

Hindustan Sanitaryware & Industries (HSIL)

VISIT NOTE

Sensex: 12,580

CMP: Rs. 92

March 07, 2007

We met the management of Hindustan Sanitaryware to gain insight about their business model and future growth drivers for the company. The following are the key takeaways from the meeting:

Company background

Incorporated in 1960, the company was set up by the Somany Enterprise in collaboration with Twyford Ltd, UK to manufacture vitreous china ceramic sanitaryware in India. It diversified into the manufacture of glass containers through the acquisition of 'The Associated Glass Industries' in 1981. It has over the years widened its product portfolio and commands a significant market share in each of those businesses.

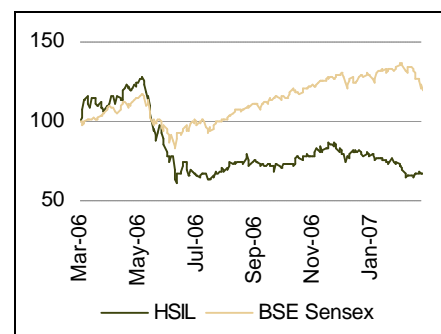
The company's business can be classified under two segments, Building products (sanitaryware) and Container glass (glass bottles). During Apr-Dec'06, building products and container glass contributed 51% and 49% to the turnover respectively whereas contribution to profitability was 73% and 27% respectively.

Hindware is the most recognized bathroom brand (AC Nielsen survey) and also recognized as one of the 100 most valuable brands in India (4P survey). The company's growth in the last few years in both the segments has been more than the industry growth rate and it aims to continue with this going forward.

Bloomberg Code	:	HIS@IN
Reuters Code	:	HSNT.BO
BSE Code	:	500187
NSE Code	:	HINDSANIT
52-Week Range (H/L)	:	190 / 85
Market Cap (Rs mn)	:	5,065
Share O/S (mn)	:	55.0
Free float (mn)	:	24.4
3m Avg. Volume	:	16,537
Face Value	:	2

Price Performance (%)

	3m	6m	12m
Absolute	-24.2	-17.0	-37.4
Relative	-13.3	-21.3	-53.0



Rs. Mn.	FY04	FY05	FY06	YTD-FY07
Gross Sales	3,055	3,316	4,383	3,862
Excise Duty & Sales Tax	340	344	418	353
Net Sales	2,715	2,971	3,965	3,508
Operating Profit	490	571	710	617
OPM %	18.0	19.2	17.9	17.6
PBT	215	290	404	362
Adjusted PAT	175	191	258	231
NPM %	6.4	6.4	6.5	6.6
Equity Paid Up	56	94	94	110
EPS (Rs)	6.2	4.1	5.5	4.2
PE (x)	14.7	22.5	16.7	-

Building Products

The company currently offers complete solutions for the bathrooms and kitchens through a mix of in house manufacturing (60%) and outsourcing (40%). This addresses the varied needs of customers in the residential, commercial, retail and hospitality sectors.

Strategy: HSIL aims to be a complete home solutions provider in the next three years through organic and inorganic initiatives. For this, it intends to extend its product mix beyond sanitaryware products and transform its focus from manufacturing to marketing (outsourcing).

Geographical set-up: With a combined capacity of 32,000 tpa, the division operates through two manufacturing locations - AP (Bibinagar) and Haryana (Bahadurgarh). The geographical location of the plants enables the company cater to the demand across India. Besides it operates the trading business (outsourced products) through three centres- AP (Bibinagar), Haryana (Bahadurgarh) and Delhi (Tikri). It has the largest distribution network in India- 1,000 dealers and 12,000 retailers.

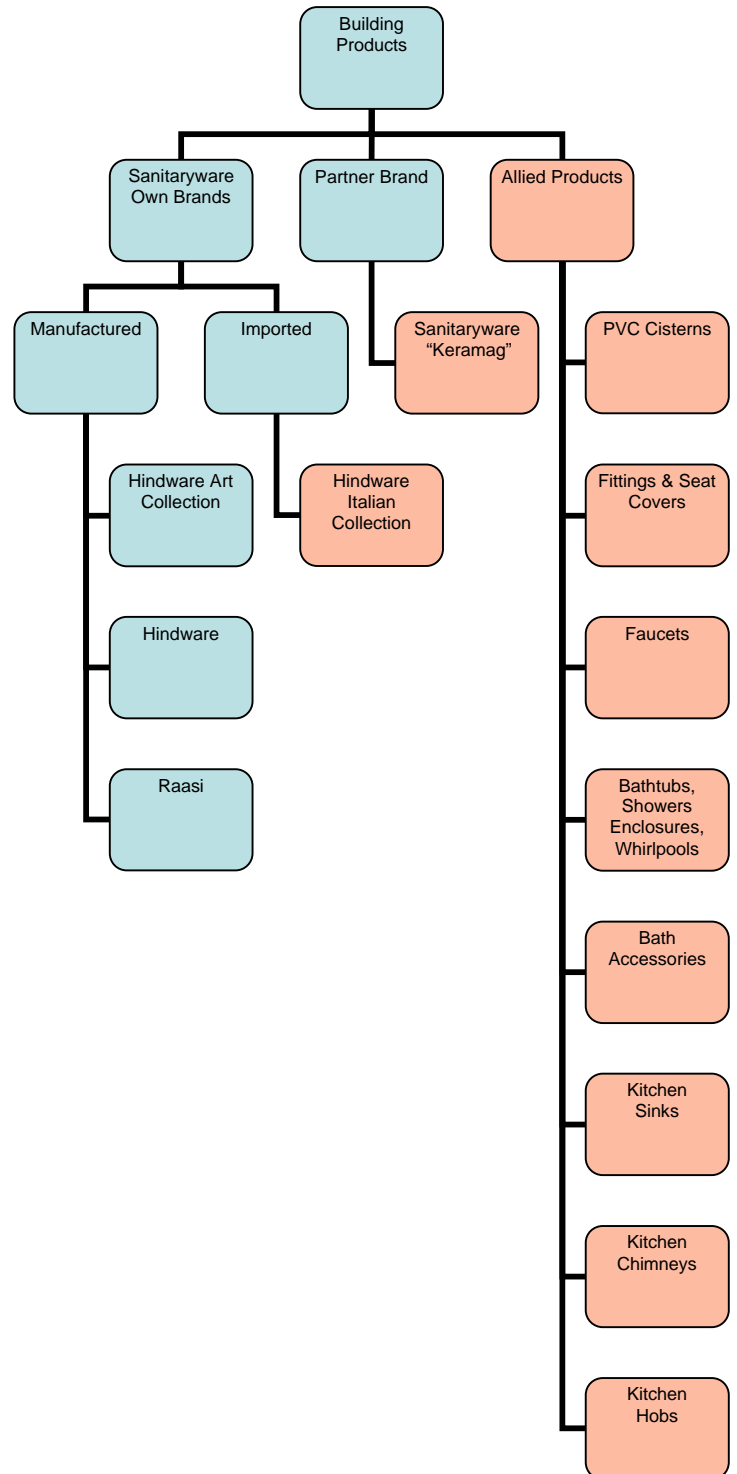
It expects the segment to grow at over 25% in the next 2-3 years.

Sanitaryware: Indian market is estimated at Rs 8 bn out of which, 60% is the share of organized market. HSIL and EID Parry with a market share of ~40% each in the organized market are the leaders with the balance being shared by four other players. The total market is currently growing at ~13% with the organized market growing ~18%. This is expected to continue going forward on the back of substantial investments planned in the real estate sector.

HSIL sells its products under two brands, 'Hindware' and 'Raasi' wherein the latter caters to the low end basic segment. It also has an exclusive alliance with global major Sanitec for all brands for the SAARC region. The company derives a much larger portion of its revenues from the retail clients as realisations are 10-15% higher than the institutional segment.

Allied Products: HSIL currently supplies most of the allied products (faucets, bathtubs, shower enclosures, kitchen sinks, chimneys & hobs) through the outsourcing model. It expects the demand for these allied products to grow at a CAGR of over 30% in the medium term.

Enthused by the stupendous response to these products coupled with inherent strategic advantages (brand equity, network, industry experience), it plans to explore new segments in its pursuit to become a complete home solutions provider. Some of the potential segments that could be tapped are tiles, prefab kitchens, furniture, electric installations.



Glass Container

HSIL is the second largest manufacturer of glass containers in India with a market share of 15%. It services the requirement of beverages, liquor, pharma and food containers.

Glass is the preferred packaging medium given its inherent advantages of cost, durability and is environment friendly as compared to aluminum and PET. Indian glass container market is estimated at Rs 15bn and accounts for ~12% of the packaging industry. It has grown at 6-8% in the last five years and is expected to grow at ~8% in the near future. The industry is operating at ~90% capacity with no additional capacity expected in the near future.

HSIL operates through a manufacturing location in Hyderabad with a capacity of 953 mn pieces. It expects the business to grow ~10-11% p.a. in the coming years.

The company expects the availability of natural gas in AP from 2008. This would substitute the current fuel (LPG) used and lead to a substantial potential savings.

Segmental Performance

	YTD-FY07	YTD-FY06	Var%	FY06
Revenue				
- Building Products *	1,977.4	1,661.7	19%	2,359.3
- Glassware	1,912.0	1,396.0	37%	2,075.1
- Others	11.9	7.4	61%	23.0
Total	3,901.3	3,065.1	27%	4,457.4
Inter Segment Rev.	-	-	-	-
Gross Sales	3,901.3	3,065.1	27%	4,457.4
PBIT				
- Building Products	385.1	318.5	21%	452.3
% of Revenue	19.5%	19.2%		19.2%
- Glassware	144.3	93.5	54%	139.1
% of Revenue	7.5%	6.7%		6.7%
Total	529.4	412.0	28%	591.4

* Q3FY07 turnover and PBIT was impacted due to a production loss of 17 days on account of implementation of SAP; H1-FY07 revenue and PBIT growth was 29% and 33% respectively.

Outlook

HSIL is a leading player in both the building products and glass containers businesses. The company is well geared to cater to the incremental demand arising out of these segments going forward.

The transition of focus from manufacturing to marketing in the building products segment (outsourcing) will ensure that the future growth would be less capital intensive. We believe the company's experience in the sanitaryware segment together with a strong brand, will enable it capture an increasing share of the building products industry going forward.

Valuation

Net Sales for the period Apr-Dec'06 rose by 28% yoy to Rs 3.5 bn. PAT for the similar period grew by 31% yoy to Rs 231 mn.

At the CMP of Rs 92, the stock trades at 16.5x YTD FY07 annualised earnings.