

April 06, 2020

V-Guard Industries Limited: Ratings reaffirmed at [ICRA]AA (Stable) and [ICRA]A1+

Summary of rated instruments

Instrument*	Previously Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund based	285.00	285.00	Reaffirmed at [ICRA]AA
Long-term unallocated	19.87	19.87	(Stable)
Short-term non-fund based	40.00	40.00	Reaffirmed at [ICRA]A1+
Total	344.87	344.87	

*Instrument details in Annexure - I

Rationale

The reaffirmation of ratings draws comfort from VGIL's strong financial profile characterized by conservative debt metrics; strong profitability and liquidity position; and its healthy improvement in profit margins in 9M FY2020. VGIL's healthy accruals and relatively low capex for its scale have resulted in minimal debt over the last four-five years; the company did not have long-term debt as on December 31, 2019 and has remained net debt negative since FY2016, with a surplus of Rs. 318.9 crore as on December 31, 2019. VGIL's liquidity position also remained strong, resulting in nil fund based working capital utilization (as on month ends) in the last one year. The company's operating margins have improved by 300 bps YoY to 10.8% in 9M FY2020 aided by accommodative commodity prices and VGIL's effective pricing strategy, favourable product mix and fixed cost saving initiatives. Further, VGIL continues to have healthy RoCE (27.0% in FY2019), supported by its asset-light business model and healthy profits. The company's financial profile is likely to remain strong going forward with no significant increase in debt levels anticipated over the medium term.

ICRA also draws comfort from the strong equity of the 'V-Guard' brand in the electrical and electronics space, especially in South India, the company's market leadership in stabilizers and its established presence in other products such as water heater, solar water heater and house wiring cables. The company has also diversified its product portfolio with periodic inclusion of adjacent products over the last several years. Although VGIL's revenues remain concentrated in the South-Indian market, ICRA notes that the company is undertaking focussed initiatives to improve its geographic diversification and that the proportion of revenues from non-south markets has improved over the last few years from 25% in FY2013 to 40% in 9M FY2020.

The Covid-19 outbreak and consequent lockdown has significantly impacted demand for consumer durables with closure of retail outlets in Mar 2020 and April 2020. Further, it will impact demand for consumer durables in H1 FY2021 due to the continued closure of retail outlets till the lockdown ends, adverse economic impact and pull down in consumer confidence. This is expected to impact VGIL's revenues. The eventual duration of Covid-19 and its impact on consumer confidence will determine the extent of demand fallout. Nevertheless, VGIL's strong liquidity position will support the company in meeting its business and financial obligations comfortably, should there be an extended lockdown and prolonged demand slowdown. VGIL's products witness intense pricing competition from other incumbents. Also, being in the B2C space, constant focus on advertising/branding, discounts/schemes and competitive trade margins are critical for maintenance of sales and brand recall; reduction in any of these could impact sales.

The company continues to explore opportunities for inorganic growth. ICRA will evaluate the impact of such investments on a case-by-case basis.

Key rating drivers and their description

Credit strengths

Established presence in electrical and electronic products; strong brand equity and diversified product portfolio – ‘V-Guard’ is a well-known brand in the electrical and electronics space, especially in South India, with presence for over four decades. VGIL commenced operations with its first product – stabilizers in 1977 and has gradually expanded its product profile over the years to seventeen products as on date. It is the market leader in stabilizers with about 36% market share and a strong player in other products such as water heater, solar water heater and house wiring cables.

Increasing penetration into non-south markets resulting in gradual geographical diversification – VGIL has predominantly been a South-India based player since inception. Although the company continues to derive majority of its revenues from the five southern states, VGIL’s presence in non-south markets has increased over the years, aided by focussed initiatives. The company derived about 40% of its revenues from non-south markets in 9M FY2020, as against 25% in FY2013.

Improvement in operating margins in 9M FY2020; healthy profitability – The company’s operating profit margin improved by 300 bps YoY to 10.8% in 9M FY2020 aided by accommodative commodity prices and VGIL’s effective pricing strategy, favourable product mix and fixed cost saving initiatives. VGIL also continues to have healthy RoCE (27.0% in FY2019), aided by its asset-light business model, negligible debt levels and healthy profits.

Conservative debt metrics and strong liquidity position – VGIL’s debt and liquidity position has improved significantly in the last four-five years, attributed to its healthy accruals and relatively modest capex. The company’s gross debt remained minimal at Rs. 14.5 crore as on December 31, 2019; net debt stood at a negative Rs. 318.9 crore as on December 31, 2019 (with cash and liquid investments of Rs.333.3 crore). The negligible gross debt and healthy accruals have resulted in strong capital structure and coverage metrics. VGIL’s interest coverage stood at 66.1 times for 9M FY2020 while its Net Cash Accruals (NCA)/Total Debt (TD) stood at 1220% for 9M FY2020. The company’s fund based working capital utilization was also nil in the last one year (as on month ends).

Credit challenges

Muted demand environment and potential revenue pressure due to Covid-19 related lockdown - The Covid-19 outbreak and consequent lockdown has significantly impacted demand for consumer durables with closure of retail outlets in Mar 2020. Further, it will impact the consumer durables demand in H1 FY2021 due to the continued closure of retail outlets till the lockdown ends, adverse economic impact and pull down in consumer confidence. This is expected to impact VGIL’s revenues and the eventual duration of Covid-19 will determine the extent of demand fallout. Nevertheless, VGIL’s strong liquidity position will support the company in meeting its business and financial obligations comfortably, should there be an extended lockdown and prolonged demand slowdown.

Intense competition; vulnerability of profit margins to unfavourable forex movements and raw material price fluctuations – VGIL witnesses intense pricing competition across most product categories by virtue of presence of several organized and unorganized players. Also, VGIL’s margins are susceptible to unfavourable forex movements and commodity/crude price fluctuations; the former by virtue of the company being a net importer (Rs.258.3 crore of net imports in FY2019). However, the company’s effective pricing mechanism ensures stability in the company’s overall profit margins and mitigates these risks to a large extent.

Constant focus on sales promotion activities and advertisements required – Akin to other B2C businesses, below-the-line sales promotion activities such as discounts/schemes and competitive margins to retailers are critical for VGIL for maintaining sales volumes. Equally important is constant spend on advertising and branding for brand recall. VGIL spends about Rs. 65-70 crore a year on an average on advertisements, business promotion activities and cash discounts. Further, while VGIL launches new products periodically to meet increasing customer requirements and technological advancements, the company also revamped its logo and tagline in FY2018 for contemporary relevance.

Liquidity Position: Strong

VGIL's liquidity is strong with positive free cash flows in FY2019; cash and bank balances and liquid investments of Rs. 333.3 crore as on December 31, 2019; and undrawn fund based working capital limits of Rs. 175.0 crore (as of March 25, 2020). Also, VGIL does not have long-term debt and the company has had nil utilization of its fund-based working capital lines (as on month ends) in the last twelve months. In relation to these sources of cash, VGIL has done a capex of Rs. 120.0 crore for FY2020 and has total commitment ~Rs. 60.0 crore for FY2021 and FY2022, to be funded through internal accruals. Overall, ICRA expects VGIL to be able to meet its medium-term commitments through internal sources of cash and yet be left with healthy cash/liquid investment surplus.

Rating sensitivities

Positive triggers – An upgrade is unlikely in the near term, given the weak macro environment, accentuated by the Covid-19 pandemic. However, ICRA could upgrade VGIL's ratings if its RoCE improves to 25% on sustained basis, while maintaining its strong debt metrics.

Negative triggers – Downward pressure on VGIL's rating could emerge with sharp deterioration in the earnings; or, significant rise in net debt either due to working capital stretch or significant capex. VGIL is open to acquisitions in related verticals; the acquisitions, upon materialization, would be evaluated on case-by-case basis.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation / Standalone	The ratings are based on the consolidated financial profile of the company. Details of subsidiary provided in Annexure-2

About the company:

V-Guard Industries Limited (VGIL/the company) is an established player in the electrical and electronics industry, with strong market position in South India. The company has a diversified product portfolio across three segments: electronics – such as stabilizers and digital UPS; electricals – such as house wiring cables, water heaters, solar water heaters, pumps, fans, switches, air cooler and modular switches; and consumer durables – such as kitchen appliances such as gas top, induction stoves, rice cookers and mixers. From being a small-scale stabilizer company four decades back, VGIL has diversified its presence over the years and across product segments. Also, the company works on an asset-light manufacturing model for most of its products except cables, water heaters and solar water heaters; about 42% of the overall requirements are currently outsourced.

VGIL is currently managed by Mr. Mithun Chittilappily, son of the founder Chairman, Mr. Kochouseph Chittilappily. Apart from VGIL, the promoters have interest in three other entities – V-Star Creations Private Limited, Wonderla Holidays Limited (rated [ICRA]AA- (Stable)/[ICRA]A1+) and Veegaland Developers Private Limited.

Key financial indicators (audited)

Consolidated	FY2018	FY2019
Operating Income (Rs. crore)	2,325.7	2,594.0
PAT (Rs. crore)	135.1	168.0
OPBDIT/ OI (%)	8.2%	8.8%
RoCE (%)	26.5%	27.0%
Total Outside Liabilities/ TNW (times)	0.6	0.5
Total Debt/ OPBDIT (times)	0.04	0.1
Interest coverage (times)	93.8	129.0
Debt Service Coverage Ratio (times)	29.7	45.3

Source: Company, ICRA research; OPBDIT: Operating Profit before Depreciation, Interest and Taxes; PAT: Profit After Tax; RoCE: Return on Capital Employed; TNW: Tangible Net Worth

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2021)		Chronology of Rating History for the past 3 years			
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating April 06, 2020	Date & Rating in FY2020 May 10, 2019	Date & Rating in FY2018 Mar 29, 2018	Date & Rating in FY2017 Oct 18, 2016
1 Long-term fund based	Long Term	285.00		[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Positive)
2 Long-term unallocated	Long Term	19.87					
3 Short-term non-fund based	Short Term	40.00		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
CC				285.00	
Long-term unallocated	NA			19.87	[ICRA]AA (Stable)
LC/BG				40.00	[ICRA]A1+

Source: V-Guard Industries Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Guts Electro-Mech Limited	74%	Full consolidation

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