# IDEA2WIN – Chemplast Sanmar Ltd

*CMP: ₹625-655. 1-Year Target: ₹768*

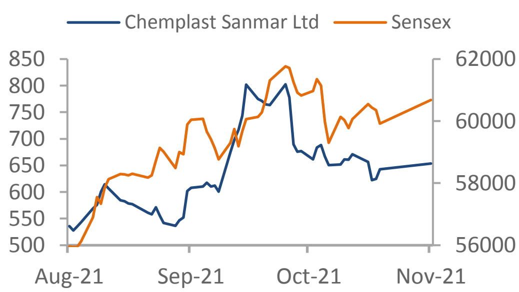
| Sector | Chemicals |
|---|---|
| Recommendation | BUY |
| Upside | 20% |

| Stock Data | |
|---|---|
| Sensex | 60,150 |
| 52 Week h/l (₹) | 826/510 |
| Market cap (` Cr) | 10,159 |
| BSE code | 543336 |
| NSE code | CHEMPLASTS |
| FV (₹) | 5 |
| Div. yield (%) | 0.0% |

| Shareholding Pattern | Sept-21 |
|---|---|
| Promoters | 54.99 |
| FII+DII | 36.53 |
| Public | 8.47 |

*Source: www.bseindia.com*

## Share Price Trend

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## Profile

Chemplast Sanmar Ltd (CSL) is the largest manufacturer of paste PVC resin in India, with an installed production capacity of 66ktpa. Further, the company's wholly-owned subsidiary, Chemplast Cuddalore Vinyls (CCVL), is the second-largest manufacturer of suspension PVC resin in India (capacity: 300ktpa) and the largest manufacturer in South India. Notably, PVC is the company's main business, contributing 78% of consolidated contribution in FY21. The company's remaining business portfolio (except custom manufacturing) – comprising caustic soda, chloromethanes, hydrogen peroxide and R-22 refrigerant – primarily serves to extract value from the by-products generated from the backward integration of the PVC business.

## Investment Rationale

**Favorable industry dynamics:** Demand for PVC in India should benefit from low per capita consumption and growth in end-user industries such as leather & automotives (for paste) and irrigation & construction (for suspension). There are limited producers of PVC in India and rationalisation of global capacities (partly due to environmental reasons) is likely to drive growth. Customer stickiness is an added positive. CSM business should benefit from India's low-cost advantage and 'China+1' theme.

**Leadership position in an industry with high entry barriers:** CSL holds a 46% share in India's paste PVC market (82% share of domestic supplies) and 8% share in suspension PVC (20% of domestic supplies). India is supply-starved in both products, leaving ample room for import substitution, but access to technology (in paste) and capex intensity (in suspension) bar new entrants. In the CSM business, customer approval is the key barrier, and CSL has one established relationship (with Syngenta), with more on the way.

**Expanding capacities to cater to growing demand:** CSL is investing Rs6.2bn in phases over FY22-25 to (i) increase production capacity of paste PVC by 35ktpa; (ii) set up a multipurpose facility for custom manufacturing; (iii) increase capacity of suspension PVC by 31ktpa. These expansions, backed by favorable demand-supply dynamics, should drive 37% EPS CAGR over FY21-24. Near-term earnings could be particularly robust, given rising prices of PVC.

### Custom manufacturing

The demand for custom manufacturing is projected to record a CAGR of ~12% over FY20-25 (source: CRISIL Report) due to factors including India's low-cost manufacturing advantage, the revised strategy of major economies to reduce their dependence on a single country, and the Indian government's initiatives to support growth of the pharmaceutical industry via measures including the PLI Scheme.

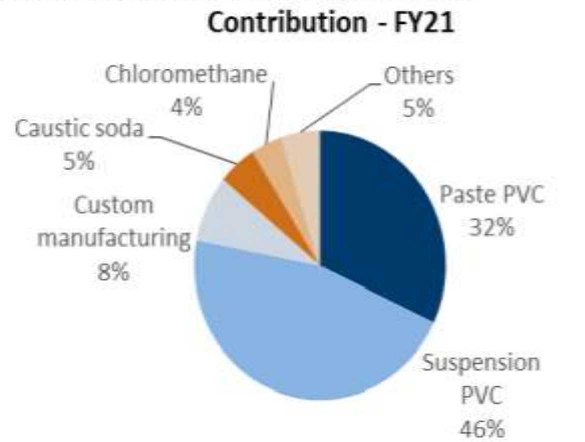
**Vertically-integrated operations**

CSL's operations are vertically-integrated, incorporating the production of a variety of value-added products (caustic soda, chloromethanes and hydrogen peroxide) as well as captive production of power and salt. This brings significant advantages, including stable supply of raw materials, a competitive cost structure, sustainable development of the business, incremental revenues from joint products, and flexible manufacturing planning.

**Strong focus on sustainability**

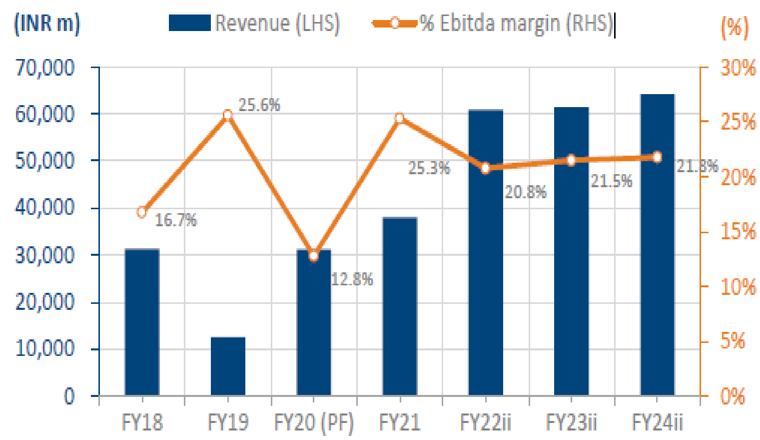
CSL has demonstrated a strong focus on sustainability in all aspects of its operations. The company has adopted 'zero liquid discharge' practices at its production units, under which no treated effluent from manufacturing operations is discharged on to the land or into the sea. CSL established desalination units at its Karaikal and Cuddalore facilities. CSL has also undertaken various measures in the recent past to optimise energy conservation. Such focus on sustainability is beneficial for the company's business operations, as (i) it leads to minimal disruptions from neighboring communities where manufacturing facilities are located; (ii) it leads to more enquiries from potential customers for custom manufacturing due to their increased focus on sustainability; and (iii) it helps reduce power and water costs.

Breakdown of contribution (= profit before fixed costs) by product line




Source: Company, IIFL Research

Revenue and Margin Trends




Source: Company, IIFL research

## Risks

**Covid-19 third wave:** If there is a third wave of Covid-19 in India, the company would see slowdown in production which could affect their normal course of business.

**Downturn is PVC Market**: A sharp and prolonged cyclical downturn in PVC market – contrary to current expectations – may put earnings estimates at risk.

## Outlook & Valuation:

We initiate coverage on Chemplast Sanmar (CSL) with a BUY recommendation and an SOTP-based Dec-22 TP of Rs768. As India's dominant producer of paste PVC and 2nd-largest producer of suspension PVC, CSL is well-placed to benefit from the favourable industry dynamics playing out in these markets. Additionally, more than half the company's capex budget is directed towards the promising custom manufacturing (CSM) business – clearly a focus growth area. We believe the CSM business alone could be valued at ~Rs40bn by Mar-2024, potentially driving a re-rating of the stock.

**Financial Summary**

| Consolidated (INR in mn) | FY20 | FY21 | FY22ii | FY23ii | FY24ii |
|---|---|---|---|---|---|
| Total Income | 31,212 | 37,987 | 60,914 | 61,431 | 64,181 |
| YoY growth (%) | - | 21.7 | 60.4 | 0.8 | 4.5 |
| EBITDA margin (%) | 12.8 | 25.3 | 20.8 | 21.5 | 21.8 |
| Pre-exceptional PAT | 190 | 2,768 | 6,518 | 8,013 | 8,488 |
| ROE (%) | 1.1 | 40.2 | 94.7 | 38.5 | 30.2 |
| P/B (x) | 8.2 | - | 5.6 | 4.1 | 3.1 |
| EV/EBITDA (x) | 23.1 | 9.6 | 7.3 | 7.0 | 6.6 |
| Net Debt/Equity (x) | 1.1 | -3.9 | -0.4 | -0.4 | -0.4 |

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Buy – Absolute return of over +10%
Accumulate – Absolute return between 0% to +10%
Reduce – Absolute return between 0% to -10%
Sell – Absolute return below -10%

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