13 March 2021

Initiating Coverage | Sector: Consumer Durables

# Orient Electric


# Reinventing through innovation

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# Orient Electric: Reinventing through innovation

# Orient Electric

| BSE Sensex | S&P CNX |
|---|---|
| 50,792 | 15,031 |

**Stock Info**

| | |
|---|---|
| Bloomberg | ORIENTEL IN |
| Equity Shares (m) | 212.2 |
| M.Cap.(INRb)/(USDb) | 62.7 / 0.9 |
| 52-Week Range (INR) | 302 / 138 |
| 1, 6, 12 Rel. Per (%) | 10/21/-16 |
| 12M Avg Val (INR M) | 91 |
| Free float (%) | 61.5 |

**Financial Snapshot (INR b)**

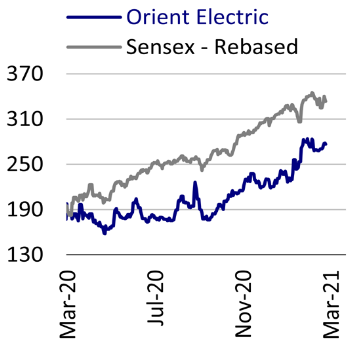
| Y/E Mar | 2020 | 2021E | 2022E |
|---|---|---|---|
| Sales | 20.6 | 20.0 | 25.0 |
| EBITDA | 1.8 | 2.1 | 2.5 |
| PAT | 0.8 | 1.1 | 1.4 |
| EBITDA (%) | 8.6 | 10.5 | 10.0 |
| EPS (INR) | 3.7 | 5.3 | 6.5 |
| EPS Gr. (%) | 13.4 | 42.8 | 23.1 |
| BV/Sh. (INR) | 16.9 | 19.7 | 23.1 |
| **Ratios** | | | |
| Net D/E | 0.3 | 0.0 | (0.0) |
| RoE (%) | 21.9 | 26.9 | 28.2 |
| RoCE (%) | 22.1 | 28.0 | 29.1 |
| Payout (%) | 37.4 | 48.0 | 48.0 |
| **Valuations** | | | |
| P/E (x) | 79.7 | 55.8 | 45.4 |
| P/BV (x) | 17.4 | 15.0 | 12.8 |
| EV/EBITDA (x) | 36.0 | 29.9 | 25.1 |
| Div Yield (%) | 0.4 | 0.7 | 0.9 |
| FCF Yield (%) | 1.3 | 2.6 | 1.4 |

**Shareholding pattern (%)**

| As On | Dec-20 | Sep-20 | Dec-19 |
|---|---|---|---|
| Promoter | 38.5 | 38.5 | 38.5 |
| DII | 23.0 | 22.0 | 19.1 |
| FII | 7.5 | 6.1 | 5.4 |
| Others | 30.9 | 33.4 | 37.0 |

FII Includes depository receipts

**Stock Performance (1-year)**




**CMP: INR295** **TP: INR350 (+19%)** **Buy**

## Reinventing through innovation

- **Orient Electric (OEL), since its demerger from Orient Paper & Industries in FY17, is fast emerging as a serious competitor in the Electrical Consumer Durables (ECD) space. It is the third largest player in the Fans segment and has been in operation for over 60 years. Recently, it diversified into related product categories like Lighting, Switchgears, Air Coolers, Water Heaters, etc. OEL's 13.5% revenue CAGR over FY18-20 has outpaced Havells India (+7.6% CAGR) and Crompton Greaves Consumer Electricals (+5.9%).**
- **OEL enjoys a similar gross margin as its peers, but has one of the lowest EBITDA margin. This is on higher employee cost and advertising spends, suggesting that OEL is perhaps in the investment phase. There is a strong case for margin convergence, with leading players like Havells and Crompton in a steady state.**
- **Despite higher investments in people and branding-related spends, and hence potentially lower margin at present, OEL generates a RoE of over 22%, which is superior to many peers. We forecast revenue/EBITDA/PAT growth of 20%/18%/21% over FY21-23E. We initiate coverage on the stock with a Buy rating, assigning a TP of INR350 per share.**

### New management → New Energy → New aspirations

The biggest change in OEL's ECD business has been appointment of new management. The company got demerged from Orient Paper & Industries in FY17. Mr. Rakesh Khanna was appointed MD & CEO from 23 Jan'18 for four-years and has been instrumental in building an altogether new team. The average age of employees stood at 37 years in FY18. It introduced an Employee Stock Option Scheme and a Long-Term Cash Incentive Plan to retain and incentivize key members of the senior management team. This aligns the interest of the senior management with the company's prospects. Since its demerger, OEL's 13.5% revenue CAGR over FY18-20 has outpaced Havells (+7.6% CAGR) and Crompton (+5.9%).

### Established brand in the Fans segment; new product offerings encouraging

OEL is a 60-year old brand in the Fans segment and is the third largest player at present after Crompton and Havells. Owing to its long presence, it enjoys a superior brand recall in the Fans segment. Recently, it started diversifying into related categories including Lighting, Switchgears, Air Coolers, and Water Heaters, along with growing its market share in the Fans segment. The ECD segment, comprising Fans and other appliances, has grown by ~11% CAGR over FY11-20 and forms ~70% of the revenue, while the Lighting and Switchgear segment has grown ~29% CAGR and constitutes the remainder of revenue. We expect revenue to grow by ~20% CAGR over FY21-23E, helped by a lower base. Over the longer term, we expect the product portfolio to witness 12% revenue CAGR structurally.

There is a strong case for OEL's EBITDA margin to converge to the 13-15% range enjoyed by Havells and Crompton

## Innovation at the heart of its growth strategy

Even though the company is an established player in the Fans segment, it continues to re-invent its product offerings, thereby negating any complacency. OEL has impressed with its innovative noise reducing 'Aeroquiet' Fans, thereby creating a new price category. It has introduced a range of aerodynamic fans, showcasing its in-house R&D capabilities. In the Lighting segment, it has launched LED Lighting products, which have improved the lighting quality by controlling the flickering of LED bulbs. It has introduced new modular switches with Triple Arc Blocking (3AB) technology to provide the highest level of safety.

## Expect EBITDA margin differential with leading companies to converge

OEL enjoys a similar gross margin as its peers, suggesting that the brand is at par with leading companies on account of its pricing/procurement strategy. However, it has one of the lowest EBITDA margin compared to peers. EBITDA margin stood at just 8.6% in FY20 v/s an average of 11.1% for its peers. In fact, its EBITDA margin is 4.6pp below Crompton, despite the fact that both companies have a similar product portfolio. Our analysis of overheads suggests that such a differential can be attributed to employee cost, ad spends, etc. and OEL is perhaps in the investment phase. There is a strong case for EBITDA margin to converge with the 13-15% range enjoyed by Havells and Crompton. It has already reached double-digit margin in FY21, thus validating the potential of our thesis.

## Initiate with a Buy rating and TP of INR350/share

OEL's near-term earnings doesn't capture the true value of the franchise as the company is currently in the investment phase (brand building) and hence its margin is below peers. Earnings are also depressed on higher depreciation v/s peers (absolute depreciation is higher than the leader in the Fan industry, i.e. Crompton) due to greater in-house manufacturing content. Despite higher investments in people and branding-related spends, and hence potentially lower margin at present, it generates a RoE of over 22%, which is superior to many peers. We value OEL at a target multiple of 45x on Mar'23E EPS to arrive at our TP of INR350/share. Note that our target multiple is at a discount of ~10% to Havells, but at a premium to Crompton (target multiple of 40x) as our thesis is based on the narrowing of the margin differential over the next five years. At CMP, the stock trades at 25% discount to Havells on a FY23E P/E basis. However, the discount increases to 37% on an EV/EBITDA basis. While it trades at ~10% premium to Crompton on a P/E basis, our EV/EBITDA analysis suggests a discount of 17%.

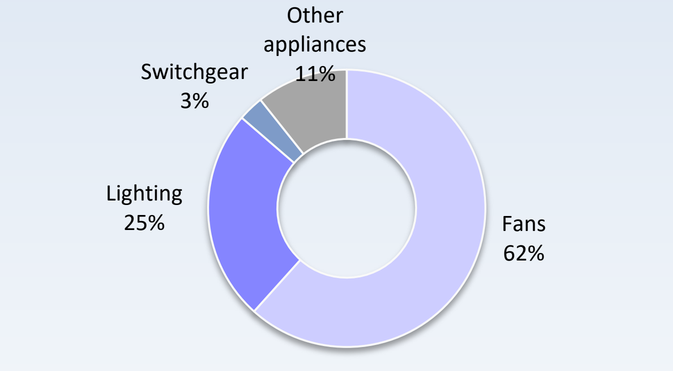
**Exhibit 1: Valuation summary | On an EV/EBITDA basis, OEL trades cheaper than peers like Havells and Crompton despite generating one of the best RoE**

| Company | M-cap (INR b) | CMP (INR) | P/E (x) | | | EV/EBITDA (x) | | | RoE (%) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E |
| Havells | 691 | 1,104 | 67.0 | 56.4 | 50.3 | 43.4 | 37.9 | 33.7 | 20.6 | 21.2 | 20.6 |
| Voltas | 348 | 1,053 | 73.8 | 50.6 | 43.6 | 60.4 | 40.6 | 35.4 | 10.2 | 13.5 | 14.1 |
| Whirlpool | 306 | 2,409 | 88.4 | 53.0 | 43.9 | 55.8 | 35.0 | 29.3 | 12.3 | 17.4 | 17.8 |
| Crompton | 257 | 410 | 49.1 | 38.6 | 34.0 | 35.6 | 28.3 | 25.4 | 29.4 | 30.5 | 28.7 |
| Blue Star | 91 | 945 | 102.7 | 52.4 | 37.3 | 38.0 | 26.9 | 21.5 | 10.8 | 19.6 | 24.8 |
| **OEL** | **63** | **295** | **55.8** | **45.4** | **38.2** | **29.9** | **25.1** | **21.4** | **26.9** | **28.2** | **28.6** |

Source: MOFSL, Bloomberg, Company

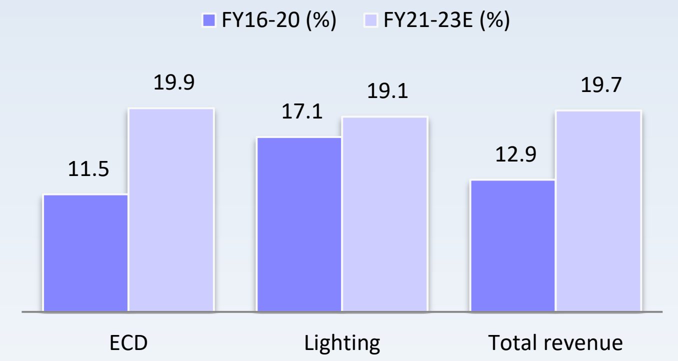
## STORY IN CHARTS

**Exhibit 2: Revenue breakdown (FY20)**



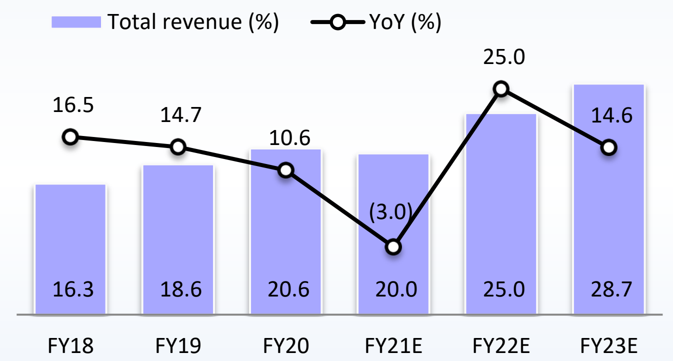

Source: MOFSL, Company

**Exhibit 3: Revenue growth to be equally driven by ECD and Lighting segments**



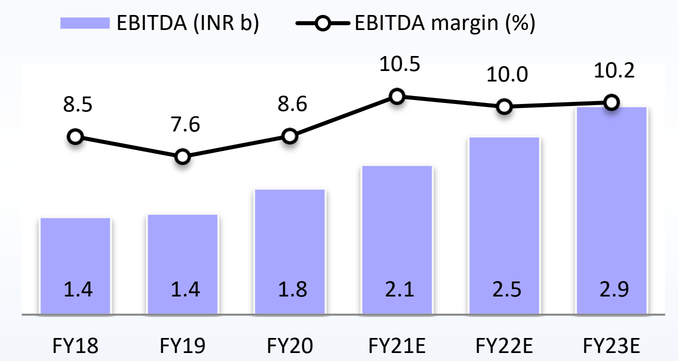

Source: MOFSL, Company

**Exhibit 4: Expect total revenue to grow ~20% CAGR over FY21-23E**



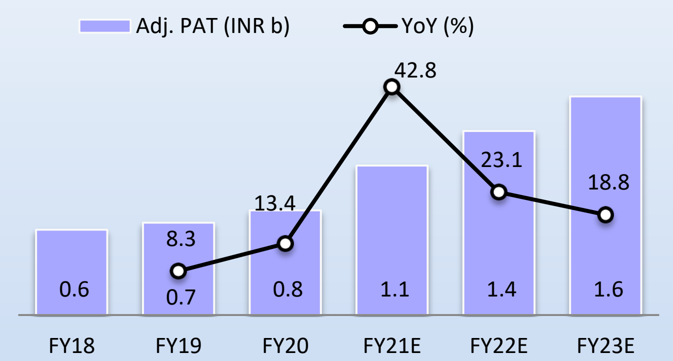

Source: MOFSL, Company

**Exhibit 5: Expect EBITDA to grow at 18% CAGR over FY21-23E with double-digit margin**



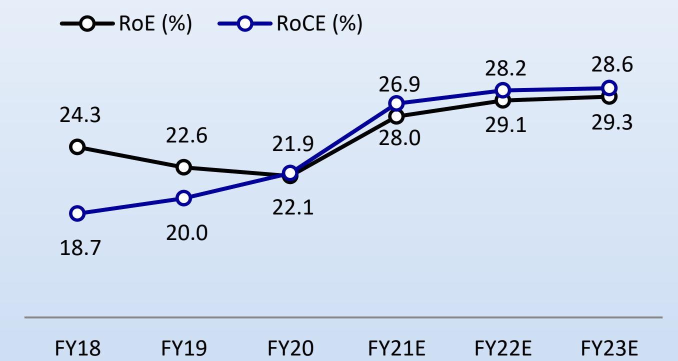

Source: MOFSL, Company

**Exhibit 6: Higher operating leverage to lead to 21% PAT CAGR over FY21-23E**




Source: MOFSL, Company

**Exhibit 7: Return ratios to remain robust over FY21-23E, led by strong operating performance**




Source: MOFSL, Company

## Aspirations + innovation = Formidable challenger

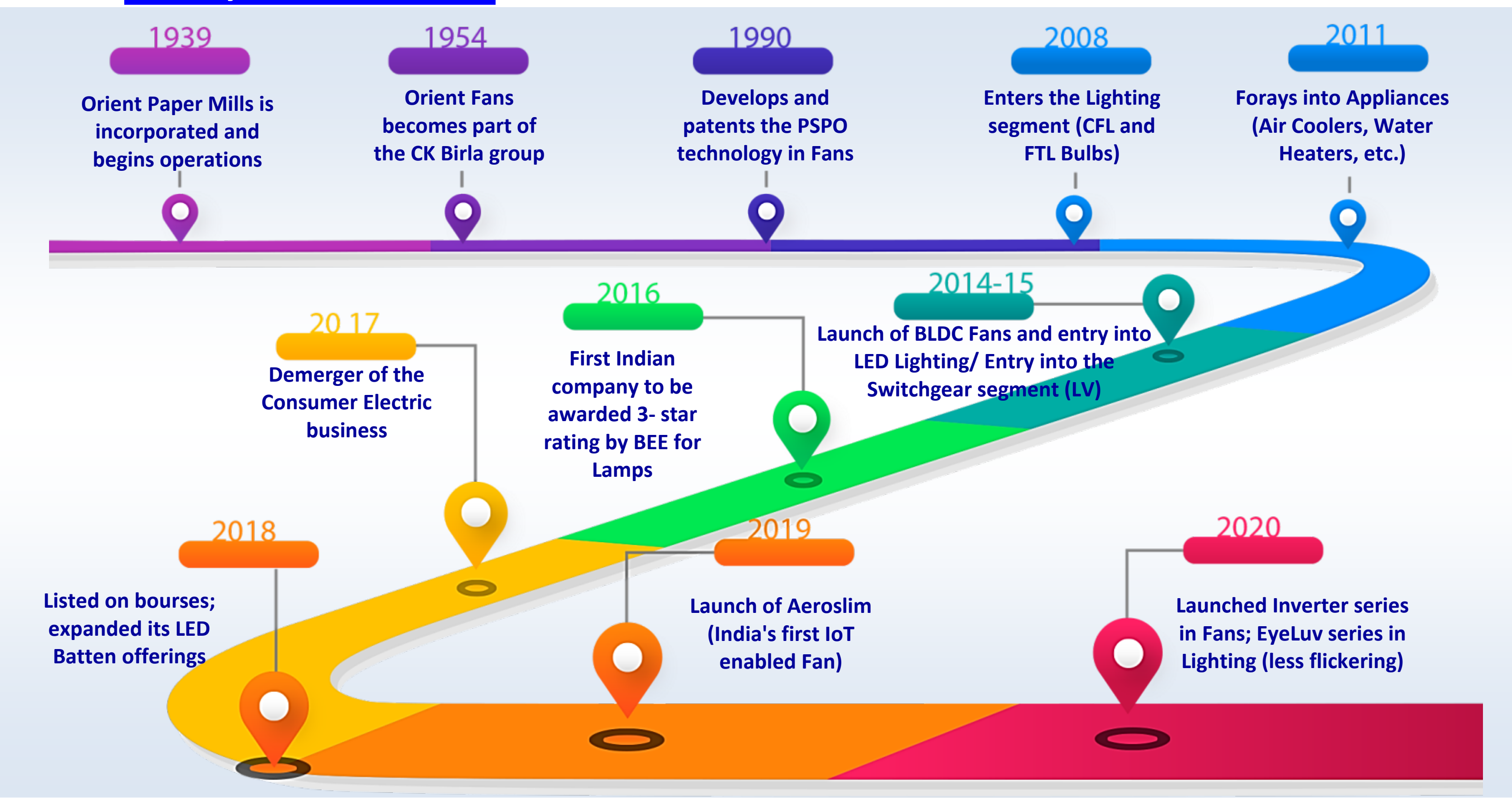
The demerger led to renewed focus on the brand, led by innovative product launches

The brand 'Orient' enjoys strong recall in the minds of consumers. It has been servicing the Indian consumer for over six decades now. Post demerger from Orient Paper & Industries in FY17, OEL is fast establishing itself as an innovative brand in the Indian Fan industry, while looking to expand into adjacent product categories in Lighting, Appliances and Switchgear. The demerger resulted in renewed management focus on the business, led by innovations. Despite such a long presence in the Indian market, we find the brand quite 'young' and 'aspirational' – key ingredients for a sustainable long-term business model in the challenging Consumer Durables industry in India.

### Demerger has been a game changer

OEL traces its origins to the erstwhile Calcutta Electrical Company, which became a part of the 150-year-old CK Birla group in 1954. Within the CK Birla group, it was a part of Orient Paper & Industries. The Consumer Electrical business was demerged into OEL on 1st Mar'17. OEL has been revamping its management team since 2014 to focus exclusively on the Consumer business. Post demerger, it has demonstrated strong growth, which suggests that the brand is moving in the right direction. We note that a similar demerger event helped Crompton (albeit due to a change of promoter) to consolidate its position in the Indian Electricals market.

**Journey of brand 'Orient'**




Source: MOFSL, Company

In 2015, Orient Paper & Industries hired Mr. Rakesh Khanna to lead its Consumer Electrical business. Mr. Khanna previously headed Jumbo Electronics and led brands like Sony in the UAE. OEL also made a host of key appointments across different business units with highly experienced personnel.

**Exhibit 8: OEL has built an experienced management team since FY14**

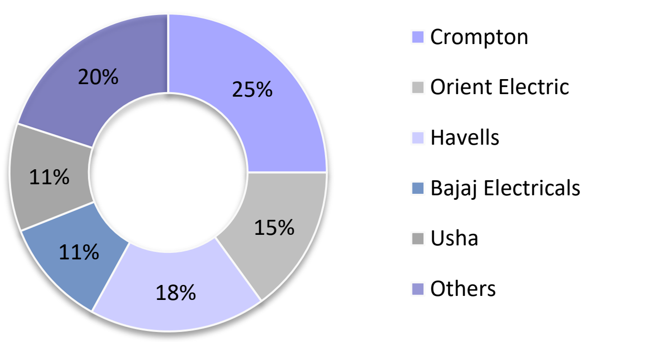
| Management | Designation | Age (yrs) | Total work experience (yrs) | Previous work experience | Tenure commencement in OEL |
|---|---|---|---|---|---|
| Mr. Rakesh Khanna | ❖ MD & CEO | 57.0 | 34.0 | ❖ Jumbo Electronic – Head, Sony UAE | Dec'14 |
| Mr. Atul Jain | ❖ SBU Head (Fans & International Business) | 53.0 | 30.0 | ❖ LeEco Technology – COO & Head of India Operations | Jul'17 |
| Mr. Saibal Sengupta | ❖ CFO | 57.0 | 23.0 | ❖ Usha International – CFO | Apr'18 |
| Mr. Srihari Madhava Rao | ❖ Sr. Vice President – Innovation | 48.0 | 26.0 | ❖ Philips Lighting India – VP & Global R&D Head Professional Lighting System | Mar'18 |
| Mr. Puneet Dhawan | ❖ SBU Head – Lighting BU, Switchgear & Wiring Accessories BU | 52.0 | 29.0 | ❖ Crompton Greaves – GM Sales (Consumer Business Unit) | Sep'13 |
| Mr. Arvind Kumar Singh | ❖ VP & Head Manufacturing – Fans | 54.0 | 31.0 | ❖ Hero Cycles – Executive Director – Operations | May'16 |
| Mr. Ashok Kumar Singh | ❖ SBU Head (Switchgear & Wiring Accessories) | 56.0 | 30.0 | ❖ Havells India – VP – Industrial Product | Jun'15 |
| Ms. Nitu Jaiswal | ❖ Asst. VP (Special Channel) | 52.0 | 22.0 | ❖ Spencer's Retail – VP Marketing | May'18 |

Source: MOFSL, Company

## OEL is the third largest brand in the Fan industry

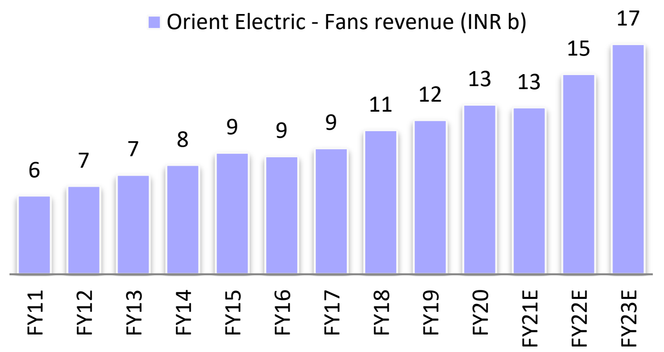
The Indian Fan industry is pegged ~INR80b, with the top brands constituting 80% of the organized sector. Crompton is the largest brand, commanding a market share of ~25% in value terms, followed by Havells and OEL. Along with Usha International and Bajaj Electricals, the top five brands command a strong brand recall and market share positioning in the Indian market. Apart from Havells, the other four brands have been operating in India since 4-5 decades. While many companies have tried entering the Fan market, they have been unable to grow into a sizeable business. The only exception has been Havells – a late entrant in CY05, but commanding the second position now. OEL has been at the forefront of innovation, with attractive product launches at regular intervals and backed by regular ad spends.

**Exhibit 9: Market share breakup for the Indian Fan industry (INR80b)**




Source: MOFSL, Company

**Exhibit 10: Revenue trend for OEL in Fans**

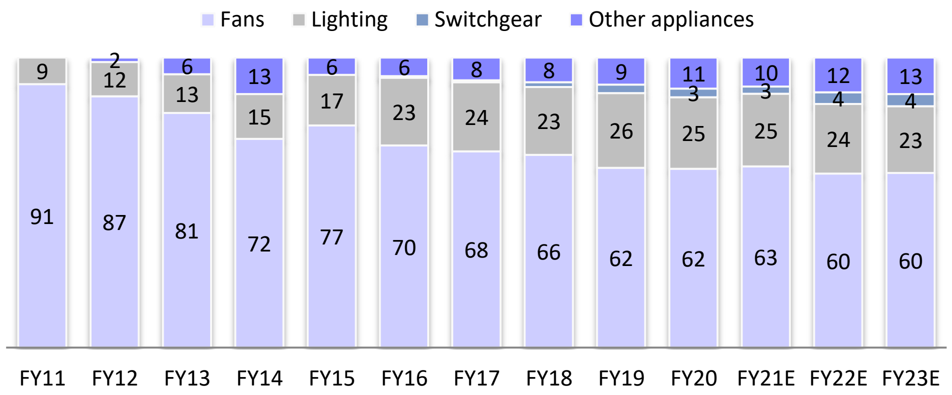



Source: MOFSL, Company

## Expansion into Lighting and Appliances to aid growth

Until FY09, OEL was largely a Fans player in the Indian Appliances market. It entered the Lighting market in 2008 with the launch of CFL Bulbs, Fluorescent Tube Lamps, and Luminaries. It transitioned to LED Bulbs from CFL Bulbs and launched a range of LED products in 2011 and 2012. In 2011, it decided to diversify into other appliances like Water Heaters, Air Coolers, Mixers and Grinders, Electric Irons, and Rice Cookers.

**Exhibit 11: Diversification strategy in place, the share of Fans fell to ~60% in FY20 from over 90% in FY11**




Source: MOFSL, Company

Expansion into other categories has de-risked dependence on revenue from the Fans segment

## Innovation led growth

OEL has been carving out a niche for itself, especially after its demerger, by continuously introducing innovative products. It has been at the forefront of technology. This has helped the brand position itself strongly in the minds of customers and channel partners.

**Exhibit 12: Key innovation and launches**

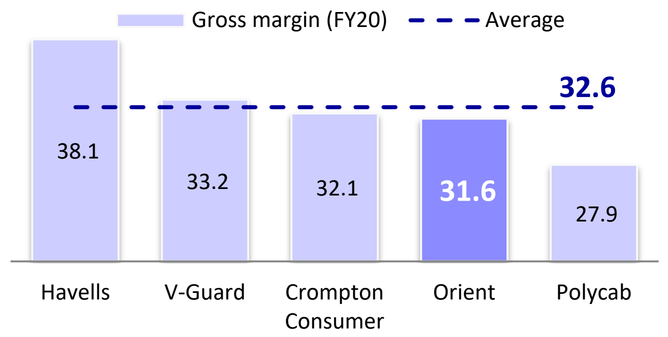
| Segment | FY16 | FY17 | FY18 | FY19 | FY20 |
|---|---|---|---|---|---|
| **Fans** | ❖ BLDC technology fans (50% less energy consumption) | ❖ 48" ECO QUASAR (Decorative BLDC fan with high efficient DC motor) | ❖ Aerostorm, Aerocool, Aeroquiet BLDC, Aerolite series in premium segment | ❖ India's first IoT enabled fan (Aeroslim) based on invertor technology | ❖ Eleganza series of air-circulating luxury chandeliers |
| **Lighting** | | ❖ 3 STAR rated BEE certified LED Lamps of 5W, 7W and 9W | ❖ Three new products under LED Batten with features like colour changing, high brightness and low glare | ❖ BEE 5-Star-rated 9W LED bulb and eyeLuv - LED lightings to reduce strains on the eyes | ❖ Expansion of EyeLuv series into Luminaire and Battens |
| **Appliances** | | ❖ 5 new SKUs of Air Coolers, 1 new SKU of heating and 3 new SKUs of Kitchen Appliances in about 100 cities | ❖ India's first outdoor metal coolers in modular and assembled versions and 18 models of water heaters | ❖ IoT enabled air cooler range | ❖ Ultimo and Knight desert coolers, Glassline water heaters |
| **Switchgear** | | ❖ Product launches at the top-end of the market | ❖ New range of modular switches with 3AB technology | ❖ Premium range of switches | ❖ Salus Bloom chrome plate range of switches |

Source: MOFSL, Company

### Strong gross margin, EBITDA margin depressed during the investment phase

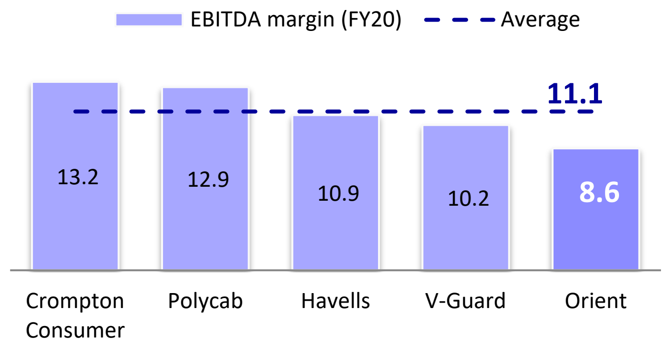
OEL enjoys a similar gross margin as its peers, suggesting that the brand is at par with leading companies on account of its pricing/procurement strategy. It has one of the lowest EBITDA margin compared to peers. EBITDA margin stood at just 8.6% in FY20 v/s an average of 11.1% for its peers. In fact, its EBITDA margin is 4.6pp below Crompton, despite the fact that both companies have a similar product portfolio. Our analysis of overheads suggests that such a differential can be attributed to employee cost, ad spends, etc. and OEL is perhaps in the investment phase. There is a strong case for a potential improvement in steady state EBITDA margin towards double-digits.

**Exhibit 13: OEL enjoys gross margins at par with its peers…**



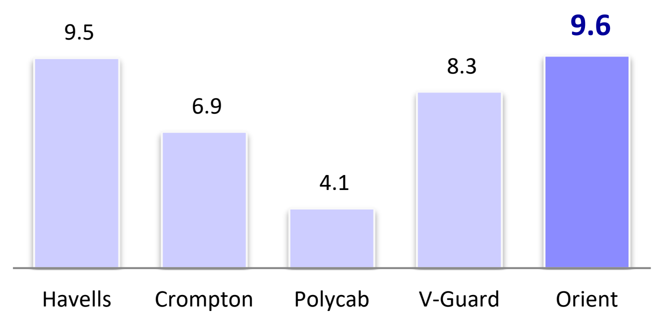

Source: MOFSL, Company

**Exhibit 14: …but lags on EBITDA margin due to higher overheads**



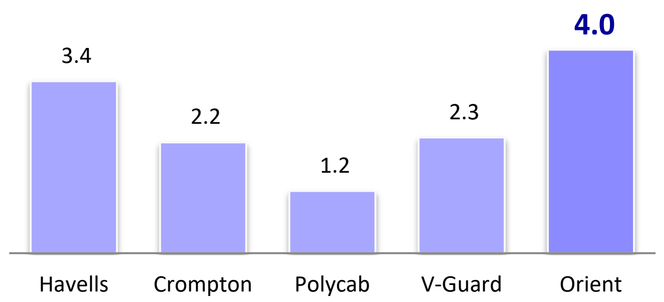

Source: MOFSL, Company

**Exhibit 15: Employee cost as a percentage of sales v/s peers**




Source: MOFSL, Company

**Exhibit 16: Ad spends as a percentage of sales v/s peers**




Source: MOFSL, Company

### Attribute higher return ratios to OEL's asset light model

Despite higher investments in people and branding-related spends, and hence potentially lower margin at present, OEL generates a RoE of over 22%, which is superior to many peers. Our DuPont analysis suggests that the key reason for higher return ratios is the asset light model as suggested by a higher asset turnover ratio. With the potential for margin expansion as it bridges the wide gap with peers, there is room for RoE to expand to over 28%.

**Exhibit 17: DuPont Analysis | Asset light business model aids RoE of over 22%; further room to expand as margin differential with peers narrows**

| RoE - DuPont Analysis | FY18 | FY19 | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|---|
| Net margin | 4.0 | 3.7 | 3.8 | 5.6 | 5.5 | 5.7 |
| Asset turnover | 3.7 | 4.4 | 4.7 | 4.4 | 4.7 | 4.7 |
| Leverage | 1.6 | 1.4 | 1.2 | 1.1 | 1.1 | 1.1 |
| **RoE** | **24.3** | **22.6** | **21.9** | **26.9** | **28.2** | **28.6** |

Source: MOFSL, Company

## Deserves premium valuation; initiate with a Buy rating and TP of INR350/share

OEL's near-term earnings doesn't capture the true value of the franchise as the company is currently in the investment phase (brand building) and hence its margin is below peers. Earnings are also depressed on higher depreciation v/s peers (absolute depreciation is higher than the leader in the Fan industry, i.e. Crompton) due to greater in-house manufacturing content. Despite higher investments in people and branding-related spends, and hence potentially lower margin at present, it generates a RoE of over 22%, which is superior to many peers. We value OEL at a target multiple of 45x on Mar'23E EPS to arrive at our TP of INR350/share. Note that our target multiple is at a discount of ~10% to Havells, but at a premium to Crompton (target multiple of 40x) as our thesis is based on the narrowing of the margin differential over the next five years. At CMP, the stock trades at a 25% discount to Havells on a FY23E P/E basis. However, the discount increases to 37% on an EV/EBITDA basis. While it trades at ~10% premium to Crompton on a P/E basis, our EV/EBITDA analysis suggests a discount of 17%.

**Exhibit 18: We value OEL at a target multiple of 45x Mar'23E EPS to arrive at our TP of INR350 per share**

| Valuation | Basis | Multiple (x) | Mar'23E EPS | TP (INR) |
|---|---|---|---|---|
| Core business | Mar'23E P/E | 45x | 7.7 | 350 |
| **Total (rounded off)** | | | **7.7** | **350** |

Source: MOFSL, Company

**Exhibit 19: Valuation summary | On an EV/EBITDA basis, OEL trades cheaper than peers like Havells and Crompton despite generating one of the best RoE**

| Company | M-cap (INR b) | CMP (INR) | P/E (x) | | | EV/EBITDA (x) | | | RoE (%) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E |
| Havells | 691 | 1,104 | 67.0 | 56.4 | 50.3 | 43.4 | 37.9 | 33.7 | 20.6 | 21.2 | 20.6 |
| Voltas | 348 | 1,053 | 73.8 | 50.6 | 43.6 | 60.4 | 40.6 | 35.4 | 10.2 | 13.5 | 14.1 |
| Whirlpool | 306 | 2,409 | 88.4 | 53.0 | 43.9 | 55.8 | 35.0 | 29.3 | 12.3 | 17.4 | 17.8 |
| Crompton | 257 | 410 | 49.1 | 38.6 | 34.0 | 35.6 | 28.3 | 25.4 | 29.4 | 30.5 | 28.7 |
| Blue Star | 91 | 945 | 102.7 | 52.4 | 37.3 | 38.0 | 26.9 | 21.5 | 10.8 | 19.6 | 24.8 |
| **OEL** | **63** | **295** | **55.8** | **45.4** | **38.2** | **29.9** | **25.1** | **21.4** | **26.9** | **28.2** | **28.6** |

Source: MOFSL, Bloomberg, Company

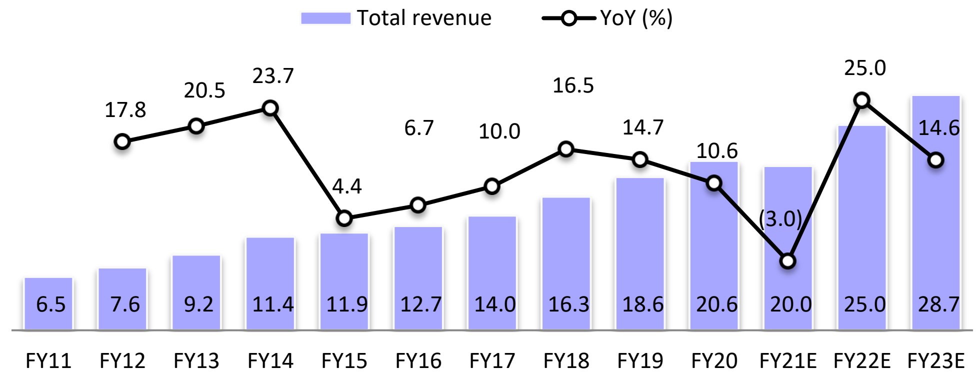
# Financial Analysis

## Expect ~20% revenue CAGR over FY21-23E partly aided by a lower base

Over FY11-20, OEL's revenue grew by ~14% CAGR aided by the entry into newer categories of Switchgears and Appliances and scaling up of the Lighting product portfolio. The ECD segment, comprising Fans and other Appliances, has grown by ~11% CAGR over FY11-20, while the Lighting and Switchgear segment has grown by ~29% CAGR. We expect revenue to grow by ~20% CAGR over FY21-23E, evenly distributed across both segments and market share gains in the Fans category. The BEE rating change led price increase is expected to aid revenue growth. Over the longer term, we estimate OEL to grow at 12% CAGR structurally.

**In the categories that OEL operates in, we expect it to grow by ~12% CAGR over the longer term**

**Exhibit 20: Expect revenue to grow by ~20% CAGR over FY21-23E, led by similar growth across both ECD and the Lighting and Switchgear segments**



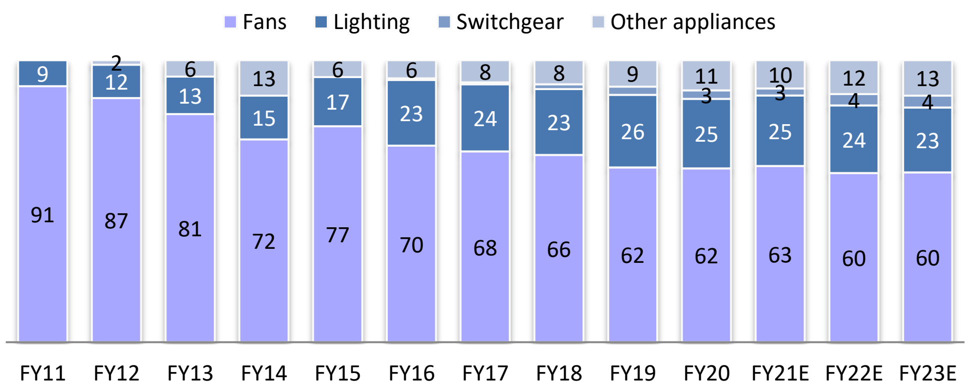

Source: MOFSL, Company

## Entry into newer categories reduces dependence on Fans

In FY11, revenue from Fans stood at 91%, indicating complete dependence on this segment. With the entry into the Appliances category towards the end of FY11 and scaling up of the Lighting segment, revenue share from Fans gradually dropped to 68% by F17. In FY18, the management further diversified with the entry into the Switchgear category. By FY20, revenue contribution from Fans dropped down to 62%. Given its strong product recall in Fans, we expect it to remain the mainstay product within the product portfolio, with a revenue share ~60% over FY21-23E.

**Though OEL has expanded into other categories, we expect Fans to remain its mainstay product over FY21-23E**

**Exhibit 21: Dependence on Fans is reducing with the entry into new categories**



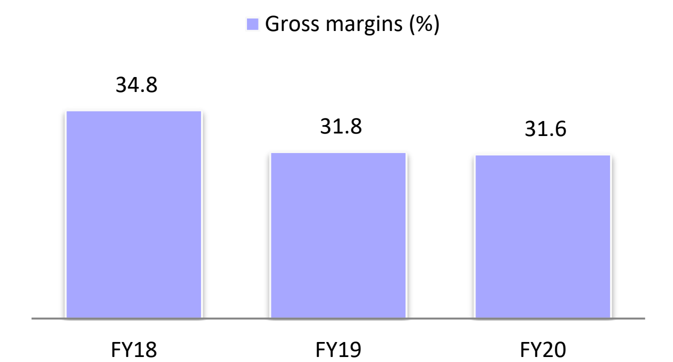

Source: MOFSL, Company

### Steady gross margin; EBITDA margin to expand when the investment phase ends

OEL enjoys gross margin similar to its peers, suggesting that the brand is at par with leading companies on account of its pricing/procurement strategy. Over FY18-20, gross margin stood above 30%. The moderation over FY18 could be due to higher sale of traded goods as the company expands its product portfolio beyond Fans.

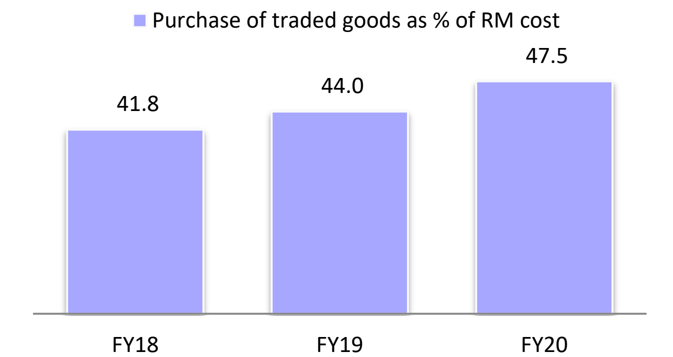
The company has one of the lowest EBITDA margin compared to its peers. Our analysis of overheads indicates that the company could be in the investment phase.

**Exhibit 22: Gross margin remains flat YoY in FY20 after moderating from FY18 levels**




Source: MOFSL, Company

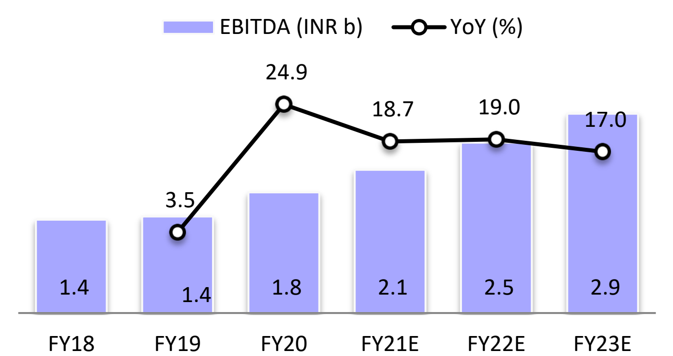
**Exhibit 23: Purchase of traded goods slightly increases over FY18-20**




Source: MOFSL, Company

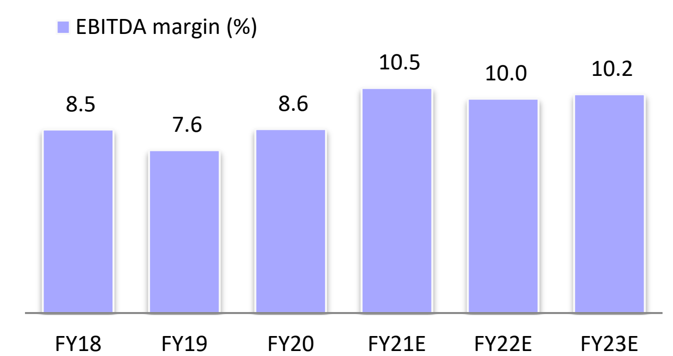
Over FY18-20, EBITDA grew by ~14% CAGR, in line with revenue growth of ~13%. However, EBITDA margin has remained flat over this period as the company invested in ad spends and talent acquisition. We expect EBITDA to grow by ~18% CAGR over FY21-23E, with double-digit margin, as brand-related investments are expected to reap dividends.

**Exhibit 24: Expect EBITDA to grow at 18% CAGR over FY21-23E…**




Source: MOFSL, Company

**Exhibit 25: ..with EBITDA margin moderating from FY21E as the company scale back its brand spends**

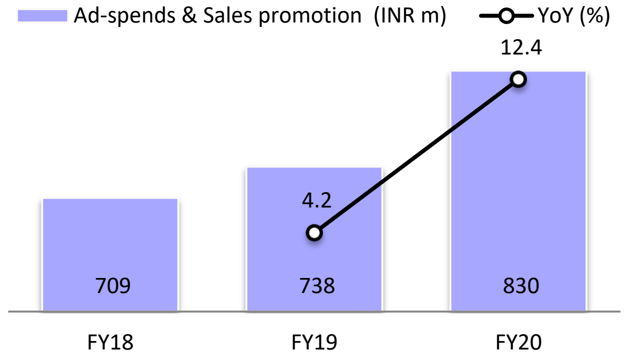



Source: MOFSL, Company

### Ad spends one of the highest among peers

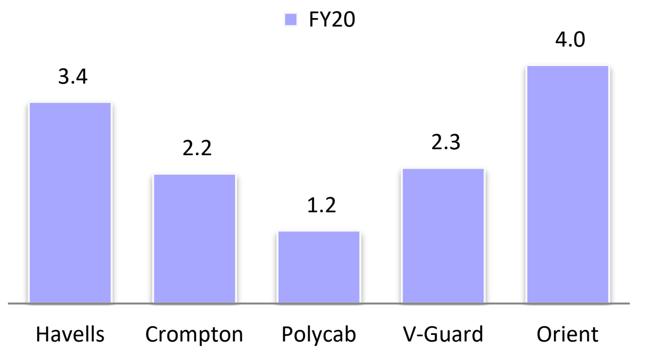
Ad spends and promotion increased by 12% YoY in FY20, in line with the increase in sales, as the management has been focusing on adequately advertising its innovative launches across key product categories. As a percentage of sales, ad spends remained at 4% in FY20 and at similar levels over FY18-20. This is still higher when compared to 3.4%/2.2%/1.2%/2.3% for Havells/Crompton/Polycab/V-Guard.

**Exhibit 26: Higher focus on ad spends as the brand consolidates itself in the Electricals market**




Source: MOFSL, Company

**Exhibit 27: Ad spends, as a percentage of sales, is among the highest v/s peers**

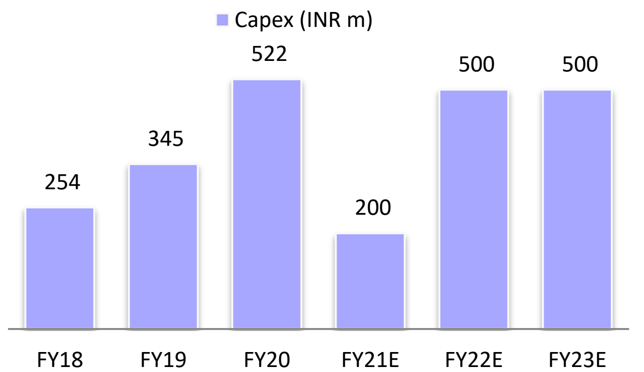



Source: MOFSL, Company

## Rising capex intensity with a focus on in-house manufacturing; lower tax rate to mitigate impact of higher depreciation on PAT growth

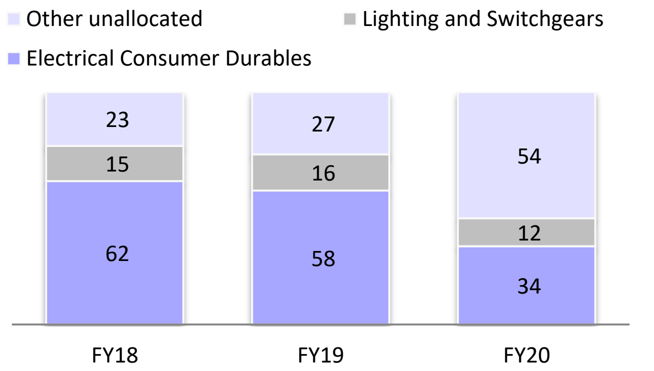
Over FY18-20, the management focused on increasing in-house manufacturing, resulting in a steady rise in capex. We expect the capex intensity to continue over FY22-23E with the company gradually manufacturing most of its products in-house.

**Exhibit 28: Capex rises on in-house manufacturing**




Source: MOFSL, Company

**Exhibit 29: Share of ECD in total capex gradually moderates over FY18-20**

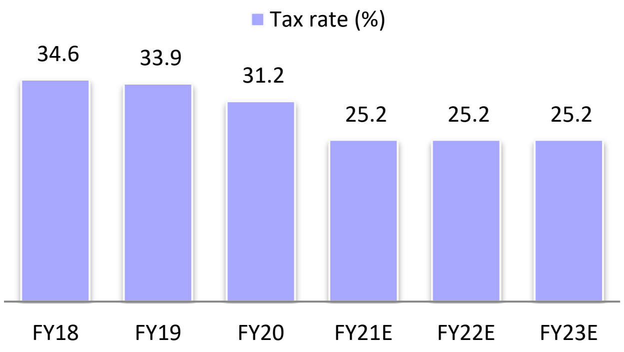



Source: MOFSL, Company

## Estimate adjusted PAT CAGR of 21% over FY21-23E

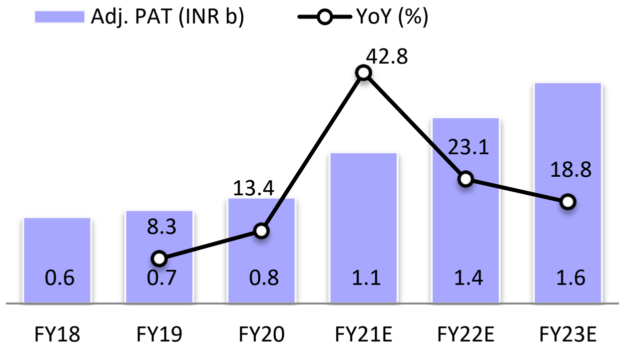
Adjusted PAT grew by ~11% CAGR over FY18-20, lower than revenue growth of ~14%, due to higher depreciation as a result of rising capex. Over FY21-23E, we expect adjusted PAT to grow ~21% CAGR (revenue CAGR of ~20%), partly aided by moderation in interest cost.

**Exhibit 30: Effective tax rate lower in FY20 on migration to the new tax rate**




Source: MOFSL, Company

**Exhibit 31: Adjusted PAT to grow by ~21% CAGR over FY21-23E v/s ~20% revenue CAGR**

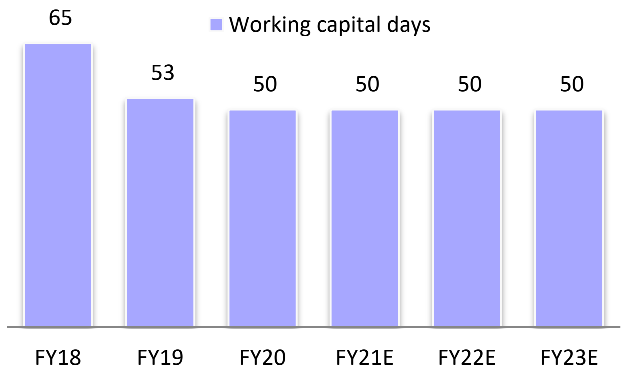



Source: MOFSL, Company

## Debt to reduce given OEL's strong focus on cash flows and working capital

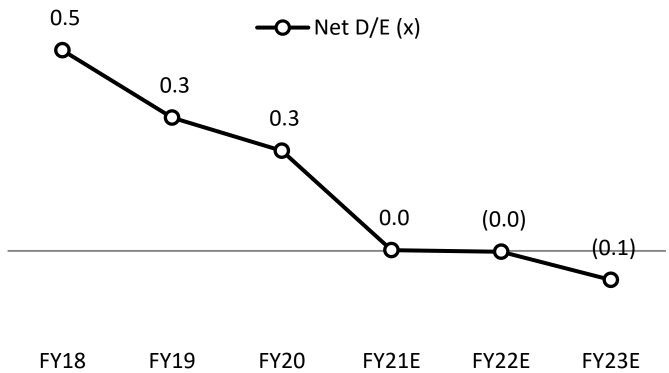
Owing to a reduction in working capital requirements, leading to higher free cash flow, the company has successfully reduced its debt to INR1b in FY20 from INR1.6b in FY18. We expect the reduction in debt to continue and see OEL becoming a net cash company by FY22E. The working capital cycle has gradually improved to 50 days in FY20 (v/s 65 days in FY18) owing to a reduction in debtor days.

**Exhibit 32: Working capital intensity moderates over FY18-20 due to decrease in receivable days**




Source: MOFSL, Company

**Exhibit 33: Owing to strong cash flow, net debt-to-equity has gradually reduced. Expect OEL to turn net cash by FY22E**

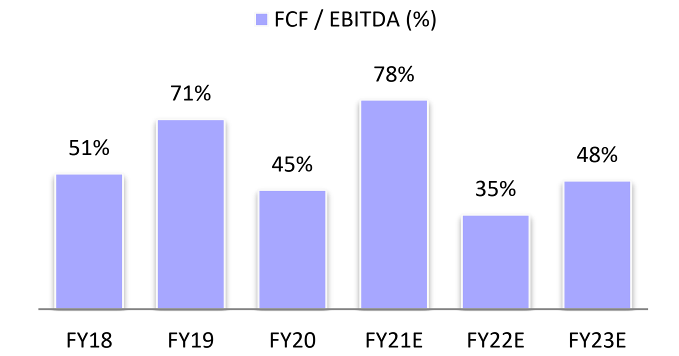



Source: MOFSL, Company

## FCF-to-PAT conversion to be strong ~95% over FY21-23E

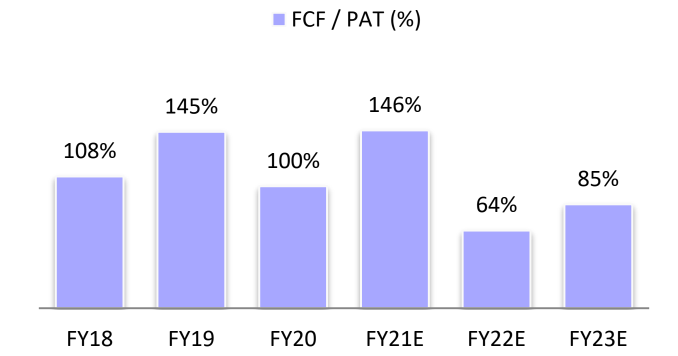
With superior working capital management, OEL has generated strong FCF over FY18-20 in spite of rising capex. Over FY18-20, FCF stood at ~INR2.5b and is expected to rise to ~INR3.9b over FY21-23E. We expect FCF-to-PAT conversion to remain strong at 95% over FY21-23E. Cash generated on account of lower working capital requirements is expected to be deployed for capex and debt reduction.

**Exhibit 34: Expect FCF-to-EBITDA conversion ~50%...**



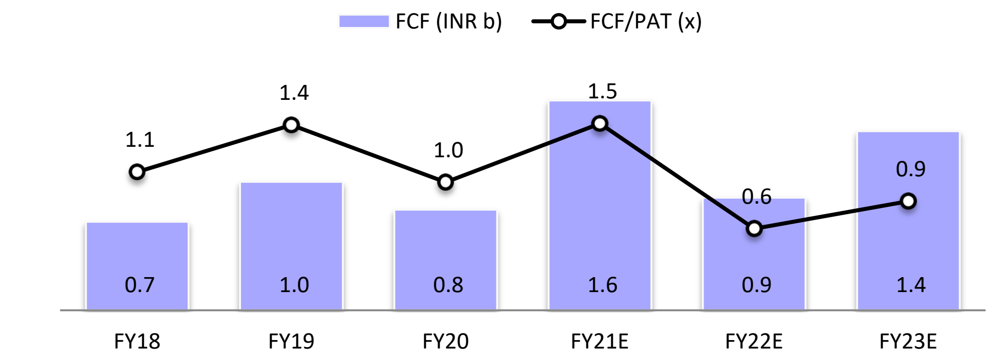

Source: MOFSL, Company

**Exhibit 35: ...with FCF-to-PAT conversion at 95% over FY21-23E**




Source: MOFSL, Company

**Exhibit 36: Superior operating performance will lead to strong cash flows over FY21-23E. Expect this cash to be partly utilized towards capex and debt reduction**

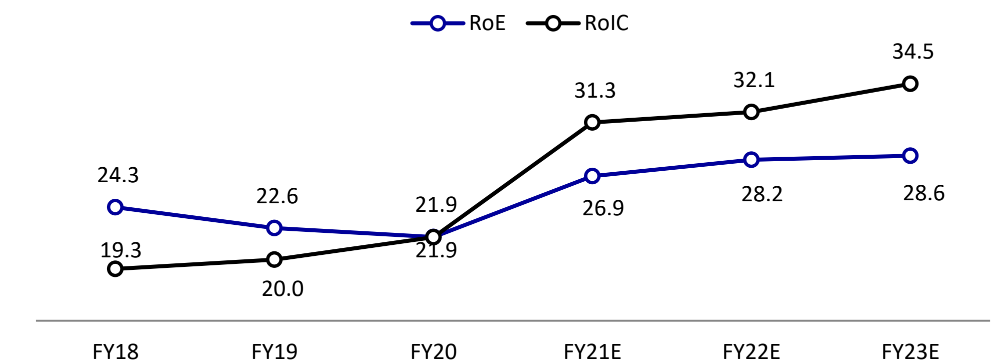



Source: MOFSL, Company

## Robust return ratios owing to a strong business model

Strong operating performance, in-house manufacturing, robust working capital cycle, and lower tax rate is expected to aid RoE of 27-29% over FY21-23E. We expect RoIC to remain at 31-35% over this period, indicating a robust business model.

**Exhibit 37: RoE to expand over FY21-23E owing to strong operating performance, aided by rising manufacturing in-house**



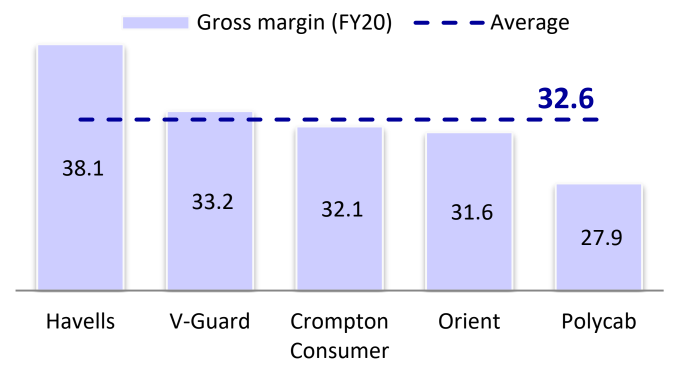

Source: MOFSL, Company

## Initiate with a Buy rating and TP of INR350/share

### Expect EBITDA margin differential with leading companies to converge

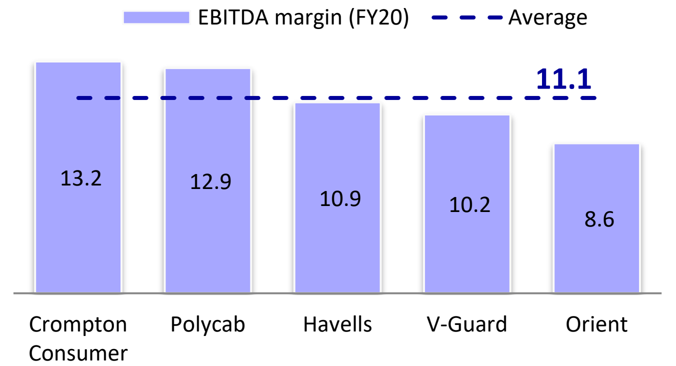
OEL enjoys a similar gross margin as its peers, suggesting that the brand is at par with leading companies on account of its pricing/procurement strategy. It has one of the lowest EBITDA margin compared to peers. EBITDA margin stood at just 8.6% in FY20 v/s an average of 11.1% for its peers. In fact, its EBITDA margin is 4.6pp below Crompton, despite the fact that both companies have a similar product portfolio. Our analysis of overheads suggests that such a differential can be attributed to employee cost, ad spends, etc. and OEL is perhaps in the investment phase. There is a strong case for a potential improvement in steady state EBITDA margin towards double-digits.

**Exhibit 38: OEL enjoys gross margin at par with peers…**



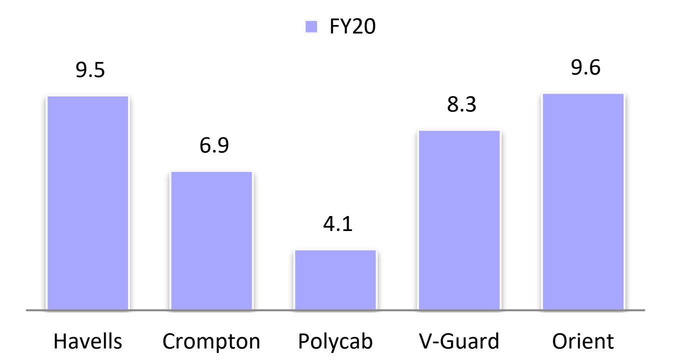

Source: MOFSL, Company

**Exhibit 39: …but lags on EBITDA margin due to higher overheads**



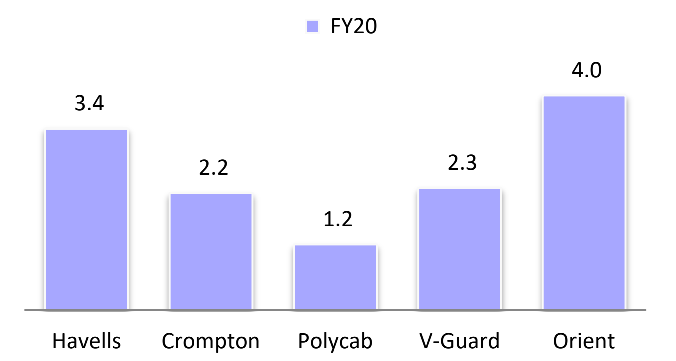

Source: MOFSL, Company

**Exhibit 40: Employee cost as a percentage of sales v/s peers**




Source: MOFSL, Company

**Exhibit 41: Ad spends as a percentage of sales v/s peers**




Source: MOFSL, Company

### High return ratios attributable to asset light model

Despite higher investments in people and branding-related spends, and hence potentially lower margin at present, OEL generates a RoE of over 22%, which is superior to many peers. Our DuPont analysis suggests that the key reason for higher return ratios is its asset light model as suggested by the high asset turnover ratio. With the potential for margin expansion, as it bridges the wide gap with peers, we expect RoE to expand to over 28%.

**Exhibit 42: DuPont Analysis | Asset light business model aids RoE of over 22%; further room to expand as margin differential with peers narrows**

| RoE - DuPont Analysis | FY18 | FY19 | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|---|
| Net margin | 4.0 | 3.7 | 3.8 | 5.6 | 5.5 | 5.7 |
| Asset turnover | 3.7 | 4.4 | 4.7 | 4.4 | 4.7 | 4.7 |
| Leverage | 1.6 | 1.4 | 1.2 | 1.1 | 1.1 | 1.1 |
| **RoE** | **24.3** | **22.6** | **21.9** | **26.9** | **28.2** | **28.6** |

Source: MOFSL, Company

## Deserves premium valuation; initiate with a Buy rating and TP of INR350/share

OEL's near-term earnings doesn't capture the true value of the franchise as the company is currently in the investment phase (brand building) and hence its margin is below peers. Earnings are also depressed on higher depreciation v/s peers (absolute depreciation is higher than the leader in the Fan industry, i.e. Crompton) due to greater in-house manufacturing content. Despite higher investments in people and branding-related spends, and hence potentially lower margin at present, it generates a RoE of over 22%, which is superior to many peers. We value OEL at a target multiple of 45x on Mar'23E EPS to arrive at our TP of INR350/share. Note that our target multiple is at a discount of ~10% to Havells, but at a premium to Crompton (target multiple of 40x) as our thesis is based on the narrowing of the margin differential over the next five years. At CMP, the stock trades at a 25% discount to Havells on a FY23E P/E basis. However, the discount increases to 37% on an EV/EBITDA basis. While it trades at ~10% premium to Crompton on a P/E basis, our EV/EBITDA analysis suggests a discount of 17%.

**Exhibit 43: We value OEL at a target multiple of 45x Mar'23E EPS to arrive at our TP of INR350 per share**

| Valuation | Basis | Multiple (x) | Mar'23E EPS | TP (INR) |
|---|---|---|---|---|
| Core business | Mar'23E P/E | 45x | 7.7 | 350 |
| **Total (rounded off)** | | | **7.7** | **350** |

Source: MOFSL, Company

**Exhibit 44: Valuation summary | On an EV/EBITDA basis, OEL trades cheaper than peers like Havells and Crompton despite generating one of the best RoE**

| Company | M-cap (INR b) | CMP (INR) | P/E (x) | | | EV/EBITDA (x) | | | RoE (%) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E |
| Havells | 691 | 1,104 | 67.0 | 56.4 | 50.3 | 43.4 | 37.9 | 33.7 | 20.6 | 21.2 | 20.6 |
| Voltas | 348 | 1,053 | 73.8 | 50.6 | 43.6 | 60.4 | 40.6 | 35.4 | 10.2 | 13.5 | 14.1 |
| Whirlpool | 306 | 2,409 | 88.4 | 53.0 | 43.9 | 55.8 | 35.0 | 29.3 | 12.3 | 17.4 | 17.8 |
| Crompton | 257 | 410 | 49.1 | 38.6 | 34.0 | 35.6 | 28.3 | 25.4 | 29.4 | 30.5 | 28.7 |
| Blue Star | 91 | 945 | 102.7 | 52.4 | 37.3 | 38.0 | 26.9 | 21.5 | 10.8 | 19.6 | 24.8 |
| **OEL** | **63** | **295** | **55.8** | **45.4** | **38.2** | **29.9** | **25.1** | **21.4** | **26.9** | **28.2** | **28.6** |

Source: MOFSL, Bloomberg, Company

## SWOT Analysis


### STRENGTHS

**Strong brand name in the Fans market:** OEL has been one of the stronger players in in the Indian Fans business for over six decades. It is the largest manufacturer and exporter of Fans with more than 60% share of exports.

**Experienced top management:** The latter has extensive industry and management experience, with Mr. Rakesh Khanna at the helm of the business since Dec'14. The top management across the key verticals of Fans, Lighting, Switchgear, and Appliances have an industry experience of ~30 years.

**Local manufacturing capabilities to aid margin expansion:** OEL has increased its capex intensity in the recent years with the aim to increase in-house manufacturing and gradually reduce its dependence on imports. Higher in-house manufacturing will aid the company in better cost controls in a competitive industry.

**Higher focus on branding with a focus on ad spends:** The company has one of the highest ad spends among peers, suggesting new product launches are adequately backed up by ad spends. It has signed India's star cricketer Mr. M.S. Dhoni as its brand ambassador from 2006.

### WEAKNESSES

**Higher dependency on Fans:** The company has diversified off late with the entry into Switchgears and Appliances and gradually scaled up its Lighting business. However, Fans still constitute ~62% of FY20 revenue (down from ~90% in FY11). As a category, the Fans market has been growing at high single-digits, with some market share gains for large organized players accruing from unorganized and smaller organized players.

### OPPORTUNITIES

**Diversification into wider Electrical products and Appliances category:** A strong distribution reach with 5,000 dealers and 125,000 retailers presents a ready to serve market for OEL to expand its product offerings and widen its offerings in order to further de-risk itself from higher exposure to revenue from the Fans segment.

### THREATS

**Strong competition, likely supply chain normalization could aid unorganized/smaller players:** While larger organized players like Havells, Crompton and OEL have enjoyed market share gains from unorganized players, the risk from the unorganized market remains, in hindsight, as the supply chain normalizes. Even if the unorganized and smaller organized players are unable to establish themselves again, competition would then be against large brands with an established distribution network.

## Bull and Bear Case

### Bull Case

- ☑ We assume higher revenue/EBITDA/PAT CAGR of 23%/25%/30% over FY21-23E.
- ☑ We expect gross margin to expand owing to rising in-house manufacturing and product premiumization.
- ☑ Assuming similar target PE of 45x, we arrive at our target price of INR450 per share, a ~60% upside.

### Bear Case

- ☑ We assume slower offtake for OEL in its respective segments, factoring in revenue/EBITDA/PAT CAGR of 12%/3%/nil over FY21-23E.
- ☑ As the company has already invested in the business prior to COVID-19, we assume a contraction in margin owing to lower operating leverage.
- ☑ Assuming a target PE of 40x, we arrive at a target price of INR210 per share, a 25% downside.

**Scenario analysis - Bull Case**

| (INR b) | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|
| Revenue | 20.6 | 20.8 | 26.2 | 31.3 |
| Growth (%) | 10.6 | 0.9 | 26.0 | 19.4 |
| EBITDA | 1.8 | 2.2 | 2.8 | 3.5 |
| YoY growth (%) | 24.9 | 27.5 | 23.2 | 27.7 |
| EBITDA margin (%) | 8.6 | 10.8 | 10.6 | 11.3 |
| PAT | 0.8 | 1.2 | 1.6 | 2.1 |
| EPS (INR) | 3.7 | 5.8 | 7.5 | 9.9 |
| P/E multiple (x) | | | | 45 |
| Target price (INR) | | | | 450 |
| Upside/(downside) (%) | | | | 61.0 |

Source: Company, MOFSL

**Scenario analysis – Bear Case**

| (INR b) | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|
| Revenue | 20.6 | 20.0 | 22.6 | 24.9 |
| Growth (%) | 10.6 | (3.0) | 13.0 | 10.3 |
| EBITDA | 1.8 | 2.1 | 2.0 | 2.2 |
| YoY growth (%) | 24.9 | 18.7 | (2.7) | 8.4 |
| EBITDA margin (%) | 8.6 | 10.5 | 9.0 | 8.9 |
| PAT | 0.8 | 1.1 | 1.0 | 1.1 |
| EPS (INR) | 3.7 | 5.3 | 4.9 | 5.2 |
| P/E multiple (x) | | | | 40 |
| Target price (INR) | | | | 210 |
| Upside/(downside) (%) | | | | (25.0) |

Source: Company, MOFSL

# Management overview

## Mr. Chandra Kant Birla, Chairman (Non-Executive, Non-Independent)

Mr. Chandra Kant Birla is the promoter of OEL. He was appointed as Non-Executive Director and Chairman on 19th Jan'19 after the demerger of OEL. He has completed his Bachelor of Arts and has a rich business experience in managing diversified industrial enterprises. He is also Chairman of several companies in the CK Birla group. The Group has interests across industries such as Automotive, Technology, Infrastructure, Building Products, Healthcare, and Education.

## Mr. Deepak Khetrapal, Vice Chairman

Mr. Deepak Khetrapal has been appointed as Vice Chairman of OEL post its demerger. He has a rich experience in Industrial, Consumer, and Retail businesses and is the Managing director and CEO of Orient Cements, Non-Executive Director of HIL and Independent director at Oriental Bank of Commerce. He is a business leader with a track record of leading and transforming large and diversified organizations across industries including Services, Industrials, Consumer, and Retail businesses.

## Mr. Rakesh Khanna, Managing Director and CEO

Mr. Rakesh Khanna was appointed as CEO to lead the Consumer Electricals business of the merged entity in Dec'14. He has been on the board since its demerger. He has over 31 years of work experience in India and abroad in the Consumer Durables, Consumer Electronics, Electrical, and Lighting sectors. His earlier role involved heading Jumbo Electronics.

## Mr. TCA Ranganathan, Independent Director

Mr. TCA Ranganathan was associated with State Bank of India and Export Import Bank of India. He is currently associated as an arbitrator on the panels of various stock exchanges and the Indian Council of Arbitration. He is also associated with the United Nations Development Program for promoting growth in Africa and Asia. He has more than 38 years of experience in corporate finance, international banking, and investment banking.

## Mr. K Pradeep Chandra, Independent Director

Mr. K. Pradeep Chandra is a retired IAS officer. He began his career as a graduate engineer trainee in Whirlpool of India. He headed a number of state public sector undertakings and has over 35 years of experience in Education, Finance, as well as the Industries and Commerce Departments of the Governments of Andhra Pradesh and Telangana.

## Ms. Alka Marezban Bharucha, Independent Director

Ms. Alka Bharucha is the founding partner of Bharucha & Partners, a solicitor at the Bombay High Court, and an Advocate on record at the Supreme Court of India. She has over 31 years of experience in mergers and acquisitions, joint ventures, private equity investments, foreign venture capital investors, brokers, merchant bankers, and other financial intermediaries. She guides trans-national corporations with regard to their Retail, Real Estate, Defense, Power, and Banking investments.

# Industry overview

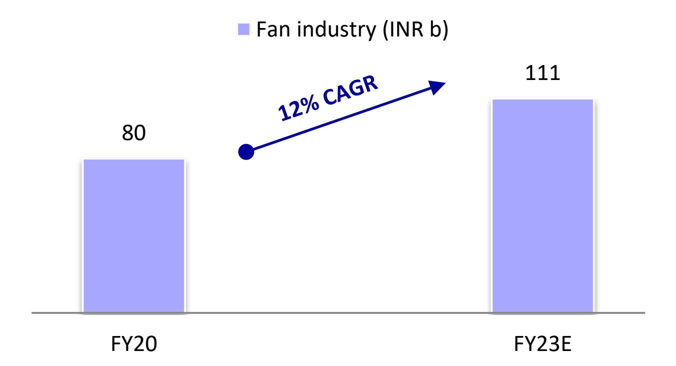
## Fan industry: Premiumization trend to continue

We expect the Indian Fan industry to deliver 12% CAGR over FY20-23E, with the Premium segment growing at 20% over the same period

- **Industry size and growth trends:** The ~INR80b Electric Fan industry has been witnessing volume growth in the 7-8% range. Ceiling Fans account for 70% of India's Electric Fan industry. Ceiling Fan volumes have been impacted by the slowdown in the Real Estate sector over the past few years. Over FY12-20, we estimate Ceiling Fan volume CAGR of ~7%. Fans have higher penetration (~80%), thus the opportunity from higher penetration led growth is limited. The premiumization story is just unfolding, with the industry moving towards better quality and aesthetic offerings. Going forward, thanks to the premiumization trend as well as likely price increases on account of the BEE rating change, we expect the Indian Fan industry to deliver 12% CAGR over FY20-23E, with the Premium segment growing at 20%.

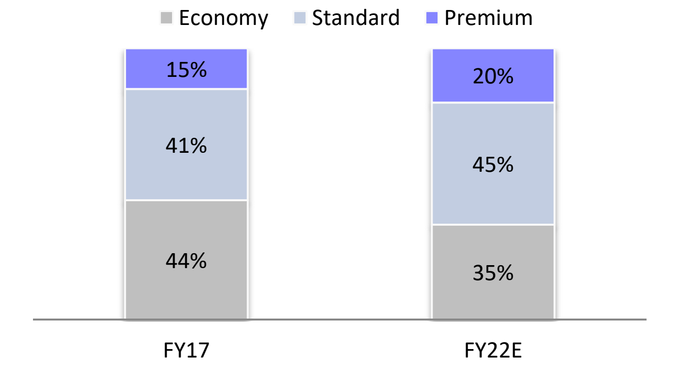
- **Premiumization driving value growth ahead of volume growth:** Growth has been driven by an increasing preference for Premium category products, including Decorative Fans, Energy Efficient Fans, and Custom-made Fans. Premium Fans (over INR 2,500/unit) constituted 15% of the overall industry in FY17 and its share is expected to rise to 20% by FY22.

**Exhibit 45: Expect Fan industry to deliver a steady 12% CAGR over FY20-23E**




Source: MOFSL, Industry report

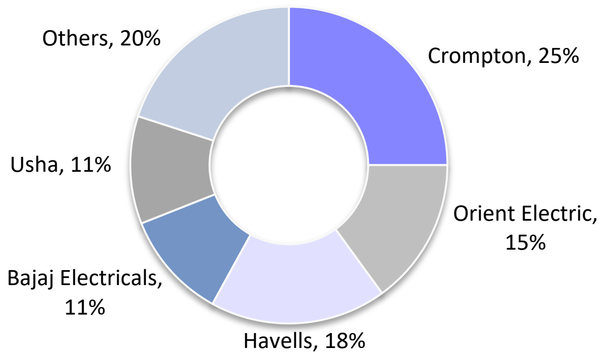
**Exhibit 46: Expect Premium Fans segment to constitute 20% of the industry by FY22E**




Source: MOFSL, Industry report

- **Key players:** Crompton, OEL, and Havells are the market leaders in the Fan segment. Crompton/OEL enjoys a higher market share in Economy/Standard categories, while Havells focuses on the Premium segment, where it is the market leader. This strategy has helped Havells to clock higher margin compared to peers in the Fan segment. Recently, many new players entered this segment to capitalize on the premiumization trend, which has led to higher competition. New entrants include Polycab India, Finolex Cables, and Surya Roshni.

**Exhibit 47: Market share breakup for the Indian Fan industry (INR80b)**




Source: MOFSL, Company

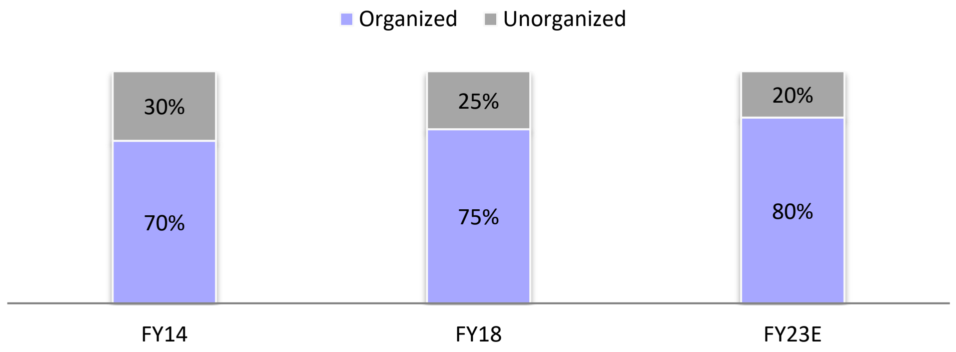
A large part of the urban growth will be via replacement demand

- **Replacement demand at 65%:** Fans are a mature category, with growth rates in high single-digits and most of the growth accruing via replacement demand, which constitutes ~65% of total demand. Unless Real Estate and allied Housing activity significantly picks up, growth in Fans is anticipated to be in single-digits. While growth in rural areas can be attributed to increasing penetration levels, the same in urban is largely led by replacement demand. The Economy category in Fans is slated to grow on rising penetration in the rural market, while urban/semi-urban cities will drive growth in the Premium category.
- **Urban demand led by premiumization:** Fans have become a necessity in urban/semi-urban regions, with penetration levels significantly higher than the category average. Most demand from urban and semi-urban towns is towards Premium products. Havells is the market leader in the Premium Fans segment. Crompton, under a new management, is steadily raising its share of Premium Fan sales. OEL has been growing its Premium Fans portfolio. All three companies are looking to capitalize on the premiumization-led trend in this segment.

The COVID outbreak has accelerated the pace of market shift to large organized players from the unorganized sector

- **Clear shift to organized from the unorganized segment:** Post structural reforms like demonetization and GST, there has been an anticipation of market shift to organized brands from unorganized players. This was attributed to the higher compliance requirement, which has led to lower probability of tax evasion, a key price delta between organized and unorganized players. The COVID-19 pandemic has aided this market shift to organized players as the supply chains of unorganized players were severely impacted.
- **BEE rating changes to further benefit the organized sector:** Another key reason for the likely continuance of the shift to the organized from the unorganized sector is the change in BEE ratings of key products like Fans and Pumps. The rising cost of compliance due to this rating change is likely to shrink the share of the unorganized market.

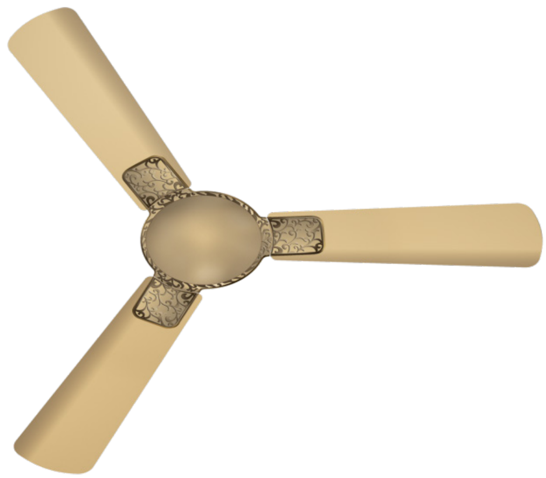
Exhibit 48: Expect formalization of economy to further support organized sector




Source: MOFSL, Channel checks

- **Innovation has picked up in Fans**
  - **Havells – focus on Aesthetics:** Apart from efficient Fans, Havells has also focused on aesthetics with its 'Enticer' range, which offers decorative features like metallic finish at a lower price point.

Exhibit 49: Havells' Enticer range of Decorative Fans



Source: MOFSL, Company

Exhibit 50: Havells' Stealth range of Fans

Source: MOFSL, Company

  - **Crompton – Anti-Dust, Air 360:** The new management at Crompton has been increasingly focusing on innovation. The 'Anti-Dust' and 'Air 360' series of Fans have been driving growth. Anti-Dust Fans use a special type of paint coating, which leads to 50% lesser accumulation of dust compared to regular Fans. Air 360 has superior aerodynamic designed blades which ensure 50% greater air circulation across the house.

**Exhibit 51: Crompton's Air 360 Fans**

Source: MOFSL, Company

**Exhibit 52: Crompton's Anti-Dust Fans**

Source: MOFSL, Company

- **OEL – Aeroquiet:** Post demerger, the management team aggressively focused on new launches. It launched 'Aeroquiet' Fans with rust-free blades and an advanced aerodynamic blade design, which ensures higher speed while ensuring smooth operations.

**Exhibit 53: OEL's Aeroquiet range of Premium Fans**

Source: MOFSL, Company

**Exhibit 54: OEL's Aeroslim range of Fans**

Source: MOFSL, Company

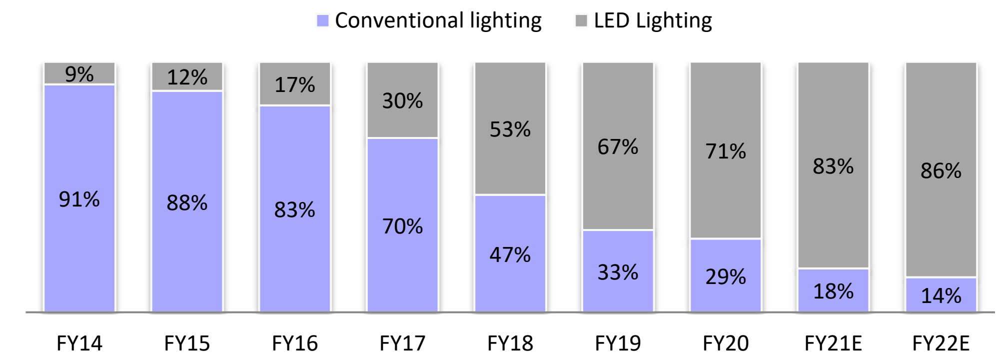
## Lighting industry: Consolidation underway, price erosion over

- **An overview:** The Lighting industry – comprising Conventional Lighting, LED Lighting, and accessories – is estimated ~INR220b. During FY13-18, the Indian Lighting industry witnessed massive LED adaption, replacing Conventional Lighting, aided by orders from Energy Efficiency Services (EESL).

We expect LED Lighting to constitute ~86% of the Lighting industry by FY22E

- **Shift to LEDs:** The industry witnessed rapid LED adoption, driven by government initiatives and falling sales of Conventional Lighting products (GLS, FTL, and CFLs). Over FY13-17, the LED segment delivered 67% CAGR, while Conventional Lighting CAGR was muted at 4%. Conventional Lighting sales peaked out in FY15, and thereafter, have been declining at a rapid pace. This trend is expected to continue over the next 4-5 years, with the share of the LED segment increasing to ~86% by FY22E.

**Exhibit 55: LED replacing Conventional Lighting at a rapid pace**




Source: MOFSL, Channel checks

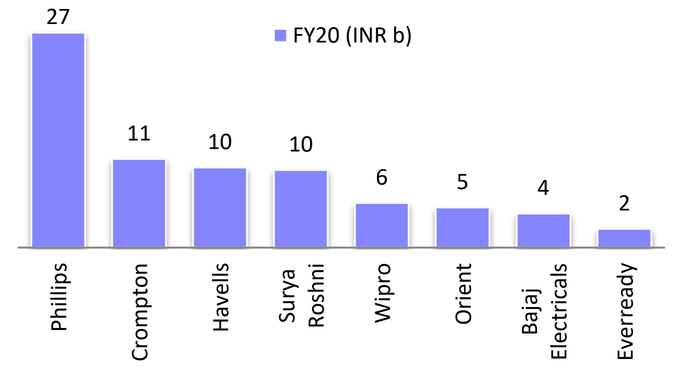
LED prices have bottomed out, after declining by over 60% in the last few years

- **Economies of scale played out making LEDs affordable:** LED chip prices have declined by more than 60% over the past few years, reducing the cost of in-house manufacturing. This has incentivized manufacturers to upgrade to LED Lighting. Though the benefits from improved economies of scale having reached their peak and LED chip prices having bottomed out, LED prices are unlikely to decline further.

- **Growth drivers:** Following are a few macro growth enablers for the industry:
  - Investment in public infrastructure
  - Government's push for Affordable Housing and initiatives to improve Power availability
  - Growth of the Automobile segment
  - Positive macroeconomic environment to drive growth in the Indian Lighting and Luminaires industry over the medium-to-long term
  - Demand for the LED segment to stem from the retail segment over the medium-to-long term.
  - Softer aspects such as environmentally friendly features, energy efficiency, relatively affordable prices, and enhanced aesthetics (compared to CFLs) are expected to favor the LED Lighting segment from a retail perspective.

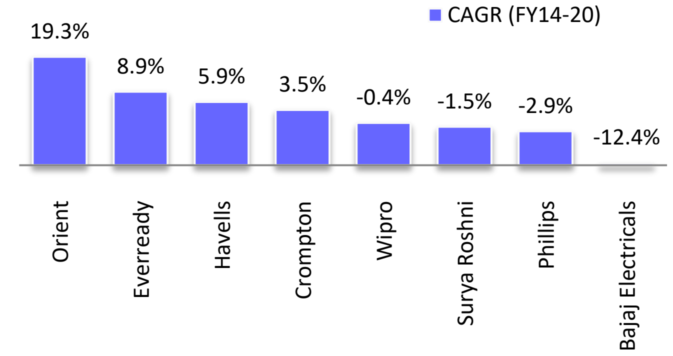
- **Key players:** Phillips Lighting, Havells, Osram, Surya Roshni, Crompton, Syska, and Bajaj. Philips is the undisputed market leader in this segment. Growth in the Lighting segment for Philips has been flat over the past five years, with higher LED segment sales offset by a decline in Conventional Lighting sales. Havells, Crompton, and other new entrants have expanded their market share.

**Exhibit 56: Lighting revenues of key players in FY20 – Philips is still the numero uno player**




Source: MOFSL, Company

**Exhibit 57: New entrants have grown at a higher rate v/s leaders like Philips by capitalizing on the LED opportunity**

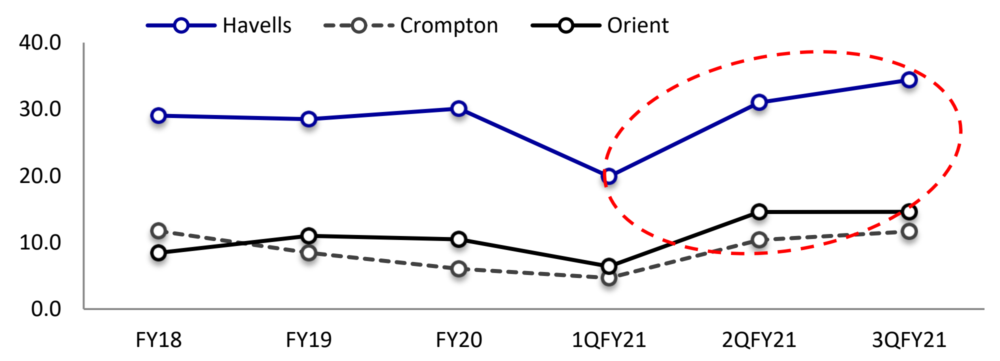



Source: MOFSL, Company

- **Price erosion has bottomed out, margin to improve:** Competitive intensity has bottomed out in the Lighting industry, though it is not completely over. This can be gauged by the price hikes over the past year. The last round of price cuts occurred in Aug'19. Since then, there has been two rounds of price hikes. We expect value growth in the Lighting segment to follow volume growth, and the uptrend in margins to continue. This is clearly playing out since 2QFY21 as reflected in the segmental financials of Crompton, Havells, and OEL.

**Since the last round of price cuts in Aug'19, there has been gradual price hikes, indicating a bottoming of LED prices**

**Exhibit 58: Organized players seeing an uptick in Lighting margin, with the bottoming of LED price erosion and subsequent price hikes**




Source: MOFSL, Company,

Note: Have considered EBIT margin for Crompton and OEL and contribution margin for Havells

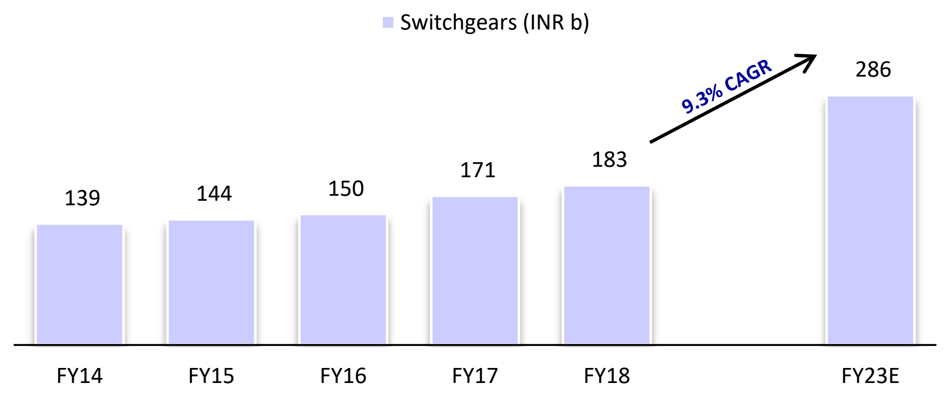
## Switches and Switchgears: MCBs and Modular Switches to aid growth

The Switchgear market is estimated at INR183b, and Switches ~INR40b

- **Industry size and growth trends:** The Switches and Switchgear industry are estimated ~INR223b, delivering 7.2% CAGR over FY14-18. Switches form ~INR40b of the market. The Switchgear market is estimated at INR183b. The market has grown in single-digits since FY14 owing to the slowdown in Real Estate and Construction activity. Switchgears are further segmented into LV (low voltage), MV (medium voltage), and HV (high voltage). LV Switchgears are mostly used in the Residential segment, whereas MV and HV Switchgears are used in the Industrial and Power Utilities segment.
- **MCBs and Modular Switches to aid growth of Switchgears and Switches:** Increasing safety awareness and higher voltage fluctuations are expected to lead to higher use of MCBs in households. With Switches being a visible part of home décor, we expect Modular Switches to drive growth within this category.
- **Lower presence of unorganized players in Switchgears and Switches:** Since the product requirement in Switchgears is technically superior, the share of organized players within the market is as high as 90%.

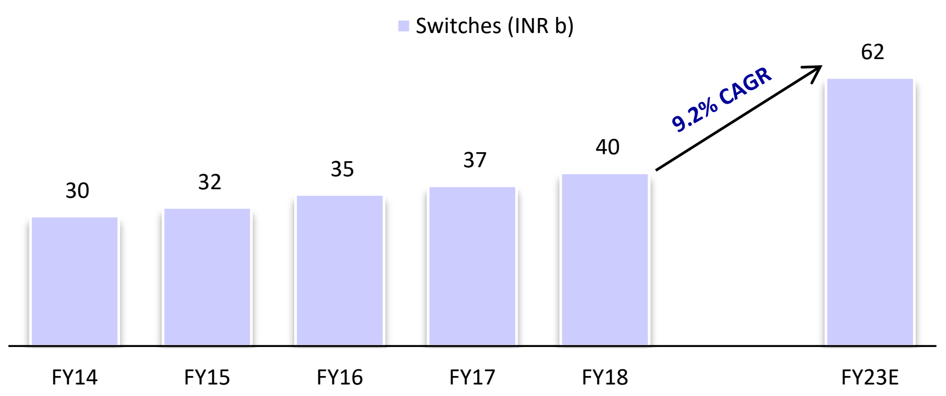
Switchgear and Switches are expected to grow ~9% CAGR over FY18-23E, with scope for accelerated growth if the Real Estate sector revives

**Exhibit 59: Expect Switchgear segment to deliver 9.3% CAGR over FY18-23E**




Source: MOFSL, Company

**Exhibit 60: Expect Switches segment to deliver 9.2% CAGR over FY18-23E**




Source: MOFSL, Company

# Financials and valuations

| Income Statement | | | | | | (INR m) |
|---|---|---|---|---|---|---|
| **Y/E March** | **FY18** | **FY19** | **FY20** | **FY21E** | **FY22E** | **FY23E** |
| **Net Sales** | **15,998** | **18,644** | **20,618** | **20,000** | **25,000** | **28,650** |
| Change (%) | | 16.5 | 10.6 | -3.0 | 25.0 | 14.6 |
| **EBITDA** | **1,365** | **1,413** | **1,764** | **2,094** | **2,492** | **2,915** |
| % of Net Sales | 8.5 | 7.6 | 8.6 | 10.5 | 10.0 | 10.2 |
| Depreciation | 198 | 231 | 401 | 433 | 486 | 561 |
| Interest | 245 | 229 | 261 | 200 | 200 | 200 |
| Other Income | 55 | 95 | 41 | 40 | 40 | 40 |
| **PBT** | **978** | **1,049** | **1,143** | **1,501** | **1,847** | **2,194** |
| Tax | 338 | 356 | 357 | 378 | 465 | 552 |
| Rate (%) | 34.6 | 33.9 | 31.2 | 25.2 | 25.2 | 25.2 |
| Extra-ordinary Inc. (net) | 0 | 0 | 0 | 0 | 0 | 0 |
| **Reported PAT** | **640** | **693** | **786** | **1,123** | **1,382** | **1,642** |
| Change (%) | | 8.3 | 13.4 | 42.8 | 23.1 | 18.8 |
| **Adjusted PAT** | **640** | **693** | **786** | **1,123** | **1,382** | **1,642** |
| Change (%) | | 8.3 | 13.4 | 42.8 | 23.1 | 18.8 |

| Balance sheet | | | | | | (INR m) |
|---|---|---|---|---|---|---|
| **Y/E March** | **FY18** | **FY19** | **FY20** | **FY21E** | **FY22E** | **FY23E** |
| Share Capital | 212 | 212 | 212 | 212 | 212 | 212 |
| Reserves | 2,420 | 2,854 | 3,382 | 3,966 | 4,684 | 5,538 |
| **Net Worth** | **2,632** | **3,066** | **3,594** | **4,178** | **4,896** | **5,750** |
| Loans | 1,641 | 1,349 | 985 | 585 | 585 | 585 |
| Deferred Tax Liability | 0 | -197 | -214 | -214 | -214 | -214 |
| **Capital Employed** | **4,274** | **4,219** | **4,365** | **4,549** | **5,267** | **6,121** |
| Gross Fixed Assets | 2,115 | 2,388 | 2,788 | 2,988 | 3,488 | 3,988 |
| Less: Depreciation | 1,058 | 1,223 | 1,430 | 1,863 | 2,349 | 2,909 |
| **Net Fixed Assets** | **1,057** | **1,166** | **1,358** | **1,125** | **1,139** | **1,079** |
| Capital WIP | 47 | 43 | 103 | 103 | 103 | 103 |
| Investments | 0 | 0 | 0 | 0 | 0 | 0 |
| **Curr. Assets** | **6,980** | **7,483** | **7,929** | **8,196** | **10,119** | **11,923** |
| Inventory | 2,091 | 2,640 | 2,865 | 2,779 | 3,474 | 3,981 |
| Debtors | 3,864 | 4,047 | 3,889 | 3,772 | 4,715 | 5,404 |
| Cash and Bank Balance | 305 | 316 | 75 | 577 | 595 | 1,009 |
| Loans and Advances | 97 | 0 | 0 | 0 | 0 | 0 |
| Other Current Assets | 624 | 479 | 1,101 | 1,068 | 1,334 | 1,529 |
| **Current Liab. and Prov.** | **3,810** | **4,473** | **5,025** | **4,875** | **6,093** | **6,983** |
| Creditors | 2,762 | 3,509 | 3,305 | 3,206 | 4,007 | 4,592 |
| Other Liabilities | 743 | 569 | 1,257 | 1,219 | 1,524 | 1,746 |
| Provisions | 306 | 395 | 464 | 450 | 563 | 645 |
| **Net Current Assets** | **3,170** | **3,010** | **2,904** | **3,321** | **4,025** | **4,940** |
| **Application of Funds** | **4,274** | **4,219** | **4,365** | **4,549** | **5,267** | **6,121** |

## Financials and valuations

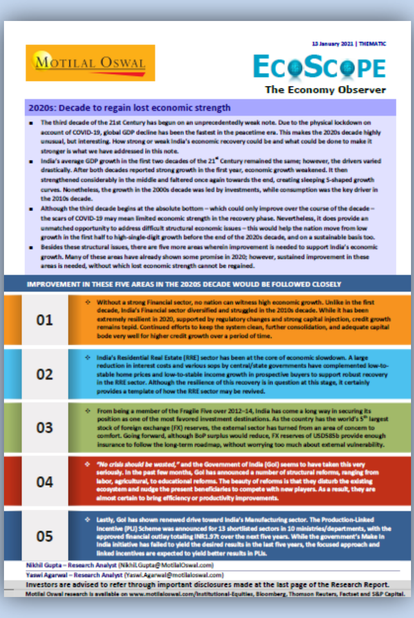
**Ratios**

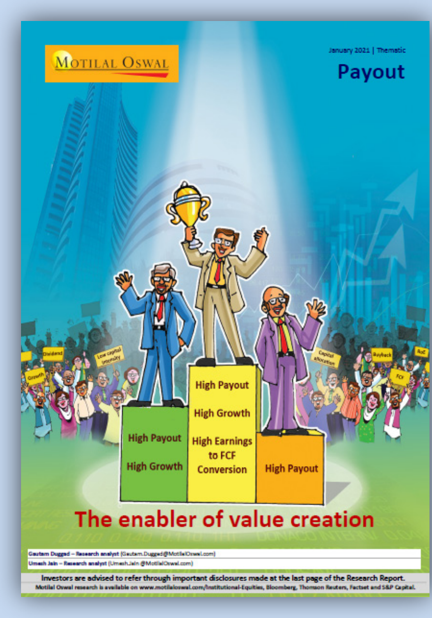
| Y/E March | FY18 | FY19 | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|---|
| **Basic EPS (INR)** | | | | | | |
| **Adjusted EPS** | **3.0** | **3.3** | **3.7** | **5.3** | **6.5** | **7.7** |
| Growth (%) | | 8.2 | 13.4 | 42.8 | 23.1 | 18.8 |
| Cash EPS | 3.9 | 4.4 | 5.6 | 7.3 | 8.8 | 10.4 |
| Book Value | 12.4 | 14.4 | 16.9 | 19.7 | 23.1 | 27.1 |
| DPS | 0.5 | 1.0 | 1.2 | 2.1 | 2.6 | 3.1 |
| Payout (incl. Div. Tax.) | 19.9 | 36.9 | 37.4 | 48.0 | 48.0 | 48.0 |
| **Valuation (x)** | | | | | | |
| P/Sales | 3.9 | 3.4 | 3.0 | 3.1 | 2.5 | 2.2 |
| P/E | 97.9 | 90.4 | 79.7 | 55.8 | 45.4 | 38.2 |
| Cash P/E | 74.8 | 67.9 | 52.8 | 40.3 | 33.6 | 28.5 |
| EV/EBITDA | 46.9 | 45.1 | 36.0 | 29.9 | 25.1 | 21.4 |
| EV/Sales | 4.0 | 3.4 | 3.1 | 3.1 | 2.5 | 2.2 |
| Price/Book Value | 23.8 | 20.4 | 17.4 | 15.0 | 12.8 | 10.9 |
| Dividend Yield (%) | 0.2 | 0.3 | 0.4 | 0.7 | 0.9 | 1.0 |
| **Profitability Ratios (%)** | | | | | | |
| RoE | 24.3 | 22.6 | 21.9 | 26.9 | 28.2 | 28.6 |
| RoCE | 18.7 | 20.0 | 22.1 | 28.0 | 29.1 | 29.3 |
| RoIC | 19.3 | 20.0 | 21.9 | 31.3 | 32.1 | 34.5 |
| **Turnover Ratios** | | | | | | |
| Debtors (Days) | 88 | 79 | 69 | 69 | 69 | 69 |
| Inventory (Days) | 48 | 52 | 51 | 51 | 51 | 51 |
| Creditors (Days) | 63 | 69 | 59 | 59 | 59 | 59 |
| Asset Turnover (x) | 3.7 | 4.4 | 4.7 | 4.4 | 4.7 | 4.7 |
| **Leverage Ratio** | | | | | | |
| Net Debt/Equity (x) | 0.5 | 0.3 | 0.3 | 0.0 | 0.0 | -0.1 |

**Cash Flow Statement** **(INR m)**

| Y/E March | FY18 | FY19 | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|---|
| **PBT before EO Items** | **978** | **1,049** | **1,143** | **1,501** | **1,847** | **2,194** |
| Add: Depreciation | 198 | 231 | 401 | 433 | 486 | 561 |
| Interest | 245 | 229 | 261 | 200 | 200 | 200 |
| Less: Direct Taxes Paid | 259 | 301 | 482 | 378 | 465 | 552 |
| (Inc.)/Dec. in WC | 489 | 303 | 423 | -85 | 686 | 501 |
| Others | 274 | 446 | 409 | 0 | 0 | 0 |
| **CF from Operations** | **947** | **1,349** | **1,310** | **1,841** | **1,381** | **1,902** |
| (Inc.)/Dec. in FA | -254 | -345 | -522 | -200 | -500 | -500 |
| **Free Cash Flow** | **693** | **1,005** | **788** | **1,641** | **881** | **1,402** |
| (Pur.)/Sale of Investments | 0 | 0 | 0 | 0 | 0 | 0 |
| **CF from Investments** | **-254** | **-345** | **-522** | **-200** | **-500** | **-500** |
| (Inc.)/Dec. in Debt | -246 | -513 | -476 | -400 | 0 | 0 |
| Less: Interest Paid | 245 | 229 | 259 | 200 | 200 | 200 |
| Dividend Paid | 128 | 256 | 294 | 539 | 663 | 788 |
| Others | -3 | 4 | 0 | 0 | 0 | 0 |
| **CF from Fin. Activity** | **-622** | **-994** | **-1,029** | **-1,139** | **-863** | **-988** |
| **Inc./Dec. in Cash** | **71** | **11** | **-241** | **502** | **18** | **414** |
| Add: Beginning Balance | 234 | 305 | 316 | 75 | 577 | 595 |
| **Closing Balance** | **305** | **316** | **75** | **577** | **595** | **1,009** |

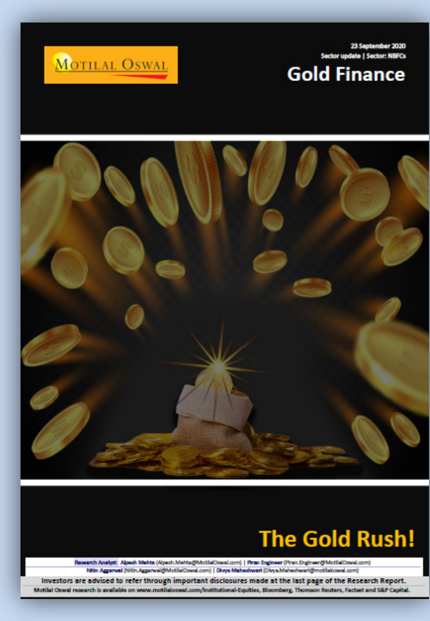
# THEMATIC/STRATEGY RESEARCH GALLERY









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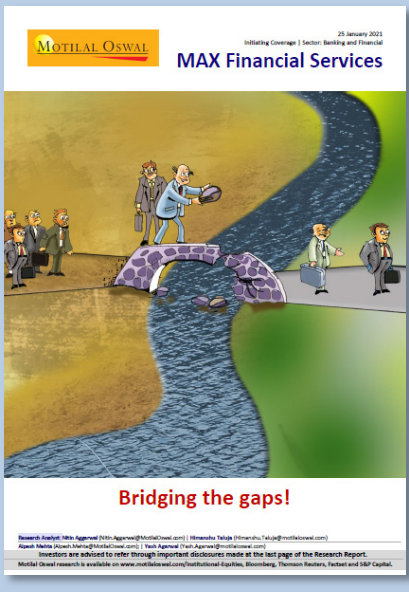



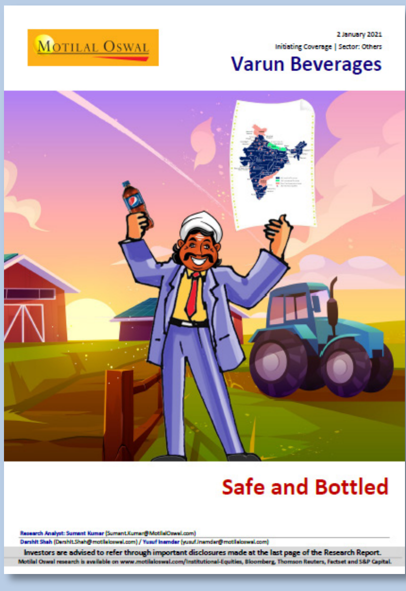



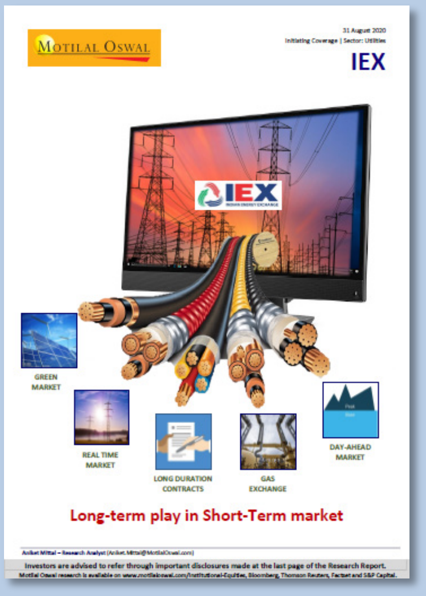


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- Best Sales Person
- Best Overall Research 2nd Rank

| Explanation of Investment Rating | |
|---|---|
| **Investment Rating** | **Expected return (over 12-month)** |
| BUY | >=15% |
| SELL | < - 10% |
| NEUTRAL | < - 10 % to 15% |
| UNDER REVIEW | Rating may undergo a change |
| NOT RATED | We have forward looking estimates for the stock but we refrain from assigning recommendation |

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