

V-Guard Industries Ltd (VGRD IN)

Better penetration in non-south markets

INDIA | MIDCAP - ELECTRICALS | Quarterly Update

1 February 2017

Top takeaways from Q3FY17

- Higher sales volumes of products such as pumps, fans, stabilizer, and switchgears resulted in a 10% revenue jump.
- Lower input cost (lower commodity prices in first half of the quarter), a price hike, and product mix helped a 270bps yoy improvement in gross margin. However, higher selling and administrative expenses capped OPM at 8.4% (vs. 8.3% in Q3FY16).
- PAT vaulted 30% yoy to Rs 280mn on better margins, higher other income, and lower interest burden and tax rate.

Key highlights: Incentives (trade discounts) and higher sales of key products helped growth. VGRD also gained from better penetration in non-south-Indian markets (non-south revenue up 23% yoy). Product mix and price hike facilitated gross margin improvement of 270bps yoy. Despite marketing and administrative expenses rising 33% yoy, EBITDA improved 12% yoy. Healthy operational cash flows and controlled working-capital cycle resulted in lower interest outgo and higher other income.

Management comments/concall/analyst-meet takeaways

- ✓ Good monsoon resulted in pumps sales growth of 38% yoy – 35% volume growth and 2.5% value growth. Agri pumps sales were up 70%, household pumps up 25%.
- ↔ South markets (67% of sales) were up 5% yoy, impacted quite a bit by liquidity issues due to demonetisation, the socio-economic situation in Tamil Nadu, and cyclone in Chennai and suburban areas.
- ✓ The non-south market showed strong growth of 23% yoy (33% of sales). Profitability profile in these markets has improved significantly (in 9MFY17 OPM was ~5%).
- ✓ Management has maintained revenue growth guidance of 13-15% and margin guidance of 10-11% for FY17. Expects this run rate to continue for the next two years.

Outlook and valuation: 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 a demand shift to organised players (after demonetisation and GST) and improving demand of household goods. With VGRD increasing its penetration in the non-south market and its improving product mix, we have increased our FY17/18/19 earnings by 10%/11%/11%. In recognition of its debt-free balance sheet and better cash-conversion cycle, we have revised our earnings multiple to 30x (vs. 26x earlier) (~15% discount to the industry leader). Consequently, we have raised our target price to Rs 216 (vs. Rs 170 earlier).

However, given the sharp run up, we maintain our Neutral rating. At this multiple, VGRD 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 205

TARGET RS 216 (+5%)

COMPANY DATA

O/S SHARES (MN) :	302
MARKET CAP (RSBN) :	56
MARKET CAP (USDBN) :	0.8
52 - WK HI/LO (RS) :	226 / 79
LIQUIDITY 3M (USDMN) :	1.9
PAR VALUE (RS) :	10

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	8.21
NON PRO :	2.3	2.1	2.09
PUBLIC & OTHERS :	7.8	7.1	7.3

Key Financials

Rs mn	FY17E	FY18E	FY19E
Net Sales	21,015	23,843	27,458
EBIDTA	2,164	2,535	3,006
Net Profit	1,498	1,780	2,172
EPS, Rs	5.0	5.9	7.2
PER, x	41.3	34.7	28.5
EV/EBIDTA, x	26.6	22.8	19.1
P/BV, x	10.5	8.5	6.9
ROE, %	28.3	27.1	26.8

CHANGE IN ESTIMATES

Rs mn	Revised Est.		% Revision	
	FY18E	FY19E	FY18E	FY19E
Revenue	23,843	27,458	8.4	7.0
EBITDA	2,535	3,006	8.5	5.2
PAT	1,780	2,172	11.1	10.7

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(Rs mn)	Q3FY17	Q3FY16	yoy growth %	Q2FY16	qoq growth %	vs Expectations	Comments
Sales	4,596	4,163	10	4,951	-7.2	13.4	Higher sales of pumps, fans, and strong non-south market
EBITDA	386	346	11	533	-27.6	16.1	Higher S&A Exp, capped price hike, and product mix benefit
EBITDA margin	8.4	8.3	8bps	10.8	-236.6	19bps	
Interest	5	15	(66)	5	-6.1		
Depreciation	42	38	10	40	6.2		
Other income	33	18	84	38	-11.4		Surplus cash generated some treasury income
PBT	372	311	20	526	-29.2		
Tax	93	97	(4)	134	-30.7		
Tax rate	25	31	-609bps	25	-53.5		
PAT	280	215	30	392	-28.7	32.9	

Segment-wise performance for 3QFY17

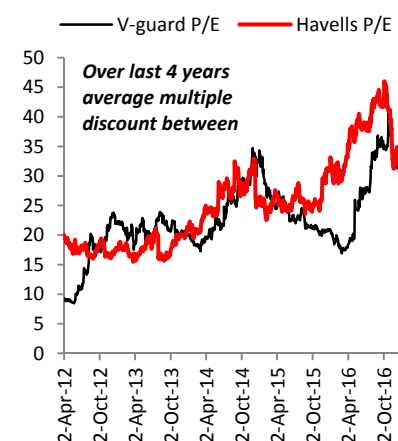
V-guard Product Portfolio:	Total Market Share (Rs bn)	Organised (%)	Unorganised (%)	VGRD - 3QFY17 Rev. (Rs mn)	VGRD - 3QFY16 Rev. (Rs mn)	YoY Growth (%)	Share (%)
Stabilizer	14	40%	60%	834	763	9.3%	18%
UPS (Digital + Standalone)	95	85%	15%	353	336	5.1%	8%
Pump	24	50%	50%	595	432	37.7%	13%
Cable & Wires	172	65%	35%	1,381	1,305	5.8%	30%
Water Heaters (Electric + Solar)	22	62%	38%	960	907	5.8%	21%
Fan	60	75%	25%	301	261	15.3%	7%
Kitchen Appliances	-	-	-	80	75	6.7%	2%
Switchgears	50	73%	27%	91	84	8.3%	2%

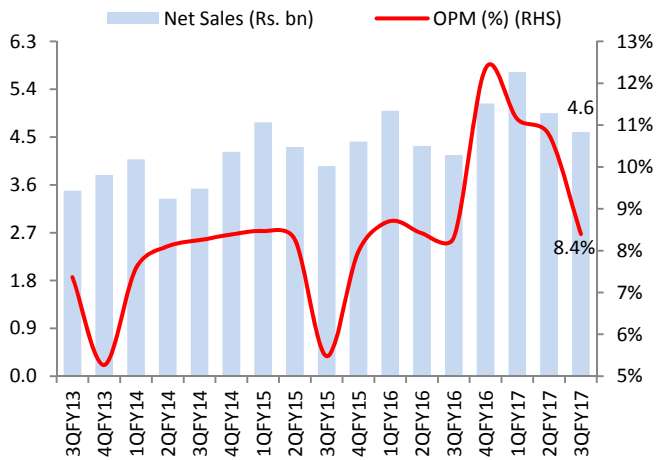
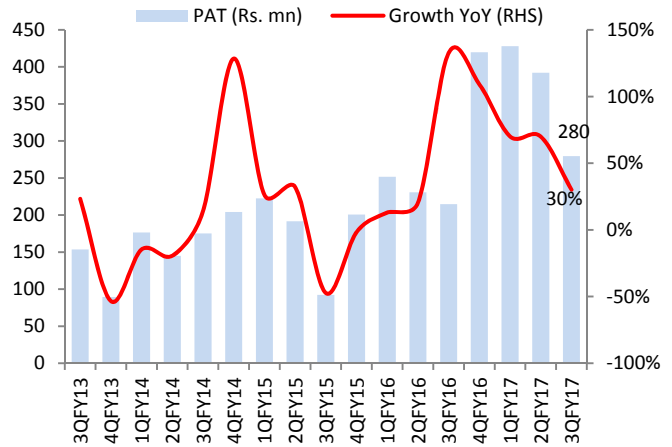
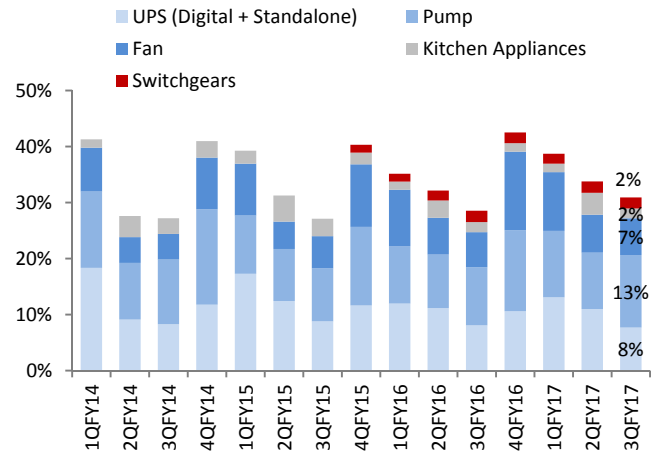
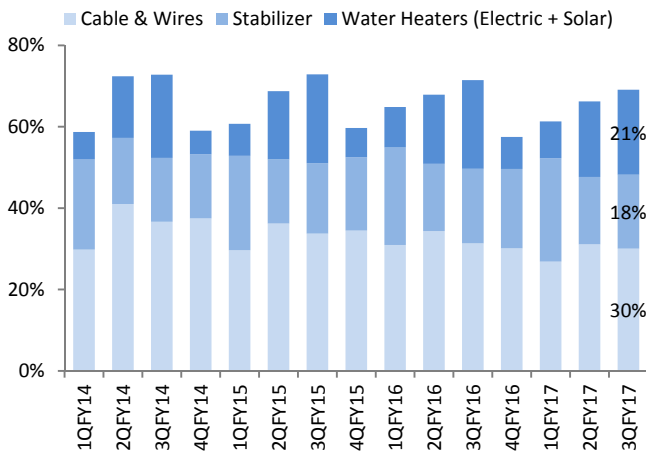
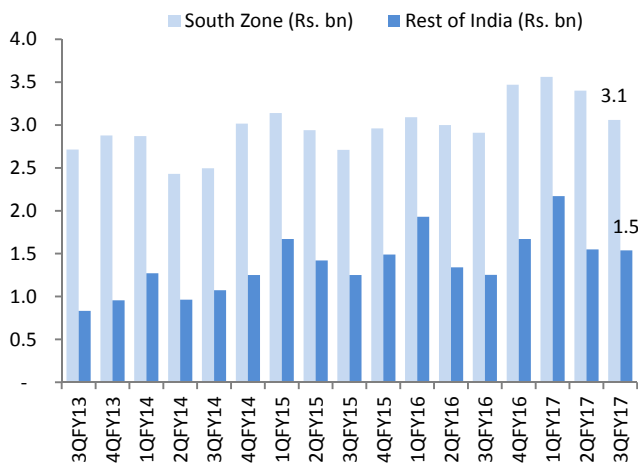
Source: Company, PhillipCapital India Research

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

Other key takeaways

- ✓ Fan business was up 15% yoy (pre-season buying). Some shift from unorganised players
- ⇔ Sales volumes of wires and cables up ~4% (lower construction activity), realisations up 2.5%. Took a price hike in 3Q, mainly to pass on higher copper prices
- ⇔ Water heaters (~20% of revenue) grew 6% yoy to Rs 960mn; growth was lower due to demonetisation and shorter winter in the south
- ⇔ Its key market Kerala was impacted immediately after demonetisation because of liquidity shortage (most people keep their money with cooperative banks as they offer higher interest rates). *December 2016 and January 2017 sales have bounced back.*
- ✓ In non-south market, east and west showed strong growth. North was up 12% yoy.
- ✓ To increase its portfolio in the non-south market, VGRD will add products like switch gears and agri. Pumps.
- ✓ Tight control in collection resulted in debtor days improving by 6 days yoy (8 days qoq) to 41 days, helping the working capital cycle improve to 62 days vs. 68 yoy (67 in 2QFY17).
- ⇔ Selling & administrative expenses were up 33% majorly because of higher advertisement expenses and higher freight costs. In November 2016, addition trade discount (0.5% of November 2016 sales) were used to incentivize channel partners. November sales were flat yoy.
- ✓ To overcome the liquidity issue (demonetisation), VGRD has taken several steps (cash discounts, installing card machines). It also introduced NBFC-financing schemes for customers for high-value purchases like inverters and solar water heaters (tie up with Bajaj Finance).
- ✓ VGRD has increased its investment to Rs 1.4bn vs. Rs 160mn in December 2015, which has resulted in higher other income of Rs 33mn vs. Rs 18mn in Q3FY16.
- ✓ Expects Sikkim plants to start commercial production by March 2017 (capex for stabilisers seen at Rs 125mn and electrical water heaters at Rs 250mn). Expect revenue generation of Rs 5bn at full utilisation.
- ✓ Will be taking 3-5% price hikes in most products, mainly to pass on higher commodity prices.
- ✓ Board recommends a bonus issue of two equity shares of Rs 1 for every five held, subject to approvals.

V-Guard and Havells PE


Net sales and OPM trend

Trend in net profits

Product-wise revenue break-up (% of sales)

Geographical revenue breakup – Non south market at 33%

Key Ratios

Key Ratios	3QFY17	2QFY17	3QFY16
Working Capital Days:	62	67	69
Debtors (days)	41	49	47
Inventory (days)	69	67	66
Creditors (days)	48	49	44
ROE (%)	26%	26%	20%
ROCE (%)	34%	35%	28%
Gross debt / Equity (x)	0.01	0.01	0.05

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY16	FY17E	FY18E	FY19E
Net sales	18,623	21,015	23,843	27,458
Growth, %	6.7%	12.8%	13.5%	15.2%
Raw Material expenses	13,208	14,332	16,147	18,383
Operating expenses	2,527	3,278	3,766	4,463
Employee expenses	1,108	1,241	1,396	1,606
EBITDA (Core)	1,780	2,164	2,535	3,006
Growth, %	33.8%	21.6%	17.1%	18.6%
Margin, %	10%	10%	11%	11%
Depreciation	154	168	188	209
EBIT	1,626	1,996	2,347	2,797
Growth, %	38.3%	22.8%	17.6%	19.2%
Margin, %	9%	10%	10%	10%
Interest paid	89	22	19	17
Other Non-Operating Income	72	135	145	155
Pre-tax profit	1,609	2,110	2,473	2,936
Tax provided	493	612	692	763
Profit after tax	1,117	1,498	1,780	2,172
Net Profit	1,117	1,498	1,780	2,172
Growth, %	57.9%	34.1%	18.9%	22.0%
Margin, %	6.0%	7.1%	7.5%	7.9%
Net Profit (adjusted)	1,117	1,498	1,780	2,172
No. of Eq. Sh O/S (m nos)	302	302	302	302

Balance Sheet

Y/E Mar, Rs mn	FY16	FY17E	FY18E	FY19E
Cash & bank	76	110	192	657
Debtors	2,792	2,510	2,980	3,509
Inventory	2,047	3,299	3,847	4,415
Loans & advances	445	445	545	695
Total current assets	5,360	6,364	7,564	9,277
Gross fixed assets	2,526	2,897	3,237	3,602
Less: Depreciation	916	1,084	1,272	1,481
Add: Capital WIP	1	30	100	100
Net fixed assets	1,611	1,843	2,065	2,221
Total assets	7,165	8,851	10,424	12,492
Current liabilities	1,881	2,409	2,604	2,991
Provisions	398	398	398	398
Total current liabilities	2,279	2,806	3,002	3,388
Debt	104	94	84	74
Deferred Tax Liability	75	75	75	75
Total liabilities	2,457	2,975	3,160	3,537
Paid-up capital	301	302	302	302
Reserves & surplus	4,407	5,574	6,961	8,654
Shareholders' equity	4,708	5,876	7,263	8,956
Total equity & liabilities	7,165	8,851	10,424	12,492

Source: Company, PhillipCapital India Research Estimates

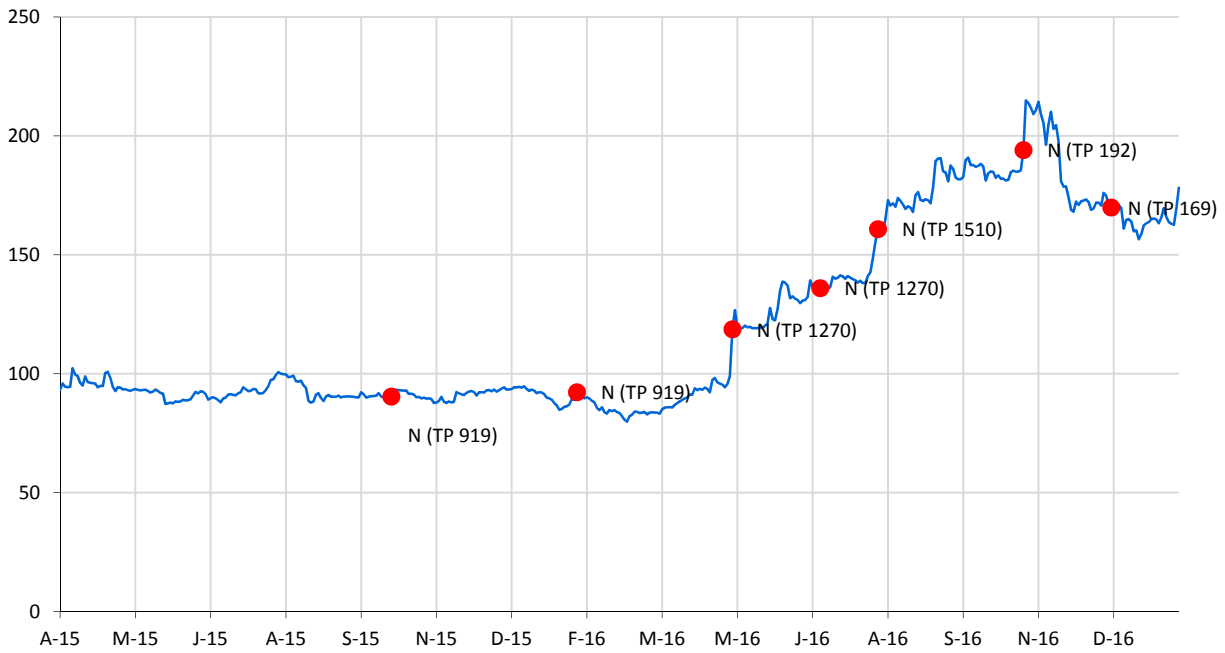
Cash Flow

Y/E Mar, Rs mn	FY16	FY17E	FY18E	FY19E
Pre-tax profit	1,609	2,110	2,473	2,936
Depreciation	154	168	188	209
Chg in working capital	-116	-442	-923	-861
Total tax paid	-498	-612	-692	-763
Other operating activities	163	-113	-126	-138
Cash flow from operating activ.	1,311	1,110	919	1,381
Capital expenditure	-140	-400	-410	-365
Chg in investments	-194	-450	-150	-200
Other investing activities	17	135	145	155
Cash flow from investing activ.	-316	-715	-415	-410
Free cash flow	995	395	504	972
Equity raised/(repaid)	31	1	0	0
Debt raised/(repaid)	-574	-10	-10	-10
Dividend (incl. tax)	-325	-331	-393	-480
Other financing activities	-73	-22	-19	-17
Cash flow from financing activi.	-941	-362	-422	-506
Net chg in cash	54	34	82	466

Valuation Ratios

	FY16	FY17E	FY18E	FY19E
Per Share data				
Dil. EPS (INR)	3.7	5.0	5.9	7.2
Growth, %	57.9	34.1	18.9	22.0
Book NAV/ FD share (INR)	15.6	19.5	24.1	29.7
CEPS (INR)	4.2	5.5	6.5	7.9
CFPS (INR)	4.3	3.7	3.0	4.6
DPS (INR)	0.7	0.9	1.1	1.4
Return ratios				
Return on assets (%)	15.6	16.9	17.1	17.4
Return on equity (%)	26.3	28.3	27.1	26.8
Return on capital employed (%)	36.0	39.0	37.0	35.7
Turnover ratios				
Sales/Total assets (x)	3.8	3.5	3.2	3.0
Sales/Net FA (x)	11.6	11.6	12.1	12.9
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	43.0	45.0	46.0
Inventory days	43.8	63.0	65.0	65.0
Loans, Adv (days)	8.6	7.6	8.2	9.1
Payable days	40.2	46.0	44.0	44.0
Working capital days	66.1	67.6	74.2	76.1
Liquidity ratios				
Current ratio (x)	2.4	2.3	2.5	2.7
Quick ratio (x)	1.5	1.1	1.2	1.4
Interest cover (x)	15.2	77.6	104.0	144.8
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)	(0.0)	(0.1)
Valuation				
PER (x)	55.4	41.3	34.7	28.5
PEG (x) - y-o-y growth	1.0	1.2	1.8	1.3
Price/Book (x)	13.1	10.5	8.5	6.9
Yield (%)	0.3	0.5	0.5	0.7
EV/Net sales (x)	3.3	2.9	2.6	2.2
EV/EBITDA (x)	33.2	26.6	22.8	19.1
EV/EBIT (x)	36.2	28.7	24.5	20.4

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%.

Management

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Kishor Binwal (9122) 6667 9989		
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