Company Analysis

* Brief Description about the firm

Real Estate Solution Company

* What service or product does the firm make?

Roofing – asbestos (800k tons) and non-asbestos (15k tons)\*, Building Solutions – bricks and bonds/panels, Polymers – pipes and putty and Flooring Segment. \*(Q3FY22)

* What is the location of the assets?

Pan India. Except the flooring segment which is in Germany and Austria.

* How does it make or provide the service?

They have their own production lines. Roofing has 8 lines. Blocks – in house (4+1(acquired) factory, 100% and 60% capacity utilization) and outsourced. Boards and panels – in house (3 factories). Putty – Outsourced. Pipes – 3 factories. Capacity utilization in H1FY232 of North India is 85%, West India is 50% and South India is 100%. Flooring – Germany and Austria (60% capacity utilization as of H1FY23).

* Whom does it sell its product/service to?

Caters to construction business. Roofing retail outlets – 24000 (Dec 22). ACC blocks – construction agency. Flooring segment caters to the European markets – Commercial projects – consulting companies, influences, interior designers. Residential projects – DIY- normal consumers.

* If it is manufacturing products –

1. What raw materials are required?

Roofing – Asbestos (8kg), Cement(43kg), Fly ash(28kg), wood(1kg), Water(20kg). Asbestos accounts for 50% of the cost. Blocks – cement and fly ash. Boards – fly ash and wooden panels. Pipes – plastic. Flooring – HDF and MDF boards.

1. Where are the raw materials sourced from?

Fiber – Russia, Brazil. Fly ash – locally.

* What is its business strategy (purchase strategy, production strategy, product strategy, marketing strategy, financing strategy)?
* They started with roofing and have now ventured in all the aspects of building – pipes, putty, panels and flooring. They are fully leveraging the supply chain. They have also ventured in outsourcing of building chemicals. 30 cr only.
* Branding – Charminar is a hit in the roofing solution. They have about 24000 outlets. 23% market share in roofing of asbestos. Grew by double digit % by volume in roofing in FY22. In Q1FY23, their volume was 350000 tons of roofing volume.
* Effective resource allocation – no investment in roofing because there is an over capacity by 35% and the market grows by single digit YoY.
* The roofing setup can make both asbestos and non-asbestos roofing solutions. This is to mitigate the regulatory risk if the government wants to ban the asbestos sheets.
* R&D centers in Hyderabad to come up with better mixes in roofing solutions. 0.17% of Revenue.
* Commands better selling prices (3-5%) due to better penetration, product and retailer and distributor relationship.
* The blocks require less sand, water, steel. They are better insulator of sound and thermal. Their ACC blocks constitutes 15% of the brick market. 4 manufacturing facilities. Bought 1 more. They outsource their manufacturing of the blocks because of 100% capacity utilization.
* Boards and panels – 3 manufacturing capacities. Expanding. Roofing plant can also make boards.
* Polymer – Ranked 3 or 4 in the putty business. Putty grew by 38% in FY22. Pipes grew by 51%.
* Looking for an expansion in NE.
* Enter in long term agreements with key raw material suppliers.
* Successfully de-leveraged their company from 1 D/E to .25 D/E.
* Company wants to develop a one stop solution for all the construction needs.
* They have decentralized plant because the sheets/blocks break during transportation. Therefore, they have 24 manufacturing facilities across India.
* Set up a company in UK because there is no big manufacturer of flooring there. After Brexit, they will have an upper hand.
* Parador is number 1 brand in Germany, number 2 in Spain for flooring.
* Profit drivers of the company –

1. Industry choice – Choice of industries in which the firm operates in?

Rural – Construction, Farm (pipes). Real Estate – residential and non-residential. Industrial Roofing.

Roofing – 80% rural and 20% from industrial, warehouses and slums.

1. Competitive positioning – Manner in which the firm competes with other firms in the industry?

Price, touch points.

1. Cost efficiency – Ability to carry out ops with low costs

* IoT and 6 sigma implementations in all divisions. The company modifies the processes to produce different products with the same assets. Example it produces non-asbestos sheets and wooden boards for panels in the same machine that it produces the asbestos sheets. The capacity utilization of the roof making machines are 100% in the 2 quarters and 50% in the other 2 quarters. So, the company will make the wooden boards in the same line during the off season.
* Started getting 50% advances from construction agency in FY22. Ease on WC.
* Digital connect – Help it maintain the number 1 brand in roofing.
* The tech behind manufacturing non-asbestos sheets is the company’s own and has been patented.

1. Corporate strategy – Way in which firms creates synergies across its range of businesses. Benefits and risks of each business segment and relation across the businesses

* HIL has made the entire ecosystem of building materials. It is leveraging their existing customers, retailers to cross sell other building materials.
* The company has a brand. It has outsourced the manufacturing of chemicals and is just selling under its brand name. Later, it may invest in manufacturing these chemicals.
* Its 6 Sigma team is very adept to cut costs in between department. It relocated the team to Germany and to a new acquired ACC brick making company to cut costs.
* How is the company’s growth of – Revenues, Profit, Total assets, Cash from operations and what is the source of this growth?
* Indian business is growing splendidly between FY22 and 23. They have at least 25% growth in all verticals (except roofing where it managed a growth of 6% vs market grew by 3%). The revenue is increasing more than the capital employed because of different modifications.
* The market share of roofing increased from 19.5% in FY21 to 22% in FY22 to 25% in Q1FY23.
* They are currently laying the strategy to grow the international business. They are expanding in other countries and are in aggressive mode. When the economy is better, they will bounce back.
* Link Business Strategy to Financial Statements –

1. Associate each business segments with its revenues and expenses (operating activities)
2. Associate each business segments with its assets (investing activities)

* Growth drivers and risks of the company –

1. Growth opportunities (SWOT) – existing vs new customer/product/market, organic vs inorganic

* Chemical Business – H1 revenue is 7 cr. By March 23 it will be 30 cr. Immense growth. In 2-3 years, revenue is 30 cr. 100 channel partners, 25 products, 170 SKUs by H1 FY 23.
* Polymer – 1400 cr from 500 cr in March 22 (1000 pipes and 400 putty) in 3 years. The company was doing 55 cr 3-4 years back. They grow their retailers by 200 to 300 every year. H1FY23, 3500 to 4000 retailers. Added 200 new pipe SKUs in FY22. Adding new pipe SKUs in the Hyderabad plant in order to grow in SI. Market share of pipe is 2% and putty is 5% (Q3FY22).
* Building Solutions – H1FY23 is 240 cr. 400 cr (FY22) -> 800 cr in 3-4 years. Double digit growth in profitability.
* Parador – FY22 revenue – 190 mil Euro up from 140, 2 years back. Plant capacity is 250 mil euros. Expand it to UK, Switzerland, Spain, France, China, Nordics and US. China can give rev up to 40 mil. Systematic expansion. First hit the revenues and then expand the capacity to hit the revenue in between 350 to 400 mil. They will not do any more M&A.
* Indian geography – Growth in NE. They have done a capex of 82 cr. Revamped the board making facility and roofing solution factory. Did M&A of ACC brick-making company. Also, the company is making efforts to increase penetration in Tier 2 to Tier 4 cities.
* Roofing – grow from 950 cr to 1400 cr by selling different solutions to grow. Will not add a lot of capex. Non asbestos sheets will also penetrate the steel roofing industrial market.
* Color non-asbestos roofing – Q3FY22 –12000 tons. Traction is good. Will triple it in 3 years.
* Parador – Expanding it to other less economic hit countries such as Spain and the Nordics.

1. Systematic risks

Geopolitical risks in Europe, inflation, polymer, Indian economic risks, Chinese JV - only 100 k Euro investment.

1. Downside risks – Essentials vs Luxuries, Obsolescence

The roofing product is made up of asbestos which is dangerous. Can get banned. Less chances because there is no other cheap roofing product available.

1. Cost control and flexibility – Reliance on external providers, Labor supply factors, Operating Leverage

Their roofing line can make panels and boards for the building solutions and non-asbestos sheets if the asbestos sheets get banned.

1. Access to cash – Ability to take advantage of opportunities, Cushion to tide over downturns

There is enough cushion. Bettered their D/E ratios. Interest Coverage ratio – from 14 to 50 in FY22. Current ratio – 1.28 to 1.36 in FY22.

* Notes on Corporate Governance

A very strong board – Very diverse and well qualified.

Good track record of growing the business.

The management warns the investors through the con-calls if the company will face tough times in the future. Example , after Q1FY22, the management said that they would face problems in Parador.

Industry Analysis

* Understand the industry –

1. Who are the main players?

Roofing – 4 – 6 main players.

1. What are the characteristics of the industry?
2. Concentrated / Fragmented / Dominated by few players

Roofing – Oligopoly. Pipes – Oligopoly.

1. How important is the independent sector?
2. High / Low competition

India – High competition.

1. Competitive factors

India – Price, distribution networks, quality especially breakages, brand.

International –

Commercial projects such as malls, hotels etc. done by consulting companies, influences, interior designers – Design is most important and then price and quality.

Residential Projects – normal consumers – Price, design and technology.

1. Selling channels

Company -> Dealers -> Sub dealers -> Retailers -> Consumers

Company -> Consumers

* Examine the link between the industry and the macroeconomy

1. Relation with economic factors – Average disposable income, Employment rate, Economic growth, Income Distribution

The business is highly dependent on the economy and rains (domestic). If the general parameters of health of the economy is not great the consumers will not invest in the building.

More rain -> Better agricultural yield -> Higher disposable income -> More housing investment.

1. Relation with demographic factors – Population growth, Age of household head, Household size, Household composition, Number of wage earners

Very important for the company. More houses = more buildings = more requirement of building materials.

1. Effect of regulations

The industry has a risk. The govt. can ban asbestos roofing sheet. It is unlikely but it is possible as asbestos in air is dangerous to health.

* Analyze industry profitability

1. Revenue drivers

Roofing – Monsoon. Required for covering their homes. Plus, good spending power as the crop yield increases. Strong rural economy. Construction projects. Non-residential projects such as parking lots, offices etc. Government support.

Flooring – Accounts 10% of all the household expense.

1. Cost structure and operating leverage

The company is trying to reduce the fixed cost by modifying machines to make different products.

It also has a central cost cutting team that it deploys at various locations.

1. Porter’s five forces analysis of industry profitability – Internal rivalry, Substitutes, Entry barriers, Supplier power, Buyer power

Substitutes –

India – Low – Some products such as pipes have high substitutes but other segments such as roofing, putty, bricks, panels does not have high substitution because of branding, superior quality and extensive distribution network. Roofing can also be substituted by metal sheets.

International – Low – In the markets that Parador is established, it is hard for other company to compete. It identifies geography in which it can be a market leader.

Entry Barriers –

India and International – High – It is hard to make a brand, the vast distribution network of HIL and achieve operation efficiency. Some products require the company to engage with architects, interior designers on regular basis.

1. Analysis of competition

Roofing – Leaders – price, quality, distribution. The other incumbents cut prices. Whereas HIL increases the prices of roofing segment. Customer stickiness is high. Example in Q1FY23.

Parador – 20% of the competitors have backward integration to MDF/HDF. 80% of them are relying on the plants to supply.

1. Analysis of bargaining power relative to customers and relative to suppliers

Suppliers –

Parador – High – HDF and MDF manufacturers will not budge in reducing cost. They rather shut the manufacturing facilities to decrease supply & increase cost. The costs increased by 100% in FY23.

India – Except fiber, which was in acute shortage in FY23, I don’t think that there is any problem in negotiating price as the commodities such as cement and fly ash are market driven.

Buyers –

India and International – Low – HIL commands the market in quality. In India, Charminar is sold with a 5% premium. The competitors cannot capture the market easily despite cutting selling prices.

* Examine the actual performance of the industry

1. Compare actual performance with above analysis – Validate and understand reasons behind the performance

* Forecast future performance of the industry

Roofing – Fiber Cement Boards and Sheets – Market is about to grow by 5% from FY23-FY27 to 963 mil $. It is 90% organized sector.

ACC blocks organized market is about 1000 crores as of Q3FY22. HIL has 19% market share. Structural shift from red bricks to ACC blocks.

Board market is about 600 crores as of Q3FY22.

Fiber Cement market – 4.2 million $?? Or 4.2 billion $ ?

Real Estate market – 1 trillion $ by 2030 up from 170 billion $ in 2017.

Unusual Tailwinds or Headwinds

Not an income boosting transaction but a cost boosting transaction due to headwinds from Jan 2023 to Dec 2023 –

High fiber cost in roofing. Fiber is 50% of the roofing raw material cost. Main supplier was Russia. Now it is importing from Brazil. The costs were up by as much as 20% during the year.

High freight cost – Fiber is imported and the final products from Parador is exported.

High HDF/MDF cost – They are required to manufacture floorings. 80% of the supply was from Ukraine. It took time to figure the supply source. During the year the cost went up by 100% and Parador was not profitable in the first half of the year.

High inventory cost of PVC due to sudden reduction of polymer cost – The pipes division suffered huge losses because of sudden decrease in price of PVC polymer resins.

Poor overall disclosure

Amazing Disclosure. The investors in the call are always very impressed.