MOTILAL OSWAL

20 December 2016

Update | Sector: Consumer

V-Guard Industries

BSE SENSEX	S&P CNX
26,375	8,104

Stock Info

Bloomberg	VGRD IN
Equity Shares (m)	302.1939
52-Week Range (INR)	226 / 79
1, 6, 12 Rel. Per (%)	-3/25/77
M.Cap. (INR b)	51.3
M.Cap. (USD b)	0.8
Avg Val, INRm	77
Free float (%)	34.5

Financials Snapshot (INR b)

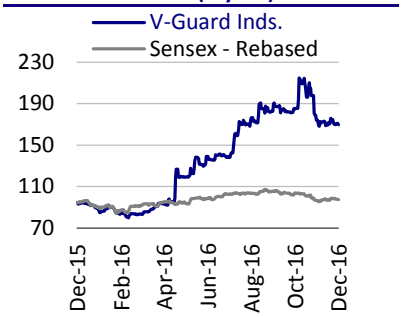
Y/E Mar	2016	2017E	2018E
Sales	18.6	19.5	22.5
EBITDA	1.8	2.0	2.5
NP	1.1	1.4	1.7
EPS (INR)	3.7	4.5	5.8
EPS Gr. (%)	57.5	21.6	27.7
BV/Sh (INR)	15.6	19.0	23.2
RoE (%)	26.3	26.1	27.4
RoCE (%)	24.9	25.9	27.4
P/E (x)	45.8	37.6	29.5
P/BV (x)	10.9	9.0	7.3

Shareholding pattern (%)

As On	Sep-16	Jun-16	Sep-15
Promoter	65.5	65.7	65.9
DII	11.6	12.3	7.5
FII	12.9	12.9	17.1
Others	10.1	9.2	9.6

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR170 TP: INR179 (+5%) Neutral

Near-term demonetization impact not steep

Valuations rich; retain Neutral

- **Demonetization impact softer than anticipated in November:** VGRD saw lower, single-digit YoY growth in November. Fans, stabilizers and inverters (November being off season for these products) witnessed sales pressure. In wires & cables, VGRD saw expansion on both fronts (volume as well as value) due to rise in copper prices; it hiked prices by 15% in November – commodity price rise/decline is directly passed on in this segment. According to the management, post demonetization, the price gap between VGRD and unorganized players should narrow down from 25% to 3% in cables, which is a long-term positive. Water heater sales were on the softer side due to slower onset of winter in certain areas; sales should pick up in December. Pumps have performed well, especially in non-South markets in November due to higher water levels. Kerala (30% of revenue) and Tamil Nadu have been most impacted probably because of higher compliance and discipline followed by channel partners than in other regions.
- **Selective credit incentive schemes for dealers:** VGRD has offered higher incentives for its dealers and wholesalers that clear their outstanding dues towards the company. It is not giving discounts on any product categories, currently. The management may roll out more schemes and may even extend debtor days; with collection of cash in November, VGRD's balance sheet is in a better position than at the end of 2QFY17.
- **GST coupled with demonetization to be positive for organized sector:** GST coupled with demonetization is expected to lead to higher tax compliance. Both these measures will impact the unorganized sector that currently does a large part of its dealings in cash. The management believes if GST is implemented from April 1, 2017, it will impact sales in 4QFY17, as trade channels may not want to receive products taxed as per current tax structure and claim input credit later.
- **Near-term pressure likely; growth outlook intact:** Following demonetization, the management expects flat growth in 3QFY17. VGRD hasn't gone for any major production cut in 3QFY17. It has cut its ad spends by INR50m in 3QFY17 (from expected INR150m) and will decide on the future amounts based on market outlook. However, the management maintains its structural growth guidance of 15% CAGR for the next three years (barring FY17), with a 50bp EBITDA margin expansion every year (due to gross margin expansion because of benefits of supply chain initiatives undertaken this year and improvement in its non-South margins every year).

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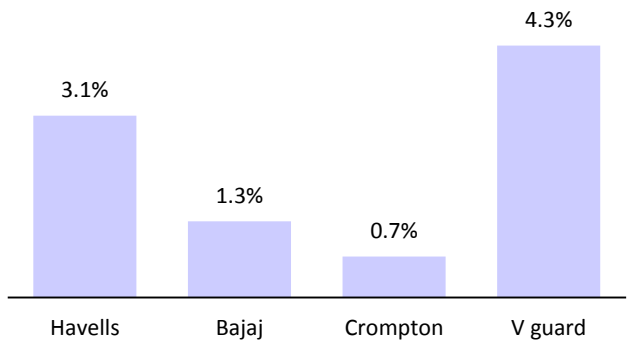
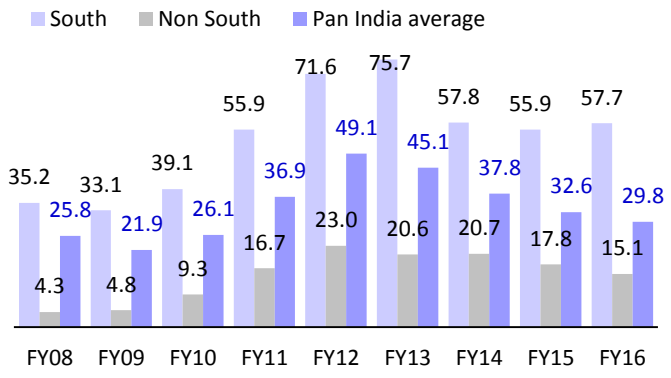
- **Valuation and view:** We believe near-term pressure due to demonetization would impact 2HFY17 performance. However, this does not change our structural outlook. We believe VGRD is well poised to capture the shift from the unorganized to the organized segment (with GST rollout) and the uptick in consumer demand in the long run. We (a) retain our FY17 estimates, as we had already factored in changes earlier, (b) cut our FY18 PAT estimate by 5%, and (c) introduce our FY19 estimates. We expect revenue CAGR of 12% and PAT CAGR of 24%, with 195bp margin expansion over FY16-19. We roll over our target price to September 2018E, and value VGRD at 28x (instead of 30x FY18E EPS). Our target price of INR179 implies just 5% upside; maintain **Neutral**.

Exhibit 1: V-Guard's ad spends highest among peers



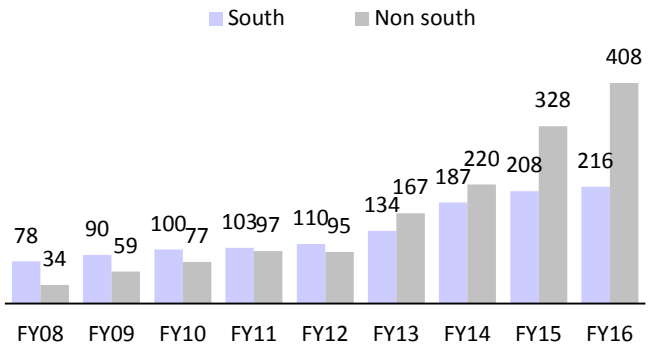
Source: Company, MOSL

Exhibit 2: Revenue/ Distribution pan India trend (m)



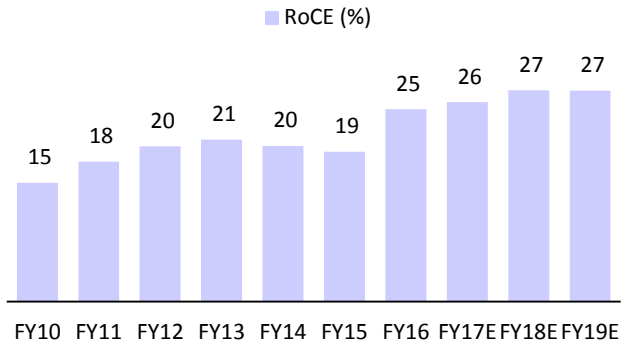
Source: Company, MOSL

Exhibit 3: Distribution network pan India trend



Source: Company, MOSL

Exhibit 4: Robust RoCEs



Source: Company, MOSL

Demonetization impact softer than anticipated in November

- VGRD saw lower, single-digit YoY growth in November. Yet, sales were not as weak as we had initially expected.
- **Fans**, **stabilizers** and **inverters** (November being off season for these products) witnessed sales pressure.
- In **wires & cables**, VGRD saw expansion on both fronts (volume as well as value) due to rise in copper prices; it hiked prices by 15% in November – commodity price rise/decline is directly passed on in this segment. Unorganized players constitute ~30% of this segment. According to the management, post demonetization, the price gap between VGRD and unorganized players should narrow down from 25% to 3% in cables, which is a long-term positive.
- **Water heater** sales were on the softer side due to slower onset of winter in certain areas; sales should pick up in December.
- **Pumps** have performed well, especially in non-South markets in November due to higher water levels.
- In **kitchen appliances**, VGRD may introduce new SKUs in existing products, but is not looking at new product introductions. This segment may witness some deferment in purchases for the next two quarters.
- In **switchgears**, the company is mainly in low-voltage/production switchgears and not in the modular segment.
- Regionally, Kerala and Tamil Nadu have been most impacted, probably because of higher compliance and discipline by channel partners than in other regions. The southern states are believed to be more compliant with government regulations than the rest of India. Other southern states (Karnataka, Andhra Pradesh and Telangana) have not been hit as badly.
- In **Kerala** (~30% of VGRD's sales), sales might have been hit also because (a) November sales are generally tepid, and (b) many people in Kerala keep their money in cooperative banks, which have been particularly hit due to demonetization.

Selective credit incentive schemes for dealers

- VGRD is receiving payments on a regular basis from its wholesalers. The average collection days are 45 days.
- VGRD has offered higher incentive schemes for dealers and wholesalers who clear all their outstanding dues towards the company.
- It has tied up with financial institutions to aid its channel partners in making electronic payments and offering down-payment sales in some products like water heaters.
- The company is also providing card machines to select leading dealers.
- The management may roll out more schemes and may even extend debtor days; with collection of cash in November, VGRD's balance sheet is in a better position than at the end of 2QFY17.

GST coupled with demonetization to be positive for organized sector

- GST coupled with demonetization is expected to lead to higher tax compliance. Both these measures will impact the unorganized sector that does a large part of its dealings in cash.

- The management believes if GST is implemented from April 1, 2017, it will impact sales in 4QFY17, as trade channels may not want to receive products taxed as per current tax structure and claim input credit later.
- Revenue neutral rate under GST is expected to be 18% for VGRD.

Looking for inorganic opportunities

- VGRD is identifying inorganic growth opportunities. It is looking at an acquisition with a ticket size of ~INR5b after taking price and business synergy into consideration.
- It is comfortable with debt-equity of 1:1, if the acquisition is a right fit for the company.
- The management is clear that demonetization would not come in the way of its inorganic growth considerations.
- For any new acquisition, the company will target RoCE levels of over 25%.

Near-term pressure likely; growth outlook intact

- The management expects flat growth in 3QFY17.
- It has cut ad spends in 3QFY17 by INR50m (of expected INR150m), and will decide on the ad spends for FY18 based on market outlook.
- Many wholesalers and retailers are witnessing an expansion in working capital cycle mainly due to large inventory with unorganized players. Retailers and wholesalers stock products of both organized as well as unorganized players. The key pain arising is because of challenges in selling unbranded products, currently.
- VGRD does not sell directly to large real estate players. Also, the management believes that its channel partners supplying to the real estate industry have not witnessed any major stress due to demonetization.
- On the distribution front, ~60% of VGRD's sales happen through its distribution channel, while the rest 40% is through the wholesale model. According to the management, the southern region is more inclined towards the distributor model while the other regions are more inclined towards the wholesale model.
- In our interactions, the management indicated that most of its dealers (80-90%) expect near-term pain due to demonetization, but expect the long-term impact to be positive.
- On the region mix, 40-45% of VGRD's product sales are in urban areas, with the rest in tier-3 & 4 towns.
- Due to the current uncertain scenario, the management is not questioning its sales team if targets are not achieved. Also, it is closely monitoring inventory levels at distributor/retailer end and wants to avoid pile-up of further inventory.
- Currently, EBITDA margins are ~13% in the South and ~6% in non-South markets.

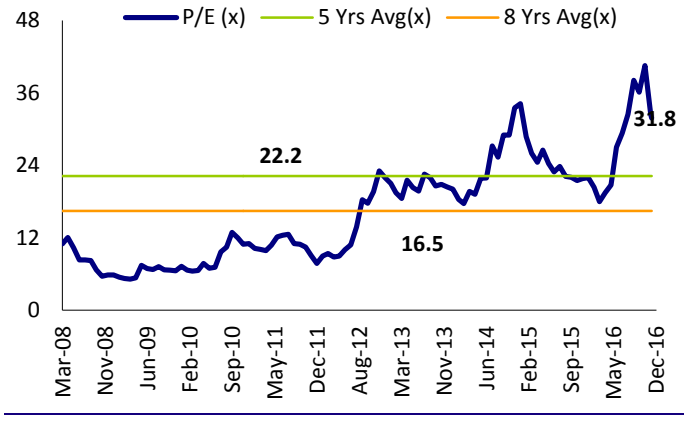
Valuation and view

We believe near-term pressure due to demonetization would impact 2HFY17 performance. However, this does not change our structural outlook. We believe VGRD is well poised to capture the shift from the unorganized to the organized segment (with GST rollout) and the uptick in consumer demand in the long run. We (a) retain our FY17 estimates, as we had already factored in changes earlier, (b) cut our FY18 PAT estimate by 5%, and (c) introduce our FY19 estimates. We expect revenue CAGR of 12% and PAT CAGR of 24%, with 195bp margin expansion over FY16-19. We roll over our target price to September 2018E, and value VGRD at 28x (instead of 30x FY18E EPS). Our target price of INR179 implies just 5% upside; maintain **Neutral**.

We believe our valuation multiple is justified considering:

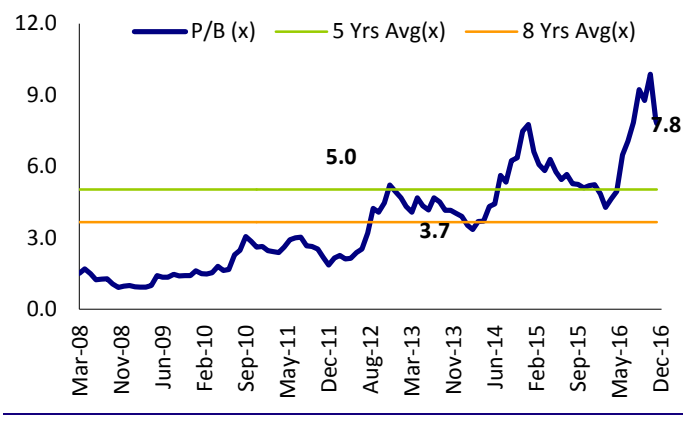
- **Strong return ratios**: VGRD derives 60% of its revenue through outsourcing model, thereby keeping its business asset-light, and focuses on branding. The outsourcing model leads to higher RoCE (overall corporate RoCE of 27% for FY19E) and a debt-free balance sheet.
- **Significant potential for growth and margin expansion:** Over the past five years, VGRD has significantly expanded its presence in non-South markets, with distributors in non-South markets at 408, higher than the 216 distributors in the South. However, revenue per distributor in non-South markets stands at INR15m-20m as against INR55m-60m in South markets, implying significant scalability from non-South markets. Distributor margins and discounts in non-South margins are currently slightly higher than in South markets, which we expect will decline going forward, thus improving margins.

Exhibit 5: Price to earnings (one year forward)



Source: Company, MOSL

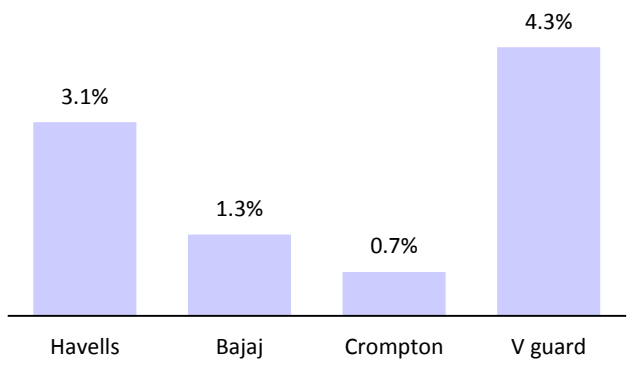
Exhibit 6: Price to book (one year forward)



Source: Company, MOSL

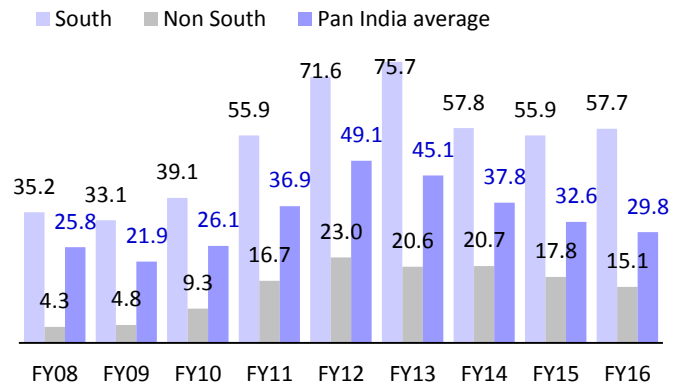
Story in charts

Exhibit 7: V-Guard's ad spends highest among peers



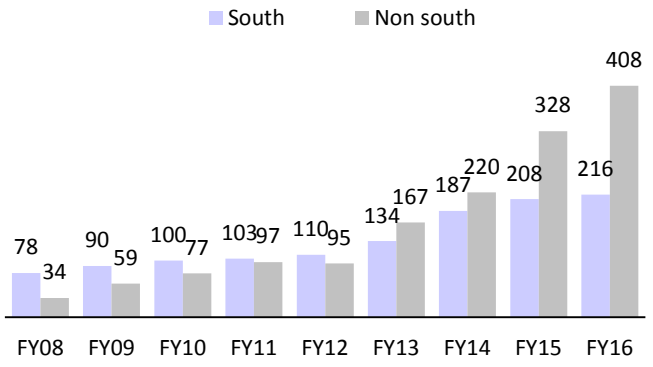
Source: Company, MOSL

Exhibit 8: Revenue/ Distribution pan India trend (m)



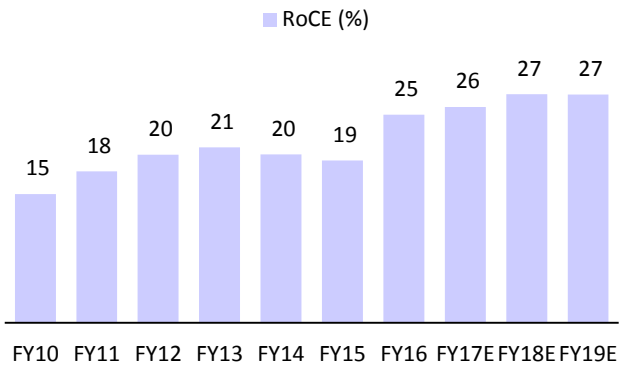
Source: Company, MOSL

Exhibit 9: Distribution network pan India trend



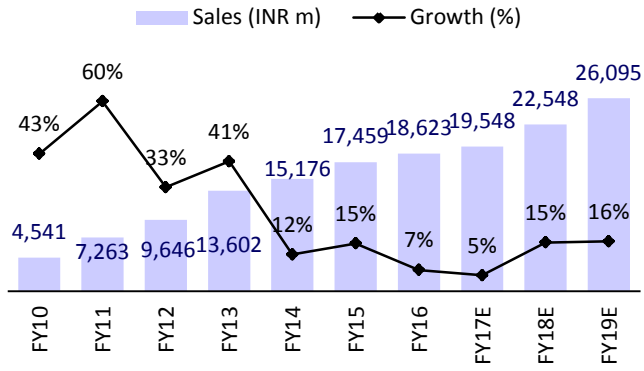
Source: Company, MOSL

Exhibit 10: Robust RoCEs



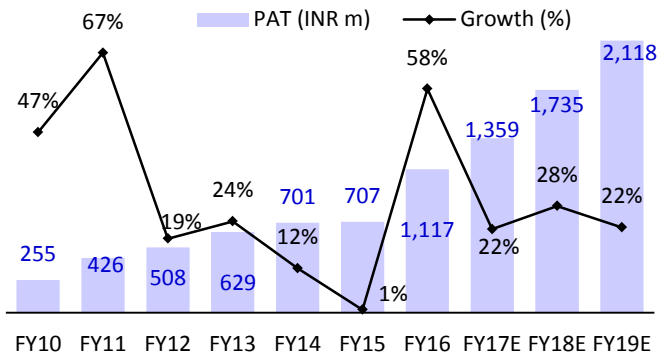
Source: Company, MOSL

Exhibit 11: Annual sales trend



Source: Company, MOSL

Exhibit 12: Annual PAT trend



Source: Company, MOSL

Financials and Valuations

Standalone - Income Statement (INR Million)

Y/E March	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E
Net Sales	**9,646**	**13,602**	**15,176**	**17,459**	**18,623**	**19,548**	**22,548**	**26,095**
Change (%)	32.8	41.0	11.6	15.0	6.7	5.0	15.3	15.7
EBITDA	**936**	**1,099**	**1,225**	**1,330**	**1,779**	**1,994**	**2,480**	**3,001**
Margin (%)	9.7	8.1	8.1	7.6	9.6	10.2	11.0	11.5
Depreciation	97	114	120	154	153	169	191	209
EBIT	**839**	**985**	**1,105**	**1,176**	**1,627**	**1,825**	**2,290**	**2,792**
Int. and Finance Charges	170	200	211	206	89	34	0	0
Other Income - Rec.	24	36	48	44	72	123	154	192
PBT bef. EO Exp.	**692**	**821**	**943**	**1,014**	**1,610**	**1,914**	**2,443**	**2,984**
PBT after EO Exp.	**692**	**821**	**943**	**1,014**	**1,610**	**1,914**	**2,443**	**2,984**
Current Tax	202	156	225	305	493	555	709	865
Deferred Tax	-19	36	16	2	0	0	0	0
Tax Rate (%)	26.6	23.4	25.6	30.3	30.6	29.0	29.0	29.0
Reported PAT	**508**	**629**	**701**	**707**	**1,117**	**1,359**	**1,735**	**2,118**
PAT Adj for EO items	**508**	**629**	**701**	**707**	**1,117**	**1,359**	**1,735**	**2,118**
Change (%)	27.0	23.7	11.5	0.8	58.1	21.6	27.7	22.1
Margin (%)	5.3	4.6	4.6	4.0	6.0	7.0	7.7	8.1

Standalone - Balance Sheet (INR Million)

Y/E March	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E
Equity Share Capital	298	298	298	300	301	301	301	301
Total Reserves	1,808	2,315	2,886	3,478	4,407	5,403	6,665	8,239
Net Worth	**2,106**	**2,613**	**3,184**	**3,777**	**4,708**	**5,703**	**6,966**	**8,540**
Deferred Liabilities	43	79	95	92	75	75	75	75
Total Loans	1,091	1,650	1,084	728	272	0	0	0
Capital Employed	**3,240**	**4,343**	**4,363**	**4,597**	**5,054**	**5,778**	**7,041**	**8,614**
Gross Block	1,625	1,888	2,280	2,407	2,526	2,926	3,226	3,526
Less: Accum. Deprn.	395	506	618	783	916	1,085	1,276	1,485
Net Fixed Assets	**1,230**	**1,382**	**1,662**	**1,624**	**1,610**	**1,841**	**1,951**	**2,041**
Capital WIP	111	88	35	12	1	0	0	0
Total Investments	**0**	**0**	**0**	**0**	**194**	**194**	**194**	**194**
Curr. Assets, Loans&Adv.	**3,365**	**5,079**	**5,053**	**5,613**	**5,360**	**6,190**	**7,728**	**8,975**
Inventory	1,574	2,486	2,525	2,609	2,047	2,156	2,302	2,645
Account Receivables	1,478	1,988	2,121	2,437	2,792	2,571	2,903	3,360
Cash and Bank Balance	34	149	28	22	76	964	1,949	2,310
Loans and Advances	279	455	379	545	445	499	574	660
Curr. Liability & Prov.	**1,466**	**2,205**	**2,386**	**2,652**	**2,111**	**2,447**	**2,832**	**2,596**
Account Payables	1,222	1,959	2,069	2,255	1,713	1,970	2,259	2,596
Provisions	245	246	317	397	398	477	573	0
Net Current Assets	**1,899**	**2,873**	**2,667**	**2,961**	**3,249**	**3,743**	**4,896**	**6,379**
Appl. of Funds	**3,240**	**4,343**	**4,363**	**4,597**	**5,054**	**5,778**	**7,041**	**8,614**

E: MOSL Estimates

Financials and Valuations

Ratios

Y/E March	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E
Basic (INR)								
EPS	**1.7**	**2.1**	**2.3**	**2.4**	**3.7**	**4.5**	**5.8**	**7.0**
Cash EPS	2.0	2.5	2.8	2.9	4.2	5.1	6.4	7.7
BV/Share	7.1	8.8	10.7	12.6	15.6	19.0	23.2	28.4
DPS	0.4	0.4	0.4	0.5	0.7	1.0	1.3	1.5
Payout (%)	23.9	19.3	17.3	23.0	22.7	26.7	27.2	25.7
Valuation (x)								
P/E				72.1	45.8	37.6	29.5	24.1
Cash P/E				59.2	40.3	33.5	26.6	22.0
P/BV				13.5	10.9	9.0	7.3	6.0
EV/Sales				3.0	2.8	2.6	2.2	1.9
EV/EBITDA				39.0	28.9	25.2	19.8	16.3
Dividend Yield (%)				0.3	0.4	0.6	0.8	0.9
Return Ratios (%)								
RoE	26.6	26.6	24.2	20.3	26.3	26.1	27.4	27.3
RoCE	20.1	21.0	20.1	19.4	24.9	25.9	27.4	27.3
Working Capital Ratios								
Asset Turnover (x)	3.0	3.1	3.5	3.8	3.7	3.4	3.2	3.0
Inventory (Days)	60	67	61	55	40	40	37	37
Debtor (Days)	55	52	50	51	54	47	46	46
Creditor (Days)	46	53	50	47	34	37	37	36
Working Capital Turnover (Days)	71	73	63	61	62	52	48	57
Leverage Ratio (x)								
Current Ratio	2.3	2.3	2.1	2.1	2.5	2.5	2.7	3.5
Debt/Equity	0.5	0.6	0.3	0.2	0.1	0.0	0.0	0.0

Standalone - Cash Flow Statement

Y/E March	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E
Oper. Profit/(Loss) before Tax	692	822	943	1,014	1,610	1,914	2,443	2,984
Depreciation	97	114	120	154	154	169	191	209
Interest and finance charges	162	180	191	191	66	34	0	0
Direct Taxes Paid	157	256	189	305	498	555	709	865
(Inc)/Dec in WC	30	-772	-23	-210	-116	395	-169	-1,122
CF from Operations	**823**	**88**	**1,042**	**845**	**1,215**	**1,957**	**1,756**	**1,206**
EO expense	14	17	66	42	55	0	0	0
CF from Operating incl EO	**837**	**105**	**1,108**	**887**	**1,270**	**1,957**	**1,756**	**1,206**
(inc)/dec in FA	-293	-256	-324	-122	-140	-399	-300	-300
Free Cash Flow	**544**	**-151**	**784**	**765**	**1,131**	**1,557**	**1,456**	**906**
(Pur)/Sale of Invest.	0	0	0	0	-194	0	0	0
Others	15	3	44	-11	90	0	0	0
CF from investments	**-277**	**-254**	**-280**	**-133**	**-244**	**-399**	**-300**	**-300**
(Inc)/Dec in Debt	-310	575	-591	-406	-574	-272	0	0
Interest Paid	-166	-190	-236	-196	-73	-34	0	0
Dividend Paid	-121	-121	-122	-157	-326	-363	-472	-545
CF from Fin. Activity	**-597**	**265**	**-950**	**-759**	**-973**	**-669**	**-472**	**-545**
Inc/Dec of Cash	**-38**	**116**	**-122**	**-6**	**53**	**889**	**984**	**361**
Add: Beginning Balance	71	34	149	28	22	76	964	1,949
Closing Balance	**33**	**150**	**27**	**22**	**75**	**964**	**1,949**	**2,310**

E: MOSL Estimates

NOTES

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