DIXON

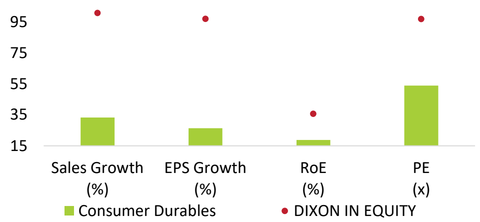
COMPANY UPDATE

COFFEE WITH CEO

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	5,112
12 month price target (INR)	5,700
Market cap (INR bn/USD bn)	303/4.0
Free float/Foreign ownership (%)	60.9/0.0
What's Changed	
Target Price	–
Rating/Risk Rating	–

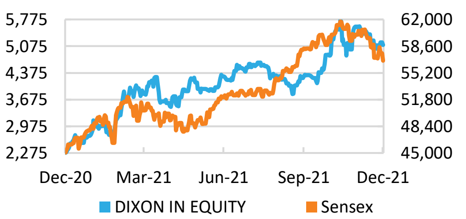
INVESTMENT METRICS



FINANCIALS (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Revenue	64,482	1,29,380	1,90,344	2,62,514
EBITDA	2,866	5,312	8,202	11,811
Adjusted profit	1,598	3,145	5,002	7,404
Diluted EPS (INR)	26.9	52.9	84.1	124.5
EPS growth (%)	30.8	96.8	59.1	48.0
RoAE (%)	25.0	35.5	39.4	40.5
P/E (x)	190.2	96.7	60.8	41.1
EV/EBITDA (x)	106.1	57.2	36.8	25.3
Dividend yield (%)	0	0.1	0.1	0.2

PRICE PERFORMANCE



Explore:

Financial model

Podcast

Corporate access

Video

Returns-centric scale; global ambitions

We recently interacted with Mr Sunil Vachani, Executive Chairman at Dixon. Highlights: i) Penetration and imports substitution in categories wherein Dixon has presence offer huge growth potential, and Dixon aspires to be a top five global player in EMS by revenue and capability. ii) Management remains confident of attracting global/local partners that prioritise players with solid execution track record, cost edge, etc.

Dixon's sustainable returns-centric scale ambition reinforces confidence w.r.t. opportunity basket. Automation, migration to ODM (especially mobile phone), and a downstream component ecosystem are critical to its long-term revenue and competitive edge. Retain 'BUY'.

Local-Global scale ambition; key areas of focus for leadership

Management highlighted a few growth drivers: significant penetration-led growth in domestic market and import substitution in key segments targeted by Dixon such as LED lights (25% imported) and monitors (largely imported). Dixon is well on track to comply with mobile PLI ceiling, and also to achieve revenue of INR70bn (FY23E). The company is in talks with more customers for feature/smart phones. Global majors are looking for domestic players with faster ability to scale up manufacturing, low-cost structure and execution track record, all of which lend Dixon an edge. Dixon is actively targeting to create a component ecosystem to better capture growth.

Balanced approach to growth; some challenges along the way

Expanding into scalable and new categories, Dixon has a clear long-run returns threshold, which is a clear filter. In our view, while global business would pose challenges to overall returns as it offers high scale, Dixon's ability to generate returns above the expected rate would remain key for stakeholders. Refrigerator, washing machine and LED lights have a high ODM share, whereas mobile phones have multiple aspects and call for greater clarity on multiple components. Skill upgradation and automation are consistent focus areas for management, and they expect commodity volatility to settle by FY23E. (Refer to ***detailed Q&A.***)

Outlook and valuation: 'Growth by design'; retain 'BUY'

In our recent ***initiation report***, we highlighted the growth/returns super-cycle for Dixon, which distinguishes it from large global peers. Revenue mix (OEM versus ODM) and share of global revenues would remain key to overall returns, and remains a key monitorable for investors. Dixon's ongoing expansion will be key to its quantum scale in revenues over FY21–24E (45% CAGR) and seems to be on track.

In the long run, returns would depend on strategic choices regarding domestic and exports segments, R&D and other investments, etc. Retain **'BUY/SO'** with a TP of INR5,700, Dixon is among our top sector picks.

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Financial Statements

Income Statement (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Total operating income	64,482	1,29,380	1,90,344	2,62,514
Gross profit	6,785	13,326	19,605	27,301
Employee costs	1,371	1,545	1,886	2,365
Other expenses	2,548	6,469	9,517	13,126
EBITDA	2,866	5,312	8,202	11,811
Depreciation	437	798	1,123	1,513
Less: Interest expense	274	353	453	486
Add: Other income	16	43	61	86
Profit before tax	2,170	4,204	6,688	9,898
Prov for tax	572	1,060	1,685	2,494
Less: Other adj	0	0	0	0
Reported profit	1,598	3,145	5,002	7,404
Less: Excp.item (net)	0	0	0	0
Adjusted profit	1,598	3,145	5,002	7,404
Diluted shares o/s	59	59	59	59
Adjusted diluted EPS	26.9	52.9	84.1	124.5
DPS (INR)	1.0	2.7	4.3	12.7
Tax rate (%)	26.4	25.2	25.2	25.2

Balance Sheet (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Share capital	117	117	117	117
Reserves	7,256	10,212	14,915	21,431
Shareholders funds	7,373	10,329	15,032	21,548
Minority interest	0	0	0	0
Borrowings	1,513	2,013	2,513	2,883
Trade payables	17,097	26,390	38,825	53,487
Other liabs & prov	1,081	1,216	1,371	1,549
Total liabilities	28,457	41,480	59,426	81,320
Net block	4,099	6,011	8,139	10,527
Intangible assets	82	82	82	82
Capital WIP	2,046	2,046	2,046	2,046
Total fixed assets	6,226	8,138	10,267	12,655
Non current inv	1,272	1,272	1,272	1,272
Cash/cash equivalent	689	1,585	3,837	7,330
Sundry debtors	10,891	15,951	23,467	32,365
Loans & advances	145	153	160	168
Other assets	9,234	14,381	20,422	27,529
Total assets	28,457	41,480	59,426	81,320

Important Ratios (%)

Year to March	FY21A	FY22E	FY23E	FY24E
COGS (% of rev)	89.5	89.7	89.7	89.6
Employee cost (%of rev)	2.1	1.2	1.0	0.9
Other exp (% of rev)	4.0	5.0	5.0	5.0
EBITDA margin (%)	4.4	4.1	4.3	4.5
Net profit margin (%)	2.5	2.4	2.6	2.8
Revenue growth (% YoY)	46.5	100.6	47.1	37.9
EBITDA growth (% YoY)	28.5	85.4	54.4	44.0
Adj. profit growth (%)	32.6	96.8	59.1	48.0

Free Cash Flow (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Reported profit	1,598	3,145	5,002	7,404
Add: Depreciation	437	798	1,123	1,513
Interest (net of tax)	202	264	339	363
Others	756	1,106	1,738	2,531
Less: Changes in WC	(743)	(648)	(822)	(1,005)
Operating cash flow	1,701	3,605	5,695	8,311
Less: Capex	(1,682)	(2,710)	(3,252)	(3,901)
Free cash flow	19	895	2,444	4,410

Assumptions (%)

Year to March	FY21A	FY22E	FY23E	FY24E
GDP (YoY %)	(7.3)	9.0	7.0	7.0
Repo rate (%)	4.0	4.0	4.3	5.3
USD/INR (average)	74.2	73.0	72.0	71.0
CE rev grwth (%)	83.4	74.0	43.4	30.6
Mobile rev grwth (%)	56.4	235.9	67.3	56.9
Lighting rev grwth (%)	(3.2)	72.3	23.5	26.4
HA rev grwth (%)	8.8	102.0	37.6	22.2
Depreciation (% of FA)	6.9	10.0	10.0	10.0
Tax rate (%)	0.3	0.3	0.3	0.3

Key Ratios

Year to March	FY21A	FY22E	FY23E	FY24E
RoE (%)	25.0	35.5	39.4	40.5
RoCE (%)	32.3	42.9	47.8	49.5
Inventory days	39	31	33	34
Receivable days	45	38	38	39
Payable days	84	68	70	72
Working cap (% sales)	3.5	2.4	2.1	2.0
Gross debt/equity (x)	0.2	0.2	0.2	0.1
Net debt/equity (x)	0.1	0	(0.1)	(0.2)
Interest coverage (x)	8.9	12.8	15.6	21.2

Valuation Metrics

Year to March	FY21A	FY22E	FY23E	FY24E
Diluted P/E (x)	190.2	96.7	60.8	41.1
Price/BV (x)	41.2	29.4	20.2	14.1
EV/EBITDA (x)	106.1	57.2	36.8	25.3
Dividend yield (%)	0	0.1	0.1	0.2

Source: Company and Edelweiss estimates

Valuation Drivers

Year to March	FY21A	FY22E	FY23E	FY24E
EPS growth (%)	30.8	96.8	59.1	48.0
RoE (%)	25.0	35.5	39.4	40.5
EBITDA growth (%)	28.5	85.4	54.4	44.0
Payout ratio (%)	3.7	5.0	5.0	10.0

Key highlights

Opening remarks

- These are very exciting times for the industry.
- Penetration levels for categories that Dixon has presence in are very low and offer room for expansion.
- Brands are looking at outsourcing and believe India will be the next hub for electronics manufacturing.
- PLI would help strengthen the component ecosystem.
- Looking at 3x FY21 turnover by FY23.
- Added marquee customers across verticals.
- Looking at entering new verticals through the telecom PLI.
- Have been able to build trust with customers, and witnessing stickiness with them.
- *Sitting on a huge opportunity as a company, and expect Dixon to become a top 5 player in the world, not only in terms of revenue but other parameters as well.*
- Refrigerators to be 100% ODM and looking at increasing ODM share in other categories through backward integration.
- Plan to further de-risk the business by expanding the basket of products offered.
- *ROCE to be the key focus area.*
- Automation and migration to ODM, especially in categories such as mobile phones, to be a key challenge.

Question and answers

Q. Do you believe, ex-mobile phones, the IT hardware business can be as big as the consumer electronics industry?

A. Seeing major growth from mobile phones with expected revenue of INR70bn. In the process of adding customers in the feature as well as smartphone category. IT hardware has huge potential. Currently imports are around USD5.5-6bn in India and expect large part of this to be driven by local manufacturing due to the PLI. The IT hardware business will be slow to start off. In talks with customers for tablet manufacturing as well. Need to look at life without PLI, and that can happen only through investment in scale.

Q. What is your target for ODM in the mobile phone segment?

A. Targeting low end 4G market and the 2G mobile phones market.

Q. What is the level of imports in the categories that Dixon caters to?

A. Television – very small level of imports currently. Penetration levels very low with only 15% owning a TV. 90% of TVs manufactured domestically and the same for lighting would be 75%. Growth will come from expansion of the market and entry into similar products such as monitor screens. Huge demand for monitors from private as well as government. USD65-70bn global lighting market, excluding street lights. *Exports will become a major contributor for the lighting segment.* As a country hardly exporting lights and currently a very small number for Dixon as well. In the process of getting approvals for lighting exports and also in the process of expanding the capacity. Once orders flow in, scaling up should not take a lot of time.

Q. What are the parameters considered by brands in deciding their outsourcing partners?

A. Quality, cost and delivery are the major factors. Execution skills of the partner also plays a pivotal role. *Due to the PLI scheme, Indian companies have an edge especially in the low cost products.*

Q. When do you see the shift towards ODM happening in the mobile phone segment?

A. Process involves collaborating with chipset companies, operating system vendors, etc. Difficult to say when we will be able to launch it but in the next 2-3 months should be able to give a better timeline.

Q. By when do you think Dixon will have more consistency in margins? With the scale expected in the EMS business, what kind of margins do you expect?

A. In the prescriptive business the margins are a pass through. In the ODM business the margins are much better. Once the scale picks up and operating leverage kicks in, margins should stabilize.

Q. How do you view the labour situation, and what kind of inflation are you building in for employee cost?

A. Did face issues during the first and second wave. The challenge currently is to provide more employment opportunities.

Q. Could you throw some light on the downstream component systems, and how is that evolving vis-à-vis other countries?

A. No doubt that to build a strong sustainable model and to be competitive beyond the PLI, a strong component systems is required. The AC and LED PLI emphasized on the component ecosystem which is a big positive. Working with a design house in India for designing a driver IC for the lighting segment.

Q. How do you balance the business strategy when given an opportunity to be in partnership with a global brand versus maintaining your returns thresholds?

A. The decision is based on the vision for each segment. Initially, the segments will take time to scale up but once they attain scale, the returns should follow.

Company Description

Dixon, founded in 1993, is a leading player in the Indian electronics manufacturing services industry. It started out as a manufacturer of colour televisions in 1994, but has ventured in to multiple segments over the years, including consumer durables, home appliances, lighting, mobile phones and security devices. It also provides refurbishment services for a wide range of products such as set-top boxes, mobile phones and LED TV panels. The company caters to global as well as domestic brands as an original equipment manufacturer (OEM) and an original design manufacturer (ODM). Backward integration and cost-effective manufacturing are the key differentiating factors from its competitors. It has 16 integrated manufacturing plants with presence in north as well as south India (Noida, Dehradun and Tirupati).

Investment theme

Dixon's business model is highly scalable yet profitable, thanks to its frugal cost structure, capital-light intensity and, above all, high manufacturing fungibility. Domestic electronic/consumer durables manufacturing is slated to grow 2x-plus versus the sector over coming 3–5 years, offering a huge 3x jump in TAM for Dixon over FY21–25E as brands localise supply-chains. And breaking into global supply chain could enormously expand global TAM for Dixon in our view.

Key risks

Dixon has a major capex ramp-up plan, which requires significant production mandate from local/global markets and efficient execution. Delay in approval cycle and execution challenges w.r.t. production ramp-up pose key risks to our hypothesis.

Competition, particularly from incumbents, could risk expected global penetration.

Additional Data

Management

Exec. Chairman	Sunil Vachani
VC & MD	Atul B. Lall
CFO	Saurabh Gupta
CS, Head Legal & HR	Ashish Kumar
Auditor	M/s S.N. Dhawan & Co. LLP

Holdings – Top 10*

	% Holding		% Holding
Nippon Life Ind	2.65	Royal Bank Of C	1.00
Vanguard Group	2.05	Ameriprise Fina	0.76
Steadview Capit	2.02	Blackrock Inc	0.75
Icici Prudentia	1.73	William Blair &	0.69
Life Insurance	1.05	Goldman Sachs G	0.69

**Latest public data*

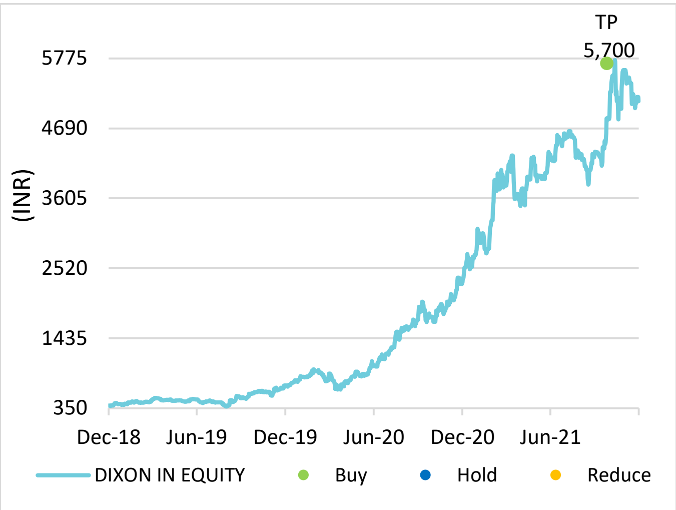
Recent Company Research

Date	Title	Price	Reco
29-Oct-21	Strategy & scale on track amid volatilit; *Result Update*	4975	Buy
01-Oct-21	Local dominance, global ambition; *Initiating Coverage*	4611.9	Buy

Recent Sector Research

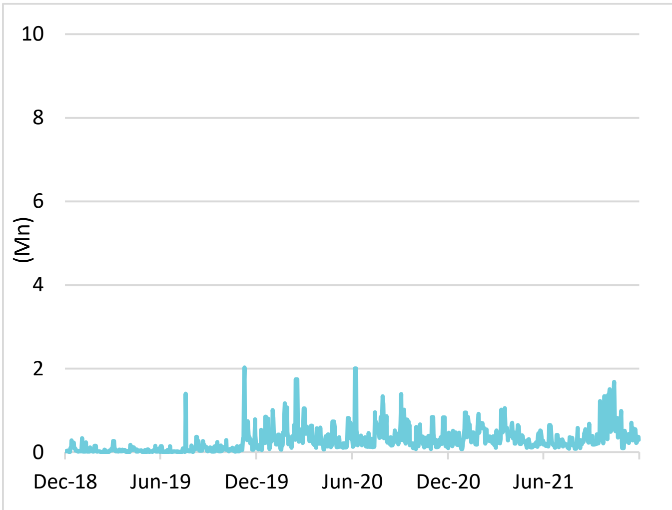
Date	Name of Co./Sector	Title
12-Nov-21	Bajaj Electrical	Growth and balance sheet on track; *Result Update*
02-Nov-21	Whirlpool of India	Consistent miss; sticky challenges; *Result Update*
01-Nov-21	Amber Enterprises	RAC weak; components faring better; *Result Update*

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	187	52	18	258
	>50bn	**>10bn and <50bn**	**<10bn**	**Total**
Market Cap (INR)	229	43	3	275

**1 stocks under review*

Rating Rationale

Rating	Expected absolute returns over 12 months
Buy:	>15%
Hold:	>15% and <-5%
Reduce:	<-5%

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