Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

V-Guard Industries Ltd

Mixed bag quarter, encouraging business outlook

Capital Goods	Sharekhan code: VGUARD
Reco/View: Buy ⇔	CMP: Rs. 224
Price Target: Rs. 280 ⇔	

↑ Upgrade ⇔ Maintain ↓ Downgrade

Stock Update

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		⇔	

ESG Disclosure Score NEW

ESG RISK RATING Updated Jul 08, 2022	28.69

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

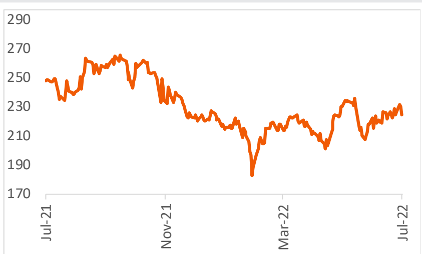
Company details

Market cap:	Rs. 9,667 cr
52-week high/low:	Rs. 285/181
NSE volume: (No of shares)	4.1 lakh
BSE code:	532953
NSE code:	VGUARD
Free float: (No of shares)	19 cr

Shareholding (%)

Promoters	55.9
FII	12.4
DIIs	18.1
Others	13.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.2	6.1	14.2	-9.3
Relative to Sensex	-2.6	7.3	13.2	-17.7

Sharekhan Research, Bloomberg

Summary

- We retain a Buy on V-Guard Industries Ltd with an unchanged PT of Rs. 280 given encouraging business outlook coupled with strong balance sheet and improving working capital cycle.
- V-Guard's standalone performance bettered estimates on sales fronts but missed our OPM and net profit estimates due to inventory loss of Rs 10 crore. All the three segments - Electronics, Electricals and Consumer Durables reported healthy growth led by sustained demand and low base.
- Management is optimistic about good demand given a wider product portfolio, expansion in national presence by adding dealers and investments in capacity augmentation (cables and fans).
- Company expects GPM/OPM to revert to pre covid levels in the medium term given resilient consumer demand in most of its product categories, cooling off of commodity prices and increase in in-house manufacturing in the medium to long-term.

V-Guard Industries' result beat our expectations on revenue front but lagged our OPM estimates. Sales grew by ~80% y-o-y to Rs 1,010cr (versus our estimate of Rs 881cr). Gross profit margin declined by 327 bps y-o-y but improved sequentially by 100 bps to 29.8%, thereby reflecting the positive impact of price hikes taken earlier. Operating profit grew by 89% y-o-y to Rs 82cr (versus our estimate of Rs 90cr). OPM improved by 38 bps y-o-y to 8.1%, but lower than our estimate of 10.2%. The company had to write off Rs 10 crore inventory which had a negative impact of 100 bps on OPM margin. Net Profit grew by 119% y-o-y to Rs 54 cr led by strong sales, higher other income and lower tax rate. Segment wise; Electronics and Consumer Durables led the top-line by delivering ~91%/100% y-o-y growth. EBIT margin in Electronics improved by 148 bps y-o-y to 14.5%. Consumer durables reported profit of Rs 4 cr vs loss of Rs 6 cr in Q1FY22, while margin in the Electricals segment declined by 258 bps y-o-y to 6.8% in Q1FY23. The company is optimistic about future revenue growth and expects GPM/OPM to revert to pre-covid levels as volumes pick up and input costs stabilize for all product categories.

Key positives

- All the three segments – Electronics, Electricals and Consumer Durables registered a healthy revenue growth of ~91%/~62%/100% y-o-y respectively.
- The Electronics PBIT margin have improved y-o-y by 150bps to 14.5%, while Consumer Durables' margin stood at 1.3% against loss at PBIT level in Q1FY22.
- Inventory days reduced from 129 days in Q4FY22 to 108 days in Q1FY23. The inventory level is expected to normalize in the next 3-4 months.

Key negatives

- Although gross margin improved q-o-q by 100bps, OPM declined 244bps q-o-q due to higher other expenses mainly advertisement and promotion expenses.
- PBIT margin in Electricals declined by 258bps y-o-y despite healthy revenue growth. This was mainly on account of significant drop in copper prices during June which affected wires margins as the company had to liquidate its high-cost inventory.
- Demand was subdued for certain products like inverters, battery and pumps.

Management Commentary

- There was a broad-based contribution from both South and Non-South markets that witnessed y-o-y growth of 68.2% and 95.6%, respectively. Non-South markets contributed ~47% to total revenues in Q1FY2023 as compared to ~43% in Q1FY2022.
- Inventory levels are beginning to normalize and the company expects inventories to fully revert to their normative levels over the next 3-4 months.
- Gross margins to recover to their normal levels over the next 1-2 quarters if the commodity prices and input cost stabilize.
- CFO generation at the end of Q1FY2023 was Rs. 178 crore, improving significantly from a negative ~Rs.102 crore at the end of Q1FY2022.
- Net cash of ~Rs 173 crore as on 30th June 2022, as against Rs 154 crore as on 30th June 2021 on account of improved working capital position. Working capital days have decreased to 84 days as compared to 106 days mainly due to a decline in inventory days from 129 days to 108 days during the same period.
- Adequate price hikes and fixed cost absorption due to higher volumes (water heaters to do well in Q2/Q3) would lead to further improvement in Consumer Durables margin

Revision in estimates – We have broadly maintained our FY2022-FY2024E estimates.

Our Call

Valuation – We maintain Buy with an unchanged PT of Rs. 280: The company is expected to see strong demand across its verticals, barring near-term weakness in the eastern region. Operating profit margin (OPM) is expected to improve with price hikes, higher volumes and increasing in-house manufacturing. Further, focus on increasing in-house manufacturing capacity would ensure better control on the supply of raw materials; thereby helping normalize the inventory levels going forward. The company has a strong balance sheet with healthy cash flows and working capital cycle is expected to revert to earlier levels coupled with robust business fundamentals that provide comfort. Hence, we continue to maintain Buy on the stock with an unchanged PT of Rs. 280.

Key Risks

Relatively weak demand environment in some of the product categories may affect earnings.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net sales	2,699	3,475	4,098	4,722
OPM (%)	11.4	9.6	9.6	10.3
Net profit	199	227	251	318
% Y-o-Y growth	7.5	14.0	10.8	26.6
Adj. EPS (Rs.)	4.6	5.3	5.8	7.4
P/E (x)	48.8	42.8	38.6	30.5
P/B (x)	8.0	6.9	6.1	5.2
EV/EBIDTA (x)	28.6	27.7	23.1	18.5
RoNW (%)	18.1	17.4	16.7	18.4
RoCE (%)	26.1	22.6	22.8	25.0

Source: Company; Sharekhan estimates

Strong top-line but profit lags estimates

V-guard Industries' results beat our expectations on the revenue front but lagged our OPM and profit estimates. Sales grew by ~80% y-o-y to Rs 1,010cr (versus our estimate of Rs 881cr). Gross profit margin declined by 327 bps y-o-y but improved sequentially by 100 bps to 29.8%, thereby reflecting the positive impact of price hikes and fall in commodity prices in a few segments. Operating profit grew by 89% y-o-y to Rs 82cr (versus our estimate of Rs 90cr). OPM improved by 38 bps y-o-y to 8.1%, but lower than our estimate of 10.2%. Net Profit grew by 119% y-o-y to Rs 54 cr led by strong sales, higher other income and lower tax rate. Segment wise; Electronics and Consumer Durables led the top-line by delivering ~91%/100% y-o-y growth. EBIT margin in Electronics improved by 148 bps y-o-y to 14.5%. Consumer durables reported profit of Rs 4 cr vs loss of Rs 6 cr in Q1FY22, while the margin in the Electricals segment declined by 258 bps y-o-y to 6.8% in Q1FY23.

Demand to remain healthy, capacity augmentation would lead to margin gain

The company has indicated healthy demand going forward as a contribution from smaller categories such as fansbatteriesry, inverters, water heaters increase. Going ahead, the margins would be driven by volume growth across categories particularly with lower volume base. Further, an increase in in-house manufacturing would help the company become more cost competitive thereby improving its market share. The company seems well-positioned to benefit from the resilient customer demand based on its diversified product portfolio, increasing national presence (aims to add 3,000-4,000 dealers per annum) and investments in capacity building.

V-Guard Industries Q1FY2023 Investor Update and Concall Highlights

- **Price hikes lead to improvement in Electronics and Consumer Durables margin:** Pricing action taken in Q4FY22 and start of Q1FY23 have led to better margins in certain product categories in both Electronics and Consumer Durables.
- **Summer-led products performed well:** Summer led prodstabilizersstabilizer, fans and water heaters did well backed by lower base, although June month was subdued.
- **Acquisition of additional stake in Guts Electro-Mech :** The company has acquired the remaining 26% stake in its subsidiary Guts Electro-Mech for Rs 6.2 crore. The subsidiary is engagedthe in manufacturing of switchgear.
- **Higher other expenses:** Out of the sharp increase of 67% y-o-y in other expenses, Rs 33 crore is attributed to volume-related expenses. In addition, advertisement and promotional expenses, as well as travel expenses, have increased.
- **Electronics –** In electronics, AC stabilizer sales were good while inverter and battery sales were subdued as raw material supplies were impacted. Since the company is a market leader in stabilizers the growth is expected to be in line with the industry growth. However, in inverter and ,battery the company has a mere 3% share in the 12000cr market which provides wide scope for future growth.
- **100 bps impact on OPM due to high-value copper inventory in Electricals:** The company had to write off Rs 10 cr due to high-value copper inventory in wires which lowered the company level OPM margin by 100 bps. The company expects July month could also be impacted; however low input cost benefit should flow to the margin from August onwards. The company believes that a pre-covid gross margin of 32-33% could be achieved in the next few quarters.
- **Consumer Durables – on a strong footing:** The company is focusing on in-house manufacturing of premium category fans. Currently, premium fans are 40-50% of the total fan sales and its share is expected to rise as BLDC energy-efficient fans gain traction. In water heaters, the company has regained its lost share and the growth trajectory is promising. Water heater is also a higher margin segment and expected to do well in Q2/Q3. In fans too, since the aluminium prices are coming down, margins are likely to improve going forward. The company aims 7% EBIT margin by January –March quarter in Consumer Durables.

- **Pumps:** In Electricals, pumps contribute ~10% to total revenue. The category has seen multiple rounds of price increases, however, volumes and margins are still subdued in this category but expected to improve going forward.
- **Strong growth in switches and switchgear:** The company expects this category to grow at 25-30% p.a. over the next 3-4 years.
- **Inventory status:** Copper inventory is 60 days, while finished goods inventory is 70-80 days
- **In-house manufacturing to increase:** The company expects in-house manufacturing to increase to 75% from current 60% in the next two-three years as manufacturing facilities for fans, inverters and batteries come on board.
- **Non-south market performance:** The northern and western regions experienced a good summer season, while growth in the east was impacted due to rains.
- **Price hikes:** since commodity prices are cooling off, price hikes are not required in most of the categories except for marginal price increases in Consumer Durables. The company had taken price hikes of 2-2.5% in Q1FY23.
- **Employee cost:** Higher employee cost is a result of variable pay accrual having an additional impact of Rs 7 cr during Q1FY23.
- **Channel inventory at normal level:** Inventory currently is at a normal level except wire category which has witnessed destocking. Demand slowdown was witnessed in the last leg of Q1FY23 in weather related products like inverter, battery, stabilizers and fans.
- **Volume growth:** The company targets 15% volume growth in FY23.

Results (Standalone) Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-y (%)	Q4FY22	QoQ (%)
Revenues	1,009.6	560.7	80.1	1,050.3	(3.9)
Operating profit	81.9	43.4	88.9	110.8	(26.1)
Other income	5.1	4.0	27.4	3.3	53.0
Interest	1.7	1.5	15.5	1.6	10.1
Depreciation	12.9	10.9	18.0	12.3	4.7
PBT	72.3	34.9	107.2	100.2	(27.8)
Tax	18.3	10.3	78.0	9.6	90.0
Adj PAT	54.0	24.6	119.3	90.6	(40.4)
Reported PAT	54.0	24.6	119.3	90.6	(40.4)
Adj EPS (Rs.)	1.3	0.6	119.3	2.1	(40.4)
Margin (%)			**bps**		**bps**
GPM	29.8	33.0	(327)	28.7	100
OPM	8.1	7.7	38	10.6	(244)
NPM	5.4	4.4	96	8.6	(328)
Tax rate	25.3	29.5	(415)	9.6	1,570

Source: Company; Sharekhan Research

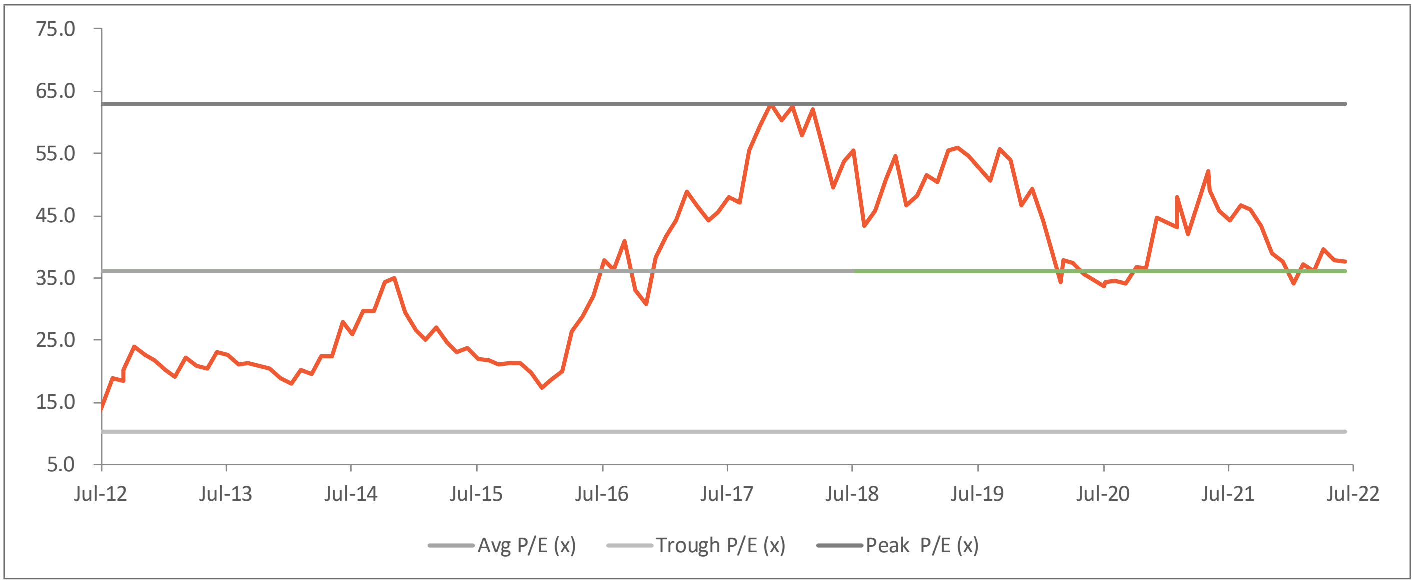
Outlook and Valuation

■ **Sector View – Uncertain environment likely to normalize in the medium term:** The COVID-19 outbreak and the shutdown led to the stoppage of work at most factories, forcing brakes on demand. Further, inflationary pressures and supply side challenges have posed fresh challenges. However, the consumer durable/electrical industry has seen good demand since H2FY21, the momentum of which is expected to continue further. The government's Atmanirbhar Bharat initiative is expected to benefit with capital subsidies and industrial benefit policies being doled out to give a push to in-house manufacturing. Further, demand for electricals and electronics from the housing sector has been robust due to low-interest cost and ease of financing. The management expects better supply security and margin improvement with an increase in in-house manufacturing. Healthy cash positions are likely to aid companies in inorganic growth opportunities, as organised players benefit from the tough environment.

■ **Company outlook – Varied growth levers:** Management expects healthy growth to sustain going forward. The company remains focused on 1) evolving category mix and product mix, 2) Go to market with a focus on e-commerce and modern trade, and 3) distribution enhancement in smaller town and rural along with an increase in the non-south region. The company expects to add 3,000-4,000 retailers every year in non-south region. VGIL has 40,000 retail points - around 18,000 in the south and balance in non-south with continuous additions. Overall, management is focusing on maintaining a healthy cash position, cost rationalization and expediting digitization.

■ **Valuation – We maintain Buy with an unchanged PT of Rs. 280:** The company is expected to see strong demand across its verticals, barring near-term weakness in the eastern region. Operating profit margin (OPM) is expected to improve with price hikes, higher volumes and increasing in-house manufacturing. Further, focus on increasing in-house manufacturing capacity would ensure better control on the supply of raw materials; thereby helping normalize the inventory levels going forward. The company has a strong balance sheet with healthy cash flows and working capital cycle is expected to revert to earlier levels coupled with robust business fundamentals that provide comfort. Hence, we continue to maintain Buy on the stock with an unchanged PT of Rs. 280.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

About the company

V-guard is a major electrical appliances manufacturer in India and the largest in Kerala. The company is one of India's consumers' goods companies 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. Its business segments comprise of Electronics, Electricals and Consumer Durables which contributed 23.5%, 30.6% and 45.9% to FY22 revenues respectively.

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

Relatively weak demand environment in southern and eastern regions may affect earnings in the near term.

Additional Data

Key management personnel

Mr. Kochouseph Chittilappilly	Chairman
Cherian Punnose	Vice-Chairman
Mithun K Chittilappilly	Managing Director
V Ramachandran	Director and Chief Operating Officer
Sudarshan Kasturi	Senior VP and CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management	8.5
2	Kotak Small Cap Fund	5.3
3	Nalanda India Equity Fund Ltd.	4.2
4	Priya Sarah Cheeran Joseph	4.1
5	Nalanda India Fund Limited	1.9
6	Fundrock Management Co SA	1.6
7	Aditya Birla Sun Life Asset Management	1.3
8	HDFC Life Insurance	1.3
9	Vanguard Group Inc.	1.2
10	BlackRock Inc.	0.6

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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