Quality franchise' but valuations are stretched…

We initiate coverage on Astral Polytechnik with a SELL recommendation and price target of Rs 758/-. India's Real Estate (esp. residential) was struggling prior to Covid-19 and has been further pushed to brink due to Covid-19 induced circumstances, viz., migration of labourers and uncertainty over jobs. Building materials industry including pipes would have to bear the brunt of the Real Estate slowdown. Despite being leader in CPVC pipes backed by first generation, innovative management, we are of the opinion that it would be difficult for Astral Polytechnik to post growth that justifies the current valuations.

We expect Astral Polytechnik (Consol.) to outperform the industry given its leadership, broad product basket focused on CPVC pipes along with brand recall but would report relatively tepid growth over next two years on account of the industry wide slowdown and its after effects. We have penciled in Revenue/EBIDTA/PAT CAGR of 3%/1%/1% over FY20-22 vis-à-vis 13%/21%/27% CAGR for FY15-20. Given the low single digit growth over next two years, the current valuations are relatively rich (50 plus times our estimated FY22 earnings) and hence we value Astral Polytechnik at 40x FY22E earnings to arrive at Rs 758/-.

Our SELL is based on following premise

Industry wide pains to continue

Indian Real estate industry is passing through trying times having been at receiving end ever since demonetization and introduction of RERA and GST. Implementation of regulations have negatively impacted the Real Estate (RE) industry leading to consolidation and the impact has been varied across price segments and micro markets. Already struggling residential real estate has been further weakened post Covid-19 pandemic amidst uncertainty over jobs due to bleak economic outlook, migration of labour, and lack of meaningful stimulus support from government to revive the sector. Deferral in purchases and high risk of cancellations of recent purchases cannot be denied in near future as full exit from lockdown happens and the prevailing businesses take stock of situation, business prospects etc. Further, the liquidity issues faced by the sector in wake of NBFC crisis post IL&FS is also going to worsen the situation over next couple of quarters thereby shaking out the whole shadow banking sector in India which would have lasting impact on the RE industry.

Capex done, but demand side constraints to put pressure on utilization

Astral Poly has pipe manufacturing capacity of 2,38,730 MT at the end of FY20 spread across 6 different plants in northern, western and southern parts of India and has committed capex to build another plant to cater to eastern parts of the country. At the end of FY20, the company produced 1,35,640 MT pipes thus taking the capacity utilization to 57%. Given the demand side constraints we expect further deterioration of capacity utilization for FY21. Additional capacity of around 22,500 MT at its Orissa plant would be ready by end FY21, putting further pressure on the capacity utilization in FY22. Assuming a slight revival in RE industry by FY22, we have estimated improvement in overall capacity utilization nearer to FY20 levels.

Adhesives business still in infancy of growth

Adhesive business of Astral Poly is around 10% of the market leader; the company is working on improving both the market share and profitability which has reflected in its results, so far. The company's adhesive business Revenue/EBIDTA/PAT has grown at CAGR of 10%/15%/9% respectively over FY16-20. Going forward, we estimate the adhesive segment to post Revenue/EBIDTA/PAT to grow at CAGR of 2%/(2%)/(6%) respectively over FY20-22.

Outlook & valuation – Initiate with a SELL

Given the current state of economy and the Indian Real Estate, the demand for pipes and adhesives is likely to be muted. We estimate Astral Polytechnik to post consolidated Revenue/EBIDTA/PAT to grow at CAGR of 6%/8%/5% respectively over FY20-22; we are of the opinion that the stock price does not warrant rich valuations at which it is trading currently and hence recommend a SELL with price target of Rs 758/- (downside of 16%).

Key Financials (Consolidated)

(Rs. Cr)	FY19	FY20P	FY21E	FY22E
Net Sales	2,507	2,578	2,221	2,737
EBITDA	385	443	321	453
Net Profit	196	248	151	254
EPS (Rs.)	12.97	16.42	10.02	16.85
PER (x)	71.5	56.3	92.3	54.9
EV/EBITDA (x)	29.0	31.5	42.9	29.9
P/BV (x)	11.0	9.3	8.6	7.5
ROE (%)	17.0	17.7	9.6	14.5

Source: Company, Axis Research

CMP as of Jun 19, 2020)	
CMP (Rs)	907
Upside / (Downside) (%)	(16%)
High/Low (Rs)	1,265/748
Market cap (Cr)	13,559
Avg. daily vol. (6m) Shrs.	68,271
No. of shares (Cr)	15.1

Shareholding (%)

	Mar-20P	Dec-19	Sep-19
Promoter	55.7	55.7	58.1
FIIs	20.1	20.4	21.9
MFs / UTI	8.2	8.0	6.1
Banks / FIs	0.5	0.5	0.0
Others	15.5	15.4	13.8

Financial & Valuations

Y/E Mar (Rs. Cr)	FY20P	FY21E	FY22E
Net Sales	2,578	2,221	2,737
EBITDA	443	321	453
Net Profit	248	151	254
EPS (Rs.)	16.42	10.02	16.85
PER (x)	56.3	92.3	54.9
EV/EBITDA (x)	31.5	42.9	29.9
P/BV (x)	9.3	8.6	7.5
ROE (%)	17.7	9.6	14.5

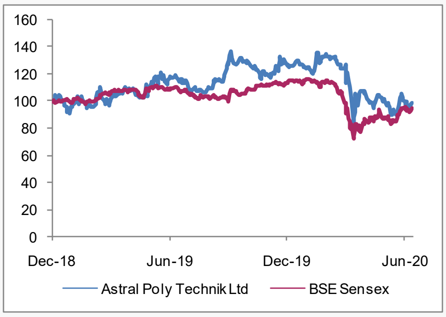
Key Drivers (%) (Growth in %)

Y/E Dec	FY20P	FY21E	FY22E
Sales Growth (%)	2.82	(13.86)	23.26
EBITDA Growth	15.06	(27.62)	41.26
PAT Growth (%)	26.62	(38.98)	68.17

Axis vs Consensus

EPS Estimates	2021	2022
Axis	10.0	16.8
Consensus	14.0	21.5
Mean Consensus TP (12M)		**898**

Relative performance



Source: Capitaline, Axis Securities

Pankaj Bobade
Research Analyst

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email: pankaj.bobade@axissecurities.in

Story in charts

Exhibit 1: Strategic Capacity increase to support future growth;
Low capacity utilization expected over near term before recovery

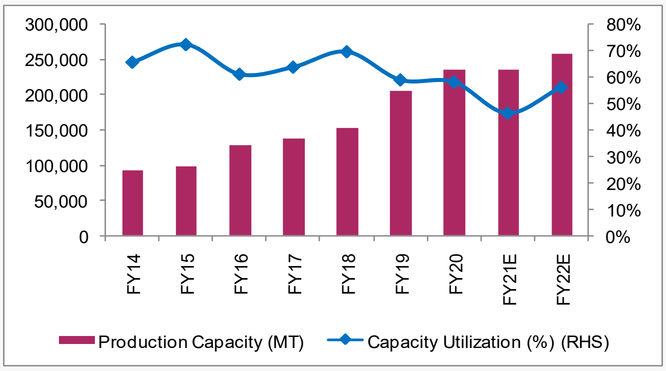
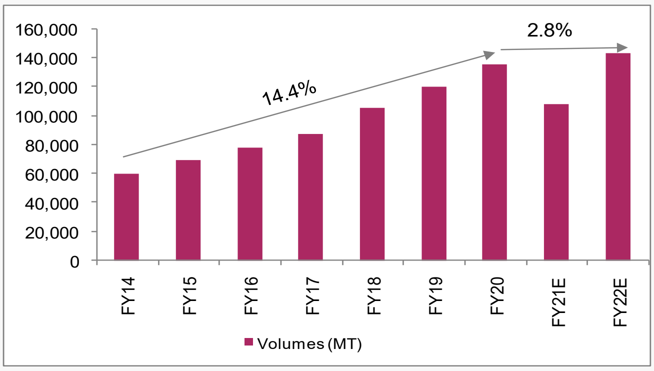


Exhibit 2: Muted Volume Growth for pipes expected over FY20-22E



Source: Company, Axis Securities

Exhibit 3: Muted growth expected over FY20-22E

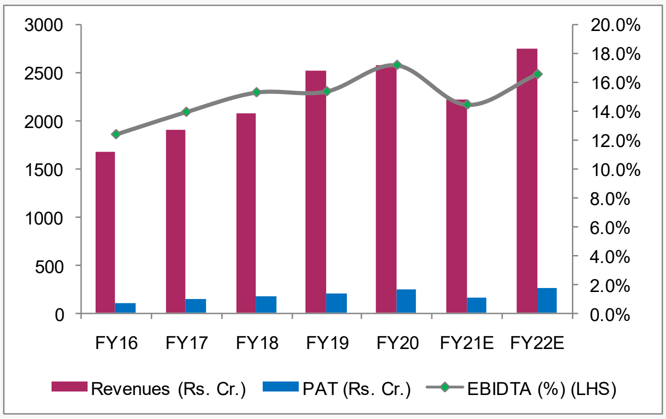
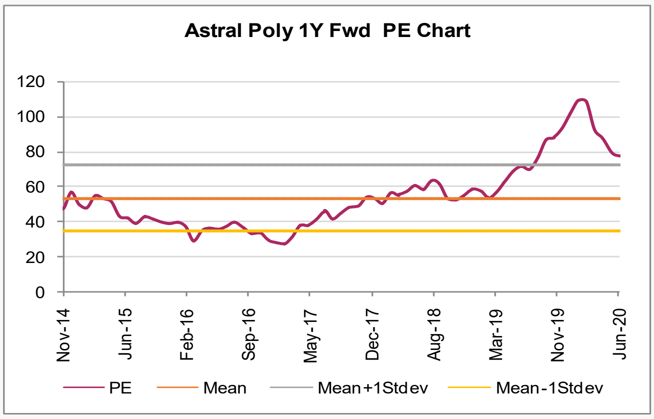


Exhibit 4: Stretched Valuations



Source: Company, Axis Securities

Exhibit 5: Industry Wide Pipes Market Share FY19

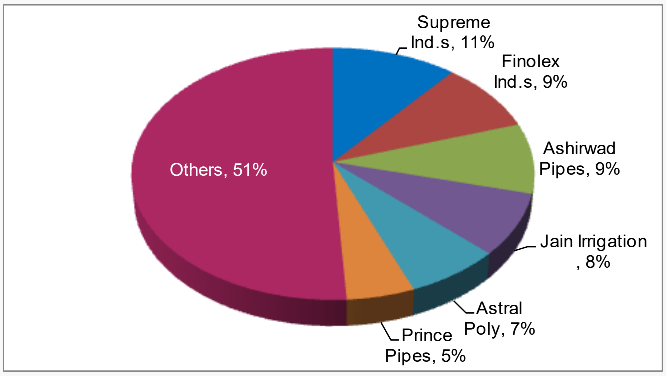
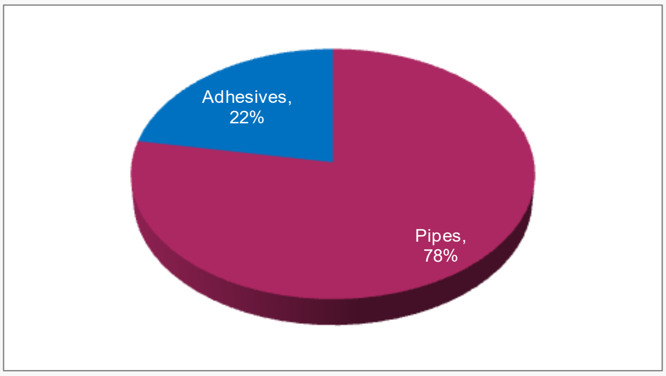


Exhibit 6: Revenue Breakup (FY20)



Source: Prince Pipes DRHP

Source: Axis Securities

Market leader in CPVC pipes, but demand deferral to impact volumes

Astral Poly has been a leading player in the organized space in Pipes segment enjoying almost 25% share of the CPVC pipes market and around 7% in overall plastic pipes market. Astral Poly had reported consistent growth for its Pipes business with overall pipes volume rising at CAGR of 13% between FY15-20. Thus Astral Poly had outgrown the industry due to its product mix which was skewed towards CPVC pipes. Going forward, we estimate the overall pipes volume for Astral Poly to grow at CAGR of around 3% over next 2 years which is far lower than the volume growth it had reported over last 5 years. Consequently, we expect that over next couple of years, Astral Poly would fall short of the same volume growth and hence the earnings growth that it had displayed over last 5 of years - the sole reason for rich valuation commanded by the stock (Astral Poly has reported earnings growth of 27% over FY15-20).

Stressed Real Estate industry to impact fresh demand; existing projects to get delayed

Indian Real Estate (RE) Industry has been affected ever since demonetization happened which was then followed up by new regulations viz., RERA and GST. Meanwhile, the liquidity crisis, post IL&FS saga (late 2018), has shaken out the shadow banking sector which happens to be the main source of debt fund for both developers and buyers. Thus, RE is under stress for both supply and demand side. Moreover, the migration of labour to their hometowns, following the strict lockdown to contain Covid-19, has exacerbated the situation in near term for resumption of construction activities as the lockdown is exited in phases in the hotspots; general expectation is that the migrant labour, which hailed from states of UP, Bihar, Chhattisgarh, Jharkhand and Bengal, would not return before festive season as they would get employed in or near their hometown under the government driven MNREGA scheme. Hence, the existing/ running RE projects are likely to get delayed while the launch of fresh projects would get deferred.

Moreover, the lockdown has put a spanner in already slowing economy. It needs to be seen how the manufacturing activities pick-up in near future as the lockdown is exited. Though the fears of large scale job cuts would be unfounded, there has been pay cuts in various industries while others have done away with annual increments for the year. Some of the service industry viz., movie exhibition, restaurants and hotels, leisure travel, etc. would be hugely hit for rest of the year due to fear factor associated with travel. Fear of possible job loss would lead to deferment of big ticket decisions like residential Real Estate for the end consumer. With RE industry under stress, the incremental demand from new projects can be wished off for FY21 which would probably return in FY22 though in calibrated manner. Second wave of Covid-19 cases, if any, would deteriorate the situation further.

Branded players to get support from replacement demand

The CPVC Piping system demand has been riding the replacement and fresh projects demand over last 5 years. As mentioned above, the fresh projects demand is expected to be muted in near future but the replacement demand (at expense of the metal and other alternative piping systems) is likely to continue, though at subdued pace. Though there is no empirical evidence to support, the replacement market size is said to be around half of the total annual pipes demand for CPVC segment. CPVC piping system is replacing the hot and cold potable water distribution system for use in existing apartments, high-rises, hotels, and commercial establishments as the CPVC offers durability, low bacterial growth, non-corrosive nature and resistance to scale formation as compared to existing Galvanized Iron (GI) metal pipes. Moreover, it is lead free, fire resistant and unaffected by chlorine if present in water supply as compared to GI pipes. CPVC pipes are easier to handle, cheaper and cost effective to install along with long life compared to GI pipes. Plastic pipes are connected using cold welding/ solvent. Since the fittings segment enjoys higher margins because of the specialized product nature, high precision etc., it becomes a constrain for the unorganized players to enter this space thereby creating a natural entry barrier and providing a long lasting moat for the branded players. Thus, the branded players have been aggressively expanding their product portfolio and fittings capacity over the years to cater to the high demand in this segment thereby not only protecting their revenues and margins but also expanding their market share at the cost of unorganized players. Given the growth opportunity available from replacement market in housing, irrigation, infrastructure sectors, the overall organized plastic pipes industry would be able to protect itself in such a dire situation where the fresh projects demand is expected to be slowing down. The organized segment (~65% of market size) is expected to eat into the market share of unorganized space on back of the competitive landscape in terms of production capabilities, distribution network, strong brand equity and the robust balance sheet. Astral Poly, the leader in CPVC pipes segment, would be better placed compared to its peers as it would be able to partially compensate for loss of volumes from projects side through the replacement demand.

Underutilized Capacities to lead to negative operating leverage in near term

Astral Poly has been growing by diversifying its presence across the nation. Freight cost is a substantial expense for plastic pipes as it is equivalent to transport of air; beyond certain distance the transportation cost becomes unviable from profitability point of view, hence it is advisable to have a manufacturing capacity near the target market. Astral Poly had taken strategic decision to expand capacities near to the end market and accordingly have been expanding its production capacity; in FY13, Astral Poly had all its capacities limited to west i.e. in Santej and Dholka, Gujarat. Having started building its franchise and brand, the company started with expansion in Hosur, Karnataka in FY14, Giloth (Rajasthan) in FY18 and Sitarganj, (Uttarakhand) in FY19. Come FY23, Astral would have a full fledged pipe production at Bhubaneshwar, Orissa to service the eastern part of the country. Currently, around 75% of the capacity is in western India (Gujarat & Maharashtra), 12% in South (Hosur, Karnataka), and rest is in north India (Giloth, (Raj.) & Sitarganj (UK)). Addition of Bhubaneshwar capacity would further help the company geographically diversify its production and sales mix. With its production footprint in all the four corners of the country, the company would have to focus on improving utilization of the capacities which have been utilized around 60% on an average over last 5 years. Demand drop in FY21 is expected to further impact the capacity utilization; we estimate the capacity utilization to be below 50% for FY21 but improve nearer to FY20 levels by FY22. On account of the same, the margins of pipes business is expected to under pressure in FY21 and FY22 before reverting back to FY20 levels.

Exhibit 7: Drop in pipes demand to take toll of capacity utilization in near term

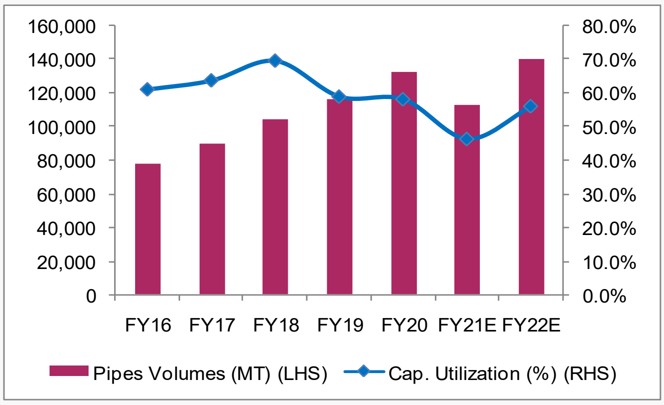
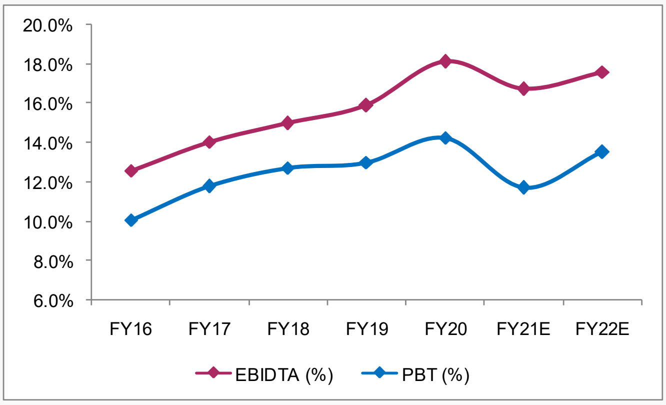


Exhibit 8: and margins….

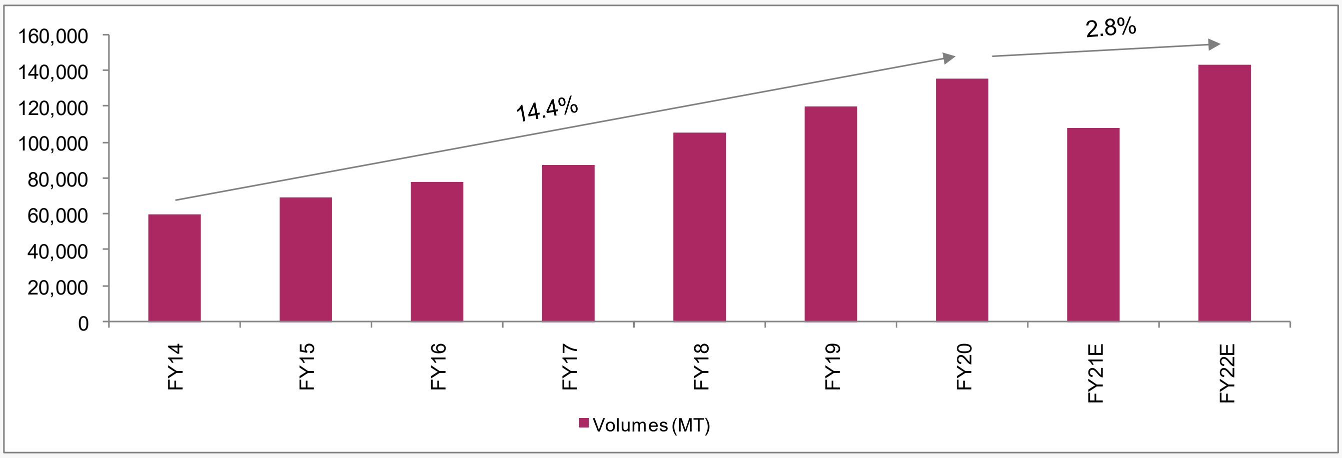


Source: Company, Axis Securities

Broad & Diversified product portfolio to help Astral Poly outperform the industry over long term, but short term growth is doubtful

Astral Poly has been consistently growing its plastic pipes portfolio on back of CPVC pipes; the company has reported healthy 13% sales volume growth over FY15-20 for the overall plastic pipes portfolio. The company has over a period of time launched wide variety of products to cater to specific end use like pipes for domestic plumbing, sewerage drainage pipes, fire sprinklers, industrial pipes, surface drainage system, agriculture pipes, corrugated pipes, pipes for cable protection and insulation tubes along with the appropriate fittings for the same. Diversified product basket, its networking with plumbers along with established brand would come to rescue for Astral Poly as and when the demand returns. In near term, the demand is expected to be tepid on account of after effects of nationwide lockdown to contain the spread of Covid-19, headwinds of liquidity constraints for institutional customers and trade channels along with deferral in purchases as plastic pipes do not happen to be essential/ priority buy for the retail customer. We have penciled in plastic pipes sales volume growth of 3% over FY20-22E.

Exhibit 9: Pipes Volume to be under pressure in near term



Source: Company, Axis Securities

Margins, return ratios to be under pressure over near term

Astral Poly's margins were under pressure post acquisitions of adhesives business in FY15. Over the period, the company has worked upon and has been quite successful in improving its consolidated margin profile. Last year, the company has invested into rooftop solar panel system which would help save power and fuel cost for the company in future; management expects a payback period of around 3.5 years for the investment of around Rs 25-30 cr on the rooftop solar panel system. Over near term, we estimate margins to be under pressure due to underutilized capacity for plastic pipes following demand deferment and delay in ramp up of the adhesives business as was planned before the pandemic had hit the economy. Following the drop in margins, the return on equity is also expected to be under pressure thereby further questioning the multiple at which the stock is trading. Return on Capital employed is also expected to be under pressure as the capacity utilization (which has been around 60% in last 5 years) drops further again on account of demand deferral. Despite being a leader in CPVC pipes, Astral Poly would have limited scope for price hikes to defend its margins as it would also have to protect its market share in these uncertain times. Moreover, margins are likely to be further impacted in case of sharp depreciation of INR since the company imports the raw material required for CPVC pipes; the impact of currency fluctuations would be passed on, albeit with a lag.

Exhibit 10: PAT is expected to be flat over FY20-22E

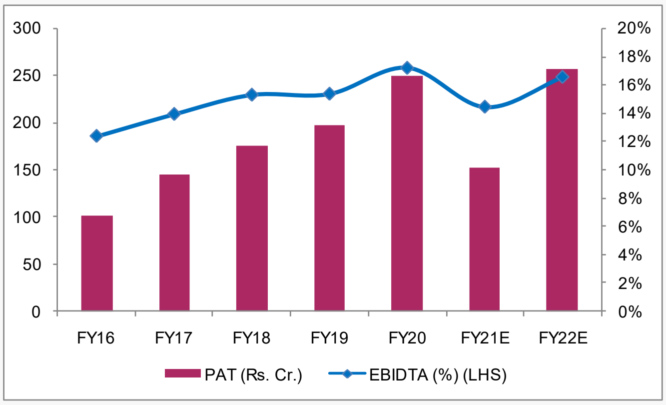
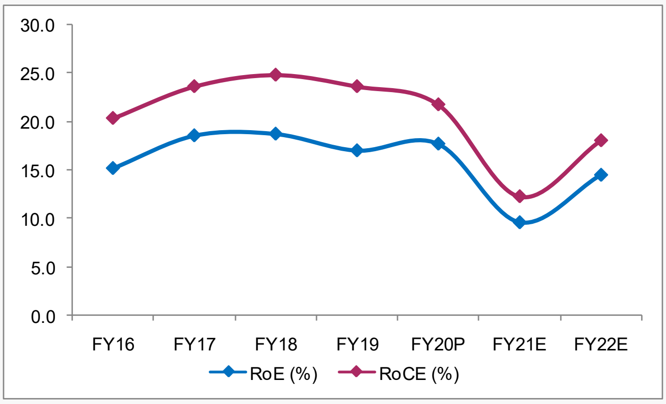


Exhibit 11: Subdued earnings to impact return ratios in near term



Source: Company, Axis Securities

Healthy balance sheet and comfortable WC cycle to provide succour

Astral Poly has light balance sheet with Rs 130 cr debt (LT + ST) on the books and the management has indicated that it would be retiring the same in near term. Similarly, the WC has been under control with cash conversion cycle of just 43 days for FY20. We feel that strong and healthy balance sheet to help Astral Poly sail through difficult times.

Exhibit 12: Healthy BS to provide comfort in these trying times

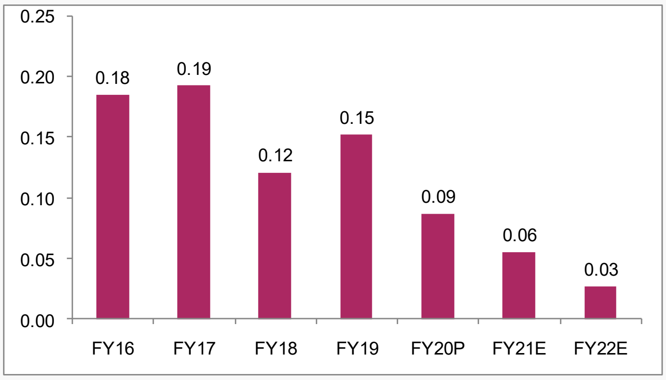
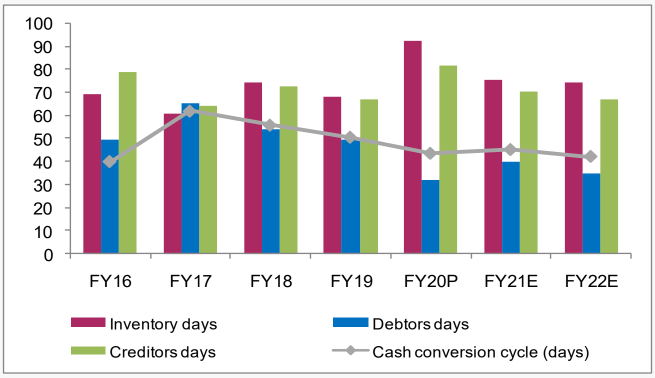


Exhibit 13: Cash conversion cycle under control



Source: Company, Axis Securities

Adhesive business- a small player against established behemoths

Adhesives market in India is concentrated with handful of players who together are ruling over 85% of the market share. In order to diversify its portfolio from pipes only, Astral Poly expanded into adhesives business using its experience of producing and selling solvents for joining pipes. Astral Poly acquired Resinova and Seal IT in FY15 to become a sizable player in adhesive business.

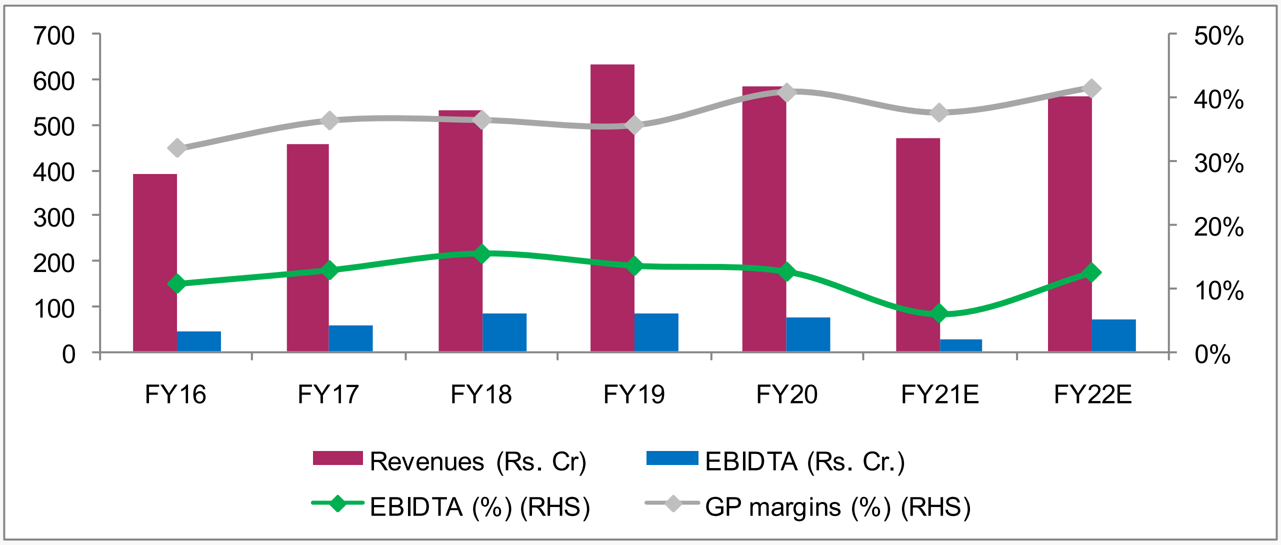
Acquisitions in Adhesives segment

Year	Subsidiary	Remarks
FY15	Seal IT, UK	Astral acquired 80% stake for Rs 45 cr
FY15	Resinova Chemie	Astral paid Rs 215 cr for 76% in FY15; acquired the rest for Rs 70 cr in FY16
FY17	Seal IT, USA	Seal UK acquired silicone tape business from Rowe US for USD 3.25 mn

Source: Company, Axis Securities

Currently, the adhesive business is roughly 1/10th of the business size of the market leader. So far, between FY16-20, the business has displayed promising growth- the revenues have grown at 10% CAGR over FY16-20 while the profitability has expanded by 9% CAGR over the same period in face of formidable competition with deep pockets. The company has improved its GP margins for adhesives business from 32% in FY16 to 41% in FY20. Recently, the management has rationalized their distribution strategy thereby removing one layer in the distribution pyramid and keeping the associated margins with them. Management's plans to ramp up the profitability in the adhesives business is expected to take a hit as the target industry viz., Real Estate and home improvement slides down the priority list for the end consumer in wake of economic slowdown following the impact of Covid-19 pandemic. Given the uncertainty and the economic slowdown along with the size of business, we estimate the adhesives business of Astral Poly to report Revenues/EBIDTA/ PAT at 2%/(2%)/(6%) CAGR over FY20-22.

Exhibit 14: Adhesives segment: too small to move the needle



Source: Company, Axis Securities

Supernormal valuation premium to narrow down:

In last 10 years, the plastic pipes industry has reported excellent growth in earnings and so has been the growth of market cap of respective companies. We are of the opinon that growth in market cap of respective companies has not been uniform and there exist valuation premium for Astral Poly over its peers which was mainly on account of its skewed portfolio towards CPVC pipes and its ability to report consistent volume growth. Going forward, as the pillar of expensive valuation viz., the CPVC pipes volume growth normalizes, we expect the valuation premium commanded by the stock to narrow down. Below is the bubble chart which shows the change in market cap for Astral Poly relative to the growth in Sales and earnings. Over last 10 years i.e. between FY10 to FY20, the Net Sales of Astral Poly has grown at CAGR of 24%, PAT at CAGR of 24% but the market cap has grown at whooping 39% CAGR.

Exhibit 15: Market Cap growth far exceeds the earnings growth

Source: Company, Axis Securities; * Bubble size represent Market cap.

Valuations and Outlook

We initiate coverage on Astral Polytecnik Ltd with "SELL" rating & target price of Rs. 758/share arrived by giving a multiple of 45x FY22E, downside 16% over 12-15 months.

Although Astral Poly is a great franchise' with tried and tested products and strong brand recall, the stock is trading at stretched valuations (almost 55x FY22E). Given the state of economy and Real Estate industry which is the main consumer of the product, we estimate low single digit growth earnings over FY20-22, hence, we feel that the rich valuations are not sustainable and would correct in near term.

Exhibit 16: FWD PE (x)

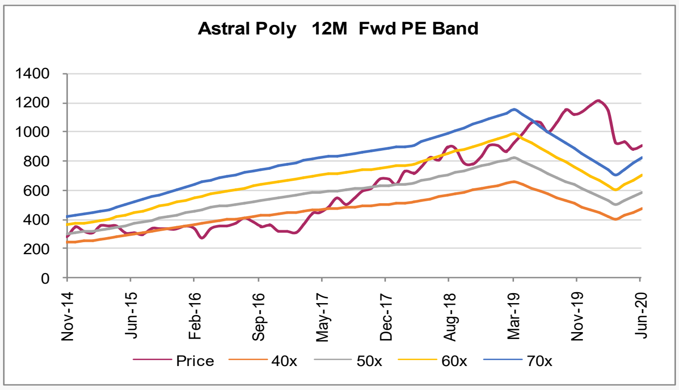
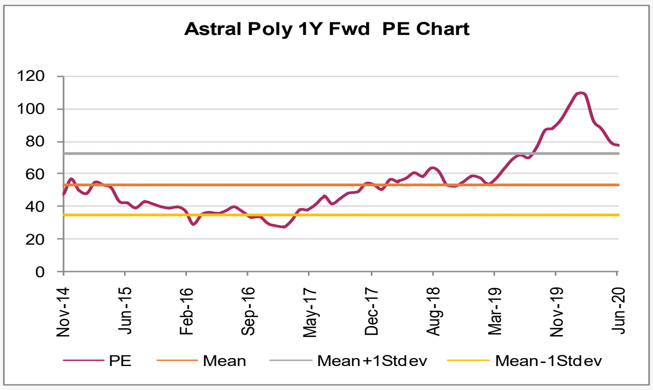


Exhibit 17: FWD PE BAND (x)



Source: Company, Axis Securities

Key Risks

- Sharp drop in USD would play out in company's favour as the company imports the raw material for its CPVC pipes business.
- Drop in competitive intensity amongst domestic plastic pipes manufacturers would positively impact Astral Poly's market share

About the company

Astral Pipes, established in 1996 with the aim of manufacturing plumbing and drainage systems in India, has been promoted by first generation entrepreneur Mr Sandeep Engineer. Astral Poly has attained leadership in the CPVC pipes segment with market share of almost 25% and has developed a large PVC portfolio over the last decade. With a logical expansion in the adhesive segment, Astral Poly has expanded its building materials portfolio. The diversified product portfolio in both piping and adhesive has enabled it to play the growing building material opportunity.

Financials (consolidated)

Profit & Loss

(Rs Cr)

Y/E March	FY19	FY20P	FY21E	FY22E
Net sales	**2,507**	**2,578**	**2,221**	**2,737**
Other operating income	0	0	0	0
Total income	2,507	2,578	2,221	2,737
Cost of goods sold	2,013	2,016	1,802	2,167
Contribution (%)	*19.7%*	*21.8%*	*18.9%*	*20.9%*
Advt/Sales/Distrn O/H	109.3	118.6	98.2	117.9
Operating Profit	**385**	**443**	**321**	**453**
Other income	15	12	12	16
PBIDT	**400**	**455**	**333**	**468**
Depreciation	81	108	120	128
Interest & Fin Chg.	26	21	8	3
E/o income / (Expense)	6	18	8	7
Pre-tax profit	**287**	**308**	**197**	**330**
Tax provision	86	57	42	71
(-) Minority Interests	2	2	1	2
Associates	(4)	(2)	(2)	(3)
Adjusted PAT	**191**	**233**	**145**	**249**
Reported PAT	**196**	**248**	**151**	**254**

Source: Company, Axis Securities

Balance Sheet

(Rs Cr)

Y/E March	FY19	FY20P	FY21E	FY22E
Total assets	**1,543**	**1,698**	**1,809**	**2,003**
Gross block	1,078.3	1,250.7	1,325.7	1,375.7
Net Block	851.7	923.6	878.5	800.2
CWIP	80.8	44.4	18.8	15.0
Goodwill	253.8	255.3	255.3	255.3
Investments	41.8	102.8	102.8	102.8
Wkg. cap. (excl cash)	216	242	220	253
Cash / Bank balance	98.1	130.1	334.0	576.0
Misc. Assets	0.0	0.0	0.0	0.0
Capital employed	**1,543**	**1,698**	**1,809**	**2,003**
Equity capital	12.0	15.1	15.1	15.1
Reserves	1,266	1,488	1,615	1,844
Minority Interests	15.0	16.8	18.0	20.1
Borrowings	197	135	95	55
Def tax Liabilities	53.3	42.9	66.3	68.8

Source: Company, Axis Securities

Cash Flow (Rs Cr)

Y/E March	FY19	FY20P	FY21E	FY22E
Sources	**432**	**256**	**231**	**322**
Cash profit	304	379	281	388
(-) Dividends	10	24	26	27
Retained earnings	295	355	255	360
Issue of equity	0.0	3.1	0.0	0.0
Change in Oth. Reserves	74.7	(24.0)	1.2	2.1
Borrowings	72	(61)	(40)	(40)
Others	(10)	(17)	15	(0)
Applications	**432**	**256**	**231**	**322**
Capital expenditure	374.5	198.8	49.4	46.3
Investments	0.2	(0.2)	0.0	0.0
Net current assets	2.8	25.1	(21.8)	33.6
Change in cash	54.5	32.0	203.9	242.0

Source: Company, Axis Securities

Ratio Analysis (%)

Y/E March	FY19	FY20P	FY21E	FY22E
Sales growth	**21.0**	**2.8**	**(13.9)**	**23.3**
OPM	**15.4**	**17.2**	**14.4**	**16.5**
Oper. profit growth	21.5	15.1	(27.6)	41.3
COGS / Net sales	80.3	78.2	81.1	79.1
Overheads/Net sales	4.4	4.6	4.4	4.3
Depreciation / G. block	7.6	8.6	9.1	9.3
Effective interest rate	16.3	13.0	7.4	4.3
Net wkg.cap / Net sales	0.09	0.09	0.10	0.09
Net sales / Gr block (x)	2.3	2.1	1.7	2.0
RoCE	**23.7**	**21.8**	**12.3**	**18.1**
Debt / equity (x)	0.15	0.09	0.06	0.03
Effective tax rate	30.4	18.5	21.7	21.7
RoE	**17.0**	**17.7**	**9.6**	**14.5**
Payout ratio (Div/NP)	4.9	9.7	17.0	10.8
EPS (Rs.)	**13.0**	**16.4**	**10.0**	**16.8**
EPS Growth	11.8	26.6	(39.0)	68.2
CEPS (Rs.)	18.4	23.6	18.0	25.3
DPS (Rs.)	0.6	1.4	1.5	1.6

Source: Company, Axis Securities

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