24th Nov'18

Alpha report – Initiation note

Kanpur Plastipack Ltd (BSE Code – 507779)

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We have released 24th Nov'18: Kanpur Plastipack Ltd (BSE Code – 507779) – Alpha/Alpha Plus stock for Nov'18. For details and other updates, please log into the website at the following link - http://katalystwealth.com/index.php/my-account/

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Date: 24th Nov'18

CMP – 115.00 (BSE)

Rating – Positive – 4% weightage; this is not an investment advice (refer rating interpretation)

Introduction

Kanpur Plastipack Ltd (KPL) is a star export house engaged in manufacturing of Flexible Intermediate Bulk Containers (FIBCs), HDPE/PP Woven Sacks, PP Box Bags, Fabrics and High Tenacity PP. The company is also a Consignment Stockist of Indian Oil Corporation Limited and owns and operates solar power generation facility at A1-A2 units of the Company. The company is in the process of expanding its manufacturing capacities and has also raised capital through rights issue during the year.

The company has a long standing track record in the industrial bulk packaging industry and has been supplying products to customers across 40 countries.

As on date, we like several points about this company and they are as below:

FIBC industry growing well – As per one of the reports India is now gaining centre stage in global packaging industry and contributes to 42% of the global market share of FIBCs. There are only 25-30 players in the Indian FIBC industry and only 10 players have large capacities. Globally, there's competition from China, Turkey and some South American nations; however increasingly they seem to be losing market share (turkey is losing share because of political reasons) to their Indian counterparts there should be industry wide growth of 10-15%.

Capacity expansion on the verge of completion – The Company is facing capacity constraints since the last 3 years and to overcome the same a major project is underway which will be instrumental in substantial expansion of the existing capacities and consolidation of operations.

The Greenfield expansion will result in 60% increase in capacity of FIBCs and 100% increase in capacity of multi-filament yarn (MFY).

Capacity expansions without much strain on balance sheet – In the last 2.5 years the company has expanded its net block by more than 100%.

The company has spent around 80 crore on capacity expansions; however the absolute debt has increased by only 50 crore while the debt equity ratio has deteriorated marginally from 0.98 to 1.10 (as of Sep'18).

Reasonable valuations – Last but not the least, the stock is currently trading around 8 times trailing twelve months earnings while during the last 3-4 years it has traded in the range of 5 times to around 20 times earnings.

Taking into account the capacity expansion and the expected improvement in earnings, we believe the downside is limited at around 15-20% against a probable gain of more than 100% in next 2-3 years.

Basic details

What are FIBCs and MFYs – FIBCs are industrial bulk packaging products finding applications in the bulk packaging of Food Stuffs, Chemicals, Minerals, Agricultural products and even building materials.

FIBC as a packaging medium is prevalent in developed countries like US and Europe. It leads to savings of labour costs while handling bulk commodities.

FIBC bags are strong and flexible, and are designed in a way that allows easy recycling when the economic life is over. They come in various dimensions along with a diverse range of filling, discharging and lifting facilities.

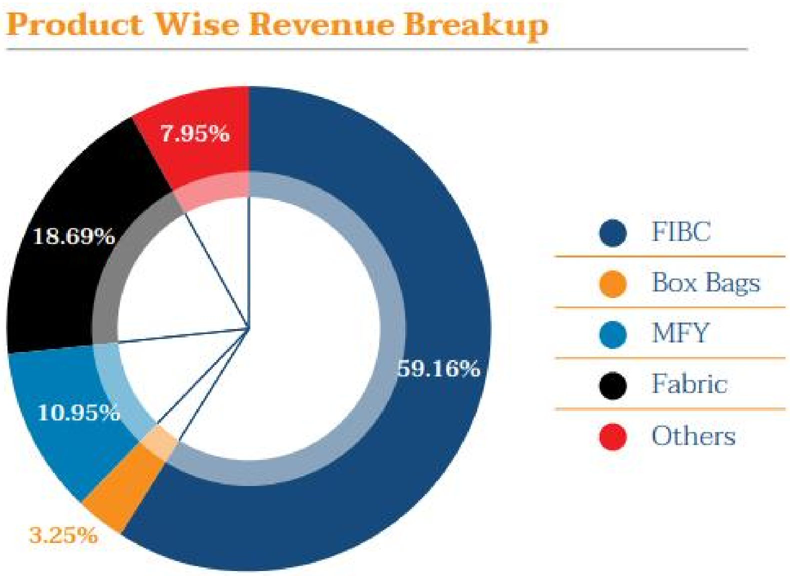
MFY – As far as MFY is concerned, it is used for the weaving of specialized fabric and stitching of Bags. Made up of polypropylene, Multifilament Yarn is used across industries due to its high tenacity. The yarn is water-resistant, is available in eye-appealing colours and is easily customisable. Multifilament Yarn is used in manufacturing ropes, elastic band, safety net and narrow woven fabric among others.

Coming back to KPL, it was set up in Kanpur in 1971 as a private limited company by Mr. Mahesh Swarup Agarwal. Then, KPL had a capacity of 130 tonne per annum (TPA) to manufacture high-density polyethylene woven fabric and sacks, and plastic packaging materials.

KPL shifted focus to FIBCs from woven fabric and sacks in fiscal 2004 and is currently one of the top few producers of FIBCs (Jumbo Bags or Big Bags) in India. It is basically a fully integrated Company providing end-to-end industrial bulk packaging solutions globally.

Besides providing Industrial packaging solutions, the company also manufactures Food Grade and Clean room bags as its facilities are BRC and ISO 22000 certified. In the separate clean room facilities the company ensures that the products are free from debris, contamination and impurities.

As far as product wise revenue contribution is concerned, around 63% comes from FIBCs and Box bags, 18-19% from fabric, 11% from MFY and remaining from others.



Source: KPL AR 2018

Capacity expansion – Since the last few years the company has been facing capacity constraints in its FIBC segment; thus, to follow the growth momentum and overcome capacity constraints, the company is in the process of expanding its FIBC and Woven Sacks capacity by 8,400 tonnes from the current 14,500 tonnes. Similarly, it is in the process of doubling its capacity of MFY from the current 3,350 tonnes.

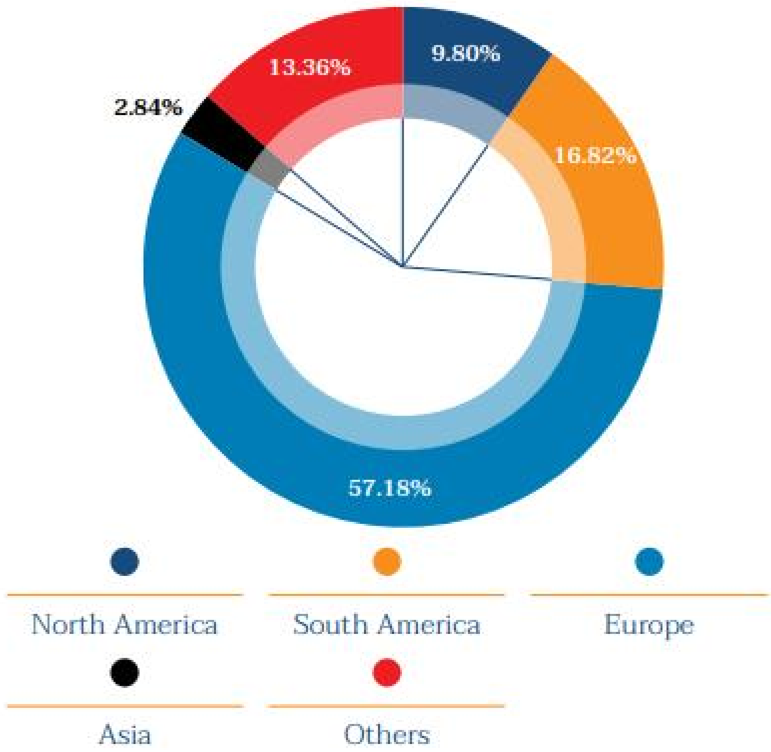
Product	2015-16	2016-17	2017-18
	(Quantity of Sales in MT)		
FIBC	10308	9311	9619
Small Bags	449	418	392
Fabrics/Liner/ Granules etc.	4518	3515	3969
MFY	2106	2106	2478

Source: KPL AR 2018

The company has already commercialized some of the capacities; however the entire project (including shifting from existing locations) is expected to go on stream in FY 20.

On the back of the Greenfield expansions and consolidation of existing operations at the new site, the company is hopeful of recording a turnover of Rs 450 crore in next 2 years.

Exports – Exports account for around 75-80% of the sales of the company. The company sells its products in more than 40 countries with 57% revenue contribution from Europe, 17% from South America, 10% from North America and remaining from others.



Source: KPL AR 2018

Exports	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18
Exports (in cr.)	90.96	152.39	145.31	172.98	185.81	203.36	196.9	219.73
Exports as % of sales	76.96%	82.58%	82.43%	81.00%	74.96%	81.80%	80.33%	77.46%

Source: KPL Annual Reports

The primary reason for exports accounting for 3/4th sales of the company is the fact that FIBC as a packaging medium is prevalent in developed countries like US and Europe due to high mechanisation and low human intervention. It leads to savings of labour costs while handling bulk commodities.

Client concentration – At the end of FY 18, top five clients of the company contributed 46% to the company's revenue, next top five contributed 16% of the revenue, and 38% came from the remaining clients.

Promoters/Management

Like several Indian companies, KPL is largely an owner operated business.

Mr. Manoj Agarwal is the Managing Director of the company. He holds a Masters in Management Studies from BITS, Pilani and has been guiding the Company's Operations for over 40 years.

He is ably supported by his son Mr. Shashank Agarwal who is also the Deputy Managing Director of the company and Mr. Sunil Mehta who is an Executive Director in the company. Shashank holds degree in B. Engg. (Hons) (Manufacturing Engineering & Operation Management) from the University of Nottingham, UK and has been instrumental in streamlining the Company's operations with backward integration and product diversification. He has set his vision on evolving the enterprise into one of the world's top FIBC producers.

Sunil is a B. Tech (Textile Technology) from TIT, Bhiwani and has over 30 years of experience in the woven sacks industry. He joined the Company in the year 2002 as Vice President.

In owner operated companies it is important from shareholder's perspective that owners have high stake in the company and in the case of KPL the promoters own 71.56% stake in the company. In fact what is good is that in the recently concluded rights issue the promoters increased their stake in the company from 69.20% to 71.56% by subscribing to unsubscribed shares at Rs 75/- per share.

Operating Performance

Particulars (in cr.)	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18
Income from operations	118.19	184.53	176.28	213.56	247.88	248.61	245.10	283.66
Gross profit	44.71	67.06	69.94	81.99	95.00	109.77	115.02	125.46
Gross profit margin (%)	37.83%	36.34%	39.68%	38.39%	38.32%	44.15%	46.93%	44.23%
Manufacturing expenses								
Employee expenses	-6.64	-9.06	-9.77	-11.12	-13.03	-15.8	-22.06	-27.05
Other expenses	-27.30	-36.29	-37.71	-43.55	-54.04	-57.63	-60.10	-64.08
Op expenses as % of revenue	-28.72%	-24.58%	-26.93%	-25.60%	-27.06%	-29.54%	-33.52%	-32.13%
Operating Profit	10.77	21.71	22.46	27.32	27.93	36.34	32.86	34.33
Operating profit margin (%)	9.11%	11.77%	12.74%	12.79%	11.27%	14.62%	13.41%	12.10%
Other Income								
Interest income and other income	0.16	2.43	0.70	0.95	1.34	1.19	1.24	1.52
Finance charge	-4.06	-6.32	-8.56	-8.86	-8.87	-7.66	-6.79	-6.4
Depreciation	-1.81	-2.46	-2.98	-3.74	-3.78	-4.11	-4.19	-4.11
Profit Before tax (PBT)	5.06	15.36	11.62	15.67	16.62	25.76	23.12	25.34
Profit After tax (PAT)	3.47	10.37	6.9	10.87	11.45	16.45	14.46	16.92

Source: KPL Annual Reports

KPL has performed well over the years with steady growth in sales and profits while maintaining a healthy balance sheet.

Between FY 11 and FY 15 the company grew its sales at a CAGR of 20% and profits at a CAGR of 35%. Since FY 14 the growth in sales and profits has slowed down to 4.7% CAGR and 14% CAGR respectively.

The reason for slowdown in sales since FY 15 is the fact that company has been facing capacity constraints in its FIBC and Woven sacks unit and the two together account for around 80% of the sales of the company.

To overcome stagnation a major project is underway which will be instrumental in substantial expansion of the existing capacities and consolidation of operations. The company is basically in the process of expanding its FIBC and Woven Sacks capacity by 8,400 tonnes from the current 14,500 tonnes. Similarly, it is in the process of doubling its capacity of MFY from the current 3,350 tonnes.

The Greenfield expansion will result in 60% increase in the capacity of FIBCs and 100% increase in capacity of multi-filament yarn (MFY).

The company has already commercialized some of the capacities; however the entire project (including shifting from existing locations) is expected to go on stream in FY 20.

On the back of the Greenfield expansions and consolidation of existing operations at the new site, the management is hopeful of recording a turnover of Rs 450 crore by FY 21 and with similar operating margins.

What is good about the upcoming expansion is that out of expected project cost of Rs 87 crore, the company has spent almost 81 crore with 74 crore already capitalized; so basically there's not much time before the entire project gets commercialized and starts delivering on revenue front.

The company has funded the capex through a mix of debt, rights issue and internal accruals. So, since FY 17, the debt has increased by around 50 crore; further the company has raised around 17.91 crore through rights issue and the rest will be internal accruals. What we like about the company is that over the last many years it didn't dilute equity at all and even now they gave an equal opportunity to all the shareholders to participate in the growth process. In fact, as certain shareholders didn't subscribe to their portion of rights issue, the promoters pitched in with more funds and bought in the unsubscribed part.

Important Numbers	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18
ROAE (%)	17.20%	39.53%	20.51%	26.00%	22.31%	26.26%	19.09%	18.10%
Cash Flows from operations	-2.22	1.2	0.55	-0.94	27.02	17.57	0.99	23.46
Net working capital	36.3	49.45	59.02	75.79	65.64	67.53	87.06	89.26
Sales to working capital	3.26	3.73	2.99	2.82	3.78	3.68	2.82	3.18
Net Debt	50.44	60.28	74.96	83.71	70.79	64.00	74.14	84.42
Debt to Equity ratio	2.32	2.06	2.07	1.83	1.29	0.94	0.98	0.84

Source: KPL Annual Reports

Besides maintaining decent growth in sales and profitability, KPL has also done well on other important metrics like return ratios, cash flows, balance sheet management, etc.

As can be seen from the above illustration, over the years the debt equity ratio of the company has improved from 2.32 to 0.84 while still maintaining Return on average equity at around 20% or more. Similarly, the company has consistently maintained Sales to working capital ratio in the range of 2.8-3.8 and even the operating margins have been maintained around 12-13%. If the crude remains where it is and the INR doesn't appreciate much against EURO, USD, etc, the operating margins may seen an improvement.

In the above illustration the reported Cash flows from operations have been adjusted for interest payments and therefore present a true picture of cash flow generation from operations and here as well the company has done reasonably well with major improvement in the last few years.

In our view, with expanded capacities in place, the company is likely to sustain 25%+ CAGR in sales and 20% + CAGR in profitability over the next 2-3 years. Here, we are assuming EBITDA margins of around 12% and see slightly lower growth in profitability on account of increased finance and depreciation cost of around 20 crore (combined) against FY 18 value of 10.5 crore.

Valuations

From the above sections we know that KPL is a well managed company operating in the business of industrial bulk packaging through FIBCs. The company has a long standing history of operations with reasonable growth in sales and profits across the years.

We also know that FIBC industry in India is growing well on account of both good demand from western countries and by capturing market share from countries like Turkey, China, etc.

Since the last few years the company had been facing capacity constraints; however it is in the midst of major capital expansion which will increase the capacity of FIBCs and woven sacks by 60% and double the capacity of MFYs. Also, while some of the capacities have already been commercialized, the entire project will go on stream in FY 20 which isn’t very far.

On the back of expanded capacities we expect the company to record 25% + CAGR in sales and 20% + CAGR in profitability over the next 2-3 years.

Thus, considering the above factors we believe the valuations are reasonable at around 8 times trailing twelve months earnings and 10 times FY 18 earnings while during the last 5 years it has traded in the range of 5 times to around 20 times earnings.

In case of really bad markets the downside might be limited at around 15-20% while the gains could be of the order of 100% in next 2-3 years.

Risks and Concerns

The company’s operations have a lot of moving parts like foreign currency, crude related raw material, export incentives, etc. and any significant change in the value of any of these can result in significant change in the profitability of the company.

In the past there have been periods when currencies like EURO, USD, Pound, etc have depreciated significantly against INR; if it were to happen again, being a net exporter it would be detrimental to the interests of the company.

The company got around 5 crore in the form of export incentives in FY 18 and the value of the same has been increasing with increasing exports. As the same adds directly to the bottom-line of the company, any significant reduction in such schemes by the govt will impact the profitability of the company.

The key raw materials used by the company are PP and LDPE granules, the prices of which are very volatile due to instability in the prices of crude oil.

Last, but not the least, the liquidity in the stock is low.

Disclosure: I hold one share of Kanpur Plastipack Ltd with no transaction in the last 30 days.

Best Regards,

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Positive – Expected return of ~15% + on annualized basis in medium to long term for investment recommendations and in short term for Special situations
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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

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

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Details of Associates: Not Applicable

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