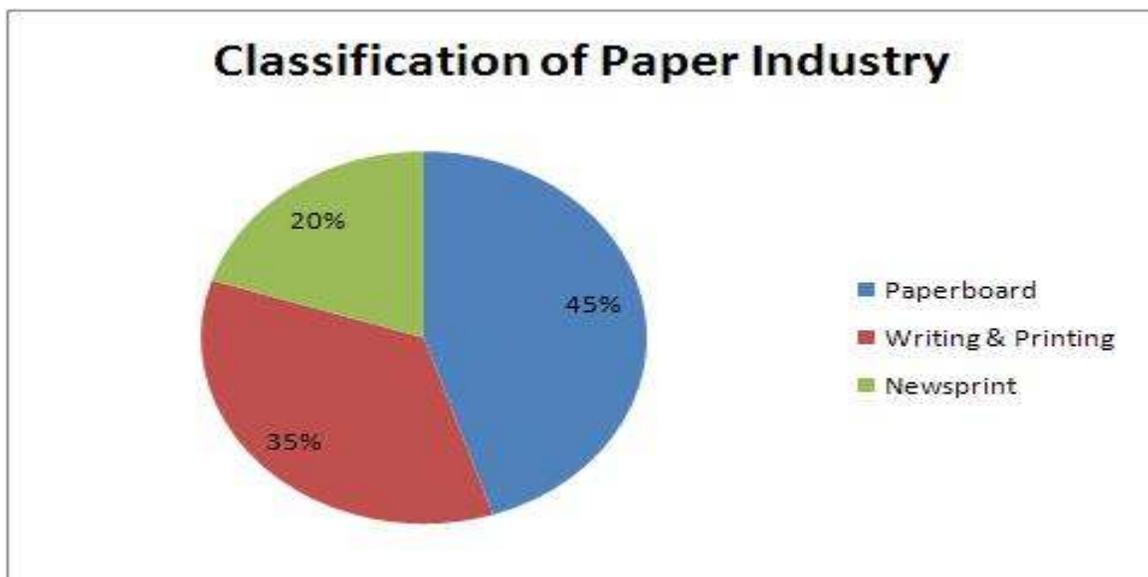


Low per capita consumption of paper major potential for growth in paper demand

The paper industry in India has been in existence since ancient times, experiencing a paradigm change over the years. The existing paper mills in the country employ diverse technologies-from legacy to advanced methods. The mills use a variety of raw materials including wood/chemical pulp, agro residues and recycled fibre to produce paper and paper products. While the demand for paper remained subdued in the developed markets during last five years, the Indian paper and paper products sector saw a rapid growth. The sector saw consistent growth in consumption and increased production. This trend motivated the paper manufacturers in the country to implement capacity expansion and growth plans.

Following rapid consumption growth witnessed in the past few years, the Indian paper industry experienced a lull in FY13; for that matter, most sectors of the Indian economy experienced a slowdown during this period. High inflation was a deterrent for consumption. Furthermore, rising raw material prices forced the manufacturers to increase the price of paper, temporarily forcing players in the industry to rethink their growth strategy. Some deferred their expansion plans, while others scaled down their operations. However, the long term outlook for Indian paper sector is stable because of existing low per capita paper consumption. Government support and technology upgrades will further add to the growth of this sector.

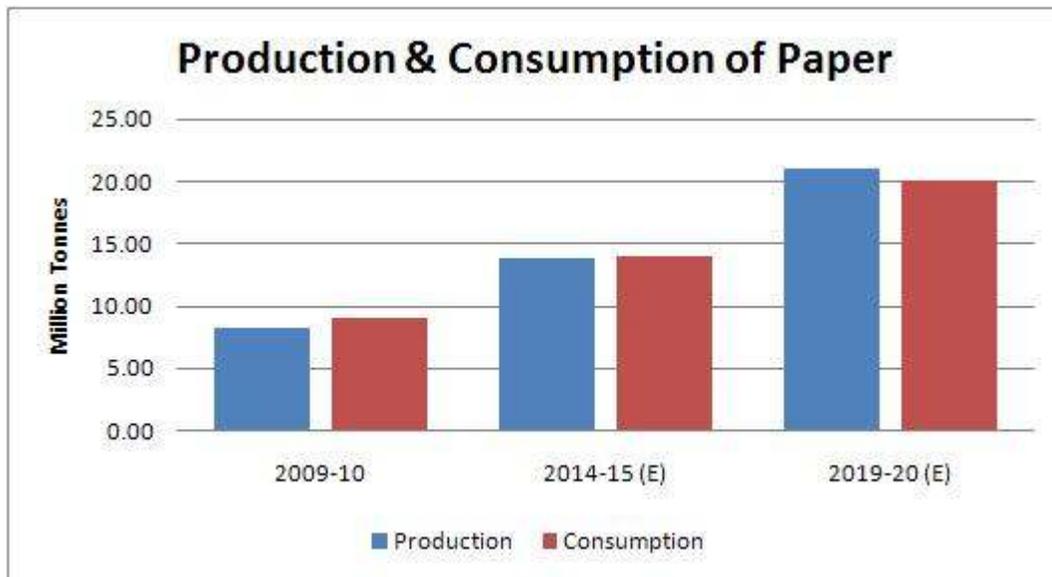
Indian paper industry is broadly classified into three segments - Writing & Printing (W&P), Newsprint and Paperboard & Industrial Packaging. Paperboard is the largest segment, accounting for 45% of total domestic paper demand, followed by W&P and Newsprint. Indian paper industry uses a variety of raw materials, including non-wood materials such as rice straw, wheat straw, bagasse, sabai grass and bamboo. Other raw materials are hard woods, such as eucalyptus and casuarinas, and recycled papers. The industry is further categorized on the basis of raw-material used for manufacturing paper including agro- residues, waste paper, imported pulp and wood & bamboo.



Performance of the industry

The paper industry in India has been growing at a rapid pace as the domestic demand is on the rise. Increasing population, literacy rate, growth in GDP and changes in lifestyle of individuals are expected to account for the growth in the paper industry of India. BILT and ITC are the largest producers of paper in India. The paper industry in India is expected to grow at the CAGR of around 9.6% during 2012-2017. The revenues of paper industry of India are expected to reach up to \$11.83 Billion by 2017. About 70% of the total installed capacity of paper production in India is held by the states of Gujarat, West Bengal, Orissa, Andhra Pradesh, Karnataka and Maharashtra. Uttar Pradesh, Tamil Nadu, Haryana, Kerala, Bihar and Assam together account for about 25% of the total paper production in India.

India's paper consumption had grown at a steady rate of 8% in the last five years. The Indian paper industry has an annual turnover of about Rs 40,000 crore in FY14. India has 17% of the world's population, but it consumes just about 3% of paper globally. The per capita consumption of paper in India is at around 10 kg, which is well below the global average of 55 kg. With the growth in GDP and increase in literacy, paper consumption in India is forecasted to go up. Consumption of paper and related products in India is set to increase to 20 million tonnes by 2020, from the current level of 12 million tonne.



Installed capacity

On the supply side, the industry saw significant capacity additions of 1.6 million MT during FY09-FY11 (15% of domestic paper capacity in FY09) particularly in the printing-writing paper (PWP) segment. The bunching of these capacities resulted in over-supply scenario during FY11 and FY12, as these incremental capacities could not be absorbed in the market. As a result, most players saw significant built-up of inventories as well as pricing pressures in FY12. But with

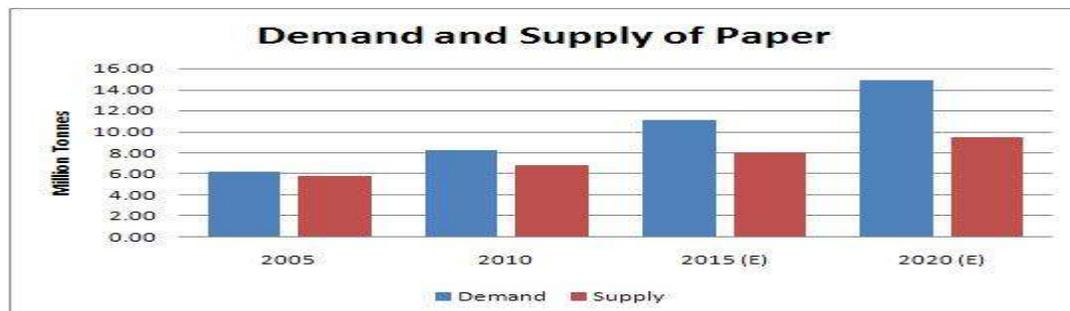
steady growth in demand, the market has now started absorbing these incremental supplies and the inventory build-up that was noticed in Q2 and Q3 FY12 is absent now. Most of the paper mills that expanded capacities have achieved operating rates of over 80% in FY13. Further, the industry has gone slow on new capacity announcements.

Category	Capacity Range (Tonnes)	Number of units	Capacity (TPA)
Small	<2000	69	75,522
	2000–5000	107	2,96,980
	5000–10000	123	9,17,880
Total (Small)	Up to 10000	299	12,90,382
Medium	10000-20000	116	16,69,460
Large	>20000	70	38,93,048

Meanwhile, only five new projects had been announced in the last four quarters between Q1 to Q4 of FY13 with an investment of Rs 300 crore. However, some of the capacity expansions which were announced earlier are already on track and are likely to be completed by FY14. The expected capacities of 0.3 million metric tonnes will be added during FY15 as against current capacity of 13 million metric tonnes. Even after assuming a conservative demand growth of 6% p.a., 0.7 million metric tonnes of additional demand is expected to be generated each year; hence the new capacities will be absorbed in the market, although there may be temporary supply pressures in some quarters.

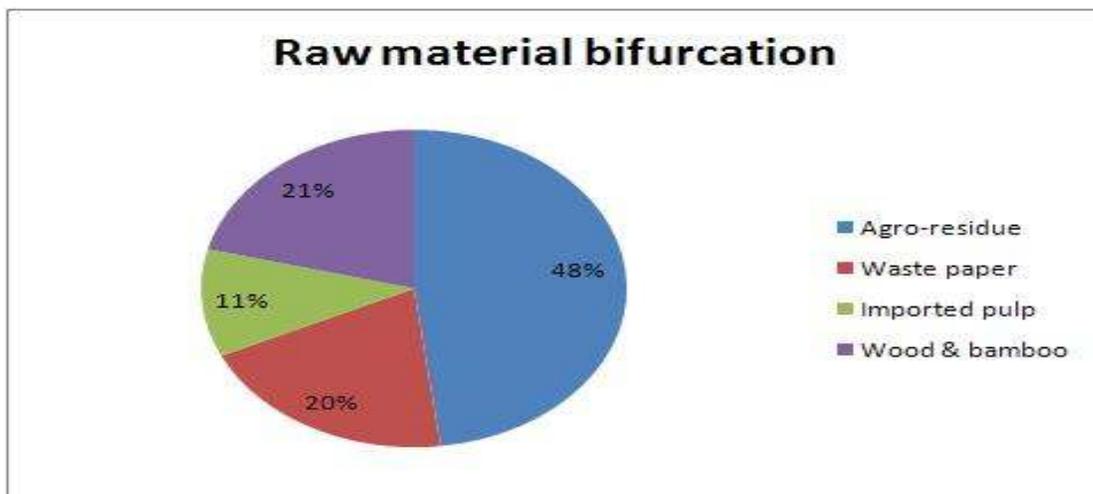
Demand and supply gap

The current demand for paper and paperboard was around 10.05 million tonnes and is expected to reach 15 million tonnes by 2020. The pulp and paper industry is forecasted to grow at 6-7 per cent each year. Paper production is likely to grow at 8.4 per cent, while the consumption of paper is likely to grow at 9 per cent. Thus, new capacity is needed to cover the demand growth. As it stands, the gap between production and consumption will be met through the import of pulp and paper from other countries.



Looming concern over availability of raw material

Raw material availability continues to remain a key concern for the industry. The wood availability for pulp making has been constrained on account of government regulations on captive plantations by paper mills. The availability of waste paper has been limited because of low collection levels of waste paper due to alternate uses of such paper in other applications such as packaging. The collection rate of waste paper in India is limited to around 20% of the total paper consumption in the country as compared to around 55-60% levels in developed countries. Further the quality of waste paper available from the domestic sources is generally of inferior quality. As a result the companies have to depend on imported waste paper, exposing the mills to movement in international waste paper prices. For the industry players based on agro- residues, the availability has been affected by cycles in agricultural produce as well as alternate use of bagasse in power generation. Apart from issues regarding availability and quality of raw materials, the paper mills have been affected by rising input costs.



The prices of key raw materials such as wood and chemicals have increased consistently over the years. Further, increase in domestic coal prices, reduced availability of low cost linkage coal has increased the power and fuel costs for paper companies. Though, international coal and pulp prices too have declined, but this benefit has been largely offset by depreciation of the Indian currency. The domestic coal prices had consistently increased over the years. In May 2013, Coal India revised the price of low-grade coal by an average of 10%. Paper manufacturers had increased prices over the last two years to pass on the costs but the price hike had been insufficient to absorb the costs.

Growth drivers for the industry

Growth in press publications: The print industry continued to buck the global slowdown trend. The industry grew at a CAGR of 8.5 per cent in 2013 CY to touch Rs 24300 crore. Regional markets performed exceedingly well on the back of steady advertiser spends, the state election

impact and new launches. However, with the validity of IRS data called into question by the industry majors, the segment in the short term suffers from the lack of a robust measurement system, critical for decisions on media planning and allocations. The strong growth in the printing industry is expected to continue to fuel the demand for paper.

Increased demand for packaging: The Indian packaging industry is currently valued at Rs 65000 crore (\$13.5 billion) and is expected to grow to Rs 82500 crore (\$17 billion) by 2015. Additionally, the Indian FMCG sector is growing at a rapid rate due to strong demand from a large and growing middle class. As a result, the packaging industry, growing by more than 15 percent annually, is likely to increase demand for corrugated boxes, leading to increased demand for kraft papers, the key raw material.

Growing affluence of the population: The GDP has grown at a rate of more than 8 percent in the last decade, increasing affluence. This has led to increased consumption growth in key urban towns and rural markets. The higher consumption per capita leads to a higher newspaper and magazine reader base, which in turn can fuel demand for paper.

Challenges

Over the last decade, paper industry in western countries is experiencing unimpressive growth and it is expected to continue in future despite its economic improvement. Leading manufacturers in industry are gearing their thoughts to overcome these challenges to get strategic shift by focusing their development in eastern countries. The consolidated deals in Asian paper industry had risen from 25 percent to nearly 30 percent in 2013. This is an obvious indication that western industries are intending to capture their market in countries which are emerged. Among the targeted ones India is the major one where 75 percent of acquisitions have made in India particularly in APPM (Andhra Pradesh Paper Mills). Meanwhile, most of the Indian mills are privately owned and few have running under the government of India. The capacity addition players in those are like Ballarpur and West Coast Tamil Nadu industry which resulted in CAGR(Compounded Annual Growth Rate). The estimation of paper consumption is likely to reach nearly 15 million tonnes by 2015-16.

The paper industry in India is growing in a rapid speed with demand increment and opportunity creation and attraction to the international players. The forecasted demand of Indian paper is 10 million tonnes and 33 percent of this demand is for W&P papers. Even though India has covered 15% of population in world, the paper consumption levels stands very low. Poverty, illiteracy, low corporate spending can be the factors behind this low level consumption. The leading global paper manufacturers are gaining nearly 5% on average and it stands at 8% approximately among Asia. However, for Indian market it is 12% or above which sounds very lucrative for Indian paper industry.

There should be impact on the printing paper industry in India which is significant but unfortunately in India it is less. The impact on pace on digital spending is very low in India and has much difference compared to other countries. If one considers segmentation in

advertisements industry, 25% share is consumed by the printing sector and online advertising consumes 2% in India.

Outlook

The paper industry is expected to continue at 6-8% growth rate in the medium to long term although there may be aberrant years given the cyclical nature of the industry. The low per capita consumption of paper provides tremendous potential for growth in paper demand. Further the capacity addition programme has now come to an end and there has been a considerable slowdown in new project announcement and completion. With recent capacity additions being completed, any fresh announcements are unlikely in the near term and with a gestation period of 24-30 months for new capacities, supply side pressures have started easing. Assuming a moderate growth of 6% p.a., the market would expand by around 0.7 million metric tonnes annually which would be sufficient to absorb the new capacities that will come up in the next 2-3 years.

However, favourable demand-supply dynamics may not immediately translate into higher profits for paper companies. The cost for most of the key inputs is currently at a very high level and domestic coal and wood prices are still increasing at a rapid pace. The ability of the companies to pass on these costs will remain the key to profitability. Companies with better cost and capital structures and a diversified portfolio of products would be better placed to endure the pressures in the medium to long term.

Companies Financial Data In Industry

Company Name	CMP	MCAP	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
Kwantum Papers Ltd.	83.00	72.43	130.59	0.00	38.88	2.13
Tamil Nadu Newsprint & Papers Ltd.	136.85	947.15	169.34	4.38	22.43	6.10
Seshasayee Paper & Boards Ltd.	220.00	277.50	308.52	1.82	19.84	11.09
Shree Ajit Pulp & Paper Ltd.	51.90	27.80	129.95	0.96	15.48	3.35
Metroglobal Ltd.	51.55	84.16	138.55	3.88	14.59	3.53
Sangal Papers Ltd.	42.45	5.55	136.97	0.00	12.58	3.37
Shreyans Industries Ltd.	31.55	43.62	63.47	3.80	8.98	3.51
South India Paper Mills Ltd.	60.05	90.08	69.34	2.50	6.50	9.23
Ruchira Papers Ltd.	21.00	47.09	44.24	5.71	5.47	3.84
Pudumjee Pulp & Paper Mills Ltd.	14.25	58.43	40.02	2.11	3.62	3.93
Emami Paper Mills Ltd.	44.50	269.22	52.48	1.35	2.94	15.12
Rainbow Papers Ltd.	78.90	838.05	44.70	0.51	2.21	35.66
Rama Pulp & Papers Ltd.	6.32	6.95	33.13	0.00	2.11	3.00
Saffron Industries Ltd.	2.37	1.70	-12.18	0.00	1.44	1.64
West Coast Paper Mills Ltd.	55.90	369.21	91.89	1.79	1.44	38.95
Pudumjee Industries Ltd.	11.34	24.61	24.03	0.00	1.04	10.89

Yash Papers Ltd.	10.36	28.70	17.05	0.00	0.92	11.20
Mohit Paper Mills Ltd.	5.20	7.28	17.49	0.00	0.89	5.84
Malu Paper Mills Ltd.	11.00	18.77	6.19	0.00	0.82	13.42
Cosboard Industries Ltd.	10.00	4.29	4.67	0.00	0.71	14.12
Ballarpur Industries Ltd.	16.00	1048.84	24.90	1.25	0.54	29.78
NR Agarwal Industries Ltd.	23.00	39.14	65.80	0.00	0.34	67.84
Superb Papers Ltd.	65.45	35.61	3.65	0.00	0.10	659.41
Kay Power and Paper Ltd.	15.35	16.33	-3.24	0.00	0.08	181.47
Sarda Papers Ltd.	9.46	2.95	-13.55	0.00	0.07	134.11
Bio Green Papers Ltd.	3.24	2.59	50.55	0.00	0.02	136.48
Tridev InfraEstates Ltd.	3.91	2.55	7.02	0.00	0.01	364.49
Speciality Papers Ltd.	1.94	30.30	23.43	0.00	-0.25	0.00
Sree Sakthi Paper Mills Ltd.	14.80	24.33	25.53	4.05	-0.87	0.00
Shree Rama Newsprint Ltd.	7.40	43.04	3.90	0.00	-1.73	0.00
International Paper APPM Ltd.	287.55	1143.59	102.11	0.00	-3.12	0.00
Rama Paper Mills Ltd.	9.75	7.39	18.44	0.00	-4.43	0.00
Magnum Ventures Ltd.	3.50	13.16	2.79	0.00	-4.83	0.00
Servalakshmi Paper Ltd.	3.50	15.09	-18.78	0.00	-6.11	0.00
Mysore Paper Mills Ltd.	5.69	67.65	8.01	0.00	-7.26	0.00
JK Paper Ltd.	30.00	409.86	54.86	0.00	-7.40	0.00
Star Paper Mills Ltd.	11.85	18.50	19.75	0.00	-11.63	0.00
Shree Bhawani Paper Mills Ltd.	2.64	9.19	-34.15	0.00	-15.69	0.00
Sirpur Paper Mills Ltd.	15.40	26.16	-28.88	0.00	-52.12	0.00

Source – Ace Equity

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