IFB Industries

View: Positive

Discretionary player all set to cash-in on the urban revival

CMP: Rs526

Key points

- **Presence in high-growth, underpenetrated categories:** IFB Industries (IFB) is a leader in the front-loading washing machine with a 50% market share. It is also present in the other categories of white goods segment viz- top loading washing machine, microwave oven, dryer and dishwasher with a substantial market share. The company has also recently forayed into the air conditioning market. All these categories are underpenetrated providing ample scope for growth averaging over 20% for the next five years' time frame. By virtue of being present in these growing categories, we expect IFB to post a strong 18% CAGR over FY2015-17.
- **Strong growth coupled with multiple levers at work to result in margin expansion ahead:** The company's healthy growth in revenues coupled with multiple levers like improvement in the front-loading utilisation levels via entering export segment (from current 30-35% to 60%+), replacement of imports with own manufacturing of top-loading machine and strong entry into the air conditioning segment would result in better absorption of the fixed overheads, thereby leading to a sharp improvement in the margins. We expect IFB to post a 350-BPS expansion in two years' time frame from FY2015 to FY2017. Consequently, the operating profit is expected to grow at 45% CAGR over FY2015-17.
- **Efficient working capital and low capex to result in healthy cash generation ahead:** The company has an efficient working capital management, its net working capital requirement averages to 25-30 days. It provides credit for utmost 7-15 days depending on the distribution mode, while its inventory period ranges between 50-60 days. It gets credit of 50-60 days from its creditors. Going forward with the completion of the capex cycle (In FY2015, it added 1.5-lakh-unit capacity in the top loading washing machine), the company is likely to generate free cash. We expect it to generate an aggregate free cash of Rs125 crore over FY2015-17.
- **Quasi discretionary play; available at attractive valuations:** We believe IFB being a quasi play on the revival in the urban discretionary consumption space with a strong earnings potential, decent brand name and a strong balance sheet position (zero debt company; with net cash and cash equivalent of Rs150 crore) is available at an attractive valuation (20.7x its FY2017). We believe that with the growth in the volumes and the improvement in the margin profile, the valuation re-rating for IFB is likely to fructify and hence expect the company to post 20-25% returns from the current levels.
- **Key risk:** A lower-than-expected improvement in the overall discretionary demand would pose as a risk to our revenue and earnings estimates.

Valuations (consolidated)

Particulars	FY2012	FY2013	FY2014	FY2015	FY2016E	FY2017E
Net sales (Rs cr)	803	916	1,021	1,262	1,497	1,763
Growth (%)		14.1	11.5	23.5	18.7	17.8
Operating profit (Rs cr)	41.2	50.2	45.2	86.6	132.8	182.1
Growth (%)		22.0	(10.1)	91.6	53.4	37.1
Operating profit margin (%)	5.1	5.5	4.4	6.9	8.9	10.3
Net profit (Rs cr)	31	31	22	50	66	105
Growth (%)		3.0	(31.3)	130.2	31.8	59.7
EPS (Rs)	8.8	7.6	5.2	12.0	15.9	25.4
PER (x)	62.5	69.0	100.5	43.7	33.1	20.7
RoCE (%)	13.5	10.5	6.1	11.9	13.6	18.5
RoE (%)	14	11	7	14	16	21

Key investment arguments

- **Strong pent-up demand waiting to fructify in the consumer durable segment:** A favourable demographic dividend (around 65% of the population below the age group of 35 years), rising income levels, increasing trend towards working women and a low level of penetration of the white goods/consumer durables in the country across the categories, barring television, ranging from washing machine, refrigerators, air conditioners (AC), microwave ovens to dishwashers provide a huge scope for the manufacturers and marketers of these products. We believe with the enabling factors in place, the consumer durable industry in India is expected to grow strong, as per the industry estimates, it would grow at 15% compounded annual growth rate (CAGR) for the next five years. We believe that by virtue of its presence in this low penetrated and high-growth segment, the company is expected to witness a CAGR growth of 18% over FY2015-17.

- **Multiple levers at work; benefits to flow**

  a) **Entry into high-growth AC market:** The company has entered the high-growth AC market. Currently, the AC market is estimated at Rs10,000 crore and is expected to grow at over 20% CAGR over next five years. IFB entered this huge market in the last year and has now stabilised itself, and it imports products from the international market and sells the same in India with its brand, IFB. We expect this category to be the key growth driver for the revenue and earnings growth for the company. We expect the company to post a CAGR of 45% over FY2015-17 for this category.

  b) **Manufacturing top loading washing machine as against imports earlier:** Till FY2014, the company used to import all its top loading washing machine, while restricting its manufacturing to only front loading washing machine and dryers. In FY2015, the company entered to create a facility for top loading washing machine, which has grown strong and further is expected to grow strong over the next five years. The company has invested Rs60 crore for the facility which has a capacity to manufacture 1.5 lakh units. The trial runs have already been completed and have been successful. Further, starting FY2016, the company would replace imports against its own manufacturing and would also increase the range and volumes for the category that would aid in growth of volume, revenue and earnings ahead. We expect the washing machine segment of the company to grow at a CAGR of 20% over FY2015-17, with an improvement in the margins.

  c) **Entry into export market for increasing the utilisation level of front loading washing machine:** The company manufactures front loading washing machine along with dryers in its plant in Goa. Till H2FY2015, the company was running at 35% utilisation levels that led to a drag in its margin profile. In order to utilise its capacity, the company has started undertaking exports order under which it will be acting as a subcontractor for a global brand. It has already received its first order from Panasonic Global. This thrust into the exports market would enable in optimum utilisation in its spare capacity, further resulting in absorption of fixed overheads and cost and thereby leading to improvement in the margin profile and thereby overall earnings.

  d) **Expanding the distribution reach employing multitude resources**: The company employs multiple distribution modes for the marketing and sales of its product. It primarily sells via distributors, which in turn retails through the multi-brand stores. IFB has an aggregate of 70,000 retailers on a pan-India basis, while 70% of its sales comprises of this mode. It also sells its product through its own branded stores called *IFB Points*. These are the company's exclusive stores akin to LG showroom or the Samsung Store, wherein all the company's products, categories and range are showcased and displayed. These stores act as branding and sales promotion points for the company and are low capital intensive as they are franchisee owned and operated. The company is all set to expand its distribution reach across its distribution vertical from distributors, dealers to the IFB stores which is expected to yield results ahead.

- **Margins expected to improve by 350BPS over the next two years:** Entry into new categories like AC, mid-range refrigerator, along with various other strategic shifts like make versus import for top loading washing machine, venturing into the export segment to improve utilisation levels are likely to result in a better absorption of the fixed overheads, and thereby resulting in a sharp improvement in the operating profit margin (OPM). We expect the company to post 210-

basis point (BPS) margin expansion at the consolidated level from 6.9% in FY2015 to 10.3% in FY2017. Consequently, the operating profit is expected to grow at 45% CAGR over FY2015-17.

- **Efficient working capital management and low capex ahead to result in cash generation:** The company has an efficient working capital management, its net working capital requirement averages to 25-30 days. It provides credit for utmost 7-15 days depending on the distribution mode, while its inventory period ranges between 50-60 days. Also, it gets credit of 50-60 days from its creditors. Going forward with the completion of the capital expenditure (capex) cycle (In FY2015, it added 1.5-lakh-unit capacity on the top loading washing machine), the company is likely to generate free cash. We expect it to generate an aggregate free cash of Rs125 crore over FY2015-17.

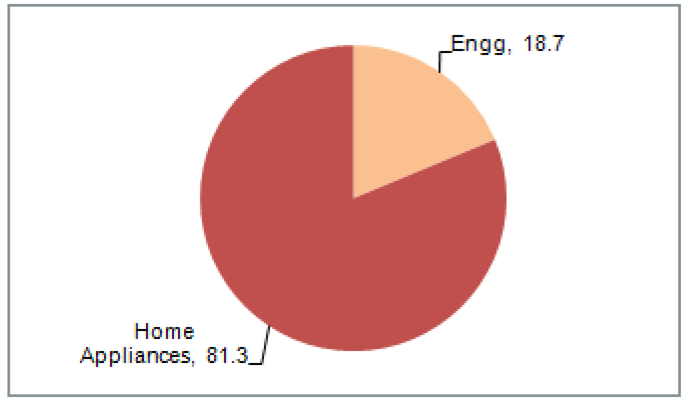
- **Improving margin profile, strong returns and well managed working capital cycle to make IFB a strong investment:** Healthy growth with an improvement in the margin profile (expect 350-BPS margin expansion from the current levels), strong return ratios (averaging 19% over FY2015-17) and debt free status with net cash and cash equivalents at around Rs150 crore (constituting 7-8% of the market cap) along with a brand is available at 20x its FY2017E earnings. We believe that with the growth in the volumes and the improvement in the margin profile, the valuation re-rating for IFB is likely to fructify.

Background of the company

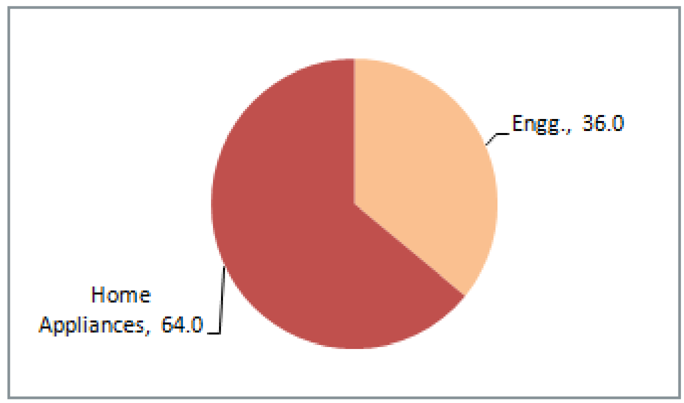
- IFB's operations consist of two divisions; fine blanking and the appliance division. The fine blanking division has two manufacturing facilities; one each at Kolkata and Bengaluru. The appliance division on the other hand has its manufacturing facility in Goa and imports some of its products from various countries across the globe.

- The manufacturing facility in Goa makes washing machine and clothes dryer while rest of the products are imported from various quality suppliers around the globe to the specifications described by the IFB Industries as needed by the brand.

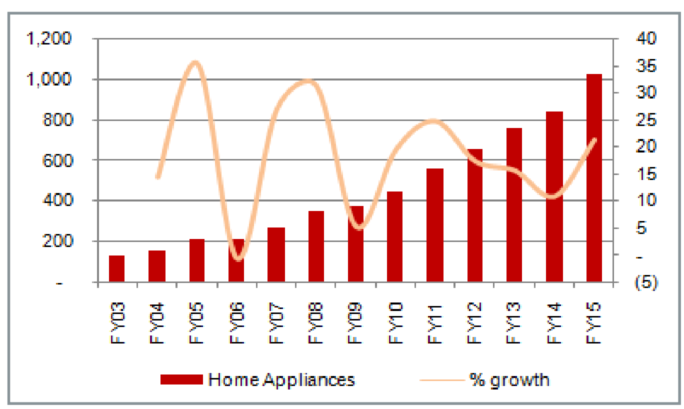
FY2015 revenue mix



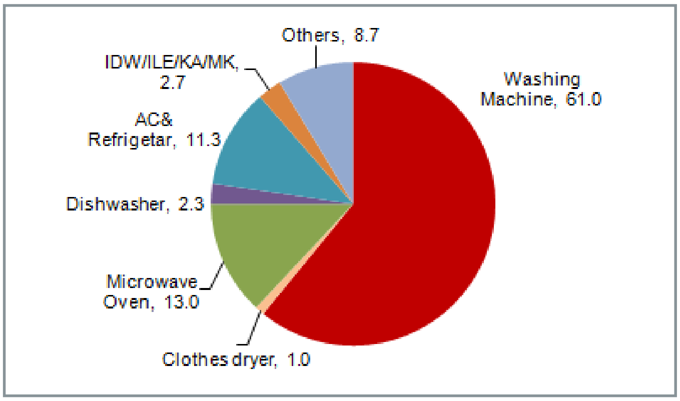
FY2015 EBIT mix



Home appliances business has grown at a CAGR of 18.3% over FY2003-FY15



Appliances category revenue mix



In the appliances business, the company is present in various segments of the white goods industry viz- washing machine, microwave, dishwasher, dryer and has also recently forayed into high-growth AC segment.

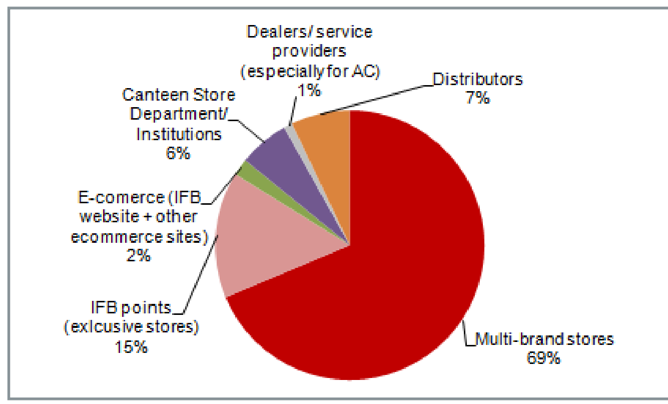
- **Washing machine business:** The company is a market leader in the front loading washing machine with a market share of 50%. Given the fact that the market size and the growth opportunity in the top loading washing machine are higher, the company also has presence in the top loading washing machine. Up till now the company imports the top loading washing machine, which will now be replaced with the in-house manufacturing. IFB has created a capacity to manufacture 1.5 lakh units of top loading washing machine with a capex of Rs60 crore and the commercial launch from the same would start from as early as April 2015. Further, the company is looking at the export market, and for the same it has just concluded the start of commercial supplies to a Japanese major under the original equipment manufacturer (OEM) arrangement. The company is also establishing manning in areas, such as the Middle East and will see significant sales in the export segment which will also enable them to improve gross margins and also cover overheads, and improve purchase efficiency.

- **Air conditioning market:** The company has recently forayed into the AC market, which is a huge opportunity with a market size of over Rs10,000 crore, growing at a 20% CAGR and is highly under penetrated. It is just a year old in this business and currently imports all its requirements. With huge and healthy growth in the category coupled with innovative products and features introduced by IFB, we believe that the company is poised to witness a strong revenue growth from this category.

- **Refrigerators**: The company till date has been selective in this category and has been working with some select high-end models. Further, the company plans to enter the mid-end level models by Q1FY2016 for which the field and laboratory testing are in progress and would continue in quarters ahead.

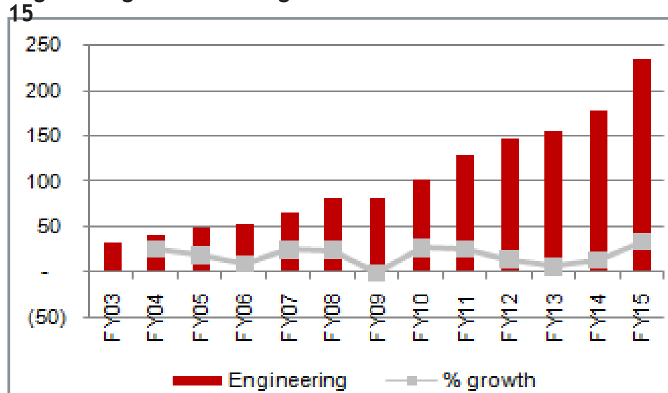
Distribution model: The company sells its product through a mix of distribution channels, with 69% of the sales derived from the multi-brand outlets, while 14% of its sales come from its exclusive stores called the *IFB Points*. These *IFB Points* are run by franchisee, and IFB Industries reimburses part of initial operating costs, such as rental etc. The company also invests in the initial branding and promotion of the stores. The entire initial support cost of the *IFB Points* is being charged to the profit & loss account. The company currently has 289 *IFB Points* and plans to expand this mode of distribution. The other distribution mode includes canteen stores, e-commerce and direct distributors.

Distribution mix



Engineering business: The company is also present in the engineering (fine blanking) business, wherein it serves the two-wheeler and the four-wheeler industry. Sensing a decline in demand from the four-wheeler segment in 2014, the company started focusing in the two-wheeler space and currently two-wheelers contribute over 50% to the segment's topline.

Engineering business has grown at a CAGR of 18% over FY2003-15



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