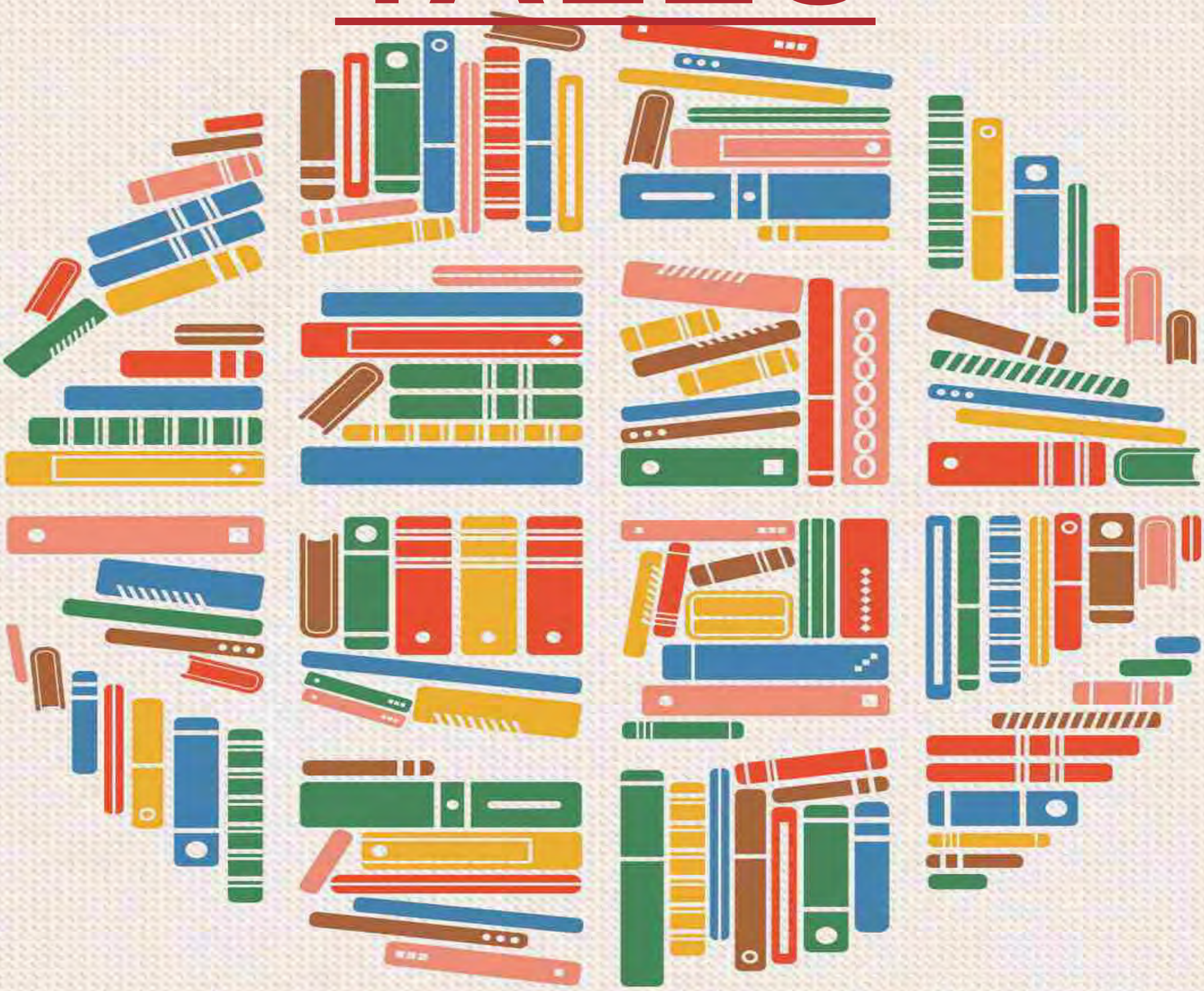
ICICI direct Research

December 23, 2020

Stock TALES



Stock Tales are concise, holistic stock reports across wider spectrum of sectors. Updates will not be periodical but based on significant events or change in price.

Crompton Greaves Consumer Electricals (CROGR)

CMP: ₹ 360 | Target: ₹ 440 (22%) | Target Period: 15 months | **BUY**

December 23, 2020

Worthy mix of strong brand, healthy financials...

Crompton Greaves Consumer Electricals (CGCEL) is a compelling long term growth story with a strong brand, leadership position in India's fan industry and healthy financials. Over the years, CGCEL has leveraged its strong distribution network (of 3500+ dealers) to expand into other product categories like water pump, lightings and small appliances. Post demerger in 2015, CGCEL has focused on margin improvement and asset light strategy to ensure a robust return ratio profile (RoE- 34%, RoCE-38%). Despite revenue loss for almost 40 days due to lockdown, CGCEL's revenue is likely to register growth in FY21, supported by strong pent up demand of home appliances in semi-urban and rural India. **We believe, going forward, business revival in metros (post ease in lockdown) and increased focus of the government on rural housing, infrastructure will drive demand for home appliances. With a strong supply chain and distribution network in place, we believe CGCEL is set to benefit from spike in demand as economy gets back on track. We value CGCEL at 38xFY23E earnings and assign BUY rating with a target price of ~₹ 440/share, considering its revenue PAT CAGR of** 13% each in FY20-23E and robust balance sheet condition.

Focus on premium products to drive revenue, earnings growth

Post demerger, CGCEL has remained focused on increasing the contribution of premium products in its topline. The premium fan category of CGCEL grew at 16% CAGR in FY18-20 while its contribution in total fan revenue has also increased to ~20% now from ~14% in FY17. The company further aims to take this contribution to 30% by FY23E (I-direct estimate: 26%). On the lighting front, CGCEL is focusing on high margin street lights, fixtures and battens business. We believe changing product mix (towards premium category) will not only help drive better margins for the company but will also help it to stay ahead of competition and thereby gain market share. We model electrical consumer durable (ECD) & lighting segment revenue CAGR of 13% & 12%, respectively. We expect EBITDA margin to stay elevated on better product mix and rationalisation of other fixed costs.

One of the best operating matrix in industry

CGCEL has maintained strong EBITDA margin of ~13%, which is one of the best in the industry. In addition, it also has one of the best cash conversion cycle of ~23 days among peers, followed by Havells India (27 days) & Orient Electric (61 days). Low capital requirements along with elevated margin profile have led to better RoE, RoCE of 34%, 38%, respectively, by FY20.

Valuation & Outlook

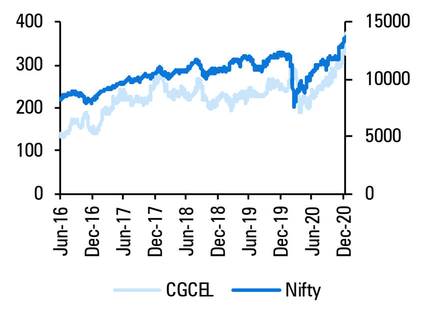
CGCEL's revenue, earnings are likely to grow at 13% CAGR each in FY20-23E supported by elevated margins and saving in interest outgo. The strong brand, quality management and robust free cash flows (~80% of OCF) make CGCEL a strong franchise in the fast moving electrical goods (FMEG) industry. We assign a BUY rating to the stock with a target price of ₹ 440/share, valuing the company at 38x FY23E earnings.

LET'S HANGOUT GHAR PE!
Crompton

Stock Data

Particular	Ammount
Market cap (₹ crore)	22564.8
Total Debt (FY20 ₹ crore)	179.7
Cash & Inves (FY20 ₹ crore)	48.1
EV (₹ crore)	23009.8
52 Week H/L (₹)	393/177
Equity Capital (₹ crore)	125.4
Face Value(₹)	2.0

Price Chart



Key Highlights

- Strong (No. 1) brand in domestic fan industry with market share of ~24% and 1 lakh retail touch points
- Strong balance sheet, quality management and strong free cash flows (~80% of OCF).

Risk to our call

- Delay in government's flagship programmes may lead to lower sales growth
- New entrants into fan and LED lightings may lead to pricing pressure on CGCEL's core business

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Key Financial Summary

(₹ crore)	FY19	FY20E	FY21E	FY22E	FY23E	CAGR(20-23E)
Net Sales	4478.9	4520.3	4639.8	5669.7	6483.5	12.8
EBITDA	584.3	599.1	707.2	844.8	940.1	16.2
EBITDA Margin (%)	13.0	13.3	15.2	14.9	14.5	
Net Profit	401.4	496.4	522.2	637.4	724.2	13.4
EPS (₹)	6.4	7.9	8.3	10.2	11.6	
P/E (x)	56.2	45.5	43.8	35.4	31.2	
RoE (%)	36.6	33.8	28.4	29.4	30.3	
RoCE (%)	42.8	38.3	32.2	36.1	38.9	

Source: ICICI Direct Research, Company

Company Background

Business profile

Crompton Greaves Consumer Electrical (CGCEL) is India's leading fast moving electrical goods (FMEG) company with a strong presence in the fan and residential pump category. The company was originally formed as Crompton Parkinson Works by leading Indian industrialist LK Thapar in 1947. Later in 1966, the company was renamed CG Power and Industrial Solutions Ltd (CGPIL) with business operations in two segments: 1) power & industrial systems and 2) consumer durables. In 2015, CGPIL was further demerged into two separate business entities to focus on the power & industrial business and consumer durable business separately.

In 1966, CG Power and Industrial Solutions (CGPIL) was formed with business operations in two segments: 1) power & industrial systems and 2) consumer durables

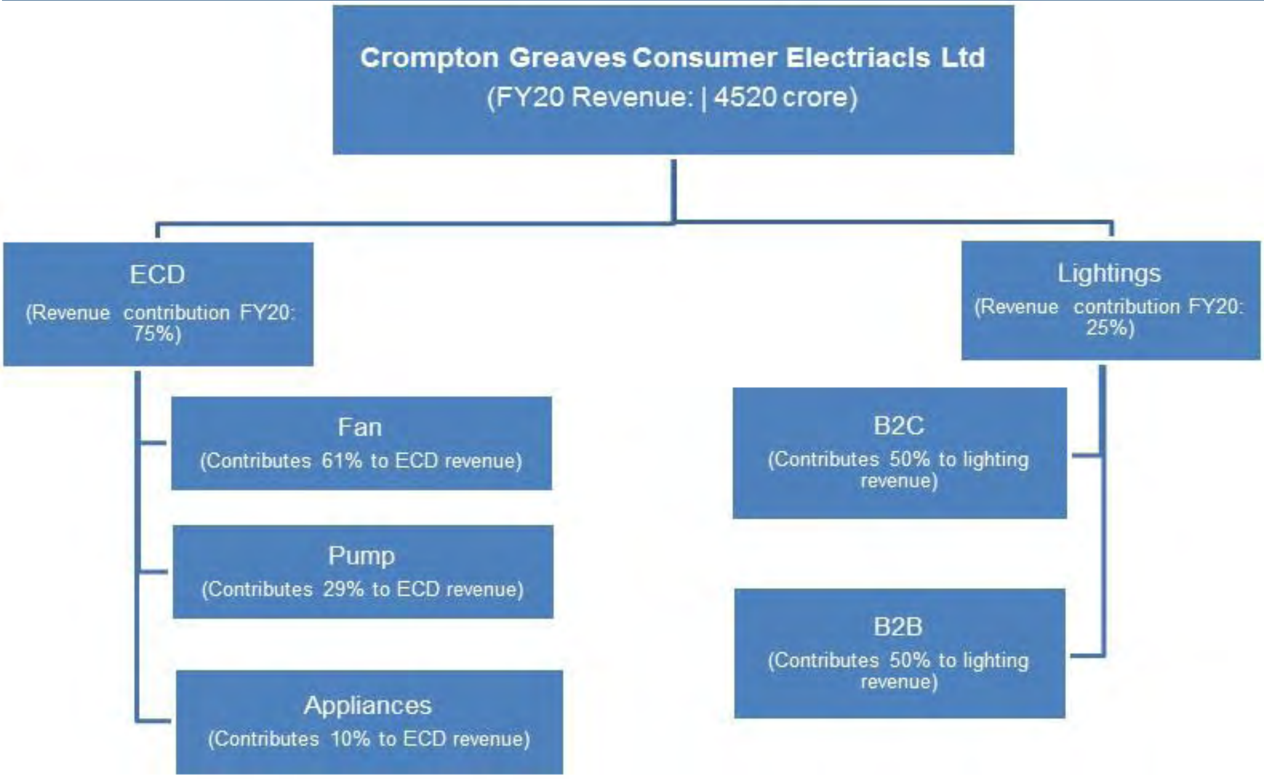
In 2015, Gautam Thapar-controlled Avantha Group inked a deal to sell its entire 34.3% stake in the consumer products business of Crompton Greaves to two PE firm Advent International and Temasek for ₹ 2,000 crore. The company was valued at 1.8x MCap/sales on FY15 sales of ~₹ 3200 crore. On the management front, Shantanu Khosla (erstwhile MD & CEO of Procter & Gamble India) and Mathew Job (erstwhile MD of Racold Thermo) were appointed the new MD and CEO, respectively, of the newly formed CGCEL.

Advent International and Temasek acquired 34.3% stake of promoter for consideration of ₹ 2000 crore, valuing the firm at 1.8x MCap of FY15 sales

CGCEL is the market leader in the domestic fan and residential water pump business with value market share of 24% and 28%, respectively. Post demerger, the company aims to increase share of premium products in the fan, pump & lighting segments (together contribute ~92% to the topline). The company plans to leverage its extensive retail reach (~100,000+ retails touch) to expand into small appliances business (contributes ~8% in total revenue) categories, which includes air cooler, geyser and mixer grinders, etc. The company's strong earnings CAGR of 24% in FY18-20 was largely supported by better EBITDA margin and lower interest & tax outgo. Low working capital requirements & asset light model strategy resulted in free cash flow of ~ ₹ 900 crore in FY18-20. This has helped in debt reduction (by 72% over FY18-20).

CGCEL is the market leader in the domestic fan and residential water pump industry with value market share of 24% and 28%, respectively

Exhibit 1: Organisational structure



Source: Company, ICICI Direct Research

Investment Rationale

Demand remaining intact in hinterlands a key catalyst

Despite a significant revenue loss in Q1FY21 due to Covid-19 related lockdown, we expect the home appliances industry to witness ~100% business recovery in FY21E itself led by strong demand from hinterlands. Leading consumer appliances players like CGCEL, Havells India and Bajaj Electricals reported revenue growth ~13%, 28% and ~13% YoY, respectively, in Q2FY21. According to the management, work from home culture along with market share gains from unorganised segment would continue to drive demand for kitchen appliances (like food processors, juicer, mixers grinders, hand blenders, etc), going forward. In addition to this, various government measures/reforms taken during Covid-19 (e.g. central government's measure to increase MGNREGS allocation by ₹ 40, 000 crore to ~1 lakh crore) would give a thrust to improved demand for appliances from hinterlands, going forward. Besides, long term growth drivers such as growing urbanisation rate, rising income levels, governments infra push (such as Housing for all, smart cities, etc) would also aid future growth in consumer appliances.

The consumer electrical industry (wherein CGCEL operates) is pegged at ~ ₹ 47,000 crore, growing at CAGR of 13% over the last five years

We believe home appliance companies are well placed to gain from the demographic dividends of India through their strong retail brands, capability to generate free cashflows and asset light strategy.

CGCEL is the leader in the domestic fan & residential pump industry. Further, the company's future plan to increase revenue contribution from premium fans segment (to 26% from 20% currently) and expand small appliances business (includes, water heather, air cooler, mixer grinder, etc) would further help drive revenue, earning for CGCEL in FY20-23E.

Demographic dividend of India and focus of companies to tap untapped markets would continue to drive sales of home appliances in India

Exhibit 2: Industry dynamics, market share of CGCEL

Industry	Market size	Market share	Long term growth drivers	Competitors
Fans	₹ 8400 crore	24%	**1.** 23% houses (~6 crore) are in the form of Kuttcha and semi Pucca conditions **2.** Housing thrust through PMAY **3.** Fans are the among the first purchase of any new household **4.** Replacement demand to drive premium product category	Orient, Havells, Usha, Bajaj Electrical
Pumps	₹ 10000 crore	Residential- 28% Agro- 7%	**1.** Water scarcity **2.** Regulatory push for water management **3.** Tax subsidies on solar pump **4.** Energy efficient pump to drive replacement demand	Kirloskar, Texmo, CRI
LED Lightings	₹ 17800 crore	7%	**1.** Improving electrification across rural household **2.** Lights are among the first purchase of any new houses **3.** Consolidation in LED segment expected to stabilize pricings	Havells, Surya Roshni, Syska, Signify, Bajaj Electrical
Appliances*	₹ 10900 crore	Geysers- 8% Air cooler- 3% Others: NA	**1.** Low penetration of homeappliances **2.** Rising aspiration of customers **3.** Increase in disposable income and easy finance 4. Shift from unorganized to organzied	Bajaj Electricals, Havells, Orient, Preethi

*Source: Company, *includes water heater, Air Cooler, Mixer Grinders, small kitchen appliances, Industry,ICICI Direct Research*

Exhibit 3: Product profile

Source: Company, ICICI Direct Research

Major industry growth drivers

Housing for All - Demand booster for home appliances

The Pradhan Mantri Awas Yojana - Urban and Gramin (PMAY-U & G) was launched in 2015 and 2016 to construct ~1 crore urban and ~2.3 crore rural houses, respectively. The government has achieved ~36% and 52% of targeted urban and rural houses, respectively. The urban house construction targets have been delayed compared to rural construction mainly due to low budgetary allocations. We believe construction of remaining ~1.7 crore new houses (urban and rural) would be extended beyond the set deadline of FY22 due to Covid-19 related disruption. However, gradual addition of new houses under PMAY will give a significant boost to demand for necessary home appliances such as fans and lighting products.

Construction of 1.7 crore new houses under PMAY will give a significant boost to demand for necessary home appliances like fans and lighting products

Exhibit 4: Housing for All to boost demand for consumer appliances, going forward

Housing project	Particulars	Target	Completed as on 7th Dec'20	To be delivered
PMAY-U	Urban	1.1	0.4	0.7
PMAY-G	Rural	2.3	1.2	1.1
Total		3.4	1.6	1.7

Source: pmayg.nic.in, pmay-urban.gov.in. ICICI Direct Research

Urbanisation

The share of India's urban population in relation to total population has been rising over the years. People from rural areas move to cities for better job opportunities, education and a better life among other reasons. According to World Economic Forum report, 40% of Indians will be urban residents by the end of 2030. The top nine cities and 31 towns will be richer than other cities. However, there will also be >5,000 small urban towns (50,000-100,000 persons each) and >50,000 developed rural towns (5,000-10,000 persons each) that already have income profiles very similar to that of 31 top towns. Increasing urbanisation in India coupled with rising income levels have resulted in a progressive increase in demand for housing, particularly quality housing, across Indian cities. We believe that this growing demand for quality housing will drive demand for electrical goods, going forward.

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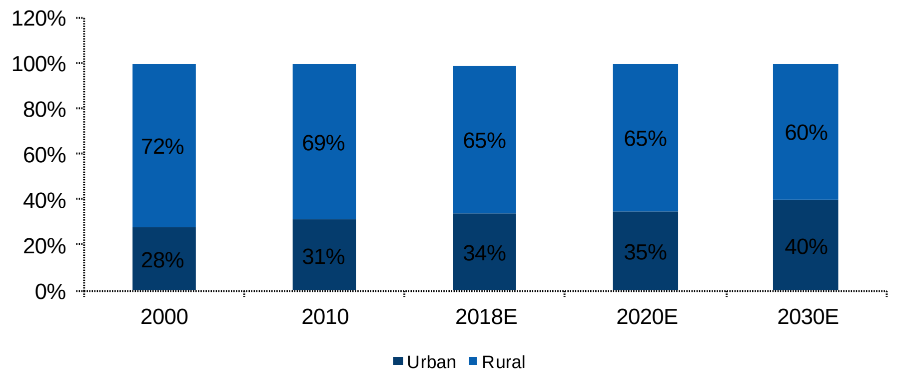
Exhibit 5: India's urbanisation trend



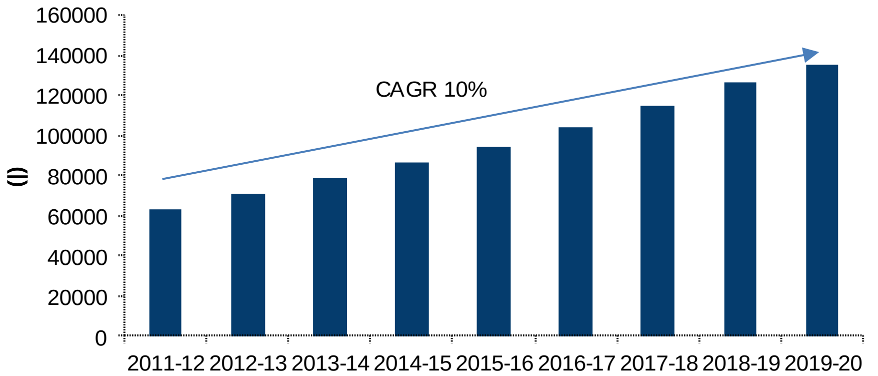
Source: World Urbanisation Prospects, ICICI Direct Research

Rising aspiration supported by rise in income level

Rising income (per capita income grew at 10% CAGR) and increasing awareness on consumer goods has fuelled demand for home appliances among rural & urban customers. Further, rising aspirations & income level help drive demand for premium products among the middle class over the last 10 years. We believe changing trend of owning premium products supported by increasing disposable incomes will continue to drive demand for FMEG in India, going forward.

Per capita income growth at 10% over the last 10 years would help drive demand for home appliances, going forward

Exhibit 6: Per capita income growth trend



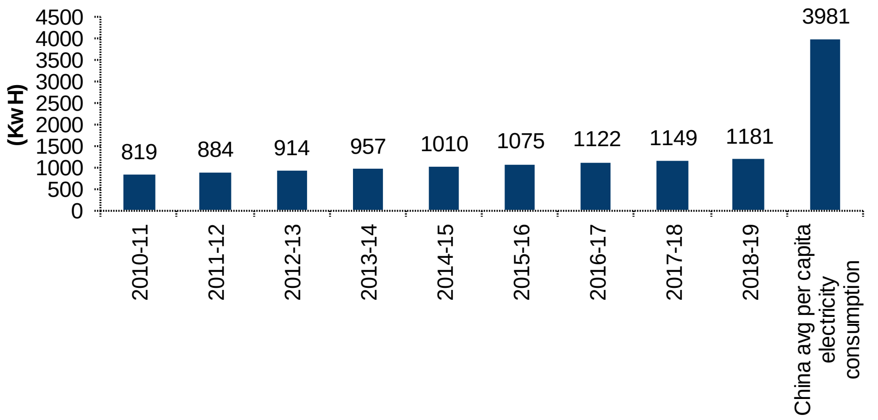
Source: Industry, ICICI Direct Research

Low per capita electricity consumption provides scope for further penetration of electrical goods

Over the last 10 years, per capita electricity consumption has increased at a CAGR of 5% to 1181 kWhr (provisional), which is still lower compared to China. We expect a revival in economic conditions and 100% electrification of households to drive per capita electricity consumption up, going forward. The improved availability of power would lead to increase in demand for home appliances thereby benefiting strong brands like Crompton Greaves Consumer to increase market share in untapped markets.

India's per capita electricity consumption at 1181 kWhr is lower than China's 3981 kWhr

Exhibit 7: Trend of per capita electricity consumption in India vs. China



Source: Industry, ICICI Direct Research

India's residential market: Low interest rates to drive recovery

The residential market across India witnessed a muted demand trend in FY15-17 due to policy change (introduction of RERA), GST and demonetisation, resulting in a decline in sales and launches of residential projects across cities. In 2018, the impact of policy changes subsided and residential sector saw a recovery with sales volume CAGR of 20.6% in FY17-19 (on a lower base). We believe the industry will again witness some setback on recovery due to Covid-19 pandemic. However, to support the residential sector (also one of the major job generators) both government and central bank have intervened and took various steps. One among such moves was to reduce repo rates to 4% in March 2020 vs. 7.5% in March 2015. The SBI MCLR rate, benchmark for home loan rates has consequently come down. We believe highest ever cut in interest rates and home upgradation on account of a rise in 'work from home' culture would lead to a faster recovery in residential real estate industry, going forward.

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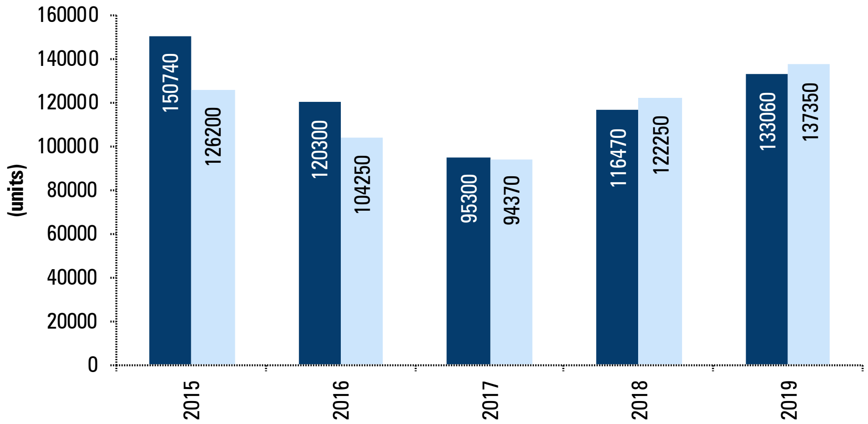
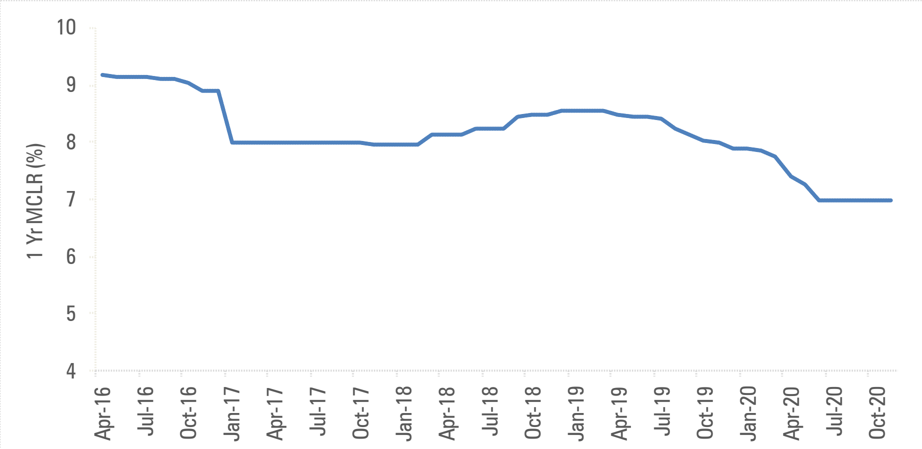
Exhibit 8: Supply & absorption - Top five Indian markets*



*Source: Industry, ICICI Direct Research, *Bengaluru, Chennai, Mumbai region, NCR and Pune*

Exhibit 9: Support to Indian residential markets through interest rate cut



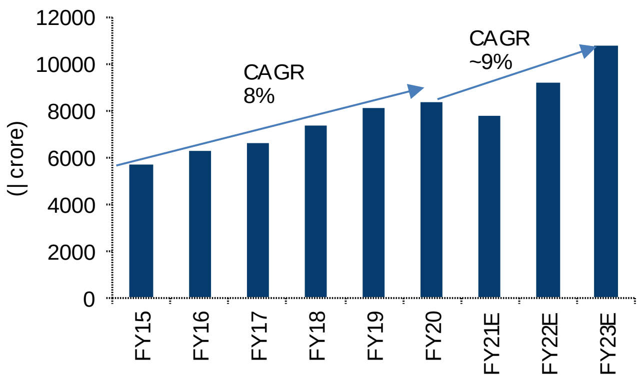
Source: SBI, SBI MCLR rate for 1 Year,, ICICI Direct Research,

Crompton: Leader in domestic fan industry

The Indian fan industry is pegged at ₹ 8400 crore while CGCEL has remained a leader in the domestic fan industry with value market share of ~24%. The fan industry, which comprises economy, standard and premium segments, is likely to grow at a CAGR of 9% in FY20-23E supported by construction of new houses, replacement demand and conversion from kutcha to pucca houses. Also, the premium fans segment is expected to grow at a higher rate of ~13% in the same period led by rising aspiration and income level of middle class households. We believe CGCEL's fan revenue will grow at a CAGR of 10% in FY20-23 supported by ~21% CAGR in the premium fan segment on a lower base and dealer additions (in semi urban and urban regions), going forward.

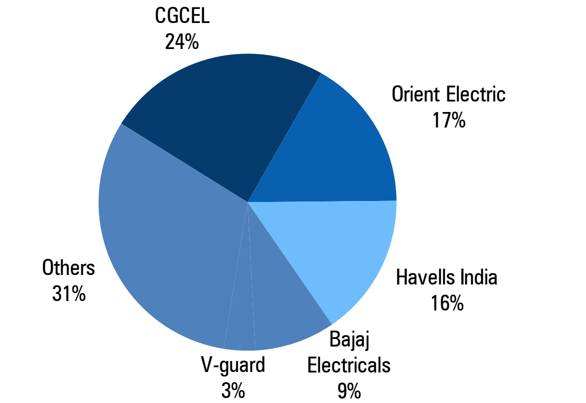
Domestic fan industry likely to grow at CAGR of 9% supported by premiumisation and improved power availability of rural India

Exhibit 10: Fan industry growth trend



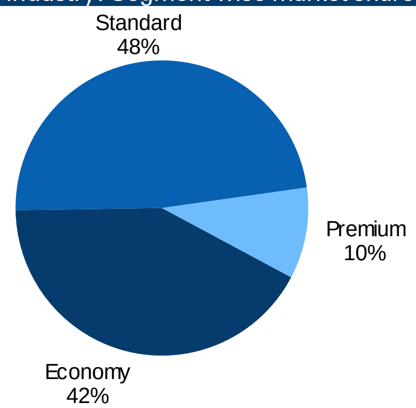
Source: Company, ICICI Direct Research

Exhibit 11: Market leader in fan segment



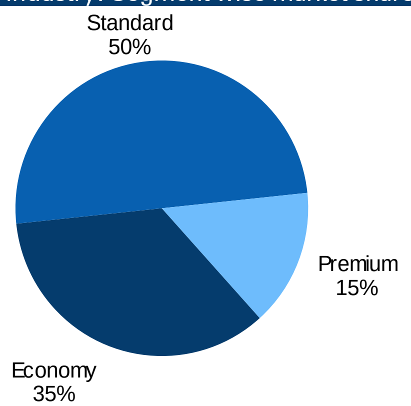
Source: Company, Industry, ICICI Direct Research

Exhibit 12: Fan industry: Segment wise market share in FY15



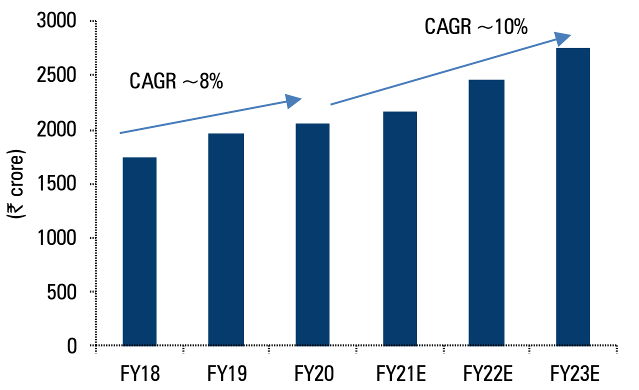
Source: Company, ICICI Direct Research

Exhibit 13: Fan industry: Segment wise market share in FY20



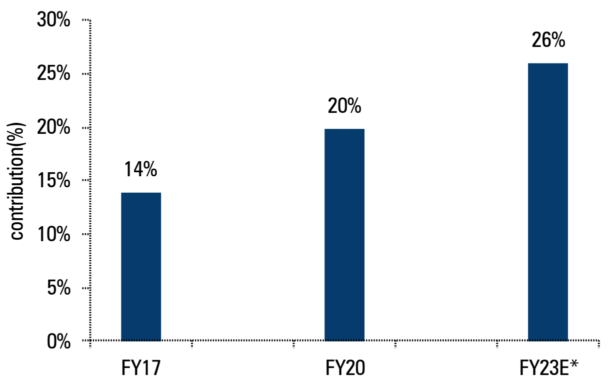
Source: Company, ICICI Direct Research

Exhibit 14: CGCEL growth better than industry, led by…



Source: Company, ICICI Direct Research

Exhibit 15: ….rising contribution of premium fan category



*Source: Company, ICICI Direct Research, *we have factored in 26% contribution against company's guidance of 30%*

Pump segment: Residential, agri segment to drive growth

The Indian pump industry is pegged at ~₹ 10000 crore with agriculture and residential segment together contributing 55% to industry size while the rest is contributed by industrial pump segments (used in oil & gas, metal & mining, power generation, etc). The Indian pump industry has grown at a CAGR of 8% during FY15-20 led by ~10% and 8% growth in the agriculture and housing segment, respectively. We believe the domestic pump industry will grow at a higher rate of 13% in FY20-23E led by demand remaining intact in agriculture and residential pumps. The key catalyst for this growth would be Housing for All and distribution of energy efficient water pumps by government under the scheme of Kisan Urja Suraksha Evam Utthan Mahabhiyan (Kusum).

The residential and agri pump industry growth was largely fuelled by increased government thrust on housing and agriculture sectors (with increasing rural electrification) and depleting ground water level in India

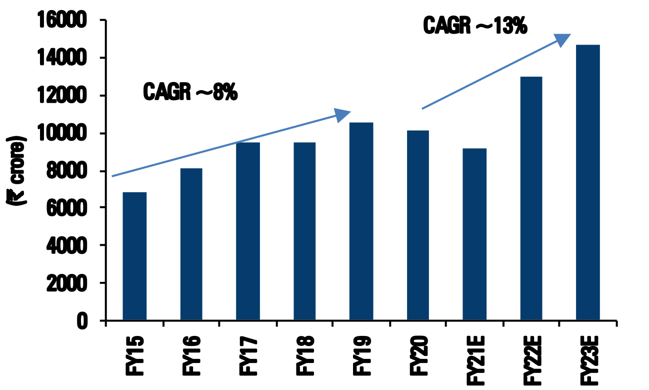
Replacement demand to fuel solar based agriculture pump demand

At present, over 30 million (mn) agricultural pumps are installed in India. Out of this, ~10 million pumps are diesel-based while the balance i.e. 20 million are electric, grid-connected pumps. According to a study, these grid connected pumps consume ~17% of total annual electricity consumption in the country. Hence, these 20 million grid connected water pumps are planned to be replaced by energy efficient solar water pump under government flagship scheme *Kusum*. In addition, the government has also set a target to install 2.8 mn fresh solar-based water pumps over five years.

Under the government's flagship programme "Kusum", ~20 million grid connected pumps will be replaced by solar water pump, which will drive demand for pump industry, going forward

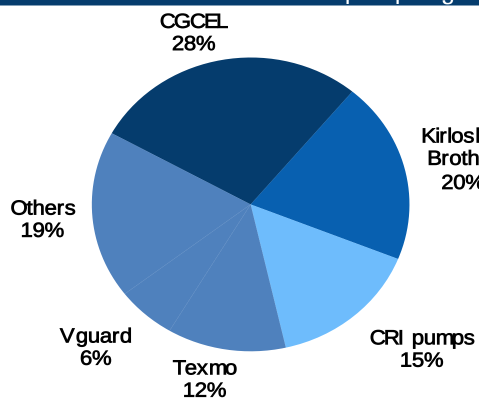
We believe residential and agri pump segment creates a significant growth opportunity for CGCEL's pump business. While the company is the market leader in the residential pump segment (with 28% market share), it also plans to increase market share in the agriculture segment, going forward. We believe with its brand legacy and strong distribution and service reach, CGCEL's pump segment would grow at 13% CAGR, going forward.

Exhibit 16: Residential, agri to drive pump industry growth



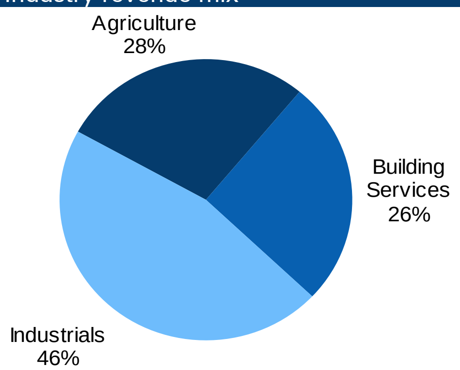
Source: Company, ICICI Direct Research

Exhibit 17: Market leader in residential pump segment



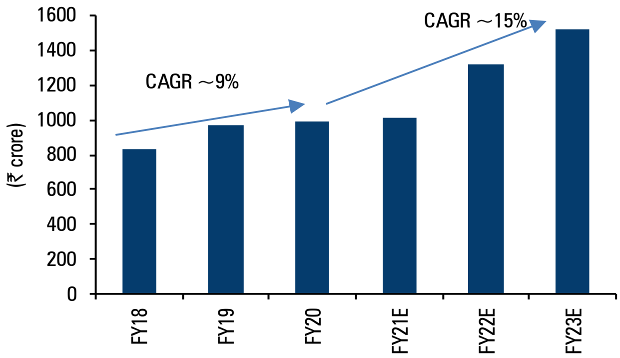
Source: Company, ICICI Direct Research

Exhibit 18: Industry revenue mix



Source: Company, ICICI Direct Research

Exhibit 19: Water pump segment revenue trend for CGCEL



Source: Company, ICICI Direct Research

Lighting segment: Street light programme, premiumisation to drive next leg of growth for Indian lighting industry

Government initiatives such as Unnat Jyoti by Affordable LEDs for All (UJALA) and Street Lighting National Programme (SLNP) would drive LED lighting industry at a CAGR of ~11% during FY20-23E

The Indian lighting industry is evolving rapidly due to the shift from conventional bulbs to LEDs, rising consumer awareness on energy-efficient products, innovative product offerings and rural electrification. The lighting industry comprises conventional lighting, LED lighting and accessories has grown at ~6% CAGR in FY15-20 to ₹ 22,700 crore. LED lightings, which is ~70% of the total industry, have grown at a phenomenal rate of 29% during the same period mainly due to replacement of conventional lightings systems. The LED lighting industry is likely to continue grow at CAGR of 11% in FY20-23E backed by government's Unnat Jyoti by Affordable LEDs for All (UJALA) and Street Lighting National Programme (SLNP). We see the government's SLNP as a big booster for the Indian lighting industry, going forward. SLNP has two parts. The first is to replace ~13.4 mn conventional streetlights in India (~10 mn had already been replaced) with smart LED lights. In the second part, the government aims to retrofit ~30.8 mn conventional streetlights to LED street lights in Gram Panchayats. Till date, 2.3 mn LED streetlights have already been retrofitted in Gram Panchayats in Andhra Pradesh, Telangana, Goa and Andaman & Nicobar Islands. The government has an ambitious plan to cover the entire gram panchayat in the next four to five years to retrofit/install LED streetlights with an investment of ₹ 8000 crore.

Apart from EESL, the LED lighting industry will also get a thrust from construction of new houses (Housing for All), Smart Cities and commencement of airports (Civil Aviation Ministry's "Vision 2040" report says there will be 190-200 functioning airports in India by 2040), which would help drive demand for LED lightings, going forward.

Stability in prices, change in product mix to drive profitability

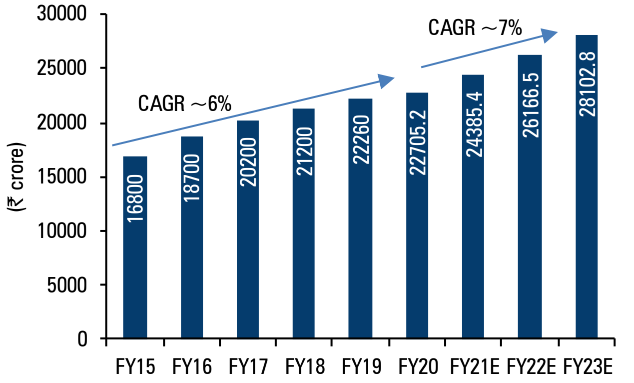
The lighting segment of CGCEL contributes ~25% to the topline while revenue split between B2C and B2B at 50:50. Further, the LED lighting & fittings contributes ~80% of lighting revenue while ~20% is from conventional lighting products. CGCEL has launched various innovative products in the B2C categories such as Anti-Bac bulb (kills 85% bacteria) and 'Back up Lamp', which works even after a power failure (launched two variant one with an hour back-up and other with four-hour backup capacity).

Price hike, focus on high margin products to help drive profitability of business, going forward

While the segment recorded double digit volume growth in FY20, the company reported value de-growth of ~11% YoY mainly due to pricing pressure in the B2C segment and delays in execution of government orders due to economic slowdown. CGCEL has taken various initiatives from FY20 onwards such as change in product mix (mix skewed towards high street lights compared to lighting), price hike of ~2% in B2B category and cost optimisation efforts, resulting in a recovery in profitability of the business (EBIT margin increased ~650 bps YoY to 11.7% in Q2FY21).

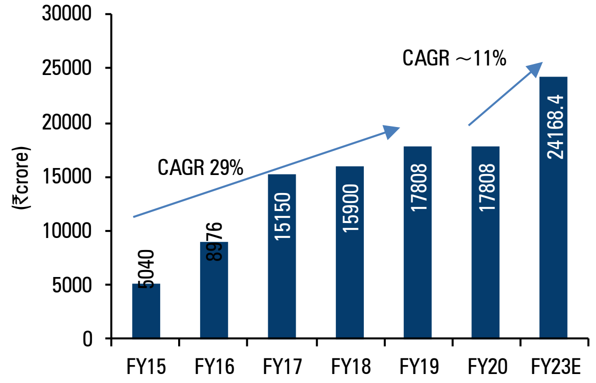
We believe CGCEL's lighting revenue would grow at a CAGR of ~12% in FY20-23 supported by focus on street lighting segments, smart city projects and increasing distribution reach in tier-II and tier-III cities. We also believe the cost optimisation measures, change in product mix would also help improve the profitability of the business, going forward.

Exhibit 20: Indian lighting industry growth trend



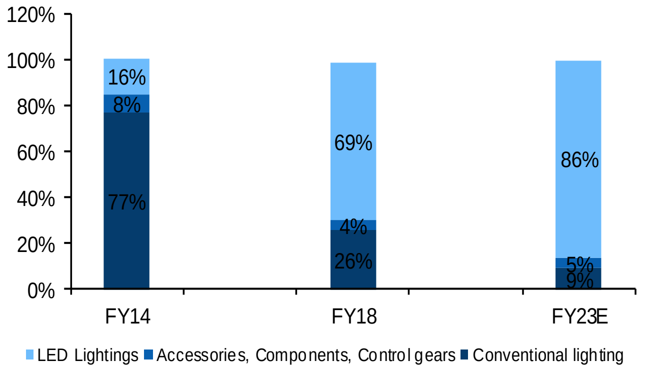
Source: Company, Industry, ICICI Direct Research

Exhibit 21: LED lighting industry growth trend



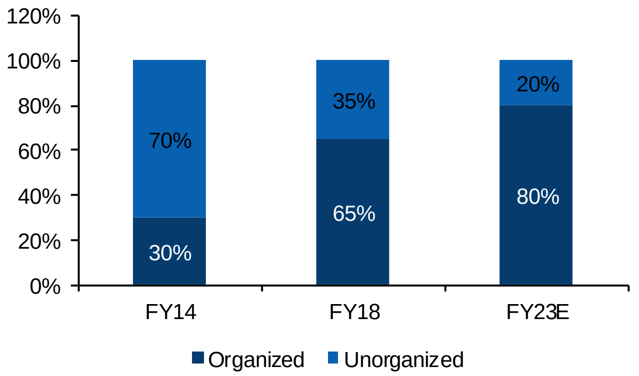
Source: Company, Industry, ICICI Direct Research

Exhibit 22: LED to dominate with ~86% market share by FY23



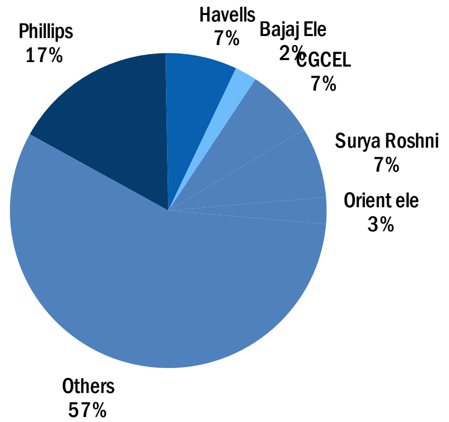
Source: Company, Industry,, ICICI Direct Research

Exhibit 23: Organised players continue to gain market share



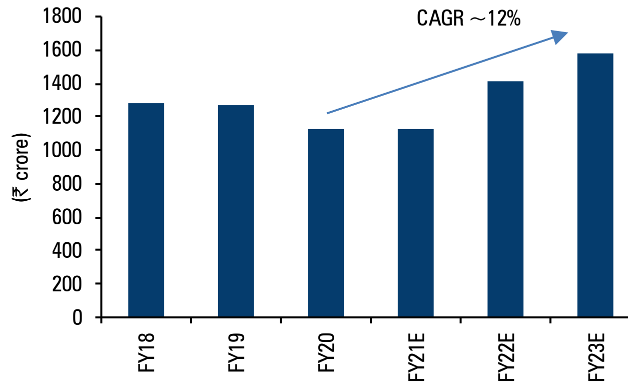
Source: Company, Industry, ICICI Direct Research

Exhibit 24: Lighting segment market share



Source: Company, Industry, ICICI Direct Research

Exhibit 25: CGCEL's lighting segment revenue growth trend



Source: Company, ICICI Direct Research

Appliances: Future growth driver

CGCEL's appliances (water heater, air cooler, mixer grinder, food processors etc) division grew at a CAGR of 23% in the last two years and contributes ~7.5% to overall revenue. The small appliances industry (air cooler, water heater, mixer grinder, small appliances) is pegged at ~₹ 10,900 crore and grew at ~7% CAGR (pre-Covid growth rate) backed by increasing purchasing power of the growing middle class and continued urbanisation in the country.

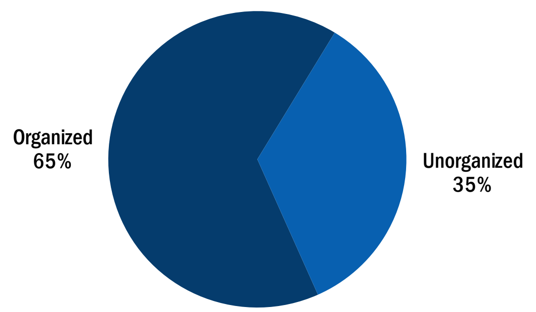
A favourable population composition in terms of increasing number of nuclear families and easier access through online channels will continue to aid growth in demand. Further, introduction of energy efficient and feature-rich product offerings will help drive premiumisation in this segment

For CGCEL, the appliances division is largely dominated by water heater and air cooler segment. The water heater and air cooler industry is pegged at ₹ 2800 crore and ₹ 4200 crore with significant presence of unorganised/regional play of about ~35% and 70%, respectively. The appliances segment of CGCEL contributes ~8% to the overall topline and has grown at a CAGR of ~23% in FY18-20. We believe the segment will continue to grow at the same rate in FY20-23 as well on a lower base, dealer additions and market share gains from unorganised markets. Alongside, the company plans to introduce premium range of mixer grinder and food processor products under kitchen appliances categories, which would further aid the growth and margin of this segment, going forward.

Exhibit 26: CGCEL's appliances products portfolio

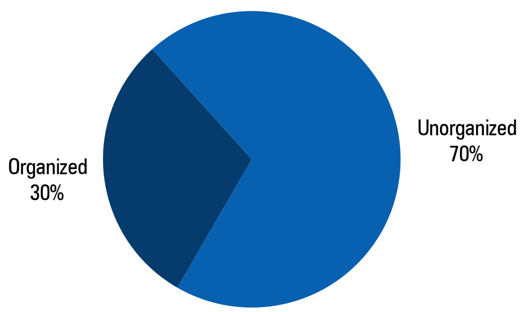
Source: Company, Industry, ICICI Direct Research

Exhibit 27: Water heater segment industry mix



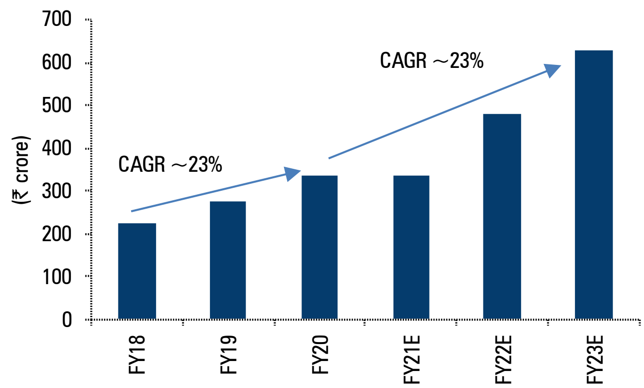
Source: Company, Industry, ICICI Direct Research

Exhibit 28: Air cooler industry mix



Source: Company, Industry, ICICI Direct Research

Exhibit 29: CGCEL's appliances segment revenue trend



Source: Company, Industry, ICICI Direct Research

Five strategic levers to capitalise on macro opportunities

In order to capitalise on macro opportunities such as Housing for All, multiple smart cities and rising aspiration of Indian households, CGCEL has identified five levers to drive future growth. These are Brand Excellence, Portfolio Excellence, Go-to-market Excellence, Operational Excellence and Organisational Excellence. The strategy is to improve profitability through new launches in the premium categories along with increased penetration in untapped markets.

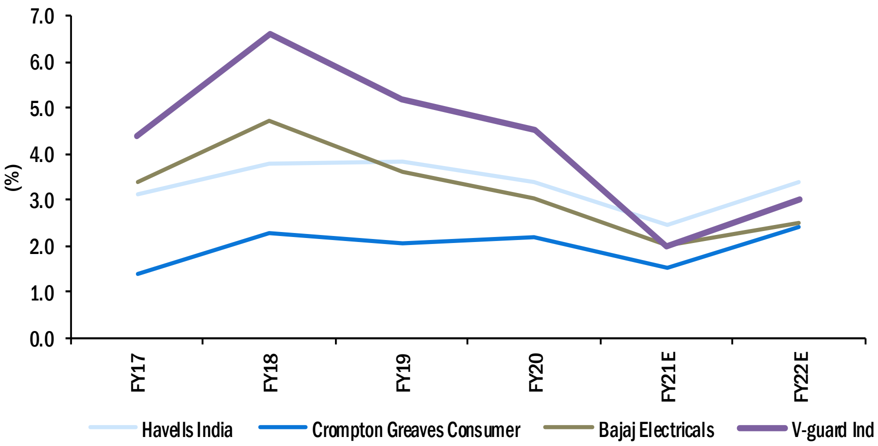
Exhibit 30: Strategic levers to enhance market value for CGCEL

Source: Company, ICICI Direct Research

Brand Excellence: Continuous increase in ad spends

Through "Brand Excellence" strategy, CGCEL has managed to change the perception of Crompton being a fan company to India's leading consumer durable companies in the last four years. The company has increased its annual advertisement budget from 1.4% FY17 to 2.2% of sales by FY20. The increased promotion activities have also helped CGCEL to create awareness on CGCEL's innovative energy efficient products among new millennials. We believe the company's advertisement expenses will remain high in coming years considering the fact that CGCEL is aggressively launching new products in the appliances categories.

Exhibit 31: CGCEL's advertisement, promotional expense vis-à-vis industry



Source: Company, ICICI Direct Research

Portfolio Excellence: Focus on premiumisation by launching innovative products

Post demerger, the company has strengthened its portfolio by launching innovative products under fan, pump and lighting categories. The anti-dust fan, AirBuddy kitchen fan and anti bacteria LED bulbs are a few examples of innovative products that have been launched in the Indian markets in the last four years. In addition, the company has now shifted focus from basic LED lights to integrated energy efficient decorative LED lights, lamp and fixtures segments that are relatively higher margin businesses compared to basic LED lights. In the pump segment, CGCEL has launched a range of wide voltage pumps, which provide the desired water output despite fluctuating voltage. We believe CGCEL's focus on driving sales through premium product (e.g. premium fan revenue contribution to fan revenue has doubled to 20% in the last four years) would help drive gross margins higher by 150 bps in FY20-23E.

Exhibit 32: Launch of various innovative product to drive premiumisation

Segment	Customer Insight	New Products	Year of launch	Key innovation
Fans	• Accumulation of dust on the fans	• **Premium Fans** : Aura Anti Dust Fan 	FY17	• **Attracts 50% less** dust than regular fans
	• Aesthetically appealing Fan with longer warranty	• **Premium Fans** : Aura Fluidic 	FY18	• **First 5 Year warranty Fan in India** – Duratech Technology
	• Celling fans disturbs the gas flames while cooking in kitchen	• **Premium Fans:** Air Buddy Kitchen Fan 	FY19	• **Provides cooling** in the kitchen **without disturbing the flames**
Lighting	• Anti-bacterial bulb	• **LED**: Anti-bac LED Bulb 	FY19	• **Kills micro-organisms/bacteria**
	• Lighting coverage area & Energy efficiency	• **LED**: LYOR LED Bulb	FY19	• **India's first BEE 5 Star** rated energy efficient lamp; delivers light over 270 degrees
Pumps	• Existing range doesn't cater to requirements	• **Agri. Pump**: Mini Crest, Submersible Pump 	FY18	• Redesigned product (spec change) to **lower cost and price**
Small Appliances	• Product design aesthetically unappealing	• **Air Coolers:** Optimus 	FY18	• Air cooler with higher cooling, air delivery and lower humidity
	• Limited functional properties	• **Geysers:** Solarium Neo and Qube	FY19 (revamp)	• Entire range of water heaters with enhanced aesthetics and features

Source: Company, ICICI Direct Research

Go to Market Excellence: Focus on increasing distribution reach

The "Go to Market" (GTM) strategy of CGCEL is to strengthen its distribution network in towns with population between 50,000 & 1,00,000 and where demand is largely served by unorganised players. The GTM strategy of CGCEL is defined by two parameters: 1) width of the sales network and 2) depth of coverage within shops (in terms of product range). Through GTM the company has streamlined its distribution strategy by eliminating price differential between distributors and wholesalers. CGCEL is also leveraging its fan distribution channels to push new products like geysers and coolers.

Exhibit 33: Retail reach of India's top FMEG companies

Retail Networks	
Havells India	150000
Crompton Greaves Consumer	100000
Bajaj Electricals	220000
V-guard	40000
Orient Electric	125000

Source: Company, ICICI Direct Research

Operational Excellence: Focus on streamlining supply chain, cost optimisation measures

CGCEL's constant focus on streamlining its supply chain, launch of innovative products and cost optimisation measures helped improve the profitability and reduce working capital requirements despite various macro headwinds. On the supply chain front, consolidation of warehouses, launch of data analytics app for frontline sales team and distributor management system (a secondary sales tracking system that helps track product demand in particular region) helped the company to manage inventory efficiently. On the cost front, CGCEL has focused on various cost optimisation measures, especially on the sourcing and direct cost fronts across all four business verticals. Saving in raw material cost and other expenditure (as both costs were lower by ~100 bps and ~200 bps, respectively), resulted in ~100 bps expansion in EBITDA margin during FY17-20 (gains were partially offset by higher employee cost). Strong supply chain and saving through various cost optimisation measures helped in increased branding and advertising activities for CGCEL, thereby helping in market share gains amid pandemic.

Exhibit 34: Cost structure of major FMEG players

		FY17	FY18	FY19	FY20
Havells India	Raw material cost	59.5%	61.2%	62.5%	61.9%
	Employee cost	8.2%	8.0%	8.3%	9.5%
	Advertisement Exp	3.1%	3.8%	3.8%	3.4%
	Other Expenditure	15.8%	14.1%	13.7%	14.3%
	EBITDA margin	**13.4%**	**12.9%**	**11.8%**	**10.9%**
CGCEL	Raw material cost	68.8%	68.6%	69.0%	67.9%
	Employee cost	5.7%	6.9%	6.5%	6.9%
	Advertisement Exp	1.4%	2.3%	2.0%	2.2%
	Other Expenditure	11.8%	9.2%	9.4%	9.8%
	EBITDA margin	**12.3%**	**13.0%**	**13.0%**	**13.3%**
Orient Electric	Raw material cost	NM	65.2%	68.3%	68.3%
	Employee cost	NM	8.9%	9.3%	9.6%
	Advertisement Exp	NM	4.4%	4.5%	3.6%
	Other Expenditure	NM	12.9%	10.5%	9.9%
	EBITDA margin	NM	**8.5%**	**7.4%**	**8.6%**
V-guard	Raw material cost	70.9%	69.9%	70.1%	66.8%
	Employee cost	6.9%	7.4%	7.9%	8.3%
	Advertisement Exp	2.5%	4.3%	2.5%	2.3%
	Other Expenditure	9.7%	10.4%	10.9%	12.4%
	EBITDA margin	**10.0%**	**8.1%**	**8.5%**	**10.2%**

Source: Company, ICICI Direct Research

Organisational Excellence: Employee capability building

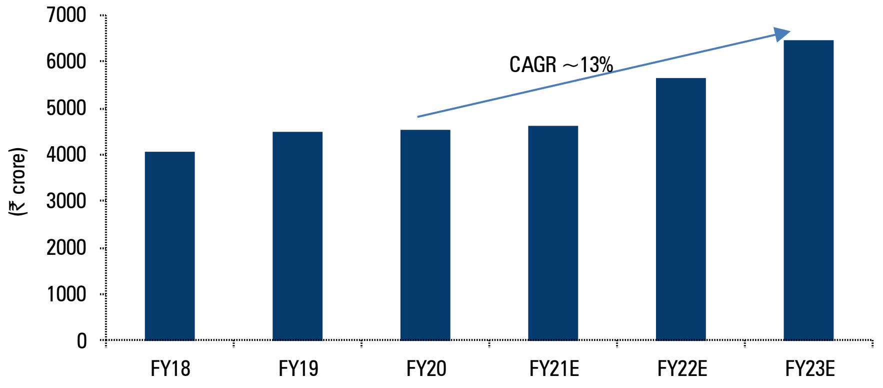
The Organisational Excellence strategy of CGCEL aims at employee development programmes for building best-in-class capability in the areas of go-to-market; operational excellence; brand & portfolio management and innovation.

Financials

Faster recovery in FMEG business to drive revenue growth

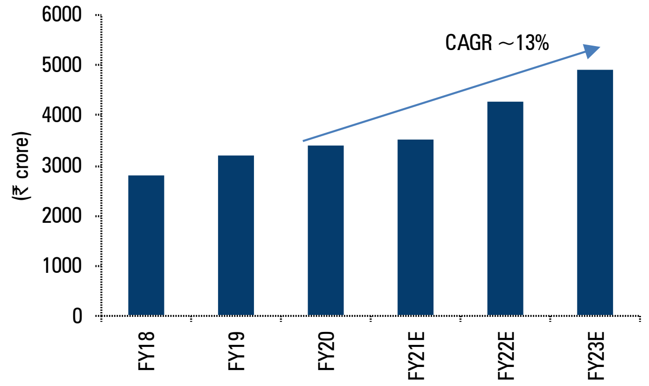
We believe FMEG, as a category, will witness a faster recovery in demand led by semi urban and rural India where the impact of the pandemic was limited. Additionally, a gradual opening up of metro regions and noteworthy recovery in home sales data would further help boost demand for home appliances in the near future. We believe CGCEL would benefit from its robust supply chain and dealer networks across India that would help the company to gain market share from unorganised players (~30% of industry). We believe CGCEL's consolidated sales would grow at ~13% CAGR in FY20-23E, led by ECD and lighting revenue CAGR of ~13% and ~12%, respectively, during the same period.

Exhibit 35: CGCEL's consolidated revenue growth trend



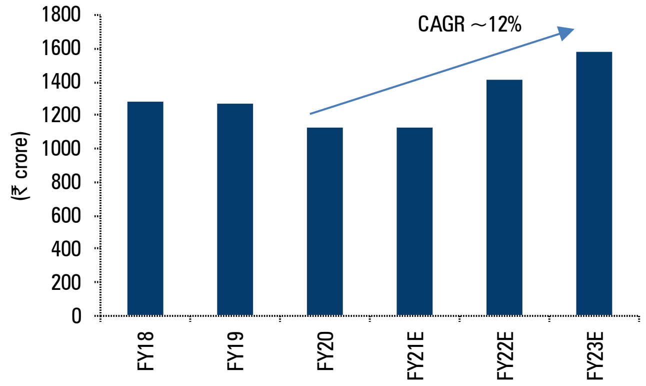
Source: Company, ICICI Direct Research

Exhibit 36: ECD segment revenue growth trend



Source: Company, ICICI Direct Research

Exhibit 37: Lighting segment revenue growth trend



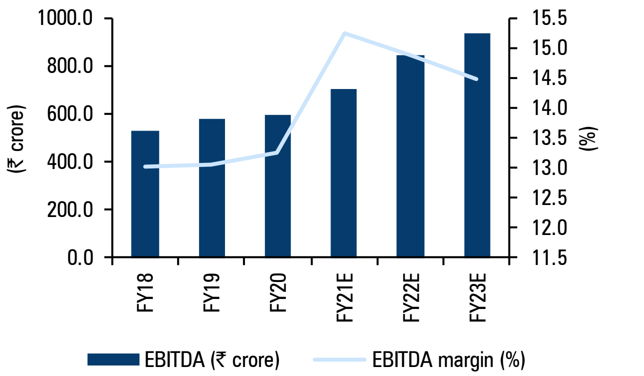
Source: Company, ICICI Direct Research

Strong EBITDA margin to drive PAT growth, going forward

Despite various macro headwinds, CGCEL witnessed ~111 bps YoY expansion in gross margin in FY20 largely supported by changing product mix (increasing proportion of premium fans in topline) and price stabilisation in the lighting segment. Further, the company reported ~80% sales recovery in H1FY21 supported by strong demand for FMEG products from tier II and tier III cities. Further, various cost optimisation measures helped the company to drive EBITDA margin up by 185 bps YoY to 15% in H1FY21. We believe despite restoration of some operating costs (like travelling, advertisement costs), the EBITDA margin is likely to remain elevated supported by a better product mix (premium category fan contribution in topline may increase to 26% in FY23 vs. 20% in FY20), stability in LED prices and continuous effort to optimise costs.

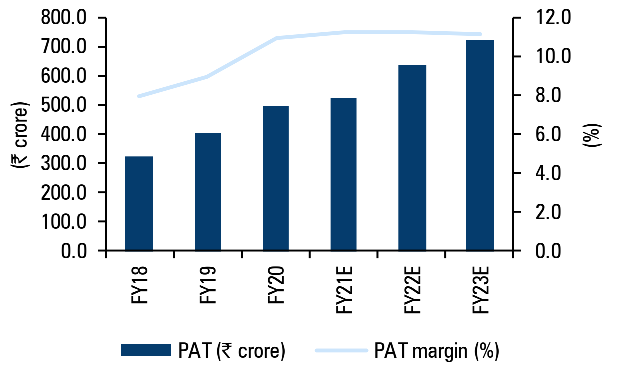
CGCEL raised ~₹ 300 crore through NCDs (redeemable non-convertible debentures on private Placement basis) in May 2020, taking total NCD outstanding to ₹ 480 crore as on H1FY21. Issuance of NCDs was to support short term working capital requirement amid uncertainty. The maturity schedule of NCDs is as follows: ₹ 180 crore by June 2021, ₹ 300 crore by May 2023, respectively. Lower interest outgo on account of gradual redemption of NCDs and improved profitability would help drive PAT at a CAGR of 13% in FY20-23E and lead to improved RoE, RoCE of 29%, 36% in FY22E & ~30%, ~39% in FY23E, respectively. We believe improved profitability, no major capex (due to asset light model) along with prudent working capital management would generate strong free cash flow of ~₹ 1362 crore in FY21E-23E. This would help in redemption of NCDs and higher dividend payout.

Exhibit 38: EBITDA margin trend



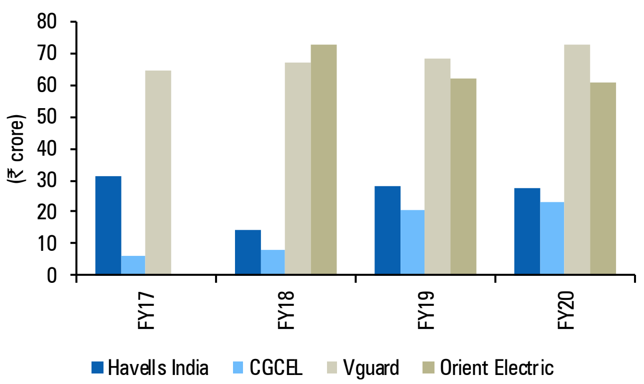
Source: Company, ICICI Direct Research

Exhibit 39: PAT margin trend



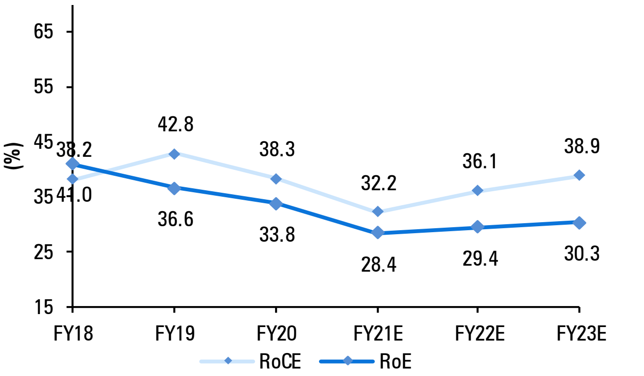
Source: Company, ICICI Direct Research

Exhibit 40: CGCEL's cash conversion best among peers



Source: Company, ICICI Direct Research

Exhibit 41: Strong return ratio despite macro headwinds



Source: Company, ICICI Direct Research

Risks & Concerns

Sporadic lockdown may delay recovery

The outbreak of pandemic Covid-19 has led to a nationwide lockdown resulting in sales loss for almost 40 days in Q1FY21. We believe although opening up of economy brought relief for companies (supported by improving consumer demand), any intermediary lockdowns to stem the spread of pandemic would dent a business recovery in FY21.

Delay in government's flagship programmes may weigh on FMEG demand

We believe Housing for All, smart cities and implementation of street lights programmes across gram panchayats are going to be one of the major revenue drivers for electrical goods companies in the medium to long term. A delay in construction activity on part of the government amid pandemic may lead to a slow demand recovery for CGCEL's fan and lighting products (contributes ~70% in topline).

Rising competition in CGCEL's core business

In the last five years, the industry has witnessed new entrants in the fan and LED segment including Eveready, Luminous, Sujata, Polycab, etc. While established players are diversifying into premium categories, new entrants into appliances can limit the market share gain for established players like CGCEL.

Ownership of PE funds

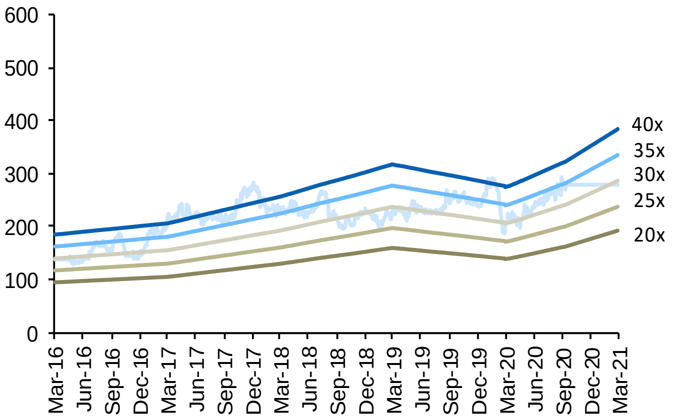
PE firms Advent International Corp and Temasek Holdings hold 20.4% (as on November 2020) in the company through their subsidiaries Amalfiaco Ltd (11.4%) and Macritchie Investment (~9%), respectively. Of this, Amalfiaco has pledged ~100% of its holdings. We believe the pledge would have been created partially to fund the acquisition of CGCEL in 2015 and for some other commitments of PE players. However, we believe the strong financial background of both PE firms provides them a cushion for release of pledged shares in the market.

Valuation

CGCEL is a strong No. 1 player in the Indian fan industry and residential water pump segment with market share of 24% and 28%, respectively. The company recorded a healthy earnings CAGR of 24% in FY18-20 led by improved margin, lower interest cost and tax rate. Among peers, CGCEL has one of the lowest cash conversion cycles of ~23 days followed by Havells India (27 days) and Orient Electric (61 days). This, coupled with CGCEL's asset light model (gross block turnover of ~24x) resulted in a free cash flow ~₹ 900 crore in FY18-20. The company has utilised these funds to redeem NCDs worth ₹ 300 crore in FY20. Additionally, the lean balance sheet and improved profitability resulted in RoCE, RoE of about 38% and 34%, respectively, in FY20. We model revenue earnings CAGR of ~13% each in FY20-23E supported by elevated margin and reducing interest cost.

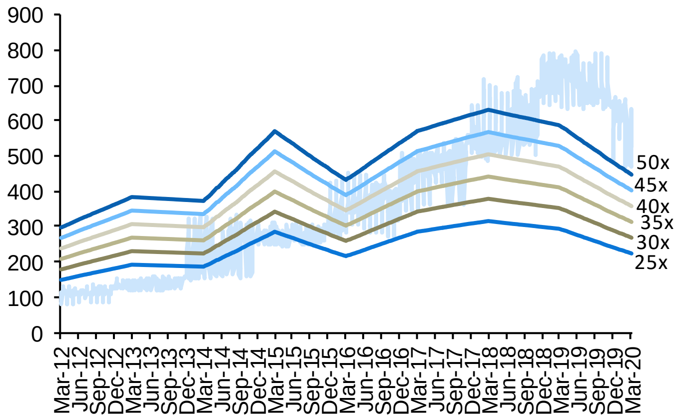
With its limited history (listed in May 2016), CGCEL is trading at an average one year forward PE of 38x. We value the company at 38x FY23E EPS of ₹ 11.6 to arrive at a target price of ₹ 440/share, with a **BUY** rating on the stock.

Exhibit 42: CGCEL one year forward PE band



Source: Company, ICICI Direct Research

Exhibit 43: Havells India one year forward PE band



Source: Company, ICICI Direct Research

Exhibit 44: Valuation Matrix (Peer) (check CGCEL return ratios)

	Mcap	Sales				EBITDA margin				PAT				RoE				RoCE				PE			
	₹ crore	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
Havells Ind	55,278	9429.0	9625.2	11912.9	13600.9	10.9	14.1	13.1	13.9	732.8	882.7	1021.7	1256.8	17.0	18.5	20.3	24.3	19.6	21.5	24.4	28.9	75.4	62.6	54.1	44.0
Bajaj Ele	6,946	4987.2	4702.6	5412.1	5937.4	4.2	6.1	6.8	7.5	-10.3	134.7	194.0	261.9	-0.8	8.3	13.0	15.4	8.0	10.8	14.7	18.6	NM	51.6	35.8	26.5
V-guard	8,052	2482.0	2360.4	2984.3	3336.6	10.2	9.5	10.5	11.0	185.2	157.8	227.7	266.2	18.6	15.1	19.5	20.8	24.8	20.1	25.3	26.9	43.5	51.0	35.4	30.2
CGCEL	22,565	4520.3	4639.8	5669.7	6483.5	13.3	15.2	14.9	14.5	496.4	522.2	637.4	724.2	33.8	28.4	29.4	30.3	38.3	32.2	36.1	38.9	45.5	43.8	35.4	31.2

Source: Company, ICICI Direct Research

Financial Summary (consolidated)

Exhibit 45: Profit & Loss Statement

(Year-end March)	FY20	FY21E	FY22E	FY23E
Revenue	**4,520.3**	**4,639.8**	**5,669.7**	**6,483.5**
Growth (%)	0.9	2.6	22.2	14.4
Expenses				
Raw material exp	3,070.3	3,130.0	3,798.7	4,311.5
Employee exp	311.0	320.1	357.2	453.8
Other exp	440.9	380.5	510.3	583.5
Total Operating exp	3,921.2	3,932.6	4,824.9	5,543.4
EBITDA	**599.1**	**707.2**	**844.8**	**940.1**
Growth (%)	2.5	18.0	19.5	11.3
Depreciation	26.8	33.9	39.7	43.4
Interest	40.7	49.2	39.0	20.2
Other Income	59.1	74.2	85.0	90.8
PBT	590.7	698.3	851.2	967.2
Total Tax	94.3	176.1	213.8	243.0
PAT	**496.4**	**522.2**	**637.4**	**724.2**

Source: Company, ICICI Direct Research

Exhibit 46: Cash Flow Statement

(Year-end March)	FY20	FY21E	FY22E	FY23E
Profit after Tax	496.4	522.2	637.4	724.2
Add: Depreciation	26.8	33.9	39.7	43.4
(Inc)/dec in Current Assets	-124.5	-323.2	-192.9	-294.7
Inc/(dec) in CL and Provisions	-119.3	95.2	95.7	26.6
Others	40.7	49.2	39.0	20.2
CF from operating activities	320.1	377.3	618.8	519.9
(Inc)/dec in Investments	0.4	-80.0	-100.0	200.0
(Inc)/dec in Fixed Assets	-92.5	-40.0	-60.0	-70.0
Others	12.7	-0.2	-1.8	-1.4
CF from investing activities	-79.4	-120.2	-161.8	128.6
Issue/(Buy back) of Equity	0.1	0.0	0.0	0.0
Inc/(dec) in loan funds	-169.5	300.0	-180.0	-150.0
Dividend paid & dividend tax	-151.1	-150.4	-313.4	-501.4
Others	-15.1	-48.2	-39.0	-20.2
CF from financing activities	-335.6	101.3	-532.4	-671.7
Net Cash flow	-94.9	358.4	-75.3	-23.2
Opening Cash	143.0	48.1	406.6	331.2
Closing Cash	48.1	406.6	331.2	308.0

Source: Company, ICICI Direct Research

Exhibit 47: Balance Sheet

(Year-end March)	FY20	FY21E	FY22E	FY23E
Liabilities				
Equity Capital	125.5	125.5	125.5	125.5
Reserve and Surplus	1,342.9	1,715.7	2,039.6	2,262.4
Total Shareholders funds	1,468.4	1,841.1	2,165.1	2,387.9
Total Debt	179.7	479.7	299.7	149.7
Total Liabilities	**1,648.1**	**2,320.9**	**2,464.8**	**2,537.6**
Assets				
Gross Block	191.1	231.1	291.1	361.1
Less: Acc Depreciation	61.6	95.4	135.1	178.6
Total Fixed Assets	149.5	155.6	175.9	202.5
Goodwill	779.4	779.4	779.4	779.4
Investments	540.8	620.8	720.8	520.8
Inventory	463.6	572.0	574.7	657.2
Debtors	463.5	648.3	776.7	888.1
Other CA	248.5	278.4	340.2	440.9
Cash	48.1	406.6	331.2	308.0
Total Current Assets	1,223.7	1,905.3	2,022.8	2,294.3
Creditors	643.6	711.9	807.7	923.7
Provisions	184.6	204.2	231.7	267.9
Other CL	275.6	282.9	255.1	129.7
Total Current Liabilities	1,103.8	1,198.9	1,294.6	1,321.2
Net current assets	119.9	706.3	728.2	973.0
Other non current assets	58.5	58.7	60.5	61.9
Total Assets	**1,648.1**	**2,320.9**	**2,464.8**	**2,537.6**

Source: Company, ICICI Direct Research

Exhibit 48: Key Ratios

(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
EPS	7.9	8.3	10.2	11.6
Cash EPS	8.3	8.9	10.8	12.2
BV	23.4	29.4	34.5	38.1
DPS	2.4	2.4	5.0	8.0
Operating Ratios (%)				
EBITDA Margin	13.3	15.2	14.9	14.5
PAT Margin	11.0	11.3	11.2	11.2
Asset Turnover	23.7	20.1	19.5	18.0
Inventory Days	37.4	45.0	37.0	37.0
Debtor Days	37.4	51.0	50.0	50.0
Creditor Days	52.0	56.0	52.0	52.0
Return Ratios (%)				
RoE	33.8	28.4	29.4	30.3
RoCE	38.3	32.2	36.1	38.9
RoIC	120.0	93.7	99.6	91.8
Valuation Ratios (x)				
P/E	45.5	43.8	35.4	31.2
EV / EBITDA	37.5	31.6	26.2	23.6
EV / Net Sales	5.0	4.8	3.9	3.4
Market Cap / Sales	5.0	4.9	4.0	3.5
Price to Book Value	15.4	12.4	10.6	9.6
Solvency Ratios				
Debt / Equity	0.1	0.3	0.1	0.1
Current Ratio	1.4	1.6	1.6	1.7
Quick Ratio	0.9	1.0	1.1	1.1

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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