16 November 2012

MOTILAL OSWAL

the Corner Office

Interaction with the CEO

Too big to be small, too small to be big

Focused strategies to drive growth

- **"Too big to be small, too small to be big". These innocuous lines sums up the current transition pangs at Crompton Greaves (CG). Earnest efforts are being made to make a transition from being an 'Indian corporation with an international business' to a 'Global corporation'.**
- **In the power business, while ongoing restructuring shall correct the cost structure and bring synergy benefits, the attempt in industrial business is for internationalization and integration of drives with motors, and in the consumer business the attempt is for a complete rejuvenation. The road ahead is challenging or as the management stated: the next two quarters will be bumpy.**
- **In our view, the stock's performance would largely be driven by an improvement in overseas business, though standalone performance would protect downsides. We maintain Buy, with a target price of INR131.**

Crompton Greaves

Mr Laurent Demortier
CEO and Managing Director

Mr Demortier holds an MBA from Wharton School of the University of Pennsylvania, USA and a Masters Engineering Degree in Physics from Ecole Centrale Marseille, France. Prior to joining CG, he was Senior Vice-President, Alstom Power Sector, in-charge of Power Automation and Control Business.

Belgium operations to maintain revenues, post restructuring: Power transformers capacity to be curtailed from 12,500MVA to 5,000MVA eventually. However, the actual production over the past few years was 8,000-8,500MVA and thus Phase I attempts to right-size the capacity and associated infrastructure; going forward, there is flexibility to further downsize to 5,000MVA. Apart from power transformers, Belgium facilities include distribution transformers, system business (for wind offshore), service revenues, repairs facility (transformers) and the global headquarters with functions like warehousing, logistics, purchases, marketing etc. Hence, the restructuring shall ensure that the revenue potential from Belgium would not decline meaningfully from ~INR20b levels in FY12, as the attempt initially is to right-size capacity in power transformers, and also rationalize the business functions.

Normalization of operations in Hungary and Canada/US: Hungary operations, from a net loss of INR630m in FY12, are expected to be profitable in 3Q/4QFY13 as capacity utilization has increased (v/s 40% in FY12). However, given the risk of possible delivery delays during the transition period (31 projects transferred from Belgium), there could be liquidated damages. These delays could impact revenue recognition in the interim period and also impact CG's systems business as several related orders have been transferred to Hungary.

Consumer business' rejuvenation, a focused strategy: Consumer business' contribution to standalone EBIT improved from 25% in 1QFY11 to 35% currently, and the management stated that the key growth drivers are: lighting and fans. Boston Consulting Group has been engaged to suggest the rejuvenation plan and the key elements are: i) capacity expansion (Vadodara for lighting products, etc), ii) channel management program is being carried out and the target is to increase the penetration, for example in fans, from 40% to 60-70% which will drive a meaningful increase in market share, iii) Chinese sourcing footprint being established and iv) appliances strategy is being reworked as, excluding geysers, CG's presence continues to be limited.

Crompton Greaves: Financial and valuation summary

Bloomberg	CRG IN
CMP (INR)	111
Equity Shares (m)	641.5
52-Week Range (INR)	167/102
1,6,12 Rel. Perf. (%)	-16/-17/-26
M.Cap. (INR b)	71.2
M.Cap. (USD b)	1.3

Year End	Net Sales (INR m)	PAT* (INR m)	EPS* (INR)	EPS* Gr. (%)	P/E (X)	P/BV (X)	RoE (%)	RoCE (%)	EV/ Sales	EV/ EBITDA
3/11A	100,051	9,268	14.3	12.4	-	-	30.5	28.1	-	-
3/12A	112,486	3,733	5.7	-59.7	19.4	2.0	10.7	9.6	0.9	13.3
3/13E	119,899	2,214	3.3	-40.7	33.8	2.0	5.9	5.1	0.7	12.6
3/14E	129,466	5,829	9.1	163.3	12.4	1.8	14.9	11.6	0.6	7.6

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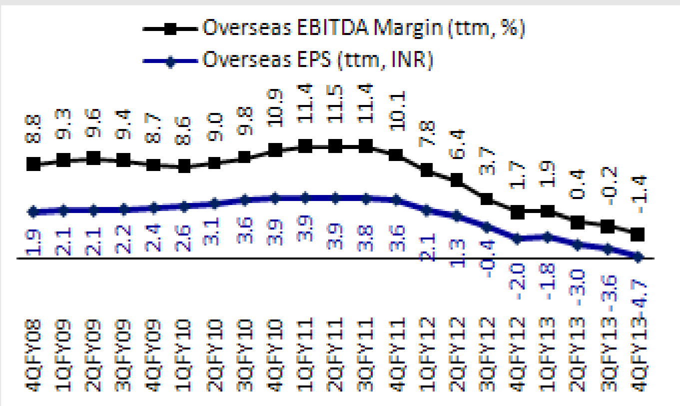
Belgium operations to maintain revenues, post restructuring

CG is currently restructuring operations in its Belgium factory. Company announced plans to reduce the workforce by 38% (240 employees) and increasing the capacity in Hungary (a low cost country).

- Belgium facilities include power transformers, distribution transformers, system business (for wind offshore), service revenues, repairs facility (transformers) and also the global headquarters, with functions like warehousing, logistics, purchases, marketing etc. The ongoing restructuring entails a combination of blue and white collar employees in the ratio of ~47:53. Thus, apart from power transformers, the restructuring also entails key business functions to reduce overhead costs.
- In terms of capacity rationalization, power transformers shall witness a reduction from 12,500MVA to 5,000MVA eventually. However, actual production over the past few years has been ~8,000-8,500MVA and thus Phase I attempts to right-size capacity and the associated infrastructure. Going forward, there is flexibility to further downsize to 5,000MVA and the Belgium plant would focus on very large transformers.
- Hence, the restructuring shall ensure that the revenue potential from Belgium does not decline from ~INR20b levels in FY12.

Overseas subsidiaries: EBIDTA margins (ttm, %) and EPS (INR/sh)



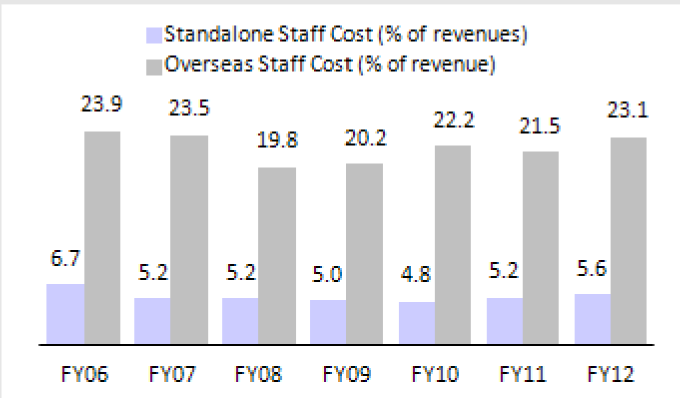
Key subsidiaries reported large losses in FY12 (INR M)

		Revenues			PBT	
	% Share	FY12	FY11	%YoY	FY12	FY11
Belgium	36	20,202	20,259	(0.3)	(420)	1,493
USA	24	13,512	8,216	64.5	110	432
Ireland	9	5,070	4,577	10.8	233	411
Indonesia	9	4,807	3,818	25.9	657	902
Hungary	9	4,794	6,007	(20.2)	(632)	840
Canada	6	3,228	4,384	(26.4)	(387)	662
Others	8	4,670	2,294	103.6	1,064	493
	100	**56,284**	**49,555**	**13.6**	**626**	**5,234**

Source: Company, MOSL

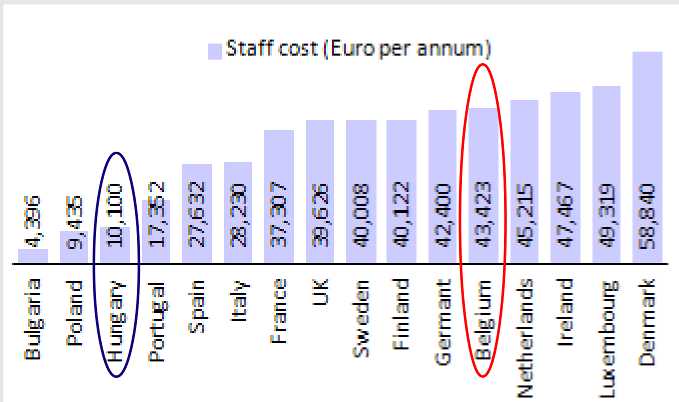
Management expects Belgium operations' restructuring to be completed by end-3QFY13. Staff costs account for ~23% of revenues in the overseas markets. As the cost differential between Belgium and Hungary is ~350%, potential savings from Belgium operations' restructuring could be significant.

Staff cost differential meaningful between standalone and subsidiaries (% of revenues)



Source: Company, MOSL

Staff cost differential between Belgium / Hungary stands at ~350%



Source: Eurostat

Normalization of operations in Hungary and Canada/US

- We note that Hungary operations, from a net loss of INR630m in FY12, are expected to be profitable in 3Q/4QFY13, as capacity utilization has increased (v/s 40% in FY12). We believe this could further improve to 85-90% by end-4QFY13 due to increased customer acceptance. Around 31 projects have been transferred from Belgium to Hungary and are largely from Middle East/systems business of CG, which shall lead to improved utilization levels. Given the possibilities of delivery delays, there could be liquidated damages (LDs capped at 15% of project value). Also, these could impact revenue recognition in the interim period and from the systems business as several of the related orders have been transferred to Hungary. Inventory has increased by ~INR3b in Hungary as most of the orders transferred from Belgium are in WIP status.
- CG's factories in the US were impacted due to stabilization issues/inventory build-up/product development costs and have possibly stabilized. Profitability from these operations could improve, going forward.
- Canadian operations are expected to take time to stabilize. A new management team was named ~6 months ago to reduce the overheads.
- Progress in terms of lean manufacturing initiatives continues to be strong.

Expanding footprint in automation

CG has made 3 acquisitions so far which gives it access to various parts of the automation business in specific segments. The key missing gap was the HV automation products, which was bridged with the recent acquisition of ZIV. CG already has a sales force of 647 employees, which will also market the grid automation offerings of ZIV. Based on this synergy being captured over time, the 3-year revenue target from ZIV is EUR200m (v/s EUR75m TTM ending June 2012).

Acquisitions in Automation segment

Company	Acquisition Date	Location	Cost (EV)	Revenues	Segments
Microsol	May-07	Ireland	EUR10.5m	EUR6m	Automation products and systems for sub-stations
QEI	May-11	USA	USD30m	EUR12m	Automation for Electric utilities and Electrified Transit (Railways)
ZIV	Jul-12	Spain	EUR150m	EUR75m	Grid Automation, Metering, Smart Grids

Source: Company

Rejuvenation of consumer business

In the consumer segment, CG is the market leader in fans (24% market share) and pumps (~20% market share) and is No. 2 in the lighting segment (~13-14% market share). Consumer business' contribution to standalone EBIT improved from 25% in 1QFY11 to 35% currently and we expect further improvement. Management stated that the highways to growth are lighting and fans. Boston Consulting Group has been engaged to contribute to the rejuvenation plan.

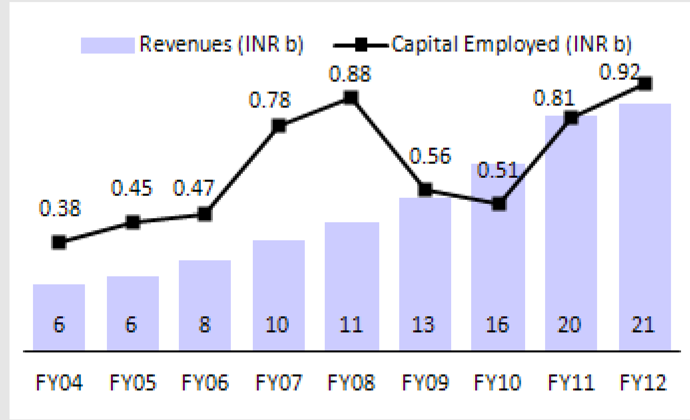
Key elements are:

- Capacity is being expanded in India (investing in a new capacity in Vadodara for lighting products, including LED). This, coupled with new product introductions, shall drive lighting business' robust growth.
- Channel management program being carried out and the plan is to increase the reach, for example fans, from 40% to 60-70%. Also, as a part of the channel

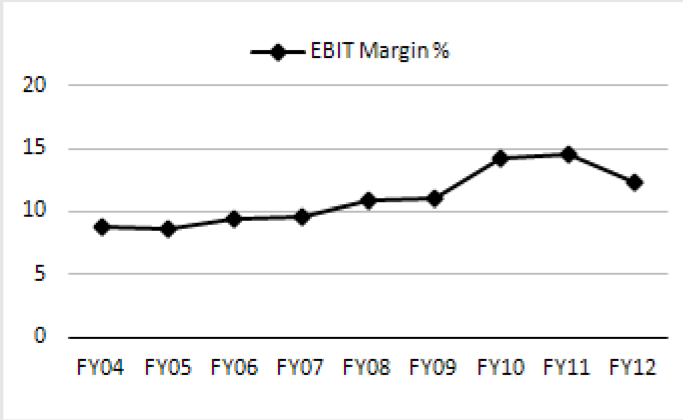
management, focus is on reorganization towards 'single channel - distributors' v/s 'multiple channel' in the past. These initiatives, coupled with premium product launches etc, are expected to drive a significant increase in fans business' market share.

- Chinese sourcing footprint being established.
- Appliances strategy is being reworked as, excluding geysers, CG's presence continues to be limited.

Consumer business: Negligible working capital funds supporting growth in other businesses

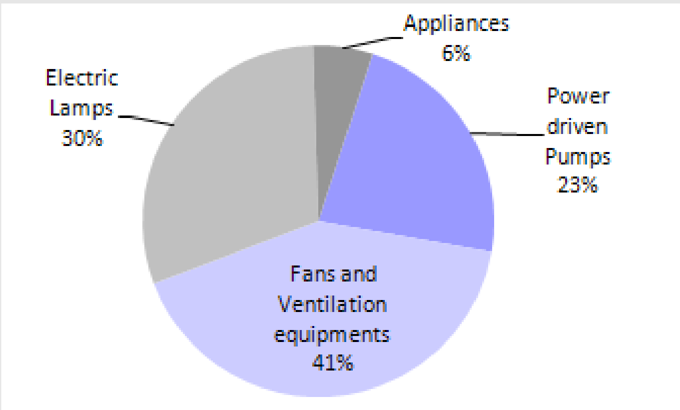


EBIT margins have been largely in a range (%)

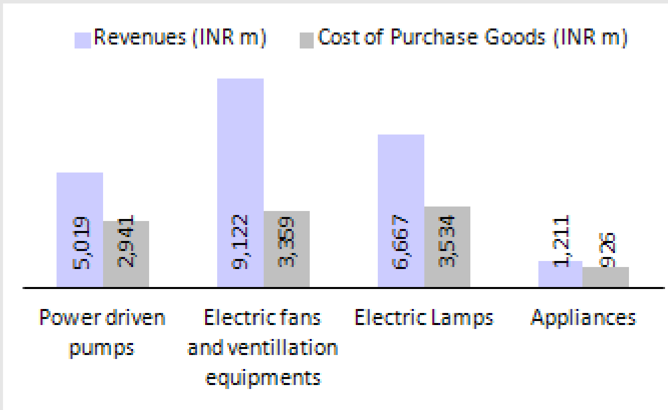


Source: Company, MOSL

Consumer Business: Sales composition (FY12)



Large parts of product portfolio is outsourced



Source: Company/MOSL

Income Statement

(INR Million)

Y/E March	2009	2010	2011	2012	2013E	2014E
Net Sales	**87,373**	**91,409**	**100,051**	**112,486**	**119,899**	**129,466**
Change (%)	27.9	4.6	9.5	12.4	6.6	8.0
Raw Materials	56,938	57,966	64,980	76,850	81,052	84,672
Staff Cost	10,646	11,131	11,811	14,662	17,573	17,520
Other Mfg. Expenses	9,833	9,542	9,822	12,937	14,944	17,244
EBITDA	**9,956**	**12,770**	**13,438**	**8,036**	**6,329**	**10,031**
% of Net Sales	11.4	14.0	13.4	7.1	5.3	7.7
Depreciation	1,216	1,551	1,936	2,603	2,216	2,374
Interest	808	428	352	463	755	807
Other Income	740	1,100	1,142	524	711	748
EO Items (as rep.)	0	352	-381	0	0	0
PBT	**8,672**	**12,243**	**11,910**	**5,494**	**4,069**	**7,598**
Tax	3,047	3,650	3,100	1,821	1,924	1,836
Rate (%)	35.1	29.8	26.0	33.1	47.3	24.2
Reported PAT	**5,625**	**8,593**	**8,810**	**3,673**	**2,145**	**5,762**
Extra-ordinary Inc.(net)	0	352	-381	0	0	0
Adjusted PAT	**5,625**	**8,241**	**9,191**	**3,673**	**2,145**	**5,762**
Minority Int	-26.0	6.0	76.5	60.0	69.0	67.0
Consolidated PAT	**5,599**	**8,247**	**9,268**	**3,733**	**2,214**	**5,829**
Change (%)	37.7	47.3	12.4	-59.7	-40.7	163.3

Balance Sheet

(INR Million)

Y/E March	2009	2010	2011	2012	2013E	2014E
Share Capital	733	1,283	1,283	1,283	1,283	1,283
Reserves	17,577	23,760	31,464	34,826	35,662	39,230
Net Worth	**18,311**	**25,043**	**32,747**	**36,109**	**36,945**	**40,513**
Loans	7,182	5,010	3,955	9,849	16,804	16,652
Deffered Tax Liability	-482	49	160	-122	-557	-529
Minority Interest	139	43	157	157	157	157
Capital Employed	**25,149**	**30,145**	**37,019**	**45,992**	**53,348**	**56,793**
Gross Fixed Assets	30,289	29,858	37,805	44,477	58,273	61,047
Less: Depreciation	17,040	17,234	19,490	23,005	25,674	27,544
Net Fixed Assets	**13,248**	**12,623**	**18,315**	**21,473**	**32,598**	**33,504**
Capital WIP	537	1,137	1,102	1,097	418	409
Investments	1,672	5,536	6,747	7,864	6,511	8,321
Curr. Assets	**39,452**	**41,018**	**45,646**	**55,343**	**55,503**	**57,161**
Inventory	10,949	10,412	11,893	12,233	16,064	14,313
Debtors	20,556	21,463	25,427	31,432	31,169	32,612
Cash & Bank Balance	5,656	6,688	2,984	4,976	3,038	4,577
Loans & Advances	2,290	2,455	5,342	6,703	5,232	5,659
Current Liab. & Prov.	**29,760**	**30,170**	**34,786**	**40,181**	**41,683**	**42,601**
Creditors	15,884	16,098	18,585	21,076	22,083	21,979
Other Liabilities	10,138	10,469	12,148	15,318	15,812	16,732
Provisions	3,739	3,603	4,054	3,787	3,788	3,890
Net Current Assets	**9,692**	**10,849**	**10,860**	**15,162**	**13,820**	**14,560**
Application of Funds	**25,149**	**30,145**	**37,024**	**45,992**	**53,348**	**56,793**

E: MOSL Estimates; Consolidated Financials

Ratios

Y/E March	2009	2010	2011	2012	2013E	2014E
Basic (INR)						
Consolidated EPS	**8.8**	**12.8**	**14.3**	**5.7**	**3.3**	**9.1**
Growth (%)	37.3	46.5	11.5	-60.0	-41.6	171.7
Cash EPS	18.7	15.3	17.3	9.8	6.8	12.7
Book Value	28.5	39.0	51.0	56.3	57.6	63.2
DPS	1.1	1.3	2.2	1.4	1.8	2.0
Payout (incl. Div. Tax.)	21.6	15.3	23.7	20.7	25.0	25.0
Valuation (x)						
P/E (standalone)				21.7	13.8	12.3
P/E (consolidated)				19.4	33.8	12.4
Cash P/E				11.3	16.6	8.9
EV/EBITDA				13.3	12.6	7.6
EV/Sales				0.9	0.7	0.6
Price/Book Value				2.0	2.0	1.8
Dividend Yield (%)				1.3	1.5	1.7
Profitability Ratios (%)						
RoE	35.9	39.6	30.5	10.7	5.9	14.9
RoCE	26.7	30.9	28.1	9.6	5.1	11.6
Turnover Ratios						
Debtors (Days)	46	42	43	40	49	40
Inventory (Days)	46	42	43	40	49	40
Creditors. (Days)	66	64	68	68	67	62
Asset Turnover (x)	3.5	3.0	2.7	2.4	2.2	2.3
Leverage Ratio						
Debt/Equity (x)	0	0	-0.1	0.0	0.3	0.2

Cash Flow Statement (INR Million)

Y/E March	2009	2010	2011	2012	2013E	2014E
PBT before EO Items	8,672	11,891	12,291	5,494	4,069	7,598
Add : Depreciation	1,216	1,551	1,936	2,603	2,216	2,374
Interest	808	428	352	463	755	807
Less : Direct Taxes Paid	3,047	3,650	3,100	2,494	1,969	1,807
(Inc)/Dec in WC	1,113	-125	-3,715	-2,311	-596	800
CF from Operations	**8,762**	**10,094**	**7,765**	**3,756**	**4,475**	**9,771**
CF from Oper. incl. EO Items	8,762	10,446	7,384	3,756	4,475	9,771
(Inc)/Dec in FA	-2,557	-1,526	-7,593	-5,756	-12,662	-3,270
(Pur)/Sale of Investments	-245	-2,210	-190	-53	0	0
CF from Investments	**-3,295**	**-5,389**	**-8,805**	**-6,873**	**-11,309**	**-5,080**
(Inc)/Dec in Net Worth	525	-917	538	390	5	-717
(Inc)/Dec in Debt	-1,238	-2,173	-1,055	5,894	6,955	-151
Less : Interest Paid	808	428	352	463	755	807
Dividend Paid	858	944	1,644	1,044	1,314	1,478
CF from Fin. Activity	**-2,378**	**-4,461**	**-2,513**	**4,777**	**4,891**	**-3,152**
Inc/Dec of Cash	3,212	1,032	-3,709	1,851	-1,944	1,539
Add: Beginning Balance	2,445	5,656	6,688	2,984	4,976	3,038
Closing Balance	**5,656**	**6,688**	**2,984**	**4,976**	**3,037**	**4,577**

E: MOSL Estimates

N O T E S

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