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Finolex Industries Ltd

PRICE: RS.416 **RECOMMENDATION: BUY**
TARGET PRICE: RS.504 **FY18E PE: 15.7x**

Stock details

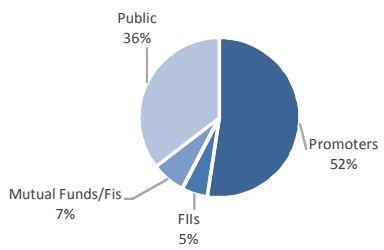
BSE Code	:	500940
NSE Code	:	FINPIPE
Market Cap (Rs mn)	:	51624
Free Float (%)	:	47.5
52 week Hi/Lo (Rs)	:	426/245
Avg Daily Volume	:	108045
Shares (o/s) (mn)	:	124

Summary table - Standalone

(Rs mn)	FY16	FY17E	FY18E
Revenue	24,528	28,031	32,601
Growth (%)	(0.9)	14.3	16.3
EBITDA	3,751	4,396	5,242
EBITDA margin (%)	15.3	15.7	16.1
PBT	3,435	3,909	4,842
PAT	2,336	2,659	3,293
EPS	18.8	21.4	26.5
EPS Growth(%)	388.9	13.8	23.9
CEPS (Rs)	22.9	25.6	30.7
BV (Rs/share)	77.2	89.0	106.0
Dividend/share (Rs)	10.0	7.0	7.0
ROE (%)	26.8	25.8	27.2
ROCE (%)	25.0	32.4	36.7
Net cash (debt)	(2017)	(1060)	904
NW Capital (Days)	21.2	28.8	40.7
P/E (x)	22.1	19.4	15.7
EV/EBITDA (x)	14.1	12.0	9.7
P/BV (x)	5.4	4.7	3.9
EV/Sales (x)	2.2	1.9	1.6

Source: Company,
Kotak Securities - Private Client Research

Shareholding pattern



Source: Capitaline

One-year performance (Rel to Sensex)

Source: Capitaline

Finolex Industries Ltd (FIL) is a leading company in Indian PVC pipes and fittings industry with 19% market share in volume terms. It has strong brand equity and enjoys market leadership in agri segment with 70% of its revenue being contributed by this segment where pipes are used in irrigation. The government has emphasized on increasing land under irrigation and is focused on improving rural water and sanitation infrastructure, which is positive for pipes' demand. We believe that, FIL would be a major beneficiary if rural consumption improves on normal monsoon as forecasted by IMD and Skymet. In order to meet the rising demand, FIL is expanding its capacity by 100000 tonnes in the next three years with Rs 1 bn of total investment. This is expected to add another Rs 10 bn of revenue over the next 4-5 years. FIL is generating strong cash flows which would be used in meeting its funding requirement and making it debt free in next 1-2 years. We expect revenue and PAT of FIL to grow at a CAGR of 16.1% and 18.5% respectively in FY16-18E, on a strong base of FY16, led by improvement in demand from agriculture segment and increase in capacity. Margins are expected to remain firm, assuming no major volatility in crude prices, increased share of high margin value added products, etc. We expect RoCE to improve from 25% in FY16 to 36.3% in FY18E. We assign buy on the stock with target price of Rs 504, valuing the stock at 19x on FY18E earnings.

Investment argument

- **Strong brand equity in Agri segment with consistently expanding product range and geographic reach.** FIL is the market leader in agri segment with high brand recall. About 70% of FIL's revenue is contributed by agriculture segment. Its pipes command premium over its peers. The company is diversifying its revenue mix in terms of product and geography. It is focusing on increasing its sales from high margin value added products like fittings, column pipes, etc and intends to scale up their contribution. The company has total ~1400-1500 varieties of fittings and intends to add another 200 in FY17E. FIL has set up manufacturing in three different locations in order to cater to different geographies and thus is geographically diversified. Further, it is strengthening its distribution in new geographies through warehouses. It presently has warehouses at three different locations in MP, UP and Odisha and targets to setup 3-4 new warehouses in FY17 with major focus on southern region.

- **Robust industry growth outlook led by rural and infra boost.** Domestic PVC pipes market at 1.8 mn tonnes is growing at 12-15% CAGR in volume terms. About 40% of the industry is unorganized. The industry is steadily shifting toward organized players with shift expected to gather pace after the introduction of GST and would be positive for organized players. The government has emphasized on increasing land under irrigation and is focusing on improving rural water and sanitation infrastructure. The government has given high importance to micro irrigation, watershed development and 'Pradhan Mantri Krishi Sinchai Yojana' and allocated Rs 53 bn for these schemes in the budget 2016. Government initiatives on irrigation projects and development of smart cities will be a boost to PVC pipes consumption in India. Further, we believe that, FIL would be a major beneficiary if rural consumption improves on normal monsoon as forecasted by IMD and Skymet.

- **Focus shifting to predictable and better ROCE B2C PVC pipes business.** FIL is steadily moving away from commoditized B2B business of PVC resin where margins are highly volatile, to relatively better and stable ROCE B2C business of PVC pipes and fittings. FIL is presently using 57% of PVC resins in-house and balance is sold in the market. The company targets to fully utilize the raw material in-house in a longer run which would result in better and more predictable RoCE for the company. We expect FIL's RoCE to be strong at over 30% based on improvement in asset turnover (from 1.9x to 2.5x) and improvement in EBIT margins from 13.2% in FY16 to 14.5% by FY18E.
- **Strong cash flows to help in meeting capex and reducing debt.** FIL is generating strong cash flows which would be used in meeting its funding requirement and reducing debt. It is expanding its PVC pipes capacity by 100000 tonnes in the next three years with Rs 1 bn of total investment at its existing plants. The increased capacity is expected to add ~Rs 10 bn of revenue over the next 4-5 years. FIL has repaid Rs 4 bn debt in FY16 which has resulted in the present net debt to equity falling to 0.2x. It is targeting to become debt free in the next 1-2 years by repaying its debt. This would result in interest cost coming down by 58% CAGR and would positively impact its earnings which are expected to grow by 18.7% CAGR in FY16-18E.

Valuation

Based on FY17E and FY18E EPS Rs 21.4 and 26.5, the stock is trading at PE of 19.4x and 15.7x. The stock has traded at average forward PE of 16x in the last 5 years. Presently, the stock is trading at a discount to its peers in the sector. We expect re-rating of the stock considering high RoCE, strong margins profile and company's focus on high RoCE B2C business. We assign Buy rating on the stock with target price Rs 504. At our target price the stock will trade at 19x FY18E earnings.

Key Risk & Concerns

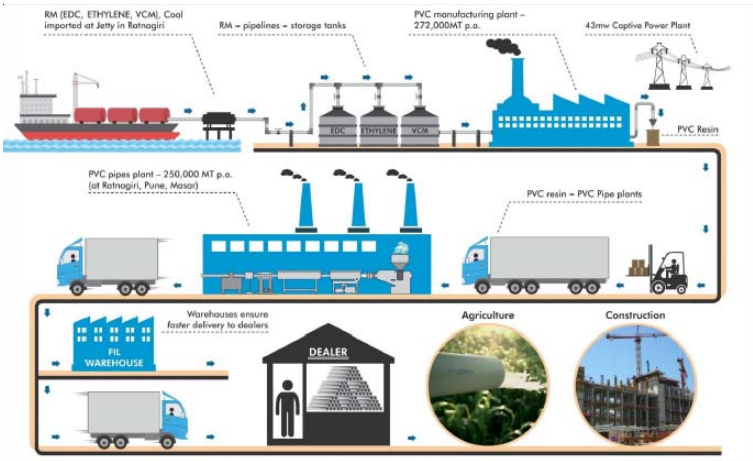
- **High volatility in raw material prices:** The raw materials used by the company are crude derivatives. Any high volatility in the raw material prices would impact the earnings estimates led by inventory gain/losses.
- **Disappointment from rural demand:** FIL's pipes business is driven by demand from agri-segment. As per forecast by IMD and Skymet, the rainfall in FY17 is estimated to be marginally above average which would positively impact rural demand. Any major disappointment on monsoon would negatively impact the rural demand and in turn our sales volume estimates.

Company Background

Finolex Industries Ltd (formerly Finolex Pipes Ltd), was incorporated in 1981, and is a leading brand in Indian PVC pipes and fittings market. The company manufactures and sells PVC pipes, fittings and PVC resin. 73% of its revenue is contributed by PVC pipes and fittings and balance 27% is contributed by PVC resins. The company began its journey as a PVC pipes player and further diversified in manufacturing of PVC resin in 1994 as part of its backward integration strategy. Further, it commissioned 43 MW thermal power plant at Ratnagiri in 2009-10 to reduce its dependency on the grid for its power requirements.

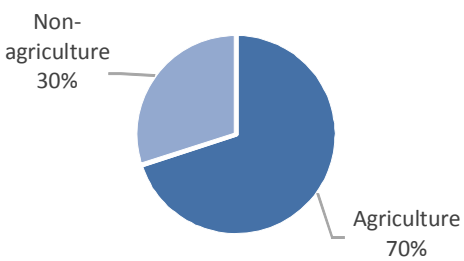
Presently, FIL is the largest player in terms of market share in agriculture pipes segment and is a leading player in PVC resin business (after RIL and Chemplast) in India. FIL has three manufacturing plants located in Pune (Maharashtra), Ratnagiri (Maharashtra) and Masar (near Vadodara, Gujarat) and four warehouses in Chinchwad, Cuttack, Noida, and Indore catering to different geographies across India. The company has 280000 tpa (tonnes per annum) capacity of PVC and 272000 tpa of PVC resins. The company has increased capacity of PVC pipes by 30000 tpa to 280000 tpa at its existing plant in Ratnagiri in the current financial year. FIL has strong distribution network with over 700 dealers and 17,000+ retail touch points across country. Its sales, EBITDA and PAT grew at CAGR of 4.4%, 11.3% and 25.1% respectively over FY11-16 with EBITDA margins in the range of 8-16% led by volatility in the PVC resins business.

Value Chain



Source: Company

Agriculture Vs non-agriculture breakup of FIL



Source: Company

Business summary

Particulars	PVC Pipes & Fittings	PVC Resins
Products	Agriculture pipes and fittings (casing pipes, column pipes) and plumbing & sanitation pipes and fittings	PVC Resins
Key Raw material	PVC Resins	EDC, Ethylene and VCM
Target Customers	B2C Business: Agriculture (70%) and Non-agriculture (30%)	B2B Business: In-house consumption & external sales to various industries
Revenue contribution	73%	27%
CAGR (FY11-16)	12%	-9%
EBIT contribution	42%	50%
CAGR (FY11-16)	17%	25%
EBIT Margins	9-10%	5-15%
Market Size & Growth	INR 235 bn, 20%+ (1.8 mn tonne)	Huge, 13%
Market Share	19% (in volume terms, organised)	very low
Competition	High (Supreme, Astral, etc)	High (RIL, imports, etc)
Growth driver	Agriculture, housing, infra, replacement	Pickup in economic growth
Growth Expectations	20%	Will decline in a longer run due to increasing captive consumption

Source: Company, Kotak Securities - Private Client Research

Top management

Name	Designation
Prakash P Chhabria	Executive Chairman
S S Dhanorkar	Managing Director
S N Inamdar	Director
K N Atmaramani	Director
Sunil U Pathak	Director
P D Karandikar	Director
D N Damania	Director
Sanjay K Asher	Director
S S Math	Director (Operation)
Ritu Prakash Chhabria	Director

Source: Company

Investment Rationale

Strong brand equity in Agri segment with consistently expanding product range and geographic reach

- FIL is the market leader in agri segment with high brand recall with 70% of its revenue being contributed by this segment.
- FIL is focusing on increasing its sales from high margin value added products like fittings, column pipes, etc and intends to increase the revenue share from these in longer run. The company has total ~1400-1500 varieties of fittings and has continuously been adding to its product portfolio.
- FIL has set up manufacturing in three different locations in order to cater to different geographies and thus is geographically diversified. This year, FIL targets to setup 3-4 new warehouses with major focus on southern region.

Market leader in agri segment with strong brand recall

FIL is the market leader in agri segment with high brand recall. 70% of its revenue is contributed by agriculture segment where pipes are used in irrigation. The company sells its pipes through its strong network of over 700 dealers and 17,000+ retail touch points across country. Its pipes command premium over its peers. The company is focused on branding and advertisements. It is participating in exhibitions to promote its products and is also using social media for increasing brand awareness.

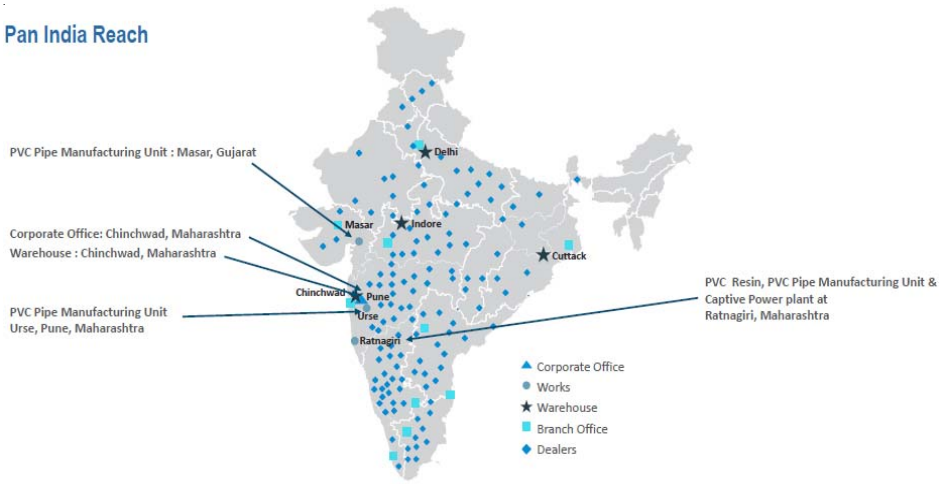
Diversifying revenue mix with focus on value added products

FIL is focusing on increasing its sales from high margin value added products like fittings, column pipes, etc. The company has total ~1400-1500 varieties of fittings and has continuously been adding to its product portfolio. In FY16 it has added more than 200 varieties and intends to add another 200 in FY17E. The company manufactures as well as sources these. Per unit realizations of fittings are ~90% higher than pipes and they command much higher margins. The company intends to scale up share of fittings in sales mix which is presently at 10% (in FY16). It has also diversified within pipes business by offering CPVC pipes. It is sourcing raw materials from Arkema to manufacture CPVC pipes which are relatively better margin products and cater to demand in the plumbing segment.

Geographically diversified to meet demand across region

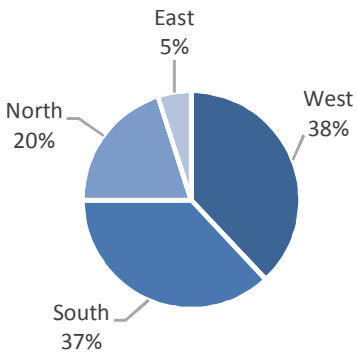
FIL has set up manufacturing units in three different locations in order to cater to different geographies. It's facility in Ratnagiri primarily caters to southern region while facility located in Pune caters to western and eastern region. The facility in Gujarat caters to PVC pipes demand from northern India. Recently commissioned warehouses at Indore (MP), Noida (UP) and Cuttack (Odisha) have ensured faster delivery and enhanced distribution reach across geographies. The facility in Cuttack would cater to north eastern region where it has relatively lower presence and contributes 5% of its revenue. The region includes Odisha, Bihar, Uttar Pradesh, West Bengal and other north eastern states. This year, FIL targets to setup 3-4 new warehouses with major focus on southern region.

Finolex Pan India network



Source: Company

Geographical breakup of pipes revenue



Source: Company

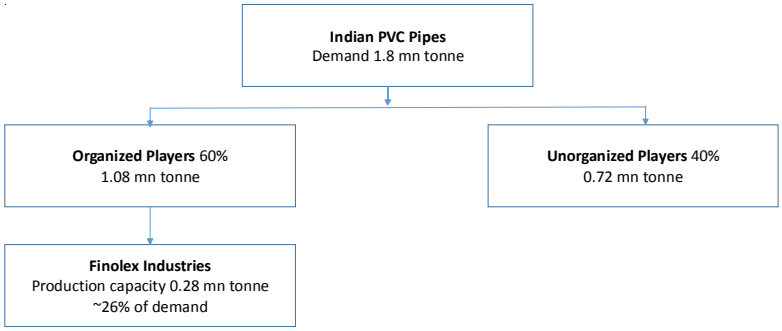
Robust industry growth outlook led by rural and infra boost

- Domestic PVC pipes market at 1.8 mn tonnes is growing at 12-15% in volume terms of which 60% is the share of organized market and 40% is unorganized (FIL's FY16 PPT). Introduction of GST and would be positive for organized players.
- Agriculture and infrastructure sector are major demand drivers for PVC pipes in India. Government initiatives on irrigation projects and development of smart cities will be a boost to PVC consumption in India.
- In the last two years, monsoon was weak on account of El Nino which negatively impacted rural demand. Any improvement in the rainfall will positively impact rural economy and, in turn, will be positive for PVC pipes demand in agri segment where FIL is more focused.

Strong industry growth with shift towards organized players

Domestic PVC pipes market is 1.8 mn tonnes in volume and Rs 235 bn in terms of value of which 60% is the share of organized market and 40% is unorganized. The Indian plastic pipes industry has been growing at 12-15% CAGR in value terms. The industry is steadily shifting toward organized players led by quality and variants in pipes and fittings. The shift is expected to gather pace after the introduction of GST and would be positive for organized players. FIL command over 19% market share in the organized market in terms of sales volume (in FY16).

PVC Pipes industry structure

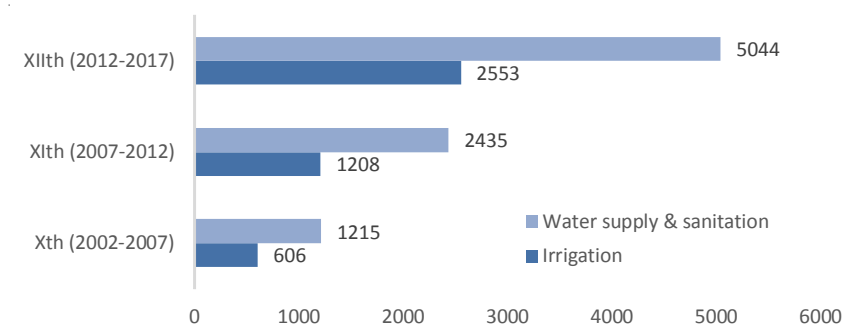


Source: Company

Government focus on Agriculture and infrastructure sector; positive for PVC pipes demand

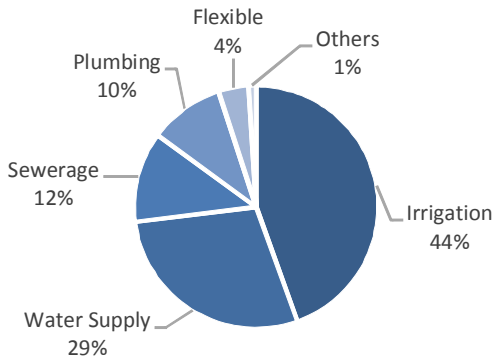
Agriculture and infrastructure sector are major demand drivers for PVC pipes in India. In India only 44% agriculture land is provided with irrigation facility while balance is rain dependent. Of this, 60% of the irrigated land depends on ground water for its water requirements. The government has emphasized on increasing land under irrigation and is focusing on improving rural water and sanitation infrastructure. Budget 2016-17 proposed to improve agriculture and increase farmers' welfare. It targets to bring 2.85 million hectares under irrigation. The budget announced Rs 2.87 trn or USD 42.11 billion grant in aid to be given to gram panchayats and municipalities. The government has given high importance to micro irrigation, watershed development and 'Pradhan Mantri Krishi Sinchai Yojana' and allocated Rs 53 bn (USD 777.6 million) for these schemes in the budget 2016. Further, it also urged the states to focus on this sector. Thus, government initiatives on irrigation projects under various schemes would be positive for demand of PVC pipes. Further, the development of smart cities will be a boost to PVC consumption in India due to the huge investment in urban infrastructure like water and sanitation.

Investment in water supply and irrigation (Rs bn)



Source: Company, 5 year plans documents

Sectoral breakup of PVC pipes



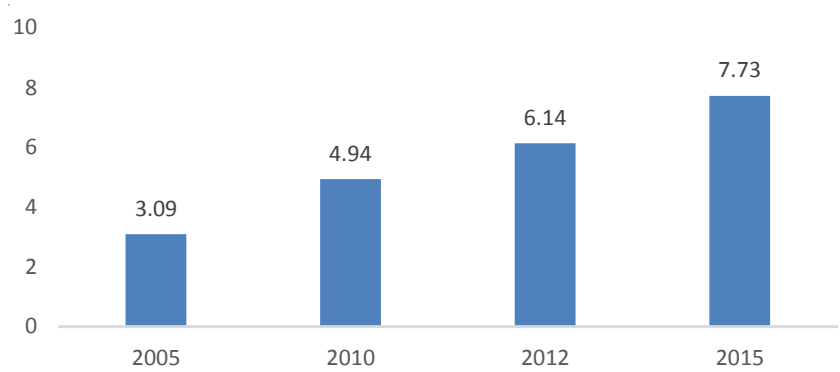
Source: Company

Emphasis on Micro irrigation would be positive for PVC pipes demand

India, with areable land of 140 mn hectares has huge potential for micro irrigation as 50% of the cultivable land is still rain fed. Micro Irrigation technology can reduce dependency on Monsoon and can provide major relief for drought prone areas of the country. But the penetration of micro irrigation systems is still very low in India. The average penetration at the all India level is ~8 mn hectares or 5.5 percent which is much lesser compared to countries like Israel, US and even China. Area covered under micro irrigation has seen a growth of 9.6% in 2005-15 and has scope to grow faster considering low penetration and government focus. States like Maharashtra, Rajasthan, Gujarat, Haryana, Bihar, Karnataka and Andhra Pradesh are among the leading states having high potential of Micro Irrigation in India.

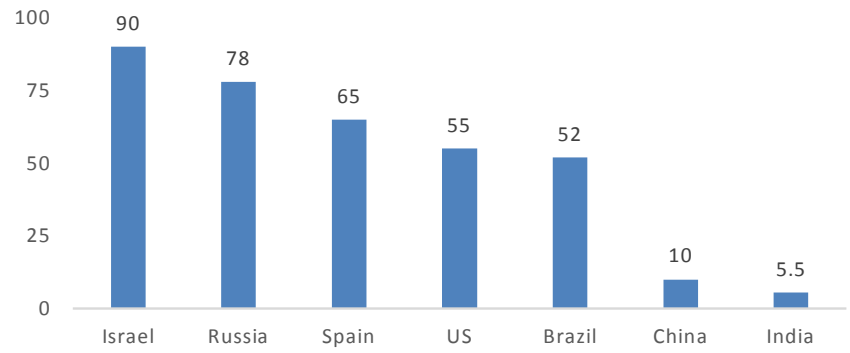
Task-force on micro irrigation (2004) estimated a potential of 27 mn hectares for drip irrigation and 42.5 mn hectares for sprinkler irrigation with total potential of 69.5 mn hectares (source: Grant Thornton report). Assuming average cost per mn hectare at Rs 47 bn (based on channel checks), the total investment potential in Micro Irrigation space would be ~ Rs 3.3 trn. This results in total opportunity size of Rs 0.66 trn or 7.7 mn tonne (Vs annual demand of 1.8 mn tonne) for PVC pipes and fittings as it comprises ~20% cost of micro irrigation system (based on channel checks). Thus, increasing focus on Micro Irrigation would be positive for PVC pipes demand.

Area under micro irrigation in India (mn hectares)



Source: Grant Thornton report, Accelerating growth of Indian agriculture

Micro irrigation penetration across nations (%)



Source: Grant Thornton report, Accelerating growth of Indian agriculture

Demand from housing sector

The housing sector will also be a major driver for PVC pipes on account of increased preference of PVC over tradition GI pipes. India plans to build 100 smart cities across 21 states in next 5 years. A total of Rs 980 bn has been approved by the cabinet for 100 smart cities and rejuvenation of 500 others. This will also be positive for housing sector. Government focus on building new industrial cities and housing for all would drive demand for PVC, CPVC, HDPE, etc pipes as plumbing constitutes 5-10% of the building construction cost. Besides this, plastic pipes have more advantages over galvanized iron pipes in terms of life, price, quality, etc.

Advantage of PVC pipes over other pipes

Factor	PVC Pipes	CPVC Pipes	GI Pipes
Life	30-35 years	30-35 years	10-15 years
Cost	40% cheaper than CPVC, 70% cheaper than GI	Costlier	Most Expensive
Heat resistance	Low Thermal Conductivity, temperature resistant upto 55 degree centigrade	High Thermal Conductivity, temperature resistant upto 93 degree centigrade	High Thermal conductivity
Corrosion	Anti-Corrosive	Anti-Corrosive	Corrosive in nature
Installation	Easy	Easy	Tedious
Hygiene factor	High	High	Low

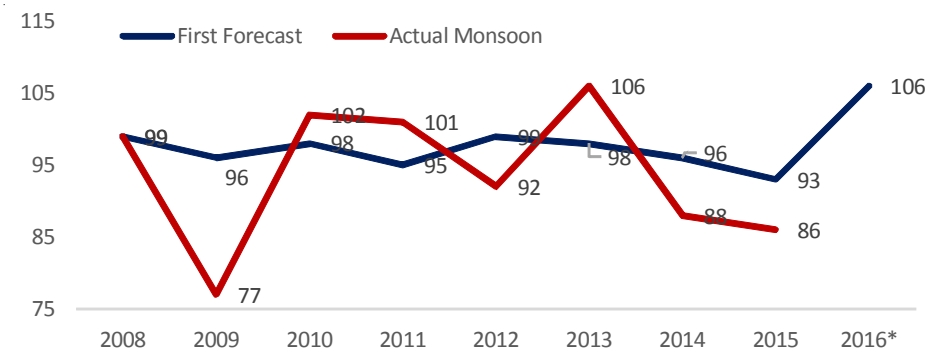
Source: Industry, Kotak Securities - Private Client Research

Any revival in rural economy, positive for PVC pipes demand

Agri segment contributes 70% of FIL PVC pipes business. The pipes manufactured by the company are used for supply of water to fields and in irrigation systems. In the last two years, monsoon was weak on account of El Nino which resulted in southwest monsoon being 12% and 14% below normal in 2014 and 2015, respectively. This has negatively impacted farmers and rural economy.

As per Indian Meteorological Department (IMD) and other foreign agencies, El Nino weather event has already peaked and they expect rainfall from June to September to be more than normal. It forecast monsoon at 106 per cent of the Long Period Average (LPA) with monsoon gathering pace during the second half of the season. In addition, Skymet also forecast slightly above normal monsoon at 105 per cent of the LPA. Despite weak monsoon in the past two years, FIL was able to grow its revenue in pipes business. Any improvement in the rainfall will positively impact rural economy and inturn be positive for PVC pipes demand in agri segment.

Monsoon Forecast Vs Actual trend



Source: IMD, Note: 2016 is forecast only

Forecast for 2016 by IMD

Category	Rainfall Range (% of LPA)	Forecast Probability (%)
Excess	>110	23
Above Normal	104-110	40
Normal	96-104	33
Below Normal	90-96	4
Deficient	<90	0

Source: IMD

Forecast for 2016 by Skymet

Monsoon status	Probability
Excess	20% probability
Above Normal	35% probability
Normal	30% probability
Below Normal	10% probability
Drought	5% probability

Source: Skymet

Focus shifting to predictable and better ROCE B2C PVC pipes business

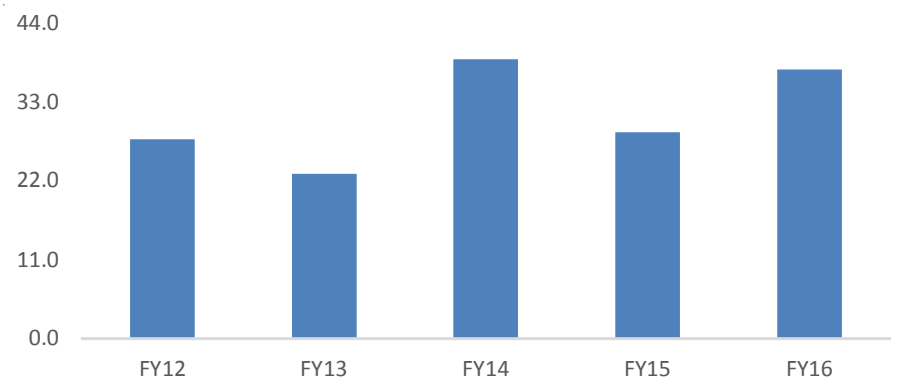
- FIL is steadily moving away from commoditized B2B business of PVC resin where margins are highly volatile to a relatively better and stable ROCE B2C business of PVC pipes and fittings.
- FIL is presently using 57% of PVC resins in-house and balance is sold in the market. The company targets to fully utilize the raw material in-house in a longer run.
- FIL's RoCE is expected to be strong at over 30% based on improvement in asset turnover (from 1.9x to 2.5x) and improvement in EBIT margins from 13.2% in FY16 to 14.5% by FY18E.

Increasing focus towards PVC pipes business

FIL has adopted an integrated business model and is manufacturing the key raw material-PVC resin. It uses EDC, VCM and ethylene as key raw materials which are mostly imported from middle-east for manufacturing PVC resins. The company entered into manufacturing of PVC resin in 1994 when the import duty on PVC was very high at over 40% but now it is reduced to 7.5%. Hence PVC is easily imported at competitive price. Thus the competitive intensity has increased in the PVC resin business.

But the backward integration ensures timely supply of raw material for the pipes business and reduces dependency over import/suppliers. The company is presently using 57% of PVC resins in-house and balance is sold in the market. The company targets to fully utilize in-house its raw material in a longer run and it intends to increase its pipes production capacity to meet its future growth requirement. Further it will not be increasing capacity of PVC resin considering the business is capital intensive and highly volatile in terms of margins. Thus, FIL is steadily moving away from a B2B business of PVC resin to B2C business of PVC pipes and fittings.

RoCE in PVC Pipes business

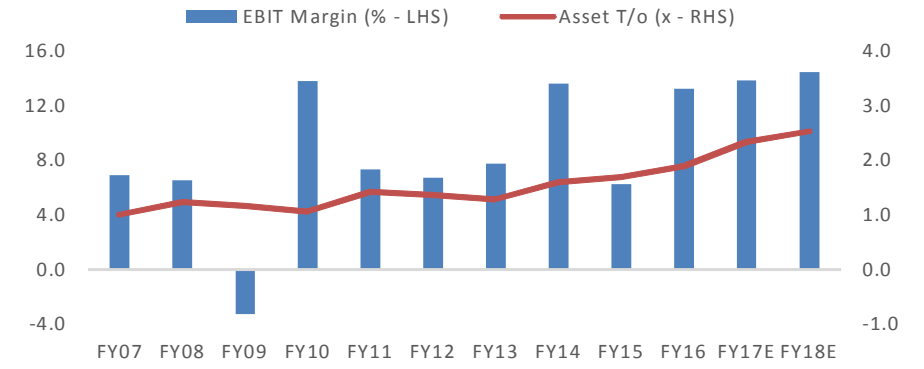


Source: Company, Kotak Securities - Private Client Research

RoCE to improve to above 30%

FIL's RoCE is expected to be strong at over 30% based on improvement in asset turnover (from 1.9x to 2.5x) and improvement in EBIT margins from 13.2% in FY16 to 14.5% by FY18E. The expected revival in demand of PVC pipes from agriculture segment would be positive for FIL. We expect 15% volume growth in PVC pipes and fitting business in FY16-18E which would result in capacity utilization of 81% (Vs 74% in FY16) even after capacity additions. As a result, the asset turnover of the company is expected to improve from 1.9x in FY16 to 2.5x in FY18E. Besides this, EBIT margins are also expected to improve by 130 bps to 14.5% by FY18E led by 1) improvement in margins in pipes segment and 2) PVC-EDC spread to be at comfortable level of ~USD 600 per tonne assuming crude price to be less volatile. We expect RoCE to improve from 25% in FY16 to 36.7% in FY18E.

EBIT margin vs Asset T/o



Source: Company, Kotak Securities - Private Client Research

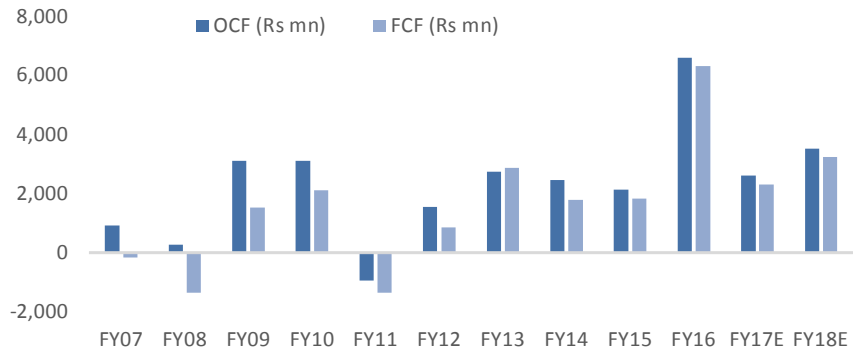
Strong Cash flows to help in meeting capex and reducing debt

- FIL is generating strong cash flows which would be used to meet its funding requirement. It is expanding its PVC pipes capacity by 100000 tonnes in the next three years with Rs 1 bn of total investment at its existing plants.
- The increased capacity is expected to add ~Rs 10 bn of revenue over the next 4-5 years.
- Targeting to become debt free in the next 1-2 years.

Meeting capacity expansion requirement through internal accruals:

FIL is expanding its PVC pipes capacity by 100000 tonnes in the next three years with Rs 1 bn of total investment at its existing plants. Thus, the company would be incurring Rs 300-400 mn of capex per annum to achieve this capacity. It has added 30000 tonnes with the total capex of Rs 300 mn in the current financial year. The company will be meeting its capex requirement through internal accruals. FIL is generating strong cash flows which would be used to meet its funding requirement. With this, the company intends to increase its PVC pipes and fittings capacity to 340000 tpa from present 280000 tpa by FY18E. The increased capacity is expected to add ~Rs 10 bn of revenue over the next 4-5 years.

Strong cashflows

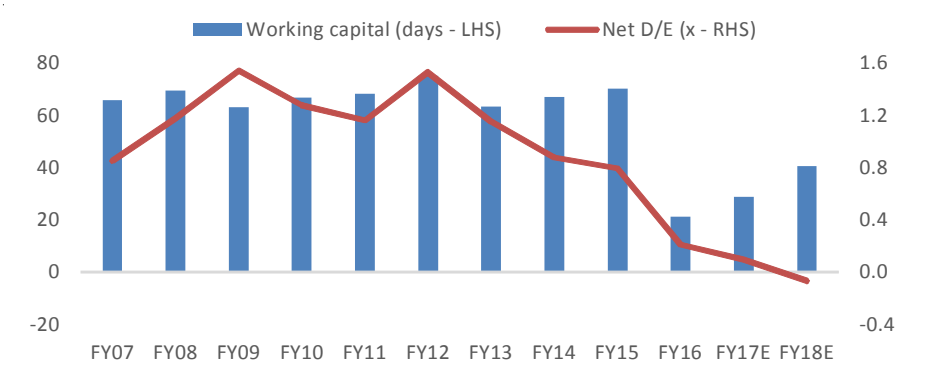


Source: Company, Kotak Securities - Private Client Research

Targets to become debt free, positive impact on earnings:

FIL has repaid Rs 4 bn debt in FY16 which has resulted in the present net debt to equity falling to 0.2x. It is targeting to become debt free in the next 1-2 years by repaying its debt. The strong cash flows would help it to be debt free. Besides this, its working capital is also at controlled levels of ~2 months of sales and is expected to remain so. This would result in interest cost coming down by 58% CAGR and would positively impact its earnings which are expected to grow by 18.7% CAGR in FY16-18E.

Net debt to equity expected to be negligible by FY18

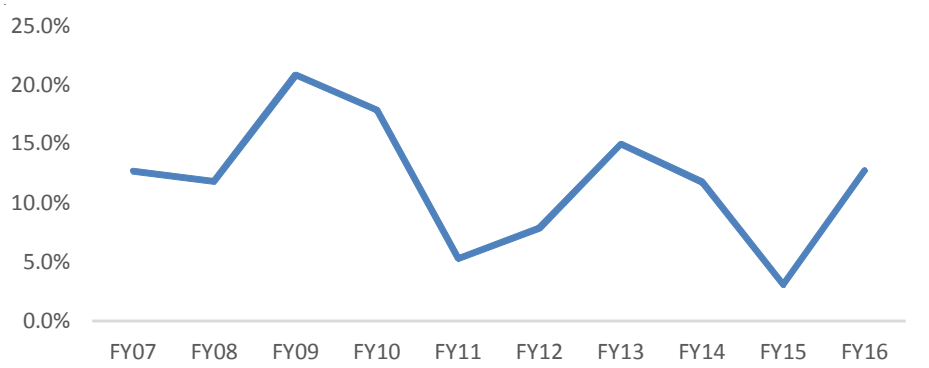


Source: Company, Kotak Securities - Private Client Research

PVC EDC spread in favour

FIL's PVC resin business is highly volatile in terms of margins considering commoditized nature of the business. The margin in the business get impacted when the crude price moves sharply. In FY15, the price of crude oil fell sharply and the volatility resulted in sharp decline in the margins of the business. EBIT margins in the PVC resin business has witnessed revival in FY16 as the PVC EDC spread turned favorable in the band of ~ USD 500-600 per tonne. The spread at the end of FY16 was at USD600 per tonne. We have assumed PVC EDC spread to be in the comfortable range of USD 500-600 per tonne with the assumption of no major volatility in the crude price.

EBIT margins in PVC resin



Source: Company, Kotak Securities - Private Client Research

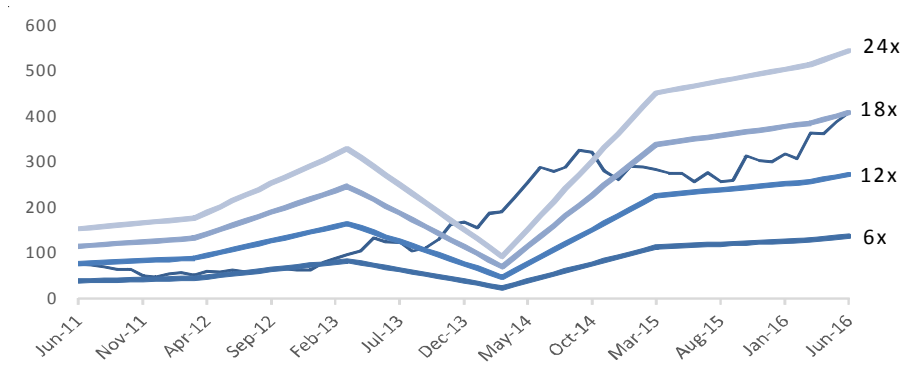
Key Risk & Concerns

- **High volatility in raw material prices:** The raw materials used by the company are crude derivatives. Any high volatility in the raw material prices would impact the earnings estimates led by inventory gain/losses.
- **Disappointment from rural demand:** FIL's pipes business is driven by demand from agri-segment. As per forecast by IMD and Skymet, the rainfall in FY17 is estimated to be marginally above average which would positively impact rural demand. Any major disappointment on monsoon would negatively impact the rural demand and in turn our sales volume estimates.

Valuation

We expect revenue and PAT of FIL to grow at 15.3% and 18.7% respectively in FY16-18E on a strong base of FY16, led by improvement in demand from agriculture segment and increased capacity. Margins are expected to remain firm assuming no major volatility in crude prices and increased share of high margin value added products. Based on FY17E and FY18E EPS Rs 21.4 and 26.5, the stock is trading at PE of 19.4x and 15.7x respectively. The stock has traded at average forward PE of 16x in the last 5 years. Presently, the stock is trading at a discount to its peers in the sector. We expect re-rating in the stock considering that RoCE is expected to strengthen further from 25% in FY16 to 36.7% in FY18E led by high capacity utilization levels, controlled working capital, strong margins profile and company's focus on high RoCE B2C business. We assign Buy rating on the stock with target price Rs 504. At our target price the stock will trade at 19x FY18E earnings.

PE Band



Source: Kotak Securities - Private Client Research

Peer Comparison table

Comparative	CMP (Rs)	Mcap (Rs bn)	EV (Rs bn)	Sales (Rs bn)	FY17E PE (x)	FY18E PE (x)	FY17E EV/ EBITDA	FY18E EV/ EBITDA	FY16 RoE (%)	FY16 RoCE (%)
Finolex Industries	416	51.6	58.2	24.8	19.4	15.7	12.0	9.7	26.8	25.0
Supreme Industries	898	114.0	112.7	42.5	28.8	23.4	14.5	12.5	30.2	35.7
Astral Poly Technik	452	55.4	57.3	14.3	35.2	27.0	20.7	16.5	16.8	21.1

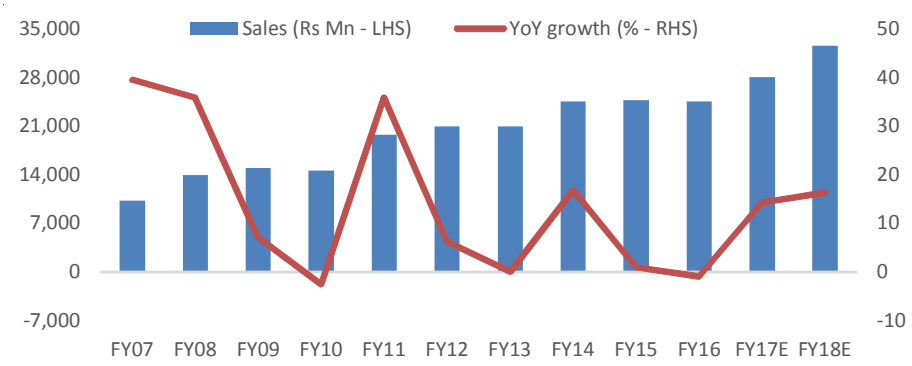
Source: Kotak Securities - Private Client Research, Bloomberg, Capitaline

Financial Outlook

Expect 15.3% Sales CAGR in FY16-18E

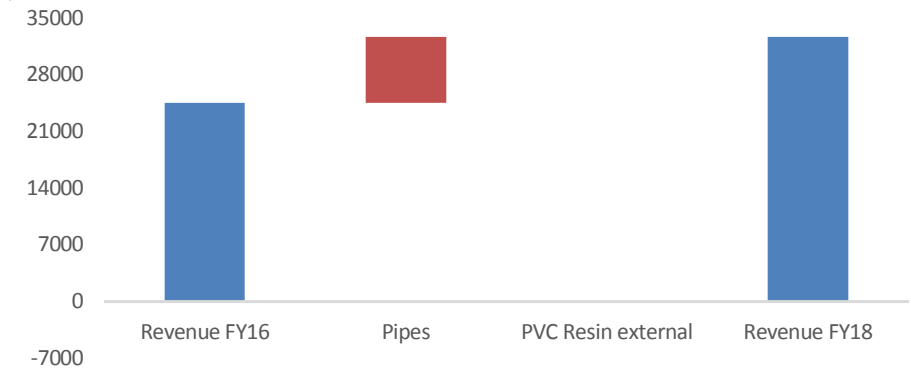
We expect revenue of FIL to grow at a CAGR of 15.3% in FY16-18E led by 20.8% revenue CAGR in PVC pipes and fittings business, while PVC resin business is expected to decline at 0.7% CAGR in FY16-18E. We expect 15% CAGR in volume and 5% CAGR in realization in PVC pipes and fittings during the period. FY17E and FY18E volume growth in PVC pipes business is based on improved demand from agriculture segment which contributes 70% revenue in PVC pipes business. We expect revenue in PVC resin business to decline marginally at 0.7% CAGR considering increase in share of in-house consumption (57% in FY16 to 63% in FY18) and no capacity addition in the resin business. The company intends to completely utilize resin for captive consumption in a longer run.

Expect revival in revenue growth in FY17E



Source: Company, Kotak Securities - Private Client Research

Sales breakup

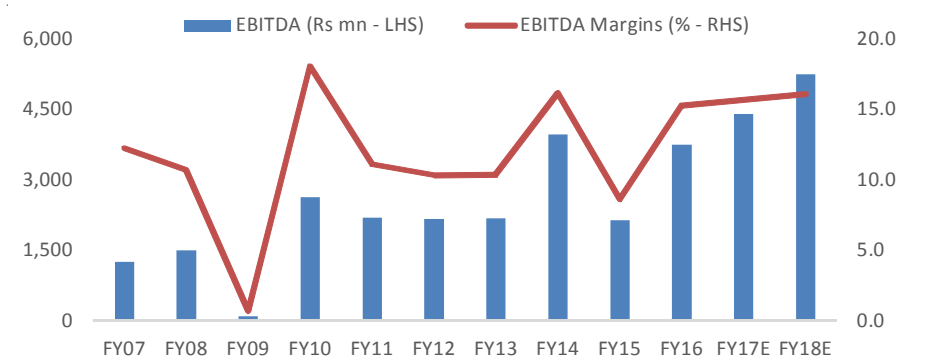


Source: Company, Kotak Securities - Private Client Research

Expect 18.7% PAT CAGR in FY16-18E led by strong margins and decline in interest cost

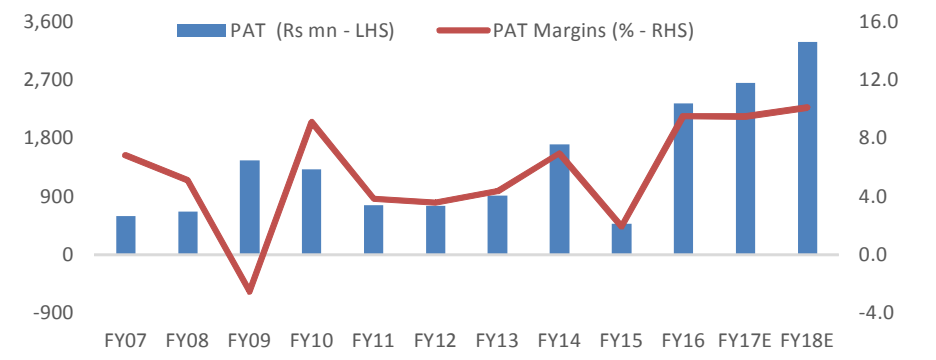
We expect PAT to grow at a CAGR of 18.7% in FY16-18E driven by 1) improvement in EBITDA margins by 80 bps, from 15.3% in FY16 to 16.1% in FY18E and 2) decline in interest expenses as FIL intends to become debt free. The stronger margins are based on assumption that 1) margins in PVC pipes business will improve on increased share of high margins value added products (improved from 7% in FY14 to 10% in FY16) 2) increased captive consumption of PVC resins (from 57% to 63% by FY18E) and 3) PVC-EDC spread to be at present level of USD 600 (assuming crude price to stabilize at ~USD 50/ barrel). We expect reduction in debt considering strong cash generation which would result in net debt to equity coming down from 0.2x to -0.1 by FY18.

EBITDA margins expected to be above 15% in FY16-18E



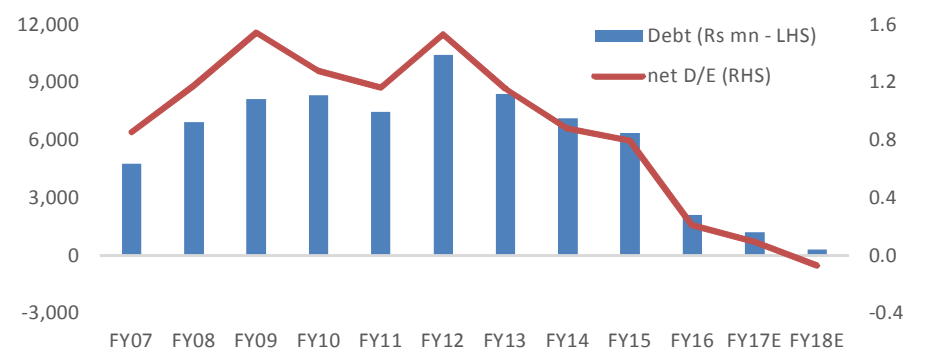
Source: Company, Kotak Securities - Private Client Research

PAT to grow at 18.7% CAGR



Source: Company, Kotak Securities - Private Client Research

Expected to be debt free company



Source: Company, Kotak Securities - Private Client Research

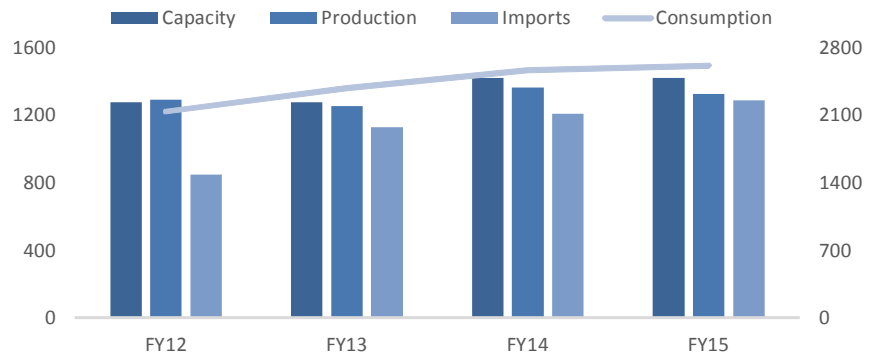
ANNEXURE

Indian PVC demand estimated to grow at 13%

The global PVC resin market is at USD 56 bn and is expected to reach revenue of USD 65 bn in 2019, with average annual demand expected to increase at 3.9%. The PVC industry in India is valued at over Rs. 200 bn containing five major producers with RIL being the largest player, followed by Chemplast and Finolex. The total demand for PVC in the country in FY15 was at 2.56 mn tonne which grew by 6% compared to FY14. For the period between 2002 and 2015, the total demand for PVC in the country grew at a CAGR of 8.7%. During the same period domestic capacity and production grew at a CAGR of 4.6 % and 3.7% respectively whereas imports grew at a CAGR of 32.5%. After the drop in duty levels in mid 2000s from over 40% to present 7.5%, imports grew fast and hence, capacity addition lagged.

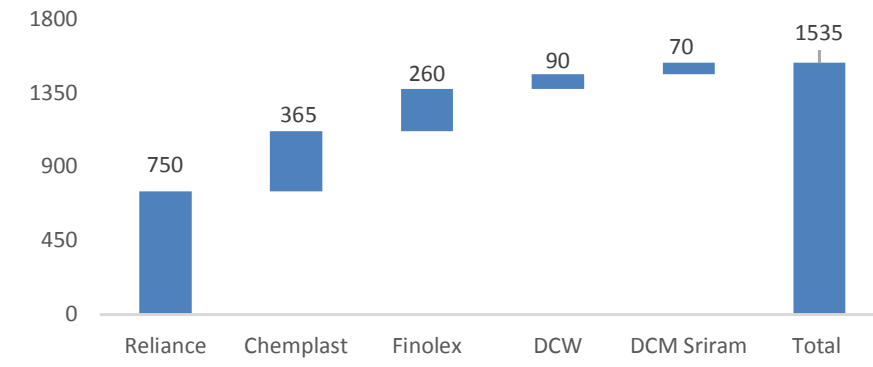
As per FICCI report, the CAGR in demand of PVC in India is estimated at 13% in the next 5 years and is expected to cross 5 mn tonnes by 2020. Indian PVC demand in the future would be driven by sectors such as agriculture, infrastructure, housing, and packaging in FMCG, pharmaceutical & retail segments. PVC pipes and fittings which are used in housing, irrigation and infrastructure space comprise 73% of PVC demand.

PVC demand and supply trend



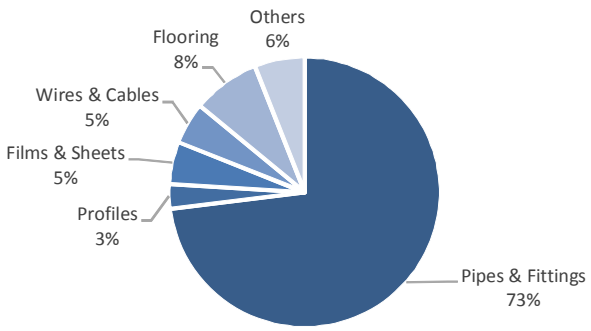
Source: FICCI report

Major domestic players



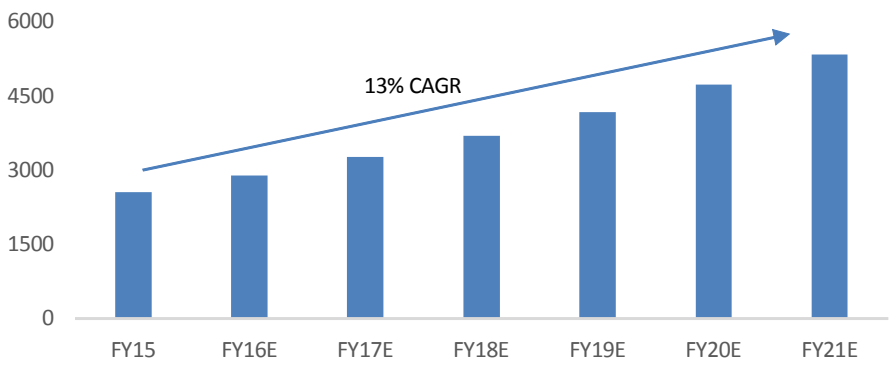
Source: FICCI report

End user industry breakup for PVC resins



Source: FICCI report

Demand in India for PVC Resins (000 tonnes)

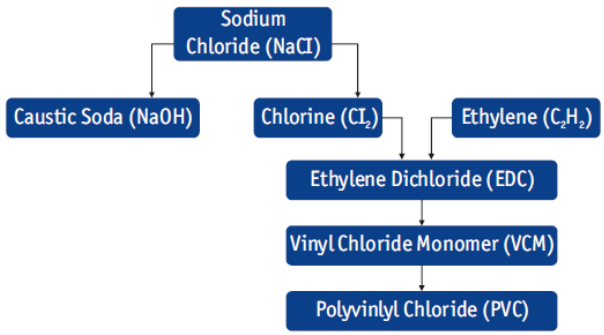


Source: FICCI report

PVC Value Chain

PVC is a synthetic resin made from the polymerization of vinyl chloride. Polyvinyl Chloride (PVC) is the end product which is derived from 1) chlorine from common salt (NACL) and 2) ethylene which is a crude derivative. Chlorine and ethylene gives Ethylene Dichloride (EDC) which is used to produce Vinyl Chloride Monomer (VCM). In further step PVC is produced from VCM.

PVC Value chain



Source: FICCI report

FINANCIALS (STANDALONE)

Profit and Loss Statement

(Rs mn)	FY15	FY16	FY17E	FY18E
Net Revenue	24,761	24,528	28,031	32,601
Growth %	0.9	(0.9)	14.3	16.3
Total Expenses	22,628	20,777	23,635	27,359
Growth %	10.0	(8.2)	13.8	15.8
EBITDA	2,134	3,751	4,396	5,242
Growth %	(46.2)	75.8	17.2	19.3
Other Income	202.4	391.2	202.4	202.4
Interest	597.7	446.4	175.0	80.3
Depreciation	586.7	505.7	514.0	522.0
PBT	807.8	3,434.9	3,909.3	4,842.4
Tax	330.0	1,099.0	1,250.7	1,549.3
PAT	478	2,336	2,659	3,293
Growth %	(71.9)	388.9	13.8	23.9
Shares outstanding (mn)	124.1	124.1	124.1	124.1
EPS (Rs)	3.9	18.8	21.4	26.5
DPS (Rs)	2.0	10.0	7.0	7.0
CEPS (Rs)	8.6	22.9	25.6	30.7
BVPS (Rs)	63.5	77.2	89.0	106.0

Source: Company, Kotak Securities - Private Client Research

Cash Flow Statement (Rs mn)

(Rs mn)	FY15	FY16	FY17E	FY18E
Pre-Tax Profit	808	3,435	3,909	4,842
Depreciation & Non Cash	587	506	514	522
Interest & others	567	446	175	80
Chg in Working Cap	478	3,319	(726)	(362)
Tax Paid	(392)	(1,099)	(1,251)	(1,549)
Operating CashFlow	**2,144**	**6,607**	**2,621**	**3,533**
Capex	(307)	(287)	(300)	(300)
Free Cash Flow	1,837	6,320	2,321	3,233
Investments	528	(1,084)	0	0
Investment cash flow	**221**	**(1,371)**	**(300)**	**(300)**
Equity Capital	0	0	0	0
Loans	(923	(4,258	(900	(900
Dividend	(981	(632	(1,189)	(1,189)
Interest & Others	(548)	(374)	(175)	(80)
Financing cash flows	**(2,452)**	**(5,264)**	**(2,264)**	**(2,169)**
Net Change in Cash	(86)	(28)	57	1,064
Opening Cash Position	209	123	95	152
Closing Cash Position	123	95	152	1,217

Source: Company, Kotak Securities - Private Client Research

Balance sheet

(Rs mn)	FY15	FY16	FY17E	FY18E
Equity Share Capital	1,241	1,241	1,241	1,241
Reserves	6,633	8,337	9,807	11,911
Networth	7,874	9,578	11,048	13,152
Total Share Holders' Fund	7,874	9,578	11,048	13,152
Loan Funds	6,371	2,113	1,213	313
Total Liabilities	**14,245**	**11,691**	**12,260**	**13,464**
Gross Block	18,939	19,264	19,564	19,864
Less: Accmulated Dep	10,262	10,767	11,281	11,803
Net Block	8,678	8,497	8,283	8,061
Capital Work In Progress	104	66	66	66
Investments	1,797	2,880	2,880	2,880
Current Assets	8,013	6,743	7,564	9,599
Inventories	5,587	4,472	5,111	5,944
Debtors	487	176	201	234
Cash&Bank	123	95	152	1,217
Loans&Advances	1,817	1,999	2,099	2,204
Current Liabilities & Prov	3,239	5,316	5,353	5,962
Creditors	2,000	2,432	2,779	3,232
Provisions	393	1,617	1,617	1,617
Net Current Assets	4,774	1,427	2,211	3,637
Net Deferred Tax	(1,108)	(1,180)	(1,180)	(1,180)
Total Assets	**14,245**	**11,691**	**12,260**	**13,464**

Source: Company, Kotak Securities - Private Client Research

Ratio Analysis

	FY15	FY16	FY17E	FY18E
Profitability/Returns (%)				
EBITDA Mgn	8.6	15.3	15.7	16.1
EBIT Margin	6.2	13.2	13.8	14.5
PAT Mgn	1.9	9.5	9.5	10.1
Adj EPS Growth%	(71.9)	388.9	13.8	23.9
Turnover (X Days)				
Debtor Days	7	3	3	3
Inventory Days	82	67	67	67
Current Liability Days	42	55	49	49
Net Working Cap Days	70	21	29	41
Fixed Asset T/O (x)	1.3	1.3	1.4	1.7
Asset T/O (x)	1.7	1.9	2.3	2.5
Net Debt/Equity	0.8	0.2	0.1	-0.1
Returns Ratios				
RoE	6.1	26.8	25.8	27.2
RoCE	10.6	25.0	32.4	36.7
Dividend Yield %	0.5	2.4	1.7	1.7
Valuations (X)				
PER	108.0	22.1	19.4	15.7
P/BV	6.6	5.4	4.7	3.9
EV/Sales	2.3	2.2	1.9	1.6
EV/EBITDA	27.1	14.3	12.0	9.7

Source: Company, Kotak Securities - Private Client Research

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 9 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 9 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 9 months
SELL	–	We expect the stock to deliver negative returns over the next 9 months
NR	–	**Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
RS	–	**Rating Suspended.** Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA	–	**Not Available or Not Applicable.** The information is not available for display or is not applicable
NM	–	**Not Meaningful.** The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 9-month perspective. Returns stated in the rating scale are our internal benchmark.

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