"HSIL Limited Q4 FY18 Results Conference Call"

June 01, 2018

MANAGEMENT: MR. SANDEEP SIKKA - CFO, HSIL LIMITED
MR. R.B. KABRA - PRESIDENT (BUILDING PRODUCTS), HSIL LIMITED
MR. NAVEEN MALIK – HEAD (CORPORATE FINANCE), HSIL LIMITED

MODERATOR: MR. SANJEEV SINGH - EMKAY GLOBAL

Moderator: Ladies and gentlemen, good day and welcome to the Q4 FY18 Results Call of HSIL hosted by Emkay Global Financial Services. We have with us today, Mr. Sandeep Sikka - CFO, Mr. R.B. Kabra - President for Building Products and Mr. Naveen Malik – Head of Corporate Finance. As a reminder, all participant lines will be in the listen only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal for an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I would now like to turn the floor over to Mr. Sanjeev Singh from Emkay Global. Thank you and over to you, sir.

Sanjeev Singh: Good afternoon everyone. I would like to welcome the management and thank them for giving us this opportunity. I would now hand over the call to the management for the opening remarks. Over to you, sir.

Naveen Malik: Good afternoon, 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 and twelve months ended 31st March 2018 have been prepared in compliance with the applicable Indian Accounting Standards (Ind AS) notified by the MCA.

Govt. of India has implemented GST from 1st July 2017 replacing existing Excise, Service tax & various Indirect taxes. As per Ind AS 18, revenues for the quarter ended 31.03.2018 and 31.12.2017, are reported net of GST. In this conference call, we are comparing revenue net of Excise/GST and financial figures are rounded off. You may refer to note 4 of results shared with stock exchange for further details.

HSIL has for the quarter and twelve months ended 31st March 2018 achieved revenue of around Rs.661 crore and Rs.2250 crore. After adjusting for GST impact as explained in note 4, there is a revenue growth of 11% and 9% respectively.

The operating profit i.e. EBITDA for the quarter and twelve months ended 31st March 2018 is around Rs.81 crore and Rs.282 crore as compared to previous year corresponding figure of around Rs.74 crore and Rs.294 crore respectively.

The company operates through four business segments:

In terms of segment revenue, the Building products division for the quarter and twelve months ended 31st March 2018 achieved revenue of around Rs.300 crore and Rs.1029 crore. After adjusting for GST impact, there is revenue growth of around 5% and 6% respectively.

EBIT for the Building products division for the quarter and twelve months ended 31st March 2018 is around Rs.45 crore and Rs.168 crore as compared to previous year corresponding figure of around Rs.47 crore and Rs.165 crore.

Packaging products division for the quarter and twelve months ended 31st March 2018 achieved revenue of around Rs.279 crore and Rs.920 crore after adjusting for GST impact, there is revenue growth of around 18% and 5%.

EBIT for the packaging products division for the quarter and twelve months ended 31st March 2018 is around Rs.18 crore and Rs.67 crore as compared to previous year corresponding figure of around Rs.24 crore and Rs.99 crore respectively. There has been drop in EBIT of around Rs.6 crore in Q4 and Rs.32 crore in twelve months mainly due to higher fuel cost as compared to previous year.

Consumer Products division for the quarter and twelve months ended 31st March 2018 achieved revenue of around Rs.61 crore and Rs.208 crore representing growth of 48% and 65% over previous year corresponding figure.

EBIT for the Consumer Products division for the quarter and twelve months ended 31st March 2018 is negative Rs.2 crore and negative Rs.17 crore as compared to previous year corresponding figure of negative Rs.9 crore and negative Rs.24 crore.

The Retail division for the quarter and twelve months ended 31st March 2018 achieved revenue of around Rs.24 crore and Rs.96 crore against previous year corresponding year figure of Rs.30 crore and Rs.96 crore respectively.

EBIT for the Retail division for the quarter and twelve months ended 31st March 2018 is around Rs.0.13 crore and around negative Rs.12 crore as compared to previous year corresponding figure of around negative Rs.1 crore and negative Rs.15 crore respectively.

So, for the quarter and twelve months ended 31st March, 2018, PBT before Exceptional items is around Rs.29 crore and Rs.112 crore, as compared to previous year figure of around Rs.40 crore and Rs.150 crore. After reducing Exceptional item of Rs.6.54 crore as referred in note 8, PBT comes to Rs.106 crore for the twelve months ended 31st March 2018.

Profit after tax for the quarter and twelve months ended 31st March, 2018 is around Rs.24 crore and Rs.75 crore, as compared to previous year corresponding figure of Rs.31 crore and Rs.103 crore.

The total net bank debt of the company as on 31st March 2018 is around Rs.964 Crore with overall loan funding cost at 6.98%.

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

Moderator: Thank you, sir. Ladies and gentlemen, we will now begin with the question and answer session. Sir, we have a question which is from the line of Harsh Kumar Dhanuka from Ncubate Capital Partners. Please go ahead

Harsh Kumar Dhanuka: Sir, we launched this 'Moonbow' brand for water purifier and air purifiers segment. How has been the year and the volumes in this segment and what is the outlook you see for the next year?

Sandeep Sikka: This question is very important to understand from the fact that company over the last 2 to 3 years has taken few initiatives which are strategic. First is expanding the sanitaryware and faucet capacity which is the core business of the organization and second is taking a limited amount of risk by entering into new businesses like the Consumer product business, Pipes business and value added line of Caps and closure business. Till 31st March 2018 many of these projects were either in incubation (i.e. either in the production & factory set up stage or the product approval stage). Financial year 2018-2019 is the first year when major chunk of these businesses will start performing in the market. I will talk business-by-business.

Let us first talk about the consumer product business. This business started around 3 years back from this financial year, and clocked turnover of around Rs.208 crore with a negative EBIT level of around Rs.17 crore but in Q4 FY 2017-18 we had a negative EBIT level of around Rs.2.08 crore. Substantial growth on the revenue side and product acceptability is there.

On Caps and closures side we started with small caps. The project was under trial run for few months and in the month of January 2018 we put it into commercial production. Good response from the consumers again and as we told last time also that we are expanding the capacity to around a billion caps from initial capacity of around 650 to 700 million caps. These projects are all strategic.

The third project which we did was pipes. Plant is ready and is in trial run production, we are building up the inventory. Trial run sales and product acceptability have been very good.

Considering all these facts we feel that we will get tremendous growth on an overall business ranging 13% to 16% in coming financial years on the topline and we will also consolidate much on the bottom-line on the all investments which we made. We have been saying in various analyst meets that when we go a year ahead i.e. FY 2019-2020, then most of these projects will actually scale up to their peak level also. We feel that transitions are fairly medium term story where in you will see opening up of various growth avenues for the company for which the initiatives have been done since 2015 onwards.

Harsh Kumar Dhanuka: Can you comment in terms of within the consumer business, different products contributions are around?

Sandeep Sikka: Within the Consumer business the largest sector is Kitchen hoods & hobs and Kitchen chimneys. The only thing which we can confirm here is that this is not a market report, and this report is based out on our own team estimate, that we are currently poised either number 2 or 3 in the market, number 1 and 2 used to be Elica and Faber. This business contributes almost 48% of the turnover of consumer product business. Last year, we have done Rs.208 crore and 48% of that is Rs.100 crore plus in this business. Second largest business is Water heater business where overall sales growth is good & this business also contributes a good chunk. Other products are again very well-accepted. We have Water purifiers and Air purifiers which are taking time to establish. These three businesses which are Water heaters, Kitchen hoods & hobs, Kitchen chimneys and Air coolers have set a base for themselves.

Moderator: Thank you. Next question is from the line of Gautam Behl from Mauryan Capital. Pease go ahead.

Gautam Behl: I have a couple of them. First one, sir on the demerger scheme could you give us an update, I know in the earnings result you said that the BSE, NSE approvals has been taken already. But just any update on the timeline if you can give us from now from hereon?

Sandeep Sikka: NCLT Kolkata is right now on their vacations and will open on 4th June which is Monday and we are ready to file papers. Company has already received principal approval from all its lenders and once it is put to NCLT, they will call a meeting of shareholders as well as the creditors. We feel that timeline should be around 4 to 5 months from now, in terms of seeking approval from NCLT of Kolkata. But I put a caveat, it is a time bound programs under the requirement of law and there are other cases also which are coming up in NCLT. We feel that 4 to 5 months is an appropriate time by which we should be able to take the approval from NCLT.

Gautam Behl: It sounds like only routine things are left, there should not be any hiccups apart from this right?

Sandeep Sikka: Yes, the critical approvals of both the Stock exchanges and lenders are there. Shareholders will vote on the meeting itself. We are fairly confident that in 4 to 5 months we should be able to get the approvals.

Gautam Behl: And post the approval it is a matter of week before the actual listing happens, right?

Sandeep Sikka: Listing may take time as per the legal advice which we have received, because right now the stock exchanges has given the in-principal approvals for listing of Somany Homes. But post the demergers we will have to apply with the full set of papers through the exchanges for final listing approval. It may take sometime around 30 to 45 days for the listing of SHIL, which is Somany Homes Innovation Limited.

Gautam Behl: Sir and a couple of questions on the various divisions, on the building products I think in past meetings and calls we have guided for a 15% to 20% topline growth in that in the coming years. I think Mr. Somany in an interview recently also said that. But this quarter was only a 5% topline growth adjusted for GST. Any comments on that?

Sandeep Sikka: The main chunk of growth for us is the sanitaryware and faucets markets. Sanitaryware market to a large extent is linked to the developments of real estate which is still not that great, but company has historically been able to grow on the faucets at more than 15% plus CAGR in the last 3 to 4 years. But at the same time company has initiated number of initiatives during the year due to which the demand of the sanitaryware and the demand towards the premium side of the sanitaryware increased. We launched the brand called 'Alchymi' which was basically a new innovation of doing a coloured sanitaryware. We are using a black and grey sanitaryware which is very well accepted in the market. The company keeps moving towards all these initiatives so that engagement with the consumer especially towards the premium consumer is always taken as a priority. But going forward we feel that the market should come back and when Mr. Somany talks he talks on the overall building material business which includes the pipes and other businesses also. Pipes a new sector and as we have been giving guidance that in 3 years we should be able to touch around Rs.400 crore plus of revenues in the pipes. Sanitaryware will do a normal growth based on the real estate but faucet again we are bullish. We expect then on an overall basis of the building product division we should be able to clock the numbers which we just talked about.

Gautam Behl: And the first couple of months of the new financial year have been along the same line to give you confident to say that?

Sandeep Sikka: Yes, I can talk about that.

Gautam Behl: And sir, just lastly from me, the consumer business we had a run rate of around 60% to 70% growth in the past few quarters. I mean 48% growth is still great but it is a slight slowdown. What do we expect in that going ahead?

Sandeep Sikka: Answering any queries on a particular quarter is little bit towards the aberration, but I can tell that business has grown substantially in last 3 years. We started with a very small base of around Rs.15 crore to Rs.20 crore around 3 years back which we have been able to build to around Rs.208 crore and we feel that we should be able to grow at around 50% plus on this as we move forward.

Gautam Behl: And the scale-up on this we still sort of targeting Rs.500 crore type number in FY20?

Sandeep Sikka: Yes, in 2 years it should be feasible.

Gautam Behl: And sir, last one from my side net debt has gone up a bit more than I would have expected year-on-year. Any particular reason for that?

Sandeep Sikka: Most of the projects have started; working capital build up for all those projects is also coming like for pipes project we are now building inventories; same for caps and closures also. The size of business is also growing like for consumer business when you see on an apple-to-apple basis, last year was around Rs.120 crore to Rs.125 crore. There is an increase in sales volume and new projects coming up which has resulted in higher working capital blockage. As turnover will build up the number of day's inventory will get normalized. Apart from this all the CAPEX which has been done historically leading to these projects. Now major chunk of money has been spent. And as we move forward, we feel that it will start reflecting in the growth in EBITDA and most of the figures will get normalize as I said at the start of the call. We can see in next 18 months a lot of transformation both on the sale side and the EBITDA side.

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

Prashant Kutty: A couple of questions with regards to the quarterly numbers. What is the growth in the segment of the building product side for the quarter adjusted for GST?

Sandeep Sikka: That is around 6%.

Prashant Kutty: And how much would be, let us say sanitaryware growth and faucet ware growth?

Sandeep Sikka: Sanitaryware is around 4% and faucet is around 13%.

Prashant Kutty: And like you are saying to the earlier participants when you typically talking about 15% topline growth you are taking into account pipes from the next year onwards as well or are we just typically only talking about sanitaryware and faucets?

Sandeep Sikka: Pipe will be a part of building product division going forward. Project is under trial run now and no turnover has been acknowledged in this business. As of now we can give guidance that in 3 years we should be able to scale this business to a level of around Rs.400 crore. When we give guidance from the overall product side we do include the pipes business also as a part of that.

Prashant Kutty: Now, because if I am talking about Rs.400 crore kind of topline in the next three years. Is it largely got to be back-ended because I am talking about 15% growth rate in the building product side and I am talking about Rs.400 crore from a 0 base today on the pipes side. So, I am assuming the growth rate should be a little higher that is why I was kind of alluding to that?

Sandeep Sikka: We are on a zero base, you will see the initial growth much higher as compared to the growth later on.

R.B. Kabra: Prashant, to answer your question we still maintain that sanitaryware, if the real estate things normalizes in next 2 quarters should go back to its market growth of 12% to 14%. Faucets, of course, are growing 13% to 15% now on the little larger base and it used to grow 24% to 25% for last 2 years. Because now the base is large and we are number two in the country for the faucets. So, now we are expecting a faucet growth of anywhere between 13% to 16%. So, that is number two and pipe of course, will be additional. So, if we work out that way. Now this year pipe, the first year is highly unpredictable because the product launch we feel that whatever sample have been shown to the dealer community or the distributor community, they have highly appreciated the quality of the fitting and the pipes both. So, you are right that including pipe the growth rate should be higher than 15% which is right but what will be the pipe sale in the first year that is to be seen, we are confident that in 3 years' time it will be Rs.400 crore. But the first year is always unpredictable because we have to go to the customer tell them give them to bill the product. But I think this year pipes should be doing more than Rs.100 crore going forward. And the sanitaryware should grow for the whole year anywhere between 10% to 13% and faucet anywhere between 13% to 15%.

Prashant Kutty: Sir, like I said probably will be more back-ended as far as pipes are concerned? Sir my second question is again on the building product side. If we look at the margin structures I understand that faucet share has been increasing but what would be a more sustainable level of margins because every quarter, we have been seeing some kind of moderation as well as the margins have been concerned. What could be specifically the reasons over there? As you see the power and fuel cost number has gone up? Any other thing apart from power and fuel cost which should have impacted this margin number and what would be believe as a normalized number for the building product side inclusive pipes.

Sandeep Sikka: Are you talking about EBIT numbers percentage to sale?

Prashant Kutty: That is right, yes EBIT numbers.

Sandeep Sikka: We had 16.18% EBIT last year and 16.56% EBIT this year. One figure you have to subtract is the figure of around Rs.2.1 crore at EBITDA level and Rs.2.45 crore at EBIT level. This is the loses relating to the pipes division which we could not capitalize under the trial run. These are basically branding and related other expenses. Pipe is under the brand called 'Truflo' by Hindware. Trial run sales are already in the market for establishing the quality and other parameters. We had some initial media launches on this. We have been able to maintain the EBIT margin as a percentage to sales on a year-to-year, in fact slight improvement from 16.18% to 16.56%.

Prashant Kutty: And that should be a sustainable number going forward because next year we are going to be seen some more trial runs and probably more marketing expense towards the pipe segments. Where do we expect the margins to settle let us say in the next year?

Sandeep Sikka: Next few quarters although pipe will be included within the building product division. But the numbers will be presented separately to make it is easy for the analyst community to understand apple-to-apple comparison.

Prashant Kutty: And sir one more point on the building material product side again itself, we have been seeing a couple of pipe players become fairly aggressive in terms of the sanitaryware size well. I understand their size might be relatively smaller but at least in terms of plans that they are pretty much talking about aggressive capacity additional that side. And again, scope for market growth over there as well. So anything again, you think that would probably be a challenge for you incrementally or given that there is a fair bit of aggressive competition and only just normalize competition but formidable players in that side?

R.B. Kabra: Prashant, our competition has been there since beginning as we have been telling and it is true for any building product you talk off. Sanitaryware as a business has the highest level of EBITDA percentage in terms of margins. So, everybody wants to enter this business segment because if you see the tile EBITDAs normally except Kajaria is 7% to 9%; sanitaryware gives EBITDA more than 20%. Similarly, for the faucet EBITDA is 12% to 13%. So, everybody would like to try their luck and see whether they can add some basket of sanitaryware to their revenues. So, that will happen and building revenues of up to Rs. 100 crore with the trading module may be possible but beyond that people have to put up sanitaryware plant and running sanitaryware plant is not as easy as it seems while trading. So, going forward we have to see that how the market shapes up but yes you are right that currently lot of people are trying to enter where they have the same counter where they sell faucets, or they sell tiles because those same counter sells sanitaryware also. So, going forward, year-to-year yes, they will try but with the brand, with the quality, we are very confident that we will be able to maintain our market share as well as the leadership in the business.

Prashant Kutty: So, have we maintained a market share until now or we have seen an increase? How our market share behaved let us say year to date right now?

R.B. Kabra: Amongst top of the organized market players, our share still continues around 36%-37%.

Prashant Kutty: Sir, since Y-o-Y same?

R.B. Kabra: Yes.

Prashant Kutty: Sir, on the packaging side if I may probably sneak in a couple of questions. On the packaging side of it, sir we saw a growth coming up in the quarter. I mean, you have to say that probably you are seeing demand kind of getting back as far as this segment is concerned or was it just a matter of base?

Sandeep Sikka: What we can say here is that demand has come back on the glass side wherein we have been able to demonstrate 17% growth. Partly although it is a one quarter number we got a lot of de-stocking on the liquor because of the demonetization. I think Q3 FY'18 and Q4 FY'18 has been a bit of a revival. We may have to watch one or two quarters before confirming that whether this is fairly sustainable on a short-term to medium-term growth. But right now market is looking good and market is looking positive on the glass side.

Prashant Kutty: Would be with margins as well, because you have seen the margins move in the other directions?

Sandeep Sikka: Margins have been under pressure for last 1 or 2 quarters because of the fuel hikes. And we have been talking for a price hike with our customers and we should be able to get that this quarter or may be next quarter.

Prashant Kutty: And Caps and closure numbers have started coming in or it is not yet into the numbers? Or when you will start coming in?

Sandeep Sikka: It is a part of Packaging Product division.

Prashant Kutty: Yes, I am asking as it started coming into the numbers as of now?

Sandeep Sikka: Yes. It is there.

Prashant Kutty: We have some Caps and Closure business in the quarter as well?

Sandeep Sikka: Yes.

Moderator: Thank you. Next question is from the line of Bhavesh Jain from Envision Capital. Please go ahead.

Bhavesh Jain: Sir, what will be our CAPEX plan for FY19?

Sandeep Sikka: Overall Capital expenditure which we are expecting in financial year 2018-2019 will be in the range of around Rs.200 crore to Rs.225 crore. One big expenditure out of this would be relining of one of the glass furnace. Just to give a background, we restarted one of our furnaces which we use to call as furnace 3 last financial year and now one more furnace comes under schedule lining for which Rs.80 crore has been earmarked. This figure of Rs.200 crore to Rs.225 crore includes the spent of around Rs.80 crore on the glass relining of furnace 4.

Bhavesh Jain: And sir for this expansion of this caps and closure capacity how much we will be spending on that?

Sandeep Sikka: For almost a billion cap plus. The total plant expenditure is in the range of around Rs.160 crore to Rs.165 crore.

Bhavesh Jain: And sir any new products which we are planning to add in consumer products or we will be as of now consolidating with the existing products?

Sandeep Sikka: We keep working on various products in house, but right now the plan is to consolidate with the five products which we have. Any new thing we plan, will definitely inform as per the disclosure requirement to the market also.

Bhavesh Jain: And so, for the whole year what has been the A&P spend?

Sandeep Sikka: Yes, for which business?

Bhavesh Jain: For consumer products?

Sandeep Sikka: It is around Rs.45 crore.

Moderator: Thank you. Next question is from the line of Manjit Buwaria from Solidarity Investments. Please go ahead.

Manjit Buwaria: I just had a question related to the A&P spend, did I here right that 45 crore was the spent for consumer products?

Sandeep Sikka: Yes.

Manjit Buwaria: Sir, my follow up question on this is I remember on one of the calls you mentioned that consumer product division is normally a 30% gross margin business and you had also mentioned that around Rs.250 crore it becomes EBITDA breakeven. Am I right?

Sandeep Sikka: Broadly the guidance provided in the last quarters, we should have been saying is that most of the products relating to the consumer product we make a gross margin between 35% to 40%. We have been fairly meeting this and at around Rs.300 crore, we should be able to breakeven at EBITDA level, provided that we do not do more campaigns on our new brand of consumer products which is the 'Moonbow' brand. As Mr. Kabra is giving us a figure and it includes media spend on a new brand. Just to give a background here, Air purifiers and Water purifiers are sold under the 'Moonbow brand'. Hence it is a new brand, basically to invest money in preparation of this brand. In all the guidance what we said is subject to further advertisement expense, because when you run a campaign, the campaign is pretty costly.

Manjit Buwaria: Sir, so is the fixed overhead for this consumer product division at around Rs.30 crore to Rs. 35 crore?

Sandeep Sikka: Difficult to answer right now. I can give you guidance.

R.B. Kabra: Fixed expenses, expense between 15% to 17% currently of the revenues of last year.

Manjit Buwaria: 15% to 17% of CPD revenues.

R.B. Kabra: Yes.

Manjit Buwaria: Sir, my next is, I just wanted to understand when the strategy on consumer division and then coming from the fact that the industry leader in any product category whether I think air coolers for examples would be spending around Rs.40 crore to Rs45 crore just on advertising?

I was going through the Kent water purifier's numbers and they spent almost around Rs.100 crore on advertising and promotion combined. So, I just want to understand when the industry leaders spent so much. How do we gain share in a market? Because I understand the push where you reach out to the distribution but how is the pull created? How do you compete on that?

R.B. Kabra: See, basically we have never said that we would be number one going forward in any of these products categories. What we have been saying is that we are targeting market share of anywhere between 10% to 15% going forward. And the market size is so large that if we get even 10% share of the cooler; 10% share of the Geysers, in the kitchen appliances we already have more than 10% share of the market. So, if we see that this revenue which is Rs.700 crore to Rs.800 crore is very easy to reach. We have never said that we are striving to be number one in any of the product category and yes, we have to keep in mind the profitability also and some day we have to make money in this business. So, we cannot keep spending too much on the advertising and publicity also. So, within our means, we want to have a profitable growth, going forward.

Manjit Buwaria: Sir, so my question stems from one of your peer companies had kind of given and understanding that the top three players in any product category captured around 80% of the profits of that category? So, is that understanding, right or you would differ on that?

R.B. Kabra: Very difficult to say for me.

Moderator: Yes, sir. We do not have any further questions in the queue.

Sandeep Sikka: Thank you everybody for joining us. If you have any further questions, you can definitely write back to us and we will be happy to respond to you. Thanks a lot for joining again. Thank you.

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