Sharekhan by BNP PARIBAS

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Stock Update

Finolex Cables Limited

Steady Q3; Outlook positive

Capital Goods	Sharekhan code: FINCABLES	Results 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. 387**	
Price Target: **Rs. 475**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 5,915 cr
52-week high/low:	Rs. 426 / 165
NSE volume: (No of shares)	1.1 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	5	39	36	6
Relative to Sensex	-2	22	2	-20

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Finolex cables with a revised PT of Rs. 475 considering its reasonable valuation and improving growth outlook.
- Steady quarter led by strong revenue growth better than estimates along with stable operating profit margins and PAT which remained in line with estimates.
- Expect better FY2022 as cables and wires sees improvement with rising infrastructure investments and scaling of its FMEG business with improving demand and expect revenues to improve on better volumes.
- Finolex's strong balance sheet and net cash position remains its salient features.

Finolex Cables reported a steady quarter led by strong revenue growth along with stable y-o-y operating profit margins and PAT. Its standalone revenue grew 18.2 % y-o-y, to Rs. 830.2 crore (better than estimates) led by higher volume growth across product categories. Operating margins declined marginally by 31 bps y-o-y to 12.8% (in line with estimates) due to lower gross margins impacted (higher discounts to distributors leading to lower realisations). Accordingly, EBITDA stood at Rs. 106.6 crore (up 15.4% y-o-y) on higher revenues. Lower other income (down 29.4% y-o-y) and higher tax rate (29% vs 26% in Q3FY20) led to muted PAT to Rs. 82.8 cr y-o-y (up 2.6% y-o-y, in line with estimates). The management indicated that the demand has been good in Q3FY21 which has been sustaining in the current quarter both for FMEG products and wires. With improving business sentiments demand for the electric cables normalising as new residential projects picking up, wherein the company's major product line remains wires used in housing and commercial establishments, leading to a better demand for the C&W segment. Going ahead, a revival in the in government, private capex by key sectors, along with pick-up in real estate should boost C&W growth, thereby benefitting Finolex. On telecom cable, the management highlighted that demand for products such as speaker, LAN, CCTV and coaxial cables have remained strong and are expected to continue. In optical fibre cable (largely B2B dominated by government orders) tendering from centres and states have been slow, although expect tendering from states / gram panchayats to happen as things improve. There have been some orders being floated from BSNL too. The company's FMEG business (5% 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 which is reaping benefits with improving sales in FMEG. The company has launched conduit pipe and accessories for construction Industry which fits in the current product profile for the company. The current market size for the conduit pipes is in the range of Rs. 1400-1500 crore and company expects to garner 10-15% market over a period with its wide network and expects market penetration to be quick. The management indicated that the unlock phases across country are leading to improving business sentiments with improving demand environment. Further, repeated assurances from the government towards economy building, provides confidence. 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 FY2021-FY2022E. The stock is trading at a reasonable valuation of 16.5x and 13.8x its FY2022E and FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 475.

Key positives

- Revenues remained strong during Q3FY21 lead by electrical cables and FMEG business
- Cash position remains strong with cash as on 31st Dec FY21 stands at Rs. 1476 crore vs. Rs 1201 crore 31st Dec FY20

Key negatives

- Gross margins declined by 154 bps on higher discounts to its distributors leading to lower realizations.

Our Call

Valuation: Retain Buy with a revised PT of Rs. 475: We believe the company's operations are expected to improve as supply chain becomes stable with an improving demand environment and rising infrastructure investments. Further, COVID-19 led impact on unorganized players provides the company to increase its market share. Finolex's strong 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 16.5x and 13.8x its FY2022E and FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 475.

Key Risks

Fluctuations in raw-material prices could sharply affect margins.

Valuation (standalone) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	2,877	2,572	2,956	3,435
OPM (%)	12.9	11.3	13.1	13.6
Adjusted PAT	402	257	358	427
% y-o-y growth	*17.0*	*(36.1)*	*39.1*	*19.5*
Adjusted EPS (Rs.)	26.3	16.8	23.4	27.9
P/E (x)	14.7	23.0	16.5	13.8
P/B (x)	2.2	2.0	1.8	1.7
EV/EBITDA (x)	9.2	12.7	9.3	7.8
RoNW (%)	18.6	11.3	15.8	17.5
RoCE (%)	19.5	12.3	15.6	16.9

Source: Company; Sharekhan estimates

Steady Q3: Finolex Cables reported a steady quarter led by strong revenue growth along with stable y-o-y operating profit margins and PAT. Its standalone revenue grew 18.2 % y-o-y, to Rs. 830.2 crore (much better than estimates) led by better volumes across product categories. Segmentally electric cables revenue improved 18.6 % y-o-y to Rs 693 crore (7% volume growth) while Communication Cables grew 6.5% y-o-y to Rs 96 crore. Volumes in Electrical Cables and Communication Cables including optical fibre cable improved by 9% and 25% y-o-y. In new Business (FMEG) revenues improved 35.7% y-o-y to Rs. 34 crore. The newer categories of Lamps, Switches, Switchgear, Fans and Water Heaters continued on the trend from the previous quarters, notching growth rates of around 30%. Operating margins marginally declined by 31 bps y-o-y to 12.8% (in line with estimates) due to lower gross margins impacted (higher discounts to distributors leading to lower realizations). Accordingly, EBITDA stood at Rs 106.6 crore (up 15.4%) on higher revenues. Lower other income (down 29.4%) and higher tax rate (29% vs 26% in Q3FY20) led to muted PAT to Rs 82.8 cr y-o-y (up 2.6% y-o-y, in line with estimates).

Business environment looking up: The management indicated that the 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 the electric cables normalising as new residential projects 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, a revival in the 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 the telecom cable demand for products such as speaker cables, LAN, CCTV wires and coaxial has been strong expected to continue. In optical fibre cable (largely B2B dominated by government orders) tendering from centres and states have been slow, although expect tendering from states / gram panchayats to happen as things improve. The company's FMEG business (2-3% 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 Q3FY21 Concall Highlights

- **Electrical cables/wires:** Volume growth seen across the products with 9% overall growth wherein auto cable wire (+30% volume growth)
- **FMEG business (Fans, Water Heaters, Lamps, Switches and Switchgear):** Business have shown constant improvements with volume growth of more than 30% y-o-y during Q3FY21 due to improved distribution effort. Current company has ~490 distributors connecting 1,40,000 retail touch points and expect to reach 500 distributors connecting 1,50,000 touchpoints.
- **Telecom cables:** Both COVID related disruptions as well as structural issues in the industry have continued to impact this segment but seen some respite with regular products in communication cable products such as speaker cables, LAN, CCTV cables and coaxial cables growing by 25% in volumes. In optical fibre cable (largely B2B dominated by government orders) consumption remained 25% higher q-o-q. Tendering from centers and states have been slow, although we expect tendering from states / gram panchayats to happen during as things improve. Some orders being floated by BSNL.
- **Demand:** The management indicated that the demand remained good as seen with good volume increase and it has been sustaining the current quarter. So overall outlook remains positive.
- **Gross margins:** Gross margins lower due to higher discounts (earlier discounts based on targets) given to distributors as no targets set which has continued from Q1 and expected to continue till Q4FY21, so lower realization leading to lower gross margins. However, a bit aggressive targets being expected from Q1FY22 to recover some ground and higher growth. Any hike in raw material is a pass through with a lag.
- **B2B and B2C revenue allocation:** Company B2C /B2B comprises 65/35% of revenues.
- **Capex:** The company has maintained its capex plans of Rs. 200 crore in the next ~18-20 months wherein they have done capex of Rs. 30 crore by Q3FY21.

- **New product:** The company introduced conduit and fittings which are used in pulling wires through fitted inside the wall and used in construction and fits in the current product basket company caters. Market size for the conduit pipes is in the range of Rs. 1400-1500 crore and company expects to garner 10-15% market over a period of time.
- **Cash:** Cash position remains strong with cash as on 31st Dec FY21 stands at Rs 1476 crore vs. Rs. 1201 crore 31st Dec FY20.
- **Net Working capital days:** NWC days in Q3FY21 stands at 52 days against 55 days in Q2FY21 (57 days in Q3FY20).

Results **Rs cr**

Particulars	Q3FY19	Q3FY18	Y-o-Y %	Q2FY19	Q-o-Q %
Revenue	750	657	14.1%	714	5.0%
Operating profit	110	98	11.7%	86	27.7%
Other Income	19	18	8.7%	58	-66.9%
Interest	0	-		0	
Depreciation	10	11	-8.6%	11	-11.8%
PBT	119	105	13.2%	133	-10.3%
Tax	43	30	42.4%	40	8.1%
EO	-	-		-	
Reported PAT	76	75	1.4%	93	-18.3%
Adj. PAT	76	75	1.4%	93	-18.3%
Adj.EPS	5.0	4.9	1.4%	6.1	-18.3%
Margin			**BPS**		**BPS**
OPM (%)	14.6	14.9	(32)	12.0	260
NPM (%)	10.1	11.4	(127)	13.0	(288)
Tax rate	36.3	28.8	-	30.1	-

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 6.3mn 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 a 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. The 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.

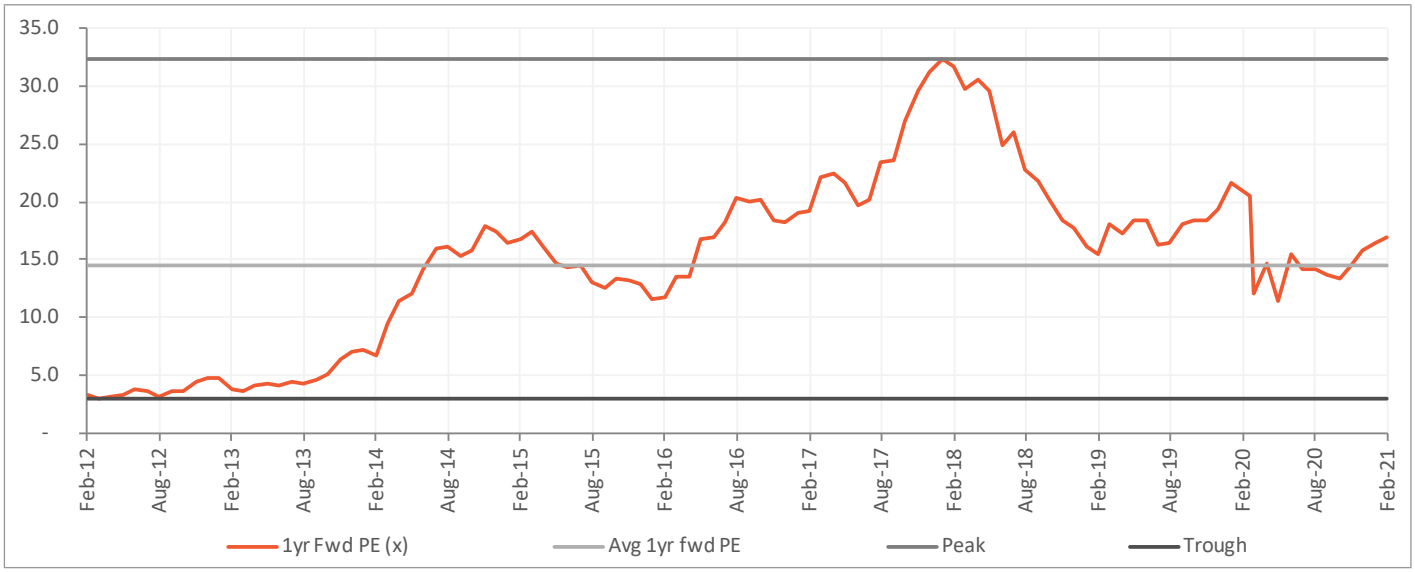
■ Company outlook - Operations on an improving trajectory:

Demand for the electric cables are 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 festival season 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 opportunity to increase market share organically as the pandemic has had a severe impact on unorganised sector players. The management indicated that unlocking across country will lead to improving business sentiments. Further, repeated assurances from government towards economy building, provides confidence.

■ Valuation - Retain Buy with a revised PT of Rs. 475:

We believe the company's operations are expected to improve 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 the opportunity to increase its market share. Finolex's strong 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 16.5x and 13.8x its FY2022E and FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 475.

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 & 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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