

## Equities

4 May 2012 | 13 pages

# Havells India (HVEL.BO)

## Buy: Plenty of Steam Still Left

- Company Update
- Target Price Change
- Estimate Change

- We spoke to Havells' management to get an update on the business.
- **FY13E sales growth guidance of 15%-20% and EBITDA margin of 13%-13.5%** — Given 9MFY12 performance (revenue/EBITDA/PAT growth of 25%/ 34%/44% and 90bps margin expansion in 9MFY12) and traction in lighting and consumer durable businesses (20%+ growth), FY13 guidance looks easily achievable with high possibility of actual results being closer to the higher end of guidance.
- **Sylvania first debt tranche has been refinanced** — First tranche of Eur40mn due in April 2012 has been refinanced and negotiations are on for a second tranche of Eur50mn due in April 2013. With current EBITDA run rate of EUR35-36mn (which is growing) and net debt of ~Eur125mn, Sylvania is self sufficient and can service the debt over a slightly longer time horizon.
- **Raising target price to Rs633 (from Rs554)** — We roll over India business P/E multiple of 18x and Sylvania EV/EBITDA of 5x from March 13E to September 13E. We have also raised our India business EPS estimate marginally by 4%/5% in FY13E/FY14E to factor in slightly higher revenues and 25bps higher EBITDA margin. There is no change in Sylvania estimates.
- **Maintain Buy** — Havells has outperformed Sensex by 46%/ 12% over the past 6 months / 3 months respectively. However, business momentum remains robust with healthy EPS growth, cash flow generation and high RoEs. We believe the stock has plenty of steam left and maintain our Buy rating.
- **Risks** — Downside risks to our target price include poorer performance from Sylvania, higher commodity prices, unsuccessful new-product launches, increase in competitive intensity and demand slowdown in India

<b>Buy</b>	<b>1</b>
Price (04 May 12)	Rs540.00
Target price	Rs633.00
	<i>from Rs554.00</i>
Expected share price return	17.2%
Expected dividend yield	0.5%
<b>Expected total return</b>	<b>17.7%</b>
Market Cap	Rs67,378M
	US\$1,263M

### Price Performance (RIC: HVEL.BO, BB: HAVL IN)



Figure 1. Statistical Abstract

Year to	Parent PAT	Parent EPS	Chg	P/E	RoE	Cons PAT	Cons EPS	Chg Conso	P/E	ROE	Yield
31-Mar	(RsM)	(Rs)	(%)	(x)	(%)	(RsM)	(Rs)	(%)	(x)	(%)	(%)
2008A	1,435	12.4	30%	44.3	31.5%	1,610	13.9	46.3%	39.5	34.5%	0.2%
2009A	1,451	12.1	-3%	45.5	18.4%	384	3.2	-77.0%	171.8	6.0%	0.2%
2010A	2,287	18.3	52%	30.0	22.1%	701	5.6	75.7%	97.8	13.8%	0.3%
2011A	2,420	19.4	6%	28.3	19.5%	3,071	24.6	338.3%	22.3	58.3%	0.5%
2012E	3,107	24.9	28%	22.0	21.1%	3,692	29.6	20.2%	18.6	45.3%	0.6%
2013E	3,741	30.0	20%	18.3	21.2%	4,522	36.2	22.5%	15.2	38.5%	0.7%
2014E	4,523	36.3	21%	15.1	21.4%	5,333	42.7	18.0%	12.8	39.0%	0.9%

Source: Citi Investment Research and Analysis

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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HVEL.BO: Fiscal year end 31-Mar						Price: Rs540.00; TP: Rs633.00; Market Cap: Rs67,378m; Recomm: Buy					
Profit & Loss (Rsm)	2010	2011	2012E	2013E	2014E	Valuation ratios	2010	2011	2012E	2013E	2014E
Sales revenue	23,714	28,817	35,588	41,488	48,132	PE (x)	29.5	27.8	21.7	18.0	14.9
Cost of sales	-20,606	-25,411	-31,139	-36,198	-41,995	PB (x)	5.9	5.0	4.2	3.5	2.9
Gross profit	3,108	3,406	4,448	5,290	6,137	EV/EBITDA (x)	20.2	18.2	13.7	11.2	9.3
Gross Margin (%)	13.1	11.8	12.5	12.8	12.8	FCF yield (%)	0.5	2.7	2.6	3.6	4.6
<b>EBITDA</b>	<b>3,108</b>	<b>3,406</b>	<b>4,448</b>	<b>5,290</b>	<b>6,137</b>	Dividend yield (%)	0.3	0.5	0.6	0.7	0.9
EBITDA Margin (%)	13.1	11.8	12.5	12.8	12.8	Payout ratio (%)	10	13	13	13	13
Depreciation	-233	-293	-375	-446	-500	ROE (%)	22.1	19.5	21.1	21.2	21.4
Amortisation	0	0	0	0	0	<b>Cashflow (Rsm)</b>	<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>
<b>EBIT</b>	<b>2,875</b>	<b>3,113</b>	<b>4,074</b>	<b>4,844</b>	<b>5,637</b>	EBITDA	3,108	3,406	4,448	5,290	6,137
EBIT Margin (%)	12.1	10.8	11.4	11.7	11.7	Working capital	-682	437	-3	-432	-483
Net interest	-117	-191	-290	-290	-290	Other	-487	-416	-815	-1,066	-1,240
Associates	0	0	0	0	0	<b>Operating cashflow</b>	<b>1,938</b>	<b>3,427</b>	<b>3,631</b>	<b>3,792</b>	<b>4,414</b>
Non-op/Except	145	177	100	242	452	Capex	-1,590	-1,584	-1,900	-1,340	-1,300
<b>Pre-tax profit</b>	<b>2,903</b>	<b>3,099</b>	<b>3,884</b>	<b>4,796</b>	<b>5,799</b>	Net acq/disposals	0	0	0	0	0
Tax	-617	-679	-777	-1,055	-1,276	Other	-1,324	-1,699	80	188	353
Extraord./Min.Int./Pref.div.	0	0	0	0	0	<b>Investing cashflow</b>	<b>-2,914</b>	<b>-3,283</b>	<b>-1,820</b>	<b>-1,152</b>	<b>-947</b>
<b>Reported net profit</b>	<b>2,287</b>	<b>2,420</b>	<b>3,107</b>	<b>3,741</b>	<b>4,523</b>	Dividends paid	-271	-363	-465	-560	-677
Net Margin (%)	9.6	8.4	8.7	9.0	9.4	<b>Financing cashflow</b>	<b>90</b>	<b>-335</b>	<b>-697</b>	<b>-786</b>	<b>-904</b>
Core NPAT	2,287	2,420	3,107	3,741	4,523	<b>Net change in cash</b>	<b>-886</b>	<b>-192</b>	<b>1,113</b>	<b>1,854</b>	<b>2,563</b>
<b>Per share data</b>	<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>	<b>Free cashflow to s/holders</b>	<b>348</b>	<b>1,842</b>	<b>1,731</b>	<b>2,452</b>	<b>3,114</b>
Reported EPS (Rs)	18.33	19.39	24.90	29.98	36.25						
Core EPS (Rs)	18.33	19.39	24.90	29.98	36.25						
DPS (Rs)	1.85	2.50	3.21	3.86	4.67						
CFPS (Rs)	15.54	27.46	29.10	30.39	35.37						
FCFPS (Rs)	2.79	14.77	13.87	19.65	24.95						
BVPS (Rs)	90.99	107.45	128.62	154.11	184.93						
Wtd avg ord shares (m)	125	125	125	125	125						
Wtd avg diluted shares (m)	125	125	125	125	125						
<b>Growth rates</b>	<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>						
Sales revenue (%)	7.9	21.5	23.5	16.6	16.0						
EBIT (%)	55.7	8.3	30.9	18.9	16.4						
Core NPAT (%)	57.5	5.8	28.4	20.4	20.9						
Core EPS (%)	51.9	5.8	28.4	20.4	20.9						
<b>Balance Sheet (Rsm)</b>	<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>						
Cash & cash equiv.	683	492	1,605	3,459	6,022						
Accounts receivables	795	1,121	1,365	1,591	1,846						
Inventory	3,307	4,699	5,850	6,820	7,912						
Net fixed & other tangibles	6,012	7,303	8,828	9,723	10,523						
Goodwill & intangibles	0	0	0	0	0						
Financial & other assets	6,145	8,088	8,130	8,174	8,220						
<b>Total assets</b>	<b>16,942</b>	<b>21,702</b>	<b>25,778</b>	<b>29,767</b>	<b>34,523</b>						
Accounts payable	2,713	3,319	4,875	5,683	6,593						
Short-term debt	0	0	0	0	0						
Long-term debt	1,158	1,336	1,336	1,336	1,336						
Provisions & other liab	1,719	3,639	3,517	3,517	3,517						
<b>Total liabilities</b>	<b>5,590</b>	<b>8,294</b>	<b>9,729</b>	<b>10,537</b>	<b>11,447</b>						
Shareholders' equity	11,352	13,408	16,050	19,230	23,076						
Minority interests	0	0	0	0	0						
<b>Total equity</b>	<b>11,352</b>	<b>13,408</b>	<b>16,050</b>	<b>19,230</b>	<b>23,076</b>						
<b>Net debt</b>	<b>475</b>	<b>844</b>	<b>-269</b>	<b>-2,123</b>	<b>-4,686</b>						
Net debt to equity (%)	4.2	6.3	-1.7	-11.0	-20.3						

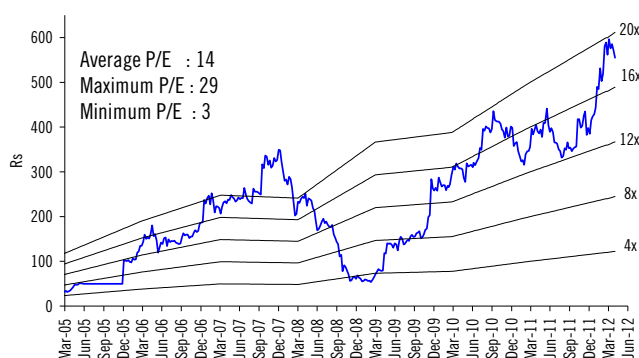
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For definitions of the items in this table, please click [here](#).

## Buy – Target Price Rs633

- **Outperformance to continue** – Havells has outperformed the Sensex by 46%/12% over the past 6 months / 3 months respectively. Despite this strong performance, we believe that business momentum is likely to remain strong and more upside is left in the stock. We spoke to Havells' management to get an update on business and medium-term outlook. Medium-term outlook remains robust and Havells' India business has substantial room to maintain current growth rates of 16-17% over the next 3-4 years.
- **Business momentum is strong despite general slowdown** – The strength of Havells' India business can be gauged from the fact that despite concerns of slowing economy impacting domestic demand, Havell's India business has posted revenue growth of 25%, EBITDA growth of 34%, PAT growth of 44% and 90bps margin expansion in 9MFY12 (v/s earlier FY12 guidance of 15-18% revenue growth and flat margins).
- **FY13E guidance looks easily achievable** – We believe that in case the macro environment, especially construction and real estate activity, were to improve in FY13E, Havells' India business has potential to surpass current growth expectations. Further a rebound in construction activity, if any, will lead to a pick up in growth in switchgear segment (most levered to construction activity) which will help margins through improved revenue mix.
- **India business FY13 margins expected to be in 13-13.5% range** – Havells has reported ~13.5% EBITDA margins in 2Q and 3QFY12. Management has guided to 13-13.5% EBITDA margin in FY13 (CIRA est. – 12.75%).
- **Qualitative improvement in business** – The qualitative improvement in the business is also apparent from increasing ease with which Havells India has been able to pass on fluctuations in raw material prices to customers (especially in cables and wires business). For example significant fluctuation in copper price did not have any material impact on 2QFY12 results. Health of CFL business has also improved.
- **Distribution network gives competitive advantage** – Company's business strategy revolves around established distribution network of 4300 dealers and more than 35,000 retail points. Company has continuously strengthened its relationship with dealers by 1) engaging directly with large number of dealers 2) minimizing administrative hassles of the dealer 3) capturing larger share of dealer's revenue (30%-40% on an average) 4) arranging channel financing for dealers 5) adopting consistent pricing and discounting policies 6) and showing long-term commitment to business.
- **Scope to capture incremental revenue** – Out of these ~4300 dealers, ~ 2700 dealers are more important in terms of business. Havells is now focusing on increasing business with remaining ~1500 dealers. Management mentioned that so far growth has been driven primarily by grabbing larger share of business of more important dealers and hence the scope to capture incremental revenue from other dealers is strong.
- **Sylvania has stabilized, margins have improved** – Sylvania is likely post FY12 EBITDA of Eur35-36mn (CIRA est. EUR33mn). EBITDA has improved substantially from ~EUR7mn in FY10 and ~EUR26mn in FY11. Sylvania is targeting increasing EBITDA to ~EUR55mn and in worst case (but not providing for substantial macro economic upheaval in Europe) expects to reach EBITDA of EUR45mn in FY13 (CIRA est. EUR38mn).

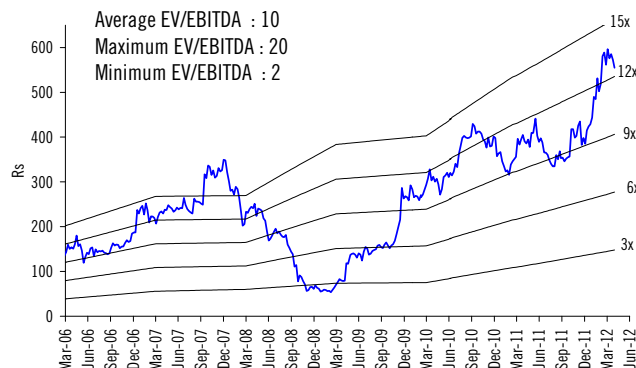
- Sylvania debt first tranche has been refinanced** – First tranche of Sylvania’s debt (EUR40mn) has been refinanced in April, 2012 while second tranche (EUR50mn) is due for refinancing in April, 2013. With current EBITDA run rate of EUR35-36mn (which is growing), we believe Sylvania is self sufficient and can service the debt over slightly longer time horizon. We believe refinancing of remaining debt is not a concern for Sylvania. Sylvania can refinance EUR50mn on its own but will need to pay 8-9% interest. However, if Havells India extends equity support or corporate guarantee, the interest costs could be brought down to 5-6%.
- Focus on advertising** – Even though the company operates in competitive market segments with large number of competitors, it enjoys scale and scope advantages over many of its competitors. Company sells a number of products and as a result spends ~Rs1bn per year (i.e. ~3-4% of revenues) on advertising and brand building. Company’s smaller competitors may not be able to afford this kind of advertising and brand building expense. Due to presence in related product segments, company does reap benefits of brand recall across product segments
- 23% PAT CAGR in India business** – We expect Havell’s (standalone) revenue and PAT to grow at CAGR of 19% and 23% over FY11-14E. Company will maintain healthy RoE/ RoCE of ~21% and 19% respectively over the same period. We expect Sylvania revenues to grow at ~2% CAGR over FY11-14E due to growth in Latin America and EBITDA margins to increase to 7.5%/8.4% in FY12E/FY13E from 5.8% in FY11. The improvement in Sylvania’s EBITDA margins will be driven by operating leverage in Latin America, increased outsourcing from India and China and continuing focus on profitability in Europe.

Figure 2. Havells (standalone) – PE chart



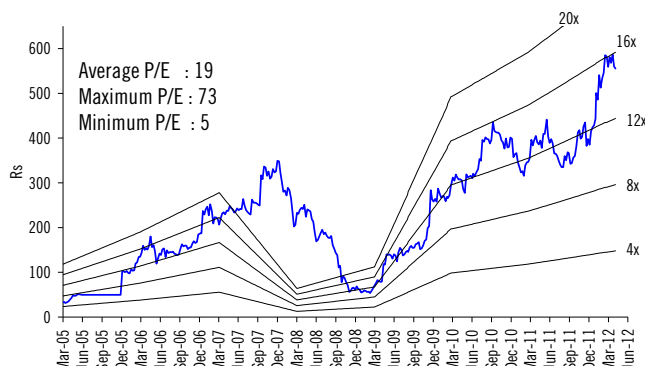
Source: Citi Investment Research and Analysis

Figure 3. Havells (standalone) – EV/EBITDA chart



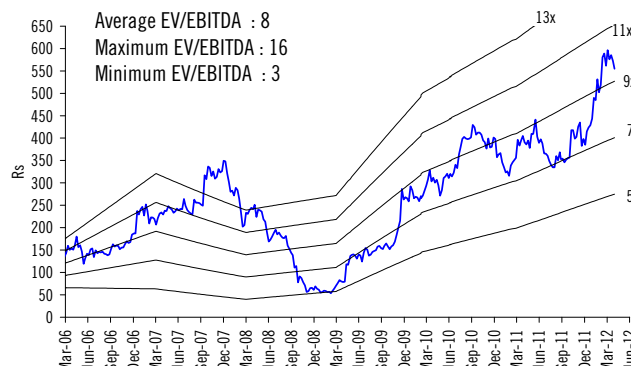
Source: Citi Investment Research and Analysis

Figure 4. Havells (consolidated) – PE chart



Source: Citi Investment Research and Analysis

Figure 5. Havells (consolidated) – EV/EBITDA chart



Source: Citi Investment Research and Analysis

Figure 6. Havells – Absolute Stock Price Performance

Since	Havells	Sensex	Alstom	ABB	Siemens	Crompton	Finolex	KEI Industries	Sterlite technologies	Bajaj Electricals	Orient
1 Month	-6.9%	-3.2%	-17.7%	-8.2%	-3.6%	-13.8%	9.8%	-10.7%	-14.5%	-2.1%	-5.0%
3 Months	9.7%	-2.2%	-15.2%	-8.4%	4.1%	-13.6%	6.7%	-10.2%	-11.4%	10.7%	1.8%
6 Months	43.8%	-2.4%	-23.1%	16.3%	-10.5%	-10.1%	-3.0%	-6.8%	-10.9%	-2.8%	-8.7%
1 Yr	50.2%	-6.4%	-39.5%	-9.9%	-9.9%	-48.3%	-28.6%	-35.4%	-39.5%	-22.6%	-2.6%
2 Yr	83.3%	-0.3%	-38.6%	8.3%	12.9%	-52.0%	-32.1%	-54.1%	-64.9%	-13.2%	-5.0%
3 Yr	575.3%	40.5%	-29.0%	67.1%	133.0%	27.9%	46.3%	14.5%	88.1%	335.9%	60.3%
5 Yr	132.8%	22.3%	-35.6%	-4.5%	27.4%	-0.5%	-61.7%	-80.0%	-5.9%	Na	20.1%
10 Yr	6605.3%	404.1%	3824.6%	1353.2%	2370.8%	3806.0%	12.0%	Na	27.7%	Na	3834.1%

Source: Citi Investment Research and Analysis

Figure 7. Havells – Relative Stock Price Performance

Since	Sensex	Areva	ABB.BO	Siemens	Crompton	Finolex	KEI Industries	Sterlite technologies	Bajaj Electricals	Orient
1 Month	-4%	11%	1%	-3%	7%	-17%	4%	8%	-5%	-2%
3 Months	12%	25%	18%	6%	23%	3%	20%	21%	-1%	8%
6 Months	46%	67%	28%	54%	54%	47%	51%	55%	47%	53%
1 Yr	57%	90%	60%	60%	98%	79%	86%	90%	73%	53%
2 Yr	84%	122%	75%	70%	135%	115%	137%	148%	97%	88%
3 Yr	535%	604%	508%	442%	547%	529%	561%	487%	239%	515%
5 Yr	111%	168%	137%	105%	133%	195%	213%	139%	Na	113%
10 Yr	6201.2%	2780.7%	5252.2%	4234.6%	2799.3%	6593.4%	Na	6577.7%	Na	2771.3%

Source: Citi Investment Research and Analysis

## Target Price Raised to Rs633 (Rs554 earlier)

- We raise our target price to Rs633 (Rs554 earlier) as we increase India business EPS by 4%/5% in FY13E/FY14E and roll over target P/E multiple of 18x from March 13E to September 13E.
- There is no change in Sylvania EV/EBITDA multiple and estimates. We have rolled over Sylvania's EV/EBITDA to September 13E from March 13E.

**Figure 8. Havells – Target Price Change**

<b>Havells India Business</b>	<b>New</b>	<b>Old</b>
Parent EPS (Sep 13)	33	29
P/E Multiple	18	15
<b>Parent Value</b>	<b>596</b>	<b>520</b>
<b>Sylvania</b>		
EBITDA (Sep 13)	2,545	2,491
EV/EBITDA	5.0	5.0
<b>EV</b>	<b>12,724</b>	<b>12,453</b>
<b>Net Debt (3QFY12)</b>	<b>8,151</b>	<b>8,151</b>
Equity Value	4,573	4,302
<b>Sylvania Per share</b>	<b>37</b>	<b>34</b>
<b>Total Value</b>	<b>633</b>	<b>554</b>

Source: Citi Investment Research and Analysis estimates

**Figure 9. Havells – Parent (India business) Earnings Revision**

<b>Parent</b>	<b>FY12E</b>	<b>FY13E</b>	<b>FY14E</b>
<b>Revenue</b>			
New	35,588	41,488	48,132
Old	35,588	40,926	47,065
% Diff	0%	1%	2%
<b>EBITDA</b>			
New	4,448	5,290	6,137
Old	4,448	5,116	5,883
% Diff	0%	3%	4%
<b>EBITDA Margin</b>			
New	12.5%	12.8%	12.8%
Old	12.5%	12.5%	12.5%
% Diff	0	25	25
<b>PAT</b>			
New	3,107	3,741	4,523
Old	3,107	3,602	4,314
% Diff	0%	4%	5%
<b>EPS</b>			
New	24.9	30.0	36.3
Old	24.9	28.9	34.6
% Diff	0%	4%	5%

Source: Citi Investment Research and Analysis estimates

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**Figure 10. Havells – Consolidated Earnings Revision**

<b>Consolidated</b>	<b>FY12E</b>	<b>FY13E</b>	<b>FY14E</b>
<b>Revenue</b>			
New	64,135	70,984	78,690
Old	64,135	70,422	77,624
% Diff	0.0%	0.8%	1.4%
<b>EBITDA</b>			
New	6,582	7,780	8,736
Old	6,582	7,606	8,482
% Diff	0.0%	2.3%	3.0%
<b>PAT</b>			
New	3,692	4,522	5,333
Old	3,692	4,383	5,124
% Diff	0.0%	3.2%	4.1%
<b>EPS</b>			
New	29.6	36.2	42.7
Old	29.6	35.1	41.1
% Diff	0.0%	3.2%	4.1%

Source: Citi Investment Research and Analysis

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## Havells India

### Company description

Havells is an electrical and power distribution equipment manufacturer with a presence in industrial and domestic circuit protection switchgears, cables and wires, motors, fans, power capacitors, CFL lamps, luminaries for domestic/commercial and industrial applications, and modular switches. It owns several brands across these products, namely Crabtree, Sylvania, Concord, Luminance, Linolite, and SLI Lighting. Havells has 11 manufacturing plants in India located at Haridwar, Baddi, Noida, Sahibabad, Faridabad, Alwar, Neemrana, and 6 manufacturing plants located across Europe and Latin America.

### Investment strategy

We rate Havells shares Buy, with a target price of Rs633. We believe that Havells' India business is a quality play on domestic construction and consumer demand. Company has managed to create entry barriers in a competitive business and has established large network of dealers (~4300) across India to sell its products. Moreover recent results have demonstrated stability of demand in India. Business in Europe remains stable with focus on profitability. Latin American business remains on growth path with ~10-12% growth and ~9-10% EBITDA margins

### Valuation

Our target price of Rs633 is based on a sum-of-the-parts approach. We value the India business at Rs596 and Sylvania at Rs37. The parent business is valued at 18x September13 P/E, at a premium to its historical average of 14x to reflect buoyant demand and strong business traction in India. The 18x P/E is supported by a ~23% EPS CAGR over FY11-14E and ~21% average RoE. P/E is generally used to value branded consumer and capital goods companies, segments in which Havells operates. We value Sylvania on 5x September 13E EV/EBITDA. Despite recovery in operations and profitability, PAT is expected to remain depressed due to high depreciation and interest costs and thus we prefer to use EV/EBITDA. We conservatively use 5x, derived from a comps analysis and taking the European risks into consideration. At our TP of Rs633, Havells will trade at consolidated P/E of ~17x on FY13 EPS with FY11-14 EPS CAGR of 20%.

### Risks

Downside risks to our target price include poorer performance from Sylvania, higher commodity prices, unsuccessful new-product launches, increase in competitive intensity and demand slowdown in India.

## Appendix A-1

### Analyst Certification

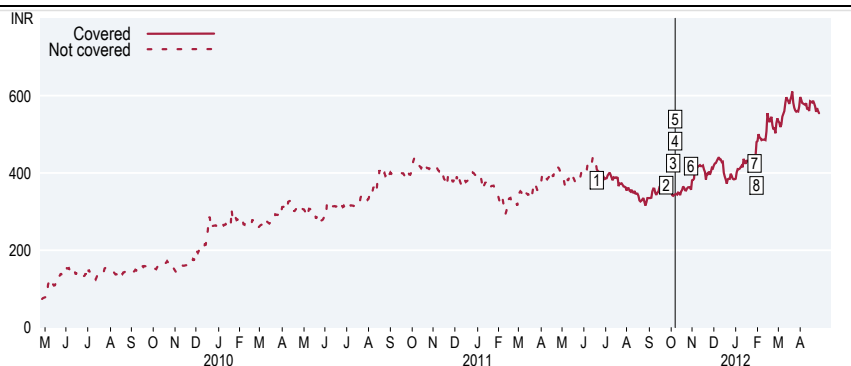
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Analyst: Atul Tiwari, CFA  
Covered since June 20 2011



	Date	Rating	Target Price	Closing Price
1	20-Jun-11	*3L	*425.00	409.35
2	26-Sep-11	3L	*347.00	357.65
3	5-Oct-11	3L	*335.00	340.70

	Date	Rating	Target Price	Closing Price
4	7-Oct-11	Stock rating system changed		
5	7-Oct-11	*3	335.00	344.85
6	31-Oct-11	*1	*425.00	356.35

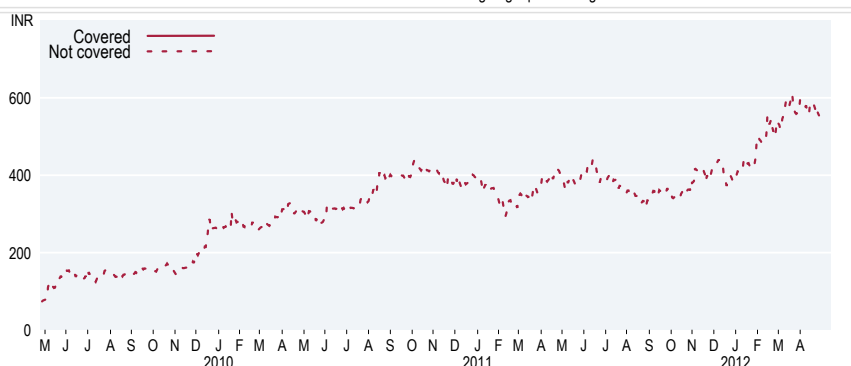
	Date	Rating	Target Price	Closing Price
7	27-Jan-12	1	*502.00	428.85
8	31-Jan-12	1	*554.00	480.00

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

### Havells India (HVEL.BO) Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

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Data current as of 31 Mar 2012

	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
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