

## Crompton Greaves

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,573	CRG IN
	REUTERS CODE
S&P CNX: 3,115	CROM.BO

24 May 2006

**Buy**
*Previous Recommendation: Buy*
**R983**

Equity Shares (m)	52.4
52-Week Range	1,225/434
1,6,12 Rel. Perf. (%)	4/24/41
M.Cap. (Rs b)	51.5
M.Cap. (US\$ b)	1.1

YEAR	NET SALES	PAT*	EPS*	EPS*	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/06A	25,206	2,320	44.3	60.3	25.2	10.2	43.2	29.7	2.1	23.0
3/07E	29,756	2,659	50.8	14.6	19.4	8.0	34.5	36.5	1.8	16.3
3/08E	33,390	3,261	62.3	22.6	15.8	6.3	32.5	36.5	1.6	13.7

\* Consolidated nos, pre exceptionals

**Robust financial performance:** During FY06 Crompton reported revenues of Rs25.2b (up 28% YoY), EBITDA of Rs2.3b (up 42% YoY) and PAT of Rs1.9b (up 38% YoY). Power Systems largely drove the improved performance — FY06 revenues were up 38% YoY; EBIT margins up 137bp.

**US\$1b revenue company:** During FY06, consolidated revenues (integrated with Pauwels over 13 May 2005-31 March 2006) stood at Rs43.5b (US\$985m), v/s US\$479m in FY05. This was a positive surprise, as Pauwels' numbers were impacted by the change in accounting policy from percentage completion method to one based on dispatch. Consolidated net profit was Rs2.3b (standalone Rs1.6b), the result of a smart turnaround at Pauwels.

**Order book up 45% YoY (FY06):** Unexecuted order book of Crompton (standalone) as at March 2006 stood at Rs15b, up 45% YoY. The current order book indicates that both Crompton and Pauwels are booked for the next 12 months, operating at near 100% capacity utilization rates.

**Valuation and view:** We expect consolidated profits to witness 18.5% CAGR over FY06-FY08. Management also approved a stock split — one Rs10 share to five Rs2 shares. At CMP of Rs983, Crompton trades at a PER of 19.4x FY07E, and 15.8x FY08E (consolidated). We reiterate **Buy**, with price target of Rs1,195 (an upside of 21.6%).

**QUARTERLY PERFORMANCE**

	(Rs Million)									
	FY05				FY06				FY05	FY06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
<b>Sales</b>	4,232	4,530	4,719	6,245	5,198	5,546	6,479	7,983	19,725	25,206
Change (%)	13.9	10.9	18.8	17.0	22.8	22.4	37.3	27.8	15.3	27.8
<b>EBITDA</b>	282	395	472	486	455	529	590	752	1,635	2,326
Change (%)	9.9	-0.8	33.6	7.0	61.1	34.0	25.0	54.8	3.8	42.3
As of % Sales	6.7	8.7	10.0	7.8	8.7	9.5	10.9	11.8	9.5	10.4
Depreciation	104	103	103	111	105	104	104	129	421	442
Interest	60	52	71	48	75	59	66	64	231	264
Other Income	57	36	58	119	77	65	66	119	269	327
Exceptional items (reported)	0	0	0	-4	0	0	0	0	-4	0
<b>PBT</b>	175	276	357	441	352	431	487	679	1,248	1,948
Tax	-1	27	41	33	39	106	55	118	100	318
Effective Tax Rate (%)	-0.3	9.6	11.5	7.6	11.1	24.6	11.2	17.3	8.0	16.3
<b>Reported PAT</b>	175	249	316	407	313	325	432	561	1,148	1,631
<b>Adj PAT</b>	175	249	316	411	313	325	548	748	1,152	1,934
Change (%)	460.2	9.8	83.5	43.0	78.3	30.4	73.3	82.0	30.2	67.9

E: MOST Estimates

### Robust financial performance

During 4QFY06, Crompton reported robust financial performance, with reported net profit of Rs561m (up 37.7% YoY) and adjusted net profit at Rs748m (up 82% YoY). 4QFY06 numbers include extraordinary expenses of Rs37.3m on account of VRS and Rs150m for sales tax liability under the accounting standard 29 and payment of independent auditor fees for Pauwels. This robust performance is being driven by 27.8% YoY growth in revenues (better than our expectations) and 400bp YoY expansion in EBITDA margins.

During FY06, the company posted revenues of Rs25.2b (up 27.8%), reported net profit of Rs1.6b (up 42% YoY) and adjusted net profit at Rs1.9b (up 38% YoY). FY06 numbers include total VRS expense of Rs152.7m and sales tax liability and payment of independent auditor fees for Pauwels of Rs150m. EBITDA margins (adjusted for extraordinary) during FY06 was up 88bp YoY to 10.4%.

### Buoyant revenue growth of 27.8% YoY (FY06)

Crompton reported robust revenue growth of 27.8% YoY to Rs25.2b during FY06, mainly driven by strong performance of the Power Systems division. During FY06, revenues of Power Systems grew to Rs12.2b, up 38% YoY. Industrial Systems revenues increased 20.1% YoY to Rs6.9b, largely due to capacity constraints. Going forward, we expect the division to witness growth rates of 20%-25% YoY, post de-bottlenecking. Consumer Systems division revenues were up 21.7% during the same period to Rs8.2b, largely on the back of expansion in the product range to include geysers, steam iron, mixer, juicer etc.

### EBITDA margin improvement to 10.4% (adjusted) during FY06

During FY06, EBITDA increased 42.3% YoY to Rs2.3b, while EBITDA margins improved by 88bp to 10.4% v/s 9.5% in FY05. This is being driven by better absorption of fixed costs on back of a 27.8% YoY revenue growth. The EBITDA margins are adjusted for extraordinary (charge of Rs248m in FY05 and Rs303m in FY06).

#### TREND IN SEGMENT-WISE REVENUES AND EBIT

(RS MILLION)

	FY05				FY05	FY06				FY06
	1Q	2Q	3Q	4Q		1Q	2Q	3Q	4Q	
<b>Revenues</b>										
Power Systems	1,493	2,136	2,075	3,114	8,818	2,085	2,667	3,332	4,085	2,168
YoY Growth (%)	16.3	12.9	14.0	21.7	16.7	39.6	24.9	60.6	31.2	38.0
Consumer Products	1,816	1,366	1,539	1,994	6,715	2,079	1,690	1,871	2,531	8,171
YoY Growth (%)	5.2	2.2	17.2	13.3	9.4	14.5	23.7	21.5	27.0	21.7
Industrial Systems	1,220	1,368	1,480	1,638	5,706	1,494	1,652	1,739	1,970	6,856
YoY Growth (%)	30.7	27.9	31.2	18.1	26.3	22.5	20.8	17.5	20.3	20.1
Digital Group	97	112	112	134	455	91	85	102	102	379
YoY Growth (%)	-28.3	-23.7	14.8	-17.5	-16.1	-6.3	-23.9	-8.9	-24.3	-16.6
<b>Total</b>	<b>4,627</b>	<b>4,981</b>	<b>5,205</b>	<b>6,881</b>	<b>21,694</b>	<b>5,750</b>	<b>6,093</b>	<b>7,043</b>	<b>8,688</b>	<b>7,574</b>
Inter-segment	46	25	37	58	273	52	37	39	61	189
<b>Total Revenues</b>	<b>4,581</b>	<b>4,957</b>	<b>5,168</b>	<b>6,822</b>	<b>21,528</b>	<b>5,698</b>	<b>6,057</b>	<b>7,005</b>	<b>8,626</b>	<b>27,386</b>
<b>EBIT</b>										
Power Systems	61	161	149	289	660	143	228	323	385	1,078
Margin (%)	4.1	7.5	7.2	9.3	7.5	6.9	8.5	9.7	9.4	8.9
Consumer Products	142	120	126	192	580	198	138	166	276	777
Margin (%)	7.8	8.8	8.2	9.6	8.6	9.5	8.1	8.8	10.9	9.5
Industrial Systems	127	183	271	186	767	209	221	259	241	930
Margin (%)	10.4	13.4	18.3	11.4	13.4	14.0	13.4	14.9	12.2	13.6
Digital Group	-22	-27	-42	-51	-143	-33	-1	-31	-15	-80
Margin (%)	-22.6	-24.6	-37.9	-37.9	-31.4	-36.4	-0.9	-30.0	-15.0	-21.0

Source: Company/Motilal Oswal Securities

Margin expansion was mainly driven by the Power Systems, which recorded an expansion of 137bp in EBIT margins to 8.9% in FY06 v/s 7.5% in FY05. Consumer division witnessed margin expansion to 9.5% in FY06 v/s 8.6% in FY05, largely a result of better absorption of fixed costs and stabilization of new products launched. In geysers, Crompton is already the number 2 brand in the market. In the industrial division, margins expanded by 12bp to 13.6% in FY06.

### Higher tax rates, as a result of reduction in carry forward losses

Crompton's effective tax rate has increased from 8% in FY05 to 16.3% in FY06, due to reduction in the quantum of carry forward losses. Further, management has indicated that tax rates would increase to 30%-32% during FY07 and FY08.

### Crompton is a US\$1b revenue company

During FY06, Crompton's consolidated revenues (integrated with Pauwels for the period 13 May 2005-31 March 2006) stands at Rs43.5b (US\$985m), v/s US\$479m in FY05. This came as a positive surprise as Pauwels numbers have been impacted by change in accounting policy from percentage completion method to one based on dispatch. Consolidated net profit stood at Rs2.3b (EPS Rs44/sh).

### Key takeaways from conference call:

#### Extraordinaries in FY06 (standalone)

FY06 reported numbers include the following extraordinaries:

- ✍ **Rs150m:** sales tax liability as per Accounting Standard 29 and payment to independent auditors (for Pauwels) accounted in 4QFY06.
- ✍ **Rs152.7m:** VRS (Rs115.4m in 3QFY06 and Rs37.3m in 4QFY06)

Thus, the adjusted standalone net profit stands at Rs1.9b.

### Order book: Crompton (Rs15b, up 45% YoY), Pauwels (Euro 250m)

Unexecuted order book of Crompton (standalone) as at March 2006 is Rs15b, up 45% YoY. This comprises 60%

from Power Systems division and rest from Industrial Systems. The order book of Pauwels is Euro250m.

The management has guided for a revenue growth of 25%-26% during FY07 and stagnant EBIDTA margins. Further, tax rates in FY07 for the standalone company would increase to 30%-33% v/s 16.3% in FY06.

### Pauwels has turned around

Crompton acquired Pauwels on 13 May 2005. During the period 13 May 2005 to 31 March 2006, Pauwels reported revenues of Rs16b (v/s Rs12.5b in CY04), EBIDTA margin of 5.2% (v/s 2.3% in CY04), PBT of Rs730m and net profit of Rs610m (v/s loss of Rs110m). During FY06, Pauwels' numbers includes other income of Rs200m, of which Rs140m pertains to forex gains. As at March 2006, order book for Pauwels stood at Euro250m.

The management has guided for a revenue growth of 15% during FY07 and EBITDA margin expansion of 100bp. The margin expansion in FY06 was largely a result of operating leverage, while in FY07, the margins would be driven by benefits from supply chain management, raw-material sourcing etc. The management has guided for moderate tax rates to continue going forward, given the large carry forward losses.

### Capex of Rs1b during FY07

The management has indicated a capex of Rs620m in FY06 and plans of Rs1b during FY07. A significant part of this capex is intended towards the 765KV transformer factory at Manideep, to be commissioned by FY07. The capacity in power transmission is being expanded to 25,000MVA from the current 19,000MVA and in power distribution to 3,000MVA from 2,000MVA.

### Valuation and view

We expect consolidated profits to witness CAGR of 18.5% over FY06 to FY08. The management has also approved stock-split from one share of Rs10 to five shares of Rs2. At CMP of Rs983, Crompton trades at a PER of 19.4x FY07E, and 15.8x FY08E (consolidated). We reiterate **Buy**, with price target of Rs1,195 (an upside of 21.6%).

## Crompton Greaves: an investment profile

### Company description

Crompton Greaves (CG), established in 1937, is the market leader in Power Systems, industrial motors and consumer fans in India. The recent acquisition of Pauwels has catapulted it to the world's seventh largest transformer manufacturer in the world, with a global market share of 3.3%. The company now has access to US and European markets, and is poised to leverage the advantage of global scale with Indian cost economics.

### Key investment arguments

- ✍ Acquisition of Pauwels has catapulted Crompton as the seventh largest transformer manufacturer globally, with a market share of 3.3%.
- ✍ Successful turnaround of Pauwels indicates the management bandwidth in managing large acquisitions.
- ✍ Order booking is strong – Crompton up 45% YoY. Also, both Crompton and Pauwels are operating at ~100% utilization rates.

### Key investment risks

- ✍ Slowdown of power sector reforms, deterioration of financial health of SEBs and downturn in the industrial capex cycle may hamper growth.
- ✍ Competitive pressures from domestic and MNC companies.

### Recent developments

- ✍ Rs320m committed to expand its transformer division in Mandideep, Madhya Pradesh for which the company has entered into a technical collaboration with Toshiba, Japan.
- ✍ Interim dividend for FY06 is Rs7 (70%).
- ✍ Management has approved the stock-split from one share of Rs10 to five shares of Rs2.

### Valuation and view

- ✍ At CMP of Rs983, Crompton trades at a PER of 15.8x FY08E (consolidated), a significant discount to its peers like ABB and Siemens.
- ✍ We reiterate a **Buy** with a price target of Rs1,195 (an upside of 21.6%).

### Sector view

- ✍ Power sector is expected to witness increased traction till FY07, both on generation and transmission.
- ✍ Investments in manufacturing industries are likely to continue their momentum as they are operating at their peak utilization rates.
- ✍ Buoyant demand and stable raw-material prices have resulted in EBITDA margins expansion.
- ✍ We remain positive view on the sector.

#### COMPARATIVE VALUATIONS

		CROMPTON	BHEL	L&T
P/E (x)	FY07E	19.4	21.7	21.2
	FY08E	15.8	16.6	17.1
P/BV (x)	FY07E	8.0	5.2	6.1
	FY08E	6.3	4.1	5.2
EV/Sales (x)	FY07E	1.8	2.5	1.5
	FY08E	1.6	1.9	1.3
EV/EBITDA (x)	FY07E	16.3	12.3	17.5
	FY08E	13.7	9.1	14.6

#### SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	39.3	38.1	38.4
Domestic Institutions	26.0	25.1	27.4
FII's/FDIs	23.5	26.1	22.7
Others	11.2	10.7	11.5

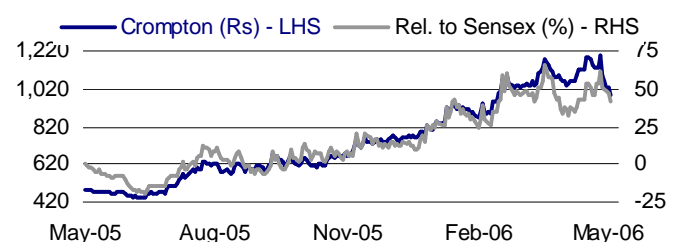
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	50.8	44.1	15.3
FY08	62.3	53.7	16.1

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
983	1,195	21.6	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>Net Sales</b>	<b>17,113</b>	<b>19,725</b>	<b>25,206</b>	<b>29,756</b>	<b>33,390</b>	
Change (%)	7.8	5.3	27.8	18.1	12.2	
Raw Materials	12,061	13,698	17,702	20,978	23,540	
Staff Cost	1,364	1,423	1,696	1,691	1,826	
Other Mfg. Expenses	2,112	2,848	3,482	3,830	4,213	
<b>EBITDA</b>	<b>1,576</b>	<b>1,756</b>	<b>2,326</b>	<b>3,257</b>	<b>3,811</b>	
% of Net Sales	9.2	8.9	10.4	10.9	11.4	
Depreciation	441	420	442	509	561	
Amortization	183	122	0	0	0	
Interest	385	231	264	217	220	
Other Income	270	269	327	363	437	
Extra-ordinary Items (as rep.)	58	-4	0	0	0	
<b>PBT</b>	<b>895</b>	<b>1,248</b>	<b>1,948</b>	<b>2,894</b>	<b>3,466</b>	
Tax	187	100	318	926	1,109	
Rate (%)	20.9	8.0	16.3	32.0	32.0	
<b>Reported PAT</b>	<b>708</b>	<b>1,147</b>	<b>1,631</b>	<b>1,968</b>	<b>2,357</b>	
Extra-ordinary Income (net of)	-2	-248	-303	0	0	
<b>Adjusted PAT</b>	<b>711</b>	<b>1,396</b>	<b>1,934</b>	<b>1,968</b>	<b>2,357</b>	
Change (%)	61.5	96.5	38.5	1.8	19.8	
<b>Consolidated PAT</b>	<b>701</b>	<b>1,447</b>	<b>2,320</b>	<b>2,659</b>	<b>3,261</b>	
Change (%)	106.4	60.3	14.6	22.6		

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Share Capital	524	524	524	524	524	
Reserves	2,721	3,407	4,502	5,874	7,605	
<b>Net Worth</b>	<b>3,245</b>	<b>3,931</b>	<b>5,025</b>	<b>6,397</b>	<b>8,129</b>	
Loans	3,337	3,145	2,784	2,819	2,859	
Deferred Tax Liability	103	0	0	0	0	
<b>Capital Employed</b>	<b>6,684</b>	<b>7,076</b>	<b>7,809</b>	<b>9,217</b>	<b>10,988</b>	
Gross Fixed Assets	7,744	7,929	8,673	9,673	10,673	
Less: Depreciation	4,328	4,665	5,014	5,522	6,084	
<b>Net Fixed Assets</b>	<b>3,416</b>	<b>3,264</b>	<b>3,660</b>	<b>4,151</b>	<b>4,590</b>	
Capital WIP	109	95	100	100	100	
Investments	699	682	510	500	550	
<b>Curr. Assets</b>	<b>8,943</b>	<b>8,908</b>	<b>11,193</b>	<b>13,553</b>	<b>15,929</b>	
Inventory	1,743	1,771	2,251	2,673	2,994	
Debtors	5,269	5,411	6,753	8,019	8,983	
Cash & Bank Balance	762	734	838	1,258	2,155	
Loans & Advances	1,170	992	1,351	1,604	1,797	
<b>Current Liab. &amp; Prov.</b>	<b>6,483</b>	<b>5,872</b>	<b>7,653</b>	<b>9,088</b>	<b>10,181</b>	
Creditors	5,719	5,139	6,603	7,840	8,783	
Other Liabilities	385	577	750	891	998	
Provisions	379	157	300	356	399	
<b>Net Current Assets</b>	<b>2,460</b>	<b>3,036</b>	<b>3,540</b>	<b>4,466</b>	<b>5,748</b>	
<b>Application of Funds</b>	<b>6,684</b>	<b>7,076</b>	<b>7,809</b>	<b>9,217</b>	<b>10,988</b>	

E: MOST Estimates

RATIOS						
Y/E MARCH	2004	2005	2006E	2007E	2008E	
<b>Basic (Rs)</b>						
<b>Adjusted EPS</b>	<b>13.6</b>	<b>26.7</b>	<b>36.9</b>	<b>37.6</b>	<b>45.0</b>	
Growth (%)	61.5	96.5	38.5	1.8	19.8	
<b>Consolidated EPS</b>	<b>13.4</b>	<b>27.6</b>	<b>44.3</b>	<b>50.8</b>	<b>62.3</b>	
Growth (%)	106.4	60.3	14.6	22.6		
Cash EPS	22.0	34.7	45.4	47.3	55.7	
Book Value	62.0	75.1	96.0	122.2	155.2	
DPS	7.0	7.0	9.0	10.0	10.5	
Payout (incl. Div. Tax.)	51.8	32.0	28.9	26.6	23.3	
<b>Valuation (x)</b>						
P/E (standalone)		36.9	26.6	26.1	21.8	
P/E (consolidated)		35.6	25.2	19.4	15.8	
Cash P/E		28.3	21.7	20.8	17.6	
EV/EBITDA		30.7	23.0	16.3	13.7	
EV/Sales		2.7	2.1	1.8	1.6	
Price/Book Value		13.1	10.2	8.0	6.3	
Dividend Yield (%)		0.7	0.9	1.0	1.1	
<b>Profitability Ratios (%)</b>						
RoE	20.9	38.9	43.2	34.5	32.5	
RoCE	16.5	21.6	29.7	36.5	36.5	
<b>Turnover Ratios</b>						
Debtors (Days)	103	92	90	90	90	
Inventory (Days)	34	30	30	30	30	
Creditors. (Days)	112	87	88	88	88	
Asset Turnover (x)	2.6	2.8	3.2	3.2	3.0	
<b>Leverage Ratio</b>						
Debt/Equity (x)	1.0	0.8	0.6	0.4	0.4	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
PBT before EO Items	837	1,252	1,948	2,894	3,466	
Add : Depreciation	624	542	442	509	561	
Interest	385	231	264	217	220	
Less : Direct Taxes Paid	187	100	318	926	1,109	
(Inc)/Dec in WC	579	-603	-399	-506	-386	
<b>CF from Operations</b>	<b>2,238</b>	<b>1,321</b>	<b>1,937</b>	<b>2,188</b>	<b>2,753</b>	
EO Income	58	-4	0	0	0	
<b>CF from Oper. incl. EO I</b>	<b>2,297</b>	<b>1,317</b>	<b>1,937</b>	<b>2,188</b>	<b>2,753</b>	
(Inc)/Dec in FA	-384	-375	-843	-1,000	-1,000	
(Pur)/Sale of Investments	40	17	172	10	-50	
<b>CF from Investments</b>	<b>-343</b>	<b>-358</b>	<b>-671</b>	<b>-990</b>	<b>-1,050</b>	
(Inc)/Dec in Networth	315	-149	0	0	0	
(Inc)/Dec in Debt	-1,256	-191	-361	35	40	
Less : Interest Paid	385	231	264	217	220	
Dividend Paid	414	416	536	596	626	
<b>CF from Fin. Activity</b>	<b>-1,739</b>	<b>-986</b>	<b>-1,161</b>	<b>-778</b>	<b>-806</b>	
<b>Inc/Dec of Cash</b>	<b>214</b>	<b>-27</b>	<b>104</b>	<b>420</b>	<b>897</b>	
Add: Beginning Balance	547	762	734	838	1,258	
<b>Closing Balance</b>	<b>761</b>	<b>734</b>	<b>838</b>	<b>1,258</b>	<b>2,155</b>	



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**Crompton Greaves**

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