**Shree Ajit Pulp and Paper Limited**

**About:** Incorporated in March 1995, Shree Ajit Pulp and Paper Limited (erstwhile M/s Shree Ajit Pulp and Paper Private Limited) is engaged in the manufacturing of different varieties of **kraft paper**, which find application in the **packaging industry**, particularly in the manufacturing of **corrugated boxes.** The company has its production facility in Vapi, Gujarat, with an installed manufacturing capacity of 108,000 metric tonne per annum (MTPA). SAPPL has installed two wind mills in Rajkot (1.50 MW, installed in FY2010) and Jamnagar (1.25 MW, installed in FY2012). The company also commissioned a 2.00-MW co-generation unit at its manufacturing unit in October 2013.

**Long track record of the company in the paper industry with an established distribution network built over the years** – SAPPL has been manufacturing kraft paper since 1995 and has developed an established presence and distribution network in the industry over the past two decades.

Furthermore, the captive power generation from the company’s co-generation unit leads to cost savings and continues to support the company’s profitability

**SAPPL’s profitability remains vulnerable to fluctuations in the prices of key input costs:** The main raw material used in the manufacturing process is waste kraft paper, which accounts for ~85% of the total raw material costs. The operating profit margins of the company remain vulnerable to fluctuations in waste paper prices.

**HIGHLY COMPETITIVE AND COMMODITIZED INDUSTRY:** The company has presence in the highly competitive kraft paper industry with stiff competition, particularly in the lower BF segment that limits the pricing flexibility of the company. Moreover, intense competition in the kraft paper segment owing to the presence of many unorganised players, results in pricing pressure and limits the company’s ability to pass on the fluctuations in raw-material prices.

**Turnover expected to increase over medium term driven by strong demand for kraft paper from end-user industry –** The uptick in turnover is due to increase in demand from the end-user industry, being e-commerce, which has pushed the average realisation per MT of kraft paper upwards. ICRA notes that the company is currently operating at high capacity-utilisation levels, which might result into higher sales for FY2021, and support the top line in the near term. \

Credit rating improved from A-(negative) to A (stable) over last 3 years.

The capex undertaken in the recent past has helped it to improve the production efficiency and support profitability margins.

**ACQUISITION OF NEW UNIT:** The objective of the acquisition is to **enhance the manufacturing capacity by acquisition of this new asset and also produce specialised higher grade Kraft paper targeted at import replacement, domestic and export market.** The new unit will have a production capacity of 82,500 MTPA after certain modification/ installation/ upgradation of equipment's at the said plant. This will help the company **to diversify their product mix into different types of higher grades of Kraft paper**. The **cost of acquisition is Rs. 99.0 crores**, plus applicable taxes and the purchase transactions is expected to be completed by March 2022. The same is expected to be funded by existing cash balance, proceeds from sale of group entity, internal accruals and external debt.

**NUMBERS**

* **SALES:**  Decent Sales growth. From 131cr in fy11 to 362cr in fy21 with the company hitting 100cr in a quarter for the first time in the sep21 quarter
* **OPERATING MARGINS:** Operating (EBIDTA) margins have fluctuated from 9% to 16% over the last 11 years with the **average being fairly stable at 13% over 5-8-11 years.**
* **DEBT:** Debt has reduced from 51cr in fy18 to 25cr in fy21. Company is currently **net debt free** (Cash and cash equivalents of 26cr.)
* **CASH FLOW:** Company has been **generating solid cash flows** for a commodity business. OCF/EBIDTA – 89% FCF/EBIDTA – 43% FCFE/EBIDTA – 27%

Company generates enough operating cash flow to easily sustain any interest payments that will required for the debt through which acquisition of new plant will happen.

* **RETURNS ON CAPITAL:** Company has been generating **robust returns on capital** indicating that it is a well run and efficiently managed business.

AVG 10 YEAR ROCE – 19% AVG 5 YEAR ROCE – 18% AVG 10 YEAR ROE – 18%

* **VALUATION:**

**CONSERVATIVE:** Ebidta margin at 13%, cost of capital at 12%. Value of the company – 432rs per share. CMP – 330 RS. UPSIDE – 30-35%

**NORMAL:** ROCE AT 18%, COC AT 12%. VALUE OF THE COMPANY – 556RS PER SHARE. CMP – 330 RS. UPSIDE – 68%

**INVESTMENT RATIONALE**

* This is first and foremost **purely a value investment**. The business is still a commodity business even though it is a well-run business.

There are certain growth drivers present as well that offer even more margin of safety and more upside on the investment (Sustained demand for corrugated boxes due to e-commerce and acquisition of new plant leading to increased capacities and potentially higher growth).

**But the growth drivers take a secondary place.** The primary earnings driver are explained below

* The earnings of the company are almost entirely driven by raw material – finished product spreads. Currently, the prices of waste paper (key raw material) are at **an all time high.** Also fuel and logistics cost are currently very high as well. This has resulted into operating margins being near their bottom levels (9-10% EBIDTA). The company has shown that it can earn 16-20% EBIDTA margins when raw material prices are at normal levels. **Given that raw material prices are at an all time high, the bet is that we are currently at cyclical low for the business and that reversion to mean will happen, resulting in profit growth and subsequently, share price growth**.
* Valuation of the company even at the most conservative end (Ebidta margins at 10% which is the cyclical low) is coming at 432rs per share. Cmp is 330rs. This means there is a 30% upside even for the worst-case scenario. The presence of growth drivers is the possible cherry on the top.
* **FINAL VERDICT : BUY. QUANTITY – 4000/5000 SHARES**