RETAIL EQUITY RESEARCH

# FINOLEX CABLES LTD

## Electrical Equipments

**BSE CODE:** 500144 **NSE CODE:** FINCABLES
**Bloomberg CODE:** FNXC IN **SENSEX:** 21,239

# BUY

**CMP** Rs60.9 **TARGET** Rs77.4 **RETURN 27%**

5th November, 2013

## Getting past 'The derivative affair'

**Even during tough economic scenario of FY09-13, Finolex Cables Ltd (FCL) generated healthy business growth were sales (ex-copper rods division) grew by 20% CAGR. Still stock performance was muted due to derivative contracts loss and forex fluctuation loss (totally Rs3bn booked during FY08-FY13). Now derivative losses are completely off the books as all such contracts have extinguished. Also ECB's have reduced to Rs362mn from Rs1827mn, which drastically reduces risk of forex fluctuation losses. All these factors and a reduced D/E at 0.2x from 0.5x make a strong case for higher valuations. FCL is currently trading at attractive valuation of 6.1x and 5.5x on FY14E and FY15E respectively, which is at a steep discount of 56% to its average 1yr Fwd valuations during FY03-FY07 (pre forex loss period). We currently value FCL with a target P/E of 7x on FY15E earnings, which is its average valuation since FY10 and recommend a BUY rating.**

## Exceptional losses are off the books...

FCL's worries were largely on account of its forex fluctuation loss (Rs1.8bn) and derivative contracts loss (Rs1.2bn) booked during FY08-FY13. Considering outstanding External Commercial Borrowing (ECB) of just Rs362mn, risk of further Forex fluctuation losses have subsided. In the case of derivatives loss, as no outstanding derivatives exist, further losses are unlikely. This augurs well for FCL's valuation which had taken a hit owing to such losses.

## In sound operational footing

FCL has consistently generated decent operational cash flows of ~Rs1.5bn per annum which aided D/E to decline from 0.5x to 0.2x, despite incurring a Rs2.3bn capex during FY09-FY13. In FY13, EBITDA margins and PAT margins improved to 10.1% & 6.4% respectively, the highest since FY09. On the whole, better sales mix, stability in INR and lower copper prices would help FCL in maintaining margins.

## Long-term structural driver still in place....

In a market characterised by fierce competition and under tough economic scenario during FY09-13, FCL generated healthy business growth were sales (ex-copper rods division) grew by 20% CAGR. FCL's, Electrical Cables Segment (ECS), performance is likely to improve along revival in user-industries and benefit from customers turning to quality products. The turnaround in Communication Cables Segment (CCS) division is impressive as it sustained its growth momentum of 25% (FY13) in Q1FY14 too. We anticipate this segment to grow at 25.3% in FY14E and 23.1% in FY15E driven primarily by coaxial cables and optic fibre cables.

## Valuations

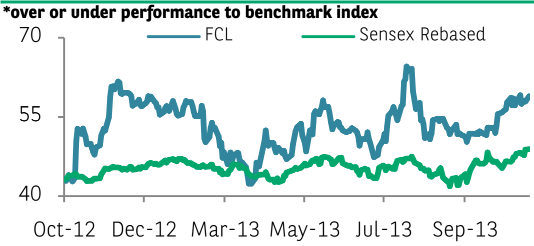
At CMP of Rs60.9, FCL is trading at an attractive valuation of 6.1x and 5.5x on FY14E and FY15E EPS of Rs10 and Rs11.1 respectively. Considering FCL's larger worries of Derivative losses are behind, we see a strong fundamental reason for a sharp rebound in valuation. But given the broad economic challenges and relative mid-cap valuations we currently value FCL conservatively at a target P/E of 7x. We recommend BUY with a target price of Rs77.

| Company Data | |
|---|---|
| Market Cap (mn) | Rs9,312 |
| Enterprise Value (mn) | Rs10,937 |
| Outstanding Shares (mn) | 152.9 |
| Free Float | 50% |
| Dividend Yield | 2.3% |
| 52 week high | Rs65.9 |
| 52 week low | Rs41.3 |
| 6m average volume (mn) | 0.4 |
| Beta | 0.9 |
| Face value | Rs2 |

| Shareholding % | Q4 FY13 | Q1 FY14 | Q2 FY14 |
|---|---|---|---|
| Promoters | 35.78 | 35.78 | 35.78 |
| FII's | 0.96 | 0.99 | 1.10 |
| MFs/Insti | 11.27 | 10.47 | 10.21 |
| Public | 30.61 | 31.72 | 30.94 |
| Others | 21.38 | 21.04 | 21.97 |
| Total | 100.0 | 100.0 | 100.0 |

| Price Performance | 3mth | 6mth | 1 Year |
|---|---|---|---|
| Absolute Return | 17.8% | 16.1% | 38.6% |
| Absolute Sensex | 10.7% | 8.0% | 13.2% |
| Relative Return* | 6.4% | 7.6% | 22.4% |

***over or under performance to benchmark index**




| Y.E Mar (Rs bn) | FY13A | FY14E | FY15E |
|---|---|---|---|
| Sales | 22.7 | 24.8 | 27.8 |
| Growth (%) | *10.0* | *9.2* | *12.0* |
| EBITDA | 2.3 | 2.4 | 2.8 |
| Growth (%) | *28.2* | *3.4* | *16.7* |
| PAT Adj | 1.7 | 1.5 | 1.7 |
| Growth (%) | *25.1* | *-9.1* | *10.6* |
| EPS | 11.0 | 10.0 | 11.1 |
| Growth (%) | *25.1* | *-9.1* | *10.6* |
| P/E | 5.5 | 6.1 | 5.5 |
| P/B | 1.0 | 0.9 | 0.8 |
| EV/EBITDA | 4.8 | 4.7 | 4.0 |
| RoE (%) | *16.8* | *15.4* | *15.0* |
| D/E | 0.2 | 0.2 | 0.2 |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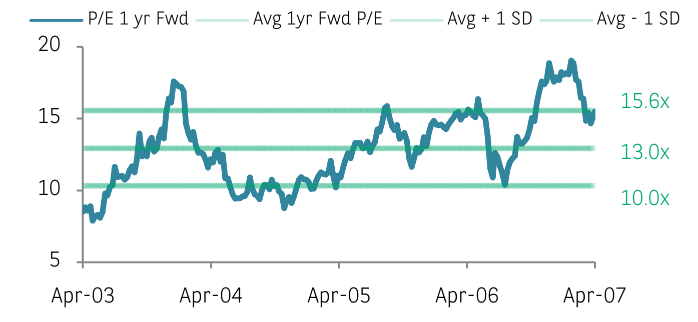
# Valuations

## Trading at a steep discount

FCL, at the CMP of Rs60.9 is trading at 1yr fwd P/E of 5.7x, which is at a steep discount of 56% its average 1yr Fwd valuations during FY04-FY07 and 18.5% discount to its average valuations since FY10.

As depicted in the graph below, FCL used to trade at healthy valuations of 13x one year forward P/E, its four year average multiple during FY04-07. During the same period, earnings grew at a CAGR of 33%. But such healthy valuation could not be maintained as FCL posted losses because of adverse macro economic conditions, higher inventory costs and heavy forex losses in FY09.

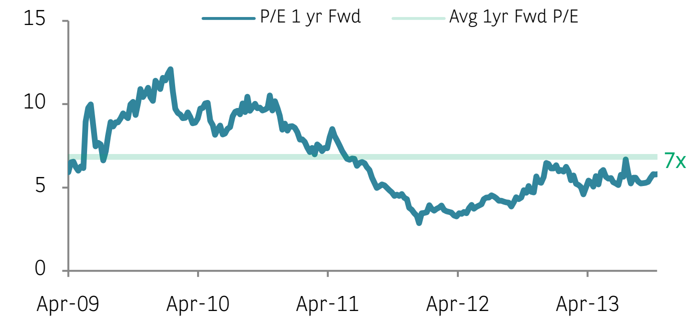
### P/E Trend Pre-Forex loss




*Source: Geojit BNP Paribas Research, Bloomberg.*

Post a bleak FY09, FCL continued its growth momentum in sales (Ex-copper rods) by registering growth of 20% CAGR during FY09-FY13. Over the same period PAT grew from –Rs355mn to Rs1,453mn and PAT margins peaked to 6.4% in FY13.

### P/E Trend-line




*Source: Geojit BNP Paribas Research, Bloomberg.*

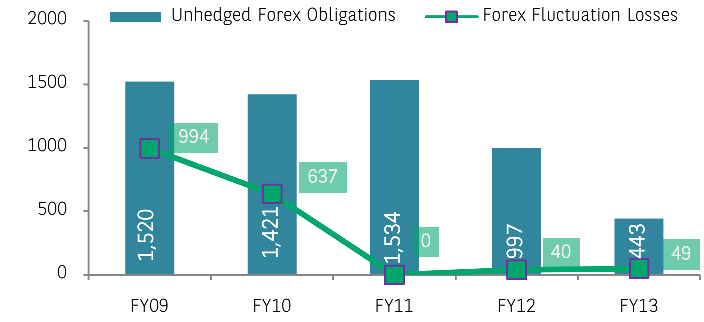
Yet, valuation continued to correct largely on account of forex related losses. At current price, FCL is trading at low multiple of 5.7x, which is cheap considering its relative strong fundamentals.

## Forex fluctuation losses to subside on ECB payoff

As touched upon earlier, FCL's worries are largely on account of its losses on foreign exchange fluctuations and on derivative contracts over FY08-FY13.

During FY09-FY11, amidst higher volatility in rupee movement post the financial crisis, losses on account of forex fluctuation were high. FCL carried high Forex obligation including External Commercial Borrowings (ECB) to the extent of Rs1.8bn in books and this comprised most of the unhedged forex obligation. But as depicted in the graph below, losses subsided as loans were paid off. As on FY13, FCL had Rs362mn worth of ECB in books which along with some payables, remain unhedged. As Rs362mn ECB is scheduled for repayment by FY15E, we believe FCL would be incurring an aggregate of Rs40-75mn forex fluctuation losses by FY15E which considering FCLs large book size, impact would be negligible.

### Unhedged obligations and forex losses




*Source: Company, Geojit BNP Paribas Research.*

## Exceptional losses are off the books...

During FY08-FY13, FCL had booked cumulative derivative losses of Rs1,231mn. As given in the table below it is hard to imagine the need for such high forex derivative contracts. But we understand that management has taken corrective steps and have adopted sound risk management policies.

| Outstanding Contracts (Rs bn) | FY08 | FY09 | FY10 | FY11 | FY12 | FY13 |
|---|---|---|---|---|---|---|
| Forex Fwrds/Options | 9.2 | 3.4 | 1.4 | 0.8 | - | - |
| Interest Rate Swaps | 4.9 | 5.3 | 3.5 | 0.9 | 0.2 | - |
| Currency swaps | 2.5 | 1.5 | 1.8 | 1.8 | - | - |
| Derivative Losses | 0.1 | 0.1 | 0.1 | 0.3 | 0.4 | 0.2 |

*Source: Company, Geojit BNP Paribas Research*

The associated losses during FY08-13, made management to rectify its steps, including making changes at top management level and reducing exposure over the years.

## FCL... getting past 'the derivative affair'

Over FY08-FY13, FCL recognised its entire losses attributed to contracts and has no outstanding derivative contracts, hence further losses are unlikely. This augurs well for FCL's valuation which had taken a hit owing to these derivative losses.

As there will be no further derivative losses the PBT will get additional boost but the benefit to PAT will be lower due to expiry of tax exemption from Roorkee facility. Taking this into account, we project higher tax rate for FY14E and FY15E. Our projections for PAT margins in FY14E and FY15E are 6.2% and 6.1% respectively. We have factored lower PAT margins in FY15E as MAT credit expires taking the effective tax rate to higher levels of 26% for FY15E v/s 23% in FY14E & 15% in FY13.

## A rebound in valuations expected...

At CMP of Rs60.9, FCL is trading at an attractive valuation of 6.1x and 5.5x its FY14E and FY15E earnings. Considering the closure of derivative contracts along with associated losses being fully recognised we see strong fundamental reasons for a rebound in valuations. Yet, given the present relative valuations in the mid-cap space, we have been conservative and value FCL with a target P/E of 7x. This happens to be FCL's average valuations since FY10. We recommend BUY with a target price of Rs77.

## Peer Comparison

| Company (mn) | Mar. Cap | FY13-15E EPS CAGR | FY15E P/E |
|---|---|---|---|
| Havells India | 93,912 | 19 % | 17.0 |
| V-Guard Ind. | 14,364 | 31 % | 13.4 |
| Apar India Ltd | 4,420 | 12% | 3.2 |
| Finolex Cables | 8,870 | 8 % | 5.5 |

*Source: Bloomberg, Geojit BNP Paribas*

# Investment Rationale

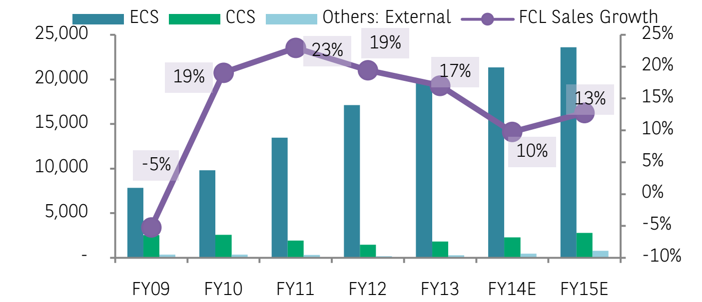
## Ranking high on brand recognition ladder

In a market characterised by fierce competition, Finolex is a major player in the cables market and has become a brand with excellent top of mind recall. Two factors that define the brand 'Finolex' have been its quality consciousness and marketing initiatives. In order to maintain technical superiority and quality, FCL's strategy to employ backward integration of key inputs like copper rods and optic fibre, has played out well in terms of quality and in delivering stable margins during the slowdown. Over FY09-FY13, sales (Ex-Copper Rods) soared by 20% CAGR supported by FCL's advertising and marketing initiatives. FCL had pioneered advertising on T.V and it has made continuous investment in ads both in national T.V and print media. Going forward, we believe FCL top-line is poised for growth driven by rising demand from user industries for branded wires & cables and expect top-line (Ex Copper Rods) to grow by 11.3% CAGR over FY13-FY15E.

## FCL in sound operational footing

FCL's top-line is driven principally by two segments, namely Electrical Cables Segment (ECS) and Communication Cables Segment (CCS), contributing 87% and 8% respectively. Copper Rods segment and "Others" segment are largely meant for captive consumption. Yet, a smaller portion of these segments are third party sales. For a better analysis of FCL's top-line performance, we consider the main divisions, comprising – ECS, CCS and External sales of 'Others' segment.

### Segment-wise Sales Trend (Ex Copper Rods)

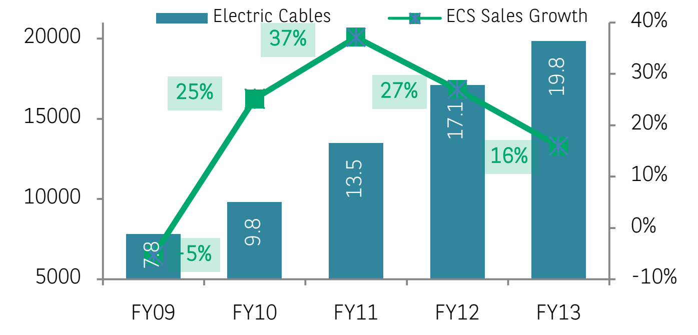



*Source: Company, Geojit BNP Paribas Research*

## ECS to remain resilient in tough times...

ECS, being the main segment, has a greater say in FCL's top-line performance. Post Lehman, on the back of significant growth achieved by domestic user industries like construction, auto and industrial, FCL's top-line grew at a higher momentum through FY09-FY12 (*as exhibited in the graph below*).

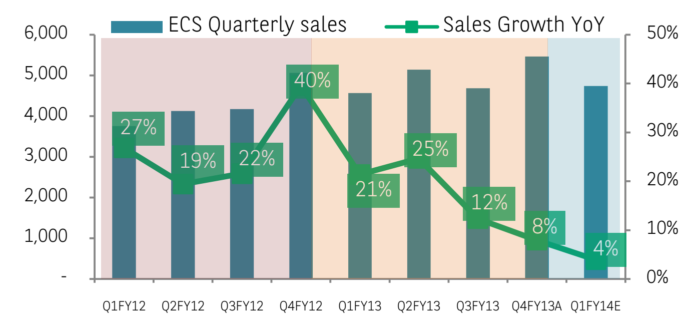
### ECS Annual Sales Trend (Rs bn)




*Source: Company, Geojit BNP Paribas Research*

In FY13, as user industries were affected by the slowdown, segment sales still grew by a respectable 16% in FY13, aided by strong performance in the first half of the year.

### ECS Quarterly Sales Trend




*Source: Company, Geojit BNP Paribas Research*

Going by the quarterly numbers, the higher growth momentum was sustained until H2FY13, post which growth on YoY basis declined in concurrence with pronounced effects of domestic issues like policy logjam and tighter liquidity. Such effects of slow down are likely to spill-over through H1FY14E as reflected in the Q1FY14 results, where Segment sales grew by a mere 4% YoY compared to 21% YoY in Q1FY13. FCL has incurred Rs1.6bn as capital expenditure for ECS during FY09-FY13. During this period, Asset Turnover ratio of electrical cables segment improved to 3.2x from 2.4x. FCL plans to expand its capacity at a total budget of Rs1000mn at its Roorkee plant. This plant is expected to be operational by FY14E and would further complement future demand for the segment.

## Good monsoons to revive user industries

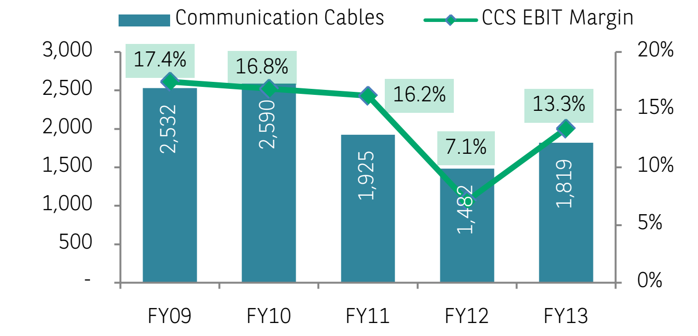
The situation is poised for an improvement in H2FY14E, aided by better monsoons, bringing the much needed boost to user industries affected by the slowdown and also indicating that a further decline is unlikely. Yet the pickup in H2FY14E would be slower than FY13, as tight liquidity environment hinders new investments. Along these lines, we anticipate the segment to grow by 7.6% in FY14E and further improve by 10.5% in FY15E. We anticipate that in FY15E, FCL could see respectable sales numbers post general elections scheduled in May, 2014 and a lower interest rate environment can be an additional catalyst for a better year.

On the margin front, EBIT stood at Rs518.6mn in Q1FY14, 6% lower than Q1FY13 EBIT of Rs 552.4mn. The EBIT margins contracted by 120 bps YoY to 10.9% in Q1FY14. We anticipate the margins to hover around 11.5%-12% in FY14E and marginally expand to 12%-12.5% in FY15E, as demand picks.

## Communication Cables showing strong rebound

This segment contributes 8% of total revenue and has shown 23% growth in sales in FY13 over de-growth of -23% & -26% in the preceding two years. The preceding two years were impacted by minimal capex and uncertainties in the telecom space in India. Against a low base, FY13 growth in top-line signalled a bottoming-out, supported by higher coaxial cable sales and telecom service providers incurring capex on commencement of 4G services. The segment had sustained its growth momentum in Q1FY14 too. The segment reported YoY sales growth of 26% in Q1FY14 against 8% in Q1FY13.

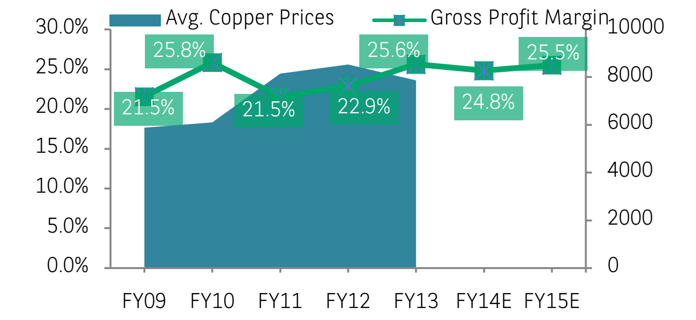
### Communication Cable Segment Sales




*Source: Company, Geojit BNP Paribas Research*

We anticipate the segment to grow at 25.3% in FY14E and 23.1% in FY15E driven primarily by cable digitization and National Optic Fibre Network project. EBITDA margins too expanded significantly to 13.3% in FY13 compared to 7.1% in FY12. As per the latest quarter results, margin stood higher at 12.2%, an improvement of 620 bps from Q1FY13.This was as a result of a favourable sales mix. We believe the segment could maintain a better margin profile on the back of higher composition of Optic Fibre cables (44%) and Coaxial cables (33%) on segment sales, for the next two years.

## OPM and Copper Price trend




*Source: Company, Geojit BNP Paribas Research*

## Cable digitisation to feed coaxial cable demand

The process of full cable TV digitisation is proposed to be over by December 2014. As per ministry of Information & Broadcasting, 75 million Set Top Boxes (STB) are required for the III and IV phases for cable digitisation compared to 9.5 million STBs sold in Phase I and II. This augurs well for FCLs coaxial cable demand in the coming quarters.

## 'NOFN' to restart Optic Fibre cable Industry

National Optical Fibre Network (NOFN) project aims to connect 2.5lakh Panchayats via optic fibre network. This would make a revival of optic fibre demand in India. The process of bidding for +400,000kms of Optic Fibre had started on 3rd April, 2013. It's learned that the timeframe could possibly be extended to 2017/2018 from the initially set deadline of Oct, 2013 and the project being rolled out in 3 phases. Nevertheless we could see FCL gaining as much as Rs4,000mn from the contract, spread over the next 3-4 years. Besides, the tender for the NFS project for Armed Forces and demand emanating from private telecom service providers would also drive the market in the near future. FCL's timely decision to upgrade and enhance its production capacity and J.V with Corning Incorporated works well to complement higher demand for the coming 2-3 years.

During FY09-FY13, communication cables segment witnessed its Asset Turnover ratio declining to 0.8x from 1.1x. This was on account of FCL's strategy to replace Jelly Filled Telephone cables with high margin Optic fibre cables. Resultantly, the contribution of Communication cables segment to FCL's total revenue, declined from 19% to 8%. As touched upon earlier, potential for Optic fibre cable is huge in India and FCL's decision to increase capacity at its Goa facility at a cost of Rs500mn in FY14E, would complement the rising demand

## The copper rupee trade-off...

As bulks of FCL's product portfolio are copper based cables, copper prices are a decisive factor for FCL's operating margin (OPM).

During FY10, FCL benefitted from price hikes that aided its OPM to expand to 26% as depicted in the graph below. But subsequently, the OPM margins dipped owing to higher copper prices. Aided by ~8% decline in Copper prices in FY13, OPM revived to its FY10 levels.

As mentioned, copper prices constitute the major portion of raw material cost and it's a function of Copper LME prices and USD:INR movements. Though current copper prices are likely to soften further, we factor FY14E Gross Profit Margins to dip by 80bps to 24.8%. Assuming Rupee to stabilize at an average of Rs59-Rs63 vs. USD in FY14E, any benefit accruing to the decline in copper prices will be offset by ~9-13% YoY weakening of rupee in FY14E. We believe gross profit margin would likely move up to 25.5% in FY15E as projected growth of top-line will yield positive efficiency benefits from better capacity utilisation and sales mix.

## Improved Sales mix to support margins

FCL registered average margins of 7% during FY10-FY13 in contrast to -3% in FY09. In FY13, EBIT margins improved by 100bps to 8%, aided by better margin profile in all its segments.

CCS reported 620bps jump in margins while ECS reported 80bps jump on a YoY basis. Though ECS segment benefitted from lower copper, significant jump in CCS margins were due to better composition of high margin optic fibre cables (44%) and coaxial cables (33%) on total segment sales. The 'Others' segment is likely to breakeven in FY14E and move to 1-3% margin territory in FY15E. This segment has reduced its loss from -8.4% in FY09 to -1.4% in FY13. The margins for Copper rods division however hovered at 0.6% both in FY12 & FY13. Yet, the margins in FY13 were likely to have been lower as copper prices de-grew by 8%. But FCL's decision to reduce external sales in FY13 by 47% on YoY basis, helped sustain segment margins. Though copper prices are expected to trend lower than current levels, a weaker rupee could eventually raise the cost of revenue. Higher depreciation led by Rs1.4bn FY14 capex would lead to lower EBIT margins at 7.4% in FY14E, 70bps lower on YoY basis. In FY15E, higher top-line growth and efficiency benefits would trigger the EBIT margins to expand to 7.7%.

## CFL & Switches

FCL has expanded into consumer product segments which are complimentary to the electrical cables market. The products, switches and CFL lights, are promoted under "Finolex" brand name and leverage its wide distribution network for sales. The segment sales grew by 100% in FY13, in value terms. The co: has plans to improve its distribution coverage and expand its product portfolio to LED lights too. Though the segment contributes ~1% to the top-line and is in its nascent stage, FCL's effort to diversify would contribute to the top-line in the future.

## Notable Management Initiatives

### Solar plant to arrest power cost

FCL expects to commission a 5MW solar power plant at its Urse facility for captive consumption at total capex of Rs400mn. The initiative would enable FCL to cap its power cost at levels that would lead to savings of Rs135mn in Power and fuel cost per annum as it gets operational by Q4FY14E. Considering the higher cost of fuel in Maharashtra and likelihood that this would further increase in future, management initiative to address the issue, is a welcome move.

### New products in pipeline

FCL has a wide portfolio of products and is a total cables solution company. In FY13, FCL introduced new lamp models including LED lighting systems meant for home, commercial and street lighting. The company also intends to enter the switchgear segment and is scheduled to launch products within MCB, ELCB and MCCB range in FY14E.

### Expansion Projects under way

FCL is undergoing capital expenditures to build capacity in Optic fibre and electrical cables segment. Apart from Rs400mn envisaged for the power plant, FCL is likely to incur further capex of Rs1000mn in FY14E.

| Product Category | Facility | Tot.Capex | Completion |
|---|---|---|---|
| 5MW Power Plant | Urse | Rs400mn | Q4FY14E |
| Electrical Cables | Roorkee | Rs1000mn | Q4FY14E |
| Optic Fibre | Goa | Rs500mn | FY14E |

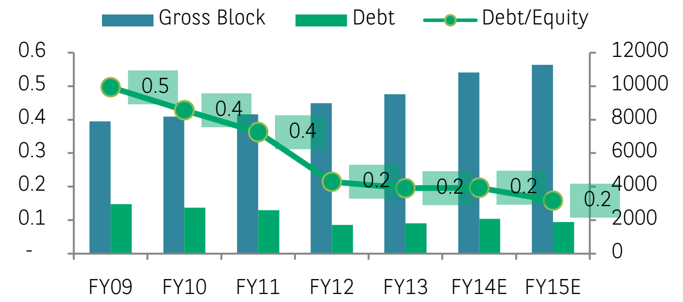
We believe the capex incurred on optic fibre facility and electrical cables would complement the impending demand arising from revival of user industries in electrical cables and telecom industry's demand for optic fibre cables.

## Financials

### Decent Cash Flow aided debt payoffs and capex

FCL's ability to generate decent operational cash flows of ~Rs1.5bn per annum has aided D/E to decline from 0.5x to 0.2x while gross block grew at a CAGR of 5.2% over FY09-FY13.

Debt Payoff & Asset addition




*Source: Company, Geojit BNP Paribas Research.*

FCL had recognised derivative losses to the tune of Rs1.2bn in books, during FY08-FY13, of which Rs605.6mn is still outstanding. The outstanding amount is expected to be paid off in 2-4 yrs timeframe. We have factored the payoff of this liability on derivative contracts, along with capex and debt repayment scheduled for the immediate two years. We believe the net cash and liquid instruments position in FCL's balance sheet to be within a healthy range of Rs1.5bn-Rs2bn in FY14E-FY15E.

FCL managed sales growth (Ex copper rods) of an impressive 19.6% CAGR through FY09-FY13. Post a bleak FY09, aided by lower copper prices and lower forex fluctuation loss, EBITDA margins peaked to 10.1% in FY13 which is an improvement of 300bps over the FY09-FY13 average. During the same period, PAT margins too expanded to its highest levels of 6.4% in FY13, an improvement of 400bps over the average. This was contributed by declining derivative loss and a 48% decline in interest costs.

Over FY13-FY15E, we factor sales (ex copper rods) to grow by a lower 11.3% after considering the macro environment to have its toll on the overall sales for FY14E. Yet, given the boost that the impending general elections could have on capex decisions, we have built a better demand scenario in FY15E. As touched upon earlier, we have built a marginally lower EBITDA margin in FY14E on account of higher raw material cost influenced by rupee depreciation. Yet, margins are likely to pick up by FY15E to 10% driven by efficiency benefits bought in by higher sales and favourable sales mix.

Our projection factors a higher depreciation charge on the capex likely to be incurred by FCL and a marginal increase of 10% and 8% in interest cost for FY14E and FY15E. Consequently, we expect FCL to register PAT margins of 6.2% and 6.1% for FY14E and FY15E respectively. PAT margins for FY15E would also be impacted by the higher tax rate as MAT credit expires by FY14E and coupled with tax exemption expiry at Roorkee facility could contribute a higher effective tax rate of 26% in FY15E in contrast to 15% and 23% in FY13 and FY15E respectively.

FCL reported ROE and ROCE of 16.8% and 11.3% in FY13 against the average of 12% and 9% post negative returns in FY09. On the whole, considering the macro environment, FCL is likely to be in a better operational footing that would put earlier worries of derivative losses and higher debt behind us.

| Financials | FY12 | FY13 | FY14E | FY15E |
|---|---|---|---|---|
| Sales Growth ex-copper (%) | *19.5* | *17.0* | *9.8* | *12.8* |
| EBITDA Margin (%) | *8.7* | *10.1* | *9.6* | *10.0* |
| Net Profit Margin (%) | *4.8* | *6.4* | *6.2* | *6.1* |
| ROE (%) | *12.9* | *16.8* | *15.4* | *15.0* |
| D/E (x) | 0.2 | 0.2 | 0.2 | 0.2 |

## Risks

- Delay in reform measures, tighter liquidity and worsening macro fundamentals could lead to a slowdown of user industries.
- Copper price fluctuations and rupee volatility would derail margin expectations.
- Competition from unorganised sector negatively impinging sales and margins.

## Company Profile

Finolex Cables Ltd (FCL), the flagship company of Finolex Group was established in 1958, in Pune. It is one of India's largest manufacturer of electrical and telecommunication cables. FCL holds a strong brand image and value. The company has manufacturing facilities at Pimpri and Urse in Pune as well as at Goa & Uttarakhand and operates under three main divisions namely: ECS, CCS, CCR and Others.

### ECS

Electrical Cables Segment (ECS) segment contributes 87% of total turnover. Key user industries are construction, industrial, auto, agriculture, and infrastructure (power) where the construction activity has the highest weightage on segment sales. The products include **PVC insulated cables** meant for electrification of industrial establishments, consumer electric goods and submersible pumps and motors, **cables** for UPS, Auto battery and **low/high voltage cables** used in power distribution purpose. In power cables category FCL has the ability to manufacture cables within the range of 1.1kV to 66kV. This segment faces significant competition from the unorganised sector producing low quality and low cost cables. FCL did benefit from the introduction of VAT and further, GST rollout would help in further consolidation in the market benefitting major players like FCL. FCL has joint venture with J-Power Systems enabling it to compete in Power cables market. Thus far FCL has certifications to manufacture cables to the extent of 220kV range and has helped FCL to participate in tenders both domestically and abroad.

### CCS

Communication cables segment (CCS) comprises new generation cables and traditional telephone cables. The new generation cables are mostly copper based and glass-based and include products like Optic fibre cables, coaxial cables, LAN cables, switchboard cables and V-SAT cables catering to demands from the telecom industry. The traditional telephone cables include JFTC cables connecting landline connections to telephone exchange.

The FCL management has successfully shifted its focus from JFTC to Optic fibre cables considering the low demand scenario and inculcated broadband feature to its JFTC cables to aid the modest demand coming from public sector and certain private sector enterprises. This move was instrumental for the turnaround. The joint venture with Corning SAS, Corning Finolex Optical Fibre private limited had commenced its operation during the last quarter of FY13. Corning Inc of USA is the inventor of glass fibre and is the largest player to manufacture glass and fibre in the world which benefits FCL in meeting technological and market based challenges.

### CCR

Continuous Copper Rods (CCR) plant in Goa supports FCL's requirement for copper rods of desired quality. The surpluses, over captive consumption, are allocated as third party sales. FCL procures copper cathodes locally under long term supply contracts. This is later converted to copper rods for feeding its cables segment. The total sales for the segment contribute 4% to FCL's FY13 revenue. The share of third party sales has contracted to 10.6% in FY13 from 20% in FY12. As value addition has been lower, the margins too hovered around 0.1%-1.5% during the period FY09-FY13. Expansion of cable capacity at its existing plants and J.V with J-Power Systems Corp would result in higher capacity utilisation aiding future margins.

## Standalone Financials

### Profit & Loss Account

| Y.E Dec (Rs mn) | FY11A | FY12A | FY13A | FY14E | FY15E |
|---|---|---|---|---|---|
| **Sales** | 20,358 | 20,642 | 22,707 | 24,787 | 27,765 |
| *% change* | *25.8* | *1.4* | *10.0* | *9.2* | *12.0* |
| EBITDA | 1,734 | 1,792 | 2,297 | 2,374 | 2,770 |
| *% change* | *32.4* | *3.3* | *28.2* | *3.4* | *16.7* |
| Depreciation | 388 | 395 | 466 | 540 | 641 |
| EBIT | 1,347 | 1,397 | 1,830 | 1,834 | 2,129 |
| Interest | 191 | 261 | 134 | 148 | 159 |
| Other Income | 261 | 320 | 242 | 300 | 300 |
| PBT | 1,072 | 1,093 | 1,708 | 1,987 | 2,270 |
| *% change* | *20.2* | *1.9* | *56.3* | *16.3* | *14.3* |
| Tax | 205 | 111 | 255 | 457 | 579 |
| *Tax Rate (%)* | *19* | *10* | *15* | *23* | *26* |
| Reported PAT | 867 | 982 | 1,453 | 1,530 | 1,691 |
| Adj* | (344) | (364) | (230) | - | - |
| Adj PAT | 1,212 | 1,346 | 1,683 | 1,530 | 1,691 |
| *% change* | *79.2* | *11.0* | *25.1* | *(9.1)* | *10.6* |
| No. of shares (mn) | 153 | 153 | 153 | 153 | 153 |
| EPS (Rs) | 8 | 9 | 11 | 10 | 11 |
| *% change* | *79.2* | *11.0* | *25.1* | *(9.1)* | *10.6* |
| DPS (Rs) | 0.8 | 0.9 | 1.4 | 1.4 | 1.4 |
| CEPS (Rs) | 10 | 11 | 14 | 14 | 15 |

### Balance Sheet

| Y.E Dec (Rs mn) | FY11A | FY12A | FY13A | FY14E | FY15E |
|---|---|---|---|---|---|
| Cash | 213 | 490 | 398 | 400 | 400 |
| Accounts Receivable | 1,302 | 1,141 | 1,497 | 1,698 | 2,054 |
| Inventories | 2,808 | 2,811 | 3,296 | 3,677 | 4,137 |
| Other Current Assets | 1,418 | 956 | 1,841 | 2,036 | 2,858 |
| Investments | 2,090 | 2,189 | 2,174 | 2,234 | 2,334 |
| Gross Fixed Assets | 8,129 | 8,874 | 9,164 | 10,464 | 10,914 |
| Net Fixed Assets | 4,033 | 4,292 | 4,121 | 4,881 | 4,690 |
| CWIP | 188 | 120 | 357 | 357 | 357 |
| Intangible Assets | 0 | 0 | 0 | 0 | 0 |
| Def. Tax (Net) | (310) | (326) | (345) | (365) | (385) |
| Other Assets | 143 | 161 | 357 | 357 | 357 |
| **Total Assets** | 11,886 | 11,834 | 13,697 | 15,276 | 16,803 |
| Current Liabilities | 2,750 | 1,754 | 2,024 | 2,064 | 2,253 |
| Provisions | 698 | 529 | 793 | 745 | 605 |
| Debt Funds | 1,262 | 1,545 | 1,623 | 1,894 | 1,894 |
| Other Liabilities | - | 2 | 14 | 14 | 14 |
| Equity Capital | 306 | 306 | 306 | 306 | 306 |
| Reserves and Surplus | 6,869 | 7,698 | 8937 | 10,253 | 11,731 |
| Shareholder's Fund | 7,175 | 8,004 | 9,243 | 10,559 | 12,036 |
| **Total Liabilities** | 11,886 | 11,834 | 13,697 | 15,275 | 16,803 |
| **BVPS (Rs)** | 47 | 52 | 60 | 69 | 79 |

### Cash flow

| Y.E Dec (Rs mn) | FY11A | FY12A | FY13A | FY14E | FY15E |
|---|---|---|---|---|---|
| Net inc. + Depn. | 1255 | 1377 | 1919 | 2069 | 2332 |
| Non-cash adj. | 218 | 527 | 131 | 168 | 179 |
| Changes in W.C | -1135 | 160 | -478 | -701 | -910 |
| C.F.O | 338 | 2063 | 1572 | 1536 | 1601 |
| Capital exp. | -292 | -461 | -498 | -1300 | -450 |
| Change in inv. | -116 | -56 | 22 | -60 | -100 |
| Other invest.CF | 158 | 214 | 152 | 0 | 0 |
| C.F - investing | -250 | -304 | -325 | -1360 | -550 |
| Issue of equity | 0 | 0 | 0 | 0 | 0 |
| Issue/repay debt | -111 | -884 | 90 | 272 | 0 |
| Dividends paid | -107 | -124 | -142 | -214 | -214 |
| Other finance.CF | -517 | -652 | -404 | -148 | -159 |
| C.F - Financing | -734 | -1660 | -456 | -90 | -373 |
| Chg. in cash | -646 | 100 | 792 | 86 | 678 |
| Closing cash | 580 | 673 | 1467 | 1553 | 2231 |

### Ratios

| Y.E Dec (Rs mn) | FY11A | FY12A | FY13A | FY14E | FY15E |
|---|---|---|---|---|---|
| **Profitab. & Return** | | | | | |
| EBITDA margin (%) | 8.5 | 8.7 | 10.1 | 9.6 | 10.0 |
| EBIT margin (%) | 6.6 | 6.8 | 8.1 | 7.4 | 7.7 |
| Net profit mgn.(%) | 4.3 | 4.8 | 6.4 | 6.2 | 6.1 |
| ROE (%) | 12.7 | 12.9 | 16.8 | 15.4 | 15.0 |
| ROCE (%) | 9.3 | 10.4 | 11.3 | 10.1 | 10.4 |
| **W.C & Liquidity** | | | | | |
| Receivables (days) | 18.0 | 21.6 | 21.2 | 23.5 | 24.7 |
| Inventory (days) | 57.3 | 64.4 | 66.0 | 68.3 | 68.9 |
| Payables (days) | 9.6 | 10.0 | 12.9 | 12.5 | 11.9 |
| Current ratio (x) | 1.7 | 2.4 | 2.5 | 2.8 | 3.3 |
| Quick ratio (x) | 0.5 | 0.9 | 0.9 | 0.8 | 0.9 |
| **Turnover & Levg.** | | | | | |
| Gross asset T.O (x) | 2.5 | 2.4 | 2.5 | 2.5 | 2.6 |
| Total asset T.O (x) | 1.8 | 1.7 | 1.8 | 1.7 | 1.7 |
| Int. covge. ratio (x) | 7.0 | 5.4 | 13.7 | 12.4 | 13.4 |
| Adj. debt/equity (x) | 0.4 | 0.2 | 0.1 | 0.1 | 0.1 |
| **Valuation ratios** | | | | | |
| EV/Sales (x) | 0.5 | 0.5 | 0.5 | 0.5 | 0.4 |
| EV/EBITDA (x) | 6.1 | 6.1 | 4.8 | 4.7 | 4.0 |
| P/E (x) | 7.7 | 6.9 | 5.5 | 6.1 | 5.5 |
| P/BV (x) | 1.3 | 1.2 | 1.0 | 0.9 | 0.8 |

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Recommendation Criteria:
The recommendations are based on a 12 month horizon, unless otherwise specified. The recommendations are on absolute positive/negative return basis. It is possible that due to volatile price fluctuation in the near to medium term there could be a temporary mismatch between the analyst recommendation and the actual absolute returns based on the current market price.

| | | |
|---|---|---|
| BUY | - | Absolute return of more than 18%. |
| Accumulate | - | Absolute returns between 10% - 18%. |
| Hold | - | Absolute returns between 0% - 10%. |
| Sell | - | Absolute returns of less than 0%. |

* Accumulate is a better rating than SELL and HOLD, but lower than BUY recommendation. Clients are advised not to sell their holding in the stock and buy the stock whenever the stock provides a suitable price correction. The Analyst has a positive outlook about the company's business model; hence the stock is recommended to be brought over a period in a SIP (Systematic Investment Plan) fashion. Analyst has not given a BUY rating for reasons of premium valuations/clarity/events etc and may revisit rating at appropriate time. Please note that the stock always carries the risk of being downgraded to a HOLD or SELL recommendation on outcome of adverse events.