



JOINDRE CAPITAL SERVICES LTD.

SEBI REGN NO. INH000002061 / INB 230766739 / INB 011107555

RESEARCH REPORT

11th Dec 2017

COMPUAGE INFOCOM LIMITED

BSE : COMPUAGE

Sector: IT PRODUCTS DISTRIBUTION BUSINESS

BSE: 532456

View - BUY

CMP : Rs. 43

Target Price: Rs 82 (In next 12 to 18 mths)

BUSINESS BACKGROUND

Compuage Infocom Limited is an information technology distribution company that distributes computer peripherals, Telecom and Power Products. CIL also provides products support services for Information Technology products and Installation and annual maintenance services for these products.

CIL was founded in 1987 and has its headquarters in Mumbai. The company also has subsidiaries in Singapore. Over the last 30 years CIL has developed a strong network of over 10000 channel partners across 800 cities & is currently associated with 32 marquee brands with 42 warehouses & 61 service centres across pan India.

INVESTMENT HIGHLIGHTS

Steady Financials for CIL as on H1 FY18 –

CIL reported a steady set of H1FY18 numbers with net sales at Rs 1885 crs, as compared to a revenue of Rs 1627 crs in H1 last year, with EBIDTA placed at Rs 34.64 crs from Rs 31.16 crs in H1 last year and the PAT in H1 FY18 at Rs 10.40 crs against Rs 10.18 crs in H1 last year.

For FY17 the company has recorded net income of Rs 3551 crs, a EBIDTA of Rs 56.89 crs and a PAT of Rs 17.62 crs. CIL declared a dividend of 20% last year.

CIL has a broad based product mix across 3 main Group Categories –

CIL's product mix is spread across three product category groups which includes the IT Product Vertical, Enterprise Product Vertical and the Mobility Product Vertical.

IT Product Verticals includes products like PC Components like TFD Screens, HD, Optical Drives, Peripherals, Spares, memory products, accessories, Laptops/Desktops

Enterprise Product vertical includes products like providing enterprise solutions which include passive networking, active networking, Digital Signage and Softwares, cloud management services, Vertical solutions and Business Applications.

Mobility Vertical Solutions Group includes products like SmartPhones, Tablets, Mobile Accessories, Fire Alarm and Public Address Systems, Access Control & Video Surveillance services.

CIL generates around 85% of its Topline from the IT Product Verticals which includes Enterprise products also with the rest 15% coming in from the Mobility business vertical.

KEY DATA

FACE VALUE	Rs	2.00
DIVID YIELD %		0.93
52 WK HI/LOW		64/21
NSE CODE		COMPINFO
BSE CODE		COMPUAGE
MARKET CAP		RS 252 CRS

SHAREHOLDING PATTERN

PROMOTERS	-	61%
BANKS, MFs & DIIs	-	%
FIIs	-	9%
PUBLIC	-	30%

KEY FUNDAMENTALS

YE	FY18	FY19	FY20
Rev Gr%	16	20	20
EBIDTA Gr%	28	23	20
PAT Gr%	15	34	48
EPS Gr%	15	34	48
EPS (Rs)	3,46	4.62	6.85
ROE %	16	19	23
ROCE %	15	17	19
P/E(x)		9	6



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CIL is associated with 32 Global Brands as on date –

Some of the key brands where CIL is associated with are mentioned below



Top 3 vendors for CIL include HP, Cisco and Samsung.

During FY17 CIL has added 14 new principal relationships to its product portfolio. These include

- Extreme Networks (Complete Networking)
- Hanwha - Samsung (Security and Surveillance in CCTV)
- Xerox (Printers)
- Sandisk (Flash and SSD Products)
- Linksys (Networking Products)
- LG (Signages)
- Emerson (UPS)



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Lenovo (Consumer PC's for MP)
Molex (Passive Networking Products)
BenQ (Projectors)
TP Link (Networking Products)
Tyco Security Products (Surveillance and Security Products)
24 Online (Software Products)
Reliance Lyf/Jio (Devices, Recharge Coupons)

CIL has also made huge inroads PAN India through its Geographical Reach which is a key variable in this industry –

CIL has increased its strength of reseller network to more than 10,000 during the year from 7,800 in the previous year. This network includes 105 System Integrators that address the enterprise segment, with the addition of 40 in FY2017

CIL has also expanded its reach to nearly 800+ cities/ towns. The proportion of B, C and D category cities / towns in the total reach of CIL has increased considerably. In the coming years, CIL is further planning to expand its reach and connect with more B, C, D cities / towns through its network, as the Indian consumption landscape in the small towns is dramatically changing.

Deeper reach into such smaller markets but growing rapidly is a key differentiator for CIL which is a investment for future growth and is surely expected to help CIL penetrate new markets which are likely to grow exponentially in the next 3-4 years. It has also helped the company in forging partnerships with many principals who are keen to expand their product reach in smaller towns and cities.

CIL has also proactively adopted newer channels such as e-commerce, which are experiencing high growth by selling directly to e-commerce websites thus increasing the reach and pace of growth.

Currently, direct sales to e-Commerce contribute less than 10% of its overall revenues.

To cater to the Export markets CIL plans to cater to the SAARC region by exporting from Singapore to these international markets. This strategic shift would help CIL to expand its network connections to India's neighboring countries, which are relatively similar markets with traditional linkages with India.

However as a core business strategy CIL is looking at the Domestic Market as a big opportunity over the next 5 years especially from the smaller Tier 2 and 3 cities where it has been building a strong reseller network and where it expects business to grow at a solid pace over the medium to long term.

In the current scenario of Digital disruption, and where the market shift is happening from "products" to "experiences", Connected ecosystems, Big Data, device management, Cloud and IoT CIL is putting up stronger systems and processes which will give it access to bigger partnerships, scale up its operating scale & Skills and provide the customer strong product with support efficiency.

According to IDC and MAIT the total addressable market size here by FY20 is estimated at \$ 900 bn but the key challenges going ahead for players like CIL would be to sustain its working capital skills and provide service support going ahead which it is already doing quite commendably for its existing bouquet of products offered currently.



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CIL has outlined a 4 point strategy to propel and sustain its growth engine in future also –

This includes – Service Orientation with Vendors, Cash Flow Management, Regular investments in Technology and Strong Relationship Management with its Reseller network

Service Orientation with Product Vendors –

Enabling downstream partners to sell better, understanding customer needs more accurately and resolving customer issues promptly lead to a service ethic that retains customers and partners. This is paramount in CIL's business as both selection of the Brand and the distribution arm have to work in tandem together with service being a strong plus point if the association has to lead to a meaningful business relationship. In fact most large product vendors look at the Distributors service capability before engaging new business possibilities with them.

CIL has been investing regularly in strong, robust pre and post-sales support teams with efficient logistics, to ensure that it meets the needs of customer segments including consumer and enterprise, thus developing long-term partnerships with its network.

Cash Flow Management is also critical to survive in this industry –

Along with smooth flow of goods, it is also critical for the distributor to ensure smooth flow of capital across the chain. CIL has put a constant focus on reseller credibility and credit checks, along with exposure management which is a standard business mantra at CIL. Over the last two decades CIL has put in place systems and a well-defined processes to manage these operations.

Technology Investments are also a key variable to stay ahead –

Automated order processing, inventory management and credit management are necessary for efficient operations and preventing blockage of capital. CIL has moved its operations to SAP in 2013 and completed the implementation in a record time of 8 months. Now, CIL is poised to introduce B2B e-commerce to bring the convenience of 24/7 online ordering to our channel partners.

Relationship Management with Reseller network –

The key underlying parameter for successful relationships within Resellers is the right choice of a partner. People, objectives, processes and business practices that consistently enable a partner to grow the business.

CIL has set clear benchmarks for selection of resellers, which are followed rigorously to ensure that it enjoys the right partners onboard.

Ethical business practices of not bypassing or under-cutting resellers are equally important for the trust they have placed in the company.



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NOTABLE TRENDS IN THE ELECTRONICS SECTOR –

Consumer electronics –

Increased presence of organised retail and affordability due to technological advancement. Expansion into new segments such as HDTVs, tablets and smart phones. Under Union Budget FY17, government has exempted parts & components, subparts for manufacturing of routers, broadband modems, set-top boxes for internet & TV, CCTV camera/IP camera, lithium-ion battery except mobile handsets from the purview of BCD, CVD, SAD duties.

Industrial electronics

Application of state-of-the-art systems such as Decision Analysis, 3–D coordinate systems, smart image processing, Nanotechnology, Nano scale assemblies, DCS, etc., across various sections of the industry. Introduction of robotics to manage process and equipment's for sensitive industries like Chemical Industry, Nuclear Power Generation etc. Integration of production and business operations Artificial Intelligence has been made available which would help the sector to improve its quality control thereby making it more efficient

Computers –

One of the fastest-growing IT systems and hardware market in Asia Pacific. Notebooks segment have recorded a growth rate of 17% in FY15; tablet ownership registered a growth of 27% in 2014 – 15 from the previous year. The industry of computer hardware in India grew from USD2.9 billion in FY14 to USD3.06 billion in FY15. Expansion of server market into smaller cities, and small and medium businesses.

Electronic components

Semiconductors lead segmental growth. High growth in key determinants for electronic components, namely consumer electronics, telecom, defence and IT verticals. Total Semiconductor market in India is estimated to reach USD9.66 billion by the end of 2015

C&B equipment's

Growing broadband subscriber base. As on 30th June, 2016, the total number of telephone subscribers in the country was 1,059.86 million, covering wireless subscriber base of 1,035.12 million and wire line subscriber base of 24.74 million, respectively

Increasing Consumption and potential for production

Increasing PFCE on Recreational and Educational services and Home appliances are expected to contribute to the rise in consumption and production of Electronics and IT Hardware. Growth of 17 per cent is expected with major contributors being Consumer Electronics, Telecom and computers



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MULTIPLE FACTORS FAVOUR INVESTMENT IN ELECTRONICS

Growing customer base

Market for electronics is expected to expand at a CAGR of 66% during 2015–20. The demand for electronics hardware in India is projected to increase to USD139 billion by 2018

Incentives and concessions under govt schemes

Export Oriented Unit (EOU) Scheme, Electronics Hardware Technology Park (EHTP) Scheme, Software Technology Park (STP) Scheme and EOU/EHTP/STP Schemes

Targeted reduction in import bill

Domestic electronic production accounts for around 45% of the total market demand. Therefore, in order to reduce the import bill, the government plans to boost the domestic manufacturing capabilities and is considering a proposal to give preference to Indian electronic products in its purchases

Policy and investment support

To compliment the targeted reduction in import bill, the government has proposed a minimum investment of USD555.0 million for semiconductor manufacturing plants and USD222.0 million for ecosystem units. This is considered a major step toward attracting foreign companies to set up manufacturing facilities in India. In Union Budget 2016 – 17, inputs, parts, components & subparts for manufacturing of charger/adaptor, battery & wired handsets/speakers of mobile phones are fully exempted from Basic Customs Duty (BCD), Counter Veiling Duty (CVD) and Special Additional Duty (SAD)

ADVANTAGE INDIA

Growing demand

Demand from households is set to accelerate given rising disposable incomes, changing lifestyles, and easier access to credit. Government and corporate spending will also contribute to growth in demand

Attractive opportunities

The electronics market is expected to expand at a CAGR of 41% during 2016–20. Intended reduction in government's import bill is likely to boost domestic electronics manufacturers.

Higher Investments

Sector has attracted strong investments in the form of M&As and other FDI inflows. Companies are set to augment investments in production, distribution and R&D in the next few years. Government has received investment proposals for USD17.5 million for which they intend to provide incentives under M-SIPS scheme. Applications received before July, 2020 will be considered.

Policy support

100% FDI allowed in the electronics hardware manufacturing sector under the automatic route. Initiatives like Modified Special Incentive Package Scheme(M-SIPS) will provide a capex subsidy of 20 – 25 per cent. As per Make in India Initiative, Electronic Development Fund Policy has been approved which would rationalise an inverted duty structure



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CIL has targeted a \$ 1 bn Target Topline by FY20 –

CIL's next goal is to achieve sales of US\$ 1 billion by 2020 and to achieve this it plans to bring on board new brands in its product portfolio.

In FY2016-17, the overall IT hardware and packaged software market recovered from the sluggish growth in the previous year. As per the NASSCOM estimates, the revenue growth for the IT Hardware segment picked up from 2% in FY2015-16 to 5.4% in FY2016-17 and that for the packaged software went up from 4.5% to 10.4%

In this market context, CIL has once again managed to beat the industry growth by delivering a Y-o-Y increase of 32% in operating revenue from the Indian market in FY2016-17. In line with the market trends, the biggest growth driver for CIL has been Enterprise Business.

Presently CIL is selling Software, Networking and Security products through System Integrators to this segment. Mobility segment currently contributes 15% of the overall business, much less than peers, but in future going ahead it will also be a key growth driver.

In line with this strategy, CIL entered into an agreement with 'Apple', in April 2017, to distribute their products in the Northern and Eastern regions of the country. The benefits for the same shall start accruing from FY2017-18 onwards.

CIL enjoys a reasonably good balance sheet and both Topline and Bottomline growth is likely to remain strong going ahead –

CIL has a highly leveraged balance sheet with debt of around Rs 324 crs as on FY17 as compared to a tangible networth of Rs 116 crs as on March 2017. The CIL management is looking at seriously reducing debt which will contribute to a better bottomline going ahead.

We expect that going ahead overall bottomline growth in the next 3 years starting FY17 onwards should easily increase at a CAGR of 25-30% and with very little capex expected over the next 2 years. This is because CIL enjoys a Asset Light model and has managed to keep its Working Capital management very tight with its dealers thus ensuring that it generates free cash flows since last 4 -5 years. Hence going ahead also we believe that net cash flows generated will remain healthy going ahead.



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Business Outlook & Stock Valuation –

On a rough cut basis, in FY18, Revenue is expected to touch Rs 4119 crs.

On the bottomline level we expect the company to record a PAT of Rs 20.30 crs in FY18E. Thus on a conservative basis, CIL should record a EPS of Rs 3.46 for FY18E. For FY19E and FY20E our expectation is that earnings traction for CIL will continue to remain strong wherein we expect a EPS of Rs 4.6 and Rs 6.85 respectively.

CIL has progressively invested in people, transforming the customer experience, enhancing its capabilities, and strengthened its network which are all positives which will play out in the next 2-3 years.

Also considering the growing market potential for digital technologies in India consumer demand for digital technologies is going to be primarily driven by the need to access the internet. According to IAMAI-IMRB report, the number of internet users in the country is expected to go up from 432 million in December 2016 to more than 500 million by 2018. Urban India at 60% penetration is starting to get saturated, but rural India offers a significant opportunity with only 17% Internet penetration. India is an extremely value-conscious market, and as a result, one can see that the smartphones have disrupted PC market for the consumers, and Cloud Computing is similarly disrupting the enterprise market.

77% of urban and 92% of rural users use mobile as the primary device for accessing the internet, and not the PC. However, with increasing disposable incomes, growing broadband penetration, Digital India initiative, new tech developments and restrictive form factor of smartphones, the market for PC and peripherals will continue to have a steady growth over the long term.

Gartner has forecasted for 2017 projects a growth of 8.8% in IT spends in India on Data Center Systems, Software and Devices. Smartphone shipments are expected to grow by 15% in 2017 recovering from the impact of demonetization in 2016. With growth increasingly coming from the rural markets, the C and D category cities which are a core strength of CIL will help it reap maximum benefit from future growth

We expect that going ahead overall bottomline growth in the next 3 years starting FY17 onwards should easily increase at a CAGR of 25-30% and with capex expected to be low we believe that net cash flows generated will remain healthy going ahead. The ROE and ROCE is also expected to improve to 19% and 23% and 17% and 19% by FY19 and FY20.

Going ahead we expect CIL's earnings to grow at a 25-30% over FY17-20E led by a rising healthy Topline growth, prudent product strategy and hopefully savings in interest costs.

The CIL stock trades at a P/E of 9x and 6x based on FY19E and FY20E, which looks attractive considering its strong execution capability, consistent financial track record and looking at future potential for IOT and Smartphone demand which will provide huge scalability ahead for CIL. Also valuations at 0.05x Market Cap to Revenue based on FY19E don't look very expensive and hence we believe that the CIL stock should be purchased at the current price for a price target of around Rs 82 over the next 12 to 18 months.



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FINANCIALS

For the Year Ended March RsCrs	FY17A	FY18E	FY19E	FY20E
Net Sales	3551.42	4119.65	4943.58	5932.29
EBIDTA	56.89	72.64	88.98	106.78
EBIDTA %	1.60	1.76	1.80	1.80
Interest	45.00	48.00	51.00	53.00
Depreciation	3.44	3.50	3.60	3.80
Non Operational Other Income	19.14	12.00	12.00	12.00
Profit Before Tax	27.69	33.14	46.38	61.98
Profit After Tax	17.62	20.30	27.10	40.20
Diluted EPS (Rs)	3.00	3.46	4.62	6.85
Equity Capital	11.74	11.74	11.74	11.74
Reserves	103.88	122.18	146.78	183.98
Borrowings	324.6	334.6	346.6	351.6
GrossBlock	33.51	34.51	36.01	36.5
Investments	0.35	0.35	0.35	0.35

Source Company our Estimates

KEY CONCERNS

Slowdown in the Electronic Market will have a direct negative impact on CIL's business

Increase in working capital cycle will hit CIL and hence any slowdown or recovery problems with dealers can also impact CIL's financials negatively.



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