

Havells India Limited

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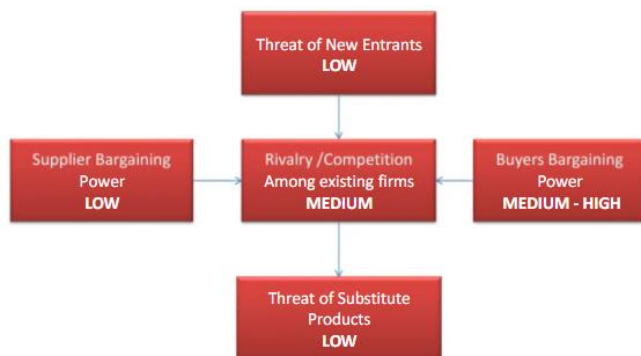
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Section 1: Qualitative Analysis

Vision: To be a globally recognised corporation for excellence, governance, consumer delight and fairness to each stakeholder including the society and Our Mission environment we operate in.

Mission: To achieve our vision through business ethics, global reach, technological expertise, building long-term relationships with all our associates, customers, partners and employees.

Porter's Five Force Model:



Competitors:

Bajaj, Orient Electric, Finolex, Legrand, Anchor-Roma, Phillips, Osram, KEI, Schneider

- **Suppliers Bargaining Power:** This is relatively low as Havells has the benefit of having in-house manufacturing facilities meaning it has to only buy raw materials. As a result, it is difficult for the supplier to exercise control on the cost structure as raw material prices have low margins compared to finished products
- **Buyers Bargaining Power:** With a wide variety of options available to choose from, bargaining power of individual buyers is high. The company has attempted to minimize this via sales to construction businesses where the end buyer has no choice and by product customisation strategy in order to differentiate their products.
- **Threat of Substitute Products:** As a result of product customisation and differentiation as well as construction sector supply contracts, threat of substitution is minimized. Furthermore, it is attempting to create an integrated ecosystem of electrical products that might win them loyal customers in the long run.
- **Threat of New Entrants:** As a large-scale manufacturing giant, threat of new entrants is minimised as entry costs are very high. Moreover, Havells has a robust distribution network which will be difficult for new players to acquire.
- **Rivalry among existing firms:** Havells has established itself in a niche by diversification into related businesses and hence has managed to keep competition at a moderate level.

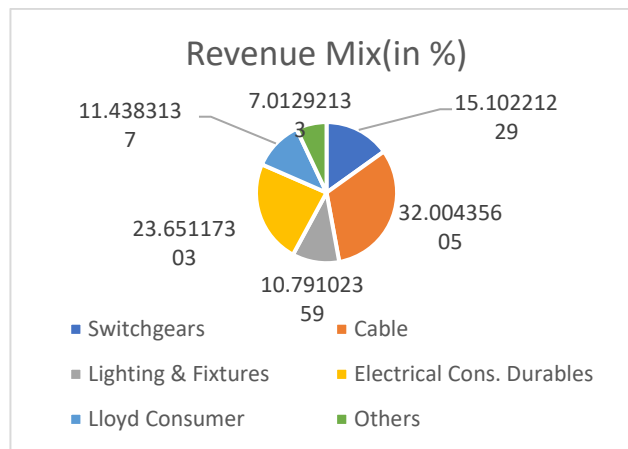
Business Strategy Analysis (Competitive and Corporate):

1. Havells possesses a world-class infrastructure with a global presence with one of the largest manufacturing capacities in India.
2. It has invested heavily in its brand image over the years and has even opened 'Havells Galaxy' retail stores pan-India as a one stop shop for Havells products.
3. Havells has retained a 20% stake in Sylvania Lighting International and has plans for acquisitions of Chinese firms having already opened a representative office under Havells Guangzhou International Limited.

4. With prominent brands under its wing such as Lloyd, Crabtree, Standard, Reo and several more, it has expanded into a wide range of Fast-Moving Electrical Products. The diversification strategy includes operational relatedness so that its sub-brands can share the financial, intellectual and other resources of its parent.
5. Its dedicated R&D wing specialises in low energy and eco-friendly lighting solutions (best in industry) and relevant international certifications and is well poised to capture this fast-growing market.
6. Its switch gears are ready for factory deployment out of the box helping them gain share in a market filled with predecessor variants (Blue Ocean Strategy).
7. It has also attempted to attract consumers via low margins, direct replacement and customisation options (price as well as product differentiation).
8. Furthermore, it has forayed into air conditioners, washing machines, water purifiers and more recently refrigerators which indicate its intention for product diversification.

BCG Matrix:

Product line	Revenue Mix	Revenue Mix(in %)
Switchgears	370.27	15.10221229
Cable	784.67	32.00435605
Lighting & Fixtures	264.57	10.79102359
Electrical Cons. Durables	579.87	23.65117303
Lloyd Consumer	280.44	11.4383137
Others	171.94	7.01292133
	2451.76	100



The pie chart derived from the quarterly report (Sep 30, 2020) of Havells India clearly shows its revenue streams from various segments. Since these percentage distributions remain more or less constant over the past year quarterly reports, we can arrive at the following BCG matrix:

	High	Low
High	Stars Switch Gears Introduced in 2014 and occupy 15% of revenue now	Question Marks Refrigerators (2020) Anti-bacterial Switch (2020)
Low	Cash Cows Cables	Dogs Electrical Consumer Durables such as Electrical Heater

Section 2: ROE Decomposition

Return on Equity Decomposition:

Term	Value
Net Income	735.35
Interest Expenses	5.17
Interest Income	62.46
Applicable Tax Rate	0.25168
Net Interest expense after tax	-42.871253
NOPAT	692.47875
Current Assets	3460.84
Current Liabilities	2326.9
Cash and Marketable Securities	267.7
Repayment of long term borrowings	54
Operating Working Capital	920.24
Net long term assets	3592.81
Net Assets	4513.05
Total Interest Bearing Liabilities	40.5
Net debt	-227.2
Sales	9407.1
Operating ROS	0.0736124
Net Assets Turnover	2.0844218
Operating ROA	0.1534392
Effective interest rate after tax	0.1886939
Equity	4311.56
Net financial leverage	-0.0526955
Return on Equity	0.155297
Return on Equity (in %)	15.53%

Net interest expense after tax (NIE) =
 $(\text{Interest expense} - \text{Interest income}) \times (1 - \text{Tax Rate})$
 NOPAT = Net Income + NIE

C&MS

LTB Repaid (Cash flow statement reveals no repayment of short term borrowings)
 Operating Working Capital (OWC) =
 $(\text{CA} - \text{C\&MS}) - (\text{CL} - \text{LTB Repaid})$

Net Assets = Net long term assets + OWC

Net debt = Total interest bearing liabilities – C&MS

Operating ROS = NOPAT/Sales
 Net Assets Turnover = Sales / Net Assets
 Operating ROA = Operating ROS * Net Assets Turnover
 Effective interest rate after tax (R) = Net debt / NIE

Net financial leverage = Net debt / Equity

Return on Equity = Operating ROA +
 Net financial leverage * (Operating ROA – R)



Return on Equity
Decomposition.xlsx

The Operating ROA is nominally greater than the ROE which results from a negative debt. This arises from the Cash and Marketable securities being greater than the total interest bearing liabilities resulting in a negative net financial leverage. The firm is thus majorly reliant on equity for financing its expansion plans.

The Operating Working Capital is roughly 20% of the net assets which is typical for a capital intensive firm like Havells which is heavily reliant on a fixed asset base.

Another figure that comes to the fore is the Net Assets turnover. With a Net Assets Turnover of about 2.08, it is evident that Havells is able to efficiently utilise its assets in generating revenue. This is very rare for capital intensive firms. However, the low levels of ROS indicate an increasing reliance on cost leadership strategy to maximize sales.

Valuation of Havells India Limited

1. Beta Calculation of Havells:

Unlevered beta = 1.152945 (Calculation in excel sheet attached)

Applicable Tax Rate = 25.168%

Long Term Debt = 40.5

Equity Capital = 4311.56

Debt/Equity Ratio = 0.009393

Levered beta = Unlevered beta * (1 + (1 - Tax rate)*D/E)

Levered beta = Unlevered beta

Levered beta = 1.152945

2. Cost of equity calculation:

CAPM Model used; it is assumed that unsystematic risk averted by diversification

Risk free rate (Rf) = 5.83% (10 year government securities rate)

Rm = 8.501905% (Average return of NSE index)

Cost of equity = Rf + (levered beta*(Rm-Rf))

Cost of equity = 8.910561%

3. Weighted Average Cost of Capital (Details given in the WACC Calculation spreadsheet):

As per CARE ratings, Havells has a rating of AAA



CARE rating.pdf

Cost of debt = Risk free rate + Default spread

Cost of debt = 10-year government securities rate + spread of AAA rated bonds

AAA bond spread = 1.09%

Pre-tax Cost of Debt = 6.92%

After Tax Cost of Debt = 5.178%

Total Debt/Equity (X)	0.00	0.01	0.03	0.06	0.03
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The relatively constant leverage coupled with the fact that beta of the company is close to 1 (as with Toyota) enables us to use the FCFE approach to value the firm in which the rate of discounting:

Rate of discounting = Cost of Equity

Rate of discounting = 8.910561%

4. Growth Rate Calculation:

Non-Cash ROE

Net Income	735.35
Book value of equity	4311.56
Cash and cash equivalents	267.7
Pre-tax income from cash and cash equivalents	76.6
Applicable tax	0.25168
After-tax income from cash and cash equivalents	57.32131
Non-cash net income	678.0287
Non-cash ROE	0.167669

Equity Reinvestment Rate

Capital Expenditure	371.3	
	March 31, 2020	March 31, 2019
Current Assets	3,460.84	3,826.23
Current Liabilities	2,326.90	2,539.58
Working Capital	1,133.94	1,286.65
Net change in Working Capital	-152.71	
Depreciation and Amortisation Expenses	217.97	
	March 31, 2020	March 31, 2019
Long term Borrowing	0	40.5
Debt issued	-40.5	
Equity Reinvestment Rate	0.060646401	

It is worth noting that in 2020, the company has had a dividend payout ratio of 72.33% as sharp contrast from the usual dividend payout ratio in the last 5 years which usually lay around 30%. This might indicate an effect of the coronavirus pandemic and needs to be corrected. I will assume that Non-cash ROE remains relatively

Growth rate = 1.0169%

	March 31, 2019	March 31, 2018	March 31, 2017	March 31, 2016	March 31, 2015	March 31, 2014
Capital Expenditure	477.48	1,680.78	196.39	213.08	211.71	
Current Assets	3,826.23	3,706.66	3,234.43	2,634.43	2,948.61	3,606.78
Current Liabilities	2,539.58	2,529.98	1,575.17	1,236.89	2,088.69	2,484.90
Working Capital	1,286.65	1,176.68	1,659.26	1,397.54	859.92	1,121.88
Net change in Working Capital	109.97	-482.58	261.72	537.62	-261.96	
Depreciation and Amortisation Expenses	152.61	140.49	120.51	134.4	138.66	
Long term Financial liabilities	40.5	81.00	0.00	1.67	226.4	705.57
Debt issued	-40.50	81.00	-1.67	-224.73	-479.17	
Equity Reinvestment Rate	0.65	1.55	0.79	0.66	0.80	
Average Equity Reinvestment Rate		0.75				

Average growth rate in 5 years = 12.6018%

	March 31, 2020	March 31, 2019	March 31, 2018	March 31, 2017	March 31, 2016	March 31, 2015
Net Income	735.35	787.61	660.97	494.11	1300.45	385.42
Pre-tax income from cash and cash equivalents	76.6	79.62	45.6	99.19	53.13	34.59
Applicable tax rate	0.25168	0.34944	0.34608	0.34608	0.34608	0.3399
After-tax income from cash and cash equivalents	57.321312	51.7975872	29.818752	64.8623248	34.7427696	22.832859
Non-cash net income	678.028688	735.8124128	631.151248	429.2476752	1265.70723	362.587141
Normalised Non Cash Net Income	683.7557326					

[illegible]

Since the company has been historically seen to raise funds primarily via equity financing, I assume this trend will continue into the future

Expected net income in year 11	1524.206733						
Equity reinvestment in year 11	0.751590152		Stable Period Growth Rate	0.067133646			
FCFE in year 11	378.6279634						
Terminal Value	17064.1525						
Present Value of Terminal Value	7253.062023		Stable period cost of equity				
Value of Equity in Operating Assets	9732.65905		Risk free rate	0.0583			
Cash and Marketable securities	267.7		Rm	0.085019053			
Value of Equity	10000.35905		Beta	1.161049643			
Number of Shares	62,58,02,834		Cost of Equity	0.089322147			
Value of Equity per share	159.8004756						

At the time of valuation, Havells share price was Rs. 826.10

Hence Havells share is overvalued and recommendation is to sell

Now while such high disparity between intrinsic value (159.8) and share price (826.10) seems anomalous, various online resources arrive at intrinsic values between 125-188. Therefore, the share is grossly overvalued. As per some resources online, there has been insider trading which may explain such behaviour.

Online resources with similar valuations:

<http://www.attainix.com/ICTrackerDetail.aspx?stockcode=HAVELLS.IN>

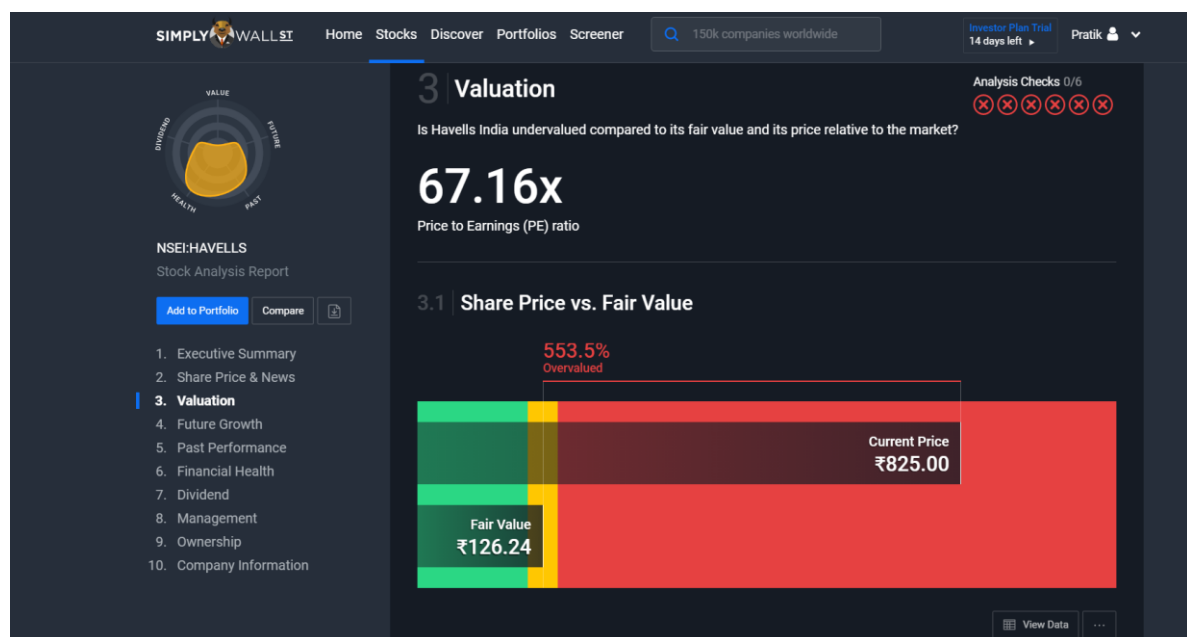
<https://billiondollarvaluation.com/havells-valuation-excel-model-and-intrinsic-value-of-shares/?amp>

<https://simplywall.st/stocks/in/capital-goods/nse-havells/havells-india-shares>

https://www.gurufocus.com/term/iv_dcf_share/NSE:HAVELLS/Intrinsic-Value-Projected-FCF/Havells-India-Ltd



Valuation of Havells.xlsx



References:

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3. <https://www.slideshare.net/mbabrothers/havells-india-limited>
4. <http://www.attainix.com/ICTrackerDetail.aspx?stockcode=HAVELLS.IN>
5. <https://billiondollarvaluation.com/havells-valuation-excel-model-and-intrinsic-value-of-shares/?amp>
6. <https://simplywall.st/stocks/in/capital-goods/nse-havells/havells-india-shares>
7. https://www.gurufocus.com/term/iv_dcf_share/NSE:HAVELLS/Intrinsic-Value-Projected-FCF/Havells-India-Ltd
8. <https://www.tickertape.in/stocks/havells-india-HVEL>