

ADD

TP: Rs 625 | ▲ 7%

FINOLEX INDUSTRIES

Plastic Products

13 November 2019

## Lower PVC-EDC delta hurts profitability

Finolex Industries (FNPX) reported above-expected Q2FY20 revenue growth of 6.3% YoY, aided by a 6% increase in PVC pipe volumes while PVC resins declined 4.7%. EBITDA margins shrank 880bps YoY to 14.2% due to lower PVC resin margins, following ~9% YoY contraction in the PVC-EDC delta – this pulled EBITDA/PBT down by 34%/32% YoY. Management maintained guidance for 12-14% volume growth in PVC pipes during FY20. We broadly retain estimates and roll over to a Sep'20 TP of Rs 625 (earlier Rs 610).

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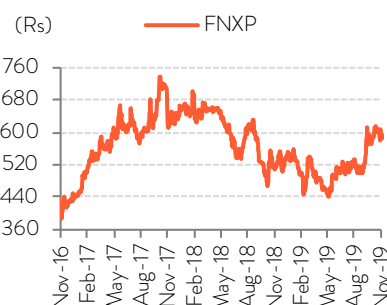
**Modest revenue growth:** FNPX's Q2 revenue increased 6.3% YoY to Rs 5.8bn. The PVC resin segment declined 7.3% YoY with both volumes/realisations slipping 4.7%/2.8% YoY, while PVC pipes & fittings grew 9.9% YoY backed by higher volumes/realisations of 6.1%/3.6% YoY. Pipe volumes were dampened by heavy rains during the quarter. During H1FY20, PVC pipe & fitting volumes grew 13.6% YoY; management expects similar growth in the busy H2 season and hence retained its FY20 guidance of 12-14% growth in PVC pipe volumes.

Ticker/Price	FNPX IN/Rs 586
Market cap	US\$ 1.0bn
Shares o/s	124mn
3M ADV	US\$ 0.4mn
52wk high/low	Rs 627/Rs 437
Promoter/FPI/DII	52%/2%/45%

Source: NSE

**Lower PVC-EDC delta compresses margins:** FNPX's operating margins plunged 880bps YoY as raw material cost surged 730bps – consequently, EBITDA/PBT dropped 34%/32% YoY. The PVC resin segment saw EBIT margins collapse ~13ppt YoY due to hardening ethylene di-chloride (EDC) prices and sliding PVC prices, which led to a ~9% YoY drop in PVC-EDC delta. The delta has remained at similar levels (~US\$ 590/mt) during October.

## STOCK PERFORMANCE



Source: NSE

**Maintain ADD:** We largely maintain our earnings estimates and roll forward to a Sep'20 TP of Rs 625 (earlier Rs 610), set at an unchanged 20x one-year forward P/E.

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	27,378	30,913	34,955	38,041	41,532
EBITDA (Rs mn)	4,839	6,043	5,041	5,324	5,767
Adj. net profit (Rs mn)	2,993	3,857	3,538	3,706	4,061
Adj. EPS (Rs)	24.1	31.1	28.5	29.9	32.7
Adj. EPS growth (%)	(15.7)	28.9	(8.3)	4.7	9.6
Adj. ROAE (%)	11.7	14.4	13.4	13.3	13.8
Adj. P/E (x)	24.3	18.8	20.5	19.6	17.9
EV/EBITDA (x)	15.1	12.1	14.1	12.8	11.8

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

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



**FIG 1 – STANDALONE QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
<b>Net sales</b>	<b>5,767</b>	<b>5,426</b>	<b>6.3</b>	<b>9,438</b>	<b>(38.9)</b>
COGS	3,497	2,892	20.9	6,668	(47.6)
Employee expenses	338	309	9.6	344	(1.6)
Other expenses	1,112	977	13.8	1,190	(6.6)
<b>EBITDA</b>	<b>820</b>	<b>1,249</b>	<b>(34.4)</b>	<b>1,236</b>	<b>(33.6)</b>
EBITDA margin (%)	14.2	23.0	(880bps)	13.1	113bps
Depreciation & amortisation	194	166	17.0	168	15.7
<b>EBIT</b>	<b>626</b>	<b>1,083</b>	<b>(42.2)</b>	<b>1,068</b>	<b>(41.4)</b>
EBIT margin (%)	10.9	20.0	(911bps)	11.3	(46bps)
Other income	174	123	42.0	57	205.6
Finance costs	2	29	(92.0)	9	(73.6)
<b>Profit before tax</b>	<b>798</b>	<b>1,177</b>	<b>(32.2)</b>	<b>1,116</b>	<b>(28.5)</b>
Tax expenses	(229)	413	NA	391	NA
<b>Reported Net profit</b>	<b>1,027</b>	<b>764</b>	<b>34.4</b>	<b>725</b>	<b>41.6</b>

Source: Company, BOBCAPS Research

**FIG 2 – STANDALONE SEGMENTAL PERFORMANCE**

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
<b>Revenue</b>					
PVC	3,027	3,266	(7.3)	5,349	(43.4)
PVC pipes & fittings	5,170	4,705	9.9	8,512	(39.3)
<b>Total</b>	<b>8,197</b>	<b>7,972</b>	<b>2.8</b>	<b>13,861</b>	<b>(40.9)</b>
Inter-segment revenues	2,430	2,545	(4.5)	4,423	(45.1)
Net sales (inc. other op. inc.)	5,767	5,426	6.3	9,438	(38.9)
<b>Segment results</b>					
PVC	451	918	(50.8)	413.1	9.2
PVC pipes & fittings	238	183	30.4	723.6	(67.1)
<b>Total</b>	<b>690</b>	<b>1,100</b>	<b>(37.3)</b>	<b>1,137</b>	<b>(39.3)</b>
<b>Margins (%)</b>					
PVC	14.9	28.1	(1,318bps)	7.7	719bps
PVC pipes & fittings	4.6	3.9	73bps	8.5	(389bps)
<b>Total</b>	<b>12.0</b>	<b>22.1</b>	<b>(1,017bps)</b>	<b>12.0</b>	<b>(8bps)</b>

Source: Company, BOBCAPS Research

**FIG 3 – CONSOLIDATED QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
<b>Net sales</b>	<b>5,767</b>	<b>5,426</b>	<b>6.3</b>	<b>9,438</b>	<b>(38.9)</b>
COGS	3,497	2,891	20.9	6,668	(47.6)
Employee expenses	338	298	13.6	344	(1.6)
Other expenses	1,112	987	12.6	1,190	(6.6)
<b>EBITDA</b>	<b>820</b>	<b>1,250</b>	<b>(34.4)</b>	<b>1,236</b>	<b>(33.6)</b>
EBITDA margin (%)	14.2	23.0	(881bps)	13.1	113bps
Depreciation & amortisation	194	166	17.0	168	15.7
<b>EBIT</b>	<b>626</b>	<b>1,084</b>	<b>(42.3)</b>	<b>1,068</b>	<b>(41.4)</b>
EBIT margin (%)	10.9	20.0	(912bps)	11.3	(46bps)
Other income	165	123	34.4	57	189.3
Finance costs	2	30	(92.2)	9	(73.6)
<b>Profit before tax</b>	<b>789</b>	<b>1,177</b>	<b>(33.0)</b>	<b>1,116</b>	<b>(29.3)</b>
Tax expenses	(193)	427	NA	403	NA
Share of profit from associates	41	28	44.8	19	120.0
<b>Reported Net profit</b>	<b>1,023</b>	<b>778</b>	<b>31.4</b>	<b>732</b>	<b>39.8</b>

Source: Company, BOBCAPS Research

**FIG 4 – QUARTERLY VOLUMES & REALISATIONS**

Particulars	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
<b>Volume</b>					
PVC (MT)	41,422	43,461	(4.7)	78,512	(47.2)
PVC pipes (MT)	48,024	45,272	6.1	91,655	(47.6)
<b>Realisation</b>					
PVC (Rs/t)	73,065	75,150	(2.8)	68,128	7.2
PVC pipes (Rs/t)	1,07,663	1,03,937	3.6	92,871	15.9
<b>EBIT/tonne</b>					
PVC (Rs/t)	10,895	21,113	(48.4)	5,262	107.1
PVC pipes (Rs/t)	4,964	4,038	22.9	7,895	(37.1)

Source: Company, BOBCAPS Research

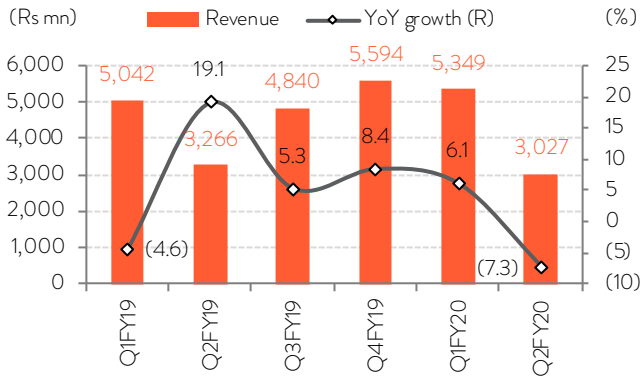
**FIG 5 – PVC-EDC DELTA**

PVC/EDC Spread	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Spread (US\$/mt)	785	688	641	535	523	490	583

Source: Company, BOBCAPS Research

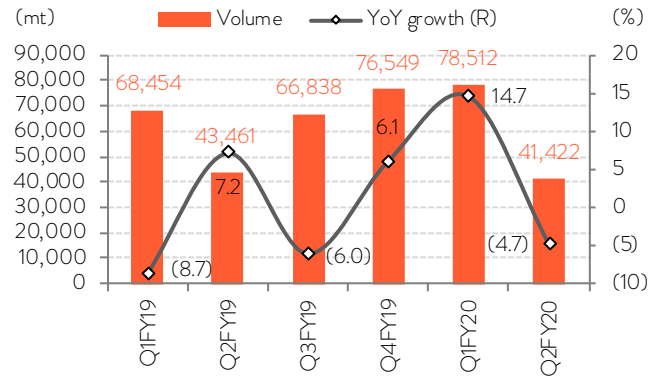
**STANDALONE QUARTERLY TRENDS**

**FIG 6 – PVC RESIN REVENUE GROWTH**



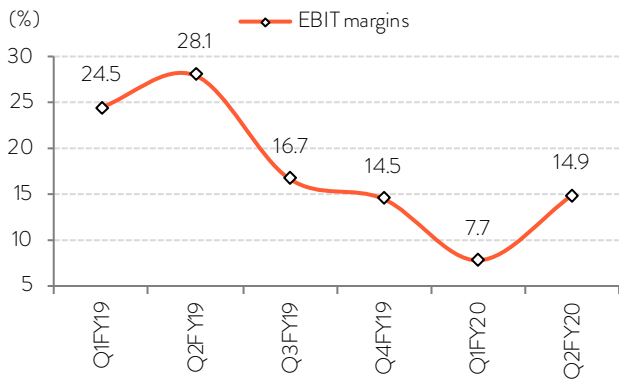
Source: Company, BOBCAPS Research

**FIG 7 – PVC RESIN VOLUME GROWTH**



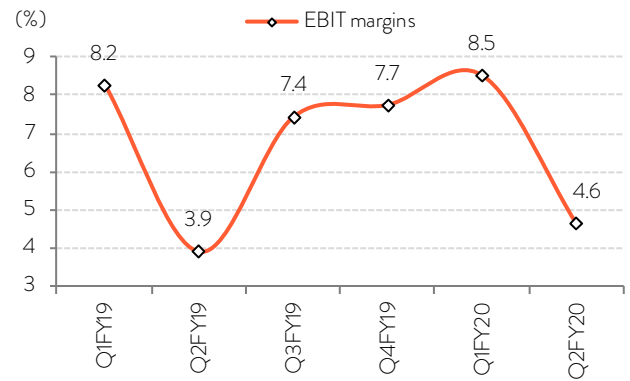
Source: Company, BOBCAPS Research

**FIG 8 – PVC RESIN EBIT MARGINS**



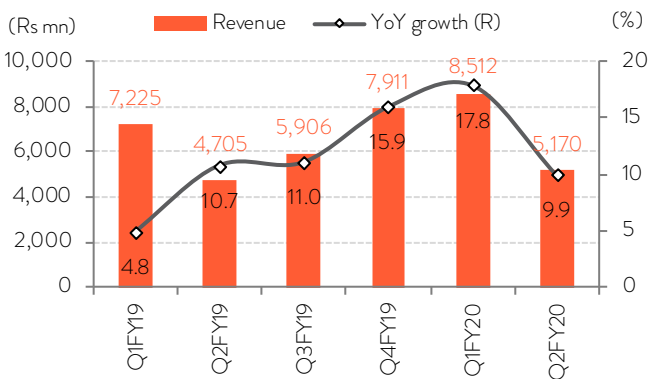
Source: Company, BOBCAPS Research

**FIG 9 – PVC PIPES & FITTINGS EBIT MARGINS**



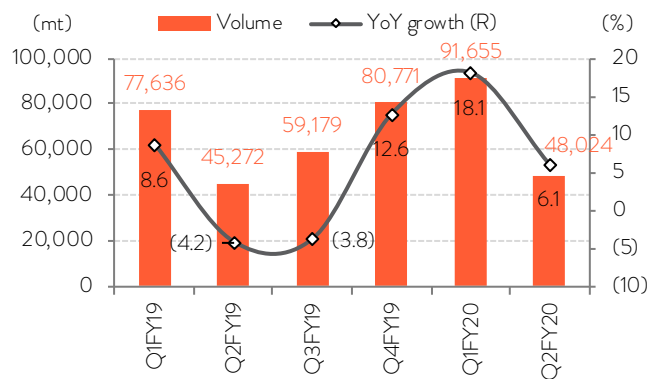
Source: Company, BOBCAPS Research

**FIG 10 – PVC PIPES & FITTINGS REVENUE GROWTH**



Source: Company, BOBCAPS Research

**FIG 11 – PVC PIPES & FITTINGS VOLUME GROWTH**



Source: Company, BOBCAPS Research

## Earnings call highlights

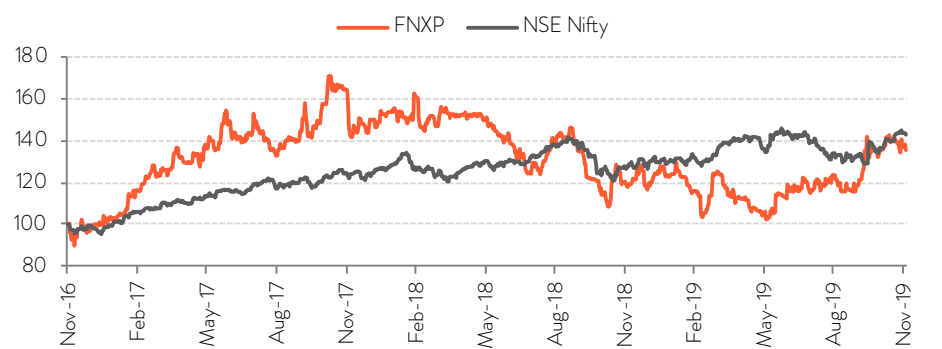
- Q2 is a seasonally dull quarter for FNXP and was further affected by heavy rains in the company's major markets, dampening volume growth in PVC pipes & fittings.
- Agricultural pipes continue to form 70% of total revenues and the balance comes from the plumbing segment.
- The fall in both PVC prices and PVC-EDC delta eroded PVC resin segment margins during the quarter. The average PVC-EDC delta in Q2 stood at US\$ 583/mn tonnes (mt).
- CPVC sales increased ~10% YoY to Rs 580mn in Q2FY20. H1 volumes grew 22% YoY and the company is targeting ~25% volume growth from this segment in FY20.
- Management retained guidance of 12-14% pipe volume growth in FY20 following 13.6% growth in H1.
- CPVC pipes have better margins than agriculture pipes for the company.
- Management expects the share of pipe fittings in total sales to increase given higher traction in the non-agri space. The agriculture/non-agriculture pipe segments grew 12.4%/18% in H1FY20.
- The PVC pipe & fitting market in India is estimated at ~2mt in volumes and expected to increase by ~10% to 2.2-2.3mt in FY20.
- The company plans to add 30,000-40,000mt of pipe capacity at a total capex of Rs 1bn in FY20.
- FNXP has not seen any input price increase for CPVC as it has an annual contract with Lubrizol.
- The company has restarted its jetty from Oct'19 now that the monsoon season is over.

## 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.

We largely maintain our estimates and roll over to a revised Sept'20 target price of Rs 625 (earlier Rs 610), set at an unchanged 20x one-year forward P/E multiple – in line with the stock's five-year average. Maintain ADD.

**FIG 12 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

Key downside 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	FY19A	FY20E	FY21E	FY22E
<b>Total revenue</b>	<b>27,378</b>	<b>30,913</b>	<b>34,955</b>	<b>38,041</b>	<b>41,532</b>
EBITDA	4,839	6,043	5,041	5,324	5,767
Depreciation	(606)	(701)	(769)	(837)	(872)
EBIT	4,233	5,342	4,272	4,487	4,895
Net interest income/(expenses)	(98)	(123)	(101)	(85)	(57)
Other income/(expenses)	202	404	434	418	440
Exceptional items	0	0	0	0	0
EBT	4,379	5,624	4,605	4,821	5,278
Income taxes	(1,588)	(1,812)	(1,217)	(1,275)	(1,397)
Extraordinary items	109	(279)	0	0	0
Min. int./Inc. from associates	163	140	150	160	180
<b>Reported net profit</b>	<b>3,063</b>	<b>3,672</b>	<b>3,538</b>	<b>3,706</b>	<b>4,061</b>
Adjustments	(70)	184	0	0	0
<b>Adjusted net profit</b>	<b>2,993</b>	<b>3,857</b>	<b>3,538</b>	<b>3,706</b>	<b>4,061</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	2,505	2,838	3,355	3,675	4,018
Other current liabilities	1,385	1,411	1,411	1,411	1,411
Provisions	14	0	2,123	2,223	2,437
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	25,936	27,418	29,043
Shareholders' fund	27,951	25,762	27,177	28,659	30,284
<b>Total liabilities and equities</b>	<b>35,060</b>	<b>33,327</b>	<b>37,073</b>	<b>38,665</b>	<b>40,536</b>
Cash and cash eq.	68	291	705	117	164
Accounts receivables	431	743	862	938	1,024
Inventories	6,116	6,205	7,679	8,409	9,196
Other current assets	810	1,035	1,149	1,251	1,365
Investments	16,068	13,619	15,819	16,419	16,619
Net fixed assets	8,842	9,509	9,740	10,403	11,031
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	1,118	1,127	1,136
<b>Total assets</b>	<b>35,060</b>	<b>33,327</b>	<b>37,073</b>	<b>38,665</b>	<b>40,536</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	5,094	6,045	5,374	5,658	6,150
Interest expenses	98	123	101	85	57
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(436)	(280)	(1,190)	(589)	(644)
Other operating cash flows	(1,861)	(2,425)	(1,651)	(1,693)	(1,837)
<b>Cash flow from operations</b>	<b>2,895</b>	<b>3,463</b>	<b>2,634</b>	<b>3,460</b>	<b>3,726</b>
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)	(182)	240
<b>Cash flow from investing</b>	<b>(1,388)</b>	<b>(2,971)</b>	<b>(1,864)</b>	<b>(1,682)</b>	<b>(1,260)</b>
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)	(2,123)	(2,223)	(2,437)
Other financing cash flows	257	1,487	2,067	142	274
<b>Cash flow from financing</b>	<b>(1,494)</b>	<b>(269)</b>	<b>(356)</b>	<b>(2,366)</b>	<b>(2,420)</b>
<b>Changes in cash and cash eq.</b>	<b>13</b>	<b>223</b>	<b>414</b>	<b>(588)</b>	<b>47</b>
<b>Closing cash and cash eq.</b>	<b>68</b>	<b>291</b>	<b>705</b>	<b>117</b>	<b>164</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	24.7	29.6	28.5	29.9	32.7
Adjusted EPS	24.1	31.1	28.5	29.9	32.7
Dividend per share	11.5	10.0	13.7	14.3	15.7
Book value per share	225.2	207.6	219.0	230.9	244.0

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.7	2.4	2.0	1.8	1.6
EV/EBITDA	15.1	12.1	14.1	12.8	11.8
Adjusted P/E	24.3	18.8	20.5	19.6	17.9
P/BV	2.6	2.8	2.7	2.5	2.4

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	68.3	68.6	76.8	76.9	76.9
Interest burden (PBT/EBIT)	103.4	105.3	107.8	107.4	107.8
EBIT margin (EBIT/Revenue)	15.5	17.3	12.2	11.8	11.8
Asset turnover (Revenue/Avg TA)	84.2	90.4	99.3	100.5	104.9
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.3	1.4	1.3
Adjusted ROAE	11.7	14.4	13.4	13.3	13.8

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



**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	5.2	12.9	13.1	8.8	9.2
EBITDA	(14.1)	24.9	(16.6)	5.6	8.3
Adjusted EPS	(15.7)	28.9	(8.3)	4.7	9.6
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	17.7	19.5	14.4	14.0	13.9
EBIT margin	15.5	17.3	12.2	11.8	11.8
Adjusted profit margin	10.9	12.5	10.1	9.7	9.8
Adjusted ROAE	11.7	14.4	13.4	13.3	13.8
ROCE	16.0	19.2	15.7	15.7	16.4
<b>Working capital days (days)</b>					
Receivables	6	7	8	9	9
Inventory	121	117	108	114	114
Payables	39	39	38	39	39
<b>Ratios (x)</b>					
Gross asset turnover	1.4	1.4	1.6	1.6	1.6
Current ratio	1.5	1.6	1.4	1.4	1.4
Net interest coverage ratio	43.1	43.5	42.4	52.9	86.2
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%

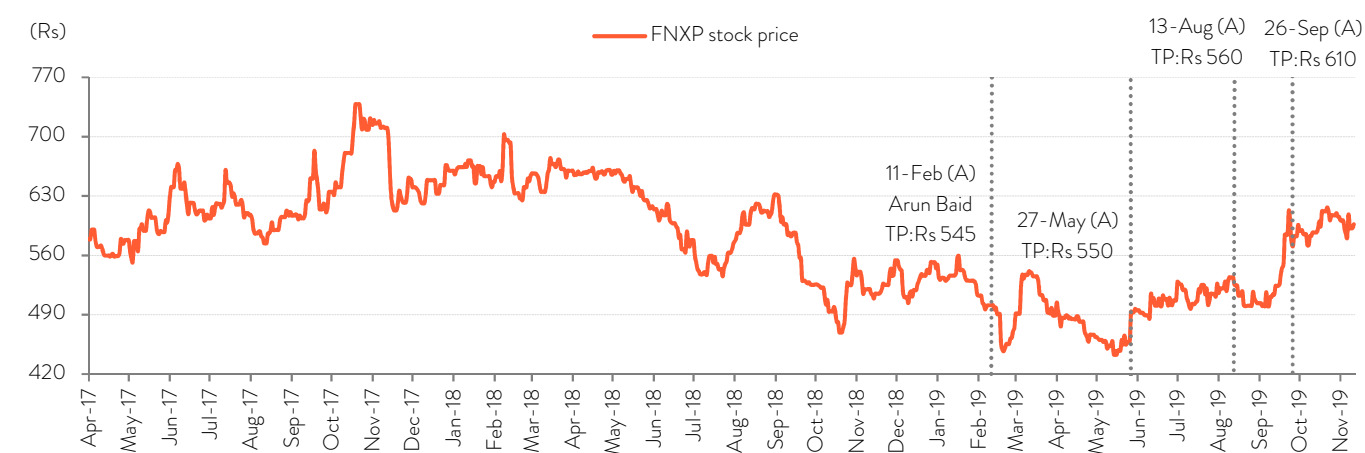
**ADD** – Expected return from >+5% to +15%

**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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