

## FINOLEX INDUSTRIES

MISCELLANEOUS

# HOLD

Target Price: Rs 562

### Growth on track

Finolex Industries' Q4FY17 PAT increased 50% YoY to Rs 1.2 bn on firm EDC-PVC spread (Rs 15,000/ MT vs. Rs 6,600/ MT in Q4FY16) leading to doubling of EBIT for PVC segment (~60% of FY17 EBIT).

Despite flat volume growth in pipes, management remains confident of achieving double digit volume growth over next couple of years on strong agri demand and several government initiatives in irrigation, sanitation and housing. Management is aggressively focusing on increasing its share in (high margin) non-agri pipes (~50% vs. 30% currently) over the next few years. While EDC-PVC spread is expected to remain firm, we expect PVC margin to normalize at Rs 10,000/MT. Our FY18E and FY19E EPS stand at Rs 25 and Rs 28. **Maintain HOLD with TP of Rs 562** (20x FY19E EPS).

CMP : Rs 598  
Potential Upside : -6%

#### MARKET DATA

No. of Shares : 124 mn  
Free Float : 48%  
Market Cap : Rs 74 bn  
52-week High / Low : Rs 624 / Rs 383  
Avg. Daily vol. (6mth) : 76,771 shares  
Bloomberg Code : FNXP IB Equity  
Promoters Holding : 52%  
FII / DII : 5% / 8%

### Segmental highlights

- ◆ **PVC pipes'** revenue (~70% of FY17 revenue) increased 10% YoY to ~Rs 7 bn due to higher realization at Rs 103,557/ ton in Q4FY17 (Rs 93,591/ ton in Q4FY16). Volume declined to 63,982MT due to prolonged impact of demonetization (67,693MT in Q4FY16). However, since the past few months, volume has bounced back and management expects double digit growth over the next couple of years. EBIT at ~Rs 9,200/MT (Rs 7,900 in Q4FY16) is slated to improve, as Finolex focuses on increasing sales of higher-margin products such as fittings, column pipes and CPVC pipes.

It intends to increase pipe capacity by 150,000 MT by FY19-20 (currently 290,000 MT) with capex of Rs 3 bn. New warehouses in Cuttack, Indore and Delhi have ensured faster delivery and enhanced distribution reach. The company will continue to add to its ~18,000 retail touch points. Government initiatives such as 'Smart Cities' and 'Housing for All' coupled with continued focus on water and sanitation augur well for growth. We expect 15% volume CAGR over the next couple of years with margin improving to Rs 9,500/ton.

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#### Financial summary (Standalone)

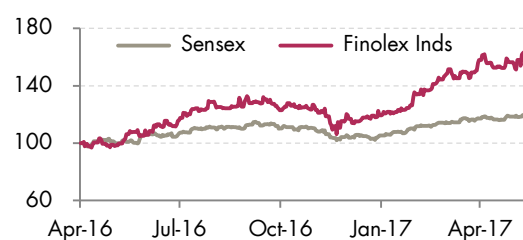
Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs mn)	28,431	29,876	32,026	35,871
PAT (Rs mn)	2,228	3,455	3,083	3,361
Con. EPS* (Rs)	-	-	27.6	30.8
EPS (Rs)	18.8	28.6	25.7	28.1
Change YOY (%)	236.8	52.1	(10.3)	9.5
P/E (x)	31.8	20.9	23.3	21.3
RoE (%)	18.6	17.6	13.4	13.8
RoCE (%)	22.9	23.8	17.4	18.3
EV/E (x)	16.8	11.3	13.4	12.0
DPS (Rs)	10.0	11.5	12.5	14.5

Source: \*Consensus broker estimates, Company, Axis Capital

#### Key drivers

(Rs)	FY17	FY18E	FY19E
PVC margin - EBIT/ton	15,085	10,000	10,000
PVC pipe margin - EBIT/ton	8,472	8,750	9,500

#### Price performance



**Exhibit 1: Results update**

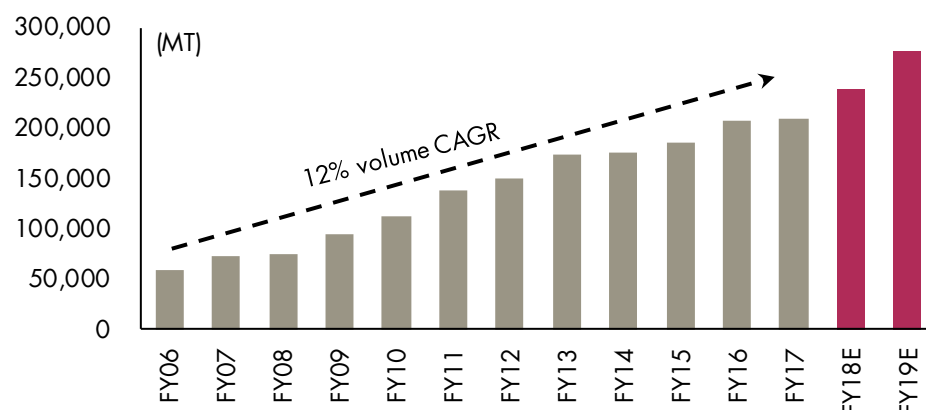
(Rs mn)	Quarter ended					12 months ended		
	Mar-17	Mar-16	% Chg	Dec-16	% Chg	FY18E	FY17	% Chg
<b>Net Sales</b>	<b>10,164</b>	<b>9,260</b>	<b>10</b>	<b>6,656</b>	<b>53</b>	<b>32,026</b>	<b>29,876</b>	<b>7</b>
EBIDTA	1,785	1,156	54	1,329	34	4,821	5,630	(14)
Other income	94	198	(53)	29	228	200	232	(14)
<b>PBIDT</b>	<b>1,879</b>	<b>1,354</b>	<b>39</b>	<b>1,358</b>	<b>38</b>	<b>5,021</b>	<b>5,862</b>	<b>(14)</b>
Depreciation	139	127	9	140	(1)	569	550	3
Interest	11	45	(75)	59	(81)	48	153	(69)
<b>PBT</b>	<b>1,729</b>	<b>1,182</b>	<b>46</b>	<b>1,158</b>	<b>49</b>	<b>4,404</b>	<b>5,158</b>	<b>(15)</b>
Tax	496	361	37	416	19	1,321	1,703	(22)
<b>Adjusted PAT</b>	<b>1,233</b>	<b>820</b>	<b>50</b>	<b>742</b>	<b>66</b>	<b>3,083</b>	<b>3,455</b>	<b>(11)</b>
Extra ordinary income/ (exp.)	0	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>1,233</b>	<b>820</b>	<b>50</b>	<b>742</b>	<b>66</b>	<b>3,083</b>	<b>3,455</b>	<b>(11)</b>
No. of shares (mn)	124	124	-	124	-	124	124	-
EBIDTA margin (%)	17.6	12.5	-	20.0	-	15.1	18.8	-
PBIDT margin (%)	18.5	14.6	-	20.4	-	15.7	19.6	-
<b>EPS - annualized (Rs)</b>	<b>39.7</b>	<b>26.4</b>	<b>50</b>	<b>23.9</b>	<b>66</b>	<b>24.8</b>	<b>27.8</b>	<b>(11)</b>

Source: Company, Axis Capital

(...Continued from page 1)

**Focus on non-agripipe segment:** Finolex intends to leverage on Lubrizol's CPVC resin capabilities and expand aggressively into the CPVC segment. The company plans to augment its distribution reach for non-agri pipes by setting up parallel dealerships as well leveraging existing dealer relations. We believe an already well excepted brand will help Finolex make successful inroads in the CPVC market. The company has deviated from its existing strategy of 'cash and carry' and extended 30 day credit to its CPVC dealers as it aggressively focuses on the CPVC market. Over the next 4-5 years, Finolex intends to derive ~50% of pipe revenue from the non-agri segment (currently 30% of pipes rev).

- ◆ **PVC resin** volume declined 8% YoY to 76,541 MT, while realization increased 9% YoY to ~Rs 66,200/ MT, which resulted in revenue of Rs 6 bn. External sales was at 36,000 MT. EBIT margin increased to Rs ~15,000/MT (Rs 6,600/MT in Q4FY16), as EDC-PVC spread remained strong at ~USD 660/ton. We estimate lower EBIT margin of Rs 10,000/ ton for FY18 and FY19.

**Exhibit 2: Expect 15% volume CAGR in pipes over the next couple of years**


Source: Company, Axis Capital

## Financial summary (Standalone)

### Profit & loss (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	28,431	29,876	32,026	35,871
Other operating income	-	-	-	-
<b>Total operating income</b>	<b>28,431</b>	<b>29,876</b>	<b>32,026</b>	<b>35,871</b>
Cost of goods sold	(21,839)	(21,848)	(23,109)	(25,883)
Gross profit	6,592	8,028	8,918	9,988
<i>Gross margin (%)</i>	<i>23.2</i>	<i>26.9</i>	<i>27.8</i>	<i>27.8</i>
Total operating expenses	(2,548)	(2,398)	(4,096)	(4,714)
<b>EBITDA</b>	<b>4,044</b>	<b>5,630</b>	<b>4,821</b>	<b>5,275</b>
<i>EBITDA margin (%)</i>	<i>14.2</i>	<i>18.8</i>	<i>15.1</i>	<i>14.7</i>
Depreciation	(506)	(550)	(569)	(583)
<b>EBIT</b>	<b>3,539</b>	<b>5,080</b>	<b>4,252</b>	<b>4,691</b>
Net interest	(447)	(153)	(48)	(90)
Other income	387	232	200	200
<b>Profit before tax</b>	<b>3,479</b>	<b>5,158</b>	<b>4,404</b>	<b>4,801</b>
Total taxation	(1,251)	(1,703)	(1,321)	(1,440)
<i>Tax rate (%)</i>	<i>36.0</i>	<i>33.0</i>	<i>30.0</i>	<i>30.0</i>
Profit after tax	2,228	3,455	3,083	3,361
Minorities	-	-	-	-
Profit/ Loss associate co(s)	105	93	100	125
Adjusted net profit	2,333	3,548	3,183	3,486
<i>Adj. PAT margin (%)</i>	<i>8.2</i>	<i>11.9</i>	<i>9.9</i>	<i>9.7</i>
Net non-recurring items	-	-	-	-
Reported net profit	2,333	3,548	3,183	3,486

### Balance sheet (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	1,241	1,241	1,241	1,241
Reserves & surplus	15,905	21,907	23,275	24,656
Net worth	17,146	23,148	24,516	25,897
Borrowing	1,117	942	367	367
Other non-current liabilities	1,187	1,089	1,089	1,089
<b>Total liabilities</b>	<b>19,451</b>	<b>25,179</b>	<b>25,972</b>	<b>27,353</b>
Gross fixed assets	19,227	19,832	20,332	20,832
Less: Depreciation	(10,730)	(11,281)	(11,850)	(12,433)
Net fixed assets	8,496	8,551	8,482	8,399
Add: Capital WIP	66	217	217	217
Total fixed assets	8,563	8,769	8,699	8,616
Other Investment	-	-	-	-
Inventory	4,472	5,574	6,405	6,522
Debtors	176	525	320	359
Cash & bank	104	163	8,525	9,754
Loans & advances	2	2	2,242	2,332
Current liabilities	5,395	4,464	4,036	4,207
Net current assets	410	2,728	13,456	14,760
Other non-current assets	1,939	1,046	1,067	1,227
<b>Total assets</b>	<b>19,451</b>	<b>25,178</b>	<b>25,972</b>	<b>27,353</b>

Source: Company, Axis Capital

### Cash flow (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	3,479	5,158	4,404	4,801
Depreciation & Amortisation	506	550	569	583
<i>Chg in working capital</i>	<i>2,298</i>	<i>(2,381)</i>	<i>(3,295)</i>	<i>(74)</i>
<b>Cash flow from operations</b>	<b>5,706</b>	<b>2,010</b>	<b>606</b>	<b>4,160</b>
<i>Capital expenditure</i>	<i>(326)</i>	<i>(454)</i>	<i>(500)</i>	<i>(500)</i>
<b>Cash flow from investing</b>	<b>(835)</b>	<b>(5,597)</b>	<b>9,386</b>	<b>(500)</b>
<i>Equity raised/ (repaid)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>(4,126)</i>	<i>(175)</i>	<i>(575)</i>	<i>-</i>
<i>Dividend paid</i>	<i>(291)</i>	<i>(1,427)</i>	<i>(1,551)</i>	<i>(1,799)</i>
<b>Cash flow from financing</b>	<b>(4,890)</b>	<b>(1,756)</b>	<b>(2,174)</b>	<b>(1,889)</b>
Net chg in cash	(19)	(5,343)	7,818	1,770

### Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
<b>OPERATIONAL</b>				
FDEPS (Rs)	18.8	28.6	25.7	28.1
CEPS (Rs)	22.9	33.0	30.2	32.8
DPS (Rs)	10.0	11.5	12.5	14.5
Dividend payout ratio (%)	53.2	40.2	48.7	51.6
<b>GROWTH</b>				
Net sales (%)	14.8	5.1	7.2	12.0
EBITDA (%)	91.6	39.2	(14.4)	9.4
Adj net profit (%)	236.8	52.1	(10.3)	9.5
FDEPS (%)	236.8	52.1	(10.3)	9.5
<b>PERFORMANCE</b>				
RoE (%)	18.6	17.6	13.4	13.8
RoCE (%)	22.9	23.8	17.4	18.3
<b>EFFICIENCY</b>				
Asset turnover (x)	2.4	2.6	2.3	2.4
Sales/ total assets (x)	1.3	1.1	1.1	1.2
Working capital/ sales (x)	0.1	-	0.1	0.1
Receivable days	2.3	6.4	3.7	3.7
Inventory days	66.9	83.9	85.9	77.8
Payable days	78.9	63.7	52.2	48.2
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	0.1	-	-	-
Net debt/ equity (x)	(0.5)	(0.5)	(0.4)	(0.4)
Current ratio (x)	1.1	1.6	4.3	4.5
Interest cover (x)	7.9	33.1	89.1	52.1
<b>VALUATION</b>				
PE (x)	31.8	20.9	23.3	21.3
EV/ EBITDA (x)	16.8	11.3	13.4	12.0
EV/ Net sales (x)	2.4	2.1	2.0	1.8
PB (x)	4.3	3.2	3.0	2.9
Dividend yield (%)	1.7	1.9	2.1	2.4
Free cash flow yield (%)	7.3	2.1	0.1	4.9

Source: Company, Axis Capital

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