# FIRST LIGHT

05 August 2022

## RESEARCH

### Voltas | Target: Rs 1,100 | +10% | HOLD

Competitive edge appears blunted; downgrade to HOLD

### Dixon Technologies | Target: Rs 4,500 | +20% | BUY

Annual report analysis: Targeting higher EMS share

### Power

Expert call – GNA a potential gamechanger

## SUMMARY

### Voltas

- Subpar Q1 on double whammy of lower cooling business margins and provisioning-led losses in projects business
- Market share recouped by ~400bps to 24% but at cost of margins; both metrics remain key monitorables
- FY23/FY24 EPS cut ~12% post two offseason quarters and limited price relief; downgrade from BUY to HOLD with new TP of Rs 1,100 (vs. Rs 1,250)

**Click here for the full report.**

### Dixon Technologies

- Key initiatives taken in FY22 to bolster business in electronic manufacturing services (EMS), including PLI initiatives
- Mobiles and consumer electronics represent primary growth drivers for the company
- FY22 return ratios (ROE at 22%) and balance sheet (net D/E at 0.1x) robust; retain BUY with unchanged TP of Rs 4,500

**Click here for the full report.**

### Daily macro indicators

| Indicator | 02-Aug | 03-Aug | Chg (%) |
|---|---|---|---|
| US 10Y yield (%) | 2.75 | 2.7 | (4bps) |
| India 10Y yield (%) | 7.2 | 7.24 | 4bps |
| USD/INR | 78.71 | 79.16 | (0.6) |
| Brent Crude (US$/bbl) | 100.5 | 96.8 | (3.7) |
| Dow | 32,396 | 32,813 | 1.3 |
| Hang Seng | 19,689 | 19,767 | 0.4 |
| Sensex | 58,136 | 58,351 | 0.4 |
| **India FII (US$ mn)** | **01-Aug** | **02-Aug** | **Chg ($ mn)** |
| FII-D | 49.1 | (17.7) | (66.8) |
| FII-E | 675.4 | 211.5 | (463.9) |

Source: Bank of Baroda Economics Research

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## Power

- Proposed general network access (GNA) policy, which places onus of transmission on buyers rather than generators, a key policy shift
- Draft policy on capacity trading another potential reform that will help utilise stranded power assets
- Some coal capacity necessary to meet future demand; however, capacity not as much a constraint as coal availability

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**HOLD**
**TP: Rs 1,100 | ⮝ 10%**

**VOLTAS** | Consumer Durables | 04 August 2022

# Competitive edge appears blunted; downgrade to HOLD

- **Subpar Q1 on double whammy of lower cooling business margins and provisioning-led losses in projects business**
- **Market share recouped by ~400bps to 24% but at cost of margins; both metrics remain key monitorables**
- **FY23/FY24 EPS cut ~12% post two offseason quarters and limited price relief; downgrade from BUY to HOLD with new TP of Rs 1,100 (vs. Rs 1,250)**

**Vinod Chari | Tanay Rasal**
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**Disappointing quarter:** Q1FY23 was a disappointing quarter from VOLT led by muted EBIT margins in unitary cooling (-300bps QoQ to 7.7%) and expected credit loss (ECL) provisioning in the projects business. Subsequently, Net profit was also a miss at Rs 1.1bn (Rs 2bn est.)

**Market share recouped at cost of margins:** VOLT had an exit market share of 24.1% for Jun'22 vs. 21.6%/19.6% in April/March. However, this growth came at the cost of its operating margin, which plunged 300bps QoQ to 7.7% amid increasing competitive intensity. Management has guided market share at ~25% by July/Aug'22, however, talks pertaining to improvement in margin remained elusive.

**Competitive edge waning:** VOLT's high operating margins (a 5ppt+ lead over peers in the air conditioner space) have been under pressure, as evident in the two previous quarters as well. Further, peers such as Lloyd have an aggressive growth trajectory (3Y revenue CAGR at 19% vs. 7% for VOLT), which is forcing the market leader to change its strategy. VOLT's lagging presence in the southern region is another worry as this is a key market due to lower product ownership (for details, see our note of 12 May: **Strong strategy for southern market holds the key**).

**Immediate price hike unlikely**: In Q1FY23, there were neither significant price hikes nor discounts. Besides, no price increases are expected in the near term, and the same is true for the competitor. However, beginning in Q3, when dealers begin to build inventory, the company will look to pass on input costs.

**Next real test is ensuing summer; cut to HOLD:** Margins in the unitary cooling business are the most important monitorable for VOLT. We believe any recovery will shift to the summer of 2023, given that the next two quarters are seasonally weak and unlikely to see much pricing action. Considering these headwinds, we turn cautious on the stock and cut our FY23/FY24 EPS estimates by 13%/12% while downgrading our rating from BUY to HOLD. Post estimate change, our revised TP stands at Rs 1,100 (vs. Rs 1,250), based on an unchanged 50x FY24E P/E multiple.

## Key changes

| Target | Rating |
|---|---|
| ▼ | ▼ |

| | |
|---|---|
| Ticker/Price | VOLT IN/Rs 1,000 |
| Market cap | US$ 4.2bn |
| Free float | 70% |
| 3M ADV | US$ 16.3mn |
| 52wk high/low | Rs 1,357/Rs 923 |
| Promoter/FPI/DII | 30%/25%/30% |

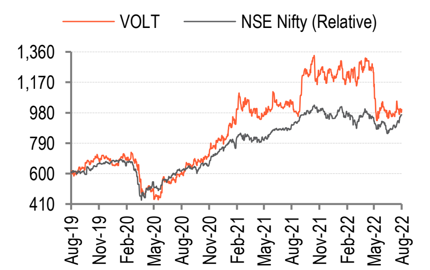
Source: NSE | Price as of 4 Aug 2022

## Key financials

| Y/E 31 Mar | FY22A | FY23E | FY24E |
|---|---|---|---|
| Total revenue (Rs mn) | 79,345 | 88,613 | 1,07,669 |
| EBITDA (Rs mn) | 6,816 | 7,508 | 10,279 |
| Adj. net profit (Rs mn) | 5,060 | 5,335 | 7,266 |
| Adj. EPS (Rs) | 15.3 | 16.1 | 22.0 |
| Consensus EPS (Rs) | 15.3 | 20.9 | 26.8 |
| Adj. ROAE (%) | 9.6 | 9.4 | 11.9 |
| Adj. P/E (x) | 65.4 | 62.0 | 45.5 |
| EV/EBITDA (x) | 48.6 | 44.1 | 32.2 |
| Adj. EPS growth (%) | (4.3) | 5.4 | 36.2 |

Source: Company, Bloomberg, BOBCAPS Research

## Stock performance




Source: NSE

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**BUY**
**TP: Rs 4,500 | ⮝ 20%**

**DIXON TECHNOLOGIES** | Consumer Durables | 04 August 2022

## Annual report analysis: Targeting higher EMS share

- **Key initiatives taken in FY22 to bolster business in electronic manufacturing services (EMS), including PLI initiatives**
- **Mobiles and consumer electronics represent primary growth drivers for the company**
- **FY22 return ratios (ROE at 22%) and balance sheet (net D/E at 0.1x) robust; retain BUY with unchanged TP of Rs 4,500**

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DIXON's FY22 annual report outlines steps taken to build share in EMS. Key highlights:

**Mobiles business to lead growth:** The mobiles segment is a key driver for DIXON along with consumer electronics. Management expects business from marquee client Motorola to ramp up, driving growth in FY23. The company has guided for the mobiles segment (excluding set-top boxes and medical equipment) to generate revenue of Rs 65bn-70bn in FY23 as against Rs 27bn in FY22, with annual volumes from Motorola anticipated at 5mn-5.5mn.

**Planned foray into new segments with ODM focus:** In order to diversify its portfolio, DIXON plans to venture into OEM (original equipment manufacturing) of laptops, wearables, hearables and consumer-end telecom products, which would later shift towards ODM (original design manufacturing). In particular, the company aspires to increase the mix of ODM products while maintaining its stronghold in OEM products.

**Key PLI beneficiary:** DIXON is a key beneficiary of the government's production-linked incentive (PLI) scheme. It has applied for five PLI schemes (lighting, mobiles, IT hardware, air conditioners, wearables & hearables), and was the first company to meet the investment and ceiling revenue requirements for mobile phones. In laptops, it has met the investment and minimum revenue threshold

**Capex to boost capabilities:** DIXON has incurred capex of Rs 4.2bn in FY22 and has a planned outlay of Rs 3bn-3.2bn for FY23. This would be primarily incurred towards expansion of capacities across existing verticals as well as diversifying into new verticals linked to its core business of electronics, backward integration, PLI-related capex and development of state-of the-art infrastructure.

**Maintain BUY:** We expect sustained product addition, customer acquisition and the PLI scheme to benefit the company. Further, return ratios are healthy (ROE of 22%) and its financial position remains strong with net cash of Rs 3.2bn and net D/E of 0.1x in FY22. We retain BUY with an unchanged TP of Rs 4,500, based on 55x FY24E EPS, a 20% premium to its 4Y average.

### Key changes

| Target | Rating |
|---|---|
| ◀ ▶ | ◀ ▶ |

| | |
|---|---|
| Ticker/Price | DIXON IN/Rs 3,755 |
| Market cap | US$ 2.8bn |
| Free float | 66% |
| 3M ADV | US$ 17.6mn |
| 52wk high/low | Rs 6,244/Rs 3,181 |
| Promoter/FPI/DII | 34%/15%/8% |

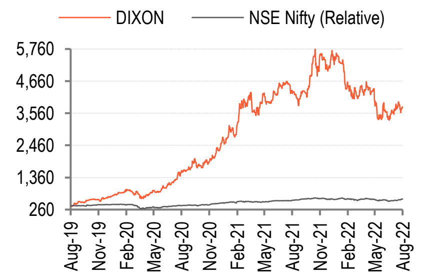
Source: NSE | Price as of 3 Aug 2022

### Key financials

| Y/E 31 Mar | FY22A | FY23E | FY24E |
|---|---|---|---|
| Total revenue (Rs mn) | 1,06,971 | 1,71,280 | 2,20,502 |
| EBITDA (Rs mn) | 3,791 | 6,507 | 8,473 |
| Adj. net profit (Rs mn) | 1,903 | 3,396 | 4,779 |
| Adj. EPS (Rs) | 32.1 | 57.2 | 80.5 |
| Consensus EPS (Rs) | 32.1 | 62.7 | 92.0 |
| Adj. ROAE (%) | 22.0 | 29.1 | 30.3 |
| Adj. P/E (x) | 117.1 | 65.6 | 46.6 |
| EV/EBITDA (x) | 58.8 | 34.2 | 26.3 |
| Adj. EPS growth (%) | 19.1 | 78.4 | 40.7 |

Source: Company, Bloomberg, BOBCAPS Research

### Stock performance




Source: NSE

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POWER

04 August 2022

# Expert call – GNA a potential gamechanger

- **Proposed general network access (GNA) policy, which places onus of transmission on buyers rather than generators, a key policy shift**
- **Draft policy on capacity trading another potential reform that will help utilise stranded power assets**
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We hosted a call with power sector expert Arun Kumar to discuss the current challenges facing the industry. Key takeaways:

**General network access – a key proposed policy change:** GNA refers to non-discriminatory or open access to the interstate transmission system for injection of power and for drawing of power by customers for a specified period. GNA will be customer-driven rather than producer-driven, and demand management thus becomes more important. It will engender greater discipline among states as they will be penalised for overdrawing power. This also translates the government's notion of 'One Nation, One Grid' into reality given access to interstate systems. India has enough transmission capacity for GNA implementation, and the proposed policy will align the sector with international practices.

**Power exchange market must be deepened:** India's third power exchange, HPX, was launched last month. The sector is dominated by IEX, which has a near monopoly (>95% market share), and it remains to be seen whether HPX can make inroads. That said, the power market needs to be deepened via higher traded volumes. Currently, traded power accounts for just ~5% of the country's total units.

**Draft policy on traded capacity likely:** The government may soon come out with a draft policy on capacity addition for both renewables and traditional power. The idea is to create a market where capacities can be traded, which will be useful for stranded assets where spare capacity can be used to meet increasing demand.

**Coal supply critical to meet demand:** While players like NTPC have indicated that the supply overhang is behind us and new power generation capacity needs to be added, it is actually coal supply that is a more pressing issue to meet the rising demand. India's national PLF (plant load factor) is still at ~60% levels and can go higher. More important will be the planning and logistics of coal supply than the need for new capacity itself.

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**Recommendation scale: Recommendations and Absolute returns (%) over 12 months**

**BUY** – Expected return >+15%

**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

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