Sharekhan by BNP PARIBAS

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V-Guard Industries Limited

Stable quarter

Capital Goods	Sharekhan code: VGUARD	Result Update

Stock Update

Summary

- We retain Buy on V-Guard Industries Limited (V-Guard) with an unchanged PT of Rs. 211, considering its reasonable valuations and improving business operations
- V-Guard reported flat revenues with stable operating margins in line with estimates. Higher tax rate in Q2FY21 vs Q2FY20 and lower other income led to 12.7% decline in net profit.
- Management expects to get back on to the growth path with rebound in business environment and expects revenue to remain flat y-o-y in FY21 and cost saving measures initiated would aid margin expansion in H2FY21.
- The company's strong balance sheet, cash flow and reputed brand along with strong business fundamentals provide comfort in the present environment.

V-Guard Industries Limited's (V-Guard) Q2FY2020 performance witnessed a sharp rebound from the virus-caused weakness in Q1FY21. The net sales for Q2FY21 remained flat y-o-y while up 52% q-o-q to Rs 617 crore (in-line with our estimates). The company witnessed improvements in both its electronics and electrical businesses (up 2%/2% y-o-y and 24.2%/54.6% q-o-q) while Consumer durable business declined 6.6% y-o-y to Rs 163 crore (although up 91% Q-o-Q). Pumps, Fans and Digital UPS categories performed well. South revenues declined by 3.2% y-o-y while non-south revenues improved 4.4% y-o-y. EBITDA margins declined 54 bps y-o-y to 12% (in line with expectation) mainly due to under-utilisation of Sikkim factory on account of lockdown and higher employee expenses partly offset by lower other expenses. This led to a EBITDA decline by 4.7% y-o-y to Rs 74 crore (inline with expectation). Higher tax rate of 29.7% vs 25.3% in Q2FY20 and lower other income (-4% y-o-y) led to net profit of Rs 50 crore (down 12.7% y-o-y, marginally lower than expectation). During this quarter, the company launched new products viz. water purifiers, breakfast appliances, kitchen hobs and chimneys through online channels, an extension of its kitchen appliances business. Initially the company will follow an outsourcing model to gain certain size, build capability on the supply side in few years and then move to in-house manufacturing as done successfully for other products. The categories should start contributing meaningfully 2-3 years from now. V Guard has managed to resolve its supply chain issues and expects strong recovery in festive season. Inventory with the company is low and channel inventory is lower by 10-15 days than normal levels. Rural demand has been stronger than urban, with certain exceptions like Bangalore. However, urban areas like Mumbai and Delhi have now indicated recovery. Going ahead, the company expects revenue to remain flat y-o-y in FY21, translating to ~20% y-o-y growth for H2FY21 and expects Non-South growth to be 10% higher than of South for H2FY21, which will continue to increase Non-South revenue share. We have fine-tuned our estimates for FY2021E-FY2022E. The stock is currently trading at a P/E of 33.1x/28.9x its FY2022E/FY2023E EPS. Company's cash flow generation remains strong at Rs 326.2 (vs Rs 151 crore in H1FY20) along with net cash of Rs 452.7 crore on balance sheet as on 30th September, 2020 (vs Rs. 288.9 crore in Sept, 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 provide comfort in the present environment. Hence, we continue to maintain Buy on the stock with an unchanged price target (PT) of Rs. 211.

Key Positives

- CFO generation at the end of H1FY21 of Rs. 326.2 crore vs Rs.151 crore in H1FY20.
- Working capital days at 53 days vs. 58 days in Q2FY20 mainly due to lower debtor days.

Key negatives

- Gross margins lower by 220 bps y-o-y mainly due to under-utilisation of Sikkim factory on account of lockdown and product mix.

Our Call

Valuation – We maintain Buy with an unchanged PT of Rs. 211: V-Guard has reached near normal operations in August and September with easing restrictions of the unlock and it has managed to resolve its supply chain issues and expects strong recovery in festive season. Increased e-commerce product portfolio is expected to improve upon its e-commerce sales for select categories. 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 33.1x/28.9x its FY2022E/FY2023E EPS. 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 an unchanged PT of Rs. 211.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	2,482	2,488	2,786	3,124
OPM (%)	10.2	9.5	10.7	10.8
Adjusted PAT	185	173	218	250
% YoY growth	11.9	(6.8)	26.2	14.6
Adjusted EPS (Rs.)	4.3	4.0	5.1	5.8
P/E (x)	39.0	41.8	33.1	28.9
P/B (x)	7.3	6.4	5.5	4.8
EV/EBITDA (x)	25.4	26.9	21.1	18.6
RoNW (%)	19.6	16.2	17.9	17.8
RoCE (%)	26.0	21.6	24.1	23.9

Source: Company; Sharekhan estimates

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

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 168**	
Price Target: **Rs. 211**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 7,225 cr
52-week high/low:	Rs. 260/149
NSE volume: (No of shares)	4.2 lakh
BSE code:	532953
NSE code:	VGUARD
Free float: (No of shares)	16.0 cr

Shareholding (%)

Promoters	62.6
FII	12.5
DII	13.1
Others	11.7

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	0	2	-5	-28
Relative to Sensex	-5	-2	-27	-28

Sharekhan Research, Bloomberg

Stable performance: V-Guard Industries Limited's (V-Guard) Q2FY2020 performance witnessed a sharp rebound from the virus-caused weakness in Q1FY21. The net sales for Q2FY21 remained flat y-o-y and 52% growth q-o-q (in-line with our estimates) to Rs 617 crore. The company witnessed improvements in both Electronics and electrical businesses (up 2% y-o-y and 24.2%/54.6% q-o-q) while Consumer durable business declined 6.6% y-o-y to Rs 163 crore (improving 91% Q-o-Q). Both, Electricals and Electronics segment growth was led by strong sales in digital UPS and pumps. In the consumer durable segment, fans registered healthy growth. Overall growth was impacted by second wave in Kerala and supply chain impacted by disruptions in Sikkim. South revenues remained flat y-o-y (-3.2% y-o-y) while non-south revenues improved 4.4% y-o-y. EBITDA margins declined 54 bps y-o-y to 12% y-o-y (in line with expectation of 11.9%) mainly due to under-utilisation of Sikkim factory on account of lockdown and higher employee expenses partly offset by lower other expenses. This led to EBITDA decline by 4.7% y-o-y to Rs 74 crore (inline with expectation). Higher tax rate of 29.7% vs 25.3% in Q2FY20 and lower other income (-4% y-o-y) led to net profit of Rs 50 crore (down 12.7% y-o-y, marginally lower than expectation). V Guard has managed to resolve its supply chain issues and expects strong recovery in festive season.

Key conference call highlights

Industry/Company Strategy

- The south was impacted primarily by the resurgence of cases in Kerala. However, Karnataka and Andhra Pradesh performed well.
- Non-South saw 4% growth driven by North and West markets.
- East was impacted due to extended lockdowns in Bihar and West Bengal.
- Company expects Non-South growth to be 10% ahead of South for 2HFY21, which will continue to increase

Non-South revenue mix.

- E-comm grew by 40% y-o-y, although revenue salience remained low. Healthy trend to sustain.
- Supply chain related issues have been resolved and the co expects to return to a growth trajectory during the upcoming festive season.
- Labour availability is back to 80-90% in most areas now.
- Company has not witnessed any significant downtrading trends.
- Reduction in interest rate has resulted in slight uptick in real estate demand.
- Rural demand has been stronger than urban, with certain exceptions like Bangalore. However, urban areas like Mumbai and Delhi have now indicated recovery.
- Inventory with the company is low. Channel inventory is lower by 10-15 days than normal levels.

Revenue

- Company expects revenue to remain flat y-o-y in FY21, indicating ~20% y-o-y growth in 2HFY21.
- Water Heaters declined due to supply chain disruptions. Water Heater plant remained closed for a prolonged period resulting in loss of revenue of Rs 300mn.
- During the quarter, the company colaunched Water Purifier, Breakfast appliances and Kitchen Hobs & Chimneys primarily in the E-comm channel.
- New categories are expected to be 35-40% of the segment in 3-4 years.
- Company launched a new range of premium fans (25% above mass segment) which saw good traction (3-5 months of order backlog).

Margins

- Input prices increased due to headwinds in commodity prices. The company is considering price increases in impacted products.
- V-Guard focused on cost control through various initiatives to improve efficiency.
- Non-South EBTIDA margin is 4-5% below South. However, certain markets like Eastern markets and UP have similar EBITDA margin to South.

Results (Standalone) **Rs cr**

Particulars	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Revenues	617	619	(0.4)	406	51.9
RM cost	422	410	2.9	287	46.9
Staff cost	50	45	11.6	55	(8.1)
Other Exp	71	87	(18.5)	55	28.6
Operating Expenses	543	542	0.2	397	36.8
Operating profits	74	78	(4.7)	9	-
Other Income	7	7	(4.0)	5	41.4
Interest	1	1	26.0	1	(3.7)
Depreciation	8	7	20.7	8	6.2
PBT	71	77	(7.3)	5	-
Tax	21	19	9.0	1	-
Adj PAT	50.0	57	(12.7)	4	-
Reported PAT	50	57	(12.7)	4	-
Adj EPS	1.2	1.3	(12.7)	0.1	-
			bps		**bps**
OPM	12.0%	12.5%	(54)	2.2%	-
NPM	8.1%	9.3%	(115)	0.9%	-
Tax rate	29.7%	25.3%	-	24%	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - 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 is close to 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.

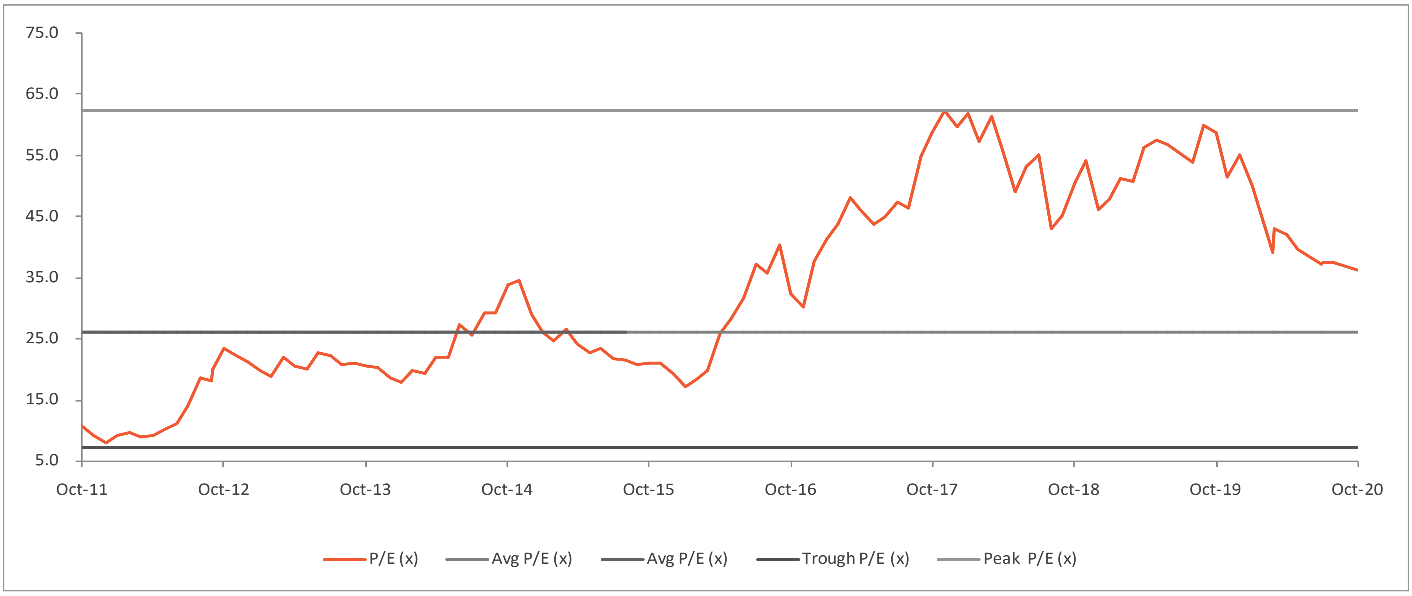
■ Company outlook - Gradually going back to business

V-Guard is witnessing a near normal environment 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. Going ahead company expects revenue to remain flat YoY in FY21, indicating ~20% YoY growth in 2HFY21 and expects Non-South growth to be 10% ahead of South for H2FY21, which will continue to increase Non-South revenue mix. Overall, the 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 an unchanged PT of Rs. 211

V-Guard has reached near normal operations in August and September with easing restrictions of the unlock and it has managed to resolve its supply chain issues and expects strong recovery in festive season. Increased e-commerce product portfolio is expected to improve upon its e-commerce sales for select categories. 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 33.1x/28.9x its FY2022E/FY2023E EPS. 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 an unchanged PT of Rs. 211.

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

- Road express continue to gain market share from air express.
- Any sharp fall in oil price
- Domestic network operating costs have structurally risen and fall in these costs will pose risk to margins

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

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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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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