

HPL Electric & Power Limited

IPO Note – Weak on profitability, low on ROE

HPL Electric & Power Private Limited (HPL) is a New Delhi based company engaged in manufacturing of energy meters, switchgears, lighting equipments and wires and cables. Company operates seven manufacturing facilities located in Haryana and Himachal Pradesh. HPL has pan-India presence and its distribution network includes 2,400 authorized dealers/distributors, selling products to 15,000 retailers. As per its FY16 numbers, Metering contributes 47% of the total revenues whereas switchgears (15%), Lighting equipment (24%) and Wires and cables (14%) form the rest of the business mix. B2C sales represent 44% of the total sales and B2B sales represent remaining 56% sales.

Major business has seen slower growth in last three years: HPL's three business segments (Meters, Switchgears and wires and cables) contribute 3/4th of the total revenues. In the last three years revenues from these segments have remained flat. Company holds meaningful market share in Meters and Switchgears, despite which it has not been able to generate higher revenues. Its fourth segment Lighting has been a consistent performer due to its exposure to LED lamps however it has low contribution in revenues.

High working capital requirements: HPL has high working capital requirements than its peers. Company derives bulk of its revenues from the debt ridden power utilities which is the cause of the problem. Over last few years, working capital have deteriorated with working capital cycle stretching from 140 days in FY13 to 160 days in FY16. Company is hopeful of ease in the working capital once Ujwal DISCOM Assurance Yojana (UDAY) is fully implemented. We remain uncertain over the time line of ease in its working capital.

Lower ROE than peers: HPL has been a low ROE business compared to its peers. Higher working capital cycle, increased depreciation due to increased capacity and high debt has impacted its profitability and ROE. Company will have to significantly improve operating performance in near future to maintain current ROE levels. With the further equity dilution, we don't see significant jump in the ROE profile.

Existing litigation against HPL by Havells India: Two of promoter companies of HPL use name Havells in their name. HPL and Havells India Limited have been engaged in the litigation over the use of name 'Havell's' in the corporate name. HPL has clarified that its promoters and promoter group companies are not associated with Havells India limited in any manner.

Outlook & Valuation: On the valuation front, at the upper end of the price band, the pre-issue P/E works out to 25.6x of its FY2016 earnings which is lower compared to its peers. However this discount is justified considering its significantly low ROE, stretched working capital and low profitability compared to its peers. **Considering past financial performance and poor visibility on future growth, we rate this issue as NEUTRAL.**

NEUTRAL

Issue Open: September 22, 2016
 Issue Close: September 26, 2016

Issue Details

Face Value: ₹10

Present Eq. Paid up Capital: ₹46.4cr

Fresh Issue: ₹2.06*- 1.78cr**

Offer for sale:-NA

Post Eq. Paid up Capital: ₹64.3cr

Market Lot: 70 Shares

Issue (amount): ₹361cr

Price Band: ₹175-202

Post-issue implied mkt. cap ₹1,174cr*-
 1,299cr**

Note: *at Lower price band and **Upper price band

Book Building

QIBs	50%
Non-Institutional	15%
Retail	35%

Post Issue Shareholding Pattern(%)

Promoters Group	72.1
Public	27.9

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Key Financial

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales	724	916	1,016	1,052	1,121
% chg	-	26.4	11.0	3.5	6.6
Net Profit	28	31	28	35	37
% chg	-	10.7	(9.7)	22.0	5.8
OPM (%)	10.9	11.3	9.5	10.8	11.3
EPS (₹)	6.3	6.8	6.1	7.5	7.9
P/E (x)	32.0	29.7	33.1	27.1	25.6
P/BV (x)	3.8	3.3	3.0	2.9	2.6
RoE (%)	11.8	11.1	9.2	10.9	10.3
RoCE (%)	13.5	15.8	13.0	13.5	13.3
EV/Sales (x)	1.7	1.4	1.3	1.4	1.4
EV/EBITDA (x)	14.6	11.1	12.2	10.9	10.6

Source: Company, Angel Research; Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

Company background

HPL Electric & Power Private Limited (HPL) is a New Delhi based company engaged in manufacturing of energy meters, switchgears, lighting equipments and wires and cables. It was founded as HPL-Socomec Private Limited in 1991 as a joint venture between Socomec and Havells Electronics Private Limited (now Havells India limited). The current promoter and promoter group holds 99.92% shares of the company. In 2010, its name was changed to HPL Electric & Power Private Limited.

Company operates seven manufacturing facilities located in Haryana and Himachal. HPL has pan-India presence and its distribution network includes 2,400 authorized dealers or distributors selling products to 15,000 retailers. In addition, company supplies products to Power Utilities, which primarily includes supply of meters to electricity boards and power distribution companies. HPL also sells its products to developers of residential and commercial building projects, original equipment manufacturers and to industrial customers through a mix of direct sales and through authorized dealer network. It also has two in-house research and development centers in Haryana.

As per its FY16 numbers, meters contribute 47% of the total revenues whereas switchgears (15%), Lighting equipment (24%) and Wires and cables (14%) form the rest of the business mix. B2C sales represent 44% of the total sales and B2B sales represent remaining 56% sales.

Issue details

The company is raising ₹361cr through fresh issue (1.78cr share) of equity shares in the price band of ₹175-202. The fresh issue will constitute ~28% of the post-issue paid-up equity share capital of the company assuming the issue is subscribed at the upper end of the price band.

Exhibit 1: Shareholding pattern

Particulars	Pre-Issue		Post-Issue	
	No. of shares	(%)	No. of shares	(%)
Promoter group	46,391,699	99.9%	46,391,699	72.1%
Others	37,500	0.1%	17,908,787	27.9%
Total	46,429,199	100.0%	64,300,486	100.0%

Source: Company, Angel Research

Objects of the offer

- ~₹130cr will be used for repayment/prepayment of certain indebtedness
- ~₹180cr will be used for funding working capital requirements
- The balance will be used for general corporate purposes.

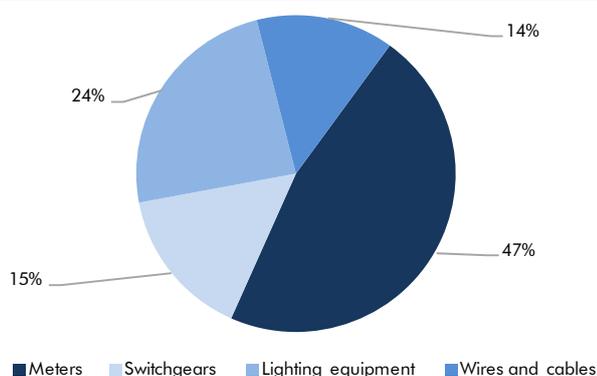
Investment rationale

Major business has seen slower growth in last three years

Majority of HPL's business has grown at slower rate in last three years. More than half of its business comes from Meters and Switchgears segment (62% of gross sales in FY16). Both the segments have witnessed weak revenue growth in the last three years. Despite the company having ~20% market share in Electricity Energy Meters, it has witnessed low CAGR of 5% in Meters revenue between FY14-FY16. The Smart Cities Mission project announced by the central government is expected to be the fortune changer for Meters market; however that is only expected after 2022 when the civil work for the smart cities will be near the completion and hence we do not expect any immediate impact on this industry.

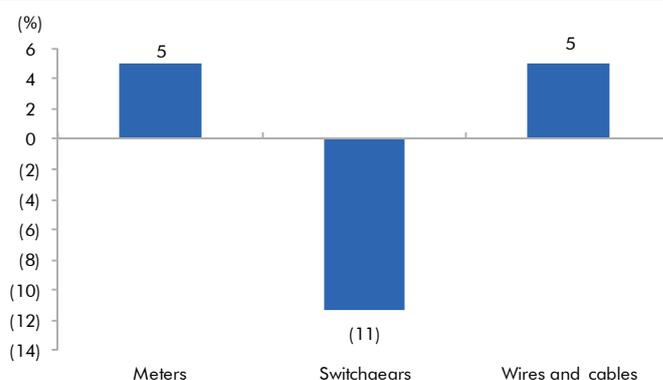
The switchgears segment, has witnessed CAGR of -11.3% in the gross revenues between FY14-FY16. In the switchgears segment, company competes with the bigger companies such as L&T, Schneider Electric ABB Limited, Havells Industries Limited, etc. While company claims to have 5% market share in this segment, strong decline in revenues from switchgears suggest that company is facing huge competition or the market is not growing fast enough to accommodate all players. Company claims that it's Wires and cables business segment is a 100% B2C business but it has a very low operating margin profile (4.4% EBIT margins in FY16). This business has remained flat in the last three years growing from ₹169.3cr in FY14 to ₹173.5cr in FY16. Overall nearly 3/4th of HPL's business has seen slow growth for last three years affecting its operating performance.

Exhibit 2: HPL's revenue mix



Source: Company, Angel Research

Exhibit 3: Performance of major business FY2014-16



Source: Company, Angel Research

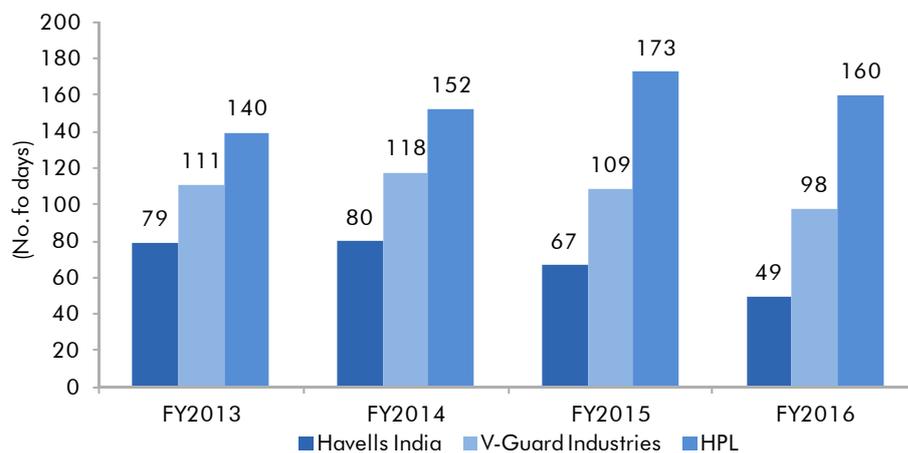
Lighting segment at bright spot

HPL's Lighting segment contributed 24% of its revenues in FY16 and has seen a CAGR of 29.3% between FY14-FY16. This is the only segment of HPL which has been consistent in growth. HPL manufactures wide range of LED lamps (including down-lighters), luminaires and CFLs. Strong growth drivers for LED specially has been main reason that HPL's lighting segment has been witnessing strong growth. Indian LED lighting market is further expected to grow at a CAGR of 62% between 2016 and 2020. HPL holds 5% market share in LED lamps and hence we remain positive over the growth of this segment. This positive impact however would be offset by its lower revenue contribution in overall revenue mix.

High working capital requirements

HPL's working capital cycle is a certainly an issue considering it takes more than 150 days to convert working capital in actual revenues. Working capital turnover which stood at 2.8x in FY11 deteriorated to 2.1x in FY16 indicating high working capital requirement. Receivables have seen a sharp increase as sizable proportion of its revenues (45% in FY16) comes from debt ridden power utilities which have been plagued by poor operating performances for several years. HPL believes that Ujwal DISCOM Assurance Yojana (UDAY), announced by central government in November-2015, is expected to ease it's the working capital conditions. The UDAY scheme is in early stages of implementation and earlier reforms in the power sector have not been highly successful to improve the performance of state electricity boards. Nearly half portion of the IPO proceeds is allocated to fund the working capital so company has understood its pain area however there is no timeline when HPL will see ease in working capital.

Exhibit 4: Higher working capital cycle than peers



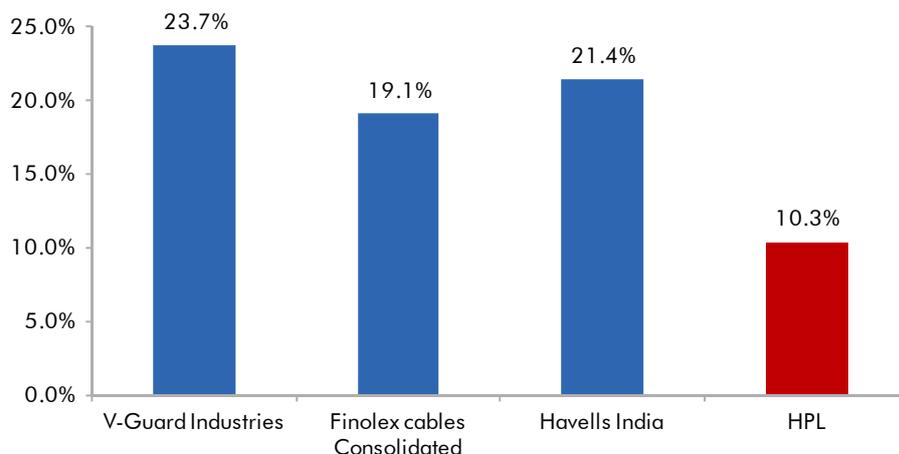
Source: Company, Angel Research

Lower ROE than peers

HPL has been a low ROE business for many years which is due to its weak working capital, high debt and rise in depreciation due to the recent capacity additions. HPL's ROE of 17% in FY11 has been declining and stood 10.3% in FY16. During this period, HPL's debt has increased 2.73x from ₹ 220cr to ₹ 601cr. Its interest cost has also remained at elevated levers which has reduced its net profit margins from 6.6% in FY11 to 3.3% in FY16 despite having EBITDA margins between 12% to 13%.

The company has lower ROE compared to its peers such as Havells India (23%), V-Guard Industries (23%), Finolex Cables (19%), etc. The company is expected to repay ₹130cr of the IPO proceeds which will help it to improve the net margins; however the 28% dilution is also expected to offset this impact and hence leaving the ROE unchanged.

Exhibit 5: HPL has lower ROE compared to peers



Source: Company, Angel Research

Existing litigation against HPL by Havells India

Among the promoters of HPL are two companies named Havell’s Private Limited and Havells Electronics Private Limited. This is highly confusing due the similarity of the name ‘Havells’ with Havells India Limited (HIL), which is a much larger company listed on the bourses and also in the business of electrical consumer durables. Due to this, HIL and Q.R.G. Enterprises have filed a litigation against HPL refraining it from using word ‘Havell’s’ in its corporate name. HPL has disclosed in the RHP that HPL and its promoters are not associated with Havells India limited in any manner and they are two different companies.

Outlook and Valuation

On the valuation front, at the upper end of the price band, the pre-issue P/E works out to 25.6x of its FY2016 earnings which is lower compared to its peers. However this discount is justified considering its low ROE, high working capital conditions and low profitability compared to its peers. **Considering past financial performance and poor visibility on future growth, we rate this issue as NEUTRAL.**

Exhibit 6: Comparative Valuation

FY2016	P/E	P/BV	ROE	EV/Sales	EV/EBITDA
Pre issue valuation ^	(x)	(x)	(%)	(x)	(x)
HPL Electric & Power Ltd.	25.6	2.6	10.3	1.3	9.8
Havells India Ltd.	42.6	9.7	24.4	4.2	21.1
V-Guard Industries	49.2	11.7	23.7	3.0	27.5
Finolex Cables	21.2	4.0	19.1	2.3	12.0
KEC International	16.2	2.0	12.6	0.6	8.1

Source: RHP, Note: ^ based on price at upper band & pre-market cap

Upside risks

Strong traction in Lighting business: Strong growth in lighting business may alter the business mix significantly which could lead to better operating performance.

Decline in working capital: Success UDAY could lead to ease in HPL's working capital which could improve its financial performance.

Profit & Loss Statement

Y/E March (₹ cr)	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Total operating income	568	724	916	1,016	1,052	1,121
% chg		27.6	26.4	11.0	3.5	6.6
Total Expenditure	494	638	801	906	922	975
Raw Material Consumed	387	503	647	720	715	741
Personnel Expenses	34	48	54	58	68	107
Others Expenses	73	88	100	128	139	127
EBITDA	73	86	115	110	130	146
% chg		17.1	33.5	(4.0)	18.0	12.2
(% of Net Sales)	12.9	11.9	12.5	10.8	12.4	13.0
Depreciation & Amortisation	5	7	11	13	16	19
EBIT	68	79	103	97	114	127
% chg		16.0	30.5	(6.3)	17.5	11.2
(% of Net Sales)	12.0	10.9	11.3	9.5	10.8	11.3
Interest & other Charges	21	41	62	59	70	78
Recurring PBT	47	38	42	38	44	48
% chg		(19.7)	9.8	(9.7)	16.7	10.1
Extraordinary Expense/(Inc.)	-	-	-	-	-	-
PBT (reported)	47	38	42	38	44	48
Tax	10	10	10	9	9	12
(% of PBT)	21.3	25.2	24.7	24.7	21.2	24.3
PAT before MI	37	28	31	28	35	37
Minority Interest (after tax)	-	-	-	-	-	-
Profit/Loss of Associate Co.	-	-	-	-	-	-
PAT after MI (reported)	37	28	31	28	35	37
Exceptional Items	-	-	-	-	-	-
Reported PAT	37	28	31	28	35	37
% chg		(23.8)	10.7	(9.7)	22.0	5.8
(% of Net Sales)	6.6	3.9	3.4	2.8	3.3	3.3
Basic EPS (₹)	8.0	6.1	6.8	6.1	7.5	7.9
Fully Diluted EPS (₹)	8.0	6.1	6.8	6.1	7.5	7.9
% chg		(23.8)	10.7	(9.7)	22.0	5.8

Balance Sheet

Y/E March (₹ cr)	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
SOURCES OF FUNDS						
Equity Share Capital	18	18	19	19	19	46
Reserves & Surplus	195	223	263	291	300	308
Shareholders Funds	213	241	282	310	318	354
Minority Interest	-	-	-	-	-	-
Total Loans	220	347	374	433	526	601
Other long term liabilities	6	8	16	17	18	14
Long-term provisions	1	1	1	1	2	3
Deferred Tax Liability	7	11	13	16	19	24
Total Liabilities	447	609	687	778	881	996
APPLICATION OF FUNDS						
Gross Block	145	199	249	326	372	419
Less: Acc. Depreciation	18	25	36	49	65	84
Net Block	127	175	213	277	307	335
Intangible assets	-	-	0	-	-	-
Capital Work in Progress	72	66	53	29	-	3
Investments	15	15	15	15	15	54
Current Assets	351	511	627	663	819	948
Inventories	138	211	264	260	308	317
Sundry Debtors	144	217	269	328	401	512
Cash	30	47	52	46	54	52
Loans & Advances	38	35	41	27	54	65
Other Assets	0	1	1	1	1	2
Current liabilities	119	160	222	208	261	353
Net Current Assets	231	352	405	455	558	595
Long term loans and advances	1	1	1	1	1	9
Total Assets	447	609	687	778	881	996

Cash Flow Statement

Y/E March (₹ cr)	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Profit before tax	47	38	42	38	44	48
Depreciation	5	7	11	13	16	19
Change in Working Capital	23	(91)	(39)	(53)	(89)	(31)
Interest / Dividend (Net)	20	38	58	55	66	74
Direct taxes paid	(10)	(8)	(9)	(7)	(11)	(8)
Cash Flow from Operations	85	(16)	63	46	27	103
(Inc.)/ Dec. in Fixed Assets	(78)	(48)	(37)	(54)	(43)	(50)
(Inc.)/ Dec. in Investments	1	3	4	4	4	(42)
Cash Flow from Investing	(77)	(45)	(33)	(49)	(39)	(92)
Issue of Equity	6.0	-	9.6	-	-	-
Inc./(Dec.) in loans	16.8	123.1	28.1	57.1	90.3	64.6
Dividend Paid (Incl. Tax)	(2.1)	(3.1)	(0.4)	(0.2)	(0.2)	(0.2)
Interest / Dividend (Net)	(21.0)	(41.3)	(61.7)	(59.3)	(69.9)	(78.2)
Cash Flow from Financing	(0)	79	(24)	(2)	20	(14)
Inc./(Dec.) in Cash	8	17	5	(6)	8	(3)
Opening Cash balances	22	30	47	52	46	54
Closing Cash balances	30	47	52	46	54	52

Key Ratio

Y/E March	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Valuation Ratio (x)						
P/E (on FDEPS)	25.2	33.0	29.9	33.1	27.1	25.6
P/CEPS	22.1	26.7	21.9	22.5	18.5	16.8
P/BV	4.4	3.9	3.3	3.0	2.9	2.6
Dividend yield (%)	0.2	0.3	0.0	0.0	0.0	0.0
EV/Sales	2.0	1.7	1.4	1.3	1.3	1.3
EV/EBITDA	15.2	14.2	10.8	11.9	10.7	9.8
EV / Total Assets	2.0	1.6	1.4	1.3	1.2	1.1
Per Share Data (₹)						
EPS (Basic)	8.0	6.1	6.8	6.1	7.5	7.9
EPS (fully diluted)	8.0	6.1	6.8	6.1	7.5	7.9
Cash EPS	9.1	7.6	9.2	9.0	10.9	12.1
DPS	0.4	0.6	0.1	0.0	0.0	0.0
Book Value	45.9	51.9	60.7	66.8	68.5	76.3
Returns (%)						
ROCE	15.8	13.5	15.8	13.0	13.5	13.3
Angel ROIC (Pre-tax)	21.6	17.2	19.3	14.9	14.7	15.0
ROE	17.5	11.8	11.1	9.2	10.9	10.3
Turnover ratios (x)						
Asset Turnover (Gross Block)	3.9	3.6	3.7	3.1	2.8	2.7
Inventory / Sales (days)	130	153	149	132	157	156
Receivables (days)	93	110	108	118	140	168
Payables (days)	97	107	117	98	125	164
WC cycle (ex-cash) (days)	127	156	140	152	173	160
Solvency ratios (x)						
Net debt to equity	0.8	1.2	1.1	1.2	1.4	1.4
Net debt to EBITDA	2.4	3.3	2.7	3.4	3.5	3.4
Int. Coverage (EBIT / Int.)	3.3	1.9	1.7	1.6	1.6	1.6

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