Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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 Aug 08, 2022

Medium Risk

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

Source: Morningstar

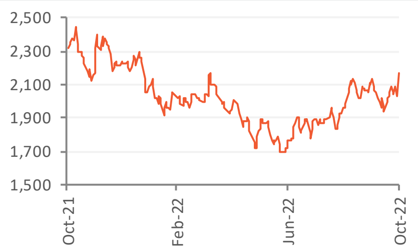
Company details

Market cap:	Rs. 27,581 cr
52-week high/low:	Rs. 2,500/1,669
NSE volume: (No of shares)	4.4 lakh
BSE code:	509930
NSE code:	SUPREMEIND
Free float: (No of shares)	6.5 cr

Shareholding (%)

FII	16
Institutions	19
Public & others	16
Promoters	49

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.9	14.5	7.9	-6.2
Relative to Sensex	-3.9	8.9	1.3	-7.2

Sharekhan Research, Bloomberg

Supreme Industries Ltd

Weak Q2; Demand buoyancy to sustain

Building Materials	Sharekhan code: SUPREMEIND
Reco/View: Buy ↔	CMP: **Rs. 2,171**
Price Target: **Rs. 2,520** ↑	

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We retain Buy on Supreme Industries Limited (SIL) with a revised PT of Rs. 2,520, considering its relatively low valuation and healthy earnings growth outlook.
- SIL reported lower-than-expected consolidated net profit for Q2FY2023 owing to high inventory losses, although it surprised positively on the revenue front.
- Management expects strong demand environment to aid in 20% y-o-y growth in consolidated revenue although OPM may come in at 12-12.5% in FY2023.
- Capex of Rs. 700 crore, including carry-forward commitments majorly to augment plastic piping capacities, is likely to aid in strong volume growth.

Supreme Industries Limited (SIL) reported lower-than-expected consolidated net earnings for Q2FY2023, owing to higher inventory losses, although it surprised positively on the revenue front. Consolidated revenue increased by 8.2% y-o-y to Rs. 2,087 crore, led by 8.9% y-o-y growth in plastic goods volumes. However, OPM at 7.1% (down 906 bps y-o-y, down 514 bps q-o-q) was affected by inventory losses (as prices of various polymers corrected by 21% to 38% since April 2022). Consequently, operating profit and net profit declined by 53% y-o-y and 64% y-o-y to Rs. 147 crore and Rs. 82 crore, respectively. The company is slated to benefit from strong demand environment in H2FY2023, which has led to management's guidance of 20% y-o-y consolidated revenue growth for FY2023 (aided by 25%+ volume growth in the plastic piping division). However, sustained decline in PVC prices continuing post Q2FY2023 and low-price PVC supply from the US is expected to lead to lower OPM at 12-12.5% in FY2023. The company's capacity addition of 80,000 tonne in FY2023 is likely to add 30,000 tonne sales volumes in FY2023.

Key positives

- Higher-than-expected volume growth of 8.9% y-o-y despite the 21-38% drop in polymer prices since April 2022.
- Turnover from value-added products increased by 5% y-o-y to Rs. 798 crore.

Key negatives

- OPM at 7.1% was much lower than expectations due to inventory losses of Rs. 200-250 crore in H1FY2023, of which a major portion was booked in Q2FY2023.
- PVC resin prices declined further by Rs. 7/kg during October 2022.

Management Commentary

- The company expects plastic piping volume growth of over 25% for FY2023. It expects consolidated revenue of Rs. 9,000 crore for FY2023. EBITDA margin for FY2023 is expected to be 12-12.5%.
- As per the company's interaction with Reliance, PVC consumption in FY2022 was 2.73 million tonne, which is expected to increase to 3.26 million tonne in FY2023.
- The company's capex plan for FY2023 is Rs. 700 crore, including carry-forward commitment of Rs. 280 crore. The company is planning capacity addition of 80,000 tonne in FY2023, of which it is expected to achieve 30,000 tonne volumes.

Revision in estimates – We have lowered our estimates for FY2023-FY2024, factoring in lower OPM.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 2,520: SIL is expected to benefit from sustained housing and infrastructure demand along with strong demand outlook from the agri segment. The sharp reduction in polymer prices is expected to drive robust volume growth for the company going ahead. However, OPM is expected to normalise from FY2024. The company's aggressive expansion plans, which are funded entirely through internal accruals, are expected to keep its balance sheet strong. We have introduced our FY2025E earnings in this note. A healthy demand outlook along with incremental capacity additions is likely to provide double-digit net earnings growth over FY2022-FY2025. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 2,520, owing to its relatively lower valuation and healthy earnings growth outlook.

Key Risks

The demand slowdown could affect revenue growth. Adverse commodity price fluctuation might impact the margin profile.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	7,773	9,029	10,160	11,220
OPM (%)	16.0	12.5	15.1	15.6
Adjusted PAT	968	828	1,180	1,358
% YoY growth	*(1.0)*	*(14.5)*	*42.6*	*15.0*
Adjusted EPS (Rs.)	76.3	65.2	92.9	106.9
P/E (x)	28.5	33.3	23.4	20.3
P/B (x)	7.2	6.3	5.4	4.6
EV/EBITDA (x)	21.4	23.2	16.8	14.7
RoNW (%)	25.2	18.9	22.9	22.5
RoCE (%)	25.3	18.9	23.2	22.9

Source: Company; Sharekhan estimates

Sharp fall in PVC prices affect profitability; Demand outlook remains positive

The company reported consolidated net revenue of Rs. 2,087 crore, up 8.2% y-o-y (down 5.4% q-o-q), which was much higher than our estimate. The company's volume grew by 8.9% y-o-y, led by strong volume growth in plastic piping (+9.3% y-o-y) and industrial products (+19.2% y-o-y), followed by packaging (+3.0% y-o-y), while consumer products registered volume decline (-7.7% y-o-y). The turnover from value-added products grew by 5.3% y-o-y to Rs. 798 crore. Revenue from plastic piping/packaging/industrial/consumer products rose 2.2%/18.3%/32.4%/0.7% y-o-y to Rs. 1295/328/335/112 crore. OPM came in much lower than estimate at 7.1% (down 906 bps y-o-y, down 514 bps q-o-q) on account of increased raw-material costs. Gross profit margin declined by 830 bps y-o-y to 23.2%. Lower OPM led to 52.7% y-o-y decline in operating profit at Rs. 147 crore, which was much lower than our estimate. Weak operational performance led to a 64.1% y-o-y decline in consolidated net profit at Rs. 82 crore, which was much lower than our estimate. The company's plastic pipe system business profit was severely affected by continued fall in PVC resin prices, which started with effect from April 2022 (38% decline). The company's net cash surplus declined to Rs. 493 crore from Rs. 533 crore in Q1FY2023. The company expects to achieve over 25% volume growth for FY2023. The company's envisaged capex plan of Rs. 700 crore for the year, including carry forward commitment of Rs. 280 crore, is progressing with a little delay.

Key Conference call takeaways

- **Guidance:** Management expects plastic piping volume growth of over 25% for FY2023. It expects consolidated revenue of Rs. 9,000 crore for FY2023. EBITDA margin for FY2023 is expected to be 12-12.5%.
- **Q2FY2023 performance:** The company sold 1,11,803 tonne of plastic goods for Q2FY2023. Volume and value growth for Q2FY2023 was 9% y-o-y and 8% y-o-y, respectively. Volume growth was led by strong demand from housing and infrastructure, while agri demand remained low due to seasonality. CPVC volume growth for Q2FY2023 and H1FY2023 was 21% y-o-y and 44% y-o-y, respectively. Higher other expense during Q2 can aabe attributed to higher freight costs and advertisement and publicity expense.
- **Segment-wise performance:** Segment-wise volume and value growth were as follows: plastic piping (9%/2%), packaging (3%/18%); and industrial products (19%/32%) and consumer products (-8%/1%). Value-added products grew by 5% y-o-y to Rs. 798 crore. Cash surplus stood at Rs. 493 crore versus Rs. 518 crore as on March 2022.
- **Capacity addition:** The company is planning capacity addition of 80,000 tonne in FY2023, of which it is expected to achieve 30,000 tonne volumes. Segment-wise capacity at the end of FY2023 will be as follows: plastic piping – 580,000 tonne, industrial products – 83000 tonne, packaging – 90,000 tonne, and consumer products – 30,000 tonne.
- **PVC outlook:** As per the company's interaction with Reliance, PVC consumption in FY2022 was 2.73 million tonne, which is expected to increase to 3.26 million tonne in FY2023. The drop in housing demand (80% of PVC is consumed in housing) in the US because of interest rate hikes has led to price drop in PVC in India. Today, U.S. is the lowest price supplier for PVC.
- **Inventory losses:** Inventory losses during H1FY2023 are estimated at Rs. 200-250 crore, of which a major portion was in Q2FY2023. The 8-10% dip in gross margin in Q2FY2023 was entirely due to inventory losses.

- **PVC resin prices:** PVC resin prices declined 38% (Rs. 55/kg) since April 2022. PVC prices declined by Rs. 7/kg in October 2022. The company rolled out a scheme to dealers of Rs. 2-4/kg. PVC prices have already reached almost bottom at Rs. 79/kg.
- **Capex:** The company's capex plan for FY2023 is Rs. 700 crore, including carry forward commitment of Rs. 280 crore.

Results (Consolidated) Rs cr

Particular	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Revenue	**2,086.6**	**1,928.5**	**8.2**	**2,206.0**	**-5.4**
Total expenditure	1,939.5	1,617.8	19.9	1,937.1	0.1
EBITDA	**147.1**	**310.8**	**-52.7**	**268.9**	**-45.3**
Depreciation	64.9	57.1	13.5	61.7	5.1
EBIT	**82.3**	**253.7**	**-67.6**	**207.2**	**-60.3**
Other income	5.5	4.1	35.0	4.6	21.3
Interest expenses	1.2	0.7	76.5	1.6	-26.4
PBT	**86.6**	**257.1**	**-66.3**	**210.2**	**-58.8**
Tax expenses	23.1	67.5	-65.7	54.3	-57.4
Share of profit from associate	-18.6	-39.1	-52.5	-58.0	-68.0
Adjusted net profit	**82.0**	**228.7**	**-64.1**	**213.9**	**-61.6**
Extra ordinary itmes	0.0	0.0	-	0.0	-
Reported net profit	**82.0**	**228.7**	**-64.1**	**213.9**	**-61.6**
Adjusted EPS (Rs.)	6.5	18.0	-64.1	16.8	-61.6
			BPS		**BPS**
EBITDA Margin (%)	7.1	16.1	-900	12.2	-510
PAT Margin (%)	3.9	11.9	-800	9.7	-580
Effective tax rate (%)	26.7	26.2	50	25.8	90

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 the 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.

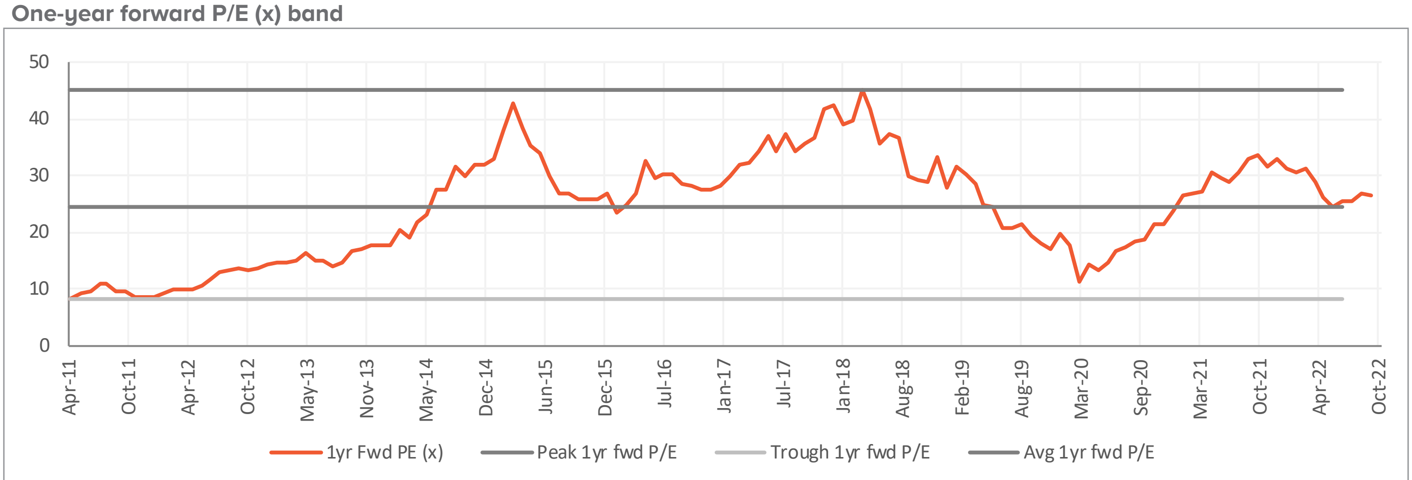
■ Company Outlook – Eyeing healthy demand growth

The company is witnessing 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 sales growth for July 2021 to date. Management remains optimistic on reporting minimum 25% y-o-y volume growth for FY2023. It expects OPM at 12-12.5% owing to weak OPM during Q2FY2023. 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 a revised PT of Rs. 2,520

SIL is expected to benefit from sustained housing and infrastructure demand along with strong demand outlook from the agri segment. The sharp reduction in polymer prices is expected to drive robust volume growth for the company going ahead. However, OPM is expected to normalise from FY2024. The company's aggressive expansion plans, which are funded entirely through internal accruals, are expected to keep its balance sheet strong. We have introduced our FY2025E earnings in this note. A healthy demand outlook along with incremental capacity additions is likely to provide strong double-digit net earnings growth over FY2022-FY2025. We retain our Buy rating on the stock with a revised PT of Rs. 2,520, owing to its relatively lower valuation and healthy earnings growth outlook.

One-year forward P/E (x) band



Source: 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	33.3	23.4	23.2	16.8	6.3	5.4	18.9	22.9
Astral Poly Technik	85.3	62.9	50.1	37.9	14.6	11.9	18.6	20.9

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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by BNP PARIBAS

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