



V-Guard Industries

Q2FY12 Post Results Conference Call
Hosted by IDBI Capital Market Services Ltd.

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Moderators

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Moderator: Good evening ladies and gentlemen. I am Allwyn, moderator for this conference. Welcome to the post results conference call of V-Guard Industries hosted by IDBI Capital Markets Limited. We have with us today, Mr. Arun Baid, from IDBI Capital and the management team of V-Guard Industries. At this moment, all participants are in listen only mode. Later, we will conduct a question and answer session. At that time, if you have a question, please press * and 1 on your telephone keypad. Please note this conference is recorded. I would now like to hand over the conference to Mr. Arun Baid of IDBI Capital.

Arun Baid: Good afternoon ladies and gentlemen. On behalf of IDBI Capital I welcome you all at the post results con call of V-Guard Industries for the quarter ended September 2011. Today, we have with us from the management side Mr. Mithun, Executive Director and Mr. Jacob, CFO. I request now to Mr. Mithun to give opening remarks and then the floor will be open for question and answers. Over to you Mithun.

Mithun K. Chittilappilly: Thank you Arun. Good afternoon everyone and thank you very much for taking time to participate in our post results conference call. The Q2 ended in September 2011 has been both encouraging and challenging. It has been encouraging as we have had a good sales growth, our sales has grown by about 38% on an overall basis. This considering the tough economic conditions that were existing in the market has been a good achievement. The 4 South Indian states have grown by about 35% and the new markets, that is, the non south markets have grown by about 41% making an overall sales growth of 38%. If you look at the product-wise sales growth, our wires segment has grown by 42%, our stabilizer segment has grown by 28%, the pump segment has grown by 20%, water heater segment has grown by 55%, UPS segment has grown by 40%, the digital UPS that is the Inverter segment has grown by 200%, the solar water heater segment has grown by 25%, all put together growing at about 38%. It has been challenging because we have had a shrink in our margins, our EBITDA margins have been under pressure and our EBITDA margins for the quarter has been roughly 7% vis-à-vis about 11% the previous financial year second quarter. There are 4 basic reasons for reduction in our EBITDA margins. The cost of goods sold to sales have increased from 71.98% to 73.4%, the selling and distribution expenses, which were about 7.73% last year second quarter has increased to 9.86%. The establishment expenses, which was 3.81% last year has increased to 4.55%. These 3 reasons put together has caused a reduction of 4.29% on EBITDA margins. Due to heavy rains in most parts of India in Q2, the sales of fans and pumps have been facing significant pressure. Competitors are resorting to price cuts forcing us to do the same. This is the main reason for increase in discounts given, which is reflected in the increased selling and distribution expenses. Also apart from these two products, sales of air-conditioners have also been lackluster and this segment, that is the air-conditioner stabilizer segment has degrown. But the stabilizer vertical has done well on an overall basis due to increase in sales of refrigerators as well as flat panel TV stabilizers. We are however optimistic in the coming two quarters and is confident that the margins will improve. One reason is the advertisement cost, which was high in Q1 and Q2 for us will come down in Q3 and Q4 pushing up the operating margins. We will also see an improvement in sales of fans and pumps due to better realization and better weather condition. The rains have almost stopped in most parts of India and we are seeing good traction and demand for these products. Also we are expecting a good summer season in the coming month and we hope that the sales of air-conditioner stabilizers also will pick up. Thank you once again for taking time to attend this conference call. Myself and Mr. Jacob are here to answer any of your questions.

Moderator: Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone keypad and wait for your turn to ask the question. If your question has been answered before your turn and you wish to withdraw your request, you may do so by pressing * and 1 again. Dear participants, please press * and 1 for your questions.

First question comes from Mr. Sujay Mishra from Kotak India Focus Fund.

Sujay Mishra: Thank you for taking my question. My question essentially pertains to the segmental margins that you provided. One was on stabilizers; we have seen a year-on-year pretty significant decline in margins, if you can just explain that in a little more detail. And we see sustained low margins in cables as well. Why is it actually? So if you can highlight it, is that the sustained margin levels that will continue going into the future or we can expect that to improve.

Mithun Chittilappilly: As far as stabilizer margins are concerned, the EBITDA margins for second quarter had come in at about 12% and last year it was roughly 20%. So there is a huge decline in the stabilizer margins. This is mainly on account of one

reason; it is mainly due to the advertisement costs. Now, as far as stabilizer is concerned, we have done a major activity in the first quarter, that is partnering with IPL and almost all our ad expenses were accounted in the first quarter, barring 3.5 crores. About 3.5 crores worth of advertisement expenses, which was done in first quarter has also come in, in the second quarter as well, I mean, it has been accounted only in the second quarter. So, to that extent the stabilizer margins have taken a hit due to this factor. Also, as far as stabilizers are concerned, last year Q2 we had not done any major campaign during the second quarter, but in this year we have introduced a new range of washing machine and treadmill stabilizers, which were introduced in Kerala, so there is a one-time launch expenses of about 40 lakhs for the advertisements, which was done in addition to the normal ad expenses. So these are the two main reasons why stabilizer margins have declined. Now, wire margins last year was about 8.9%, EBITDA margins, last year's Q2 and now it has come in at about 4.24%. Wire margins have been declined on two reasons. One is, again, the IPL apart from this 3.5 crores I talked about, is also accounted with wires as well, because wires is the second major product that was advertised during IPL. The second reason is during September there was decline in copper prices, in fact almost a crash in copper prices, which has meant that we had to forcibly discount the product, which was made with higher copper cost. So during the month of September we had to write down our inventory and we also had to provide discounts for the products that existingly produced and kept as inventory to be sold. So because of these two factors the wires margins have taken a hit and have almost come down to half. But I think it is a one time thing and I think in Q3 we should see wires margins going up back to 6% to 7%. It may not be possible for us to maintain that 9% EBITDA margins for wires, but I think 7% EBITDA margins is what we should expect in Q3 and Q4.

Sujay Mishra:

Just a followup question on margins. If you can also highlight, you talked about solar water heaters, where you had to give subsidy before you actually received it. Is there an issue in the kind of margins we will earn in solar water heaters going forward as a result of what is happening and margins will be lower than what has been historically and as far as in pumps you talked about you had to clear up stocks because season was poor, the margins were lower. What is the sustainable level of margin in pumps, if you could just highlight that?

Mithun Chittilappilly:

Okay. As far as solar water heater is concerned, yes, this has affected our margins, that is, we had to provide, give discounts even before we are actually availing subsidy. We are hopeful on availing this subsidy, we have already got the MNRE certification and the ratings by CRISIL has already being done. We are in the process of giving out a plan for the current year and once we complete 50% of the plan we should be getting subsidy. We have come to know that some of our competitors have already started availing this subsidy. So, as far as the margins are concerned, we believe this will continue to be impacted for the next six months, after which we will start getting the subsidy and the margins should go back to at least 15% EBITDA margin. So that is one issue. The second thing what we have done is, we are moving to a new technology as far as solar water heater is concerned, from the traditional stainless steel based tank, we are moving into an engineering polymer tank, which will improve the life of the product and also bring down the cost by 15%, 20%. So, we believe that we should be able to produce a product with the new technology by end of January and we will be ready for the next season with that product. What it will do for us, is that even without getting subsidy we believe that this product will still be competitive in the market while getting us reasonable margins. So, even if we are not getting the subsidy we are confident of competing in the market with this new product. This is the reason we are putting up a new plant in Perundurai, near Coimbatore. The construction of this plant started about 8, 9 months back. We have almost finished construction and the machinery installation is happening as we speak and we will be commencing trial production and the commercial production is due to be started in January. So, as far as solar water heater is concerned, I think, this year we will still get impacted, but I think next year we should be back due to two reasons, one is we should also be availing subsidy by then, by which we would have completed 50% of our plan, which we have given to MNRE and also with this new product line, which we are also trying again to get this product registered with MNRE, but however, we have not yet started producing the product. Once the product is started to produce, then we will get it registered with MNRE. But even if we do not get subsidy for the product, we believe that the product cost will be substantially lower helping us to compete in the market even without government subsidy. So that is as far as solar water heater is concerned. As far as pump is concerned, yes, we have had a pretty bad Q2. Our sales have been under pressure, we have struggled, and our volume growth in pump has been only 11% with value growth of 20%. And as far as pumps are concerned, we had to give huge discount to liquidate the inventory because till May of the current year we were expecting reasonably good sales, but I think by the mid of April to May we realized that the sales in summer was not up to the mark due to increased rainfall in many parts of

India. So this has meant that many of the people in the trading of pumps, that is the pump retailers have been stuck with huge stock, which has been shipped to them right from January to March. So, this is the reason there has been a general slowness in the market and many competitors are sitting on huge inventory of pumps and they are resorting to price cuts and again forcing us to do the same. So pump margins in Q2 were about only 0.8% EBITDA margin. However, I think it will improve and on a full year basis, we should see more respectable margins like 6% to 7%. So that is my opinion. I think we should be able to close this year with about 6% to 7% EBITDA margins.

Sujay Mishra: Thank you.

Mithun Chittilappilly: Thank you.

Moderator: Thank you sir. Next question comes from Dheeraj Devta from ICICI Prudential.

Dheeraj Devta: Hello sir.

Mithun Chittilappilly: Hello, yes.

Dheeraj Devta: I missed the growth in the fan segment, could you just throw some light on the same?

Mithun Chittilappilly: Yeah, the fan sales growth volume-wise has been about 10%, but value-wise we have had a decline in growth, the sales have not grown, so which means that our average realization in fans has come down due to the discounts given. So fan sales are just like the pump sales I had mentioned has been a victim of poor season and we have had our competitors resorting to rollbacks in prices that they had increased last year forcing us to also give additional discounts for the products already produced. So, in fan segment, we are facing still it is a challenging environment and as far as sales is concerned in Q2, we have not grown, there has been a slight degrowth. But I think we should, that was also due to the fact that last year in Q2 we had done extremely well doing about close to 10.5 to 11 crores whereas in this year we have done only just 10 crores. So there has been a slight decline in sales of fans, so there has not been any growth.

Dheeraj Devta: Okay. Could you give me the numbers for the various segments?

Mithun Chittilappilly: Yes. You want the sales growth?

Dheeraj Devta: Yeah. Not the sales growth, in terms of value.

Mithun Chittilappilly: Value, okay, so I will start with Q2 figures. Wires, it has done 65 crores, stabilizer has done 43 crores, pump has done 29 crores, water heater 25 crores, LT cables 32.4 crores, UPS 12.3 crores, inverters 10.4 crores, electric fan 10 crores, solar water heater 6.5 crores, and component sales about 1.5 crores. Yeah?

Dheeraj Devta: Great. And any update on the channel financing partner?

Jacob Kuruvilla: Channel financing, we have already started channel financing with the Yes Bank, they have given us 10 crore portfolio, which we have split among our loyal distributors. It has already started and during the quarter ended September 30th, already about 4 to 5 crores has been availed by our distributors. We have also started this facility with Axis Bank who have also given us a portfolio of 10 crores, so totally we have, as on date 20 crores portfolio, which we want to increase by another 10 crores to 30 crores. By end of March, we hope that we will be able to cover about 30 crores through channel financing, which will bring down our working capital and take it outside our balance sheet.

Dheeraj Devta: So, what would your full year guidance of margins would be around?

Jacob Kuruvilla: Pardon?

Dheeraj Devta: The full year guidance of margins will be around?

Mithun Chittilappilly: As far as EBITDA margins are concerned, we are confident of getting back to the 9% to 10% EBITDA margins in the next two quarters, so we should see us, as far as full year is concerned, I think we should be hovering around 9% EBITDA margins.

Dheeraj Devta: For the year.

Mithun Chittilappilly: Yes.

- Dheeraj Devta:** Okay thanks sir. I will get back to you if I have any other questions.
- Mithun Chittilappilly:** Okay thank you.
- Moderator:** Thank you sir. Next question comes from Ms. Uma Agarwal from Sahara Mutual Fund.
- Uma Agarwal:** Hello sir.
- Mithun Chittilappilly:** Hello, yes.
- Uma Agarwal:** Sir, if I look at the last few quarters, the depreciation as well as the interest has been increasing in each quarter. So can you just help me to understand this?
- Mithun Chittilappilly:** Yes. So, I will start with the interest costs first. If you look at our interest cost to sales, it is about 1.9% in the current quarter, whereas last year second quarter it was 1.23%, so roughly there has been a 0.7% impact as far as the margins are concerned, quarter-on-quarter. And if you look at our working capital cycle, our cash conversion cycle is roughly 80 days in the current year second quarter vis-à-vis 87 days last year second quarter. Our working capital bank borrowings are roughly 549 crores in the current year vis-à-vis 121 crores. So our working capital borrowings have grown, gone up by about 23% and comparing with a sales growth of 38%. Having said that, I think there is still scope for improvement in bringing down the cash conversion cycle, we are sitting on little or more inventory of fans and pumps than we would like to have and our debtors have also gone up by 3 to 4 days when compared with last year. So we do hope that we can bring this down. As far as the interest rate is concerned, the interest rate has gone up from 8.5% to 9% to 12.5%. So that is the main reason for increasing interest costs. And the second question you had asked is regarding depreciation. I think one of the reasons why the depreciation cost is increased over the last one or two years is due to the fact that we have had new plants that were commissioned two years back and over the quarters we have increased the utilization level, so when a plant goes from single shift operation to second shift and third shift, definitely that depreciation charge would also increase. So, I think, the reason why the depreciation figure is gone up over the last one year is probably because of increased utilization of the two new plants, the one in Kashipur and one in Coimbatore.
- Uma Agarwal:** Okay. And sir looking at the percentage of tax, it has come down to 23% as compared to 53% for the same quarter last year. So if you can just throw some light?
- Jacob Kuruvilla:** Actually our utilization of capacity at Kashipur factory, where we produce house wiring cables, we have got a cash holiday there. So normal tax rate will remain at around 28%, this time this 53% was due to shifting, earlier we were using only two shifts there, now we have started making 3-shift production there. So there is an adjustment for that, about one crore adjustment, that's why they have come down to 23%, but overall during the year the tax rate will be something like 28%. 23% is during this quarter because of this change in number of shifts working there.
- Uma Agarwal:** Okay. That's all from my side. Thank you sir.
- Mithun Chittilappilly:** Thank you.
- Moderator:** Thank you madam. Next question comes from Mr. Saurabh Das from Sundaram Mutual Fund.
- Saurabh Das:** Good afternoon sir and thanks for the opportunity. My first question pertains to the competitive dynamics a) on the stabilizer segment and b) on fans. If you can just give us a sense on stabilizers, what has been the volume growth, and second, if you can give us a broad sense of the number of players, which have entered the segment, are there any very significant challenges because you cited ad expenses as one of the reasons for the margins being lower in the quarter, but typically one would assume that a company should be able to price that to the customer, ad expenses being reason for margins going down may not be really encouraging signs. So if you can just comment on that.
- Mithun Chittilappilly:** Yeah. I will start with the stabilizer. The Q2 vis-à-vis Q2 of last year volume growth is 18% and value growth is 28%, so there has been an 18% volume growth vis-à-vis last year. And as far as ad expenses are concerned, yes, we should be able to price the ad expenses into the product. It has already been priced, but we have to also understand that we are in a seasonal nature of business, so our sales also tend to peak depending upon seasonal factors like Onam, Dussehra, Deepavali, etc. And also in summer due to factors like AC sales are higher in summer and hence the sales for our AC stabilizer also will be higher. So basically from this year onwards we have decided to have most of the advertisement spend, that is at least 80% of the advertisement spend would be spent in Q1 and Q2 itself.

Whereas in previous years we were not doing that kind of strategy, we were kind of focusing more on advertising in regional channels and as according to when regional festivals do occur. So there has been a change in the way we advertise, so that is one reason why there is a shift in the margins. But as far as full year sales are concerned, we are confident of having an EBITDA margin of 15 to 16%. So we have only completed six months and we have spent most of the budget for stabilizers, so whereas in the next six months we will be getting almost our other half of the sale with very little ad expenses coming in. So it is also due to the seasonal nature of how we are doing the ad campaign that the margins are getting affected.

Saurabh Das: Right. If you can also give us a sense of what is your full year ad expense budget and how much have you already spent?

Mithun Chittilappilly: Yeah. We have a full year ad budget of about 35 crores, out of the 35 crores roughly 21 to 22 crores has already been accounted in Q1 and Q2. So the balance remaining is about 13 crores, which will come in the next six months.

Saurabh Das: Right and on competition in this space, if you can comment something on that?

Mithun Chittilappilly: In stabilizer segment we mainly have competition from regional players. There are strong regional brands in both south as well as in north India. They are quite strong in their hometowns, but they typically operate in one or two states. They do not have that much of a reach as far as their network is concerned. And most of these brands are quite strong in their regional areas. So we have not had a very strong competition coming from a national player, however, in the last couple of years we have seen players like Hitachi, Whirlpool entering into this segment having their own branded stabilizers and promoting them especially in northern India. However, these guys have not yet made a huge dent in terms of getting market share from us or from the other regional strong brand. So, as far as the competitive landscape is concerned, there are a lot of regional brands that are there and they are quite strong in their own regional areas. So although we are quite strong in south part of India, we are yet to gain a commanding position in this product segment outside south. So till that time we will be trying to take market share from these regional players in these new markets.

Saurabh Das: And what is the broad split between your AC and refrigerator and other stabilizers?

Mithun Chittilappilly: The broad split would be, about 40% would be contributed by AC stabilizers, about 30% by refrigerator segment, and about another 30% from television segment. So that would be the broad split.

Saurabh Das: And will the margins profile be very different across the three segments?

Mithun Chittilappilly: Yeah. Our margin in refrigerator and television stabilizer segment is higher than when compared to our margins in air-conditioner stabilizers.

Saurabh Das: Okay, so in the current quarter AC sales would have got impacted, so your margins should have, from a product mix perspective, helped you.

Mithun Chittilappilly: Yes. Product mix perspective, it should have ideally gone up, but it was also compensated by the fact that we have had very bad AC stabilizer sales. So, also although we were selling refrigerator and television stabilizers, we were finding it hard to sell AC stabilizers. So for that particular product segment we had to offer additional discounts.

Saurabh Das: Okay. And finally on fans, do you see the segment to be extremely challenging given that the leader itself has rolled back prices and there is over capacity, so that will take at least some time for you to bring back your margins to your aspired levels. Any colour on that?

Mithun Chittilappilly: I think as far as fans are concerned, the last three years, barring this current year, I think everyone had a good run, I think every year most companies were reporting sales growth of 30%. We were almost doubling sales in the last 3 or 4 years. In the current year, I think, there has been definitely a change in the market, I think, we were all expecting at least 20% growth in sales of the market, whereas the market has not grown at all, so definitely there is an over capacity in the market. I think it will take some time for things to get back to normal in terms of people have cut down their production capacities to max the demand. But I think this is one way to look at it. Another reason is that we are not clear whether this is an issue with the market expanding, the suppliers to expanding too fast. Also the fact that we have had continuous rains in the current year right from April till August and even September in south of India, so I think also there is a climatic factor in which the temperatures were cooler, which meant that maybe replacement sale

of fans have come down and also the fact that due to poor real estate demand, new housing demand, and new housing fan sales have probably come down. So I think these two factors have really impacted and I don't think this is a long term issue, I think in the next one or two quarters we should see the demand pick up. But, of course, till that time it will be challenging, yes.

Saurabh Das: And do you see down trading happening in fans as in the Havells and the premium end fans, actually doing worse than say a Bajaj or some of the lower priced fans? I think you figure somewhere in between in terms of price point.

Mithun Chittilappilly: I don't think that is the issue, I don't think it is the case where people who are selling premium end fans have been affected more than people who have been selling budget fans, the economic segment. I think across the range we have been affected and one of the main categories that were affected was the table, pedestal, and wall category that was the category that was generating margins for most companies in India, good margins. So that category has been affected. And most of these fans are imported, so all the manufacturers including us had expected a huge growth in the sales of that particular category and there has been an increase in import of such fans. So I think that has been the case. I don't think that Bajaj may be doing well vis-à-vis Havells. I think across the board there has been reduction in demand. Primarily because right from I would say last year November to last year March, all the companies including us were pushing products to the trade and finally when at the season time it did not sell, I think the trade, especially the electrical shops, they refused to stock any more products because they were already sitting with huge inventory of fans. So that has been the reason for this sort of slowdown in the market. So as soon as the season does pick up, it gets warm and those inventories from the shops are liquidated, I am pretty sure the orders will start coming in again.

Saurabh Das: And finally on the rupee movement impacting your cost of imports, did that play any role in your margins or do you see you paying the rupee fixed price with your Chinese vendors or anything on that?

Mithun Chittilappilly: See, I think, as far as import is concerned for fans, about 25% of the total sales, that is the table, pedestal, and wall sales are imported. And most of the manufacturers, we have had to pay higher rates because most of the rate is fixed in dollar terms. As far as last year, since the rupee was about 43, 44, now it has come to 48, 49, so definitely that has impacted. But I don't think that impact of that will come in the current quarter because most of these fans were imported in the month of April and May, which we are still selling. So the new lot of shipments will start arriving only from November onwards, and at that time we are, plus almost all the manufacturers are planning to raise the prices at that time. So I think that may have a small reason, but it is not the main reason to have impacted the margins.

Saurabh Das: Got it and your stabilizer portfolio is largely insulated from these import contents?

Mithun Chittilappilly: Yeah, stabilizer portfolios manufacturing is done 100% in India, so we don't have any exchange rate issues as far as stabilizer is concerned.

Saurabh Das: And how about pumps?

Mithun Chittilappilly: Pump is also, yeah, almost 100% is made in India, so again we are not importing any pumps from outside India as far as pumps is concerned. I would say about 25% of fans and 10% of water heaters are imported.

Saurabh Das: And is your outlook for FY13 largely intact in terms of your growth rates and can you remind us what kind of growth are we looking at?

Mithun Chittilappilly: In the current year we are looking at about 35% growth vis-à-vis last year and I think we are confident of maintaining that momentum at least going for the next couple of years. We do admit that the environment is a little bit challenging, but I strongly believe this is a temporary setback and I think we should be back on track in the next couple of quarters.

Saurabh Das: Great, thank you and all the very best.

Mithun Chittilappilly: Thank you.

Moderator: Thank you, sir. Next question comes from Mr. Amol Rao from Antique Stock Broking.

Amol Rao: Yeah, hi Mithun.

- Mithun Chittilappilly:** Hi, Amol.
- Amol Rao:** Yeah, I just wanted to know we had lined up a couple of products for imminent launch over the next 3 to 4 quarters, something like an induction cooker and various things, kitchen appliances, so any thoughts on that, what is the progress there, I mean, anything...
- Mithun Chittilappilly:** Yeah, I am happy to say that we are very close to launching the first product segment that was the switch gear that we had talked about sometime back and we are initially launching this in Kerala and I think the first, we are hoping to do the first billing sometime in the next couple of weeks, so we will be officially launching the switch gear product range in the current quarter in Kerala and probably by April we should be rolling this out to the other South Indian states and I think for the next couple of years we might not be even looking outside South India for this particular product. We have already tied up with about 10 distributors in Kerala and we will be launching this product in the next 2 to 3 weeks' time. So, that is as far as switch gear is concerned. The induction cook tops we are hoping that we can launch this product before the end of the current financial year. We are in negotiation with various vendors in terms of finalizing the product pricing and models and the ranges that we require. As far as the mixer-grinder segment is concerned, we are in the process of designing a couple of new shapes without which we don't want to introduce a product. We are really hopeful of getting the product, at least the first batch of pilot products to be built before this financial year. We are really looking at next year Onam to be the main platform of launch for the mixer-grinder segment.
- Amol Rao:** Alright and just another small bookkeeping question, we were holding out our ERP system for better checks and balances, so how about that, how is that progressing?
- Mithun Chittilappilly:** Yes, we have already finalized the vendors, the implementation partner and SAP ECC 6.0 as the package and we already have the IBM consultants who started their implementation process about a month and a half back. We are planning to go live in two phases, the first phase which will include the financial modules we are going live as on February 1st and the second module we will go live as on May 1st. So by May 1st we should have all the modules of SAP going live. So, by May 1st is the goal I base.
- Amol Rao:** Alright, thank you so much, Mithun, all the very best.
- Mithun Chittilappilly:** Thank you.
- Moderator:** Thank you sir. Next question comes from Mr. Jagadishwar Pasunoori from Karvy Stock Broking.
- Jagadishwar Pasunoori:** Hello, Mr. Mithun.
- Mithun Chittilappilly:** Hello.
- Jagadishwar Pasunoori:** I think I missed the margins numbers and by each product, do you mind giving them again?
- Mithun Chittilappilly:** No, no problem, 1 sec. I will start with the current year Q2 margins. Stabilizer margins are 11.95%, PVC wires 4.24%, motor pump 0.8%, electric water heaters 17.67%, LT cables negative 4%, UPS systems 16.4%, inverter segment 1.5%, electric fan negative 8%, solar water heater 8.4%. So, this is the product-wise margins for the current quarter.
- Jagadishwar Pasunoori:** Okay, can you also give me this inverters volume or how much you made in numbers, how many crores was it?
- Mithun Chittilappilly:** Yeah, inverter segment we did a revenue of 10 crores in the second quarter, which was about 3 crores in the last financial year. According to the data I have in terms of numbers...
- Jacob Kuruvilla:** I have it, this year we sold 1.26 lakhs against 90,000 during the corresponding period of previous year.
- Jagadishwar Pasunoori:** Okay, got it. Thanks. One more thing like, can you, like you were talking about these copper prices went down and so you had to write down some of the inventory and reduce the prices, can you talk more about this, like how much you had to write down this inventory and then what was the realizations went down?
- Mithun Chittilappilly:** I think, for example, when the copper prices did crash from the 8500, 9000 levels to 7000 levels, we roughly had to discount the products price by about 8% in various stages, so initially we had given a discount of 3, then another 3, then another 2, so roughly about 8% discounts were given at various stages in September. As far as the inventory write down is concerned...
- Jacob Kuruvilla:** Yeah, the inventory impact maybe for the total inventory it maybe in the tune of say 15 to 20 lakhs maximum.

- Jagadishwar Pasunoori:** Okay and can you throw some light on like this non-South India, which is like which markets do you operate and what are the major cities or in terms of tier 1, tier 2, tier 3 cities, how you are doing there?
- Mithun Chittilappilly:** Okay, so we are present in now almost all states except Jammu and Kashmir and the Northeastern states. As far as west zone is concerned, the main markets that we are doing well, we are doing well in Maharashtra. Maharashtra turnover contributes almost 50% of the total west zone sales and another main market for us is Madhya Pradesh and Rajasthan. So, if you take west we are doing well in Maharashtra, Madhya Pradesh and Rajasthan. We are yet to pickup in Gujarat. In terms of north zone, NCR is a huge market for us. NCR and Haryana contributes roughly 30% and Punjab contributes maybe 20% and Uttar Pradesh nearly 33% of the total sales. So, as far as north is concerned, NCR and UP are the main thrust areas where we are getting reasonably good traction. In the east zone we are doing well in Orissa which is the branch that was started, one of the first branches that was started outside South India. Orissa contributes about roughly 40% of the sales of east zone and then we are also doing well in Jharkhand, but of course Jharkhand, West Bengal and Chhattisgarh are yet to really be comparable to the other states, so the sales volume is relatively less. So, these are the main states we are doing well outside South.
- Jagadishwar Pasunoori:** Okay, that's it from my side. I will get back to you if I have any questions, thank you.
- Mithun Chittilappilly:** Okay.
- Moderator:** Thank you sir. Next question comes from Ms. Hiral Sanghvi from Dalal and Broacha.
- Hiral Sanghvi:** Yeah, thank you. My questions have been answered.
- Moderator:** Thank you madam. Next question comes from Mr. Jasdeep Walia from Kotak Securities.
- Jasdeep Walia:** Hi, my questions have been answered. Thank you.
- Moderator:** Thank you sir. Next question comes from Mr. Tejas Shah from Spark Capital.
- Tejas Shah:** Hello?
- Mithun Chittilappilly:** Hello.
- Tejas Shah:** Yeah, hi Mithun, I just missed out on your South India and non-South India numbers for the quarter.
- Mithun Chittilappilly:** If you look at Q2 the total sale was 221 crores out of which 177 crores were from South and the rest from outside South India whereas last year we did about 130 crores in South India out of the total of 160 crores, so that is the basic split.
- Tejas Shah:** Okay and can you share the number of distributors you have in non-South India market as of today?
- Mithun Chittilappilly:** Yeah, we have roughly about 80 distributors outside South India.
- Tejas Shah:** Okay and Mithun, was just wondering, are your terms of trade very different in non-South India market and South India markets?
- Mithun Chittilappilly:** Yeah, they are slightly different, for example our payment terms in South India on an average maybe about 35 to 40 days whereas in the new markets it may be from 50 to 55 days on an average, so in terms of our payment terms there is a slight relaxation that we are giving in this new markets and also in terms of the pricing, many of the products that we are selling in south are probably discounted by 2, 3 percentages in outside South India. That maybe passed on to the market or even given as incentives to the distributor depending upon the product.
- Tejas Shah:** Okay. Mithun, was just wondering, we are trying to improve our working capital cycle by introducing this channel financing and I believe the right way would be to start from your South India market where you know the distributor very well. At the same time when you are moving in the non-South India market where your terms of trade are relatively weaker compared to South India market, so on a consolidated basis your working capital will improve going forward as your contribution from non-South India market increases or you will scale your channel financing facility to non-South India market also very soon?
- Mithun Chittilappilly:** I think we are probably in the initial phase not looking at providing this channel financing to outside South India distributors, because like you have mentioned, we know the distributors in South India much better and we know their financial soundness and credit worthiness better because we have been in business with them longer and as far as

the terms of payment, yes, I know that as of now there is this difference in terms of the number of days of payment, but we are increasingly reducing our, we are trying to bring down the debtors as much as possible, so of course if two years back the payment terms probably outside South India was close to 60 days, which we are now able to bring down an average of 50 days. So, going forward I think we will be further tightening and bringing it down and maybe in the next year we will look at maybe the A class distributors in outside South India where we might be able to offer them this channel financing facility.

Tejas Shah: Okay and by what period you are seeing channel financing covering your most of or majority of your South India distributors?

Mithun Chittilappilly: No, and current year our target for channel financing is about 30 crores whereas our total debtors is probably about 100, 110 crores and South Indian debtors out of that maybe about 75 crores, so we are looking at about 30 crores in the current financial year. In the next financial year we might probably look at an additional of 10 or 20 crores, so totally maybe 50 crores. So, probably we will look at about 50% of our South Indian debtors to be financed by the channel financing scheme.

Tejas Shah: Okay, thanks. Thanks Mithun and all the best.

Mithun Chittilappilly: Thank you.

Moderator: Thank you sir. Next question comes from Mr. Kamalesh Kotak from Asian Markets.

Kamalesh Kotak: Hello?

Mithun Chittilappilly: Hello, yes.

Kamalesh Kotak: Sir, going forward what should be the bias for business, we will be looking more towards the industrial or more towards consumer appliances business, and how you see the business growth coming from?

Mithun Chittilappilly: I think we are primarily a consumer company and most of the products we are selling are in the consumer space, so I think as far as the inclination of the company is concerned, we will still be inclined to being a consumer company, but if that means that we are having some strength that we are able to leverage and sell certain products in the industrial segment we will look at it, but of course the general focus will be on the consumer segment where a good brand, good after sales service and all these things are much valued and for which the consumer is willing to pay a premium, so we will look at that side of the business.

Kamalesh Kotak: And that will restrict to only the small electric appliances or also we are looking at white goods as a kind of complete chain of product portfolio.

Mithun Chittilappilly: I think we may not enter the major white goods market in India as it is already heavily competitive and it has also got a lot of large MNC and Chinese and Korean competitors and the margins we do know are very thin in that segment, so we will look at entering probably the smaller appliances segment where the focus of these big players is not there too much. So, we will look at something like kitchen appliances in the first phase, so I think in the next few years we will look mostly at smaller appliances.

Kamalesh Kotak: Okay and sir also could you get some idea as to how our market is shaped up in tier 1, tier 2 cities and the kind of rural urban kind of a market penetration?

Mithun Chittilappilly: I think I will first talk about South India because if you look at north our penetration level is very less, so if you look at South India we are present both in all the major towns and cities as well as the tier 2 markets. So, if you take an example, if you look at Karnataka roughly 60% of the turnover is contributed, in Karnataka in the current year we will do roughly about 200 crores in revenue so that is the target. Out of which we are expecting the Bangalore branch to do about 120 crores and the Hubli branch to do about 80 crores. So, if you look at the Bangalore branch, out of the 120 crores nearly 50%, 60% of their turnover comes just from Bangalore city alone whereas if you look at the Hubli branch it is primarily the agricultural belt and the tier 2, tier 3 towns because there are no major cities in that zone, so we are catering to both the markets and the product profile also changes, like in our Hubli branch we will be selling more of pumps and agricultural pumps, we will be selling more of economy fans, economy products, we will also be selling very small UPS systems for very small shops and those kind of things, whereas if you look at our Bangalore Branch they will be selling more of higher end items, more profitable items and those kind of things. So, we are now

present, if you look at south both these markets and we have products that cater to both the ranges, but the product profile slightly changes when you go from larger cities to smaller towns, but in smaller towns we have less competition so that means we probably get more margins, but whereas in the cities when the competition is higher so probably earn less, so it kind of negates the whole premium product vis-à-vis an economy product.

- Kamalesh Kotak:** And sir, what is our pump revenue; I missed that and which kind of pumps we are making?
- Mithun Chittilappilly:** We are making both single phase pumps and 3-phase agricultural pumps. We have pumps ranging from 0.5 horse power to 25 horse power and we have roughly about 250 to 300 models in this range.
- Kamalesh Kotak:** So, that includes submersible pumps also?
- Mithun Chittilappilly:** Yes, in single phase and 3-phase we have both submersible, monobloc and centrifugal.
- Kamalesh Kotak:** Okay and how much is the revenue from these particular products you are getting?
- Mithun Chittilappilly:** The pump revenue roughly contributes about 15% of our total revenues.
- Kamalesh Kotak:** Okay and sir, do we have all our manufacturing in-house or also we have outsourcing kind of model in terms of manufacturing of products as we expand our product portfolio, what would be the model for us?
- Mithun Chittilappilly:** I think we have a mix, certain products like wires we are manufacturing on our own 100%, but certain products like stabilizers we are not manufacturing any product, it is completely outsourced. Certain products like fan, water heater and pumps we manufacture about 10% to 15% and 85% of the products is outsourced, so it is a kind of a mix and match strategy depending upon the product line we are in. Going forward at least in the next, the couple of new products that I was talking about we will be initially going ahead with outsourced manufacturing, but we will be investing in certain assets like moulds and those kind of items where we will have a distinct advantage in terms of shapes and our own distinguishability as far as competitors are concerned, but the actual manufacturing process will be outsourced.
- Kamalesh Kotak:** Okay, that's all sir, thank you.
- Mithun Chittilappilly:** Thank you.
- Moderator:** Thank you sir. Next question comes from Ms. Nidhi Agarwal from Sharekhan.
- Nidhi Agarwal:** Sir, very good evening.
- Mithun Chittilappilly:** Yes, good evening.
- Nidhi Agarwal:** Yeah, I just wanted to know that non-south region if we see quarter-on-quarter why is the fall in 30% and it is contributing now 20% to your total sales?
- Mithun Chittilappilly:** Yes, so when you look at the non-south region, if you look at on a quarter-on-quarter basis you are right, after the first quarter the share of non-south region has come down, but that is typically a trend in those markets where the temperature variations are much higher, so the demand variation for products are also high, for example in July or August in a place like Delhi we will be very hard pressed to sell any air-conditioner stabilizers whereas we will still be selling some products in South India where the temperature variation is not so much, but if you look on our year-on-year basis, we have still grown by about 45%, however we are not completely happy with the growth in the new market and the issue I talked about that is the rains throughout the country and the cooler climate affecting the sales, it has affected us more in certain parts of non-south markets rather than in south, so a large part of that climatic conditions that affected our sales that has affected our sales more in non-south than in south. In south of course we only got affected mainly in Andhra Pradesh where there was some political disturbances in the last quarter, but apart from that all the other states have done well.
- Nidhi Agarwal:** So, earlier guidance of around 30% of sales from non-south region still hold or you see some...
- Mithun Chittilappilly:** I think we were looking at the non-south markets to contribute at least 30% of our sales and last year it was roughly 25% if I am not mistaken, last year it was about 22%. I think we are still looking at 30% however given the fact that we have not done well in Q2 in these markets it may be a tall order, but like I said the demand, if we do have a

normal summer I think right from Jan we should start seeing a lot of sales coming in from most products in these markets and we should be able to close somewhere with about 28% or 29%, so it is possible to reach 30%.

Nidhi Agarwal: Okay and again on the margin side, a guidance of 9% for the year requires a margin of around 10% in the H2, so that kind of margins looks possible?

Mithun Chittilappilly: 10% of margins, EBITDA margins, right?

Nidhi Agarwal: Right.

Mithun Chittilappilly: Yes, I think 10% of margins is possible because we will see lower selling and distribution cost due to two reasons, one is the less, like I explained most of the ad expenditure has already been accounted in the first two quarters, we will not be seeing much of that coming in and we are also expecting Q4 to be a really strong quarter for many products in terms of the season coming in and so we will be providing less discounts, so I think, yes, 8% to 9% margins for a full year basis is still possible.

Nidhi Agarwal: And this other expenses also has jumped up very sharply 6 to 7%.

Mithun Chittilappilly: Yes.

Nidhi Agarwal: So, some measures taken to contain that?

Mithun Chittilappilly: Yeah, I think the, you are talking about other expenses, right?

Nidhi Agarwal: Right.

Mithun Chittilappilly: Okay, I think as far as the establishment expenses are concerned, one of the reasons, we have couple of reasons why it's gone up, one is the rent portion, the rent we are paying for various offices and warehouses, that has gone up. That is mainly due to the fact that we have moved to larger warehouses in many parts of the country and we are going to be operating on a hub and spoke model where we have identified four major hubs across India which will be feeding to smaller branches, so that is a one-time expense and we do believe that the next couple of years we won't be requiring any additional space, so that is one reason. We have also had a one-time 35 lakh write off of an asset that has also increased the other establishment expenses, so I think in the next couple of quarters we will not see such a huge surge and if the sales volume does pickup I think we will see a decline in establishment expenses as a percentage of sales. So, I think it should further come down as far as the percentage of sale is concerned.

Nidhi Agarwal: Okay and lastly on the CAPEX plan, 25 crores for the year still holds good?

Jacob Kuruvilla: Yeah, definitely, we have to complete two projects earlier, one is in Hubli another one is Vijayawada, two major warehouses which we are building and also about Perundurai, the place where we have taken some land from SIPCOT, we are constructing our factory for solar water heater and we have got some spend on this ERP which we are implementing. All put together this 25 crores we are going to spend during this year.

Nidhi Agarwal: Okay, yeah, sir thanks for taking the question and all the very best.

Mithun Chittilappilly: Thank you.

Moderator: Thank you madam. Next question comes from Mr. Jagadishwar Pasunoori from Karvy Stock Broking.

Jagadishwar Pasunoori: Hello sir, thanks for taking my question again. Sir, you talked about revenue growth in FY13, 35% that is what you are expecting, can you give some guidance on the EBITDA margins also for FY13?

Mithun Chittilappilly: I think 8% to 9% EBITDA margins that we are expecting in the current year, I think we should be able to continue in the next year also. We do believe that we will be helped by the fact that there are certain overheads that may not increase as we grow in size for the next couple of years in terms of rent and all those things, so that should help us and some of these new branches that we are talking about that is outside South India they are yet to reach their full potentials, so as far as those branches are concerned the overheads like salaries and other expenses maybe high as of now compared to the sales, so which we should see improving when we see increase in volumes. So, I think 8% to 9% EBITDA margins is possible next year as well.

Jagadishwar Pasunoori: Okay and another thing sir, can you tell me about these current inventory levels in like, fans, maybe pumps and LT cables, it looks like these inventories have gone up, please correct me if I am wrong and is it going to have a pressure on the pricing going forward in the next 1 or 2 quarters?

- Mithun Chittilappilly:** Our average number of days of inventory as on September is 61 days, so that is roughly 140 crores worth of inventory. Out of the 140 crores finished goods inventory is about 100 crores and the balance made up by raw materials and work-in-progress and certain inventories in transit. So, out of this 100 crores, of course, the inventory level is 61 days. Last year in the second quarter our inventory level was about 65 days of sales, so there has been slight improvement when compared with last year, but we were expecting a lower inventory, it has mainly increased due to pump inventory, the pump inventory roughly is about more than two months of sales of inventory we are currently holding and we are also holding fan inventory, which is also more than what we are expected, so because of these two products we are holding more inventory than we had initially expected, so this is the reason for increase in the inventory.
- Jagadishwar Pasunoori:** It is just pumps and fans?
- Mithun Chittilappilly:** Yes, mainly pumps and fans, yes.
- Jagadishwar Pasunoori:** Okay, sir this LT cables I don't think they have reached a positive EBITDA margins as of yet, can you throw some more light on this, sir?
- Mithun Chittilappilly:** LT cable margins, no, we have not broken even yet, our EBITDA is about negative 4. Last year our EBITDA was about minus 11, so there has been an improvement or there has been a reduction in losses, however, in the current quarter we were expecting to breakeven. We had some issues in that product, because this is a product that primarily goes, is supplied to various projects and when there is a slowdown in the construction activity, there is an impact on the sale of this product. So due to the rising interest rates we have seen that many projects are getting postponed, some projects are getting shelved, so that has meant that the selling of this product has become more challenging and that is the reason why we are not able to breakeven in this product. So, as soon as we do feel that there should be some softening of rates coming up soon then you will see the demand for this product picking up. So, our aim in the current year is to at least breakeven in the product that is to at least reach zero losses for this product in the current year.
- Jagadishwar Pasunoori:** Okay sir and one last thing sir, what was the growth for these LT cables in this quarter, I missed the number, sir?
- Mithun Chittilappilly:** Our sales growth was about 60% compared to last year, but we have to understand that last year we had just entered the market, but the sales of LT cable when compared with Q1 sales were more or less flat, so we have not grown on a quarter-on-quarter basis, we have grown on a yearly basis, so that is the reason I said it has been challenging, but of course compared to last year we have grown by 60%.
- Jagadishwar Pasunoori:** Okay sir, thanks a lot, sir. Good luck.
- Mithun Chittilappilly:** Thank you.
- Moderator:** Thank you sir. There are no further questions. I hand over the floor to Mr. Arun Baid of IDBI Capital for closing comments.
- Arun Baid:** I would like to thank the management of V-Guard for giving us a chance to hold the con-call as well as all the participants for participating in it. Thank you.
- Moderator:** Thank you sir. Ladies and gentlemen, this concludes your conference for today. Thank you for your participation and for using Door Sabha's conference call service. You may disconnect your lines now. Thank you and have a pleasant day.

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