Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Dixon Technologies Limited

Strong performance; Structural growth drivers intact

Capital Goods	Sharekhan code: DIXON	Result Update

Stock 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. 15,716**	
Price Target: **Rs. 18,700**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

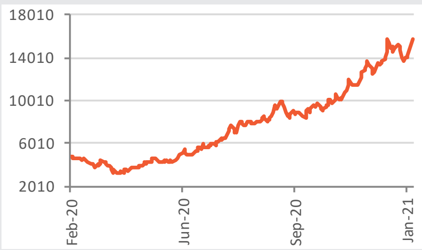
Company details

Market cap:	Rs. 18,404 cr
52-week high/low:	Rs. 16,789 / 2,900
NSE volume: (No of shares)	0.7 lakh
BSE code:	540699
NSE code:	DIXON
Free float: (No of shares)	0.8 cr

Shareholding (%)

Promoters	35.1
FII	20.3
DII	15.2
Others	29.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	15	65	97	231
Relative to Sensex	11	42	62	218

Sharekhan Research, Bloomberg

Summary

- We retain a Buy rating on Dixon Technologies with a revised PT of Rs. 18700 considering its strong net earnings growth outlook for FY2021E-FY2023E and its strong compounding structural growth story.
- Strong performance during Q3FY21 led by strong beat in revenues along with stable margins leading to strong PAT beat. It continued to add new clients and scale up wallet share from existing clients.
- Macro tailwinds and sharp rise in new business volumes, scaling-up of mobile vertical with approval of PLI scheme and capacity expansions brightens core business' growth outlook.
- 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 a strong beat on revenues and PAT during Q3FY2021 which remained broad based led by an improvement in consumer sentiment and festive season. Consolidated revenue for Q3FY21 grew by strong 119% y-o-y to Rs. 2182 crore, led by a strong growth of 199% y-o-y in consumer electronics revenue to Rs1360 crore. Revenue from lighting, home appliances, and mobile phones grew by 26%/68%/114% y-o-y, respectively while security systems grew 10% y-o-y and reverse logistics declined 3% y-o-y. EBITDA grew +95% y-o-y to Rs100.5 crore while margins saw 58bps y-o-y contraction to 4.6% (largely inline) due to lagged passing of price hikes (reflective in GM at 9.5% vs 12.8% y-o-y and 11.8% q-o-q) and higher commodity prices. Higher revenues led to the net profit growth of 134% y-o-y to Rs 61.6 crore (better than estimates). With more brands looking to outsource and Dixon, being the only diversified Indian electronic manufacturing player in the consumer electronics with a reasonable size and scale, it is in a sweet spot to leverage opportunities for partnering with global brands, increasing local sourcing footprint and exploring export opportunities. Capacity expansion in LED TVs, batons, down lighters, and washing machines on track. On the PLI front, the company is on track to meet ceiling revenues along with adding new customers (signed two marquee clients i.e Nokia and Motorola during the quarter). The company indicated that Nokia production started (for domestic markets) while Motorola audit is on and will start production from end-Feb/early March. The management also indicated that it is in advanced discussion with very large global brands for further addition on PLI. On reaching the milestone for FY21 the management told that industry has requested for flexibility/extension for FY21 due to supply side issues. The company also plans to explore backward integration for charger, batteries and other mechanicals. On set top boxes, the company indicated that it is a Rs 350-400 crore opportunity and the current order book stands at 3-4 lac units/month from Jio, Siti and Dish which remains strong. The company's net debt stood at Rs 54 crore and cash at Rs 150 crore. The capex for FY21 likely at Rs160 crore with Rs 104 crore already completed. Overall, the company remains upbeat on increasing capacities across product segments over the next 2-3 years. We have revised our estimates upward factoring higher revenues during Q3FY21. The stock is currently trading at 67.5x/46.2x its FY22E/FY23E. With an asset-light model, consistency in earnings, strong balance sheet and high return ratios and has an efficient working capital cycle Dixon is poised to ride on strong growth trajectory over 3-5 years delivering strong net earnings growth. Hence, we retain a Buy rating on the stock with a revised price target of Rs. 18700.

Key positives

- Strong revenue growth of 119% which remained broad based.
- Discussions for manufacturing tie-up with large global brands for mobiles.

Key negatives

- Dip in revenue y-o-y in reverse logistics.

Our Call

Valuation: Retain Buy with a revised PT of Rs. 18700: Dixon has gained from the opening of the economy driving, along with improvement in consumer sentiment leading to strong performance during Q3FY21. The company is expected to benefit significantly from the government's PLI scheme in mobiles as it has a strong balance sheet and liquidity as compared to its competitors. The company also generates higher return ratios as it operates on an asset-light model and has an efficient working capital cycle. Given Dixon's leadership position, government policy support and emergence of new growth opportunities with deepening of manufacturing and widening portfolio will help company attain higher benefits. At CMP, the stock is currently trading at 67.5x/46.2x its FY22E/FY23E. With an asset-light model, consistency in earnings, strong balance sheet and high return ratios and has an efficient working capital cycle Dixon is poised to ride on strong growth trajectory over 3-5 years delivering strong net earnings growth. Hence, we retain a Buy rating on the stock with a revised price target of Rs. 18700.

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.

Valuations (Consolidated) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	4,400	6,003	10,119	13,297
OPM (%)	5.0	4.9	4.7	4.8
Adjusted PAT	119	149	269	393
% y-o-y growth	88.2	25.4	80.3	46.0
Adjusted EPS (Rs.)	103.0	129.2	232.8	340.0
P/E (x)	152.5	121.7	67.5	46.2
P/B (x)	33.6	26.4	19.0	13.5
EV/EBITDA (x)	81.9	61.8	38.3	27.7
RoNW (%)	25.9	24.3	32.8	34.2
RoCE (%)	30.0	30.2	39.5	41.1

Source: Company; Sharekhan estimates

Strong Quarter: Dixon reported strong beat on revenues and PAT Q3FY2021 which remained broad based led by an improvement in consumer sentiment and the festive season. Consolidated revenue for Q3 grew by strong 119% y-o-y to Rs. 2182 crore, led by strong growth of 199% y-o-y in consumer electronics revenue to Rs1359.83 crore. Revenue from lighting, home appliances, and mobile phones grew by 26%/68%/114% y-o-y, respectively while its security systems grew 10% y-o-y and reverse logistics declined 3% y-o-y. EBITDA grew +95% y-o-y to Rs100.5 crore while margins saw 58bps y-o-y contraction to 4.6% (largely inline) and margin contraction on lagged passing of price hikes (reflective in GM at 9.5% vs 12.8% y-o-y and 11.8% q-o-q) and higher commodity prices. Higher revenues and lower tax rate (24.6% vs 25.8% in Q3FY20) offset by higher depreciation and lower other income (up 14% y-o-y) led to net profit growth of 134% y-o-y to Rs 61.6 crore (better than estimates).

Growth momentum remains strong and planned capacity expansion on schedule:

With more brands looking to outsource and Dixon, is in a sweet spot to leverage opportunities for partnering with global brands, increasing local sourcing footprint and exploring export opportunities. Its advantage is being the only diversified Indian electronic manufacturing player in consumer electronics with a reasonable size and scale,. Capacity expansion in LED TVs, batons, down lighters, and washing machines are on track. On the PLI front, the company is on track to meet ceiling revenues along with adding new customers (signed two marquee clients i.e Nokia and Motorola during the quarter). The company indicated that Nokia production started (for domestic markets) while Motorola audit is on and will start production from end-Feb/early March. The management also indicated that it is in advanced discussions with very large global brands for further addition on PLI. On reaching the milestone for FY21 the management told that industry has requested for flexibility/extension for FY21 due to supply side issues. On the outlook for on mobiles it indicated that breach ceiling every year from FY22E. The company also plans to explore backward integration for its charger, batteries and other mechanicals. On set top boxes the company indicated that it is a Rs350-400 crore opportunity, and the current order book stands at 3-4 lac units/month from Jio, Siti and Dish which remains strong. The company's net debt stood at Rs 54 crore and cash at Rs 150 crore. The capex for FY21 likely at Rs160 crore with Rs104 crore already completed. Overall, the company remains upbeat on increasing capacities across product segments over the next 2-3 years. With an asset-light model, consistency in earnings, strong balance sheet and high return ratios and has an efficient working capital cycle Dixon is poised to ride on strong growth trajectory over 3-5 years delivering strong net earnings growth.

Dixon Technologies Q3FY2021 Concall Highlights:

Strong growth path across verticals, new verticals to be added

- TV – 30% of India requirement – scaling up to 40% next year
- Added lot of clients such as VU, Toshiba, Samsung, etc – apart from scale up and higher wallet share from existing clients
- Change in mix towards larger sized LED TV (32 to 43 and now 65 inch) driving strong value growth
- Increasing capacity for 65inch+ as also PCB and SMT lines – will aid growth (will become 40% of India requirement) and margin improvement.
- In short term, open cell availability is short, which could impact supplies. All players are facing shortages. Target ~3mn sets in FY21 vs 2mn in FY20.

Lighting

- Amongst top 5 players globally, scaling up further – poised for PLI and exports
- Margins expanded on operating leverage, higher ODM, value engineering, productivity and product mix improvement. Accumulated inventory of Driver and IC chips in Sept/Oct to ensure no supply issues
- Setting another factory for lighting - should be up by Q3FY22- likely to be calibrated with PLI
- Developed solutions for smart led bulb, batons and emergency bulbs Street light LED portfolio will be launched by Q2FY22
- Among top companies in world in volumes for certain SKUs. Exporting to Indonesia and in talks with large retail chains globally.

Washing machine – client additions and fully automatic washing machine (WM) to drive growth

- Increase in input prices and freight rates impacted margin and pressure will continue in Q4 as well. OB remain strong.
- Looking for expansion at new site adjacent to Dehradun plant for SA WM from 1.2 to 1.6mn capacity.
- Tirupati plant for FA WM is almost complete – lines laid and trials will begin from Feb/early March). Capacity of 600k/year.
- Product offering strong in semi-automatic WM from 6kg to 11.5kg offering (largest offering of 170 models)

Mobiles – on track to meet ceiling revenues, adding more customers

- 75% of revenues from Xiaomi and Samsung in Q3 and balance from other brands.
- Nokia production started (for domestic markets); Motorola audit on and will start production from end-feb/ early march.
- Advanced discussion with very large global brands.
- Will breach ceiling every year from FY22. Industry has requested for flexibility/extension for FY21 due to supply side issues.
- Exploring backward integration for charger, batteries and other mechanicals
- Tracking would be very strict in Motorola. Delivery is would be key for global competency and deeper relations.

EMS

- Set-top boxes are Rs350-400 crore opportunity. Current order book for 3-4 lac units/month from Jio, Siti Cable and Dish
- Arrangement with boat should bode well over long term (PLI scheme being planned for wearables too)

Balance sheet and capex

- Net debt at Rs 54.0 crore and cash at Rs150 crore.
- Capex for FY21 likely at Rs160 crore with Rs104 crore completed

Other key comments:

- Looking at both IT and wearable PLI.
- In case of wearables¸ already have partner, for IT have relationship with a large player

Results (Consolidated) Rs cr

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Revenues	2,182.8	993.8	119.6	1,638.7	33.2
Operating Expenses	2,082.3	942.3	121.0	1,549.4	34.4
Operating profits	100.5	51.5	95.0	89.4	12.4
Other Income	0.1	1.8	(92.3)	0.3	(44.0)
Interest	7.7	8.1	(4.3)	6.9	11.6
Depreciation	11.3	9.8	14.3	10.9	3.0
PBT	81.7	35.5	130.3	71.8	13.7
Tax	20.1	9.2	119.3	19.5	3.3
Reported PAT	61.6	26.3	134.2	52.4	17.6
Adj PAT	61.6	26.3	134.2	52.4	17.6
Adj EPS	53.2	26.3	134.2	52.4	17.6
			bps		**bps**
OPM	4.6%	5.2%	(58)	5.5%	(85)
NPM	2.8%	2.6%	18	3.2%	(37)
Tax rate	24.6%	25.8%	-	27.1%	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view – Demand outlook encouraging, healthy growth prospects

The Indian electronics and consumer durable industry is ~Rs 4,00,000 crore and growing rapidly. Manufacturing can be a significant growth driver from a medium to long-term perspective, providing enormous opportunities owing to the shift in manufacturing bases outside China and the government's incentives to enhance manufacturing through the Make in India initiative like the PLI scheme which aims to kick-start the process, with strong industry participation.

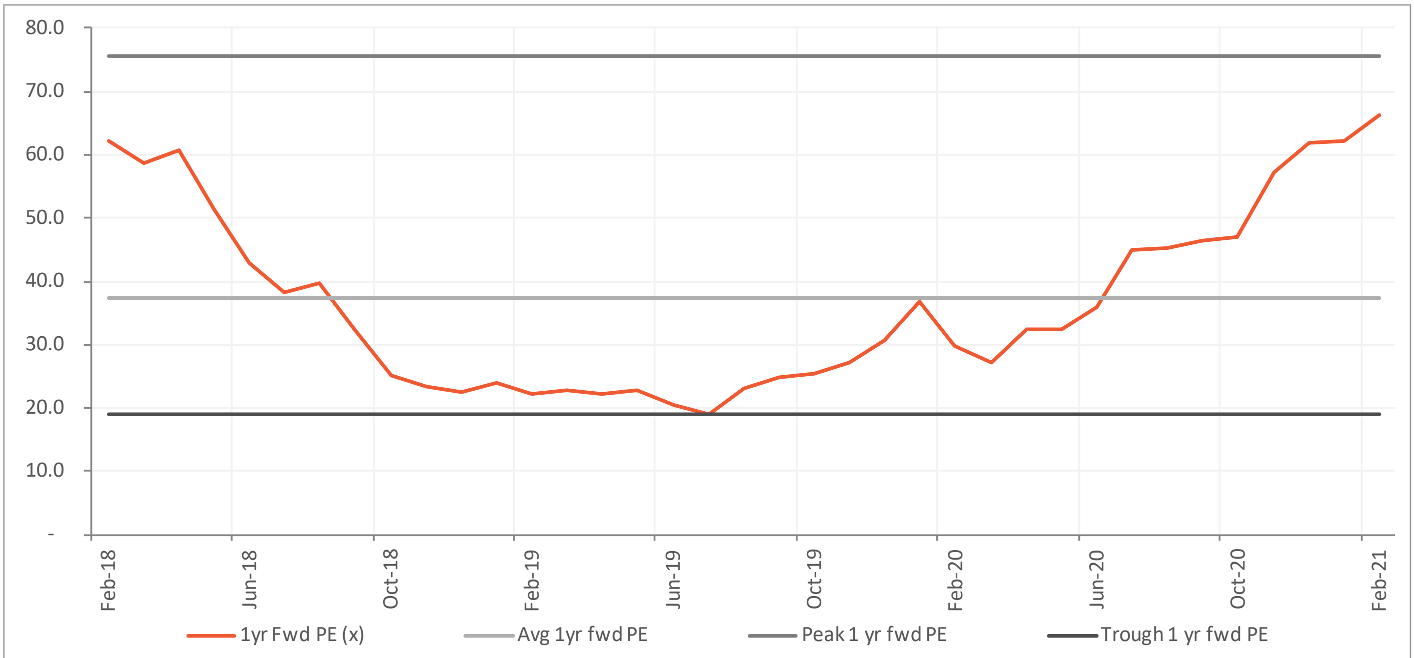
■ Company outlook – Promising outlook ahead

Dixon's leadership position is a key 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 product portfolio of existing business verticals, and penetrate further into South India by forging an alliance with original equipment manufacturers (OEMs) and add them as clients. Expanded capacity in consumer electronics and home appliances coupled with a PLI scheme licence for mobile phones is likely to drive revenue growth momentum, while margin may expand due to economies of scale and automation in the lighting business.

■ Valuation - Retain Buy with a revised PT of Rs. 18700

Dixon has gained from the opening of the economy driving, along with improvement in consumer sentiment leading to strong performance during Q3FY21. The company is expected to benefit significantly from the government's PLI scheme in mobiles as it has a strong balance sheet and liquidity as compared to its competitors. The company also generates higher return ratios as it operates on an asset-light model and has an efficient working capital cycle. Given Dixon's leadership position, government policy support and emergence of new growth opportunities with deepening of manufacturing and widening portfolio will help company attain higher benefits. At CMP, the stock is currently trading at 67.5x/46.2x its FY22E/FY23E. With an asset-light model, consistency in earnings, strong balance sheet and high return ratios and has an efficient working capital cycle Dixon is poised to ride on strong growth trajectory over 3-5 years delivering strong net earnings growth. Hence, we retain a Buy rating on the stock with a revised price target of Rs. 18700.

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 Website

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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