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Supreme Industries Ltd

Demand recovery to stay strong

Building Materials	Sharekhan code: SUPREMEIND

Reco/View: Buy	↔	CMP: Rs. 1,950	Price Target: Rs. 2,500	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Supreme Industries reported better-than-expected consolidated revenues for Q4FY2022 led by strong volume growth. OPM were affected by product mix.
- A decline in PVC prices and expectation of it being range bound in FY2023 is expected to support demand growth. The management expect minimum 15% y-o-y volume growth with 15-15.5% OPM for FY2023.
- Capex of Rs. 700 crore including carry-forward commitments majorly to augment plastic piping capacities highlights underlying strong demand growth expectations.
- We retain a Buy on Supreme Industries Limited (SIL) with an unchanged PT of Rs. 2,500.

Supreme Industries Limited (SIL) reported better-than-expected consolidated revenues for Q4FY2022 at Rs. 2557 crore, up 22.7% y-o-y led by strong overall 15.6% y-o-y growth in plastic goods volumes. However, OPM at 15.3% (down 920bps y-o-y, down 100 bps q-o-q) was affected by a change in product mix (higher share of agri pipe sales). Consequently, operating profit and net profit declined by 23% y-o-y and 28% y-o-y to Rs. 391 crore and Rs. 324 crore, respectively, although were ahead of our estimates. The decline in PVC prices led by higher Chinese imports is expected to drive demand during FY2023. The management conservatively pegs volume growth at a minimum of 15% y-o-y for FY2023. At operating level, it targets higher than Rs. 30/kg EBITDA for FY2023. The company is undertaking a Rs. 700 crore capex (including Rs. 280 crore carry forward commitments) majorly for expanding capacity in Plastic Piping, which will be funded through internal accruals.

Key positives

- Higher-than-expected volume growth of 15.6% y-o-y led by revival of growth for Agri pipes along with growth in CPVC segment.
- Turnover from value added products increased 20% y-o-y to Rs. 972 crore.

Key negatives

- OPM at 15.3% were lower than expectations due to change in product mix.
- Volumes in Packaging and Consumer products declined by 16% y-o-y and 11% y-o-y respectively.

Management Commentary

- The management expects minimum volume growth of 15% y-o-y for FY2023. The OPM are expected to be 15-15.5% if prices remain at current level.
- PVC prices are declining due to improvement in supply amid the Chinese economy's slowdown along with increasing imports from China. The management expects it to be range bound during FY2023.
- The company is undertaking Rs. 55-60 crore capex for doubling the capacity to make around one million cylinders per year by November 2022. Once, the expansion is complete, it can generate Rs. 200-250 crore revenues per annum.

Revision in estimates – We have revised our estimates downwards for FY2023-FY2024 factoring lower PVC prices.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 2,500: SIL has been continuously gaining market share led by healthy demand environment and continuous capacity expansion. PVC prices are expected to be rangebound during FY2023 driving overall demand. The company's aggressive expansion plans which are funded entirely through internal accruals is expected to keep its balance sheet strong. A healthy demand outlook along with incremental capacity additions is likely to provide healthy double digit revenue growth over FY2022-FY2024. SIL is expected to benefit from strong housing demand and government schemes such as 'Nal se Jal'. We retain a Buy rating on the stock with an unchanged PT of Rs. 2,500.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	6,357	7,773	8,210	9,495
OPM (%)	20.2	16.0	15.6	15.8
Adjusted PAT	978	968	955	1,123
% YoY growth	109.3	(1.0)	(1.4)	17.6
Adjusted EPS (Rs.)	77.0	76.3	75.2	88.5
P/E (x)	25.3	25.6	25.9	22.0
P/B (x)	7.8	6.4	5.5	4.8
EV/EBITDA (x)	19.9	20.4	20.1	17.4
RoNW (%)	30.9	25.2	21.4	21.6
RoCE (%)	32.3	25.3	21.5	21.8

Source: Company; Sharekhan estimates

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 25.07

Updated Feb 02, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 24,767 cr
52-week high/low:	Rs. 2,689/1,856
NSE volume: (No of shares)	4.3 lakh
BSE code:	509930
NSE code:	SUPREMEIND
Free float: (No of shares)	6.5 cr

Shareholding (%)

FII	16.2
Institutions	19.7
Public & others	15.3
Promoters	48.9

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-2.2	-7.2	-15.7	-4.9
Relative to Sensex	0.6	-5.6	-10.6	-21.9

Sharekhan Research, Bloomberg

Strong volume growth leads to better than expected net earnings

Consolidated net revenues stood at Rs. 2,557 crore, up 22.7% y-o-y (up 31.5% q-o-q), which was much higher than our estimates. Volumes rose by 15.6% y-o-y led by strong growth in plastic piping volumes (+27% y-o-y). The revival in Agri demand along with growth in CPVC segment drove overall growth. Turnover from value-added products rose by 20% y-o-y to Rs. 972 crore. Revenues from Plastic Piping/Packaging/Industrial/consumer products rose 34%/3%/2%/-5% y-o-y to Rs. 1800/319/300/118 crore. Overall value growth was 6% y-o-y. OPM came in lower than estimates at 15.3% (down 915 bps y-o-y, down 103 bps q-o-q) of account of a change in the product mix. Gross profit margins declined by almost 1100 bps y-o-y at 27.9%. Lower OPM led to a 23% y-o-y decline in operating profit and 28% y-o-y decline in net profit, although they were higher than our expectations.

Expect demand environment to be strong in FY2023

The management remains optimistic on demand from the housing and agriculture segment and expects to achieve minimum 15% y-o-y volume growth with 15-15.5% OPM for FY2023. The company has a capital expenditure plan of Rs. 700 crore (including Rs. 280 crore carry-forward commitments), majorly in increasing plastic piping systems capacities. The company's progress in putting up plants at Guwahati, Cuttack and Erode are moving smoothly. The first phase at Cuttack and Erode will be operational by August-September 2022. The company is undertaking Rs. 55-60 crore capex for doubling the composite cycling capacity to make around one million cylinders per year by November 2022. Once the said expansion is complete, it can generate Rs. 200-250 crore revenues per annum. It is also adding new product range and investing in rooftop solar energy generation plants at various locations.

Key Conference Call Takeaways

- **Q4 & FY2022 performance:** The company achieved volume and value-led growth of 16% and 23% y-o-y, respectively, for plastic goods. The margins were lower on account of change in product mix (higher sale of Agri pipes compared CPVC pipes growth). For FY2022, it saw volume de-growth of 4% y-o-y while value grew by 23% y-o-y. During March 2022, the company achieved highest ever dispatches in PVC piping systems.
- **Guidance:** The management expects a minimum volume growth of 15% y-o-y for FY2023. The OPM are expected to be 15-15.5% if prices remain at current level.
- **Demand outlook:** Demand is expected to be higher versus last year. The PVC prices will go down which will boost demand.
- **PVC prices:** The PVC prices are showing downward trend due to improvement in availability of PVC due to Chinese economy slowdown along with increasing imports from China. The material expected to arrive in July is at lower prices. The management expects it to be range bound during FY2023.
- **Value-added products:** The value added products grew 17% y-o-y in terms of revenues to Rs. 2911 crore for FY2022. The products having more than 17% OPM are classified as VAP.
- **Cash & cash equivalents:** The cash surplus stood at Rs. 518 crore as against Rs. 759 crore in FY2021.
- **Capex:** It undertook capex of Rs. 259 crores in FY2022 towards ramping up the capacities in plastic piping system, introduction of new products in various business segments, automation, replacing some old production equipment with new technology machines and increasing captive solar generation capacity. It was funded through internal accruals. It plans capex of Rs. 700 crore (including carry forward capex of Rs. 280 crores) majorly in increasing plastic piping capacity from current 525,000 tonnes to 585,000-590,000 tonnes. The capex would be funded through internal accruals.
- **Polymer prices:** The polymer prices rallied from March up to November 2021, post which prices fell steeply destroying demand of Plastic Pipe systems temporarily.
- **Capacity:** The overall capacity of plastic goods is 725,000MT (Plastic Piping 525,000MT, Industrial products 80,000MT, Packaging products 90,000MT and Consumer Products 30,000MT). The plastic goods capacity is targeted to reach 800,000MT by FY2023 end.

- **Composite cylinders:** The company is undertaking a Rs. 55-60 crore capex for doubling the capacity to make around one million cylinders per year by November 2022. Once the expansion is complete, it can generate Rs. 200-250 crore revenues per annum. The Company has successfully participated and received Letter of Intent (LOI) for supply of 7,35,186 Nos of 10 Kg. capacity Composite LPG Cylinders valuing about Rs.170 Crores from Indian Oil Corporation Limited (IOCL).
- **Supreme Petrochem:** The company achieved volume growth of 16.7% y-o-y. It expects strong demand from ACs and Refrigerators lead by government's PLI led manufacturing push. It has embarked on Rs. 1270 crore capex starting last year till 2025. It would be increasing mass ABS capacity by 1.4 lakh tone and Polystyrene capacity by 3 lakh tone.

Results (Consolidated) **Rs cr**

Particulars	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)
Revenue	**2,557.1**	**2,084.6**	**22.7**	**1,945.1**	**31.5**
Total expenditure	2,165.7	1,574.9	37.5	1,627.2	33.1
EBITDA	**391.4**	**509.7**	**-23.2**	**317.9**	**23.1**
Depreciation	58.8	54.8	7.3	57.5	2.3
EBIT	**332.6**	**454.9**	**-26.9**	**260.4**	**27.7**
Other income	8.6	8.2	4.4	2.9	192.5
Interest expenses	1.9	5.0	-62.7	0.5	308.7
PBT	**339.3**	**458.1**	**-25.9**	**262.9**	**29.1**
Tax expenses	85.1	78.1	8.9	67.8	25.4
Share of profit from associate	-69.6	-70.3	-1.0	-50.7	37.4
Adjusted net profit	**323.9**	**450.4**	**-28.1**	**245.7**	**31.8**
Extra ordinary itmes	0.0	0.0	-	0.0	-
Reported net profit	**323.9**	**450.4**	**-28.1**	**245.7**	**31.8**
Adjusted EPS (Rs.)	25.5	35.5	-28.1	19.3	31.8
			BPS		BPS
EBITDA Margin (%)	15.3	24.5	-920	16.3	-100
PAT Margin (%)	12.7	21.6	-890	12.6	10
Effective tax rate (%)	25.1	17.0	810	25.8	-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, dragging down its net earnings. However, from June, the sector has been one of the fastest to recover as lockdown eased. The sector witnessed resumption of dealer and distribution networks and a sharp improvement in capacity utilisation. Most players have begun to see demand and revenue run-rate reaching 80-90% as 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.

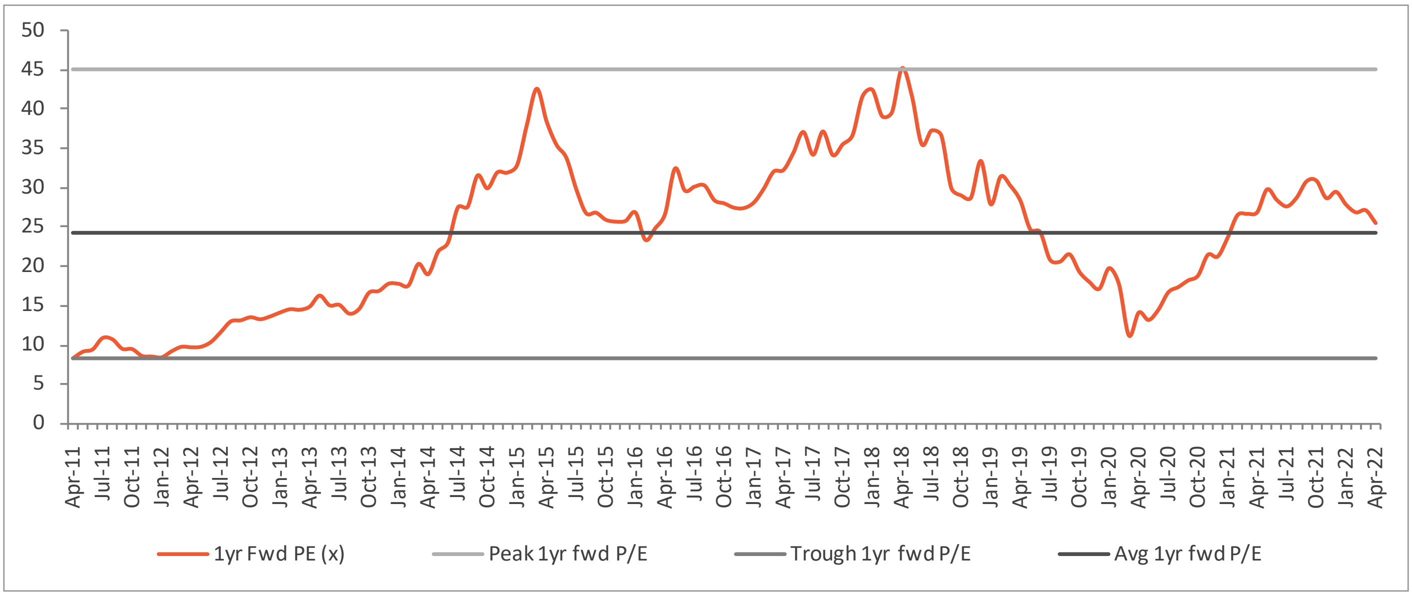
Company outlook - Eyeing healthy demand growth

The company is witnessing a pick-up in demand from metros in the housing sector. Demand for all its products remains strong along with healthy revival in agriculture sector. The company has gained market share during FY2021 in both PVC and CPVC segments. SIL witnessed positive growth in sales for July 2021 till date. The management remain optimistic on reporting minimum 15% y-o-y volume growth for FY2023. It expects OPM at 15-15.5% with expectations of PVC prices being range bound during FY2023. It is expecting healthy demand from infrastructure and housing sectors along with demand emanating from "Nal Se Jal" scheme going ahead. The company has a capital expenditure plan of Rs. 700 crore which would be entirely funded through internal accruals.

Valuation - Maintain Buy with an unchanged PT of Rs. 2,500

SIL has been continuously gaining market share led by healthy demand environment and continuous capacity expansion. PVC prices are expected to be rangebound during FY2023 driving overall demand. The company's aggressive expansion plans which are funded entirely through internal accruals is expected to keep its balance sheet strong. A healthy demand outlook along with incremental capacity additions is likely to provide healthy double digit revenue growth over FY2022-FY2024. SIL is expected to benefit from strong housing demand and government schemes such as 'Nal se Jal'. We retain a Buy rating on the stock with an unchanged PT of Rs. 2,500.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Supreme Industries	25.9	22.0	20.1	17.4	5.5	4.8	21.4	21.6
APL Apollo Tubes	35.3	27.9	20.6	16.2	9.3	7.3	29.6	29.4
Astral Poly Technik	63.1	49.3	41.5	33.4	14.2	11.1	25.2	25.2

Source: Company, Sharekhan 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
ShivratanJeetmal 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	5.14
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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