Sharekhan
by BNP PARIBAS

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Stock Update

Supreme Industries

Outperforming industry growth rates

Building Materials	Sharekhan code: SUPREMEIND	Result Update

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

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,732**	
Price Target: **Rs. 2,020**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

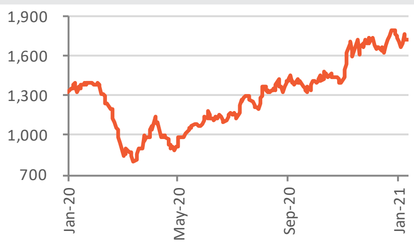
Company details

Market cap:	Rs. 21,997 cr
52-week high/low:	Rs. 1,847 / 791
NSE volume: (No of shares)	94,430
BSE code:	509930
NSE code:	SUPREMEIND
Free float: (No of shares)	6.5 cr

Shareholding (%)

Promoters	9
FII	25
DII	18
Others	49

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.6	21.8	47.7	31.1
Relative to Sensex	3.5	1.4	20.2	14.9

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Supreme IndustriesLimited (SIL) with an unchanged PT of Rs. 2,020, revising our FY2021E-FY2023E earnings estimates upwards and considering strong net earnings growth over FY2021E-FY2023E.
- The company continued to report strong outperformance in revenue, OPM, and net profitability in Q3FY2021. Share of value-added products is on the rise. Cash surplus further improves.
- The company is witnessing housing-led demand pick up from metro cities. We expect sustainable 10%-12% volume-led growth going ahead.
- The company will focus on appointing distributors, addition of products, and deeper penetration. Capex of Rs. 400 crore has been earmarked for this year.

Supreme Industries Limited (SIL) continued to outperform during Q3FY2021 on all fronts. Consolidated revenue grew by 34.3% y-o-y to Rs. 1,844 crore, led by 10.1% y-o-y rise in volume for plastic goods at 111,584MT and 24.8% y-o-y rise in blended realization (Rs. 165/kg). Revenue from value-added products grew by 33.5% y-o-y to Rs. 758 crore with contribution to overall revenue rising to 41% from 39% in Q1FY2021. SIL also reported 569 bps y-o-y improvement in OPM to 21.8%,led by higher gross margin (up 177 bps y-o-y) and lower other expense. The company booked Rs. 80 crore inventory gain during the quarter, which pumped up OPM by 4% (excluding inventory gain, OPM would have been 17.2%). PVC resin prices have gone up by Rs. 23 per kg during the quarter with an increase of 25% in its prices, which led to inventory gain. Hence, operating profit grew by 81.8% y-o-y to Rs. 402 crore. Strong operational performance led to 2.5x y-o-y rise in consolidated net profit to Rs. 312 crore, which came in much higher than our as well as street estimates. The company is witnessing pickup in demand from metro cities in the housing sector. Demand for all its products remains strong except in the agriculture sector. The company has gained market share during 9MFY2021 in both PVC and CPVC segments. Management expects Q4FY2021 to be better than Q4FY2020. Management expects 10%-12% sustainable volume growth in piping, although it is unable to ascertain value-led growth. The company also improved cash surplus to Rs. 432 crore from Rs. 215 crore in Q2FY2021. The company would be investing around Rs. 400 crore during this year including carried forward commitment of Rs. 182 crore. The company is undertaking Brownfield expansion at seven sites and Greenfield expansion at three new sites. SIL aims to put these new plants in production in FY2022. We have increased our earnings estimates for FY2021E-FY2023E, as we factor in higher-than-expected volume growth and OPM due to improved growth outlook going ahead. The stock is currently trading at 28.9x/24.8x 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 an unchanged PT of Rs. 2,020.

Key positives

- **The company posted outperformance across revenue, OPM, and net earnings.**
- **Cash surplus further improved to Rs. 432 crore from Rs. 215 crore in Q2FY2021 end.**
- **Housing-led demand pick up in metros is expected to sustain.**

Key negatives

- Agri demand remained weak due to high PVC prices.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 2,020: SIL is one of the fastest companies to recover in the post unlock 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. SIL is expected to benefit from strong housing demand and government schemes such as 'Nal se Jal'. We have increased our earnings estimates for FY2021E-FY2023E, as we factor in higher-than-expected volume growth and OPM due to improved growth outlook going ahead. The stock is currently trading at 28.9x/24.8x 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 an unchanged PT of Rs. 2,020.

Key Risks

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

Valuations (Consolidated) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	5,512	6,027	6,985	7,984
OPM (%)	15.1	18.5	17.3	17.5
Adjusted PAT	467	713	760	887
% YoY growth	22.5	52.5	6.6	16.8
Adjusted EPS (Rs.)	36.8	56.1	59.8	69.9
P/E (x)	47.1	30.9	28.9	24.8
P/B (x)	8.9	7.5	6.4	5.5
EV/EBITDA (x)	26.3	19.8	18.2	15.7
RoNW (%)	19.0	24.4	22.3	22.2
RoCE (%)	23.4	28.6	26.3	26.5

Source: Company; Sharekhan estimates

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

SIL continued to outperform during Q3FY2021 on all fronts. Consolidated revenue grew by 34.3% y-o-y to Rs. 1,844 crore, led by 10.1% y-o-y rise in volume for plastic goods at 111,584MT and 24.8% y-o-y rise in blended realisation (Rs. 165/kg). Revenue from value-added products grew by 33.5% y-o-y to Rs. 758 crore with contribution to overall revenue rising to 41% from 39% in Q1FY2021. SIL also reported 569 bps y-o-y improvement in OPM to 21.8% led by higher gross margins (up 177 bps y-o-y) and lower other expense. The company booked Rs. 80 crore inventory gain during the quarter, which pumped up OPM by 4% (excluding inventory gain, OPM would have been 17.2%). PVC resin prices have gone up by Rs. 23 per kg during the quarter with an increase of 25% in its prices, which led to inventory gain. Hence, operating profit grew by 81.8% y-o-y to Rs. 402 crore. Strong operational performance led to 2.5x y-o-y rise in consolidated net profit to Rs. 312 crore, which came in much higher than our as well as street estimates.

Healthy growth prospects to sustain:

The company is witnessing pickup in demand from metro cities in the housing sector. Demand for all its products remains strong, except in the agriculture sector. The company has gained market share during 9MFY2021 in both PVC and CPVC segments. Management expects Q4FY2021 to be better than Q4FY2020. Management expects 10%-12% sustainable volume growth in piping although it is unable to ascertain value-led growth. The company also improved cash surplus to Rs. 432 crore from Rs. 215 crore in Q2FY2021. The company has also introduced the economy model of Tarpaulin in the cross laminated film segment having lower value addition. However, overall demand for cross laminated film products for the year is expected at a higher level, which may boost business to 21,000 MT duringthe year compared to 17,000 MT in the previous year.

Expansion to continue, led by healthy cash flow position:

The company's capex plan is going smoothly. Along with carried forward investment commitment of Rs. 182 crore, the company has made a plan to invest around Rs. 400 crore in this year. The said investment is made mostly in its existing plants where additionalconstruction activities are going on at seven sites. The company is also now putting up new plantsat three locations. Land for these plants have been already acquired at Orissa and Tamil Nadu. InAssam, the plant is being constructed on a lease agreement basis. The company aims to put allthese new plants in production in the year 2021-2022.

Key Conference Call Takeaways

- **Guidance:** Management expects Q4FY2021 to be better than Q4FY2020. The company expects 10%-12% volume led growth while it cannot comment on value growth.
- **Demand environment:** The demand environment is good except the agricultural segment. In housing, demand from metro cities is picking up. PWC enquiries are coming but it is selective. Present capacity is 12,000 tonne per annum for PWC, but currently it is not utilising full capacity.
- **Industry versus company growth:** In India, PVC consumption for nine months saw a decline of 20.5%, while the company declined by 3.7%. In CPVC, the country witnessed a decline of 13.5%, while the company declined by 2.9%. Hence, the company has increased market share in nine months in PVC and CPVC.
- **OPM excluding inventory gain:** In Q3, OPM stood at 21.53%, Rs. 80 crore inventory gain on Rs. 1,765 crore turnover comes to more than 4%. Excluding inventory gain, OPM would be 17.2%.
- **Valued¬-added growth:** Strong growth in value-added products across categories especially in cross laminated products (100%), several new products in the plastic pipe segment (42% share), furniture (52.5%), material handling system and performance packaging products (60%). These combined have gave a boost of Rs. 190 crore during the quarter. Focus of the company remains to introduce value-added products.
- **Agri pipes performance:** Agri pipes are witnessing weak demand as prices have gone up. PVC prices have gone up by Rs. 42/kg since March. Prices may come down to some level in two to three months. Demand may revive thereafter.
- **Capacity expansion:** Putting up 10 new facilities at three new locations. By December end, it will be supplying tanks from all locations. Today, it is supplying from five locations. Currently, it is selling Rs. 15 crore-16 crore tanks every month. Going forward, the business will keep on growing and have location advantage. Margins in the tanks business is of value-added product margins. For 2021, including carry forward Rs. 182 crore, capex of Rs. 400 crore is to be done. The company would be making presence in each tehsil (there are 5,700 tehsils/talukas) and would be adding more SKUs.

- **Industrial segment's high growth:** There is strong demand from the e-commerce sector for pellets, while the company is a big producer of plastic pellets. Large warehouses are being created by e-commerce companies, which led to strong growth. In industrial components, the consumer durables segment led to good growth.
- **RoCE:** RoCE should remain above 25% and the company's desire is to go beyond 30% from 28%-29%currently.
- **Packaging product segment:** In the performance packaging film lot of capacity came up at a time and prices of LDP had gone up and the company did not participate in some business. That led to overall lower growth. Now, in the current quarter, prices have started coming down and so management expects better performance in Q4FY2021.
- **Packaging margin:** In the process of cross-laminated, film business generates lot of scrap. Offer consumer six-month lifetime at a lower cost to add value to customers. In the current year, estimate business of 2,000 tonne.
- **Distribution strength:** In Q3FY2021, distribution strength stood at 4,001 (versus 3,567 as of Q4FY2020), of which piping is 1,373, material handling is 205, furniture is 1,214, cross laminated is 504, and protective packaging is 705.
- **Capacity breakup:** As ofQ3FY2021, plastic piping stood at 4,99,111 (4,40,671), industrial stood at 74,897 (75,000), packaging was at 90,554 (90,500), and consumer i.e., furniture stood at 29,848 (30,000). So, overall, 6,94,409 as against 6,35,969 (as of Q4FY2020).
- **Supreme petro performance:** Polystyrene capacity stood at 24,000 tonne per month at two locations. After the mishap, the company has strong domestic demand, while only 1,000 tonne is exported. The company is putting in another train of polystyrene, which will be operational by December 2021.
- The company has started insurance cover for plumbers, which are influencers for the company's business.

Financials (Consolidated) Rs cr

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Revenue	**1,843.8**	**1,373.3**	**34.3**	**1,374.8**	**34.1**
Total expenditure	1,442.2	1,152.4	25.2	1,118.9	28.9
EBITDA	**401.6**	**220.9**	**81.8**	**255.9**	**57.0**
Depreciation	54.9	51.5	6.6	52.3	5.0
EBIT	**346.6**	**169.4**	**104.6**	**203.6**	**70.3**
Other income	0.3	0.8	-68.8	0.1	212.5
Interest expenses	-1.2	5.7	-	2.5	-
PBT	**348.1**	**164.5**	**111.6**	**201.1**	**73.1**
Tax expenses	88.6	41.9	111.5	52.7	68.2
Share of profit from association	-52.8	-0.8	-	-26.5	-
Adjusted net profit	**312.3**	**123.4**	**153.1**	**175.0**	**78.5**
Extra ordinary itmes	0.0	0.0	-	0.0	-
Reported net profit	**312.3**	**123.4**	**153.1**	**175.0**	**78.5**
Adjusted EPS (Rs.)	24.6	9.7	153.1	13.8	78.5
			BPS		**BPS**
EBITDA Margin (%)	21.8	16.1	570	18.6	320
PAT Margin (%)	16.9	9.0	790	12.7	420
Effective tax rate (%)	25.5	25.5	0	26.2	-70

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 of the lockdown 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.

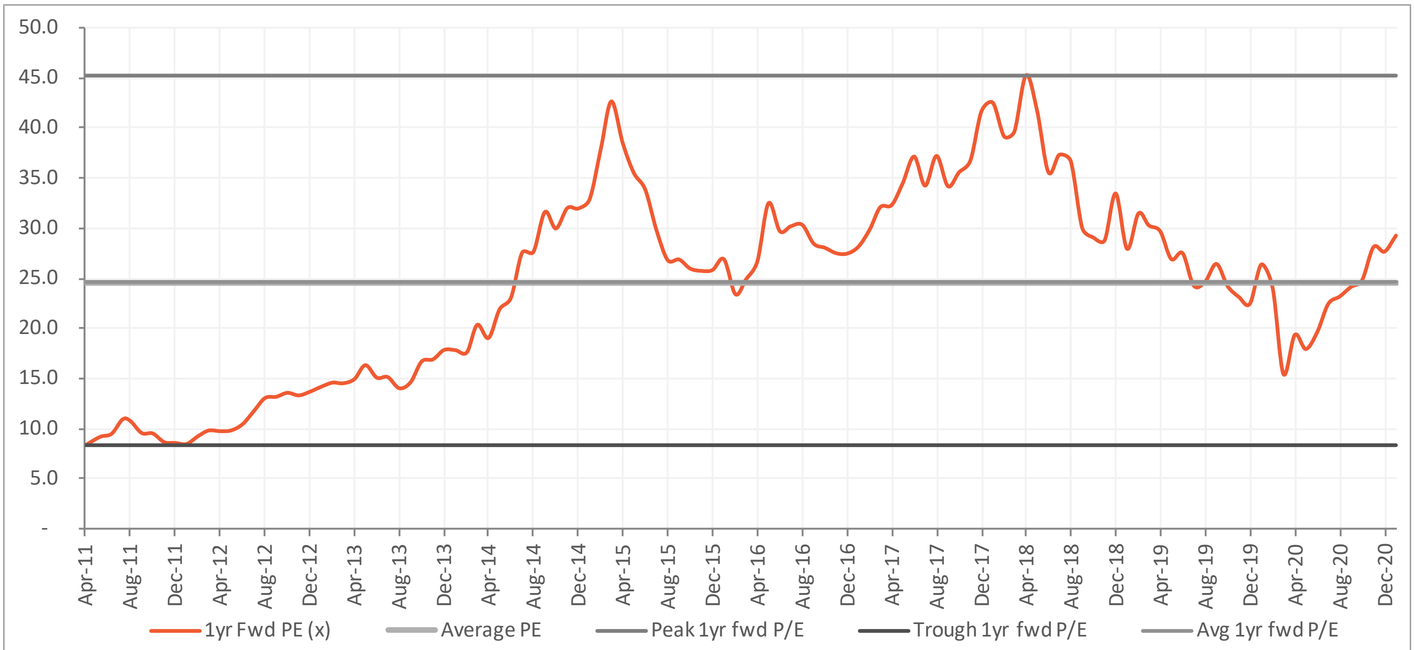
■ Company outlook – Healthy demand outlook in rural and affordable housing segments

The company is witnessing pickup in demand from metro cities in the housing sector. Demand for all its products remains strong except in the agriculture sector. The company has gained market share during 9MFY2021 in both PVC and CPVC segments. Management expects Q4FY2021 to be better than Q4FY2020. Management expects 10%-12% sustainable volume growth in piping, although it is unable to ascertain value-led growth. The company is seeing healthy signs such as better crop output this year, larger acreage crop sowing for Rabi, and higher MSP, among others, to benefit going ahead. Although management has refrained from giving any concrete guidance, its commentary over the next five months for the domestic market remains encouraging.

■ Valuation - Maintain Buy with an unchanged PT of Rs. 2,020

SIL is one of the fastest companies to recover in the post unlock 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. The company is expected to benefit from strong housing demand and government schemes such as 'Nal se Jal'. We have increased our earnings estimates for FY2021E-FY2023E, as we factor in higher-than-expected volume growth and OPM due to improved growth outlook going ahead. The stock is currently trading at 28.9x/24.8x 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 an unchanged PT of Rs. 2,020.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Supreme Industries	28.9	24.8	18.2	15.7	6.4	5.5	22.3	22.2
Astral Poly Technik	71.5	58.4	42.9	36.1	12.0	10.0	18.3	18.7
Prince Pipes*	23.8	19.6	12.0	10.3	3.1	2.7	13.7	14.6

*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 growing plastic consumption in India because of a diversified product portfolio, an extensive distribution network, improved capital structure, and government's 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 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 Website

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	5.14
5	Nalanda India Fund Ltd	4.81
6	Kotak Mahindra Asset Management	3.81
7	JPMorgan Chase	3.07
8	DSP Investment Managers	2.25
9	HDFC Asset Management	2.23
10	GOVERNMENT PENSION FUND - GLOBAL	1.63

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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