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Hindustan Sanitaryware & Industries Limited | Annual Report 2007-08

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Forward-looking statement

In this Annual Report we have disclosed forward-looking information to enable investors to comprehend our prospects and take informed investment decisions. This report and other statements - written and oral - that we periodically make contain forward-looking statements that set out anticipated results based on the management's plans and assumptions. We have tried wherever possible

to identify such statements by using words such as 'anticipate', 'estimate', 'expects', 'projects', 'intends', 'plans', 'believes', and words of similar substance in connection with any discussion of future performance.

We cannot guarantee that these forward-looking statements will be realised, although we believe we have been prudent in our assumptions. The achievement of results is subject to risks, uncertainties and even

inaccurate assumptions. Should known or unknown risks or uncertainties materialise, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Readers should bear this in mind.

We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

Customers are lost at the point of sale than most would care to concede. More customers are lost *after* the sale than most would care to recognise.

At Hindustan Sanitaryware, we have enjoyed one of the largest shares of India's sanitaryware and container glass segments for decades.

Through a singular commitment.

Service!



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Hindware stands for service

Right product



Right time



Right place



Right price



Right support

Right attitude



Pedigree

The Company was incorporated as Hindustan Twyford Ltd. in 1960 by the Somany family (promoter group) in collaboration with Twyford Ltd., UK, to introduce vitreous china ceramic sanitaryware in India. The Company changed its name to Hindustan Sanitaryware & Industries Ltd. in 1969 and has since been popularly known as 'HSIL'.

Product portfolio

- ◆ The Company is the most respected sanitaryware manufacturer in India today
- ◆ It diversified into the manufacture of glass containers through the acquisition of Associated Glass Industries Limited in 1981
- ◆ It widened its product basket with a range of bathroom and kitchen appliances products, leveraging the power of the *Hindware* brand
- ◆ It expanded in the retail business of Speciality Home Interior Solutions in 2007 through a wholly owned subsidiary, called Hindware Home Retail Pvt. Ltd. (HHRL). Its first store commenced operations in May 2008 under the 'EVOK' brand

Prestige

- ◆ The Company's *Hindware* brand has been recognised as a Superbrand for the last four years in a row

- ◆ It holds a significant market share in all the business verticals of its presence
- ◆ Its institutional customers in the Building Products Division comprises reputed builders like DLF, Unitech L&T, Raheja's and Puravankara
- ◆ Its institutional customers in the Container Glass Division (AGI) comprises brand-enhancing names like Coca Cola, Pepsi, GlaxoSmithkline, Pfizer, AstraZenca, Ranbaxy, Dr Reddy's Laboratories, Hindustan Unilever, Priya, Global Green, Continental Coffee, Reckitt Benckiser, Seagram, Sab Miller, McDowell, Shaw Wallace and United Breweries to name a few
- ◆ It possesses the largest distribution network in India's building products industry, supported by 1086, 4109, and 6000 dealers, sub-dealers and retail outlets respectively

Public holding

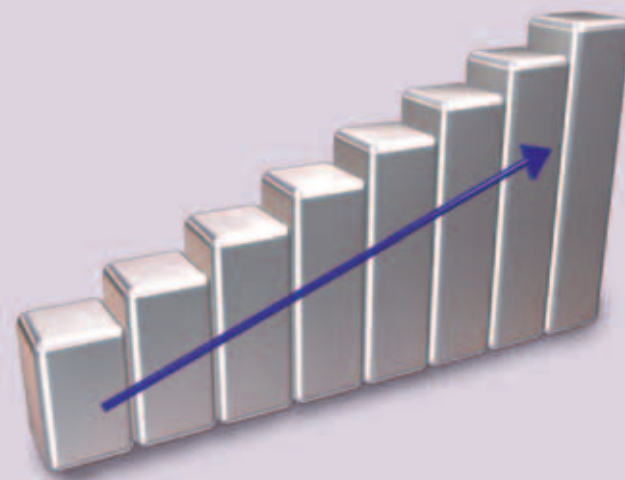
- ◆ The Company's shares are listed on the Bombay Stock Exchange and the National Stock Exchange
- ◆ Its non-promoter shareholding is 44.37% denoting 24,416,963 equity shares

Presence

- ◆ The Company is headquartered in New Delhi, supported by four regional offices and four area offices
- ◆ It derived nearly 89.87% of revenues from within India and 10.13% from exports to 54 countries in 2007-08

Business segment	Location	Annual capacity
Building Products Division	Bahadurgarh (Haryana)	14,000 MT
Building Products Division	Somanyapuram, (Andhra Pradesh)	18,000 MT
Container Glass Division (AGI)	Sanathnagar (Hyderabad)	953.10 million pieces

This is what we achieved in 2007-08



Absolutes

- ◆ 9.58% increase in revenue from Rs. 5,329.74 million in 2006-07 to Rs. 5,840.38 million in 2007-08; a CAGR of 13.67% over the last five years
- ◆ 4.77% increase in EBIDTA from Rs. 846.92 million in 2006-07 to Rs. 887.33 million in 2007-08; a CAGR of 11.57% over the last five years
- ◆ 1.91% increase in cash profit from Rs. 539.37 million in 2006-07 to Rs. 549.65 million in 2007-08; a CAGR of 7.33% over the last five years

Manufacturing

- ◆ Highest capacity utilisation of 107.10% at the Bahadurgarh plant
- ◆ Capacity utilisation of 89.28% at the Somanyapuram plant
- ◆ Sanitaryware plants witnessed a 8.55% increase in capacity utilisation to 97.08%
- ◆ AGI witnessed a 8.87% increase in plant capacity utilisation to 89.65%
- ◆ 3.42% reduction in power consumption at Bahadurgarh
- ◆ 6.21% reduction in power consumption at Somanyapuram
- ◆ 13.42% increase in people productivity at Bahadurgarh
- ◆ 10.39% increase in people productivity at Somanyapuram

Marketing

- ◆ 13.10% increase in revenue from the Building Products Division to Rs. 3,044.33 million
- ◆ 5.19% increase in revenue of the Container Glass Division to Rs. 2,752.39 million
- ◆ Introduced 28 new designs in the manufactured sanitaryware products and added 138 new models in the outsourced product range

Recognition

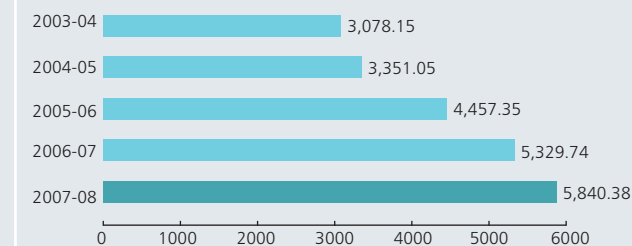
The *Hindware* brand was recognised through the following in 2007-08:

- ◆ Superbrand Consumer Validated
- ◆ Business Superbrand Award
- ◆ Reader's Digest Trusted Brands Gold Award
- ◆ 4P's India's 100 most Valuable Brands
- ◆ 4P's Most Admired Companies Award
- ◆ Mera Brand Award

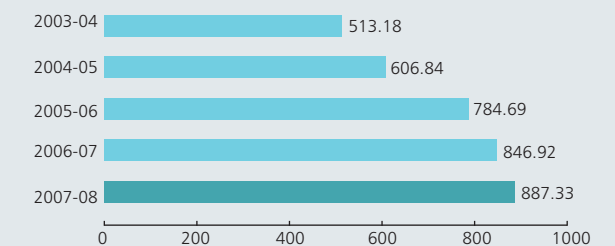
Board room

The Company approved the setting up of a 475 TPD container glass manufacturing facility at Bhongir, 60 kms from Hyderabad.

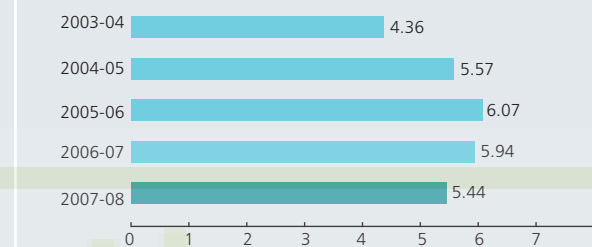
Growing revenue from operations (Rs. million)



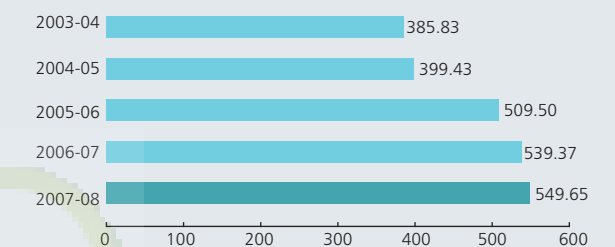
Strengthening EBIDTA (Rs. million)



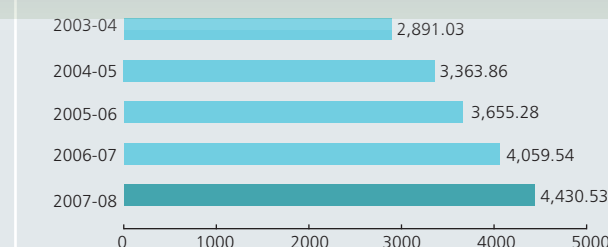
Robust interest cover



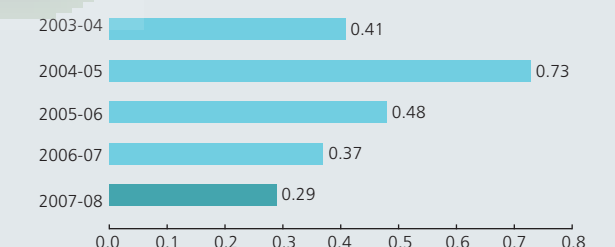
Rising cash profit (Rs. million)



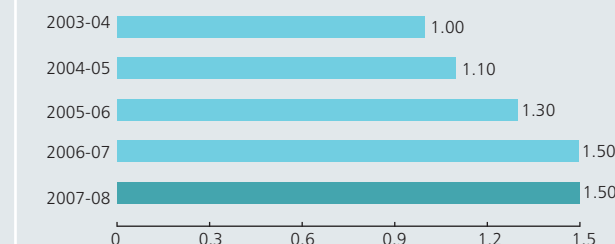
Increasing gross block (Rs. million)



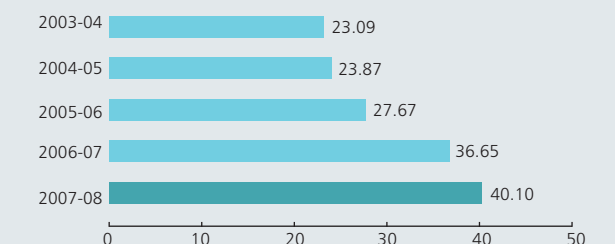
Strong long term debt-equity ratio



Attractive dividend per share on the face value of Rs. 2 (Rs.)



Rising book value per share (Rs.)



We strengthened our customer support function through the creation of an exclusive service team by extending beyond the quality of the product to the quality of customer experience.



Superior service through a differentiated mindset

Sell the product. Forget the customer.
Unfortunate general reality.

At Hindustan Sanitaryware, we have countered this reality through a simple conviction. That the transaction truly begins while the customer is still undecided on which brand to select from the vast choice available at the point of purchase and across the broad life cycle of the product thereafter. The result is an end-to-end management of the customer experience.

This distinctive mindset has helped us not just create customers, but retain their loyalty for life – across repurchase and referrals.

During 2007-08, we strengthened our customer support function through the creation of an exclusive service team by extending beyond the quality of the product to the quality of customer experience.

We created a management tier – seven functional teams in the service department with a customer-centric focus i.e. customer relations, parts operations, service operations, strategy and MIS, training and development – to institutionalise service delivery.

We established helpline facilities across key locations in India.

We created a team of 52 technical professionals to address product problems with speed and service quality.

Going ahead, we will offer various value-added services comprising annual maintenance contracts, installation services, home solutions and bathroom renovations, among others.

This service delivery will be measured by the customer and dealer satisfaction (Voice of Customer).

An ongoing interaction with customers will generate feedback on product and service quality.

The complement of these will graduate customer satisfaction to customer delight.

We created the EWC ('Matrix extra high') and wash basin ('Matrix small') for convenient use by the physically challenged



Service through a diversely wide range

Same kind of sanitaryware products. Same features. Same colours. That's one of the reasons why their purchase would inevitably be delegated to someone else. No longer.

Pioneering products introduced

- ◆ The Company introduced European Water Closet (EWC) called 'Matrix extra high' and wash basin called 'Matrix small' for convenience of less abled people
- ◆ It introduced the 'Aqua Free' waterless urinal that does not require water flushing
- ◆ It introduced the 'Senso Urinal' and 'Sensomatic Urinal' with built-in sensors for pre-and post-use auto flushing
- ◆ It introduced the EWC called 'Automate' a remote control-operated system with features like adjustable seat temperature for comfort during cold weather; cleaning, drying and dual flushing options to conserve water; night lighting, slow falling seat cover and automatic deodorizing among several others

- ◆ It introduced over the counter/under the counter and pedestal wash basins to complement the design, aesthetics and utility of contemporary washrooms
- ◆ It introduced accessories like mini angle valves, health faucets and vario bends to support Hindware products
- ◆ It made innovations in seat covers comprising slow falling detachable seat covers and seat covers with inbuilt wash jets
- ◆ It launched shower panels, Multi Functions, Massage Tubs, shower enclosures, concealed cisterns and new range of faucets

Over the years, the Company developed the following value-added products:

- ◆ Various small wash basins for enhanced economy of space
- ◆ Wall mounted EWCs for easy floor cleaning
- ◆ Wash basins with built-in counters for optimum space use
- ◆ Wash basin and water closet in attractive colours and animated designs for convenient use by children

We entered the speciality home interior solutions segment through brand 'EVOK' of our subsidiary Hindware Home Retail Pvt. Ltd. EVOK Home Fashion Mega Stores provide contemporary lifestyle concepts across the living, kitchen and bath domains



Superior service through convenience

Different products. Different places. Different experiences. That's the way products have been usually marketed.

At Hindustan Sanitaryware, we have countered this reality through a simple belief. That more people want to buy all their products and services from a single location.

During 2007-08, this progressive realisation helped us to strengthen our services portfolio by transforming from a Company manufacturing products to a brand providing solutions and enriching the consumer experience.

Initiatives

- ◆ We entered into the speciality home interior solutions segment through brand 'EVOK' of our subsidiary Hindware Home Retail Pvt. Ltd. Our 'EVOK' Home Fashion Mega Store provides contemporary lifestyle concepts in living, kitchen and bath domains
- ◆ We developed a global sourcing base of best-in-class suppliers across all product categories
- ◆ We provided personalised interior design and visualisation services through 'Home Viz' design studios integrated with our retail formats. We extended our services portfolio through EVOK Easy Finance consumer credit schemes, warranty and installation services

We launched our first 25,000 sq.ft 'EVOK' – Home Fashion Mega Store in May 2008 at Crown Interiorz Mall, Mathura Road (Faridabad), near New Delhi. Going ahead, we plan to open another three mega stores in the NCR in 2008-09 followed by 50 such pan-India stores with a retail footprint of 1.5 mn sq.ft within the next four-five years. Our objective is to emerge as the first choice partner for customers, aspiring for a value-rich single-window Home Interior Solutions.

We rationalised the consumption of water per flush in our products from 15 litres in 1962 to 10 litres in 1984 to 6 litres in 2004 (a potential saving of 35,000 litres annually by a four-member family)



Superior service through environmental friendliness

Customer-friendly alright. But earth-friendly? Most people are not even aware that this concept exists.

At Hindustan Sanitaryware, we have for long extended our service mindset from the direct customer to the indirect customer. From the person who pays for the product to the world that finally foots the bill.

This far-reaching maturity reconciled economic realities with a respect for deeply ecological considerations.

Over the years, we have been painfully aware of the reality that potable water is also used in flushing water closets and that bathroom applications account for a third of the water consumed in Indian households.

We responded to this reality through following initiatives:

- ◆ We were instrumental in helping the Bureau of Indian Standards (BIS) for reduction in water consumption per flushing over the years;
- ◆ We commissioned an R&D centre (recognised by the, Department of Science & Technology, Ministry of Science, Govt. of India for more than 30 years), the first such instance in our industry;
- ◆ We rationalised the consumption of water per flush in our products from 15 litres in 1962 to 10 litres in 1984 and 6/3 litres in 2004 (a potential saving of 35,000 litres per annum across a family of four),
- ◆ We launched European Water Closet (EWC) which consumes only 3.5 litres of water per flush



“We expect to capitalise on rising disposable incomes and change in the consumption pattern towards ‘lifestyle’ products.”

Mr. R.K. Somany, Chairman and Managing Director, outlines the basis of his optimism across the foreseeable future.

Dear fellow Shareowners,

I must start on a point of humility: 2007-08 was not a superlative year for us. We grew our revenues by 9.58% and EBIDTA by 4.77% over the previous year.

And yet, I am optimistic and a happy man.

The short term aberration notwithstanding, I am convinced that the future is bright for the following reasons:

There is a critical need for our business presence. One in every 10 diseases and 6% of all deaths globally are caused by unsafe water and improper hygiene. In India, 10.30 million people die annually and, of this, nearly 7.5% – 0.78 million deaths – is related to water, sanitation and hygiene. The report 'Safer water for better health' – the first WHO report depicting country-by-country estimates of the burden of disease due to water, sanitation and hygiene – indicates that 9.1% of the global burden of disease could be prevented simply by promoting cleanliness and sanitation. The figure is even higher in the 32 worst-hit countries including India, where 15% of the disease burden could be prevented by improving water, sanitation and hygiene. The WHO report says investing in drinking water

and sanitation will allow healthcare agencies to save US\$7 billion and individuals US\$340 million a year on healthcare costs. Interestingly, this is the implication:

- ◆ Those aged 15-59 could gain 320 million productive working days
- ◆ This would mean an extra 272 million school attendance days a year
- ◆ That would add 1.50 billion healthy days for children under five years of age
- ◆ This would translate into productivity gains of US\$9.90 billion a year
- ◆ The value of deaths averted, based on future earnings, would amount to US\$3.60 billion a year
- ◆ This would mean a total payback of US\$84 billion a year from the US\$11.73 billion annual investment needed to meet the drinking water and sanitation target of Millennium Development Goal-7

Challenges

India is passing through one of its highest inflation rates in years, marked by rising land, fuel, cement, steel and people costs. This has vast implications for companies like ours, with high energy intensity in both of our businesses – Sanitaryware and Container Glass manufacture. We need to counter this reality through enhanced operational efficiencies and proactive price negotiations with

customers. By doing so, we expect to rationalize the impact of rising costs, although we are fully aware that we may not be able to reduce the absolute outgo.

In the Container Glass Division, the availability of other substitutes for packaging represents an area of great concern. However, studies have shown that harmful chemicals present in plastic containers can have a damaging impact on food contents, may lead to health problems and are environment unfriendly. With this awareness gradually rising, we expect the trend to soon reverse in favour of glass packaging.

Increasing competition from foreign brands in the Building Products Division is another challenge. However, our extensive pan-India presence comprising the largest dealer network in the industry, top-of-the-mind recall of the Hindware brand and the largest collection of designs are expected to serve as an effective hedge. HSIL possesses a dealer and sub-dealer network nearly 25% larger than its nearest competitor. The Hindware brand has been recognised as a Superbrand for the last four years. The Company has been consistently adding new design to its product mix. The result: the total number of designs in our product portfolio far exceeds the other imported brands. In 2007-08, we reinforced our service by creating a

dedicated wing to address the needs of customers and in doing so expect to emerge as the only sanitaryware brand in India offering an end-to-end solution.

Our social responsibility

Our service mindset is rooted from our manufacturing operations. We are committed to a hygienic and safe working environment for employees. Our plant sites are ISO 9002:14001:18001 certified, showcasing our commitment in meeting the highest operational health and safety standards. All our sites are equipped with effluent treatment plants making zero discharge. The treated water is used in green belt development enhancing the aesthetics of our factory environment.

Outlook

At HSIL, we expect that the interplay of market bullishness and business strengths will translate into superior returns. While competitors attempt to merely satisfy customers, we will delight them through superior service.

In doing so, we expect the market share for AGI to grow from 15% to 26% and our market share in the Building Products Division to grow substantially as well by 2010.

Rajendra K Somany
Chairman and Managing Director

- ◆ There is a shortage of about 24.71 million housing units in India today
- ◆ The share of construction as a proportion of the GDP has grown from 5.2% in 2003 to over 7% in 2007-08.
- ◆ The hotel industry has a shortage of 150,000 rooms; demand is expected to exceed supply by at least 100% over the next two years; rising room rates have created a demand for budget hotels
- ◆ About 80% of the demand for office spaces in India is driven by the IT/ ITes sector. This sector is expected to grow at a CAGR of 20-25% (NASSCOM estimate)



“We have been outperforming the industry CAGR for the last five years. We have now laid the foundation to accelerate this momentum.”

Mr. Sandip Somany, Joint Managing Director, reviews the performance of the Company in 2007-08 and outlines the Company's growth strategy.

Q: How would you assess the performance of the Company in 2007-08?

We did moderately well during the year under review. Our revenues increased by 9.58% during the year and EBITDA rose by 4.77%. The Building Products Division accounted for 52.13% and the Container Glass Division contributed 47.13% during the year.

However, the reality is that our performance was below our projections for two reasons. One, we embarked on a structural change in our interaction with channel partners (dealers) that improved the quality of our revenues but moderated volumes marginally and temporarily; two, our business was affected by rising energy prices.

Q: Can you elaborate?

We integrated our sales and distribution functions with SAP during the year. This gave us a precise understanding of the amount of credit

within the distribution pipeline. It also gave us an insight into how dealers would over-order material from us against an extended credit period, giving us a misplaced confidence of sales within the system. Besides, in some cases, after ordering, the dealers would be compelled to liquidate their stocks at a discount or press on returning back to us. From a brand perspective, this was damaging and needed to be corrected.

We responded with an increase in the proportion of Cash/PDC (post-dated cheque) transactions in the total sales mix from 45% in 2005-06 to 82% in 2007-08. This translated into a decline in receivables by 7% in terms of the days of turnover equivalent. In other words, we achieved a significant improvement in the quality of our revenues and also reallocated organisational time from chasing debtors to directly growing our business.

Q: What about the increase in fuel costs?

Nearly 24% of the total cost of

production in our Container Glass Division comprised power and fuel. The average cost of fuel, comprising principally LPG and heavy oil, increased by 17% over the previous year. We looked inward to mitigate the impact of this unprecedented increase. Enhanced efficiencies helped maintain the energy cost as a percentage of net revenue at 21.07% in 2007-08 compared with 19.31% in 2006-07.

Q: What were some of the other highlights and challenges for the year?

During the year under review, we invested Rs. 103.98 million in an aggressive sales promotion and advertisement of building products in the print and audio-visual media. This depressed our profits proportionately although the benefits of this will transpire over the next few years. We were also affected by the rupee appreciation in our export realisations.