Angel Broking
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May 27, 2016

HSIL

Company Update

Y/E March (₹ cr)	4QFY16	4QFY15	% chg (yoy)	3QFY16	% chg (qoq)
Net sales	596	559	6.6	506	17.7
EBITDA	99	106	(6.3)	95	4.0
EBITDA margin (%)	16.6	18.9	(230)bp	18.8	(220)bp
Adjusted PAT	38	40	(4.3)	37	3.1

Source: Company, Angel Research

HSIL's reported standalone numbers for 4QFY2016 have come in mostly in-line with our estimates. The top-line grew by 6.6% yoy to ₹596cr. The raw material cost declined by 77bp yoy to 39.9% of sales while employee and other expenses increased by 139bp yoy and 168bp yoy to 11.1% and 32.4% of sales, respectively. As a result, the EBITDA margin declined by 230bp yoy to 16.6%. Interest cost was lower by 49.9% yoy while tax rate was higher at 38.5% vs 30.8% in 4QFY2015. Consequently, the bottom-line de-grew by 4.3% yoy to ₹38cr.

Building products' performance under pressure; but long term prospects intact: The quarterly numbers for the core Building products division were under pressure reflecting overall sluggishness in the new construction market. However, the Faucets division continued its strong performance which will likely drive the revenue growth in the near term. On the profitability front, the company has made incremental investments in setting up its sales channel for the Consumer products division and increased its advertisement spend by roping in some Bollywood celebrities to endorse products, coupled with initial losses in the consumer products business which impacted segmental margins during the quarter. However, the Management has indicated that excluding the cost for development of sales channel, the EBIT margin for the core business is stable. We believe that the margin for the segment should improve gradually once the Consumer products division's sales pick up. In the longer run, we expect HSIL to leverage on its strong position/brand in the sanitaryware industry to capitalize on improvement in the real-estate sector.

Packaging products' profitability improves: Although the segment has posted muted growth numbers on the top-line front, the profitability of the segment has improved on account of a better product mix in terms of revenue composition, better cost management, and due to decline in fuel prices. Going forward, the Management has acknowledged the threat of further prohibition on liquor by state governments but expects the damage to be somewhat offset by rising beer consumption.

Outlook and valuation: We has revised downwards our estimates for FY2017 for both Building and Packaging products segments but expect FY2018E to be better on account of contribution from newer businesses as well as pick up in volumes. Further, favorable pricing for the core Building products business should also aid the company in delivering better numbers.

At the current market price, the stock trades at 15.0x its FY2018E earnings. **We have an Accumulate rating on the stock with a target price of ₹310.**

Key Financials (Consolidated)

Y/E March	Sales (₹ cr)	OPM (%)	PAT (₹ cr)	EPS (₹)	ROE (%)	PE (x)	PBV (x)	EV/EBITDA (x)	EV/sales (x)
FY2016	2,056	15.3	89	12.3	6.6	23.5	1.5	7.2	1.3
FY2017E	2,223	15.8	111	15.3	7.8	18.9	1.4	6.5	1.3
FY2018E	2,515	16.3	140	19.4	9.3	15.0	1.4	5.5	1.1

Source: Company, Angel Research; Note: CMP as of May 26, 2016

ACCUMULATE

CMP	₹290
Target Price	₹310
Investment Period	12 Months

Stock Info	
Sector	Ceramic Products
Market Cap (₹ cr)	2,095
Net Debt	596
Beta	0.8
52 Week High / Low	370 / 224
Avg. Daily Volume	18,724
Face Value (₹)	2
BSE Sensex	26,367
Nifty	8,070
Reuters Code	HSNT.BO
Bloomberg Code	HSI.IN

Shareholding Pattern (%)	
Promoters	47.1
MF / Banks / Indian Fls	26.4
FII / NRIs / OCBs	12.0
Indian Public / Others	14.4

Abs.(%)	3m	1yr	3yr
Sensex	13.9	(4.2)	31.6
HSIL	25.3	(21.5)	166.6

3 Year Daily price chart

Source: Company, Angel Research

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Exhibit 1: 4QFY2016 performance (Standalone)

Y/E March (₹ cr)	4QFY16	4QFY15	% chg (yoy)	3QFY16	% chg (qoq)	1HFY16	1HFY15	% chg
Net Sales	**596**	**559**	*6.6*	**506**	*17.7*	**842**	**836**	*0.7*
Net raw material	238	227	*4.6*	181	*31.3*	277	283	*(2.0)*
(% of Sales)	*39.9*	*40.7*	*(77)bp*	*35.8*	*411bp*	*32.9*	*33.8*	*(92)bp*
Staff Costs	66	54	*21.9*	61	*9.1*	107	91	*18.6*
(% of Sales)	*11.1*	*9.7*	*139bp*	*12.0*	*(88)bp*	*12.8*	*10.8*	*192bp*
Other Expenses	193	172	*12.5*	169	*14.1*	318	322	*(1.0)*
(% of Sales)	*32.4*	*30.7*	*168bp*	*33.4*	*(104)bp*	*37.8*	*38.5*	*(68)bp*
Total Expenditure	**497**	**453**	*9.6*	**411**	*20.9*	**703**	**695**	*1.1*
Operating Profit	**99**	**106**	*(6.3)*	**95**	*4.0*	**140**	**141**	*(1.1)*
OPM (%)	*16.6*	*18.9*	*(230)bp*	*18.8*	*(220)bp*	*16.6*	*16.9*	*(32)bp*
Interest	9	18	*(49.9)*	10	*(6.4)*	20	36	*(45.5)*
Depreciation	29	31	*(6.6)*	29	*0.5*	57	57	*1.1*
Other Income	1	1	*32.7*	1	*(12.7)*	2	2	*2.6*
PBT	**62**	**58**	*7.8*	**58**	*7.3*	**65**	**51**	*27.9*
(% of Sales)	*10.4*	*10.3*		*11.4*		*7.7*	*6.1*	
Tax	24	17.7	*34.9*	21	*14.7*	24	17	*39.1*
(% of PBT)	*38.5*	*30.8*		*36.1*		*36.1*	*33.2*	
Reported PAT	**38**	**40**	*(4.3)*	**37**	*3.1*	**42**	**34**	*22.4*
PATM	*6.4*	*7.1*	*245bp*	*7.3*		*4.9*	*4.1*	*245bp*

Source: Company, Angel Research

Exhibit 2: Actual vs. Angel estimates (4QFY2016)

	Actual (₹ cr)	Estimate (₹ cr)	Var (%)
Total Income	**596**	**581**	**2.6**
EBIDTA	99	96	**3.2**
EBIDTA margin (%)	*16.6*	*16.6*	*8bp*
Adjusted PAT	**38**	**37**	**3.1**

Source: Company, Angel Research

HSIL's numbers for 4QFY2016 have come in in-line with our estimates. Its standalone top-line for the quarter grew by 6.6% yoy to ₹596cr (vs our estimate of ₹581cr). The Building products segment grew by 9.0% yoy to ₹314cr while the Packaging products segment grew by 4.1% yoy to ₹282cr.

The raw material cost was stable during the quarter; however employee and other expenses grew by 139bp yoy and 168bp yoy to 11.1% and 32.4% of sales, respectively. This could be attributed to higher costs related to setting up a channel for the Consumer products division and due to higher advertisement spend. As a result, the EBITDA margin contracted by 230bp yoy to 16.6%, which is the same as our estimate. The EBIT margin for the Building products segment declined by 530bp yoy to 13.2% while that of the Packaging products business increased by 265bp yoy to 15.1%.

Owing to lower debt on the balance sheet, the interest expense for the quarter declined by 49.9% yoy to ₹9cr but the tax rate was higher at 38.5% vs 30.8% in 4QFY2015. With the operating performance coming under pressure, the net profit declined by 4.3% yoy to ₹38cr vis-à-vis our estimate of ₹37cr.

Segmental Performance

Exhibit 3: Segmental Review (Standalone)

Y/E Mar (₹ cr)	4QFY16	4QFY15	% chg (yoy)	3QFY16	% chg (qoq)
Revenue					
A) Building Products	314	288	9.0	268	17.4
B) Packaging Products	282	270	4.1	239	18.1
Total	596	559	6.6	506	17.7
EBIT					
A) Building Products	41.4	53.2	(22.3)	43.3	(4.4)
B) Packaging Products	42.5	33.6	26.3	35.3	20.3
EBIT Margin(%)					
A) Building Products	13.2	18.5	(530)bp	16.2	(300)bp
B) Packaging Products	15.1	12.4	265bp	14.8	28bp

Source: Company, Angel Research

Conference call takeaways

- For FY2016, the sanitaryware business grew by ~7% and accounted for 65% of the Building products business' revenue. Demand is likely to remain muted in the near term. The company is likely to raise capacity from 3.8mn pieces to 4.2mn pieces by FY2017E. Utilization levels stood at ~91% for FY2016.
- The Faucet division posted robust growth of ~22% for FY2016 and accounted for 24% of Building products segment's revenue. The capacity utilization was at ~65%.
- Building products' margins were under pressure on account of higher ad spend and expenses related to setting up of a channel for the Consumer products business. Core business EBIT margins were stable.
- The Consumer products business' revenue for the year was at ₹60cr vs ₹25cr in FY2016. For 4QFY2016, the revenue from Consumer products was ₹13.5cr and it contributed a loss of ₹9cr towards the total EBIT for Building products.
- All capital expenditure related to the Pipes business is expected to be capitalized in FY2017.
- The Packaging products business is likely to be under pressure. The company will monitor developments to determine the status of the fourth furnace. The capacity utilization on basis of three furnaces stood at 95%.
- The company's Retail business continues to be a drag on profitability. The company is taking measures to curb costs and is selectively closing down loss-making stores. The Management remains hopeful about the long term prospects of the business.

Investment arguments

Enhanced capacity to pay-off once demand scenario improves

HSIL's Management has guided that it will be increasing its capacity for the sanitaryware business from the existing 3.8mn pieces to 4.2mn pieces/year. This was due to be augmented in FY2016 but in light of dampened new construction market, the expansion was deferred as per our reckoning. The Faucet division is performing well and the company will look to gear the utilization levels at its faucet plant where work was previously being outsourced. Although in the near term, the sanitaryware business is expected to remain under mild pressure as top cities are facing high inventory levels, the company has been making inroads into Tier II & III towns to drive volumes. We expect volumes to flow in once the demand scenario improves.

Packaging Products profitability improves, volumes to remain lackluster

The poor performing Packaging products business had been a drag on the overall performance of the company in the past. This was on account of low demand, over capacity in the industry and rising fuel & raw materials costs. Improvement in market conditions which resulted in better realizations along with measures taken by the company such as substituting high cost furnace oil with alternate fuel, renegotiation of terms with vendors for raw material sourcing, and new product introductions amongst others, have resulted in improvement in profitability of the business. Going forward, the volumes for the division are expected to remain under pressure on account of various state governments mulling over banning liquor sales. However, the Management has mentioned that it will look to drive volumes from the beer segment on account of its growing popularity.

Leading position in Building products industry with strong brand recall to provide an edge

HSIL holds a leading position in the sanitaryware industry (organized segment). Of the total revenue, ~85% is accounted by the dealer distribution network (amongst the largest in the industry) while 15% is contributed by institutional sales to large builders, commercial space developers, hospitals, and hotels. The company has a wide product offering catering to various price points in the sanitaryware, faucets and in other product lines. The company has been aggressive in promoting its brand and has roped in some Bollywood celebrities to push sales.

New businesses to add to Consumer products revenues

The Consumer products business of the company has been entailing investment in terms of setting up separate sales vertical. The company has launched consumer electrical products like water and air purifiers, water heaters, etc in the recent past and expects them to garner a share of ~5% share in the ~₹10,000cr market. The company is focusing on the premium segment which garner gross margins of ~35%.

Financials

Exhibit 4: Key assumptions (Consolidated)

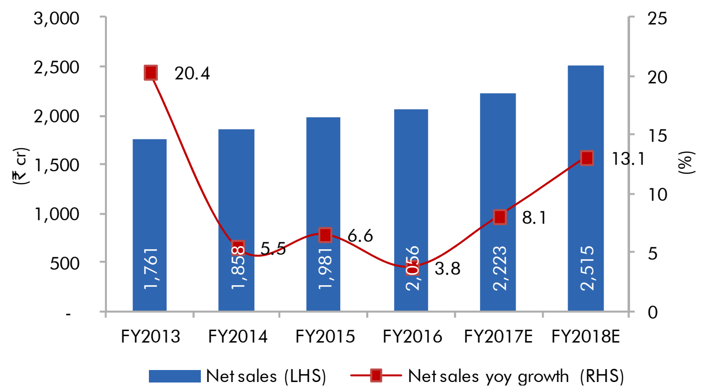
Key Assumptions	FY2017E	FY2018E
Building Products Sales (₹ cr)	1,179	1,418
Yoy Growth	*14.0*	*20.3*
Packaging Products Sales (₹ cr)	933	975
Yoy Growth	*2.6*	*4.5*

Source: Company, Angel Research

Top-line to post 10.6% CAGR over FY2016-FY2018E

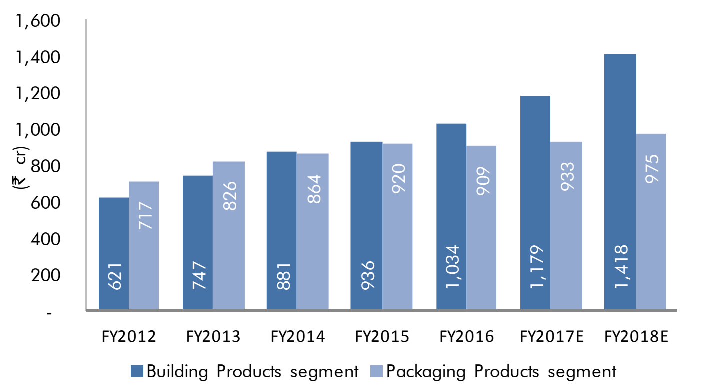
We expect the Building products business to grow at 14.0% in FY2017E on account of continued performance of the Faucet business and slightly higher contribution from the Consumer electrical products business. As the Management has guided that the Pipes business will be capitalized in FY2017E, we expect some contribution from it towards the Building products segment revenue in FY2018E. The Packaging products business is expected to post nominal growth over FY2016-18E. As a result, we expect the top-line to post a revenue CAGR of 10.6% over FY2016-18E to ₹2,515cr.

Exhibit 5: Sales growth to rebound



Source: Company, Angel Research

Exhibit 6: Segmental sales trend

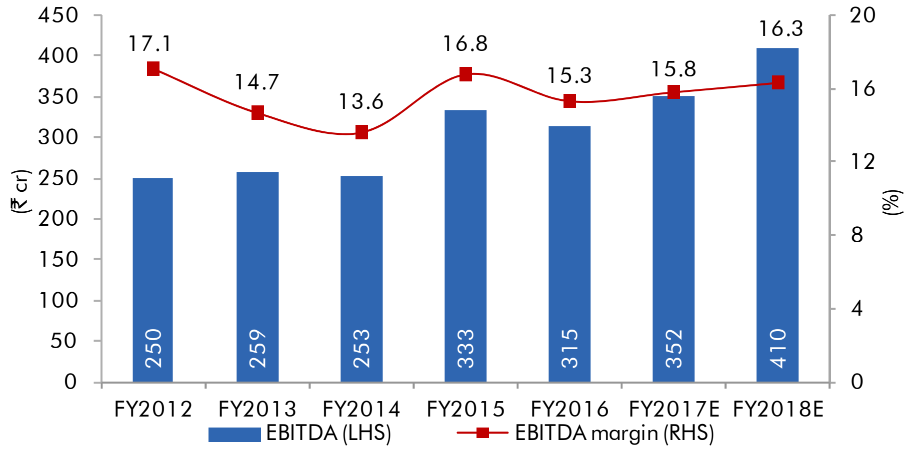


Source: Company, Angel Research

EBITDA to post CAGR of 14.1% over FY2016-18E

As the Management has incurred higher expenses in FY2016 towards development of sales channel for the Consumer products business and advertisement, coupled with losses in initial phase for the Consumer business, the EBITDA margin has contracted by 146bp yoy to 15.3%. With the Consumer division gaining traction, we expect the margins to improve from here on.

Exhibit 7: EBIDTA margin trend

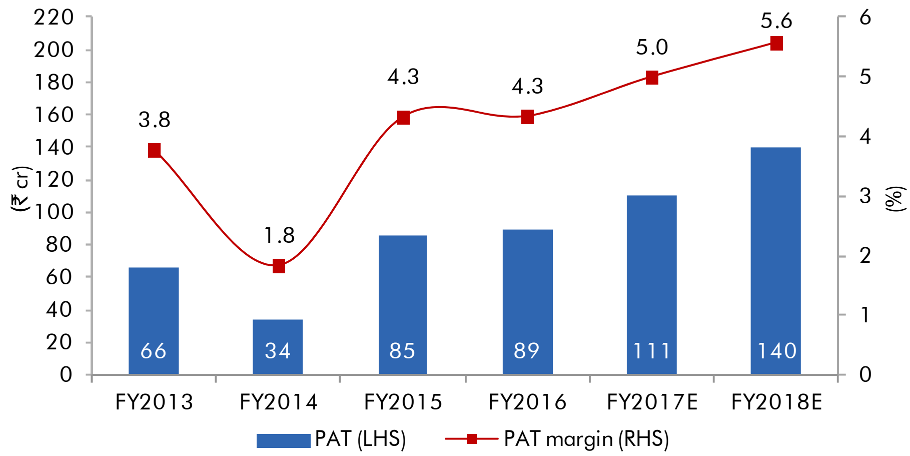


Source: Company, Angel Research

Net profit to post a 25.4% CAGR over FY2016-18E

Depreciation expense is expected to increase FY2017E onwards as the Pipes business capex will get capitalized in FY2017E. Also on account of higher losses in the subsidiary, the consolidated tax rate is higher in FY2016. We expect the tax rate to retract to 35% on the subsidiary trimming its losses. As a result, we expect the bottom-line to post a CAGR 25.4% over FY2016-18E to ₹140cr.

Exhibit 8: Lower interest cost to lead PAT northwards



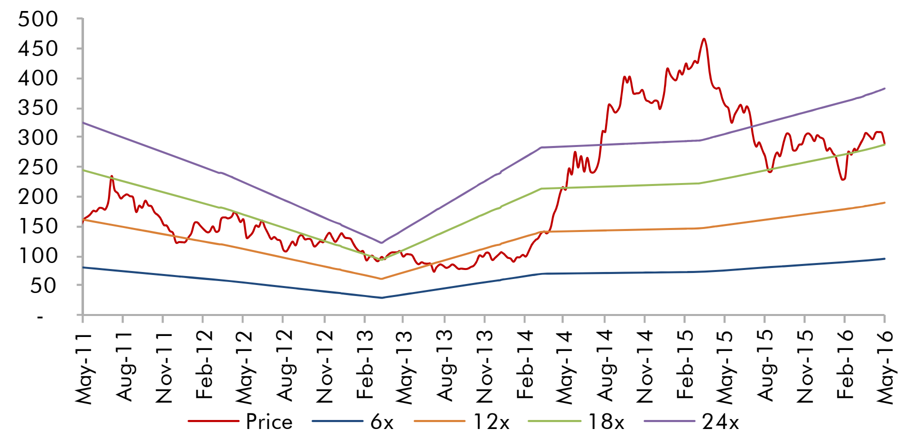
Source: Company, Angel Research

Outlook and Valuation

We has revised downwards our estimates for FY2017 for both Building and Packaging products segments but expect FY2018E to be better on account of contribution from newer businesses as well as pick up in volumes. Further, favorable pricing for the core Building products business should also aid the company in delivering better numbers.

At the current market price, the stock trades at 15.0x its FY2018E earnings. We have an Accumulate rating on the stock with a target price of ₹310.

Exhibit 9: One-year forward PE band



Source: Company, Angel Research,

Risk factors

- Unorganized sanitaryware manufacturers pose a threat since they enjoy the benefit of nil excise duty and sales tax. Hence, their products are ~70% cheaper than the organized sector's products. The increase in excise duty from 8% to 12% has made products from organized players more expensive.
- Low-cost imports from China.
- Any drastic change in government policy related to housing construction and imports among others is bound to impact the industry.
- Raw material cost- Any increase in the price of brass, the main raw material for faucets, may dent the company's EBITDA margin. Rise in the cost of raw materials such as soda ash could dent operational margins.
- Continued slowdown in the housing segment will cease growth, as in India the major demand for sanitaryware is fresh demand.
- External Commercial Borrowings (ECBs) formed a significant portion of total borrowing of the company. Weakness in INR against the USD owing to global macro economic slowdown and imminent interest rate hike in the US will impact the performance of the company and work against our estimates.

Profit and Loss (Consolidated)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Total operating income	1,858	1,981	2,056	2,223	2,515
% chg	*5.5*	*6.6*	*3.8*	*8.1*	*13.1*
Net Raw Materials	648	732	763	829	922
% chg	*19.3*	*13.0*	*4.3*	*8.7*	*11.3*
Power and Fuel	377	280	231	253	289
% chg	*(6.6)*	*(25.7)*	*(17.5)*	*9.6*	*14.1*
Personnel	188	216	251	271	307
% chg	*3.4*	*14.6*	*16.2*	*8.1*	*13.1*
Other	392	421	496	518	586
% chg	*4.8*	*7.3*	*18.0*	*4.4*	*13.1*
Total Expenditure	1,605	1,648	1,741	1,871	2,104
EBITDA	253	333	315	352	410
% chg	*(2.1)*	*31.3*	*(5.2)*	*11.6*	*16.8*
(% of Net Sales)	*13.6*	*16.8*	*15.3*	*15.8*	*16.3*
Depreciation& Amortisation	110	125	120	127	145
EBIT	143	207	195	225	266
% chg	*(13.5)*	*44.9*	*(6.0)*	*15.4*	*18.2*
(% of Net Sales)	*7.7*	*10.5*	*9.5*	*10.1*	*10.6*
Interest & other Charges	72	78	41	49	56
Other Income	4	4	4	3	5
(% of Net Sales)	*0.2*	*0.2*	*0.2*	*0.1*	*0.2*
Recurring PBT	71	130	154	176	210
% chg	*(25.7)*	*82.0*	*18.3*	*14.4*	*19.5*
PBT (reported)	75	134	157	179	215
Tax	41	48	68	68	75
(% of PBT)	*54.8*	*36.0*	*43.4*	*38.0*	*35.0*
PAT (reported)	34	85	89	111	140
Extraordinary Expense/(Inc.)	0	0	0	0	0
ADJ. PAT	34	85	89	111	140
% chg	*(48.8)*	*151.5*	*4.2*	*24.5*	*26.2*
(% of Net Sales)	*1.8*	*4.3*	*4.3*	*5.0*	*5.6*
Basic EPS (₹)	5.1	11.8	12.3	15.3	19.4
Fully Diluted EPS (₹)	5.1	11.8	12.3	15.3	19.4
% chg	*(48.8)*	*129.7*	*4.2*	*24.5*	*26.2*

Balance Sheet (Consolidated)

Y/E March (₹ cr)	FY2014	FY2015	FY2016E	FY2017E	FY2018E
SOURCES OF FUNDS					
Equity Share Capital	13	14	14	14	14
Reserves& Surplus	1,015	1,308	1,363	1,440	1,536
Shareholders' Funds	1,028	1,323	1,378	1,454	1,551
Total Loans	1,133	786	627	756	767
Other Long Term Liabilities	15	18	20	20	20
Long Term Provisions	5	5	9	9	9
Deferred Tax (Net)	115	105	101	101	101
Total Liabilities	2,297	2,237	2,135	2,340	2,447
APPLICATION OF FUNDS					
Gross Block	2,018	2,211	2,266	2,449	2,622
Less: Acc. Depreciation	537	654	774	901	1,045
Net Block	1,481	1,557	1,492	1,549	1,577
Capital Work-in-Progress	119	34	57	100	50
Goodwill	38	31	27	23	19
Investments	11	11	11	11	11
Long Term Loans and adv.	55	32	45	49	55
Other Non-current asset	2	1	0	1	1
Current Assets	968	965	950	1,045	1,225
Cash	60	25	20	33	89
Loans & Advances	42	50	49	53	59
Inventory	444	474	490	522	584
Debtors	419	414	390	435	492
Other current assets	2	2	2	2	2
Current liabilities	377	394	447	436	490
Net Current Assets	590	571	503	609	735
Misc. Exp. not written off	-	-	-	-	-
Total Assets	2,297	2,237	2,135	2,340	2,447

Cash flow statement (Consolidated)

Y/E March (₹ cr)	FY2014	FY2015	FY2016E	FY2017E	FY2018E
Profit before tax	75	134	157	179	215
Depreciation	110	125	120	127	145
Change in Working Capital	(52)	(16)	62	(92)	(71)
Direct taxes paid	(41)	(48)	(68)	(68)	(75)
Others	(4)	(4)	(4)	(3)	(5)
Cash Flow from Operations	**88**	**191**	**268**	**142**	**208**
(Inc.)/Dec. in Fixed Assets	(171)	(100)	(74)	(223)	(119)
(Inc.)/Dec. in Investments	(0)	(0)	0	-	-
(Incr)/Decr In LT loans & adv.	(1)	23	(12)	(4)	(6)
Others	4	4	4	3	5
Cash Flow from Investing	**(169)**	**(73)**	**(82)**	**(223)**	**(120)**
Issue of Equity	-	1	-	-	-
Inc./(Dec.) in loans	99	(345)	(151)	129	11
Dividend Paid (Incl. Tax)	(23)	(30)	(35)	(35)	(43)
Others	(17)	221	(5)	-	-
Cash Flow from Financing	**59**	**(153)**	**(191)**	**95**	**(33)**
Inc./(Dec.) in Cash	(22)	(35)	(5)	14	55
Opening Cash balances	**82**	**60**	**25**	**20**	**33**
Closing Cash balances	**60**	**25**	**20**	**33**	**89**

Key ratios (Consolidated)

Y/E March	FY2014	FY2015	FY2016E	FY2017E	FY2018E
Valuation Ratio (x)					
P/E (on FDEPS)	61.7	24.5	23.5	18.9	15.0
P/CEPS	14.5	10.0	10.0	8.8	7.4
P/BV	2.0	1.6	1.5	1.4	1.4
EV/Net sales	1.7	1.4	1.3	1.3	1.1
EV/EBITDA	9.0	6.8	7.2	6.5	5.5
EV / Total Assets	1.4	1.3	1.3	1.2	1.1
Per Share Data (₹)					
EPS (Basic)	5.1	11.8	12.3	15.3	19.4
EPS (fully diluted)	5.1	11.8	12.3	15.3	19.4
Cash EPS	21.8	29.1	28.9	32.8	39.3
DPS	3.0	3.5	4.0	4.0	5.0
Book Value	155.7	183.0	190.6	201.1	214.5
DuPont Analysis					
EBIT margin	7.7	10.5	9.5	10.1	10.6
Tax retention ratio	0.5	0.6	0.6	0.6	0.7
Asset turnover (x)	0.9	0.9	1.0	1.1	1.1
ROIC (Post-tax)	3.2	6.3	5.3	6.7	7.8
Cost of Debt (Post Tax)	3.0	5.2	3.3	4.4	4.8
Leverage (x)	1.0	0.6	0.4	0.5	0.4
Operating ROE	3.4	7.0	6.2	7.8	9.1
Returns (%)					
ROCE (Pre-tax)	6.4	9.2	8.9	10.1	11.1
Angel ROIC (Pre-tax)	7.1	9.9	9.4	10.7	11.9
ROE	3.3	7.3	6.6	7.8	9.3
Turnover ratios (x)					
Asset TO (Gross Block)	1.0	0.9	0.9	0.9	1.0
Inventory / Net sales (days)	84	85	86	83	80
Receivables (days)	79	77	71	71	71
Payables (days)	86	85	88	85	85
WC cycle (ex-cash) (days)	99	99	91	87	89
Solvency ratios (x)					
Net debt to equity	1.0	0.6	0.4	0.5	0.4
Net debt to EBITDA	4.2	2.3	1.9	2.0	1.6
Int. Coverage (EBIT/ Int.)	2.0	2.7	4.7	4.6	4.8

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Disclosure of Interest Statement	**HSIL**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹ 1 lakh for Angel, its Group companies and Directors

Ratings (Based on expected returns over 12 months investment period):	*Buy (> 15%)*	*Accumulate (5% to 15%)* *Reduce (-5% to -15%)*	*Neutral (-5 to 5%)* *Sell (< -15)*