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Dixon Technologies Limited

Strong outperformance; On track to expand

Capital Goods	Sharekhan code: DIXON	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 9,317**	
Price Target: **Rs. 11,000**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

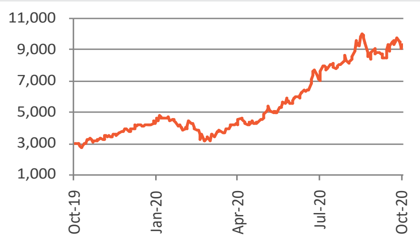
Company details

Market cap:	Rs. 10,780 cr
52-week high/low:	Rs.10,281/2,671
NSE volume: (No of shares)	0.7 lakh
BSE code:	540699
NSE code:	DIXON
Free float: (No of shares)	0.7 cr

Shareholding (%)

Promoters	36
DII	18
FII	16
Others	30

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.1	22.1	103.2	208.5
Relative to Sensex	2.8	16.8	78.3	209.8

Sharekhan Research, Bloomberg

Summary

- We recommend Buy on Dixon Technologies (Dixon) with a price target of Rs. 11,000, as we see further room for upside considering strong net earnings growth outlook over FY2021E-FY2023E.
- Strong beat on operational performance as OPM rise on a y-o-y basis for almost all verticals. Overall, average capacity utilisation at 75%-80% for Q2.
- Gearing up on scaling mobile vertical with approval of PLI scheme. Talks at final stages with three large customers in addition to the current anchor brand.
- Capacity expansion in LED TVs, batons, down lighters, and washing machines on track. Upbeat on increasing overall ODM share as the mobile vertical achieves scale.

Dixon Technologies (Dixon) reported strong beat on Q2FY2021 results. Consolidated revenue for Q2 grew by 16.9% y-o-y to Rs. 1,639 crore, led by 29.6% y-o-y rise in consumer electronics revenue to Rs. 957 crore. Revenue from lighting, home appliances, and mobile phones grew by 4.2%/4.5%/2.1% y-o-y, respectively. Reverse logistics and security systems posted y-o-y dip. OPM surprised positively at 5.5% (up 96 bps y-o-y, up 219 bps q-o-q) due to operating leverage, improved sales mix, value engineering, productivity, and cost efficiencies. OPM surged across all segments (barring reverse logistics). Strong operational performance partly negated by higher effective tax rate led to lower rise in net profit at 21.7% y-o-y to Rs. 52.4 crore. Dixon is gearing up for expanding capacities in mobile (on receipt of license under PLI scheme) with 2,00,000 square feet factory in Noida taken on lease and final discussions underway with three large global brands (in addition to the current anchor brand) for domestic and global manufacturing tie-up. The company estimates to generate cumulative revenue of Rs. 28,000 crore-30,000 crore over five years with descent OPM (~3%), healthy RoCE, and early payback period. In consumer electronics, Dixon is expanding LED TV capacity from current 4.4 million to 5.5 million by Q4FY2021. In lighting, Dixon is expanding capacities for batons, down lighters along with venturing into outdoor lighting and automation in LED bulbs. In home appliances, the company's Tirupati facility for Fully Automatic Top Loading (FATL) washing machine would begin trials by Q3FY2021 end and commercial production by Q4FY2021. Dixon has already closed anchor agreement with a large global MNC. The scaling up of set top box manufacturing is on track. Overall, the company remains upbeat on increasing capacities across product segments over the next two to three years.

Key Positives

- Rise in OPM across product verticals barring reverse logistics.
- Discussions for manufacturing tie-up with three large customers at final stages for mobiles.

Key Negatives

- Rise in working capital led by higher transit period in imports and customs clearance time in LED TV.
- Dip in revenue y-o-y in reverse logistics and security systems.

Our Call

Valuation: Recommend Buy with a PT of Rs. 11,000: Dixon is expected to significantly benefit from the government's PLI scheme in mobiles as it has a strong balance sheet and liquidity relative to its competitors. Consequently, the company's revenue and earnings are expected to register a CAGR of 42% and 55% over FY2021E-FY2023E, respectively. The company also generates higher return ratios as it operates on an asset-light model and has an efficient working capital cycle. At the CMP, the stock is currently trading at 37.8x/29.7x its FY2022E/FY2023E earnings, which we believe leaves further room for upside considering its strong net earnings growth trajectory. Hence, we recommend Buy with a price target (PT) of Rs. 11,000.

Key Risks

- Delay in the commissioning of its capex project, slowdown in consumer discretionary spends, and discontinuation of business from key customers might affect revenue growth.
- Adverse raw-material prices, delay in the ability to pass on price hikes adequately, and adverse forex fluctuations might affect margins.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	2,984	4,400	5,492	8,883	11,022
OPM (%)	4.5	5.0	5.4	5.6	5.6
Adjusted PAT	63	119	152	285	363
% y-o-y growth	4.0	88.2	27.3	87.8	27.5
Adjusted EPS (Rs.)	55.9	103.0	131.1	246.3	314.1
P/E (x)	166.6	90.4	71.1	37.8	29.7
P/B (x)	27.9	19.9	15.6	11.1	8.1
EV/EBITDA (x)	78.9	48.5	36.7	21.3	16.7
RoNW (%)	18.3	25.9	24.6	34.3	31.5
RoCE (%)	26.4	30.0	30.2	41.2	39.1

Source: Company; Sharekhan estimates

Note: We now convert Dixon Technologies into a Stock Update; It was earlier a 'Viewpoint' under our coverage

Strong Quarter

Results were better on all fronts with healthy revenue growth along with margin expansion, resulting in net profit growth. During Q2FY2021, consolidated revenue came in at Rs. 1,639 crore, up 16.9% y-o-y (better than estimates, ahead of consensus estimates), wherein consumer electric grew by 29.6%, lighting products grew by 4.2%, home appliances grew by 4.5%, mobile phones grew by 2.1%, reverse logistics declined by 5.2%, and security systems declined by 8.7%. Stable raw-material prices offset by higher other expenses (up 32% y-o-y) led to EBITDA margin expansion to 5.5% from 4.5% (up 96 bps y-o-y) in Q2FY2020 (ahead of estimates). Margin expansion was led by improved sales mix, operating leverage, value engineering, productivity improvement, and other cost efficiencies. Margin expansion was seen across all key categories. Accordingly, EBITDA was up 41.8% y-o-y to Rs. 89 crore. Lower interest cost was offset by lower other income (down -91% y-o-y), higher depreciation (up 33.7% y-o-y), and higher tax rate of 27.1% versus 11% in Q2FY2020, thus limiting growth in net profit to 21.7% to Rs. 5,236 crore (better than our and street estimates). Net debt reduced from Rs. 61 crore to Rs. 17.1 crore sequentially. During the quarter, working capital spiked as transit period in imports and customs clearance time expanded by 12-15 days in the LED segment. However, it is expected to come back to normal levels by Q3FY2021 end.

PLI scheme update, in talks with three large brands

The company updated on PLI scheme and stated that it is ramping up its capacity to 15 mn-16 mn over couple of years versus 3 mn today. The company has taken a 2,00,000 sq. ft. factory on lease in Noida and is confident of starting new capacity by January 2021. Dixon is in final discussions with three large global brands in addition to the present anchor brand for domestic and global manufacturing tie-up. Management remains confident of generating cumulative revenue of Rs. 28,000 crore-30,000 crore over five years with descent OPM (~3%), strong ROCE, and early payback. On set top box, it delivered 5.2 lakh for Jio, dish, and citi cable and generated revenue of Rs. 35 crore. The company has a strong order book of 0.3 mn per month from October.

Dixon Technologies Q2FY2021 Concall Highlights:

- **Higher margins in Q2:** Margin expansion led by improved sales mix, operating leverage, value engineering, productivity improvement, and other cost efficiencies. Margin expansion witnessed across all key categories.
- **Capacity utilisation:** In Q2FY2021, lightning was 81%, LED TV 78%, home appliance was 83%, mobile 2G was 68%, smartphone was 35%, and security systems was 35%-37%. Overall, it has been 75%-80%.
- **ODM share:** The current ODM share is 100% in appliances, 90% in lighting, and consumer electronics is just 3%. If the company is able to get a breakthrough in smartphone such as in LED TV, then over a couple of years, significant portion of business will come from ODM.
- **Set-top box scale up:** Set-top box revenue to be close to Rs. 500 crore for FY2021 and is projected at Rs. 1,200 crore in FY2022. Margins are likely to remain at 3.0%-3.2%.
- **Customer concentration:** The top most customer contributes 30%-32% of revenue, followed by the second at 17%. However, on profitability, the biggest customer contributes 14.0%-14.7%.
- **PLI update:** The company plans to ramp-up capacity to 15 mn-16 mn over couple of years versus 3 mn today. The company has taken a 200,000 sq ft. factory on lease in Noida. The company is confident of starting new capacity by January 2021. The company is in final discussions with three large global brands in addition to the present anchor brand for domestic and global manufacturing tie-up. Three customers are enough to reach ceiling PLI revenue. Management is confident of generating cumulative revenue of Rs. 28,000 crore-30,000 crore over five years with descent OPM (~3%), strong ROCE, and early payback. On set top box, it delivered 5.2 lakh for Jio, dish, and citi cable and generated revenue of Rs. 35 crore. The company has strong order book of 0.3 mn per month from October.
- **Working capital rising:** Transit period in imports and customs clearance time expanded by 12-15 days in the LED segment. This will come back to normal by Q3 end.
- **Capex:** PLI mobile capex of Rs. 50 crore p.a. In FY2021, fully automatic washing machine capex is Rs. 65 crore-70 crore, out of which it did Rs. 18 crore-20 crore and the balance would be incurred during remaining five months. In other verticals, capex is expected to be Rs. 10 crore-20 crore.
- **Consumer electronics:** LED TV revenue is Rs. 957 crore versus. Rs. 738 crore, operating profit up 50% y-o-y to Rs. 26.5 crore versus Rs. 17.7 crore. Scale, expansion of PCB capacity, and higher share of large screen sizes TV generating better margins. The current capacity of 4.4 million TV set is ~30% of the Indian LED TV market. To meet requirements of newly acquired customers such as Samsung, Nokia, and Toshiba

and recent notification of the government shifting imports in prohibited category, it is witnessing traction in volumes. So, the company is expanding capacity to 5.5 mn by Q4FY2021. Latest customer (significant domestic player) addition for which production will start in November. The company acquired One Plus as a customer for which production will start in Q4FY2021.

- **Lighting:** Revenue in Q2 was up 2% y-o-y to Rs. 296 crore. Operating profit grew by 21% y-o-y to Rs. 27.7 crore. OPM up from 8.1% last year to 9.4% due to operating leverage and migration to more ODM (90%+ share in Q2). The company is the largest ODM player in lighting having 215 mn capacity for LED bulbs, which is more than 40% of Indian requirement. The company doubled capacity for smart bulbs and batons. In phase I, baton capacity increased to 1.5 million from 250,000 per month and 2 million per month will start from December. In down lighters, the company has expanded capacity from 1,50,000 to 6,00,000 per month and will further go to 1.2 mn by Q1FY2022. One-third of lines for bulbs will get automated in Q3FY2021, which will aid productivity. The company is venturing in outdoor lighting and is confident of launching product portfolio by Q1FY2022.
- **Home Appliances:** Revenue for Q2 grew by 4% to Rs. 145 crore. Operating profit increased by 5% to Rs. 17.3 crores. OPM is 11.9%. The company had the highest-ever sale of 1.14 lakh and 1.17 lakh machines in August and September, respectively. To meet the festive demand, the company added one more line. Presently, the company has 140 models from 6 kg to 10 kg with an annual capacity of 2 mn. In Q3FY2021, Dixon would launch a new 10 kg model and an electronic panel model. Expansion of Fully Automatic Top Loading (FATL) washing machine is on track in Tirupati, with trials to start in Q3FY2021 end, and will have 6 lakh p.a. capacity. The company targets to start commercial production in Q4FY2021. The company closed an anchor agreement with one large global MNC. Dixon is confident of bringing imports to 30% in 18-24 months in this category.
- **Mobile/EMS:** Mobile revenue of Rs. 197 crore versus Rs. 193 crore last year. Set top box and medical equipment revenue stood at Rs. 35 crore versus Rs. 96 lakh. Operating profit stood at Rs. 16.2 crore versus Rs. 4.2 crore due to anchor customer and set-top box business. The company has the largest phone capacity of 2G phones in India. Numbers for Q3 and Q4 are expected to be better than Q2.
- **Security Surveillance System:** Revenue dipped by 9% y-o-y for its share of 30% business to Rs. 40 crore. Operating profit grew to Rs. 1.17 crore. The business is now operating at normal capacity utilisation.
- **Reverse Logistics:** Revenue was Rs. 3.6 crore with operating profit of Rs. 37 lakh.
- Cash balance of Rs. 74 crore and net debt of Rs. 17 crore.

Results (Consolidated) Rs cr

Particulars	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Revenue	1,638.7	1,402.0	16.9	516.9	217.0
Operating Expenses	1,549.4	1,338.9	15.7	500.1	209.8
Operating profits	89.4	63.1	41.8	16.9	429.2
Other Income	0.3	2.8	(91.2)	0.2	19.0
Interest	6.9	9.4	(26.3)	5.7	21.4
Depreciation	10.9	8.2	33.7	9.3	18.1
PBT	71.8	48.3	48.5	2.2	-
Tax	19.5	5.3	266.3	0.6	-
Adj PAT	52.4	43.0	21.7	1.6	-
Reported PAT	52.4	43.0	21.7	1.6	-
Adj. EPS (Rs.)	45.3	37.2	21.7	1.4	-
			bps		bps
OPM	5.5%	4.5%	96	3.3%	219
NPM	3.2%	3.1%	13	0.3%	289
Tax rate	27.1%	11.0%	1,610	25.9%	116

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Demand outlook encouraging, healthy growth prospects

The COVID-19 outbreak that resulted in a lockdown in several countries is likely to impact the company's performance in the near term. However, from the medium to long-term perspective, it will provide enormous opportunities owing to the shift in manufacturing base outside China and the government's incentives to enhance manufacturing through Make in India initiative. An enhanced capacity, wider product offerings, and customer penetration are likely to drive the company's performance in addition to healthy demand outlook for the electronics outsourcing industry.

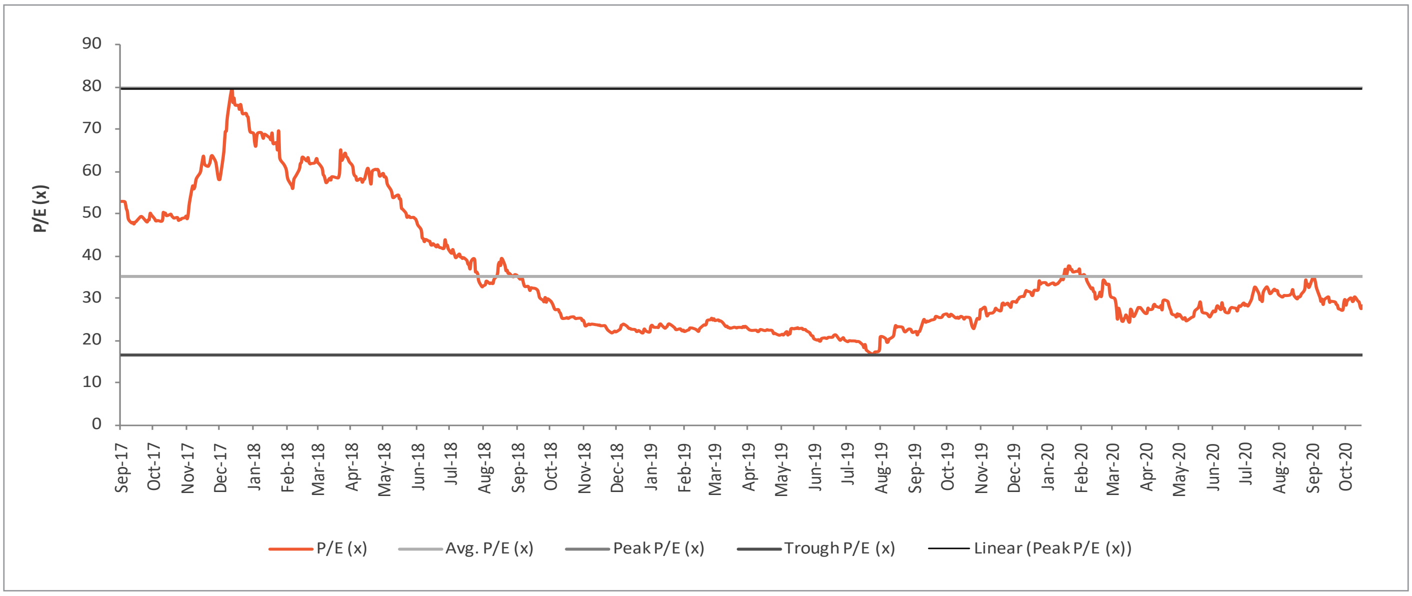
■ Company outlook - Eyes on PLI scheme execution, promising outlook ahead

With a leadership position in key business segments, Dixon stands to benefit in the electronic outsourcing business. The company's Tirupati facility is expected to add a new dimension to growth prospects as it will foray into new business verticals, expand the product portfolio of its existing business verticals, and penetrate further into southern Indian market by forging an alliance with original equipment manufacturers (OEMs) and add them as clients. The expanded capacity in consumer electronics and home appliance coupled with a PLI scheme in mobile phones is likely to drive revenue growth momentum, while margin may expand due to economies of scale and automation in lighting.

■ Valuation - Recommend Buy with a PT of Rs. 11,000

Dixon is expected to significantly benefit from the government's PLI scheme in mobiles as it has a strong balance sheet and liquidity relative to its competitors. Consequently, the company's revenue and earnings are expected to grow at a CAGR of 42% and 55%, respectively, over FY2021E-FY2023E. The company also generates higher return ratios as it operates on an asset-light model and has an efficient working capital cycle. At the CMP, the stock is currently trading at 37.8x/29.7x its FY2022E/FY2023E earnings, which we believe leaves further room for upside, considering its strong net earnings growth trajectory. Hence, we recommend Buy with a PT of Rs. 11,000.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Founded by Mr. Sunil Vachani, Dixon is a leading manufacturer of products for key consumer durable brands in India. The company currently has 10 state-of-the-art manufacturing units, four in Noida (Uttar Pradesh) and three each in Dehradun (Uttarakhand) and Tirupati (Andhra Pradesh). The company manufactures products with a capacity of 3.4 million LED TVs per year in the consumer durables segment, 20 million LED bulbs per month in the lighting segment, 1.2 million washing machines per year in home appliances, mobile phones, 7 lakh CCTVs, and 1.5 lakh DVDs per month in the security devices segment in India. The company also provides solutions in reverse logistics i.e., repair and refurbishment services of STBs, mobile phones, and LED TV panels. Based on a report, 'Project Rise' by Frost & Sullivan India, Dixon is the largest home-grown, design-focused products and solutions company.

Investment theme

Local manufacturing is expected to get a boost given the strong 17% CAGR in demand during FY2016-FY2021 in the consumer electronics market in India. The EMS industry is expected to witness a higher CAGR of 30.8% during the same period, as players scale up their offerings from assembly-only to design-led manufacturing. Dixon stands to benefit in the electronic outsourcing business with a leadership position in key business segments. The company's Tirupati facility is expected to add a new dimension to the company's growth prospects, as it will foray into new business verticals, expand product portfolio of existing business verticals, and penetrate further into southern Indian market by forging alliance with OEMs and add them as clients. Moreover, eyes are on the PLI scheme in the mobile phones vertical for which the company has filed two applications.

Key Risks

Delay in commissioning of capex project, slowdown in consumer discretionary spends, and discontinuation of business from key customers might affect revenue growth. Adverse raw-material prices, delay in the ability to pass on price hikes adequately in time, and adverse forex fluctuation might affect margins.

Additional Data

Key management personnel

Sunil Vachani	Executive Chairperson
Atul B. Lall	Executive Director
Saurabh Gupta	Chief Financial Officer
Abhijit Kotnis	Chief Operating Officer
Ashish Kumar	Company Secretary & Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management Pvt Ltd.	6.83
2	Reliance Capital Trustee Co Ltd.	5.7
3	Steadview Capital Mauritius Ltd.	3.87
4	Goldman Sachs Group Inc	1.73
5	ICICI Prudential Asset Management	1.60
6	ICICI Prudential Life Insurance Co	1.50
7	Mankani Sunita	1.47
8	Vaswani Geeta	1.44
9	Sippy Shobha	1.32
10	Edelweiss Asset Management	1.07

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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