

HOLD

TP: Rs 130 | ▼ 3%

FINOLEX INDUSTRIES

Plastic Products

25 October 2022

Revival slipped to Q4

- Q2 revenue decreased 13% YoY as realisations in PVC resin/PVC pipes & fittings dropped 29%/17%
- PVC price drop (-32% QoQ), high-cost inventory and agricultural demand deferral drove EBITDA loss of Rs 1.4bn
- We cut FY23/FY24 PAT by 7%/8% and revise our TP to Rs 130 (vs. Rs 140); maintain HOLD

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Subdued realisations dampen topline: FNXP reported a 13% YoY (-21% QoQ) decline in Q2FY23 revenue to Rs 9.4bn due to a significant fall in realisations for PVC pipes & fittings (-17% YoY, -14% QoQ) and PVC resin (-29% YoY, -29% QoQ). Volumes did move up in both segments by 7% YoY (-18% QoQ) and 4% YoY (-14% QoQ) respectively.

EBITDA loss due to high-cost inventory: A steep drop in PVC prices (~32% QoQ) to Rs 80-81/kg and inventory losses resulted in an EBITDA loss of Rs 1.4bn in Q2 against positive EBITDA of Rs 3bn in the year-ago quarter. At normal price levels, the company typically earns an EBIT/kg of Rs 8-10 in pipes and Rs 15 in PVC resin.

PVC continues to correct: PVC prices stood at US\$ 900/t in Q2FY23 vs. US\$ 1,450/t in Q1FY23 (US\$ 830/t currently). EDC more than halved to US\$ 300/t in Q2 (US\$ 320/t currently) vs. US\$ 670/t in Q1. The average PVC-EDC delta fell to US\$ 600/t in Q2FY23 (US\$ 510/t currently) vs. US\$ 780/t in Q1 and US\$ 790/t in Q2FY22. VCM prices stood at US\$ 1,175/t in Q2 (US\$ 880 currently), taking the PVC-VCM spread to US\$ 235/t (US\$ 170/t currently) vs. US\$ 275/t in Q1 and US\$ 391/t in Q2FY22. Ethylene was at US\$ 975/t in Q2 (US\$ 900/t currently) vs. US\$ 1,175/t in Q1.

Spillover of high-cost inventory to hurt Q3 margins: 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 H1FY23 owing to pressure on PVC prices, channel destocking and demand deferment from the agricultural sector. Per management, PVC prices are expected to decline further over the next two weeks. We thus expect Q3 to witness inventory losses and demand deferral from agri, putting added pressure on margins.

Maintain HOLD: We cut our FY23/FY24 PAT estimates by 7%/8% to incorporate the Q2 numbers as well as margin pressure anticipated in Q3 led by PVC price volatility and a tepid demand outlook. Our TP thus reduces to Rs 130 from Rs 140, based on an unchanged 16x FY24E P/E multiple vs. the stock's 5Y median of 17.3x – we maintain HOLD.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	FNXP IN/Rs 134
Market cap	US\$ 1.0bn
Free float	48%
3M ADV	US\$ 1.1mn
52wk high/low	Rs 234/Rs 122
Promoter/FPI/DII	52%/6%/42%

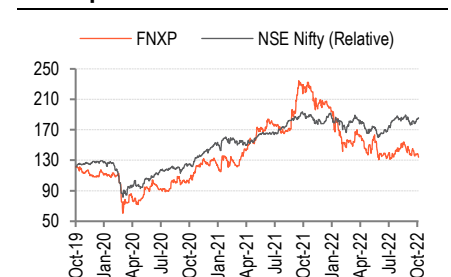
Source: NSE | Price as of 25 Oct 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	46,473	46,683	48,191
EBITDA (Rs mn)	10,237	6,217	7,248
Adj. net profit (Rs mn)	10,453	4,328	5,009
Adj. EPS (Rs)	16.8	7.0	8.1
Consensus EPS (Rs)	16.8	10.1	10.8
Adj. ROAE (%)	29.6	10.7	11.6
Adj. P/E (x)	8.0	19.2	16.6
EV/EBITDA (x)	7.8	11.7	9.4
Adj. EPS growth (%)	41.7	(58.6)	15.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call highlights

- **Pricing:** PVC prices are highly volatile and have declined by ~Rs 40/kg (-32% QoQ) to Rs 80-81/kg in Q2FY23. Management expects to incur inventory loss in Q3FY23 as well, as prices are yet to stabilise and could decline further over the next fortnight.
- **Demand:** Demand in the pipes and fittings business has fallen, especially from the agricultural segment, due to deferral of purchases given volatile PVC prices. Management believes the decline in PVC prices after stabilising will drive buying from the agricultural segment as farmers were postponing purchases due to the high prices. Moreover, channel inventory remains low.
- **EBIT/kg:** In the PVC resin business, EBIT/kg was negative at -Rs 20.5/kg in Q2FY23 vs. +Rs 11.6/kg in Q1FY23 and +Rs 44.3/kg in Q2FY22. PVC pipes & fittings also had negative EBIT/kg at -Rs 8/kg vs. +Rs 6/kg in Q1FY23 and +Rs 10.4/kg in Q2FY22. FNXP attributed the negative EBIT/kg to lower demand from the agricultural segment and inventory losses amid falling PVC prices.
- **PVC/EDC spreads:** During Q2FY23, the average polyvinyl chloride-ethylene dichloride (PVC-EDC) delta stood at US\$ 600/t (US\$ 780/t in Q1FY23 and US\$ 790/t in Q2FY22). The PVC-VCM (vinyl chloride monomer) spread also fell to US\$ 235/t (US\$ 170/t currently) vs. US\$ 275/t in Q1 and US\$ 391/t in Q2FY22.
- **Agri/non-agricultural volume breakup:** In Q2FY23, the agri/non-agricultural contribution to overall volumes was at 53%/37% vs. 54%/36% in Q1FY23 and 58%/42% in Q2FY22.
- **Volumes:** Volumes in PVC pipes and fittings were at 59,218t for the quarter vs. 55,453t in Q2FY22 and 71,960t in Q1FY23. Volumes in PVC resin stood at 54,063t vs. 52,029t in Q2FY22 and 62,746t in Q1FY23. CPVC clocked in at 4,000t (+11% YoY) with revenue at Rs 1.07bn in Q2 (-14% YoY).
- **Capex:** Capex for the next 1-1.5 years is planned at Rs 2bn-2.5bn.

Fig 1 – Standalone quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Net Sales	9,411	10,830	(13.1)	11,898	(20.9)	21,309	20,487	4.0
COGS	8,528	6,027	41.5	7,999	6.6	16,527	11,816	39.9
Employee expenses	423	423	0.1	511	(17.2)	934	877	6.4
Other expenses	1,887	1,365	38.2	2,130	(11.4)	4,017	2,684	49.7
EBITDA	(1,427)	3,015	(147.3)	1,259	(213.3)	(168)	5,110	(103.3)
EBITDA margin (%)	(15.2)	27.8	(4,300bps)	10.6	(2,574bps)	(0.8)	24.9	(2,573bps)
Depreciation & amortization	216	206	4.6	213	1.0	429	407	5.5
EBIT	(1,642)	2,809	(158.5)	1,046	(257.1)	(597)	4,703	(112.7)
EBIT margin (%)	(17.5)	25.9	(4,338bps)	8.8	(2,624bps)	(2.8)	23.0	(2,576bps)
Other income	393	299	31.5	251	56.7	644	452	42.3
Finance costs	43	4	951.2	113	(62.0)	156	52	202.5
Exceptional items	-	-	-	-	-	-	-	-
Profit before tax	(1,293)	3,103	(141.7)	1,183	(209.2)	(109)	5,104	(102.1)
Tax expenses	(353)	752	(147.0)	182	(293.9)	(171)	1,285	(113.3)
Reported Net Profit	(939)	2,351	(140.0)	1,001	(193.8)	62	3,819	(98.4)
Adjusted Net Profit	(939)	2,351	(140.0)	1,001	(193.8)	62	3,819	(98.4)

Source: Company, BOBCAPS Research

Fig 2 – Standalone segmental performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Revenue								
PVC resin	4,811	6,543	(26.5)	7,846	(38.7)	12,657	12,815	(1.2)
PVC pipes & fittings	8,017	8,996	(10.9)	11,320	(29.2)	19,337	17,450	10.8
Total	12,828	15,540	(17.5)	19,166	(33.1)	31,994	30,265	5.7
Inter-segment revenues	3,417	4,710	(27.5)	7,268	(53.0)	10,685	9,778	9.3
Net sales (inc. other op. inc.)	9,411	10,830	(13.1)	11,898	(20.9)	21,309	20,487	4.0
EBIT								
PVC resin	(1,107)	2,306	(148.0)	729	(251.8)	(378)	3,884	(109.7)
PVC pipes & fittings	(476)	575	(182.9)	426	(211.9)	(51)	1,011	(105.0)
Total	(1,583)	2,880	(155.0)	1,155	(237.1)	(428)	4,895	(108.7)
EBIT Margins (%)								
PVC resin	(23.0)	35.2	(5,825bps)	9.3	(3,230bps)	(3.0)	30.3	(5,332bps)
PVC pipes & fittings	(5.9)	6.4	(1,233bps)	3.8	(970bps)	(0.3)	5.8	(1,173bps)
Total	(16.8)	26.6	(4,342bps)	9.7	(2,653bps)	(2.0)	23.9	(4,072bps)

Source: Company, BOBCAPS Research

Fig 3 – Volumes and Realisations

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Volumes								
PVC resin (MT)	54,063	52,029	3.9	62,746	(13.8)	1,16,809	1,02,278	14.2
PVC pipes & fittings (MT)	59,218	55,453	6.8	71,960	(17.7)	1,31,178	1,11,272	17.9
Realisations								
PVC resin (Rs/t)	88,983	1,25,764	(29.2)	1,25,041	(28.8)	1,08,352	1,25,291	(13.5)
PVC pipes & fittings (Rs/t)	1,35,386	1,62,233	(16.5)	1,57,311	(13.9)	1,47,413	1,56,825	(6.0)
EBIT/t								
PVC resin (Rs/t)	(20,472)	44,320	(146.2)	11,618	(276.2)	(3,234)	37,979	(108.5)
PVC pipes & fittings (Rs/t)	(8,043)	10,360	(177.6)	5,917	(235.9)	(385)	9,085	(104.2)

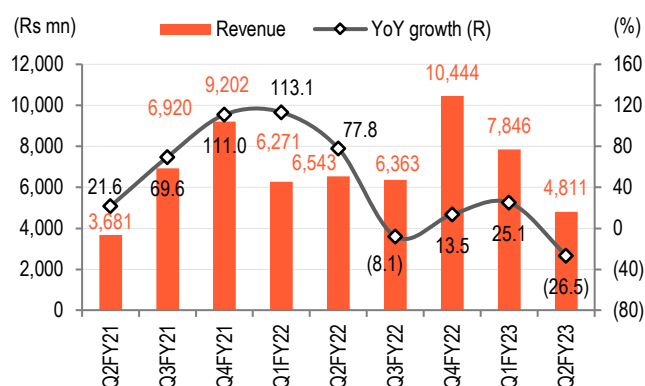
Source: Company, BOBCAPS Research

Fig 4 – Consolidated quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Net sales	9,411	10,830	(13.1)	11,898	(20.9)	21,309	20,487	4.0
COGS	8,528	6,027	41.5	7,999	6.6	16,527	11,816	39.9
Employee expenses	423	423	0.1	511	(17.2)	934	877	6.4
Other expenses	1,887	1,365	38.2	2,130	(11.4)	4,017	2,684	49.7
EBITDA	(1,427)	3,015	(147.3)	1,259	(213.3)	(168)	5,110	(103.3)
EBITDA margin (%)	(15.2)	27.8	(4,300bps)	10.6	(2,574bps)	(0.8)	24.9	(2,573bps)
Depreciation & amortization	216	206	4.6	213	1.0	429	407	5.5
EBIT	(1,642)	2,809	(158.5)	1,046	(257.1)	(597)	4,703	(112.7)
EBIT margin (%)	(17.5)	25.9	(4,338bps)	8.8	(2,624bps)	(2.8)	23.0	(2,576bps)
Other income	388	289	34.2	251	54.9	639	443	44.3
Finance costs	43	4	951.2	113	(62.0)	156	52	202.5
Exceptional items	-	-	-	-	-	-	-	-
Profit before tax	(1,297)	3,094	(141.9)	1,183	(209.6)	(114)	5,094	(102.2)
Tax expenses	(350)	748	(146.8)	177	(297.6)	(173)	1,277	(113.5)
Share of profit from associates	(7)	(14)	(51.9)	(14)	(53.2)	(20)	(30)	(30.8)
Reported Net Profit	(954)	2,333	(140.9)	992	(196.1)	38	3,788	(99.0)
Adjusted Net Profit	(954)	2,333	(140.9)	992	(196.1)	38	3,788	(99.0)

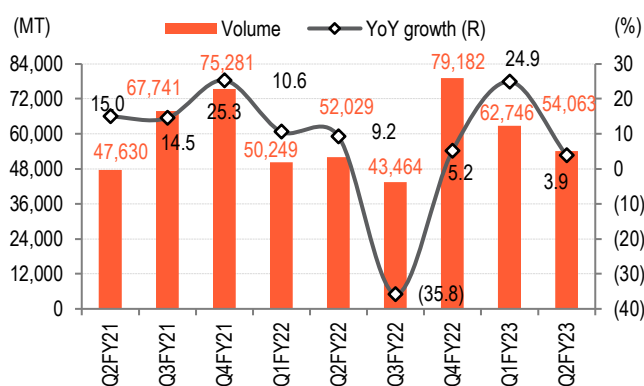
Source: Company, BOBCAPS Research

Fig 5 – Standalone PVC resin revenue growth



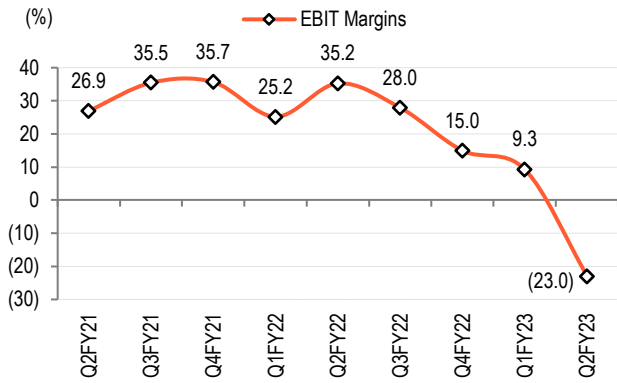
Source: Company, BOBCAPS Research

Fig 6 – Standalone PVC resin volume growth



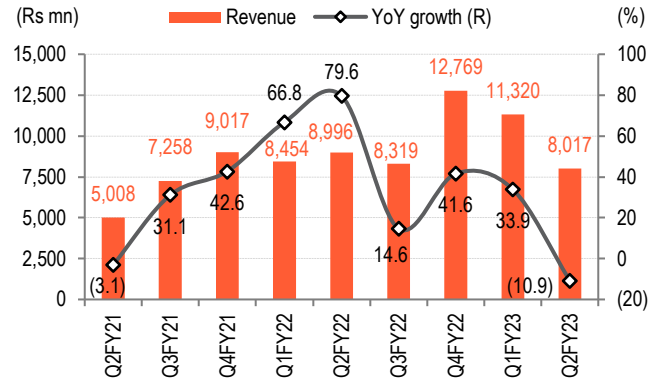
Source: Company, BOBCAPS Research

Fig 7 – Standalone PVC resin EBIT margin



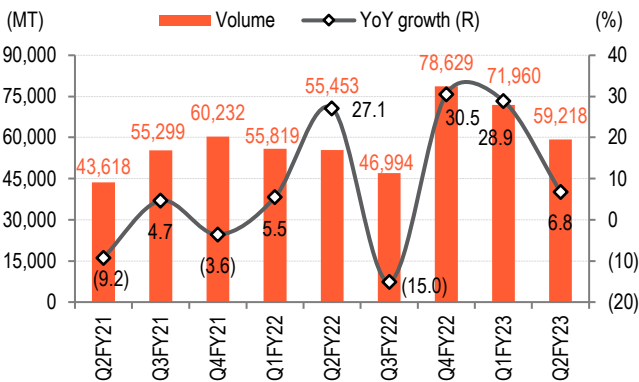
Source: Company, BOBCAPS Research

Fig 8 – Standalone PVC pipes & fittings revenue growth



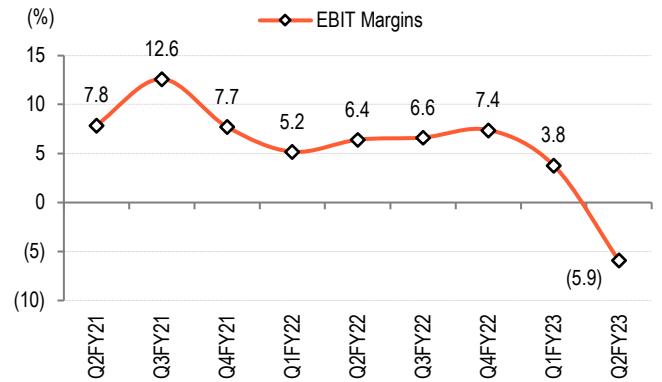
Source: Company, BOBCAPS Research

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 H1FY23 owing to pressure on PVC prices, channel destocking and demand deferral from the agricultural sector. Per management, PVC prices are expected to decline further over the next two weeks (currently trading at Rs 80-81/kg). Thus, we expect Q3 to witness inventory losses and deferral in demand from agri, putting added pressure on margins. However, the gradual shift in sales mix towards non-agricultural pipes could bring in better margins and valuations over the long term.

We cut our FY23/FY24 PAT estimates by 7%/8% to incorporate the Q2FY23 numbers as well as margin pressure anticipated in Q3 from PVC price volatility and a tepid demand outlook. Our TP thus reduces to Rs 130 from Rs 140, based on an unchanged 16x FY24E P/E multiple vs. the stock's five-year median of 17.3x – maintain HOLD.

Fig 11 – Revised estimates

(Rs mn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Net Sales	46,683	48,191	47,924	49,495	(2.6)	(2.6)
EBITDA	6,217	7,248	6,684	7,899	(7.0)	(8.2)
EBITDA (%)	13.3	15.0	13.9	16.0	(60bps)	(100bps)
PAT	4,335	5,009	4,662	5,435	(7.0)	(7.8)

Source: BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- increasing PVC-EDC spreads,
- higher contribution from non-agricultural segment,
- faster revival in agricultural/housing markets, and
- complacent behaviour from unorganised players.

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	4.8	1,987	2,205	HOLD
Finolex Industries	FNXP IN	1.0	134	130	HOLD
Supreme Industries	SI IN	3.1	2,047	2,055	HOLD

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

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Total revenue	29,860	34,628	46,473	46,683	48,191
EBITDA	4,481	9,893	10,237	6,217	7,248
Depreciation	(738)	(777)	(834)	(1,167)	(1,205)
EBIT	3,743	9,116	9,403	5,050	6,044
Net interest inc./(exp.)	(119)	(73)	(141)	(177)	(262)
Other inc./(exp.)	299	716	822	863	865
Exceptional items	0	0	0	0	0
EBT	3,923	9,759	10,085	5,735	6,647
Income taxes	(852)	(2,543)	(3,377)	(1,458)	(1,688)
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	4,328	5,009
Adjustments	0	0	0	0	0
Adjusted net profit	3,327	7,378	10,453	4,328	5,009

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	2,334	3,952	4,631	5,746	4,935
Other current liabilities	1,723	3,085	4,429	2,942	3,037
Provisions	297	420	197	639	660
Debt funds	2,827	2,039	2,780	2,280	2,080
Other liabilities	1,873	2,053	2,138	2,028	1,918
Equity capital	1,241	1,241	1,241	1,237	1,237
Reserves & surplus	18,619	30,149	38,037	40,421	43,176
Shareholders' fund	19,860	31,390	39,278	41,658	44,413
Total liab. and equities	28,913	42,939	53,454	55,294	57,043
Cash and cash eq.	932	3,363	810	156	978
Accounts receivables	732	1,480	3,345	2,814	2,641
Inventories	8,578	9,188	10,155	11,493	11,515
Other current assets	710	779	222	639	660
Investments	6,607	16,792	27,177	27,877	28,577
Net fixed assets	10,153	10,013	9,922	10,336	10,631
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	1,918	1,980
Total assets	28,913	42,939	53,454	55,294	57,044

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Cash flow from operations	1,057	9,209	9,917	2,962	4,913
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	(500)	(200)
Interest expenses	(119)	(73)	(141)	(177)	(262)
Dividends paid	(2,873)	(42)	(4,704)	(1,947)	(2,254)
Other financing cash flows	315	632	2,855	1,164	826
Cash flow from financing	(756)	(271)	(1,248)	(1,461)	(1,890)
Chg in cash & cash eq.	641	2,431	(2,552)	(654)	822
Closing cash & cash eq.	932	3,363	810	156	978

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	1.1	11.9	16.8	7.0	8.1
Adjusted EPS	1.1	11.9	16.8	7.0	8.1
Dividend per share	2.0	4.0	6.3	2.6	3.0
Book value per share	6.4	50.6	63.3	67.1	71.6

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	2.8	2.4	1.7	1.6	1.4
EV/EBITDA	18.4	8.4	7.8	11.7	9.4
Adjusted P/E	125.0	11.3	8.0	19.2	16.6
P/BV	20.9	2.6	2.1	2.0	1.9

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	84.8	75.6	103.7	75.5	75.4
Interest burden (PBT/EBIT)	104.8	107.1	107.2	113.6	110.0
EBIT margin (EBIT/Revenue)	12.5	26.3	20.2	10.8	12.5
Asset turnover (Rev./Avg TA)	95.9	96.4	96.4	85.9	85.8
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.4	1.3	1.3
Adjusted ROAE	14.6	28.8	29.6	10.7	11.6

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
YoY growth (%)					
Revenue	(3.4)	16.0	34.2	0.5	3.2
EBITDA	(25.9)	120.8	3.5	(39.3)	16.6
Adjusted EPS	(13.8)	1009.0	41.7	(58.6)	15.8
Profitability & Return ratios (%)					
EBITDA margin	15.0	28.6	22.0	13.3	15.0
EBIT margin	12.5	26.3	20.2	10.8	12.5
Adjusted profit margin	11.1	21.3	22.5	9.3	10.4
Adjusted ROAE	14.6	28.8	29.6	10.7	11.6
ROCE	15.2	32.5	24.9	11.7	13.4
Working capital days (days)					
Receivables	9	12	19	24	21
Inventory	139	168	124	132	140
Payables	37	46	43	47	48
Ratios (x)					
Gross asset turnover	1.3	1.5	1.9	1.8	1.8
Current ratio	1.5	1.6	1.2	1.3	1.5
Net interest coverage ratio	31.4	125.4	66.7	28.5	23.1
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%

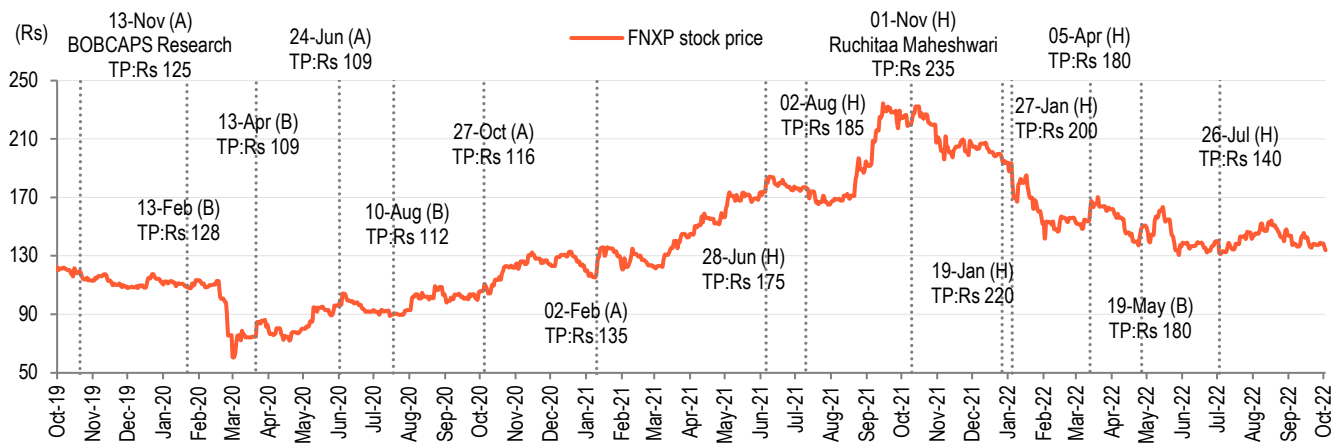
HOLD – Expected return from -6% to +15%

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 (FNPX IN)



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

Rating distribution

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