Business Standard

JK Paper: A bright spot in a forgotten industry

Date: 01/05/2017 | Edition: Kolkata | Page: 12 | Source: Mudar Patherya | Clip size (cm): W: 15 H: 16

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MARKET MIND

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The country's paper industry went into a trough when it needed to evolve from the use of chlorine to clean manufacture, warranting a reinvestment in new technologies. Those who invested sizeably in this capital-intensive business needed to sweat their plants to cover interest and depreciation. Those who invested in the wood-based capacities needed to secure resource access through proximate and abundant supply. Those who are worried about the resource productivity needed to work with farmers and clonal technologies, are widening their bandwidth from core manufacture to a different domain. And in the midst of all this, realisations stayed sluggish; market optimists looked elsewhere.

The worst could be over; the paper industry could be headed for a multi-year bull run. India accounts for 17 per cent of the world's population and a mere four per cent of the world's paper sector. Much of India's increasing paper demand is likely to be addressed through brownfield capacity; greenfield capacities will take over 48 months given environment controls, resource constraints and land acquisition issues. It is only partly true that digitisation has eaten into paper consumption; the next time you order online and the package is delivered home, you are strengthening prospects for paper and board makers.

It is indeed a commentary on the extent of sectoral underperformance that the country's largest cement manufacturer posted a Q4 post-tax bottomline of ₹726 crore; the best of India's paper companies posts an annualised Ebitda of around ₹520 crore (based on Q3 results).

The times could be changin'. The one company that I am tracking keenly is JK Paper. It reported an increase in revenue and Ebitda for seven of the last nine sequential quarters. Margins have climbed 424 basis points in the space of four quarters, which tells me that they have been able to produce (and sell) more while graduating to value-added varieties. The company has reported a consistent increase in 'other income' — from ₹3.37 crore in the first quarter of the last financial year to ₹6.74 crore in the third quarter — which I perceive to be treasury income generated from surplus cash. The result has been a consistent increase in net interest cover: From 2.61 to 3.11 across the period (it's not heaven, but definitely better).

The third eyebrow-raising feature is a consistent decline in the cost of raw materials — from 51 per cent in Q3 FY16 to 48.2 per cent in Q3 FY17 — which indicates that either the company is producing superior varieties (already indicated) or moderating resource costs through proximate wood procurement.

Curiously, BILT (Ballarpur Industries) has been phased out of our stock picking consciousness, leaving a suddenly-reinvented JK Paper to smooth itself into the emotional number one sectoral position. I would buy JK Paper for its sheer discount — an annualised third quarter Ebitda of ₹520 crore against a market capitalisation of around ₹1600 crore, a quarter-on-quarter improvement in interest cover and the possibility that all long-term debt may be liquidated across the foreseeable future.

To misapply Louis Amrstrong: It's a kiss to build a dream on.

The author is a stock market writer, tracking corporate earnings and investor psychology to gauge where markets are not headed