

Crompton Greaves Consumer Electricals

23 June 2017

Reuters: CROP.BO; Bloomberg: CROMPTON IN

Rechristened For An Electrifying Future

We remain optimistic about healthy growth in the consumer electricals sector over the next five to seven years because of favourable macro-economic drivers like higher GDP growth, rising rural electrification, increased urbanisation, growth in affordable housing, lower inflation, higher disposable income as well as rising trend of product upgradation by urban consumers. Crompton Greaves Consumer Electricals (CGCEL) is well placed to reap the benefits of upturn in the industry driven by its strong management pedigree, the revitalised Crompton brand, increasing product innovation and augmenting distribution network. With a strong focus on product premiumisation as well as scaling up hitherto untapped categories like premium fans, residential LED luminaires and agricultural pumps, CGCEL is likely to register 13.3% revenue CAGR and 24.6% earnings CAGR over FY17-FY19E. The financial profile remains superlative with healthy profitability, highest fixed-asset turnover and return ratios among peers and a negative working capital cycle. We initiate coverage on CGCEL with a Buy rating and a target price of Rs260 based on 36x FY19E earnings.

Consumer electricals to witness long-term sustainable growth: With rising affordability and growing necessity of basic electrical products like fans and lighting, rural demand is likely to get a strong impetus from healthy improvement in rural electrification and the push for affordable housing. The number of households electrified rose from 55% in 2011 to 70% in 2016 while the government aims to achieve 100% electrification by the end of 2018. Similarly to attain its objective of 'Housing For All' by 2022, 113mn affordable houses have to be constructed, which has potential to double the market size of electrical products even with a 50%-60% achievement rate. In urban areas, replacement demand is the main driver where an increased shift towards premium products is underway driven by rising disposable income and the aspiration for upgrading lifestyle and room décor.

Revitalised Crompton offers bright future prospects: Under the new management, Crompton is rebuilding its brand after years of under-investment. The brand has been revitalised with a new logo and increased advertisements which clearly appeal to the youth. The emphasis on deepening consumer connect by communicating the strength of the brand (as a mark of trust and quality) along with new and improved product range offering better aesthetics, functionality and innovation is aiding growth. Along with renewed brand building, initiatives such as rising product innovation, augmenting distribution network, premiumisation of product portfolio as well as enhancing focus on hitherto untapped opportunities like premium fans, residential LED luminaires and agricultural pumps is likely to drive a healthy 110bps EBITDA margin expansion and 24.6% earnings CAGR over FY17-FY19E.

Outlook and valuation: CGCEL is a strong financial franchise with 24.6% earnings CAGR over FY17-FY19E, strong operating/free cash flow (Rs9bn/Rs8.5bn over FY17-FY19E), highest fixed-asset turnover (19.1x in FY19E) and return ratios among peers (RoCE/RoIC of 44.4%/76.2% in FY19E, respectively) and a negative working capital cycle which will aid its valuation. We have valued CGCEL at 36x FY19E earnings with a target price of Rs260, up 20% from the CMP, and assigned Buy rating to it. The target P/E of 36x is in line with that of Havells India and factors in a PEG ratio of 1.5x.

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E
Net revenues	18,117	39,759	44,875	51,073
EBITDA	2,095	4,902	5,692	6,828
PAT	1,052	2,907	3,651	4,514
EPS (Rs)	1.7	4.6	5.8	7.2
EPS growth (%)	NA	38.2	25.6	23.6
EBITDA margin (%)	11.6	12.3	12.7	13.4
P/E (x)	129.9	47.0	37.4	30.3
P/BV (x)	59.7	25.3	18.1	13.4
EV/EBITDA (x)	67.9	29.1	24.7	20.3
RoCE (%)	46.5	40.3	42.1	44.4
RoIC (%)	51.9	59.8	66.1	76.2

Note: FY16 comprises of six months. Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Consumer Electricals

CMP: Rs218

Target Price: Rs260

Upside: 20%

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Key Data

Current Shares O/S (mn)	626.7
Mkt Cap (Rsbn/US\$bn)	136.6/2.1
52 Wk H / L (Rs)	246/130
Daily Vol. (3M NSE Avg.)	1,201,618

Shareholding (%)	4QFY17	3QFY17	2QFY17
Foreign Promoter	34.4	34.4	34.4
FII	29.1	26.5	23.4
DII	13.2	14.9	13.2
Others	23.3	23.3	23.3

One -Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
CGCEL	1.2	51.6	59.2
Nifty Index	2.2	20.2	16.0

Source: Bloomberg

Crompton Greaves Consumer Electricals – Business overview

CGCEL came into existence on 1 October 2015 as a result of the acquisition of consumer electricals business of erstwhile Crompton Greaves (CGL). The original entity was promoted by the Thapar group (founded by Mr. Lala Karam Chand Thapar in Kolkata more than eighty years ago) and later rechristened as Avantha Group in November 2007 (after the partition of the Thapar Group's assets among its family members). On 1 October 2015, Avantha Holdings sold its entire stake of 34.37% in the consumer electrical entity to private equity investors Advent International and Temasek Holdings, who renamed the company as CGCEL. Today, CGCEL manufactures and markets a wide spectrum of consumer products ranging from fans, light sources and luminaires, pumps and household appliances such as geysers, mixer-grinders, toasters and irons and sells them under the brand name Crompton. Crompton has been the market leader in fans, domestic pumps and street lighting for over 20 years. It has manufacturing locations in Goa, Vadodara, Ahmednagar and Baddi. 50% of its products are manufactured in-house while the remaining 50% are outsourced. The retail presence of Crompton products spans across nearly 100,000 outlets in India.

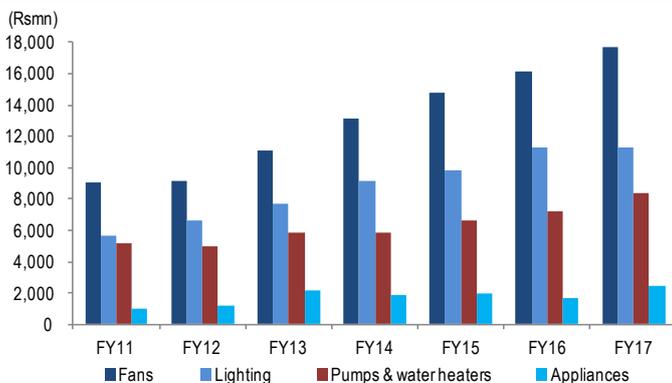
Currently, fans account for the largest part of CGCEL's product portfolio with ~45% share where Crompton is an industry leader with 25% market share. Lighting is the second-largest segment for CGCEL, accounting for 28% of its FY17 revenues. Crompton has 10% market share in India's lighting segment and is the third-largest brand while it is a leader in the street lighting segment. Pumps is the third-largest division accounting for 18% of sales where Crompton has industry leader status in the residential pumps category with 28% market share, while in overall pumps industry Crompton has 8% market share. The remaining revenues come from the appliance segment where Crompton sells geysers, mixer-grinders, toasters and irons and has a very low market share. Under the new management, Crompton is rebuilding its brand by focusing on product innovation, improving brand positioning, increasing advertising, augmenting distribution network and focusing on premiumisation across categories.

Exhibit 1: Electricals industry synopsis

Electrical products	Size - FY17 (Rsbn)	Organised market share (%)	Crompton's market share	Share in Crompton's FY17 revenues	Top 4 players
Lighting	112	60%	10%	28%	Philips, Surya Roshni, Crompton, Bajaj,
Fans	69	75%	25%	45%	Crompton, Orient, Usha, Havells,
Pumps	113	70%	8%	21%	Kirloskar, CRI, KSB, Crompton

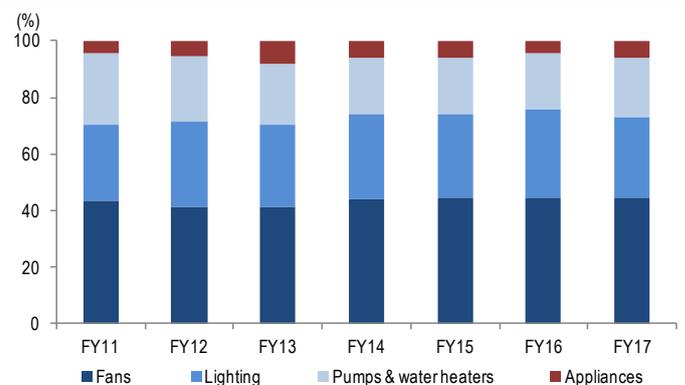
Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 2: Product category-wise revenue trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Product category-wise revenue mix

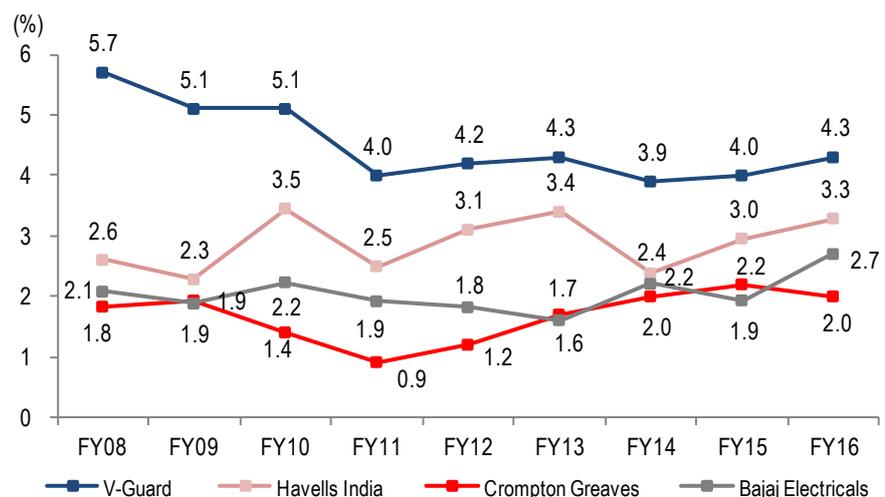


Source: Company, Nirmal Bang Institutional Equities Research

How things are changing under the new management

- Strong pedigree of the new management:** Avantha Holdings, the erstwhile promoters of Crompton Greaves, divested its entire stake of 34.37% in the consumer products business (now renamed as CGCEL) to private equity investors, Advent International and Temasek Holdings. The new promoters of CGCEL have appointed an impressive senior management team having a strong performance track record and rich experience across various consumer-focused businesses in their previous stints. Mr. Shantanu Khosla, managing director, has rich experience in consumer products giant Procter & Gamble India where he served as its MD & CEO from July 2002 to June 2015. Mr. Mathew Job, chief executive officer, has worked with Philips Electronics India for 15 years and prior to joining CGCEL he was MD of water heater giant Racold Thermo. Mr Sandeep Batra, chief financial officer, held a similar position in Pidilite Industries for seven years prior to joining CGCEL. With such a rich and diverse experience of handling strong pedigree brands, their distribution network, product positioning as well as engaging consumers through advertising and sales promotion, the senior management of CGCEL is expected to chart a strong growth trajectory for the company along with elevating the brand Crompton towards superior positioning.
- Investment in building the Crompton brand:** Under the erstwhile promoters, the brand Crompton was under-invested owing to higher focus on the larger business of power T&D. While other electric peers like Havells India and V-Guard Industries spent around 3%-5% of their annual revenues towards advertisement and promotion, Crompton Greaves lagged behind at around 2%. Further, lack of focus on premium offerings and product innovations as well as absence of consumer communication owing to negligible TV commercials posed the risk of the Crompton brand losing its appeal among the youth. The new management of CGCEL has clearly identified deepening consumer connect of the Crompton brand as a key priority. The brand has been revitalised with a new logo and increased TV advertisements which clearly appeal to the youth. Communicating the strength of the brand (as a mark of trust and quality) along with new and improved product range offering better aesthetics, functionality and innovation helped in reinvigorating the Crompton brand. Further, the focus on a premium range of products in advertisements also helped to improve the brand equity of Crompton in the minds of consumers. CGCEL's management aims to maintain advertising expenditure in line with peers and keep investing in building the brand for long-term sustenance.

Exhibit 4: Peer comparison in advertisement spending



Source: Respective companies, Nirmal Bang Institutional Equities Research

- Rising focus on R&D and product innovation:** CGCEL's management has intensified its focus on product innovation as well as research and development (R&D) so as to stay ahead of peers and keep providing the consumers with aesthetically appealing and performance-wise superior products. In particular, a strong focus is laid on three core growth drivers - premium fans, LED lights and agricultural pumps. The management has identified core parameters like energy efficiency, better functionality and smart products as the key features to be imbibed in its product portfolio. CGCEL incorporated state-of-the-art design tools and techniques covering thermal, optical and electronic aspects to develop high performance, aesthetic and highly energy efficient products along with focusing on value engineering in order to be cost-competitive. Some of the key innovative product launches includes the Hawk series of

streetlights, Pluto/Neptune/Jupiter series of industrial lights, India's first intelligent ceiling fan which can adjust its speed by sensing the room temperature, India's first anti-dust fan and two stage monobloc pumps with an 80m 'head'. New product sales contributed 18% to total lighting sales and 4% to fan sales last year.

- **Augmenting distribution reach:** CGCEL is placing a lot of importance on building 'go-to-market' reach as having a strong distribution network is one of the critical factors for success in the consumer electricals industry. CGCEL currently has more than 3,500 distributors and a retail presence of 1,00,000 outlets which it aims to enhance further to ensure the right product at the right price and at the right place. With a focus on increasing distribution to new geographies and expanding retail reach in smaller towns, CGCEL increased its presence in channels like modern retail (to cover 850 stores across formats) and e-commerce (via exclusive online brand outlets on Flipkart, Paytm and Snapdeal). Products like LEDs, geysers, coolers and mixer-grinders are among the best-sellers in the organised retail as well as the online format. Further, to deliver best-in-class after-sales service, the reach of service centres was expanded to over 500 with a focus on faster resolution of service requests (89% of service requests were resolved in 48 hours, up from 86% earlier). Also, registration of service requests via company's website was enabled to improve accessibility.
- **Enhanced focus on premium fans:** Across product categories, there is an increasing shift towards premium and differentiated products driven by rising disposable income of consumers. While the core driver of fans in rural areas is increased electrification, the core driver in urban areas is replacement demand whereby the trend of rising demand for premium and decorative fans is clearly visible. Even though Crompton Greaves has been a market leader in fans in India since many years, it had relatively lesser focus and lower product portfolio aimed at premium fans. The premium fan market was strongly tapped by Havells India, which became the market leader in this category by creating a strong brand equity despite entering the fan segment much later in 2002 compared to legacy brands like Crompton, Orient, Usha and Bajaj Electricals which were present since many decades. Consequently, the management of CGCEL has rightly identified significantly enhancing its presence in the premium fan segment - not only to plug the product portfolio gap but also to drive incremental revenue growth and profitability owing to higher realisation in premium fans. CGCEL made a couple of breakthrough innovations in the ceiling fan category by launching India's first intelligent ceiling fan which can adjust its speed by sensing the room temperature (named Avancer) and India's first anti-dust fan which uses dust-proof coating material on the blades of the fan (named Aura Prime). The share of premium fans in total fan revenues jumped from 7% in 3QFY16 (when CGCEL came into existence) to 16% in 4QFY17 and achieved volume growth of 35%/30% in FY16/FY17, respectively, thus vindicating the management's approach.
- **More focus on LED lights & luminaires:** The lighting industry is undergoing a major shift from traditional light sources such as incandescent bulbs, FTL and CFL to energy-efficient LED lights. Government initiatives such as Integrated Power Development Scheme (IPDS) and Deendayal Upadhyaya Gram Jyoti Yojana (DDUGJY) have helped in increasing electrification and providing uninterrupted supply of power in both urban and rural areas. At the same time, government schemes such as Unnat Jyoti by Affordable LEDs For All (UJALA) to promote LED lighting and Street Light National Programme (SLNP) to replace street lights have aided rapid commercialisation of LED technology owing to bulk sourcing, thereby driving the prices down for consumers. CGCEL is actively participating in such schemes as it helps to garner volume which aids in bringing down the cost of production and prices of LEDs owing to economies of scale. CGCEL launched high performance, aesthetic and highly energy-efficient products like the Hawk series of street lights and the Pluto/Neptune/Jupiter series of industrial lights to cater to commercial lighting (45%-50% share of India's lighting industry) and outdoor lighting (street lights, flood lights and infrastructure projects – 20%-25% share of total industry). CGCEL won orders for 14mn LED lamps and LED street lights from Energy Efficiency Services (EESL). Residential lighting forms the remaining 25%-30% of India's lighting industry where Crompton has a strong brand pull, believed to be second after Philips. Overall, new product sales formed 18% of total sales in the lighting segment last year. Apart from LED lights, our channel checks suggest that LED luminaire/fixture is another low hanging fruit (but much more profitable) that CGCEL is on course to tap owing to its limited presence so far.

Exhibit 5: CGCEL versus peers - financial comparison

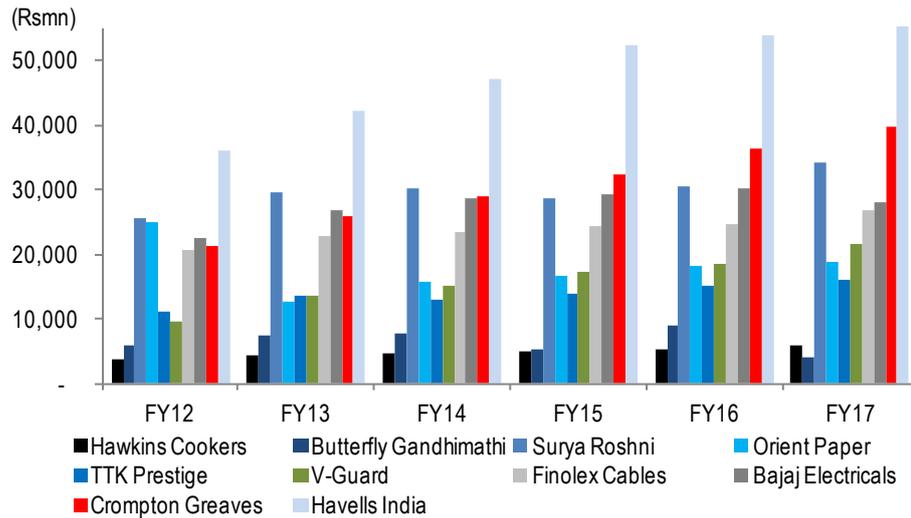
Financial comparison	Crompton Greaves			Havells India			V-Guard Industries			Bajaj Electricals		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Y/E March, (Rsmn)												
Revenues	39,759	44,875	51,073	61,353	71,301	83,496	21,506	24,884	29,010	42,617	48,165	54,895
Revenue growth (%)	9.7	12.9	13.8	14.1	16.2	17.1	15.5	15.7	16.6	(7.2)	13.0	14.0
EBITDA	4,902	5,692	6,828	8,241	9,850	12,036	2,150	2,532	3,085	2,428	2,979	3,821
PAT	2,907	3,651	4,514	5,969	7,405	9,073	1,518	1,873	2,401	1,077	1,519	2,160
EPS (Rs)	4.6	5.8	7.2	9.6	11.9	14.5	3.6	4.4	5.7	10.7	15.0	21.4
EPS growth (%)	38.2	25.6	23.6	17.1	24.1	22.5	35.9	23.4	28.2	(2.4)	41.1	42.2
Dividend Yield (%)	0.7	0.9	1.1	0.7	1.1	1.4	0.4	0.6	0.8	0.8	1.2	1.8
Valuation (x)												
CMP (Rs)		218			483			186			342	
P/E	47.0	37.4	30.3	50.6	40.8	33.3	52.0	42.2	32.9	32.1	22.7	16.0
P/BV	25.3	18.1	13.4	9.2	8.4	7.6	12.4	10.3	8.4	4.0	3.6	3.1
EV/EBITDA	29.1	24.7	20.3	34.5	28.6	23.1	36.7	30.9	25.1	16.2	12.8	9.8
EV/Sales	3.6	3.1	2.7	4.6	4.0	3.3	3.7	3.1	2.7	0.9	0.8	0.7
Return ratio (%)												
RoCE	40.3	42.1	44.4	19.6	21.9	24.8	30.8	30.5	30.7	15.0	18.6	22.6
RoE	53.9	48.5	44.4	18.2	20.6	22.8	23.8	24.4	25.6	12.4	15.6	19.4
RoIC	59.8	66.1	76.2	58.6	65.9	80.0	36.8	38.1	41.8	16.7	21.2	26.2
Profitability ratio (%)												
Gross margin	31.2	31.5	31.9	40.5	40.2	40.0	31.3	31.0	30.8	28.4	28.7	29.0
EBITDA margin	12.3	12.7	13.4	13.4	13.8	14.4	10.0	10.2	10.6	5.7	6.2	7.0
PAT margin	7.3	8.1	8.8	9.7	10.4	10.9	7.1	7.5	8.3	2.5	3.2	3.9
Free cash flow yield	1.2	1.3	1.7	1.2	0.8	1.2	0.4	0.7	1.2	0.7	0.4	0.2
Free cash flow / Revenue (%)	4.1	3.9	4.4	6.0	3.2	4.2	1.6	2.1	3.3	5.9	2.6	1.3
Turnover ratio												
Total asset turnover ratio (x)	3.3	3.4	3.4	1.7	1.8	1.9	3.3	3.2	3.1	3.0	3.4	3.6
Fixed asset turnover ratio (x)	18.3	18.5	19.1	3.5	3.7	4.0	7.8	7.6	8.0	8.2	8.4	8.9
Debtor days (on sales)	50	52	54	14	13	12	54	55	53	142	137	132
Inventory days (on direct costs)	31	32	33	93	91	90	68	64	62	68	63	59
Creditors days (on direct costs)	95	95	96	63	60	58	54	53	52	75	80	82

Source: Respective companies, Nirmal Bang Institutional Equities Research

Key business strength of Crompton versus peers

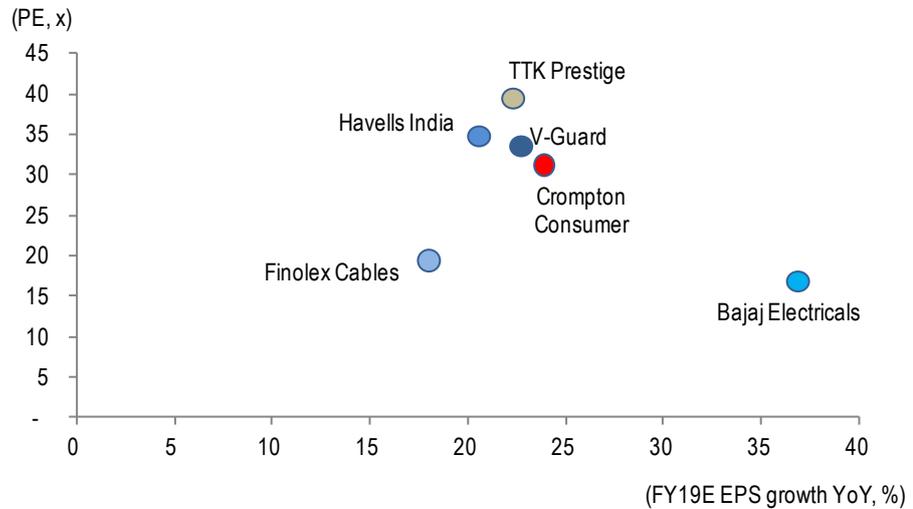
- Crompton is the second-largest electricals company in India with FY17 sales of ~Rs40bn, next to Havells (Rs61bn sales).
- Crompton has industry leader status in fans (25% market share) and residential pumps (28% market share) and is the third-largest lighting brand (10% market share).
- Crompton is favourably placed compared to peers as it does not have a presence in the cable & wire segment (a commodity business and worst-hit because of 28% GST rate).
- Crompton has best-in-class return ratios and fixed-asset turnover among peers, operating with an ex-cash negative working capital cycle.
- Brand Crompton is undergoing revitalisation under the new promoters and a strong management pedigree.

Exhibit 6: Revenue trend of consumer electrical companies



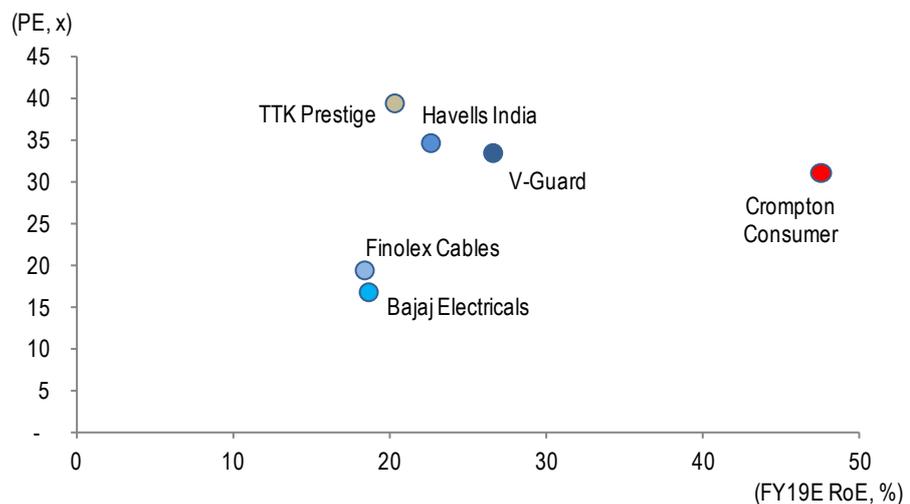
Note: Only consumer products business across companies has been considered for like-to-like comparison
Source: Respective companies, Nirmal Bang Institutional Equities Research

Exhibit 7: Peer comparison - FY19E P/E versus EPS growth metrics



Note: Bloomberg consensus numbers for all companies, Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 8: Peer comparison - FY19E P/E versus RoE metrics



Note: Bloomberg consensus numbers for all companies, Source: Bloomberg, Nirmal Bang Institutional Equities Research

Key feedback from our Lohar Chawl ground research

We visited multiple dealers and distributors of Crompton as well as other electrical brands at Lohar Chawl on 9 June and 20 June 2017 to find out the impact on trade owing to GST as well as competitive positioning and brand salience of Crompton versus its peers. Key takeaways are as follows:

Impact of GST

- Most of the dealers were not sure of the exact financial impact because of GST and were looking to clear old inventory. However, the prices were steady and there were no large discounts or slump sales.
- None of the electrical companies have announced any additional incentives to dealers for clearing old inventory, unlike at the time of demonetisation.
- Electrical companies themselves were asking dealers to be light on inventory and focus on clearing old stock, but if old inventory remains unsold till 1 July 2017 then dealers do not have the option of returning it back to the companies.
- Some dealers were expecting a rebate at the rate of 60% of excise duty paid on stocks older than two months prior to GST implementation.
- Our overall belief is that large dealers are not concerned about GST as they are already doing business in white with a legal invoice. However, small dealers who sell without an invoice by undercutting prices to the extent of tax evaded are likely to be adversely affected.
- Most dealers were aware of the fact that they will have to make changes after GST implementation to get into the formal/organised segment. However, most dealers were not aware of what will be the change in pricing, trade terms and working capital needs post GST implementation.
- Business is completely back to normal after a brief lull post demonetisation. Cash is back in circulation in a big way because of the liquidity situation easing in the past few months. While many dealers have stopped using card machines (that were installed during the demonetization period), most of those who accept card payment were charging 2% extra as transaction costs.

Feedback of fan segment

- Crompton is the highest-selling fan brand at Lohar Chawl with wide product offerings across most dealers.
- On an average, there has been a price hike of Rs50-Rs150/unit over the past three months across all brands of fans.
- Anti-dust fans of Crompton were witnessing good demand with some multi-brand fan dealers feeling that it has an edge over premium fans of Havells. The anti-dust fans of Crompton were priced around Rs2,400-Rs2,600 across most dealers.
- In the regular economy category of fans (Rs1,300-Rs1,700 range), high speed fans witnessed good demand.
- One of the dealers stated that they get a margin of around 2%-6% on sale of Crompton fans, but the key focus remains on attaining higher volume. The credit period offered by Crompton on fans was 30 days.

Feedback of lighting segment

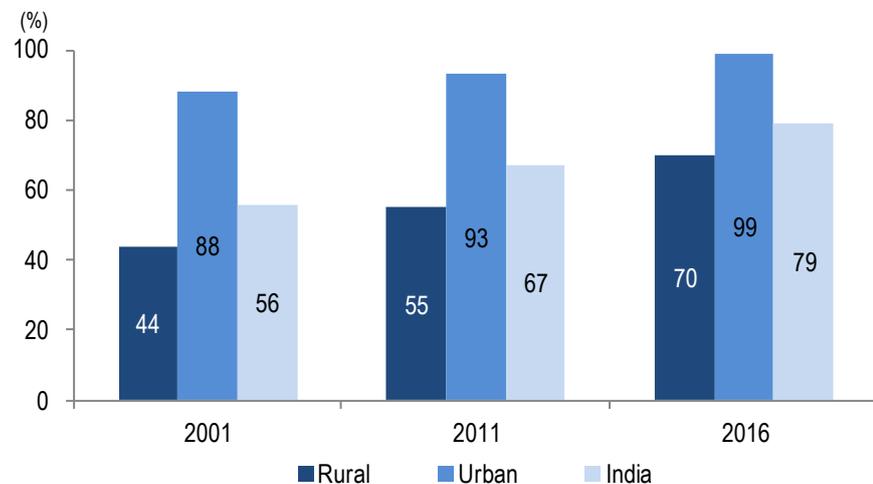
- Philips, Havells and Crompton are the most widely available lighting brands.
- In LED bulbs, the prices of Philips and Crompton were the lowest and at par with the price of a 7 watt LED bulb of both brands available between Rs100 to Rs110 each, while a 9 watt LED bulb of both brands costs Rs140-Rs160 each. A 20 watt LED tubelight of both brands was priced around Rs500-Rs600.
- A Crompton dealer stated that he gets a credit period of 42 days and a two-year warranty on tube lights and bulbs.
- However, Crompton clearly lagged behind Philips and Havells in terms of availability of luminaires and fixtures. Even large exclusive Crompton lighting dealers had limited stock of luminaires.

Key growth drivers of electricals industry

- Rising electrification:** Lack of electrification has been one of the key deterrents in widespread penetration of electrical products in India. As seen in Exhibit 9, the electrification level (percentage of household electrified) in rural areas remained low at 55% in 2011 and grew at a low pace of only 11% in 10 years from the level of 44% in 2001. Consequently, the penetration level in rural areas for most products is low. However, over the past few years, there has been a sharp rise in rural electrification driven by rising government focus on electrifying all villages in India. From 2011 to 2016, the electrification level improved from 55% to 70% while the urban electrification level rose from 93% to 99%. Consequently, electrification on a pan-India level rose from 67% in 2011 to 79% in 2016. Further, the government set an ambitious target to achieve 100% electrification by the end of 2018 and provide power 24x7 to all households. This will spur the demand for electrical products in a large way as products like lights and fans are basic necessities which a household will buy first on having access to electricity.

A case in point being the low penetration level of 65% of fans in rural areas compared to 90% in urban areas until FY15, as per CRISIL. Similarly, in the lighting industry in India, commercial lighting dominates the overall lighting market with 45%-50% share followed by residential lighting at 25%-30%. In contrast, globally the residential segment commands a higher share of 40%-45%. The reason for lower residential share in India is on account of lower level of electrification as well as unavailability of continuous power supply throughout the country. As the electrification scenario improves, core electrical products like fans and lighting are likely to witness higher market penetration.

Exhibit 9: Household electrification

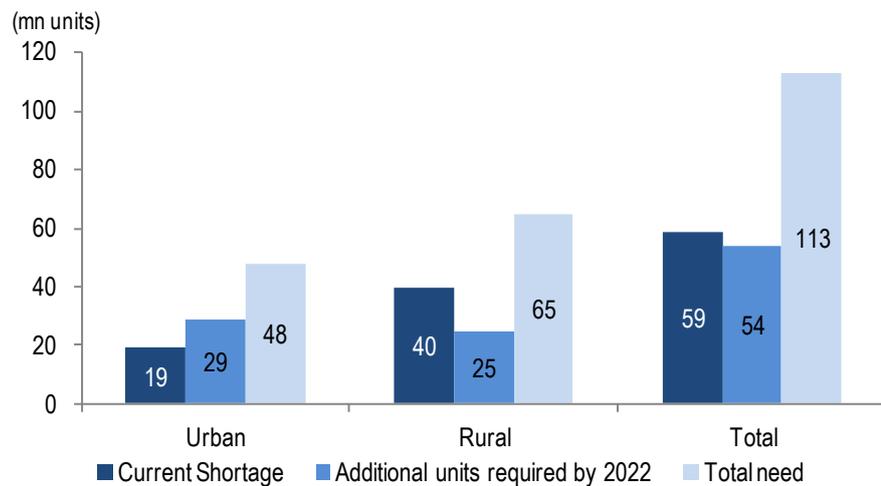


Source: Ministry of power, Nirmal Bang Institutional Equities Research

- Support of various government schemes:** In order to expedite the pace of electrification and support faster adoption of electrical products in a cost-efficient manner, the Central government launched many initiatives and schemes. While Integrated Power Development Scheme (IPDS) has been launched to ensure uninterrupted availability of power in urban areas, Deendayal Upadhyaya Gram Jyoti Yojana (DDUGJY) has been undertaken for a rise in rural penetration with increased electrification. Further, electrical product-specific schemes have also been launched to ensure procurement in bulk quantity to provide economies of scale to manufacturers and drive down prices for consumers. Some of the successful schemes include Unnat Jyoti by Affordable LEDs for All (UJALA) to promote more efficient LED lighting, Street Light National Programme (SLNP) to replace street lights with energy-efficient lighting options, National Energy Efficiency Fans Programme (NEEFP) to promote energy-efficient fans and Super-Efficient Equipment Programme (SEEP) to encourage adoption of more-efficient appliances having better functionality by providing financial stimulus. Support of such government schemes is likely to make electrical products more affordable owing to bulk sourcing and increase the pace of their adoption.

- Affordable housing and urbanisation:** The aim of the Central government to provide housing for all citizens by 2022 is likely to be a strong growth driver for off-take of electrical products. As seen in Exhibit 10, the current shortage of housing is 59mn units while an additional requirement of 54mn units by 2022 is necessary to achieve the target of 113mn units for achieving the objective of housing for all by 2022. Out of the total housing requirement of 113mn units, urban areas account for 48mn units while rural areas account for 65mn units. 70% of urban housing and almost entire rural housing units are under the affordable housing category which has been recently conferred with infrastructure status. Under government schemes such as Pradhan Mantri Awas Yojna (PMAY), Central grant and interest subvention is likely to be provided to support affordable housing construction. Even if we assume a 50% success rate for this scheme, then 50mn housing units could come up by 2022, resulting in good demand for basic electrical products such as fans and lights. Considering just one room per affordable house, the incremental demand for fans over the next six years works out to 50mn units, thereby providing an opportunity for the current fan industry size of 60mn units to double itself. Various state governments have started constructing affordable houses under PMAY for economically weaker sections of society. Recently, Andhra Pradesh awarded a turnkey contract worth Rs13.3bn to Larsen & Toubro (L&T) for construction of 22,000 residential units housed under multiple buildings in West Godavari district.

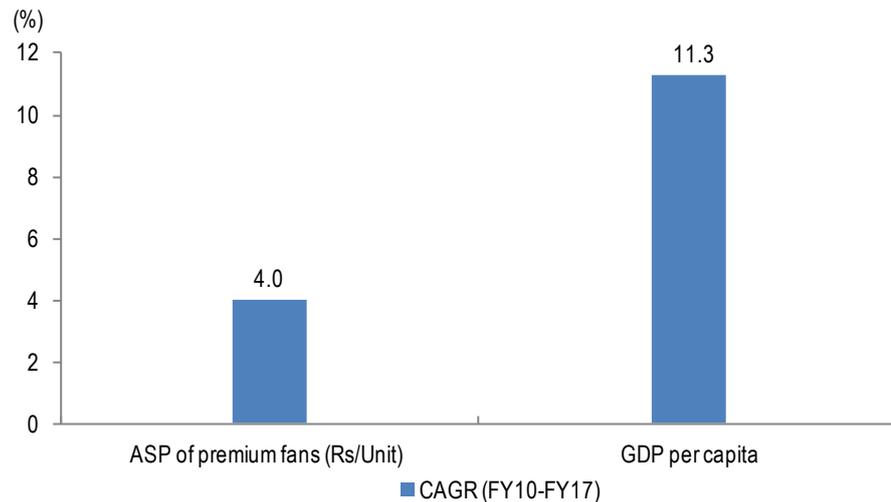
Exhibit 10: Total housing requirement in India



Source: Industry, Nirmal Bang Institutional Equities Research

- Replacement demand and premiumisation in urban areas:** In urban areas, replacement demand is one of the main growth drivers with the average life of fans at 10 years and a light source (bulb or tube light) being 2 years. The penetration level of basic electrical products in urban areas is already high (in case of fans it was 90% in 2015, as per CRISIL), but there is a rising trend of urban consumers opting for premium products to improve their lifestyle. While LED lights have witnessed a sharp rise in penetration in urban areas, partly driven by falling prices, a healthy growth in luminaires is also being witnessed as the spending on interior decoration rises. Similarly, an increased shift towards premium and decorative fans is underway, driven by rising disposable income of consumers. While the per capita GDP in India posted 11.3% CAGR over FY10-FY17, the average selling price of even a high-end segment like premium fans rose only by 4% CAGR over the same period to Rs2,500 per unit. Considering the fact that a premium fan or LED luminaire is highly affordable owing to low ticket size, the shift towards premiumisation in urban areas is likely to increase further.

Exhibit 11: FY10-FY17 CAGR in per capita GDP and ASP of premium fans



Note: ASP – Average selling price

Source: Central Statistical Organisation, Industry, Nirmal Bang Institutional Equities Research

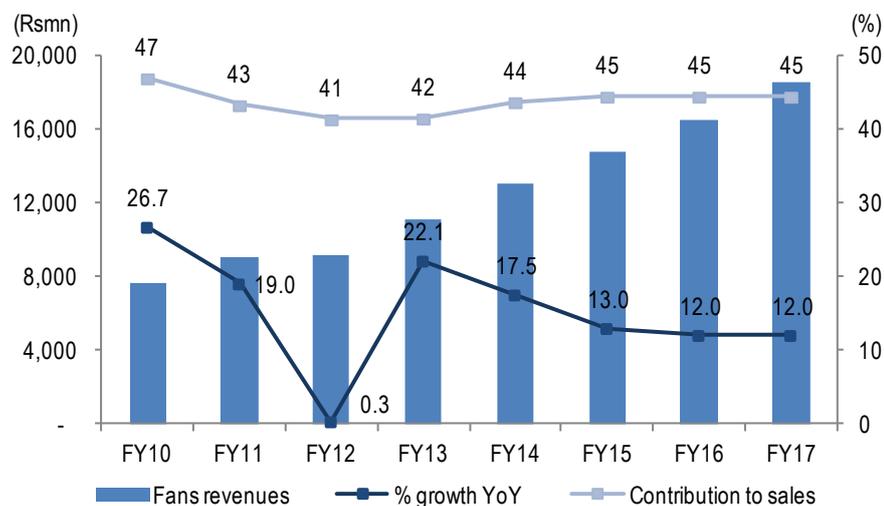
- EESL:** One of the significant and most successful initiatives of the Central government’s energy efficiency programme has been its EESL venture. Through the UJALA scheme, the government has proactively driven technology changes in the lighting industry towards faster adoption of energy- efficient LED lights. Along with achieving its goal of savings in power cost, EESL also helped in improving awareness of the benefits of LED lights and rapid commercialisation of the technology owing to bulk sourcing, thereby driving the prices down for consumers. Success in LED lighting is sought to be leveraged in other product categories such as ceiling fans and agricultural pumps. CGCEL also participated in the EESL programme and won orders for 14mn LED lamps and LED street lights.

Fan segment – Crompton has industry leader status

The brand Crompton is synonymous with the product category of fans where it has industry leader status since many years along with strongest brand recall, wide product portfolio and highest distribution reach in India. The fan market size in India is estimated at 60mn units currently in volume terms and Rs69bn in value terms, with rural penetration level of 65% and urban penetration level of 90%. Unlike the AC segment which is highly fragmented, in fan segment top 5 legacy brands account for 90% of the organised market share, with Crompton being the leader (25% market share), followed by Orient (22%), Usha (19%), Havells (15%) and Bajaj Electricals (10%). Unorganised market caters to 25% of total demand for fans. Rising electrification in rural areas and replacement demand and premiumisation in urban areas are key growth drivers of the fan segment. Further, a significant increase in affordable housing and urbanisation led by Pradhan Mantri Awas Yojana as well as various government schemes to popularise usage of efficient fans such as NEEFP could act as a catalyst for incremental demand.

CGCEL has identified expanding its presence in the premium fan category as a key focus area as it had a limited presence in it under the previous management. The market size for premium fans is estimated to be Rs10bn where Havells has become the market leader. CGCEL launched innovative premium fans such as intelligent fan which automatically adjusts its speed as per room temperature and anti-dust fan which has achieved strong success, resulting in Crompton’s premium fans portfolio posting strong volume growth of 35%/30% in FY16/FY17, respectively. Consequently, the share of premium fans in total fan revenues rose from 7% in 3QFY16 to 16% in 4QFY17. With only two players having a strong brand pull in the premium fan category (Havells and Crompton), the future growth outlook remains buoyant. While rising sales of premium fans will lead to higher value growth owing to better realisation, it will also aid profitability because of premium pricing.

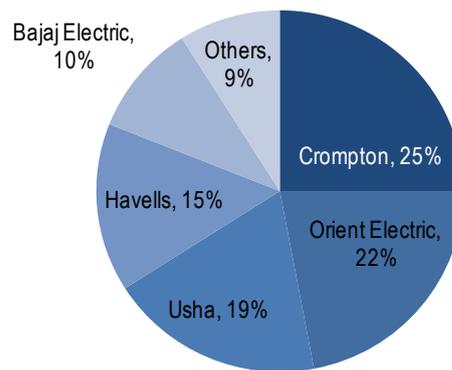
Exhibit 12: Revenue trend in fans



Source: Company, Nirmal Bang Institutional Equities Research

With rising electrification in rural areas (from 55% in 2011 to 70% in 2016, the government’s ambition is to achieve 100% by end-2018), the sales growth of fans is expected to be faster fueled by first-time buyers. Considering the fact that a fan is a basic necessity and is more affordable (compared to coolers and air-conditioners) it will aid its penetration in rural areas (currently at 65%). The price range of fans starts from Rs900 for brands in the unorganised segment and Rs1,100 for brands in the organised segment. In urban areas, fans have already achieved a high penetration level of 90%. The key growth drivers for fans in urban areas are replacement demand and premiumisation. The average life of a fan is 8-10 years after which replacement kicks in, whereby the trend of rising demand for premium and decorative fans is clearly visible driven by rising disposable income of urban consumers. While India’s per capita GDP expanded by 11.3% CAGR over FY10-FY17, the average selling price of premium fans rose by only 4% CAGR - from Rs 1,900 in FY10 to Rs2,500 in FY17 - thereby making premium fans an attractive option for upgrading lifestyle and room decor.

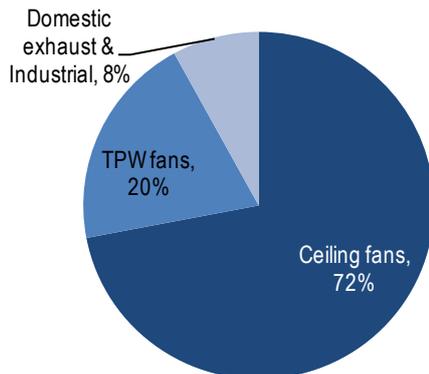
Exhibit 13: Market share break-up in fan category



Source: Industry, Nirmal Bang Institutional Equities Research

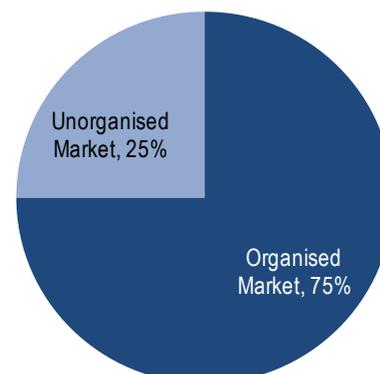
Fans can be broadly classified into three product categories, namely ceiling fans, table pedestal and wall fans (TPW), and domestic exhaust/industrial fans. In terms of prices, fans have been categorised into three segments - entry level (sub-economy, Rs1,100-Rs1,500), economy (Rs1,500-Rs2,000) and decorative (premium, above Rs2,000). Ceiling fans (72% of total market) are most widely used. They are attached to the ceiling and are immobile. TPW fans (20% of total market) are mobile and used in places which require localised cooling. Domestic exhaust fans are used in kitchen and washrooms while industrial fans are used for directing air flow in various industrial processes. Together, domestic exhaust and industrial fans form 8% of the total fan market. CGCEL is present in all three categories of fans. Around 60% of the fans supplied by Crompton are manufactured in-house while the rest 40% are outsourced from local suppliers. For the entire fan industry, the demand is largely met locally, with imports accounting for 8%-10%, mainly from China.

Exhibit 14: Segmentation of electric fans



Source: CRISIL, Nirmal Bang Institutional Equities Research

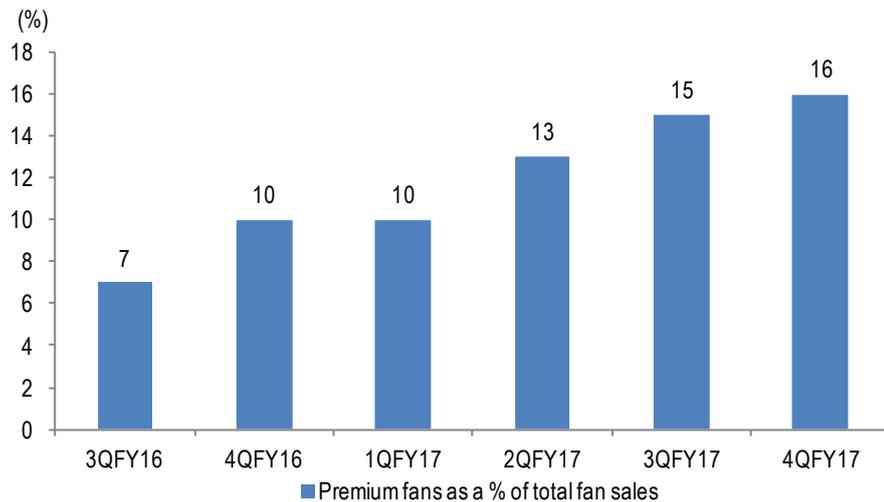
Exhibit 15: Organised versus unorganised segment market share



Source: CRISIL, Nirmal Bang Institutional Equities Research

The management of CGCEL has rightly identified significantly enhancing its presence in the premium fans segment to not only plug the product portfolio gap but also to drive incremental revenue growth and profitability owing to higher realisation in premium fans. Demand for premium fans in urban areas is on the rise with consumers increasingly focusing on aesthetics and appearance. CGCEL made a couple of breakthrough innovations in the premium fan category by launching India's first intelligent ceiling fan which can adjust its speed by sensing the room temperature (named Avancer) and India's first anti-dust fan which uses dust-proof coating material on the blades of the fan (named Aura Prime). The share of premium fans in total fan revenues jumped from 7% in 3QFY16 (when CGCEL came into existence) to 16% in 4QFY17 and achieved volume growth of 35%/30% in FY16/FY17, respectively. The success of these innovative products signifies the management's focus on premium products and vindicates its strategy.

Exhibit 16: Rising share of premium fans



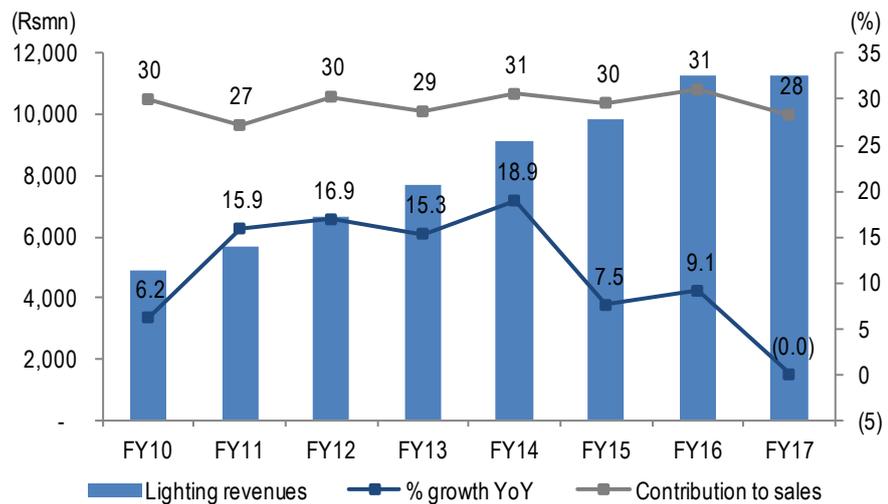
Source: Company, Nirmal Bang Institutional Equities Research

With strongest brand recall, wide product portfolio and highest distribution reach in India, the fan segment is set for a healthy growth with rising profitability. The growing presence of fans across retail stores (over 1,00,000 touch points currently) will aid CGCEL's revenue growth. Rising rural penetration (expected to touch 78% by FY20), replacement demand, premiumisation and initiatives such as affordable housing will be catalysts for driving growth. Under the PMAY scheme, 113mn housing units are required to achieve the objective of Housing For All scheme by 2022. Assuming a 50% success rate for this scheme, 50mn housing units could come up by 2022 and result in additional requirement of 50mn fans (considering just one room per affordable house), thereby providing an opportunity for the current fan industry size of 60mn units to double itself. We are factoring in 11% volume growth for CGCEL's fan portfolio over FY17-FY19E. Rising share of premium fans (having higher realisation) and likely price hike of 2%-3% across the industry (owing to 28% GST rate) will translate to 14% value growth over FY17-FY19E. While CGCEL does not report operating margin of fans separately, it is the core driver of ECD segment's strong EBIT margin of 17.3% in FY17, up 160bps YoY, as fans account for 65% of ECD sales. With rising share of premium fans, improving operating leverage and healthy growth outlook for pumps category (29% of ECD sales), we expect ECD segment to register 70bps rise in EBIT margin over FY17-FY19E.

Lighting – Rising share of LEDs to drive growth

Lighting industry is undergoing a significant transformation with the market size of traditional light sources (GLS, FTL and CFL) declining in volume and value terms as the industry is shifting towards LED. Lighting is the second-largest product segment of CGCEL, accounting for 28% of its FY17 sales. The lighting market in India is estimated at Rs112bn currently wherein the top 6 players account for 73% of the organised market. With its early entry into LED lights, Philips leads the market with 23% share followed by Surya Roshni (14%), Crompton (10%), Bajaj Electricals (10%), Wipro (8%) and Havells (8%). The remaining 27% of the organised market is highly fragmented. The unorganised market accounts for 40% of the total market, primarily aided by lack of quality standards for LED lights earlier. However, the bulk sourcing initiative from EESL proved to be a game changer for the lighting industry and the organised players. Rising rural electrification, 24x7 power supply in urban areas, rising awareness of LED lights, Street Light National Programme (SLNP) initiative of the government and the growth in affordable housing are some of the key growth drivers for the lighting segment.

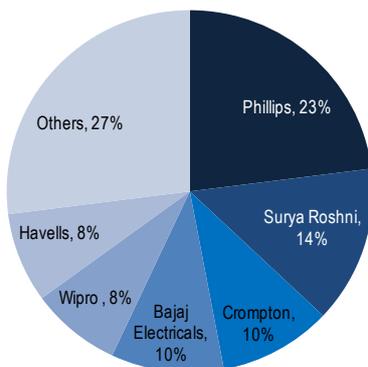
Exhibit 17: Lighting revenue trend



Note: FY16 revenue has been annualised. Source: Company, Nirmal Bang Institutional Equities Research

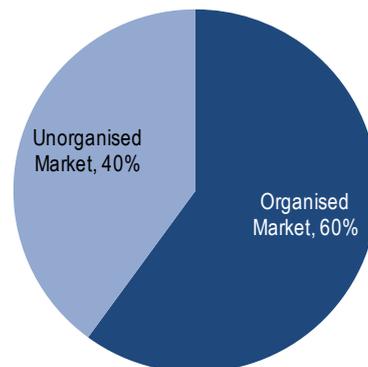
The lighting industry is witnessing a rapid shift from traditional GLS, FTL and CFL lamps to LED lamps fuelled by the mass sourcing initiative of EESL. Through the UJALA scheme, the government has proactively driven technology changes in the lighting industry towards faster adoption of energy-efficient LED lights. Along with achieving its goal of savings in power cost, EESL also helped in improving awareness of the benefits of LED lights and rapid commercialisation of the technology owing to bulk sourcing, thereby driving the prices down for the consumers.

Exhibit 18: Estimated market share of various players



Source: CRISIL, Nirmal Bang Institutional Equities Research

Exhibit 19: Organised and unorganised segment market share

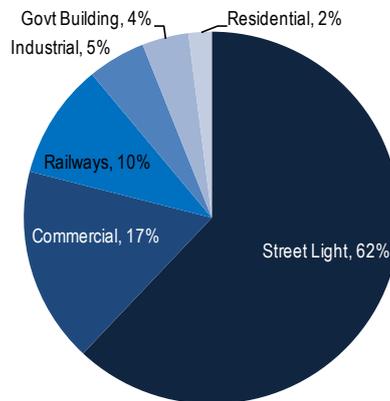


Source: CRISIL, Nirmal Bang Institutional Equities Research

The lighting segment is classified into two product categories - lamp and fixture. Lamp is further sub-divided into LED and conventional while fixture (also known as luminarie) is further sub-divided into consumer and professional. 64% of lighting sales of Crompton is accounted for by LED products (up from 44% in 4QFY16). Within LED, fixtures account for 60% of Crompton's sales while lamps account for the remaining 40%.

Lighting sales of Crompton are equally divided between B2B and B2C customers. Historically, Crompton has been strong in the B2B channel (like street lights, commercial lighting and infrastructure projects) and intends to scale up its presence in the B2C segment (retail customers) by focusing on strengthening its distribution network. Out of total LED sales in India, 62% is accounted for by street lighting, 17% by the commercial segment, 10% by railways, 5% by the industrial segment, 4% by government buildings and only 2% by the residential segment.

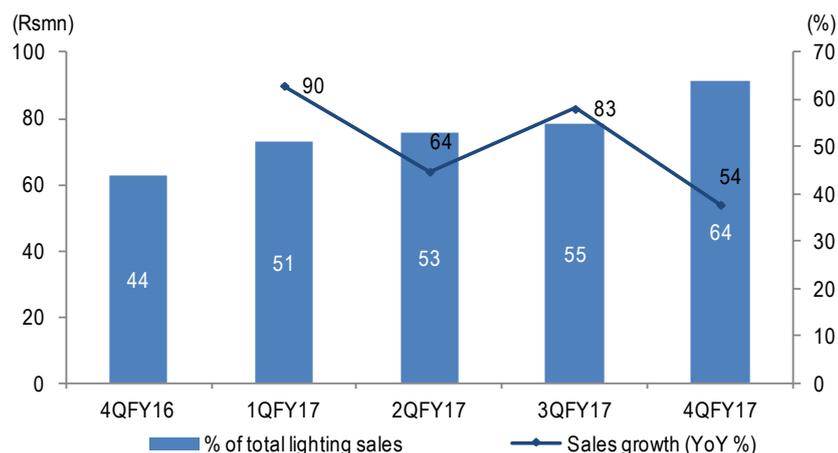
Exhibit 20: User segmentation of LEDs



Source: CRISIL, Nirmal Bang Institutional Equities Research

Crompton is leader in the street lighting segment with a market share of 20%. Aided by government initiative of Street Light National Programme (SLNP) to replace street lights with efficient LED lights, this segment is poised for a healthy growth in future. Under SLNP, 100 cities have been selected with an aim to replace 35mn units of street lights with LEDs by March 2019. Further, low penetration of LED lights in the industrial and residential segments also presents a huge opportunity of replacement demand for organised LED players. One of the high-margin category which remains untapped by Crompton is the residential LED fixture segment. The management has identified it as a key focus area and is increasing its product offerings of fixtures and strengthening the retail distribution network to improve its market share. The management does not feel that LED lights or EESL orders are margin-dilutive and believes that all forms of sales channels like retail, B2B, e-commerce, government and EESL can co-exist together and grow. While CGCEL posted ~65% YoY growth in LED sales in FY17, its overall lighting sales were flat because of decline in traditional light sources. However, having attained a favourable base of LED (57% of lighting segment revenues in FY17), stabilisation of LED prices and strong growth likely in luminaires (~70% YoY growth in 2HFY17), we expect CGCEL to register 11% revenue CAGR over FY17-FY19E. The lighting segment enjoyed a decent EBIT margin of 8.7% in FY17, flat on YoY basis. Considering the sharp reduction in LED prices over the past few years owing to bulk sourcing of EESL, Crompton has attained cost leadership to preserve the current level of margins. With rising share of more profitable residential luminaires business, stabilisation in prices of LED and favourable sales mix of LED in total lighting portfolio from FY17 onwards, we expect CGCEL to register 50bps rise in EBIT margin over FY17-FY19E to 9.2% in FY19E.

Exhibit 21: Rising share of LED in Crompton's lighting revenues

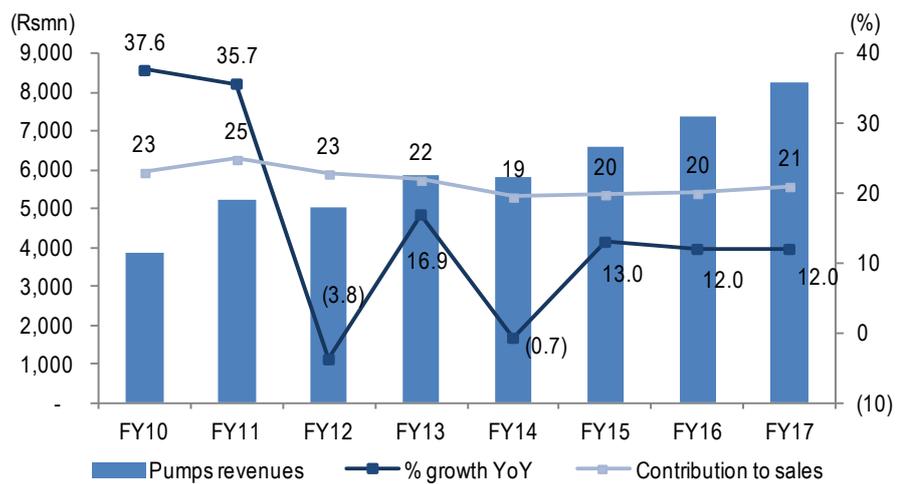


Source: Company, Nirmal Bang Institutional Equities Research

Pumps segment – residential pumps drive growth

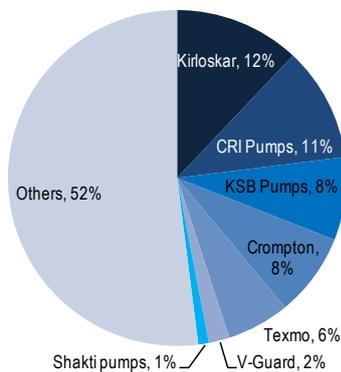
Pumps is the third-largest product segment for CGCEL accounting for 21% of its FY17 revenues. The market size of pumps is estimated to be Rs113bn currently. Top 5 players account for 45% of the organised market share led by Kirloskar (12%), CRI Pumps (11%), KSB Pumps (8%), Crompton (8%) and Texmo (6%). The remaining 55% of the organised market is highly fragmented while 30% of the industry is catered to by the unorganised market. CGCEL is mainly present in water pumps, which forms 59% of the total market, while non-water pumps accounted for the remaining 41%. The current market size for water pumps is estimated to be around Rs63bn in value terms, with the agricultural sector accounting for 45% of it followed by domestic (35%) and industrial pumps (20%). In the water pump category, CGCEL leads the residential pump market with 28% market share wherein it has a dominating market share of 40% in North and East India. CGCEL manufactures 25% of its pumps in-house while the remaining 75% is outsourced. The growth in pump industry is likely to be driven by increase in irrigation investment leading to higher penetration, government schemes like Housing For All, growth in industrial activity and decreasing ground water level. With about half of farmland in India still lacking irrigation system, the outlook for pump segment looks bright.

Exhibit 22: Revenue growth trend in case of pumps



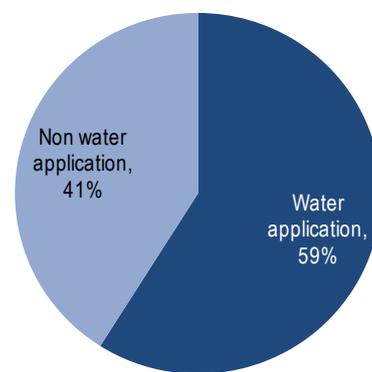
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 23: Market share break-up of pump segment



Source: CRISIL, Nirmal Bang Institutional Equities Research

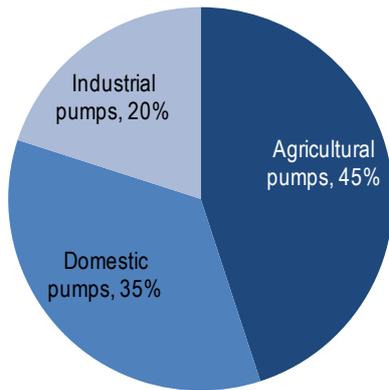
Exhibit 24: Break-up of water & non-water application pumps



Source: CRISIL, Nirmal Bang Institutional Equities Research

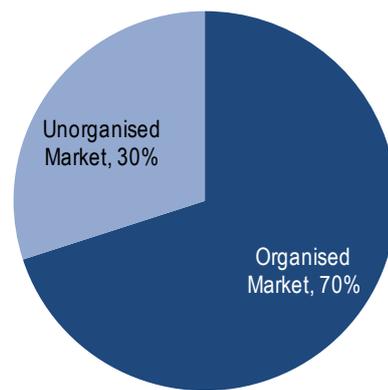
Demand for residential and agricultural pumps is linked to the monsoon. Schemes like Accelerated Irrigation Benefits Programme (AIBP) and Command Area Development (CAD) launched by the government will help expedite the demand for pumps. Industrial demand for water pumps will largely be driven by government's focus on developing urban infrastructure. In residential pump category, where Crompton is the market leader, the company's key focus area is to expand its presence in West and South India. Similarly, it aims to enhance its presence in agricultural pumps, which had received limited focus under the previous management. With a healthy performance of some of its products like de-watering pumps, CGCEL continues to gain market share by focusing on new product launches (like sewage submersible pumps). With a growing share of residential pumps and scaling up of agricultural pumps, we expect the pump segment to post 14% revenue CAGR over FY17-FY19E.

Exhibit 25: Market segmentation for water pumps



Source: CRISIL, Nirmal Bang Institutional Equities Research

Exhibit 26: Organised and unorganised segment market share



Source: CRISIL, Nirmal Bang Institutional Equities Research

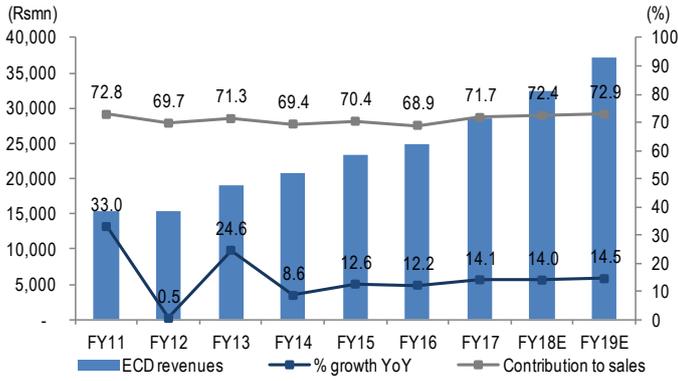
Appliances – small but a promising category

Crompton aims to leverage its brand equity of fans, lights and pumps to scale up its appliance business. Water heaters account for a major part of appliances while other key products are air-coolers, mixer-grinders and irons. While the immediate focus area of Crompton is to expand its presence in three core growth drivers of premium fans, LED lights and agriculture pumps, the appliance category can provide high growth because of its relatively low base. Apart from organic growth (driven by improvement in existing distribution network), CGCEL is also willing to explore inorganic opportunities which could elevate it among the Top 3 players of that category.

The growth of small appliances market is expected to be driven by product innovation, upgradation of existing products, and value-added features in the coming years. Increase in middle class population and addition to workforce will have a positive impact on demand for small appliances. Further, growth in urban and rural housing along with a rise in rural penetration is also likely to have a significant impact on the demand for small appliances. With the penetration of branded household appliances still not very high, there are plenty of opportunities for organised players to grow.

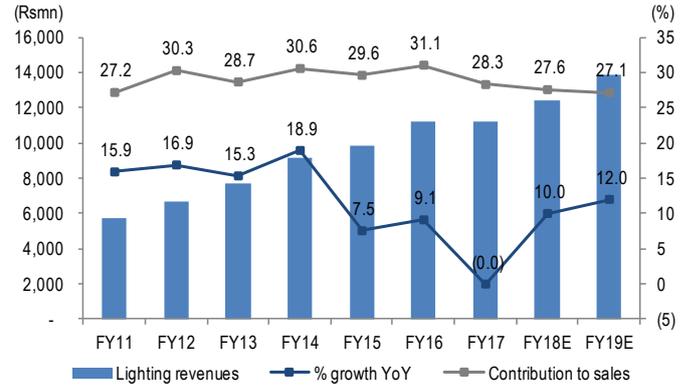
Plan to scale up export business

Exports currently account for only 1.0%-1.5% of total sales of CGCEL. The management has identified geographies such as the Indian subcontinent, Middle East and Africa where it can scale up exports by building a good distribution network.

Exhibit 27: ECD revenue growth trend


Source: Company, Nirmal Bang Institutional Equities Research

Note: FY16 revenues has been annualised

Exhibit 28: Lighting revenue growth trend


Source: Company, Nirmal Bang Institutional Equities Research

Note: FY16 revenues has been annualised

Exhibit 29: Share of in-house manufacturing and outsourcing

Product	In-house manufacturing	Outsourcing
Fans	60%	40%
Lights	50%	50%
Pumps	25%	75%
Appliances	0%	100%

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 30: GST rates and its impact on CGCEL product portfolio

Product	GST rate	Impact
Fans	28%	Slightly negative, 2%-3% price hike needed
Lights	12%	Neutral
Pumps	12%	Neutral
Appliances	28%	Slightly negative, marginal price hike needed
Air-coolers	18%	Neutral

Source: Company, Nirmal Bang Institutional Equities Research

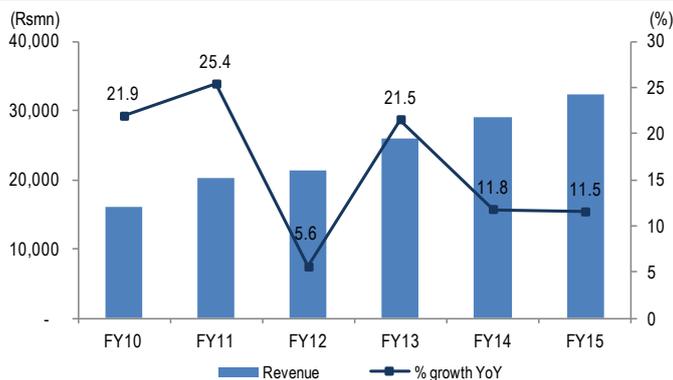
Financials

Healthy 13.3% revenue CAGR likely over FY17-FY19E

Crompton is the second largest consumer electrical firm in India with FY17 revenues of Rs39.8bn, next only to Havells India which has FY17 sales of Rs61.3bn (refer Exhibit 6). The company posted FY11-FY15 revenue CAGR of 12.5% under the previous promoters, driven by 13% revenue CAGR in fans and 14.6% revenue CAGR in lighting segment. Post the change in management, CGCEL has undertaken measures such as strong brand building, rising product innovation, augmenting distribution network as well as enhancing focus on untapped opportunities like premium fans, LED lights and agricultural pumps.

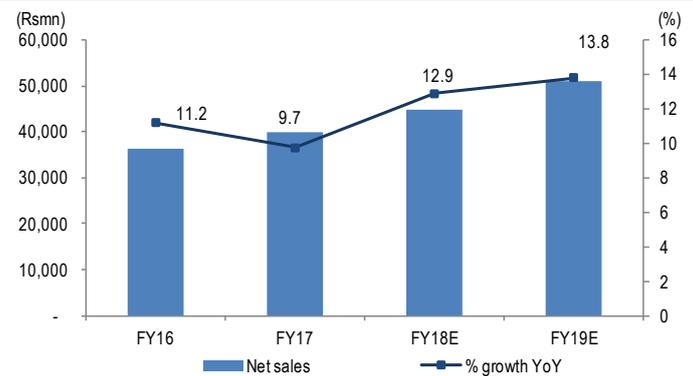
Further, we believe consumer electricals industry will sustain a healthy and sustainable long-term growth trajectory driven by factors such as higher GDP growth, rising disposable income, increasing urbanisation, improving rural electrification, strong focus on housing development as well as rising affordability and growing necessity of electrical products. We expect CGCEL to post 13.3% revenue CAGR over FY17-FY19E. We are factoring a 14.2% revenue CAGR in ECD segment (11% volume CAGR) driven by rising share of premium fans, 2%-3% price hikes post GST and healthy growth in pumps segment. For the lighting segment, favorable base of LED (57% of lighting segment sales) and scaling up of residential luminaires business is likely to result in 11% CAGR over FY17-FY19E.

Exhibit 31: Revenue growth trend under the previous management



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 32: Revenue trend under the new management

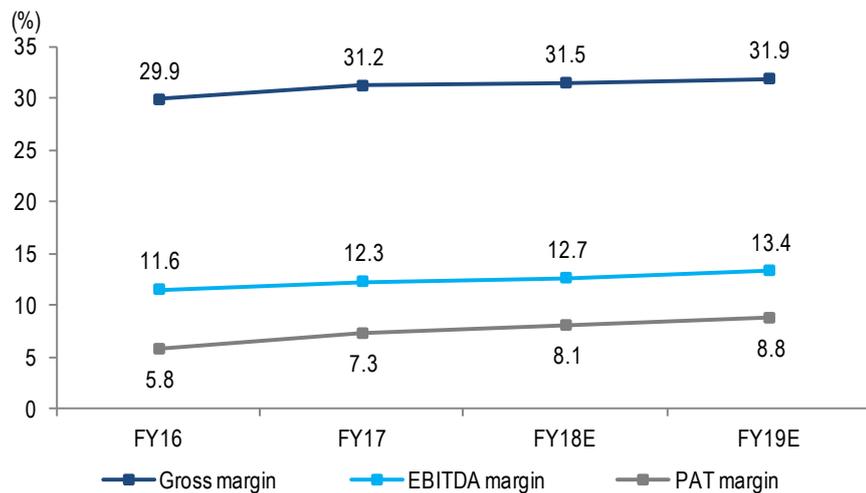


Source: Company, Nirmal Bang Institutional Equities Research

Note: FY16 revenue has been annualised

EBITDA margin likely to rise 110bps over FY17-FY19E

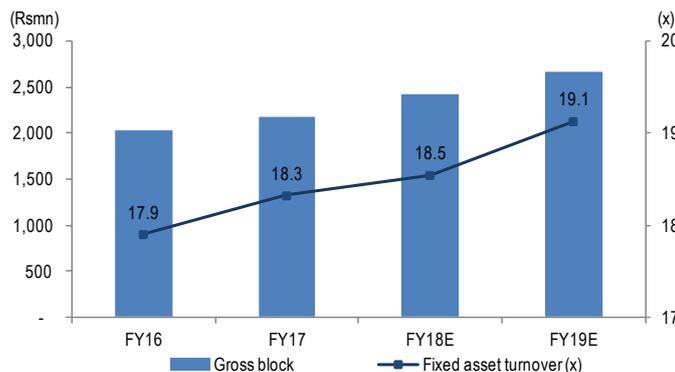
CGCEL posted a healthy improvement in gross margin by 130bps YoY from 29.9% in FY16 to 31.2% in FY17. This resulted in a rise in EBITDA margin from 11.6% in FY16 to 12.3% in FY17. With improved operating leverage and rising share of premium products, we expect a 70bps rise in gross margin over FY17-FY19E. We expect ECD/lighting segment to register 70bps/50bps margin expansion over FY17-FY19E driven by product premiumisation and cost leadership. With rising economies of scale (13.3% revenue CAGR), improving operating leverage and completion of business transition expense payable to CGL, we expect an 110bps rise in EBITDA margin from 12.3% in FY17 to 13.4% in FY19E. Further, rising other income owing to increased cash balance will lead to a rise in PAT margin from 7.3% in FY17 to 8.8% in FY19E.

Exhibit 33: Margin trend


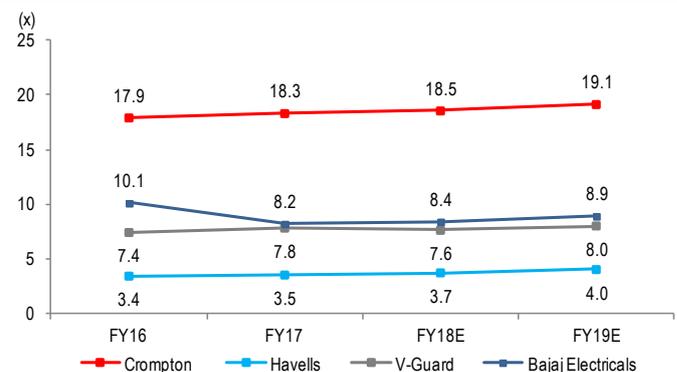
Source: Company, Nirmal Bang Institutional Equities Research

Fixed-asset turnover is highest among peers

CGCEL enjoyed industry-leading fixed-asset turnover of 18.3x in FY17, much above the industry peers (refer Exhibit 35). The high fixed asset turn is also partly aided by highly depreciated base of fixed assets which were transferred at the time of sale of consumer business to CGCEL. With minimal need of capex (Rs500mn over FY17-FY19E including opex) owing to lean manufacturing and 50% outsourcing content, optimal plant utilisation (currently at 85%) and improving scale of operations (13.3% revenue CAGR), the fixed asset turnover is likely to rise further to 19.1x in FY19E.

Exhibit 34: Gross block and fixed-asset turnover trend


Source: Company, Nirmal Bang Institutional Equities Research

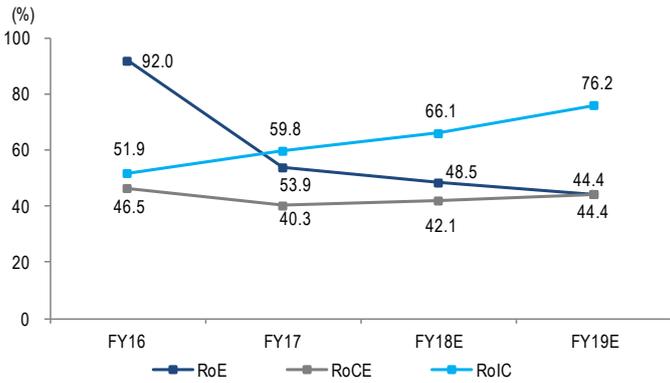
Exhibit 35: Fixed-asset turnover of peers


Source: Company, Nirmal Bang Institutional Equities Research

Return ratios are best among the peers

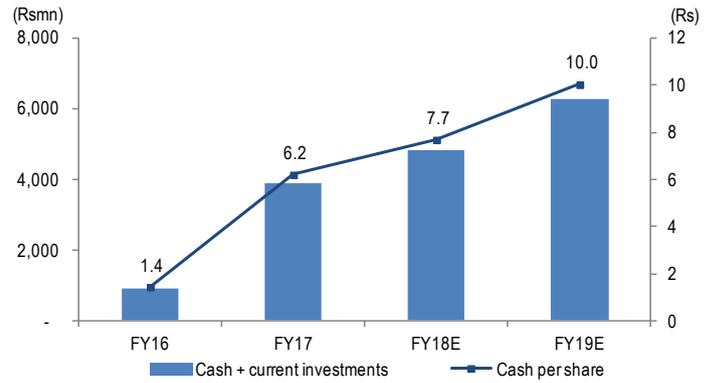
CGCEL is a strong financial franchise with healthy revenue and earnings growth, low capex requirement, high profitability and lower in-house manufacturing content at 50% (compared with 92% in case of Havells India). It enjoys strongest return ratios compared to peers (refer Exhibit 38 and 39) with RoE/RoCE of 53.9%/40.3%, respectively, in FY17, partly also aided by lower base of capital employed owing to recent demerger and sale of consumer business from CGL. CGCEL also has healthy liquid investment of Rs3.2bn and cash balance of Rs700mn as on FY17, translating to Rs6.2/share (2.8% of CMP). With improving profitability, negative working capital cycle and healthy free cash flow generation, cash and investment per share in FY19E will rise to Rs6.3bn or Rs10/share (4.6% of CMP). The rising cash balance will suppress RoE/RoCE to 44.4%/44.4% in FY19E, however, they will continue to be highest among peers. RoIC is likely to rise further from 59.8% in FY17 to 76.2% in FY19E.

Exhibit 36: Trend in return ratios



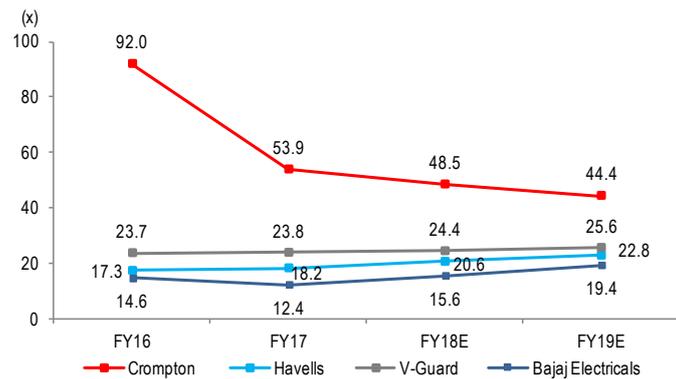
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 37: Rising cash and investment



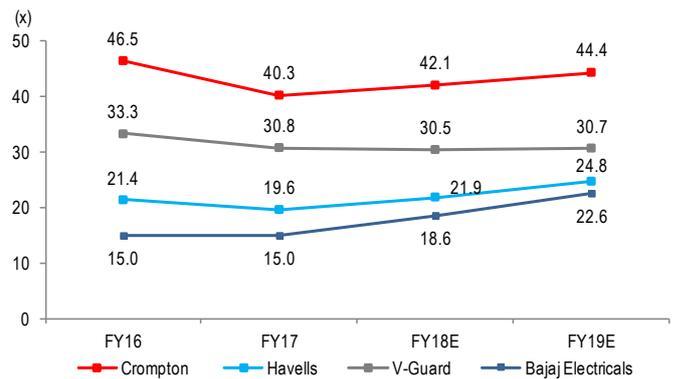
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 38: RoE of peers



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 39: RoCE of peers

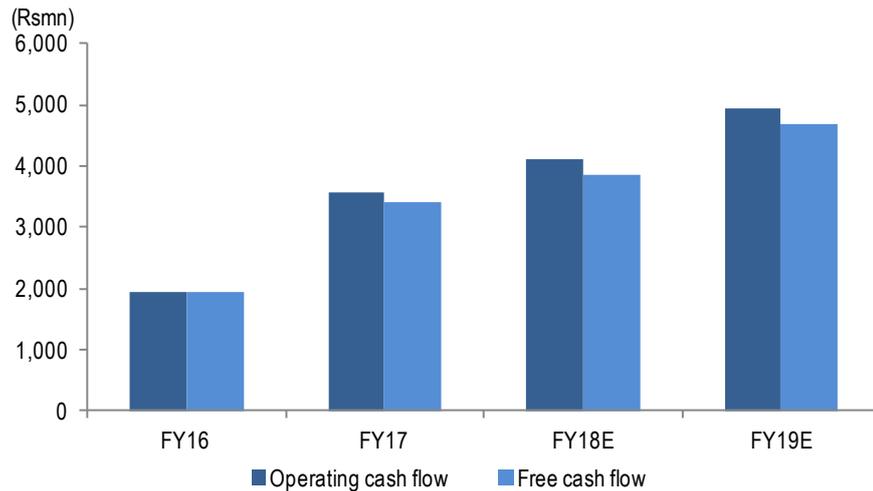


Source: Company, Nirmal Bang Institutional Equities Research

Strong cash flow generation

With healthy revenue growth, strong profitability and negative working capital cycle, CGCEL is likely to generate total operating cash flow of Rs9bn over FY17-FY19E as compared to Rs5.5bn in FY16-FY17. With a lower capex outlay of Rs500mn over FY17-FY19E, we expect CGCEL to generate total free cash flow of Rs8.5bn over FY17-FY19E as compared to Rs5.3bn in FY16-FY17. The free cash flow yield would improve from 1.2% in FY17 to 1.7% in FY19E while free cash flow as a percentage of annual revenues would rise from 4.1% in FY17 to 4.4% in FY19E.

Exhibit 40: Operating and free cash flow trend

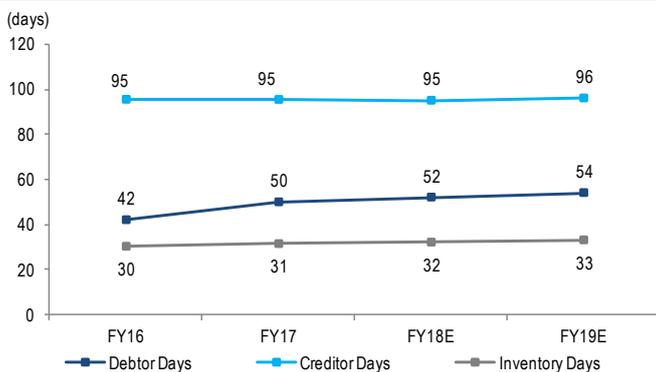


Note: FY16 comprises of only six months as CGCEL came in to legal existence from 1st October 2015.
Source: Company, Nirmal Bang Institutional Equities Research

Lean working capital cycle to continue

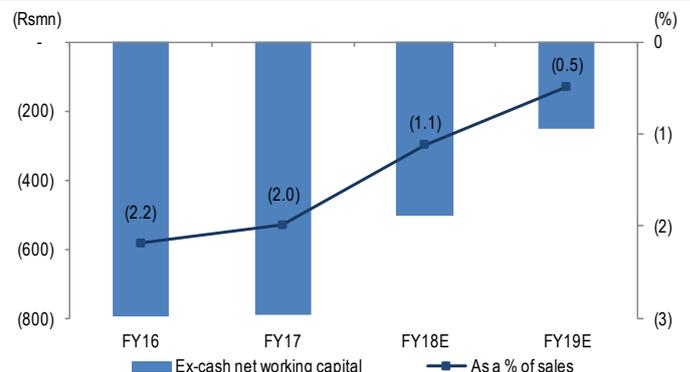
CGCEL operates with a negative ex-cash net working capital cycle. Its cash conversion cycle stood at a negative 23 days in FY16 and negative 14 days in FY17, primarily owing to higher creditor days (95 days). In the past two years, ex-cash net working capital as a percentage of sales was negative and stood at (2.2%) in FY16 and (2%) in FY17. With a healthy revenue CAGR of 13.3% over FY17-FY19E, we are factoring in a rise in the working capital position as a matter of prudence. Over FY17-FY19E, we are factoring in rise in debtor days from 50 in FY17 to 54 in FY19E and rise in inventory days from 31 in FY17 to 33 in FY19E while assuming creditor days to be constant. For FY18E/FY19E, we expect ex-cash net working capital, as a percentage of sales, to be (1.1%)/(0.5%), respectively. The working capital position will continue to be lean.

Exhibit 41: Trend in working capital cycle



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 42: Ex-cash net working capital position



Source: Company, Nirmal Bang Institutional Equities Research

Quarterly trend

Exhibit 43: CGCEL's quarterly performance

Y/E March (Rsmn)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	YoY (%)	QoQ (%)
Revenues (net)	8,101	10,016	11,208	8,900	8,889	10,762	7.4	21.1
Raw material	5,743	6,960	7,714	6,146	6,077	7,411	6.5	21.9
Staff cost	451	553	473	498	595	685	24.0	15.2
Other expenses	1,079	1,233	1,471	1,282	1,224	1,280	3.8	4.6
Total expenditure	7,273	8,745	9,659	7,926	7,896	9,376	7.2	18.7
EBITDA	828	1,272	1,550	974	993	1,386	9.0	39.5
EBITDA margin (%)	10.2	12.7	13.8	10.9	11.2	12.9	-	-
Depreciation	30	33	28	27	26	29	(12.4)	9.9
Interest	179	176	180	161	162	153	(13.0)	(6.0)
Other income	22	16	34	42	50	69	319.5	36.5
Exceptional items	(12)	(93)	-	(5)	-	-	-	-
PBT	629	987	1,376	823	855	1,273	29.0	48.9
Tax	218	321	457	273	281	388	21.0	38.0
Net profit	412	666	919	550	574	885	32.9	54.3
PAT margin (%)	5.1	6.7	8.2	6.2	6.5	8.2	-	-
EPS (Rs)	0.7	1.1	1.5	0.9	0.9	1.4	32.9	54.3

Source: Company, Nirmal Bang Institutional Equities Research

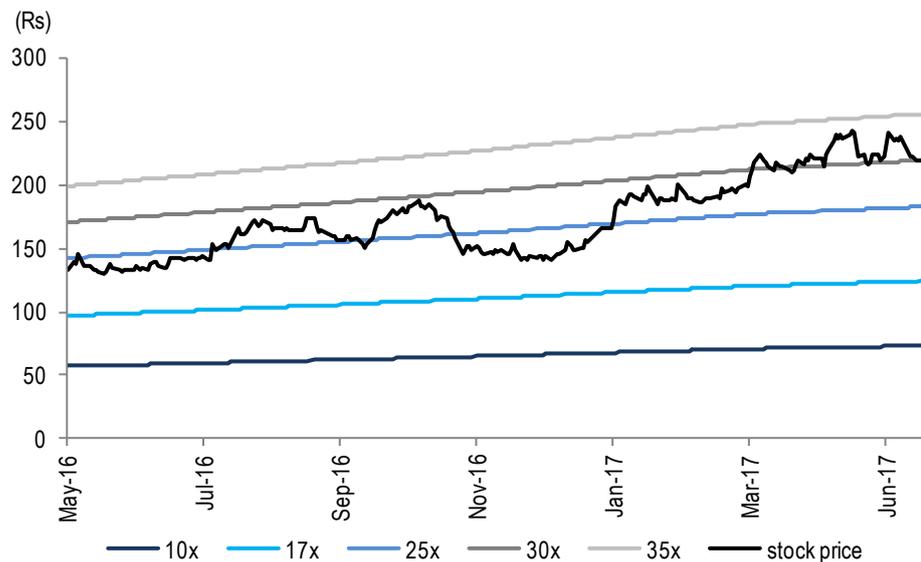
- CGCEL posted 4QFY17 revenues of Rs10.8bn, up 7% YoY. ECD sales grew 8% YoY to Rs7.8bn (71.5% of total sales) while Lighting revenues grew 5% YoY to Rs3bn (28.5% of total sales).
- Gross margin rose 60bps YoY to 31.1% in 4QFY17.
- Staff costs jumped 24% YoY to Rs685mn owing to Rs113mn non-cash ESOP charge.
- EBITDA grew 9% YoY to Rs1.4bn, translating to EBITDA margin of 12.9%, up 20bps YoY.
- EBIT margin of ECD segment improved 120bps YoY to 19.3% (because of premiumisation) while EBIT margin of the lighting segment rose 110bps YoY to 7.5% (because of cost leadership).
- CGCEL scaled back the special incentives it rolled out during demonetisation. Further, its internal cost efficiency helped in absorbing higher commodity prices in 4QFY17 amid pricing pressure from competitors.
- Aided by higher other income (Rs69mn versus Rs16mn YoY), PAT jumped 30% YoY to Rs864mn, and was 5% above consensus estimate.

Outlook and valuation

We remain optimistic about a healthy growth in consumer electrical sector over the next five to seven years with favorable macro-economic drivers like higher GDP growth, rising rural electrification, 24x7 availability of power in urban areas, growth in affordable housing driven by various government initiatives, lower inflation, higher disposable income, rising trend of product upgradation by urban consumers as well as the likely shift of from the unorganised to the organised segment. Under the new management, CGCEL aims to ramp up its presence in hitherto less focused categories like premium fans, residential LED luminaires and agricultural pumps along with enhancing its focus on premiumisation of product portfolio across categories. By expanding its distribution reach further, CGCEL intends to maximise synergy from the channel partners. Hence, we expect CGCEL to post 13.3% revenue CAGR over FY17-FY19E.

With the new management strongly focused on profitability, CGCEL's gross margin grew 130bps - from 29.9% in FY16 to 31.2% in FY17 - while EBITDA margin rose 90bps from 11.6% in FY16 to 12.3% in FY17. With a rising share of premium products and prudent cost management, we have factored in a 110bps EBITDA margin expansion from 12.3% to 13.4% over FY17-FY19E, leading to 18% EBITDA CAGR. With rising other income owing to high cash and liquid investments, we expect 24.6% earnings CAGR over FY17-FY19E. CGCEL is a robust financial franchise with strong operating/free cash flow (Rs9bn/Rs8.5bn over FY17-FY19E), highest fixed-asset turnover (19.1x in FY19E) and return ratios among peers (RoCE/RoIC of 44.4%/76.2% in FY19E, respectively) and negative working capital cycle which would support its valuation. We have valued CGCEL at 36x FY19E earnings with a target price of Rs260, up 20% from the CMP, and assigned Buy rating to it. The target P/E of 36x is in line with that of Havells India and factors in a PEG ratio of 1.5x.

Exhibit 44: One year forward PE Chart



Source: Company, Nirmal Bang Institutional Equities Research

Company background

CGCEL came in to existence on 1 October 2015 as a result of the acquisition of consumer electricals business of erstwhile Crompton Greaves Ltd. The original entity was promoted by the Thapar group (founded by Mr. Lala Karam Chand Thapar in Kolkata more than eighty years ago) and later rechristened as Avantha Group in November 2007 (after the partition of the Thapar Group's assets among its family members). On 1 October 2015, Avantha Holdings sold its entire stake of 34.37% in the consumer electrical entity to private equity investors Advent International and Temasek Holdings, who renamed the company as CGCEL.

Today, CGCEL manufactures and markets a wide spectrum of consumer products ranging from fans, light sources and luminaires, pumps and household appliances such as geysers, mixer-grinders, toasters and irons and sells them under the brand name Crompton. Crompton has been the market leader in fans, domestic pumps and street lighting for over 20 years. It has manufacturing locations in Goa, Vadodara, Ahmednagar and Baddi. 50% of its products are manufactured in-house while the remaining 50% are outsourced. The retail presence of Crompton products spans across nearly 100,000 outlets in India.

Crompton customer service is the benchmark in the industry as is the product quality. Crompton's portfolio of energy-efficient products includes 5 star-rated durable lights, fans, pumps and appliances for home and offices. It has the largest number of 5 star-rated energy-efficient products. It was the first company to cross sales of a million fans in 1989.

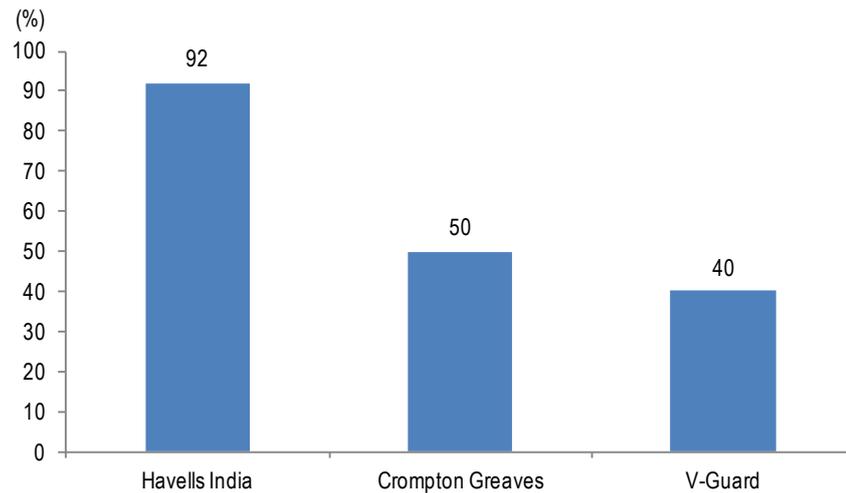
Key management personnel

- Mr. Shantanu Khosla – Managing Director:** Mr. Khosla joined CGCEL in January 2016. Prior to joining CGCEL, he served as the MD & CEO of Procter & Gamble India from July 2002 to June 2015. He served at P&G since 1983, leading the AAI Health Care Global Business Unit and Special Global Projects. Mr. Khosla also served as MD of Procter & Gamble Hygiene and Health Care from 1 June 2007 to 30 June 2015. He has, over the period, gained valuable experience of overseeing P&G's international business in the UK, Malaysia and Japan. He joined as a management trainee in Richardson Hindustan which was rechristened as Procter & Gamble India in 1985. He is an alumnus of IIT, Mumbai and IIM, Kolkata.
- Mr. Mathew Job – Chief Executive Officer:** Mr. Job joined CGCEL in January 2016. His prior experience includes a long stint with Philips Electronics India from June 1994 to October 2009, where he held several key positions. From November 2009 till January 2012, Mr. Job was working with Grohe India as vice-president and managing director. He then moved on to Racold (Ariston) Thermo as managing director till September 2015 before joining CGCEL. He is an alumnus of IIM, Kolkata.
- Mr. Sandeep Batra - Chief Financial Officer:** Mr. Batra joined CGCEL in January 2016. His prior experience includes a long stint with ICI Limited from January 1988 to January 2009, where he held various important responsibilities and eventually assumed the role of CFO. He then joined Pidilite Industries as its CFO in January 2009 for a seven year period before joining CGCEL. He is a Chartered Accountant and Company Secretary by qualification.

Exhibit 45: Details about manufacturing plants

Product	No of units	Location
Fans	4	Two each at Goa (Ponda & Jundaim) and Himachal Pradesh (Baddi)
Lighting	2	Gujarat (Baroda) and Himachal Pradesh (Baddi)
Pumps	1	Maharashtra (Ahmednagar)
Appliances	1	Himachal Pradesh (Baddi)

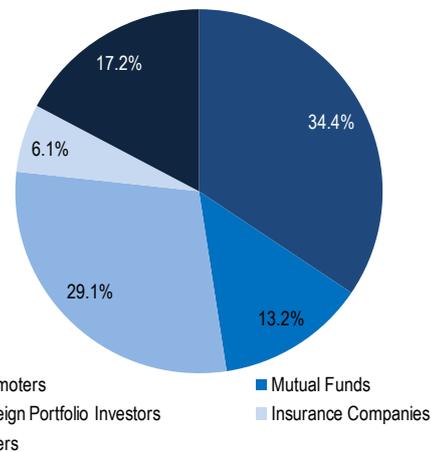
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 46: Peer comparison of in-house manufacturing share


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 47: Key shareholders

Shareholding pattern	
Promoter & promoter group	34.4
Amalfiaco (Advent International)	22.3
Macritchie Investments (Temasek Holdings)	12.0
Mutual funds	13.2
ICICI Prudential Balanced Advantage Fund	1.3
Birla Sun Life Balanced 95 Fund	3.8
HDFC Equity Fund	3.5
Franklin India Prima Fund	1.2
Reliance Capital Builder Fund	1.1
Foreign portfolio investors	29.1
Nomura India Investment Fund	2.2
TIAA CREF International Equity Fund	2.4
Smallcap World Fund Inc.	4.7
Franklin Templeton Investment Funds	1.2
Goldman Sachs India	1.2
HSBC Global Investment Funds	1.2
Amansa Holdings Private Limited	1.9
Insurance companies	6.1
LIC Of India Pension Mixed Fund	4.8
Others	17.2



Source: Company, Nirmal Bang Institutional Equities Research

Key risks

- Significant slowdown in consumer spending could impact industry demand and affect CGCEL's revenue growth.
- Any unforeseen rise in competitive intensity, especially by premium brands, could impact the margins.
- Any adverse change in terms of trade by CGCEL could lead to elongation in the working capital cycle.
- Wild fluctuations in commodity prices, if cannot be passed on to consumers, could impact profitability.
- Any disruption in manufacturing plants of CGCEL could impact availability of products. Similarly, for outsourced products, any disruption in manufacturing plants of suppliers or a break-down in CGCEL's relationship with suppliers could impact product availability temporarily.

Financials

Exhibit 48: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E
Net sales	18,117	39,759	44,875	51,073
% growth	NA	9.7	12.9	13.8
Raw material costs	12,702	27,349	30,740	34,780
Staff costs	1,005	2,252	2,603	2,911
Other overheads	2,315	5,257	5,841	6,553
Total expenditure	16,022	34,857	39,183	44,244
EBITDA	2,095	4,902	5,692	6,828
% growth	NA	17.0	16.1	20.0
EBITDA margin (%)	11.6	12.3	12.7	13.4
Other income	39	195	260	290
Interest costs	355	655	610	530
Depreciation	63	110	126	140
Exceptional items	(139)	(25)	-	-
Profit before tax	1,577	4,306	5,216	6,448
Tax	525	1,399	1,565	1,934
PAT	1,052	2,907	3,651	4,514
PAT margin (%)	5.8	7.3	8.1	8.8
EPS (Rs)	1.7	4.6	5.8	7.2
% growth	NA	38.2	25.6	23.6

Note: FY16 comprises of only six months as CGCEL came in to legal existence from 1st October 2015

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 50: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E
Share capital	1,253	1,253	1,253	1,253
Reserves	1,034	4,138	6,281	8,909
Net worth	2,287	5,392	7,534	10,162
Borrowings	6,445	6,500	5,700	4,900
Total liabilities	8,732	11,892	13,234	15,062
Gross block	2,024	2,170	2,420	2,670
Depreciation	1,238	1,349	1,475	1,615
Net block	786	822	945	1,055
Goodwill	7,794	7,794	7,794	7,794
Investments	0	3,185	3,185	3,185
Inventories	2,100	2,348	2,695	3,145
Debtors	4,165	5,434	6,393	7,556
Cash	900	700	1,629	3,096
Other current assets	742	685	808	919
Total current assets	7,907	9,167	11,525	14,716
Creditors	6,641	7,145	8,001	9,148
Other current liabilities & provisions	1,158	2,113	2,396	2,722
Total current liabilities	7,799	9,258	10,397	11,870
Net current assets	108	(91)	1,128	2,846
Deferred tax asset (net)	43	182	182	182
Total assets	8,732	11,892	13,234	15,062

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 49: Cash flow

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E
EBIT	2,032	4,792	5,566	6,688
(Inc./dec. in working capital)	357	(2)	(290)	(251)
Cash flow from operations	2,389	4,790	5,276	6,437
Other income	39	195	260	290
Depreciation	63	110	126	140
Tax paid (-)	(540)	(1,538)	(1,565)	(1,934)
Net cash from operations	1,949	3,558	4,098	4,933
Capital expenditure (-)	(13)	(145)	(250)	(250)
Net cash after capex	1,937	3,413	3,848	4,683
Interest paid (-)	(355)	(655)	(610)	(530)
Dividends paid (-)	-	(1,132)	(1,509)	(1,886)
Inc./dec. in total borrowings	(533)	55	(800)	(800)
Inc./dec. in investments	-	(3,185)	-	-
Cash from financial activities	(887)	(4,917)	(2,919)	(3,216)
Others	(150)	1,304	-	-
Opening cash balance	1	900	700	1,629
Closing cash balance	900	700	1,629	3,096
Change in cash balance	900	(200)	929	1,467

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 51: Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
Per share (Rs)				
EPS	1.7	4.6	5.8	7.2
Book value	3.6	8.6	12.0	16.2
Valuation (x)				
P/E	129.9	47.0	37.4	30.3
P/BV	59.7	25.3	18.1	13.4
EV/EBITDA	67.9	29.1	24.7	20.3
EV/sales	7.8	3.6	3.1	2.7
Return ratios (%)				
RoCE	46.5	40.3	42.1	44.4
RoE	92.0	53.9	48.5	44.4
RoIC	51.9	59.8	66.1	76.2
Profitability ratios (%)				
EBITDA margin	11.6	12.3	12.7	13.4
EBIT margin	11.2	12.1	12.4	13.1
PAT margin	5.8	7.3	8.1	8.8
Turnover ratios				
Total asset turnover ratio (x)	4.1	3.3	3.4	3.4
Fixed asset turnover ratio (x)	17.9	18.3	18.5	19.1
Debtor days	42	50	52	54
Inventory days	30	31	32	33
Creditor days	95	95	95	96

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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