Initiating Coverage

Finolex Industries Ltd.

September 15, 2021

Finolex Industries Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Building Materials	Rs 184.8	Buy in the band of Rs 180-186 and further add at Rs 166	Rs 206	Rs 222	2 quarters

HDFC Scrip Code	FININDEQNR
BSE Code	500940
NSE Code	FINPIPE
Bloomberg	FNXP: IN
CMP Sep 14, 2021	184.8
Equity Capital (Rs cr)	124
Face Value (Rs)	2
Equity Share O/S (cr)	62
Market Cap (Rs cr)	11,470
Book Value (Rs)	51
Avg. 52 Wk Volumes	491,156
52 Week High	199
52 Week Low	97

Share holding Pattern % (Jun, 2021)	
Promoters	52.5
Institutions	14.5
Non Institutions	33.0
Total	100.0

* Refer at the end for explanation on Risk Ratings

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Our Take:

Finolex Industries (FIL) is one of the largest and only fully integrated plastic piping company in India. It has a strong track record of consistently expanding its piping capacity by more than 3x (114k MT in FY10 to 370k Mt in FY21) over the last decade and has been simultaneously operating a net debt free balance sheet with strong free cash flow generation which has been cumulatively to the tune of Rs. 2521cr over last 10 years. The company has been operating with a clear focus on "cash and carry" business model whereby its receivable days are amongst the lowest in the industry. FIL mainly caters to the agriculture space which contributes ~70% of its overall revenues. It has been constantly expanding its footprint in the non-agri space (CPVC ~12% of its piping revenue) mainly in tier 2-3 cities through its robust network of 900+ dealers and 21,000+ retailers spread across India.

On the PVC resin side, the company has been constantly scaling-up its captive use for PVC piping segment which has increased from 36% in FY12 to ~70% as on FY21. It has a capacity of 270k MT on the PVC resin side which has been almost the same for more than a decade. Going forward, the company has no plans to further expand on the PVC resin side. On the piping side, the company aims to continuously expand its capacity by ~25k MT every year in its existing facilities. Also in order to expand in Eastern India, the company is evaluating and is in an early exploratory stage of setting-up a green-field facility in Eastern India.

Valuation & Recommendation:

FIL's earnings grew at a CAGR 17% during FY10-21. Going forward, we are positive on the future growth prospects of agri piping, housing and building materials segment. In our view, FIL's revenue is likely to record a growth of 11% over FY21-23E while PAT is expected to decline at CAGR 3.3% on an extremely high base. Along with this it's expected to generate consistent FCF with stable working capital. Segment-wise, we expect, Piping/Resin segment revenue to report +19/-5.7% CAGR growth over the same period. The company's balance sheet comprises of a 14.53% stake in Finolex Cables (FCL), which as on the current price is worth ~Rs 1150cr. As on FY21, FIL non-current investment of in FCL was 24% of its total assets and 27% of its networth.

The management has reiterated to grow sales volume by ~10%-15% in FY22E and aims to achieve pre-pandemic sales volume. Though the two year CAGR growth on the bottom line does not seem too exciting, in the interim FIL could post very good numbers due to favorable finished goods prices. Also the gradual shift from agri to non-agri in its piping segment could bring in better margins and valuation. The entire chemicals and pipes space has been rerated over the past few quarters while FIL is available at attractive valuations on a relative basis. The dispute among the promoters family is one of the reasons for the stock not getting its due valuation. However we feel the discount given by the street to FIL on this count is quite high.

The stock is currently trading at valuation of 16x FY23E earnings. We feel the base case fair value of the stock is Rs. 206 (18.6x FY23E) and bull case fair value is Rs. 222 (20x FY23E). Investors willing to take risk can buy the stock in the band of Rs. 180-186 and add on dips at the price of Rs 166.

Financial Summary

Particulars (Rs cr)	Q1FY22	Q1FY21	YoY-%	Q4FY21	QoQ-%	FY19	FY20	FY21	FY22E	FY23E
Total Operating Income	966	562	71.9	1249	-22.7	3,091	2,986	3,463	3,707	4,258
EBITDA	208	88	135.7	410	-49.3	576	448	990	886	926
Depreciation	20	19	6.2	20	0.0	70	74	78	85	93
Other Income	15	8	80.3	17	-11.8	42	31	72	85	94
Interest Cost	5	3	52.4	2	150.0	12	12	7	4	2
Tax	52	19	168.9	106	-50.9	186	69	254	228	235
PAT	146	55	164.9	299	-51.2	336	330	738	655	690
Diluted EPS (Rs)	2	1	164.6	5	-51.2	5.4	5.3	11.9	10.5	11.1
RoE						17%	14%	31%	22%	20%
P/E (x)						33.2	33.8	15.1	17.1	16.2
EV/EBITDA						19.5	25.4	11.5	12.6	12.1

(Source: Company, HDFC sec)

Q1FY22 Result Review

Revenue for the quarter registered a growth of 72% on YoY basis, which stood at Rs. 966 Cr. Higher growth was mainly on the back of favorable base. PVC piping and PVC resin revenue stood at Rs. 846cr +67/-6.2% YoY/QoQ and Rs. 627cr +113/-32% on YoY/QoQ basis. In terms of volume growth PVC pipes grew by 5.5% to 55,819MT while resin grew by 10.6% to 50,249 MT on a YoY basis.

Sequentially the revenues were down due to impact of Covid-2 in rural areas. During FY21, PVC prices were at historical high levels leading to sharp improvement in PVC resin margin. The commodity costs softened in Q1FY22 in international markets. Hence margins fell sequentially. Though the PVC ECM spread did not fall sharply in Q1FY22, inventory changes and lower off-take resulted in higher impact on EBITDA margins. This could get rectified in the coming quarters.

EBITDA for the quarter stood at Rs. 208cr +1.36/-50% on YoY and sequential basis. Segment-wise PVC pipes EBIT stood at 5.2% v/s 10.1% while PVC resin margins for the quarter were at 25.2% v/s 7.9% as on Q1FY21. Consequently, PAT stood at Rs. 146cr up 1.65x and-51% on a YoY/QoQ basis.

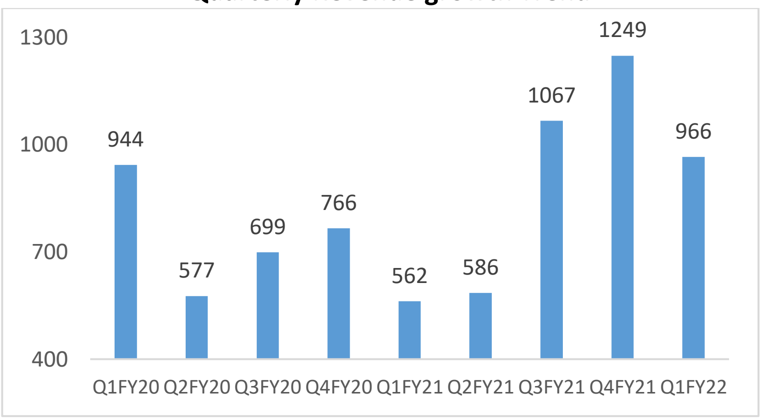
As per the management, PVC resin prices are expected are expected to stay in the range of $1250-1450/MT till Dec '21. This is mainly due to global supply side constraints and higher logistics cost. However, eventually the prices are expected to reverse back to its mean in the medium term. The company has been targeting to increase its non-agri revenue pie and aims to achieve 40% of its revenue from non-agri over next 3-5 years from ~30% currently. CPVC revenues for the quarter registered a growth of 24% YoY.

Recent Triggers

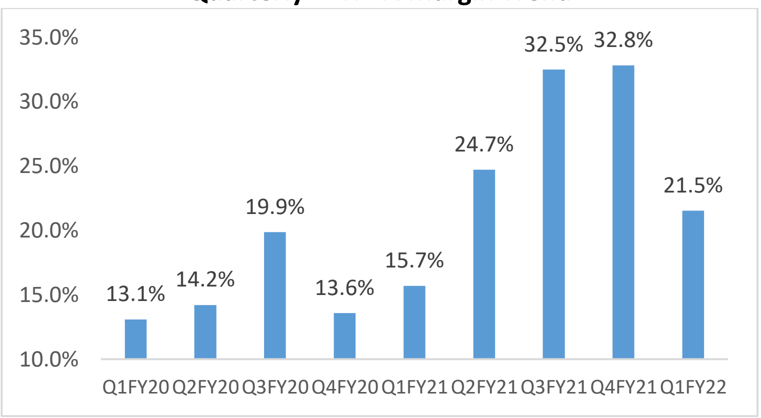
Strong pent-up demand post lockdown coupled with margin expansion driven by cost rationalization

In the universe of building materials space, organized large plastic piping companies were relatively less impacted on account of Covid-19 related slowdown. Higher growth was mainly driven by consistent market share gains by larger players, robust demand for agri piping due to strong monsoon and lower impact on rural India. Also in urban India, there was a strong pent-up demand and revival in plumbing and SWR segment post the first wave of pandemic. Apart from this, there was a strong tailwind of inventory gains which resulted in EBITDA margin expansion of 1360bps for FY21. FIL due to its backward integration and presence in the resin business was the biggest beneficiary in the PVC piping space. However with PVC/EDC spreads contracting, Q1FY22 margins declined by 1130bps on a sequential basis. Going forward, we expect, overall piping demand to be resilient this year on the back of healthy demand outlook.

Quarterly Revenue growth Trend



Quarterly EBITDA Margin Trend



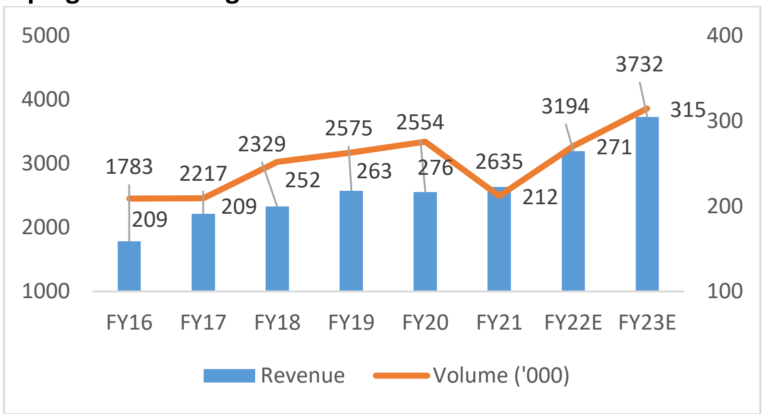
(Source: Company, HDFC sec)

Long Term Triggers

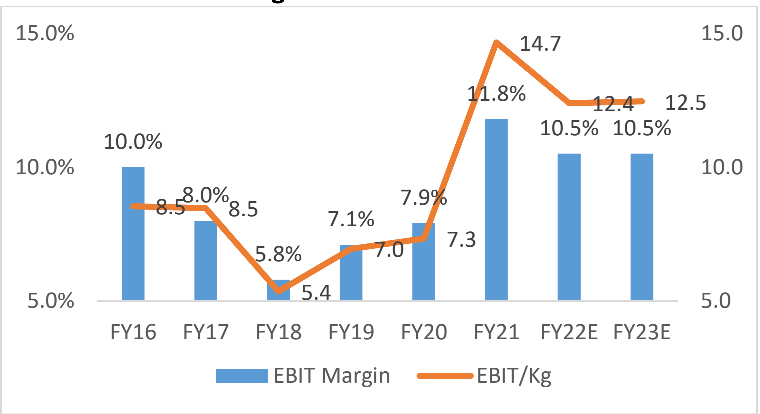
Leader in Agriculture piping space and constant scale-up on the plumbing segment

The Indian Pipes Industry is highly fragmented and has a large number of small and mid-sized unorganized players which account for ~35-40% share of total industry. This is mainly on account of low entry barriers (technology, licenses, and capital expenditure) and a relatively higher availability of raw material, especially UPVC, in the domestic market. FIL with its pan-India distribution network has a dominant market positioning and presence across categories in the Indian Piping and fitting industry. Its overall market share as on FY21 stood at ~8%. It is one of the largest agriculture piping companies in India. Agriculture pipes comprises of almost 70% of its overall piping revenues. Over the years, company has also been sharpening its focus on non-agri housing and real estate piping products. In its plumbing portfolio, CPVC is the fastest growing segment for the company which currently contributes ~12% of its overall piping revenues. CPVC revenues grew by CAGR 35% over FY18-21.

Piping revenue to grow at CAGR 19% over FY21-23E



EBIT to grow at CAGR 12% over FY21-23E



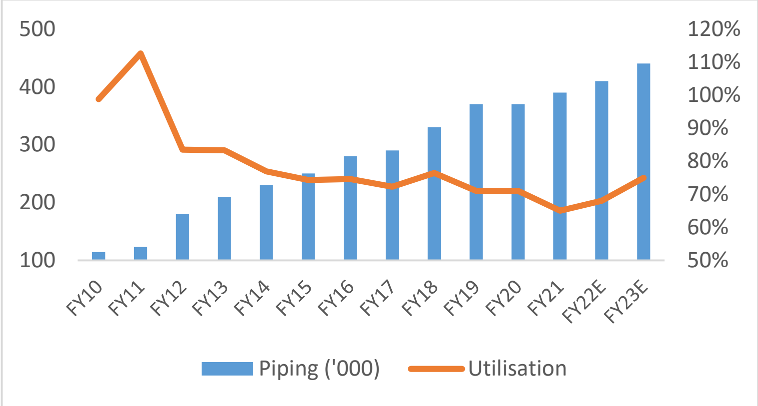
(Source: Company, HDFC sec)

The piping segment is the largest and the key growth driver for FIL. It grew by CAGR 7.6% over FY15-21 v/s 3.4% overall growth for the same period. Despite piping contributing ~3/4th of overall revenue, at EBIT levels it only contributes ~34%. We expect the contribution of piping business in overall profitability to improve which will be led by 1) change in product mix with aggressive new product launches resulting in higher growth in the non-agri business 2) higher focus on margin accretive CPVC and fitting segment 3) lower discounting in the agri piping space on the back of industry consolidation. Going forward, FIL volume growth to be driven by industry consolidation, strong government focus on agri and housing for all segments. We expect this segment to grow at CAGR 19% over FY21-23E.

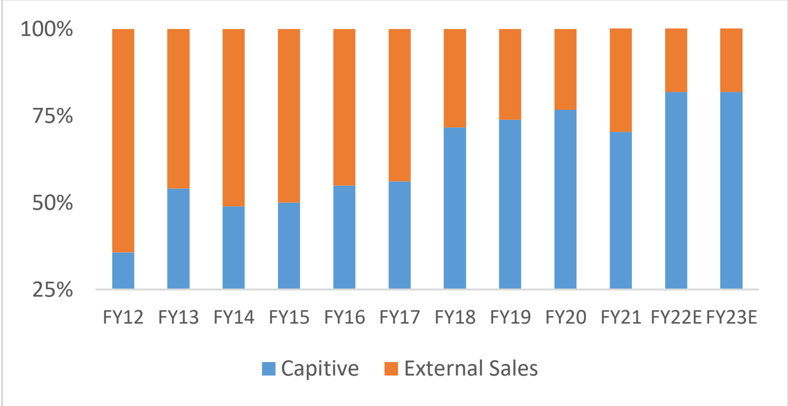
Consistent and calibrated approach towards expansion in the piping

FIL has witnessed a rapid & strategic built-up in capacities over last decade. It started from modest capacity of 114k MTPA capacity in FY10 and has a current capacity of ~370k MT as on FY21 which is spread across its 3 manufacturing facilities in India. In terms of volumes FIL grew at CAGR 9.5% over FY10-FY20 while in FY21, on account of the pandemic there was an aberration where volume growth was muted resulting in a decline of 23% over FY20.The company has also been consistently reducing its exposure to external sales of highly volatile PVC resin business and focusing more on captive usage of the same which has increased from 36% in FY12 to 77% as on FY20. In FY21, due to favorable PVC/ EDC spreads in the resin business, FIL share of PVC resin external revenue had increased to 36% v/s 23% in FY20. Going forward, with incremental capacity expansion in the piping segment, we expect, higher captive and internal use of resin which will reduce volatility in overall margins. Also, the company aims to continuously expand its capacity by ~25k MT every year in its existing facilities. In longer term, in order to expand its geographical footprint, the company is also evaluating and is in an early exploratory stage of setting-up a green-field facility in Eastern India.

Piping capacity scaled-up by more than 3x in last decade



Constant increase in captive use of PVC resin



(Source: Company, HDFC sec)

Key Financial Summary

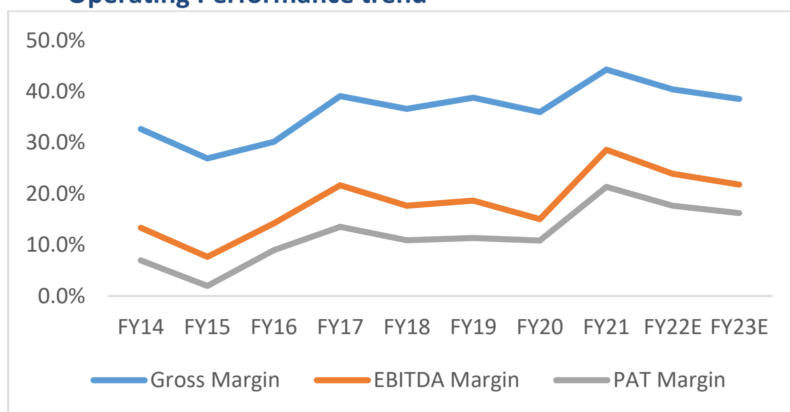
- FIL has delivered a healthy revenue growth of CAGR 8.2% over FY10-21 aided by its consistent focus on product innovation, expansion of its distribution reach and scale-up of its stable margin piping segment. The contribution of piping business had increased from 45% in FY10 to 87% of overall revenues as on FY20 and 76% as on FY21. Over last decade SIL has increased its piping capacity by more than 3x from 114kMT in FY10 to 370k MT as on FY21. Going forward, we expect, the company to report a revenue CAGR of 10.9% over

FY21-23E, mainly driven by 19% CAGR growth in the plastic piping business. Within the piping business, we expect CPVC segment to grow at CAGR of 43% over FY21-23E.

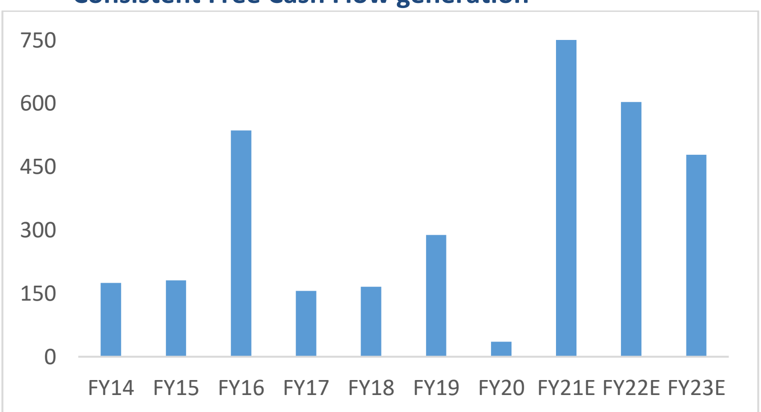
- Its EBITDA and PAT grew by CAGR 13%/17% respectively over FY10-21. Despite volatile raw material prices and higher capex, FIL has been able to report steady earnings growth over last decade. Its gross margins has been oscillating between 30% to 45% for the same period due to volatile raw material prices which mainly had been impacting the resin business. Going forward, post extremely robust performance in FY21, we expect its operational performance to improve with incremental capacity expansion in the piping business which is likely to reduce volatility in margins over the longer timeframe. We expect, EBITDA and PAT both likely to decline at CAGR of 3.3% over FY21-23E. Growth in margins is likely to be moderate in medium term as higher margins in the resin business are not sustainable and we expect PVC/EDC spread to be back to its historical mean levels.

- Despite, constant capacity expansion in the piping business, the company has been able to constantly reduce its Net debt (1.3x in FY10 to 0.01x as on FY21) due to strong free flow generation (FY11-21 cumulative ~Rs. 2521cr) and lean working capital structure (10-Yr average 50 days). The company has also been consistently operating a high dividend payout of ~35% and is currently net cash positive with robust return ratios of ~30% as on FY21.

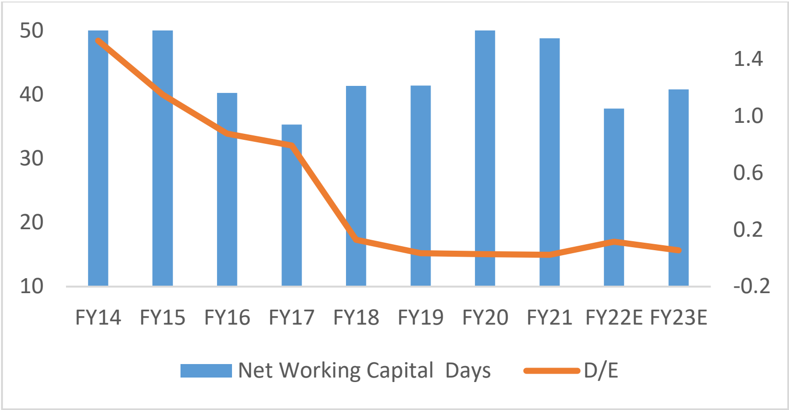
Operating Performance trend



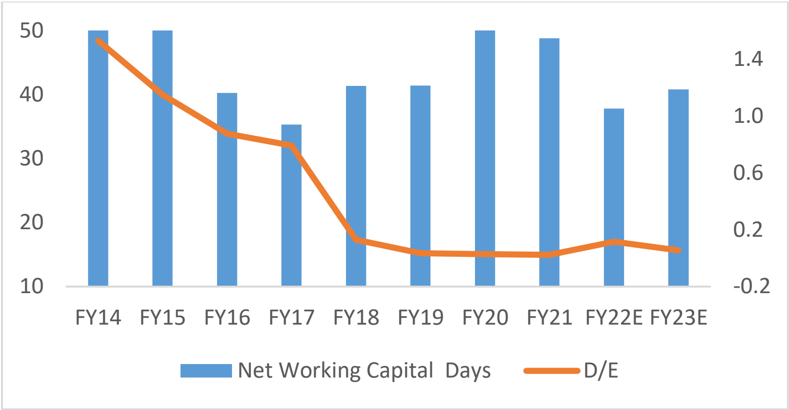
Consistent Free Cash Flow generation



Constant reduction in Net D/E with lean NWC days



Strong return ratios



(Source: Company, HDFC sec)

What could go wrong?

Prolonged slowdown in economy

FIL derives the majority of revenue from the piping business which caters to plumbing, irrigation and water transportation and sewerage applications, which in turn depend on core economy sectors like housing, construction, agriculture and industrials. Any prolonged slowdown in core economy sectors can impact FIL financial performance.

Sharp rise in raw material Inflation

Key raw materials used in the plastic pipes industry are Polyethylene (PE), PPR, PVC and CPVC resin. FIL is the only piping company to have backward integration where by more than 75% of its PVC resin is captively used. Resin margins have been historically highly volatile. These prices depend on crude oil price movements and other factors such as changes in the global demand supply scenario and import-export regulations. Crude oil price is highly volatile, thus imparting volatility to prices of petrochemical products. Since raw material costs constitute 65-70% of operating income, any large inflationary pressure needs to be adjusted by end product prices in order to protect margins.

Seasonality and high concentration in the western region

FIL earnings are highly dependent on the performance of the piping business. Within this segment almost ~3/4rd of revenues are attributed to the agriculture space which are seasonal in nature. A large part of these revenues are concentrated in the Q4 and Q1 quarters. Any major deviation in monsoon trends or lower than expected rainfall can impact the performance of the piping business. Also all the 3 manufacturing facilities of the company are located in western India which contributes a major chunk of its revenues. Inability of the company to diversify in newer regions and any adverse climatic or geo-political challenges in the western region can impact FIL.

Inability to continue the cash and carry model due higher competition

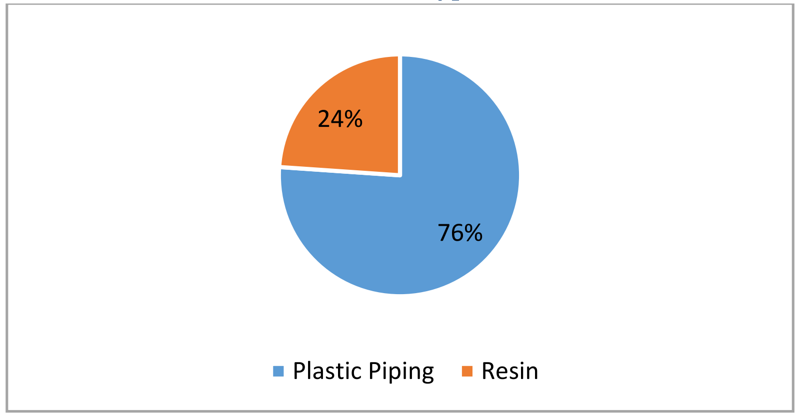
FIL has been a leading player in the PVC piping business wherein it commands a strong customer patronage mainly in the agriculture space. This has enabled the company to continuously operate a cash and carry model which has resulted in a lean working capital structure. In case if there is a disruptive behavior by competition or any other market forces and FIL is compelled to operate at high working capital, there can be adverse impact on company's return ratios and cash flows.

Ongoing legal battle within the promoter Chabbria family for ownership in group companies continues to be an overhang on the stock price performance

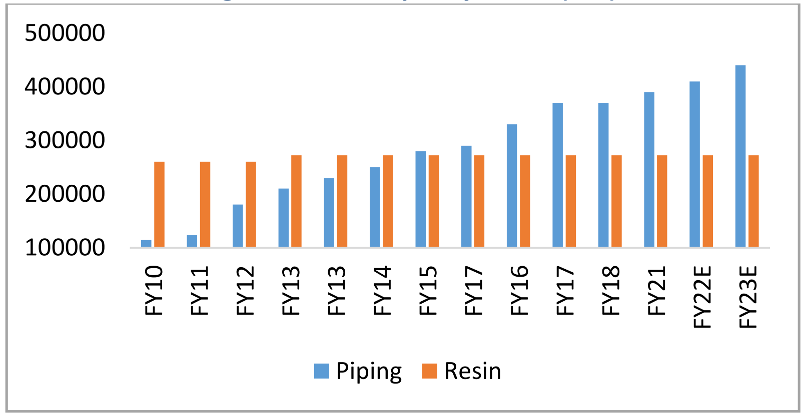
About the company

Finolex Industries Ltd (FIL) established in 1981, is India's largest manufacturer of PVC pipes and fittings. It has 3 manufacturing facilities (Pune, Ratnagiri and Masar) in India and has presence across 21,000+ retailers through its 900 dealers spread across India. It operates in 2 key business segments- a) PVC pipes and fittings – wherein it offers manufactures a wide range of products catering to the agriculture and non-agriculture sectors & b) PVC resin – the company manufactures PVC resin providing consistent raw material for captive consumption (backward integration) and sales in the open market. The company has 2,100+ SKUs in PVC pipes & fittings of which SKU range in CPVC pipes is ~375. CPVC pipes volume in FY21 was ~9,635 MT (~9,299 MT in FY20) with revenue at ~Rs 3 bn (~Rs 2.9 bn in FY20)

Product-wise Revenue Break-up



Segment-wise Capacity Trend (MT)



(Source: Company, HDFC sec)

Peer Comparison

	Mcap	Revenue			EBITDA Margin			PAT			ROE			Net D/E		
		FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY21
Supreme	27187	5612	5512	6357	14%	15%	20%	449	467	978	21%	21%	31%	0.1	0.1	0.0
Astral Ltd	43000	2507	2578	2176	15%	17%	20%	196	248	404	16%	17%	21%	0.1	0.1	0.0
Finolex Ind	11,169	3091	2986	3463	19%	15%	29%	350	324	738	13%	15%	29%	0.0	0.1	0.1
Prince Pipes	8000	1572	1636	2072	12%	14%	18%	82	113	222	21%	15%	21%	0.7	0.0	0.0

	EPS Growth	P/E		EV/EBITDA	
	FY21-23E	FY22E	FY23E	FY22E	FY23E
Supreme	-9%	34	33	21	19
Astral Ltd	30%	83	63	40	33
Finolex Ind	5%	15	14	11	11
Prince Pipes	16%	36	27	22	16

(Source: Company, HDFC sec)

Quarterly segmental operating performance

	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22
Revenue									
Piping	851	517	553.5	632.2	507.1	500.8	725.8	902	846
PVC Resins	535	303	408	434	294	368	692	920	627
EBIT									
Piping	66	24	44	63	51	39	91	70	44
PVC Resins	78	45	82	32	23	99	246	329	158
EBIT Margins									
Piping	7.7%	4.6%	7.9%	10.0%	10.1%	7.8%	12.6%	7.7%	5.2%
PVC Resins	14.5%	14.9%	20.1%	7.3%	7.9%	26.9%	35.5%	35.8%	25.2%
EBIT/kg									
Piping	7.2	5.0	8.3	10.1	9.7	9.0	16.5	11.5	7.9
PVC Resins	9.9	10.9	13.9	5.3	5.1	20.8	36.3	43.7	31.4

(Source: Company, HDFC sec)

Quarterly raw material and margin trend

	PVC	EDC	Ethylene	VCM	PVC/EDC Delta QoQ	EBITDA Margin
Q1FY20	883	393	858	718	-6%	13%
Q2FY20	900	317	780	735	19%	14%
Q3FY20	868	279	769	740	1%	20%
Q4FY20	883	308	688	758	-3%	14%
Q1FY21	740	193	537	516	-5%	16%
Q2FY21	920	267	730	712	20%	25%
Q3FY21	1235	470	843	960	17%	32%
Q4FY21	1483	605	963	1152	15%	33%
Q1FY22	1543	709	991	1233	-5%	22%

(Source: Company, HDFC sec)

Financials – Consolidated

Income Statement

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
Net Revenues	**3091**	**2986**	**3463**	**3707**	**4258**
Growth (%)	13%	-3%	16%	7%	15%
Operating Expenses	2515	2538	2473	2821	3332
EBITDA	**576**	**448**	**990**	**886**	**926**
Growth (%)	**19%**	**-22%**	**121%**	**-11%**	**5%**
EBITDA Margin (%)	**18.6**	**15.0**	**28.6**	**23.9**	**21.8**
Depreciation	70	74	78	85	93
EBIT	**506**	**374**	**912**	**801**	**833**
Other Income	42	31	72	85	94
Interest expenses	12	12	7	4	2
PBT	**536**	**393**	**976**	**882**	**924**
Tax	186	69	254	228	235
RPAT	**350**	**324**	**722**	**655**	**690**
APAT	**336**	**330**	**738**	**655**	**690**
Growth (%)	17%	-7%	128%	-11%	5%
EPS	5.4	5.3	11.9	10.5	11.1

Balance Sheet

As at March	FY19	FY20	FY21	FY22E	FY23E
SOURCE OF FUNDS					
Share Capital	124	124	124	124	124
Reserves	2404	1806	3015	3421	3863
Shareholders' Funds	**2528**	**1930**	**3139**	**3545**	**3987**
Long Term Debt	90	283	204	114	60
Net Deferred Taxes	151	116	139	146	154
Other Liabilities	79	78	66	69	73
Minority Interest					
Total Source of Funds	**2848**	**2407**	**3548**	**3875**	**4273**
APPLICATION OF FUNDS					
Net Block & Goodwill	951	1017	1002	1097	1254
CWIP	90	7	8	8	8
Other Non-Current Assets	103	111	123	163	192
Total Non -Current Assets	**1144**	**1135**	**1133**	**1268**	**1453**
Current Investments	1303	585	1679	1847	2050
Inventories	620	858	919	711	817
Trade Receivables	74	73	148	81	93
Cash & Equivalents	28	93	336	401	355
Other Current Assets	102	71	78	111	128
Total Current Assets	**2128**	**1680**	**3160**	**3151**	**3442**
Trade Payables	284	233	395	305	350
Other Current Liab & Provisions	141	176	350	240	273
Total Current Liabilities	**425**	**409**	**745**	**544**	**623**
Net Current Assets	1703	1271	2415	2607	2820
Total Application of Funds	**2848**	**2407**	**3548**	**3875**	**4273**

Cash Flow Statement

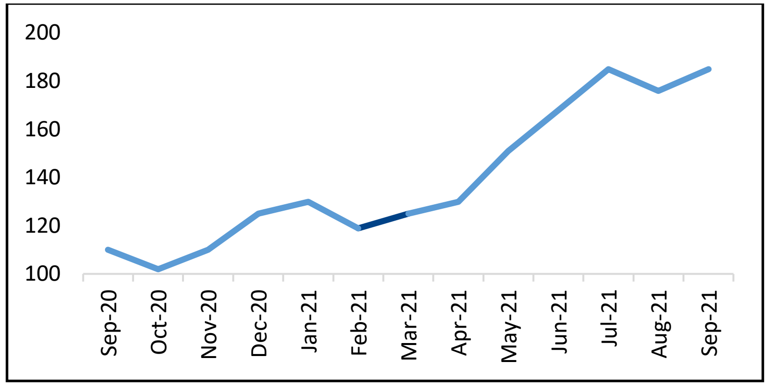
(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
Reported PBT	536	393	992	882	924
Non-operating & EO items	-37	1	-68	0	0
Interest Expenses	7	10	7	4	2
Depreciation	70	74	78	85	93
Working Capital Change	-8	-268	144	41	-56
Tax Paid	-177	-113	-212	-228	-235
OPERATING CASH FLOW (a)	**391**	**97**	**941**	**784**	**729**
Capex	-102	-61	-65	-180	-250
Free Cash Flow	289	36	876	604	479
Investments	-152	103	-586	-169	-203
Non-operating income	26	17	-12	-40	-28
INVESTING CASH FLOW (b)	**-228**	**59**	**-663**	**-388**	**-482**
Debt Issuance / (Repaid)	-11	193	-78	-90	-54
Interest Expenses	-7	-11	-8	-4	-2
FCFE	271	218	790	510	423
Share Capital Issuance	0.0	0.0	0.0	0.0	0.0
Others	-133	-287	-4	-238	-237
FINANCING CASH FLOW (c)	**-151**	**-105**	**-90**	**-332**	**-294**
NET CASH FLOW (a+b+c)	**12**	**51**	**188**	**64**	**-46**

Key Ratios

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
EBITDA Margin	18.6%	15.0%	28.6%	23.9%	21.8%
EBIT Margin	16.4%	12.5%	26.3%	21.6%	19.6%
APAT Margin	10.9%	11.1%	21.3%	17.7%	16.2%
RoE	13%	15%	29%	20%	18%
RoCE	17%	14%	31%	22%	20%
Solvency Ratio					
Net Debt/EBITDA (x)	-0.2	0.3	-0.2	-0.2	-0.2
Net D/E	0.0	0.1	0.1	0.0	0.0
PER SHARE DATA					
EPS	5	5	12	11	11
CEPS	7	6	13	12	13
Dividend	9	10	4	4	4
BVPS	41	31	51	57	64
Turnover Ratios (days)					
Debtor days	7	9	12	8	8
Inventory days	73	90	94	70	70
Creditors days	32	32	33	30	30
VALUATION					
P/E	33	34	15	17	16
P/BV	4	6	4	3	3
EV/EBITDA	19	25	11	13	12
EV / Revenues	4	4	3	3	3
Dividend Yield (%)	1%	1%	2%	2%	2%
Dividend Payout	34%	37%	29%	38%	36%

(Source:: Company, HDFCsec)

One Year Stock Price Chart



(Source: Company, HDFC sec)

HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.