

Sector: Capital Goods
Results Update

	Change
Reco: Hold	↔
CMP: Rs. 357	
Price Target: Rs. 390	↓

↑ Upgrade ↔ No change ↓ Downgrade

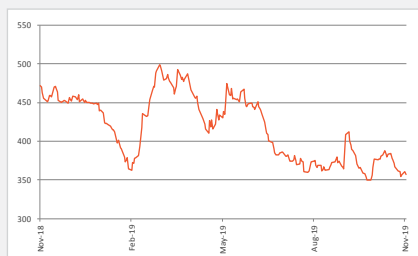
Company details

Market cap:	Rs. 5,460 cr
52-week high/low:	Rs. 507/334
NSE volume: (No of shares)	0.6 lakh
BSE code:	500144
NSE code:	FINCABLES
Sharekhan code:	FINCABLES
Free float: (No of shares)	9.8 cr

Shareholding (%)

Promoters	35.9
FII	10.5
DII	19.4
Others	34.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	x	x	x	x
Relative to Sensex	x	x	x	x

Sharekhan Research, Bloomberg

Finolex Cables Limited (Finolex) reported weak results for Q2FY2020. Revenue remained flat y-o-y (4% below our estimates) due to lower offtake from the automobile, industrial and communication sectors. The electrical cable segment's revenue increased by 4.6% y-o-y, affected by slowdown in the automobile and industrial sectors, while electrical wires and agri applications witnessed healthy volume growth. The communication cable segment continued to disappoint with revenue declining by 17.9% y-o-y, wherein optic fibre cable (OFC) volumes were impacted by slowdown in government spending and lower offtake from private telecommunications players. EBITDA margin contracted by 23 BPS y-o-y due to higher other expenses (higher promotional expenses in its fast-moving electronic goods (FMEG) segment). However, lower ETR (11.5% in Q2FY2020 vs. 30.1% in Q2FY2019) resulted in higher net profit of Rs. 123 crore (up 32.5% y-o-y). Management expects subdued level of activity in OFC to continue for a few quarters as telecom companies try to financially restructure themselves. We expect pain in the construction and OFC segments to continue in the near term, leading to subdued net earnings growth for FY2019-FY2021 coupled with margin contraction due to higher ad spends in the FMEG segment. Hence, we have fine tuned our net earnings estimates for FY2020-FY2021E. Moreover, a key hangover with respect to issue surrounding re-appointment of the chairman is sub-judice and, thus, remains unresolved. Hence, we have maintained our Hold rating with a revised price target (PT) of Rs. 390 (lowering our valuation multiple on account of muted growth outlook and unresolved issues surrounding promoters' group companies).

Key positives

- ◆ Volumes improved for the electrical wires segment (+12% y-o-y) and agri applications (+25% y-o-y).
- ◆ Targets to reach 1.5 lakh touch points over a period of time.

Key negatives

- ◆ Communication sector's OFC volumes declined by 25% y-o-y and are expected to continue for a few quarters.
- ◆ Ad spends to remain higher due to higher promotional expense.

Our Call

Valuation: Reiterate Hold with a revised PT of Rs. 390: We expect Finolex to continue to be affected by slowdown in the construction activity (60% mix), affecting its electrical division, while funding crunch in the telecom industry is likely to affect OFC revenue (70% mix), impacting the communication cable segment. Further, increased ad spends in consumer durables are expected to limit its profitability in the FMEG space. Hence, we have lowered our net earnings estimates for FY2020-FY2021, scaling down OPM, leading to just 7% CAGR in net earnings over FY2019-FY2021. The stock is currently trading at a P/E of 13.4x its FY2021E, which provides unfavourable risk-reward ratio owing to muted net earnings CAGR during FY2019-FY2021E and unresolved issues surrounding promoters of group companies. Hence, we maintain our Hold rating on the stock with a revised PT of Rs. 390.

Key Risks

Fluctuations in raw-material prices could sharply affect margins.

Valuation (Standalone)

Particulars	Rs cr			
	FY18	FY19	FY20E	FY21E
Revenue	2,815	3,078	3,226	3,463
OPM (%)	15.0	14.7	12.9	13.1
Adjusted PAT	358	344	379	408
% YoY growth	13.4	(3.9)	10.1	7.7
Adjusted EPS (Rs.)	23.4	22.5	24.8	26.7
P/E (x)	15.2	15.9	14.4	13.4
P/B (x)	2.5	2.2	2.0	1.8
EV/EBITDA (x)	9.7	9.4	9.9	8.9
RoNW (%)	33.7	30.4	30.3	29.2
RoCE (%)	24.8	23.0	19.3	18.8

Source: Company; Sharekhan estimates

Weak Q2: Finolex reported weak results for Q2FY2020. The company's revenue remained flat (4% below our estimates) due to lower offtake from the automobile, industrial and communication sectors. Revenue of the electrical cable segment came at Rs. 588 crore (up 4.6% y-o-y), affected by slowdown in the automobile and industrial sectors. Electrical wires saw volume growth of 12% y-o-y and agricultural applications wires witnessed 25% y-o-y growth. Communication cable continued to disappoint with revenue declining by 17.9% y-o-y to Rs. 106 crore due to consistent decline in government spending and lower offtake from private telecommunications players, in turn affecting optic fibre cable volumes (declined 25% y-o-y). Other segment comprising fans and lightings declined by 10.3% y-o-y to Rs. 16 crore. Operating profit declined by 2% y-o-y on higher other expenses, including higher promotional expenses in its FMEG segment, leading to contraction of 23 BPS y-o-y in OPM to 11.8%. However, lower ETR (11.5% Q2FY2020 vs. 30.1% in Q2FY2019) resulted in higher net profit of Rs. 123 crore (increased by 32.5% y-o-y).

Blended EBIT margin expanded for the quarter: The company's EBITDA margin contracted by 23 BPS y-o-y and the communication segment's EBIT margin contracted by 572 BPS to 7.4%. This was due to lower contribution of high-margin optical fibre. Electrical cable's EBIT margin expanded by 330 BPS y-o-y to 14.3% due to higher contribution from electrical wires. Management has stated that there was some uptick in construction, which contributed positively, although industrial cable still remained lacklustre. Higher spends on advertisement and market development activities resulted in lower profitability in the FMEG segment's margins. Overall, blended EBIT margin expanded by 63 BPS y-o-y to 11.8%.

Key conference call highlights

Enhancing distribution network for newer products: The company plans to expand its distribution reach, wherein it plans to add 500 distributors to its new standard platform (real-time data sharing between retailers and distributors) in which each distributor will be covering 300 retailers (targets to reach 1.5 lakh touch points over a period of time). Currently, the company has 248 distributors on board, out of 500 planned. Management has stated that results from the same will take time.

Slowdown in optic fibre cable to continue: Management has stated that the slowdown in optic fibre cable will continue for a couple of quarters as telecom companies try to financially restructure themselves.

Advertisement and promotional spends: Ad and promotional spends will continue to remain at elevated levels (currently at 1.5x to sales). Further, management stated that with the increase in volumes, ad spends would also increase.

Festive season sales: Management stated that the festive season during October was not great in context to FMEG sales.

Capex plans: The company had earlier planned for Rs. 200 crore capex in 18 months, but timelines for the same have been shifted to 24 months.

Newer products: The company plans to add products in electrical cables application side, such as solar application cables.

Results

Particulars	Rs cr				
	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
Revenue	715.8	714.0	0.3%	808	-11.4%
Operating profit	84.4	85.8	-1.7%	106	-20.4%
Other Income	64.7	58.4	10.8%	22	194.5%
Interest	0.23	0.3	-28.1%	0	
Depreciation	9.8	11.0	-11.2%	10	-1.0%
PBT	139.1	132.9	4.6%	118	18.0%
Tax	16.0	40.0	-60.1%	36	-56.0%
EO	-	-		-	
Reported PAT	123.1	92.9	32.5%	82	50.9%
Adj. EPS (Rs.)	8.0	6.1	32.5%	5.3	50.9%
Margin			BPS		BPS
OPM (%)	11.8	12.0	(23)	13.1	(133)
NPM (%)	17.2	13.0	419	10.1	710
Tax rate	11.5	30.1	-	30.8	-

Source: Company; Sharekhan Research

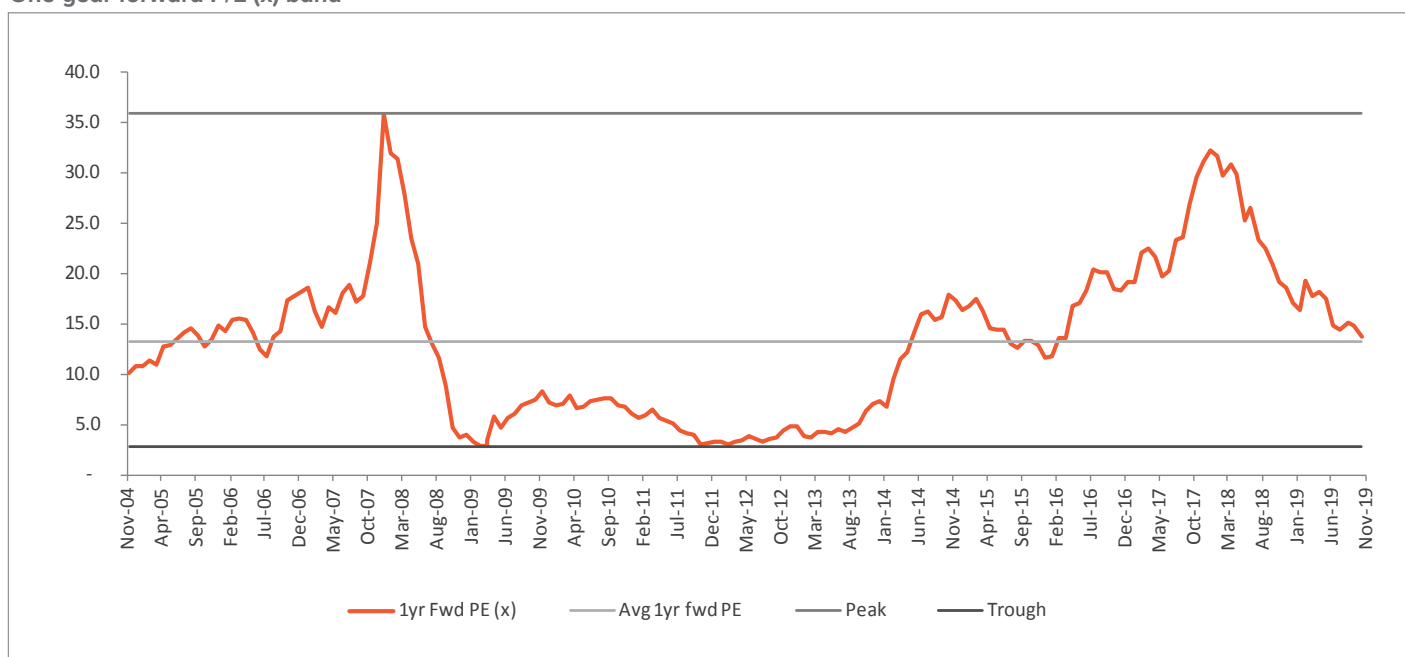
Outlook

Weak business outlook in key verticals to persist: Management stated that pain in the construction and OFC segment (due to funding crunch in the telecom industry) is likely to continue in the near term. Further, higher ad spends in the FMEG segment will continue for some years to enhance brand visibility, limiting the profitability of the segment and overall margins. Management expects to scale up the FMEG business through better distribution network and a greater number of retail touch points, but scaling up of new products still remains slow amidst competition. Currently, it is facing difficulties to make its presence felt. Ramp-up in the segment as expected remains a challenge in view of the intense competition, which would continue to affect the company's growth trajectory.

Valuation

Reiterate Hold with a revised PT of Rs. 390: We expect Finolex to continue to be affected by slowdown in construction activity (60% mix), affecting its electrical division, while funding crunch in the telecom industry is likely to affect OFC revenue (70% mix), impacting its communication cable segment. Further, increased ad spends in consumer durables are expected to limit its profitability in the FMEG space. Hence, we have lowered our net earnings estimates for FY2020-FY2021, scaling down OPM, leading to just 7% CAGR in net earnings over FY2019-FY2021. The stock is currently trading at a P/E of 13.4x its FY2021E, which provides unfavourable risk-reward ratio owing to muted net earnings CAGR during FY2019-FY2021E and unresolved issues surrounding promoters of group companies. Hence, we maintain our Hold rating on the stock with a revised PT of Rs. 390.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Company	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Finolex Cables	14.4	13.4	9.9	8.9	2.0	1.8	30.3	29.2
KEI Industries	16.2	13.1	8.1	6.4	3.4	2.6	25.4	24.1
Polycab India	19.5	15.9	11.4	9.5	3.6	2.9	21.1	20.2

Source: Company, Sharekhan research

About company

Finolex is India's largest and leading manufacturer of electrical and communication cables. The company offers a wide range of electrical and communication cables. The company's wire and cable products are used in applications such as automobile, lighting, cable TV, telephone and computers to industrial applications touching every person in his daily life. Finolex has added electrical switches, LED-based lamps, fans, low-voltage MCBs and water heaters to its range of products.

Investment theme

While the government's focus on Housing for All by FY2022 is expected to drive demand for housing wires, slowdown in housing demand continues to affect performance of the electrical cables segment—65% of the company's total revenue constitutes housing wires. Further, ongoing government programmes (Bharat Net Phase II) are expected to improve broadband connectivity and related technologies will continue to drive growth for communication cables.

Key Risks

- ♦ Fluctuations in raw-material prices: Any sharp increase or decrease in key raw-material (copper) prices will sharply affect the company's margins.
- ♦ Weak housing demand and construction activity will impact the company's electrical cables growth.

Additional Data

Key management personnel

Mr. D.K. Chhabria	Executive Chairperson
Mr. Mahesh Vishwanathan	Deputy MD & CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Orbit Electricals Pvt Ltd	30.7
2	Finolex Industries Ltd	14.51
3	Franklin Resources Inc	5.73
4	DSP Investment Managers Pvt Ltd	4.52
5	NA	3.93
6	CHHABRIA ANIL R	3.11
7	L&T Mutual Fund Trustee Ltd/India	3.08
8	KATARA ARUNA MUKESH	1.84
9	Dimensional Fund Advisors LP	1.82
10	Aditya Birla Sun Life Asset Manage	1.77

Source: Bloomberg

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