Piramal Glass

Going beyond glass ceiling

Giant inroads into C&P business

Piramal Glass is strategizing to shift from the commoditized glass packaging business of pharma sector to the high end segment of Cosmetics and Perfumery (C&P) business that offers superior realization rates and stable revenues. The C&P segment derives average realization rate of ~INR79,000 per tonne, i.e. a sizeable 100% over pharma and specialty segment. In order to keep pace with the growing demand from the premium segment, it plans to shift 75 TPD of pharma capacity to C&P and upgrade a 65 TPD C&P to 95 by Q1FY12E. Subsequently, we expect top-line CAGR of 12% over FY10-12E, led by spike in average realization rates.

Improving realizations to prop up bottom line manifold

The premium C&P segment is expected to grow from 47% of the overall C&P in Q1FY11 to about 65% by FY12E. Realization rates in this segment are over 5-7times in comparison to the mass segment. Additionally, the company plans to shift its C&P production from the US to the low cost producing base in India. We have factored a conservative 6% reduction in staff costs over the next two fiscals, which would save nearly INR130mn. Thus, we expect the company to enhance EBITDA margin by 496bps overFY10-12E led by an improving revenue mix and shifting US base.

Cleaner balance sheet in the next two years

Piramal Glass targets to reduce debt equity to less than 2x over the next two years from the current 3.5x. This implies a repayment of nearly INR1.5bn over the next two years. The company will generate approximately INR5.3bn operating cash flows over FY11-12E and will incur a capex of nearly INR1.6bn. This should give the company sufficient leeway for repayments. Additionally, the company has turned FCF positive in FY10, and we expect it to scale up ROCE to 15% in FY12E from the current 12%.

Rating : Buy

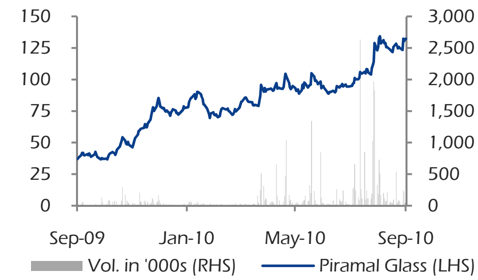
Target Price : INR186
Upside : 41%
CMP : INR132 (as on 3 September 2010)

Key data*

Bloomberg /Reuters Code	PIRA IN/PRML.BO
Current /Dil. Shares O/S (mn)	80/80
Mkt Cap (INRbn/US$mn)	10.6/228.1
Daily Vol. (3M NSE Avg.)	133,434
Face Value (INR)	10
1 US$= INR 46.6	

Source: Bloomberg ; * As on 3 September 2010

Price & Volume



Source: Bloomberg

Share holding (%)	Q2FY10	Q3FY10	Q4FY10	Q1FY11
Promoter	76.8	76.8	76.8	76.8
Institutional Investors	0.0	0.1	0.1	0.1
Other Investors	10.5	11.1	11.1	11.8
General Public	12.7	12.1	12.0	11.4

Source: Bloomberg

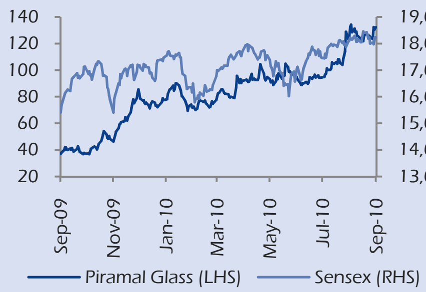
Price performance (%)	3M	6M	12M
Sensex	7.0	7.2	18.3
Piramal Glass	39.4	64.8	257.8

Source: Bloomberg

Valuation

Piramal Glass is well poised for a sharp re-rating and a premium valuation. The changing revenue mix is expected to improve return ratios and garner low earnings beta. Led by a high gestation period to break into the premium segment of C&P and sticky client base, the company faces limited competitive threat and subsequently strong earning visibility. Global peers in the premium C&P space are commanding P/E of over 11x and EV/EBITDA of 6x on FY12E earnings, despite reducing market share. We assign a 7.0x multiple to FY12E EBITDA of INR3211mn, deriving a target price of INR186 per share. We initiate the coverage with a 'Buy' rating and an upside of 41% from the CMP of INR132.

Price movement



Source: Bloomberg

Key Financials

Y/E Mar (INR mn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Rep PAT	YoY (%)	Fully DEPS	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY08	7,786	11.1	1,017	13.1	(228)	(41.5)	(12.7)	(0.1)	0.0	(10.7)	20.1
FY09	10,088	29.6	1,279	12.7	(1,026)	349.2	(44.5)	(116.4)	(1.1)	(3.0)	16.0
FY10	11,039	9.4	2,160	19.6	44	(104.3)	0.8	1.6	7.2	157.4	9.5
FY11E	11,883	7.6	2,457	20.7	735	1,559.3	9.1	20.7	10.4	14.5	8.3
FY12E	13,095	10.2	3,211	24.5	1,254	70.5	15.6	25.6	15.3	8.5	6.4

Source: Company, Elara Securities Estimate

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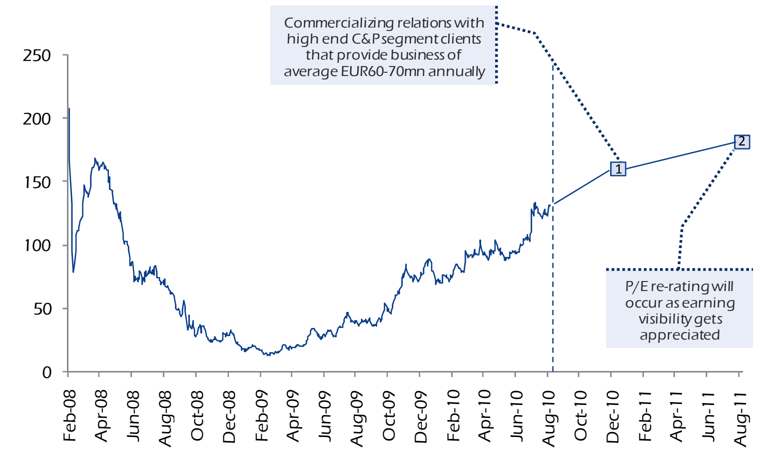
Valuation trigger



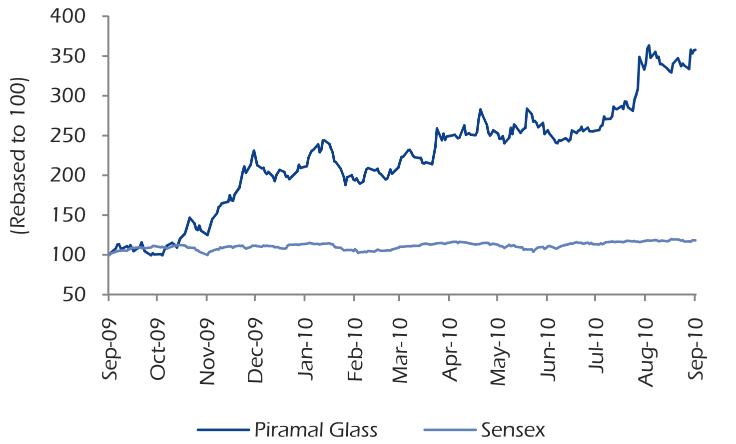
Source: Bloomberg, Elara Securities Estimates

Valuation overview

Particulars (INR mn)	FY 2012E
EBITDA	3,211
Target Multiple (x)	7.0
Enterprise Value	22,479
Net Debt	7,517
Mkt Cap	14,961
No of Diluted shares (mn)	80.4
Target Price (INR)	186
CMP (INR)	132.2
Upside (%)	40.7

Source: Elara Securities Estimates

Valuation driver



Source: Elara Securities Research

Investment summary

- Sharp turnaround in profitability led by an improving sales mix and subsequent margin augmentation by nearly 496bps.
- ROCE to reach 15% by FY12E, ROE to reach over 25%.
- FCF positive position to fund deleveraging exercise and reduce interest burden.

Valuation trigger

1. Commercializing relations with high end C&P segment clients that provide business of average EUR60-70mn annually.
2. P/E re-rating will occur as earning visibility gets appreciated.

Key risks

- Inability to commercialize relationship with high end C&P customers.
- Significant rise in PET substitution in the pharma segment.
- Slower than expected turnaround of US subsidiary.
- Currency risk due to rising exports

Our assumptions

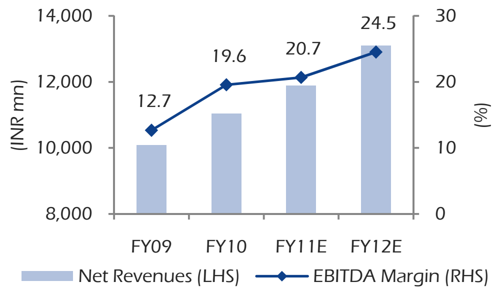
- Increase in average realization rate on account of improvement in revenue mix.
- Shifting Indian pharma capacity to premium C&P production by Q1FY12E.

Consolidated Financials (Y/E Mar)

Income Statement (INR mn)	FY09	FY10	FY11E	FY12E
Net Revenues	10,088	11,039	11,883	13,095
Operating EBITDA	**1,279**	**2,160**	**2,457**	**3,211**
Less:- Forex exp	540	339	200	200
OPBIDTA	739	1,822	2,257	3,011
Less :- Depreciation & Amortization	892	907	915	967
EBIT	**(153)**	**915**	**1,343**	**2,044**
Less:- Interest exp	1314	1049	781	658
Add Other income	209	221	221	221
PBT	**(1,258)**	**87**	**782**	**1,607**
Less :- Taxes	(186)	54	0	273
PAT	**(1,072)**	**32**	**782**	**1,334**
Add/Less: - Minority Interests	(47)	(12)	47	80
PAT after minority	**(1,026)**	**44**	**735**	**1,254**
Balance Sheet (INR mn)	**FY09**	**FY10**	**FY11E**	**FY12E**
Share Capital	180	804	804	804
Reserves	254	1,595	2,330	3,584
Minority Interest	447	376	423	503
Borrowings	13,571	9,824	9,224	8,324
Deferred Tax (Net)	93	113	113	113
Total Liabilities	**14,544**	**12,713**	**12,895**	**13,329**
Gross Block	14,052	13,673	14,473	15,273
Less:- Accumulated Depreciation	4,490	5,252	6,167	7,133
Net Block	9,562	8,421	8,306	8,139
Add:- Capital work in progress	148	141	141	141
Investments	1	1	1	1
Net Working Capital	4,833	4,150	4,447	5,047
Other Assets	0	-	-	-
Total Assets	**14,545**	**12,713**	**12,895**	**13,329**
Cash Flow Statement (INR mn)	**FY09**	**FY10**	**FY11E**	**FY12E**
Cash profit adjusted for non cash items	940	2,008	2,478	2,959
Add/Less : Working Capital Changes	(1,192)	573	(123)	(39)
Operating Cash Flow	(253)	2,580	2,355	2,920
Less:- Capex	(1,645)	(244)	(800)	(800)
Free Cash Flow	(1,897)	2,337	1,555	2,120
Financing Cash Flow	1,832	(2,352)	(1,381)	(1,558)
Investing Cash Flow	(1,547)	(208)	(800)	(800)
Net change in Cash	**32**	**21**	**174**	**562**
Ratio Analysis	**FY09**	**FY10**	**FY11E**	**FY12E**
Income Statement Ratios(%)				
Revenue Growth	29.6	9.4	7.6	10.2
EBITDA Growth	25.7	68.9	13.8	30.7
PAT Growth	369.6	(103.0)	2,318.6	70.5
EBITDA Margin	12.7	19.6	20.7	24.5
Net Margin	(10.6)	0.3	6.6	10.2
Return & Liquidity Ratios				
Net Debt/Equity (x)	15.3	3.5	2.5	1.5
ROE (%)	(116.4)	1.6	20.7	25.6
ROCE (%)	(1.1)	7.2	10.4	15.3
Per Share data & Valuation Ratios				
Diluted EPS (INR/Share)	(44.5)	0.8	9.1	15.6
EPS Growth (%)	NA	NA	988.3	70.5
DPS (INR/Share)	0.0	0.0	0.0	0.0
P/E Ratio (x)	(3.0)	157.4	14.5	8.5
EV/EBITDA (x)	16.0	9.5	8.3	6.4
EV/Sales (x)	2.0	1.9	1.7	1.6
Price/Book (x)	24.5	4.4	3.4	2.4
Dividend Yield (%)	-	-	-	-

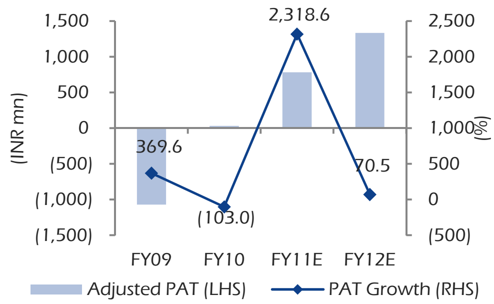
Source: Company, Elara Securities Estimates

Revenue & margins growth trend



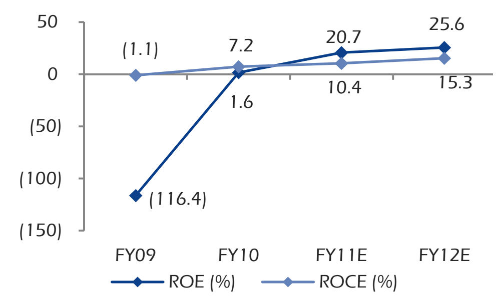
Source: Company, Elara Securities Estimates

Adjusted profits growth trend



Source: Company, Elara Securities Estimates

Return ratios



Source: Company, Elara Securities Estimates

Spike in margin led by shift in revenue mix

Higher profitability, FCF positive status, to advance deleveraging exercise

Packaging

Investment Rationale

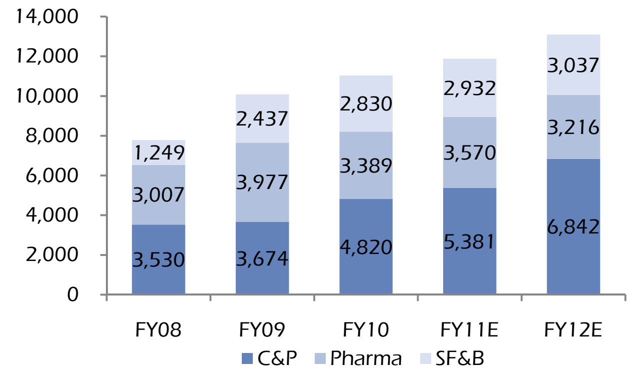
- **Shift in revenue mix in favour of C&P segment to anchor topline growth**
- **Improving margins to prop up bottom line**
- **Cleaner balance sheet in the next two years**

Revenue mix shift favouring C&P sector to anchor topline growth

Giant inroads into the C&P business

Piramal Glass operates in the glass packaging market, producing glass bottles for three segments viz., Cosmetics and Perfumery (C&P), pharma and specialty food and beverages (SF&B). Over the past five years, the company has strategically shifted from commoditized glass packaging business of pharma to high end segment of C&P business that offers superior realization rates and stable revenues. Subsequently, the contribution of the C&P segment to sales has grown from 30% in FY05 to about 43% as of FY10.

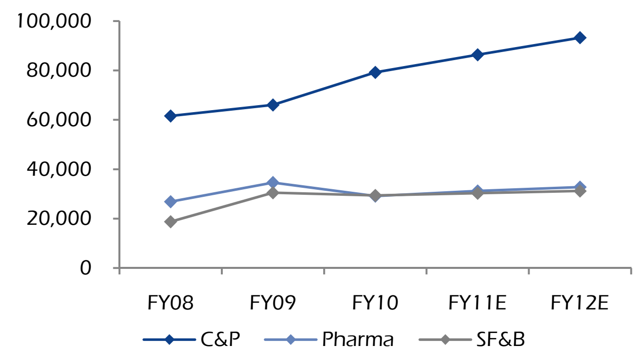
Exhibit 1: Revenue mix tilting towards C&P (INR mn)



Source: Company, Elara Securities Estimates

Piramal Glass is making giant inroads into the premium C&P market where it remains the only Asian player with significant price competency. Despite the one fourth product pricing vis-à-vis peers, the C&P segment derives average realization rate of ~INR79,000 per tonne, i.e. a sizeable 100% over pharma and specialty segment.

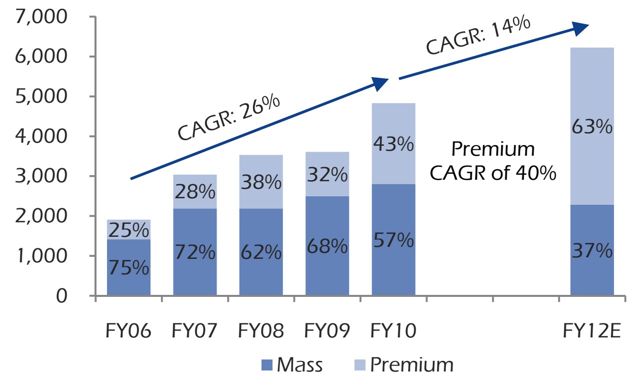
Exhibit 2: Avg realization rate (INR/tonne)



Source: Company, Elara Securities Estimates

Thus the company's strategy to change the revenue mix will enable to fuel significant business growth. We believe over the next two years, the C&P segment will derive nearly 65% of the revenue from the premium segment, standing at nearly 47% as of Q1FY11. This will give a strong impetus to growth. It also plans to shift 75 TPD of pharma capacity to C&P and upgrade a 65 TPD C&P to 95 TPD by Q1FY12E, in order to keep pace with the growing demand from premium C&P segment. We expect the company to record a topline CAGR of 12% over FY10-12E, led by improving realization rates that is expected to grow at a CAGR of 8.5% over the same period.

Exhibit 3: C&P segment revenues (INR mn)



Source: Company

The premium segment of the C&P market has a concentrated client mix of mere 20 clients contributing nearly two-third of the market. Piramal Glass has broken into large clients that include P&G, Coty, Merck, Elizabeth Arden and Estee Lauder. At present, Piramal Glass has begun commercial relationship with about 17 out of 20 clients and has about 155 new products in the pipeline.

Typically, the high end C&P companies procure one type of product from just one source, on account of the complexity of the product and constant quality check requirements. Thus each of these new products could give significant business. On an average, the bottle requirement of the premium C&P companies is about EUR60-70mn annually, while customers like P&G and Coty offer business of over EUR100-125mn annually. Piramal Glass has recently started receiving business from Coty of about EUR4-5mn and we believe this can go up significantly. Currently the top 10 clients contribute 27% of the C&P revenues.

Sole Asian player

Sticky clients, high skill job, stringent quality audits, constant copyright checks by customer, and a high gestation period of nearly 3-4 years to penetrate the market provide significant barriers of entry in the premium C&P market. Piramal Glass remains the sole Asian player servicing the premium C&P market which provides the company significant cost competitive advantage. The Chinese players have not been able to make a mark in this field on account of the copyright issues.

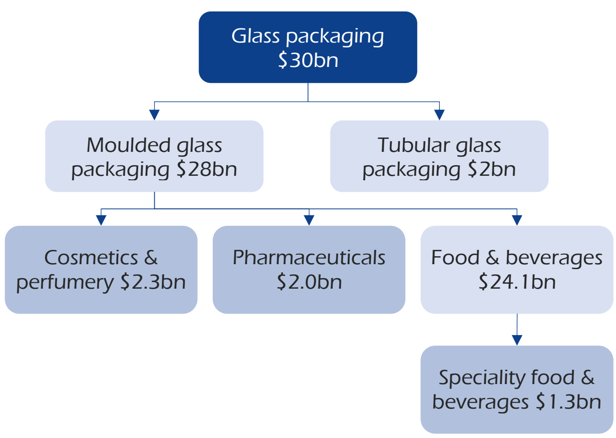
The large players from Europe and US like Gerresheimer, SGD and Zignago Vetro have tried and tested the model of shifting base to low cost producing countries like China but due to the prevalent copyright issues, they have not been able to develop the business model. Softer issues like communication barrier also play a significant role since there is vast human skills required in the production process and the transfer of skills have not been possible. There are about 110 process parameters that need to be adhered without any thumb rule on the parameters, thus it is the human expertise that drives the business.

Strategic US buy gives entry to premium C&P market

In FY05, Piramal Glass acquired The Glass Group and upgraded the facility for an overall cost of USD350mn. The US acquisition provided access to technological know-how and 37% of global premium C&P market. **With 100+ year existence, the company has established relationships with leading C&P customers like Elizabeth Arden, Estee Lauder, L'Oreal, Revlon etc and thus enabled Piramal Glass to penetrate in the high barrier premium C&P segment.** The acquired company is one of only two local manufacturers in US with a10% market share of C&P and hence gave awareness on quality and delivery standards.

C&P packaging industry

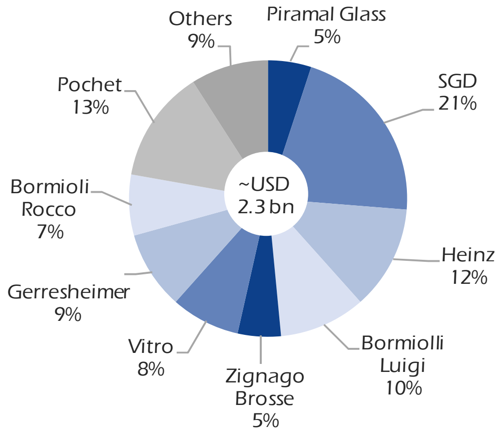
Exhibit 4: Piramal's addressable market globally



Source: Euromonitor

The molded glass market is USD28bn, out of which Piramal's addressable market remains at USD5.6bn. The global C&P market is estimated to be USD2.3bn out of which Piramal holds about 5% market share. Historically, the global C&P glass market has been growing by around 3-5% over the past five years. The emerging economies viz., BRIC countries as well as Turkey has grown at about 15-20%, while US and Europe have grown at about 2-3%.

Exhibit 5: C&P packaging market share



Source: Company

In the last two years, the market was severely impacted by the recessionary trends. The C&P market being a luxury goods segment de-grew in the range of almost 20%. This trend has adversely impacted players in Europe that are currently operating at 65-70% utilization levels. However, during the recent past, we have seen a strong revival in the off-take across the globe which is expected to restock the bounce back.

Creeping market share

The company is aggressively gaining share from its competitors in Europe. Currently Piramal Glass has about 2.5% of the premium C&P market and about 5% of the overall C&P bottle industry. The company plans to ramp this up to over 10% over the next two-three fiscal. The company's gaining share of loss making European companies like SGD and Gerresheimer that are dearer on the pricing front hence unable to compete with Piramal on the cost efficiencies. Thus although the market may witness macro constraints, Piramal Glass should maintain its topline growth momentum.

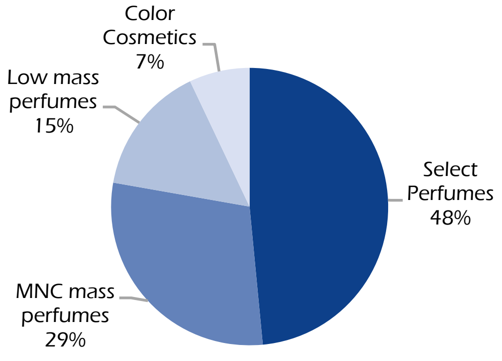
The C&P market can be categorized into four segments on account of its quality and pricing.

Exhibit 6: C&P packaging industry

Particulars (USD)	End Product Price	Bottle Price	midpoint bottle cost as % of end product	ROCE (%)
Select Perfumes	60	0.33 - 1.0	1.1	25 – 30
MNC mass perfumes	15	0.16 - 0.33	1.6	20 – 25
Low mass perfumes	8	0.085 - 0.16	1.5	10 – 15
Color Cosmetics	1.5	0.02 - 0.04	2.0	10 – 15

Source: Company

Exhibit 7: High end C&P holds three-fourth of market



Source: Company

Color cosmetics market

The color cosmetic market size stands at around USD155mn with about 8% of the overall C&P market. The products largely include nail polish bottles, with prices of around USD20-40 per 1000 bottles. The growth is being driven largely by emerging economies (where fragmented markets are serviced by regional players). Duplication remains a major concern hence lot of new designs are required, particularly in the mass market. MNCs such as OPI, Del, Revlon, L'Oreal and P&G are the largest customers. Piramal currently has global leadership in color cosmetics with 26% market share, servicing customers across 44 countries.

The company's proactive novel ideas, launching ~40 new designs every year enables it to compete in this market, servicing customers largely in Latin America and Western Europe. Being a low value segment, customers have limited quality consciousness and place more emphasis on cost reduction. This has been driving up competition from China & Brazil that focus on mass manufacturing with high production runs. Thus, in order to safeguard the profit margins, the company plans to shift to the premium C&P market.

Low mass perfumes

The low mass perfumes segment is largely sold in the emerging markets with a product end price in the range of USD8 and bottle realization rates of USD85-160 per 1000 bottles. With a fragmented market base, the segment stands at USD400mn, constituting 15% of the C&P. Presently, the company has global leadership with about 8% market share. Piramal's major markets include India, Latin America, Turkey, Russia and Middle East where Attar is a major product. The vertical is characterized by frequent new product launches and short production runs with customers preferring integrated packaging (caps, cartons, etc). Simple designs and easier quality norms enable it to garner higher manufacturing efficiencies. The business is characterized by low margin and competition from regional players - China and Poland. Piramal plans to use it as a filler capacity till its migration to premium perfumery segment.

Premium C&P segment holding the larger chunk

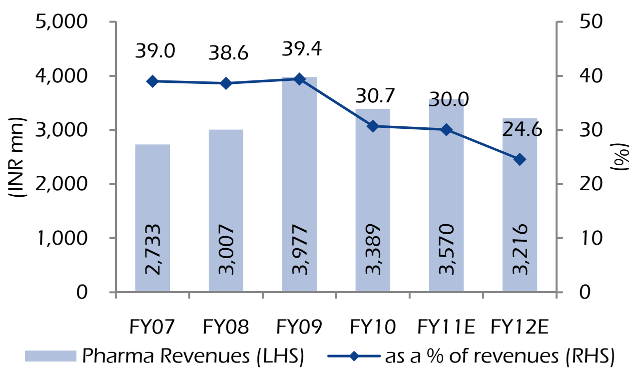
The premium segment of the C&P market with a size of about USD1.52bn comprises 77% of the overall C&P market. Piramal Glass has approx 2.5% market share in the premium category of the business, and has plans of aggressive penetration and scale up the market share to about 5% over the next two-three fiscals. The premium segment has MNC mass business contributing nearly 29% of the C&P, while select perfumes vertical holds about half of the overall C&P market. The MNC mass segment caters to perfumes and skincare products with end price in the range of USD15 primarily in developed economies. The bottles are priced in the range of USD160-330 per 1000 bottles. The select perfumes segment is high-end perfume with end price in the range of USD60plus, produced largely in France and the US. The bottles are priced in the range of USD330-1000+ per 1000 bottles. Thus in terms of realizations, the premium segment commands realization of about 5x over the low end segment and ranges to the peak of nearly 8-10x.

The key differentiator of premium C&P product is its long lifecycle of nearly 20-30 years and product development cycle ranging between 6 and 18 months. The clients are largely based out of Europe and the US thus majority is serviced through suppliers in the local region on account of stringent quality audits. The select perfume segment has a concentrated customer base of mere 20 clients.

Higher quality requirements, stringent plant audits, and needs of high skill sets pose extremely high entry barrier to this business, taking nearly 3-4 years to enter the market. The production involves 110 process parameters which do not have any scientific thumb rule and therefore requires significant human skills. Subsequently, the segment remains labor intensive and dependent to perform thorough quality audits. It has taken about 4-5 years for Piramal to penetrate this segment after its US acquisition. The company has considerable competitive advantages and limited threats from new entrants. Thus we believe, the company will maintain a high growth trajectory in the premium C&P segment.

Focus on premium biz in pharma, SP&F

Exhibit 8: Pharma segment



Source: Company, Elara Securities Estimates

The pharma packaging segment contributes about 31% of the overall revenues. Piramal Glass is the major player with a 35% market competing with Hindusthan National Glass with about 32% share. The company's strategy remains to shift focus from commoditized glass business to high value added products such as Type I injectibles where it remains the sole major player domestically and competes with merely 4-5 players globally. Due to the critical nature of the product, injectibles require packaging material that has zero reaction with the product. Thus there are stringent quality requirements and high entry barriers in this segment.

The company has a strong hold in the Indian injectibles market supplying to pharma companies like Torrent Pharma, Orchid Pharma and R K Pharma. These companies have contracts with US companies and therefore require high quality glass packaging for injectibles. The average realization rate of this product is nearly INR70,000 per tonne in comparison to INR30,000 for the normal bottles i.e. double the regular pricing.

Optimizing capacities

Piramal Glass plans to ramp up the existing 25 TPD capacity for the Type I borosilicate glass production to 45 TPD owing to the high demand from the domestic pharma companies. Additionally, it plans to shift 75 TPD pharma capacity in favor of high value C&P segment by the Q1FY12E. This will enable it to mitigate the risk of reducing glass packaging demand in the Indian pharma market. Thus the pharma segment is expected to reduce its contribution to overall revenues from about 40% of revenues in FY09 to 25% by FY12E. This will enable the company to churn better realizations and add to the bottom line.

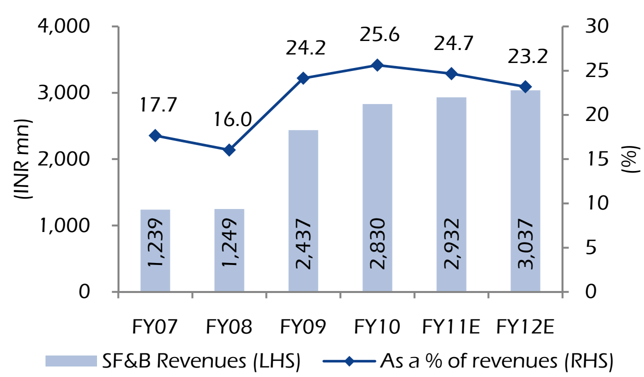
Focus shifts to exports to offset lowering Indian market

The Indian pharma market stands at INR5bn (USD111mn) while the global pharma market size remains at USD2.0bn. Piramal Glass has 35% market share in the Indian market and sells nearly 62% of its produce in the Indian market, while exporting the remaining to over 20 countries primarily the US. The Indian pharma market is passing through a structural shift from glass bottles to PET substitution that was witnessed by global markets about ten years back. During the past couple of years, the Indian market has declined by 10% as liquid orals that have minimal quality requirements are moving towards PET substitution. This has led Piramal to increase focus on the premium international market that has stabilized after undergoing a similar market contraction and is now growing at around 5-10% as per industry sources. The company has longstanding relations with international clients hence it would focus on the export business to mitigate the reducing domestic demand.

Regional focus on SF&B business

The Specialty Food and Beverages (SF&B) segment contributes 26% of the overall revenues with majority operations being in the US and Sri Lanka, servicing niche market for boutique alcoholic drinks. The US market is largely sourced through European suppliers that have stationed large capacities for premium glass market. The local players in the US market include SGD and Mexico based Vetri Specialty. Due to the heavy weight of the bottles and higher freight costs, the SF&B remains largely a regional market. In order to optimize capacity, the company plans to shift the C&P production to India and dedicate US facility fully to SF&B segment and reap the freight cost advantage.

Exhibit 9: SF&P segment

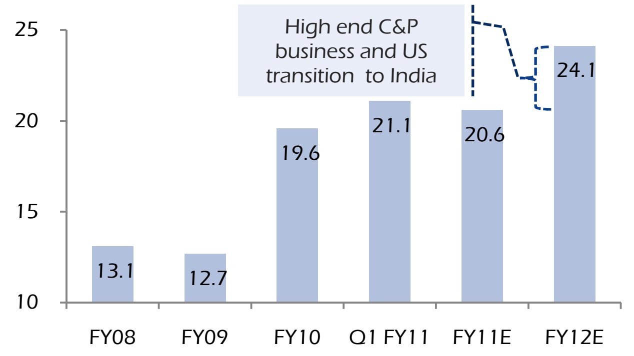


Source: Company, Elara Securities Estimates

In Sri Lanka, it is the single source supplier in the domestic market with 88% market share. The company also plans to export specialty value added liquor and boutique wine bottles to neighboring markets like India, Australia and South Africa to improve realization rates. We expect the average realizations to improve by a modest 3% annually.

Improving margins to prop up bottom line

Exhibit 10: Operating EBITDA margin to scale up (%)



Source: Company, Elara Securities Estimates

Targeting premium C&P market

The premium C&P segment is expected to grow from 47% in Q1FY11 to about 65% of the overall C&P by FY12E. Realization rates in this segment are over 5-7times in comparison to the mass segment. While rejection ratios are also higher in this segment ranging in the upper band of 15-45%, the pricing factors the high rejections and therefore ensure better profit margins. We believe the improving realizations will enable the company to garner superior margins as it would trigger minimal impact on cost and thus translate into better bottom line. Moreover, the company's growing expertise in the segment will also lead to better efficiency and lower rejection ratio. This should subsequently shift Piramal Glass to the lower band of rejection ratio and improve margins. We expect the company to enhance EBITDA margins by 496bps by FY12E reaching 24.5%, led by an improving revenue mix and elevated average realization rates.

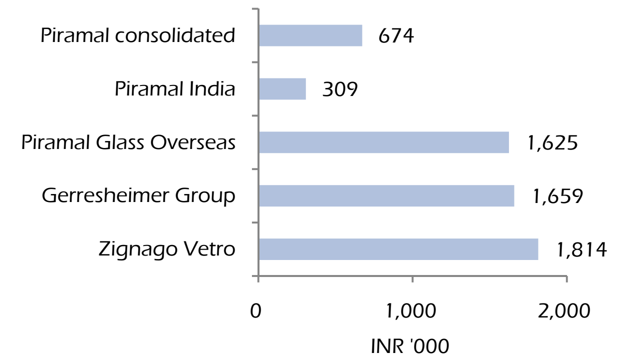
Exhibit 11: Cost savings vs peers in Europe (%)

Cost	India	France
Total	46	100
Raw material	6	6
Packing material	4	4
Energy	8	8
Labour	4	53
Mold cost	1	4
Depreciation	7	12
Overheads	10	12
Freight	6	1

Source: Company

PGL continues to build on its strategy of developing a strong front-end in the Western market, while building a robust manufacturing base in low cost regions. The company plans to shift its C&P production to low cost production bases in India while the US capacity will be used for premium F&B bottles. This will reduce employee costs that comprise nearly 20% of the sales apart from other overheads. F&B bottles are large in size and incur high freight cost. Thus the company plans to service the US F&B bottle demand through the US facility.

Exhibit 12: Employee cost difference (cost per employee)



Source: Companies, Elara Securities

The standalone cost per employee that includes Indian operations remain at ~INR309,000 while the overseas cost per employee remains at ~INR1.62mn which is over five times. The overseas employees also include Sri Lankan operations that would be at a lower base. Thus the US cost per employee can easily be assumed to be over 7-8 times of Indian counterparts. Subsequently, the shifting of operations from US to India will enable the company to improve margins significantly. Over the past four years, the employee costs have come down from 29% of sales to 20%, on account of shifting to Indian capacity and improving revenue mix.

We expect the US capacity to cut the fat that will enable the company to keep employee costs at lower levels. Additionally, this will also increase the company's competitiveness with European players that are operating in high cost producing regions and incur 7-8 times employee cost. We have factored a conservative 9% reduction in staff cost over the next two fiscals, which would save nearly INR184mn, despite rising topline and add significantly to the bottom line.

Towards a cleaner balance sheet

Capex cycle over: To add value over coming period

Piramal Glass has heavily invested in acquisition, capacity expansion and realignment during FY05-07, and has now reached the harvesting stage. The company incurred about INR3.5bn in the US acquisition while INR4.5bn in ramping up capacities. This will provide an impetus to growth over the next two-three fiscals leading to minimal investment requirements.

Exhibit 13: Recent capex execution

Particulars	Cost
US acquisition - FY05	USD3.5bn
Acquisition cost	USD18mn
Capacity upgradation	USD14mn
Working capital	USD10mn
Financial losses	USD30mn
Capacity expansion - FY07	
135 TPD capacity in India C&P	
70 TPD capacity in India Pharma	USD4.5bn
130 TPD capacity in Srilanka SF&B	

Source: Company

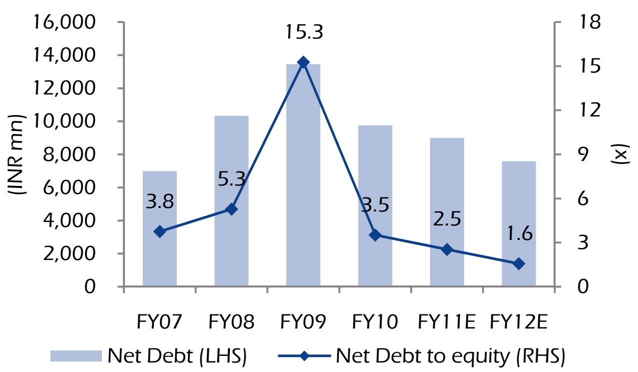
The US acquisition that was tactical to venture in new business line has turned cash positive in FY10 and is expected to turn PAT positive in the current fiscal. The expanded capacities are running at full operating levels and would garner superior realization in forthcoming quarters with emphasis on premium product manufacturing and enable the company to enhance bottom line.

Improving liquidity position

Reducing debt and interest burden

The company has reduced debt from previous highs of 15x leverage to the current levels of 3.5x via right issue of about INR185mn in FY10. It targets to reduce debt-equity to 2x over the next two years from the current 3.5x. We expect the company to repay debt of nearly INR1.5bn over the next two years. Piramal Glass will generate approx INR5.3bn operating cash flows over FY11-12E and will incur capex of nearly INR1.6bn. This should leave sufficient headroom for repayments.

Exhibit 14: Improving leverage

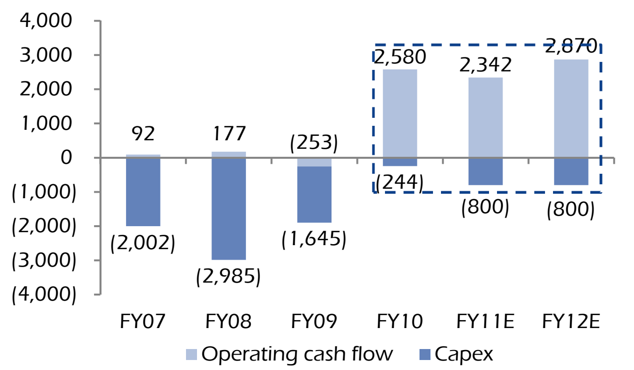


Source: Company, Elara Securities Estimates

Additionally, reducing debt levels also provides the company with a high bargaining power to cut interest costs. The company has reduced the interest cost from the peak of 13% to nearly 9.2% over the past two-three fiscals, thereby reducing the interest burden by 20% in FY10. Piramal Glass has debt rollovers of nearly INR4bn in a year's time and we expect the company to obtain better credit terms owing to improved profitability and regular accomplishment of earnings guidance. Thus the interest rates are expected to scale down to nearly 7.5% over the next two fiscals and interest burden reducing 26% in FY11E. This should further add to the company PAT margins and strengthen the balance sheet.

FCF to turn positive

Exhibit 15: Free cash flow (INR mn)



Source: Company, Elara Securities Estimates

Negative operating cash flows and high capex have kept the company's liquidity position under tremendous stress in the past. Heavy cash outflows occured on account of the US acquisition, capacity expansions, working capital requirements and cash burn due to operating losses. All these aspects led to FCF position to be continuously in the red. With all these cost burdens behind, the company looks much cleaner in terms of the cash flow position. Piramal's focus on higher profitability can further be gauged through its margin expansion strategy via premium business ventures and US operation shift. We expect the company to turn FCF positive in the current year and sustain these levels in the coming future. The company's robust operating cash flow position and minimal capex requirement will only add to the improving liquidity position and allow it to utilize cash for better options viz., debt reduction, inorganic growth options and others.

Packaging

Valuation & Recommendation

- **Re-rating on course with improving earning visibility, strengthening balance sheet**
- **Improving return ratios to support valuations**
- **We initiate coverage with Buy rating; assigning 7x EV/EBITDA on FY12E earnings**

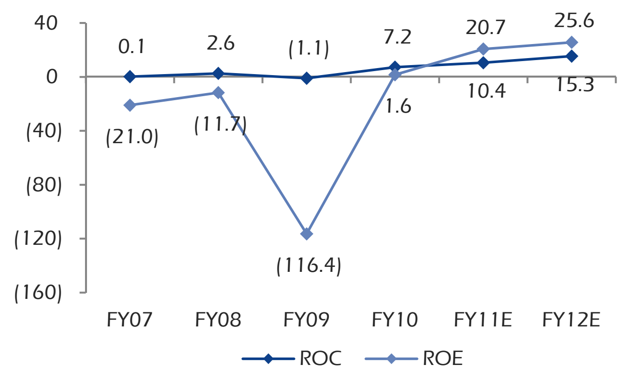
Re-rating on course

The company is moving up - from a commoditized packaging business to a premium segment which has its own high entry barriers, and robust earning visibility, unlike the commoditized packaging market. Led by a high gestation period to break into clients and sticky client base, the company faces limited competitive threat hence a strong earning visibility. This is expected to result in significant margin improvement as witnessed over the past 6-7 quarters. We believe that these factors make case of compelling valuations and well poised for a sharp re-rating.

Return ratios to move upwards

The changing revenue mix is expected to improve realization rates and enhance operating margins. Peers in the premium C&P segment already command ROCEs of over 20%. Thus as the company shifts to the high end market, it will garner better return ratios. We expect the company's ROCE to reach 15% by FY12E and ROEs of over 25%.

Exhibit 16: Reaping high return ratios (%)



Source: Company, Elara Securities Estimates

The company is also under the process of deleveraging the balance sheet. The deleveraging exercise will curtail high credit cost and perk up the interest coverage ratios, displaying superior risk absorbing capacity. We expect the deleveraging to be performed largely through internal sources that eliminate the threat of earnings dilution. All these factors will enable the company to command superior valuation.

Underpriced against global peers

Global peers in the C&P space are commanding P/E of over 11x and EV/EBITDA of 6x. We believe, this is largely on account of their long term earning visibility, over 50 years of existence in the market and stable return ratios. We expect Piramal Glass to move to a similar environment with improving EBITDA margins that will reproduce superior return ratios and low earnings beta.

Exhibit 17: Peer comparison (2012 Estimates)

Particulars	Mkt cap (INR mn)	ROE (%)	EBITDA margin (%)	Est P/E (2012) (x)	EV/EBITDA (x)
Piramal Glass	10,633	25.6	24.5	8.5	6.4
Zignago Vetro	22,492	28.6	27,1	11.2	5.9
Gerrishiemer	53,560	12.3	20.4	11.8	5.9

Exchange rate: 1 Euro = INR 59.819

Source: Bloomberg

Piramal's edge over its peers comes from its lower cost advantage that should lead to growing market share. Thus we believe, the company should command better valuation than its peers.

Exhibit 18: Valuation overview

Particulars (INR mn)	FY 2012E
EBITDA	3,211
Target Multiple (x)	7.0
Enterprise Value	22,479
Net Debt	7,517
Mkt Cap	14,961
No of Diluted shares (mn)	80.4
Target Price (INR)	186
CMP (INR)	132.2
Upside (%)	40.7

Source: Piramal Glass, Elara Securities

We assign a 7.0x target multiple to Piramal Glass FY12E EBITDA of INR3,211mn, deriving a target price of INR186 per share. We initiate the coverage with a 'Buy' rating and an upside of 41% from the CMP of INR132.

Company Description

Piramal Glass Limited operates in the molded glass business, producing glass containers for the pharmaceuticals, cosmetics and perfumery, and specialty food and beverage industry. PGL manufactures a range of glass bottles and jars, in sizes ranging from 2 milliliters to 2.5 liters. The glass containers manufactured in cosmetics and perfumery are used to fill nail polish, perfumes, foundation and attars. Pharmaceutical glass container division manufactures amber bottles, amber and flint vials for liquid oral formulations. Specialty food and beverages division caters to market for wine, liquor and food. The company's subsidiaries include the Sri Lankan production arm, Piramal Glass Ceylon Plc, the US production arm, Piramal Glass Flat River Llc, Piramal Glass Williamstown Llc. The company manages clients through its international subsidiaries viz., Piramal Glass International Inc., Piramal Glass-USA Inc., and Piramal Glass (UK) Ltd.

Board of Directors & Management

Ajay G. Piramal - Chairman

Ajay G. Piramal serves as Non-Executive Chairman of the Board of Piramal Glass Ltd. He is the promoter of the company, having interests in pharmaceuticals, pharma research, glass containers for pharma as well as cosmetics and perfumery industry, real estate development and financial services.

Vijay Shah - Managing Director

Vijay Shah serves as Managing Director, Executive Director of Piramal Glass Ltd. He has been with the Piramal Group since 1988, managing the group's various businesses. He has been instrumental in the growth of Piramal Glass, turning the US acquisition into profitability. He is a Bachelor of Commerce and a Chartered Accountant and has done his Management Education Programme from IIM, Ahmedabad and Advanced Management Programme from Harvard Business School, USA.

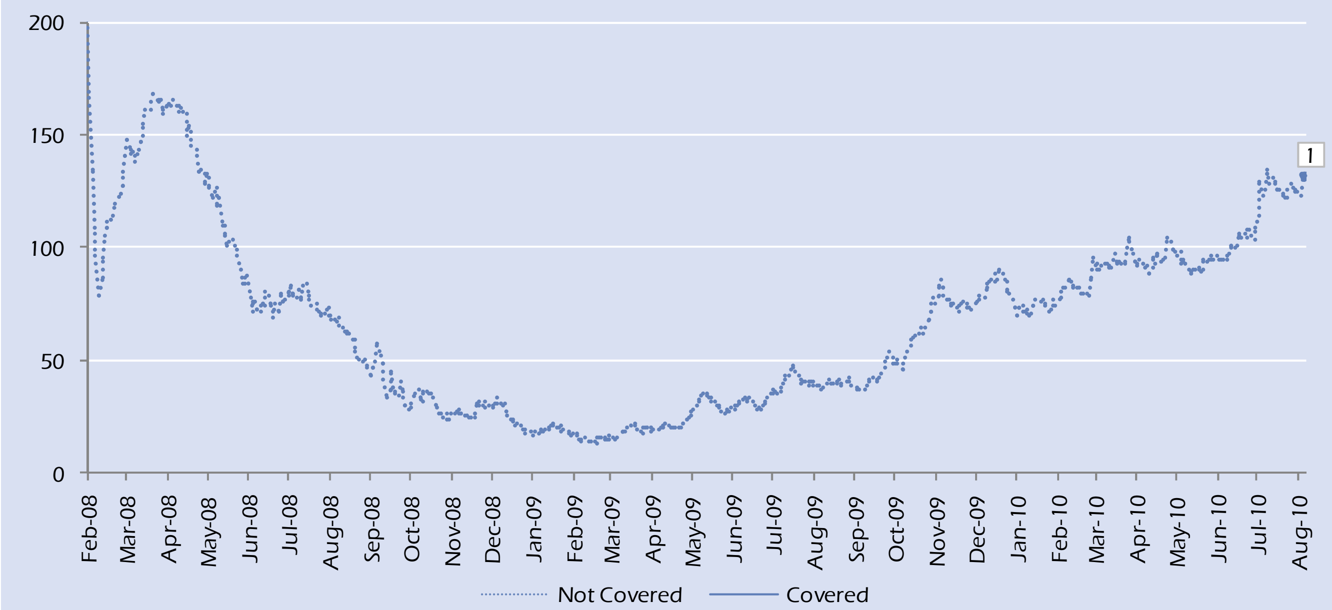
Dr. Swati Piramal - Non-Executive Director

She serves as Non-Executive Director of Piramal Glass Ltd. She is a Member of the Confederation of Indian Industries (CII), Knowledge Industries Council, Chairperson of the Life Science & Biotech Committee & Economic Growth Committee and Chairperson CII Maharashtra Biotech Committee 2006. She is the Senior Vice President of ASSOCHAM. Dr. Piramal has been nominated as a Member on the Board of the Council of Scientific & Industrial Research. She is also an Member of the Planning Commission, Government of India.

Sandeep Arora - Chief Financial Officer

Arora is responsible in taking calls relating to the company's financial health and stability. The company has significant exposure in foreign currency due to its high export business. Mr. Arora is responsible for hedging the currency risk and derisking the business from any vagaries in the forex market.

Coverage History



	Date	Rating	Target Price	Closing Price
1	3-Sep-2010	Buy	INR186	INR132

Guide to Research Rating

BUY	Absolute Return >+20%
ACCUMULATE	Absolute Return +5% to +20%
REDUCE	Absolute Return -5% to +5%
SELL	Absolute Return < -5%

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