"HSIL Limited Q2 FY2018 Earnings Conference Call"

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Moderator: Ladies and gentlemen good day and welcome to the Q2 FY2018 Results Call of HSIL Limited hosted by Emkay Global Financial Services. We have with us today Mr. Sandeep Sikka – CFO, and Mr. Naveen Malik – Head of Corporate Finance. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask the questions at the end of today's presentation. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Amit Purohit of Emkay Global. Thank you and over to you Sir!

Amit Purohit: Good evening everyone I would like to welcome the management and thank them for giving us the opportunity. I would like now hand over the call to Mr. Sikka for his opening remarks. Over to you Sir.

Sandeep Sikka: Good evening to everybody. I think let Naveen start with the opening remarks quite of a bit.

Naveen Malik: As the start of the conference call, I would like to refer to the disclaimer from our investor presentation. Certain statements in this conference call concerning our future growth prospects are forward-looking statements within the meaning of applicable security laws and regulations and involve a number of risks and uncertainties beyond the control of the company that could cause actual results to differ materially from those appearing in such forward-looking statements.

You are requested to refer to the disclaimer from our investor presentation before acting or taking any decision on the basis of this conference call.

The results for the quarter ended September 30, 2017, have been prepared in compliance with applicable Indian accounting standard, IndAS notified by the MCA.

The financial results in respect of prior periods (including earlier published results) have been restated to give effect to Composite Scheme of Arrangement approved in May 2017. You may refer to note 3 of the results shared with stock exchange for further details.

With effect from 1st July 2017, GST has replaced Excise Duty, Service Tax, and various indirect taxes. Revenue for corresponding previous reporting periods was reported inclusive of Excise Duty whereas revenue for the quarter ended 30 September 2017 is reported net of GST. Comparative revenue of the Company would have been different if previously reported corresponding period revenue was shown net of excise duty. In this conference call, we are comparing revenue net of excise. You may refer to note 5 of results shared with stock exchange for further details.

HSIL as per the quarter ended September 30, 2017 achieved revenue of around Rs.533 Crores after adjusting for GST impact as explained in note five there is a revenue growth of 7.4%. The operating profit that is EBITDA for quarter ended September 30, 2017 is around Rs.74 Crores as compared to previous year corresponding figure of around Rs.80 Crores.

The company operates through four business segments;

In terms of segment revenue, the building product division for the quarter ended September 30, 2017 achieved revenue of around Rs.258 Crores after adjusting for GST impact there is a revenue growth of around 7%.

EBIT for the building product division for the quarter ended September 30, 2017 is around Rs.50 Crores as compared to previous year corresponding figure of around Rs.46 Crores.

Packaging product division for the quarter ended September 30, 2017 achieved revenue of around Rs.202 Crores after adjusting for GST impact there is a slight revenue de-growth of around 0.7% they almost remain flattish only.

EBIT for the packaging product division for the quarter ended September 30, 2017 is around Rs.15 Crores as compared to previous year corresponding figure of around Rs.25 Crores. There has been drop of around Rs.10 Crores in EBIT during Q2 this year due to demand slowdown post Honorable Supreme Court order with respect to liquor vends on highway and higher fuel cost as compared to corresponding quarter of previous year.

In terms of segment revenue the consumer product division for the quarter ended September 30, 2017 continued its growth and achieved revenue of around Rs.55 Crores representing growth of 93% over previous year corresponding figure.

EBIT for the consumer product division for the quarter ended September 30, 2017 is around negative Rs.4.32 Crores as compared to previous year corresponding figure of around negative Rs.5.51 Crores.

The retail division for the quarter ended September 30, 2017 achieved revenue of around Rs.25 Crores as against previous year corresponding figure of around Rs.22 Crores.

EBIT for the retail division for the quarter ended 30th September 2017 is around negative Rs.3.68 Crores as compared to previous year corresponding figure of around negative Rs.3.29 Crores.

During quarter ended September 30, 2017 there is a drop in overall EBITDA as well as respective business EBIT as compared to previous year corresponding quarter on account of factors explained earlier.

The company for the quarter ended September 30, 2017 earned a profit before tax of around Rs.35 Crores as compared to previous year corresponding figure of around Rs.44 Crores.

The PAT (profit after tax) for the quarter ended September 30, 2017 is Rs.23.5 Crores as compared to previous year corresponding figure of around 28.5 Crores.

The total net bank debt of the company as on September 30, 2017 is around Rs.879 Crores with overall loan funding cost at 5.82%.

Sandeep Sikka: I think we can take the question-and-answers, if any, required from the participants.

Moderator: Thank you very much Sir. Ladies and gentlemen we will now begin the question-and-answer session. We have our first question from the line of Aniruddha Jain from Inviquest. Please go ahead.

Aniruddha Jain: Sir my question is regarding proposed demerger. Sir any particular reason for not listing BPD and division as it clearly consist of 41% of our total revenue and making it subsidiary there will be again a hold co discount so how it will unlock shareholders value?

Sandeep Sikka: I will just give a slight background Aniruddha to this and then talk about it. Now if you see HSIL is primarily operating through four key business segments, one is the building product, second is consumer product, third is the retail and fourth is the packaging. What we had tried to do through this scheme of demerger is try to create the businesses and put them into the respective bucket in a manner that each of the businesses focus on the growth which is required for that particular business. Now if you see the number of activities which we do in the building products and the consumer products and the retail almost 80% - 90% of them are tilted towards the consumer facing businesses which is creating new designs, creating new products, branding, marketing, servicing, after sales servicing, supply chain management and etc. So the whole hypothesis and the whole rationality of doing this is now putting the right assets into the right bucket so that we can unlock the value over a period of time.

Now coming to your question why it has been put into wholly owned subsidiary. Given the fact that consumer today is a different business as compared to the building material business. If you see the success of the consumer, we had achieved 90% sales growth in last two years even for the quarter we had 93% sales growth. Over last two and a half years of working, we have been communicating regularly. Now we have around 4,000 active retail touch points in the market on the consumer side and these products have been very well established. At the same time on the building material side, we have around 20,000 plus retail touch points. So these are two separate go to market approach and, as we move forward, we expect there should not be much holding company discounts because the main company, Somany Home Innovations Ltd which will get listed, will have its own critical mass of a turnover in next two to three years. This will also facilitate raising of a growth capital at a subsidiary level, if required, for further expansion / growth in the market.

Aniruddha Jain: So any further demerger we can expect.

Sandeep Sikka: As such I can't talk about it. If something has been approved by the board then it will be communicated.

Aniruddha Jain: And the last question is can you just give some ballpark on the revenue mix say by after 2020 or something?

Sandeep Sikka: Revenue mix of.

Aniruddha Jain: PPDM division and CPDM division?

Sandeep Sikka: We generally do not give a future going projection to our guidance to the market.

Aniruddha Jain: Thank you Sir.

Moderator: Thank you. We have our next question from the line of Hardik Jain from Whitestone financial Services. Please go ahead.

Hardik Jain: Sir first question is again about the demerger we have mentioned that the marketing and the distribution will be transferred just wanted to clarify even the manufacturing plants will get transferred to the building product manufacturing plants is also get transferred or just wanted a clarification on that?

Sandeep Sikka: As I said, the residual HSIL post demerger will be core excellence of manufacturing entity. So as a part of scheme we are not moving manufacturing facilities even for the building products to the new company Brilloca, which is marketing and branding arms of the building products. Today if you see our overall mix, it is not that 100% of our goods are procured or manufactured within our own factory. We procure around 40%-45% in value of our goods from outside and this is what will happen. If we see an overall margin game, we feel that creating a distinction between the manufacturing and the branding will improve the operational efficiencies at both ends and will make Brilloca very asset light model because there will not be any manufacturing facility & it is more of a working capital. The return on capital employed and other financial will improve substantially for Brilloca.

Hardik Jain: So the debt of around 880 Crores so I suppose that most of that debt will remain in HSIL and very less amount of debt will get transfer to the company one or company two if you can clarify the amount if you can specify the amount?

Sandeep Sikka: I can broadly give you guidance. If you are talking on overall debt of 880 Crores, half of the debt around 400 Crores is a long-term debt, rest is all linked to current assets which are inventory, debtors and the current liability. Major chunk of long-term debt, because no major assets are moving as a part of the scheme, will predominantly remain in HSIL. The debt, relating to the normal working capital borrowing, will go to the respective entities. So let us say if my total inventory and the debtors together is 100 and if I am moving inventory of 60 into B company or Brilloca then that 60% proportionate will move into the B company.

Hardik Jain: 60% will go for the company two I guess?

Sandeep Sikka: No I am giving a hypothetical figure. Whatever is drawing power of the working capital banks linked to the level of inventory and debtors because the ultimate sales to the market is being done by the distribution and the marketing companies. Whatever credit they are giving to the market and whatever inventory they are holding in the market, based on that they will get the working capital usage. That will be the working capital debt which will be transferred to their end because what I was giving was the hypothetical figure.

Hardik Jain: Sir one more thing in the glass business division is it the margins and the profitability was impacted because of one was the highway ban the liquor ban and also the one reason was the fuel cost so if you can give us the in terms of volumes what was the degrowth that we have seen in terms of percentage if you can give?

Sandeep Sikka: Volume, generally, we do not give because the product mix and everything changes quarter-to-quarter but I can broadly tell you like there are three key events one was the demonetization last year, then was the Supreme Court order and then was the GST implementation. We have spoken during last call on the post results that there has been lot of destocking, which is there especially on the liquor side. If you see the results of liquor companies for the last quarter, they are slightly better as compared to the first quarter of the last year that implies restocking in the industry has started happening. Supreme Court has further clarified that the ban is restricted or it is more linked to the liquor vends on the highway so that restocking is that we feel that should come up and Q3 and Q4 should be better. If I give you figures in a more discrete manner we had a negative 14% sales growth in the quarter one and if you see the quarter two it is almost flattish so there is an improvement from Q1 year-on-year to Q2 year-on-year.

Hardik Jain: In terms of volumes I just wanted to get a feel from you that are we getting back to the normalcy?

Sandeep Sikka: I can say that we are slightly getting back to the normalcy in the month based on the performance of October and based on the current performance of November but we have to cross Q3 and to see what the overall impact is. We are positive right now that the buildup of demand is happening again in the market. Just to try to reiterate, if you see the first half of last year, we had an excellent performance on glass wherein we had achieved around 10% sales growth. Here I am talking about last financial year first half and then we had all these events which led to lot of destocking in the market. We now expect that Q3, Q4 should be the quarters where the restocking in the industry happens and the buildup of the inventory of the liquor and other pharmaceuticals and the other liquor and soft drinks should happen.

Hardik Jain: The last one more question and then I will get back onto the queue. Regarding the cost, I think the major factor would be the is the fuel cost and which is related to the gas prices if I am correct and what is the situation of passing on the cost rise to the customers are you able to pass on or you still facing some difficulty in doing that?

Sandeep Sikka: Right now no. We have been able to protect our pricing so there is no price hike as of now on the glass side but definitely there is an increase in the fuel cost which has happened on a year-on-year basis. We have to bear that cost right now because till the demand comes back you can't go and talk to the customer or there should be the huge demand. So right now given the demand situation, if the gas prices remain upwards of like this then maybe inQ4 or maybe Q1 of next financial year, we may start the pricing discussions with the customer.

Hardik Jain: I will get back in the queue. Thank you.

Moderator: Thank you very much Sir. We have a next question from the line of Prashant Kutty from Sundaram Mutual Fund. Please go ahead.

Prashant Kutty: Firstly couple of questions on our base business results. So one is just first of all a clarification, sir that the adjusted revenue growth in the building product segment is 7% right?

Sandeep Sikka: Yes it is around 6.7%.

Prashant Kutty: The first question is on the margin anything out of the ordinary that there are margins have completely sprung up to about 19% in the quarter as far as building products is concerned if you could just side reasons for the same?

Sandeep Sikka: You are talking about building products.

Prashant Kutty: Yes.

Sandeep Sikka: Can you repeat your question. It was not that clear?

Prashant Kutty: I was just referring to the margins part on the building product segment anything which is kind of we have seen the margin performance is very strong over here anything which you would like to highlight as to what really led this because the last four, five quarters the margin traction has been kind off coming of just want to understand what is anything out of the ordinary over here on the building product segment margins.

Sandeep Sikka: The growth in the faucets has been good and the contribution from sales for the faucets has been good. One better thing, we have been able to load our Kaharani plant fully for the faucets. We have been talking on how much has been loading on the Kaharani plant. It is reaching a level of 85% to 90% capacity utilization and we are now going for the next level of capex at Kaharani to increase the capacity from 2.5 million to around 3.6 million pieces, almost an increase of about 45% - 60%. This capex was initially approved & was a part of our overall capex plan that we have been discussing historically but was put on hold. In last 2-3 months, we have been able to fully load our facility. This will now be needed to further debottleneck and expand the facility. I think that is one part and the product mix definitely plays an important role which is also another part. These are the two key highlights, which I can say that has contributed to higher margins.

Prashant Kutty: When you say product mix are you referring to like even sanitaryware grew well because typically that is the highest margin business for us actually?

Sandeep Sikka: Yes, so within the sanitaryware there is various product mixes. As you are aware that we are the only brand who work from the bottom of the pyramid to the top including premium and super premium also. So the product mix is slightly better on that which also resulted in better utilization of the sources and higher EBIT margins.

Prashant Kutty: So what would actually be a sustainable number as far as building product margins are concerned because if you look at the last almost four, five quarters the margins have been in the range of about 15% or so and this is almost a 19% number so what as per your estimate could be a sustainable number as well as this margins in this segment is concerned?

Sandeep Sikka: We have been saying that as our share of faucets is increasing & percentage margins in faucet business is lower as compared to sanitaryware. Actually in our business you have to understand that sanitaryware is not one brand we operate in, we operate in sub-set of around 6-7 brands and similarly in faucets. So giving a quarter-to-quarter guidance becomes extremely difficult but we are saying on medium to long term or we will be able to sustain between 16%-18% EBITDA margins at the full utilization of our faucet facilities and the sanitaryware facilities.

Prashant Kutty: 16% to 18% EBIT margins right.

Sandeep Sikka: EBITDA margins I am talking.

Prashant Kutty: EBITDA margins.

Sandeep Sikka: Yes.

Prashant Kutty: Sir this is definitely a bit of an aberration. So second question is regard to the consumer product business again the losses over here kind of have reduced as compared to the last three four quarters when are we really expect and because in terms of size I think if you look at it right now I think it is already at about close to 100 odd Crores close to 100 Crores in terms of H1 numbers I remember faintly has spoken about that business kind of start generating profitability about 100, 225 Crores so just wanted to ask where are we on that profit side as far as this business is concerned?

Sandeep Sikka: Last year itself, this business had a turnover of 127 Crores and we had given guidance that as it touches a turnover of around 225 - 250 Crores, it should be near breakeven. But the only caveat here was that if we have to spend more on advertisement. It is not all Hindware, it includes our water purification and air purification business which is under the brand called Moonbow. Moonbow being a new brand, if you have to promote then there are some product promotion cost so that was the cause. We had a higher cost during the quarter one and also quarter four because Moonbow water purifier was launched and we have to go for advertisement and other things. Business otherwise is doing good, we are having a healthy gross margin between 35% - 45% depending on product to product. As the products grow, I think by Q4 of this financial or maybe Q1 of next financial, we expect that the breakeven barrier should be breached.

Prashant Kutty: By Q1 FY2019 we should be breakeven.

Sandeep Sikka: Yes on the EBITDA and what I am talking is EBITDA level.

Prashant Kutty: And the next question is move on the scheme of arrangement sir, so firstly a clarification over here one is you have given the revenue numbers of the CPDM undertaking the retail undertaking, the BPDM undertaking. Does that mean that this entire revenues is this kind of a going to get transferred to the new entity which you are referring to both these entities that is a right assessment right?

Sandeep Sikka: Yes, that is the right assessment and only thing is that once the demerger becomes effective, on an overall basis there will be slight increase in the revenues. Whatever the factory, relating to building products, manufactures will be sold to the Brilloca and that will be treated as a sale not as an inter-unit transaction. So that factor may slightly increases overall sales profile of the both HSIL residual and rest of the companies together but since these will be two listed companies, they will have to treat their revenues separately.

Prashant Kutty: Yes, but at the end of the day it will be like if you look at the BPD and segment the revenues of that particular, which is still largely manufactured it will be like a double revenue over there so it is like if eventually like an intersegment for itself revenue going forward?

Sandeep Sikka: So it is like-to-like the intersegment which we cannot knock it off once it gets.

Prashant Kutty: I understand if I knock it off but probably our margin will definitely get knocked off over here right for example you will have your manufacturing margin separate over here and we will have your trading margin separate over here that is how it is going to operate right.

Sandeep Sikka: Yes.

Prashant Kutty: But can you just give us an broad sense in terms of what is the kind of manufacturing margins that you are looking and what are the kind of trading margins that you might look to over here if you just want to make an assessment over here how do we really look go about it because this coming from we have numbers in the BPDM segment more so prominent because there is the larger history it operates at about 18% to 20% kind of an EBITDA margin numbers so how would that really breakup over here?

Sandeep Sikka: There are three separate distinct businesses like Sanitaryware, Faucets and we do some trading activities relating to all wellness so Other Wellness which we do not manufacture & is entirely outsourced to the third party. In Sanitaryware and Faucet, part of faucets i.e. around 40% - 45% is still outsourced and, in Sanitaryware, a lower component is outsourced. We have done some benchmarking report. Most of the transactions, which will happen between the HSIL residual and this company Brilloca, will be on arms length basis. Broad guidance, which we have based on the benchmark reports, of cost plus around 4% -

7% is the range, which have been advised by one of the big four, on which I think we should be able to benchmark it.

Prashant Kutty: This is for the manufacturing entity you are referring to right?

Sandeep Sikka: Yes.

Prashant Kutty: Manufacturing it will be at about cost plus 4% to 5%.

Sandeep Sikka: 4% to 6%.

Prashant Kutty: Sir second point is you said that another point of mentioning over there is that the resulting company one will be issuing shares of the resulting company two as well so wanted to understand over here this resulting company one will still be the subsidiary of HSIL right is that the right or it ceases to be the subsidiary because you have mentioned it as demerger so I am just a little confused in that front sorry?

Sandeep Sikka: Today let's say there are two companies i.e. Resulting company 1 and Resulting company 2. As on date today, Resulting company 1 is the wholly owned subsidiary of HSIL and Resulting company 2 is the wholly owned subsidiary of Resulting company 1. Once the demerger is effective, the share capital held by HSIL in the Resulting company 1 will get extinguished and each shareholder of HSIL, holding one share of HSIL will get one share of the Resulting company 1. The share capital is very thin right now, at around Rs.10 lakhs, between HSIL and the thing (Resulting company 1) that will get extinguished.

Prashant Kutty: So that is what it will ceases to be a subsidiary itself there will be a different entity all together right.

Sandeep Sikka: Yes.

Prashant Kutty: And R1 will have a subsidiary which is by the name of R2?

Sandeep Sikka: Yes, R1 is a company called the Somany Home Innovation Limited and the other company which is wholly owned subsidiary of the Somany Home Innovation Limited is called Brilloca Limited.

Prashant Kutty: Which is Brilloca

Sandeep Sikka: Yes.

Prashant Kutty: That is where you will have the entire and here the capital employed is clearly going to be just the working capital arrangement we just spoke about the balance 400, 440 Crores which is going to be there.

Sandeep Sikka: The entire 440 will not be shifted to Brilloca because that working capital also involves manufacturing working capital, working capital relating to consumer product & EVOK. Therefore Brilloca will have its own subset of working capital which is relating to the building product division.

Prashant Kutty: Thank you very much and I should come back in the queue.

Moderator: Thank you sir. We have a next question from the line of Kinjal Desai from Reliance Mutual Fund. Please go ahead.

Kinjal Desai: Sir I just want to understand if you can just give an idea how to gross block would get broken so while you indicated that most of the manufacturing assets would be with HSIL so if you just take an example that it is about say Rs.100 right now then I must say FY2017 then what is the kind of percentage your gross block that you can divide it between the two companies?

Sandeep Sikka: Almost 95% - 97% of gross block will remain within the manufacturing as it is related to manufacturing. There are certain items capitalized which are relating to display centers like we have five display centers in India called Lacasa, then we have various other displays around where we use shop in shop & other things which is called Galleria that we capitalize and charge off over a period of time. Almost 95% - 97% of gross block will remain with HSIL.

Kinjal Desai: Sir also in the debt front where you mentioned 400 Crores is almost would stay with HSIL of the balance amount is it to say that the building products to have a very significant working capital would be the right way to see?

Sandeep Sikka: We can broadly dissect the rest of the working capital. When I talk about 400 Crores of working capital utilization, that working capital utilization is also towards packaging products. I do not have figures right now about how much is getting towards our packaging. I will tell you separately about the working capital utilized for packaging. It is utilized for Consumer, it is utilized for Retail division and also for the building products. The usage of working capital, as on date, towards the packaging is still higher because it has some level of seasonality. We keep producing during the first half and then the major chunk of sales happen during Q3 and Q4. Based on the past trending of the industry, when the summer season starts in the month of February-March, the procurement of glass bottles starts but we have to keep manufacturing so inventory as on date is higher on the packaging side. Definitely more working capital will also be witnessed in HSIL residual.

Kinjal Desai: Thank you very much.

Moderator: Thank you. We have a next question from the line of Dhaval Mehta from Yes Securities. Please go ahead.

Dhaval Mehta: Sir just to add on this demerger part so that the brand Hindware will be part of the demerged entity right it will not be part of HSIL?

Sandeep Sikka: Hindware, the whole genesis of doing the demerger is that the activities relating to branding, brand promotion, product development, product design, servicing the customer will henceforth, relating to building products, lie in a company called Brilloca and brand will actually move as a part of the scheme to the company.

Dhaval Mehta: HSIL the manufacturing entity will be manufacturing only for Somany Homes it will not be supplying to any other companies.

Sandeep Sikka: See post demerger these will be two separate entities. HSIL residual can manufacture and sell in the market but it cannot use the Hindware brand or the Hindware designs.

Dhaval Mehta: My second question is on the glassware pertaining to the current result so HNG was quite aggressive in terms of pricing especially in south so even we have reduced our pricing or we have maintain the prices to the prior levels?

Sandeep Sikka: I cannot comment on the competitor but we are not discounting our products to be very frank and you can see the margins between HNG and us. You can easily make the statement that we have underperformed on sales or we have over performed on sales. Once you start discounting your product pricing, it is very difficult to come back. Our customers want to stay with us because we have a very strong long-term relationship with them. There is a huge delta between our EBITDA margins and the EBITDA margins of HNG because of our product mix and also maybe for the prices as we are not much aware how they are pricing their product. I cannot comment on their company but we are not discounting our products.

Dhaval Mehta: So the right thing is the worst is over for glassware segment because last two quarters we were impacted by the liquor sales demand but now things are stabilizing on that front?

Sandeep Sikka: Yes, I think it is not last two quarters may be last four quarters have been impacted.

Dhaval Mehta: Yes post demonetisation.

Sandeep Sikka: Yes Q3 was demonetization, Q4 was demonetization plus the Supreme Court order and then Q1 was the GST, as I said due to all these factors, not only liquor, majority of businesses have seen destocking across especially relating to GST. Now everything is getting stabilized so businesses are starting to come back now.

Dhaval Mehta: Sir how is the growth in the pharma and the FMCG segment in glassware so we were facing some hindrances especially post demonetization so how has the growth picked up in that segment?

Sandeep Sikka: The main hindrances were more on the liquor side not on the pharma side, liquor and the soft drinks were impacted. Now we are trying, although we do not disclose our shares publically of this segment-by-segment, to increase / enhance our share more towards food, more towards pharma because they ultimately leads to better realization. Opportunities exist but these are low volume opportunities & we are trying to capture each of the opportunity in the market.

Dhaval Mehta: That is it from me. Thank you and all the very best Sir.

Moderator: Thank you Sir. We have a next question from the line of Sunil Kothari from Unique Investments. Please go ahead.

Sunil Kothari: Sir just to clarify on this demerger scheme new projects we are putting in to one is the pipe and other is this caps closure that will remain with HSIL right.

Sandeep Sikka: Yes.

Sunil Kothari: Every manufacturing portion whereas the packaging or building material everything will remain with the HSIL?

Sandeep Sikka: Anything which is getting manufactured will remain in HSIL.

Sunil Kothari: Sir over a period one is this cost plus what you are saying is 4% to 7% plus cost is the margin we should think about for building material but packaging will remain marketing also will remain here in HSIL?

Sandeep Sikka: Yes, packaging is not end consumer facing because we do not service any consumer directly.

Sunil Kothari: So Sir over a period HSIL should be should we believe as a 10% EBITDA margin company or it will be less than that?

Sandeep Sikka: No. Our packaging business has almost, if you see last one year or so, 17% - 18% EBITDA margin. When we have been talking, there is a misnomer that packaging is actually making losses. If you see last year, before the unallocable expenditure, the glass itself made a EBITDA level of around 170 Crore. It is not that the residual HSIL will be left with low EBITDA. The packaging has EBITDA margin and plus when we do a cost plus on the sanitaryware and faucets, that all gets to good EBITDA level.

Sunil Kothari: So double-digit margin is very likely?

Sandeep Sikka: Sorry.

Sunil Kothari: The double-digit margin for manufacturing portion will remain it is double-digit more than double-digit?

Sandeep Sikka: Yes, because this is without branding, without distribution and without sales cost. If you see any organization, ideally if it is not branded, it will have to spend huge amount in distribution. If you see cost structure, we made good amount of gross margin but lot of gross margin gets spread in servicing the market. We will have a huge sales team & marketing team, product development team which requires lot of cost. So HSIL residual will not have those costs unless they decided on their own subsequently that they want to do some other business. All these expenditure has actually borne by the sales and distribution arm so this whole exercise of demerger will bring the overall efficiency in the system wherein manufacturing will try to be excellent & further reduce the cost whereas, on the branding company side, we will be more effective towards how to approach go to market, branding, consumers and increase our market share in the market. It will create very niche purpose for each of the organizations.

Sunil Kothari: Sir one more thing is currently we are in consumer business with this our gross margin is around 35% to 40% just now you mentioned so should we think about 30% plus gross margin in new division which will be doing just marketing only?

Sandeep Sikka: I am not being able to understand your question.

Sunil Kothari: Sir at present consumer business has a 35% to 45% gross margin that is what you just now say is right.

Sandeep Sikka: Yes.

Sunil Kothari: And that is just marketing consumer marketing no manufacturing.

Sandeep Sikka: Yes. We have been telling the consumer product business and the building product businesses internally are two separate verticals. Their distribution is different from the distribution on the building product. They cater to kitchen segments, water heaters, water purifiers, air purifiers so they have their own service network. They have their own supply chain. Internally these are two separate distinct divisions as such undertaking as such. Since it is a new business, which was actually develop to around two & a half years back, there is an infrastructure cost in terms of managing the entire distribution, the supply chain, the warehousing cost and other things. From an overall gross margin point, I think we are very competitive in line with the rest of the players in the market. As the turnover is built, we will be able to cover a lot of fixed cost here.

Sunil Kothari: Sir that is what my question is just new division which we are creating this new company that will have totally branded marketing business so will it have a gross margin of 30%, 35%.

Sandeep Sikka: Gross margin, I have told, 35% - 40% or you are talking of building products.

Sunil Kothari: Yes, combined now full and new entity which will be doing every business of CPDM, retail and BPDM?

Sandeep Sikka: If you combine & consolidate everything, it will be still higher than 30%.

Sunil Kothari: Thank you very much. Gross margin, yes understood. Thank you.

Moderator: Thank you sir. We have a next question from the line of Hardik Jain from Whitestone Financial Advsiors. Please go ahead.

Hardik Jain: Sir the pipe division I think we have done a capex of around 150 Crores and for caps we have done around 100, 120 Crores capex so by when these plants are going to start?

Sandeep Sikka: This is a very good question and, in fact, we wanted to interact more on Caps and closure. The total project cost was 112 Crores and till date what we have spent is somewhere around 70 Crores of expenditure which has been done out of the Capex. The Phase I of the project can make small cap with the capacity of around 275 million pieces; the trials have been successful, both with the domestic as well as the international market. The large caps are also expected under the trial production in next two to three months and we are getting a very good response. The challenge, here, is to load the plant fully because we have conceived this entire project in phases and based on the overall market requirement. Let's say if any one of our customer start putting our cap on a particular SKU; that particular SKU state wise and then ultimately country as a whole should need to have only one cap. We are feeling that, maybe in next one year or so, we will be short of the capacity. Based on this, the company has taken a decision to further grow at few more machines and few more molds. There will be some additional cost to be spent till March 2019 of around 60 Crores on Caps and Closure project which will ultimately lead us to a capacity of over a billion caps by March 2019. Money will not be spent immediately; the money will be spent in various phases. What we are doing is that we have taken a modular approach in this project. The overall factory shed building has been constructed and we are adding machinery & molds phase-by-phase so that we are able to have best of the product accepted from our customers and then see to it grow from building up the capacity in phases so has to have a better return on capital employed. We feel that, by March 2019, the capacity of this project will be almost a billion caps inclusive of small caps and large caps, as required by the industry. Good part is that the acceptability of the caps is there & the demand profile which is coming is also good. On the Pipe, there has been a delay. The project was scheduled, as per the last call we have said, by September – October, it should have got online but there is some more delay. I think maybe in next one or two months, we will see the trial run from the Pipe also coming up. The major chunk of turnover, we expect to happen only in the next financial year. In Q4, maybe we have one to two months of commercial sale of production of Pipe as major revenue will come through the next year.

Hardik Jain: Just wanted to understand because you are sounding very confident on the caps front you are saying that we will be fully utilized we were utilizing the plant in before March 2019 so at full capacity utilization what turnover we can get from caps plant?

Sandeep Sikka: If we have a billion Caps, Caps ideally sells at around, there is a base price and there are some value additions as we are not only putting caps; we are putting some value addition lines like polishing lines, printing lines that we can give a wholesome solution. You can on an average assume average realization of Rs.1.30 per caps on a billion caps, once the project is fully operational.

Hardik Jain: And what kind of EBTIDA margin do we expect here?

Sandeep Sikka: We expect EBITDA margins ranging between 25% and 35% here, depending on the value addition we further give to the cap.

Hardik Jain: The margins will be booked by HSIL so the marketing this part of the business will be with HSIL?

Sandeep Sikka: Yes, because this is all B2B business for liquor companies. It is not the end consumer business.

Hardik Jain: For the pipe business the marketing part will be handled by company two and the manufacturing will be done by HSIL?

Sandeep Sikka: Yes.

Hardik Jain: So in the pipe business by when what kind of turnover do we expect to achieve? I think we have done the capex for 12000 tons initially and we have said somewhere that we want to ramp it up to 30000 tons in times to come so at 30000 tons what kind of turnover do we expect to do?

Sandeep Sikka: Once the project is fully loaded; again the whole site has been developed for a 30000 tons capacity plant but we are putting lesser number of machines. We have told that we have around 600 molds. When we deploy lower machines, the mold time replacement also reduces the capacity. Later when you keep putting more extruders, more machines, more CNC machines, then mold time reduction happens and there is an increase & unlocking in the value of the capacity. We expect, with 30000 tons, the overall sales should exceed somewhere around 425 to 450 Crores and there can be further upside on 30000 also which we can achieve.

Hardik Jain: At 450 Crores what kind of margin do we expect to achieve?

Sandeep Sikka: This industry is competitive so we expect around 12% to 14% margin.

Hardik Jain: Because you have set up the plant for 30000 ton and the initial phase you have bought the machinery for 12000 ton so from going to 12000 to 30000 ton what kind of additional capex we need to do.

Sandeep Sikka: Sorry, go again, I missed your question from “going from”?

Hardik Jain: Going up from 12000 tons to 30000 tons we will need to put additional machines only because the infra is set for the entire 30000 tons so what will be the capex requirement for that additional machine.

Sandeep Sikka: It will not be much, may be 15 to 20 Crores per year, spread over next one and a half years at least.

Hardik Jain: Sir so one thing again coming back to the demerger because our company two is a subsidiary of a company one and I think in lot of cash will be generated in company two because that is a sizable business there so what are your thoughts on because this company is a marketing company it will not need much funds for the capex because capex are not going to be done here so regarding the dividend my question is how do you see that because the funds will be lying in the subsidiary and shareholders will be holding the holding company shares so in terms of dividend what should we expect.

Sandeep Sikka: What we need to understand is that when the company has the cash; lot of this cash will be ideally deployed for long-term growth of the business and dividend. We have a sort of a dividend policy historically wherein our dividends are pretty stable. If you see the payout ratios, in last two to three years, has been somewhere ranging between 25% - 30% out of profits of HSIL as it is today. So going forward, the absolute dividend payouts maybe in that range only but we have to see when we reach there. The dividend philosophy should ideally be the same but we will get two separate listed entities.

Hardik Jain: Yes because from you will have to flow the cash from company two to company one and then company one can payout out to the shareholders?

Sandeep Sikka: You have understood it rightly.

Hardik Jain: What are your thoughts on expansion on retail business?

Sandeep Sikka: We have set up one new store during this year and have now almost 15 stores. The sales growth has been around an 11% year-on-year. We are losing money because we need to have that minimum critical sale of that level to achieve / recover the fixed cost. Lot of cost cutting has also happened; we are just trying to improvise this business but going slow on this business, not getting aggressive in terms of setting up new stores and other things.

Hardik Jain: So any new capex plans will be done in HSIL so I was just wondering how those capex will be mostly will be funded by HSIL only then either it has to be fresh equity or the borrowings in the HSIL?

Sandeep Sikka: Yes.

Hardik Jain: Thank you Sir. That is it from my side.

Moderator: Thank you Sir. We have a next question from the line of Krishna Kumar from Sundaram Mutual Fund. Please go ahead.

Krishna Kumar: Good evening Sir. First of all congratulations for getting this demerger scheme through and trying to create value for investors. Is it possible to give some kind of timeline Sir in terms of when do we see this getting operational on the exchanges?

Sandeep Sikka: This demerger process is under the NCLT route, which was earlier as high court route. The board had approved it last Friday &, maybe within next couple of days, we will be filing this with stock exchanges. Ideally stock exchange will take around 45 to 60 days to approve, after which it will go to NCLT. A broader sense is that NCLT will call the share holder meeting and the creditors meeting. We expect that the whole process should ideally get completed between May to July next year. Now depending on how fast the NCLT is able to process, the case is time consuming. Generally we have been advised by our consultants that it may take around 7 - 9 months in terms of completing the process.

Krishna Kumar: Sir I think in the press release you talked about some of the opportunities like optimal norm, development of respective business etc., by attracting focused investors and the strategic partner so you believe that in the current structure where you have company A and B which is the consumer division and the building products division separately you would be able to kind of carryout further value unlocking by bringing in any kind investors have required have to mentioned here is this structure amenable for that and is there some kind of timeline for that where we can expect some strategic or what was that investors to come in is there anything that you can disclose at this point in time Sir?

Sandeep Sikka: I cannot disclose right now anything which is not committed or until and unless as per the regulation something which is not approved by the board or something which is not binding; it will not be appropriate for me to talk. I can tell you on a broader sense that there is an active interest because till date many investors wanted to invest into HSIL but everybody used to ask what is the ROCE of glass, how is manufacturing, more these thing. Now investors who are there, have an opportunity to invest into branding & retailing company. The set of investors who are more interested in manufacturing, they also have their facilitation. On both the companies, we feel that going forward there will be very active investor interest. It is only that we have to communicate more with all class of investors for which we are taking adequate measures.

Krishna Kumar: Does this activity of trying to bring in partners or investors if at all can it run parallel to this NCLT process or does one have to wait for that to complete before the board can approve such a move or the independent?

Sandeep Sikka: I think all the opportunities are there which can run parallel also. While we are closing the transaction, we will be clearer but definitely the processes can go parallelly.

Krishna Kumar: Thank you very much Sir. Wish you all the best.

Moderator: Thank you sir. We have a next question from the line of Chandra Gopal from JM Financial. Please go ahead.

Chandra Gopal: Just I missed on this caps and closure strategy potential if you can throw some light again?

Sandeep Sikka: Potential in terms of market demand?

Chandra Gopal: Yes so basically at full capacity how much it can generate and what is the demand right now which you foresee?

Sandeep Sikka: If you see what is the overall number of liquor bottles sold in India, part of them only has security measures. We have been told that for few of the caps, the security measures which are there, the counterfiet of that has already been created. When company took this project it had done almost one & a half to two years of research and design was completed using a German designer. We created lot of security features into our caps and have also created a cap in a way that creating a counterfeit of a cap will require a huge capital expenditure, in terms of mold requirement and other things. Going forward we feel that this opportunity is very huge for us. There are still many caps, which does not have a security feature, on the liquor side and there is a huge counterfeit market especially relating to liquor in India that's why we started this project. Getting the approval of the cap is very critical from the customer side so that cap does not leak, once it is in hold on the bottle. We have been fairly successful with the few leading customers. We have not yet spoken to all the customers because once the demand start coming in, we do not have a capacity to service everybody and, for that particular reason, we are trying to further spend on these machines & mold and talked about the capex and building up the capacity. When the project was conceived, we had a capacity of around 700 million caps which has now been increased to almost a billion caps. Going forward, we may further increase the capacity in phases. We are not trying to put the entire money upfront on this business. We are moving phase-by-phase so that unlocking of capacity also happens in phases. We feel that there is an opportunity to a business of somewhere around 200 Crores plus in next five years from now on this particular trade.

Chandra Gopal: Sir that 1 billion cap capacity it will be around half of that or so 100 Crores, 150 Crores?

Sandeep Sikka: 1 billion cap should ideally, I have told that the cap sell in a range of Rs.1.25 to Rs.1.40. It can be even higher based on the value addition which we do in terms of printing, finalizing the cap.

Chandra Gopal: Thank you so much and all the best.

Moderator: Thank you Sir. We have a next question from the line of Nehal Shah from ICICI Securities. Please go ahead.

Nehal Shah: Sir on the pipes business just wanted to understand you said the optimum utilization would give you revenues of 425 to 450 Crores by when would you expect that to come in?

Sandeep Sikka: Around three and a half years.

Nehal Shah: FY2019 revenues in pipes what are you targeting?

Sandeep Sikka: FY2019 maybe around 100 Crores plus.

Nehal Shah: And breakeven by?

Sandeep Sikka: It should breakeven at a level of around 160 to 170 Crores.

Nehal Shah: Thank you so much.

Moderator: Thank you Sir. We have a next question from Sunil Kothari from Unique Investments. Please go ahead.

Sunil Kothari: Sir just clarification in one of the reply you said that EBITDA margin of packaging division is EBITDA number was 170 Crores last year is it what I understood is correct?

Sandeep Sikka: Last year EBITDA was 170 Crores on the packaging side and you can see the segmental results also for the last year which we have published.

Sunil Kothari: Yes that is including the EBIT.

Sandeep Sikka: Packaging had EBIT of around 100 Crores plus & there is a depreciation charge also on the packaging side. What I am talking is the EBITDA coming in.

Sunil Kothari: 170 right.

Sandeep Sikka: 170.

Sunil Kothari: Thank you Sir. Thank you very much.

Moderator: Thank you Sir. We have a next question from the line of Amit Purohit from Emkay Global. Please go ahead.

Amit Purohit: Just two things one, I wanted to know what is our capex plan for FY2018-2019? Second also if you could just broadly help us in understanding what is the working capital requirement currently for the building products and the packaging material?

Sandeep Sikka: Capex, which we are talking for financial year 2018-2019 and 2019-2020. We expect that we should spend cash outgo of around 140-145 Crores each in both years, based on all the discussions in the capex we have had. In terms of the overall number of days of inventory, we have to see annually. As I told you on the packaging side, the inventory holding norms for the September and March are very different. We produce material in the first half for the sales for Q3 and Q4. Ideally we will have around 90 days of total inventory, around 90 is the net figure of net of credit. Around 120 days of inventory and debtors gross figure for building products and other 20 days for the working for the packaging product around 140 days.

Moderator: Thank you very much Sir. Ladies and gentlemen that was the last question I now hand the conference over to the management for closing comments. Over to you Sir!

Sandeep Sikka: Many questions are especially more relating to demerger but important point to understand is that the intent of the demerger is to create two verticals in the businesses. One which is excellence of manufacturing, more catering to B2B businesses, packaging manufacturing whereas go-to market approach to the market is evolving in India which requires a different strategy, different mindsets and different synergies. These two verticals have been created so that they can create excellent value over a period of time and as a byproduct will also unlock the value over a period of time for all the stakeholders; let it be shareholders, let it be creditors or the distributors. We feel that this is a model, which will help us grow much faster and that is why the board has taken a very positive call and it has been approved. I think you will have to see few more quarters till this whole exercise gets completed. It will require a time period of around 7 - 9 months. This whole demerger is effective April 1, 2018, which is the prospective date. We feel by 2018-2019, once we are there, people will start seeing the unlocking on value & also in seeing results. Thank you very much for all of you who have participated here. Any particular question you can send it on an email to us so that we will be happy to respond to you. Thank you.

Moderator: Thank you very much sir. Ladies and gentlemen, on behalf of Emkay Global Financial Services that concludes this conference call. Thank you for joining us, you may now disconnect your lines.