

ADD

TP: Rs 560 | ▲ 7%

FINOLEX INDUSTRIES

Plastic Products

13 August 2019

Profitability drained by lower PVC-EDC delta

Finolex Industries (FNXP) reported above-expected Q1FY20 revenue growth of 14% YoY, aided by 15%/18% higher volumes in PVC resin/PVC pipes. But EBITDA margins shrank 1,030bps YoY to 13.1% due to lower PVC resin margins as PVC-EDC delta contracted, dragging EBITDA/PAT down 36%/40% YoY. Management maintained guidance for 12-15% volume growth in PVC pipes with segmental EBIT margins of 8-9% in FY20. We cut FY20/FY21 earnings 5%/1% on tepid Q1 profits and roll over to a Jun'20 TP of Rs 560 (earlier Rs 550).

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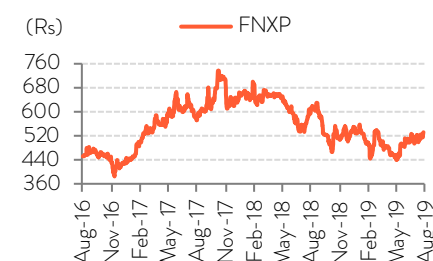
Volume-led revenue growth: FNXP's Q1 revenue increased 14% YoY to Rs 9.4bn. The PVC resin segment grew 6% YoY aided by a 14.7% uptick in volumes (realisation down 7.5%), while PVC pipes & fittings grew 17.8% YoY backed by 18% higher volumes (realisation flat). The sharp increase in PVC pipe volumes stemmed from both agri and non-agri segment. Management retained guidance of 12-15% volume growth in PVC pipes for FY20.

Ticker/Price	FNXP IN/Rs 526
Market cap	US\$ 915.3mn
Shares o/s	124mn
3M ADV	US\$ 0.4mn
52wk high/low	Rs 639/Rs 437
Promoter/FPI/DII	52%/2%/45%

Source: NSE

Lower PVC-EDC delta compresses margins: FNXP's operating margins plunged 1,030bps YoY as raw material cost spiralled (+1,000bps YoY). The PVC resin segment saw EBIT margins collapse ~17ppt due to hardening ethylene di-chloride (EDC) prices and sliding PVC prices – this caused the PVC-EDC delta to contract 29% YoY, eroding overall profitability. This delta has improved by ~12% in July and, if sustained, will support better profitability QoQ. Management has maintained guidance of 8-9% EBIT margins for the PVC pipes & fittings segment in FY20.

STOCK PERFORMANCE



Source: NSE

Maintain ADD: Though we like FNXP for its strong brand name, large distribution reach and well-rounded portfolio post CPVC entry, we expect near-term margin pressure from lower PVC-EDC spreads. We adjust estimates to bake in a weak Q1 and move to a Jun'20 TP of Rs 560.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	2,993	3,857	3,166	3,361	3,662
Adj. EPS (Rs)	24.1	31.1	25.5	27.1	29.5
Adj. EPS growth (%)	(15.7)	28.9	(17.9)	6.2	9.0
Adj. ROAE (%)	11.7	14.4	12.0	12.1	12.6
Adj. P/E (x)	21.8	16.9	20.6	19.4	17.8
EV/EBITDA (x)	13.5	10.8	12.3	11.0	10.2

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – STANDALONE QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Net sales	9,438	8,278	14.0	9,642	(2.1)
COGS	6,668	5,024	32.7	6,419	3.9
Employee expenses	344	316	8.8	382	(10.0)
Other expenses	1,190	1,000	19.1	1,376	(13.5)
EBITDA	1,236	1,939	(36.3)	1,465	(15.7)
EBITDA margin (%)	13.1	23.4	(1,033bps)	15.2	(210bps)
Depreciation & amortisation	168	162	3.6	177	(5.1)
EBIT	1,068	1,777	(39.9)	1,288	(17.1)
EBIT margin (%)	11.3	21.5	(1,015bps)	13.4	(205bps)
Other income	57	137	(58.5)	122	(53.5)
Finance costs	9	52	(83.4)	24	(63.1)
Exceptional items	-	(279)	na	-	na
Profit before tax	1,116	1,583	(29.5)	1,387	(19.5)
Tax expenses	391	550	(28.8)	473	(17.3)
Reported net profit	725	1,033	(29.8)	914	(20.7)
Adjusted net profit	725	1,214.32	(40.3)	914	(20.7)

Source: Company, BOBCAPS Research

FIG 2 – STANDALONE SEGMENTAL PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Revenue					
PVC	5,349	5,042	6.1	5,594	(4.4)
PVC pipes & fittings	8,512	7,225	17.8	7,911	7.6
Total	13,861	12,267	13.0	13,505	2.6
Inter-segment revenues	4,423	3,988	10.9	3862.7	14.5
Net sales (inc. other op. inc.)	9,438	8,278	14.0	9,642	(2.1)
EBIT					
PVC	413	1,236	(66.6)	810.4	(49.0)
PVC pipes & fittings	724	596	21.5	611.6	18.3
Total	1,137	1,832	(37.9)	1,422	(20.1)
EBIT Margins (%)					
PVC	7.7	24.5	(1,679bps)	14.5	(676bps)
PVC pipes & fittings	8.5	8.2	25bps	7.7	77bps
Total	12.0	22.1	(1,008bps)	14.7	(270bps)

Source: Company, BOBCAPS Research

FIG 3 – CONSOLIDATED QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Net sales	9,438	8,278	14.0	9,642	(2.1)
COGS	6,668	5,024	32.7	6,419	3.9
Employee expenses	344	316	8.8	382	(10.0)
Other expenses	1,190	1,000	19.1	1,376	(13.5)
EBITDA	1,236	1,939	(36.3)	1,465	(15.7)
EBITDA margin (%)	13.1	23.4	(1,033bps)	15.2	(210bps)
Depreciation & amortisation	168	162	3.6	177	(5.1)
EBIT	1,068	1,777	(39.9)	1,288	(17.1)
EBIT margin (%)	11.3	21.5	(1,015bps)	13.4	(205bps)
Other income	57	137	(58.5)	122	(53.5)
Finance costs	9	52	(83.4)	24	(63.1)
Exceptional items	-	(279)	na	-	na
Profit before tax	1,116	1,583	(29.5)	1,387	(19.5)
Tax expenses	403	480	(16.0)	495	(18.7)
Share of profit from associates	19	20	(5.6)	40	(54.0)
Reported net profit	732	1,123	(34.8)	932	(21.5)
Adjusted net profit	732	1,317	(44.4)	932	(21.5)

Source: Company, BOBCAPS Research

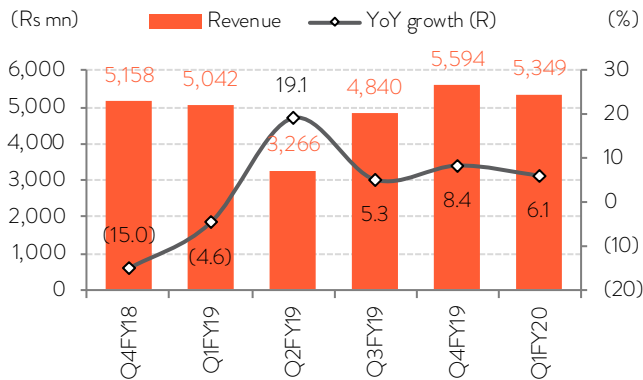
FIG 4 – QUARTERLY VOLUME & REALISATION

Particulars	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Volume					
PVC (mt)	78,512	68,454	14.7	76,549	2.6
PVC pipes (mt)	91,655	77,636	18.1	80,771	13.5
Realisation					
PVC (Rs/t)	68,128	73,650	(7.5)	73,076	(6.8)
PVC pipes (Rs/t)	92,871	93,064	(0.2)	97,946	(5.2)

Source: Company, BOBCAPS Research

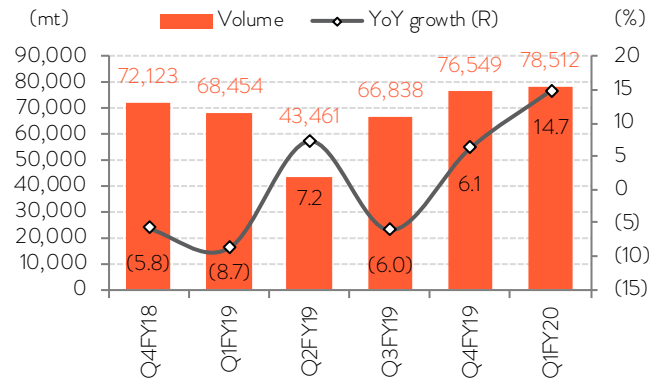
STANDALONE QUARTERLY TRENDS

FIG 5 – PVC RESIN REVENUE GROWTH



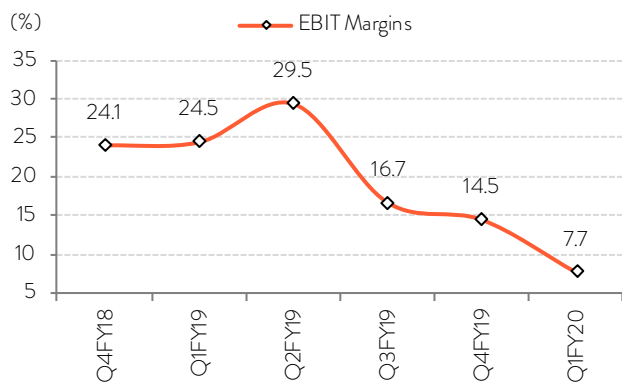
Source: Company, BOBCAPS Research

FIG 6 – PVC RESIN VOLUME GROWTH



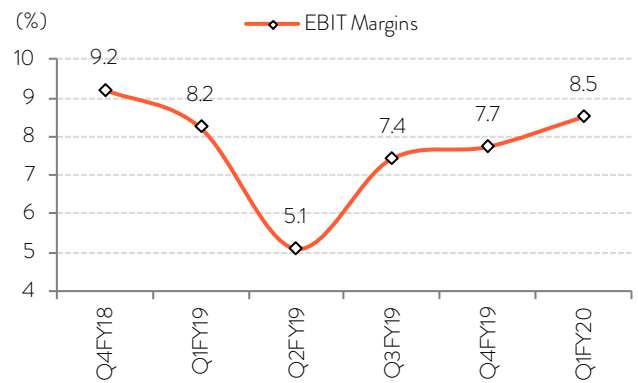
Source: Company, BOBCAPS Research

FIG 7 – PVC RESIN EBIT MARGINS



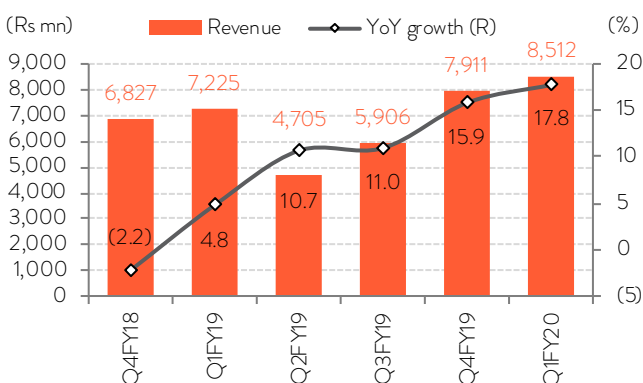
Source: Company, BOBCAPS Research

FIG 8 – PVC PIPES & FITTINGS EBIT MARGINS



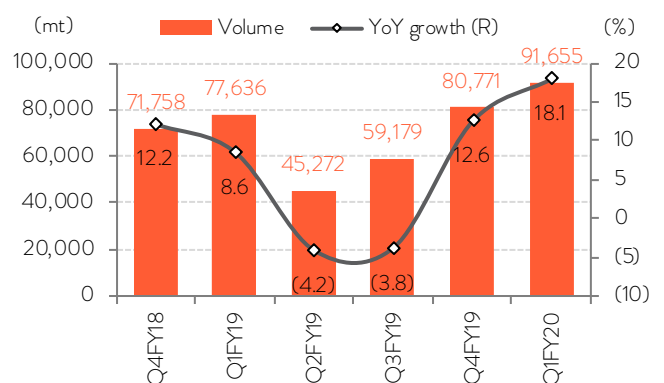
Source: Company, BOBCAPS Research

FIG 9 – PVC PIPES & FITTINGS REVENUE GROWTH



Source: Company, BOBCAPS Research

FIG 10 – PVC PIPES & FITTINGS VOLUME GROWTH



Source: Company, BOBCAPS Research

FIG 11 – CPVC VOLUMES & REVENUES

CPVC Volume & Revenue growth	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Volume (mt)	2,321	1,704	36.2	2,725	(14.8)
Revenues (Rs mn)	660	430	53.5	750	(12.0)

Source: Company, BOBCAPS Research

FIG 12 – PVC-EDC DELTA

	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Spread (US\$/mt)	785	688	641	535	523	490

Source: Company, BOBCAPS Research

Earnings call highlights

- Q1 is a seasonally strong quarter for FNXP, aiding good growth in pipes & fittings from both the agri and non-agri segments. Agricultural pipes continue to form 70% of total revenues and the rest comes from plumbing.
- A dull Q4FY19 aided better growth in Q1FY20. Also, the company did see some demand shift from the unorganised to the organised sector during the quarter.
- FNXP did not offer any special discounts to enable volume growth in Q1.
- The fall in PVC prices and also a lower PVC-EDC delta resulted in a steep drop in PVC resin segment margins during the quarter. Lower PVC prices also resulted in inventory loss. The PVC-EDC delta has improved by ~12% in July to US\$ 550/mt from the Q1 average of US\$ 490/mt.
- Management maintained its guidance of 12-15% volume growth in PVC pipes & fittings with 8-9% EBIT margins.
- To grow the non-agri piping business, FNXP has started to give 30 days of credit, as per the demands of distributors. In agri pipes, it continues to operate on a cash & carry mode.
- CPVC sales increased on a low base by 53% YoY to Rs 660mn in Q1FY20. FNXP has 1,500 SKUs of which 200 are in CPVC.
- CPVC pipes have the best return ratios for the company. Also, the non-agri pipe segment has higher return ratios than the agri pipe segment.
- Management expects the share of pipe fittings in total sales to increase given higher traction in the non-agri segment.
- The company plans to add 30,000-40,000mt of pipe capacity at a total capex of Rs 1bn in FY20.

Valuation methodology

FNXP is one of the major PVC pipe players in India with 18,000 dealers spread across the country. The company has a strong presence in the agricultural pipe market and plans to build a significant footprint in the plumbing market following its recent foray into CPVC pipes.

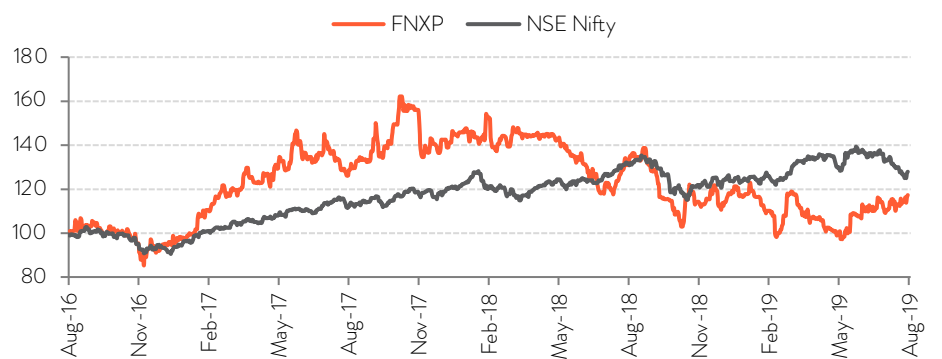
Due to tepid Q1 profitability, we prune our FY20/FY21 earnings estimates by 5%/1%. On rolling valuations forward, we have a revised Jun'20 target price of Rs 560 (earlier Rs 550), set at an unchanged 20x one-year forward P/E multiple – in line with the five-year average. Maintain ADD.

FIG 13 – REVISED ESTIMATES

(Rs mn)	New		Old		YoY (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	33,005	35,536	33,005	35,536	0.0	0.0
EBITDA	5,177	5,522	5,439	5,561	(4.8)	(0.7)
PAT	3,166	3,361	3,335	3,384	(5.1)	(0.7)

Source: Company, BOBCAPS Research

FIG 14 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key risks to our estimates are:

- volatility in PVC-EDC spreads,
- a slowdown in agricultural/housing markets, and
- increased competition from unorganised players, leading to lower profitability.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Total revenue	27,378	30,913	33,005	35,536	38,388
EBITDA	4,839	6,043	5,177	5,522	5,959
EBIT	4,233	5,342	4,418	4,705	5,076
Net interest income/(expenses)	(98)	(123)	(101)	(85)	(57)
Other income/(expenses)	202	404	434	423	470
Exceptional items	0	0	0	0	0
EBT	4,379	5,624	4,751	5,043	5,489
Income taxes	(1,588)	(1,812)	(1,735)	(1,842)	(2,007)
Extraordinary items	109	(279)	0	0	0
Min. int./Inc. from associates	163	140	150	160	180
Reported net profit	3,063	3,672	3,166	3,361	3,662
Adjustments	(70)	184	0	0	0
Adjusted net profit	2,993	3,857	3,166	3,361	3,662

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Accounts payables	2,505	2,838	3,109	3,354	3,625
Other current liabilities	1,385	1,411	1,411	1,411	1,411
Provisions	14	0	1,900	2,017	2,197
Debt funds	1,007	906	706	506	306
Other liabilities	2,198	2,411	2,301	2,191	2,081
Equity capital	1,241	1,241	1,241	1,241	1,241
Reserves & surplus	26,710	24,521	25,787	27,132	28,597
Shareholders' fund	27,951	25,762	27,028	28,373	29,838
Total liabilities and equities	35,060	33,327	36,454	37,851	39,457
Cash and cash eq.	68	291	758	158	156
Accounts receivables	431	743	814	876	947
Inventories	6,116	6,205	7,114	7,677	8,295
Other current assets	810	1,035	1,085	1,168	1,262
Investments	16,068	13,619	15,819	16,419	16,619
Net fixed assets	8,842	9,509	9,750	10,432	11,050
CWIP	903	902	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	1,822	1,023	1,113	1,120	1,128
Total assets	35,060	33,327	36,454	37,851	39,457

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Net income + Depreciation	5,094	6,045	5,510	5,860	6,372
Interest expenses	98	123	101	85	57
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(436)	(280)	(760)	(462)	(512)
Other operating cash flows	(1,861)	(2,425)	(2,169)	(2,265)	(2,477)
Cash flow from operations	2,895	3,463	2,682	3,218	3,440
Capital expenditures	(1,500)	(1,366)	(98)	(1,500)	(1,500)
Change in investments	0	0	0	0	0
Other investing cash flows	111	(1,605)	(1,766)	(177)	270
Cash flow from investing	(1,388)	(2,971)	(1,864)	(1,677)	(1,230)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	65	(101)	(200)	(200)	(200)
Interest expenses	(98)	(123)	(101)	(85)	(57)
Dividends paid	(1,718)	(1,532)	(1,900)	(2,017)	(2,197)
Other financing cash flows	257	1,487	1,849	160	243
Cash flow from financing	(1,494)	(269)	(351)	(2,141)	(2,211)
Changes in cash and cash eq.	13	223	467	(600)	(2)
Closing cash and cash eq.	68	291	758	158	156

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19P	FY20E	FY21E	FY22E
Reported EPS	24.7	29.6	25.5	27.1	29.5
Adjusted EPS	24.1	31.1	25.5	27.1	29.5
Dividend per share	11.5	10.0	12.2	13.0	14.2
Book value per share	225.2	207.6	217.8	228.6	240.4

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19P	FY20E	FY21E	FY22E
EV/Sales	2.4	2.1	1.9	1.7	1.6
EV/EBITDA	13.5	10.8	12.3	11.0	10.2
Adjusted P/E	21.8	16.9	20.6	19.4	17.8
P/BV	2.3	2.5	2.4	2.3	2.2

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19P	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	68.3	68.6	66.6	66.6	66.7
Interest burden (PBT/EBIT)	103.4	105.3	107.5	107.2	108.1
EBIT margin (EBIT/Revenue)	15.5	17.3	13.4	13.2	13.2
Asset turnover (Revenue/Avg TA)	84.2	90.4	94.6	95.6	99.3
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.3	1.3	1.3
Adjusted ROAE	11.7	14.4	12.0	12.1	12.6

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	5.2	12.9	6.8	7.7	8.0
EBITDA	(14.1)	24.9	(14.3)	6.7	7.9
Adjusted EPS	(15.7)	28.9	(17.9)	6.2	9.0
Profitability & Return ratios (%)					
EBITDA margin	17.7	19.5	15.7	15.5	15.5
EBIT margin	15.5	17.3	13.4	13.2	13.2
Adjusted profit margin	10.9	12.5	9.6	9.5	9.5
Adjusted ROAE	11.7	14.4	12.0	12.1	12.6
ROCE	16.0	19.2	16.2	16.6	17.2
Working capital days (days)					
Receivables	6	7	9	9	9
Inventory	121	117	111	115	115
Payables	39	39	39	39	39
Ratios (x)					
Gross asset turnover	1.4	1.4	1.5	1.5	1.5
Current ratio	1.5	1.6	1.4	1.4	1.4
Net interest coverage ratio	43.1	43.5	43.9	55.5	89.4
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

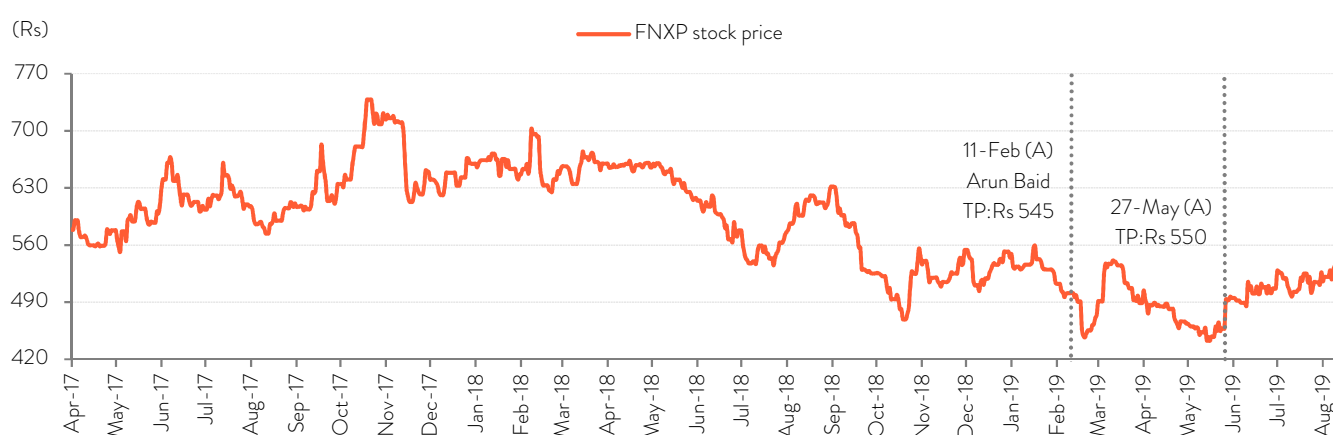
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: FINOLEX INDUSTRIES (FNPX IN)



B – Buy, A – Add, R – Reduce, S – Sell

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