V-Guard

BUY

INDUSTRY	APPLIANCES
CMP *(as on 27 Sep 17)*	**Rs 179**
Target Price	**Rs 214**
Nifty	9,736
Sensex	31,160

KEY STOCK DATA	
Bloomberg	VGRD IN
No. of Shares (mn)	425
MCap (Rs bn)/(US$ mn)	76/1,155
6m avg traded value (Rs mn)	220

STOCK PERFORMANCE (%)

52 Week high / low **Rs 221 / 109**

	3M	6M	12M
Absolute (%)	1.7	5.9	33.1
Relative (%)	1.1	(0.7)	22.7

SHAREHOLDING PATTERN (%)	
Promoters	65.17
FIs & Local MFs	10.03
FPIs	12.52
Public & Others	12.28

Source : BSE

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On track

We arranged a road-show with the management of V-Guard. Our confidence in the company's long-term business trajectory was further strengthened, despite the short-term hiccups caused by GST.

The company is confident of achieving 15% revenue growth in FY18, despite revenue being flat in 1QFY18. Healthy underlying growth with restocking should register high double-digit figures in the coming quarters. Management is also confident of maintaining 10% EBITDA margin in FY18 (1QFY18 margin was at 5.8%, -574bps YoY).

We expect V-Guard to deliver 15% revenue CAGR over FY17-20. Healthy revenue growth, higher fixed cost absorption in the Non-South regions, and better margins in new product launches should help expand the EBITDA margin by 200bps over FY17-20. We foresee EPS CAGR of 27% over FY17-20E. We value V-Guard based on a P/E of 32x Sep-19EPS, and arrive at a TP of Rs 214. We maintain BUY.

- **GST and restocking**: The company has witnessed restocking benefits starting mid-July, and management expects healthy revenue growth in 2QFY18. Distributors in the South and West of India were better prepared than those in the East and North. Hence, recovery was swift in the Western and Southern regions. The company also enjoyed the benefits of the festive season, as Onam affected the company positively as it witnessed mid-teens revenue growth. Management is hopeful for better growth in the upcoming festive season.
- **Distribution and marketing:** Management still sees 30-35% scope for increase in distribution outlets. As of now, V-Guard has tapped ~25,000 outlets, and management plans to increase this to ~40,000 over the next few years. Recently, in an effort to improve its sales strategy, V-Guard has start using *salesforce.com* (CRM). This would be supportive, especially in the Non-South market that caters to two-third's of the sales force of the company.
- **South and Non-South:** Gross margins in the South and Non-South are almost at par (only 1% difference). However, there is a large gap in the EBITDA margins (~700bps) of these two regions. The company has already invested a large amount in fixed costs (sales force, distribution etc) in the Non-South; hence, enough headroom for leveraging these fixed costs. The Non-South comprises two-third of V-Guard's sales force, though contributing only 35% to V-Guard's revenues.
- **Management guidance:** Management foresees ~15% revenue CAGR over the next few years. As per management, Fans, KEA and Pumps can grow at ~20% revenue CAGR over the next two to three years, while Stabilisers, Wires and Water Heaters would grow ~10%. Management expects EBITDA margin to improve by 200bps to 12% over the next 3- 4 years.

Financial Summary

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	18,623	21,506	24,200	28,110	32,477
EBITDA	1,780	2,151	2,527	3,232	3,893
APAT	1,117	1,518	1,911	2,512	3,108
Diluted EPS (Rs)	2.7	3.6	4.5	5.9	7.3
P/E (x)	67.4	50.0	39.7	30.2	24.4
EV / EBITDA (x)	42.2	34.8	29.2	22.4	18.1
Core RoCE (%)	24.1	27.7	30.4	36.3	40.3

Source: Company, HDFC sec Inst Research

Recovery should support 2Q performance

Onam was good for V-Guard, as it registered healthy double-digit growth

Huge scope for improvement in Non-South EBITDA margin

Brief of CFO

Sudarshan Kasturi joined V-Guard in Feb-17, and has been working as the company's CFO since Jun-17. Prior to V-Guard, he has worked for Unilever for 25 years, covering geographies like India, US and Nigeria. As per the CFO, V-Guard's strong corporate governance, proactive management and promising future were the key reasons for his decision to work for the company. He is willing to take various initiatives to take V-Guard to the next level.

Meeting takeaways

(A) COMPANY-SPECIFIC TAKEAWAYS

- **GST and restocking**: The company has witnessed restocking benefits from mid-July, and management expects healthy revenue growth in 2QFY18. Distributors in the South and West were better prepared for this than those in the East and North. Hence, recovery was swift in the Western and Southern regions. The GST process has not yet stabilised, as claiming transaction credit has not been enabled from the government. Management expects complete stability in the next three to four months. The company lost revenue worth Rs 700-800mn (~13% of 1QFY18 revenues) during 1QFY18, owing to destocking. The management believes to recover lost revenues in 2QFY18 and 3QFY18. GST implementation has slightly increased its working capital by ~Rs 200mn, and it should be settled in the coming quarters. Management is hopeful of gaining share from unorganised players. V-Guard has taken a ~3-4% price hike at the company level owing to GST.

- **Festive season:** Onam was good for V-Guard, and the company witnessed mid-teen revenue growth. Management is hopeful for healthy revenue growth in the upcoming festive season.
- **Sikkim plant:** The recently-commissioned Sikkim plant is for Stabilisers and Water Heaters. This plant is now also manufacturing Stabilisers. At full capacity, this plant can supply 35-40% of Stabilisers requirement.
- **Acquisition:** V-Guard is open to inorganic growth, and may look for brands in the Kitchen Electrical Appliances (KEA) space. Management may look for Rs 5-10bn size of acquisition deal.
- **Distribution and marketing initiatives**
  - The company is present across all states, comprises 670 distributors, 6,000 direct dealers and about 25,000 retail outlets. Management sees enough headroom for further expanding its distribution reach, and plans to reach out to 40,000 retail outlets over the next two to three years.
    Besides distribution, the company has been focussing on improving after-sales service in the last few years.
  - Recently, in an effort to improve its sales strategy, V-Guard has start using *salesforce.com* (CRM). This would be supportive, especially in the Non-South market that caters to two-third's of the sales force of the company.
- **South and Non-South:** As per management, gross margins in the South and Non-South are almost at par (only 1% difference now), there is a big gap between EBITDA margins (~700bps) of these regions The company has already invested a large amount of funds on fixed costs (sales force, distribution etc) in Non-South. The Non-South comprises two-third of V-

Wires business to register strong growth in 2Q

Management witnessed healthy growth across products in 2QFY18

Guard's sales force, though contributing only 35% to V-Guard's revenues. Hence, enough headroom is available for leveraging the fixed cost in the Non-South. Better growth in the Non-South would improve the EBITDA margin. Many products are still only available in the Southern market, and combined, they contribute ~30% to revenues of V-Guard. A pan-India launch would further accelerate growth in the Non-South.

- **ESOPs:** The revaluation of ESOPs (owing to IND AS) would have an impact of ~Rs 80mn on EBITDA in FY18. The company has already taken a ~Rs 25mn impact in 1QFY18, and Rs 25-30mn impact would be in 2QFY18 also.
- **Management guidance**
  - **On revenue**: Management is maintaining 15% revenue guidance for FY18, despite a weak show in 1QFY18. The company would have to report ~20% growth in the next three quarters to achieve 15% growth in FY18. As per management, Fans, KEA and Pumps can grow at ~20% revenue CAGR over the next two to three years, while Stabilisers, Wires and Water Heaters would grow ~10%.
  - **On margins**: Management expects to achieve 10% EBITDA margin in FY18 (at par with FY17), despite EBITDA margin contracted by 574bps YoY in 1QFY18. As per the management, 1QFY18 EBITDA margin was down owing to (1) One-off GST-related cost (setting up new system and compensating distributors on inventory), (2) Revenue loss of Rs 700-800mn owing to destocking and (3) A delay in price hike to pass on input inflation. As per management, these issues are not present now, and EBITDA margin is in a healthy range. Management expects ~200bps EBITDA margin improvement over the next three to four years.
  - **On in-house manufacturing:** In-house manufacturing contributes ~45% as of now, and management plans to reach ~55-60% over the next two to three years (at full capacity utilisation at the Sikkim plant).
  - **On others:** (1) The company plans to invest ~Rs 400-500mn on capex (largely maintenance) in FY18, (2) Management expect rise in ASP spend in the coming years to support new products/market opportunities. V-Guard's ASP spends is at 4.4% of revenues in FY17 and we expect it to increase it to ~5% in FY20.

(B) PRODUCT-SPECIFIC TAKEAWAYS

- **Cables & Wires (30% of revenue):** V-Guard has witnessed revenue growth acceleration in Cables & Wire business during the last three months. Volume was flat in 1QFY18, which as per management has reached to high single digit. V-Guard's lower dependence on B-to-B has resulted in healthy growth. The company has already taken ~14% price hike (8% for GST and 6% to pass on raw material cost pressure) since July.
- **Stabilisers (20% of revenue):** The Stabiliser segment growth has picked up during 2Q as compared to 2% contraction in 1Q. The upcoming festive season can also accelerate growth. As of now, 20% Stablisers are manufactured in-house, and this would increase to ~40% over the next two to three years owing to the Sikkim plant.
- **Water Heaters (13% of revenue):** V-Guard's success in the Water Heater segment has continued, and the company has allegedly become the leading brand by value (crossing Racold brand). A strong product range

Management is interested in any acquisition opportunities in the KEA space

Switchgears to reach Rs1bn mark by FY20

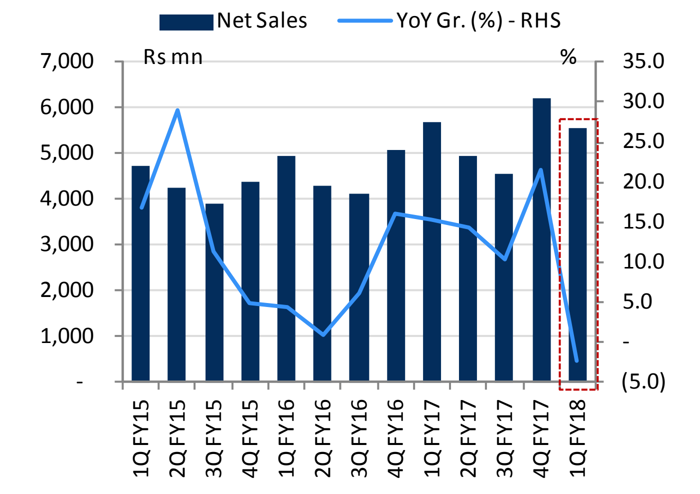
(across price points), and distribution and marketing efforts have resulted in this success. The Sikkim plant could also support more new launches.

- **Pumps (12% of revenue):** The Pump business is witnessing healthy growth in the last three months. Pump growth in 1QFY18 was at 5% YoY. As per management, the growth momentum will continue in the Pump business.
- **Fans (10% of revenue):** V-Guard has been witnessing healthy growth in Fans in the last three months. Management's continues focus on premiumisation has paid off well. Havells and Crompton also focusing on premium segment. V-Guard's premium fans contribute ~35% to its Fan business.
- **KEA (2% of revenue):** V-Guard sells cook tops (Induction and LPG) and mixer grinders in Kitchen Electrical Appliances (KEA). The company has recently launched these products in Bangalore, and plans a pan-India launch in the next one or two years. Management is willing to increase KEA's revenue share over the next few years. Management is also interested in any acquisition opportunities in the KEA space.
- **Switchgears (2% of revenue):** Switchgears are growing at a healthy pace, and management is optimistic to achieve Rs 1,000mn revenue market by FY20 vs. Rs 430mn reported in FY17.

GST led destocking and demonetisation has slowed down the revenue growth

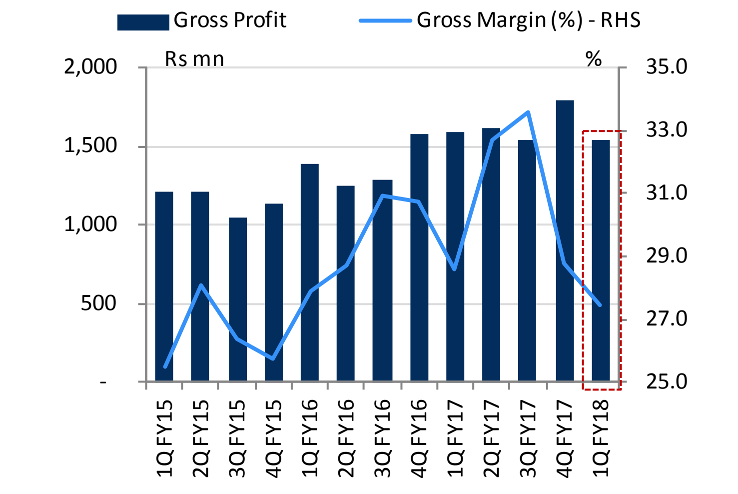
Rising raw material prices along with delay in price hike has impacted the gross margin

Net Revenue



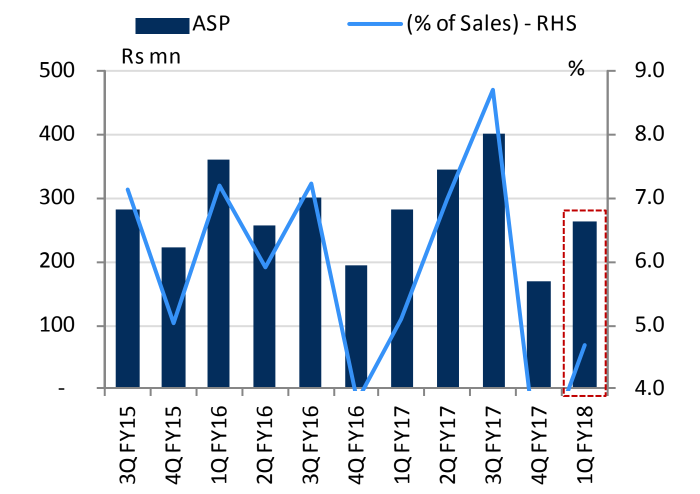
Source: Company, HDFC sec Inst Research

Gross Margin



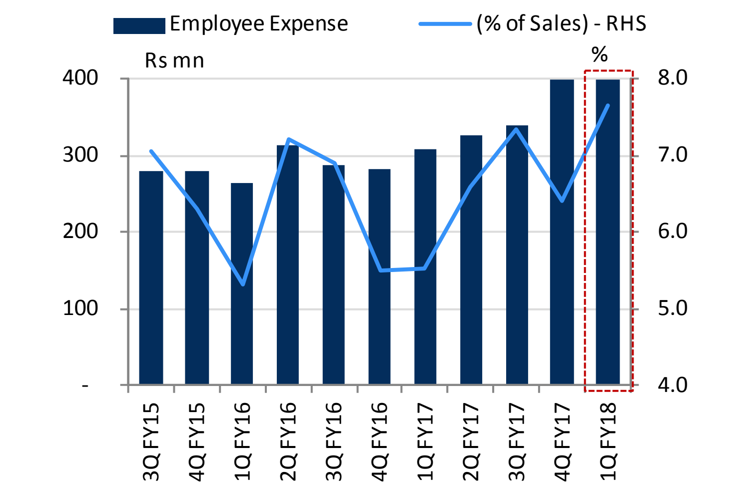
Source: Company, HDFC sec Inst Research

ASP Expense



Source: Company, HDFC sec Inst Research

Employee Expense

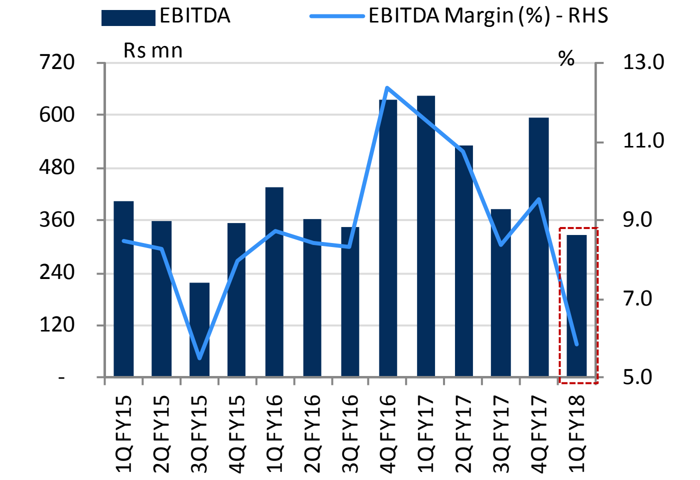


Source: Company, HDFC sec Inst Research

The Southern market witnessed more destocking pressure and registered revenue contraction of 2.4%. Management expects faster recovery in the market in the south.

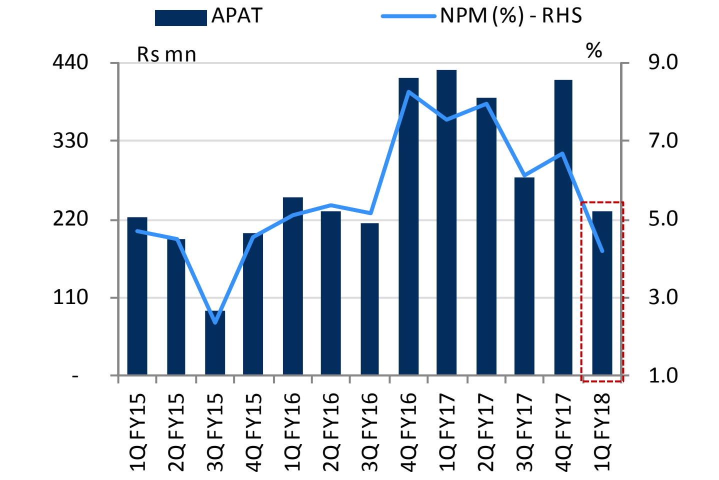
Non-South reported 8% growth, despite channel destocking pressure

EBITDA



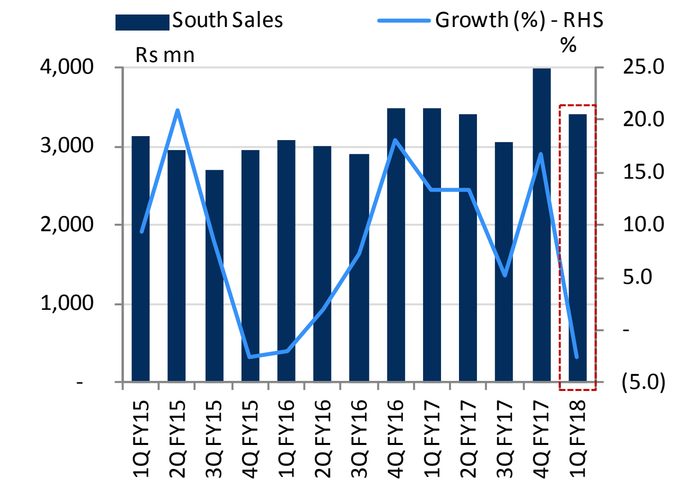
Source: Company, HDFC sec Inst Research

APAT



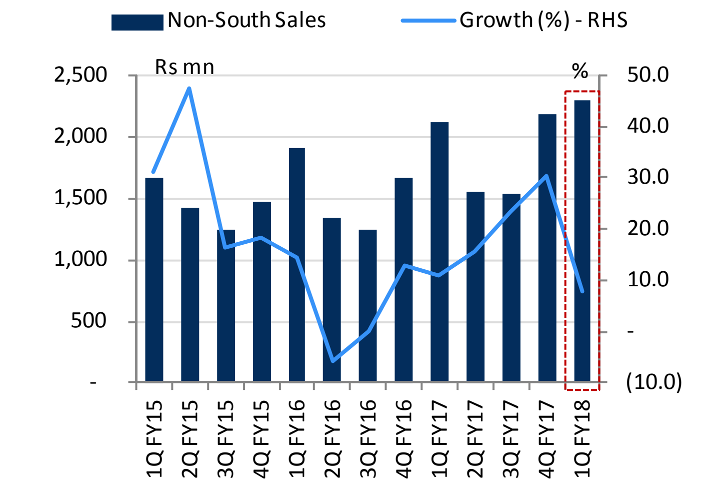
Source: Company, HDFC sec Inst Research

South Sales Performance



Source: Company, HDFC sec Inst Research

Non-South Sales Performance



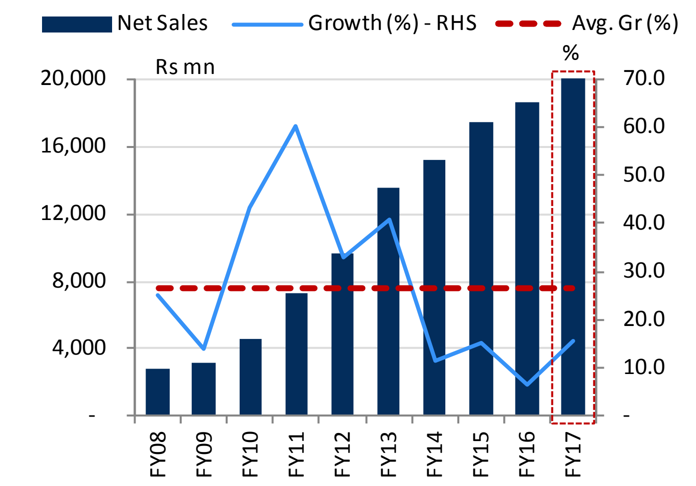
Source: Company, HDFC sec Inst Research

Sales growth has slowed, but was still >15% in FY17

Better traction from non-south market has improved the EBITDA margin in the last two years

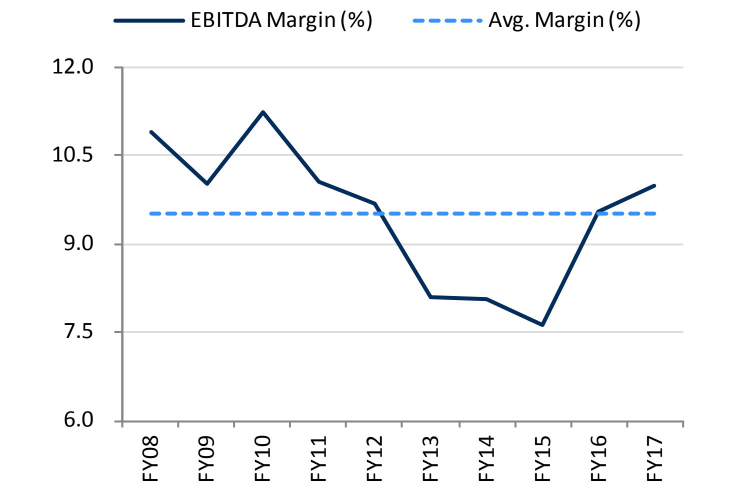
No big change in the outsourcing and manufacturing strategy

Sales Performance



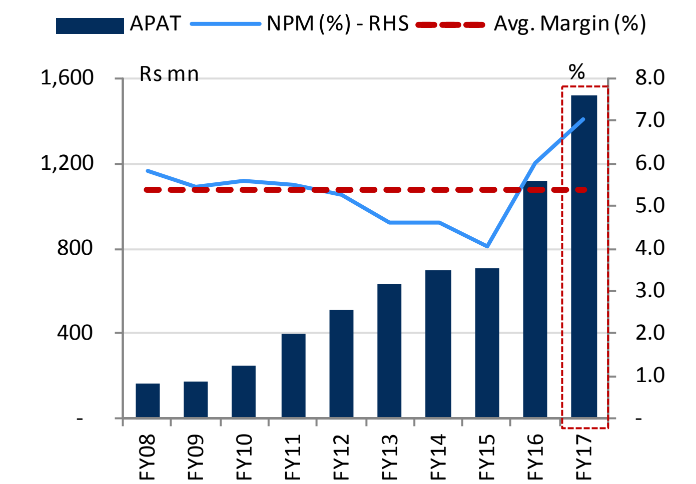
Source: Company, HDFC sec Inst Research

EBITDA Margin



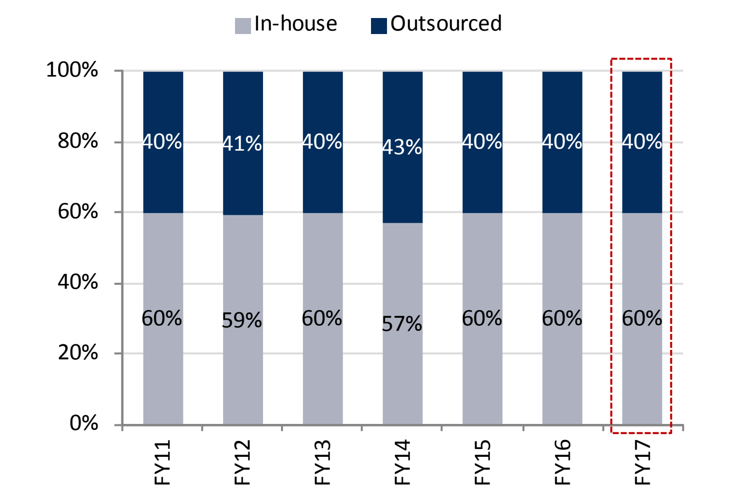
Source: Company, HDFC sec Inst Research

PAT Performance



Source: Company, HDFC sec Inst Research

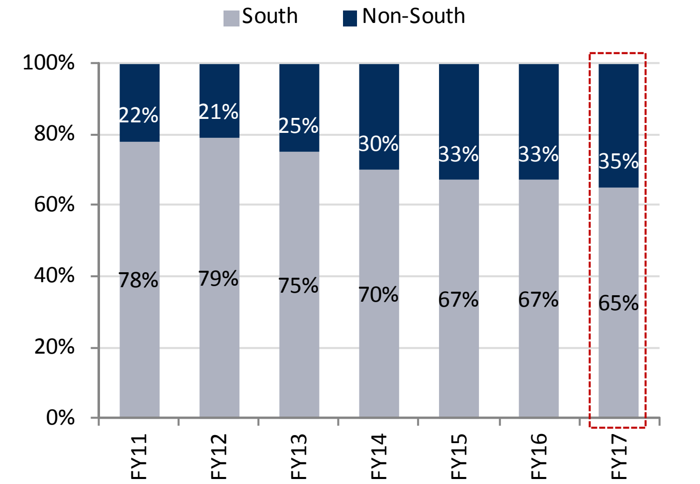
In-house Manufacturing Vs. Outsourcing



Source: Company, HDFC sec Inst Research

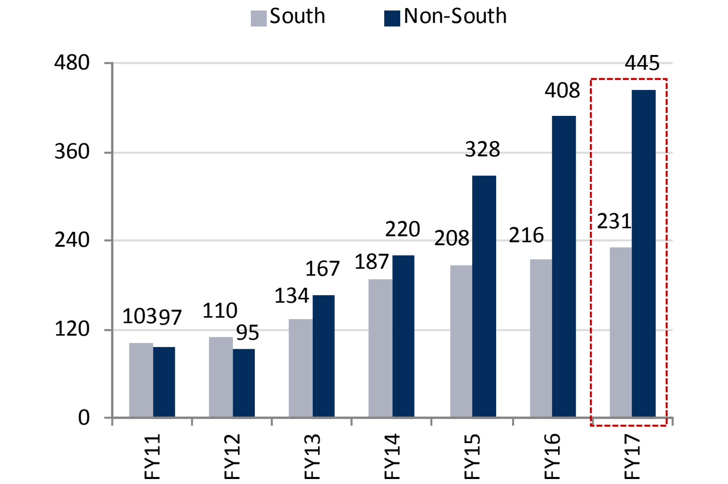
Dealer expansion in non-South has been >4x during FY11-17 vs. 2.5x in the South. This reflects management's substantial efforts to become a national brand

South andNon-South Sales Mix



Source: Company, HDFC sec Inst Research

Dealer Network



Source: Company, HDFC sec Inst Research

Assumptions

Particulars	FY16	FY17	FY18E	FY19E	FY20E
Revenue Growth (%)					
Stabilizers	12.5	18.0	12.3	15.4	15.0
UPS (Digital + Standalone)	(11.7)	18.8	14.8	15.4	15.6
Pumps	11.1	27.0	14.8	14.5	14.0
Cables & Wires (PVC + LT)	0.9	7.4	13.5	15.2	15.0
Water Heaters (Electric + Solar)	11.5	11.0	12.6	14.2	14.3
Fan	28.5	15.8	11.1	15.0	14.0
New Products Total	17.0	24.8	22.6	30.8	30.8
Gross Margin (%)	28.9	30.5	32.7	33.2	33.3
ASP (% of sales)	4.3	4.4	4.4	4.4	4.4
Distribution (% of sales)	1.0	1.1	1.0	1.0	1.0
EBITDA Margin (%)	9.6	10.0	10.4	11.5	12.0
ETR (%)	30.6	27.8	24.9	25.0	25.0

Source: Company, HDFC sec Inst Research

Income Statement

Year End March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	**18,623**	**21,506**	**24,200**	**28,110**	**32,477**
Growth (%)	***6.7***	***15.5***	***12.5***	***16.2***	***15.5***
Material Expenses	13,246	14,949	16,283	18,764	21,673
Employee Expense	1,266	1,576	1,728	1,972	2,251
ASP Expense	803	951	1,070	1,243	1,436
Distribution Expense	194	247	250	291	336
Other Expenses	1,248	1,521	2,216	2,461	2,719
EBITDA	**1,780**	**2,151**	**2,527**	**3,232**	**3,893**
EBITDA Growth (%)	***33.8***	***20.8***	***17.5***	***27.9***	***20.4***
EBITDA Margin (%)	***9.6***	***10.0***	***10.4***	***11.5***	***12.0***
Depreciation	154	162	178	194	210
EBIT	**1,627**	**1,989**	**2,349**	**3,038**	**3,683**
Other Income (Including EO Items)	72	135	200	314	462
Interest	89	21	6	2	1
PBT	**1,610**	**2,102**	**2,543**	**3,350**	**4,144**
Tax	493	584	632	837	1,036
RPAT	**1,117**	**1,518**	**1,911**	**2,512**	**3,108**
Adjustment	-	-	-	-	-
APAT	**1,117**	**1,518**	**1,911**	**2,512**	**3,108**
APAT Growth (%)	***57.9***	***36.0***	***25.8***	***31.5***	***23.7***
Adjusted EPS (Rs)	**2.65**	**3.58**	**4.50**	**5.92**	**7.32**
EPS Growth (%)	***57.3***	***34.8***	***25.8***	***31.5***	***23.7***

Source: Company, HDFC sec Inst Research

Balance Sheet

Year End March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital - Equity	301	425	425	425	425
Reserves	4,407	5,946	7,360	9,251	11,613
Total Shareholders Funds	**4,708**	**6,371**	**7,785**	**9,676**	**12,038**
Long Term Debt	56	24	4	2	0
Short Term Debt	15	1	1	1	1
Total Debt	**71**	**25**	**5**	**3**	**1**
Net Deferred Taxes	75	54	54	54	54
Long Term Provisions & Others	176	217	241	272	305
TOTAL SOURCES OF FUNDS	**5,029**	**6,667**	**8,085**	**10,004**	**12,398**
APPLICATION OF FUNDS					
Net Block	1,611	1,684	1,811	1,917	2,007
CWIP	21	221	151	151	151
Non Current Investments	-	-	-	-	-
LT Loans & Advances	180	207	222	237	252
Other Non Current Assets	2	1	1	1	1
Total Non-current Assets	**1,814**	**2,112**	**2,185**	**2,305**	**2,410**
Inventories	2,047	2,736	2,947	3,346	3,776
Debtors	2,792	3,193	3,526	4,019	4,554
Other Current Assets	242	317	317	317	317
Cash & Equivalents	270	1,048	2,094	3,438	5,269
Total Current Assets	**5,351**	**7,295**	**8,885**	**11,120**	**13,917**
Creditors	1,511	2,206	2,403	2,769	3,198
Other Current Liabilities & Provns	625	534	582	652	731
Total Current Liabilities	**2,136**	**2,740**	**2,985**	**3,421**	**3,929**
Net Current Assets	**3,216**	**4,555**	**5,900**	**7,699**	**9,988**
TOTAL APPLICATION OF FUNDS	**5,029**	**6,667**	**8,085**	**10,004**	**12,398**

Source: Company, HDFC sec Inst Research

Cash Flow Statement

Year End March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	1,610	2,102	2,543	3,350	4,144
Non-operating & EO Items	-	86	-	-	-
Interest Expenses	89	(4)	6	2	1
Depreciation	154	162	178	194	210
Working Capital Change	(517)	(501)	(299)	(455)	(458)
Tax Paid	(511)	(656)	(632)	(837)	(1,036)
OPERATING CASH FLOW (a)	**825**	**1,189**	**1,796**	**2,253**	**2,861**
Capex	(108)	(422)	(236)	(300)	(300)
Free Cash Flow (FCF)	*717*	*767*	*1,561*	*1,953*	*2,561*
Investments	(209)	(686)	(165)	(165)	(165)
Non-operating Income	-	55	-	-	-
INVESTING CASH FLOW (b)	**(317)**	**(1,053)**	**(401)**	**(465)**	**(465)**
Debt Issuance/(Repaid)	(178)	(47)	(7)	12	14
Interest Expenses	(89)	(10)	(6)	(2)	(1)
FCFE	*450*	*710*	*1,547*	*1,964*	*2,574*
Share Capital Issuance	58	92	-	-	-
Dividend	(246)	(91)	(497)	(621)	(745)
Others	-	-	11	16	18
FINANCING CASH FLOW (c)	**(456)**	**(55)**	**(499)**	**(595)**	**(715)**
NET CASH FLOW (a+b+c)	**53**	**81**	**896**	**1,193**	**1,681**
EO Items, Others	(2)	-	-	-	-
Closing Cash & Equivalents	76	157	1,053	2,246	3,928

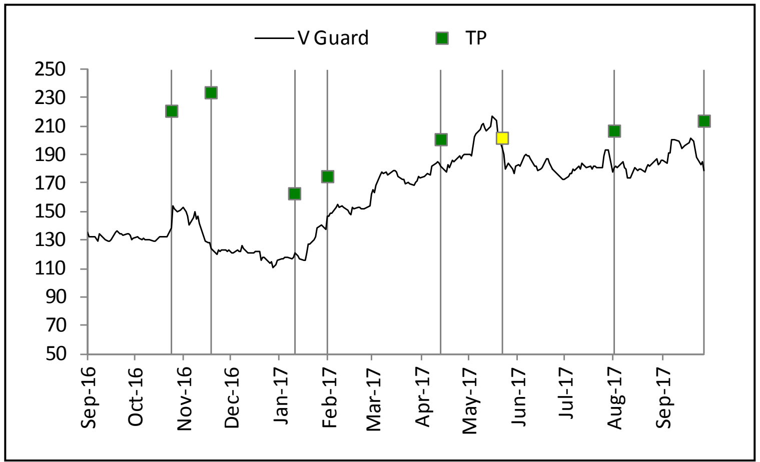
Source: Company, HDFC sec Inst Research

Key Ratios

	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY (%)					
GPM	28.9	30.5	32.7	33.2	33.3
EBITDA Margin	9.6	10.0	10.4	11.5	12.0
EBIT Margin	8.7	9.2	9.7	10.8	11.3
APAT Margin	6.0	7.1	7.9	8.9	9.6
RoE	26.3	27.4	27.0	28.8	28.6
RoIC (or Core RoCE)	24.1	27.7	30.4	36.3	40.3
RoCE	24.4	26.2	26.0	27.8	27.8
EFFICIENCY					
Tax Rate (%)	30.6	27.8	24.9	25.0	25.0
Fixed Asset Turnover (x)	7.4	7.8	7.9	8.3	8.9
Inventory (days)	*40.1*	*46.4*	*44.4*	*43.4*	*42.4*
Debtors (days)	*54.7*	*54.2*	*53.2*	*52.2*	*51.2*
Other Current Assets (days)	*4.7*	*5.4*	*4.8*	*4.1*	*3.6*
Payables (days)	*29.6*	*37.4*	*36.2*	*36.0*	*35.9*
Other Current Liab & Provns (days)	*12.2*	*9.1*	*8.8*	*8.5*	*8.2*
Cash Conversion Cycle (days)	57.7	59.5	57.4	55.3	53.0
Net D/E (x)	(0.0)	(0.2)	(0.3)	(0.4)	(0.4)
Interest Coverage (x)	18.2	94.7	365.7	1,875.3	4,932.4
PER SHARE DATA (Rs)					
EPS	2.7	3.6	4.5	5.9	7.3
CEPS	3.0	4.0	4.9	6.4	7.8
Dividend	0.7	0.7	1.0	1.3	1.5
Book Value	15.6	15.0	18.3	22.8	28.3
VALUATION					
P/E (x)	67.4	50.0	39.7	30.2	24.4
P/BV (x)	11.4	11.9	9.8	7.8	6.3
EV/EBITDA (x)	42.2	34.8	29.2	22.4	18.1
EV/Revenues (x)	4.0	3.5	3.1	2.6	2.2
OCF/EV (%)	1.1	1.6	2.4	3.1	4.0
FCF/EV (%)	1.6	1.0	2.1	2.7	3.6
FCFE/Mkt Cap (%)	0.6	0.9	2.0	2.6	3.4
Dividend Yield (%)	0.4	0.4	0.6	0.7	0.8

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
24-Oct-16	139	BUY	158
21-Nov-16	124	BUY	167
10-Jan-17	118	BUY	163
31-Jan-17	146	BUY	175
14-Apr-17	182	BUY	201
22-May-17	194	NEU	201
2-Aug-17	181	BUY	207
27-Sep-17	179	BUY	214

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

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