Finolex Industries

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STOCK BROKING PVT. LTD.

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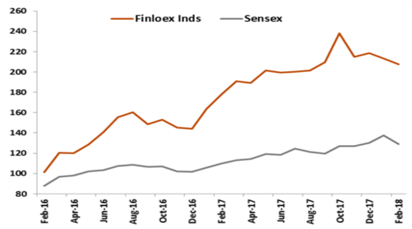
BUY	
Current Price	626
Target Price	781
Upside/Downside	25%
52 Week Range	Rs.753/516

Key Share Data	
Market Cap (Rs.bn)	78
Market Cap (US$ mn)	1214
No of o/s shares (mn)	124.1
Face Value	10
Monthly Avg.vol(BSE+NSE) Nos	1,51,940
BSE Code	500940
NSE Code	FINPIPE
Bloomberg	FNXP IN

Price performance



% Shareholding	Sept-17	Sept-17
Promoters	52.5	52.5
Institutions	14.1	8.80
Others	33.4	38.7
Total	**100.0**	**100.0**

Management resounding confidence on growth in near to long term:
After meeting the Finolex Industries (Finolex) management, we remain positive and believe that the company would sustain its healthy growth trajectory, backed by (1) pipe capacity expansion from 290,000mt to 370,000mt by mid-FY19 and (2) a rising share of high-margin products such as fittings and CPVC pipes in its sales mix. 3) Structural demand shift to the organised segment post GST.

Multiple growth triggers: Going ahead Finolex expects the demand to stay robust mainly from the agriculture and non-agriculture segment (construction & plumbing). Finolex also expects to expand volumes of CPVC pipes and fittings five-fold to ~20,000mt by FY20 – this ramp-up is likely to enrich its product mix as well as profitability. Pipe capacity is being raised by almost a third to 370,000mt (currently at ~30K MT) by mid- FY19 at a capex outlay of ~Rs 2.5bn, which should further support volumes.

Distribution: Finolex enjoys a pan-India presence, with ~850 dealers and ~18K retail touch points. Almost 50% of the dealers are present in rural areas, and the rest in urban. The company's operations are focussed on South and West India, which contribute 70%+ to the top-line and want to further expand in East and North where the Finolex market share is low. Finolex had added 150 SKUs for CPVC pipes.

3QFY18 result snapshot: Finolex posted robust Q3FY18 sales growth of 25% YoY to Rs 7.2bn, driven by 50% volume growth in pipes & fittings. However, EBITDA margins fell 680bps YoY to 15.7%, due to discount/pricing strategy in pipes and fittings led by an 810bps drop in gross margin.Finolex volume push in pipes & fittings yielded strong volume growth of 50% YoY to 61,514mt in Q3FY18 (24% in 9MFY18). PVC resin volumes also recorded healthy growth of 27% YoY to 71,107mt (61% captively consumed). Revenue growth in the pipes & fittings/PVC resin segments stood at 35%/14% YoY, while EBIT margins came in at 6%/17% (8%/23% in Q3FY17), indicating relatively subdued pricing for pipes and fittings compared to last year.

Outlook & Valuation: We believe that Finolex would be a major beneficiary from government's focus on irrigation and improvement in rural consumption in long term. We foresee strong business triggers for Finolex, (1) a structural demand shift to the organised segment post GST, (2) ramp up in CPVC revenues, (3) focus on the higher-margin non-agriculture segment resulting in a rising revenue share of fittings, and (4) pipe capacity expansion from 290k mt to 370k mt by mid-FY19, which could boost volumes. AT the current CMP the stock is trading at PE of 22x/ 17x FY19E & FY20E EPS respectively. We introduce FY20E earnings and maintain our Buy rating on the stock. We value the stock at 20x FY20E EPS with a target price of Rs 780.

Key Financials

Rs mn	Net Sales	% Growth	EBITDA	OPM%	PAT	% Growth	EPS	P/E (x)	ROE %	RoCE%
FY17	26024	4.9%	5630	21.6%	3549	171.2%	28.6	22.1	15.3%	21.5%
FY18E	29919	15.0%	4588	15.3%	2954	-17.4%	23.8	26.5	12.1%	17.1%
FY19E	34284	14.6%	5454	15.9%	3563	20.5%	28.7	22.0	13.8%	19.8%
FY20E	39866	16.3%	7320	18.4%	4845	37.3%	39.0	16.2	16.9%	24.4%

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Result Highlights

3QFY18 Result snapshot	INRm				
Particulars	**3QFY18**	**3QFY17**	**YoY (%)**	**2QFY17**	**QoQ (%)**
Total Op. Income	**7,227**	**5,765**	**25.4**	**4,753**	**52.1**
Expenditure	**6,094**	**4,468**	**36.4**	**4,257**	**43.2**
Raw Materials	4,856	3,407	42.5	3,134	55.0
Staff Cost	294	255	15.2	285	3.1
Other Expenditure	944	806	17.1	838	12.6
Operating Profit	**1,133**	**1,297**	**(12.6)**	**496**	**128.5**
OPM (%)	*15.7*	*22.5*	*(681.1)*	*10.4*	
Depreciation	154	140	9.6	151	1.6
Other Income	103	29	258.6	109	(6.1)
Interest	(4)	59	(106.0)	38	(109.4)
Exceptional Items	0	0		0	
PBT	**1,086**	**1,126**	**(3.5)**	**416**	**161.3**
Tax	390	407	(4.0)	133	194.0
Share of Associate Profit					
Reported PAT	**695**	**719**	(3.3)	**283**	145.9
Adjusted PAT	**695**	**719**	**(3.3)**	**283**	**145.9**
NPM (%)	*9.6*	*12.5*		*6.0*	
Key ratios (%)					
Raw material cost/Sales	67.2	59.1		65.9	
Employee expenses/Sales	4.1	4.4		6.0	
Other operating exp./Sales	13.1	14.0		17.6	
EBITDA margin	15.7	22.5		10.4	
PBT Margin	15.0	19.5		8.7	
Tax rate	35.9	36.1		31.9	
PAT Margin	9.6	12.5		6.0	
EPS (Rs)	6.4	7.9		9.9	

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Financials

Profit & Loss (Rs Mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	24,819	26,024	29,919	34,284	39,866
			15.0%	14.6%	16.3%
Raw Materials	(16,477)	(16,096)	(20,345)	(23,313)	(27,109)
Employee Cost	(925)	(1,049)	(1,257)	(1,543)	(1,794)
Other Expenses	(3,373)	(3,249)	(3,729)	(3,974)	(3,644)
Cost of Sales	(20,775)	(20,393)	(25,331)	(28,830)	(32,547)
Operating Profit	**4,045**	**5,630**	**4,588**	**5,454**	**7,320**
Depreciation	(506)	(550)	(589)	(643)	(676)
PBIT	3,539	5,080	4,000	4,811	6,643
Other Income	387	232	340	411	486
Interest	(447)	(153)	(112)	(91)	(85)
Prior period items	0	0	0	0	0
Profit Before Tax	3,479	5,158	4,228	5,131	7,044
Provision for Tax	(1,251)	(1,703)	(1,374)	(1,693)	(2,325)
PAT	**2,228**	**3,455**	**2,854**	**3,438**	**4,720**
Extra ordinary Items	245	0	0	0	0
Share of JV/ Associate	105	93	100	125	125
Adj. PAT	**2,578**	**3,549**	**2,954**	**3,563**	**4,845**

Balance Sheet (Rs Mn)	FY16	FY17	FY18E	FY19E	FY20E
Equity Capital	1,241	1,241	1,241	1,241	1,241
Reserves	14,664	21,907	23,118	24,648	27,460
Net Worth	**15,905**	**23,148**	**24,359**	**25,889**	**28,701**
Long term borrowings	4	3	1,000	500	500
Short term borrowings	2,559	1,498	0	0	0
Total Debt	2,563	1,501	1,000	500	500
Capital Employed	**18,468**	**24,649**	**25,359**	**26,389**	**29,201**
Gross Block	19,264	19,869	21,020	22,170	23,320
Accumulated Depreciation	10,767	11,318	11,906	12,549	13,226
Net Block	8,496	8,551	9,113	9,620	10,094
Capital WIP	66	217	217	217	217
Total Fixed Assets	**8,563**	**8,769**	**9,330**	**9,837**	**10,311**
Goodwill & Intagible	0	0	0	0	0
Investments	9,063	13,209	13,209	13,209	13,209
Long term liabilities	528	613	675	742	817
Inventories	4,472	5,574	5,738	6,575	7,646
Sundry debtors	176	525	328	376	437
Cash & bank	104	163	692	677	2,536
Loans & advances and Oth	1,475	1,699	1,800	2,000	2,000
Trade Paybles	(2,432)	(2,275)	(2,623)	(3,006)	(3,495)
Current Liabilities	(1,921)	(2,009)	(2,150)	(2,365)	(2,601)
Provisions	(123)	(124)	(144)	(160)	(161)
Working Capital	1,751	3,554	3,641	4,097	6,361
Deffered Tax Liabilities	-1,436	-1,496	-1,496	-1,496	-1,496
Capital Deployed	**18,468**	**24,649**	**25,359**	**26,389**	**29,201**

Cash Flow Statement (Rs Mn)	FY16	FY17	FY18E	FY19E	FY20E
Pre tax Profit	3724	5158	4228	5131	7044
Add: Dep. & Amortization	506	550	589	643	676
Total tax paid	(1251)	(1703)	(1374)	(1693)	(2325)
Other Adjsutments	447	153	112	91	85
Cash Profit	**3426**	**4159**	**3554**	**4171**	**5481**
(Inc) / Dec in					
Sundry Debtors	311	(349)	197	(48)	(61)
Inventories	1114	(1102)	(164)	(837)	(1071)
Loans & Advances	328	(224)	(101)	(200)	0
Current liabilities & Trade paybles	2040	(9)	509	614	727
Change in Working Capital	**3793**	**(1683)**	**442**	**(471)**	**(404)**
CF from Operating Activities	**7219**	**2476**	**3996**	**3701**	**5077**
CF from Investing Activities	**(1814)**	**(4902)**	**(1150)**	**(1150)**	**(1150)**
CF from Financing Activities	**(5424)**	**2486**	**(2317)**	**(2586)**	**(2080)**
Cash Generated (Utilised)	(19)	59	529	(36)	1846
Cash at the start of year	123	104	163	692	677
Cash at the end of year	104	164	692	657	2523

Ratios	FY16	FY17	FY18E	FY19E	FY20E
OPM	16.3	21.6	15.3	15.9	18.4
NPM	9.0	13.3	9.5	10.0	11.8
Tax Rate %	(35.9)	(33.0)	(32.5)	(33.0)	(33.0)
Growth Ratio (%)					
Net Sales	1.2	4.9	15.0	14.6	16.3
Operating Profit	89.6	39.2	(18.5)	18.9	34.2
PAT	171.2	55.1	(17.4)	20.5	37.3
Per Share					
Earning Per Share (EPS)	20.8	28.6	23.8	28.7	39.0
Cash Earnings (CPS)	22.0	32.3	27.7	32.9	43.5
Dividend	10.0	11.5	12.0	14.0	14.0
Book Value	128.2	186.5	196.3	208.6	231.3
Free Cash flow	55.9	16.9	28.0	27.4	38.4
Valuation Ratios					
P/E (x)	30.4	22.1	26.5	22.0	16.2
P/B (x)	4.9	3.4	3.2	3.0	2.7
EV / Sales	3.3	3.1	2.6	2.3	1.9
EV / EBIDTA	20.0	14.1	17.1	14.3	10.4
Div. Yield (%)	1.6	1.8	1.9	2.2	2.2
FCF Yield (%)	8.9	2.7	4.4	4.3	6.1
Return Ratios (%)					
ROE	16.2	15.3	12.1	13.8	16.9
ROCE*	21.3	21.5	17.1	19.8	24.4

* includes other income

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