

3 June 2019

Finolex Cables – BUY

CMP :Rs.456.0
Target Price :Rs.567.0
Upside : 22%+
Stop Loss :Rs.414.0 (Closing basis)

Investment Thesis

Recently, the stock price of Finolex Cables Ltd. (Finolex Cables) corrected by ~38% from 52-week high of Rs.738 as the company reported lower margins due to lower contribution from high margin communication segment and higher raw material costs in the recent quarters.

Finolex Cables' focus on availability of products in different product categories where peers are dominant in the electrical cables segment has aided growth in the recent past. Its communication segment has high growth potential and is expected to perform well, led by demand emerging from government programs such as Bharat Net Phase-II. Going ahead, with pick-up in reconstruction activities and stable demand from optic fibre cables, revenue of the segment will further pick up. We believe that business from newer product will also pick up gradually with an upward bias in operating margins going ahead. Currently, Finolex Cables has a network of over 3,500 distributors and it is focusing on expanding its distributor and retailer network further. Over the past three years, it has increased its advertisement spend to create a brand-pull for consumer durable segment, as well as expanding its distribution network.

Finolex Cables has started its operation in new Roorkee unit in FY15, which has expanded its presence in North and East India. The new manufacturing unit will help the company re-position itself stronger in the region. Finolex Cables has also diversified its product portfolio beyond cables to include fans and switchgears. The products have been well received by the market on the back of strong brand name Finolex, with a strong supply chain system. Finolex Cables has plans to setup a facility at Goa plant to manufacture a range of PVC electrical conduits and fittings. This would further expand the product range of the company building the trade along with range of electrical wires.

Financials

- During the past 5 years, revenue of Finolex Cables grew at a CAGR of 4.4% while PAT grew at a CAGR of 19.8% in the same period.

Standal. (Rs.Mn.)	FY16	FY17	FY18	FY19E	FY20E
Revenue	23,603	24,448	28,151	29,559	33,106
EBITDA	3,389	3,714	4,168	4,794	5,513
% growth	30.5	9.6	12.2	15.0	15.0
PAT	2,489	3,159	3,582	4,091	4,688
EPS (INR)	16.3	20.7	23.4	26.7	30.6
P/E (x)	29.1	22.9	20.2	17.7	15.4
RoE (%)	14.0%	14.8%	14.7%	15.3%	16.0%

- Finolex Cables reported 14.1% YoY growth in revenue to Rs.7,496mn in Q3FY19 led by strong growth in electrical cables segment on pick-up in volume growth in construction and agriculture applications.

Stock Data

Market Cap (Rs. Mn)	72,424
Market Cap (\$ Mn)	1,046.6
Shares O/S (in Mn)	153.0
Avg. Volume (3 month)	112,000
52-Week Range (Rs.)	738/ 357

Shareholding Pattern

Promoters	37.33%
FIIIs	6.59%
Institutions	20.42%
Others (incl. body corporate)	35.66%

Performance (%)	1M	6M	1Yr
Absolute	8.9%	-4.3%	-32.6%
BSE CD	6.5%	25.7%	6.3%

Key Ratios

Div Yield	0.8%
TTM PE	21.2x
ROE	14.6%
TTM EPS (Rs.)	22.3/-

- Finolex Cables' EBITDA grew by 11.7% YoY to Rs.1,096mn in Q3FY19. However, EBITDA margin declined by 30bps YoY to 14.6% due to lower contribution from high margin communication segment and higher other expenses.
- PAT of Finolex Cables marginally grew by 1.4% YoY to Rs.759mn on account of higher tax expenses partly due to the tax exemptions to the Roorkee facility expiring.

Key Business Highlights

- Finolex Cables has emerged as one of the biggest and most diversified manufacturers of electrical and telecommunication cables in India.
- Finolex Cables has widest range of cable products in the electrical & communication cables segment and becomes as a total cable solutions company which can provide cable solutions for every need.
- Finolex Cables has also expanded into product segments that are complementary to the electrical cables market such as CFLs, LED lamps, electrical switches and fans. It is technically superior to its competitors and enjoys cost advantage through its backward integration into materials such as CCC rods, PVC compounds, optical fibre and fibre rods.

Valuation

- Central government's focus on rural electrification under the DeendayalUpadhyayaa Gram Jyoti Yojana (DDUGJY) with total outlay of Rs.756bn over FY14-19 and 'Power for All' with the objective to make power available to all has improved the availability of electricity across India with increase in the number of villages electrified. We believe, Finolex Cables will be major beneficial of this given its leadership in the domestic cables & wires industry. The company has one of the best product portfolios and a strong distribution network of over 3,500 dealers, mainly focused in South and West India.
- Finolex Cables' communications cable segment is expected to grow at high double-digit growth rate led by huge demand as India remains highly under fiberised. India's cumulative fiber-deployed-to-population ratio stands at ~ 0.1x as against 1.2x of United States and 0.7x of China, with only ~20% of the towers (for incumbents) currently fiberised against ~65-75% required to support 4G and 100% fiberisation for 5G going ahead. We believe, India's fiber rollout to increase significantly as the government continues to invest in project like, BharatNet, in building networks to bridge the digital divide. Also, rollout of 5G by FY20 will require more fiber deployment due to higher wireless speed. Thus, India's annual optic fiber cable demand is expected to rise to 35-40mn km over next three years.
- With a dominant player in the electrical cables segment, pick-up in reconstruction activities and stable demand from optic fibre cables, diversified its product portfolio beyond cables, government's focus on rural electrification and communications cable segment is expected to grow at high double-digit growth rate, we value Finolex Cables at 18.5x FY20E EPS of Rs.30.60 to arrive at target price of Rs.567.00, an upside of ~22%.

Risk & Concern

- Finolex Cables is exposed to volatility in its crucial raw material like copper and aluminium, which may adversely impact its profitability.
- Cables & wires business of Finolex Cables is a commoditized business and hence is exposed to higher competition given low entry barriers.
- Finolex Cables import raw materials, which are exposed to exchange rate fluctuations and adversely affect the cost thereby impacting margins adversely.

Graphs & Charts

Figure 1: Net Sales Trend

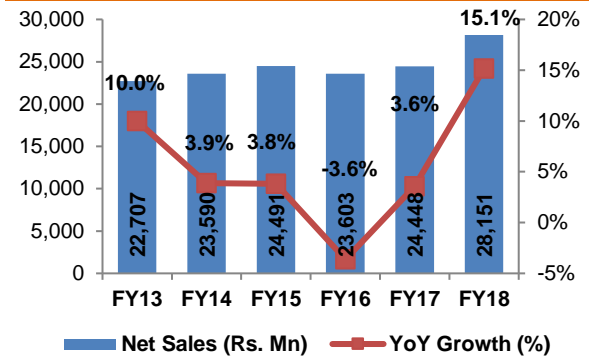


Figure 2: EBITDA & EBITDA Margin Trend

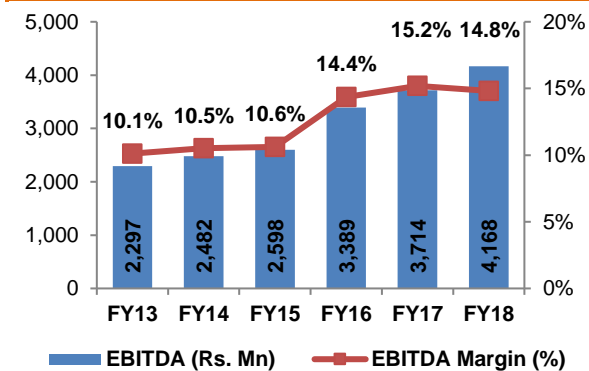


Figure 3: PAT Trend

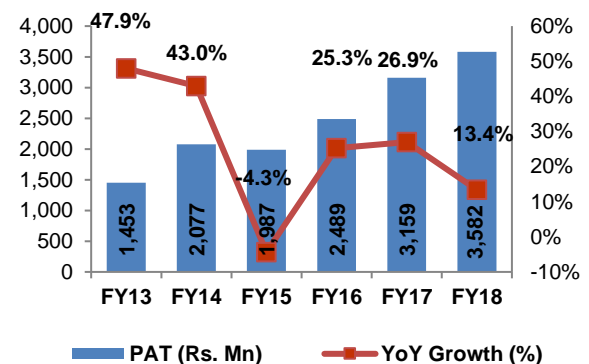
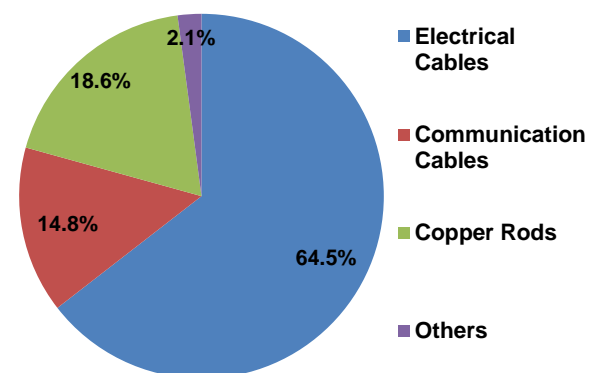


Figure 4: Segment-wise Revenue Contribution



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