Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Polycab India Ltd

Operating performance leads show, outlook bright

Capital Goods	Sharekhan code: POLYCAB
Reco/View: Buy ↔	CMP: Rs. 2,707 / Price Target: Rs. 3,215 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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 25.1

Updated July 08, 2022

Medium Risk

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

Source: Morningstar

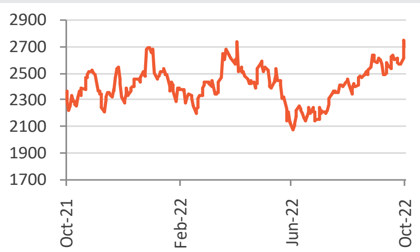
Company details

Market cap:	Rs. 40,454 cr
52-week high/low:	Rs. 2,863/2,044
NSE volume: (No of shares)	3.6 lakh
BSE code:	542652
NSE code:	POLYCAB
Free float: (No of shares)	4.8 cr

Shareholding (%)

Promoters	68.0
FII	5.7
DII	9.0
Others	17.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.8	27.7	7.1	10.6
Relative to Sensex	5.6	19.6	4.0	15.2

Sharekhan Research, Bloomberg

Summary

- Q2FY2023 performance was led by healthy volume growth in Wires & Cables (W&C) and sharp increase in gross/operating margins.
- Augmentation of exports, strong traction in Etira brand, capacity expansion and improving working capital cycle bodes well for long-term growth.
- Company is well-poised to leverage the rising demand for W&C through its large product basket and deeper penetration.
- We retain a Buy on Polycab India Limited (Polycab) with a revised PT of Rs. 3,215 (based on October FY24E EPS) on account of healthy H1FY2023 and various long-term catalysts in terms of market share gains through widening distribution reach and product launches.

Polycab India Limited's (Polycab's) Q2FY23 results were broadly in line with our expectations with a beat on gross margin and operating margin expectations. Its revenue grew by ~11% y-o-y to Rs. 3,332crore (versus our estimate of Rs 3,395crore). The growth was largely led by 12% y-o-y growth in Wires and Cables (W&C) revenue to Rs. 2,901 crore. However, FMEG sales declined by 11% y-o-y to Rs 305 crore, while others (EPC) segment posted growth of 10.5% y-o-y to Rs. 105crore. GPM improved by 418 bps/110 bps y-o-y/q-o-q to 26.1% on account of proportionate decline in raw material cost. Operating profit grew by 46% y-o-y to Rs 428 crore and OPM improved by 309 bps y-o-y to 12.8% (versus our estimate of 12.3%). Net profit grew by ~37% y-o-y to Rs 268 crore (Versus our estimate of Rs 279crore). EBIT margin in wires & cables segment jumped to 11.9% (versus 8.7% in Q2FY22), while FMEG reported loss of Rs 3 crore at the EBIT level.

Key positives

- In W&C, both domestic and institutional segments posted healthy volume growth which was in mid to high teens on y-o-y basis and mid-teens on q-o-q basis.
- Exports had remarkable growth of 75% y-o-y led by USA, Europe and Asia. Overall, exports business contributed 13% of revenue in Q2FY23 versus 8.4% in Q2FY22.
- OPM improved y-o-y and q-o-q to 12.8% led by strong growth in exports and prudent price revisions.
- Polycab's economy sub brand "Etira" in the W&C segment gained further traction and posted strong growth of 100% y-o-y.

Key negatives

- FMEG business had a soft quarter with 11% y-o-y decline in revenues and a loss of Rs. 3 crore at the EBIT level.
- Other income was negative at Rs 2 crore due to MTM losses.

Management Commentary

- The company is trying to replace/support some dealers in order to accelerate growth of FMEG division. The realignment of distribution and dealers' network should continue till March 2023.
- Polycab is seeing broad based recovery in USA, Australia and other countries and was able to gain significant traction in Africa during Q2FY23.
- The company is constantly striving for working capital optimization. Channel financing has been achieved at 75% in W&C and at 60-70% in FMEG. Inventory optimization can be at 90 days and with 25 days of receivables, working capital is sustainable at 45-50 days.
- The company's cash balance has improved to Rs 1,120 crore as there has been a considerable reduction in working capital requirements.
- As per the past trend, Polycab expects H2FY2023 to be better than H1FY2023.

Revision in estimates – We have tweaked our estimates for FY2023/FY2024 to build in lower revenue/EBIT contribution from FMEG and introduced FY2025 estimates.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 3,215: Polycab is expediting efforts to gain market share by growing its B2C business, scaling up FMEG business and boosting its exports. Further, realignment of distribution strategy in the FMEG segment, launch of new products and increasing penetration in the rural markets bodes well for long-term growth. In the long term, Polycab is expected to benefit from government infrastructure investments, increase in housing demand and pick up in private capex spending. Operating performance is likely to further improve on y-o-y basis with increase in scale and backward integration. Thus, the company is on a healthy growth trajectory, owing to its leadership position and a strong product portfolio both in W&C as well as a widening distribution network and in-house manufacturing capabilities. Hence, we recommend Buy with a revised PT of Rs. 3,215 (rolling forward our estimates to October FY24E EPS).

Key Risks

Fluctuations in raw-material prices and intense competition are key concerns.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenues	12,204	14,766	17,188	19,974
OPM (%)	10.4	11.4	11.6	11.8
Adj. Net profit	845	1,128	1,337	1,583
Growth (Y-o-y) %	0.4	33.5	18.5	18.4
Adj. EPS (Rs)	56.7	75.7	89.7	106.2
PER (x)	47.8	35.8	30.2	25.5
P/B (x)	7.3	6.3	5.3	4.5
EV/EBIDTA (x)	29.0	21.8	18.3	15.4
RoCE (%)	21.7	25.6	25.8	26.0
RoNW (%)	16.4	18.8	19.0	19.1

Source: Company; Sharekhan estimates

Strong operating performance amid inflationary pressures

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Promising long –term business outlook

Polycab is confident of delivering strong performance as it aims to deliver industry leading growth in B2B in W&C through growth in both domestic and exports, scaling up of B2C business (currently 38% of revenue). It is also focused on ramping up FMEG business through realignment of its distribution strategy and merging of verticals. The company reiterated its initiative, Project Leap, through which it intends to achieve a revenue of Rs. 20,000 crore, by FY2026E and aims to grow faster than the industry. The company would incur an annual capex of Rs. 400 crore per annum of which two-thirds would be spent towards cables segment to augment exports, maintenance capex as well as building capabilities in products where utilisation is very high. The rest would be attributed to the FMEG business for enhancing product portfolio and expanding market reach. Thus, Polycab is well poised for a sustainable and healthy growth in the medium to long term.

Polycab Q2FY2023 Investor Update and Earnings Concall Highlights

Healthy volume growth in W&C segment: In the W&C segment, both domestic and institutional segments posted healthy revenue growth. Volume growth was in mid to high teens on a y-o-y basis and mid-teens on q-o-q basis.

Strong performance from exports: Exports had a remarkable growth of 75% y-o-y led by the US, Europe and Asia. Demand from sectors like oil & gas, renewables and infrastructure remained strong globally. Overall, exports business contributed to 13% of revenue in Q2FY23 versus 8.4% in Q2FY22. The company is seeing broad based recovery in USA, Australia and other countries and was able to gain significant traction in Africa. In exports, 55% sales is coming from distribution channels. Exports have similar margins as domestic business.

FMEG segment to perform better in FY24: It was a soft quarter for FMEG business as demand was subdued in rural markets. Fans volumes were impacted due to lean season, inflationary environment and transition to the new BEE regulations. Switch business recovered from the lows of Q1FY23, posting 123% q-o-q growth. In addition, realignment in distribution strategy also impacted the growth for Q2FY23. The net price hikes have been between 0-3% across products on q-o-q basis. The company is calibrating to replace/support some of the dealers in order to accelerate growth of this division. The realignment of distribution and dealers' network should continue till March 2023. In October, the company merged fans vertical with lights & luminaries and retail wires vertical with switches & switchgears to unlock value through cross - selling opportunities and operational efficiencies. The company expects FMEG sales and operating performance to improve significantly in FY2024E and expects FMEG to clock 10% EBITDA margin by FY2026.

Channel Inventory at the optimum level: The company is asking dealers and distributors to optimize inventory and work on higher turnover as they are more exposed to price fluctuations. The company would keep sufficient inventory as it can better mitigate the price variations.

Price revisions: So far, price hikes in W&C have been in mid-teens across products. Further, price reduction is lower than the benefit the company has received from low-cost procurement (due to drop in copper prices).

Working capital sustainable at 45-50 days: The company is constantly striving for working capital optimization. Channel financing has been achieved at 75% in W&C and at 60-70% in FMEG. Inventory optimization can be at 90 days and with 25 days of receivables, working capital is sustainable at 45 -50 days.

Strengthening cash position: The company's cash stands at Rs 1,120 crore as there has been a considerable reduction in working capital requirements. The company plans ~Rs 400 crore of capex every year in order to enhance manufacturing capacities and more acquisitions in the lines of Silvan Innovation.

Impressive ramp up of Etira brand: Etira brand in the economy segment has gained traction and clocked 100% y-o-y growth. Although largely it's a new business, the company stated that there has been some amount of cannibalization with Polycab's products. Further, the brand is helping Polycab penetrate rural markets as customers are cost conscious. The pricing difference is mid to high single digits as compared to unorganized players' products.

Capacity utilization: In W&C capacity utilization is at 65-70%. FMEG there is lower utilization in fans, while capacity in switches and switchgear is being ramped up.

Litigation with Atomberg Technologies: The litigation is with reference to a particular model of fans which has immaterial contribution to total fans revenue. The interim order is scheduled in November wherein Polycab will present its side. As of now the company has stopped selling products of this particular SKU.

Increase in A&P spend – As the company plans to ramp up its B2C business, its advertisement and promotional spend would be 3-5% of its B2C revenues.

Product launches: The company plans to launch 300+ new products across B to C business. The company is also focusing on premiumization of its offerings in the FMEG segment.

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	Y-o-y %	Q1FY23	QoQ %
Net Sales	**3,332**	**3,007**	**10.8**	**2,737**	**21.8**
Operating profit	428	293	46.0	311	37.5
Other Income	(2)	27	NM	44	NM
Interest	14	5	173.0	8	64.9
Depreciation	52	51	2.7	51	2.5
PBT	359	264	35.8	296	21.4
Tax	88	66	32.6	72	21.9
Reported PAT	270	198	36.7	223	21.5
Adjusted PAT	268	195	37.2	220	21.9
Adj. EPS (Rs.)	17.9	13.1	37.2	14.7	21.9
Margin			**BPS**		**BPS**
GPM (%)	26.1	21.9	418	25.0	110
OPM (%)	12.8	9.7	309	11.4	147
NPM (%)	8.0	6.5	154	8.0	1
Tax rate (%)	24.5	25.1	(60)	24.4	11

Source: Company, Sharekhan Research

Segment wise revenue break-up Rs cr

Particulars	Q2FY23	Q2FY22	Y-o-Y (%)	Q1FY23	Q-o-Q (%)
Net sales					
*Wires & Cables (W&C)	2,901	2,584	12.3	2,361	22.9
FMEG	305	343	-11.0	308	-0.9
Others	105	95	10.5	100	5.2
Total Net sales	**3,312**	**3,022**	**9.6**	**2,769**	**19.6**
PBIT					
Wires & Cables (W&C)	346	225	53.9	277	24.9
FMEG	-3	17	NM	6	NM
Others	16	16	0.7	12	27.0
Total PBIT	**359**	**258**	**39.3**	**296**	**21.3**
PBIT Margin (%)			**BPS**		**BPS**
Wires & Cables (W&C)	11.9	8.7	323	11.7	19
FMEG	-0.9	5.0	NM	2.1	NM
Others	15.1	16.6	-147	12.5	259

*Source: Company Data, Sharekhan research, * adjusted for inter-segment revenue*

Outlook and Valuation

■ Sector view - Ample scope for growth

The W&C industry contributes 40-45% of India's electrical equipment industry. In terms of volumes, the Indian W&C industry (including exports) has grown from 6.3 million km in FY2014 to 14.5 million km 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 is expected to register a 14.5% CAGR from Rs. 52,500 crore in FY2018 to Rs. 1,03,300 crore by FY2023. The government has envisaged Rs. 111 lakh crore capital expenditure in infrastructure sectors in India during FY2020 to FY2025. The continued thrust of the government on infrastructure investment is expected to improve demand 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, urbanization, and digital connectivity. Products such as energy-efficient fans, modular switches, building and home automation, and LED lights are riding an ever-increasing wave of consumer demand. There is also a rising demand for various electrical appliances.

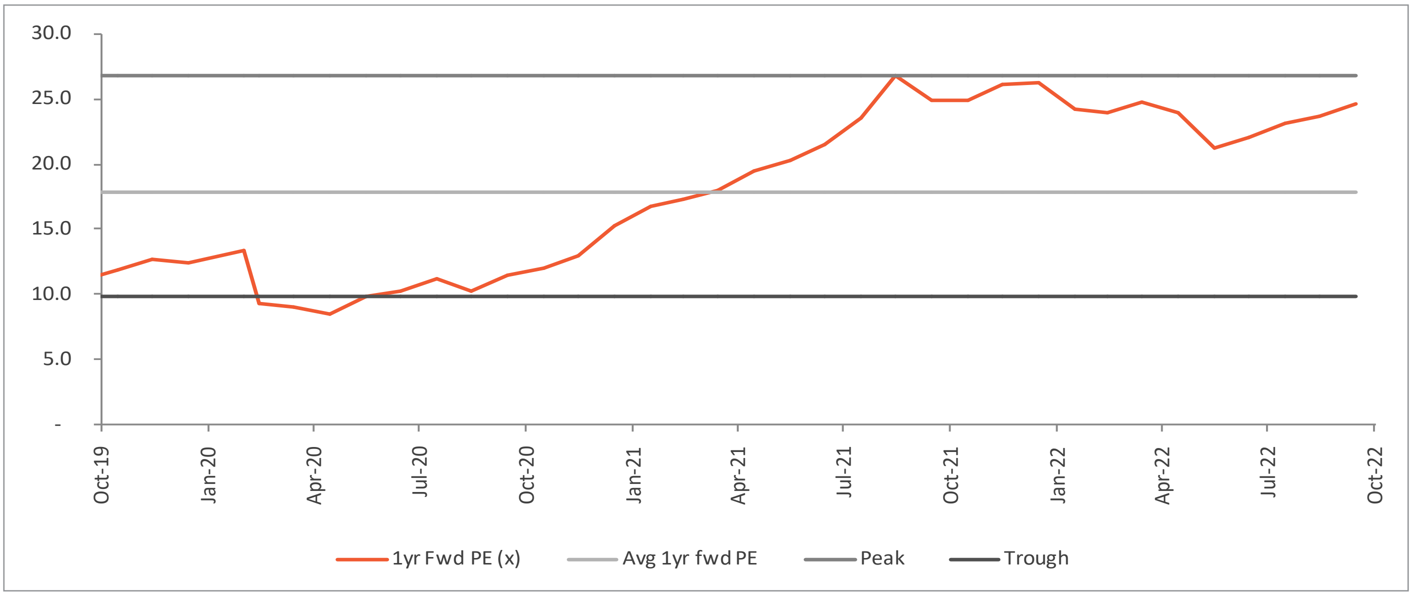
■ Company outlook - Growth prospects bright

Overall, outlook remains positive despite near-term challenges, which remains transient given the growth prospects ahead through various initiatives taken by the company such as Project Udaan and Project Leap. Polycab has gained share in the organized market (20-22% from 18% in FY2020), auguring well for growth. The company has outlined its new initiative Project Leap through which it intends to achieve Rs. 20,000 crore in revenues by FY2026E on superior growth versus the industry in B2C segments (2x in FMEG and 1.5x in retail wires) and stronger position in B2B segments.

■ Valuation - Retain Buy with a revised PT of Rs. 3,215

Polycab is expediting efforts to gain market share by growing its B2C business, scaling up FMEG business and boosting its exports. Further, realignment of distribution strategy in the FMEG segment, launch of new products and increasing penetration in the rural markets bodes well for long-term growth. In the long term, Polycab is expected to benefit from government infrastructure investments, increase in housing demand and pick up in private capex spending. Operating performance is likely to further improve on y-o-y basis with increase in scale, backward integration. Thus, the company is on a healthy growth trajectory, owing to its leadership position and a strong product portfolio both in W&C and FMEG businesses as well as a widening distribution network and in-house manufacturing capabilities. Hence, we recommend Buy with a revised PT of Rs. 3,215 (rolling forward our estimates to October FY24E EPS).

One-year forward P/E (x) band



Source: Sharekhan Research

About company

POLYCAB manufactures and sells wires and cables and FMEGs besides executing a few EPC projects. The company has 25 manufacturing facilities, including two joint ventures with Techno and Trafigura, located across Gujarat, Maharashtra, Uttarakhand, and the union territory of Daman and Diu. POLYCAB strives to deliver customised and innovative products with speed and quality service.

Investment theme

POLYCAB is the market leader in the wires and cables space with an extensive product portfolio and distribution reach coupled with accelerated growth in the FMEG space, which augurs well for growth visibility. The company's market position and success are driven by its robust distribution network, wide range of product offerings, efficient supply chain management, and strong brand image. POLYCAB's five-year roadmap to achieve to achieve Rs. 20,000 crore in FY2026E with more focus towards brand positioning, operations and business growth along with strong emphasis on governance and sustainability outpacing the industry's growth provides healthy visibility ahead. Revenue from the wires and cable segment has seen a decent 14.4% CAGR during FY2018-FY2022 and FMEG grew by ~27% CAGR during the same period. Further, increasing market share of organized players, which grew from 61% in FY2014 to 66% in FY2018, is expected to touch 74% in FY2023E, which augurs well for the industry leaders.

Key Risks

- **Fluctuations in raw-material prices pose a key challenge:** Any sharp increase or decrease in the prices of key raw material (copper and aluminium) could impact margins.
- **Increasing competition:** W&C and FMEG industry is highly fragmented and has many unorganized players. Hence, competitive intensity is high.

Additional Data

Key management personnel

Inder T. Jaisinghani	Chairman and Managing Director
Ajay T. Jaisinghani	Whole-Time Director
R. Ramakrishnan	Chief Executive Officer
Bharat A. Jaisinghani	Director – FMEG Business (Non-board member)
Manoj Verma	Executive President and Chief Operating Officer (CE)
Gandharv Tongia	Deputy Chief Financial Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	DSP Investment Managers	1.69
2	Sundaram Asset Management	1.26
3	Canara Robeco Asset Management	0.88
4	T Rowe Price Group Inc	0.85
5	Aditya Birla Sun Life Asset Management	0.83
6	Tata Asset Management	0.67
7	Nippon Life India Asset Management	0.55
8	Vanguard Group Inc.	0.54
9	Blackrock Inc.	0.45
10	Capital Group Cos Inc.	0.44

Source: Capitaline, 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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by BNP PARIBAS

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