10 October 2012

Update | Sector: Capital Goods

Crompton Greaves

BSE SENSEX	S&P CNX
18,709	5,676

CMP: INR134 **TP: INR163** **Upgrade to Buy**

Bloomberg	CRG IN
Equity Shares (m)	641.5
52-Week Range (INR)	175/102
1,6,12 Rel. Perf. (%)	16/-11/-25
M.Cap. (INR b)	86.0
M.Cap. (USD b)	1.6

Valuation summary (INR b)

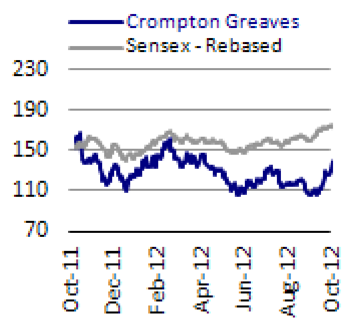
Y/E March	2012	2013E	2014E
Net Sales	112.5	131.3	145.9
EBITDA	8.0	10.9	13.8
NP	3.7	6.0	8.0
EPS(INR)	**5.7**	**9.3**	**12.6**
EPS Gr. (%)	-60.0	62.2	36.0
BV/Sh (INR)	56.3	63.0	71.4
P/E (x)	**23.4**	**14.4**	**10.6**
P/BV (x)	2.4	2.1	1.9
EV/EBITDA (x)	13.3	8.3	6.3
EV/ Sales (x)	0.9	0.7	0.6
RoE (%)	10.7	15.6	18.7
RoCE (%)	9.6	13.0	15.0

* Consolidated

Shareholding pattern (%)

As on	Jun-12	Mar-12	Jun-11
Promoter	41.7	41.7	42.8
Dom. Inst	21.7	20.3	18.3
Foreign	21.0	20.3	23.2
Others	15.6	17.7	15.7

Stock performance (1 year)



Investors are advised to refer through disclosures made at the end of the Research Report.

One CG: Whole > Sum of Parts

Overseas turnaround a key trigger; risk-reward favorable

- **For Crompton Greaves (CG), the attempt now is to ensure that 'the value of the whole is substantially more than the sum of the parts' and make a full transformation to a global corporation. We believe this journey provides several levers to boost revenues.**
- **Expect Hungary, Canada and USA (40% of international subsidiary revenues) to turn profitable by mid-FY13, leading to turnaround in overseas operations.**
- **We model 47% consolidated EPS CAGR over FY12-14 driven by 14% revenue CAGR and 230bp margin expansion. The key risk is that macro environment remains challenging.**
- **We arrive at price target of INR163, based on P/E of 12x FY14E for standalone business and EV/EBITDA of 8x FY14E for overseas business. Upgrade to Buy.**

Synergy-led revenue growth; breaking 'silo structures'

Over the years, CG has evolved from being largely an "India player" to an "Indian corporation with an international business". The attempt now is to make a full transformation to a global corporation. This journey provides several levers to boost revenues:

❶ Organizational restructuring across geographies / product segments to break 'silo' structures for integrated product offerings

❷ Internationalization and integration of industrial business, to possibly double revenues over the medium-term

❸ New factories / new products in new geographies to contribute meaningfully

❹ Recent acquisitions like Emotron / ZIV have targets to nearly treble revenues in 3 years given synergy benefits,

❺ Rejuvenation of consumer business portfolio, and

❻ Steady growth and dominant positioning (market share 25-50%) in niche areas of renewable segments, etc.

Potential turnaround in international operations in FY13

In the overseas markets, performance in key geographies like Belgium (36% of revenues), USA (24%), Hungary (9%) and Canada (6%) were impacted in FY12 given pricing pressures and region / factory specific issues. We believe USA, Hungary and Canada could become profitable during FY13. The recovery will also be aided by benefits of improve d raw material sourcing and decline in commodity prices. We expect international subsidiaries to report FY13/14 EPS of INR0.5/1.7, from loss of INR2.1/sh in FY12.

Expect Consolidated EPS CAGR of 47% over FY12-14; Upgrade to Buy

We model 47% consolidated EPS CAGR over FY12-14 driven by 14% revenue CAGR and 230bp margin expansion. The key risk is that macro environment remains challenging. Also, reported financials over past five quarters have been disappointing and stock price have reacted sharply, post results. We arrive at price target of INR163, based on P/E of 12x FY14E for standalone business and EV/EBIDTA of 8x FY14E for overseas business. **Upgrade to Buy.**

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Synergy-led revenue growth

Breaking 'silo structures' for integrated product offerings

Over the years, CG has evolved from being largely an "India player" to an "Indian corporation with an international business". The attempt now is to make a full transformation to a global corporation. This journey provides several levers to boost revenues:

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- ❹ **Recent acquisitions like Emotron / ZIV have targets to nearly treble revenues in 3 years given synergy benefits,**
- ❺ **Rejuvenation of consumer business portfolio, and**
- ❻ **Steady growth and dominant positioning (market share 25-50%) in niche areas of renewable segments, etc.**

Acquisition-led growth strategy:
Attempt now to integrate and ensure that value of the Whole is substantially higher than the sum of the parts

Company	Acquisition Date	Location	Cost (EV)	Revenues	Benefit
Pauwels	May-05	Belgium	Eur32m	Eur297m	Access to technology for transformers up to 525 kV, slim transformers, mobile sub-stations
Ganz	Oct-06	Hungary	Eur35m	Eur24m	Access to technology for EHV transformers up to 1200 kV, GIS substations, 12 MW class of motors
Microsol	May-07	Ireland	Eur10.5m	Eur6m	Automation products and systems for sub- stations
Sonomatra	May-08	France	Eur1.3m		Servicing of transformers and on-site maintenance
MSE	Sep-08	USA	USD16m		EPC for wind and power systems; MSE has interconnected over 23% of all wind power in USA
Power Technology Soln.	Mar-10	UK	GBP30m		Engineering services for HV substations
Nelco	Apr-10	India	INR920m		Acquired traction electronics, SCADA and Industrial drives businesses of Nelco
Emotron	May-11	Sweden	Eur57.8m	Eur35m	Variable speed drives and Industrial automation
QEI	May-11	USA	USD30m	Eur12m	Automation for Electric utilities and Electrified Transit (Railways)
ZIV	Jul-12	Spain	Eur150m	Eur75m	Grid Automation, Metering, Smart Grids
Power Products	Automation	Turnkey and Services			Industrial Segment

Source: Company, MOSL

Driver #1 Organizational restructuring to tap synergy benefits

To realize the full benefits of synergies across businesses, CG has now shifted focus towards a complete integration involving manufacturing, marketing, sourcing, etc. Till FY11, the various business operations of CG Global have been operating largely in 'silo' structures, leading to very minimal cross selling opportunities, duplication of key functions and inefficient cost structures. The initial levels of integration among the ten acquisitions since 2005 have largely focused on initiatives like:

- Unified presence of CG Power (deeper customer interface)
- Global platform for design of power transformers (Unipower) and distribution transformers (DesDT)
- 'One World Quality' at all manufacturing locations globally and
- Integrating global R&D and executive teams.

Initial Phase of integration (2006 onwards) focused on improving efficiencies

The initial phase of integration revolved around design, quality, customer interface, executive teams, R&D, etc

Unipower	Global platform for design of power transformers
DesDT	Global platform for design of distribution transformers
One World Quality	Implemented at all manufacturing locations globally
CG Power	Unified presence of CRG's power business globally, leading to deeper customer interface
Other Key Areas	Integrating global R&D and executive teams, etc

FY12 saw focused organizational attention, on the creation of 'One CG Fast CG Lean CG'

Over the years, CG has transformed from being largely an India oriented player to Indian corporation with an international business. The attempt now is to make a full transformation to a global corporation.

One CG	To leverage the right resources and skills to produce the best possible product or solution for selling anywhere. This will ensure that the DNA of selling must be one where customers come first, not where the factory is.
Fast CG	Restructuring of the operations into six geographic areas and also business verticals - resulting in quick reaction to business opportunities.
Lean CG	Global best practices in sourcing, manufacturing, etc.

Example: Initial Success looks promising

Integrated solutions (railways) and new business (Oil & gas): Combining strengths in 'power', 'industrial' and also 'consumer' segments

1. Railways: Integrated product offerings

Aggregated, CG supplies a gamut of products which can start, control and stop a train.

Power Systems	Supplies trackside and loco transformers and switchgears, which are critical in regulating the voltage level of motors used in electric locomotives & railway electrification networks.
Industrial Systems	Supplies traction motors, alternators, control electrics/electronics, point machines, signaling relays and coach products which are used in locomotives, driver consoles, signaling and track switching operations. A recent entrant to the CG Group.
CG Automation US (formerly QEI)	Experienced supplier of SCADA systems, used by transportation utilities for maintaining traction power and managing rail traffic.

2. Oil & Gas: Complete Solutions Provider

Product offerings	Full electrical solution, including breakers, transformers, variable speed drives, motors and automation
Business commenced in 2HFY12	In the course of four months till March 2012, **(a tentative order pipeline of EUR150m)** had been developed.
Infrastructure largely in place	The requisite sales infrastructure is being set up in various locations, such as Houston (US), the Middle East and Asia. Structures of business cooperation between CG and other entities in medium- and low-voltage transformer space are being created to: (i) offer a larger suite of products to oil & gas majors and international EPC players, and (ii) access major oil and gas markets in USA, Russia, the Caspian and the Middle East.
Synergy benefits	CG products from India and Indonesia are in the process of being prequalified for oil & gas end-users and global EPC contractors.

Restructuring of business operations, aimed at breaking the 'silos'

The existing business operations have been restructured into six geographic areas and also business verticals - resulting in quick reaction to business opportunities.

Geographies	Business Verticals
❶ SE Asia	❶ Renewables
❷ India	❷ Oil and Gas
❸ Middle East and Africa	❸ Mining
❹ Europe and Russia	❹ Railways
❺ North America	
❻ Latin America	

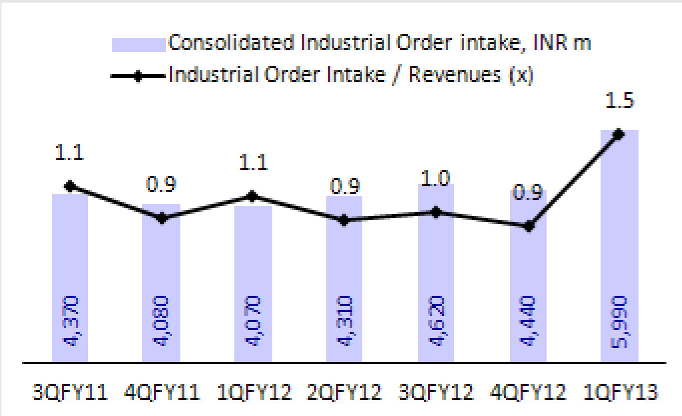
Driver #2 Internationalization and integration of industrial business

We believe there is exponential growth possibility in CG's industrial business. Post acquisition of Emotron in May 2011, CG can now leverage the network to -

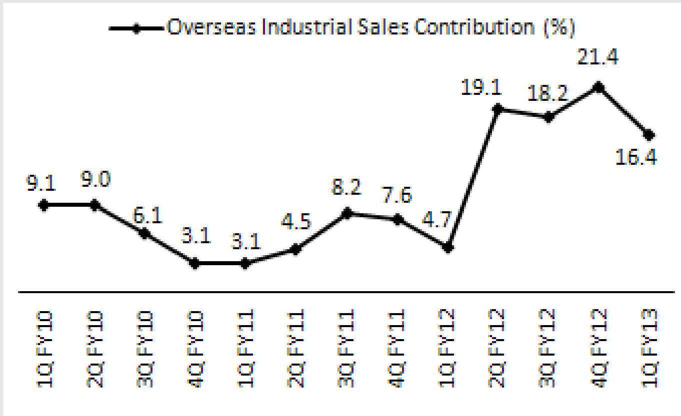
❶ **Drive increased internationalization of revenues of the industrial business:** We believe this is an important objective. Currently, international business contributes 16-21% of the revenues of the industrial business v/s 6% in FY11. CG is in the process of commissioning its drives factory in Manideep in 3QFY13. This will lead to introduction of drives in the Indian market (an important earnings trigger), and also increase exports to Europe.

❷ **Integrate motors with variable speed drives:** This remains an important priority; success here could be a game-changer. CG is the largest player in the Indian 'motors' market. The acquisition of Emotron will thus help CG to penetrate the 'Drives' segment (estimated market size of INR15b with 75% of the market concentrated with ABB and Siemens). Also, given the strong base of Emotron in Germany, Belgium, Netherlands, Luxemburg, etc, the acquisition will also help CG cross-sell motors to Emotron's international client base.

Order intake and Intake / Revenues (x)



Overseas Revenues in Industrial (% of total indl revenues)



Source: Company, MOSL

Example: Initial success has been encouraging

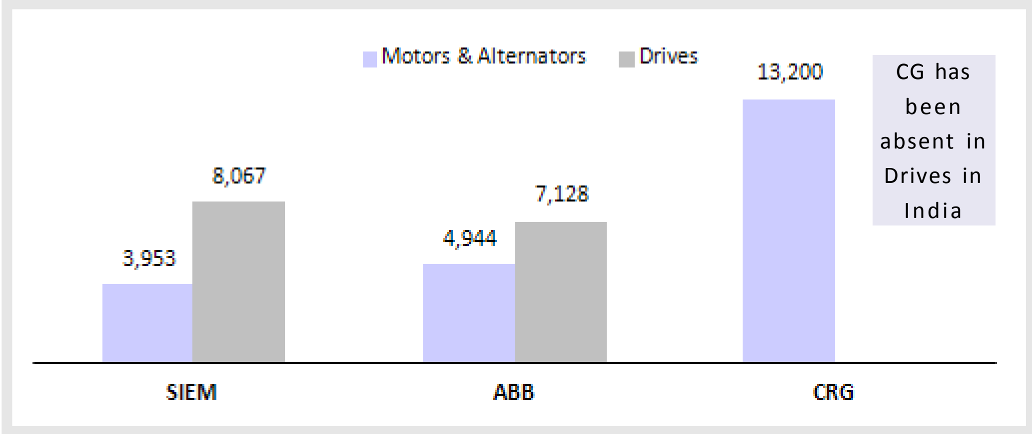
Motors orders received by CG

Hungary	8.3 MW, 8 Pole, 6.6 kV motors for a steel mill in the Middle East
Hungary	4.5 MW, 20 Pole, 6 kV motors as well as 3.3 MW, 22 Pole, 6 kV water-cooled motors for circulating water pump of Rostov nuclear power plant in Russia
Manideep	2.85 MW, 16 Pole, 11 kV motors for a thermal power plant in India
Manideep	7.5 MW, 6 Pole, 11 kV motor for a cement mill in Egypt
Manideep	4.6 MW, 6 Pole, 3.3 kV cage rotor motor for a cement mill in the UK
Manideep	Large flame-proof motors for oil and gas applications

Source: Company, MOSL

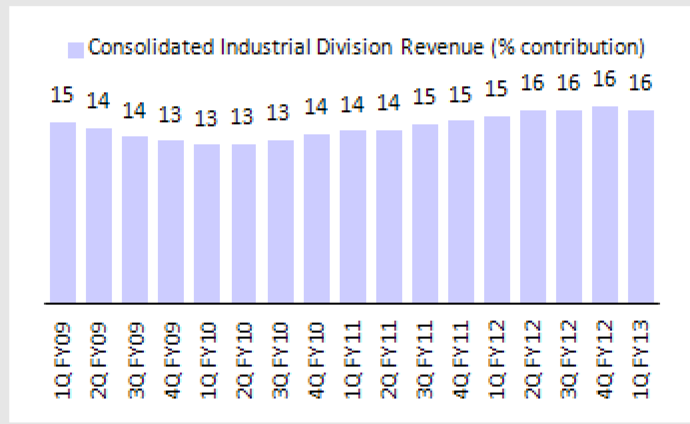
Drives sales are almost double the sales of motors and alternators in case of SIEM and ABB. While CG is the largest player in motors it has just started its journey in drives through acquisition of Emotron

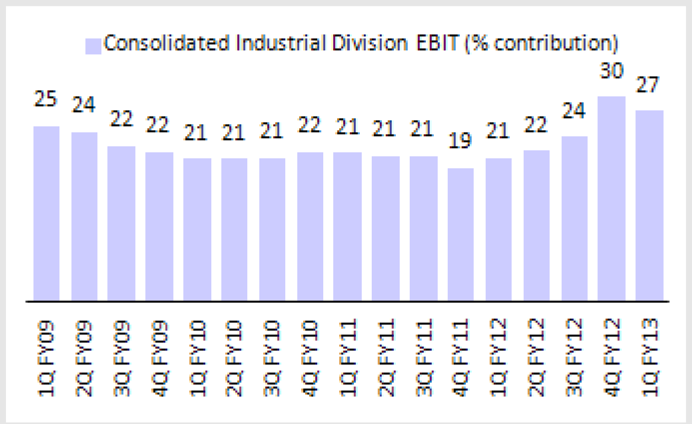
Drives constitutes an important part of revenues for ABB / Siemens (INR m)



Source: Company, MOSL

Industrial business is profitable, contributing 16% to revenues but 27% to EBIT





Source: Company, MOSL

Driver #3 New factories, new geographies, new products

CG is in the process of commissioning several manufacturing plants over the next 18 months, targeting new geographies and new segments:

- **The switchgear plant in Brazil** is expected to add USD100m to revenues, contributing to ~10% of the overseas business revenues
- **In India, commissioning of the drives plant in 3QFY13** will also contribute meaningfully to standalone operations.
- **Plans to double transformer capacity in India** by setting up a 50,000MVA plant; this will be an important game-changer in our opinion, as the pertinent issue of customer acceptance can be possibly addressed through a modern plant.
- **Plans to set up transformer plants in Brazil and Saudi Arabia** are also important milestones.

New factories for new geographies and new products

❶ **Switchgear factory, Brazil [June 2012]**	CG commenced operations of Extra High Voltage Switchgear manufacturing facility in Sapucaia do Sul in the state of Rio Grande do Sul, Brazil in June 2012. This is the first factory of CG in Latin America, and will enable it to tap emerging opportunities in this geography. The total market represents more than **USD1b and CG intends to capture 10% of the market.** Revenue in the first year of operation is expected at USD50m+, and the company has already received orders from utilities such as CEMIG, CPFL, CEEE, RGE and Toshiba.
❷ **Transformer factory, Brazil**	In November 2011, CG had laid the foundation stone for new factory in Guaiba's Industrial District in Brazil to manufacture transformers and circuit breakers. The factory will employ 250 people, with investment of USD47m. We understand that this will possibly be commissioned in FY14.
❸ **Power Transformer plant, Saudi Arabia [FY13]**	CG has created a joint venture in Saudi Arabia to manufacture medium-voltage power transformers to meet growing demand in the Middle East. The plant will have the capacity to produce transformers in the 100MVA and 132kV class. In addition, it will be able to undertake repairs for units up to 120MVA, 220kV. It is targeted for completion in FY13.
❹ **Drives factory in Manideep [3QFY13]**	CG is in the process of commissioning its drives factory in Manideep in 3QFY13. This will lead to introduction of drives in the Indian market (an important earnings trigger), and also increase exports to Europe.

Plans to nearly double transformer capacity in India - game changer in our opinion

CG plans to nearly double its transformer capacity in India by adding ~50,000MVA at a new location. We understand that the facility is being proposed to be set up in Vadodara, and will also cater to requirements of the overseas business. We understand that construction is expected to commence in FY13, and this facility will be commissioned in ~24 months.

Being a modern plant, the pertinent issue of customer acceptance from Western Europe can also possibly be addressed, given the 'One World Quality' initiative. We believe that this 50,000MVA facility can be a game changer, as it will materially alter CG's manufacturing footprint (consolidated CG Global transformer capacity currently stands at 85,000MVA).

CG's standalone exports (from India) has remained stagnant, and largely concentrated towards developing countries which indicates product exchanges / outsourcing for Western Europe have been limited, and the synergy benefits have not been captured. This is largely given issues of customer acceptance, which could possibly be addressed with a modern plant.

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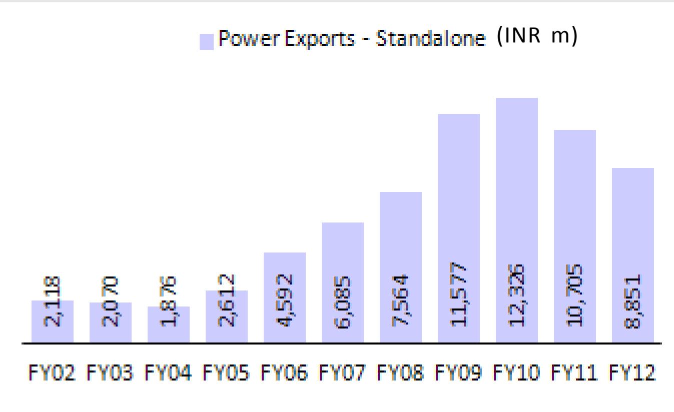
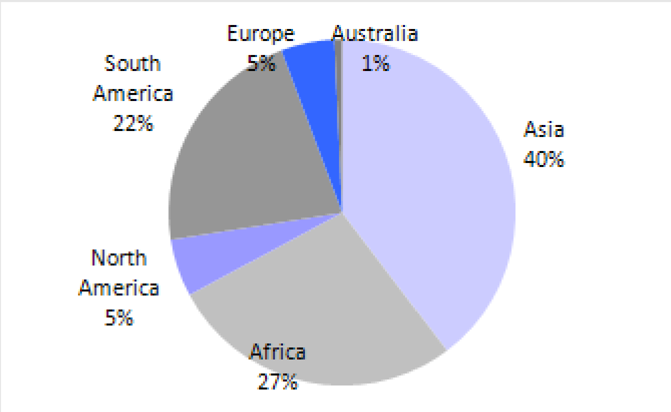
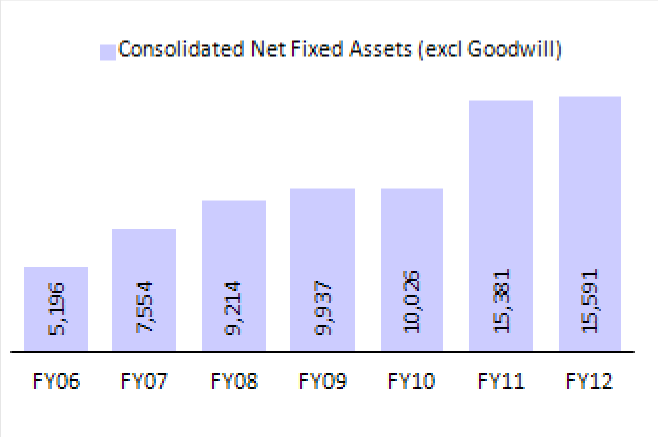




Source: Company, MOSL

3 year capex plans of USD300m is nearly equivalent to existing gross fixed assets (INR m)



Emotron and ZIV have targets to triple revenues in 3 years

Emotron	Management in past stated that it expects revenues to grow to EUR80m by 2013 from EUR37m in 2010.
ZIV	Expects topline at EUR200m in next 3 years, from EUR75m expected in CY12; driven by synergy benefits.

Source: Company, MOSL

Expanding footprint in automation

CG has made ~3 acquisitions so far which give it access to various parts of the automation business, in specific segments. The key missing gap was the HV automation products, which has been bridged via the recent acquisition of ZIV. CG's management believes that the growth will be driven largely in Western Europe and USA. CG already has a sales force of 647 employees, who will now also market the grid automation offerings of ZIV. Based on this synergy getting captured over time, the 3-year revenue target from ZIV is EUR200m (v/s EUR75m TTM ending June 2012).

Acquisitions in Automation segment

Company	Acquisition Date	Location	Cost (EV)	Revenues	Segments
Microsol	May-07	Ireland	EUR10.5m	EUR6m	Automation products and systems for sub-stations
QEI	May-11	USA	USD30m	EUR12m	Automation for Electric utilities and Electrified Transit (Railways)
ZIV	Jul-12	Spain	EUR150m	EUR75m	Grid Automation, Metering, Smart Grids

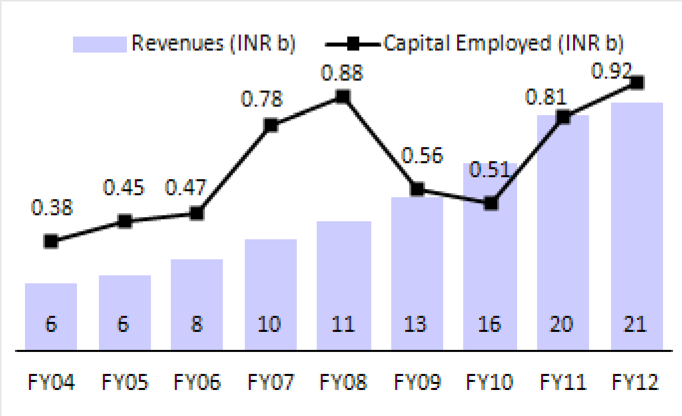
Driver #4 Rejuvenation of the consumer business

In the consumer segment, CG is the market leader in Fans (24% market share) and Pumps (~20% market share), and is the Number 2 player in Lighting segment (~13-14% market share). FY12 revenue growth at just 5.6% was impacted by poor market growth in Pumps (down 8%) and Fans (down 2%), while Appliances are yet to make a significant mark (6% contribution).

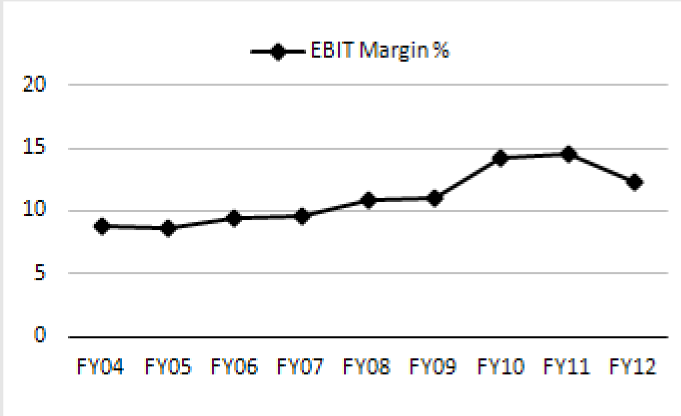
As a strategy, CG's attempt is towards complete rejuvenation to drive strong performance. This is showing signs of paying off - in FY12, nearly 32% of Consumer segment's revenue was contributed by new products. The rejuvenation measures include the following -

- Chinese sourcing footprint is being established
- 'Intelligence' is increasingly being built into products
- Capacity is being expanded in India (like investing in new capacity in Vadodara for lighting products, including LED) and
- Channel management program is being carried out
- Product portfolio is also being expanded to cover kitchen appliances, coolers, personal care products, etc.

Consumer business: Negligible working capital funds supporting growth in other businesses



EBIT margins have been largely in a range (%)



Source: Company, MOSL

Driver #5 Niche positioning in renewables

CG is the global market leader in offshore wind transformer applications. Its market share has increased from 42% in FY10/11 to 51% in FY12. CG has also successfully forayed into turnkey solutions for the renewable segment in Western Europe - it completed its maiden project of designing and building the transmission grid connection offshore windpark ('Belwind', 165MW) on the coastal waters of Belgium in September 2010. Over the last 10 months, it has received 4 new projects (1,000MW+), leading to strong traction in order intake for CG Global. From a zero base 3 years ago, CG now accounts for 4.2% of the global offshore wind market in systems, and the management expects this share to increase in future.

In USA, CG is already a market leader having inter-connected 23% of the wind capacity to the grid. During FY12, CG Power also entered the solar renewables market. Two key orders received are from First Solar USA worth EUR19.5m and SMA worth EUR5m. These orders have provided CG 5.9% share of the overall US solar market, and 23.5% of the US solar utility market.

The renewable segment contributed EUR270m of revenues in FY12 (~37% of CG Global overseas revenues); at end FY12, a renewable project pipeline of EUR214m was in place which includes wind (EUR148m) and solar (EUR66m). For CG, renewables contribute ~37% of revenues in Europe and ~50%+ of revenues in USA.

In July 2012, CG received a 216MW offshore wind installation contract; and is the fifth such contract

Wind Power: Turnkey projects drive order intake, strong traction witnessed

Award	Project	MW	Country	IPP	Execution
9-Jul-12	Northwind offshore wind farm	216	Belgium		Sep-13
11-Jan-12	Humber Gateway offshore wind farm	219	UK	EON	Early 2014
19-Dec-11	Amrumbank West GmbH	288	Germany	EON	2014
14-Sep-11	Butendiek project	288	Germany	WPD WINDFARM	2013
2009	Belwind Phase 1	165	Belgium		2010

All contracts are turnkey contracts

Leveraging the MSE acquisition to build turnkey applications in wind segment in Western Europe

Acquisition	CG acquired MSE Power Systems in September 2008 at an EV of USD16m. MSE was engaged in engineering, procurement and construction of high voltage electric power applications. It was a systems integrator in international EPC business, especially in the renewable energy (wind) segment. MSE had interconnected over 23% of all wind power in the USA to the grid and was a market leader in the segment.
Integration, leading to increased offering	MSE's expertise has been leveraged with the product offering in the wind business (especially of Pauwels) to build turnkey applications in Europe.
What next?	Going forward, MSE will be the key organization for smart grids in the USA. MSE has also developed balance-of-plant solutions for photovoltaic solar plants; this is also becoming an interesting growth opportunity.

For CG, renewables contribute ~37% of revenues in Europe and ~50%+ of revenues in USA.

Revenues in Renewable Business

Euro M	FY12
Products	**105**
Europe, ME and Africa	55
The Americas	50
Systems	**165**
Europe, ME and Africa	80
The Americas	85
Total	**270**

Turnaround in international operations?

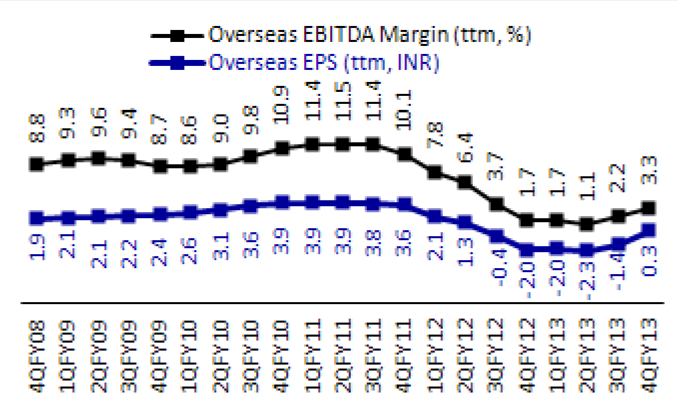
Hungary, Canada and USA could become profitable by mid FY13

- **In the overseas markets, performance in key geographies like Belgium (36% of revenues), USA (24%), Hungary (9%) and Canada (6%) was impacted in FY12 given pricing pressure and region/factory specific issues (lower capacity utilization in Hungary, inventory build-up at Canada, high product development costs in USA, etc).**
- **We believe USA, Hungary and Canada could become profitable during the course of FY13, driving a turnaround in overall international operations. The process will also be aided by other measures like rationalizing sourcing, decline in commodity prices, etc.**
- **We expect international subsidiaries to report FY13/14 EPS of INR0.5/1.7 against loss of INR2.1/sh in FY12.**

Reasons for muted performance of overseas business (as stated by the management)

1QFY12	Slower off take by customers in MENA reason resulting into significant inventory pile up and under absorption of fixed costs.
2QFY12	Speedy execution/closure of a near-zero margin EUR50m project, losses on inventory
4QFY12	Sales postponement in Europe, etc given macro headwinds
1QFY13	Deferment of offtake in HT motors by cement customers (loss of profit: INR100m), loss of profit in Belgium plant (INR500m)

Overseas subsidiaries: EBIDTA margins (ttm, %) and EPS (INR/sh)



Key subsidiaries reported large losses in FY12 (INR M)

		Revenues			PBT	
	% Share	FY12	FY11	%YoY	FY12	FY11
Belgium	36	20,202	20,259	(0.3)	(420)	1,493
USA	24	13,512	8,216	64.5	110	432
Ireland	9	5,070	4,577	10.8	233	411
Indonesia	9	4,807	3,818	25.9	657	902
Hungary	9	4,794	6,007	(20.2)	(632)	840
Canada	6	3,228	4,384	(26.4)	(387)	662
Others	8	4,670	2,294	103.6	1,064	493
	100	**56,284**	**49,555**	**13.6**	**626**	**5,234**

Source: Company, MOSL

What can drive the turnaround in international operations

We expect CRG's international subsidiaries to report FY13/14 EPS of INR0.5/1.7 against loss of INR2.1/sh in FY12. We believe the following hold the key to this turnaround:

- Normalization of operations in Hungary and Canada/USA
- Belgium losses (INR360m in FY12) to be addressed post the restructuring (expect more clarity by end 3QFY13)
- Increasing share of Low cost country in manufacturing
- Efficient sourcing of raw materials and
- Decline in commodity prices.

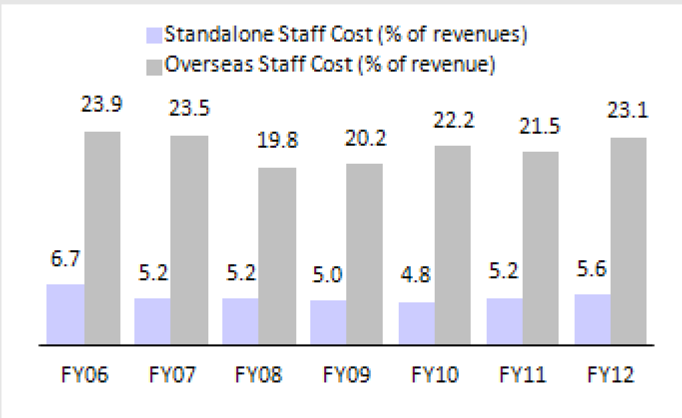
Normalization of operations in Hungary and Canada/USA

- We understand that Hungary from net loss of INR630m in FY12 is now profitable as capacity utilization has increased to 70% currently (v/s 40% in FY12). We believe this could further improve to 85-90% by end 2QFY13 on the back of increased customer acceptance, largely from Western Europe.
- Canada / USA factories had been impacted given stabilization issues / inventory build-up / product development costs and these factors have possibly stabilized. Profitability here could improve going forward.

Restructuring of Belgium operations

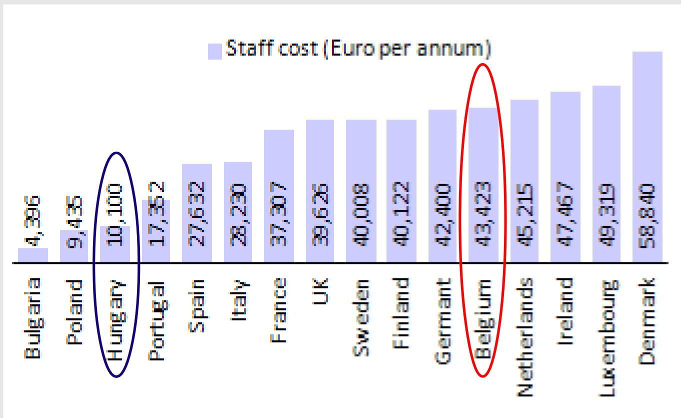
CG is currently restructuring operations in its Belgium factory. It has announced plans to reduce workforce by 38% (260 employees) to shift production to Hungary (low cost country) where transformer capacity is being expanded from 5,000MVA to 17,000MVA (whereas Belgium capacity is being lowered from 15,000MVA to 5,000MVA). Management stated that Phase 1 consultations with employees are expected to be completed by Oct-Nov 2012 (however, this is not a time-bound program, and given the tough environment in Europe, the process can take longer). The management is hopeful that restructuring of the Belgium operations should be completed by end-3QFY13. Staff costs account for ~23% of revenues in overseas markets; as the cost differential between Belgium and Hungary is ~350%, the potential savings from restructuring Belgium operations could be meaningful.

Staff cost differential meaningful between standalone and subsidiaries (% of revenues)



Source: Company, MOSL

Staff cost differential between Belgium / Hungary stands at ~350%



Source: Eurostat

Increasing share of LCC in manufacturing

On a consolidated basis, 57% of CG's manufacturing is in high cost countries (HCC). Based on the same, we estimate that for the overseas business (ex India), a high 75% of the manufacturing footprint is in HCC. Increasing the shift towards LCC (low cost countries) is important, as the staff cost differential stands at a meaningful 18% of revenues. Factories in HCCs like Belgium (~40% of CG Global overseas) have order book extending up to 2 years, while LCCs like Hungary (~12% contribution) have factories operating at barely 50% of capacity. Hence, the challenge is about customer acceptability (to be addressed through One World Quality), and thus targeting a large part of the incremental orders to be manufactured from factories in LCCs.

Efficient sourcing of raw materials

In June 2012, CG established an International Procurement Office in China, and commodity managers have been appointed for sourcing of key raw materials. The benefits of centralized raw material sourcing are expected to start kicking in shortly. Efficient raw material sourcing is a key determinant of cost structure and profit, given that raw material costs constitute 65-68% of revenues. The management highlighted a two-pronged strategy on sourcing:

(1) Increase share of purchases from LCCs like Eastern Europe, China, India and rest of Asia (FY11 at 46%) and

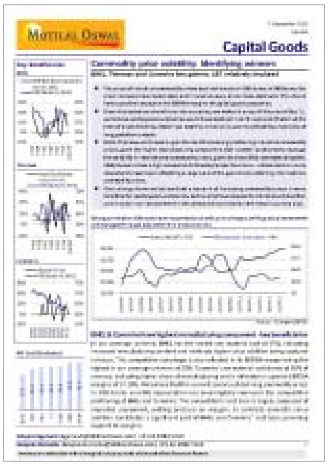
(2) Lower the inefficiencies in the chain (like fragmented raw material sourcing from 3,000+ suppliers in power business, etc).

We expect the benefits of this strategy to start flowing in from end-FY13.

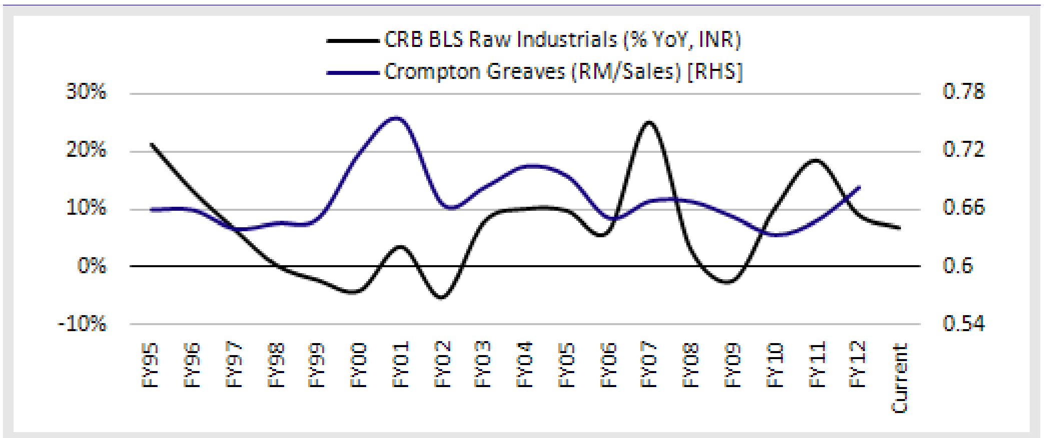
Decline in commodity prices

CG's raw material costs have a strong correlation with commodity prices: this is largely in the power segment (65% of consolidated revenues); industrial / consumer business have a short cycle, and thus it is possible to pass on cost variations. We believe CG is a major beneficiary of any decline in commodity prices, particularly in its overseas business (47% of consolidated revenues), where most of the contracts are fixed price.

For details please refer to our report "Commodity price volatility: Identifying winners", dated 7 Sep 2012



Strong correlation of raw material cost with industrial commodities



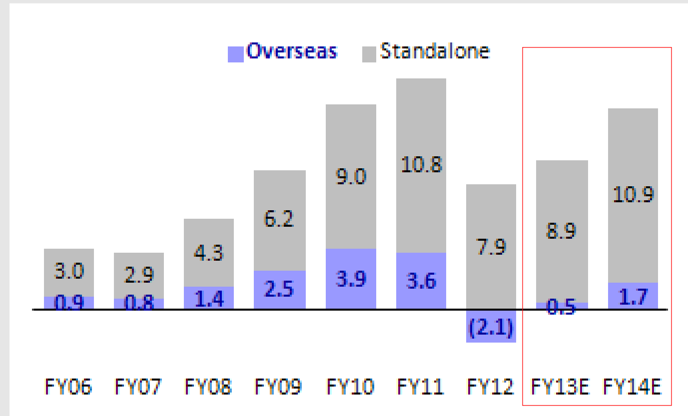
Source: Company, MOSL

Expect Consolidated EPS CAGR of 47% over FY12-14; Upgrade to Buy

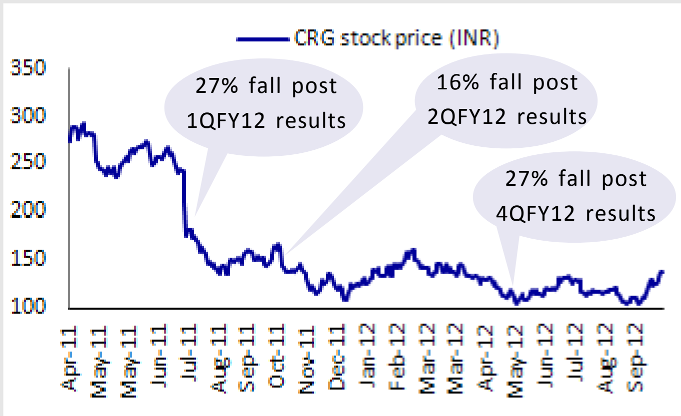
Target price of INR163 offers 22% upside

- **We expect CRG to report standalone EPS of INR8.9 in FY13 (up 13%) and INR10.9 in FY14 (up 22%). As stated earlier, international subsidiaries should EPS of INR0.5 in FY13 and INR1.7 in FY14.**
- **We model 47% consolidated EPS CAGR over FY12-14 driven by 14% revenue CAGR and 230bp margin expansion. But the key risk is that macro environment remains challenging.**
- **We arrive at price target of INR163, based on P/E of 12x FY14E for standalone business and EV/EBIDTA of 8x FY14E for overseas business. Upgrade to Buy.**

Turnaround of overseas subsidiaries to drive stock performance (EPS INR)



Stock price has reacted sharply post disappointing quarterly performance



Source: Company, MOSL

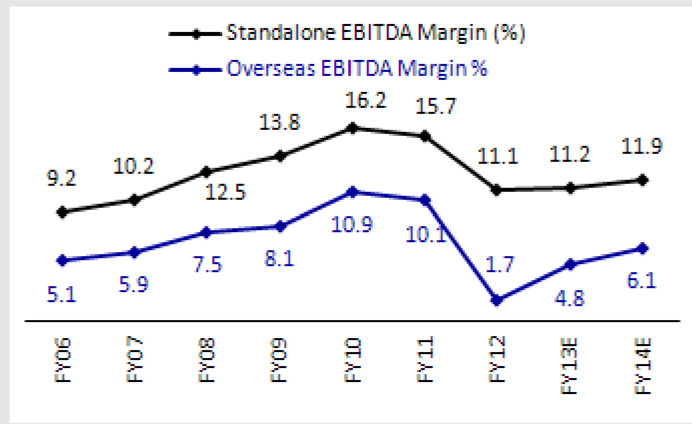
Long-term guidance: 450bp profitability improvement in 3 years

The management stated that a three-year strategy to improve profitability is in place. This includes 4 focus areas, which should result in EBITDA margin expanding 450bp over the next three years (from 7.1% in FY12 to ~11.5% by FY15).

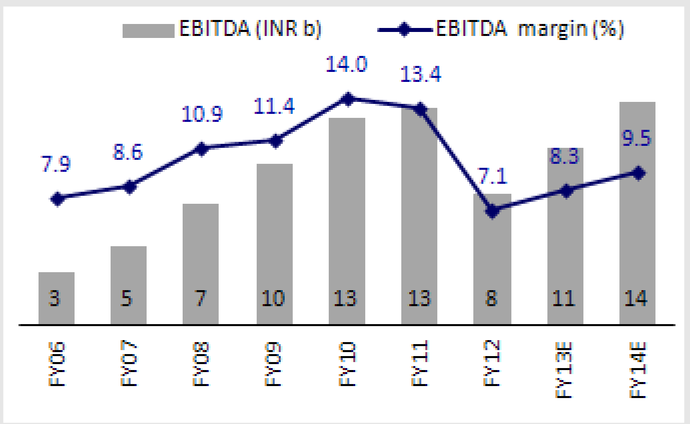
1. **Improved offerings,** largely towards high technology/high voltage products including EHV segment and building up service business portfolio, penetration into new geographies like Middle East and Brazil **(+150bp EBITDA margin).**
2. **Rationalization of raw material sourcing** and focus on low cost countries including China **(+150bp EBITDA margin).**
3. **Change in manufacturing footprint,** with rationalization of capacity utilization in European factories, and capacity expansion from 85,000MVA to 140,000MVA (+50,000MVA incremental capacity in India) over the next 3 years **(+100bp EBITDA margin).**
4. **Improvement in manufacturing processes** by implementing Six Sigma and sustainability program across factories **(+50bp EBITDA margin).**

We model in EBIDTA margin improvement of 240bp till FY14

Standalone and Subsidiaries EBIDTA margins



Consolidated EBIDTA (INR M) and EBIDTA margins (%)



Source: Company, MOSL

Current valuations do not factor in meaningful value for overseas business

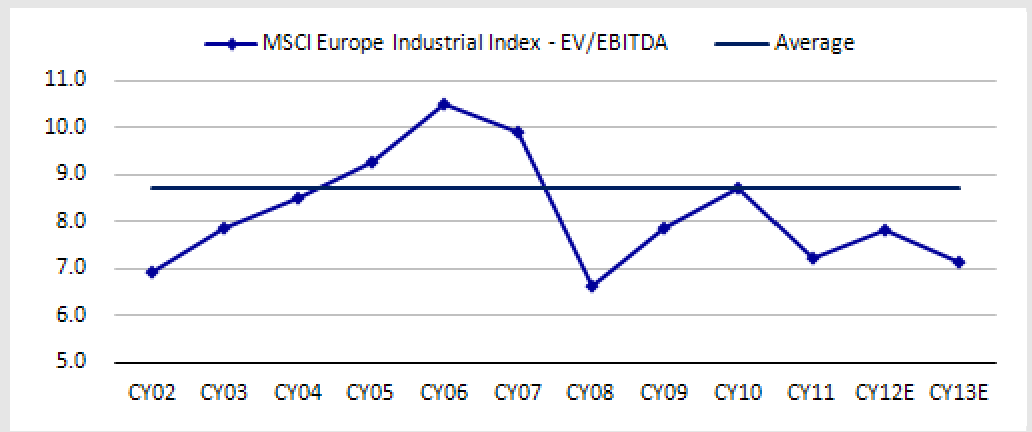
In our view current valuations seems to be largely ignoring the value of overseas business given the headwins in terms of business environment. We arrive at price target of INR163, based on P/E of 12x FY14E for standalone business and EV/EBIDTA of 8x FY14E for overseas business.

CG: SOTP valuation

		Multiple	INR/sh
Standalone Business	PE FY14 (x)	12	131
Overseas Business	EV/EBIDTA (x)	8	29
Avantha	PBV (x)	1	4
Target Price			**163**

Our valuation of the overseas business is based on the global valuation metrics of industrial majors. We note that historically MSCI European industrial index has traded at a long term average EV/EBITDA of 8-9 (x) over the last 15 years while the EBITDA margin have varied between 10-15% over the same period.

MSCI Industrial Index EV/EBITDA (x)



Source: Bloomberg, MOSL

Global Industrial and Electrical valuation metrics

	Year End	EV/Sales	EV/EBITDA	PER (x)	EBITDA Margin (%)
ABB	Dec-11	1.1	7.7	15.1	15.0
Mitsubishi	Mar-12	0.5	5.1	11.1	9.7
Alstom	Mar-12	0.6	5.7	10.9	10.2
Siemens	Sep-11	0.9	6.6	14.7	14.1
GE	Dec-11	3.2	18.9	16.3	17.5
Hitachi	Mar-12	0.5	5.5	5.5	9.2
RWE/ SMIT	Dec-11	0.8	5.0	12.0	16.9
Hyundai	Dec-11	0.8	6.1	7.7	12.5
Average		**1.0**	**7.6**	**11.7**	**13.1**

Based on prices as 9 October 2012 and latest reported financials Source: Bloomberg

Financials and Valuation

Income Statement (Consolidated) (INR Million)

Y/E March	FY10	FY11	FY12	FY13E	FY14E
Net Sales	**91,409**	**100,051**	**112,486**	**131,290**	**145,945**
Change (%)	4.6	9.5	12.4	16.7	11.2
Raw Materials	57,966	64,980	76,850	85,343	95,328
Staff Cost	11,131	11,811	14,662	16,303	17,169
Other Mfg. Expenses	9,542	9,822	12,937	18,714	19,618
EBITDA	**12,770**	**13,438**	**8,036**	**10,930**	**13,828**
% of Net Sales	14.0	13.4	7.1	8.3	9.5
Depreciation	1,551	1,936	2,603	2,540	2,730
Interest	428	352	463	830	967
Other Income	1,100	1,142	524	480	486
EO Items (as rep.)	352	-381	0	0	0
PBT	**12,243**	**11,910**	**5,494**	**8,040**	**10,618**
Tax	3,650	3,100	1,821	2,080	2,580
Rate (%)	29.8	26.0	33.1	25.9	24.3
Reported PAT	**8,593**	**8,810**	**3,673**	**5,960**	**8,037**
Extra-ordinary Inc.(net)	352	-381	0	0	0
Adjusted PAT	**8,241**	**9,191**	**3,673**	**5,960**	**8,037**
Minority Int	6.0	76.5	60.0	69.0	67.0
Consolidated PAT	**8,247**	**9,268**	**3,733**	**6,029**	**8,104**
Change (%)	47.3	12.4	-59.7	61.5	34.4

Balance Sheet (INR Million)

Y/E March	FY10	FY11	FY12	FY13E	FY14E
Share Capital	1,283	1,283	1,283	1,283	1,283
Reserves	23,760	31,464	34,826	39,106	44,496
Net Worth	**25,043**	**32,747**	**36,109**	**40,389**	**45,779**
Loans	5,010	3,955	9,849	15,831	15,708
Deffered Tax Liability	49	160	-122	-557	-529
Minority Interest	43	157	157	157	157
Capital Employed	**30,145**	**37,019**	**45,992**	**55,819**	**61,114**
Gross Fixed Assets	29,858	37,805	44,477	58,273	61,047
Less: Depreciation	17,234	19,490	23,005	25,999	28,216
Net Fixed Assets	**12,623**	**18,315**	**21,473**	**32,274**	**32,831**
Capital WIP	1,137	1,102	1,097	418	409
Investments	5,536	6,747	7,864	5,902	7,962
Curr. Assets	**41,018**	**45,646**	**55,343**	**60,639**	**66,541**
Inventory	10,412	11,893	12,233	13,551	14,471
Debtors	21,463	25,427	31,432	34,359	37,071
Cash & Bank Balance	6,688	2,984	4,976	5,411	7,039
Loans & Advances	2,455	5,342	6,703	7,318	7,961
Current Liab. & Prov.	**30,170**	**34,786**	**40,181**	**43,414**	**46,628**
Creditors	16,098	18,585	21,076	22,004	24,019
Other Liabilities	10,469	12,148	15,318	17,268	18,265
Provisions	3,603	4,054	3,787	4,141	4,344
Net Current Assets	**10,849**	**10,860**	**15,162**	**17,225**	**19,913**
Application of Funds	**30,145**	**37,024**	**45,992**	**55,819**	**61,114**

E: MOSL Estimates; Consolidated Financials

Financials and Valuation (Consolidated)

Ratios

Y/E March	FY10	FY11	FY12	FY13E	FY14E
Basic (INR)					
Consolidated EPS	12.8	14.3	5.7	9.3	12.6
Growth (%)	46.5	11.5	-60.0	62.2	36.0
Cash EPS	15.3	17.3	9.8	13.2	16.8
Book Value	39.0	51.0	56.3	63.0	71.4
DPS	1.3	2.2	1.4	1.9	2.3
Payout (incl. Div. Tax.)	15.3	23.7	20.7	25.0	25.0
Valuation (x)					
P/E (standalone)			21.7	15.0	12.3
P/E (consolidated)			23.4	14.4	10.6
Cash P/E			13.7	10.1	8.0
EV/EBITDA			13.3	8.3	6.3
EV/Sales			0.9	0.7	0.6
Price/Book Value			2.4	2.1	1.9
Dividend Yield (%)			1.0	1.4	1.7
Profitability Ratios (%)					
RoE	39.6	30.5	10.7	15.6	18.7
RoCE	30.9	28.1	9.6	13.0	15.0
Turnover Ratios					
Debtors (Days)	42	43	40	38	36
Inventory (Days)	42	43	40	38	36
Creditors. (Days)	64	68	68	61	60
Asset Turnover (x)	3.0	2.7	2.4	2.4	2.4
Leverage Ratio					
Debt/Equity (x)	0	-0.1	0.0	0.2	0.1

Cash Flow Statement (INR Million)

Y/E March	FY10	FY11	FY12	FY13E	FY14E
PBT before EO Items	11,891	12,291	5,494	8,040	10,618
Add : Depreciation	1,551	1,936	2,603	2,540	2,730
Interest	428	352	463	830	967
Less : Direct Taxes Paid	3,650	3,100	2,494	2,125	2,552
(Inc)/Dec in WC	-125	-3,715	-2,311	-1,628	-1,060
CF from Operations	**10,094**	**7,765**	**3,756**	**7,657**	**10,703**
(Inc)/Dec in FA	-1,526	-7,593	-5,756	-12,662	-3,278
(Pur)/Sale of Investments	-3,864	-1,211	-1,117	1,962	-2,060
CF from Investments	**-5,389**	**-8,805**	**-6,873**	**-10,700**	**-5,338**
(Inc)/Dec in Net Worth	-917	538	390	-249	-897
(Inc)/Dec in Debt	-2,173	-1,055	5,894	5,982	-123
Less : Interest Paid	428	352	463	830	967
Dividend Paid	944	1,644	1,044	1,431	1,750
CF from Fin. Activity	**-4,461**	**-2,513**	**4,777**	**3,472**	**-3,737**
Inc/Dec of Cash	**1,032**	**-3,709**	**1,851**	**429**	**1,628**
Add: Beginning Balance	5,656	6,688	2,984	4,976	5,411
Closing Balance	**6,688**	**2,984**	**4,976**	**5,410**	**7,039**

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