Crompton Greaves

2 February 2012

Reuters: CROM.BO; Bloomberg: CRG IN

3QFY12 Analyst Meet Update

Robust order inflow, but margins unlikely to recover

Crompton Greaves (CGL) reported strong order inflow of Rs34bn for 3QFY12, up 66% YoY. However, following the sharp erosion in profitability during the quarter, the management remained non-committal about the prospects of meeting its FY12 consolidated EBITDA margin guidance of 8-10% (given in 2QFY12). Higher order inflow and a pick-up in order execution in the power systems segment leads us to revise our revenue estimates upwards by 3.8%/4.5% for FY12E/13E, respectively. However, a sequential fall in margins (from a low base of 1HFY12) of the domestic power systems and industrial systems segments, operating losses in international subsidiaries and higher tax rate guidance of 34.4% for FY12 (versus 15% earlier) leads us to cut our EBITDA/PAT estimates by 12.1%/26.4% for FY12E and 7.3%/8.9% for FY13E, respectively. Consequently, we cut our EPS estimates by 26.7%/8.4% for FY12E/FY13E. We retain our Sell rating on CGL with a revised target price of Rs108 (Rs118) based on 11xFY13E EPS.

Power systems segment drives order inflow growth: The power systems segment posted 82% YoY growth in order inflow at Rs29.4bn while the industrial systems segment saw 6% rise in order intake at Rs437mn. As a result, the order book rose 17% YoY to Rs81.8bn, thereby marginally improving the order backlog to TTM sales ratio sequentially from 0.68x to 0.74x. However, we expect incremental order inflow in the power systems segment to yield lower margins because of increased competition in the domestic T&D segment and entry in the low-margin sub-station segment.

Substantial recovery in margins unlikely: The management has highlighted measures like raw material sourcing from low-cost countries, cost rationalisation and productivity improvement as key drivers for recovery in margins. However, we expect only a modest recovery in margins across business segments in FY13, as these are long-run strategic business decisions and are unlikely to have a significant bearing over the medium term.

Segmental outlook: We expect the power systems segment to register 13%/10% YoY growth in revenue for FY12E/FY13E, respectively, on the back of improved order book. However severe pricing pressure in the domestic T&D market and 25% of order backlog from the low-margin systems business will cap recovery in margins. In the consumer products segment, we expect modest revenue growth of 3%/5% in FY12E/FY13E due to lower demand, but operating margin is likely to remain stable at 12.5%. We expect revenue growth of the industrial systems segment to be lower at 15% YoY in FY13E as the high base effect of incremental revenue from Emotron and QEI kicks in, while the operating margin is likely to witness a slow recovery from 11.8% in the 9MFY12 period to 13.0% in FY13E.

SELL

Sector: Capital Goods

CMP: Rs144

Target Price: Rs108

Downside: 25%

Chirag Muchhala
chirag.muchhala@nirmalbang.com
+91-22-3926 8092

Key Data

Current Shares O/S (mn)	641.5
Mkt Cap (Rsbn/US$bn)	92.4/1.9
52 Wk H / L (Rs)	297/107
Daily Vol. (3M NSE Avg.)	2,126,940

Price Performance (%)

	1 M	6 M	1 Yr
Crompton Greaves	15.8	(12.5)	(46.8)
Nifty Index	12.9	(4.0)	(3.6)

Source: Bloomberg

Y/E March (Rsmn) (consolidated)	FY09	FY10	FY11	FY12E	FY13E
Net sales	87,373	91,409	100,051	112,438	123,547
EBITDA	9,956	12,770	13,438	8,461	10,648
Net profit	5,599	8,599	8,887	4,060	6,271
EPS (Rs)	8.7	13.4	13.9	6.3	9.8
EPS growth (%)	*37.7*	*53.6*	*3.3*	*(54.3)*	*54.4*
EBITDA margin (%)	*11.4*	*14.0*	*13.4*	*7.5*	*8.6*
PER (x)	16.5	10.7	10.4	22.8	14.7
P/BV (x)	5.0	3.7	2.8	2.7	2.4
EV/EBITDA (x)	9.4	7.1	7.0	11.1	9.1
Dividend yield (%)	1.6	1.0	1.8	2.4	2.8
RoCE (%)	*37.0*	*40.3*	*34.0*	*15.5*	*20.5*
RoE (%)	*35.7*	*38.0*	*32.1*	*12.1*	*17.2*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Segmental projections (consolidated)

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E
Power systems - domestic revenue	25,103	25,542	28,096	30,906
% growth	*12.9*	*1.7*	*10.0*	*10.0*
EBITDA	4,622	4,602	3,231	3,709
Operating margin (%)	*18.4*	*18.0*	*11.5*	*12.0*
Power systems - overseas subsidiaries revenue	36,942	39,486	45,409	49,950
% growth	*(6.5)*	*6.9*	*15.0*	*10.0*
EBITDA	3,072	3,467	454	1,498
Operating margin (%)	*8.3*	*8.8*	*1.0*	*3.0*
(A) Total Power systems revenue	62,045	65,028	73,505	80,856
% growth	*0.5*	*4.8*	*13.0*	*10.0*
EBITDA	7,694	8,069	3,685	5,207
Operating margin (%)	*12.4*	*12.4*	*5.0*	*6.4*
(B) Consumer products revenue	16,120	20,212	20,818	21,859
% growth	*21.9*	*25.4*	*3.0*	*5.0*
EBITDA	2,299	2,928	2,602	2,732
Operating margin (%)	*14.3*	*14.5*	*12.5*	*12.5*
(C) Industrial systems revenue	12,587	14,971	18,115	20,832
% growth	*9.5*	*18.9*	*21.0*	*15.0*
EBITDA	2,760	2,642	2,174	2,708
Operating margin (%)	*21.9*	*17.6*	*12.0*	*13.0*
Total revenue (A+B+C)	**90,752**	**100,211**	**112,438**	**123,547**
% growth	*5.0*	*10.4*	*12.2*	*9.9*
Total EBITDA	12,753	13,639	8,461	10,648
Operating margin (%)	*14.1*	*13.6*	*7.5*	*8.6*

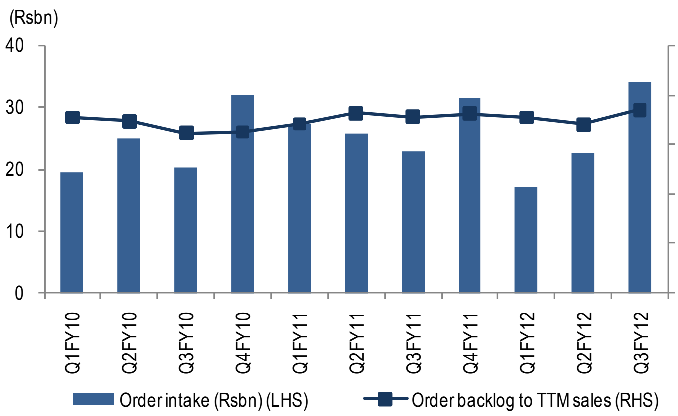
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Change in our earnings estimates

Y/E March	Old		New		*Variation (%)*	
(Rsmn)	FY12E	FY13E	FY12E	FY13E	*FY12E*	*FY13E*
Revenue	108,291	118,239	112,438	123,547	*3.8*	*4.5*
EBITDA	9,625	11,482	8,461	10,648	*(12.1)*	*(7.3)*
PAT	5,520	6,884	4,060	6,271	*(26.4)*	*(8.9)*
EPS(Rs)	8.6	10.7	6.3	9.8	*(26.7)*	*(8.4)*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Quarterly order intake, earnings visibility (consolidated)



Source: Company, Nirmal Bang Institutional Equities Research

Key highlights of 3QFY12 analyst meet:

- The management attributed the sharp fall in consolidated EBITDA to: (a) Aggressive order execution in some systems projects (worth euro 50mn) delivered at 0% margin because of cost escalation, thereby leading to 500bps rise in costs, and (b) Cost overrun in Europe leading to a 300bps rise in costs. However, the management was non-committal as to whether the operating margin will bounce back in 4QFY12 or FY13 to the 8-10% level, as per the guidance given during the 2QFY12 analyst meet.
- Translation gain led to revenue being higher by Rs1bn YoY and by Rs400mn QoQ in 3QFY12. As a result, 3QFY12 growth in consolidated revenue of 26.3% YoY would have been 22% YoY excluding the translation benefit. For the 9MFY12 period, translation gain led to Rs3.2bn higher revenue YoY.
- 3QFY12 order intake stood at Rs34bn, a rise of 66% YoY, comprising Rs29.4bn orders from the power systems segment and Rs462mn orders from the industrial systems segment. The geographical break-up of order intake was India (38%), Europe & Middle East (35%), Asia Pacific (15%) and America (12%).
- The guidance regarding tax rate given earlier of 15% for FY12 will not fructify as some research and development (R&D) outlay in the pipeline gets delayed. The tax rate for FY12 will be in line with the 9MFY12 period (34.4%).
- Emotron will witness goodwill write-off amounting to euro 1.0mn to 1.5 mn every quarter while QEI will see goodwill write-off amounting to US$350,000 every quarter. Crompton Greaves follows the policy of amortising goodwill over a period of 10 years.
- The company's aircraft has been sold at book value prevailing on the date of sale. Hence there will be no profit or loss on sale.
- Consolidated debt as of end 3QFY12 stood at Rs7bn. Inventory witnessed a sharp reduction from 84 days to 52 days QoQ because of liquidation of unsold inventory.
- Industrial orders were driven by HT (high tension) motors and variable speed drives.
- The company is setting up a new factory in Brazil for making disconnectors and medium voltage circuit-breakers. Its Indonesia factory will be expanded by introducing manufacturing capacity for 500KV transformers.
- Power Grid Corporation of India has confirmed orders for 17 765KV reactors in January 2012, which will be booked in 4QFY12.

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
27 January 2012	Sell	142	118
31 January 2012	Sell	134	118

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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Team Details:

Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	+91 22 3926 8098 / 99
Hemindra Hazari	Head of Research	hemindra.hazari@nirmalbang.com	+91 22 3926 8017 / 18
Sales and Dealing:			
Neha Grover	AVP Sales	neha.grover@nirmalbang.com	+91 22 3926 8093
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 3926 8230, +91 22 6636 8833
Sudhindar Rao	Dealing Desk	sudhindar.rao@nirmalbang.com	+91 22 3926 8229, +91 22 6636 8832
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 3926 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 3926 8102/8103, +91 22 6636 8830

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address
B-2, 301/302, Marathon Innova,
Nr. Peninsula Corporate Park
Lower Parel (W), Mumbai-400013.
Board No. : 91 22 3926 8000/1
Fax. : 022 3926 8010