



Issue Details	
Issue Dates	22 nd Sep to 26 th Sep
Issue Type	Primary Issue
Issue Size	1.78 Cr Shares
Price Band	₹175 to ₹202
Market Cap at Upper Band	₹1,297 Cr
EV at Upper Band	₹1,483 Cr
FY16 EBITDA	₹141 Cr
FY16 PAT	₹36.6 Cr
FY16 P/E at Upper Band	35.4x
FY16 EV/EBITDA at Upper Band	13.5x

About the Company: HPL Electric & Power Ltd. is an established multi-product electric equipment company. The company's product range can be primarily divided into four verticals

■ **Metering Solutions:**

- Started in 1998, with a new facility commissioned in 2010, current capacity stands at 9mn Units/annum
- Market Share: 20%
- Revenue Contribution: 46.6%
- EBIT Margins: 17.7%
- Opportunity: Dominant market share, market to grow at a CAGR of 11.5% until 2020*
- Key Risks: B2B supply to utilities results in high payable days, however implementation of Uday scheme might help bring the same down

■ **Switch Gears:**

- Started in 1992, with a new facility commissioned in 2011, current capacity stands at 17mn Units/annum
- Market share of 5% with a ~50% market share for changeover switches
- Revenue Contribution: 15.4%
- EBIT Margins: 19.2%
- Opportunity: Market to grow at a CAGR of 6.1% until 2020*
- Key Risks: Sharp drop of ~22.5% in FY16 revenues, implying a ~1.5% drop in market share, also resulted in an EBIT margin erosion of 390 bps between FY14 & FY16. Further revenue drop/ operating de-leverage would be detrimental to overall financials

■ **Lighting Equipment:**

- Started in 2008, entered the LED segment in 2015, current capacity stands at 26mn LED Units/annum
- Market share of 5% in the LED segment
- Revenue contribution: 24%
- EBIT Margins: 18.2%
- Opportunity: Garnered 5% LED market share in 1 year, Market to grow at a CAGR of 62% until 2020*
- Risks: Prices of LED bulbs have dropped sharply (85%) in the recent past to as low as ₹ 38 in September 2016, from ₹310 in 2014
 - RM & supplier margins account for ~88% of an LED bulbs cost with the companies cost structure accounting for ~12%, thus the ability to bargain with component manufactures along with a strong brand to generate pricing power would be key for profitable growth in the LED segment

■ **Wires & Cables:**

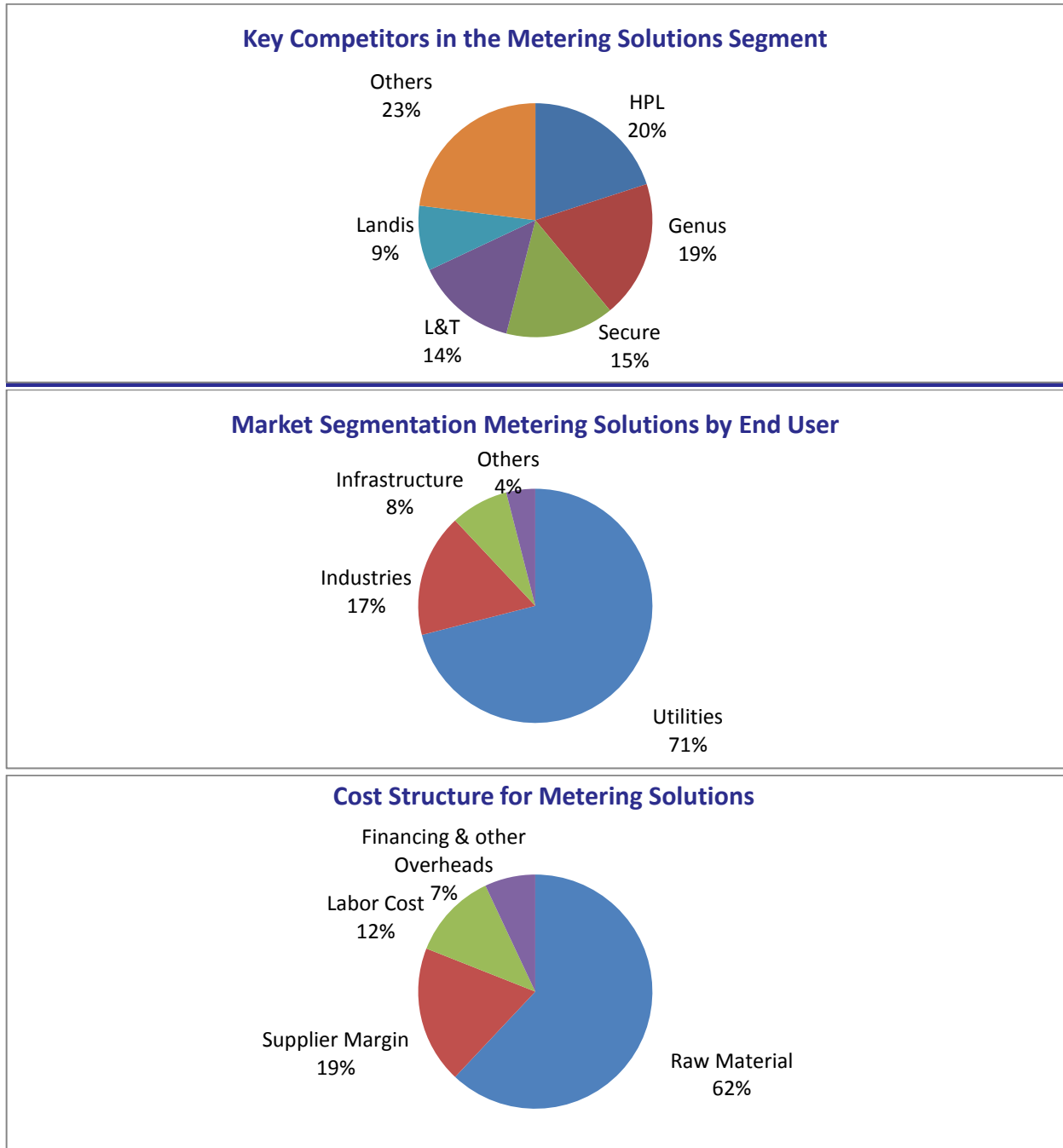
- Started in 2014 with a capacity of 194mn Metres across a wide range of products
- Market share of ~1.4% in FY16
- Revenue contribution: 13.9%
- EBIT Margins: 4.4%
- Opportunity: Market to grow at a CAGR of 4.4% until 2020*
- Risks: Is a low margin business, RM prices & supplier margin accounts for ~83% of manufacturing cost
 - Building a strong brand & generating cross-selling efficiencies would be key for profitable growth

* Source: Frost & Sullivan report, February 2016, RHP



Market Segmentation across Key Verticals:

Metering Solutions:



Source: RHP

■ Industry Characteristics:

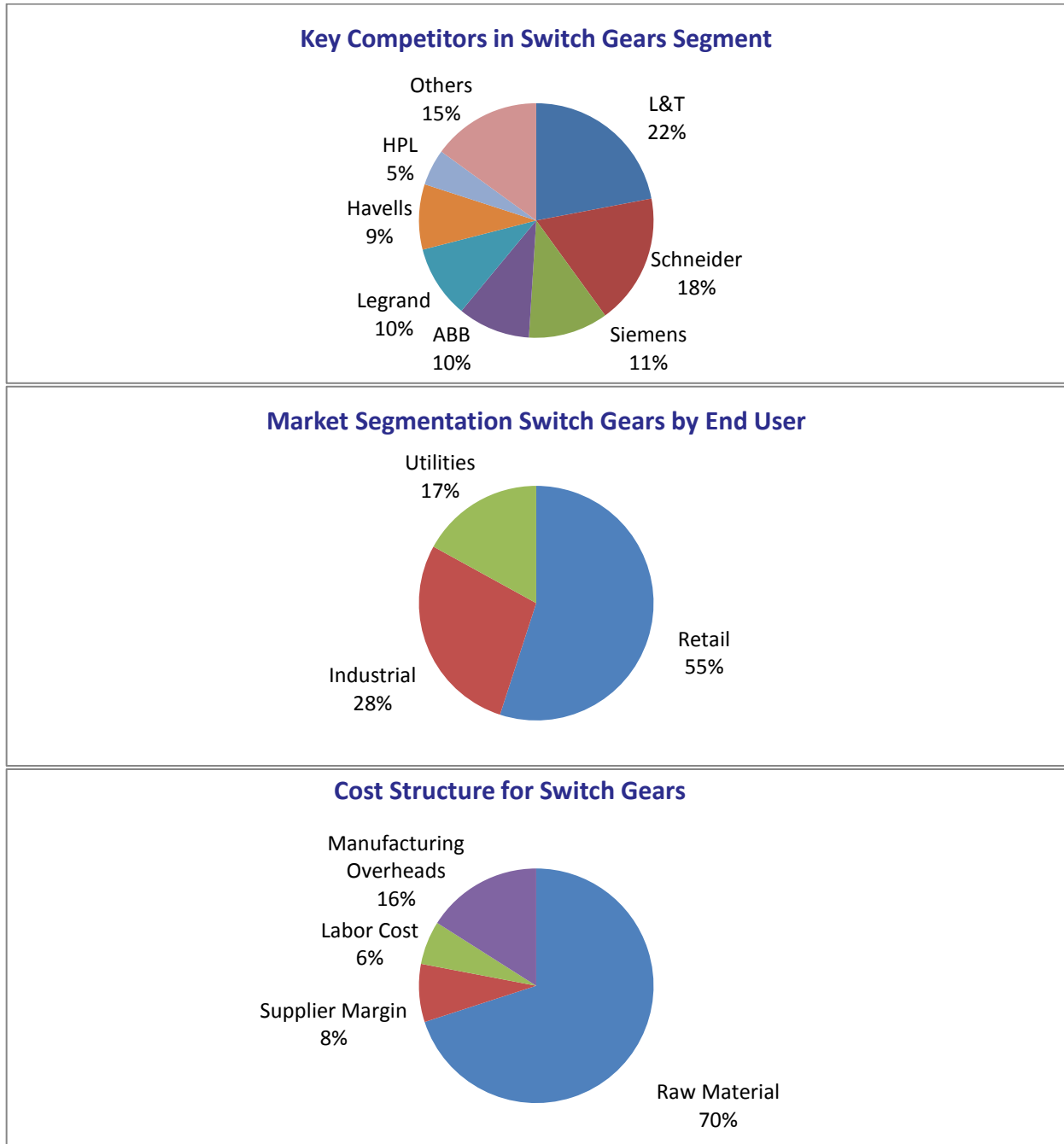
- The industry is clearly one with high barriers to entry given the stringent quality checks and historical track record required by most power utilities which account for 71% of demand

■ Opportunities:

- It is unlikely that there would be major shifts in market share given the industry is a mature one.
- One can expect the company to grow in line with the overall market at ~11.5% per annum and maintain a similar margin structure going ahead, given limited operating leverage in the business
- Implementation of Uday scheme could help reduce working capital in this segment considerably as the company currently has receivable days of ~195 days for the metering segment



Switch Gears:



Source: Company, RHP

■ Industry Characteristics:

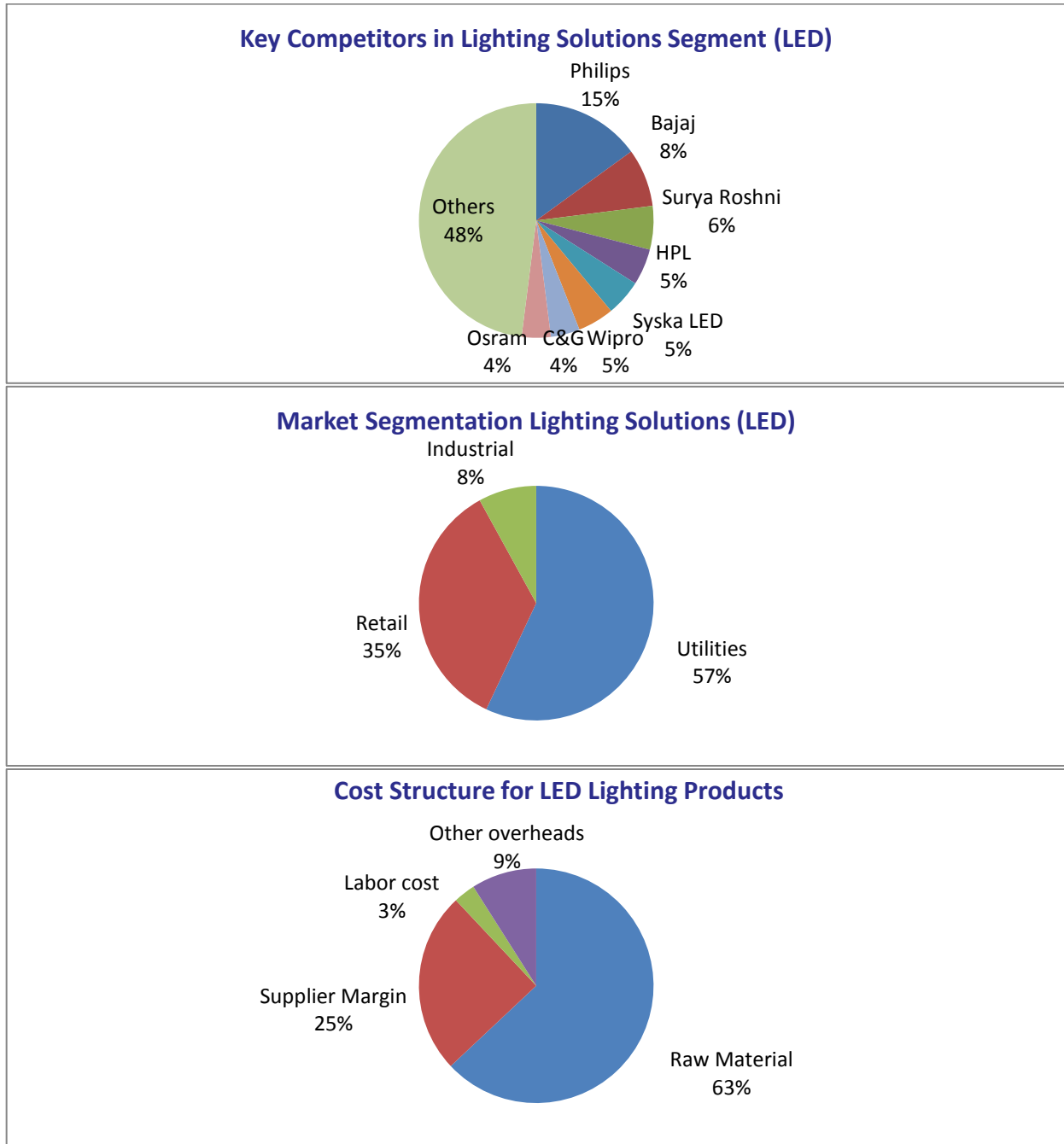
- The industry is one with high entry barriers, however requires a strong brand for success as ~55% of sales come from the retail segment

■ Risks:

- The company lags market leaders by a significant margin despite being in the switch-gear business since inception (1992)
- Despite a growing market the company saw a significant sales decline of ~22% in FY16, losing market share in an otherwise growing market
- One could expect further margin pressure and sales decline in the switch gear segment, unless the company is able to strengthen its brand & distribution network



Lighting Solutions:

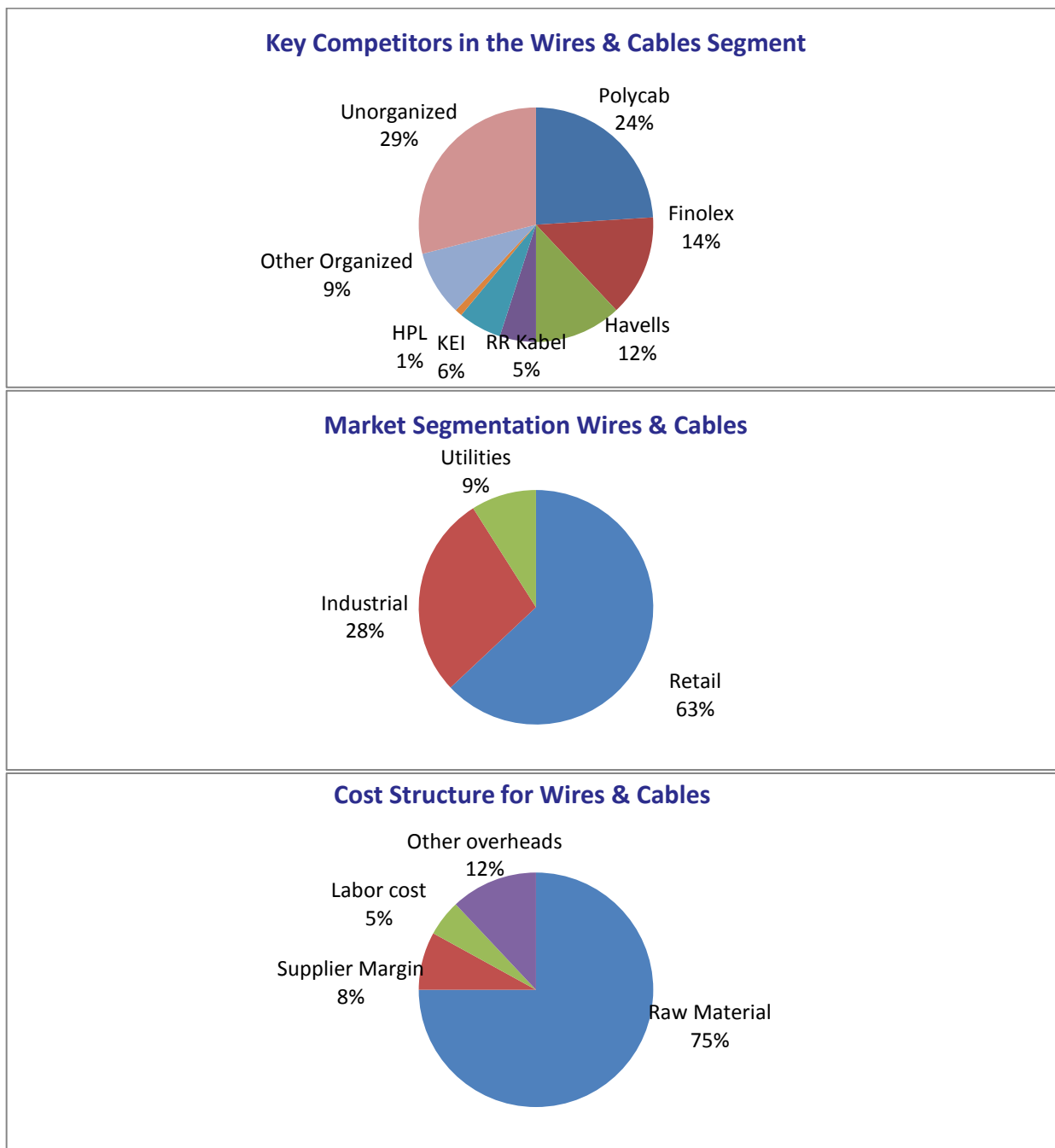


Source: Company, RHP

- **Industry Characteristics:**
 - The industry is highly fragmented with low entry barriers especially for the utility supply business
- **Risks & Opportunities:**
 - Demand for LED products is expected to grow at a breakneck 62% CAGR till 2020 providing ample room for growth, however this is coupled with a strong deflationary trend with prices correcting ~85% since 2014
 - RM & supplier margins account for ~88% of an LED bulbs cost with the companies cost structure accounting for ~12%, thus the ability to bargain with component manufactures along with a strong brand to generate pricing power would be key for profitable growth in the LED segment
 - The company is better positioned as compared to most competition due to smaller presence in the shrinking and obsolete CFL segment, which could be a significant financial drag for competition



Wires & Cables:



Source: Company, RHP

■ Industry Characteristics:

- The industry is highly fragmented with a significant 29% of industry supply coming from the unorganized sector
- As 63% of the industry demand is from the B2C segment a strong brand & product quality would be key to garner pricing power which is essential in an industry with ~83% of costs being RM linked

■ Risks & Opportunities:

- GST could see a significant shift of share from the unorganized segment to the organized players
- The company has shown a robust 17% revenue growth in the wires & cables industry in FY16 despite falling commodity prices, implying a stronger volume growth
- The company however saw EBIT margins for the wires & cables segment shrink by 120bps in FY16 due to the sharp drop in commodity prices causing inventory losses



Utilization of Issue Proceeds:

- The company plans to utilize ~60% of the issue proceeds toward working capital needs and use the rest ~40% towards retiring debt
 - The same should see the companies interest costs come down by ~20% resulting in savings of ₹16 Cr at the PBT level, at the company's current blended cost of borrowing of 12.2%

Segmental Revenue Mix:

Particulars ₹cr	FY12	FY13	FY14	FY15	FY16	Remarks
Metering	391	498	527	503	580	Steady revenue growth
(%) of Revenues	49.5%	49.0%	46.9%	43.4%	46.6%	
(%) Growth		27.4%	5.8%	-4.6%	15.3%	
Switch Gears	160	207	244	246	192	De-growth, cause of concern
(%) of Revenues	20.2%	20.3%	21.7%	21.2%	15.4%	
(%) Growth		29.4%	17.9%	0.8%	-22.0%	
Lighting	123	163	179	259	298	Robust growth, efficiency key
(%) of Revenues	15.6%	16.0%	15.9%	22.3%	24.0%	
(%) Growth		32.5%	9.8%	44.7%	15.1%	
Wires & Cables	111	141	169	149	173	Robust growth, Branding needed
(%) of Revenues	14.0%	13.9%	15.1%	12.9%	13.9%	
(%) Growth		27.0%	19.9%	-11.8%	16.1%	
Projects	6	8	4	2	1	Negligible revenue stream
(%) of Revenues	0.7%	0.8%	0.3%	0.2%	0.1%	
(%) Growth		49.1%	-54.9%	-45.9%	-45.0%	
Gross Revenues	790.5	1017.2	1122.7	1159	1244.1	



Key Historical Financials:

Particulars ₹cr	FY12	FY13	FY14	FY15	FY16	Remarks
Gross Revenues	790.5	1017.2	1122.7	1159	1244.1	
Excise Duty	69	97	111	121	129	
(%) Duty	8.8%	9.5%	9.9%	10.4%	10.3%	Rising excise duty (%)
Net Revenues	721	920	1012	1038	1116	
(%) Growth		27.6%	9.9%	2.6%	7.5%	
Key RM Consumption						
Copper	85	116	134	116	130	Resultant of product mix shift, volatility well managed
(%) of Revenues	11.7%	12.6%	13.2%	11.2%	11.7%	
Electronic Components	276	303	327	313	327	Steadily increasing bargaining power
(%) of Revenues	38.3%	32.9%	32.3%	30.2%	29.3%	
Plastic	68	70	75	80	112	Resultant of product mix shift, volatility well managed
(%) of Revenues	9%	8%	7%	8%	10%	
Packaging	15	19	20	21	16	Sharp Increase in Efficiency shown in FY16
(%) of Revenues	2.1%	2.1%	2.0%	2.0%	1.4%	
Others	109	169	174	213	162	Sharp Increase in Efficiency shown in FY16
(%) of Revenues	15.1%	18.4%	17.2%	20.5%	14.5%	
Total RM Consumption	553	677	730	743	747	
Inventory Adjustment	-51	-30	-10	-29	-5	
Gross Profit	220	273	292	323	374	
(%) Growth		24%	7%	11%	16%	Robust growth in gross margins
Gross Margins (%)	30.5%	29.7%	28.8%	31.2%	33.5%	
Employee Benefits	48	54	58	68	107	Management Pay hikes, Pre IPO jump
(%) of Revenues	6.6%	5.9%	5.7%	6.5%	9.6%	
Other Expenses	88	100	129	139	127	
(%) of Revenues	12%	11%	13%	13%	11%	
EBIDTA	84	120	106	117	140	Stable despite growing GM, showing room for expansion
EBIDTA Margin (%)	11.7%	13.0%	10.4%	11.2%	12.6%	
Other Income	3	4	5	5	5	
Finance Costs	41	62	59	70	78	
Depreciation	7	11	13	16	19	
PBT	39	51	38	35	48	
Tax Expenses	10	10	9	9	12	
Tax (%)	24%	20%	24%	26%	25%	
PAT	30	40	29	26	36	
Pat Margin (%)	4.1%	4.4%	2.8%	2.5%	3.2%	
Net Worth	241	282	311	319	355	



Key Ratios

Key Ratios	FY12	FY13	FY14	FY15	FY16	Remarks
RONW	12.3%	14.3%	9.2%	8.2%	10.0%	
Receivable Days	110	106	118	141	168	Sharp rise reason for concern
Inventory Days (Sales)	107	104	92	108	103	Stable at ~100 days
Payable Days (Sales)	74	82	70	86	109	Sustainability of increase questionable
Working Capital Cycle	142	128	140	163	162	Lower due to payable days
Fixed Assets	175	213	277	307	334	Steady Capex for past 5 years
Fixed Asset Turnover (x)	4.1	4.3	3.7	3.4	3.3	Function of capacity utilization

Relative Valuations:

Company	FY16 Sales	FY16 EBITDA	FY16 PAT	P/E	EV/EBITDA	Networth	ROE (%)
<u>Metering Solutions</u>							
Genus Power	858	124	71	16.2	9.9	660	10.8%
<u>Switch Gear</u>							
Salzer Electronics	361	43	17	17.4	9.0	181	9.4%
Veto Switchgears	123	17	12	20.3	15.9	72	16.7%
<u>Lighting</u>							
Surya Roshni	3079	241	63	13.9	7.1	687	9.2%
<u>Wires & cables</u>							
Finolex	2461	339	249	28.3	19.1	1467	17.0%
Kei Industries	2325	242	62.2	14.2	5.7	367	16.9%
Shilpi Cables	3895	308	163.5	13.7	9.4	729	22.4%
<u>Diversified Electrical Equipment</u>							
Havells	7714	803	715	35.9	31.8	2552	28.0%
Bajaj Electricals	4611	259	96	27.9	11.2	743	12.9%
V Guard	1862	178	111	49.7	30.9	470	23.6%
Average				23.8	15.0		16.7%
HPL Electronics & Power	1120	140	36	36.0	10.6	354	10.2%

*At the upper end of the price band

- The company appears to be significantly overvalued at the listing price as compared to peers, especially when one takes into account the stretched working capital cycle and low return ratios



Growth Drivers:

- **Make in India:** Manufacturing is one of the company's core competencies, backed with an ability to quickly adapt to changes in product requirements (100 member strong R&D team)
- **GST:** Would allow the company easier movement of goods, a reduction in warehouse count, inventory days and a potential market share gain from the unorganized sector in the wires & cables segment
- **Expansion of T&D Network:** Power Grid corporation of India is expected to double its Net Block by FY-20, the same would provide opportunities to scale for the entire electrical equipment's industry

Risk Factors:

- **Regulatory:** - The implementation of Uday scheme & reduction in receivable days is key for the company to lower working capital requirements
- **Brand Investments:** In order to grow profitably the company would have to significantly increase A&P expenses which could cause a drag on profitability in the near future without revenue visibility as the company's management has no experience in building brands
- **Working Capital:** The company's working capital for FY16 seems artificially lower due to stretched payable days, If the same is not controlled it could stretch the company's working capital requirements significantly
- **Brand Name:** The name HPL stands for "Havells Private Limited." And is under litigation as the brand name Havells belongs to Havells India which is not related to HPL. Any court ruling asking HPL to change it's brand name would be a significant negative for the company as the company might be generating a sizable chunk of it's sales as a rub-off of the Havells brand equity

Valuations & Recommendation:

- HPL Electric & Power Ltd. seems to be priced beyond perfection at 35x FY16 PE, 10x FY16 EV/EBITDA given it's modest return ratios, competitive business environment and lack of brand equity
- We would advise investors to avoid the issue as there are better opportunities in the listed space and recommend waiting for clarity to emerge on key issues such as the brand litigation and working capital efficiency before considering HPL as an investment



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