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Stock Update

Supreme Industries

Fastest recovery pick up in building material segment

Building Materials	Sharekhan code: SUPREMEIND	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,459**	
Price Target: **Rs. 1,725**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

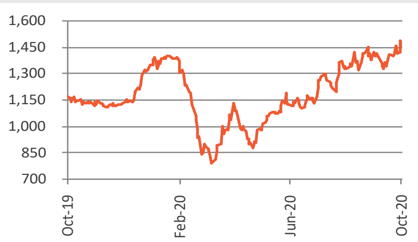
Company details

Market cap:	Rs. 18,536 cr
52-week high/low:	Rs. 1500/791
NSE volume: (No of shares)	4.3 lakh
BSE code:	509930
NSE code:	SUPREMEIND
Free float: (No of shares)	6.5 cr

Shareholding (%)

FII	9
Institutions	25
Public & others	18
Promoters	49

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.1	15.4	33.7	24.5
Relative to Sensex	-1.1	10.5	11.7	24.2

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Supreme Industries with a revised PT of Rs. 1725, revising our FY2021E-FY2023E earnings estimates upwards and considering strong net earnings growth over FY2021E-FY2023E.
- The company reported strong outperformance in revenues, OPM and net profitability in Q2FY2021. Cash surplus further improves.
- October till date continued to see y-o-y growth across all business verticals. The company remains optimistic on rural, tier III, tier IV economies along with demand generation from the affordable housing segment.
- SIL is one of the fastest to recover in post lock-down era in the building material space. The company will focus on appointing distributors, addition of products and deeper penetration.

Supreme Industries Limited (SIL) delivered yet another better-than-expected performance in Q2FY2021. The consolidated revenues grew 8.2% y-o-y to Rs. 1375 crore, led by a rise of 1.4% y-o-y in volume for plastic goods at 94,836MT and 3.7% y-o-y rise in blended realization (Rs. 145/kg). The revenues from value added products grew 8.6% y-o-y to Rs. 533 crore with contribution to overall revenues remaining at 39%. SIL also reported 500 bps y-o-y improvement in OPM led by higher gross margins (up 424 bps y-o-y) and lower other expense. It also benefited from inventory gain in plastic piping segment. Hence, operating profit grew 48.1% y-o-y to Rs. 256 crore. Strong operational performance along with lower interest expense led to PBT growth of 75.6% y-o-y. Consolidated net profit grew 25.3% y-o-y (lower growth due to tax write back in Q2FY2020) to Rs. 175 crore, which came in much higher than our as well as street estimates.The management has seen y-o-y growth across all its segments during October till date. The company remains quite optimistic on rural, tier III, tier IV economies along with demand being generated for affordable housing pan-India. The company also improved cash surplus to Rs. 215 crore from Rs. 31 crore in Q1FY2021. We have increased our earnings estimates for FY2021E-FY2023E as we factor in higher than expected volume growth and OPM achieved in Q2FY2021 and improved growth outlook going ahead. Supreme Industries is expected to be one of the fastest recovery pick in the building material segment. The stock is currently trading at 31.0x/25.5x P/E on FY2022E/FY2023E earnings which we believe leaves further room for upside considering its strong net earnings growth trajectory over FY2021E-FY2023E. Hence, we retain our Buy rating on the stock with revised PT of Rs. 1725.

Key Positives

- Company posted outperformance across revenues, OPM and net earnings.
- Cash surplus further improved to Rs. 215 crore from Rs. 31 crore in Q1FY2021 end.
- October till date has seen y-o-y growth across all its segments.

Key Negatives

- Margins in plastic piping partly contributed by inventory gain which is expected to reverse in Q4FY2021.
- PVC resin prices are moving northwards.

Our Call

Valuation –Maintain Buy with a revised PT of Rs. 1725: SIL is one of the fastest to recover in the post lock-down era in the building material sector. The company's growth outlook remains healthy going ahead along with strong improvement in cash surplus. The company is expected to focus on appointing more distributors, adding more products and deeper penetration. We have increased our earnings estimates for FY2021E-FY2023E as we factor in higher than expected volume growth and OPM achieved in Q2FY2021 and improved growth outlook going ahead. Supreme Industries is expected to be one of the fastest recovery pick in the building material segment. The stock is currently trading at 31.0x/25.5x P/E on FY2022E/FY2023E earnings which we believe leaves further room for upside considering its strong net earnings growth trajectory over FY2021E-FY2023E. Hence, we retain our Buy rating on the stock with revised PT of Rs. 1725.

Key Risks

Slowdown in demand offtake could impact revenue growth rates. Adverse commodity price fluctuation might impact the margin profile.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	5,612	5,512	5,275	6,433	7,435
OPM (%)	14.0	15.1	14.7	15.5	15.7
Adjusted PAT	381	467	439	597	727
% YoY growth	(11.7)	22.5	(6.2)	36.2	21.8
Adjusted EPS (Rs.)	30.0	36.8	34.5	47.0	57.3
P/E (x)	48.6	39.7	42.3	31.0	25.5
P/B (x)	8.6	7.5	6.8	5.9	5.1
EV/EBITDA (x)	23.5	22.1	24.1	18.5	15.8
RoNW (%)	17.7	19.0	16.0	19.1	20.2
RoCE (%)	24.5	23.4	18.8	22.4	23.8

Source: Company; Sharekhan estimates

Healthy revenue growth along with strong OPM leads to beat in net earnings

The company's consolidated revenues for Q2FY2021 grew 8.2% y-o-y to Rs. 1375 crore led by 1.4% y-o-y rise in volume of plastic goods at 94,836MT while blended realization improved 3.7% y-o-y (Rs. 145/kg). The revenues from value added products grew 8.6% to Rs. 533 crore (comprising 39% of total revenues) in Q2FY2021. The company's gross margins improved 424 bps y-o-y to 38.3% on account of product mix along with inventory gain in plastic piping segment. Higher gross margins along with lower other expense (14.4% of sales vs. 15.0% in Q2FY2020) led to 500 bps y-o-y rise in OPM to 18.6%. Hence, operating profit grew sharply by 48.1% y-o-y to Rs. 256 crore. Strong operational performance along with lower interest expense (down 64.8% y-o-y) led to PBT growth of 75.6% y-o-y to Rs. 201 crore. The company's consolidated net profit grew at 25.3% y-o-y to Rs. 175 crore on account of Rs. 33.6 crore deferred tax liabilities write back in Q2FY2020.

Strong growth prospects to sustain going ahead

The company has been witnessing healthy business prospects from August 2020 in all its segments. During October till date, it has seen every business segment growing higher on a y-o-y basis. The CPVC segment which had seen de-growth in H1FY2021 has also seen growth during October 2020. The company is seeing healthy signs like better crop output this year, larger acreage crop sowing for Rabi, higher MSP etc to benefit going ahead. The management is also optimistic on affordable housing demand over the next five months as migrant workers return to project sites, lower interest rates and lower stamp duty in some states. Hence, although the management refrained from giving any concrete guidance, its commentary over next five months for the domestic market remains encouraging.

Expansion to continue led by healthy cash flow position: The company further improved upon its cash surplus to Rs. 215 crores as on Q2FY2021 end as against cash surplus of Rs. 31 crores on Q1FY2021 end and net debt of Rs 217 crore as on FY2020 end. Also the average borrowing cost of the company improved to 5.89% versus 7.53% in Q1FY2021 and 8.35% as on 31st March 2020. The company is putting up a piping project in Odisha with an envisaged capacity of 45,000MT at a cost of Rs. 135 crores over a period of two years. Further, the company is contemplating setting up new plants in other states, for which land negotiations are progressing in Assam and TamilNadu.

Key Conference Call Takeaways

- **October month update:** Every segment of the company grew y-o-y during October 2020. The demand for plastic pipes and packaging is expected to grow m-o-m going ahead.
- **Guidance:** The management did not give any guidance as it is difficult on account of the second and third wave of the pandemic emerging in Europe and USA.
- **Price increase:** The price of PVC has gone up due to which its customers are maintaining low inventory. The prices are expected to go down over two to three months. The company did not take price hike till now but is expected to take one in November and December. It consciously decided to go slow on increasing prices.
- **Margins in Plastic Piping:** The higher margins in plastic piping was partly due to inventory gain. In Q4, it may post inventory loss.
- **Industry growth vs company's:** The PVC resin is estimated to have declined by 25.5% y-o-y while plastic piping (76% of PVC resin used) declined by 7.5% in H1. The company gained market share in plastic piping system. The PVC resin demand is expected to decline 12-15% y-o-y for FY2021.
- **Housing demand:** Barring Mumbai, the demand for housing is good in India. The management is quite optimistic about the demand from affordable housing segment over next five months.
- **Credit days:** It maintained credit days at 21 days despite rise in PVC prices.
- **Distributor addition:** The company added 86 distributors in H1 taking total distributors in Plastic Piping system to 1300.

- **Strategy for growth:** It would be putting plants at more locations (currently present in 11 states) and increase the mix of branded products (82% right now). It has a three-pronged strategy for growth going ahead vix. appointing more distributors, adding more products and reaching more tehsils.
- **Expansion:** The company is setting up 45,000MT capacity piping project in Odisha at a cost of Rs. 135 crores over a period of two years. It is identifying land in Assam and Tamil Nadu for new plants.
- **Composite cylinder:** The company has received aceptance for small export orders to three to four countries. Unless it bags bulk orders, it won't be able to utilize capacity (4.5 lakh pieces/p.a.)
- **Biofloc:** It has supplied 212 units in eleven states. It is still under observation.
- **Plastic tank expansion:** It is undertaking capacity expansion of plastic tank capacity which is currently at 14,000 MT/p.a. and slated to reach 17,000-18,000MT/p.a. post expansion. It can generate Rs. 200-230 crore peak revenue from the division post expansion.

Results (Consolidated) Rs cr

Particulars	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Revenue	**1,374.8**	**1,270.9**	**8.2**	**1,053.9**	**30.4**
Total expenditure	1,118.9	1,098.1	1.9	936.8	19.4
EBITDA	**255.9**	**172.8**	**48.1**	**117.1**	**118.5**
Depreciation	52.3	51.7	1.1	50.8	3.0
EBIT	**203.6**	**121.1**	**68.1**	**66.3**	**206.9**
Other income	0.1	0.5	-85.2	0.3	-71.4
Interest expenses	2.5	7.1	-64.8	7.8	-68.0
PBT	**201.1**	**114.6**	**75.6**	**58.8**	**242.0**
Tax expenses	52.7	-14.0	-475.4	14.6	260.0
Share of profit from association	-26.5	-11.0	141.2	3.7	-826.3
Adjusted net profit	**175.0**	**139.6**	**25.3**	**40.5**	**331.7**
Extra ordinary itmes	0.0	0.0	-	0.0	-
Reported net profit	**175.0**	**139.6**	**25.3**	**40.5**	**331.7**
Adjusted EPS (Rs)	13.8	11.0	25.3	3.2	331.7
			BPS		**BPS**
EBITDA Margin (%)	18.6	13.6	500	11.1	750
PAT Margin (%)	12.7	11.0	170	3.8	890
Effective tax rate (%)	26.2	-12.3	3,850	24.9	130

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Expect faster recovery in operations

The building materials industry was severely affected by COVID-19 led lockdown during Q1FY2021, which had affected its peak sales period of the year. Additionally, its high fixed cost structure had affected OPM, draggingdown its net earnings. However, from June, the sector has been one of the fastest in recovery with easing oflockdowns domestically. The sector witnessed resumption of dealer and distribution networks and a sharp improvement in capacity utilisationlevels. Most players have begun to see demand and revenue run-rate reaching 80-90% compared to pre-COVID levels. Scaling up of revenue is also expected to lead to better absorption of fixed costs going ahead, aiding net earnings recovery. The industry is expected to rebound with strong growth in FY2022.

■ Company outlook - Healthy demand outlook in rural and affordable housing segments

The company has been witnessing healthy business prospects from August 2020 in all its segments. During October till date, it has seen every business segment growing higher y-o-y. The CPVC segment which had seen de-growth in H1FY2021 has also seen growth during October 2020. The company is seeing healthy signs like better crop output this year, larger acreage crop sowing for Rabi, higher MSP etc to benefit going ahead. The management is also optimistic on affordable housing demand over the next five months as migrant workers return to project sites, lower interest rates and lower stamp duty in some states. Hence, although the management refrained from giving any concrete guidance, its commentary over next five months for domestic market remains encouraging.

■ Valuation - Maintain Buy with a revised PT of Rs. 1725

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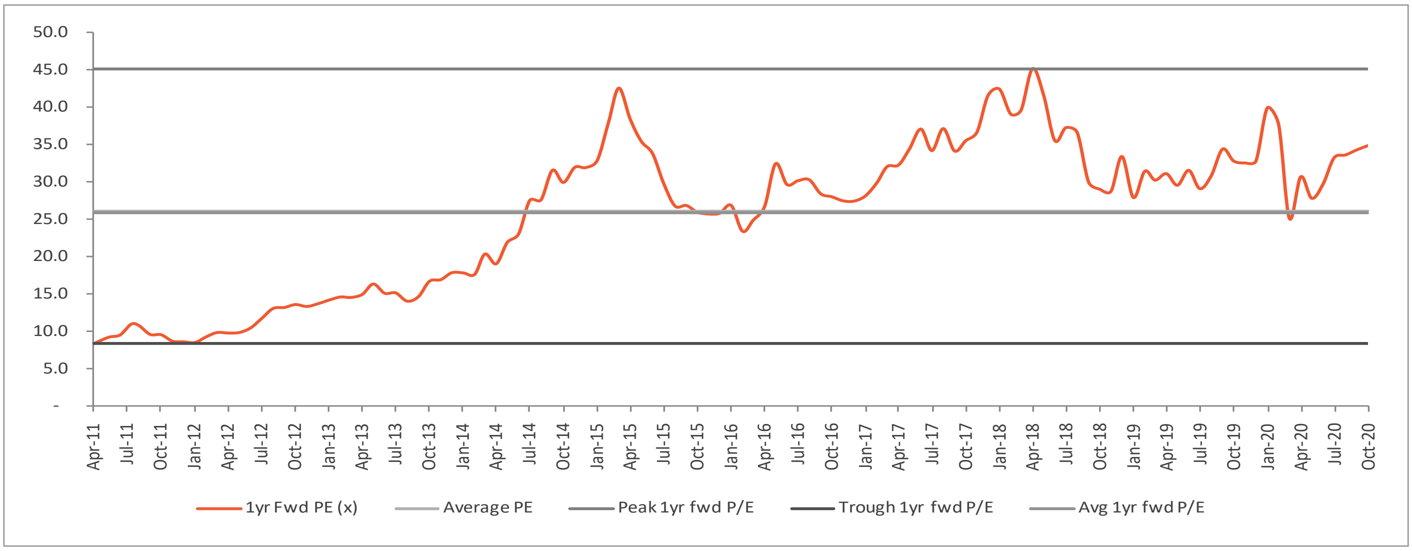
One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Supreme Industries	31.0	25.5	18.5	15.8	5.9	5.1	19.1	20.2
Astral Poly Technik	48.7	39.5	29.0	24.1	8.2	6.9	18.4	18.9
Prince Pipes*	21.0	18.3	10.4	9.5	2.5	2.2	12.4	12.2

*Source: Sharekhan Research, * Bloomberg Estimates*

About company

SIL is a leading manufacturer of plastic products with a significant presence across piping, packaging, industrial and consumer segments. The company has emerged as one of the best proxy plays on the growing plastic consumption in India because of a diversified product portfolio, an extensive distribution network, improved capital structure and government thrust on building a better infrastructure.

Investment theme

SIL is on a firm footing, with a strong product portfolio and new product launches, which are expected to drive growth in the coming years. The government's thrust on affordable housing and enhanced allocation towards irrigation projects will aid future growth for the companies such as SIL.We remain positive on the introduction of value-added products and capacity expansion plans, which are largely funded by robust internal accruals. SIL enjoys superior return ratios with low gearing levels, and we expect the company to maintain high return ratios going forward.

Key Risks

Slowdown in demand offtake from the user industry can impact revenue growth rates. Adverse commodity price fluctuation might impact margin profile.

Additional Data

Key management personnel

Bajranglal Surajmal Taparia	Non Executive Chairman
Mahavirprasad Surajmal Taparia	Executive Director
Shivratan Jeetmal Taparia	Executive Director
Vijaykumar Bajranglal Taparia	Executive Director
P C Somani	Chief Finance Officer
Rajendra J Saboo	AVP (Corporate Affairs) & Company Secretary & Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Jovial Investment & Trading	16.12
2	Boon Investment & Trading	16.11
3	Venktesh Investment & Trading	14.20
4	Axis Asset Management	5.01
5	Nalanda India Fund Ltd	4.81
6	Kotak Mahindra Asset Management	3.72
7	JPMorgan Chase	3.24
8	HDFC Asset Management	2.23
9	DSP Investment Managers	1.93
10	L&T Mutual Fund Trustee	1.68

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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