Sharekhan by BNP PARIBAS

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Stock Update

Result Update

V-Guard Industries Ltd

Weak Q3, Favourable summer is key to recovery

Capital Goods	Sharekhan code: VGUARD

Reco/View: Buy	↔	CMP: **Rs. 246**	Price Target: **Rs. 320**	↔

↑ 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 Updated Dec 08, 2022				28.69
Medium Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

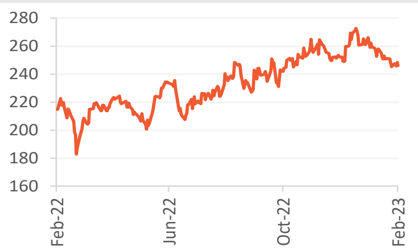
Company details

Market cap:	Rs. 10,619 cr
52-week high/low:	Rs. 275/181
NSE volume: (No of shares)	3.3 lakh
BSE code:	532953
NSE code:	VGUARD
Free float: (No of shares)	19.0 cr

Shareholding (%)

Promoters	55.9
FII	12.9
DIIs	18.9
Others	12.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.6	-6.2	3.4	14.2
Relative to Sensex	-4.6	-4.6	0.3	13.6

Sharekhan Research, Bloomberg

Summary

- V-Guard Industries Limited (V-Guard) delivered muted Q3 particularly on the profitability front, owing to high-cost inventory, increased ad expenses, and weak demand in certain product categories.
- Management expects GPM/OPM to revert to pre-Covid levels in Q4FY2023/Q1FY2024, given cooling-off of commodity prices, onset of the summer season, increased in-house manufacturing, and depletion of high-cost inventory.
- Sunflame's acquisition would help V-Guard unlock synergy benefits in areas such as geography, product portfolio, and channels since Sunflame has a strong presence in north and west through traditional channels, while V-Guard can cater to the southern region and is present on e-commerce/modern trade channels.
- We maintain Buy with an unchanged PT of Rs. 320, given increasing presence in non-south markets, entry into new product categories, Sunflame's acquisition, and volume-driven growth across verticals.

V-Guard Industries Limited's (V-Guard) standalone results were below our expectations during Q3FY2023. Sales grew by just 1.7% y-o-y to Rs. 977 crore. Gross profit margin declined by 245 bps y-o-y. Operating profit dipped by 29% y-o-y to Rs. 60 crore (versus our estimate of Rs. 83 crore). Operating profit margin (OPM) dipped by 267 bps y-o-y to 6.1% (vs. our estimate of 8.1%). Net profit declined by 31.8% y-o-y to Rs. 36 crore due to poor operating performance. Segment wise, consumer durables (fans, water heaters, kitchen appliances, and air coolers) recorded 4.5% topline growth, while electronics sales dropped 3.5% y-o-y and electricals reported 1.9% y-o-y growth in sales. EBIT margin in electronics dipped by 620 bps y-o-y to 10.8%, while electricals margin inched upwards and reported 60 bps y-o-y growth in margin. The consumer durables segment reported loss at the EBIT level. Lower offtake in fans, pumps, and water heaters and higher-than-normal inventory at an elevated cost were the key reasons for loss in the consumer durables sector.

Key positives

- The consumer durables segment registered revenue growth of ~4.5%.
- The non-south markets grew by 10.5% y-o-y, contributing 45.6% to total revenue in Q3FY2023, higher than 41.8% in Q3FY2022.
- Electricals margin rose to 8.5% and reported 60 bps y-o-y/340 bps q-o-q margin expansion.

Key negatives

- GPM and OPM declined by 245 bps/267 bps y-o-y to 28.2%/6.1%, respectively, due to high-cost inventories in the consumer durables segment and shift in revenue mix.
- EBIT margin in electronics dipped by 620 bps y-o-y to 10.8% due to high-cost inventory in stabilisers.
- High competitive intensity in products such as pumps and fans. Further, water heaters sales were below expectations.

Management Commentary

- The south market declined by 5.2% y-o-y due to high base impact of last year, while non-south markets grew by 10.5% y-o-y.
- Ad and promotional spends are at 2.7% of revenue in Q3FY2023 as compared to 1.7% in Q3FY2022. Ad and promotional expenses have reverted to normal levels.
- The company expects that BEE norms-complaint ceiling fans would get back to historical margins by Q1FY2024 as the old inventory of fans gets depleted in the market.
- Sunflame Enterprises' 9MFY2023 revenue growth has been flat to negative as there has been a decline of 3-4% in the institutional business. The combined V-Guard and Sunflame in-house to outsourcing mix would be 65:35; and in five years, it would change to 75:25.
- The company would be consolidating Sunflame Enterprises' numbers from Q4FY2023.
- CFO generation for 9MFY2023 at Rs. 433.5 crore improved significantly as compared to negative Rs. 83.5 crore for 9MFY2022 on account of reduction in inventory to normative levels.

Revision in estimates – We have tweaked our FY2023-FY2025E estimates to build in higher sales and gradual margin recovery.

Our Call

We maintain Buy with an unchanged PT of Rs. 320: V-Guard 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. We are also positive on V-Guard's acquisition of Sunflame Enterprises as it would help the company expand its presence in the fast-growing kitchen appliances segment. The acquisition has huge potential as V-Guard can leverage on Sunflame's strong presence in traditional channels and scale up its presence in modern trade and e-commerce platforms. 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 five years, leading to more cost competitiveness and efficiency. We expect margins to improve going forward, following depletion of high-cost inventory, in-house manufacturing, rising volumes, and deeper penetration into non-south markets. We expect Revenue/PAT CAGR of ~19%/~39% over FY2023-FY2025E EPS. Hence, we retain our Buy recommendation on V-Guard with an unchanged price target (PT) of Rs. 320.

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Net sales	3,475	4,152	4,918	5,844
OPM (%)	9.6	7.4	9.3	9.7
Net profit	227	192	297	374
% Y-o-Y growth	14.0	(15.2)	54.3	26.0
Adj. EPS (Rs.)	5.3	4.5	6.9	8.7
P/E (x)	46.8	55.2	35.8	28.4
P/B (x)	7.6	6.8	5.9	5.0
EV/EBIDTA (x)	30.3	31.6	21.7	17.4
RoNW (%)	17.4	13.0	17.7	19.2
RoCE (%)	22.6	17.8	24.0	25.9

Source: Company; Sharekhan estimates

High-cost inventory and increasing ad expenses weigh on performance

V-Guard's standalone results were below our expectations during Q3FY2023. Sales grew by just 1.7% y-o-y to Rs. 977 crore. Sales were largely driven by non-south markets, which grew by 10.5% y-o-y, while south market sales plunged 5.2% y-o-y due to muted demand. Gross profit margin declined by 245 bps y-o-y mainly due to high-cost inventory. Ad and promotional spends increased in Q3FY2023 and were at 2.7% of revenue in Q3FY2023, as compared with 1.7% in Q3FY2022. This coupled with high inventory cost led to a dip in operating profit by 29% y-o-y to Rs. 60 crore (versus our estimate of Rs. 83 crore). Operating profit margin (OPM) dipped by 267 bps y-o-y to 6.1% (vs. our estimate of 8.1%). Net profit declined by 31.8% y-o-y to Rs. 36 crore due to poor operating performance. Segment wise, consumer durables (fans, water heaters, kitchen appliances, and air coolers) recorded 4.5% topline growth, while electronics sales dropped y-o-y by 3.5% and electricals reported 1.9% y-o-y growth in sales. EBIT margin in electronics dipped by 620 bps y-o-y to 10.8%, while electricals margin inched upwards and reported 60 bps y-o-y growth in margin. The consumer durables segment reported loss at the EBIT level. We believe apart from subdued demand, higher-than-normal inventory at an elevated cost has impacted profitability.

Multiple growth enablers to drive long-term performance

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. 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. 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 a lower volume base. Further, an increase in in-house manufacturing would help the company become more cost-competitive, thereby improving its market share.

V-Guard's Q3FY2023 Investor Update and Concall Highlights

Higher base leads to a decline in south region: The decline in southern markets is caused due to high base of last year when southern markets had grown substantially. 9MFY2023 y-o-y sales growth for the southern region is ~15%.

Optimistic gross margin guidance: The company expects margins to improve as high-cost inventory gets depleted in fans, electricals, and stabilisers in a phased way. The margin would be going to pre-Covid levels in the next 3-6 months.

Margin improvement likely in the electronics segment: The company has regained lot of market share. Stabilisers have high-cost inventory, which the company expects would get absorbed by Q1FY2024. The company has seen margin progress in the battery segment, particularly in the automotive battery segment. The electronics segment is 2/3 stabilizers and 1/3 inverters. In battery, lead prices have gone up but end product price increases have not taken place. However, the company expects once the season of these products begins, price increases are likely and would lead to higher realisation and margin improvement.

In-house manufacturing plans would drive competitiveness: According to management, in-house manufacturing of products would improve its competitiveness and help the company place its products at a better price point. Apart from stabilisers, manufacturing of mixer grinders, TPW fans, and batteries would be done in-house, which shall lead to a meaningful improvement in margins going forward.

Consumer durables margin to improve going forward: The company expects ceiling fans would get back to historical margins by Q1FY2024 as the old inventory of fans gets depleted in the market. Air cooler margins would also come back to normal in Q1FY2024. For water heaters, the season has not gone so well, and this category will be the last to recover. However, the company regained its lost market share in water heaters.

Optimistic demand outlook for fans in the upcoming summer season: The company' inventory of non-BE rated fans was sold out by mid-November. However, some companies resorted to heavy discounting to deplete their old inventory, which affected demand for higher priced BEE-rated fans. The price increase w.r.t. new energy efficiency norms has been 6-8% in the premium segment and is lower at entry levels. The company expects demand for fans to pick up from February onwards.

Sunflame Enterprises' 9MFY2023/9MFY2022 performance has been flat: Revenue growth has broadly been flat to negative as there has been a decline of 3-4% in the institutional business. Sunflame manufactures 65-70% of its products in-house, while the rest are outsourced. The combined V-Guard and Sunflame in-house to outsourcing mix would be 65:35 and it would change to 75:25 in five years.

Sunflame to be consolidated from Q4FY2023: The company funded the acquisition by raising debt of Rs. 275 crore at 8.85% interest rate and balance Rs. 400 crore was through internal accruals. Hence, the current investments and cash stand lower at Rs. 50 crore. The company would be consolidating Sunflame Enterprises' numbers from Q4FY2023.

High competitive intensity and aggressive pricing have impacted pumps sales: Demand for residential pumps and margins have been impacted by excess rains in some of the regions. Aggressive pricing by some of the small and unorganised players has impacted the market. If the summer season lasts long, demand for pumps should increase.

Impact of the increase in custom duty on kitchen chimneys on Sunflame is transitory: In the latest budget, the basic customs duty on electric kitchen chimney increased from 7.5% to 15%. As per V-Guard, the impact on Sunflame would be transitory as the company is gradually shifting to in-house manufacturing and should be manufacturing 85% of the products domestically and would import 15% of the products, largely in the premium category.

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	YoY %	Q2FY23	QoQ %
Net Sales	**977**	**961**	**1.7**	**981**	**(0.3)**
Operating Profit	**60**	**84**	**(29.1)**	**71**	**(15.4)**
Other Income	7	3	123.1	3	88.3
Interest	2	1	60.3	2	27.7
Depreciation	15	13	15.3	14	10.7
PBT	49	72	(33.0)	58	(16.8)
Tax	13	20	(36.3)	15	(16.3)
Adj. PAT	36	53	(31.8)	43	(17.0)
Reported PAT	36	53	(31.8)	43	(17.0)
Adj. EPS (Rs.)	0.8	1.2	(31.8)	1.0	(17.0)
Margin (%)			**bps**		**bps**
GPM	28.2	30.6	(245)	28.6	(44)
OPM	6.1	8.8	(267)	7.2	(109)
NPM	3.7	5.5	(180)	4.4	(73)
Tax rate	26.2	27.5	(134)	26.0	15

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.

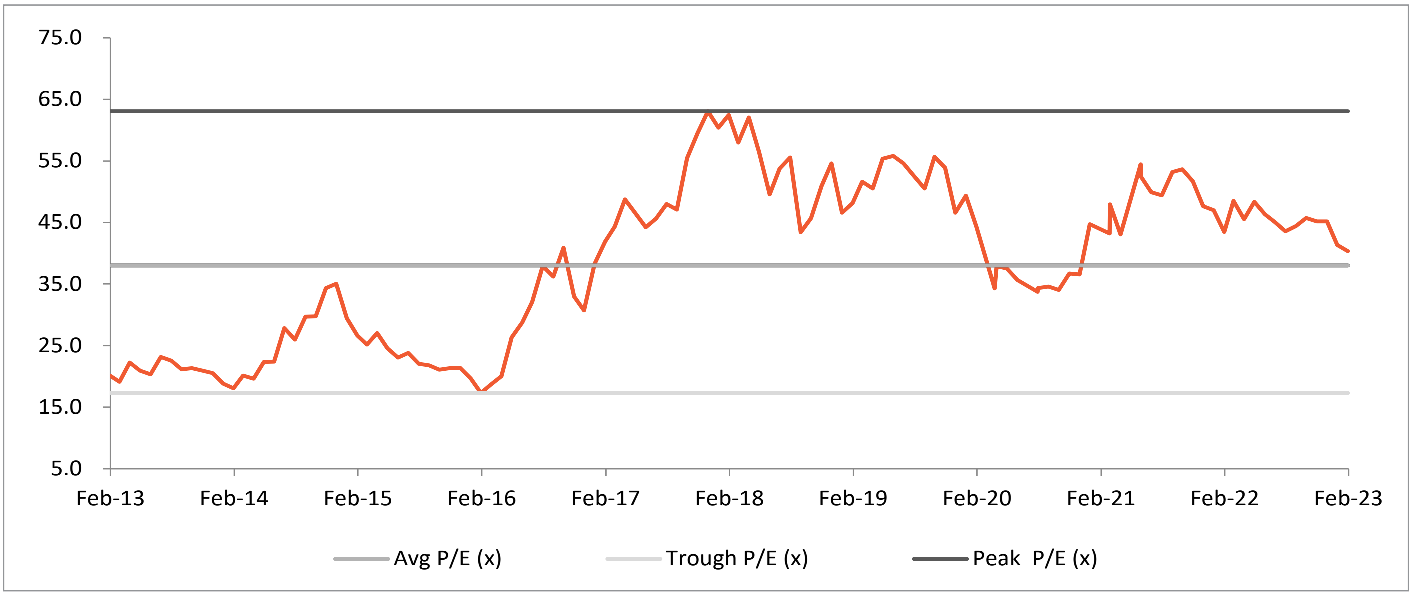
■ Company outlook - Varied growth levers

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 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 the non-south region. V-Guard 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. The acquisition of leading kitchen appliances brand – Sunflame Enterprises Private Ltd. (SEPL) is in line with its strategy to become a significant player in the domestic kitchen appliances industry, which currently forms just 4-5% of its total revenue.

■ Valuation - We maintain Buy with an unchanged PT of Rs. 320

V-Guard 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. We are also positive on V-Guard's acquisition of Sunflame Enterprises as it would help the company expand its presence in the fast-growing kitchen appliances segment. The acquisition has huge potential as V-Guard can leverage on Sunflame's strong presence in traditional channels and scale up its presence in modern trade and e-commerce platforms. 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 five years, leading to more cost competitiveness and efficiency. We expect margins to improve going forward, following depletion of high-cost inventory, in-house manufacturing, rising volumes, and deeper penetration into non-south markets. We expect Revenue/PAT CAGR of ~19%/~39% over FY2023-FY2025E EPS. Hence, we retain our Buy recommendation on V-Guard with an unchanged PT of Rs. 320.

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. The company is one of India's consumer 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

V-Guard 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 is also aggressively expanding in non-south markets and is particularly focusing on tier-II and tier-III cities, where demand is increasing for consumer electricals products. Non-south markets' contribution has increased from 5% of total revenue in FY2008 to around 42% of total revenue in FY2022. Significant investments continue to be made to expand its outlet coverage in the non-south geographies and become a dominant pan-India player. V-Guard has a diversified client base and an extensive marketing and distribution network. The client base differs from product to product and includes direct marketing agents, distributors, and retailers.

Key Risks

- Relatively weak demand environment in some of the regions may affect earnings in the near term.
- Intensifying competition and weak performance of consumer durables is a key concern.

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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management Ltd.	9.27
2	Kotak Mahindra Asset Management Co. Ltd.	5.78
3	FundRock Management Co SA	1.61
4	Vanguard group Inc.	1.36
5	Aditya Birla Sun Life Asset Management Co. Ltd.	1.27
6	Canara Robeco Asset Management Co. Ltd.	0.79
7	ICICI Prudential Asset Management Co. Ltd.	0.75
8	BlackRock Inc.	0.62
9	Dimensional Fund Advisors LP	0.43
10	Schroders PLC	0.29

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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