



HSIL Limited

Initiating coverage

MARKET DATA

NSE TICKER	HSIL
Networth H1FY17 (Rs in Crs)	1523
P/BV Ratio (FY17E) (x)	1.2X
EPS (TTM)(Rs.)	9.8
Market Price (Rs.)	281
P/E Ratio (TTM) (x)	28.7X
52 Week High (04/07/2016)(Rs)	406
52 Week Low (20/02/2016)(Rs)	186
Market Capitalisation (rs. Cr)	1858

AVERAGE MONTHLY VOLUME ('000)

BSE	12.5
NSE	68.6

SHARE HOLDING PATTERN

Promoter (No pledge)	48.9
FII	4.3
DII	27.6
Public	19.2

RETURN (%)	3M	6M	12M
HSIL	21.1	21.0	-25.4
Nifty	8.7	10.7	11.5

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Hindustan Sanitaryware and Industries Limited (HSIL) is an Indian company engaged in the business of manufacturing sanitary ware, faucets, PVC pipes, glass bottles and dealing in consumer goods. HSIL is the owner of flagship brand 'Hindware' which is one of the renowned brands in sanitary ware market.

HSIL saw four years of stagnation in its business mainly due to slackening of consumer demand, and disruptions from GST and demonetization. However, we believe that this lean period is bottoming out for the company and expect it to see some growth coming back across all segments.

Building Products Division (BPD) to get back to growth track.

The BPD division saw a modest growth of 4.4% CAGR over last four years, with the turnover of this division increasing from Rs. 914 cr to Rs. 1087 cr in FY19. Going ahead, we expect the sanitary ware industry to rebound from multi-year lows and post a modest growth during FY20 and build on that growth over next three to five years on the back of pick up in residential and commercial real estate market and rise in replacement and renovation demand. This recovery augurs well for HSIL which has a strong brand and network reach. We expect company to witness revenue growth of ~9% CAGR through FY19 to FY21 to Rs. 1,283 cr.

Packaging Division: Proxy play on the fast growing beverage industry

After three years of stagnation when the industry faced sales restriction, we expect consumption of alcohol to resume uptrend and HSIL's packaging division to piggy-back the growth in the underlying industry. We are factoring in ~7-9% volume growth over the forecast period for HSIL which will translate into revenue growth of 13.5%. Firming up of demand and stabilization of input cost will also enable passing on of input price hikes and recovery in margins which had dipped to multi-year low.

Consumer Products: Leveraging brand name and distribution reach:

Over last 3 years, HSIL expanded its distribution and retailer network to 575+ and 8500+ respectively, which led to a rapid growth in its consumer product segment. The product categories in which HSIL delves in are of aspirational qualities and has only marginal penetration in Indian markets. Given the strong growth drivers in terms of favourable demographic curve, changing preferences and faster replacement and higher disposable incomes, we expect this segment to grow at 20-22% CAGR over next 2-3 years.

Valuation & View:

At CMP of Rs. 284, the stock is trading at ~14.9X FY20 EPS which translates into EV/EBITDA of 7.3X on FY20 EBITDA. Given the improving financials of HSIL which will translate into better profitability and return ratios, we are valuing the stock at 22X FY21 EPS of Rs. 17.7 to arrive at our target price of Rs. 390 for the stock which represents an upside potential of 47%, implying a CAGR return of 21.3% over next two years.

Year	FY18	FY19	FY20E	FY21E
Revenue	2254.1	2713.0	3112.8	3502.5
EBITDA	273.2	316.2	387.8	462.8
EBITDA Margin	12.1%	11.7%	12.5%	13.2%
PAT	82.1	70.7	87.5	128.3
EPS	10.5	9.8	12.1	17.7



❖ About Company

HSIL Limited is an Indian company, which offers sanitaryware, faucets and glass bottles. The company's segments include building products division and packaging products division. The company's brands include QUEO, Amore, Hindware Italian Collection/Hindware Art, Benelave, Raasi, Moonbow, EVOK, AGI and Garden Polymers.

Dissecting HSIL's business:

Segment	Revenue %	Descriptions
Building products	45.0%	Manufacturing of; <ul style="list-style-type: none"> Sanitaryware: water closets, wash basin, cisterns, bath tubs, urinals. Faucets: Faucets, showers and accessories.
Packaging	40.4%	Company manufactures glass containers, PET bottles and caps and closures, and caters to beverages, liquor, chemical and pharmaceutical companies.
Consumer Products	11.3%	HSIL started this division in FY17 and it deals with products like Kitchen Hobs, Chimneys, Water Purifiers, Air purifiers, Air coolers, Water heaters,
Retail	3.4%	It's a small segment through which company operates retail furniture outlets. It's not a focus area and will continue to remain insignificant part of the company.

❖ Investment Rationale:

Building Products Division (BPD) to get back to growth track.

The BPD division saw a modest growth of 4.4% CAGR over last four years, with the turnover of this division increasing from Rs. 914 cr to Rs. 1087 cr in FY19. However, this growth was largely led by faucet division which was started by the company in FY13. This division grew at a rapid pace on a smaller base and driven by company's strong brand and distribution reach. Between FY15 to FY19, revenues from faucets division grew at a CAGR of 15.7% compared to a mere 2.8% CAGR growth in sanitary ware division. The growth of sanitary ware division is largely based on the growth of the real estate construction market and some replacement demand. Slowdown in real estate construction market in last 3-5 years impacted the performance of HSIL as well.

BPD segment revenue (excluding sales from pipes)

Year	FY15	FY16	FY17	FY18	FY19	CAGR
Total BPD Revenue	913.7	1,006.5	1027.2	1174.9	1283.2	4.4%
Faucets	205.8	236.7	267.5	335.0	368.4	15.7%
Sanitaryware	643.8	684.4	669.7	689.9	718.8	2.8%

BPD Division market dynamics:

The sanitary ware industry comprises a variety of products such as washbasins, water closets, bathtubs, faucets, cisterns, seat covers, sinks, bidets, other accessories, etc.

Segment	Size of the market	Organized market	Unorganized
Sanitaryware	4,400 cr	60%	40%
Faucets	8,000 cr	50%	50%

The combined size of the market is estimated at Rs. 12,500 cr. and around 45% of the market is catered by unorganized/smaller players. The market is bifurcated on the basis of pricing points like low end, mass market, premium and luxury. The unorganized/smaller players largely cater to the low end consumers and lower portion of the mass market, while the organized sector caters to upper end of the mass market and the premium and luxury consumers.

Given the different segment of customers they are catering to, there won't be a large shift from unorganized to organized space as it was widely anticipated at the time of GST implementation. The shift of business to the organized



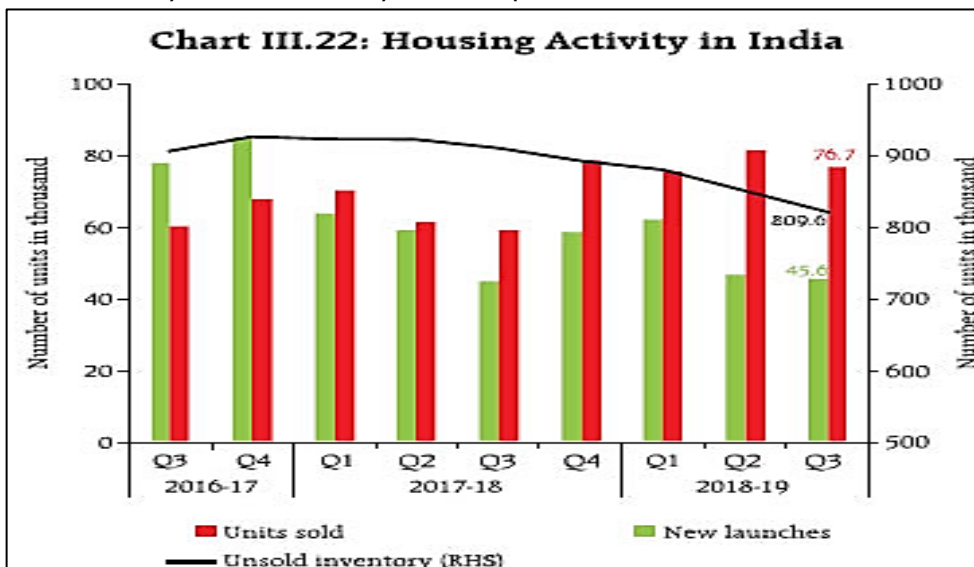
players will come from the mass consumers moving up the value chain and starts buying premium products. That is something which we expect to happen, albeit gradually.

We expect the overall sanitary ware industry to rebound from multi-year lows and post a modest growth during FY20 and build on that growth over next three to five years. The demand for faucets and sanitary ware can be dissected into the following three drivers:

- Growth in residential real estate construction- 70% of demand
- Increase in renovation/replacement market- 15% of demand
- Commercial real estate construction- 15% of demand.

i) The residential real estate market has been in a lull over last 3-5 years. Except for the affordable housing segment, which got a significant push from the Govt, the broader market witnessed limited off take and new launches. The credit crunch witnessed by the HFs post IL&FS saga further aggravated the situation.

However, over last couple of quarters, the sales have picked up slowly and the levels of unsold inventory are gradually coming down. New launches, which spur the economic activity and which is more important for HSIL's BPD division is yet to show recovery, but we expect it to follow soon.



- ii) The renovation market which forms ~15% of total sanitary ware demand will be driven by following factors:
- Increase in the population of middle income group and trend of nuclear families which is increasing the size of the target market.
 - Improving standard of living and increase in beautification of bathroom.
 - Huge replacement market from low end to mass and premium products.
- iii) The commercial real estate market has held well, despite overall slowdown in economic activities. With the Lok Sabha election behind us and a stable regime at the helm for another term, we believe that the private capex recovery which has remained elusive is expected to come to fruition over next year or so, and provide an impetus to commercial real estate market.

The combined impact of the above factors augurs well for HSIL which has a strong brand and network reach. We expect company to witness revenue growth of ~9% CAGR through FY19 to FY21 to Rs. 1,283 cr.

HSIL BPD Division sales forecast:

Year	FY19	FY20E	FY21E	CAGR
Total BPD Revenue	1087.1	1174.7	1283.4	8.7%
Faucets	368.4	401.2	439.1	9.2%
Sanitaryware	718.8	773.5	844.3	8.4%



Foray into CPVC pipes to expand company's addressable market.

During FY19, HSIL begun the commercial production of its CPVC pipes plant. Company has invested Rs. 160 cr for this plant which has a nameplate capacity of 30,000 MT at the moment. Company has future plans to ramp up the capacity to 60,000 MT over next 3 years. Company will be selling its pipe under the brand name 'Truflo' and it has already built a decent order-book which would enable them to operate the plant at 60-70% utilization by the end of FY20.

The market size of plastic pipe industry in India stands at around Rs. 30,000 crore and is expected to grow at a CAGR of 10-12% in medium term. Within this, the market size of plastic pipes business catering to plumbing and sanitation (CPVC Pipes) is estimated at Rs. 8,500 crore. Thus, foraying into this segment will increase the addressable market size for the company. The CPVC segment is expected to see much faster growth of ~15-18% CAGR over next 3 years. The overall share of CPVC pipes which was 12% within the Pipe Industry in 2016-17, would go up to 15% by 2022. The unorganized sector in pipe business is ~35-40% but it is largely concentrated in agricultural and plumbing sector.

The key growth drivers of CPVC pipes are:

- Substitution and Replacement of old pipes and even steel/DI pipes. CPVC pipes are lighter, more durable and costs less in transportation compared to steel/DI pipes. Thus at household level, metal pipes will see lot of replacement from CPVC pipes.
- Various Govt. schemes for urban infra, irrigation and real estate segment like smart cities, AMRUT, push to affordable housing and
- Increasing rate of urbanization and uptick in housing sales.

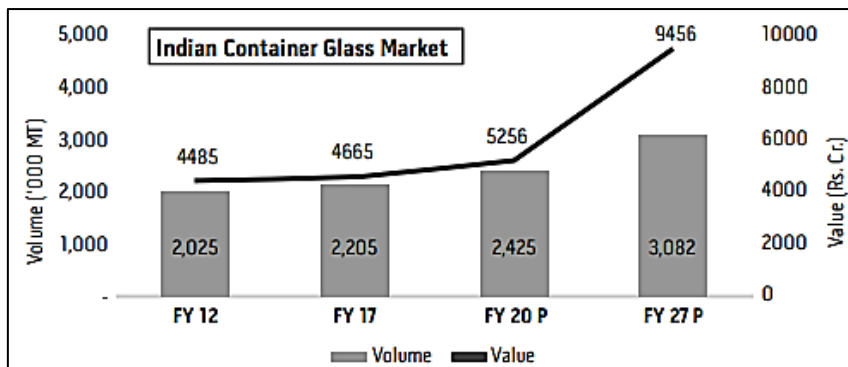


Packaging Division: Proxy play on the fast growing beverage industry

Under packaging division, HSIL manufactures Glass containers, including specially coloured glass bottles, PET and counterfeit-resistant security caps and closures. However, company derives ~95% of its revenues from glass bottles and rest from the other products.

Glass containers:

The size of the glass container market in India is estimated at Rs 4,700 crores and it caters to various sectors like packaged beverages, food, beer, liquor, chemical and pharmaceutical. The glass market in total is expected to grow at 7% CAGR for next ten years, of which the volume growth will be ~4-5%. With the beverage and pharmaceutical industry gradually shifting towards PET bottles and cans, some demand from that sector is expected to come off. However, large portion of the growth is expected to come from liquor segment which prefers glass containers due to its aesthetic appeal, hygiene, durability and preservation ability. Since HSIL derives major portion of its revenues from the liquor segment, it will see a higher volume growth compared to industry. (Write plastic ban part in Opportunities)



The alcohol market is relatively under-penetrated in India and is expected to witness a growth of 10-12% CAGR over next 5-8 years. Increase in disposable income, demographic shift towards adolescence, rising affluence, increasing trend of alcohol consumption among female and adoption of more liberal lifestyle are the key growth for alcohol consumption in India. Compared globally, India ranks amongst the lowest in per capita alcohol consumption:

Per capita consumption of alcohol (litre per capita)

Russia	UK	China	S. Africa	India	Brazil
15.1	11.6	8.0	11.5	4.6	9.1

However, in case of soft-drink the market is shifting away from glass containers. With growing cost pressure and ease of use, Coca Cola and Pepsi are shifting their containers from glass bottles to PET bottles. Share of glass packaging has fallen from 34% in FY 09 to 22% at present and is further expected to decrease. Though HSIL is present in this segment in a small way, it wont be enough to move the needle for them.

The revenue from this segment has stagnated over last 4 years, but largely the trend has followed the liquor sales. HSIL’s revenue from this segment has grown at 2.5% while the IMFL liquor sales were 2.6% during the same period.

Particulars	FY14	FY15	FY16	FY17	FY18	9MFY19
Revenues	851.9	905.6	883.9	969.1	940.5	767.6
EBIT	10.0	83.9	112.9	99.4	66.6	25.2
EBIT Margin	1.3%	9.3%	12.8%	10.3%	7.1%	3.3%

Particulars	FY14	FY15	FY16	FY17	FY18	CAGR
IMFL industry revenue	14,050	14,078	14,730	14,939	15,584	2.6%

The glass bottles industry also suffered from the situation of over-capacity during FY15-FY17 when the industry capacity utilization was ~65-70%. The margins were squeezed due to increase in crude oil prices from FY16 to FY18 and sharp spike in the prices of soda ash and several other raw materials. Due to lacklustre demand from the



underlying IMFL industry, company was not able to pass on such sharp increase in commodity prices which led to significant fall in the margins. Moreover during FY19, HSIL refurbished two of its furnaces which led partial closure of its plant and temporary loss of business. However, since Q4FY19 all of the company's furnaces are on stream and running normally which can be seen from improved performance it reported during the quarter.

After three years of stagnation when the industry faced sales restriction, we expect consumption of alcohol to resume uptrend and HSIL's packaging division to piggy-back the growth in the underlying industry. We are factoring in ~7-9% volume growth over the forecast period for HSIL which will translate into revenue growth of 13.5%. Firming up of demand and stabilization of input cost will also enable passing on of input price hikes and recovery in margins.



Consumer Products: Leveraging brand name and distribution reach:

HSIL's product portfolio comprises of Kitchen Hobs, Chimneys, Water Purifiers, Air purifiers, Air coolers and Water heaters.

India's consumer durables market recorded a robust growth of 16.3% CAGR during FY 2012-17 and reached Rs. 1 lakh cr at the end of FY17 and is expected to grow at 10% CAGR over next 5 years. Currently, urban India contributes over 65% to the total revenue of the sector, while rural India accounts for the rest.

Key growth drivers for consumer durables:

- Positive Demographic Age Curve: - ~ 25% of India's population is aged 15 – 25 implying ~8.5 cr new households and kitchens which would be set-up over the next decade or so.
- Technological evolution of products and changing preferences has increased the rate of replacement of products.
- Increase in per capita disposable income and emergence of the new middle class.

On a small base company has grown the business of this segment rapidly, leveraging its dealer network and existing clientele. The real challenge would lie ahead as it grows bigger in size and incremental growth would come only through market share gains. Over last 3 years, HSIL expanded its distribution and retailer network to 575+ and 8500+ respectively, which is one of the reasons for rapid growth in this division.

One of the reasons for our optimism on this segment is that the penetration of some of the company's products like hobs, chimneys, air purifier and water purifier is still pretty low in India and this segment is growing pretty rapidly.

To put things in perspective, in 2017, around 2,00,000 units of air purifiers were sold in India while in China this number stood at 9 million. According to ASSOCHAM this product category would grow at nearly 30% CAGR from 2018 to 2023 to \$39 mn in India. Even in the case of kitchen chimney, the size of the market currently stands at 260,000-300,000 units which is just one-eighth compared to Chinese market. Thus we believe that HSIL would continue to clock high double digit growth in this segment which will also help to turn this division into profits, which ended with negative EBIT of Rs. 0.6 cr in FY19.

Impending de-merger has potential to further unlock the value of the stock:

HSIL is demerging its consumer and building materials business, which is expected to be completed by end of CY19. In this demerger, branding, marketing, sales, distribution, etc. of consumer products and that of furniture, furnishings, home décor (Retail Undertaking) will be demerged into an entity named Somany Home Innovation Limited

HSIL Demerger explained in snapshot:

Current Structure:

HSIL Ltd: All the business are housed under this entity, namely;

- Building Product Division (BPD)
- Packaging products (Glass bottles and caps)
- Consumer product division
- Retail business (EVOK)

Post demerger, three companies will be created:

1. HSIL Ltd.
2. Somany Home Innovation Ltd (SHIL)
3. Brilloca Ltd.

SHIL will list on the bourses and Brilloca will remain an unlisted company as a 100% subsidiary of SHIL. After the demerger, the above businesses will be housed in these three companies as follows:

HSIL:

- Packaging Division- manufacturing and distribution
- Manufacturing of building products (sanitary ware, faucets and pipes)



SHIL:

- Consumer product distribution and marketing
- Retail business (EVOK)
Brilloca Ltd:
- Distribution and Marketing of building products (sanitary ware, faucets and pipes)

Rough financials of the de-merged entities (based on FY18 numbers):

Particulars	HSIL	SHIL (incl Brilloca)	Consol.
EBITDA	130 cr	140 cr	270 cr
Debt	865 cr	365 cr	1230.9 cr

Risks & Concerns:

- Sharp increases in input costs: Since large portion of raw materials are imported and is commodity based (in BPD and packaging division) sharp increase in prices will have negative impact on margins especially when the demand scenario is weak during which company is not in a position to pass on the cost escalations.
- Limited market and increasing competitors. Due to clear segmentation of market between organized and unorganized players, the shift from latter to former will be limited. And to avoid brand dilution, organized players won't cater low end markets. This leads to increasing competition with the target market growing moderately.
- There is a threat of increasing competition in consumer product division, since increasing number of companies are venturing into this market to capture some pie of the fast growing business. This can cap the upside on the margins, since company may lose some pricing power.



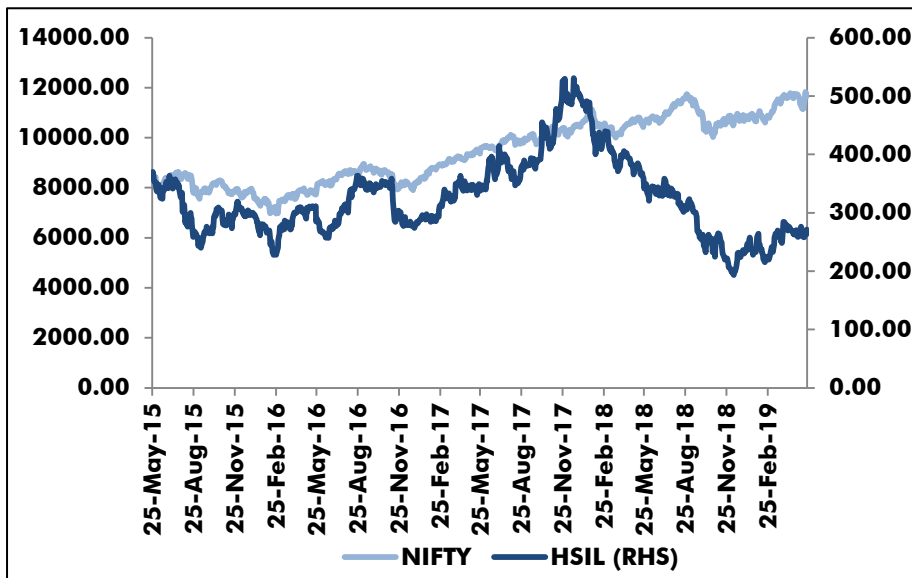
Valuations

At CMP of Rs. 284, the stock is trading at ~14.9X FY20 EPS which translates into EV/EBITDA of 7.3X on FY20 EBITDA. On relative basis, Company's close peer Cera Sanitaryware, which of course is more efficient compared to HSIL in operational terms, trades at an average P/E of 30-35X on normalized earnings and ~20X on EV/EBITDA.

Given the improving financials of HSIL which will translate into better profitability and return ratios, we are valuing the stock at 22X FY21 EPS of Rs. 17.7 to arrive at our target price of Rs. 390 for the stock which represents an upside potential of 47%, implying a CAGR return of 21.3% over next two years.

An optionality on the stock will be on the retail business post demerger. The Street has an enchantment for retail businesses with strong brands. HSIL has a bouquet of strong brands, especially its flagship brand 'Hindware'. Post de-merger of retail business, there is a possibility of the retail business getting premium valuation than what we are assigning, which can provide a further upside on the stock.

5 - Yr Price Chart: Zee vs. Nifty





Financials

HSIL Ltd.- Statement of Profit & Loss					
DESCRIPTION	FY17	FY18	FY19	FY20E	FY21E
Net Sales	2076.7	2254.1	2713.0	3112.8	3502.5
EXPENDITURE :					
Raw Material Consumed	805.5	887.1	1132.9	1312.9	1480.7
as % of Sales	38.8%	39.4%	41.8%	42.2%	42.3%
Power & Fuel Cost	248.5	284.4	350.8	407.7	459.4
Employee Cost	286.6	309.0	360.5	387.5	416.6
Other Manufacturing Expenses	208.8	234.7	266.0	300.7	335.6
General Overheads	114.9	123.1	125.3	132.8	143.5
S&D Overheads	125.8	142.7	161.3	183.3	203.9
EBITDA (Ex OI)	286.6	273.2	316.2	387.8	462.8
EBITDA Margin	13.8%	12.1%	11.7%	12.5%	13.2%
Depreciation	109.5	114.0	150.7	170.0	180.9
EBIT	177.1	159.2	165.5	217.8	282.0
Other Income	4.6	9.7	29.9	1.8	0.0
Interest	33.5	55.8	87.5	86.0	86.1
Profit Before Taxation	148.2	113.1	107.9	133.6	195.9
Provision for Tax	47.0	31.0	37.2	46.1	67.6
Profit After Tax	101.2	82.1	70.7	87.5	128.3
Adjusted EPS	14.0	10.5	9.8	12.1	17.7

HSIL Ltd.- Balance Sheet					
DESCRIPTION	FY17	FY18	FY19	FY20E	FY21E
Share Capital	14.5	14.5	14.5	14.5	14.5
Total Reserves	1432.1	1473.0	1508.8	1561.6	1655.2
Shareholder's Funds	1446.5	1487.5	1523.3	1576.1	1669.7
Total Borrowings	911.3	1230.0	1143.5	1180.7	1145.0
Other Non Current Liabilities					
Total Non-Current Liabilities	1186.0	1506.3	1421.3	1467.6	1440.6
Trade Payables	196.7	217.4	262.4	309.6	348.3
Other Current Liabilities	255.6	262.5	272.5	312.6	351.8
Total Current Liabilities	452.3	479.9	534.9	622.2	700.1
Total Liabilities	3084.8	3473.7	3479.4	3665.8	3810.4
Fixed Assets	1675.2	1890.7	1943.0	1895.2	1832.1
Other Non Current Assets	202.8	153.8	172.8	198.2	223.1
Total Non-Current Assets	1877.9	2044.5	2115.8	2093.5	2055.2
Current Investments	104.6	0.3	0.0	0.0	0.0
Inventories	492.5	564.3	576.8	674.5	752.2
Sundry Debtors	397.5	513.8	585.0	679.1	767.7
Cash and Bank	144.3	240.2	60.0	63.0	66.2
Other Current Assets	68.0	110.6	133.1	152.7	171.8
Total Current Assets	1206.9	1429.1	1354.8	1569.4	1757.8
Total Assets	3084.8	3473.7	3470.6	3662.8	3813.0



HSIL Ltd.- Cash Flow Summary					
DESCRIPTION	FY17	FY18	FY19	FY20E	FY21E
PAT (ex OI)	96.6	65.9	40.6	85.7	128.3
Add: Depreciation	109.5	114.0	150.7	170.0	180.9
Change in WC	-15.9	-180.0	-67.0	-134.9	-117.8
Cash From Operating Activities	190.3	-0.2	124.3	120.8	191.4
Cash from Investing Activities	-328.6	-183.1	-203.0	-122.2	-117.8
Cash from Financing Activities	296.2	308.2	-56.6	39.1	-35.7
Dividend	-34.7	-34.7	-34.7	-34.7	-34.7
Free Cash Flows after Div	123.1	90.2	-170.0	3.0	3.2
Opening Cash Balance	16.7	139.8	230.0	60.0	63.0
Closing Cash Balance	139.8	230.0	60.0	63.0	66.2

HSIL Ltd.- Key Ratios					
DESCRIPTION	FY17	FY18	FY19	FY20E	FY21E
EBITDAM (%)	13.8%	12.1%	11.7%	12.5%	13.2%
ROE (%)	7.1%	5.2%	4.7%	5.6%	7.9%
ROCE (%)	8.0%	6.8%	6.5%	8.2%	10.4%
Receivable days	56.3	59.7	66.0	67.0	68.0
Inventory Days	101.3	101.6	94.0	96.0	95.0
Payable days	34.6	33.5	35.3	36.3	36.3
Total Debt/Equity(x)	0.6	0.8	0.8	0.7	0.7
Current Ratio(x)	2.7	3.0	2.5	2.5	2.5
Interest Cover(x)	5.3	2.9	1.9	2.5	3.3
Adjusted P/E Ratio	19.4	25.9	27.8	22.4	15.3
Price/ Book value	1.4	1.3	1.3	1.2	1.2



ANALYST CERTIFICATION

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