Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

# Dixon Technologies Ltd

## Maintain Hold on rich valuations

| Capital Goods | Sharekhan code: DIXON |
|---|---|
| **Reco/View: Hold** ↔ | CMP: **Rs. 5,341** / Price Target: **Rs. 5,700** ↑ |

↑ Upgrade ↔ Maintain ↓ Downgrade


### Summary

- Consolidated net earnings for Q2FY2024 beat estimates, led by a strong division mobile & EMS division performance. OPMs marginally lagged owing to weak margins in Lighting products.
- Expect the mobile & EMS division to sustain high growth momentum for FY2024 while Lighting remains affected by price erosion and market shrinkage. Consumer electronics to see marginal growth due to slow H1.
- The focus remains on sustaining high growth momentum through building capacities, investing in existing capabilities, diversifying into new categories, and cost optimisations through backward integrations.
- We maintain our Hold rating on Dixon Technologies with a revised PT of Rs. 5700 owing to rich valuation which factors high earnings growth trajectory over FY2023-FY2026E earnings.


### 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 16.17

Updated Jul 08, 2023

Low Risk

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

Source: Morningstar

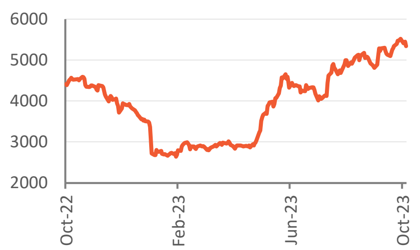
### Company details

| | |
|---|---|
| Market cap: | Rs. 31,814 cr |
| 52-week high/low: | Rs. 5,607 / 2,555 |
| NSE volume: (No of shares) | 5.51 lakh |
| BSE code: | 540699 |
| NSE code: | DIXON |
| Free float: (No of shares) | 3.9 cr |

### Shareholding (%)

| | |
|---|---|
| Promoters | 33.8 |
| FII | 15.7 |
| DII | 27.4 |
| Others | 23.1 |

### Price chart




### Price performance

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 1.1 | 30.7 | 83.7 | 21.2 |
| Relative to Sensex | 5.6 | 36.0 | 80.5 | 15.5 |

Sharekhan Research, Bloomberg

**Dixon Technologies reported a beat on consolidated net earnings for Q2FY2024, led by strong performance by mobile & EMS revenues. Consolidated revenues were up 28% y-o-y at Rs. 4943 crore (19% higher than our expectation), led by a 77% y-o-y rise in mobile & EMS revenues while lighting products remained weak (down 38% y-o-y). Consolidated OPM at 4% (up 27 bps y-o-y) came in lower than our estimate of 4.3% due to weak margins in Lighting products (down 45 bps y-o-y). Consolidated operating profit/net profit grew 37% y-o-y/39% y-o-y to Rs. 199 crore/Rs. 107 crore (11% higher than our estimates). The company's mobile & EMS division is expected to maintain the growth momentum, led by strong order book accretions. Consumer Electronics is expected to see marginal growth owing to slower H1, while the lighting business is affected by price erosion and overall market shrinkage in the LED category. Home appliances are expected to see healthy volume growth but accompanied by price erosion and a fall in commodity prices.**

### Key positives

- Mobile & EMS division (57% revenue share) reported strong 77% y-o-y growth and 57% q-o-q revenue growth.
- Home appliances and Mobile verticals saw 73 bps q-o-q and 35 bps q-o-q expansion in operating margins.

### Key negatives

- Lighting products reported weak performance with a 38% y-o-y dip in revenues and over 100 bps y-o-y contraction in operating margins.
- Consumer Electronics reported a 4% y-o-y dip in revenues owing to a shift of festive demand to Q3FY2024.

### Management Commentary

- The management is confident of healthy growth in the long term driven by new customer additions mainly in the mobile and EMS segment. The mobile segment's contribution remains 50% of the revenue, which the management believes will reach 60-70% over the next few years.
- The company has secured a large orderbook of 15 million units of Jio-Bharat phones and 1.5 million have already been manufactured by September. The manufacturing of Xiaomi smart phones started with management guiding to scale up production from 0.3 million units in Q4FY24 to 2.5 million units in subsequent months after that.
- The company has done capex of around Rs 331 Crore in H1, and for FY2024, it has guided for Rs 500 crore capex. The capex intensity for FY2025 is expected to be lower.

**Revision in estimates –** We have marginally increased our revenue estimates for FY2024-2025E to build in a higher revenue growth trajectory for the mobile & EMS vertical.

### Our Call

**Valuation – Maintain Hold with a revised PT of 5,700:** Dixon Technologies reported healthy outperformance for Q2FY2024 led by sustained high growth momentum in the mobile & EMS division aided by improving OPMs. The segment is expected to remain the forerunner of growth as other verticals scale up. Over the longer term, Dixon could benefit from scaling up its existing verticals, making new customer additions and expansion into different verticals such as refrigerators, LED monitors, AC components, and other hardware products. We have introduced our FY2026E earnings in this note. We expect Revenues/PAT CAGR of 30%/38% over FY23-FY26E. However, we advise investors to wait for a better entry point, given the expensive valuation, as the stock trades at 61x/48x FY25E/FY26E EPS. Hence, we retain Hold with a revised PT of Rs. 5,700.

### Key Risks

- A slowdown in consumer discretionary spending and discontinuation or delay in the finalisation of business from its key customers might affect revenue growth.
- Adverse raw-material prices, a delay in passing on price hikes adequately, and adverse forex fluctuations might affect margins.

**Valuation (Consolidated)** Rs cr

| Particulars | FY23 | FY24E | FY25E | FY26E |
|---|---|---|---|---|
| Revenue | 12,192 | 17,770 | 21,839 | 26,969 |
| OPM (%) | 4.2 | 4.2 | 4.3 | 4.3 |
| Adjusted PAT | 252 | 401 | 519 | 668 |
| % y-o-y growth | 32.4 | 59.1 | 29.4 | 28.8 |
| Adjusted EPS (Rs.) | 42.3 | 67.3 | 87.1 | 112.2 |
| P/E (x) | 126.3 | 79.4 | 61.3 | 47.6 |
| EV/EBITDA (x) | 61.9 | 42.9 | 34.0 | 26.8 |
| RoCE (%) | 23.2 | 30.2 | 31.1 | 32.1 |
| RoNW (%) | 22.1 | 27.1 | 26.9 | 26.6 |

Source: Company; Sharekhan estimates

Stock Update

Result Update

## Key Management Commentary

- **Outlook:** The management is confident of healthy growth in the long term driven by new customer additions mainly in the mobile and cEMS segment. The mobile segment's contribution remains 50% of the revenue, which the management believes will reach 60-70% in the next 3-5 years.
- **Mobile EMS:** The division reported revenues for the quarter were INR2819 crores, a growth of 77% year-on-year. The mobile order book has increased from Motorola. The company has secured a a large orderbook of 15 million Jio-Bharat phones, and 1.5 million have already been manufactured by September. The manufacturing of Xiaomi smart phones started with management guiding to scale up production from 0.3 million units in Q4FY24 to 2.5 million units in subsequent months after that.
- **Phone Volume:** During the H1 FY24, the company manufactured 6.7 million smart phones, including 4.2 million for Smasung and 12 million feature phones. The monthly capacity of smartphone manufacturing stands around 2.5 million units, and 5.5-6 million units of feature phones
- **Home Appliance Dvision:** Company started manufacturing fully automatic washing machines for Voltas Beko and new models for Lloyd and Panasonic. Management is expecting a sale of 1.7 million units in the semi-automatic washing machine category for FY24 against 1.4 million units in FY24
- **The lighting segment:** The LED bulb segment is witnessing technology migration to the DPB segment, which is cheaper by 25-30%; the overall led part has recorded volume degrowth.
- **Capex:** The company has done a capex of around Rs 331 Crore in H1 and for the entire year guided for Rs 500 crore target.
- **Refrigerator segment:** The Company has set up a capacity of 1.7 million units of DC refrigerators for which it is going into the trial phase of manufacturing of DC refrigerators of 190-235 liters category.

**Results (Consolidated)** — **Rs cr**

| Particulars | Q2FY24 | Q2FY23 | Y-o-Y % | Q1FY24 | Q-o-Q % |
|---|---|---|---|---|---|
| **Revenue** | **4,943** | **3,867** | **27.8** | **3,272** | **51.1** |
| Operating Expenses | 4,744 | 3,722 | 27.5 | 3,140 | 51.1 |
| **Operating profit** | **199** | **145** | **37.0** | **132** | **50.8** |
| Other Income | 1 | 1 | 30.9 | 2.9 | (74.7) |
| Interest | 17 | 16 | 8.1 | 14 | 22.3 |
| Depreciation | 36 | 29 | 25.2 | 34 | 8.1 |
| PBT | 146 | 101 | 44.9 | 87 | 67.9 |
| Tax | 35 | 23 | 52.4 | 23 | 54.0 |
| Reported PAT | 113 | 77 | 47.0 | 67 | 68.7 |
| **Adjusted PAT** | **107** | **77** | **38.9** | **69** | **55.9** |
| Adj. EPS (Rs.) | 18.1 | 13.0 | 38.9 | 11.6 | 55.9 |
| **Margin** | | | **bps** | | **bps** |
| OPM (%) | 4.0 | 3.8 | 27 | 4.0 | (1) |
| NPM (%) | 2.3 | 2.0 | 30 | 2.1 | 24 |
| Tax rate (%) | 24.1 | 22.9 | 118 | 26.3 | (218) |

Source: Company; Sharekhan Research

## Outlook and Valuation

### ■ Sector View – Promising long-term demand outlook

The Indian electronics and consumer durable industry are ~Rs. 4,00,000 crore and proliferating. 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.

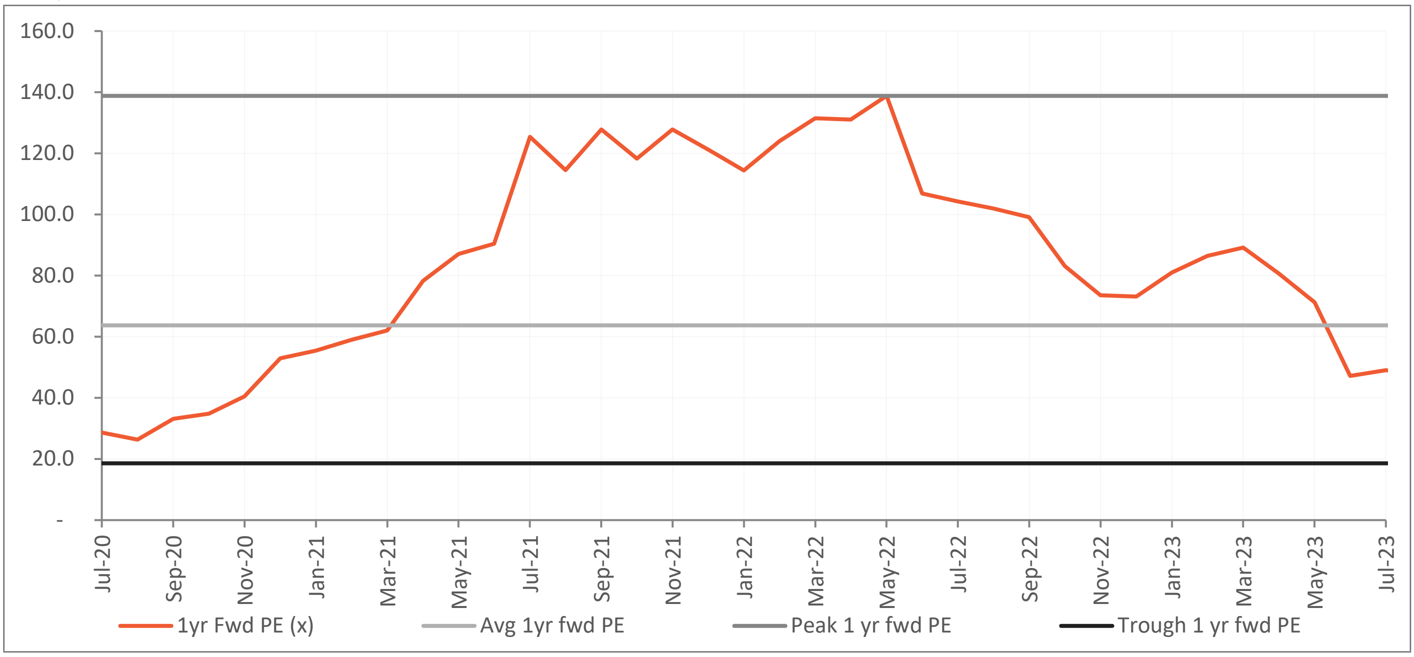
### ■ Company Outlook – Client addition and margin expansion would be key growth catalysts

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, coupled with a PLI scheme license for mobile phones, will likely drive revenue growth momentum. In contrast, the margin may expand due to the lighting business's economies of scale and automation. 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 – Maintain Hold with a revised PT of 5,700

Dixon Technologies reported healthy outperformance for Q2FY2024 led by sustained high growth momentum in the mobile & EMS division aided by improving OPMs. The segment is expected to remain the bellwether of growth going ahead as other verticals scale up. Over a longer term, Dixon could benefit from scaling up its existing verticals, new customer additions and expansion into other verticals such as refrigerators, LED monitors, AC components, and other hardware products. We have introduced our FY2026E earnings in this note. We expect Revenues/PAT CAGR of 30%/38% over FY23-FY26E. However, we advise investors wait for a better entry point, given the expensive valuation as the stock trades at 61x/48x FY25E/FY26E EPS. Hence, we retain Hold with a revised PT of Rs. 5,700.

**One-year forward P/E (x) band**




Source: Sharekhan Research

## About company

Founded by Mr Mr Sunil Vachani, Dixon is a leading manufacturer of products for key consumer durable brands in India. The company currently has ten 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 a home-grown, design-focused products and solutions company.

## Investment theme

Local manufacturing is expected to boost due to the 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 benefits in the electronic outsourcing business with a leadership position in key business segments. The company is foraying into new business verticals and expanding its product portfolio of existing business verticals. Moreover, its eying export markets for its products augurs well for long-term growth. An increase in the share of ODM revenues would also lead to margin expansion, thereby setting a healthy growth trajectory for the long term.

## Key Risks

- A delay in commissioning capex projects, the slowdown in consumer discretionary spending, and the discontinuation of business from key customers might affect revenue growth.
- Adverse raw-material prices, a delay in passing 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 | Vachani Sunil | 26.23 |
| 2 | Kamal Vachani | 6.94 |
| 3 | Vachani Gayatri | 6.53 |
| 4 | Life Insurance Corp of India | 5.48 |
| 5 | LICI ASM NON PAR | 5 |
| 6 | Lall Atul Bihari | 3.52 |
| 7 | Nippon Life India Asset Management | 2.76 |
| 8 | Vanguard Group Inc/The | 2.28 |
| 9 | ICICI Prudential Life Insurance Co | 2.09 |
| 10 | MAX LIFE INSURANCE CO LTD | 2.07 |

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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