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# Finolex Industries

4QFY2008 Result Update

## BUY

| | |
|---|---|
| **Price** | **Rs58** |
| **Target Price** | **Rs90** |
| **Investment Period** | **12 months** |

**Stock Info**

| | |
|---|---|
| Sector | Petrochemicals |
| Market Cap (Rs cr) | 724 |
| Beta | 0.89 |
| 52 WK High / Low | 126/57 |
| Avg Daily Volume | 239251 |
| Face Value (Rs) | 10 |
| BSE Sensex | 14,293 |
| Nifty | 4,266 |
| BSE Code | 500940 |
| NSE Code | FINPIPE |
| Reuters Code | FINX.BO |
| Bloomberg Code | FXP IN |

**Shareholding Pattern (%)**

| | |
|---|---|
| Promoters | 52.1 |
| MF/Banks/Indian FIs | 8.4 |
| FII/ NRIs/ OCBs | 4.3 |
| Indian Public | 35.2 |

| Abs. | 3m | 1yr | 3yr |
|---|---|---|---|
| Sensex (%) | (6.5) | (1.3) | 99.9 |
| Finolex Ind. (%) | 0.8 | (29.3) | (16.0) |

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## Performance Highlights

- **Topline up 63%:** For 4QFY2008, Finolex Industries (Finolex) posted a yoy Top-line growth of 63.4% to Rs501cr (Rs307cr). Revenue increased on account of the hike in the finished product prices and higher volumes of PVC resin sold. Revenues ended higher by over 60% yoy for the third consecutive quarter.

- **Margins contract substantially:** Finolex's OPM for 4QFY2008 contracted to 5.6% (11.3%) primarily due to the increase in raw material costs. The international prices of its primary raw materials spiked 30-35% during 4QFY2008. Such increase in costs is usually passed on with a lag of approximately two months. The decline in OPM was however, to a large extent, restricted owing to the hike in the finished product prices. However, the decline in OPM resulted in 4QFY2008 Operating Profit dipping to Rs28.2cr (Rs34.6cr).

- **Finance costs increase 271%:** Finance costs during 4QFY2008 increased to Rs13.7cr (Rs3.7cr) owing to the derivative losses. Finolex imports most of its raw material requirements and has an active foreign exchange hedge policy in place. We believe that the company will continue using the hedges as it has substantial foreign currency exposure.

- **Net Profit declines a substantial 93.1%:** Finolex's Earnings for the quarter declined 93.1% yoy to Rs1.2cr (Rs17.5cr). Earnings were impacted by the decline in OPMs and increase in finance costs.

**Key Financials**

| Y/E March (Rs cr) | FY2007 | FY2008 | FY2009E | FY2010E |
|---|---|---|---|---|
| **Net Sales** | **1,027.1** | **1,635.0** | **1,840.3** | **1,895.7** |
| *% chg* | *39.5* | *59.2* | *12.6* | *3.0* |
| **Net Profit** | **69.9** | **71.2** | **69.5** | **87.3** |
| *% chg* | *65.2* | *1.9* | *-2.3* | *25.5* |
| **Diluted EPS (Rs)** | **5.6** | **5.7** | **5.6** | **7.0** |
| EBITDA Margin (%) | 12.2 | 9.1 | 10.3 | 11.3 |
| P/E (x) | 10.4 | 10.2 | 10.4 | 8.3 |
| RoE (%) | 13.2 | 12.8 | 11.9 | 13.9 |
| RoCE (%) | 8.3 | 9.4 | 9.7 | 10.9 |
| P/BV (x) | 1.4 | 1.3 | 1.2 | 1.2 |
| EV/Sales (x) | 1.1 | 0.7 | 0.6 | 0.6 |
| EV/EBITDA (x) | 9.4 | 7.9 | 6.2 | 5.5 |

*Source: Company, Angel Research*

## Key Developments

- **FY2008 Highlights:** Revenues for FY2008 increased 59% to Rs1,635cr (Rs1,027cr) on account of an approximately 35% hike in the prices across products and over 50% increase in the sales volume of PVC resin. OPMs during FY2008 declined by 311bp yoy to 9.1% (12.2%). Finance costs of the company increased to Rs30.3cr (Rs13.7cr) primarily on account of foreign exchange derivative losses. The company has an active foreign exchange hedge policy in place. We expect the company to continue to use the derivative products as a major hedge against its foreign currency exposure.
- **Commissioning of captive power plant (CPP) delayed:** Finolex is in the process of installing a CPP in two phases. The first phase of 22MW was expected to be completed during 4QFY2008, but the commissioning has been delayed to the beginning of 3QFY2008. PVC manufacturing being a power-intensive industry, had the first phase of the CPP been completed as per schedule, it would have reduced the company's operating costs for the quarter under review. On a conservative basis, we believe that the CPP would be fully commissioned during 4QFY2009E and benefits from the same would start accruing from the beginning of FY2010E. We have factored in benefits of the CPP accruing from FY2010E as against our earlier estimate of the benefits accruing from FY2009E.
- **Sale of land at Pune drags:** Finolex plans to sell its 80 acre plot at Pune, which is expected to fetch approximately Rs500cr. However, there has been continuous delay in the sale of this land. Further, the Real Estate market in India has also been witnessing a slowdown over the past several months. We believe the environment is not conducive for a real estate deal of this size to materialise. As per our interaction with the management, they maintained continuing their pursuits to sell the land. Accordingly, we have conservatively valued the land at Rs5cr per acre amounting to Rs400cr for the 80 acres. Any change in the deal price would impact our Target Price accordingly.

**Exhibit 1: Average Crude oil prices**

| Quarter | Average price | Move | % Move |
|---|---|---|---|
| 4QFY2007 | 58.1 | (2.4) | (4.0) |
| 1QFY2008 | 68.8 | 10.7 | 18 |
| 2QFY2008 | 75.0 | 6.3 | 9 |
| 3QFY2008 | 89.0 | 14.0 | 19 |
| 4QFY2008 | 96.6 | 7.5 | 8 |
| 1QFY2009 | 120.6 | 24.1 | 25 |

*Source: Bloomberg, Angel Research, Note: 1QFY2009 prices are average for date up to 19.06.2008*

- **Steep upward movement in the raw material prices:** The crude oil prices have been moving up rapidly during the last several quarters. The main raw materials for the manufacture of PVC are crude oil derivatives, Ethylene and EDC. The raw materials track the crude oil prices with a lag effect. As for Finolex, it passes on the increase in raw material prices with a lag effect of approximately 45-60 days. Hence, any upward movement in the crude oil prices impacts the company's OPMs in the immediate quarter. Conversely, when the raw material prices dip, benefits of the same are also passed on with a lag effect leading to increase in OPM in the interim. In line with this, the 19% and 8% upward movement in the crude oil prices during 3QFY2008 and 4QFY2008 respectively, adversely impacted Finolex's 4QFY2008 OPM. During 1QFY2009, crude oil prices spurted 25%. We have built in the price hike in our model and have assumed that the crude oil prices will remain range bound at $120 per barrel during 2HFY2009 and slip to $110 per barrel in FY2010E. Any further downward movement in the crude oil prices would pose an upside risk to our estimates. *Refer to sensitivity table on next page.*

**Exhibit 2: Sensitivity analysis (Rs cr) - FY2009E**

| Average oil price | Revenue | OPM (%) | Operating Profit |
|---|---|---|---|
| $110 | 1,775.9 | 11.0 | 194.5 |
| ***$120*** | *1,840.3* | *10.3* | *188.6* |
| $130 | 1,950.8 | 9.2 | 180.4 |

**Exhibit 3: Sensitivity analysis (Rs cr) - FY2010E**

| Average oil price | Revenue | OPM (%) | Operating Profit |
|---|---|---|---|
| $100 | 1,819.9 | 12.0 | 217.8 |
| ***$110*** | *1,895.7* | *11.3* | *213.3* |
| $120 | 2,009.4 | 10.3 | 206.0 |

*Source: Company, Angel Research*

**Outlook and Valuation**

The demand for PVC in India outstrips supply. The major raw materials for manufacturing PVC are petroleum-based products. Finolex passes on any increase in the raw material prices with a lag effect.

We are assuming average crude oil prices to remain flat in the range of $120 per barrel in FY2009E and drop to $110 per barrel in FY2010E. Also, benefits of CPP would start accruing from FY2010E.

We are downgrading our FY2010E EV/EBITDA multiple for the stock form 6x to 5x owing to the volatility in the prices of petroleum-based products and reduce our EBITDA estimates from Rs266cr to Rs213cr. We continue to include the value of the 14.5% stake held by the company in Finolex Cables at 25% discount to the current market value of that stock. We have also downgraded our estimated value of the Pune land that the company plans to sell from Rs500cr to Rs400cr due to the cooling off in the real estate market. **We maintain a Buy on the stock, with a SOTP Target Price of Rs90.**

**Exhibit 4: SOTP**

| | |
|---|---|
| EBITDA FY2010 *(PVC business)(Rs cr)* | 213 |
| *EV/EBITDA Multiple (x)* | *5* |
| EV (Rs cr) | 1,066 |
| *(Less)* Debt (Rs cr) | 519 |
| *(Add)* Cash (Rs cr) | 71 |
| Total Value of PVC Business (Rs cr) | 618 |
| Value of Finolex Cables shares (Rs cr) | 98 |
| Value of the land | 400 |
| Total value of Equity (Rs cr) | 1,117 |
| **Value/Share (Rs)** | **90** |

*Source: Angel Research*

**Exhibit 5: 4QFY2008 Performance**

| Y/E Mar (Rs cr) | 4QFY2008 | 4QFY2007 | *% chg* | FY2008 | FY2007 | *% chg* |
|---|---|---|---|---|---|---|
| **Net Sales** | **501.0** | **306.6** | ***63.4*** | **1,635.0** | **1,027.1** | ***59.2*** |
| Total Expenditure | 472.8 | 272.0 | *73.8* | 1,486.0 | 901.5 | *64.8* |
| **Operating Profit** | **28.2** | **34.6** | ***(18.5)*** | **149.1** | **125.6** | ***18.6*** |
| OPM (%) | 5.6 | 11.3 | - | 9.1 | 12.2 | - |
| Interest | 13.7 | 3.7 | *271.5* | 30.3 | 13.7 | *120.8* |
| Depreciation | 14.7 | 13.9 | *5.8* | 57.5 | 54.6 | *5.2* |
| Other Income | 3.6 | 9.5 | *(62.1)* | 40.5 | 44.4 | *(8.9)* |
| **Profit before Tax** | **3.4** | **26.5** | ***(87.3)*** | **101.8** | **101.7** | ***0.1*** |
| Tax | 2.1 | 9.0 | *(76.2)* | 30.6 | 31.8 | *(3.9)* |
| **Profit after Tax** | **1.2** | **17.5** | ***(93.1)*** | **71.2** | **69.9** | ***1.9*** |
| **Diluted EPS (Rs)** | **0.1** | **1.4** | ***(93.1)*** | **5.7** | **5.6** | ***1.9*** |

*Source: Angel Research*

Angel Broking Limited

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| Ratings (Returns) : | Buy (Upside > 15%) | Accumulate (Upside upto 15%) | Neutral (5 to -5%) |
|---|---|---|---|
| | Reduce (Downside upto 15%) | Sell (Downside > 15%) | |