**Phoenix lamps – rising up from the ashes ?**

**CMP – INR 115**

Having learnt from both Warren Buffet and Phil Fisher, I have developed my own unique style of stock analysis – that involves about 40-50% of analysis on the ground (which a lot of analysts miss out on) the rest in desk research- reading AR’s, analysing numbers etc. I would like to call this the Holmesian way of analysing stocks - unlike conventional analysis that relies heavily on secondary research, this creates a double loop mechanism that feeds into the other engine and helps validate or reject the thesis. This has often proven to be quite an advantage in micro caps where often “what you see is not what you get in the numbers” and vice versa.

Said all of this, it is seldom that I come across a stock that is a purists value investor’s delight which offers a triple play of reversion to mean, de-merger/spin-off optionality and pure and simple undervaluation. I must thank my friend, Gokul raj who introduce me to this stock and also shared his note with me from which I have generously borrowed.

**Company background – phoenix lamps – left for the dead, about to fly higher**

The company is Phoenix lamps and is a small/micro cap with a Market cap of INR 3,250 MM with no analyst following (don’t I just love these) and of course low liquidity and institutional interest.

The company, which was majority owned by Actis was a classic study in “di-worsefication”. A near monopoly business in automotive head lamps/tail lamps gone terribly awry through a diversification into CFL’s which is cut throat, high intensity, B2C, branding heavy business. A decade later and the mistake corrected through a slump sale of the loss making CFL business, look at the ratios and you will be impressed. High RoE, high ROCE, FCF positive business with high asset turns (11 x FA turns) with a 20 % + EBITDA margin with ROCE of 30 % +. It’s got near FMCG characteristics given the standard nature (My friend at bosch says the key to a higher margin business in auto is a. high standardisation b. high value to weight/volume c. OEM + after market possibilities and that’s why bosch is always in things like ABS, wipers, air bags which are critical parts and fairly standard. The only exception are high finesse items which involve a lot of high end labour like machining and critical engine parts.

I looked at the company in the past and the only reason why I let it slip was the lack of alignment between shareholders and management – the existing shareholder actis wanted to sell, the management guys were all professionals who had no clue about shareholder value.

Recently the company got bought over by suprajit engineering and this got me delving deeper again.

**Triple play – great, proven capital allocator at the helm + improving business prospects + re-rating possibilities**

Let’s get the easy one out of the way –actis has been stuck in the company for 9 years and started selling down their shares (from 70 % to 60 % ) and this has resulted in the share price going down from Rs. 180 to Rs. 100 over six months with no change in fundamentals. That’s gone and a simple reversion to mean should take this at least 50 % up.

The business is the largest and one of the top 3 (Philips, osram) in the automotive OEM. It’s the largest with 55 % market share in cars/PVs, 60 % + in CVs and 80 % in two wheeler OEMs. Had lights are a small value but critical item where there can be no downside – since that entails warranty claims and OEM’s prefer to play safe with an indian manufacturer. Inspite of all the mega issues involving loss of focus, it is to phoenix’s credit that it continues to be a leading player – the threat of Chinese exists in aftermarket but not at OEM level (double verified) because of quality/warranty issues.

Given the research I have done by talking to a dealer/distributor, this can be a 15 % growth in the aftermarket and a 7-8 % in OEMs, going forward.

Suprajit is well known to value investors in the indian market. I have personally interacted with ajit rai and I think he is an outsider CEO – buys cheap and is an exceptional operator with a focus on bottomline and cash flows. He has been looking at acquisitions for long and finally bought one which in his own words was a company that manufactures :

* Scalable, global standardized product
* With a market leadership position in indian market
* With export possibilities
* Complementary to his core business of two wheeler cables
* High margins and strong cash flows with minimal debt

Given what he has done with suprajit – have a look at ROIC of 30 % consistently and his own salary/remuneration etc. and I am sure that he will do a good job of at least maintaining status quo – which by itself should lead to a re-rating

**Scuttle butt and research**

Spoke to a couple of distributors and a friend at Philips ;

Philips guys’ inputs – already exited this market by selling their entire global lighting division. Used to be focussed on auto market but has slowly exited – still sells high margin products in after market but for all practical purposes has stopped supplying to OEMs because of pricing pressures – they exited this business as they were manufacturing in high cost locations and they want to concentrate on high margin medical business

<http://www.bloomberg.com/news/articles/2015-03-31/philips-to-gain-2-8-billion-from-sale-of-lighting-unit-stake>

**Distributors :**

Phoenix brand is well known in north but not so in south/west

Quality is still the best – very few customers come back for returns

Supplies white labels to even brands like bosch and has a good reputation for quality

Last 3-4 years have been playing hot, playing cold – not enough attention in the market

**Valuation :**

I am attaching an excel sheet from the screener template and you will find that both EBITDA, asset turns and RoCE are increasing and last year’s dividend yield was a whopping 11 %- expect this year’s to be at least 4- 5 %. (that’s a 5 % off on an already discounted price for suprajit). It’s trading a 8 x FY 15 and at about 1.8 x PB with an RoE of 30 % translating into a shareholder’s RoE of about 16-17 % - I look for fat pitches with a minority shareholders’ RoE of 10 % (viz., ROE divided by P/B) and that’s a fat pitch IMHO.

Just mere re-rating to 12-15x with an EPS growth of 15 % which is doable can lead to a 3-4 x over a few years and of course if this gets merged into suprajit (which by all means it should), it should be a fairy tale ending similar to sun/Ranbaxy.

This has characteristics similar to companies like Bosch (definitely a notch inferior) on EBITDA margins etc. – not for nothing does Bosch think highly of this company.

I also expect modest synergies from cross selling to suprajit’s clients.

The fly in the ointment is the acquisitions they made in Europe which had a zero profit – they apparently repackage the bulbs manufactured here and brand them and sell them in Europe – which IMHO, is a so-so business unless suprajit can turn this around. I expect zero contribution from this going forward and I would be pleased if there is no good money to be thrown after bad.

LED’s are a risk but from my talks with several industry experts given the :

* Price differential
* Harsh indian conditions of frequent hits which lead to replacement of expensive bulbs
* Wear and tear and rattling that result in LED life getting shortened

LED’s are not a threat at elast in the low end cars/CVs/ two wheelers for a long time to come. Even otherwise, LED’s are only a supplement and cannot replace head lamps – most have only day time running lights that are LED’s. Only Rs. 20 lakh plus cars have xenons and LEDs’ and that will take some time to percolate down given the huge costs and maintenance issues.

I see this as a high RoE business in a slow growth industry (similar to Duracell purchase of warren buffet) which can maximize FCFs and grow at a steady pace of 10-15 % easily without any incremental capital and provide for a dividend yield of 3 – 4 % with a PE re-rating upside.