PHOENIX LAMPS

INR 240

Edelweiss
Ideas create, values protect

Luminous

BUY

January 3, 2007

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Domestic CFL market growing at 40%; Phoenix in a sweet spot to capture this growth

The Indian market for compact fluorescent lamps (CFL) estimated at INR 8.3 bn in 2006 *(Source:ELCOMA India)* has been growing at ~40% over the past few years. Phoenix Lamps is looking to triple its current capacity of 25 mn units to 75 mn units by FY09E, post which the company would be one of the largest producers of CFL in the country. Its association with Eveready Industries will help increase its market penetration and brand awareness. The CFL segment, which contributed 45% to Phoenix Lamps' FY07 turnover, is likely to grow at a CAGR of 46% over FY07-10E and contribute INR 4 bn (64% of total sales) to revenues in FY10E.

Domestic market leader in automotive halogen lamps; widening its global reach

Phoenix Lamps, domestic market leader in automotive halogen lamps, is increasing its installed capacity of automotive lamps by 14% to 80 mn pieces by Q1FY09. The company plans to augment its presence in international markets by capitalizing on its existing relationships with OEMs like Suzuki, Renault, and Hyundai. Exports, which mainly included automotive lamps, contributed 33% of revenues in FY07. The automotive lamps business, which contributed 55% to FY07 revenues, is likely to grow at ~11% CAGR over FY07-10E to INR 2.2 bn in FY10E.

CFLs gaining favour; rising awareness and affordability fuel growth

Lower energy requirements and heat emissions, higher product life, and increasing affordability, are the main reasons behind consumers switching over to CFL. Proactive measures by the Indian government towards energy conservation such as providing CFLs at lower rates for below-poverty-line households and lowering of VAT in some states, will help augment the market for CFLs in the country. Considering these initiatives to promote CFL, we believe Phoenix Lamps is well placed to exploit opportunities in the domestic market.

Outlook and valuations: Attractive; initiating coverage with 'BUY'

The CFL segment, which grew at 48% CAGR over FY04-07, is likely to steer the company's growth over the next few years on the back of a radically changing industry. We expect the company's revenues and profits to grow at a CAGR of 29% and 24%, respectively, over FY07-10E. At INR 240, the stock is trading at 13.8x and 11.2x our FY09E and FY10E EPS of INR 17.4 and INR 21.5 respectively. Given the growth in its CFL segment, decent valuations, and high management pedigree, we initiate coverage on the stock with a **'BUY'** recommendation.

Financials

Year to March	FY07	FY08E	FY09E	FY10E
Revenues (INR mn)	2,778	3,507	5,015	6,051
EBITDA (INR mn)	454	563	775	929
Net profit (INR mn)	315	386	487	601
EPS (INR)	11.2	13.8	17.4	21.5
EPS growth (%)	*12.1*	*22.4*	*26.3*	*23.5*
CEPS (INR)	15.1	18.1	23.7	28.3
P/E (x)	21.3	17.4	13.8	11.2
P/CEPS (x)	15.9	13.3	10.1	8.5
EV/EBITDA	15.9	13.2	10.1	8.2
Dividend yield (%)	1.2	1.5	1.7	1.9
ROE (%)	24.1	24.4	25.2	25.1

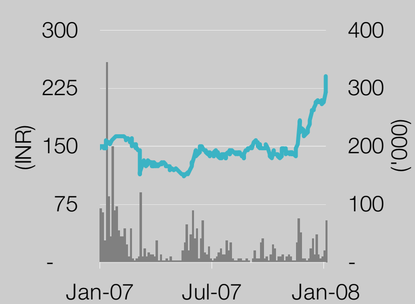
Reuters	:	PHLM.BO
Bloomberg	:	PL IN

Market Data

52-week range (INR)	:	254 / 108
Share in issue (mn)	:	28.0
M cap (INR bn/USD mn)	:	6.7 / 170.2
Avg. Dly Vol.BSE ('000)	:	50.5

Share Holding Pattern (%)

Promoters	:	66.1
MFs, FIs & Banks	:	2.0
FIIs	:	1.9
Others	:	30.0

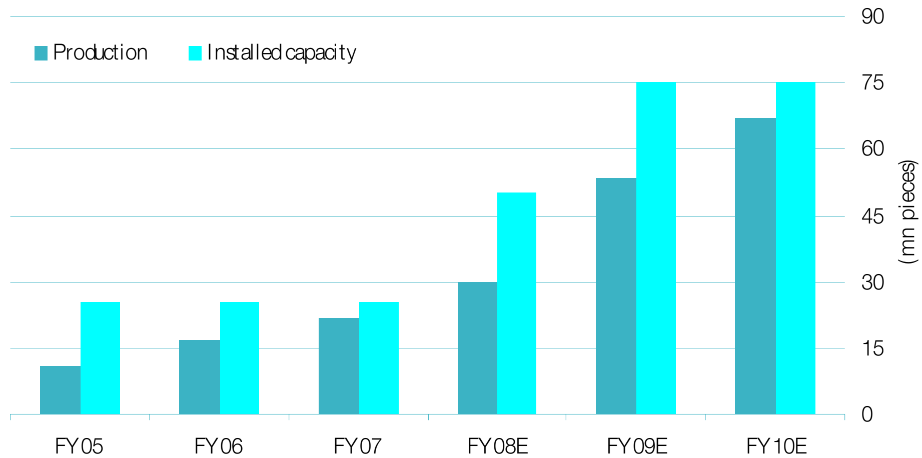


Investment Rationale

Domestic CFL market growing at 40%; Phoenix Lamps in a sweet spot to capture this growth

The Indian market for CFLs estimated at INR 8.3 bn in 2006 *(Source:ELCOMA India)* has been growing at ~40% over the past few years. Phoenix Lamps, a leading player in CFLs, is looking to triple its current capacity of 25 mn units to 75 mn units by FY09E. Its association with Eveready Industries is a strategic step towards increasing its market penetration and brand awareness in a fiercely competitive market. Favorable market trends towards CFL in domestic as well as international markets puts Phoenix Lamps in a sweet spot for the coming few years. The CFL segment, which contributed 45% to Phoenix Lamps' FY07 turnover, is likely to grow at a CAGR of 46% over FY07-10E and contribute INR 4 bn (64% of total sales) to revenues in FY10E.

Chart 1: Capacity expansions



Source: Company, Edelweiss research

Considering the growth opportunity in the CFL space, Phoenix Lamps is ramping up its current capacity of 25 mn units to 75 mn units by FY09E in two phases:

- Phase 1: Addition of 25 mn units during Q4FY08E.
- Phase 2: Addition of 25 mn units during Q2FY09E.

The proposed expansion is at a cost of INR 700-800 mn, which will be funded by debt and internal accruals. With a capacity of 75 mn lamps post expansion, the company would be one of the largest producers of CFL in the country.

Domestic market leader in automotive halogen lamps; widening its global reach

Phoenix Lamps, domestic market leader in automotive halogen lamps, is increasing its installed capacity of automotive lamps by 14% to 80 mn pieces by Q1FY09. The company, with its diverse geographical client base and exports covering over 40 countries (mainly in Europe), has ensured a de-risked business model. Exports, which mainly included automotive lamps, contributed 33% of revenues in FY07. The company plans to augment its presence in international markets by capitalizing on its existing relationships with OEMs like Suzuki, Renault, and Hyundai. The automotive business, which contributed 55% to FY07 revenues, is likely to grow at a steady ~11% CAGR over FY07-10E to INR 2.2 bn in FY10E.

CFLs gaining favour; rising awareness and affordability fuel growth

Advantages such as lower energy requirements and heat emissions, higher product life, and increasing affordability, over incandescent bulbs are the main reasons behind countries banning the sale of incandescent bulbs and switching over to CFLs. Although the Indian government has not issued any official policy in this regard, proactive measures towards energy conservation such as providing CFLs at lower rates for below-poverty-line households and lowering of VAT in some states will help augment the market for CFLs in the country. Considering these initiatives to promote CFL, we believe Phoenix Lamps is well placed to exploit opportunities in the domestic markets.

Table 1: General lighting services versus CFL: How they compare

	GLS (60 watt)	CFL (15 watt)	Savings
Purchase price (INR)	12	120	
Efficacy (lumen/watt)	12	42-60	
Lifetime (hours)	1,000	7,000	
Cost incurred in 1000 hrs (INR)	300	75	
Total cost over 7,000 hrs (INR)	2,184	645	1,539
CO2 emissions per 1,000 hrs (kg)	52.2	13.1	39.2

Source: Greenpeace

Outlook and valuations: Attractive; initiating coverage with 'BUY'

Phoenix Lamps' CFL business, which grew at 48% CAGR over FY04-07, is likely to steer the company's growth over the next few years on the back a radically changing industry. Its sales and profits have grown at 23.4% and 50.6% CAGR, respectively, over FY04-07. Profits have grown at a faster pace compared to sales over the past three years on account of lower tax rates. We expect the company's revenues and profits to grow at a CAGR of 29% and 24%, respectively, over FY07-10E. At INR 240, the stock is trading at 13.8x and 11.2x our FY09E and FY10E EPS of INR 17.4 and INR 21.5 respectively. Given the growth in its CFL segment, decent valuations, and high management pedigree, we initiate coverage on the stock with a 'BUY' recommendation.

Key Risks

Higher than anticipated rise in raw material costs

Phoenix Lamps' gross margins in the CFL segment are lower than those in the automotive lamps segment mainly due to competitive pressures as well as higher cost of inputs. Since CFLs are likely to account for bulk of future revenues, raw material costs as a percentage of sales will increase, which could result in lower operating margins.

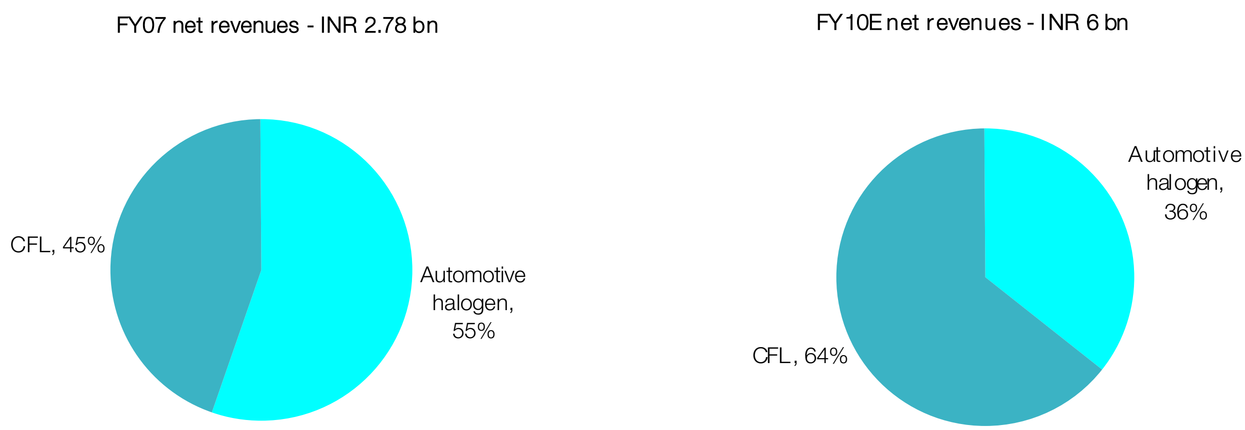
Rising competition

Domestic players like Havells, Phillips, and Indo Asian Fuse Gear are in an expansion mode which may lead to a price war in the domestic market. However, we believe the market is large enough to accommodate this growth as additional production within the country will be used to substitute imports from China as well as feed the growing export markets.

Company Description

Incorporated in 1991, Phoenix Lamps manufactures automotive halogen lamps, CFL, and halogen lamps for general lighting under the brand *Halonix*. The company has an installed capacity of 95 mn lamps p.a. (70 mn automotive lamps and 25 mn CFLs) and a product portfolio of ~500 types of lamps across segments. Its plants are located at Noida, Dehradun, and Haridwar.

Chart 2: Revenue breakup



Source: Company, Edelweiss Research

The percentage of exports to total revenues has declined from 54% in FY04 to 33% in FY07 which demonstrates the company's focus on domestic markets largely driven by the CFL segment. However, on the back of expanded capacities in the CFL segment, we believe the company is in a good position to tap international markets in addition to the fast growing domestic CFL market.

Automotive halogen lamps: Phoenix Lamps is a dominant player in the INR 2-bn domestic automotive lamps industry. This segment has been growing at ~15% and contributed 55% to revenues in FY07, compared to 65% in FY04. Its current customer base includes OEMs like Maruti Suzuki, Tata Motors, Renault, Hyundai, and tier 1 suppliers like Bosch, Hella and Osram (USA). Exports, which mainly included automotive lamps, contributed 33% of revenues in FY07. The company plans to increase its overseas automotive lamps business by capitalizing on its existing relationships with global OEMs like Suzuki, Hyundai, and Renault. The company is in the process of increasing its installed capacity of automotive lamps by 14% to 80 mn pieces by Q1FY09. Other key players in this space are Phillips, Osram, and Jagan Lamps.

Compact fluorescent lamps (CFL): One of the early birds in the CFL business, Phoenix Lamps started producing CFLs in 1992-93 and is currently one of the largest manufactures of CFLs in India with an installed capacity of 25 mn units. This segment of the company has been growing at 48% CAGR since the past three years and contributed 45% to FY07 revenues, compared to 24% in FY04. Phoenix Lamps contract manufactures CFLs for various international and domestic players as well as retails them under its own brand (Own brand sales contribute ~25% of CFL sales). Other players producing CFLs in the country are Havells, Phillips, Bajaj, Surya Roshni, Wipro, and Indo Asian Fuse Gear.

Income tax exemption at Haridwar likely to offset falling EBITDA margins

The new facility will be commissioned in Haridwar with 100% income tax exemption for five years and a 30% exemption for the next five years; the plant also enjoys 100% excise duty exemption for ten years. Due to the competitive nature of the industry CFLs attract lower margins than automotive lamps and hence overall EBITDA margins of the company are likely to decline going forward. However we believe tax exemptions would help maintain net margins at ~10%.

Distribution tie up with Eveready Industries provides wider footprint

Phoenix Lamps has tied up with Eveready Industries for sale and distribution of its CFLs, thus leveraging on the latter's distribution reach of 3 mn FMCG outlets throughout the country. These lamps will be sold under the *Eveready Halonix* brand. This, we believe, will help Phoenix Lamps augment its distribution reach as well as increase brand awareness.

Controlling stake by Actis

Actis has acquired 66% of Phoenix Lamps' equity capital (18,509,587 shares) in March 2007. A leading private equity investor in emerging markets for over 60 years, Actis has USD 3.5 bn of funds under management:

Actis stake acquisition:

- 8,735,727 from erstwhile promoters (the Gupta family) at INR 190/share.
- 5,603,860 through an open offer at INR 190/share.
- 4,170,000 by way of conversion of warrants, allotted in June 2006, at INR 102/share.

The erstwhile promoters have signed a three year non-competing agreement with Actis which prohibits them from entering into similar businesses till March 2010.

Industry Overview

Global CFL industry: Sales have grown 15x

Global CFL sales have grown at a CAGR of ~25% over the past 15 years and have risen 15-fold from 100 mn units in 1990 to more than 1.5 bn units in 2006 *(Source: Australian Greenhouse Office)*. Inexpensive labour, cheaper material and economies of large-scale production have helped China increase its market share from 56% in 1997 to more than 90% in 2006. Aided by falling production costs, India is likely to increase its production of CFL to 172 mn units by 2009E *(Source: Australian Greenhouse Office)*. This will not only limit India's import of CFL but will also help the country establish a larger global market for CFL exports. Japan, Korea, Germany, and Italy are other countries which help meet the global CFL demand. Phillips, GE and Osram are the largest global players.

Domestic CFL industry: Growing at 35-40% p.a.

The CFL market in India, valued at INR 8.3 bn in 2006, has been growing at ~40% p.a. since the past few years on the back of perceptible advantages of CFL over traditional incandescent bulbs:

- **Longer life:** Life of a CFL is 7-10x that of an incandescent bulb.
- **Energy efficient**: CFLs use one fourth to one fifth of the energy consumed by traditional bulbs to produce the same amount of light.
- **Environment friendly**: CFLs convert only 30% of energy consumed into heat versus 90% by incandescent lamps.

Table 2: Lighting industry in India as in 2006

Category	Value (INR bn)	Quantity (mn pieces)
GLS Lamps	6.9	830
FTL	12.1	176
CFL	**8.3**	**100**
Special Lamps	4.4	14
Other Lamps	2.2	NA
Luminaires	10.0	NA
Control Gears and High Masts	2.1	NA
Accessories	2.1	NA
Components	2.2	NA
Total	50.6	NA

Source: ELCOMA India

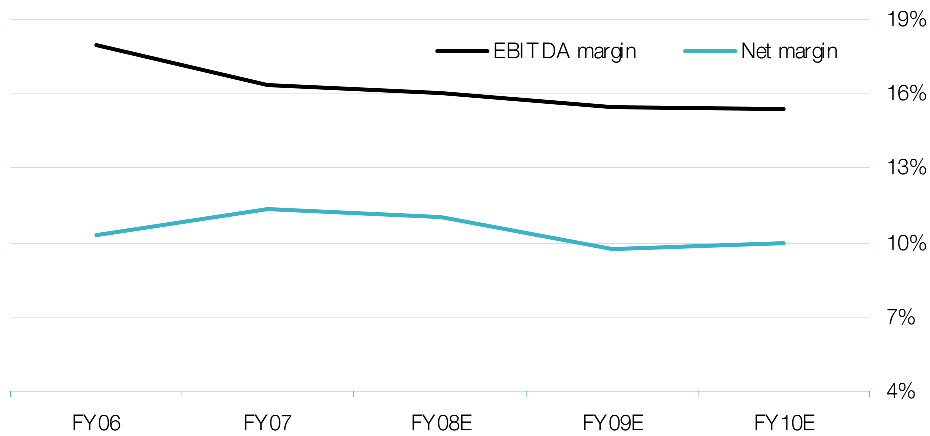
"Ban the bulb" campaign: Venezuela and Cuba were the first countries to take a decision in 2005 to phase out incandescent bulbs; Australia and Canada have enacted a law to ban the sale of incandescent bulbs by 2010 and 2012, respectively; the European Union (EU) and California (US) are also considering a similar law.

The Indian government has not issued any official policy in this regard. However, Greenpeace had launched a "ban the bulb" campaign across the country in April 2007 and according to their study, switching over to CFL will help India save 12,000 MW a year, leading to a 4% reduction in CO2 emission.

Financial Outlook

We are optimistic on the Indian CFL industry and believe that Phoenix Lamps will be a major beneficiary of the growth in the CFL industry over the next few years. We expect revenues and profits to grow at 29% and 24% respectively over FY07-10E driven by the CFL segment.

Chart 3: Marginal decline in margins due to higher contribution of CFL



Source: Company, Edelweiss research

As can be seen from the graph above, Phoenix Lamps' EBITDA margins have dipped from 17.9% in FY06 to 16.3% in FY07, mainly on account of a change in product mix in favor of CFL. Raw material costs as a percentage of sales have increased from 48% in FY06 to 52% in FY07, primarily due to the competitive nature of the CFL industry as well as higher costs of inputs. We expect EBITDA and net margins to marginally decline to 15.3% and 9.9% respectively in FY10E.

Financial Statements

Income statement (INR mn)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net Sales	2,327	2,778	3,507	5,015	6,051
Raw material cost	1,110	1,439	1,969	2,897	3,518
Goods for resale	43	4	-	-	-
Employee cost	214	248	274	351	417
Power & fuel cost	64	60	70	100	121
Other mfg exp	298	346	368	517	611
Selling & administration exp.	178	216	249	356	430
Miscellaneous expenses	3	12	14	20	24
Total operating expenses	1,910	2,324	2,944	4,241	5,122
EBITDA	417	454	563	775	929
Depreciation	143	108	121	177	192
EBIT	274	347	441	597	737
Interest expense	69	72	69	106	117
Other income	34	28	35	30	30
Profit before tax	239	302	407	521	650
Provision for tax	10	(25)	21	34	49
Profit after tax	229	327	386	487	601
Extraordinary income / loss	(10)	12	-	-	-
Net profit	239	315	386	487	601
Earnings per share (INR)	10.0	11.2	13.8	17.4	21.5
Shares outstanding (mn)	23.8	28.0	28.0	28.0	28.0
Dividend (INR/share)	2.0	2.9	3.5	4.0	4.5

Common size metrics as % on revenues

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Operating expenses	82.1	83.7	84.0	84.6	84.7
Depreciation	6.1	3.9	3.5	3.5	3.2
EBITDA margins	17.9	16.3	16.0	15.4	15.3
Net profit margins	10.3	11.3	11.0	9.7	9.9

Growth metrics (%)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Revenues	20.6	19.4	26.2	43.0	20.6
EBITDA	10.2	8.8	23.9	37.6	19.9
PBT	40.3	26.4	34.7	28.1	24.8
Net profit	91.3	31.7	22.4	26.3	23.5
EPS	91.3	12.1	22.4	26.3	23.5

Cash flow statement (INR mn)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Cash flow from operations	382	410	528	699	842
Cash for working capital	(167)	(205)	(243)	(512)	(354)
Net operating cash flow- A	215	205	285	186	488
Net purchase of fixed assets	(113)	(200)	(370)	(400)	(50)
Net cash flow from investing- B	(113)	(199)	(370)	(400)	(50)
Proceeds from equity	-	415	-	-	-
Proceeds from preference issue	-	(97)	-	-	-
Proc./Repayments from borrowings	123	(298)	240	425	(225)
Dividend payments	(63)	(110)	(113)	(129)	(145)
Net cash flow from financing- C	60	(91)	127	296	(370)
Net cash flow (A+B+C)	**161**	**(85)**	**43**	**82**	**68**

Balance sheet (INR mn)

As on 31st March	FY06	FY07	FY08E	FY09E	FY10E
Equity capital	238	280	280	280	280
Prefrence capital	229	132	132	132	132
Reserves & surplus	316	894	1,167	1,525	1,981
Shareholders funds	783	1,305	1,578	1,937	2,393
Secured loans	558	510	750	1,175	950
Unsecured loans	250	-	-	-	-
Deferred tax liability	85	55	30	5	(20)
Source of funds	1,676	1,870	2,358	3,116	3,323
Gross block	2,016	2,055	2,617	3,017	3,067
Depreciation	1,193	1,295	1,417	1,594	1,786
Net block	823	760	1,201	1,423	1,282
Capital work in progress	37	192	-	-	-
Net fixed assets	860	952	1,201	1,423	1,282
Cash, bank bal & deposits	130	27	23	47	41
Inventory	423	464	586	838	1,011
Sundry debtors	431	589	743	1,063	1,282
Loans & advances	27	76	76	76	76
Other Current assets	6	8	8	8	8
Total current assets	1,017	1,164	1,437	2,032	2,419
Sundry creditors	65	57	77	110	133
Others	74	81	90	100	100
Provisions	62	109	113	129	145
Total current liabilities	201	247	280	339	378
Net current assets	816	918	1,157	1,693	2,041
Application of funds	1,676	1,870	2,358	3,116	3,323
Book value (BV) per share (INR)	33	47	56	69	85

Ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
ROE (%)	30.5	24.1	24.4	25.2	25.1
ROCE (%)	18.4	20.7	19.3	19.0	21.6
Inventory days	66	61	61	61	61
Debtor days	68	77	77	77	77
Fixed assets t/o	1.2	1.4	1.4	1.7	2.0
Debt/Equity	1.0	0.4	0.5	0.6	0.4

Valuation parameters

Year to March	FY06	FY07	FY08E	FY09E	FY10E
EPS (INR)	10.0	11.2	13.8	17.4	21.5
Y-o-Y growth (%)	91.3	12.1	22.4	26.3	23.5
CEPS (INR)	16.0	15.1	18.1	23.7	28.3
P/E (x)	23.9	21.3	17.4	13.8	11.2
P/CEPS (x)	15.0	15.9	13.3	10.1	8.5
Price/BV (x)	7.3	5.2	4.3	3.5	2.8
EV/Sales (x)	2.8	2.6	2.1	1.6	1.3
EV/EBITDA (x)	15.3	15.9	13.2	10.1	8.2

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Accumulate	Expected to appreciate up to 20% over a 12-month period
Sell	Expected to depreciate more than 10% over a 12-month period		

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