Tactical Buy: Orient Paper & Industries Ltd

Attractive valuation with strong growth & ROCE in a niche paper segment

CMP INR 40
Target INR 51
Upside: 27%
Rating: BUY

Utkarsh Nopany
Research Analyst
utkarsh.nopany@edelweissfin.com

Praveen Sahay
Research Analyst
praveen.sahay@edelweissfin.com

Orient Paper & Industries Ltd (OPIL) is a leading paper manufacturer in India, with a capacity of 105 ktpa (P&W: 55 ktpa; tissue paper: 50 ktpa). OPIL is the largest player in domestic tissue paper segment, with a market share of ~17%. Tissue paper is the fastest growing segment in the Indian Paper Industry, growing at ~12% vs the industry growth of ~6%. OPIL's ROCE is projected to improve by 9.4% to 26.9% over the next two years. Its strong balance sheet position also provides room for future growth opportunities. After deducting 50% of market value of investment in equity shares of HIL Ltd of ~INR 218 crore, OPIL currently trades at 4.6x of FY20E EBITDA.

Largest player in Indian Tissue paper segment due to edge over peers

The Indian tissue paper industry is witnessing a) an improvement in domestic demand on rising disposable income and increasing hygiene awareness, and b) a rise in exports due to benefit to domestic producers following the sharp rise in global pulp prices vis-à-vis decline in domestic wood prices. Tissue paper exports from India grew by 46% in FY18 and 57% in 2MFY19. OPIL is the largest player in India's Tissue Paper segment in India and had a 44% share of tissue paper exports in FY18. The company has an edge over its peers due to its established presence in both the domestic & international market on the back of its first mover advantage in India (in 1997) whereas most other major paper manufacturers have not yet entered this segment.

ROCE to improve by ~9.4% to 26.9% in FY20 on positive fundamentals and better product mix

OPIL's EBITDA is projected to rise at a 19.6% CAGR to INR 160 crore during FY18-20 on expectation of a) ramping up of its new tissue paper line to full scale, b) improved realisations due to firm global pulp prices and a weak rupee (vis-à-vis weak raw-material costs due to increased focus on farm forestry program); c) a better product-mix with tissue paper's revenue share to improve from 33% in FY18 to 42% in FY20, and d) benefits accruing from operating leverage. Excl. the impact of revaluation of assets, ROCE is projected to improve from 17.5% in FY18 to 26.9% in FY20.

Balance sheet to remain highly comfortable, despite implementation of recent capex plan

OPIL has a strong balance sheet position, with gross debt of only INR 69 crore in June'18 vs expected CFO of INR 119 crore in FY19. The company has recently announced its plan to enhance pulp capacity from 72.5 ktpa to 100 ktpa to eliminate its reliance on market pulp at a cost of ~INR 75 crore and setting up of new recovery boiler at a cost of ~INR 150 crore. The project is proposed to be completed by September 2020. We believe the balance sheet to remain light in the future as the proposed capex will be funded out of internal accruals and/or divestment of equity stake in Century Textile & Industries Ltd (CTIL). The management has already intended to divest its investment in CTIL in the near-future.

OPIL to generate healthy ROCE on new capex due to brownfield nature of expansion

OPIL can generate an ROCE of 20% for its new tissue paper facility due to the low capex on brownfield expansion vs 12-13% generated on greenfield capex by its peers. The company could enhance its tissue paper capacity by 25 ktpa at a minimal cost in the future due to huge land bank at its existing site, surplus power capacity (16-17 MW) and surplus pulp facility post expansion (~20 ktpa). We believe the company could plan for enhancement in tissue paper capacity by 25 ktpa once the new line reaches to optimum level of production. The company expects to ramp up the capacity of new tissue paper facility to 90% by March 2019.

Initiating coverage with 'Tactical Buy' rating, TP of INR 51; offering 37% upside potential

We initiate coverage on OPIL with a 'Tactical Buy' rating and a target price (TP) of INR 51 per share, which offers a 37% upside potential to investors. Our TP is based on a 6x multiple of FY20E EBITDA. Key risks include changes in government regulation, strong rupee or global slowdown.

Bloomberg:	OPI: IN
52-week range (INR):	25/65
Share in issue (cr):	21.2
M cap (INR cr):	848
Avg. Daily Vol. BSE/NSE :('000):	55/522
Promoter Holding (%)	38.52

Year to March	FY16	FY17	FY18	FY19E	FY20E
Revenues (INR Cr)	519	511	661	692	773
Rev growth (%)	9.6	(1.4)	29.3	4.7	11.7
EBITDA (INR Cr)	22	32	112	131	160
Net Profit (INR Cr)	(8)	11	49	71	88
P/E (x)	NA	67.9	15.0	10.4	8.4
EV/EBITDA (x)	NA	29.0	7.4	6.0	4.6
RoACE (%)	NA	1.4	17.5	20.3	26.9
RoAE (%)	NA	3.7	14.2	16.7	18.5

Date: 6th August, 2018

During FY18-FY20E, OPIL's PAT is expected to grow by 34% CAGR mainly driven by ramping up of capacity of new tissue paper facility, improvement in operating margin due to favorable industry environment & improved product-mix and reduction of interest cost due to sharp reduction in debt.

PAT growth will be mainly driven by ramping up of new tissue paper facility in a favorable market environment and reduction in interest cost

	FY17	FY18	FY19E	FY20E
Revenue	511	661	692	773
EBITDA	32	112	131	160
EBITDA Margin	6.2	16.9	18.9	20.7
PAT	11	49	71	88

OPIL's balance sheet to remain healthy, despite implementation of recent capex announcement

	FY17	FY18	FY19E	FY20E
Gross Debt to Equity (x)	0.63	0.23	0.16	0.11
Net Debt to Equity (x)	0.60	0.21	0.10	(0.02)

We recommend a 'Tactical BUY' with target price of INR 51/share, valuing the stock at 6x on FY20 EBITDA estimates

	EV/EBITDA Multiple	Price Target
OPIL	6x	51

Entry = INR 40

+

OPIL to benefit due to ramping up of capacity in a favourable market environment + strong balance sheet provides future growth opportunities in a niche growing tissue paper segment

Total Return of 27%

Price Target	**INR 51**	Overall capacity utilisation of 88% in FY19 (vs 86% in FY18) and 94% in FY20; an average price hike of 4% p.a.; EBITDA margin of 18.9% for FY19 & 20.7% for FY20 and applying an EV/EBITDA multiple of 6x
Bull	**INR 65**	Overall capacity utilization of 90% in FY19 and 97% in FY20; an average price hike of 6% p.a.; EBITDA margin of 19.5% for FY19 & 21.4% for FY20 and applying an EV/EBITDA multiple of 7x
Base	**INR 50**	Overall capacity utilization of 88% in FY19 and 94% in FY20; an average price hike of 4% p.a.; EBITDA margin of 18.9% for FY19 & 20.7% for FY20 and applying an EV/EBITDA multiple of 6x
Bear	**INR 35**	Overall capacity utilization of 86% in FY19 and 91% in FY20; an average price hike of 2% p.a.; EBITDA margin of 18% for FY19 & FY20 and applying an EV/EBITDA multiple of 5x

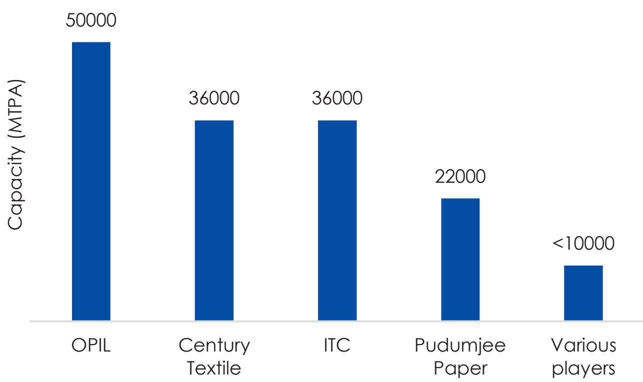
Average Daily Turnover (INR cr)			Stock Price Return (%)				Nifty Return (%)			
1 months	3 months	5 months	1 month	3 months	5 months	7 months	1 month	3 months	5 months	10 months
2.48	1.67	1.39	23	(12)	(10)	(29)	6	6	9	7

Business Value Drivers

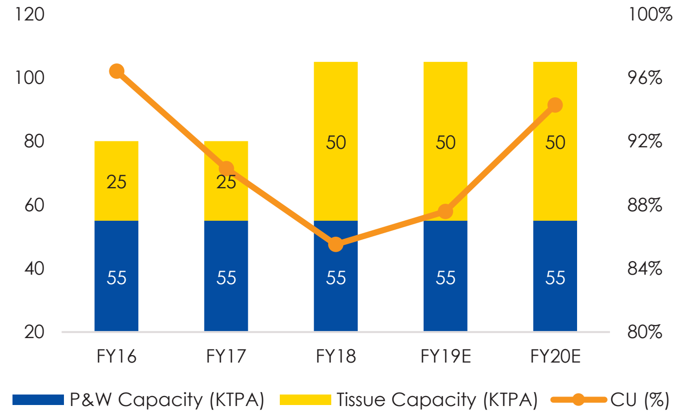
Nature of Industry	The Indian paper industry can be categorised into four segments: printing & writing (P&W), newsprint, paperboard (packaging paper) and tissue paper. Paper can be produced using three raw-materials: wood/bamboo, agro residues and recycled paper. Paper produced out of virgin pulp (i.e. wood/bamboo and agri residues) earns higher operating margin than paper produced from recycled paper due to capital intensive nature of operations and highly fragmented structure of recycled paper industry. OPIL has a presence in virgin-pulp based P&W and Tissue paper products.
Opportunity Size	The Indian Paper Industry demand was estimated to be 17 MT in FY17; which is projected to grow at a 6.3% CAGR to 21.7 MT by FY21. OPIL is present in P&W and tissue paper segment. P&W segment is growing at a rate of 4-5% p.a. and the tissue paper is growing at a rate of ~12% p.a. OPIL is the largest player in the Indian tissue paper segment. The company has an edge over its peers in the domestic tissue paper segment due to its first mover advantage. We believe OPIL would be a key beneficiary of the rising demand in the domestic & export market.
Capital Allocation	OPIL has been prudent in capital allocation. The management considers pulp a key raw-material and intends to further expand operations in the wood-based tissue paper segment, which generates significantly a higher realization (at INR 67/t) vs other paper products (INR 35-60/t).
Predictability	OPIL's operating performance is linked to global pulp prices and movement in the rupee. Its operating profit is expected to remain healthy over the medium-term due to the ramping up of its new tissue paper capacity (commissioned in May 2017) in a favourable market environment over the next 2 years, and also due to the benefits of operating leverage.
Sustainability	The global paper industry is cyclical in nature, but we believe the industry's fundamental would remain strong over the medium-term on expectations of tight global pulp supplies over the next 2-3 years due to growing global demand vs limited capacity additions.
Disproportionate Future	OPIL can hit a high growth trajectory in case of better-than-expected ramping up of new tissue paper facility and/or if the Indian govt. imposes anti-dumping duty (ADD) on uncoated paper in FY19. The govt. has initiated investigation on imposition of ADD on uncoated paper in Nov 2017.
Business Strategy & Planned Initiatives	OPIL plans to enhance its pulp capacity from 72.5 ktpa to 100 ktpa to eliminate its reliance on market pulp at a cost of INR 75 crore and setting up of new recovery boiler at a cost of INR 150 crore. The project is expected to be funded out of divestment of investments in shares of CTIL and internal accrual. The project is expected to be completed by September 2020.
Near Term Visibility	OPIL's EPS is expected to rise at a 34% CAGR during FY18-20E mainly due to the a) ramping up of its tissue paper capacity in a favourable market environment, and b) benefit of operating leverage.
Long Term Visibility	OPIL's strong balance sheet position provides avenues for growth over the next 3-5 years.

Focus charts – Story in a nutshell

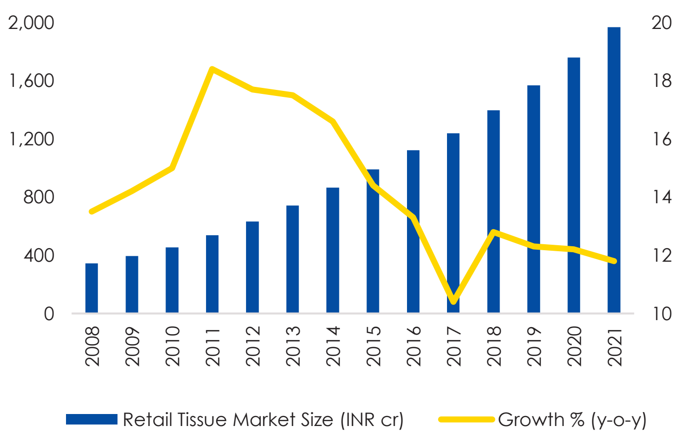
OPIL is the largest tissue paper manufacturer in India



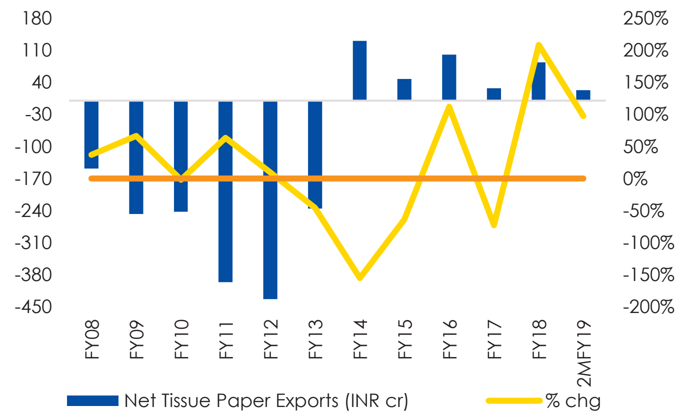
Rising tissue paper demand to improve capacity utilisation



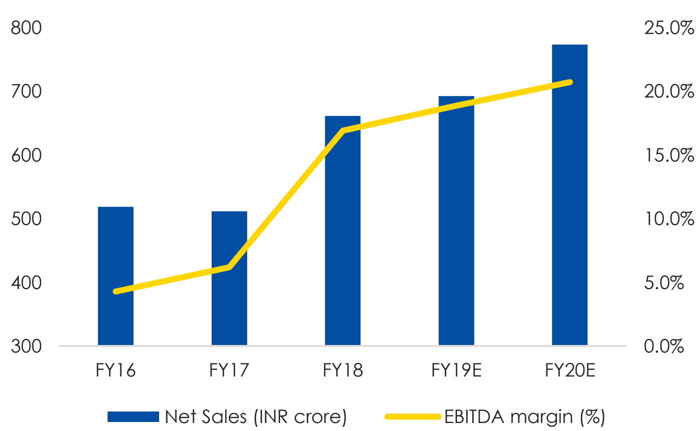
Indian retail tissue paper market to grow at 12% CAGR to ~INR 2000 crore by FY21 on rising disposable income and hygiene awareness



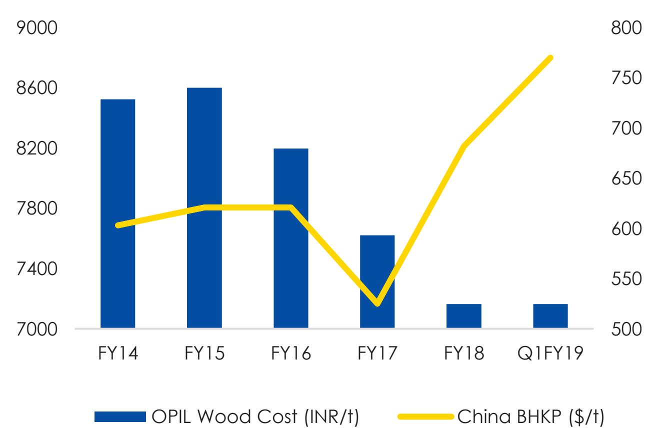
Indian tissue paper net exports grew by 208% in FY18 and 98% in 2MFY19 due to rising global pulp prices & weak rupee



OPIL's EBITDA projected to grow at 19.6% CAGR during FY18-FY20..

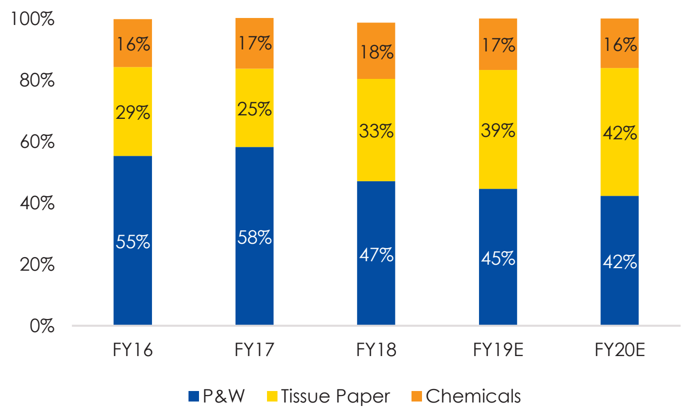


..due to weak domestic wood price vs rising global pulp price..

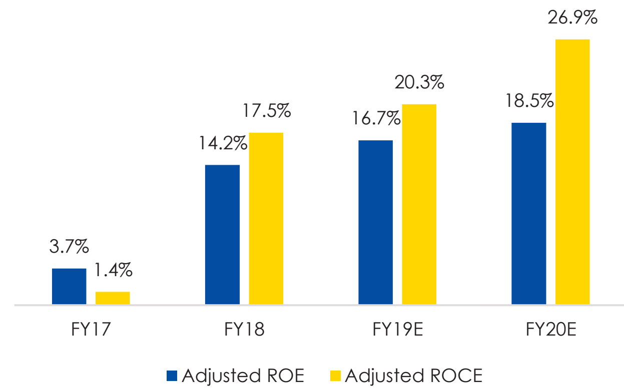


Source: Ministry of Commerce, Company, Edelweiss Investment Research

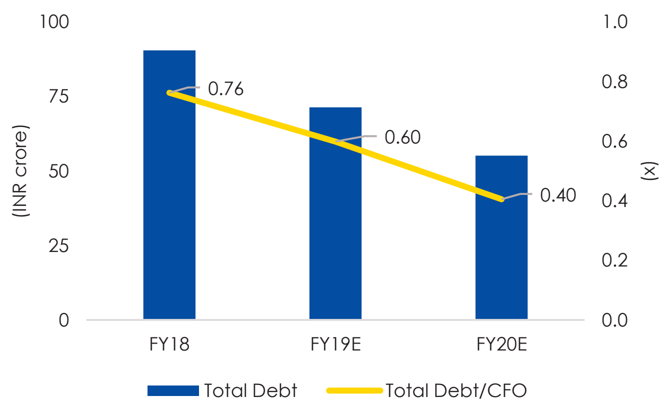
..and improving mix of high-margin tissue paper sales..



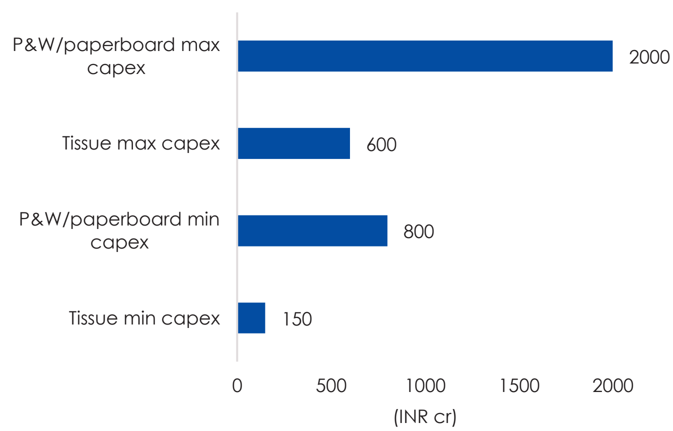
ROCE (excl. revaluation) to improve by 9.4% to 26.9% by FY20



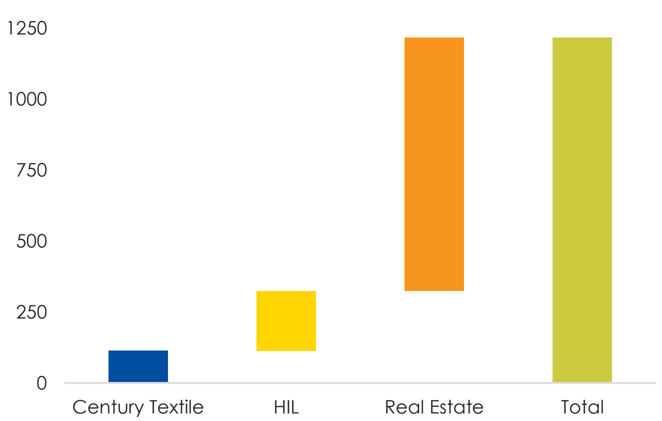
OPIL's gross debt to CFO is <1x in FY18, which indicates healthy balance sheet position



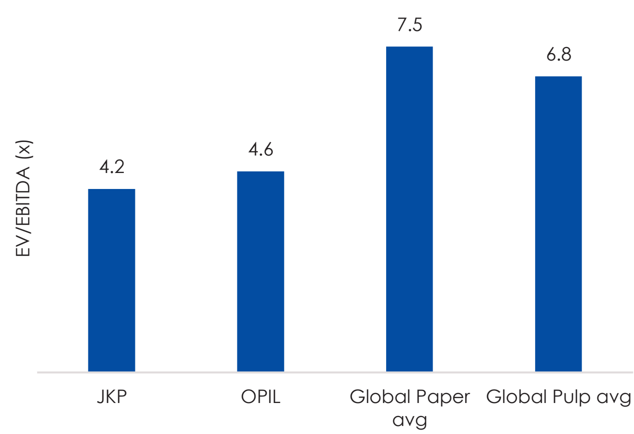
B/S to remain healthy even OPIL proposes to enhance its tissue paper capacity due to strong CFO & low capex in tissue paper



OPIL's investment in equity shares of Century Textile & HIL Ltd and real estate worth (~INR 1224 cr) > current market cap (INR 848 cr)



OPIL is available at an attractive valuation compared to its peers



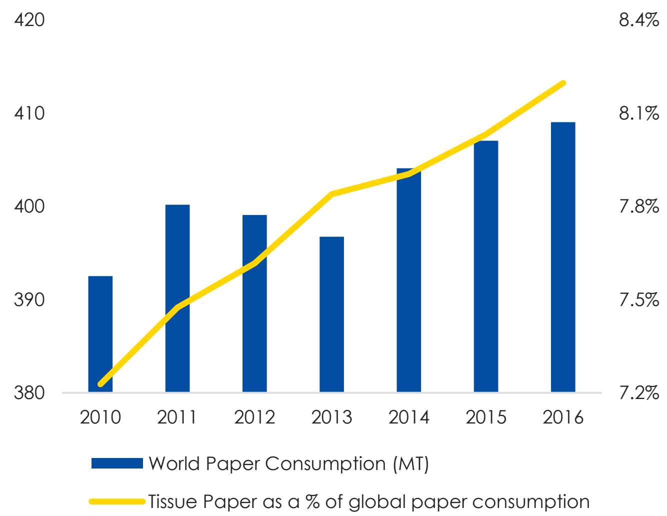
Source: Bloomberg, Company, Edelweiss Investment Research

I. India to play a key role in Global Tissue Paper industry due to rising domestic demand and growing exports

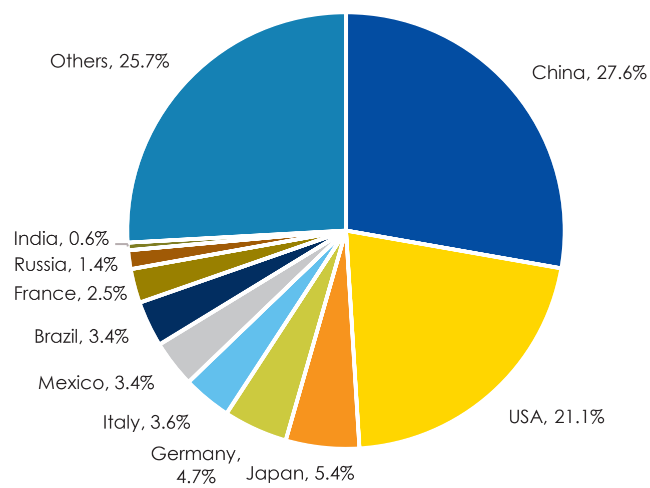
Tissue paper share as a % of global paper demand rises from 7.2% in 2010 to 8.2% in 2016

Tissue paper is consumed in the form of toilet paper, facial tissues, towels, etc. The demand for tissue paper as a proportion of global demand for paper grew from 7.2% in 2010 to 8.2% in 2016 as tissue paper is the fastest growing segment in the world paper industry. According to industry experts, the global demand for tissue paper is projected to grow at 3.2% against 1% growth for global paper demand during FY17-FY21. Top 5 countries accounted for 62.4% of the global tissue paper demand in 2016. Meanwhile, India is the world's second largest populated country (account for 17.5% of global population) and consumes ~0.6% of global tissue paper.

Tissue paper share as a % global paper demand rises from 7.2% in 2010 to 8.2% in 2016



India accounted for 17.5% of global population in 2017, but accounts for only 0.6% of global tissue paper demand

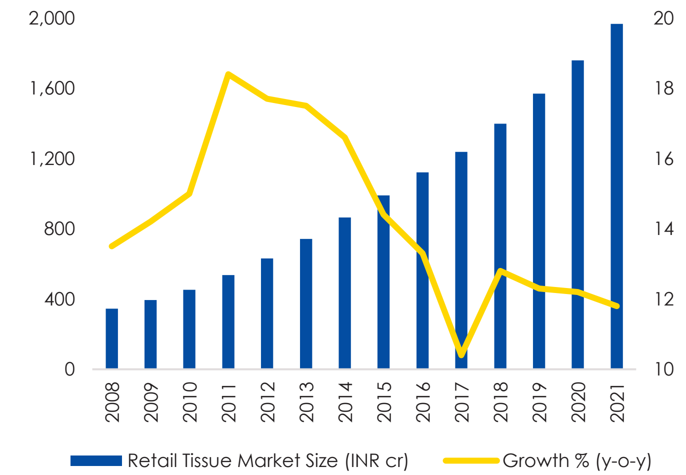


Source: FAO, IMF, Edelweiss Investment Research

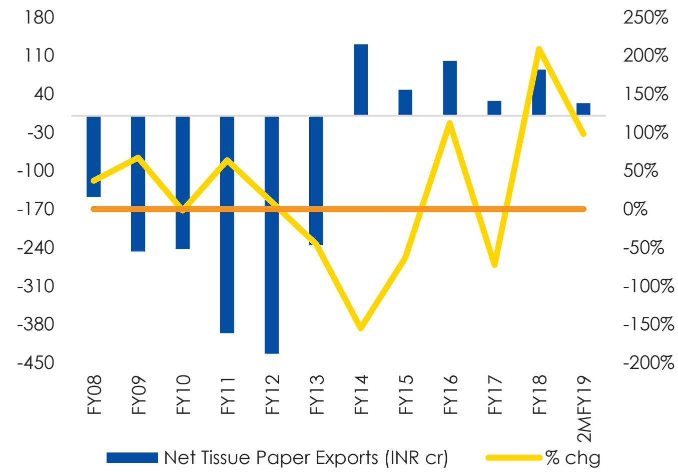
India's role in global tissue to increase on rising domestic demand and increasing exports

According to OPIL management, India's tissue paper demand is estimated to be around 150 ktpa in FY18. The tissue paper demand in India is projected to grow at a rate of 7-8% p.a. (in volume terms) due to improving domestic demand. Per capita consumption of tissue paper in India (at 0.14 kg) is well below that of emerging economies (Russia – 3.2 kg, South Africa – 4 kg and Brazil – 5.4 kg). Given the expectation of rising disposable income and an increasing hygiene awareness, the domestic demand for tissue paper is expected to remain buoyant over the long-term. India is also a net exporter of tissue paper and OPIL is the largest exporter of tissue paper in India (with a 44% share in tissue paper exports from India in FY18). Tissue paper net exports grew 208% y-o-y in FY18 and 98% in 2MFY19 as the sharp increase in global pulp prices and weak domestic wood prices improved the competitive position of quality tissue paper manufacturers in India. OPIL's tissue paper exports volume also grew sharply by 57% y-o-y in FY18.

Indian retail tissue paper market size to grow at 12% CAGR to ~INR 2000 crore by FY21



India tissue paper net exports grew by 208% in FY18 and 98% in 2MFY19 due to rising global pulp prices

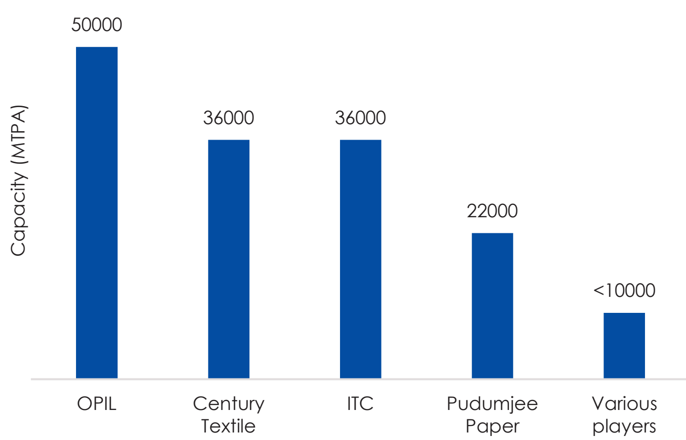


Source: Ministry of Commerce, Edelweiss Investment Research

Indian tissue paper is concentrated in nature due to small size & difficulty in scaling up operations

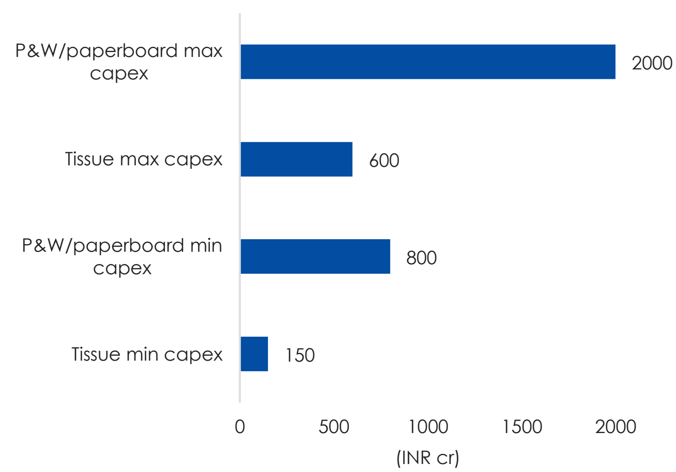
The tissue paper industry in India is highly concentrated due to the necessity of setting up small-sized facilities and the intense efforts required in scaling up operations as tissue paper products are mainly consumed in small quantities. According to a leading global tissue paper machinery provider, Valmet, typical capacity of a tissue paper facility is 15-60 ktpa vs 150-200 ktpa for P&W and paperboard segments. Thus, most key domestic paper manufacturers (such as TNPL, JK Paper, WCPM, SSPB, IP APPM, Trident) are yet to enter this segment. In the organized segment, the tissue paper market is mainly dominated by few players. OPIL is the largest player in tissue paper segment in India (50 ktpa capacity), followed by Century Textile & Industries Ltd (36 ktpa), ITC (36 ktpa) and Pudumjee Paper Products Ltd (22 ktpa).

Indian tissue paper industry is concentrated in nature..



Source: Edelweiss Investment Research

..due to small size & difficulty in scaling up operations



Source: Valmet, Edelweiss Investment Research

OPIL is the largest player in Indian Tissue paper segment due to edge over peers

OPIL is the first domestic paper company to venture into manufacturing tissue paper in India in 1997. Since then, it has expanded its tissue paper capacity from 10 ktpa to 25 ktpa in FY10 and then to 50 ktpa in FY18. In contrast, existing players are not able to ramp up the capacity to full level (CTIL, which is the second largest tissue paper producer, operated at 74% in FY18) and key domestic paper producers (TNPL, JK Paper, WCPM, SSPB, IP APPM and Trident) are yet to enter this segment. We believe OPIL has an edge over its peers due to its established presence in both the domestic & international markets. Furthermore, the company can generate ROCE of 20% for its new tissue paper facility due to the low capex on brownfield expansion, which is significantly superior to the ROCE (as 12-13%) generated on greenfield capex by its peers.

Particulars	Tissue Paper		P&W
ROCE comparison of brownfield vs greenfield capex	OPIL's recent Brownfield	Greenfield	Greenfield
Capex for non-integrated new tissue paper facility (INR crore)	90		
Capex for proposed pulp facility (INR crore)	75		
Capex for integrated tissue paper facility (INR crore)	165		
Tissue paper capacity (MTPA)	25000		
Capex cost (INR/tonne) – a	66000	100000	100000
Current Realization (INR/tonne)	67,000	67,000	58,000
EBITDA margin (%)	25%	25%	25%
D&A as a % of capex cost per ton (%)	5%	5%	5%
EBIT margin (%)	20%	20%	20%
EBIT (INR/tonne) – b	13,400	13,400	11,600
ROCE (%) – b/a	20.3%	13.4%	11.6%

Source: Edelweiss Investment Research

OPIL to be a key beneficiary of growing domestic tissue paper market

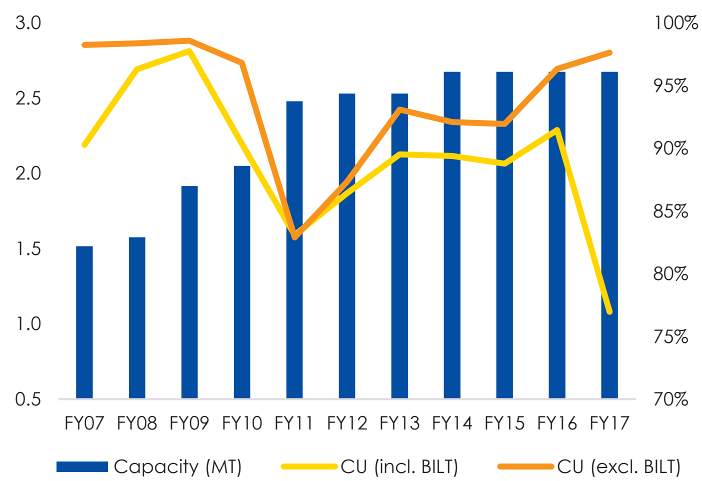
OPIL has proposed to enhance its pulp capacity from 72.5 ktpa to 100 ktpa by September 2020, which can cater to pulp requirement of paper capacity of 125-130 ktpa (as against current paper capacity of 105 ktpa). In addition, the company has surplus power capacity (16-17 MW) and huge land bank available at its existing site in Madhya Pradesh. We believe the company could plan for enhancement in tissue paper capacity by 25 ktpa once the new line (which became operation from May 2017) reaches to optimum level of production. The management expects to ramp up the capacity of new facility to 90% by the end of March 2019. Thus, we believe OPIL could be a potential beneficiary of the growing tissue paper demand in both domestic & export market.

II. Healthy profitability outlook on high global pulp prices and weak rupee

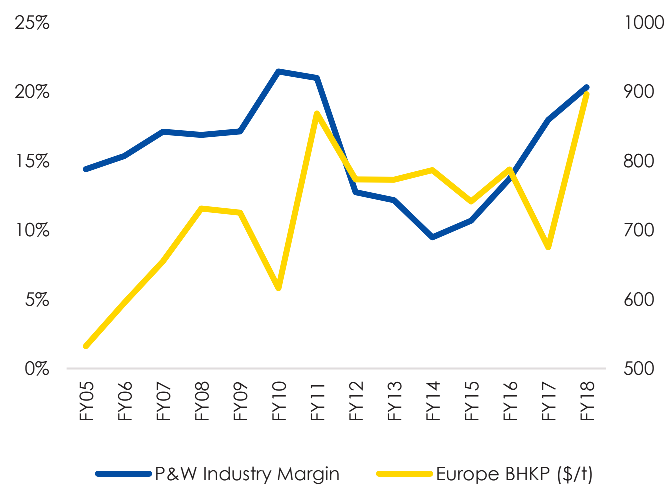
Indian Paper Industry in a sweet spot due to high global pulp prices and weak rupee

Despite a sharp increase in other input costs (i.e. chemicals and energy - which together accounts for ~25% of the cost of sales), the Indian paper industry's operating margin improved from 18% in FY17 to 20.3% in FY18 due to improving competitive position of domestic producers after global pulp prices surged by 30% vis-à-vis domestic wood prices declined by ~7%. Global pulp prices are likely to remain firm over the next 2-3 years due to incremental demand exceeding supply. This coupled with a weakening in the rupee should lead to improved realisation in FY19 & FY20. However, domestic wood/bamboo prices are expected to remain stable due to increased wood supplies on account of farm forestry drive of major domestic paper producers and bamboo's reclassification from 'forest' produce to 'non-forest' produce in Dec 2017 (which resulted in decline in bamboo imports in India by 21.8% y-o-y to INR 27.4 cr in 2MFY19). Thus, the domestic paper industry margin is projected to remain firm with a positive bias over the next 2-3 years.

Indian P&W Industry CU up from 83% in FY11 to ~100% in FY18



P&W margin trending up on tight supplies & strong pulp prices



Source: Company, Edelweiss Investment Research

Indian Paper Prices are highly correlated to global pulp prices and forex movement

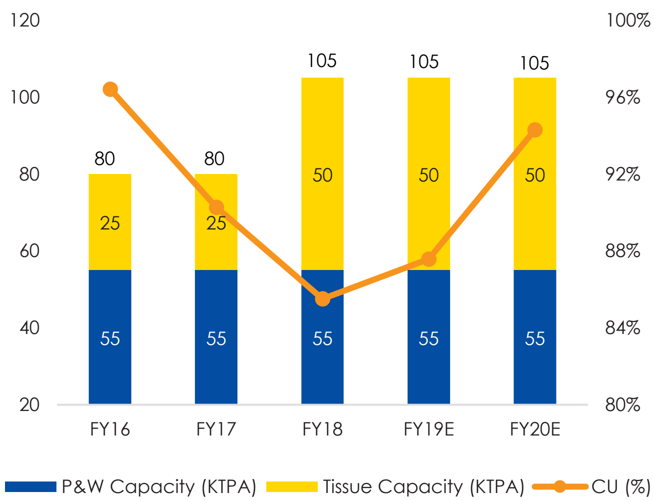
Year	Europe BHKP ($/t)	% chg	Fx (INR/USD)	% chg	JK Paper avg realisation (INR/t)	% chg	Reason for higher realisation
FY07	655	10.1%	45	2%	35.8	6.3%	Due to high pulp prices
FY08	731	11.7%	40	-11%	38.1	6.5%	Due to high pulp prices
FY09	725	-0.8%	46	14%	41.9	10.1%	Due to weak rupee
FY10	616	-15.1%	47	3%	41.7	-0.5%	Due to weak pulp prices
FY11	869	41.1%	46	-4%	46.1	10.5%	Due to high pulp prices
FY12	773	-11.0%	48	5%	47.8	3.8%	-
FY13	773	0.0%	54	14%	50.0	4.6%	Due to weak rupee
FY14	787	1.8%	60	11%	53.6	7.1%	Due to weak rupee
FY15	741	-5.8%	61	1%	53.7	0.1%	Due to weak pulp prices
FY16	788	6.3%	65	7%	52.6	-1.9%	Flat realization due to weak pulp prices and strong dollar
FY17	675	-14.3%	67	2%	54.0	2.5%	
FY18	896	32.8%	64	-4%	56.1	3.8%	Due to high pulp prices
Q1FY19	1050	17.1%	69	6%	58.5	3.9%	Due to high pulp prices & weak INR

Source: Edelweiss Investment Research

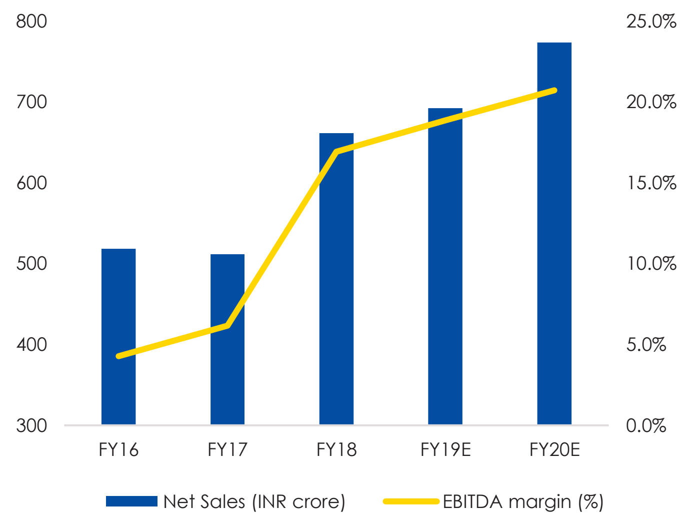
OPIL to benefit from timely enhancement in tissue paper capacity in a favourable environment
We believe the company that can add capacity and source pulp from the domestic market stands to gain the most in this favourable environment. While almost all domestic paper manufacturers are operating at full capacity, OPIL stands to gain the most due to the timely enhancement of its tissue paper capacity from 25 ktpa to 50 ktpa in May 2017 and its low dependency on market pulp (<10%) for its current paper manufacturing operations. OPIL plans to increase its pulp capacity from 72,500 MTPA to 100,000 MTPA by Sep 2020, which will completely reduce its reliance on market pulp over the long-term.

OPIL's revenue to rise at 8.1% CAGR over FY18-20 on ramp up of new tissue paper capacity
OPIL's revenue grew by 29.3% y-o-y to INR 661 crore in FY18 due to higher sales volumes (+22.7%) and improved realization. The performance also improved due to sharp increase in caustic soda prices (grew by >30% in FY18) on the back of shutdown of plants based on mercury process in the EU and environmental restrictions in China. Chemical segment accounted for 18% of revenue in FY18. Going ahead, OPIL's revenue is projected to increase at 8.1% CAGR by FY20 in anticipation of better utilisation of the new tissue paper facility (CU to improve from 69% in FY18 to 90% in FY20) and improved pricing environment arising from strong global pulp prices & a weak rupee.

OPIL's CU to improve from 86% in FY18 to 97% in FY20



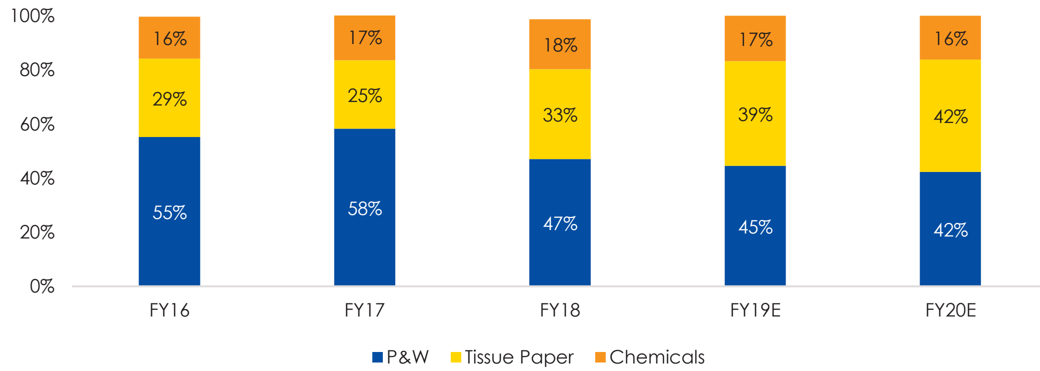
OPIL's revenue to grow at 8.5% CAGR during FY18-20



Source: Company, Edelweiss Investment Research

Operating margin up from 6.2% in FY17 to 16.9% in FY18; projected to improve to 20.7% in FY20
OPIL's operating margin improved significantly from 6.2% in FY17 to 16.9% in FY18 due to a) benefit of a sharp increase in global pulp prices (+33%) and a decline in domestic wood prices (-7%); b) better product-mix (tissue paper revenue share rose from 25% in FY17 to 33% in FY18); c) improved profitability of the chemical segment (which makes for ~18% of the total revenue) due to a surge in caustic soda prices; and d) better absorption of fixed cost overhead. The company's operating margin is projected to further improve to 20.7% in FY20 in anticipation of favourable pricing environment to persist over the next 2-3 years due to strong global pulp prices & a weak rupee vis-à-vis stable raw-material prices and an improvement in product-mix (tissue paper share to rise to 42% in FY20). In Q1FY19, global players have taken a price hike of 6-8% for P&W products and 9-12% for tissue paper. However, we have conservatively assumed a 4% price hike for paper segment in FY19 & FY20, which provides scope for margin expansion in the future.

Tissue paper revenue share to rise from 33% in FY18 to 42% in FY20



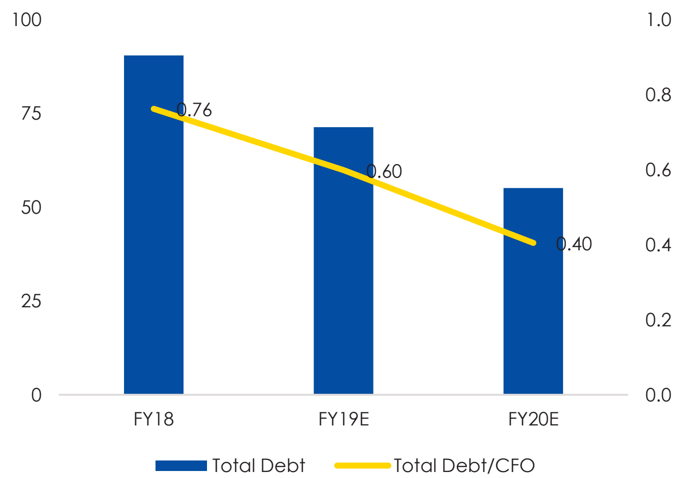
Source: Company, Edelweiss Investment Research

III. Strong B/S position provides avenues for future growth opportunities

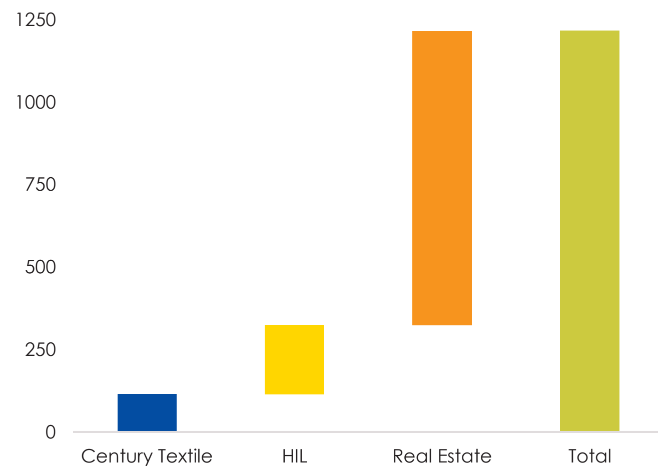
Strong balance sheet position provides avenues for future growth opportunities

OPIL has a strong balance sheet position, with gross debt of INR 69 crore in June'18 vs an expected annual cash flow from operation of INR 119-136 crore in FY19 & FY20. Further, it holds investments worth ~INR 332 crore in the form of equity shares of HIL Ltd (INR 218 crore) & CTIL (INR 115 crore). The management intends to divest the entire stake in CTIL in the near-term, which would further improve the company's liquidity position. Also, it holds land bank and real estate properties worth around INR 900 crore as against its current market capitalization of INR 784 crore. OPIL has the best credit rating [at CARE AA- (Stable)/ CARE A1+] in the entire paper industry, which indicates quite healthy financial risk profile.

OPIL's gross debt to cash profit in FY18 is <1x, which indicates healthy B/S position



OPIL's investment in equity shares of Century Textile & HIL Ltd and real estate worth > current market capitalization



Source: Company, Edelweiss Investment Research

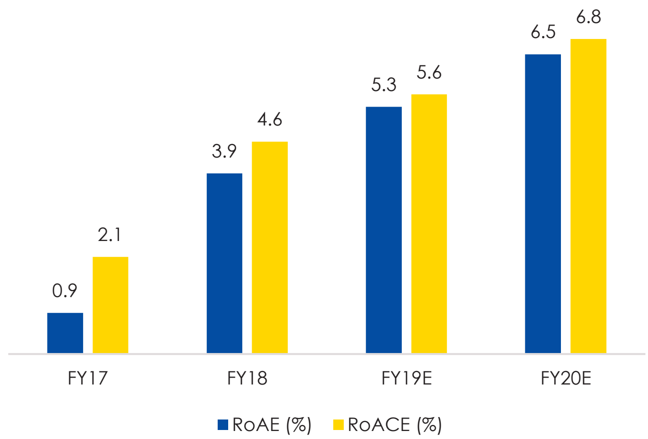
Balance Sheet to remain highly comfortable, despite implementation of recent capex plan

OPIL has a strong balance sheet position, with gross debt of only INR 69 crore in June'18 vs expected CFO of INR 119 crore in FY19. The company has recently announced its plan to enhance pulp capacity from 72.5 ktpa to 100 ktpa to eliminate its reliance on market pulp at a cost of ~INR 75 crore and setting up of new recovery boiler at a cost of ~INR 150 crore. The project is proposed to be completed by September 2020. We believe the balance sheet to remain light in the future as the proposed capex will be funded out of internal accruals and/or divestment of equity stake in CTIL. The management has already intended to divest investment in CTIL in the near-future.

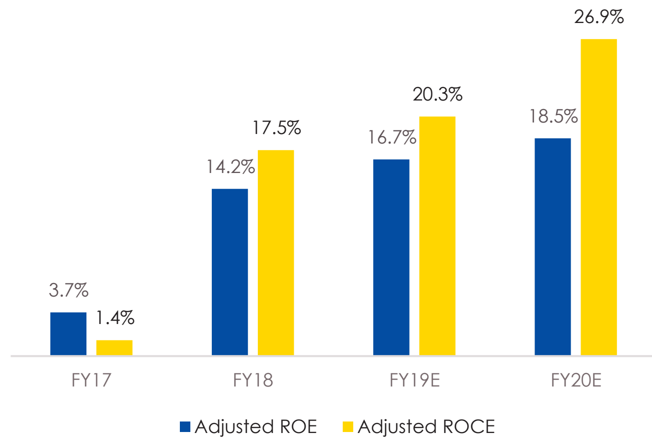
Adjusted ROCE to improve from 17.5% in FY18 to 26.9% in FY20

OPIL's return ratios profile prima facia looks poor (ROE of 3.9% and ROCE of 4.6% in FY18) due to revaluation of assets & investments post demerger of electric business w.e.f March 1, 2017. Excluding the impact of revaluation, ROE (14.2%) and ROCE (17.5%) stood at comfortable level in FY18. Furthermore, adjusted ROCE is projected to improve from 17.5% in FY18 to 26.9% in FY20 mainly due to optimal utilization of its existing facility and improvement in operating margin.

Return ratios profile look weak due to revaluation of assets & investments post demerger of electrical business in Jan 2018..



..adjusted return ratios (excl revaluation) was at healthy level and projected to improve significantly over the next two years



Source: Edelweiss Investment Research

II. Valuation and Key Risks

We are initiating coverage on OPIL with a 'Tactical Buy' rating and a TP of INR 51 per share, which offers a 27% upside potential to investors. Our TP is based on a 6x multiple of FY20 EBITDA estimates, which is relatively in-line with the industry's long-term average historical multiple of 6x. After deducting 50% of market value of investment in equity shares of HIL Ltd of ~INR 218 crore, the company is currently trading at 4.6x of FY20 EBITDA estimates. Given the expectation of strong free cash flow generation, improving & healthy return ratios and huge potential to expand the tissue business in India, we believe OPIL should trade at least in-line with the industry's avg levels.

Calculation of Target price based on EV/EBITDA methodology

Particulars	Current Market Value (INR cr)	Discount Factor	Amount (INR cr)
FY20 EBITDA estimate			160
Industry average EV/EBITDA multiple			6
Enterprise Value			**961**
Less: Net Debt			-10
Add: Equity Investments in HIL Ltd	210	50%	105
Equity Value			**1076**
No. of shares			21.2
Target Price (INR/share)			**51**

Relative Valuation

Name	Currency	Sales (in crore)			EBITDA margin (%)			P/E			EV/EBITDA			Net Debt/EBITDA			ROE (%)		
		FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
Global Pulp Companies																			
Fibria	Brazilian Real	1174	1812	1906	38.1	50.3	50.4	28.9	10.7	8.8	7.4	6.0	5.7	2.8	1.2	0.8	20.9	28.9	23.1
Suzano	Brazilian Real	1052	1316	1476	44.2	50.7	60.0	22.3	16.6	11.3	8.6	8.7	6.6	2.0	1.2	1.9	21.9	24.4	23.5
CMPC	Chilean Peso	514	609	628	15.2	26.7	25.9	37.7	17.4	16.4	12.6	8.1	8.1	4.2	1.7	1.5	NA	NA	NA
Average					**32.5**	**42.6**	**45.4**	**29.6**	**14.9**	**12.2**	**9.5**	**7.6**	**6.8**	**3.0**	**1.4**	**1.4**	**21.4**	**26.7**	**23.3**
Global Paper Companies																			
International Paper	USD	2174	2340	2384	13.1	18.5	19.0	11.5	10.0	9.1	9.1	7.4	7.1	3.6	2.2	1.9	29.9	25.8	26.2
Stora Enso	EUR	1005	1052	1073	13.3	18.0	17.8	12.9	11.5	11.5	10.0	7.3	7.2	1.8	1.1	0.9	15.3	14.1	13.2
UPM	EUR	1001	1044	1051	16.7	18.4	17.9	14.8	14.0	14.1	9.1	8.8	9.0	0.2	-0.2	-0.5	13.6	12.1	11.4
Sappi	Sth African Rand	530	580	615	14.7	13.6	13.9	11.7	11.7	10.3	6.1	7.1	6.5	1.7	1.9	1.8	20.0	NA	NA
Average					**14.4**	**17.1**	**17.1**	**12.7**	**11.8**	**11.2**	**8.6**	**7.7**	**7.5**	**1.8**	**1.3**	**1.0**	**19.7**	**17.3**	**16.9**
Domestic Paper Companies																			
JK Paper*	INR	2844	3135	3367	21.6	24.0	24.0	11.1	7.8	6.9	6.3	5.0	4.2	1.7	1.5	1.4	20.8	20.4	18.2
Orient Paper*	INR	661	692	773	16.9	18.9	20.7	15.0	10.4	8.4	7.4	6.0	4.6	0.8	0.4	-0.1	16.7	18.5	17.0
Average					**19.2**	**21.4**	**22.4**	**13.1**	**9.1**	**7.7**	**6.9**	**5.5**	**4.4**	**1.2**	**0.9**	**0.7**	**18.7**	**19.4**	**17.6**

Source: Bloomberg, *Edelweiss Investment Research

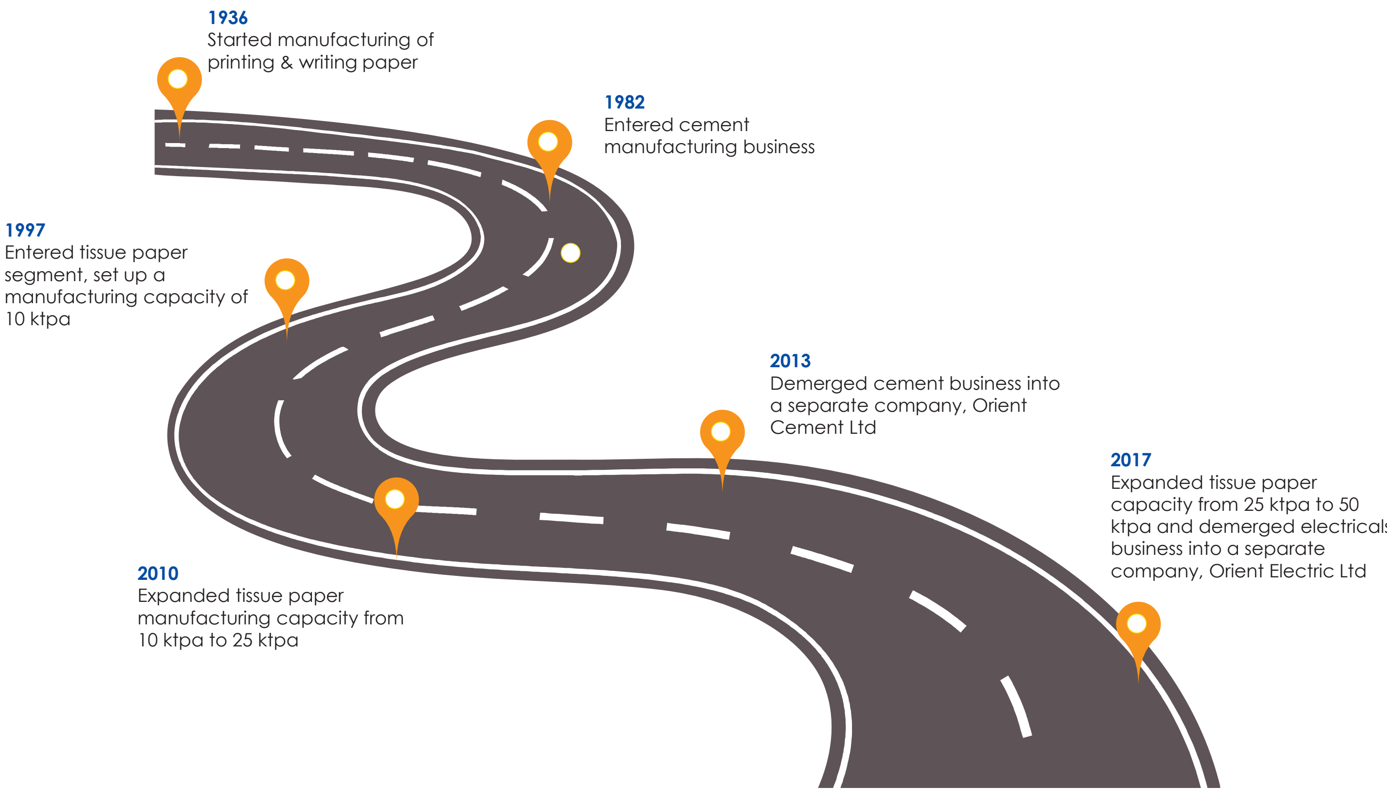
Key Risks

- Sharp rupee appreciation: may reduce the competitive advantage of domestically sourced wood vs imported pulp
- Slowdown in global economy: Global pulp & paper demand is linked to global economic activities
- Sharp increase in prices of agri commodities: Farmers may shift from wood cultivation to other crops because of improved crop economics arising from a steep increase in the prices of cash crops. Recent reports state that eucalyptus plantations help farmers earn 60-70% more than other crops.
- Government regulations: Unfavourable changes in duty structure, restrictions on water usage, etc may hit the domestic paper industry.

VI. Key Management

Name	Designation	Profile
Mr. C. K. Birla	*Chairman, Promoter*	Mr. Chandra Kant Birla, B.A., is an industrialist with rich experience. He is associated with various group companies (Orient Cement Ltd, HIL Ltd, National Engineering Ind. Ltd., etc).
Mr. M. L. Pachisia	*Managing Director*	Mr. Manohar Lal Pachisia, B.Com has been OPIL's MD and CEO since April 1991. He serves as a non-executive independent director in various CK Birla group companies.
Mr. P. K. Sonthalia	*CFO*	Mr. P. K. Sonthalia is associated with OPIL since 1980. He served as an independent non-executive director at Orient Cement Ltd until March 2013. He is a Chartered Accountant and a Cost Accountant.

Key Milestone



Business Overview

Company Brief

OPIL, incorporated in 1936, belongs to a leading business conglomerate, the CK Birla Group. OPIL is an integrated paper manufacturer with capacities of 72,500 MTPA of pulp, 55,000 MTPA of P&W paper, 50,000 MTPA of tissue paper and 55 MW of power in Amlai, MP. The company sources its entire requirement of coal from M/s. South Eastern Coalfield Ltd.

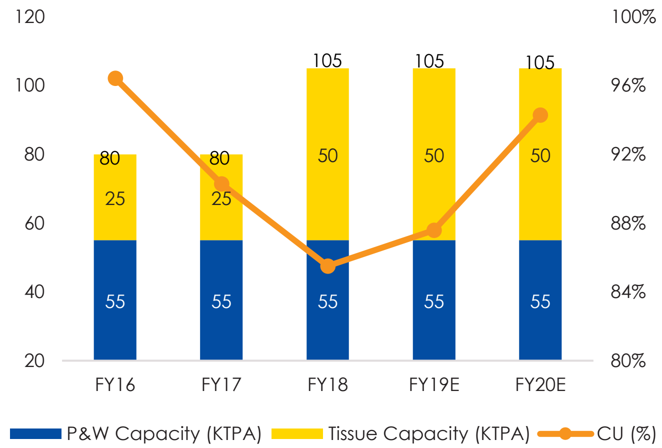
Business Model	OPIL is a leading wood-based paper manufacturer in India, with a capacity of 105 ktpa (P&W; 55 ktpa; tissue paper; 50 ktpa). The company is almost fully integrated and has low reliance on market pulp for its paper operations. The management intends to expand operation in the tissue paper segment only in the future.
Strategic Positioning	OPIL is the largest player in the domestic tissue paper segment, holding a market share of ~17% in terms of capacity. It is the largest exporter of tissue paper from India, holding a share of ~44% in total tissue paper exports from the country in FY18.
Competitive Edge	OPIL has an edge over its peers in the tissue paper segment. The company successfully expanded its tissue paper capacity from 10 ktpa to 25 ktpa in FY10 and then to 50 ktpa in FY18. Meanwhile, its peers have either not yet entered in this segment or not able to operate the existing capacity at full capacity. Thus, we believe OPIL would be the potential beneficiary of India's growing demand for tissue paper due to its first mover advantage in the segment.
Financial Structure	OPIL has a strong balance sheet position, with total debt/CFO at 0.76x in FY18. Further, the management intends to divest OPIL's entire stake in CTIL in the near-term, which would further improve the company's liquidity position. The improved balance sheet position provides room for growth opportunities. Given the lower capital expenditure involved in setting up the tissue paper facility (INR 100-200 crore) and strong annual cash generation (around INR 120-140 crore), the company's balance sheet is expected to remain healthy even after the new capex project starts.
Key Competitors	OPIL's key competitors are BILT, TNPL, Century, ITC, WCPM, SSPB, IP APPM and Trident
Industry Revenue Drivers	The rising rates of literacy rate, consumerism and economic activities are the key revenue drivers in this industry.
Shareholder Value Proposition	We are initiating coverage on OPIL with a 'Tactical Buy' rating and TP of INR 51 per share, which offers a 27% upside potential to investors. Our TP is based on a 6x multiple of FY20 EBITDA estimates, which is in-line with the industry's historical multiple. OPIL is currently trading at 4.6x of FY20 EBITDA estimates, which is arrived after deducting 50% of market value of investments in HIL Ltd worth INR 218 crore. Given the expectation of strong free cash flow generation, improving & healthy return ratios and huge potential to expand the tissue business in India, we believe OPIL should trade at least in-line with the industry historical average levels.

Financials Analysis

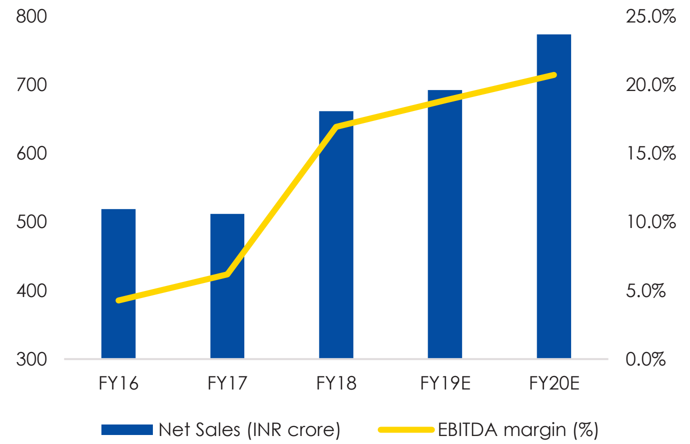
OPIL's revenue to rise at 8.1% CAGR over FY18-20 on ramp up of new tissue paper capacity

OPIL's revenue is projected to increase at 8.1% CAGR by FY20 in anticipation of better utilisation of the new tissue paper facility (CU to improve from 69% in FY18 to 90% in FY20) and improved price realisation (+4% p.a.). The tissue paper sales volumes are projected to increase by 17% in FY19 and 15% in FY20 due to rising demand in the domestic market and surging exports. Given expectation of strong pulp prices and a weak rupee environment, we project the company's realisation to grow by 4% p.a. over the next two years.

OPIL's CU to improve from 86% in FY18 to 97% in FY20



OPIL's revenue to grow at 8.5% CAGR during FY18-20

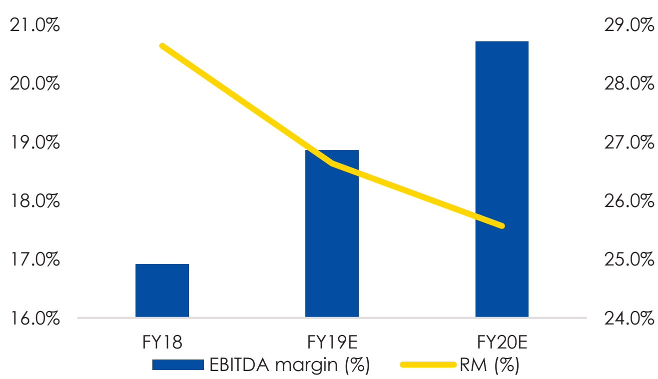


Source: Company, Edelweiss Investment Research estimates

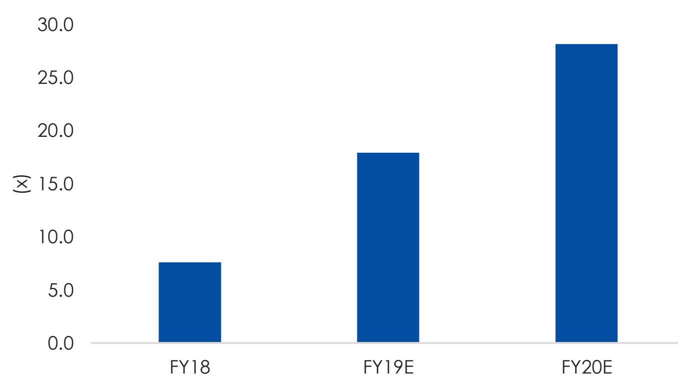
OPIL operating margin to improve from 16.9% in FY18 to 20.7% in FY20

OPIL's operating margin is projected to improve from 16.9% in FY18 to 20.7% in FY20 mainly due to improvement in gross margin (driven by better realisation and improved product-mix). The company witnessed an improvement in gross margin by 350 bps to 75.5% in Q1FY19. However, we have assumed lower gross margin of 73.4% in FY19 and 74.4% in FY20 on a conservative basis, which provides scope for improvement in operating margin in the future. Interest coverage ratio is projected to improve from 7.6x in FY18 to 28.3x in FY20 on expectation of significant improvement in operating profit and lower interest cost following gradual repayment of its term loan.

EBITDA margin to improve from 16.9% in FY20 to 20.7% in FY20



Interest coverage to improve from 7.6x in FY18 to 28.2x in FY20

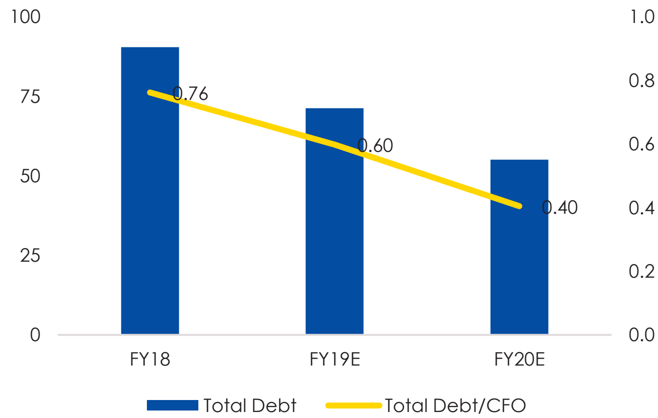


Source: Company, Edelweiss Investment Research estimates

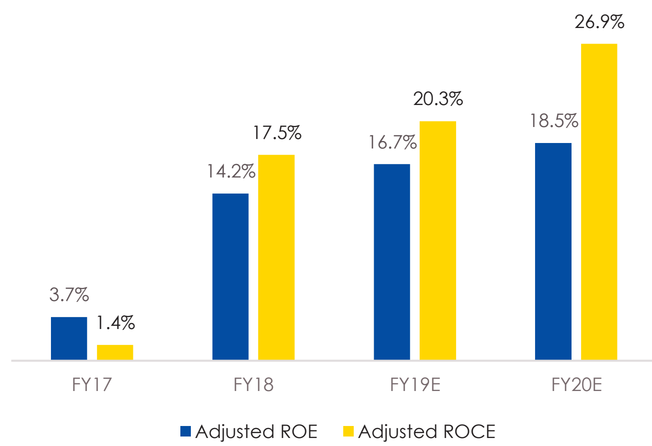
Balance Sheet to remain highly comfortable, despite implementation of recent capex plan

OPIL has a strong balance sheet position, with gross debt of only INR 69 crore in June'18 vs expected CFO of INR 119 crore in FY19. The company has recently announced its plan to enhance pulp capacity from 72.5 ktpa to 100 ktpa to eliminate its reliance on market pulp at a cost of ~INR 75 crore and setting up of new recovery boiler at a cost of ~INR 150 crore. The project is proposed to be completed by September 2020. We believe the balance sheet to remain light in the future as the proposed capex will be funded out of internal accruals and/or divestment of equity stake in CTIL. The management has already intended to divest the said investment in the near-future.

OPIL's gross debt to cash profit in FY18 is <1x, which indicates healthy B/S position



ROCE to improve from 17.5% in FY18 to 26.9% in FY20



Source: Company, Edelweiss Investment Research estimates

Adjusted ROCE to improve from 17.5% in FY18 to 26.9% in FY20

OPIL's return ratios profile prima facia looks poor (ROE of 3.9% and ROCE of 4.6% in FY18) due to revaluation of assets & investments post demerger of electric business w.e.f March 1, 2017. Excluding the impact of revaluation, ROE (14.2%) and ROCE (17.5%) stood at comfortable level in FY18. Furthermore, adjusted ROCE is projected to improve from 17.5% in FY18 to 26.9% in FY20 mainly due to optimal utilization of its existing facility and improvement in operating margin.

Orient Paper & Industries Ltd.

Financials

Income statement (Standalone) (INR cr)

Year to March	FY17	FY18	FY19E	FY20E
Income from operations	511	661	692	773
Direct costs	309	360	365	398
Employee costs	82	80	86	92
Other expenses	89	109	111	123
Total operating expenses	480	549	562	613
EBITDA	32	112	131	160
Depreciation and amortisation	25	28	31	27
EBIT	6	84	100	134
Interest expenses	21	15	7	6
Other income	20	11	14	5
Profit before tax	6	80	107	133
Provision for tax	-5	31	36	45
Core profit	11	49	71	88
Extraordinary items	0	0	0	0
Profit after tax	11	49	71	88
Minority Interest	0	0	0	0
Share from associates	0	0	0	0
Adjusted net profit	11	49	71	88
Equity shares outstanding (mn)	21	21	21	21
EPS (INR) basic	0.5	2.3	3.3	4.2
Diluted shares (Cr)	21.2	21.2	21.2	21.2
EPS (INR) fully diluted	0.5	2.3	3.3	4.2
Dividend per share	NM	1.4	1.0	1.0
Dividend payout (%)	NM	60.3	30.0	24.0

Common size metrics- as % of net revenues

Year to March	FY17	FY18	FY19E	FY20E
Operating expenses	93.8	83.1	81.1	79.3
Depreciation	4.9	4.3	4.5	3.4
Interest expenditure	4.0	2.2	1.1	0.7
EBITDA margins	6.2	16.9	18.9	20.7
Net profit margins	2.1	7.5	10.2	11.4

Growth metrics (%)

Year to March	FY17	FY18	FY19E	FY20E
Revenues	(1.4)	29.3	4.7	11.7
EBITDA	42.3	254.7	16.7	22.7
PBT	NM	1,297.9	33.0	24.9
Net profit	NM	353.2	43.6	24.9
EPS	NA	353.2	43.6	24.9

Ratios

Year to March	FY17	FY18	FY19E	FY20E
ROAE (%)	0.9	3.9	5.3	6.5
ROACE (%)	2.1	4.6	5.6	6.8
Current ratio	0.6	0.7	0.8	0.9
Debtors (days)	17	20	20	20
Inventory (days)	56	34	34	34
Payable (days)	59	38	38	38
Cash conversion cycle (days)	14	16	16	16
Debt/EBITDA	5.9	0.8	0.5	0.3
Debt/Equity	0.6	0.2	0.2	0.1
Adjusted debt/Equity	0.6	0.2	0.1	(0.0)

Valuation parameters

Year to March	FY17	FY18	FY19E	FY20E
Diluted EPS (INR)	0.5	2.3	3.3	4.2
Y-o-Y growth (%)	*NA*	*353.2*	*43.6*	*24.9*
CEPS (INR)	1.2	4.3	5.4	6.2
Diluted P/E (x)	67.9	15.0	10.4	8.4
Price/BV(x)	2.9	2.1	1.9	1.7
EV/Sales (x)	1.8	1.2	1.1	0.9
EV/EBITDA (x)	29.0	7.4	6.0	4.6
Diluted shares O/S	21.2	21.2	21.2	21.2
Basic EPS	0.5	2.3	3.3	4.2
Basic PE (x)	67.9	15.0	10.4	8.4
Dividend yield (%)	NA	3.5	2.5	2.5

Balance sheet (Standalone) INR cr

As on 31st March	FY17	FY18	FY19E	FY20E
Equity share capital	21	21	21	21
Preference Share Capital	0	0	0	0
Reserves & surplus	1,189	1,296	1,312	1,375
Shareholders funds	1,210	1,318	1,333	1,396
Borrowings	186	90	71	55
Sources of funds	**1,396**	**1,408**	**1,404**	**1,451**
Gross block	1,648	1,749	1,348	1,317
Depreciation	385	410	31	27
Net block	1,263	1,338	1,317	1,290
Capital work in progress	86	10	100	225
Total fixed assets	1,349	1,348	1,417	1,515
Investments	254	314	239	168
Inventories	78	61	64	71
Sundry debtors	24	37	39	43
Cash and equivalents	10	5	25	65
Loans and advances	2	2	2	2
Other current assets	84	42	41	43
Total current assets	199	148	170	224
Sundry creditors and others	141	130	136	152
Provisions	18	18	18	19
Total CL & provisions	159	147	154	171
Net current assets	40	0	16	53
Net Deferred tax	-248	-254	-268	-285
Uses of funds	**1,396**	**1,408**	**1,404**	**1,451**
Book value per share (INR)	57	62	63	66

Cash flow statement

Year to March	FY17	FY18	FY19E	FY20E
Net profit	-	49	71	88
Add: Depreciation	-	28	31	27
Add: Deferred tax	-	6	14	17
Add: Others	-	0	0	0
Gross cash flow	-	84	116	132
Less: Changes in W. C.	-	-35	-4	-4
Operating cash flow	-	119	119	136
Less: Capex	-	27	100	125
Free cash flow	**-**	**92**	**19**	**11**

Edelweiss Broking Limited, 1st Floor, Tower 3, Wing B, Kohinoor City Mall, Kohinoor City, Kirol Road, Kurla(W)
Board: (91-22) 4272 2200

Vinay Khattar
Head Research
vinay.khattar@edelweissfin.com

VINAY KHATTAR

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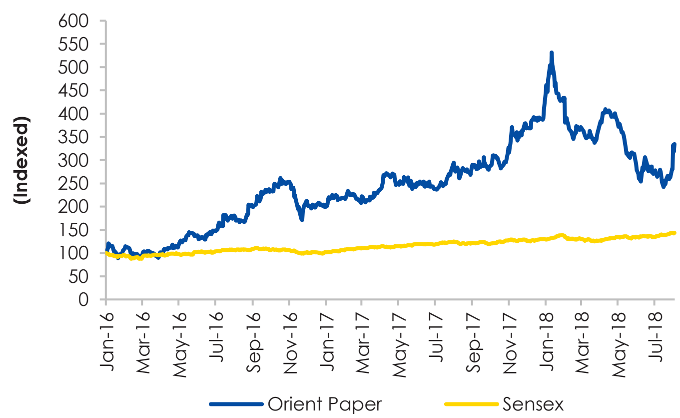
Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate between 5-15% over a 12-month period
Reduce	Return below 5% over a 12-month period



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