

Ex-Pack Corrugated Cartons Limited: Initial Public Offering

Ex-pack Corrugated Cartons Ltd (EXPA), a fully owned subsidiary of Aberdeen Holdings, is the market leader in corrugated carton industry in Sri Lanka, catering to approximately 18% of local demand. In FY21, EXPA derived 73% of the revenue through manufacturing and sale of corrugated cartons, 23% through manufacture of paper reels while 4% of revenue was derived through the sale of waste paper and cotton waste. EXPA also exports to Maldives, India, USA, Qatar, Australia, Madagascar, Seychelles and Reunion Island, earning 52% of the group's revenue in USD. Neptune Papers (Pvt) Ltd, a 100% owned subsidiary of EXPA is engaged in wastepaper recycling, contributing to approximately 30% of EXPA's topline.

Furthermore, EXPA is now planning to raise LKR 700Mn via an initial public offering (IPO) for a 25% stake. The funds are expected to be utilized to construct a manufacturing plant (cost of LKR 2.98Bn) by 2Q'FY23. The group plans to fund the balance required LKR 2.2Bn through investment property sale (LKR 450Mn), internal funds (LKR 602Mn) and debt (LKR 1.2Bn). EXPA intends to phase out production in the current manufacturing plant over the next two years and to fully utilize the new plant by FY25, which then will have a manufacturing capacity of 4000MT/month (cf. current 2750MT/month). By FY 25 EXPA also plans to bring down the debt portion by selling the existing facility for LKR1Bn (current valuation of the property comes close to LKR 855Mn).

Pick-up in economic activities and expected growth in exports to drive demand: We expect the topline of EXPA to grow by 22%YoY in FY22 and to rise by a CAGR of 11% by FY25 backed by (i) expected increase in household consumption and pickup in economic activities (ii) increased contribution from export revenue (iii) stable margins and (iv) expansion strategy.

Revival in economic activities and strong consumer demand in Sri Lanka as well as globe is expected to bode well with EXPA in our view due to its significant exposure (~80% of topline) to consumer and consumer durables market. Revival in consumption specially after a successful drive of inoculation in Sri Lanka, buttressed by relatively low rates and tourism activities will push the demand for consumer and consumer durables over and above pre covid levels in our view, implying higher demand for corrugated boxes. EXPA's export income which accounts to >50% of topline is too expected to follow suit with world output anticipated to spike up by >5% (despite some concerns over supply & surge in energy prices) which should invariably cushion EXPA's subsidiary- Neptune Papers (Pvt) Ltd -one of the leading wastepaper exporters in Sri Lanka.

Due to this unprecedented demand, management also decided to expand its capacity by ~45% (to 4,000MT/month), where EXPA expects to commence the construction in 3Q'FY22 and complete by 2Q'FY23. EXPA is expected to complete the first phase within a year, adding 1000-1500MT/month (from current 2750MT/month) and will run in full swing by FY25, where by then will stand as the largest corrugated factory in Sri Lanka. The additional capacity would also allow EXPA to increase its topline by a CAGR of 11% by FY25, surpassing a revenue of > LKR 7.9Bn (from current LKR 4.7Bn). Most part of the additional revenue will get directed to export sales boosting the dollar income, where the composition from export to local will then stand at 59: 41 (from current 52:48) (EXPA is primarily a B2B supplier with both local and foreign consumers with Maldives been one of its biggest export markets. The Company is also a direct exporter to several countries both within and outside the Asia-Pacific).

Although global paper prices- the main raw material of EXPA - is on the rise (paper prices increased by 51%YoY due to the higher demand, lower supply and higher freight charges), EXPA has yet managed to maintain its GP margins at 19% levels , with constant changes in selling prices which was possible due to EXPA's strong partnerships with its clients (EXPA maintains strong partnerships with over 600 clients in different sectors with 30 clients who account for >50% of revenue, with ten years partnership).

Issue Highlights

Total issue of shares	83,333,333
Issue per share	8.40
Market cap. (LKR Bn)	2.8
% of holding to the public	25%
Opening of the subscription list	22nd October 2021
Closure of the subscription list	11th November 2021

Shareholding Pattern

	Pre IPO
Aberdeen Holdings Private Ltd	100%

	Post IPO
Aberdeen Holdings Private Ltd	75%
IPO Shareholders	25%

Earnings multiples of large scale global peers hovers around 17.7x-35.9x

Company	Country of origin	PE (x)
International Paper	USA	19.41
Amcpr PLC	USA	19.28
Crown Holdings	USA	20.81
Ball corporation	USA	35.90
Smurfit Kappa Group PLC	Ireland	19.28
Stora Enso	Finland	17.07

Domestic FMCG and consumer durables too are trading at higher multiples

Company	Market Cap. (LKR Mn)
Nestle Lanka PLC	69,306
Hemas Holdings PLC	43,667
Sunshine Holdings PLC	11,441
Abans Electricals PLC	790
Regnis (Lanka) PLC	1,582
Ceylon Cold Stores PLC	57,024
Renuka Foods PLC	1,592
Keells Food Products PLC	4,010
Cargills (Ceylon) PLC	60,554
Distilleries company of Sri Lanka	82,340
Sector PE	13.45

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We think maintaining these margins is possible, especially with help of EXPA's subsidiary - Neptune Papers- who export 80% of its production, fetching the rising global waste paper prices. This along with the expected upward revision in unit prices (EXPA plans to increase per unit price by 10%-15% in Oct'21) we are of the view that EXPA will comfortably maintain GP margins at 19% levels in the near future while improving to 20% levels with economies of scale trickling in with the expansions

EXPA to benefit from currency depreciation: EXPA's cost of raw material import- mainly paper- accounts to 60% of cost of sales or 40% of revenue, exposing the group to currency and global commodity price fluctuations. However, with export income accounting to a notable 52% of topline, it not only provides a powerful currency hedge, but also benefits the excess dollar buffer through any currency weakness. The benefit is expected to widen even more with export composition increasing to ~60% along with the planned expansion.

Discounted cash flow method indicates a 26% upside to the issue price: We estimate EXPA's normalized profits to range between LKR 355-360Mn for FY21/22E , a 74%YoY jump, benefiting both from higher consumption and optimal capacity utilization . Profits are expected rise to LKR > 420Mn levels after part of the expansion comes in to play in FY24 and spike to LKR 780-800Mn levels (85%YoY) by FY25 once the expansion is fully completed. Thus, based on a discounted cash flow method we have arrived at a price of LKR 10.60 for EXPA, a 26% immediate upside to the issue price of LKR 8.40. Based on a dividend payout of 50%, EXPA also derives a dividend yield 7.6% adding up to a total return of >34%. Furthermore, when looking at some global packing players too, EXPA trades at a notable 177% discount (7.9x) compared to an average global peer price multiple of 21.9x . When looking at some of the counters in FMCG and consumer durables space in Sri Lanka (as 85% of EXPA's topline is derived from these two segments), EXPA will still trade at a 41% discount. Hence, when looking at both relative and intrinsic valuations, we believe EXPA's issue price is undervalued. Thus, we recommend subscribe.

Earnings Forecast

YE Mar	2019	2020	2021	2022E	2023E	2024E
Income Statement (LKR Mns)						
Revenue	5,181	4,600	4,787	5,838	6,330	7,510
Gross Profit	857	710	929	1,080	1,247	1,464
Selling & Distribution Expenses	- 203	- 224	- 224	- 234	- 253	- 285
Admin Expenses	- 360	- 355	- 310	- 321	- 329	- 376
PBT	75	50	218	457	454	490
PAT	12	98	205	425	391	421
Gain on disposal of investment property				68		
Normalized PAT	12	98	205	357	391	421
Balance Sheet (LKR Mn)						
Property Plant & Equipment	947	957	1,039	2,008	3,216	3,136
Total Assets	1,152	1,673	1,740	3,927	4,496	4,445
Total Equity	712	765	753	593	783	1,404
Ratios & Other						
GP Margin	17%	15%	19%	19%	20%	20%
EBIT Margin	6%	4%	10%	11%	12%	11%
NP Margin	0%	-2%	4%	7%	6%	6%
EPS pre IPO	0.05	-0.39	0.82			
EPS post IPO	0.04	-0.43	0.60	1.27	1.17	1.26
NAVPS pre IPO	3.01	2.37	3.13			
NAVPS post IPO	2.26	1.78	2.35	4.21	4.80	5.43
PE (x) post IPO	230.78	NA	14.11	7.85	7.17	6.65
PBV (x) post IPO	3.72	4.72	3.57	1.99	1.75	1.55
Dividend payout	1051%	-51%	50%	50%	50%	50%
Dividend yield	4.6%	1.8%	3.7%	7.6%	7.0%	7.5%
ROE	2%	-15%	30%	39%	26%	25%

Source: IPO prospectus, Investing.com, The Global Economy.com, FRED Economic Data

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