

Dixon Technologies (India)

16 April 2019

Reuters: DIXO.BO; Bloomberg: DIXON IN

Acquisition To Aid Growth In Mobile Phone Segment

We attended the conference-call of Dixon Technologies (India) or Dixon to discuss the recent acquisition of its partner's 50% stake in Padget Electronics Pvt Ltd, a joint venture (JV) company. Dixon ventured into mobile phone manufacturing in 2016 through a 50-50 JV with Mr. Pradeep Jain (owner of Karbonn mobiles) to form Padget Electronics. On 12 April 2019, Dixon acquired its partner's 50% stake for a total cash consideration of Rs270mn, thus making Padget Electronics its wholly-owned subsidiary. The key drivers for the acquisition are: (a) Likely surge in the domestic mobile phone market. (b) Imminent addition of a strong mobile brand as its customer. (c) Backward integrated business model which offers higher value addition to customers and margin enhancement to Dixon. The management has given revenue guidance of Rs6.5bn to Rs7bn and EBITDA/PBT margin of 3.5%/3%, respectively, for the mobile phone segment in FY20. We maintain Buy rating on the stock with a target price of Rs3,190 based on 28x FY21E earnings. Key takeaways from the con-call are stated below.

Padget Electronics – The journey so far:

- In 2016, Dixon entered into a 50-50 JV (named as Padget Electronics) with Mr. Pradeep Jain (owner of Karbonn mobiles) to manufacture mobile phones in India as Mr. Jain's firm was the brand licensee of Panasonic mobile phones in India.
- The key customers of Padget Electronics included brands such as Panasonic, Gionee, Karbonn and InFocus. However, Padget Electronics could not scale up its business on expected lines as its customers were not doing well in the market place following stiff competition from brands such as Xiaomi, Oppo, Vivo and Samsung.
- Total revenues of Padget Electronics in FY18 stood at Rs1.35bn with PAT at Rs80mn.
- In FY19, Padget Electronics registered total sales of 300,000 units for Gionee while sales to Karbonn stood at 35,000 smart phones and 0.5mn feature phones. Value-wise, sales to these two brands stood at Rs1bn.

Contours of the deal:

- On 12 April 2019, Dixon acquired its partner's 50% stake in Padget Electronics for a total cash consideration of Rs270mn. The derived valuation of Padget Electronics was Rs540mn based on a P/E of 5x FY20E earnings. Padget Electronics has net worth of Rs360mn and cash of Rs160mn. It operates at negative ex-cash net working capital of Rs60mn-Rs70mn.
- To acquire 50% stake, Dixon will pay cash consideration of Rs270mn. However, considering Rs160mn cash on the balance sheet of Padget Electronics, the effective cash outflow for Dixon will be Rs110mn. After the deal, Padget Electronics will be a 100% owned subsidiary of Dixon.
- Karbonn mobile's promoters decided to exit the JV to focus on their core business strength of distribution and marketing. Dixon's core focus continues to be manufacturing.

Future business outlook for Dixon's mobile phone segment:

- The current mobile phone market in India consists of 160mn to 170mn units of smart phones and 120mn to 130mn units of feature phones. Over the next three years, the mobile phone market size is likely to expand to 550mn units, inclusive of export potential.
- Currently, Xiaomi has the highest market share at 26%-27%, followed by Samsung at 23%-24%. Oppo and Vivo have a combined market share of 21%-22%. While Xiaomi's manufacturing is primarily outsourced to Foxconn, the other three large brands (Samsung, Oppo, Vivo) are doing in-house manufacturing. Dixon believes that there is a growing trend of brands looking to outsource their manufacturing and, hence, there is a lot of potential for Dixon to add new customers. In fact, addition of a large brand as a customer for Dixon is imminent.
- Under the phased manufacturing program, Dixon has already done backward integration of PCBA (motherboard) which led to expansion in its EBITDA margin to 2.9% in 3QFY19. Because of this depth of manufacturing, Dixon expects EBITDA/PBT margin of 3.5%/3%, respectively, in FY20.
- Government of India has announced lot of incentives ranging from 7% to 10% to boost exports of mobile phones. Dixon expects a large export opportunity, especially for feature phones.
- Dixon reported 9MFY19 mobile phone revenues of Rs2.9bn (based on 50% stake) with 2% EBITDA margin. Mobile phone segment accounted for 13% of Dixon's consolidated revenues and 6% of EBITDA in 9MFY19. In FY20, management targets revenues of Rs6.5bn-Rs7bn (based on 100% stake) with EBITDA margin of 3.5%.

Outlook and valuation: Over FY18-FY21E, we expect Dixon to register revenue/earnings CAGR of 14%/28%, respectively. Robust growth prospects, healthy return ratios, lean working capital cycle and high fixed-asset turnover will sustain Dixon's healthy financial position and support its valuation.

BUY

Sector: Consumer Electronics

CMP: Rs2,348

Target Price: Rs3,190

Upside: 36%

Chirag Muchhala

Research Analyst

chirag.muchhala@nirmalbang.com

+91-22-6273 8092

Key Data

Current Shares O/S (mn)	11.3
Mkt. Cap (Rsbn/US\$m)	26.6/383.9
52 Wk H / L (Rs)	3,731/1,890
Daily Vol. (3M NSE Avg.)	9,183

Price Performance (%)

	1 M	6 M	1 Yr
Dixon Tech	(6.3)	(0.5)	(33.6)
Nifty Index	2.3	10.4	11.0

Source: Bloomberg

Financials (consolidated)

Exhibit 1: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net sales	24,570	28,416	29,968	35,405	41,955
% growth	76.8	15.7	5.5	18.1	18.5
Raw material costs	21,801	24,870	26,062	30,702	36,317
Staff costs	639	728	779	938	1,091
Other overheads	1,218	1,692	1,719	1,927	2,266
Total expenditure	23,658	27,289	28,560	33,568	39,673
EBITDA	912	1,127	1,408	1,837	2,282
% growth	55.5	23.5	24.9	30.5	24.2
EBITDA margin (%)	3.7	4.0	4.7	5.2	5.4
Depreciation	107	152	199	229	255
Interest costs	155	135	215	194	174
Other income	14	42	58	64	72
Profit before tax	664	882	1,052	1,479	1,924
Tax	188	273	347	488	635
Net profit	476	609	705	991	1,289
% growth	54.1	28.0	15.7	40.5	30.1
PAT margin (%)	1.9	2.1	2.4	2.8	3.1
EPS (Rs)	43.3	53.8	62.2	87.5	113.8
No. of shares (mn)	11.0	11.3	11.3	11.3	11.3

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Share capital	110	113	113	113	113
Reserves & surplus	1,861	3,036	3,673	4,542	5,627
Net worth	1,971	3,150	3,787	4,655	5,740
Short-term loans	331	326	940	690	540
Long-term loans	99	80	80	80	80
Total loans	430	406	1,020	770	620
Deferred tax liability (net)	(3)	41	41	41	41
Total liabilities	2,398	3,597	4,848	5,466	6,402
Gross block	1,472	2,084	2,923	3,623	4,223
Depreciation	106	259	458	687	942
Net block	1,366	1,824	2,465	2,936	3,281
Capital WIP	20	125	-	-	-
Investments	-	111	111	111	111
Inventories	2,822	3,223	3,784	4,206	4,776
Debtors	2,802	3,007	3,777	4,365	5,172
Cash	153	441	551	549	776
Other current assets	722	1,126	1,349	1,593	1,888
Total current assets	6,499	7,798	9,461	10,713	12,613
Creditors	5,030	5,147	6,212	7,150	8,258
Other current liabilities & provisions	456	1,114	977	1,144	1,345
Total current liabilities	5,487	6,262	7,189	8,294	9,603
Net current assets	1,013	1,536	2,272	2,419	3,010
Total assets	2,398	3,597	4,848	5,466	6,402

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Cash flow

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
EBIT	805	975	1,209	1,608	2,027
(Inc.)/dec. in working capital	(198)	(235)	(626)	(149)	(363)
Cash flow from operations	607	740	583	1,459	1,663
Other income	14	42	58	64	72
Depreciation	107	152	199	229	255
Tax paid (-)	(164)	(230)	(347)	(488)	(635)
Net cash from operations	564	703	493	1,264	1,355
Capital expenditure (-)	(373)	(716)	(714)	(700)	(600)
Net cash after capex	191	(13)	(221)	564	755
Interest paid (-)	(155)	(135)	(215)	(194)	(174)
Dividends paid (-)	(79)	(27)	(68)	(122)	(204)
Inc./(dec.) in short-term borrowing	81	(4)	614	(250)	(150)
Inc./(dec.) in long-term borrowing	(396)	(19)	-	-	-
Inc./(dec.) in total borrowings	(314)	(23)	614	(250)	(150)
(Inc.)/Dec. in investments	1	(111)	-	-	-
Equity issue/(buyback)	456	571	-	-	-
Cash from financial activities	(92)	275	331	(566)	(528)
Others	(20)	26	-	-	-
Opening cash balance	75	153	441	551	549
Closing cash balance	153	441	551	549	776
Change in cash balance	79	288	110	(2)	227

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Key ratios

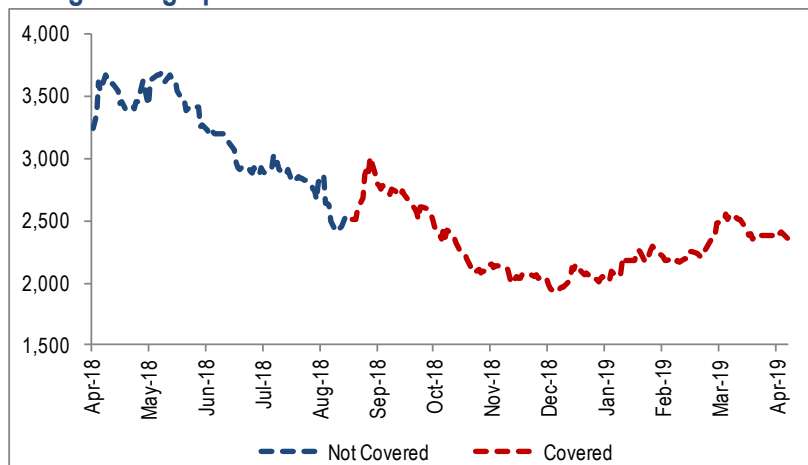
Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Per share (Rs)					
EPS	43.3	53.8	62.2	87.5	113.8
Book value	179.4	278.1	334.4	411.0	506.9
Valuation (x)					
P/E	54.2	43.6	37.7	26.8	20.6
P/BV	13.1	8.4	7.0	5.7	4.6
EV/EBITDA	29.5	23.6	19.3	14.6	11.6
EV/sales	1.1	0.9	0.9	0.8	0.6
Return ratios (%)					
RoCE	33.6	27.1	24.9	29.4	31.7
RoE	24.1	19.3	18.6	21.3	22.5
RoIC	35.9	32.0	28.9	33.5	36.8
Profitability ratios (%)					
EBITDA margin	3.7	4.0	4.7	5.2	5.4
EBIT margin	3.3	3.4	4.0	4.5	4.8
PAT margin	1.9	2.1	2.4	2.8	3.1
Turnover ratios					
Fixed-asset turnover (x)	16.2	16.0	12.0	10.8	10.7
Debtor days	42	39	46	45	45
Inventory days	47	47	53	50	48
Creditor days	84	76	87	85	83
Solvency ratios (x)					
Debt-equity	0.2	0.1	0.3	0.2	0.1

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price	Target price (Rs)
21 August 2018	Buy	2,515	3,285
9 October 2018	Buy	2,348	3,285
2 November 2018	Buy	2,115	2,990
9 January 2019	Buy	2,095	2,990
31 January 2019	Buy	2,218	3,020
9 April 2019	Buy	2,377	3,190
16 April 2019	Buy	2,348	3,190

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

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Team Details:			
Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	-
Girish Pai	Head of Research	girish.pai@nirmalbang.com	+91 22 6273 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 6273 8230, +91 22 6636 8833
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 6273 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 6273 8102/8103, +91 22 6636 8830

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address

B-2, 301/302, Marathon Innova,
 Nr. Peninsula Corporate Park,
 Lower Parel (W), Mumbai-400013.

Board No. : 91 22 6273 8000/1; Fax. : 022 6273 8010