CRISIL Ratings

Press release

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Flexible packaging industry stares at decadal low profitability as oversupply stings

Weak export demand also impacting performance; recovery expected next fiscal

Sizeable capacity additions over the past two fiscals and the resultant oversupply will beat down profitability of Indian flexible packaging industry to a decadal low of ~8% this fiscal. Additionally, the weakness in export demand will contribute to the dent in profitability. Revenue will decline 3-5% as realisations remain subdued due to the supply glut.

The credit risk profiles of manufacturers will remain under pressure till an expected recovery in operating performance kicks in towards the end of the fiscal.

A CRISIL Ratings analysis of eight large flexible packaging players, which account for over 75% of the domestic capacity, indicates as much.

The industry has historically seen cycles of chunky capacity addition and oversupply. Last fiscal, for instance, capacity addition crumpled the industry's operating margin to ~10.5% from 18-20% seen during the pandemic.

The industry comprises bi-axially oriented polypropylene (BOPP) and bi-axially oriented polyethylene (BOPET) films. BOPET films have diverse end-use applications on account of their higher oxygen-retention power, high tensile strength, longer shelf life and better print quality compared with BOPP films. However, BOPP films have higher moisture resistance properties and are cheaper, making them ideal to package food products.

Says Mohit Makhija, Senior Director, CRISIL Ratings Ltd, "The industry operating margin is expected to shrink ~250 basis points to ~8% this fiscal, after a sharp correction of ~750 basis points last fiscal. BOPET film makers have added ~45% capacity and BOPP film makers ~20% in the last two fiscals, while domestic demand has increased only ~11% in the period. This imbalance was compounded by a fall in exports (typically 25-30% of total revenue) because of slowdown in Europe and the US, the key markets."

While food packaging, pharmaceuticals and personal care segments are likely to help keep domestic demand resilient, exports may recover slowly towards the end of this fiscal. With no major capacity coming online this fiscal and the next, demand-supply balance is expected to improve gradually over the next 6-12 months. Given these dynamics, volume growth is expected to be moderate at 5-6% this fiscal.

On the supply side, raw material prices typically follow the crude price movement. The average raw material prices this fiscal will be lower on-year and the same will also impact the realisations. Consequently, revenue of the industry will degrow 3-5%. This will be on the back of a stagnant revenue performance last fiscal.

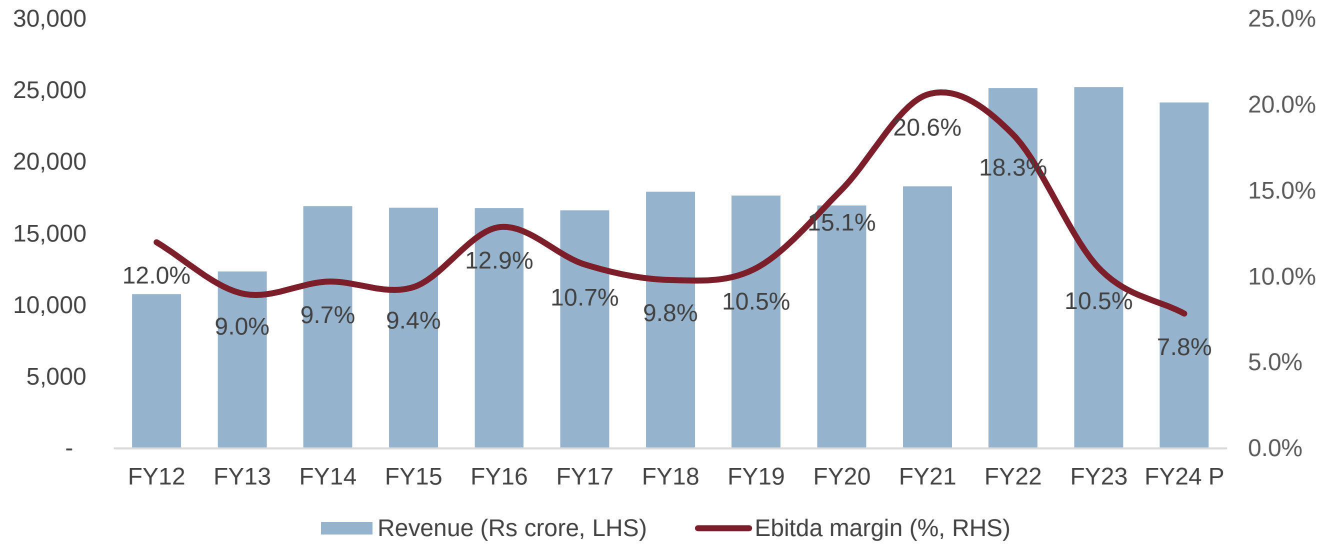
Manufacturers will need to rely on balance sheet liquidity and financial flexibility to sail through this cyclical downturn.

Says Anand Kulkarni, Director, CRISIL Ratings Ltd, "The credit profiles of flexible packaging companies are expected to stay under pressure due to weak operating performance in the current fiscal. Additionally, capacity additions in the recent past have increased debt levels. Hence, debt metrics of these companies have weakened considerably. Debt to Ebitda (earnings before interest, taxes, depreciation, and amortisation) and interest coverage ratios are estimated at ~3.9 times and ~2.8 times, respectively, this fiscal against 10-year average of ~2.5 times and ~5.0 times."

In the near term, any major capex that may increase the demand-supply imbalance will remain monitorable, as will macroeconomic developments that impact commodity prices.

Annexure

Chart 1: Decadal average of operating margin



Source: Company financials, CRISIL Ratings and company investor presentations

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