

HOLD

TP: Rs 140 | ▲ 6%

FINOLEX INDUSTRIES

| Plastic Products

| 26 July 2022

Near-term pain ahead; downgrade to HOLD

- Q1 revenue increased 23% YoY as volumes/realisations rose 29%/4% in PVC pipes & fittings and 25%/0.2% in PVC resin
- EBITDA margin fell 1,110bps YoY to 10.6% on higher RM (+730bps) and other costs; PVC price volatility and tepid demand key near-term concerns
- We cut FY23/FY24 PAT 24%/13%, lower our target P/E to 16x (vs. 18x) and revise our TP to Rs 140 (vs. Rs 180); downgrade from BUY to HOLD

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Soft base, higher realisations and volumes bolster topline: FNXP reported a 23% YoY increase in Q1FY23 revenue to Rs 11.9bn (-25% QoQ) due to higher YoY volumes in PVC pipes & fittings (+29% YoY, -9% QoQ) and PVC resin (+25% YoY, -21% QoQ). In addition, realisations in PVC pipes & fittings increased 4% (-3.1% QoQ) while PVC resin was flat YoY (-5.2% QoQ).

EBITDA margin contracts 11ppt: An increase in raw material cost (+730bps) and other expenses (+420bps) resulted in a substantial fall in EBITDA margin by 1,110bps YoY to 10.6%. EBITDA declined 40% YoY to Rs 1.3bn.

PVC prices corrected further: PVC prices stood at US\$ 1,450/t in Q1FY23 vs. US\$ 1,563/t in Q4FY22 and have corrected further to ~US\$ 1,050/t (currently). EDC prices stood at US\$ 670/t in Q1 (US\$ 520/t currently) vs. US\$ 835/t in Q4FY22. The average PVC-EDC delta was at US\$ 780/t in Q1FY23 (US\$ 530/t currently) vs. US\$ 728/t in Q4FY22 and US\$ 834/t in Q1FY22. VCM stood at US\$ 1,175/t in Q1 (US\$ 880 currently). PVC/VCM spread was at US\$ 275/t (US\$ 170/t currently) vs. US\$ 350/t in Q4FY22 and US\$ 310/t in Q1FY22.

Near-term pain to worsen: We like FNXP for its pipes business and robust balance sheet but expect earnings to be lower over FY22-FY24 due to a high base and correcting PVC/EDC spreads. Demand was lukewarm in Q1 owing to pressure on PVC prices. In July, PVC pricing declined further by Rs 20/kg and is trading at ~Rs 99/kg. We expect Q2 to witness inventory loss, putting added pressure on margins. Moreover, Jul-Sep is a lean season and hence likely to see muted demand.

Cut to HOLD on declining PVC prices and lukewarm demand: We cut our PAT estimates by 24% for FY23 and 13% for FY24 to incorporate the Q1 numbers, PVC price volatility and tepid demand outlook. We have also lowered our target FY24E P/E multiple from 18x to 16x (vs. the 5Y median of 17.7x) to factor in the near-term pain. Our TP thus reduces to Rs 140 from Rs 180 and we downgrade our rating from BUY to HOLD.

Key changes

Target	Rating
▼	▼

Ticker/Price	FNXP IN/Rs 132
Market cap	US\$ 1.0bn
Free float	48%
3M ADV	US\$ 0.7mn
52wk high/low	Rs 245/Rs 125
Promoter/FPI/DII	52%/6%/42%

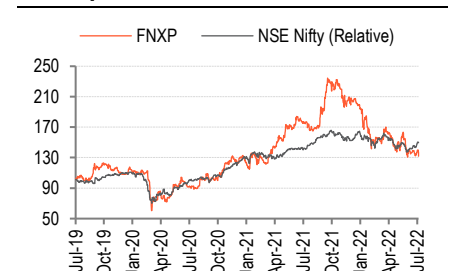
Source: NSE | Price as of 25 Jul 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	46,473	47,924	49,495
EBITDA (Rs mn)	10,237	6,684	7,899
Adj. net profit (Rs mn)	10,453	4,662	5,435
Adj. EPS (Rs)	16.8	7.5	8.8
Consensus EPS (Rs)	16.8	10.1	10.8
Adj. ROAE (%)	29.6	11.5	12.5
Adj. P/E (x)	7.8	17.6	15.1
EV/EBITDA (x)	7.7	10.7	8.6
Adj. EPS growth (%)	41.7	(55.4)	16.6

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call highlights

- **Pricing:** PVC prices are highly volatile and have declined by Rs 20/kg (-14% QoQ) in Q1FY23. Prices further dropped by Rs 20/kg in Jul'22 to trade at ~Rs 99/kg. Management expects to incur inventory loss in Q2FY23 as prices are yet to stabilise.
- **Demand:** Demand in the pipes and fittings business is lower than pre-Covid levels, especially in the agricultural segment. Management aims to achieve pre-Covid demand levels during FY23. Non-agri segment revenue contribution grew 20% YoY in Q1. As per management, the decline in PVC prices will open up buying from the agricultural segment as farmers were deferring purchases due to the high prices.
- **Agri/non-agri volume breakup:** In Q1FY23, the agri/non-agri contribution was at 54%/36% vs. 68%/32% in Q1FY22 (pre-Covid Q1FY20: 80%/20% vs. Q1FY21: 75%/25%).
- **EBITDA/kg:** PVC resin EBITDA/kg stood at Rs 11.6/kg in Q1FY23 vs. Rs 23.1/kg in Q4FY22 and Rs 31.4/kg in Q1FY22. PVC pipes & fittings EBITDA/kg came down to Rs 5.9/kg from ~Rs 12/kg in Q4FY22 and Rs 7.8/kg in Q1FY22. The decline is attributed to lower demand from the agricultural segment and inventory loss amid falling PVC prices.
- **PVC/EDC Spreads:** During Q1FY23, the average PVC-EDC delta stood at US\$ 780/t (US\$ 728/t in Q4FY22 and US\$ 834/t in Q1FY22).
- **Volumes:** Volumes in PVC pipes and fittings stood at 71,960t for the quarter vs. 55,819t in Q1FY22 and 78,629t in Q4FY22. Volumes in PVC resin stood at 62,746t vs. 50,249t in Q1FY22 and 79,182t in Q4FY22. Volumes in CPVC were flattish QoQ at 3,600t (+50% YoY) with revenue at ~Rs 1.5bn in Q1.
- **Other expenses:** During the quarter, other expenses stood at 17.9% of sales vs. 13.7% in Q1FY22 and 10.2% in Q4FY22 due to (1) an increase in power and fuel cost (more than Rs 700mn in Q1FY23 vs. Rs 470mn in Q4FY22) led by a jump in coal prices, and (2) forex losses of Rs 200mn-250mn (majorly from the PVC segments).
- **Capex:** Capex for the next 1-1.5 years is planned at Rs 2bn-2.5bn.
- **SKUs:** The company has +2,000 SKUs.

Fig 1 – Standalone quarterly performance

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Net sales	11,898	9,657	23.2	15,946	(25.4)	46,473	34,628	34.2
COGS	7,999	5,789	38.2	11,083	(27.8)	28,491	19,288	47.7
Employee expenses	511	455	12.3	583	(12.4)	1,908	1,668	14.4
Other expenses	2,130	1,319	61.5	1,634	30.4	5,837	3,780	54.4
EBITDA	1,259	2,095	(39.9)	2,647	(52.4)	10,237	9,893	3.5
EBITDA margin (%)	10.6	21.7	(1,111bps)	16.6	(602bps)	22.0	28.6	(654bps)
Depreciation & amortization	213	201	6.4	216	(1.0)	834	777	7.3
EBIT	1,046	1,895	(44.8)	2,431	(57.0)	9,403	9,116	3.2
EBIT margin (%)	8.8	19.6	(1,083bps)	15.2	(646bps)	20.2	26.3	(609bps)
Other income	251	154	63.3	248	1.3	832	725	14.7
Finance costs	113	48	138.0	81	40.6	141	73	93.8
Exceptional items	-	-	-	3,761	-	3,761	-	-
Profit before tax	1,183	2,000	(40.9)	6,359	(81.4)	13,855	9,768	41.8
Tax expenses	182	532	(65.8)	1,421	(87.2)	3,320	2,488	33.5
Reported Net Profit	1,001	1,468	(31.8)	4,938	(79.7)	10,535	7,280	44.7
Adjusted Net Profit	1,001	1,468	(31.8)	2,018	(50.4)	7,675	7,280	5.4

Source: Company, BOBCAPS Research

Fig 2 – Standalone segmental performance

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Revenue								
PVC resin	7,846	6,271	25.1	10,444	(24.9)	29,621	22,733	30.3
PVC pipes & fittings	11,320	8,454	33.9	12,769	(11.3)	38,527	26,353	46.2
Total	19,166	14,725	30.2	23,213	(17.4)	68,148	49,086	38.8
Inter-segment revenues	7,268	5,068	43.4	7,268	0.0	21,675	14,458	49.9
Net sales (inc. other op. inc.)	11,898	9,657	23.2	15,946	(25.4)	46,473	34,628	34.2
EBIT								
PVC resin	729	1,579	(53.8)	1,565	(53.4)	7,228	6,964	3.8
PVC pipes & fittings	426	436	(2.4)	942	(54.8)	2,502	2,512	(0.4)
Total	1,155	2,015	(42.7)	2,507	(53.9)	9,730	9,476	2.7
EBIT Margins (%)								
PVC resin	9.3	25.2	(1,588bps)	15.0	(569bps)	24.4	30.6	(2,134bps)
PVC pipes & fittings	3.8	5.2	(140bps)	7.4	(362bps)	6.5	9.5	(577bps)
Total	9.7	20.9	(1,116bps)	15.7	(601bps)	20.9	27.4	(1,766bps)

Source: Company, BOBCAPS Research

Fig 3 – Volumes and Realisations

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Volumes								
PVC resin (MT)	62,746	50,249	24.9	79,182	(20.8)	2,36,895	2,36,087	0.3
PVC pipes & fittings (MT)	71,960	55,819	28.9	78,629	(8.5)	2,24,924	2,12,060	6.1
Realisations								
PVC resin (Rs/t)	1,25,041	1,24,800	0.2	1,31,899	(5.2)	1,25,039	96,291	29.9
PVC pipes & fittings (Rs/t)	1,57,311	1,51,452	3.9	1,62,398	(3.1)	1,71,288	1,24,271	37.8
EBIT/t								
PVC resin (Rs/t)	11,618	31,414	(63.0)	19,760	(41.2)	30,511	29,498	3.4
PVC pipes & fittings (Rs/t)	5,917	7,818	(24.3)	11,980	(50.6)	11,126	11,845	(6.1)

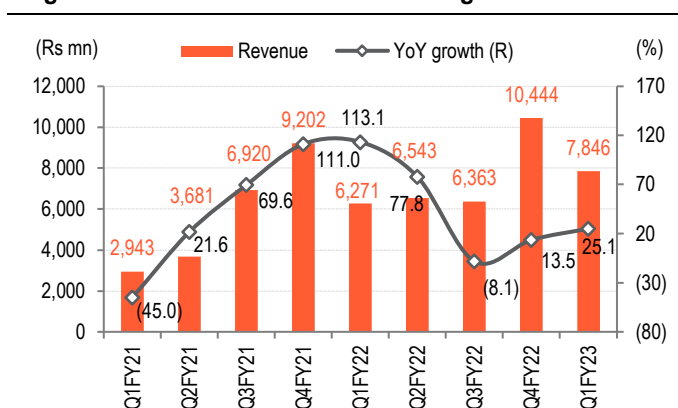
Source: Company, BOBCAPS Research

Fig 4 – Consolidated quarterly performance

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Net sales	11,898	9,657	23.2	15,946	(25.4)	46,473	34,628	34.2
COGS	7,999	5,789	38.2	11,083	(27.8)	28,491	19,288	47.7
Employee expenses	511	455	12.3	583	(12.4)	1,908	1,668	14.4
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EBITDA	1,259	2,095	(39.9)	2,647	(52.4)	10,237	9,893	3.5
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EBIT margin (%)	8.8	19.6	(1,083bps)	15.2	(646bps)	20.2	26.3	(609bps)
Other income	251	154	63.3	248	1.3	822	716	14.9
Finance costs	113	48	138.0	81	40.6	141	73	93.8
Exceptional items	-	-	-	3,761	(100.0)	3,761	-	-
Profit before tax	1,183	2,000	(40.9)	6,359	(81.4)	13,845	9,759	41.9
Tax expenses	177	529	(66.6)	1,429	(87.6)	3,317	2,543	30.5
Share of profit from associates	(14)	(16)	(13.1)	22	(163.8)	(15)	162	(109.1)
Reported Net Profit	992	1,455	(31.8)	4,951	(80.0)	10,513	7,378	42.5
Adjusted Net Profit	992	1,455	(31.8)	2,036	(51.3)	7,654	7,378	3.7

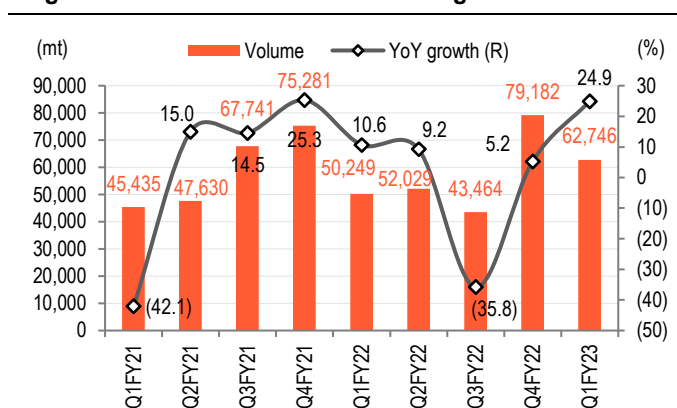
Source: Company, BOBCAPS Research

Fig 5 – Standalone PVC resin revenue growth



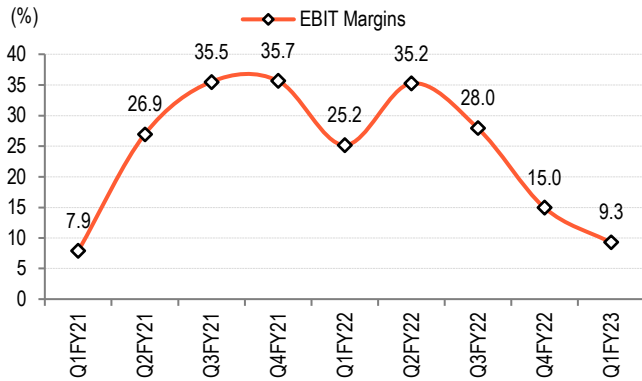
Source: Company, BOBCAPS Research

Fig 6 – Standalone PVC resin volume growth



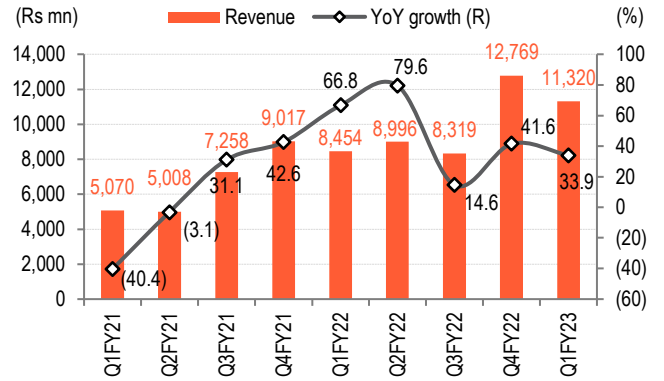
Source: Company, BOBCAPS Research

Fig 7 – Standalone PVC resin EBIT margin



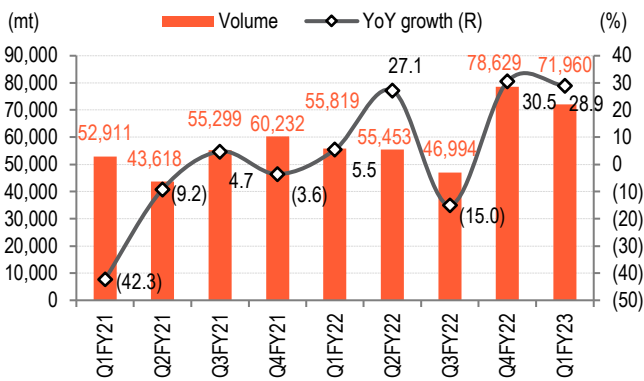
Source: Company, BOBCAPS Research

Fig 8 – Standalone PVC pipes & fittings revenue growth



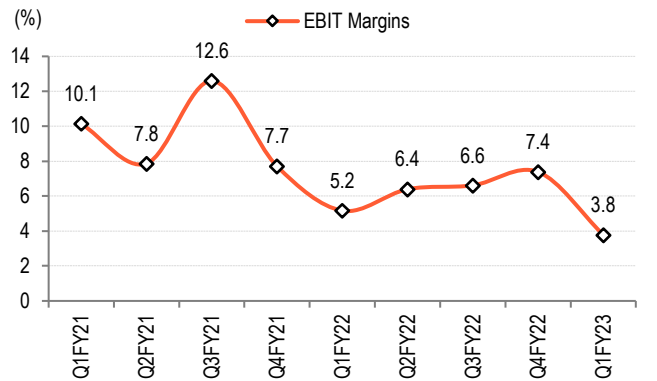
Source: Company, BOBCAPS Research

Fig 9 – Standalone PVC pipes & fittings volume growth



Source: Company, BOBCAPS Research

Fig 10 – Standalone PVC pipes & fittings EBIT margin



Source: Company, BOBCAPS Research

Valuation methodology

We like FNXP for its pipes business and robust balance sheet but expect earnings to be lower over FY22-FY24 due to a high base and correcting PVC/EDC spreads. Demand was lukewarm in Q1FY23 owing to pressure on PVC prices, resulting in a substantial decline in margins. Given the further drop in PVC prices by Rs 20/kg thus far in July and a lean season in Q2, we expect demand and margins to remain under pressure. However, the gradual shift in sales mix from agricultural to non-agricultural pipes could bring in better margins and valuations in the long term.

We cut our PAT estimates by 24% for FY23 and 13% for FY24 to incorporate the Q1 numbers, PVC price volatility and tepid demand outlook. We also lower our target FY24E P/E multiple from 18x to 16x (vs. the five-year median of 17.7x) to factor in the near-term pain. Our TP thus reduces to Rs 140 from Rs 180 as we downgrade our rating from BUY to HOLD.

Fig 11 – Revised estimates

(Rs mn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Net Sales	47,924	49,495	49,553	51,379	(3.3)	(3.7)
EBITDA	6,684	7,899	8,682	8,972	(23.0)	(12.0)
EBITDA (%)	13.9	16.0	17.5	17.5	(360bps)	(150bps)
PAT	4,662	5,435	6,125	6,226	(23.9)	(12.7)

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- volatility in PVC-EDC spreads,
- slowdown in agricultural/housing markets, and
- increased competition from unorganised players, leading to lower profitability.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Astral	ASTRA IN	4.4	1,760	2,205	BUY
Finolex Industries	FNXP IN	1.0	132	140	HOLD
Supreme Industries	SI IN	2.9	1,823	2,400	BUY

Source: BOBCAPS Research, NSE | Price as of 25 Jul 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Total revenue	29,860	34,628	46,473	47,924	49,495
EBITDA	4,481	9,893	10,237	6,684	7,899
Depreciation	(738)	(777)	(834)	(1,198)	(1,237)
EBIT	3,743	9,116	9,403	5,486	6,662
Net interest inc./(exp.)	(119)	(73)	(141)	(167)	(226)
Other inc./(exp.)	299	716	822	863	780
Exceptional items	0	0	0	0	0
EBT	3,923	9,759	10,085	6,182	7,216
Income taxes	(852)	(2,543)	(3,377)	(1,570)	(1,831)
Extraordinary items	0	0	3,761	0	0
Min. int./Inc. from assoc.	256	162	(15)	50	50
Reported net profit	3,327	7,378	10,453	4,662	5,435
Adjustments	0	0	0	0	0
Adjusted net profit	3,327	7,378	10,453	4,662	5,435

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	2,334	3,952	4,631	3,762	3,753
Other current liabilities	1,723	3,085	4,429	3,020	3,119
Provisions	297	420	197	656	678
Debt funds	2,827	2,039	2,780	1,980	1,780
Other liabilities	1,873	2,053	2,138	2,028	1,918
Equity capital	1,241	1,241	1,241	1,241	1,241
Reserves & surplus	18,619	30,149	38,037	40,601	43,590
Shareholders' fund	19,860	31,390	39,278	41,842	44,831
Total liab. and equities	28,913	42,939	53,454	53,289	56,079
Cash and cash eq.	932	3,363	810	(1,552)	453
Accounts receivables	732	1,480	3,345	1,313	1,356
Inventories	8,578	9,188	10,155	11,872	11,676
Other current assets	710	779	222	1,444	1,356
Investments	6,607	16,792	27,177	27,877	28,577
Net fixed assets	10,153	10,013	9,922	10,305	10,568
CWIP	73	82	95	50	50
Intangible assets	16	11	11	11	11
Deferred tax assets, net	0	0	0	0	0
Other assets	1,113	1,233	1,719	1,969	2,034
Total assets	28,913	42,939	53,454	53,289	56,079

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Cash flow from operations	1,057	9,209	9,917	1,677	6,335
Capital expenditures	(603)	(647)	(837)	(1,455)	(1,500)
Change in investments	0	0	0	0	0
Other investing cash flows	942	(5,859)	(10,384)	(700)	(700)
Cash flow from investing	340	(6,507)	(11,222)	(2,155)	(2,200)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	1,921	(788)	742	(800)	(200)
Interest expenses	(119)	(73)	(141)	(167)	(226)
Dividends paid	(2,873)	(42)	(4,704)	(2,098)	(2,446)
Other financing cash flows	315	632	2,855	1,181	741
Cash flow from financing	(756)	(271)	(1,248)	(1,884)	(2,130)
Chg in cash & cash eq.	641	2,431	(2,552)	(2,362)	2,004
Closing cash & cash eq.	932	3,363	810	(1,552)	453

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	1.1	11.9	16.8	7.5	8.8
Adjusted EPS	1.1	11.9	16.8	7.5	8.8
Dividend per share	2.0	4.0	6.3	2.8	3.3
Book value per share	6.4	50.6	63.3	67.4	72.3

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	2.7	2.3	1.7	1.5	1.4
EV/EBITDA	18.1	8.2	7.7	10.7	8.6
Adjusted P/E	123.0	11.1	7.8	17.6	15.1
P/BV	20.6	2.6	2.1	2.0	1.8

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	84.8	75.6	103.7	75.4	75.3
Interest burden (PBT/EBIT)	104.8	107.1	107.2	112.7	108.3
EBIT margin (EBIT/Revenue)	12.5	26.3	20.2	11.4	13.5
Asset turnover (Rev./Avg TA)	95.9	96.4	96.4	89.8	90.5
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.4	1.3	1.3
Adjusted ROAE	14.6	28.8	29.6	11.5	12.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
YoY growth (%)					
Revenue	(3.4)	16.0	34.2	3.1	3.3
EBITDA	(25.9)	120.8	3.5	(34.7)	18.2
Adjusted EPS	(13.8)	1009.0	41.7	(55.4)	16.6
Profitability & Return ratios (%)					
EBITDA margin	15.0	28.6	22.0	13.9	16.0
EBIT margin	12.5	26.3	20.2	11.4	13.5
Adjusted profit margin	11.1	21.3	22.5	9.7	11.0
Adjusted ROAE	14.6	28.8	29.6	11.5	12.5
ROCE	15.2	32.5	24.9	12.8	14.7
Working capital days (days)					
Receivables	9	12	19	18	10
Inventory	139	168	124	132	141
Payables	37	46	43	37	33
Ratios (x)					
Gross asset turnover	1.3	1.5	1.9	1.9	1.8
Current ratio	1.5	1.6	1.2	1.4	1.6
Net interest coverage ratio	31.4	125.4	66.7	32.9	29.5
Adjusted debt/equity	0.1	0.0	0.1	0.1	0.0

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

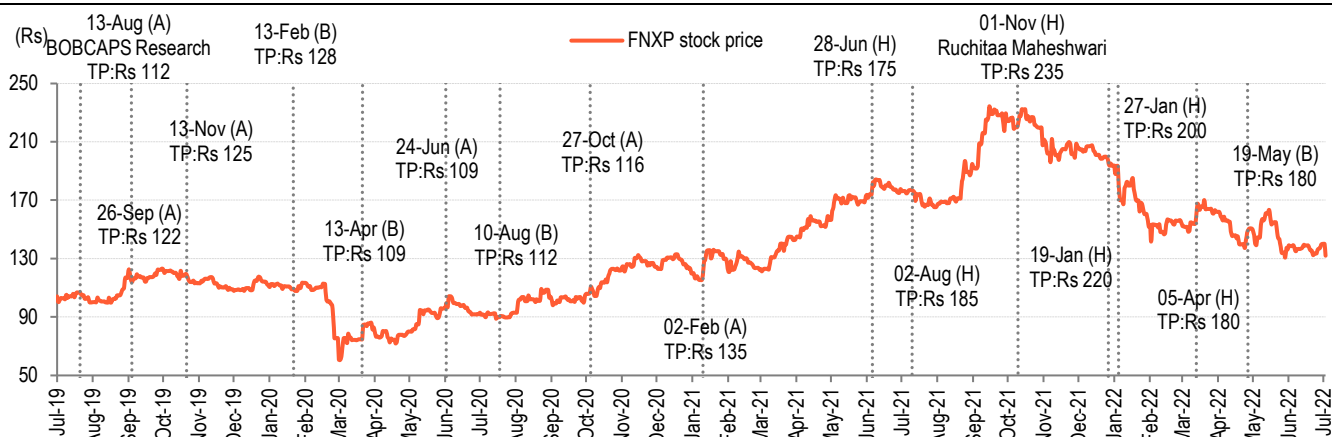
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): FINOLEX INDUSTRIES (FNXP IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

Rating distribution

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