

COMPANY NOTE

Estimate Change

India | Industrials | Diversified Industrials

27 May 2019

Jefferies

Finolex Industries (FNPX IN) Q4FY19: Robust Volume Growth - the Saving Grace; Maintain BUY

Key Takeaway

FNPX's Q4 sales were ahead of JEFe, aided by strong volume growth of 13% in Pipes. However, profitability was below estimates, marred by a plunge in PVC prices (~10%) in Q4 and a shrinking PVC/EDC spread (523 \$/MT vs 785 \$/MT in Q4FY18). Mgmt has guided for 12-15% volume growth in Pipes in FY20e. Capex is on track, with likely adds of 30-40k MT p.a. Valuation at PE of 16x FY20e seems inexpensive. Maintain BUY & PT of Rs640. PVC/EDC remains a key monitorable.

Revenue: FNPX's Q4 sales (net of inter-segmental revenue) registered an increase of 19.2% YoY to Rs9.6bn, driven by volumes. Segmental sales (prior to inter segmental) were : 1) PVC resin at Rs 5.6bn (+8% YoY); and 2) PVC pipes & fittings at Rs 7.9bn (+16% YoY).

Volumes: Segmental break-up in Q4 as follows: 1) PVC resin at 76,549 MT (+6% YoY) and 2) PVC pipes & fittings at 80,771 MT (+13% YoY). In FY19, FNPX's pipe & fitting volumes registered a growth of 4% YoY (-1% in 9MFY19). *Mgmt cited a strong volume recovery in Mar'19, particularly led by offtake in Maharashtra and Karnataka (FNPX's key markets) post the resolution of delayed sugarcane payments witnessed in Q3.* The company hopes to clock 12-15% pipe volumes in FY20e.

Margins: Segmental EBIT margins in Q4 as follows: 1) PVC at 14.5% (24.1% YoY) and 2) PVC pipes & fittings at 7.7% (9.2% YoY). Spiraling EDC coupled with softening PVC prices resulted in subdued PVC/EDC spread, impacting FNPX's resin margin. Also, a steep fall in PVC resin prices in Q4 resulted in inventory loss in the pipes segment.

CPVC Pipes: For FY19, CPVC sales stood at Rs 2.3bn, clocking a strong growth of 58% YoY, albeit at a low base. Volumes registered a growth of 49% to 8,800 MT (vs 5900 MT YoY).

Raw material trend: In Q4FY19, average PVC/EDC spread stood at 523 \$/MT (785 \$/MT YoY ; 535 \$/MT QoQ). This spread has been weakening in recent quarters, driven mainly by global dynamics. In Q4FY19, average RM prices for FNPX were as follows: PVC at 934 \$/MT , EDC at 411 \$/MT and ethylene at 937 \$/MT.

Capacities: FNPX's current capacity for pipes & fittings stands at 370k MT , (330K MT in FY18), with avg. utilisation at 65-70%. Company envisages to add 30-40k MT p.a. entailing capex of ~Rs 1bn. PVC resin capacity remains stable at 272k MT.

Maintain Buy: We estimate FNPX's revenue/PAT to register 11%/12% CAGR over FY19-21e, exercising caution in view of shrinking spreads. Maintain Buy with PT of Rs 640 (18x FY21e).

Key risk: Steep fall in PVC/EDC spread could impact margins, Subdued volume growth could impact operating leverage.

INR	Prev.	2018A	Prev.	2019E	Prev.	2020E	Prev.	2021E
Rev. (MM)	--	27,378.0	30,057.0	30,913.0	33,679.0	33,942.0	37,694.0	37,903.0
Net Gearing	--	3.0%	--	3.0%	--	0.0%	--	(5.0)%
EBITDA (MM)	--	4,839.0	5,702.0	6,043.0	6,155.0	6,232.0	6,964.0	7,076.0
Net Profit	--	2,985.0	3,536.0	3,498.0	3,860.0	3,814.0	4,407.0	4,396.0
EPS	--	24.10	28.50	28.20	31.10	30.70	35.50	35.40
Consensus EPS	--	--	30.20	29.30	32.50	30.60	34.10	33.40
ROE	--	11.8%	12.4%	14.3%	12.7%	14.4%	13.6%	15.1%
ROCE	--	16.6%	17.8%	20.4%	18.4%	20.6%	19.7%	21.8%
FY P/E	--	20.5x	--	17.5x	--	16.1x	--	14.0x
EV/EBITDA								
FY Mar	--	13.1x	--	11.0x	--	10.2x	--	8.9x

BUY

Price target INR640.00
Price INR493.95^

Financial Summary

Book Value (MM):	INR27,646.0
Book Value/Share:	INR222.80
Net Debt (MM):	INR773.0
Dividend Yield:	1.7%

Market Data

52 Week Range:	INR712.90 - INR440.00
Total Entprs. Value:	INR62.1B
Market Cap.:	INR61.3B
Shares Out. (MM):	124.1
Float (MM):	52.3
Avg. Daily Vol.:	2,156

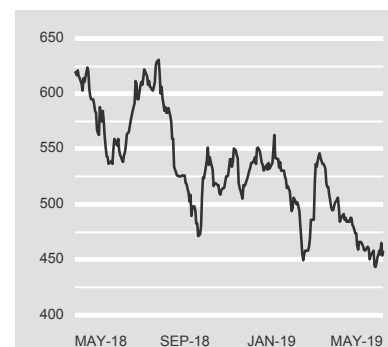
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Price Performance



^Prior trading day's closing price unless otherwise noted.

Exhibit 1: Quarterly Snapshot Q4FY19

(Rs mn)	Q4FY19	Q4FY18	% Chg. y-o-y	Q3FY19	% Chg. q-o-q
Net sales	9,642	8,091	19.2%	7,566	27.4%
Raw material costs	6,419	4,771	34.5%	4,875	31.7%
Employee costs	382	298	28.5%	328	16.6%
Other expenses	1,376	1,143	20.3%	1,113	23.6%
Total expenditure	8,178	6,212	31.6%	6,316	29.5%
EBITDA	1,465	1,879	-22.0%	1,250	17.2%
Other non-operating income	122	28	344.3%	173	-29.1%
Depreciation	177	156	13.3%	196	-10.0%
Interest expense	24	34	-29.8%	17	37.9%
PBT	1,387	1,717	-19.2%	1,209	14.7%
Less: Tax	473	508	-6.8%	422	12.1%
Adjusted PAT	914	1,209	-24.4%	787	16.1%
Extraordinary items	0	0		0	
Reported PAT	914	1,209	-24.4%	787	16.1%
Reported EPS (in Rs)	7.36	9.75	-24.4%	6.34	16.1%
Gross Margin (%)	33.4%	41.0%	-7.6%	35.6%	-2.1%
EBITDA Margin (%)	15.2%	23.2%	-8.0%	16.5%	-1.3%
Adj. PAT margin (%)	9.5%	14.9%	-5.5%	10.4%	-0.9%
Employee costs as % to net sales	4.0%	3.7%	0.3%	4.3%	-0.4%
Other expenses as % to net sales	14.3%	14.1%	0.1%	14.7%	-0.4%

Source: Jefferies, Company data

Exhibit 2: Segmental Revenue Break-up

(Rs mn)	Q4FY19	Q4FY18	YoY (%)	Q3FY19	QoQ (%)
PVC Resin	5,594	5,158	8%	4,840	16%
PVC Pipes & Fittings	7,911	6,827	16%	5,906	34%
Total Revenue	13,505	11,985	13%	10,746	26%

Source: Jefferies, Company data; Note: As cited by FNXP, Captive Power Plant as a separate segment is no longer material compared to the company's overall operations and the management does not analyse its performance separately. Therefore, as per Ind AS 108 "Operating Segments", FNXP has decided to disclose only two segments i.e. PVC resin and PVC pipes & fittings

Exhibit 3: Segmental Volume Break-up

(MT)	Q4FY19	Q4FY18	YoY (%)	Q3FY19	QoQ (%)
PVC Resin (MT)	76,549	72,123	6%	66,838	15%
PVC Pipes & Fittings (MT)	80,771	71,759	13%	59,178	36%

Source: Jefferies, Company data

Exhibit 4: Segmental Profits (EBIT)

(Rs mn)	Q4FY19	Q4FY18	YoY (%)	Q3FY19	QoQ (%)
PVC Resin	810	1,242	-35%	809	0%
PVC Pipes & Fittings	612	629	-3%	438	40%
Overall Segmental Profit	1,422	1,871	-24%	1,247	14%

Source: Jefferies, Company data

Exhibit 5: Segmental EBIT Margins

(%)	Q4FY19	Q4FY18	% Diff.	Q3FY19	% Diff.
PVC Resin	14.5%	24.1%	-9.6%	16.7%	-2.2%
PVC Pipes & Fittings	7.7%	9.2%	-1.5%	7.4%	0.3%
Overall EBIT Margin	10.5%	15.6%	-5.1%	11.6%	-1.1%

Source: Jefferies, company data

Exhibit 6: Segmental Capital Employed

(mn)	Q4FY19	Q4FY18	YoY (%)	Q3FY19	QoQ (%)
PVC Resin	6,046	6,821	-11%	6,457	-6%
PVC Pipes & Fittings	8,713	7,269	20%	8,975	-3%
Total Capital Employed	14,759	14,090	5%	15,432	-4%

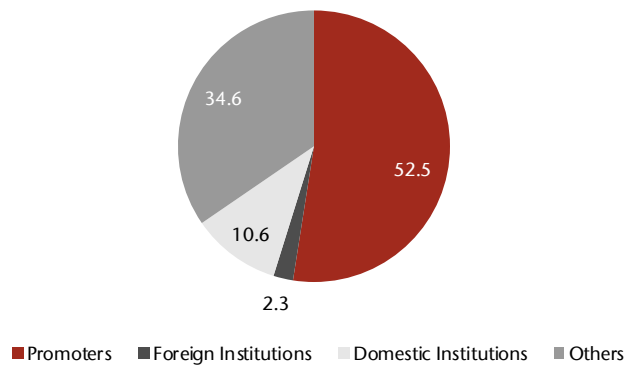
Source: Jefferies, company data

Exhibit 7: Segmental RoCE

(%)	Q4FY19	Q4FY18	% Diff.	Q3FY19	% Diff.
PVC Resin	13.4%	18.2%	-4.8%	12.5%	0.9%
PVC Pipes & Fittings	7.0%	8.7%	-1.6%	4.9%	2.1%
Overall RoCE	9.6%	13.3%	-3.6%	8.1%	1.6%

Source: Jefferies, company data

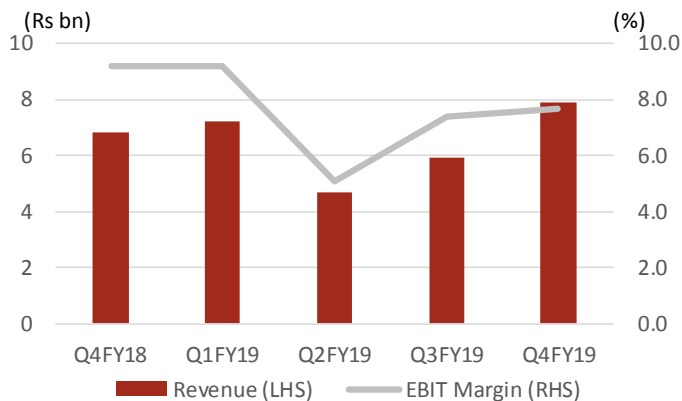
Exhibit 8: Finolex industries Shareholding Pattern (ending Mar' 19)



Source: BSE

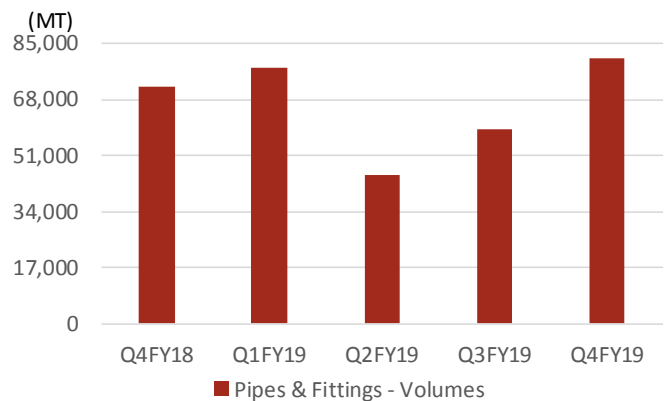
Quarterly Exhibits

Exhibit 9: Pipes & Fittings – Revenue & EBIT Margin



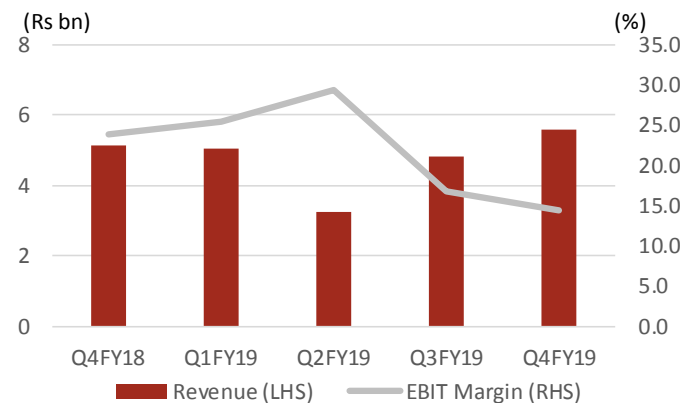
Source: Jefferies, Company data

Exhibit 10: Pipes & Fittings – Volumes



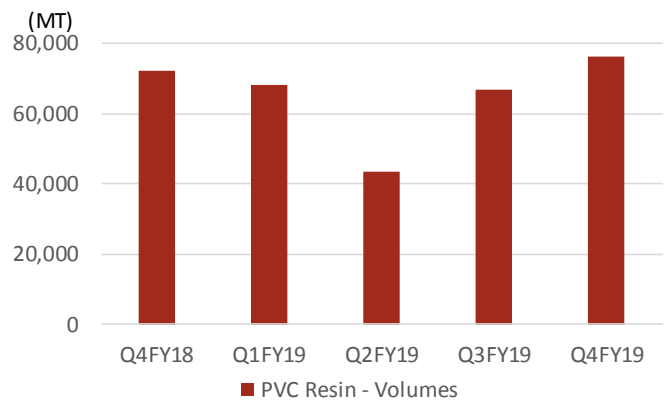
Source: Jefferies, Company data

Exhibit 11: PVC Resin – Revenue & EBIT Margin



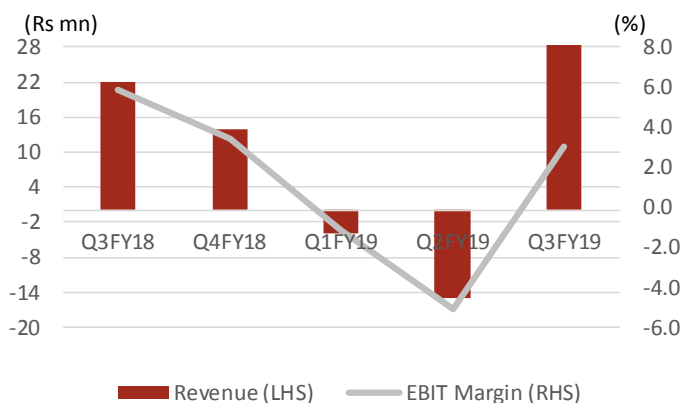
Source: Jefferies, Company data

Exhibit 12: PVC Resin – Volumes



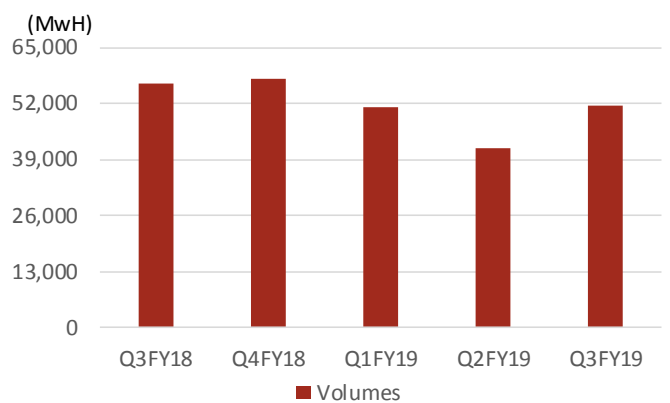
Source: Jefferies, Company data

Exhibit 13: Power – Revenue & EBIT Margin



Source: Jefferies, Company data; Note: Company has stopped reporting details of the power segment from Q4FY19

Exhibit 14: Power – Volumes

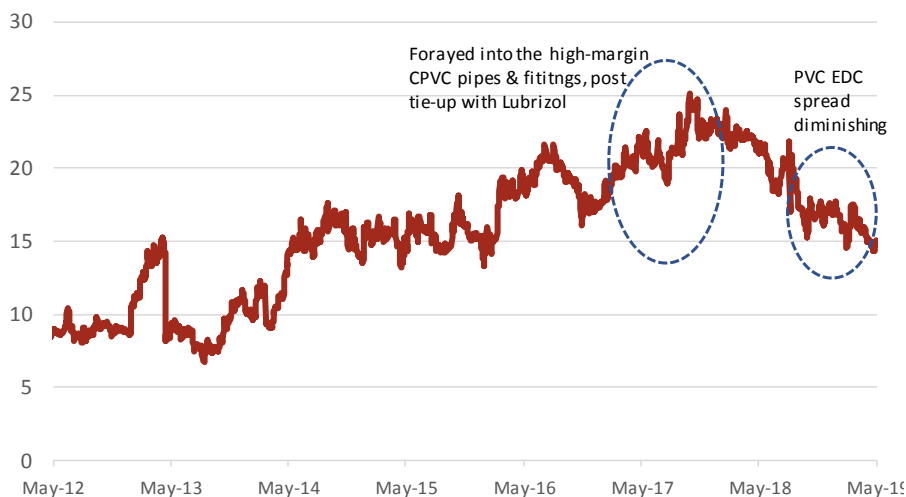


Source: Jefferies, Company data

Valuation

FNXP is currently trading at 16x/14x PE multiple on its FY20/21E earnings. We estimate FNXP's revenue/PAT to register 11%/12% CAGR over FY19-21e, factoring caution in view of the softening PVC/EDC spreads. Maintain target PE at 18x, broadly in line with FNXP's five-year historical average. Maintain BUY rating with PT of Rs 640 (18 x FY21e EPS).

Exhibit 15: Finolex Industries - Trend in Rolling Forward P/E



Source: Jefferies estimates, Bloomberg, Company data

Key Risks / Catalysts

Risks to our PT and estimates

- Slower ramp-up of the CPVC segment.
- Tepid traction in construction, lower farm income – impacting pipes volumes.
- Competition in agricultural pipes, leading to pricing pressures
- Unfavourable PVC/EDC spread remains a key monitorable that could impact profitability.

Key catalysts

- Ramp-up in CPVC pipes and fittings – in FY18, within a year of launch, Finolex has ramped up CPVC volumes to 5,800 MT in FY18 (with ~150 SKUs) and revenue at Rs1.47bn (6% of pipes and fittings revenue).
- Favourable raw materials spreads owing to firm PVC demand and higher supply (new capacities) of EDC globally – this could boost profitability of PVC resin business.
- Capex additions sufficient to demand – majority capex outlay behind us.
- Improved operating leverage (currently 75%) could boost margins and profitability.
- Expansion of existing product line, with new launches.
- Strong growth opportunity, in light of government's thrust on housing, irrigation & farming, infrastructure development.
- Accelerated demand shift to organized players, post GST and E-Way Bill.

Key Financial Statements

Exhibit 16: Profit & loss Statement

Rs mn	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	26,024	27,378	30,913	33,942	37,903
Raw material cost	16,096	17,644	19,209	21,671	24,086
as % of sales	61.9	64.4	62.1	63.8	63.5
Employee cost	1,049	1,161	1,344	1,440	1,608
as % of sales	4.0	4.2	4.3	4.2	4.2
Selling & admin overheads	921	1,095	1,237	1,358	1,516
as % of sales	3.5	4.0	4.0	4.0	4.0
Other expenses	2,328	2,638	3,080	3,241	3,617
as % of sales	8.9	9.6	10.0	9.5	9.5
Total Expenditure	20,394	22,539	24,870	27,710	30,827
EBITDA	5,630	4,839	6,043	6,232	7,076
EBITDA %	21.6	17.7	19.5	18.4	18.7
Depreciation	550	606	701	756	789
Other income	243	253	416	305	341
Interest expense	154	98	123	91	71
PBT	5,169	4,388	5,635	5,691	6,558
Tax	1648	1403	1858	1876	2162
Tax rate %	31.9	32.0	33.0	33.0	33.0
PAT (Adjusted)	3,521	2,985	3,777	3,814	4,396
Extraordinary items	245	0	279	0	0
PAT (Reported)	3,277	2,985	3,498	3,814	4,396

Source: Company data, Jefferies estimates

Exhibit 17: Balance Sheet

Rs mn	FY17	FY18	FY19E	FY20E	FY21E
Inventories	5,574	6,116	6,205	6,817	7,484
Sundry debtors	525	431	743	816	911
Other current assets	930	1300	1032	1133	1265
Cash & cash equivalents	163	234	218	882	2,056
Current assets	7,192	8,081	8,198	9,647	11,716
Net fixed assets	8,551	8,842	9,509	9,753	9,964
Capital work in Progress	217	903	902	950	950
Investments	12,222	14,896	13,030	14,000	14,500
Deferred tax asset, net	-909	-1207	-1513	-1400	-1300
Other assets	936	1,822	1,023	1,073	1,123
Total assets	28,209	33,338	31,149	34,023	36,953
Other Current liabilities	1,338	1,385	1,387	1,586	1,764
Sundry Creditors	2,275	2,505	2,838	3,151	3,504
Provisions	12	14	24	25	30
Long-term debt	942	0	0	0	0
Short-term debt	0	1,007	906	906	500
Other liabilities	728	782	710	710	710
Minority interests	0	0	0	0	0
Shareholder's equity	22,914	27,646	25,284	27,647	30,445
Total liabilities & equity	28,209	33,338	31,149	34,023	36,953

Source: Company data, Jefferies estimates

Exhibit 18: Cash Flow Statements

Rs mn	FY17	FY18	FY19E	FY20E	FY21E
Cash flow from operations (a)	2,518	3,385	5,503	3,918	4,406
Cash flow from investing (b)	346	-1,619	916	-1,712	-1,159
Cash flow from financing (c)	-2,804	-1,694	-6,478	-1,500	-2,074
Net inc/dec in cash (a+b+c)	59	71	-59	707	1,174
Opening cash and bank balances	104	163	235	175	882
Closing cash & bank balances	163	235	175	882	2,056

Source: Company data, Jefferies estimates

Exhibit 19: Key Ratios

	FY17	FY18	FY19E	FY20E	FY21E
Adjusted EPS	28.4	24.1	30.4	30.7	35.4
Reported EPS	26.4	24.1	28.2	30.7	35.4
BVPS (Rs)	185	223	204	223	245
Dividend per share	11.5	8.7	10.0	10.0	11.0
FCFF (Rs mn)	1,571	1,662	4,137	2,871	3,406

Valuation (x)

	FY17	FY18	FY19E	FY20E	FY21E
PE	19	21	18	16	14
EV/EBITDA	11.0	12.8	10.2	9.8	8.4
EV/Sales	2.4	2.3	2.0	1.8	1.6
P/BV	2.7	2.2	2.4	2.2	2.0

Profitability Ratios

	FY17	FY18	FY19E	FY20E	FY21E
ROCE %	25.3	16.6	20.4	20.6	21.8
ROE%	18.2	11.8	14.3	14.4	15.1

Working Capital

	FY17	FY18	FY19E	FY20E	FY21E
Inventory in days	105	105	97	96	95
Debtor days	6	6	9	9	9
Creditors turnover days	41	41	42	41	41
Working Capital cycle	71	70	64	63	62

Source: Company data, Jefferies estimates

Company Description

Finolex Industries

Finolex is a key player in the PVC pipes & fittings segment, especially the agriculture pipes. In 2017, the company forayed into the higher-margin CPVC pipes & fittings segment post their partnership with Lubrizol.

Company Valuation/Risks

Finolex Industries

We derive our one-year forward PT of Rs 640 by assigning PE multiple of 18x to Mar' 21 earnings; our target PE is broadly in line with the company's historical five-year avg. multiple. Risks: 1) slower ramp-up of CPVC segment, 2) tepid traction in construction, lower farm income - impacting volumes, 3) competition in agri-pipes, leading to pricing pressures and, (4) PVC/EDC spread remains a key monitorable.

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Investment Recommendation Record

(Article 3(1)e and Article 7 of MAR)

Recommendation Published	May 27, 2019 , 13:13 ET.
Recommendation Distributed	May 27, 2019 , 13:13 ET.

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Buy - Describes securities that we expect to provide a total return (price appreciation plus yield) of 15% or more within a 12-month period.

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The expected total return (price appreciation plus yield) for Buy rated securities with an average security price consistently below \$10 is 20% or more within a 12-month period as these companies are typically more volatile than the overall stock market. For Hold rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is plus or minus 20% within a 12-month period. For Underperform rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is minus 20% or less within a 12-month period.

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Other Companies Mentioned in This Report

- Finolex Industries Limited (FNXP IN: INR493.95, BUY)

Rating and Price Target History for: Finolex Industries Limited (FNXP IN) as of 05-24-2019



Notes: Each box in the Rating and Price Target History chart above represents actions over the past three years in which an analyst initiated on a company, made a change to a rating or price target of a company or discontinued coverage of a company.

Legend:

I: Initiating Coverage

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

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Rating	Count	Percent	IB Serv./Past 12 Mos.		JIL Mkt Serv./Past 12 Mos.	
			Count	Percent	Count	Percent
BUY	1147	54.23%	89	7.76%	15	1.31%
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UNDERPERFORM	145	6.86%	1	0.69%	0	0.00%

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