JOINDRE CAPITAL SERVICES LTD.

SEBI REGN NO. INH000002061 / INZ000174034

RESEARCH REPORT

27TH Sept 2018

PG ELECTROPLAST LIMITED

BSE : PGEL | **Sector: OEM/ODM SUPPLIER** | **BSE: 533581**

View - BUY

CMP : Rs. 139

Target Price: Rs 240 (In next 12 to 18 mths)

BUSINESS BACKGROUND

PG Electroplast Limited (PGEL) is a diversified Electronic Manufacturing Services and Plastic Injection Moulding company catering to leading OEMs in Consumer Electronics and Automotive Industry. PGEL specializes in turnkey solutions as an EMS for PCB Assemblies, full product assembly, plastic injection molding and engineering services for Consumer Electronics, Home and Kitchen Appliances, Automotive Industry Parts, Lighting industry and Mobile Phones.

PGEL has 5 plants located at strategic locations near its customer base which include 4 plants based in Noida & 1 plant based at Pune Maharashtra.

INVESTMENT HIGHLIGHTS

Strong Financial Performance for FY18 –

PGEL reported a strong set of FY18 numbers with net sales at Rs 412.78 crs with EBIDTA placed at Rs 24.55 crs from Rs 20.71 crs last year with the PAT placed at Rs 7.69 crs from Rs 3.54 crs up by 117% YoY.

For PGEL Q1FY19 was a difficult quarter due to industry headwinds hence Sales totalled Rs 116.49 crs with EBIDTA at Rs 7.68 crs with PAT at Rs 3.01 crs. EBIDTA margins in Q1FY19 improved to 6.59% from 6% in Q1 last year.

PGEL enjoys a strong clientele base in the Consumer Durable & Automotive Segments –

PGEL has large and reputed customers across the Consumer Electronics, Automotive, Bathroom Fittings, Lightings, Mobiles and small domestic appliances business segments. Some large and medium customers where PGEL caters to these varied industry segments include OEMs like LG, Voltas, Panasonic, Carrier, Intex, Samsung, Spark Minda, Bright Autoplast, ITW, SMR, Kohler, Jaguar, Halonix Surya, Havells, Orient, Usha, Lava and Salcomp.

PGEL services all these large & medium OEM customers as a full service provider and offers comprehensive manufacturing capabilities in terms of plastic moulding, tool manufacturing, PCB assembly, motor manufacturing, final product assembly and mobile manufacturing. This has helped PGEL enjoy a key vendor status in the supply chain management of its large OEM customers helping it garner increased wallet share from such clients.

KEY DATA

FACE VALUE Rs	10.00
DIVD YIELD %	NA
52 WK HI/LOW	460/138
NSE CODE	PGEL
BSE CODE	PGEL
MARKET CAP	RS 228 CRS

SHAREHOLDING PATTERN

PROMOTERS	-	65%
BANKS, MFs & DIIs	-	%
FIIs	-	%
PUBLIC	-	35%

KEY FUNDAMENTALS

YE	FY19	FY20	FY21
Rev Gr%	18	25	25
EBIDTA Gr%	29	32	28
PAT Gr%	24	34	59
EPS Gr%	24	34	59
EPS (Rs)	5.79	7.75	12.34
ROE %	7	9	12
ROCE %	7	9	11
P/E(x)		18	11

PGEL enjoys a diversified Product Range across strategic plant locations –

PGEL has 5 strategically located plants at Noida and Pune to cater to the diverse needs of its customers. Brief details of the plants are as under :

PGEL UNIT-1 NOIDA Industrial Plastic Mouldings Final Assembly Lines

PGEL UNIT-2 Noida ELECTRONICS DIVISION Printed Circuit Board Assemblies Settop Box Final Assembly

PGEL UNIT-3 NOIDA Industrial Plastic Moldings & Final Assembly Line

PGEL UNIT-4 PUNE to Mobile Assemblies Industrial Plastic Moldings & Final Assembly

PGEL UNIT-5 NOIDA Tool Manufacturing & Blow Moulding

PGEL is one of the largest manufacturers of Plastic Molded Parts in India for Consumer Electronics & Automotive Industry. PGEL currently has more than 120 molding machines ranging from 90T to 1600T spread over 3 plants in Greater Noida & Pune. PGEL specializes in small, medium and Big sized, high-precision, surface critical injection molded components offering an extensive range of components for automotive and electronics industries. PGEL also specialises in moulding of robust thermoset polymers, which are desired for their high tenacity and high temperature applications, particularly in the automotive industry.

PGEL also provides end-to-end assembly for industry leaders in consumer products. Its appliances and final products are endowed with top of the class features like extended durability, effective performance, aesthetic looks, low power and voltage consumption, ranging variety and cost effectiveness.

PGEL has been successful in adapting to the growing demands of its customers, wherein it has innovated and managed disruptive changes proactively since the last 3 years which has seen the introduction of several new products with higher value addition – like, plastic blades for ceiling fans, Air coolers, Washing machines, UF toilet seats, and which has helped PGEL in successfully adding new clients like Kohler, Orient Fan, Voltas, Intex, Whirlpool, etc

Also for providing superior surface finish solutions, PGEL has installed a state of the-art PU Paint shop in Greater Noida. Here PGEL supplies a number of parts in different shapes and sizes for automotive, electrical and consumer durables industry and where this facility is equipped with automated painting line to attend to all kinds of painting related needs.

KEY PRODUCTS in PGEL's PORTFOLIO

PGEL – AIR COOLER ASSEMBLY

BATHROOM FITTINGS

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NON AUTOMOTIVE - FG PRODUCTS

NON AUTOMOTIVE – CUSTOMERS

Key Automotive Customers –

FORCE

PGEL incurred a large capex in FY18 and expects this to moderate going ahead –

During FY18 PGEL added new capacity of PU paint shop, started UF thermoset toilet seat facility with the technology from Hoti (Xiamen) Plumbing Inc., China. The Tool Room facility for making moulds has been further ramped up during the year and company commercially launched a semi automatic Washing machine under the ODM model

PGEL has incurred Rs 36.28 crs on capital expenditure in FY18 wherein the Company has installed several new injection moulding machines in its factories and increased covered area by constructing new buildings/floors at its existing facilities.

In terms of capex going ahead the company expects to spend around Rs 20 crs over the next 2 years which will be funded largely by internal accruals largely.

Headwinds for the domestic EMS Industry look strong going ahead –

Demand within the EMS industry to grow at a CAGR of 30% between FY18-21E largely due to development of the consumer electronics and appliances ecosystem in India (CEA, market size of Rs 2,350bn in FY17), due to favorable government policy (correction in inverted duty structure, "Make in India" initiative and M-SIPS scheme), the country's low-cost advantage over China (leading to a rise in domestic manufacturing and creation of large exports opportunity) and the rise in outsourcing strategy adopted by consumer brands.

OEM vs ODM business model –

Original equipment Manufacturer (OEM) model – Here Product design, raw material specifications, supplier details etc are provided by the customers. Any volatility in raw material prices is a pass-through (but with a 1 to 2 month lag).

Margin under this model is low (2-3%) but no requirement of making any working capital investment, leading to high Return on Capital employed.

Original design manufacturer (ODM) model includes Product designing, R&D, working capital management, manufacturing, delivery and packaging of products

Here the relationship with brands is stronger as the partnership is more strategic in nature. A ODM player commands high margin, but needs to bear risk of raw material price volatility and makes investment on working capital leading to lower return on Capital employed.

Most EMS companies aspire to evolve their business model from OEM to ODM as going ahead we expect strong growth for India's EMS industry considering the following factors

Favorable government policy initiatives;

Large exports opportunity with migration of global manufacturing hub to low-cost India

Huge domestic demand

Fall in imports

Large Outsourcing strategy adopted by OEMs, due to EMS superior value proposition: cost effectiveness, flexibility in product design updates, faster time to market and reduction in working capital cycle

Hence OEMs focus more on core competency of innovation, product differentiation, marketing & distribution and prefer in-house manufacturing for latest products.

Going ahead Regulatory support is likely to encourage more investments by local players in the EMS space by several govt policy initiatives -

The government wants to focus on providing employment through manufacturing and reduce imports in consumer electronics by CY20. It has announced flagship program, “Make in India” to boost manufacturing and electronics is one key focus area

It has also announced a modified special incentive package scheme (M-SIPS) wherein it provides capital subsidy of 20% in SEZ (25% in non- SEZ areas) for units engaged in electronics manufacturing. Under the scheme, the government will offer incentives of up to USD 1.7bn until July 2020.

Merchandise exports from India scheme (MEIS) Under this initiative govt provides incentives for exports (2-5% of FOB value) and the aim is to make exporters cost-effective by offsetting losses due to infrastructure inefficiency

Start of the Electronics development fund which involves developing a special fund of Rs 100 bn to generate an R&D ecosystem in electronics by providing risk capital to companies developing new technologies

Encourage Electronics manufacturing clusters (EMC) wherein these clusters would provide support for creating world-class infrastructure to attract investments in the electronics systems design and manufacturing (ESDM) sector. This measure will help to offset challenges arising due to lack of reliable infrastructure.

The government will provide financial assistance of up to 50% and 75% of project cost for developing Greenfield and Brownfield EMC, respectively (subject to ceiling of Rs 50 crs for every 100 acres of land). To date, 20 Greenfield and three Brownfield EMC have been approved

Phased manufacturing program (PMP): The FY16 Union Budget introduced a differential excise duty for domestic mobile manufacturers. Under this, countervailing duty (CVD) on imports was imposed at 12.5% and excise duty at 1% without input tax
credit (or 12.5% with input tax credit).

To enable domestic manufacturers produce products at lower excise duty, all input have been exempted from basic customs duty. This exemption will however be withdrawn product-wise based on pre-decided timelines.

The scheme will progressively increase domestic value addition and build mobile handset manufacturing ecosystem in India.

Rationalization of inverted duty structure –

Earlier Inverted import duty existed on various electronics products like mobile phones, which caused domestically manufactured products dependent on imported raw materials uncompetitive. Inverted duty structure exists when import duty on finished goods is lower (due to India being part of regional & bilateral Free Trade Agreement [FTA]) than import duty on intermediates or raw materials.

India has realized that the inverted duty structure has been a key hindrance on increasing scale of manufacturing in the country. The government therefore has taken measures over the past few years to resolve this issue (by increasing import duty on finished products and reducing it on raw materials).

Import duty on fully built mobile phone and FPD TV has been increased to 20%, and open cells used in LED TV manufacturing have been reduced to 5%. Mobile components import duty varies based on the phased manufacturing program of the government.

Some other recent developments in the EMS space –

Samsung has committed Rs 50bn to double its mobile phone production to 120mn handsets pa by 2020 at its Noida facility, near New Delhi, India, and also start exporting from this facility

Foxconn has committed to invest USD 5bn, which includes USD 3bn investment in setting up display fab, USD 250mn towards mechanics like CNC, lithium ion cell battery and facilities for printed circuit boards) in Maharashtra, India.

Post expansion manufacturing capacity will increase to 10mn units per month

LG is looking to establish India as one of its global manufacturing hubs to cater to markets of South Asia, Africa, and the Middle East, as China is no more cost competitive.

Voltas and Ardutch have agreed to establish Rs 6.5bn joint venture to manufacture refrigerators, washing machine and microwaves.

Midea plans to invest INR 8bn to set up a manufacturing facility at Pune for refrigerators, washing machines and water treatment products

Jabil plans to acquire Ericsson's India manufacturing unit, which involves printed circuit board assembly and testing activities

Rise in share of outsourcing –

Consumer durables brands have been continuously increasing their dependence on EMS firms, appreciating the benefits derived from outsourcing (cost-effectiveness, flexibility in product design updates, faster time to market and reduction in working capital cycle).

Late adoption, due to lack of affordability, has resulted in the market being dominated by segments where Tier 1 global firms are absent or do not focus, such as like semiautomatic washing machine (56% of India's washing machine market), feature mobile phones (66% of India's mobile phone market) and flat panel design LED TV less than 43-inch size (95% of India FPD TV market).

These categories usually do not exist in advanced economies, thereby global brands may not manufacture them and prefer to partner with EMS firms to complete product portfolio in India. So, a large mass market exists for EMS firms in India

Rise in prominence of tier II, regional & private labels Tier II, regional and private labels prefer outsourcing, as they are unsure of their market share, given increased competition, diverse consumer needs, change in customer preference and lack of scale & capability.

Brands usually prefer to import or outsource production until they gain a sizeable market share. Also, private labels usually prefer outsourcing as manufacturing is not their core competence.

Most Consumer brands prefer outsourcing due to cost effectiveness, flexibility in product design updates, faster time to market and reduction in working capital cycle and achieving asset light business model

AC demand continues to be on an uptrend –

Rising disposable income levels (14% CAGR in past two decades) and improving infrastructure (availability of power) have been key demand growth drivers for the RAC segment in past two decades – registered healthy 18% CAGR during the period.

On sustained rise in disposable income levels and better power availability well complemented with rising temperature levels, room ACs demand is well poised to grow at 11 to 13% CAGR over FY18-22E, in volume terms.

Hence the low penetration levels of India's RAC industry (4 to 5%), we believe, is set to improve with: a) changing Indian demographics, aided by a rising middle class, youth population and higher disposable income; b) sustained rise in average temperatures; and c) government's push towards 'Power for All', which will improve availability of electricity supported by higher non-food consumption expenditure in the rural areas.

Changing demographics, rising affordability to push the demand for RAC's

Also we expect RAC penetration to surge on improving demographics (increasing middle class population) and rising affordability (higher disposable income) as India get younger (India has the youngest population) accompanied by the youth aspiring to have a better lifestyle.

Hence going ahead one is likely to witness a higher spending on discretionary consumer durables and premium products (which is expected to jump to 45% of household income by 2025 vs. 40% currently). These will aid growth of Indian RAC market in the next 3 to 4 years going ahead.

Rising outsourcing/value added products ramping up market share –

Consumer durable (CD) players have also been able to generate strong cash/returns by retaining their asset light models and channelising most of their financial resources towards brand building/distribution expansion.

Additionally, we expect the outsourcing trend to continue and translate into 12% volume CAGR over FY18-22 with the share of ODM/OEMs in overall RAC industry expected to reach 37-38% by FY22

This would be driven by increased investments towards marketing/distribution by CD brand owners, and economies of scale offered by OEM/ODM players.

Once viewed as a luxury item, room ACs (RAC) have rapidly emerged as a necessity for the growing Indian middle class. In past 10-15 years, the RAC segment has grown at a healthy 18% CAGR.

Key catalysts for the surge in demand for room AC's include factors like –

Rising disposable income levels (14% CAGR in past two decades);

Improving infrastructure (availability of power); and

Deepening penetration levels - mere ~4 to 5% penentration, which is significantly beloe the global average of 30%

The need for consumer durable players to focus on brand building and distribution while preferring to stay asset light has seen opportunities bulging for the OEM's/ODM's. Increase in electronic components in the bill of material of inverter AC's
is further expanding scope of the domestic OEM/ODM AC players.

Also Improving growth visibility in domestic white goods space coupled with rising competition amongst domestic & MNC consumer durable (CD) players has in past few years thrown up new market opportunities for the OEM/ODMs.

Most of the CD players have been able to generate strong cash/returns by maintaining asset-light models. The CD players have been channelising their financial resources to brand building/widening their distribution reach considering the following facts like

Brand owners are ramping up investments towards marketing/distribution, while preferring to stay light on manufacturing.

Economies of scale by OEM/ODM players has been encouraging CD players to collaborate with them for their design, manufacturing and reverse logistics requirements.

Working capital cycle is curtailed due to outsourcing of the manufacturing process.

Flexibility of providing multiple RAC models with quick turnaround time

Rising use of electronic components in AC's expanding opportunities for OEM's/ODM's players –

In a fixed-speed AC, the compressor is either off or on, works at full capacity and electricity consumption is as configured.

The compressor constitutes 28-30% of the total bill of material, while printed circuit boards (PCB's) accounts for a mere 5%. On the other hand, technology used in inverter's AC is very different wherein the compressor is always on, for which a smarter PCB is required.

This increase in the electronic components in the bill of material of inverter AC's along with an expected rise in customs duty is expected to expand the scope for domestic OEM's/ODM's.

Higher customs duty will discourage imports while increasing the reliance on domestic OEM's/ODM's. Thus, we believe, PGEL's existing PCB facility will help it manage costs better and also boost its growth opportunities apart from helping it move up higher the CD value chain.

PGEL has already started its journey of transformation from a pure OEM player to a ODM player going ahead –

Going ahead after the successful launch of Air Coolers and Washing Machines, the company is exploring opportunities in ODM space for other products segments like LED TVs and Air Conditioners.

It also plans to launch a fully automatic washing machine in coming financial year and is already in talks with several large RAC players for ODM business possibilities. The management is confident of getting the ODM business in the medium term for which the company expects business visibility from FY20 onwards.

Going ahead, PGEL plans to become an end to end solution solutions provider which will lead to higher profitability and better growth rates. With its strong customer engagement, positive market sentiment, healthy balance sheet and diversified product portfolio, PGEL has the ability to cater to customers across segments and it aspires to become a key player in EMS space in India

PGEL enjoys a reasonably good balance sheet with huge scalability potential going ahead –

PGEL runs a strong business model covering multiple product segments across multi locations with a efficient working capital management while it continues to invest on a sustained basis largely from its internal accruals.

PGEL has total debt of Rs 116 crs on the balance sheet as on FY18 as compared to a tangible networth of Rs 131 crs. While this debt looks high in future we believe that DE should gradually come down to lower levels.

We expect that going ahead overall bottomline growth in the next 3 years starting FY18 onwards should easily increase at a CAGR of 23-25% and with capex funded largely from internal cash flows.

What is PGEL's key USP –

Firstly PGEL is a large player in the Plastic Moulding and OEM supplier market

Secondly PGEL has completed its first ODM product namely a semi automatic washing machine and is now looking at a major revenue and profit push from the ODM segment which will be reflected fully in FY20 numbers

Thirdly PGEL enjoys large RAC & CD customers like Voltas, Kohler, Intex, Samsung, LG, Panasonic, Whirlpool, Carrier, Orient and several other large CD and RAC players

Also PGEL is a large approved OEM vendor to large Auto OEMS like Mahindra, Tatas, Motherson Sumi, GM, Toyota, Maruti and Minda.

Overall the EMS market in the Domestic markets look good over the next 2-3 years –

We expect the domestic market to remain in a healthy shape with growth remaining in strong double digits.

Demand within the EMS industry to grow at a CAGR of 30% between FY18-21E largely due to development of the consumer electronics and appliances ecosystem in India (CEA, market size of Rs 2,350bn in FY17), due to favorable government policy (correction in inverted duty structure, "Make in India" initiative and M-SIPS scheme), the country's low-cost advantage over China (leading to a rise in domestic manufacturing and creation of large exports opportunity) and the rise in outsourcing strategy adopted by consumer brands.

Key Triggers for PGEL ahead –

PGEL expects strong mprovement in the demand of RAC, CDs from the domestic Markets which will spur demand for quality vendors like PGEL both from a OEM and ODM perspective.

It also plans to launch a fully automatic washing machine in coming financial year and is already in talks with several large RAC players for ODM business possibilities. The management is confident of getting the ODM business in the medium term for which the company expects business visibility from FY20 onwards.

Going ahead, PGEL plans to become an end to end solution solutions provider which will lead to higher profitability and better growth rates. With its strong customer engagement, positive market sentiment, healthy balance sheet and diversified product portfolio

Experienced Management and Skilled Employee Base:

Promoters of the company have over 35 years' experience in plastic moulding, tool manufacturing, PCB assembly, motor manufacturing, final product industry. The majority of company's Key Management Personnel have been employed with the company for over ten years and have contributed towards growth of the company through their commitment and experience

The company places strong emphasis on research and product development to enhance its product range and improve its manufacturing processes. The company has offered a number of cost reduction and value engineering proposals to its customers on the basis of in-house improvements in manufacturing processes which resulted in low input cost and low operation costs.

Business Outlook & Stock Valuation –

On a rough cut basis, in FY19, Topline will see a steady rise wherein Topline is expected to touch Rs 487 crs in FY19E.

On the bottomline level we expect the company to record a PAT of Rs 9.50 crs in FY19E. Thus on a conservative basis, PGEL should record a EPS of Rs 5.79 for FY19E. For FY20E and FY21E our expectation is that earnings traction for PGEL would continue to be strong wherein we expect a EPS of Rs 7.75 and Rs 12.34 respectively.

Also another attractive point for PGEL is that EPS growth over the next three years between FY18 to FY21 is expected to average 25% plus YoY.

To add to this at the current market cap of PGEL at Rs 227 crs, the PGEL stock trades a market cap to sales multiple of just 0.46x on FY19E and at a EV/Sales multiple of 0.72 on FY19E whereas the potential revenue over the next 2 years is over Rs 750 crs

The company management is confident of improving EBIDTA margins in coming two years via operational efficiency and better product mix.

The key growth drivers in FY2020 would be the fructification of new ODM business which is expected to increase PGEL's topline significantly and give a boost to its margins profile going ahead.

Going ahead, PGEL plans to become an end to end solution solutions provider which will lead to higher profitability and better growth rates. With its strong customer engagement, positive market sentiment, healthy balance sheet and diversified product portfolio we believe PGEL has got good scope to get rerated provided its ODM strategy gathers faster momentum in the coming 2 years

Hence we believe that the PGEL stock should be purchased at the current price for a price target of around Rs 240 over the next 12 to 18 months based on a EV/Sales multiple of 1.10x on FY20 Sales.

In fact the present market cap of Rs 228 crs is below the present EV value of Rs 344 crs as on FY18 which clearly indicates the extent of undervaluation as on date. We hence believe that as the ODM strategy gets reflected in numbers this stock could surely get rerated by the market as other comparable but larger peers like Amber and Dixon trade at premium valuations.

FINANCIALS

For the Year Ended March RsCrs	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	407.10	412.78	487.08	608.85	761.06
EBIDTA	20.71	24.55	31.66	42.01	54.04
EBIDTA %	5.09	5.95	6.50	6.90	7.10
Interest	9.90	10.64	11.00	12.20	13.00
Depreciation	10.58	11.74	12.25	13.40	14.10
Non Operational Other Income	3.13	5.31	1.75	1.75	2.00
Profit Before Tax	3.36	7.48	10.16	18.16	28.94
Profit After Tax	3.54	7.69	9.50	12.71	20.25
Diluted EPS (Rs)	2.16	4.69	5.79	7.75	12.34
Equity Capital	16.41	16.41	16.41	16.41	16.41
Reserves	106.75	114.41	124.41	137.12	157.37
Borrowings	95.73	116.00	115.00	118.00	122.00
GrossBlock	164.72	201.00	211.00	221.00	233.00
Investments	0.00	0.00	0.00	0.00	0.00

Source Company our Estimates

KEY CONCERNS

Any sharp down turn in the RAC and CD Industry can impact PGEL's financials adversely.

Also any negative development in the new product launches of OEMs could also impact PGELs financials negatively

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DISCLAIMERS AND DISCLOSURES

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