

Finolex Cables

Performance Highlights

Y/E March (₹ cr)	2QFY16	2QFY15	% chg (yoy)	1QFY16	% chg (qoq)
Total operating income	605	637	(4.9)	588	2.9
EBITDA	75	80	(5.9)	73	3.4
EBITDA Margin (%)	12.5	12.6	(12)bp	12.4	6bp
Adj. PAT	65	79	(17.8)	48	35.2

Source: Company, Angel Research

Finolex Cables (FCL) has reported its 2QFY2016 numbers which are below our estimates. The top-line declined by 4.9% yoy to ₹605cr. The decline is on account of lower commodity prices which were passed on, resulting in lower realizations. The raw material cost declined by 178bp yoy to 72.1% of sales but the same was negated by 59bp yoy increase in employee cost to 4.3% of sales and 131bp yoy increase in other expenses to 11.1% of sales. This resulted in the EBITDA margin contracting by 12bp yoy to 12.5%. Other income during the quarter declined by 24.4% yoy to ₹28cr. As a result, the net profit declined by 17.8% yoy to ₹65cr against ₹79cr in the same quarter of the previous year.

Revival in capex cycle to drive growth: The growth of the company is closely related to revival in the capex cycle of the industries catered to. The company has evolved into an electrical equipment company from a wire and cables company by enhancing its product portfolio with entry into new product segments. This is expected to drive earning of the company in the coming years. With the government's increased focus on industrial and infrastructure sectors, FCL is well placed to reap benefits of the same. However, in the near term the outlook is subdued with no visible signs of pick-up.

Higher tax rate to dent profitability, recommend Neutral: We expect the company's top-line and EBITDA to post a 8.5% and 15.2% CAGR over FY2015–17E to ₹2,883cr and ₹345cr respectively with EBITDA margin at 12.0% in FY2017E. However, benefit of low material cost and interest outgo is expected to be offset by higher tax rate which will dent profitability. As a result, the bottom-line is expected to post a modest CAGR of 4.3% for the same period to ₹217cr. **We recommend a Neutral rating on the stock as it trades at fair valuations of 18.2x its FY2017E earnings.**

Key Financials

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Net Sales	2,271	2,359	2,449	2,520	2,883
% chg	10.0	3.9	3.8	2.9	14.4
Net Profit	145	208	199	194	217
% chg	47.9	43.0	(4.0)	(2.8)	12.1
EBITDA Margin (%)	10.1	10.5	10.6	12.2	12.0
FDEPS (₹)	9.5	13.6	13.0	12.7	14.2
P/E (x)	27.2	19.0	19.8	20.4	18.2
P/BV (x)	4.3	3.6	3.1	2.8	2.5
RoE (%)	15.7	18.8	15.8	13.6	13.5
RoCE (%)	23.5	25.4	27.6	33.7	34.0
EV/Sales (x)	1.7	1.5	1.4	1.3	1.1
EV/EBITDA (x)	16.3	14.6	13.0	10.8	9.2

Source: Company, Angel Research; Note: CMP as of November 16, 2015

NEUTRAL

CMP	₹258
Target Price	-

Investment Period	-
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Stock Info

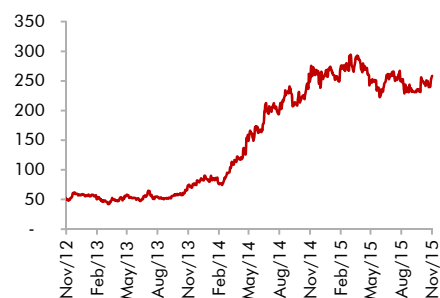
Sector	Cables-Power
Market Cap (₹ cr)	3,953
Net Debt	(581.4)
Beta	0.7
52 Week High / Low	306 / 215
Avg. Daily Volume	37,448
Face Value (₹)	2
BSE Sensex	25,760
Nifty	7,807
Reuters Code	FNXC.BO
Bloomberg Code	FNXC.IN

Shareholding Pattern (%)

Promoters	35.9
MF / Banks / Indian Fls	14.9
FII / NRIs / OCBs	7.5
Indian Public / Others	41.7

Abs.(%)	3m	1yr	3yr
Sensex	(7.6)	(8.6)	40.7
Finolex	2.1	4.0	420.5

3-Year Daily Price Chart



Source: Company, Angel Research

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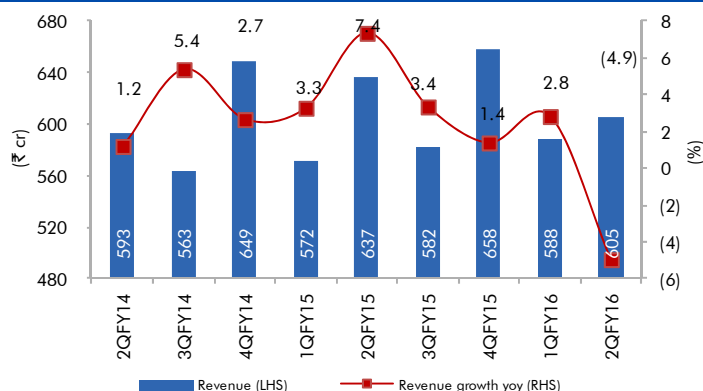
Exhibit 1: 2QFY2016 performance highlights

Y/E March (₹ cr)	2QFY16	2QFY15	% chg (yoy)	1QFY16	% chg (qoq)	1HFY16	1HFY15	% chg
Total operating income	605	637	(4.9)	588	2.9	1,194	1,209	(1.3)
Net raw material	436	470	(7.2)	423	3.1	860	899	(4.4)
(% of Sales)	72.1	73.9	(178)bp	71.9	15bp	72.0	74.4	(238)bp
Employee cost	26	24	10.2	25	3.9	51	46	10.8
(% of Sales)	4.3	3.7	59bp	4.3	4bp	4.3	3.8	47bp
Other Expenses	67	63	7.8	67	0.7	134	127	5.7
(% of Sales)	11.1	9.8	131bp	11.4	(25)bp	11.3	10.5	74bp
Total expenditure	530	557	(4.8)	515	2.8	1,045	1,073	(2.6)
EBITDA	75	80	(5.9)	73	3.4	148	136	9.0
EBITDA Margin (%)	12.5	12.6	(12)bp	12.4	6bp	12.4	11.3	10bp
Interest	3	3	(19.8)	3	(14.8)	6	7	(12.4)
Depreciation	13	14	(6.5)	13	0.8	26	28	(6.1)
Other income	28	37	(24.4)	9	227.5	37	45	(18.0)
PBT	88	100	(12.2)	65	34.1	153	146	4.6
(% of Sales)	14.5	15.7		11.1		12.8	12.1	
Tax	23	21	8.9	17	31.0	40	33	22.9
(% of PBT)	25.9	20.9		26.5		26.2	22.3	
Reported PAT	65	79	(17.8)	48	35.2	113	114	(0.6)
Exceptional items	0	0		0		0	0	
Adjusted PAT	65	79	(17.8)	48	35.2	113	114	(0.6)
PATM (%)	10.7	12.4		8.2		9.5	9.4	

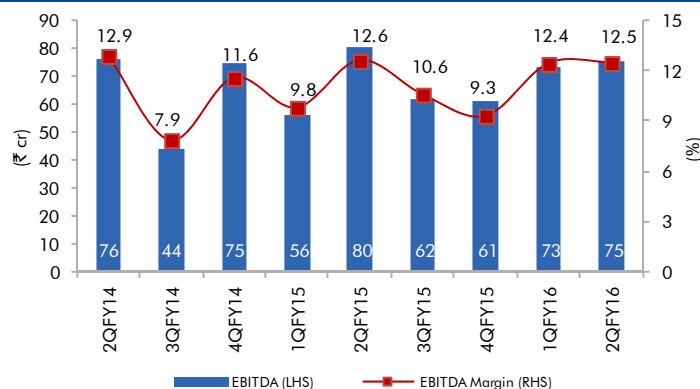
Source: Company, Angel Research

Performance below expectations

FCL's 2QFY2016 numbers have come in below our estimates. The top-line declined by 4.9% yoy to ₹605cr, which is below our estimate of ₹691cr. The decline is on account of lower commodity prices, which were passed on, resulting in lower realizations. In terms of volume growth, Electrical Cables posted modest growth numbers while Communication Cables posted a more than 20% yoy growth. The raw material cost declined by 178bp yoy to 72.1% of sales but the same was negated by 59bp yoy increase in employee cost to 4.3% of sales and 131bp yoy increase in other expenses to 11.1% of sales. This resulted in the EBITDA margin contracting by 12bp yoy to 12.5%. Other income during the quarter declined by 24.4% yoy to ₹28cr, but the same is in-line with our estimate of ₹27cr. As a result, the net profit declined by 17.8% yoy to ₹65cr as against ₹79cr in the same quarter of the previous year.

Exhibit 2: Revenue growth continues to disappoint


Source: Company, Angel Research

Exhibit 3: EBITDA margins declines further


Source: Company, Angel Research

Exhibit 4: Actual vs Angel's Estimates for 2QFY2016

Particulars	Actual (₹ cr)	Estimate (₹ cr)	% Variation
Total Income (₹ cr)	605	691	(12.4)
EBITDA (₹ cr)	75	96	(21.2)
EBITDA Margin (%)	12.5	13.9	(139)bp
Adjusted PAT (₹ cr)	65	80	(19.0)

Source: Company, Angel Research

Segment-wise performance

For 2QFY2016, revenue from the Electrical cables (EC) segment declined by 10% yoy to ₹491cr. This was owing to lower realization as the company had to pass on the benefit of lower copper prices to the customers. EBIT for the segment declined by 13.4% yoy and came in at ₹70cr, while the EBIT margin contracted by 55bp yoy to 14.2%.

The Communication cables (CC) segment revenue grew by 113.1% yoy to ₹110cr. EBIT increased by 668.3% yoy to ₹13cr, resulting in margin expanding by 824bp yoy to 11.4%.

The revenue from Continuous Copper Rods (CCR) segment declined by 91.0% yoy to ₹4cr during the quarter. The EBIT margins came in at 14.0% vs. 3.5% in 2QFY2015. The segment's contribution has been declining gradually since the company is reducing its exposure to third parties owing to thin margins and production is mainly for captive purpose.

Exhibit 5: Segment-wise performance

Y/E March (₹ cr)	2QFY16	2QFY15	% chg (yoy)	1QFY16	% chg (qoq)
Total Revenue					
A) Electrical Cables	491	546	(10.0)	502	(2.2)
B) Communications Cables	110	52	113.1	63	75.8
C) Copper Rods	4	39	(91.0)	23	(84.8)
D) Others	15	72	(79.7)	8	72.1
Total Net sales	605	637	(4.9)	588	2.9
EBIT					
A) Electrical Cables	70	80	(13.4)	81	(14.0)
B) Communications Cables	13	2	668.3	6	127.4
C) Copper Rods	0	1	(64.2)	0	345.5
D) Others	7	20	(61.9)	(18)	(141.0)
Total EBIT	90	103	(12.4)	68	31.9
EBIT Margin (%)					
A) Electrical Cables	14.2	14.7	(55)bp	16.1	(195)bp
B) Communications Cables	11.4	3.2	824bp	8.8	259bp
C) Copper Rods	14.0	3.5	1,046bp	0.5	1,352bp
D) Others	51.2	27.3	2,392bp	(215.3)	26,658bp

Source: Company, Angel Research

Investment arguments

Capex plans to complement revival in user industry

FCL serves varied user industries through its EC segment with contribution from the construction sector being the largest followed by industrial, automotive, power and agriculture sectors. The construction sector growth appears to be coming in from Tier 2 and Tier 3 cities rather than being restricted to larger cities. With the government determined on developing a robust and stable infrastructure and industrial activity expected to pick-up, potential demand outlook for the company's offering looks encouraging.

FCL has executed its capex plans which have led to higher capacity at its existing plants coupled with technological upgradation. In the CC segment, the company has been awarded a tender of ₹200cr by the National Optical Fibre Network (NOFN) backbone project and in order to service the tender, FCL has expanded its capacity at Urse and Goa from 8,000 km-a-month to 10,000 km-a-month.

Organic growth and diversifying portfolio to drive earnings

FCL has a wide range of products in its offering, ranging within speaker wires, to T5 tube lights and fittings in the lighting division. Further, FCL forayed into manufacturing of electrical products like electric motors and transformers with a separate dealer network for these products. The company has been expanding its presence in north and central India by gradually adding dealers and distributors. The company also has set up a new switchgear division that will initially make miniature circuit breakers. Given its wide distribution network and strong brand recall, we expect the company to take advantage of the same which will lead to higher earnings growth going ahead. Further, with an expansion of its product portfolio, FCL intends to change its legacy image of being a cable and wire manufacturer to a 'manufacturer of electrical products'.

Changing sales mix to boost margins

The company has expanded its product portfolio which includes high margin products which will improve realizations and margins. Further, FCL is gradually reducing its exposure to the copper rod segment as the surplus production was used for third party sales which have low margins. The company has increased its focus on creating brand awareness across product lines through increased advertisement expense and increasing distribution reach.

Healthy balance sheet

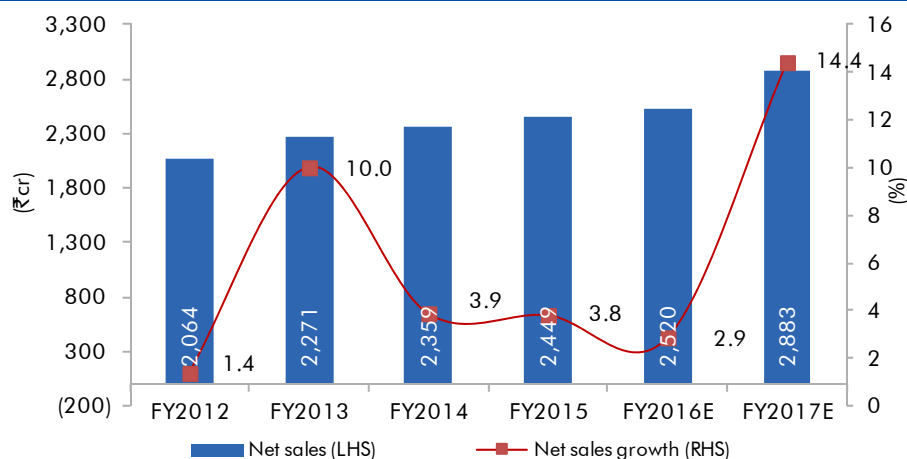
The company has been successful in its debt reduction plans and has been utilizing internal accruals to reduce debt. This will lead to saving in interest expense going ahead which will improve its profit. The cash generation from operating activities continues to be strong. The working capital days reduced to 34 days in FY2015, led by lower trade receivables days and higher payable days.

Financials

Net sales to grow at CAGR of 8.5% over FY2015-17E

The net sales for the company are expected to be driven by high single digit volume growth. We expect the net sales to grow at a CAGR of 8.5% over FY2015-FY2017E to ₹2,883cr.

Exhibit 6: Net Sales growth trend

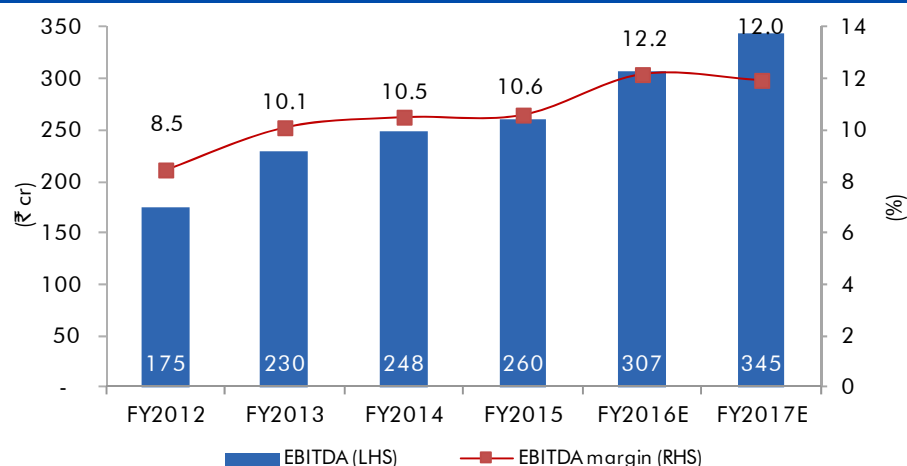


Source: Company, Angel Research

EBITDA to post CAGR of 15.2% over FY2015-17E

FCL's EBITDA, on back of decent top-line growth and improved operational efficiency, is expected to grow at a CAGR of 15.2% over FY2015-17E. The EBITDA is expected to rise from ₹260cr in FY2015 to ₹345cr in FY2017E and EBITDA margins are expected to be at 12.0% in FY2017E.

Exhibit 7: EBITDA and EBITDA margin trend

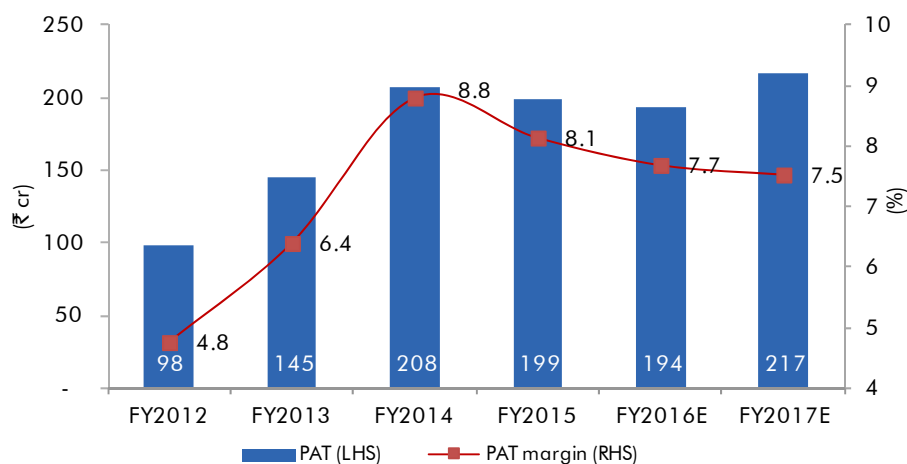


Source: Company, Angel Research

PAT to register modest CAGR of 4.3%

Despite decent top-line growth coupled with better operating performance the net profit growth is expected to grow at a modest CAGR of 4.3%, largely owing to higher tax rate.

Exhibit 8: PAT and PAT margin trend

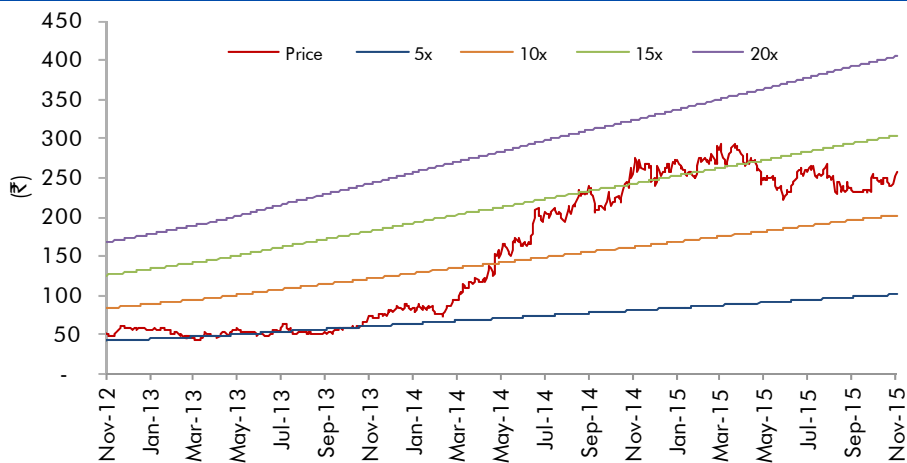


Source: Company, Angel Research

Outlook and Valuation

We expect the company’s top-line and EBITDA to post an 8.5% and 15.2% CAGR over FY2015–17E to ₹2,883cr and ₹345cr respectively with EBITDA margin at 12.0% in FY2017E. However, benefit of low material cost and interest outgo is expected to be offset by higher tax rate which will dent profitability. As a result, the bottom-line is expected to post a modest CAGR of 4.3% for the same period to ₹217cr. **We recommend a Neutral rating on the stock as it trades at fair valuations of 18.2x PE on FY2017E.**

Exhibit 9: One-year forward PE



Source: Company, Angel Research

Concerns

- Competition from the unorganized sector is a concern since the products available from them are relatively cheaper and they thus cannibalize into market volumes.
- Fluctuation in the price of copper, which is an essential raw material (~80% of total raw material), is a key concern as it would directly impact operational efficiency. Although prices have fallen recently, volatility in commodity markets persists.
- Slowdown in the user industry could hurt the company's volumes.

Company background

FCL is India's largest and leading manufacturer of electrical and communication cables. Its wire and cable products are used in applications such as automobile, lightning, cable TV, telephone and computers to industrial applications. The company mainly operates through 4 divisions; 1) Electrical cables, 2) Communication cables, 3) Continuous Cast Copper rods and 4) Others-comprising switches, compact fluorescent lamps manufactured and LED based lamps through its facilities set up at Roorkee, Goa, and Pune (at Pimpri, Urse).

Profit and Loss statement

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Gross sales	2,424	2,510	2,575	2,669	3,057
Less: Excise duty	153	151	126	149	174
Net Sales	2,271	2,359	2,449	2,520	2,883
% chg	10.0	3.9	3.8	2.9	14.4
Net Raw Materials	1,689	1,766	1,824	1,822	2,097
% chg	7.7	4.5	3.3	(0.1)	15.1
Personnel	85	85	94	103	121
% chg	21.7	0.3	10.8	9.9	17.2
Other Mfg costs	112	116	101	115	123
% chg	-	(4.0)	12.7	(13.3)	(6.8)
Other	156	144	170	173	198
% chg	-	7.2	(18.0)	(1.5)	(14.4)
Total Expenditure	2,041	2,111	2,189	2,213	2,538
EBITDA	230	248	260	307	345
% chg	31.4	8.1	4.7	18.2	12.3
EBITDA Margin	10.1	10.5	10.6	12.2	12.0
Depreciation & Amort.	47	48	64	55	63
EBIT	183	200	196	252	282
% chg	35.3	9.1	(2.0)	28.5	11.9
(% of Net Sales)	8.1	8.5	8.0	10.0	9.8
Interest & other Charges	13	14	13	9	7
Other Income	24	48	58	47	49
(% of Net Sales)	1.1	2.0	2.4	1.9	1.7
Recurring PBT	170	185	183	243	275
% chg	55.3	9.2	(1.3)	32.6	13.4
Exceptional Expense/(Inc.)	23	(10)	(23)	-	-
PBT (reported)	171	244	264	289	324
Tax	26	36	64	95	107
(% of PBT)	15.0	14.9	24.4	33.0	33.0
PAT (reported)	145	208	199	194	217
ADJ. PAT	145	208	199	194	217
% chg	47.9	43.0	(4.0)	(2.8)	12.1
(% of Net Sales)	6.4	8.8	8.1	7.7	7.5
Basic EPS (₹)	9.5	13.6	13.0	12.7	14.2
Fully Diluted EPS (₹)	9.5	13.6	13.0	12.7	14.2
% chg	48.0	43.0	(4.0)	(2.8)	12.1

Balance sheet

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
SOURCES OF FUNDS					
Equity Share Capital	31	31	31	31	31
Preference Capital	-	-	-	-	-
Reserves & Surplus	894	1,073	1,234	1,392	1,574
Shareholders' Funds	924	1,103	1,265	1,423	1,604
Total Loans	162	127	51	46	28
Other Long term liability	58	5	5	5	5
Net Deferred tax liability	34	30	30	30	30
Total Liabilities	1,179	1,265	1,351	1,504	1,667
APPLICATION OF FUNDS					
Gross Block	929	1,031	1,059	1,112	1,223
Less: Acc. Depreciation	487	535	599	654	717
Net Block	412	496	460	457	505
Capital Work-in-Progress	36	11	11	60	45
Goodwill	-	-	-	-	-
Long term Loans & Adv.	17	5	4	4	4
Investments	324	403	494	544	625
Other non-current assets	19	26	19	19	19
Current Assets	596	623	646	714	805
Cash	40	65	138	155	169
Loans & Advances	77	61	70	72	82
Inventory	330	352	319	351	398
Debtors	150	145	119	136	155
Other current assets	0	0	-	-	-
Current liabilities	225	299	282	294	337
Net Current Assets	372	324	363	420	468
Mis. Exp. not written off	-	-	-	-	-
Total Assets	1,179	1,265	1,351	1,504	1,667

Cash flow statement

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Profit before tax	171	244	264	289	324
Depreciation	47	48	64	55	63
(Inc.)/ Dec. in Working Capital	(53)	73	34	(40)	(34)
Less: Other income	(24)	(48)	(58)	(47)	(49)
Direct taxes paid	(26)	(36)	(64)	(95)	(107)
Cash Flow from Operations	114	280	239	163	197
(Inc.)/ Dec. in Fixed Assets	(88)	(77)	(28)	(102)	(96)
(Inc.)/ Dec. in Investments	(100)	(67)	(91)	(49)	(82)
Other income	24	48	58	47	49
Cash Flow from Investing	(164)	(96)	(60)	(105)	(129)
Issue of Equity	-	-	-	-	-
Inc./(Dec.) in loans	33	(93)	(75)	(5)	(18)
Dividend Paid (Incl. Tax)	(21)	(29)	(32)	(36)	(36)
Others	28	(38)	1	-	-
Cash Flow from Financing	40	(160)	(106)	(41)	(54)
Inc./(Dec.) in Cash	(9)	25	74	17	14
Opening Cash balances	49	40	65	138	155
Closing Cash balances	40	65	138	155	169

Key ratios

Y/E March	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Valuation Ratio (x)					
P/E (on FDEPS)	27.2	19.0	19.8	20.4	18.2
P/CEPS	20.6	15.4	15.0	15.9	14.1
P/BV	4.3	3.6	3.1	2.8	2.5
Dividend yield (%)	0.5	0.6	0.7	0.8	0.8
EV/Sales	1.7	1.5	1.4	1.3	1.1
EV/EBITDA	16.3	14.6	13.0	10.8	9.2
EV / Total Assets	3.2	2.9	2.5	2.2	1.9
Per Share Data (₹)					
EPS (Basic)	9.5	13.6	13.0	12.7	14.2
EPS (fully diluted)	9.5	13.6	13.0	12.7	14.2
Cash EPS	12.6	16.8	17.2	16.3	18.3
DPS	1.2	1.6	1.8	2.0	2.0
Book Value	60.5	72.2	82.7	93.1	104.9
Dupont Analysis					
EBIT margin	8.1	8.5	8.0	10.0	9.8
Tax retention ratio	0.9	0.9	0.8	0.7	0.7
Asset turnover (x)	2.9	3.0	3.5	3.4	3.5
ROIC (Post-tax)	20.0	21.6	20.9	22.6	22.8
Cost of Debt (Post Tax)	7.0	9.7	19.1	13.1	15.9
Leverage (x)	(0.2)	(0.3)	(0.5)	(0.5)	(0.5)
Operating ROE	17.1	17.9	20.0	18.2	19.5
Returns (%)					
ROCE (Pre-tax)	15.5	15.8	14.5	16.7	16.9
Angel ROIC (Pre-tax)	23.5	25.4	27.6	33.7	34.0
ROE	15.7	18.8	15.8	13.6	13.5
Turnover ratios (x)					
Asset Turnover (Gross Block)	2.4	2.3	2.3	2.3	2.4
Inventory / Sales (days)	49	53	50	48	47
Receivables (days)	21	23	20	20	20
Payables (days)	37	45	48	48	48
WC cycle (ex-cash) (days)	53	40	34	38	38
Solvency ratios (x)					
Net debt to equity	(0.2)	(0.3)	(0.5)	(0.5)	(0.5)
Net debt to EBITDA	(0.9)	(1.4)	(2.2)	(2.1)	(2.2)
Interest Coverage (EBIT/Int.)	13.7	13.8	15.2	27.9	43.0

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Disclosure of Interest Statement

Finolex Cables

1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)