CERA Sanitaryware Limited

Q1 FY22 Earnings Conference Call Transcript

August 06, 2021

Moderator: Good morning ladies and gentlemen, welcome to the Q1 FY22 earnings conference call of Cera Sanitaryware Limited. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Mayank Vaswani of CDR India. Thank you and over to you sir.

Mayank Vaswani: Thank you, Lizzan. Good morning, everyone and thank you for joining us on the earnings call for Cera Sanitaryware Limited for Q1 FY22, the earnings of which were announced yesterday. We have with us today, the management team comprising Mr. Ayush Bagla - Executive Director, Mr. Rajesh B. Shah - CFO and CEO of the Company, and Mr. Mahesh Taparia - the Deputy CFO.

We will start with brief opening remarks from the management, following which we will open the call for Q&A. Kindly note the disclaimer before we begin the prepared remarks. Some of the statements made in today's conference call may be forward-looking in nature, and a detailed note in this regard is contained in the results documents that have been shared with all of you earlier.

I will now turn the call over to Mr. Ayush Bagla for his opening remarks.

Ayush Bagla: Thank you, Mayank. Good morning everyone and thank you for taking time to join our call. The earnings for the first quarter of the financial year 2021-22 were adopted by the Board of Directors yesterday 5th August 2021. The earnings documents have been released to the stock exchanges.

During Q1 FY22, India witnessed the second wave of the pandemic. While the country had witnessed a national lockdown at the time of the first wave, this time around there were phase-wise and region-specific lockdown which did not disrupt operations at our manufacturing facilities, but had an impact on inter-state transport and market closures. Due to the high severity of the second wave, the Company witnessed a drop in volumes and consequently in its revenues. This, we believe, is more in the nature of deferred purchase decisions which will translate into sales as customers return to purchase activity from mid-June onwards.

While in the case of the first wave, it was the metro cities and urban centers which were more severely affected, this time the impact has been visible and equally severe in non-metros and smaller cities and towns as well as in rural areas. As most of you are aware, CERA which enjoys between 55% to 60% of topline from tier-3 cities and beyond, witnessed material pandemic impact in these areas which is reflected in its revenue.

On the production side, CERA has managed to operate their plants at fairly high-capacity utilization this quarter. Capacity utilization of the sanitaryware plant was 88% and of the faucetware plant was 72% after a fairly underwhelming year in FY21. This was largely made possible as the Company stringently followed the recommended guidelines mandated by local authorities. Best practices in terms of social distancing, masking as well as sanitization protocols were followed. The Company has also undertaken efforts to vaccinate its eligible shop floor employees and their families.

The employees and team at CERA have displayed exemplary commitment and dedication to help us counter the challenges caused by the second wave of the pandemic.

As some of you may recall, we had faced one-off disruption in our plant operations during Q3FY21, and it took us some days in Q4FY21 as well to a stabilize production. At that time, we had leveraged our outsourcing arrangements to cater to the ongoing demand. During FY21 to tackle the on-ground challenges due to reduced availability of product, CERA's strategy to fulfill the ongoing demand for its products using agile infrastructure, a mix of in-house and outsourced facilities worked. These initiatives proved highly beneficial in the backdrop of the partial disruption as the Company was able to increase its volumes from its vendors to cater to the improved demand. The normal percentage of outsourcing in sanitaryware is 50% to 55%, which was 55% this quarter, after increasing to 77% in Q3 during FY20-21. In faucetware, the normal percentage of outsourcing is 50% to 55%, which was 55% this quarter after rising to 59% over the last two quarters. Production has stabilized this quarter and own manufacturing is once again contributing to the desired ratio, enabling us to replenish stocks of high end and complex products.

Working capital had contracted during the last fiscal from Rs. 341 crore to Rs. 234 crore, releasing Rs. 107 crore of cash in the absence of all around availability of products and channel inventory remaining dry. This quarter, with the increased utilization at our manufacturing plants and the responsiveness by vendors in the face of the second wave, we have been able to replenish the channel inventory.

We have established localized warehouses across locations to rapidly serve the markets and efficiently manage finished goods inventory. This is serving us well as we drive a re-stocking of the pipeline. As a result, we expect our capital deployed in inventory to rise requiring an increase in working capital this fiscal. Given the adequate cash reserves for Rs. 433 crore on 30th June 2021, we expect that during the year portion of the available cash can be used in increasing working capital, and more specifically in increasing inventory days. Getting products to market and product availability is a high priority for the Company as markets remained strong.

Since August 2020, demand has been very robust on the back of completely redefined elasticity of demand, reduced interest rates and reduced monthly home loan payments. The sector has witnessed record registrations in Maharashtra and many other states in the last 12 months, barring a brief pause during the second wave. Since July 2021, the overall demand has returned to a fairly positive trajectory similar to the one between August 2020 to March 2021. The sales numbers of July 2021 bear out this phenomena.

On the other parts of working capital, there is a concerted focus on managing receivables within a comfortable range, and we have been encouraging customers to allow us to work with them on schedules which are smaller dispatches of products closely aligned to project completion, enabling faster and smaller billing cycles and better receivables management. As we had shared before, we are also driving increase in cash-and-carry component in the tiles business. In the Sanitaryware and Faucetware business, it is already high. Receivable management has traditionally been Cera's strength and we continue to build on the theme.

The other development to share has been the inflationary environment in raw materials being witnessed across all industries this quarter. On the sanitaryware side, there have been relatively smaller price increases in some of the ancillary cost items like transportation costs and packaging. Key items like clay and feldspar which constitute 95% of sanitaryware, raw materials mix have been relatively stable in the sanitaryware business, though zinc has moved higher. Due to availability of gas from isolated wells near our plant, the pricing of gas from GAIL dropped further to Rs. 9.63 per cubic meter as against Rs. 40.51 from Sabarmati, which is the market-driven pricing. Renewable energy, given that 90% of our energy requirement is met from wind and solar power sources, we have been able to keep significant parts of our cost basket stable. For faucetware, we have witnessed a meaningful increase in prices of brass, which is an important raw material, and we have continued to raise prices of faucetware products accordingly.

We drove price hike this quarter to remain ahead of cost pressures. In sanitaryware, our last two price hikes were implemented in August 2020 of 3% to 5% and from February 2021 of 5% to 7%. From 1st August 2021, we have implemented another price hike of 4%. In faucetware, the price hike was from 1st February 2021 of 8% to 10%. From August 2021, we have implemented another price hike in faucetware of another 10%.

Sales mix and its importance - Despite the drop in sales this quarter due to the second wave, the sales mix remains favorable as Sanitaryware and Faucets remain our core focus area and we are confident of the prospects on a sustained basis. Sanitaryware contributed 50% and faucetware contributed 31% of topline this quarter.

In that backdrop, we can go over the financials on a Y-o-Y basis.

Revenues in Q1 FY22 were Rs. 222.84 versus Rs. 142.59 crore in Q1 FY21. EBITDA excluding other income was Rs. 19.84 crore in Q1 versus Rs. 6.64 crore in Q1 of FY21. The EBITDA margin has been 8.9% versus 4.7% in Q1 FY21.

PAT was Rs. 12.92 crore in Q1 FY22 versus Rs. 2.91 crore in Q1 FY21. EPS for Q1 was Rs. 9.93 versus Rs. 2.24 in Q1 FY21.

For Q1 FY22, 50% of the topline was from sanitaryware, 31% from faucetware, tiles was 17% and wellness 2%. On a Y-o-Y basis, Sanitaryware revenues registered an increase of 53.8%, faucetware revenues increased by 69.1%, tiles by 50.4% and wellness increased by 11%. The sanitaryware and faucetware verticals remain the bedrock of the business with contribution of 81% to our overall revenues.

CERA continues to witness encouraging demand for its newly launched products. During Q1 FY22, the new product development program contributed close to 21% of revenues. The Company has been receiving positive responses to its new packaging designs which were introduced with an aim to create more brand awareness and for retail customer visibility.

Inventory days in Q1 FY22 was 60.86 days compared to 59.83 days in Q1 FY21. Receivable days in Q1 FY22 were 38.51 days versus 51.36 days. Payable days in Q1 were 29 days against 31 days in Q1 of FY21. Therefore, net working capital days in Q1 FY22 were 70.37 days versus 79.40 days in Q1 FY21.

As on 30th June 2021, our cash and cash equivalents increased to Rs. 433 crore compared to Rs. 268 crore on 30th June 2020. On cash balance we see an increase in working capital going ahead and some portion of cash getting absorbed in increasing inventory days. Rs. 46 crore has been used in Q1 for increasing WIP, inventory and overall working capital. Cash on the books on 31st July 2021 is Rs. 470 crore.

After a fairly low CAPEX last year, as against the CAPEX budget of Rs. 21.82 crore for FY21, the total CAPEX spent was Rs. 9.84 crore. In the current year, the CAPEX budget is Rs. 17.19 crore, of which Rs. 6.69 crore is for sanitaryware automation, Rs. 4.97 crore is for faucetware automation and Rs. 5.53 crore is for logistics and IT.

To conclude, while the second wave of the pandemic did disrupt our overall performance momentum, the long-term growth dynamics of the Company remain intact. We remain optimistic of the outlook given robust indicators of demand, the continued strength of affordable housing and the prevailing low interest rates for housing loan. One of the premier Banks of the country has waived processing fee on home loans and several State Governments have offered waivers on stamp duty and regulatory costs. We are also under cusp of the festive season in India over the next two quarters. Overall, we remain confident in the inherent strengths of CERA Sanitaryware and consider ourselves well placed to rebound as the operating environment stabilizes.

On that note, I would request the moderator to open the line for Q&A and thank you very much.

Moderator: Ladies and gentlemen, we will now begin with the question-and-answer session. The first question is from the line of Arun Baid from BOB Capital Markets. Please go ahead.

Arun Baid: Two book-keeping questions. Can you just give us a break up for the quarter segment wise?

Ayush Bagla: So from the topline perspective, Sanitaryware was 50.38% of which outsourcing was 55.21% and own manufacturing was 44.79%. Faucetware was 30.88% of topline, of which outsourcing was 54.55% and own manufacturing was 45.45%. Tiles were 16.74%, entirely outsourcing if you consider our JV's and outside third-party vendors. Wellness was 2.01% of topline entirely outsourced.

Arun Baid: And the second question is in this quarter, we saw our gross margin doing very well, one of the best gross margins we have reported for a long period of time. So can you highlight something there? Your other expenses were pretty high, which led to lower EBITDA. So can you just throw light on these two aspects particularly?

Ayush Bagla: Gross margins have traditionally been in that 47%-51% region , this quarter it was at 56%. So there's been a lot of pressure on negotiating with vendors, with raw material suppliers, with outsourcing partners. So despite the tepid topline numbers, we were able to control costs at the shop floor level and at the outsourcing level. So COGS has been 44% against the traditional 51% to 58% variation. And on the EBITDA margin front, if we would have bought a topline of Rs. 280 crore and beyond, you would have seen our normal EBITDA margins of between 13% -14.5% which you saw for FY21. For this year, we do expect that sales which have regained a positive trajectory from June onwards, we have seen cracker of July and if these numbers remain, you will see that EBITDA margin coming back to 14%-plus very soon.

Arun Baid: And whatever we had guided, we had aspirational said that we're looking at least Rs. 150 crore of turnover, that looks on track, because the last phase has come back, is it right to interpret?

Ayush Bagla: Yes, from 1,223 to 1,460 is a 15% topline growth which is definitely possible this year and EBITDA percentage of 14% plus is also definitely possible this year. But as you know, Mr. Baid, we never guide, we just make our own estimates and we tell the analyst and investor community that the Company size is still not large enough for the Company to be able to give out the guidance.

Arun Baid: And second thing, there is this market thing that, you know the competition is saying a lot of raw material availability issue. Can you just give some, your take on what's happening in the market?

Ayush Bagla: See this is a very interesting and very important question. We have always maintained that you have to have own manufacturing excellence and you have to do it onshore in India. So, some of the participants in the industry who had no background in sanitaryware they came from a faucetware background. They entered sanitaryware purely on the strength of China imports and on the basis of trade discounting and China imports, they thought they could make a serious dent in the industry, they did make a temporary splash, but they have no product for the last one and a half months and they claim they have no products for the next 90-days. So, again, we come back to the overall Company philosophy, "Do you have manufacturing excellence in India?" "Do you have a strong vendor base for low end products?" These were things that took a long effort to build; we have done it over the last 15-years. And any Company trying to quick fix their way into entering Sanitaryware , it does not work as one of the largest peer group companies have just discovered. So there is no problem of raw material availability either in faucetware of brass and cartridges and rubber and plastic items or in sanitaryware of clay, feldspar, zinc oxide. But the Chinese vendors, there have been some disruptions; the Chinese currency has been very volatile. So those companies which depend on China, they are facing all sorts of issues, both of availability, pricing, and finding the right product to place in the market. We have always given out a number that our toplines 5% is overall imports, and China is one of those pieces of that import. Other companies have numbers of 50%, 60% and of complicated products they have probably 100%. So this strategy is now bearing fruit and that's why the June, July numbers and probably what you are going to see in August, September will bear out. So whatever this peer group Company, topline was in sanitaryware of Rs.300, 400 crore is ripe for the taking.

Arun Baid: So, we will be a big beneficiary because we had production issues which were resolved, and at the same time, we had a good inventory buildup in Q1 because of COVID-2, is that the right way to look at?

Ayush Bagla: Absolutely, so whatever channel (inaudible) was running dry has been replenished during Q1 because sales outlets were closed, inter-state transport was compromised, but manufacturing operations were not shut even for one day. So now after a long time, we are in even keel where sales, supplies, demand and manufacturing are all aligned.

Arun Baid: There was this notice which came with regards to your divestment in Anjani Tiles. Can you just throw light on that?

Ayush Bagla: See, about 5-6 years ago, we partnered with the entrepreneur who has got a past history in cement and tiles manufacturing. He is an expert in that manufacturing business. He has other joint ventures with the leading tiles players as well. We partnered with him and provided equity to set up a manufacturing base in Andhra Pradesh. We had an obligation also to buy tiles from that venture. Now, given the buoyancy in the tiles market, we have received an indicative interest from our partner to buy out CERA's equity. So the numbers, etc., are at a very preliminary level of discussion, nothing is finalized, no document has been signed. We are in the process of trying to release our capital from the equity of that manufacturing JV. And the other implied benefit of that is the obligation to buy tiles from that JV will now become an option to buy. So there will be two huge benefits that Cera gets.

Arun Baid: We are going to sell to the other partner only, that's the idea, right?

Ayush Bagla: Yes, that is the level of interest and intent we have received from our partner. So it is just too preliminary right now and we also found that the tile ecosystem in Gujarat has plenty of available capacity. So our customers will not find any difference in availability, designs and ranges going forward, and at the same time, we have an option to buy a small, large or entire production of that company.

Moderator: We'll move on to the next question that is from the line of Rahul Agarwal from InCred Capital. Please go ahead.

Rahul Agarwal: Sir, just to take that question further, Ayush, on the Anjani Tiles thing, so whenever that transaction basically happens, till that point the supply is ensured, right?

Ayush Bagla: That's right. The old supply arrangement is in place. And we continue to buy tiles from Anjani which constitutes less than 1/3 of CERA's tiles is currently. So in any case, we have to go to third-party vendors to buy two-third of our tiles requirement. The advantage of buying from Anjani is let's say, there is almost a Rs.3 freight advantage for sales that are to be made in South India, because the plant is located in AP.

Rahul Agarwal: Any P&L impact you could foresee, essentially, what I can look in your balance sheet is Rs. 10 crore of equity investments, Rs. 24 crore of preference and Rs. 12 crore of advances, so essentially all of this all comes back, is that the right understanding?

Ayush Bagla: The numbers are still under discussion. So I won't be able to give you more specifics on the equity and preference. The advances are business call between buyer and seller of tile. So that depending on the volumes going forward, will come down, go up. That's just a normal call between a buyer and seller.

Rahul Agarwal: Well I thought we had some facilities from Federal Bank, which was supporting Anjani in working capital. So I thought that was also something which could be get rid of, right, if we don't get into this transaction, isn't that correct?

Ayush Bagla: Federal Bank has lent to the SPV. CERA has not provided any kind of comfort, guarantee, whether implied letter of comfort, keep well agreement, none of that from CERA has been provided to the Federal Bank. Purely on the strength of the SPV and its financials, its partners, its ability to make revenues, so it's an independent loan by Federal Bank to that SPV. So if the transaction goes through, then the new owner of 100% of ATS equity will be dealing with Federal Bank as a normal client.

Rahul Agarwal: So essentially, will you be looking for any new equity tie-ups or you are comfortable that you will be having like outsourcing capacity, and vendors will provide whatever you need, so are you keen basically on any equity tie-up going forward, that's the question?

Ayush Bagla: Currently, there is enough availability of tiles. If that situation were to change, which it doesn't look like it will change in the short term, so in the short term, we may not look at equity tie-up, but if that situation were to change, of course, we will come back to you with a revised view that given the shortage of scarcity of tiles, we will need to invest equity in the venture.

Rahul Agarwal: One last housekeeping question was if you could help us with the tier wise revenue breakdown and the entry, mid and premium sales, if you could help across segments?

Ayush Bagla: Exports in Q1 last year was 2%, this time it was 4%, Tier-1 sales which were 24% in last year were 27% this year, Tier-2 sales which was 10% last year is 14% this year and Tier-3 sales which was 64% last year, is 55% this year. Then we come to premium and mid classification. Last year in sanitaryware, entry products were 41% of sales, this year it was 34%, mid-price products were 13%, they remain at 13%, premium products were 46%, and they become 53%. In faucetware last year, entry products were 32%, this time is 29%, mid products were 15%, they remain 15% and premium products, which were 53% of sales became 56% of sales.

Moderator: The next question is from the line of Madhav Marda from Fidelity Investments. Please go ahead.

Madhav Marda: I just have two questions. The first one was if you could give us a sense on like your demand outlook for the coming year across urban and more Tier-3, Tier-4 cities, how are you expecting it to play out? And my second question was on the working capital side. So I couldn't fully grasp your comment that you made initially. You are expecting some working capital build up this year versus last year. Could you help me understand what that was about?

Ayush Bagla: So the demand environment from August 2020 has been higher than supply both for the industry and definitely for CERA. CERA had a mixture of external and internal issues last year, that has all got sorted out, in Q1 of this year, where there was only one external issue. From 15th June onwards, there is neither an external or internal issues or demand, supply, increase level of supply both from own manufacturing and from vendors is now sync with the demand trends. And the industry which has grown for in single digits for the last many years is seeing a surge in demand, it's definitely in double digits. Now, whether it's 10 or 15 or 18 that is something we will wait for the year to end, but the demand is definitely very, very high. The second point of working capital is last year due to channels running dry, very high ratio of cash-and-carry and reduced manufacturing and therefore the need to not deploy capital in WIP there was a significant capital that was released from working capital. So, we expect that we would like to have more capital deployed in WIP, finished goods and in inventory, and some part of the cash available will be used for that. So in the opening statement, we said Rs. 46 crore of the cash of Rs. 479 crore was used in excess finished goods or inventory days and receivable days. Now, that number is back to Rs. 470 crore from Rs. 433 crore on 30th June, but our aim this year is not to maximize or optimize inventory days. Our aim this year is to increase inventory days, increase if required even receivable days, but to ensure product availability. So I'm saying some part of the Rs. 470 crore cash will be used to ensure product availability. Now as far as market demand is concerned, we are coming back again and again to the most important aim which is strength of own manufacturing. You've seen one of the challengers in the sanitaryware industry run dry for the last more than a month and have no product for the next three months. So that market share is there for the taking. This is the same discussion we had at the end of Q3 last year, when a lot of our investors and analysts asked us, "Is there a permanent change in market share?" And we said "No, once our products are available, we'll claw back our market share." But this time in Q2 and going forward in Q3 we will be clawing back much more than our market share because the challenger has no product.

Madhav Marda: On the increase in input costs which is happening, have we been able to pass it on largely or there could be some more price hikes that would be required in coming quarters?

Ayush Bagla: We'll just go over some of the raw materials. China clay is 50% of raw material in sanitaryware. There was a 3% to 5% hike from April this year. Feldspar which is 45% of sanitaryware RM was 3% higher again from April this year. Then glazing and colors which is 1% of RM, there was no major change. Zinc Oxide which is 1% of RM, there was a 7% price hike from April this year. Plaster of Paris which is used in the molds, which is 1% of RM, there was no change this year. But on the price hike, we took one of 3% to 5% in August 2020, one of 5% to 7% in February 2021 and in August 2021 of 4%. So our price hikes have been one step ahead of the raw material pricing curve. And if raw material prices soften, there's going to be no change in the pricing. Similarly, brass, which is let's say 55% of the entire cost of faucetware raw material has seen a lot of volatility, and over the last three quarters of one-way increase. So, to offset that, both brass and zamac we have taken a price hike of 8% to 10% in February and a price hike of 10% in August 2021. So we have stayed one step ahead of the curve and once again brass prices will cool, but we won't be reducing our prices.

Madhav Marda: So, basically, the demand/supply environment remains very supportive for a Company like ours besides our own manufacturing, even price hikes we are able to pass it through because RM inflation is not a problem?

Ayush Bagla: There are two, three reasons for that; one is the brand is very strong, the dealer network is very strong and it's 100% pull sales, there are no push sales. So pull sales are end consumer driven. Even project sales, in most of the projects, the procurement teams have specified you can buy a brand CERA or brand B or C . The industry is itself a close industry and customer loyalty in this industry changes after 10-15 years. So the stickiness of customer loyalty is very high because the product is going to last you between 10 and 20 years.

Moderator: The next question is from the line of Sumit Jain from ASK Investment Managers. Please go ahead.

Sumit Jain: You said the competitor would gain market share now. For next three months, you will not be able to do all China supplies to him. But if you are referring to the same player, and he has been a leader in faucet market and attacking the sanitaryware market, if we ourselves are outsourcing eventually, he also can outsource it from domestic player, isn't it, and so how sustainable this market share gain would be?

Ayush Bagla: In most cases, domestic sanitaryware vendors can supply basic products. They don't have the capability of let's say the manufacturing excellence of CERA's plant which have robotic glazing and the gills which are German-made kilns, etc., and the quality parameters. So, there is huge differentiation between the products that is made in the factory and by a vendor. Then, most of the complicated SKUs which are table top sinks, single piece wall-mounted WCs, floor standing single piece and large WCs, these are not being made by most of the vendors in sanitaryware in India, which is why the challenger was dependent on Chinese imports. So there's a huge differentiation. Otherwise, there would be no need for anyone to have any plant. And we could go the symphony model of 100% outsourcing.

Sumit Jain: But If I look at your CAPEX, let's say we've done a very significant compounding FY20 behind for 10 years, and if our ambition is to grow at 15% CAGR and double our sales in five years from Rs. 300 crore in sanitaryware, CAPEX is absolutely not commensurate with that, most of that is on brand spend, this, that, etc., whereas when you see in the tiles industry, the leaders are eagerly doing a strategy of their own manufacturing. So if the incremental sales and ambition and aspiration are going to come from outsourcing, even we will be like that other player only? And including the Anjani transaction that you are doing in which you invested Rs.5 crore equity last year and now you are pulling out, clearly shows along with your CAPEX plan that increasingly incremental sales will come from outsource. Where do we stand on this?

Ayush Bagla: See, on Anjani, the thinking is very clear it depends on availability of tiles in the market. In any case, we were dependent on two-third of our tile sales from third-party vendors. In case this transaction happens and it becomes a third-party vendor, 100% of our tiles will be a trading business with a significant EBITDA margin. So, all financial ratios will improve and there is no differentiation in the tiles market between vendors, there are no quality parameters, which are vastly different unlike in sanitaryware and faucetware.

Now, coming to sanitaryware, yes, and a lot of CAPEX, more than Rs. 190 crore of CAPEX was spent on the shop floor between 2015 and 2019, which is why there has been a pause on CAPEX in large numbers over the last two years. So, the Rs. 190 crore of CAPEX that was spent at the shop floor over four years from 2015 to 2019, that is giving us the benefits both in the ability to make complicated products and increase the number of SKUs. That has been the main driver of our sales, both in sanitaryware and faucetware. And in Q1 last year, we disclosed to the market, we have acquired a land parcel in case there is a significant faucetware expansion plan next to our current manufacturing facility. So, we are fully aware of what you are saying. But the list of SKUs that are to be outsourced to a vendor changes periodically, not only annually, sometimes during the year, lower and lower end and less complicated pieces are outsourced to a vendor, and more complicated newer SKUs are made in-house. So from a percentage basis, outsourcing might increase with the increase in sales, but from a complexity standpoint, own manufacturing will always have 100% market share of complicated products.

Sumit Jain: One request. Once in a year, if we get to hear from Vikram ji about strategy, about Company plans for five, 10 years, etc., that will be great. Thank you.

Ayush Bagla: Okay, we'll make it happen.

Moderator: The next question is from the line of Sneha Talreja from Edelweiss Securities. Please go ahead.

Sneha Talreja: My question is more pertaining to the industry. We have very recently there is transportation strike which is happening and from what we've heard is associations have come out that there will do a one month of production cut in Double Charged Vitrified Tiles. What are your thoughts here and why is it only happening to Double Charged or do you think this can spread over to even other categories, any thought processes?

Ayush Bagla: Our sanitaryware industry is Rs. 45,000 crore, CERA is Rs. 300 crore player and our double charged vitrified sale would be let's say, just looking at the number, it will be close to Rs. 6 crore per quarter. So we are you know the fourth decimal point removed from the zero. So for us there will be no supply disruption.

Sneha Talreja: Absolutely, but my question is in a broader levels if this strike is happening and dispatches from Morbi would be impacted, I don't think they should only be constrained to maybe a double charge or even tiles for that matter, I think impacting sanitaryware too. So that was a first question.

Ayush Bagla: Currently, from our vendors, we have a model of zero inventory days. So our vendors in Morbi, and many other places, and even from our JV in South India, we have zero inventory days, and they dispatch tiles directly to markets, directly to customers. That's the model we have been working on for many months now. And that has also freed up a lot of working capital that has reduced transport cost, warehousing cost and breakage during transportation and loading, unloading. So that model is on and that is working. If there is a temporary transport strike, I can call you and tell you about it, but currently our tiles team has not been impacted, our sales has not been impacted. And if there's something material, we will surely share it with you.

Sneha Talreja: So second question was more related to the demand. Is there anything that you can highlight that where were we in terms of how was the pickup was in the month of July and how it has been so far, and how is the pickup happening from the same?

Ayush Bagla: See, we have looked at the July data for the last 7-10 years, every year was an increasing trend till the highest July numbers was achieved in July 19, because July 20, was partially a COVID period. July 21 numbers dramatically exceeds the July 19 numbers as well. I won't be able to put a numerical value to it because only one set of shareholders and investors and analysts are on the call and this number has to be disclosed to the entire market at the same time. So the numerical value is higher than the July 19 numbers, but we expect this trend to continue both in August and beyond. So Q2, Q3, we expect this trend to continue and in sanitaryware, the market is dry, so one of the players has no product, so the balance three players will absorb that market share. So let's see how that trend plays out.

Moderator: The next question is from the line of Hiral Desai from Anived Portfolio Managers Private Limited. Please go ahead.

Hiral Desai: A couple of questions. One was in terms of revenues, I remember in the Q4 call, you had mentioned that April and May put together was about a three-digit crore number which essentially means that June has been in that 100 to sort of 115 crore kind of range, which looks a bit soft given the opening up of the economy and the pent up that we had. So, would it be possible to at least give the sort of June 16 to 30th growth versus the first half of June; if you can't share the July number?

Ayush Bagla: We can split that up, but again we'll have to declare to the entire market at the same time, so we'll figure out a way…

Hiral Desai: You may disclose it to the exchange also, no issues with that.

Ayush Bagla: Yes. So we will just figure out a way of how to go about that.

Hiral Desai: Yes, yes, if that's possible. The second question was related to volatility in the gross margin. So I'm looking at last nine quarters, the highest gross margin is 56%, which is in the current quarter, and the lowest is 42%, in Q3 of FY21. So that is two quarters ago. So what causes this significant sort of swing in the gross margin? So it is difficult to keep a track on sort of where they are heading given that you have already taken a few pricing action in last 12 months or so.

Ayush Bagla: The most important thing is the overall average of the last 12 quarters if you see, the gross margin will be around 50% - 51%. Q3 of last year was abnormal quarter because the plant was shut for 82 days out of 90 days. So that's why gross margin was the lowest. And this quarter, again, the tile business was only 16% of topline. Normally, it's 19% - 20% of topline. So tile is the lowest contributor to gross margins, because it's fully outsourced model. So that has very high impact on the gross margin calculation.

Hiral Desai: You did mention that steady state this number should ideally be between 47% to 51%. So, that is the long term range that we should work with?

Ayush Bagla: Yes, because COGS will increase as share of outsourcing increases. And the only counterbalance to that will be a share of tile reducing as a percentage, maybe not as an absolute number, but as a percentage.

Hiral Desai: The other was related to one of the questions which were asked earlier on the capacity. So I guess the number that you mentioned for this quarter was a capacity utilization of about 88% on sanitaryware. And this is as you are sort of getting back from the factory lockdown. So, assuming that you continue to grow between let's say, 10% - 15% over the next couple of years, wouldn't you be short on capacity as we go along?

Ayush Bagla: Sanitaryware, despite all the efforts taken towards automation continues to be very, very manually dependent. The skill set required to manufacture sanitaryware is available in only 2-3 locations across the country. Then comes the availability of gas. Can you manufacture sanitaryware while paying Rs. 41 rupees for gas? So those are the variables to keep in mind while talking about a Greenfield project. Then the second thing is availability of any existing plant. We have not found any great options so far on availability of an acquisition target. Then comes partnering with someone who has a plant. So, those are various parameters that we analyze and we also look at Brownfield expansion of our own plant, "Is there land available near our own factory, etc.? Is there more skilled labor available? Can GAIL increase its gas throughput, or we'll go back to Sabarmati at Rs. 41 for increased throughput?" So, various studies are going on, and soon there will be some outcome.

Hiral Desai: What is the current capacity of sanitaryware?

Ayush Bagla: See, we don't have a per piece capacity because the SKUs have increased dramatically and the share of complex products has also increased. So, we don't have a number of pieces kind of capacity.

Hiral Desai: But like how would we understand in case you end up doing something Brownfield, what is the kind of incremental capacity that you can take up?

Ayush Bagla: In value or tonnage? That is how we look at it, but that's also a moving target.

Hiral Desai: No-no, so in percentage terms just wanted to understand like, if you do a brownfield, what is the kind of capacity that you can add in percentage terms value or whichever.

Ayush Bagla: So, in Brownfield also, the availability of land near our manufacturing facilities is being looked at. Currently, we have not found any. So, we are looking at that right now. So, whether there exists an opportunity for Brownfield, that itself is something that is unclear at the moment.

Hiral Desai: Lastly, as investors we are very happy that the focus has gone back to product availability versus excess focus on working capital. So very happy with that. Congratulations and all the best.

Ayush Bagla: Thank you so much.

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

Pritesh Chheda: Sir, I have one broader question. So for our type of products, is there any research paper done whereby one can figure out that what is the replacement-led demand in the product and how much of the demand is linked to a housing purchase, whether it's a completely new house purchase or a resale activity, which induces the need for this product, so any assessment there sir?

Ayush Bagla: See, we don't have access to any outside data. We have asked for many agencies to give us this data, but we have never got anything, but I will tell you how we look at it and why we look at it that way. So we look at it of share of Government sales, share of direct billing to developers and share of sale through dealer. Share of Government sales is definitely a negotiated price, share of sales to large developers is also a negotiated price, and sale through dealers is not a negotiated price. So in Q1 sanitaryware and faucetware business 65% of sales were through dealers and retail, project was 32% and export was 3%.

Pritesh Chheda: Project here would be Government and developers, right?

Ayush Bagla: Project includes Government sales and large billing to developers. Tiles, retail sales were 74%, project sales…

Pritesh Chheda: I'm okay at the Company level. So, I figure out that it is something like 70:30 or 60:40.

Ayush Bagla: Yes, 70:30 is the ratio that you will find out of which in the 30, share of Government used to be 3%, 4%, that number is increasing and even within that 30%, the Company is not comfortable taking credit call, so 21% out of that 30% is billing through dealers.

Pritesh Chheda: But still this doesn't answer my question that demand generated on account of a housing transaction would be what percentage of the total; will it be more than 80% of the demand is linked to a housing purchase, whether it is new or repurchase, completely new build or repurchase?

Ayush Bagla: See, I'll tell you how the industry operates. A newer brand which is not established, which is very close to a white label brand will approach a developer for any project and try and discount its way into an order. Whereas the established brand like CERA will not do that, the established brands like CERA will depend on pull sales from dealers, that is the difference. And therefore there is a huge pricing advantage that we enjoy. So the share of 70% of topline through dealers is retail sales. If a dealer is selling to a developer, then that is a transaction between the two of them where we have no role to play.

Pritesh Chheda: I'll take this offline. My second question or clarification is so based on the price increases that have flowed through in the last eight, nine months now, what will be the blended price-led growth that would flow in for FY22?

Ayush Bagla: Sanitaryware you can say 20% because it was February and August this year. So August, you will get at least seven months…

Pritesh Chheda: You mentioned in sanitaryware 4% in '21 and 4% in August, so 8%.

Ayush Bagla: Yes, and faucetware is 20%. So you can multiply into that ratio of 50 and..

Pritesh Chheda: So it's blended in percentage where it is. And my last question is based on the commentary that you were mentioning about activity levels and about general industry, and the fact that last three, four years were largely soft, do you see a case where you actually see a situation of consistent volume growth for your business over the next three years now and the case is much stronger?

Ayush Bagla: All the telltale signs are in place, that the next three years will be a period of increased volume and value consumption, both from the end consumer and from projects that all the telltale signs and the ingredients are in place.

Moderator: Thank you. Ladies and gentlemen, due to time constraint, that was the last question. I now hand the conference over to the management for their closing comments.

Ayush Bagla: 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 would help it deliver steady and consistent growth going forward. With this, I hope I have been able to answer your questions satisfactorily. However, should you need any further clarification or would like to know more about the Company, please feel free to reach out to me or CDR India. Thank you once again for taking out time to join our call and see you all next quarter. Thank-you very much.
