

Supreme[©]

People who know plastics best



**Supreme Industries Ltd (NSE Code: SUPREMEIND) – Alpha/Alpha +
stock recommendation for Aug'12**

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Dear Members,

Supreme Industries is a name synonymous with plastic products in India, being the only company with the polymer processing capacity of more than 3.5 lakh tonnes annually.

It touches many spheres of our life with its wide and diverse product portfolio consisting of more than 5,500 products categorized into pipes and fittings, consumer products, packaging products and industrial products.

We believe Supreme Industries is a very good company run by one of the most investor friendly and ethical management. Over the last 50 years, they have walked the talk of growing their business with dignity and respect and therefore it should not come as a surprise that they are now the largest company in India in their area of operations.

Before we discuss the finer details, here's a brief snapshot:

- Market capitalization – Rs 3,500 cr.
- Net debt – Rs 350 cr.
- Cash and cash equivalents – Rs 14 crores
- Average cash flows from operations (post tax) for the last 3 years – Rs 203.1
- Average Net profit for the last 3 years – Rs 186.77

Investment Snapshot (As on 28th Aug'12)

Recommendation – Buy

Portfolio Allocation Strategy –

1. Start with ~4% portfolio allocation in the range of 270-285.
2. We may consider increasing allocation to around 6-7% in case of a correction to 230-240

Profit Booking – Refer Alpha/Alpha + weekly

BSE Code – 509930; **NSE Code** – SUPREMEIND

Bloomberg Code – SI: IN

Market capitalization – Rs 3,500 cr.

Total Equity shares – 12.70 cr.

Face Value – Rs 2.00

52 Weeks High/Low – Rs 288.95/ Rs 160.10

Promoter's holding – 49.62%

Supreme Industries Ltd – An Introduction

Founded in 1942, Supreme (SIL) is an acknowledged leader of India's plastics industry processing over 2.45 lakh metric tonnes of polymers per annum. The company's core operations involve processing polymers and resins into plastic products which are quite diversified and spread over four broad product categories namely – Piping products, Industrial products, Consumer products, and Packaging products. The latest introduction to its portfolio of products is Composite products.



SIL operates 19 plants that are located at Derabassi, Durgapur, Gadegaon, Guwahati, Halol, Hosur, Jalgaon, Kanhe, Kanpur, Khopoli, Khushkheda, Malanpur, Nandesari, Noida, Pondicherry, Silvassa, Sriperumbudur and Urse.

Supreme is credited with pioneering several products in India. These include Cross-Laminated Films, HMHD Films, Multilayer Films, SWR Piping Systems and more.

SIL is involved in an industry that is extremely under-penetrated, fragmented and dominated by the unorganized sector and thereby offers tremendous scope for a large and organized player the potential to stake a claim and scale up its operations.

In order to capitalize on the vast opportunity, the company has already embarked on an expansion plan with an estimated capital outlay of 1000-1100 crore by 2015-16. The same would enhance the polymer processing capacity of the company to 6.4 Lakh MT and shall help the company clock annual revenue in excess of 6,000 crores.

Plastics Industry – Overview

Considering the fact that India is a developing country, we believe that almost every industry holds good growth prospects and is scalable; however this does not mean that every company in the sector is good and is scalable.

There are only few companies which are able to tap the potential of any given sector and are able to outgrow competition year after year. In case of plastics industry, Supreme Industries has been able to capture and capitalize on the growth prospects of the same and over the years has developed certain strengths/capabilities (as will be seen later) which should help it sustain the growth momentum.

For the moment, let's quickly scroll through key features of India's plastics industry:

- Current per capita polymer consumption in India is about 7 kg which is significantly lower against 30 kg to 70 kg in other countries.
- Indian plastic industry is highly fragmented, under penetrated and possesses a highly dominant unorganized sector.
- India plastic manufacturers are proving to be quite popular on the global front. While the qualities of finished goods are quite superior, what actually swings it in the Indian plastic manufacturers' favor is the cost of production. Production costs in India are estimated to be 20-25% lower than in the US.
- Plastic consumption in India in 2010-11 was 7.5 Million Tonnes and the same is expected to reach 24 Million Tonnes by 2020.

- **Consider this:** China has numerous companies with polymer processing capacity in excess of 1 million tonnes, whereas with a capacity of 0.35 million tonnes, Supreme is one of the largest in India.

The demand for plastic pipes, tubes, hoses & fittings from sectors like infrastructure, agriculture and construction is expected to grow at a healthy pace over the next two years.

Increased government thrust on infrastructure development is expected to increase the demand for plastic pipes and tubes. Besides a deficient rainfall is expected to increase the demand for irrigation systems, which will boost the demand for pipes, tubes & hoses. Demand from construction sector, too, is expected to grow at a healthy pace.

Hence, CMIE expects production to grow by a healthy 11.6 per cent in 2012-13. Growth is expected to remain healthy at 9.2 per cent in 2013-14. Fresh capacities are also likely to increase production in these years. CMIE's CapEx database shows that capacities to manufacture 1.8 lakh tonnes of plastic pipes, tubes, hoses & fittings are scheduled to come on stream during 2012-14.

	Units	2008-09	2009-10	2010-11	2011-12(E)	2012-13(E)	2013-14(E)
Capacity	Tonnes	7,96,327.9	10,07,160	12,04,226	10,71,809	12,46,029	12,46,029
Production	Tonnes	3,58,516.3	4,17,100.5	4,71,770.1	4,91,151.7	5,47,928.8	5,98,173.9
Export	Rs. crore	402.8	408.9	420.1	495.1	593.8	620.7
Import	Rs. crore	351.1	355.0	448.2	520.0	604.8	639.7
Realisation	Rs./kg	74.1	72.5	74.5	83.0	92.0	87.5
Sales	Rs. crore	2,658.2	3,025	3,513	4,076.6	5,041	5,234
Domestic market value	Rs. crore	2,606.5	2,971.1	3,541.2	4,101.5	5,052	5,253

Source: CMIE

Some major strengths of the company

Before we discuss the products and the performance of the company in detail, let's look at some of the key strengths that have helped Supreme reign over the polymer processing industry.

Consistent diversification and innovation – The Company continues to remain focused on manufacturing plastics products, however it tries to chose and move into new products in such a manner that it neither has to compete against imported plastics products nor it can be affected by the products made by the un-organized sector in the country in an adverse manner.

With constant innovation, the company has successfully kept pace with technological improvements, entered into exclusive license agreements with patent holders and churned its product portfolio to include more of premium, value added products, to maintain its strong competitive position and accrue high margins.

Consider this: The Company was at one time the largest supplier of plastic sheets for milk packets (over 90% market share). But, as competition intensified, the company began reducing its exposure to the milk packaging segment and entered the 5-layer film segment (edible oil packaging) and even the 7-layer film segment; currently, milk packaging makes negligible contribution.

Likewise, the company has introduced various technologies in the market, either through international tie-ups or on its own, such as:


- Cross laminated films
- SWR drainage systems, Aqua Gold high pressure plumbing systems
- Lacquered and upholstered furniture in the furniture segment, etc.

Plant locations across the length and breadth of India – As at Jul'12, Supreme had plants at 19 locations spread across the length and breadth of India, while beginning January 2013, the Company will have 22 plants manufacturing varieties of products spread across the country.

As it is well known, most of the plastic products are bulky and the freight cost for their transportation from one location to another is high.

With Supreme's manufacturing locations being spread out geographically, it helps the company meet the requirements of its customers of any particular region in cost effective and timely manner.

Plant Locations



Sr. No	Location	Plastic Piping System	Industrial products	Consumer Products	Packaging Products
1	Jalgaon 1	✓			
2	Noida		✓		
3	Pune		✓		
4	Halol				✓
5	Malanpur 1				✓
6	Raigad				✓
7	Hosur				✓
8	Pondicherry		✓	✓	
9	Silvassa				✓
10	Khushkhhera		✓		
11	Derabassi		✓	✓	
12	Durgapur		✓	✓	
13	Kanpur	✓			
14	Guwahati			✓	
15	Gadegaon	✓	✓	✓	✓
16	Urse				✓
17	Jalgaon 2	✓			
18	Malanpur 2				✓
19	Sriperumbdur		✓		

Wide distribution network – Over the years, Supreme has set up strong pan-India retail net work well serviced by the distributors/channel partners.

A wide distribution network makes the product not just easily accessible to customers; it also helps build the brand equity of the company by being more visible to them.

A well established brand in a not so brand oriented business – We believe, establishing a brand is the toughest aspect of any business, however once a brand is established it creates a positive loop and adds immensely to the competitive advantage of the company.

In case of Supreme, we believe the company has been able to establish a brand in a not so brand oriented business and company's products command respect in the segments they operate due to its superior quality, range and service, and continuous introduction of newer products in that product group.

Supreme Industries – Details

Supreme Industries – Product portfolio				
Product/Segment	Plastic pipes and fittings	Packaging Products	Consumer Products	Industrial Products
Revenue Contribution (FY 12)*	Rs 1,320 cr.	Rs 687 cr.	Rs 292 cr.	Rs 560 cr.
Product/Service offering	uPVC, CPVC, PPRC and HDPE pipes, injection molded and handmade fittings, LLDPE Tube and Inspection Chambers	Performance films, Protective packaging films, cross laminated films	Furniture	<ul style="list-style-type: none"> • Moulded parts like dashboards and other interior and exterior parts for automobiles • Plastic body for consumer durables • Material handling products like pallets, crates and bins
Market Position	Second largest player with 18% of the organized plastic pipe market	33-39% market share across various products in protective packaging; market leader in cross laminated films	Second largest player with 15% market share	18% market share in material handling products; preferred supplier to OEMs
Demand drivers	<p>Government's thrust on development of irrigation facilities and urban sanitation</p> <p>Demand for pipes for new houses</p> <p>Replacement demand from GI pipes in housing and industry</p>	<p>Protective packaging - Growth directly linked to growth in varied end user industries such as manufacturing, white goods, automobiles, etc</p> <p>Performance films - Increasing thrust on packaged food</p>	<p>Urbanization and rising per capita income in rural and semi-urban segments</p> <p>Increasing acceptance of plastic furniture among tier 2 and tier 3 cities in India</p>	<p>12-13% growth in automobile industry over FY11-13 to boost demand for plastic components</p> <p>Rising income levels to boost consumer durables industry</p> <p>Soft drinks industry to grow at over 20%</p>
Key Competitors	PVC - Finolex	6-7 large players and	Nilkamal, which	Large and mid-sized

	Industries Ltd, Chemplast Sanmar Ltd, Kriti Industries India Ltd, Tulsi Extrusions Ltd, Jain Irrigation Systems Ltd CPVC - Astral Polytechnik and Ashirvad Pipes	other unorganized players	has a 30% share and Wimplast	competitors such as Tata Auto Comp Systems Ltd, Varroc Group, Motherson Sumi Systems Limited, Sintex Industries Ltd, Mutual Industries Ltd
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* - Balance constitutes "Others" which includes income from trading of raw materials and real estate project

As can be observed from the above illustration, Supreme has established itself as the leading player in all the major segments of the plastic products industry. Besides manufacturing a wide variety of products which protects the company from major threats to any single product or a segment as a whole, it's either the market leader or occupies one of the top 3 slots in each segment.

Plastic pipes and Fittings segment

Plastic pipes and fittings segment		
	FY 12	FY 11
Full year sales (in crore)	1320	1036
4th Qtr sales (in crore)	475	357
Operating margins for FY 12 – 13%		

Plastic pipes and fittings are the largest contributor to the revenue of the company and also one of the fastest growing segments. Supreme is one of the leading players with over 5300 products for 19 different application systems.

The largest company in the plastic pipes segment is Finolex Industries and it supplies only PVC pipes, while Supreme is the only company in India that manufactures pipes and fittings from all major polymers like PVC, CPVC, PE and PPR.

Supreme's plastic piping systems find application in potable water supply, irrigation, drainage and sanitation and housing. Out of Rs 1,320 crore revenue contribution from plastic pipes and fittings segment, housing/construction segment contributed ~ Rs 850 crores. The company has already established a strong brand name and markets its pipes under various brand names such as Aqua Gold, Indo-green, Eco-drain, and Lifeline - CPVC etc.

CPVC segment – Talking about CPVC as its one of the fastest growing segments, Supreme was late to introduce piping and plumbing systems manufactured from CPVC compound. However, since the time they launched **Lifeline CPVC** brand, they have been able to tap their strong brand identity and wide distribution network and have been recording extremely strong growth.

Consider this: Supreme recorded ~50 crore from CPVC in FY 10, 102 crore in FY 11 and for FY 12 they clocked in Rs ~165 crores revenue (based on Jul'12 con-call), though they were targeting 150-160 crores in FY 12.

Supreme sources its CPVC raw material requirement from Kaneka (Japan) and are the largest customer for Kaneka in India (Kaneka has 4 other customers in India who together source around 50% of what Supreme Industries buys from Kaneka).



As per the management, at the moment Ashirwad pipes and Astral are the two largest players (been in the business for more than a decade against Supreme's foray just 3 years

back) in the CPVC segment and Supreme claims the third spot; however the management is confident of claiming the leadership position sooner than later.

We believe the only major hurdle in Supreme's growth trajectory could be the inadequate supply of CPVC resin from Kaneka as the global production capacity of Kaneka is just 46,000 tonnes/year at the moment.

However, it is important to note here that Kaneka has formed a JV company for setting up 20,000 tonnes per annum CPVC production facility in India. The plant is expected to start production in 2014.

CPVC Resin and CPVC compound – Lubrizol provides the final CPVC compound to its licensees (Astral, Ashirwad, etc) while Kaneka provides only the base resin and, therefore, subsequent compounding needs to be done in India. On account of the same it was being assumed that the quality of Supreme's products could be inferior in comparison to Astral's or Ashirwad's.

It's important to note here that Supreme is that most quality conscious company in the polymer processing industry and this is probably what has kept them miles ahead of both organized and un-organized players.

Further, on double checking with the dealers, they spoke in the same breath for all the 3 companies.

As far as the management of Supreme is concerned, this is what they had to say with respect to the debate on CPVC resin and CPVC compound:

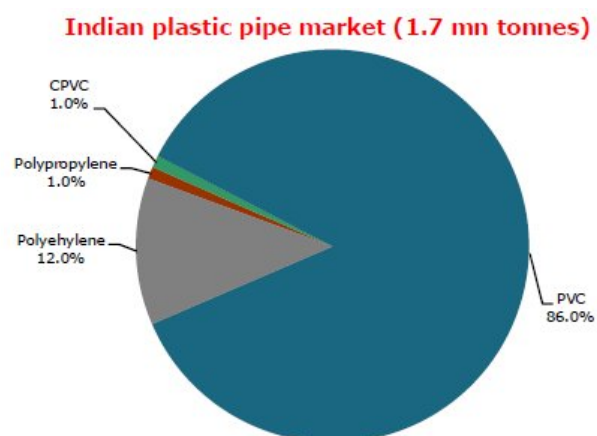
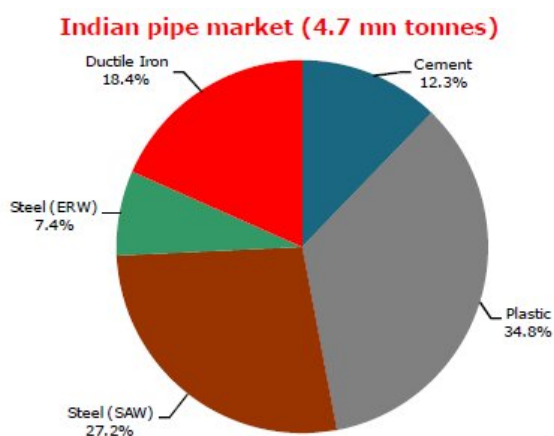
M/s. Kaneka provides us complete knowhow to make the compound, and we import some of the additives from them from Japan. We make our own compounded resin and then we pelletize, there is no difference between our quality and their quality. Actually by doing this we are able to add more value than what is being added by the customers of Lubrizol.

Total solutions provider – In the plastic pipes and fittings segment, Supreme has one of the largest product portfolio that meet the varied requirements of irrigation, bore-wells, portable water supply, plumbing, drainage, sewerage, rainwater harvesting and water management.

Whether it is above-the-ground requirements of building and installation, or underground applications of civil construction and infrastructure, Supreme is the one-stop-source for everything in plastic piping products. Thus, the company has an edge over other companies as it has established itself as the total solutions provider and has to its credit some very prestigious projects such as: DELL Chandigarh, Wockhardt Hospital, International Convention Centre Pune, TCS Chennai, Infosys Pune, Taj Residency Calicut, etc.

Demand for Plastic pipes, fittings to remain robust – The Indian pipe industry is dominated by plastic pipes, within which PVC pipes are the most prominent. The proportion of plastic pipes in the overall pipe industry is expected to increase further driven by new demand in housing/construction and agriculture space and the replacement demand in housing applications.

It is important to note here that real estate/construction sector is a huge area in India and the potential going forward is enormous. Plumbing and clean water transportation is a very important area and crucial part of a construction project. Repairing of plumbing work is a very troublesome and costly affair and hence one won't compromise on this front.



Source: CRISIL – The above figures are as at 2009-10

At the moment, the plumbing industry in India is undergoing a smart change. Earlier, GI and cement pipes used to dominate the market but now PVC and CPVC pipes are fast replacing the GI Pipes. PVC and CPVC pipes are safe, long-lasting and cost-effective for both hot and cold water usage. Hence as awareness and quality consciousness is increasing, more and more people are adopting CPVC and PVC pipes for plumbing needs.

New product launches in the Plastic pipes and fittings segment – As per the management, amongst the existing products the Inspection Chambers and Eco-Drain Pipes have gained acceptance in the market. As a result the business of NU-Drain System may increase multifold in near future.

Supreme is also working on Manhole with 1.2 meter diameter and is expected to launch the product immediately after monsoon season. As per the management, this Manhole may create increased demand for Pipes and Fittings in various applications like storm water projects and sewage transportation projects. Once it is established and accepted by Government and Semi Government bodies including Municipal Corporation, this business may see good growth potential.

To meet the growing demand of Hi-Tech SWR System for use in Hi-rise Apartments, the Company has planned to introduce the new series of Hi-Tech SWR System around November/December 2012. On demand of its channel partners, the Company has planned to extend the range of its plumbing products to include varieties of Bath Room Fittings. These Fittings will be made from engineering plastics and will add to the portfolio of value added products (products that command operating margins in excess of 17%) of the company.

During FY 12, the company's Value Added Product sale reached 24.24% to total sale against 21.87% in plastic pipes and fittings system of the previous year.

Packaging Products

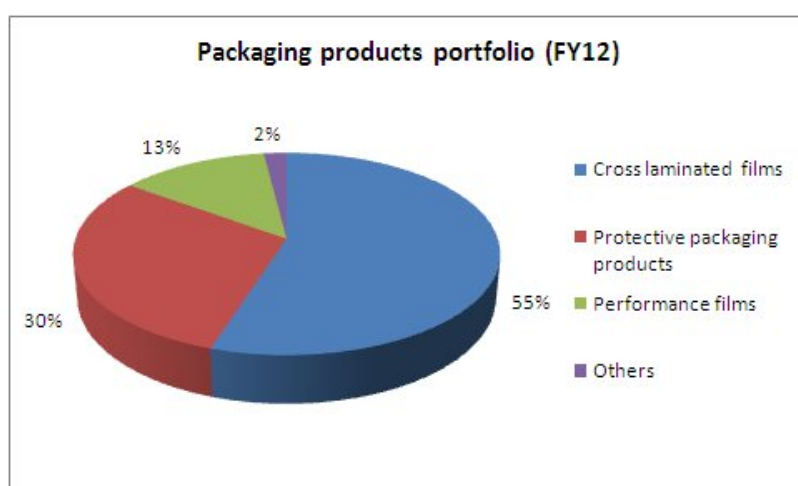
Packaging Products		
	FY 12	FY 11
Full year sales (in crore)	687	580
4 th Qtr sales (in crore)	198	165
Operating margins for FY 12 – 20%		

Packaging products is the second largest segment for Supreme Industries with 25% revenue contribution and is the most profitable segment with ~20% operating margins.

Under this segment, Supreme manufactures:

- Cross laminated films,
- Protective packaging products (PE foam, bubble wraps, Cross linked foam) and
- Performance films (extruded plastic sheets used for packaging)

For FY 12, packaging products contributed a sum of Rs 687 crores towards the revenue of the company and amongst the three, the contribution from Cross laminated films was highest at ~55%.



Cross Laminated films – Supreme is the only Indian company to have the technology to manufacture cross laminated XF films and it sells its product under the brand name of “Silpaulin”.

XF films and products offer the assurance of 100% water proofing, are extremely light weight (one-seventh the weight of conventional cotton tarpaulin), inert to most chemical and acids and tear and puncture resistant with excellent tensile strength.

On account of such attributes, Supreme’s “Silpaulin” and “Silsacks” have been witnessing strong demand for a variety of applications – agricultural applications such as pond lining, covering of agriculture produce, cattle sheds; civil engineering applications such as basement capping, swimming pool capping, and general applications such as covering of raw materials, machinery etc.

Cross laminated films is an important segment for Supreme from several perspectives:

- It’s a value added product (for Supreme a value added product is one that delivers more than 17% operating margin) with significant revenue contribution.
- There’s complete entry barrier as it’s a patented product and the patent is valid up till 2019.
- Supreme enjoys the technical collaboration and exclusive distribution rights till 2019 from Rasmussen Polymer Development AG, the owner of the patent.
- Earlier, Supreme had the sole rights for manufacturing and marketing this product in India and South Asia. However, due to the success the company achieved in penetrating the product in India, the exclusive manufacturing and marketing right has been extended for Africa as well.
- Since there’s virtually no competition for XF Films and since the demand for the product has been strong, Supreme enjoys ~25% operating margins and does not entertain credit sales.

In order to capitalize on the robust demand for SILPAULIN and SILSACKS, Supreme has embarked on a green field expansion at Halol and has ordered 3 new lines for XF films that would enhance the capacity to 30,000 MT from the current 18,000 MT.

The company has planned for further expansion in capacity by 8,000 MT by Apr'14 and de-bottlenecking at existing site that will enhance the capacity by 1000 MT. In all, the total capacity is expected to increase from current 18,000 MT to 39,000 MT by FY14.

The plant at Halol is expected to go operational by Oct'12 and the Supreme expects to sell 24,000 MT in FY13 from the existing and new units against 17,000 MT sold in FY 12.

Protective packaging – During FY 2012, Protective Packaging segment grew by 13% in volume and 17% in value.

Supreme has a basket of protective packaging products including thermoplastic polyethylene foam sheets and profiles, cap cells, cross-linked and blending PE foams, air bubble films and customized products including foam and bubble films that are corrosion resistant, anti-static, UV resistant and metal laminated.

Supreme has a 25-45% market share in various categories of protective packaging products. Around 35% of the business comes directly from OEMs while the rest is distributed through dealers. Since this segment has many products which are low-value adding and the company has to compete with a large number of unorganized players, these products typically have lower margins (10-12%)

Protective packaging products	
Products	Supreme's share in 2010-11
EPE Foam	38%
Air Bubble Film	26%
Cap Cell	28%
XLPE	42%

Turnkey packaging solutions provider – In addition to offering a wide variety of packaging products, Supreme also offers turnkey packaging solutions under the **Packaging Services and Logistics (PSL)** division.

Besides designing the packaging, it oversees the packaging operations at the customer's site and sources and incorporates other materials in the process wherever necessary.

Whether a client is a large scale manufacturer with heavy and regular packing needs, or a small exporter with the occasional requirement, Supreme offers complete end-to-end solutions ranging from recommendation and selection of the right material, customized design and fabrication, packing, and even dispatch.

Initiatives like these extend the competitive advantage of the company over small, unorganized players and help it retain clients.

Performance films – Performance films are co-extruded plastic packaging films used for applications such as vacuum packing, gas flushing, hot filling, pasteurization, sterilization, MAP, freezing, chilling and thermoforming of food items, oral care products, cosmetics, ready to cook foods, lubricants, fruit concentrates etc.

It's a competitive segment, however here too Supreme has been able to maintain margins by gradually exiting competitive segments such as two-layer films, while entering higher value added segments such as five and seven-layer films.

For FY 12, performance films segment of the company recorded a muted growth of 7% on account of Government's reluctance on buying 5 layer films for distribution of edible oil under PDS system.

In order to overcome the vagaries of the demand from the Government, Supreme has embarked on the drive to boost exports of its 5 and 7 layer films and expects the exports to grow 19% in value for FY13 and overall 15% growth for the packaging films segment in FY13.

Consumer Products

Consumer Products		
	FY 12	FY 11
Full year sales (in crore)	292	279
4th Qtr sales (in crore)	82	75
Operating margins for FY 12 – 14%		

Supreme is the second largest player in the plastic molded furniture segment with a processing capacity of 30,000 MT.

Intangible benefits from Consumer products segment – Though, over the years the contribution from this segment has reduced to just about 10%, nevertheless it's an important segment in terms of establishing the brand Supreme in the minds of consumers.

Supreme's focus on good quality, modern & designer molded plastic furniture (the first company to introduce lacquered and upholstered molded plastic furniture in India) has helped the company establish brand Supreme as the manufacturer of good quality and premium plastic products.

Further, the Company has 253 Exclusive Franchise Show Rooms on All-India basis displaying entire range of Supreme Furniture which adds to the visibility of the brand.

The contribution of consumer products segment in brand building is not quantifiable, however we believe that it does work towards Supreme's advantage, especially in case of Pipes, fittings and plumbing segment for real estate/housing.

Focus on premium/value added products – As mentioned in one of the segments above, value added products are the ones that command higher margins (17% or above) and as in other segments, Supreme's been working towards increasing the share of premium furniture in the consumer products segment.

At the moment, Supreme has only one consumer product – Molded furniture and it constitutes two segments commodity furniture and premium furniture. In line with its strategy of moving away from competitive and commoditized segments, Supreme Industries has been aggressively working towards increasing the share of premium products, as such products command higher margins and the company is able to pass on the increased cost of raw materials.

Consider this: At the end of FY 11, premium furniture accounted for 30% of the furniture business of the company, while during FY 12 the contribution from premium furniture increased to 37.7% and the same is further expected to increase to 46% in FY 13.

Industrial Products

Industrial Products		
	FY 12	FY 11
Full year sales (in crore)	560	491
4 th Qtr sales (in crore)	151	137
Operating margins for FY 12 – 13%		

In the industrial products segment, Supreme manufactures dashboards, bumpers for automobiles, plastic body for consumer electronics and home appliances, as well as material handling products for soft drinks industry and other FMCG companies.

Supreme is the preferred supplier to an elite corporate clientele:

Automotive Segment – Maruti Suzuki, Tata Motors, Mahindra, Ashok Leyland, Denso, Exide, Hindustan Motors, Kinetic Engineering.

Consumer durables segment – Largest player in the consumer durables segment and is the major supplier to Samsung (India) for plastic requirements ranging from television sets to computers. Others include Whirlpool, Hitachi, Panasonic, Tata Chemicals, and Videocon.

Material handling segment – Largest supplier of bottle crates to the soft drinks industry.

Despite the market conditions being not favorable during the entire FY 12 for Automotive and consumer durables segment, Supreme could still record a decent growth of 14% in the industrial products segment.

For FY 13, the company is confident of reporting much better performance in the industrial products segment on the back of strong demand from the soft drinks industry, better outlook for the automotive segment with problems subsiding at Maruti Suzuki and production take off for Tata Swach from Tata Chemicals.

Construction Business

Supreme has developed a commercial real estate project in Andheri, Mumbai. The project was undertaken to unlock the value in the company's factory plot located in Mumbai. With help from R. Raheja Group (who are equal partners with The Supreme Industries Ltd in Supreme Petrochem Ltd), the company executed the commercial real estate project.

The Company had incurred Rs 140.57 crores towards Cost of Construction as on 30th June, 2012, which together with the estimated Outstanding Expenses/ Liabilities is expected to reach Rs 155 crores.

The company has already started the process of monetization and has realized Rs 127.07 crores net from the sale of six office blocks comprising about 81,682 sq. ft., out of total Saleable Area of around 2.79 lakh sq. ft. which includes realization of Rs 69.16 Crores from sale of 41,678 sq. ft during FY 12.

The management expects to generate a sum of Rs 320 crores plus from the sale of remaining space over the next 2-3 years.

Composite products – New initiative

As mentioned above, one of the key strengths of Supreme has been **consistent diversification and innovation**. The Company continues to introduce new products in a manner that neither it has to compete much against imported plastics products nor it can be affected by the products made by the un-organized sector in the country in an adverse manner.

In line with the above strategy, Supreme has identified Composite products as the new segment with high margins and significant demand.

Composite LPG cylinders – Due to availability of huge market both on domestic and international front, Supreme has decided to venture into manufacturing of composite LPG cylinders for household use.

Cooking gas cylinders made of composite material are explosion proof and will only weigh one-third of what a steel cylinder weighs (30kg when fully loaded). Although, these cylinders are expensive compared to steel cylinders but they are safe, as in case of accident they do not explode like steel cylinders. Also, the cylinder being translucent, the level of gas can also be seen which will be added advantage to the consumers.



Supreme has committed to invest Rs. 70 crores for production capacity of 5 lakh cylinders per annum and the plant is expected to go operational by Mar'13.

It is important to note here that in the beginning the company will focus on exports of composite cylinders to European and Middle East countries as there's huge demand for composite cylinders in those parts of the world and since domestic OMCs are yet to float a tender for such cylinders.

Composite pipes – Besides cylinders, Supreme is also foraying into the manufacturing of composite pipes. The company has already entered in technical tie up on exclusive basis for India with its collaborator M/s. NBL Corporation of Japan, which has the patented technology and process to manufacture High Pressure Composite Pipes where burst pressure is 100 Mega Pascal.

Composite pipes are much lighter in weight compared to present special steel pipes in use in oil exploration. Though such pipes will be expensive by ~25%, however their useful life will be more than 25 years against that of 5 years of steel pipes.

At the moment, the company is making a total investment of Rs 16 crores for a small size plant with a capacity to produce 15,000 pipes of 10 meters per annum and the plant is expected to start commercial production from Nov'12.

Performance Snapshot

Particulars (In cr.)	FY 12	FY 11	FY 10	FY 09	FY 08
Net Sales	2965.30	2468.98	2013.78	1655.45	1312.58
Operating Profit	471.9	357.39	297.38	241.47	146.14
Operating Profit Margin (%)	15.91%	14.47%	14.76%	14.58%	11.13%
Other Income	10.91	9.69	8.18	5.52	6.58
Finance cost	54.79	42.50	33.02	54.56	38.98
Depreciation	72.46	62.84	52.92	52.53	39.51
Profit Before Tax	355.55	262.70	219.61	146.12	74.27
Exceptional Items					
Tax	115.04	87.73	74.89	48.74	24.29
Profit After Tax	240.51	174.97	144.83	97.38	51.11
Profit After Tax Margin (%)	8.08%	7.06%	7.16%	5.86%	3.87%
Cash from Opt.	293.80	169.95	145.55	188.62	105.70
Return on Average Equity	42.52%	40.24%	43.72%	36.55%	21.71%

As can be observed from the above illustration, the performance of the company has been excellent on various parameters: growth, margins, profitability, cash flows from operation, return on shareholder's funds etc.

It is important to note here that the management has indicated that they will strive to maintain 14-15% operating profit margins even when they will not be eligible for capital subsidy post FY 14. They expect to achieve the same by increasing the share of value added products (that fetch more than 17% operating margins) in the overall turnover of the company.

And it's not that management is just making statements, they have walked the talk and have already increased the contribution of Value added products from 25.26% in FY 10 to 31.5% in FY 12.

	Debt Equity ratio	Net Block (cr.)	Working Capital (cr.)	Net Sales (cr.)	*Operating Cash flows before tax (cr.)
FY 08	1.60	489.0	156.5	1312.58	120.69
FY 09	1.30	544.3	177.97	1655.45	210.15
FY 10	0.90	565.6	223.4	2013.78	213.19
FY 11	0.90	741.67	279.02	2468.98	259.55
FY 12	0.55	739.38	275.08	2965.30	410.48

Further, as can be observed from the above illustration, there has been marked improvement in operating efficiency with the company increasingly generating more revenue and higher cash flows for every rupee of capital employed in the business.

The same has helped the company reduce its debt not just in relative terms but also in absolute terms.

It is important to note here that certain value added products help not only achieve higher margins, but also help lower the working capital requirement of the company. For instance, in case of products made out of cross laminate film, the company does not sell the products on credit, it rather asks for advance payment for customers.

In the very beginning, we had mentioned that Supreme has charted out an expansion plan entailing an investment of 1000-1100 crore from 2011-12 to 2015-16 and the same should help the company clock revenues in excess of 6000 crores by FY 16.

Now, the critical question is, how does the company intend to fund its expansion?

Well, as per the management they are confident of achieving the expansion from internal accruals, supplier's credit and the sale proceeds of construction business.

Considering the amount of operating cash flows the company has been generating, along with improving payment terms with both the suppliers and the customers, it seems very

likely that the company will be able to fund the expansion without further burdening its balance sheet.

How does the company confront the volatility in the prices of raw materials?

Particulars (In cr.)	FY 12	FY 11	FY 10	FY 09	FY 08
Net Sales (excluding industrial subsidy, other income and construction business)	2864.11	2401.12	1989.50	1655.98	1312.58
Operating Profit (excluding subsidy, other income and construction business)	396.01	304.05	279.27	241.47	146.14
Operating Profit Margin (%)	13.83%	12.66%	14.04%	14.58%	11.13%

In the above illustration we have excluded the income from construction business and also the subsidy income.

As can be observed above, the company has graduated to ~14% operating margins from its plastics business and is likely to maintain or further increase it to 15% with the introduction of more number of value added products.

FY 12 could have been a tough year for the company both on account of increasing crude prices and rupee depreciation as the company imports ~40% of its raw materials requirement; however, even in the face of double whammy, it could still maintain ~14% operating margins which is to a certain extent reflective of the pricing power of the company.

As per the management, till now they have been able to continuously pass on the increased prices of raw materials. In case of plastic pipes, they do it on the very next day, while in case of other products there's a lag of 2-3 weeks.

Dividend Policy

Dividend Payout ratio					
	Jun'08	Jun'09	Jun'10	Jun'11	Jun'12
Dividend Payout ratio	43.24%	31.31%	31.57%	31.22%	31.69%

As can be observed from the above illustration, the dividend payout has been very generous at over 31.5% of the net profit consistently.

Further, in the recent past there's been no dilution of equity. Rather, in 2008-09 the company carried out a buy-back of equity shares.

A generous dividend payout could have been a cause of concern if the company had been burdening its balance sheet with debt, instead, during the same period the company reduced the debt by 100 crores, while carrying out expansion at the same time.

At current price, the dividend yield is ~2.2% and the same would provide cushion to the downside in case of adverse market conditions.

Valuations

As has been observed in the previous few sections, Supreme has been very efficient with capital allocation, delivered consistently high return on shareholder's funds and has developed certain strengths/capabilities which should help the company extend advantage over its peers and grow at a much higher pace in comparison to the industry.

Further, considering the current per capita polymer consumption in India and the highly under-penetrated and fragmented nature of the industry, Supreme is best placed in terms of manufacturing locations, distribution network and product diversity to benefit from the rising demand for plastic products in India which is expected to more than treble from 7.5 million tonnes at the end of 2010-11 to 24 million tonnes by 2020.

As far as valuations are concerned, Supreme Industries is currently available at a market cap of Rs 3,500 crores and holds debt of Rs 350 crores.

For FY 12, the company recorded a net profit of Rs 240 crores and Rs 290 crores cash flows from operations. Even for the last 5 years, the operating cash flows before tax have averaged at Rs 240 crores.

Considering the operating efficiency, consistently high returns on capital employed and high dividend payout, we believe the valuations are in the fair zone and are neither excessively low, nor high.

In view of the same, we would suggest an initial portfolio allocation of 4% with further increase in allocation to 6-7% in case of a correction to Rs 230-240.

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Katalyst Wealth Alpha/Alpha + Portfolio service is focused on helping individual investors/institutions beat market returns by a wide margin without taking large risks through in-depth research, analysis and follow up on the stock.

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