

ADD

TP: Rs 545 | ▲ 9%

FINOLEX INDUSTRIES

Plastic Products

24 June 2020

Lockdown dents performance – cut to ADD

Finolex Industries' (FNPX) Q4 revenue declined 21% YoY, with a 23%/22% drop in PVC pipe/resin volumes due to the lockdown. EBITDA margins shrank 160bps YoY to 13.6% owing to negative operating leverage on lower volume sales, inducing EBITDA/PAT declines of 29%/39%. Management pointed to stronger demand for agri pipes after easing of the lockdown, though labour availability remains an issue. We broadly maintain estimates and retain our Mar'21 TP of Rs 545, but downgrade the stock from BUY to ADD on limited upside.

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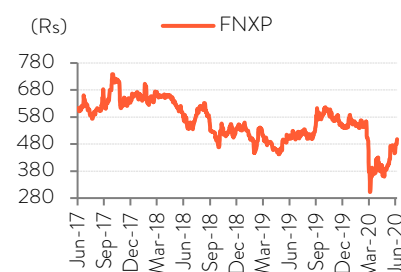
Lockdown impacts volumes: FNPX's Q4FY20 standalone revenue decreased 21% YoY to Rs 7.7bn. The PVC resin segment declined 23% YoY with both volumes/realisations slipping 22%/1% YoY. Revenue from PVC pipes & fittings also dropped 20% YoY, with volumes down 23% whereas realisations increased 3%. Management stated that the Covid-19 lockdown has severely affected agricultural pipe volumes during the peak season (March to June). Demand has improved post easing of restrictions and could sustain in H2 given a normal monsoon forecast and good reservoir levels.

Ticker/Price	FNPX IN/Rs 498
Market cap	US\$ 816.9mn
Shares o/s	124mn
3M ADV	US\$ 0.3mn
52wk high/low	Rs 627/Rs 290
Promoter/FPI/DII	52%/2%/45%

Source: NSE

Margins contract: Despite higher gross margins (+120bps YoY), operating margins declined 160bps YoY to 13.6% due to negative operating leverage on account of lower volumes sold in the quarter – standalone EBITDA/PAT thus declined 29%/39% YoY. The PVC-EDC delta in Q4 was up 9.8% YoY at US\$ 574/mt and is currently at US\$ 640/mt, but FNPX will be unable to capture the benefit in the near term due to high-cost inventory carried over from Q4.

STOCK PERFORMANCE



Source: NSE

Downgrade to ADD: FNPX faces near-term demand headwinds due to the lockdown and we expect recovery only from Q4FY21. We keep our earnings estimates and target price of Rs 545 unchanged, but cut our rating from BUY to ADD as upsides look capped at current valuations of 18.4x FY22E EPS.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	27,378	30,913	29,860	26,456	31,225
EBITDA (Rs mn)	4,839	6,043	4,481	4,403	4,754
Adj. net profit (Rs mn)	2,993	3,857	3,327	3,075	3,358
Adj. EPS (Rs)	24.1	31.1	26.8	24.8	27.1
Adj. EPS growth (%)	(15.7)	28.9	(13.8)	(7.5)	9.2
Adj. ROAE (%)	11.7	14.4	14.6	14.9	14.9
Adj. P/E (x)	20.6	16.0	18.6	20.1	18.4
EV/EBITDA (x)	12.8	10.3	13.6	13.9	12.8

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)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
Net sales	7,661	9,642	(20.5)	6,994	9.5	29,860	30,913	(3.4)
COGS	5,009	6,419	(22.0)	4,252	17.8	19,427	19,209	1.1
Employee expenses	408	382	6.6	336	21.3	1,456	1,344	8.3
Other expenses	1,203	1,376	(12.5)	1,021	17.8	4,497	4,317	4.2
EBITDA	1,041	1,465	(29.0)	1,384	(24.8)	4,481	6,043	(25.9)
EBITDA margin (%)	13.6	15.2	(161bps)	19.8	(621bps)	15.0	19.5	(454bps)
Depreciation & amortisation	189	177	6.8	188	0.6	738	701	5.3
EBIT	852	1,288	(33.9)	1,197	(28.8)	3,743	5,342	(29.9)
EBIT margin (%)	11.1	13.4	(224bps)	17.1	(599bps)	12.5	17.3	(475bps)
Other income	10	122	(92.0)	67	(85.4)	308	416	(25.8)
Finance costs	90	24	283.3	18	410.2	119	123	(3.0)
Exceptional items	-	-	NA	-	NA	-	(279)	NA
Profit before tax	771	1,387	(44.4)	1,246	(38.1)	3,932	5,356	(26.6)
Tax expenses	214	473	(54.7)	313	(31.6)	690	1,858	(62.9)
Reported Net profit	557	914	(39.0)	933	(40.3)	3,242	3,498	(7.3)

Source: Company, BOBCAPS Research

FIG 2 – STANDALONE SEGMENTAL PERFORMANCE

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
Revenue								
PVC	4,336	5,594	(22.5)	4,080	6.3	16,792	18,742	(10.4)
PVC pipes & fittings	6,322	7,911	(20.1)	5,535	14.2	25,540	25,748	(0.8)
Total	10,658	13,505	(21.1)	9,615	10.8	42,331	44,490	(4.9)
Inter-segment revenues	2,997	3,863	(22.4)	2621.4	14.3	12,471	13,577	(8.1)
Net sales	7,661	9,642	(20.5)	6,994	9.5	29,860	30,913	(3.4)
EBIT								
PVC	315	810	(61.1)	818.2	(61.5)	1,998	3,773	(47.0)
PVC pipes & fittings	629	612	2.9	435.6	44.4	2,027	1,828	10.9
Total	944	1,422	(33.6)	1,254	(24.7)	4,025	5,601	(28.1)
EBIT margin								
PVC	7.3	14.5	(722bps)	20.1	(1,278bps)	11.9	20.1	(1,286bps)
PVC pipes & fittings	10.0	7.7	222bps	7.9	208bps	7.9	7.1	285bps
Total	12.3	14.7	(242bps)	17.9	(560bps)	13.5	18.1	(579bps)

Source: Company, BOBCAPS Research

FIG 3 – CONSOLIDATED QUARTERLY PERFORMANCE

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
Net sales	7,661	9,642	(20.5)	6,994	9.5	29,860	21,271	40.4
COGS	5,009	6,419	(22.0)	4,252	17.8	19,427	12,790	51.9
Employee expenses	408	382	6.6	336	21.3	1,456	933	56.0
Other expenses	1,203	1,376	(12.5)	1,021	17.8	4,497	2,970	51.4
EBITDA	1,041	1,465	(29.0)	1,384	(24.8)	4,481	4,578	(2.1)
EBITDA margin (%)	13.6	15.2	(161bps)	19.8	(621bps)	15.0	21.5	(652bps)
Depreciation & amortisation	189	177	6.8	188	0.6	738	524	40.9
EBIT	852	1,288	(33.9)	1,197	(28.8)	3,743	4,054	(7.7)
EBIT margin (%)	11.1	13.4	(224bps)	17.1	(599bps)	12.5	19.1	(653bps)
Other income	10	122	(92.0)	67	(85.4)	299	282	6.2
Finance costs	90	24	283.3	18	410.2	119	99	20.1
Exceptional items	-	-	NA	-	NA	-	(279)	NA
Profit before tax	771	1,387	(44.4)	1,246	(38.1)	3,923	3,958	(0.9)
Tax expenses	301	453	(33.7)	341	(11.9)	852	1,359	(37.3)
Share of profit from associates	116	40	188.6	80	44.3	256	100	155.9
Reported Net profit	587	974	(39.8)	985	(40.5)	3,327	2,699	23.3

Source: Company, BOBCAPS Research

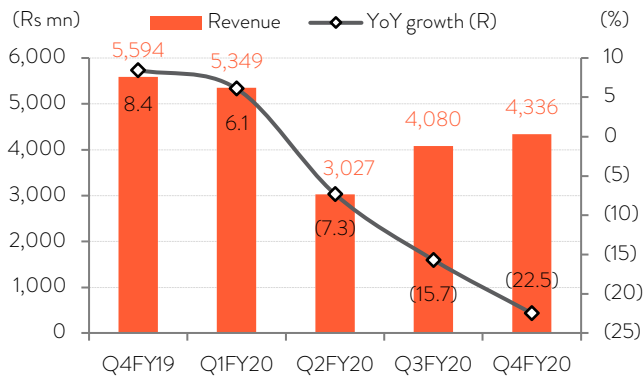
FIG 4 – VOLUME AND REALISATION TREND

Particulars	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
Volume								
PVC (MT)	60,100	76,549	(21.5)	59,154	1.6	2,39,188	2,55,302	(6.3)
PVC pipes (MT)	62,464	80,771	(22.7)	52,815	18.3	2,54,958	2,62,858	(3.0)
Realisation								
PVC (Rs/t)	72,146	73,076	(1.3)	68,978	4.6	70,203	73,410	(4.4)
PVC pipes (Rs/t)	1,01,209	97,946	3.3	1,04,802	(3.4)	1,00,171	97,954	2.3
EBIT/tonne								
PVC (Rs/t)	5,246	10,587	(50.4)	13,832	(62.1)	8,353	14,778	(43.5)
PVC pipes (Rs/t)	10,071	7,572	33.0	8,248	22.1	7,950	6,955	14.3

Source: Company, BOBCAPS Research

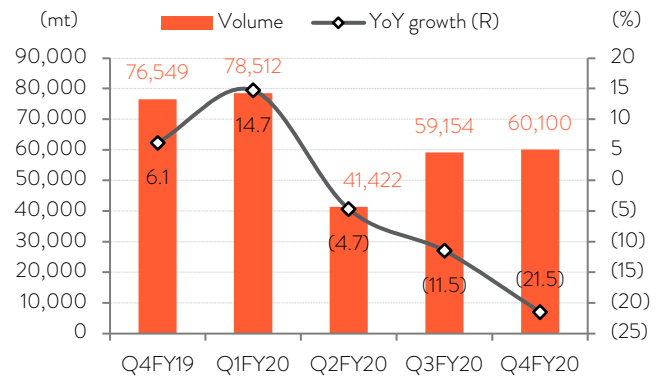
STANDALONE QUARTERLY TRENDS

FIG 5 – PVC RESIN REVENUE GROWTH



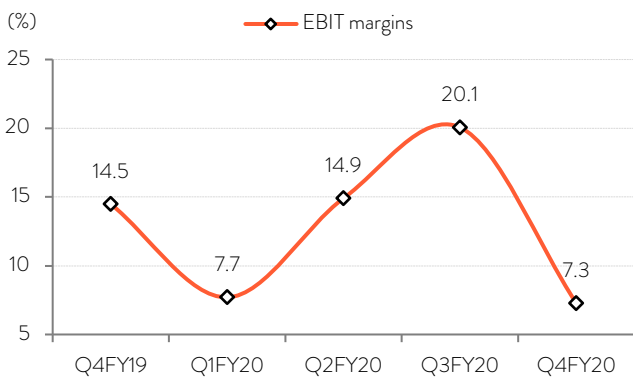
Source: Company, BOBCAPS Research

FIG 6 – PVC RESIN VOLUME GROWTH



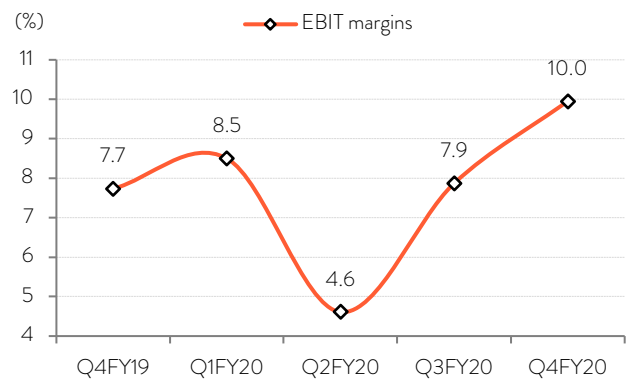
Source: Company, BOBCAPS Research

FIG 7 – PVC RESIN EBIT MARGINS



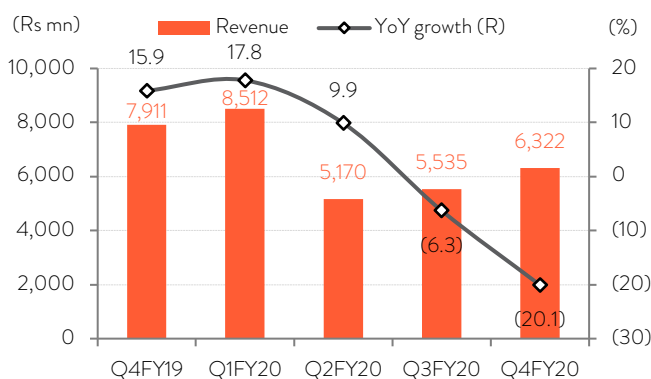
Source: Company, BOBCAPS Research

FIG 8 – PVC PIPES & FITTINGS EBIT MARGINS



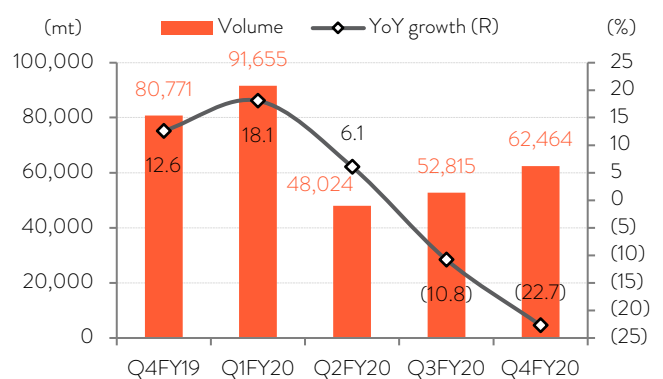
Source: Company, BOBCAPS Research

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
Spread (US\$/mt)	523	490	583	589	574
YoY (%)	(33.4)	(28.8)	(9.0)	10.1	9.8

Source: Company, BOBCAPS Research

Earnings call highlights

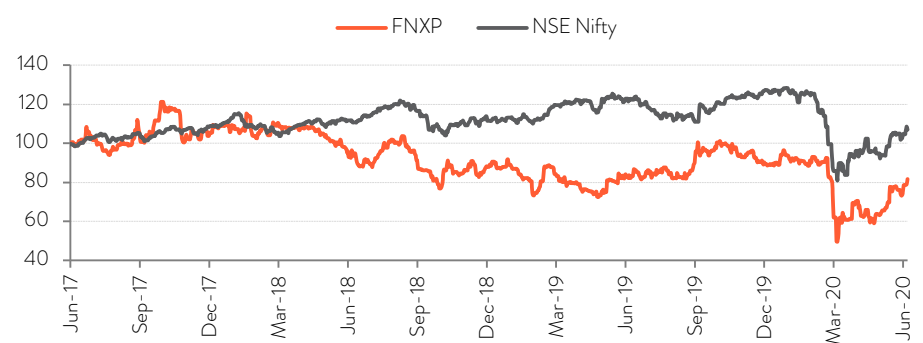
- FNXP's Q4FY20 performance was severely affected by the lockdown which coincided with the peak season for agricultural pipe sales (March to June). The company earns ~70% of revenues from the agri pipe sector and the balance from the non-agriculture sector.
- Demand for agricultural pipes has rebounded post-Q4 on easing of lockdown restrictions. Nonetheless, issues such as unavailability of unskilled labour continue to hamper operations.
- Management believes demand for agricultural pipes will remain robust due to good water availability in reservoirs and expectations of a normal monsoon. Government support for the rural sector including liquidity measures has also boosted demand.
- The pandemic continues to cloud the outlook on non-agriculture pipe sales.
- As per management, some unorganised players will encounter operational issues due to stretched balance sheets, which will benefit FNXP.
- In FY20, the company's agricultural pipe revenues declined 3% YoY but non-agri pipes grew ~9%.
- In Q4, pipe segment margins increased to 10% and the company aims to maintain this level going forward.
- A high-cost raw material (EDC/VCM) inventory will result in lower margins in Q1 and to some extent Q2FY21 despite higher PVC prices.
- FNXP follows a cash-&-carry model in agricultural pipes; it does offer some credit in the non-agri space.
- The company had short term debt of ~Rs 2.8bn as of Mar'20 but expects to be debt-free by end-Jun'20.
- Capex will be kept to a minimum in FY21 until a clearer picture on demand emerges.
- The company has 2,000 SKUs and 18,000 dealers and sub-dealers as of FY20. In order to support its dealers in these tough times, FNXP has given them incentives despite non-achievement of targets.

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.

However, FNXP faces near-term demand headwinds due to the lockdown and we expect recovery only from Q4FY21. The stock is currently trading at 18.4x FY22E EPS. We maintain our earnings estimates and Mar'21 target price of Rs 545 which is set at an unchanged 20x one-year forward P/E multiple, but cut our rating from BUY to ADD as upsides look capped.

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	FY20P	FY21E	FY22E
Total revenue	27,378	30,913	29,860	26,456	31,225
EBITDA	4,839	6,043	4,481	4,403	4,754
Depreciation	(606)	(701)	(738)	(767)	(796)
EBIT	4,233	5,342	3,743	3,635	3,958
Net interest income/(expenses)	(98)	(123)	(119)	(113)	(58)
Other income/(expenses)	202	404	299	200	307
Exceptional items	0	0	0	0	0
EBT	4,379	5,624	3,923	3,723	4,207
Income taxes	(1,588)	(1,812)	(852)	(867)	(1,119)
Extraordinary items	109	(279)	0	0	0
Min. int./Inc. from associates	163	140	256	220	270
Reported net profit	3,063	3,672	3,327	3,075	3,358
Adjustments	(70)	184	0	0	0
Adjusted net profit	2,993	3,857	3,327	3,075	3,358

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	2,505	2,838	2,334	2,021	2,506
Other current liabilities	1,385	1,387	1,723	1,160	1,369
Provisions	149	230	297	217	342
Debt funds	1,007	906	2,827	927	727
Other liabilities	2,064	2,205	1,873	1,763	1,653
Equity capital	1,241	1,241	1,241	1,241	1,241
Reserves & surplus	26,710	24,521	18,619	20,310	22,157
Shareholders' fund	27,951	25,762	19,860	21,551	23,398
Total liabilities and equities	35,060	33,327	28,913	27,639	29,994
Cash and cash eq.	68	291	932	1,440	2,139
Accounts receivables	431	743	732	725	855
Inventories	6,116	6,205	8,578	6,582	6,777
Other current assets	810	1,035	710	870	1,027
Investments	16,068	13,619	5,772	6,272	6,472
Net fixed assets	8,817	9,489	10,988	10,721	11,425
CWIP	903	902	73	0	0
Intangible assets	26	20	16	16	16
Deferred tax assets, net	0	0	0	0	0
Other assets	1,822	1,023	1,113	1,015	1,283
Total assets	35,060	33,327	28,913	27,639	29,994

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	5,094	6,045	4,661	4,490	5,003
Interest expenses	98	123	119	113	58
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(436)	(209)	(2,295)	1,066	(58)
Other operating cash flows	(1,861)	(2,425)	(1,428)	(1,068)	(1,426)
Cash flow from operations	2,895	3,535	1,057	4,601	3,577
Capital expenditures	(1,500)	(1,366)	(603)	(427)	(1,500)
Change in investments	0	0	0	0	0
Other investing cash flows	111	(1,605)	942	(500)	(200)
Cash flow from investing	(1,388)	(2,971)	340	(927)	(1,700)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	65	(101)	1,921	(1,900)	(200)
Interest expenses	(98)	(123)	(119)	(113)	(58)
Dividends paid	(1,718)	(1,532)	(2,873)	(1,384)	(1,511)
Other financing cash flows	256	1,416	315	230	592
Cash flow from financing	(1,494)	(340)	(756)	(3,166)	(1,177)
Changes in cash and cash eq.	13	223	641	508	700
Closing cash and cash eq.	68	291	932	1,440	2,139

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	24.7	29.6	26.8	24.8	27.1
Adjusted EPS	24.1	31.1	26.8	24.8	27.1
Dividend per share	11.5	10.0	10.0	8.9	9.7
Book value per share	225.2	207.6	160.0	173.7	188.5

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	2.3	2.0	2.0	2.3	2.0
EV/EBITDA	12.8	10.3	13.6	13.9	12.8
Adjusted P/E	20.6	16.0	18.6	20.1	18.4
P/BV	2.2	2.4	3.1	2.9	2.6

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	68.3	68.6	84.8	82.6	79.8
Interest burden (PBT/EBIT)	103.4	105.3	104.8	102.4	106.3
EBIT margin (EBIT/Revenue)	15.5	17.3	12.5	13.7	12.7
Asset turnover (Revenue/Avg TA)	84.2	90.4	95.9	93.6	108.4
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.4	1.4	1.3
Adjusted ROAE	11.7	14.4	14.6	14.9	14.9

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
YoY growth (%)					
Revenue	5.2	12.9	(3.4)	(11.4)	18.0
EBITDA	(14.1)	24.9	(25.9)	(1.7)	8.0
Adjusted EPS	(15.7)	28.9	(13.8)	(7.5)	9.2
Profitability & Return ratios (%)					
EBITDA margin	17.7	19.5	15.0	16.6	15.2
EBIT margin	15.5	17.3	12.5	13.7	12.7
Adjusted profit margin	10.9	12.5	11.1	11.6	10.8
Adjusted ROAE	11.7	14.4	14.6	14.9	14.9
ROCE	16.0	19.2	15.2	16.1	17.0
Working capital days (days)					
Receivables	6	7	9	10	9
Inventory	121	117	139	161	117
Payables	39	39	37	36	31
Ratios (x)					
Gross asset turnover	1.4	1.4	1.3	1.1	1.2
Current ratio	1.5	1.5	1.5	2.2	2.2
Net interest coverage ratio	43.1	43.5	31.4	32.3	68.4
Adjusted debt/equity	0.0	0.0	0.1	0.0	(0.1)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

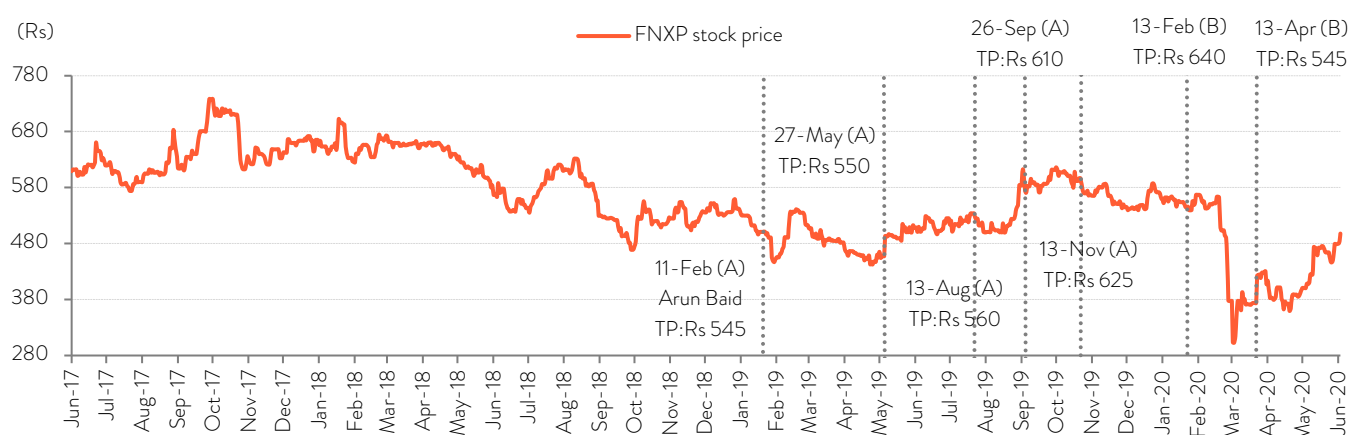
ADD – Expected return from >+5% to +15%

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)

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



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

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As of 31 May 2020, out of 92 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 55 have BUY ratings, 20 have ADD ratings, 9 are rated REDUCE, 7 are rated SELL and 1 is UNDER REVIEW. None of these companies have been investment banking clients in the last 12 months.

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