Havells: On track for brighter days

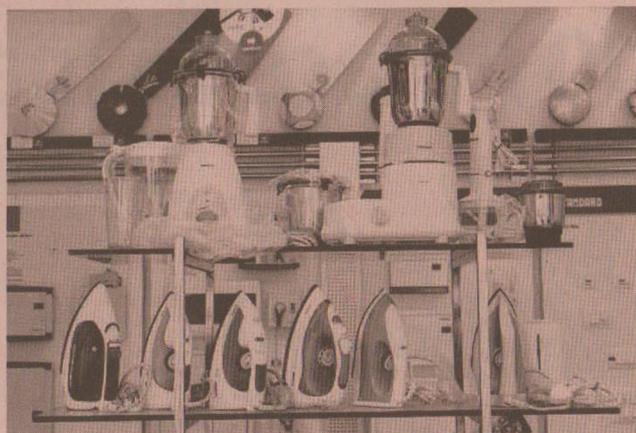
Strong revenue growth across all segments and improving prospects of its Sylvania subsidiary are key drivers going ahead

SHEETAL AGARWAL

Havells India (Havells) posted in-line consolidated results for the September 2014 quarter at the operational level. But, higher tax outgo and pension liabilities led to lower than expected net profit and eclipsed strong revenue growth in the quarter. Consequently, Havells' stock has fallen about 3.6 per cent post results announcement last Thursday. While the net profit miss has driven some earnings cuts by analysts, most of them remain bullish on the stock despite Havells trading at a PE of 24.5 times based on FY16 estimated consolidated earnings. And there are many reasons besides the company's strong growth prospects.

"We think Havells' valuation premium to its historical average is justified, as gearing has moderated at Sylvania; governance concerns have receded; earnings quality is improving (lower reliance on tax benefits); and it has a demonstrated ability to penetrate new product categories", says Aditya Bhartia of Espirito Santo Securities. He has a target price of ₹308 on the scrip.

Of the 23 analysts polled by Bloomberg post results, 11 have a Buy, nine have a Hold and two have Sell rating on the stock. Their average target price of ₹291 indicates upside potential of about eight per cent from current levels. Investors with a long-term perspective can accumulate the stock on declines.



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Havells, which figures among top consumer brands in India's electrical goods industry, also has a strong global footprint across 50 countries. Over the last few years, the company has proved its ability to gain ranks in the domestic business as well as through the acquisition of the lighting business of Frankfurt-based Sylvania in 2007. And, with India's economic growth expected to look up, the domestic consumer (fans, lighting, heater, switches, domestic appliances, etc) and industrial (switchgear, capacitors, etc) businesses should do even better.

"Havells' persistent focus on key strengths – introduction of new products, strengthening dealer network and improving consumer connect (brand) – has driven revenues and boosted margins. We expect strong 23 per cent consolidated earnings CAGR over FY14-16. We believe Havells will continue to trade at rich multiples given strong free cash flows and superior return ratios", says Bhoomika Nair of IDFC securities in a post results note on the company.

Improving cash flows and declining net debt levels will further improve its balance-sheet, which a few years back was highly leveraged post the acquisition of Sylvania.

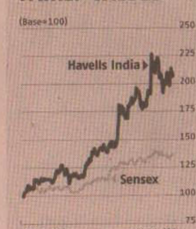
Meanwhile, for the September 2014 quarter, Havells' consolidated sales grew 8.7 per cent year-on-year to ₹2,207 crore and was led by healthy growth across all business segments including switchgears, cable, lighting & fixtures and electrical consumer durables as well as for Sylvania (revenues up five per cent year-on-year). Higher ad spends (up 220 basis points year-on-year to 3.5 per cent of sales) impacted Ebitda margin in standalone (domestic) business which fell 100 basis points to 13.4 per cent. Sylvania's Ebitda margin, however, expanded 116 basis points to 4.1 per cent on account of strong top-line growth.

IMPROVING PROFITABILITY

In ₹ crore	Q2'FY15	FY15E	FY16E
Revenues	2,207	9,085	10,249
% change y-o-y	8.7	11.0	12.8
Ebitda (%)	10.0	10.1	10.8
Bps change y-o-y	40	101	70
Adjusted Net profit	113	536	674
% change y-o-y	1.3	20.1	25.7

E:Estimates All figures are on a consolidated basis Source: Company, brokerage reports

FAIRLY VALUED



Data compiled by BS Research Bureau

While the operational performance was along expectations, higher tax outgo (up 910 basis points to 33.5 per cent), pension liability for Sylvania and Sylvania's higher forex expenses resulted in a muted growth of 1.3 per cent in consolidated net profit to ₹113 crore. Sylvania posted net loss of 1.1 Euro million, as against analysts' expectations of around Euro two million net profit.

Notably, Havells' management has maintained its guidance of full year standalone revenue growth of 17-20 per cent for FY15. For Sylvania, the management maintained FY15 EBITDA margin guidance of 5-6 per cent and revenue growth guidance of 3-4 per cent. Analysts believe the company is well placed to meet this guidance. While slowdown in consumption demand and/or construction activity in India as well as Europe is a key risk, lower copper prices could positively impact Havells' margins in the cables and wire businesses.