



Symphony Ltd (www.symphonycomfort.com)

Simply Cool

The world's largest portable aircooler company has been growing rapidly in a lowly-penetrated category on the back of domestic consumptions surge & expansion overseas. This is expected to continue as there is vast untapped potential. This 'free cash flow positive' company can go places with sagacious use/distribution of free cash.

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Sector – Consumer Durable

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Important disclosure on the last page

DCF Value Rs.1550

Current Price Rs.600

Potential 2.6x

The stock currently trades at 7.9 times and 5.3 times the estimated EPS for FY11 (Rs.76) and FY12 (Rs.114) respectively. We expect EPS to grow 40% plus in both of these years. Our DCF value estimate comes to around Rs.1550 (CoE & WACC at 16.1%). We estimate its RoCE and RoE to be maintained at 40% plus.

Key Data

Market Cap	Rs. 4.2bn US\$89mn
Shares Outstanding	7mn
52 week High-Low	683 - 80
Avg Trading Vol	No. of shares
3 months	5400
12 months	3800
BSE Scrip Code	517385
BSE Group	B
Shareholding %	30Jun10
Promoters	75.00
Institutions	00.14
Others	24.86
Multiple Valuation	YE Jun11E
EV/EBITDA	4.6x
EV/ EBIT	4.7x
Market Cap/Sales	1.5x
P/E	7.9x

Key Investment Points

- Shift in business strategy from multiple products for one market to focused strategy of one product (coolers) for multiple markets (the world)
- Very low penetration, rising disposable income, low ticket item, improving quality & range, rising heat to drive growth
- Barely scratched surface in international markets. Acquisition of 49% indirect stake in a Mexican cooler company, first major move to tap international potential.
- Market share gain from large unorganised sector to continue on the back of innovation, quality, reliability & relevance.
- Edge over organised competitors like Kenstar & Bajaj
- Significant cost & other benefits over ACs as a cooling solution
- Introduction of new models, strengthening of distribution & service network to enable growth
- Huge growth potential, low capital intensity & competitive edge – a potent combination

Value Kickers

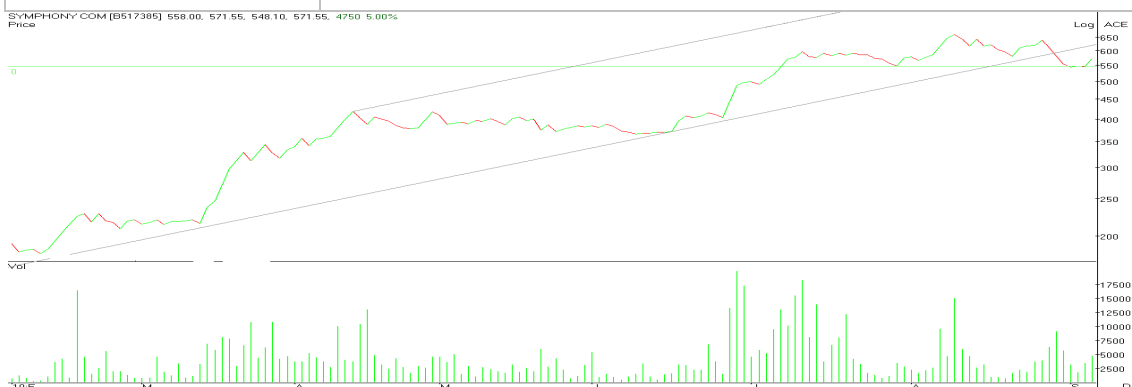
- Launch of industrial & commercial coolers this year
- Gainful deployment or distribution of substantial free cash

Products & Services

Air Coolers (Evaporative)
Water Heaters (Geysers)

Points of Concern

- Rising input costs may impact margins in short term
- Deployment of free cash in capital intensive opportunities
- Information asymmetry for minority shareholders
- Retention of substantial free cash





Introduction

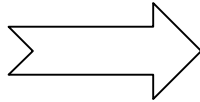
Symphony Ltd (Symphony Comfort Systems Ltd till Jun 10) is the world's largest in portable air coolers (room coolers) with annual revenues of Rs.1.9bn. Air Coolers' is a fragmented industry with a large unorganized sector. Symphony was the first company in the organized sector and introduced aesthetics & sophistication in air coolers. Exports contributed 16% to YE Jun10 revenues. It also holds 49% indirect stake in Impco, an air cooler company in Mexico.

Air coolers use evaporative cooling process. In this process, a fan/blower pulls air through wet pads. The air thus pulled is cooled air due to evaporation and is thrown in the space to be cooled. Air cooler works best in dry climate and hence is normally not seen in areas with humid climate like coastal areas. The company considers its business to be that of climate control equipments. Though, it has a small presence in Geysers (water heaters) accounting for 2-3% of its sales.

Symphony commenced air coolers business in 1988. It then diversified into other white goods like washing machines and domestic flour mills. Symphony could not get desired success in these white goods. It also got into bad debts with its regional distributors and had disputed sales tax liabilities. These issues had weighed down the company despite success of its air coolers. The company put an end to all these issues in YE Jun09. With the past behind it (debts recovered, liabilities cleaned up), the company appears all set to leap ahead with renewed focus on air coolers.

Shift in business strategy

Multiple products
for
One Market



One Product
for
Multiple Markets

Investment Arguments

Single digit penetration in air coolers

Aircooler penetration in India is estimated at less than 10% of households/ establishments in dry climate areas. It takes time for any product concept to catch on. The concept of aircoolers, especially branded aircoolers, is catching on and we think the tipping point is yet to come. With such low penetration, the category is at an early stage of product/category growth cycle. There are a number of years of growth ahead for the category.

"Considering the vast latent potential of the air cooler category, we believe our work has barely begun." Mr Achal Bakeri, Chairman, Symphony Ltd.

Domestic consumption surge in consumer durables augurs well

Consumer durable sector is one of the best performing sectors in India today. This is being driven by rising disposable incomes, nuclearisation of families, new home sales, and better products at same/lower prices. Aircooler category has also been growing in line with consumer durable space. Rising heat has been an additional driver for the growth of this category. Due to expected high economic growth in India, most of these drivers are expected to be in place for a long time to come and keep driving sales of



durables including coolers. Durables did well even in FY09, a year of gloom for many. Symphony's domestic sales grew 55% in YE Jun09.

Market share gain from unorganized sector

Aircooler category has a large number of local unorganized players. When Symphony came in this business in 1988, coolers were made only by these unorganized players. Symphony pioneered many innovations in coolers over time – aesthetically superior non-rusting ABS plastic body instead of wooden/metal body; electronic controls, silent instead of noisy, powerful air throw, compact instead of large-sized/bulky, different models with different shapes, sizes, capacities, and features for various segments. While some of these have been copied by competition over time, the Symphony brand recall (even unaided) is very high among consumers.

While the category is growing, Symphony has been growing faster due to gain in market share from unorganized sector due to its innovative, quality products that come with assurance, consistency & reliability of a branded product. We expect organized sector including Symphony to continue to gain market share from the unorganized local fringe.

Symphony has been lately introducing many smaller, lower priced models to further take on this fringe.

Symphony is one-up over organized competitors

Kenstar (Videocon group) and Bajaj (Bajaj Electricals) are number two and three respectively in organized aircoolers market. Symphony continues to be number one in terms of sales as well as number of models that it offers. There are other branded players like Usha, Birla Lifestyle but these are too small. None of these players are focused players in aircoolers; they all straddle various product categories. Symphony is the only pure play focused player in Aircoolers. Over the years, many branded players entered the category and exited; some of them are Onida, Crompton, and Polar. In the mid 1990s, there were ~20 branded cooler players.

Brands	No of Models	Estimated Organized Market Share %	Key Strategic Differentiation
Symphony	13 (to add 2 more shortly)	40-45	Premium pricing over competition, Price-maker, Innovation
Kenstar	11	30-35	Mass market, trade driven, price-taker
Bajaj	10	10	Trade driven, price-taker

Significant cost advantage over Air-conditioners

Coolers have significantly lower upfront and running cost as compared to ACs. Branded coolers are priced in the range of Rs.3,000-9,000. Branded Window ACs are priced in the range of Rs.10,000-33,000. In general, upfront cost of a cooler is one-third the cost of an AC. Similarly, running cost (electricity & maintenance) of a cooler is mere 10-20% of the cost of running an AC. Despite growing sales of ACs, an AC is still a luxury for most people in India. To get respite from scorching heat, cooler is their main savior.



Air cooler: Not just a poor man's AC

Coolers are not just poor men's AC. They are much more than that. Besides significant cost advantage, coolers offer many other benefits over ACs. Coolers are portable; offer much needed humidity & fresh air; offer flexibility to move around, as doors can be kept open; are the only cooling solution for open air areas like open-air restaurants, lawns.

Introducing new models to straddle across segments

Symphony keeps introducing new models to cater to varying needs of different segments of consumers. It currently has 13 models in market and is going to introduce two more models soon. Symphony has the largest range of models in the industry.

Strengthening distribution & Service infrastructure

In light of the past bad experience with regional distributors; the company has set up its own distribution network and has appointed its own sales, marketing & sales personnel throughout the country. Symphony currently has 22 decentralized warehousing facilities, over 400 distributors and over 6400 retail dealers. Its products are available in over 2000 cities and towns across India. It has been increasing its trade partners. It is appointing a new set of dealers for focused marketing of new range of DIET coolers.

After sales service is a key success factor for a consumer durable brand. The company continues to strengthen its service infrastructure by appointing more franchisees. There has been 40-50% rise in trade channel last year and a similar rise is expected this year as well.

International markets – huge untapped potential

Symphony has barely scratched surface in international markets. There is a huge untapped potential out there. In YE Jun09, exports contributed 21% to sales and 23% to PAT. Yet, Rs.259mn sales in a handful of countries is nothing more than scratching the surface, as the company is yet to have a meaningful penetration in these countries and targets to expand its presence from a handful of countries (Philippines, Iraq, etc) to most of the 183 countries in the world. It entered South Africa, Brazil & Mali last year. In tropical areas of the developed countries like the US, aircoolers still sell. Contrary to popular belief, aircoolers are not just for third world.

Symphony's coolers have got CE mark (European standard for safety), SASO (Saudi Arabian Standard Organization), and UL mark (the highest standard of quality for USA).

Till YE Jun08, it was only exporting to some of the countries. In YE Jun09, its then wholly owned subsidiary Sylvan Holdings Pte Ltd Singapore (Sylvan) acquired 99.99% in Impco, a Mexican aircooler company. By Sep-09, Symphony's stake in Sylvan was reduced to 49%. Two other investors in aggregate now hold 51% in Sylvan. We understand that these two investors' fund contribution in Sylvan is similar to that of Symphony. Thus, Symphony now holds an indirect 49% stake in Impco through Sylvan.

This indirect stake in Impco has given Symphony access to the US and Mexican markets. Impco has a manufacturing facility in North Mexico. Symphony has started selling its own products as well in these markets. It sells to stores like Wal-Mart and Home Depot.

As it expands its international presence, seasonality will become less & less pronounced. Summer period differs from country to country. Countries in northern hemisphere and those in southern hemisphere have summers at totally different periods of the year. The company will be able to utilize its facilities better with lessened seasonality.



Symphony's exports grew 178% to Rs.259mn in YE Jun09, a year of global recession.

Industrial & Commercial Coolers – new product range to be launched

Investment in Impco gives Symphony access to industrial & commercial coolers. Symphony plans to start marketing these in India shortly. The initial feedback from HVAC consultants and a few potential customers has been encouraging. These coolers are much bigger in capacity, made of metal body, and more sophisticated than metal body coolers from unorganized players. These will be aimed at Malls, Factories, and large commercial establishments.

Huge Cash Surplus & Low capex requirements

Symphony had Rs.316mn (Rs.45/share) of surplus cash at the end of Jun09. We estimate the surplus to rise to Rs.506mn (Rs.72/share) at the end of Jun10. We estimate the surplus to go up to Rs.2.3bn by Jun-13 assuming token dividends and no acquisition.

Almost the entire operational cash flows are free cash-flows, as capex requirement is minimal. Dies and moulds are its major capital expenditures. Most of the components are bought out and it is largely an assembly operation. Advertisement, brand building, promotion are its major expenses but these are operational expenses. Sagacious deployment or distribution of free cash-flows can make or mar its valuation.

Very low beta stock

We calculated Symphony's beta against Sensex using 1-year, 3-year and 5-year data with both simple and log returns. The maximum beta amongst the six betas is 0.49. The low beta makes it an extremely defensive stock for portfolios. Yet, we chose to use beta of 1.0 for valuation to build in conservatism and build in free-cash flow usage risk or information asymmetry risk detailed later in this report.

Risks / Concerns

Sharp rise in input costs

Key inputs to a cooler are polymers (for body), fan/blower, motor, and pump. Polymer prices are a function of crude oil prices among others. Other components prices are a function of prices of steel, copper among others. There has been a sharp rise in input prices last year due to both cost push and demand pull. This led to margin contraction of 2-3 percentage points last year. We would expect the cost increases to be passed on in the next year beginning Jul-10.

We understand that it is difficult to pass on cost increases in the middle of the season (production period is Oct-Jul). Therefore, cost increases, that take place mid-season, are likely to impact margins in the interim.

Deployment of surplus cash in relatively capital-intensive opportunities

In YE Jun-09, Symphony acquired 99.99% of Impco Mexico through an SPV Sylvan Holdings Pte Ltd Singapore. It was acquired from Castle Harlan, a New York-based private equity firm. By Sep-09, it reduced its holding in Sylvan to 49% by bringing two investors in Sylvan. We understand that these investors also brought in similar funds as contributed by Symphony into Sylvan/Impco. At the end of Jun09, Symphony had invested a total Rs.227mn in Sylvan. Bulk of this was by way of interest bearing loan. Sylvan in turn invested this amount in Impco -- again bulk of this was by way of loan. Assuming similar funds inflow from other strategic investors, an amount of about Rs.500mn would have been infused in Impco. We understand that bulk of the amount is



for working capital during season, which is Jun-Aug for Impco. However, working capital is released by Oct-Nov due to long credit extended to trade there. Symphony does not extend credit to trade and operates on negative net working capital. In light of this, the acquisition appears highly working-capital intensive as compared to Symphony's operations.

Symphony has plans to grow overseas through JVs & acquisitions. We hope & wish that the company does not deploy cash in any kind of capital-intensive opportunity like Impco.

Information asymmetry risk for Minority Shareholders

The Structure of Impco transaction puts minority shareholders at an information asymmetry risk. Unknowns for minority shareholders include Impco's financials, identity of co-investors, and cost of acquisition. These would not have mattered had it been a small investment. At the end of Jun09, 44% of Symphony's net-worth was invested in Impco via Sylvan.

Impco Mexico was acquired from Castle Harlan, a New York-based private equity fund. The fund had acquired Impco as part of acquisition of AdobeAir Inc in Nov-99 for \$102mn. Impco Mexico was a wholly owned subsidiary of AdobeAir, one of leading manufacturers of evaporative coolers.

Retention of surplus cash

It is always best to find gainful deployment opportunities for surplus funds in business. However, retention of surplus in the absence of such opportunities depresses overall return on capital leading to compression in valuation. We think it's best to return surplus cash back to shareholders and let them deploy it gainfully elsewhere. Retention of large surpluses is a concern. One can always leverage and raise funds back from shareholders, who will be too happy to invest if surpluses are returned to them when not required in near term.

Ownership & Management

The company is owned 75% by promoters – Bakeris from Ahmedabad. Mr Achal Bakeri, who holds masters in business management from the University of Southern California, is chairman & managing director of the company. He is supported by professional managers in key positions. There is negligible holding by institutional investors at present.

Valuation and key underlying assumptions

We estimate fair value per share to be around Rs.1550 using the discounted free cash flows. Key assumptions for the valuation are 5% terminal growth rate in NOPLAT, 3% terminal ROIC spread over WACC, Cost of equity at 16.1% based on beta of one (though the calculated beta is 0.49), risk free rate of 8.1% and market risk premium of 8%.

At the current price of Rs.600, the stock trades at 11.4 times YE Jun10 EPS of Rs.52.83. It trades at 7.9x and 5.3x expected EPS for YEJun11 and YEJun12 respectively. The company has no net debt and is cash positive.



Financials

Income Statement

Rs. Mn.	Jun10	Jun11	Jun12
Revenues	1,902	2,770	3,892
EBIT	521	763	1,141
PBT	554	796	1,196
PAT	370	532	799
EPS Rupees	52.83	76.02	114.16

Ratios

%	Jun10	Jun11	Jun12
Revenue Gr%	51.7	45.6	40.5
EPS Growth %	30.8	43.9	50.2
RoE %	52.7	47.1	45.3
D/E x	-	-	-
Debtor days	23	23	23
L&A/Rev	11.4	12.8	12.8
TaxProv/Tax	25%	25%	25%

Balance Sheets

Rs. Mn.	Jun10	Jun11	Jun12
Assets			
Net Block	130	160	175
Net Curr.	207	360	508
Assets			
Investments	29	29	29
Surplus Funds	506	822	1,410
Liabilities			
Equity Capital	70	70	70
Reserves	794	1,293	2,043
Debt	-	-	-

Interim Performance

Rs. Mn.	Sep09	Dec09	Mar10	Jun10
Months	3	3	3	3
Revenues	72	257	696	876
EBITDA	-6	41	215	295
EBIT	-9	38	211	292
PBT	-6	39	217	303
PAT	-6	29	144	202
Eq Capital	70	70	70	70
EPS Rs.	-0.82	4.15	20.54	28.90
EBIT Margin	-13.0	14.7	30.3	33.4
Other income/PBT	-	15.1	3.0	4.8
Tax/PBT	-	26.4	33.7	34.0

Multiple Valuation

	Jun10	Jun11	Jun12
EV/EBITDA x	6.7	4.6	3.1
EV/EBIT x	6.9	4.7	3.1
Mkt. Cap/Sales x	2.2	1.5	1.1
P/E x	11.4	7.9	5.3
Price/Book x	4.9	3.1	2.0

Free Cash Flow

Rs. Mn.	Jun10	Jun11	Jun12
NOPLAT	348	510	762
Change in Net Working Capital	63	165	164
Operating Cash Flows	285	345	598
Net Capex & others	68	30	14
Free Cash Flow	217	315	584
Non-opr. Cash flow	26	22	37
Cash Flow to Investors	242	337	621

Financing Cash Flow

Rs. Mn	Jun10	Jun11	Jun12
Post-tax Interest	4	-	-
Repayment/ (issue) of Debt	9	-	-
Equity Share Dividend	8	20	33
Inc / (Dec) in surplus cash/Investments	221	316	588
Financing Cash Flow	242	337	621

DCF Valuation

Key Assumptions	%
Terminal Growth Rate	5.0
WACC	16.1
Cost of Equity	16.1
Terminal ROIC	19.1
Outcome	Rs.
Fair Value Per Share (Rs.)	1550



Important Disclosure

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