

**ADD**

TP: Rs 580 | ▲ 5%

**FINOLEX INDUSTRIES**

Plastic Products

27 October 2020

## Higher PVC resin prices aid profits; valuations fair – cut to ADD

Finolex Industries' (FNPX) Q2FY21 revenue grew 2% YoY, aided by a 15% rise in PVC resin volumes while pipes declined 9%. EBITDA margins swelled 10ppt YoY to 24.7% on higher PVC resin prices, spurring 77% YoY growth in EBITDA. Management retained guidance of flat pipe volumes in FY21. We raise FY21 EPS 17% to factor in the (transient) PVC price rise and keep FY22/FY23 broadly unchanged. On rollover, we have a new Dec'21 TP of Rs 580 (vs. Rs 560). At 18.9x FY23E EPS, positives look priced in after the recent rally – cut from BUY to ADD.

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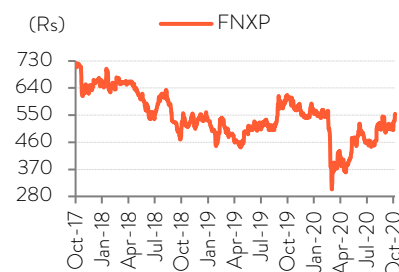
**Modest revenue growth:** FNPX's Q2 revenue increased 1.6% YoY to Rs 5.9bn. The PVC resin segment increased 22% YoY with both volumes/realisations rising 15%/6% YoY, while PVC pipes & fittings declined 3% YoY due to a 9% drop in volumes even as realisations increased 7% YoY. Pipe volumes increased in the non-agriculture segment whereas agricultural pipes declined during the quarter. Management expects strong demand for agri pipes in H2 due to good monsoons this year, and has maintained guidance of flat pipe volumes in FY21.

Ticker/Price	FNPX IN/Rs 554
Market cap	US\$ 932.6mn
Shares o/s	124mn
3M ADV	US\$ 0.4mn
52wk high/low	Rs 619/Rs 290
Promoter/FPI/DII	52%/2%/45%

Source: NSE

**Higher PVC prices aid margins:** Operating margins expanded 1,050bps YoY due to inventory gains from rising PVC prices – consequently, EBITDA increased 77% YoY. EBIT margins in the PVC resin segment surged 1,200bps YoY due to inventory gains. Management believes PVC prices will normalise by end-Q3/early-Q4 as supply conditions improve.

## STOCK PERFORMANCE



Source: NSE

**Downgrade to ADD:** We raise FY21 earnings estimates by 17% due to inventory gains on PVC resin but keep FY22/FY23 forecasts broadly unchanged. After the recent rally, FNPX is trading at 18.9x FY23E EPS. We see limited upside from these levels and hence downgrade the stock from BUY to ADD. Our revised Dec'21 TP of Rs 580 is set at an unchanged 20x one-year forward P/E.

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	30,913	29,860	30,387	31,114	33,543
EBITDA (Rs mn)	6,043	4,481	5,293	4,842	5,106
Adj. net profit (Rs mn)	3,857	3,327	3,737	3,366	3,637
Adj. EPS (Rs)	31.1	26.8	30.1	27.1	29.3
Adj. EPS growth (%)	28.9	(13.8)	12.3	(9.9)	8.1
Adj. ROAE (%)	14.4	14.6	17.9	14.7	14.7
Adj. P/E (x)	17.8	20.7	18.4	20.4	18.9
EV/EBITDA (x)	11.4	15.2	12.9	14.1	12.9

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)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
<b>Net sales</b>	<b>5,858</b>	<b>5,767</b>	<b>1.6</b>	<b>5,621</b>	<b>4.2</b>	<b>11,479</b>	<b>15,205</b>	<b>(24.5)</b>
COGS	3,181	3,497	(9.0)	3,826	(16.8)	7,007	10,165	(31.1)
Employee expenses	361	348	3.9	346	4.3	707	701	0.8
Other expenses	868	1,103	(21.3)	567	53.2	1,434	2,283	(37.2)
<b>EBITDA</b>	<b>1,448</b>	<b>820</b>	<b>76.5</b>	<b>882</b>	<b>64.1</b>	<b>2,330</b>	<b>2,056</b>	<b>13.3</b>
EBITDA margin (%)	24.7	14.2	1,049bps	15.7	901bps	20.3	13.5	678bps
Depreciation & amortisation	193	194	(0.3)	188	2.7	382	362	5.5
<b>EBIT</b>	<b>1,254</b>	<b>626</b>	<b>100.4</b>	<b>694</b>	<b>80.7</b>	<b>1,948</b>	<b>1,694</b>	<b>15.0</b>
EBIT margin (%)	21.4	10.9	1,056bps	12.3	906bps	17.0	11.1	583bps
Other income	255	174	46.2	83	206.0	338	231	46.0
Finance costs	8	2	234.8	33	(76.5)	41	11	264.9
Exceptional items	(70)	-	NM	-	NM	(70)	-	NM
<b>Profit before tax</b>	<b>1,571</b>	<b>798</b>	<b>96.9</b>	<b>745</b>	<b>111.0</b>	<b>2,316</b>	<b>1,914</b>	<b>21.0</b>
Tax expenses	374	(229)	(263.5)	193	93.4	567	163	249.2
<b>Reported Net profit</b>	<b>1,197</b>	<b>1,027</b>	<b>16.6</b>	<b>551</b>	<b>117.2</b>	<b>1,748</b>	<b>1,752</b>	<b>(0.2)</b>
Adjusted Net Profit	1,144	1,027	11.4	551.10	107.6	1,695	1,752	(3.2)

Source: Company, BOBCAPS Research

**FIG 2 – STANDALONE SEGMENTAL PERFORMANCE**

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
<b>Revenue</b>								
PVC	3,681	3,027	21.6	2,943	25.1	6,623	8,375	(20.9)
PVC pipes & fittings	5,008	5,170	(3.1)	5,070	(1.2)	10,078	13,683	(26.3)
<b>Total</b>	<b>8,689</b>	<b>8,197</b>	<b>6.0</b>	<b>8,013</b>	<b>8.4</b>	<b>16,702</b>	<b>22,058</b>	<b>(24.3)</b>
Inter-segment revenues	2,831	2,430	16.5	2,392	18.4	5,223	6,853	(23.8)
<b>Net sales (inc. other op. inc.)</b>	<b>5,858</b>	<b>5,767</b>	<b>1.6</b>	<b>5,621</b>	<b>4.2</b>	<b>11,479</b>	<b>15,205</b>	<b>(24.5)</b>
<b>EBIT</b>								
PVC	991	451	119.6	232	327.0	1,223	864	41.5
PVC pipes & fittings	393	238	64.8	514	(23.6)	907	962	(5.7)
<b>Total</b>	<b>1,384</b>	<b>690</b>	<b>100.7</b>	<b>747</b>	<b>85.4</b>	<b>2,131</b>	<b>1,826</b>	<b>16.7</b>
<b>EBIT Margins (%)</b>								
PVC	26.9	14.9	1,201bps	7.9	1,904bps	18.5	10.3	1,660bps
PVC pipes & fittings	7.8	4.6	324bps	10.1	(230bps)	9.0	7.0	82bps
<b>Total</b>	<b>23.6</b>	<b>12.0</b>	<b>1,167bps</b>	<b>13.3</b>	<b>1,035bps</b>	<b>18.6</b>	<b>12.0</b>	<b>1,161bps</b>

Source: Company, BOBCAPS Research

**FIG 3 – VOLUME AND REALISATION TRENDS**

Particulars	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
<b>Volume</b>								
PVC (MT)	47,630	41,422	15.0	45,435	4.8	93,065	1,19,934	(22.4)
PVC pipes (MT)	43,618	48,024	(9.2)	52,911	(17.6)	96,529	1,39,679	(30.9)
<b>Realisation</b>								
PVC (Rs/t)	77,275	73,065	5.8	64,769	19.3	71,170	69,833	1.9
PVC pipes (Rs/t)	1,14,822	1,07,663	6.6	95,818	19.8	1,04,405	97,957	6.6
<b>EBIT/tonne</b>								
PVC (Rs/t)	20,806	10,895	91.0	5,108	307.3	13,142	7,207	82.3
PVC pipes (Rs/t)	9,010	4,964	81.5	9,722	(7.3)	9,400	6,887	36.5

Source: Company, BOBCAPS Research

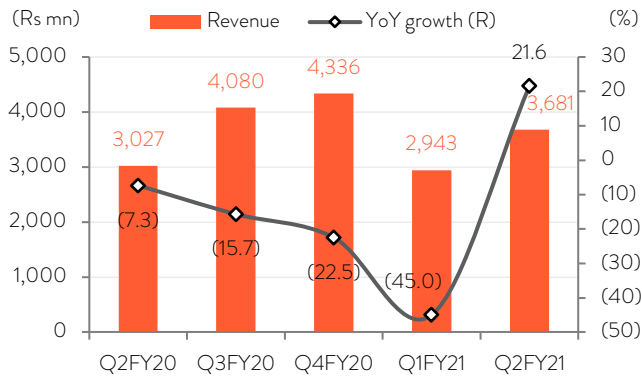
**FIG 4 – CONSOLIDATED QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
<b>Net sales</b>	<b>5,858</b>	<b>5,767</b>	<b>1.6</b>	<b>5,621</b>	<b>4.2</b>	<b>11,479</b>	<b>15,205</b>	<b>(24.5)</b>
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EBIT margin (%)	21.4	10.9	1,056bps	12.3	906bps	17.0	11.1	583bps
Other income	315	165	91.2	83	279.0	399	222	79.5
Finance costs	8	2	234.8	33	(76.5)	41	11	264.9
<b>Profit before tax</b>	<b>1,562</b>	<b>789</b>	<b>98.1</b>	<b>745</b>	<b>109.8</b>	<b>2,306</b>	<b>1,905</b>	<b>21.1</b>
Tax expenses	379	(193)	(295.8)	206	83.6	585	210	179.0
Share of profit from associates	45	41	10.6	29	55.7	74	59	24.8
<b>Reported Net profit</b>	<b>1,228</b>	<b>1,023</b>	<b>20.1</b>	<b>567</b>	<b>116.6</b>	<b>1,796</b>	<b>1,755</b>	<b>2.3</b>
Adjusted Net Profit	1,228	1,023	20.1	567	116.6	1,796	1,755	2.3

Source: Company, BOBCAPS Research

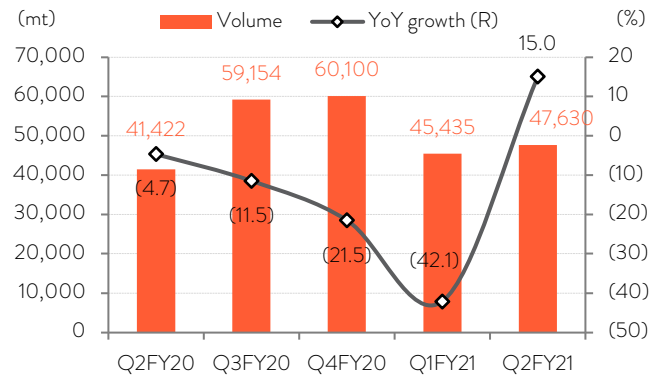
STANDALONE QUARTERLY TRENDS

FIG 5 – PVC RESIN REVENUE GROWTH



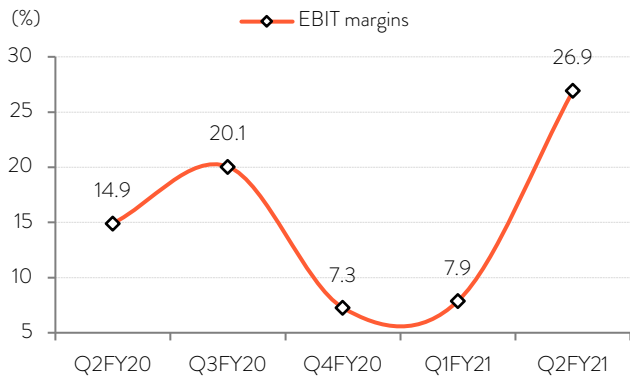
Source: Company, BOBCAPS Research

FIG 6 – PVC RESIN VOLUME GROWTH



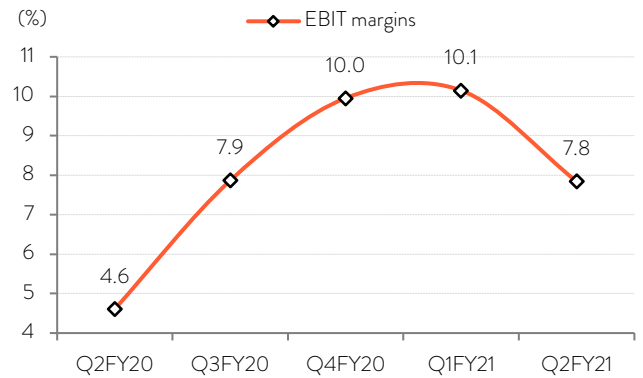
Source: Company, BOBCAPS Research

FIG 7 – PVC RESIN EBIT MARGINS



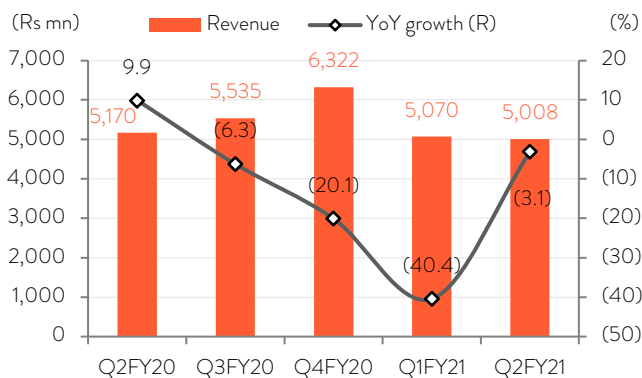
Source: Company, BOBCAPS Research

FIG 8 – PVC PIPES & FITTINGS EBIT MARGINS



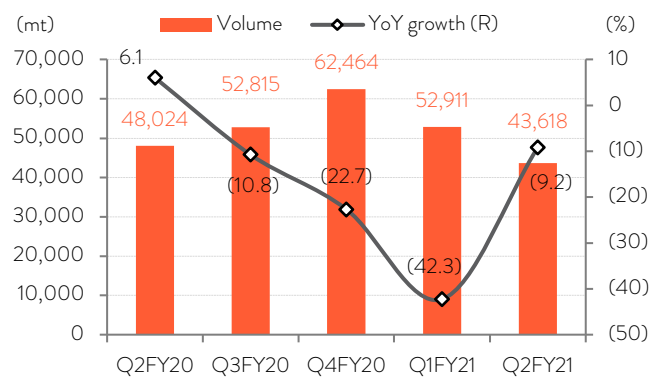
Source: Company, BOBCAPS Research

FIG 9 – PVC PIPES & FITTINGS REVENUE GROWTH



Source: Company, BOBCAPS Research

FIG 10 – PVC PIPES & FITTINGS VOLUME GROWTH



Source: Company, BOBCAPS Research

FIG 11 – PVC-EDC DELTA

PVC/EDC Spread	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
Spread (US\$/mt)	523	490	583	589	574	547	654
YoY (%)	(33.4)	(28.8)	(9.0)	10.1	9.8	11.6	12.2

Source: Company, BOBCAPS Research

## Earnings call highlights

- Q2 is a seasonally dull quarter for FNXP, especially for agricultural pipes. Non-agricultural pipes saw demand return during the quarter and contributed to 38% of volumes and 46% of revenues.
- Management believes agricultural demand will improve in H2FY21 due to the good monsoons this year, and continues to guide for flat volumes in FY21.
- Supply-side issues due to Covid-19 have been resolved and all the company's production facilities are fully operational.
- PVC prices have risen by Rs 14/kg in Q2 and a further Rs 7-8/kg in October to Rs 95/kg due to lower import availability. Many large global players have taken shutdowns amid the pandemic – given India's reliance on imports, prices have shot up.
- In dollar terms, PVC prices are currently at US\$ 1,100/mt. Management believes these will revert to historical levels of US\$ 900-950/mt by end-Q3/early-Q4 as supplies resume globally.
- The company has discontinued its CPVC supply arrangement with Lubrizol in Sep'20 and is sourcing material from other players. It does not see any pressure on sales due to the split with Lubrizol.
- In Q2, CPVC volumes declined 10% YoY whereas revenues fell ~6% YoY.
- FNXP is focusing on further increasing its dealer reach so as to have more business in the non-agri pipe segment.
- Margins in non-agricultural pipes are better as compared to agri pipes. Also, the share of fittings (which has better margins) is comparatively higher in the non-agri segment.
- Other income increased during the quarter due to higher dividend from Finolex Cables.

## Valuation methodology

FNXP is one of the major PVC pipe players in India with 18,000 dealers and sub-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.

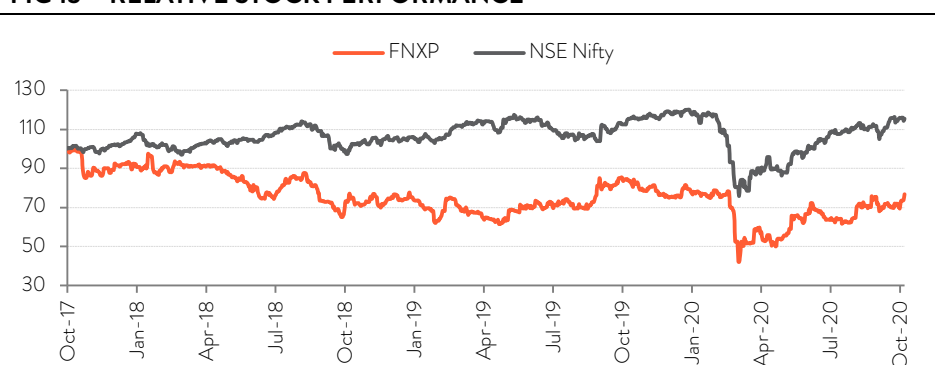
Post Q2, we increase our FY21 PAT estimate by 17% and roll over to a revised Dec'21 target price of Rs 580 (earlier Rs 560), based on an unchanged 20x one-year forward P/E multiple. After the recent rally, FNXP is trading at 18.9x FY23E EPS. We see limited upside from these levels and hence downgrade the stock from BUY to ADD.

**FIG 12 – REVISED ESTIMATES**

(Rs mn)	New			Old			YoY (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	30,387	31,114	33,543	28,490	30,992	33,397	6.7	0.4	0.4
EBITDA	5,293	4,842	5,106	4,630	4,755	5,046	14.3	1.8	1.2
PAT	3,737	3,366	3,637	3,207	3,349	3,611	16.5	0.5	0.7

Source: Company, BOBCAPS Research

**FIG 13 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

Key downside risks to our estimates are:

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

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>30,913</b>	<b>29,860</b>	<b>30,387</b>	<b>31,114</b>	<b>33,543</b>
EBITDA	6,043	4,481	5,293	4,842	5,106
Depreciation	(701)	(738)	(820)	(840)	(906)
EBIT	5,342	3,743	4,473	4,002	4,201
Net interest income/(expenses)	(123)	(119)	(75)	(58)	(44)
Other income/(expenses)	404	299	378	286	385
Exceptional items	0	0	0	0	0
EBT	5,624	3,923	4,776	4,229	4,542
Income taxes	(1,812)	(852)	(1,259)	(1,134)	(1,225)
Extraordinary items	(279)	0	0	0	0
Min. int./Inc. from associates	140	256	220	270	320
<b>Reported net profit</b>	<b>3,672</b>	<b>3,327</b>	<b>3,737</b>	<b>3,366</b>	<b>3,637</b>
Adjustments	184	0	0	0	0
<b>Adjusted net profit</b>	<b>3,857</b>	<b>3,327</b>	<b>3,737</b>	<b>3,366</b>	<b>3,637</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	2,838	2,334	2,294	2,484	2,692
Other current liabilities	1,387	1,723	1,332	1,364	1,470
Provisions	230	297	250	341	368
Debt funds	906	2,827	927	727	527
Other liabilities	2,205	1,873	1,763	1,653	1,543
Equity capital	1,241	1,241	1,241	1,241	1,241
Reserves & surplus	24,521	18,619	20,674	22,525	24,525
Shareholders' fund	25,762	19,860	21,915	23,766	25,766
<b>Total liabilities and equities</b>	<b>33,327</b>	<b>28,913</b>	<b>28,480</b>	<b>30,335</b>	<b>32,366</b>
Cash and cash eq.	291	932	1,009	2,596	3,025
Accounts receivables	743	732	833	852	919
Inventories	6,205	8,578	7,469	6,719	7,281
Other current assets	1,035	710	999	1,023	1,103
Investments	13,619	6,607	7,107	7,307	8,007
Net fixed assets	9,489	10,153	9,832	10,492	10,587
CWIP	902	73	50	50	50
Intangible assets	20	16	16	16	16
Other assets	1,023	1,113	1,166	1,279	1,378
<b>Total assets</b>	<b>33,327</b>	<b>28,913</b>	<b>28,480</b>	<b>30,335</b>	<b>32,366</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	6,045	4,661	5,596	5,069	5,448
Interest expenses	123	119	75	58	44
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(209)	(2,295)	236	815	(494)
Other operating cash flows	(2,425)	(1,428)	(1,637)	(1,419)	(1,611)
<b>Cash flow from operations</b>	<b>3,535</b>	<b>1,057</b>	<b>4,270</b>	<b>4,523</b>	<b>3,387</b>
Capital expenditures	(1,366)	(603)	(477)	(1,500)	(1,000)
Change in investments	0	0	0	0	0
Other investing cash flows	(1,605)	942	(500)	(200)	(700)
<b>Cash flow from investing</b>	<b>(2,971)</b>	<b>340</b>	<b>(977)</b>	<b>(1,700)</b>	<b>(1,700)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(101)	1,921	(1,900)	(200)	(200)
Interest expenses	(123)	(119)	(75)	(58)	(44)
Dividends paid	(1,532)	(2,873)	(1,682)	(1,514)	(1,637)
Other financing cash flows	1,416	315	440	537	622
<b>Cash flow from financing</b>	<b>(340)</b>	<b>(756)</b>	<b>(3,216)</b>	<b>(1,236)</b>	<b>(1,259)</b>
<b>Changes in cash and cash eq.</b>	<b>223</b>	<b>641</b>	<b>77</b>	<b>1,587</b>	<b>429</b>
<b>Closing cash and cash eq.</b>	<b>291</b>	<b>932</b>	<b>1,009</b>	<b>2,596</b>	<b>3,025</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	29.6	26.8	30.1	27.1	29.3
Adjusted EPS	31.1	26.8	30.1	27.1	29.3
Dividend per share	10.0	10.0	10.8	9.8	10.6
Book value per share	207.6	160.0	176.6	191.5	207.6

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.2	2.3	2.2	2.2	2.0
EV/EBITDA	11.4	15.2	12.9	14.1	12.9
Adjusted P/E	17.8	20.7	18.4	20.4	18.9
P/BV	2.7	3.5	3.1	2.9	2.7

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	68.6	84.8	78.2	79.6	80.1
Interest burden (PBT/EBIT)	105.3	104.8	106.8	105.7	108.1
EBIT margin (EBIT/Revenue)	17.3	12.5	14.7	12.9	12.5
Asset turnover (Revenue/Avg TA)	90.4	95.9	105.9	105.8	107.0
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.4	1.3	1.3
Adjusted ROAE	14.4	14.6	17.9	14.7	14.7

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



**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	12.9	(3.4)	1.8	2.4	7.8
EBITDA	24.9	(25.9)	18.1	(8.5)	5.5
Adjusted EPS	28.9	(13.8)	12.3	(9.9)	8.1
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	19.5	15.0	17.4	15.6	15.2
EBIT margin	17.3	12.5	14.7	12.9	12.5
Adjusted profit margin	12.5	11.1	12.3	10.8	10.8
Adjusted ROAE	14.4	14.6	17.9	14.7	14.7
ROCE	19.2	15.2	19.6	16.9	16.5
<b>Working capital days (days)</b>					
Receivables	7	9	9	10	10
Inventory	117	139	150	126	114
Payables	39	37	34	33	33
<b>Ratios (x)</b>					
Gross asset turnover	1.4	1.3	1.3	1.3	1.3
Current ratio	1.5	1.5	2.1	2.3	2.4
Net interest coverage ratio	43.5	31.4	59.6	69.1	95.8
Adjusted debt/equity	0.0	0.1	0.0	(0.1)	(0.1)

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

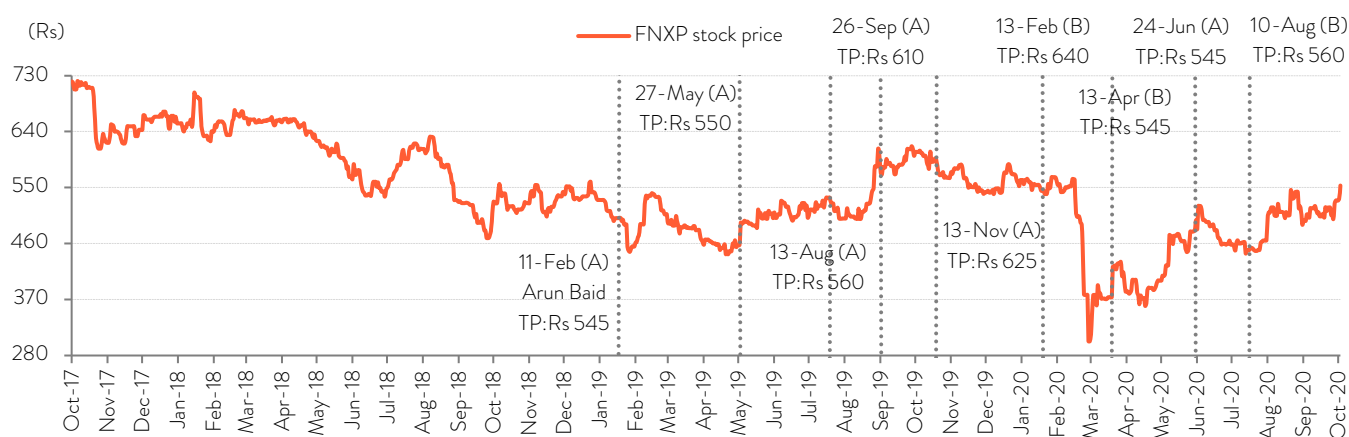
**ADD** – Expected return from >+5% to +15%

**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)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): FINOLEX INDUSTRIES (FNPX IN)



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

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