Changing the stars

You've probably heard this one before.

A Zen master visiting New York City went up to a hot dog vendor and said, "Make me one with everything."
The hot dog vendor fixed a hot dog and handed it to the Zen master, who paid with a 20-dollar bill.
The vendor put the bill in the cash box and closed it.
"Excuse me, but where's my change?" asked the Zen master.
The vendor responded, "Change must come from within."

If change doesn't come, then some businesses will themselves be reduced to (chump) change. In today's world of startups, change is better known as a 'pivot'. Jargon notwithstanding, 30 years ago too, Indian businesses were going through their own trials by fire. One of the companies we own today, was founded in 1996, but that was only after a series of pivots by its founder. That gentleman, Mr. Sandeep Engineer, a first-generation entrepreneur, had seen 3 other of his businesses - all in the chemicals industry - collapse and shut. When he pivoted to CPVC (chlorinated polyvinyl chloride) piping, success came, but not before his company teetered on the precipice of bankruptcy first.

Mr. Engineer became interested in CPVC in the mid-90s when he noticed corrosion issues with galvanized pipes. CPVC was a new anti-corrosion solution for plastic pipes, replacing metal pipes in the US. CPVC was superior to PVC, with higher ductile strength, allowing it to handle hot water up to 200°F (93°C) compared to PVC's 140°F (60°C) limit. An American company (BF Goodrich / Lubrizol) held the patent for CPVC resin technology at the time, and Mr. Engineer tied up with them to bring CPVC to India via his company Astral Poly Technik. He also forged a JV with Thompson Plastics of the USA for techno-financial assistance. For his own equity contribution to the setup, he sold his house, and mortgaged everything else he possessed. If it appears that the story should get immediately better from here, then appearances can indeed be deceptive!

At the time, galvanized iron (GI) pipes were the market standard, with steel pipes dominated by giants like Tata Steel and Jindal Steel, while plastic pipes were led by Supreme Industries. Apart from corrosion issues, GI pipes had other structural challenges like pinhole leaks and blockages due to impurities. GI pipes also needed to be welded on-site, unlike CPVC pipes which could be joined using adhesives, the latter being much easier. However, Astral's CPVC product was 20% costlier than metal pipes. The GI pipe market was so entrenched that there were no takers for a more expensive (albeit better) product. The response was so poor, that in 2000, Astral's plant was only operational 4 days a month, while being shut the remaining 26 days. In 2001, a devastating earthquake in the Indian state of Gujarat crippled Engineer's struggling pharma business. Simultaneously, Astral's primary lender, Madhavpura Mercantile Cooperative Bank, collapsed due to its involvement in a stock market scam. With Astral's working capital drying up, it couldn't fulfil one large order, and the company's bankruptcy seemed imminent.

Our flagship strategy backs entrepreneur and family run businesses because we believe they unearth opportunities from a distance that most others couldn't spot even if right in front of their eyes. Mr. Engineer was steadfast in his belief in CPVC and convinced the Alabama-based Thompson family to infuse capital to buy molds and injection molding machines. He also switched banks. With financing taken care of, his focus shifted to turning the business around.

Being a tiny player in the highly competitive industrial pipes segment meant a pivot was necessary. So, Mr. Engineer decided to sell his CPVC pipes for plumbing applications rather than for industrial ones. This wasn't easy either, because his CPVC pipes were more expensive than the prevailing solutions. He began by meeting the largest plumbing pipe consumers: real estate developers and hotels, and highlighting to them the advantages of using CPVC pipes. Next, he had to convince dealers and distributors to stock his product. He did this by showcasing the pipes at trade shows across the length and breadth of India. While the product was attractive, it's price was not. And so the

Astral masterstroke was to price the CPVC pipes at parity to conventional GI or PVC pipes. The loss in the process was recovered by selling pipe fittings (essential components in a piping system that come in various shapes, materials and join, bend, cap or reduce piping diameter) at a premium. Mr. Engineer saw plumbers as key decision makers, and thus made them his first brand ambassadors, running training programs for them, and providing snacks and branded T-shirts at construction sites. Each step led to initial orders, followed by a steadily increasing acceptance of Astral's brand and product in the market.

The journey was by no means easy, but Astral had its priorities in place. They knew that they'd created a new niche, but if they didn't expand capacities quickly, then others would partake in the fruit of Astral's labor. So, expanding capacities is what they did, double, triple, 5x even, at one point. Astral today is the 4th largest plastic pipe company in India, and the largest in CPVC pipes, with a ~25% market share. It has grown over the past decade at ~19% as against ~11% for the industry. In August 2016, Astral Poly Technik took a bold step and ended a two-decade partnership with US-based Lubrizol, their supplier of CPVC compound. Instead of seeking out a new partner, they decided to forge their own path and set up an in-house compounding facility. They also formed a relationship with Japanese resin supplier Sekisui. By becoming the first company in India to receive approval from the National Sanitation Foundation for their own CPVC compound, Astral reduced its dependence on external suppliers and improved its gross margins.

India's per-capita plastic consumption is among the lowest globally, creating a favorable environment for robust growth over the next five years. The Indian market for plastic pipes and fittings is projected to expand by 10-12% over the next five years. The organized sector in the Indian piping industry has made substantial progress, reaching a share of 67.5% in FY21, up from 50% in FY10. The industry has become increasingly concentrated, with the top five players increasing their share to 37.3% in FY22, from 30.3% in FY16. CPVC pipes pose technological barriers to entry, which has also given organized players an opportunity to increase their market share to 80% vs. 65% in PVC pipes.

While Astral has made big inroads into the pipes market, they haven't stopped there. Unlike some peers who have attempted to go wider and deeper within the pipes market, Astral has set their aim on becoming a 'building materials' brand, and successfully diversified into adhesives & sealants to begin with. In the last couple of years, the company has further ventured into water tanks, valves, sanitaryware & faucets, and paints. We think the company's profile could be very different even just 5 years from today, and this is what excites us. This transformation is reflected in the higher multiples the stock trades at versus peers too. The appropriate comparables for Astral are perhaps the likes of Asian Paints, Pidilite and Havells, which is what the market seems to think too. With a trailblazing 10-year PAT CAGR of 29% over FY12-22, Astral has stuck to the high growth plastic pipes segment in plastic processing and judiciously used cash flows to expand into other high growth and high RoCE building material subsegments. What are these other subsegments like?

Let's look at adhesives first. Astral started making solvent cement in 2012 after acquiring a stake in Advanced Adhesives Ltd and entering a technical collaboration with IPS Corp. In 2015, it acquired a majority stake in Resinova Chemie Ltd, a company that produced adhesives, construction chemicals, sealants, and industrial maintenance products. In 2014, it acquired 80% of Seal IT Services in the UK, and in 2017, Seal IT fully acquired the silicone tape business of Rowe Industries in the US. These acquisitions allowed Astral to increase its product and geographical reach. The Indian adhesive and sealant industry, valued at ~USD 2 bn, is expected to grow by double digits in the next 5 years, driven by the auto, packaging, and housing industries. The top 5 players control >80% of the market and Astral, although a very small player, grew at a quick 19% CAGR from 2016 to 2022. The company offers 600+ SKUs and has sufficient capacity, suggesting sustained high growth in the future is possible.

Astral subsequently launched anti-rust, lead-free and lightweight plastic valves for plumbing and industrial use. For the latter, the company is focusing on large sized valves for higher margins. Valve manufacturers typically generate healthy asset turns of 4-5x and operating margins of 20-30%. Astral also entered the plastic tanks segment through an acquisition. The tanks business has low capital intensity, asset turns can be 2-3x, and an EBITDA margin of 15% is feasible. In June 2022, Astral entered the ~USD 2 bn sanitaryware and faucets segment, aiming to leverage the company's brand and its network of 33,000+ pipe dealers and 130,000+ adhesives and sealant dealers.

The most recent foray by the company is into the paints business. Astral acquired a controlling 51% equity stake in the operating business of Gem Paints Private Limited. The latter was founded in 1980 and has been involved in manufacturing high performance industrial and decorative coatings in South India. Its competitive edge lies in its resin manufacturing capabilities and in-house R&D. Gem Paints has 3,000+ dealers and 10 depots in South India with 28+ brands and 100+ SKUs across price points. The company is debt free and has enough headroom to grow 4-5x without any additional capex. This could translate to ~15-20%+ growth over the next 3-4 years, while maintaining EBITDA margins of ~15%, hopefully no different from its previous 25 years.

All of the above could lead Astral to deliver EPS CAGR of ~20% over the next 5 years with average RoE of ~22%. Given capex is likely to peak in FY23E, the company could generate healthy FCFs which is likely to be used for higher dividend payout or buyback. Do risks exist? Of course, always. A prolonged slowdown in the economy could hurt investments and impact revenues. Sharp increases in raw material prices could hurt margins if not passed on to customers. New products not taking off could impact profitability. Since its IPO in early 2007, a rupee invested in Astral is worth ~INR 280 today, implying a ~42.2% CAGR excluding dividends. The same rupee invested in the MSCI India (INR terms) would be a meagre INR 3.8 today, or an ~8.7% CAGR. The strong performance was driven by (a) consistent ROCE-focused capital allocation in the pipes business; (b) strengthening competitive advantages through well-thought-through expansion and new product launches; and (c) an intense focus on genuinely helping every stakeholder involved in the company's journey - employees, distributors, plumbers and shareholders. This is a stellar company that has 'changed' and continues to 'change', for the better.

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Data sources: publicly available media articles, sector reports.

Prior Editions of Access India Equity Insights:

1. An electrifying perspective – Mar 2023 (link)
2. Building with APLomb – Feb 2023 (link)
3. cARPU diem – Jan 2023 (link)
4. All's Well That Trends Well – Nov 2022 (link)
5. 'Foods' for Thought – Oct 2022 (link)
6. EV Wonder – Sep 2022 (link)
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