Publication: The Hindu Business Line	Edition: Online
Date: September 20, 2016	Page:

HPL Electric & Power IPO: aftershocks possible

HPL Electric and Power, a manufacturer of electrical appliances, switch-gears, electronic energy meters and electrical protection equipment, is making an initial public offer to raise ₹361 crore. Of this, HPL expects to use ₹130 crore to repay term loans and ₹180 crore for working capital requirements.

Govt thrust vs poor finances

The Centre's increased thrust in curtailing electricity losses, accelerating rural electrification programmes and the thrust on promoting LED-powered lighting provide visibility to the company's business. But the poor finances of power utilities, which are its biggest clients, could lead to delayed payments, increasing the working capital needs and finance cost of the company.

HPL's shares are being offered at a post-issue P/E multiple of 24 to 26 times, after consolidating the business of Himachal Energy, that was merged with the company this May. While this appears inexpensive compared to the P/E ratio of Havells India that trades at a trailing price earning multiple of around 50 times, Havells is predominantly in the B2C space and hence, benefits from the premium currently being accorded to consumer companies. Given the smaller business of HPL, relatively less-known brand and its exposure to power utilities, the offer seems expensive.

Investors can avoid this offer and consider buying the stock in the secondary market after tracking its performance over the next couple of quarters.

Business basics

HPL's post-issue debt will be about ₹452 crore after accounting for repayment from the issue proceeds. According to India Ratings and Research, credit ratings assigned for long-term borrowing and working capital for fiscal year ending 2016 stands at A-. With close to 100 per cent of the electronic components imported in the lighting segment from Taiwan, South Korea and China, the risk of margin erosion due to rupee depreciation is high.

The metering segment, which contributed nearly 50 per cent of FY16 revenue, recorded an annualised revenue growth of about 10 per cent over the last five years. HPL supplies around 75 per cent of its meters to power utilities while the rest is supplied through trade channels. Delayed payment by these power utilities that are facing financial stress is affecting the company's working capital cycle. Its average debtor days have increased to 167 days in 2015-16 from 118 days in 2013-14.

The lighting segment, which contributes around 23 per cent of FY16 revenue, is predominantly driven by increased demand for LED bulbs. This segment grew at a CAGR of 25 per cent over the last five years. Poor growth in the industrial power equipment sector coupled with a slump in the real estate market, has however, decelerated revenue in the switchgear segment. The wires and cables segment too, have seen meagre growth in revenue in recent times.

Financial picture

After consolidating the recently-acquired Himachal Energy into HPL's finances, gross revenue and operating profit have grown at a CAGR of 12 per cent and 11 per cent, respectively, over the past five years. The net profit for the year FY16 stood at ₹48.6 crore with the net profit margin at 4.1 per cent.
Interest cost has grown at about 17 per cent over the past five years and stood at ₹78 crore for the year ending 2015-16. The debt-to-equity ratio was, however, not too high, at 1.25 times post-issue.

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