FIRST LIGHT

29 September 2022

RESEARCH

Plastic Products

Expect revival in H2 but a muted FY23

SUMMARY

Plastic Products

- Leading pipe companies likely to report high inventory losses in Q2FY23 owing to freefall in PVC prices (trading below Rs 90/kg)
- Volume offtake should improve in H2 as PVC prices expected to stabilise, agricultural demand picks up and channel re-stocking kicks in
- Retain HOLD on ASTRA, SI and FNXP; use any weakness in ASTRA and SI as an opportunity to enter

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Daily macro indicators

Indicator	26-Sep	27-Sep	Chg (%)
US 10Y yield (%)	3.92	3.95	2bps
India 10Y yield (%)	7.36	7.29	(7bps)
USD/INR	81.63	81.58	0.1
Brent Crude (US$/bbl)	84.1	86.3	2.6
Dow	29,261	29,135	(0.4)
Hang Seng	17,855	17,860	0.0
Sensex	57,145	57,108	(0.1)
India FII (US$ mn)	**23-Sep**	**26-Sep**	**Chg ($ mn)**
FII-D	(29.4)	53.4	82.8
FII-E	(321.3)	(570.3)	(248.9)

Source: Bank of Baroda Economics Research

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PVC prices in freefall: PVC prices are currently at ~Rs 88/kg from Rs 119/kg in Q1FY23, following a ~Rs 4/kg reduction by Reliance Industries. This coupled with lean stocking by channel partners is likely to exert pressure on Q2FY23 margins.

Expect heavy inventory losses in Q2: In Q1FY23, PVC prices fell by Rs 32.5/kg, fuelling inventory losses among pipe companies with ASTRA/SI/FNXP reporting EBIT/kg declines of 13%/34%/24% YoY (and 22%/28%/51% QoQ). Companies that carried above-normal stock reported inventory losses during Q1 (ASTRA: Rs 250mn; SI & FNXP: undisclosed). We expect further unwinding of high-cost inventory and, hence, losses to continue in Q2 given the sustained downslide in PVC prices during Jul-Sep'22 thus far by Rs 23.5/kg (-20% QoQ).

Profitability pressures forecast for Q2: Our market checks indicate that pipe companies could report lower sale volumes in Q2FY23 as channel partners have delayed restocking due to the fluctuating PVC prices. This adds to headwinds from demand deferral by the agriculture segment, subdued demand from the plumbing segment where new projects have slowed, and seasonal weakness in Q2 due to lower construction activity during the monsoons. We believe lower PVC prices can bolster volume offtake in the agricultural segment due to the price elasticity of rural demand, but note that margins here are lower than the plumbing/SWR (soil, waste, rain) segment.

Expansion into adjacent products: Given significant channel overlap, pipe companies are aggressively focusing on deepening the addressable market through innovations, launches (plastic storage tanks, industrial valves), and forays into bathware. For instance, ASTRA bought a ready-to-use asset in Jamnagar in Q1FY23 for the manufacture of faucets and expects a meaningful contribution from Q3. We believe these initiatives will further boost the growth longevity for pipe companies.

Maintain HOLD: ASTRA (TP Rs 2,205) has strong growth prospects and is emerging as a complete building solutions player, while SI (TP Rs 2,055) leads in pipes and incremental capacity to support long-term growth. But at 62x and 29x FY24E P/E respectively, valuations appear full; we retain HOLD and recommend buying on dips.

Recommendation snapshot

Ticker	Price	Target	Rating
ASTRA IN	2,162	2,205	HOLD
FNXP IN	139	140	HOLD
SI IN	2,060	2,055	HOLD

Price & Target in Rupees | Price as of 27 Sep 2022

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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