December 7, 2022

Sharp margin recovery in H2 for piping players

Key raw materials such as PVC, HDPE, LDPE and VAM prices have witnessed a contraction of 30-52% from their peak in March 2022 (12-21% from Q2FY23 level). We believe plastic piping companies are likely to benefit from easing raw material prices from their recent peaks and subsiding inventory losses, going forward. We build in EBITDA margin recovery of 700 bps for Supreme Industries and 400 bps for astral in H2FY23 over H1, respectively. On the demand front, fresh inventory build-up at dealer's levels amid strong agri & housing demand will drive volume growth for Supreme and Astral by ~19% and ~17% YoY, respectively, in H2FY23.

On a long term basis, higher government capex, real estate upcycles and new product launches will be key demand drivers for the plastic piping industry. We introduce FY25E estimates and model volume CAGR of 17% and 16% over FY22-25E for Supreme and Astral, respectively. We upgrade our rating on Astral Ltd from HOLD to **BUY** considering strong revenue growth (led by new product launches and dealer expansions in both piping & paints & adhesive segments) and margin recovery (led by easing of raw material prices). We maintain our **BUY** rating on Supreme Industries factoring in strong agri demand in the piping segment and EBITDA margin expansion over FY22-25E.

Strong piping demand to drive volume growth in H2

Piping players have witnessed slow volume offtake by channel partners in H1FY23 due to muted rural demand and volatile PVC prices. Now, as PVC prices are returning to their pre Covid level (43% YTD in FY23), the fresh inventory build-up is likely to start from Q3FY23 onwards. We believe, Supreme and Astral are likely to report strong piping volume growth of ~19% and ~17% in H2FY23 backed by strong demand from both agri & housing sectors and a favourable base of last years. On the long term, we believe piping players will benefit from higher government capex, real estate upcycle and new product launches, which will drive piping volume growth. We model piping volume CAGR of ~17% and ~14% for Supreme Industries and Astral Ltd, respectively, over FY22-25E.

Lower RM prices to help sharp EBITDA margin recovery

Piping players witnessed gross margin pressure due to inventory losses and lower agri demand in H1FY23 amid high inflation. Further, key raw materials such as PVC, HDPE, LDPE and VAM prices have witnessed a contraction of 30-52% FY23 YTD (12-21% from its Q2FY23 level). Companies are expected to see a sharp margin recovery in H2FY23 supported by easing raw material prices and subsiding inventory losses in H2. We build in EBITDA margin expansion of 700 bps and 400 bps for Supreme and Astral Ltd in H2FY23 over H1. Over FY22-25E, we believe EBITDA margin will move higher by 300 bps and 200 bps for Supreme Industries and Astral Ltd, respectively, over FY19 (pre-Covid level margin) supported by improved product mix and positive operating leverage.

Maintain BUY on Supreme; upgrade Astral to BUY

We introduce our FY25 estimates for Supreme Ind and Astral Ltd. We model Astral's revenue, earning CAGR of 19%, 20%, respectively, over FY22-25E led by launch of new products (in both piping and paints & adhesive segments), dealer expansion and easing raw material prices. We believe a sharp correction in raw material prices and positive operating leverage supported by pick up in sales of new categories (paints & sanitary ware) will drive fast EBITDA margin for Astral over FY22-25E. We believe improved margin and no major capex post FY23 will lead to higher RoEs, RoCEs for Astral over FY22-25E. We roll over our valuation on FY25E and revise our rating on Astral Ltd from HOLD to BUY. We value the company at 55xFY25E earnings with a revised target price of ₹ 2380/share.
For Supreme, we model revenue CAGR of 12% over FY22-25E led by piping segment revenue CAGR of ~13%. On the margin front, we model EBITDA margin of ~15% and ~17% in FY24E and FY25E, respectively vs. 14% in FY19, supported by improved sales mix, easing raw material prices and positive operating leverage. We roll over our valuation on FY25E and value the stock at 28xFY25E earnings with revised target price of ₹ 2850/share. We maintain our BUY rating on the stock.

Sector view: Positive

Top Picks in Piping Space

Company	CMP (₹/share)	Target (₹/share)	Upside (%)	Rating
Supreme Industries	2432	2850	17%	BUY
Astral Ltd	2002	2380	19%	BUY

Key Highlights

- Cooling off of raw material prices from their peak (down 30-52% from their peak in March 2022) and subsiding inventory losses will drive margin recovery for Supreme Industries and Astral Ltd
- We believe low channel inventory, higher government capex and strong piping demand from agri & housing segment will drive volume growth in H2FY23
- We upgrade our rating on Astral as BUY while maintaining BUY rating on Supreme Industries

Recent event & key risks

Key Risk: (i) Sharp fall in raw material from current level will lead to higher inventory loss (ii) Lower than expected volume growth can negatively impact revenue growth

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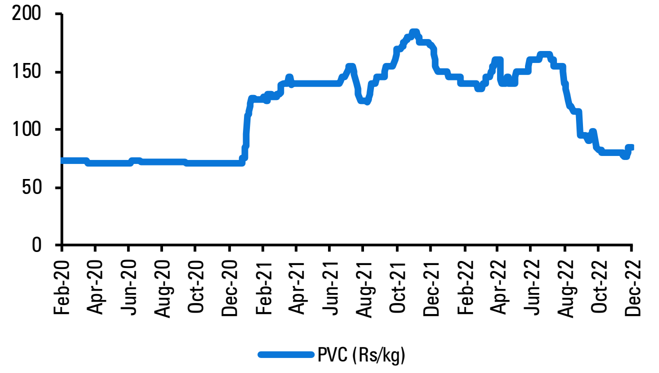
Sector Update

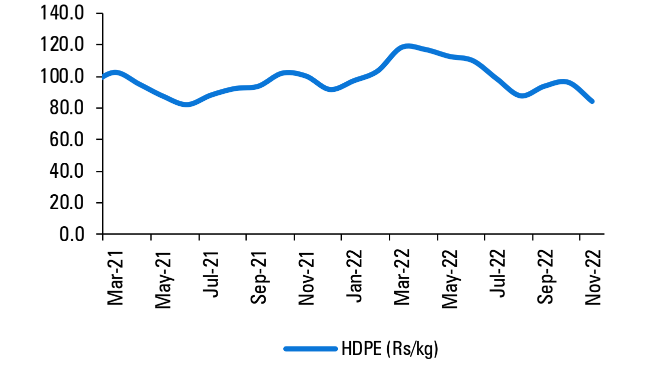
ICICI Securities – Retail Equity Research

Exhibit 1: Price movement of PVC



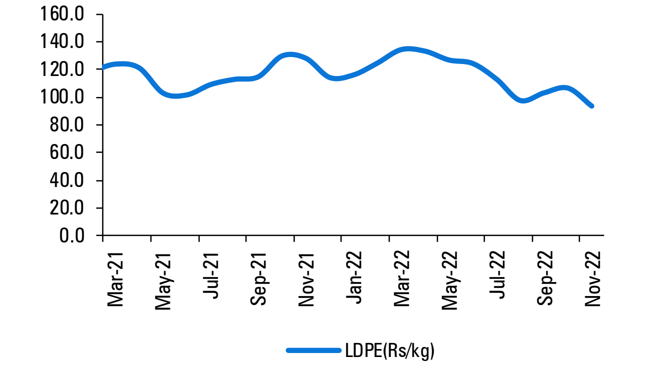
Source: Bloomberg, ICICI Direct Research

Exhibit 2: Price movement of HDPE



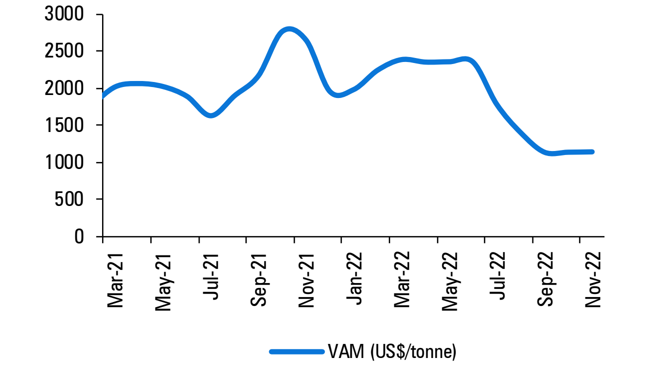
Source: Bloomberg, ICICI Direct Research

Exhibit 3: Price movement of LDPE



Source: Bloomberg ICICI Direct Research

Exhibit 4: Price movement of VAM



Source: Bloomberg ICICI Direct Research

Top bets in plastic piping space

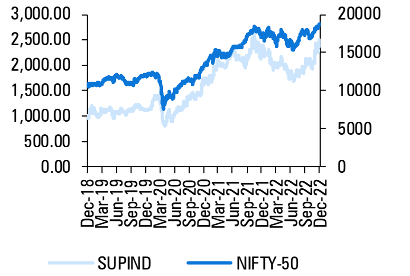
Supreme Industries (SUPIND)

Supreme Industries (SIL) is the market leader in the PVC piping industry with value market share of ~15%. The company's Q2FY23 performance was negatively impacted by historical low EBITDA margin of 7%, lower than its pre-Covid level margin range of 14-15%. This was largely due to inventory loss amid a sharp fall in PVC prices. We believe the major impact of high cost inventories has already been taken into account in H1FY23 and the company will witness sharp EBITDA margin recovery from H2FY23 onwards. We believe EBITDA margins will bottom out in FY23E and will improve from FY24E onwards supported by stable PVC prices, new product launches in the value added product segment and improved operating leverage. We model EBITDA margin of ~15% and ~17% for FY24E and FY25E, respectively, higher than FY19 EBITDA margin of 14%.

On the revenue front, piping segment volume growth at 9% was supported by housing and infrastructure sector. However, rural demand remained muted owing to higher inflations and slow channel inventory build-up. We believe the recent fall in PVC prices will help drive rural demand, going ahead. We believe SIL's piping segment will report a volume CAGR of 17% over FY22-25E supported by a revival in agri, housing and infrastructure pipe demand. We believe government sponsored schemes such as Nal Se Jal Mission, Swatch Bharat Abhiyan, sanitation, affordable housing can be key catalysts for SIL's volume growth.

We maintain our **BUY** rating on the stock considering the strong growth outlook in the company's core business and robust balance sheet condition. We roll over our valuation on FY25E and maintain our BUY rating on the stock. We value the company at 28xFY25E earnings with a revised target price of ₹ 2850/share.

Price Chart



Particulars

Particular	Amount
Market Capitalization (₹ Crore)	30,854.9
Total Debt (FY22) (₹ Crore)	0.0
Cash & Invest. (FY22) (₹ Crore)	526.4
EV (₹ Crore)	30,328.4
52 week H/L	2568/ 1666
Equity capital (₹ Crore)	25.4
Face value (₹)	2.0

Exhibit 5: Financial summary for Supreme Industries

(₹ Crore)	FY20	FY21	FY22	5Yr CAGR (FY17-22E)	FY23E	FY24E	FY25E	3Yr CAGR (FY22-25E)
Net Sales	5511.5	6357.1	7772.8	11.7	9069.1	9780.3	11046.1	12.4
EBITDA	834.5	1284.3	1242.1	10.3	1158.8	1494.3	1902.5	15.3
EBITDA Margin (%)	15.1	20.2	16.0		12.8	15.3	17.2	
Net Profit	467.4	978.1	968.5	17.7	801.7	1027.0	1313.4	10.7
EPS (₹)	36.8	77.0	76.2		63.1	80.8	103.4	
P/E (x)	66.0	31.5	31.9		38.5	30.0	23.5	
Price/Book (x)	13.6	9.7	8.0		7.9	7.1	6.1	
Mcap/Sales (x)	5.6	4.9	4.0		3.4	3.2	2.8	
RoE (%)	20.7	30.9	25.2		20.5	23.7	26.1	
RoCE (%)	22.2	33.1	25.9		22.6	27.2	30.9	

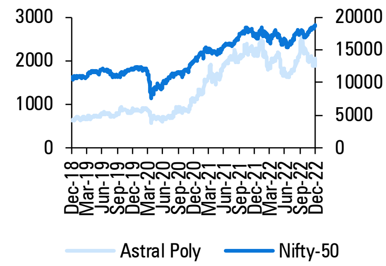
Source: Company, ICICI Direct Research

Astral Ltd (ASTPOL)

Astral is the leader in the CPVC piping segment and is expanding into other building material business such as adhesive, paints and sanitary ware. The company's Q2FY23 performance was marred by lower piping volume offtake amid muted rural demand and inventory de-stocking owing to volatile PVC prices. Astral has also faced one-time inventory losses in the piping segment while a delay in price hikes in the adhesive segment have hurt the company's overall EBITDA margin to the tune of 534 bps YoY to ~12%. On the revenue front, piping segment revenue (~70% of consolidated revenue) declined 11% YoY in Q2FY23 owing to both lower volume (down by 4% YoY) and realisations. The paint & adhesive segment (~30% of revenue) reported strong growth of ~27% YoY led by new launches and consolidation of the paints business. On a three year CAGR basis, Astral's piping segment volume CAGR of ~6% is better than its peers mainly due to new product launches and strong demand from the real estate industry.

According to the management, inventory build-up of pipes is expected to gain momentum from Q3FY23 onwards with stability in PVC prices. Launch of new products in the sanitary ware and paints segment from H2FY23 onwards will aid consolidated revenue growth. We introduce FY25E estimates, building in consolidated revenue CAGR of 20% over FY22-25E factoring in 17% and 30% revenue CAGR in the piping and adhesive business, respectively. We believe the company will report a sharp recovery in EBITDA margin by ~400 bps in H2FY23E over H1FY23 supported by easing raw material prices (PVC and VAM prices declined 43% and 52% YTD in FY23). We build in EBITDA margin of ~16% and ~17% over FY24E and FY25E, respectively, higher than ~15% margin in FY19. We believe improved margin and no major capex post FY23 will lead to higher RoEs, RoCEs over FY22-25E. We roll over our valuation on FY25E and revise our rating on the stock from HOLD to **BUY**. We value the company at 55xFY25E earnings with a revised target price of ₹ 2380/share.

Price Chart



Particulars

Particular	Amount
Market Cap (₹ Crore)	40,477.9
Debt (FY22) (₹ Crore)	85.1
Cash&Inv (FY22) (₹ Crore)	641.8
EV (₹ Crore)	39,921.1
52 week H/L	2655/ 1582
Equity capital (₹ Crore)	20.1
Face value (₹)	1.0

Exhibit 6: Financial summary for Astral

₹ crore	FY20	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-25E)
Net Sales	2577.9	3176.3	4394.0	18%	5354.8	6584.3	7654.2	20%
EBITDA	442.9	644.5	755.3	23%	799.8	1058.1	1335.4	21%
EBITDA Margin (%)	17.2	20.3	17.2		14.9	16.1	17.4	
Net Profit	249.6	408.2	490.4	28%	464.8	682.8	869.7	21%
EPS (₹)	16.6	20.3	24.4		23.1	34.0	43.3	
P/E(x)	121.6	99.2	82.5		87.1	59.3	46.5	
Price/book value (x)	20.2	21.4	17.3		15.7	13.4	11.1	
Mcap/sales (x)	15.7	12.7	9.2		7.6	6.1	5.3	
RoE (%)	16.6	21.5	21.0		18.0	22.6	23.8	
RoCE (%)	20.5	27.5	26.6		24.2	28.4	29.5	

Source: Company, ICICI Direct Research

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Reduce: -5% to -15%;

Sell: <-15%

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