

Sector: Capital Goods  
Results Update

	Change
Reco: <b>Buy</b>	↔
CMP: <b>Rs. 242</b>	
Price Target: <b>Rs. 285</b>	↑

↑ Upgrade ↔ No change ↓ Downgrade

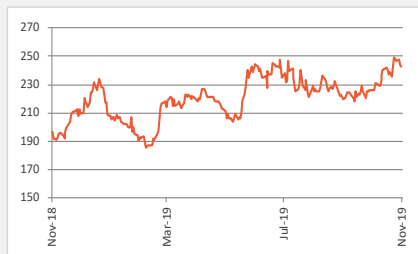
## Company details

Market cap:	Rs. 10,380 cr
52-week high/low:	Rs. 260/183
NSE volume: (No of shares)	6.0 lakh
BSE code:	532953
NSE code:	VGUARD
Sharekhan code:	VGUARD
Free float: (No of shares)	15.3 cr

## Shareholding (%)

Promoters	64.1
FII	13.7
DII	12.5
Others	9.8

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	8.1	7.0	14.7	24.6
Relative to Sensex	0.5	-2.5	8.4	6.5

Sharekhan Research, Bloomberg

V-Guard reported a strong quarter with net profit rising by 50% y-o-y to Rs. 57 crore for Q2FY2020. The strong net earnings growth was led by 400 bps+ improvement in gross and operating margin (favorable commodity & currency, higher in house manufacturing and price hikes across products). As a consequence, while top-line growth was subdued at 4% y-o-y, EBITDA margin expanded from 8.3% to 10.9% (after adjusting the benefit from write back of ESOP expenses pertaining to preceding period) with margin expansion seen across its key product categories. The revenue growth was affected by the loss of 2-3 weeks sales in key states like Kerala, Bihar, Karnataka and Maharashtra owing to heavy rains. Hence, South region revenue grew just 1.5% y-o-y while Non-South regions grew at 7.5% y-o-y. ECD segment revenue declined ~4% y-o-y (due to supply issues for water heaters from China) while electronics grew by 3.8% y-o-y. The management will be targeting 10-11% revenue from the earlier guidance of 12% y-o-y as it expects a gradual recovery in consumer demand as against sudden upsurge. The key focus areas for the company is expected to be replacement of low margin products with premium products, expanding reach in suburbs and tier II & III cities and the launch of new products in kitchen appliances and water purifier range. We have tweaked our estimates for FY2020, factoring in higher operating profit. We retain a Buy rating with revised price target (PT) of Rs. 285.

## Key positives

- Gross margins improved 418 bps benefitting from price hikes, in-house manufacturing and favorable commodity prices
- Management expects better H2 than H1 and expect gradual recovery in consumer demand.

## Key negatives

- Competitive intensity remains high with deep discounting across products from new players.
- Floods in different states like Kerala, Maharashtra, Karnataka and Bihar impacted sales.

## Our Call

**Valuation – We maintain Buy with a revised PT of Rs. 285:** We have tweaked our estimate for FY2020 factoring higher operating margins. We believe V-Guard's strategy of differentiating products and avoiding deep discounting is expected to protect OPM going ahead. The gradual improvement in consumer demand along with start of best period for sales from December 2019 to March 2020 augurs well for the company's product portfolio. The increasing contribution from non-South region, launch of new products and increasing penetration in tier II & III cities is expected to revive the company's higher revenue growth trajectory. Further, moving towards in-house manufacturing for stabilisers (currently 50% in-house production), water heaters (50% in-house), and fans (nil) over the next 2-3 years will bring in benefits of scale and better control over gross margins. Hence, we retain Buy with a revised PT of Rs. 285 due to presence of multiple growth levers on the medium to long term

## Key Risks

Unfavourable climatic conditions can have a negative impact (on stabilisers, fans and pumps) and increased competitive intensity.

## Valuation (Consolidated)

Particulars	Rs cr			
	FY18	FY19	FY20E	FY21E
Revenue	2,312	2,566	2,851	3,241
OPM (%)	9.6	8.5	10.3	10.5
Adjusted PAT	169	166	223	264
% YoY growth	16.8	(2.1)	34.6	18.3
Adjusted EPS (Rs.)	4.0	3.9	5.2	6.2
P/E (x)	60.9	62.4	46.4	39.2
P/B (x)	13.7	11.5	9.6	8.0
EV/EBITDA (x)	43.6	42.7	31.7	27.0
RoNW (%)	24.4	20.0	22.5	22.3
RoCE (%)	31.0	26.0	29.4	28.9

Source: Company; Sharekhan estimates

**Margin expansion boosts net profit:** For Q2FY2020, net sales of V-Guard Industries (V-Guard) rose by 3.6% y-o-y to Rs. 619 crore broadly in-line with our estimates. The revenues remained muted due to weakness in consumer demand, tight liquidity conditions, reduced discretionary spending and floods in Kerala which further impacted revenues. The Electrical cable segment grew by 8.9% y-o-y while the Electronics segment grew 3.8% and Consumer Durable segment declined by 3.9% y-o-y. Stabilisers, wires and pumps witnessed good growth during the quarter. Further, the non-South markets accounted for 37% of the net revenue in Q2FY20 against 35% in Q2 FY19 and reported a 7.5% y-o-y growth in revenues. The operating margins expanded 418 bps and 415bps in gross and operating margin respectively due to stable commodity & currency, higher in house manufacturing and price hikes across products. As a consequence, while top-line growth was subdued, EBITDA margin expanded from 8.3% to 10.9% (after adjusting the benefit from write back of ESOP expenses pertaining to preceding period) with margin expansion across all our key product categories. Higher other income (up 76% y-o-y) offset by higher interest cost, depreciation and higher ETR (25.3% vs 20.5% in Q2FY19) led to 50% y-o-y growth in net profit to Rs. 57 crore for Q2FY2020

### Key conference call highlights

**Revenue Guidance:** The management will be targeting 10-11% revenue guidance on weak consumer demand conditions and sustainable gross margins of 32% going ahead.

**Price hike across products:** Price hike was taken across three products (water heater, stabiliser and inverter battery) in Q2FY20. Further there was some supply issues in water heaters from China (recent mandatory changes from Government of India on imported components to be ISI marked) which impacted water heater sales in the ECD segment

**Floods impacted revenues:** Floods in several states like Maharashtra, Karnataka and Kerala impacted sales. Due to weak demand environment, the festival season too remained slow

**Competition remains high:** The competitive intensity has remained high for last 10-18 months with deep discounting across products from new players. The company mentioned that it won't participate in this deep discounting and will protect their margins

**Strong return ratios:** Strong return ratios maintained with ROE and ROCE of 21.0% and 25.4% respectively (TTM basis) at the end of Q2 FY20.

**Working capital cycle:** The working capital cycle improved from 59 days to 58 days y-o-y

**In-house production preferred going ahead:** The Company has laid stress on shifting its manufacturing in-house compared to its earlier stance of outsourcing and outsourcing only to smaller categories. The company has capex plans of Rs. 70 crore in FY2020E.

**Non-south region contribution:** The non-South markets accounted for 37% of the net revenue in Q2FY20 against 35% in Q2 FY19 and reported a 7.5% y-o-y growth in revenues. The Company envisages adding 3,000-5,000 retailers across the country every year over the next five years with higher addition in the non-South region.

Results (Standalone)					Rs cr	
Particulars	Q2FY20	Q2FY19	YoY %	Q1FY20	QoQ %	
Revenues	619	598	3.6	699	(11.4)	
RM cost	410	421	(2.5)	472	(13.0)	
Staff cost	45	51	(11.0)	60	(25.3)	
Other Exp	87	77	13.0	96	(10.1)	
Operating Expenses	542	548	(1.1)	628	(13.8)	
Operating profits	78	50	55.6	71	9.1	
Other Income	7	4	76.3	6	7.1	
Interest	1	0	214.4	1	(21.0)	
Depreciation	7	5	27.0	7	2.8	
PBT	77	48	59.7	70	9.9	
Tax	19	10	96.8	17	12.1	
Adj PAT	57	38	50.1	52	9.3	
Reported PAT	57	38	50.1	52	9.3	
Adj EPS	1.3	0.9	50.1	1.2	9.3	
			<b>bps</b>		<b>bps</b>	
GPM	33.8%	29.6%	415	32.6%	122	
OPM *	12.5%	8.3%	418	10.2%	236	
NPM	9.3%	6.4%	286	7.5%	175	
Tax rate	25.3%	20.5%	477	25%	48	

Source: Company; Sharekhan Research

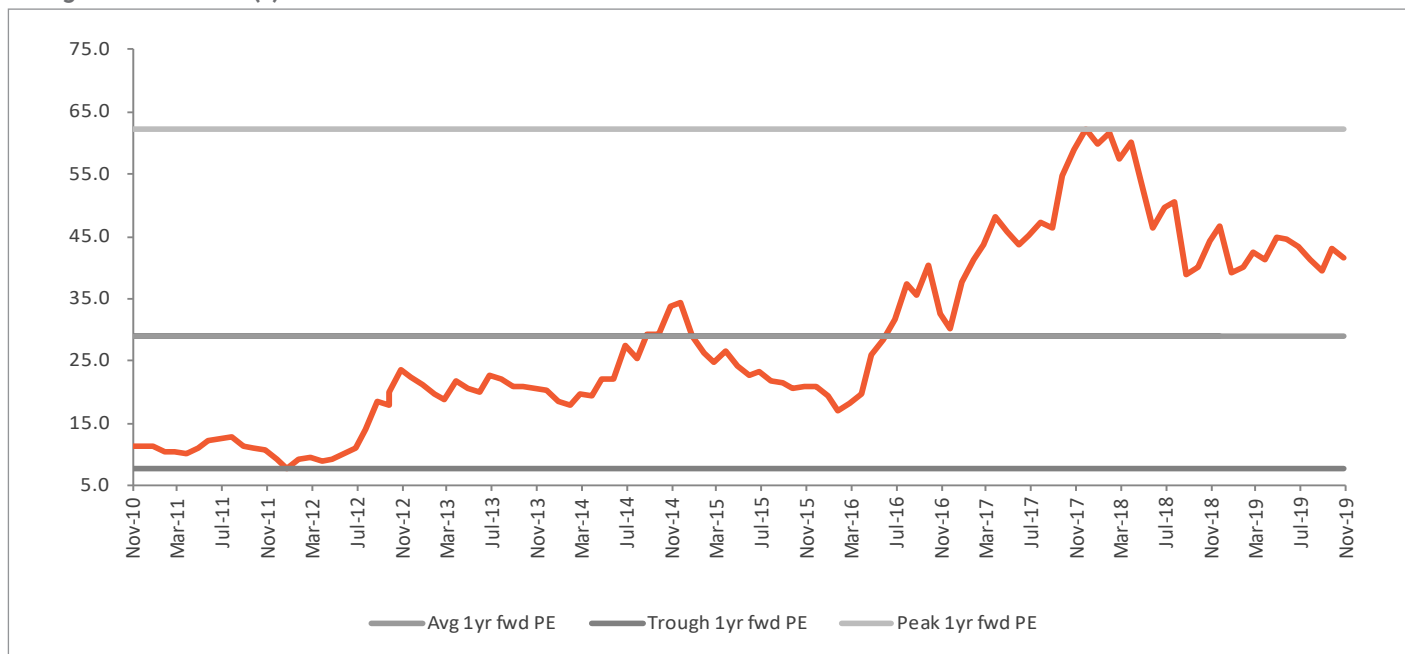
**Outlook - Medium to long-term growth levers intact**

The management will be targeting 10-11% revenue from the earlier guidance of 12% y-o-y as it expects a gradual recovery in consumer demand as against sudden upsurge. The key focus areas for the company is expected to be replacement of low margin products with premium products, expanding reach in suburbs and tier II & III cities and the launch of new products in kitchen appliances and water purifier range. The company plans on moving towards in-house manufacturing of products and stabilising of newly launched products. Further, V-Guard is beginning to replicate its dominance in non-south regions as with the southern regions. In the long run, the company expects equal revenue contribution from both the regions and is in the process to achieve that with increasing distribution reach and product introduction. The cash-positive balance sheet enables it to pursue inorganic opportunities at attractive valuations, given the weak macro environment. It is looking at companies having product range synergy with V-Guard, providing manufacturing capabilities, or strong regional players where V-Guard can expand its geographic footprint.

**Valuation - We maintain Buy with a revised PT of Rs. 285**

We have tweaked our estimate for FY2020 on account of reasons mentioned above. Further, we believe with improvement in weak environment, V-Guard would regain a higher growth trajectory. Increasing contribution from non-south region and the recently launched products is expected to revive the company’s higher revenue growth trajectory post FY2020. Further, moving towards in-house manufacturing for stabilisers (currently 50% in-house production), water heaters (50% in-house), and fans (nil) over the next 2-3 years will bring in benefits of scale and better control over gross margins. Hence, we retain Buy with a revised PT of Rs. 285 due to presence of multiple growth levers on the medium to long term.

**One-year forward P/E (x) band**



Source: Sharekhan Research

**Peer Comparison**

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Havells India	53.0	46.8	32.0	27.8	9.6	8.6	22.7	23.6
Crompton Greaves Consumer Electrical	34.3	29.4	23.1	19.9	13.1	10.4	40.2	39.5
V-Guard	46.4	39.2	31.7	27.0	9.6	8.0	22.5	22.3

Source: Sharekhan Research

## About company

V-Guard is a major electrical appliances manufacturer in India, and the largest in Kerala. V-Guard is one of India's consumer goods company with diversified product offerings. Headquartered in Kochi, Kerala, the company now has over 500 distributors, 30,000 retailers, and numerous branches across India. The company manufactures voltage stabilisers, electrical cables, electric pumps, electric motors, geysers, solar water heaters, air coolers and UPSs.

## Investment theme

V-Guard is an established brand in the electrical and household goods space, particularly in south India. Over the years, it has successfully ramped up its operations and network to become a multi-product company. The company has a strong presence in the southern region. The company is also aggressively expanding in non-south markets and is particularly focusing on tier-II and III cities, where there is lot of pent-up demand for its products.

## Key Risks

- ◆ Unfavourable climatic conditions can have a negative impact (stabilisers, fans and pumps).
- ◆ Increased competitive intensity.
- ◆ Volatility in commodity prices and forex variations.

## Additional Data

### Key management personnel

Mr. Kochouseph Chittilappilly	Chairman
Cherian Punnose	Vice-Chairman
Mithun K Chittilappilly	Managing Director
V Ramachandran	Director and Chief Operating Officer
Sudarshan Kasturi	Senior VP and CFO

Source: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Chittilappilly Kochouseph Thomas	18.42
2	Chittilappilly Mithun K	16.86
3	KOCHOUSEPH SHEELA GRACE	10.87
4	CHITTILAPPILLY ARUN K	8.66
5	KOCHOUSEPH CHITTILAPPILLY	4.87
6	CHITTILAPPILLY KOCHOUSEPH	4.33
7	Nalanda India Equity Fund Ltd	4.27
8	Axis Asset Management Co Ltd/India	4.24
9	DSP Investment Managers Pvt Ltd	3.58
10	Nalanda India Fund Ltd	1.95

Source: Bloomberg

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by BNP PARIBAS

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