

# V-Guard Industries Ltd (VGRD IN)

## Expects short-term pressure

INDIA | MIDCAP - ELECTRICALS | Company Update

13 December 2016

We attended a call with VGRD's management to understand the impact of demonetisation on the Indian electrical industry and on VGRD. The management and other channel partners highlighted that (1) November 2016 was not impacted much, but expect short-term pressure, (2) cables division was less impacted vs. consumer durables and white goods (CD & WG), and (3) shift to organised players will happen faster. We believe that postponement/delay in purchases (mainly in CD & WG) would be more visible from December 2016 in terms of lower sales. We have revised our FY17/18 estimates by -8%/-11% for revenue and -11%/-15% for EBITDA.

For channel partner meeting takeaways – [Click here](#).

### Key takeaways

**South market vs. non-south:** VGRD has a strong presence in south India (~70% of sales). It believes that demonetisation has dented the south market more than the rest. It highlighted that the south market (such as Kerala) has a liquidity shortage mainly because most people keep their money with Co-operative Banks as they offer higher interest rates. The states that were badly affected include Kerala, Tamil Nadu, and Karnataka. Management expects strong recovery from the south market.

**Wires outperforming other product portfolios:** Wires and cables (30% of sales) has not been impacted. Management has seen value and volume growth in this vertical while other portfolios saw lower volume growth or declines. This is majorly due to inventory stocking up by channel partners, in the anticipation of a price hike (as RM copper has increased by ~7% yoy in November 2016). VGRD will be increasing prices by ~ 5% in the next couple of days.

**Shift form unorganised to organised players:** VGRD's management and our channel checks highlighted that due to the liquidity issue, several unorganised players are shutting shop (majorly in wire and cables). As the economy is moving towards cash-less transactions, organised players with strong balance sheets get the benefits of the discounting model, which helps the channel in its working capital cycle. Approaching GST could lead to more shutdowns amongst unorganised players.

**Strong recovery in receivables in November 2016:** VGRD focused on collections (receivable cycle currently at 40 days). Management said that November 2016 was the best month in terms of collection. VGRD initiated some schemes that helped it to receive most of its September 2016 sales payments. However, we believe that improvement in working capital was short term; we expect working capital days at 59/60 for FY17/18.

**Outlook and valuation:** While the scope for gross-margin improvement is limited, we believe increased channel sweating and tight working capital management should lead to better absorption of fixed costs. However, due to demonetisation, liquidity issue will result in postponement/delay in the purchases of CD & WG; will see higher impact from this December 2016 onwards. In the light of this, we have revised our EPS estimates by -12%/-15%/-12% for FY17/18/19. We maintain our earnings multiple at 26x on FY19 EPS to arrive at a target price of Rs 169 (vs. Rs 192 earlier). With lesser clarity on the impact of demonetisation, we maintain our Neutral rating.

## Neutral (Maintain)

CMP RS 171

TARGET RS 169

### COMPANY DATA

O/S SHARES (MN) :	301
MARKET CAP (RSBN) :	56
MARKET CAP (USDBN) :	0.8
52 - WK HI/LO (RS) :	199 / 79
LIQUIDITY 3M (USDMN) :	0.8
PAR VALUE (RS) :	1.3

### SHARE HOLDING PATTERN, %

	Sep 16	Jun 16	Mar 16
PROMOTERS :	65.5	65.7	65.7
FII / NRI :	12.9	12.9	16.7
FI / MF :	11.6	12.3	8.2
NON PRO :	8.3	2.1	2.1
PUBLIC & OTHERS :	1.8	7.1	7.3

### Key Financials

Rs mn	FY17E	FY18E	FY19E
Net Sales	19,778	21,986	25,673
EBIDTA	2,059	2,336	2,857
Net Profit	1,365	1,602	1,962
EPS, Rs	4.5	5.3	6.5
PER, x	37.6	32.0	26.1
EV/EBIDTA, x	23.2	20.2	16.4
P/BV, x	8.9	7.3	6.0
ROE, %	26.0	25.0	25.2

### CHANGE IN ESTIMATES

	Revised Est.		Revision		%
Rs mn	FY17E	FY18E	FY17E	FY18E	
Revenue	19,778	21,986	-8%	-11%	
EBITDA	2,059	2,336	-11%	-15%	
PAT	1,365	1,602	-12%	-15%	

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**Segment-wise performance for November 2016**

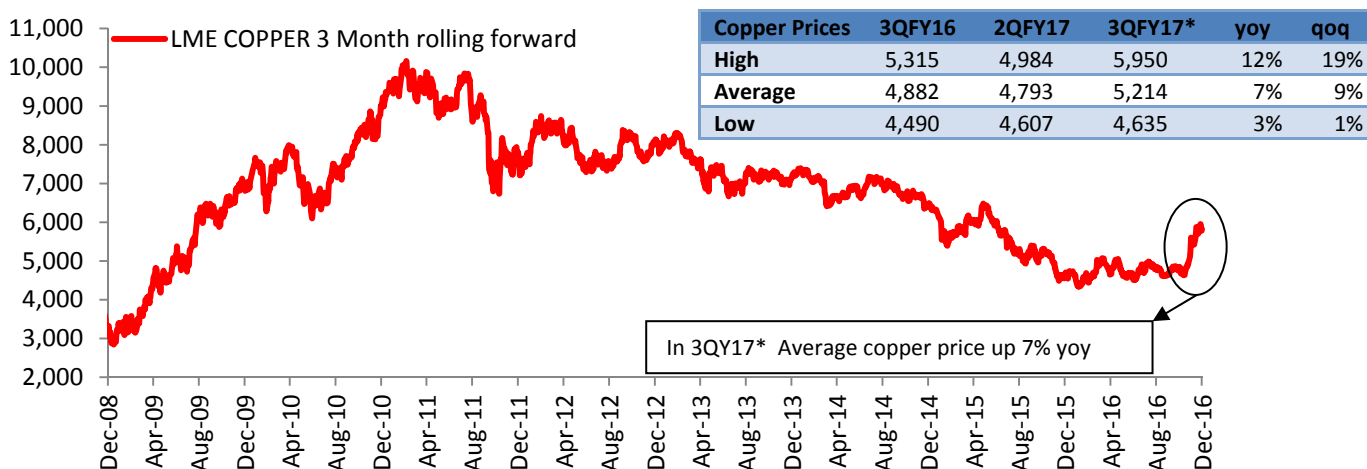
V-guard Product Portfolio:	Total Market Share (Rs bn)	Organized (%)	Unorganized (%)	VGRD - 1HFY17 Rev. (Rs mn)	VGRD - Rev. Share (%)	VGRD- Nov'16 impact	Remark
Stabilizer	14	40%	60%	2,277	21 %	↓	Off season – postponed purchases
UPS (Digital + Standalone)	95	85%	15%	1,294	12%	↓	Off season – postponed purchases
Pump	24	50%	50%	1,175	11 %	↑	Good monsoon in south India
Cable & Wires	172	65%	35%	3,077	29%	↑	Stocking by the channel partners
Water Heaters (Electric + Solar)	22	62%	38%	1,437	14%	↔	On track; expected to show improvement due to winters
Fan	60	75%	25%	936	9%	↓	Off season – postponed purchases
Kitchen Appliances	-	-	-	280	3%	↔	Festive season was good; expect slow offtake, postponed purchases.
Switchgears	50	73%	27%	202	2%	↓	Cash liquidity shortage - postponed purchases

Source: Company, PhillipCapital India Research

**Other key takeaways**

- ✓ Pumps (11% of sales) grew in November 2016, majorly driven by healthy monsoon in south India.
- ✗ Fans and UPS (digital + standalone) impacted majorly due to off-season. Channel partners haven't yet started stocking for the season. Management expects a delay of ~ 2-3 months by channel partners.
- ✗ Retailers have seen a sharp decline in sales, majorly due to cash shortage.
- ✓ Strong collection in November 2016; introduced some schemes and additional discount of ~ 0.5% (on total sales).
- ⇔ To push sales for large-ticket products such as water heater and invertors, VGRD introduced zero down-payment scheme.
- ⇔ Management has not changed its revenue and margin guidance; will revise after December 2016.
- ✓ Will continue with its inorganic growth plans. To acquire another company for expanding its network and kitchen appliances business.
- ✗ Due to lower offtake, VGRD took a production cut of ~ Rs 100-150mn.

*Non-branded market will see pain; management expects a sharp shift from unorganised to organised*

**Copper prices: LEM copper (USD/MT)**


Source: Bloomberg, PhillipCapital India Research \*Note: 3QFY17 is from Oct'16 to 12 Dec'16

## Financials

### Income Statement

Y/E Mar, Rs mn	FY16	FY17E	FY18E	FY19E
<b>Net sales</b>	<b>18,623</b>	<b>19,778</b>	<b>21,986</b>	<b>25,673</b>
Growth, %	6.7%	6.2%	11.2%	16.8%
Raw Material expenses	13,208	13,815	15,432	18,071
Operating expenses	2,527	2,684	2,877	3,243
Employee expenses	1,108	1,219	1,341	1,502
<b>EBITDA (Core)</b>	<b>1,780</b>	<b>2,059</b>	<b>2,336</b>	<b>2,857</b>
Growth, %	33.8%	15.7%	13.5%	22.3%
Margin, %	10%	10%	11%	11%
Depreciation	154	180	191	218
<b>EBIT</b>	<b>1,626</b>	<b>1,878</b>	<b>2,145</b>	<b>2,639</b>
Growth, %	38.3%	15.5%	14.2%	23.0%
Margin, %	9%	9%	10%	10%
Interest paid	89	32	28	25
Other Non-Operating Income	72	120	140	150
<b>Pre-tax profit</b>	<b>1,609</b>	<b>1,967</b>	<b>2,256</b>	<b>2,764</b>
Tax provided	493	602	654	802
<b>Profit after tax</b>	<b>1,117</b>	<b>1,365</b>	<b>1,602</b>	<b>1,962</b>
<b>Net Profit</b>	<b>1,117</b>	<b>1,365</b>	<b>1,602</b>	<b>1,962</b>
Growth, %	57.9%	22.2%	17.4%	22.5%
Margin, %	6.0%	6.9%	7.3%	7.6%
<b>Net Profit (adjusted)</b>	<b>1,117</b>	<b>1,365</b>	<b>1,602</b>	<b>1,962</b>
No. of Eq. Sh O/S (m nos)	302	302	298	298

### Balance Sheet

Y/E Mar, Rs mn	FY16	FY17E	FY18E	FY19E
Cash & bank	76	200	587	939
Debtors	2,792	3,022	3,420	3,994
Inventory	2,047	2,166	2,402	2,852
Loans & advances	445	445	545	695
<b>Total current assets</b>	<b>5,360</b>	<b>5,832</b>	<b>6,954</b>	<b>8,481</b>
Gross fixed assets	2,526	2,897	3,200	3,562
Less: Depreciation	916	1,096	1,288	1,505
Add: Capital WIP	1	30	100	100
<b>Net fixed assets</b>	<b>1,611</b>	<b>1,831</b>	<b>2,012</b>	<b>2,157</b>
<b>Total assets</b>	<b>7,165</b>	<b>8,307</b>	<b>9,760</b>	<b>11,632</b>
Current liabilities	1,881	1,969	2,183	2,537
Provisions	398	398	398	398
Total current liabilities	<b>2,279</b>	<b>2,366</b>	<b>2,581</b>	<b>2,935</b>
Debt	104	94	84	74
Deferred Tax Liability	75	75	75	75
<b>Total liabilities</b>	<b>2,457</b>	<b>2,535</b>	<b>2,739</b>	<b>3,083</b>
Paid-up capital	301	302	302	302
Reserves & surplus	4,407	5,470	6,718	8,247
Shareholders' equity	4,708	5,772	7,020	8,549
<b>Total equity &amp; liabilities</b>	<b>7,165</b>	<b>8,307</b>	<b>9,760</b>	<b>11,632</b>

Source: Company, PhillipCapital India ResearchEstimates

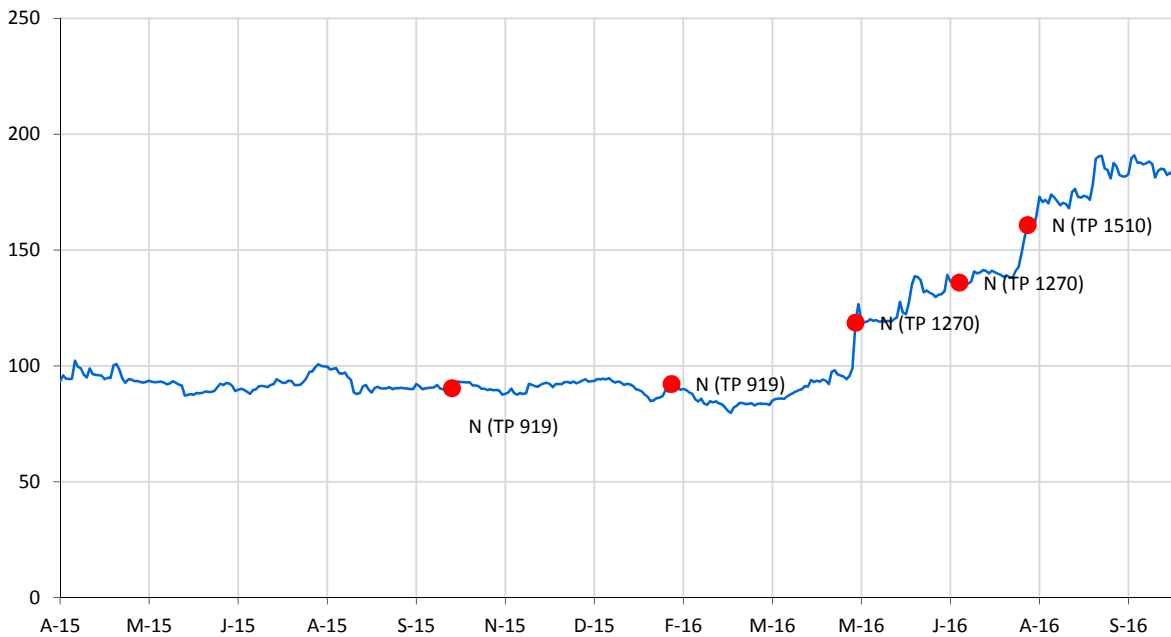
### Cash Flow

Y/E Mar, Rs mn	FY16	FY17E	FY18E	FY19E
Pre-tax profit	1,609	1,967	2,256	2,764
Depreciation	154	180	191	218
Chg in working capital	-116	-260	-520	-822
Total tax paid	-498	-602	-654	-802
Other operating activities	163	-88	-112	-125
<b>Cash flow from operating activi.</b>	<b>1,311</b>	<b>1,196</b>	<b>1,162</b>	<b>1,233</b>
Capital expenditure	-140	-400	-373	-363
Chg in investments	-194	-450	-150	-200
Other investing activities	17	120	140	150
<b>Cash flow from investing active.</b>	<b>-316</b>	<b>-730</b>	<b>-383</b>	<b>-413</b>
Free cash flow	995	466	779	820
Equity raised/(repaid)	31	1	0	0
Debt raised/(repaid)	-574	-10	-10	-10
Dividend (incl. tax)	-325	-301	-354	-433
Other financing activities	-73	-32	-28	-25
<b>Cash flow from financing active.</b>	<b>-941</b>	<b>-342</b>	<b>-392</b>	<b>-469</b>
Net chg in cash	54	124	387	352

### Valuation Ratios

	FY16	FY17E	FY18E	FY19E
<b>Per Share data</b>				
Dil. EPS (INR)	3.7	4.5	5.3	6.5
Growth, %	57.9	22.2	17.4	22.5
Book NAV/ FD share (INR)	15.6	19.1	23.3	28.3
CEPS (INR)	4.2	5.1	5.9	7.2
CFPS (INR)	4.3	4.0	3.9	4.1
DPS (INR)	0.7	0.9	1.0	1.2
<b>Return ratios</b>				
Return on assets (%)	15.6	16.4	16.4	16.9
Return on equity (%)	26.3	26.0	25.0	25.2
Return on capital employed (%)	36.0	36.9	34.8	35.1
<b>Turnover ratios</b>				
Sales/Total assets (x)	3.8	3.3	3.1	3.0
Sales/Net FA (x)	11.6	11.0	11.5	12.5
Working capital/Sales (x)	0.2	0.2	0.2	0.2
Fixed capital/Sales (x)	0.1	0.1	0.1	0.1
Receivable days	54.0	55.0	56.0	56.0
Inventory days	43.8	44.0	44.0	45.0
Loans, Adv (days)	8.6	8.1	8.9	9.7
Payable days	40.2	40.0	40.0	40.0
Working capital days	66.1	67.1	68.9	70.7
<b>Liquidity ratios</b>				
Current ratio (x)	2.4	2.5	2.7	2.9
Quick ratio (x)	1.5	1.5	1.8	1.9
Interest cover (x)	15.2	49.8	64.1	87.4
Dividend cover (x)	5.3	5.3	5.3	5.3
Total debt/Equity (%)	0.0	0.0	0.0	0.0
Net debt/Equity (%)	0.0	(0.0)	(0.1)	(0.1)
<b>Valuation</b>				
PER (x)	45.9	37.6	32.0	26.1
PEG (x) - y-o-y growth	0.8	1.7	1.8	1.2
Price/Book (x)	10.9	8.9	7.3	6.0
Yield (%)	0.4	0.5	0.6	0.7
EV/Net sales (x)	2.7	2.6	2.3	1.9
EV/EBITDA (x)	27.5	23.2	20.2	16.4
EV/EBIT (x)	30.0	25.3	21.9	17.7

### Stock Price, Price Target and Rating History



### Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	$\geq +15\%$	Target price is equal to or more than 15% of current market price
NEUTRAL	$-15\% > \text{to} < +15\%$	Target price is less than +15% but more than -15%
SELL	$\leq -15\%$	Target price is less than or equal to -15%.

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