Three-tier strategy to drive profitable growth

Strengthening the core while nourishing new growth drivers

In our meeting with Mr Shantanu Khosla, Managing Director, Crompton Greaves Consumer Electricals (CGCEL), we discussed the company's three-tier strategy to drive profitable growth. CGCEL is focusing on sustaining and growing its "Core" segments of Fans and Pumps, while a disproportionate growth is expected from Lighting and Appliances. The following are the key highlights of our meeting:

Focus on "Building the Core": CGCEL aims to sustain and grow the "**Core**" segments of Fans and Pumps where it has market leadership while the Lighting and Appliances segments will record a disproportionate growth over the next few years. It has formulated a three tier strategy for the next few years and aims at: a) Sales growth to be at levels higher than industry by gaining market share b) Profit growth to be in line or higher than sales growth and c) Cash flow to be more than 100% of profit. The new management team has been with the company for over six months now and the implementation of this strategy is already underway

"How to Win": In order to implement its growth strategy, the company has identified the following measures to be taken: a) **Increasing spend on branding** - Invest the cash flow generated back into the business to create greater consumer awareness. CGCEL has been an under-invested brand over the years, and the company has now increased its ad spend starting with TVCs from April onwards. CGCEL is targeting to bring its ad spend in line with that of its competitors. It must be noted that Havells spends ~3-3.5% of its total sales on advertising and in our view, CGCEL could also be targeting a similar level of ad spend. b) **Go to market -** CGCEL already has a strong electrical distribution network (100,000+ touch points), but plans to switch to more of an FMCG/white goods mode of distribution and substantially increase its number of touch points. The aim is to have the right product available at the right store at the right price. c) **Supply chain -** The company will retain its asset light model. Currently, 50% of the products sold by CGCEL are made in-house, though the company will make continued efforts to further improve its operational efficiencies and reduce costs through measures, such as improved demand forecasting. d) **Increasing connect with the youth** by identifying their needs and catering to this particular segment. e) **Product -** Innovate and introduce premium products with better aesthetics and new features across product categories.

Strong competitive advantages in fans: In the fans market, CGCEL has an edge over its competitors in terms of blade design and motor. With the fans market fast transitioning towards energy efficient/5-star rated fans, CGCEL is able to offer industry-leading energy efficient fans which consume 50% less power than traditional fans. It must be noted that as compared to normal fans which use 75W/hour of power, 5-star rated fans use 50W/hour, while Brushless Motor (BLDC) fans use only 35W/hour.

Crompton Greaves Consumer Electricals

Mr Shantanu Khosla
Managing Director

Mr Shantanu Khosla joined CG Consumer Electricals in July 2015. Mr Khosla brings with him a rich experience in managing the consumer business across markets, product categories and functions.
An alumnus of the Indian Institute of Technology, Bombay and the Indian Institute of Management, Calcutta, Mr Khosla had joined Procter & Gamble India as a management trainee in 1985. From thereon, he served the company in multiple roles.

After several stints abroad in Newcastle, UK and Kobe, Japan, as well as Singapore and Malaysia, he returned to India in 2002 as CEO & MD of Procter & Gamble India. In his 13-year stint with the company, he drove a 15-fold growth in revenue to USD1.8b, making it one of the fastest growing consumer companies in India. Mr Khosla has served as the MD of two big legal entities in India – P&G Hygiene and Health Care Limited, and Gillette India Limited.

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Increased focus on "Premium" fans segment: In order to increase its market share in premium fans (10% of total sales), CGCEL is launching new variants and creating awareness about these new models; it must be noted that in 2HFY16, sales of premium fans grew by 35% YoY. CGCEL was earlier a part of an engineering company which resulted in lower focus on aesthetics. However, aesthetics, innovation and branding are currently the key focus areas in this category. Dust free fans, under light fans and fans with sensors, are some of the new variants being launched by the company. In our view, increasing share in the mass/mid segments of fans (<INR2000) should be easier for CGCEL,as there is absence of credible competition in that space. Even within the premium segment, despite the presence of Havells (market leader with +25% share), the premiumisation trend in fans will ensure market share gains for CGCEL.

Lighting – focus is on LEDs: CGCEL is focusing strongly on LEDs and plans to use technology to differentiate its products from those of its competitors. The company is targeting the premium segment in LEDs by offering products such as dimming and color changing LEDs and fixtures. CGCEL aims to grow at a faster pace than the market and is not content with being at the No.4 position.

Pumps – expand presence in agricultural pumps: CGCEL is the market leader (+25%) in the domestic/residential pump market and is now aiming to increase its share in the agricultural pumps market where it has a relatively weaker presence. In order to expand its presence in this segment, CGCEL is: a) Adapting its pumps to work at different voltage levels as per requirements of various states b) Launching rural reach programs to connect with farmers.

Appliances – lower share offers large growth opportunity: CGCEL had entered the Appliances segment in FY12 and is a relatively small player in this category (~2% share, as per MOSLe). Similar to other players in the industry, CGCEL also imports its entire appliance range from China. However, over the next few years, the company plans to increase the share of in-sourced component in order to enjoy the benefits of better quality control and lower costs.

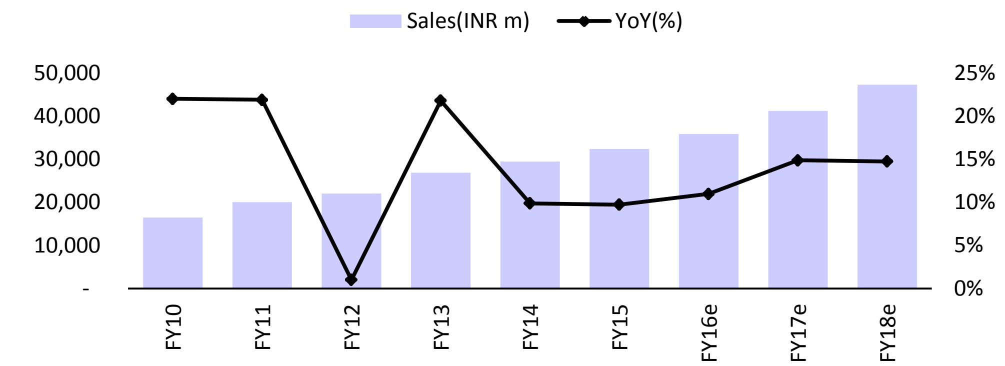
Excess cash likely to be paid out as dividend: Given the strong operating cash flow generated every year (~INR3.5b in FY17E) and relatively low capex (INR0.3b-0.4b) in FY17, we expect the company to pay back the excess cash as dividend to its shareholders. CGCEL's gross debt stood at INR6.5b in Q416 and the company is now refinancing this debt at a lower rate to reduce its interest costs. The new debt raised will be in the form of debentures to be repaid over the next 3-4 years.

Participation in EESL program subject to meeting profitablility criterion: CGCEL is participating in the government bulk sourcing program for LEDs, but will not sacrifice profitability for the sake of volume. On one hand, the program is good because it adds to the current distribution channel for manufacturers while allowing them to supply large volumes, and on the other hand, it also dilutes their brand value.

CG Consumer Electricals – India's leading electrical appliances player

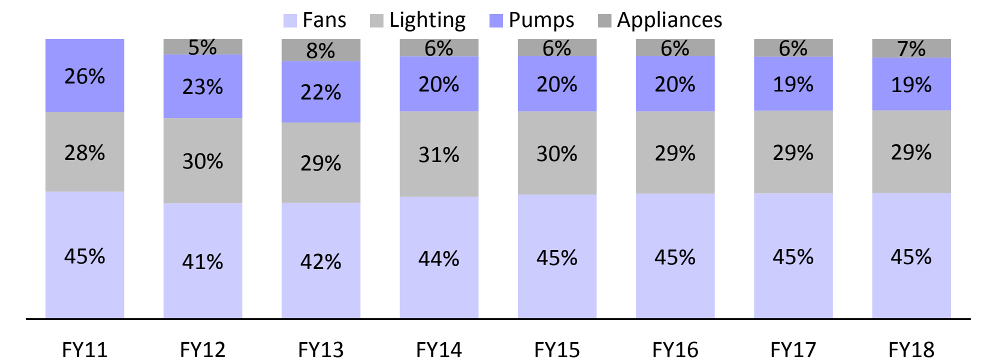
- Crompton Greaves Consumer Electricals (CGCEL) is among India's leading consumer electrical companies with a presence across fans, lighting, pumps and appliances. In FY15, 45% of the company's revenue came from fans, 30% from lighting, 20% from pumps and 6% from appliances.

Exhibit 1: CGCEL's sales and YoY growth (%)



Source: Company, MOSL

Exhibit 2: CGCEL's segment-wise revenue



Source: Company, MOSL

- CGCEL is the No 1. player in the Indian fans market with a share of 26-28%, while it is also among the top five players in the domestic lighting and pumps markets. The company also forayed into the consumer appliances market in FY12 and the segment already contributes to 6% of its total sales as of FY15.
- The Board of Directors of CGL and CGCEL had approved the scheme of arrangement to separate the consumer products business from the parent and demerge it into a new company called CGCEL which will be listed. All of CGL's existing shareholders will be allotted shares of CGCEL in the same proportion (share entitlement ratio being 1:1) as the shares held by them in the existing CGL.
- The appointed date for the demerger of the consumer products business has been set from October 2015, while the Mumbai High Court has approved the scheme via its order dated Nov-20, 2015, with the scheme coming into effect from Jan-1, 2016.

Fans - focusing on the premium range

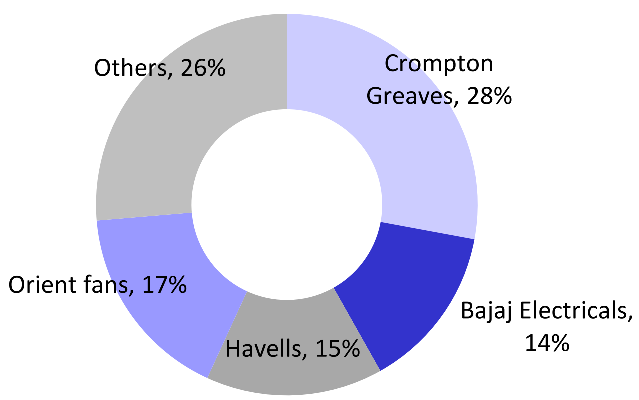
- CGCEL has been the undisputed leader in the Indian fan market with a share of around 26-28%. Our interaction with dealers and channel partners indicates that customers prefer the Crompton brand for its durability (long life), reliability (low maintenance) and the trust associated with the brand.
- A comparison of the fan models available in the market shows that CGCEL has the largest portfolio in ceiling fans with 75 models. More importantly, ~30% of CGCEL's fan models are in the "Standard/Plain" category, while the balance 70% is in the "Premium" category. In contrast, Havells has only 13% of its range in the Standard category, as a result of which the company is increasing its focus on the "Premium" range of the market where the margins typically tend to be higher.
- In our view, CGCEL is also looking to aggressively target the "Premium" category of fans, while retaining/growing its market share in the "Standard" category. Premium fans contributed 9% of CGCEL's sales in FY15 and the company plans to further increase this share in a meaningful manner.

Exhibit 3: Ceiling fans market break-up in terms of segments and players

Ceiling fans	Crompton	Havells	Orient	Usha	Bajaj
Under light fans	18%	17%	22%	15%	8%
Kids fans	4%	6%	4%	13%	13%
Decorative fans	40%	**61%**	47%	30%	48%
BEE 5 Star rated/ BLDC fans	9%	4%	10%	29%	13%
Standard/Plain fans	30%	**13%**	18%	15%	18%
Total no. of models	**75**	**54**	**49**	**62**	**39**

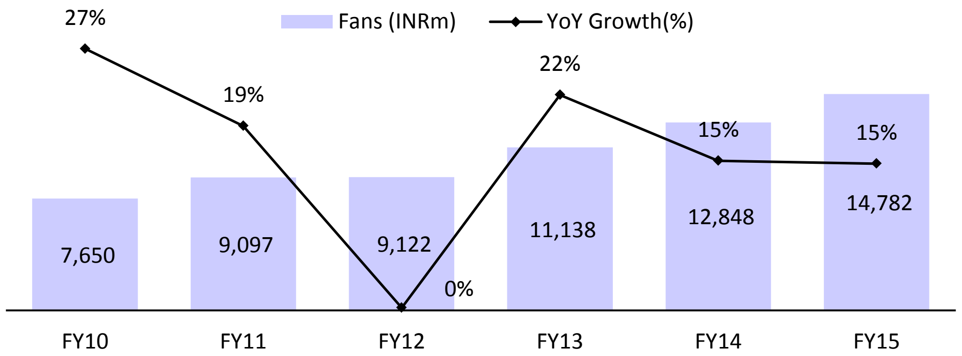
Source: Company websites, MOSL

Exhibit 4: Market share break-up of INR52b Indian fans industry



Source: Company, MOSL

Exhibit 5: CGCEL's fan sales CAGR of 14% over FY10-15 surpasses industry CAGR of 9-10%

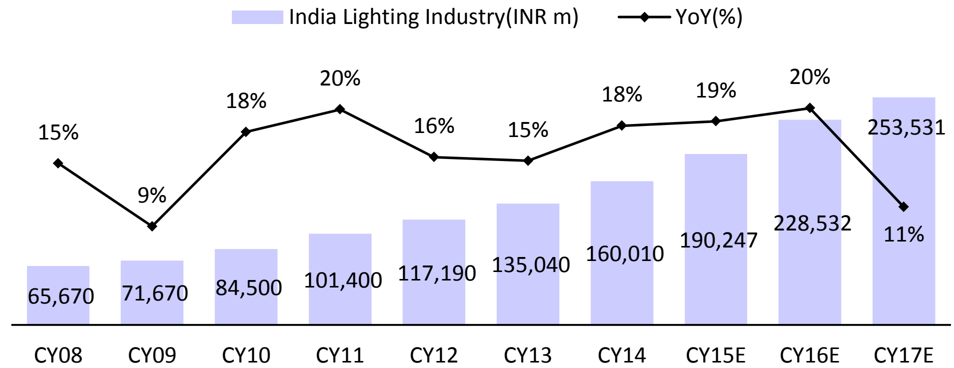


Source: Company, MOSL

Lighting – industry shifting to LEDs; CGCEL at the forefront

- In January 2015, the Indian government launched the "National Program for LED based Home and Street Lighting", with the aim of replacing incandescent bulbs (ICLs) with LED in residential and street lighting. Recently, the Power Minister, Mr Piyush Goyal had stated that the government was aiming to replace 770m ICLs and 35m street lights with LEDs by FY19 under its Demand Side Management initiatives. This program has been named as "UJALA" or "Unnat Jyoti by Affordable LEDs for All".
- As a result of these government initiatives, the LED market which stood at INR5b in CY10 is expected to jump up to INR115b by CY17E and form ~45-50% of the overall lighting market, as compared to 6% in CY10. We estimate the overall lighting market to grow to INR253b in CY17E (17% CAGR over CY15-17E)

Exhibit 6: Indian lighting industry's growth over CY08-17E



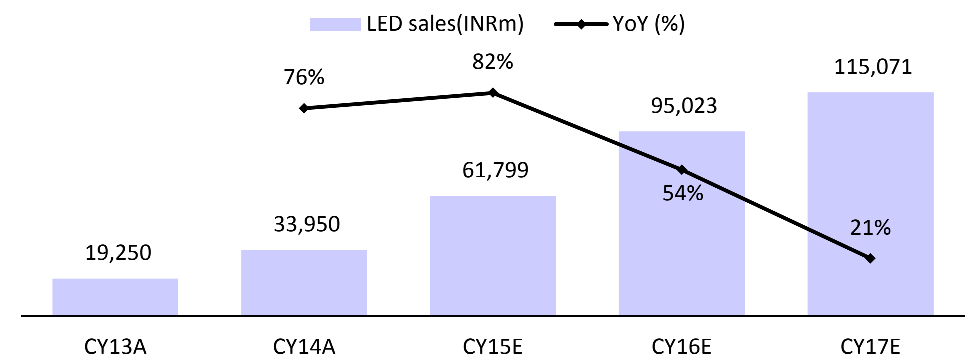
Source: Company, MOSL

Industry growth to be driven by shift from traditional lamps to LEDs

- Over the next two years, we expect the growth in the Indian lighting industry to be driven by a sharp increase in LED sales. The LED market which stood at INR5b in CY10 is expected to jump to INR115b by CY17E, driven by the government's initiatives, and form ~45-50% of the overall lighting market, as compared to 6% in CY10. We estimate the overall lighting market to grow to INR253b in CY17E (17% CAGR over CY15-17E).
- Replacing ICLs and CFLs with LEDs makes economic sense as the latter has a much longer life (50,000 hours as compared to 10,000 hours for CFL and 1,500 hours for ICL), is more energy efficient (80-100 lumen/watt as compared to 50 lumen/watt for CFL and 13-15 lumen/watt for ICL), and has a lower payback period of 2-2.5 years than CFLs.

- The key driver of the increased usage of LEDs over the next few years will be the government's push to replace street lighting (via municipalities) and residential lighting (via state discoms) to achieve greater energy efficiency and savings. India has ~27m street lights which the government is targeting to replace with LEDs by FY19. The government intends to ban the sale of 100W, 60W and 40W ICLs, which coupled with a further decline in prices of LEDs (already down to INR200 from INR1,000-1,200 earlier), will drive a large scale shift to LEDs. We also expect commercial establishments (retail outlets/offices/shops) to increasingly replace the less efficient FTLs and CFLs with LED down lights, as the price gap between LED and CFL down lights has narrowed significantly, thus providing a good incentive to switch to LED lights.

Exhibit 7: LED sales over CY13-17E



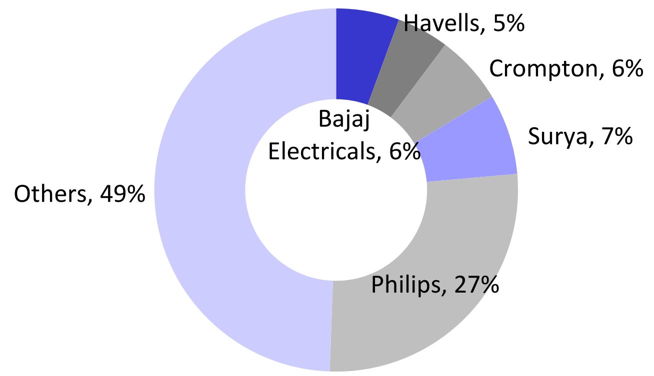
Source: MOSL, Company

Exhibit 8: ICL, CFL and LED cost comparison

Description	Units	ICL	CFL	LED
Life span	Hours	1,500	10,000	50,000
Wattage	Watts	60	14	6
Power consumed per hour	Kilowatt-hour (kWh)	0.06	0.014	0.006
Cost of usage for one hour @INR6 per kWh	INR	0.36	0.084	0.036
Cost of usage for 50,000 hours	INR	18000	4200	1800
Bulbs needed for 50,000 hours of running	No. of bulbs	33	5	1
Bulb cost	INR	10	120	300
Cost of replacement	INR	330	600	0
Total 50,000 hours of lighting cost	INR	18330	4800	2100
Ratio of cost	Ratio	8.7	2.3	1.0

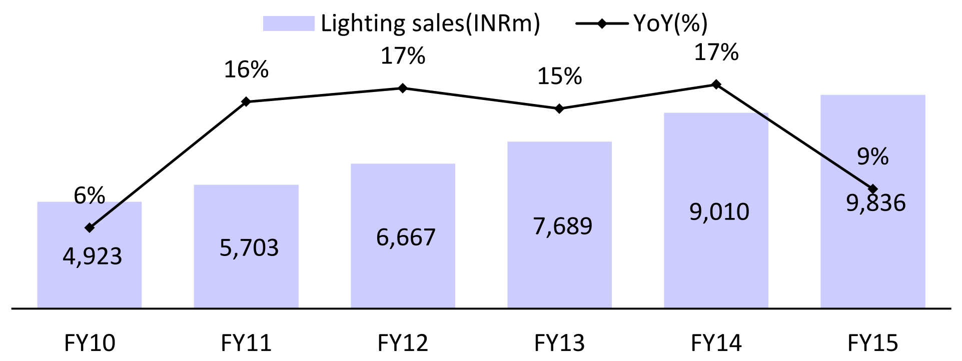
Source: Company, MOSL

Exhibit 9: Market share break-up of INR160b Indian lighting industry



Source: MOSL, Industry

Exhibit 10: CGCEL's lighting sales CAGR of 15% over FY10-15 surpasses industry CAGR of 10%

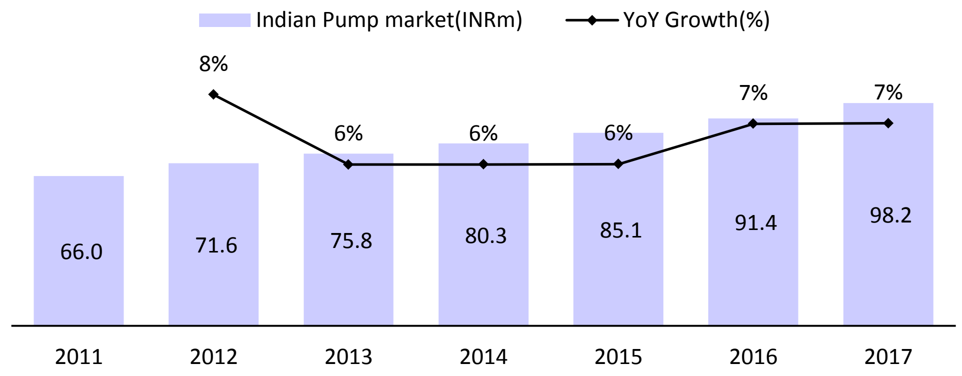


Source: Company, MOSL

Pumps – Agriculture and Household to be near-term growth drivers

- The Indian pump industry has grown at CAGR of 6% to INR85b over FY11-15, with 2m pumps being sold each year. Weak monsoons over the past two years have led to a decline in the sale of agricultural pumps. However, with above average monsoon anticipated for FY17, we expect a pick-up in demand for agricultural pumps (27% of the market).
- We expect the industry growth to remain subdued at 5-7% over the next 2-3 years on account of the weak industrial capex environment (46% of the end market), which will dampen the overall demand for pumps.

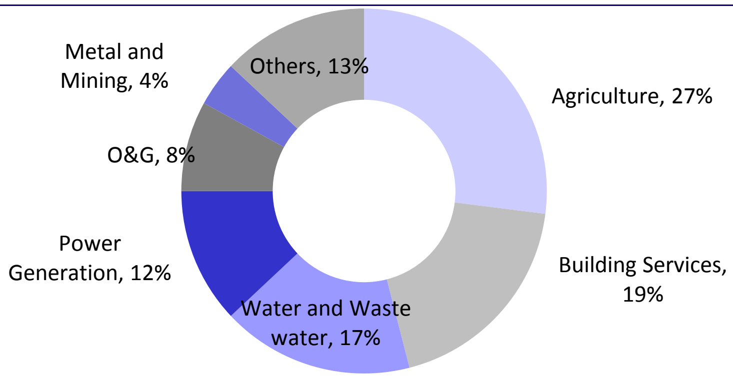
Exhibit 11: Indian pump market (INR m) and YoY growth (%)



Source: Company, MOSL

- The overall Industrial segment constitutes 46% of the total pumps sold in the country, out of which Power Generation, O&G and Metals form 24%. Pumps for use in agriculture form the largest proportion at 27% of the total pumps sold.

Exhibit 12: End market-wise usage of pumps



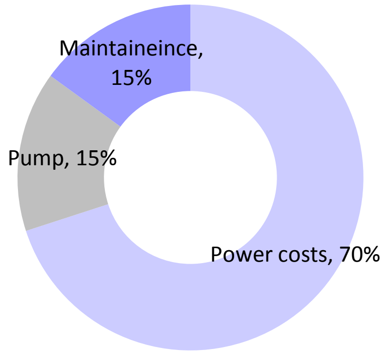
Source: Company, MOSL

- Below is our view on each of the key end markets for pumps and their outlook for the next few years:
  a. **Agriculture**: Currently subdued following two consecutive years of a weak monsoon. Expectations of an above average monsoon in CY16 should provide a boost to the demand for agricultural pumps. ABB and KSB Pumps are now targeting solar powered pump sets (launched by KSB in July 2015). EESL plans to replace all the existing 20m agriculture pumps with solar pumps to reduce electricity costs.
  b. **Oil & Gas**: Post the subdued demand over the last few years, we expect new refineries to come up and drive a revival in demand.
  c. **Power Generation**: Boiler feed pumps are used in power plants, though the current slump in power generation orders has made the market quite subdued. Super critical pumps that are being mainly imported at the moment are likely to drive the growth in this space.
  d. **Fertilizer**: 6-7m ton of fertilizer currently being imported will have to be replaced and new fertilizer plants are being planned, which should boost demand.
  e. **Water/Wastewater**: Increased spending on development of urban infrastructure, 100 Smart Cities in India and the Namami Ganga program will provide a boost to the industry.
  f. **Pulp/Steel:** We expect both these end markets to decline, as a result of which their contribution will be marginal.

Power costs, reliability and service the key differentiating factors

- Power costs constitute 70% of a pump's running cost, thus making it one of the key factors influencing the purchase of pumps. There is a clear preference towards purchase of higher star rated pumps that reduce power consumption.
- The other key factors influencing the purchase of pumps are reliability, service and zero down time.

Exhibit 13: Life cycle costs for a pump – power costs are the highest



Source: Company, MOSL

Exhibit 14: Pump usage by type

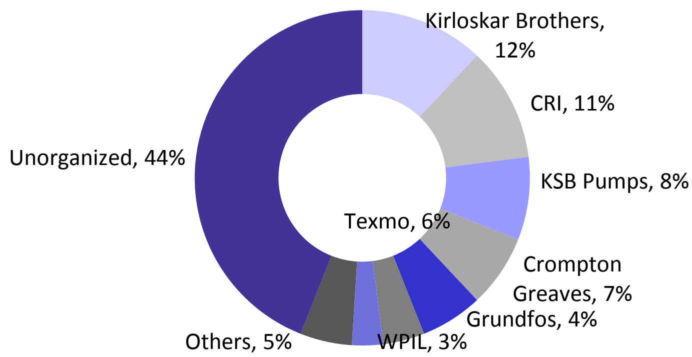
Description	HP rating	End market
Residential/ Domestic pumps	0.25-20	Agriculture, Residential and Commercial buildings
Industrial	2- 500	Across industries - Cement, Steel, Oil & Gas
Pumps used for EPC projects	500HP and above	Power plants, Irrigation and Municipal projects

Source: Company, MOSL

Market share by player

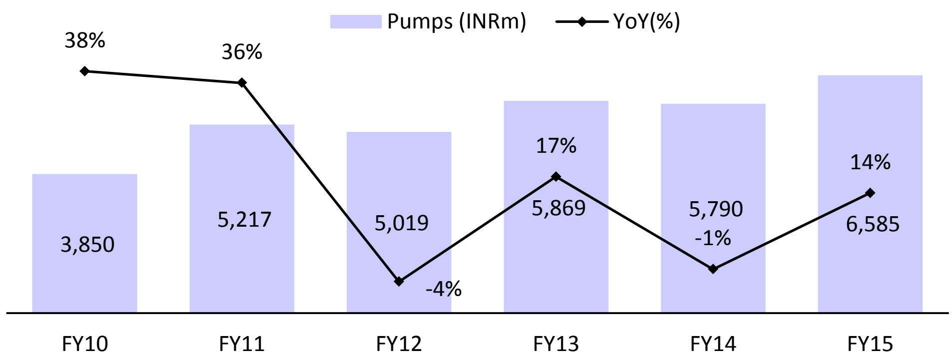
- The Indian pump market is quite fragmented with only 56% comprising of organized players. The top five players control about 44% of the overall market.
- Kirloskar Brothers is the market leader in this segment due to its market leadership position in agricultural pumps. CGCEL has a share of 7% in the Indian pump market.

Exhibit 15: Indian pump market player-wise share



Source: Company, MOSL

Exhibit 16: CGCEL's pump sales grow at 12% CAGR over FY10-15



Source: MOSL, Company

Financials and valuations

Income Statement			(INR Million)
Y/E March	**2016E**	**2017E**	**2018E**
Total Revenues	**18,117**	**41,203**	**47,274**
Change (%)	-	127.4	14.7
Raw Materials	12,702	28,724	32,957
Staff Cost	1,005	2,432	2,727
Other Expenses	2,315	5,417	6,007
EBITDA	**2,095**	**4,630**	**5,584**
% of Total Revenues	11.6	11.2	11.8
Depreciation	63	136	149
Other Income	2	19	15
Interest	318	633	468
PBT	**1,716**	**3,880**	**4,982**
Tax	525	1,242	1,644
Rate (%)	30.6	32.0	33.0
Adjusted PAT	**1,191**	**2,639**	**3,338**
Extra-ordinary Income (net)	-139	0	0
Reported PAT	**1,052**	**2,639**	**3,338**
Change (%)	-96.7	150.8	26.5

Balance Sheet			(INR Million)
Y/E March	**2016E**	**2017E**	**2018E**
Share Capital	1,254	1,254	1,254
Reserves	1,034	2,406	4,142
Net Worth	**2,287**	**3,659**	**5,395**
Loans	6,500	5,000	3,500
Deferred Tax Liability	-43	-43	-43
Capital Employed	**8,744**	**8,616**	**8,852**
Gross Fixed Assets	2,030	2,330	2,630
Less: Depreciation	1,244	1,380	1,528
Net Fixed Assets	**787**	**951**	**1,102**
Capital WIP	0	0	0
Goodwill	7,794	7,794	7,794
Curr. Assets	**7,907**	**8,765**	**10,160**
Inventory	2,100	2,412	2,767
Debtors	4,165	4,784	4,971
Cash & Bank Balance	900	716	1,444
Loans & Advances	734	844	968
Other Assets	7	8	9
Current Liab. & Prov.	**7,742**	**8,894**	**10,204**
Current Liabilities	7,317	8,405	9,644
Provisions	425	488	560
Net Current Assets	**164**	**-129**	**-44**
Application of Funds	**8,745**	**8,616**	**8,852**

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	2016	2017E	2018E
Basic (INR)			
Adj EPS	**1.9**	**4.2**	**5.3**
Cash EPS	2.0	4.4	5.6
Book Value	3.6	5.8	8.6
DPS	0.0	1.7	2.1
Payout (incl. Div. Tax.)	0.0	40.0	40.0
Valuation (x)			
P/E	71.6	32.3	25.5
Cash P/E	68.0	30.7	24.4
EV/EBITDA	43.4	19.3	15.6
EV/Sales	5.0	2.2	1.8
Price/Book Value	37.3	23.3	15.8
Dividend Yield (%)	-	1.2	1.6
Profitability Ratios (%)			
RoE	52.1	88.7	73.7
RoCE	28.1	35.2	41.6
Turnover Ratios			
Debtors (Days)	42	42	38
Inventory (Days)	21	21	21
Creditors. (Days)	68	68	68
Asset Turnover (x)	2.1	4.8	5.3
Leverage Ratio			
Debt/Equity (x)	2.8	1.4	0.6

Cash Flow Statement (INR Million)

Y/E March	2016E	2017E	2018E
PBT before EO Items	**1,716**	**3,880**	**4,982**
Depreciation	63	136	149
Interest	318	633	468
Direct Taxes Paid	-525	-1,242	-1,644
(Inc)/Dec in WC	(229)	108	643
CF from Operations	**1,342**	**3,515**	**4,597**
EO Income	0	0	0
CF from Oper. Incl. EO Items	**1,342**	**3,515**	**4,597**
(Inc)/Dec in FA	(1)	(300)	(300)
Free Cash Flow	**1,342**	**3,215**	**4,297**
Investment & Others	0	0	0
CF from Investments	**-1**	**-300**	**-300**
(Inc)/Dec in Net worth	(18)	0	0
(Inc)/Dec in Debt	-316	-1,500	-1,500
Interest Paid	-318	-633	-468
Dividend Paid	0	-1,267	-1,602
Others	210		
CF from Fin. Activity	**(442)**	**(3,399)**	**(3,570)**
Inc/Dec of Cash	**900**	**(184)**	**727**
Add: Beginning Balance	1	900	716
Closing Balance	**900**	**716**	**1,444**

E: MOSL Estimates

Disclosures

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