Finolex Cables Limited

Q4 beats estimates; growth to ride on economic revival

Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Capital Goods	Sharekhan code: FINCABLES	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 511**	
Price Target: **Rs. 623**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 7,815 cr
52-week high/low:	Rs. 548/257
NSE volume: (No of shares)	4.8 lakh
BSE code:	500144
NSE code:	FINCABLES
Free float: (No of shares)	9.8 cr

Shareholding (%)

Promoters	35.9
FII	7.6
DII	18.3
Others	38.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	6.0	31.0	47.0	111.0
Relative to Sensex	1.0	6.0	10.0	67.0

Sharekhan Research, Bloomberg

Summary

- We retain our Buy rating on Finolex Cables Limited (FNXC) with a revised PT of Rs. 623, considering improvement in distribution efforts, which has led to pick up in volumes.
- FNXC reported a strong quarter, driven by strong revenue growth along with stable y-o-y operating profit margins. Its standalone revenue grew by 41% y-o-y to Rs. 921.4 crore (better than estimates), led by higher volume growth across product categories.
- We expect strong performance in FY2022 as the cables segment saw infrastructure investments; the communication cables segment has already seen good tendering in Q1FY2022 and scaling up of its FMEG business with improving demand and strong dealer network.
- The company's healthy operating cash flow generation, tight working capital management (policy of advance payments from dealers), and limited capex are expected to further build upon its cash reserves.

Finolex Cables Limited (Finolex) reported a strong quarter, led by strong revenue growth along with stable y-o-y operating profit margins and PAT. The company's standalone revenue grew by 41% y-o-y to Rs. 921.4 crore (better than estimates), led by higher volume growth across product categories. Operating profit margin (OPM) improved marginally by 88 bps y-o-y to 14.3% (better than estimates) due to lower gross margin (decline by 328 bps y-o-y) and 43% y-o-y increased raw-material costs. Accordingly, EBITDA stood at Rs. 131.3 crore (up 51% y-o-y), as the company reported strong growth in the electric cables segment (+43% y-o-y). Lower other income (down 73% y-o-y) and higher tax rate (29.6% versus 13.5% in Q3FY2020) led to muted PAT to Rs. 96 crore y-o-y (down 18% y-o-y). The electrical cables segment improved with gradual resumption of economic activities and is expected to improve further with volumes nearing pre-COVID levels. Electrical cables business was impacted due to slow growth in the real estate sector; however, Finolex reported strong performance in the general electric wire sub segment, which caters to the construction space and automobile wire segment. In the cables segment, slowdown due to COVID-19 as well as structural issues in the industry continue to adversely impact this segment. The other segment, which comprises fans, water heaters, lamps, switches, and switchgear offerings reported a 73% y-o-y increase in revenue due to improved distribution and pick up in volumes. The company has been focusing on better distribution with ~490 distributors connecting 1,40,000 retail touch points, which is reaping benefits with improving sales in FMEG. The company's healthy operating cash flow generation, tight working capital management (policy of advance payments from dealers), and limited capex are expected to further build upon its cash reserves. We have fine-tuned our net earnings estimates for FY2022E-FY2023E. The stock is trading at a reasonable valuation of 21x and 18x its FY2022E and FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with a revised PT of Rs. 623.

Key positives

- Revenue remained strong during Q4FY2021 led by electrical cables and FMEG business.

Key negatives

- Gross margin declined by 328 bps on higher discounts to its distributors, leading to lower realisation.

Our Call

Valuation - Retain Buy with a revised PT of Rs. 623: We believe the company's operations are expected to improve further as supply chain becomes stable with an improving demand environment and rising infrastructure investments. Further, COVID-19 led impact on unorganised players allows the company to increase its market share. Finolex's debt free balance sheet and net cash position provide comfort in the present environment. Further, the government's push for optical fibre cable will aid business and boost demand for telecom cables for the company. The stock is trading at a reasonable valuation of 21x and 18x its FY2022E and FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with a revised SOTP-based PT of Rs. 623 (15x its P/E on FY2023E standalone EPS and 20% holding company discount for its stake in Finolex Industries).

Key risk

Fluctuations in raw-material prices could sharply affect margins.

Valuation (standalone) Rs cr

Particulars	FY20	FY21	FY22E	FY23E
Revenue	2,877.3	2,768.1	2,978.7	3,276.6
OPM (%)	12.9	12.8	13.3	14.1
Adjusted PAT	402.5	282.9	371.5	431.6
% YoY growth	*(6.5)*	*(3.8)*	*7.6*	*10.0*
Adjusted EPS (Rs.)	26.3	18.5	24.3	28.2
P/E (x)	19.4	27.7	21.1	18.1
P/B (x)	2.9	2.8	2.5	2.3
EV/EBITDA (x)	12.7	18.0	14.5	12.5
RoNW (%)	17.0	14.0	17.0	18.4
RoCE (%)	19.5	13.9	16.4	17.6

Source: Company; Sharekhan estimates

Q4FY2021 beats estimates: Finolex reported a strong quarter led by robust revenue growth along with stable y-o-y OPM and PAT. The company's standalone revenue grew by 41% y-o-y to Rs. 921.4 crore (better than estimates), led by higher volume growth across product categories. OPM improved marginally by 88 bps y-o-y to 14.3% (better than estimates) due to lower gross margins (down 328 bps y-o-y) and 43% y-o-y increase in raw-material costs. Accordingly, EBITDA stood at Rs. 131.3 crore (up 51% y-o-y) as the company reported strong growth in the electric cables segment (+43% y-o-y). Lower other income (down 73% y-o-y) and higher tax rate (29.6% versus 13.5% in Q3FY2020) led to muted PAT to Rs. 96 crore y-o-y (down 18% y-o-y). The electric cables and FMEG segment reported 43% and 74% y-o-y growth, respectively, both these segments are performing well and scaling up with an improving demand environment.

Business slowly and steadily retuning to normality: Demand has been good as seen with good volume increase during quarter and it has been sustaining in the current quarter both for FMEG products and wires. With improving business sentiments, demand for electric cables is normalising as new residential projects are picking up, wherein the company's major product line remains wires used in housing and commercial establishments, leading to better demand for the C&W segment. Going ahead, revival in government spends (power, infra, railways, and housing), private capex by key sectors, along with pick-up in real estate should boost C&W growth, thereby benefitting Finolex. On telecom cable demand for products such as speaker cables, LAN, CCTV wires, and coaxial have been strong expected to continue. In optical fibre cable (largely B2B dominated by government orders), tendering from centres and states have been slow, although management expects tendering from states/gram panchayats to happen as things improve. The company's FMEG business (4.4% mix) is performing well and scaling up with an improving demand environment. The company has been focusing on better distribution with ~490 distributors connecting 1,40,000 retail touch points and expect to reach 500 distributors connecting 1,50,000 touchpoints.

Finolex Cables Q4FY2021 Concall Highlights

- **FMEG business:** Business has shown constant improvements with revenue growth of 74% y-o-y during Q4FY2021 due to improved distribution effort. Currently, Finolex has ~490 distributors connecting 1,40,000 retail touch points and expects to reach 500 distributors connecting 1,50,000 touchpoints.
- **Telecom cables:** Both COVID related disruptions as well as structural issues in the industry continue to impact this segment. The telecom sector was impacted due to fall in international fiber prices, which led to lower selling price and delay in execution of domestic projects due to liquidity crunch. However, management is confident of a turnaround in this segment as it has received a good number of tenders in Q1FY2022, which will see improved contribution from this segment.
- **Demand:** Management indicated that demand remained good as seen with good volume increase and it has been sustaining in the current quarter with 15-17% growth on an annual basis but was also cautious about the current situation.
- **Price hike:** Management mentioned that last two quarters, business has been impacted by price hikes and was forced to take several price hikes. In FY2021, Finolex has taken about 12 price hikes to counter increased input costs.
- **Inventory:** Finolex reported high inventory due to high input cost of copper (from $4,500 to $11,000/MT) and polymer. However, management remained confident that overall inventory days will return to 55-60 days quickly.

Results (Standalone) **Rs cr**

Particulars	4Q FY21	4Q FY20	YoY	3Q FY21	QoQ
Total Income	921.4	651.4	41%	830.2	11%
EBITDA	131.3	87.1	51%	106.6	23%
Other Income	16.0	58.7	-73%	18.7	-14%
Interest	0.2	0.7	-67%	0.2	41%
Depreciation	10.7	9.6	11%	8.5	26%
PBT	136.4	135.5	1%	116.7	17%
Tax	39.3	34.4	14%	34.5	14%
Reported PAT	96.1	117.2	-18%	82.8	16%
Reported PAT	96.1	117.2	-18%	82.8	16%
Adjusted EPS (Rs.)	6.28	7.66	-18%	5.41	16%
Margin			**BPS**		**BPS**
EBITDA Margin	14.3%	13.4%	88	12.8%	141
PAT Margin	10.4%	18.0%	-756	10.0%	46
Tax Rate	29.6%	13.5%	1604	29.1%	48

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Ample levers offers scope for growth

Domestic demand side is improving with unlocking, infrastructure, and construction back in action with labour issues largely resolved, which provides a positive outlook ahead. The wires and cables industry contributes 40-45% to India's electrical equipment industry. In terms of volumes, the Indian wires and cables industry (including exports) has grown from 6.3million kms in FY2014 to 14.5million kms in FY2018, posting a ~23% CAGR over the period. The industry registered an ~11% CAGR in value terms, from Rs. 34,600 crore in FY2014 to Rs. 52,500 crore in FY2018. The C&W industry was expected to register a CAGR of 14.5% from Rs. 52,500 crore in FY2018 to Rs. 1,03,300 crore by FY2023. However, a slowdown in infrastructure growth and uncertainty in real estate will lead to moderation in growth for the C&W segment. Gradual resumption of normal economic activity and infrastructure projects will push recovery to H2FY2021.The Government has envisaged Rs. 111 lakh crore capital expenditure in infrastructure sectors in India during FY2020 to FY2025. Continued thrust of government on infrastructure investment is expected to improve the demand environment for the W&C industry. The Indian FMEG industry has many growth opportunities led by macro drivers such as evolving consumer aspirations, increasing awareness, rising income, rural electrification, urbanisation, and digital connectivity. 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.

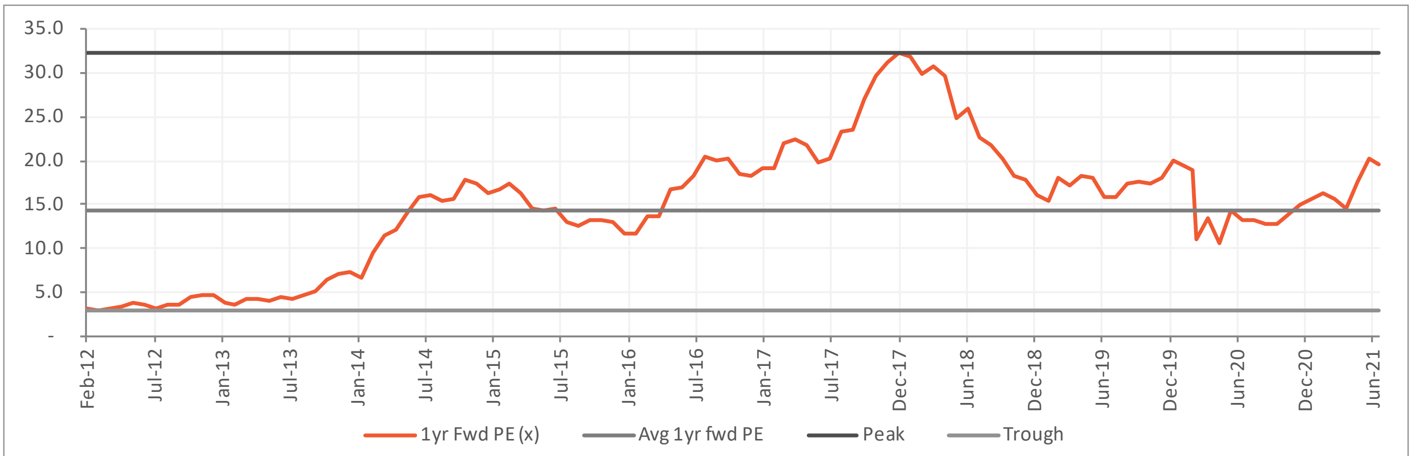
■ Company Outlook – Operations on an improving trajectory

Demand for electric cables is expected to normalise going ahead, as labour, transport, and supply chain issues get resolved along with improving business environment. New products (2-3% mix) are performing well and scaling up with improving demand environment along with the festival season are expected to further boost demand. Healthy operating cash flow generation, tight working capital management (policy of advance payments from dealers), and limited capex are expected to further build upon its cash reserves. The company also has the opportunity to increase market share organically as the pandemic has had a severe impact on unorganised sector players. Management indicated that unlocking across the country will lead to improving business sentiments. Further, repeated assurances from the government towards economy building provides confidence.

■ Valuation – Retain Buy with a revised PT of Rs. 623

We believe the company's operations are expected to improve further as supply chain becomes stable with an improving demand environment and rising infrastructure investments. Further, COVID-19 led impact on unorganised players provides the company to increase its market share. Finolex's debt-free balance sheet and net cash position provide comfort in the present environment. Further, the government's push for optical fibre cable will aid business and boost demand for telecom cables for the company. The stock is trading at a reasonable valuation of 21x and 18x its FY2022E and FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with a revised SOTP-based PT of Rs. 623 (15x its P/E on FY2023E standalone EPS and 20% holding company discount for its stake in Finolex Industries).

One-year forward P/E (x) band



Source: 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 and 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.	6.76
4	DSP Investment Managers Pvt. Ltd.	5.13
5	L&T Mutual Fund Tustee Ltd./India	3.38
6	Chhabria Anil R	3.11
7	HDFC Life Insurance Co. Ltd.	1.98
8	LGOF Global Opportunities	1.88
9	GopichandParmanandHinduj	1.88
10	KataraArunaMukesh	1.84

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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