Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Finolex Cables Ltd

Wired for growth

Capital Goods	Sharekhan code: FINCABLES
Reco/View: Buy ↔	CMP: **Rs. 545** / Price Target: **Rs. 660** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update

Company 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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 22.97

Updated Oct 08, 2022

Medium Risk

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

Source: Morningstar

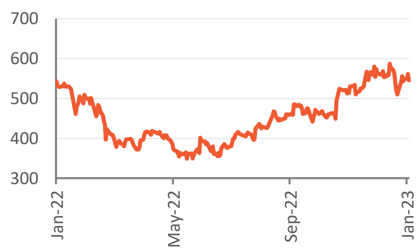
Company details

Market cap:	Rs. 8,335 cr
52-week high/low:	Rs. 594 / 344
NSE volume: (No of shares)	3.3 lakh
BSE code:	500144
NSE code:	FINCABLES
Free float: (No of shares)	9.8 cr

Shareholding (%)

Promoters	35.9
FII	9.7
DII	18.3
Others	36.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.5	21.8	48.4	4.5
Relative to Sensex	2.0	13.8	32.5	0.9

Sharekhan Research, Bloomberg

Summary

- We retain our Buy rating on Finolex Cables Limited (Finolex) with revised PT of Rs. 660, as we believe its valuation should catch up with its peers, given improving product mix and strong long-term growth prospects.
- The communication cables segment has immense growth potential, given India's focus on network connectivity and broadband penetration through optic fibre cables (OFC). Further, scalability in EHV, power cables, and FMEG would boost revenue and earnings growth.
- We expect decent volume growth in Q3FY2023E, driven by the construction, auto, and industrial sectors. Sequential margin expansion is likely led by higher volumes.
- Improving margin trajectory, zero debt, healthy cash and investments of ~Rs. 1,350 crore and tight working capital management give us further comfort.

Finolex Cables Limited (Finolex) is a leading manufacturer of electrical and telecommunication cables. The company has ~22% market share in the organised wires industry. The company has also forayed into the Fast Moving Electrical Goods (FMEG) segment, thereby de-risking its business and capturing new growth opportunities. The company boasts of more than 5,000 channel partners and 1,50,000 retail touch points and has a wide presence across small and big Indian cities. The company also plans to scale up its EHV business, which currently has an order book of Rs. 300 crore. EHV is a higher-margin business with less competition. Going forward, volumes in electric cables would continue to be driven by demand from construction, automobile, and industrial products. We believe the company's focus on improving brand visibility, product development, expansion in distribution network, and scaling up of the FMEG business would catapult it to a leading consumer electronics player, reducing the valuation gap between Finolex and its peers such as Polycab India and KEI Industries. The company is debt free and has healthy cash flow generation and tight working capital management (policy of advance payments from dealers). Further, any amicable resolution of the dispute between promotors would be a key upside catalyst.

- **Robust long-term demand outlook:** Demand for electric cables is likely to improve as new residential projects are picking up and the momentum in industrial and automobile industries is expected to be good. Further, demand for OFC is expected to be robust, given the government's focus on network connectivity. The construction segment, which contributes 65% to total electrical cables, has also witnessed strong volumes. Housing demand is normalising in rural and urban areas and catching up to pre-Covid demand gradually. Industry wise, sales break-up is as follows – Construction: 60%, Auto: 10-12%, Industrials: 10-12%, Agriculture: 10%, and remaining would be from power cables. The company's EPC order book in EHV cables stands at Rs. 300 crore and its current market share in EHV would be 15-20%. The company has begun the expansion of its wires and conduit pipes capacity in FY2022 and would spend a total of ~Rs. 200 crore by FY2023. In electrical cables, utilisation is at 70%, including capacity added in the past 12 months. Given the current demand scenario, utilisation may reach 80-85% in 9-12 months.
- **Decent performance eyed in Q3FY23E, Fans sales may be muted due to changes in BEE norms:** We expect the company to post decent numbers in Q3FY23E. The sales will be driven by demand from construction, automobile and industrial sectors. Further, growth will be aided by strong performance of communication cables led by OFC. While, volumes would be good, realization could be lower due to decline in copper prices. On the gross margin front, we expect y-o-y decline as automobile and industrial sectors have lower margins. However, in the last two months, copper prices have appreciated and therefore low-cost inventory at the beginning of Q3FY23 may lead to margin expansion on q-o-q basis. Further, the company has moderated its discounts (5-8% discount during Covid times) which shall support margin increment on q-o-q basis. We expect the company to report flat to single-digit y-o-y PAT growth in Q3FY23E. In FMEG, fans - a key contributor to revenues has been impacted due to changes in BEE rating norms which would be applicable from January 2023. In Q2FY23, fans volume off-take was low as the channel partners were de-stocking old inventory ahead of implementation of new BEE norms. The price differential between a star-rated fans vs non-star rated fans is likely to be ~5-8%. Further, new fans would have brushless direct current (BLDC) motor fans and mandatory star labelling. Channel partners are adopting wait and watch approach due to lack of clarity in terms of pricing and consumer response to cost escalation. Major players like Finolex Cables, Havells India and Polycab India anticipate muted demand of Q2FY23 to continue in Q3FY23. However, normalisation would kick-in as the customers become aware about cost saving in the long-term.

Revision in estimates: We have marginally tweaked our estimates for FY2023-FY2024E and introduced FY2025E estimates.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 660: Finolex Cables' performance has been tepid in the last quarter, given the high-cost inventory following the fall in copper prices and change in product mix. Nevertheless, we believe the company's long-term growth momentum would continue, backed by demand from key sectors such as auto, construction, and industrials. Further, the government's push and telecom players' capex for OFC will aid business and boost demand for communication cables for the company. The company has expanded wires and conduit pipes capacity, which would boost volumes going forward. Finolex's debt-free balance sheet and strong 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. 660 (14x its P/E on December FY2024E standalone Core EPS and 30% holding company discount for its stake in Finolex Industries). We believe that dispute between promotors regarding control of the company is an overhang on the stock and resolution of the same would be a key upside catalyst.

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) Rs cr

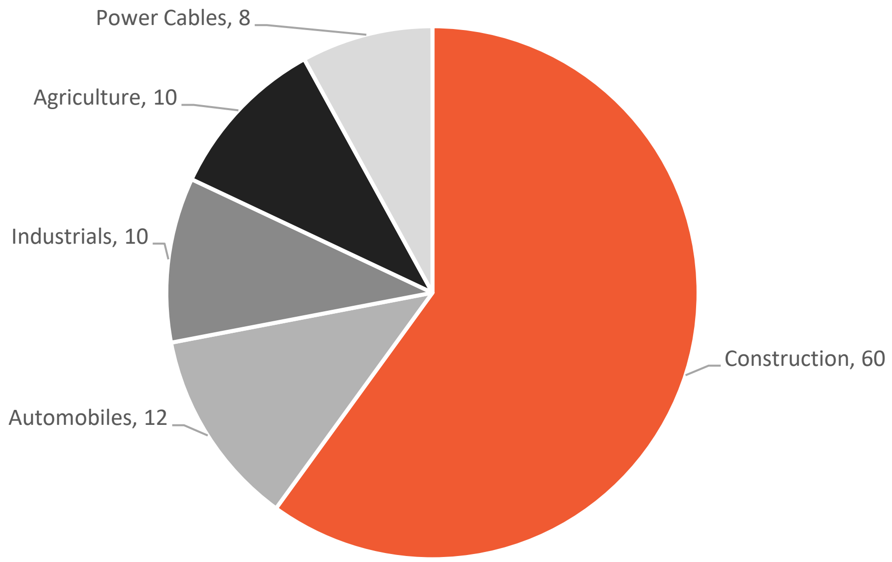
Particulars	FY22	FY23E	FY24E	FY25E
Net sales	3,768	4,455	4,994	5,593
OPM (%)	11.0	11.2	12.1	12.5
Net profit	405	462	553	633
Growth y-o-y (%)	43.0	14.2	19.7	14.5
Adjusted EPS (Rs.)	26.5	30.2	36.2	41.4
P/E (x)	20.6	18.0	15.1	13.2
P/B (x)	2.6	2.3	2.0	1.8
EV/EBIDTA (x)	14.6	12.4	10.3	8.9
RoCE (%)	16.9	17.9	19.1	19.4
Core RoE (%)	11.5	16.8	17.7	18.3

Source: Company; Sharekhan estimates

Robust demand outlook aided by capacity build-up

Demand for electric cables is likely to improve as new residential projects are picking up and the momentum in industrial and automobile industries is expected to be good. Further, demand for OFC is expected to rise further. The construction segment, which contributes 62-65% to total electrical cables, has also witnessed strong volumes. Housing demand is normalising in rural and urban areas and catching up to pre-Covid demand gradually. Industry wise, sales break-up is as follows – Construction: 60%, Auto: 10-12%, Industrials: 10-12%, Agriculture: 10%, and remaining would be from power cables. The company's EPC order book in EHV cables stands at Rs. 300 crore and its current market share would be 15-20%. The company has begun the expansion of its wires and conduit pipes capacity in FY2022 and would spend a total of ~Rs. 200 crore by FY2023. In electrical cables, utilisation is at 70%, including the capacity added in the past 12 months. Given the current demand scenario, utilisation may reach 80-85% in 9-12 months.

Industry wise % revenue break-up for electrical cables



Source: Company, Sharekhan Research

Uptrend in communication cables, particularly optic fibre cables would aid growth

In communication cables, OFC is the largest contributor, while other products include telephone cables, speaker cables, CCTV applications, LAN cables, and coaxial cables. The company has been witnessing good growth across all product lines. For OFC, Finolex has been a primary supplier of Bharti Airtel. Companies such as Bharti and Reliance are investing in 5G; and hence, volume growth is expected to be robust in the near future. Currently, the company's market share in OFC is under 18%. Currently, procurement under the government's Bharat NET project, however, is slow due to funding constraints. However, the government's focus on network connectivity and data penetration in rural regions bode well for long-term growth prospects of communication cables.

Changes in BEE rating norms for fans may impact Q3FY2023 volumes as well

In FMEG, fans – a key contributor to revenue – have been impacted by changes in BEE rating norms, which would be applicable from January 2023. In Q2FY2023, fans volume offtake was low as channel partners were de-stocking old inventory ahead of implementation of new BEE norms. The price differential between star-rated fans versus non-star rated fans is likely to be 5-8%. Further, new fans would have brushless direct current (BLDC) motor fans and mandatory star labelling. Fans consume 20-25% of total electricity in Indian households and, hence, it is rational for consumers to opt for energy-efficient fans as it can lead to substantial cost savings in the long run. The anticipated changes in energy norms for fans have led to low channel inventory and destocking as there is uncertainty regarding demand and cost dynamics for new fans. Channel partners are adopting the wait and watch approach due to lack of clarity in terms of pricing and consumer response to cost escalation. Major players such as Finolex Cables, Havells India, and Polycab India anticipate muted demand of Q2FY2023 to continue in Q3FY2023, which is a lean season for fans. Hence, FY2023 is expected to be challenging for the fans industry post which companies expect normalisation to kick in as customers become aware of cost saving in the long term.

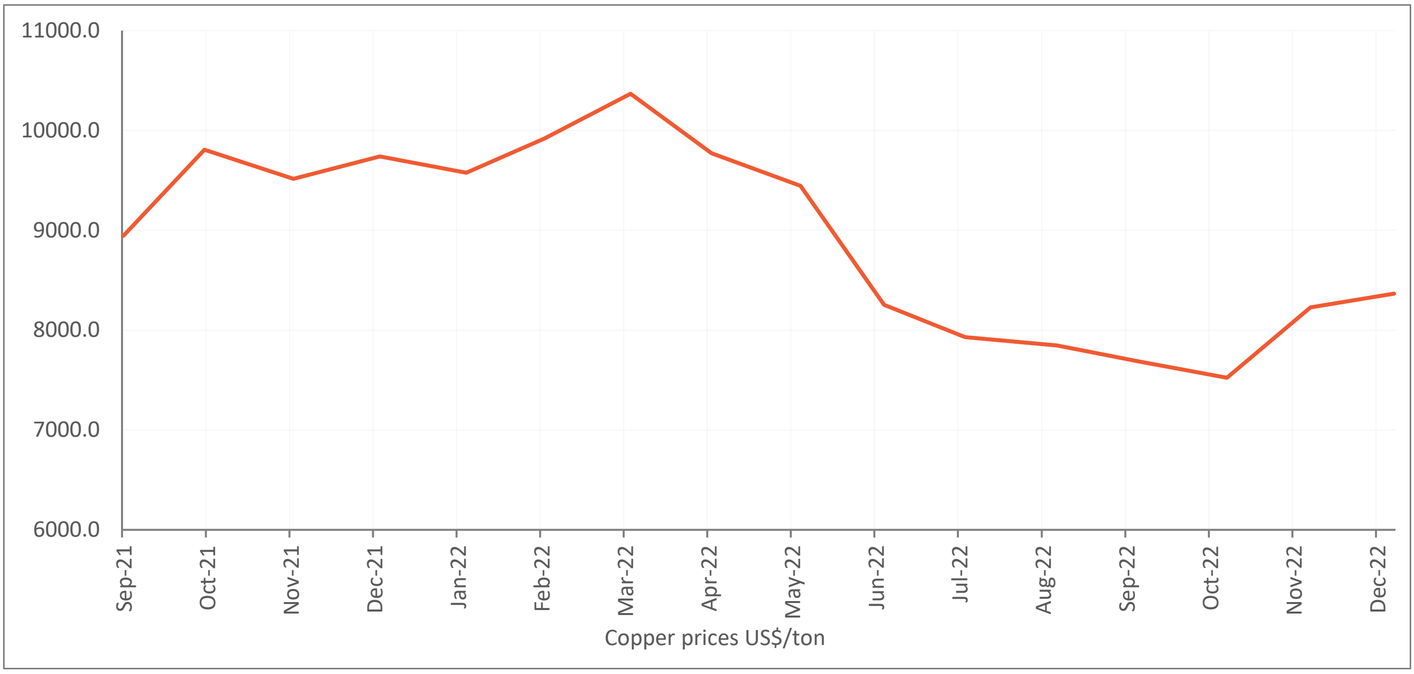
FMEG business to scale up in the next two-three years

In the FMEG space, the company aims to reach revenue of Rs. 500 crore over the next two to three years. The company aims to break even when the annual revenue reaches ~Rs. 180 crore. The company's FMEG business would scale up further with an improving demand environment. 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 an equal share of traditional channels and distributors for its products.

Decent performance eyed in Q3FY2023E

We expect the company to post decent numbers in Q3FY2023E. Sales will be driven by demand from the construction, automobile, and industrial sectors. Further, growth will be aided by strong performance of communication cables led by OFC. While volumes would be good, realisation could be lower due to a decline in copper prices. On the gross margin front, we expect a y-o-y decline as automobile and industrial sectors have lower margins. Further, in the past two months, copper prices have appreciated and, therefore, low-cost inventory at the beginning of Q3FY2023 may lead to margin expansion. Further, the company has moderated its discounts to customers (5-8% discount during Covid-19 times). We expect the company to report flat or single-digit y-o-y PAT growth in Q3FY2023E.

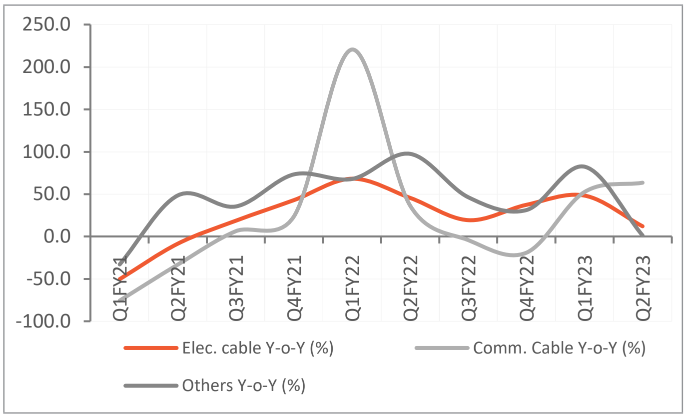
Copper prices have declined in Q3FY2023 vs. Q3FY2022



Source: Bloomberg; Sharekhan Research

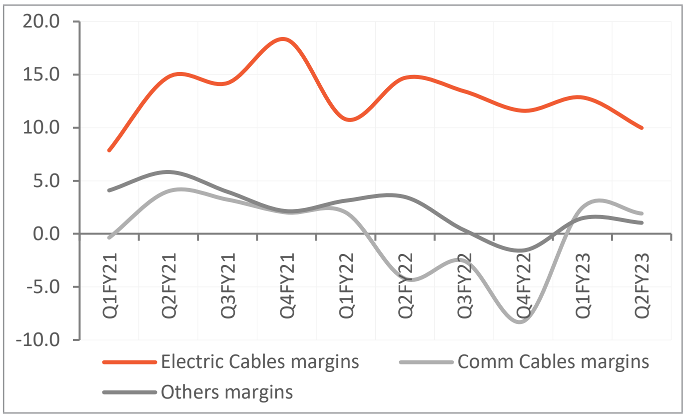
Financials in charts

Segment wise Revenue growth trend



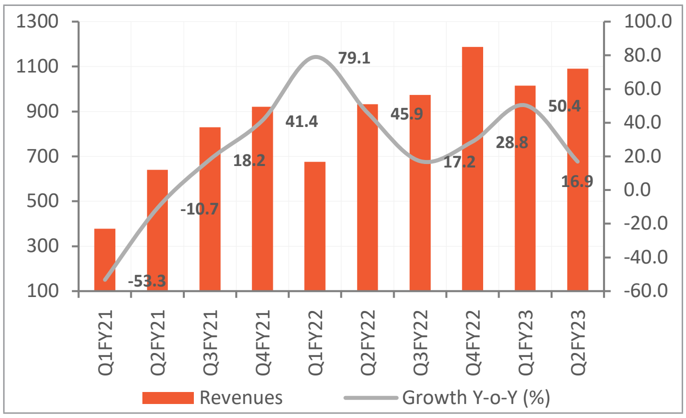
Source: Company, Sharekhan Research

Segment wise PBIT margin trend



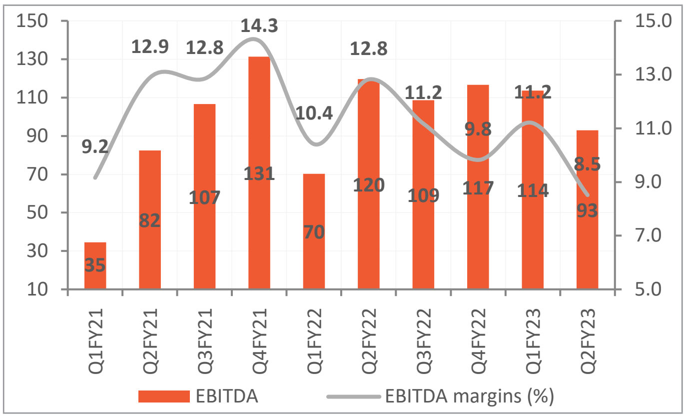
Source: Company, Sharekhan Research

Revenue growth trend



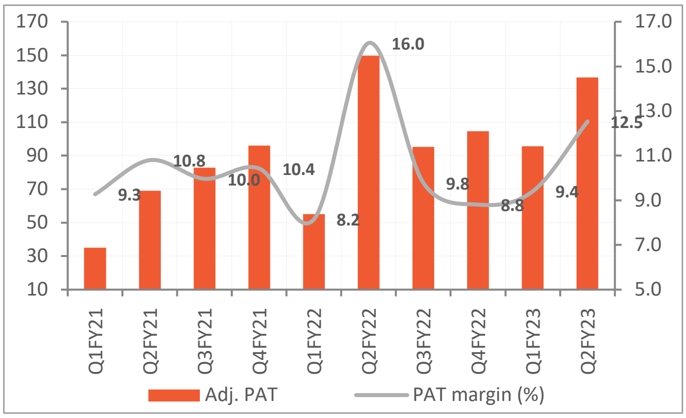
Source: Company, Sharekhan Research

EBITDA and margin trend



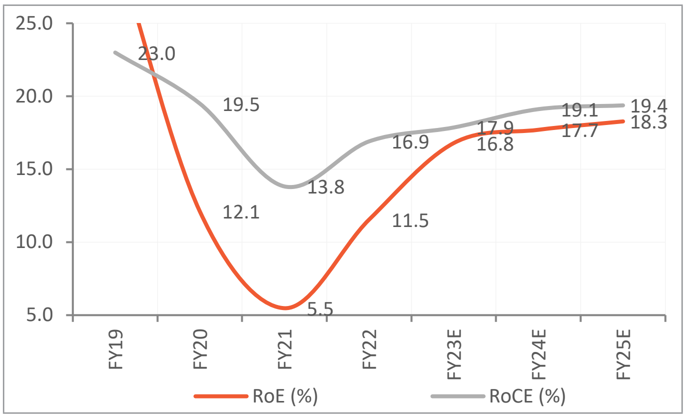
Source: Company, Sharekhan Research

PAT and margin trend



Source: Company, Sharekhan Research

Return ratios trend



Source: Company, Sharekhan Research

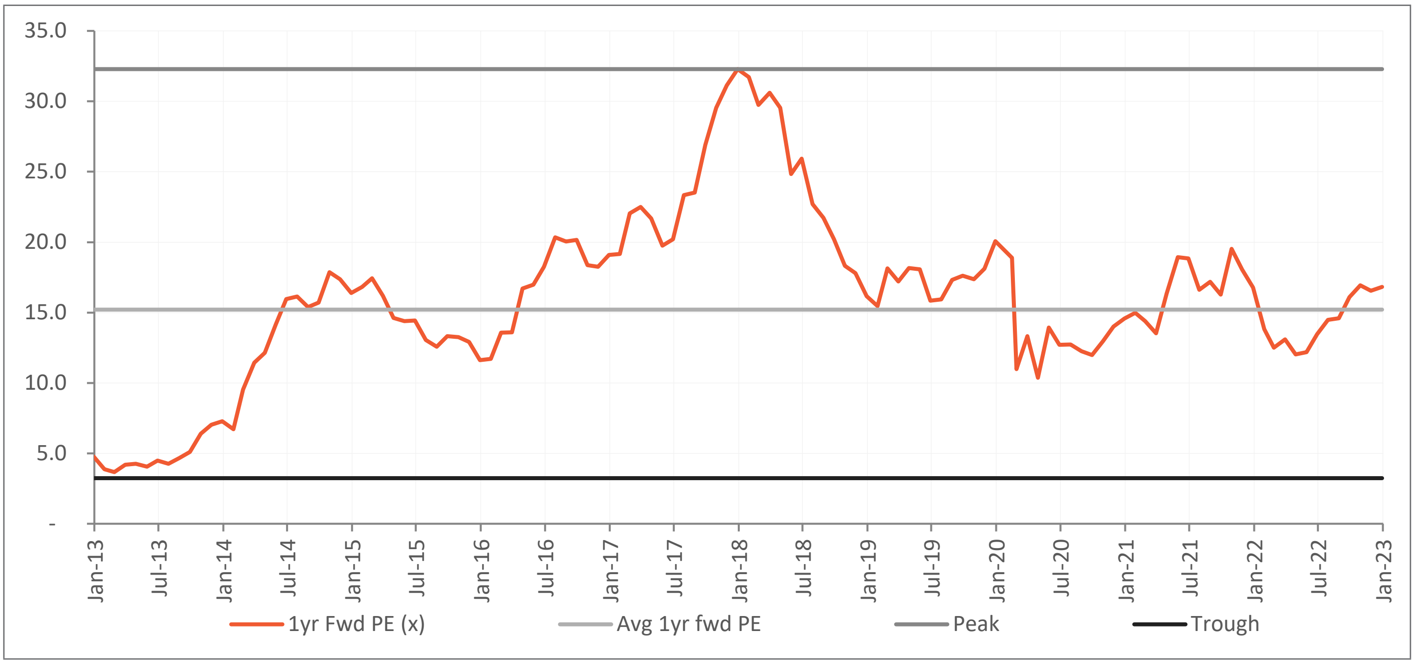
Outlook and Valuation

- **Sector View – Ample levers for long-term 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 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 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 the 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 has normalised and communication cables 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. 660:** Finolex Cables' performance has been tepid in the last quarter, given the high-cost inventory following the fall in copper prices and change in product mix. Nevertheless, we believe the company's long-term growth momentum would continue, backed by demand from key sectors such as auto, construction, and industrials. Further, the government's push and telecom players' capex for OFC will aid business and boost demand for communication cables for the company. The company has expanded wires and conduit pipes capacity, which would boost volumes going forward. Finolex's debt-free balance sheet and strong 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. 660 (14x its P/E on December FY2024E standalone Core EPS and 30% holding company discount for its stake in Finolex Industries). We believe that dispute between promotors regarding control of the company is an overhang on the stock and resolution of the same would be a key upside catalyst.

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

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 Asset Management	4.38
2	HDFC Asset Management	2.30
3	Franklin Resources Inc.	2.29
4	L&T Mutual Fund Trustee	1.98
5	LGOF Global Opportunities	1.88
6	HDFC Life Insurance	1.82
7	Vanguard Group Inc.	1.63
8	DSP Small Cap Fund	1.58
9	Dimensional Fund Advisors	1.02
10	Matthews International Capital Management	0.96

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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