Twitter Thread by Raghav Chaudhary

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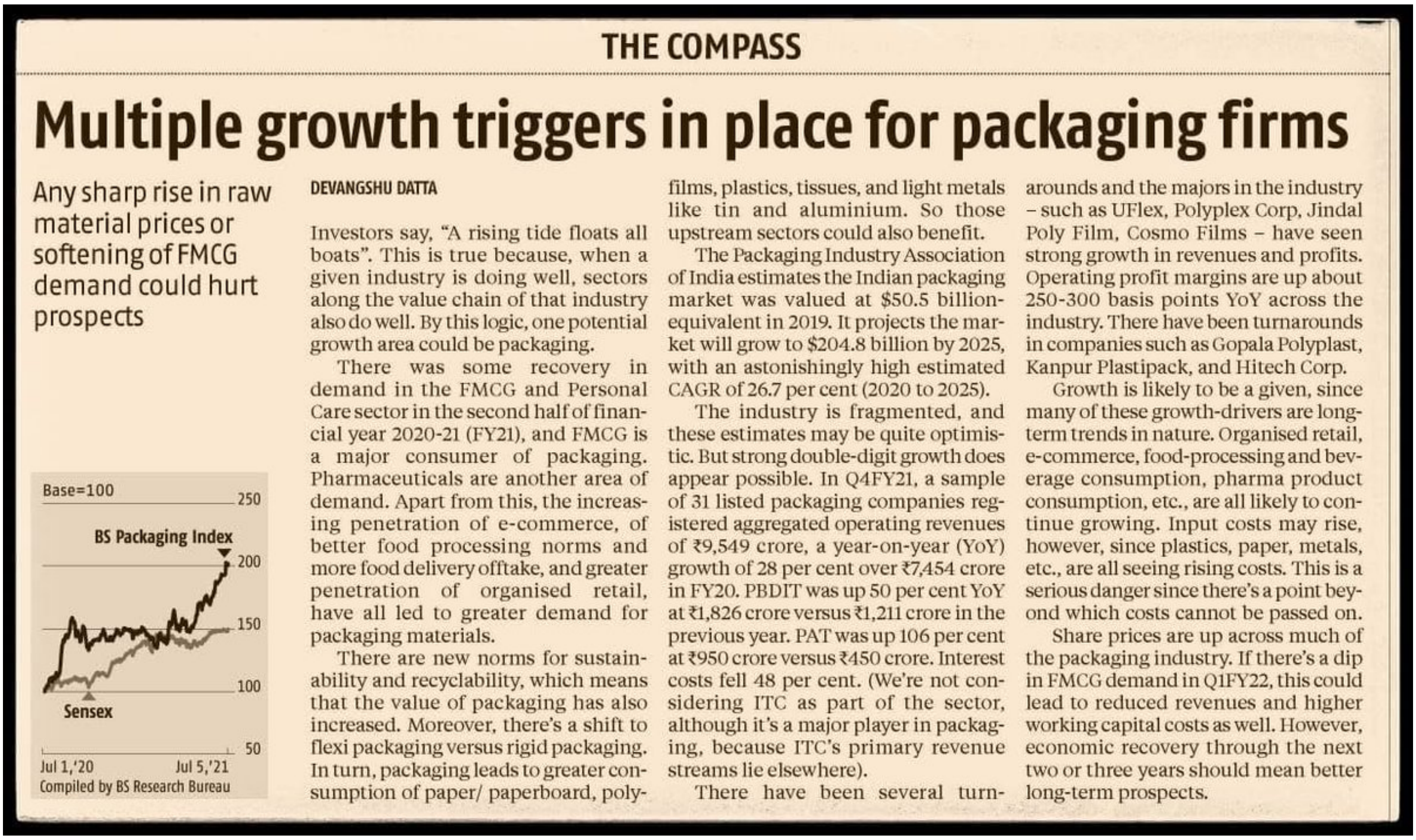
#Polyplex - New Indonesia Plant Commissioning in Q2. Valuations it should be given post a recent deal in packaging sector ? Interesting Times!



THE COMPASS

Multiple growth triggers in place for packaging firms

Any sharp rise in raw material prices or softening of FMCG demand could hurt prospects

Base=100
BS Packaging Index
Sensex
250
200
150
100
50
Jul 1,'20
Jul 5,'21
Compiled by BS Research Bureau

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Investors say, "A rising tide floats all boats". This is true because, when a given industry is doing well, sectors along the value chain of that industry also do well. By this logic, one potential growth area could be packaging.

There was some recovery in demand in the FMCG and Personal Care sector in the second half of financial year 2020-21 (FY21), and FMCG is a major consumer of packaging. Pharmaceuticals are another area of demand. Apart from this, the increasing penetration of e-commerce, of better food processing norms and more food delivery offtake, and greater penetration of organised retail, have all led to greater demand for packaging materials.

There are new norms for sustainability and recyclability, which means that the value of packaging has also increased. Moreover, there's a shift to flexi packaging versus rigid packaging. In turn, packaging leads to greater consumption of paper/ paperboard, poly-films, plastics, tissues, and light metals like tin and aluminium. So those upstream sectors could also benefit.

The Packaging Industry Association of India estimates the Indian packaging market was valued at $50.5 billion-equivalent in 2019. It projects the market will grow to $204.8 billion by 2025, with an astonishingly high estimated CAGR of 26.7 per cent (2020 to 2025).

The industry is fragmented, and these estimates may be quite optimistic. But strong double-digit growth does appear possible. In Q4FY21, a sample of 31 listed packaging companies registered aggregated operating revenues of ₹9,549 crore, a year-on-year (YoY) growth of 28 per cent over ₹7,454 crore in FY20. PBDIT was up 50 per cent YoY at ₹1,826 crore versus ₹1,211 crore in the previous year. PAT was up 106 per cent at ₹950 crore versus ₹450 crore. Interest costs fell 48 per cent. (We're not considering ITC as part of the sector, although it's a major player in packaging, because ITC's primary revenue streams lie elsewhere).

There have been several turnarounds and the majors in the industry – such as UFlex, Polyplex Corp, Jindal Poly Film, Cosmo Films – have seen strong growth in revenues and profits. Operating profit margins are up about 250-300 basis points YoY across the industry. There have been turnarounds in companies such as Gopala Polyplast, Kanpur Plastipack, and Hitech Corp.

Growth is likely to be a given, since many of these growth-drivers are long-term trends in nature. Organised retail, e-commerce, food-processing and beverage consumption, pharma product consumption, etc., are all likely to continue growing. Input costs may rise, however, since plastics, paper, metals, etc., are all seeing rising costs. This is a serious danger since there's a point beyond which costs cannot be passed on.

Share prices are up across much of the packaging industry. If there's a dip in FMCG demand in Q1FY22, this could lead to reduced revenues and higher working capital costs as well. However, economic recovery through the next two or three years should mean better long-term prospects.