



# **INDEPENDENT** **EQUITY** **RESEARCH**

**Hydro S&S Industries Ltd**

**Q3FY11 Result Update**

**Enhancing investment decisions**

## Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade) The fundamental grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals) The valuation grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Fundamental Grade	Assessment	CRISIL Valuation Grade	Assessment
5/5	Excellent fundamentals	5/5	Strong upside (>25% from CMP)
4/5	Superior fundamentals	4/5	Upside (10-25% from CMP)
3/5	Good fundamentals	3/5	Align (+-10% from CMP)
2/5	Moderate fundamentals	2/5	Downside (- 10-25% from CMP)
1/5	Poor fundamentals	1/5	Strong downside (<-25% from CMP)

### Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

### Additional Disclosure

This report has been sponsored by NSE - Investor Protection Fund Trust (NSEIPFT).

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# Hydro S&S Industries Ltd

Buoyant automobile industry supports performance

Fundamental Grade 3/5 (Good fundamentals)  
Valuation Grade 5/5 (CMP has Strong upside)

Industry Chemicals

Hydro S&S Industries Ltd's (Hydro's) Q3FY11 revenues were in line with CRISIL Equities' expectations, boosted by the demand for its polypropylene (PP) compounds from a buoyant domestic automobile industry. EBITDA margins were better than our expectations owing to improved realisations. Although we remain cautious considering the rising interest rate scenario, our outlook remains positive on the domestic auto sector. Hence, we maintain our earnings estimates for Hydro. We maintain our fundamental grade of '3/5'.

## Q3FY11 result analysis

- Hydro's Q3FY11 revenues increased 20% y-o-y to Rs 351.3 mn driven by strong demand for PP compounds from the automobile industry.
- Realisations improved with raw material cost as a percentage of sales declining 15 bps y-o-y (230 bps q-o-q) to 79.4% in Q3FY11.
- However, this was offset by increased employee expense (up 17% y-o-y) and other operating expense (up 37% y-o-y) on account of expansion of the company's manufacturing facility in Pune.
- As a result, EBITDA margins declined 90 bps y-o-y (64 bps q-o-q) to 6.5% in Q3FY11. Reported EBITDA margins were better than our expectations.
- Hydro reported PAT of Rs 2.2 mn in Q3FY11 compared with Rs 3.8 mn in Q3FY10. EPS was Rs 0.3 in Q3FY11 compared with Rs 0.6 in Q3FY10.

## Key developments

- The company has increased its production capacity in Pune to 12,000 MTPA in Q3FY11 and is presently operating at a ~60% utilization level. Hydro will benefit from the ramp-up in production of Tata NANO and will cater to the material requirement from the Pune plant.
- Price of crude oil, a key raw material for PP, has increased rapidly with the benchmark Brent price increasing to US\$96 in January 2011 from US\$78 in September 2010. The prices of PP have followed the movement in crude prices. We expect increased cost pressure in the near term. The management has approached the OEMs for a price hike and expects to get the revision with effect from January 2011. However, we expect a delay in price revision from some OEMs which will lead to margin compression. Consequently we maintain our earnings estimates for FY11 and FY12.

## Valuations: Strong upside from current levels

We continue to value Hydro based on the discounted cash flow (DCF) method and maintain the fair value at Rs 37 per share. The stock price has corrected by 30% since our previous update report (November 02, 2010). Hence, we are raising our valuation grade to '5/5'. At this value, the implied P/E multiple is 9.3x FY12 earnings estimate.

## KEY FORECAST

(Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
Operating income	1,184	1,098	1,431	1,849	2,131
EBITDA	40	69	81	113	136
Adj PAT	(18)	(0.2)	5	25	40
Adj EPS-Rs	(2.8)	(0.02)	0.8	3.8	6.2
EPS growth (%)	nm	nm	nm	391.7	60.7
Dividend yield	-	-	1.8	8.7	14.1
RoCE (%)	3.4	7.3	8.4	12.6	14.8
RoE (%)	(7.2)	(0.1)	2.1	9.9	15.0
PE (x)	nm	nm	nm	5.7	3.6
P/BV (x)	0.9	0.6	0.6	0.6	0.5
EV/EBITDA (x)	13.4	6.8	6.2	4.9	4.2

NM: Not meaningful; CMP: Current Market Price

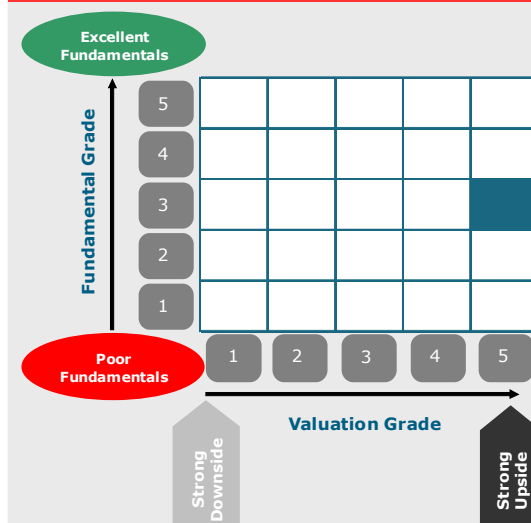
Source: CRISIL Equities estimate



February 11, 2011

Fair Value Rs 37  
CMP Rs 22

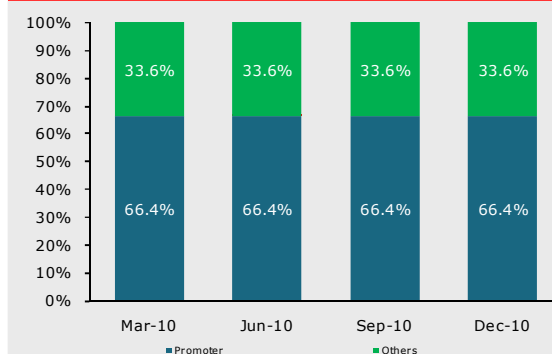
## CFV MATRIX



## KEY STOCK STATISTICS

NIFTY	5285
NSE ticker	HYDROS&S
Face value (Rs per share)	10
Shares outstanding (mn)	6.5
Market cap (Rs mn)/(US\$ mn)	137/3
Enterprise value (Rs mn)/(US\$ mn)	524/13
52-week range (Rs) (H/L)	75/21
Beta	1.5
Free float (%)	33.6%
Avg daily volumes (30-days)	6,480
Avg daily value (30-days) (Rs mn)	0.2

## SHAREHOLDING PATTERN



## PERFORMANCE VIS-À-VIS MARKET

	Returns			
	1-m	3-m	6-m	12-m
Hydro	-16%	-30%	-40%	-33%
NIFTY	-10%	-10%	1.6%	12%

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## Q3FY11 Result Summary

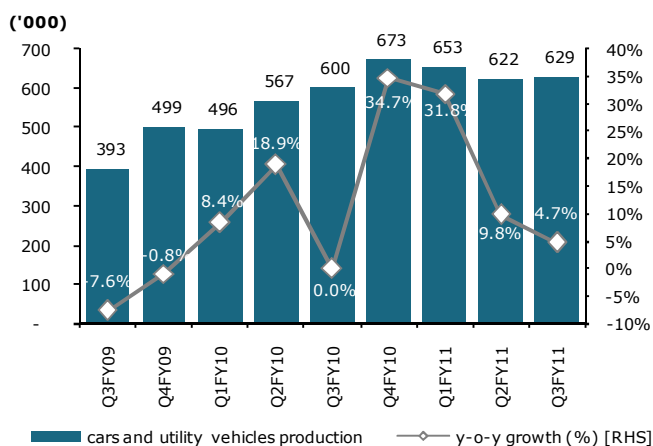
(Rs mn)	Q3FY11	Q2FY11	Q3FY10	q-o-q (%)	y-o-y (%)
Net sales	351.3	340.0	291.8	3.3%	20%
Raw materials cost	279.0	277.8	232.2	0.4%	20%
Raw materials cost (% of net sales)	79.4%	81.7%	79.6%	(230)bps	(15)bps
Employees cost	15.4	15.5	13.2	-0.6%	17%
Other expenses	34.0	22.3	24.9	52.4%	37%
<b>EBITDA</b>	22.8	24.3	21.5	-6.0%	6.1%
EBITDA margin	6.5%	7.1%	7.4%	(64)bps	(90)bps
Depreciation	6.7	6.7	6.1	0%	10%
EBIT	16.1	17.6	15.4	-8.3%	5%
Interest and finance charges	13.1	13.2	11.8	-0.7%	11%
Operating PBT	3.1	4.4	3.7	-30.7%	-17%
Other income	0.1	0.1	0.1	-10.0%	-14%
PBT	3.2	4.4	3.8	-28.7%	-17%
Tax	1.0	0.9	0.0	17.6%	nm
PAT	2.2	3.6	3.8	-39.7%	-43%
Adj PAT	2.2	3.6	3.8	-39.7%	-43%
Adj PAT margin	0.6%	1.1%	1.3%	(44)bps	(69)bps
No of equity shares (mn)	6.4	6.4	6.4	-	-
Adj EPS (Rs)	0.3	0.6	0.6	-39.7%	-43%

**Strong growth in revenues supported by buoyant domestic automobile industry**

**Increased employee and operating expense related to capacity expansion impact margins**

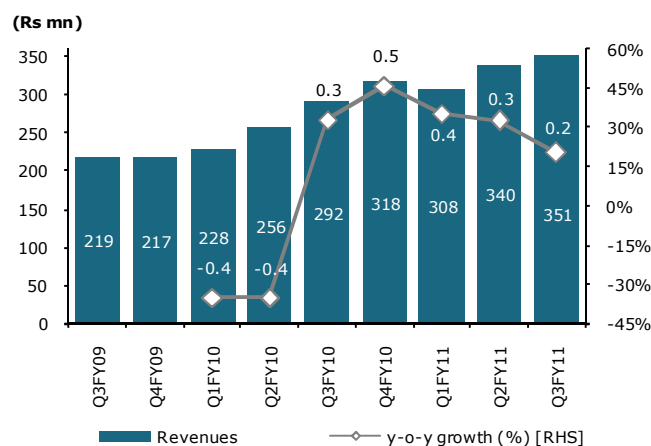
Source: Company, CRISIL Equities

### Cars and utility vehicle production on the rise



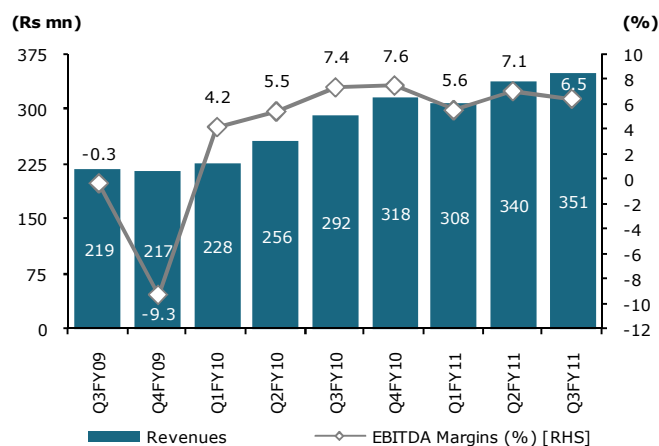
Source: CRISIL Equities

### Strong automobile industry drive revenues



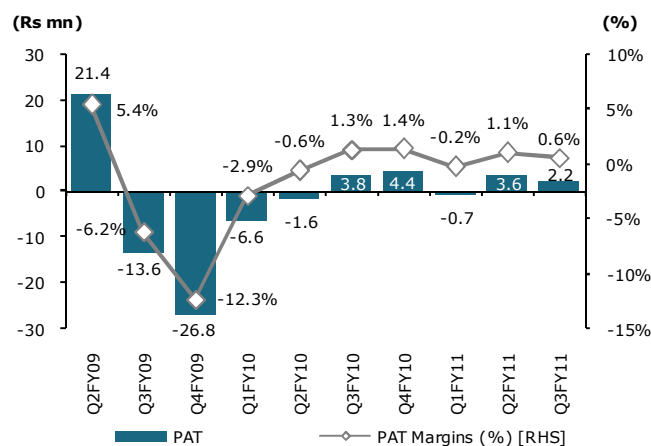
Source: CRISIL Equities

### EBITDA margins impacted by increased cost



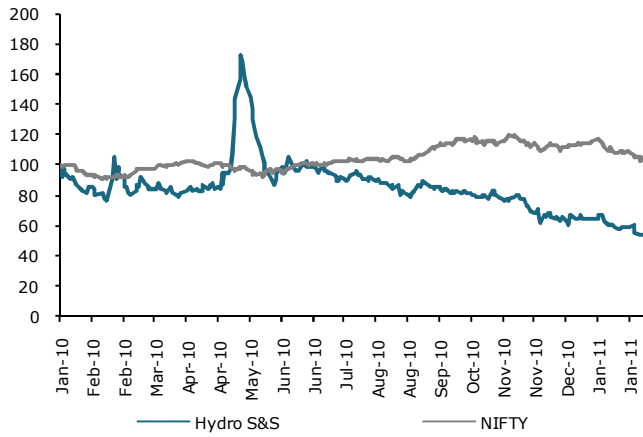
Source: CRISIL Equities

### Profit margins decline slightly



Source: CRISIL Equities

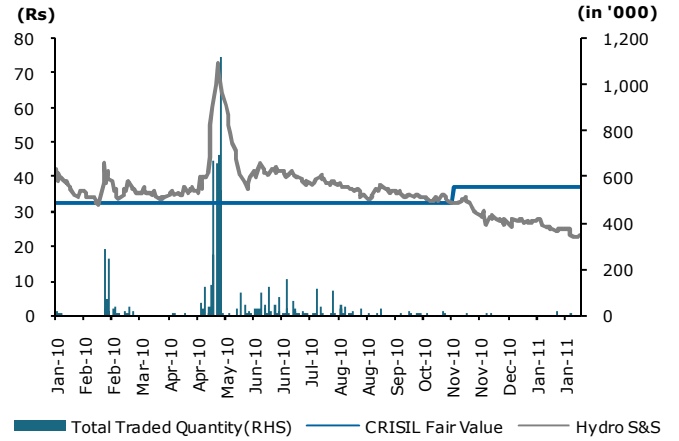
## Share price movement



-Indexed to 100

Source: NSE, CRISIL Equities

## Fair value movement since initiation



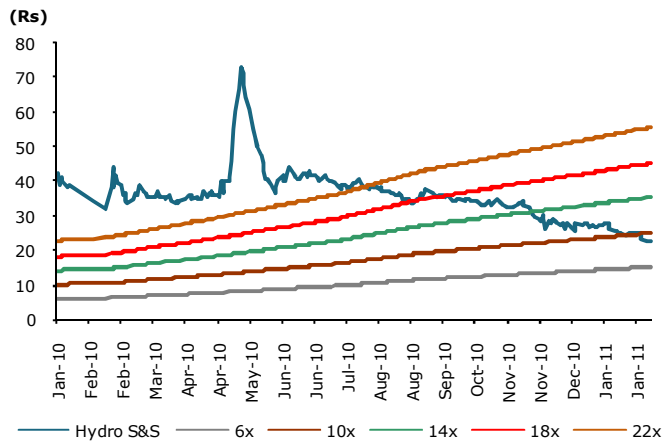
Source: NSE, CRISIL Equities

## VALUATION

We continue to value Hydro using the DCF method. We maintain our fair value of Rs 37 per share for Hydro. The stock price has corrected by 30% since our previous update report (November 02, 2010). Hence, we are revising our valuation grade to '5/5' from '4/5'. At this value, the implied P/E is 9.3x FY12 earnings estimate.

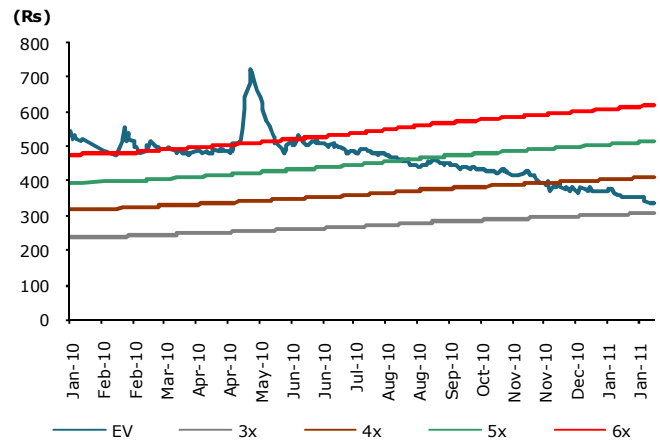
**Fair value maintained at  
Rs 37 per share**

### One-year forward P/E band



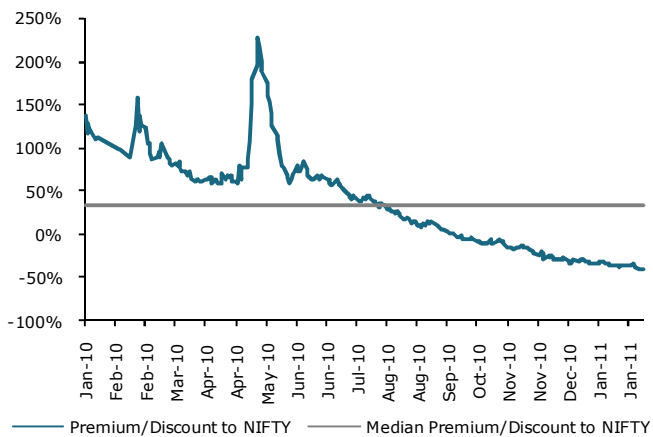
Source: NSE, CRISIL Equities

### One-year forward EV/EBITDA band



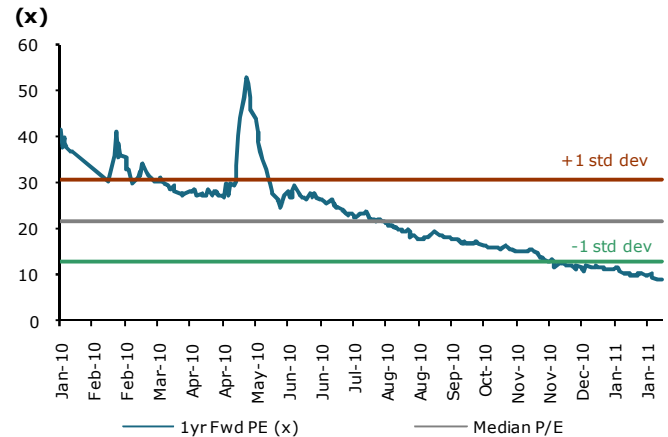
Source: NSE, CRISIL Equities

### P/E – premium/discount to NIFTY



Source: NSE, CRISIL Equities

### P/E movement



Source: NSE, CRISIL Equities

### CRISIL IER reports released on Hydro S&S Industries Ltd

Date	Nature of report	Fundamental grade	Fair value	Valuation grade	CMP (on the date of report)
13-May-10	Initiating coverage*	3/5	Rs 32.5	1/5	Rs 71.5
06-Sep-10	Q1FY11 result update	3/5	Rs 32.5	3/5	Rs 35
02-Nov-10	Q2FY11 result update	3/5	Rs 37.0	4/5	Rs 33
11-Feb-11	Q3FY11 result update	3/5	Rs 37.0	5/5	Rs 22

\* For detailed initiating coverage report please visit: [www.ier.co.in](http://www.ier.co.in)

CRISIL Independent Equity Research reports are also available on Bloomberg (CRI <go>) and Thomson Reuters.

## FINANCIALS

Income statement						Balance Sheet					
(Rs mn)	FY09	FY10	FY11E	FY12E	FY13E	(Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
<b>Operating income</b>	<b>1,184</b>	<b>1,098</b>	<b>1,431</b>	<b>1,849</b>	<b>2,131</b>	<b>Liabilities</b>					
<b>EBITDA</b>	<b>40</b>	<b>69</b>	<b>81</b>	<b>113</b>	<b>136</b>	Equity share capital	65	64	64	64	64
<b>EBITDA margin</b>	<b>3.4%</b>	<b>6.3%</b>	<b>5.6%</b>	<b>6.1%</b>	<b>6.4%</b>	Reserves	182	179	181	191	208
Depreciation	21	26	29	29	30	Minorities	-	-	-	-	-
<b>EBIT</b>	<b>20</b>	<b>44</b>	<b>51</b>	<b>84</b>	<b>106</b>	<b>Net worth</b>	<b>247</b>	<b>243</b>	<b>245</b>	<b>255</b>	<b>272</b>
Interest	48	48	50	55	58	Convertible debt	-	-	-	-	-
<b>Operating PBT</b>	<b>(29)</b>	<b>(4)</b>	<b>2</b>	<b>28</b>	<b>48</b>	Other debt	360	353	383	443	463
Other income	3	2	6	8	9	<b>Total debt</b>	<b>360</b>	<b>353</b>	<b>383</b>	<b>443</b>	<b>463</b>
Exceptional inc/(exp)	-	-	-	-	-	Deferred tax liability (net)	35	33	33	33	33
<b>PBT</b>	<b>(26)</b>	<b>(2)</b>	<b>7</b>	<b>37</b>	<b>57</b>	<b>Total liabilities</b>	<b>642</b>	<b>629</b>	<b>661</b>	<b>731</b>	<b>768</b>
Tax provision	(8)	(2)	2	12	17	<b>Assets</b>					
Minority interest	-	-	-	-	-	Net fixed assets	319	310	316	291	267
<b>PAT (Reported)</b>	<b>(18)</b>	<b>(0)</b>	<b>5</b>	<b>25</b>	<b>40</b>	Capital WIP	9	4	4	4	4
Less: Exceptionals	-	-	-	-	-	<b>Total fixed assets</b>	<b>328</b>	<b>314</b>	<b>320</b>	<b>296</b>	<b>271</b>
<b>Adjusted PAT</b>	<b>(18)</b>	<b>(0)</b>	<b>5</b>	<b>25</b>	<b>40</b>	<b>Investments</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
						<b>Current assets</b>					
						Inventory	159	155	192	248	286
						Sundry debtors	183	244	231	299	344
						Loans and advances	38	44	44	57	66
						Cash & bank balance	12	11	20	22	21
						Marketable securities	23	9	9	9	9
						<b>Total current assets</b>	<b>414</b>	<b>463</b>	<b>496</b>	<b>636</b>	<b>727</b>
						<b>Total current liabilities</b>	<b>101</b>	<b>149</b>	<b>156</b>	<b>200</b>	<b>230</b>
						<b>Net current assets</b>	<b>313</b>	<b>314</b>	<b>340</b>	<b>435</b>	<b>496</b>
						<b>Intangibles/ Misc. expenditure</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
						<b>Total assets</b>	<b>642</b>	<b>629</b>	<b>661</b>	<b>731</b>	<b>768</b>
						<b>Cash flow</b>					
						(Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
						Pre-tax profit	(26)	(2)	7	37	57
						Total tax paid	(1)	-	(2)	(12)	(17)
						Depreciation	21	26	29	29	30
						Working capital changes	54	(16)	(17)	(92)	(62)
						<b>Net cash from operations</b>	<b>48</b>	<b>7</b>	<b>17</b>	<b>(38)</b>	<b>7</b>
						<b>Cash from investments</b>					
						Capital expenditure	(115)	(12)	(35)	(5)	(5)
						Investments and others	(8)	14	-	-	-
						<b>Net cash from investments</b>	<b>(123)</b>	<b>2</b>	<b>(35)</b>	<b>(5)</b>	<b>(5)</b>
						<b>Cash from financing</b>					
						Equity raised/(repaid)	(0)	(4)	0	(0)	(0)
						Debt raised/(repaid)	77	(7)	30	60	20
						Dividend (incl. tax)	-	-	(3)	(14)	(23)
						Others (incl extraordinary)	-	-	-	-	-
						<b>Net cash from financing</b>	<b>77</b>	<b>(10)</b>	<b>27</b>	<b>46</b>	<b>(3)</b>
						Change in cash positon	2	(1)	9	2	(1)
						Closing cash	12	11	20	22	21
						<b>Quarterly financials</b>					
						(Rs mn)	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
						<b>Net Sales</b>	<b>292</b>	<b>318</b>	<b>308</b>	<b>340</b>	<b>351</b>
						Change (q-o-q)	14%	9%	-3%	10%	3%
						<b>EBITDA</b>	<b>22</b>	<b>24</b>	<b>17</b>	<b>24</b>	<b>23</b>
						Change (q-o-q)	55%	11%	-28%	42%	-6.0%
						<b>EBITDA margin</b>	<b>7.4%</b>	<b>7.5%</b>	<b>5.6%</b>	<b>7.1%</b>	<b>6.5%</b>
						PAT	3.8	4.4	(0.7)	3.6	2.2
						<b>Adj PAT</b>	<b>3.8</b>	<b>4.4</b>	<b>(0.7)</b>	<b>3.6</b>	<b>2.2</b>
						Change (q-o-q)	nm	16%	-116%	nm	-40%
						<b>Adj PAT margin</b>	<b>1.3%</b>	<b>1.4%</b>	<b>-0.2%</b>	<b>1.1%</b>	<b>0.6%</b>
						<b>Adj EPS</b>	<b>0.6</b>	<b>0.7</b>	<b>(0.1)</b>	<b>0.6</b>	<b>0.3</b>

Note: All ratios are computed on Adj PAT

Source: CRISIL Equities estimate

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