



## CERA Sanitaryware Limited

### Q2 FY22 Earnings Conference Call Transcript

October 27, 2021

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**Moderator:** Good morning, ladies and gentlemen and welcome to the Q2 FY22 earnings conference call of CERA Sanitaryware Limited. As a reminder, all participants' 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 of CDR India. Thank you.

**Mayank Vaswani:** Good morning, everyone and thank you for joining us on the earnings conference call for CERA Sanitaryware Limited for the Q2 FY22 earnings which were announced yesterday. We have with us today the management team comprising Mr. Ayush Bagla - Executive Director; Mr. Rajesh B. Shah - CFO and COO of the Company and Mr. Mahesh Taparia - the Deputy CFO of CERA Sanitaryware.

We will start with brief opening remarks from the management following which we will open the call for Q&A. A quick disclaimer before we begin, 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 would now turn the call over to Mr. Ayush Bagla for his opening remarks.

**Ayush Bagla:** Good morning everyone and thank you for taking time to join our call. The earnings for the second quarter of the financial year 2021-22 were adopted by the Board of Directors yesterday 26<sup>th</sup> October 2021. The earnings documents have been released to the stock exchanges.

During the second quarter, we saw the markets fully opened and accessible, economic activity rebound and consumers returning to markets. Data of primary sales of homes reflect this trend aided by enhanced disbursements of home loans at benign interest rates. The disruptions caused by the first and second wave are completely behind us now. We expect this trend of robust consumer demand to remain intact for the medium term. Secondary sales of homes, home improvements and upgradation became a major scheme with home owners. The focus remains on monetizing this demand by first, maximizing throughput of technologically complex SKUs at our own manufacturing facilities; two, broad basing the vendor network in India; three upgrading the capabilities and manufacturing infrastructure of our vendors and four, using the pricing power of the brand to proactively lead the sanitaryware and faucetware markets.

We have been consistent in our choices to rely on CERA's own manufacturing capabilities rather than opting for imports. This was a route taken by a few sanitaryware companies in India. The rise in the single container costs from \$600 to \$6,000 in August 2021 and then \$10,000 in September 2021, has rendered it almost unviable to import sanitaryware products from China. Since July or August 2021, we have seen many sanitaryware players unable to book orders for any deliveries before the next calendar year.

This has opened a huge opportunity for us. We have acquired new customers and have gained from this vacuum. The B2C frontend is contributing our highest share of revenue, leveraging off its power brands that have demonstrated that pricing power and customer pull in retail markets. The B2B business is at the level that we are most comfortable with. Our core business of sanitaryware and faucetware offer tremendous growth ability to innovate, opportunities to create newer niches and to expand submarkets. Demand has been robust in both verticals. Sanitaryware contributed 52% of topline for the quarter and faucetware 34%. Together, sanitaryware and faucetware contributed 86% of the topline. This composition has a direct bearing on the EBITDA margin which is noticeably higher this quarter.

On the production side, we had focused on execution. As a result, we had operated our plants at high-capacity utilization this quarter which for the sanitaryware plant was 97% and for the faucetware plant was 90%. The plants are working optimally and at close to maximum capacity, relations with labour are cordial and smooth. All efforts are being made to debottleneck specific processes in the plant and automate any process which can either enhance production or make a difference in the quality of products or in cost reduction.

This focus on ensuring optimum production as well as product availability will require us to carry higher inventories of both raw materials as well as finished goods. As a result, we expect capital deployed in working capital to raise this fiscal. Given the adequate cash reserves of Rs. 485 crore as on 30<sup>th</sup> September 2021, we are comfortably placed to do so. Getting product to market and product availability is the high priority for the Company as the demand remains strong.

In addition to complete availability of our manufacturing facilities, our entire network comprising touch points such as the large formats, there are Style Studios; the medium size format there are Style Galleries and the small format Cera Style Centers as well as 4,000 plus dealers and over 11,000 retailers are back on stream and fully operational.

Since August 2020, elasticity of demand has been completely redefined due to lower interest rates and reduced monthly home loan payments. The sector has witnessed record registration in Mumbai in September and several states and cities in the last 12 months except a brief pause during the second wave. Since July 2021, the overall demand has returned to a fairly positive trajectory similar to the August 2020 to March 2021 period. The sales numbers of homes from July to September 2021 bear out this phenomena.

On the other parts of working capital, there is a concerted effort on managing receivables within the comfortable range and we have been encouraging customers to allow us to work with them on schedules resulting in smaller dispatches of products more closely aligned to construction progress, enabling faster and smaller billing cycles and better receivable management. As we had shared before, we are also driving an increase in cash-and-carry component of the tiles business and in the sanitaryware and faucetware businesses, it is already high at 75%. Receivable management has traditionally been CERA's strength and we will continue to remain completely disciplined in that area even as we focus our energy on higher production and throughput.

The other development to touch upon is the overall inflationary environment. There has been an increase in prices of raw materials being witnessed across all industries this quarter. On the sanitaryware side, key items like China clay, feldspar and Plaster of Paris which constitute more than 95% of sanitaryware's raw material mix have been stable during Q2. In the sanitaryware business, only within the glazing recipe which constitutes less than 1.5% of sanitaryware's raw material mix as the key components moved up during Q2.

Freight has gone up by 5% adding to the total cost of materials. Due to availability of gas from isolated wells near our plant, the pricing of gas from GAIL continues to remain below market and will do so in the future. Price had moved up from Rs. 9.8 per cubic meter in September 2021 to Rs. 13.3 per cubic meter in October 2021. GAIL provides around 59% of the gas requirement of the sanitaryware business. Sabarmati pricing went up from Rs. 41 to Rs. 42 per cubic meter in September and this year to Rs. 49 to Rs. 50 per cubic meter in October 2021, supplying around 41% of gas needs of the plant. The combined impact of both the price increases is Rs. 35 lakh per month. There have also been price increases in some of the ancillary cost items like transportation cost and packaging. Costs of corrugated boxes have gone up by 15% which will be effective from Q3 onwards.

Our high reliance on renewable energy for over 2 decades has significantly benefited us given that 90% of our energy needs is made from wind and solar. As a result, we have been able to keep significant parts of our cost baskets stable. Sanitaryware vendors too have been provided a price hike as their cost of gas and labor has moved up. The range of change effective October-November 2021 will be 8.5% to 9% for sanitaryware vendors and around 5% to 6% for faucetware vendors. Many of these contracts are under final discussion. For faucetware we have witnessed a meaningful increase in the price of brass in Q2 which is up by 3% which is an important raw material and we have raised prices of faucetware products in August.

We drove price hikes to remain ahead of cost pressures. In sanitaryware, our last two price hikes were implemented in August 2020 or between 3% to 5% in February 2021 or between 5% to 7%. From 1<sup>st</sup> August 2021, we had implemented another price hike of 4%. In faucetware, the price hike was from 1<sup>st</sup> February 2021 of 8% to 10%, from August 2021, we had implemented a price hike of another 10%. In all sanitaryware products, allied, seat cover and polymer SKU's, a price hike of 8% to 12% has just been announced which is effective from 15<sup>th</sup> November 2021.

In that backdrop, we can go over the financials.

Revenues in Q2 FY22 were Rs. 393 crore versus Rs. 318 crore in Q2 FY21. EBITDA excluding other income was Rs. 58 crore in Q2 versus Rs. 40 crore in Q2 FY21. The gross margin has improved at 50.6% in Q2 FY22 as against 47.5% in Q2 FY21. The EBITDA margin is higher by 200 basis points at 14.7% in Q2 FY22 versus 12.7% in Q2 FY21.

Profit after tax was Rs. 42 crore in Q2 FY22 versus Rs. 26 crore in Q2 FY21, an increase of 60% Y-o-Y. EPS for Q2 was Rs. 32.36 versus Rs. 20.21 in Q2 FY2021. For Q2 FY22, 52% of the topline was from sanitaryware, 34% from faucetware, tiles represented 12% and wellness 2%. On a Y-o-Y basis, sanitaryware revenues registered an increase of 27.8%, faucetware revenues increased by 61.2%, tiles decreased by 25.9% and wellness decreased by 26.8%. The sanitaryware and faucetware verticals remained the bedrock of the business with contribution of 86% to our overall revenues.

We continued to witness encouraging demand for newly launched products. During the last 2 years, the new product development program contributed close to 20%-21% of revenues.

Inventory days in Q2 FY22 were 60 days compared to 51 days in Q2 FY21. Receivable days in Q2 FY22 were 31 days versus 55 days. Payable days in Q2 were 35 days against 38 days in Q2 FY21. Therefore, net working capital days in Q2 FY22 were 56 days versus 68 days in Q1 FY21.

As on 30<sup>th</sup> September 2021, our cash and cash equivalence increased to Rs. 485 crore compared to Rs. 362 crore on 30<sup>th</sup> September 2020. We see an increase in working capital going ahead and some portion of cash getting observed in increasing inventory days.

After a fairly low CAPEX year last year, during which we spend Rs. 9.84 crore against the CAPEX budget of Rs. 21.82 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, Rs. 5.53 crore is for logistics and information technology. In Q1 and Q2, the amount spend has been Rs. 4.9 crore for sanitaryware automation, Rs. 1.19 crore for faucetware automation, Rs. 1.69 crore for logistics and information technology. We continue to evaluate opportunities for creative manufacturing capacity and even inorganic opportunities if a sanitaryware plant were to be made available with quality standards that meet CERA's parameters. None of these various opportunities have reached the stage where they can be presented to the Board of Directors for further evaluation.

A few additions in personnel had taken place. Mr. Anupam Gupta has joined us from Grasim Industries as Executive Director, Technical. Mr. Gupta has been with the Aditya Birla Group for more than 17 years, various geographies in India and internationally of which the last 8 years were in Halol, Gujarat. His breadth of manufacturing experience in ceramic technology is well known in industry circles. Mr. V. Krishnamurthy joined us in 2021 from HSIL as President, Marketing with

experience of 25 years in Sanitaryware and Faucetware marketing, promotion, and product sourcing. Mr. Mahesh Taparia joined us as Deputy CFO and has a rich experience of 18 years in HDFC Bank. Mr. Ajay Jain has joined us as Vice President, Faucetware Production. He has faucetware experience in HSIL and Kohler and metallurgical experience at Hindalco. Many of you would know these senior personnel from their previous roles.

The tile industry is buoyant with an uptick in demand and pricing. CERA has been able to monetize its capital involvement in the tile manufacturing joint venture. An MoU between CERA sanitaryware Limited and Anjani Vishnu Holdings Private Limited was signed on 17<sup>th</sup> August 2021 and definitive documents was signed on 26<sup>th</sup> August 2021 regarding the transfer of preference shares and equity shares by CERA to AVHL. Accordingly, the stage wise payment aggregating to Rs. 28.69 crore consistently received by CERA as envisaged in the agreement. The sourcing arrangement to that before with CERA having no obligation to source from ATL, but an option to buy tiles from ATL after evaluating it amongst its various sourcing partners.

Related party transactions were Rs. 111 crore in FY21 which were all in a normal course of business and included purchases from the 4 joint venture companies CERA has. The same figure for half year ended FY21-22 is Rs. 61 crore, post all divestment formalities being completed by 31<sup>st</sup> March 2023 in ATL, related party transactions will reduce dramatically in FY24.

To conclude, 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 loans. Q2 witnessed satisfactory and encouraging performance on all parameters. We are making all attempts to build on that growth. The consumer is responding to CERA's products, marketing initiatives and brand positioning allowing us to monetize all the efforts of the last many years. Demand as we have been seeing is not a pent-up temporary demand increase, but an all-around sustainable change in consumption patterns for building materials and the real estate sector. Overall, we remain confident of the inherent strengths of our Company and believe we are well placed to grow further as the operating environment stabilizes.

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

**Moderator:** Thank you. Ladies and gentlemen, we will now begin with the question-and-answer session. The first question is from the line of Archana Gude from IDBI Capital. Please go ahead.

**Archana Gude:** I have 2-3 questions, firstly, a very strong player in the pipe segment has announced that they will enter into sanitaryware and faucetware segment, even the leading tile players are talking about increasing bath wares revenue going forward, so how we should see the competition in the long-term, particularly for the organized players?

**Ayush Bagla:** We feel that any new player wanting to enter sanitaryware and faucetware is more than welcome, they will end up expanding the market, so the industry gets expanded that is good for everyone. So, we welcome them and lot of tile companies have been making attempts not recently, but for the last 15 years to expand their sanitaryware and faucetware base, given that sanitaryware and faucetware is such a profitable industry, so these attempts have been going on and it has helped the industry in many ways. The conversion of unorganized to organized has helped even the largest players like CERA in sanitaryware and in faucetware that full conversion is yet to take place. So with the increases in number of players, the unorganized sector of the industry will go down and the large players will benefit, so I think it is a welcome development.

**Archana Gude:** Sir, secondly, in the last concall, if I recollect, you had spoken about one of the leading player in sanitaryware and faucetware are facing some issues in production, so any comment on that like you spoke about China that China's import has almost stopped, so I am just trying to understand if both the factors are at place, then maybe we will have more scope to grow in these two segments?

**Ayush Bagla:** We had spoken about this for the last 4 years, CERA has continuously been talking about "Make in India" and great capabilities of manufacturing in your own manufacturing facilities and bulk of our CAPEX over the last 6-7 years have gone in that direction. Those players who wanted a quick fix by importing from China and selling in India, because import duties were only 11%, they tried, I am sure they have had some success as well, but now from July/August of 2021, those markets are dry and CERA has been the biggest beneficiary as you can see from the numbers. Even now, those importers from China are unable to promise any quantity to dealers or projects before the next calendar year. Between now and the calendar year the Chinese currency has gotten more expensive, the freight rates have gone up dramatically and with the onset of the Chinese New Year, we don't know when product availability from China for those players will resume. So, we have no problem with those developments we have gained, but we saw this coming at least 3 years ago and we had consistently been talking about it in every call.

**Archana Gude:** And may be lastly if you can give some more color on how the institutional segment is doing for us and maybe the retail segment which anyway is doing very well, which part maybe Tier-2, Tier-3, other Tier, if you want to break down the segment which is really helping us to grow at this fastest pace?

**Ayush Bagla:** In any case, I will just give you our breakup of sales on Tier-1, 2, 3. We had 2% of the topline as exports, 30% as sales from Tier-1 markets which is population centers above 25 lakhs, 15% of sales from Tier-2 markets which is population centers between 10 and 25 lakh, 53% of sales from population centers below 10 lakh. That had been the normal composition of our sales and all these markets are doing well. About 10 years ago, our sales through institutions were 50% and retail was 50%, went up very slowly because waiting a broad base retail network and penetrating markets is very time consuming and expensive affair. Now, this quarter 68% of our topline is retail sales.

- Moderator:** Thank you. We will move onto the next question that is from the line of Pritesh Chheda from Lucky Investment. Please go ahead.
- Pritesh Chheda:** Sir, I missed the sanitaryware and the faucetware growth for quarter 2 if you could help and what would be the volume growth for us as a Company in quarter 2 if you could help us in that?
- Ayush Bagla:** Faucetware grew from Rs. 82.5 crore to Rs. 133.01 crore, so that is a growth of 61.23% Y-o-Y..
- Pritesh Chheda:** And sanitaryware?
- Ayush Bagla:** (Inaudible). And as far as volume is concerned, I will give you the number of SKU's. Again, 5-7 years ago the number of SKUs may be 50 or 60. Now, sanitaryware has 466 SKUs and faucetware has 919 SKUs, so volumes have become irrelevant because the range has expanded so much. Again 10 years ago, every SKUs to be made in the factory. Now, only the complicated SKUs which vendors cannot make is made in the factory, so given the changing dynamics and complexities of the business now volumes is not the best way to look at the Company.
- Pritesh Chheda:** You mentioned sanitaryware growth rate for the quarter is 60%, right and faucet is 61.2%?
- Ayush Bagla:** Sanitaryware was Rs. 159.65 crore in Q2 FY21, and in Q2 FY22 it is Rs. 203.97, a growth of 27.76% Y-o-Y and faucet is 61.23%.
- Pritesh Chheda:** Is it possible to understand what will be then the price led growths in the quarter for the Company as a whole in the topline growth of 24% that we see, you would have taken about 7-8% price hike blended looks like around February and then there is a price hike in August, so is it that the price led growth in this 24% should be at least 8% to 10%, is that a fair assumption?
- Ayush Bagla:** Yes, 8-9% is the fair weighted average assumption.
- Pritesh Chheda:** And whatever pricing actions you had to take considering the raw material increase which you saw in quarter 2, it has been done, right because you mentioned that there was no RM increase in case of sanitaryware and there was some RM increase in case of faucetware and the major RM increase is gas, so whatever price increases you had to take, you have taken or there is a gap between overall price increase and the RM increase?
- Ayush Bagla:** In sanitaryware, 95% of the basket was stable and the glazing recipe is only 1.5% of the sanitaryware basket.
- Pritesh Chheda:** I heard that comment, so considering that comment, is there any incremental need for pricing action?
- Ayush Bagla:** Given the factors of freight glazing recipe 1.5% and gas and other labour increases we have announced our price increase effective 15<sup>th</sup> November as well which is

8% to 12%, but there is no lag effect. So, we have always stayed one step ahead of cost increases, so even the previous two increases, the gas sounds like a very dramatic increase, but gas is 1.9% of the company's topline. 1.9%, there will be 5-10 basis point change, I mean in fact for the overall company, it is 35 lakhs a month for 6 months, so it will be around 2 crore for the year and if you put divide that by the topline, it will be less than 5-7 basis points. Gas again is not material. We have stayed one step ahead of all cost increases. That is why it is our attempt to give you all the components for costs in as much detail as possible on these calls.

**Pritesh Chheda:** Sir, you mentioned that you have taken another 8% increase in November that is in faucet only, right?

**Ayush Bagla:** Only sanitaryware, polymer and cistern products, 8% to 12%.

**Pritesh Chheda:** And my last question is, you mentioned that importer's import dependent models are facing challenge because of the rise in container cost in case of sanitaryware, so is it fair to assume that there would be a trend of accelerated growth for your Company versus the industry growth rate, in any case the industry itself is seeing tailwind on account of the housing sales number whether it is new housing sales or the resale number, so we would have a much faster growth rate versus the industry?

**Ayush Bagla:** That is evident in the Q2 numbers. Industry over the last 3-4 years was growing at single digit. This year, we can only estimate it might be growing at 10%-12%. So, that is evident from the numbers and we cannot really make any kind of estimate on the freight rates or Chinese vendors, what they are doing, whether they will have available quantities which have not been diverted to other geographies. That is a very difficult call because that has too many moving parts. So, whether Chinese products will be available for our peer group in 3 months, 6 months, or 12 months, that is a very difficult call to take right now.

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

**Achal Lohade:** My first question is, can you help us with the market share for FY21 or for last 6 months in sanitaryware, faucet and tiles?

**Ayush Bagla:** Achal, we don't get any kind of third party authenticated data, so the information we get is anecdotal data from the dealers in our sales network. Based on that, we can say that CERA is the largest sanitaryware Company in the country and is the second largest faucetware player in the country, but if you ask me for a Technopak study or any other study, I don't have it and there is no way of ascertaining that number.

**Achal Lohade:** My next question is, in the last call, you had indicated a possible topline of Rs. 1,460 crore with 14% margins thereabout, now given the way the Q2 has played out and 3Q is appearing, would you keep the number same or you think it can be revised upward and if yes, to what an extent?



- Ayush Bagla:** I only asked everyone to make their own estimates based on the run rate and that estimate worked out to 1,460. It could go higher based on the price increases, volume increases and the way the velocity of sales of real estate have worked out for everybody, so it could go higher. The only question mark is availability of products from vendors, maximizing on production throughput all of that. So, CERA still not the Company that is large enough to be able to accurately predict its topline 6 months later, so I think just we can make our own estimates based on the run rate. So, it could go higher than 1,460 if all these execution factors continue to be aligned.
- Achal Lohade:** Sir, my question is, you are saying that the demand is looking robust and the competitive environment is also kind of providing a breather, so in that backdrop, in terms of the capacity expansion, so first what is the utilization in the second quarter for own capacities for both sanitaryware and faucet?
- Ayush Bagla:** Sanitaryware is 97% and faucetware is 90%, though not comparable with last year, sanitaryware last year was 68%, faucetware was 46% given the various disruptions that were going on at that point in time and for the full year given the disruption, sanitaryware was 49 and faucetware was 54. So, 97 and 90 is pretty much at the top end of utilization.
- Achal Lohade:** So, in that case, where will the growth come from? Will it be more driven by the outsourcing and if yes, would the vendors have a surplus capacity or they are also operating at full throttle?
- Ayush Bagla:** In the very immediate term, yes, outsourcing percentage can increase, but in the medium term, like we discussed in Q1 of last year, we had acquired one land adjacent to the faucetware facility for organic growth of the faucetware plant. So, that continues to be available, the plans are being discussed. In sanitaryware, there are no current concrete plans of either an acquisition or an inorganic play. So, that is something that we will have to consider and come back to you on concrete proposal, but yes, capacity increase is something that we all discussed and we are cognizant of the fact.
- Achal Lohade:** My question is, if the demand is so good and everything is so well in place, what is restraining or constraining us in terms of taking a call on adding capacities, is that the location land or something else?
- Ayush Bagla:** Skills, most important in sanitaryware is skill, it is not an automated business-like tiles where you simply just have raw materials coming in from one end and finished goods and digital printing from another. At every stage, there is human intervention and those skills they need to be developed over 8-10 years or they are found in few geographies in the country and then comes land and some gas availability, so that metrics is something that only 2-3 locations in the country qualify, nearness to raw materials, etc., so based on that metrics, lot of things have been evaluated, nothing has been taken to the Board as yet because nothing reached that stage where it could be discussed with the board and with the concrete CAPEX proposal and this is the kind of SKU that can be made, this is the skill available all of that. So, if there is inorganic opportunity with plant with high quality standards, we will be very happy to look at it seriously.

**Achal Lohade:** And in terms of the margins, you said that there isn't much cost inflation actually in the sanitaryware, like 95% of the cost is fairly stable and just the glazing part of it is actually there is a modest inflation, so how do we explain this 8 to 12% price hike, what is driving this price increase and does it mean that the margins could see a significant change in the coming quarter itself?

**Ayush Bagla:** The price hike is driven by vendors. Vendors don't get GAIL gas at Rs. 13.5 which we get. They are buying Gujarat gas or any other sources at Rs. 45, Rs. 47. Their labour costs have gone up, so vendors have been discussing a price increase with us which might be anything between 7% and 10%. That is going to be finalized and implemented sometime in Q3 onwards. That is one driver, freight is one driver. So, these are the two very short-term and immediate drivers. Yes, the pricing power of the brand allows us to raise prices one step ahead of the cost. So, there has been margin expansion due to the last two price hikes and we expect that to also play out with this price hike. How much that will impact on a blended basis the three businesses, that is yet to be seen.

**Achal Lohade:** And just last question if I may, you know on the tiles business how do we look at this, I mean we are looking at the similar tailwinds even in case of tiles, but we are still having a drop Y-o-Y and I understand that even though we have broken the tie-up, you still can source, so what explains this decline in tiles and how do we see this business actually in next 2-3 years?

**Ayush Bagla:** Now, we have defined certain rules for the tiles business. Every transaction which will be largely a trading business will require certain EBITDA margin, that is one. Receivable days has been reduced dramatically in tiles and the share of retail component we want tiles to mirror the rest of the Company, to mirror the sanitaryware and faucetware business. So, the tiles had a larger component of B2B sales, we want a larger component of B2C sales, so that is the rejig in the tiles business and this is the best time to do it when the industry is buoyant.

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

**Hiral Desai:** So, if I look at the year over year growth rate in revenues for the quarter is at 24% which looks reasonable, but if I compare it with quarter 4 of last year, we had done about Rs. 430 crore, so we are down by about 10% despite an 8% to 10% kind of price impact, so I was just trying to understand were the volumes this quarter lower and it seems a bit odd given the buoyancy in the demand environment?

**Ayush Bagla:** 60-65% of any annual number is in Q3 and Q4 and Q4 is always the highest because it is the culmination of lot of trade schemes which are monthly, quarterly, and annual schemes. You will find that phenomena for the last 10-15 years in this Company and most home-improvement companies. So, I will request you to compare Q2 FY22 with the best Q2 of any year, which will probably be 19%-20%.

**Hiral Desai:** Yes, that there is a 9% CAGR I think if I take a 2-year number which obviously is fairly decent growth number. The other question that I had was, the SKUs that you spoke about which is 466 for sanitaryware and 919 for faucetware, within

that what is the share of sort of value added or complicated products that you typically make at the factory?

**Ayush Bagla:** We classify based on pricing, products into entry, mid and premium and I will give you that number. In sanitaryware, entry was 34% of sales, mid was 11% of sales and premium was 55% of sales. The same number last year in Q2 was 40%, 12% and 48%. In faucetware, entry was 30%, mid was 47% and premium was 23%. The same number last year was 31%, 16% and 53% respectively.

**Hiral Desai:** And assuming that the demand buoyancy remains in the second half of the year and as we get into FY23, you don't see a risk of capacity being a constraint, that is what sort of Achal also asked earlier, so just wanted to clarify on that, assuming there is 15% to 18% growth in FY23 which is possible from a demand side, are we equipped to be able to supply that?

**Ayush Bagla:** On the faucetware side, we have some capacity both in-house and the faucetware vendor based also have some capacity. In the sanitaryware, we have no additional capacity in-house, and we are working very closely with our vendors to move some SKUs that we produce into their facilities. That will create some capacities for us to create the most complicated products and just broad base our vendors and broad base the number of SKUs we are buying from our vendors, so that process is currently on.

**Hiral Desai:** And you also spoke about some sort of good quality facilities being available, are there enough in the country which you can sort of acquire on an inorganic basis on the sanitaryware?

**Ayush Bagla:** We are open to any such opportunity, we are not getting the kind of opportunity that fits our criteria of quality parameters and labour skill. So, in sanitaryware, there are virtually no such facilities, but we will be happy to explore if some companies leaving the country and they have a small facility which they want to divest. If any such opportunity comes our way, we will be happy to look at it seriously and evaluate. On the faucetware side, we already have adjacent land which we acquired in Q1 of 2021. So, it is the matter of time where the plants are firmed up and then presented to the Board and then finally to our shareholders and investors for approval.

**Hiral Desai:** And lastly, blended we have taken about between 15% to 20% price hike both on sanitaryware and faucetware, I am including this November price hike, you think there is enough demand buoyancy to observe this kind of 20% price hike and what is the competition done in a similar timeframe in terms of pricing?

**Ayush Bagla:** A few players who have good capacities in India, they are on the same level as CERA in terms of being able to supply products, but those who don't have adequate capacities or ability to make complicated SKUs in India, they have no product, so right now it is just the question of getting product to market, market runs completely dry, I know amongst you many do regular channel checks, we also do channel checks of our peer group of new geographies, all of that. Most markets are running completely dry.

**Moderator:** Thank you. The next question is from the line of Akhil Parekh from Elara Capital. Please go ahead.

**Akhil Parekh:** My first question is on the inventory level, how are they across the channel because in the inflation the environment we usually see the distributors tend to increase their inventory of stocking, are we seeing such kind of scenario like that at this point in time?

**Ayush Bagla:** There are a lot of sales that dealers, distributors, and retailers are seeing, it is probably the best year they had in the last 4-5 years. So, yes, they would like to stock products, but the companies don't have that kind of product to give them and there is rush at their counters, at their retail outlets, at the outlets that they service. So, everybody will be monetizing sales and asking for more products. That phenomena we have not seen for the longest time. We saw that only from the last 12 to 15 months. So, whatever can be produced, needs to be produced, the vendor base needs to be enlarged, broad based, the number of SKUs need to be moved to them, so that you free up some of your own capacity and produce more, all that process is on. Whatever reaches the market is selling and 2-3 major players are unable to get product to market because of China, so the balance players are benefiting.

**Akhil Parekh:** So, there is an abnormal increase in inventory level at the distributor segment?

**Ayush Bagla:** They are running dry, whatever the companies are providing to them including CERA that is sold immediately.

**Akhil Parekh:** From the demand side, in the past couple of calls, you had highlighted that next 10 to 12 quarters, kind of look extremely good in terms of the visibility perspective, so does that remain same? Second is, how is the demand across Tier-1, Tier-2, Tier-3 towns and if maybe I don't know if you could highlight how, it has been in commercial space, if we have any color of that?

**Ayush Bagla:** Commercial, residential, all are part of our B2B business that is 32% of sales. We would like to keep that ratio as the maximum ratio. We all want to increase share of retail. The B2B business is clamouring for product, but retail is where pricing power, brand expansion and all the benefits of promotions, advertising, social media can be monetized. So, this is the time to increase that B2C share even from 68%, 70%, 72%. As far as commercial is concerned, yes, the consumption of raw material of sanitaryware and faucetware in commercial and IT space is much lower than residential spaces, but that is a very strong segment in any case.

**Akhil Parekh:** And we have primarily been Tier-3 town, so how is that contribution in this quarter?

**Ayush Bagla:** I will give you the split again, tier 3 towns were 60% last year, they are 53% this year; Tier-2 towns were 13% last year, they are 15% this year; Tier-1 towns was 26% last year, 30% this year; exports were 1% last year, they are 2% this year. The reason CERA can do this, in Tier-3 towns, brand stickiness is very high. The consumer will think 10 times before changing a brand that he is used to specially a brand that is going to last 10 to 20 years and replacing a brand is a very tedious

process, brand loyalty is very high, our engagement with plumbing contractor, civil contractors is very high, so that stickiness is something that we always monetize and that has been the general trend. If you look at the last 6-7 years that has been the trend.

**Akhil Parekh:** Sorry, I missed that Tier-3 you said is 53% versus 60% last year and Tier-2 is how much?

**Ayush Bagla:** This quarter was 15 versus 13 last year, Tier-1 was 30 this quarter versus 26 last year and exports 2 versus 1.

**Akhil Parekh:** And would you be able to share like how much it was in terms of manufacturing in-house versus outsourcing across the products?

**Ayush Bagla:** Manufacturing in sanitaryware was 41.2%, outsourcing was 58.8%; manufacturing in faucetware was 43.32%, outsourcing was 56.6%; wellness was 100% outsourced and tiles is also 100% outsourced.

**Akhil Parekh:** Just two more questions on the ad spends side, how much we are expecting for the entire FY22 as a percentage of sales and second is on the current distribution reach across the product sales?

**Ayush Bagla:** Normally, publicity is 4% of sales, this quarter it was Rs. 12 crore versus Rs. 9.4 crore last year quarter 2, but normally 4% on an annualized basis is the number.

**Akhil Parekh:** And that is same for FY22 as well? And the distribution reach, number of dealer distributor for the quarter?

**Ayush Bagla:** So, the dealer network as on 30<sup>th</sup> September 21, sanitaryware had 2747, faucetware had 2133, tiles had 1549.

**Akhil Parekh:** How much we increased for the first half of this year versus last quarter over the year, total distribution?

**Ayush Bagla:** I can give you the same number of March. 2,640 for sanitaryware, 2,045 for faucetware and tiles was 1,527.

**Moderator:** Thank you. The next question is from the line of Ashish Poddar from Systematix. Please go ahead.

**Ashish Poddar:** Sir, if you can again touch upon your CAPEX spend for the current year and also on the industry side, how do you see the industry dynamics different from the pre-pandemic level, so may be 3-4 years ago, the kind of intensity and the response from leading players who are there earlier, how do you see it currently has the competitive intensity reduced significantly and will this continue or you see that it will come back again once things normalize, so your comments on that?

**Ayush Bagla:** Industry growth for the year 2016 to let us say 2019 were muted, but CERA doubled its sales between 2015 and 2019, so CERA has always beaten industry

norms of growth, etc. What has changed post pandemic is real estate has come back. That is sales of primary homes, but home improvement as a theme, which is basically the B2C segment that is even more important to us than the performance of the real estate business. So, home improvement has become a major theme post pandemic and people want to live in of course larger spaces and higher specs especially in their bathrooms, so that has worked out very well for us. Then of course, low interest rates and all of those macro factors have done very well and finally lack of Chinese products in India has done extremely well for CERA. So, companies who want to just import and dump in those Chinese products on Indian consumers, they were unable to do so for the last 2 quarters. That has worked out very well. I do not expect any of these macro or immediate factors to change for the next 24 months.

**Ashish Poddar:** And the CAPEX figure for this year, sir?

**Ayush Bagla:** The proposed budget for 21-22 is Rs. 17.19 crore. Sanitaryware automation is Rs. 6.69 crore, faucetware automation is Rs. 4.97 crore and logistic IT is Rs. 5.53 crore. In this quarter, out of Rs. 17.19, we spend Rs. 4.49 crore and if you want a breakup, I can give you that Rs. 2.25 was for sanitaryware automation, Rs. 1.19 was for faucetware automation, Rs. 1.05 was for logistics and IT.

**Moderator:** Thank you. The next question is from the line of Abhishek Ghosh from DSP Mutual Fund. Please go ahead.

**Abhishek Ghosh:** If you can just help us understand the strategy in the tiles part of it because that is the segment which is kind of seeing some moderation, in fact, there has been a decline, so if you can just help us chart out the tile strategies there?

**Ayush Bagla:** Tiles margin is moving up, it is soon in a few quarters or in a few years will come closer to the overall blended EBITDA margin of the Company. That is the aim. The second aim is to bring down the receivable days. In any case, CERA's overall receivable days are very small, the tiles receivable days are much higher than sanitaryware and faucetware receivable days. Our third aim is to increase the share of B2C sales in tiles. So, given these three parameters, the tile program took a short-term dip, maybe it takes another dip in Q3, we don't know we will wait to see, but the outcome of all this will mean that tiles EBITDA goes up, receivables days go down and share of B2C sales become closer to sanitaryware and faucetware B2C sales. These are just three simple metrics on which we are operating.

The flexibility that the tiles business has received is they have no obligation to buy from the joint ventures after divestment, but as option to buy it. So, even today there is no obligation to buy GVT tile from Anjani tile, but there is option to buy and it works out well for tiles given the high logistics costs to buy in Telangana and sell in surrounding areas from there and to buy from other vendors for sales in North India and Western India. So, given those flexibilities, now tiles business will perform much better.

**Abhishek Ghosh:** So, the way we should look at the tiles business is, it is going to be more of cash flow for you and not a topline business, is that the way to look at it?

- Ayush Bagla:** Yes, like any business, I mean we evaluated it on ROCE and capital deployed, working capital, what kind of risks the business is taking, what kind of inventory. We in any case, 2 years ago we moved to a zero-inventory model in tiles, our vendors are despatching product directly from their factory to the consumer, so that has resulted in significant cost savings in freight. So, the same criteria to evaluate that is used to evaluate sanitaryware and faucetware is being used for tiles.
- Abhishek Ghosh:** So, Ayush coming from in the current quarter, we have done about Rs. 200 crore of sanitaryware revenues which is largely tracking the peak of the quarterly revenues in couple of quarters that you had done in FY19, but we have almost seen about at least 20% inflation post November 15 your price hikes, so is the sanitaryware division capable of doing Rs. 250 crore kind of a revenue on a quarterly basis in peak utilizations after the price hikes?
- Ayush Bagla:** I am sure it can do that even if you look at quarter 4 of last year, I don't have the exact number in front of me, Rs. 209.58 crore, so yes that number can be gross and then there have been two price hikes, so that 209 becomes 225 in any case. Now, it is just a question of availability getting product to market. That will be name of the game for the next 24 months.
- Abhishek Ghosh:** And how should we look at the capital allocation because you are generating almost pre-CAPEX and pre-working capital almost Rs. 200 crore of cash flow every year you have fair amount of cash on your book in excess of Rs. 450 odd crore, so how should one look at it from that perspective if you can just help us understand that?
- Ayush Bagla:** Currently, there is nothing concrete in terms of inorganic or capacity expansion opportunities or plans, but those are being evaluated and both on the faucetware and sanitaryware side, capacity expansion will take place soon. By soon, I mean plans will be made soon, the Board will look at it soon, then the shareholders will look at it and we will take it from there. Whether it will be inorganic or organic that is tough to say. Everything is on the table right now, but in faucetware, the first step has been taken up of buying an adjacent land parcel.
- Abhishek Ghosh:** And using lead time of putting up a faucet plant will be something like 12 months, is that a fair assumption?
- Ayush Bagla:** Yes.
- Abhishek Ghosh:** Sir, just one last question from my side, in terms of industry, is industry able to develop new vendors for sanitaryware, what are you seeing at the market place, is that a very tough job or?
- Ayush Bagla:** For low end products it is possible, but for complicated products, we have found that their quality parameters are not up to the mark and the ability to make those complicated products are negligible, but that is also one barrier to entry for a new player, then there would be many players who would just want to make it a trading business and rely 100% on vendors. That has never been possible. That is one of the barriers to entry.

- Abhishek Ghosh:** And just one last question, given the overall pull in the market, in the demand and lesser supply, is there any scope of changing any of the dealer discount or anything of that sort to improve the overall margin profile, is that?
- Ayush Bagla:** Yes, that some moves on that effect have already taken place during Q2 and more moves on that front will be envisaged every quarter and trade is also responding. They want product, so they are willing to sacrifice some margins to the companies, at least in the case of CERA.
- Moderator:** Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the management for your closing comments.
- Ayush Bagla:** Thank you. I would like to thank everyone for attending this call and for showing interest in Cera Sanitaryware Limited. CERA remains positive that its strong positioning in the industry and improving macros would help it deliver steady and consistent growth going forward. With this, I hope, I was able to answer your questions satisfactorily. Would 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 time to join the call and see you all next quarter and Happy Diwali.

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