

Growth attracting competition

We did a roadshow with an industry veteran for consumer appliances. Key discussion was around (1) Robust performance of appliances in CY19, (2) Structural drivers of appliances, (3) Disruption from Chinese players and (4) Winning strategies.

- **Robust performance of appliances in CY19:** Large appliances have delivered robust growth in CY19. Slowdown pressure was not visible for appliances unlike other consumption categories. RAC was the outlier in CY19 driven by a strong summer-19. Refrigerator and Washing Machine also saw a healthy growth. Our channel checks (7 Jan 2020) also suggest similar trends for large home appliances. TV Panels saw massive change in customer buying between offline and online in 2019. Offline market has declined while online grew sharply. Thereby, overall growth for TV Panel was positive.
- **Structural drivers of appliances:** Appliances have several structural drivers like (1) Low penetration, (2) Rapid change in customer profile, (3) Suitable to futuristic channel. Large home appliance can sustain low double digit to mid-teens CAGR in the long run.
- **Disruption from Chinese players:** Higher number of brands in every appliance category and rising share of online reflects a change in customer preferences. Chinese products have been successful in India for mobile and TV panels in a very short span of time. 'Value for money' proposition, wider product range and higher focus on online channel have resulted into faster success for Chinese products. Chinese players

may disrupt the large appliance categories in the same fashion it has impacted mobile and TV panels.

- **Winning strategies:** Appliances companies are focusing on diversification, wrt product range, regional presence and distribution channel. However, appliances companies will need to be more agile to counter rising competition. These companies are enjoying rural electrification, category penetration and rising affordability. However, to sustain market share and margin, companies will need to focus on winning strategies i.e. (A) Deep understanding of customers, (B) Product innovation, (C) Faster increase in distribution reach, (D) Presence in futuristic channels and (E) Aggressive marketing strategies.

Our View

- **Our optimism on longevity of appliance sector is driven by (1) Rapid change in consumer affordability & preferences, (2) Rising share of branded products, (3) Multi-year growth opportunity (under penetrated), (4) Untapped rural market (rural electrification, rising rural focused strategy by leading companies) and (5) Scope of premiumisation. Appliances are more sensitive to GDP growth. Thereby, any improvement in the economy in 2020 will provide better prospects for the sector. We continue to like companies who are leaders in their respective categories and have ability to tap opportunity in other categories. In consumer appliances, we have BUY rating on Havells, Voltas, Crompton Consumer and Symphony.**

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Highlights of the Roadshow

(1) Robust performance of appliances in CY19:

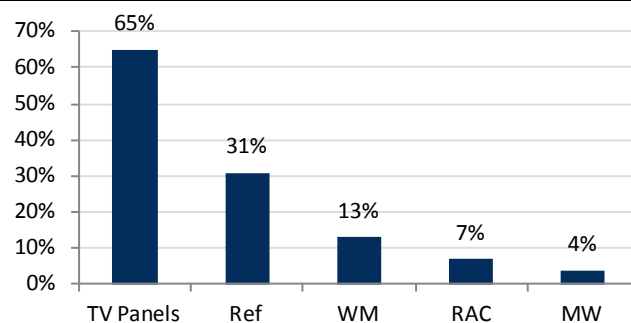
- Large appliances have delivered robust growth in CY19. Slowdown pressure was not visible for appliances unlike other consumption categories. RAC was the outlier in CY19 driven by a strong summer-19. Refrigerator and Washing Machine also saw a healthy growth (similar to our channel checks – 7 Jan 2020). TV Panels saw massive change in customer buying between offline and online in 2019. Offline market has declined while online grew sharply. Thereby, overall growth for TV Panel was positive.

(2) Structural drivers of appliances

Low penetration will continue to drive appliances

- Appliances in India are still at a nascent stage in terms of market penetration. So far, the outreach has mainly been in urban areas with rural demand lagging. This is also the reason why the current macro headwinds in rural income have not dented the sales of Consumer Appliances.
- Particularly in ACs, with a 7% market penetration, the influx of new firms and better outreach in Tier 2, Tier 3 cities and rural areas could provide a massive boost to the segment.

Penetration: Rural penetration is even more lower



Source: Industry, HDFC sec Inst Research

Rapid change in customer profile

- Consumer behavior has seen a change with the consumers deviating towards convenient and cheap alternatives over those with a reputation. Consumers today are also opting for cheaper appliances that are used for a short duration rather than expensive brands that are long lasting. Price and design plays a bigger role in the buying decision, and customers are often willing to accept a lower level of after-sales service for the cheaper appliance.
- Low penetration is still driving buying by first time buyers. While replacement and upgrade shows the constant need of such products despite having discretionary spends. Rising middle class will continue to drive premiumisation in appliances.

Fast rising preference for online, Large appliances are still having low traction in online

- Customer preference towards online is changing at a faster pace and many consumption categories have seen healthy share from online. Large appliances are still having a low share from online as compared to small appliances and TV panels. Customer still prefers the touch and feels experience before buying large appliances. However, more differentiated products on online vs. offline will increase the share in the coming years.

(3) Disruption from Chinese players

- Higher number of brands in every appliance category and rising share of online reflects a change in customer preferences. Chinese products have been successful in India for mobile and TV panels in a very short span of time. 'Value for money' proposition, wider product range and higher focus on online channel have resulted into faster success for Chinese products.
- Now the question, can these brands be successful in large home appliances? Chinese players can disrupt

the large appliance categories in the same fashion it has impacted mobile and TV panels. Chinese companies are now spending a lot more money on customer research vs. hefty money spent on advertisement over the past few years. Better customer understanding is providing a competitive edge to these Chinese products, which are already price competitively. Chinese players are entering into various consumption categories with more region specific strategies. Chinese players have a large product range in China with product ranges from Mobile, TV Panel, Large Home Appliances, Small appliances to Fashion & Apparels etc. Thereby, these players will expand the under penetrated categories by launching products at untapped price points and higher presence in fast growing online channel. Thereby, Chinese players will expand the market but will also impact leading brands.

Chinese brands presence (or plan to launch in 2020) in consumer categories

Mobile	TV Panels	Air Conditioner	Refrigerators	Washing Machines
Xiaomi	Xiaomi	Midea (Midea, Toshiba, Carrier)	Midea	Midea
Vivo	TCL	Gree	TCL	TCL
Realme	Oneplus	Haier	Haier	Haier
Oppo	Realme	TCL		
Oneplus	Hisense (Toshiba)	Hisense		
Honor	Kodak			
Huawei	Honor			
Motorola	Huawei			
Meizu	Motorola			
Gionee				

- However, as per our recent channel checks** (with various large appliance distributors), Chinese products will not see success, similar to what they saw in Mobile and TV Panels, in other larger appliance categories. As per them, TCL and other Chinese players will not impact the leading players of RACs like the co did for TV Panels. Chinese brands are weak for RAC and no big distributor will be able to justify keeping these brands because of uncertainty over after sales service and product quality. Most big distributors are already keeping many leading brands. Therefore, adding such weak brands will not be easy. TCL business model is not distributor friendly either (unpredictability over stock availability, pricing and after sales service). RAC as a product needs a lot of back end support (installation, after sales service).

(4) Winning strategies

- Appliances companies are focusing on diversification, wrt product range, regional presence and distribution channel. However, appliances companies will be needed to be more agile to counter rising competition. These companies are enjoying rural electrification, category penetration and rising affordability. However, to sustain market share and margin, companies will need to focus on winning strategies i.e. (A) Deep understanding of customers, (B) Product innovation, (C) Faster increase in distribution reach, (D) Presence in futuristic channels and (E) Aggressive marketing strategies
- (A) Deep understanding of customers:** With the biggest youth population in the world, understanding the evolving needs of the consumers will be the key to survival. Companies will have to be proactive in providing customers with products that serve their purpose in a cost effective and convenient manner. Modern customers are well informed about products and decisions are based on rationale rather than

following brand loyalty. Companies that are able to provide high quality products at affordable prices will be best placed to capture market share.

- **(B) Product innovation:** Product differentiation is the only way forward for companies to sustain and gain market share. In order to bring forth effective differentiation, companies will have to focus on developing new and innovative products or reinventing old products. Effective and efficient spending on R&D will be a necessity. They will have to strive to provide customers with the functionality they require at appropriate price points.
- **(C) Faster Increase in distribution reach:** The Appliances market in India extends mainly in urban areas. Increasing penetration and distribution reach to the semi-urban and rural areas will drive demand for small as well as large appliances. The first mover advantage in this regard can be significant for companies that place the right products at the right price. Forming tie-ups with retailers that have presence in such areas will help expand the reach of products.
- **(D) Presence in futuristic channels:** The share of online sales in the overall sales mix has been increasing consistently. In addition to this, the rise of O2O (Online to Offline) platforms has created distribution channels that completely eliminate the middle men (distributors) for the appliance producers. The adoption of such modern channels will drive down the distribution costs across the industry. Companies that utilize such channels will be capable of pricing their products at par with, or better than, the competition. This will give them a significant advantage in a cost sensitive market like India.
- **(E) Aggressive marketing strategies:** Chinese firms that look to capture market share will make the use of aggressive marketing strategies in order to do so. These strategies could involve efficient social media management, predatory pricing, promotional campaigns and targeted advertising. Existing players will have to adapt to the changing scenario in order to sustain their market share and acquire new customers. In a scenario where there will be pressure on pricing, focus will also have to be on cost rationalization across the board to keep margins stable.

Valuation Summary

Companies	MCap (Rs bn)	CMP (Rs)	Reco.	TP (Rs)	EPS (Rs)			P/E (x)			EV/EBITDA (x)			Core RoCE (%)		
					FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Havells	399	639	BUY	745	13.4	17.7	21.8	47.5	36.1	29.4	32.2	25.0	20.6	24.3	30.4	36.7
Voltas	233	705	BUY	740	19.5	23.5	27.7	35.2	29.2	24.7	26.3	22.5	19.0	29.3	30.4	31.0
Crompton	159	254	BUY	339	7.6	8.9	10.0	33.5	28.7	25.5	24.4	21.0	18.5	45.4	51.1	55.3
V-Guard	98	230	NEU	233	5.0	6.1	7.2	45.6	37.6	32.1	32.6	28.1	24.1	26.2	28.2	29.9
Symphony	84	1,203	BUY	1,863	28.1	35.5	42.9	42.9	33.9	28.0	33.4	26.1	21.3	47.7	56.4	63.8
TTK Prestige	84	6,078	NR	8,307	165.9	187.8	214.2	36.6	32.4	28.4	25.8	22.4	19.3	23.6	24.3	26.2

NR: Not Rated | TP is fair value for TTK Prestige since we don't have active coverage

Disclosure:

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