

HOLD

TP: Rs 250 | ▼ 1%

V-GUARD INDUSTRIES

Consumer Durables

28 October 2022

Margin pressure dampens performance

- Q2 subdued as EBITDA margin slid 310bps YoY to 7.4% amid absorption of high-cost inventory; RM recovery guided by Q4
- Expansion yielding desired outcome as non-south markets grew at a strong 18% YoY vs. 3% in South India
- FY23/FY24 EPS pared 5%/3% on a muted Q2; post rollover, our TP stays at Rs 250 – retain HOLD

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Revenue in line: VGRD's Q2FY23 revenue at Rs 9.9bn (+9% YoY, 3Y CAGR of 16.5%) was largely in line with our estimate. Topline growth was driven by the consumer durables segment (3Y CAGR 24%) despite a higher base and softer demand.

Margin stress continues: EBITDA margin deteriorated for the second successive quarter, falling 70bps QoQ (-310bps YoY) to 7.4% vs. the 3Y average of 10.3%. Gross margin contracted 80bps QoQ to 29.2%. Though we had factored high-cost inventory into our margin estimates (8.6% vs. 9.9% for consensus), lower realisations from price cuts in the wires business, and elevated input cost in other categories (ex-electricals) led to the miss. Additionally, less-than-expected water heaters growth & moderately higher inventory than usual, weighed on the margins. While the electricals margin dropped sharply, CD recouped to 2.9% after a two-quarter lull. A&P expenses rose to 2.2% of sales (vs. 1.5% in Q2FY22), adding pressure on margins. Consequently, PAT fell 26% YoY to Rs 437mn.

Geographical diversification on track: VGRD's thrust on expanding beyond its core southern market is yielding desired outcomes. Non-south markets contributed 42.7% of Q2 revenue vs. 39.4% in the year-ago quarter, growing at 18% YoY vs. 2.6% for the southern market. On a 3Y CAGR basis, the non-core markets have posted strong growth of 22% in Q2 vs. a more modest 13% for the southern market.

Maintain HOLD: VGRD's expansion beyond its core geography is helping to derisk business concentration but has come at the cost of margins. Recovery in ECD margin is a positive sign. Incorporating the muted Q2 performance, we pare FY23/FY24 EPS estimates by 5%/3%. We continue to value the stock at 35x FY24E EPS, a 7.5% discount to its 4Y average. On rolling valuations forward to Sep'24E, we have an unchanged TP of Rs 250; retain HOLD.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	VGRD IN/Rs 253
Market cap	US\$ 1.3bn
Free float	44%
3M ADV	US\$ 1.2mn
52wk high/low	Rs 264/Rs 181
Promoter/FPI/DII	56%/13%/18%

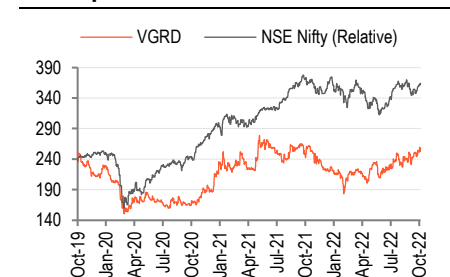
Source: NSE | Price as of 28 Oct 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	34,982	40,013	44,258
EBITDA (Rs mn)	3,382	3,992	4,611
Adj. net profit (Rs mn)	2,277	2,588	2,990
Adj. EPS (Rs)	5.3	6.0	6.9
Consensus EPS (Rs)	5.3	6.9	8.2
Adj. ROAE (%)	17.4	17.2	17.3
Adj. P/E (x)	48.0	42.2	36.5
EV/EBITDA (x)	32.3	27.3	23.7
Adj. EPS growth (%)	13.4	13.7	15.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q4FY22	Q1FY23	QoQ (%)
Revenue	9,861	9,074	8.7	10,582	10,183	(3.2)
EBITDA	727	949	(23.4)	1,110	820	(11.3)
EBITDA Margin (%)	7.4	10.5	(310bps)	10.5	8.1	(70bps)
Depreciation	150	112	-	129	137	-
Interest	19	31	-	18	18	-
Other Income	33	26	-	36	51	-
PBT	592	832	(28.9)	1,000	717	(17.4)
Tax	155	238	-	104	183	-
Adjusted PAT	437	593	(26.4)	896	534	(18.2)
Exceptional item	-	-	-	0	0	-
Reported PAT	437	593	(26.4)	897	533	(18.1)
Adj. PAT Margin (%)	4.4	6.5	(210bps)	8.5	5.2	(80bps)
EPS (Rs)	1.0	1.4	(26.5)	2.1	1.2	(18.2)

Source: Company, BOBCAPS Research

Fig 2 – Actuals vs. Estimates

(Rs mn)	Actual	Estimates	Variance (%)
Revenue	9,861	9,655	2.1
EBITDA	727	835	(12.9)
EBITDA Margin (%)	7.4	8.6	(130bps)
Adj. PAT	437	545	(19.9)

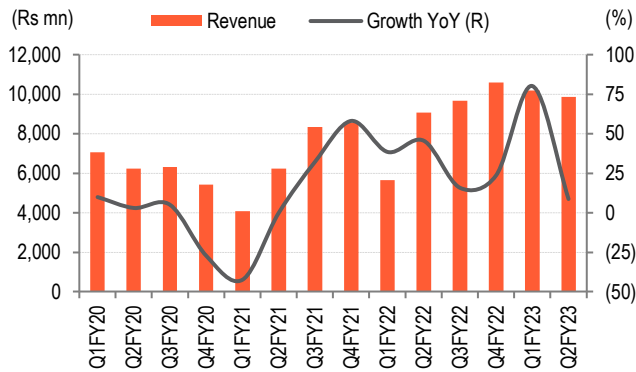
Source: Company, BOBCAPS Research

Fig 3 – Segmental performance

(Rs mn)	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	% 3Y CAGR
Revenues															
Consumer Durables	1,534	1,750	2,020	1,442	855	1,634	2,641	2,237	1,497	2,794	3,384	2,959	2,991	3,372	24.4
% of sales	22	28	32	27	21	26	32	26	26	31	35	28	29	34	
Electricals	2,704	2,807	2,762	2,467	1,848	2,886	3,635	3,888	2,565	4,188	4,292	5,152	4,159	4,216	14.5
% of sales	38	45	44	46	45	46	44	45	45	46	44	49	41	43	
Electronics	2,828	1,676	1,538	1,503	1,377	1,710	2,074	2,428	1,590	2,092	1,999	2,471	3,034	2,274	10.7
% of sales	40	27	24	28	34	27	25	28	28	23	21	23	30	23	
EBIT															
Consumer Durables	66	185	113	35	(87)	136	264	89	(59)	85	96	50	38	97	(19.4)
Margin (%)	4.3	10.6	5.6	2.5	(10.2)	8.3	10.0	4.0	(3.9)	3.0	2.8	1.7	1.3	2.9	
Electricals	139	300	229	192	59	287	331	427	254	421	355	555	283	228	(8.7)
Margin (%)	5.1	10.7	8.3	7.8	3.2	9.9	9.1	11.0	9.9	10.1	8.3	10.8	6.8	5.4	
Electronics	496	284	244	213	93	306	512	531	207	392	338	431	429	333	5.5
Margin (%)	17.5	16.9	15.9	14.1	6.8	17.9	24.7	21.9	13.0	18.7	16.9	17.4	14.1	14.6	

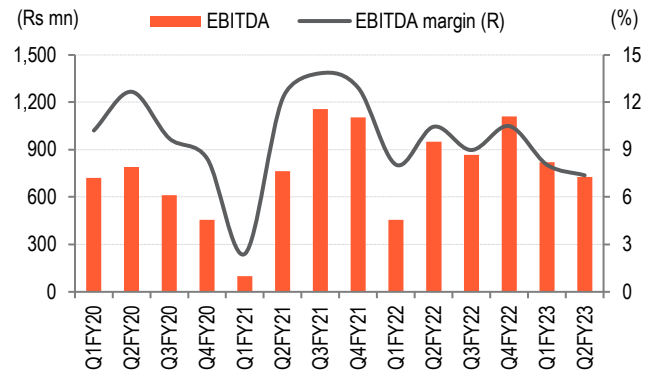
Source: Company, BOBCAPS Research

Fig 4 – Revenue growth in line with our estimates



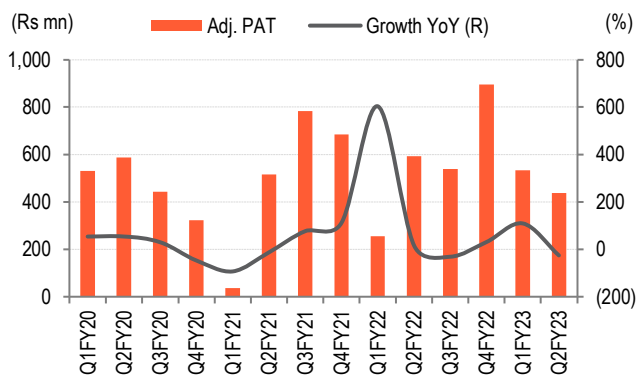
Source: Company, BOBCAPS Research

Fig 5 – EBITDA margin continues to deteriorate



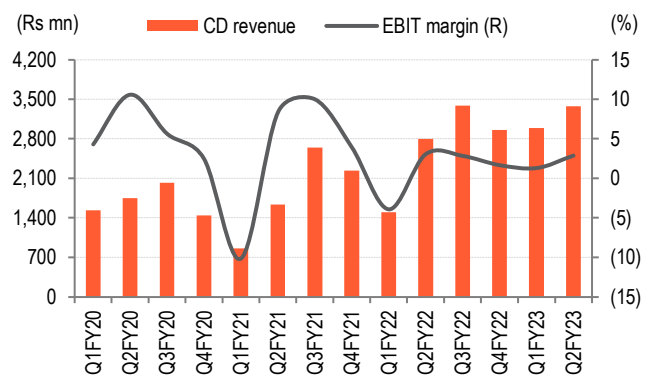
Source: Company, BOBCAPS Research

Fig 6 – Lower margins drag down profits



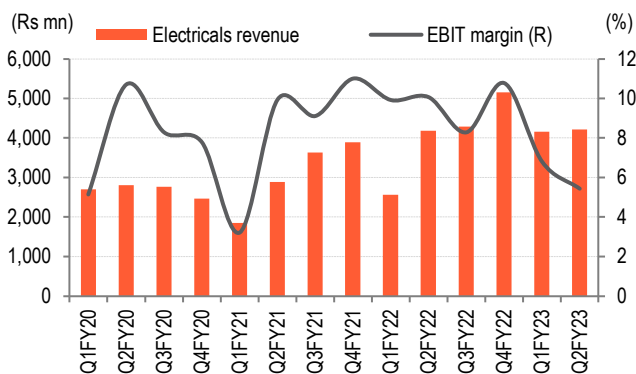
Source: Company, BOBCAPS Research

Fig 7 – Consumer durables revenue and margin show signs of revival



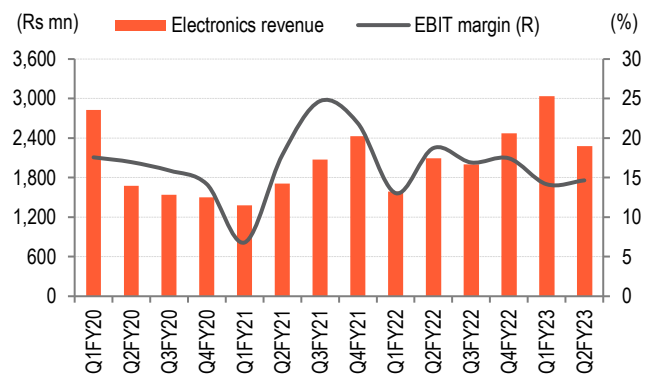
Source: Company, BOBCAPS Research

Fig 8 – Electricals business posts muted performance

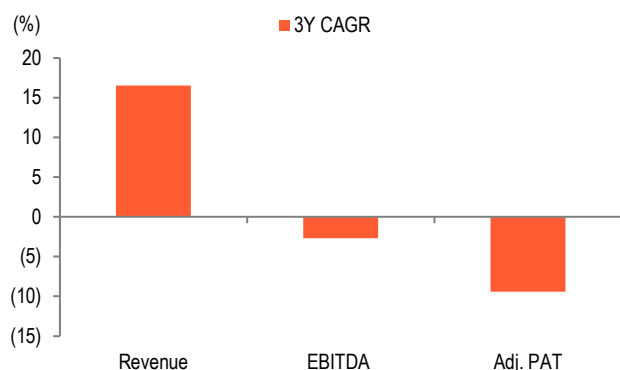


Source: Company, BOBCAPS Research

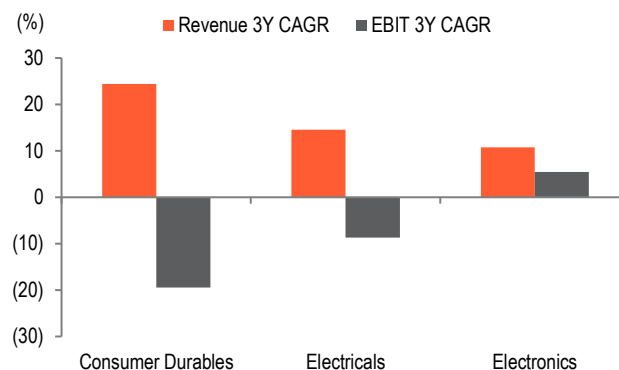
Fig 9 – Steady growth in electronics division



Source: Company, BOBCAPS Research

Fig 10 – 3Y CAGR: Revenue strong while EBITDA, PAT lower


Source: Company, BOBCAPS Research

Fig 11 – 3Y CAGR: Segmental revenues expand but margins remain muted


Source: Company, BOBCAPS Research

Earnings call highlights

- Demand:** Management is seeing stress on demand with sales falling short of expectations. This has been a persistent challenge, particularly in rural areas and small towns, owing to the rising commodity prices. The fans segment is slowing due to the upcoming energy ratings change, but this could be an opportunity for traders to stock up. In the case of wire and cables, price reductions amid falling copper prices are causing destocking in the channel. Softness in the electrical business is primarily due to the pricing climate rather than demand.
- Price hikes:** VGRD did not hike prices during Q2FY23; in fact, wires & cables saw a decrease. With commodities stabilising, management does not anticipate a significant price revision in coming quarters. However, the new energy standards would result in a 5% price rise for entry-level fans.
- Channel expansion:** Growth in the south and non-south markets was at 2.6% and 17.8% YoY respectively. Non-south markets accounted for 42.7% of total revenue in Q2FY23, up from 39.4% in Q2FY22. VGRD intends to open 5,000-6,000 non-south outlets per year over the next few years.
- Consumer durables:** The consumer durables business continued to grow well, though margins suffered from the inability to pass on higher input costs due to intense competition. Nonetheless, management expects overall gross margin to return to pre-Covid levels (20%) by Q4FY23. The company has regained market share in water heaters over the last two years, but growth has not been as anticipated. VGRD continues to believe this segment will grow faster than the market over the medium term. Mid- and high-end fans accounted for 40-50% of the durables portfolio.
- Kitchen appliances:** The business is primarily focused in the south and is growing faster than the company. VGRD is in the process of establishing a product line, supply chains and a manufacturing facility (expected to become operational in 12-18 months).
- Water purifiers:** This business is currently in the rollout phase and VGRD plans to expand the product portfolio.
- A&P spend:** A&P spends were at 2.2% of revenue vs. 1.5% in Q2FY22.
- Capex:** The company plans to spend a total of Rs 700mn over FY23 and FY24 on three plants that are expected to come online in the next 18 months.

Valuation methodology

VGRD continues to lead the market in the stabiliser segment, but margins remain under pressure due to a muted performance in other verticals. Expansion beyond its core geography of South India is helping to derisk business concentration but has come at the cost of margins. That said, recovery in ECD margin is a positive sign and could cushion overall profitability going forward.

Incorporating the muted Q2FY23 performance, we pare FY23/FY24 EPS estimates by 5%/3%. We continue to value the stock at 35x FY24E EPS, a 7.5% discount to its four-year average. On rolling valuations forward to Sep'24E, our TP stays at Rs 250; retain HOLD.

Fig 12 – Revised estimates

Particulars (Rs mn)	New			Old		Change (%)	
	FY23E	FY24E	FY25E	FY23E	FY24E	FY23E	FY24E
Sales	40,013	44,258	49,978	40,229	44,496	(0.5)	(0.5)
EBITDA	3,992	4,611	5,169	4,151	4,742	(3.8)	(2.8)
PAT	2,588	2,990	3,296	2,732	3,089	(5.3)	(3.2)
EPS (Rs)	6.0	6.9	7.6	6.3	7.2	(5.3)	(3.2)
EBITDA Margin (%)	10.0	10.4	10.3	10.3	10.7	(30bps)	(20bps)

Source: Company, BOBCAPS Research

Key risks

Key risks to our estimates are:

- **Upside risks:** Above-expected demand recovery and aggressive market share gains in non-south regions
- **Downside risks:** Prolonged margin weakness

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Amber Enterprises	AMBER IN	0.8	2,074	2,100	HOLD
Blue Star	BLSTR IN	1.4	1,221	1,100	HOLD
Crompton Greaves	CROMPTON IN	2.7	354	500	BUY
Dixon Technologies	DIXON IN	3.2	4,389	5,200	BUY
Havells India	HAVL IN	9.0	1,187	1,500	BUY
Orient Electric	ORIENTEL IN	0.7	269	310	HOLD
Polycab India	POLYCAB IN	5.0	2,753	3,300	BUY
V-Guard Industries	VGRD IN	1.3	253	250	HOLD
Voltas	VOLT IN	3.5	871	1,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 28 Oct 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	27,212	34,982	40,013	44,258	49,978
EBITDA	3,121	3,382	3,992	4,611	5,169
Depreciation	386	491	658	753	917
EBIT	2,735	2,891	3,335	3,858	4,252
Net interest inc./(exp.)	(61)	(79)	(25)	(25)	(25)
Other inc./(exp.)	207	128	141	155	170
Exceptional items	0	0	0	0	0
EBT	2,881	2,940	3,450	3,988	4,397
Income taxes	862	655	869	1,005	1,108
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	2,008	2,277	2,588	2,990	3,296
Adjustments	0	0	0	0	0
Adjusted net profit	2,008	2,277	2,588	2,990	3,296

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	4,747	4,880	6,029	6,669	7,531
Other current liabilities	1,050	1,166	1,334	1,476	1,666
Provisions	0	0	0	0	0
Debt funds	130	118	250	250	250
Other liabilities	710	732	830	912	1,023
Equity capital	430	432	432	432	432
Reserves & surplus	11,683	13,638	15,665	18,008	20,571
Shareholders' fund	12,113	14,070	16,097	18,440	21,002
Total liab. and equities	18,750	20,966	24,540	27,746	31,472
Cash and cash eq.	2,812	613	1,445	2,525	3,137
Accounts receivables	3,881	4,841	5,701	6,305	7,120
Inventories	6,315	8,596	9,866	10,913	12,323
Other current assets	1,003	1,152	1,317	1,457	1,646
Investments	0	0	0	0	0
Net fixed assets	3,913	4,842	5,184	5,431	6,014
CWIP	185	92	105	116	131
Intangible assets	129	200	200	200	200
Deferred tax assets, net	0	0	0	0	0
Other assets	513	631	722	799	902
Total assets	18,750	20,966	24,540	27,746	31,472

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	3,695	1,390	2,268	2,733	2,852
Capital expenditures	0	0	(1,000)	(1,000)	(1,500)
Change in investments	26	0	0	0	0
Other investing cash flows	383	(1,198)	(7)	(6)	(7)
Cash flow from investing	409	(1,198)	(1,007)	(1,006)	(1,507)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	2	(12)	132	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(60)	(603)	(561)	(647)	(734)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(58)	(615)	(429)	(647)	(734)
Chg in cash & cash eq.	4,047	(423)	832	1,080	611
Closing cash & cash eq.	2,812	613	1,445	2,525	3,137

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	4.7	5.3	6.0	6.9	7.6
Adjusted EPS	4.7	5.3	6.0	6.9	7.6
Dividend per share	1.2	1.3	1.3	1.5	1.7
Book value per share	28.1	32.6	37.3	42.7	48.7

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	4.0	3.1	2.7	2.5	2.2
EV/EBITDA	35.0	32.3	27.3	23.7	21.1
Adjusted P/E	54.4	48.0	42.2	36.5	33.1
P/BV	9.0	7.8	6.8	5.9	5.2

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	69.7	77.5	75.0	75.0	75.0
Interest burden (PBT/EBIT)	105.3	101.7	103.5	103.4	103.4
EBIT margin (EBIT/Revenue)	10.0	8.3	8.3	8.7	8.5
Asset turnover (Rev./Avg TA)	7.0	7.2	7.7	8.1	8.3
Leverage (Avg TA/Avg Equity)	0.4	0.4	0.3	0.3	0.3
Adjusted ROAE	18.2	17.4	17.2	17.3	16.7

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	8.7	28.6	14.4	10.6	12.9
EBITDA	21.0	8.4	18.0	15.5	12.1
Adjusted EPS	7.3	13.4	13.7	15.5	10.2
Profitability & Return ratios (%)					
EBITDA margin	11.5	9.7	10.0	10.4	10.3
EBIT margin	10.0	8.3	8.3	8.7	8.5
Adjusted profit margin	7.4	6.5	6.5	6.8	6.6
Adjusted ROAE	18.2	17.4	17.2	17.3	16.7
ROCE	18.3	17.6	17.0	17.1	16.6
Working capital days (days)					
Receivables	52	51	52	52	52
Inventory	85	90	90	90	90
Payables	64	51	55	55	55
Ratios (x)					
Gross asset turnover	6.5	6.1	5.8	5.6	5.4
Current ratio	2.4	2.5	2.4	2.5	2.6
Net interest coverage ratio	44.8	36.7	133.4	154.3	170.1
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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BUY – Expected return >+15%

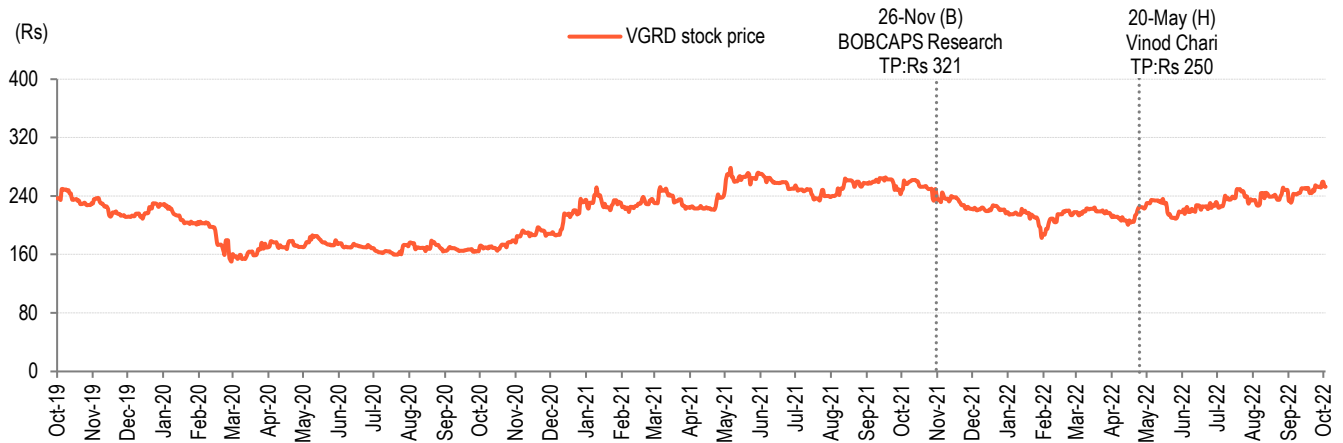
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): V-GUARD INDUSTRIES (VGRD IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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