

CG POWER AND INDUSTRIAL SOLUTIONS

Domestic operations stable; overseas exit key to re-rating

India Equity Research | Engineering and Capital Goods



CG Power (CGP) FY17 sales/EBITDA grew a reasonable 9% YoY despite corresponding Q4FY17 numbers plunging 8%/20% YoY, respectively, on consolidated basis. Key quarter highlights were: a) received an offer for US business, which it expects to close by June 30; b) traction in T&D and industrial businesses led to a reasonable 14% YoY growth in new orders, implying flat order book of INR33.5bn; c) management expects profitability to improve from Q1FY18 given stable transformer margins and upside in switchgears & motors businesses. While CGP's domestic business margin has improved driven by power product segment, we revise up FY18E and FY19E EPS ~12% each building in improved margin with revised target price of INR85(vs INR72). Maintain 'HOLD' given: (i) limited upside; and (ii) overhang pertaining to sustenance of overseas business' profitability, which we believe is a key monitorable and a key value trigger once the loss-making units are sold.

Despite tepid Q4, FY17 performance stable to improving

While CGP's Q4FY17 consol sales/EBITDA fell 8%/20%, respectively, for FY17 it clocked a reasonable 9% YoY top line & EBITDA growth, implying stable margins in power and industrial businesses. FY17 order intake improved 14% YoY to ~INR50bn led by strong industrial ordering and resilient T&D orders. Management perceives potential for margin improvement in switchgear & motors as volume ramps up over 1-2 years. We expect a strong operating leverage driving 200bps margin by FY19E at standalone level.

In exit mode in all plants, except Indonesia

CGP is trying to sell off all its overseas units, except the Indonesia business, which clocks 12-13% EBITDA margin with current top line and order book of EUR109mn and EUR147mn, respectively. The company has included this entity back in continuing operations and expects a healthy double digit growth in top line going ahead. For us exit of US/European manufacturing plant remains a key value driver going ahead.

Outlook and valuations: Cautious; maintain 'HOLD'

We like CGP's industrial business portfolio, which is likely to grow at a strong 15-20% with scope for operating leverage. In our view, the key challenge is exit from overseas businesses, which according to us will be a key value driver triggering potential re-rating given huge gap vs MNC peers. Maintain 'HOLD/SP'.

Financials (Consolidated)						(INR mn)		
Year to March	Q4FY17	Q4FY16	% change	Q3FY17	% change	FY17	FY18E	FY19E
Net revenues	17,101	18,507	(7.6)	14,281	19.7	61,198	65,442	74,512
EBITDA	1,181	1,549	(23.7)	1,232	(4.1)	4,702	4,606	5,749
Adj. profit	376	1,062	(64.6)	518	(27.4)	1,829	1,754	1,754
Dil. EPS (INR)	0.6	1.7	(64.6)	0.8	(27.4)	2.9	2.8	2.8
Diluted P/E (x)						31.9	33.2	33.2
ROAE (%)						4.2	4.2	4.2

EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA (R: CGPO BO, B: CGPOWER IN)

CMP	: INR 93
Target Price	: INR 85
52-week range (INR)	: 97 / 56
Share in issue (mn)	: 626.7
M cap (INR bn/USD mn)	: 59 / 907
Avg. Daily Vol.BSE/NSE('000)	: 4,771.1

SHARE HOLDING PATTERN (%)

	Current	Q3FY17	Q1FY17
Promoters *	34.4	34.4	34.4
MF's, FI's & BK's	30.5	31.4	34.1
FII's	21.2	19.2	18.4
Others	13.9	15.0	13.0
* Promoters pledged shares (% of share in issue)		34.42	

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Cap Goods Index
1 month	18.8	3.1	0.2
3 months	35.4	8.1	16.7
12 months	55.2	17.6	23.2

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Q4FY17 conference call: Key highlights

Overall performance and outlook: Management was satisfied with their FY17 performance and considers it to be a successful year with order intake growing (at 14%) faster than revenue growth (at 12.5%) and bottom line growing faster than top line the future of the company looks better ahead.

US subsidiary: CGP has received an offer for its power business in the US. Management expects to complete the process by June 30, 2017.

Indonesia business: CGP continues to pursue its plan of divestment of businesses in geographies outside India, except Indonesia operations. The Indonesia business has been deleted from discontinuing operations and included in continuing operations. Management is positive on the future of this business. Financials are as follows:

- **Revenue:** EUR109mn in FY17 vs EUR106mn in FY16.
- **Order Intake:** EUR159mn in FY17 vs EUR133mn in FY16.
- **Unexecuted order book:** EUR147mn in FY17 vs EUR92mn in FY16.

GST: GST impact will be neutral for some of the B2B businesses like transformers and switchgears and will entail some indirect cost benefits in the sourcing area. For CGP's rotating power business, which goes through the trade channel, GST will be a huge positive, especially considering that 10-15% of switchgear and 15-20% rotating machines businesses are dominated by unorganised segment and post GST they will be accessible to organised players.

Segmental performance:

- **Industrial systems:**
 - Industrial systems' margin fell due to steep increase in commodity prices in steel and copper. The power systems business is insulated from commodity price increase, but the Industrial business is not and has a 2-3 months' lagged impact. Also, to honour the company's commitment to OEMs CGP did not want to put pressure on pricing. But management expects this impact to go away from Q1FY18.
 - Also the company took the opportunity of Q4 to correct the inventory and stocking positions which required some recall of inventory in preparation of GST going forward.

Divestments: Restructuring/realignment of businesses in India has been completed and Indonesia has now been brought into continuing business.

Order intake and order book break up:

- **Order intake:** INR49.81bn.
 - **Power systems:** INR27.17bn.
 - **Industrial business:** INR26.64bn.
- Order book at INR(33.98bn) was flat YoY; break up:
 - **Power systems:** INR26.92bn.
 - **Industrial business:** INR7.06bn.

Margin:

- Margins were under pressure due to losses from outside businesses. Going forward, with the ZIV divestment completed the results will start to show in the form of margin expansion from Q1FY18. And also with the US announcement the results will be visible post the completion of their deal.

Other key highlights:

- **Debt position:** CGP takes debt from India to settle its overseas debt and finance its overseas losses. Hence, INR4.5bn has been borrowed from India to be supplied to overseas businesses since the last year.
- **Exceptional item:** – An exceptional item of INR0.2bn was on account of a case which was going on for 12 years, which has now been resolved and the money has been paid.
- **ZIV sale:** INR70bn was received.
- Pricing pressure on transformers will continue.
- **Break of INR4.17bn:**
 - Impairment loss of INR2.8bn, which is non-recurring.
 - Operating loss of INR1.3bn further broken into:
 1. Systems business loss: INR0.3bn.
 2. Discontinued business losses yet to be divested: INR1bn.

Financial snapshot

(INR mn)

Year to March	Q4FY17	Q4FY16	% change	Q3FY17	% change	FY17	FY18E	FY19E
Net revenues	17,101	18,507	(7.6)	14,281	19.7	61,198	65,442	74,512
Raw material	11,487	12,726	(9.7)	9,105	26.2	40,141	43,142	48,211
Staff costs	1,258	1,479	(14.9)	1,317	(4.5)	5,371	7,012	7,484
Other operating expenses	3,174	2,753	15.3	2,627	20.8	10,983	10,682	13,067
Total expenditure	15,919	16,958	(6.1)	13,049	22.0	56,495	60,836	68,762
EBITDA	1,181	1,549	(23.7)	1,232	(4.1)	4,702	4,606	5,749
Depreciation	438	451	(3.0)	341	28.4	1,500	1,653	1,705
EBIT	744	1,097	(32.2)	891	(16.5)	3,202	2,954	4,044
Other income	232	335	(30.7)	62	277.3	687	1,080	1,164
Interest	625	290	115.7	511	22.3	1,880	1,409	1,671
Add: Exceptional items	(693)	397	NA	(34)	NA	-	-	-
Profit before tax	(342)	1,540	NA	408	NA	2,009	2,625	3,537
Tax	(31)	83	NA	(80)	NA	166	893	1,202
Minority interest	-	(6)	NA	1	NA	(2)	(2)	(2)
Associate profit share	(6)	(4)	NA	(3)	NA	(16)	20	20
Reported net profit	(317)	1,459	NA	484	NA	1,829	1,754	2,357
Adjusted Profit	376	1,062	(64.6)	518	(27.4)	1,829	1,754	2,357
Equity capital(FV INR 2)	1,254	1,254		1,254		1,254	1,255	1,255
Diluted shares (mn)	627	627		627		627	627	627
Diluted EPS (INR)	0.6	1.7	(64.6)	0.8	(27.4)	2.9	2.8	3.8
As % of net revenues								
Direct costs	67.2	68.8		63.8		65.6	65.9	64.7
Employee cost	7.4	8.0		9.2		8.8	10.7	10.0
Other expenses	18.6	14.9		18.4		17.9	16.3	17.5
EBITDA	6.9	8.4		8.6		7.7	7.0	7.7
Depreciation	2.6	2.4		2.4		2.5	2.5	2.3
Interest expenditure	3.7	1.6		3.6		3.1	2.2	2.2
Tax rate	9.0	5.4		(19.7)		8.3	34.0	34.0

Change in Estimates

	New	FY18E Old	% change	New	FY19E Old	% change	Comments
Net Revenue	65,442	64,574	1.3	74,512	73,857	0.9	Building in revenues from the Indonesia plant
EBITDA	4,606	4,424	4.1	5,749	5,439	5.7	
EBITDA Margin	7.0	6.9		7.7	7.4		
Adjusted Profit After Tax	1,754	1,567	11.9	2,357	2,106	11.9	
Net Profit Margin	2.7	2.4		3.2	2.8		
Capex	1,151	1,151	0.0	1,151	1,151	0.0	

Company Description

Mumbai-based CG Power and Industrial Solutions, a part of the B. M. Thapar Group, is a pioneer in the management and application of electrical energy. It is primarily engaged in designing, manufacturing, and marketing high-technology electrical products and services related to power generation, transmission, distribution, and executing turnkey projects. The company's business comprises two segments viz. power systems and industrial systems. Recently, the consumer business was sold.

Investment Theme

CG Power has increased its focus on domestic businesses mainly power products (transformers & switchgears) & industrial (LT, HT motors etc) where it has a strong market share. The company has seen its OPMs stabilizing over last 12-15 months in T&D products given reasonable exports growth which is high margin apart from improving prospects in the domestic market. In the industrial segment, CG Power has a lead position in LT motors (>25% market share) which is witnessing a healthy growth led by infra pick up and selective private capex. We expect HT motors portfolio to catch up over next 2-3 yrs driving operating leverage for the company given bottom cycle OPMs currently.

Key Risks

Major slowdown in the T&D spending in key markets like India and Europe can potentially impact our growth assumptions. Also, deferment of sale of overseas businesses will hit the profitability of the company.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.8	5.0	5.2
Repo rate (exit rate)	6.8	6.3	6.3	5.8
USD/INR (Avg)	65.0	67.5	69.0	69.0
Company				
A) Power system -Dom	(11.3)	10.7	-	7.3
B) Power system -Exp	(96.6)	45.3	47.4	30.2
D) Indus. System	19.7	15.4	25.6	28.2
A) Power system	(20.0)	4.0	10.0	10.0
B) Power system	(80.0)	(36.0)	10.0	10.0
C) Indus. System	(10.0)	42.5	15.0	15.0
Tax rate (%)	37.3	34.0	34.0	34.0
Total no. of employees	4,138	3,869	3,947	4,026
Employee cost per head	876,283	928,860	984,591	1,043,667
Capex (INR mn)	(3,215)	(4,364)	1,151	1,151

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	55,950	61,198	65,442	74,512
Direct costs	36,116	40,141	43,142	48,211
Employee costs	5,590	5,371	7,012	7,484
Other Expenses	9,941	10,983	10,682	13,067
Total operating expenses	51,647	56,495	60,836	68,762
EBITDA	4,302	4,702	4,606	5,749
Depreciation	1,717	1,500	1,653	1,705
EBIT	2,586	3,202	2,954	4,044
Add: Other income	1,114.9	687.00	1,080.00	1,163.73
Less: Interest Expense	800	1,880	1,409	1,671
Add: Exceptional items	(1,113)	(727)	-	-
Profit Before Tax	1,788	1,282	2,625	3,537
Less: Provision for Tax	667	166	893	1,202
Minority interest	(13)	(2)	(2)	(2)
Associate profit share	12	(16)	20	20
Reported Profit	1,146	1,102	1,754	2,357
Exceptional Items	(1,113)	(727)	-	-
Adjusted Profit	2,259	1,830	1,754	2,357
Shares o /s (mn)	627	627	627	627
Diluted shares o/s (mn)	627	627	627	627
Adj. Diluted EPS (INR)	3.6	2.9	2.8	3.8
Dividend per share (DPS)	0.1	0.5	0.5	0.5

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
EBITDA margins	7.7	7.7	7.0	7.7
EBIT margins	4.6	5.2	4.5	5.4
Net Profit margins	4.0	3.0	2.7	3.2

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	1.6	9.4	6.9	13.9
EBITDA	(15.5)	9.3	(2.0)	24.8
Adjusted Profit	(15.2)	(19.0)	(4.1)	34.3

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	1,254	1,254	1,254	1,254	
Reserves & Surplus	44,718	39,857	41,246	43,237	
Shareholders' funds	45,972	41,111	42,500	44,491	
Minority Interest	-	-	(2)	(4)	
Short term borrowings	6,922	7,107	9,607	12,107	
Long term borrowings	5,990	5,059	5,059	5,059	
Total Borrowings	12,912	12,166	14,666	17,166	
Sources of funds	62,017	56,345	60,233	64,722	
Tangible assets	24,061	23,687	24,687	25,687	
Intangible Assets	15,007	13,763	13,578	13,345	
CWIP (incl. intangible)	142	282	332	382	
Total Fixed Assets	37,904	27,907	27,406	26,851	
Total net fixed assets	11,624	3,616	3,250	2,878	
Non current investments	2,303	2,039	2,039	2,039	
Cash and Equivalents	7,978	7,659	10,800	14,547	
Inventories	5,850	8,821	9,456	10,567	
Sundry Debtors	20,770	18,772	20,865	23,785	
Loans & Advances	414	829	895	967	
Other Current Assets	8,487	14,595	14,595	14,595	
Current Assets (ex cash)	35,521	43,017	45,812	49,915	
Sundry creditors	13,027	13,831	14,893	16,643	
Provisions	8,665	10,446	10,931	11,988	
Total Current Liab	21,692	24,277	25,824	28,631	
Net Curr Assets-ex cash	13,831	18,740	19,988	21,285	
Net Deferred tax	2,528	2,357	2,357	2,357	
Uses of funds	62,017	56,345	60,233	64,722	
BVPS (INR)	71.7	64.1	66.2	69.3	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	1,146	1,102	1,754	2,357	
Add: Depreciation	1,717	1,500	1,653	1,705	
Interest (Net of Tax)	501	1,241	930	1,103	
Others	(7,078)	1,178	477	566	
Less: Changes in WC	(3,106)	4,910	1,248	1,296	
Operating cash flow	(608)	112	3,566	4,434	
Less: Capex	(3,215)	(4,364)	1,151	1,151	
Free Cash Flow	2,607	4,476	2,415	3,283	

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow	(608)	112	3,566	4,434	
Investing cash flow	4,320	4,321	(1,151)	(1,151)	
Financing cash flow	(2,224)	(2,993)	726	463	
Net cash Flow	1,488	1,440	3,141	3,747	
Capex	3,215	4,364	(1,151)	(1,151)	
Dividend paid	(13)	(365)	(365)	(365)	

Profitability and efficiency ratios		FY16	FY17	FY18E	FY19E
Year to March					
ROAE (%)	5.0	4.2	4.2	5.4	
ROACE (%)	6.1	6.9	7.3	8.8	
Inventory Days	95	67	77	76	
Debtors Days	168	118	111	109	
Payable Days	170	122	122	119	
Cash Conversion Cycle	94	63	66	66	
Current Ratio	2.0	2.1	2.2	2.3	
Debt/EBITDA (x)	3.0	2.6	3.2	3.0	
Fixed asset turnover (x)	1.6	2.8	3.8	4.5	
Debt/Equity (x)	0.3	0.3	0.3	0.4	
Adjusted Debt/Equity	0.3	0.3	0.3	0.4	
Interest Coverage Ratio	3.2	1.7	2.1	2.4	

Operating ratios		FY16	FY17	FY18E	FY19E
Year to March					
Total Asset Turnover	0.9	1.0	1.1	1.2	
Fixed Asset Turnover	1.6	2.8	3.8	4.5	
Equity Turnover	1.3	1.4	1.6	1.7	

Valuation parameters		FY16	FY17	FY18E	FY19E
Year to March					
Adj. Diluted EPS (INR)	3.6	2.9	2.8	3.8	
Y-o-Y growth (%)	(15.2)	(19.0)	(4.1)	34.3	
Adjusted Cash EPS (INR)	6.3	5.3	5.4	6.5	
Diluted P/E (x)	25.9	32.0	33.4	24.8	
P/B (x)	1.3	1.5	1.4	1.3	
EV / Sales (x)	1.1	1.0	0.9	0.8	
EV / EBITDA (x)	14.7	13.4	13.5	10.6	
Dividend Yield (%)	0.1	0.5	0.5	0.5	
Basic EPS	3.6	2.9	2.8	3.8	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
CG Power and Industrial Solutions	907	26.2	19.6	1.4	1.3	5.3	6.8
ABB India	4,872	63.6	49.8	8.6	7.5	14.2	16.1
Bharat Heavy Electricals	6,010	40.9	25.6	1.2	1.1	2.8	4.5
Siemens	7,658	54.3		6.6		12.6	
Median	-	47.6	37.7	4.0	4.4	8.9	11.4
AVERAGE	-	46.3	31.7	4.4	3.3	8.7	9.1

Source: Edelweiss research

Additional Data

Directors Data

G Thapar	Chairman	L Demortier	Managing Director
M Pudumjee	Non Executive & Independent Director	O Goswami	Non Executive & Independent Director
S Prabhu	Non Executive & Independent Director	S Bayman	S Bayman Non Executive & Independent Director
S Labroo	Non Executive & Independent Director	S P Talwar	Non Executive & Independent Director
V Von Massow	Non Executive & Independent Director	S M Trehan	Vice Chairman

Auditors - Sharp Tannan & Co.

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Avantha holdings ltd	34.37	Hdfc asset managemen	9.26
Reliance capital tru	9.05	Birla sun life asset	5.65
Life insurance corp	5.24	Samena special situa	4.53
Wgi em smaller co fu	2.43	Vanguard group	2.16
Dimensional fund adv	1.52	Abu dhabi investment	1.43

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ABB India	BUY	SO	L	Bajaj Electricals	HOLD	SP	M
Bharat Forge	BUY	SO	M	Bharat Heavy Electricals	BUY	SO	M
CG Power and Industrial Solutions	HOLD	SP	M	Cummins India	BUY	SO	L
Engineers India Ltd	BUY	SO	L	Greaves Cotton	HOLD	SP	M
Havells India	BUY	SP	M	Kalpataru Power	BUY	SO	M
KEC International	BUY	SP	M	Larsen & Toubro	BUY	SO	M
Praj Industries	BUY	None	None	Ramkrishna Forgings	BUY	SP	M
Siemens	HOLD	SP	L	TD Power Systems	HOLD	None	None
Techno Electric & Engineering	BUY	SO	M	Thermax	REDUCE	SP	L
Triveni Turbine	BUY	None	None	VA Tech Wabag	BUY	None	None
Voltas	BUY	SP	L				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s):

ABB India, Bharat Heavy Electricals, Bharat Forge, Bajaj Electricals, CG Power and Industrial Solutions, Engineers India Ltd, Greaves Cotton, Havells India, KEC International, Cummins India, Kalpataru Power, Larsen & Toubro, Praj Industries, Ramkrishna Forgings, Siemens, TD Power Systems, Techno Electric & Engineering, Thermax, Triveni Turbine, VA Tech Wabag, Voltas

Recent Research

Date	Company	Title	Price (INR)	Recos
26-May-17	VA Tech Wabag	Operating results in line; Growth prospects intact; <i>Result Update</i>	675	Buy
26-May-17	Voltas	Stellar quarter; big white goods market play ; <i>Result Update</i>	475	Buy
25-May-17	Praj Industries	Poor quarter; pinning hopes on 2G ethanol; <i>Result Update</i>	77	Buy

Distribution of Ratings / Market Cap

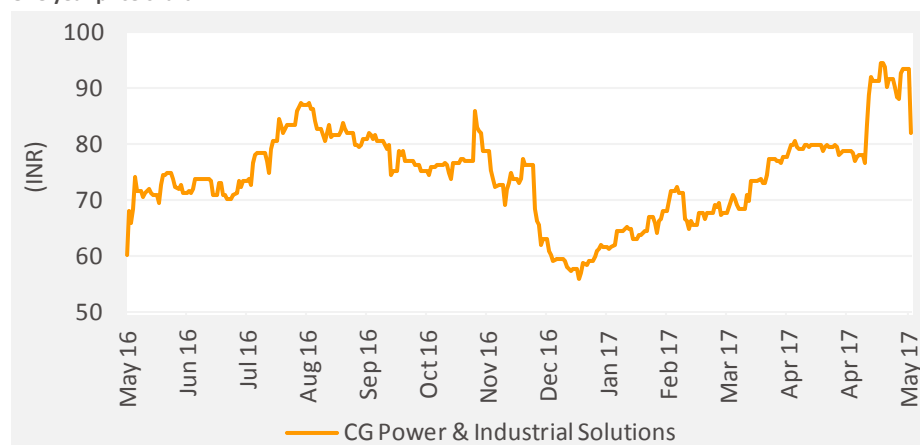
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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