"Somany Home Innovation Limited
Brilloca's acquisition of HSIL's Building Products Manufacturing Undertaking"

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Operator: Ladies and gentlemen, good day and welcome to the conference call to discuss Brilloca's acquisition of HSIL's Building Products Manufacturing Undertaking.

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 call, please signal an operator by pressing star then zero on your touch tone phone.

I would now like to turn the conference over to Mr. Gavin Desa from CDR India. Thank you and over to you sir.

Gavin Desa: Thank you and good day everyone. We'd like to welcome you all to today's call to discuss Brilloca's acquisition of HSIL's Building Products Manufacturing Undertaking. We are joined by Mr. Sandeep Sikka, the Group CFO and Mr. Naveen Malik, the CFO of SHIL.

Before we begin, I would like to mention that some statements made in today's discussions may be forward looking in nature. The actual outcome may vary, as they are dependent on several external factors as well. The participants may hence make their own assessments too.

We will start the call with opening remarks from the management following which we will have an interactive Q&A session. I will now request Mr. Naveen Malik to open the call. Over to you Mr. Malik.

Naveen Malik: Thank you. Good afternoon, everyone. Thank you for joining us on this call today. I hope that you and all your family members are in best of the health. As you are aware, the Board of Directors of Brilloca Ltd., a wholly-owned subsidiary of the Company, has approved the purchase of HSIL Ltd.'s Building Products Manufacturing Undertaking on a slump sale basis, which constitutes sanitaryware, faucets and plastic pipes and fittings manufacturing facilities, for a cash consideration of ₹630 crore, subject to closing date adjustments on an arm's length basis.

The transaction is subject to necessary shareholder, lenders, and other statutory approvals as required by both HSIL and Brilloca. The Building Products manufacturing undertaking being bought by Brilloca will include (a) the plant and machinery and other assets related to around 2 million pieces, sanitaryware manufacturing plant at Bahadurgarh in Haryana, (b) the plant and machinery and other assets related to current available capacity of 35,000 tonnes per annum, pipes and fittings manufacturing plant at Isnapur in Telangana. This plant is currently under expansion and post expansion the capacity would stand at 48,000 tonnes per annum, (c) 59.5 acres of land along with building and plant and machinery situated thereon worth 2.2 million pieces, sanitaryware manufacturing plant at Bibinagar in Telangana, and (d) leasehold land, along with the building, plant and machinery situated thereon and other assets related to the 3.7 million pieces faucets manufacturing plant at Kaharani in Rajasthan. All related inventories, other assets, business liabilities, employees, permits also form part of the deal.

As part of the deal, Brilloca will be taking the entire land and building at the Bahadurgarh and the Isnapur pipe plants on around a 10-year long-term lease, which is further extendable. That decision has been taken keeping in perspective, the underlying land cost of these two land parcels, optimizing the cost of acquisition and operating dynamics required for the business. The annual rental for these two land and building parcels would be around ₹16 crore per annum.

All these facilities are efficiently managed and have further scope for enhancing efficiencies, as we drive future growth. The current capacity utilization at two sanitaryware plant is around 90%, whereas faucet plant in Kaharani is operating at 65% to 67% capacity utilization. For plastic pipes and fittings, the Isnapur plant has a current capacity utilization of over 85%. Brilloca, over the next few years, will evaluate further plans to upgrade and enhance capacities that are aligned to meet the increasing demand for our products in the market.

We are pleased to share that Brilloca is the fastest growing building product company in its operating segments. This transaction will have several benefits including Brilloca today is entirely dependent on third party vendors and the acquisition will reduce this dependence. Since Brilloca has aggressive growth plans, it is not prudent to outsource the entire manufacturing. The changes in the macro-environment over the last two years have made it imperative for the company to have control over the entire value chain, including manufacturing, supply chain, etc., so as to sustain this sector outperformance.

The deal helps create a simpler structure by integrating the entire value chain in a single entity. Market analyst and key investors have, during the course of our discussions over a period of time, inquired about the manufacturing and sales and distribution of the building product business being split in two companies within the same group, further resulting in additional related party transactions. The proposed acquisition can be considered as a step forward towards realigning the business to enable a simpler operating structure that resonates better with our stakeholders.

Given the financial strength of Brilloca, the manufacturing processes and technologies can be upgraded and expanded to further enable accelerated rollout of new products in the marketplace. The current acquisition provides a platform, which we will further leverage for growth. This operating integration will also provide manufacturing to market synergies in the operations, resulting in better efficiencies being delivered over a period of time. Additionally, this will significantly reduce the compliance and administrative burden for management of both companies with respect to the related party transactions under Indian regulatory framework.

In terms of financial matrices, the transaction will add manufacturing margin to the Company's EBITDA. Based on current market conditions, we expect this will initially result in incremental EBITDA margin in Brilloca of around 3%, with further enhancement to around 5% over the next few years. We plan to finance the transaction by a debt of around ₹550 crore to ₹560 crore in Brilloca and balance using cash reserves and accruals. As you may be aware that Brilloca reports healthy cash flows and we believe that in the current business scenario, a large part of the debt, specific to this transaction will be repaid in the next 3-4 years.

In the sanitaryware and faucets business, we have performed well in a challenging macro environment. In the pipes business, we are the fastest growing player in the country. The acquisition of the BPD manufacturing undertaking from HSIL will only add to this momentum and enable us to deliver faster and sustained growth. Even post the transaction, our ROCE, the Return on Capital Employed, for the Brilloca will be in excess of 25%.

In conclusion, I would like to reiterate that the proposed purchase of the Building Product Division Manufacturing Undertaking of HSIL is a compelling step towards growth and we believe it will provide both immediate as well as long-term benefits enabling SHIL to create incremental and sustained value.

Now, Gavin, we are open for questions. We are happy to take the questions.

Operator: The first question is from the line of Porinju from Equity Intelligence. Please go ahead.

Porinju Veliyath Good evening, friends. I am Porinju Veliyath from Equity Intelligence. Am I audible?

Sandeep Sikka: Yeah, you're audible, Mr. Porinju.

Porinju Veliyath Thank you. Thank you, Sandeep. Okay, I really appreciate the action now by the management of acquiring this BPD manufacturing, which was very important, and I used to wonder why the manufacturing of BPD was not transferred, during the agreed merger. I have been holding the stock in the portfolio management since the last seven, eight years. And you know, I had an impression that our glass division will be demerged for various reasons, and it was looking very logical. In a way better late than never, I think, for me, it is like, correcting small mistakes we did in the past by demerging the BPD manufacturing also along with the glass division. Anyways, well and good and the transaction seems to be very professionally and very simply done. ₹600 crore of revenue is transferred at ₹630 crore the company has acquired. I understand as Naveen was explaining there is no more related party issues and something like a full integration with better margin and you can focus better going forward; that's what I firmly believe.

So, I hope the management will continue to keep things simple, that is something I think the investing community had, or analyst community had some kind of apprehension about our company. So, let this be one step forward towards that keeping things simple and striving to make much better operating margins. I used to always be wondering, now we have got our similarly strong brands of companies in India, in the similar business, like Astral, Havells, and Cera, I would say three companies. In fact, all these three companies are there in same businesses done in SHIL.

So now, Astral is quoting a 12.5 times sales, Havells is quoting a 6.6 times sales, and Cera is at something like 4.5 times the revenue, whereas SHIL is quoting at around 1.3 times sales. I hope this transaction will definitely contribute to reducing the gap between this other competitor companies and Somany Home Innovation. But I still believe you know, why there is such a big gap. So, I just would like to listen to Sandeep Sikka, going forward, how do you feel, why this kind of a gap is still there in the valuations? It's very important. It's a matter of concern and I think the perception about the company also is not very good among the investment community, most of which I believe it's a misunderstanding for lack of clarity and a little bit of gray areas and a little bit of complexity in holdings of the businesses. And that's such a valuable, wonderful brand, Hindware is not there in the name of the company. That's one important thing we have missed out. And so that itself creates confusion among the investment community that whether this is the real Hindware company. So I would like to know, from the management, what are the plans to clarify these things to the investing community and the analyst community, so that we get a reasonable kind of valuation going forward? That's all for my side and congratulations for the deal Sandeep and Naveen. Thank you very much.

Sandeep Sikka: Thanks, Mr. Porinju. Thanks for the nice words and thanks for all the support which we got from you, since you have been invested in our company for a pretty long time, and you have always been supportive, and at the same time, very critical, like you are today. So I'll answer your question one by one.

I've been saying that market should consider this transaction to be a step forward. What we did as a demerger a few years back was correct from that particular perspective. Based on the feedback which we got from most of you, who have been attending these calls we internally deliberated on it, and are a series of steps, which we are going to take on this. This is the first step towards acquiring this manufacturing entity. The benefits of this are multi-fold, as Naveen has already spoken, our reliance on the third parties, elimination of related party transactions, the financial strength of Brilloca will help us in faster decision making and also significantly reduce the administrative and other burdens.

Even from the analyst community side, while analyzing Brilloca or SHIL, they had to simultaneously analyze HSIL, which also had a BPD manufacturing division, because the whole fluctuation in the incoming raw material and other things would happen at HSIL. So, internally, we strongly feel that this will add substantial value to the bottom line of the company and over a period of time help the company to accelerate its growth on the top line as such.

Now, answering your question in terms of the understanding of the market, our strategy, over the last three- four years has been differentiated from the strategy of the other players in the market. It has been more focused on further enriching the Hindware brand in the mind of the people, taking benefit of higher brand recall of Hindware in the mind of our consumers to launch more products into various categories, which are profitable, and create long-term sustained value.

We spoke about the same things around four or five years back and they're all part of our transcripts and you can check the erstwhile HSIL transcripts which are there. Like four or five years back, we took a call in two key segments of growth, one was our consumer products and other was building products in which we went behind the wall and started selling pipes. I hope you will all appreciate that, pipes now is doung₹150 - ₹160 crore on a quarter basis and consumer products have also grown and both these businesses are profitable. They are now the new pillars of our growth going forward, other than sanitaryware and faucets wherein over the last four to six quarters if you try to map us, we have outperformed the market.

Definitely, some questions are always there in the mind of the analyst community that SHIL is now a fairly diversified business, constituting consumer appliances like kitchen chimneys, air coolers, water heaters, fans etc. We have sanitaryware and faucets and CPVC and UPVC pipes and fittings under Brilloca. But it's very important for the analyst community to understand that we have been fairly successful in terms of each of the segment, which we hopped on, we invested in the last three to four years. We are today the number two player in kitchen chimneys and hoods and hobs. And touching a good level of turnover in this segment which symbolizes that our success into the mindset of the consumers.

We are an emerging player in the pipes and fittings sector. We are pretty strong in the Sanitaryware and the faucets sector as well. Our Pipes business base is small right now, but the leadership is in the growth, and, our growth versus the growth of the rest of the industry is higher. We do make a significant impact in the mind of the consumers. One clear example of this is that we used to be a pure bathroom brand which people would use in their bathrooms, whether as a commode or the wash basin and now, people are very happy to cook food on the Hindware hoods and hobs, use chimneys, even dispense water from Hindware brand, have an air cooler of a Hindware brand, so this shows how versatile the Hindware brand is today. And we are harping on it. We are hell bent on achieving the highest growth, which can be possible into this market. We are pretty aggressive internally. We have separate business verticals, we have separate CEOs and most of our CEOs come and interact with the analyst every quarter on the results.

There are significant initiatives which we have undertaken to increase the value of the various businesses we are in. Definitely one point, Mr. Porinju, as regarding the rationality of the names, we are internally working and once it is approved by the Board, we will definitely come back to you. What I can tell here is that we are now a very unique company having three distinct go-to-market channels, not many companies have. And I'm not saying that these three distinct market channels are very small channels; in each we have almost 10,000 plus Retail touch points with each channel contributing more than annual sale of ₹400 crore plus, let it be pipes, consumers or sanitaryware, faucets is already higher.

Now we have a base on which we can grow and build the businesses, build sales, build EBITDA and also the bottom line. Thank you for all the support Mr. Porinju. I hope I have been able to answer your questions.

Operator: The next question is from the line of Sunny Gosar from MK Ventures, please go ahead.

Sunny Gosar Thanks for taking my question. I have a couple of questions. The first one being basically if we look at HSIL's Building Products Division performance in Q2, FY22, we had a revenue of about ₹230 crore, ₹240 crore and an EBIT of ₹9 crore, which I understand would broadly translate into EBIT of about odd ₹15 crore to ₹17 crore. So the question I had is, what is the scope for revenue increase on the current plant that we have acquired? And basically, incrementally what's the kind of peak

EBITDA that can be done on a say a quarterly or an annual basis from the current set of facilities that we have acquired?

Sandeep Sikka: Thanks, Sunny. We has in quarter two a sale of around ₹234 crore, ₹235 crore. We feel that based on the current capacities, which we have, we can do ₹1100 crore to ₹1200 crore of sales, based on the current market conditions, and on the current pricing of input materials.

As Naveen also spoke in the opening remarks that the pipes plant which has a capacity of 35,000 tonnes per annum is under expansion, and we feel that by 31st March 2022, major part of this expansion will be completed and then we will have an incremental capacity. Any incremental costs after 30th of September 2021, around ₹50 crore, we may have to pay more because our valuations are based on the capital work in progress status as on 30th September 2021. We feel that it can incrementally go from here too easily to a level of ₹1400 crore to ₹1450 crore, with the incremental pipe capacity coming into play.

Sunny Gosar Right. And that would what translates into about 7%, 8% EBITDA margin at that level of revenue?

Sandeep Sikka: Yes, a slight improvement in EBITDA margins will happen because some of the factory costs, which are fixed costs get a portion on to the higher. We feel that as the capacity utilization increases, we can have around 7% to 8% margins on this.

Sunny Gosar Got it. And the second part of my question is basically out of this ₹630 crore that you may end up paying by March 2022, what would be the portion of assets acquired and what would be the portion of working capital acquired, because I want to understand what is the depreciation impact going forward. And basically, what would also the borrowing cost on the debt that we will end up taking up? So will this be like EPS accretive immediately or will this basically get EPS accretive by FY24?

Sandeep Sikka: As a part of the whole deal, we are buying certain parcels of land and these parcels of land in the books of HSIL were at the old rate, but we had to now pay the current market prices for this. The value of these land parcels, which we have acquired, that range in the level of around ₹70 crore-₹80 crore. The balance will be there, which in the books of HSIL was at around, let's say, ₹15 crore, so incrementally there has been a value addition on the valuation of the land. Overall depreciation broadly will remain in line with HSIL other than the buildings which we are acquiring. And we feel that maybe there'll be one year of pressure on the bottom line but immediately after that, with all the profits, which will earn, as you said, most of this will get deleveraged over the next three to four years, it will be value accretive in the bottom line, also.

Sunny Gosar Right. And basically, what would be the borrowing cost that we are looking at?

Sandeep Sikka: Right now in HSIL, most of our long term loans are in a range of around 6.5%, working capital is in a range of 5% to 5.5%, and similar level of interest rates. We feel that Brilloca will also fund long term loans at around 6.5% and working capital is cheaper. In the ₹630 crore, there is a net working capital of odd ₹180 crore, which is being passed on to Brilloca from HSIL. And over a period of time, we'll optimize this working capital also, because right now, we have two different organizations maintaining two different working capital, and it will also bring efficiencies over a period of time.

Operator: The next question is from the line of Vineeth Gala from Monarch Network, please go ahead.

Vineeth Gala: Sir, at the outset, congratulations on a good transaction. So post transaction, as we have articulated the margins in the building products should directionally go up right?

Sandeep Sikka: Yes.

Vineeth Gala: So, on this, how do you see a long-term guidance that is on FY 25 numbers on the margin front, which was previously at 14% to 16%. So how do you go about that particular guidance?

Sandeep Sikka: With this acquisition, the incremental sales will not be much, although with some efficiencies, faster turnaround, some growth impact will be there. We feel that immediate impact in the coming quarters post acquisition will be of an incremental value of 2.5%- 3% increase in the EBITDA margins, which should further grow higher, to a level of around 4.5% to 5%, with all the production efficiencies will start coming in with faster utilization of the resources at the factories. We feel that unlocking of the EBITDA value over the next four or five years should be in a range of 4.5% - 5% around.

Vineeth Gala: So that would be over and above our previous guidance of 14% to 16% odd.

Sandeep Sikka: In the previous guidance we had given, the overall incremental margin, were more towards efficiency. Those margins were more towards better utilization of operating leverage, so we had given guidance that we should be able to incrementally earn 3% to 4% over the next three to four years. That will be over and above that guidance continues as such. What I'm talking here is more specific to the acquisition we have made here.

Vineeth Gala: Got it. Sir, and also if you can articulate the Capex need for SHIL over next three years, given that the capacity that we have acquired, especially for the faucets and pipe division, they're already at a higher utilization. So, can you quantify the Capex amount that we are expected to do over next two to three years?

Sandeep Sikka: If you see a normal maintenance CAPEX of such a plant, it should be in range of around ₹25 crore to ₹35 crore wherein we keep doing debottlenecking and adding new machineries. But we feel that in next 12 to 18 months, as the growth in pipes is substantial and we are the fastest growing brand the pipes sector today in India we may have to put another small pipe plant across the country. Today we are more focused in the state of Telangana. We do almost 1100 plus SKUs, which is very, very high in the market and that's one of the reasons we have been very successful. But pipes you know being a volumetric business has a limitation of travel, we may consider over a period of time putting up regional pipe plants, which can add value to our penetration into the local markets by selling higher pipes along with the fittings. That's one thought.

We feel that once this whole plant comes, our average Capex with the incremental capacity, debottlenecking and everything should be in range from ₹70 crore to ₹90 crore per annum, as such.

Vineeth Gala: So ₹70 crore to ₹90 crore is excluding the maintenance Capex of ₹25 crore, so?

Sandeep Sikka: If you only consider maintenance, it will be ₹25 crore to ₹35 crore but if you have to do an incremental capacity, whenever we do, we feel that it should be in the range of ₹70 crore to ₹90 crore.

Vineeth Gala: Okay, sir. And also this includes the water heater, any investment in the water heater JV that we are expected to do over next two to three years.

Sandeep Sikka: Water heater is separate; this call, we would like to focus on the building products. We can take your questions on the water heater business post results. And regarding the water heaters, the investments in that water heater factory is already disclosed in the last call. I would request if you can refer to those transcripts, you will have all your answers there because that's a part of the JV, and not a part of Brilloca.

Operator: The next question is from the line of Trilok Agarwal from Aditya Birla Sun Life Insurance. Please go ahead.

Trilok Agarwal: Good evening. Thanks for the opportunity. I'm not sure whether you guys mentioned about what kind of funding you guys will do with both an equity and debt and what's the repayment plan that you guys intend to do for?

Sandeep Sikka: Brilloca today is debt free, we're not using any debt. And in fact, we have a surplus cash which is about ₹50 to ₹60 crore today. We feel that this transaction will be completed by March 2022, and we'll have incrementally ₹40 crore - ₹50 crore surplus cash and also earn incremental margin. These are rough figures, but we feel that we will have to contract an incremental debt of around ₹550 crore to ₹560 crore and we also feel that three-fourths of this debt will get paid off in next three to four years itself, which means the debt we contract for this acquisition with the profits which we earn will get repaid itself. And so at that particular time all these benefits and other things will be highly value accretive on the bottom line.

Trilok Agarwal: So I think in one of the response you also mentioned some ₹180 crore of working capital. So, it is an inventory layer mainly because I believe you guys are sourcing completely from them.

Sandeep Sikka: When I'm saying we are debt free, it means that we're not using even long term loan and not even working capital loan, but based on the inventories today, we can borrow from our lenders. With all the profits, which we earned in last one and a half years to two years, we have parked the entire internal accruals in our borrowing, by way of paying off the short-term debt and the long-term debt, but we can definitely use this. Actual long-term loans would be ranging between ₹350 crore to ₹375 crore. Balance, as I told you, we are getting around ₹180 crore to ₹190 crore of working capital also as a part of the deal. There will be an incremental borrowing based on that and then balance if any shortfall is there, we have a surplus working capital limit, which we can utilize to pay off the entire transaction.

Trilok Agarwal: And what's the inventory that the acquired entity has, as we speak today.

Sandeep Sikka: The total inventory value as on 30th September is odd ₹260 crore, which includes inventories relating to the CPVC which we import into HSIL, the plastics in there and then inventories of brass, inventories of other elements, which are there.

Trilok Agarwal: So, is it like fair to understand this that by, let's say, in three years out, by FY23, FY24, FY25, you will probably repay ₹200 crore each in the debt that will raise because of the acquisition, that's first points. And second is what kind of capacities or space that we have in the acquired plant, in case you want to expand further by a minimum brownfield or maybe including capital lower.

Sandeep Sikka: I'll go line by line. Under HSIL, for Faucets, they did an extension around a year and a half back when they increased their 2.5 million pieces' capacity to 3.7 million pieces. We are using this capacity at around 65% -70%. On pipes, we are at a capacity of 35,000 tons, but we are at almost 80% to 85% capacity utilization, there is a margin for incremental capacity also. Under Sanitaryware, we are touching almost 85% to 87% capacity utilization. We have to see where all do we have to make additional investment within the factories or we may look out maybe one-two years down the line that we've put up a plant in a very different distinct location so that we start capturing that local market also for that particular factory.

Trilok Agarwal: Sure. And incrementally like you mentioned another ₹70 crore to ₹90 crore rupee of Capex for the bottlenecking, what is the kind of revenue generation that income with bottlenecking can generate for you guys.

Sandeep Sikka: Most of this Capex can yield a much higher turnover. Especially in the pipes business, if you see the turnover can be much higher because the switch on this is much higher. Incrementally you can easily assume we can do 1.5 to 2 times the value of the investment.

Trilok Agarwal: Okay. And lastly, if I may, is it like fair to conclude that incrementally now in order to grow we will probably need to invest to set up either manufacturing. From an outsourcing versus manufacturing what kind of mix do we expect in two years time?

Sandeep Sikka: As you see, we were doing this outsourcing mix of 70:30 on sanitaryware for a pretty long time and we would like to continue. Only thing is that over a period of time, we would like to reduce our reliance on the Chinese market for import if any, we were doing and try to do this within India. We may go for local development of vendors over a period of time, but outsourcing for sanitaryware and faucets will continue. The Pipe will be more or less than 100% in-house because most of the molds which are there are in-house for fittings and nobody else has those molds. And pipes also we would like to do on our own. I think outsourcing will be more focused on sanitaryware and faucets ranging 30% to 40%.

Operator: The 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, most of my queries have been answered. And just couple of things, I wanted to know. Is there any kind of goodwill that will come on the balance sheet because of this acquisition and if that's so, how much would that be?

Sandeep Sikka: Hindware brand is already part of Brilloca. What we have acquired as such is a slump sale of land, buildings & plants and machinery. There can be a very minimal amount because as per the accounting standard, since it is slump sale, we will have to account for each plant and machinery based on the fair valuation of each plant and machinery as on date. We have not bought any goodwill as such, the manufacturing is already coming along with the deal but we may record maybe ₹1 crore to ₹5 crore of goodwill based on the final asset by line by line valuation once we do this as on the closing date.

Deepak Poddar: Okay, so that's very minimal. And what's the absolute level of depreciation? You did mention that it would be in line with what is being seen in HSIL. So, what will be the depreciation in our books for this acquisition?

Sandeep Sikka: If you see the level of depreciation which was there in HSIL manufacturing was approx ₹24 crore per annum. Since we are not taking some buildings along with it, we feel approx ₹16 crore - ₹17 crore of depreciation would flow in here as such.

Deepak Poddar: That's ₹16 crore to ₹17 crore of depreciation. Okay. Yeah, yeah, that's about it. Thank you very much and all the best.

Sandeep Sikka: They are approximate numbers but it will be dependent on the final valuations, which we do on the allocation of the slump sale value.

Operator: The next question is from the line of Varun Pattani from Quant Mutual Fund. Please go ahead.

Varun Pattani Yeah, hi, thanks for taking my question. Actually, I missed the starting part of the conversation because of closing market hours, so I don't know if my question has been already answered but I will just ask. So can you tell me how much was the debt of the BPD divisions within HSIL?

Sandeep Sikka: Actually, the allocation of debt is done internally on actual basis in HSIL. As such, so the money which we pay from here will be utilized by them to pay off their existing term loans because there we have a concept of HO allocation of debt.

Varun Pattani Okay. Understood. So, entire ₹1100 crore - ₹1200 crore pertains to HSIL and then out of this amount, part of it would be retail.

Sandeep Sikka: Yes. They have a total long total debt including short term and long term ₹1100 crore, so ₹630 crore will be taken off.

Varun Pattani What was the basis of the valuation? Basically, I understand that it was a slump sale, but then there would be some basis, so some color on that how was the valuation done.

Sandeep Sikka: Brilloca hired Ernst & Young to do the valuation. And we had two valuers and HSIL appointed Deloitte. Both had Big4 on the either side. Both of the organization focused on valuations linked to the DCF. In fact, the weightage is on the DCF rather than the set valuation and valuations are not far off and the value of ₹630 crore is within the range of both the valuations. This is based on the negotiation between the two organizations.

Operator: The next question is from the line of Abhishek Vora from Ambit Asset Management. Please go ahead.

Abhishek Vora: Thanks for the opportunity. My first question would be on the sanitaryware business, what percentage of our raw materials are we dependent on import?

Sandeep Sikka: Under overall manufacturing in Brilloca till now, 70% was sourced from HSIL, another 15% to 20% we were importing, another 10% was contingent on other vendors in the market. But as I told, we may reduce this by 5% to 10% over the next two years, by shifting and the imports to India.

Abhishek Vora So, dependence on China would be about 15%, 20% which you will reduce it to 10%, 15%, right?

Sandeep Sikka: Yeah, yeah.

Abhishek Vora Right. Okay, thanks. And on the geography mix, where are we more dominant leader, would it be the West, North, if you can throw some color there.

Sandeep Sikka: We are strongest in South followed by North, East and then West.

Abhishek Vora: And what would be our target market, tier two, three cities, if you can give some break up there also.

Sandeep Sikka: Almost 25% of our sales comes from these top seven to eight cities and balance comes from the remaining cities. We monitor these top cities and then the classification of tier two, tier three is very different internally. But then ultimately, material gets sold through a sub-dealer mechanism into the greater interiors of India.

Abhishek Vora: Sure, sure. But 75% goes to top ten cities, right?

Sandeep Sikka: No, only 25% goes to top ten.

Abhishek Vora: 25% goes to top ten cities.

Sandeep Sikka: Yeah, yeah.

Abhishek Vora: Sure. And where are we more focused whether are we more on mass, premium, even that breakup if you could give.

Sandeep Sikka: We have a mix; our premium brand is Hindware Italian. Our mix on the premium and the mass is almost 50:50 now.

Abhishek Vora: Sure. Okay. That's it. And on competition, if anything you can mention, I think one of the pipes player has also entered, then we have already leaders in the market. How do you see the competition going, because I believe other players have lesser dependence on imports and one of the players was kind of going out of stock? So there was some dry space but what is your sense of overall competition in sanitaryware and faucets?

Sandeep Sikka: We continue to believe that markets will remain competitive, and people are seeing all kinds of opportunities today. It's not that only we are trying to enter. Everybody today is trying to fully leverage on the brand strength and the markets which they can tap in. We have internal competencies and internal strengths, which are our brands, our quality standards, and very strong after sales service, and a very high brand recall in the minds of the consumers. We do make investments linked to these, and our investments in terms of nurturing these competencies will continue going forward and we feel it will further lead to growth in times to come.

Abhishek Vora: Sure. Any growth targets that the team would have in their mind with regards to next three, four years as far as sanitaryware and faucetware is concerned.

Sandeep Sikka: Sorry, I missed your question actually. Your voice actually not cleared.

Abhishek Vora: Any revenue targets on this particular segment of sanitaryware and faucetware are concerned.

Sandeep Sikka: We have given guidance on this many times. You can refer to our transcripts, wherein we have said that we should be able to beat the market by 1.25 times to 1.5 times, so whatever the market grows, we should be able to outperform the market and segment in the Sanitaryware and faucet sector.

Operator: The next question is from the line of Mayur Gathani from OHM Group. Please go ahead.

Mayur Gathani: Thank you for the opportunity. Sir, just want to reiterate the ₹630 crore that we are paying for this, the break up is going to be long-term ₹400 crore that we are going to borrow, ₹180 crore is the working capital that we acquire from HSIL and ₹50 crore is the internal accruals that we pay. Is that a fair understanding?

Sandeep Sikka: Yes.

Mayur Gathani: Okay. And sir, you guided, I mean, if you look at the quarters before, you have guided for 14% to 16% EBITDA margins overall for the company, is that correct?

Sandeep Sikka: Yes.

Mayur Gathani: Over the next three years time or three to four years time. So, of course, with – that integration wasn't the part of the discussion at that point of time. So replying to a previous question, you did not say that the margins will further incrementally increase because of this integration. I mean, you were saying 3% increment that you can take today but overall guidance should also be 3% or 4%, higher probably over the next few years' time.

Sandeep Sikka: This is exactly when I spoke, the similar question came earlier that the incremental 2.5% - 3% margin is only on account of the acquisition. Our previous guidance to further enhance efficiencies using operating leverage will lead to another 3% to 4% incremental margins over the next three to four years. Thus is over and above this.

Mayur Gathani: Sorry, so that 14% margin that you guided previously, should we take it as a 16%, 17% in the next three, four years' time.

Sandeep Sikka: No, it is not this. If you see our operating EBITDA margins were in range of around 11%, and we also stated the same in our guidance i.e. 10% to 11%. This should be in the range of 14% to 15% without the acquisition, and with the acquisition, it will be ranging additional 2.5% - 3% over and on the top of it. This is on a consolidated SHIL basis.

Mayur Gathani: Okay. Sure, sir. Thank you and all the best. I have just one reason, I mean, previously, is it this transaction did not happen in the past, during the demerger because of stamp duty that you wanted to avoid and not unnecessarily pay. So it's just because now you're giving the land on lease and paying ₹16 crore, is that kind of taken care of?

Sandeep Sikka: Stamp duty is one part of the decision making. But there are other rationalities which are taken into consideration. When we did a the last demerger, that was based on the market conditions prevailing at that particular time i.e. our overall operations, overall holding structure, our enablement to do that demerger at that particular time. Overall economic scenario and the business scenario keeps evolving. And that's why we are saying that you can always consider this as a step forward towards what we did four years ago.

Mayur Gathani: So, I mean, is it just that you are now more confident on the business strategies, and hence the backward integration is a better step right now?

Sandeep Sikka: We were confident even at that particular time. It's basically that how fast and how agile you are. It's not like, if you see most of our transcripts, we never said that we will not do assets. No company can 100% run without any plants over a period of time, you may read through the transcripts, we said that, even for the consumer products, after a particular scale is achieved, it is important to have in-house manufacturing plants.

Mayur Gathani: I completely agree. You said that, I agree. But I was not sure why this now and why not then.

Sandeep Sikka: History is history, let's move forward now.

Operator: The next question is from the line Aditi Kasbekar from Kedaara Capital. Please go ahead.

Aditi Kasbekar: Thank you for the opportunity. The question that I have is what is the written down value of the assets that you've bought in the books of HSIL because I think the depreciation out there is somewhere around ₹26 crore - ₹27 crore. So, just trying to sort of reconcile how that works. That's part one of the question and the second one is what is the average age of the plant and machinery that you bought?

Sandeep Sikka: The overall depreciation in HSIL relating to these assets, which we are acquiring should be in the range of approx ₹24 crore to ₹26 crore and since, we are keeping some part of buildings, they are only as a part of the deed on which we will give the lease rental. Effective depreciation movement will be around ₹18 crore - ₹19 crore to the site, but this is again subject to allocation of final values because there has been some revaluation in the lands that we bought at current market value whereas in the books of HSIL they were at the book values and one of that land, Bibinagar, is very old.

On your second question relating to what is the age of the plant, like our faucet plant was commissioned it in 2014 plus and we did a Capex around a year and a half back. The Pipes plant was commissioned in 2018 and is currently undergoing expansion. Sanitaryware plants are slightly older and rich in life, but we keep investing in refurbishing these plants. The average life of the assets of the sanitaryware plant should be around 8 to 10 years.

Aditi Kasbekar: Okay. Understood. So then the rent that you're talking about a ₹15 crore, so the amount that you're saying – so basically the rent of ₹16, ₹17 crore and then there will be depreciation of ₹16 crore, ₹17 crore. Is that what you're suggesting?

Sandeep Sikka: The rent will be in range of ₹15 crore to ₹16 crore and depreciation which gets charged to Brilloca should be in range of ₹17 crore to ₹19 crore.

Aditi Kasbekar: Okay. Understood. So, it is ₹19 plus ₹16 effectively?

Sandeep Sikka: Yeah, that is the rent.

Aditi Kasbekar: Correct, correct.

Sandeep Sikka: And these rentals will get amortized into interest and depreciation as per the accounting standard, not entirely into the depreciation.

Aditi Kasbekar: Yeah, fair enough. That is Ind AS 116. Understood. Okay. Okay. Thank you.

Operator: The next question is from the line of Dixit Doshi from Whitestone Financial. Please go ahead.

Dixit Doshi: Yeah, thanks for the opportunity. Most of my questions have been answered just one thought. Before the demerger we were thinking that the business of building product was kept in Brilloca and in the future, we might look at some partner, strategic partner or investor in Brilloca. So, is this the precursor of this? Because, let's say we are considering something like that and therefore, we are now acquiring this manufacturing also in that company.

Sandeep Sikka: The question is good, but the answer is very difficult today. As I told you, Hindware brand is a very strong brand. Many international players would like to come to India and participate in such a growth story. But nothing as such today, to be very frank, and I can comment only on the things what board has approved as such. That's the crisp answer I can give on this.

Operator: The next question is from the line of Karan from Asian Market Securities. Please go ahead.

Karan: Sir, just wanted to understand the growth rate for individual segments of sanitaryware, faucets and plastic piping.

Sandeep Sikka: We have already given guidance historically and this guidance is, which were given at that particular market conditions we feel that still holds good that in next three years. We've given guidance a year back for four years. Now a year and almost nine months have gone past that we should be going beyond ₹1000 crore for pipes and we should be able to outperform the market. We also feel the sanitaryware and faucets market should ideally grow based on the current market conditions because the real estate is doing well, ranging between 10% to 12%, and thus we should be able to maintain our growth paths between 15% to 18% going forward, as such.

Operator: The next question is from the line of Puneet Khanna from BOB Investment. Please go ahead.

Punnet Khanna: Yeah, good afternoon, sir. So, my first question is that at the time of the demerger, the idea was to retain the manufacturing with Hindware and the distribution and sales side served with Somany under the umbrella of Somany. So, now, what is the reason for that change to transfer all the manufacturing? And the second question is that what are the market synergies we are expecting from this transition? What is the impact on the market shares?

Sandeep Sikka: Even during the last demerger, Hindware was not a part of HSIL. As a part of the demerger, the brand Hindware moved from HSIL to SHIL and Brilloca. HSIL residual was only a pure manufacturing entity. And the decision to retain manufacturing in HSIL was taken on how the markets were looking and how the markets were responding to the overall requirements at that particular time. Given the current COVID situation, the company felt that it should have a very strong in house integrated chain. We decided on the move as there were some turbulences when COVID started and everybody in India started undergoing some heat as the supplies were not available from the vendors, etc.

Given the fact that these two separate distinct companies are being run by two separate boards, any disruption on the sourcing part can hinder the growth plans of Brilloca This whole thought has been evaluated over the last few months, based on which the respective boards took a call. And this is most energetic now with this, Brilloca is a focused building product company. And HSIL on other side, as we understand from them, will be more focused on the packaging products side.

Puneet Khanna: Sorry, sir, one more question. Are we expecting any IPO in Brilloca or any foreign investor to take the share of Brilloca?

Sandeep Sikka: I've already answered this question a few minutes back, taking the last question. You may refer to the transcript here, please.

Operator: Thank you very much. Ladies and gentlemen, that was the last question for today. I would now like to hand the conference back to the management for closing comments.

Sandeep Sikka: I thank you, everybody. I think all the questions, were very interesting and I am happy to have answered all of them. We have an approach to the market wherein we are always very happy to answer the questions. Each one of you attending the call will be appreciative of the fact that that when we spoke 3-4 year ago in terms of development of new businesses, realigning of the businesses; we are on a path to do that. And you will see the success of our organization going forward as we playing on the key leverages, which we have generated internally. I would like to thank each one of you, who have participated in our growth. You have invested along with us. Thank you.

Operator: Thank you very much. Ladies and gentlemen, with that we conclude today's conference. Thank you all for joining us. You may please disconnect your lines now. Thank you.

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.