CERA Sanitaryware Limited

Q2 & H1 FY20 Earnings Conference Call Transcript
November 14, 2019

Moderator: Ladies and Gentlemen, Good day and welcome to the Cera Sanitaryware Limited earnings conference call. 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 now hand the conference over to Mr. Mayank Vaswani from CDR India. Thank you and over to you, Sir.

Mayank Vaswani: Thanks Stanford. Good Morning everyone and thank you for joining us on the Q2 and H1 of FY '20 earnings conference call for Cera Sanitaryware Limited. We have with us today the management team of Cera Sanitaryware Limited comprising Mr. Ayush Bagla – Executive Director, and Mr. Rajesh B. Shah – CFO and COO of the Company. We will begin the call with brief opening remarks from the management following which we will have the forum open for an interactive Q&A session.

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 were shared with all of you earlier and also uploaded on the stock exchange website.

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 the time to join our call. The earnings for the second quarter and for the half year were adopted by the Board of Directors yesterday, i.e, November 13, 2019. The earning documents have been released to the stock exchanges.

I am pleased to share that we have delivered a steady performance in the first half of the fiscal in the backdrop of postponing of consumption decisions.

Steps undertaken in Q2 have added 91 SKUs to product lines; has strengthened our distribution and sales network and further solidify our product segmentation. These have served us well. In addition to this, the equal focus on inventory and receivable management has further enhanced the cash balance thereby elevating our financial position.

We believe that over Rs. 200 crore of cash in the bank in our balance sheet provides us with a significant cushion in all situations.

Our robust financial position allows us to continue to reinvest into the business even during the present economic conditions. During the quarter, we added two company-owned large format stores, one in Morbi, Gujarat of 12,000 square feet and the other in Bangalore of 8,000 square feet.

Coming to our numbers; Revenue for the quarter stood at Rs. 327 crore versus Rs. 331 crore in Q2 of '18-'19, which is down by 1.1% on a Y-o-Y basis. For Q2 FY '20, 48.6% of the top line was sanitary ware, 24.4% was faucetware, tiles was 22.8%, and wellness was 4.17%. On a Y-o-Y basis, sanitary ware registered a decline of 9.3%, faucetware grew upwards by 5.47%, tiles grew by 4.64%, and wellness grew by 43.02%. EBITDA excluding other income for Q2 FY '20 was Rs. 42 crore versus Rs. 46 crore in Q2 of FY '19. The EBITDA margins for the period stood at 12.7% lower by 110 basis points. Profit after tax for Q2 FY '20 was Rs. 30 crore versus Rs. 28 crore in Q2 FY '19 registering an increase of 6.8%. EPS on a quarterly basis was 23.1% per share versus 21.6% per share on a Y-o-Y basis.

We welcome the recent corporate tax cuts announcement by the Government and we believe that this initiative will play an important role in reviving the trajectory of growth in the economy. From Cera's perspective, the Company is not availing any exemptions and as a payer of tax at full corporate pay, the decision to migrate to the new tax regime is fairly straightforward. The tax rate for FY 2020 now stands at 25.17% as against 36.14%. The reduced tax rate will lead to a lower tax outgo and is immediately accretive to PAT and ROE.

Inventory delays in Q2 FY20 were 52 days compared to 44 days in Q2 FY19. Receivable days in Q2 FY20 were 60 days versus 60 days in Q2 FY19. Payable days in Q2 was 32 days against 30 days in Q2 of FY19; therefore, net working capital days in Q2 FY20 were 80 days versus 74 days in Q2 FY19. Amidst tight liquidity conditions in the real estate industry, the Company has continued to follow prudent credit controls.

Government initiatives including the creation of a Rs. 25,000 crore fund for reviving select projects in the real estate sector has served to improve sentiment and should begin to replace in better economic growth in about two to three quarters' time.

On the whole, we believe we are well poised with a comprehensive product offering, a wide distribution network and high brand recall. There is momentum in our faucetware business and we expect to benefit from the improved industry dynamics in the tiles segment. Our recent advertising and marketing campaign have been well-received and in addition to our store network enhancement would enable us to reach more customers. We are geared up for the ongoing festive season and the seasonal uptick towards the second half of the year.

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, sir. Ladies and Gentlemen, we will now begin the question and answer session.

The first question is from the line of Sonali Salgaonkar from Jefferies. Please go ahead.

Sonali Salgaonkar: Sir, my question is broadly pertaining to the industry. Firstly, how is the demand from affordable housing doing over the past quarter, and secondly, what is CERA's market share in each of the market verticals that you are in?

Ayush Bagla: Affordable housing currently is the single largest segment of the industry's WIP and CERA has been traditionally focused at the lowest and mid-income housing for the last many decades. So to give you some color and statistics to that, the current WIP of the overall industry more than 70% is mid-income and affordable housing. Normally, we talk about affordable housing below Rs. 50 lakhs in metros and below Rs. 35 lakhs in non-metros. Our sales from Tier-3 towns with populations of 10 lakhs and below is 55% of our total sales, so a bulk of our sales are aligned in the same ratio as to the current WIP of the industry. The Tier-3 towns and below, the impact of slowdown and reduced velocity of sales is least pronounced.

Sonali Salgaonkar: Sir, secondly our market share in each of the verticals that we are in?

Ayush Bagla: Market share in sanitaryware, we are the single largest market shareholder in sanitaryware with about 21%-22% of the overall organized market. In faucetware, out of the total market size, we estimate that 60% is the organized market and we have about 6%-7% market share of the organized market, but a 10% incremental market share, so industry is growing at Rs. 700 crore in the faucetware business and last year we grew by Rs. 70 crore and this year we will wait for the full year to make a comment on incremental market share. And in the tiles business of course it is a Rs. 28,000 crore domestic industry of which our sales are less than Rs. 325 crore, so it is a negligible market share.

Sonali Salgaonkar: Sir, lastly our distribution touch points that we stand with right now and also our SKU count?

Ayush Bagla: Our SKUs in sanitaryware after the enhancements of Q1 and Q2 are 360, in faucetware are 882, and in tiles are 3,000.

Sonali Salgaonkar: Sir, our distribution, dealers and retailers?

Ayush Bagla: Our total dealers including sanitaryware, faucetware, and tiles are 3,289; an increase of 13% since March 2019. Our total retailers are 11,306, so total dealer plus retailer is 14,595.

Moderator: Thank you. The next question is from the line of Omkar Kulkarni from Individual Investor. Please go ahead.

Omkar Kulkarni: You said that the recent announcement by the Government to bring Rs. 25,000 crore fund would help in the recovery in the next two to three quarters. So how do you think it will materially play out, what is the management thinking about that and how it will help CERA in particular?

Ayush Bagla: CERA for its sanitaryware business and faucet business gets involved in the project at the ultimate stage between three and six months before the handover of the apartment block to a end consumer. By that time, the developer has already dealt with all the issues pertaining to land, zoning, sanctions, approvals, construction, financial closure; so we come in at a stage when a developer has amounted all those obstacles. But we also find that lot of projects are stuck at the last mile for want of Rs. 30 - Rs. 50 - Rs.100 crore and those project's WIP is very, very large. This fund is created precisely for that purpose, so we believe that those projects which were very close to handover, but did not get completed, those will suddenly find a willing backer in this particular fund and that particular market is our addressable market. So there are a lot of projects of mid-level developers and smaller developers which are stuck and i.e where we feel our demand will come from. So Rs. 25,000 crore I was told will immediately impact almost 1,600 to 2,000 projects.

Omkar Kulkarni: Okay so you expect the recovery to be in the next two to three quarters; so which mean in the remaining of the year you expect similar kind of performance which you have delivered in Q2 or like you expect the sales and EBITDA to pick up because of the festive season and all?

Ayush Bagla: See traditionally, Q3 and Q4 have always had a larger share of revenues and consequently EBITDA and PAT, if you look at our historical performance. So we feel that this year should be similar. There are lot of expectations from H2, but given the current economic conditions till they actually take place, it may not be most prudent to talk about it now.

Omkar Kulkarni: Like so far how has been the trend?

Ayush Bagla: Normally about 40% of sales come in Q1 and Q2 and 60% in Q3 and Q4.

Omkar Kulkarni: I am talking about how has been the trend in the festive season, as the festive season has already passed how has been the trend?

Ayush Bagla: Those are numbers of October and November, which we will be able to only discuss once the Q3 numbers are formalized.

Omkar Kulkarni: I am not asking you about specific numbers; just how has been the trend so far?

Ayush Bagla: It has been steady.

Omkar Kulkarni: Second thing is that you have mentioned that you have surplus cash on the books around Rs. 200 crore. So what has been the CAPEX plan so far, I mean what will be the CAPEX plan and it is not significant CAPEX than how do you plan to utilize the cash?

Ayush Bagla: For the year, we have a CAPEX plan of Rs. 56 crore, if you want the breakup I have a detailed breakup in front of me. Sanitaryware automation is Rs. 20 crore, faucetware automation is Rs. 9 crore, customer touch point is Rs. 6 crore, completion of the staff colony at the plant is Rs. 17 crore, and logistics and IT is Rs. 4 crore, total of Rs. 56 crore of which in the Q1 and Q2 we completed Rs. 19.56

crore and I can give you a breakup of that as well. Of Rs. 19.56 crore, Rs. 4.35 was sanitaryware automation, Rs. 2.64 was faucetware automation, Rs. 4.09 was customer touch points, Rs. 5.91 was staff colony at the plant, and Rs. 2.57 was logistics and IT. So the balance about Rs. 37 crore will be spent in Q3 and Q4, and this number of Rs. 55 to Rs. 70 crore has been consistent for the last four to five years. So now that our annual cash flow has hit Rs. 140 crore annually, you will find that this number is about 40% of our annual cash flow.

Omkar Kulkarni: Apart from CAPEX, how do you plan to utilize it?

Ayush Bagla: Currently, there are no inorganic plans, so we prefer to grow organically and in the faucetware business in case there is a need for additional capacity, we plan to increase our outsourcing of low-end products rather than going in for an additional CAPEX on the plant, and all the CAPEX that has been incurred in the plant level for the last three to four years has been more towards the automation and reduction of the human interface in the manufacturing process rather than increasing the number of products or increasing the number of quantity of products.

Moderator: Thank you. The next question is from the line of Archana Gude from IDBI Capital. Please go ahead.

Archana Gude: Sir, how we should read this de-growth in the sanitaryware segment in this quarter and what is the outlook going forward?

Ayush Bagla: That is reflection of what is happening in the marketplace when we speak to our sales force they tell us that in most cases, the end-consumer behavior is slightly muted, but payment from the retailer to the dealer in many cases have been delayed, and therefore, not as consistent as past trends, so dealers are now working on a just-in-time inventory. They are not risking their own capital when the retailer is not paying them on time, so these two to three factors combined has been the only reason why sanitaryware top line has not grown. As far as the future is concerned, we have expectations from H2 and then of course from the medium-term lot of expectations, we expect to go back to our normal growth trajectory, but we will wait for those things to pan out.

Archana Gude: Sir, but is it safe to assume that it has nothing to do with the industry peers, so we have not lost any share to them, is it safe to assume that?

Ayush Bagla: You see overall if you compare CERA's products to any of the industry peers, there is a huge product and technological brand leadership. As far as statistics on market share is concerned given that there is no third-party agency monitoring this, each manufacturer is free to make deductions on their market share, but we currently feel that there has been no shift in market share and our after sales service etc. those other factors have contributed in us retaining our market share.

Archana Gude: Sir, of the three main segments what we have, which segment you feel should contribute the highest to the sales or top line going forward, not in the value terms but in terms of percentage growth?

Ayush Bagla: In percentage of growth, if you see the trends of the last 18 months faucetware was the outstanding leader, but we believe that faucetware, sanitaryware, and wellness combined are high margin products and they will continue to be 80% of our or 78% of our topline, and sanitaryware on a standalone basis will be always close to 50% of our topline.

Moderator: Thank you. The next question is from the line of Gautam Trivedi from Nepean Capital. Please go ahead.

Gautam Trivedi: I have two questions, first is with respect to increased competition and what we have seen over the last 12 to 18 months is whether it is Kajaria, whether it is Somany Ceramics or HSIL, all of you guys are getting to each other's businesses and in a sense others have gone into sanitaryware, others have launched faucets, others have launched of course got into the tiles business, has that been also impacting your top line and margins as a result?

Ayush Bagla: We found that it is easy to get into lower margin businesses, which are more commoditized in nature if you are a leader in high margin businesses, but it is almost impossible to do it the other way round, so tiles companies wanting to enter faucets and sanitaryware have not been very successful, but sanitaryware and faucets companies wanting to enter tiles or any other of the allied businesses have been relatively more successful because there is a brand recall and history of customer promise which has been delivered through after-sales service etc. and reliability. So some of the names you mentioned which are predominantly tiles companies, if you breakup their sanitaryware numbers, they will not be very significant, but if you look at, for example, CERA which is only a 12 year player in faucetware, we have 10% incremental market share.

Gautam Trivedi: The other question is with respect to this whole post GST situation and a lot of these talks including yours had run up in the hope and rightly so that post GST a lot of the unorganized players would either merge or come clean or basically shutdown. How much of that have you actually seen and how much of that is still a drag on your business especially in the Tier-3 towns where as you said 55% of your revenues come from there and in affordable housing segment if you are not paying GST, not paying taxes including income tax, are you able to still compete with your unorganized players?

Ayush Bagla: GST compliance in the sanitaryware and faucetware business, we have found that to be almost 100%, not just with us but even other companies. The GST evasion would only happen in the tiles business, where tiles companies in the unorganized sector had a 35% advantage over organized players with GST and coal gasification, so both those suddenly disappeared and after elections in April-May of 2019, GST enforcement has been particularly strict so now in our opinion tiles is now also on a level playing field, sanitaryware and faucetware was always on a level playing field.

Gautam Trivedi: So you are saying the sanitaryware and faucets business, there is not much of an unorganized sector as much as there is in the tiles business?

Ayush Bagla: Even the unorganized sector is fully compliant is what we see in the market place unlike the tiles business, and the tiles pricing however will return once the inventory overhang which was built before the NGT order of 5th March of this year can fully absorbed in the market place which we feel will happen in the next three to six months.

Gautam Trivedi: Can I have a follow up question; you mentioned you opened a 12,000 square feet store in Morbi, what is the logic behind opening it in Morbi versus let us say a bigger town?

Ayush Bagla: Because lot of corporate customers nationwide visit Morbi to try and negotiate good tiles deal, so we want to show them not only our tiles, but the bulk of this 12,000 square feet is dedicated towards sanitaryware and faucetware. So we want to showcase corporate customers and architects our ability to sell at Morbi and of course Ahmedabad we have a very larger setup, Bombay we have a very large setup, they are lot of importers from GCC and far East who come to Morbi for import orders, so they are free to choose and visit as many tiles companies in Morbi, but we want to showcase to them our sanitaryware and faucets.

Moderator: Thank you. The next question is from the line of Vikrant Kashyap from Kedia Securities. Please go ahead.

Vikrant Kashyap: Sir, we understand that given the economic conditions, the industry and we are not able to grow our top line, but given the push from Government and recent activity, when do we see traction coming back in our top line growth?

Ayush Bagla: Overall top line if you see there is a difference of Rs. 3 crore which is 1%, so given whatever is happening in the outside environment, this flat performance with no changes in receivable days is also a commendable performance. But yes, you are correct, real traction and efficacy of products are often tested with only top line growth and we expect that to happen both in H2 and then in the medium term. So till then we are concentrating on all the other factors, so to give you example 91 products were added only in Q2, then credit controls, credit controls if you look at the commentary of CERA Sanitaryware, we have been talking about it for last six to seven quarters before it became a factor in the industry. Now, everyone is only talking about credit controls, so we have been very careful on all those fronts, low CAPEX, very, very strong credit controls, and keep on plugging any gaps in the portfolio.

Vikrant Kashyap: We admire that your focus on being cost optimization, credit control had led to stable growth in EBITDA and bottom line. So do we expect from FY '21 onwards, do we have come back to our previous growth labels, do you have any visibility like that?

Ayush Bagla: It is tough to say for the Company the size of CERA where top line is Rs. 1,350 crore plus GST the top line is Rs. 1,550, it is tough to give a number or any prediction going forward. We will wait for those things to pan out, I mean they are too many moving parts in the external environment like credit flows, etc., so we will wait for things to pan out.

Vikrant Kashyap: One last question, do we have any plans to add new product line to our business?

Ayush Bagla: Other than sanitaryware, faucetware, wellness, and tiles, there is no other plan to add any new businesses. We have a pilot water heater business which is a very tiny business, where we do not sell through electrical or white goods shops, we just sell them through our sanitaryware dealer and we have a small pilot in Kerala on the kitchen's business. So those are at pilot experimental stage where we do not have any manufacturing, we simply import the products from Italy and we sell them in India, we get our extended credit from our vendor and we take advance payments from our clients, so it is a negative working capital business with no capital involvement at the manufacturing level.

Moderator: Thank you. The next question is from the line of Achal Lohade from JM Financial. Please go ahead.

Achal Lohade: First could you please help us with the outsourcing mix for each of the segment, sir?

Ayush Bagla: Sanitaryware manufacturing was 46.47% and outsourcing was 53.53%, faucetware manufacturing was 45.04% and outsourcing was 54.96%, and tiles and wellness were 100% outsourced.

Achal Lohade: If you could also help us with the capacity utilization of sanitaryware and faucet and tiles?

Ayush Bagla: Sanitaryware, our own plant had a capacity utilization of 83% and our own plant in faucetware had a capacity utilization of 77%.

Achal Lohade: Tiles through the subsidiary?

Ayush Bagla: Tiles is both to our JVs and they are about six to seven vendors.

Achal Lohade: Second was with respect to in the first quarter you had indicated a 14%-15% volume growth and 14% to 15% kind of a margin range, just thought of checking, would you be reviving this number?

Ayush Bagla: On the back of a stellar Q4, we said that based on even higher installed base, we can add between Rs. 150 to Rs. 200 crore of top line each year going forward, but obviously things have turned and that is not happening, so this was a wish list more than any kind of guidance. I have always maintained that Company is too small to be able to issue any predictable and accurate guidance. So because of the number of moving parts, we will wait for things to take place and we continue to do what we do; i.e invests in product leadership, customer touch points, continue to enhance our portfolio, so none of those activities have changed in any way.

Achal Lohade: But I know you would not like to give a particular guidance, but given the way H1 has panned out and what you are seeing on the ground especially with respect to the Government measures and all, is it fair to say that for the year we could be a modest positive growth in terms of revenue?

Ayush Bagla: Well, that is the expectation from H2.

Achal Lohade: What about margins, because we have seen margins have come off fairly sharply in the quarter, obviously it is a function of product mix but given the expectations what we have, is it fair to say that margins could be at best the same of last year or it could be even lower than that?

Ayush Bagla: See margins have of course suffered and one of the reasons for that is tiles instead of 19.8% of sales it is 22.4% of sales. On the product side, I will give you some color to our product pricing, we review our pricing in sanitaryware every March and October. Instead of March, we had a price increase in May this year which was effective 2.5% increase across all products. So the October review will now instead of October may be happen in December or January, so there is no pricing pressure on the sanitaryware and faucetware businesses. Faucetware pricing is much more dynamic and linked to brass pricing which is 55% of MRP in the faucetware.

Achal Lohade: In terms of the, one of the comments you made was the retailer is keeping less inventory and he is buying what is just required. Is it the case with the dealer as well you think, have you seen a material or meaningful reduction in terms of the inventories in the channel?

Ayush Bagla: The dealer is keeping less inventories, the retailer is delaying payments through dealer and as a result the dealer is keeping less inventory; in any case I will give you our distribution format. What we have done is we have very, very large format depots which are rented by the Company. These are large format warehouses, 17 across the country. So the dealer does not have to keep inventory even at his godowns and sometimes they can lift material from the company-owned depots twice or thrice a day and send them directly to a retailer, so in any case for the last many years our efforts have been to make sure that the dealer does not have to deploy too much capital, but the problem is not so much at the dealer end, the problem is the cash flow from the retailer to the dealer end.

Achal Lohade: If you could give the mix in terms of the retail and institutional?

Ayush Bagla: That 72 retail and 28 institutional that number remains.

Achal Lohade: Would it be fair to say that even out of this 72%, some will go to the projects with the dealers or?

Ayush Bagla: Yes, especially in smaller towns where the Company may not have its own sales force that is the case and in fact that is the most profitable part of the business because discounting does not take place. Discounting only takes place when you are talking to large developers and when the Company is trying to bag a large order directly. So dealer may be willing to forego his part of the income, but the Company does not get involved in the pricing negotiations when the sales are through a dealer.

Achal Lohade: How much of this 72% you think could be, I know it could be a guess, but best case with respect to institutional?

Ayush Bagla: There is no way of capturing that data because our data is limited at the dealer end.

Achal Lohade: Just last question, with respect to tiles, we have seen a very, very sluggish growth for last few quarters now. I understand for sanitaryware given the large base, but relatively tiles is a very small business for us as well as compared to the industry. So what is happening with tiles, are we going slow deliberately or we have reached the mark where the incremental growth is not easy to come through and also with respect to the value-added tiles what has been the mix for the quarter?

Ayush Bagla: Both, if you compare on a Q-o-Q basis and H1 to H1 basis, the tiles business has grown. So we are trying to keep whatever margins there are in tiles intact, that is, number one. Second, most interesting aspect is soluble salt as a percentage of total tiles sales is only 20. So earlier maybe two years ago that number was much, much higher and 80% is value-added product including GVT, DC, outdoor tiles, porcelain, and wall. One more initiative by the Company is Company has introduced very large format slabs, 4 x 4, 6 x 4, 8 x 4. The pricing of that is sometimes 3.5 times the regular 2 x 2 GVT.

Achal Lohade: What would be the contribution of these large size slabs?

Ayush Bagla: These have just been launched about a month ago and the price of that market is very, very niche.

Moderator: Thank you. The next question is from the line of Hiral Desai from Anived PMS. Please go ahead.

Hiral Desai: Ayush when we interact with the large mortgage financiers who operate across the country, one thing is very apparent that the real estate slowdown is far more pronounced in the large cities and I think you alluded to that earlier in the call where you said, Tier-3 is almost 55% of your revenues. So would it be possible to give us, first the split between let us say large cities of Tier-2 and Tier-3 the entire breakup and how has that grown in FY '19 and first half of FY '20. I am just trying to understand if the Tier-2, Tier-3 pieces are growing much faster than the overall Company average and the large cities are actually pulling the average down meaningfully?

Ayush Bagla: In terms of percentage of growth and volume, yes you are completely correct that the Tier-3 market growth is much larger than Tier-1 and Tier-2.

Hiral Desai: That would be purely because of distribution or just the fact that the underlying momentum there is much better as compared to the larger cities?

Ayush Bagla: The bulk of these apartment projects in Tier-3 towns are G plus 4, G plus 7 which are getting completed in less than 12 months with an approval process of less than three to six months. So the project life-cycle is so small, they are not looking for large NBFC funding, they are still end-consumer funded. So we find that the whole project cycle is very straightforward and very simple. They are also willing to buy high-end products, because they are not having to spend so much on land and approvals.

Hiral Desai: That was the other question that I had, would the realizations be very different in let us say Tier-3 versus the large cities, what would be the magnitude of differential?

Ayush Bagla: I will give you one more number, I was just given this number by one economist in of the private sector Banks, he said the total credit to SME and MSME between September '17 to March '18 was Rs. 7.6 lakh crore and the same corresponding number from September '18 to March '19 was Rs. 1.5 lakh crore. So now the magnitude of the problem or crunch is visible just with that number.

Hiral Desai: I was trying to understand more in terms of your realization in Tier-3. So let us say for sanitaryware for example like what would be the average realization in Tier-3 versus let us say large cities?

Ayush Bagla: See that of course is a number of pieces divided by the revenues of Tier-3 that is not an accurate representation because there are so many SKUs, there is so much interplay between SKUs and between regions is such a difference, for example, in the Mumbai market only wall-hung WCs are sold because of lack of space. In the southern Indian market, floor-standing WCs are sold because the sizes of the toilets are much larger. Then you know there is interplay between one piece, two piece, there are just too many permutations possible to sit and derive something meaningful from that data.

Hiral Desai: Lastly let us say a city like Bombay, how many dealers and retailers would we have, just to understand what is the coverage?

Ayush Bagla: We would have between five to seven dealers and each would have between 10 to 50 retailers in a city like Bombay, but once you move to Dombivli, Thane, Mira Road then the situation completely changes for a Company like CERA because our market share in Thane, Dombivli, Mira Road would be seven to eight times our market share in Mumbai.

Hiral Desai: Why would that be the case?

Ayush Bagla: Because of the acceptance of our products in mid-income housing.

Moderator: Thank you. The next question is from the line of Akash Vora from Praj Financials. Please go ahead.

Aksh Vora: Just wanted to understand your analogy on growth for medium-to longer-term perspective say three to four years or four to five years?

Ayush Bagla: It is difficult to give a number; in the past we have grown 12% to 15% on top line and 17% plus on EBITDA and PAT level that was on a smaller base. On a higher base, if you put an absolute number anything above Rs. 100 crore top line addition and about Rs. 15 crore of EBITDA addition would be a great number to have; but at this point we will just be careful in making any kind of prediction on that about the future.

Aksh Vora: I am not asking for any predictions, just wanted to understand what is the growth we have seen in last three to four years, is that the new normal the Company would be looking to grow in next couple of years or is just that another short-term phenomena we are seeking that might end probably say six to 12 months and we might see a bigger growth and we might see the past growth coming back kind of number?

Ayush Bagla: See in the last six years, our top line growth CAGR was 15% and bottom line was 17%.

Aksh Vora: I am saying over the last three to four years and I am just saying because I understand the markets are also…

Ayush Bagla: It is 12% to 15% on top line and 15% to 17% on bottom line. Going forward, I will tell you what is going to be most important is having a very comprehensive product portfolio and investing in the brand, investing in after sales service, and investing in customer touch point. So now I will give you further details on that; so far the Company had three tiers of customer touch points. The first was company-owned, company-managed, large format, so we had nine of those across the country. Now, we have 10 across the country, 7,000 to 14,000 square feet which are experience centres, company-owned and company-managed where developers, architects, and consumers come in and compare products and then of course they are put onto a dealer in their respective geography. Below that the next Tier was 140 dealer owned customer experience centres which were completely sales oriented. These were average of 1,000 square feet, largest one being 7,000 square feet. Then the third tier was 2,700 of retailer owned display centres, so all these three are increasing and now we have also added a hybrid model where the Company is going to pay for certain fit outs of our dealers who are growing at an exponential level, so we are now trying to align the design of a dealer's showroom with the company-owned, company-managed design, so certain fit outs, placement of products, positioning, using big data to identify which products should be displayed though that is the hybrid model which has been introduced this year. So we believe that these are the most important aspects for a Company to be able to encash or monetize the future growth that is happening whether it is going to happen three months, four months or six months from now, and yes of course we would like to return to our original top line growth of 15% and bottom line growth of 17%.

Aksh Vora: Also just on the hybrid model you mentioned that we would be implying it in only in specific geographical areas or wherever the data sees like the big growth is coming, we will be implying, like we will be restricting to Tier-1 or in Tier-3 also we will be going further?

Ayush Bagla: We are currently starting from two to three states, but it will be largely data driven, those geographies which are suddenly very promising and those dealers which have performed well and one push on the display side can dramatically change the numbers, so those will be identified and have been identified and this program is going to be rolled out.

Aksh Vora: And also we will be channel partners in the entire inventory or anything specific of those dealers or it is just, can you just elaborate how would be the tie up with the dealers?

Ayush Bagla: Currently, we have two sources of channel financing, one private sector and one public sector Bank, which takes data from our performance of the dealer, takes collateral from the dealer, and then provides the high percentage of the invoice value that the Company has built the dealer, so current limits on combined of those two lenders is about Rs. 150 crore, current usage of that is around Rs. 50 crore.

Aksh Vora: Sir, another part, another aspect on sanitaryware business; are we seeing the market for us being saturated to not to grow about high probably in double digits or maintain the same growth in low single digits or it is just a demand for sector that has not been in our favor and it might turn out soon that the demand will come back soon, so the numbers might change?

Ayush Bagla: In Q1, we found that the consumers had been postponing their decisions because of floods and elections etc. We also had after Q1 a superb July, but in August again given the floods in Kerala and NCR etc. we did not have such a great August; so we believe that given these one-off impacts Q1 and Q2 have been flat, but without that we feel that the markets will come back, credit flow will improve and consumer sentiment and even within the retailer and dealer dynamics cash flow will improve. So given these factors it is a matter of time when the tide turns.

Moderator: Thank you. The next question is from the line of Manish Poddar from Nippon India. Please go ahead.

Manish Poddar: Could you highlight how much is the price increase that you have taken, was there any price increase taken now in October?

Ayush Bagla: Yeah, we normally review our pricing strategies every March, so this March '19 pricing increase was implemented in May of two and a half**(Inaudible)** across sanitaryware products.

Manish Poddar: Have we taken any further price…?

Ayush Bagla: No, because it was May, the October review will probably happen in December - January.

Manish Poddar: What according to you is now let us say the industry growth rate in the first half in sanitary?

Ayush Bagla: We do not have any authentic data and we have not even made our own calculations on that front. So we normally get to know at the end of the year about the behavior of industry size, growth, and other demographics.

Manish Poddar: But would you all have maintained share, or would you all have lost share because if I look at it your volume decline is about 12 odd percent then and despite you are doing new products, distribution expansion; has the industry declined at 15% or 20% kind of a number?

Ayush Bagla: Again, this is a Company which has been very, very financially conservative. So there are a lot of new entrants always trying to push sales and selling to projects on extended credit so they might report short-term numbers, but in the long term it all evens out. So you will have to take those factors into consideration but at the same time then I will not be able to give you an authentic number of industry growth.

Manish Poddar: What is our let us say go to market order for this kitchenware segment and what is it let us say, are we making any material revenues right now?

Ayush Bagla: The only investment we have made so far is allocated some space in our Cochin Experience Center to put up certain available formats for the kitchen. We have a vendor based in Italy who has given us extended credits for kitchens that are customized at the consumer-end measurements into Italy and then kitchen arrives in modular form to India, we install it and we get paid of course in advance, so it is a negative working capital business, no manufacturing investment, no current advertising investment other than participation in trade exhibitions etc. So meaningful revenues will start may be in a year and then we will be best positioned to take a call on how to continue that business further.

Manish Poddar: How much would be let us say, what are the margins one clocked and how is generally the ramp up, let us say Rs.50 crore - Rs.100 crore sales, what sort of margins does the company clock?

Ayush Bagla: We have started this 'Made in Italy' kitchens at the bottom of the pyramid starting from less than Rs. 2.5 lakhs for a completed kitchen without of course the white goods which are again third-party sourced, right up to Rs. 25-30 lakhs and at that end of course, at the top end it is a very crowded market. At the bottom end, you will find lot of unorganized players etc., but a 'Made in Italy' kitchen at that price is not available, so that is the reason we got into the business. But to give you any kind of numbers going forward it is tough to say, it is purely a pilot at this stage.

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

Kunal Shah: Just wanted to understand the margin trajectory for the Company considering three-four factors, one is obviously the competition that is coming up, second is how should one look at margin one considers manufacturing and outsourcing and also the margin trajectory considering the three different divisions that we are in, that is the first question. And the second question is obviously about the kitchen ware segment and the water-heater segment, how big they are and what is the thought process behind entering into it and how should one read it?

Ayush Bagla: The outsource business if you look at those companies who have been successful in this industry you will find all of them follow a hybrid model, so no Company has been successful either fully outsourcing or fully making in-house. Now, the way our sanitaryware and faucetware business work, is each year we identify a list of products which are technologically easy to make and can be outsourced and those products which are technologically difficult to make with difficult design are made in our own factory. So the cost of outsourcing, of course there is a saving on costs, but at the same time there is a limitation of those vendors and their technological capabilities even though we have our QC teams available at the vendor site whether Italy, Turkey, China, or India. So we have large QC teams on-site in each of those locations. We have IT contracts with these vendors that our designs are exclusive only to us, so that is as far as protection with the vendors is concerned. But each year the list that is outsourced changes a lot and yes there is saving if we choose to go to a vendor for a low-cost or low-value item versus making it ourselves in our own factory.

Kunal Shah: How should one look at the margin trajectory going ahead with increased competition as well?

Ayush Bagla: Between 14% to 15% has been the EBITDA margin consistently.

Kunal Shah: So we would be able to sustain that going ahead as well, is it fair to understand that?

Ayush Bagla: That is the aim.

Kunal Shah: The thought process behind entering the water-heater segment and the kitchen ware segment, if you could throw some light and how serious is that an opportunity or how serious are we considering those two segments because they are at a pilot stage now?

Ayush Bagla: The water-heater segment was a demand by our dealers and retailers who had to turn away customers to other brands when customers were asking for an integrated CERA bathroom, that is the reason we chose a vendor where again we would not have to put up any manufacturing capacity, we would buy heaters from a vendor and display them only at our retailers and dealers end, and there would be no advertising other than point-of-sale advertising, so that is what we have done over the last six to eight months. Again, as and when there is some meaningful numbers in that business, we will be able to take a call whether to continue and in what form should the business continue and that same model that was fully replicated in the kitchen business.

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

Hrishikesh Bhagat: Sir, just wanted to understand this slowdown is largely because of we are also conservative in pushing the product in light of this weakness in the credit liquidity or is it general industry slowdown also?

Ayush Bagla: We have always been very well poised to take advantage of all market opportunities, for example, water-saving products, now water-saving products is not even a niche or a segment in the sanitaryware business, so we created that niche a few years ago reducing our 8 Litre flush to 3.2 Litres and half flush of 4 Litres to 2.2 Litres. Now, a lot of our products have applied for European CE certification, a lot of the water-saving products have got two and three stars, European CE water-saving certification and that is one of the ways to market these products in India where large townships have 10,000 people, and therefore, ability to save 3 to 4 lakh Litres of water per day. So as far as taking advantage of opportunities that are currently present or may present themselves in the future, we have always done that and conservatism only restricts itself to balance sheet conservatism, there is absolutely no conservatism in product or marketplace behavior.

Hrishikesh Bhagat: Secondly, will it be possible for you to share the contribution of various brands say Senator, CERA and ISVEA?

Ayush Bagla: Senator, ISVEA, and JEET combined are less than Rs. 50 crore annually.

Hrishikesh Bhagat: Last question is how is working capital in tiles segment different than your sanitaryware or faucet?

Ayush Bagla: The receivable days profile in tiles is completely different than sanitaryware. So if you remove the receivable days of tiles then we further reduce by 16 days on our receivable days, if you remove the tiles business from the overall receivables is further reduced by 16 days.

Moderator: Thank you. The next question is from the line of Anuj Sehgal from Manas Capital. Please go ahead.

Anuj Sehgal: On the sanitaryware business, in the first quarter, your revenue was down 12.7% and in the second quarter it is down 9% and you said it is difficult to gauge at what rate the industry is growing and earlier you also mentioned about competition from some of the tile makers and you mentioned that it is difficult for them to make inroads, but we also have competition from Jaquar which is a large player in the faucet industry, who we have heard has made significant progress in the sanitaryware business. So how do you see competition from them and their ability to become a meaningful player in that segment?

Ayush Bagla: We will not be able to make any kind of comment about specific companies, but all the top four companies in sanitaryware and faucetware are making lot of efforts in improving their product portfolio, distribution, and we except that is a healthy competition which keeps everybody on their toes and we are doing the same thing. So it is impossible for a tile Company to move upwards to faucetware and sanitaryware, but possible for sanitaryware and faucet ware companies to move within each other segment and also downwards to tiles. So you find that natural behavior of all the companies. And yes, a lot of companies have done well but you should also look at their positive cash flow. So lot of companies that you are speaking about have good cash flow but their CAPEX needs are equal to their annual cash flow.

Moderator: Thank you. The next question is from the line of Sonia Lalwani from Purnartha Investment Advisors. Please go ahead.

Sonia Lalwani: Sir, I have two questions, one, could you just give us the breakup of the expenses into fixed and variables, I mean what percentage would be fixed and what percentage would be variables, and how has that changed from FY19?

Ayush Bagla: This is a very large matrix, but I can give you some color on raw material behavior and some of those aspects; for example, in the sanitaryware business, raw material constitutes 17% of total cost of production, in the faucetware business raw material constitutes 54% of total cost of production. Labor constitutes about 14.9% of total cost of production in combined sanitaryware and faucetware business, logistics and freight is about 7%, and gas costs are about 2%.

Sonia Lalwani: Sir, second question would be on the geographical front, could you give us a breakup between East, West, North, and South and how these regions are panning out since last 18 months, if that could be possible to give?

Ayush Bagla: I will give you some more color more than just geographical breakup, our top 100 dealers account for 37% of sales, our top 500 dealers account for 67% of sales, and we have added 22% of new dealers in five years, we have added 34% new retailers in five years, and sales from these new dealers added in five years is 10% of top line. Now, coming to geographical breakup, North is 25%, East is 9%, West is 22%, and South is 44%.

Sonia Lalwani: Sir, has this proportion changed from FY '19 or FY '18?

Ayush Bagla: This is the number of FY '19 that I have just given you.

Sonia Lalwani: In the upcoming quarters, do you feel this thing changing?

Ayush Bagla: We will give you again the same breakup at the end of FY '20, we expect the numbers to be similar.

Sonia Lalwani: Which region would be growing fast as per what you are seeing in the market, what you are seeing on the ground?

Ayush Bagla: South is a buyer of high margin products, so that is why we have always concentrated there, and we found a lot of success there.

Sonia Lalwani: Sir, on the revenue front should we expect flat revenue on a Y-o-Y basis in the second half as well?

Ayush Bagla: We have a lot of expectations from H2, we expect lot of our activities undertaken over the last one year to one-and-a-half year to bear out in H2 with a little aid of the market of course, so we are expecting some growth, but we will wait for that to take place.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I now hand the conference over to the management for closing comments.

Ayush Bagla: Thank you for joining our call. We are well poised for an expected recovery in the second half of the fiscal. The ongoing festive season has been encouraging as well. For any further interaction, please feel free to reach out to us or to CDR India, we look forward to interacting again next quarter. Thank you very much.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of CERA Sanitaryware Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.