

## RESEARCH

### Finolex Industries | Target: Rs 545 | +9% | ADD

Lockdown dents performance – cut to ADD

### IT Services

New H1B visa restrictions – anticipated election rhetoric

## SUMMARY

### Finolex Industries

Finolex Industries' (FNXP) 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.

[Click here for the full report.](#)

### IT Services

In a move seen as US election year rhetoric, new H1B visas have been suspended till Dec'20. Existing visa holders are unaffected. In our view, visa suspension will not have significant implications for Indian IT services players as (1) the restrictions are in place only till December, and (2) new or initial H1B applications form less than 3% of the onsite employee base for tier-I players. Over the medium-to-long term, we stay optimistic about the sector's resilience in managing onsite workforce supply.

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## TOP PICKS

### LARGE-CAP IDEAS

Company	Rating	Target
<a href="#">Bajaj Finance</a>	Buy	3,000
<a href="#">Cipla</a>	Buy	690
<a href="#">GAIL</a>	Buy	140
<a href="#">Petronet LNG</a>	Buy	330
<a href="#">Tech Mahindra</a>	Buy	690

### MID-CAP IDEAS

Company	Rating	Target
<a href="#">Alkem Labs</a>	Buy	2,950
<a href="#">Chola Investment</a>	Buy	200
<a href="#">Laurus Labs</a>	Buy	630
<a href="#">Transport Corp</a>	Buy	240
<a href="#">Mahanagar Gas</a>	Sell	710

Source: BOBCAPS Research

### DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.71	0bps	5bps	(127bps)
India 10Y yield (%)	6.03	2bps	28bps	(85bps)
USD/INR	75.65	0.5	0.4	(9.1)
Brent Crude (US\$/bbl)	42.63	(1.0)	21.3	(34.5)
Dow	26,156	0.5	6.9	(1.5)
Shanghai	2,971	0.2	5.6	(0.4)
Sensex	35,430	1.5	15.5	(10.2)
India FII (US\$ mn)	22 Jun	MTD	CYTD	FYTD
FII-D	24.1	(462.3)	(14,517.6)	(4,758.1)
FII-E	56.6	2,722.1	(2,192.5)	4,410.5

Source: Bank of Baroda Economics Research

### BOBCAPS Research

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**ADD**

TP: Rs 545 | ▲ 9%

**FINOLEX INDUSTRIES**

Plastic Products

24 June 2020

## Lockdown dents performance – cut to ADD

**Finolex Industries' (FNXP) 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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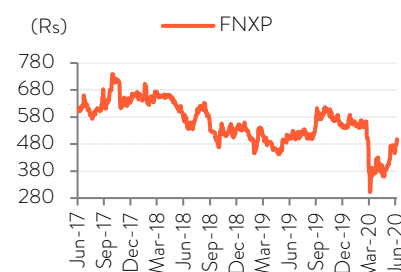
**Lockdown impacts volumes:** FNXP's Q4FY20 standalone revenue decreased 21% YoY to Rs 7.7bn. The PVC resin segment declined 23% YoY with both volumes/realisations slipping 22%/1% YoY. Revenue from PVC pipes & fittings also dropped 20% YoY, with volumes down 23% whereas realisations increased 3%. Management 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	FNXP 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 FNXP 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:** FNXP 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



## IT SERVICES

24 June 2020

## New H1B visa restrictions – anticipated election rhetoric

In a move seen as US election year rhetoric, new H1B visas have been suspended till Dec'20. Existing visa holders are unaffected. In our view, visa suspension will not have significant implications for Indian IT services players as (1) the restrictions are in place only till December, and (2) new or initial H1B applications form less than 3% of the onsite employee base for tier-I players. Over the medium-to-long term, we stay optimistic about the sector's resilience in managing onsite workforce supply.

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**Freeze to hit new visa applications:** President Trump has signed a proclamation to suspend new H1B visas (and L1 visas) in the US till Dec'20. These curbs will not apply to visa holders already in the US or those with valid visas outside the country. The suspension takes effect today and will largely affect new or initial H1B applications typically issued in October. We see limited headwinds for Indian IT players as new/initial applications form <3% of total onsite employee base (Fig 3).

**Higher local US workforce to blunt impact:** Indian IT companies have reduced visa dependence for their onsite talent pool over the last three years as administrative tightening led to higher visa denials. Focused localisation has seen Wipro, HCL Tech, Infosys and TCS build up their local workforce to >50% in the US. Players have also replicated offshore fresh talent management practices at onsite locations via setup of delivery centres and training programmes.

**More tightening on the cards:** US government officials have hinted at plans to enact permanent changes to immigration policy by: (1) offering H1B visas based on merit not lottery (the 85,000 available slots will be offered to applicants with the highest salaries and best skills), (2) tightening rules around H1B workers assigned to third-party employers as contractors, (3) recalculating the wage scale to coerce companies to pay visa holders higher salaries. We believe pressure of this nature will continue till the US elections in November.

**US polls and IT services growth adversely correlated:** Our analysis of growth trends over the last 12 years indicates a risk of protracted near-term softness for India's IT services industry in the runup to US presidential elections in Nov'20. Besides inherent anti-immigration rhetoric, we find that slow, delayed decision-making by clients in election years (FY09, FY13, FY17) has translated into cyclical growth moderation for the IT services industry (ranging from 270bps to >10ppt versus the respective prior financial year – see Fig 5).

## RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
TCS IN	2,042	2,160	ADD
INFO IN	714	760	ADD
WPRO IN	218	170	SELL
HCLT IN	560	680	BUY
TECHM IN	560	690	BUY
LTI IN	1,926	2,230	BUY
MPHL IN	863	780	SELL
MTCL IN	924	880	REDUCE
HEXW IN	321	350	ADD
NITEC IN	1,388	1,430	ADD
ECLX IN	451	420	REDUCE
PSYS IN	612	590	REDUCE
INFOE IN	2,712	1,920	SELL

Price &amp; Target in Rupees



## 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)

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