

V-Guard Industries

4 October 2017

Reuters: VGUA.BO; Bloomberg: VGRD IN

On Course Towards Healthy Scale-Up; Retain Accumulate

We had a meeting with the management of V-Guard Industries (VIL) recently to get the latest business update. The management expects healthy revenue growth momentum to continue and aims for a 15% CAGR over the next few years driven by distribution network expansion, deeper market penetration and new product development. VIL aims to gradually increase the operating margin profile driven by scale-up in non-south region and a favourable revenue mix. We remain optimistic on the long-term growth prospects of VIL driven by its business scalability potential. We have rolled forward our valuation to 1HFY20 and retained Accumulate rating on the stock with a revised target price of Rs195 (Rs182 earlier) based on unchanged P/E of 33x September 2019 estimated earnings. VIL is likely to post earnings CAGR of 21.6% over FY17-FY20E, which will support its valuation.

Following are the key takeaways from the meeting:

Update on GST impact: VIL witnessed revenue slippage of Rs800mn in 1QFY18 owing to destocking by trade channel in June 2017 because of GST (Goods & Service Tax) implementation. The pick-up in primary sales in 2QFY18 was good with VIL expecting to make up for lost revenues in a span of two quarters. VIL managed to seamlessly implement GST across its distributors as well as suppliers. It experienced a 25%-30% reduction in transit time for the movement of goods post GST implementation owing to removal of check posts etc. The inventory days also reduced by ~15 days as distributors/retailers are yet to stock the products at pre-GST level. VIL generally keeps 30 days inventory at distributor level and 20 days at the retailer level. However, this situation may normalise in the next two quarters. GST is also likely to create a level-playing field with the unorganised market, which still accounts for at least 30% of industry size in most electrical product categories.

Aim to grow revenues by 15% CAGR: The management aims to grow revenues by 15% CAGR over the next few years. VIL has multiple growth levers like distribution network expansion in new geographies, deep penetration in existing geographies, scale-up of emerging product categories in non-south region and launch of new product categories like kitchen appliances and switchgear. It expects non-south region to report higher revenue CAGR of 20%-22% owing to likely rise in economies of scale while south region is likely to register 10%-12% revenue CAGR as VIL has already achieved deep market penetration. While VIL has 445 distributors in non-south region, it forms only 35% of sales compared to 231 distributors in south region which accounts for 65% of sales.

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net revenues	18,623	21,506	24,206	28,043	32,553
EBITDA	1,780	2,150	2,312	2,914	3,488
Net profit	1,117	1,518	1,708	2,268	2,727
EPS (Rs)	2.6	3.6	4.0	5.3	6.4
EPS growth (%)	57.9	35.9	12.5	32.8	20.2
EBITDA margin (%)	9.6	10.0	9.5	10.4	10.7
P/E (x)	70.7	52.0	46.2	34.8	29.0
P/BV (x)	16.8	12.4	10.5	8.7	7.2
EV/EBITDA (x)	44.4	36.7	33.9	26.6	21.9
RoCE (%)	35.0	35.2	30.5	32.6	32.7
RoE (%)	26.3	27.4	24.6	27.3	27.3

Source: Company, Nirmal Bang Institutional Equities Research

ACCUMULATE

Sector: Consumer Electricals

CMP: Rs186

Target Price: Rs195

Upside: 5%

Chirag Muchhala

Research Analyst

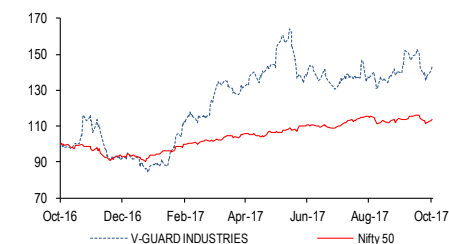
chirag.muchhala@nirmalbang.com

+91-22-3926 8092

Key Data

Current Shares O/S (mn)	424.7
Mkt. Cap (Rsbn/US\$bn)	78.9/1.2
52 Wk H / L (Rs)	221/109
Daily Vol. (3M NSE Avg.)	1,064,739

One -Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
V-Guard Ind.	1.1	6.4	41.2
Nifty Index	0.1	7.4	13.1

Source: Bloomberg

Pricing and margin outlook

The management aims to gradually improve EBITDA margin from 10% currently to 12% over the next few years driven by improvement in non-south region's margin. While the gross margin of south and non-south regions are similar currently, there is a wide difference in EBITDA margin. VIL enjoys EBITDA margin upwards of 12% in south region while non-south region's EBITDA margin is 6%-7%. As VIL attains scale in non-south region leading to improvement in revenue per distributor and better absorption of overheads, its non-south region's EBITDA margin will rise.

On the pricing front, the average impact of GST rates on VIL's portfolio was 3% while the highest impact was on the product category of wires and cables at 8%-9%. VIL, as well as other industry players, have taken adequate price hikes to pass on the GST rates. Similarly, the electrical industry has taken a couple of price hikes to pass on the impact of copper price increase over the past three months.

Emerging product categories to scale up

Having achieved a large scale, VIL expects its three core categories of voltage stabilisers, wires & cables and water heaters to post 10% CAGR over the next few years, unless the industry itself grows at a faster pace. However, emerging categories of pumps, fans, kitchen appliances and switchgear are likely to grow at more than 20% CAGR over the next few years owing to a low base and expansion in non-south region.

Voltage stabilisers witnessed healthy growth of 18% in FY17 driven by rising sale of high-value consumer appliances such as LED TVs, split/inverter air-conditioners and refrigerators. The voltage stabiliser category is also witnessing first-time buyers. For the cables & wires category, volume growth is likely to be in single digits post price hikes (owing to GST and copper price rise) as well as softness in the housing sector. Cables & wires is the only category which is dependent on new real estate construction. In water heater category, where VIL has achieved robust success and became the largest-selling brand in India with FY17 sales of Rs2.8bn, the outlook is positive for the upcoming season (October to February accounts for 70% of sales) and a trend of product premiumisation is visible. In the fan category, VIL is increasing its product offering in the premium category while it is in the process of enhancing the presence in kitchen appliance and switchgear category.

Key focus areas

The key focus areas for VIL include new product development, expansion of distribution network, sales force automation and strategic sourcing. For new product development, VIL intends to enhance its offering in existing categories by making products smarter (IOT-enabled) while it also plans to enter new categories such as decorative switches and kitchen appliances. VIL also intends to expand its distribution network from ~28,000 retail outlets currently to 40,000 outlets over the next few years with incremental addition taking place largely in non-south region. VIL also intends to strategise its sourcing with its Sikkim manufacturing plant becoming operational. Considering the higher scale, fiscal benefits as well as small-scale units losing tax advantage under GST, VIL is likely to witness an increase in in-house manufacturing content from 40% currently to 55%-60% over the next few years.

Outlook and valuation

With 14.8% revenue CAGR and 70bps expansion in operating margin over FY17-FY20E, VIL is expected to register a healthy 17.5% EBITDA CAGR over the same period. Lower tax rate (owing to tax benefit at Sikkim plant) and rising other income will lead to a strong 21.6% earnings CAGR over FY17-FY20E. Further, strong operating/free cash flow of Rs5.7bn/Rs4.7bn, respectively, over FY17-FY20E, healthy return ratios (RoCE/RoE of 35%/27%, respectively, in FY17), lean working capital cycle and high fixed-asset turnover (8x) will keep VIL in a strong financial position and support its valuation. We have rolled forward our valuation to 1HFY20 and retained Accumulate rating on the stock with a revised target price of Rs195 (Rs182 earlier) based on unchanged P/E of 33x September 2019 estimated earnings.

Exhibit 1: Product-wise break-up of revenues

Y/E March (Rsmn)	1QFY17	4QFY17	1QFY18	YoY (%)	QoQ (%)	FY16	FY17	YoY (%)
Electronics								
Voltage stabilisers	1,434	1,251	1,413	(1.5)	12.9	3,691	4,362	18.2
Inverters	727	704	842	15.8	19.6	1,936	2,351	21.4
Electronics total	2,161	1,955	2,255	4.3	15.3	5,627	6,713	19.3
Electricals								
Pumps	659	915	690	4.7	(24.6)	2,100	2,685	27.9
Cables & wires	1,527	1,877	1,578	3.3	(15.9)	5,886	6,335	7.6
Water heaters	499	446	446	(10.6)	0.0	2,554	2,843	11.3
Fans	586	823	551	(6.0)	(33.0)	1,767	2,060	16.6
Electricals total	3,271	4,061	3,265	(0.2)	(19.6)	12,307	13,923	13.1
Others								
Kitchen appliances	84	85	73	(13.1)	(14.1)	358	445	24.3
Switchgear	94	132	97	3.2	(26.5)	330	425	28.8
Others total	178	217	170	(4.5)	(21.7)	688	870	26.5
Grand total	5,610	6,233	5,690	1.4	(8.7)	18,622	21,506	15.5

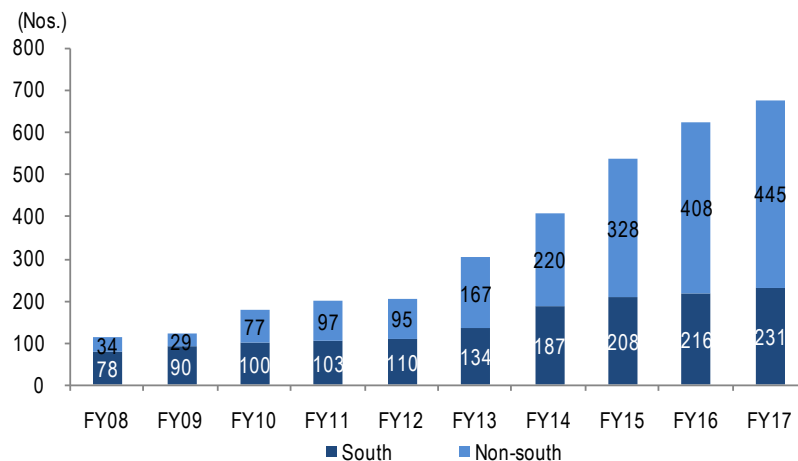
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Geography-wise break-up of revenues

Region (Rsmn)	1QFY17	4QFY17	1QFY18	YoY (%)	QoQ (%)	FY16	FY17	YoY (%)
South	3,490	4,050	3,400	(2.6)	(16.0)	12,460	14,070	12.9
Contribution (%)	62.2	65.0	59.8	-	-	66.9	65.4	-
Non-south	2,120	2,180	2,290	8.0	5.0	6,160	7,440	20.8
Contribution (%)	37.8	35.0	40.2	-	-	33.1	34.6	-
Total	5,610	6,230	5,690	1.4	(8.7)	18,620	21,510	15.5

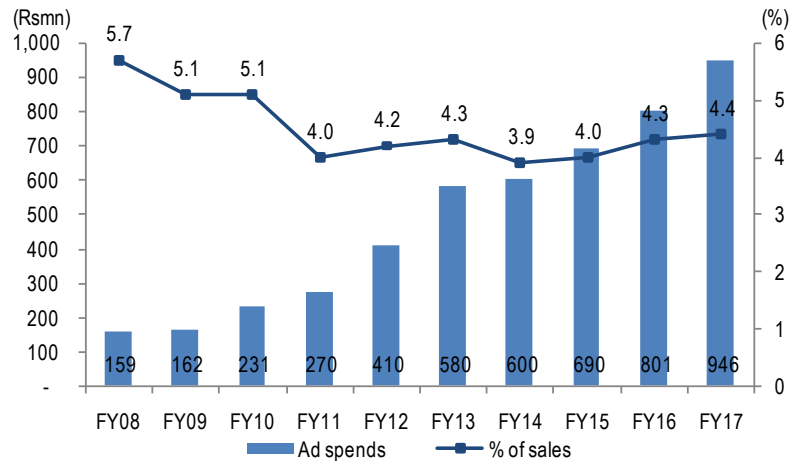
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Growth in distributor network



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Trend in advertisement expenditure



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Segment-wise share of revenues

Share of revenues (%)	FY16	FY17	FY18E	FY19E	FY20E
Stabilisers	19.8	20.3	19.8	19.7	19.5
Inverters	10.4	10.9	11.0	10.6	10.1
Pumps	11.3	12.5	12.5	12.4	12.3
Cable & wires	31.6	29.5	28.3	27.1	25.9
Water heater	13.7	13.2	13.5	13.6	13.6
Fan	9.5	9.6	9.7	10.0	10.4
Kitchen appliances	1.9	2.1	2.7	3.3	4.2
Switchgears	1.8	2.0	2.5	3.2	4.0

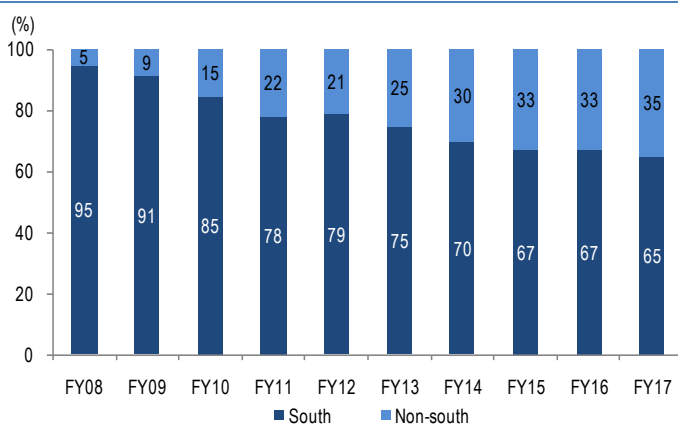
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Market size of VIL's product portfolio

Product	Market size (Rsbn)			
	Organised	Unorganised	Total	Unorganised as a % of total
Voltage stabilisers	7	5.5	12.5	44.0
Pumps	50	50	100	50.0
House-wiring cables	55	40	95	42.1
Electric water heaters	13.3	7.0	20.3	34.6
Solar water heaters	4.2	1.8	6	30.0
Fans	50	15	65	23.1
Inverters	45	7.5	52.5	14.3

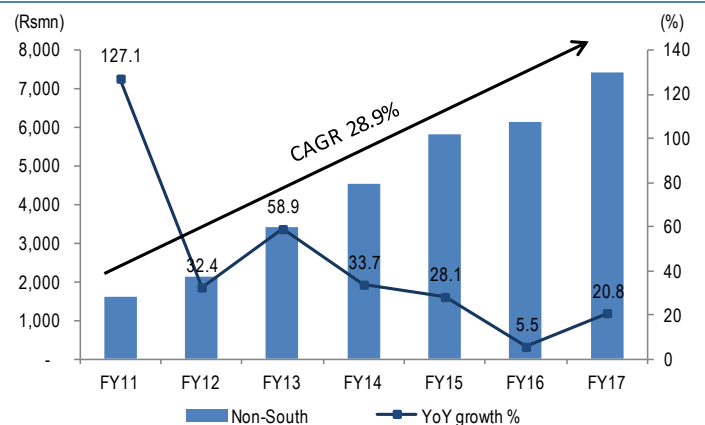
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: South and non-south revenue share break-up



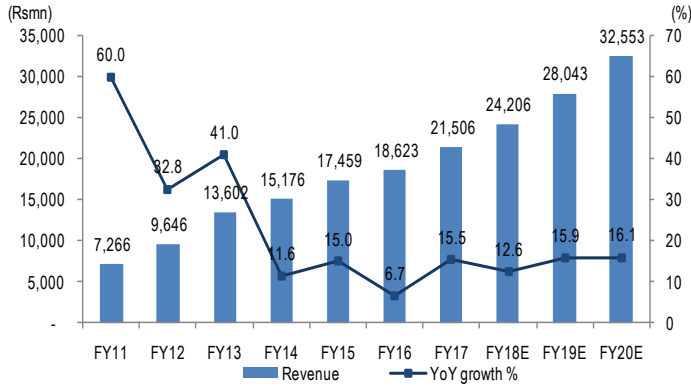
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Non-south market's revenue growth trend



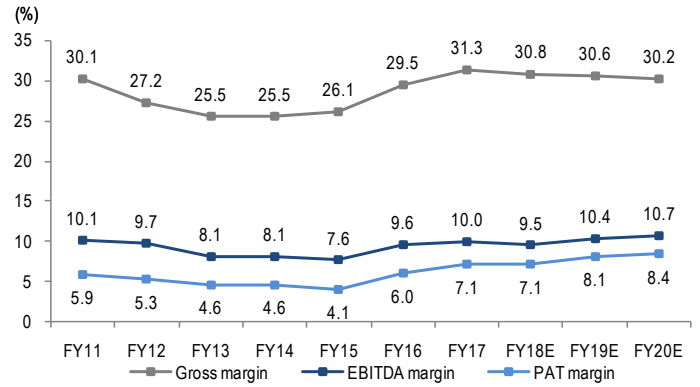
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: VIL's revenue trend



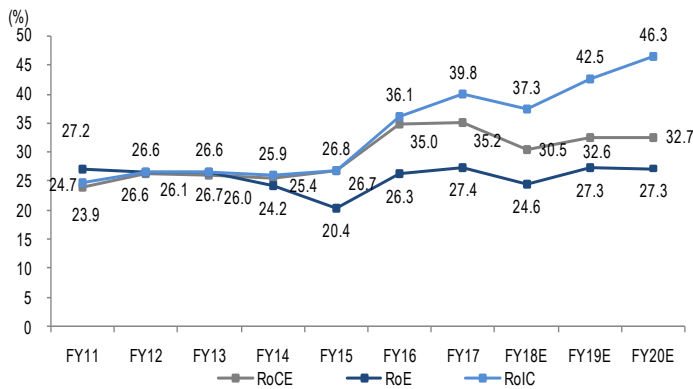
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: VIL's profitability trend



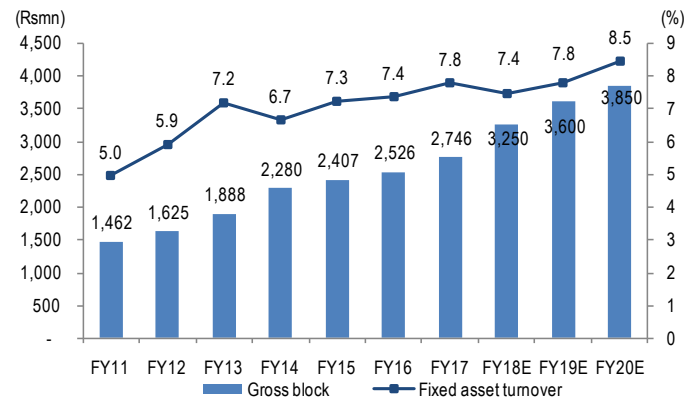
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Trend in return ratios



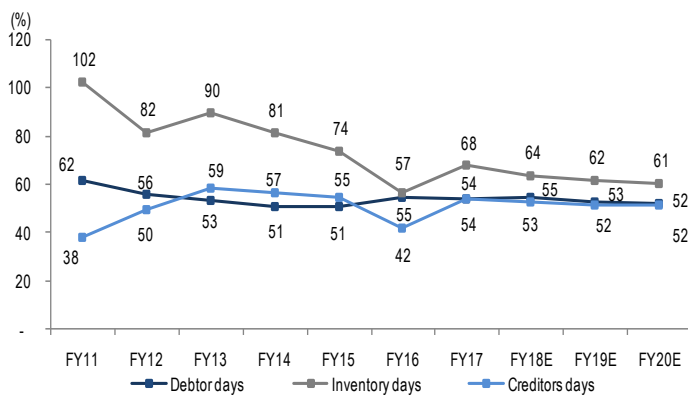
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Trend in fixed-asset turnover



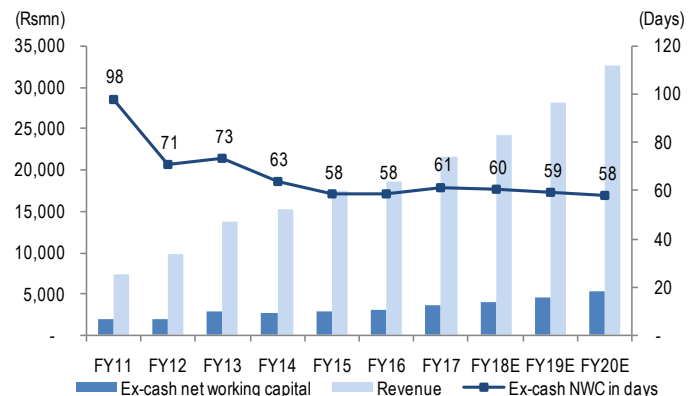
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Trend in working capital cycle



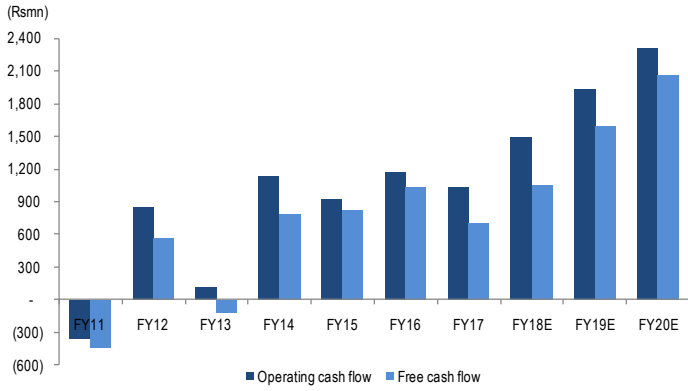
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Trend in ex-cash net working capital position



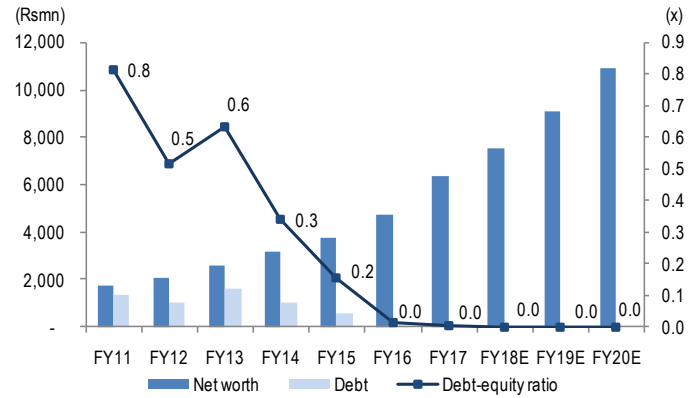
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Trend in operating/free cash flow



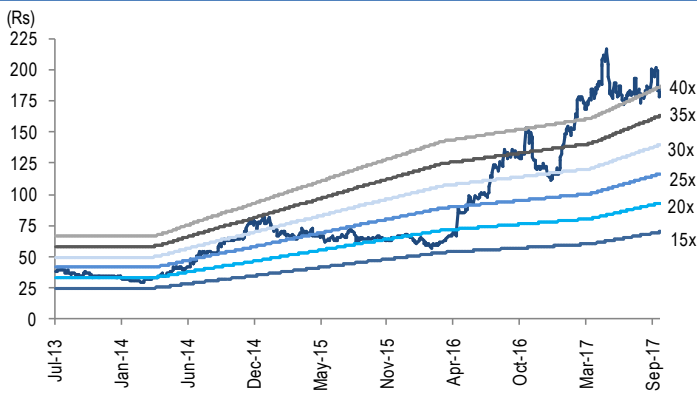
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Trend in leverage position

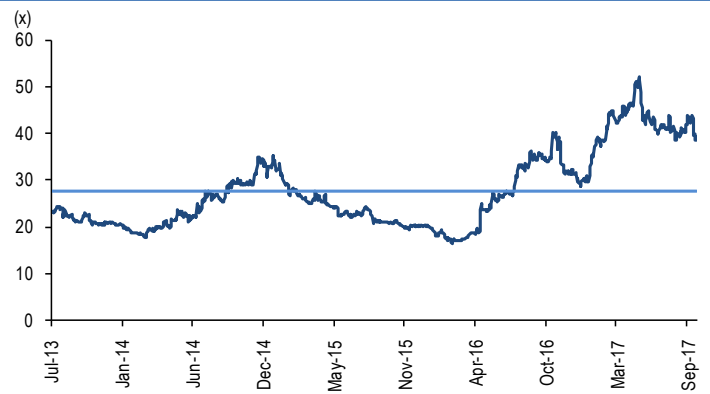


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 17: P/E charts



Source: BSE, Nirmal Bang Institutional Equities Research



Financial statements

Exhibit 18: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net sales	18,623	21,506	24,206	28,043	32,553
% growth	6.7	15.5	12.6	15.9	16.1
Raw material costs	13,123	14,780	16,750	19,462	22,722
Staff costs	1,108	1,375	1,743	1,851	2,116
Other overheads	2,611	3,201	3,401	3,817	4,227
Total expenditure	16,843	19,356	21,894	25,129	29,065
EBITDA	1,780	2,150	2,312	2,914	3,488
% growth	33.8	20.8	7.5	26.0	19.7
EBITDA margin (%)	9.6	10.0	9.5	10.4	10.7
Other income	72	135	151	183	213
Interest costs	89	21	11	-	-
Depreciation	154	162	174	188	205
Profit before tax	1,610	2,102	2,278	2,908	3,496
Tax	493	584	569	640	769
Net profit	1,117	1,518	1,708	2,268	2,727
PAT margin (%)	6.0	7.1	7.1	8.1	8.4
EPS (Rs)	2.6	3.6	4.0	5.3	6.4
% growth	57.9	35.9	12.5	32.8	20.2

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 20: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Share capital	301	425	425	425	425
Reserves	4,407	5,946	7,093	8,645	10,504
Net worth	4,708	6,371	7,517	9,070	10,928
Short-term loans	15	1	-	-	-
Long-term loans	56	24	-	-	-
Total loans	71	25	-	-	-
Deferred tax liability	75	54	54	54	54
Total liabilities	4,854	6,450	7,572	9,124	10,983
Gross block	2,526	2,746	3,250	3,600	3,850
Depreciation	916	1,062	1,236	1,424	1,629
Net block	1,610	1,684	2,014	2,176	2,221
Capital work-in-progress	1	104	50	50	50
Investments	194	891	891	891	891
Inventories	2,047	2,736	2,937	3,306	3,797
Debtors	2,792	3,193	3,647	4,072	4,638
Cash	76	157	606	1,474	2,667
Loans and advances	434	603	678	785	911
Total current assets	5,360	6,728	7,868	9,637	12,013
Creditors	1,511	2,206	2,432	2,773	3,237
Other current liabilities & provisions	800	751	820	857	956
Total current liabilities	2,311	2,957	3,252	3,630	4,193
Net current assets	3,049	3,771	4,616	6,007	7,820
Total assets	4,854	6,450	7,572	9,124	10,983

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: Cash flow

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
EBIT	1,627	1,988	2,138	2,725	3,283
(Inc.)/dec. in working capital	(181)	(641)	(397)	(523)	(620)
Cash flow from operations	1,445	1,347	1,741	2,202	2,663
Other income	72	135	151	183	213
Depreciation	154	162	174	188	205
Tax paid (-)	(511)	(604)	(569)	(640)	(769)
Net cash from operations	1,160	1,040	1,497	1,934	2,311
Capital expenditure (-)	(129)	(339)	(450)	(350)	(250)
Net cash after capex	1,032	701	1,047	1,584	2,061
Interest paid (-)	(89)	(21)	(11)	-	-
Dividends paid (-)	(253)	(358)	(562)	(715)	(869)
Inc./dec. in short-term borrowing	(352)	(15)	(1)	-	-
Inc./dec. in long-term borrowing	(156)	(32)	(24)	-	-
Inc./dec. in total borrowings	(508)	(47)	(25)	-	-
(Inc.)/dec. in investments	(194)	(697)	-	-	-
Cash from financial activities	(1,044)	(1,120)	(598)	(715)	(869)
Others	66	500	-	-	-
Opening cash balance	22	76	157	606	1,474
Closing cash balance	76	157	606	1,474	2,667
Change in cash balance	54	81	449	868	1,193

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 21: Key ratios

Y/E March	FY16	FY17	FY18E	FY19E	FY20E
Per share (Rs)					
EPS	2.6	3.6	4.0	5.3	6.4
Book value	11.1	15.0	17.7	21.4	25.7
Valuation (x)					
P/E	70.7	52.0	46.2	34.8	29.0
P/BV	16.8	12.4	10.5	8.7	7.2
EV/EBITDA	44.4	36.7	33.9	26.6	21.9
EV/sales	4.2	3.7	3.2	2.8	2.3
Return ratios (%)					
RoCE	35.0	35.2	30.5	32.6	32.7
RoE	26.3	27.4	24.6	27.3	27.3
RoIC	36.1	39.8	37.3	42.5	46.3
Profitability ratios (%)					
EBITDA margin	9.6	10.0	9.5	10.4	10.7
EBIT margin	8.7	9.2	8.8	9.7	10.1
PAT margin	6.0	7.1	7.1	8.1	8.4
Turnover ratios					
Total asset turnover ratio (x)	3.8	3.3	3.2	3.1	3.0
Fixed asset turnover ratio (x)	7.4	7.8	7.4	7.8	8.5
Debtor days	55	54	55	53	52
Inventory days	57	68	64	62	61
Creditor days	42	54	53	52	52

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

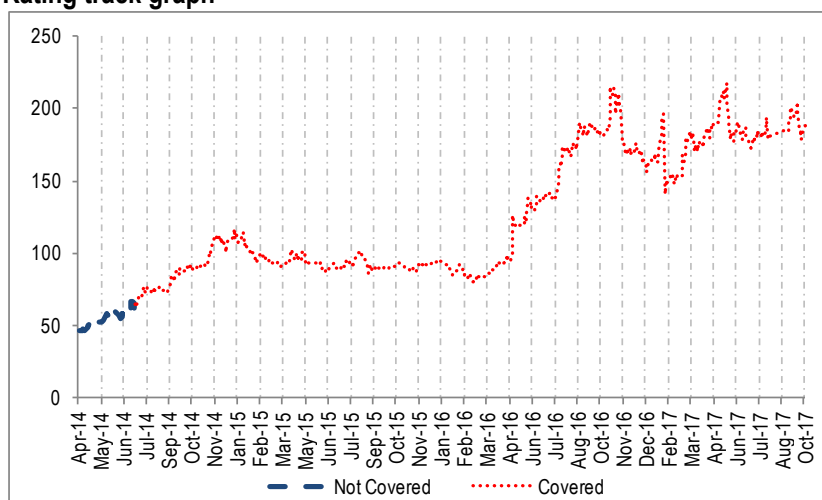
Date	Rating	Market price	Target price (Rs)
10 July 2014	Buy	640	915
30 July 2014	Buy	728	915
5 November 2014	Buy	904	1,109
19 January 2015	Buy	1,143	1,315
13 April 2015	Buy	1,021	1,315
6 May 2015	Buy	983	1,175
10 July 2015	Buy	915	1,175
5 August 2015	Buy	977	1,125
13 October 2015	Buy	910	1,125
16 October 2015	Buy	926	1,125
2 February 2016	Buy	918	1,190
6 April 2016*	Buy	890	1,153
12 April 2016	Buy	930	1,153
5 May 2016	Buy	1,195	1,451
12 July 2016	Buy	1,404	1,451
28 July 2016	Accumulate	1,608	1,671
13 October 2016 #	Accumulate	181	167
24 October 2016	Accumulate	194	215
12 December 2016	Buy	175	210
10 January 2017	Buy	166	210
1 February 2017	Accumulate	205	217
14 February 2017	Accumulate	209	237
23 February 2017	Buy	212	250
7 April 2017 \$	Buy	181	177
23 May 2017	Accumulate	193	187
6 July 2017	Accumulate	180	187
2 August 2017	Accumulate	180	182
29 September 2017	Accumulate	186	195

Note: * Coverage of the stock transferred to Chirag Muchhala

Post stock split from a face value of Rs10 to Rs1

\$ Post issue of 2:5 bonus shares

Rating track graph



Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

This report is published by Nirmal Bang's Institutional Equities Research desk. Nirmal Bang group has other business units with independent research teams separated by Chinese walls, and therefore may, at times, have different or contrary views on stocks and markets. Reports based on technical and derivative analysis may not match with reports based on a company's fundamental analysis. This report is for the personal information of the authorised recipient and is not for public distribution. This should not be reproduced or redistributed to any other person or in any form. This report is for the general information for the clients of Nirmal Bang Equities Pvt. Ltd., a division of Nirmal Bang, and should not be construed as an offer or solicitation of an offer to buy/sell any securities.

We have exercised due diligence in checking the correctness and authenticity of the information contained herein, so far as it relates to current and historical information, but do not guarantee its accuracy or completeness. The opinions expressed are our current opinions as of the date appearing in the material and may be subject to change from time to time without notice.

Nirmal Bang or any persons connected with it do not accept any liability arising from the use of this document or the information contained therein. The recipients of this material should rely on their own judgment and take their own professional advice before acting on this information. Nirmal Bang or any of its connected persons including its directors or subsidiaries or associates or employees or agents shall not be in any way responsible for any loss or damage that may arise to any person/s from any inadvertent error in the information contained, views and opinions expressed in this publication.

Nirmal Bang Equities Private Limited (hereinafter referred to as "NBEPL") is a registered Member of National Stock Exchange of India Limited, Bombay Stock Exchange Limited. NBEPL has registered with SEBI as a Research Entity in terms of SEBI (Research Analyst) Regulations, 2014. (Registration No: INH000001436 - 19.08.2015 to 18.08.2020).

NBEPL or its associates including its relatives/analyst do not hold any financial interest/beneficial ownership of more than 1% in the company covered by Analyst.

NBEPL or its associates/analyst has not received any compensation from the company covered by Analyst during the past twelve months. NBEPL /analyst has not served as an officer, director or employee of company covered by Analyst and has not been engaged in market-making activity of the company covered by Analyst.

The views expressed are based solely on information available publicly and believed to be true. Investors are advised to independently evaluate the market conditions/risks involved before making any investment decision.

Access all our reports on Bloomberg, Thomson Reuters and Factset.

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 3926 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 3926 8230, +91 22 6636 8833
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 3926 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 3926 8102/8103, +91 22 6636 8830

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address

B-2, 301/302, MarathonInnova,
 Nr.Peninsula Corporate Park,
 Lower Parel (W), Mumbai-400013.
 Board No. : 91 22 3926 8000/1; Fax. : 022 3926 8010