Sharekhan
by BNP PARIBAS

V-Guard Industries

Challenging quarter; better prepared for challenges

Sector: Capital Goods
Results Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 165**	
Price Target: **Rs. 200**	↓

↑ Upgrade ↔ No change ↓ Downgrade

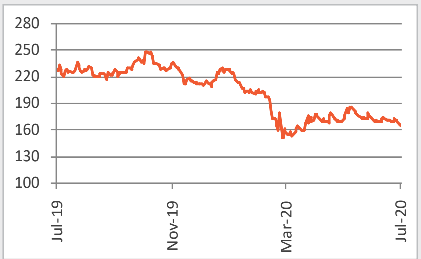
Company details

Market cap:	Rs. 7,054 cr
52-week high/low:	Rs. 260/149
NSE volume: (No of shares)	4.2 lakh
BSE code:	532953
NSE code:	VGUARD
Sharekhan code:	VGUARD
Free float: (No of shares)	16.0 cr

Shareholding (%)

Promoters	62.7
FII	13.1
DII	13.8
Others	10.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4	-7	-19	-28
Relative to Sensex	-14	-26	-19	-30

Sharekhan Research, Bloomberg

V-Guard Industries Limited's (V-Guard) Q1FY2020 revenue declined sharply by 42% y-o-y affected by COVID-19 led lockdown. April sales were nil, with recovery seen during May and June (70% and 90%) compared to the previous year's revenues. The company witnessed a decline in revenue across segments, such as electronics (down 51.3% y-o-y), electrical (down 30.6% y-o-y), and consumer durable (down 44.3% y-o-y). Regionally, non-south market revenue declined by 47% y-o-y, while south markets were lower by 37.7% y-o-y. Gross margins down 334 bps y-o-y owing to factory and market closures during the lockdown and the operating margins contracted by 794BPS y-o-y to 2.2% (due to a decline in business volumes) leading to 87.3% y-o-y decline in operating profit to Rs 9 crore. Lower operational performances along with lower other income resulted in PAT decline of 93.1% y-o-y to Rs 3.6 crore for Q1FY21.

Regionally, the company has witnessed good traction in the southern markets (Karnataka and Kerala) but non- south markets saw larger impact due to extended lockdowns where the impact has been higher in metros compared to non-metros. Inventory levels in the channels have been lower than normal as lower stocking seen across the channels due to the uncertainties and sporadic lockdowns. On the demand side, the company highlighted that it is difficult to predict whether there is any pent up demand and stated that there is more of need-based demand. On the business front, the management indicated that there is good demand seen across it electrical products (largely wires) and capacity utilization has been very good, other business utilization has been normal. For the upcoming festive season in the South (Onam) the management stated that in these uncertain circumstances, prediction is difficult but largely expect it to be subdued.

For FY2021, the company's focus will be on reducing discretionary expenditure without affecting operations. We have revised our revenue estimate downwards, factoring sporadic lockdown hampering sales and gradual improvement in the demand environment for FY2021-FY2022 and revised OPM for FY2021 weighing the fixed cost. Currently, the stock is trading at a P/E of 32x its FY2022E earnings, which is almost 26% discount to historical (trailing five year) average one-year forward P/E multiple. Company's cash flow generation remains strong at Rs 215.65 crore (vs Rs 182.5 crore in Q1FY20) along with net cash of Rs 349.3 crore on balance sheet as on 30th June, 2020 (vs Rs. 324.6 crore in June, 2019) providing the company with the opportunity for inorganic acquisitions at a favourable valuation. We believe the company's strong balance sheet, cash flows and reputed brand along with robust business fundamentals will help it 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. 200.

Key positives

- CFO generation at the end of Q1 FY21 of Rs. 215.65 crore vs Rs.182.50 crore in Q1FY20.
- Working capital days at 61 days vs. 86 days in FY20 mainly due to lower inventories.

Key negatives

- Gross margins declined sharply due to factory & market closures during lockdown.
- Industry witnessing high competitive intensity amidst a weak demand environment, increasing discounts on product offering.

Our Call

Valuation – We maintain Buy with a revised PT of Rs. 200: Like its industry peers, V-Guard has been affected hard by weak sales in Q1FY20, which remains a strong season impacting sales and margins. However, V-Guard largely caters to Tier 2/3/rural/suburban areas, which is expected to rebound quickly as seen in June where revenue was ~90% of June 2019, largely coming from non-metro areas barring the sporadic lockdowns which can hamper sales. Further, a shift from unorganised to organised is expected to help company in gaining business. We have revised our revenue estimate downwards, factoring in a gradual improvement in the demand environment for FY2021-FY2022, and have revised OPM for FY2021. Currently, the stock is trading at a P/E of 32x its FY2022E earnings, which is almost 26% discount to historical (trailing five year) average one-year forward P/E multiple. We believe the company's strong balance sheet, cash flows and reputed brand along with robust business fundamentals will help it emerge stronger from the near-term weak environment. Hence, we continue to maintain Buy on the stock with a revised PT of Rs. 200.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20E	FY21E	FY22E
Revenue	2,566	2,482	2,521	2,823
OPM (%)	8.5	10.2	9.5	10.7
Adjusted PAT	166	185	175	221
% YoY growth	(2.1)	11.9	(5.5)	26.2
Adjusted EPS (Rs.)	3.9	4.3	4.1	5.2
P/E (x)	42.5	38.1	40.3	32.0
P/B (x)	7.8	7.1	6.2	5.4
EV/EBITDA (x)	28.8	24.9	26.0	20.4
RoNW (%)	20.0	19.6	16.4	18.1
RoCE (%)	26.0	26.0	21.8	24.3

Source: Company; Sharekhan estimates

COVID-19 takes a toll on the company's performance: V-Guard's Q1FY2021 revenue declined sharply by 42% y-o-y to Rs. 406 crore, as it was affected by nil sales in the first 45 days of Q1FY20 due to COVID-19 related lockdown. Sales during April was NIL during May and June revenue recovery was 70% and 90% respectively compared to last year revenues. The company witnessed a decline in revenue across segments, such as the electronics business declined 51.3% y-o-y to Rs138 crore (seen a sharper decline based on its linkage with appliances that see larger demand in the summer season), the electrical segment declined 30.6% y-o-y to Rs 1832 crore and the consumer durable business declined 44.3% y-o-y to Rs 85 crore. Gross margins down 334 bps y-o-y owing to factory and market closures during the lockdown and the operating margins contracted by 794BPS y-o-y to 2.2% (due to a decline in business volumes) leading to a 87.3% y-o-y decline in operating profit to Rs 9 crore. Poor operational performance along with lower other income resulted in PAT decline of 93.1% y-o-y to Rs 3.6 crore for Q1FY21. Regionally, non-south market revenue declined by 47% y-o-y, while south markets were lower by 37.7% y-o-y. The non-south market saw a larger impact in revenues due to extended lockdowns during Q1FY21, whereas opening up in the south saw improved demand in states such as Karnataka and Kerala

Key conference call highlights

Q1FY2020 impact: Non-south markets saw a larger impact in revenues due to more extended lockdowns during Q1FY21, whereas opening up in the south saw improved demand.

Inventory: Inventory levels in the channels have been lower than normal as lower stocking seen across the channels due to the uncertainties and sporadic lockdown downs.

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. 30 crore-35 crore for FY2021.

Urban-Rural Mix: Non metro and rural markets have been done well in May and June 2020. In the southern region, Karnataka and Kerala have also fared well.

COVID-19 impact on the sector: The COVID-19 led disruption, has seen business moving to larger partners or key accounts. Management expects a number of unorganized, small and mid-size industry players to find it difficult to sustain. The company will be expediting digitisation during the current time period (focusing on its e-commerce platform).

Business segments seeing demand: On the business front, the management has indicated that there is good demand across its electrical products (largely wires) and capacity utilization has been very good, other business utilization has been normal.

Inorgnic acquisition: The company's net cash position remains strong providing opportunity for inorganic acquisitions at favourable valuation.

Festival season in South: For the upcoming festive season in South (Onam) the management stated that in these uncertain circumstances it is difficult to really predict but largely expect it to be subdued. However expects demand in stablisers (TV sales expected since it is major source of entertainment under the lockdown) and UPS

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 spends for the initial few months is expected to remain muted.

Results (Standalone) Rs cr

Particulars	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Revenues	406	699	(42.0)	537	(24.4)
RM cost	287	472	(39.1)	358	(19.7)
Staff cost	55	60	(9.3)	43	26.6
Other Exp	55	96	(43.0)	91	(39.4)
Operating Expenses	397	628	(36.8)	491	(19.3)
Operating profits	9	71	(87.3)	45	(79.9)
Other Income	5	6	(27.3)	5	(9.6)
Interest	1	1	2.1	1	25.9
Depreciation	8	7	16.8	7	11.1
PBT	5	70	(93.1)	42	(88.7)
Tax	1	17	(93.2)	10	(88.2)
Adj PAT	3.6	52	(93.1)	33	(88.9)
Reported PAT	4	52	(93.1)	33	(88.9)
Adj EPS	0.1	1.2	(93.1)	0.8	(88.9)
			bps		**bps**
GPM	29.2%	32.6%	(334)	33.3%	(412)
OPM *	2.2%	10.2%	(794)	8.4%	(618)
NPM	0.9%	7.5%	(661)	6.1%	(517)
Tax rate	24.4%	24.8%		23%	

Source: Company; Sharekhan Research

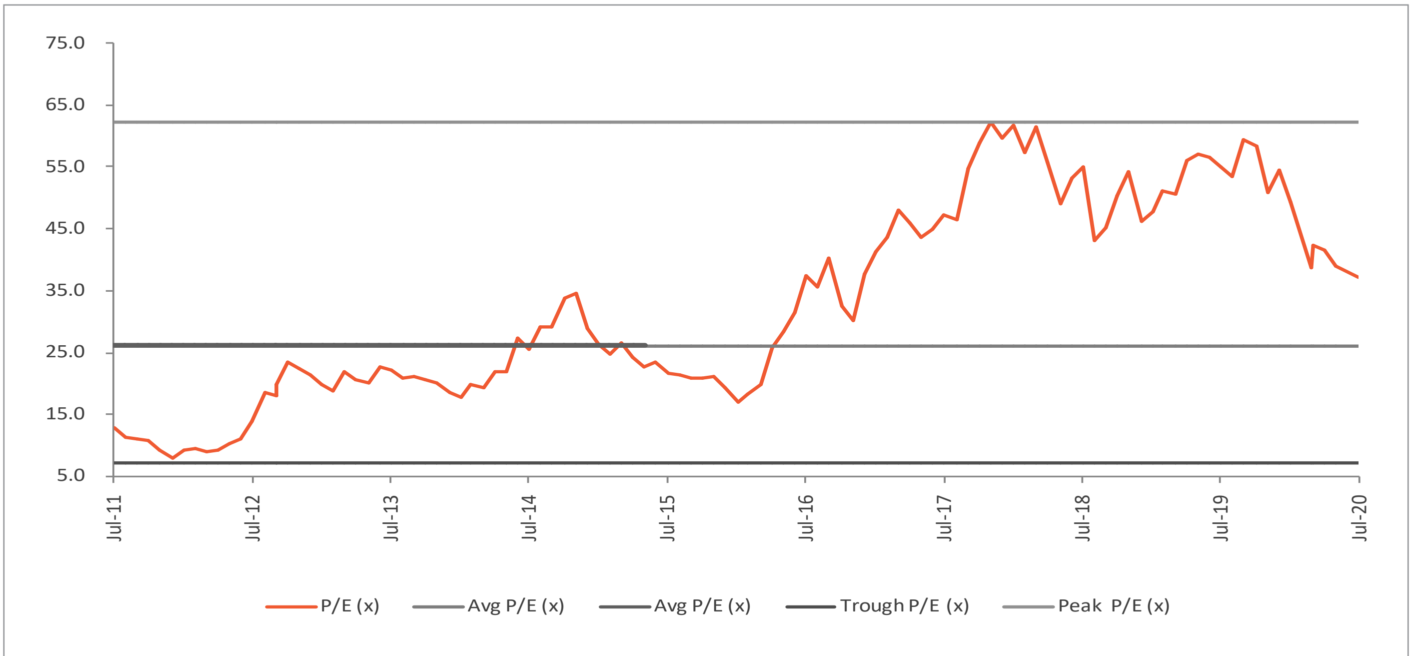
Outlook

COVID-19 pandemic to affect sales, gradually going back to business: Currently, all factories and projects are operational wherein non metro and rural markets have performed well in May and June 2020 (70% & 90% sales compares to last year). On the supply side, inventory levels in the channels have been lower than normal as lower stocking seen across the channels due to the uncertainties and sporadic lockdowns. Regionally, in southern region, Karnataka and Kerala have been doing well 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. 30 crore-35 crore is expected in FY2021 and non-essential capex will be put on hold. Management expects near term to be uncertain as localised lockdown is hampering discretionary demand although long term positives remain intact. Management is focusing on maintaining healthy cash position, cost rationalisation, and expediting digitization. The cash-positive balance sheet enables it to pursue inorganic opportunities at attractive valuations, given the weak macro environment.

Valuation

We maintain Buy with a revised PT of Rs. 200: Like its industry peers, V-Guard has been affected hard by weak sales in Q1FY20, which remains a strong season impacting sales and margins. However, V-Guard largely caters to Tier 2/3/rural/suburban areas, which is expected to rebound quickly as seen in June where revenue was ~90% of June 2019, largely coming from non-metro areas barring the sporadic lockdowns which can hamper sales. Further, a shift from unorganised to organised is expected to help company in gaining business. We have revised our revenue estimate downwards, factoring in a gradual improvement in the demand environment for FY2021-FY2022, and have revised OPM for FY2021. Currently, the stock is trading at a P/E of 32x its FY2022E earnings, which is almost 26% discount to historical (trailing five year) average one-year forward P/E multiple. We believe the company's strong balance sheet, cash flows and reputed brand along with robust business fundamentals will help it emerge stronger from the near-term weak environment. Hence, we continue to maintain Buy on the stock with a revised PT of Rs. 200.

One-year forward P/E (x) band



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 for ex-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 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

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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

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