Innovative Tech Pack Ltd

Innovative Tech Pack Ltd (INPACK) has been in the business of flexible packaging (plastic, films) for more than 25 years now, however in between 2009-11 the company was the centre for all the chaos, created by its inability to pay its debt obligations to PNB and HSBC bank, in spite of the mess created a few years back INPACK has emerged as one of prominent names in FMCG & Pharma – packaging industry. INPACK currently is headed by Mr. Ketineni Sayaji Rao who was hired as managing director of the company on 1st August, 2010 and from there on he has taken the responsibility of bringing the company back on its feet, and has done a commendable job in the past 7 years.

INPACK is involved in the business of manufacturing and reselling plastic bottles, jars and caps to some of the most prominent names in the FMCG & Pharmaceutical industry – i.e. Dabur, Marico, Bisleri, INBISCO, Funfoods, etc. After returning from BIFR the company has focused on just two aspects – *firstly* Developing good manufacturing facilities with latest machineries and technology and, as a matter of fact the company has doubled its gross block from 41 Cr in 2012 to 79 Cr 2016, currently the company has three manufacturing plants, and *secondly* on building a good order book one in each – Assam, Himachal Pradesh and Uttaranchal, and what' interesting is that each one of the plants is established in special economic zones and hence enjoys tax benefits.

At the most basic level the company is engaged in *commodity business* of manufacturing and selling plastic containers to *big clients* on *contract basis.* Does this sound like an interesting business to you? On the face of it – No, but INPACK is trying and to an extent has built good business model around this mundane business. Let's look at the facts once again.

Commodity Business – It is true that the company has invested significantly in moulds and machinery from Japanese and Italian manufacturers which are above industry average, but there isn't anything exclusive about these plants and machines that differentiate the company's product to an entirely different level.

Commodity Business .. so Commodity Margins? – the company is engaged in commodity business of manufacturing plastic containers from PET, PP and Masterbatches – where raw materials make up for 60% of the sales revenue. Now it isn't hard to notice that price of PET, PP (by product of petroleum) are fluctuating along with crude, and so must the operating margins of the company? But that isn't the case, INPACK in past 5 years has maintained an OPM of around 15 with the worst case scenario of 12%, because the company has formed an arrangement with most of its customers – which allows it to pass on any change in raw material prices, whether positive or negative, to its customers. Following is an extract from 2016 Annual Report of INPACK –

"I am pleased to inform the shareholders that your company has performed remarkably well, as in real terms there is a sales growth of over 40% in quantity terms as compared to last year. In this connection it is informed that there has been substantial reduction in PET prices (our basic raw material) as a result the selling prices automatically reduced so as to pass the benefit to the customer."

The company witnessed a 40% growth in terms of quantity sold, however the revenue rose just 20% so as to pass on the cost benefit to the customers. ***In a way company has hedged itself from the***

fluctuations in commodity pricing, by passing on the benefit of windfall profits as well as windfall expenses to its customers.

Big Clients and Contracts – Packaging industry in itself is a very wide industry where a company can choose amongst various sectors to participate in – i.e. a company can choose to supply packaging materials to sectors like – FMCG, Pharmaceutical, Paints – Chemicals & Other Industrial Products, Confectionaries, etc. According to me INPACK is in a very good position supplying to FMCG & Pharmaceutical Industry, as FMCG by its inherent design is very dynamic and concerned about packaging as a function of its product.

This point along with another one that I will mention later just might be the most important thing in this write-up and my investment thesis. The company recorded a revenue of 90 Cr in FY16 up from 61 Cr in FY13, while maintaining an operating margin of 14-15%, a lot of this revenue was coming from clients like Dabur, Preferiti and Mother Dairy amongst others.

So what changed? In the past 7-8 months the company bagged few large contracts from some of the existing clients and some new ones.

Marico Contract, Oct'16 – Marico has executed a five year contract which is expected to give revenue of 100 Cr (according to the company), 20 Cr each year for the next five year. The revenue from this contract is expected to fully start flowing from 2017, Marico has also supplied moulds worth 9-10 Cr in two of the factories of the company – which shows their commitment towards this contract. One more interesting thing about this is that 3 out of 7 Marico manufacturing units are located in the proximity of the INPACK's manufacturing plants.

Dabur Contract, Dec'16 – Dabur has executed a five year contract which is expected to give revenue of 400 Cr, 100 Cr each year for the next five years. The revenue from this contract is expected to fully start flowing from 2017, INPACK is to supply all of Dabur's PET requirements in its plants in India, Bangladesh and Nepal. One more interesting thing is that 16 out of 29 manufacturing units of Dabur are located in Baddi, where INPACK has started its latest manufacturing plant.

INBISCO Contract, Nov'16 – INBISCO is one of the largest confectionaries manufacturer of Gujarat, although INPACK hasn't mentioned the size of this contract the revenue are expected to start flowing from this year.

Bisleri Contract, April'17 – Bisleri has executed a five year contract for supply of caps from INPACK for its carbonated beverages, Bisleri has also agreed to pay Mould Amortization Cost to INPACK for this contract – which shows its commitment toward this contract.

The size of these contracts is very large as compared to the existing revenue of the company, so all these developments along with existing clientele of – Dabur, Patanjali, Emami, Godrej, Heinz, Cadila Pharmaceutical and Wipro amongst many others form a good and recurring source of revenue for the company, with tremendous opportunity for growth to be seen from next year itself not only in terms of revenue but also in building a track record for the company for executing big contracts. As the headache of commodity price fluctuations, and to a large extent subsequent fluctuations in operating margins, taken care of the company needs only to ***focus on executing existing contracts and getting new clients on board.***

After these developments it would be very beneficial to know the degree of revenue concentration, one question worth asking management is the revenue contribution by Top 3-5 clients of the company.

Apart from cost of materials consumed, other costs include employee benefit expense (around 7-8% of the sales), interest on the debt – which has substantially increased from 7 Cr to 21.5 Cr in long-term obligations and 3.8 Cr for Working capital loan down from 5.4 Cr previous year. Although the absolute amount of debt has doubled from previous year – which makes up for a *Debt to Equity ratio of 0.85*, what's good is that the company has reduced its dependence on short term funding, the quantum of debt makes me somewhat uncomfortable – however the company has ability to pay its debt and it is only expected to get stronger with the upcoming contracts.

The major raw materials that the company uses include PET, PP and Masterbatch, which the company acquires on an average credit period of 35 days and then later sells to its customers on an average credit period of 80 days. For last 3 years company required an average working capital of around 10Cr.

Management – After Mr. Ketineni Sayaji Rao has taken the position of managing director, the company has shown good recovery, and the revenue growth and clientele of the company is testimony to the fact. I have no reasons to doubt the integrity of the management.

Concerns in a glance

- Given the past incident or debt restructuring in 2010, it becomes all the more important to keep track of the debt obligations and company's ability to meet them. Currently the D/E ratio is 0.85.
- Excess revenue concentration, especially after the execution of new contracts begins.

Things not known

Following are some of the questions which I have asked to the management, and some of Dabur's and Marico's packaging team members.

1. ***What is the revenue contribution by your Top 3/Top 5 customers/clients - before 2016 and from 2017 keeping in mind the big contracts the company has won?***
2. Can you elaborate more about company's expansion plans in south India and Gujarat?
3. What merits of INPACK convinced Dabur, Marico and Bisleri to give you such big contracts?
4. More details on production capacity and utilisation rates of all the factories.

Valuation

After looking at all the factors, I find INPACK to be worthy of at least a small position in the portfolio (2-3% of portfolio) and undoubtedly a business worth tracking. My investment thesis lies on facts that – the company has build an optimum capacity at strategic locations which give it proximity to its clients and an added tax benefit for next few years, the company has already created a good order book which will utilise this investment and give it massive growth in the coming years. Further the current valuations don't seem to be reflecting the growth in revenue and subsequently in the profits that are about to flow from commencement of these contracts.

Further, on the basis on the development of these factors I would also like to increase my position.

Things to track

- *Execution of existing contracts and ability to attract new contracts.*
- *Revenue concentration from top clients and from manufacturing facilities.*
- *Debt and Interest Obligations*