



CERA Sanitaryware Limited

Q2 FY21 Earnings Conference Call Transcript

November 11, 2020

Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY'21 earning 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 "*" then '0' on your touchtone phone. Please note 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, Mr. Vaswani.

Mayank Vaswani: Thank you, Janis. Good morning, everyone, and thank you for joining us on the Q2 & H1 FY'21 earnings conference call for CERA Sanitaryware Limited. We have with us today the management team comprising Mr. Ayush Bagla -- Executive Director, and Mr. Rajesh Shah -- CFO and COO of the Company. We will begin with brief opening remarks from the management, following which we will open the call for a Q&A session.

Before we begin, I would like to mention that some of the statements made in today's 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 like to turn the call over to Mr. Ayush Bagla for his opening remarks.

Ayush Bagla: Good morning, everyone, and thank you for taking time to join our call. I hope all of you are safe and well.

The earnings for the second quarter and for the half year ended 30th September 2020 were adopted by the Board of Directors yesterday, 10th November 2020. The earning documents have been released to the stock exchanges.

As you all know we started the fiscal year with significant disruption in the business due to the lockdown and restrictions on activity which began to ease by the latter half of the first quarter. During Q2, we have witnessed a sharp recovery in demand resulting in a rebound in financial performance. This has been driven by the performance of the Sanitaryware and Faucetware business which are our core businesses and the most profitable vertical in our fold. The Sanitaryware business which had not performed to expectations in recent quarters, has recovered strongly in Q2 of this year and the Faucetware business which has been delivering robust growth for several quarters has returned to its positive trajectory.

Another positive development during the second quarter has been the robust demand from our end consumers. The earlier estimates of replacement demand have proved to be conservative given the absorption witnessed some markets categorize at tier-3 and beyond. Despite slow progress in projects across the country, there was a sharp rise in volume for Sanitaryware and Faucetware products in the second quarter indicating strong underlying demand in the home improvement category.

On the “Operational” side, we had stabilized operations towards the end of first quarter as we shared in a prior call. The normal structure of three shifts of eight hours each had resumed in July itself. Thus effective working days and hours were substantially higher this quarter compared to Q1.

Our subsidiary, joint ventures with tiles company, Anjani which resumed operations on 5th August, as indicated, has quickly ramped up to 95% utilization. In October, capacity utilization was 100%. Through a concerted focus on manufacturing excellence we have automated processes such as pressure casting, anti-bacterial glazing as well as grinding, polishing and electroplating. The emphasis on agile infrastructure with a mix of in-house and outsource facilities has allowed us to rapidly respond to shifts in demand. This keeps operations agile and flexible, providing the company with on-tap capacity and resilience which enabled it to rebound strongly in Q2.

Coming to our “numbers”, revenues in Q2 FY’21 were Rs.317.90 crore versus Rs.142.59 crore in Q1 FY’21, higher by 123%. EBITDA was Rs.44.4 crore in Q2 bouncing back from Rs.13.52 crore reported in Q1 this year. The EBITDA margin has firmed up to 13.97%, an increase of 49 basis points. PAT was Rs.26.29 crore, nearly 803% higher than in Q1.

Due to the sharp rebound in performance, the performance in Q2 this year has nearly reached parity when compared to Q2 of last year despite the challenging backdrop. For Q2 FY’21, the revenue for the quarter stood at Rs.317.90 crore versus Rs.327.23 crore in Q2 FY’20 which is down by 2.85% on a YoY basis. To reiterate, our performance during the quarter was driven by the core businesses of Sanitaryware and Faucetware, essentially from a well established presence in tier-3 markets. This was supported by the increased traction in contactless and touchless products.

For Q2 FY’21, 50% of the topline was from Sanitaryware, 26% from Faucetware, Tiles presented 21% and Wellness 3%. On a YoY basis, Sanitaryware revenues registered an increase of 0.78%, faucetware revenues increased by 3.68%, Tiles declined by 11.76% and Wellness declined by 28.52%. Sanitaryware has bounced back strongly in Q2 both from an absolute number and from a growth trajectory standpoint. Faucetware which had delivered consistent growth historically since inception, the two core verticals of the business now contribute 76% of revenues once again.

EBITDA excluding other income for FY’21 Q2 was Rs.40.46 crore versus Rs.41.59 crore in Q2 FY’20. The EBITDA margin for Q2 FY’21 stood at 12.7% at the same level of that of Q2 FY’20. Profit before tax for Q2 FY’21 is Rs.35.13 crore against PBT of Q2 FY’20 of Rs.36.70 crore, a decline of 4.3%. Tax expense for Q2 FY’21

is Rs.8.84 crore against Rs.6.67 crore in Q2 FY'20, an increase of 32.5%. Profit after tax for Q2 FY'21 is Rs.26.29 crore against a YoY number of Rs.30 crore. EPS for Q2 was Rs.20.2 versus Rs.23.1 in Q2 FY'19-20.

Inventory days in Q2 FY'21 was 51 days compared to 52 days in Q2 FY'20. Receivable days in Q2 FY'21 was 55 days versus 60 days. Payable days in Q2 was 38 days against 28 days in Q2 FY'20. Therefore, the net working capital days in Q2 FY'21 was 68 days versus 84 days in Q2 of FY'20. This has been a focus area for the Company and the efforts in the last few years towards digitization, and establishing localized warehousing, have enabled us to offer just in time inventory solution in finished goods to trade partners and large customers. This enables declogging at the respective locations and sites which leads to faster and smaller billing cycles for CERA, enabling better receivable management.

Through judicious capital management, the Company was able to increase its already high liquidity position to Rs.362 crore as on 30th September 2020 from Rs.268 crore as on 30th June 2020. Going ahead, CERA will maintain discipline credit policies while sustaining the prudent capex outlay to further elevate its robust financial position.

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

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. We take the first question from the line of Archana Gude from IDBI Capital. Please go ahead

Archana Gude: Two questions from my side. Firstly in the press release it is mentioned that the Kadi manufacturing has been disrupted due to some employees-related issues. So what is the status on that as of now?

Ayush Bagla: Hi, Archana. We have given out three communications to the stock exchange on this topic and what we have said is that some of the workers of the Sanitaryware unit were demanding higher fixed pay. So we have a system of fixed and variable pay, and as any management, it is always our attempt to incentivize the workers and pay a higher portion of variable pay. So one of the union leaders wanted an increase in fixed pay, and there was a slight disruption and we approached the Labor Department, Government of Gujarat, which on 16th October, issued a directive, prohibiting the disruption. So now, we are engaging with the union leader and labors to come back to normalcy in production. Meanwhile, the adjacent factory of Faucetware is almost unaffected. And thirdly, and most importantly, more than 53% of products in Sanitaryware are now being sourced from outsourcing partners even in Q2. So all attempts have been made to make sure there is no impact in the marketplace, and all our trade partners, whether it is dealers, or project customers continue to receive all products well in time.

Archana Gude: Is that my understanding correct that the issue what is happening there is not yet resolved?

Ayush Bagla: It is an ongoing situation. Yes, we have not come back to the same capacity utilization that we had in end of Q1 and bulk of Q2. So yes, there is a slight

disruption. But these are ongoing discussions. We did get some outside temporary workforce. So all attempts are being made to go back to that 80%-plus of capacity utilization.

Archana Gude: And secondly, during this lockdown, I am sure that many unorganized players might have faced the situation wherein there is production disruption. Have we gained the market share in the sanitaryware and faucet because of that, and how we should look at H2 FY'21, is it that the pent up demand has really helped us to force such robust sales growth for Q2 or how we should look at H2 FY'21 sir?

Ayush Bagla: Both in Q1 of this year and even in some part of Q2 of this year, bulk of the project sites were not fully operational, but there was a surge in demand. So I would not call this pent up demand, I would say that all estimates were made by companies including us on end consumer replacement demand were very conservative. So the end consumer demand is actually much higher as a percentage of total industry than we used to estimate and that was evident because most project sites were closed. So that is what you see and we have anecdotal information from our frontline dealers and sales force that a lot of households had disposable income, because there were no other avenues like travel, entertainment and other things to spend on, so home improvement became a focus area for a lot of households.

Archana Gude: Sir, just to follow up on that, given the tier-3, tier-4 and the smaller towns are really doing well, so is it fair to assume that as and when the metros and the tier-one cities will come up, we will be able to maybe surpass the growth we have shown in Q2?

Ayush Bagla: We will wait for those trends to actually take place before taking a view on them. But yes, Q2 trends have been very encouraging month-on-month and as a quarter. And sanitaryware growth is back on track, faucetware growth has been on track and continues to be on track and you can see the impact on working capital, the drastic reduction in working capital in CERA, we are always category leader in the lowest working capital, we had the lowest receivable days, but that is further going down, so which shows that a lot of business is now cash-and-carry.

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

Pritesh Chheda: Just wanted to understand a couple of things; one, you when we were at the end of the Q1 call, we were looking at overall growth. So considering what was happening in faucets, the import restrictions or challenges in sanitaryware; considering that the Q2 is a largely flattish performance, so, just wanted to take your update on how do you see it incrementally and what would have been the reason for a deviation vis-à-vis the Q1 commentary? My second question is a lot of reports are suggesting changes in market share in sanitaryware. So, if you have any comment of any change in market share or any for us as well as largely at the industry level if you could give some comments?

Ayush Bagla: First on the imports, you see the Indian consumers is now preferring "Made in India" products and we have been talking about that for a number of years, and we have built domestic capabilities in manufacturing. So, we are not one of the China import dependent companies. So, that is a welcome development. As far as

restrictions on import is concerned, there was only a marginal import duty of 5% to 10%. So, other than that, there are no barriers to import. So, other companies I am sure continue to import from China and it is a matter of time before certificate of origin will become mandatory as it has become mandatory in all eCommerce sales. That is one. As far as the topline is concerned, we are quite happy to have this topline with both the core segments firing very well. So, both sanitaryware growth and faucetware growth are back on track, working capital is reduced, inventory levels are low, receivables levels are very low, on all parameters we have done very well, we have increased our cash position by almost Rs.95 crore during the quarter, and all this is being achieved on an annual capex budget only of Rs.21 crore. So on all parameters, yes, "is there a scope for growth?" Of course, there is always scope for growth by introducing new SKUs, further segmenting the market, that is always our attempt. And as far as market share is concerned, we get numbers of course of our peer group and ourselves, but these are not authenticated by any third-party research agency, so we cannot really say who has gained and who has lost but we are a category leader in sanitaryware, we are most profitable in sanitaryware, the highest margins and lowest receivable days, lowest working capital, highest cash position. So, on all parameters and on every parameter we are a category leader.

Pritesh Chheda: Do you see any market share changes for you or the market share is largely intact because I think you said Sanitaryware growth rate is flat, right in Q2 and faucet is 3%, right?

Ayush Bagla: That is for the Company. As an industry we do not get any third-party data. But if you see for the last few quarters, our Sanitaryware business because it was operating from a very high base we were not getting QoQ or even YoY increase in topline for the sanitaryware vertical, which we have come back to. That was the major achievement.

Pritesh Chheda: And lastly, do you see from here on the growth rate incrementally converting into a double-digit growth rate, do you see that kind of movement at the ground?

Ayush Bagla: Housing is a highly interest rate sensitive sector and now home loans at 6.75, then the Awas Yojana has been a huge success, low cost and mid income housing, whoever we speak to the velocity is very-very strong. So based on those parameters, and we are squarely in that market, 70% of WIP of the real estate is mid-income housing and below. So CERA as a brand is firmly squarely positioned to capture that market. So going forward, if not double-digit, at least high single-digit is definitely possible.

Moderator: Thank you. The next question is from the line of Shanti Patel from SP Investment. Please go ahead.

Shanti Patel: My first question is what is our PAT in terms of percentage, and do you think in future it will increase? And secondly, what is our return on capital employed and return on equity today and what you think about the future?

Ayush Bagla: PAT for Q2 FY'21 is 8.17%, last year same quarter was 9.06%.

- Shanti Patel:** Fine, but do you think there is a probability of Increasing that in the next one or two years?
- Ayush Bagla:** Yes, if you see the comparison between Q1 and Q2, even though Q1 was not a normal quarter, there has been a substantial increase; we are almost at the same level of last year. That is one. PBT is even closer than PAT between last year on a YoY basis, because there was Rs. 2.5 crore extra tax payment, that is the difference you see in the PAT. That is one. Going forward, you see, we have built up a cash position during the quarter of Rs. 95 crore besides being a debt-free company. And ROCE normally, we calculate at the end of the year, so for 31st, March 20, without Treasury it was 25%, with Treasury It was 20%.
- Shanti Patel:** And what about return on equity? I think it will be same because there is no debt.
- Ayush Bagla:** No, it would not be same because of a very high tax incidence.
- Shanti Patel:** Oh, so how much it comes to?
- Ayush Bagla:** I will give you the number of last year. Siddharth, can you give that number?
- Siddharth Patel:** 20%.
- Shanti Patel:** And now the last question, because our Government has got a policy to increase the income of the farmers substantially. Now, if that happens, what will be the demand from rural area as far as the industry is concerned and what about our Company?
- Ayush Bagla:** So first, I will just give you some very interesting data; on our sales from tier-1, 2 and 3-markets, so for the quarter, 26% of our topline was from tier-1 markets with population above 25 lakhs. For the same quarter, 13% of our sales were from tier-2 markets with population of between 10 lakhs to 25 lakhs, and 60% of our sales were from tier-3 and below markets with populations of 10 lakhs and below. So, we are squarely positioned to take advantage of the rural demand, the increase in farmers income and the short gestation projects in rural and semi urban and small towns. So, these are a very short gestation.
- Shanti Patel:** But sir, I think we do not have that capacity expansion plan as on today if I am not wrong, which can cater to the substantial increase in the demand from that area. So what about that?
- Ayush Bagla:** Sir we have on-tap capacity available with the contracting vendors and partners. Again, I will give you a statistic, for the quarter; 58.8% of our sanitaryware sales were from these outsourcing partners, and 53.73% of our sales in faucetware were from outsourcing partners. So this on-tap capacity, does not require the Company to make heavy capex on its own books and we use our own dedicated capacity for complicated and high-end products. So that is the strategy. And that is why we get this ROCE.
- Shanti Patel:** But then it will not impact our margin if we get it done through contractors?

- Ayush Bagla:** In fact, the cost of manufacture in most of the contractors is lower than any Company because they have lower overheads, very high volumes and they know how to contain costs, they do not have R&D department, sales and marketing department and other typical overheads that a Company has. So we have found that buying from these outsourcing partners increases our margin and these are all incremental sales. So what you have suggested is correct, rural and semi-urban market, tier-3 and below market, that is squarely where we are focused, affordable housing, mid income housing, which is 70% of the current WIP, that is exactly where we are focused, and that is where the future market lies.
- Shanti Patel:** I think in future should be in double-digit, correct?
- Ayush Bagla:** While we wait for that to happen before giving any guidance to that effect, so we will wait for that to take place.
- Shanti Patel:** No, I mean, your opinion, from the circumstances prevalent today, and Government policy, I mean, you are the best person to judge because you are in the industry. I am not telling you to give guidance. But what is your gut feeling?
- Ayush Bagla:** For us, we will wait for those events to unfold before taking a view on them.
- Moderator:** Thank you. The next question is from the line of Hiral Desai from Anived PMS. Please go ahead.
- Hiral Desai:** I had a couple of questions. So one was on the working capital which you sort of alluded to earlier in the call. Now, we have seen a significant improvement versus even March of this year, which was a significant improvement versus the prior reporting period. And if I look at the operating cash flow for H1, we are at about Rs.143 crore versus an EBITDA of about Rs.50 crore. So, how sustainable are some of the just-in time inventory and some of the initiatives that you have spoken about? And a related question to that is given that there is a significant amount of cash pile up now happening, what is the thought on the payout or sort of any M&A in the pipeline?
- Ayush Bagla:** Most important is payable days. You see out of the three components of working capital, our payable days have been historically in the 20s. So, because the Company was cash-rich, they always used to pay, well before the contracted period and try and extract any financial concessions. But now what has happened is in discussions with our suppliers, those financial concessions are also available, and we have been able to increase the payable days from 28 to almost 38. So, that is the biggest component of the change in working capital. And the receivable days, a lot of new businesses is being done on cash-and-carry. So, especially tiles which is the lowest margin business of all three, almost all sales are being done on cash-and-carry. We have been able to increase our tiles selling price by 3% during the quarter and from credit sales we are trying to reduce it to about 80%, 85% of cash-and-carry. So, those are the two components. How sustainable they are? Yes, if we are willing to take a slower growth trajectory in tiles, but are definitely more profitable and less risky one, that is definitely sustainable.
- Hiral Desai:** And this move towards cash-and-carry would be true for the industry as a whole or this is much more specific to CERA?

- Ayush Bagla:** It is specific to CERA. The industry is moving in the other direction of somehow lubricating sales by extending credit. So, that has been a phenomena that we have seen in the industry. But you know CERA and you know how conservatively it is managed from a financial standpoint. So, they will never do something like that. And that also answers your last question on the cash; cash number has now crossed Rs.360 crore and Rs.94 crore was added during the quarter where most companies were burning cash. Currently there is no M&A activity or massive increase in capex. In fact, capex for this year has gone down from a normal number of 50, 55 crore to 21 crore. So, whether they will be a payout in the form of special dividend or buyback, that is something that I think the shareholders and board will take a collective call at a later date. But currently there is no proposal in front of the board to consider any of these activities of either M&A or special payout or buyback.
- Hiral Desai:** And my second question was on the gross margin. So if I look at it sequentially, also, there is about 150 basis points deterioration in the gross margin. Now, this is despite higher sales, lower raw material prices and the fact that I think you are likely to take a price increase in July. So just wanted to understand the gross margin?
- Ayush Bagla:** The price increase took place of around 3% in August in sanitaryware, and in faucetware the pricing is much more dynamic linked to brass pricing, so brass was down by 3%, 4%. So there was no need to take a price hike at the same time, but in any case, it is much more dynamic. But the share of entry level products in sanitaryware did increase from 38% to 40% YoY. So I will again give you the three numbers; entry level from 38 to 40, mid-level from 12 to (inaudible) and premium from 49 to 48 in Sanitaryware. In Faucetware, entry level from 32 to 31, mid-level from 19 to 16 and premium from 49 to 53.
- Hiral Desai:** But last time I think on the call, you had mentioned that there is not too much of margin differential between the entry level products versus the premium products and the move that you are talking about year-over-year is not a very large move per se. I am still not very clear on this 150 basis points, a sequential decline in the gross margin.
- Ayush Bagla:** And I will give you one more reason. I will just look at the gas prices for you. Again, not comparable, but Q1 we paid weighted average 12.4 and Q2 we paid 19.22, last year we paid 24.23. So the only other item that remains is basically discounts and sales incentives.
- Hiral Desai:** Okay. I will probably take it offline.
- Moderator:** Thank you. The next question is from the line of Abhisar Jain from Monarch AIF. Please go ahead.
- Abhisar Jain:** Sir, in the Q1 call you had mentioned that there will be tightening on the other expenses, and we had also negotiated some of the rentals down. So, what would be the overall reduction that you are looking at for this year because there could have been renegotiations on that front, are we on track for the reduction that we had mentioned in Q1?

- Ayush Bagla:** Yes, the guidance on that front was Rs.10 crore of fixed cost expenses in rentals and other fixed cost contracts to be negotiated downwards, Rs. 10 crore per annum, so that number remain.
- Abhisar Jain:** In terms of the capacity utilization across faucetware and sanitaryware, right now in Q3 what would be the level that we will be operating at?
- Ayush Bagla:** Sanitaryware for Q2 FY'21 was 68% and Faucetware was 46%.
- Abhisar Jain:** Sir, would there be some improvement from this now in Q3?
- Ayush Bagla:** Yes, we are expecting improvement, but in any case, this is not a reflection on sales, because outsourcing partners are meeting the current demand, and whatever disruption there was for a period and a slight disruption that continues is limited only to the Sanitaryware facility. So, the Faucetware facilities low capacity utilization numbers are not related to any disruption, but the kind of products that they make and the demand for those products.
- Abhisar Jain:** So actually sir, I just wanted to understand that because of this temporary disruption in the sanitaryware facilities, did we see any meaningful impact in sales also even despite having outsourcing and contract partner support, but did we see it in Q2 a meaningful impact, and are we going to see a meaningful impact even in Q3?
- Ayush Bagla:** So far, the products that are required by the market are being met through outsourcing partners. In any case, the plant is operating, products are being shipped from the plant, maybe not at the same capacity percentage that we used to, but we expect a very early resolution. So marketplace disruption, we are not seeing any major numbers or material impact so far.
- Abhisar Jain:** So, on this substantial improvement in the working capital and really good cash flow generation, congratulations for that. But sir, just wanted to understand that can they stabilize at this level whatever we are now, given a few days here and there, or will there be a little bit of volatility in this number because this is a really good level that in the past not been able to operate at this level for too long right?
- Ayush Bagla:** We have been a category leader in terms of receivable days and our entire focus is always on receivable days because payable days is something that the management can easily control. So, this time besides reducing receivable days from 59 to 54, we also turned our attention to payable days, because we always wanted to extract the best price, we used to pay earlier than contracted terms. Now, keeping those commercial gains intact, we have increased the payable days. And in tiles, and in substantial part of even Sanitaryware and Faucetware, we have moved to cash-and-carry. So we will see whether the demand trends of the future allow us to remain in cash-and-carry to the extent that we managed in Q2.
- Moderator:** Thank you. The next question is from the line of Binod Modi from Reliance Securities. Please go ahead.

- Binod Modi:** Just my question pertains to the 12.7 EBITDA margin that we have seen in this quarter, I just wanted to understand, going forward considering the fact that we have taken 3%-plus kind of price increase in the month of August in Sanitaryware categories and with growing percentage in this segment in terms of revenue, do you see that there is some scope for the margin improvement going forward in coming quarters?
- Ayush Bagla:** With the slight top line increase, there is scope for margin improvement because the raw material environment, the natural gas environment, all those are very benign, they are all trending downward. So, that is why there was no need to increase the MRP by 5%, we only needed to take a 3% increase, and going forward if the demand trends continue the way they were in Q2, if they remain as strong, then yes, that is definitely possible.
- Binod Modi:** And you also said 3% kind of price increase in tiles segment. This is mainly because of change in product mix in terms of higher GVT sales because I think from the competitors be it Kajaria and Somani, they have not said any sort of price increase industry took in the tiles segment.
- Ayush Bagla:** See, our GVT sales are now 28% of sales. Then Double Charge is 19% of sales. Wall Tiles are 31% of sales, Others are 13% and the lowest and soluble salt is now only 9% of sales. Because there is design differentiation, we are in a position to take a price increase and also try for cash-and-carry. So, bulk of sales in any case are now cash-and-carry in tiles which has been the major reason why working capital has reduced so much. So, if the markets remain as strong as they are, then this trend can continue. And even after all this, our tiles business is a very small business. So, the names you have taken, their tile businesses are very large businesses, so their pricing decisions will have far-reaching impact. Our price increase decision has a minimal impact on us and definitely no impact on industry.
- Binod Modi:** About this tile segment only, of course, our AP tiles plants have restarted from the month of August. Of course that would have some sort of impact and probably that is the reason we are seeing almost 12% kind of decline on YoY basis in this segment. So, with this full impact from this quarter, Q3 onwards do you see tiles in terms of revenue composition should increase here on and that will have impact on blended level in terms of margins?
- Ayush Bagla:** See, tiles have always been between 18% and 21% of the company's top line. And going forward that is the expected number. So tiles have least impact on margins, and, of course, impact on working capital and topline. As far as Anjani is concerned now, Anjani is a JV, and together Anjani and Milo, the two JVs contribute less than 35% of tile sales. Anjani and Milo, both make only high-end GVT tiles now. So they do not make any low end product. So those are the positive incremental steps that have been taken by the JV. And 65% of our tile sales still are procured from third-party vendors.
- Moderator:** Thank you. The next question is from the line of Lakshminarayanan from ICICI AMC. Please go ahead.
- Lakshminarayanan:** A couple of questions. First is on the Sanitaryware business, what is the volume growth you actually saw, and what is the realization per piece in Sanitaryware? Did

you increase any realization changes? The second question is like the tiles business, you said it is around 18%, 20% of the sales. What is the margin in tiles business we actually get which is after deducting the charges, direct expenses, etc., what is the margin we make and what is the catch up we can actually do in terms of margins, so what is your aspiration and where are we now? The third question was that there is a capital expenditure towards building the employee colony, if you could just help me out understand how many buildings, apartments you are constructing and where are we now on that capital expenditure?

Ayush Bagla:

So, I will come one-by-one. First of all, the tiles business, we do not really give out individual EBITDA, we have a blended EBITDA for the Company, where the Sanitaryware business has the highest EBITDA percentage, then comes Faucetware, then comes the Company blended average, and then comes tiles. So that is the nature of each of these segments across all companies. And going forward, tiles, not only is the EBITDA percentage increasing, but tiles industry generally had a problem of extended credit and long working capital cycle, low asset turns per year, all that has been addressed. First, by 65% of our tile sales being outsourced. Secondly, by keeping zero inventory. So we have been working right now in tiles on a zero inventory model. Only working capital involved was receivables minus payables. So, the payables again in this business are very high, we had kept it very low, so, we are inching closer to industry standard. Then as far as volumes in Sanitaryware, we have now crossed 425 SKUs. So, now, the per ton realization, per piece realization has very little meaning because products start at Rs.2,000 and go up to Rs.25,000 in the CERA brand, then come the "SENATOR" brand which go up to Rs.70,000 and "ISVEA" go up to Rs.3 lakhs per SKU. So, value is the best determinant because business complexity has dramatically changed in the last 10-years in Sanitaryware. And, the raw material cost in Sanitaryware continues to be very, very low. The gas prices continue to be low, energy cost continue to be low. So the bulk of the business requirements are the brand promise, the delivery of post sales services, engagement with trade partners. So that is why we always call this business a mooted business where barriers to entry have remained very, very high. None of the large cap companies have been able to enter this business because it requires 20, 25-years of building a brand promise and after sales service network. So those are the parameters on which we evaluate the Sanitaryware business.

Lakshminarayanan:

And sir last thing on the capital expenditure sir. There was some allocation towards staff colony. I just want to understand what is the cumulative allocation and where are we now on the allocation and what does it translate to in terms of either apartments or rooms like what is that broadly?

Ayush Bagla:

This was about a Rs.25, 26 crore capex undertaken in 2018 and it was completed before March 2020, and the staff and supervisory staff at both the Sanitaryware and Faucetware factories in Kadi got allocated these apartments in these buildings. So I have seen the colony, very large, very close to the factory, but number of apartments and all I can e-mail you offline.

Lakshminarayanan:

No problem sir. You are saying that capital expenditure is behind us now, there is nothing more?

Ayush Bagla:

Yes behind us now, it was a Rs.25, 26 crore project spread over two years.

Lakshminarayanan: On the tiles margin, you said you do not give it out, but just for us to understand in terms of how much of catch up can we do and how much of additional amount that can actually come in terms of profits over the next couple of years when you actually strengthen it as we go forward?

Ayush Bagla: Normal capex has been between Rs.45 crore and Rs.60 crore annually over the last five, six years. This year the number is Rs.21 crore and I can give you a split if that helps; Sanitaryware automation is about Rs.5.85 crore, Faucetware automation is Rs.4.41 crore, customer touch points is Rs.6.15 crore, the land adjacent to our Sanitaryware facility was bought for Rs.3.19 crore and logistics and IT is Rs.2.2 crore.

Moderator: Thank you. The next question is from the line of Hrishikesh Bhagat from Kotak AMC. Please go ahead.

Hrishikesh Bhagat: Firstly, when you said that you want to keep your tiles percentage from 15% to 18%, then fair to say that you are not looking at incremental any investment in JV or anywhere new JVs on tiles business also or any outsourcing partner or anything?

Ayush Bagla: You see that we have a lot of outsourcing partners. And what they tell us is that they value our off take contracts much more than they value equity. So in Milo, for instance, a year and a half ago, we put in Rs.8.5 crore as equity for 26% stake. So that equity is not as valuable to them as a 100% offtake contract. Going forward, these offtake contracts which are much more valuable to them and have zero cost for the company, that is the model that we are adopting. And part of that contract is also zero inventory. So we will keep zero inventory on the CERA balance sheet or in our plant, and direct shipping of products from our outsourcing partners to our localized warehousing across the country will take place. That model has already been implemented. So, we do not feel that there is a need to employ more capital in the tiles business at this stage. And there is enough capacity available on tap.

Hrishikesh Bhagat: Are we looking for any opportunity on exporting tiles or too early, just firstly only domestic focus?

Ayush Bagla: For us, export is not a big opportunity, but for the tile industry, it is almost a \$2 billion opportunity which the tile industry is capitalized on very well. A lot of Chinese export of tiles has been replaced by Indian tiles in Western Europe and American markets. And even the GCC countries which have been talking about anti-dumping duties, only one of them, Oman has been able to implement the anti-dumping duty against Indian tiles, all the other GCC countries continue to import a lot of tiles from India.

Hrishikesh Bhagat: I understand industry is looking. But from our perspective, are we looking at that export opportunity?

Ayush Bagla: For us, it may not make sense because first we will have to promote the CERA tiles brand in those markets. And for us, the business is too small to be able to do that.

Hrishikesh Bhagat: One last suggestion from my end. I understand we do not give segmental margins, but we are fairly open in terms of giving the segmental revenue of Sanitaryware,

Faucetware as well as tiles and other segments. It would be really great if you start incorporating this in your press release as well as in your annual report, I think that will be really great from investors perspective.

Ayush Bagla: Yes, we do that regularly. So we will be happy to incorporate it even in the investor presentation that we put on our website.

Moderator: Thank you. The next question is from the line of Ritesh Shah from Investec Capital. Please go ahead.

Ritesh Shah: How is the inventory in the channel?

Ayush Bagla: You mean our trade partners?

Ritesh Shah: Yes sir.

Ayush Bagla: See, we are billing and interaction stops post billing with the trade partners. But our sales force which meets the trade partners regularly says that demand especially for Q2 has been very strong. And then it was almost a just-in time delivery and just-in time sale of all products. So there is very little inventory with our trade partners is what we hear on anecdotal basis.

Ritesh Shah: Is our competition facing supply side issues and hence we are benefiting on volume growth, is it something which is correct?

Ayush Bagla: I think Q2 was a huge demand-led revival and previous estimates of home improvement and size of the home improvement replacement market have all had to change. So this was completely demand-led and supply was eventually caught up with demand. So I do not think supply constraints as such is the issue. It is all demand-led. And supply eventually can be ramped up, there is outsourcing, there are many other avenues, supply eventually with a lag of 15-20 days always catches up.

Ritesh Shah: Second question is on the gross margins. You explained multiple variables and you touched upon discounts and commissions, but you did not quantify anything over there? Is it possible for you to provide some color on this particular variable to understand gross margins better?

Ayush Bagla: Yes, I can give you some color on gross margins; Q2 FY'21 was 47.52 and Q2 FY'20 was 51.25.

Ritesh Shah: And sir Q1?

Ayush Bagla: H1 I can give you because Q1 was abnormal Q1. H1 was 48% versus 52.47% which incorporates the normal Q1 as well.

Ritesh Shah: Last question you did give likes on economy, medium and premium segment. Sir are we witnessing a trend in the marketplace where there is a downtrading which is happening, and to counter this, is there some bundling or any specific marketing practices that we are adopting to improve our product mix profile?

- Ayush Bagla:** You see, in any case, after the Q1 that companies had, management's and most companies are happy to take whatever sale comes their way, but the sales numbers and demand was much stronger than anticipated. But, given the fact that 70% of WIP is affordable housing, which has the highest velocity. What we are doing from the management standpoint is trying to offer bundle deals with Faucetware, Sanitaryware, wellness, tiles. So bundling of deals takes care of downtrading if it is happening. But affordable housing being the biggest theme with the highest velocity, that is where the meat of the market is.
- Ritesh Shah:** Sir that is quite an encouraging step what you indicated on bundling, it is quite a positive. Just a related data point. Is it possible for you to quantify what percentage of our sales goes through bundling strategy? That is a very encouraging measure from the management aspects.
- Ayush Bagla:** But those are done by our trade partners... see, with 70% sales being done by our trade partners, there are a lot of bundling deals that they offer consumers.
- Ritesh Shah:** Okay. It happens at the trade level, but we would not have that data from the Company level to the dealer?
- Ayush Bagla:** Company level to the dealer, also, it is a very complicated metrics of discounts, incentives, and mixture of fast moving, slow moving products, then the bundle also includes some very premium items, which you have to take with the high velocity products, is a very, very complicated metrics with too many products in the part of the bundle.
- Moderator:** Thank you. The next question is from the line of Karan Bhatelia from Asian Market Securities. Please go ahead.
- Karan Bhatelia:** Sir, how has been the growth in our touch-free products both in the Sanitaryware and faucet? We did an average of I think 6,000 units in the previous quarter. So what is the run rate as of now?
- Ayush Bagla:** 6,000 was the demand as soon as when we re-opened in the middle of Q1 and we will be selling about 1,000 to 1,200 units a month which were 100 last year, so 12x sales of touch-less products.
- Karan Bhatelia:** Organized players have added dealer, distributors in last six months, so any number that you can quantify for CERA as of now?
- Ayush Bagla:** Yes, I can tell you the dealer number changes during the last six months; as on March 2020, we had a total of 3,564 dealers, and that number became 3,631 on 30th June '20, and it became 3,670 on 30th September.
- Karan Bhatelia:** So, all these brands are now getting deeper into tier-3, tier-4 and tier-5 cities. So how is the dealer stickiness there? What is the average ticket size and how are the trade practices there, so if you can throw some light on that?
- Ayush Bagla:** So average ticket size is very granular information. The best way to look at is a dealer concentration, the top hundred dealers still account on an H1 basis 37% of

sales and top 500 dealers account for 68% of sales on H1 basis. So, sizable dealers are further expanding their footprint, that is the takeaway from dealer behavior.

Moderator: Thank you. Well, 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.

Ayush Bagla: Thank you. I would like to thank everyone for attending this call and for showing interest in CERA Sanitaryware Limited. CERA remains positive that its 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.

Before I close, on behalf of the CERA family, I warmly extend Diwali Greetings to each and every one of you and wish you all a very prosperous new year. Thank you once again for taking time to join the call and see you all next quarter.

Moderator: Thank you. On behalf of CERA Sanitaryware Limited, this concludes today's conference. Thank you for joining. You may now disconnect your lines.
