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Company Updates

HSIL – Reiterate BUY with revised target price of Rs 329

HSIL Ltd has corrected by ~50% over its 52 week high in the last one year. This fall in price could be attributed to weak demand in sanitaryware sector, decline in building products profitability and lower visibility in segmental performance. In our opinion, this fall is overdone as government continued its focus on improving sanitation levels and valuations have become attractive.

Government thrust: In the Union Budget 2016-17, the government increased allocation to Swachh Bharat Abhiyan by ~3x to Rs 90 bn. It maintained its thrust on improving the sanitation levels of the country. Also, with reforms on affordable housing and REITs, the weakness in real estate sector is likely to stall and improve with time. Focus on rural development would also have a positive impact on the overall rural demand. All these factors are likely to improve the demand for sanitaryware products and faucets sector.

Power and fuel cost: Lower gas prices are one of the major triggers for the company. From January 2016, the gas prices have been further reduced by 35% for HSIL plants. This would improve the profitability of the company in near to medium term, as both building products and packaging products segments are power intensive businesses.

Revenue diversification: HSIL diversified its building products revenue from sanitaryware products to faucets earlier. It is now positioning itself as Consumer Company by foraying into consumer durables like water geysers, air purifier, water purifiers, etc. This would lower its dependence on sanitaryware products revenue and provide more visibility to its building products performance.

Improving performance of packaging products segment: The capacity utilisation of operative packaging products capacity is improving over the last 2-3 quarters. EBIT margin of the segment is also reported at double digits due to favourable power cost. We expect the segment to continue reporting double digit EBIT margin in near to medium term. EBIT margin of the segment stood at 11.2% for 9mFY16.

Outlook and Valuation

HSIL Ltd is the leading player in sanitaryware sector with market share of more than 40%. It is the second largest player of faucets. In our opinion, the company would be the beneficiary of demand revival. The long term outlook of building products sector remains robust due to favourable demographic factors and government focus on improving the standard of living of people. Packaging products segment performance is improving due to reducing fuel costs. One of the key triggers for the stock would be the separation of building products and packaging products business which would reduce the volatility in segmental performance. Recent correction in stock price provides an opportunity to accumulate the stock.

At CMP of Rs 254, HSIL trades at PE of 19.0x and 16.4x its FY16E and FY17E earnings of Rs 13.3 and Rs 15.5 per share respectively. We value the stock on SOTP basis. Due to correction in market and peer valuation, we reduce EV/EBITDA multiple of building products segment to 10x from 12x earlier (Cera Sanitaryware, key competitor, trades at 13.5x FY17E EV/EBITDA). We maintain EV/EBITDA multiple for packaging products segment as volume growth in the segment is still not visible. Accordingly we arrive at target price of Rs 329 per share. We maintain BUY rating on the stock with long term horizon.

Key risk to our estimates would be increase in power and fuel cost lead by increase in gas prices and continuance of subdued demand.

Particulars	Methodology	EBITDA	Multiple	Value
Building products	EV/EBITDA (FY17E)	2,410	10x	24,098
Packaging Products	EV/EBITDA (FY17E)	1,860	4x	7,441
	Total EV (Rs Mn)			31,539
	Net Debt (FY15) (Rs Mn)			7,718
	Market Cap (Rs Mn)			23,821
	O/s Shares (mn)			72
	Target Price (Rs Per Share)			**329**

Source: Company, IndiaNivesh Research