

INITIATING COVERAGE

CMP: ₹348.0/-

13th February 2017

ACCUMULATE

SECTOR: PAPER & PAPERBOARD

TAMIL NADU NEWSPRINT & PAPERS LTD.



Soaring to New Heights...

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NOTE TO INVESTORS: The recent demonetization move by the government has made a direct and indirect impact on the economy. Cash crunch in the system has slowed the manufacturing and trading sector for a while. Though the degree of impact of the same is unknown we believe that the next two quarters will be crucial. With some tepidness in demand and increase in the system inventory, we believe, there could be slower growth in H2FY17. However this does not throw India off its long-term growth trajectory; just a postponement of pent up demand. Therefore we advice clients to buy our recommendations in a staggered manner over the next two quarter in the light of unknown impacts of demonetization on the economy. We have not met the management of this company. This report has been prepared from publically available data. Since the stock is not very liquid and thinly traded, we advise investors to keep accumulating the stock around the current market price (in a range of 5-10%) with medium-to-long term investment perspective. We believe, the stock has many qualities reminiscent of a steady compounder for its investors and stakeholders.

COMPANY DETAILS

KEY STOCK DATA

CMP	₹348.0/-
Market Cap (₹ Crs)	2,415.12
52W High/Low	₹392.45/185.15
Shares o/s (Crs)	6.94
Bloomberg	TNNP.IN
NSE Code	TNPL
BSE Code	531426

SHAREHOLDING PATTERN

Promoters	35.32%
FII's & DII's	36.65%
Public & Others	28.03%

COMPANY OVERVIEW

- Tamil Nadu Newsprint & Papers Ltd.(TNPL), is a Government of Tamil Nadu Enterprise. Founded on April 16, 1979 in Chennai, the key memorandum of the enterprise was to manufacture newsprint and printing & writing paper by using bagasse as its primary raw material.
- TNPL is the largest bagasse based paper unit in India. Bagasse is an agricultural residue obtained during the manufacture of sugar at sugar mills. The company commenced production in 1984 and now has emerged as the largest bagasse based paper mill in the world consuming 1 million tones of depithed bagasse (1.40 million tones of wet whole bagasse) per annum.
- The company is in the business of manufacturing and marketing of printing & writing papers. The company discontinued newsprint production in 2009 and now manufactures only printing & writing paper.
- The company operates through the following segments: Paper, Energy and Cement.

PAPER

- Commenced commercial production in 1985 with an initial capacity of 90,000 MT.
- Second largest producer of printing and writing paper in the country.
- Largest exporter of printing and writing paper from the country. 1/5th production is exported.
- Capacity Increased to 400,000 MT in 2011.
- Set up a new green-field Multilayer Coated board plant of a capacity of 200,000MT in January 2016.

ENERGY

- Entire power requirements for the paper production plants is met through captive power plants. The company's installed capacity in this segment stands at 103.62 MW at Unit I and 30 MW at Unit II.
- Surplus power is exported to the State grid (~7 MW).
- Installed first set of wind farm of a capacity 15 MW in 1993-94. Wind farm capacity has been increased to 35.5 MW in four stages. Wind power is exported to the State grid.

CEMENT

- Set up a 600 tpd Cement plant to convert the mill wastes viz. lime sludge and fly ash into high grade cement in 2013.
- The plant capacity has been upgraded to 900 tpd in January 2016 at a capital outlay of ₹50 Cr.



BACKWARD INTEGRATION

- TNPL forayed into **plantation activity** during 2004-05; 3 years in advance of expanding the Hard wood pulp capacity from 120 tpd to 330 tpd - to augment wood pulp supplies. About 1.50 lakh MT of pulpwood (about 1/3rd of total requirement) is mobilised every year through farm forestry.
- Entire **power requirement** is met through captive power plants which have a combined capacity of 133.62 MW.

FORWARD INTEGRATION

- The Company has set up a **conversion centre** at Mayanur (38.40 acre land) at a capital outlay of ₹40 Cr.
- The company also set up a 600 tpd **Cement plant** to convert the mill wastes viz. lime sludge and fly ash into high grade cement. The Cement is sold under the brand name 'TNPL Cement' in Tamil Nadu and Kerala. The plant capacity has been upgraded to 900 tpd in January 2016 at a capital outlay of ₹50 Cr.

INVESTMENT RATIONALE

Growth Drivers

- Capacity expansion of 50% in the paper segment(paperboard) capacity to drive growth over the next two years.

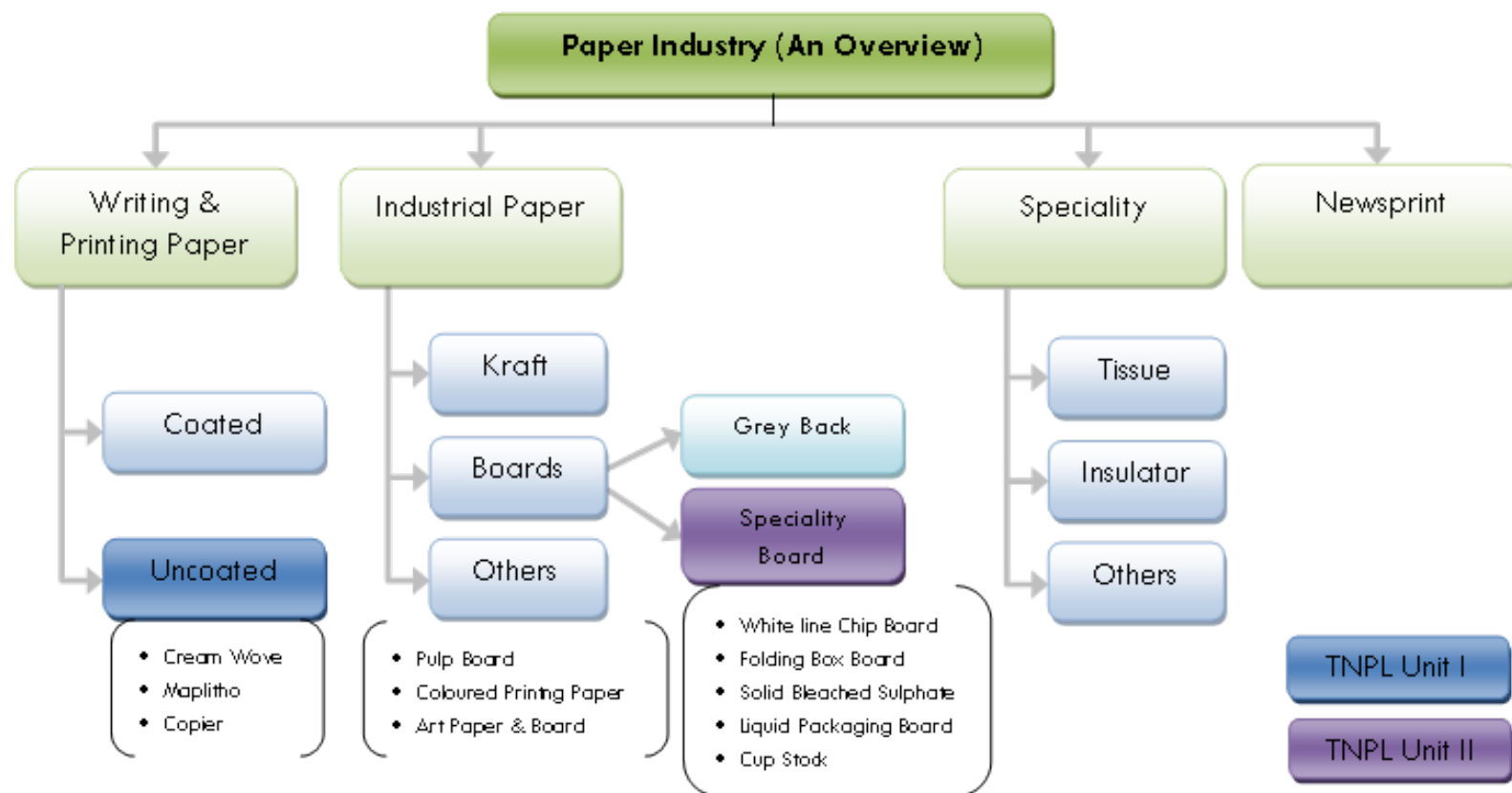
Profitability Drivers

- Integrated business model ensuing self-sufficiency and cost controls enabling it to become the lowest cost producer.
- With the ramp-up of new capacity margins to improve on as operating leverage sets in.

VALUATIONS

- The stock trades at attractive valuations of 6.2x PE & 5.2x EV/EBIDTA on its FY18 earning estimates.

- **Capacity expansion in the paperboard segment to aid topline growth over the next two years** – With the coated paperboard segment clocking 11-13% p.a. growth at the industry level, TNPL took a strategic decision to enter this segment in November 2013. At a project cost of ₹1,650crs. the scope of expansion included – One multi coated board line of 200,000 tpa along with a waste paper plant, One turbo generator 30 MW, and one cement plant with a 300 tpd capacity.



- Paperboard is growing at the fastest pace in the paper sector on account of healthy demand from the packaging sector catering to requirements from varied sectors like Pharma, FMCG, e-commerce, etc. The estimated market size for the segment is ~2.7-2.9 mn tonnes and is expected to grow at ~11-13% p.a. and to touch ~3.0-3.5 mn by FY19-20. **In November of 2013 TNPL strategically decided to enter this space to take advantage of growing demand and hence commenced investment into building capacity in this segment.**
- **In a span of 22 months (January 2016) the plant was completed. Trial production runs were undertaken from February to April 2016. The company has for the H1FY17 produced 43,575 tonnes of paperboard from the new plant hence driving 18-20% topline growth for the period. This expansion entails an ~50% expansion on the existing paper capacity which we believe can lead to a ~15-18% CAGR topline growth over the next 2-3 years. The company plans to export 15-20% of the production from the new line and has appointed export agents for the same.**

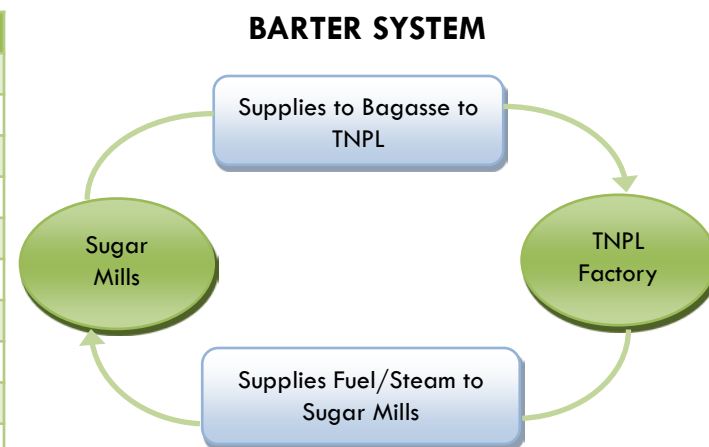
- **Intrinsically strong business model enabling it to become a lowest cost producer in its space** – Paper industry is an asset heavy business characterized by its low asset turnover. The nature of the industry is commoditised with high competitive intensity while being plagued by deficient wood-pulp supply & low import duties. Over the last few years industry players have revisited their growth strategies has have started targeting niche high growth segments such as stationary, tissue paper and packaging board paper.

Over the years TNPL has evolved from a newsprint manufacturer to a leading player in the writing & printing paper space. The company's key strengths lies in it's self sufficient business model which is well integrated both backward & forward. The key USP is it's Green Footprint which it has built into its everyday manufacturing processes. The company uses bagasse as its raw material for pulping which helps avoid cutting of trees in 35,000 acres of land per annum for paper making . Not only that bagasse is cheaper than hardwood pulp. The company has grown its pulping capabilities in-line with its paper capacity and is currently self sufficient in pulping capacity. Energy is key input for production of paper. The company has over the years built capacity to meet all its captive need. Apart from this the company is forward integrated through it's conversion centre to help in the marketing initiatives as well as waste management wherein the company utilizes the lime-sludge and fly ash to make premium grade cement.

All these initiatives have helped TNPL to enjoy the highest EBIT margins in the paper space in the industry. TNPL enjoys one of the highest margins in the paper industry. We believe on account of its lean cost model as well as operational leverage kicking in as the new plant ramps up capacity utilization, margins can expand by 100-150 bps over the next 2 – 3 years.

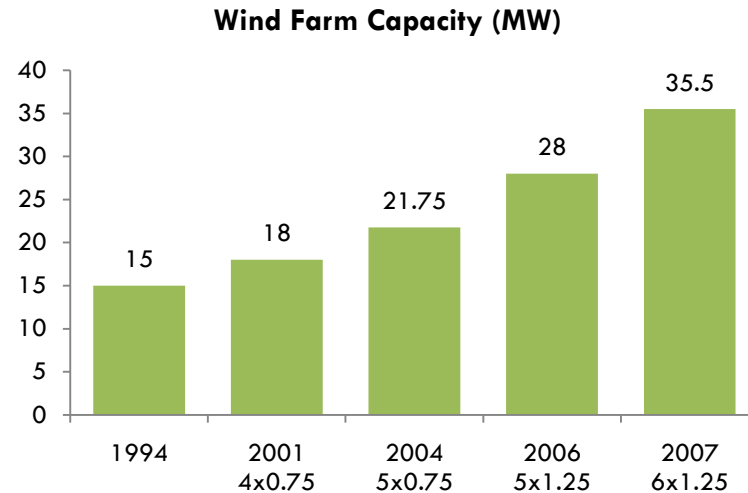
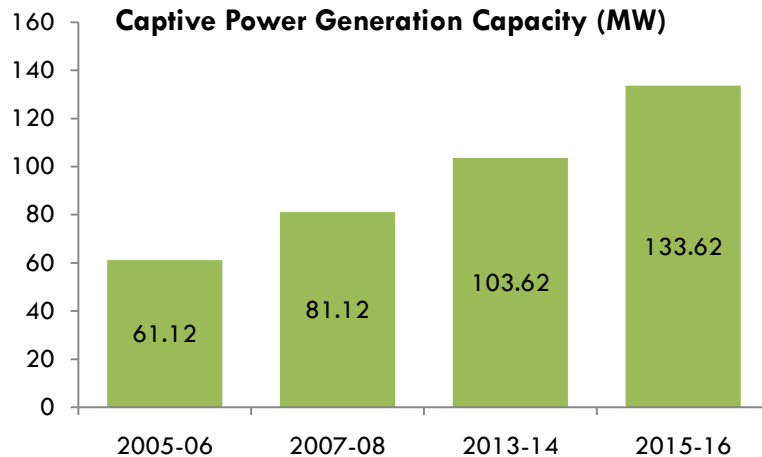
- **Self – sufficiency in raw material requirement & power requirement** – TNPL has invested in pulping capacity over the years. Hard wood and Bagasse pulping capacity increased from 275 tpd in 1985 to 880 tpd in 2010. In 2013 they set up a 300 tpd Deinking pulp plant and increased the total in-house pulping capacity to 1180 tpd in tandem with paper capacity. The company has become self sufficient in pulp and sells surplus pulp in the market.
- TNPL started plantation activity during 2004-05 i.e. 3 years in advance of expanding the Hardwood pulp capacity from 120 tpd to 330 tpd. The company has raised pulpwood plantation in over 1 lakh acres of land through Farm Forestry and Captive Plantation schemes - About 25000 farmers are covered under the above schemes in 9 districts of Tamil Nadu. About 1.50 lakh MT of pulpwood (about 1/3rd of total requirement) is mobilized every year through farm forestry.

SEGMENTS	UOM	AS OF APR 2005	AS OF DEC 2015	AS OF JAN 2016
Writing & Printing Paper	tpa	230,000	400,000	400,000
Paperboard	tpa	-	-	200,000 ↑
Pulp	tpd	480	1180	1180
Bagasse Based Pulp	tpd	360	550	550
Hardwood Pulp	tpd	120	330	330
Deinked Pulp	tpd	-	300	300
Power	MW	82.87	139.12	169.12
Captive Power Plant	MW	61.12	103.62	133.62 ↑
Wind Farm	MW	21.75	35.5	35.5
Cement	tpd	-	600	900 ↑



- TNPL is the largest bagasse based paper mill in the World. It consumes 1.40 million tonnes of wet whole bagasse per annum hence avoiding cutting of trees in 35,000 acres of land p.a. The company procures bagasse in exchange of fuel / steam through long term agreements with sugar mills. This ensures continuous availability of bagasse. Bagasse pulp has always been cheaper than hard wood pulp.

- The company's entire power requirements is met through captive power plants with a capacity of 103.62 MW in Unit I and 30 MW in Unit II. The company has 7 power boilers and 6 TGs in Unit I and 2 power boilers and 1 TG in Unit II. Both the Units are self sufficient in power. Surplus power is exported to the State grid (7 MW).



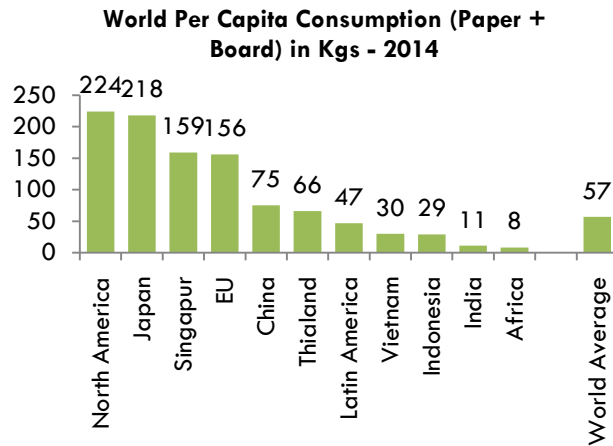
- The company installed first set of wind farm in 1993-94 with a capacity of 15 MW. Wind farm capacity has been increased to 35.5 MW in four stages. Wind power is exported to the State grid.

- **Auxiliary business segment – cement & power to aid growth** – As part of its solid wastes management initiatives, the company set up a 600 tpd cement plant in January 2013. During FY16, the company has enhanced the cement production capacity by 300 tonnes per day to 900 tonnes per day in a record time of 9 months from the date of commencement of the project activities at site. Over a span of 2 years, i.e. from FY14, the year of commencement of commercial production to FY16 sales have doubled from ₹47 crs to ₹100 crs. EBIT margins are in the range of 2.5-3%. The company has utilised its own cement for the construction of its new facility. The capacity is expected to be ramped up in the coming year.
- The company is power sufficient in its captive requirements. Of the ₹270-300 crs of gross sales ~94-95% is internally consumed and the remaining sold to the State Grid. It sells ~5-5 – 6.5crs units of power every year. With a yearly topline in the range of ₹25-30 crs this segment enjoys high margins in the range of 27% - 28%. The company commissioned a new 30 MW thermal power plant recently to meet the requirement of the new paper board capacity. The company has a 133 MW thermal power plant and a 35.5 MW wind turbine capacity. The company has received 1,06,147 Renewable Energy Certificates (RECs) for generating green power from the steam produced in the Recovery Boiler using black liquor and sold 68,496 RECs during FY16, generating revenue of ₹10.27 Crore. Balance RECs have been carried forward for sale during 2016-17.



INDUSTRY UPDATE

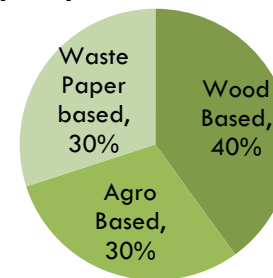
- India paper consumption is only 3% of global paper consumption while the population share is 17%. Current production is estimated at 12.75 million tonnes. Per capita consumption is about 11 kg against the World Average of 56 kg.



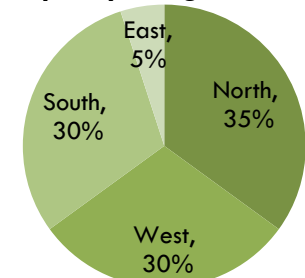
	Global - 2014			India 2014-15			India 2018-19	
Product Category	Mn Tons	% Share	CAGR Last 4 years	Mn Tons	% Share	CAGR Last 5 years	Mn Tons	CAGR Last 4 years
Coated	41.0	13.2	-2.3	0.7	4.8	6.7	0.9	7.0
Uncoated	64.0	14.2	0.0	3.8	25.9	5.6	4.8	5.7
Packaging Board	58.0	13.7	1.6	3.3	22.2	9.4	4.6	9.1
Tissue	33.0	7.7	4.2	0.1	0.6	12.0	0.2	15.5
Industrial incl. Kraft	152.0	35.7	2.8	3.9	26.5	8.0	5.5	9.0
Newsprint	27.0	8.0	-5.0	2.6	17.6	4.2	2.7	1.0
Others	33.0	7.5	1.6	0.3	2.4	7.5	0.5	8.0
Total	408.0	100.0	0.9	14.7	100.0	7.0	19.2	6.8

- There are about 700 - 800 paper mills in the country. 12 large sized paper companies account for production of about 30%.
- 40% capacity is wood based, 30% Agro residue based and 30% Waste Paper based.
- Geographical distribution: North 35%, West 30%, South 30%, East 5%.

Capacity - Raw Materialwise



Capacity - Regionwise



PEER COMPARISON, VALUATION & OUTLOOK

Company Name	Year End	Net Sales	EBIDTA	EBIDTA Margin(%)	Mcaps	EPS	ROCE (%)	RONW (%)	Price Earning (P/E)	EV/EBIDTA	Market Cap/Sales
TNPL	FY16	2417.5	579.2	24.0%	2414.3	36.7	11.8%	17.6%	9.5	8.4	1.0
JK Paper	FY16	2460.8	386.4	15.7%	1391.7	5.1	12.6%	8.2%	18.4	7.7	0.6
Ballarpur Industries	FY16	4276.8	710.6	16.6%	1075.2	-2.2	14.6%	-	-	10.0	0.3
West Coast Paper Mills	FY16	1700.0	252.8	14.9%	1048.9	1.34	8.5%	1.5%	118.5	6.6	0.6

TNPL has over the years evolved from being a newsprint paper manufacturer to a leading player in the writing & printing paper space. As can be seen from the table above, its superior operational performance is creditable to its strong business model. A leading manufacturer in the agro-based paper segment, TNPL has over the years built the largest integrated paper mill at one location & has effectively backward integrated and forward integrated enabling it to create a self-sufficient business model. The key strength of the company lies in its Bagasse procurement strategy in exchange of fuel / steam through long term agreements with sugar mills; hence ensuring continuous availability of bagasse. **The company commissioned its new paperboard plant earlier this year. This coupled with its lean cost of manufacturing will enable the company to grow at 15-18% over the next two years. In the short-term(1-2 quarters) demonitisation move may impact demand for the paperboard segment over the next 1-2 quarters as packers face a cash crunch. At the CMP of ₹348.0/- the stock is trading at attractive valuations of 8.7x & 6.4x its FY17 & FY18 estimated EPS of ₹39.9/- & ₹54.4/- respectively; ensuing the ramp up of the new capacity. We advice investors with a long-term investment horizon to ACCUMULATE the stock.**

RISKS & CONCERNS

- Weakness in demand. Short- term cash crunch at the packers level to hit demand (demonitisation) for paperboard segment for next 1-2 quarters.
- Risk of raw material availability.
- Exports to expose company to forex risk.

FINANCIALS

INCOME STATEMENT

PARTICULARS	FY15	FY16	FY17E	FY18E
Revenue From Operations(Gross)	2,235.3	2,531.5	2,859.8	3,233.3
Less: Excise Duty	99.6	114.0	140.0	160.0
Revenue From Operations(Net)	2,135.7	2,417.5	3,018.5	3,392.7
EXPENSES:				
Total Raw Material Cost	705.3	905.1	1,092.7	1,211.2
Raw Material as a % of Net Revenues	33.0%	37.4%	36.2%	35.7%
Employee Benefits Expenses	179.0	183.9	262.6	288.4
Employee Expenses as a % of Net Revenues	8.4%	7.6%	8.7%	8.5%
Other Expenses	745.8	749.3	905.6	1,000.8
Other Expenses as a % of Net Revenues	34.9%	31.0%	30.0%	29.5%
Total Expenses	1,630.0	1,838.3	2,260.9	2,500.4
EBIDTA	505.7	579.2	757.7	892.3
EBIDTA Margins	23.7%	24.0%	25.1%	26.3%
Other Income	16.6	16.8	30.0	18.0
Depreciation and Amortization Expenses	137.3	139.5	207.0	220.0
EBIT	385.1	456.5	580.7	690.3
EBIT Margins	18.0%	18.9%	19.2%	20.3%
Finance Costs	154.9	139.3	251.2	230.0
PBT	230.1	317.2	329.5	460.3
PBT Margins	10.8%	13.1%	10.9%	13.6%
Tax Expenses	63.4	63.3	52.7	82.8
Tax Rates %	27.6%	20.0%	16.0%	18.0%
Reported PAT	166.7	253.9	276.7	377.4
PAT Margins	7.8%	10.5%	9.2%	11.1%
EPS	24.0	36.6	39.9	54.4

BALANCE SHEET

PARTICULARS	FY15	FY16	FY17E	FY18E
SOURCES OF FUNDS:				
Shareholders Funds	1,201.6	1,445.6	1,677.9	1,884.2
Share Capital	69.4	69.4	69.4	69.4
Reserves & Surplus	1,132.3	1,376.2	1,608.5	1,814.8
Loan Funds	1,369.2	1,938.7	1,898.7	1,728.7
Deferred Tax Liability	359.6	375.6	360.0	360.0
Long-Term Provisions	101.3	99.8	100.0	100.0
Total Non Current Liabilities	1,830.1	2,414.1	2,358.7	2,188.7
Short-Term Borrowings	475.3	520.4	580.0	620.0
Trade Payables	550.0	585.6	614.9	645.6
Other Current Liabilities	566.0	424.0	415.5	400.0
Short-Term Provisions	74.5	98.5	95.0	100.0
Total Current Liabilities	1,665.8	1,628.6	1,705.4	1,765.6
Total Liabilities	4,697.5	5,488.2	5,742.0	5,838.5
APPLICATION OF FUNDS:				
Fixed Assets	3,040.8	4,222.1	4,250.3	4,140.3
Investments	1.1	1.1	1.1	0.9
Long-Term Loans and Advances	405.8	120.0	100.0	100.0
Other Non-Current Assets	16.3	8.0	8.0	8.0
Total Non Current Assets	3,464.0	4,351.2	4,359.4	4,249.2
Inventories	433.4	387.4	464.9	539.3
Sundry Debtors	501.4	415.8	482.3	559.5
Cash & Bank Balance	20.3	16.2	72.6	95.5
Other Current Assets	15.8	11.6	12.8	15.0
Short- term Loans & Advances	262.6	306.0	350.0	380.0
Total Current Assets	1,233.5	1,137.0	1,382.6	1,589.3
Total Assets	4,697.5	5,488.2	5,742.0	5,838.5

CASHFLOW STATEMENT

PARTICULARS	FY15	FY16	FY17E	FY18E
Cash Flow from operation	404.0	659.1	642.2	715.6
Profit before tax	230.1	317.2	329.5	460.3
Depreciation	137.3	139.5	207.0	220.0
Interest (Net)	145.6	131.7	243.2	221.0
Tax Paid	(50.3)	(56.6)	(52.7)	(82.8)
Working Capital	(57.4)	128.9	(114.7)	(120.8)
Others	(1.4)	(0.5)	30.0	18.0
Operating Cash Flow	404.0	659.1	642.2	715.6
Cash flow from Investing Activities	(740.7)	(893.4)	(242.0)	(241.0)
Capital Expenditure	(751.0)	(902.0)	(250.0)	(250.0)
Change in other non curr. assets	10.3	8.6	8.0	9.0
Free cash flow	(336.66)	(234.28)	400.21	474.61
Cash flow from Financing activities	344.7	230.1	(342.9)	(451.7)
Debt financing/disposal	576.4	540.8	(40.0)	(170.0)
Dividends paid	(41.5)	(41.5)	(51.7)	(51.7)
Interest Paid	(190.1)	(269.2)	(251.2)	(230.0)
Other items	-	-	-	-
Net Working Capital in Cash	8.1	(4.2)	57.3	22.9
Opening Cash Balance	11.5	19.5	15.3	72.6
Closing Cash Balance	19.5	15.3	72.6	95.5

RATIO ANALYSIS

GROWTH RATIOS	FY15	FY16	FY17E	FY18E
Net Sales	-6.5%	13.2%	24.9%	12.4%
EBIDTA	-0.2%	14.5%	30.8%	17.8%
PAT	3.4%	52.3%	9.0%	36.4%
VALUATION RATIOS	FY15	FY16	FY17E	FY18E
CEPS	43.8	56.7	69.7	86.1
EPS	24.0	36.6	39.9	54.4
P/CEPS	7.9	6.1	5.0	4.0
P/EPS	14.5	9.5	8.7	6.4
EV/EBIDTA	8.4	8.4	6.4	5.2
Debt/Networth	1.5	1.7	1.5	1.2
PROFITABILITY RATIOS	FY15	FY16	FY17E	FY18E
EBIDTA Margins	23.7%	24.0%	25.1%	26.3%
EBIT Margins	18.0%	18.9%	19.2%	20.3%
APAT Margins	7.8%	10.5%	9.2%	11.1%
ROCE	21.0%	18.9%	24.6%	31.5%
RONW	13.9%	17.6%	16.5%	20.0%
WORKING CAPITAL RATIOS	FY15	FY16	FY17E	FY18E
Inventory Turnover	4.9	6.2	6.5	6.3
Inventory Days	74	58	56	58
Debtor Turnover	4.5	6.1	5.9	5.8
Debtor Days	82	60	62	63
Creditor Turnover	1.3	1.3	1.8	1.9
Creditor Days	285	282	205	195
Working Capital Cycle	(129)	(163)	(88)	(73)
Current Ratio	0.7	0.7	0.8	0.9

TEAM

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Disclosure of Interest Statement in Tamil Nadu Newsprint Ltd. as on February 13, 2017

Name of the Security	Tamil Nadu Newsprint Ltd.
Name of the analyst	Shivani V. Vishwanathan
Analysts' ownership of any stock related to the information contained	NIL
Financial Interest	
Analyst :	No
Analyst's Relative : Yes / No	No
Analyst's Associate/Firm : Yes/No	No
Conflict of Interest	No
Receipt of Compensation	No
Way2Wealth ownership of any stock related to the information contained	NIL
Broking relationship with company covered	NIL
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