Sharekhan by BNP PARIBAS

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V-Guard Industries Limited

Strong quarter, demand outlook remains healthy

Capital Goods	Sharekhan code: VGUARD	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. 252**	
Price Target: **Rs. 311**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

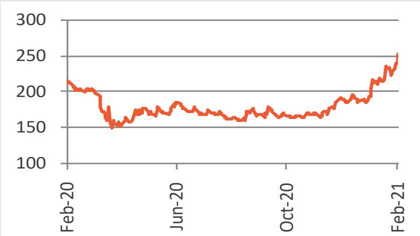
Company details

Market cap:	Rs. 10,834 cr
52-week high/low:	Rs. 255/149
NSE volume: (No of shares)	4.2 lakh
BSE code:	532953
NSE code:	VGUARD
Free float: (No of shares)	16.1 cr

Shareholding (%)

Promoters	62.6
FII	13.0
DII	13.2
Others	11.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	30	49	54	17
Relative to Sensex	25	24	20	-5

Sharekhan Research, Bloomberg

Summary

- We retain Buy on V-Guard Industries Limited (V-Guard) with a revised PT of Rs. 311, considering its improving business operations
- V-Guard reported strong revenues and operating margins leading to 79.6% y-o-y growth in net profit which remained better than estimates
- Management expects to get back on to the growth path with a rebound in business environment and highlighted that demand drivers remain healthy across businesses. Expect summer products to come back strongly with some pent-up demand.
- 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) Q3FY2021 performance remained strong due to positive market sentiment during the festive season, reflected in significant growth reported across all markets and product categories. The net sales for Q3FY21 surged 32% y-o-y (much better than estimates) to Rs 827 crore led by improved consumer sentiment, festive season and share gain from unorganised sector. The company witnessed improvements in Electronics, electrical businesses and consumer durable businesses (up 35%/31.4% and 30.8% y-o-y). Stabilizers, Wires, Fans, Pumps, Kitchen appliances and Digital UPS categories performed well. South revenues grew 25.3% y-o-y while non-south revenues improved 43% y-o-y. EBITDA margins improved on back of lower A&P spends despite lower gross margins (impact from the recent increase in commodity prices and expected to remain under pressure for next 3-4 months). Higher operating leverage offset by higher tax rate (29.7% vs 24.2% in Q2FY20) led to net profit growth of 79.6%. Going ahead, the management indicated that growth is expected on base of Q4FY19 as Q4FY20 was a washout as secondary sales continue to remain favourable and expect summer products to come back strongly with some pent-up demand. The company targets to improve EBITDA margin by 100bps every two years. Margin improvement from the levels of FY19 is possible in FY22. The company took a price hike in the range of 3-3.5% during Q3FY21. A price increase of an additional 4-7% is required to offset commodity price inflation. The management highlighted that demand drivers remain healthy and it has seen improvement as smaller players are not back to their full operation which is leading to higher share of business coming to larger players. Secondly, a revival in construction activities have broad based improvement in products related to construction/housing. The company focusses on 1) evolving category mix and product mix, 2) go to market with focus on e-commerce and modern trade, 3) distribution enhancement in smaller town and rural along with increase in non-south region and 4) in-organic expansion will generate growth for the company. V Guard has managed to resolve its supply chain issues and channel inventory is at healthy level. Currently e-commerce and modern retail contributes 14-15% of revenue excluding wires. It expects to add 3000 to 4000 retailers every year in non-south region. It has 40,000 retail points with around 18,000 in south and balance in non-south with continuous additions. Earlier the company has entered in water purifier in Q3 and is planning to expand kitchen portfolio like entering hoods and hobs. Company's CFO generation in 9MFY21 remains strong at Rs. 369.4 crore as compared to Rs. 259 crores in 9MFY20 with net cash of Rs 482.3 crore on balance sheet as on 31th Dec, 2020 (vs Rs. 323.2 crore in Dec, 2019) providing the company with the opportunity for inorganic acquisitions at a favourable valuation. We have fine-tuned our earnings estimates for FY2021-FY2022. 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 revised price target (PT) of Rs. 311.

Key positives

- CFO generation at the end of 9MFY21 at Rs. 369.4 crore 259 crores in 9MFY20.
- Revenues grew 32% with strong growth seen across the segments.

Key negatives

- Gross margins lower due to higher commodity prices.

Our Call

Valuation – We maintain Buy with a revised PT of Rs. 311: V-Guard operations are normal and it has managed to resolve its supply chain issues and expects strong recovery ahead as the demand outlook remains healthy. The company is focused on 1) evolving category mix and product mix, 2) go to market with focus on e-commerce and modern trade, 3) distribution enhancement in smaller town and rural along with increase in non-south region and 4) in-organic expansion will generate growth for the company. 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 49.4/42.9 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 a revised PT of Rs. 311.

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	2,527	2,830	3,183
OPM (%)	10.2	9.7	10.7	10.8
Adjusted PAT	185	178	219	252
% YoY growth	11.9	(3.7)	22.7	15.1
Adjusted EPS (Rs.)	4.3	4.2	5.1	5.9
P/E (x)	58.3	60.6	49.4	42.9
P/B (x)	10.9	9.5	8.3	7.2
EV/EBITDA (x)	38.4	39.2	31.5	27.7
RoNW (%)	19.6	16.7	17.9	18.1
RoCE (%)	26.0	22.1	24.3	25.0

Source: Company; Sharekhan estimates

Strong performance performance: V-Guard Industries Limited's (V-Guard) Q3FY2021 performance remained strong due to positive market sentiment during the festive season, reflecting in significant growth reported across all markets and product categories. The net sales for Q3FY21 surged 32% y-o-y (much better than estimates) to Rs 827 crore led by improved consumer sentiment, festive season and share gain from unorganised sector. The company witnessed improvements in Electronics, electrical businesses and consumer durable businesses (up 35%/31.4% and 30.8% y-o-y). Stabilizers, Wires, Fans, Pumps, Kitchen appliances and Digital UPS categories performed well. South revenues grew 25.3 y-o-y while non-south revenues improved 43% y-o-y. EBITDA margins improved on back of lower A&P spends despite lower gross margins (impact from the recent increase in commodity prices and expected to remain under pressure for next 3-4 months). Higher operating leverage offset by higher tax rate (29.7% vs 24.2% in Q2FY20) led to net profit growth of 79.6%. Going ahead, the management indicated that growth is expected on base of Q4FY19 as Q4FY20 was washout as secondary sales continue to remain favourable and expect summer products to come back strongly with some pent-up demand. The company targets to improve EBITDA margin by 100bps every two years. Margin improvement from the levels of FY19 is possible in FY22. The company took price hike in the range of 3-3.5% during Q3 and further 4-7% of price increase is required to offset commodity price inflation

Demand outlook remains healthy: The management highlighted that demand drivers remain healthy and company has seen improvement on the back of smaller players are not back to their full operation which is leading to higher share of business coming to larger players. Secondly, a revival in construction activities have broad based improvement in products related to construction/housing. The company focusses on 1) evolving category mix and product mix, 2) go to market with focus on e-commerce and modern trade, 3) distribution enhancement in smaller town and rural along with increase in non-south region and 4) in-organic expansion will generate growth for the company which future growth. V Guard has managed to resolve its supply chain issues and channel inventory is at healthy level. Currently e-commerce and modern retail contributes 14-15% of revenue excluding wires. It expects to add 3000 to 4000 retailers every year in non-south region. Company has 40,000 retail points with around 18,000 in south and balance in non-south with continuous additions. Earlier the company has entered in water purifier in Q3 and is planning to expand kitchen portfolio like entering in the product space of hoods and hobs

Key conference call highlights

- **Performance in Q3:** Positive market sentiment during the festive season, reflected in significant growth reported across all markets and product categories
- **Outlook:** The positive momentum is expected to sustain in Q4 on the back a rapidly recovering macro environment
- **Supply chain issues:** Supply chain related issues have been resolved for its water heater factory and
- **Broad based growth:** Growth seen on the context of small players still not back and supply shortage filled up by large players and shift being seen and secondly revival in construction activities have broad based improvement in products related to construction/housing.
- **Commodity impact:** Impact was seen during the quarter and appropriate price hikes taken (2-2.5%in Q3Fy21) and further expect to take 4-7% in Q4to fully compensate for commodity price hike. Expect pressure on the same to remain for 4-6 months
- **Cash:** Cash on balance sheet remains strong (Rs. 482.3 crore as on 31st Dec 2021) on the back of strong collections from customers some of it may go as situation normalize a portion to go in enhancing manufacturing activities.
- **Cash Utilisation:** Strong cash generation continues and company focus to utilize this cash on acquisition on adjacencies if something relevant to boost the current product profile (more in durable space like small appliances) or new category which can enhance growth in future else will be returned to shareholders (no timelines)
- **Margins:** Ad expenses and other expenses can go up which can have some effect on margins but 10% is the expectation can work with. The company focus remains on increasing it by 1% every 2 years. This is not the right time to access as there has been challenges

- **Levers for growth for future:** The company remains focused on 1) evolving category and product mix 2) enhancing its e-commerce (14-15% contribution at present to sales) and modern trade channels and make investments accordingly (in process 3) Enhancing distribution further into rural and small towns majorly in Non –South 4) through acquisitions if any right opportunity comes
- **Secondary sales:** The company indicated that secondary sales remained strong during the quarter
- **Demand ahead:** Favorable demand seen across wires, kitchen appliances, fans, stablisers, modular switches (revenues small as of now) and expect the summer products demand to remain strong going aheadin anticipation of good summers.
- **Channel Inventory levels:** The channel inventory remains healthy and lower than historical levels.
- **Retailers:** The company has around 40,0000 retailers (South: ~17-18000 rest Non-South).
- **Non South contribution:** The business in non-South is growing by 2-3% every year and to be at 55-60% in next 2-3 years. South and Non-South markets witnessed y-o-y growth of 25.3% and 43%, respectively
- **New category:** No plans to entre newer category. Going ahead company plans to expand its kitchen space offering
- **Cash flow from operations:** CFO generation in 9M FY21 of Rs. 369.4 crore as compared to Rs. 259 crore in 9M FY20
- **Import dependence:** The import dependence on is minimal at 4-5% of sales and expect to bring down to 1-2% going ahead
- **Inhouse/ Outsourcing:** The company currently has 50:50 ratio for in house manufacturing and outsourcing and expect to improve as it shifts more categories in house in next 3-4 years (fans factory recently

Results (Standalone) Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Revenues	827	627	32.0	617	34.2
RM cost	557	419	33.1	422	32.1
Staff cost	63	58	7.4	50	24.9
Other Exp	94	90	4.0	71	33.0
Operating Expenses	714	567	25.8	543	31.5
Operating profits	114	59	91.1	74	53.6
Other Income	5	5	(0.5)	7	(18.2)
Interest	1	1	14.5	1	8.5
Depreciation	9	7	28.6	8	12.7
PBT	108	57	91.8	71	52.4
Tax	31	14	130.0	21	48.6
Adj PAT	77.0	43	79.6	50	54.0
Reported PAT	77	43	79.6	50	54.0
Adj EPS	1.8	1.0	79.6	1.2	54.0
			bps		**bps**
OPM	32.6%	33.2%	(55)	31.6%	107
NPM	13.7%	9.5%	424	12.0%	174
Tax rate	9.3%	6.8%	-	8.1%	-

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 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.

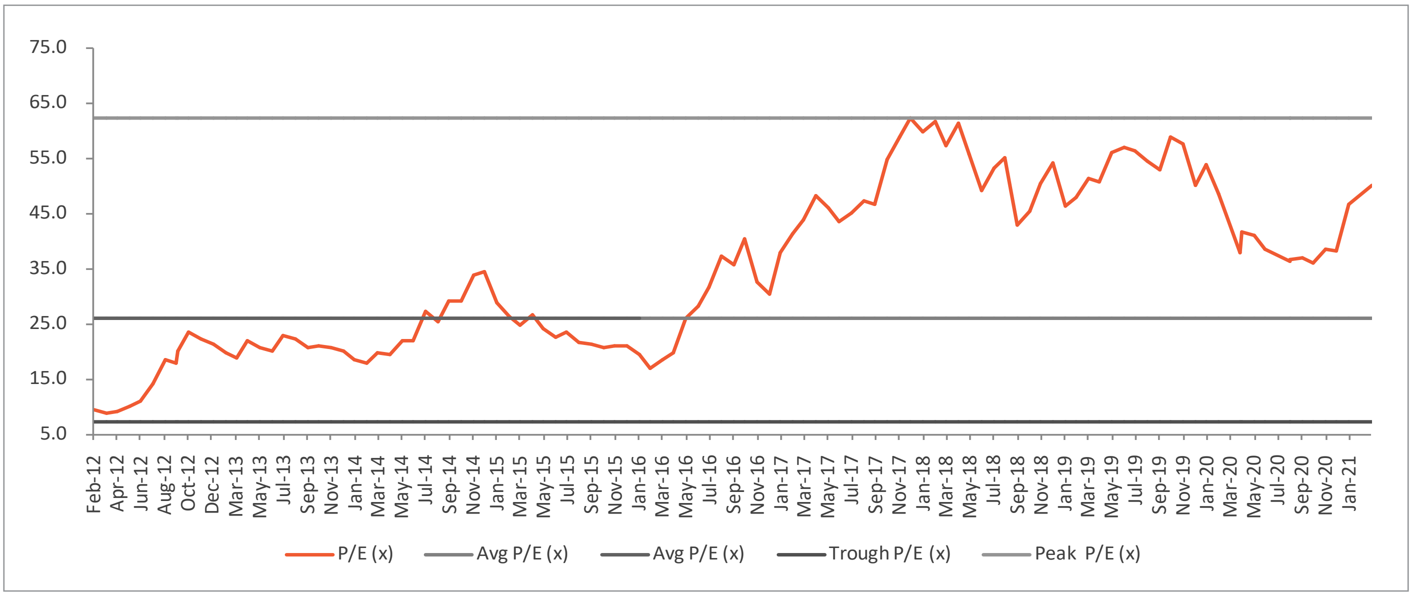
■ Company outlook - Gradually going back to business

V-Guard is witnessing near normal environment 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. Demand drivers remain healthy and company has seen improvement on the back of smaller players are not back to their full operation which is leading to higher share of business coming to larger players. Secondly revival in construction activities have broad based improvement in products related to construction/housing. 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 a revised PT of Rs. 311

V-Guard operations are normal and it has managed to resolve its supply chain issues and expects strong recovery ahead as the demand outlook remains healthy. The company focusses on 1) evolving category mix and product mix, 2) go to market with focus on e-commerce and modern trade, 3) distribution enhancement in smaller town and rural along with increase in non-south region and 4) in-organic expansion will generate growth for the company. 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 49.4/42.9 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 a revised PT of Rs. 311.

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

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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