Sharekhan by BNP PARIBAS

V-Guard Industries

Better prepared for near-term challenges

Sector: Capital Goods

Results Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 180**	
Price Target: **Rs. 215**	↓

↑ Upgrade ↔ No change ↓ Downgrade

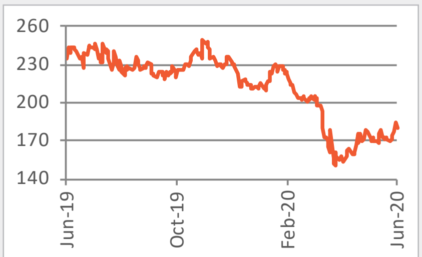
Company details

Market cap:	Rs. 7,722 cr
52-week high/low:	Rs. 260/149
NSE volume: (No of shares)	4.0 lakh
BSE code:	532953
NSE code:	VGUARD
Sharekhan code:	VGUARD
Free float: (No of shares)	16 cr

Shareholding (%)

Promoters	62.7
FII	13.4
DII	13.4
Others	10.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6	-12	-22	-23
Relative to Sensex	-1	1	-5	-8

Sharekhan Research, Bloomberg

V-Guard Industries Limited's (V-Guard) Q4FY2020 revenue declined sharply by 27.5% y-o-y (below estimates), as it was affected by COVID-19 led Lockdown in the last few days of March 2020 (peak season), which impacted sales worth Rs. 250 crore. Loss of sales during March was more adverse as the second half of March tends to be big due to pre-build of summer products at the trade and due to closing of annual schemes and incentives. The company witnessed a decline in revenue across segments, such as electronics (down 26.8% y-o-y), electrical (down 31.8% y-o-y), and consumer durable (down 19.5% y-o-y). Regionally, non-south market revenue declined by 21.2%, while south markets were lower by 31.2% y-o-y. Although, gross margin improved by 374 bps y-o-y (higher 13 bps q-o-q) benefitting from price increases and premiumisation, operating profit margin (OPM) contracted by 215 bps y-o-y to 8.4% (due to a decline in business volumes). Hence, operating profit declined by 42.2% y-o-y to Rs. 45 crore (the company estimates loss of Rs. 70 crore due to COVID-19 lockdown). Poor operational performance led to a PAT decline of 45.1% y-o-y. Currently, all factories are operational and May 2020 revenue was ~70% of May 2019 (majorly sales have been from Tier 2/3/rural/suburban areas). On the supply side, 50-60% of retailers are open pan-India and 60-70% of the company's dealers are open right now and the number has been progressively increasing. Regionally, the company has witnessed good traction in southern and eastern markets due to lower COVID-19 cases. V-Guard's lower exposure in metros (~15% revenue contribution) vis-à-vis rural markets in the current environment is expected to benefit the company. COVID-19 led disruption increased V-Guard's inventory, which is expected to correct by July 2020 end. For FY2021, the company's focus will be on cutting down on discretionary expenditure without affecting operations. We have revised our revenue estimate downwards, factoring gradual improvement in the demand environment for FY2021-FY2022, and revised OPM for FY2022. Currently, the stock is trading at a P/E of 31.6x its FY2022E earnings, which is almost 25% discount to historical (trailing five year) average one-year forward P/E multiple. We believe the company's strong balance sheet, reputed brand, and robust business fundamentals will help emerge stronger from the near-term weak environment. Hence, we continue to maintain Buy on the stock with a revised price target (PT) of Rs. 215.

Key positives

- Gross margin improved by 374 bps, benefitting from price increases and premiumisation.
- All factories operational and May 2020 revenue was ~70% of May 2019.

Key negatives

- Inventory stands at ~100 days, which is expected to reduce to 50 days by the end of July.
- Revenue loss estimated at Rs. 250 crore from loss of sales during March 2020.

Our Call

Valuation – We maintain Buy with a revised PT of Rs. 215: V-Guard, like its industry peers, has been affected hard by weak sales in March 2020, which is the peak sales period. Consequently, revenue for FY2021 and near-term working capital requirements have been affected negatively. However, V-Guard largely caters to Tier 2/3/rural/suburban areas, which is expected to rebound quickly as seen in May where revenue was ~70% of May 2019, largely coming from these Tier 2/3/rural/suburban areas. We have revised our revenue estimate downwards, factoring gradual improvement in the demand environment for FY2021-FY2022, and have revised OPM for FY2022. Currently, the stock is trading at a P/E of 31.6x its FY2022E earnings, which is almost 25% discount to historical (trailing five year) average one-year forward P/E multiple. We believe the company's strong balance sheet, reputed brand, and robust business fundamentals will help emerge stronger from the near-term weak environment. Hence, we continue to maintain Buy on the stock with a revised PT of Rs. 215.

Key Risks

Sustained weak demand environment can affect earnings over the near term.

Valuation Rs cr

Particulars	FY19	FY20E	FY21E	FY22E
Revenue	2,566	2,482	2,640	2,957
OPM (%)	8.5	10.2	10.0	10.7
Adjusted PAT	166	185	197	244
% YoY growth	(2.1)	11.9	6.6	23.7
Adjusted EPS (Rs.)	3.9	4.3	4.6	5.7
P/E (x)	46.5	41.7	39.1	31.6
P/B (x)	8.6	7.8	6.7	5.7
EV/EBITDA (x)	31.6	27.3	25.9	21.3
RoNW (%)	20.0	19.6	18.4	19.6
RoCE (%)	26.0	26.0	24.1	25.1

Source: Company; Sharekhan estimates

COVID-19 takes a toll on the company's performance: V-Guard Industries Limited's (V-Guard) Q4FY2020 revenue declined sharply by 27.5% y-o-y (below estimates), as it was affected by COVID-19 led Lockdown in the last few days of March 2020 (peak season), which impacted sales worth Rs. 250 crore. Loss of sales during March was more adverse as the second half of March tends to be big due to pre-build of summer products at the trade and due to closing of annual schemes and incentives. The electronics business declined by 26.8% y-o-y to Rs. 150 crore, while the electrical segment declined by 31.8% y-o-y to Rs. 242 crore and consumer durable business saw revenue declining by 19.5% y-o-y to Rs. 144 crore. Although, gross margin improved by 374 bps y-o-y (higher 13 bps q-o-q) benefitting from cost-control initiatives and price increases, OPM contracted by 215 bps y-o-y to 8.4% (due to lower revenue growth and decline in business volumes) leading to a 42.2% y-o-y decline in operating profit. Lower operating leverage along with lower other income and higher depreciation resulted in PAT decline of 45.1% y-o-y Q4FY2020. Regionally, non-south market revenue declined by 21.2%, while southern markets were lower by 31.2% during Q4FY2020.

Key result highlights from Concall

- **Q4FY2020 impact:** The company's revenue was affected by COVID-19 led lockdown in March 2020. In non-south regions, retailers buy products from the company in last weeks of March 2020 to avail different schemes, which did not happen due to the lockdown.
- **Inventory:** In normal circumstances, channel inventory level is 20-35 days, which had gone to 100 days. However, management expects it to come down to 50 days by June-July 2020. The company may offer relaxation of terms for retailers/dealers, which are in red zones and have been affected by the current environment.
- **Capex:** The company will be completing product-related capex. However, non-essential capex will be put on hold. It is likely to incur capex of Rs. 35 crore-40 crore for FY2021.
- **Urban-Rural Mix:** The company's exposure in metro cities is ~15% of turnover. Rural markets have been doing well during May 2020. In southern region, Karnataka, Andhra Pradesh, and Kerala have been doing well, while in the eastern region, Orissa and Bihar have been performing well.
- **COVID-19 impact on the sector:** During COVID-19 led disruption, management has seen business moving to larger partners or key accounts. Management expects a number of small and mid-size industry players to suffer. The company will be expediting digitisation during the current time period.
- **COVID-19 impact on business segments:** During COVID-19 period, electrical segments did better than average, while consumer durables having urban exposure performed lower than average.
- **Operational update:** All of the company's warehouses are operational from May 4, 2020. It has seen 70% of business taking place in May 2020 compared to May 2019. Currently, 50-60% of retailers are open.
- **Near-term outlook:** Management expects COVID-19 led disruption to affect the business environment for few months. Supply chain is expected to take few weeks to get normal. However, collections have been better.
- **Cost-control measures:** The company is undertaking cost-containment measures such as reducing overheads, deferring increments, reducing travel and rentals, among others. The company's ad spend for Q1FY2021 is expected to be very low; and for the initial few months, it is expected to remain muted.

Results (Standalone) **Rs cr**

Particulars	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Revenue	537	740	(27.5)	627	(14.4)
RM cost	358	521	(31.3)	419	(14.5)
Staff cost	43	53	(17.9)	58	(26.1)
Other Expenses	91	88	2.7	90	0.4
Operating Expenses	491	662	(25.7)	567	(13.4)
Operating profits	45	78	(42.2)	59	(24.0)
Other Income	5	7	(23.2)	5	(4.7)
Interest	1	0	286.2	1	(13.0)
Depreciation	7	6	27.8	7	(3.3)
PBT	42	79	(46.4)	57	(25.0)
Tax	10	20	(50.3)	14	(27.6)
Adjusted PAT	33	59	(45.1)	43	(24.2)
Reported PAT	33	59	(45.1)	43	(24.2)
Adjusted EPS (Rs.)	0.8	1.4	(45.1)	1.0	(24.2)
			bps		**bps**
GPM	33.3%	29.6%	374	33.2%	13
OPM	8.4%	10.6%	(215)	9.5%	(107)
NPM	6.1%	8.0%	(195)	6.8%	(78)
Tax rate	23.3%	25.1%	-	24%	-

Source: Company; Sharekhan Research

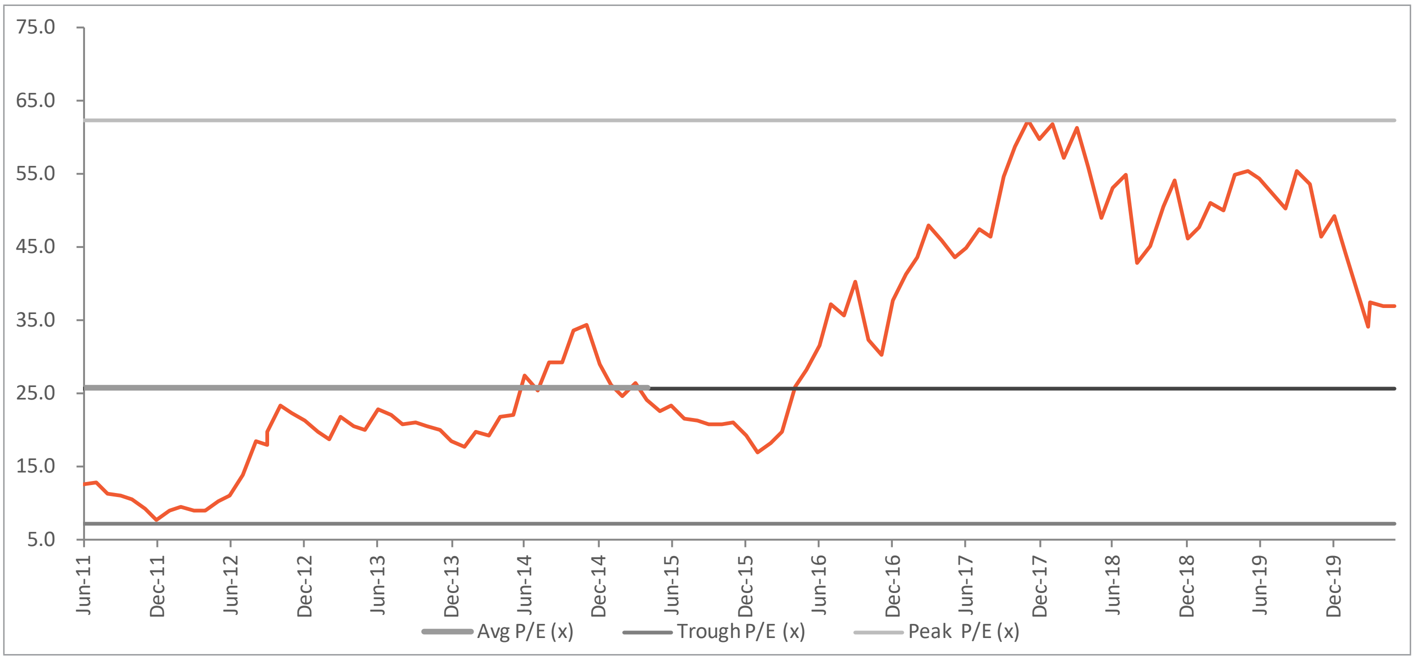
Outlook

COVID-19 pandemic to affect sales, gradually going back to business: Currently, all factories and projects are operational and May revenue was ~70% of May 2019. Almost all these sales have been from Tier 2/3/rural/suburban areas. On the supply side, 50-60% of retailers are open pan-India and 60-70% of the company's dealers are open right now and the number has been progressively increasing. Regionally, the company has witnessed good traction in southern and eastern markets since sales resumed, while metros remain weak (lower share in revenue mix ~15%). V-Guard has benefited from the faster pick up in rural markets. On the capex front, product-related capex will go ahead as planned and the company will continue investing in new product launches. However, most of the capex has already been incurred. Capex of Rs. 35 crore-40 crore is expected in FY2021 and non-essential capex will be put on hold. The company's strong balance sheet and cash position will help combat a weak macroeconomic environment and uncertainties.

Valuation

We maintain Buy with a revised PT of Rs. 215: V-Guard, like its industry peers, has been affected hard by weak sales in March 2020, which is the peak sales period. Consequently, revenue for FY2021 and near-term working capital requirements have been affected negatively. However, V-Guard largely caters to Tier 2/3/rural/suburban areas, which is expected to rebound quickly as seen in May where revenue was ~70% of May 2019, largely coming from these Tier 2/3/rural/suburban areas. We have revised our revenue estimate downwards, factoring gradual improvement in the demand environment for FY2021-FY2022, and have revised OPM for FY2022. Currently, the stock is trading at a P/E of 31.6x its FY2022E earnings, which is almost 25% discount to historical (trailing five year) average one-year forward P/E multiple. We believe the company's strong balance sheet, reputed brand, and robust business fundamentals will help emerge stronger from the near-term weak environment. Hence, we continue to maintain Buy on the stock with a revised PT of Rs. 215.

One-year forward P/E (x) band



Source: Company Data; 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 for ex-variations.

Additional Data

Key management personnel

Mr. KochousephChittilappilly	Chairman
CherianPunnose	Vice-Chairman
Mithun K Chittilappilly	Managing Director
V Ramachandran	Director and Chief Operating Officer
SudarshanKasturi	Senior VP and CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	ChittilappillyMithun K	25.18
2	ChittilappillyKochouseph 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

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