

Finolex Industries

BUY

INDUSTRY	PIPES
CMP (as on 29 May 17)	Rs 598
Target Price	Rs 765
Nifty	9,605
Sensex	31,109
KEY STOCK DATA	
Bloomberg	FNXP IN
No. of Shares (mn)	124
MCap (Rs bn) / (\$ mn)	74/1,151
6m avg traded value (Rs mn)	40
STOCK PERFORMANCE (%)	
52 Week high / low	Rs 624/381
	3M 6M 12M
Absolute (%)	11.2 40.2 56.1
Relative (%)	3.0 22.3 39.3
SHAREHOLDING PATTERN (%)	
Promoters	52.5
FIs & Local MFs	8.1
FPIs	4.0
Public & Others	35.4
<i>Source : BSE</i>	

Promising potential

4QFY17 was a strong quarter for Finolex Industries (Finolex), largely on expected lines, led by (1) 10% YoY growth in net sales to Rs 8.9 bn, despite volume slowdown (volume decline of ~6% in pipes and fittings and ~8% in PVC resin) and (2) notable margin boost in the PVC resin segment (EBIT margin at 19% in 4QFY17 vs. 14% in 4QFY16). While absolute EBITDA grew by ~55% YoY, margins improved by 580 bps to ~20%. PAT increased by 50% YoY to Rs 1.2 bn. Despite two weak quarters (Q3 & Q4), volumes in pipes and fittings were flattish YoY in FY17. RM spread (PVC/EDC delta) was at ~662 USD/MT in 4QFY17. Currently, it hovers at around 635 USD/MT.

Going forward, we believe there are multiple triggers for Finolex's volumes and profitability growth (1) Govt's focus on agriculture and housing sectors, (2) company envisages to increase share of non-agri demand in its revenue pie (from 30% now to ~50% over 4-5 years), (3) ramp-up of the higher-margin CPVC volumes over the near term, (4) GST tailwinds.

Financial Summary

(Rsmn)	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)	FY16	FY17P	FY18E	FY19E
Net Sales	8,880	8,055	10	5,797	53	24,819	26,020	28,544	32,185
EBIDTA	1,786	1,156	55	1,329	34	4,044	5,630	5,068	5,922
APAT	1,233	820	50	742	66	2,544	3,522	3,189	3,796
Diluted adj. EPS (Rs/sh)	9.9	6.6	50.4	6.0	66.2	20.5	28.4	25.7	30.6
P/E (x)						29.2	21.1	23.3	19.6
RoE (%)						21.6	18.2	13.5	15.1

Source: Company, HDFC sec Inst Research

Equipped with a strong brand, ability to backward integrate, a robust balance sheet, high return ratios, we believe that Finolex offers several years of compounding potential. **Maintain BUY rating. Our 1-year fwd TP stands at Rs 765 (25x Mar-19E EPS).**

- **Steady ramp-up in capacity:** Finolex's cumulative pipes and fittings capacity stands at 290k MT. The company plans to add 150k MT capacity and the full benefit of the same is expected to accrue by 2020. Of this, almost 50K MT could be for CPVC. The estimated outlay for this expansion could be almost Rs 2.4 bn over FY18-20.
- **Distribution:** Finolex enjoys a pan-India distribution, with ~800-900 dealers and ~18K retail touch points. Almost 50% of the dealers are present in rural areas and the rest in urban. The company's operations are focused in the south and west India, which contribute 70%+ to the top line. Finolex has 1500 SKUs (1000 in fittings and 500 in pipes)
- **Near-term outlook:** Ramp-up in CPVC business, focus on non-agri (with higher margin fittings) and GST tailwinds to drive demand. Raw material spread remains a key monitorable.

Sonali Salgaonkar

sonali.salgaonkar@hdfcsec.com

+91-22-6171-7322

10% YoY growth in net sales, despite volume slowdown (volume decline of ~6% in pipes and fittings and ~8% in PVC resin)

Notable margin boost in the PVC resin segment (EBIT margin at 19% in 4QFY17 vs. 14% in 4QFY16)

Despite two weak quarters (Q3 & Q4), volumes in pipes and fittings were flattish YoY in FY17

RM spread (PVC/EDC delta) was at ~662 USD/MT in 4QFY17

Quarterly Financials Snapshot

Particulars	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)
Net Sales	8,880	8,055	10	5,797	53
Material Expenses	5,927	5,603	6	3,407	74
Employee Expenses	268	252	6	255	5
Other Operating Expenses	899	1,045	-14	806	11
EBITDA	1,786	1,156	55	1,329	34
Depreciation	139	127	9	140	-1
EBIT	1,647	1,029	60	1,188	39
Other Income (including EO)	94	198	-53	29	228
Interest Cost	11	45	-75	59	-81
PBT	1,729	1,181	46	1,158	49
Tax	496	361	37	416	19
RPAT	1,233	820	50	742	66
APAT	1,233	820	50	742	66
Adj EPS	9.9	6.6	50	6.0	66

Source: Company, HDFC sec Inst Research

Margin Analysis

	4QFY17	4QFY16	YoY (bps)	3QFY17	QoQ (bps)
Material Expenses % Net Sales	66.7	69.6	(280.9)	58.8	797.3
Employee Expenses % Net Sales	3.0	3.1	(10.9)	4.4	(138.0)
Other Expenses % Net Sales	10.1	13.0	(284.6)	13.9	(378.6)
EBITDA Margin (%)	20.1	14.3	576.3	22.9	(280.8)
Tax Rate (%)	28.7	30.6	(189.3)	35.9	(722.5)
APAT Margin (%)	13.9	10.2	370.8	12.8	109.0

Source: Company, HDFC sec Inst Research

Pipes and fittings is a key segment in Finolex, and contribute ~50% to the company's revenue.

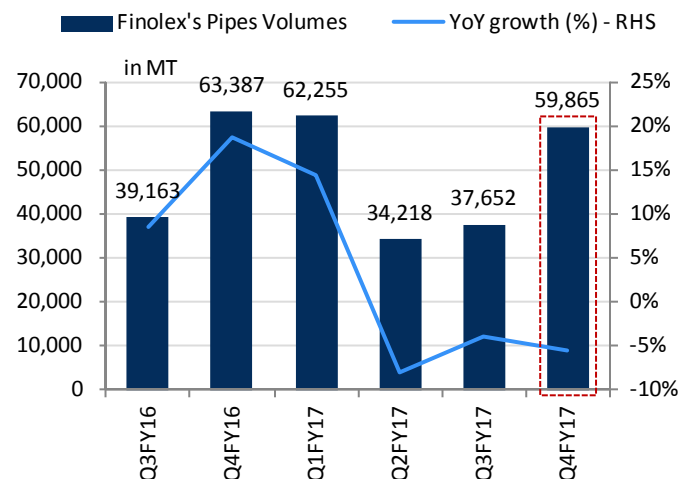
Q1 and Q4 cumulatively account for ~60% of annual volumes and revenues in pipes and fittings.

We expect the proportion of the higher-margin fittings to gradually increase in the overall volumes of the company.

In FY17, the average EBIT margin for pipes and fittings stood at ~8%.

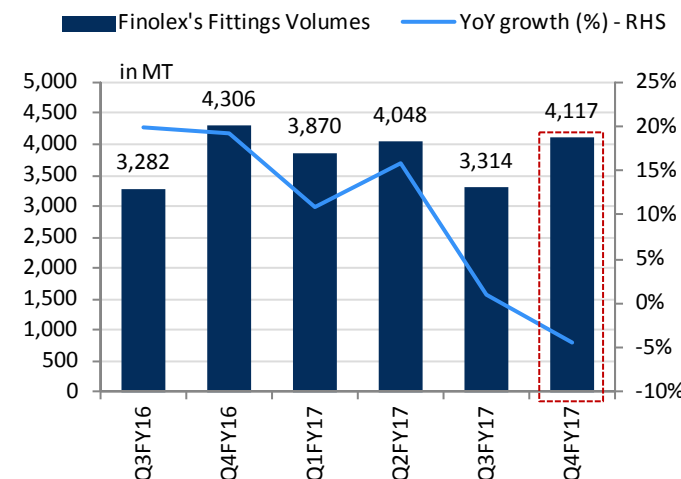
Pipes And Fittings : Quarterly Trends

Trend In Volumes Of Pipes



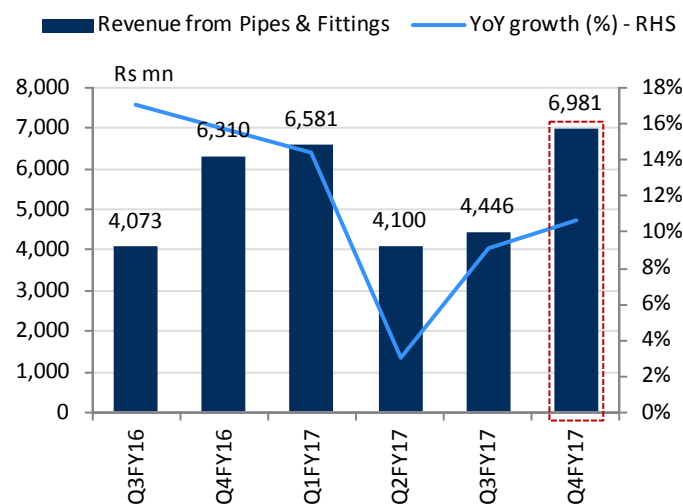
Source: Company, HDFC sec Inst Research

Trend In Volumes Of Fittings



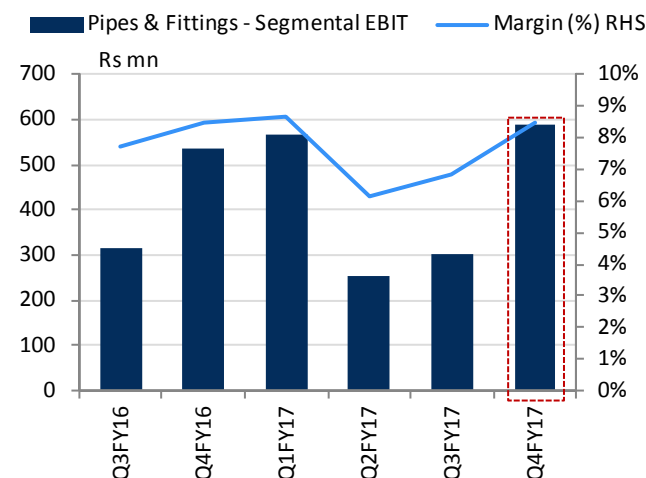
Source: Company, HDFC sec Inst Research

Trend In Revenue Of Pipes & Fittings



Source: Company, HDFC sec Inst Research

Quarterly Trend In EBIT Margin Of Pipes & Fittings



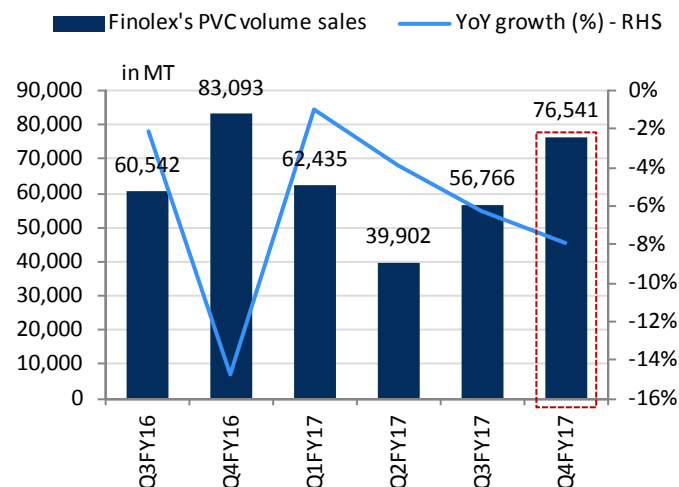
Source: Company, HDFC sec Inst Research

Increasingly, a larger proportion of PVC resin is used for captive consumption, for production of pipes and fittings.

The average EBIT margin for the PVC segment stood at ~21% in 9MFY17, mainly on account of a favourable PVC/EDC spread.

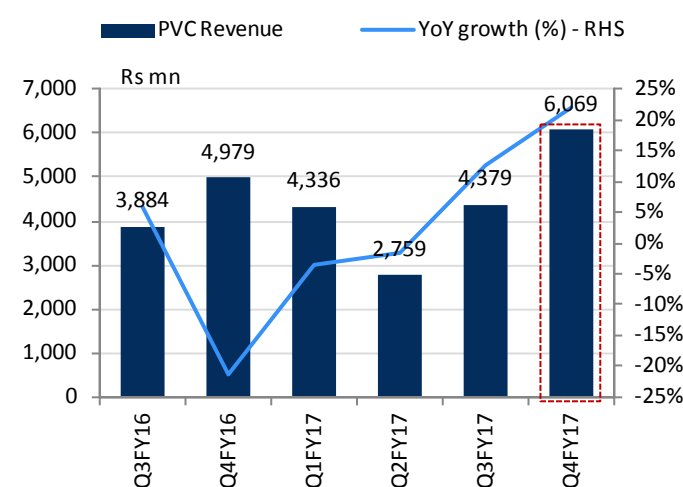
PVC Resin : Quarterly Trends

Trend In Volume Of PVC Resin



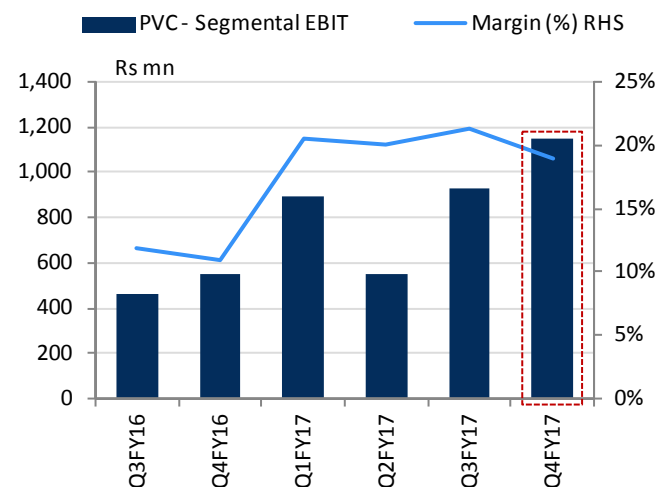
Source: Company, HDFC sec Inst Research

Trend In Revenue Of PVC



Source: Company, HDFC sec Inst Research

Trend In EBIT Margin Of PVC



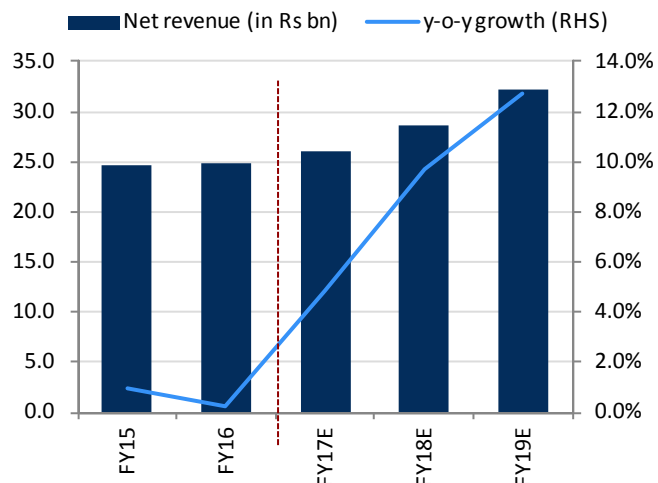
Source: Company, HDFC sec Inst Research

The top line is expected to grow at ~11% CAGR over FY17-19E

The EBIT margin for PVC segment stood at ~20% in FY17, mainly on account of favourable PVC/EDC spread.

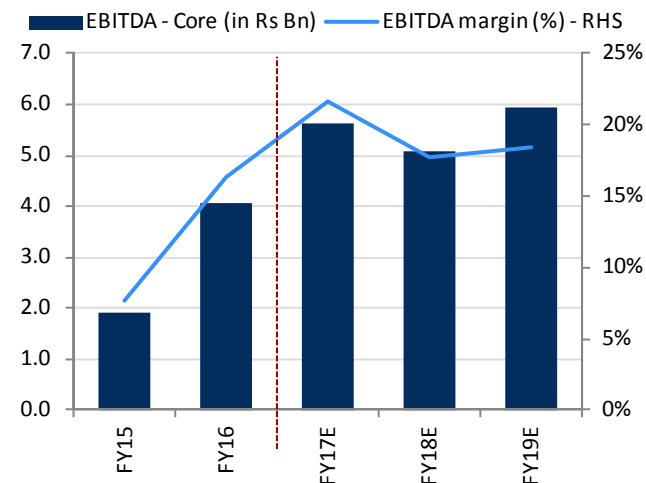
Financials

Trend In Revenue And Y-o-Y Growth



Source: Company, HDFC sec Inst Research

Trend In EBITDA And Operating Margin (Core)



Source: Company, HDFC sec Inst Research

Key Assumptions

	FY15	FY16	FY17	FY18E	FY19E
Volumes (MT)					
Pipes and fittings	185,785	208,763	209,339	234,920	261,467
% YoY		12.4%	0.3%	12.2%	11.3%
PVC resin	243,155	248,177	235,644	238,649	240,690
% YoY		2.1%	-5.1%	1.3%	0.9%
Segment EBIT margin (in %)					
Pipes and fittings	7.9%	7.9%	7.7%	8.5%	9.5%
PVC resin	3.1%	11.6%	20.0%	13.5%	13.5%

Source: Company, HDFC sec Inst Research

Peer Valuations

	Mcap (Rs bn)	CMP (Rs)	Rating	TP (Rs)	P/E (x)			EV/EBITDA (x)			P/BV (x)		
					FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
Supreme Industries	148	1,162	NR	-	30.7	25.7	23.3	17.8	15.2	13.3	7.6	6.5	6.2
Astral Polytechnik	67	560	NR	-	48.8	36.0	28.4	26.8	21.2	17.4	7.5	6.3	5.3
Finolex Industries	74	598	BUY	765	21.1	23.3	19.6	13.3	14.6	12.4	3.2	3.0	2.8

Source: HDFC sec Inst Research

Change In Estimates

Rs mn	Previous		New		% Chg	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Net Sales	28,594	33,039	28,544	32,185	0%	-3%
EBIT	4,792	5,670	4,863	5,720	1%	1%
APAT	3,156	3,778	3,189	3,796	1%	0%

Source: HDFC sec Inst Research

Income Statement

Year ending March (Rs mn)	FY15*	FY16	FY17	FY18E	FY19E
Net Revenues	24,761	24,819	26,020	28,544	32,185
Growth (%)	0.9	0.2	4.8	9.7	12.8
Material Expenses	18,098	16,477	16,092	18,268	20,502
Power & Fuel expenses	740	934	911	999	1,126
Employee Expenses	1,125	925	1,049	1,151	1,297
Other Operating Expenses	2,903	2,439	2,338	3,058	3,338
EBITDA	1,896	4,044	5,630	5,068	5,922
EBITDA Margin (%)	7.7	16.3	21.6	17.8	18.4
EBITDA Growth (%)	(42.0)	113.4	39.2	(10.0)	16.8
Depreciation	587	506	550	544	563
EBIT	1,309	3,539	5,080	4,524	5,359
Other Income (Including EO Items)	202	641	243	340	361
Interest	704	447	153	103	55
PBT	807	3,733	5,170	4,760	5,665
Tax (Incl Deferred)	330	1,189	1,648	1,571	1,870
Minority Interest & Profit/loss from associates	-	-	-	-	-
RPAT	477	2,544	3,522	3,189	3,796
EO (Loss) / Profit (Net Of Tax)	-	-	245	-	-
APAT	477	2,544	3,277	3,189	3,796
APAT Growth (%)	(71.9)	432.8	38.4	(9.4)	19.0
Adjusted EPS (Rs)	3.8	20.5	28.4	25.7	30.6
EPS Growth (%)	(71.9)	432.8	38.4	(9.4)	19.0

Source: Company, HDFC sec Inst Research

*FY15 numbers are as per the old reporting standards. FY16 and FY17 have been re-stated as per IND AS.

Balance Sheet

Year ending March (Rs mn)	FY15*	FY16	FY17	FY18E	FY19E
SOURCES OF FUNDS					
Share Capital - Equity	1,241	1,241	1,241	1,241	1,241
Reserves	6,633	14,458	21,673	23,120	24,810
Total Shareholders Funds	7,874	15,699	22,914	24,361	26,051
Minority Interest	-	-	-	-	-
Long Term Debt	6,159	1,117	942	442	300
Short Term Debt	212	-	-	-	-
Total Debt	6,371	1,117	942	442	300
Net Deferred Taxes	1,108	1,205	909	1,000	1,000
Long Term Provisions & Others	90	644	728	750	800
TOTAL SOURCES OF FUNDS	15,443	18,664	25,493	26,553	28,151
APPLICATION OF FUNDS					
Net Block	8,678	8,496	8,551	8,707	8,845
CWIP	104	66	217	239	269
Investments	1,797	8,172	12,222	12,722	13,222
Other non-current assets	588	698	936	986	1,036
Total Non-current Assets	11,166	17,433	21,926	22,653	23,371
Inventories	5,587	4,472	5,574	5,670	6,369
Debtors	487	176	525	576	649
Loans and advances	1,229	1,231	930	1,020	1,150
Cash & Equivalents	123	104	163	722	1,203
Total Current Assets	7,425	5,983	7,192	7,988	9,371
Creditors	2,000	2,432	2,275	2,568	2,884
Other Current Liabilities & Provns	1,149	2,319	1,350	1,521	1,707
Total Current Liabilities	3,149	4,751	3,625	4,089	4,591
Net Current Assets	4,276	1,232	3,567	3,899	4,780
TOTAL APPLICATION OF FUNDS	15,443	18,664	25,493	26,553	28,151

Source: Company, HDFC sec Inst Research

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Cash Flow

Year ending March (Rs mn)	FY15*	FY16	FY17E	FY18E	FY19E
Reported PBT	807	3,733	5,170	4,760	5,665
Interest expenses	567	357	153	103	55
Depreciation	587	506	550	544	563
Working Capital Change	492	2,299	(2,810)	268	(450)
Tax Paid	(392)	(663)	(1,648)	(1,571)	(1,870)
Others	61	(290)	(243)	(340)	(361)
OPERATING CASH FLOW (a)	2,122	5,941	1,173	3,765	3,603
Capex	(307)	(312)	(757)	(721)	(730)
<i>Free cash flow (FCF)</i>	<i>1,815</i>	<i>5,629</i>	<i>416</i>	<i>3,044</i>	<i>2,872</i>
Investments	480	(927)	(4,050)	(500)	(500)
Non-operating Income	10	432	243	340	361
INVESTING CASH FLOW (b)	183	(807)	(4,563)	(882)	(869)
Debt Issuance/(Repaid)	(832)	(4,126)	(175)	(500)	(142)
Interest Expenses	(579)	(439)	(153)	(103)	(55)
<i>FCFE</i>	<i>404</i>	<i>1,065</i>	<i>87</i>	<i>2,441</i>	<i>2,675</i>
Share Capital Issuance	-	-	-	-	-
Dividend	(981)	(291)	(1,427)	(1,489)	(1,799)
Others		(298)	5,205	(232)	(256)
FINANCING CASH FLOW (c)	(2,391)	(5,153)	3,449	(2,324)	(2,253)
NET CASH FLOW (a+b+c)	(86)	(19)	59	559	481
Opening bal of Cash & Cash Equ	209	123	104	163	723
Closing Cash & Equivalents	123	104	163	723	1,204

Source: Company, HDFC sec Inst Research

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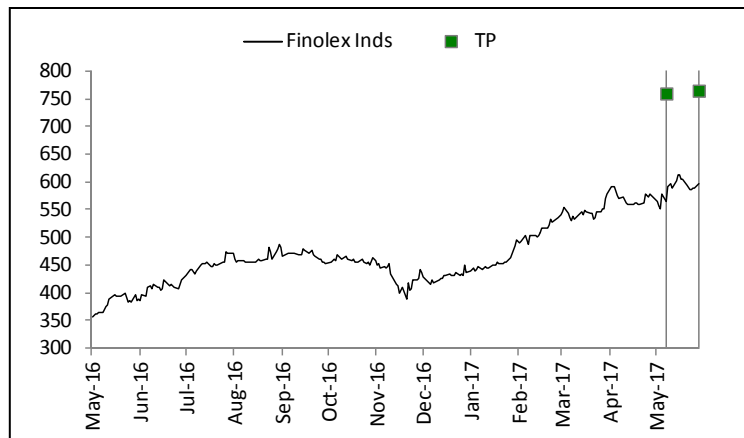
Key Ratios

	FY15*	FY16	FY17	FY18E	FY19E
PROFITABILITY (%)					
GPM	26.9	33.6	38.2	36.0	36.3
EBITDA Margin	7.7	16.3	21.6	17.8	18.4
APAT Margin	1.9	10.3	13.5	11.2	11.8
RoE	6.1	21.6	18.2	13.5	15.1
RoIC (or Core RoCE)	4.2	11.7	15.0	11.1	12.8
RoCE	5.7	16.7	16.4	12.5	14.0
EFFICIENCY					
Tax Rate (%)	40.9	31.8	31.9	33.0	33.0
Fixed Asset Turnover (x)	2.8	2.9	3.1	3.3	3.7
<i>Inventory (days)</i>	<i>82.4</i>	<i>65.8</i>	<i>78.2</i>	<i>72.5</i>	<i>72.2</i>
<i>Debtors (days)</i>	<i>7.2</i>	<i>2.6</i>	<i>7.4</i>	<i>7.4</i>	<i>7.4</i>
<i>Other Current Assets (days)</i>	<i>18.1</i>	<i>18.1</i>	<i>13.0</i>	<i>13.0</i>	<i>13.0</i>
<i>Payables (days)</i>	<i>29.5</i>	<i>35.8</i>	<i>31.9</i>	<i>32.8</i>	<i>32.7</i>
<i>Other Current Liab & Provns (days)</i>	<i>16.9</i>	<i>34.1</i>	<i>18.9</i>	<i>19.5</i>	<i>19.4</i>
Cash Conversion Cycle (days)	61.2	16.6	47.7	40.6	40.6
Debt/EBITDA (x)	3.4	0.3	0.2	0.1	0.1
Net D/E (x)	0.8	0.1	0.0	(0.0)	(0.0)
Interest Coverage (x)	1.9	7.9	33.1	43.9	97.0
PER SHARE DATA (Rs)					
EPS	3.8	20.5	28.4	25.7	30.6
CEPS	8.6	24.6	32.8	30.1	35.1
Dividend	7.0	2.0	10.0	11.5	12.0
Book Value	63.4	126.5	184.6	196.3	209.9
VALUATION					
P/E (x)	155.4	29.2	21.1	23.3	19.6
P/BV (x)	9.4	4.7	3.2	3.0	2.8
EV/EBITDA (x)	42.4	18.6	13.3	14.6	12.4
EV/Revenues (x)	3.2	3.0	2.9	2.6	2.3
OCF/EV (%)	2.6	7.9	1.6	5.1	4.9
FCF/EV (%)	2.3	7.5	0.6	4.1	3.9
FCFE/Mkt Cap (%)	0.5	1.4	0.1	3.3	3.6

Source: Company, HDFC sec Inst Research

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RECOMMENDATION HISTORY



Date	CMP	Reco	Target
8-May-17	562	BUY	760
29-May-17	598	BUY	765

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

HDFC Securities Limited, SEBI Reg. No.: NSE-INB/F/E 231109431, BSE-INB/F 011109437, AMFI Reg. No. ARN: 13549, PFRDA Reg. No. POP: 04102015, IRDA Corporate Agent License No.: HDF 2806925/HDF C000222657, SEBI Research Analyst Reg. No.: INH000002475, CIN - U67120MH2000PLC152193

Mutual Funds Investments are subject to market risk. Please read the offer and scheme related documents carefully before investing.

