Havells India

Lit up by Sylvania

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BUY

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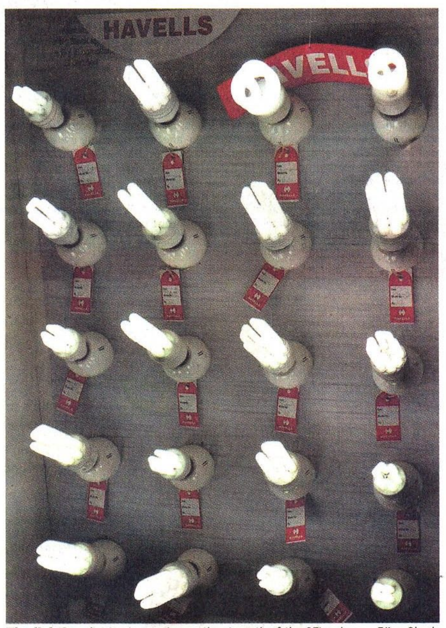
Havells India, in 2007, acquired Sylvania, a company that had a significant share of the lighting and fixtures market of Europe and Latin America. But soon after the acquisition, as Europe slipped into recession, Sylvania's sales dropped dramatically, and the company turned negative at the PAT level. With doubts over Havells' ability to turn around the much larger Sylvania, almost two-thirds was shaved off the former's stock price.

But, now, with the successful resurrection of Sylvania, the parent company seems to be in a good position to derive value from the restructured business. Investors willing to stay put for at least one year can look at buying the stock of Havells India. At the current price of Rs 396, the stock trades at 20 times its estimated FY-11 earnings.

In the recent September quarter, Sylvania reported a net profit of Rs 8.1 crore (compared to loss of Rs 71 crore in the same quarter last year). In FY-12, Sylvania is expected to contribute around half the sales and a quarter of the profits of the consolidated business. With the focus back on the top-line at Sylvania, Havells is looking to reduce its debt burden in the coming year (consolidated debt at Rs 1100 crore and debt-to-equity at 2:1 currently).

Closer home, in the domestic market, Havells is exploring additional opportunities with product launches (water heaters) and test launching Sylvania (high-end lighting products). In the first half of FY-11, Havells (standalone) reported a 19 per cent growth in sales and an eight per cent growth in net profits.



The lighting division is growing on the strength of the CFL sales. — Bijoy Ghosh

Growing market presence, an expanding dealer network and the power to pass on input price increases , all augur well for Havells. Rising copper prices (a crucial input) do not impact the company much as they get passed on to the market, though with a time lag.

This delay in passing on cost at times presses margins. Havells (standalone) makes an average margin of 11-11.5 per cent at the operating level.

DOMESTIC BUSINESS STRENGTH

Havells India makes electrical consumer products that include cables and wires, switch gears, modular switches, motors, CFLs, fans and luminaries. Over the last three years, the company's revenue has grown at a compounded rate of 17 per cent annually. A part of this is thanks to the company's aggressive brand-building initiatives. It has a network of 4000 dealers across the country. Havells plans to penetrate the smaller towns in the coming year by building on its dealer network. It has also recently doubled the capacity of its cable and wires plant and is in the process of enhancing capacity at its CFL plant. With a business that is driven by consumer demand, the company is likely to have a good year ahead, given the healthy projections on housing demand in 2011 (reports of Cushman & Wakefield).

Havells derives around 40 per cent of its domestic revenues from the cable and wires segment. The segment, however contributes only 17 per cent to profits, with a thin 8-10 per cent margin. On the other hand, switchgears contribute almost half of Havells' EBIT, though accounting for only a third of revenues.With consumers in this segment being highly quality conscious and buying decisions not being influenced only by price points, Havells has increased margins on its switchgears from an already healthy 33 per cent in 2008-09 to 37 per cent currently. The two fast growing products segments in Havells' portfolio however are lighting products and electrical consumer durables.

The lighting division is growing on the strength of the CFL sales (growing demand for energy efficient bulbs) while the consumer durable division thrives on the increasing demand for electric fans. Havells had recently introduced energy-efficient electric water heaters, which have found good response in the market.

SYLVANIA TO BREAKEVEN

Sylvania is expected to breakeven in 2010 in the December quarter (turned positive at the net level in the September quarter). Havells intends to change the focus of business at Sylvania from the European markets to the Latin American and Asian countries – a shift that will strengthen growth at the top-line. The restructuring plans are estimated to bring in an annual saving of 33.5 million euro from the coming year. Higher sales, combined with lower overheads and fixed costs should bode well for Sylvania's prospects.

Interest cost which now gobbles a significant amount of pre-tax profits will reduce from next year as the company repays portions of debt – 19 million euro (around Rs 110 crore). Consequently, Havells' interest cover and debt-equity will also improve as cash flows strengthen and profits rise.