An electrifying perspective!

One of India's renowned mystics – Ramakrishna Paramhamsa – also the Guru of Swami Vivekananda – once narrated a story about an exquisite garden. Three unrelated people visited the garden at the same time. The first was a tourist, who marveled at all the colors on display. The second was a scientist who quickly began counting the various species present and recalling their biological names. The third was a spiritual aspirant who could only see the beauty of the Creator manifested everywhere in the garden. The story ends there. However, it's not just that beauty lies in the eyes of the beholder, but also that one's perspective matters. For most people, an apple falling on their heads would be unpleasant, but to Newton in his garden, the same apple led him to discover the law of gravity.

In our flagship strategy, we aim to invest with well-established entrepreneur-driven and family-backed businesses that benefit from the founders' unique perspectives. Being closest to the action, not only are they able to grow their existing lines of business exceptionally, but they are also astute at identifying adjacencies well before others can. One of our investee companies started off in the early 80s making MCBs or miniature circuit breakers, but the same company would be unrecognizable today. This because they have now built out leadership positions by manufacturing products across 22 other categories including fans, water heaters, LED lighting, washing machines, TVs, air-conditioners and refrigerators among others. This is the quintessential entrepreneurial trait – an ability to spot credible opportunities when there appear to be none.

The electrical appliances company described above, Havells India, has benefited from a) growing urbanization, b) the government's focus on electrification, c) a shift from unorganized to organized businesses and d) India's young demographic. It might seem like the opportunity has already passed, but this couldn't be further from the truth. Over 65% of India still lives in rural India, and urbanization has many decades to go. The government's work on electrification has been exceptional – with all ~600,000 villages now electrified – including achieving 100% last-mile connectivity (Saubhagya scheme). An improvement in the quality of power (reduced load shedding and lower voltage fluctuations) should drive demand for essentials like cables, wires, switches and fans initially. As disposable income rises, this should increase demand for appliances like mixer-grinders, air coolers and TVs, and eventually for direct cooled refrigerators and room ACs. The consumer electricals sector is estimated to only be ~65% organized, leaving substantial room for further formalization. On demographics, India will net add 122 million people to the working population over the rest of this decade, as against net reductions for China, US and EU.

Havells share price has grown 500x over the last two decades (i.e., from INR 2 to INR 1000), and the company has become a household name amongst Indians. But success came from humble beginnings. Qimat Rai Gupta or QRG started his career as a schoolteacher in Punjab teaching drawing. His family's perilous financial position along with his mother's ill-health meant he had to give up on his dream of completing graduation. By a quirk of fate, he found himself managing his uncle's electrical goods shop in Delhi while on a holiday. Impressed by his enthusiasm, his uncle made him an equal partner in his trading business, and thereafter QRG bought him out. Havells gets its name from the name of its original founder – Havelli Ram Gupta, who sold the brand to QRG in the 1960s. The latter's family still owns and runs the business today. Havells was known initially for its wires and switchboards and fans via its innovative ad campaigns. They understood a common misconception well, that Indian buyers are actually "value-conscious" and not "price conscious". This led them to focus on high-quality products and unparalleled after-sales service, providing an excellent value proposition.

Havells today is a leading FMEG (Fast Moving Electrical Goods) company with a USD 2 bn top-line and a rough split of ~33% from cables, ~22% from consumer durables, ~10% from lightings and fixtures, ~13% from switchgears, ~16% from Lloyds (more on this below) and the rest ~5% from others. It has an all-India distribution network of 40+ branch offices, 15,000+ dealers and 200,000+ retailers. By leveraging its strong brand pull, vast distribution network and robust processes, it is among the top-3 players in multiple product categories. For example, in water-heaters, which is a ~USD 0.5 bn category, Havells is ranked #1 and has a ~15% market share. In domestic cables, a ~USD 8 bn category, Havells ranks #3 and has an ~8% market share.

Havells caters to a large gamut of customers, including B2B. In its best-known avatar, its premium portfolio is focused largely on metros, and tier-1 and tier-2 towns. However, considering its lower penetration in the high-growth rural areas and tier-3-and-lower towns, it launched products tailored to these markets. Havells now has a direct presence in ~3,000 rural towns covering ~40,000 retail outlets. Instead of producing cheaper quality products for this category of customers, the company dials down on the number of features instead. The company has identified that though not very well-off, rural dwellers are spending their entire life savings to build a house, so they don't want to compromise on the quality of electricals employed. In FY23, the company is expected to cover an additional ~2,800 towns, each with a population of ~10,000 to ~50,000. Currently, only certain electrical products are sold in the smaller markets and not white goods, so this represents substantial opportunities for the future.

But this is not just a numbers game, because Havells strives to take care of the entire ecosystem. QRG treated dealers & distributors like his own family. He also viewed strong distribution prowess as a significant barrier to entry and doubled down on it. This shows, given that over 60% of their dealers have been around with the company for at least 5 years. QRG's foundations as a trader meant he always understood the innate needs of the channel members of Havells, and that they could catapult the brand to great success if they were treated as strategic partners. It wasn't easy though, and QRG's biography titled *Havells: The Untold Story* highlights some fascinating anecdotes. Here's an excellent excerpt, narrated by Anil Rai Gupta (ARG), son of QRG, and current Managing Director of Havells: "*Most of the dealers were not well educated. Banks would not fund them as these weren't typical businesses. As the dealers were business oriented, they did not think of saving for their future. Whatever money came in, they ploughed it back into their businesses. In most cases, it was a one-man army. So, Havells started looking at these businesses differently—if it were me instead of him, what would I have done? And that was when we did many things for them. For instance, we organized funding for them from the banks and acted as guarantors for them. We offered them health insurance worth INR 500,000 by asking them to pay a token amount of INR 1, because my father believed that nothing should be given away free. So, those guys who owned small shops earlier grew with the company and now own large, palatial houses. My father said that if they grew, we would also grow. We put a lot at stake so that our dealers stood by us in good and bad times. These things built emotional associations with them. This was a key differentiator. No other competitor had done this in the market, and these dealers never left us.*"

During its expansionary stage in the 2000s, Havells invested as much as ~60%-70% of its profits into marketing, to create a high-recall brand despite being in a commoditized industry. Today, their Advertising & Promotions spend is ~3-4% of revenues. Havells typically never used superstar celebrities for marketing, thereby deviating from the norm. Instead, their emphasis was always on the product, often creatively bringing out India-focused stories. One advertisement with a catchline "Fans, forever" employing a yesteryear actor for the fans' division of Havells, was a play on the number of followers that actor had had during his acting career. Another ad depicted a mother cooking *rotis* (Indian flat bread) for her son on an open fire, but struggling to take them out, given the fire was scalding her skin. Her young son quickly improvises a piece of Havells wire into make-shift tongs, lending credence to the catchline "Wires that never catch fire". These ads have continued to express and impress through time. A recent innovative Havells campaign brings attention to the "fifth wall in every room – the ceiling", and how one should "decorate it with Havells Designer Fans". Havells had decided to benchmark its branding activities with those of other FMCG (C for Consumer) majors rather than FMEG peers, particularly in terms of their advertising spend. This was a highly unconventional approach, as no other player before Havells had ever invested in advertising aimed directly at the end consumer for such products.

Over the period, Havells has moved from being a predominantly industrial brand to now a consumer brand. Despite Havells being well-known in the mass-premium category, it is not a marketing or branding company. At the core of the company's business strategy are its innovative and differentiated products, created using advanced data analytics and technology to identify and fill gaps. For instance, Havells sells fans that one could call an IoT (Internet of Things) product. In addition to being compatible with voice-enabled devices like Alexa, Google Home and mobile apps, these fans also sense temperature and humidity in the room and can adjust the fan speed accordingly. Some fans also include an in-built air purifier. Per estimates, the IoT market is expected to grow to $9.28 billion by 2025 from $4.98 billion in 2020, driven by higher internet penetration and a rise in the adoption of smart applications. Havells' drinking water-purifiers do not just treat the water through Reverse Osmosis (which is common) but also alkalizes the water - adding to the health benefits. The company's recent wall switches are 'gesture' sensitive. Their water-heaters require low power and keep water warm for as long as 24 hours (unheard of, otherwise). Their "Silencio" mixer-grinders reduce perceptible noise by 50%. All this innovation and more comes from a lot of R&D, the latter more than doubling, from 0.5% of sales in FY15 to 1.1% in FY20. Havells expects this to touch 2% in the coming years and has 10 R&D centers and an innovation hub with ~400 engineers.

Local manufacturing in India is a huge opportunity for the country, and by extension to firms like Havells. The govt. is providing incentives (PLI or Production Linked Incentives) for companies that play a big role in supporting 'Make in India'. Manufacturing in the country helps Havells control technology and costs, and reduces dependence on external vendors. It has continuously invested in building in-house capacities, now accounting for over 90% of its production, unlike its FMEG peers that rely heavily on outsourcing or assembling parts. In the last five years, the company has spent ~USD 200 mn on capacity expansion, which is ~ 12% of annual revenues. Special attention is given to digitizing its factories. One advanced robotic manufacturing plant in Ghiloth, Rajasthan is already functional. The company plans to digitize all of its 14 manufacturing plants across the country. Havells uses the French company Dassault Systems' MES (Manufacturing Execution System) solution for this. It provides real-time visibility of data to executives, enabling better decision-making and eliminating non-value-added activities. This has enabled Havells to reduce rework by 50%, thereby increasing productivity significantly.

In 2017, Havells acquired Lloyd's consumer durables business for ~USD 150 mn, which made the company a challenger brand in the segment. The erstwhile Lloyd's was more of a mass-economy brand with stronger operations in tier-2 and -3 towns, ~10,000 display-points and 600+ service centers across India. Most of its sales were handled by a few large dealers who sold products in volume at huge discounts. For this reason, Lloyd was perceived more as a discount player than a brand commanding any pricing power. Contrary to the parent's focus on in-house manufacturing (~90% in FMEG), Lloyd was heavily dependent on imports from China (~80%) at the time of its acquisition and, thereby exposed to currency fluctuations and customs duties. But ARG was clear about what Havells needed to do with Lloyd's, and since the acquisition, it has now been turned into a mass premium brand, reduced reliance on Chinese imports, reduced dependency on the room AC category (from 95% to 65%), and targeted the right consumers through its distribution channels.

The acquisition has given Havells access to the ~USD 10 bn white goods and electronics industry, which is expected to grow at ~12-15% CAGR over the medium term. Lloyd itself too has been expanding, moving from room ACs and LED TVs to washing machines and refrigerators in the last couple of years. Here's how some of the key categories for Lloyd are estimated to grow: a) washing machines, by ~9% CAGR from ~USD 1.1 bn in FY19 CAGR to ~USD 1.9 bn in FY25, b) refrigerators by ~10% CAGR to ~USD 4.2 bn in the same period, c) Room Air Conditioners by ~15% CAGR to ~USD 4.6 bn, and d) Color TVs by ~11% CAGR to ~USD 5.6 bn. Despite such rates of growth, one would note that the market sizes aren't that big. Why is this? Because of the level of under-penetration in India. Being a developing nation, many appliances and gadgets are only just making their way into the homes of the country's citizens. For example, only ~5% of homes in India have ACs. And this is just one AC per house, not even one per room! Washing machine penetration is ~12%, refrigerator is ~33%, while color TV is a more respectable ~65% (these aren't necessarily fancy flat screen TVs, but even old school color TVs get counted, so there much room on the upside).

We like Havells for its leadership position in FMEG and have owned the stock for 10 years now. Among peers, the company posts the highest margins in many product categories and generates healthy FCF despite high capex (due to in-house manufacturing as discussed above). Havells has seen ~18% CAGR in revenue, ~16% CAGR in EBITDA and ~17% CAGR in PAT over the last 5 years, driven by strong performance in Electrical Consumer Durables and Lloyd segments. As you know by reading many of our *Access India Equity Insights* notes by now, such quality companies do not come cheap. Havells trades at ~45x 1-year forward earnings, which in our view is a fairly incongruous metric, given our long-term investment horizon, assuming the company continues to grow strongly with a high ROCE and FCF generation.

As always, there are risks. Volatility in raw material prices and foreign currency could impact operating margins. A slowdown in government spending on infrastructure and private capex could also dampen growth prospects. The company operates in a highly competitive industry, with potential for irrational pricing behavior. From our perspective however, Havells leadership position, strong brand equity, and vast distribution network make it less susceptible to these risks. The garden of opportunity is huge. Execution is key, and we leave that in the goods hands of India's far-sighted entrepreneurs.

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Data sources: publicly available media articles, sector reports.

Prior Editions of Access India Equity Insights:

1. Building with APLomb – Feb 2023 (link)
2. cARPU diem – Jan 2023 (link)
3. All's Well That Trends Well – Nov 2022 (link)
4. 'Foods' for Thought – Oct 2022 (link)
5. EV Wonder – Sep 2022 (link)
6. Forest or Trees – Aug 2022 (link)

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Asia Pacific & Europe	Middle East & Africa	Middle East & Israel	Americas
Nikhil Iyer	Chandrashekhar Kekane	Mithun Shrinivas	Mahesh Ramasubramanian
nikhil.iyer@ask-capital.com	ckekane@ askinvestmentmanagers.com	mithun.shrinivas@ askinvestmentmanagers.com	mahesh.r@ask-capital.com

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