

**BUY**

TP: Rs 640 | ▲ 17%

**FINOLEX INDUSTRIES**

Plastic Products

13 February 2020

## Better PVC-EDC delta aids profitability – upgrade to BUY

Finolex Industries' (FNXP) revenue declined 8% YoY, with an 11% drop in PVC pipe and resin volumes. EBITDA margins expanded 140bps YoY to 19.8% mainly due to 335bps higher PVC resin margins, following a ~10% rise in the PVC-EDC delta. Management expects stronger pipe demand in Q4 due to a good crop, and has guided for double-digit growth in FY21. We roll forward to a Mar'21 TP of Rs 640 (earlier Rs 625) and upgrade the stock from ADD to BUY as current valuations of 17x FY22E EPS offer reasonable upside post the recent correction.

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**Extended monsoon dampens revenue:** FNXP's Q3 revenue decreased 8% YoY to Rs 7bn. The PVC resin segment declined 16% YoY with both volumes/realisations slipping 11%/5% YoY. Revenue from PVC pipes & fittings also slipped 6% YoY, with volumes down 11% whereas realisations increased 5%. Pipe volumes were dampened by the extended monsoons during the quarter.

Management expects increased pipe demand in Q4 due to a good crop season, followed by double-digit growth in FY21.

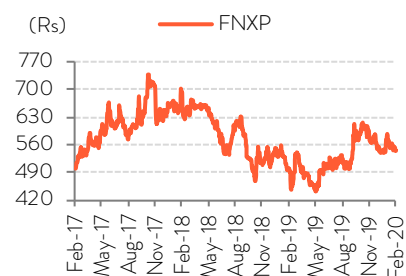
**Higher PVC-EDC delta aids margins:** Operating margins expanded 140bps YoY to 19.8% as raw material cost declined 360bps whereas employee cost/other expenses increased by 60bps/160bps – resulting in flat EBITDA YoY. The PVC resin segment saw EBIT margins rise 335bps YoY due to softening ethylene di-chloride (EDC) prices, which led to a ~10% YoY increase in PVC-EDC delta to US\$ 589/mt (albeit down to US\$ 565/mt currently in February).

**Upgrade to BUY:** We broadly maintain earnings estimates and roll over to a Mar'21 TP of Rs 640, set at an unchanged 20x one-year forward P/E. The stock has corrected ~10% since Nov'19 and offers reasonable upside potential at current valuations of 16.8x FY22E EPS, leading us to upgrade our rating from ADD to BUY.

Ticker/Price	FNXP IN/Rs 546
Market cap	US\$ 949.5mn
Shares o/s	124mn
3M ADV	US\$ 0.2mn
52wk high/low	Rs 627/Rs 437
Promoter/FPI/DII	52%/2%/45%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	27,378	30,913	32,859	35,633	38,856
EBITDA (Rs mn)	4,839	6,043	5,067	5,337	5,724
Adj. net profit (Rs mn)	2,993	3,857	3,556	3,735	4,037
Adj. EPS (Rs)	24.1	31.1	28.7	30.1	32.5
Adj. EPS growth (%)	(15.7)	28.9	(7.8)	5.0	8.1
Adj. ROAE (%)	11.7	14.4	13.4	13.4	13.7
Adj. P/E (x)	22.6	17.6	19.0	18.1	16.8
EV/EBITDA (x)	14.1	11.3	13.2	12.1	11.0

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)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
<b>Net sales</b>	<b>6,994</b>	<b>7,566</b>	<b>(7.6)</b>	<b>5,767</b>	<b>21.3</b>	<b>22,199</b>	<b>21,271</b>	<b>4.4</b>
COGS	4,252	4,875	(12.8)	3,497	21.6	14,417	12,790	12.7
Employee expenses	336	319	5.4	338	(0.7)	1,018	933	9.2
Other expenses	1,021	983	3.9	1,112	(8.1)	3,323	2,970	11.9
<b>EBITDA</b>	<b>1,384</b>	<b>1,389</b>	<b>(0.4)</b>	<b>820</b>	<b>68.8</b>	<b>3,440</b>	<b>4,578</b>	<b>(24.9)</b>
EBITDA margin (%)	19.8	18.4	143bps	14.2	557bps	15.5	21.5	(603bps)
Depreciation & amortisation	188	196	(4.4)	194	(3.3)	549	524	4.8
<b>EBIT</b>	<b>1,197</b>	<b>1,193</b>	<b>0.3</b>	<b>626</b>	<b>91.2</b>	<b>2,891</b>	<b>4,054</b>	<b>(28.7)</b>
EBIT margin (%)	17.1	15.8	134bps	10.9	625bps	13.0	19.1	(604bps)
Other income	67	33	102.7	174	(61.4)	299	293	1.8
Finance costs	18	17	3.5	2	669.6	29	99	(71.0)
Exceptional items	-	-	NA	-	NA	-	(279)	(100.0)
<b>Profit before tax</b>	<b>1,246</b>	<b>1,209</b>	<b>3.1</b>	<b>798</b>	<b>56.2</b>	<b>3,161</b>	<b>3,969</b>	<b>(20.4)</b>
Tax expenses	313	422	(25.8)	(229)	(236.8)	476	1,385	(65.7)
<b>Reported Net profit</b>	<b>933</b>	<b>787</b>	<b>18.5</b>	<b>1,027</b>	<b>(9.1)</b>	<b>2,685</b>	<b>2,584</b>	<b>3.9</b>
<b>Adjusted Net Profit</b>	<b>933</b>	<b>787.19</b>	<b>18.5</b>	<b>1,027</b>	<b>(9.1)</b>	<b>2,685</b>	<b>2,766</b>	<b>(2.9)</b>

Source: Company, BOBCAPS Research

**FIG 2 – STANDALONE SEGMENTAL PERFORMANCE**

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
<b>Revenue</b>								
PVC	4,080	4,840	(15.7)	3,027	34.8	12,456	13,148	(5.3)
PVC pipes & fittings	5,535	5,906	(6.3)	5,170	7.1	19,218	17,837	7.7
<b>Total</b>	<b>9,615</b>	<b>10,747</b>	<b>(10.5)</b>	<b>8,197</b>	<b>17.3</b>	<b>31,673</b>	<b>30,985</b>	<b>2.2</b>
Inter-segment revenues	2,621	3,180	(17.6)	2430.2	7.9	9,475	9,714	(2.5)
Net sales (inc. other op. inc.)	6,994	7,566	(7.6)	5,767	21.3	22,199	21,271	4.4
<b>EBIT</b>								
PVC	818	809	1.2	451.3	81.3	1,683	2,962	(43.2)
PVC pipes & fittings	436	438	(0.5)	238.4	82.7	1,398	1,217	14.9
<b>Total</b>	<b>1,254</b>	<b>1,247</b>	<b>0.6</b>	<b>690</b>	<b>81.8</b>	<b>3,080</b>	<b>4,179</b>	<b>(26.3)</b>
<b>EBIT Margins (%)</b>								
PVC	20.1	16.7	334bps	14.9	514bps	13.5	22.5	(248bps)
PVC pipes & fittings	7.9	7.4	45bps	4.6	326bps	7.3	6.8	105bps
<b>Total</b>	<b>17.9</b>	<b>16.5</b>	<b>145bps</b>	<b>12.0</b>	<b>597bps</b>	<b>13.9</b>	<b>19.6</b>	<b>(172bps)</b>

Source: Company, BOBCAPS Research

**FIG 3 – CONSOLIDATED QUARTERLY PERFORMANCE**

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
<b>Net sales</b>	<b>6,994</b>	<b>7,566</b>	<b>(7.6)</b>	<b>5,767</b>	<b>21.3</b>	<b>22,199</b>	<b>21,271</b>	<b>4.4</b>
COGS	4,252	4,875	(12.8)	3,497	21.6	14,417	12,790	12.7
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<b>EBITDA</b>	<b>1,384</b>	<b>1,389</b>	<b>(0.4)</b>	<b>820</b>	<b>68.8</b>	<b>3,440</b>	<b>4,578</b>	<b>(24.9)</b>
EBITDA margin (%)	19.8	18.4	143bps	14.2	557bps	15.5	21.5	(603bps)
Depreciation & amortisation	188	196	(4.4)	194	(3.3)	549	524	4.8
<b>EBIT</b>	<b>1,197</b>	<b>1,193</b>	<b>0.3</b>	<b>626</b>	<b>91.2</b>	<b>2,891</b>	<b>4,054</b>	<b>(28.7)</b>
EBIT margin (%)	17.1	15.8	134bps	10.9	625bps	13.0	19.1	(604bps)
Other income	67	22	211.6	165	(59.2)	289	282	2.7
Finance costs	18	17	3.5	2	669.6	29	99	(71.0)
Exceptional items	-	-	NA	-	NA	-	(279)	(100.0)
<b>Profit before tax</b>	<b>1,246</b>	<b>1,198</b>	<b>4.1</b>	<b>789</b>	<b>58.0</b>	<b>3,151</b>	<b>3,958</b>	<b>(20.4)</b>
Tax expenses	341	452	(24.5)	(193)	(276.5)	551	1,359	(59.5)
Share of profit from associates	80	52	54.3	41	97.5	140	100	39.7
<b>Reported Net profit</b>	<b>985</b>	<b>798</b>	<b>23.5</b>	<b>1,023</b>	<b>(3.7)</b>	<b>2,740</b>	<b>2,699</b>	<b>1.5</b>
<b>Adjusted Net Profit</b>	<b>985</b>	<b>798</b>	<b>23.5</b>	<b>1,023</b>	<b>(3.7)</b>	<b>2,740</b>	<b>2,893</b>	<b>(5.3)</b>

Source: Company, BOBCAPS Research

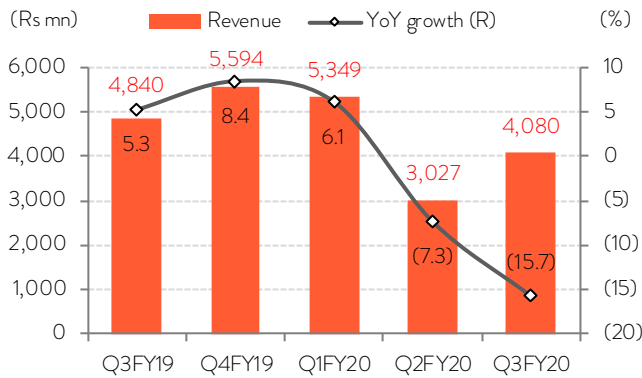
**FIG 4 – QUARTERLY VOLUMES & REALISATION**

Particulars	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
<b>Volume</b>								
PVC (MT)	59,154	66,838	(11.5)	41,422	42.8	1,79,088	1,78,753	0.2
PVC pipes (MT)	52,815	59,179	(10.8)	48,024	10.0	1,92,494	1,82,087	5.7
<b>Realisation</b>								
PVC (Rs/t)	68,978	72,418	(4.8)	73,065	(5.6)	69,551	73,553	(5.4)
PVC pipes (Rs/t)	1,04,802	99,802	5.0	1,07,663	(2.7)	99,835	97,957	1.9
<b>EBIT/tonne</b>								
PVC (Rs/t)	13,832	12,101	14.3	10,895	27.0	9,395	16,572	(43.3)
PVC pipes (Rs/t)	8,248	7,401	11.4	4,964	66.1	7,260	6,681	8.7

Source: Company, BOBCAPS Research

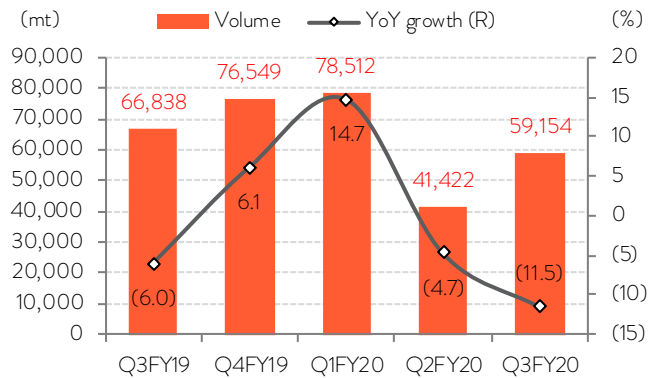
**STANDALONE QUARTERLY TRENDS**

**FIG 5 – PVC RESIN REVENUE GROWTH**



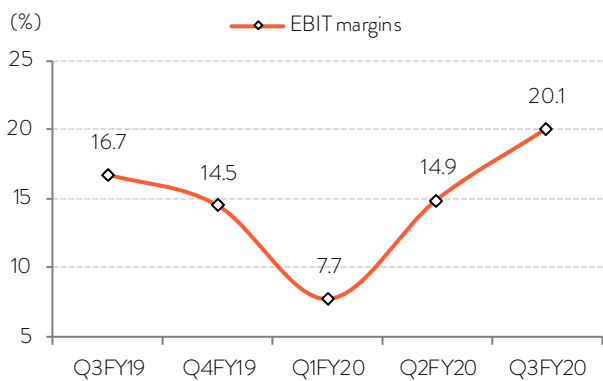
Source: Company, BOBCAPS Research

**FIG 6 – PVC RESIN VOLUME GROWTH**



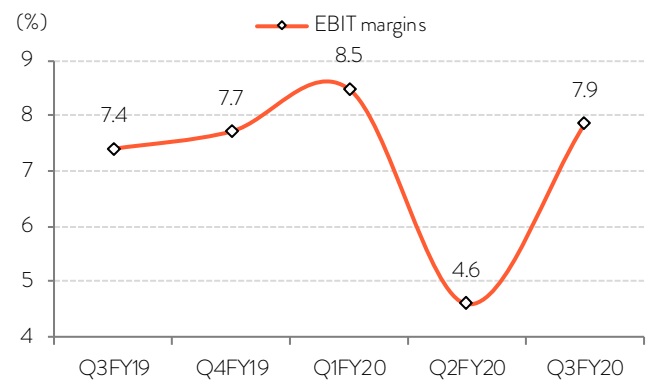
Source: Company, BOBCAPS Research

**FIG 7 – PVC RESIN EBIT MARGINS**



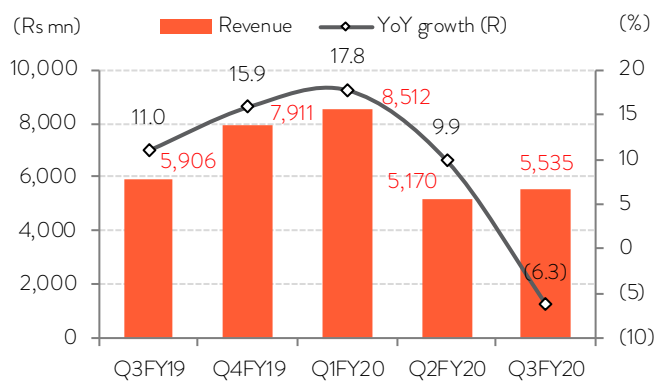
Source: Company, BOBCAPS Research

**FIG 8 – PVC PIPES & FITTINGS EBIT MARGINS**



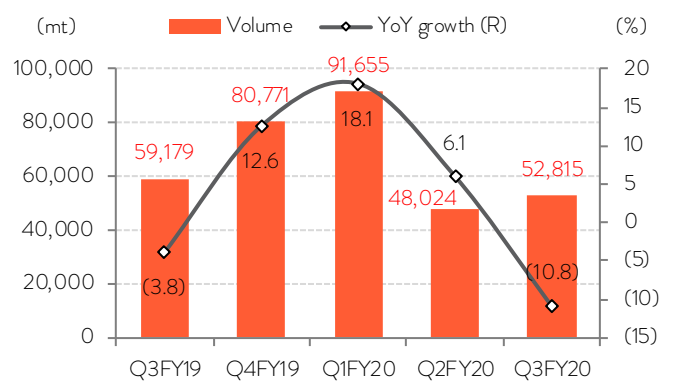
Source: Company, BOBCAPS Research

**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	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
Spread (US\$/MT)	785	688	641	535	523	490	583	589

Source: Company, BOBCAPS Research

## Earnings call highlights

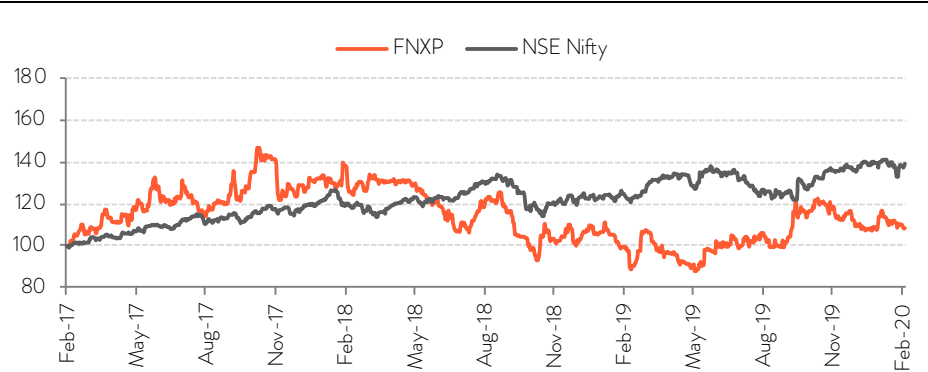
- Q3FY20 was affected by heavy rains in the company's major markets, dampening volume growth in PVC pipes & fittings.
- FNXP's agriculture pipe revenues declined by 11.8% YoY in the quarter but non-agriculture pipes grew ~15%.
- The company has ~15% market share in the agri-pipe segment.
- A fall in EDC prices and relatively higher PVC prices aided a better PVC-EDC delta during the quarter. The average delta in Q3 stood at US\$ 589/mn tonnes (mt), up 10% YoY.
- The PVC-EDC delta is currently at ~US\$ 565/mt and if these levels sustain, Q4 margins for the PVC resin segment will be adversely affected.
- CPVC volume sales increased by 9.1% YoY to 2,489tonnnes in Q3.
- FNXP earns better margins on CPVC pipes than agriculture pipes.
- Management has guided for double-digit growth in pipes in FY21, with 15-20% growth in non-agri pipes.
- The company has a Rs 1-1.5bn capex plan for the pipe segment in FY21.

## 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 Mar'21 target price of Rs 640 (earlier Rs 625), set at an unchanged 20x one-year forward P/E multiple – in line with the five-year average. The stock has corrected ~10% since Nov'19 and offers reasonable upside potential at current valuations of 16.8x FY22E EPS, leading us to upgrade our rating from ADD to BUY.

**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>32,859</b>	<b>35,633</b>	<b>38,856</b>
EBITDA	4,839	6,043	5,067	5,337	5,724
Depreciation	(606)	(701)	(739)	(784)	(816)
EBIT	4,233	5,342	4,328	4,554	4,908
Net interest income/(expenses)	(98)	(123)	(81)	(85)	(57)
Other income/(expenses)	202	404	383	391	395
Exceptional items	0	0	0	0	0
EBT	4,379	5,624	4,630	4,860	5,246
Income taxes	(1,588)	(1,812)	(1,224)	(1,285)	(1,389)
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>3,556</b>	<b>3,735</b>	<b>4,037</b>
Adjustments	(70)	184	0	0	0
<b>Adjusted net profit</b>	<b>2,993</b>	<b>3,857</b>	<b>3,556</b>	<b>3,735</b>	<b>4,037</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	2,505	2,838	3,117	3,392	3,713
Other current liabilities	1,385	1,411	1,411	1,411	1,411
Provisions	14	0	2,134	2,241	2,422
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	25,944	27,437	29,052
Shareholders' fund	27,951	25,762	27,184	28,678	30,293
<b>Total liabilities and equities</b>	<b>35,060</b>	<b>33,327</b>	<b>36,852</b>	<b>38,419</b>	<b>40,225</b>
Cash and cash eq.	68	291	1,128	580	575
Accounts receivables	431	743	810	879	958
Inventories	6,116	6,205	7,132	7,763	8,496
Other current assets	810	1,035	1,080	1,172	1,277
Investments	16,068	13,619	15,819	16,419	16,619
Net fixed assets	8,842	9,509	9,770	10,486	11,170
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	1,129
<b>Total assets</b>	<b>35,060</b>	<b>33,327</b>	<b>36,852</b>	<b>38,419</b>	<b>40,225</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	5,369	5,644	6,062
Interest expenses	98	123	81	85	57
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(436)	(280)	(762)	(515)	(598)
Other operating cash flows	(1,861)	(2,425)	(1,606)	(1,676)	(1,784)
<b>Cash flow from operations</b>	<b>2,895</b>	<b>3,463</b>	<b>3,082</b>	<b>3,538</b>	<b>3,736</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)	(1,817)	(209)	195
<b>Cash flow from investing</b>	<b>(1,388)</b>	<b>(2,971)</b>	<b>(1,915)</b>	<b>(1,709)</b>	<b>(1,305)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	65	(101)	(200)	(200)	(200)
Interest expenses	(98)	(123)	(81)	(85)	(57)
Dividends paid	(1,718)	(1,532)	(2,134)	(2,241)	(2,422)
Other financing cash flows	257	1,487	2,084	150	242
<b>Cash flow from financing</b>	<b>(1,494)</b>	<b>(269)</b>	<b>(330)</b>	<b>(2,376)</b>	<b>(2,437)</b>
<b>Changes in cash and cash eq.</b>	<b>13</b>	<b>223</b>	<b>837</b>	<b>(547)</b>	<b>(5)</b>
<b>Closing cash and cash eq.</b>	<b>68</b>	<b>291</b>	<b>1,128</b>	<b>580</b>	<b>575</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	24.7	29.6	28.7	30.1	32.5
Adjusted EPS	24.1	31.1	28.7	30.1	32.5
Dividend per share	11.5	10.0	13.8	14.4	15.6
Book value per share	225.2	207.6	219.1	231.1	244.1

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.5	2.2	2.0	1.8	1.6
EV/EBITDA	14.1	11.3	13.2	12.1	11.0
Adjusted P/E	22.6	17.6	19.0	18.1	16.8
P/BV	2.4	2.6	2.5	2.4	2.2

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	68.3	68.6	76.8	76.8	77.0
Interest burden (PBT/EBIT)	103.4	105.3	107.0	106.7	106.9
EBIT margin (EBIT/Revenue)	15.5	17.3	13.2	12.8	12.6
Asset turnover (Revenue/Avg TA)	84.2	90.4	93.6	94.7	98.8
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.3	1.3	1.3
Adjusted ROAE	11.7	14.4	13.4	13.4	13.7

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	6.3	8.4	9.0
EBITDA	(14.1)	24.9	(16.1)	5.3	7.2
Adjusted EPS	(15.7)	28.9	(7.8)	5.0	8.1
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	17.7	19.5	15.4	15.0	14.7
EBIT margin	15.5	17.3	13.2	12.8	12.6
Adjusted profit margin	10.9	12.5	10.8	10.5	10.4
Adjusted ROAE	11.7	14.4	13.4	13.4	13.7
ROCE	16.0	19.2	15.9	16.0	16.4
<b>Working capital days (days)</b>					
Receivables	6	7	9	9	9
Inventory	121	117	111	114	114
Payables	39	39	39	39	39
<b>Ratios (x)</b>					
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	53.7	53.7	86.4
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%

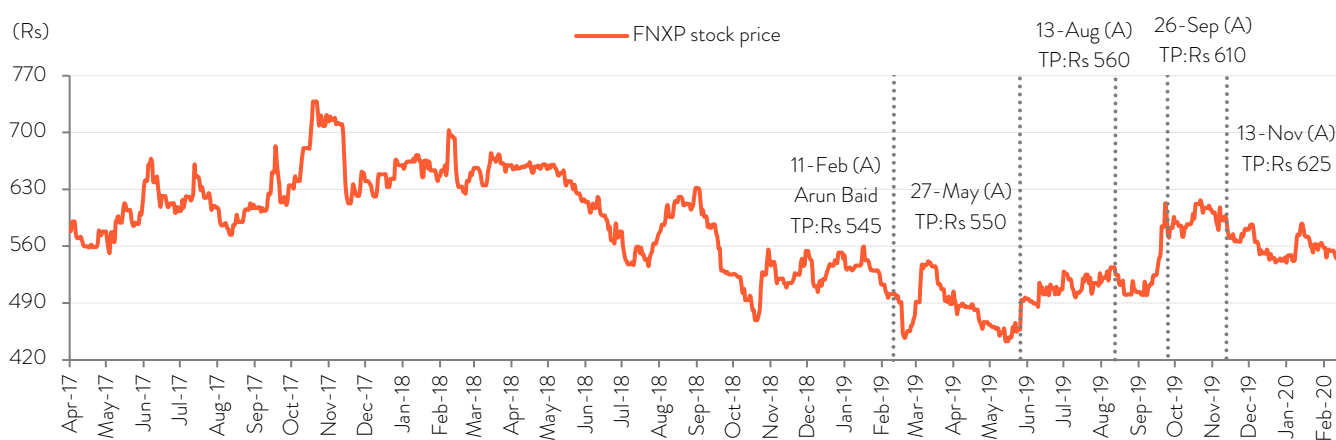
**ADD** – Expected return from >+5% to +15%

**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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