



CERA Sanitaryware Limited

Q1 FY21 Earnings Conference Call Transcript

August 06, 2020

Moderator: Ladies and Gentlemen, good day and welcome to the Q1 FY21 earnings conference call of Cera Sanitaryware Limited. 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 “*” and then ‘0’ on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Mayank Vaswani from CDR India. Thank-you and over to you, sir.

Mayank Vaswani: Thank you Janis. Good Morning everyone and thank-you for joining us on the Q1 FY21 earnings conference call for Cera Sanitaryware Limited. We have with us today the management team comprising Mr. Ayush Bagla – Executive Director, and Mr. Rajesh B. Shah – CFO and COO of the Company. We will start with brief opening remarks from the management following which we will open the call for Q&A.

Before we begin, I would like to state that some of the statements made in today’s conference call may be forward-looking in nature and a disclaimer in this regard has been placed in the results documents that have been shared with all of you earlier. I would now hand over the floor to Mr. Ayush Bagla for his opening remarks.

Ayush Bagla: Good Morning everyone and thank you for taking time to join our call. The earnings for the first quarter of the financial year 2020-21 were adopted by the Board of Directors yesterday, 5th August 2020. The earning documents have been released to the stock exchanges.

We commenced Q1 in the midst of the nationwide lockdown from March 25th. In the early days of the lockdown efforts were focused on safety and wellbeing of employees, ensuring business continuity and a seamless transition to the work from home mode for the various departments of the organization. Simultaneously, there was emphasis on securing goods in transit, safety of assets and inventory at our plants and warehouses and assuring that all our business partners, distributors, vendors, service providers were safe and in a stable position.

Upon partial easing of lockdown restrictions, we resumed our operations at our plant at Kadi on 5th May, 2020 which was 35 days into the quarter. In the first few days of resumption, we operated a single shift of 8 hours at the plant despite requisite labor at our sanitaryware and faucetware facilities, post-implementation of

revised SOP's which was spelt out in detail in our earlier communication to the stock exchanges. Due to this the effective utilization in May, 2020 even after restarting of operations was around 30%. In June the authorities permitted ramping up of shifts from one 8 hours shift to one 12 hours shift, along with the slight increase in employees on the shop floor the increase in duration of the shift led to increase in utilization to 60% for the month of June. From the month of July we were permitted to revert to our earlier structure of three shifts of 8 hours each and this has enabled utilization to improve further to 80% for most of our facilities.

The tile manufacturing JV which is called ATL at Andhra Pradesh is to recommence production in August. Even as we are currently at 80% of pre-COVID activity, the shut down and process to ramp up has significantly impacted activity in Q1. Effective working days in the quarter was 91 minus 35 which were 56 days and given the sub-optimal utilization up to early June we had meaningful operations only for 20 to 25 days in the entire quarter.

We believe that the inherent resilience of the business has shone through this quarter. Even as production was impacted to the tune of 70% we have witnessed reduced sales of only 46% which was largely serviced through inventory of finished goods. The silver lining has been the exponential growth that we have witnessed in products like touch free sensor based products, hands free products, water saving products and nano-coated anti-microbial products that offer enhanced safety and hygiene. Cera has launched additional elbow operated and foot operated faucets this quarter along with sensor based faucets. We have introduced plug-n-play type of smart installation of sanitaryware products for consumers who choose adopt 'do it yourself' installation procedures. From volumes of approximately 100 faucets per month of touch free products in the pre-COVID period; to about 6,000 faucets monthly currently.

Requisite external certification for sanitaryware by APMO India for faucetware by WEP and for sanitaryware and faucetware the globally used CE certificates. In that backdrop I will walk you through the financial performance:

For Q1 FY21 the revenue for the quarter stood at Rs. 143 crore versus Rs. 267 crore in Q1 FY20. Though not comparable registering a 46% YoY decline for Q1 FY21, 51% of the topline was from sanitaryware, 29% from faucetware, tiles presented 17% and wellness 3%. On a YoY basis sanitaryware revenues registered a decline of 47%, faucetware revenues declined by 39%, tiles declined by 53% and wellness declined by 58%. EBITDA excluding other income for Q1 FY21 was Rs. 6.64 crore versus Rs. 35.2 crore in Q1 FY20. The EBITDA margin for Q1 FY21 stood at 4.6%, lower by 851 basis points. Profit after tax for Q1 FY21 is Rs. 2.9 crore against YoY number of Rs. 19.1 crore. EPS for Q1 was Rs. 2.24 versus Rs. 14.67 in Q1 FY19-20.

Inventory days in Q1 FY21 were 59.83 days compared to 52.85 days in Q1 FY20. Receivable days in Q1 FY21 were 51.36 days versus 55.45 days. Payable days in Q1 were 31.79 days against 25.56 days in Q1 of FY20. Therefore net working capital days in Q1 FY21 were 79.40 days versus 82.74 days in Q1 of FY20. As India is prepared for lockdown 2.0, the industry expects a gradual rebound for ongoing tussle with COVID-19. Our business fundamentals remain intact and we

are cautiously optimistic about our prospects once the macroeconomic environment stabilizes.

Our confidence is predicated on five pillars:

1. **Manufacturing excellence:** Over the last 7 years manufacturing capabilities at our owned facilities have been significantly upgraded with the introduction of:
 - a. Fully automated pressure casting of sanitaryware products in the industry first,
 - b. Robotic anti-bacterial glazing of sanitaryware,
 - c. Automated grinding, polishing, threading and electroplating of faucetware.

Some of these processes have assumed greater importance in view of COVID-19. Over the years we have judiciously developed the right balance of outsourcing and in-house manufacturing. We believe our facilities are best used for complex products such as wall hung WCs, table-top basins and one piece floor standing WCs. We leverage our facilities for higher value products and have consciously avoided reliance on Chinese imports.

2. **Judicious use of capital:** Over the last few years annual CAPEX has been contained within a band of Rs. 55 crore to Rs. 70 crore despite annual cash flow of between Rs. 125 crore and 145 crore each year. This year our planned CAPEX is Rs. 21.82 crore, the lowest in many years indicating stability of our business model. This has enabled us to solidify our financial position each year, enabling us to incrementally enhance our liquid cash flow which now stands at Rs. 268 crore as on 30th June 2020.
3. **Clean and efficient operations:** We have opted for just-in-time arrangements with vendors and adhered to payment schedules to maximize cash discounts and other regular incentives for on-time payments. Further we have established localized warehouses across locations to rapidly serve the markets and efficiently manage finished goods inventory. There is a concerted focus on managing receivables within a comfortable range and we encourage the customers to allow us to work with them on schedule which are smaller dispatches of products closely aligned to the assignments enabling faster and smaller billing cycles and receivable management as well as a wide and expanding selection of touch free products, antibacterial glaze products as shared in detail earlier.
4. **Higher demand from replacement and retrofitting market:** We have well progressed to benefit from that in the replacement market of faucets, products which are easy to install, and touch free to operate. Hospitality products are ready to retro-fit entire hotel with touch free products and Cera is working on these themes.
5. **Sanitaryware and faucets remain our core focus area;** and we are confident of the prospects on a sustained basis. The tile business is more of an outsourced business with less capital employed on production than

on working capital. However with reduced capacity available in tiles across the industry we are witnessing early signs of pricing power beginning to return to the business.

On that note I would now like the moderator to open the line for Q&A. Thank you very much.

Moderator: Thank you. Ladies and gentlemen we will now begin the question and answer session. We take the first question from the line of Achal Lohade from JM Financial.

Achal Lohade: My first question was with respect to the gross margins; we see that the gross margins have come off by almost 5 percentage points YoY, can you please explain as to what has driven this gross margin reduction; is there any adjustment with respect to the discounts or is it just a product mix?

Ayush Bagla: 20% of our total costs are fixed cost and 80% are variable cost, so that 20% was spread over a smaller sales base that number became 30% this quarter. That was the only reason for change in operating margin.

Achal Lohade: Actually I was asking about the gross margin; I suppose the fixed cost will have impact on the inventory valuation rather than really the manufactured product sales, is that the outsourcing mix was higher in this quarter or the relatively lower margin product mix was higher?

Ayush Bagla: I can give you the product mix, one second. For sanitaryware we had 41% of our sales of entry-level products, 13% of mid-level and 46% of premium level. So this is slightly different from what you would have seen in the last four quarters because that same number was 37%, 12% and 50% in the last four quarters. And for faucetware 32% for entry-level, 15% mid-level and 53% was premium level for the last four quarters.

Achal Lohade: Sorry I'm not able to hear you clearly. Could you please repeat the faucet mix?

Ayush Bagla: Faucet was entry-level 32% of sales, mid-level was 15% and premium was 53%. If you compare that to the previous four quarters that number was 32%, 19% and 49% and if you combine sanitaryware and faucetware on a weighted average basis, 37% of the products were entry-level, 14% were a mid-level and 49% were premium level compared to 35%, 15% and 50% of the previous four quarters.

Achal Lohade: So is it that the gross margin for the entry-level is substantially lower than the premium because I see just the mix only 2 percentage point change in that mix?

Ayush Bagla: It's not substantially lower but it is just cost based, the slide is in the cost base, if you see the breakup of other expenses, compare it YoY, the decline has not been in the same percentage as the decline in sales on some of the items.

Achal Lohade: I guess that explains the operating margin, the EBITDA margin part but the gross margin part, is it to do with the mix in the outsourcing versus in-house? Would have you have that mix handy?

- Ayush Bagla:** Yes I have that mix. For sanitaryware outsourcing was 53%, manufacture was 47%, the faucetware outsourcing was 50.64% and own manufactured was 49.36%.
- Achal Lohade:** This is for Q1 FY20 you are talking about for sanitaryware?
- Ayush Bagla:** That's right.
- Achal Lohade:** And how was faucet?
- Ayush Bagla:** Faucet was also Q1 2021, 50.64% was outsourced, 49.6% was own manufactured and if you want to compare that to the last year numbers, for the same period outsourced was 51.55% and manufactured was 49.33% and faucetware outsourced was 55.41% and manufactured was 44.59%.
- Achal Lohade:** 55.41% is for the current quarter Q1 FY21?
- Ayush Bagla:** The same period last year.
- Achal Lohade:** My second question was we see that the other income seems to have jumped on a QoQ basis or YoY basis, is there any exceptional item here which we need to be...
- Ayush Bagla:** It is just per as per Ind-AS guidelines on M2M of the cash and cash equivalent portfolio. So if you look at our portfolio there will be some of them are in SBI FDs, some in NHAI bonds, PSP bonds AAA rated and lot of them are in AAA liquid funds, so there was a M2M gain on the AAA liquid fund, so according to Ind-AS guidelines we have done a M2M marking at the end of every quarter.
- Achal Lohade:** We see there is significant variation in the gross margin on a quarterly basis given the variables with respect to mix or the product mix etc. If I were to ask theoretically if we were like 80% or 90% level of last year, would we look at the EBITDA margin similar or you think there is a significant risk to the operating margin?
- Ayush Bagla:** Here we've basically incurred the cost for 90 days and revenues for 20-25 days, is what is happened in this quarter and only in July have we reached 80% of last year's production at about 90%-95% of last year sales. So we know in Q2 if that persists and we reach 100% of sales and production reaches 95% to 100%, so we will know the difference in this quarter.
- Achal Lohade:** But let's say theoretically if this 90%-95% level to be sustained for the rest of year; would the operating margin be in a similar range of 13%-14% what we have been having for last...
- Ayush Bagla:** Operating margin should improve because all the raw material prices have declined gas prices have declined. There has been renegotiation of contracts for rental of warehouses for our display centers, fixed costs over the year will decline atleast Rs. 10 crore just on the rental and renegotiation of rental contracts.
- Moderator:** The next question is from the line of Dhananjay Mishra from Sunidhi Securities.

- Dhananjay Mishra:** You said we have 53% outsourced from sanitaryware, so these numbers were similar in last few years or it has been increased significantly because I guess it was about 30%-35%?
- Ayush Bagla:** Last six quarters have been between 47% and 52%.
- Dhananjay Mishra:** So otherwise in the past years FY19-20 how it has been?
- Ayush Bagla:** Similar, around 50%.
- Dhananjay Mishra:** And, what is your sales and advertising expenses in this quarter and what is the outlook for the rest of the year because it has been around 9% on sales numbers, so what is your strategy for this year?
- Ayush Bagla:** Normally we split that 9.5% into two heads, so publicity is normally 4% of the topline. Last year the number was Rs. 10.75 crore, this year that number was Rs. 4.18 crore and then the balance 5.5% is sales and marketing expenses which includes lot of dealer schemes, foreign trips, incentives, etc. Last year that number was Rs. 19.91 crore, this year that number was Rs. 10.8 crore. So normally at any given 12 month period you will find that number is 9.5% split into these two heads but currently obviously given the slow sales, etc. we had curtailed that expenses, especially on the publicity side. So we are yet to take a full call on whether we will be using that 4% budget for the year.
- Dhananjay Mishra:** What was the absolute number you said publicity for this quarter?
- Ayush Bagla:** Rs. 4.18 crore.
- Dhananjay Mishra:** Versus last year same quarter?
- Ayush Bagla:** Rs. 10.75 crore.
- Dhananjay Mishra:** And sales, this incentive is Rs. 10.8 crore?
- Ayush Bagla:** Versus Rs. 19.91 crore.
- Dhananjay Mishra:** And also if you could give what was the region wise breakup and how you see the number like Tier-I, Tier-II cities and I think in the interview you said that we have more than 70% revenue coming from Tier-III and below cities this time. So how you see going forward the numbers if you can give that breakup?
- Ayush Bagla:** Normally our Tier-I sales are about 32% to 35%. This quarter it was 23.59%. Tier-II is normally 13% to 15%, this time it was 10.21% and Tier-III is 52% to 55%, this time it was 64% to 65%.
- Dhananjay Mishra:** So how do you see the rest of the year relatively?
- Ayush Bagla:** Tier-I markets were pretty much shut for the entire quarter. Those markets were really nonoperational, even now there have been sporadic openings and re-shutting etc. Tier-III markets had the least impact of COVID19, and Tier-III markets

don't depend on external financing for projects and our penetration and our dealer's penetration in these markets have been traditionally the highest. Our influencers who are in regular contact with our dealers, our plumbing contractors, all have made deep inroads in these markets traditionally and these markets are also buyers of high-end products. So we concentrate a lot of activities in Tier-III markets. Going forward we will be happy to maintain any number above 55.

Dhananjay Mishra: Mumbai dealers are still not operating because I checked most of the dealers are still closed?

Ayush Bagla: Pune dealers had opened sometime in July then they shut down again, similarly Bombay some dealers were opened for few days and they shut down again. So they were having problems of getting the requisite staff to attend their showrooms.

Dhananjay Mishra: What about Delhi and Chennai region?

Ayush Bagla: Delhi and Chennai region, I won't be able to give you anecdotal information. Delhi again had opened for a period in time. Our sales in Delhi and Chennai are not so significant.

Moderator: The next question is from the line of Jaspreet Singh Arora from Equentis PMS.

Jaspreet Singh: Just carrying on with that previous data you gave, so Tier-III's contribution to revenue has gone up from 53% to 63%, right?

Ayush Bagla: Right.

Jaspreet Singh: So can that be also a factor to a drop in gross margin because I presume the purchasing power, the margins that you might get in a Bombay-Delhi-Chennai, may be better, is that correct or no?

Ayush Bagla: No, in fact there is lesser price negotiation in Tier-III markets and in Tier-III market the Company is represented via dealers, not through direct sales offices, only where the company's sales offices are present there is scope for any price negotiation. The dealers may negotiate prices with consumers or with projects by sacrificing their own margins.

Jaspreet Singh: So when you sell via dealers is better for you, you are saying in terms of margins?

Ayush Bagla: In terms of margins and Tier-III markets are not buyers only of affordable housing products. They are buyers of all sorts of premium and luxury products.

Jaspreet Singh: So that means that our Tier-III segment should fetch you better margins in terms of gross margins is one were to take it, right?

Ayush Bagla: Not only better margins but less competition because most MNCs are not present in Tier-III markets and all MNCs are present in all Tier-I market.

- Jaspreet Singh:** The jump has happened is largely a function of the fact that the number of shops and establishments were open far higher in percentage terms in III and also the fact that COVID was not as much disrupting there, right?
- Ayush Bagla:** That's right.
- Jaspreet Singh:** I understand April was a washout and sorry if you have to repeat this, I missed the initial 2 minutes of your opening remarks. So April was a washout, so how was May and June if you could break it up in terms of...
- Ayush Bagla:** May the production level in the factory operating in terms of capacity was 30% of last year and June got up to 80%.
- Jaspreet Singh:** And July did you mention 90% to 92%...
- Ayush Bagla:** The sales in May were about 55% to 60% of last year, sales in June were about 85% of last year and July is about 95% of sales and July in any case all three shifts of 8 hours have been permitted by local authorities.
- Jaspreet Singh:** So when you say 95% it means the 95% of a regular run rate of our July last year?
- Ayush Bagla:** That's right.
- Jaspreet Singh:** And in terms of the institutional sales that we do and this directly or indirectly to real estate as well as the institutions like hospitals and hotels etc. would that still be a low 20%-25%?
- Ayush Bagla:** For this quarter retail is 75% and project is 22% because export is 3% and the same period last year retail was 69%, project was 29% and export was 2%.
- Jaspreet Singh:** So, it's also the project sales which is also taking a hit, at least temporarily in the 1Q?
- Ayush Bagla:** This is a conscious effort. If you see the commentary of the last many quarters, it's a conscious effort to increase the retail percentage because project prices are negotiated prices. So, it's a conscious effort to increase this mix and cue it towards retail.
- Jaspreet Singh:** But do you see this stabilizing, the retail at 75% and project at 22%, do you think this is how it might pan out for the rest of the year?
- Ayush Bagla:** It all depends on how the replacement market behaves and how quickly the project sites resume their normal construction activity.
- Jaspreet Singh:** So mid-way you mentioned that the replacement market was far better in terms of demand versus the new sales, so that's also a function that has led to this?
- Ayush Bagla:** And that is increasing, as the market is recovering this touch free products was never a huge business for any Company and for Cera it was a 100 SKUs a month, now the current demand is 6,000 SKUs a month. And typical faucet at the low end

starts at Rs. 2,500-3,000. The touch-less faucets starts at Rs. 9,500-10,000, goes up to Rs. 25,000 per piece.

Jaspreet Singh: So this touch-less trend is more related to faucets which is picking up you are saying?

Ayush Bagla: Yes and as far as sanitaryware is concerned, the best you can do is install either a touch-less sensor based faucet or for hospitals we have this elbow operated faucet, for factories we have a foot operated faucet which were recent launches.

Jaspreet Singh: And in terms of our marketing or communication because some of the other building materials including the ply companies are using virus free materials and all of that, is that something also now that we are trying to build-in even for tiles and sanitaryware, is there separate segment or are you using that commonly?

Ayush Bagla: Some products of sanitaryware traditionally had this antimicrobial nano-glazing, so we have a robotic glazing arm which is completely automated which is one of the first in the sanitaryware industry, so it closes whatever micro pores there are on the surface of a sanitaryware product. The life is 15 years and its scratch resistant, bacteria resistant. So those products are slightly more expensive but they are marketed differently, they have different catalogs, they are sold on completely different themes. Those have become more important. Similarly even the WC seat has antimicrobial, antibacterial coating on those seats.

Jaspreet Singh: And so this segment is witnessing better off-take, better demand in the recent months?

Ayush Bagla: Yes, substantially higher off-take and demand at again a substantially higher margin.

Moderator: The next question is from the line of Abhishek Ghosh from DSP Mutual Fund.

Abhishek Ghosh: So just couple of questions, in terms of how is the competitive scenario coming out both from the organized and the semi-organized? Lot of the parallel categories we are hearing semi-organized get weaker, so if you can just help us understand the layout here?

Ayush Bagla: Two-three things have happened globally. Chinese companies, there is a huge anti-China sentiment because of the US trade wars etc. and then of course this episode between China and India as well. So, Chinese companies used to send a lot of sanitaryware products to most manufacturers in India. We have always disclosed our Chinese imports numbers; they were between 4% and 5% of our top line. There are many in our peer group where that number is between 55% and 60%. So those products now will shift to any other countries or to Indian domestic manufacturing vendors. Again, vendors don't have the capabilities of making either wall mounted WCs or tabletop thin rimmed thing or single piece no joint WC. These are all capabilities we've created in our factories. So, vendors don't have these capabilities. So vendors in India are quite interested and capable of making mass production of basic items. But their capacity has still not ramped up, so the labor issue and the migration of labor issue for them has been much more severe than organized players. So there is already a capacity constraint for companies who are

totally dependent either on the vendors or on Chinese imports. Now that is the situation as far as sanitaryware is concerned. Sanitaryware exports which was always a single-digit number for all companies and for Cera is suddenly becoming very important because there are whole lot of enquiries from all over the world. Similar trends are also witnessed in tiles; so for last six-eight months we have we heard G8 countries imposing anti-dumping duty on Indian tiles, but they were importing from China. All that has stopped now, Indian tiles and generic tile manufacturers from Morbi are finding huge export markets globally.

Abhishek Ghosh: At present the imports that the competition does as far as the Chinese sanitaryware is concerned, it does not attract any import duty, is that understanding correct?

Ayush Bagla: Abhishek, I just got one part of your sentence.

Abhishek Ghosh: So Ayush what I was asking is that sanitaryware, these imports that they do, is there an import duty element to that?

Ayush Bagla: Yes, there is an import duty element.

Abhishek Ghosh: How much would that be and is there a risk on that getting increased, is that understanding....

Ayush Bagla: That I think is between 5% and 10%. For us imports were never a focus area because the products that are majorly imported from these Chinese companies by our competitors or peer group, those are all made in our factories. The peer group may not have had that capability of making these three types of products in their factories but you, but we have always had that. And we have always given out our Chinese import numbers. We have stated it publicly. Now currently we have find that lot of our project customers insist on a 'Made in India' certification, so we provide that not only in our sample pieces but in our cardboard packaging and then we are quite happy to additionally provide 'Made in India' certificate. That is a trend we are seeing.

Abhishek Ghosh: And is there any pricing this thing that is happening at the market place in terms of any decline/increase anything that you are seeing given short supply in imports not happening, any kind of pricing trend that's happening in sanitaryware and faucets?

Ayush Bagla: We are seeing strong demand, especially after the end of the first quarter because the vendor base is still not alive and fully operational. So we are seeing scramble by manufacturers to try and secure their supply chain.

Abhishek Ghosh: Could that means some pricing increase that would happen in the system for all the players?

Ayush Bagla: We took a last price increase in May, 2019 of 3% to 5% and we are planning to take one in this month of 3% to 5% across sanitaryware products. And this is in the environment where Zirconium has declined by 10%, zinc has declined by 10%, PA has declined by 5% and in faucetware our brass prices have declined by 10%. So again in faucetware we are the only Company to have never used any brass scrap.

We only use brass ingots and the faucetware pricing is little more dynamic than sanitaryware pricing and mirrors brass pricing.

Abhishek Ghosh: Last year we had other expense of almost about Rs. 300 odd crore. Given the initiative that you spoke about lesser power and fuel, lesser rental and also some cost rationalization, what can be the percentage increase on a very; so now you have broadly come to that 95% of last year sales level; so assuming similar sales what can that other expenses as a percentage look lower because of the initiatives?

Ayush Bagla: On fixed cost we have negotiated rentals down by Rs. 10 crore. Then I can give you some color on power and fuel; our weighted average cost of gas was Rs. 22.58 last year. That same weighted average for Q1 was Rs. 12.48 and for the same quarter last year was Rs. 21.09.

Moderator: The next question is from the line of Vikrant Kashyap from Kedia Securities.

Vikrant Kashyap: Just one question; since we have faced a lot of problem post-COVID situation in India. Do you now see the worst is behind us and this would improve from here?

Ayush Bagla: Well that is the expectation, that is the reality on the ground, that is the empirical data on a month by month basis, and all this is a flight to quality. Investors are flying to quality, consumers are flying to quality, employees are flying to quality, so the flight to quality, consolidation all that is happening. Now to give you example, CRISIL has reiterated our A1+ rating for our CP program in December 2019 where bulk of the slowdown had already kicked in. CARE in July 2019 gave us AA rating, those ratings are completely unchanged. We have never used the rating because we have zero long-term debt, we have lines of about Rs. 40 crore of working capital, we use Rs. 10-12-15 crore for a few months in the year. We have Rs. 268 crore of cash and cash equivalents, so to those investors who always ask what we plan on doing with cash, we have said that the Company traditionally has been very financially conservative and now all the same investors come and tell us that that has been the correct strategy because in our peer group there are companies with very-very high levels of debts and there are also companies which have good operational parameters but very high levels of CAPEX and as a result zero cash flow at the end of the day.

Vikrant Kashyap: So do we see recovery broad-based in our all three segments or do you think there is lag in recovery in any of these?

Ayush Bagla: We are expecting not only an increase in demand and that is bought out by the empirical data of July. But we are also seeing after many years a shortage of supply because all national and International events depend on the vendor base, so this vendor base has not been able to get its act together in terms of reaching the required requisite capacity utilization.

Moderator: The next question is from the line of Dhruv Jain from Ambit Capital.

Dhruv Jain: You mentioned about the competitive intensity in sanitaryware, if you could just throw some light on the tiles as well given you mentioned in your opening remarks about the possible increasing bargaining power for organized tiles players?

Ayush Bagla: We keep hearing about 800 to 900 plants in Morbi, now what we hear is only 50% to 60% of those plants are currently operational at a capacity utilization of 60%. That has never been the case in the last 5 to 10 years and at the same time because of the anti-Chinese sentiment globally, generic tiles manufacturers never found such a large opening of market and availability of customers globally. As far as tiles companies are concerned, they are just 10 to 12, maximum of 15 national brands which compete for large projects order. So when Cera competes, we are competing with the top 5 to 10 tiles companies for individual orders. Their price discounting does not go down beyond a certain level. That gives us the confidence that tiles which had become very generic and very price driven is now changing. Then within tiles, Cera has launched slabs and larger value and larger size products where the pricing and margin profile is completely different and third the entire industry has moved to GVT. So soluble salt is less than 10%-12% of Cera's sales and GVT has now become the industry standard. These are the developments which gives us the confidence for the tiles industry.

Dhruv Jain: Just one question from my end on this. So have we just seen some sort of initial price hikes that you guys have taken here or has that the blended realization because of mix improved for you guys at least in July?

Ayush Bagla: Tiles, there is currently a consolidation in the vendor base and that process is currently on. What we are pushing is a higher percentage of sales of GVT that is our focus. So GVT for us is 23% to 25% of sales and double charged, wall tiles, paving tiles is altogether 86% of sales. Soluble salt this quarter is only 14% of sale. The same number for 12 months of last year was 18%.

Moderator: The next question is from the line of Saurabh Shroff from QRC Investment.

Saurabh Shroff: Could you elaborate a little bit on our distribution between Tier-I, II, III? How that has evolved over the last couple of years as we have tried to move like you said to Tier-III and what the plan is there going ahead? And then I will ask my next question.

Ayush Bagla: The first is of course there is always a sales concentration with high-value dealers. So I will give you a statistic, our top 100 dealers constitute 23% of sales in this quarter and top 500 constitute 79% of sales. Now I will give you another statistic. As on June '20 we had 3,631 dealers. That same number in June '19 was 3,086 dealers and another statistic that might interest you is 22% of dealers have been added in the last 5 years which bring in 10% additional sale. So dealer concentration will always be there. These top 500 dealers have been the ones to invest in infrastructure whether it's showrooms, salespeople, three-wheelers, four-wheelers. They have established lines of credits with Banks, they have the ability to provide credit to their consumers, they share some of their margins with their consumers. In Cera's case because of the deep in-roads in Tier-III markets we have dealers who are doing between Rs. 5 and Rs. 10 crore sales in very small places like Nagpur, Kolhapur and many other Tier-III towns and that we feel is the avenue for growth because that is the place where MNCs are not present and their entire focus is on Tier-I markets and large projects of national builders in luxury markets. MNCs also compete amongst themselves for these luxury projects and undercut price to such an extent that it doesn't make sense for them but for them it's an India entry strategy. So, we don't want to participate in that battle of attrition.

Hence, our strategy traditionally has been Tier-III markets and you can see that in the numbers as a percentage of sales and on all parameter.

Moderator: We proceed to the next question. This is the last question from the line of Akhil Kalluri from Franklin Templeton.

Akhil Kalluri: Couple of questions; so first on the demand again. You indicated that July was at 95% of last year sales levels, that's quite positive. What I wanted to understand was more qualitatively based on your interactions with say dealers or builders. How much of this, do you think could be pent up demand to gauge the sustainability of the recovery?

Ayush Bagla: Pent up demand, we are not really calling it pent up demand because construction activity in April and May was completely halted. Even in June except the national developers and the national EPC companies like your Shapoorji or a L&T, we see sites in Tier-I market is still not fully recovered. So national developer, lets say a Mahindra or a L&T have the resources capability and the manpower resources to restart their sites but the other end of sites restarting is all in Tier-III markets. So we wouldn't call that pent-up demand, we will just call that a race for project completion.

Akhil Kalluri: But in case some of these Tier-III markets, while there is this race for project completion which is happening at this point; can you throw some light on new project starts or new housing starts as well which would probably be critical from may be a 6 to 9 months perspective in terms of how demand plays out?

Ayush Bagla: In any case 70% of the WIP in real estate is affordable housing. Now we are getting lot of data that even during the pandemic; apartments in affordable housing were being sold and given that these are all in the (inaudible) sensitive sectors, home loans are at 6.85-6.95% which is the lowest they win in 20 years. Affordable housing projects, the velocity is coming back. So any project that is 6 months away from completion which will therefore be eligible for GST exemption and these home loan rates sub-7%, we are seeing velocity and our role only kicks in once these projects are 6 months away from completion. So that's the data we track, there we are not finding as much of an issue in space.

Akhil Kalluri: The second bit was on the pricing and margin front. You indicated that there have been costs reductions in which sales momentum almost back to last year's levels. There could be some margin boost as well right going forward. In such an environment, just wanted to understand your thought process on thinking about the price hike instead of, maybe just offering higher discount to dealers, may be certain better working capitals, given a center of balance sheet just to gain market share. How are you evaluating the pros and cons of the two?

Ayush Bagla: We are traditionally, you know the Company, the philosophy behind conservative financial management and the receivable days. So I will give you that number. Receivable days as on June 20th was 51.36 days versus 56.78 days last year. On X tiles that number was 39.80 days versus 39.31 days. This is again the lowest in the industry. We have seen too many instances of companies trying to pump prime their sales by offering additional credit. So we just want to steer clear of those

experiments. We have seen just too many cases where things have not worked out for anybody.

Akhil Kalluri: That's fair, Ayush, and that's commendable but just in terms of the pricing as well, I think during one of the participant's earlier questions you had highlighted, you are thinking of a 3% to 5% price increase given how things are at this point. So I just wanted to understand, so do you think by probably offering higher discounts to dealers, higher incentives; can we gain market share at this point instead of thinking about a price hike?

Ayush Bagla: See if gaining market share is the objective and that is always the objective, then new product introductions are the way to go and differentiating your own product with the peer group product in terms of technology and that a bulk of our efforts are engaged in that direction. In fact we have always been tinkering with the dealer lending price. So even during this period we have been tinkering with this FY20-21 dealer lending price and we are trying to increase the dealer lending price and the MRP and the dealers have welcomed the move. Normally you would find that trades resisting such a move. Because there we are offering them newer products, more of SKUs so they are quite happy to allow the Company to tinker or increase the dealer lending price.

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

Ayush Bagla: Thank you. I would like to thank everyone for attending this call and for showing interest in Cera Sanitaryware Limited. Cera is optimistic that it's strong positioning in the industry and improving macros will help it deliver steady and consistent growth going forward. With this I hope I have been able to answer your questions satisfactorily. However, should you need any further clarification or would like to know more about the Company; please feel free to reach out to me or CDR India. Thank you once again for taking the time to join the call and see you all next quarter. Thank you very much.

Moderator: Thank you. On behalf of Cera Sanitaryware Limited that concludes this conference. Thank you for joining, you may now disconnect your lines.
