

V-Guard Industries Ltd (VGRD IN)

Impressive margins, but priced in

INDIA | MIDCAP - ELECTRICALS | Quarterly Update

27 July 2016

Top takeaways from Q1FY17

- Higher sales volumes of seasonal products such as stabilisers, fans, and pumps resulted in the 15% revenue jump.
- Firm pricing, soft commodity prices and better absorption of fixed costs boosted EBIDTA and OPM.
- Improvement in the cash-conversion cycle and lower bill discounting resulted in interest outgo falling 85%.
- PAT vaulted 70% yoy to Rs 428mn due to better margins and lower interest burden.

Key highlights: An extended summer in most parts of India facilitated higher sales of key products and helped the company to retain most benefits of softer raw material prices. It also gained from better penetration in non-south-Indian markets. These factors facilitated gross margin improvement of 300bps yoy. With the exception of marketing expenses, most fixed costs were reined in, which resulted in an OPM jump of 240bps yoy to 11.1%. Healthy operational cash flows on fall in inventory and rise in payables enabled it to cut down on bill-discounting significantly, thereby reducing interest outgo by 85% yoy.

Management comments/concall/analyst-meet takeaways

- ✓ Sale volumes of wires and cables rose 10% while realisations were 10% lower because it passed on complete benefit of softer copper prices.
- ✓ Despatches of pumps, stabilisers, water heaters, and fans picked up noticeably. This boosted operational profitability.
- ✓ Profitability profile in non-south-Indian markets has improved significantly over the years. VGI is currently breaking even at the PBT level in these markets.
- ✓ Net debt is marginally negative and V-Guard intends to steadily pay off its term loan over the next 12-18 months.

Outlook and valuation: VGI made most of climatic conditions prevailing in Q1FY17, leveraging its product portfolio to the hilt. While the scope for gross-margin improvement is limited, we believe increased channel sweating and tight working capital management should see better absorption of fixed costs. In the light of its product basket and channel penetration, we believe that normal weather patterns would be most beneficial for VGI and have increased our FY18 EBIDTA/earnings by 5%/9%. We have also increased our earnings multiple to 26x (vs. 24x) in recognition of its debt-free balance sheet and better cash conversion cycle. Consequently, we raised our target price to Rs 1,510 (vs. Rs 1,270 earlier). However, given the sharp run up, we maintain our Neutral rating. At this multiple, VGI has little room to negotiate any disruption in its cash flows and earnings, as a sizeable portion of its sales consists of seasonal products whose off-take is influenced by climatic conditions.

Neutral (Maintain)

CMP RS 1608

TARGET RS 1510

COMPANY DATA

O/S SHARES (MN) :	30
MARKET CAP (RSBN) :	43
MARKET CAP (USDBN) :	0.6
52 - WK HI/LO (RS) :	1465 / 787
LIQUIDITY 3M (USDMMN) :	2.0
PAR VALUE (RS) :	10

SHARE HOLDING PATTERN, %

	Jun 16	Mar 16	Dec 15
PROMOTERS :	65.7	65.7	65.9
FII / NRI :	12.9	16.7	17.0
FI / MF :	12.3	8.2	7.6
NON PRO :	2.1	2.1	2.5
PUBLIC & OTHERS :	7.1	7.3	7.0

Key Financials

Rs mn	FY16	FY17E	FY18E
Net Sales	18,623	21,701	25,796
EBIDTA	1,780	2,188	2,638
Net Profit	1,117	1,414	1,734
EPS, Rs	37.1	47.0	57.6
PER, x	43.3	34.2	27.9
EV/EBIDTA, x	26.0	20.9	17.1
P/BV, x	10.3	8.2	6.6
ROE, %	26.3	26.7	26.2
Debt/Equity (%)	0.0	0.0	0.0

CHANGE IN ESTIMATES

Rs mn	Revised Est.		% Revision	
	FY17E	FY18E	FY17E	FY18E
Revenue	21,701	25,796	(0.0)	(0.0)
EBITDA	2,188	2,638	9.5	4.5
PAT	1,414	1,734	16.4	9.4

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(Rs mn)	Q1FY17	Q1FY16	yoy growth %	Q4FY16	qoq growth %	vs Expectations	Comments
Sales	5,727	4,993	15	5,968	-4.0	-2.3	Higher sales of stabilizers, pumps & fans
EBITDA	638	435	47	654	-2.5	16.6	Firm pricing, soft raw mat. Prices, better cost absorption
EBITDA margin	11.1	8.7	243bps	11	18.1	180 bps	
Interest	6	40	(85)	16	-63.4		Improved working capital obviates w. cap borrowing
Depreciation	39	39	0	44	-11.9		
Other income	31	16	98	21	49.4		Surplus cash generated some treasury income
PBT	625	372	68	615	1.6		
Tax	197	121	63	201	-1.8		
Tax rate	32	32	-91bps	33	-108.5		
PAT	428	252	70	415	3.2	18.5	

Segment wise results

Rs mn	Q1FY17	Q1FY16	% yoy	FY16	FY15	% yoy
Net Revenues						
Electronic	2,204	1,786	23.4	5,627	5,489	2.5
Electrical/Electro Mechanical	3,392	3,081	10.1	12,388	11,461	8.1
Others	130	126	3.7	607	510	19.1
Total	5,727	4,993	14.7	18,623	17,459	6.7
Segment PBIT						
Electronic	322	237	36.1	766	576	33.1
Electrical/Electro Mechanical	284	158	79.6	860	642	33.9
Others	17	25	(31.1)	93	46	103.7
PBIT	623	420	48.4	1,719	1,263	36.1
(-)Interest	6	40	(85.2)	89	206	(56.7)
(-)Net un-allocable Exp	8	(8)	(202.1)	(20)	-	#DIV/0!
PBT	609	388	57.1	1,650	1,057	56.1
PBIT Margin (%)						
Electronic	14.6	13.2	-	13.6	10.5	-
Electrical/Electro Mechanical	8.4	5.1	-	6.9	5.6	-
Others	13.3	20.1	-	15.3	9.0	-
Total Comp. PBIT Margin (%)	10.9	8.4	-	9.2	7.2	-

Source: Company, PhillipCapital India Research

Other key takeaways

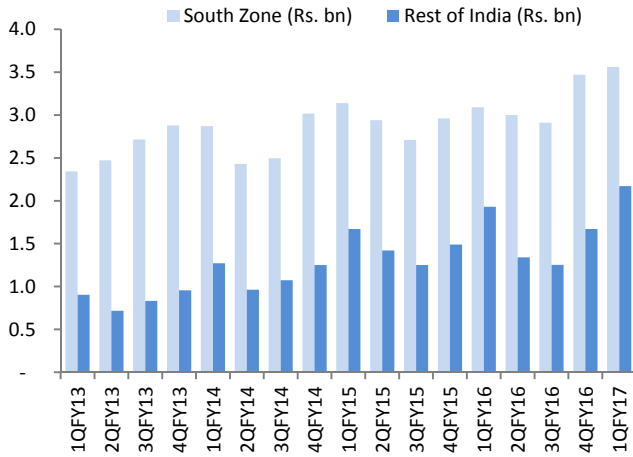
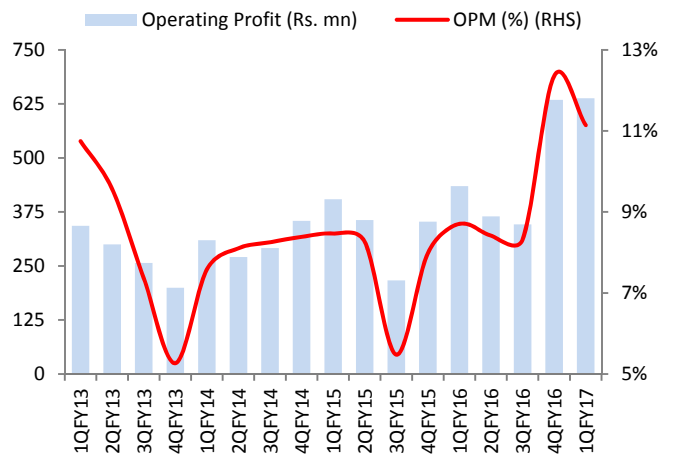
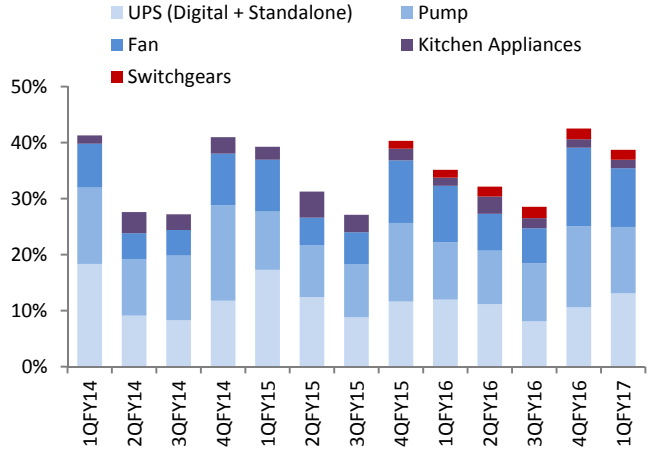
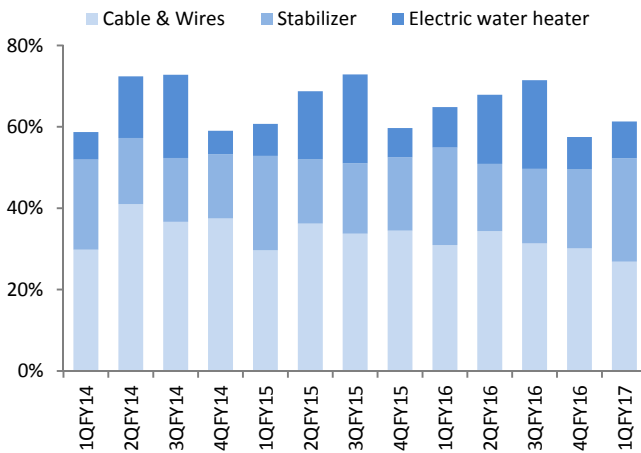
- ✓ The surge in air conditioner sales, especially those with an inbuilt inverter, provided a fillip to despatches of stabilizers (VGI recently launched these for this segment).
- ↔ As a precaution against stretching its working capital, the company kept low inventories in its sales channels outside south India. As a result of lower stocking, the management estimated that it missed out on an incremental 10% of sales.
- ✓ VGI is looking to expand its existing range of pumps by developing higher HP pumps, which will be targeted at high-rise buildings and agriculture.
- ✓ Gas cooktops will be the new addition to the company's range of kitchen appliances, which currently consists of induction cooktops and mixer-grinders.
- ✓ Management maintained its guidance for 15% revenue growth in FY17 with margins at ~10%. It expects its sales in southern India to grow by 7-8% with revenues from the remaining geographies rising 25%.

Our take

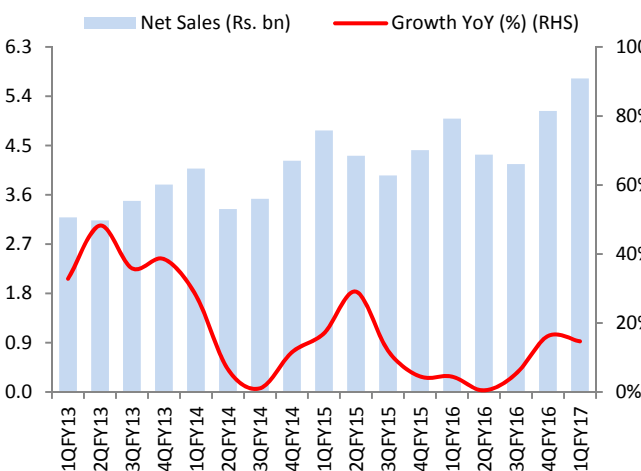
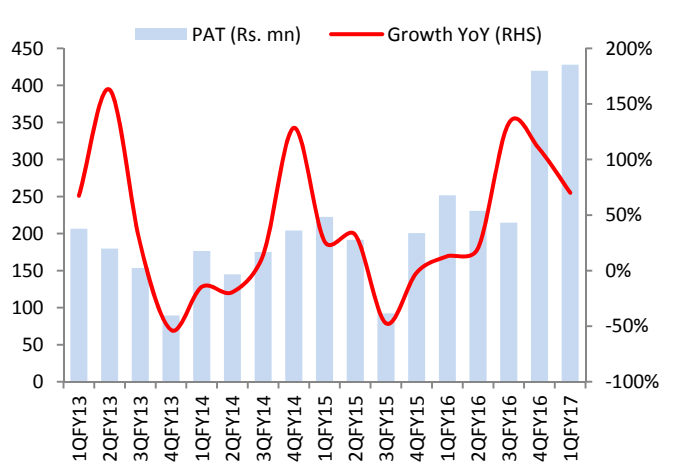
The extent of gross margin improvement in Q1FY17 came as a pleasant surprise, with its implications for EBIDTA and PAT. While the low base of Q1FY16 also helped, we expect this momentum of sales growth to sustain until Q3FY17. Hence, we have modified our estimates for EBIDTA and PAT for FY17-18. It is to the company's credit that it has improved its cash-conversion cycle to 52 days currently from 58 days (FY16).

On the margin front, we are positive on the improved performance of operations outside southern India and believe that operating leverage of 50bps p.a. is well within the company's reach over the next two years, due to fixed cost absorption. But operating leverage could be curtailed by the additional deployment of human and material resources to launch new products and increase channel sweating.

At an EV/EBIDTA multiple of 17x (FY18), VGI's valuations are currently trending very close to those of mid-sized FMCG players. While we have revised our earnings valuations for VGI to 26x FY18 (PE), this leaves limited room for its stock price to negotiate any shocks in earnings and cash flows. At these levels, it is important that the company sustain and improve its working capital cycle; while maintaining the anticipated trajectory of revenue and cash generation growth.

Geographical revenue breakup

Operating profit and OPM trend

Product wise revenue break-up (% of sales)


Source: Company, PhillipCapital India Research

Trend of net sales

Trend in net profits


Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY15	FY16	FY17E	FY18E
Net sales	17,459	18,623	21,701	25,796
Growth, %	15.0%	6.7%	16.5%	18.9%
Raw Material expenses	12,980	13,208	15,522	18,648
Operating expenses	2,204	2,527	2,785	3,183
Employee expenses	945	1,108	1,206	1,326
EBITDA (Core)	1,330	1,780	2,188	2,638
Growth, %	8.5%	33.8%	22.9%	20.6%
Margin, %	8%	10%	10%	10%
Depreciation	154	154	166	177
EBIT	1,176	1,626	2,022	2,461
Growth, %	6.4%	38.3%	24.3%	21.8%
Margin, %	7%	9%	9%	10%
Interest paid	206	89	63	44
Other Non-Operating Income	45	72	90	95
Pre-tax profit	1,014	1,609	2,049	2,512
Tax provided	307	493	635	779
Profit after tax	707	1,117	1,414	1,734
Net Profit	707	1,117	1,414	1,734
Growth, %	0.8%	57.9%	26.6%	22.6%
Margin, %	4.0%	6.0%	6.5%	6.7%
Net Profit (adjusted)	707	1,117	1,414	1,734
No. of Eq. Sh O/S (m nos)	30	30	30	30

Balance Sheet

Y/E Mar, Rs mn	FY15	FY16	FY17E	FY18E
Cash & bank	22	76	474	1,148
Debtors	2,437	2,792	3,014	3,583
Inventory	2,608	2,047	2,439	2,895
Loans & advances	508	445	445	445
Total current assets	5,575	5,360	6,372	8,071
Gross fixed assets	2,407	2,526	2,797	3,000
Less: Depreciation	773	916	1,083	1,259
Add: Capital WIP	12	1	30	100
Net fixed assets	1,646	1,611	1,745	1,840
Total assets	7,222	7,165	8,561	10,455
Current liabilities	2,239	1,881	2,168	2,573
Provisions	436	398	398	398
Total current liabilities	2,674	2,279	2,566	2,971
Debt	678	104	44	44
Deferred Tax Liability	92	75	75	75
Total liabilities	3,444	2,457	2,684	3,089
Paid-up capital	300	301	301	301
Reserves & surplus	3,478	4,407	5,576	7,065
Shareholders' equity	3,777	4,708	5,877	7,365
Total equity & liabilities	7,222	7,165	8,561	10,455

Source: Company, PhillipCapital India Research Estimates

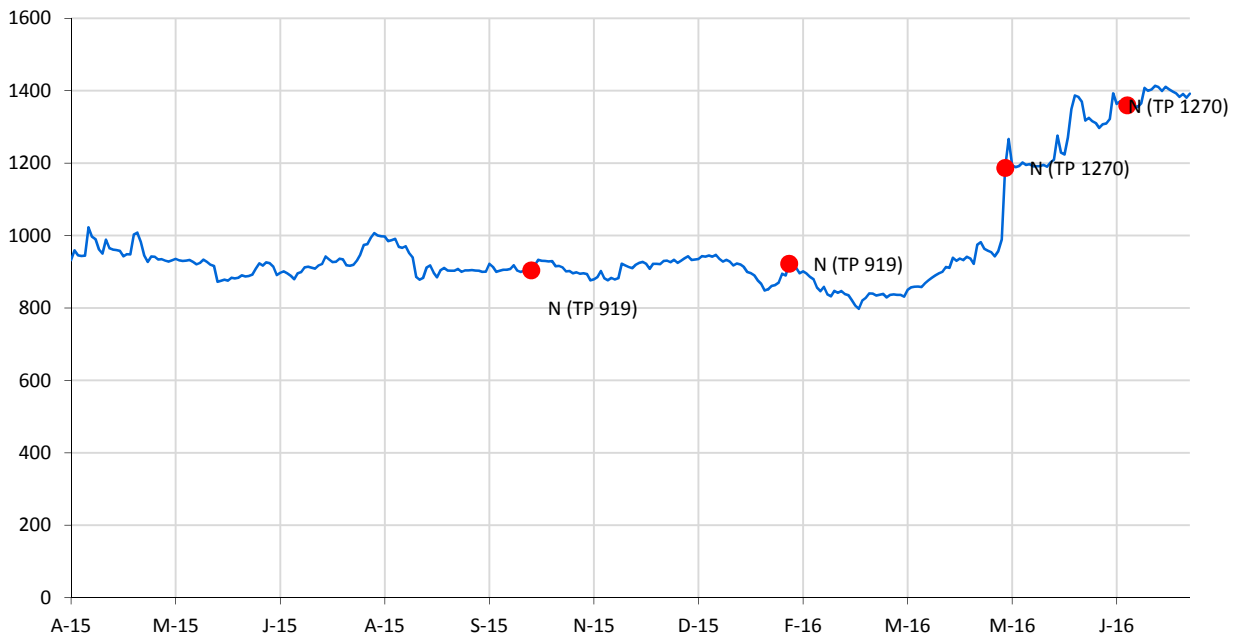
Cash Flow

	FY15	FY16	FY17E	FY18E
Pre-tax profit	1,014	1,609	2,049	2,512
Depreciation	154	154	166	177
Chg in working capital	-260	-116	-327	-619
Total tax paid	-305	-498	-635	-779
Other operating activities	230	163	-27	-51
Cash flow from operating activities	833	1,311	1,226	1,240
Capital expenditure	-123	-140	-300	-273
Chg in investments	0	-194	-250	-100
Other investing activities	19	17	90	95
Cash flow from investing activities	-104	-316	-460	-278
Free cash flow	729	995	766	962
Equity raised/(repaid)	37	31	0	0
Debt raised/(repaid)	-406	-574	-60	0
Dividend (incl. tax)	-157	-325	-245	-245
Other financing activities	-209	-73	-63	-44
Cash flow from financing activities	(735)	(941)	(368)	(289)
Net chg in cash	(6)	54	398	674

Valuation Ratios

	FY15	FY16	FY17E	FY18E
Per Share data				
Dil. EPS (INR)	23.5	37.1	47.0	57.6
Growth, %	0.8	57.9	26.6	22.6
Book NAV/ FD share (INR)	125.6	156.5	195.3	244.8
CEPS (INR)	28.7	42.2	52.5	63.5
CFPS (INR)	27.7	43.6	40.7	41.5
DPS (INR)	4.5	7.0	7.0	7.0
Return ratios				
Return on assets (%)	9.8	15.6	16.5	16.6
Return on equity (%)	20.3	26.3	26.7	26.2
Return on capital employed (%)	27.7	36.0	38.8	37.9
Turnover ratios				
Sales/Total assets (x)	3.8	3.8	3.6	3.4
Sales/Net FA (x)	10.7	11.6	12.7	14.8
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	50.3	54.0	50.0	50.0
Inventory days	58.2	43.8	45.0	45.0
Loans, Adv (days)	10.5	8.6	7.4	6.2
Payable days	50.0	40.2	40.0	40.0
Working capital days	69.0	66.1	62.4	61.2
Liquidity ratios				
Current ratio (x)	2.1	2.4	2.5	2.7
Quick ratio (x)	1.1	1.5	1.5	1.7
Interest cover (x)	5.2	15.2	26.2	44.5
Dividend cover (x)	5.2	5.3	6.7	8.2
Total debt/Equity (%)	0.2	0.0	0.0	0.0
Net debt/Equity (%)	0.2	0.0	(0.1)	(0.1)
Valuation				
PER (x)	66.1	41.8	33.0	26.9
PEG (x) - y-o-y growth	81.6	0.7	1.2	1.2
Price/Book (x)	12.4	9.9	7.9	6.3
Yield (%)	0.3	0.5	0.5	0.5
EV/Net sales (x)	2.7	2.5	2.1	1.7
EV/EBITDA (x)	34.3	25.1	20.1	16.5
EV/EBIT (x)	38.7	27.4	21.7	17.6

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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