DIXON TECHNOLOGY

BUY

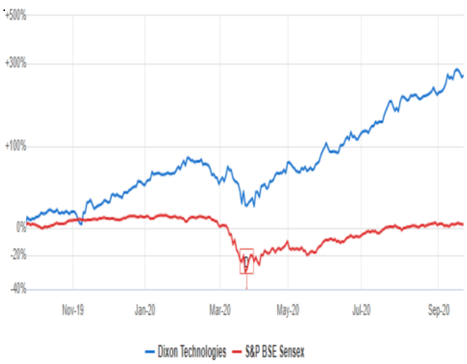
Equity Research Report

20 September 2020

CMP: ₹ 9401 (20/09/2020)	TARGET PRICE: ₹ 12000 Months: 12 Months	RATING: BUY	Upside: 28%

Company details

Market Cap	**₹ 10,877 Cr**
52 Weeks High/Low	**₹10289.50 / ₹ 2662.55**
Stock P/E	**110.40**
EPS	**104.15**
Dividend Yield	**0.04%**



Price Peformance (%)

	1m	3m	YTD	12m
Absolute	19.26	68.27	147.43	268.89

ShareHolding Pattern (%)

Promoter	36.17
DII	10.76
FII	22.95
Others	30.12

About the Company:

Founded by Mr. Sunil Vachani, Dixon Technologies (India) Limited is a leading manufacturer of products for key consumer durable brands in India. It currently has 10 state of the art manufacturing units, four in Noida (Uttar Pradesh) and three each in Dehradun (Uttarakhand), and Tirupati (Andhra Pradesh). The company is engaged in manufacturing products with capacity of 3.4 million LED TVs per annum in the consumer durables segment, 20 mn LED bulbs per month in the lighting segment, 1.2 million washing machines per annum in home appliances, mobile phones and 7 lakh CCTVs and 1.5 lakh DVDs p.m. in security devices segment in India. It also provides solutions in reverse logistics i.e. repair and refurbishment services of set top boxes, mobile phones and LED TV panels. Based on a report “Project Rise” by Frost & Sullivan India, Dixon Technologies is the largest home-grown design-focused products and solutions company.

While Q1FY21 was harmed by the lockdown, Dixon keeps on driving the oversee ment's self-reliance measures to fabricate shopper durables. It is very much positioned to profit by the PLI scheme, for which submissions have been made. The ongoing notice putting TV imports in the confined class additionally forecasts well for Dixon and supports client options. Yearly imports in item classes where Dixon works are '1.38trn (at a 11% CAGR over FY11–19) offers an expanded open door which can be tended to successfully by just a couple of makers in India. Development of Reliance Jio can facilitate in-wrinkle Dixon's addressable set-top boxes and be another '10bn open door holding back to unfurl in coming years.

Dixon is the significant recipient of the administration's emphasis on import substitution, helped by great arrangement backing and its attention on making homegrown assembling monsters equipped for being incorporated in the flexibly chain of worldwide OEMs. In light of these superpatterns, which can unfurl in FY22 and FY23.

With Normalcy picking up from Jul20, post-tepid Q1FY21. Revenue dipped 55% y/y in the Covid impacted Q1, resulting in the EBITDA margin being compressed to 3.3%, compared y/y. PAT dipped 93% y/y to 16m. However, volumes have started to ramp up from Jul20 while the pace of customer addition continues to be robust.

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Quarterly Financials (Figures in Rs. Crores)

	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Sales	597.84	592.68	738.85	793.97	858.82	1,146.92	1,401.98	993.81	857.41	516.94
Expenses	570.39	566.90	706.11	754.95	821.32	1,094.34	1,338.92	942.28	801.53	500.05
Operating Profit	27.45	25.78	32.74	39.02	37.50	52.58	63.06	51.53	55.88	16.89
Other Income	1.61	1.47	1.83	0.58	1.88	0.57	2.83	1.83	-0.03	0.21
Depreciation	4.50	4.60	5.00	5.88	6.17	7.61	8.17	9.84	10.91	9.25
Interest	4.29	5.13	4.91	6.50	8.80	9.85	9.37	8.06	7.68	5.69
Profit before tax	20.27	17.52	24.66	27.22	24.41	35.69	48.35	35.46	37.26	2.16
Tax	6.17	4.76	8.23	9.58	7.88	12.11	5.31	9.16	9.68	0.56
Net profit	14.10	12.76	16.43	17.64	16.53	23.58	43.04	26.30	27.58	1.60

Revenue declined by 54.9% y-o-y to Rs 517 crores largely owing to COVID-19 which impacted revenues across all business verticals as manufacturing facilities remained shut for a significant part of the quarter. All segments were down in the range of 32-80% yoy. Margins were at 3.3% due to lower scale of operations and under absorption of overheads, which led to a miss in the operating leverage for the company. PAT came in at Rs 16mn down 94%.

Expect working capital to improve from Q2 onwards. Operating profit breaks 68% due to COVID 19 lockdown.

Cash Flows Annual (Figures in Rs. Crores)

	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20
Cash from Operating Activity	3.91	44.90	10.40	44.50	42.25	52.88	67.88	-3.06	237.34
Cash from Investing Activity	-4.18	-8.63	1.24	-22.27	-21.61	-43.42	99.72	-63.79	-98.75
Cash from Financing Activity	0.69	-36.72	-12.76	-22.27	-20.06	-8.42	41.79	68.62	-57.36
Net Cash Flow	0.42	-0.45	-1.12	-0.04	0.59	1.04	9.95	1.76	81.23

Balance Sheet (Figures in Rs. Crores)

	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20
Equity Share Capital	3.1	3.1	3.1	3.1	3.1	10.99	11.33	11.33	11.57
Reserves	51.91	56.53	68.59	79.83	117.73	186.08	303.65	366.89	529.76
Borrowings	119.43	94.34	93.59	82.28	79.6	42.95	44.63	141.24	86.67
Other Liabilities	99.21	122.65	125.97	159.14	216.79	548.65	605.93	971.39	1068.96
Total	273.65	276.62	291.25	324.35	417.22	788.67	965.54	1490.85	1696.96
Net Block	78.98	79.85	84.22	97.01	123.59	136.56	179.05	240.94	414.08

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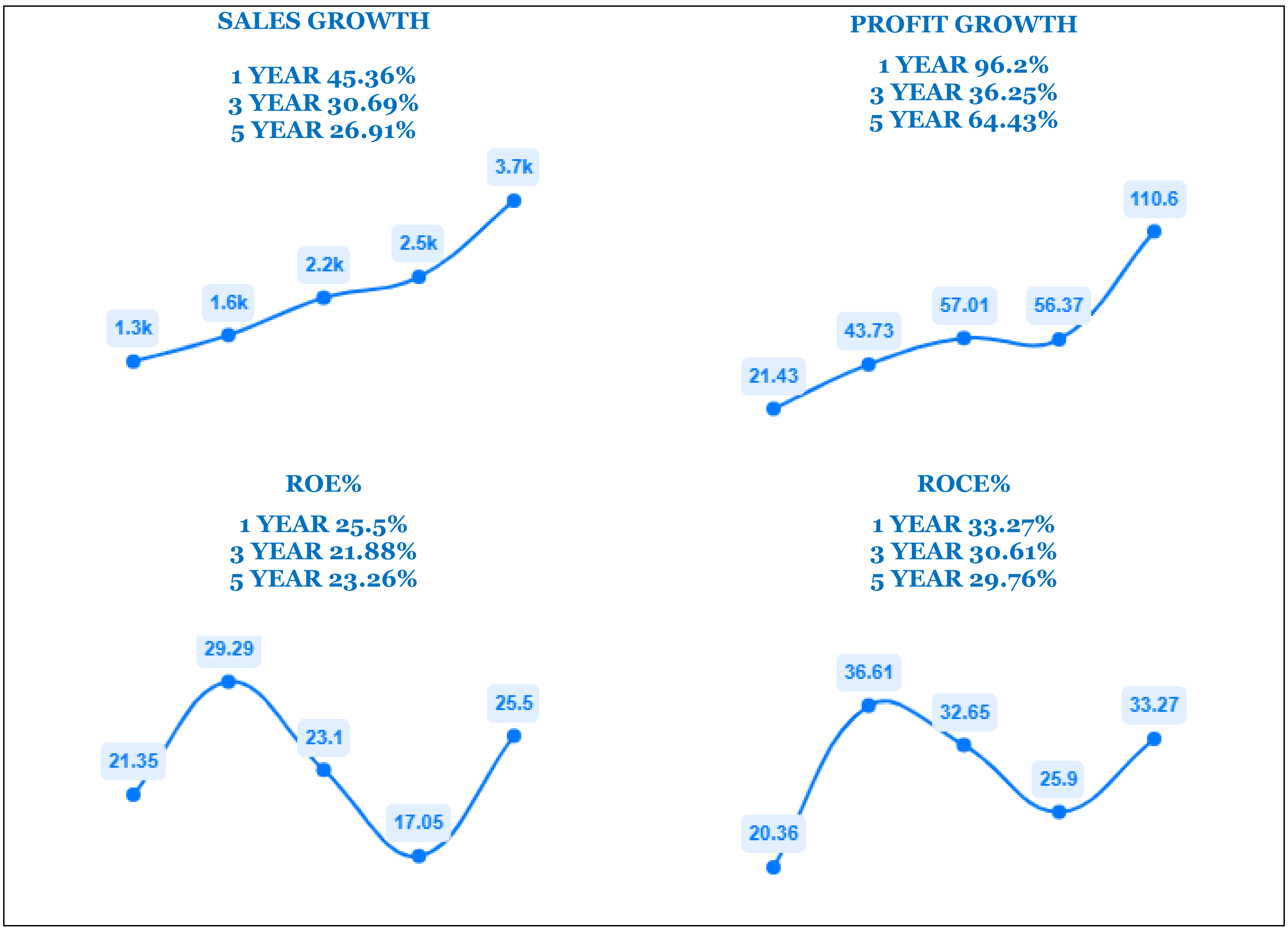
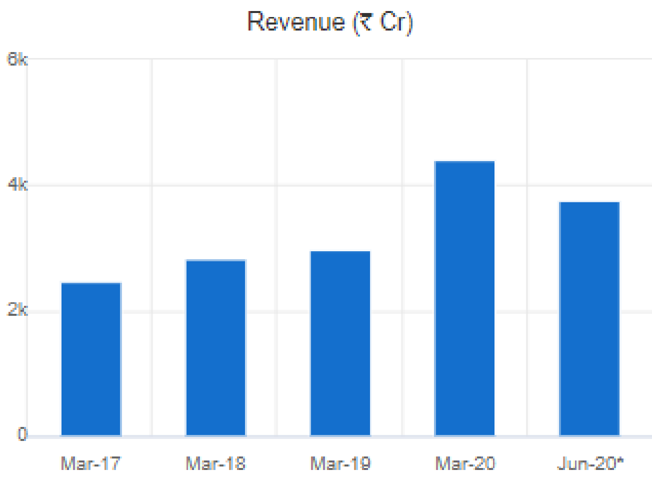
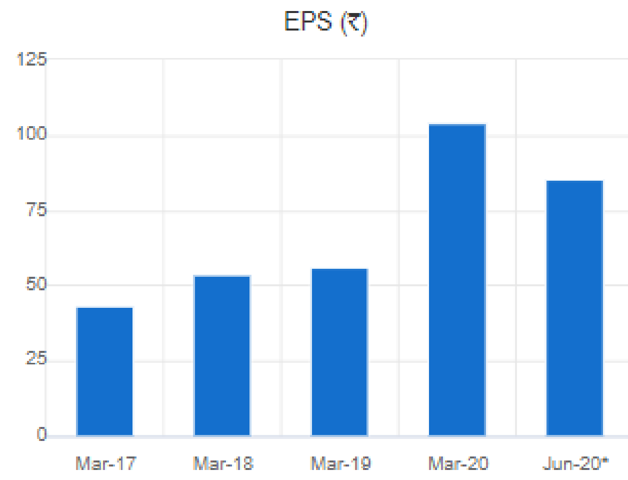
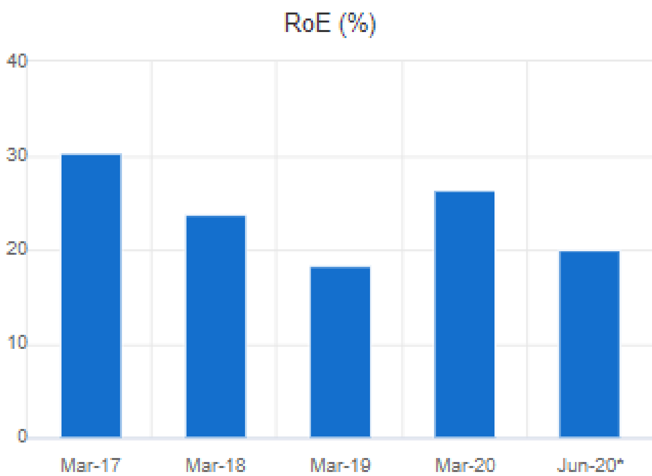
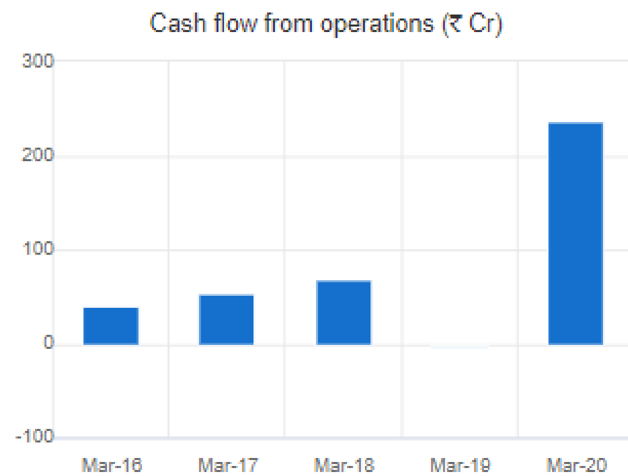
Capital Work in Progress	3.82	5.22			0.01	1.96	15.94	18.77	9.55
Investments	4.38	6.55	6.32	6.03	0.1		11.12	7.61	
Other Assets	186.47	185	200.71	221.31	293.52	650.15	759.43	1223.53	1273.33
Total	273.65	276.62	291.25	324.35	417.22	788.67	965.54	1490.85	1696.96
Receivables	56.61	41.89	46.39	54.39	87.61	280.21	298.5	516.74	515.12
Inventory	73.72	88.59	93.33	113.03	136.28	282.2	322.34	408.36	497.84
Cash & Bank	5.68	5.79	4.63	6.89	7.46	15.33	44.12	36.72	100.16











COVID-19 impacts performance:

Gross margin improved by 59 bps y-o-y to 12%. However adverse operating leverage led to EBITDA margin contraction of 132 bps y-o-y to 3.3% (173 bps below our expectation of 5%). Employee expense and other expenses increased by 134 bps and 56 bps to 3.8% and 4.9% of sales respectively. EBITDA was lower by 67.9% y-o-y to Rs 17 crore. Lower operating profit led to a significant decline in PAT, lower by 93.2% y-o-y to Rs 1.6 crore.

Revenue lowered across all segments, while margin improves in consumer electronics and mobile phones: Revenue in key business verticals such as consumer electronics, lighting, home appliance and mobile phones was down by 31.9%, 76.0%, 75.6% and 63.1% yoy to Rs 347 crore, Rs 78 crore, Rs 24 crore and Rs 53crore respectively, whereas revenue in security services and reverse logistics was down by 80.3% and 41.9% to Rs 13 crore and Rs 1 crore respectively. The absolute profitability was lower across business verticals owing to lower revenue. However, consumer electronics and mobile phones revenues improved by 26 bps and 158 bps y-o-y to 2.5% and 3.8% respectively while home appliances revenues contracted by 914 bps yoy to 1.7%.

Expansion to be funded through internal accruals, eyes on PLI scheme: A lean balance sheet, expanded capacity in consumer electronics and home appliance coupled with PLI scheme in mobile phones is likely to drive revenue growth momentum while margin is set to expand due to economies of scale and automation in lighting. The company has filed two applications under the PLI scheme for which an agreement has already been signed with one of the customers and the second agreement is under final stages and will be signed soon. The company has guided for a routine capex of Rs 80-90 crores. However, PLI schemes would require additional capex of Rs 50 crore per scheme. The company has a strong operating cashflow generating capability and aims to meet its capex funding through internal accruals. However, in case there is a need to raise funds through borrowings it has a comfortable net debt/ equity and net debt/ EBITDA position.

Outlook

Management remains confident of strong growth in the medium term as it has strong visibility in the order book in TV, Washing Machines, Mobile phones and Set-top boxes. The strong order book has resulted in Dixon expanding its capacity in TV from 4.4mn units to 5.5mn units annually and from 100k units/month to 120k units/month in Washing Machine. Management also remains upbeat on the PLI scheme and termed it to be a big game-changer as it has already managed to sign an MoU with a large brand. Return ratios to improve from FY22E on the back of increased contribution from Mobile segment, which has higher return profile, driven by strong asset turn.

Positives	Negative
• Operating at healthy utilisation level across key business verticals • Order book remains healthy • Profitability improved in consumer appliances and mobile phones • Company is deceasing its debt only 62.48 Cr left to be paid • ROE of 21.88% over the past 3 years • ROCE of 30.61% over the past 3 years • Cash Conversion Cycle of 9.55 days	• Sustained macro slowdown impacting discretionary demand • Muted demand for consumer durables for a longer period.

My Call:

I keep up Positive view and expects an upside of 20-25% over next one year. I expect income and profit CAGR of 40% and 45% during next couple of years, as we factor in income commitment from PLI conspire in portable. The organization likewise produced better yield proportions as it works on an advantage light model and has a proficient working capi-tal cycle. Purchase on plunges.

Motivation to put resources into Dixon

With a solid 17% CAGR sought after during FY16-21 in the consumer electronics market in India, local manufactures is expected to get a lift from it. The EMS business is required to observe a higher CAGR as players scale up their offerings from assembly only to design led manufacturing. With an administration position in key business fragments, Dixon Technologies, stands to profit in the electronic re-appropriating business. The organization's Tirupati office is required to add another measurement to the development possibilities as it will invasion into new business vertical, grow item arrangement of existing business verticals and infiltrate further into southern Indian market by producing collusion with OEMs and include them as customers. Additionally, eyes are on the PLI schemes in the cell phones vertical for which the organization has files two applications.

Solid clients' expansion; enhancement and fungibility are Dixon's qualities. Dixon's client acqui-sition and item profile have gotten more grounded as of late. It has won Voltas Beko as client in SAWMs in the 5-8.5 kg territory, and Samsung for FAWMs and SAWM. It has begun creation for Samsung highlighted telephones and PDAs.

It has Jio as client for set top boxes, which it will use for underutilized security frameworks limit in Tirupati. In the lighting section, Dixon has Havells, Crompton and HPL, along with all the significant brands in its kitty. A key preferred position for Dixon is its expansion across clients, items and item fungibility which makes manufacturing adaptable. At the point when it isn't making security frameworks, it can utilize that line to make set top boxes or clinical units. Additionally, its biggest OEM in TVs has a solid online deals model, which will help them in the midst of social separating. These components have helped them de-hazard their plan of action in difficult stretches.

Government push on EMS is a developing open door for Dixon is partaking in the PLI schemes which offers motivating forces to help homegrown assembling of mobiles. It is now in conversations with huge clients for the two fares and homegrown business sectors. According to standards sub $200 telephones, which is 70% of Indian market, must be finished by homegrown organizations and this puts Dixon on solid balance. The absolute capex visualized under this is Rs 2bn more than 4 years, with Rs 500mn expected to be spent in FY21 (of its complete expected FY21 capex of Rs1.2-1.3bn).

Solid possibilities ahead, anyway downsize on valuations Given new client acquisitions, developing business with existing clients, and increment in the ODM blend, we anticipate Dixon's business/EPS to develop at a CAGR of 25%/30% over FY20-22E. Dixon has various development alternatives, both current and future remembering forthcoming open doors for electronic assembling which is all hard to catch in close to term income estimates in FY20-22E.

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