

HOLD

TP: Rs 235 | ▲ 7%

FINOLEX INDUSTRIES

Plastic Products

01 November 2021

Strong realisation and volume growth aid profitability

- Q2 revenue growth robust at 85% YoY as PVC realisations surged 63% and pipe volumes grew 27% YoY
- Operating margin expanded 310bps YoY to 27.8% on lower employee cost (-225bps) and other expenses (-220bps)
- We raise FY22-FY24 PAT 23-39% on an above-expected H1 and roll to a new Sep'22 TP of Rs 235 (vs. Rs 185). Retain HOLD on full valuations

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Strong revenue growth aided by higher PVC prices: FNXP reported Q2FY22 revenue growth of 85% YoY to Rs 10.8bn as PVC resin realisations surged 63% and PVC pipe realisations increased 41%. PVC resin/PVC pipe & fittings revenue grew 78%/80% YoY. PVC is in short supply and, hence, local prices are running higher than the listed rates of local manufacturers, implying market share gains for larger players. PVC resin volumes grew 9.2% YoY whereas pipe volumes increased 27%.

Operating margin expands 310bps YoY: FNXP's standalone EBITDA margin increased 310bps YoY to 27.8% aided by higher PVC margins (+830bps) and better control of cost overheads (-450bps). EBITDA/PBT thus grew 108%/117% YoY. The average PVC-EDC delta was at US\$ 790/t (+21% YoY) in Q2 and is currently trading at US\$ 900/t.

Pricing and supply outlook: Management indicated that global supply constraints and higher logistics costs have kept PVC prices elevated. China has opened up the carbide route, which should help improve supply and bring down prices. While PVC resin margins are difficult to forecast, those in the pipe segment are more predictable and are guided to sustain at Rs 8-10/kg. The PVC business is more sustainable at Rs 15-20 EBIT/kg on a ~US\$ 600/t spread (recent trend: Rs 35-45/kg at +US\$ 800/t spread). As per management, resin prices are at an all-time high and should soften. For CPVC, supply challenges are far more acute and need to be watched.

Earnings upgraded but valuations full, HOLD: We raise FY22/FY23/FY24 PAT estimates by 39%/25%/23% given the above-expected H1FY22 PVC resin margins and volume growth. On rollover, we arrive at a new Sep'22 TP of Rs 235 (from Rs 185), set at an unchanged 24x one-year forward P/E, ~14% premium to the stock's five-year average. FNXP has a strong balance sheet and its focus on non-agricultural pipes could aid further margin gains. While we like the company, we find current valuations full at ~24x FY23E EPS – retain HOLD.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	FNXP IN/Rs 220
Market cap	US\$ 1.8bn
Free float	48%
3M ADV	US\$ 3.0mn
52wk high/low	Rs 245/Rs 103
Promoter/FPI/DII	52%/4%/43%

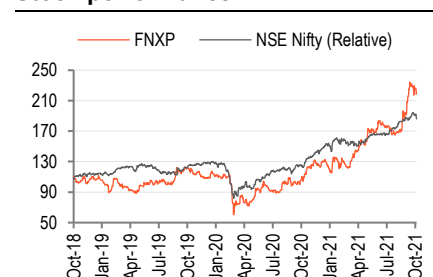
Source: NSE | Price as of 1 Nov 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	34,628	37,522	40,133
EBITDA (Rs mn)	9,893	8,809	7,940
Adj. net profit (Rs mn)	7,378	6,305	5,806
Adj. EPS (Rs)	11.9	10.2	9.4
Consensus EPS (Rs)	11.9	8.8	9.0
Adj. ROAE (%)	28.8	19.0	15.9
Adj. P/E (x)	18.5	21.7	23.5
EV/EBITDA (x)	13.8	15.2	16.3
Adj. EPS growth (%)	1009.0	(14.5)	(7.9)

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call highlights

- **PVC prices:** PVC is in short supply locally due to global supply constraints and higher international freight costs. Thus, domestic prices have moved above the list prices of local manufacturers, which implies market share gains for larger players. China has opened up the carbide route and hence supply should improve, bringing prices down. Sourcing of CPVC has been a challenge for large players and some are witnessing acute shortages. This is a key variable to watch.
- **Demand outlook:** High PVC prices are a deterrent to agricultural pipe demand. However, management is hopeful that pent-up demand will bolster sales. The CPVC segment is benefitting from the higher PVC prices. Management remains positive on agri demand and does not rule out recouping of lost volumes in H2FY22.
- **Margins:** For pipes, EBIT/kg of Rs 8-10 is sustainable. For PVC, Rs 15-20/kg is sustainable at a ~US\$ 600/t spread (recent trend: Rs 35-45/kg at +US\$ 800/t spread. PVC margins benefitted due to low-cost inventory built at end-Q1 while the pipes business did not witness any inventory gain.
- **RM availability:** FNXP has contracted raw material such as EDC, ethylene and VCM for Q3FY22 and is not facing any production issues.
- **Pricing:** In Q2FY22, PVC was priced at US\$ 1,514/t, VCM at US\$ 1,123/t, EDC at US\$ 724/t and ethylene at US\$ 985/t. During Q1FY22, PVC was at US\$ 1,543/t, VCM at US\$ 1,233/t, EDC at US\$ 709/t and ethylene at US\$ 991/t.
- **Spreads:** During Q2, the average PVC-EDC delta stood at US\$ 790/t (vs. US\$ 654/t in Q2FY21 and US\$ 834/t in Q1FY22) and is currently at US\$ 900/t. The PVC-VCM spread was at US\$ 391/t in Q2 vs. US\$ 311/t in Q1; 60% of FNXP's production is through the EDC route.
- **Volumes:** Agri/non-agri volumes increased 34%/23% YoY with a split of 42%/58%. Management believes demand for agriculture pipes would return in H2FY22.
- **CPVC:** Volumes increased 77% YoY (+50% QoQ) to 3,600t vs. 2,000t in Q2FY21 with CPVC revenue at ~Rs 1.3bn. Domestic demand is currently at ~220kt and local supply by Lubrizol and DCW at ~60kt. The gap is met by imports which have been disrupted for all players due to global supply chain disruptions.
- **Cash on books:** FNXP remains net surplus with cash on books of Rs 9.2bn, the usage of which is yet to be decided. The company recently announced the sale of MIDC land for no less than Rs 7.25bn and expects the sale to be completed within a year.

Fig 1 – Standalone quarterly performance

(Rs mn)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	H1FY22	H1FY21	YoY (%)
Net sales	10,830	5,858	84.9	9,657	12.1	20,487	11,479	78.5
COGS	6,027	3,181	89.5	5,789	4.1	11,816	7,007	68.6
Employee expenses	423	361	17.0	455	(7.0)	877	707	24.0
Other expenses	1,365	868	57.3	1,319	3.5	2,684	1,434	87.1
EBITDA	3,015	1,448	108.2	2,095	43.9	5,110	2,330	119.3
EBITDA margin (%)	27.8	24.7	312bps	21.7	614bps	24.9	20.3	464bps
Depreciation & amortization	206	193	6.6	201	2.7	407	382	6.5
EBIT	2,809	1,254	123.9	1,895	48.2	4,703	1,948	141.4
EBIT margin (%)	25.9	21.4	452bps	19.6	632bps	23.0	17.0	598bps
Other income	299	255	17.3	154	94.6	452	338	33.9
Finance costs	4	8	(46.8)	48	(91.4)	52	41	27.7
Exceptional items	-	70	(100.0)	-	-	-	70	(100.0)
Profit before tax	3,103	1,431	116.8	2,000	55.1	5,104	2,316	120.4
Tax expenses	752	374	101.1	532	41.3	1,285	567	126.4
Reported Net profit	2,351	1,057	122.4	1,468	60.1	3,819	1,748	118.4
Adjusted Net Profit	2,351	1,012	132.4	1,468	60.1	3,819	1,703	124.3

Source: Company, BOBCAPS Research

Fig 2 – Standalone segmental performance

(Rs mn)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	H1FY22	H1FY21	YoY (%)
Revenue								
PVC	6,543	3,681	77.8	6,271	4.3	12,815	6,623	93.5
PVC pipes & fittings	8,996	5,008	79.6	8,454	6.4	17,450	10,078	73.1
Total	15,540	8,689	78.8	14,725	5.5	30,265	16,702	81.2
Inter-segment revenues	4,710	2,831	66.4	5,068	(7.1)	9,778	5,223	87.2
Net sales (inc. other op. inc.)	10,830	5,858	84.9	9,657	12.1	20,487	11,479	78.5
EBIT								
PVC	2,306	991	132.7	1,579	46.1	3,884	1,223	217.6
PVC pipes & fittings	575	393	46.2	436	31.6	1,011	907	11.4
Total	2,880	1,384	108.1	2,015	43.0	4,895	2,131	129.8
EBIT Margins (%)								
PVC	35.2	26.9	832bps	25.2	1007bps	30.3	18.5	1677bps
PVC pipes & fittings	6.4	7.8	(146bps)	5.2	122bps	5.8	9.0	(262bps)
Total	26.6	23.6	297bps	20.9	573bps	23.9	18.6	804bps

Source: Company, BOBCAPS Research

Fig 3 – Consolidated quarterly performance

(Rs mn)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	% QoQ	H1FY22	H1FY21	YoY (%)
Net sales	10,830	5,858	84.9	9,657	12.1	20,487	11,479	78.5
COGS	6,027	3,181	89.5	5,789	4.1	11,816	7,007	68.6
Employee expenses	423	361	17.0	455	(7.0)	877	707	24.0
Other expenses	1,365	868	57.3	1,319	3.5	2,684	1,434	87.1
EBITDA	3,015	1,448	108.2	2,095	43.9	5,110	2,330	119.3
EBITDA margin (%)	27.8	24.7	312bps	21.7	614bps	24.9	20.3	464bps
Depreciation & amortization	206	193	6.6	201	2.7	407	382	6.5
EBIT	2,809	1,254	123.9	1,895	48.2	4,703	1,948	141.4
EBIT margin (%)	25.9	21.4	452bps	19.6	632bps	23.0	17.0	598bps
Other income	289	315	(8.2)	154	88.5	443	399	11.1
Finance costs	4	8	(46.8)	48	(91.4)	52	41	27.7
Exceptional items	-	-	-	-	-	-	-	-
Profit before tax	3,094	1,562	98.1	2,000	54.7	5,094	2,306	120.9
Tax expenses	748	379	97.5	529	41.3	1,277	585	118.4
Share of profit from associates	(14)	45	(130.0)	(16)	(15.6)	(30)	74	(139.9)
Reported Net profit	2,333	1,228	89.9	1,455	60.3	3,788	1,796	111.0

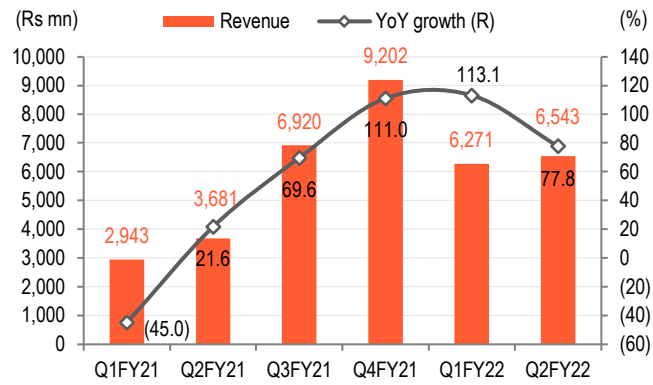
Source: Company, BOBCAPS Research

Fig 4 – Volumes and Realisations

Particulars	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	H1FY22	H1FY21	YoY (%)
Volume								
PVC (mt)	52,029	47,630	9.2	50,249	3.5	1,02,278	93,065	9.9
PVC pipes (mt)	55,453	43,618	27.1	55,819	(0.7)	1,11,272	96,529	15.3
Realisation								
PVC (Rs/t)	1,25,764	77,275	62.7	1,24,800	0.8	1,25,291	71,170	76.0
PVC pipes (Rs/t)	1,62,233	1,14,822	41.3	1,51,452	7.1	1,56,825	1,04,405	50.2
EBIT/tonne								
PVC (Rs/t)	44,320	20,806	113.0	31,414	41.1	37,979	13,142	189.0
PVC pipes (Rs/t)	10,360	9,010	15.0	7,818	32.5	9,085	9,400	(3.4)

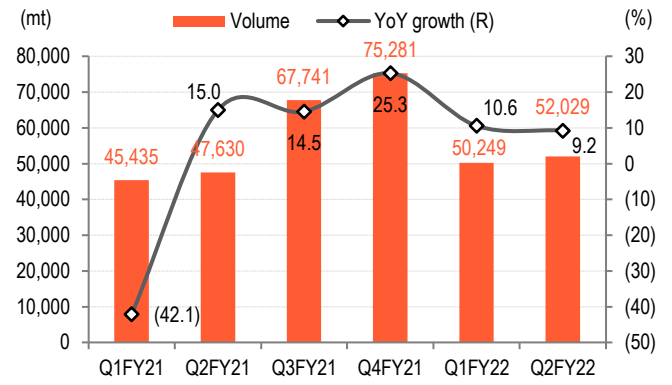
Source: Company, BOBCAPS Research

Fig 5 – Standalone PVC resin revenue growth



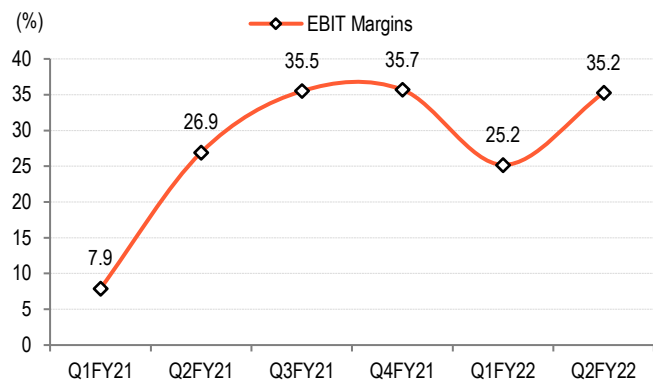
Source: Company, BOBCAPS Research

Fig 6 – Standalone PVC resin volume growth



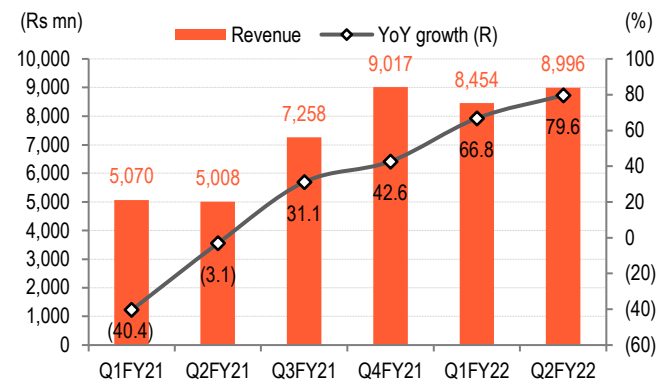
Source: Company, BOBCAPS Research

Fig 7 – Standalone PVC resin EBIT margin



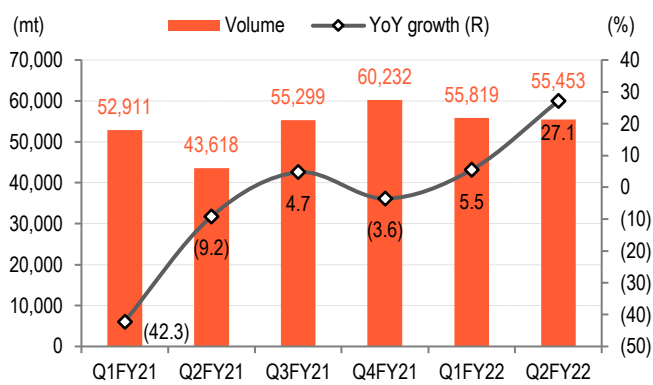
Source: Company, BOBCAPS Research

Fig 8 – Standalone PVC pipes & fittings revenue growth



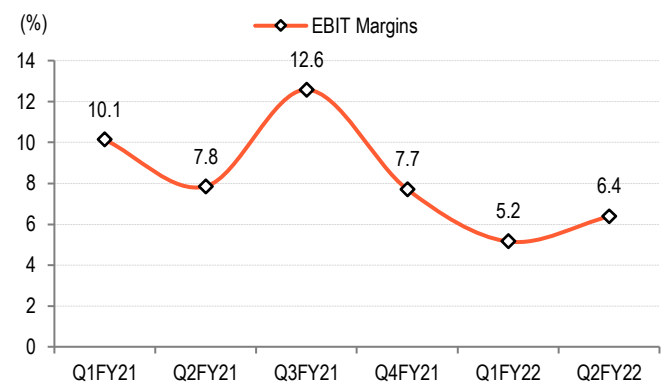
Source: Company, BOBCAPS Research

Fig 9 – Standalone PVC pipes & fittings volume growth



Source: Company, BOBCAPS Research

Fig 10 – Standalone PVC pipes & fittings EBIT margin



Source: Company, BOBCAPS Research

Valuation methodology

Despite higher PVC prices, we expect healthy volume growth in FNXP's pipes and fittings business led by the agricultural sector as deferment of demand is not possible in consecutive seasons with good monsoons and higher rural per capita income. We raise our FY22/FY23/FY24 PAT estimates by 39%/25%/23% given the above-expected H1FY22 PVC resin margins and volume growth. On rollover, we arrive at a revised Sep'22 TP of Rs 235 (from Rs 185), set at an unchanged 24x one-year forward P/E, ~14% premium to the stock's five-year average.

FNXP has a strong balance sheet and its focus on non-agricultural pipes could aid further margin gains. We also remain positive on growth prospects of the agri piping, housing and building material segments. However, though we like the company, we find current valuations full at ~24x FY23E EPS – retain HOLD.

Fig 11 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	37,522	40,133	43,318	37,386	37,593	38,957	0.4	6.8	11.2
EBITDA	8,809	7,940	8,466	6,437	6,426	6,900	36.8	23.6	22.7
EBITDA margin (%)	23.5	19.8	19.5	17.2	17.1	17.7	626bps	269bps	183bps
PAT	6,305	5,806	6,217	4,533	4,638	5,049	39.1	25.2	23.1

Source: BOBCAPS Research

Fig 12 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
PVC resin external sales (mt)	80,468	72,421	65,179	58,661
Growth (%)	44.7	(10.0)	(10.0)	(10.0)
Realisation (Rs/mt)	1,02,838	96,200	92,500	88,800
Growth (%)	32.3	(6.5)	(3.8)	(4.0)
PVC pipe volumes (mt)	2,12,060	2,33,266	2,56,593	2,82,252
Growth (%)	(16.8)	10.0	10.0	10.0
Realisation (Rs/mt)	1,24,271	1,28,000	1,30,560	1,33,171
Growth (%)	24.1	3.0	2.0	2.0
PVC pipe EBITDA (Rs/mt)	13,844	12,500	12,000	12,000
Growth (%)	44.4	(9.7)	(4.0)	0.0
PVC resin EBITDA (Rs/mt)	31,086	25,000	20,500	20,500
Growth (%)	247.7	(19.6)	(18.0)	0.0

Source: Company, BOBCAPS Research

Fig 13 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
					FY22E	FY23E	FY22E	FY23E	
Kajaria Ceramics	KJC IN	HOLD	1,393	21.5	22.8	29.6	18.9	23.3	47
Greenpanel Industries	GREENP IN	HOLD	395	27.6	14.1	18.3	21.1	22.1	20
Century Plyboard	CPBI IN	SELL	370	19.5	11.9	14.7	19.1	19.6	25
Cera Sanitaryware	CRS IN	HOLD	5,893	17.1	109.8	134.9	15.4	16.9	40
Astral	ASTRA IN	SELL	1,210	16.3	20.2	25.2	20.3	22.6	48
Finolex Ind	FNXP IN	HOLD	235	7.7	10.2	9.4	19.0	15.9	24
Supreme Ind	SI IN	BUY	2,735	22.7	76.2	91.2	28.5	29.9	30

Source: BOBCAPS Research

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)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	29,860	34,628	37,522	40,133	43,318
EBITDA	4,481	9,893	8,809	7,940	8,466
Depreciation	(738)	(777)	(938)	(1,003)	(1,083)
EBIT	3,743	9,116	7,870	6,936	7,383
Net interest inc./(exp.)	(119)	(73)	(82)	(59)	(41)
Other inc./(exp.)	299	716	481	634	669
Exceptional items	0	0	0	0	0
EBT	3,923	9,759	8,269	7,512	8,011
Income taxes	(852)	(2,543)	(2,124)	(1,956)	(2,094)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	256	162	160	250	300
Reported net profit	3,327	7,378	6,305	5,806	6,217
Adjustments	0	0	0	0	0
Adjusted net profit	3,327	7,378	6,305	5,806	6,217

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	2,334	3,952	2,631	2,996	3,249
Other current liabilities	1,723	3,085	2,570	2,529	2,730
Provisions	297	420	514	550	593
Debt funds	2,827	2,039	1,239	439	239
Other liabilities	1,873	2,053	1,943	1,833	1,723
Equity capital	1,241	1,241	1,241	1,241	1,241
Reserves & surplus	18,619	30,149	33,616	36,810	40,229
Shareholders' fund	19,860	31,390	34,857	38,051	41,470
Total liab. and equities	28,913	42,939	43,754	46,397	50,004
Cash and cash eq.	932	3,363	4,344	4,160	5,800
Accounts receivables	732	1,480	1,028	1,100	1,187
Inventories	8,578	9,188	8,184	9,455	10,108
Other current assets	710	779	1,028	1,209	1,187
Investments	6,607	16,792	16,992	17,692	18,392
Net fixed assets	10,153	10,013	10,575	11,072	11,489
CWIP	73	82	50	50	50
Intangible assets	16	11	11	11	11
Deferred tax assets, net	0	0	0	0	0
Other assets	1,113	1,233	1,542	1,649	1,780
Total assets	28,913	42,939	43,754	46,397	50,004

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	1,057	9,209	5,745	4,677	5,977
Capital expenditures	(603)	(647)	(1,469)	(1,500)	(1,500)
Change in investments	0	0	0	0	0
Other investing cash flows	942	(5,859)	(200)	(700)	(700)
Cash flow from investing	340	(6,507)	(1,669)	(2,200)	(2,200)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	1,921	(788)	(800)	(800)	(200)
Interest expenses	(119)	(73)	(82)	(59)	(41)
Dividends paid	(2,873)	(42)	(2,837)	(2,613)	(2,798)
Other financing cash flows	315	632	624	810	902
Cash flow from financing	(756)	(271)	(3,095)	(2,661)	(2,136)
Chg in cash & cash eq.	641	2,431	981	(184)	1,641
Closing cash & cash eq.	932	3,363	4,344	4,160	5,800

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	1.1	11.9	10.2	9.4	10.0
Adjusted EPS	1.1	11.9	10.2	9.4	10.0
Dividend per share	2.0	4.0	3.8	3.5	3.8
Book value per share	6.4	50.6	56.2	61.3	66.8

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	4.6	3.9	3.6	3.2	2.9
EV/EBITDA	30.3	13.8	15.2	16.3	15.1
Adjusted P/E	205.3	18.5	21.7	23.5	22.0
P/BV	34.4	4.4	3.9	3.6	3.3

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	84.8	75.6	76.2	77.3	77.6
Interest burden (PBT/EBIT)	104.8	107.1	105.1	108.3	108.5
EBIT margin (EBIT/Revenue)	12.5	26.3	21.0	17.3	17.0
Asset turnover (Rev./Avg TA)	95.9	96.4	86.6	89.0	89.9
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.3	1.2	1.2
Adjusted ROAE	14.6	28.8	19.0	15.9	15.6

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	(3.4)	16.0	8.4	7.0	7.9
EBITDA	(25.9)	120.8	(11.0)	(9.9)	6.6
Adjusted EPS	(13.8)	1009.0	(14.5)	(7.9)	7.1
Profitability & Return ratios (%)					
EBITDA margin	15.0	28.6	23.5	19.8	19.5
EBIT margin	12.5	26.3	21.0	17.3	17.0
Adjusted profit margin	11.1	21.3	16.8	14.5	14.4
Adjusted ROAE	14.6	28.8	19.0	15.9	15.6
ROCE	15.2	32.5	22.6	18.6	18.4
Working capital days (days)					
Receivables	9	12	12	10	10
Inventory	139	168	149	132	135
Payables	37	46	42	32	33
Ratios (x)					
Gross asset turnover	1.3	1.5	1.5	1.5	1.6
Current ratio	1.5	1.6	2.1	2.4	2.7
Net interest coverage ratio	31.4	125.4	96.1	118.2	181.8
Adjusted debt/equity	0.1	0.0	(0.1)	(0.1)	(0.1)

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

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

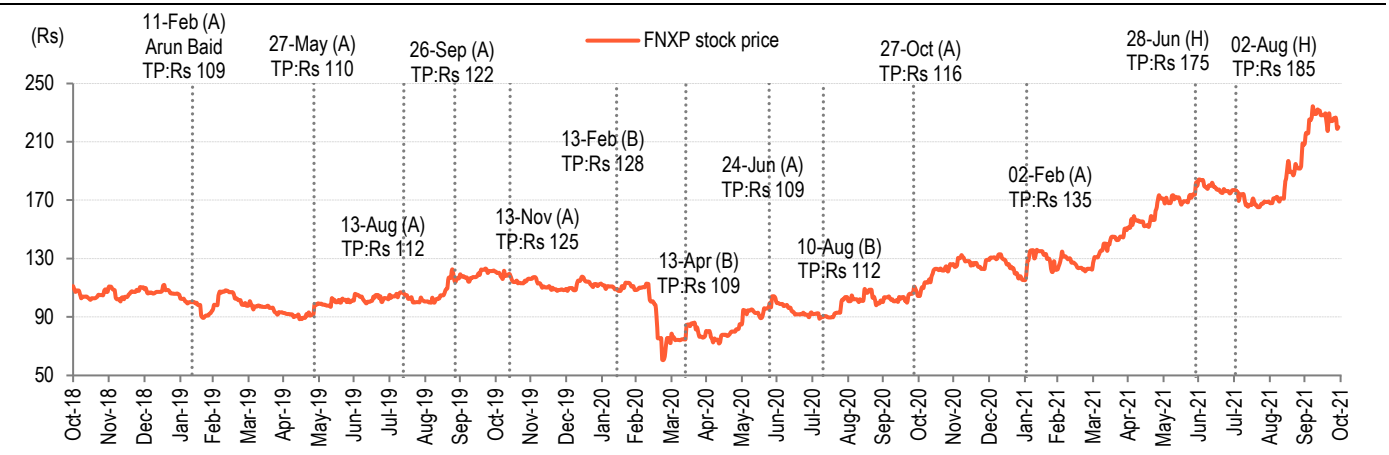
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): FINOLEX INDUSTRIES (FNPX IN)



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

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