"HSIL Limited Q3 FY2018
Results Conference Call"

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ANALYST: MR. AMIT PUROHIT - EMKAY GLOBAL FINANCIAL SERVICES

MANAGEMENT:
MR. SANDEEP SIKKA – CHIEF FINANCIAL OFFICER – HSIL LIMITED
MR. R. B KABRA – PRESIDENT, BUILDING PRODUCTS – HSIL LIMITED
MR. NAVEEN MALIK – HEAD, CORPORATE FINANCE – HSIL LIMITED

Moderator: Ladies and gentlemen welcome to the Q3 FY2018 results conference call of HSIL Limited hosted by Emkay Global Financial Services. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask 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 afternoon everyone I would like to welcome the management and thank them for giving us the opportunity. We have with us today Mr. Sandeep Sikka - CFO, Mr. R.B. Kabra - President Building Products and Mr. Naveen Malik – Head, Corporate Finance. I would now hand over the call to Mr. Sikka for his opening remarks. Over to you Sir!

Sandeep Sikka: Good afternoon everybody. In fact Naveen will carry you through the brief results and then immediately we can do the question and answer. Naveen I would request you to take this call.

Naveen Malik: Good evening friends. At the start of 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 securities 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 decisions on the basis of this conference call.

The results for the quarter ended 31st December 2017 have been prepared in compliance with the applicable Indian Accounting Standards (Ind AS) 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 31 December 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 7 of results shared with stock exchange for further details.

HSIL has for the quarter ended 31st December 2017 achieved revenue of around Rs.578 crore. After adjusting for GST impact as explained in note 7, there is a revenue growth of 14.4%. The operating profit i.e. EBIDTA for the quarter 31st December 2017 is around Rs.74 crore as compared to previous year corresponding figure of around Rs.70 crore.

The company operates through four business segments:

In terms of segment revenue, the Building products division for the quarter ended 31st December 2017 achieved revenue of around Rs.254 crore after adjusting for GST impact, there is revenue growth of around 10%.

EBIT for the Building products division for the quarter ended 31st December 2017 is around Rs.43 crore as compared to previous year corresponding figure of around Rs.38 crore.

Packaging products division for the quarter ended 31st December 2017 achieved revenue of around Rs.243 crore after adjusting for GST impact, there is revenue growth of around 12%.

EBIT for the packaging products division for the quarter ended 31st December 2017 is around Rs.18 crore as compared to previous year corresponding figure of around Rs.25 crore. There has been drop of around Rs.7 crore in EBIT during Q3, mainly due to higher fuel cost, as compared to corresponding quarter of previous year.

In terms of segment revenue, the consumer products division for the quarter ended 31st December 2017 achieved revenue of around Rs.62 crore representing growth of 76% over previous year corresponding figure.

EBIT for the consumer products division for the quarter ended 31st December 2017 is around Rs.(1.04) crore as compared to previous year corresponding figure of around Rs.(7.45) crore.

The Retail division for the quarter ended 31st December 2017 achieved revenue of around Rs.24 crore which is around the same as previous year corresponding figure.

EBIT for the Retail division for the quarter ended 31st December 2017 is around Rs.(5.29) crore as compared to previous year corresponding figure of around Rs.(3.91) crore.

The company for the quarter ended 31st December 2017 earned a profit before tax of around Rs.25 crore, after deduction of an exceptional item of Rs.6.94 crore due to Fire, as compared to previous year corresponding figure of around Rs.35 crore. You may refer to note 6(i) of results shared with stock exchange for further details.

Profit after tax for the quarter ended 31st December 2017 is Rs.15.58 crore as compared to previous year corresponding figure of around Rs.23 crore.

The total net bank debt of the company as on 31st December 2017 is around Rs.951 Crore with overall loan funding cost at 6.18%.

Now you can open the call for the question and answer.

Moderator: Thank you very much. We will now begin with the question and answer session. We have the first question from the line of Dhawal Mehta from Yes Securities. Please go ahead.

Dhawal Mehta: Good afternoon. Thanks for the opportunity. Sir, my first question is on gross margin. In this quarter gross margin declined by around 350 BPS Y-o-Y and even sequentially we have seen a decline of around 320 BPS, so any particular reason for that because our building material growth has been decent of around 10%, still our gross margins has declined?

Sandeep Sikka: Gross margin or EBITDA margin you are talking, EBIT margin?

Dhawal Mehta: Gross margin I am talking Sir.

Sandeep Sikka: We separately do not disclose any gross margins.

Dhawal Mehta: Sir, I am talking of the overall company level if you reduce COGS from sales, the margins, which we get.

R B Kabra: As Naveen just mentioned the margins drop are largely in the glass business. There is no margin drop in the building product business. There are two reasons. If you really see glass because you have seen that after four, five quarters this is the first time that there has been some sales growth in the packaging product business, otherwise, from the demonetisation time, we have been suffering in terms of growth for the glass business. So only after four or five quarters this is the first time that the growth has come in the sales, which is a positive sign for the packaging division, but over a period if you really see the cost of fuel has substantially gone up for the glass business because you all know that it is highly intensive in terms of power and fuel and because of the international prices of crude going up, prices of all fuels whatever we use whether LPG, whether RFO, whether pet coke, everything has gone up, so there is a margin drop in the glass and if you talk on how do we compensate this going forward, because there was no talk of price increase. There was no price increase for the last six quarters or seven quarters in the glass business because there was no volume pickup. Now, there is a pickup in the sales, going forward also we feel positive that there will be sales growth, so now the talks have started for raising the prices to the extent of increase in at least fuel and the direct input cost. I think in next two months or two-and-a-half months there should be some positive input in terms of price rise. So the margin drop you see as a company as a whole has two reasons, one is the power and fuel cost in the glass and the Rs.7 Crores exceptional loss of one fire in one of the EVOK warehouse.

Dhawal Mehta: I got it Sir, but I just wanted to know how has the mix played in our building material segment, so is the growth of let us say relatively lower margin faucet is higher than sanitary ware business?

R B Kabra: Yes, that is right, your understanding is correct. The faucets has been growing in terms of percentage faster than sanitary ware, but another reason is that the base for the faucet is low and it is a newer business, the plant is new, so when you see the percentage growth the faucet is higher than sanitary ware.

Dhawal Mehta: In terms of overall revenue share has the revenue share has increased sequentially as well as Y-O-Y?

R B Kabra: Faucets' share now in Q3 if you really see is around 27%, 28%, which was 24% earlier and the sanitary ware has slightly dropped to that extent. Other remains around 10% to 11%, sanitary ware which used to be 67% to 68% is now down to around 62%.

Dhawal Mehta: Sir, my last question is regarding our new factory, so we have started the production for security caps?

R B Kabra: Security caps production started and now we have declared also the commercial production in the security caps and closure division.

Sandeep Sikka: We have started the commercial production of phase one of the small caps. The production is on and whenever you launch a product like this, it requires substantially longer time with the customers for the product approval in the market. So everything is now approved and small cap production is going on in the commercial production now.

Dhawal Mehta: So, when we can expect the entire security caps production to start like and all the phases?

Sandeep Sikka: Now we have started with the commercial production of small cap then we will do phase II, which is a large cap, which is under trial right now. After that the second phase of the small cap will come up and then followed by another phase of large cap. So the entire cap, what we are projecting, is around a billion caps and we will be up running by March 2019.

Dhawal Mehta: I guess the date will be same even for pipes commercial production?

Sandeep Sikka: Trial run production for pipe has already started in January. Once we have the full level of certifications and everything in place for all the SKUs, we will declare the commercial production also. Regarding loading of the pipe plant, we have been telling that full loading will take two to three years when we reach a capacity of 30,000 tonnes touching a turnover of odd 400 Crores plus based on the current market condition with that alone.

Dhawal Mehta: That is helpful Sir. Thank you Sir, I will come back in the queue. Thank you and all the very best.

Moderator: Thank you. The next question is from the line of Prashant Kutty from Sundaram Mutual Fund. Please go ahead.

Prashant Kutty: Thank you for the opportunity Sir. Firstly, in terms of the consumer product business if you could just tell us in terms of the profitability; losses seems to have reduced quite significantly, just wanted to understand what are the reasons for the same, is it purely just a topline growth, which is hitting that, if it is probably give us some sense on that?

R B Kabra: I think if I understand your question correctly you want to know that what has helped to reduce the losses in CPD business, is that the question?

Prashant Kutty: Yes, that is right Sir.

R B Kabra: So, we have been telling that once we reach to a certain volume where the fixed cost will be absorbed and we say by the end of this year we should be more or less breakeven at the EBITDA level. I think we are heading towards that. As you say that in this quarter the loss is very little and going forward, we feel that by in Q4 we should be breakeven for EBITDA and next year onwards it will start contributing positively.

Prashant Kutty: When you talk about a bit of contribution in the next year, typically what is the kind of EBITDA margins that we are looking at as well as the business is concerned?

R B Kabra: EBITDA margin for this, we are expecting in the next year around 6% to 7%.

Prashant Kutty: 6% to 7%?

R B Kabra: Yes.

Sandeep Sikka: Once we get fully stabilized that should be around 10% to 12% with the turnover touching around 500 Crores.

Prashant Kutty: So, just wanted to understand over here typically when you are talking about full stabilization we are largely in the outsourcing, so what do you mean you are exactly by fully stabilization because typically I understand that if you look at the nine month number you have done about 160 odd Crores of business, I believe we could end the year with about 240 Crores, so I believe that kind of absorbs a fixed cost, so I am just wondering typically what is the kind of leverage if you could just explain me that part?

Sandeep Sikka: So, what I mean to say here was on a concept of gross margin and the set of semi-variable and fixed cost. When I say that by around 500 Crores, when we touch, we should be able to have around 10% EBITDA margin. This is what I wanted to say.

Prashant Kutty: So basically, that the steady state margin is actually about 10%, is the right way to assume it?

Sandeep Sikka: Go again, I missed your question.

Prashant Kutty: I said is 10% to 12% EBITDA margins you are referring to is that going to be like a steady state margin expansion after 500 Crores is that the way you are looking at it?

Sandeep Sikka: Yes, that is what I am trying to say.

Prashant Kutty: Got it and any specific segments, which you have done well as far as consumer products are concerned?

Sandeep Sikka: I think all of them are doing good.

Prashant Kutty: Anything which you like to call out specifically?

Sandeep Sikka: Kitchen segment has done wonderfully well. Water heater is the second largest and then followed by air coolers, water purifiers. Water purifier is a new thing almost a year now. We had to spend some money earlier part in Q4 of last financial and Q1 of this financial year. So I think, other than advertisement on the new brands, by Q1 next year, the business should be self sustained.

Prashant Kutty: Sir, the next question is on the retail business, if you look at the EBIT losses in the retail business seems to have kind of expanded over here, anything the call out over here on the retail business?

Sandeep Sikka: One part of the retail business is the extraordinary item. We had a fire there in one of the warehouses at Bhiwandi. Other than that also, on a year-on-year basis, there has been an incremental loss of around 2 Crores over last year in EBIT level in this business, but if you see nine months level, it is almost balancing. So we are hopeful that the business should turnaround in some time as touching a turnover of 100 Crores and getting a good gross margin of around 45%. We are hopeful that business should turnaround as we walk along with a slightly higher turnover on the retail side.

Prashant Kutty: What was the extent of loss on the fire, which we had in terms of, is there any?

R B Kabra: Around 7 Crores.

Prashant Kutty: 7 Crores, that is one off which was there?

R B Kabra: Yes.

Prashant Kutty: My last question is on the glassware segment, while you did highlight about that the power and fuel cost has been moving up, we have been seeing a lot of other companies as well, what is the estimate should be an approximate price hike that has to be taken so that we probably come back to that 10% kind of margin numbers in the glass ware segment?

R B Kabra: I think anywhere between 4% to 6%.

Prashant Kutty: But I am just extending this question over here if you typically look at lot of liquor players and all they have already taken price hikes almost a couple of quarters back itself, but is this the way typically the slag follows for almost about two quarters or three quarters let us say between input versus brand where you actually had such a variant in terms of taking price increases because we hear about lot of these liquor players have already taken price increases in the last couple of quarters just wanted to understand how does it really work in the brand versus the input credit?

R B Kabra: There is no correlation between the price hike by the liquor or beer manufacturer and the price of bottle because this business is B2B business, so normally it is on cost plus basis and whenever there is a substantial rise in the cost, we go to these customers and we show them all the papers because it is all workable as large costs are power and fuel and soda ash, which are internationally priced, but as you know that there was tremendous pressure on the volumes for last few quarters so everybody was more concerned for selling the volume than of asking for the price increase, but now the fuel price has substantially gone up and also there is a uptake in the volume, so talks have started with customers for raising the prices.

Customers have said yes they will consider it sympathetically, so may be another six to eight weeks going forward the price increase comes in.

Prashant Kutty: The last question is on the building product side again referring on the margin side, if you look at the margin there seem to be a little bit of volatility over here on the EBIT level side, so the last quarter was about 19%, this quarter was about 16.8%, the previous early quarters obviously the function of growth being lower, just wanted to understand incrementally if I assume about 10% kind of a growth rate in the building product business what should be a steady state margin in this business?

R B Kabra: EBIT margin?

Prashant Kutty: Yes.

R B Kabra: We normally talk about building product EBITDA margin around 19% to 20%. When we talk about EBIT margin I think 2% to 3% is depreciation and 2% is interest, so balance should be around 15% to 16% should be the margin going forward as it should be around 17%.

Prashant Kutty: 17%, so basically the one, which is reported in this quarter could largely be the numbers going forward as well?

R B Kabra: Yes.

Prashant Kutty: The only reason I am asking because if you look at the growth rate number, the building products the reported growth is about just 4% and on that we have managed to do a 16.8% to 17% EBIT margin number, so here does not leverage play an account I mean typically when you get back to a double digit kind of a revenue growth number does not that improve, just trying to understand that part?

R B Kabra: Actually as I just mentioned actual growth in the building product division is 14% because the last comparable quarter there was excise duty added.

Prashant Kutty: Sorry, I missed that number.

R B Kabra: The sales is now reported with net of GST actual growth is around 14%. But I just mentioned the growth is higher on the faucet business, which is a relatively lower margin business as compared to sanitary ware. So absolute margin would be going up, but percentage may drop, which is visible only because the faucet revenue is growing faster than the sanitary ware revenue.

Prashant Kutty: Thank you. Actually I did not get that number that is why I asked you. Thank you very much and all the very best.

Moderator: Thank you. The next question is from the line of Manish Ostwal from Nirmal Bang. Please go ahead.

Manish Ostwal: Thank you Sir. Thank you for the opportunity. My question on the demand trend basically from the institutional segment, the retail segment, how do you see the trend and any rough colour on the FY19 volume growth number for the business?

R B Kabra: So to answer your question, the ratio or the percentage contribution of the institutional segment in this quarter has fallen substantially. It is around 21% to 22%, which used to be 26% to 27% in last quarter. So the institutional segment has fallen, but the retail segment has improved. So the growth has largely come from the retail segment, which is positive for the company because margins are better with the retail business. So the project sale is down to 23% in comparison to 27% to 28% which we used to run.

Manish Ostwal: Outlook for FY2019 volume growth for the building material segment?

R B Kabra: Volume growth we never disclose. The normal growth numbers what we are telling for the building product as a whole anywhere is between 12% to 14% going forward because the real estate should now improve as some green shoots are visible. If project business starts improving, we talk of 12% to 15% growth in terms of value.

Manish Ostwal: Because initially we have seen the numbers of the tiles company they have reported 10% kind of volume growth, so in anticipation of next year will be strong volume growth, so that way would like to understand from you?

R B Kabra: When you say 10% volume growth, which company you are talking about because we recently saw the number of?

Manish Ostwal: I am talking about Kajaria Tiles Sir?

R B Kabra: Kajaria, I do not know whether there is a volume growth or not, you will probably see there is a very little growth in terms of value, so if they say that volume growth is 10% then probably they are compromising on prices. There is no 10% volume growth as far as our understanding of the market.

Manish Ostwal: Sure Sir. Thank you so much.

Moderator: Thank you. The next question is from the line of Sameer Raj from Reliance Mutual Fund. Please go ahead.

Sameer Raj: Thanks for taking my question. Sir, if we look at our last year's number especially Q4 numbers Q4 is usually very good for us both in terms of revenue and end of the margin, for example EBITDA margin in Q4 last year is 18.2%, so looking at such a high base how confident you are of maintaining the performance in Q4?

R B Kabra: We are confident of growth whether 14% or 10%, but we are confident of at least 10% growth.

Sameer Raj: But in terms of margin, for example last year same quarter I mean Q4 EBITDA margins are as high as 18.2%?

R B Kabra: So Sameer that happens because in the building product, whenever there is a large volume sale. Unfortunately in both businesses, glass and sanitary ware, the fixed costs are very high because both have furnaces. So once the volume goes up, the contribution goes up disproportionately. So we are confident that the Q4 will be certainly better than the quarters, which have already gone.

Sameer Raj: And it will be better than the same quarter last year?

R B Kabra: At least maintaining that because unfortunately the sanitary ware growth is lower than what is our expectation, the faucet is growing and faucet gives less contribution.

Sameer Raj: Right.

R B Kabra: So, at least we will be able to maintaining those percentages.

Sameer Raj: Sir, how do you see overall outlook for a business because so far whichever Ceramic company has reported results all are reported very poor set of numbers, it looks like the market sentiment is pretty poor, the fundamental for Ceramics are different than what they have for sanitary ware, but overall how do you see the outlook near term and medium term?

R B Kabra: People have started talking of improvements in the market place especially for the retail customers. The projects are still struggling for the money though they have started now working harder to manage their finances because now with the RERA coming, the pressure from all judiciary in terms of delivering flats in time to the customer, so everybody is running around here and there to get finances and we understand that some of them are getting finances from the private equity, project specific funds are coming in, so I think going forward in the next two or three quarters there should be improvement and in 2018-19 we are quite hopeful that at least going forward from Q2, Q3 there should be improvement in the institutional business.

Sameer Raj: Sir, lastly what is the status on the demerger, when you expect things to move?

R B Kabra: We had applied to stock exchanges immediately after last board meeting, so the stock exchange has to give the approval and then we will have to go to NCLT and then whatever time NCLT take, so I think at least four to five months.

Sandeep Sikka: I think if we get the stock exchange approval now by middle of February so maybe five to six months to complete.

Sameer Raj: Fine. That is all from my side. Wish you very best for the coming years.

Moderator: Thank you. Anyone having questions. May press'*' and answer.

Sandeep Sikka: I think there are no more questions, we can close this call.

Moderator: Sure, right. There are no further questions I would like to hand the conference back to the management for any closing comments.

R B Kabra: Thank you everyone for taking out time from your busy schedule and to hear us and to understand the working of the numbers that how these have been arrived. We are always available for any kind of further clarifications on the numbers if anybody wants, they can call us anytime. Thank you very much once again.

Moderator: Thank you very much. On behalf of Emkay Global Financial Services that concludes this conference. Thank you for joining us ladies and gentlemen. You may now disconnect your lines.