Stock Update

Result Update

Sharekhan by BNP PARIBAS

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 23.29

Updated Aug 08, 2023

Medium Risk

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

Source: Morningstar

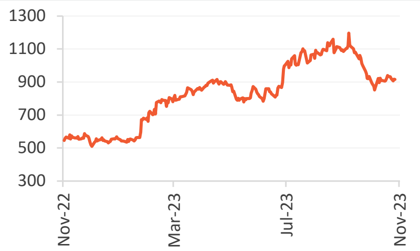
Company details

Market cap:	Rs. 13,794 cr
52-week high/low:	Rs. 1,219/491
NSE volume: (No of shares)	5.6 lakh
BSE code:	500144
NSE code:	FINCABLES
Free float: (No of shares)	9.8 cr

Shareholding (%)

Promoters	35.9
FII	11.8
DII	15.6
Others	37.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.0	-18.3	2.3	65.2
Relative to Sensex	-1.3	-18.3	-4.3	57.9

Sharekhan Research, Bloomberg

Finolex Cables Ltd

Decent Q2; on a sustainable growth path

Capital Goods	Sharekhan code: FINCABLES
Reco/View: Buy ↔	CMP: Rs. 902
	Price Target: Rs. 1,100 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q2FY2024 was marked by 10% volume growth in wires, 363bps OPM expansion, and 21% y-o-y growth in net profit.
- The communication cables segment registered a 14% decline in revenue mainly due to depressed international fibre prices and dumping from overseas market. Management expect prices to recovery from the current levels in couple of quarters.
- Capex of Rs. 400 crore in next 12-18 months two years in upgrading its offerings in OFC and backward integration would boost volumes and margins going forward. The company has healthy cash, zero debt and a lean working capital cycle.
- Family feud and court cases has created an overhang on the stock; thus, we are reducing our target multiple to 22x and lowered our TP to Rs. 1,100 while maintaining buy rating on the stock. Any clarity on the resolution of this issue could result in significant runup in the stock.

For Q2FY2024, Finolex reported better-than-expected OPM, which led to 7% beat in EBITDA, while revenue was in line with our estimate. The topline increased by 8.9% y-o-y to Rs. 1,187 crore. Electric cables reported 12.5% y-o-y growth to Rs. 989 crore. Communication cables sales fell 14% y-o-y to Rs. 136 crore. Sales from copper rods increased to Rs. 447 crore (up 71% y-o-y), while the others (FMEG) segment reported 13.7% y-o-y growth in revenue to Rs. 55 crore. In terms of volume, electrical wires grew 10% y-o-y, while cables volumes improved 37%. Within the FMEG sector, lighting and conduit witnessed significant volume growth; however, lighting products experienced significant price erosion. Operating profit grew 55% y-o-y to ~Rs. 144 crore, which was higher than our estimate of Rs. 135 crore mainly due to increased gross profit. OPM grew 363bps y-o-y to 12.1% (vs. our estimate of 11.4%). Net profit came in at Rs. 165 crore (up 21% y-o-y), in line with our estimate of Rs. 168 crore.

Key positives

- Electrical cable/copper rod reported revenue growth of 14% and 71%, respectively.
- OPM improved 363 bps y-o-y.

Key negatives

- Communication cables revenue fell 14% y-o-y.

Management Commentary

- In volume terms, electrical wires increased 10% compared to Q2 of the previous year, driven by demand from construction, realty, and other infrastructure segments.
- Unseasonal rains disrupted the FMEG segment's performance, although inflation declined from its hike. There is still much hesitancy in terms of discretionary spending.
- Management believes margin guidance of 14% is sustainable if raw-material prices remain stable for the rest of the year.
- The company will carry out capex of ~Rs. 400 crore in the next 12-18 months for expanding capacities in its product portfolio, including communication cables, solar cables, wire harnessing cables for automotive, and the construction segment.

Revision in estimates – We have fine-tuned our FY2024-FY2025 earnings estimates. We have introduced our FY2026 earnings estimates in this report.

Our Call

Retain Buy with a revised PT of Rs. 1,100: Q2FY2024 performance has been healthy, driven by decent volume growth in electrical cables. We expect the company's long-term growth momentum to continue, backed by demand from key sectors such as auto, construction, and industrials. Further, the government's push through the Bharat Net programme would boost demand for the company's communication cables. The company is also expanding capacity in all its product categories and backward integrating in OFC, which shall help the company increase volumes and margins in the long run. Finolex's debt-free balance sheet and strong cash position provide us comfort. The company's focus on strengthening its dealer/distributor channels across geographies and enhancing its product availability will likely yield the desired results. Family feud and court cases have created an overhang on the stock, thus we are reducing our target multiple to 22x and has lowered our TP to Rs, 1,100, while maintaining Buy rating on the stock. Any clarity on the resolution of this issue could result in a significant run-up in the stock.

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 the FMEG segment and inflationary pressures could affect earnings.

Valuation (Standalone) Rs cr

Particulars	FY23	FY24E	FY25E	FY26E
Net sales (Rs. cr)	4,481	5,155	6,092	6,924
Growth (YoY, %)	18.9	15.0	18.2	13.7
Operating Profit (Rs. cr)	496	603	755	900
OPM (%)	11.1	11.7	12.4	13.0
Net profit (Rs. cr)	502	597	713	827
Adjusted EPS (Rs.)	32.8	39.0	46.6	54.0
Growth (YoY, %)	24.0	19.0	19.4	16.0
PER (x)	27.7	23.3	19.5	16.8
P/B (x)	3.7	3.3	2.9	2.5
EV/EBIDTA (x)	19.8	15.8	13.2	11.4
Div Yield (%)	0.8	0.9	0.9	1.0
RoCE (%)	18.5	20.1	21.1	21.5
Core RoE (%)	22.0	20.3	20.0	19.5
RoIC (%)	26.5	37.3	38.5	39.5

Source: Company; Sharekhan estimates

Finolex's Q2FY2024 conference call and investor update highlights

Broad-based volume growth: In volume terms, electrical wires increased by 10% compared to Q2 of the previous year, driven by demand from construction, realty, and other infrastructure segments. Within the communication cables segment, metal-based product lines volumes were stable, while OFC volumes declined due to delayed announcement government tenders, which were expected in Q2FY2024, which is now expected in Q3FY2024. The Government of India (GOI) has announced approximately Rs. 1,40,000 crore to be spent on upgrading the Bharat Network over the next two to three years.

Communication cables affected by lower fibre prices and anti-dumping: In communication cables, value growth was flat due to depressed international fibre prices and the dumping from China, Indonesia, and Vietnam. However, the levy of anti-dumping duty is between 5-15%, but management expects price recovery to take two-three quarters from the current levels of around $3.15.

Muted FMEG performance: Unseasonal rains disrupted the performance, although inflation has come down from its hike. There is still much hesitancy in terms of discretionary spending.

OFC demand would rise through the Bharat Net project: As and when the tenders are opened under Bharat Network project, it will add substantially to volumes. From the private sector, telecom players also continue to invest in 5G and, therefore, rollout demand would be good.

Update on capacity expansion: The company will carry out a capex of ~Rs. 400 crore in the next 12-18 months for expanding capacities in its product portfolio, including communication cables, solar cables, wire harnessing cables for automotive, and the construction segment. The company is increasing the optic fibre capacity in communication cables to 10mn fibre km from 8mn fibre km. The company would backward integrate to produce optical fibre preforms and expand its fibre draw capacity from 4 million km to 8 million km. The E-Beam facility is delayed due to diplomatic issues with China, which is expected to be commissioned by the end of Q4FY2024. The current capacity utilisation is ~60% at the company level.

Pricing actions: The company took price cuts of 3-4% due to the correction in copper prices.

Margin guidance in wires: Management expects margin guidance of 14% is sustainable if raw-material prices remain stable for the rest of the year.

Results (Standalone) Rs cr

Particulars	Q2FY2024	Q2FY2023	YoY (%)	Q1FY2024	QoQ (%)
Net Sales	1,187	1,091	8.9	1,204	(1.4)
Operating Profit	144	93	55.3	144	(0.1)
Other Income	85	106	(20.4)	39	117.8
Interest	0.4	0.13	238.5	0.29	51.7
Depreciation	11	11	1.4	11	3.2
PBT	217	188	15.5	172	26.1
Adjusted PAT	165	137	21.0	132	25.1
Reported PAT	165	137	21.0	132	25.1
Adj. EPS (Rs.)	10.8	8.9	21.0	8.6	25.1
Margin (%)			BPS		BPS
OPM(%)	12.1	8.5	363	12.0	15
NPM (%)	13.9	12.5	139	11.0	295
Tax rate (%)	23.9	27.4	(342)	23.3	64

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. 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 moderate growth for the C&W segment. The government has envisaged Rs. 111 lakh crore capital expenditure in infrastructure sectors in India from FY2020 to FY2025. The government's continued thrust 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.

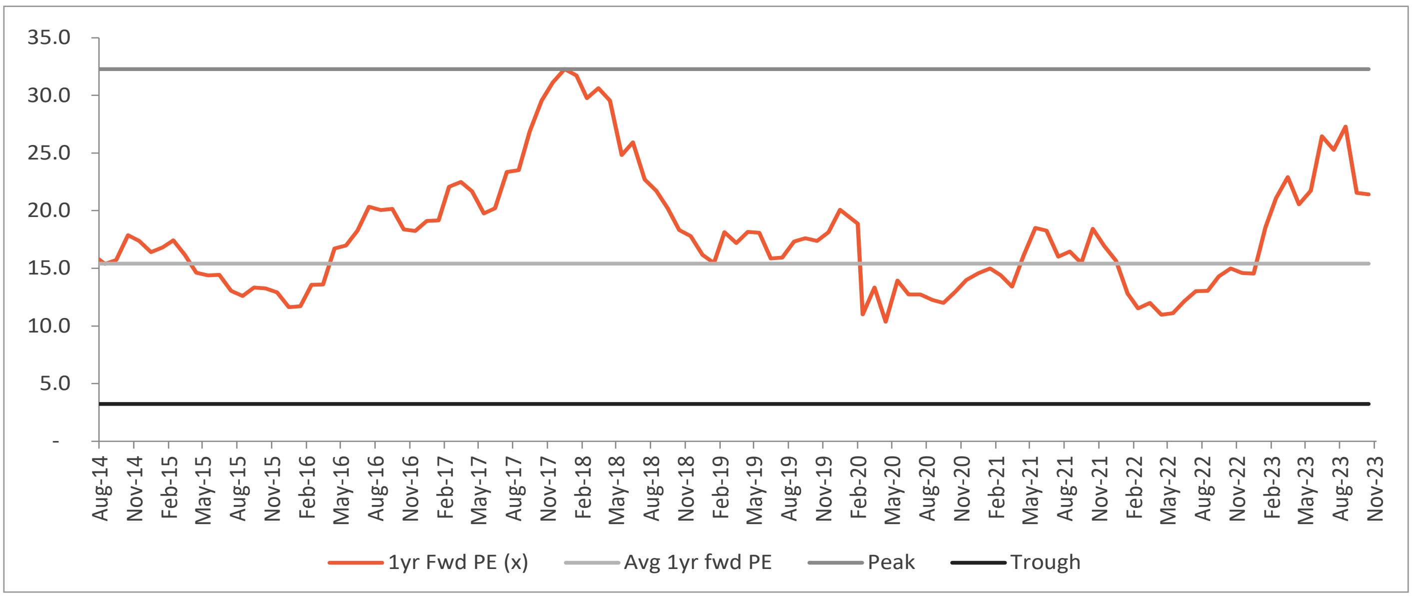
■ Company outlook - On a strong growth trajectory

Demand for electric cables has normalised and communication cables are performing well and scaling up with an improving demand environment. Healthy operating cash flow generation, tight working capital management (policy of advance payments from dealers), and capex to expand capacity to meet rising demand are expected to further build upon its cash reserves. The company also has the opportunity to increase its market share organically by penetrating into markets in certain product categories.

■ Valuation - Retain Buy with a revised PT of Rs. 1,100

Q2FY2024 performance has been healthy, driven by decent volume growth in electrical cables. We expect the company's long-term growth momentum to continue, backed by demand from key sectors such as auto, construction, and industrials. Further, the government's push through the Bharat Net programme would boost demand for the company's communication cables. The company is also expanding capacity in all its product categories and backward integrating in OFC, which shall help the company increase volumes and margins in the long run. Finolex's debt-free balance sheet and strong cash position provide us comfort. The company's focus on strengthening its dealer/distributor channels across geographies and enhancing its product availability will likely yield the desired results. Family feud and court cases have created an overhang on the stock, thus we are reducing our target multiple to 22x and has lowered our TP to Rs, 1,100, while maintaining Buy rating on the stock. Any clarity on the resolution of this issue could result in a significant run-up in the stock.

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 automobiles, lighting, cable TV, telephone, and computers for 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 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, 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 for the short term.
- Weak demand in some segments and inflationary pressures could affect earnings.

Additional Data

Key management personnel

Nikhil Naik	Executive Chairperson
Mahesh Vishwanathan	Deputy MD and CFO

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Nippon Life India Asset Management	3.2
2	L&T Mutual Fund Trustee Ltd/India	2.7
3	HDFC Asset Management Co Ltd	2.1
4	Vanguard Group Inc/The	1.9
5	HDFC Life Insurance Co Ltd	1.4
6	BlackRock Inc	1.0
7	Franklin Resources Inc	1.0
8	Matthews International Capital Man	0.9
9	DSP Investment Managers Pvt Ltd	0.8
10	Dimensional Fund Advisors LP	0.8

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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