IFB Industries Ltd: Key Takeaways from FY19 Annual Report: Multiple headwinds impacted profitability in FY19; Strategic initiatives in place to trigger growth in the medium term

We analysed IFBI's FY19 Annual Report and key takeaways are:

1. The Appliance Division's margins came under pressure in FY19 due to a) increase in import duties and b) INR depreciation. IFBI could not fully pass on the costs to the consumers.
2. IFBI is taking efforts to localize manufacturing of high cost imports as a strategic step to insulate itself from future currency depreciation. Its AC facility is expected to deliver commercial production by end of Jan'20.
3. IFBI continued to have a dominant market share in both FL and TL WM.
4. Distribution network expansion remains a key focus area for the company with continuous efforts to expand the IFB Points and Distributor channels.

Key takeaways from Director's report and Management Discussion & Analysis

- The company achieved strong top line growth (+18% yoy), however, bottom line was hit mainly due to depreciation of rupee, higher material cost, increase in custom duty on AC/MWO and higher operating expenses etc.

Appliance Division

- The Appliance Division EBITDA margins were not satisfactory due to:

  a. Increase in import duties which could not be passed onto the market
  b. INR depreciation

- IFBI's focus remains on localization for some of high cost imports. This is a key de-risking mechanism against future currency depreciation impacts on the business.
- IFBI's efforts for localizing manufacturing within India has resulted in a new generation of electronic components for models being manufactured in India. This is expected to result in a significant portion of electronic controller imports being substituted by localized production.
- The company believes that the expected healthy customer demand, combined with the launch of new models and plans to reduce material costs, provide a robust outlook for the division.
- IFBI has rolled out price increases to address the impact of the increased forex levels and additional customs duties.
- The company continued to witness high competitive intensity with competition gaining market share through under-cutting and offering large margins to channels. Accordingly, IFBI aims to address this challenge by carefully positioning its products and managing multiple channels effectively.

FL WM

- A new range of models was introduced during FY19 and this has been well received in the market. The new introduction is expected to increase the product range and competitiveness in the high volume segments and drive market share gain.
- IFBI continues to maintain a dominant market share. Its range of models covers a full spectrum of features - wash program for delicate clothes, intuitive user interface, smart mobile based technologies, etc.
- The ongoing optimization and expansion of the distribution network is expected to lead to volume increases.

- Ongoing product development continues to focus on IoT capabilities, water and energy efficiency, user convenience and interface designs.

TL WM

- IFBI continues to gain market share in TL WM category. The product range has FA TL in 6.5 to 9.5 kg capacity segments.
- IFBI's TL WM continue to enjoy a niche position in the market with their aesthetics, features and wash performance.
- During FY19, IFBI's installed TL capacity was stretched and it was unable to supply to the market in full. The capacity has now been upgraded and IFBI aims to drive significant growth in TL placements across the markets as well as increase the volumes from this category.

Clothes Dryers and Dishwashers

- IFBI has planned a design upgrade for the clothes dryer segment which is expected to be complete by 4QFY20.
- The dishwasher segment has been growing due to a marketing push in both offline and online channels. IFBI has undertaken additional promotional and demo placements of dishwashers in large retail outlets and at IFB points.

Industrial segment - Dish washing and Laundry Equipment

- IFBI's industrial dishwashing segment has significant presence in varied customer segments including defense establishments, pubs and bars, large institutions, hotels and restaurants, etc.
- Industrial laundry equipment range (with capacities upto 400 kg) has been strengthened by the newly acquired business from Ramsons. It now includes a complete and competitively priced range of dryers, ironers, finishing equipment for clothing, including suits, etc.
- Integration of operations with the newly acquired Ramsons entity was completed in 3QFY19 and the larger sales team is now in place. As per the company, this category is margin accretive and offers an opportunity to expand IFBI's institutional sales.

Kitchen Appliances

- These are aspirational products and with the modernization of the Indian kitchens and the rising disposable incomes, IFBI expects significant growth from this segment over next three years.
- ~45% of the company's sales in this category is generated from IFB Points.

Microwave Ovens

- IFBI's new models with unique "Oil Free Cooking" technology are helping to drive growth.
- The company has registered industry leading growth in this category which has remained largely flat.
- IFBI's microwave cooking class program "Spice Secrets" educates customers on how to optimize the use of microwave oven. Every month the company now conducts 800+ classes across the country meeting ~16,000 customers.

Modular Kitchens

- Goa, Bangalore and Kolkata stores are now fully operational and are building significant enquiry pipelines. Completely new design format implemented in the Goa and Bangalore showrooms since Jan'18 have received a very good response.

- IFB's design offerings include unique features such as food grade, termite resistant and boiling water proof plywood. It intends to present to customers a range of modular kitchens with appliances (stand alone and built-in) in line with global trends.
- IFBI has strengthened the organizational structure for this category in areas such as product and retail design to expand this business going forward.
- IFBI aims to have 10 stores during FY20. It will also use IFB Points to promote the modular kitchen range.

Built-in Ovens, Chimneys and Hobs

- IFBI continues to increase its presence in all markets across the country with the products displayed in ~750 stores, including ~500 IFB Points. IFB points contribute to ~45% plus of sales in this category.
- The company is investing in improving the display quality and presence across the market.

Air Conditioners

- The sales performance for ACs for FY19 was below expected level.
- IFBI's key actions ahead will be to localize manufacturing for the fixed speed and inverter ranges of air conditioners. The project is planned to deliver commercial production by end of Jan'20. The new project is located at Goa.
- Distribution expansion is an ongoing exercise and continues to be a key focus area.
- IFBI is restructuring the sales force in this category and adding a dedicated sales team to focus on the key channels of special service deliveries, distribution etc.

Distribution channels

- Multi brand stores contribute 60% of sales by volume.
- IFB Points and the IFB website contribute ~14% of sales by volume. IFBI is targeting to increase the network to 600+ exclusive stores by Dec'19. It is also improving the instore experience to significantly increase sales. Currently, the company has ~520 IFB Points across India, of which ~176 are 'Company owned Company operated' (CoCo) stores.
- Channel of Distributors accounts for 14% of sales and is expected to drive volumes going forward on account of significant work happening in the past few quarters. IFBI considers this channel key to the expansion of IFB's reach into small towns and up-country areas across India. Over the last few quarters, this channel has added 9,500 retailers to the IFB network. IFBI will continue focusing on this channel as an important lever for future growth.
- CSD and institutional channel are a significant channel for direct customer contact and contribute 1% of sales by volume.
- Sales and Service Dealers (SSD) channel largely catering to customers who buy air conditioners, contributes 1% of sales. IFBI expects this channel to grow with expansion in the AC business.

Other highlights

- Sales of additives and accessories continue to be a key focus area and are expected to continue to contribute significantly, both to the topline and bottom line in the current year.
- Service function is one of the key strengths for the Appliances Division. IFBI currently has total of 964 service franchisees and 29 service training centers across India.
- IFBI's own call center at Goa continues to be effective in issue resolution and customer feed-back / cross selling initiatives with a total current manning of 110 people. The company has also outsourced call centers at Munnar and Hyderabad.

Engineering Division

- The Indian Auto Component Industry is expected to register a turnover of $100bn backed by strong exports ranging between $80-100bn by 2026, from the current $11.2bn.
- FDI inflows into the Indian automobile industry during the period Apr'00-Dec'17 were recorded at US $ 18.41 billion, as per data by DIPP.
- Despite stiff competition, the engineering division including the AFM division grew by 17%.
- The AFM vertical focused on brand building for the "ULTRAMILES" retail brand and expanding into new geographies.
- Despite stiff competition, Fine Blanking Division (FBD) grew by 17%.
- FBD is aggressively building a profitable order book. FBD is also focusing on increasing the customer base, both in auto and non-auto segments and substantial orders are on the cards.
- FBD has taken steps to strengthen its R&D activities to provide higher value added products to its customers.
- FBD aims to increase its productivity with less capital expenditure through better utilization of machines and tools and better planning.
- FBD is successfully addressing the following issues:

a. Strong pricing pressure from customers & competitors
b. Higher cost of CRC and HRC steel
c. Consistent increase in power cost
d. Rapid increase in minimum wages
e. High cost for new machinery & technology
f. Timely Raw material availability
g. Fluctuation in volumes in the automobile exerts
h. Pressure in meeting inventory and debtors matrix

Key Takeaways from Subsidiaries financials

Trishan Metals Private Ltd (TMPL)

- TMPL's performance has still not reached its potential, and needs improvement. It is expected that things will stabilize during FY20. It is expected that in current financial Trishan Metals will be in profit.

Wholly Owned Subsidiary Global Automotive & Appliances Pte Ltd. (GAAL) and step down subsidiary Thai Automotive and Appliances Ltd. (TAAL)

- IFBI acquired 100 % equity shares of GAAL during July 2017. GAAL holds 100% equity holding in TAAL. GAAL acts as a special purpose vehicle for further investment in TAAL.
- IFBI expects sound growth of GAAL & TAAL during FY20.
- This is the first year of operation of GAAL. It is optimistic about its business plan and forecast a good growth based on increasing demand in India and other places for electronics parts and semi conductors.

Key Takeaways from Standalone financials

- IFBI's sales/EBITDA/PAT stood at Rs 25.4bn/Rs 1.2bn/Rs 546mn in FY19, +18%/-22%/-34% yoy.
- EBITDAM contracted 251bps to 4.9% in FY19 largely due to rise in raw material cost which increased from 56.0% of sales in FY18 to 58.5% of sales in FY19.
- Employee cost/other expenses as % of sales stood at 10.0%/26.6% in FY19 as against 9.8%/26.8% in FY18.
- A&P expense as a % of sales were flat yoy at 6.2% in FY19.

- Services and warranty expense as a % of sales declined from 2.7% of sales in FY18 to 2.5% of sales in FY19.
- Receivables days increased marginally from 29 days of sales in FY18 to 30 days of sales in FY19 whereas inventory days increased from 53 days of sales to 56 days of sales during the same period.
- Loans and advances fell sharply from 12 days of sales in FY18 to 6 days of sales in FY19 largely due to lower advances with statutory authorities (-Rs 215mn), with related parties (-Rs 44mn) and lower advances for goods and services (-Rs 65mn).
- Payables days/other current liabilities decreased from 62/15 days of sales in FY18 to 60/12 days of sales in FY19.
- Non-cash working capital increased from 17 days of sales in FY18 to 21 days of sales in FY19.
- CFO decreased sharply from Rs 1.2bn in FY18 to Rs 498mn in FY19 due to lower profits and higher investment in WC.
- Net change in cash was Rs 80mn in FY19 against Rs 167mn in FY18.
- Contingent liabilities decreased from Rs 246mn in FY18 to Rs 151mn in FY19 and as a % of sales declined from 31% of sales in FY18 to 21% of sales in FY19.

Exhibit 1: Breakup of P&L

Rs. Million	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**
Net Sales	9,159	10,208	12,615	15,009	17,407	21,517	25,399
Raw Materials Cost	5,489	5,957	7,108	8,607	10,054	12,045	14,855
as a % of sales	*59.9%*	*58.4%*	*56.3%*	*57.3%*	*57.8%*	*56.0%*	*58.5%*
Employee Cost							
Salaries and wages	695	817	1,001	1,273	1,348	1,755	2,068
as a % of sales	*7.6%*	*8.0%*	*7.9%*	*8.5%*	*7.7%*	*8.2%*	*8.1%*
Contribution to provident and other funds	79	68	107	141	116	162	190
as a % of sales	*0.9%*	*0.7%*	*0.9%*	*0.9%*	*0.7%*	*0.8%*	*0.7%*
Staff welfare expenses	75	94	116	142	150	195	292
as a % of sales	*0.8%*	*0.9%*	*0.9%*	*0.9%*	*0.9%*	*0.9%*	*1.2%*
Total Employee Cost	849	979	1,224	1,556	1,615	2,111	2,551
as a % of sales	*9.3%*	*9.6%*	*9.7%*	*10.4%*	*9.3%*	*9.8%*	*10.0%*
Other Expenses							
Consumption of stores and spares	369	382	571	746	849	1,044	1,218
as a % of sales	*4.0%*	*3.7%*	*4.5%*	*5.0%*	*4.9%*	*4.9%*	*4.8%*
Rent	74	77	90	131	178	236	313
Insurance	10	13	13	14	14	16	19
Freight, octroi and carriage	278	313	380	490	591	755	914
Power and fuels	100	118	154	169	195	225	249
Ancillary cost	254	293	374	415	470	498	627
Rates and taxes	47	51	84	74	75	43	19
Expenditure on Corporate Social Responsibility	0	0	1	1	3	6	5
Office expenses	173	193	245	284	317	343	397
Advertisement and sales promotion	444	566	712	921	972	1,339	1,581
as a % of sales	*4.9%*	*5.5%*	*5.6%*	*6.1%*	*5.6%*	*6.2%*	*6.2%*
Travelling	182	198	252	269	283	304	356
Repairs :	0						

Buildings	4	7	4	5	5	6	12
Plant and machinery	25	33	45	50	65	80	96
Others	19	25	36	44	49	66	68
Excise duty on differential stock	0	13	7	0	0	0	0
Loss on exchange fluctuation	3	144	26	44	0	0	0
Write off of fixed assets	11	4	3	3	3	3	11
Write off of debts / advances	12	4	4	2	4	4	2
Write off of capital advances	0	0	0	0	0	2	1
Provision for doubtful debts and advances	2	3	2	0	2	5	4
Provision for diminution in value of mutual funds	4	0	0	0	0	0	0
Bank charges	15	8	8	9	10	13	12
Directors' sitting fees	1	1	1	1	2	2	2
Service expenses	131	183	232	285	345	451	502
Warranty expenses	30	60	35	49	94	134	140
Service + Warranty expenses	**161**	**242**	**268**	**334**	**438**	**585**	**642**
as a % of sales	*1.8%*	*2.4%*	*2.1%*	*2.2%*	*2.5%*	*2.7%*	*2.5%*
Miscellaneous expenses	129	135	139	148	179	190	200
Total Other Expenses	2,318	2,819	3,417	4,152	4,705	5,763	6,746
as a % of sales	*25.3 %*	*27.6%*	*27.1%*	*27.7%*	*27.0%*	*26.8%*	*26.6%*
EBITDA Margin	*5.5%*	*4.4%*	*6.9%*	*4.6%*	*5.9%*	*7.4%*	*4.9%*

Exhibit 2: Breakup of Non-Cash Working Capital

Rs. Million	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Accounts Receivable	479	723	907	1,155	1,382	1,723	2,113
Days of sales	*19*	*26*	*26*	*28*	*29*	*29*	*30*
Inventory	1,320	1,555	2,231	2,144	2,349	3,107	3,926
Days of sales	*53*	*56*	*65*	*52*	*49*	*53*	*56*
Loans and Advances	161	210	226	249	321	719	421
Days of sales	*6*	*8*	*7*	*6*	*7*	*12*	*6*
Other Current Assets	7	8	2	7	2	5	15
Days of sales	*0*	*0*	*0*	*0*	*0*	*0*	*0*
Accounts Payable	1,199	1,420	2,267	2,253	2,630	3,664	4,163
Days of sales	*48*	*51*	*66*	*55*	*55*	*62*	*60*
Other Current Liabilities	398	586	622	685	829	859	827
Days of sales	*16*	*21*	*18*	*17*	*17*	*15*	*12*
Non-Cash Working Capital	371	490	478	617	596	1,031	1,487
Days of sales	*15*	*18*	*14*	*15*	*12*	*17*	*21*

Exhibit 3: Breakup of Cash Flows

Rs. Million	FY13	FY14	FY15	FY16	FY17	FY18	FY19

<u>Cash Flow from Operations</u>							
PBT	434	293	593	352	682	1,193	769
Depreciation	183	226	406	454	436	514	545
Others	-67	-37	-95	-61	-78	-60	-55
Tax Paid	93	56	146	92	142	210	260
Changes in Working Capital	-131	-220	66	-165	29	-262	-502
Net Cash from Operations	326	206	824	487	926	1,175	498
<u>Cash Flow from Investing</u>							
Capex	-505	-578	-815	-658	-626	-340	-651
Change in Investment	-437	225	-105	408	-419	-366	695
Others	11	-7	17	41	10	-202	-358
Net Cash from Investing Activities	-931	-360	-903	-210	-1,036	-908	-314
<u>Cash Flow from Financing</u>							
Change in debt	100	381	-136	-186	121	-69	-76
Change in Equity	420	0	0	0	0	0	0
Others	-2	-14	-18	-22	-31	-31	-29
Net Cash from Financing Activities	518	368	-153	-208	90	-100	-104
<u>Net Change in Cash and Cash Equivalents</u>	-88	214	-233	69	-19	167	80

Exhibit 4: Financials of Subsidiaries

Trishan Metals Pvt. Ltd.	FY 17	FY 18	FY 19
Sales	336	777	1,244
PBT	-55	-37	-32
PAT	-84	-35	-38

Thai Automotive & Appliances Ltd.	FY 18	FY 19
Sales	198	311
PBT	-4	0.3
PAT	-4	0.3

Global Automotive & Appliances Ltd.	FY 18	FY 19
Sales	0	185
PBT	-0.4	14
PAT	-0.4	13

Exhibit 5: Salaries of key personnel

Salaries of key personnel (Rs. Mn)	FY15	FY16	FY17	FY18	FY19
Mr. Bijon Nag	3.60	4.13*	8.45	10.24	14.17
% growth	*16.0%*	*14.8%*	*104.7%*	*21.1%*	*38.5%*
Mr. Sudam Maitra	5.16	9.00#	9.61	10.22	12.09
% growth	*NA*	*74.6%*	*6.7%*	*6.4%*	*18.3%*
Mr. Prabir Chatterjee	6.47	7.22	7.04	7.80	7.94
% growth	*58.8%*	*11.7%*	*-2.5%*	*10.8%*	*1.8%*

**The increase was mainly due to claims of earlier year entitlement made in the year of reporting*

#Employer during part of year and hence not comparable

Exhibit 6: Contingent Liabilities

Rs. Million	FY18	FY19
Disputed tax matters and other ma□ers contested in appeals	171	151
Custom duty and interest obligation for advance licenses	75	0
Total Contingent Liabilities	246	151
as a % of net profit	*31.2%*	*21.5%*