trend in Paper sector as domestic paper sector is on a roll with prices buoyant, demand steady and exports growing. Policy changes in China is jacking up pulp prices (due to ban on use of waste paper) and which is in turn resulting in higher prices of final paper, while domestic integrated manufacturers like JK Paper are benefiting significantly from this change. Share ruling at Rs 167 can move to Rs 200 in 1 year

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