Finolex Industries Limited

Dhanki Securities Pvt. Ltd.

INVESTMENT ARGUMENT

We are upbeat on Finolex Industries' (FNXP) long term growth prospects, given its vast experience and dominant presence in agri pipes and fittings, comprehensive product portfolio, strong brand recall and wide and expanding distribution reach. With steady capacity addition in pipes, fast ramp up in value added non-agri pipes and healthy demand outlook, FNXP's overall growth trajectory should remain healthy in the coming years.

Investment Rationale

Comprehensive product portfolio with dominant presence in agri pipes - With an installed capacity of 3,70,000 TPA spread across three manufacturing plants, FNXP is the largest manufacturer of PVC pipes and fittings (market leader in agri pipes), offering wide range of products (~2,000 SKUs) across agricultural and housing, construction and infra sectors, through its vast network of ~900 dealers and ~21,000 retail outlets. Further, its backward integration into PVC resin provides competitive edge in terms of raw material security and cost optimization.

Increasing focus on improving share of non-agri portfolio - FNXP is looking to aggressively strengthen its presence in the non-agri space and is targeting to increase its share to ~40% in the next 3-4 years from 30% currently. During FY21, FNXP added ~3,000 retail touch points, most of which were on non-agri side. Going forward, it focuses on adding new retail touch points largely in urban areas in the northern and eastern region. The company is also looking at exclusive distribution channel in some cities for non-agri segment.

Growth trajectory of pipes & fittings segment to improve - Led by demand uptick, steady capacity addition and increasing focus on fast growing non-agri pipes, we expect volume and revenue growth trajectory of pipes and fittings to improve in the coming years. Further, the segment's margins should improve steadily with faster ramp up of volumes in fittings and CPVC pipes.

Strong Balance Sheet - FNXP's balance sheet position remains strong with healthy operating cash flows, low leverage, prudent working capital management and decent return ratios. With healthy growth outlook, we expect cash flow generation to remain healthy and borrowings to reduce further.

Valuation and Outlook - FNXP's market leadership in agri PVC pipes & fittings, strong distribution reach, steady capacity addition in pipes and strengthening presence in non-agri segment places the company in a sweet spot to capitalize on available opportunities in the plastic piping industry. Improving product mix and cost efficiencies should keep the margin trajectory healthy. Despite quality balance sheet and strong brand equity, FNXP's current valuation discount to its peers could be largely due to its past earnings volatility and ongoing promoter dispute. However, this discount is expected to narrow going forward with scale up in non-agri space and continued improvement in business risk profile (transformation from B2B to B2C model to reduce earnings volatility). Moreover, despite PVC resin business being commoditized in nature, it has the ability to generate healthy cash, which is aiding in expansion of PVC pipes & fittings business.

Valuing on SOTP basis (valuing FNXP at 19xFY23E EPS and adding investment value in Finolex Cables at 50% discount to market cap), we recommend BUY rating on the stock with a target price of Rs 842.

Key Financials - Consolidated

Particulars (Rs mn)	FY20	FY21E	FY22E	FY23E
Net Revenue	29,859.8	32,459.3	35,416.9	39,063.5
EBITDA	4,480.7	8,507.6	6,658.4	7,461.1
Adjusted PAT	3,326.5	6,264.1	4,682.1	5,274.5
EPS (Rs)	26.8	50.5	37.7	42.5
EPS growth (%)	(13.8)	88.3	(25.3)	12.7
PE (x)	24.4	13.0	17.4	15.4
ROIC (%)	16.8	36.0	24.9	26.7
ROE (%)	14.6	26.3	16.1	16.4

BUY

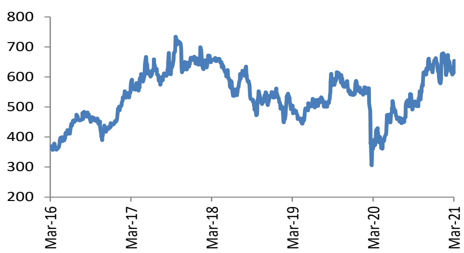
Price	655
Target Price	842
BSE Sensex	50,030
NSE Nifty	14,867

Stock Details	
Sector	Plastic Products
Reuters	FINX BO
Bloomberg	FNXP IN
Equity Cap (Rs mn)	1,241.0
Face Value (Rs)	10
No of shares o/s (mn)	124.1
52 Week H/L	696/355
Market Cap (Rs bn/USD mn)	81.3/1,107
Daily Avg Volume (No of sh)	1,56,371

Shareholding (%)	Jun'20	Sep'20	Dec'20
Promoters	52.5	52.5	52.5
Promoters Pledge	-	-	-
FII	3.5	3.2	3.4
DII	12.9	13.3	12.9
Public & Others	31.1	31.0	31.2

Stock Performance	1M	3M	12M
Absolute	5.2	-0.2	71.7
Relative to Nifty	4.5	-6.3	-8.4

Price Chart



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ABOUT THE COMPANY

Incorporated in 1981, Finolex Industries Ltd (FNXP) is India's largest manufacturer of PVC pipes and fittings and a leading producer of PVC resin. With a total installed capacity of 3,70,000 TPA of pipes and fittings, the company has three state-of-the-art manufacturing facilities located at Ratnagiri, Pune (in Maharashtra) and Masar (in Gujarat). Further, it also operates PVC resin capacity of 2,72,000 TPA (Suspension Resin: 2,50,000 MT; Emulsion Resin: 22,000 MT) at Ratnagiri, which it had backward integrated in 1994. Further it has a 43 MW captive power plant over there, thus ensuring regular supply of power to the plant.

With an extensive distribution network of ~900 dealers, ~21,000 direct and indirect retail touch points across India along with two warehouses (at Chinchwad and Cuttack), FNXP caters to customers across agricultural as well as non-agricultural segments including housing, industrial and construction. It offers a wide range of PVC pipes and fittings (currently offering ~2,000 SKUs; Fittings: ~1,500, Pipes: ~500) for diverse applications, including agricultural pipes & fittings, column pipes and casing pipes within agri segment and plumbing and SWR pipes & fittings, sewerage pipes and CPVC pipes within the non-agri space. The company holds dominant position in agri segment (irrigation and water supply), which contributes nearly 70% of its overall volumes from pipes & fittings segment. Geographically, FNXP has strong presence in West and South India, which contribute 75-80% of its total revenue.

Agri Product Portfolio

Agriculture Pipes & Fittings

Column Pipes

Casing Pipes

Solvent Cement & Lubricant

Non-Agri Product Portfolio

ASTM Pipes & Fittings

SWR Pipes & Fittings

Sewerage Pipes

CPVC Pipes & Fittings

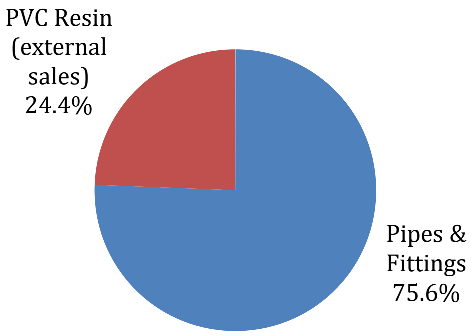
Solvent Cement & Lubricant

As a part of its PVC complex, FNXP has also set up an open sea cryogenic jetty in Ratnagiri, the first of its kind in the Indian private sector. The raw materials (EDC, Ethylene, VCM) are imported at this jetty and then transported to its Ratnagiri plant. However, the jetty is generally closed during monsoon for four months (from mid-May to mid-September). During this period, FNXP stores the feedstock in storage tanks next to jetty.

The company operates its business under two segments, viz., pipes & fittings and PVC resin. A large proportion of PVC resin produced is captively consumed by pipes & fittings division (79% in 9MFY21; 74% in FY20) and the surplus quantity is sold externally. Pipes & fittings segment contributed ~78.3% to total revenue and 75.6% to total volumes in 9MFY21 (FY20 revenue share: 85.5%; volume share: 82.1%) while PVC resin (external sales) accounted for balance ~21.7% revenue and 24.4% volumes (FY20 revenue share: 14.5%; volume share: 17.9%). Including the captive sales to pipes division, revenue and volume mix of pipes & fittings and PVC resin in 9MFY21 stood at 56:44 (60:40 in FY20) and 49:51 (52:48 in FY20) respectively.

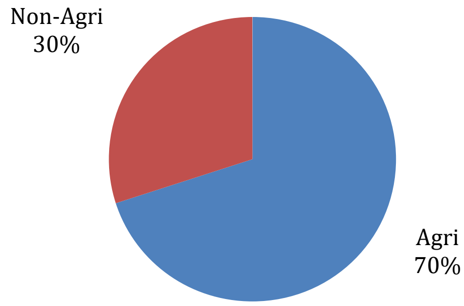
Within the pipes & fittings segment, pipes contribution (PVC and CPVC pipes) is 90.7% in volume terms and 83% in value terms (in 9MFY21). Though the proportion of fittings is low (volume share: 9.3%; value share: 17%), it has been steadily improving over the years. Within pipes, PVC pipes contribute 96% to overall sales volume (CPVC pipes: 4%) and 87% to total revenue of pipes division (CPVC pipes: 13%).

Segmental Volume Mix



Source: Dhanki Research, Company

Agri:Non Agri Volume Mix of Pipes & Fittings



Source: Dhanki Research, Company

Key Management Team

Name	Designation	Description
Prakash Chhabria	Executive Chairman	He is whole-time promoter director since March 1992 and Executive Chairman since Aug 2012. Previously, he served as Deputy MD (May 2003 to Jan 2008) and MD (Feb 2008 to Aug 2012) of FNXP. He holds a Bachelor's Degree from University of Evansville.
Sanjay Math	Managing Director (MD)	He holds position of MD since Dec 2016 (earlier, he was Director - Operations from Feb 2012 to Nov 2012). With expertise in Chemical and Petrochemical field, he has ~44 years of work experience in various projects and petrochemical plant operations.
Anil Whabi	Director Finance & CFO	He holds the position of Director Finance and CFO since Aug 2016 (President Finance and CFO since 2014). With 36 years of experience, he has expertise in strategic planning, financial structuring, better utilization of resources, etc.
Saurabh Dhanorkar	Non-Executive & Non-Independent Director	He is associated with FNXP since 1983 and has vast experience of ~40 years in finance, marketing and general management. In the past, he has worked as Finance and Marketing Head, Assistant MD & COO and MD of the company before retiring in Nov 2016.

FNXP has two associate companies, 'Finolex Plasson Industries Pvt Ltd' and 'Pawas Port'. Besides this, FNXP holds 14.5% stake in its group company Finolex Cables (FCL), which is managed by Deepak Chhabria. Further, there is cross holding with FCL holding 32.39% stake in FNXP.

Details of Associate companies

Company Name	Holdings	Nature of Business
Finolex Plasson Industries Pvt Ltd	46.35%	Engaged in manufacturing of micro irrigation systems, fittings, accessories and range of irrigation components.
Pawas Port	49.99%	Operations have not yet started.

Land Bank at Chinchwad, Pune: FNXP owns 70 acres of land in Pune of which ~15 acres are used for offices and warehousing. As per our research, the market value of the land is estimated to be around Rs 6-8bn (8-10% of FNXP's market cap). At present, the company has no intentions to re-develop this land, but has plans to monetize the same at attractive price going forward.

INVESTMENT RATIONALE

Indian Plastic Piping industry offers healthy growth potential

Industry - Structure and Application

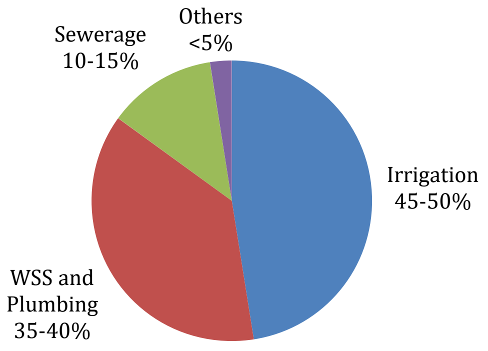
Being a cost-effective way to transport water, pipes form an integral part of infrastructure to transport, distribute and dispose life sustaining resource. They are used for a variety of end applications such as irrigation, household plumbing, sewerage and industrial applications. In the past, metal pipes (largely galvanised iron pipes) were used for most purposes. However, with easy availability of raw materials, low costs, relative resistance to leakage, higher longevity and easy installation, plastic pipes have emerged as a preferred choice for these applications.

Plastic pipes are made of different types of polymers. The four key types are unplasticised polyvinyl chloride (UPVC), which accounts for ~65% of industry demand, chlorinated polyvinyl chloride (CPVC) - ~15%, HDPE - ~15% and polypropylene (PPR) and composite pipes (mix of metal and plastic layers) - ~5%. Going by end-user industry, irrigation sector is the largest segment, accounting for 45-50% share of overall plastic pipes industry. Water supply and sanitation (WSS) and plumbing is the second largest with 35-40% share, followed by sewerage (10-15% share).

Indian plastic pipes and fittings industry is estimated at ~Rs 300bn and has grown by ~9% CAGR over FY14-20. The organized market is 60-65%, largely dominated by top 5 players like Supreme Industries (market leader with ~11.5% market share), Finolex Industries (~8.5%), Ashirvad Pipes (~9%), Astral Poly (~7%) and Prince Pipes (~5.5%).

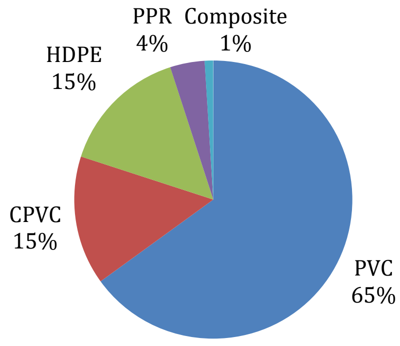
Industry growth over the years has been driven by rising demand from the construction and irrigation sectors. Increasing investments in WSS projects, substitution of metal pipes with polymer pipes, and replacement demand boosted overall offtake in the construction space. Further, initiatives such as Pradhan Mantri Krishi Sinchayee Yojana (PMKSY), Accelerated Irrigation Benefits Programme (AIBP), and Command Area Development and Water Management Programme supported the irrigation sector's growth. The industry has also received a boost from the government's Atal Mission for Rejuvenation and Urban Transformation (AMRUT) scheme, aimed at providing basic services, such as WSS, and ensuring that every household has access to a tap with assured water supply and a sewerage connection. As a result, demand for soil, waste and rain, and drainage pipes was robust.

End-user Industry Revenue Mix



Source: Dhanki Research, Company

Polymer-wise Industry Revenue Mix



Source: Dhanki Research, Company

Polymer Pipes	Application
UPVC	Irrigation, cold water plumbing, drainage.
CPVC	Hot and cold water systems, industrial application.
HDPE	Underground drainage structured wall, water supply & sanitation structured wall.
PPR	Hot and cold water systems, industrial application.
Composite	Hot and cold water systems, gas pipeline, industrial application.

Industry Growth Outlook

The industry growth outlook remains strong driven by the Government's focus on expanding areas under irrigation and increasing urban infrastructure spending which determines demand for WSS and affordable housing projects in urban, semi urban and rural areas. Various schemes and initiatives like PMKSY, Smart City projects, Housing for All by 2022, Jal Jeevan Mission (urban and rural; scheme's urban segment was announced in recent budget), etc, would provide stronger impetus to industry growth. This in turn would be further aided by the growing penetration of branded plumbing pipes in the affordable housing project segment and need-based replacement potential of plumbing pipes. The industry is expected to register healthy CAGR of ~12-14% over FY20-24E and reach near to Rs 500bn by FY24E (with FY21E likely to be muted due to Covid-19 led slowdown). The demand is likely to be driven by increasing application of HDPE and CPVC pipes.

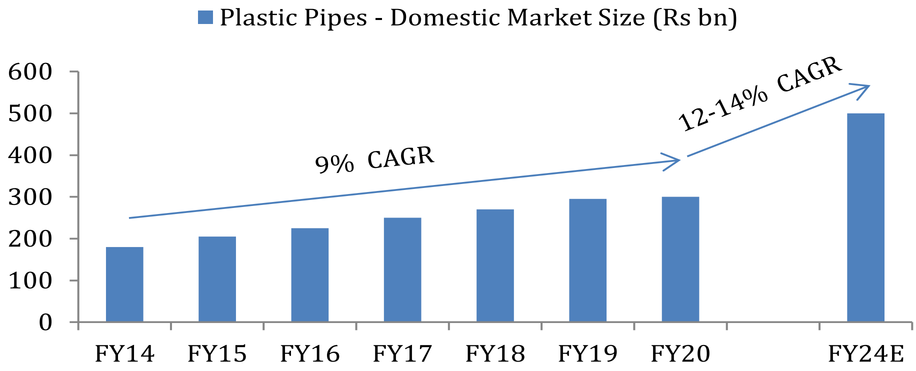
Substitution and replacement demand with CPVC and HDPE gaining prominence

Within pipes, CPVC has been the fastest growing segment over the past five to six years (CAGR of 21%). While the CPVC pipes in India are still at a nascent stage, they have been witnessing strong traction in terms of usage due to factors like longevity, corrosion free, fire resistant, being lead-free and their ability to withstand high temperatures. The share of CPVC pipes in overall plastic pipes industry has increased steadily from 9-10% in FY14 to 15% in FY19. Due to their superior properties and higher cost of raw material (CPVC resin), these pipes are priced at significant premium to normal PVC pipes and command much better operating margins (in mid teens).

With increasing demand, CPVC pipes segment would remain a major growth catalyst for plastic pipes industry and is likely to post a healthy CAGR of 20-21% over FY19-FY24E. With this, its revenue share is estimated to increase above 20% by FY24E. Further, CPVC segment provides branded players (Astral, Supreme and Ashirvad are key players in this category with Prince Pipes and FNXP steadily strengthening their presence) an opportunity to increase their market share given technological barriers for the category (currently, all CPVC polymer is imported into India making it difficult for unorganised players).

HDPE pipes, which are used in the irrigation sector, sewerage and drainage, city-gas distribution and in chemical and processing industries, have also been gaining prominence over traditional metal and cement pipes in recent times due to durability, low maintenance and longevity. While the category is witnessing near term headwinds to growth on the back of delayed government spending, extended monsoon and funding issues faced by EPC contractors in post Covid environment, its medium to long term growth story continues to look promising. The category is estimated to grow by 12-13% CAGR over FY19-24E with demand likely to be driven by government schemes such as PMKSY (drip and sprinkler irrigation) and WSS projects (large diameter sewerage pipes). Moreover, replacement of older pipes with plastic pipes will further boost demand. According to industry estimates, the replacement market accounts for ~25% of plumbing pipe demand in India.

While CPVC and HDPE pipes are likely to register faster growth, UPVC segment would remain a major growth driver for plastic pipes segment and is estimated to grow at steady pace by 11-12% CAGR over FY19-24E (notwithstanding muted growth expected in FY21E due to Covid-19 pandemic) given its wide usage across agriculture and plumbing, affordability and longer life compared to metal pipes.



Source: Dhanki Research, Company

Consolidation in plastic pipes industry to benefit organised players

Due to sharp volatility in PVC resin prices (which are at record high levels), liquidity crisis, GST compliance issues, high custom duty on CPVC resin from China and South Korea and stringent BIS norms, various small and mid-sized national and regional players have been facing balance sheet constraints over the last 15-18 months. This has compelled many unorganized players to shut down their operations. Further, financials of some known organized players like Prince SWR, Jain Irrigation, Kisan Moulding and Skipper have also been impacted sharply, resulting in significant erosion in their respective market share. This has eventually led to market share gains for large and established players (top 5-6 players) with strong brand recall and pan India presence. The Covid-19 pandemic has further tightened the liquidity position of smaller and mid-sized players, who are finding it difficult to survive due to challenges with respect to working capital and raw material sourcing. Current consolidation seen in the plastic pipe industry would continue to benefit the leading organized players and enable them to further strengthen their market position in the near future.

Outlook of domestic PVC resin market remains robust

Industry Snapshot

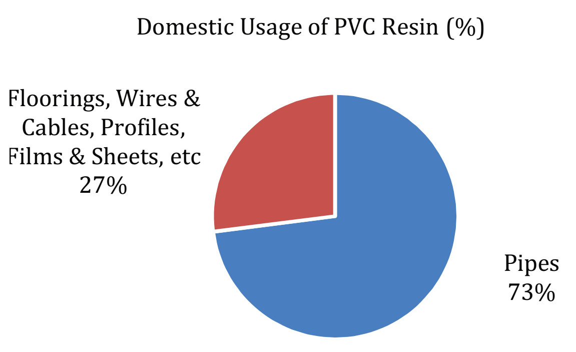
PVC resin is the third largest polymer in terms of production and consumption. It is derived from the polymerization of vinyl chloride and is custom-made for utilization as a common plastic material in the agriculture and construction sector. It is used in pipes and fittings, window frames and shutters, wires and cables, etc. It is also a preferred plastic material for application in flooring, films and sheets.

A steady rise in demand and increase in imports has made India one of the most closely-tracked PVC markets globally. India's total PVC demand is estimated at ~3.3mn MT. Of this, 40-45% of demand is met domestically (major domestic PVC resin manufacturers include Reliance Industries, FNXP, Chemplast, DCW and DCM Shriram), while nearly 55-60% of demand is met through imports (India is the largest importer of PVC resins globally). The domestic manufacturing capacity of PVC resin has grown at a CAGR of ~2.2% over CY10-18 while the consumption requirement grew at a CAGR of 8-9% during the same period. This has increased India's dependence on imports of PVC resins over the years.

Domestic demand for PVC resin to remain healthy going forward

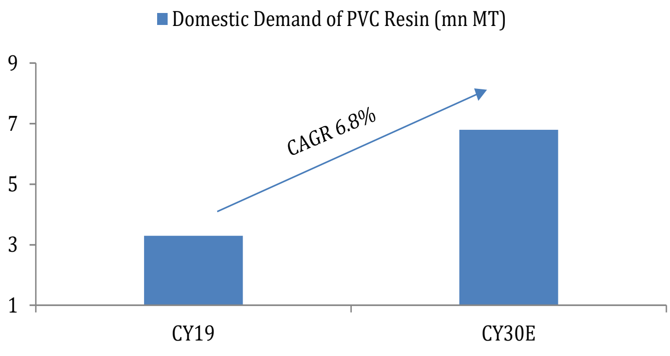
Of the total resin production in India, ~73% is consumed by pipe manufacturers. With the increase in demand for pipes, the consumption of PVC resin would continue to grow at steady pace in the coming years. The demand for PVC in India is estimated to grow by 6.8% CAGR over CY19-30E and reach 6.8mn MT by 2030E. Besides increasing demand for pipes, growing usage of PVC in flooring applications across private, commercial and industrial premises should also contribute to the growing demand for PVC resin. This should enable the domestic PVC resin manufacturers like FNXP (which captively consumes PVC resins for manufacturing pipes and also sells externally) to maintain their utilization at optimum levels going forward, thus providing operating leverage benefits.

Domestic Usage of PVC Resin



Source: Dhanki Research, Company

Domestic Demand of PVC Resin



Source: Dhanki Research, Company

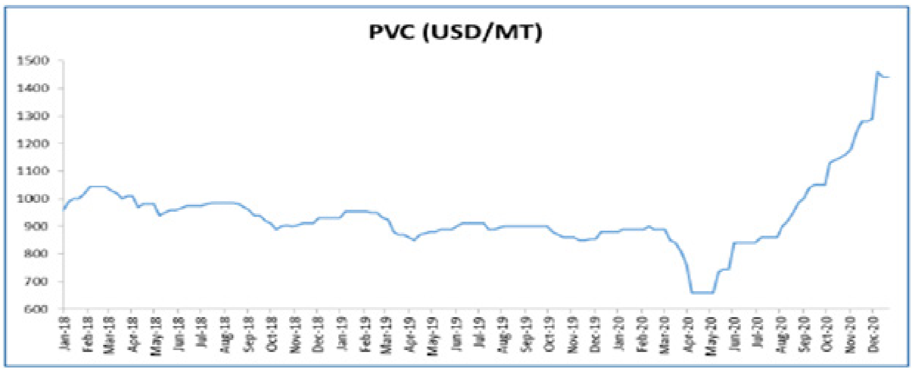
PVC prices at record highs, led by global supply shortage

The PVC resin prices have more than doubled from the pandemic lows of ~660 USD/MT in April/May 2020, led by revival in global trade activities and sustained supply side constraints. Further, the cold wave in US a couple of months back resulted in sharp production cuts or shutdowns at US Gulf Coast petrochemical plants (petrochemical-heavy Texas and Louisiana coasts), thus causing further disruptions in the supply chain and price hikes in PVC resin. The average PVC resin prices for Q3FY21 stood at 1,235 USD/MT (up ~34% over Q2FY21), which have increased further during Q4FY21 to ~1,450 USD/MT.

Under the current scenario, we expect the PVC resin prices to remain firm in the near term. This would continue to benefit the organised PVC pipe manufacturers (like FNXP, Supreme Industries, Astral Poly and Prince Pipes) in strengthening their market positioning over unorganized and regional players, which continue to face challenges with respect to working capital and raw material sourcing. Further, strong demand for PVC resin and favourable PVC/EDC spreads has resulted in strong profitability gains for domestic PVC resin manufacturers (operating leverage benefits and inventory gains) over the last two quarters and this trend is expected to continue till the spreads sustain at high levels.

While PVC-EDC spreads have sustained at higher levels during Q4FY21, notably, the recent steep price hikes in PVC resin have resulted in some demand moderation for agri pipes. Until the prices cool off / stabilize, volume growth under agri pipes segment could be impacted, though not significantly, in the near term. Further, it could be challenging for branded players to completely pass on any further input cost inflation, particularly in agri pipes segment.

We feel that over medium to long term, PVC resin prices are unlikely to sustain at such high levels. Once the supply side constraints ease with the resumption of operations of major PVC resin producers in US and also in Europe, prices are likely to moderate. Further, we also expect the PVC-EDC spreads to normalize over long term.



Source: Dhanki Research, Company

Placed in a sweet spot to capitalize on available opportunities

Comprehensive product portfolio with dominant presence in agri pipes

FNXP is India's largest manufacturer of PVC pipes and fittings, commanding market share of ~19.5% in organized PVC plastic piping space (~8.5% share in overall industry). The company has a comprehensive product portfolio, offering a wide range of PVC pipes and fittings to its customers for diverse applications in agricultural and housing, construction and infrastructure sectors, through its vast network of ~900 dealers and ~21,000 direct and indirect retail outlets. Constant brand building efforts through various marketing initiatives (like branding via campaigns, yatras, exhibitions, in-film integration, channel engagements, festive branding, etc) has enabled the company to strengthen its market positioning in pipes & fittings space across geographies. FNXP is a market leader in agri pipes & fittings segment (irrigation and water supply), deriving ~70% of its overall pipes & fittings volume. It operates its agri business entirely on cash-n-carry model, which reflects its strong brand pull in this space. While the non-agri segment's contribution is lower at 30%, the company is strongly focusing on improving this share going forward.

FNXP's Product Portfolio

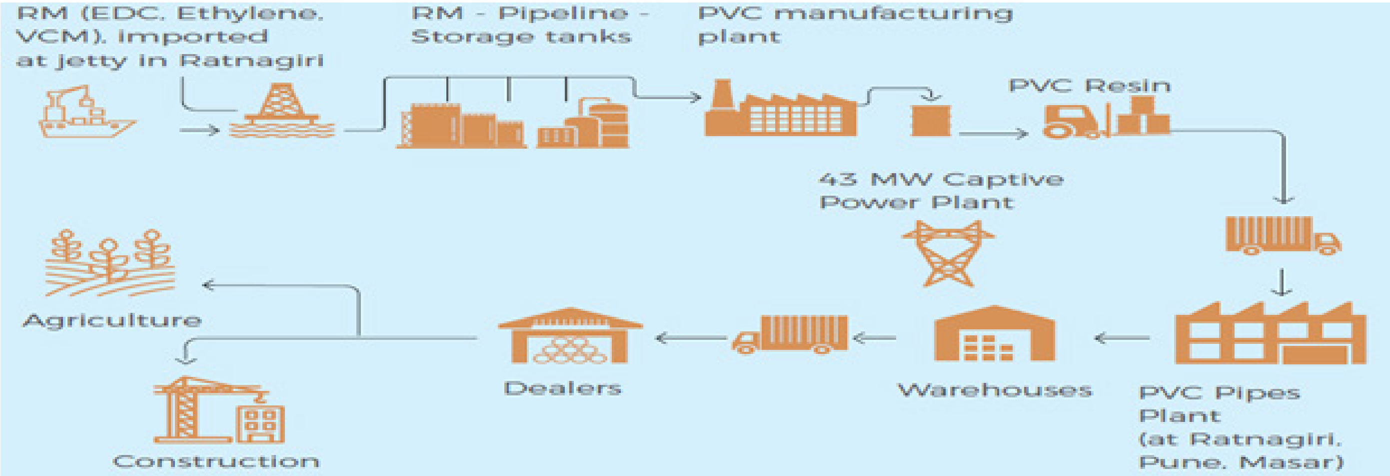
Product Offerings	Application
Agriculture Sector	
Agri Pipes & Fitting	
- *PVC-U Selfit Pipes*	These pipes have unique design with plain end and self-socketed end which enables a perfect fit without the use of couplers. Its solvent cement joint is durable, permanent and eliminates inconvenience of loose couplers, making it economical and efficient.
- *PVC-U Ringfit Pipes*	FNXP is first Indian company to offer a unique range of UPVC pipes (sizes ranging from 63mm to 400mm in diameter) that are specially designed for higher diameter requirements and which eliminate need for solvent cement.
Casing Pipes	Casing pipes are used largely for extracting clean water from bore-wells. Manufactured from unique UPVC compound, these pipes are ideal for transportation of hard, sandy, chemically aggressive water. They are anti-corrosive, easy to install and durable.
Column Pipes	These pipes are most suitable pipes for submersible pumps (through which ground water is extracted) and are preferred over GI pipes due easy installation, anti-abrasion and anti-corrosion properties.
Non-Agriculture Sector	
ASTM Pipes & Fittings	ASTM Pipes and Fittings are used for portable water distribution and varied plumbing application and are better alternative to traditional GI piping systems. They are cost effective, durable, easy to transport and install and are corrosion-resistant.
SWR Pipes and Fittings	Used for soil, waste and rain water management, these products are light in weight, easy to install, ensure protection from rusting, weathering and are generally used for non-pressure plumbing applications that discharge waste water without leakage.
Sewerage Pipes	FNXP's SDR series sewerage pipes are used in applications like treating surface water and industrial effluent. They are designed to control underground non-pressure applications like gravity drainage and sewer flow for transferring soil, water discharge.
CPVC Pipes and Fittings	These are used for hot and cold water systems and for industrial application. Their superior features include longer shelf life, leakage-free, ability to withstand higher temperature and anti-corrosion properties.
FNXP makes solvent cement for diverse applications ranging from agriculture and sanitation to plumbing.	

Only Indian pipe manufacturer who is backward integrated into PVC Resin

FNXP is the only PVC pipe manufacturing company in India which enjoys backward integration with its own PVC resins manufacturing unit. The company imports the raw materials like Ethylene dichloride (EDC), Ethylene, Vinyl Chloride Monomer (VCM) and coal from international markets (largely from Middle East, US and Europe). The imported feedstock is transported and stored in bulk at Ratnagiri plant, which is then used for manufacturing of PVC resin. Its 43 MW captive power plant ensures a steady power supply and reduces the manufacturing costs. The majority of the PVC resin produced (79% in 9MFY21; 74% in FY20) is consumed internally for manufacturing pipes & fittings and the surplus is sold in the open market. Captive consumption of resin produced has increased steadily from 37% since last decade.

Backward integration enables the company to have steady access to superior quality feedstock, which in turn ensures regular supply of PVC resin for its PVC pipes & fittings division. Considering there is significant supply shortage of PVC resin in India with nearly 55-60% demand met through imports, captive operations provides FNXP competitive advantage in terms of raw material security and cost optimization.

FNXP's Strong Value Chain



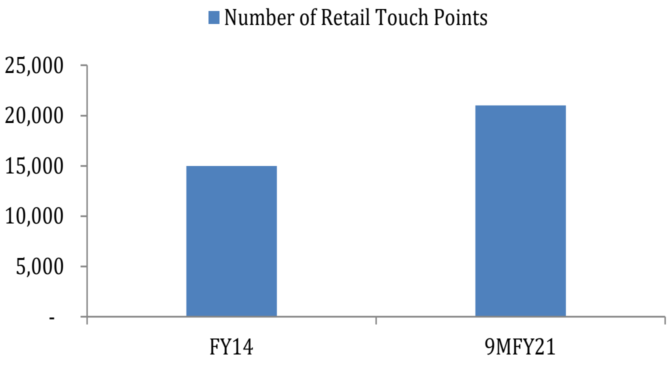
Strong and expanding distribution reach with steady capacity addition in pipes & fittings

FNXP has a strong distribution network of ~900 dealers, ~21,000 direct and indirect retail touch points across India along with two warehouses (at Chinchwad and Cuttack). The company has strengthened its brand equity over the years by steadily expanding its reach across geographies. Region-wise, FNXP has a strong presence in West and South India from where it derives nearly 75-80% of its revenue.

Going forward, in line with its strategy to strengthen its presence in the non-agri segment, FNXP plans to add new retail touch points largely in urban areas in the northern and eastern region. During FY21 (till date), the company added ~3,000 retail touch points, most of which were on non-agri side. The company is also looking at exclusive distribution channel in some cities for non-agri segment.

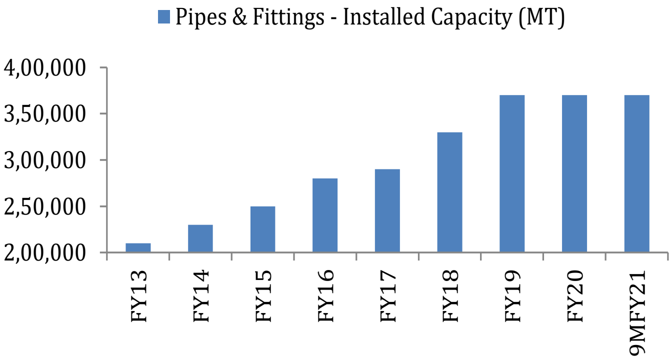
Besides steadily scaling up its distribution reach across geographies, FNXP has also expanded its pipes & fittings capacity at a consistent pace over the years (from 1,23,000 MT in FY11 to 3,70,000 MT till date; at 12% CAGR). This has enabled the company to comfortably meet the demand requirements from the user industries and strengthen its market positioning in the pipes and fittings segment. Notably, FNXP has gone slow on incurring capex and has not expanded its capacity over the last one year, largely due to Covid-led lockdown and slowdown in demand. However, with pandemic fears subsiding, the demand for pipes has also improved and is likely to revive meaningfully and remain buoyant going forward. Hence the company has decided to expand its pipes capacity by 30,000-50,000 MT (brownfield expansion) over the next one year. Overall Capex for FY22E is estimated at Rs 1.5-2bn, of which Rs 0.6-1bn is expected to be incurred towards pipes capacity addition. Further, FNXP is not looking to expand its PVC resin capacity in the foreseeable future.

Distribution Reach



Source: Dhanki Research, Company

Capacity Addition



Source: Dhanki Research, Company

Increasing focus on improving the share of non-agri portfolio

While FNXP continues to command leadership position in the agri pipes segment, it has lagged behind its peers in scaling up its non-agri portfolio, which is a fast growing and high margin segment compared to agri space. Currently, the Agri:Non Agri volume mix stands at 70:30. The management is looking to aggressively strengthen its presence in the non-agri space and is targeting to increase its share to ~40% in the next 3-4 years and to ~50% over longer term.

FNXP's intent and focus on rapidly scaling up its non-agri pipes business can be reflected from its serious efforts towards product portfolio enhancement (especially in CPVC), additions to retail touch points and SKUs within this space. During FY21 (till date), the company added ~3,000 retail touch points, most of which were on non-agri side. Going forward, it focuses on adding new retail touch points largely in urban areas in the northern and eastern region. The company is also looking at exclusive distribution channel in some cities for non-agri segment. Further, the company currently offers ~2,000 SKUs, which has increased steadily from ~1,450-1,500 in FY17. Notably, most of the SKU additions over the last 1-2 years have been in non-agri space and we expect this trend to continue going forward.

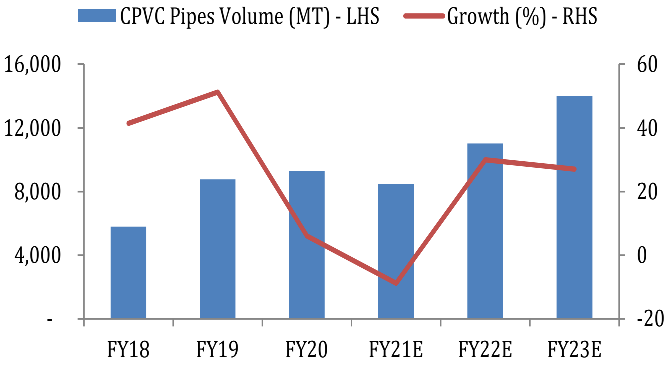
While FNXP continues to operate its agri portfolio on cash-n-carry model, it has started giving higher credits within the non-agri segment (~ 1 month credit period). This along steady addition of SKUs, networks and new markets (with strong focus on north and east) would enable the company to drive its non-agri volumes at faster pace and improve its volume and revenue mix in coming years.

CPVC pipes – a strong future growth catalyst within non-agri

FNXP has been making significant efforts to improve its presence in the non-agri pipes segment through rapid scale up of its CPVC pipes portfolio. The company offers around 370 SKUs of CPVC pipes, which have increased steadily from ~130 in 2017. Led by strong demand and steady capacity addition (CPVC pipes installed capacity has increased from 6,000 TPA in FY18 to 20,000 TPA at present) and improving penetration, the CPVC pipes volume and revenue have grown by 31% and 38% CAGR over FY15-20. Its volume and revenue share in overall pipes & fittings business has improved from 1.3% and 3.3% in FY15 to 3.7% and 10.8% respectively in FY20. While the segment volumes and revenue de-grew by 36.2% and 30.6% YoY respectively in H1FY21, impacted by Covid-led disruption and slowdown, Q3FY21 witnessed a strong demand uptick with volume and revenue growth of 20.7% and 23.6% YoY respectively.

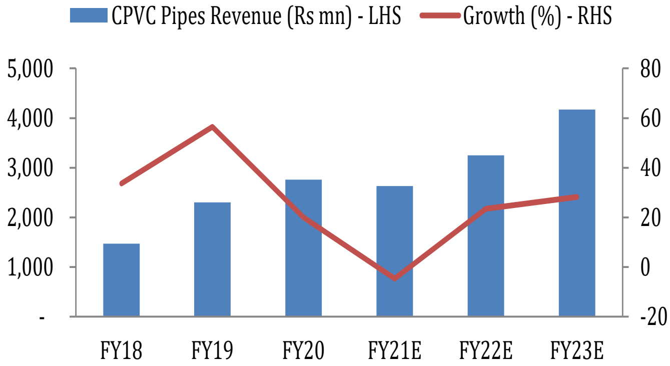
Going forward, with steady SKU additions and expanding distribution reach, FNXP would continue to remain aggressive in CPVC pipes market. Over the last few years, the company has strengthened its brand recall and reach in this segment and hence the recent non-renewal of agreement with Lubrizol is unlikely to impact its volume growth momentum. Further, we feel that captive compounding of CPVC resin would enable FNXP to save cost, thus leaving better scope for margin expansion or driving volumes (by passing on the cost benefits) under this segment. The management has stated that the current capacity is sufficient enough to drive its CPVC pipes sales volumes (which stood at 9,300 MT in FY20) in near to medium term.

CPVC Pipes Volume growth trend



Source: Dhanki Research, Company

CPVC Pipes Revenue growth trend



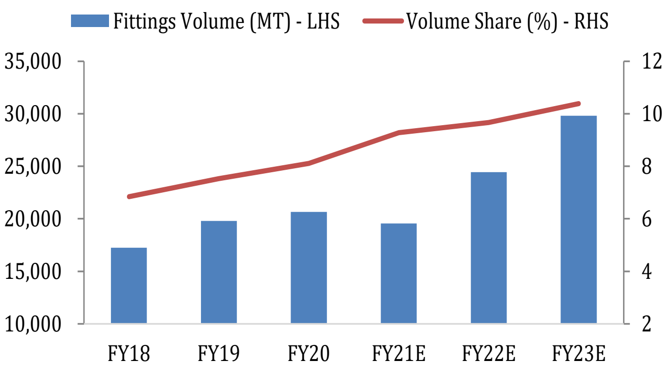
Source: Dhanki Research, Company

Steadily expanding high margin fittings portfolio

Manufacturing of fittings requires higher precision, thereby constraining the unorganised players to enter this space. Because of the specialised product nature, the fittings segment enjoys higher margins. This provides the opportunity for branded players to increase their revenues and margins. Hence, many branded players have aggressively expanded their fittings capacity and launched new products over the years to cater to high demand in this segment.

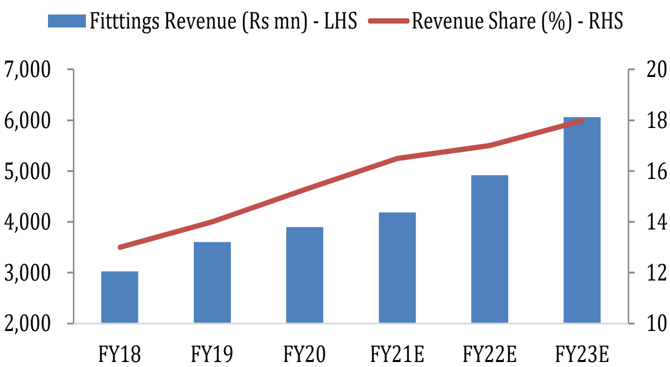
FNXP's current installed capacity of fittings is 30,000 TPA. While the segment's volume and revenue contribution to overall pipes and fittings is currently low at 9.2% and 17% respectively (in 9MFY21), it has improved steadily from 6.4% and 10.6% respectively in FY15 through consistent expansion of its agri and non-agri fittings range. Driving growth and improving share of fittings portfolio remains a key focus area for FNXP. In agri pipes, fittings component is around 6-8%, while in the non-agri pipes it is generally 14-15%. Hence, with increasing share of fast growing non-agri pipes, we expect an overall improvement in growth and share of FNXP's fittings portfolio going forward.

Fittings Business Volume Share



Source: Dhanki Research, Company

Fittings Business Revenue Share



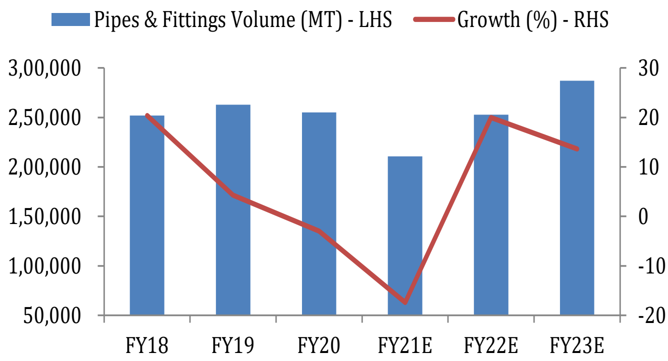
Source: Dhanki Research, Company

<u>Growth trajectory and margins of pipes & fittings segment to improve</u>

Led by demand uptick, steady capacity addition and higher share of non-agri pipes, we expect the volume and revenue growth trajectory of pipes and fittings segment to improve in the coming years. Notwithstanding a muted performance in FY21E (volume and revenue growth likely to decline by 17.4% & 0.7% respectively) on the back of Covid-led slowdown, which sharply impacted growth in H1FY21, we expect strong bounce back in volumes from FY22E. Q3FY21 has witnessed a decent demand revival with positive volume growth and Q4FY21E is also likely to see healthy traction due to strong demand for non-agri pipes (plumbing pipes, including CVPC). However, price sensitive agri pipes segment is witnessing some moderation/postponement in demand over the last 2 to 3 months due to recent unprecedented rise in the PVC resin prices. However, strong revival is expected once the prices cool off, since agri growth is likely to be robust on good monsoon and better crop output this season.

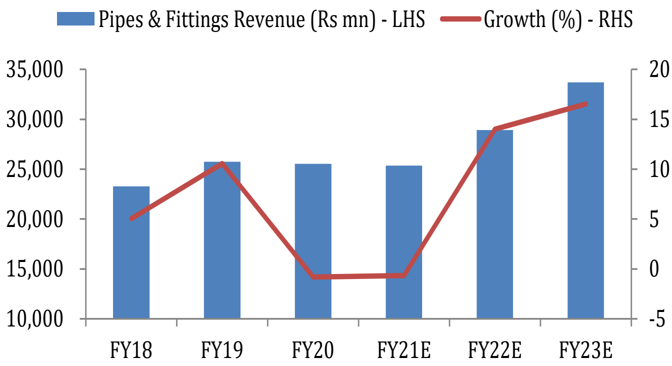
We expect pipes & fitting volume & revenue to grow by 20% & 14% respectively in FY22E and 13.6% & 16.5% respectively in FY23E. Further, with the share of non-agri pipes & fittings estimated to improve on the back of faster ramp up of volumes in fittings portfolio and CPVC pipes, we expect FNXP's overall margin trajectory of pipes & fittings business to improve (compared to segment's normalized margins of 8-9%) going forward.

Pipes & Fittings Volume growth trend



Source: Dhanki Research, Company

Pipes & Fittings Revenue growth trend



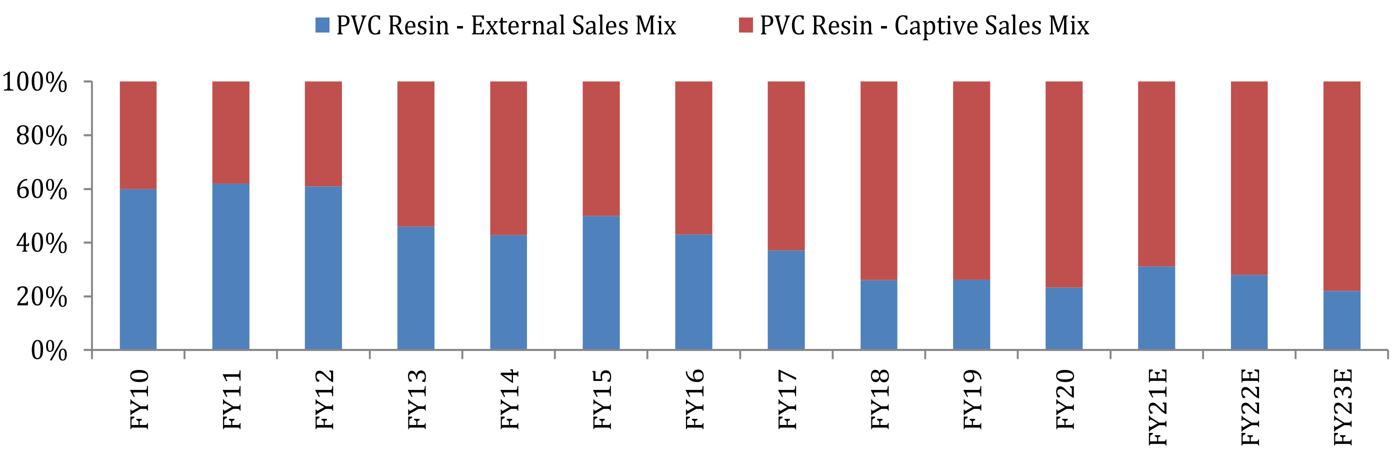
Source: Dhanki Research, Company

Transition from B2B to B2C would gradually reduce the earnings volatility

Over the years, the company has progressed steadily in transforming its business model from B2B (PVC resin) to B2C (pipes & fittings), thus reducing its dependence on external sales of PVC resin. With steady capacity addition in pipes, the captive sales of PVC resin to pipes division has increased consistently from 40% in FY10 to 77% in FY20 (in 9MFY21, it was 69.7% largely due to decline in pipes & fittings volume and strong demand for PVC resin in the open market). The volume share of pipes & fittings segment has improved steadily from around 45% to 82% during the same period (76% in 9MFY21). This has helped FNXP to gradually reduce its earnings volatility, since PVC resin's margins exhibit huge volatility (high dependence on movement of global PVC-EDC spread) due to commoditized nature of its business and limited control on pricing of PVC resin for sale in open market.

Contrary to this, margins under pipes & fittings are relatively more stable and better controlled with fluctuations in raw material prices generally passed on to the customers. Also, it allows FNXP to set a price premium for different mix of pipes & fittings products that it manufactures. Further, pipes business is less capex intensive compared to PVC resin business.

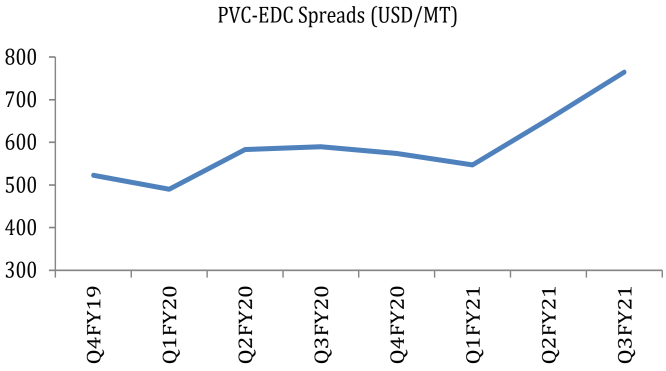
With pipes & fittings capacity likely to increase at steady pace going forward, we expect captive consumption of PVC resin for pipes division to increase further. Also, with PVC Resin unit operating near to peak utilization levels and its capacity unlikely to increase in the near term, we expect the volume mix of pipes & fittings to improve further over the next 2-3 years. This should make FNXP's earnings and margins more predictable and stable.



Healthy demand for pipes, favourable spreads driving growth of PVC resin business

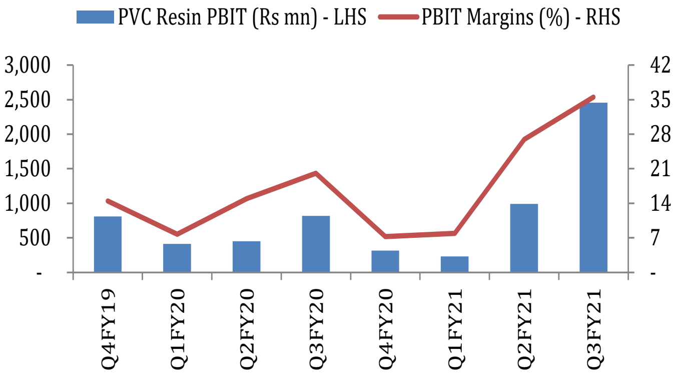
FNXP's PVC resin business has witnessed a marked turnaround in its operational performance over the last two quarters, driven by strong demand from user industries (especially pipes), unprecedented rise in PVC resin prices due to demand-supply mismatch (have more than doubled since pandemic lows in April/May 2020) and favourable PVC-EDC and PVC-VCM spreads. PVC resin volume and revenue (external sales) have increased by 27.2% and 61.4% respectively during 9MFY21, while overall volumes including captive sales to pipes division declined by 10.2% and revenue increased by 8.7%. The segment's PBIT increased significantly by 118.7% in 9MFY21, while PBIT margins improved by 1,366bps YoY to 27.2%. The PVC resin prices have increased further during Q4FY21 and spreads continue to remain favourable (better than Q3FY21). Hence we expect Q4FY21 to be another windfall quarter for the segment in terms of profitability, considering demand for PVC resin still remains healthy.

PVC-EDC Spreads (USD/MT)



Source: Dhanki Research, Company

PVC Resin PBIT Trend



Source: Dhanki Research, Company

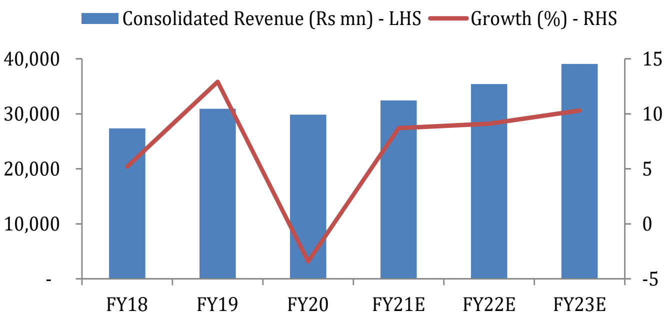
Spreads to moderate, margins to normalize

While the spreads could remain favourable in the near term, we feel over medium to long term, PVC resin prices are unlikely to sustain at such high levels. Once the supply side constraints ease, prices are likely to moderate. Further, we expect the PVC-EDC spreads to normalize over long term. Hence we feel FNXP's current PBIT margins of PVC resins are abnormally high and would correct over medium term. As per the management, the segment's normalized margins are 15-16%, which we feel is still healthy, considering commoditized nature of business.

Overall revenue and margin trajectory to remain healthy

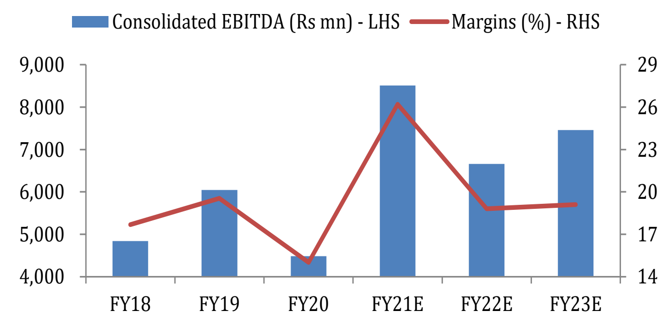
While FNXP's overall revenue growth in FY21E (estimated at 8.7%) would largely be led by PVC resin business, growth in FY22E and FY23E (9.1% and 10.3% respectively) is likely to be driven by PVC pipes & fittings segment. Notwithstanding margin contraction estimated in FY22E (with PVC resin margins anticipated to reach near to normalized levels), we expect FNXP's overall margin trajectory to remain healthy over long term. We expect margins to revive in FY23E driven by pipes & fittings business (higher share of non-agri pipes).

Revenue growth trend



Source: Dhanki Research, Company

EBITDA growth trend



Source: Dhanki Research, Company

Strong Balance Sheet

Healthy Cash Flow generation

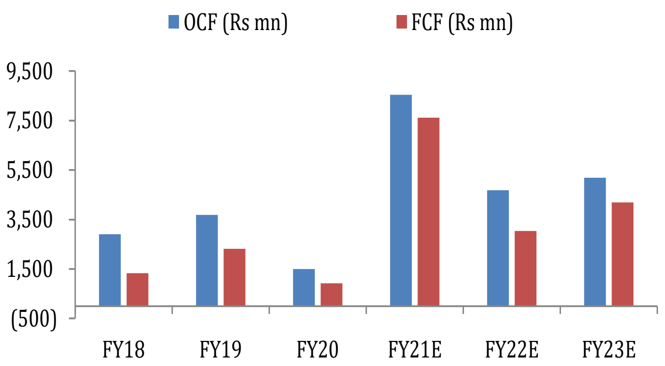
Supported by steady profit growth and prudent working capital management, FNXP's cash flow generation has remained healthy since years. Its average annual operating and free cash flows over the last 5 years (FY16-20) stood at Rs 3.2bn and Rs 2.3bn respectively. This has enabled the company to fund its capex plans largely through internal accruals. As on Sept-20, it had cash & cash equivalents of Rs 5.2bn, which has increased further till date.

During 9MFY21, FNXP generated significant cash from its PVC resin business. This coupled with lower capex incurred during this year is likely to boost its free cash flows in FY21E. We expect surplus cash to be utilized towards capacity expansion of pipes & fittings and for higher dividend payouts. With healthy profit outlook and reasonable capex, we expect operating and free cash flow generation to remain healthy.

Low leverage

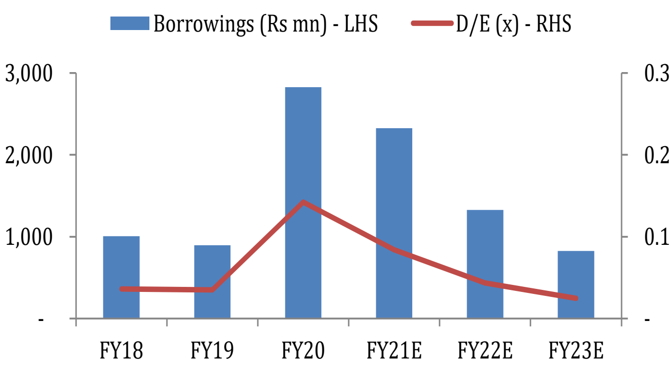
Despite a steady increase in gross block (pipes & fittings capacity has increased by 3x since FY11), FNXP has managed to reduce its borrowings significantly over the years from around Rs 10bn in FY12 to Rs 2.4bn in H1FY21, led by improving cash flows and working capital efficiency. Its D/E has reduced from 1.5x to 0.1x during the same period. The company has no long term debt in its books since FY16. As on Dec 31, 2020, the net cash surplus stood at Rs 5.9bn. With healthy cash flow generation, we expect future capex requirements to be met through internal accruals. Hence, borrowings are expected to reduce further and company's net cash position should improve further.

Healthy Cash Flows



Source: Dhanki Research, Company

Declining D/E



Source: Dhanki Research, Company

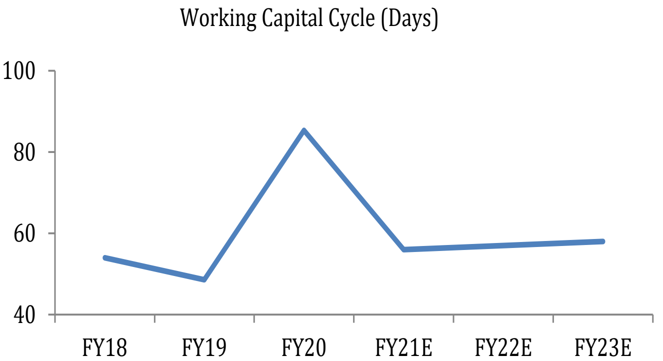
Prudent working capital management

FNXP's jetty is generally closed during monsoon for four months (from mid-May to mid-September). During this period, it stores the feedstock in storage tanks next to jetty. Hence its inventory holding period is generally higher compared to its peers. However, it has the best collection cycle in the industry (receivables at 9 days), since it operates its agri business on cash-n-carry model. This has allowed the company to manage its overall working capital cycle (WCC) prudently over the years. In FY20, WCC increased sharply to 85 days, which could be largely attributed to abnormally high inventory levels towards the end of March-20 due to lockdown. Thereafter the inventory levels have normalized and overall WCC has improved. Though the company has started giving higher credits to its channel partners for sale of non-agri pipes, collection cycle is likely to remain healthy going forward on the back of its strong brand recall. With this, we expect FNXP's overall WCC to remain at comfortable levels going forward.

Steady and Healthy Dividend Payouts

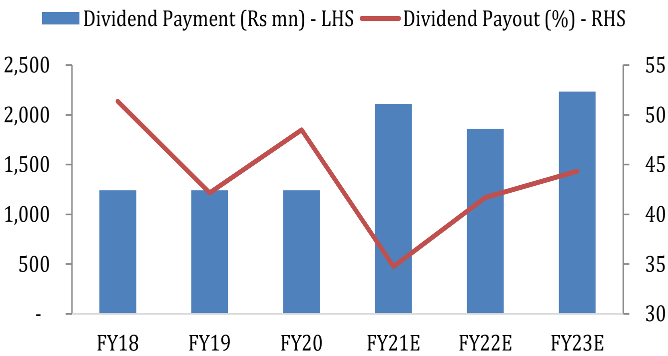
FNXP has been a steady dividend payer with dividend payouts in the range of 30-60% over the last decade. With improving profitability, its dividend payments have also increased meaningfully from Rs 370mn in FY10 to Rs 1,240mn in FY20. With healthy growth prospects, we expect this trend to continue and dividend payouts to remain healthy going forward.

Working Capital Cycle



Source: Dhanki Research, Company

Dividend Payouts

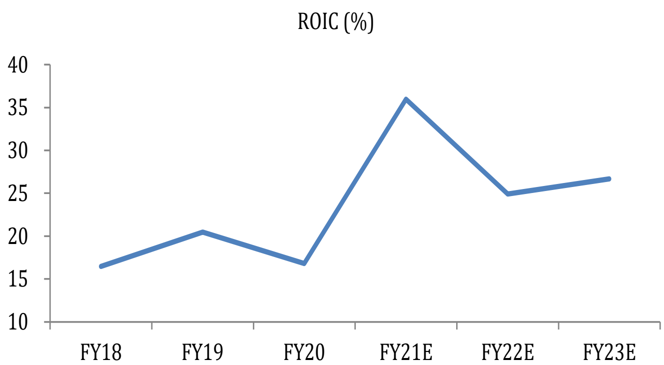


Source: Dhanki Research, Company

Healthy return ratios

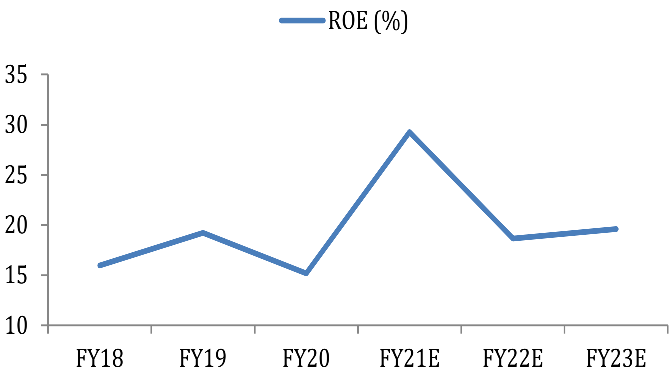
Despite capital intensive nature of its business, FNXP's return ratios stand decent with ROCE and ROE of 15.2% and 14.6% in FY20. Further, it enjoys healthy ROIC (16.8% in FY20) due to its cash rich status. We expect the return ratios to improve significantly in FY21E due to strong profitability in PVC resin business. While they are likely to normalize going forward, their trajectory is likely to remain healthy.

ROIC



Source: Dhanki Research, Company

ROE



Source: Dhanki Research, Company

RISKS & CONCERNS

- **Corporate governance risks:** Further escalation of ongoing dispute between promoters of FNXP and FCL over ownership of Finolex Group could pose some hindrances in smooth functioning of business operations and impact investor sentiments until the issue is resolved. However, the management has assured that it remains fully committed and focused on driving growth and ongoing dispute is unlikely to impact its daily operations.

- **Demand slowdown:** The plastic piping industry derives the majority of its demand from plumbing, irrigation, water transportation and sewerage applications. Any demand slowdown from these key user industries (particularly agri segment) could impact FNXP's order inflows, volume growth and overall profitability.

- **Slow ramp up in non-agri segment:** While FNXP continues to command leadership in the agri pipes segment, it has clearly lagged behind its peers in scaling up its non-agri portfolio, which is a fast growing and high margin segment compared to agri space. For accelerating its volume growth and margin trajectory in pipes & fittings, FNXP will have to aggressively scaling up its non-agri portfolio.

- **Sharp volatility in commodity prices and spreads:** EDC, Ethylene and VCM are key inputs for manufacturing of PVC resin, which in turn are used for producing PVC pipes & fittings. While PVC product pricing is on import parity, sharp fluctuations in commodity prices generally results in huge volatility in PVC-EDC and PVC-VCM spreads. While FNXP's PVC resin business has reported windfall profit gains due to favourable spreads over the past two quarters, a sharp reversal / narrowing of spreads could impact its profitability in the coming quarters.

- **Forex fluctuation risks:** FNXP imports ~80-85% of its input requirements (feedstock is entirely imported, priced in USD), thus exposing the company to forex fluctuation risks. However, PVC product pricing is on import parity and import parity value of sales of FNXP exceeds the USD payables on a six monthly rolling basis due to which a natural hedge exists and hence the company does not generally need to resort to hedging by way of forward contracts, options, etc and is thus exposed to currency fluctuation risk only in short term.

- **Increasing competition:** Plastic piping industry is highly competitive with presence of large and established organized players as well as smaller unorganized players. Increase in the competitive intensity could result in pricing pressure and impact the company's operational performance.

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Financials (Consolidated)

Profit & Loss

(Rs. mn)

Year end Mar	FY20	FY21E	FY22E	FY23E
Net Revenue	**29,859.8**	**32,459.3**	**35,416.9**	**39,063.5**
Growth	-3.6%	8.7%	9.1%	10.3%
Operating Exp	25,379.1	23,951.7	28,758.5	31,602.4
EBITDA	**4,480.7**	**8,507.6**	**6,658.4**	**7,461.1**
Growth	-25.9%	89.9%	-21.7%	12.1%
EBITDA Margin	15.0%	26.2%	18.8%	19.1%
Depreciation	738.1	785.1	876.7	965.6
EBIT	**3,742.6**	**7,722.5**	**5,781.7**	**6,495.5**
Other Income	299.1	608.8	358.3	385.7
Interest	119.1	151.2	99.5	66.1
PBT	**3,922.6**	**8,180.0**	**6,040.5**	**6,815.0**
Tax	851.7	2,111.5	1,577.4	1,777.0
PAT	3,070.9	6,068.6	4,463.1	5,038.1
P & L from Associate	255.6	195.5	219.0	236.5
Reported PAT	**3,326.5**	**6,264.1**	**4,682.1**	**5,274.5**
Growth	-13.8%	88.3%	-25.3%	12.7%
EPS	**26.8**	**50.5**	**37.7**	**42.5**

Key Ratios

Year end Mar	FY20	FY21E	FY22E	FY23E
EPS (Rs.)	26.8	50.5	37.7	42.5
CEPS (Rs.)	32.8	56.8	44.8	50.3
BV (Rs.)	160.0	223.6	246.3	270.8
P/E (x)	24.4	13.0	17.4	15.4
P/CE (x)	20.0	11.5	14.6	13.0
P/BV (x)	4.1	2.9	2.7	2.4
D/E (x)	0.1	0.1	0.0	0.0
EBITDA Margin (%)	15.0	26.2	18.8	19.1
PAT Margin (%)	11.1	18.7	12.6	12.9
RoCE (%)	15.2	29.3	18.7	19.6
RoIC (%)	16.8	36.0	24.9	26.7
RoE (%)	14.6	26.3	16.1	16.4
Wcap Cycle (days)	85.4	56.0	57.0	58.0
EV/Ebitda (x)	18.3	8.9	11.2	9.7
EV/Sales (x)	2.7	2.3	2.1	1.9

Balance Sheet

(Rs. mn)

Year end Mar	FY20	FY21E	FY22E	FY23E
Share Capital	1,241.0	1,241.0	1,241.0	1,241.0
Reserves	18,618.8	26,504.8	29,325.4	32,366.2
Shareholders' Funds	19,859.8	27,745.8	30,566.4	33,607.2
Debt	2,826.7	2,326.7	1,326.7	826.7
Net Deferred Taxes	1,356.8	1,356.8	1,356.8	1,356.8
LT Provision & Others	783.0	806.2	832.4	864.0
Source of Funds	**24,826.3**	**32,235.6**	**34,082.3**	**36,654.7**
Net Block	10,168.9	10,333.8	10,957.1	10,991.5
CWIP	72.8	50.0	200.0	200.0
Investment	6,606.9	10,743.0	11,216.7	12,137.4
LT Loans & Adv	1,113.1	1,209.9	1,318.8	1,450.7
Total Non Current Assets	17,961.7	22,336.8	23,692.7	24,779.6
Inventories	8,578.1	7,114.4	7,762.6	8,561.9
Trade Receivables	731.7	793.0	961.4	1,166.5
Cash & Equivalents	932.1	6,060.2	6,103.8	7,038.2
Other Current Assets	709.8	771.6	841.0	925.1
Total Current Assets	10,951.7	14,739.1	15,668.8	17,691.7
Trade Payables	2,334.0	2,934.7	3,202.1	3,531.8
Other Current Liabilities	1,753.1	1,905.6	2,077.1	2,284.8
Total Current Liabilities	4,087.1	4,840.3	5,279.2	5,816.6
Net Current Assets	6,864.6	9,898.8	10,389.6	11,875.1
Application of Funds	**24,826.3**	**32,235.6**	**34,082.3**	**36,654.7**

Cash Flow

(Rs. mn)

Year end Mar	FY20	FY21E	FY22E	FY23E
Net profit	3,326.5	6,264.1	4,682.1	5,274.5
Add: Depreciation	738.1	785.1	876.7	965.6
Add: Non-Operating Item	(361.0)	(603.8)	(422.6)	(496.4)
(Inc)/Dec in Inventories	(2,373.4)	1,463.7	(648.2)	(799.2)
(Inc)/Dec in Debtors	11.4	(61.3)	(168.4)	(205.1)
(Inc)/Dec in Other Assets	315.0	(61.8)	(69.4)	(84.1)
Inc/(Dec) in Current Liab	(504.0)	600.7	267.4	329.7
Inc/(Dec) in Other Liab	342.2	152.5	171.5	207.7
Changes in Wcap	(2,208.8)	2,093.8	(447.2)	(551.0)
CF from operations (A)	**1,494.8**	**8,539.2**	**4,689.0**	**5,192.7**
(Inc)/Dec in FA	(568.4)	(927.2)	(1,650.0)	(1,000.0)
Free CF	926.4	7,612.0	3,039.0	4,192.7
(Purchase)/Sale of Invst	969.6	(258.3)	(309.9)	(743.8)
Interest recd from Invst	299.1	608.8	358.3	385.7
(Inc)/Dec in Other NC Assets	(80.4)	(96.8)	(108.9)	(131.9)
CF from Investing (B)	**619.9**	**(673.5)**	**(1,710.5)**	**(1,490.0)**
Inc/(Dec) from LT Debt	0.0	0.0	0.0	0.0
Inc/(Dec) from ST Debt	1,931.7	(500.0)	(1,000.0)	(500.0)
Interest Paid	(119.1)	(151.2)	(99.5)	(66.1)
Dividend Paid	(1,489.2)	(2,109.7)	(1,861.5)	(2,233.8)
Inc/(Dec) in other NC Liab	-1786.4	23.2	26.1	31.7
CF from financing (C)	**(1,463.0)**	**(2,737.7)**	**(2,934.9)**	**(2,768.3)**
Net Cash Flow (A+B+C)	**651.7**	**5,128.1**	**43.6**	**934.5**

Dhanki Securities Pvt. Ltd.

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