



Crompton Gr. Con

BSE SENSEX
38,855

S&P CNX
11,464

CMP: INR254

TP: INR310 (+22%)

Buy

Crompton

| | |
|-----------------------|-------------|
| Bloomberg | CROMPTON IN |
| Equity Shares (m) | 627 |
| M.Cap.(INRb)/(USDb) | 159.6 / 2.1 |
| 52-Week Range (INR) | 301 / 178 |
| 1, 6, 12 Rel. Per (%) | -4/-9/6 |
| 12M Avg Val (INR M) | 292 |
| Free float (%) | 73.8 |

Financials & Valuations (INR b)

| Y/E Mar | 2020 | 2021E | 2022E |
|--------------|------|-------|-------|
| Sales | 45.1 | 40.6 | 51.0 |
| EBITDA | 6.0 | 5.6 | 7.1 |
| PAT | 4.4 | 4.2 | 5.5 |
| EBITDA (%) | 13.2 | 13.7 | 14.0 |
| EPS (INR) | 7.0 | 6.7 | 8.8 |
| EPS Gr. (%) | 16.9 | (3.6) | 31.6 |
| BV/Sh. (INR) | 23.4 | 27.3 | 32.4 |

Ratios

| | | | |
|------------|-------|-------|-------|
| Net D/E | (0.2) | (0.3) | (0.4) |
| RoE (%) | 29.8 | 24.6 | 27.3 |
| RoCE (%) | 28.9 | 23.9 | 28.0 |
| Payout (%) | 34.4 | 42.0 | 42.0 |

Valuations

| | | | |
|---------------|------|------|------|
| P/E (x) | 36.4 | 37.8 | 28.7 |
| P/BV (x) | 10.8 | 9.3 | 7.8 |
| EV/EBITDA (x) | 26.3 | 27.8 | 21.1 |
| Div Yield (%) | 0.8 | 0.9 | 1.2 |
| FCF Yield (%) | 2.3 | 2.5 | 3.2 |

Shareholding pattern (%)

| As On | Jun-20 | Mar-20 | Jun-19 |
|----------|--------|--------|--------|
| Promoter | 26.2 | 26.2 | 34.4 |
| DII | 25.7 | 26.7 | 21.3 |
| FII | 29.9 | 30.5 | 28.3 |
| Others | 18.2 | 16.6 | 16.1 |

FII Includes depository receipts

Catalysts emerging; Valuation comfort immense

- Bottoming out of Lighting price erosion to reflect in financials:** Competitive intensity has bottomed out in the Lighting industry, though not completely over. This can be gauged by the price hikes over the past six months. The last round of price cuts occurred in Aug'19 and will form part of the base Sep'20 onwards. Thus, we expect value growth in the Lighting segment to follow volume growth while margins should be on an uptrend 2QFY21 onwards (full quarter impact expected to reflect in 3QFY21 only).
- Lighting segment to drive incremental profits:** The Lighting segment has been under stress for the past two years now owing to price erosion at the industry level. Thus, despite the double-digit volume growth, Lighting revenues have dropped by 5% CAGR over FY18-20. The impact on profitability has been even more severe with PBIT margins declining to ~5-6% from 10-11% earlier. Thus, though the Lighting segment formed 25% of Crompton's turnover in FY20, the segmental PBIT contribution was limited to just 9%. We expect PBIT contribution from the Lighting segment to start increasing hereon, driving 25% incremental segmental PBIT over FY20-22E.
- ECD segment on strong footing:** Crompton's ECD segment has been performing well with double-digit growth for eight consecutive quarters prior to the COVID-19 outbreak in Mar'20. The ECD segment growth was largely supported by water heaters and air coolers. The margin performance is commendable and is the best in the industry. **In fact, like-to-like ECD category margin for Crompton is materially higher than Havells.**
- The best play in crisis times:** Crompton's business model is most resilient in times of a crisis. The company showcased best performance in 1QFY21 with EBITDA decline of ~49% (v/s decline of ~80% for our aggregate universe). Since Crompton's categories have higher replacement demand, we see higher probability of steady performance in the coming quarters and in FY22E (v/s negative impact for peers from weak consumer demand).
- Opening up of Western India to aid growth:** Crompton's earnings beat in 1QFY21 was despite one of its largest markets (West India, especially Maharashtra) being under severe lockdown. Its peers in similar categories such as Havells, Orient and Polycab have relatively lower exposure to the state. As Maharashtra has gradually opened up in 2QFY21, Crompton is set to benefit the most in the coming quarters due to pent-up demand.
- Sub-optimal channel inventory to help:** The channel inventory across key categories of Crompton is sub-optimal/adequate, and hence, there is scope of channel refilling to play out in case demand surprises on the upside going into the festive season next month. Moreover, the peak season for water heaters is around the corner and the category could support ECD growth to some extent over the next few months. Note that Crompton has been clocking strong growth over the past few quarters in water heaters and has been gaining market share as well.

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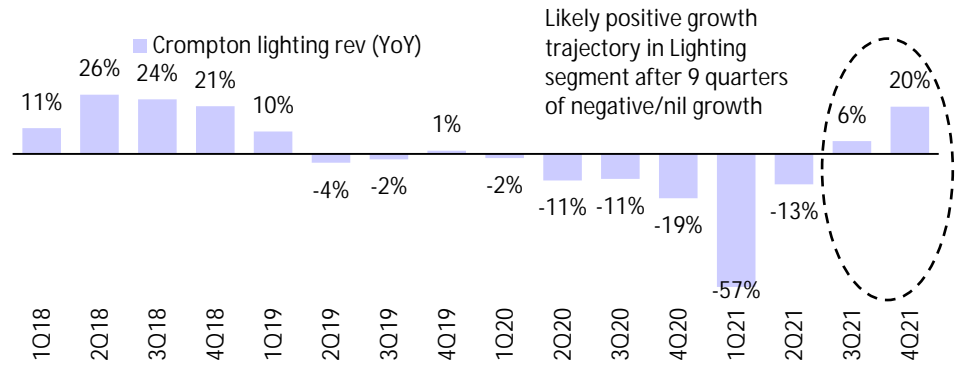
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- n **Lean business model with minimum capex:** Crompton has minimal capex requirements as 50% of its products sold are outsourced. Coupled with strong operating performance, Crompton has been able to generate healthy free cash flow (FCF) of ~INR10b over FY17-20 (v/s adj. PAT of INR11.4b over the same period), indicating FCF/PAT conversion at 0.85x.
- n **Robust return ratios:** With strong profitability and an asset-light business model, return ratios are healthy – RoE/RoCE of 30%/29% in FY20. We expect return ratios to remain at these levels in the coming days.
- n **Maintain Buy with increased TP of INR310:** The valuation gap between Crompton and Havells has expanded to ~40% on FY22E basis. While we expect Havells to command premium valuations due to its robust business footing, we expect the valuation gap between the two companies to narrow down. This is due to Crompton's strong earnings growth trajectory along with superior FCF generation. In fact, we find no reason for Crompton to trade at a discount to Orient Electric (not rated and based on consensus estimates). We increase our TP to INR310 (35x Mar'22E EPS v/s 32x earlier). Maintain **Buy**. Any inorganic growth opportunity or higher dividend payout/buyback option may re-rate the stock further, in our view.

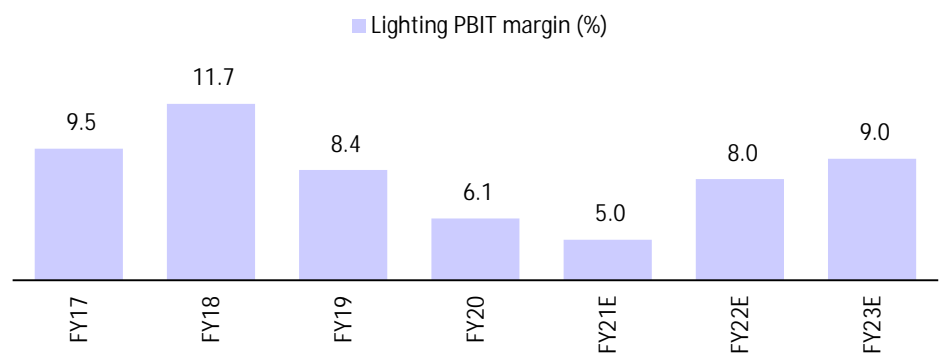
Key Charts

Exhibit 1: Price erosion may be past, Lighting revenue likely to enter positive growth trajectory



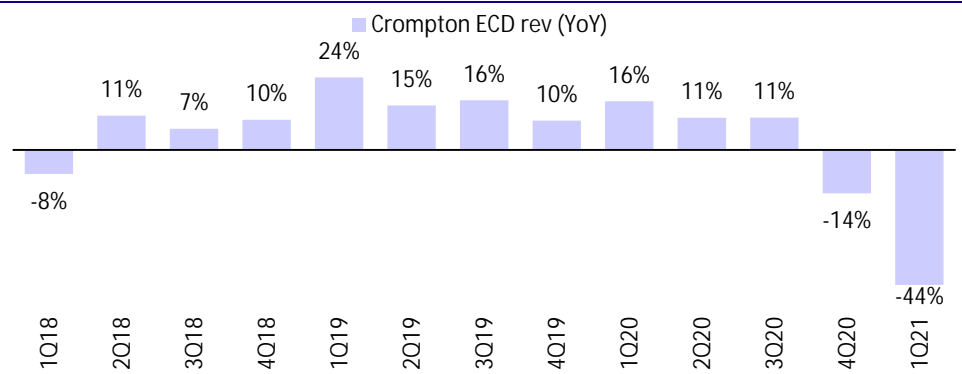
Source: Company, MOFSL

Exhibit 2: Lighting margin on verge of bottoming out as competitive intensity is easing and price hikes have taken place



Source: Company, MOFSL

Exhibit 3: Crompton's ECD revenue has been on strong footing with double-digit revenue growth for many quarters prior to COVID-19 impact



Source: Company, MOFSL

Exhibit 4: FY20 revenue break-up

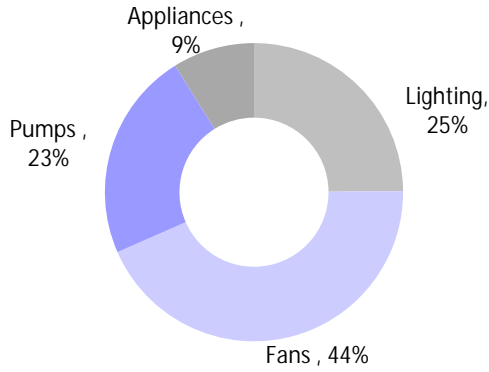


Exhibit 5: FY20-23E CAGR estimates by category

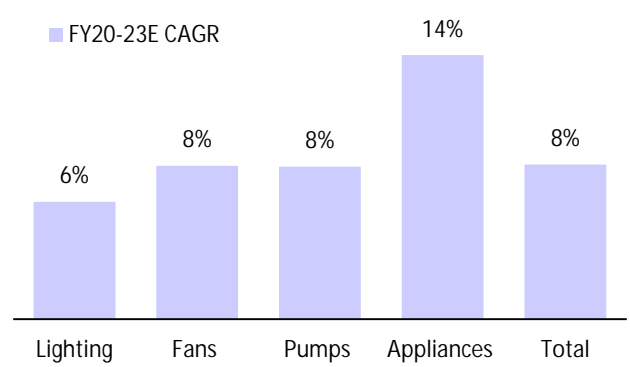


Exhibit 6: Expect Lighting revenue CAGR of 6% over FY20-23E

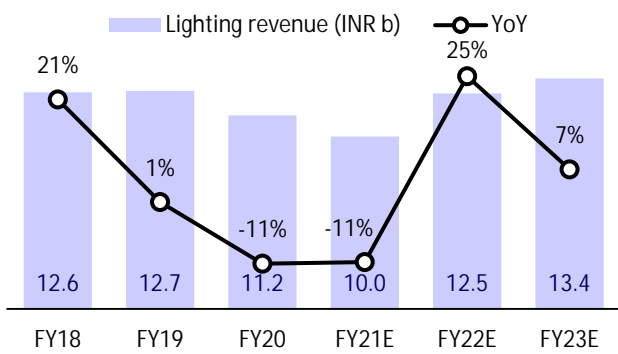


Exhibit 7: Lighting margins expected to scale up

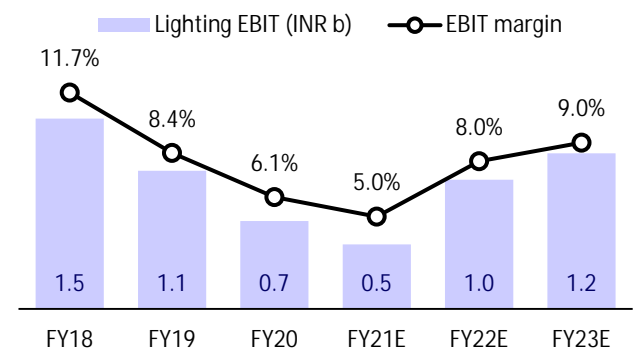


Exhibit 8: Expect ECD revenue CAGR of 8.5% over FY20-23E

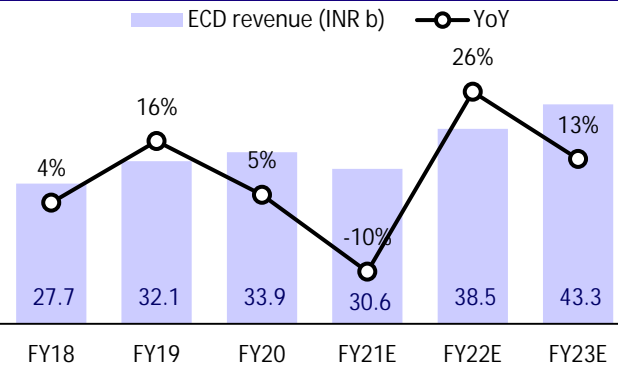


Exhibit 9: ECD margins to remain stable at 20%

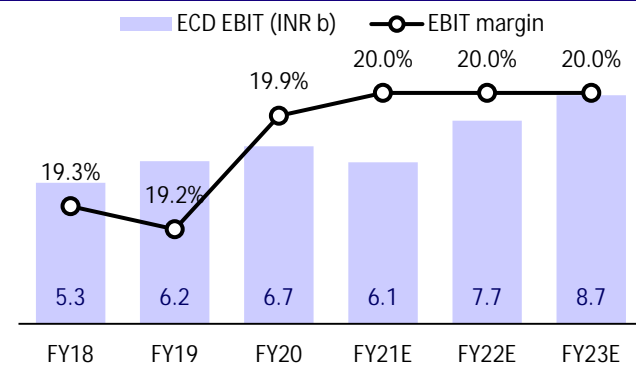


Exhibit 10: Expect revenue CAGR of 8% over FY20-23E

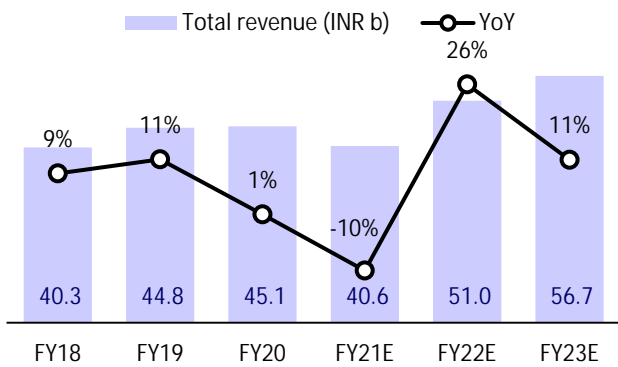
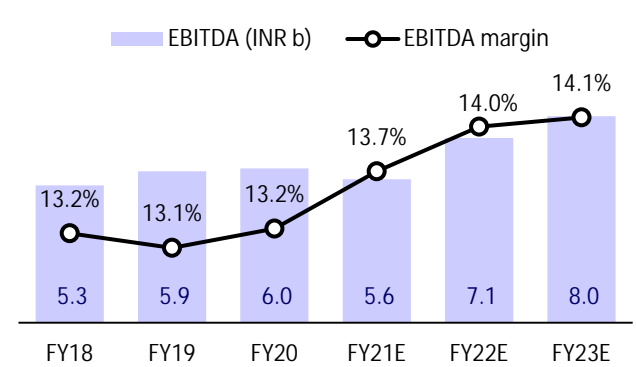


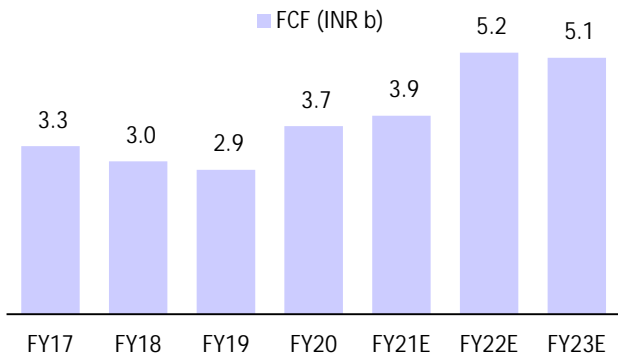
Exhibit 11: EBITDA margin to expand to 14.1% by FY23E



Source: MOFSL, Company

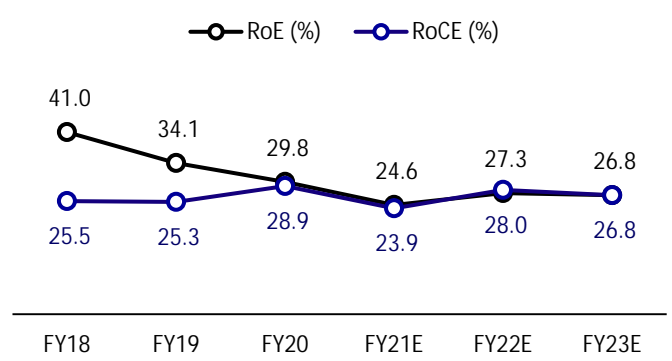
Source: MOFSL, Company

Exhibit 12: Expect FCF generation to remain robust



Source: MOFSL, Company

Exhibit 13: Return ratios to remain healthy

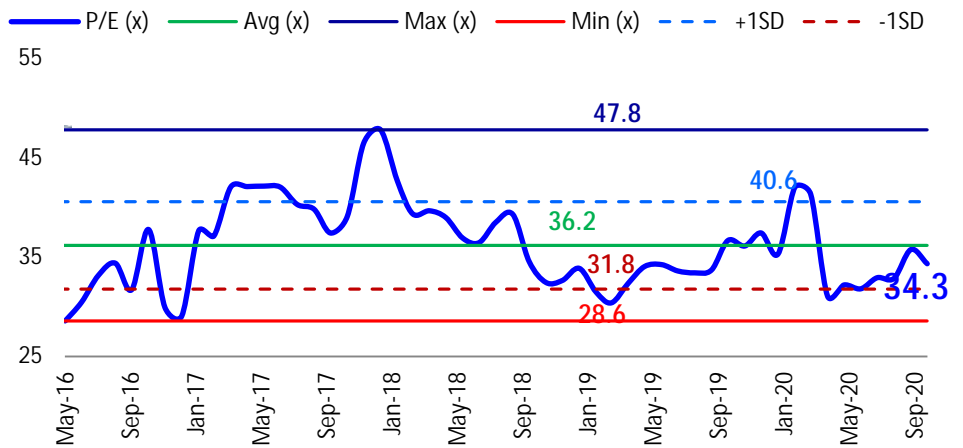


Source: MOFSL, Company

Valuation and view

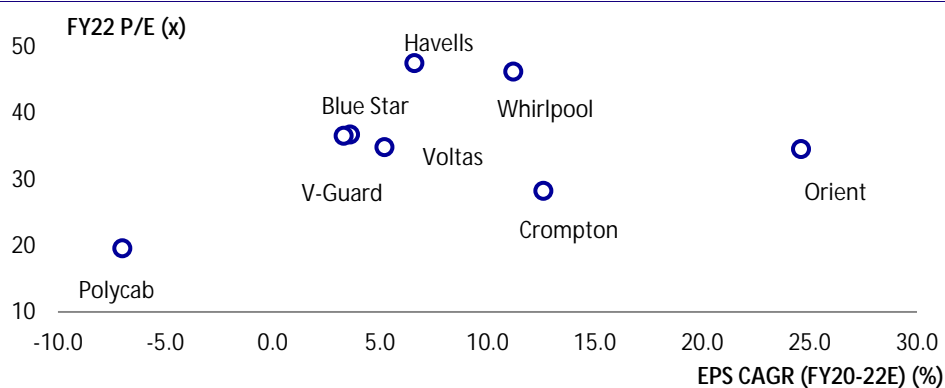
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Exhibit 14: Crompton is trading at a discount to its long-term average (v/s peers trading at a premium to long-term average)



Source: MOFSL, Company

Exhibit 15: Crompton is trading at favorable valuations and is one of the best placed considering FY20-22E EPS CAGR



Source: MOFSL, Company

Exhibit 16: Valuation summary

| | CMP (INR) | Mcap (INR b) | Rating | P/E (x) | | | EV/EBITDA (x) | | |
|-----------|-----------|--------------|-----------|---------|-------|-------|---------------|-------|-------|
| | | | | FY20 | FY21E | FY22E | FY20 | FY21E | FY22E |
| Blue Star | 604 | 58 | Neutral | 39.6 | 225.8 | 36.8 | 21.2 | 39.7 | 18.5 |
| Crompton | 254 | 159 | Buy | 36.4 | 37.8 | 28.7 | 26.3 | 27.8 | 21.1 |
| Havells | 654 | 409 | Neutral | 55.8 | 74.4 | 49.1 | 38.8 | 43.0 | 30.6 |
| Voltas | 657 | 217 | Buy | 39.2 | 55.4 | 35.5 | 31.5 | 47.5 | 28.3 |
| Orient | 194 | 41 | Not Rated | 52.5 | 79.4 | 33.8 | 23.9 | 30.8 | 18.4 |
| Polycab | 847 | 126 | Not Rated | 16.6 | 26.9 | 19.2 | 11.0 | 15.5 | 11.8 |
| V-Guard | 168 | 72 | Not Rated | 39.1 | 51.2 | 36.6 | 28.2 | 34.9 | 24.7 |
| Whirlpool | 2,141 | 272 | Not Rated | 57.0 | 75.1 | 46.1 | 38.4 | 49.1 | 30.6 |

Source: MOFSL, Company

Financials and valuations

| Income Statement | | | | | | (INR M) |
|-----------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Y/E March | 2018 | 2019 | 2020 | 2021E | 2022E | 2023E |
| Total Revenues | 40,254 | 44,789 | 45,120 | 40,600 | 51,000 | 56,705 |
| Change (%) | 8.6 | 11.3 | 0.7 | -10.0 | 25.6 | 11.2 |
| EBITDA | 5,310 | 5,858 | 5,969 | 5,550 | 7,149 | 7,989 |
| % of Total Revenues | 13.2 | 13.1 | 13.2 | 13.7 | 14.0 | 14.1 |
| Depreciation | 126 | 129 | 268 | 319 | 335 | 351 |
| Other Income | 308 | 483 | 589 | 800 | 800 | 1,000 |
| Interest | 637 | 596 | 407 | 400 | 200 | 0 |
| PBT | 4,854 | 5,616 | 5,883 | 5,632 | 7,414 | 8,638 |
| Tax | 1,617 | 1,875 | 1,510 | 1,418 | 1,866 | 2,174 |
| Rate (%) | 33.3 | 33.4 | 25.7 | 25.2 | 25.2 | 25.2 |
| Adjusted PAT | 3,238 | 3,741 | 4,373 | 4,214 | 5,548 | 6,464 |
| Extra-ordinary Income | 0 | 285 | 574 | 0 | 0 | 0 |
| Reported PAT | 3,238 | 4,025 | 4,947 | 4,214 | 5,548 | 6,464 |
| Change (%) | 14.3 | 24.3 | 22.9 | -14.8 | 31.6 | 16.5 |

| Balance Sheet | | | | | | (INR M) |
|----------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Y/E March | 2018 | 2019 | 2020 | 2021E | 2022E | 2023E |
| Share Capital | 1,254 | 1,254 | 1,255 | 1,255 | 1,255 | 1,255 |
| Reserves | 6,641 | 9,731 | 13,423 | 15,868 | 19,086 | 22,835 |
| Net Worth | 7,895 | 10,985 | 14,678 | 17,122 | 20,340 | 24,089 |
| Loans | 6,486 | 6,493 | 3,497 | 1,797 | 0 | 0 |
| Capital Employed | 14,381 | 17,477 | 18,175 | 18,919 | 20,340 | 24,089 |
| Gross Fixed Assets | 8,849 | 8,991 | 9,705 | 10,205 | 10,705 | 11,205 |
| Less: Depreciation | 234 | 359 | 616 | 934 | 1,269 | 1,619 |
| Net Fixed Assets | 8,616 | 8,632 | 9,090 | 9,271 | 9,437 | 9,586 |
| Capital WIP | 6 | 10 | 199 | 199 | 199 | 199 |
| Investments | 0 | 142 | 142 | 142 | 142 | 142 |
| Curr. Assets | 15,628 | 17,915 | 18,010 | 17,644 | 21,035 | 25,806 |
| Inventory | 3,032 | 3,524 | 4,636 | 4,172 | 4,192 | 4,661 |
| Debtors | 5,536 | 5,660 | 4,587 | 4,128 | 5,185 | 5,765 |
| Cash & Bank Balance | 5,450 | 6,724 | 5,866 | 6,718 | 8,358 | 11,711 |
| Loans & Advances | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Assets | 1,610 | 2,007 | 2,920 | 2,628 | 3,301 | 3,670 |
| Current Liab. & Prov. | 9,869 | 9,221 | 9,265 | 8,337 | 10,473 | 11,644 |
| Current Liabilities | 8,719 | 7,530 | 7,426 | 6,682 | 8,394 | 9,333 |
| Provisions | 1,150 | 1,691 | 1,839 | 1,655 | 2,078 | 2,311 |
| Net Current Assets | 5,759 | 8,694 | 8,745 | 9,307 | 10,563 | 14,162 |
| Application of Funds | 14,381 | 17,477 | 18,175 | 18,919 | 20,340 | 24,089 |

Financials and valuations

Ratios

| Y/E March | 2018 | 2019 | 2020 | 2021E | 2022E | 2023E |
|---------------------------------|------|------|------|-------|-------|-------|
| Basic (INR) | | | | | | |
| Adj EPS | 5.2 | 6.0 | 7.0 | 6.7 | 8.8 | 10.3 |
| Cash EPS | 5.4 | 6.2 | 7.4 | 7.2 | 9.4 | 10.9 |
| Book Value | 12.6 | 17.5 | 23.4 | 27.3 | 32.4 | 38.4 |
| DPS | 1.5 | 1.7 | 2.0 | 2.4 | 3.1 | 3.6 |
| Payout (incl. Div. Tax.) | 34.9 | 35.1 | 34.4 | 42.0 | 42.0 | 42.0 |
| Valuation (x) | | | | | | |
| P/E | 0.0 | 42.7 | 36.7 | 37.8 | 28.7 | 24.7 |
| Cash P/E | 0.0 | 41.2 | 34.4 | 35.2 | 27.1 | 23.4 |
| EV/EBITDA | 0.2 | 27.2 | 26.3 | 27.8 | 21.1 | 18.5 |
| EV/Sales | 0.0 | 3.6 | 3.5 | 3.8 | 3.0 | 2.6 |
| Price/Book Value | 0.0 | 14.5 | 10.8 | 9.3 | 7.8 | 6.6 |
| Dividend Yield (%) | 0.6 | 0.7 | 0.8 | 0.9 | 1.2 | 1.4 |
| Profitability Ratios (%) | | | | | | |
| RoE | 41.0 | 34.1 | 29.8 | 24.6 | 27.3 | 26.8 |
| RoCE | 25.5 | 25.3 | 28.9 | 23.9 | 28.0 | 26.8 |
| RoIC | 38.7 | 36.0 | 34.8 | 32.5 | 43.1 | 46.7 |
| Turnover Ratios | | | | | | |
| Debtors (Days) | 50 | 46 | 37 | 37 | 37 | 37 |
| Inventory (Days) | 27 | 29 | 38 | 38 | 30 | 30 |
| Creditors (Days) | 69 | 54 | 52 | 52 | 52 | 52 |
| Asset Turnover (x) | 2.8 | 2.6 | 2.5 | 2.1 | 2.5 | 2.4 |
| Leverage Ratio | | | | | | |
| Net Debt/Equity (x) | 0.1 | 0.0 | -0.2 | -0.3 | -0.4 | -0.5 |

Cash Flow Statement

| Y/E March | 2018 | 2019 | 2020 | 2021E | 2022E | 2023E |
|------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| (INR M) | | | | | | |
| PBT before EO Items | 5,423 | 5,788 | 5,817 | 5,632 | 7,414 | 8,638 |
| Depreciation | 126 | 129 | 268 | 319 | 335 | 351 |
| Interest & other | 350 | 293 | 173 | -400 | -600 | -1,000 |
| Direct Taxes Paid | -1,812 | -1,994 | -1,445 | -1,418 | -1,866 | -2,174 |
| (Inc)/Dec in WC | -933 | -1,202 | -602 | 288 | 385 | -247 |
| CF from Operations | 3,154 | 3,014 | 4,211 | 4,421 | 5,668 | 5,568 |
| (Inc)/Dec in FA | -133 | -160 | -494 | -500 | -500 | -500 |
| Free Cash Flow | 3,021 | 2,855 | 3,717 | 3,921 | 5,168 | 5,068 |
| Investment & Others | -188 | -1,343 | -18 | 800 | 800 | 1,000 |
| CF from Investments | -322 | -1,503 | -512 | 300 | 300 | 500 |
| (Inc)/Dec in Debt | 0 | 0 | -3,088 | -1,700 | -1,797 | 0 |
| Interest Paid | -634 | -587 | -586 | -400 | -200 | 0 |
| Dividend Paid | -1,129 | -1,312 | -1,506 | -1,770 | -2,330 | -2,715 |
| Others | 486 | 1,624 | 572 | 0 | 0 | 0 |
| CF from Fin. Activity | -1,269 | -237 | -4,556 | -3,870 | -4,327 | -2,715 |
| Inc/Dec of Cash | 1,564 | 1,274 | -857 | 851 | 1,640 | 3,353 |
| Add: Beginning Balance | 3,886 | 5,450 | 6,724 | 5,866 | 6,718 | 8,358 |
| Closing Balance | 5,450 | 6,724 | 5,866 | 6,718 | 8,358 | 11,711 |

| Explanation of Investment Rating | |
|----------------------------------|--|
| Investment Rating | Expected return (over 12-month) |
| BUY | >=15% |
| SELL | < - 10% |
| NEUTRAL | < - 10 % to 15% |
| UNDER REVIEW | Rating may undergo a change |
| NOT RATED | We have forward looking estimates for the stock but we refrain from assigning recommendation |

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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