

JANUARY 29, 2015
RESULT

Coverage view:

Price (₹): **263**

Target price (₹): **300**

BSE-30: **29,682**

Sylvania disappoints. Havells' 3QFY15 results were in line with estimates at the operating level. Large one-offs and yearly charges booked in the quarter led to Sylvania reporting a PAT loss of ₹833 mn. As per the management, demand conditions in India will remain soft in 4QFY15 as well. However, declining inflation and interest rates augur well for demand in the coming year. We have cut our estimates, led by a cut in Sylvania's earnings. Retain ADD with a revised TP of ₹300 (₹310 earlier).

Company data and valuation summary

Havells India

Stock data

52-week range (Rs) (high,low) 347-149

Market Cap. (Rs bn) 164.3

Shareholding pattern (%)

Promoters 61.6

FIs 25.4

MFs 2.7

Price performance (%)

Absolute (2.9) (5.9) 70.9

Rel. to BSE-30 (10.4) (14.1) 18.9

Forecasts/Valuations

2015 2016E 2017E

EPS (Rs) 7.5 10.3 12.2

EPS growth (%) (5.7) 36.9 18.2

P/E (X) 34.9 25.5 21.6

Sales (Rs bn) 89.4 102.1 115.3

Net profits (Rs bn) 4.7 6.4 7.6

EBITDA (Rs bn) 8.8 10.8 12.5

EV/EBITDA (X) 18.7 15.0 12.6

ROE (%) 26.6 31.5 31.6

Div. Yield (%) 1.0 1.5 1.8

Standalone business performs in line

Havells' 3QFY15 consolidated sales were ₹21.2 bn (+1% yoy, -4% qoq) while standalone sales were ₹12.5 bn (+5% yoy, -9% qoq). Sales growth was subdued as: (1) Industrial-cable sales grew only 1% yoy (value) because of subdued demand conditions and price cuts, (2) domestic wire sales grew only 6% yoy as volume growth of 9% was offset by price cuts, and (3) lighting business sales were flat yoy led by weakness in its traditional lighting business (mainly CFLs), which accounted for 63% of 3QFY15 lighting sales. LED (incl. fixtures) sales grew 64% yoy from a small base and constituted 27% of lighting sales. SA EBITDA was ₹1.8 bn (+9% yoy) as margins expanded to 14.3% from 13.8% in 3QFY14, led by better gross margins (39.7% from 37.8%). SA PAT, at ₹1.16 bn, fell 4.3% yoy because of higher tax rate (27% versus 22%).

Sylvania disappoints because of one-offs and booking of yearly expenses in the quarter

Sylvania's 3QFY15 sales were €111 mn (-1% yoy), EBITDA was €5.6 mn (-36% yoy) and PAT (loss) was €10.7 mn. Earnings were impacted due to: (1) €6.1 mn expenditure because of an increase in pension liability, as bond yields in Germany declined, (2) a €2.9 mn charge for returns/rebates in Thailand, (3) €1.3 mn impairment expense booked under depreciation, and (4) €2 mn payment pertaining to tax assessment in Italy for CY2005-12.

Demand environment should get better, given a trend of declining inflation and interest rates

The management indicated that there is no change in the demand situation on the ground in 4QFY15 versus 3QFY15. However, declining inflation and interest rates bode well for the economy and hence for demand in the coming year. We have reduced our earnings estimates (led by Sylvania's) based on: (1) higher exceptional costs, (2) higher taxes, and (3) lower margins. We maintain ADD with a revised target price of ₹300 (₹310 earlier). We value the domestic business at 27X December 2016 EPS and Sylvania at ₹14 per share (FY2014 BV).

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Exhibit 1: Below estimates led by Sylvania

Interim results of Havells, consolidated, March fiscal year-ends (₹ mn)

	3QFY15	3QFY15E	3QFY14	2QFY15	(% change)			9 months months		
					KIE est.	yoy	qoq	FY2015	FY2014	Chng. (%)
Net revenues	21,151	21,874	21,037	22,066	(3)	1	(4)	64,510	59,567	8.3
Total expenditure	(18,932)	(19,713)	(18,756)	(19,797)	(4)	1	(4)	(57,978)	(53,471)	8.4
EBITDA	2,219	2,161	2,281	2,269	3	(3)	(2)	6,532	6,097	7.1
Margins (%)	10.5	9.9	10.8	10.3				10.1	10.2	
Other income	85	130	126	116				314	259	21.2
Depreciation	(362)	(365)	(286)	(363)				(1,063)	(871)	22.0
EBIT	1,942	1,926	2,121	2,022	1	(8)	(4)	5,783	5,485	5.4
Margins (%)	9.2	8.8	10.1	9.2				9.0	9.2	
Net Interest	(205)	(165)	(208)	(171)				(517)	(558)	(7.3)
PBT	1,737	1,761	1,913	1,851	(1)	(9)	(6)	5,266	4,927	6.9
Extraordinaries	(723)	(400)	(162)	(150)				(921)	(571)	
Reported PBT	1,014	1361	1751	1,701	(25)	(42)	(40)	4,345	4,356	(0)
Tax	(666)	(504)	(383)	(570)				(1,748)	(1,001)	74.6
Reported PAT	348	857	1,368	1,131	(59)	(75)	(69)	2,597	3,355	(23)

Notes:

(a) We have included expenses on account of pension liabilities as part of one-off costs.

Source: Company, Kotak Institutional Equities

Exhibit 2: Sylvania disappoints led by one-off costs and booking of yearly expenses in the quarter

Interim results of Sylvania, March fiscal year-ends (Euro mn)

	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15	Change (%)		9 months	
										yoy	qoq	FY2015	FY2014
Net sales	109	113	107	107	112	115	107	113	111	(1)	(2)	331	325
Total expenditure	(102)	(106)	(103)	(104)	(103)	(109)	(103)	(107)	(105)			(314)	(309)
EBITDA	7	6.9	4.2	3.1	8.7	6.1	5.5	5.5	5.6	(36)	2	16.5	16.5
OPM (%)	6.4	6.1	3.9	2.9	7.8	5.3	5.1	4.9	5.1			5.0	5.1
Pension liability expense	(2)	1	—	—	(1)	(4)	(1)	(1)	(6)			(7.9)	(1.8)
Other income	1	(0)	(0)	0	(2)	(0)	—	(0)	0			0.2	0.5
Interest	(2.0)	(0.6)	(1.4)	(1.3)	(1.3)	(1.3)	(1.2)	(1.3)	(1.7)			(4.2)	(3.9)
Depreciation	(1.5)	(2.2)	(1.7)	(1.7)	(1.5)	(1.5)	(1.6)	(1.7)	(3.0)			(6.2)	(4.9)
Pretax profits	4.0	4.9	0.9	0.2	2.2	(1.4)	1.8	1.5	(4.9)			(1.6)	6.4
Extraordinaries	(1.5)	(0.1)	(1.5)	(1.0)	—	—	(0.4)	(1.3)	(2.8)			(4.5)	(5)
Tax	0.5	1.3	0.6	(0.8)	(0.5)	(1.9)	(1.1)	(1.3)	(3.0)			(5)	(1.9)
Net income	3.0	6.1	—	(1.6)	1.7	(3.3)	0.3	(1.1)	(10.7)			(11.5)	(0.7)

Notes:

(a) Pension liability expense of Euro 2mn in 3QFY13 and Euro 3.3 mn in 3QFY12 has been apportioned over four quarters. One quarter's expense is considered as operational and accounted above EBITDA.

Source: Company, Kotak Institutional Equities

Exhibit 3: Sales in Americas grew 12% in constant-currency terms; however, in Euro terms, numbers are lower because of currency fluctuations

Trend in sales for Sylvania, March fiscal year-ends (Euro mn)

	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15	(% change)	
										yoy	qoq
Europe	66	70	61	60	66	71	64	65	68	3	4
Americas	36.1	36.4	39.3	40.2	37.6	37.7	35.8	41.0	40.2	7	(2)
Others	5.4	1.8	6.9	7.0	8.0	6.6	7.1	6.4	2.9	(64)	(55)
Total	110	113	107	107	112	115	107	113	111	(1)	(2)

Source: Company, Kotak Institutional Equities

Exhibit 4: Standalone business performed in line

Interim results of Havells, standalone, March fiscal year-ends (₹ mn)

	3QFY15	3QFY15E	3QFY14	2QFY15	Change (%)			9 months		
					KIE est	yoy	qoq	FY2015	FY2014	(% chg)
Net revenues	12,474	12,555	11,844	13,651	(0.6)	5.3	(8.6)	38,894	34,097	14.1
Total expenditure	(10,693)	(10,860)	(10,212)	(11,847)	—	—	—	(33,699)	(29,364)	
EBITDA	1,781	1,695	1,633	1,804	5.1	9.1	(1.3)	5,195	4,733	9.8
Margins (%)	14.3	13.5	13.8	13.2	—	—	—	13.4	13.9	
Other income	89	110	107	115	—	—	—	318	217	
Depreciation	(230)	(230)	(161)	(225)	—	—	—	(662)	(476)	
EBIT	1,640	1,575	1,578	1,693	4.1	3.9	(3.1)	4,851	4,474	8.4
Margins (%)	13.1	12.5	13.3	12.4	—	—	—	12.5	13.1	
Net Interest	(72)	(60)	(85)	(59)	—	—	—	(164)	(202)	
PBT	1,569	1,515	1,493	1,634	3.5	5.0	(4.0)	4,687	4,272	
Extraordinaries	22	—	66	30	—	—	—	63	(5)	
Reported PBT	1,591	1,515	1,560	1,664	5.0	2.0	(4.4)	4,750	4,267	11.3
Tax	(428)	(424)	(345)	(468)	—	—	—	(1,319)	(848)	
Reported PAT	1,162	1,091	1,215	1,196	6.5	(4.3)	(2.8)	3,431	3,419	0.4
As % of revenue										
Raw material costs	60.3		62.2	60.3				60.5	61.4	
Employee costs	6.5		5.2	5.7				6.0	5.1	
Other costs	18.9		18.9	20.7				20.2	19.6	
Segmental										
Revenues										
Switchgear	3,275	—	3,093	3,387		5.9	(3.3)	9,735	8,988	8
Cable and Wires	4,951	—	4,751	5,914		4.2	(16.3)	16,214	13,674	19
Lighting and fixtures - India	1,940	—	1,935	1,936		0.3	0.2	5,530	5,214	6
Electrical consumer durables	2,308	—	2,066	2,414		11.7	(4.4)	7,416	6,221	19
Others	—	—	—	—		—	—	—	—	
Total	12,474	—	11,844	13,651		5	(9)	38,894	34,097	
Contribution										
Switchgear	1,125		1,096	1,239		2.6	(9.3)	3,484	3,238	8
Cable and Wires	585		486	709		20.4	(17.6)	1,881	1,390	35
Lighting and fixtures - India	535		450	521		18.7	2.6	1,485	1,228	21
Electrical consumer durables	564		541	600		4.3	(6.0)	1,848	1,667	11
Others	—		—	—		—	—	—	—	
Unallocable	(1,146)		(928)	(1,347)		23.4	(14.9)	(3,785)	(3,053)	
Total	1,662		1,644	1,723		1	(4)	4,914	4,469	
Contribution margin (%)										
Switchgear	34.3		35.4	36.6				35.8	36.0	
Cable and Wires	11.8		10.2	12.0				11.6	10.2	
Lighting and fixtures - India	27.6		23.3	26.9				26.9	23.5	
Electrical consumer durables	24.4		26.2	24.9				24.9	26.8	
Others	—		—	—				—	—	
Total	13.3		13.9	12.6				12.6	13.1	

Source: Company, Kotak Institutional Equities

Exhibit 5: Havells' interim balance, standalone, March fiscal year-ends (₹ mn)

	Mar'14	Jun'14	Sept'14	Dec't'14
Shareholders fund	624	624	624	624
Reserves and surpluses	20,675	21,726	23,008	24,170
Total equity capital	21,299	22,350	23,632	24,794
Loan funds	1,955	1,731	1,259	1,066
Term loans	1,325	1,102	1,259	1,066
Dealer deposits	630	629	—	—
Deferred income tax	517	499	457	511
Total sources of funds	23,771	24,580	25,348	26,371
Fixed assets	9,341	9,420	9,650	9,882
Investments	8,825	9,009	9,186	9,359
Inventories	6,827	7,869	8,916	8,032
Debtors	1,365	1,606	1,695	1,478
Others	1,362	1,295	1,408	1,121
Cash and cash balances	6,261	6,446	4,383	5,458
Less:				
Sundry creditors	10,210	11,065	9,890	8,959
Provisions				
Total uses of funds	23,771	24,580	25,348	26,371

Source: Company, Kotak Institutional Equities

Exhibit 6: Generated ₹1.5 bn of FCF in 9MFY15 after capex and investment into subsidiary
Cash flows for Havells, standalone, March fiscal year-ends (₹ mn)

	YTD Dec 13	YTD Dec 14
PBT	4,267	4,750
Unrealised forex (gain)/loss	118	29
Other adjustments	499	507
Operating cash before working capital changes	4,884	5,286
Change in working capital	1,072	(992)
Trade receivables	302	(103)
Inventories	(617)	(1,205)
Trade payables	515	(760)
Others	872	1,076
Cash from operations	5,956	4,294
Direct taxes	(770)	(1,107)
Net cash from operations	5,186	3,187
Cash flow from investing activities		
Capital expenditure	(669)	(1,220)
Investment in subsidiary	(574)	(534)
Others	180	188
Net cash from investing activities	(1,063)	(1,566)
Movement in debt	753	(938)
Dividend	(936)	(1,248)
Interest	(100)	(135)
Others	(104)	(113)
Net cash from financing activities	(387)	(2,434)
Net increase/decrease in cash	3,736	(813)
Opening cash	2,465	6,261
Others	6	1
Closing cash	6,207	5,449

Source: Company, Kotak Institutional Equities

Exhibit 7: Sylvania's interim balance sheet, March fiscal year-ends (Euro mn)

	Mar'14	Jun'14	Sept'14	Dec'14
Shareholder funds	63	62	65	54
Share capital	141	141	141	141
Reserves and surplus	(78)	(79)	(77)	(87)
Non current liabilities	106	100	102	99
Long term borrowings	60	52	53	46
Others (pension)	47	48	49	53
Current liabilities	171	174	177	169
Short term borrowings	13	15	15	11
Trade payables	95	94	92	87
Others	63	65	71	71
Total sources of funds	340	336	343	322
Fixed assets	32	31	32	30
Other non current assets	1	1	1	1
Goodwill	53	53	53	53
Current assets	253	251	257	238
Inventories	99	103	101	92
Trade receivables	106	107	108	103
Cash and cash balances	29	20	25	28
Others	20	20	23	15
Total uses of funds	340	336	343	322

Source: Company, Kotak Institutional Equities

Other highlights

- ▶ The company has incurred a capex (SA) of ₹1.2 bn in 9MFY15 and will close the year with an aggregate capex of ₹1.4 bn. In FY2016, it expects to spend a lower amount (₹1 bn) on capex as most of it would be maintenance related.
- ▶ To drive growth, it is trying to increase its distribution footprint in terms of retail points of sale. The management communicated that it is spending significant amounts on IT systems, which would allow Havells to track sales at the retail level (like the FMCG industry does). Currently, its systems can track sales only up to the distributor level; hence, it has almost no data to determine the effectiveness of its retail footprint. Once it has mapped sales data at the retail level, it will be able to identify distribution-gaps fulfillment, which should drive growth.
- ▶ In 3QFY15, Havells has invested ₹173 mn into Sylvania's holding company to repay the installment of recourse debt (€26 mn), which reduces Havells' guarantee by a similar amount. In 9MFY15, it has invested ₹534 mn into Sylvania's holding company.
- ▶ Its water-heater plant at Neemrana (Rajasthan), constructed at a capex of ₹430 mn with a capacity of 0.3 mn units, has started commercial operations.
- ▶ In 3QFY15, 27% of its overall lighting revenues are from LEDs.
- ▶ In 3QFY15, it has taken a price cut of 3% in its cables/wires business. Given the sharp correction in commodity prices in 4QFY15, more price cuts should happen in the market.
- ▶ Havells has a long-term plan of creating a fund in Germany to take care of its pension liabilities in that country. Since these liabilities are currently under-funded, it booked a one-off expense of €6.1 mn during 3QFY15, because of a decline in bond yields in Germany. Its FY2014 annual report says that its total under-funded pension liabilities were ₹3.7 bn.
- ▶ The company said it has sustained its market share in various product segments in 9MFY15.

- It is evaluating the opportunity in the LED space vis-à-vis government orders. It is trying to analyze if the price points in these government tenders are attractive enough to warrant exposure to this business. As per the management, the government has mandated that only domestic players can participate in these orders.

Exhibit 8: Our assumptions for Havells, consolidated, March fiscal year-ends (₹ mn)

	New estimates			Old estimates			Change (%)		
	2015E	2016E	2017E	2015E	2016E	2017E	2015E	2016E	2017E
Revenues	89,423	102,143	115,306	89,423	102,143	115,306	—	—	—
India	54,058	65,363	77,055	54,058	65,363	77,055	—	—	—
Sylvania	35,365	36,780	38,251	35,365	36,780	38,251	—	—	—
EBITDA	8,812	10,831	12,513	9,165	11,198	12,895	(4)	(3)	(3)
India	7,220	8,992	10,600	7,220	8,992	10,600	—	—	—
Sylvania	1,591	1,839	1,913	1,945	2,207	2,295	(18.2)	(16.7)	(16.7)
EBITDA (%)	9.9	10.6	10.9	10.5	11.0	11.2			
India	13.4	13.8	13.8	13.4	13.8	13.8			
Sylvania	4.5	5.0	5.0	5.5	6.0	6.0			
PAT	3,974	6,231	7,480	5,117	6,794	8,104	(22)	(8)	(8)
India	5,036	5,830	6,886	5,072	6,147	7,254	(1)	(5)	(5)
Sylvania	(1,062)	401	594	44	647	850	(2,496)	(38)	(30)
EPS (Rs)	6.4	10.0	12.0	8.2	10.9	13.0	(22)	(8)	(8)

Source: Kotak Institutional Equities estimates

Exhibit 9: Summary financials: Havells

Profit and loss account, cash flow statement and balance sheet for Havells, consolidated, March fiscal year-ends (₹ mn)

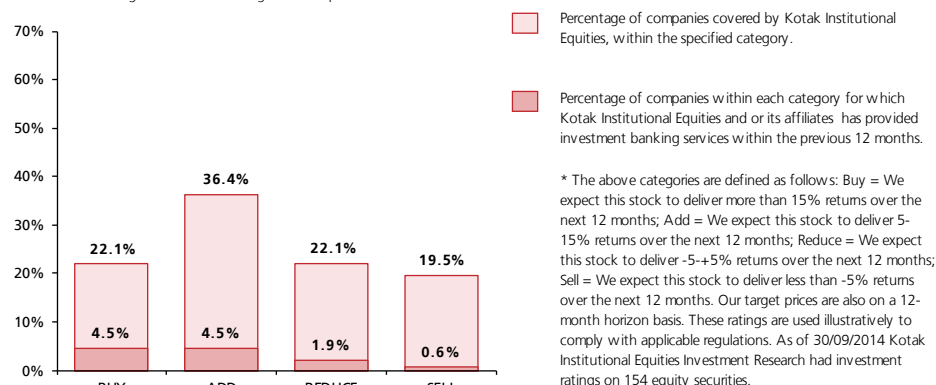
	2010	2011	2012	2013	2014	2015E	2016E	2017E
Profit model								
Total income	54,256	56,126	65,182	72,479	81,858	89,423	102,143	115,306
EBITDA	3,206	5,570	6,864	6,747	8,126	8,812	10,831	12,513
Interest (expense)/income	(979)	(902)	(1,281)	(1,232)	(741)	(736)	(653)	(599)
Depreciation	(837)	(804)	(949)	(1,097)	(1,155)	(1,410)	(1,537)	(1,576)
Other income	222	237	414	334	413	466	458	639
Pretax profits	1,611	4,101	5,048	4,751	6,642	7,131	9,098	10,976
Extraordinary items	—	(31)	(291)	1,887	(701)	(1,110)	(300)	(200)
Reported PBT	1,611	4,070	4,757	6,638	5,941	6,021	8,798	10,776
Tax	(931)	(1,031)	(1,058)	(824)	(1,478)	(2,047)	(2,567)	(3,296)
Profit after tax	680	3,039	3,699	5,814	4,463	3,974	6,231	7,480
Adjusted PAT	680	3,063	3,925	4,162	4,990	4,707	6,443	7,619
Diluted earnings per share (Rs)	1.1	4.9	6.3	6.7	8.0	7.5	10.3	12.2
Balance sheet								
Total equity	4,004	6,543	9,557	14,421	16,661	18,776	22,091	26,070
Deferred taxation liability	266	559	556	480	466	466	466	466
Total borrowings	10,666	11,173	10,271	9,785	10,506	6,512	5,732	4,952
Current liabilities	15,876	17,361	21,370	19,893	25,690	26,476	29,383	32,514
Total liabilities and equity	30,813	35,635	41,754	44,579	53,324	52,230	57,672	64,002
Cash	1,484	1,779	2,336	4,736	8,820	5,603	8,111	11,642
Other current assets	16,907	20,299	24,847	24,594	28,057	30,120	33,254	36,467
Goodwill	3,212	3,354	3,625	3,694	4,380	4,380	4,380	4,380
Tangible fixed assets	9,210	10,204	10,946	11,555	12,067	12,127	11,928	11,514
Total assets	30,813	35,635	41,754	44,579	53,324	52,230	57,672	64,002
Free cash flow								
Operating cash flow, excl. working capital	(518)	3,769	4,539	4,671	6,440	3,809	7,010	8,217
Working capital changes	2,543	(2,013)	(1,204)	(1,419)	1,719	(1,278)	(226)	(83)
Capital expenditure	(1,444)	(1,887)	(1,716)	(1,750)	(1,764)	(1,470)	(1,338)	(1,162)
Free cash flow	582	(131)	1,619	1,502	6,395	1,061	5,446	6,972
Ratios (%)								
EBITDA margin	5.9	9.9	10.5	9.3	9.9	9.9	10.6	10.9
Debt/equity	249.9	157.5	101.6	65.7	61.4	33.8	25.4	18.7
Net debt/equity	215.2	132.5	78.5	33.9	9.9	4.7	(10.5)	(25.2)
RoAE	13.2	53.9	45.6	33.3	31.2	25.9	30.8	31.0
RoACE	6.6	22.5	25.5	23.3	21.2	19.5	25.6	26.9

Source: Company, Kotak Institutional Equities estimates

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Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of September 30, 2014

Ratings and other definitions/identifiers

Definitions of rating

BUY. We expect this stock to deliver more than 15% returns over the next 12 months.

ADD. We expect this stock to deliver 5-15% returns over the next 12 months.

REDUCE. We expect this stock to deliver -5 to +5% returns over the next 12 months.

SELL. We expect this stock to deliver <-5% returns over the next 12 months.

Our target prices are also on a 12-month horizon basis.

Other definitions

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