"Somany Home Innovation Limited
Q2 FY2022 Earnings Conference Call"

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Dolat Capital

CHORUS CALL®

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Moderator: Ladies and gentlemen, good day and welcome to the conference call hosted by Dolat Capital. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Umesh Raut. Thank you and over to you Mr. Raut.

Umesh Raut: Thank you, Good day everyone, on the behalf of Dolat Capital, we welcome you all for Q2 FY2022 post results conference call of Somany Home Innovation Limited. We are pleased to have senior management team from the company represented by Mr. Rakesh Kaul, CEO & Whole Time Director; Mr. Rajesh Pajnoo, President, Pipes Business; Mr. Sudhanshu Pokhriyal, CEO, Bath Business; Mr. Sandeep Sikka, Group CFO; Mr. Naveen Malik, CFO, Somany Home Innovation Limited. I would like to hand over the call to Mr. Naveen Malik for his opening remarks. Over to you, Sir.

Naveen Malik: Thank you. Good afternoon, ladies and gentlemen, and welcome to the Somany Home Innovation Limited Q2 and H1 FY2022 earnings call. I hope you and your loved ones are safe and healthy. I have with me Mr. Rakesh Kaul, CEO & Whole Time Director; Somany Home Innovation Limited, Mr. Rajesh Pajnoo, President, Pipes Business; Mr. Sudhanshu Pokhriyal, CEO, Bath Business; Mr. Sandeep Sikka, Group CFO. I will begin the call by taking you through the financial performance for the quarter and half year ended September 30, 2021, post which Mr. Kaul, Mr. Pokhriyal and Mr. Pajnoo will discuss the key highlights of their respective businesses.

We have delivered a strong performance for the quarter as can be seen from our financials. Both Consumer appliances and Building products divisions delivered good growth which was ably supported by the Retail business which has delivered positive EBIT for the quarter. This is a result of our strong brand salience, innovative product portfolio and wide distribution network.

Before I share the financials, I would like to state that the calculations made for computing year-on-year growth in revenue, EBITDA and EBIT for the quarter and half year are based on management reported numbers post adjusting the water heater business share which was transferred under slump sale to Hintastica Private Limited, now 50:50 joint venture with Group Atlantic.

Starting with the quarterly performance, our consolidated revenue from operations stood at Rs. 617 crore, registering a robust growth of 56% year-on-year and 80% sequentially. EBITDA for the quarter stood at Rs. 58 crore, having grown by 41%

year-on-year and 2.4x on a sequential basis. Despite absolute growth in EBITDA margins were slightly lower on account of the elevated input prices.

In order to mitigate the impact, we implemented price hikes across product categories during the quarter the full impact of which will be visible in subsequent quarters. I will let the respective business heads share further details on the same.

Profit after tax for the quarter came in at Rs. 25 crore registering a growth of 28% year-on-year. The sequential comparison may not be a fair representation given that Q1 included exceptional items comprising recognition of gains of Rs. 66.11 crore from our investment in Hintastica Private Limited on account of loss of control of subsidiary and gain of Rs. 34.75 crore on account of slump sale of water heater business undertaking by the Company to Hintastica Private Limited.

For H1 FY 2022, Consolidated revenue from operations stood at Rs. 959 crore growing by 58% year-on-year. EBITDA stood at Rs. 75 crore growing 1.2x over H1 FY2021. Profit after tax came in at Rs. 129 crore, a substantial growth over a loss of Rs. 5 crore in H1 of last year.

Let me now take you through our segmental performance: Revenue for the Consumer appliances business was Rs. 112 crore up 35% year-on-year and 56% sequentially. EBIT for this business stood at Rs. 7 crore growing by 7% year-on-year and on a sequential basis it has grown from an EBIT loss of Rs. 5 crore. EBIT margin stood at 6.2% in Q2 FY2022.

Building products division revenue came in at Rs. 484 crore, registering a growth of 66% year-on-year and 82% sequentially. Our innovative product portfolio coupled with improving real estate demand has aided this stellar growth in the revenue. EBIT stood at Rs. 40 crore growing by 48% year-on-year and 1.6x sequentially. EBIT margin for the Building products business came in at 8.2%.

The Retail business stood at Rs. 21 crore growing by 6% year-on-year and 1.2x sequentially. EBIT came in at Rs. 2 crore as compared to EBIT loss of Rs. 3 crore and loss of Rs. 1 crore in Q2 FY2021 and Q1 FY2022 respectively. EBIT margin for the quarter was 9.8%. Profitability for the Retail business has returned to being positive after the previous quarter's EBIT loss due to the COVID induced lockdowns. We remain confident that the business will maintain this profitability in the coming quarters.

Q2 FY2022 was yet another quarter wherein the company demonstrated strength and resilience by delivering strong growth and profitability. We will try to maintain this performance and improve upon it going ahead. We continue to drive our business on the back of regular, innovative product launches and the robust distribution of our business.

I would now request Mr. Rakesh Kaul to take you all through the Consumer appliances and Retail businesses. Over to you, Rakesh.

Rakesh Kaul: Thank you, Mr. Naveen Malik, and a very good afternoon to everyone and welcome to SHIL's Q2 and H1 FY2022 Earnings Call. I sincerely hope that all of you and your loved ones had a pleasant Diwali and are keeping safe.

I am happy to report that SHIL grew its revenue at a healthy clip during the quarter, indicative of the strong demand for our products. We have seen a steady pickup in demand and sales with the easing of the various lockdowns across states due to the subsiding of the second wave. The business, however, in line with the sector, faced challenges with regards to increasing input prices. In order to protect our margins, we announced price hikes for some of our products.

We actively implemented various strategic initiatives such as new product launches, expansion of our distribution network and our marketing campaigns to make the most of the resurgence in demand. We launched several new products in Q2 FY2022 designed with innovation and aesthetics in mind. These product launches were supported by major marketing campaigns which were well received by the market and helped us to connect with the consumer during the festive season.

Revenue and the EBIT for the Consumer appliances delivered a healthy growth on Y-o-Y basis adjusting for the share of the water heater business. As you may all recollect this business was part of our wholly owned subsidiary Hintastica Private Limited, which after capital infusion from Groupe Atlantic, France became a 50:50 JV with them.

The said adjustment has been made to make the Q2 FY2022 and Q2 FY2021 financials comparable. Comparing to the financial performance during Q2, revenue witnessed a healthy growth of 36% year-on-year and 66% sequentially. EBIT stood at Rs. 7 crore compared to Rs. 6.5 crore in last year Q2 FY2021 and EBIT loss of Rs. 5 crore in the previous quarter. EBIT margin stood at 6.2% slightly lower than 7.8% on the same quarter last year owing to high input cost.

To counter this, we have taken frequent price hikes across categories during the quarter and benefits of the same are expected to be realized in the coming quarters. We are monitoring the situation closely with regard to commodity prices, ocean freight increase and are prepared to undertake further price hikes if and when required.

Coming to the Retail business. With increasing demand for real estate in the home innovation, this business has seen growth in its revenues as well as profitability. Revenues grew by 6% year-on-year and 1.2x sequentially. EBIT is back to being positive from minor blip during the first quarter of this financial year largely owing to the lockdowns related issues. Baring Q1 FY2022, the business has shown resilience with regard to maintaining and driving profitability. We are happy to see the business return to that trajectory this quarter and are confident that it will continue to strengthen in the coming quarters.

EBIT margin for the quarter stood at 9.8%. In terms of PBT too, we are a profit making entity. We continue to focus on expanding our online presence and our franchise stores through the pillars of brand and a strong product focus.

Before I hand over the call to Sudhanshu, I would like to share that SHIL was also recognized as a great place to work by the Great Places to Work Institute, India. It is an honor to be a part of this list and is a testimony to our efforts to ensure that the organization seems like a second home to all employees providing them with an environment that is conducive to their physical and mental health as well as their productivity.

With increasing demand, we are confident of growth in our topline and the bottom line will improve with input cost returning to normal.

With this, I would like to hand over the call to Mr. Sudhanshu Pokhriyal.

Sudhanshu Pokhriyal: Thanks, Rakesh, and a very good afternoon to everyone on the call. Thanks for joining us today. The bath business has delivered a stellar growth in Q2 FY2022 as can be seen in our financials. SHIL is the fastest growing player in sanitaryware and faucets over the past quarter and I am very happy to share that with you. The strong growth seen in both revenue and EBIT during the quarter stems from improved realization, innovative launches and strong demand in the real estate sector. We have also seen much higher sales volume in Q2.

We have launched a slew of products and designs during the quarter. Many of these address the need of coming times and are based on the idea of contactless usage. We continue to complement these launches with strong marketing campaigns around them which are making waves across platforms. I am sure you must have seen our advertisement around touchfree, etc..

Coming to the performance during the quarter revenue from operations delivered a robust growth of 66% year-on-year and 82% on a sequential basis. EBIT too displayed a very healthy growth of 48% year-on-year and 1.6x sequentially. EBIT margin for the quarter stood at 8.2% as compared to 5.7% in the previous quarter which is higher by about 2.5x. However, when compared to year-on-year basis margins have compressed by 1x, largely owing to rising commodity prices. However, we have undertaken price hikes in both sanitaryware and faucets in the last week of August and the benefits of the same are expected to be realized in the coming quarters as well.

To conclude, Q2 FY2022 has been a tremendous quarter for our Bath business, a period wherein we have seen good improvement in realizations as well as volumes. The business is regaining its past momentum as is evident in the growth of revenue and profitability over the last few quarters and we are very confident of maintaining the same.

Let me now invite Mr. Pajnoo to take you through the plastic pipes and fitting business. On this note where we are being the fastest growing business in the sanitaryware and faucets business in the last quarter. Rajesh over to you.

Rajesh Pajnoo: Thank you Mr. Sudhanshu and good afternoon to everyone here. Thank you all for joining us on this call. The plastic pipes and fittings business continues to perform well and maintained its revenue momentum, having grown 74% year-on-year and 82% on a sequential basis to report a revenue of Rs. 158 crore for the quarter. Demand for our products continues to remain strong. In addition to the revenue momentum, the pipe business contributes positively to the bottom line. The strong growth in the quarter came on the back of the launch of new SKUs and expansion of the distribution channel. The increase in the real estate demand is helping widen the market pie and has given a major boost to sales in this quarter. The increased demand led to robust sales volume growth. The strong wave of real estate demand has also been a key contributor with the growth of this business.

We are also seeing healthy traction in our institutional and project businesses on the back of registrations with various authorities.

We have been working towards maintaining a strong connect with the influencer community and have made steady progress during the quarter by reinitiating the plumber connect program through physical meets. In this quarter alone, we have reconnected with our 20,000 plumbers, and we will continue to engage them in the coming quarters. We also continue to organize training programs for our various channel partners and influencers, a strategy that has delivered results in the past and we are hopeful that it will continue to do so.

Before I end my remarks, I would like to reiterate that the plastic pipes and fittings business continues to clock a healthy run rate. We are confident that the real estate sector demand will be instrumental in helping us maximize sales in the coming quarters. we believe that the robust houses demand and the high input cost for PVC will provide a boost in demand for CPVC segments as well.

Thank you very much and I would like to conclude the opening remarks and open the floor for questions and answers, if any. Thank you.

Moderator: Ladies and gentlemen, we will now begin the question and answer session. We will take our first question from the line of Chetan Gindodia from Alfa Accurate. Please go ahead.

Chetan Gindodia: Hello Sir. Congratulations on a great set of numbers especially on the top line. Firstly wanted to understand what would be our EBIT margin or EBITDA margin in the pipes business and what is the trajectory over the last few quarters.

Sandeep Sikka: If you see on pipes division, we did a sale of Rs. 158 crore during the quarter. We have EBIT margin on an overall basis for the Building products business. We don't separately disclose the EBIT margin for the pipes business, but broadly, EBIT margins are in the range of 6.5 to 9%.

Chetan Gindodia: 6.5-9%.is for the overall building material segment or just for pipes,

Sandeep Sikka: Broadly for pipes.

Chetan Gindodia: Okay and where do you see this margin going over next two years given that now scale is increasing to Rs. 150 crore plus revenue run rate.

Sandeep Sikka: We still have a lot of operating leverage to use on because it is a separate business internally. These are separate verticals wherein we have separate sales teams, separate supply chain. As the sales volumes keep enhancing, the margin expansion will keep happening. To just give a background, the pipes business is around a three year old business. We started the commercial production and sales into market in August 2018. The success of the business is based on the last three years of performance and we feel that this performance will continue to grow. We have already given the number that on the pipes we have grown by around 74% to 75% on a year on year basis.

Chetan Gindodia: Okay and with respect to margin in the building material overall basis, so even though on the revenue front we have substantially crossed both Q3 and Q4 numbers, but we are still quite low on the margin front. So how do you see overall building material

EBIT margin when having passed on the total RM inflation and can we return to normalize margin from Q3?

Sandeep Sikka: So here you have to see from two points. First point is that Brilloca Limited (Brilloca), is a wholly owned subsidiary of SHIL, where the results gets consolidated for the Building products. These entire margins are without any manufacturing margins because manufacturing is not a part of Brilloca. Most of the analyst what they do is they try to compare us with the other producers or other competition wherein they have the manufacturing margin also built into the business. Today, we are buying materials both from third parties as well as one of the group company on arms-length basis. Then, Brilloca do rest of the branding business, after sales service, distribution, so all the entire gamut of activities we do is in SHIL. EBIT Margins, as far as Brilloca is concerned, on an overall basis is of 8.2% but in Q4 we had 11.9%, as it was one of the best quarters we have with higher turnover comes into the picture and also lot of fixed cost gets absorbed. But we feel that right now margins are around 1% to 2% down due to raw material inflationary trend. We expect that in the next two quarters, we should be able to iron out and regain back the margins. This is despite the fact that we had taken one or two price hikes in the last two quarters continuously. We are seeing the market and how the market behaves and accordingly we are taking the price hike also.

Chetan Gindodia: So our normalized margin for FY2023 onwards would be say around EBIT margins 9% is what we are targeting?

Sandeep Sikka: 9% is Q2.

Chetan Gindodia: If you can explain what is driving the growth in the consumer business and if you can give the segment wise revenue within consumer as in kitchen top, appliances separately it would be helpful.

Sandeep Sikka: Generally, if you see kitchen appliance today contributes almost 45% to 48% of the sales of the Consumer appliances business group and as far as the market growth is concerned, Rakesh I would request if you can address to this question how the market looks like.

Rakesh Kaul: Thank you so much for the question. You know the growth in Q2 has been largely driven by our kitchen appliances segment. We continue to grow stronger in this category to be among the top three players in the market as of now particularly in the category of kitchen hood, kitchen chimney, kitchen hobs as well as cooktops. So I think the growth has been primarily driven by our focus on technology and innovation as you would be well aware that we were India’s first IoT chimney. We launched last year Hindware and Optimus I-Pro for which we did a massive campaign on TV and print recently. That has turned out to be one of our best sellers in the market because the consumer is feeling it much easier to use an IoT chimney. No one else in the competition has that. At the same time, our continuous focus on research and development to create innovations in this category has resulted in creating the largest range of silent chimneys in the country so now we can easily boast of the range of chimneys that are most silent. In fact, our chimney Optimus I-Pro is 32% more silent than the most silent chimney in the competition. Our intensive consumer research in terms of what are the needs of the consumer and through this research we have found out many of the consumers actually do not switch on a chimney because it makes a too much of noise. I think our focus on innovation, focus on technology, and creating feature rich products which can make the lives of the consumer easier has been the hallmark and benchmark of Consumer appliances that is what will continue to give us growth. However, one part of our business is also air-cooling business which suffered a massive jolt in Q1 this year as well as last year, primarily because of COVID induced lockdown. And as you know cooling products predominantly 60% of the sell-out happens in Q1. So having said that, we hope that COVID is largely behind us and we will register a significant growth in the cooling category as well in the coming times. I hope I answered your question.

Moderator: Thank you. Our next question is from the line of Pritesh Chheda from Lucky Investment. Please go ahead.

Pritesh Chheda: The question is on margin side, so let us say when you were commenting on Q4 versus what you saw this quarter. I think the key difference on a similar size of revenue is the gross margin impact numbers. So we were kind of double-digit margin in quarter for a Rs. 600 crore revenue and we are a single digit margin in Q2 for a Rs. 600 crore plus revenue. So the question here is, first of all is this assessment correct and which part of the building product is where the gross margin pressure is there? What are the efforts that we are taking to offset these gross margin because some of the competing companies in Building products, in similar product lines did not have a pressure to such an extent? And where are we on the journey of improving sales, given leverage driving the margin of our overall business? These are my broader questions.

Sandeep Sikka: Yes, broadly I think your assessment is correct that on an apple-to-apple basis, on a turnover basis, margins have shrunk a little bit as compared to Q4. But as I told you, the markets have been very volatile over the last six months in terms of the price hike for the input raw material and it is not possible for businesses to immediately pass the price. If you see brass, it has moved to almost Rs. 480 per kilogram, so every player who is into brass and uses brass for the purpose of manufacturing process, it is a steep input cost. The cost factor was as high as 60% to 65% for certain products as most of the companies wait and watch how much is the absorption in the market. Price hikes can happen anytime but the volume growth as well as the absorption of the price hike into the market has to happen so similar sort of trend is there. Despite the price hike which we have already done, we expect that in the next two quarters or so we will be further looking at price hikes and will be able to bring back the margins and retain the margins what we had initially.

Pritesh Chheda: On the longer horizon of improvement of margins double digit which we have been commenting all these quarters, on improving scale any thought process there, any changes there?

Sandeep Sikka: I think one good event which we did is, we were very high on the working capital. But if you see the numbers now, on the building product on an overall basis, we have been able to reduce the number of days by around 20 to 25 days. We had given guidance to the market that we are working on it and some of the things have already started appearing and coming through.

Pritesh Chheda: I saw that. Will this working capital now sustain because there is a significant improvement at least that we see in this quarter? So it is a reduction to 90 days which you had earlier mentioned from 110 days. So this 90 days you think will sustain?

Sundeep Sikka: Yes, we are still working on it. We have continuously taken a number of initiatives to improve the return on capital employed on the overall business as such and this is one of the key events which we are doing in terms of bringing back the good level of ROCE number into the picture. Considering this if you see on Q2 ROCE basis, on a consolidated result basis Q2 if we analyze and get the ROCE, we are at 35% ROCE today.

Moderator: Thank you. Our next question is from the line of George John from Equity Intelligence. Please go ahead.

George John: My question is regarding our share of profit from the water heater business and how it is spanning out on the new entity?

Rakesh Kaul: Thank you so much for the question. We have registered a double digit growth over the comparable period when the water heater business was a part of the earlier SHIL business. Even in profitability while the input prices have increased tremendously a steep hike. In water heater business we have registered certain price increases which has led to more stability for our brand and also the fact that in the recently concluded quarter we became number two brand on Flipkart, number three brand overall. E-commerce which has helped us sustain our margins and our revenues as well. Whereas largely if you see water heater business as an industry has suffered a minor de-growth in the first six months actually. So from that perspective I think we are on the right path. At the same time as a company, we have also introduced heating products recently so that will also bolster the revenues in the coming quarters.

George John: Okay thank you, Sir. That was helpful. And have we had any market share gains in the Consumer appliances segment?

Rakesh Kaul: Yes, I think if you would see we have grown in the category of kitchen hoods. While kitchen hoods category is not covered by registered and well known research agency like GFK but our internal market estimates say that we have moved from 17% to almost 18.5% in the category of kitchen hood and in kitchen hobs also we have broken into the top five players, registering a gain. In case of air-coolers, the market has de grown in Q2 and Q1 whereas we have grown by 7% and our e-commerce market share has moved to 16.7% by value as per GFK there. In water heaters, our market share has moved to 12.3% on e-commerce and overall we are at 7.3%, so we have made marginal gains in market share of water heaters and air coolers and substantial ones in kitchen chimney and kitchen hobs.

Moderator: Thank you. Our next question is from the line of Sriram Rajaram from Ratnatraya Capital. Please go ahead.

Sriram Rajaram: A couple of questions from my end. One on the pipe business. Based on your half year numbers what is the volume growth? And my second is on the consumer product business so if I look at the first half numbers, like we have clocked about Rs. 180 crore and if I look at pre-COVID period, which is H1 FY2020, we have done about Rs. 175 crore. Now if I were to normalize these two figures, I just want to understand what is growth on H1 to H1?

Sandeep Sikka: Your question is on pipes.

Sriram Rajaram: My question is first on pipe that is what is the volume growth for first half?

Sandeep Sikka: We do not **give** volume growth separately for SKU-wise because it varies from SKU to SKU and the product mix. Like on building materials some quarters, we sell bigger pieces, some quarter we sell smaller pieces. But if you see H1 to H1 of last year our overall growth is 85%.

Sriram Rajaram: That is the overall growth.

Sandeep Sikka: Yes. On the pipes.

Sriram Rajaram: And on the consumer product space if I were to compare H1 of FY2022 versus H1 of FY2020, like normalize for the water heater and all those things?

Sandeep Sikka: If you net off the water heaters business, it is 44%.

Sriram Rajaram: 44% growth on H1 of FY2020, am I right? I am not talking about H1 of FY2021 I just want to get an understanding of H1 of FY2020 versus 2022.

Sandeep Sikka: It is 44% and this is apple to apple without water heaters in both the columns.

Rakesh Kaul: No, I think Mr. Sandeep Sikka he wants to know the pre-COVID period which means 2019 to 2020 financial year 2019 to 2020, am I right?

Sandeep Sikka: Right now it is not in front of me. I will have to get back to you.

Sriram Rajaram: Okay I will connect with you offline on that. And Sir my last question like if you can give the breakup for the consumer product business, the current set that will be useful.

Sandeep Sikka: Like I have told you it is 45% to 48% for kitchen appliance and balance generally 15% to 20% is the water heater and 15% to 20% is air coolers and rest are the other products.

Sriram Rajaram: So just 15 to 20% has gone out right? So that is no longer there now?

Sandeep Sikka: Yes, then you have to adjust accordingly**.** Because last year, it was there as part of the business operation and this year it is not.

Moderator: Thank you. We will take our next question from the line of Prakash Iyer from Haldiram's Family Office. Please go ahead.

Prakash Iyer: I wanted to understand from the management that what is the percentage of group company buying. I am just looking at it from a corporate governance standpoint. Arms length is very well understandable but to get comfort on the governance aspect is what I was wanting to know, Mr. Sikka, on all the businesses piping as well as kitchen appliances and so on.

Sandeep Sikka: I will start from the top like kitchen appliances and the entire business of Somany Home Innovation Ltd. standalone. Today, we do not procure anything from other group company and all are from the third parties. For Brilloca, sanitaryware and faucets, on an average basis, we buy around 65% from our group company HSIL and for pipes almost 98% is sourced from HSIL. This is based on transfer pricing which is bench marked on the report of one of the big four.

Prakash Iyer: And this is done quarterly?

Sandeep Sikka: Bench marking is on an annual basis. Not on quarterly basis**.**

Prakash Iyer: Okay thank you.

Moderator: Thank you. Our next question from the line of Sonal Minhas from Prescient Capital. Please go ahead.

Sonal Minhas: I have just a book keeping question. Just wanted to understand your effective tax rate for the period and just want to understand like for FY2022 to FY2023 what we should factor as an effective tax rate because the number varies quite a lot.

Sandeep Sikka: I understand where your question is coming from. If you look at the consolidated results, the effective tax rate may look higher because Brilloca during the quarter paid a dividend to parent and parent has not paid out the dividend as of now in this quarter. As per the tax laws, we have provided the tax on it. But when you consolidate the figure, you have to net off since it is a transaction between parent and a subsidiary, the dividend is not coming as consolidated, but the incidental tax is coming that is why it is looking higher. Brilloca is under the regime of 22% plus surcharge and SHIL is under the regime of 30% plus surcharge because we made some EBITDA investment initially in SHIL, and till that recovery happens, maybe for another year or so. On a weighted average basis, you can assume almost 30%, maybe 28% around the average tax rate.

Sonal Minhas: The tax rate for the period?

Sandeep Sikka: For next two years maybe.

Sonal Minhas: The JV that we have done. The profits for them also are getting accrued below the PBT number or that is not getting accrued yet?

Sandeep Sikka: We have taken the equity method for it. So the net profits from the JV, they are reported below the PAT.

Moderator: Thank you. Our next question is from the line of Puneet Khanna from BOB Investment. Please go ahead.

Puneet Khanna: I just wanted to understand about Building products line, what is the breakup of sanitary and faucet, first question. What is the mix of retail and institutional sales? And third question is what is the market shares we are aiming for in the building product segment?

Sandeep Sikka: Sanitaryware and faucets, you want separate?

Sudhanshu Pokhriyal: Hi, this is Sudhanshu**.** On the six-monthly basis, we have about 32% to 33% is our faucets sale and the balance is what is categorized in sanitaryware. And similarly on the six-monthly basis for the financial year our retail sale is about 74% and 26% is our project sales. We typically do not give a specific number here, but we believe that we will gain market share and we target 1.5 to 2 times the overall market growth rate. And like we said we have been growing in the past quarters and we are the fastest growing company in the sanitaryware and faucets. We believe that we will continue this trend and continue to grow at 1.5 to 2 times the market growth rate.

Moderator: Thank you. Our next question is from the line of Pritesh Chheda from Lucky Investment. Please go ahead.

Pritesh Chheda: Just on the pure sanitaryware and faucets ware side of the business so when we try to compare a couple of years back numbers, we were in a streak of low growth or losing market share. Now between half yearly this year and let us say half yearly a couple of years back, the business which would have added and improved would be the pipes business. So adjusting for pipe business what is the growth rate that we have seen in pure sanitaryware faucetware and where are we on that market share table now?.

Sandeep Sikka: I think we disclosed that number. If you go to segment results, the sanitaryware and faucets together have grown by around 65% to 66% based on Q2 Y-o-Y and the pipes have grown by around almost 74% to 75% Q2 Y-o-Y. Sudhanshu has already spoken about it and in fact, we have been giving guidance for almost 6 months that we expect that we will beat the market growth by almost 1.25 to 1.5 times and this guidance was given earlier this year and even in the month of May this year, and we are proving what we had said historically with this numbers. You can compare us with other peers in the market who work in the sanitaryware and faucets space and the similar industries like CERA or something, and today we are the fastest growing company in this sector or in this industry today.

Pritesh Chheda: For us what is the half yearly growth?

Sandeep Sikka: Half yearly overall growth is 76%. which we had done. On sanitaryware and faucets, it is around 69%.

Pritesh Chheda: Now we are improving market shares or?

Sandeep Sikka: Number shows it. We are very aggressive in the market now.

Pritesh Chheda: Okay and on the pricing side, how much price increases you have to take to come back to a double digit margin if one would have assumed at the Rs. 600 crore revenue number so what kind of pricing actions you have to take on this portfolio?

Sandeep Sikka: Your question is good, but it is not that easy to answer to be very frank. I will just take you back in last two quarters on sanitaryware we have taken two price hikes and on faucets we have taken one price hike. Maybe another one or two price hikes, that is what we have been able to retain the margin. But again, we have to see how the input prices keep moving so input prices can go up or can come down over a period of time but despite the price hikes the raw materials keep moving. We will have to further evaluate and further do the price hikes in the market. The broad guidance is that may be next one or two quarters we should be able to iron out the differential in the margin which is due to the input material price hike.

Pritesh Chheda: Sir my guess is that input insulation is only on faucets, it is not on sanitaryware, right?

Sandeep Sikka: While manufacturing sanitaryware you have to bake in kiln where fuel is a major cost. The gas prices gone very high. It has almost doubled actually in the last few months.

Sudhanshu Pokhriyal: Additionally, there is use of PP (polypropylene) and there has been a huge price increase in the raw materials which is used for largely the seat covers as well as cisterns, and that also cost is nearly 15 to 20% of the total cost. There is a substantial price hike over the last 12 months on that raw material as well such as gas as well as PP and brass, these are the three key ones. About 14% to 15% of our total sanitaryware is imported from China and we all understand what is happening in terms of the overall increase in ocean freight, which has actually gone up by more than five times. There is an overall price increase in the raw material as well as in freight which is impacting even in the sanitaryware category, not just faucets.

Pritesh Chheda: I think the biggest variation there is imported part between us and the other competitor listed and the faucets side of the inflation because what we understand is power cost may not swing so much as a percentage of sales in terms of increase. What we are doing then on the faucets side where the inflation is there and on the pricing of it, because competition seems to be suggesting that they have taken the price hike? And on the imported sanitaryware side are we now developing any alternatives to it or any other option do we have?

Sudhanshu Pokhriyal: Yes, so like Mr. Sikka said we have taken one price hike in faucets this year and two in sanitaryware. We intend to take one more price hike in sanitaryware by the end of November and we are continuously evaluating if we need to have another price hike in faucets. We have strategically moved to reducing our dependence on China for imports, which used to be nearly 20% to 21% of our total sanitaryware requirement to now which is less than 15%. So we have reduced our dependence on China, so that is one aspect we have done and that we have done by developing local vendors. We have increased our production within the facilities through HSIL and also through other domestic vendors. So both these actions have been taken along with the increase in prices. I am also happy to share with you that we have undertaken a lot of cost reduction initiatives which we believe will start giving us an improvement as we go forward. These initiatives are in the product reengineering section. They are also in process reengineering and overall value chain improvement. We believe that in the next one to two quarters, we would be able to mitigate most of the input price hikes which have come into our P&L right now.

Pritesh Chheda: Lastly Sir can you quantify the price hike what has been taken so far in the last six months in faucetware and sanitaryware?

Sandeep Sikka: Two prices hikes ranging between 8% to 10% each.

Pritesh Chheda: Two times 8% to 10%?

Sandeep Sikka: Yes on sanitaryware.

Pritesh Chheda: And faucets?

Sandeep Sikka: Broadly in the similar range

Sudhanshu Pokhriyal: Faucets was about 10% and sanitaryware was 5% to 8% and the second was 8%.

Pritesh Chheda: So 16% in the case of sanitaryware and 20% in the case of faucetware?

Sudhanshu Pokhriyal: 10% in the case of faucet.

Pritesh Chheda: You said 10% two times, right?

Sudhanshu Pokhriyal: Faucets is only one time.

Moderator: Thank you. Our next question is from the line of Sriram Rajaram from Ratnatraya Capital. Please go ahead.

Sriram Rajaram: Sir my question is basically on the arrangement with HSIL. Now that I understand that there are two parts to it so basically one is that we purchase products from them, and we also receive some kind of income in the form of management fee. Now I just want to understand what are the basis for these and if you can disclose like what are the ballpark margins retained by the HSIL and how do we arrive at the management fees and so on?

Sandeep Sikka: If you see the big quantum of related party transaction is sourcing from HSIL and you can see the results of HSIL on the building product segment and you would know how much they are selling. The entire sale is to Brilloca. On a broader side, the EBIT margin range around 4%, so this is an EBIT level margin, which is charged by them in terms of OEM production. HSIL does not impart any management services. Post the demerger in the entire group, there were some common services like finance, accounting, IT, and legal, so all these things get allocated broadly to the other group companies so that we bring efficiency into the system and their also the mark-ups and other thing are all approved by a big four as part of the related party transactions.

Moderator: Thank you. We will take the next question from the line of Gaurav Singh from Sarath Capital. Please go ahead.

Gaurav Singh: Sir just one question taking cue from what you said earlier in the call where you said that it will be unfair to compare our margins to companies that are manufacturing by themselves. So in the past couple of quarters call we have mentioned that in the next three to four years we intent to get to 14% to 16% EBITDA margin. So how do we get there without manufacturing and outsourcing a lot of our manufacturing, because those EBITDA margins are quite comparable to what the other companies are doing while manufacturing?

Sandeep Sikka: There were some newer businesses inside the overall SHIL consolidated. Consumer business and pipe business are fairly new businesses. There is an element, wherein as the volumes for each of these businesses are increasing and when we are asking for third party vendors to manufacture it for us, we feel that there will be some volume discounts which will get billed on. I am just normalizing the input cost here. Apart from it, if you can see we still have higher employee cost as a percentage to sales because these newer businesses, these are separate verticals internally, there is some sort of an operating cost or an operating leverage which we will use as the volume expansion happens. With that we feel that margin expansion will enhance. These are the two key points and some internal efficiencies, some working on design to value, some improvements in the product, and some value addition to the products like Rakesh talked about IOT products wherein with some incremental expenses, we are able to change the whole game and make an incremental gross margin. It is not one initiative. There are subsets of many initiatives, wherein we had given a guidance that over the next three to four years, we should be able to expand our margins by around 3% to 5%.

Gaurav Singh: We still maintain that despite not manufacturing we can get there? Because my doubts came from the fact that if you look so in the pipe segment everyone is doing 17%, like top companies are doing at 17% to 18%. In the Consumer appliances it is broadly 10% to 11%. That is my question?

Sandeep Sikka: It is very easy. The margins which we leave in HSIL which they charge from Brilloca, are very transparent to you. You can go to HSIL results and just pick up the building margins and add to us so you would know because if you see on a pre-demerger basis on sanitaryware or faucets together we work in a range of around 18% to 20%. The pipes business had not started during that time on a pre-demerger basis so the margins which we are retaining there on pre-demerger basis are not available. So, let us say tomorrow if we have manufacturing with us we feel that margins will be still stronger, that is our directionality of our discussion was not that the 3% to 4% incremental margin will come with a manufacturing in house. It is purely relating to economics. It is also relating to efficiency which we will bring. So if manufacturing is required one day like that will be a top up.

Gaurav Singh: So that is an option that we keep open if you could manufacture as well?

Sandeep Sikka: Yes.

Moderator: Thank you. Our next question is from the line of Puneet Khanna from BOB Investment. Please go ahead.

Puneet Khanna: Just have another question. What is the price of natural gas we are right now buying for sanitaryware and what are the sales from tier one to tier three cities?

Sandeep Sikka: We do not buy any natural gas as we do not have any manufacturing facilities. We procure our products from third parties who buy natural gas. But definitely it is passed on. But the broad numbers, which we have is that natural gas prices on an average in the last two quarters has moved from Rs. 25 to almost Rs. 50. That is almost doubling of the price. It depends on state to state and on in the sort of agreements that these vendors have with the agencies. As regards to tier 1 and tier 3 if you see, sanitaryware or faucets, if you go to the top few cities, metros constitute almost 30% of our sales and then non metros. First Bengaluru, Chennai, Delhi, Hyderabad, Kolkata, Mumbai, and Pune, so they constitute around 30% and the rest of the country constitutes around 70%.

Moderator: Thank you. Our next question is from the line of Deepak Poddar from Sapphire Capital. Please go ahead.

Deepak Poddar: Thank you very much Sir for the opportunity. Sir I just wanted to check like in the previous call as well you have been talking about may be 20% kind of a revenue CAGR over the next three years, whereas the kind of growth that we are witnessing right now is in another trajectory. So is there any kind of revision that we want to do on the CAGR that we were looking at over the next two to three years?

Sandeep Sikka: The guidance which we gave around six to nine months back was based on that market condition but post that many input raw material prices have moved. They may drop over a period of time also, but our numbers today stand in the same value like what we have spoken about the expected growth on consumer or the pipes or the rest of the Building products.

Deepak Poddar: So we are kind of looking at same range, 20% to 25% is what you are saying?

Sandeep Sikka: Yes, but I think there is an element of more bullishness here. So we have a chance of doing more also.

Deepak Poddar: Because given the price hike it is close to may be 10% to 15%, right?

Sandeep Sikka: Yes.

Moderator: Thank you. Our next question is from the line of Shreyans Jain from Quest Investment Advisors. Please go ahead.

Shreyans Jain: Just one question what would be our component of gas in manufacturing of Building products like sanitary and faucetware?

Sandeep Sikka: As I told in Brilloca, we do not have manufacturing.

Shreyans Jain: Right but just broadly, I just wanted to understand the gas component.

Sandeep Sikka: While manufacturing sanitaryware, the kiln is used. It is not much used in faucets, average production cost to the overall gas cost is somewhere around 22% to 25% of the production cost.

Shreyans Jain: Alright and just last bit on the sanitary and faucetware business, so what I am trying to understand is that FY2021 was lower base and on that base our growth really high so do you think we will be able to cater to the demand that is there and are we really confident of 25% to 30% kind of growth rate?

Sandeep Sikka: Based on the current market condition, I think like last quarter we have 66% growth. Definitely there is some element of last year COVID impact. But based on the current market condition we are very confident on the numbers you are talking. At least we can do these numbers for the next two quarters.

Moderator: Thank you. We will take our next question from the line of Arjun Goyal an Individual Investor. Please go ahead.

Arjun Goyal: I actually had a question again related to the current market conditions. If you can give your comments on the current festival season that has just gone by for different lines of our businesses and how do we see closing out FY2022?

Sandeep Sikka: May I request Rakesh to take this question please.

Rakesh Kaul: So the recently concluded festival sales were a little bit different in the sense that we have seen less number of consumers in shop in the recently concluded festival sales but they have moved up the value chain which means that higher ASP products have sold more during the recently concluded festival and we still see there is a little bit of resistance towards the mass based products which shows the COVID impact on the lower and the middle class is slightly more. But having said that it gives an opportunity to a company like us because we focus on technology and innovation, and since the majority of the products which we got sold during the recently concluded festival, the sizeable portion of that remains smart products and connected appliances. This gives us a lot of scope and focus and lot of hope that the subsequent months would turn out to be better and we might eventually increase our ASP as well, not only because of price hike, but because of higher input. The premium products are selling more during this festive season.

Arjun Goyal: What was the building product segment in the retail how has that been performing currently?

Rakesh Kaul: So retail for Consumer appliances business or retail for?

Arjun Goyal: The retail subsegment that we classify?

Rakesh Kaul: We have moved because we had two big pillars - one was a brilliant product in the commercial business and also the brand which is Evok by Hindware. We realized the potential of the brand by getting into a very asset light model where we subsequently reduced the count of our stores. We currently have these two owned stores and we have subsequently increased the franchisee stores to 29 by the end of the Q2. Let me tell you that we have grown by more than 185% in our franchise business over the last year and even if you take for like for like franchise stores we have grown by 50% in H1 despite the COVID induced lockdown in Q1. So our recalibration of the model in retail has helped us to a significant extent. At the same time, we are very strongly focused D2C approach in the Retail business which is evok.in, which has more than 800,000 unique visitors coming on the website every month. We believe that in future we will optimize our digital capabilities by going hyper local and we are also working in such a way that many of the consumers who are logging into our website, we are now getting products delivered through franchises across the country thereby making the offline as well as part of the inclusive growth. So, I think from that perspective the EBIT margins of retail has shown us a significant improvement than what they were earlier.

Arjun Goyal: Sir just a quick clarification when we say retail as a sub-segment we include online and offline as well right or is it only the physical franchise that we have?

Rakesh Kaul: So, while the physical franchise and the physical stores are part of the Somany Home Innovations Ltd. but we have 100% subsidiary called HHRPL which is basically the D2C which looks at the digital B2C business.

Arjun Goyal: This comes under the retail sub-category?

Rakesh Kaul: Yes, this comes under the retail sub-category. If you ask me now retail and e-tail are merging. So while we are working on this, our future focus will remain D2C. While in SHIL also for Consumer appliances businesses we are looking at D2C to not only to drive revenues but make brand more aspirational and give an experience to our consumers about our products and offerings. I think we have a merging of e-tail and retail so to say, but yes you are right the ecommerce business, the D2C part of the business of retail falls into 100% subsidiary called HHRPL.

Arjun Goyal: Finally regarding the Building products segment, in your competitors call they seem to suggest that the second half of the financial year, they are going end on a very strong note so are you seeing similar trends as well any thoughts and any comments?

Sudhanshu Pokhriyal: In the sanitaryware and faucets business, we are also seeing extremely good market response and we believe our performance is going to be exceedingly good in H2 as well. I reiterate the demand which is there right now, which has been there from the real estate market, both for replacement as well as new demand, we have no doubt that the business is going to be robust in H2 as well.

Moderator: Thank you. Ladies and gentleman, that was the last question. I now hand over the floor back to the management for closing comments. Over to you, Sir.

Sandeep Sikka: Thank you every body for joining us on this call today. The markets have turned out to be very good for each of the segment in which we are operating. We are very confident that Q3 and Q4 will give us further impetus for growth, and we have given medium to long term guidance to the market. Based on the current market condition we feel that we are walking in the right path of that trajectory of growth which we have mapped for us, and we can further improvise and improve on the numbers as we move forward. Thanks for joining again and we are very happy to answer all your questions as we move forward. Thank you very much.

Moderator: Thank you. Ladies and gentlemen, on behalf of Dolat Capital that concludes this conference. Thank you for joining us and you may now disconnect your lines.

Notes:

1. This transcript has been edited for readability and does not purport to be a verbatim record of the proceedings.
2. Figures have been rounded off for convenience and ease of reference.
3.