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Havells India | Annual Report Analysis

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Havells India's (Havells) FY12 annual report analysis highlights robust operating cash flows supported by higher acceptances. Under-funded status of defined benefit plans and actuarial losses may impact cash flows and profitability. During FY12, the company has paid trademark fees/royalty of INR379.2mn, 8% of FY12 PBT (FY11: INR292.8mn) to a promoter group company.

Higher acceptances bolster surge in cash flow from operations

Cash flow from operations increased from INR2.5bn in FY11 to INR4.6bn in FY12, primarily due to higher acceptances which more than doubled from INR1.5bn in FY11 to INR3.7bn in FY12 with average payable days at 88 (FY11: 78).

Under-funded status of defined benefit plan

During CY11, Havells recognised actuarial loss of EUR4.5mn (~INR307mn) as against a gain of EUR5.4mn (~INR340mn) in CY10 in P&L on defined benefit plans (DBP). It has an under-funded status of EUR43.2mn (~INR2.9bn) in CY11 (CY10: EUR38.3mn (~INR2.4bn) on account of its DBP.

Post CY11, the defined benefit pension plan in Switzerland was bought out with an insurer hence only the insurance premium is required to be paid. However, the company is required to pay obligations till CY11.

Trademark fees and royalty @8% of FY12 PBT

During FY12, the company paid INR572.6mn (FY11: INR467.0mn) to promoter group companies. Of this, INR379.2mn (8.0% of FY12 PBT) is towards payment of trademark fees/royalty and the balance as rent to QRG Enterprises (a promoter group company).

Securitisation/channel financing leads to lower receivables

Receivables in FY12 stood at INR8.9bn of which INR1.4bn pertained to domestic markets and balance to overseas markets. Receivable days stood at 15 for domestic market and 89 for overseas market.

The lower receivable days in India are due to securitisation of receivables of INR2.4bn (10% recourse) and channel financing facility of INR2.7bn (5-10% recourse) in FY12. The company incurred discounting charges (forming part of EBITDA) of INR189.1mn in FY12.

Other financial highlights

The company has not recognised deferred tax asset (DTA) in respect of carried forward losses of INR16.9bn (FY11: INR12.4bn) due to absence of a reasonable certainty that future taxable income will be available against which DTA can be realised.

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Market Data

52-week range (INR)	:	616 / 335
Share in issue (mn)	:	124.8
M cap (INR bn/USD mn)	:	72 / 1,302
Avg. Daily Vol. BSE/NSE ('000)	:	335.1

Shareholding Pattern (%)

Promoters	:	61.6
MFs, FIs & Banks	:	0.9
FIIs	:	20.0
Others	:	17.5
**Promoters pledged shares (% of share in issue)*	:	Nil

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Aggregate amount of related party transactions stood at INR572.6mn in FY12 (FY11: INR467.0mn)

Trademark fees and royalty @8% of FY12 PBT

- During FY12, the company paid trademark fees and royalty of INR379.2mn (~1% of FY12 standalone sales) (FY11: INR292.8mn) to its promoter group company (QRG Enterprises).
- The company has also paid rent/usage charges of INR193.4mn (FY11: INR174.2mn) to QRG Enterprises.

Table 1: Transactions with promoter group company **(INR mn)**

Particulars	FY11	FY12
Trademarks fees and royalty	292.8	379.2
Rent/usage charges paid	174.2	193.4
Total	**467.0**	**572.6**

Source: Company's Annual Report, Edelweiss research

Post CY11, DBPP in Switzerland is bought out with an insurer hence only insurance premium is payable

Obligations till CY11 have to be borne by the company

Under-funded pension status stood at EUR43.2mn (~INR2.9bn) in CY11

Actuarial loss of EUR4.5mn (~INR307mn) in CY11 against EUR5.4mn in CY10 (~INR340mn))

Under-funded status of defined benefit plan

- Havells has a defined benefit pension plan (DBPP) for employees in Germany, Thailand, France, Italy, and UK. It also has a post-retirement medical benefit plan in Switzerland (unfunded) and an early retirement plan in Belgium.
- Post CY11, the defined benefit pension plan in Switzerland was fully bought out with an insurer. Hence, only insurance premium has to be paid by the company. However, the company is required to pay the obligations till CY11.
- Havells has recognised actuarial loss of EUR4.5mn (~INR307mn) in CY11 (CY10: EUR5.4mn (~INR340mn)) on account of its defined benefit plans in P&L.

Table 2: Under-funded status of DBP **(Euro mn)**

Particulars	CY10	CY11
Present value of funded obligations	82.6	82.2
Fair value of plan assets	(49.8)	(47.0)
Sub-total	**32.7**	**35.2**
Present value of other unfunded obligations	5.6	8.1
Total	**38.3**	**43.2**

Table 3: DBP charge through P&L **(Euro mn)**

Particulars	CY10	CY11
Current service cost	0.8	0.4
Interest cost	4.4	4.1
Curtailments and settlements	(0.5)	-
Actuarial (gain)/loss	(5.4)	4.5
Expected return on plan assets	(2.9)	(2.9)
Total	**(3.6)**	**6.1**

Source: Company, Company's Annual Report, Edelweiss research

Majority of the pension fund assets invested in UK

Table 4: Geography-wise asset distribution **(Euro mn)**

	CY10			CY11	
Particulars	**UK**	**Germany**	**Switzerland**	**UK**	**Germany**
Equities	24.6			24.3	-
Corporate bonds	13.6			14.8	-
Gilts	4.7			5.2	-
Insurance contracts	-	2.4		-	2.3
Other	0.2	-	4.4	0.3	-
Total	**43.1**	**2.4**	**4.4**	**44.7**	**2.3**

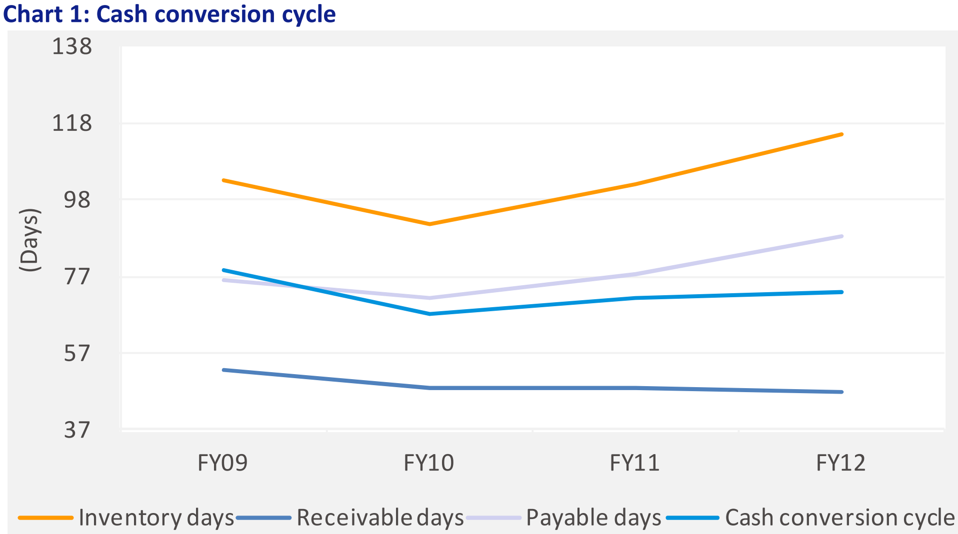
Source: Company, Company's Annual Report, Edelweiss research

Inventory days increased from 101 in FY11 to 115 in FY12 with cash conversion cycle flat at 73 days

Higher acceptances bolster surge in cash flow from operations

- Cash flow from operations increased from INR2.5bn in FY11 to INR4.6bn in FY12 primarily due to higher acceptances which more than doubled from INR1.5bn in FY11 to INR3.7bn in FY12.
- Trade payables increased from INR8.2bn in FY11 to INR10.7bn in FY12 with average payable days at 88 (FY11: 78 days).
- Inventories rose from INR10.9bn in FY11 to INR13.7bn in FY12.

Chart 1: Cash conversion cycle



Source: Company's Annual Report, Edelweiss research

Table 5: Cash flow analysis **(INR mn)**

Particulars	FY11		FY12	
Profit before tax		**4,070.2**		**4,757.3**
Non-operating expense	895.4		1,350.3	
Non-cash adjustments	412.8		810.2	
Direct taxes paid	(850.3)		(1,097.2)	
Cash profit after tax		**4,528.1**		**5,820.6**
Increase in trade and other receivables	(781.6)		(1,306.7)	
Increase in inventories	(2,751.2)		(2,817.5)	
(Increase)/Decrease in loans, advance and other assets	232.6		(478.2)	
Increase in trade payables	1,922.7		$\boxed{2,520.9}$	
Increase/(Decrease) in other liabilities and provisions	(620.7)		877.6	
Increase in working capital		**(1,998.2)**		**(1,203.9)**
Net cash from operating activities		**2,529.9**		**4,616.7**
Interest expenses paid		(850.3)		(1,097.2)
Net cash from operating activities post interest		**1,679.6**		**3,519.5**

Source: Company's Annual Report, Edelweiss research

Securitisation/channel financing aids in lower receivables

Discounting charges of INR189.1mn forms a part of EBITDA

Total securitisation/channel financing of INR5.1bn for customers with 5-10% recourse to the company

Lower receivable days in India due to securitisation of receivables and channel financing facility

- Receivables at FY12 end stood at INR8.9bn, of which INR1.4bn pertained to domestic market and balance INR7.5bn to overseas markets. Receivable days stood at 15 for domestic market and 89 for overseas market.
- The lower receivable days in India are primarily due to securitisation of receivables of INR2.4bn (10% recourse to company) incurring total discounting charges of INR189.1mn in FY12 which is forming part of EBITDA.
- Havells has also arranged for channel finance facility (5-10% recourse to company) for its customers, which stood at INR2.7bn in FY12 (FY11: INR1.2bn).
- Further, the company has provided trade receivables of INR174.3mn in FY12 (FY11: INR71.8mn).

Table 6: Debtor and revenue distribution **(INR mn)**

Particulars	Revenue		Debtors		Receivable days (closing)	
	FY11	FY12	FY11	FY12	FY11	FY12
Within India	27,763	34,428	860	1,385	11	15
Outside India	28,363	30,754	6,861	7,521	88	89
Total	**56,126**	**65,182**	**7,721**	**8,905**	**50**	**50**

Source: Company's Annual Report, Edelweiss research

Expense analysis

Legal and professional charges and advertisement expenses as a % of sales increased during FY12

- Legal and professional charges rose from INR408.3mn in FY11 to INR629.6mn in FY12; 1.0% of FY12 sales (FY11: 0.7%).
- Advertisement and sales promotion surged from INR1.3bn in FY11 to INR1.8bn in FY12; 2.8% of FY12 sales (FY11: 2.3%).
- Havells has written back excess provision of INR205.1mn in FY12 (FY11: INR30.6mn); 4.3% of FY12 PBT (FY11: 0.8%).

Exchange loss of INR306.4mn @ 6.4% of PBT

- The company's exchange loss stood at INR306.4mn in FY12 (6.4% of FY12 PBT); of which INR94.6mn has been classified as finance cost on account of interest rate parity due to Revised Schedule VI changes and balance INR211.8mn has been recognised as exchange loss.

INR depreciation may result in higher exchange loss on unhedged payables of INR1.1bn

Table 7: Unhedged receivable/(payable) position **(INR mn)**

Particulars	FY11	FY12
Receivables	202	138
Payables	1,309	1,231
Net payable	**(1,107.2)**	**(1,092.8)**

Hedging of import creditors during CY12 along with interest rate swaps

Table 8: Derivative position **(INR bn)**

Particulars	Currency	FY11	FY12	Purpose
Forward contracts (Buy)	EUR-USD	-	1.3	Hedge import creditors
Forward contracts (Buy)	GBP-USD	-	0.1	Hedge import creditors
Interest swap		3.9	2.7	Hedge int. expense on term loan

Source: Company's Annual Report, Edelweiss research

D/E down; borrowing cost on the rise

Debt reduced from INR11.1bn in FY11 to INR9.8bn in FY12

- Havell's borrowing cost has increased from 7.5% in FY11 to 10.4% in FY12 with interest cost rising from INR0.8bn to INR1.1bn.

Long-term loans of INR1.1bn and INR3.6bn to be repaid in FY13 and FY14 respectively

- The company's debt dipped from INR11.1bn in FY11 to INR9.8bn in FY12 with D/E reducing from 1.7x to 1.0x.
- It is due to repay long-term loans of INR1109.8mn in FY13 and INR3583.3mn in FY14.

During Q1FY13, the company refinanced loans of EUR77.5mn (~INR5.4bn)

- During Q1FY13, the company has refinanced EUR77.5mn (~INR5.4bn). As informed by the management, this will result in EUR3-4mn (~INR0.2bn) of savings in interest cost.

Other financial highlights

- Business reconstruction reserve formed for the purpose of adjustment of certain expenses as per the scheme of arrangement stood at INR1,049.3mn in FY12 (FY11: INR1,049.3mn).

Business reconstruction reserve at INR1.0bn in FY12

- Havells Holding (wholly-owned subsidiary) has taken a loan of EUR38mn (INR2,660mn) in April 2012, which is guaranteed by the company.
- The company has not recognised deferred tax asset (DTA) in respect of carried forward losses of INR16.9bn (FY11: INR12.4bn) due to absence of reasonable certainity that future taxable income will be available against which DTA can be realised.
- VAT receivables increased from INR3.4mn in FY11 to INR229.6mn.
- The company sold net fixed assets of INR291.3mn at loss of INR85.8mn (net) in FY12.

Profit for the year boosts shareholder funds

Table 9: Shareholders' funds analysis **(INR mn)**

Particulars		FY12
Opening shareholders' fund		**6,537.4**
Add		
Profit for the year	3,704.3	
Exchange difference during the year on net investment in non-integral foreign operations	257.0	
		3,961.3
Less: Dividend and tax thereon		942.6
Closing shareholders' fund		**9,556.1**

Source: Company's Annual Report, Edelweiss research

RoE analyser

ROE analyser analyses the profitability on the scale of operating efficiency and capital allocation efficiency (detailed concept explained in Annexure A). We have analysed Havell's profitability for the year ended FY11 and FY12; results and key findings of same are as follows:

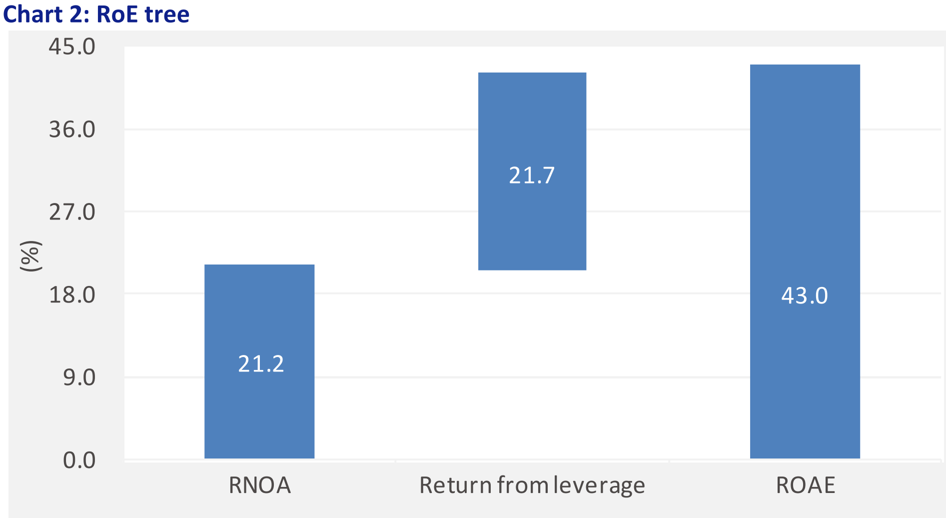
Higher borrowing cost and lower leverage led to lower RoEs

Table 10: RoE table

Particulars	FY11		FY12	
A. Return on net operating assets (RNOA) (OPATO x NOPAT margin) (%)		**20.5**		**21.2**
OPATO (operating asset turnover) (x)	3.2		3.0	
NOPAT margin (%)	6.4		7.2	
B. Return from leverage (FLEV x spread) (%)		**35.1**		**21.7**
FLEV (financial leverage) (x)	2.2		1.6	
NBC (net borrowing cost) (%)	4.3		7.4	
Net financial spread (RNOA -NBC) (%)	16.2		13.8	
C. Return from other funding (%)		**(0.1)**		**0.0**
ROE Derived (A+B+C) (%)		**55.5**		**43.0**

Source: Company's Annual Report, Edelweiss research

Chart 2: RoE tree



Source: Company's Annual Report, Edelweiss research

Table 11: Major subsidiaries snapshot **(INR mn)**

Subsidiary company	FY11			FY12		
	Networth	Turnover	PAT	Networth	Turnover	PAT
Havells Sylvania Europe	2,676	16,774	175	4,003	17,962	1,072
Havells Exim	4	639	4	29	5,362	22
Havells Sylvania Germany GmbH	297	2,287	141	490	2,593	163
Havells Sylvania Colombia S.A.	1,268	2,121	26	1,600	2,302	174
Panama Americas Trading Hub SA	26	311	25	164	1,903	125
Havells Sylvania Brasila Iluminacao	(1,012)	1,812	(291)	(1,122)	1,582	(223)
Havells Sylvania Lighting Belgium N.V.	767	1,137	(173)	874	1,281	43
Havells Sylvania Costa Rica S.A.	378	1,255	76	470	1,227	55
Havells Sylvania Fixtures UK	38	1,072	(33)	119	1,225	7
Havells Sylvania Lighting France SAS	112	1,283	(4)	109	1,190	(11)
Havells SLI Mexico S.A. de C.V.	289	793	72	390	1,089	102
Havells Sylvania Argentina S.A.	187	640	57	271	1,068	69
Havells USA Inc.	(630)	1,033	(27)	(1,006)	1,007	(146)
Havells Sylvania Fixtures Netherlands B.V.	1,540	528	117	1,805	468	135
Havells Sylvania Tunisia S.A.R.L.	(974)	235	9	(1,074)	204	(21)
SLI Europe B.V.	1,461	-	(65)	1,642	-	61
Sylvania Lighting International B.V.	5,283	-	12	6,150	-	425
Havell's Malta	5,938	-	0	7,021	-	(1)
Havell's Netherlands Holdings B.V.	5,908	-	21	7,008	-	19
Havell's Netherlands B.V.	5,096	-	(166)	5,464	-	(41)
Havells Sylvania Holdings BV1	1,213	-	-	1,327	-	-
Havell's Holdings	6,793	(0)	(2)	7,945	-	(2)

The performance of the subsidiaries improved during the year. Goodwill stood at INR3.6bn in FY12 (FY11: INR3.4bn); ~38.0% of FY12 networth (FY11: 51.3%).

Table 12: Summary financials **(INR mn)**

Particulars	FY08	FY09	FY10	FY11	FY12
Sales	50,029	54,775	51,626	56,126	65,182
Total income	50,280	54,861	51,847	56,364	65,596
EBITDA	3,466	2,886	3,222	5,570	6,573
EBITDA margin (%)	6.9	5.3	6.2	9.9	10.1
Depreciation	694	905	837	804	949
Financial costs	1,036	1,253	979	902	1,281
Net profit	1,610	(1,602)	696	3,036	3,699
Equity shareholders' funds	6,722	6,121	4,002	6,537	9,556
Loan funds	12,962	12,278	10,664	11,065	9,795
Net fixed assets	11,669	12,421	12,422	13,558	14,571
Current assets loans and advances	23,229	20,215	18,556	21,685	26,718
Current liabilities and provisions	15,142	14,308	15,876	14,623	18,672
Net current assets	8,087	5,907	2,680	7,061	8,046
Cash flow from operating activities	(239)	2,199	3,087	2,530	4,617
Cash flow from investing activities	(7,693)	(1,626)	(961)	(1,762)	(1,053)
Cash flow from financing activities	9,192	(515)	(3,130)	(654)	(2,568)
Net cash flows	1,260	57	(1,005)	114	996
CAPEX	(1,213)	(1,496)	(1,536)	(1,886)	(1,716)
Working capital investments	(3,498)	2,168	2,369	(1,998)	(1,204)

Source: Company's Annual Report, Edelweiss research

ANNEXURES

Annexure A – ROE analyzer

ROE analyser analyses the profitability on the scale of operating efficiency and capital allocation efficiency. While operating efficiency is a measure of how efficiently the company is making use of operating assets, capital efficiency is the measure of balance sheet efficiency.

The above analysis involves:

1. Dissection of profitability along two major drivers:

    a. Return from operating activities (RNOA: return on net operating assets).

    b. Return from financing activities (leveraging effect on ROE).

    ROE = Return from operating activities (RNOA) + Return from leverage

    Or

    ROE = Operating margin x Operating assets turnover + Leverage spread x Leverage multiplier

    Whereas:

    RNOA = NOPAT/Average operating assets

    Operating margin = NOPAT/Operating revenue

    Operating assets turnover = Operating revenue/Average operating assets

    Leverage spread = RNOA – Net borrowing cost

    Leverage multiplier = Average net financial obligation/Average common shareholders' equity

2. Reformulation of balance sheet, wherein we have regrouped assets and liabilities into operating and financing categories (against traditional current and non-current categorisation).

3. Reformulation of income statement, wherein we have regrouped income and expenses into operating and financing activities.

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