

## Indian Paper Industry: out of the woods

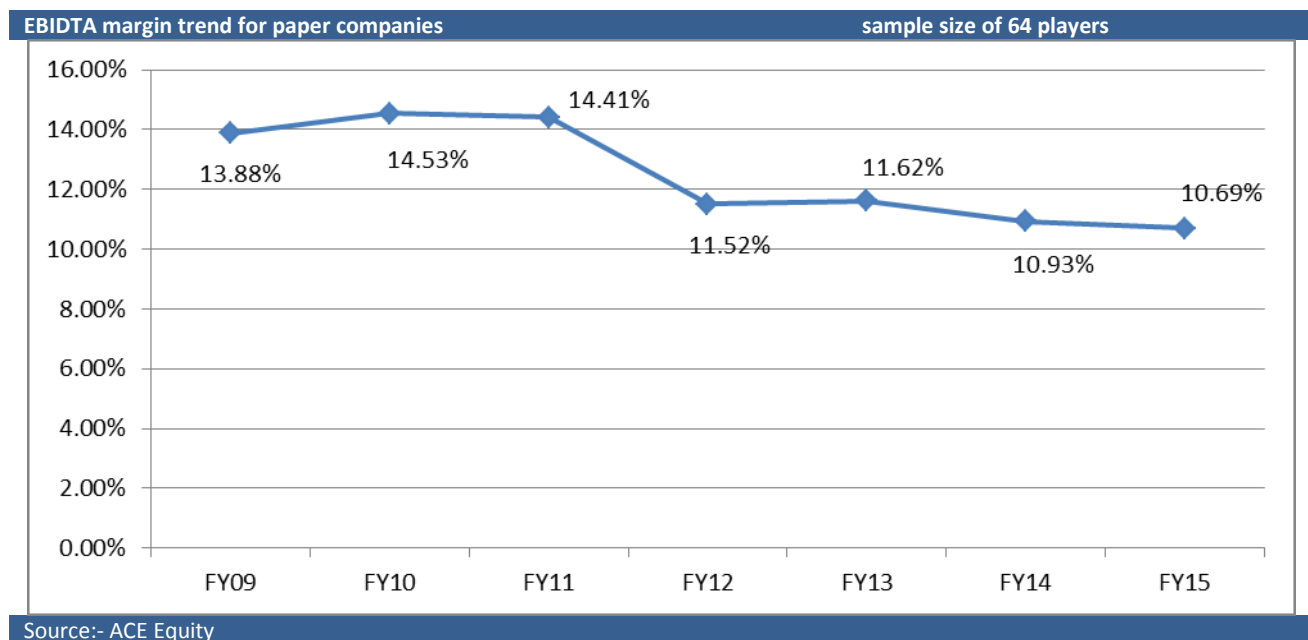
*CARE Ratings believes credit risk profiles of the companies in the printing & writing (P&W) segment and packaging & paperboard segment in India to improve over medium term on the back of increased demand, softening raw material and lower coal prices. On the other hand, credit profiles of newsprint segment companies may continue to be impacted by lack of pricing power given threat of imports and dependence on imported raw material i.e. wastepaper. Paper companies across the segments faced margin pressure during FY13 –H1FY16 largely due to raw material cost increase amidst stable paper pricing.*

The Indian paper industry with approximately 13 mn tonnes of capacity accounts for about 3% of global paper production. According to Indian Paper Mills Association, the domestic consumption of paper in India during 2014-15 was 13.9 mn tones, yoy growth of 6%. The per capita consumption of paper in India stands at ~11 kg, which is relatively lower compared to other developed and developing countries. With increasing focus by government on education and general uptick in macro economy, CARE Rating expects Indian paper industry to witness a CAGR of 7% over the next five years to about 20 mn tones. The growth will be largely driven by printing & writing and packaging & paper board segment. The Indian paper industry can be broadly classified into three segments:

- 1. Printing & writing (P&W):** Printing and writing segment caters to office stationary, textbooks, copier papers, notebooks etc. This segment forms ~31% of domestic paper industry. Governments thrust on education through steps like Right to Education, Sarva Shiksha Abhiyan, rise in service sector are key factors contributing to the growth of this segment.
- 2. Packaging & paper board:** Packaging paper & board segment caters to tertiary and flexible packaging purposes in industries such as FMCG, food, pharma, textiles etc. This segment forms ~47% of the domestic paper industry. This is currently fastest growing segment owing to factors such as rising urbanization, increasing penetration of organized retail, higher growth in FMCG, pharmaceutical.
- 3. Newsprint:** Newsprint serves the newspaper & magazines industry. This segment forms ~18% of Indian paper industry. This segment is under stress due to lower growth rates and import threat.

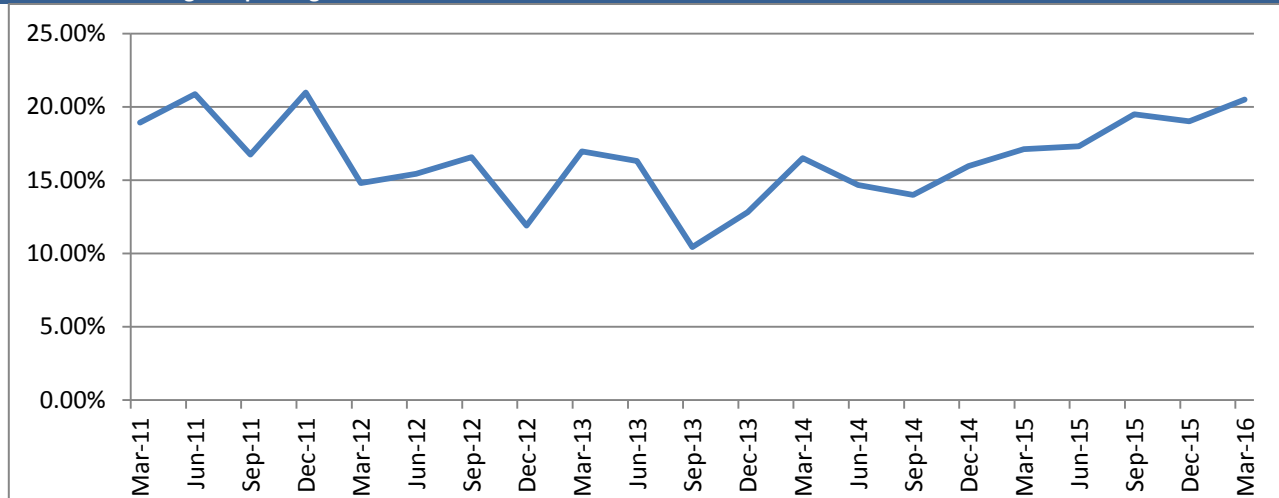
**Operating profit margin improving for paper players from H2FY16.**

The major cost heads for paper industry players are raw material (constituting ~50% of net sales) and power and fuel cost (constituting ~ 16% of net sales). The operating margins of the paper companies were in the range of 14 % during FY09 to FY11 due to lower costs and better price realizations backed by good demand growth. However, during FY12 to FY14, the operating margin trend showed a declining trend with increase in raw material prices and power and fuel cost largely during FY13. Also, with capacity expansion during FY09 to FY11, players could not increase the prices and faced import threat. Due to this the operating margin declined to ~11% during FY12 to FY14. The fall in margin was arrested in FY15 and H2FY16 witnessed improvement in margins due to declining RM costs and power & fuel cost.



Within the paper industry, P&W players operating margins improved to 20% in Q4FY16 from a low of 10% in Q2FY14. During FY16, key players increased prices by Rs 2 per kg in December month. Also, the companies benefitted from lower domestic wood prices and coal prices impacting power & fuel cost. Agro forestry initiatives taken by players yielded results.

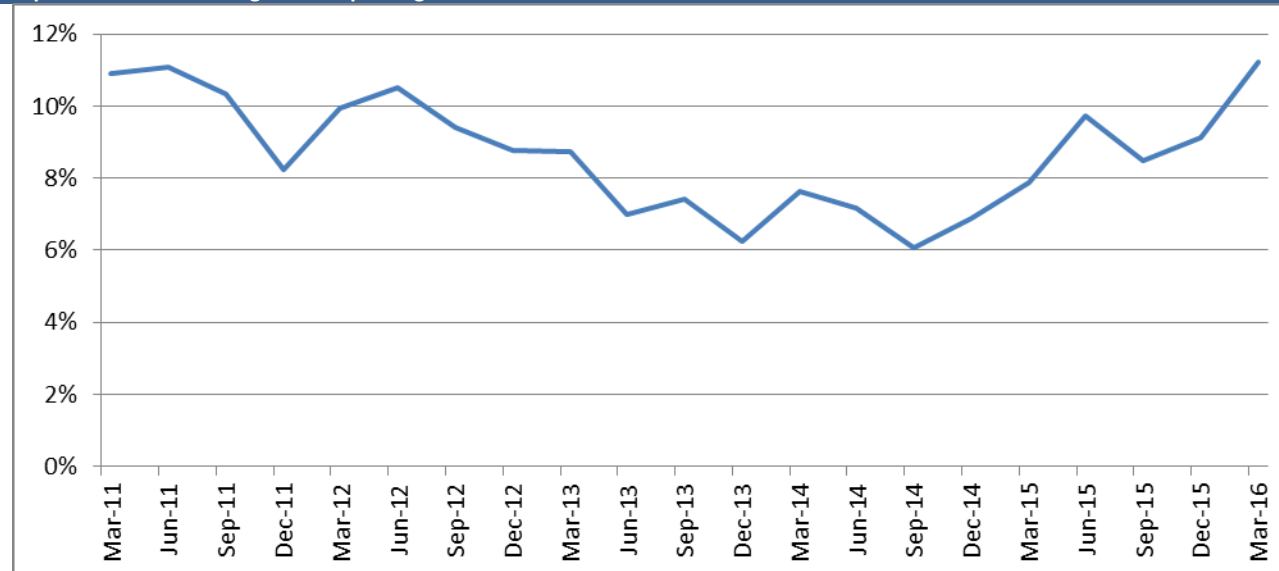
**P&W EBIDTA margin improving**



Source:- ACE Equity and CARE Ratings

Sample companies – Seshasayee Paper and Boards Ltd, Ballarpur Industries Limited, JK Paper Limited, Tamil Nadu Newsprint & Papers Limited, International Papers Andhra Pradesh Paper Mills Ltd.

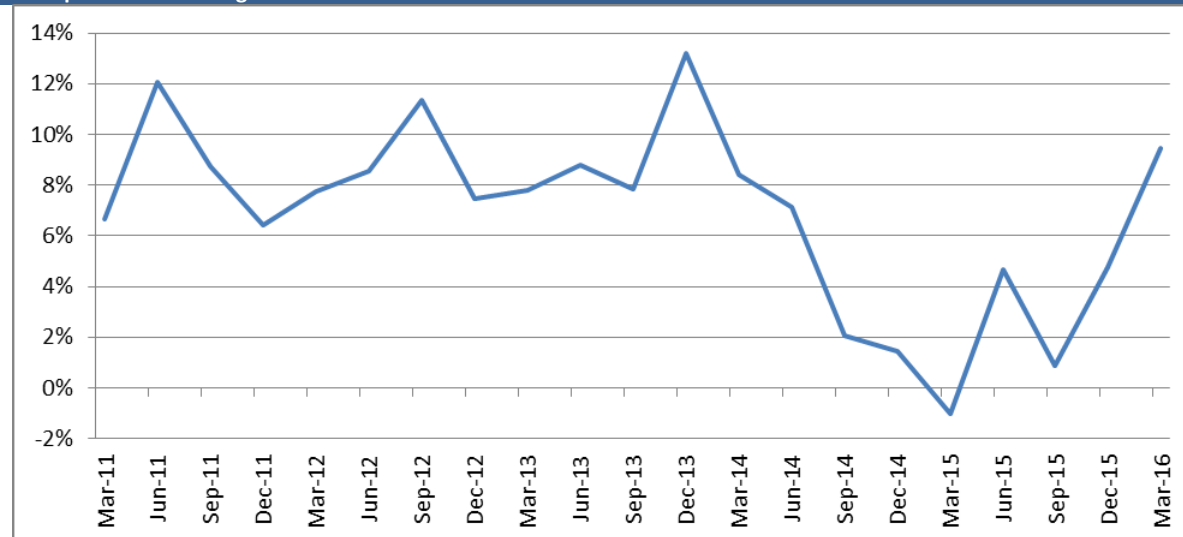
**Paperboard EBIDTA margin too improving**



Source:- ACE Equity and CARE Ratings

Sample of companies – NR Agarwal Industries, Shree Ajit Pulp & Paper, South India Paper Mills

**Newsprint EBITDA margin**



Source:- ACE Equity and CARE Ratings

Sample of companies – Emami Paper Mills, Shree Rama Newsprint

**Stabilizing raw material prices**

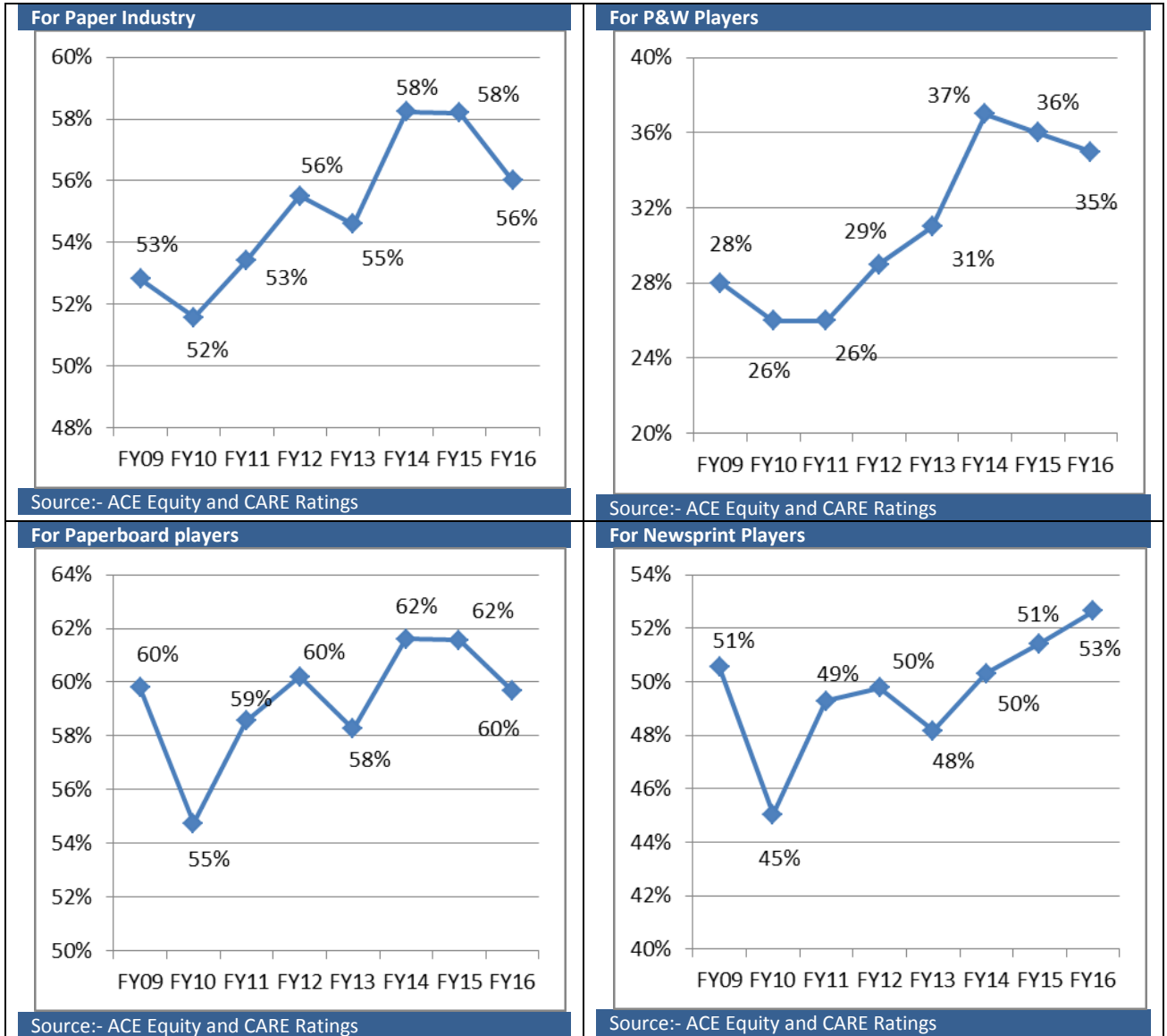
Pulp is the primary raw material used for manufacturing of paper, and is obtained through processing of fibers separated from wood, wastepaper, agriculture residues etc. Indian paper industry is facing issue of pulpwood deficit in domestic market. To compensate for this deficit, Indian paper companies import pulp. This deficit can be mainly attributed to deforestation, increase in wood demand from other industries like construction industry, plywood & MDF board industry, bio-energy plants etc. To counter the issue of wood deficit, Indian paper companies gave thrust to initiatives like agro forestry which have now started yielding results. The increase in raw material prices from FY11 – FY14 has stabilized from FY15. In Union Budget 2016, basic customs duty on wood in chips or particles for manufacture of paper, paperboard and news print has been reduced to nil from 5%. This will augur well for Indian companies depending upon imported wood chips.

**Segment wise RM source:**

	RM source	RM cost % to net sales	% of RM imports
<b>P&amp;W</b>	Wood, Bamboo	35%	22%
<b>Paperboard</b>	Agriculture Residue, Wastepaper	60%	45%
<b>Newsprint</b>	Wastepaper	50%	30%

Source: CARE Ratings

**Raw material cost as % of net sales**

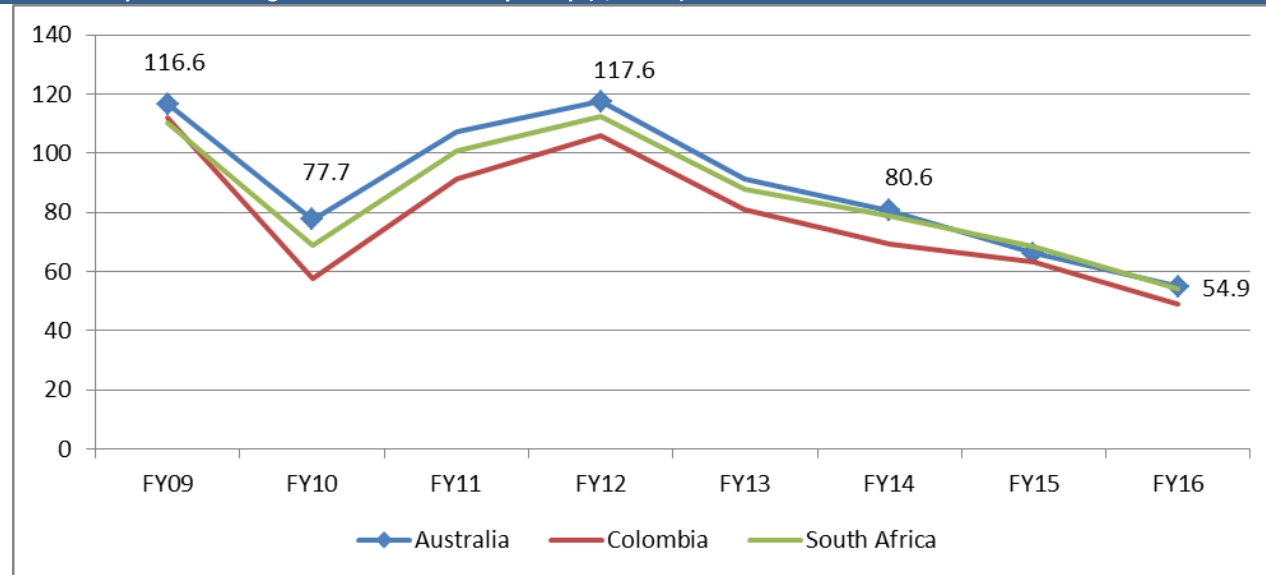


**Declining coal prices to reduce power and fuel cost**

Indian paper players depend on imported coal to meet their power requirements. The declining trend in global coal prices has helped Indian paper industry to improve margins. Amongst the various segments, power & fuel cost for P&W players is ~17%, for Paperboard segment is ~15% and for Newsprint segment it is around 18%. Earlier Indian paper industry was considered as core sector industry and hence it used to get coal on priority basis and at subsidized rates but from 2005 it is in non-core list of industries and hence paper players have to purchase domestic coal at higher prices. Timely availability of coal is another

pertinent issue. To counter this, Indian paper players rely on imported coal which is available at lower cost as compared to domestic coal. From FY12 to FY16 imported coal prices have reduced by ~53% while INR has depreciated by ~37% to USD, which has benefited Indian paper industry.

Global coal prices declining in line with commodity slump (\$/Tonne)

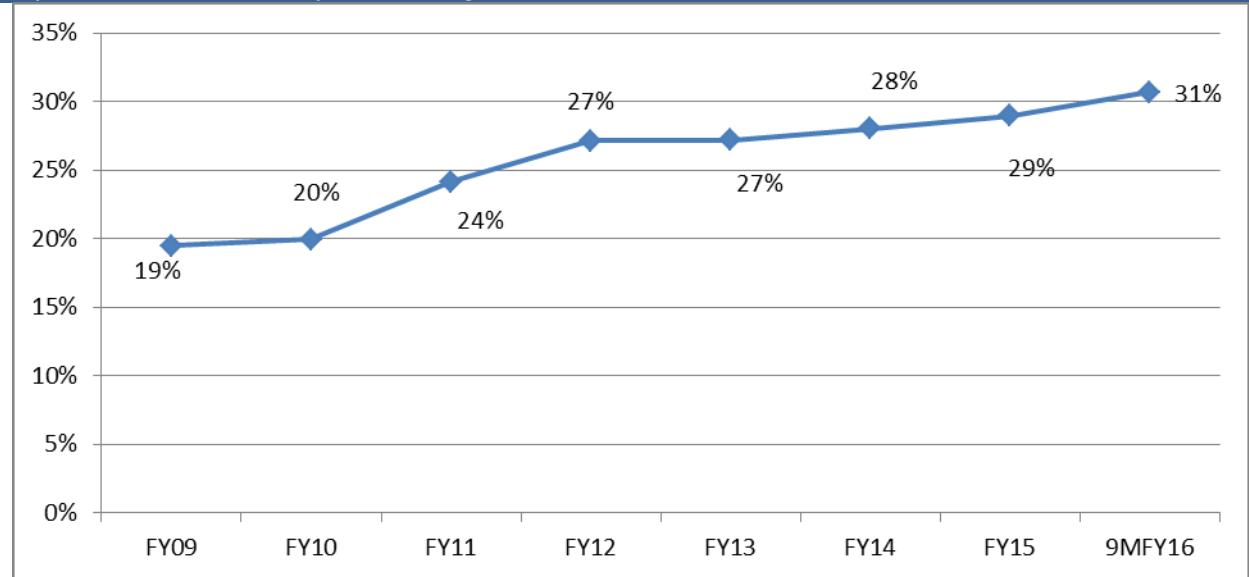


Source:- CMIE

**Paper players face import threat**

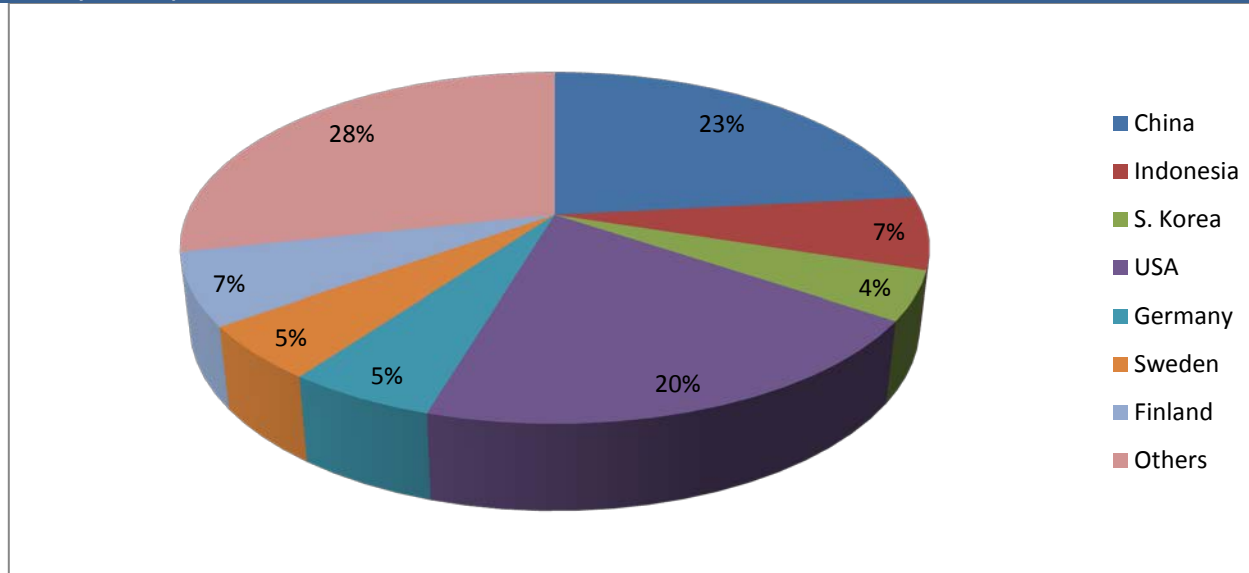
The 2.5% customs duty on paper in India has been brought down to Zero; from 1st January 2014, as per the terms of the free trade agreement with the Association of Southeast Asian Nations (ASEAN). Due to this there has been a rise in paper imports from ASEAN countries which has resulted in increasing share of imports in paper consumption in India. Earlier only few special grade paper and newsprint were imported but now, P&W paper is too being imported. In newsprint segment itself, imports increased from 47% of total consumption in FY09 to 59% in FY15.

**Imports as a % of total consumption increasing**



Source:- CMIE

**Country wise Imports % in FY15**



Source:- CMIE and CARE Ratings

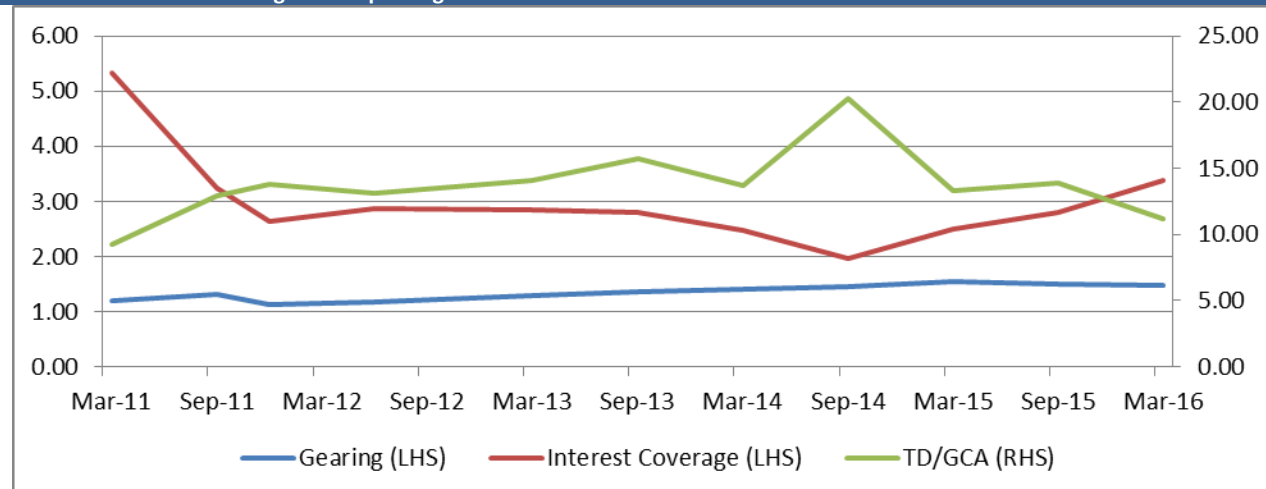
**Impact on the Credit profile of paper players**

Increasing cost pressure coupled with stable pricing impacted the financial performance and thus debt protection metrics of the paper players weakened during the period FY12 to FY15. However, CARE Ratings believes that worst is over for its rated players in the P&W paper segment with softening of wood prices and will largely maintain stable credit risk over the near to medium term. This will largely be due to cost pressure subsidizing and expected improvement in domestic demand and export opportunities. Packaging

and paperboard segment will benefit from higher growth while newsprint segment will continue to face pressure from newsprint imports.

### P&W segment

Credit Parameters P&W segment improving

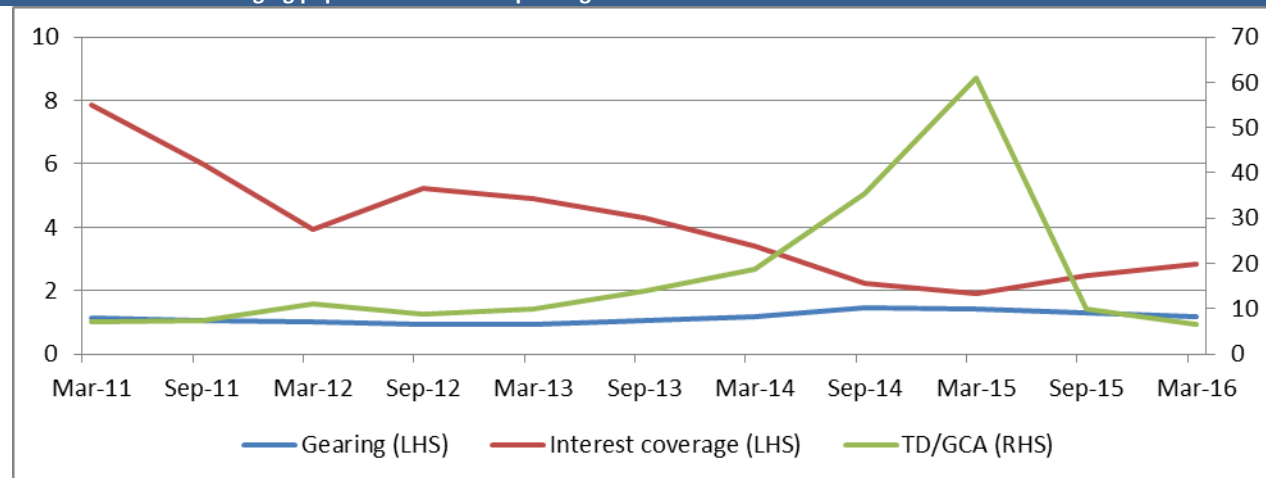


Source:- ACE Equity and CARE Ratings

Sample of companies – Seshasayee Paper and Boards Ltd, JK Paper Limited, Tamil Nadu Newsprint & Papers Limited, International Papers Andhra Pradesh Paper Mills Ltd.

### Packaging paper & board

Credit Parameters Packaging paper & board too improving



Source:- ACE Equity and CARE Ratings

Sample of companies – NR Agarwal Industries, Shree Ajit Pulp & Paper, South India Paper Mills,



**CARE Rating Dispersion:**

Of the paper companies rated by CARE during FY16, 62% are in below investment grade category ('BB' and below category; as seen in the table below) due to several factors such as high raw material cost, inability of companies to pass on incremental raw material cost to customers due to import pressure, high leverage, stretched liquidity position etc. During FY16, the credit profile of CARE rated paper companies has broadly remained stable with 69% companies being reaffirmed.

Credit Profile of CARE rated Paper Players (as on March 31, 2016)							
Credit Profile				Rating Transition			
Rating Band	% of Total rated firms			Rating Transition	% of Total rated firms		
	FY14	FY15	FY16		FY14	FY15	FY16
A	13%	14%	12%	Downgrade	17%	8%	10%
BBB	23%	28%	26%	No Change	68%	58%	69%
BB	40%	37%	38%	Upgrade	15%	33%	21%
B	12%	13%	16%				
C	2%	3%	1%				
D	10%	5%	7%				

Source:- CARE Rating

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