Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

V-Guard Industries

Set to gain in the post pandemic era

Capital Goods	Sharekhan code: VGUARD	Company Update

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 176**	
Price Target: **Rs. 211**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

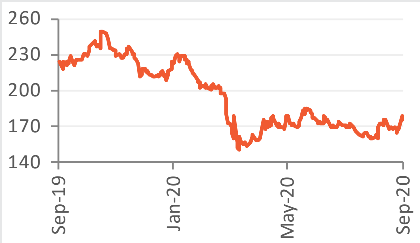
Company details

Market cap:	Rs. 7,537 cr
52-week high/low:	Rs. 260/149
NSE volume: (No of shares)	6.2 lakh
BSE code:	532953
NSE code:	VGUARD
Free float: (No of shares)	16.0 cr

Shareholding (%)

Promoters	62.7
FII	13.1
DII	13.3
Others	10.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	10	0	2	-22
Relative to Sensex	7	-17	-23	-27

Sharekhan Research, Bloomberg

Summary

- We retain Buy on V-Guard Industries Limited (V-Guard) with a revised PT of Rs. 211, considering its reasonable valuations and improving business operations. We have introduced FY2023E earnings.
- Market demand at 80-85% of normal in August-September, while factories are currently operating at 70-80%. The company is set to increase inventory to cater to demand surge in the festive season..
- Launch of e-commerce exclusive products. Expect scale up in appliance revenue with key role played by the e-commerce segment.
- Targeting acquisitions with appetite for Rs. 500 crore-600 crore acquisition size to build scale in allied products. We expect organised players such as itself to benefit in the current tough environment.

We interacted with the management of V-Guard Industries Limited (V-Guard) regarding the recent developments and future outlook of the company and industry. The company is witnessing near normal environment with 80-85% markets opened in August and September, while factories are operating at 70-80% capacity utilisation. Channel inventory has begun to normalise with March-end inventory stocks getting sold. The company is planning to increase inventory at company level by one to one and a half week to cater to any foreseeable surge in demand in the near future in anticipation of the festive period. The company has launched products exclusively for e-commerce (6-7% of turnover sold through e-commerce for categories such as stabilisers, water heaters, fans, kitchen appliances, and air coolers). The company expects to scale up its appliance segment over the next 2-3 years, which contributed ~Rs. 85 crore (3.5% of FY2020 turnover) in which it expects digital channels to play a key role. The company is in the process of developing local sourcing for fans (currently imported) in one to two years. The scale up of capacity utilisation for its water heater plant would ensure nil dependence from imports from next year. The shift to in-house manufacturing/local sourcing would aid in supply security and better margins for water heaters and fans. On the south and non-south mix (which is about 60% south and 40% non-south), the company expects to reach 50:50 mix over 4-5 years (increasing non-south mix by 2% per annum each). The company is also targeting few acquisitions in allied product categories with an appetite of Rs. 500 crore-600 crore for acquisitions (as cash balance stood at Rs. 352 crore in June 2020). Additionally, post COVID-19, the company expects national brands such as itself to gain as smaller players would have been severely affected. Going ahead, with the onset of the festive season and good demand seen across its all-weather products such as wires, switches, and kitchen appliances along with improving capacity utilisation, the company should see strong improvement in revenue. Currently, the stock is trading at P/E of 34.2x/30.2x its FY2022E/FY2023E earnings, which is at a discount to its 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 price target (PT) of Rs. 211. We have also introduced FY2023 estimated in this update.

Our Call

Valuation – We maintain Buy with a revised PT of Rs. 211: V-Guard has reached near normal operations in August and September with easing restrictions of the unlock. The company has started to increase inventory at its level in anticipation of improved festive demand. Increased e-commerce product portfolio is expected to improve upon its e-commerce sales for select categories. The company's wires category has reached pre-COVID-19 level growth profile of 5-6% per year. The company's reputed brand is expected to gain from smaller players post the pandemic, as smaller players would have been severely hit. The company also has a strong cash balance for inorganic expansion during the current weak environment. Currently, the stock is trading at P/E of 34.2x/30.2x its FY2022E/FY2023E earnings, which is at a discount to its 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. 211. We have also introduced FY2023 estimates in this update.

Key Risks

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

Valuations (Consolidated) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	2,482	2,521	2,823	3,124
OPM (%)	10.2	9.5	10.7	10.8
Adjusted PAT	185	175	221	250
% YoY growth	11.9	(5.5)	26.2	13.1
Adjusted EPS (Rs.)	4.3	4.1	5.2	5.8
P/E (x)	40.8	43.1	34.2	30.2
P/B (x)	7.6	6.7	5.8	5.0
EV/EBITDA (x)	26.6	27.8	21.8	19.5
RoNW (%)	19.6	16.4	18.1	17.7
RoCE (%)	26.0	21.8	24.3	23.9

Source: Company; Sharekhan estimates

Demand recovery better in non-metros and suburban to benefit V-Guard: Demand recovery in non-metros and suburban regions has been faster compared to metros and tier-1 cities. Recovery in July was also progressing, with ~70% outlets starting operations despite intermediary lockdowns. V-Guard with its concentration more towards the suburban and tier-2,3 cities has seen increasing revenue run-rate since April 2020 (a washout month) and is expected to pick up as more and more restrictions are lifted. Further, onset of the festive season and good demand seen across its all-weather products such as wires, switches, and kitchen appliances along with improving capacity utilisation provide comfort. For FY2021, the company's focus will be on reducing discretionary expenditure without affecting operations.

Focus remains on the non-south market: V-Guard has expanded aggressively in non-south markets to reduce the company's dependence on southern markets. Revenue mix of non-south was above 40% for the first time in FY2020. This presents a huge untapped market for the company to grow into with the help of our multiple product categories. Further, demand recovery in non-metros and suburban regions has been faster compared to metros and tier-1 cities. V-Guard largely caters to tier-2/3/rural/suburban areas (non-south is dominant in Orissa, Bihar, MP, West Bengal, and dominant in non-south region), which is expected to rebound quickly, as seen in June with further improvements in July 2020. The company envisages the non-south markets to contribute to 50% over the next five years.

Extended distribution network coupled with thrust on innovation, branding, and promotion to tap the potential market share in the long run: The company currently has 30,000-35,000 retail touch points and envisages adding 3,000-5,000 retailers across the country every year over the next five years with higher additions in the non-south region. Currently, two-thirds of the company's distribution network has been established in the non-south region having significant potential for meaningfully adding to revenue growth and operating leverage to expand to existing investments. The company's sustained efforts on innovation, R&D, and product development will continue to be made to roll out differentiated products, keeping competition in mind. Cost optimisation (through methods such as lean manufacturing and efficient raw-material utilisation) is an endeavour being taken across its 10 plants to improve efficiency and margins.

Shift from unorganised to organised: The company is present in key product categories having significant market size and demonstrate medium to low branded penetration, leaving immense headroom for organised players to benefit, especially market leaders, with established brands and entrenched manufacturing and distribution capabilities. The pandemic provides opportunities for players such as V-Guard to improve its market share, as unorganised players face challenges meeting financial obligations.

Upgrading digital capabilities: The company has been focusing on upgradation of its digital capabilities, including further strengthening of its e-commerce platforms, where the company is witnessing ramp-up in its orders post the lockdown. Further, the company has launched products exclusively for e-commerce (6-7% of turnover sold through e-commerce for categories such as stabilisers, water heaters, fans, kitchen appliances, and air coolers). The company expects to scale up its appliance segment over the next 2-3 years, which contributed ~Rs. 85 crore (3.5% of FY2020 turnover) in which it expects digital channels to play a key role.

Looking at opportunities to consolidate its market share through strategic acquisitions: V-Guard is the market leader in most core categories that it operates in southern markets. The company is also looking to consolidate its market share through strategic acquisitions in allied product categories with an appetite of Rs. 500 crore-600 crore for acquisitions. The cash-positive balance sheet (as cash balance stood at Rs. 352 crore in June 2020) enables it to pursue inorganic opportunities at attractive valuations, given the weak macro environment. The company 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.

Key highlights of our interaction with Sudarshan Kasturi - CFO, V-Guard

- **Business scenario on improving trend:** The company is witnessing near normal environment with 80-85% markets opened in August and September, while factories are operating at 70-80% capacity utilisation. Initial pent up in demand has normalised both in south and non-south markets and supply-side issues had largely come down, barring few in containment zones, which remain low in the whole scheme of things.

- **Inventory levels:** Channel inventory has begun to normalise with March-end inventory stocks getting sold. The company is planning to increase inventory at company level by one to one and a half week to cater to any foreseeable surge in demand in the near future in anticipation of the festive period

- **Wires and cables:** Management indicated that it is seeing the slackness in the realty business, which is continuing from some time (although the company attained pre-COVID-19 sales of 5-6% in wires and cables with uptick in suburban areas).

- **Import content to reduce:** The company is in the process of developing local sourcing for fans (currently imported mainly for pedestal and exhausts) in one to two years. The scale up of capacity utilisation for its water heater plant would ensure nil dependence from imports from next year. The shift to in-house manufacturing/local sourcing would aid in supply security and better margins for water heaters and fans.

- **E-commerce:** The company has launched products exclusively for e-commerce (6-7% of turnover sold through e-commerce for categories such as stabilisers, water heaters, fans, kitchen appliances, and air coolers). The company expects to scale up its appliance segment over the next 2-3 years, which contributed ~Rs. 85 crore (3.5% of FY2020 turnover) in which it expects digital channels to play a key role.

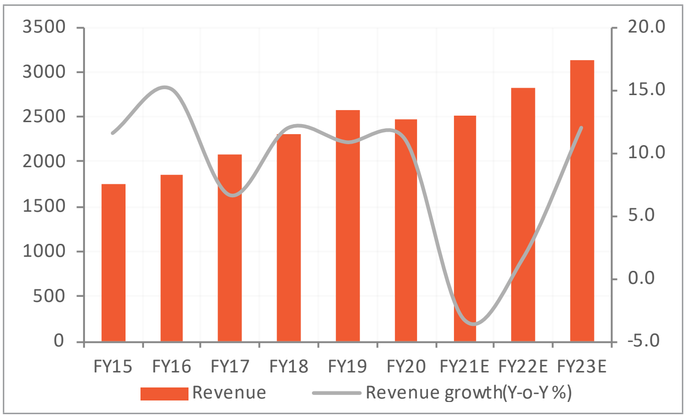
- **Normalised competition seen:** Management indicated that competition remains at normal level with no cost cutting seen across products.

- **Inorganic opportunities:** The company is also targeting few acquisitions in allied product categories with an appetite of Rs. 500 crore-600 crore for acquisitions (as cash balance stood at Rs. 352 crore in June 2020).

- **South and Non-South Mix:** On the south and non-south mix (which is about 60% south and 40% non-south), the company expects to reach 50:50 mix over 4-5 years (increasing non-south mix by 2% per annum each)

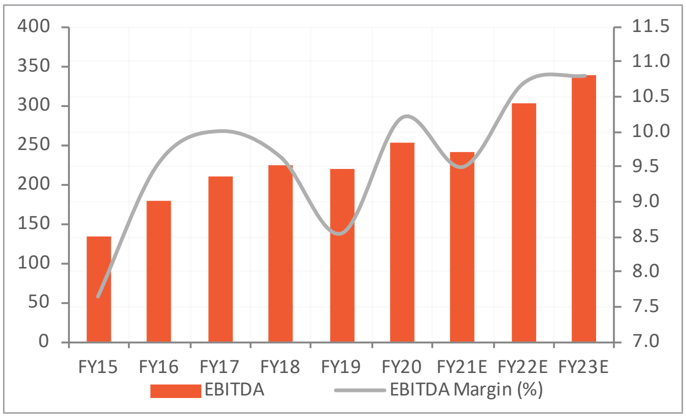
Financials in charts

Revenue Trend (Rs. cr)



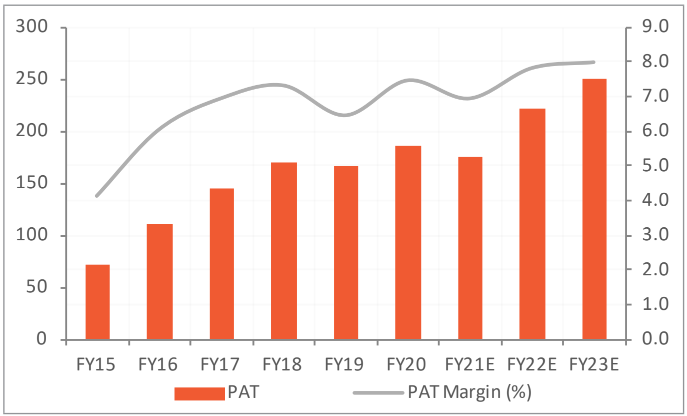
Source: Company, Sharekhan Research

EBITDA (Rs. cr) and EBITDA margins trend



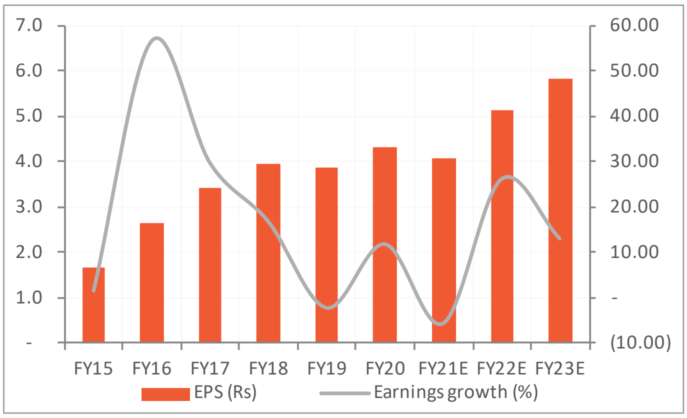
Source: Company, Sharekhan Research

PAT (Rs cr) and PAT margin trend



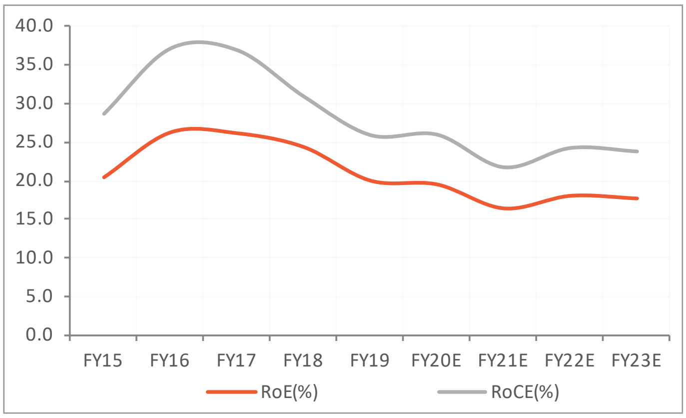
Source: Company, Sharekhan Research

EPS and earnings



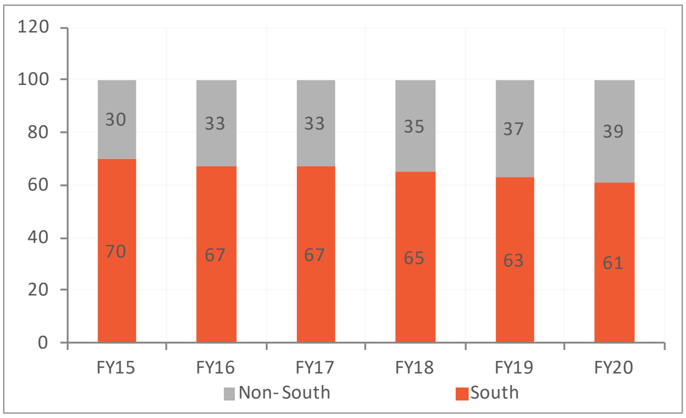
Source: Company, Sharekhan Research

Return ratios trend



Source: Company, Sharekhan Research

Expanding geographic presence



Source: Company, Sharekhan Research

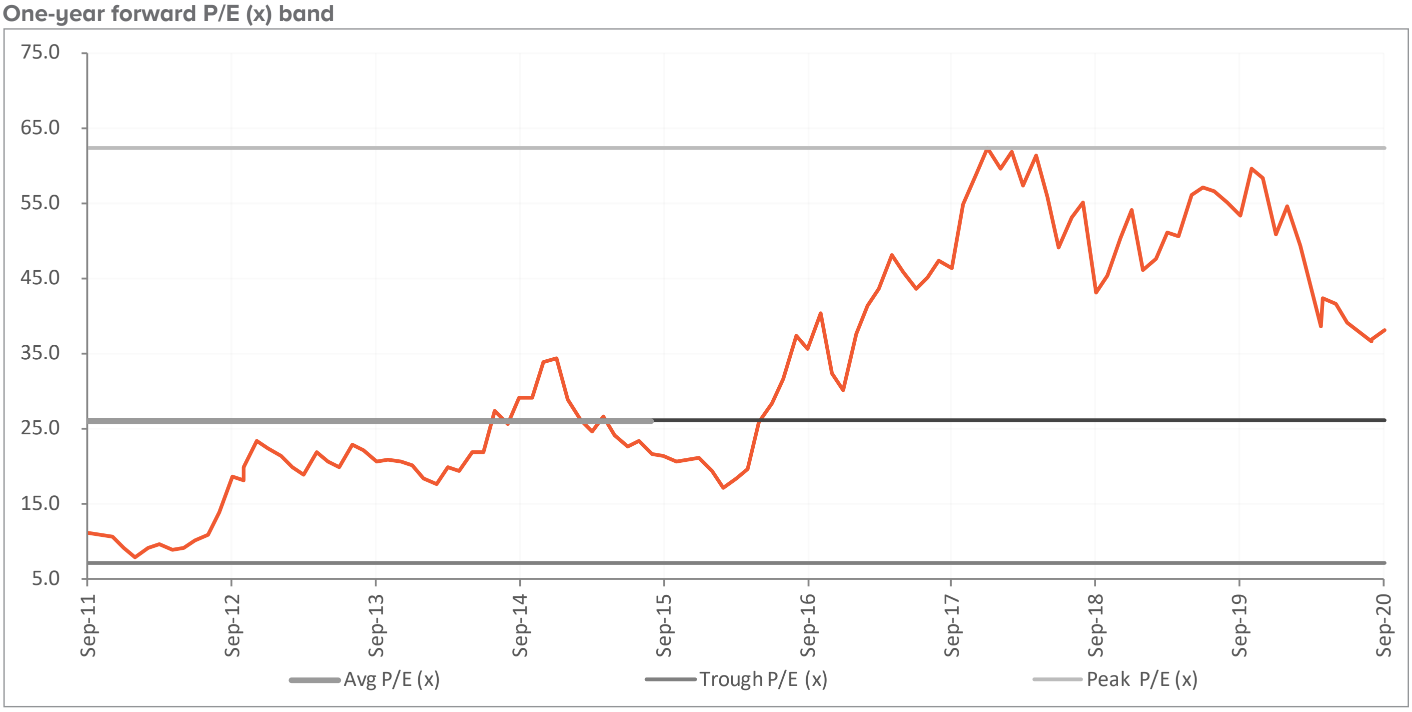
Outlook and Valuation

Sector Outlook - Uncertain environment likely to normalise by H2FY2021: The COVID-19 outbreak and the shutdown led to stoppage of work at most factories, forcing brakes on demand. However, the consumer durable/ electrical industry has started reaching near normal demand environment along with channel inventory getting normalised and expectations of demand pick up with onset of the festive season. The government's Atmanirbhar initiative is expected to benefit with capital subsidies and industrial benefit policies being doled out to give a push to in-house manufacturing. Management expects better supply security and margin improvement with in-house manufacturing for the industry. Healthy cash positions to aid companies in inorganic growth opportunities, as organised players benefit from the tough environment.

Company outlook - Gradually going back to business: V-Guard is witnessing near normal environment with 80-85% markets opened in August and September, while factories are operating at 70-80% capacity utilisation Demand recovery in non-metros and suburban regions has been faster compared to metros and tier-1 cities, which aided the company due to higher concentration in these regions. Hence, leaving aside April 2020, the company's performance has been relatively strong. 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. Further, the shift to in-house manufacturing/ local sourcing would aid in supply security and better margins for water heaters and fans. On the south and non-south mix (which is about 60% south and 40% non-south), the company expects to reach 50:50 mix over 4-5 years. Overall, management is focusing on maintaining healthy cash position, cost rationalization and expediting digitisation. 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. 211: V-Guard has reached near normal operations in August and September with easing restrictions of the unlock. The company has started to increase inventory at its level in anticipation of improved festive demand. Increased e-commerce product portfolio is expected to improve upon its e-commerce sales for select categories. The company's wires category has reached pre-COVID-19 level growth profile of 5-6% per year. The company's reputed brand is expected to gain from smaller players post the pandemic, as smaller players would have been severely hit. The company also has a strong cash balance for inorganic expansion during the current weak environment. Currently, the stock is trading at P/E of 34.2x/30.2x its FY2022E/FY2023E earnings, which is at a discount to its 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. 211. We have also introduced FY2023 estimates in this update.

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, the company 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: Bloomberg

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

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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