Ruchira Papers (NSE Code: RUCHIRA) – Alpha/Alpha + stock report for Mar'17

Content Index

Company Snapshot (26th Mar'17)

Rating – Positive – 3% weightage; this is not an investment advice (refer rating interpretation), the rating is only for indicative purpose and please take your own decision regarding the same.

CMP – 145.40 (BSE); 145.60 (NSE)

Dividend yield – 1.03%

BSE Code – 532785; **NSE Code** – RUCHIRA

Market capitalization – Rs 326.00 cr.

Total Equity shares – 2.24 cr.

Face Value – Rs 10.00

52 Weeks High/Low – Rs 149.05/60.00

Particulars (in cr.)	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16
Total sales from operations	160.97	199.45	254.02	284.28	297.41	320.13	346.56	362.58
Total cost of goods sold	-113.68	-136.93	-173.89	-193.11	-188.86	-203.31	-235.88	-232.68
Gross Profit (in cr)	47.29	62.52	80.13	91.17	108.55	116.82	110.68	129.9
Gross Profit margin (%)	29.38%	31.35%	31.54%	32.07%	36.50%	36.49%	31.94%	35.83%
EBITDA	14.44	18.59	32.62	40.38	50.88	48.80	39.18	47.49
EBITDA margin (%)	8.97%	9.32%	12.84%	14.20%	17.11%	15.24%	11.31%	13.10%
Other Income								
Interest income	0.32	0.78	1.14	1.27	1.61	1.75	1.36	1.14
Other operating income	1.2	0.01	0.13	0.2	0.13	0.05		
Depreciation	-6.87	-10.29	-10.61	-10.65	-10.99	-11.68	-9.58	-9.5
Finance Charge	-11.06	-15.99	-17.41	-19.79	-16.93	-13.54	-10.45	-7.4
PBT	-1.97	-6.90	5.87	11.41	24.70	25.38	20.51	31.73
PAT	-1.59	-4.31	3.88	7.58	16.45	15.28	12.83	19.47
ROAE	-2.49%	-7.09%	6.42%	11.45%	21.39%	17.00%	12.75%	17.23%
Cash flows from Operations	4.93	2.35	11.16	8.76	28.64	19.99	29.55	34.68
Net Debt	141.48	141.01	131.94	124.4	106.49	92.57	71.31	73.02
Debt to Equity ratio	2.24	2.41	2.11	1.78	1.27	0.96	0.68	0.60

Introduction

Promoted by Mr. Umesh Chander Garg, Mr. Jatinder Singh and Mr. Subhash Chander Garg, Ruchira Papers Ltd (RPL) is engaged in the manufacturing of Kraft Paper and Writing & Printing Paper (WPP).

The company manufactures Paper only from agriculture waste and waste paper and is therefore engaged in paper production with very low carbon footprint.

We are looking at Ruchira Papers from medium term investment perspective as we believe there are industry tailwinds and at the same time find RPL as one of the most efficient players to capitalize on the opportunity.

The company has been gradually expanding its capacity without going for any big-bang expansion and has shown great consistency in maintaining margins despite the commodity nature of the industry.

Lastly, what is pleasing to note is that promoters have been continuously increasing their stake in the company through open market purchases. Over the last 5 years, the promoters have increased their stake in the company from 54.82% at the end of Dec'11 to 61.07% at the end of Dec'16.

One concern that we have right now is that post Mar'18, the company will lose excise exemption benefit on its writing and printing paper facility; however as per the management the impact will be limited at 1-2% of realization and they will try and overcome the same through price increase.

Understanding Business and Company

As mentioned above, Company is engaged in the manufacturing of Kraft Paper and Writing & Printing Paper. Writing and Printing Paper is used for multiple purposes like printing and stationery etc.

Kraft Paper finds its application in the packaging Industry especially for making Corrugated Boxes / Cartons and for other packaging requirements.

The company manufactures paper using agricultural residues such as wheat straw, bagasse, sarkanda and other materials. It doesn't rely on wood based fiber for its raw material requirements.

As per the management, until some years ago, there was no economic use of the straw that remained after farmers harvested their cereal crops in Himachal Pradesh, Haryana and Punjab. Nearly 90% of the remaining stalks were burned to clear fields for the next harvest and this caused immense pollution.

Manufacturing paper from agricultural residue has several benefits:

- Promotes the use of renewable crop, reducing the demand for wood-based fiber
- Reduced cost from the transportation of wood-based moulded to lighter, stronger alternative
- Reduced CO2 emission by 25% compared with conventional wood fiber pulping

Revenue share between WPP and Kraft paper – Around 30 years back the company set up Kraft Paper manufacturing facility with a small 2,310 TPA (tonnes per annum) capacity. Over the years the company undertook several phases of expansion and increased the capacity to around 52,800 TPA and now expanding further.

In 2008, the company set up a 33,000 TPA manufacturing facility for writing and printing paper, while prior to that it was manufacturing only Kraft paper.

Revenue contribution	FY 12	FY 13	FY 14	FY 15	FY 16
% rev from writing and printing	56.05%	58.71%	61.95%	58.81%	62.35%
% rev from kraft paper	44.04%	41.29%	38.05%	41.19%	37.65%
Writing Paper realization (per tonne)	39661	42806	47875	46975	48024
Kraft Paper realization (per tonne)	24453	24705	25525	26424	26223

Source: Ruchira Paper's ARs

It is important to note here that WPP commands much higher realizations than Kraft Paper and therefore despite lower sales in terms of tonnage, WPP now accounts for more than 60% of the sales of the company against 0% before 2008.

Value added – Within WPP, the company has extended from the manufacturing of ordinary paper varieties to various value-added. The company introduced coloured paper in 2011; the proportion of revenue derived from this product is increasing in the Writing & Printing business.

Particulars	FY 13	FY 14	FY 15	FY 16
% of writing and printing from colored paper	12.67%	19.61%	14.90%	25.25%

Source: Ruchira Paper's ARs

Coloured paper generates a premium of Rs 2 to Rs 3 per kg over the prevailing Writing & Printing paper average.

Capacity expansion – After remaining stuck at 85,800 TPA for some years, the company has carried out de-bottlenecking exercises through which it has been able to increase combined capacity to around 116,000 TPA. The company is carrying out further enhancements through which the capacity will be increased to 128,000 TPA and the benefits of the same will accrue over the next 2 years.

It is important to note here that in the past company has been able to run its plants at more than 100% capacity utilization.

Further, as per the management the company will seek to continue enhancing production by 10-15% each year through various initiatives – rebalancing equipment, generating more from less and responding to emerging opportunities.

We believe, unlike 2008, when company carried out a major expansion and suffered on the profitability front for the next few years, the expansions going forward will be more nuanced.

Paper industry overview

The paper industry plays crucial role for the country's social strength, as use of paper is supposed to be an index of cultural growth. The paper industry also contributes towards fulfillment of various requirements of the industry as a whole like information dissemination, publicity etc. which in turn stimulates industrial growth of the country. The paper industry has, thus, a catalytic role to play not only for the overall growth of the industry but also for the living standards of the people.

In the last few years, India's paper industry has grown reasonably well. In the coming years, the sector is poised to grow with decent pace on account of expected spurt in demand for writing and printing paper. The demand for upstream market of paper products, like, tissue paper, tea bags, filter paper, light weight online coated paper, medical grade coated paper, etc., is also growing. These developments are expected to give fillip to the industry.

The Indian paper industry with approximately 13 million (mn) tonnes of capacity accounts for about 3% of global paper production. According to Indian Paper Mills Association, the domestic consumption of paper in India during 2014-15 was 13.9 mn tones, yoy growth of 6%.

According to various sources, global average per-capita paper consumption stands at around 58 kg, whereas the same is around 110 kg in Europe and 337 kg in North America. In India, on the other hand, the per capita paper consumption hovers between 9 and 11 kg. With increasing focus by government on education and general uptick in macro economy, CARE Rating expects Indian paper industry to witness a CAGR of 7% over the next five years to about 20 mn tones. The growth will be largely driven by printing & writing and packaging & paper board segment.

- **Printing and writing segment** – Printing and writing segment caters to office stationary, textbooks, copier papers, notebooks etc. This segment accounts for ~31% of domestic paper industry. Governments thrust on education through steps like Right to Education, Sarva Shiksha Abhiyan, rise in service sector are key factors contributing to the growth of this segment.

- **Packaging paper and Board** – Packaging paper & board segment caters to tertiary and flexible packaging purposes in industries such as FMCG, food, pharma, textiles etc. This segment forms ~47% of the domestic paper industry. This is currently fastest growing segment owing to factors such as rising urbanization, increasing penetration of organized retail, higher growth in FMCG, pharmaceutical.

India is the fastest growing market for paper globally and it presents an exciting scenario, with paper consumption poised for a big leap forward in sync with the economic growth. The futuristic view is that growth in paper consumption would be in multiples of GDP and hence an increase in consumption by one kg per capita would lead to an increase in demand of 1 million tonnes.

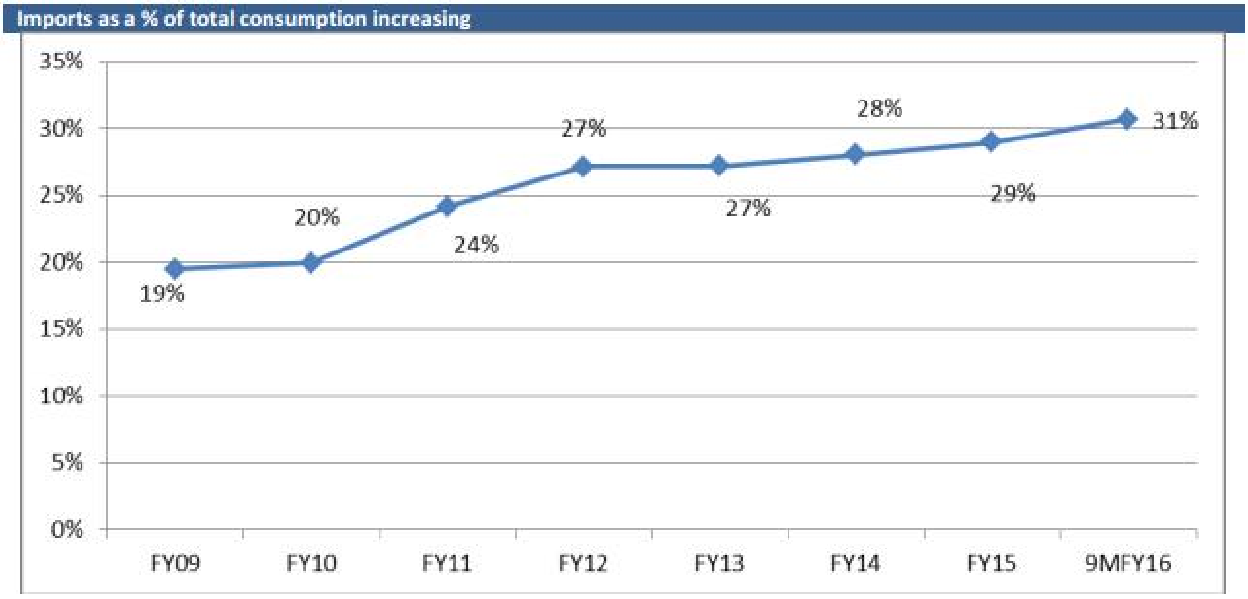
E-commerce growth to provide support to the paper industry – E-commerce boom in the country is expected to help paper industry (especially packaging paper and board segment) enter new phase of growth. Increasing number of Internet users and rising middle-class in the society with higher disposable income has boosted the demand for paper packaging products in the shipment industry. This seems like it will continue for years to come. Indian e-commerce market is expected to grow to $228 billion by 2030, as it is still below the size of the market today in China ($328 billion) and the US ($281 billion). The industry is entering new phase of growth and this will surely help paper packaging industry in coming time.

Concerns for the domestic paper industry

Raw material shortage – Pulp is the primary raw material used for manufacturing of paper, and is obtained through processing of fibers separated from wood, wastepaper, agriculture residues etc.

Indian paper industry is facing issue of pulpwood deficit in domestic market. India is a wood fibre deficient country and inadequate raw material availability domestically is a major constraint for the paper industry. This deficit can be mainly attributed to deforestation, increase in wood demand from other industries like construction industry, plywood & MDF board industry, bio-energy plants etc. To counter the issue of wood deficit, Indian paper companies gave thrust to initiatives like agro forestry which have now started yielding results.

Rising imports – Domestic paper companies fear a sharp increase in dumping from China and Indonesia after the United States imposed countervailing/anti subsidy duty of 5.82% - 131.12% in June last year on import of paper from China and Indonesia. This has renewed concerns of further dumping of paper by these countries into India, which is a growing market for them.



Source – CMIE

In the past four years, imports of paper and paperboards have risen at a compounded annual growth rate (CAGR) of 15%. A large quantity of paper and paperboard is being imported at significantly lower costs under the aegis of FTA. Under the India-ASEAN FTA, import duties on most of the paper and paperboard have been progressively reduced, and from a base rate of 10%, basic customs duty is now non-existent. As per the FTA entered into with South Korea, there is regressive reduction in basic customs duty and it will be zero in the year 2017.

Promoters/Management

Ruchira Papers is an owner operated business. The company is promoted by Mr. Umesh Chander Garg, Mr. Jatinder Singh and Mr. Subhash Chander Garg.

The above 3 are from diverse fields and look after various operations of the company. Mr. Jatinder Singh addresses finance, administration and procurement, Mr. Subhash Chander Garg looks after taxation, marketing and sales while Mr. Umesh Chander Garg manages the production, maintenance and technical aspects.

In small cap companies, we believe it's important as an investor that the promoters hold reasonably high stake and in the case of Ruchira Papers the promoters own more than 60% stake in the company.

What is even more significant is the way the promoters have increased stake over the last 5 years and that too through open market purchases. Promoters increasing stake in their own company through open market purchases is almost always indicative of good prospects of the company.

Overall we find the promoters to be good as they have managed the operations very efficiently. We like their focus on various aspects of the business such as water conservation, working capital management, power and fuel consumption efficiency, value addition, etc. Since FY 10 they have been continuously reducing debt while gradually expanding the manufacturing capacity.

Shareholding pattern (as reported on BSE)

	Dec'16	Sep'16	Jun'16
Promoter and Promoter Group	**61.07%**	**60.32%**	**59.98%**
India	61.07%	60.32%	59.98%
Foreign			
Public	**38.93%**	**39.68%**	**40.02%**
Total	**2,24,21,084**	**2,24,21,084**	**2,24,21,084**

As per the latest shareholding records, Promoters own 61.07% stake in the company which is reasonably high and aligns the interests of those running the company in line with minority shareholders.

Promoters are further going for preferential allotment of 18.30 lakh warrants at Rs 140.50/- per share. If converted fully, their holding in the company will increase to around 64%.

As on 31st Dec'16, the major shareholders of the company and their stakes are as below:

Name of the shareholder	Category	% stake in Ruchira Papers
Promoters and PAC	Promoters	61.07%
Dolly Khanna	Public	1.49%

Ruchira Papers – Performance Snapshot

Particulars (in cr.)	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16
Total sales from operations	160.97	199.45	254.02	284.28	297.41	320.13	346.56	362.58
Total cost of goods sold	-113.68	-136.93	-173.89	-193.11	-188.86	-203.31	-235.88	-232.68
Gross Profit (in cr)	47.29	62.52	80.13	91.17	108.55	116.82	110.68	129.9
Gross Profit margin (%)	29.38%	31.35%	31.54%	32.07%	36.50%	36.49%	31.94%	35.83%
EBITDA	14.44	18.59	32.62	40.38	50.88	48.80	39.18	47.49
EBITDA margin (%)	8.97%	9.32%	12.84%	14.20%	17.11%	15.24%	11.31%	13.10%
Other Income								
Interest income	0.32	0.78	1.14	1.27	1.61	1.75	1.36	1.14
Other operating income	1.2	0.01	0.13	0.2	0.13	0.05		
Depreciation	-6.87	-10.29	-10.61	-10.65	-10.99	-11.68	-9.58	-9.5
Finance Charge	-11.06	-15.99	-17.41	-19.79	-16.93	-13.54	-10.45	-7.4
PBT	-1.97	-6.90	5.87	11.41	24.70	25.38	20.51	31.73
PAT	-1.59	-4.31	3.88	7.58	16.45	15.28	12.83	19.47
ROAE	-2.49%	-7.09%	6.42%	11.45%	21.39%	17.00%	12.75%	17.23%
Cash flows from Operations	4.93	2.35	11.16	8.76	28.64	19.99	29.55	34.68
Net Debt	141.48	141.01	131.94	124.4	106.49	92.57	71.31	73.02
Debt to Equity ratio	2.24	2.41	2.11	1.78	1.27	0.96	0.68	0.60

Source: Ruchira Paper's ARs

Paper Industry is very competitive with not much differentiation in terms of end product and therefore the industry is largely commodity in nature.

In tough industries such as paper, what differentiates one company from the other is basically the way the operations are executed, the efficiency of the operations and the rationality of the management and that's where we believe Ruchira Papers scores above other Paper manufacturers.

There are companies much bigger than Ruchira in paper manufacturing space; however a lot of them are saddled with huge amounts of debt or facing working capital woes or raw material shortage; for instance Ballarpur Industries (BILT), which is one of India's largest producer of writing and printing paper has been scouting for investors and debt re-cast from lenders for starting its paper manufacturing units; while on the other hand we believe Ruchira seems to be executing well on all the major business fronts.

Coming back to operating performance of Ruchira Papers, we believe the company is gradually moving towards being a more efficient player with respect to both business operations and financial parameters.

Instead of big bang expansion, the management now seems more focused on gradual expansion through de-bottlenecking, efficiency enhancement exercises and technological improvements.

In the past, basically from FY 05 to FY 11, the company reported very strong growth in sales at more than 30% CAGR; however the profitability suffered as company resorted to big ticket expansion for setting up WPP manufacturing facility and took on huge debt.

Since FY 11, the company's focus has been on consolidation and efficient utilization of existing capacity by mining more out of available infrastructure and resources. As a result, the profitability has improved substantially with improvement in gross margins, reduction in interest cost and lower depreciation charge as a % of sales.

On the sales front, while the sales growth since FY 11 has been sluggish at around 7.5% CAGR, we believe the run-rate can improve going forward to around 15% on the back of steady capacity expansion and growth in realizations. Over the last few years the realizations have improved at a rate of 1.8% CAGR for Kraft Paper and 5% CAGR for WPP.

Realization (per MT)	FY 12	FY 13	FY 14	FY 15	FY 16
Writing Paper	39661	42806	47875	46975	48024
Kraft Paper	24453	24705	25525	26424	26223

Source: Ruchira Paper's ARs

On the margins front, it is interesting to note that gross margins of the company have improved over the years from 29-30% to around current levels of 35-36%. We believe, it could be on account of several factors including higher proportion of sales from writing and printing paper and factors such as lower wastages, losses and minor changes in input material mix.

On the back of expansion in gross margins, the EBITDA margins of the company have also improved to around 13-14% from lows of 9%. Over the last 7-8 years, the operating expenses as a % of sales of the company have ranged between 18-22% depending to a large extent on the phase of capacity expansion and utilization levels.

What is good to note is that despite increase in scale of operations and company expanding capacity in a gradual manner, the depreciation and interest costs haven't increased much over the years; in fact Ruchira has been able to pay off debt and reduce leverage on the balance sheet both in absolute and relative terms.

Important Numbers	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16
Inventory days	62	59	59	53	43	47	48	41
Debtor days	42	36	39	45	51	50	36	35
ROAE	-2.49%	-7.09%	6.42%	11.45%	21.39%	17.00%	12.75%	17.23%
Cash flows from Operations	4.93	2.35	11.16	8.76	28.64	19.99	29.55	34.68
Net Debt	141.48	141.01	131.94	124.4	106.49	92.57	71.31	73.02
Debt to Equity ratio	2.24	2.41	2.11	1.78	1.27	0.96	0.68	0.60

Source: Ruchira Paper's ARs

Company has also done well in terms of working capital management and as a result its cash flows from operations have consistently been good and more or less in line with reported profits.

As can be seen from the above illustration the inventory days have reduced from earlier levels of 55-60 days to around current levels of 40-45 days. On the front of debtor days, there's no definite trend with some years witnessing higher number of debtor days at around 50, while the last 2 years have been good with debtor days at around 35.

Thus, with well executed CAPEX and efficient working capital management, the company has been able to reduce absolute debt by around 70 crores and now has a healthy balance sheet with debt equity ratio of only 0.6.

As mentioned above, on the growth front we believe the run-rate can improve going forward to around 15% on the back of steady capacity expansion and growth in realizations.

Valuations

At around current price of 145 the market capitalization of the company is Rs 327 crores and the enterprise value is ~ Rs 395 crores. Over the last few years the absolute debt of the company has reduced from around Rs 140 crores to Rs 70 crores and the debt equity ratio has improved from 2.4 to 0.5.

For the trailing twelve months the stock has recorded PAT of Rs 27 crores and EBIT of Rs 48 crores. The stock is therefore trading at 12.11 times trailing twelve months earnings and EV/EBIT multiple of 8.25.

We believe the current valuations on absolute basis are reasonable; though sustainability of the same would depend on earnings trajectory over the next few quarters. What is good from minority shareholder's perspective is that promoters have been buyer of the stock around levels of 100 and above. Further, they are also going for preferential allotment of share warrants at Rs 140.50/- per share.

As far as sustainability of earnings is concerned, as mentioned above (barring unforeseen circumstances) the company is likely to record ~15% CAGR in sales and profits for the next 2 years or so.

The stock offers 1% dividend yield.

Dividend Policy

Dividend Payout					
	FY 12	FY 13	FY 14	FY 15	FY 16
Dividend (Rs. Per share	0	1.00	1.20	1.30	1.50
Dividend Payout ratio	0.00%	13.94%	18.15%	23.81%	17.90%

Ruchira Papers wasn't paying dividends prior to FY 13; however since FY 13 it has been continuously paying dividends with increase in pay-out with every passing year.

While there's no absolute stated dividend policy, since the last few years the dividend payout ratio has been in the range of 15-20% which we believe is reasonable considering company is expanding capacity and reducing debt at the same time.

Risks & Concerns

Paper manufacturing is a very competitive industry; so while Ruchira Papers has shown good resilience in terms of maintenance of margins; they may go for a toss (especially in short term) if there's wide variation in prices of raw materials or if imports increase substantially.

Water is an essential ingredient in the paper manufacturing process; any restriction on the usage of water can adversely impact the production of the company.

Effluent treatment is also an essential part of paper manufacturing process; any laxity on that front can bring in troubles for the company.

Sustainability of earnings growth will be important for the sustenance of current level of valuations; else stock might witness de-rating.

Disclosure: I don't have any investment in Ruchira Papers and have not traded in the stock in the last 30 days.

Best Regards,

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Rating Interpretation

Positive – Expected return of ~15% + on annualized basis in medium to long term
Neutral – Expected Absolute return in the range of +/- 15%
Negative – Expected Absolute return of over -15%
Coverage closure – No further update on the stock
% weightage – allocation in the subject stock with respect to equity investments

Short term – Less than 1 year
Medium term – Greater than 1 year and less than 3 years
Long term – Greater than 3 years

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Analyst ownership of the stock: No

Details of Associates: Not Applicable

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