



Powered by the Sharekhan 3R Research Philosophy

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 | ■ | ↔ | ■ |

ESG Disclosure Score

NEW

ESG RISK RATING

Updated Jul 08, 2022

23.97

Medium Risk

| NEGL | LOW | MED | HIGH | SEVERE |
|------|-------|-------|-------|--------|
| 0-10 | 10-20 | 20-30 | 30-40 | 40+ |

Source: Morningstar

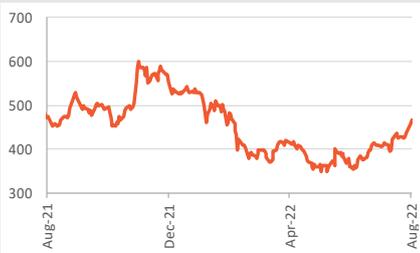
Company details

| | |
|-------------------------------|---------------|
| Market cap: | Rs. 7,142 cr |
| 52-week high/low: | Rs. 609 / 343 |
| NSE volume: (No of shares) | 2.29 lakh |
| BSE code: | 500144 |
| NSE code: | FINCABLES |
| Free float: (No of shares) | 9.8 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 35.9 |
| FII | 9.3 |
| DII | 15.3 |
| Others | 39.6 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|------|------|------|------|
| Absolute | 15.0 | 28.7 | -0.3 | -1.1 |
| Relative to Sensex | 4.5 | 17.8 | -4.5 | -9.1 |

Sharekhan Research, Bloomberg

Finolex Cables Ltd

Strong Q1; Upbeat future outlook

Capital Goods

Sharekhan code: FINCABLES

Reco/View: Buy



CMP: Rs. 467

Price Target: Rs. 581



Upgrade



Maintain



Downgrade

Summary

- We retain our Buy rating on Finolex Cables Limited (Finolex) with a revised PT of Rs. 581, given compelling valuations and strong long-term growth prospects.
- Finolex reported healthy performance, backed by robust volumes in electrical wires (24% y-o-y) despite a challenging environment and intense competition.
- We expect robust demand from sectors such as real estate, auto, and industrials for its wires and cables business. Further, scalability in power cables and FMEG would boost revenue and earnings growth.
- Scope of margin improvement, healthy operating cash flow generation, tight working capital management, and limited capex requirements give us further comfort.

Finolex Cables Limited's (Finolex) standalone Q1 numbers were better than our estimates. The company's topline increased by 50% yoy to Rs. 1,016 crore (vs. our estimate of Rs. 1,069 crore). Cables reported strong growth of 48% yoy to Rs 827 crore. Communication cables sales were up 53% yoy to Rs. 134 crore. Sales from copper rods increased over 7x y-o-y to Rs. 299 crore, while the others (FMEG) segment reported revenue of Rs. 50 crore (up ~83% yoy). In volume terms, electrical wires increased by 24% y-o-y, while power cables increased by 2%. Within the communication cables segment, volume of metal-based products improved by 14% during the quarter, while optic fibre cable volumes grew by over 200% during the quarter. New products within the FMEG sector grew significantly. Volume growth could have been better, but inflationary pressures affected consumer sentiment in the latter half of the quarter. Operating profit was up 62% yoy to ~Rs. 114 crore. Operating profit margin (OPM) increased 78 bps yoy to 11.2% (vs. our estimate of 10%). Segment wise, the major segment, electrical cables' EBIT margin was up 206 bps yoy to 12.8% in Q1FY2023, while EBIT margin of the other (FMEG) segment remained muted at 1.5%. Strong topline led to 74% yoy growth in profit after tax to Rs. 96 crore (vs. our estimate of Rs. 88 crore).

Key positives

- Volumes of electrical wires increased by 24% y-o-y in Q1FY2023. Optic fiber cable volumes grew by over 200% during the quarter.
- OPM increased by 78bps y-o-y to 11.2% due to proportionate decline in employee cost and other expenses.
- EBIT margin for the electrical cables segment improved by 206 bps y-o-y to 12.8%.

Key negatives

- Overall volume growth could have been better but inflationary pressures affected consumer sentiment in the latter half of the quarter.
- Gross profit margin declined by 97 bps y-o-y to 21%, however it improved on a q-o-q basis by 195 bps.
- EBIT margin of the other (FMEG) segment remained muted at 1.5%.

Management Commentary

- In volume terms, electrical wires increased by 24% y-o-y, while power cables increased by 2%.
- Within the communication cables segment, volume of metal-based products improved by 14% during the quarter, while optic fibre cable volumes grew by over 200%.
- New products within the FMEG sector grew significantly.

Revision in estimates – We have maintained our estimates for FY2023-FY2024E.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 581: We believe the company's growth momentum would continue, backed by demand from key sectors such as real estate, auto, construction, and industrials. Further, the government's push for optical fibre cable will aid business and boost demand for telecom cables for the company. The company is expanding wires and conduit pipes capacity, which would boost volumes going forward. Finolex's debt-free balance sheet and net cash position provide us comfort. The company's strategy of taking advance payments and facilitate channel financing for its channel partners, without any recourse to the company, ensures timely cash flows and less stress on its working capital. With strong growth visibility, we retain our Buy rating on the stock with a revised SOTP-based PT of Rs. 581 (13.5x its P/E on FY2024E standalone Core EPS and 30% holding company discount for its stake in Finolex Industries).

Key Risks

- Any sharp increase or decrease in key raw-material (copper) prices would lead to volatility in the company's margins.
- Weak demand in some of the segments and inflationary pressures could affect earnings.

Valuation (Standalone)

| Particulars | Rs cr | | | |
|--------------------|--------|-------|-------|-------|
| | FY21 | FY22 | FY23E | FY24E |
| Net sales | 2,768 | 3,768 | 4,455 | 5,014 |
| OPM (%) | 12.8 | 11.0 | 12.2 | 13.1 |
| Net profit | 283 | 405 | 475 | 571 |
| Growth y-o-y (%) | (29.7) | 43.0 | 17.5 | 20.0 |
| Adjusted EPS (Rs.) | 18.5 | 26.5 | 31.1 | 37.3 |
| P/E (x) | 25.2 | 17.7 | 15.0 | 12.5 |
| P/B (x) | 2.4 | 2.2 | 2.0 | 1.7 |
| EV/EBIDTA (x) | 16.3 | 12.5 | 10.3 | 8.5 |
| RoCE (%) | 13.8 | 16.9 | 18.3 | 19.6 |
| RoE (%) | 9.8 | 11.5 | 17.2 | 18.1 |

Source: Company; Sharekhan estimates

Results beat estimates, healthy volume growth

Finolex's standalone Q1 numbers were better than our estimates. Topline increased by 50% yoy to Rs. 1,016 crore (vs. our estimate of Rs. 1,069 crore). Cables reported strong growth of 48% y-o-y to Rs. 827 crore. Communication cables sales were up by 53% yoy to Rs. 134 crore. Sales from copper rods increased over 7x y-o-y to Rs. 299 crore, while the others (FMEG) segment reported revenue of Rs. 50 crore (up ~83% y-o-y). In volume terms, electrical wires increased by 24% y-o-y, while power cables increased by 2%. Within the communication cables segment, volume of metal-based products improved by 14% during the quarter, while optic fibre cable volumes grew by over 200% during the quarter. New products within the FMEG sector grew significantly. Volume growth could have been better, but inflationary pressures affected consumer sentiment in the latter half of the quarter. Operating profit was up 62% y-o-y to ~Rs. 114 crore. OPM was up by 78bps y-o-y to 11.2% (vs. our estimate of 10%). Segment wise, the major segment, electrical cables' EBIT margin was up by 206 bps y-o-y to 12.8% in Q1FY2023, while EBIT margin of the other (FMEG) segment remained muted at 1.5%. Strong topline led to 74% y-o-y growth in profit after tax to Rs. 96 crore (vs, our estimate of Rs. 88 crore).

Optimistic growth outlook led by demand, capacity expansion, and new launches

Demand in the wires segment has been good, given strong volume growth of 24% y-o-y. Demand for electric cables is likely to improve as new residential projects is picking up. The company has begun expansion of its wires and conduit pipes capacity in FY2022 and would spend total of ~Rs. 200 crore by FY2023. The company's FMEG business is performing well and is likely to scale up further with an improving demand environment. In the FMEG space, the company's aim is to reach revenue of Rs. 500 crore over the next two to three years. Lights, fans, and PVC conduit contribute largely to FMEG revenue. Once fans revenue crosses over Rs. 100 crore, the company plans to start in-house manufacturing of fans. The company also plans to introduce new products in this domain. Finolex has equal share of traditional channels and distributors for its products.

Results (Standalone)

| Particulars | Rs cr | | | | |
|------------------|---------|--------|------------|---------|------------|
| | Q1FY23 | Q1FY22 | Y-o-Y % | Q4FY22 | Q-o-Q % |
| Net Sales | 1,015.7 | 675.4 | 50.4 | 1,186.9 | (14.4) |
| Operating Profit | 113.7 | 70.3 | 61.7 | 116.6 | (2.5) |
| Adjusted PAT | 95.6 | 55.1 | 73.5 | 104.6 | (8.6) |
| Reported PAT | 95.6 | 55.1 | 73.5 | 104.6 | (8.6) |
| Adj. EPS (Rs.) | 6.2 | 3.6 | 73.5 | 6.8 | (8.6) |
| Margin | | | BPS | | BPS |
| OPM(%) | 11.2 | 10.4 | 78 | 9.8 | 137 |
| NPM (%) | 9.4 | 8.2 | 125 | 8.8 | 60 |
| Tax rate (%) | 25.0 | 27.4 | (236) | 17.3 | 775 |

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Ample levers offer 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 6.3 million kms in FY2014 to 14.5 million 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, slowdown in infrastructure growth and uncertainty in real estate will lead to moderation in growth for the C&W segment. 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. 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.

■ Valuation – Retain Buy with a revised PT of Rs. 581:

We believe the company's growth momentum would continue, backed by demand from key sectors such as real estate, auto, construction, and industrials. Further, the government's push for optical fibre cable will aid business and boost demand for telecom cables for the company. The company is expanding wires and conduit pipes capacity, which would boost volumes going forward. Finolex's debt-free balance sheet and net cash position provide us comfort. The company's strategy of taking advance payments and facilitate channel financing for its channel partners, without any recourse to the company, ensures timely cash flows and less stress on its working capital. With strong growth visibility, we retain our Buy rating on the stock with a revised SOTP-based PT of Rs. 581 (13.5x its P/E on FY2024E standalone Core EPS and 30% holding company discount for its stake in Finolex Industries).

One-year forward P/E (x) band



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. Finolex has added electrical switches, LED-based lamps, fans, low-voltage MCBs, and water heaters to its product range.

Investment theme

The pick-up in capex in real estate, construction, industrials, and auto sector post COVID-19 is likely to lead to robust demand for housing wires and cables. 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. Moreover, foray into FMEG products would aid revenue growth once the products reach a sizeable revenue. The company also plans to pursue inorganic opportunities to expand its product portfolio.

Key Risks

- ◆ Any sharp increase or decrease in key raw-material (copper) prices would lead to volatility in the company's margins.
- ◆ Weak demand in some of the segments and inflationary pressures could affect earnings.

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 | Nippon Life India Trustee Ltd. | 4.39 |
| 2 | Templeton India Value Fund | 3.46 |
| 3 | Anil Ramchand Chhabria | 3.12 |
| 4 | HDFC Trustee Co. Ltd. | 2.30 |
| 5 | L&T Mutual Fund Trustee Ltd. | 2.01 |
| 6 | Gopichand Parmanand Hinduja | 1.89 |
| 7 | LGOF Global Opportunities Fund Ltd. | 1.89 |
| 8 | Katara Aruna Mukesh | 1.84 |
| 9 | HDFC Life Insurance Company Ltd. | 1.82 |
| 10 | DSP Small Cap Fund | 1.66 |

Source: Bloomberg; Capitaline

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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 deteriorating 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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