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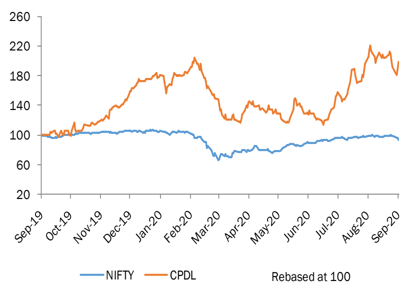
Creative Peripherals and Distribution Limited

29 September 2020

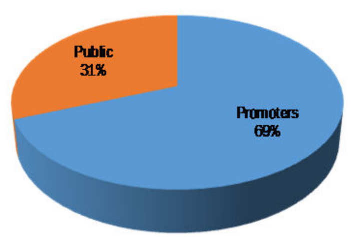
A promising portfolio of niche businesses with distribution expertise — BUY

Sector	: Consumer Goods
Target Price	: Rs 177
Current Market Price	: Rs 119
Market Cap	: Rs 138 crore
52-week High/Low	: Rs 138/58
Daily Avg Vol (12M)	: 11,124
Face Value	: Rs 10
Beta	: 0.53
Pledged Shares	: 0%
Year End	: March
BSE Scrip Code	: N/A
NSE Scrip Code	: CREATIVE
Bloomberg Code	: CREATIVE IN
Reuters Code	: CREA.NS
Nifty	: 11,228
BSE Sensex	: 37,982
Analyst	: Research Team

Price Performance



Shareholding Pattern



Initiating Coverage

Investment Summary

- Creative Peripherals and Distribution Limited (CPDL) is a specialist distributor of consumer electronic and lifestyle products with a portfolio of 3,000 SKUs and 5,000 partners.
- CPDL has carved out a niche for itself in the consumer electronics distribution space as a market entry specialist for global niche brands.
- CPDL designs and manufactures consumer and enterprise electronic products under licence from Honeywell. The licensed manufacturing business is poised to grow with potential for further partnerships.
- CPDL's B2B e-commerce platform Ckart, a first-of-its-kind in India, enables its existing and new customers to "transact, discover and share" with other customers digitally. Besides the promise of becoming a key growth driver, Ckart will enable CPDL to reduce its inventory and debtor days by facilitating direct transactions between users.
- CPDL's asset-light model and digital focus will generate operating leverage and improve working capital cycle.
- Expansion into international markets through tie-ups is a credible strategy that de-risks business model and presents bright prospects.
- We expect relatively muted sales growth in FY21 as a fallout of the COVID-19 pandemic. Growth is seen to accelerate from FY22 onwards as the global economy recovers. CPDL's management has set a goal to reach Rs 1,000 crore in revenues by FY23 with a half of it seen come from the licensed manufacturing business. EBITDA margin expansion led by improved product mix, increase in licensed manufacturing, and scale-up of the platform business (Ckart), and improvements in the working capital cycle will positively impact cash flow generation and drive return ratios. The CPDL stock currently trades at an attractive forward P/E level of 7.4x FY22E EPS. Valuing at 11.0x FY22E EPS of Rs 16.12, our target price of Rs 177 informs a BUY rating with an upside potential of 49%.

Key Financial Metrics

Rs lakh	FY18A	FY19A	FY20A	FY21E	FY22E
Operating revenue	24,983	36,765	45,772	50,216	64,728
Growth		*47.2%*	*24.5%*	*9.7%*	*28.9%*
EBITDA	639	1,026	1,548	1,908	2,719
EBITDA margin	*2.6%*	*2.8%*	*3.4%*	*3.8%*	*4.2%*
PAT	289	585	778	1,148	1,870
PAT margin	*1.2%*	*1.6%*	*1.7%*	*2.3%*	*2.9%*
Diluted EPS (Rs)	2.51	5.01	6.78	9.89	16.12

Note: Consolidated from FY20 onwards
Source: Company data; Khambatta Research

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CPDL is a marketer and distributor of consumer electronics, ICT and lifestyle products

Company Profile

Established in 1992, Creative Peripherals and Distribution Limited (CPDL) is engaged in marketing and distribution of consumer electronics, ICT and lifestyle products. The company has an omnichannel presence across online, offline and retail trade.

CPDL specialises in market entry and penetration strategies for global brands, especially in niche spaces. The company offers demographic intelligence and enables the formulation and execution of marketing strategies for its clients. CPDL focuses on timely delivery, diversification of its product portfolio, long-term relationships with channel partners, and extending value-added services over and above distribution.

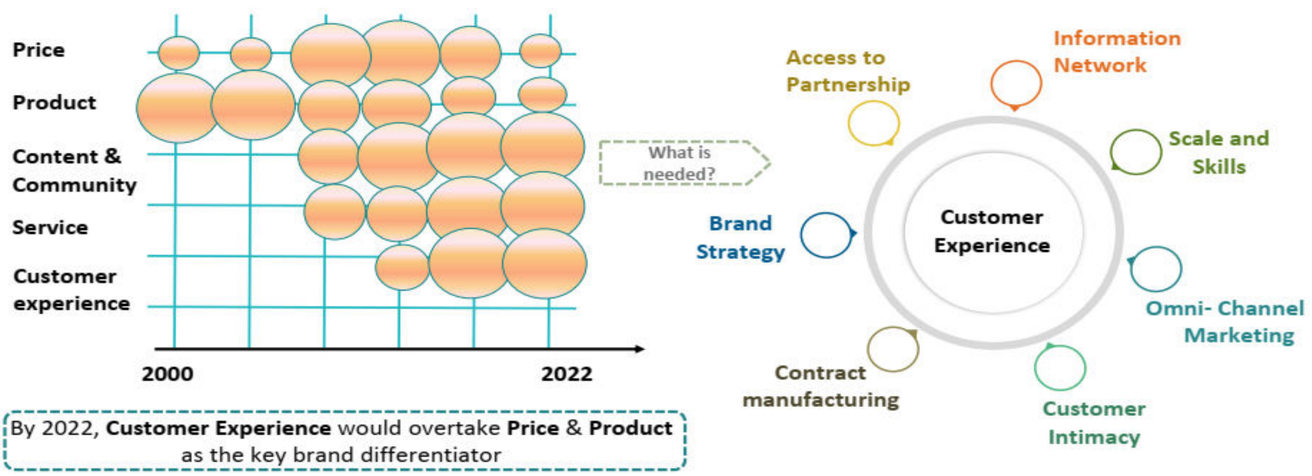
Creative Peripherals' business model revolves around a three-pillar strategy.

Market entry and penetration for niche brands: CPDL has a portfolio of more than 20 brands which are market leaders in their categories. The company's strategy involves regularly refreshing its brand/product portfolio with niche high-margin products that are relevant to current market trends and have a strong scope for market expansion.

Brand licensing: CPDL designs and distributes a wide range of consumer and enterprise products under licence from Honeywell with the production outsourced to contract manufacturers. The company has a geographical reach in 29 countries across APAC and the Middle East.

Ckart B2B e-commerce platform: CPDL's latest venture is the B2B e-commerce platform, Ckart. Ckart hosts the company's client-base online and enables customers to "transact, discover and share" products/requirements between one another. The platform hosts a "virtual warehouse" with an inventory of products that may not be a part of CPDL's portfolio, thereby expanding the company's portfolio.

CPDL's strategy of driving digital transformation



Source: Company data

Peer Comparison

While Redington and Compuage are CPDL's peers in physical distribution, IndiaMART is a competitor in the e-commerce space

CPDL does not have any identical peer, especially in India. In the physical distribution business its peers include Redington (India) and Compuage Infocom while IndiaMART and Udaan operate in the B2B e-commerce space. We have not considered Udaan in our peer group analysis as it is a privately-held company.

Redington (India): A distribution and supply chain solutions provider, Redington is India's second largest distributor of IT products. The company, along with its subsidiaries, distributes products from over 220 OEMs through 39,800 channel partners in India.

Compuage Infocom: Compuage is a leading IT and mobility distribution company with 46 offices and 69 service centres across India and relationship with more than 12,500 online and offline retailers, resellers and system integrators. The company has footprints in 7 SAARC countries, focusing on enterprise solutions, cloud computing, PC & components, and mobility.

IndiaMART InterMESH: IndiaMART is India's largest online B2B marketplace, with 60% market share of the online B2B classified space in India. One the earliest e-commerce companies of India, the company deals in approximately 97,000 product categories.

Peer Comparison: Key Financials Metrics, FY20

Rs crore	CPDL	Redington	Compuage	IndiaMART
Revenue	457.7	51,465.2	4,232.5	638.9
EBITDA	15.5	1,022.8	94.6	168.9
EBITDA margin	*3.4%*	*2.0%*	*2.2%*	*26.4%*
PAT	7.8	515.2	30.5	147.4
PAT margin	*1.7%*	*1.0%*	*0.7%*	*23.1%*
Diluted EPS (Rs)	6.78	13.24	4.70	50.24
ROCE	27.8%	17.0%	35.0%	N/A
ROE	18.9%	12.5%	16.1%	N/A

Source: Company data; Bloomberg; Khambatta Research

Investment Thesis

CPDL has distribution rights of 23 global brands for the Indian market

A specialist distributor of consumer electronic and lifestyle products, CPDL has a portfolio of 3,000 SKUs and 5,000 partners. CPDL has distribution rights of 23 global brands (most of them exclusive) for the Indian market with a majority of them being niche products as opposed to mass consumer products. CPDL has a repertoire of over 3,000 SKUs, which it distributes through 5,000 sub-distributors and retailers across India. The company also sells its products through online marketplaces such as Amazon and Flipkart, thereby pursuing an omnichannel approach. CPDL also helps brands in implementing go-to-market strategies and carrying out brand engagement and marketing campaigns, with the company having executed over 100 marketing events successfully. The company's core business strategy is based on digital transformation with "customer experience" as a key brand differentiator.

CPDL's brand portfolio: Some leading brands

Source: Company data

CPDL's target audience includes professionals, millennials and gaming enthusiasts for many of its products

CPDL positions itself as a market entry specialist for niche global brands. CPDL has carved out a niche for itself in the consumer electronics distribution space as a market entry specialist for niche products and brands. The company targets professionals, millennials and gaming enthusiasts for many of its products such as cameras and high-performance gaming hardware. For instance, in the imaging market, a key product category for CPDL, the company focuses on action cameras with brands like GoPro as opposed to mass market digicams and DSLRs. Likewise, ViewSonic is another key brand in its portfolio where the company focuses on high-end projectors and monitors. Other niche brands in the company's portfolio include Cooler Master, a provider of PC cooling and casing solutions, and BaByliss, a premium personal grooming brand. For GoPro, CPDL undertakes a gamut of marketing activities and training such as participation in festivals and sporting events like Harley Davidson H.O.G. events where such products can be marketed to an audience with common interests.

CPDL's top imaging brands

CPDL's top lifestyle and security brands

Source: Company data

Licensed manufacturing business is poised to grow with potential for further partnerships. CPDL designs and manufactures electronic/electrical products under licence from Honeywell (primarily for the consumer market which Honeywell does not cater to directly). These products are contract-manufactured from Honeywell-certified factories with currently CPDL outsourcing the manufacturing from 4 factories located in Taiwan, China and India while it is in the process of contracting a new facility in Vietnam. CPDL has distribution rights for Honeywell-branded products in India and 29 countries in the Middle East and APAC regions. The product portfolio ranges from networking solutions for consumers to structured cabling solutions for enterprises and includes a range of chargers, cables, surge suppressors and copper cables amongst others. CPDL has a five-year agreement with Honeywell, which was recently renewed in 2020. The company looks to expand this line of business under the Honeywell licence as well as through new partnerships. By 2023, CPDL targets to generate 50% (~ Rs 500 crore) of its revenue from licensed manufacturing with Honeywell accounting for a majority of licence revenues (~Rs 300-400 crore). The licensing business has a strong growth potential with an ability to boost CPDL's overall profitability as it offers around 40% gross margin.

CPDL has distribution rights for Honeywell-branded products in India and 29 countries in the Middle East and APAC

Ckart is a first-of-its-kind B2B e-commerce platform to launch in India. Ckart is a B2B e-commerce platform launched by CPDL that enables its existing and new customers to "transact, discover and share" with other customers digitally, and is positioned as a one-stop-shop for all product and service requirements of CPDL's customers. The platform is an online marketplace for businesses to view products, interact and transact online. While there are other e-commerce platforms operating in the Indian B2B space such as IndiaMart and Udaan (funded by Tencent, Altimeter Capital, Hillhouse Capital, GGV Capital, Footpath Ventures and Citi Ventures), Ckart is unique as it differentiates itself from the others by offering customers the option to have their own e-commerce portal. Value added services such as drop-shipment and invoicing make Ckart an attractive proposition for all players in the supply chain. The platform's technology renders it the capability to scale up as the business and traffic grow. Unlike a subscription-based model, CPDL will have a higher degree of control over content and activity hosted on the platform. By facilitating direct transactions between users (on which CPDL will be earning a commission), Ckart will enable CPDL to reduce its inventory and debtor days. Ckart's technology platform has been developed by CPDL's in-house team and is integrated with the company's existing ERP system. As a result, the customer base, along with branch and inventory data, in the ERP is seamlessly synced with the platform. Due to the in-house development, the entire system was built cost-efficiently. CPDL expects Ckart to clock a revenue run-rate of Rs 10 crore per month as the company looks to double its customer base through Ckart without additional manpower costs.

Ckart differentiates itself from peers by offering customers the option to have their own e-commerce portal and other value added services

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CPDL's asset-light model and digital focus will generate operating leverage and improve working capital cycle. CPDL plans to remain asset-light and grow by leveraging its physical as well as digital assets. The company looks to leverage its well-spread-out physical distribution network for market entry and penetration of niche brands while its licensed manufacturing expertise, knowhow and product designs will fetch increasing economies of scale as more product lines and geographies are added. On the other hand, Ckart (CPDL's digital asset) is a scalable model with the potential of growing the user base rapidly. The technology backend of the platform allows addition of functionalities as requirement/demand grows. Ckart has the capability to link with large format retailers (LFRs) through APIs to enable catalogue sales, which the company's management sees as a potential future opportunity. CPDL expects Ckart to improve its operating efficiency and working capital cycle by easing up pressure on inventory and debtors, and consequently boost operating cash flow.

CPDL expects Ckart to its boost operating cash flow by improving the working capital cycle

Expansion into international markets through tie-ups is a credible strategy that de-risks and presents bright prospects. CPDL has been expanding into international markets over the last few years. The company has subsidiaries in Hong Kong to oversee international operations. CPDL has primarily structured its international business based on collaboration with existing players in the value chain having experience in those markets (like distribution partnerships) or expertise in processes (like outsourcing of manufacturing). The company works with other distributors such as Redington in various international markets to penetrate them effectively. As the licensing business grows, CPDL will look to enter in partnerships with other OEMs in the consumer electronics space such as Philips and Nokia under the licensed manufacturing model. Exposure to foreign markets will also reduce risks arising from dependence on the domestic market.

CPDL works with other distributors such as Redington in various international markets to penetrate them effectively

Private labels have the potential to emerge as an important segment in the future. CPDL recently launched a range of private-label personal healthcare products such as thermometers, thermal scanners, pulse oximeters and masks under its own brand, B-Safe. The company is also working on new products such as robotic vacuum cleaners under its own brand as well as in collaboration with Lenovo. Leveraging its expertise and experience in licensed manufacturing, CPDL has the ability to drive the private label business to develop it into an important business segment in the future.

Valuation

At 11.0x FY22E EPS of Rs 16.12, we rate CPDL a BUY with a target price of Rs 177 and an upside potential of 49%. We expect relatively muted sales growth in FY21 as a fallout of the COVID-19 pandemic. Growth is seen to accelerate from FY22 onwards as the global economy recovers and demand picks up. CPDL's management has set a goal to reach Rs 1,000 crore in revenues by FY23 with a half of it seen come from the licensed manufacturing business. However, in this report we are considering forecasts to FY22 to value CPDL. We have modelled EBITDA margin expansion led by

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improved product mix, increase in licensed manufacturing, and scale-up of the platform business (Ckart). This, coupled with improvements in the working capital cycle, will positively impact cash flow generation and drive return ratios. The company's recently-acquired rights to distribute Honeywell-branded products in Southeast Asia is not factored into our projections, which presents an upside potential to our forecast. With robust cash flows, dependence working capital loans will reduce, leading to a decline in the debt (total)-to-equity ratio. Basis the robust earnings growth forecast, the CPDL stock currently trades at an attractive forward P/E level of 7.4x FY22E EPS. Valuing at 11.0x FY22E EPS of Rs 16.12, our target price of Rs 177 informs a BUY rating with an upside potential of 49%.

At current price the CPDL stock trades at an attractive forward P/E of 7.4x FY22E EPS

Profit & Loss Account

Rs lakh	FY18A	FY19A	FY20A	FY21E	FY22E
Revenue from operations	**24,983**	**36,765**	**45,772**	**50,216**	**64,728**
Growth		*47.2%*	*24.5%*	*9.7%*	*28.9%*
Cost of sales and operations	24,345	35,740	44,224	48,307	62,009
EBITDA	**639**	**1,026**	**1,548**	**1,908**	**2,719**
EBITDA margin	*2.6%*	*2.8%*	*3.4%*	*3.8%*	*4.2%*
Depreciation & amortization	14	53	86	60	55
PBIT	737	1,279	1,596	2,048	2,914
Interest expense	302	452	480	518	420
PBT	434	827	1,116	1,530	2,494
Tax expense	146	243	339	383	623
PAT	**289**	**585**	**778**	**1,148**	**1,870**
PAT margin	*1.2%*	*1.6%*	*1.7%*	*2.3%*	*2.9%*
Diluted EPS (Rs)	**2.51**	**5.01**	**6.78**	**9.89**	**16.12**

Source: Company data; Khambatta Research

Abridged Balance Sheet

Rs lakh	FY18A	FY19A	FY20A	FY21E	FY22E
Total shareholders' equity	2,761	3,331	4,124	5,360	7,230
Total debt	2,524	3,590	3,188	4,107	3,207
Trade payables	3,423	2,659	2,930	3,727	4,959
Total equity & liabilities	**10,027**	**11,852**	**15,488**	**16,221**	**19,304**
Property, plant & equipment	765	893	889	829	774
Inventory	2,792	2,779	6,029	5,218	5,758
Trade receivables	4,285	4,405	3,858	5,503	6,384
Cash and bank balance	224	359	389	807	2,667
Total assets	**10,027**	**11,852**	**15,488**	**16,221**	**19,304**

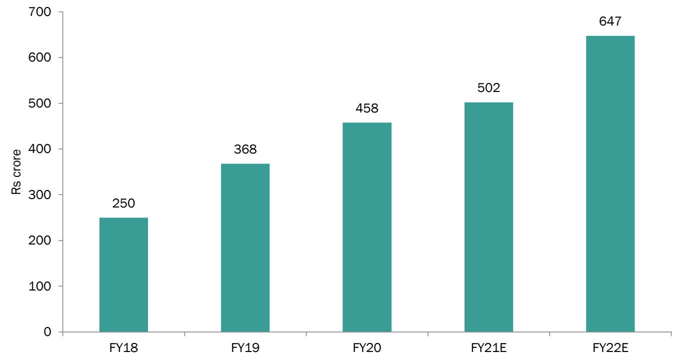
Source: Company data; Khambatta Research

Ratio Analysis

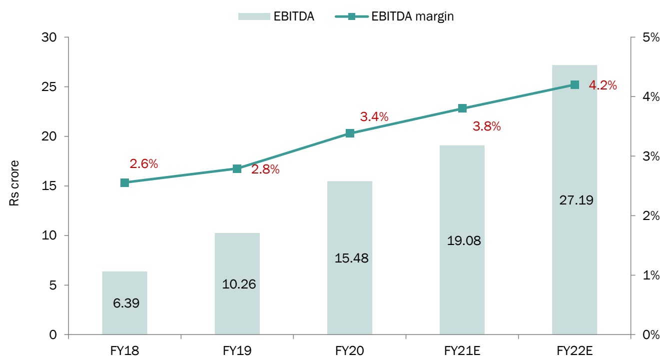
	FY18A	FY19A	FY20A	FY21E	FY22E
ROA	2.9%	4.9%	5.0%	7.1%	9.7%
ROCE	26.2%	31.9%	27.8%	35.0%	38.7%
ROE	10.5%	17.6%	18.9%	21.4%	25.9%
Debt-to-equity ratio	0.9x	1.1x	0.8x	0.8x	0.4x

Source: Company data; Khambatta Research

Total revenue

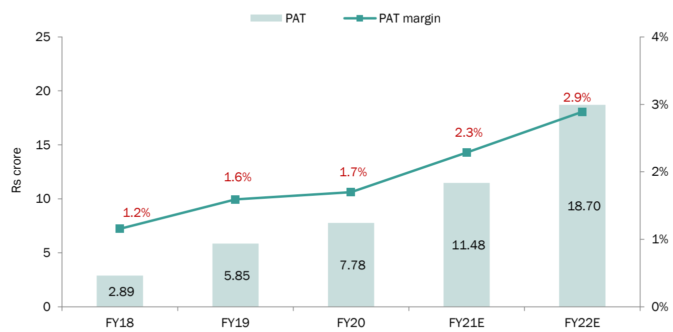


Operating profitability

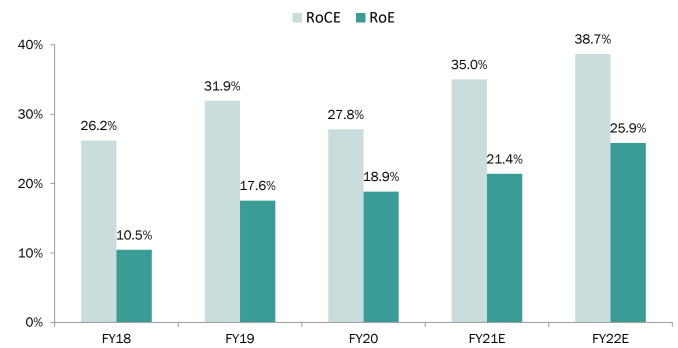


Source: Company data; Khambatta Research

PAT & PAT margin



Return ratios



Source: Company data; Khambatta Research

Note: CPDL started reporting consolidated financials from FY20. FY19 standalone and consolidated financial statements are identical while only standalone financial statements were reported in FY18.

Key Risks

- Discontinuation of exclusivity agreement or of relationship by any of the major brands in CPDL's portfolio will negatively impact revenues and earnings.
- Our forecasts are significantly driven by expectations of expansion of the licensed manufacturing business and Ckart. The company's inability to successfully execute these projects/plans, especially those relating to Ckart which is a novel and unproven business model, will lead to underperformance of our estimates.
- An extended economic downturn owing to / as a fallout of the COVID-19 pandemic may lead to underperformance of our forecasts.

Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

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Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Hold recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

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