

Sector: Capital Goods
Results Update

	Change
Reco: Buy	↔
CMP: Rs. 218	
Price Target: Rs. 270	↓
↑ Upgrade	↔ No change
↓ Downgrade	

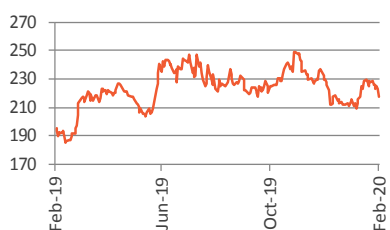
Company details

Market cap:	Rs. 9,331 cr
52-week high/low:	Rs. 260/183
NSE volume: (No of shares)	26,585
BSE code:	532953
NSE code:	VGUARD
Sharekhan code:	VGUARD
Free float: (No of shares)	15.9 cr

Shareholding (%)

Promoters	62.8
FII	14.2
DII	13.1
Others	9.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.0	-9.7	-3.2	15.0
Relative to Sensex	7.4	-11.1	-11.1	1.3

Sharekhan Research, Bloomberg

V-Guard reported lower than estimated net profit at Rs. 42.9 crore (up 27% y-o-y) on account of muted topline growth (up 5.4% y-o-y) and lower than expected OPM (due to lower absorption of fixed costs led by muted revenue growth). The muted revenue growth was affected by one-off weak demand for its Electronics segment (Stabilizers and UPS). The Electricals (up 5% y-o-y) and Consumer Durables (up 9.9% y-o-y) fared relatively well in a tough environment. Gross margins improved by 319 bps y-o-y (lower 57 bps q-o-q) benefitting from favorable commodity. As a consequence, EBITDA margin expanded by 192 bps y-o-y (although lower by 304 bps q-o-q) to 9.5%. Regionally, revenues from South region grew just 4% y-o-y while Non-South regions grew at 7.8% y-o-y for Q3. Healthy operational performance led to 27% y-o-y growth in net profit to Rs.42.9 crore. The management expects higher gross margins to be sustainable. OPM may remain volatile depending on revenue growth. The management saw green shoots in demand environment since December 2019 although risks related to Coronavirus in Kerala and China (critical electronics and chemicals getting sourced) looms in the near term. It expects double digit revenue growth over the medium term factoring higher single digit growth in South and 20-22% growth in non-South markets. The double digit revenue growth is expected to come from expansion in non-South market (roll out of Kitchen appliances in East, switches & switchgears in East & North). We have fine tuned our estimates for FY2020-FY2021 and have introduced FY2022E estimate in this note. Factoring in the near term weak demand environment, we have lowered our valuation multiple and have also rolled forward it to FY2022E earnings. Hence, we arrive at a revised PT of Rs. 270. We continue to maintain Buy as we expect strong net earnings growth driven by OPM expansion in a muted near term demand environment.

Key positives

- Gross margins improved 319 bps benefitting from price hikes and lower volatility in commodity prices
- Management has witnessed improved demand since December 2019.

Key negatives

- Competitive intensity remains high with deep discounting across products from new players especially in South.
- Uncertainty with respect to Coronavirus in Kerala and China (as key source for electrical components).

Our Call

Valuation – We maintain Buy with revised PT of Rs. 270: V-Guard is currently facing near term headwinds like weak demand, increased competitive intensity and possible scarcity of key components from China. However, 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 double digit revenue growth trajectory in the medium term. We have fine tuned our estimates for FY2020-FY2021 and have introduced FY2022E estimate in this note. Factoring in near term weak demand environment, we have lowered our valuation multiple and have also rolled forward it to FY2022E earnings. Hence, we arrive at a revised PT of Rs. 270. We continue to maintain Buy as we expect strong net earnings growth driven by OPM expansion in a muted near term demand environment.

Key Risks

Sustained weak demand environment and possible scarcity of key components in electronics from China can affect earnings over the near term.

Valuation (Consolidated)

Particulars	Rs cr			
	FY19	FY20E	FY21E	FY22E
Revenue	2,566	2,762	3,129	3,530
OPM (%)	8.5	10.7	11.0	11.0
Adjusted PAT	166	223	264	289
% YoY growth	(2.1)	35.0	18.2	9.3
Adjusted EPS (Rs.)	3.9	5.2	6.2	6.8
P/E (x)	56.2	41.6	35.2	32.2
P/B (x)	10.3	8.6	7.2	6.1
EV/EBITDA (x)	38.4	28.3	24.2	21.4
RoNW (%)	20.0	22.6	22.3	20.6
RoCE (%)	26.0	29.5	28.9	27.5

Source: Company; Sharekhan estimates

Margin expansion boosts net profit: V-Guard reported lower than estimated net profit at Rs. 42.9 crore (up 27% y-o-y) on account of muted topline growth (up 5.4% y-o-y) and lower than expected OPM (due to lower absorption of fixed costs led by muted revenue growth). The muted revenue growth was largely affected by one-off weak demand for its Electronics segment (Stabilizers and UPS). The Consumer Durables (up 9.9% y-o-y) led by fans and heaters and Electricals (up 5% y-o-y) fared relatively well in a tough environment. Gross margins improved by 319 bps y-o-y (lower 57 bps q-o-q) benefitting from favorable commodity, higher in house manufacturing and price hikes. As a consequence, EBITDA margin expanded by 192 bps y-o-y (although lower by 304 bps q-o-q) to 9.5%. Regionally, revenues from the South region grew just 4% y-o-y while the Non-South markets accounted for 38.1% of the net revenue in Q3FY20 against 37% in Q3 FY19 and reported a 7.8% y-o-y growth in revenues. Healthy operational performance led to 27% y-o-y growth in net profit to Rs 42.9 crore.

Key conference call highlights

- ◆ **Demand improvement:** Management highlighted that there has been an improvement in demand in Dec/Jan vs the weakness seen in previous months.
- ◆ **Competition remains high:** The competitive intensity has remained high for last 10-18 months with deep discounting across products (like water heaters) 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 25.5% respectively (TTM basis) at the end of Q3FY20.
- ◆ **Working capital cycle:** The working capital cycle continues to remain under control at 58 days in Q3FY20 similar to Q2FY20 in tight liquidity conditions.
- ◆ **Net Cash position:** Company's net cash position improved further to Rs. 323 crore (up Rs 120.43 crore) as on 31st December 2019 despite the annual dividend pay-out based on higher operating margins and stable cash conversion metrics
- ◆ **Custom duty hikes:** Government has increased custom duties on many electronics imports from 10% to 20% in the Budget 2020-21. While 7-8% of the total revenues are met via imports, this won't affect the company materially. Further V-Guard has been increasing the share for localisation particularly in water heaters, which should be completed by next year.
- ◆ **China Coronavirus update:** Considering the import requirements across product categories for electronics, the risk in terms of delay of opening up the shipments beyond 15th Feb could have an impact on product availability and revenues by March end/ April, depending on each players inventory levels.
- ◆ **Non-south region contribution:** The non-South markets accounted for 38.1% of the net revenue in Q3FY20 against 37% in Q2FY19 and reported a 7.8% 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)

Particulars	Rs cr				
	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)
Revenues	627	594	5.4	619	1.2
RM cost	419	416	0.6	410	2.1
Staff cost	58	49	18.8	45	29.7
Other Exp	90	84	7.1	87	4.2
Operating Expenses	567	549	3.3	542	4.7
Operating profits	59	45	32.2	78	(23.4)
Other Income	5	4	25.1	7	(21.2)
Interest	1	1	85.3	1	18.0
Depreciation	7	6	31.3	7	5.8
PBT	57	43	30.9	77	(26.3)
Tax	14	9	43.9	19	(29.6)
Adj PAT	43	34	27.2	57	(25.2)
Reported PAT	43	34	27.2	57	(25.2)
Adj EPS	1.0	0.8	27.2	1.3	(25.2)
			bps		bps
GPM	33.2%	30.0%	319	33.8%	(57)
OPM *	9.5%	7.6%	192	12.5%	(304)
NPM	6.8%	5.7%	117	9.3%	(241)
Tax rate	24.2%	22.0%	218	25%	(113)

Source: Company; Sharekhan Research

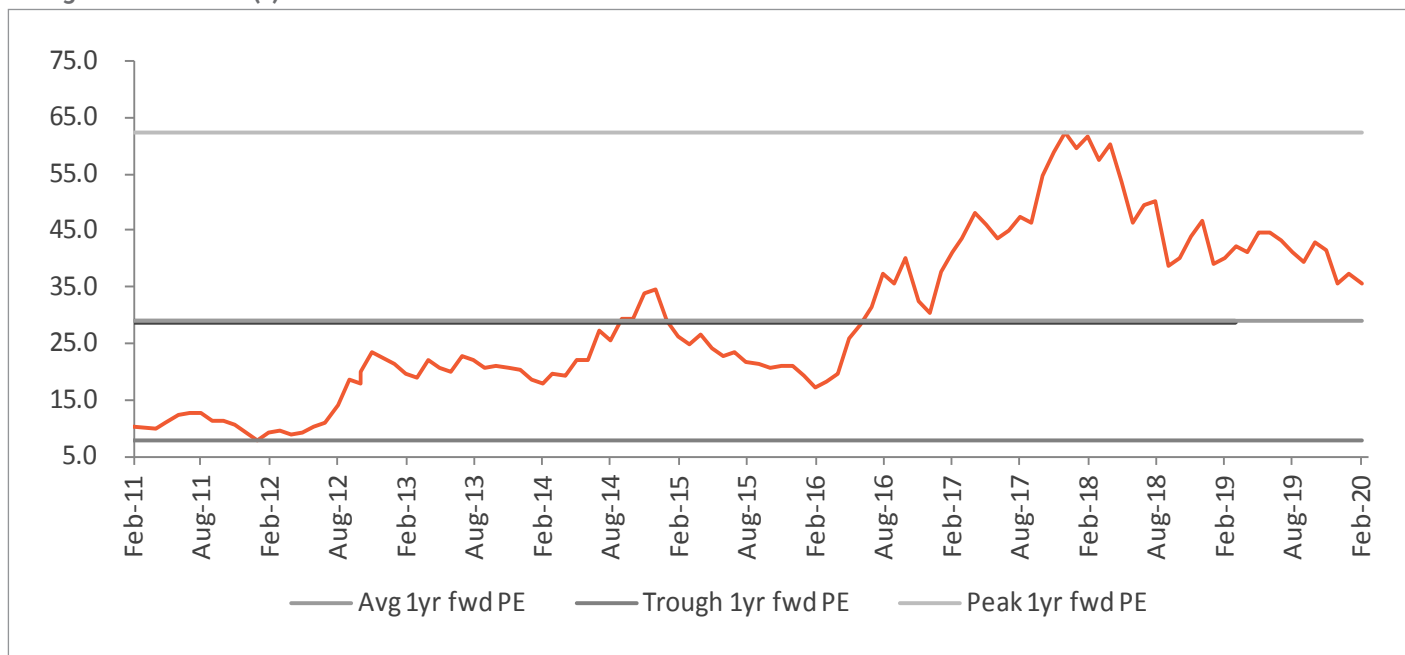
Outlook

Medium to long-term growth levers intact: V-Guard is currently facing near term headwinds like weak demand, increased competitive intensity and possible scarcity of key components from China. However, 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 double digit revenue growth trajectory in the medium term. 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 the 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 revised PT of Rs. 270: V-Guard is currently facing near term headwinds like weak demand, increased competitive intensity and possible scarcity of key components from China. However, 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 double digit revenue growth trajectory in the medium term. We have fine tuned our estimates for FY2020-FY2021 and have introduced FY2022E estimate in this note. Factoring in the near term weak demand environment, we have lowered our valuation multiple and have also rolled forward it to FY2022E earnings. Hence, we arrive at a revised PT of Rs. 270. We continue to maintain Buy as we expect strong net earnings growth driven by OPM expansion in a muted near term demand environment.

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*	45.8	35.9	31.3	25.6	7.9	7.2	18.5	19.9
Crompton Greaves Consumer Electrical*	35.9	31.6	27.3	23.9	12.6	10.0	40.1	35.3
V-Guard	35.2	32.2	24.2	21.4	7.2	6.1	22.3	20.6

Source: Sharekhan Research, *Bloomberg estimates

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.
- ◆ Sustained weak demand environment and possible scarcity of key components in electronics from China can affect earnings over the near term.

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 Mithun K	25.18
2	Chittilappilly Kochouseph Thomas	17.22
3	CHITTILAPPILLY ARUN K	8.66
4	KOCHOUSEPH CHITTILAPPILLY	4.87
5	CHITTILAPPILLY KOCHOUSEPH	4.33
6	Nalanda India Equity Fund Ltd	4.27
7	Axis Asset Management Co Ltd/India	4.27
8	DSP Investment Managers Pvt Ltd	3.33
9	KOCHOUSEPH SHEELA GRACE	2.56
10	Nalanda India Fund Ltd	1.95

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;

Disclaimer: Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com; Investment in securities market are subject to market risks, read all the related documents carefully before investing.