CRISIL RESEARCH

CRISIL IER Independent Equity Research

The Supreme Industries Ltd

Detailed Report

Enhancing investment decisions

Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade) The fundamental grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals) The valuation grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Fundamental Grade	Assessment	CRISIL Valuation Grade	Assessment
5/5	Excellent fundamentals	5/5	Strong upside (>25% from CMP)
4/5	Superior fundamentals	4/5	Upside (10-25% from CMP)
3/5	Good fundamentals	3/5	Align (+-10% from CMP)
2/5	Moderate fundamentals	2/5	Downside (negative 10-25% from CMP)
1/5	Poor fundamentals	1/5	Strong downside (<-25% from CMP)

About CRISIL Limited

CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services. We are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations.

About CRISIL Research

CRISIL Research is India's largest independent and integrated research house. We provide insights, opinions, and analysis on the Indian economy, industries, capital markets and companies. We are India's most credible provider of economy and industry research. Our industry research covers 70 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our network of more than 4,500 primary sources, including industry experts, industry associations, and trade channels. We play a key role in India's fixed income markets. We are India's largest provider of valuations of fixed income securities, serving the mutual fund, insurance, and banking industries. We are the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today India's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgements and forecasts with complete objectivity. We leverage our deep understanding of the macroeconomy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. We deliver our research through an innovative web-based research platform. Our talent pool comprises economists, sector experts, company analysts, and information management specialists.

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Last updated: August, 2014

Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

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The Supreme Industries Ltd

Fundamental strengths assure a healthy future

Fundamental Grade	5/5 (Excellent fundamentals)
Valuation Grade	3/5 (CMP is aligned)
Industry	Plastic products

CRISIL RESEARCH

September 23, 2014

Fair Value	₹620
CMP	₹650

The Supreme Industries Ltd (Supreme) has sustained its growth trajectory despite a challenging FY14. It was able to pass on the increase in raw material prices across segments, despite muted demand, due to its strong brand equity. Though volumes moderated, margins were healthy. Additionally, strengths such as a diversified product portfolio, pan India presence through a wide distribution network, stringent working capital management and focus on new product development have enabled Supreme to entrench its dominance in the plastic processing industry. With its fundamental strengths and a strong management team, Supreme is one of the best placed to benefit from pick-up in plastic demand following economic revival. Hence, we upgrade Supreme's fundamental grade to **5/5,** indicating 'Excellent fundamentals' compared to all other listed securities in India.

Plastic piping: Healthy opportunity; Supreme is an established player

Plastic piping has been Supreme's fastest growing segment led by strong domestic demand and the company's established position in the industry. Though FY14 volume growth moderated to 7%, we expect it to recover led by healthy demand for PVC pipes for irrigation, plumbing and water supply and sanitation (WSS) applications. CPVC pipes sales are expected to remain healthy driven by an increase in preference for this product in hot and cold water plumbing applications. We forecast plastic piping revenues to grow at 16% CAGR over FY14-16 led by 13% volume CAGR.

XF: Superior product, established brand; FY15 growth hinges on normal agri output

Supreme is the only Indian manufacturer of high-margin cross laminated (XF) films, a patented product of a Switzerland-based company which Supreme has licensed. Superior quality over conventional tarpaulin, wide applications and its established position as a quality product under the brand 'SILPAULIN' brighten up the long-term prospects of this product. However, since XF films are mostly used in rural areas, growth in the current year is dependent on the normalcy of agricultural output, following weak onset of monsoons.

Consistently healthy free cash flows; unutilised cash distributed to shareholders

Supreme has consistently generated healthy cash flows from operations. On most occasions over the past four years, its operating cash flow has been greater than PAT and the cash flow has been sufficient to meet its capital requirements. Its average net debt:equity has been 0.5x for the past three years. Most of the unutilised cash flows are passed on to the shareholders in the form of dividend, which is a positive.

Revenues to grow at 14% CAGR; fair value increased to ₹620 per share

Consolidated sales are expected to post a two-year revenue CAGR of 14% to ₹50.9 bn by FY16. Supreme's RoE is expected to remain >25% over FY14-16. We increase the discounted cash flow-based fair value to ₹620 per share. This fair value implies P/E multiples of 20.8x FY15E and 19.3x FY16E EPS.

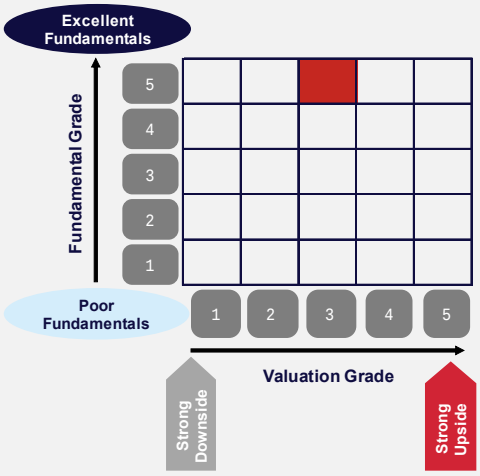
KEY FORECAST

(₹ mn)	FY12	FY13	FY14	FY15E	FY16E
Operating income	29,659	33,933	39,537	45,086	50,992
EBITDA	4,712	5,341	5,871	6,746	7,294
Adj net income	2,408	2,886	2,818	3,785	4,083
Adj EPS (₹)	19.0	22.7	22.2	29.8	32.1
EPS growth (%)	24.1	19.8	(2.4)	34.3	7.9
Dividend yield (%)	0.9	1.2	1.2	1.5	1.7
RoCE (%)	37.8	37.8	34.0	37.1	37.3
RoE (%)	38.7	36.6	29.4	32.9	29.6
PE (x)	34.3	28.6	29.3	21.8	20.2
P/BV (x)	11.9	9.4	7.9	6.5	5.5
EV/EBITDA (x)	18.2	16.3	14.8	12.6	11.5

NM: Not meaningful; CMP: Current market price

Source: Company, CRISIL Research estimates

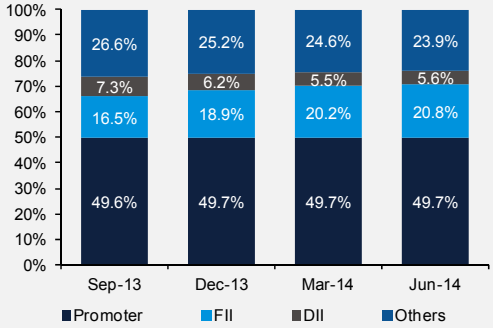
CFV MATRIX



KEY STOCK STATISTICS

NIFTY/SENSEX	8146/27245
NSE/BSE ticker	SUPREMEIND
Face value (₹ per share)	2
Shares outstanding (mn)	127.0
Market cap (₹ mn)/(US$ mn)	82,568/1,354
Enterprise value (₹ mn)/(US$ mn)	87,020/1,450
52-week range (₹)/(H/L)	689/323
Beta	0.7
Free float (%)	50.3%
Avg daily volumes (30-days)	95,999
Avg daily value (30-days) (₹ mn)	62.1

SHAREHOLDING PATTERN



PERFORMANCE VIS-À-VIS MARKET

	Returns			
	1-m	3-m	6-m	12-m
Supreme	12%	30%	31%	99%
CNX 500	4%	9%	31%	44%

ANALYTICAL CONTACT

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For detailed initiating coverage report please visit: www.ier.co.in
CRISIL Independent Equity Research reports are also available on Bloomberg (CRI <go>) and Thomson Reuters.

Table 1: Supreme - Business environment

Product / segment	Plastic piping system	Packaging products	Consumer products	Industrial products
Revenue contribution (FY14)*	53%	21%	7%	15%
Revenue contribution (FY16E)*	56%	20%	6%	15%
Product / service offering	PVC (polyvinyl chloride), CPVC (chlorinated polyvinyl chloride), PPRC (polypropylene random co-polymer) and HDPE (high density polyethylene) pipes, injection moulded and handmade fittings	Performance films, protective packaging films, cross laminated films	Moulded furniture	■ Moulded parts such as dashboards and other interior and exterior parts for automobiles ■ Plastic body for consumer durable products ■ Material handling products such as pallets, crates and bins
Market position	The second largest domestic player with 18% share of the organised plastic pipe market	33-39% market share across various products in protective packaging; market leader in cross laminated films	Second largest domestic player with 15% market share	18% market share in material handling products; preferred supplier to OEMs
Sales growth (FY12-FY14 – 2-yr CAGR)	26% (11.5% volume CAGR, 13% realisation CAGR due to increase in raw material prices)	9% (2% volume CAGR due to muted sales of XF films, 7% realisation CAGR)	-2% (11% decline in realisations as the company is moving away from the competitive commodity furniture segment, 10% realisation CAGR)	4% (6% volume decline due to weak demand from auto and consumer durables industries, 11% realisation CAGR)
Sales forecast (FY14-FY16E – 2-yr CAGR)	16% (13% volume CAGR, 3% realisation CAGR)	13% (12% volume CAGR as we expect pick-up in demand for XF films, 1% realisation CAGR)	3% (flat volumes as the company is likely to continue to withdraw from commodity furniture, 3% realisation due to increase in contribution of premium furniture)	11% (9% volume CAGR on pick-up in demand from auto and consumer durables industries, 2% realisation CAGR)
Demand drivers	■ The government's thrust on development of irrigation facilities and urban sanitation ■ Demand for pipes for new houses ■ Replacement demand as plastic pipes are replacing galvanised iron (GI) pipes in houses	■ Protective packaging – growth directly linked to performance of end-user industries such as construction, manufacturing, white goods, automobiles, etc. ■ Performance films – increasing thrust on packaged food ■ Cross laminated films – wide application of these films coupled with superior quality vs conventional tarpaulin is expected to drive growth	■ Urbanisation and rising per capita income in rural and semi-urban areas ■ Increasing acceptance of plastic furniture in tier II and tier III cities in India	■ Rising income levels to boost the consumer durables industry ■ Strong growth in the soft drinks industry

Product / segment	Plastic piping system	Packaging products	Consumer products	Industrial products
Key competitors	■ PVC - Finolex Industries Ltd, Jain Irrigation Systems Ltd, Kisan Mouldings Ltd, Prince Pipes and Fittings Pvt. Ltd ■ CPVC - Astral Polytechnic, Ashirvad Pipes, Ajay Industrial Corporation Ltd	Six-seven large players and other unorganised players	Nilkamal Ltd (which has a 30-35% share), Wim Plast, VIP Industries	Large and mid-sized competitors such as Tata Auto Comp Systems Ltd, Varroc Group, Motherson Sumi Systems Ltd, Sintex Industries Ltd, Mutual Industries Ltd, Nilkamal and Time Technoplast
Key risks	■ Entry of new players in the plastic pipes segment ■ Competition from the unorganised segment	■ Competition from the unorganised segment ■ Increase in raw material prices		■ Decline in demand/offtake from clients for whom the company has set up dedicated plants ■ Slowdown in end-user industries, i.e. auto and consumer durables ■ Increase in raw material prices

** Balance is contributed by real estate sales and subsidy income*

Source: Company, CRISIL Research

Grading Rationale

Healthy performance despite a weak year

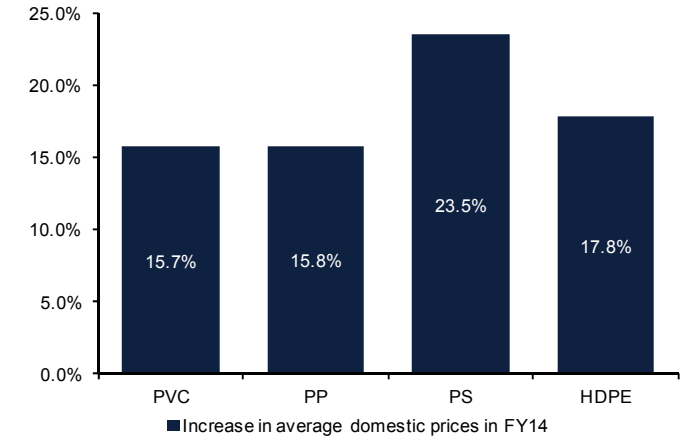
FY14 was a weak year for the plastic processing industry. Polymer consumption declined. Profitability of most players was impacted by the sharp fluctuation in the rupee-dollar exchange rate and increase in prices of key raw materials. However, Supreme recorded stable performance as it was able to pass on the increase in raw material prices across segments despite muted demand, resulting in healthy margins. Additionally, strengths such as diversified product portfolio, pan India presence through a wide distribution network, stringent working capital management and focus on new product development have enabled the company to maintain its dominance in the industry. With the economic revival, domestic demand for plastic is likely to bounce back. Powered by the aforementioned fundamental strengths, Supreme is well poised to capture growth in the domestic plastic processing industry – we forecast volume growth of 12% over FY14-16.

We forecast volume growth of 12% over FY14-16

Proven ability to pass on the increase in raw material prices

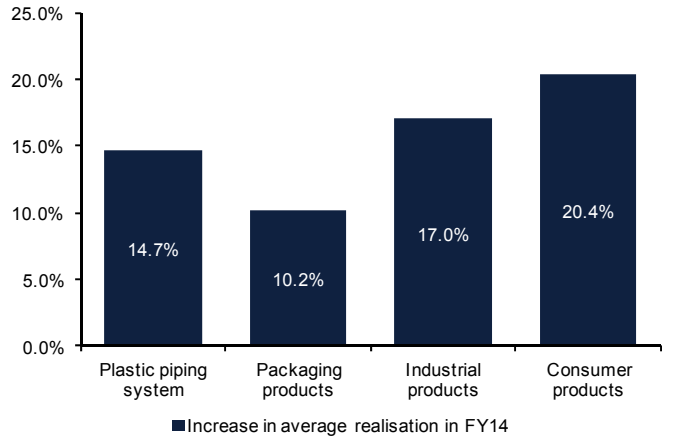
Over the years, Supreme has been able to pass on the increase in raw material prices due to a strong brand equity. This was one of our concerns when we initiated coverage on the company; it has now alleviated and gives us confidence that the company can maintain its profitability in the future despite volatile raw material prices. Domestic polymer prices and landed cost of imports increased sharply in FY14 led by an increase in global prices and 10.4% depreciation in the rupee. In the previous year too, prices were very volatile. Despite this, Supreme posted healthy core business margin of 14.1%; down 140 bps y-o-y as FY13 margins were supported by inventory gains. While the pass-on was immediate in the plastic piping system and packaging products, it was with a lag in the other two segments. In consumer products, the company was able to increase prices despite stiff competition. It was able to secure a price increase in its B2B business of industrial products too even though the key end-user industries – auto and consumer durables – posted weak performance during the year.

Figure 1: Prices of key polymers increased sharply in FY14



Source: Company, CRISIL Research

Figure 2: Supreme's realisations rose across segments



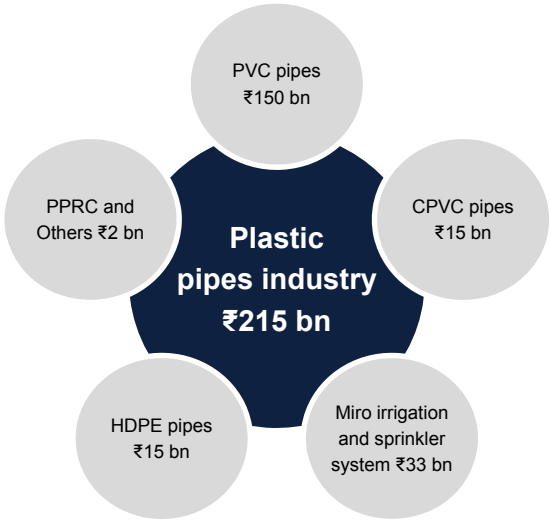
Source: Company, CRISIL Research

Plastic piping system: Healthy opportunity, Supreme in the right spot

The plastic piping segment has been Supreme's fastest growing segment driven by strong domestic demand and the company's established position in the industry. While volume growth moderated to 7% in FY14 due to prolonged monsoons and unseasonal rainfall in winter, we expect volume growth to bounce back led by healthy demand for PVC pipes for irrigation, plumbing and WSS applications. CPVC pipes sales are expected to remain healthy led by an increase in preference for these pipes in hot and cold water plumbing applications. Also, Supreme is putting up a greenfield facility in West Bengal, likely to be operational byend-FY15, which will give the company access to the eastern market; this should boost revenues. We forecast plastic piping revenues to log 16% CAGR over FY14-16 led by 13% volume CAGR.

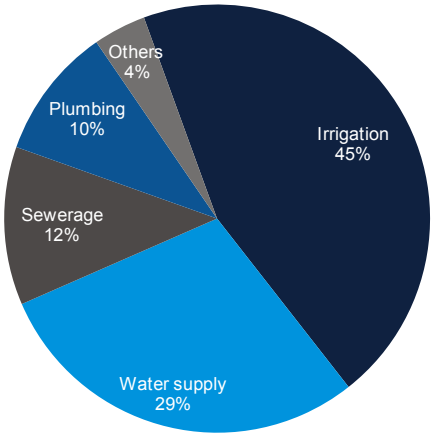
The domestic plastic pipes industry has posted 15% sales CAGR over the past five years

Figure 3: Domestic plastic piping industry



Source: Industry sources, CRISIL Research

Figure 4: End user-wise PVC pipes consumption



Source: Industry sources, CRISIL Research

Pick-up in end-user investments; rise in preference for branded PVC pipes

WSS infrastructure, irrigation and real estate to see healthy investments

WSS infrastructure: There is significant scope for improvement in water supply and sanitation infrastructure in India given that over 50% of the Indian households do not have access to basic sanitation facilities and over a third do not have access to safe drinking water. Investments to improve water supply and sanitation will be driven by both state government and centrally-sponsored programmes such as the Jawaharlal Nehru National Urban Renewal Mission (JNNURM), National Rural Drinking Water Programme (NRDWP) and the Urban Infrastructure Development Scheme for Small and Medium Towns (UIDSSMT). CRISIL Research expects ₹2.3 trillion to be invested in WSS infrastructure over FY14-18 vs ₹1.5 trillion over FY11-14.

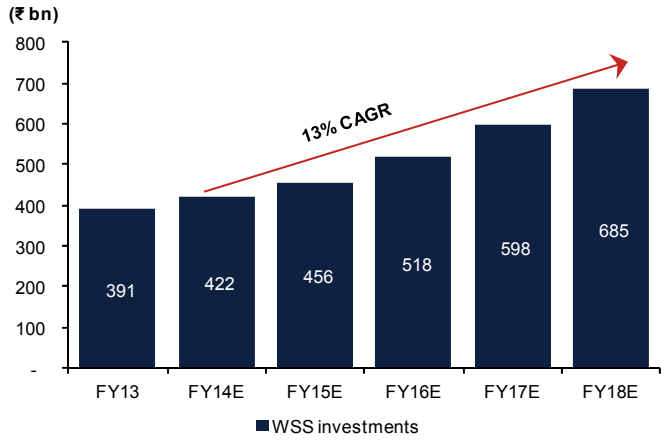
The government's thrust on increasing area under irrigation from 40% at present is likely to result in higher demand for PVC pipes

Irrigation: Currently, 40% of the total agricultural land in India is irrigated. Given the erratic and unevenly distributed monsoons, the government has been focussing on increasing the area under irrigation. Based on this, CRISIL Research expects the spend on irrigation infrastructure to increase to ₹3 trillion over FY14-18 from ₹2.1 trillion over FY11-14.

Real estate: After a weak couple of years, CRISIL Research expects the housing supply in metros to show positive growth from CY15 onwards (calculated based on the estimated supply in top six cities). Further, supply in tier II and III cities is expected to increase due to the new government's thrust on affordable housing; the government has allocated ₹40 bn for low-cost housing in the FY14-15 budget along with other sops.

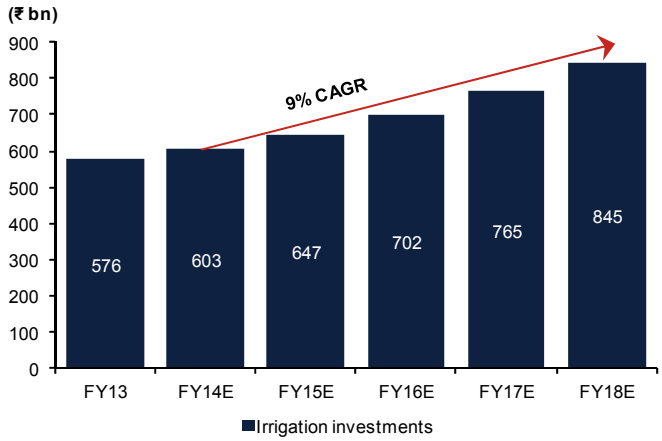
CRISIL Research expects the spend on irrigation infrastructure to increase to ₹3 trillion over FY14-18 from ₹2.1 trillion over FY11-14

Figure 5: WSS investments to grow at 13% over FY14-18



Source: CRISIL Research

Figure 6: Irrigation investments to grow at 9% over FY14-18



Source: CRISIL Research

Table 2: Real estate supply expected to pick up in CY15

Mn Sq ft	CY12	CY13	CY14	CY15
MMR	66	43	36	37
NCR	116	96	86	91
Bengaluru	58	57	47	49
Chennai	42	27	33	35
Pune	43	27	21	22
Hyderabad	20	11	8	9
Total	**346**	**261**	**231**	**243**
% growth		-24.6%	-11.4%	5.0%

Source: CRISIL Research

PVC pipes replacing GI pipes; preference for branded products on the rise

Due to the advantages of lower cost and higher durability compared with galvanised iron (GI) pipes, PVC pipes are being preferred in plumbing and irrigation applications. As per industry sources, the penetration of plastic pipes (predominantly PVC pipes) has increased from 20% to 37% over the past 10 years. We expect the substitution to continue and expect healthy replacement demand in the medium term. Also, despite premium pricing, preference for branded pipes is increasing due to focus on quality products. Hence, we expect organised players (50% market share currently) such as Supreme to grow faster than the industry.

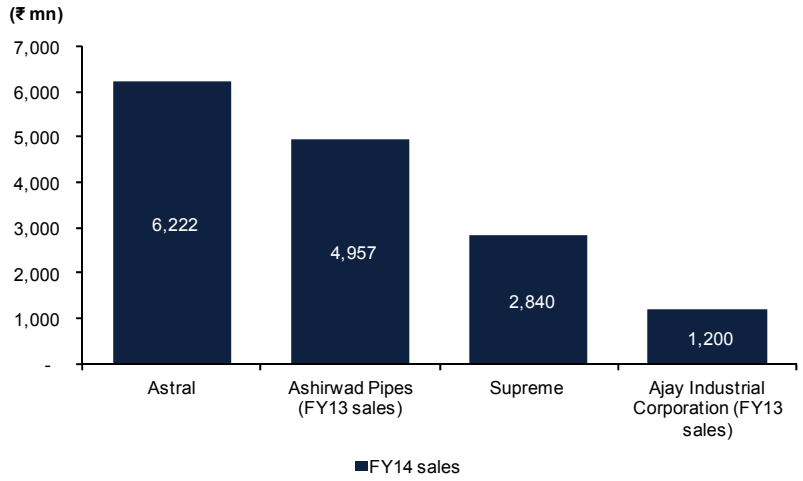
Supreme's CPVC sales grew 30% in FY14 to ₹2.8 bn led by 20% volume growth

CPVC pipes: Healthy demand; raw material availability is an entry barrier

The ₹15-17 bn domestic CPVC industry has continued to post robust growth due to the rise in penetration in the hot and cold water pipes used in plumbing. Industry growth is expected to be led by replacement demand and healthy fresh demand from real estate. Also, as the availability of CPVC resin (raw material) is an entry barrier in this industry, we expect the industry to continue to be dominated by organised players and do not foresee any margin pressure in the medium term.

Organised players account for 50% of the PVC pipes industry

Figure 7: CPVC pipes – player-wise revenues



Source: CRISIL Research

Access to CPVC resin is an entry barrier

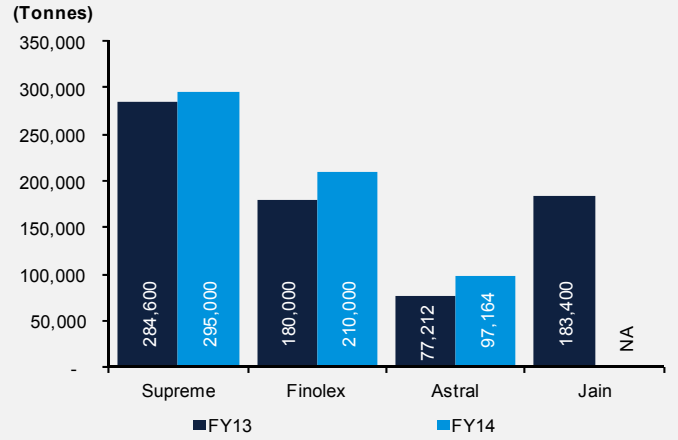
CPVC resin is not locally manufactured. Indian CPVC pipe manufacturers import CPVC resin from Lubrizol Corporation (the US), Kaneka Corporation (Japan), Sekisui Chemical (Japan), Axiall Corporation (North America) and Arkema (France). Lubrizol (60% of global supply) has a policy of giving two-three licences per country and other players have limited supply as they do not have large capacities. Hence, the availability of CPVC resin is limited due to which the penetration of this product is low. Until recently, Lubrizol also used to provide CPVC resin to Ajay Industrial Corporation but the licence was cancelled due to some regulatory issues. Supreme sources its raw material from Kaneka Corporation.

Greenfield capacity in West Bengal = access to eastern markets

For its plastic piping system, Supreme currently has manufacturing facilities in North (Kanpur, Uttar Pradesh), West (Gadegaon, Maharashtra) and Central (Malanpur, Madhya Pradesh) India. In order to strengthen its presence in eastern India (which was being catered to by the Malanpur facility until now) the company is setting up a 25,000-tonne greenfield facility in Kharagpur (West Bengal); the plant is expected to be operational by end-FY15. The commissioning of this facility will significantly reduce freight cost and lead time for customers. Also, it would enable the company to increase its penetration in eastern India by tapping smaller dealers who order smaller consignments – supplying to them from Malanpur is not commercially viable. Further, none of Supreme's large competitors have manufacturing facilities in West Bengal, which should enable it to capture market share.

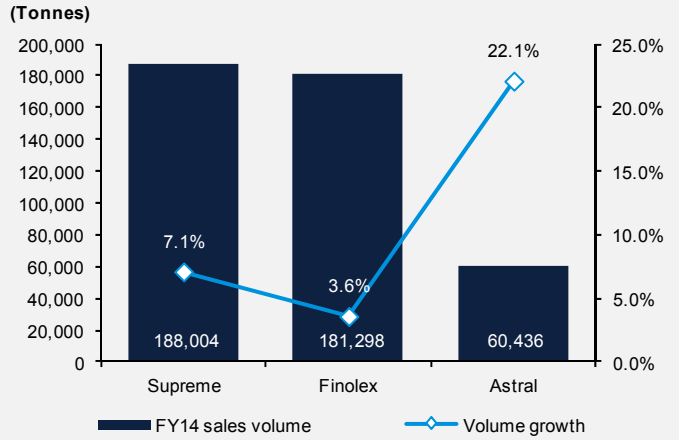
Performance of plastic pipes players in FY14

Figure 8: All players added capacity in FY14



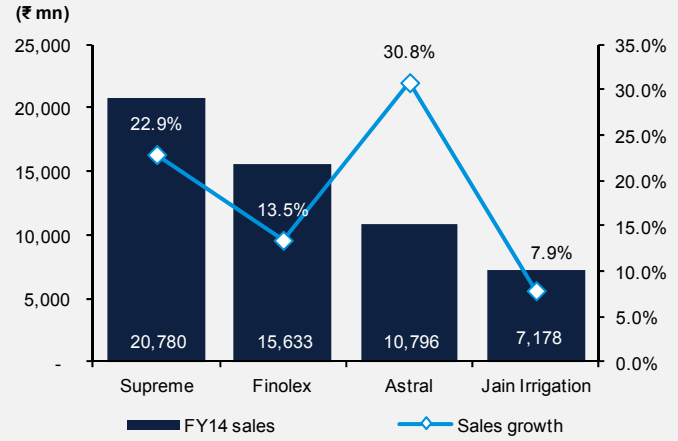
Source: Company presentations, CRISIL Research

Figure 9: Volume growth trend in FY14



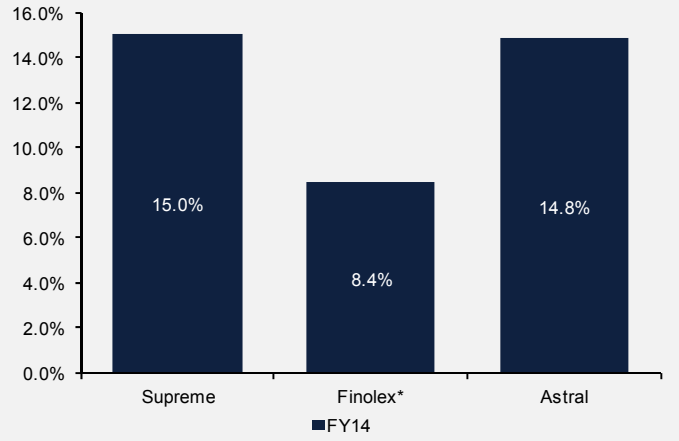
Source: Company presentations, CRISIL Research

Figure 10: Revenue growth was led by realisations



Source: Company presentations, CRISIL Research

Figure 11: EBITDA margin profile in FY14



** Represents EBIT margin*

Source: Company presentations, CRISIL Research

Table 3: Details of dealer network

	Dealers	Distributors/retailers
Supreme	600+	16,000
Finolex	500	15,000
Astral	400+	18,000

Source: Company presentations, CRISIL Research

XF films: Superior product + established brand = strong long-term prospects

Supreme is the sole domestic manufacturer of XF films, a patented product of Switzerland-based Rasmussen Polymer Development which Supreme has licensed. Superior quality over conventional tarpaulin, longer life, wide applications, addition of new products such as 35 GSM films (lower in thickness than the existing products) and its established position as a quality product under the brand 'SILPAULIN' brighten up the long-term prospects of these films. XF films find applications in many industries as highlighted in table 4. In the near term, there may be some challenges; sales in FY15 depend on normal agricultural output, which is a key monitorable.

Supreme currently has over 200 distributors of XF films

Table 4: Applications of XF films

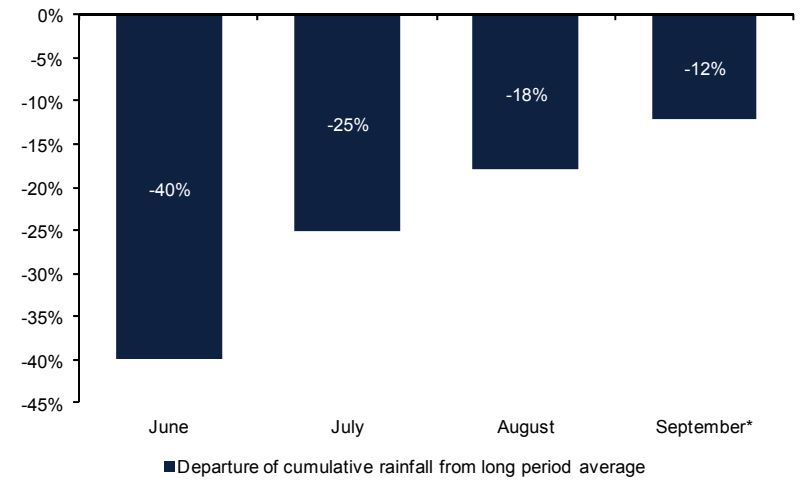
Agriculture	Civil engineering	Packaging	Others
Farm ponds / pond lining / fresh water ponds / fish ponds / raw water reservoirs / community water tank / portable water tank	As column footing underlay	Shipping bags for plastic granules, confectionery, fire chemicals, detergents, animal feed, chemicals, etc.	Covering machinery, raw materials, packing materials, finished products, paper cartons
Covering of agricultural produce	As raft underlay	Drum liners	Protection for any transit material
Portable vermi compost beds	As floor underlay		Privacy walls, camping tents
Portable plant nutrition bed	As parking floor underlay		Temporary shelters
Green house / low tunnels / nursery sheds	Side curtain for retaining walls		Scaffolding at construction sites, etc.
Drying of spices, areca nuts, coconut, rubber, chilies, turmeric, grapes and other agricultural produce	Terrace garden underlay		Covering of raw bricks, cement, etc.
Fumigation of tobacco leaves food grains, grapes and other agricultural produce	Basement capping / swimming pool capping		
Poultry curtains and roofs	Lining for waste pits / sludge ponds		
Covering of tendu leaves, tamarind and other forest/hill produce	Lining for large water bodies / water reservoirs / ponds		
Floor underlays (dunnage sheets)	Membrane for concrete roads and runways		
Cattle shed covers			

Source: Company

FY15 growth hinges on normalcy of agricultural output

Since XF films are mostly used in rural India for waterproofing and packaging, its sales are correlated with monsoons and agricultural output. The weak onset of monsoons during the year had raised a concern on demand. However, monsoon revival in July-August coupled with increase in sowing is expected to boost the demand for XF films; agricultural output during the year is a key monitorable.

Figure 12: Monsoon deficit has reduced



** Until September 19, 2014*

Source: IMD, CRISIL Research

Area sown under kharif crops (until September 19, 2014) was 2.5% lower than last year

Flat volumes in FY14 due to lower exports and procurement from government agencies

In FY14, XF films sales volumes remained flat y-o-y. Export sales were impacted due to competition from Chinese me-too products. Domestic sales remained flat as offtake from government agencies was impacted due to a change in storage of food grains from outdoors to warehouses in a few states. The management has indicated that the quality of Chinese products is inferior and, hence, their demand is shrinking which should revive sales growth in the export markets. However, demand from government agencies is unlikely to recover.

Industrial products: Gradual revival in end-user industries to drive sales

Industrial products volume declined 15.5% in FY14 due to poor demand from auto and consumer durables industries for industrial components and from beverages industry for material handling products. CRISIL Research forecasts gradual revival in these industries from here on. Supreme is a key vendor to large players in these industries and is expected to benefit from demand revival. We forecast this segment to post revenue CAGR of 11% over FY14-16 driven by 9% volume CAGR.

Expect 9% volume CAGR in industrial products over FY14-16

Table 5: Supreme's key clients in industrial products division

Industry	Key clients
Auto	Mahindra and Mahindra Ltd, Maruti Suzuki India Ltd, Tata Motors Ltd, Honda Motors
Consumer durables	Hitachi India Pvt. Ltd, Samsung India Electronics Ltd, Tata Chemicals Ltd, Whirlpool India Ltd, Panasonic and Daikin
Material handling	Pepsico India and Coca Cola

Source: Company

CRISIL RESEARCH

Healthy long-term prospects of end-user industries

Auto: In FY15, CRISIL Research expects passenger vehicle demand to grow 4-6% after a 6% decline in FY14. Demand revival is likely to be driven by expectations of higher GDP growth and, hence, income growth and lower cost of ownership due to excise duty cuts on cars and utility vehicles. Over the next five years, passenger vehicles sales are expected to post 10-12% CAGR.

Consumer durables: The demand for consumer durables is expected to remain weak in FY15 and post 2.9% volume growth owing to significant increase in prices. However, over the next five years, demand is expected to post 8.4% CAGR due to an improvement in the economic scenario and, hence, higher income levels and increase in penetration of consumer durables.

Beverages: CRISIL Research expects the ~₹360 bn non-alcoholic beverages industry to post 20% CAGR over the next two-three years.

CRISIL Research expects passenger vehicle demand to grow 4-6% in FY15

Other packaging films: Moderate growth

Protective packaging – packaging vertical healthy, slow growth in construction and insulation segments

- **Packaging:** Key end-users for packaging include the computer and automobile industries. Despite stiff competition, Supreme has been able to report steady growth in this vertical by widening its dealer network and through introduction of new products. However, margins in this product remain low. We expect this vertical to grow in line with the end-user industries. Further, the company is setting up a facility to manufacture packaging films in Kharagpur along with the plastic piping facility. This would give the company access to the eastern markets and aid revenue growth.
- **Construction and insulation:** Construction and insulation films find applications in real estate. Despite approvals from various architects and consultants, sales of these films have been muted as these films are premium products and the company was unable to ramp up sales in a fragile macroeconomic environment. The company plans to add some new products to its portfolio to increase sales in this segment.

Performance films – growth has picked up but margins remain squeezed

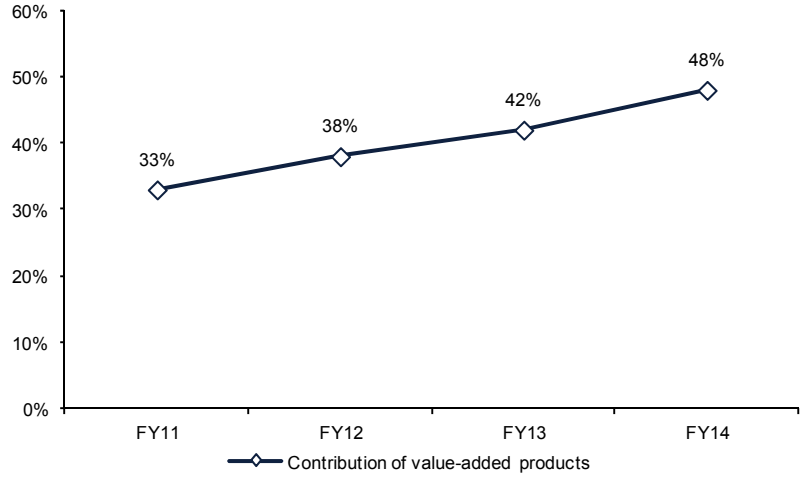
Performance films, which are primarily used in edible oil packaging, grew 30% in volumes in FY14 driven by domestic demand. However, a number of new entrants in the domestic market have intensified competition. Also, export demand has not materialised. Considering that this is a low-margin product and contributes only 2.5% to the top line, we expect the management's focus on this segment to remain limited.

Consumer products: Expect muted growth over FY14-16

In line with its strategy of withdrawing from low-margin segments, Supreme has reduced the sales of commodity furniture as competition from the unorganised segment has kept margins under pressure. The contribution of value-added products increased to 48% in FY14 from 42% in FY13. However, reduction in sales of commodity furniture led to 21% decline in volumes and 6% decline in revenues. We expect the company to continue to reduce its

exposure to the commodity furniture segment which is likely to keep volume growth under pressure – we forecast flat volumes over FY14-16.

Figure 13: Share of value-added products on the rise



Source: Company

Composite cylinders: Capacity on stream but offtake uncertain

Supreme's 4,50,000 composite cylinders facility in Halol, Gujarat was commissioned in July 2014. The facility has received approvals from various international agencies but is yet to be certified by Indian authority Petroleum and Explosives Safety Organisation (PESO). The management has indicated that they are likely to focus on exports of this product. The company currently has an order book of 50,000 cylinders to be supplied to South Korea in FY15. We believe that the company will take time to ramp up sales due to the following reasons: (a) approval processes for securing export orders are time consuming and (b) Indian oil marketing companies, which dominate domestic cylinders consumption, are yet to accept this product. Supreme's domestic competitor, Time Technoplast, commissioned its facility in March 2013 but has been unable to scale up revenues due to the above reasons. Hence, we remain cautious of the offtake in this segment – we forecast sales of ₹150 mn in FY15 and ₹225 mn in FY16.

Supreme will manufacture composite cylinders in six sizes: 12.5, 18.2, 20.6, 24.5, 30.5 and 33.3 litres

Healthy cash flows, stress-free balance sheet

Supreme has consistently generated healthy cash flow from operations – on most occasions, the operating cash flow has been greater than or equal to PAT and the cash flow has been sufficient to meet its capital requirements; its average net debt:equity has been 0.5x for the past three years. Notably, it has been able to maintain the growth pace by expanding operations and at the same time it has handsomely rewarded its shareholders – we observe that the company pays most of its unutilised cash flows as dividends and does not maintain large cash on its books, which we believe is a positive for the minority shareholders.

Table 6: Summary of Supreme's cash flows

(₹ mn)	FY12	FY13	FY14
PAT	2,408	2,886	2,818
Cash flow from operations	3,550	3,678	2,616
Capex	1,027	3,497	1,418
Free cash flow	2,779	323	1,370
Dividend paid	886	1,113	1,189

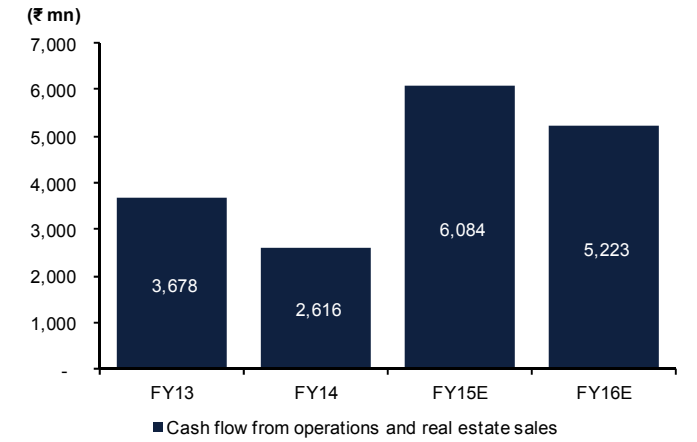
Healthy cash flow from operations and free cash flow

Source: Company

Capex over FY14-16 to be funded through monetisation of real estate, internal accruals

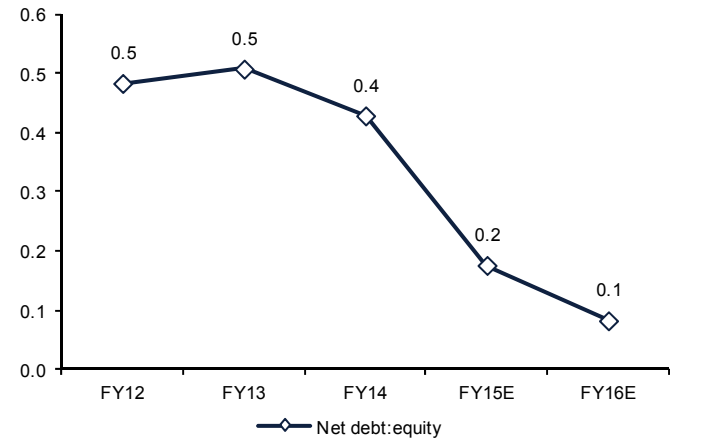
We expect Supreme to incur capex of ₹4 bn over FY14-16 on setting up a new facility in West Bengal, setting up a greenfield facility in South India, expanding existing facilities and augmenting its product portfolio. We have factored in full monetisation of its real estate project over this period. This coupled with healthy cash flows from core operations is expected to be sufficient to fund the capex and also reduce debt on the books – we forecast net debt:equity to decline to 0.1x in FY16 from 0.4x in FY14.

Figure 14: Healthy cash flows over FY14-16



Source: Company, CRISIL Research

Figure 15: Debt:equity to decline sharply



Source: Company, CRISIL Research

Commercial real estate to be completely monetised by FY16

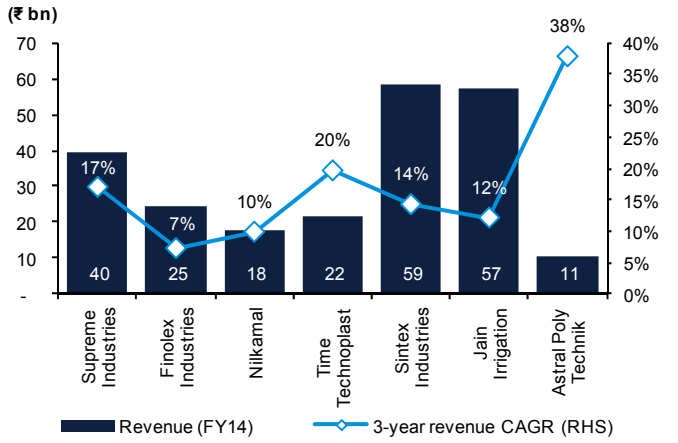
Sale of Supreme's commercial real estate complex in Andheri, Mumbai has improved – the company sold space worth ₹600 mn (37,832 sq ft) in FY14 vs ₹160 mn (10,950 sq ft) in FY13. The management has indicated that sale enquiries have also picked up. Currently, 1,42,393 sq ft is unsold (after adjusting for 6,681 sq ft which will be used by the company), which we have assumed to be sold over FY14-16. We have factored in revenues of ₹1.1 bn in FY15 and ₹950 mn in FY16.

Currently, 1,42,393 sq ft of Supreme's commercial real estate complex is unsold

Superior returns vis-à-vis peers

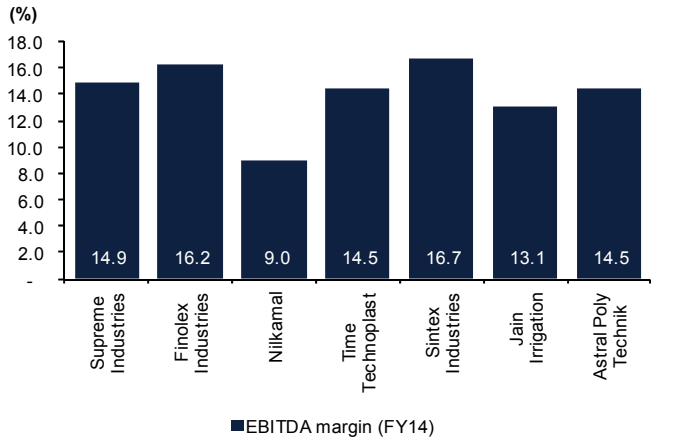
While Supreme's growth and margins are comparable to most peers, the company has consistently posted superior returns. We believe that Supreme's focus on innovative products and efficient working capital management have enabled the company to generate higher returns.

Figure 16: Revenue growth faster than most peers



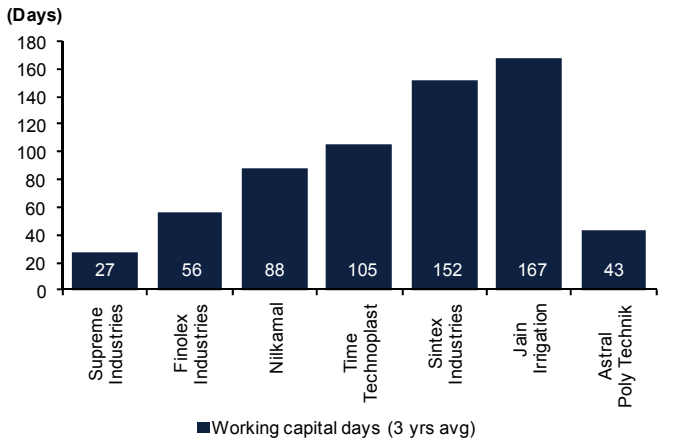
Source: Company, CRISIL Research

Figure 17: EBITDA margin comparable with peers



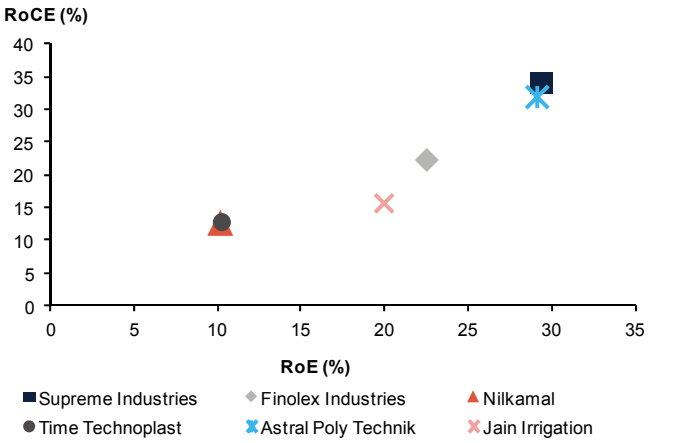
Source: Company, CRISIL Research

Figure 18: Leaner working capital cycle...



Source: Company, CRISIL Research

Figure 19: ... and superior return ratios vs most peers



Source: Company, CRISIL Research

Key Risks

Dependence on a single supplier for CPVC resin

Supreme currently sources 100% of its CPVC requirement from Japan-based Kaneka Corporation. Change in Kaneka's supply policy or its inability to supply due to production disruptions, etc. would impact Supreme's sales of CPVC pipes.

Unhedged forex exposure

From FY15, Supreme's management plans to keep 30% of the company's short-term forex exposure (mainly buyer's credit) unhedged – it is currently US$25 mn. In FY14, the company had fully covered its forex exposure when the rupee depreciated sharply; however, the subsequent appreciation of the rupee in H2FY14 resulted in increase in cost of raw material imports. Also, the company had to incur high hedging cost. We expect the rupee to remain stable and, hence, do not expect any loss from unhedged exposure. However, depreciation of the rupee may result in losses and impact the company's profitability.

US$25 mn of Supreme's forex exposure is unhedged

Adverse weather conditions

Demand for pipes was adversely impacted by prolonged monsoon and unseasonal rainfall during winter in FY14. Further, the demand for XF films (predominantly used in rural areas) typically suffers if rainfall is below normal – as was in FY13.

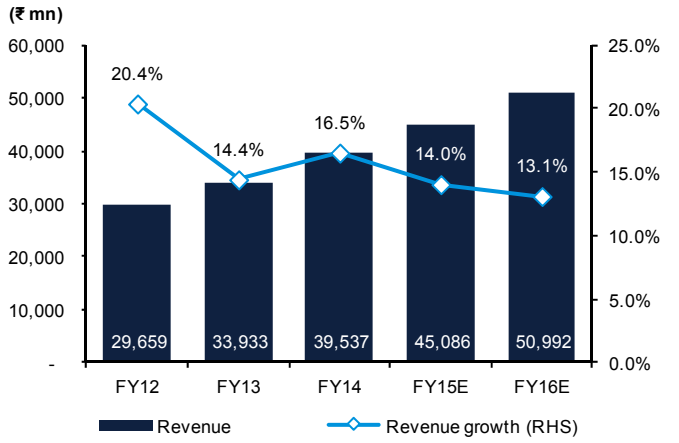
Financial Outlook

Core business to grow at a two-year CAGR of 14%

Supreme's consolidated sales are expected to post a two-year revenue CAGR of 14% to ₹50.9 bn by FY16. The core business revenues are expected to grow at a two-year CAGR of 14% driven by the plastic piping segment. We expect real estate sales worth ₹1.1 bn in FY15 and ₹950 mn in FY16.

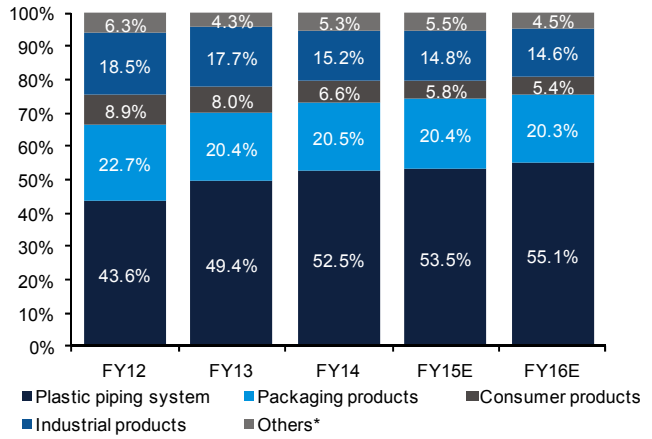
Core business revenue growth over FY14-16 to be driven by the plastic piping segment

Figure 20: Revenue and revenue growth trend



Source: Company, CRISIL Research

Figure 21: Segment-wise contribution



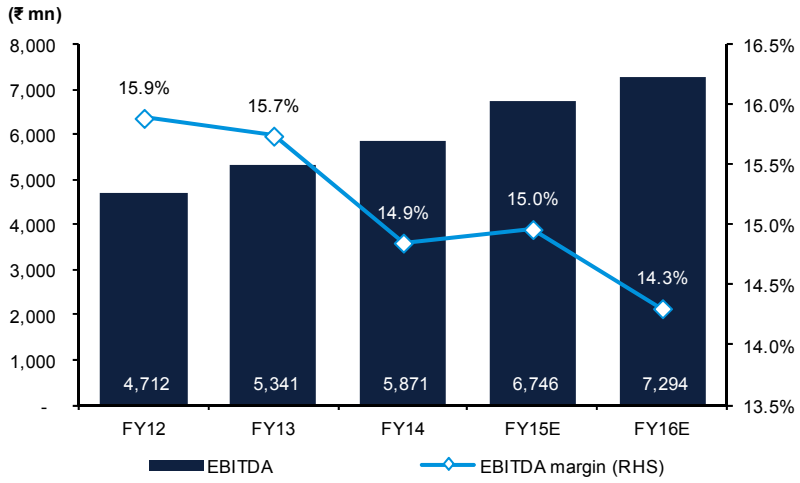
** Includes income from trading, real estate and industrial subsidy*

Source: Company, CRISIL Research

EBITDA margin to decline to 14.3% in FY16; absence of subsidy income to impact core business EBITDA

Supreme's EBITDA is expected to grow at a two-year CAGR of 11% to ₹7.3 bn by FY16. EBITDA margin is expected to decline from 14.9% in FY14 to 14.3% in FY16. Core business EBITDA margin is expected to decline from 14.1% in FY14 to 13.7% in FY16 as the company is likely to exhaust the industrial subsidy on the Gagegaon plant (₹550 mn in FY14).

Figure 22: EBITDA and EBITDA margin trend



Source: CRISIL Research

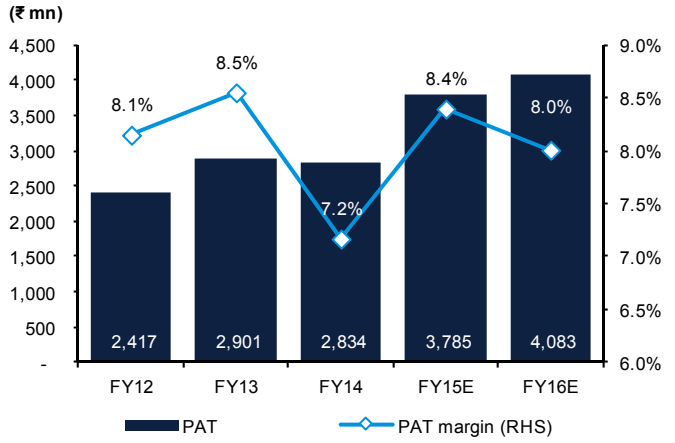
CRISIL RESEARCH

PAT to post 20% CAGR over FY14-16; returns to remain strong

PAT is expected to grow at a two-year CAGR of 20% to ₹4.1 bn by FY16. PAT margin is expected to increase to 8% in FY16 from 7.2% in FY14 despite lower EBITDA margin due to lower interest cost as a percentage of sales. Supreme's RoE is expected to remain healthy over FY14-16.

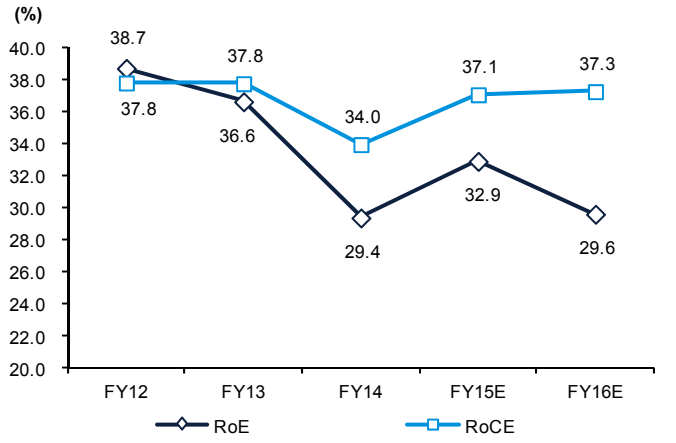
PAT margin to improve by 90 bps over FY14-16

Figure 23: PAT margin on the rise



Source: Company, CRISIL Research

Figure 24: Healthy returns



Source: Company, CRISIL Research

Management Overview

CRISIL's fundamental grading methodology includes a broad assessment of management quality, apart from other key factors such as industry and business prospects, and financial performance.

Seasoned top management with proven capabilities

Supreme's top management is led by its promoter directors who have vast experience in the plastic processing industry. Mr M. P. Taparia is the Managing Director of the company. He is supported by his brother Mr S. J. Taparia (Executive Director) and nephew Mr V. K. Taparia (Executive Director). All three family members have an equal stake in the company (~16%). Under the leadership of the Taparia family, Supreme has established itself as one of the leading plastic processing companies in India – it has clocked a five-year revenue CAGR of 19% and PAT CAGR of 26%.

Experienced second line ably supports top management

While the promoters hold key top management positions, the company has experienced personnel in the second line of management. Each of the four business segments are headed by professionals. Most of these people have been with the company for over 20 years and have strong technical expertise and in-depth understanding of the industry. Also, based on our interactions, we believe that the risk of attrition in the second line is low.

Strategy to increase contribution of branded products is a positive

Branded products, which are sold through the dealer and distributor networks, currently account for 80% of the company's revenues. These include plastic pipes, cross laminated films, some protective packaging films, XF films and consumer products. By virtue of its established brand, we believe that Supreme has pricing power in these segments. The management is now concentrating on increasing their contribution to 90% over the coming years. This strategy would help the company maintain/improve margins.

New product development and strategy to move away from competitive segments have enabled Supreme to maintain profitability and market position

Corporate Governance

CRISIL's fundamental grading methodology includes a broad assessment of corporate governance and management quality, apart from other key factors such as industry and business prospects, and financial performance. In this context, CRISIL Research analyses the shareholding structure, board composition, typical board processes, disclosure standards and related-party transactions. Any qualifications by regulators or auditors also serve as useful inputs while assessing a company's corporate governance.

Overall, corporate governance at Supreme is good and is supported by superior disclosure levels, good board practices and an independent board.

Supreme's disclosures are sufficient to analyse various business aspects of the company

Superior disclosure levels; transparent and ethical management

Based on the information furnished in the annual reports, presentations, websites and quarterly earnings call, we believe that Supreme's disclosure levels are superior. For instance, the segment-wise operating level details are furnished on a quarterly basis. We believe that the information provided is sufficient to analyse the various aspects of the business. Also, based on our interactions over the past few years, we believe that the management is transparent, follows ethical practices and is forthcoming with information.

Experienced independent directors from diverse backgrounds

Supreme's board comprises 11 members, of whom seven are independent directors, which is more than the requirement under Clause 49 of SEBI's listing guidelines. The board is chaired by Mr B. L. Taparia, who is the non-executive director. All independent directors are highly qualified and have diverse industry experience. We believe they have a fairly good understanding of the company's business and its processes, and their participation in board meetings is good.

Adequate governance systems and processes in place

The company has all the necessary committees – audit, remuneration and investor grievance – in place to support corporate governance practices. The audit committee is chaired by an independent director, Mr H. S. Parikh, who is a practising chartered accountant.

Good quality of earnings; minority shareholders have benefitted in the past

Good quality of earnings: We believe that Supreme's quality of earnings is strong. The company has consistently generated operating cash flows over the past few years. Further, it has been able to maintain an extremely lean working capital cycle with an average of 27 days over the past three years.

Maintained healthy dividend payout: Supreme has consistently rewarded shareholders and at the same time maintained the pace of growth. The company bought back shares in FY09. Also, it has consistently maintained dividend payout of 35-40% over the past five years.

Valuation Grade: 3/5

We increase the discounted cash flow-based fair value of ₹620 per share from ₹600 due to 30 bps reduction in cost of equity following a revision in the fundamental grade. This fair value implies P/E multiples of 20.8x FY15E and 19.3x FY16E EPS. The core business is valued at ₹599, implying P/E multiples of 22.8x FY15E and 19.9x FY16E EPS. Supreme's stake in associate Supreme Petrochem Ltd is valued at ₹13 per share. At the current market price of ₹650, the valuation grade is **3/5.**

Fair value increased to ₹620

Break-up of fair value

	(₹)
Core plastics business	599
Real estate	9
Supreme Petrochem	13
Fair value	**620**

Key DCF assumptions

- We have taken FY16 as the first year of discounting and have considered the discounted value of the firm's estimated free cash flows from FY15 to FY24.
- We have assumed a terminal growth rate of 4% beyond the explicit forecast

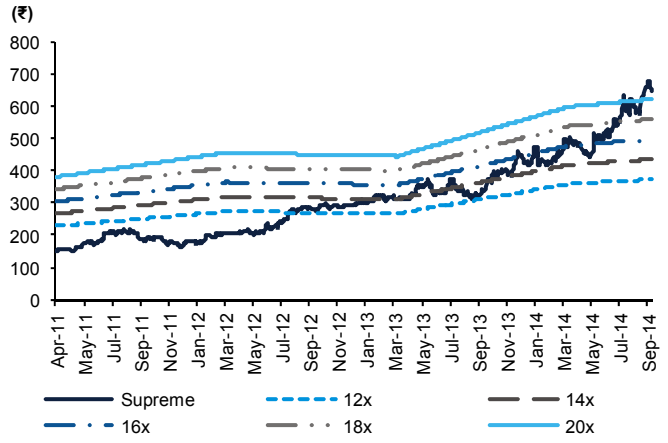
WACC computation

	FY15-24	Terminal value
Cost of equity	13.1%	13.1%
Cost of debt (post tax)	8.2%	8.2%
WACC	**11.6%**	**11.6%**
Terminal growth rate		4.00%

Sensitivity analysis (core business valuation)

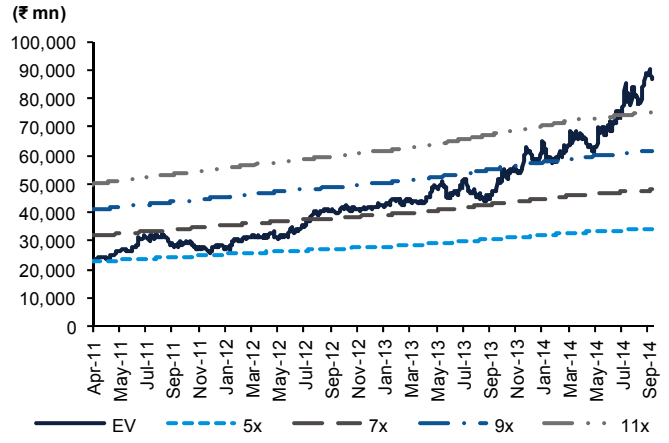
		Terminal growth rate				
		2.0%	3.0%	4.0%	5.0%	6.0%
Terminal WACC	9.6%	654	722	815	948	1,156
	10.6%	577	625	689	775	898
	11.6%	518	553	**599**	658	738
	12.6%	472	499	532	574	629
	13.6%	435	456	481	512	551

One-year forward P/E band



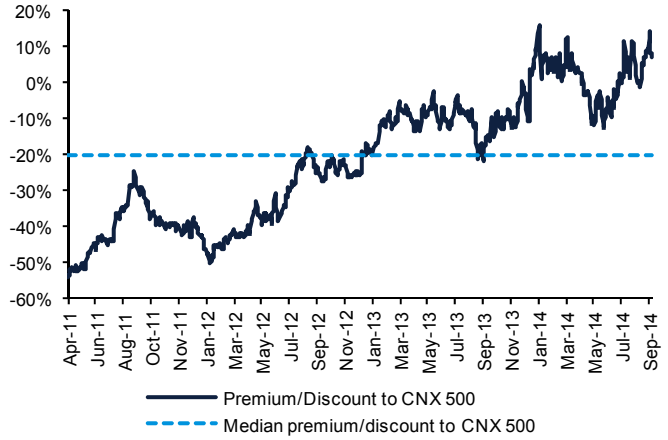
Source: NSE, CRISIL Research

One-year forward EV/EBITDA band



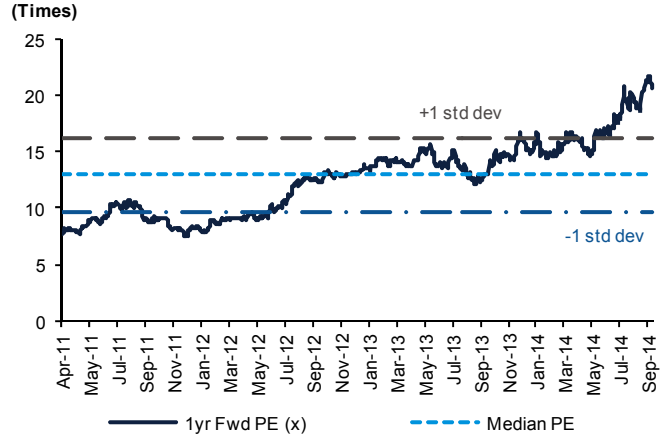
Source: NSE, CRISIL Research

P/E – premium / discount to CNX 500



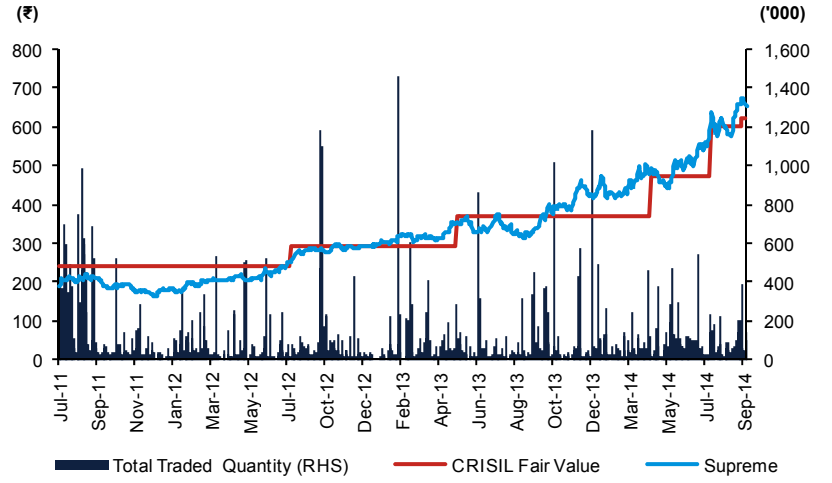
Source: NSE, CRISIL Research

P/E movement



Source: NSE, CRISIL Research

Fair value movement since initiation



Source: NSE, BSE, CRISIL Research

Peer comparison

Company	M.cap (₹ mn)	P/E (x)			P/BV (x)			EV/EBITDA (x)			RoE (%)		
		FY14	FY15E	FY16E	FY14	FY15E	FY16E	FY14	FY15E	FY16E	FY14	FY15E	FY16E
Supreme	82,568	29.3	21.8	20.2	7.9	6.5	5.5	14.8	12.6	11.5	29.4	32.9	29.6
Astral Polytechnic	46,975	33.2	39.1	29.5	8.3	11.1	8.2	17.3	24.0	18.9	28.4	32.5	32.1
Finolex Industries	41,448	13.9	17.8	15.5	3.0	4.6	4.1	7.5	11.0	9.9	22.5	26.2	27.5
Nilkamal	6,085	7.4	12.8	12.8	0.6	1.2	1.1	4.1	5.9	5.5	9.0	8.5	8.6
Time Technoplast	11,325	11.9	9.1	6.9	1.2	1.0	0.9	6.4	5.6	4.7	10.3	11.9	14.1
Sintex Industries	26,619	4.0	NA	NA	0.5	NA	NA	6.6	NA	NA	11.5	NA	NA

Source: CRISIL Research, Industry sources

Supreme is currently trading at 21.8x FY15E EPS and 20.2x FY16E EPS, and 12.6x FY15E EBITDA and 11.5x FY16E EBITDA. These multiples are higher than those for all peers except Astral Polytechnic. Given Supreme's superior RoE, diversified product portfolio and better market position compared with peers, we believe the valuation premium is justified.

CRISIL IER reports released on The Supreme Industries Ltd

Date	Nature of report	Fundamental grade	Fair value	Valuation grade	CMP (on the date of report)
14-Jul-11	Initiating coverage	4/5	₹239	4/5	₹192
28-Jul-11	Q4FY11 result update	4/5	₹239	4/5	₹209
10-Nov-11	Q1FY12 result update	4/5	₹239	4/5	₹194
24-Feb-12	Q2FY12 result update	4/5	₹239	4/5	₹197
04-May-12	Q3FY12 result update	4/5	₹239	4/5	₹210
23-Jul-12	Q4FY12 result update	4/5	₹291	4/5	₹237
12-Sep-12	Detailed report	4/5	₹291	3/5	₹286
31-Oct-12	Q1FY13 result update	4/5	₹291	3/5	₹291
24-Jan-13	Q2FY13 result update	4/5	₹291	3/5	₹302
03-May-13	Q3FY13 result update	4/5	₹370	4/5	₹326
23-Jul-13	Q4FY13 result update	4/5	₹370	3/5	₹374
12-Aug-13	Detailed report	4/5	₹370	3/5	₹337
01-Nov-13	Q1FY14 result update	4/5	₹370	3/5	₹390
27-Jan-14	Q2FY14 result update	4/5	₹370	2/5	₹420
29-Apr-14	Q3FY14 result update	4/5	₹471	3/5	₹460
31-Jul-14	Q4FY14 result update	4/5	₹600	3/5	₹606
23-Sep-14	Detailed report	5/5	₹620	3/5	₹650

Company Overview

Mumbai-based Supreme is one of the leading players in the domestic plastic processing industry. It has a diversified portfolio of products which include plastic piping system, packaging films, industrial products, consumer products and composite products. The company has 23 manufacturing facilities across India.

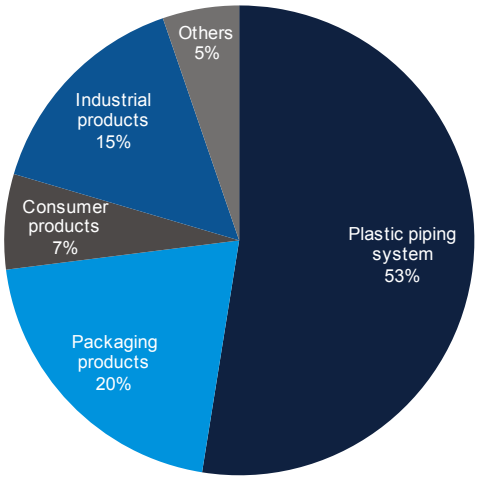
Plastic piping system is the largest business segment with 53% revenue contribution in FY14

Details of business segments

Segment	Products
Plastic piping system	UPVC pipes, plastic fittings, HDPE pipes, CPVC pipes system, PPRC pipes system, LLDPE pipes
Packaging products	Speciality, protective packaging and cross laminated films
Industrial products	Industrial components for auto and consumer durables, material handling products
Consumer products	Furniture
Composite products	Composite cylinders

Source: Company, CRISIL Research

Business segment-wise contribution in FY14



Source: Company, CRISIL Research

Technical collaborations

Company	Country	Products
Rasmussen Polymer Development	Switzerland	Cross laminated films
Sapac Packaging Solution	Belgium	Instant packaging solution
Foam Partner	Switzerland	Reticulated PU foam
Sanwa Kako	Japan	Two-stage foam
PE Tech	Korea	Cross linked foam
Wavin Overseas	Holland	Plastic piping system
Industrie Polieco MPB SRL	Italy	Sewerage system
Kumi Kasai Co. Ltd	Japan	Automotive components
NBL Corporation	Japan	Composite pipes

Source: Company, CRISIL Research

Annexure: Financials

Income statement

(₹ mn)	FY12	FY13	FY14	FY15E	FY16E
Operating income	**29,659**	**33,933**	**39,537**	**45,086**	**50,992**
EBITDA	**4,712**	**5,341**	**5,871**	**6,746**	**7,294**
EBITDA margin	**15.9%**	**15.7%**	**14.9%**	**15.0%**	**14.3%**
Depreciation	725	817	1,015	1,102	1,234
EBIT	**3,987**	**4,524**	**4,856**	**5,644**	**6,060**
Interest	578	552	789	482	319
Operating PBT	**3,409**	**3,972**	**4,067**	**5,163**	**5,741**
Other income	56	27	59	36	37
Exceptional inc/(exp)	8	15	17	-	-
PBT	**3,474**	**4,014**	**4,143**	**5,198**	**5,778**
Tax provision	1,150	1,330	1,400	1,700	2,011
Share of profit in associate	93	217	91	287	316
PAT (Reported)	**2,417**	**2,901**	**2,834**	**3,785**	**4,083**
Less: Exceptionals	8	15	17	-	-
Adjusted PAT	**2,408**	**2,886**	**2,818**	**3,785**	**4,083**

Ratios

	FY12	FY13	FY14	FY15E	FY16E
Growth					
Operating income (%)	20.4	14.4	16.5	14.0	13.1
EBITDA (%)	32.1	13.3	9.9	14.9	8.1
Adj PAT (%)	24.1	19.8	(2.4)	34.3	7.9
Adj EPS (%)	24.1	19.8	(2.4)	34.3	7.9
Profitability					
EBITDA margin (%)	15.9	15.7	14.9	15.0	14.3
Adj PAT Margin (%)	8.1	8.5	7.1	8.4	8.0
RoE (%)	38.7	36.6	29.4	32.9	29.6
RoCE (%)	37.8	37.8	34.0	37.1	37.3
RoIC (%)	32.8	33.9	28.9	33.6	33.9
Valuations					
Price-earnings (x)	34.3	28.6	29.3	21.8	20.2
Price-book (x)	11.9	9.4	7.9	6.5	5.5
EV/EBITDA (x)	18.2	16.3	14.8	12.6	11.5
EV/Sales (x)	2.9	2.6	2.2	1.9	1.6
Dividend payout ratio (%)	31.5	32.8	35.9	33.5	34.4
Dividend yield (%)	0.9	1.2	1.2	1.5	1.7
B/S ratios					
Inventory days	34	50	48	40	40
Creditors days	45	60	47	51	51
Debtor days	21	20	20	22	22
Working capital days	29	24	28	26	19
Gross asset turnover (x)	2.4	2.4	2.4	2.4	2.5
Net asset turnover (x)	4.0	3.9	3.8	4.0	4.1
Sales/operating assets (x)	3.7	3.6	3.6	3.9	4.1
Current ratio (x)	1.6	1.4	1.7	1.5	1.5
Debt-equity (x)	0.5	0.5	0.5	0.2	0.1
Net debt/equity (x)	0.5	0.5	0.4	0.2	0.1
EBITDA/interest (x)	8.2	9.7	7.4	14.0	22.8
EBIT/interest (x)	6.9	8.2	6.2	11.7	19.0

Per share

	FY12	FY13	FY14	FY15E	FY16E
Adj EPS (₹)	19.0	22.7	22.2	29.8	32.1
CEPS	24.7	29.1	30.2	38.5	41.9
Book value	54.8	69.2	81.8	99.3	117.8
Dividend (₹)	6.0	7.5	8.0	10.0	11.0
Actual o/s shares (mn)	127.0	127.0	127.0	127.0	127.0

Balance Sheet

(₹ mn)	FY12	FY13	FY14	FY15E	FY16E
Liabilities					
Equity share capital	254	254	254	254	254
Reserves	6,713	8,536	10,138	12,359	14,710
Minorities	-	-	-	-	-
Net worth	**6,967**	**8,790**	**10,392**	**12,613**	**14,964**
Convertible debt	-	-	-	-	-
Other debt	3,511	4,698	4,726	2,726	2,226
Total debt	**3,511**	**4,698**	**4,726**	**2,726**	**2,226**
Deferred tax liability (net)	833	907	1,168	1,168	1,168
Total liabilities	**11,311**	**14,395**	**16,286**	**16,507**	**18,358**
Assets					
Net fixed assets	7,388	10,200	10,820	11,968	12,934
Capital WIP	703	499	300	50	40
Total fixed assets	**8,091**	**10,699**	**11,120**	**12,018**	**12,974**
Investments	**887**	**1,098**	**1,074**	**1,361**	**1,677**
Current assets					
Inventory	2,158	3,722	4,217	3,734	4,272
Sundry debtors	1,712	2,031	2,348	2,664	3,013
Loans and advances	2,278	2,269	2,614	2,480	2,550
Cash & bank balance	92	199	238	467	953
Marketable securities	52	40	36	40	40
Total current assets	**6,292**	**8,262**	**9,453**	**9,385**	**10,827**
Total current liabilities	**3,965**	**5,742**	**5,420**	**6,315**	**7,179**
Net current assets	**2,327**	**2,520**	**4,033**	**3,070**	**3,648**
Intangibles/Misc. expenditure	**6**	**78**	**59**	**59**	**59**
Total assets	**11,311**	**14,395**	**16,286**	**16,507**	**18,358**

Cash flow

(₹ mn)	FY12	FY13	FY14	FY15E	FY16E
Pre-tax profit	3,559	4,216	4,217	5,485	6,094
Total tax paid	(1,113)	(1,256)	(1,139)	(1,700)	(2,011)
Depreciation	725	817	1,015	1,102	1,234
Working capital changes	379	(99)	(1,478)	1,197	(94)
Net cash from operations	**3,550**	**3,678**	**2,616**	**6,084**	**5,223**
Cash from investments					
Capital expenditure	(1,027)	(3,497)	(1,418)	(2,000)	(2,190)
Investments and others	18	(199)	29	(291)	(316)
Net cash from investments	**(1,009)**	**(3,696)**	**(1,389)**	**(2,291)**	**(2,506)**
Cash from financing					
Equity raised/(repaid)	-	-	-	-	-
Debt raised/(repaid)	(1,632)	1,187	28	(2,000)	(500)
Dividend (incl. tax)	(886)	(1,113)	(1,189)	(1,563)	(1,732)
Others (incl extraordinaries)	(32)	50	(27)	-	(0)
Net cash from financing	**(2,550)**	**124**	**(1,188)**	**(3,563)**	**(2,232)**
Change in cash position	(9)	107	39	230	485
Closing cash	92	199	238	467	953

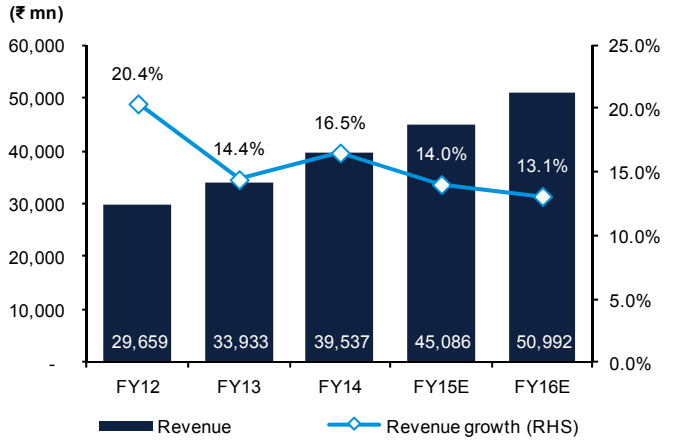
Quarterly financials

(₹ mn)	Q4FY13	Q1FY14	Q2FY14	Q3FY14	Q4FY14
Net Sales	**10,537**	**7,051**	**9,746**	**10,052**	**12,773**
Change (q-o-q)	15%	-33%	38%	3%	27%
EBITDA	**1,971**	**920**	**1,459**	**1,286**	**2,223**
Change (q-o-q)	47%	-53%	59%	-12%	73%
EBITDA margin	**18.7%**	**13.0%**	**15.0%**	**12.8%**	**17.4%**
PAT	1,089	430	626	583	1,194
Adj PAT	**1,089**	**430**	**626**	**583**	**1,194**
Change (q-o-q)	44%	-61%	46%	-7%	105%
Adj PAT margin	**10.3%**	**6.1%**	**6.4%**	**5.8%**	**9.4%**
Adj EPS	**8.6**	**3.4**	**4.9**	**4.6**	**9.4**

Source: CRISIL Research

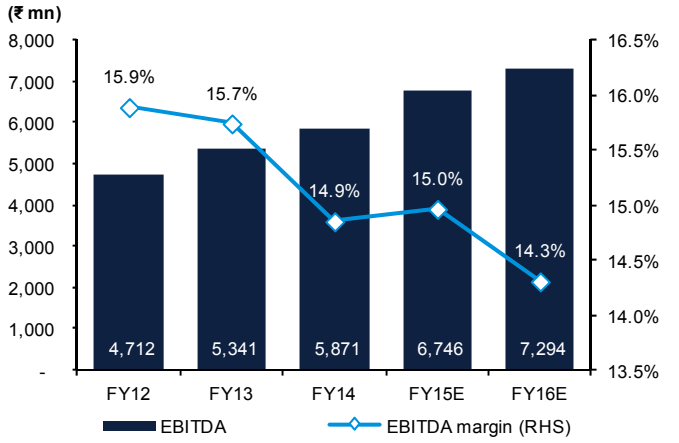
Focus Charts

Revenues to grow at 14% CAGR over FY14-16



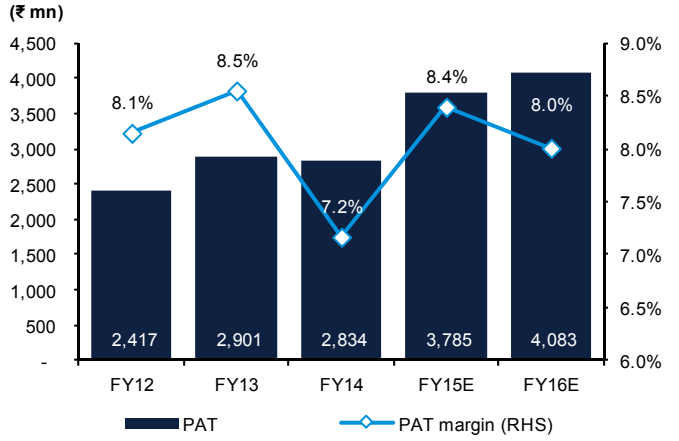
Source: Company, CRISIL Research

EBITDA margin to decline to 14.3% in FY16



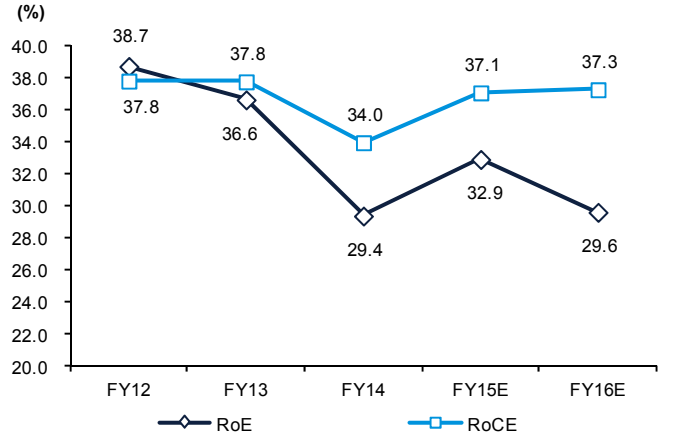
Source: Company, CRISIL Research

PAT margin to improve on lower interest cost



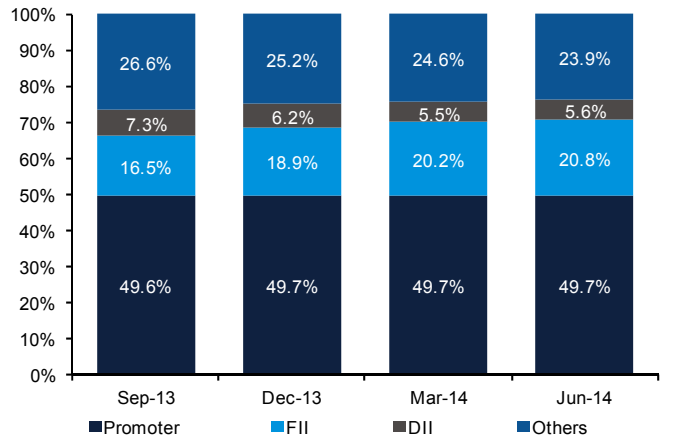
Source: Company, CRISIL Research

RoE and RoCE to remain healthy



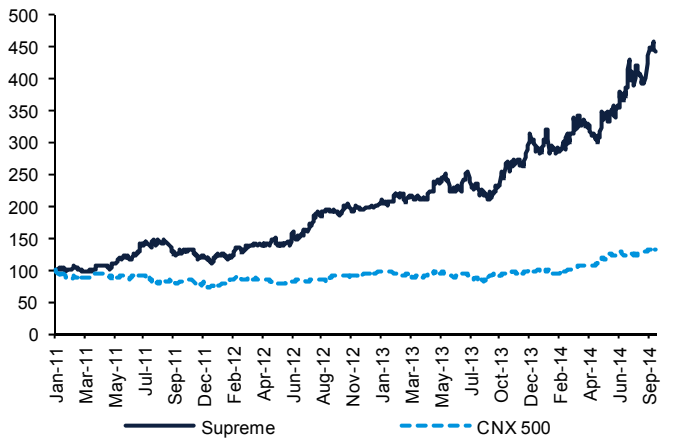
Source: Company, CRISIL Research

Shareholding pattern over the quarters



Source: Company, CRISIL Research

Share price movement



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Source: Company, CRISIL Research

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