Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Supreme Industries Ltd

Business dynamics to improve from H2FY2023

Building Materials	Sharekhan code: SUPREMEIND
Reco/View: Buy ↔	CMP: Rs. 1,817
Price Target: Rs. 2,300 ↓	

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We retain a Buy on Supreme Industries Limited (SIL) with a revised PT of Rs. 2,300 lowering our valuation multiple to factor in near term headwinds.
- Supreme Industries reported better-than-expected consolidated revenues for Q1FY2023 while it disappointed on OPM front owing to inventory losses and changes in product mix.
- The management expects the business improvement from the fag end of Q2FY2023 with PVC prices bottoming out. It expects overall 15% volume growth and 15% OPM for FY2023.
- Capex of Rs. 700 crore including carry-forward commitments majorly to augment plastic piping capacities highlights underlying strong demand growth expectations.

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 Jul 08, 2022

Medium Risk

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

Source: Morningstar

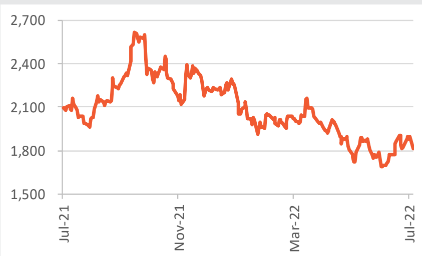
Company details

Market cap:	Rs. 23,082 cr
52-week high/low:	Rs. 2,689 / 1,669
NSE volume: (No of shares)	12.7 lakh
BSE code:	509930
NSE code:	SUPREMEIND
Free float: (No of shares)	6.5 cr

Shareholding (%)

Promoters	49
FII	16
DII	20
Others	16

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.9	-6.3	-11.7	-13.2
Relative to Sensex	2.0	-3.6	-9.0	-18.7

Sharekhan Research, Bloomberg

Supreme Industries Limited (SIL) reported better-than-expected consolidated revenues for Q1FY2023 although it disappointed on the OPM front led by inventory losses. The consolidated revenues were up 64.4% y-o-y at Rs. 2206 crore led by 52.8% y-o-y growth in plastic goods volumes (supported by 64% y-o-y growth in agri pipe volumes). However, OPM at 12.2% (down 430bps y-o-y, down 310 bps q-o-q) was affected by inventory losses (as prices of various polymers corrected by 13% to 32% since April 2022 to date) and a change in product mix (higher share of agri pipe sales). Consequently, operating profit and net profit grew by 21% y-o-y and 26% y-o-y to Rs. 269 crore and Rs. 214 crore, respectively. The company is expected to suffer inventory losses (lower OPM) during Q2FY2023 as PVC prices continue to tread lower during July-August 2022. However, the business is expected to improve from September 2022 onwards. Consequently, the management retained overall volume growth of 15% y-o-y (pipes volumes to grow at 15%+ y-o-y) along with 15% OPM for FY2023. The company is undertaking an Rs. 700 crore capex (including Rs. 280 crores 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 52.8% y-o-y led by the revival of growth for Agri pipes along with growth in CPVC segment.
- Turnover from a value-added products increased 47% y-o-y to Rs. 761 crores.

Key negatives

- OPM at 12.2% were much lower than expectations due to inventory losses and change in product mix.
- Working capital days increased to 42 days from 30 days in FY2022.

Management Commentary

- The company expects overall volume to grow by 15% y-o-y for FY2023 while pipes would grow higher than 15%. The company maintained an OPM of 15% for FY2023. Post FY2023, it expects to grow volumes at 10-12% CAGR in piping systems.
- The industry demand grew by 27% y-o-y during Q1FY2023 while the company's volume growth was 53% y-o-y. In CPVC, it grew in double digits. It has more than 20% market share in CPVC segment.
- The company is undertaking Rs. 55-60 crore capex for doubling the capacity to make around one million cylinders per year by November 2022.

Revision in estimates – We have fine-tuned our estimates for FY2023-FY2024 factoring in higher volumes and lower OPM.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 2,300: SIL has been continuously gaining market share led by a healthy demand environment and continuous capacity expansion. However, the company is likely to be affected by inventory losses leading to lower OPM in Q2FY2023 with the business expected to pick up from fag end of Q2FY2023. The lower PVC prices are expected to drive 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 a revised PT of Rs. 2,300 lowering our valuation multiple to factor in near-term headwinds.

Key Risks

The 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	9,036	10,449
OPM (%)	20.2	16.0	15.0	15.7
Adjusted PAT	978	968	1,034	1,264
% YoY growth	*109.3*	*(1.0)*	*6.8*	*22.3*
Adjusted EPS (Rs.)	77.0	76.3	81.4	99.6
P/E (x)	23.6	23.8	22.3	18.3
P/B (x)	7.3	6.0	5.1	4.3
EV/EBITDA (x)	17.1	17.8	16.0	12.9
RoNW (%)	30.9	25.2	22.9	23.7
RoCE (%)	32.3	25.3	23.0	24.0

Source: Company; Sharekhan estimates

Strong volume growth leads to revenues beat; OPM disappoint

Consolidated net revenues stood at Rs. 2,206 crore, up 64.4% y-o-y (down 13.7% q-o-q), which was 11% higher than our estimates. Volumes rose by 52.8% y-o-y led by strong growth in plastic piping volumes (+65% y-o-y). The strong growth in Agri demand which saw volume growth of 64% y-o-y along with double-digit volume growth in CPVC segment drove overall growth. Turnover from value-added products rose by 47% y-o-y to Rs. 761 crore. Revenues from Plastic Piping/Packaging/Industrial/consumer products rose 76%/34%/52%/98% y-o-y to Rs. 1463/326/306/96 crore. Overall value growth was 7.5% y-o-y. However, OPM at 12.2% (down 430bps y-o-y, down 310 bps q-o-q) was affected by inventory losses (as prices of various polymers corrected by 13% to 32% since April 2022 to date) and a change in product mix (higher share of agri pipe sales). Consequently, operating profit and net profit grew by 21% y-o-y and 26% y-o-y to Rs. 269 crore and Rs. 214 crores, respectively.

Capacity expansion plans

The company's new unit at Guwahati (Assam) commenced commercial production and units at Cuttak & Erode are likely to go into production by Sept.-Oct.,2022. The Company has augmented its offering in Plumbing Systems by introducing PEX plain pipes and PEX composite pipes which are ideal pipe systems to carry hot water. The Company's Olefin fittings & Electrofusion fittings have received positive responses in "Nal Se Jal" scheme which the Governmnent has committed to implement throughout the country by 2024. The Company plans to launch a variety of new models and remain focused in the Premium Range of Plastic Furniture. In composite LPG cylinder, work on doubling the capacity is progressing smoothly and is likely to be operational by November 2022. The Company's envisaged Capex plan for FY2023 of about Rs. 700 Crs. Including a carry forward commitment of Rs. 280 Crs is progressing smoothly and shall be funded entirely from internal accruals..

Key Conference Call Takeaways

- **Guidance:** The company expects overall volume to grow by 15% y-o-y for FY2023 while pipes would grow higher than 15%. Further, inventory loss is expected in Q2FY2023 because of an expected dip in PVC prices in July and August. It expects business to improve from September onwards. The company maintained OPM of 15% for FY2023 despite the 12.24% reported in Q1FY2023 and expected lower OPM in Q2FY2023 led by inventory losses. Post FY2023, it expects to grow volumes at 10-12% CAGR in piping systems.
- **Industry Vs supreme:** The industry demand grew by 27% y-o-y during Q1FY2023 while the company's volume growth was 53% y-o-y because it caters to agri demand which witnessed strong growth (65% y-o-y volume growth). In CPVC, it grew in double-digit. It has more than 20% market share in the CPVC segment. The overall plastic piping industry size is Rs. 40,000 crores. Supreme has 15% market share in the organized segment.
- **Channel inventory:** The channel inventory is very low with some items stocked out. The company normally keeps 30 to 45 days of inventory combined for PVC and CPVC.
- **Segment wise volume & value growth:** Plastic Piping grew 65%/76% y-o-y on volume/value for Q1FY2023. Packaging Products grew by 12%/34%, Industrial products by 36%/52% and Consumer products grew by 77%/98%.
- **Value added products:** The value-added products grew 47% y-o-y to Rs. 761 crores. The value added products have 17% OPM.
- **Cash:** The cash and cash equivalents stood at Rs. 533 crores as against Rs. 518 crores in Q4FY2022.
- **Capex:** It envisages Capex plan of Rs. 700 crores for FY2023 including carry forward commitment of Rs. 280 crores.
- **Raw material sources:** The company sources PVC resins from Reliance industries, Chemplast and through imports. The CPVC resins are sourced from karaoke and many other suppliers.
- **China:** China produces 50% of the PVC resins. Out of 45 million tones of PVC resin, China produces 22 million tones. From the second half of February 2022, anti-dumping duty on China was removed.
- **CPVC prices:** The CPVC prices are $2200-2300 per tone.

Results (Consolidated) Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Revenue	**2,206.0**	**1,342.1**	**64.4**	**2,557.1**	**-13.7**
Total expenditure	1,937.1	1,120.1	72.9	2,165.7	-10.6
EBITDA	**268.9**	**222.0**	**21.1**	**391.4**	**-31.3**
Depreciation	61.7	56.1	9.9	58.8	4.9
EBIT	**207.2**	**165.9**	**24.9**	**332.6**	**-37.7**
Other income	4.6	4.3	5.3	8.6	-47.1
Interest expenses	1.6	2.1	-23.5	1.9	-13.3
PBT	**210.2**	**168.1**	**25.0**	**339.3**	**-38.1**
Tax expenses	54.3	43.0	26.4	85.1	-36.2
Share of profit from associate	-58.0	-45.0	28.8	-69.6	-16.7
Adjusted net profit	**213.9**	**170.2**	**25.7**	**323.9**	**-34.0**
Extra ordinary itmes	0.0	0.0	-	0.0	-
Reported net profit	**213.9**	**170.2**	**25.7**	**323.9**	**-34.0**
Adjusted EPS (Rs.)	16.8	13.4	25.7	25.5	-34.0
			BPS		**BPS**
EBITDA Margin (%)	12.2	16.5	-430	15.3	-310
PAT Margin (%)	9.7	12.7	-300	12.7	-300
Effective tax rate (%)	25.8	25.6	20	25.1	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 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 a 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.

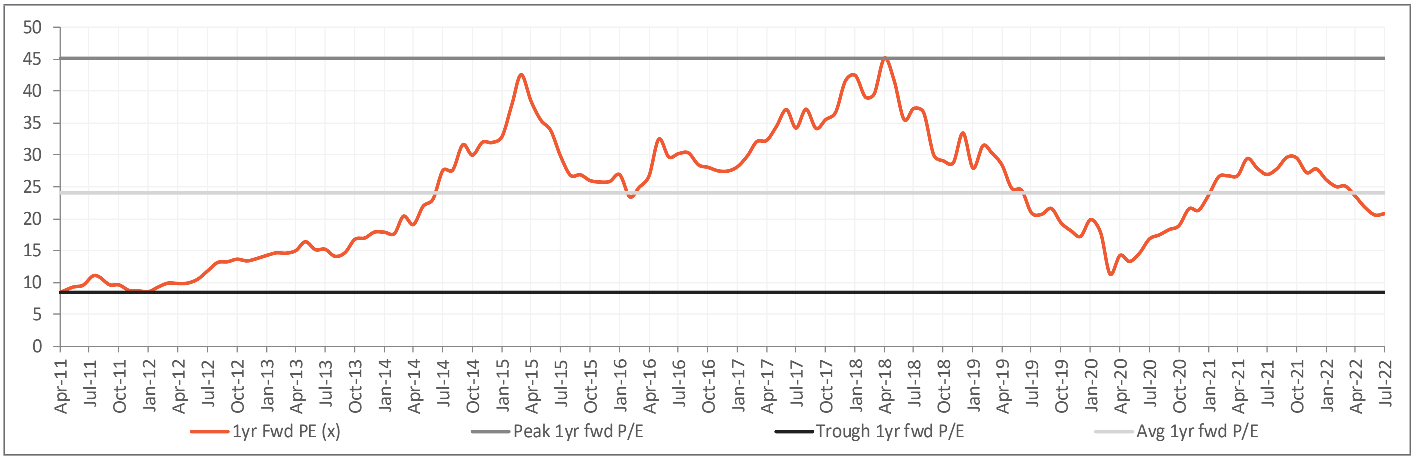
■ Company Outlook – Eyeing healthy demand growth

The company is witnessing a pick-up in demand from metros in the housing sector. Demand for all its products remains strong along with a healthy revival in the agriculture sector. The company has gained market share during FY2022 in both PVC and CPVC segments. SIL witnessed positive growth in sales for July 2021 to date. The management remains optimistic on reporting minimum 15% y-o-y volume growth for FY2023. It expects OPM at 15% with expectations of PVC prices getting bottomed out by August 2022. 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 crores which would be entirely funded through internal accruals.

■ Valuation – Maintain Buy with a revised PT of Rs. 2,300

SIL has been continuously gaining market share led by a healthy demand environment and continuous capacity expansion. However, the company is likely to be affected by inventory losses leading to lower OPM in Q2FY2023 with the business expected to pick up from fag end of Q2FY2023. The lower PVC prices are expected to drive 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 a revised PT of Rs. 2,300 lowering our valuation multiple to factor in near term headwinds.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Supreme Industries	22.3	18.3	16.0	12.9	5.1	4.3	22.9	23.7
APL Apollo Tubes	28.4	22.8	16.8	13.1	7.5	5.9	29.7	29.1
Astral Poly Technik	65.2	51.2	41.2	32.7	12.4	10.0	20.9	21.6

Source: Sharekhan Research

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 the Government's thrust on building 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 about 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 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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