Sharekhan by BNP PARIBAS

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Stock Update

Result Update

V-Guard Industries Ltd

Muted quarter, optimistic outlook

Capital Goods	Sharekhan code: VGUARD
Reco/View: Buy ↔	CMP: Rs. 253 / Price Target: Rs. 300 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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 28.69

Updated Oct 08, 2022

Medium Risk

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

Source: Morningstar

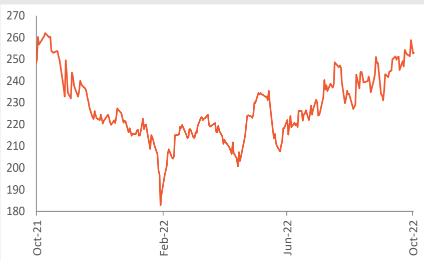
Company details

Market cap:	Rs. 10,918 cr
52-week high/low:	Rs. 264/181
NSE volume: (No of shares)	3.8 lakh
BSE code:	532953
NSE code:	VGUARD
Free float: (No of shares)	19 cr

Shareholding (%)

Promoters	55.9
FII	12.9
DIIs	18.1
Others	13.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.5	12.8	19.5	-2.8
Relative to Sensex	3.5	7.3	15.3	-2.7

Sharekhan Research, Bloomberg

Summary

- We retain our Buy rating on V-Guard Industries Limited's (VGIL) with an unchanged PT of Rs. 300, given increasing presence in non-South markets, entry into new product categories, and volume-driven growth across verticals.
- VGIL's Q2 performance was below estimates on the profitability front mainly due to poor performance of the electricals segment. Consumer durables reported healthy growth and firm margin on a y-o-y basis.
- The company aims to scale up in-house manufacturing to enhance competitiveness and efficiency, which would lead to margin improvement. Manufacturing facilities for fans, inverters, and batteries are expected to come on board in the near future.
- The company expects GPM/OPM to revert to pre-Covid levels in Q4FY2023, given cooling-off of commodity prices, increased in-house manufacturing, and depletion of high-cost inventory.

V-Guard Industries Limited's (VGIL) results were below our expectations on the profitability front during Q2FY2023. Sales grew by ~9% y-o-y to Rs. 981 crore, in line with our estimates. South and non-south markets witnessed 2.6% and 17.8% growth, respectively. Gross profit margin declined by 231 bps y-o-y. Operating profit dipped by 24% y-o-y to Rs. 71 crore (versus our estimate of Rs. 94 crore). Operating profit margin (OPM) dipped by 315 bps y-o-y to 7.2% (vs. our estimate of 10.4%). Net profit declined by 27% y-o-y to Rs. 43 crore due to poor operating performance. Segment wise, consumer durables (fans, water heaters, kitchen appliances, and air coolers) led the top-line growth by delivering ~21% y-o-y growth, while electronics and electricals registered 8.7% and 0.4% sales growth, respectively. EBIT margin in electronics and electricals declined by 420 bps/470 bps y-o-y to 15%/5.1%. EBIT margin of the consumer durables segment was flat on a y-o-y basis; however, it improved considerably on a q-o-q basis by 160 bps.

Key positives

- The consumer durables segment registered healthy revenue growth of ~21% and EBIT margin remained firm at 2.9% y-o-y, while it improved by 160 bps on a q-o-q basis.
- Electronics sales grew by 8.7% y-o-y, while EBIT margin improved on a q-o-q basis by 46 bps to 15%.

Key negatives

- GPM and OPM declined by 231 bps/315 bps y-o-y to 28.6%/7.2%, respectively.
- EBIT margin in electricals declined by 470bps y-o-y. This was mainly on account of a significant drop in copper prices, which affected realisations.
- Demand was soft for products such as fans. Volumes of water heaters were also lower than the company's expectations.

Management Commentary

- South and non-south markets grew by 2.6% and 17.8% y-o-y, respectively. Strong growth from non-south markets contributed ~43% to total revenue in Q2FY2023, higher than 39.4% in Q2FY2022.
- If wire prices had remained stable, overall sales growth could have been ~11.5%.
- Inventory levels are beginning to normalise; however, they are still higher by 20 days than normal levels.
- Gross margin is expected to recover to pre-Covid levels by Q4FY2023, as commodity prices have fallen and high-cost inventory gets depleted.
- CFO generation at the end of Q2FY2023 was Rs. 234 crore, improving significantly from ~Rs. 26 crore at the end of Q2FY2022.
- Net cash of ~Rs. 151 crore as against Rs. 185 crore. Working capital days have slightly increased to 88 days as compared with 84 days mainly due to higher inventory levels and reduction in payables.
- Price hikes and fixed cost absorption would lead to further improvement in consumer durables margin.
- Currently, mid to premium fans are 40-50% of total fan sales and their share is expected to rise as BLDC energy-efficient fans gain traction.

Revision in estimates – We have broadly maintained our FY2022-FY2024 estimates.

Our Call

View: We maintain Buy with an unchanged PT of Rs. 300: VGIL is on the cusp of a high-growth trajectory, as it is deploying multiple levers for the next level of growth. The company is expanding its product portfolio in all divisions to widen its customer and geographical base. The company also intends to increase contribution of products such as batteries, inverters, and pumps in total revenue. Further, in fans, the company's focus lies on premiumisation, leading to higher realisation and margins. The company would increase its in-house manufacturing base to 75% in the coming years, leading to more cost competitiveness and efficiency. We expect margins to improve going forward, driven by strong volumes, price increases in key product categories, and deeper penetration into non-south markets. We expect Revenue/PAT CAGR of ~19%/~22% over FY2022-FY2024E EPS. Hence, we retain our Buy recommendation on VGIL with an unchanged price target (PT) of Rs. 300.

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	10.4
Net profit	199	227	251	335
% Y-o-Y growth	7.5	14.0	10.8	33.1
Adj. EPS (Rs.)	4.6	5.3	5.8	7.8
P/E (x)	54.9	48.1	43.4	32.6
P/B (x)	9.0	7.8	6.8	5.8
EV/EBIDTA (x)	32.3	31.2	26.1	20.0
RoNW (%)	18.1	17.4	16.7	19.2
RoCE (%)	26.1	22.6	22.8	26.1

Source: Company; Sharekhan estimates

Sales in-line but margin lags estimates

VGIL's results were below our expectations on the profitability front. Sales grew by ~9% y-o-y to Rs. 981 crore, in-line with our estimates. South and non-south markets witnessed growth of 2.6% and 17.8%, respectively. Gross profit margin declined by 231 bps y-o-y. Operating profit dipped by 24% y-o-y to Rs. 71 crore (versus our estimate of Rs. 94 crore). OPM dipped by 315 bps y-o-y to 7.2% (vs. our estimate of 10.4%). The company's advertisement and promotional (A&P) spends stood at 2.2% of Q2FY2023 sales as compared to 1.5% in Q2F20Y22, as ad spends are normalising after dipping during the Covid-19 period. Further, margins were impacted by sale of higher-cost wires inventory at lower realisations due to correction in copper prices. Even in the other categories, input costs remained significantly higher than long-term averages, despite some reduction in the past few months. Net profit declined by 27% y-o-y to Rs. 43 crore due to poor operating performance. Segment wise, consumer durables led the top-line growth by delivering ~21% y-o-y growth, while electronics and electricals registered 8.7% and 0.4% sales growth, respectively. EBIT margin of electronics and electricals declined by 420 bps/470 bps yoy to 15%/5.1%. EBIT margin of consumer durables was flat on a y-o-y basis; however, it improved considerably on a q-o-q basis by 160 bps. The company had a net cash balance of Rs. 151 crore as on September 30, 2022.

Optimistic long-term outlook

In consumer durables, the company has expanded its fans portfolio, targeting the mid-segment range in the decorative segment. The company expects good traction in the recently introduced BLDC fans segment, where it is preparing for the new energy-efficiency norms. The company is focusing on in-house manufacturing of premium category fans. Currently, premium fans are 40-50% of the total fan sales and their share is expected to rise as BLDC energy-efficient fans gain traction. The company aims 7% EBIT margin by January-March quarter in consumer durables. In electronics, its subsidiary - VCPL's first plant has started operations. The company has invested about Rs. 60 crore in VCPL's plant. Going ahead, 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 has continued to expand its market visibility and has grown its retailer base to over 50,000 touchpoints.

VGIL's Q2FY2023 Investor Update and Concall Highlights

- **Consumer Durables:** There has not been any price increase since April. Fans category sales have been impacted by new BEE norms being implemented. There has been de-stocking by trade channels for non-BEE compliant products. The company expects Q3FY2023 fan sales to be impacted for the same reason. As per the company, BLDC is a fast-growing category in fans. Prices of newer models in fans would be higher by 5-8%. In fans, contribution of mid-to-premium range is more than 40-50%. In fans, since aluminium prices are coming down, margins are likely to improve going forward. Water heaters sales during the quarter were lower compared with the company's expectations.
- **Margin to revert to pre-Covid levels:** The company is confident of achieving pre-Covid gross margins by Q4FY2023. Margins should improve as the old inventory gets depleted and the company procures fresh raw material at reduced prices. Further, absorption of overhead cost going forward would lead to better margins.
- **Kitchen appliances –** In the kitchen appliances category, the company is more focused on the southern markets. The company's manufacturing facility should be ready in the next few quarters. It expects tax benefit of 2% from the new facility once it ramps up in FY2025.
- **Demand:** Demand has been soft for entry-level products in rural areas. The company stated that the latter half of Q2FY2023 had witnessed demand slowdown. Demand from real estate is slower, which is impacting wires, switches, and switchgears categories, where sales are primarily retail.
- **Pricing in south vs. non-south:** There is no difference in pricing and gross margins between south and non-south regions in the past three years.

- **Electricals:** Electricals sales have been impacted largely because of wires. Wire sales have been slower due to lower realisation and de-stocking by trade channels, given the price drop in copper.
- **Inventory levels:** Inventory levels are higher by 20 days than normal levels. Hence, Q3FY2023 could also see some impact of high-cost inventory on numbers.
- **Capex –** The company currently has three manufacturing plants under construction, and it would take about a year to ramp up. The company expects Rs. 70 crore capex for the next two years.
- **Water purifiers segment is still in a nascent stage –** The company is still expanding its products in the water purifier category and is currently focusing on e-commerce channels to scale up the business.
- **Simon Electric's acquisition:** Simon Electric would be merged with VGIL. The company would provide further update in the next quarter.

Results (Standalone) Rs cr

Particulars	Q2FY23	Q2FY22	YoY%	Q1FY23	QoQ%
Net Sales	981	903	8.6	1,010	(2.9)
Operating Profit	71	94	(24.4)	82	(13.7)
Other income	3	3	27.3	5	(31.3)
Interest	2	3	(40.3)	2	5.1
Depreciation	14	11	29.5	13	8.5
PBT	58	82	(29.2)	72	(19.3)
Tax	15	23	(35.0)	18	(17.0)
Adj. PAT	43	59	(26.9)	54	(20.1)
Reported PAT	43	59	(26.9)	54	(20.1)
Adj. EPS (Rs.)	1.0	1.4	(26.9)	1.3	(20.1)
Margin (%)			**bps**		**bps**
GPM	28.6	30.9	(231)	29.8	(112)
OPM	7.2	10.4	(315)	8.1	(90)
NPM	4.4	6.5	(214)	5.4	(95)
Tax rate	26.0	28.4	(231)	25.3	74

Source: Company; Sharekhan Research

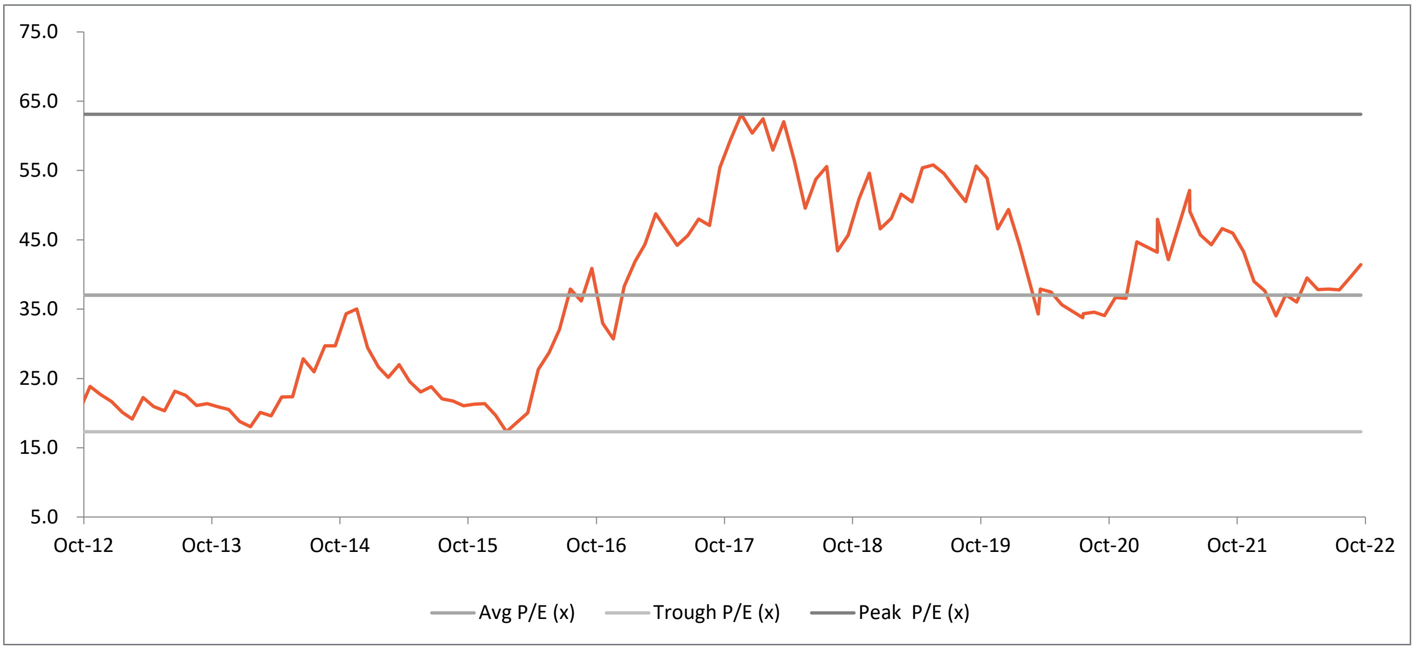
Outlook and Valuation

- **Sector View – Uncertain environment likely to normalise in the medium term:** The consumer durable/electrical industry has seen good demand since H2FY2021, the momentum of which is expected to continue further. The government's Atmanirbhar Bharat initiative is expected to benefit from 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. Management expects better supply security and margin improvement with increased 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 towns and rural along with an increase in the non-south region. The company expects to add 3,000-4,000 retailers every year in the 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 rationalisation, and expediting digitisation.

- **Valuation – We maintain Buy with an unchanged PT of Rs. 300:** VGIL is on the cusp of a high-growth trajectory, as it is deploying multiple levers for the next level of growth. The company is expanding its product portfolio in all divisions to widen its customer and geographical base. The company also intends to increase contribution of products such as batteries, inverters, and pumps in total revenue. Further, in fans, the company's focus lies on premiumisation, leading to higher realisation and margins. The company would increase its in-house manufacturing base to 75% in the coming years, leading to more cost competitiveness and efficiency. We expect margins to improve going forward, driven by strong volumes, price increases in key product categories, and deeper penetration into non-south markets. We expect Revenue/PAT CAGR of ~19%/~22% over FY2022-FY2024E EPS. Hence, we retain our Buy recommendation on VGIL with an unchanged PT of Rs. 300.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

About the company

VGIL 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. The company's business segments comprise electronics, electricals, and consumer durables, which contributed 23.5%, 30.6%, and 45.9%, respectively, to FY2022 revenue.

Investment theme

VGIL is an established brand in the electrical and household goods space, particularly in south India. Over the years, the company 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 tier-III cities, where there is immense 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 Small Cap Fund	9.1
2	Arun K. Chittilappilly	8.8
3	Kotak Small Cap Fund	5.3
4	Mithun Kochouseph Chittilappilly (Anekha Chittilappilly Trust)	4.9
5	Kochouseph Thomas Chittilappilly	4.8
6	Kochouseph Chittilappilly	4.3
7	Nalanda India Equity Fund	4.2
8	Priya Sarah Cheeran Joseph	4.1
9	Nalanda India Fund	1.9
10	Aditya Birla Sun Life Trustee Private Limited	1.3

Source: Bloomberg, Capitaline

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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