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Mar 16, 2012

BUY

Hitachi Home and Life Solution

Rating Mix

CMP	Rs127
Target Price	Rs142
Time Period	1 year

Stock Info

Sector	Electronic
Market Cap (Rs cr.)	293
52 Week High/Low	248/93
Average Volume	4,701
Face Value (Re.)	10
BSE Sensex	17,466
Nifty	5,318

Shareholding

Promoters	70
MF/Banks/FIs	3
FII /NRI's/ OCB's	0
Indian Public /Others	27

Analyst – Pooja Chowksey

@ - pooja.chowksey@gmail.com

C – 9819833753

http://www.linkedin.com/in/poojachowksey

Positioning into mass premium segment - Hitachi Home and Life Solutions (HHLS) that primarily caters to the premium segment, is now entering tier-II and tier-III cities with low-priced products. The company has launched new range of window and split AC "KAZE" as low price product. This will help the company gain market share in the Room Air conditioners segment in the near future. The company has set a target to capture 10% market share in terms of sales volume, compared to the current market share of 7 %.

Rural markets offer a big opportunity - Rural consumer durables market is growing by 30% currently, while it is expected to grow by 45% in FY12. Rural markets are expected to post much faster growth than urban markets in medium term led by increased rural Income, increased distribution reach of companies, and customized products for rural consumers. The industry is expected to grow at a compounded annual growth rate (CAGR) of 18% till 2014-15.

Outlook & Valuation - The AC industry is expected to grow at 15-20% over 3-5 years, while we expect HHLS to register a CAGR of 14% over FY2011-13E. The decline in EBITDA in FY11 over FY10 was mainly because of the rise in raw material prices (mainly copper). We expect EBITDA margins to improve to 6.1% in FY13E. The forecasted PAT shows decrease of 32% in FY12E mainly due to decline in sales because of climatic change, short summer season and longer winter season. The PAT is expected to rise by 50% in FY13. At current valuations the stock is trading at 9.8x FY2013E EPS. **We have arrived at Target Price of Rs142. Hence, we recommend BUY on the stock.**

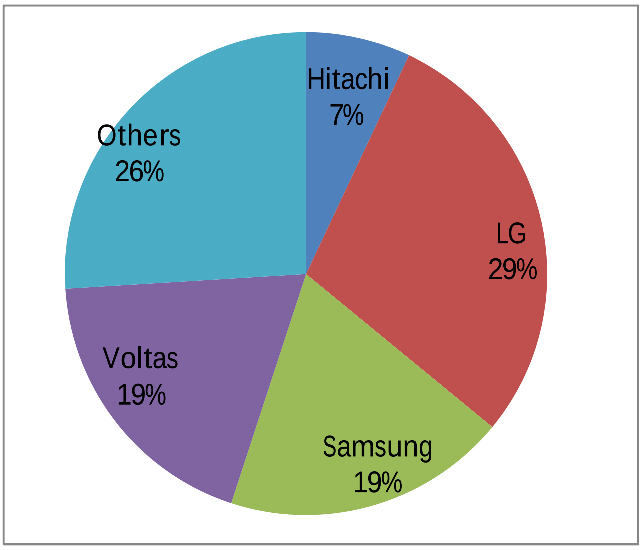
Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
Net Sales	**641**	**763**	**807**	**976**
% chg	36.3	19.2	5.8	20.8
Adj Profit	**45.6**	**31.9**	**19.9**	**29.9**
% chg	108.1	(30.0)	(37.7)	50.1
EBITDA (%)	9.1	6.9	5.3	6.1
Adj EPS (Rs)	**19.9**	**13.9**	**8.7**	**13.0**
P/E (x)	6.4	9.2	14.7	9.8
P/BV (x)	2.0	1.7	1.6	1.4
RoE (%)	36.3	20.1	11.1	14.9
RoCE (%)	25.7	15.5	8.0	10.7
EV/Sales (x)	0.5	0.5	0.5	0.4
EV/EBITDA (x)	5.5	7.3	9.4	6.5

INVESTMENT RATIONALE

Positioning into mass premium segment

HHLS which caters to the premium segment is now entering into tier-II and tier-III cities with low-priced products. India's future growth will come from smaller towns and the customers in those markets are aspiring for the advanced, high quality & premium products. The company keeping their aspirations in mind has launched new range of window and split AC, "KAZE" as a relatively low priced product range, which will help in reaching out to those customers from middle level income group. This will help the company gain market share in Room Air conditioners segment in near future. The company has set a target to capture 10% market share in terms of sales volume, from the current market share of 7%. The company has started this endeavour this year.

Exhibit 1 - HHLS Market Share



Source - CMEA reports

Rural market offers a big opportunity

Rural consumer durables market is growing by 30% currently and is expected to grow by 45% in FY12. Approximately 69% population resides in rural India, yet only 35% sales are contributed by rural markets. However, this sales contribution is expected to increase to ~45% in the near future. Rural markets are expected to post much faster growth than urban markets in the medium term, led by increasing rural Income, increased distribution reach of consumer durable companies and customized products for rural consumers.

Initiates its owned & operated service centre

The company has started its own service centres called "Hitachi Customer Satisfaction" (HCS), to improve the service quality and better customer satisfaction. It has started 18 centres in 11 towns. There will be an increase to 30 in the first phase. Also, the company has its own call centre to help its customers. These endeavours help strengthen HHLS's brand image and customer satisfaction.

Pioneer of technological innovations

The company is well known for its technical "KNOW HOW" which acts as a catalyst of change. The company has been ahead of the competition in introducing new concepts with features like green and energy efficiency technology in air-conditioning, due to its strength of R&D. It has introduced "Direct Efficient Technology" in its range of Split Air conditioners *i-Clean* with automatic filter cleaning technology and high energy efficiency with a five-star rating. Despite high costs of green technology, consumers are increasingly basing their purchase decisions on the environment friendly products and their ability to reduce energy costs and carbon footprints.

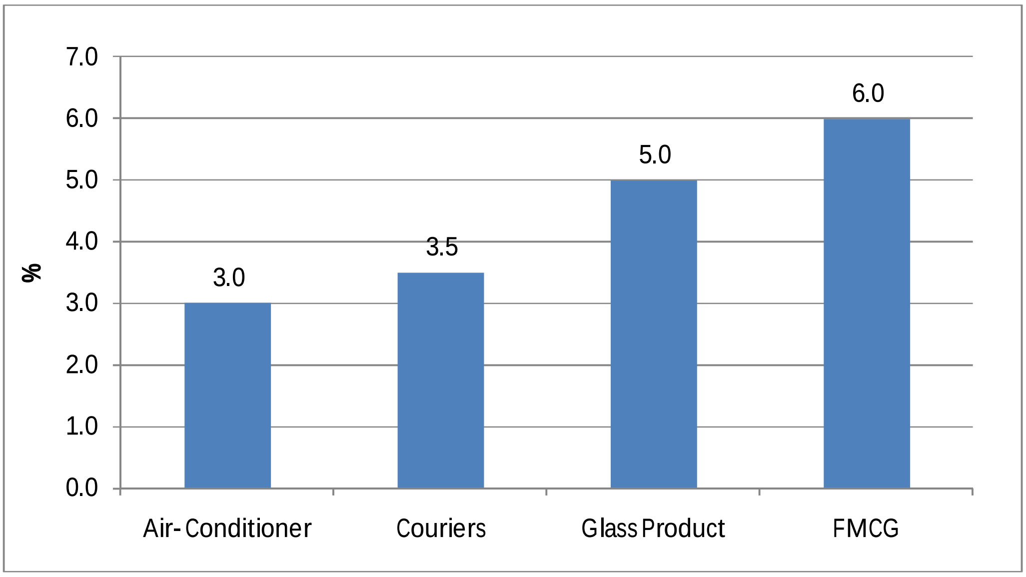
Geographical expansion by enhancing production capacity

HHLS has the largest AC manufacturing facility in India, situated at Kadi (Gujarat). The new plant was built in a record time of only 7 ½ months. Even in the slowdown in markets, believing in the Indian market, the company has installed this plant. Commercial Air-conditioner business depends on the country's economic health. Strong economic growth drives the realty sector growth and the positive rub–off effect has started. The new plant would manufacture commercial air-conditioners including large air-conditioner chiller plants, ductable air-conditioners. Ductable category of Air conditioners has witnessed a downturn. However we expect the sales to start picking up. The telecom segment has shown a linear trend maintain leadership position with about 32% market share in this category.

Air conditioner has become a necessity from being a luxury

Over the past quarter century, the air conditioner industry has undergone a sea change. Depletion of the ozone layer, global warming, and rising population are all hot factors that are driving ahead the need for a cool world. Presently, comfort-conditioning has become a necessity, from being a luxury. This metamorphosis has opened a completely new world of opportunities. The AC industry in India has a penetration of only 3%, which is expected to grow to 5% by FY2015E. This promises a strong growth in the market for the air conditioners.

Exhibit 2 – AC penetration in India

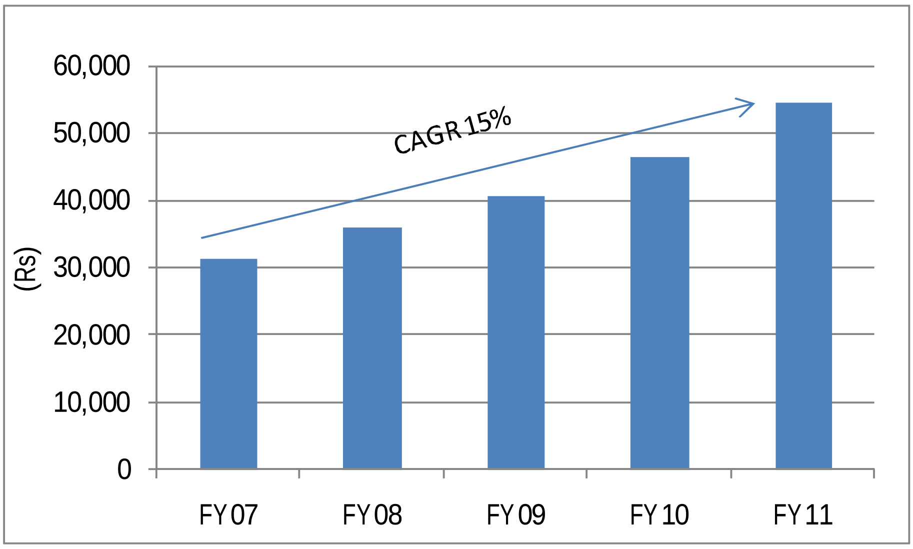


Source - IBEF Research

Indian consumers are not price-conscious but value-conscious

The industry has witnessed a considerable change due to rising demand from Indian consumers fuelled by growing population, increasing incomes and nuclear families, improved lifestyles, increasing working women and the desire for products that pack in performance with aesthetics. Also there is a demand shift of consumer durables from metropolitans to smaller towns and cities due to improving rural economy. There is a lot of scope to increase the penetration and create a wider customer base.

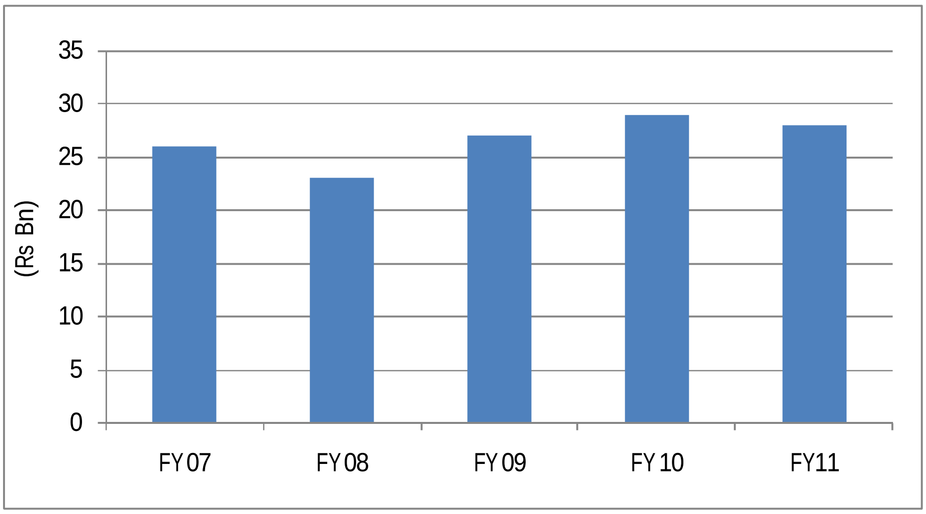
Exhibit 3 – Growth in Per Capita Income in India



Source - IBEF Research

The domestic consumption is driving India's air-conditioner market. The availability of easy access to finance has improved the demand for air-conditioners even in smaller cities as more households join the buoying middle-class segment. The consumer expenditure has also shown growth in consumer durable goods over the years.

Exhibit 4 – Consumer Expenditure on consumer durable goods in India

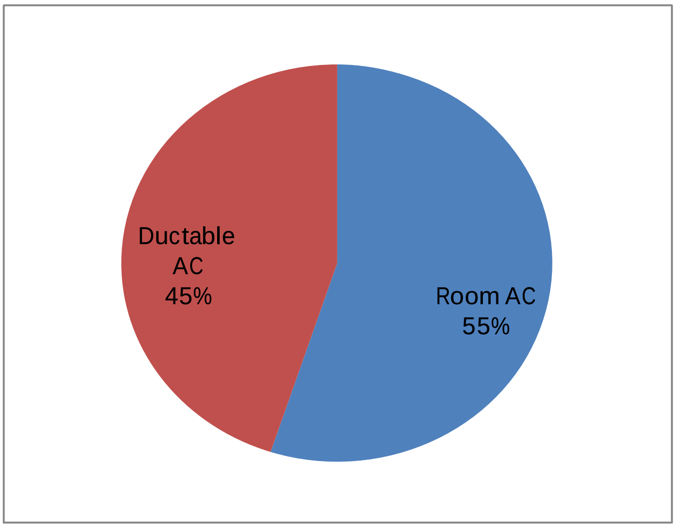


Source - IBEF Research

Air-conditioning industry has started gearing up to push sales

The air-conditioning industry is expected to grow at a compounded annual growth rate (CAGR) of 18% till 2014-15. The industry size is Rs13,100cr, as of March 2011, room air conditioners (RAC) contributes Rs7,100cr and the remaining by ductable/central air-conditioning systems (CAS). The RAC market grew at a CAGR of 20%, while the ductable /CAS market grew at a CAGR of 17% over FY2006-11.

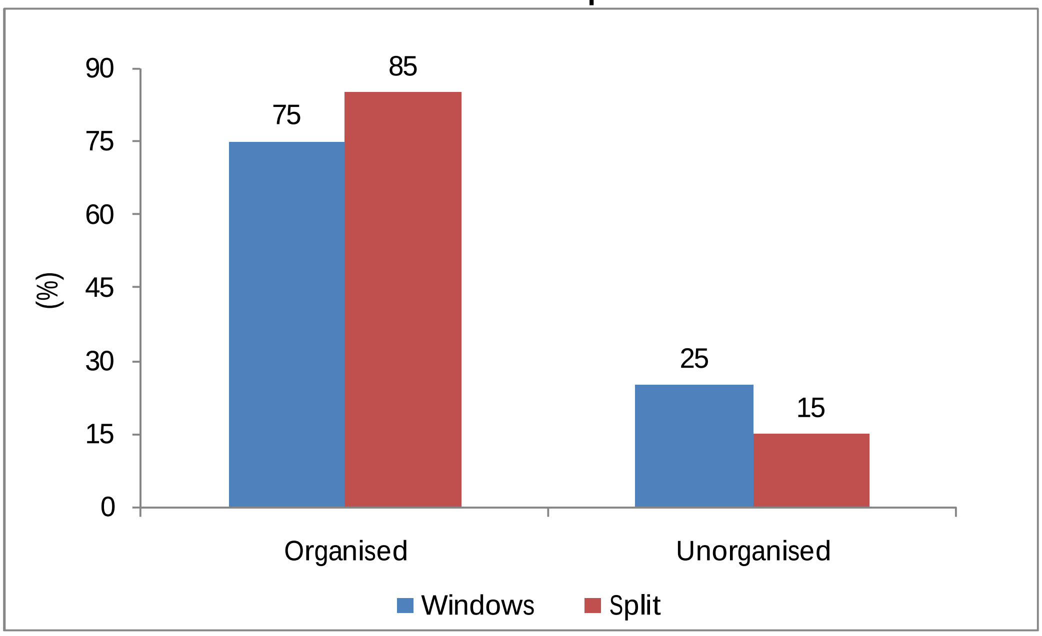
Exhibit 5 – AC Market Segment



Source - IBEF Research

Growth in the white goods segment was largely driven by the Air-conditioner (AC) segment. Within this, split ACs have been the main growth drivers, recording a growth of over 80 per cent in 2011. The window AC segment is less organised as compared to split AC segment. Sales of spilt air conditioners are predicted to grow by a 21% (retail volume CAGR) compared to a 10% CAGR for window air conditioners. HHLS offer 25 models of split ACs and 10 models of window ACs.

Exhibit 6 – Window and Split AC Market



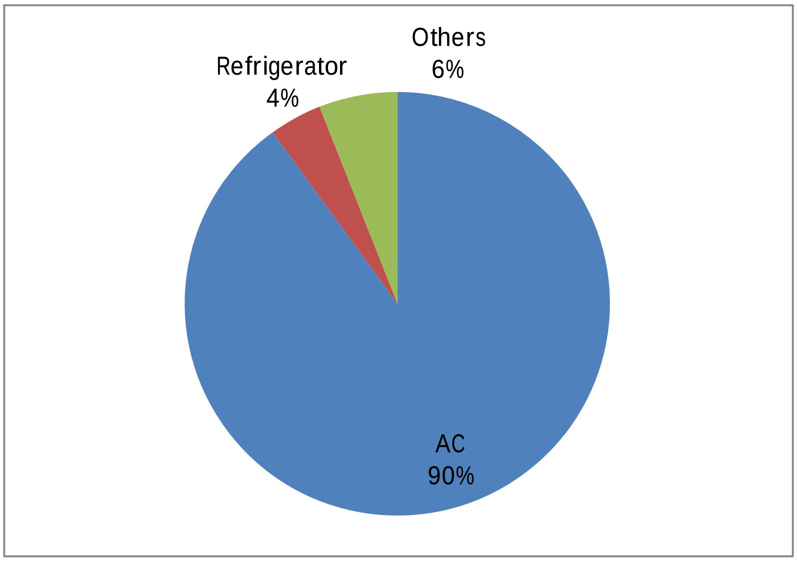
Source - IBEF Research

FINANCIAL OVERVIEW

Revenue contribution

The company's revenue is generated mostly by the Air Conditioner business. 90% of the revenue is driven by the sales of AC and remaining by refrigerator business and others.

Exhibit 7 – Revenue contribution segmentwise - FY2011

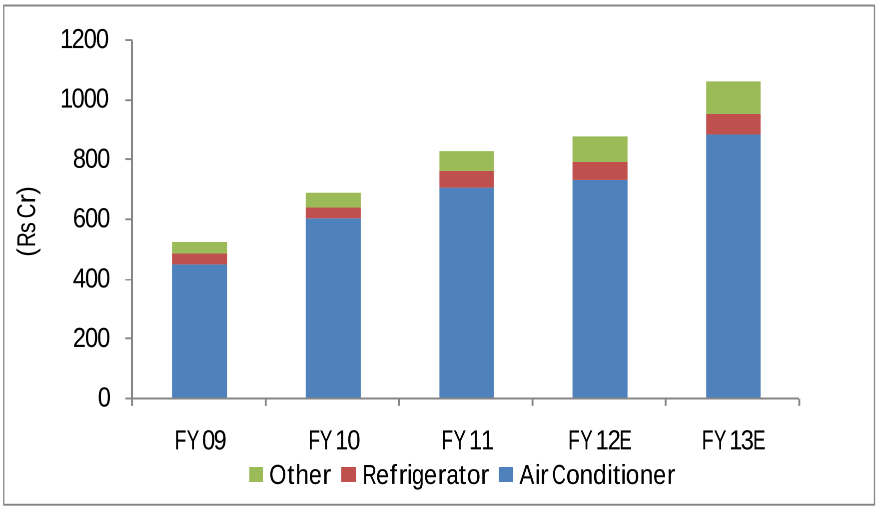


Source - Equitorials Research

Operations

The AC industry CAGR over last 5 years has been ~ 20%. However, the company has outperformed with 24% sales growth. The expected growth in the AC industry during medium term (3-5 years) is 15-20%. However, the forecasted CAGR of HHLS from FY11 to FY13E is 14%. Hitachi has started to adopt an aggressive marketing plan. FY13E growth would be driven by new ACs and refrigerators launched for Tier II and Tier III cities at low prices.

Exhibit 8 – Sales Mix



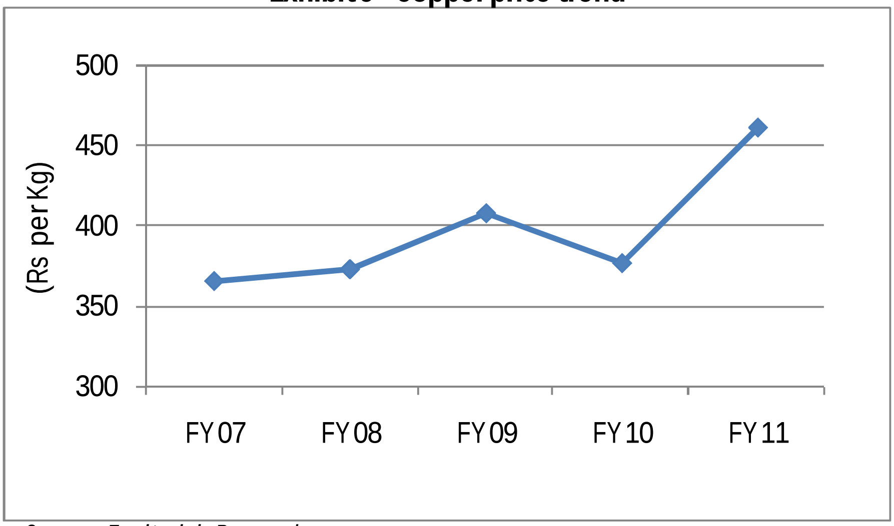
Source - Equitorials Research

EBITDA

During FY09-10, there was a sharp increase in the EBITDA margin due to overall recovery of Indian economy. The rise of middle class and increase in per capita income in India resulted in rise in demand and consumption of white goods leading to increase in sales.

The decline in EBITDA in FY11 over FY10 was mainly because of rise in the prices of raw material. Copper is the major raw material used to manufacture Air Conditioner. The instability in copper prices affects the EBITDA Margins in long run. The following chart shows the HHLS Copper consumption rate per kg over the years.

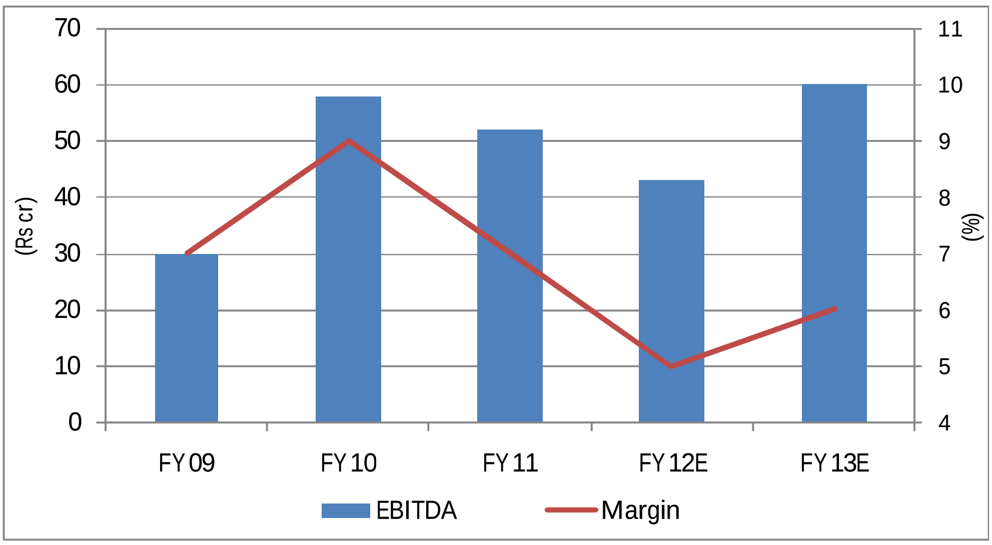
Exhibit 9 - Copper price trend



Source - Equitorials Research

We expect to EBITDA margins to improve to 6.1% in FY13E. The outlook for the sector is positive expecting the consumer durable sector to have a good growth.

Exhibit 10 – EBITDA trend



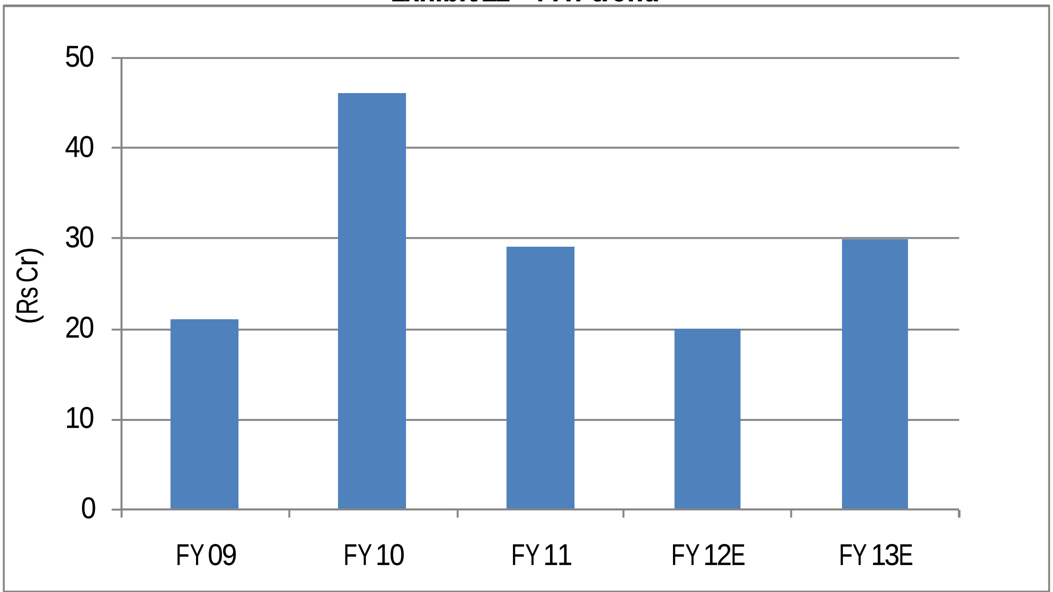
Source - Equitorials Research

PAT

The worst of 2008-09 global financial crisis passed, the consumer product sector showed a return to growth in 2010. PAT posted a decline in FY11 due to increase in the interest rates leading to high borrowing cost impacting the sales, thus impacting the profitability.

The forecasted PAT shows further decrease in FY12E mainly due to decline in sales because of climatic change, short summer season and longer winter season. PAT is expected to rise in FY13.

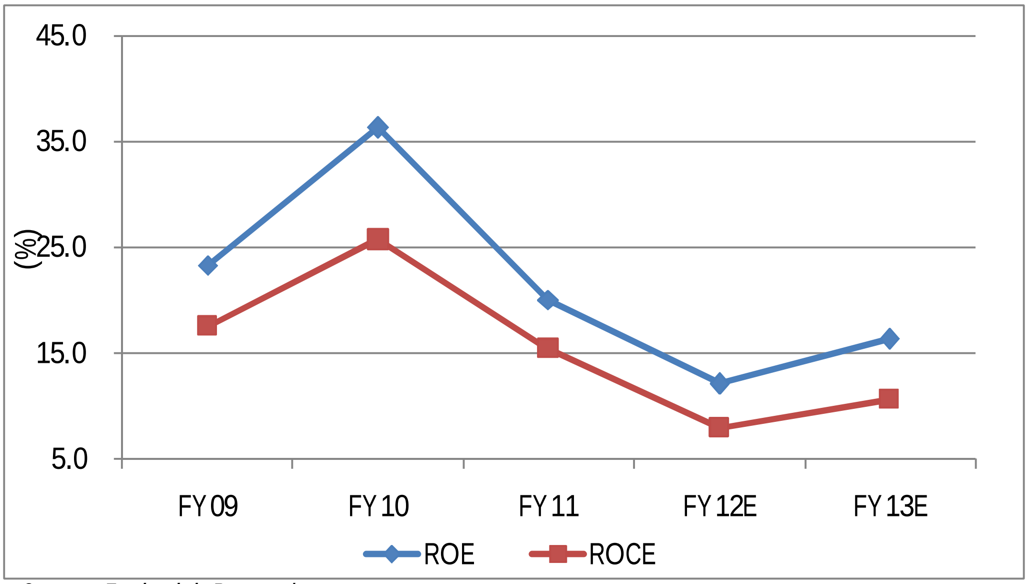
Exhibit 11 – PAT trend



Source - Equitorials Research

We expect HHLS to post a decline in ROE in FY12E due to lower EBITDA Margins and decline in Sales growth. We expect the ROE and ROCE margins to increase in FY13E due to new innovative models and penetration in a totally new segment of Class II and III towns.

Exhibit 12 – ROE and ROCE trend

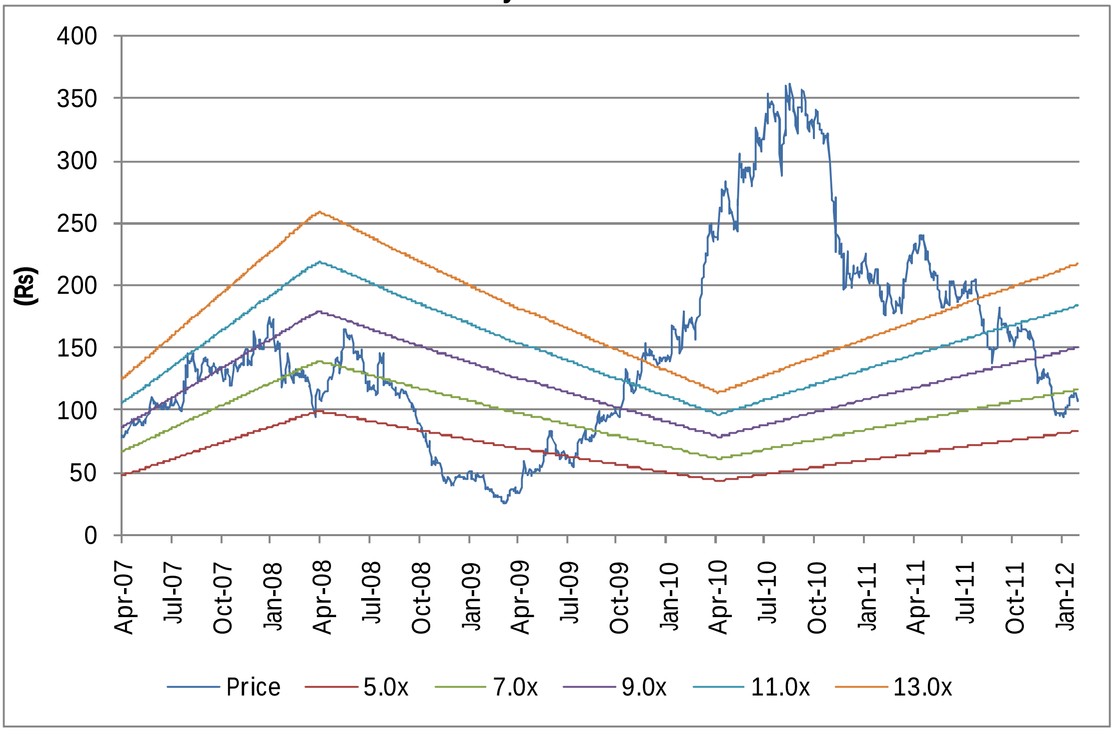


Source - Equitorials Research

Valuation

Over past 6 years the stock has traded at a maximum P/E of 33 and an average of 12x. We have arrived at theoretical target PE of 11x. We have taken theoretical PE to be conservative. Accordingly we have arrived at Target Price of Rs142. Hence, we recommend BUY on the stock.

Exhibit 13 – 1 year forward P/E band



Source - Equitorials Research

Profit & Loss Statement (Rs cr)

Y/E March	FY2009	FY2010	FY2011	FY2012E	FY2013E
Gross sales	519	686	829	878	1,061
Less: Excise duty	49	45	66	70	85
Net Sales	470	641	763	807	976
Total operating income	**470**	**641**	**763**	**807**	**976**
% chg	*5.2*	*36.3*	*19.2*	*5.8*	*20.8*
Total Expenditure	440	582	711	765	916
Net Raw Materials	305	413	497	537	644
Other Mfg costs	55	57	75	83	98
Personnel	24	31	44	44	53
Other	56	81	94	100	122
EBITDA	**30**	**58**	**52**	**43**	**60**
% chg	*(34.5)*	*93.9*	*(10.4)*	*(18.3)*	*39.1*
(% of Net Sales)	*6.4*	*9.1*	*6.9*	*5.3*	*6.1*
Depreciation& Amortisation	8	12	16	20	25
EBIT	**22**	**47**	**36**	**23**	**35**
% chg	*(42.3)*	*110.7*	*(22.2)*	*(37.3)*	*52.1*
(% of Net Sales)	*4.7*	*7.3*	*4.8*	*2.8*	*3.6*
Interest & other Charges	3	2	2	3	2
Other Income	7	12	6	7	9
(% of PBT)	*27.1*	*20.7*	*14.1*	*25.7*	*20.8*
Recurring PBT	**27**	**57**	**40**	**27**	**41**
% chg	*(43.0)*	*113.3*	*(30.0)*	*(31.7)*	*50.1*
PBT (reported)	**27**	**57**	**40**	**27**	**41**
Tax	6	11	11	7	11
(% of PBT)	*21.2*	*19.1*	*26.6*	*26.6*	*26.6*
PAT (reported)	**21**	**46**	**29**	**20**	**30**
Less: Minority interest (MI)	-	-	-	-	-
PAT after MI (reported)	**21**	**46**	**29**	**20**	**30**
ADJ. PAT	**22**	**46**	**32**	**20**	**30**
% chg	*(33.2)*	*108.1*	*(30.0)*	*(37.7)*	*50.1*
(% of Net Sales)	*4.6*	*7.0*	*4.2*	*2.4*	*3.0*
Basic EPS (Rs)	**9.5**	**19.9**	**13.9**	**8.7**	**13.0**
Fully Diluted EPS (Rs)	**9.5**	**19.9**	**13.9**	**8.7**	**13.0**
% chg	*(33.2)*	*108.1*	*(30.0)*	*(37.7)*	*50.1*

Balance Sheet (Rs cr)

Y/E March	FY2009	FY2010	FY2011	FY2012E	FY2013E
SOURCES OF FUNDS					
Equity Share Capital	23	23	23	23	23
Preference Capital	-	-	-	-	-
Reserves& Surplus	82	124	149	165	191
Shareholders Funds	**105**	**147**	**172**	**188**	**214**
Minority Interest	-	-	-	-	-
Total Loans	51	60	90	120	125
Deferred Tax Liability	1	1	0	0	0
Total Liabilities	**156**	**207**	**262**	**308**	**339**
APPLICATION OF FUNDS					
Gross Block	110	159	199	246	300
Less: Acc. Depreciation	45	54	68	88	113
Net Block	**65**	**105**	**131**	**159**	**188**
Capital Work-in-Progress	18	15	7	12	12
Goodwill					
Investments	**-**	**-**	**-**	**-**	**-**
Current Assets	254	330	485	469	537
Cash	23	28	2	10	29
Loans & Advances	22	25	31	31	37
Other	198	276	452	420	457
Current liabilities	181	243	360	332	399
Net Current Assets	**74**	**88**	**125**	**137**	**138**
Mis. Exp. not written off	-	-	-	-	-
Total Assets	**156**	**207**	**262**	**308**	**339**

Cash flow statement (Rs cr)

Y/E March	FY2009	FY2010	FY2011	FY2012E	FY2013E
Profit before tax	27	57	40	27	41
Depreciation	8	12	16	20	25
Change in Working Capital	(3)	(33)	(67)	(5)	19
Less: Other income					
Direct taxes paid	(1)	1	2	(7)	(11)
Cash Flow from Operations	**30**	**37**	**(9)**	**35**	**74**
(Inc.)/ Dec. in Fixed Assets	(42)	(39)	(31)	(53)	(54)
(Inc.)/ Dec. in Investments	(5)	(8)	(0)	-	-
Inc./ (Dec.) in loans and advances					
Other income					
Cash Flow from Investing	**(47)**	**(47)**	**(31)**	**(53)**	**(54)**
Issue of Equity	-	-	-	-	-
Inc./(Dec.) in loans	35	12	25	30	5
Dividend Paid (Incl. Tax)	-	-	(4)	-	(4)
Others	(3)	(1)	(2)	(3)	(2)
Cash Flow from Financing	**32**	**11**	**19**	**27**	**(1)**
Inc./(Dec.) in Cash	15	1	(21)	9	19
Opening Cash balances	**6**	**22**	**23**	**2**	**10**
Closing Cash balances	**22**	**23**	**1**	**11**	**29**

Key Ratios

Y/E March	FY2009	FY2010	FY2011	FY2012E	FY2013E
Valuation Ratio (x)					
P/E (on FDEPS)	13.3	6.4	9.2	14.7	9.8
P/CEPS	9.8	5.1	6.1	7.3	5.3
P/BV	2.8	2.0	1.7	1.6	1.4
Dividend yield (%)	-	1.2	1.2	1.2	1.2
EV/Sales	0.7	0.5	0.5	0.5	0.4
EV/EBITDA	10.6	5.5	7.3	9.4	6.5
EV / Total Assets	2.0	1.6	1.4	1.3	1.1
Per Share Data (Rs)					
EPS (Basic)	9.5	19.9	13.9	8.7	13.0
EPS (fully diluted)	9.5	19.9	13.9	8.7	13.0
Cash EPS	13.0	25.0	20.9	17.4	23.8
DPS	-	1.5	1.5	1.5	1.5
Book Value	45.5	63.9	74.9	81.8	93.1
Dupont Analysis					
EBIT margin	4.7	7.3	4.8	2.8	3.6
Tax retention ratio	78.8	80.9	73.4	73.4	73.4
Asset turnover (x)	4.2	4.1	3.5	2.9	3.2
ROIC (Post-tax)	15.7	24.2	12.2	6.0	8.4
Cost of Debt (Post Tax)	6.8	2.2	2.0	3.7	3.3
Leverage (x)	0.2	0.2	0.3	0.5	0.5
Operating ROE	17.1	28.6	15.7	7.2	10.8
Returns (%)					
ROCE (Pre-tax)	17.6	25.7	15.5	8.0	10.7
Angel ROIC (Pre-tax)	22.6	33.4	17.4	8.5	11.9
ROE	23.3	36.3	20.1	11.1	14.9
Turnover ratios (x)					
Asset Turnover (Gross Block)	5.1	4.8	4.3	3.6	3.6
Inventory / Sales (days)	92.0	84.6	121.3	125.0	121.0
Receivables (days)	63.6	54.7	59.7	70.0	66.0
Payables (days)	150.3	127.6	147.5	155.0	165.0
Working capital cycle (ex-cash) (days)	41.9	36.0	50.3	64.1	51.4
Solvency ratios (x)					
Net debt to equity	0.3	0.2	0.5	0.6	0.5
Net debt to EBITDA	0.9	0.5	1.7	2.6	1.6
Interest Coverage (EBIT / Interest)	8.3	30.9	17.8	9.1	15.7

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