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Abhijit R. Akella, CFA
 Abhijit.Akella@jmfinancial.in
 Tel: (91 22) 6630 3066

- **A niche manufacturer of glass containers:** Piramal Glass Limited (PGL), a Piramal Group company, is a manufacturer of glass containers for the pharmaceuticals, cosmetics & perfumery (C&P), and specialty food and beverage (SF&B) industries. The company is already a global leader in multiple niches, including color cosmetics and low mass perfumes within the C&P market. It aims to drive future revenues and profits by focusing on the high-margin premium segment of the C&P market. We recently met with the company's management and this note is an introduction to their business and strategy.
- **A turnaround story; emerging out of a difficult period:** PGL has reported profits for the last two quarters, marking a turnaround from a period of sustained loss-making following the acquisition of certain assets from a bankrupt glass manufacturer in the U.S. The U.S. operations (The Glass Group Inc., formerly known as Wheaton Glass), after incurring cumulative losses of US \$30mn since the acquisition, posted a small profit of US\$0.3mn in 3QFY10 driven by revenue growth as well as cost-cutting. PGL aims to use the customer relationships brought by this acquisition to drive revenue growth in the premium C&P segment while simultaneously boosting EBITDA margins by shifting manufacturing from the U.S. to India.
- **Strategy of focusing on high-margin C&P business:** In contrast to its global leadership position in the low-end, mass segments of the C&P market, PGL occupies only a 2% share within the premium segment as entry barriers are high due to a need for high levels of skill and experience. However, by using the technical know-how and customer relationships provided by the U.S. acquisition, and combining them with modern manufacturing facilities, a low-cost manufacturing base and an extensive marketing network, PGL aims to gain market share from entrenched European competitors. The RoCE in the premium segment is typically in the 25-30% range, nearly twice that in the mass segment.
- **Revenue CAGR of 10-12% through FY12E, supported by margin expansion:** Management expects revenues to grow at a 10-12% CAGR from FY09-12E driven by 49% CAGR in the premium C&P segment and supported by 16% CAGR in the SF&B business. The pharmaceuticals business, in contrast, will see a rationalization of its product and market portfolio and will cede capacity to C&P. EBITDA margins at the consolidated level are seen mounting to 28% by FY12E from 14% in FY09 driven by increased contribution to revenues from high-margin businesses and cost cuts effected by shifting manufacturing capacity to India.
- **Trading at 4.5x management's expected FY12E EBITDA:** At Friday's closing share price of Rs74.6, the PGL's market capitalization is Rs6.0bn. After accounting for the Rs10.0bn of debt on the books as on December 31, 2009 as well as for cash and minority interest, the enterprise value of Rs16.7bn is 11.8x FY09 EBITDA of Rs1.4bn but 4.5x FY12E EBITDA (based on management expectations) of Rs3.7bn. There are currently no earnings estimates for the company from the analyst community. We believe the key determinant of earnings growth will be the extent of the company's success in penetrating the premium segment of the C&P market.

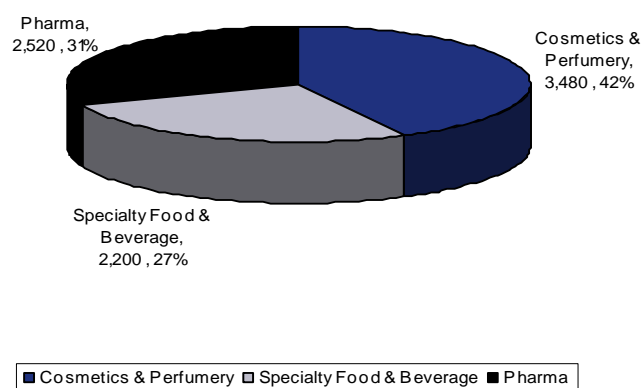
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Business description

Piramal Glass is a manufacturer of glass containers for the cosmetics and perfumery, pharmaceuticals, and specialty food and beverage industries. Applications to which the company's products are put include: (a) within the cosmetics and perfumery business - glass bottles for nail polish, foundations, fragrances, roll-ons and creams; (b) within the pharmaceuticals business - glass bottles for injectibles, vials and ampules; and (c) within the food and beverages business - glass bottles for high-end alcoholic and non-alcoholic beverages and miniature foods served in airlines. PGL provides end-to-end solutions including decoration, designing, in-house mould design and manufacturing and also has tie-ups with third party ancillary units for accessories like caps, cartons and brushes. The company's vision is to be recognized as one among the top 3 niche specialty glass manufacturers in the world.

Exhibit 1. Revenue Breakup by Business (Revenues in Rs mn, Share in %)



Source: Company data.

PGL's addressable opportunity within its targeted business segments adds up to over US \$5bn, i.e., a niche portion within the \$30bn glass packaging industry worldwide.

Exhibit 2. Addressable Opportunity and Installed Capacity

Market	Size (US \$bn)	PGL Installed Capacity (Tons per day)
Cosmetics & Perfumery	2.1	340
Specialty Food & Beverage	1.3	440
Pharma	2.0	335
Total	5.4	1,115

Source: Company data.

Cosmetics & Perfumery Business

PGL's principal focus area for the future is the premium segment of the cosmetics & perfumery (C&P) market which represents an opportunity of over \$1.6bn.

Exhibit 3. C&P Market: Breakup by Segment (US \$ mn)

Segment	Size	% of total market	RoCE %
Select perfumes	1,016	48%	25-30%
MNC mass perfumes & skin care	616	29%	20-25%
Low mass perfumes	320	15%	10-15%
Color cosmetics	146	7%	10-15%
Total	2,098	100%	

Source: Company data.

The premium segment comprises the select perfumes market and the MNC mass perfumes and skin care market. The mass segment comprises low mass perfumes and color cosmetics. Exhibit 3 shows that the premium segment represents 77% of the C&P market and also offers considerably higher returns on capital than the mass segment. PGL is currently a leading player in the mass segment: it is a global leader in both the color cosmetics segment (with a market share of 26%) and the low mass perfumes segment (with a market share of 10%). However, PGL has only a 2% share in the premium segment, where it hasn't been as successful in gaining market share. Unlike the mass segment, where a low cost producer has a significant competitive advantage, the premium segment carries much higher entry barriers in the form of a need for high skills. The decoration of glass bottles for the premium segment forms around 40% of the cost of production, and this requires high levels of skilled manual intervention. Additionally, customers in the premium segment conduct extensive audits of manufacturers' facilities and production processes before approval. Given that the customer base is highly concentrated – the top 20 customers represent 80% of the market – and that the customer acquisition cycle is long, PGL has found it more difficult to challenge the established leaders in the segment.

Exhibit 4. Key Competitors and Market Shares (%)

Firm	Market Share %
SGD	21%
Pochet	13%
Heinz	12%
Bormioli Luigi	10%
Gerresheimer	9%
Others	9%
Vitro	8%
Bormioli Rocco	7%
Piramal Glass	5%
Zignago Brosse	5%

Source: Company data.

The acquisition of Wheaton Glass has, however, brought relationships with 17 of the top 20 customers in the premium segment, which should support PGL's attempts at market penetration. Going forward, PGL expects its revenues within the premium segment to grow at a CAGR of 49% from FY09-12E. The U.S. acquisition has grown revenues at a CAGR of 9% to \$72mn in FY09, with PGL successfully winning back a few lost customers.

PGL believes that its key competitive advantages in this market, in addition to being the lowest-cost producer, include its extensive global marketing network, its modern manufacturing capacity and its existing customer relationships. The cost of production in India is much lower than in the West, principally due to lower labor costs. A McKinsey study has indicated that the cost differential between India and France (which is a major center for the premium segment) could be as high as 54%. PGL aims to shift 70% of the US facility's C&P operations to India in order to leverage this cost differential. So far, around 15% of C&P capacity based in the US has already been shifted to India, while customers have approved the shift of an additional 35%. PGL expects this shift to boost EBITDA margins.

Exhibit 5 presents a breakdown of the C&P market by segment with the company's projections for FY12E. The exhibit shows that the company intends to emphasize growth in the premium segment, which it expects will drive growth in the overall C&P business at a 19% CAGR through FY12E.

Exhibit 5. Piramal Glass C&P Revenues: Breakup by Segment (Rs Mn)

Segment	FY06	FY07	FY08	FY09	CAGR FY06-09	FY12E	CAGR FY09-12E
Premium	475	851	1,345	1,178	35%	3,895	49%
Mass	1,425	2,189	2,195	2,502	21%	2,306	-3%
Total	1,900	3,040	3,540	3,680	25%	6,201	19%

Source: Company reports, JM calculations.

Specialty food & beverage business

PGL's presence within the specialty food & beverage (SF&B) business is limited to manufacturing specialty bottles for a niche market for boutique alcoholic drinks. PGL expects to grow this business at a good rate by positioning its U.S. facility as an alternative to European suppliers who are its principal competitors. The advantages to customers of sourcing locally from the U.S. are a saving in freight cost as well as a reduction in lead time and inventory. PGL plans to dedicate its U.S. facility completely to the SF&B business, once its C&P capacity has been shifted to India.

Pharmaceuticals business

The pharmaceuticals business comes last in the pecking order for PGL. The company is a market leader in the Rs5bn Indian market with a share of 35%. However, faced with the looming threat of a shift by customers from glass to plastic for certain products, PGL is focusing on rationalizing its product and market mix to boost profitability. The company plans to focus on high value-added injectibles and infusion exports and to increase its sales in the US. It plans to reduce capacity by 80 tons per day in the U.S.

Strategy and outlook

PGL's business strategy involves focusing principally on the premium segment of the C&P market and, to a lesser extent, the specialty F&B business, while simultaneously rationalizing capacity within the pharmaceuticals business. Consequently, the company expects its revenue mix to change as shown in the table below.

Exhibit 6. Revenue Breakdown by Business (Rs Mn)

Business	FY04	FY05	FY06	FY07	FY08	FY09	CAGR FY04-09	FY12E	CAGR FY09-12E
Cosmetics & Perfumery	580	1,000	1,900	3,040	3,540	3,680	45%	6,201	19%
Specialty Food & Beverage	580	560	880	1,240	1,370	2,430	33%	3,826	16%
Pharma	1,910	1,800	2,150	2,730	2,870	3,980	16%	3,167	-7%
Total	3,070	3,360	4,930	7,010	7,780	10,090	27%	13,194	9%

Source: Company reports, JM calculations.

PGL projects that its revenues from the premium segment of C&P will grow at a CAGR of 49% from FY09 to FY12E, so that its contribution to total company revenues increases from 12% to 30%. This is expected to drive a 19% CAGR in the total C&P business (which includes the premium as well as mass segments). Additionally, based on data provided by the company, we conclude that it expects the SF&B business to grow at a 16% CAGR through FY12E. The pharma business is expected to decline modestly as a result of product and market rationalization. The company sees its total revenues growing at a CAGR of 10-12% from FY09 to FY12E.

The company also sees EBITDA margins expanding from 14% in FY09 to 28% in FY12E, driven by a greater contribution to total revenues from the high-margin premium C&P segment, as well as by a shift in manufacturing capacity from the U.S. to India. Exhibit 7 shows the ramp in EBITDA implied by company disclosures.

Exhibit 7. Revenues and EBITDA (Rs Mn) and EBITDA Margins (%)

Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10 YTD	FY12E
Revenues	3,070	3,360	4,930	7,010	7,780	10,090	8,200	13,194
EBITDA	869	954	942	617	459	1,413	1,697	3,694
Margin %	28.3%	28.4%	19.1%	8.8%	5.9%	14.0%	20.7%	28.0%

Source: Company reports, JM calculations.

Valuations

Based on Friday's closing share price of Rs74.6, estimated shares outstanding stand at 80.4mn, debt as of December 31 at Rs10.4bn, and cash and minority interests as of March 31, 2009 at Rs118mn and Rs447mn respectively. We calculate an enterprise value of Rs16.7bn for PGL.

Exhibit 8. Piramal Glass Enterprise Value Calculation (Rs Mn)

Share Price	74.6
<u>x Shares o/s</u>	<u>80.4</u>
= Market Cap	5,997
+ Debt	10,380
- Cash	(118)
<u>+ Minority Interest</u>	<u>447</u>
= Enterprise Value	16,706

Source: Company reports, JM calculations.

This enterprise value implies an EV/EBITDA multiple of 11.8x the FY09 EBITDA of Rs1.4bn and 4.5x the FY12E EBITDA of Rs3.7bn implied by company disclosures. The critical factor that will determine the ramp in EBITDA will, we believe, be the extent of the company's success in penetrating the high-margin premium C&P segment. Given PGL's current market share of 2% in the premium C&P segment, there is potential for a substantial increase in EBITDA through FY12E and beyond if the company succeeds in challenging the market leader, who currently carries a share of over 20%.

History

The Piramal Group entered the glass business in 1984 by acquiring a controlling stake in Gujarat Glass Limited, then a listed company engaged in the business of manufacturing glass containers for the pharmaceuticals industry. In 1991, Gujarat Glass was merged with Piramal Healthcare Ltd., within which it operated as a separate division until 1998, when it was spun off into a separate company named Gujarat Glass Private Limited in which private equity investors acquired a 46% stake and Piramal Healthcare held the remaining 54%. In 2003, Piramal Healthcare's 54% stake was transferred to a holding company named Kojam Fininvest, which obtained listing on the stock exchanges as a public company. In 2008, Kojam merged into Gujarat Glass Limited, which got relisted and was renamed Piramal Glass.

Over the years, Piramal Glass and its predecessors have acquired multiple overseas entities to boost their international business. In 1999, it acquired a majority stake in Ceylon Glass Company Ltd., Sri Lanka. In 2005, it acquired certain assets of The Glass Group (formerly known as Wheaton Glass) in the United States. Around the same time, it also acquired certain assets of the International Bottle Company Limited in the United Kingdom.

Following its acquisition of Wheaton Glass in the U.S. out of a Chapter 11 bankruptcy filing, PGL incurred losses through FY09 as its consolidated financials were weighed down by losses at the U.S. operations. The U.S. business suffered in the face of high fixed costs, including labor expenses, in a difficult market environment.

The company invested \$70 mn in the U.S. overall since acquisition, including the purchase price, working capital and accumulated losses. After considerable erosion in net worth, the company opted for a rights issue guaranteed by the promoters (who currently own more than 76% of PGL) in August 2009 in order to bring leverage down to more manageable levels. The business has since been turned around. Costs at the U.S. operations have been brought down from \$66 mn to \$56 mn, while revenues have increased from \$56 mn to \$72 mn. PGL has reported profits at the consolidated level in the last two quarters. 3QFY10 EPS was Rs1.34.

Exhibit 9. Consolidated Income Statement (Rs mn, except per share)

Rs mn, except per share	FY07	FY08	1Q FY09	2Q FY09	3Q FY09	4Q FY09	FY09	1Q FY10	2Q FY10	3Q FY10
Net sales / income from operations	7,007.6	7,786.2	2,209.7	2,561.7	2,699.9	2,617.0	10,088.3	2,456.6	2,928.1	2,818.9
Other operating income	196.1	188.8	45.5	64.4	60.3	38.5	208.7	51.6	61.5	43.4
Total revenues	7,203.7	7,975.0	2,255.2	2,626.1	2,760.2	2,655.5	10,297.0	2,508.2	2,989.6	2,862.3
Change in stock-in-trade & WIP	145.2	466.2	288.1	153.3	43.9	90.2	575.5	-126.8	-93.6	-11.8
Consumption of raw materials	-1,452.0	-1,582.8	-561.5	-529.4	-636.0	-773.2	-2,500.1	-431.7	-626.2	-516.0
Cost of traded goods	-34.9	-145.4	-32.6	-107.0	-16.3	-55.7	-211.6	-60.1	-42.0	-15.3
Employee cost	-2,063.0	-2,103.2	-597.0	-574.2	-614.4	-565.1	-2,350.7	-527.6	-530.4	-575.7
Depreciation	-515.1	-693.2	-211.0	-225.5	-230.0	-226.0	-892.5	-229.5	-228.6	-228.6
Energy cost	-1,155.4	-1,428.0	-477.3	-537.1	-493.7	-441.1	-1,949.2	-394.9	-440.1	-430.3
Freight cost	-553.9	-660.8	-174.7	-201.5	-182.4	-153.8	-712.4	-120.8	-156.1	-211.9
Foreign exchange loss / (gain), net	0.0	86.9	-21.0	-75.2	-274.6	-168.8	-539.6	-76.6	-68.7	-71.5
Other expenditure	-1,366.0	-1,314.8	-354.6	-372.0	-431.5	-502.2	-1,660.3	-397.4	-473.7	-476.3
Operating profit	208.6	599.9	113.6	157.5	-74.8	-140.2	56.1	142.8	330.2	324.9
Other income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest, net	-347.5	-724.6	-254.7	-297.8	-362.8	-398.4	-1,313.7	-365.6	-309.8	-196.7
Exceptional items	-109.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit before tax	-248.7	-124.7	-141.1	-140.3	-437.6	-538.6	-1,257.6	-222.8	20.4	128.2
Tax expense	-126.9	-102.1	7.3	-9.3	55.4	132.4	185.8	14.3	-14.7	-15.2
Extraordinary items, net of tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minority interest	-15.4	-1.6	19.2	10.1	10.8	6.4	46.5	25.0	-0.3	-5.2
Profit after tax	-391.0	-228.4	-114.6	-139.5	-371.4	-399.8	-1,025.3	-183.5	5.4	107.8
Basic EPS	-21.75	-12.70	-6.37	-6.06	-16.14		-44.54	-10.21	0.17	1.34
Diluted EPS	-21.75	-12.70	-6.37	-6.06	-16.14		-44.54	-10.21	0.17	1.34

Source: Company reports.

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51, Maker Chambers III, Nariman Point, Mumbai 400 021, India.

Board: +9122 6630 3030 | Fax: +91 22 6747 1825 | Email: jmfinancial.research@jmfinancial.in | www.jmfinancial.in

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