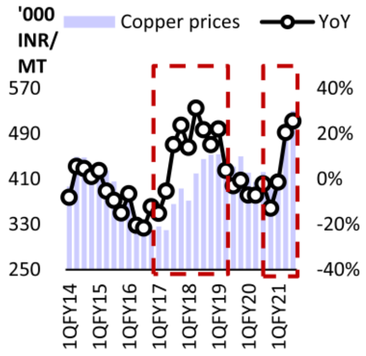
Sector Update | 15 December 2020

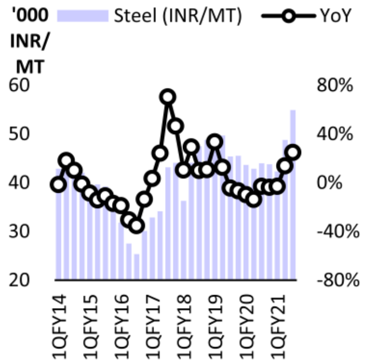
Consumer Durables

Copper prices up 25% YoY in 3QFY21 till date



Source: MOFSL, Bloomberg; *till date

Steel prices up 25% in 3QFY21 till date



Source: MOFSL, Bloomberg; *till date

Ranking various categories with the ability to undertake price hikes

Category	Relative ability to take prices hikes	Impact on companies
Cables	Easy	Positive for HAVL, KEII, POLYCAB, FNXC
Electricals (Fans/ Lighting)	Moderate	Neutral impact for HAVL and CROMPTON
White Goods	Difficult	Negative for VOLT, BLSTR, and HAVL

Source: MOFSL
*KEII, POLYCAB, FNXC (Not rated)

Commodity price inflation warrants price hikes

The recent price increases in various commodities have emerged as a key input price risk to the sector. While we are witnessing price actions across categories to offset such risks, the impact may vary across categories/companies as summarized below:

- **All eyes on commodity price inflation:** Various commodities are witnessing a 15-25% YoY surge in prices, thereby raising concerns on input costs. For instance, copper is up 25%, steel (over 25%), and aluminum (over 14%). Even plastic prices are seeing a strong upsurge. Contrary to normal wisdom, commodity price inflation is not necessarily a negative catalyst as its impact varies across segments, and thereby various companies, depending on their product portfolio as well as their ability to undertake price increases.
- **Cables segment can actually be a beneficiary:** Cables and Wires segment tends to benefit from rising copper prices. Note that a cable is not a discretionary product. We are entering into a peak construction phase in India: November to May/June till the monsoon. Cables demand is price inelastic and the input cost inflation gets passed on to the consumer within a month. Analysis of HAVL's Cables segment as well as KEII (unrated) suggests a surge in the profits of the Cables segment in a rising copper price scenario. Additionally, companies can experience inventory gains as well.
- **Consumer Electricals like Fans also tend to defend margins:** Electrical Goods like Fans and Lighting are also able to pass on input cost pressures. These categories are small ticket size items and higher replacement demand products. At times, there may be a delay in price hikes by a month or so, but overall they tend to tide over the commodity price inflation risks. In current scenario, companies have already started undertaking price hikes – thanks to the supply-side disruption impacting normalization of the unorganized sector. Thus, we don't see much risk to Consumer Electrical products unless commodity price escalates materially. However, certain supply-side disruptions, especially in the import of key components (for instance: LED chip for bulbs), may hinder the capture of entire industry demand. The leading brands should be better off compared to the unorganized sector – quite similar to the trend in 2QFY21.
- **White Goods may see margin headwinds in FY22:** The risks to margins are relatively higher in White Goods on a relative basis. The White Goods space is quite competitive. Even prior to COVID-19, brands resisted price increases despite import duty hikes as well as a rupee depreciation to the dollar. This rightly reflected in a decline in margins from peak levels for various companies in the past. Also, White Goods have an element of discretion, which allows for the postponement of purchases, although not as discretionary as say high ticket size item like a 4W. Thus, we do see risks to FY22E margins for White Goods players, especially ACs (risks to VOLT and BLSTR margins). However, a stronger summer season can very well offset these risks.

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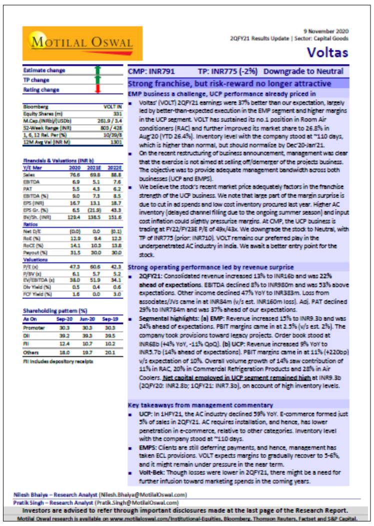

MOTILAL OSWAL

9 November 2020

2QFY21 Results Update | Sector: Capital Goods

Voltas

Estimate change	↑
TP change	↑
Rating change	↓

Bloomberg	VOLT IN
Equity Shares (m)	331
M.Cap.(INRb)/(USDb)	261.9 / 3.4
52-Week Range (INR)	803 / 428
1, 6, 12 Rel. Per (%)	10/39/8
12M Avg Val (INR M)	1301

Financials & Valuations (INR b)

Y/E Mar	2020	2021E	2022E
Sales	76.6	69.8	88.8
EBITDA	6.9	5.1	7.6
PAT	5.5	4.3	6.2
EBITDA (%)	9.0	7.3	8.5
EPS (INR)	16.7	13.1	18.7
EPS Gr. (%)	6.5	(21.9)	43.3
BV/Sh. (INR)	129.4	138.5	151.6
Ratios			
Net D/E	(0.0)	0.0	(0.1)
RoE (%)	12.9	9.4	12.3
RoCE (%)	14.1	10.3	13.8
Payout (%)	31.5	30.0	30.0
Valuations			
P/E (x)	47.3	60.6	42.3
P/BV (x)	6.1	5.7	5.2
EV/EBITDA (x)	38.0	51.9	34.1
Div Yield (%)	0.5	0.4	0.6
FCF Yield (%)	1.6	0.0	3.0

Shareholding pattern (%)

As On	Sep-20	Jun-20	Sep-19
Promoter	30.3	30.3	30.3
DII	39.2	39.3	39.5
FII	12.4	10.7	10.2
Others	18.0	19.7	20.1

FII Includes depository receipts

CMP: INR791 TP: INR775 (-2%) Downgrade to Neutral

Strong franchise, but risk-reward no longer attractive

EMP business a challenge, UCP performance already priced in

- Voltas' (VOLT) 2QFY21 earnings were 37% better than our expectation, largely led by better-than-expected execution in the EMP segment and higher margins in the UCP segment. VOLT has sustained its no.1 position in Room Air conditioners (RAC) and further improved its market share to 26.8% in Aug'20 (YTD 26.4%). Inventory level with the company stood at ~110 days, which is higher than normal, but should normalize by Dec'20-Jan'21.
- On the recent restructuring of business announcement, management was clear that the exercise is not aimed at selling off/demerger of the projects business. The objective was to provide adequate management bandwidth across both businesses (UCP and EMPS).
- We believe the stock's recent market price adequately factors in the franchise strength of the UCP business. We note that large part of the margin surprise is due to cut in ad spends and low cost inventory procured last year. Higher AC inventory (delayed channel filling due to the ongoing summer season) and input cost inflation could slightly pressurize margins. At CMP, the UCP business is trading at FY22/FY23E P/E of 49x/43x. We downgrade the stock to Neutral, with TP of INR775 (prior: INR710). VOLT remains our preferred play in the underpenetrated AC industry in India. We await a better entry point for the stock.

Strong operating performance led by revenue surprise

- **2QFY21:** Consolidated revenue increased 13% to INR16b and was 22% **ahead of expectations**. EBITDA declined 8% to INR980m and was 53% above expectations. Other income declined 47% YoY to INR383m. Loss from associates/JVs came in at INR84m (v/s est. INR160m loss). Adj. PAT declined 29% to INR784m and was 37% ahead of our expectations.
- **Segmental highlights: (a) EMP:** Revenue increased 15% to INR9.3b and was 24% ahead of expectations. PBIT margins came in at 2.5% (v/s est. 2%). The company took provisions toward legacy projects. Order book stood at INR68b (+4% YoY, -11% QoQ). **(b) UCP:** Revenue increased 9% YoY to INR5.7b (14% ahead of expectations). PBIT margins came in at 11% (+220bp) v/s expectation of 10%. Overall volume growth of 14% saw contribution of 11% in RAC, 20% in Commercial Refrigeration Products and 28% in Air Coolers. **Net capital employed in UCP segment remained high** at INR9.3b (2QFY20: INR2.8b; 1QFY21: INR7.3b), on account of high inventory levels.

Key takeaways from management commentary

- **UCP:** In 1HFY21, the AC industry declined 59% YoY. E-commerce formed just 5% of sales in 2QFY21. AC requires installation, and hence, has lower penetration in e-commerce, relative to other categories. Inventory level with the company stood at ~110 days.
- **EMPS:** Clients are still deferring payments, and hence, management has taken ECL provisions. VOLT expects margins to gradually recover to 5-6%, and it might remain under pressure in the near term.
- **Volt-Bek:** Though losses were lower in 2QFY21, there might be a need for further infusion toward marketing spends in the coming years.

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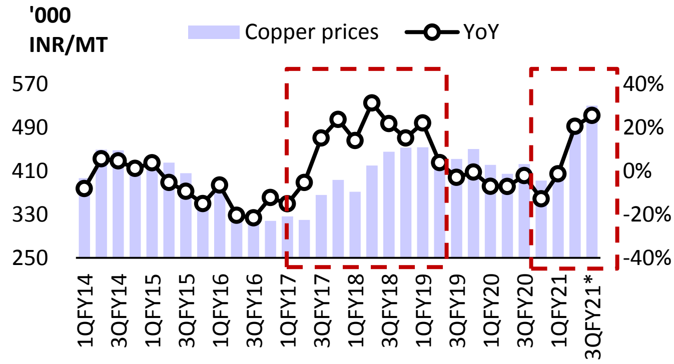
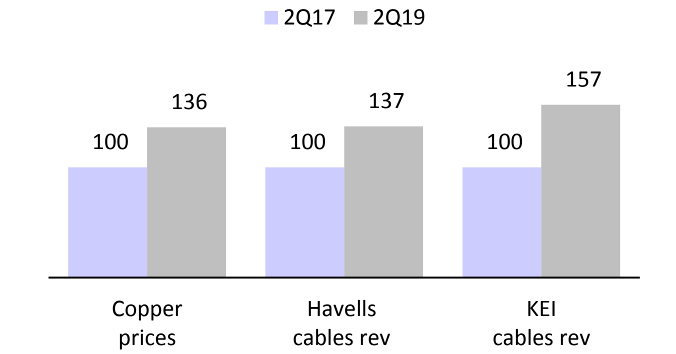
- **CROMPTON is our top pick, downgrade BLSTR to Sell: a) CROMPTON (New TP: INR390** *(Prior: INR360)*, **Buy)** is our top pick in the sector as it is resilient to input cost pressures as well as the ongoing revival/pent-up demand in Real Estate can aid revenue growth. Valuations are also comfortable at 30x FY23E P/E. **b) HAVL (TP: INR850** *(Prior: INR765)*, **Neutral)** – Given the diversified nature of its portfolio and various degrees of impact from cost inflation, the cost inflation issue tends to nullify. Also, margin levers, including lower advertising spends, travelling costs, etc., provide scope to offset margin pressure and should aid strong earnings growth in the near term. We remain Neutral on expensive valuations. **c) VOLT (TP: INR815** *(Prior: INR775)*, **Neutral) –** While VOLT may see margin expansion for a quarter or two owing to low-cost inventory (VOLT is carrying the highest AC inventory across listed entities of ~INR10b as of Sep'20 end and that too at low cost), we do see margin risks in FY22E. Valuations provide no margin of safety unless the summer season surprises on the positive side. We recently downgraded VOLT (**link**) and maintain our Neutral view. **d) BLSTR (TP: INR680** *(Prior: INR570)*, **downgrade to Sell) – We downgrade BLSTR to Sell.** Adjusted for the projects business, the stock is now more expensive than VOLT. Also, BLSTR remains a single product company, while VOLT is expanding into the wider White Goods space of Refrigerators and Washing Machines. Restructuring of VOLT's Projects business may be a precursor to a demerger and can help sustain higher multiples. Thus, on a relative basis, VOLT scores over BLSTR as an investment thesis. Note that all our TPs are based on Mar'23E EPS estimates.

Exhibit 1: Copper prices up 25% YoY in 3QFY21 till date



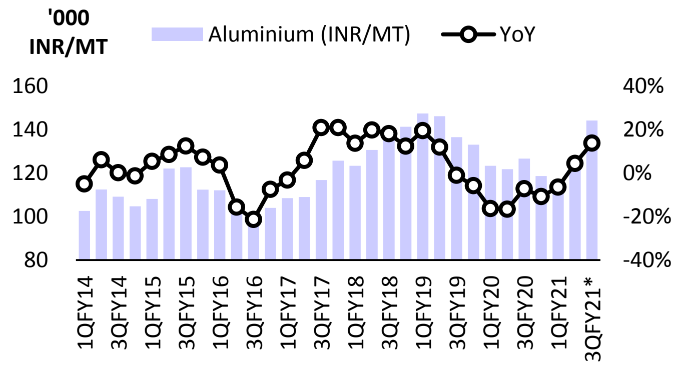
Source: MOFSL, Bloomberg; *till date

Exhibit 2: In line with the 36% rise in copper prices between 2QFY17 and 2QFY19, Cables revenue for HAVL, KEI surge



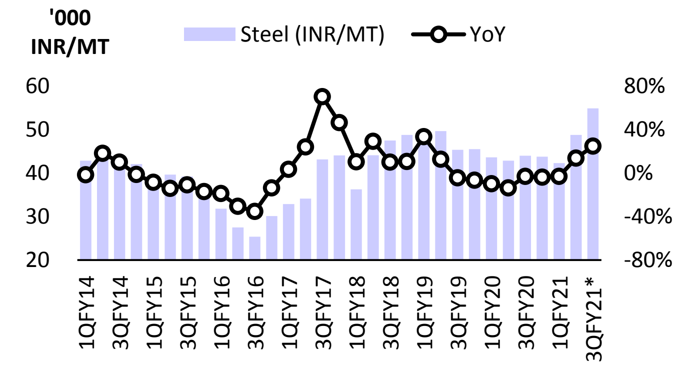
Source: MOFSL, Bloomberg;
*Indexing at the level of 100 for comparison purpose

Exhibit 3: Aluminum prices back to 1HFY19 levels; up 14% in 3QFY21 till date



Source: MOFSL, Bloomberg; *till date

Exhibit 4: Steel prices up 25% in 3QFY21 till date



Source: MOFSL, Bloomberg; *till date

Exhibit 5: Ranking various categories with the ability to undertake price hikes

Category	Relative ability to take prices hikes	Remarks	Impact on companies
Cables	Easy	❖ Copper is the key commodity and price inflation gets passed on the consumer (B2B/B2C) within a month.	❖ Positive for HAVL (Cables segment), KEII (unrated), POLYCAB (unrated), FNXC (unrated)
Electricals (Fans/Lighting)	Moderate	❖ Electrical items are low ticket sizes as well as have higher replacement demand. The ability to undertake price hikes is moderate.	❖ Neutral impact for HAVL and CROMPTON
White Goods	Difficult	❖ The segment has a strong MNCs presence. Players give priority to market share over margins, especially in ACs. White Goods have an element of discretion compared to the Consumer Electrical category.	❖ Negative for VOLT, BLSTR, and HAVL (Lloyd business)

Source: MOFSL

Exhibit 6: Consumer Durables – Peer valuation

Company	Ticker	M-cap (INR b)	CMP (INR)	TP (INR)	Upside (%)	Rating	P/E (x) FY21E	FY22E	FY23E	RoE (%) FY21E	FY22E	FY23E
Blue Star	BLSTR IN	75	776	680	-13%	Sell	101.3	41.9	30.8	9.1	20.2	24.7
Crompton	CROMPTON IN	213	340	390	15%	Buy	43.9	35.3	30.3	27.8	28.8	28.0
Havells	HAVL IN	541	865	850	-2%	Neutral	62.0	53.2	45.7	17.8	18.3	18.7
Voltas	VOLT IN	274	830	815	-1%	Neutral	61.3	44.3	39.5	9.7	12.3	12.6

Source: MOFSL, Company, Bloomberg

Exhibit 7: Peer valuation comparison adjusted for the Projects business of BLSTR and VOLT – CROMPTON is the cheapest stock while BLSTR is most expensive, based on FY22E/FY23E earnings

Current P/E (x)	Rating	FY20	FY21E	FY22E	FY23E	FY23E Target P/E
BLSTR	Sell	*84.3*	*186.5*	*63.4*	*47.4*	*40.0*
CROMPTON	Buy	*48.8*	*43.9*	*35.3*	*30.3*	*35.0*
HAVL	Neutral	*73.8*	*62.0*	*53.2*	*45.7*	*45.0*
VOLT	Neutral	*57.0*	*64.5*	*52.1*	*45.8*	*45.0*

Source: MOFSL, Company, Bloomberg

Exhibit 8: HAVL - Earnings change summary

	Old			New			Change		
INR m	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	92,500	1,11,000	1,25,710	95,500	1,13,000	1,27,870	3%	2%	2%
EBITDA	12,639	14,402	16,436	13,329	14,842	16,912	5%	3%	3%
EBITDA margin	13.7%	13.0%	13.1%	14.0%	13.1%	13.2%	0.3%	0.2%	0.2%
Adjusted PAT	8,212	9,829	11,448	8,729	10,168	11,834	6%	3%	3%

Source: MOFSL, Company

Exhibit 9: CROMPTON - Earnings change summary

	Old			New			Change		
INR m	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	43,200	52,000	57,915	44,000	53,000	59,010	2%	2%	2%
EBITDA	6,395	7,666	8,587	6,508	7,811	8,745	2%	2%	2%
EBITDA margin	14.8%	14.7%	14.8%	14.8%	14.7%	14.8%	0.0%	0.0%	0.0%
Adjusted PAT	4,771	5,935	6,911	4,856	6,044	7,030	2%	2%	2%

Source: MOFSL, Company

Exhibit 10: VOLT - Earnings change summary

	Old			New			Change		
INR m	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	69,800	88,800	95,916	69,800	88,800	95,916	0%	0%	0%
EBITDA	5,074	7,592	8,260	5,283	7,592	8,260	4%	0%	0%
EBITDA margin	7.3%	8.5%	8.6%	7.6%	8.5%	8.6%	0.3%	0.0%	0.0%
Adjusted PAT	4,321	6,194	6,941	4,478	6,194	6,941	4%	0%	0%

Source: MOFSL, Company

Exhibit 11: BLSTR - Earnings upgrade largely led by the Projects business; higher operating leverage implies larger variation in earnings

	Old			New			Change		
INR m	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	42,500	56,500	63,599	43,000	59,000	67,549	1%	4%	6%
EBITDA	2,116	3,234	3,765	2,187	3,474	4,195	3%	7%	11%
EBITDA margin	5.0%	5.7%	5.9%	5.1%	5.9%	6.2%	0.1%	0.2%	0.3%
Adjusted PAT	685	1,596	2,088	738	1,785	2,424	8%	12%	16%

Source: MOFSL, Company

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BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
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