

HOLD

TP: Rs 200 | ▲ 11%

FINOLEX INDUSTRIES

| Plastic Products

| 27 January 2022

Tepid earnings outlook; PVC prices volatile

- Q3 revenue declined 6% YoY as volumes fell 15% in PVC pipes & fittings and 36% in PVC resin
- Operating margin contracted 845bps YoY to 24.1% on higher employee cost (+110bps) and other expenses (+670bps)
- Target FY24E P/E pared from 22x to 20x given soft earnings outlook, yielding TP of Rs 200 (vs. Rs 220); retain HOLD on reasonable valuation

Ruchitaa Maheshwari

researchreport@bobcaps.in

Realisations rise but volume decline hurts topline: FNXP reported a 6% YoY decline in Q3FY22 revenue to Rs 10.1bn due to a drop in volumes by 15% in PVC pipes & fittings and 36% in PVC resin. Volumes slipped on lower offtake in the agriculture segment owing to torrential rain in some parts of the country, channel destocking at the dealer level and supply chain disruptions. During the quarter, realisations increased 35% YoY in PVC pipes and 43% in PVC resin.

EBITDA margin contracts 845bps: An increase in employee cost by 110bps YoY and other expenses by 670bps resulted in a substantial fall in EBITDA margin by 845bps YoY to 24.1%. EBITDA declined 30% YoY to Rs 2.4bn. The average PVC-EDC delta was at US\$ 795/t (+4% YoY) in Q3.

PVC prices have begun to correct: PVC price stood at US\$ 1,753/t in Q3FY22 (US\$ 1,500/t currently) vs. US\$ 1,235/t in Q3FY21. EDC price was at US\$ 959/t (US\$ 920/t currently) vs. US \$470/t in Q3FY21. The average PVC-EDC delta for the quarter stood at US\$ 795/t vs. US\$ 765/t in Q3FY21 and is at US\$ 580/t currently. With the PVC/EDC spread correcting, we believe FNXP's profit growth will be muted in the near term.

Tepid earnings outlook: We like FNXP for its pipe business and robust balance sheet but expect earnings to be muted over FY21-FY24 due to a high base and correcting PVC/EDC spreads. We forecast a revenue CAGR of 7.7% through FY24 while PAT declines at a 5.5% CAGR. However, the gradual shift in sales mix from agri to non-agri pipes (management is targeting ~40% segmental revenue share in the midterm from the current 35%) could bring in better margins and valuation.

Valuations reasonable; retain HOLD: The stock is trading at 18x FY24E EPS compared to its five-year median of 20x, which we feel is reasonable on the back of its strong brand, increasing focus on high-margin non-agri business and a net debt-free balance sheet. We thus retain HOLD even as we bake in the weak earnings outlook by paring our target FY24E P/E multiple to 20x (from 22x), yielding a reduced TP of Rs 200 (from Rs 220).

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	FNXP IN/Rs 180
Market cap	US\$ 1.5bn
Free float	48%
3M ADV	US\$ 1.4mn
52wk high/low	Rs 245/Rs 114
Promoter/FPI/DII	52%/6%/42%

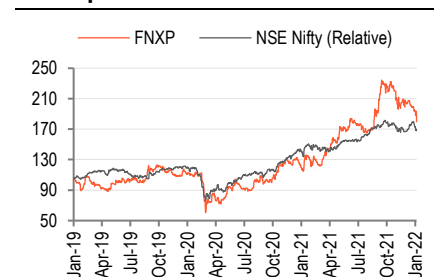
Source: NSE | Price as of 27 Jan 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	34,628	37,522	40,133
EBITDA (Rs mn)	9,893	8,809	7,940
Adj. net profit (Rs mn)	7,378	6,305	5,806
Adj. EPS (Rs)	11.9	10.2	9.4
Consensus EPS (Rs)	11.9	11.3	9.8
Adj. ROAE (%)	28.8	19.0	15.9
Adj. P/E (x)	15.1	17.7	19.2
EV/EBITDA (x)	11.2	12.3	13.1
Adj. EPS growth (%)	1009.0	(14.5)	(7.9)

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call highlights

- **Demand:** Revenue from agriculture pipes declined 24% QoQ and 5% YoY in Q3FY22 whereas non-agri pipes grew 4% QoQ and 30% YoY. Demand in the agriculture segment has been affected in anticipation of a price correction post removal of the ~10% anti-dumping duty on China and the US (expiring next month), which may put further pressure on PVC prices. Torrential rainfall in some parts of the country during Q3 further dented demand. Growth was muted in January as well due to continued rainfall but management is hopeful of better demand from mid-February.

In Q3, agri pipes contributed 60% of segmental volumes and 65% of value. Management expects value share of the non-agri segment to improve from 35% to ~40% in the medium term, which will bolster margins going forward.

- **Pricing:** In Q3FY22, PVC was priced at US\$ 1,753/t (US\$ 1,235/t in Q3FY21), VCM at US\$ 1,403/t (US\$ 960/t), EDC at US\$ 959/t (US\$ 470/t) and ethylene at US\$ 1,068/t (US\$ 843/t).
- **Spreads:** During Q3, the average PVC-EDC delta stood at US\$ 795/t (US\$ 765/t in Q3FY21 and US\$ 791/t in Q2FY22) and is currently at US\$ 580/t.
- **Margins:** Management believes EBIT/kg of Rs 10-12 is sustainable in the pipes business.
- **RM availability:** FNXP had contracted raw material such as EDC, ethylene and VCM for Q3 and is not facing any production issues.
- **A&P:** A&P spend is 1-1.5% of total sales.
- **PVC fittings:** Volumes in PVC fittings stood at 6,121t for the quarter vs. 5,873t in Q3FY21 and 6,854t in Q2FY22.
- **CPVC:** Volumes of CPVC increased 13% YoY (-6% QoQ) to 3,400t with revenue at ~Rs 1.3bn in Q3.
- **SKU:** The company currently has 2,200 SKUs, of which 1,200-1,300 are in the non-agri segment.
- **Capex:** For FY22 and FY23, capex is planned at ~Rs 1bn each.
- **Cash on books:** FNXP remains net surplus with net cash on books of Rs 5bn, the usage of which is yet to be decided. The company has announced the sale of MIDC land for no less than Rs 7.25bn, which may take place in CY22.

Fig 1 – Standalone quarterly performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Net sales	10,053	10,669	(5.8)	10,830	(7.2)	30,539	22,147	37.9
COGS	5,592	5,863	(4.6)	6,027	(7.2)	17,408	12,870	35.3
Employee expenses	449	368	22.1	423	6.2	1,326	1,075	23.4
Other expenses	1,593	971	64.0	1,365	16.7	4,271	2,406	77.6
EBITDA	2,419	3,467	(30.2)	3,015	(19.8)	7,534	5,797	30.0
EBITDA margin (%)	24.1	32.5	(843bps)	27.8	(377bps)	24.7	26.2	(150bps)
Depreciation & amortization	212	199	6.7	206	2.8	619	580	6.6
EBIT	2,207	3,268	(32.5)	2,809	(21.4)	6,916	5,217	32.6
EBIT margin (%)	22.0	30.6	(868bps)	25.9	(398bps)	22.6	23.6	(91bps)
Other income	194	182	6.7	299	(35.2)	641	589	8.7
Finance costs	9	18	(52.5)	4	107.3	60	58	3.1
Exceptional items	-	-	-	-	-	-	-	-
Profit before tax	2,392	3,432	(30.3)	3,103	(22.9)	7,496	5,748	30.4
Tax expenses	615	873	(29.6)	752	(18.3)	1,899	1,441	31.8
Reported Net profit	1,778	2,559	(30.5)	2,351	(24.4)	5,597	4,307	29.9
Adjusted Net Profit	1,778	2,559	(30.5)	2,351	(24.4)	5,597	4,307	29.9

Source: Company, BOBCAPS Research

Fig 2 – Standalone segmental performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Revenue								
PVC	6,363	6,920	(8.1)	6,543	(2.8)	19,177	13,543	41.6
PVC pipes & fittings	8,319	7,258	14.6	8,996	(7.5)	25,769	17,336	48.6
Total	14,681	14,178	3.6	15,540	(5.5)	44,946	30,879	45.6
Inter-segment revenues	4,629	3,509	31.9	4,710	(1.7)	14,407	8,732	65.0
Net sales (inc. other op. inc.)	10,053	10,669	(5.8)	10,830	(7.2)	30,539	22,147	37.9
EBIT								
PVC	1,779	2,456	(27.6)	2,306	(22.9)	5,663	3,680	53.9
PVC pipes & fittings	550	914	(39.8)	575	(4.3)	1,560	1,821	(14.3)
Total	2,328	3,370	(30.9)	2,880	(19.2)	7,224	5,500	31.3
EBIT Margins (%)								
PVC	28.0	35.5	(754bps)	35.2	(728bps)	29.5	27.2	79bps
PVC pipes & fittings	6.6	12.6	(598bps)	6.4	22bps	6.1	10.5	(390bps)
Total	23.2	31.6	(843bps)	26.6	(344bps)	23.7	24.8	(167bps)

Source: Company, BOBCAPS Research

Fig 3 – Volumes and Realisations

Particulars	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Volume								
PVC (mt)	43,464	67,741	(35.8)	52,029	(16.5)	1,45,742	1,60,806	(9.4)
PVC pipes (mt)	46,994	55,299	(15.0)	55,453	(15.3)	1,58,266	1,51,828	4.2
Realisation								
PVC (Rs/t)	1,46,386	1,02,149	43.3	1,25,764	16.4	1,31,582	84,220	56.2
PVC pipes (Rs/t)	1,77,020	1,31,250	34.9	1,62,233	9.1	1,62,821	1,14,182	42.6
EBIT/tonne								
PVC (Rs/t)	40,924	36,262	12.9	44,320	(7.7)	38,858	22,882	69.8
PVC pipes (Rs/t)	11,695	16,519	(29.2)	10,360	12.9	9,859	11,993	(17.8)

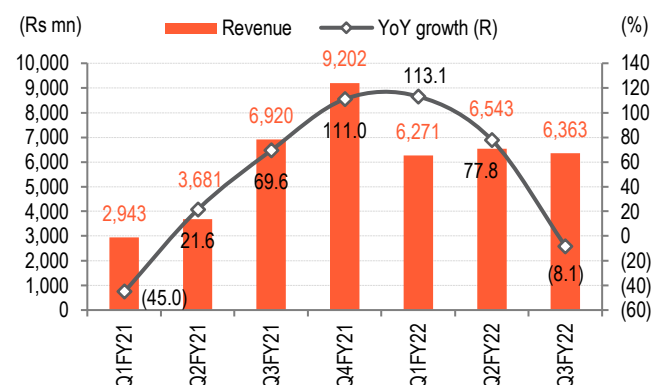
Source: Company, BOBCAPS Research

Fig 4 – Consolidated quarterly performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Net sales	10,053	10,669	(5.8)	10,830	(7.2)	30,539	22,147	37.9
COGS	5,592	5,863	(4.6)	6,027	(7.2)	17,408	12,870	35.3
Employee expenses	449	368	22.1	423	6.2	1,326	1,075	23.4
Other expenses	1,593	971	64.0	1,365	16.7	4,271	2,406	77.6
EBITDA	2,419	3,467	(30.2)	3,015	(19.8)	7,534	5,797	30.0
EBITDA margin (%)	24.1	32.5	(843bps)	27.8	(377bps)	24.7	26.2	(150bps)
Depreciation & amortization	212	199	6.7	206	2.8	619	580	6.6
EBIT	2,207	3,268	(32.5)	2,809	(21.4)	6,916	5,217	32.6
EBIT margin (%)	22.0	30.6	(868bps)	25.9	(398bps)	22.6	23.6	(91bps)
Other income	194	182	6.7	289	(33.1)	631	580	8.8
Finance costs	9	18	(52.5)	4	107.3	60	58	3.1
Exceptional items	-	-	-	-	-	-	-	-
Profit before tax	2,392	3,432	(30.3)	3,094	(22.7)	7,487	5,738	30.5
Tax expenses	611	896	(31.8)	748	(18.3)	1,888	1,480	27.5
Share of profit from associates	(7)	58	(112.1)	(14)	(48.1)	(37)	132	(127.7)
Reported Net profit	1,774	2,594	(31.6)	2,333	(23.9)	5,562	4,390	26.7

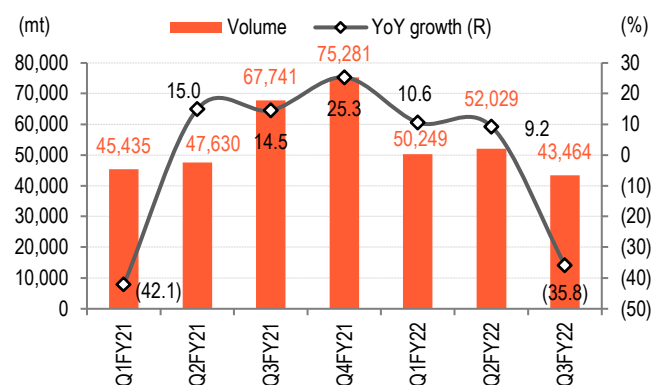
Source: Company, BOBCAPS Research

Fig 5 – Standalone PVC resin revenue growth



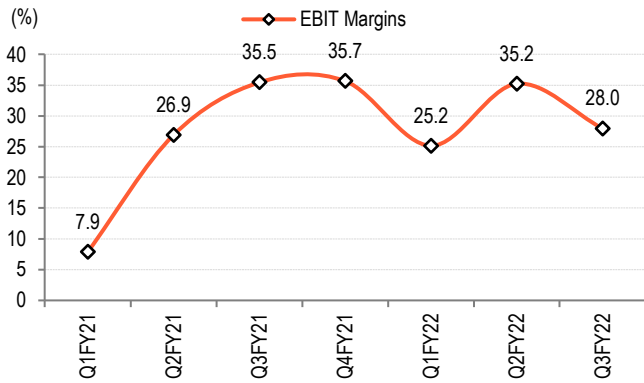
Source: Company, BOBCAPS Research

Fig 6 – Standalone PVC resin volume growth



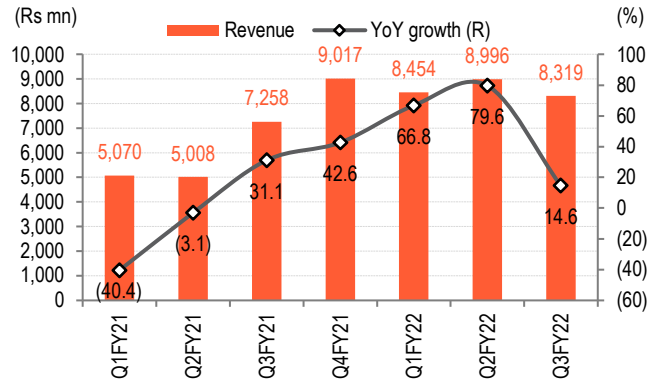
Source: Company, BOBCAPS Research

Fig 7 – Standalone PVC resin EBIT margin



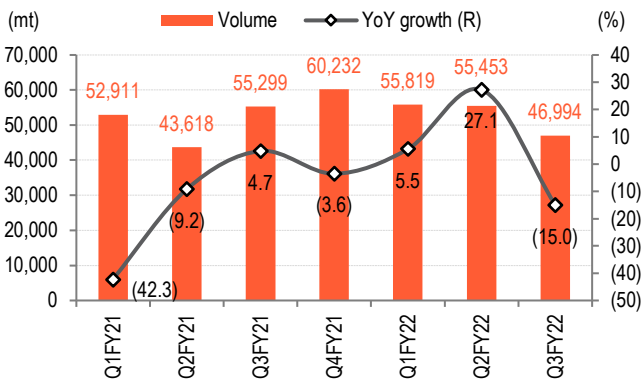
Source: Company, BOBCAPS Research

Fig 8 – Standalone PVC pipes & fittings revenue growth



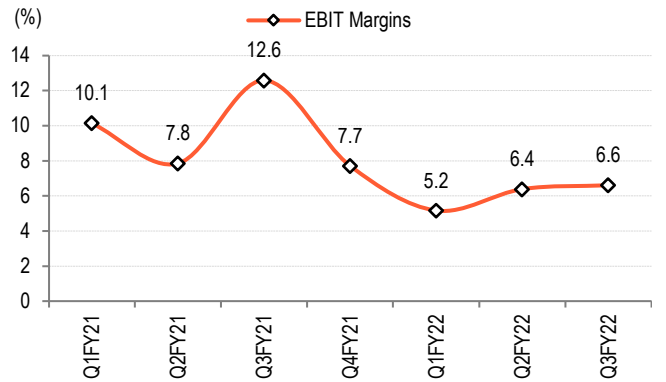
Source: Company, BOBCAPS Research

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 pipe business and robust balance sheet but expect earnings to be muted over FY21-FY24 due to a high base and correcting PVC/EDC spreads. We forecast a revenue CAGR of 7.7% through FY24 while PAT declines at a 5.5% CAGR. However, the gradual shift in sales mix from agri to non-agri pipes (management is targeting ~40% segmental revenue share in the midterm from the current 35%) could bring in better margins and valuations.

The stock is trading at 18x FY24E EPS compared to its five-year median of 20x, which we feel is reasonable on the back of its strong brand, increasing focus on high-margin non-agri business and a net debt-free balance sheet. We thus retain HOLD even as we bake in the weak earnings outlook by paring our target FY24E P/E multiple to 20x (from 22x), yielding a reduced TP of Rs 200 (from Rs 220).

Fig 11 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
PVC resin external sales (mt)	80,468	72,421	65,179	58,661
Growth (%)	44.7	(10.0)	(10.0)	(10.0)
Realisation (Rs/mt)	1,02,838	96,200	92,500	88,800
Growth (%)	32.3	(6.5)	(3.8)	(4.0)
PVC pipe volumes (mt)	2,12,060	2,33,266	2,56,593	2,82,252
Growth (%)	(16.8)	10.0	10.0	10.0
Realisation (Rs/mt)	1,24,271	1,28,000	1,30,560	1,33,171
Growth (%)	24.1	3.0	2.0	2.0
PVC pipe EBITDA (Rs/mt)	13,844	12,500	12,000	12,000
Growth (%)	44.4	(9.7)	(4.0)	0.0
PVC resin EBITDA (Rs/mt)	31,086	25,000	20,500	20,500
Growth (%)	247.7	(19.6)	(18.0)	0.0

Source: Company, BOBCAPS Research

Fig 12 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
					FY22E	FY23E	FY22E	FY23E	
Kajaria Ceramics	KJC IN	BUY	1,460	21.5	22.8	29.6	18.9	23.3	40
Somany Ceramics	SOMC IN	BUY	1,140	19.0	20.5	32.8	12.5	17.3	25
Greenply Ind	MTLM IN	BUY	260	18.0	7.7	10.2	19.7	21.4	22
Century Plyboard	CPBI IN	HOLD	735	23.8	13.6	16.7	22.1	22.1	35
Greenpanel Ind	GREENP	BUY	595	34.0	16.0	21.7	23.7	25.1	23
Cera Sanitaryware	CRS IN	BUY	5,590	17.1	109.8	134.9	15.4	16.9	35
Astral	ASTRA IN	HOLD	2,465	22.3	22.5	29.5	22.5	26.0	65
Finolex Ind	FNXP IN	HOLD	200	7.7	10.2	9.4	19.0	15.9	20
Supreme Ind	SI IN	HOLD	2,535	15.7	74.7	80.7	28.0	26.7	30

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- volatility in PVC-EDC spreads,
- slowdown in agricultural/housing markets,
- increased competition from unorganised players, leading to lower profitability, and
- the ongoing legal battle within the promoter Chabbria family for ownership in group companies, which remains an overhang on stock performance.

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	29,860	34,628	37,522	40,133	43,318
EBITDA	4,481	9,893	8,809	7,940	8,466
Depreciation	(738)	(777)	(938)	(1,003)	(1,083)
EBIT	3,743	9,116	7,870	6,936	7,383
Net interest inc./(exp.)	(119)	(73)	(82)	(59)	(41)
Other inc./(exp.)	299	716	481	634	669
Exceptional items	0	0	0	0	0
EBT	3,923	9,759	8,269	7,512	8,011
Income taxes	(852)	(2,543)	(2,124)	(1,956)	(2,094)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	256	162	160	250	300
Reported net profit	3,327	7,378	6,305	5,806	6,217
Adjustments	0	0	0	0	0
Adjusted net profit	3,327	7,378	6,305	5,806	6,217

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	2,334	3,952	2,631	2,996	3,249
Other current liabilities	1,723	3,085	2,570	2,529	2,730
Provisions	297	420	514	550	593
Debt funds	2,827	2,039	1,239	439	239
Other liabilities	1,873	2,053	1,943	1,833	1,723
Equity capital	1,241	1,241	1,241	1,241	1,241
Reserves & surplus	18,619	30,149	33,616	36,810	40,229
Shareholders' fund	19,860	31,390	34,857	38,051	41,470
Total liab. and equities	28,913	42,939	43,754	46,397	50,004
Cash and cash eq.	932	3,363	4,344	4,160	5,800
Accounts receivables	732	1,480	1,028	1,100	1,187
Inventories	8,578	9,188	8,184	9,455	10,108
Other current assets	710	779	1,028	1,209	1,187
Investments	6,607	16,792	16,992	17,692	18,392
Net fixed assets	10,153	10,013	10,575	11,072	11,489
CWIP	73	82	50	50	50
Intangible assets	16	11	11	11	11
Deferred tax assets, net	0	0	0	0	0
Other assets	1,113	1,233	1,542	1,649	1,780
Total assets	28,913	42,939	43,754	46,397	50,004

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	1,057	9,209	5,745	4,677	5,977
Capital expenditures	(603)	(647)	(1,469)	(1,500)	(1,500)
Change in investments	0	0	0	0	0
Other investing cash flows	942	(5,859)	(200)	(700)	(700)
Cash flow from investing	340	(6,507)	(1,669)	(2,200)	(2,200)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	1,921	(788)	(800)	(800)	(200)
Interest expenses	(119)	(73)	(82)	(59)	(41)
Dividends paid	(2,873)	(42)	(2,837)	(2,613)	(2,798)
Other financing cash flows	315	632	624	810	902
Cash flow from financing	(756)	(271)	(3,095)	(2,661)	(2,136)
Chg in cash & cash eq.	641	2,431	981	(184)	1,641
Closing cash & cash eq.	932	3,363	4,344	4,160	5,800

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	1.1	11.9	10.2	9.4	10.0
Adjusted EPS	1.1	11.9	10.2	9.4	10.0
Dividend per share	2.0	4.0	3.8	3.5	3.8
Book value per share	6.4	50.6	56.2	61.3	66.8

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	3.7	3.2	2.9	2.6	2.4
EV/EBITDA	24.7	11.2	12.3	13.1	12.1
Adjusted P/E	167.7	15.1	17.7	19.2	17.9
P/BV	28.1	3.6	3.2	2.9	2.7

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	84.8	75.6	76.2	77.3	77.6
Interest burden (PBT/EBIT)	104.8	107.1	105.1	108.3	108.5
EBIT margin (EBIT/Revenue)	12.5	26.3	21.0	17.3	17.0
Asset turnover (Rev./Avg TA)	95.9	96.4	86.6	89.0	89.9
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.3	1.2	1.2
Adjusted ROAE	14.6	28.8	19.0	15.9	15.6

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	(3.4)	16.0	8.4	7.0	7.9
EBITDA	(25.9)	120.8	(11.0)	(9.9)	6.6
Adjusted EPS	(13.8)	1009.0	(14.5)	(7.9)	7.1
Profitability & Return ratios (%)					
EBITDA margin	15.0	28.6	23.5	19.8	19.5
EBIT margin	12.5	26.3	21.0	17.3	17.0
Adjusted profit margin	11.1	21.3	16.8	14.5	14.4
Adjusted ROAE	14.6	28.8	19.0	15.9	15.6
ROCE	15.2	32.5	22.6	18.6	18.4
Working capital days (days)					
Receivables	9	12	12	10	10
Inventory	139	168	149	132	135
Payables	37	46	42	32	33
Ratios (x)					
Gross asset turnover	1.3	1.5	1.5	1.5	1.6
Current ratio	1.5	1.6	2.1	2.4	2.7
Net interest coverage ratio	31.4	125.4	96.1	118.2	181.8
Adjusted debt/equity	0.1	0.0	(0.1)	(0.1)	(0.1)

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

Disclaimer

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

BUY – Expected return >+15%

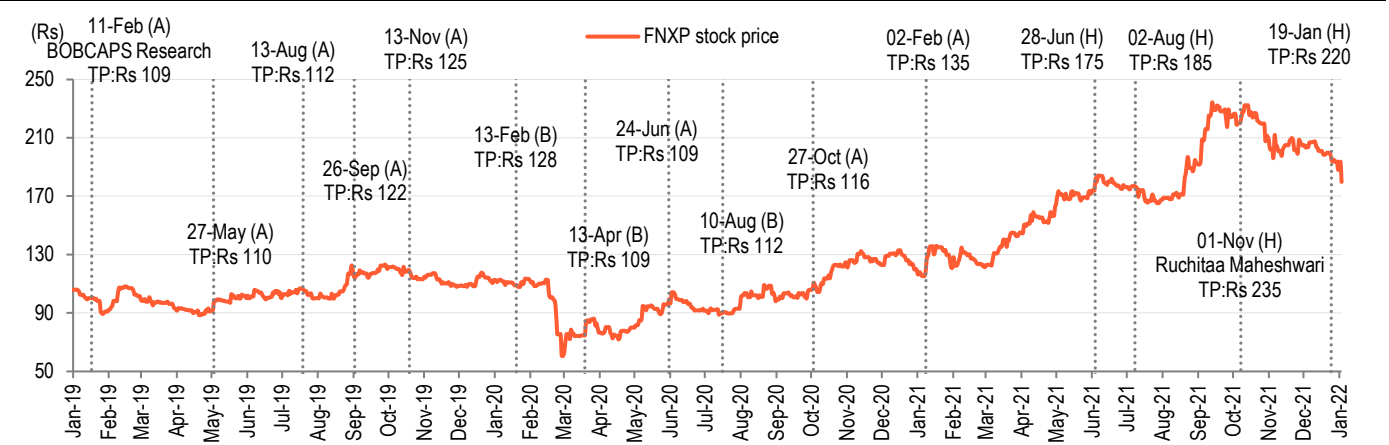
HOLD – Expected return from -6% to +15%

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

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