

Veto Switchgears and Cables Ltd

Industry	Scrip Code	CMP	Recommendation	Add on dips to	Target	Time Horizon
Electrical Equipment	VETSWIEQNR	Rs. 109	Buy at CMP and add on declines	Rs. 86-95	Rs. 129-155	2-3 quarters

We had issued a stock note (see link <http://hdfcsec.com/Share-Market-Research/Research-Details/StockReports/3015694>) on Veto Switchgears & Cables on Jan 04, 2016 (CMP Rs.102) suggesting a buy at the CMP and add on dips to Rs.77-90 band for sequential targets of Rs.129 and Rs.155 in 3-4 quarters. Post the issue of the report, the stock made a high of Rs.124 on Jan 12, 2016, post which it fell to Rs.85.15 on Apr 01, 2016 (thus entering our add band). We reiterate a buy on the stock considering the recent updates given below.

Recent Updates

- Recently Veto has launched Cooler Kit (Fan) in the market after the previous launches of Fans, CFL Bulbs and LED. It is planning to launch Geyser in next couple of months. More products under the same brand will enable Veto to capture a larger share of spending by consumers and give retailers a bigger bouquet to offer to their customers. Veto plans to enhance its capacity utilization from its two plants at Haridwar and Vasai going forward.
- Apart from domestic business of Veto, the group has an associate company in Dubai, JMTC FZCO which is trading electrical goods. Veto formed a 100% subsidiary in Dubai on Oct 2015 to take over the business of JMTC FZCO gradually without diluting equity.
- Apart from this, another subsidiary of the domestic business Veto Electricals Pvt Ltd is expected to commence business in FY17 (from June 2016 onward), by exporting electrical goods from its new plant in Jaipur (in Mahindra SEZ).
- Due to this consolidation, we may see a notable jump in Revenues and PAT from FY17 onwards. The management has also guided that the domestic business is likely grow at a CAGR of 20% due to expansion of territories and products. We expect overall business could grow at a CAGR of 52% (FY16E-FY19E) post consolidation of Dubai based promoter group company and business from SEZ (Jaipur).
- Veto Switchgears and Cables Ltd (Veto) has dealer network of ~2,500 across India compared to 2,314 dealers in Q3FY16. However, company plans to expand its dealer network across India and increase its network count to 5,000 in next 2-3 years. Apart from its main state Rajasthan, Veto has decent presence in Gujarat, Haryana, Punjab, Uttarakhand, J&K. Apart from these Jharkhand, MP, Assam, Kerala are some other states where it has made some inroads.
- Rajasthan contributes ~70% of total revenue (though fallen from 90%+ a couple of years back) while the rest of India contributes the balance. The management has guided at bringing the proportion of Rajasthan to ~50% in the next 2-3 years by expanding Veto's presence across, Gujarat, Maharashtra, Uttarakhand, UP, Kerala, Himachal Pradesh, NCR, MP, J&K and other unrepresented areas.
- Veto is looking to expand its business across India and follow the industry standard by appointing distributors across India. This will help Veto increase the scale of the business and lower the working capital requirement. Veto plans to appoint 100 distributors across India in the next two years from the current ~6. This will help to reduce its working capital cycle going forward. Currently it has a working capital cycle of ~six months, which is high compared to Crompton Greaves (~three months) V-Guard (~two months) and Havells (~ one month). Further, consolidating its Dubai subsidiary numbers could also lead to lower working capital cycle as that subsidiary works on tighter working capital cycle.
- Competition with new players in Rajasthan region could be a concern for the company going forward. Recently RR Poly has entered in Rajasthan market and sells products at lower price points than Veto. However, given its strong distribution network, product quality and advantage of early entry, company is confident to face the challenges. Slowdown in the industry due to economic conditions could be another cause for concern. Heightened competition from existing and new players may hamper the plan of Veto to record the growth it has anticipated. Any slowdown/postponement in the transfer of business from promoter owned Dubai company to the listed Veto could also hamper the growth rates for Veto.

- Veto expects to benefit from introduction of GST (as unorganized sector will lose its benefit). Further the boost to affordable housing provided by the Govt will also likely result in better sales growth for Veto over the medium term.
- Q4 is generally a good quarter for Veto in domestic market. Veto could also distribute 20-25% of its PAT by way of dividend (it has already paid out 5% interim dividend in 28th Jan 2016). The Board will consider final dividend when it meets to adopt results for FY16. This could also increase the attractiveness of the stock.

View and Valuation:

With positive outlook for the sector in the medium to long term, Veto Switchgear could post 52% CAGR of sales growth for FY15-FY19E going by the expectations of the management, the recent restructuring of Dubai business and contribution from its new Jaipur SEZ subsidiary (expected from FY17).

We have revised the estimates for FY16, FY17 and FY18 to factor in delayed sales transfer from Dubai group Company and higher overall margins.

Considering its expected growth in revenue, margin expansion and healthy return ratios going forward, we feel investors could buy the stock at the CMP and add on dips to Rs.86-95 band (5-5.5x FY18E EPS) for sequential targets of Rs 129 and Rs.155 (7.5x and 9x FY18E EPS) over the next 2-3 quarters. At the CMP of Rs 109 the stock trades at 6.3x FY18E EPS. If management delivers as per anticipation, the stock could over 4-6 quarters touch Rs.207.6 (12x FY18E EPS).

Financial Summary

Particulars (Rs cr)	Q3FY16	Q2FY16	FY15	FY16OE	FY16RE	FY17OE	FY17RE	FY18OE	FY18RE
Net Sales	29.1	28.1	97.30	170.0	170.0	348.7	283.7	453.2	423.2
EBITDA	4.7	4.8	15.2	21.5	21.6	40.8	34.2	54.2	51.0
APAT	-0.9	2.4	7.1	15.4	16.5	20.0	20.1	28.6	31.7
Diluted EPS (Rs)	-0.5	1.31	3.9	8.4	9.0	10.9	11.0	15.6	17.3
P/E (x)			27.9	13.0	12.1	10.0	9.9	7.0	6.3
P/BV (x)			2.7	2.3	2.3	2.0	2.1	1.8	1.8

(Source: Company, HDFC sec)

Financials (Consolidated)

Income Statement

Particulars, Rs in Cr	FY14	FY15	FY16E	FY17E	FY18E
Net Sales	94.5	97.3	170.0	283.7	423.2
Cost of materials consumed	68.5	64.5	112.2	193.7	290.5
Employee benefits expense	5.3	6.0	10.5	18.4	27.5
Other expenses	9.9	11.6	25.7	37.5	54.2
Total Expenses	83.7	82.1	148.4	249.6	372.2
EBITDA	10.8	15.2	21.6	34.2	51.0
Depreciation and Amort- exp	1.2	2.0	2.4	2.9	3.3
EBIT	9.6	13.2	19.2	31.3	47.7
Other income	0.9	0.5	0.6	0.9	0.8
Finance costs	2.0	4.0	5.4	8.6	11.2

Cash Flow

Particulars, Rs in Cr	FY14	FY15	FY16E	FY17E	FY18E
EBT	8.4	9.8	14.4	23.6	37.2
Depreciation and Amort-	1.2	2.1	2.4	2.9	3.3
Interest /Dividend paid	2.0	4.0	5.4	8.6	11.2
Other Adjustment	-0.5	-0.2	3.2	-8.3	-14.2
(Inc)/Dec in working Capital	-9.0	-15.8	-40.9	-47.7	-41.0
Tax Paid	-1.8	-1.9	-3.2	-3.5	-5.6
CF from Operating Activities	0.4	-2.1	-18.7	-24.5	-9.1
Capital expenditure	-12.9	-3.2	-8.0	-6.0	-6.0
Proceeds from sale of F. Asst	0.0	0.8	0.5	0.3	0.5
(Purchase)/Sale of Investment	0.0	2.7	3.6	-0.3	-0.7

EBT	8.4	9.8	14.4	23.6	37.2
Tax	2.3	2.6	3.2	3.5	5.6
PAT	6.1	7.1	11.3	20.1	31.7
Extra ordinary Item	0.0	0.0	-5.2	0.0	0.0
PAT Adjusted	6.1	7.1	16.5	20.1	31.7
EPS	3.3	3.9	9.0	11.0	17.3

Others	-12.8	2.9	0.4	-0.3	-0.4
CF from Investing Activities	-25.7	3.2	-3.9	-6.0	-6.2
Inc/(Dec) in Debt	31.2	-0.8	37.0	60.0	28.0
Dividend and Interest Paid	-2.0	-4.0	-8.1	-12.9	-17.2
CF from Financing Activities	29.1	-4.8	28.9	47.1	10.8
Net Cash Flow	3.8	-3.7	6.2	16.5	-4.5
Opening Balance	1.4	5.2	1.6	7.8	24.4
Closing Balance	5.2	1.6	7.8	24.4	19.8

(Source: Company, HDFC sec)

Balance Sheet

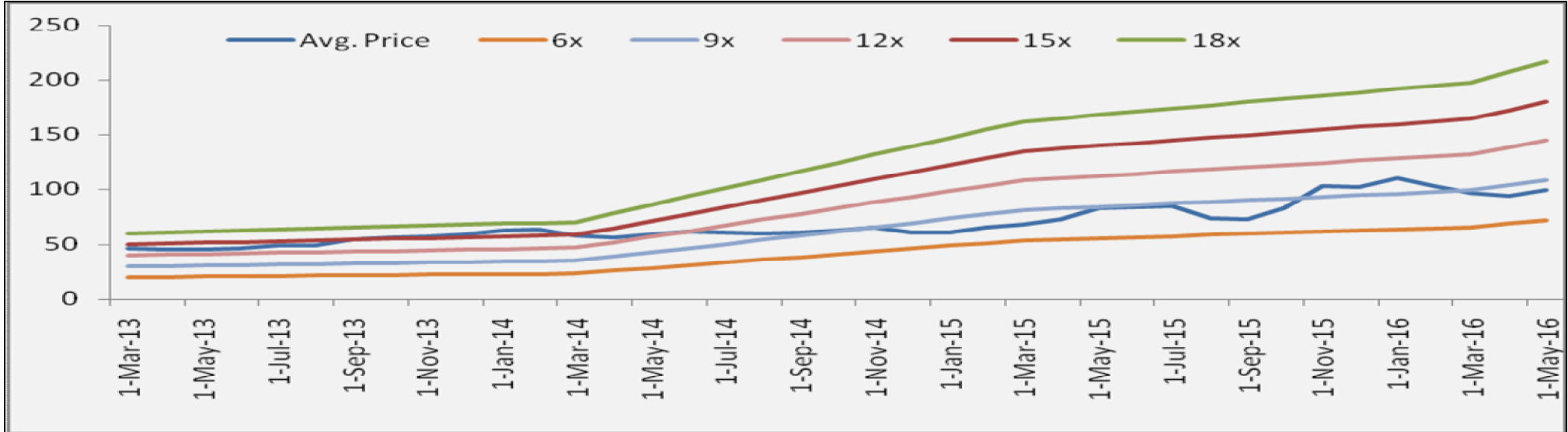
Particulars, Rs in Cr	FY14	FY15	FY16E	FY17E	FY18E
EQUITY AND LIABILITIES					
Share capital	18.3	18.3	18.3	18.3	18.3
Reserves & surplus	47.2	54.3	68.0	83.7	109.4
Shareholders' Funds	65.5	72.7	86.4	97.3	112.9
Minority Interest	0.01	0.0	0.0	0.0	0.0
Long-term borrowings	6.3	6.3	8.3	28.3	31.3
Deferred tax liabilities (Net)	0.1	-0.2	-0.2	-0.2	-0.2
Long-term provisions	0.0	0.1	0.1	0.1	0.1
Non-current liabilities	6.5	6.2	8.2	28.1	31.1
Short-term borrowings	29.1	28.4	63.4	103.4	128.4
Trade payables	7.2	10.3	21.0	31.1	46.4
Other current liabilities	3.7	3.6	3.9	4.3	4.8
Current liabilities	40.0	42.2	88.2	138.8	179.5
Total	112.0	121.0	182.8	264.2	323.5
ASSETS					
Fixed assets	21.5	21.7	29.7	35.7	41.7
Long - term loans and advances	16.4	17.9	14.3	14.6	15.4
Non-current assets	37.9	39.7	44.1	50.4	57.1
Current investments	0.9	0.5	23.0	14.0	0.0
Inventories	25.8	25.0	39.6	66.1	92.8
Trade receivables	30.3	33.4	46.6	85.5	127.5
Cash and bank balances	12.9	2.2	7.8	24.4	19.8
Short - term loans and advances	4.2	3.7	3.3	3.7	4.0
Other Current Assets	0.0	16.7	18.4	20.2	22.2
Current assets	74.1	81.5	138.7	213.8	266.4
Total	112.0	121.1	182.8	264.2	323.5

Key Ratios

Particulars, Rs in Cr	FY14	FY15	FY16E	FY17E	FY18E
No of Equity Shares-cr	1.8	1.8	1.8	1.8	1.8
Enterprise Value-cr	222.1	231.9	263.3	306.7	339.2
EPS	3.3	3.9	9.0	11.0	17.3
Cash EPS (PAT + Depreciation)	4.0	5.0	10.3	12.5	19.1
Book Value Per Share(Rs.)	35.8	39.7	47.2	53.1	61.7
PE(x)	32.8	27.9	12.1	9.9	6.3
P/BV (x)	3.0	2.7	2.3	2.1	1.8
Mcap/Sales(x)	2.1	2.1	1.2	0.7	0.5
EV/EBITDA	20.5	15.3	12.2	9.0	6.7
EBITDAM (%)	11.4%	15.6%	12.7%	12.1%	12.1%
PATM (%)	6.4%	7.3%	9.7%	7.1%	7.5%
ROCE (%)	10.4%	12.8%	12.5%	14.1%	17.8%
RONW (%)	9.3%	9.8%	19.1%	20.6%	28.0%
Debt-Equity	0.5	0.5	0.8	1.4	1.4

(Source: Company, HDFC sec)

One Year forward P/E Chart



(Source: Company, HDFC sec)

Fundamental Research Analyst: Abdul Karim (abdul.karim@hdfcsec.com)

HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066
Website: www.hdfcsec.com Email: hdfcsecetailresearch@hdfcsec.com.

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