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Ajmera House, Pathakwadi,
L.T. Marg,
Mumbai - 400002. INDIA

Tel: +91 22 4062 8853

Email: broking@ajmera.co.in

Website: www.ajmerax-change.co.in

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VOL. 01/23

SECTOR REPORT

5 October 2017

Paper: Consumption to grow over 50% to 20 mt by 2020

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. According to International Paper APPM annual report 2016-17, despite the continued focus on digitalisation, India's demand for paper is expected to rise 53% in the next six years, primarily due to a sustained increase in the number of school-going children in rural areas. Growing consumerism, modern retailing, rising literacy (continued government spending on education through the Sarva Shiksha Abhiyan) and the increasing use of documentation will keep demand for writing and printing paper buoyant.

The geographical spread of the industry as well as market is mainly responsible for regional balance of production and consumption. There is near self-sufficiency with the indigenous production of most varieties of paper and paperboards. Certain varieties of specialty papers are however, imported.

The operating capacity of the industry currently stands at around 14 million metric tons. The domestic production is estimated to be 11 million metric tons. As per industry estimates, over all paper consumption has now touched about 14 million metric tons. The industry grew with the rising level of literacy, improving well-being of the people and surging aspiration levels. Paper usage has increased over the years. Yet, the per capita consumption in India is estimated to be barely 10 kgs compared with 75 kgs in China, 156 kgs each in European Union, 159 kgs in Korea, Taiwan, Hong Kong, Singapore & Malaysia, 215 kgs in Japan, 221 kgs in North America, while the global average itself is a healthy 57 kgs.

India has 17% of the world's population yet accounts for only about 3% of the world's production of paper and paperboard. The estimated turnover of the industry is approximately Rs 50,000 crore, contributes Rs 4,500 crore to the exchequer and provides employment to more than 0.5 million people directly and 1.5 million people indirectly. Most of the paper mills have been in existence for a long time and hence present technologies fall in a wide spectrum ranging from oldest to the most modern. The mills use a variety of raw material viz. wood, bamboo, recycled fiber, bagasse,

wheat straw, rice husk, etc.; approximately 35% are based on wood, 40% on recycled fibre and 25% on agro-residues. India's wood resources suitable for paper production are inadequate. Cost of wood is hence much higher in comparison to the rest of the world. Since there is conspicuous absence of enabling policies favoring corporate plantation or farming, securing future wood supplies will be the industry's biggest challenge.

Wood based segment of the paper industry meets its current requirements mainly through social/farm forestry and supplements it with purchases from the state forest development corporations. A few manufacturers have even explored import of raw wood from neighboring countries. In the recent budget, the government has announced basic customs duty cut on import of woods.

The paper industry in India is majorly categorized into writing and printing (W&P), paperboard and newsprint segments. Paperboards constitute approximately 46% of the demand volume, while W&P accounts for approximately 30%. Newsprint makes for another 19%. Specialty papers make the balance 5%.

Major varieties of W&P are creamwove, maplitho, cut-size and coated paper. Recent trends indicate higher quality paper segments such as cut-size and coated varieties have been gaining volumes, while creamwove has a stable market. Maplitho, cut-size and coated paper command higher realizations, while creamwove is a volume runner. According to industry estimates, creamwove commands 46% of the W&P market, maplitho occupies 34% and cut-sizes constitute the balance 20%.

Paperboard, primarily used for industrial purposes, consists of kraft paper board, virgin board and recycled board. Kraft paper is produced in several varieties generally differentiated by properties of strength and grammage. Paperboard varieties include coated/uncoated duplex, chromo and triplex boards.

Cost competitiveness has differentiated the performance of paper mills, largely affected by location of the mills. Successful mills have been located near source of raw material i.e. wood as well as near source of coal, water and

skilled labor. Availability and cost of power had also had a bearing on the performance of paper mills.

So far, the growth in paper industry has mirrored the growth in GDP. Demand is driven by general commercial activity and population growth. The profitability of individual companies depends on efficient operations, as products are sold mainly based on price. Big companies have advantages in distribution and can supply to large customers. There are few economies of scale in manufacturing; large and small producers operate the same kinds of plants - large producers just have more of them. Small companies compete successfully by making specialty products or serving a small geographical market.

India is a fast growing market for paper globally and it presents an exciting scenario; the operating capacity of the industry currently stands at about 13.9 million metric tons. Of these, packaging production is about 6.4 million metric tons, W&P constitutes 4.1 million metric tons, newsprint makes for 2.7 million metric tons and Specialty Papers about 0.7 million tons. Amongst W&P, uncoated paper accounts for 84% and the balance 16% is made up of coated paper (art board, art paper and chrome paper). As per industry experts, paper demand is likely to grow at 5.5-6.5% to touch 18.5-19 million tons in 2020-21. Amongst these, the sectoral forecast is as follows:

- Demand for paperboard is expected to grow at a healthy 7-8% CAGR over the next 5 years, driven by packaging of fast-moving consumer goods products, readymade garments, pharmaceuticals, e-commerce, and household appliances;
- Writing and printing demand is expected to grow at 4-5% CAGR (as against 3.6% between 2010-11 and 2015-16) on account of a likely pick-up from the corporate and education sector with improving literacy rates;
- Specialty paper (majorly tissue paper and thermal paper) is expected to continue to grow at a robust 9-11% CAGR.
- Uncoated W&P is expected to increase to 6.4 million metric tons by 2022 while paperboard production is estimated to increase rapidly to 7.6 million metric tons by as early as 2017-18 with improved FMCG sales, wider reach of organized retail, penetration of healthcare into the rural economy, sustained demand for packaged products in line with rising aspiration levels and changing lifestyles. The demand for cut-size segment (~20% of W&P segment) will continue to remain strong and grow at 9-10% CAGR through 2021, primarily on account of rise in incremental spend on stationery by corporates and rise in number of offices, coupled with steady growth in service industry.

It is estimated by industry experts that an increase in consumption by one kg per capita on a 100 basis point increase in GDP, would lead to an increase in demand of 1 million metric ton. With growth in GDP and increase in literacy, paper consumption in India is bound to go up. In fact,

consumption in India is estimated to touch 18.5-19 million metric tons by 2020-21

Newsprint Sector:

As per Emami Paper Mills annual report 2016-17, India's Rs .30000 crore print media industry is set to grow by 8% annually for the next three years. The growth driver, though, isn't English language dailies. It is regional media. Vernacular or local language print media will grow at 10-12% in fiscal 2017. Only 10% of the 1.2 billion Indians speak English. That leaves an overwhelming majority to rely on regional media.

So there is still a huge untapped market. Additionally, literacy rates in the country's villages are improving. The figure for rural areas jumped from about 45% in 1991 to 69% in 2011. A total of 5,423 new publications were registered during the year, taking the total count of registered publications to 110,851 from 105,443 in the previous year. The rapid expansion of the Internet was accompanied by a newspaper revolution. Growth in technology and the importing of new printing equipment meant that it was becoming commercially viable for newspapers to be printed in a variety of regional languages rather than predominantly either in Hindi or English. Increasing literacy rates across India has driven the localization of newspapers, made possible by the changes in printing technology.

Underwriting the localization of India's newspapers is media advertising, which has grown alongside newspaper circulations. The growth of media advertising meant that Indian newspapers began to receive investment and this made the decentralization of news possible. Incentives are often offered in order to increase circulation.

However, the lower growth in GDP and decrease in the number of pages per newspaper due to lower advertising spend, has resulted in a sharp decline for the demand of newsprint. The used newspaper being the main raw material for newsprint has a cascading impact on its availability and consequently the price of waste paper has started moving upwards. The impact was more severe on newsprint industry due to lower sales realization on account of cheaper imports coupled with rupee appreciation. The newsprint industry is also expected to witness a decline in demand in long-term primarily on account of increasing adoption of digital media and proliferation of smartphone usage.

Packaging Board Sector:

Packaging is among the high growth industries in India and developing @11% per annum and becoming a preferred hub for packaging industry. Currently the 5th largest sector of India's economy, the industry has reported steady growth over past several years and shows high potential for much expansion, particularly in the export market. Over the last few years Packaging Industry is an important sector driving technology and innovation growth in the country. The global

packaging industry is developing and expanding day by day and Indian packaging industry is also growing at rapidly. This growth is primarily driven by factors like growing pharmaceutical, food processing, manufacturing industry. FMCG, healthcare sector and ancillary in the emerging economies like China, India, Brazil, Russia and few other East European countries.

Raw Material cost

From present report we have started taking wood pulp producer price index from US instead of Sweden Woodpulp Price (North Sea Ports). As per wood pulp producer price index, there has been rise seen in wood pulp prices from March 2017 onwards till July 2017. Rupee has appreciated against Dollar and is trading around Rs 63.9. The coal price on the other hand has shown 42% YoY incline in last 1 year to \$ 95.9/MT in August 2017.

Increase in coal price will impact power & fuel cost for paper industry. Earlier, the declining trend in global coal prices has helped Indian paper industry to improve margins. Power & fuel cost for printing & writing players is ~17%, for Paperboard segment is ~15% and for Newsprint segment it is around 18%.

Performance of key sector companies for the quarter ended June 2017 on YoY basis

Major paper companies have had a good first quarter, backed by peak season demand from the education segment, which contributed to higher production and sales. Margins have been good on stable raw material pricing and absence of a significant cost push. Raw material prices, particularly that of pulp wood, have been constant and units with captive pulping capability have benefited. There has not been a major cost push during the quarter, which is also the peak demand period as most orders for notebooks, text books and paper from schools and colleges are met in this quarter.

Also, Ballarpur Industries, the largest producer in the domestic market, has been inconsistent with its supply due to a financial crunch. But exact estimates of the shortfall cannot be estimated.

Tamil Nadu Newsprint and Papers Ltd (TNPL) was hit by an acute water shortage in the State and had to shut down one of its paper machines. The production loss during the quarter, according to the company, was about 43,000 tonnes of paper and about 24,000 tonnes of packaging board. The reduced presence of the two large players helped their peers.

Seshasayee Paper, also in Tamil Nadu, managed to weather the water crunch better, and more or less conserved its profit. In contrast to subdued growth in demand for printing and writing paper globally, pegged at less than 1%, domestic demand is growing at about 5%. This is likely to sustain for the next five years. Prices have been buoyant at about Rs 57,000 a tonne,

which is 6-7% higher than in the previous year.

Printing and writing paper accounts for nearly one-third of the total estimated demand of about 15 million tonnes according to the Indian Paper Mills Association (IPMA). IPMA believes that despite the initial disruption in paper supply chain ahead of GST launch, the new tax regime will give a hand up for printing and writing paper.

Copier paper — which is growing at 10-12% — will particularly see a positive impact as most documents that truckers have to carry will be on A4 sheets. West Coast Paper tripled its net profit in the first quarter and is targeting the mass market segment in copier paper.

JK Paper's net profit doubled over that of the comparable quarter. The control on raw material costs achieved over the past three-four years by sourcing pulp wood from own areas, efficiency improvements in fibre, power and productivity, and a product mix focussed on premium copier paper and value added products contributed to better net sales realisations.

The aggregate net sales of 10 paper companies declined 17% to Rs 2991 crore due to fall in sales of Ballarpur Industries. (The base period contain consolidated P&L figures for Rainbow Papers which is not there in present quarter). The aggregate PBDIT margin declined 130bps to 15.6%. The aggregate PBDIT decreased 23% to Rs 467 crore due to fall in PBDIT in Ballarpur Industries, Tamil Nadu Newsprint and Paper and Emami Paper Mills . The aggregate loss stood at Rs 277 crore.

Writing and printing paper mills have seen a sharp increase in their top and bottom lines over the last six quarters. Seshasayee Paper posted a nearly 10-fold increase in its net profit to Rs 39.54 crore in the March quarter and West Coast Paper posted a two-and-a-half times jump. Profits of International Paper, JK Paper and Tamil Nadu Newsprint also increased, but at a slower pace. Their income is up significantly.

A number of small and medium size mills have shut down over the past six quarters due to stringent environmental laws. Mills are required to make large capital investments in clean technology, which the smaller ones could not afford.

According to leading industry player JK Paper, around 20 % of India's writing and printing paper mills have shut down and this has benefited the larger players.

(IPMA) estimates India's writing and printing paper market at 4.6 million tonnes in 2015-16, growing at 5 % annually. Firm prices and falling costs following investments in efficiency improvement were bolstering profitability in this sector. Writing and printing paper prices have jumped by 6-7 % to trade currently at Rs 57,000 per metric tonne.

The paper industry is expected to hold on to its healthy operating margins and improved cash generation is expected to lead to a decline in net debt levels by 25-30%.

Tamil Nadu Newsprint and Paper (TNPL)

The revenue for Q1 FY18 decreased 25% to Rs 555.51 crore. The loss at bottomline stood at Rs 89.15 crore against net profit of Rs 69.51 crore in the corresponding quarter of last year. Paper segment revenue de-grew by 32% to Rs 524.84 crore while loss at PBIT stood Rs 14.54 crore. The revenue from the energy segment decreased 15% to Rs 55.82 crore, while PBIT stood at Rs 3.02 crore. The revenue from cement segment has increased by 18% to Rs 30.60 crore while loss at PBIT stood at Rs 1.34 crore.

Due to water shortage, the production of in house pulp, paper and packaging board impacted the company's June 2017 quarter. With the onset of southwest monsoon and water flow in the river, the company got back to normal production of from early 27th July 2017.

Packaging Board quality is well accepted in the market. Printing & Writing Paper production during Q1 FY18 was at 56946 MT (against capacity of 100000 MT) vs. 95956 MT in Q1FY17 indicating a decline in capacity utilization from 95% to 57% in this quarter. Packaging Board production was 25642 MT (against capacity of 50000 MT) vs. 24584 MT in Q1FY17. On a blended basis, the capacity utilization for Paper and paper board put together seems to have fallen to 55% vs. 80% in Q1FY17. Apart from the plant shutdown sales were also impacted due to implementation of GST.

JK Paper

The net sales for Q1 FY18 has increased by 4% to Rs 632 crore and net profit up 125% to Rs 60.11 crore. Volume for Q1 FY18 is lower vs Q1 FY17 due to change on product mix which give higher NSR (net sales realization). Also April - June quarter is not good quarter for paper industry as April to June months are vacation months. July sales were good and demand was picking up. Q2 would be better quarter from demand point of view and expects channel inventory to go up as in Q2, School and institutions open up,

April - June quarter is not good quarter for paper industry as April to June months are vacation months. Volume for Q1 FY18 is lower vs Q1 FY17 due to change on product mix which give higher NSR (net sales realization). GST impacted sales in June and channel inventory were down drastically. July sales were good and demand was picking up. Q2 would be better quarter from demand point of view and expects channel inventory to go up. Also in Q2, School and institutions open up, so it's a good quarter.

Volume for Q1 is 190k MT including sourcing. Otherwise its 120K MT.

Operating profit up in Q1 because increase in NSR, operation efficiency and raw material (RM) cost came down future. QoQ RM cost coming down due to local procurement of wood.

Odisha plant has local procurement of RM upto 60% while Gujarat plant RM procurement for paper is 100%. Local procurement helping in bringing down logistic cost. The

company target is 70% local procurement for Odisha plant

The paperboard packing unit in Gujarat requires imported pulp, In that also there are 2 varieties of pulps. Out of which 1 pulp is BCCMP pulp which is no produced in India, so imported and some quantity of bleach pulp is imported. In last 4-5 moths there was good rise in global pulp price which impact the profitability of the company.

Power cost has gone up. The company has to buy coal from open market which is costly and import costly coal as Coal India was unable to supply required amount of coal. But in Q2, the company hopes to get coal from Coal India.

Finance cost came down because working capital is lower, outstanding came down, and inventory came down. Also rate of interest is lower. Rating upgradation help in getting lower rate. Net debt came down. Surplus cash is helping in reducing debt. The company has Rs 1400 crore of long term debt and it is repaying around Rs 250- 300 crore every year. Total Long term and short term loan is Rs 1500 crore. In 5 years time it will be zero but the mgmt said that it don't want to be zero debt level.

Avg. current cost of borrowing – 8.9% Long term and working capital is 6%. Gng fwd – 8-8.5% it will be as foreign currency loan which was earlier more than Indian loan is getting repaid. Next rating upgrade will help cost of borrowing to come down

De-bottling and cost efficiency improvement will help capacity utilization to grow. The company can increase capacity by 5-10% in next 2 yrs through this way

The company's market share is 24% in copier paper, which has come down from 26% as market has grown while the company's capacity has not grown. In maplitho paper, the market share has moved up from 3% to 4-5%.

The company would be doing 8-10% sales of value added products and target is to go to 15% over a period of 2 years. Margin in value added products is 30-35% vs normal product of 20%.

The company's own manufactured pulp cost is Rs 35000 per MT at zero moisture and for imported pulp it will cost around Rs 46000 per MT at zero moisture

The Company is sourcing substantial part of coating paper and selling it as its own brand. As such, not necessary it will put manufacturing unit and without new capex also it can grow.

International paper APPM

The company's sales inclined 7% to Rs 311 crore. The net profit inclined by 52% to Rs 23.85 crore..

In the previous year, the Hon'ble High Court for the State of Telangana and the State of Andhra Pradesh upheld the validity of levy of electricity duty @ 25 paise per unit by the State Government on consumption of electricity by captive generating units relating to earlier years. The Company

(along with other petitioners) filed a Special Leave Petition in the Hon'ble Supreme Court, which in the interim, directed the petitioners to pay partial amount without prejudice to the rights and contentions of the petitioners, pursuant to which the Company had paid Rs 15.02 crore under protest in the previous year. The matter is pending hearing. In view of the inherent uncertainty in predicting the final outcome of the above litigation, the Management has, on grounds of prudence and abundant caution, made a provision amounting to Rs 23.57 crore during the previous year towards the potential liability in the event of an unfavourable verdict in this matter, which amount was disclosed as an Exceptional item. Additionally, an amount of Rs 15.72 crore has been disclosed as Contingent liability. On the basis of the legal advice obtained, in the opinion of the Management no further provision would be required in relation to this disputed matter.

There is disruption of operations at the manufacturing facility located in Rajahmundry due to illegal strike by contract workers since July 26, 2017.

West Coast Paper Mills

The company's net sale de-grew 6% to Rs 386.52 crore. The net profit grew 260% to Rs 53.71 crore due to improved OPM and fall in interest cost. The sales of paper & paper board have decreased by 3% to Rs 394.40 crore while PBIT increased by 36% to Rs 61.67 crore. The sales of telecommunication cable have decreased by 39% to Rs 15.84 crore while PBIT decreased by 72% to Rs 0.82 crore. Better operating efficiencies resulted in improved profitability over corresponding quarter

Seshasayee Paper

The company's net sale de-grew 1% to Rs 238.64 crore. The net profit de-grew 10% to Rs 21.75 crore. While there has not been much improvement in the River water flow, both Unit: Erode and Tirunelveli are maintaining production.

Emami paper

The company's net sale grew by 10% to Rs 278.30 crore. The net profit de-grew by 58% to Rs 2.58 crore. During the quarter, the company has undertaken following up-gradation:- Paper machine – 2 which was producing newsprint with a capacity of 32000 TPA successfully converted into value added writing & printing paper with an enhanced capacity of 42000 TPA w.e.f 1st August 2017; Capacity enhancement of captive power plant – 2 from 15 MW to 18 MW with state of art technology for better fuel efficiency by 10%. As a result production during the quarter is lowered by 15% with consequential impact on sales and profitability.

Ballarpur Industries (BILT)

The revenue on consolidated basis has declined by 48% to Rs 466.96 crore.. The loss at bottom-line stood at Rs 377.58

crore against loss of Rs 165.93 crore in the corresponding quarter of last year.

After invocation of Strategic Debt Restructuring Scheme of the Reserve Bank of India by the Lenders, the Company had on 25th July 2017 allotted 63,79,31,917 Equity Shares of Rs.2/- each at Rs 15.83 per equity share to its Lenders (consequent upon conversion of debt of Rs 1009.85 crore into equity) ranking pari passu in all respects with existing fully paid up equity of the Company, as approved by Members of the Company on 14th July 2017.

Sabah Forest Industries Sdn.Bhd, Malaysia step down subsidiary of the Company has commenced operations on 30th June 2017 and is being ramped up.

Industry Developments

Capacity expansion in paper industry at a standstill

As per Indian Paper Manufacturers Association (IPMA) president Saurabh Bangur, the paper mills in the country are finding it difficult to tap the growth potential, which is in tune with the gross domestic product (GDP) growth, due to the imports of cheaper paper from Asean countries. The industry in India has not been expanding capacity for the last 12 months or more, owing to this challenge. The capacity of Indian mills has saturated almost one and a half years ago, and is currently working at 100% capacity. Now, whatever growth happening is being taken care of by the import.

Outlook

The Paper Industry is cyclical in nature and its performance depends on the global pulp and paper demand supply situation. The domestic paper sector is likely to see marginal improvement in demand from education and corporate sectors, aided by expected higher GDP growth of the country. The per capita paper consumption in India is only 11.5 kilograms as opposed to a global average of 58 kilograms, highlighting ample room for growth.

Moreover, with India reinforcing its status as one of the fastest-growing major economies as well as the fastest growing paper market (~6% per annum), it is expected that paper consumption could grow over 50% to ~20 million tonnes by 2020 and to ~23.5 million tonnes by 2024-25. India's e-commerce market is growing at a rate of 51% and is expected to jump to \$120 billion in 2020. Consequently, demand for packaging such as cartons, corrugated boxes, labels, invoices and envelopes will increase and give a further impetus to the paper industry as per JK Paper annual report 2016-17. Over mid-term, outlook for paper industry looks bright.