Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Company Update

Dixon Technologies Ltd

Strong FY2024E, cautious near-term outlook

Capital Goods	Sharekhan code: DIXON		
Reco/View: Buy ↔	CMP: Rs. 3,877	Price Target: Rs. 4,960 ↔	

↑ 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 16.33

Updated Oct 08, 2022

Low Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 23,010 cr
52-week high/low:	Rs. 5,726/3,181
NSE volume: (No of shares)	2.6 lakh
BSE code:	540699
NSE code:	DIXON
Free float: (No of shares)	3.9 cr

Shareholding (%)

Promoters	34.3
FII	15.1
DII	8.1
Others	42.6

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-9.2	-12.3	13.8	-28.4
Relative to Sensex	-9.1	-15.0	-2.4	-36.8

Sharekhan Research, Bloomberg

Summary

- In our interaction with Dixon, management highlighted near-term headwinds in terms of lower volume offtake post the festive season in TVs and mobiles. Further, COVID-lockdowns in China may disrupt the supply chain although for a brief period.
- The company is confident of strong long-term growth given new customer additions in key product categories, improving performance of lighting and consumer electronics businesses and margin expansion.
- Ramp-up of high margin original design manufacturer (ODM) products, liquidation of high-cost inventory, cost optimisation and a fall in input prices, would improve profitability.
- A healthy balance sheet, low working capital and strong revenue/PAT CAGR of ~31%/~47% over FY22-25E justify its rich valuation. Recent correction is a good buying opportunity for long-term investors. We retain a Buy on Dixon Technologies (Dixon) with an unchanged PT of Rs. 4,960.

Dixon Technologies (India) Limited (DIXON) is a leader in the outsourcing EMS industry with 35% share in LED TV and 50% share in lighting market in India based on capacity. Besides a strong manufacturing base, the company is building capabilities in designing and aims to capture bigger share of the market through backward integration and capacity expansion. The company boasts of strong clientele in all its product categories, which is being further enriched by addition of marquee global brands to its portfolio consistently. Although volumes are expected to be muted in Q3FY2023 in mobile, TV and certain other product categories, strong order book across washing machines, mobile, security surveillance systems indicates healthy long-term revenue visibility. Operating margin are expected to improve driven by cost optimization, operating leverage, decline in commodity prices and increase in high-margin ODM revenues in the long term. Further, Dixon is well poised to be a key beneficiary of several PLI schemes. Recently, it received a second disbursement of ~Rs 60 crore under PLI for mobile manufacturing through its subsidiary Padget Electronics. In addition to mobile, Dixon has approval under lighting, IT hardware, air conditioners, wearables and hearables.

- **Muted volume expectations in the near-term but robust long-term order book:** As per the company, post Diwali, demand in certain categories such as mobile, IT products and TVs has been muted as customer wallet share is going more to hospitality industry than to consumer electronics. Therefore, the company expects soft volumes in Q3FY2023. Further, exports have also been muted in these product categories. However, the company is confident of a demand recovery in Q4FY2023 on back of strong order book. However, demand seems to be recovering in washing machines, telecom and lighting. The company has received approval for PLI incentive of ~Rs 60 crore for January-March 2022 taking the total of incentives received in FY2023 to ~Rs. 110 crore. The company has already achieved capex threshold of Rs 200 crore. It would also achieve a revenue ceiling of Rs 6,000 crore in mobile by FY2024 as against the timeline of FY2025. Dixon with its manufacturing capabilities is well poised to be a key beneficiary of several PLI schemes. In mobiles, it is the first Indian company to achieve the capex and revenue threshold.
- **Mobile revenue guidance revised downwards to Rs 4,000-4,500 crore for FY2023:** In lieu of muted demand in the mobiles segment in the near term, the company has revised its revenue guidance downwards from earlier Rs 4,500 crore to 5,000 crore. However, the company is on the verge of finalizing manufacturing contracts from two large mobile players in the near term. Hence, it is confident of doubling its mobile sales to Rs 8,500-9,000 crore in FY2024 and thereafter expects a consistent growth of 20-25% for the next two years.
- **Efforts to increase ODM share in revenues:** Currently, the OEM: ODM mix in the portfolio is 75:25. Dixon aims to increase ODM mix in its portfolio while maintaining its growth in OEM products. The company plans to gradually shift some existing and new products in OEM to ODM. This shall lead to better margins as ODM margins are 100-150 bps higher vs OEM. Apart from lighting, 32/33/55- inch TVs, semi-automatic washing machines have ODM-based model. The customers are gradually adopting ODM solutions in front load WMs as well. The company is confident that gradually mobile, smart phones and wearables would come under ODM category as the company deepens its level of backward integration and designing.

Revision in estimates – We have fine-tuned our estimates for FY2023-24E following cut in mobile revenue guidance for FY2023E and robust guidance for FY2024E and thereafter.

Our Call

Valuation – Retain Buy with an unchanged PT of 4,960: Dixon Technologies with its leadership in outsourcing EMS industry is well poised to be one of the key beneficiaries of the government's impetus on increasing domestic manufacturing through PLI schemes. The company has been continuously expanding capacities in its existing verticals and is now backward integrating and expanding into other verticals such as refrigerators, LED monitors, AC components, and other hardware products. The company is set for a strong growth trajectory over the next 3-4 years with the management targeting to triple its size through customer acquisition across verticals, foray into new products, backward integration, and growth in exports. Further, margins are expected to improve backed by backward integration, cost optimization and operating leverage. We envisage revenue/PAT CAGR of ~31%/~47% over FY2022-2025E. The recent correction in the stock price following a cautious management commentary for the current quarter provides long-term investors a buying opportunity. We value the stock on September FY2024E EPS and maintain our Buy rating on the stock with an unchanged PT of Rs. 4,960.

Key Risks

- Possible instability in supply chain following lockdowns in China due to surge in covid cases is a key near term risk.
- Slowdown in consumer discretionary spending and discontinuation of business from key customers might affect revenue growth.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	10,697	13,991	19,709	24,071
OPM (%)	3.5	3.9	4.2	4.4
Adjusted PAT	190	275	452	606
% y-o-y growth	19.4	44.7	64.2	34.0
Adjusted EPS (Rs.)	32.1	49.8	76.6	102.5
P/E (x)	120.9	83.6	50.9	38.0
EV/EBITDA (x)	61.1	43.1	28.4	21.8
RoCE (%)	21.8	23.7	32.1	34.0
RoNW (%)	21.9	24.4	30.5	30.3

Source: Company; Sharekhan estimates

Dixon Technologies management interaction highlights

Muted volume expectations for Q3FY2023: As per the company, post-Diwali demand in certain categories such as mobiles, IT products and TVs has been muted as the customer wallet share is going more to hospitality industry than to consumer electronics. Therefore, the company expects subdued volumes in Q3FY2023. Further, exports have also been muted in these product categories. However, the company is confident of demand recovery in Q4FY2023 on back of strong order book. However, demand seems to be recovering in washing machines, telecom and lighting.

Mobiles revenue guidance revised downwards to Rs 4,000-4,500 crore for FY2023: In lieu of muted demand in mobile in the near term, the company has revised its revenue guidance downwards from earlier Rs 4,500-5,000 crore to Rs 4,000-4,500 crore. However, the company is on the verge of finalizing manufacturing contracts from two large mobile players in the near term. Hence, its confident of doubling its mobile sales to Rs 8,500-9,000 crore in FY2024 and thereby expect a consistent growth of 20-25% for the next two years.

Discussions with Apple may lead to some fruitful opportunity: Apple already has Foxconn, Pegatron and Wistron as its suppliers for i-phone in India. Apple, however, plans to manufacture one out of every four i-phones from India by 2026 and in that case it may seek additional supplier in the future. Further, apart from phones, Dixon is also eying opportunity to manufacture some other Apple products.

COVID situation in China may interrupt supply chain in the near term: Rising covid cases in China may lead to stricter lockdowns which could lead to supply side challenges in the short term. However, this may also reinforce China+1 strategy in the long run which could benefit Indian suppliers.

Dixon has achieved Rs 200-crore capex threshold for PLI incentive: The company has received second approval for an incentive of Rs 60 crore for January-March 2022. The company has already achieved capex threshold of Rs 200 crore. It would also achieve revenue ceiling of Rs 6,000 crore by FY2024 as against the timeline of FY2025. Dixon with its manufacturing capabilities is well poised to be a key beneficiary of several PLI schemes. In mobiles, it is the first Indian company to achieve the capex and revenue threshold. It has received total disbursement of ~Rs 110 crore under PLI for mobile manufacturing through its subsidiary Padget Electronics. However, the company would have to share the incentive with the brands/customers for which it is manufacturing the products. This scheme extends an incentive of 4-6% on net incremental sale of manufactured goods, including mobile phones and specified electronic components subject to conditions. The total outlay of incentives under the scheme is ~Rs 40,000 crore. In addition to mobile, Dixon has approval under lighting, IT hardware, air conditioners, wearables and hearables. The consumer electronics and IT hardware industry is heavily reliant on imports for sourcing its components. It is expected that PLI scheme and 'Make in India' initiative by the government could help create a robust component ecosystem, which would also reduce current operating cost and encourage local manufacturing.

India's phone exports to grow multifold in the coming years: Currently, India's contribution in phone exports in the global pie is very low. However, as many companies are de-risking their global supply chain and looking at India as an alternative. The company believes that given India's low labour cost and improving component eco-system through PLI schemes, the country's exports can rise multi-fold in the coming years and Dixon being the largest OEM solutions provider in the mobile space stands to benefit. Dixon is already catering to

North American markets as it manufactures mobile for Motorola which has 6% share in these markets. Dixon may start exporting Samsung mobile phones to Bangladesh. Further, in lighting too the company is exploring more opportunities in Middle East etc.

Efforts to increase ODM share in revenues: Currently, the OEM:ODM mix in the portfolio is 75:25. Dixon aims to increase ODM mix in its portfolio while maintaining its growth in OEM products. The company plans to gradually shift some of its existing and new products in OEM to ODM. This shall lead to better margins as ODM margins are 100-150 bps higher vs OEM. Apart from lighting, 32, 33, 55- inch TVs, semi-automatic washing machines (WMs) have an ODM-based model. The customers are gradually adopting ODM solutions in front load WMs as well. The company is confident that gradually mobile, smart phones and wearables would come under ODM category as the company deepens its level of backward integration and designing.

Update on lighting division: The lighting division continues to be slow in terms of volumes in the current quarter. However, as far as the profitability is concerned, the company has undertaken value engineering which has led to cost reduction and therefore the company expects margin expansion going forward.

Strong potential to add new customers by offering google and android platform in TVs: Dixon is the first contract manufacturer in India to get the sub licensing rights relating to Android & Google TV. Currently, out of 15 mn TV sets manufactured annually, 9.5 mn are on google/android of which Dixon has 3.6 mn volumes. Further, potential 5.9 mn sets can be converted to these platforms. Shifting to the Google/Android platform does not require a huge investment, but it entails sourcing the solutions and installing software.

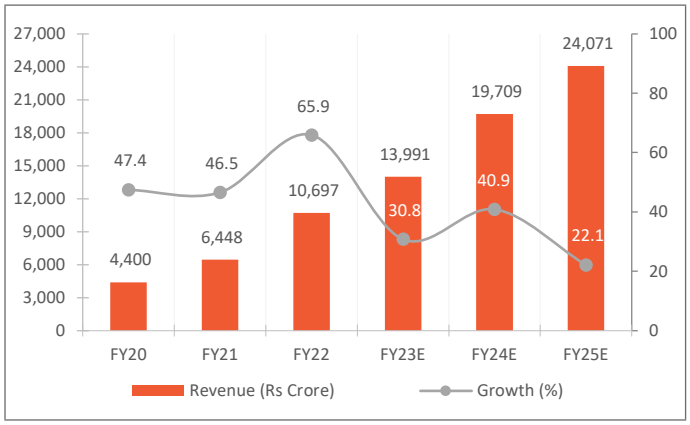
Refrigerator business would act as an import substitution: The refrigerator business would be scaled up more as an import substitution as lot of leading brands largely rely on imports.

Revenue & margin guidance: The company maintained guidance of ~Rs 14,500 – 15,000 crore revenue and OPM @3.8-4% for FY2023. Despite the addition of new products and customers, Dixon has opted for conservative guidance as delay in the ramp of IT hardware and telecom segments and a slowdown in the mobile industry may affect H2FY2023.

Capex guidance: Dixon has guided for capex of Rs 330 crore in FY2023. The capex will be incurred for capacity expansion for PLI scheme and more backward integration in most of the products.

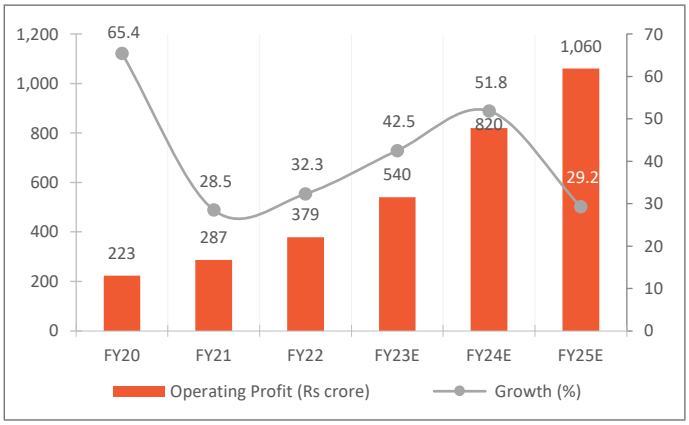
Financials in charts

Revenue growth trend



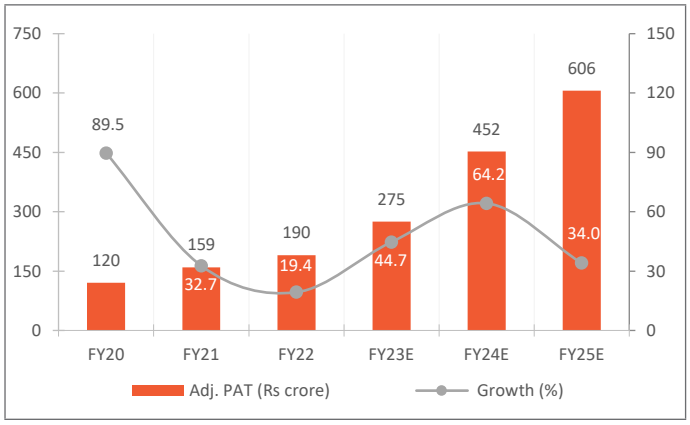
Source: Company, Sharekhan Research

Operating Profit growth trend



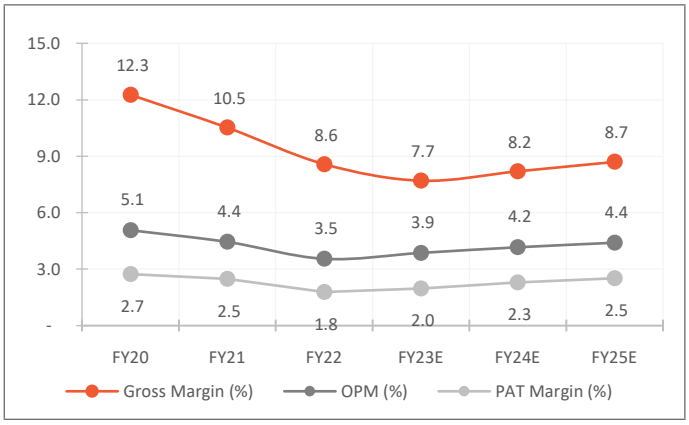
Source: Company, Sharekhan Research

PAT growth trend



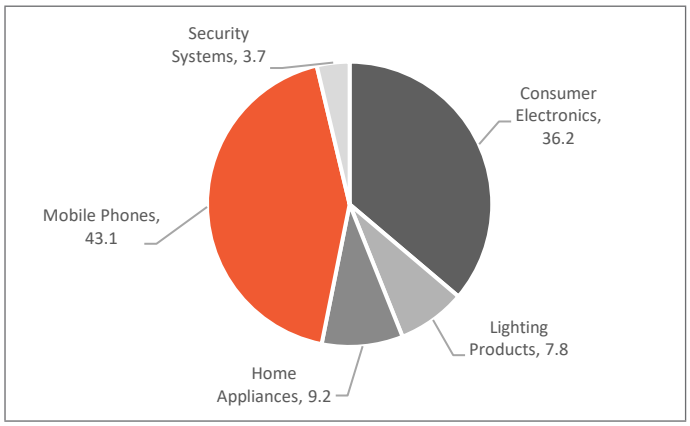
Source: Company, Sharekhan Research

Margin trend



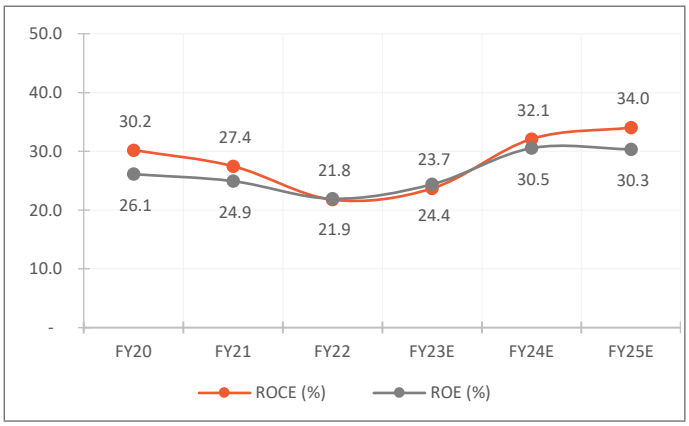
Source: Company, Sharekhan Research

H1FY2023 Segment Revenue Contribution (%)



Source: Company, Sharekhan Research

Return ratios trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Demand outlook encouraging, healthy growth prospects

The Indian electronics and consumer durable industry are ~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.

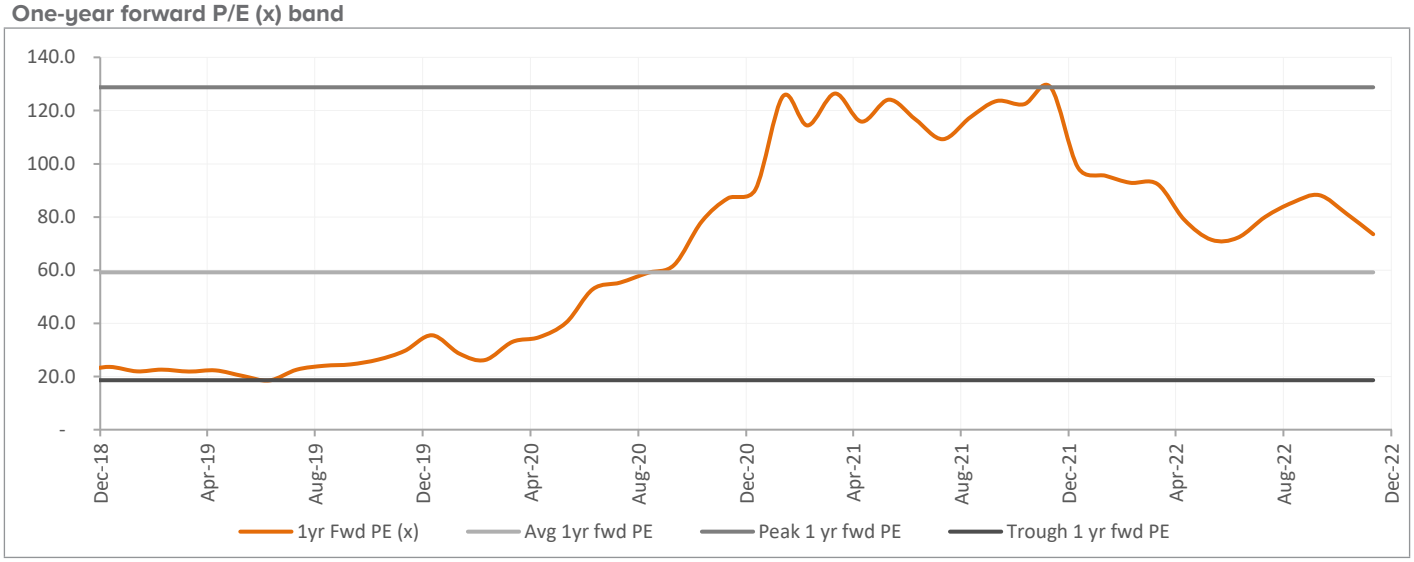
■ Company Outlook – Promising outlook ahead

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 the product portfolio of existing business verticals, and penetrate further into South India by forging alliances with original equipment manufacturers (OEMs) and add them as clients. Expanded capacity in consumer electronics and home appliances and a PLI scheme license for mobile phones is likely to drive revenue growth momentum, while the margin may expand due to economies of scale and automation in the lighting business. The company is also applying for PLI schemes in 1) IT (laptops, tablets, hardware) 2) Lighting (extrusions, batons, plastics, mechanicals) 3) AC components and 4) Telecom (modems, routers, IoT devices) which augurs well for long-term growth opportunities.

■ Valuation – Retain Buy with an unchanged PT of 4,960

Dixon Technologies with its leadership in outsourcing EMS industry is well poised to be one of the key beneficiaries of the government's impetus on increasing domestic manufacturing through PLI schemes. The company has been continuously expanding capacities in its existing verticals and is now backward integrating and expanding into other verticals such as refrigerators, LED monitors, AC components, and other hardware products. The company is set for a strong growth trajectory over the next 3-4 years with the management targeting to triple its size through customer acquisition across verticals, foray into new products, backward integration, and growth in exports. Further, margins are expected to improve backed by backward integration, cost optimization and operating leverage. We envisage revenue/PAT CAGR of ~31%/~47% over FY22-25E. The recent correction in the stock price following a cautious management commentary for the current quarter provides long-term investors a buying opportunity. We value the stock on September FY24E EPS and maintain our Buy rating on the stock with an unchanged PT of Rs. 4,960.

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 due to increasing emphasis on Make in India and the Government's PLI scheme. 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 the product portfolio of existing business verticals, and penetrate further into the South Indian market by forging an 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 a few applications.

Key Risks

- A delay in the commissioning of capex projects, slowdown in consumer discretionary spends, and the 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	ICICI Prudential Life Insurance Company Limited	2.35
2	Vanguard Group Inc.	1.90
3	Nippon Life India Asset Management	1.65
4	Steadview Capital Mauritius Limited	1.09
5	Morgan Stanley	1.08
6	DSP Investment Managers	1.01
7	BlackRock Inc.	0.88
8	Sundaram Asset Management	0.76
9	ICICI Prudential Asset Management	0.73
10	L&T Mutual Fund	0.68

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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