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5 MINUTE STOCK IDEA

BY SMART SYNC INVESTMENT ADVISORY SERVICES

TARSONS PRODUCTS LTD

WHAT WE LIKE

STRONG MARKET POSITIONING:

The company has over 4 decades of experience in manufacturing and trading of plastic lab-ware equipment. The company has maintained a strong ROCE of 15%+ **led by~**

- **High market share:** The company is among the top 3 domestic players & has a high market share of around 20%. Further, owing to its strong cost advantage wherein, it is one of the only end-to-end manufacturers (its peers depend on outsourcing), which has helped in scaling up its export business steadily.
- **Wide SKUs:** The company has around 1700 SKUs leading to strong value addition to its high client & and distributor stickiness
- **Wide distribution network across the globe~** distribution is the moat in this business since the end consumer base is relatively fragmented & therefore, building a strong distribution network is an important driver of the moat. Further, its new acquisition of a foreign distributor at a distressed valuation is expected to improve its position globally.
- **High entry barrier:** The peak fixed asset turnover for the industry is only 0.7X, therefore unless margins are high (which might not be possible for a new entrant), generating high ROCE is a distant dream. Similarly, owing to the high inventory cycle (due to wide SKUs & industry norms), working capital intensity is also very high deterring a new entrant.
- **Marquee clientele:** The company has a diversified revenue profile deriving revenues from different industries like Academia, Diagnostics, CRO among others & has reputed clientele including the likes of Dr. Reddy, Dr. Lal pathlabs, Metropolis & Syngene.

HEALTHY TRACK RECORD & FUTURE PROSPECTS:

The company's past track record has been good owing to tailwinds in the pharma, diagnostics & life sciences industries.

Despite tough times post-COVID due to a higher base & margins have collapsed from 45% to 38%, the company has several long-term tailwinds ~

- **Huge capex:** The company's mammoth capex of Rs.550 Crs for the production of cell culture & existing capacity expansions which has revenue potential of around Rs.300-350 (FY23 sales=285 Crs) is expected to commercialise by Q1FY25.
- **Domestic & export tailwinds~**The current plastic labware market size in India is close to Rs.1200 Crs, however, the market is expected to expand at 12% CAGR going forward. Further, the company is expected to benefit from the Europe+1 trend owing to high manufacturing costs in Europe~ production unviable.
- **Value migration from Glassware to plasticware~** Lower cost, higher applicability, more durability & ease of handling.
- **Fillip owing to COVID~** Since the company derived roughly 25-30% of its revenues from COVID testing products like PCR in FY20-22. Any mandatory testing policy or surge in cases will boost the company's revenues & profitability.

WHAT WE DON'T LIKE

PROJECT EXECUTION & RAMP UP RISKS:

The company has forayed into cell culture which has very high competitive intensity & owing to complexity of the product, it takes around 4-5 years to get client approvals

POSSIBLE REDUCTION IN ROCE:

The company incurred a mega-capex of 550 Crs in FY22 at the time of its IPO. However, the company is currently facing difficulty in clocking high capacity utilisations in its existing facilities due to subdued demand coupled with increased competitive intensity.**Further, given the asset turnover of 0.7X, the company is expected to generate only 20% ROCE in its new capex (however, incremental capex will have higher ROCE).**

Therefore, as a result of high capital intensity which leads to operational deleverage,the company is expected to see poor qualitative performance (low ROCE%) going forward.

ELONGATED WORKING CAPITAL CYCLE:

The company maintains atleast 4-5 months of finished goods inventory.Further, raw material supply is getting tougher because of the implementation of BIS wherein government is not allowing imports unless the certification is present leading to high stocking of raw materials in advance. As a result of this, the company's CFO/PAT conversion has been poor.

	Mar 2019	Mar 2020	Mar 2021	Mar 2022	Mar 2023
Cash from Operating Activity -	51	64	68	83	76
Profit from operations	77	73	108	159	136

GEOGRAPHICAL CONCENTRATION RISKS:

Raw material consumption is the single largest cost component i.e. 65-70% of total cost of sales. Plastic granule is the primary raw material required for manufacturing plastic laboratory products. Majority of raw materials are imported from Singapore, Europe and USA.

Given the huge inventory requirements, it is exposed to the risk of volatility in raw material prices.

REDUCING ENTRY BARRIERS:

The company has sustained a very dominant position in the last 4 decades which is visible from its OPM% of 40%. However, competitive intensity is increasing rapidly which might be a result of low entry barriers or high competitive intensity from existing players. Management has earlier stated that a lower pricing by other players might make distributors switch to the newer supplier (which actually happened due to high competitive intensit

UNUSUAL NARRATIVES+HIGH VALUATIONS:

The company has consistently missed & revised its revenue guidance post listing which has led to share price falling by 50%+ since its IPO. Further, it has revised its guidance nos for the ramp-up of capex from 18-24 months to 4-5 years.

Lastly, based on our understanding of Borosil Ltd's business (Glassware lab products manufacturer Vs plasticware), we don't believe in the value migration narrative. Therefore, **given its small TAM & high valuations where EV/EBITDA~25X & P/S~11X, we don't believe that there is enough margin of safety.** There is a huge scope of potential operational deleverage potential coupled with increasing debt levels which will negatively affect its bottmline.