



CERA Sanitaryware Limited

Q3 FY21 Earnings Conference Call Transcript

February 03, 2021

Moderator: Ladies and gentlemen, good day and welcome to Q3 FY21 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 '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Mayank Vaswani of CDR India. Thank you and over to you, Mr. Vaswani.

Mayank Vaswani: Thank you Janice. Good morning everyone and thank you for joining us on the earnings conference call for Cera Sanitaryware Limited for the Q3 and nine months of FY21. We have with us today the management team comprising Mr. Ayush Bagla – Executive Director and Mr. Rajesh B. Shah – CFO and COO of the Company. We will start with brief opening remarks from the management, following which we will open the call for Q&A.

A quick disclaimer before we begin, some of the statements made in today's call may be forward-looking in nature and a note in this regard is contained in the result's documents that have been shared with all of you earlier and have also been uploaded on the stock exchange websites. 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 the time to join our call. The earnings for the third quarter and nine months ended December 31st, 2020 were adopted by the Board of Directors yesterday, 2nd February, 2021. The earnings documents have been released to the stock exchanges.

As we indicated during the last quarter, the overall demand backdrop was robust and we witnessed strong traction across all markets and products, especially from Tier II and below towns and cities. The home improvement theme has been resonating with consumers. Savings and disposable income for consumers due to restrictions on travel, entertainment found its way to upgradation and renovation of homes. The limited impact of COVID in Tier III and below centers has allowed civil contractors, plumbing contractors, and interior home designers to reengage with the consumer. Project sites which gradually opened up during Q2 were in most cases, fully operational. The impact of reduced interest rates for home loans at 7% and below has been the single most important factor for the surge in interest for new home purchases. We truly experienced the elasticity of demand in relation to cost of capital in real estate. Stamp duty reduction in a few geographies for a

limited period, made consumers bring forward their new home buying decisions. This resulted in a reduction in inventory at the Company level.

As the challenges posed by COVID19 steadily reduced, we started witnessing a notable improvement in our performance. I am happy to share that the positive rebound demand we witnessed in Q2 FY21 from our most profitable verticals, i.e sanitaryware and faucetware businesses continue to sustain into the third quarter as well. As we had shared the sanitaryware business has exhibited signs of returning to growth while the faucetware business continued with its positive trajectory of growth of the last many quarters pre-COVID. The media campaign on 'staycation at home', which was unfurled by the Company from September, 2019 directly connected with consumers post lockdown.

The Company, however, could not take complete advantage and monetize the uptick in demand due to the partial disruption witnessed at the manufacturing facility. As intimated to the exchanges periodically during the quarter, a group of workers remained unauthorizedly absent from their duties with effect from 29th September, 2020. Following this on 16th October, 2020, the labor department of the Government of Gujarat declared the disruption as illegal and directed the group of workers to resume their duties. The High Court supported this position and issued further directives following which all workers have completely resumed their manufacturing activities from 22nd December, 2020.

Restoring the overall normalcy in production took longer than expected and therefore CERA Sanitaryware's production and consequently performance for this quarter was impacted materially. The production of faucetware had been impacted marginally.

Consistent efforts undertaken in the past to drive automation largely enabled the Company to run its factory with the help of the available skeleton staff. To elaborate a bit further on this aspect; there have been several enhancements which we had undertaken at our manufacturing infrastructure at the plant. Processes such as pressure casting, in sanitaryware and grinding, polishing, electroplating in faucetware had been automated to enhance efficiency, consistency, and finishing.

There has been a strategy to develop agile infrastructure by leveraging a mix of in-house and outsourced facilities to enable us to rapidly respond to circumstances. This proved highly beneficial in the backdrop of the partial disruption as we were able to increase volumes from our vendors to cater to the improved demand. The normal percentage of outsourcing in sanitaryware is 50% to 55% and this quarter it's close to 77%. In faucetware the normal percentage of outsourcing is 50% to 55%, which rose to 59%. Certain high complexity products, which are manufactured in-house were impacted since these could not be outsourced. The production cycle for newer products at the vendor base involves mould making, establishing quality parameters and thus take 3 to 4 months.

We estimate the partial disruption has led to lost sales of Rs. 65 crore and reduced EBITDA by Rs. 10 crore in Q3.

Coming to our numbers; revenues in Q3 FY21 were Rs. 310 crore, lower by 2.5% on a sequential quarter basis. EBITDA including other income was Rs. 48 crore in Q3 from Rs. 44.4 crore reported in Q2 this year. The EBITDA margin has firmed up to 15.14% versus 13.8% in Q2 FY21, an increase of 134 basis points. PAT was Rs. 29 crore in Q3 FY21 versus Rs. 26.29 in Q2 FY21.

Due to the sharp rebound and performance, the performance in Q3 this year has nearly reached parity when compared to Q3 last year, despite the challenging backdrop due to the partial disruption at the manufacturing facility. For Q3 FY21, the revenue for the quarter stood at Rs. 310 crore versus Rs. 321 crore in Q3 FY20, which is down by only 3.4% on a YOY basis. On a YOY basis EBITDA excluding other income for Q3 FY21 was Rs. 40 crore versus Rs. 43 crore in Q3 FY20. The EBITDA margin for Q3 FY21 stood at 12.8%, lower by 53 basis points. Profit after tax for Q3 FY21 is Rs. 29 crore against YOY number of Rs. 28 crore. EPS for Q3 was Rs. 22.37 versus Rs. 21.81 in Q3 FY19-20.

For Q3 FY21, 45% of the topline was from sanitaryware, 28% from faucetware, tiles represented 24% and wellness 3%. On a YOY basis, sanitaryware revenues registered a decrease of 5%, faucetware revenues increased by 7.7%, tiles declined by 6.6% and wellness declined by 37.1%. Contribution from sanitaryware was impacted in Q3 due to the one-off disruption. However CERA's ability to tap into its vendor ecosystem led to increased outsourcing and with the continued growth from faucetware these two verticals remained the bedrock of the business with contribution of 73% to revenues.

Inventory days in Q3 FY21 were 53.88 days compared to 52.83 days in Q3 FY20. Receivable days in Q3 FY21 were 53.93 days versus 58.34 days. Payable days in Q3 were 46.25 days against 39 days in Q3 FY20. Therefore, net working capital days in Q3 FY21 was 61.56 days versus 72.17 days in Q3 of FY20. Those of you closely tracking CERA are aware that this has been a focus area for the Company, which has required considerable effort over the last few quarters. Initiatives, such as digitization and established localized warehousing have enabled us to offer 'Just-in-time' inventory to trade partners and large customers. This has enabled debottlenecking at the dealer locations and customer sites leading to faster and smaller billing cycles for CERA enabling better receivable management. The company was able to further increase its liquidity position to Rs. 409 crore as on 31st December, 2020 from Rs. 362 crore as on 30th September, 2020.

To conclude overall; the sector fundamentals are strong and the domestic demand continues to grow at a steady pace. As we look ahead, we continue to see an immense potential for our products. Healthy demand coupled with our strong positioning in the industry should enable sustain traction. On the whole, we are confident of the future growth potential and opportunities across our markets over the medium to long term. On that note, I would now like the moderator to open up the line for Q&A. Thank you very much.

Moderator:

Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Omkar Kulkarni, individual investor.

Omkar Kulkarni: So I wanted to know how the currency scenario is panning out, now the disruption at the facility is over. How do you think your growth can be like next couple of quarters?

Ayush Bagla: See the first and most glaring thing about the demand scenario is there was demand much in excess of available products and in excess of supply. Not only in Q3, but going forward for atleast the next 2-3 quarters, our estimate is demand is way ahead of our ability to supply even though we are back on a three shift basis from 22nd December and our outsourcing partners in India and abroad are working on a full steam basis. Given the sudden surge in demand from projects and retail customers for the foreseeable future, there is going to be no dearth of demand, inventory both at the dealer level and at the company level is going to be as close to zero as possible and practical across a vast number of products. So demand has proven to be very-very elastic. The single largest factor of course is the interest rate scenario, we have always talked about the interest rate sensitive sectors behave, but we have never tested this theory with a sub-7% below home loan regime. So given that the home loan regime will stay below 7%, which is the most likely scenario, demand will outstrip supply for the next few quarters. And that is reflective not only in the shortage of products Q3 but the surge in numbers post reopening on 22nd December, so January was a fantastic month and all indications for the balance two months of Q4 are very strong and atleast for the next 2-3 quarters.

Omkar Kulkarni: So the capacity utilization was 100%?

Ayush Bagla: You see capacity utilization, I'll give you the numbers. We had only nine full working days in the quarter at the sanitaryware facility because of the partial disruption, which we kept on informing our stakeholders from time to time. So on a 90 day basis, sanitaryware was at a capacity utilization of 20% and faucetware was at the capacity utilization of 58%. But our trade partners and vendors were operating at as close to full capacity as possible. And from 22nd December, we have been working three shifts. It's taken some time for the molds of 'Plaster of Paris' to be remade, etc. So from January is when full supply lines have been restored.

Omkar Kulkarni: So, excluding this, unforeseen scenario, you would have grown by around 13%-14% on the topline I guess.

Ayush Bagla: Yes, we estimate that we lost sales of about Rs. 65 crore and these lost sales of Rs. 65 crore are all high-end complicated products, which are made in our own manufacturing facility. So they couldn't have been substituted by products from our vendors. So other than this Rs. 65 crore which is in our mind a one-off event, the Q4 onwards you will see normalcy in production sales and all efforts will be made to best monetize the available demand scenario.

Omkar Kulkarni: Whatever you are saying atleast a double digit growth can be seen, right?

Ayush Bagla: We will be a little careful about making any kind of prediction about Q4 and beyond in terms of numerical. We'll wait for that scenario to actually take place and then take a view from there.

Omkar Kulkarni: The second question is on the liquidity position. You are sitting comfortably on quite a huge amount of cash. I would like to know how you would be deploying or rewarding investor, now that even dividend distribution tax has been abolished. What has been your dividend policy of around giving back, what is the percentage, say 30%-40% of the total cash, so what has been your policy of dividend?

Ayush Bagla: Our past policy has been 15% to 18% of PAT has normally been given out as dividend if you look at the last 6 years. But on the face value of Rs. 5, we have normally given out last 3 years, Rs. 13. So that's 260% on face value. That of course the Board will make a call as and when the year closes. Yes, we understand the point that liquidity has been growing in every quarter even in Q1 where we got less than 45 days of actual working and in Q2 where bulk of our project customers continue to remain closed, liquidity was enhanced. Even in Q3 where our factory was as good as, disrupted and partially closed for 82 days out of 90 days, we increased our cash. So that is an outcome of very careful working capital management, inventory management, receivable management, and increasing the payable days. Going forward, if working capital were to expand because we might want to stock up on little higher inventory etc. we may not see this kind of addition to cash going forward. Currently there are no real concrete plans in front of the Board of utilizing the cash whether in the form of a buyback or dividend or any kind of a CAPEX. So the normal CAPEX program continues. Now I'll give you just some figures on the normal CAPEX program. The beginning of the year, we had indicated that the CAPEX program for this year is Rs. 21.82 crore. But out of that only Rs. 5.96 crore have been spent. In Q4 only another Rs. 6 crore are being planned to be spent. So a total of Rs. 12 crore is being spent this year out of our allocated budget of Rs. 21.82 crore. So CAPEX is also low and we have developed an ecosystem where we have agile infrastructure and on tap capacity. In most of the products, especially in the low end non-complicated products, we have been able to use this agile infrastructure. The vendors cannot have the same level of skill and sophistication in their factory that the Company has. So which is why, the disruption hit us to the extent of Rs. 65 crore.

Omkar Kulkarni: The cash you have been setting, so it would be beneficial for the shareholders if you increase the payout ratio from 15% to 18% around 25%-30%.

Ayush Bagla: All those various options I am sure will be considered by the board before a final decision is taken and once the 12-month numbers are available.

Moderator: The next question is from the line of Pritesh Chheda from Lucky Investment.

Pritesh Chheda: You mentioned that the sanitaryware growth in the quarter was (- 7%) whereas faucets grew. That's how you put it and tiles and wellness declined. That's how you put the numbers?

Ayush Bagla: I will just repeat the numbers, on a YOY basis sanitaryware declined by 5% and faucetware went up by 7.66%, tiles went down by 6.5% and wellness, a very small base of Rs. 7 crore went down by 37%.

Pritesh Chheda: So what grew in the quarter was basically faucet at 8%.

Ayush Bagla: Yes. In sanitaryware we would have been close to Rs. 200 crore (inaudible) Rs. 140 crore, if the factory not had that one time disruption.

Pritesh Chheda: What was the loss of days of production in case of a sanitaryware?

Ayush Bagla: 82 days out of 90 days, we were operating at a below 20% capacity.

Pritesh Chheda: So adjusting for the two, it seems that you would have grown about 14%-15% for the quarter. A lot of the products in the building material space, whatever commentaries that we are hearing are indicating towards a double digit, comfortably double digit growth rate, high double digit growth rate in the forthcoming quarters. So do you ascribe to the same opinion, especially in the fact that, you would have taken about 4%-5% price hike, both in sanitaryware and faucetware if recall in the last quarter plus there is this value mix possibility. So some percentage outlook if you would share. And if you could share the outlook on the costing on the RMC side, if any pressure is there in the business?

Ayush Bagla: I will just come to price hike and RMC and then go to the demand scenario. Sanitaryware our last price hike was in August 2020 which is 3% to 5% and the next price hike was on 1st February of 5% to 7%. In faucetware again the price have increased from 1st February of 8% to 10% and now coming to the raw materials scenario; 50% of raw material is China clay and sanitaryware, there has been no change. 45% again it's feldspars where there's been no change, both in price and availability in color and glaze again, no change. Zinc, which is 1% of sanitaryware raw material is up by 10% in nine months. Plaster of Paris again, which is little more than 1% of sanitaryware RM, it's up 7% in nine months. What is up is the freight element in all of this. The freight element is up significantly. As far as faucetware is concerned brass is very volatile. Brass plus the cartridge and washers are 55%-60% of the cost of production. Brass which is 90% of that 55%-60% is up by 12% in nine months. (Inaudible) which is 10% of raw material faucetware is up by 23%. As far as wellness is concerned, ABS based products such as health faucets, showers have gone up by 160%. Stainless steel, which is used in towel rack, shower arms and other accessories is up by 25%. So all this will be negated by the 1st February price hike that we have taken of 5% to 7% in sanitaryware and 8% to 10% in faucetware.

Now coming to the demand scenario; +10% plus demand is easily achievable. That's a very conservative number. You can tell from our topline of Rs. 318 crore that if we missed out on Rs. 65 crore of sales, the additional sales would have been 18% to 20% of YOY Q3 last year. So going forward the next 2-3 quarters and maybe even beyond if interest rates are here to stay below 7% for home loans, demand for both new launches, projects in the last stage of completion and home improvements is here to stay. So demand will not be a problem for companies like CERA and brands like CERA which have established products and lines of distribution. Now just feeding the demand will require all our energies.

Pritesh Chheda: You took what price hike in faucetware in August?

Ayush Bagla: No, there was no a price hike in faucetware in August.

Pritesh Chheda: So this is a first hike of 8% to 10%?

Ayush Bagla: Yes. Before that it was April review, the number we shared in the previous quarter.

Moderator: The next question is from the line of Ashish Agarwal from Pareto Capital.

Ashish Agarwal: I actually had a couple of questions. First, a small clarification, you mentioned that due to the production disruption, we lost about Rs. 65 crore of sales and Rs. 10 crore on EBITDA. Is that correct?

Ayush Bagla: Yes.

Ashish Agarwal: So my confusion over here is that, typically when your gross margins are about 50%, though this quarter is a bit higher and one would normally expect that all the expenses below the gross margin should be normally a clean pass through. How should we read this? Do we assume that the gross margins on the lost production, on the lost sales are lower?

Ayush Bagla: In fact, the lost sales constitute 65% of factory made products where the gross margin is the highest. So sanitaryware in any case is the highest grossing business, after which is faucetware then comes the blended average and then comes tiles. But we have for calculation sake taken 15% or Rs. 65 crore because that is the best number to estimate the previous historical EBITDA margins. Based on Rs. 65 crore of top line losses Rs. 10 crore would have been the impact on EBITDA.

Ashish Agarwal: So going by the historical EBITDA margin trend to estimate EBITDA loss?

Ayush Bagla: Yes.

Ashish Agarwal: Second thing that I have noticed is gross margin has gone up. So I did miss part of your commentary on the previous question on your cost elements. But I see your gross margin has inched up in this quarter vis-à-vis the previous quarter. So then if you are expecting that sanitaryware would be having a still higher margin. So would we be safe enough to assume that, margins can actually inch further up from here?

Ayush Bagla: See, we have not seen this kind of demand scenario after 2012. After 8 years we are now witnessing a scenario where it's difficult to meet the demand. In that scenario, every Company is only focusing at production and sourcing and somehow monetizing this demand. So similarly CERA is also doing that. So in Q4, you will see the benefits of that and going forward you'll see substantial inroads being made into the markets because of this trend. So 2-3 philosophies that we have been talking about last 8 quarters, like non reliance on Chinese import. All those things have now become important. For example, now sanitaryware has a 10% import duty on sanitaryware and 15% in faucetware. So those things it's a matter of time before they rise, just like they're rising in most of the sectors. And our dependence on total imports are less than 5% of topline versus our peer group which has between 25% to 40% of complicated products being imported. So all those things are now going to be important for the Company.

- Ashish Agarwal:** That's helpful. Another question that I have is, you mentioned about a very strong demand and that we are running three shifts despite unable to meet the demand. I was seeing in March, 2019 you had crossed the turnover of Rs. 417 crore odd. Were there some one-off in that number or given that you're producing more at full capacity, how can I compare myself with that March, 2019 quarter if I can?
- Ayush Bagla:** We had Rs. 418 crore of topline which was also a great number despite the fact that we lost Rs. 120 crore of topline due to the last 10 days of March.
- Ashish Agarwal:** I am saying about March 2019.
- Ayush Bagla:** March '19, we had Rs. 297 crore of top line versus Rs. 418 crore of previous year. The different was Rs. 120 crores of topline lost due to last 10 days of March.
- Ashish Agarwal:** No, actually my question was a little different. I'll just rephrase it. In March, 2019 we clocked about Rs. 417 crore. Since then our product basket has become wider and I'm pretty sure we've also added more partnerships on the sourcing side. Currently, as you mentioned that we are running at three shifts and all our production chain is completely occupied. Given that would it be fair to say that our revenues can actually exceed the Rs. 420 crore that we got in March 2019 by a healthy margin?
- Ayush Bagla:** Well, all efforts are in that direction but I'll be careful before putting a numerical value to it. If you look at the trends of January, yes, they are definitely possible. January was about 20% higher than the previous year, January '21 was 20% higher than the previous year.
- Ashish Agarwal:** Just one final question before I get back in the queue. Due to the production disruption how much working capital change you would have seen and where do you see that get back to now that you've resumed normal production?
- Ayush Bagla:** We might need to deploy a little more capital in RM and WIP and little more inventory to avoid a situation of any loss sales or certain surge in demand in any part of the country. The cash that we've been adding to treasury every quarter that may not be evident in Q4 but that number is yet to be known.
- Moderator:** The next question is from the liner of Saurabh Patwa from HDFC mutual.
- Saurabh Patwa:** Just one small clarification. This Rs. 65 crore number which you mentioned, was this institutional sales order or distributor sales or its demand scenario based on your forecast? Basically idea is to understand how much of this will spill over in Q4 and beyond.
- Ayush Bagla:** This is a mix of project and retail sales, primarily retail sales because most of our project customers who are able to stagger their supply schedules, so we didn't have too much impact on project. It was primarily retail sales.
- Saurabh Patwa:** This will get spread out overtime or some of this may we have actually lost also maybe because of some consumer which would have bought somewhere else possibly?

Ayush Bagla: So on a retail basis, yes but on a project basis, they're spread out. These are large projects and they can easily spread out their procurement schedule. So that's what we've done for project sales.

Moderator: The next question is from the line of Archana Gude from IDBI Capital.

Archana Gude: I have two questions; you have been consistently talking about demand being very strong. Can you just throw some more light on the demand front for the mid and high-end products, in sanitaryware and faucets and also has the sales been back to pre-COVID level for us from urban and Tier I cities?

Ayush Bagla: I can give you a Q3 breakup though Q3 is not so relevant. I can give you a breakup of what happened in Q3, entry was 30% of sales, mid was 12% and premium was 59% of sales. It's a blended average of sanitaryware and faucetware and if you want a breakup within sanitaryware and faucetware even that I have available. Sanitaryware was 26.5% entry, 10.2% mid and 63.3% premium. Faucetware was 33.8% entry, 13.9% mid and 52.3% premium. Now, if you look at the demand trends, Jan-to-Jan comparison, there was a difference of 20% even though the plant in eight days of working did not come up to a full production. Again in January we could not cater to the entire demand and going forward demand is rising at such a pace that I don't think any Company can cater to complete demand because nobody has ideal capacity and even vendors take a long time in ramping up their capacity or production. As far as outsources is concerned, we have identified products that can be outsourced, where our QC teams are comfortable, that so-and-so vendor can make these products at a particular cost, quality and pass all the QC tests. Asking those vendors to suddenly increase the number of products or use different molds takes minimum 12 to 15 weeks. So that's not an overnight process, so that process is also on. In Q3 lot of our vendors in the Morbi area continue to have labor shortage. Though we didn't have labor shortage per se. The Morbi area for sanitaryware vendors was not running at full capacity.

Archana Gude: And your comment on the sales from urban and Tier I for us, has it come back to pre-COVID level?

Ayush Bagla: If January is the indicator yes, we are 20% higher. Pre-COVID, January '20 and comparable to January '21 is a 20% high. And demand will not be an issue going forward. It will only be catering to the demand and see after 2012 we had a conscious effort of focusing on the retail customer. But we find now that the project customer has come back very-very strong and these are large orders of large national players. That is a welcome development, it's happened after 8 years.

Archana Gude: My second question was on the margin front. Which are the levers apart from maybe the increase in price hike we'll be looking at if I just want to calculate a 100 or 150 bps EBITDA margin expansion going forward, so what are the levers you are looking at? How we should look at the numbers going forward you are talking about demand and then price hike, so how one should look at the numbers going forward?

Ayush Bagla: There are 2-3 things. One will be top-line growth; one will be share of sanitaryware and faucetware. If that remains around 75% and above then of course the margin profile will be very good because sanitaryware and faucetware both have an

excellent margin profile. Third of course, de-risking the model by doing maximum cash and carry sales, so currently on a weighted average basis, more than 50% are cash and carry, cash discount billing kind of sales. If that trend continues then the working capital cycle will be well taken care off. The final thing of course is our CAPEX model. If we can keep the CAPEX budget in that Rs. 40-45 crore region going forward, I'm talking about 2 years from now. In 2021 the budget is yet to be finalized but that number will be very conservative.

Moderator: The next question is from the line of Amit Zade from Antique Stock Broking.

Amit Zade: Again on demand side, last year we had seen around sales growth of Rs. 120 crore in the month of March itself and given such an improved demand scenario, would we be disappointed with maybe revenue of less than 40% in the fourth quarter? Is that a fair understanding or is it too early to say?

Ayush Bagla: See fourth quarter prediction, we'll wait for things to take place. The early trends are January numbers which are behind us and that's 18% to 20% increase. That's the best indicator of what is happening in Q4.

Amit Zade: Given our majority of sales happened in the last fortnight of the March. So that is still far away, right?

Ayush Bagla: Yes and the last year's number was 297 crore which is a very low base. On a low base, we can exceed this number quite dramatically, but again we will wait for the numbers to play out before taking a view.

Amit Zade: Secondly on our tiles volume, what explains the decline in tiles volumes? Because even the industry has seen, at least for larger organized player has witnessed at least a double digit growth. If not double digit high single digit growth in volumes, so what explains the declined for us?

Ayush Bagla: Two things, our share of GVT has gone up to 36% and share of soluble salt has declined to only 6% and share of double charge is 19% wall tile is 29% and balanced tiles is 10% to that explains the move to high end tiles that's one, secondly the move to cash and carry sales.

Amit Zade: But I think this cash and carry trend has been across for all the players, if I'm not wrong, even for the unorganized players that has been the case. And also another thing, I think we were operating at mid-single digit EBITDA margin especially in tiles. So do we see improved profitability going ahead in next year or can we reach lower double digit EBITDA margins in this segment?

Ayush Bagla: We can definitely reach a high single digit EBITDA margin in tiles. And the pluses that we have are very different from other players; you'll have to look at us very differently. We have deployed no capital capacity. We have no capacity on our own balance sheet. So if you look at the two JVs where we have an equity commitment that caters to 35% of our topline in tiles and the balance 65% are purely outsourced third parties. So that is a derisk model where you cannot have the risks or the advantages associated with having your own capacities.

- Amit Zade:** What was our Ad spend budget for a FY21 and FY22?
- Ayush Bagla:** FY-21, normally it's about 4% of topline that varies from quarter to quarter, so normally at the end of the year it all equalizes to about 4% of topline and that has been consistent across many years. It will change quarter to quarter.
- Amit Zade:** I thought for given in first half of COVID that could have been lower for this year.
- Ayush Bagla:** Yes, it was lower for this year and given the demand scenario that kind of spending may not be required, when there's actually a shortage of products. So will see it what finally emerges at the end of the year, but 4% is the best way to look at this number.
- Moderator:** The next question is from the line of Hrushikesh Bhagat from Kotak AMC.
- Hrushikesh Bhagat:** Just on this extending this tiles volume decline, revenue decline, so is it then fair to assume you spoke about derisk business then over the medium to long-term this tiles business might not be able to grow in line with industry, probably will remain in low single digit or such kind of growth considering of our lack of willingness report incremental capital in this business. Secondly, are there challenges on the outsourcing front in this business, because Morbi is fairly full of export order. So, that's the number one question from my end.
- Ayush Bagla:** You see Morbi, if you look at the total tiles industries, let's say Rs. 42,000 to 45,000 crore of our own. Exports are only Rs. 12,000 to Rs. 14,000 crore out of Rs. 42,000 crore. So domestic demand is still two and a half times the export entire market and there's no shortage of production. In fact, two-three things that happened in more be in tiles, the switch from coal to gas which was looking like a very painful procedure is now become very painless, even in the face of rising gas prices because most of these 700-800 plants are now operating at very high capacity utilization and they have found markets for all their products. So that is a welcome development. The industry is getting not only size but much more efficient that's one. And as far as sourcing of those tiles is concerned, we have ample supply lines for sourcing. It is about now just managing your receivable days, inventory days and ensuring that there is a certain EBITDA margin on every transaction of tiles purchase and sales.
- Hrushikesh Bhagat:** I would like to interrupt, because lot of your peers in tiles are also focused on receivable dues and working capital have rather shown improvement in working capital across the industry. So in that backdrop, the decline in tiles revenue frankly looks lightly perplexing because are which other more conservative compared to the existing players in tiles. That's how we should read it? So if you can help around that.
- Ayush Bagla:** If you are comparing the CERA Tiles, which is a Rs. 300 crore and below business to companies which are either Rs. 1,700 crore or Rs. 3,000 crore, those companies have been in the tiles business for 30-40 years, where their brand name is almost like a generic name for tiles. We have been in this business for 6-7 years and the brand premium in the tiles industry in any case is much lower compared to faucetware and sanitaryware. And the CERA Tiles brand premium is nowhere near the top three-four names in the industry. So that is the major difference in pricing

part and therefore all on sites. If we increase our receivable days of course we can take this to a Rs. 500 crore business, but then that's not something we would like to do.

Hrushikesh Bhagat: My second question, I think one point you made in the sense rather of consistently made in this call is that regarding the demand-supply mismatch and fair bit of strong demand trend that you are witnessing. Now, if I look at the other building material category, I think that has also shown a lot of building material companies are also showing the similar demand trends and lot of them obviously have reached their margin guidance are probably talking about margin, potential margin way higher than the historically that they have made. So against that backdrop do you think that something like that could be possible in sanitary or do you think the unorganized segment is relatively not that big in sanitary, so that is not possible in this case, that will be helpful.

Ayush Bagla: In sanitaryware the biggest gainers will be the top four brands with this kind of market expansion and even amongst the top four brands, those who can monetize this demand environment, who can work on their supply lines. So the unorganized market in sanitaryware in any case is below 30%, the price difference between the organized and unorganized in low-end product is Rs. 500 to 1,000 for products that are going to have a life of 20 years and of course there is associated QC, after sales service, warranty issues that only organized players can afford. So given all those factors, unorganized is not a threat. Now it is about grabbing market share from one another and grabbing a share of incremental market share in the growth of the market.

Hrushikesh Bhagat: So that's what I was coming to, that in other product categories there are larger unorganized segment where there is a disruption and those companies are benefitting. That is not possible probably as you highlighted in sanitaryware, but in that backdrop since you guys will be probably competing against organized players itself, do you think that margin improvement looks possible or in the sense can margin expansion is possible?

Ayush Bagla: It depends on each company's operating leverage. In our case only 20% of our total costs are fixed and 80% of variable. So yes, there will be a difference with increasing topline. It will not be that dramatic in a Company where capacity utilization is low and fixed costs are very high, but the fight will be between the top four players.

Moderator: The next question is from the line of Mithun Aswath from Kivah Advisors.

Mithun Aswath: I just wanted to understand obviously you had some issues with the employees in the last quarter or so. I just wanted to understand, has that been resolved? What is the issue that they have, would you need to take some sort of salary hikes or anything, for that to get resolved? That was question one. I also wanted to understand, you mentioned that your own production facilities got hit and where you make high-end products. Now if this comes back on stream, are the margins in this business higher than your current overall margins of around 14%? So those were the two questions that I had.

Ayush Bagla: See, we had disruption in our main manufacturing facility of sanitaryware in Mehsana from 29th of September, which was the second last day of Q2 and that resulted in the bulk of the workforce being absent from that day onwards. We approached the Government of Gujarat, where the labor ministry conducted hearings, called all the sides including union management, all of that and gave an order on 16th of October saying that the disruption is illegal and all the labor should immediately report to work. When that didn't happen the matter reached High Court and after extensive hearings, the High Court gave an order on 22nd December asking all the workers to join which they did. So from that day onwards, we have started three shifts working, but that was only the last nine days out of the 90 days of the quarter. There was no increase in either fixed or variable. So there was no change in any of the commercial terms of the workers and the disruption caused of course immense production loss to the Company to the extent of at least we estimate Rs. 65 crore and top line losses. In an environment where there was plenty full demand from retail and project customers. So the consequent impact on EBITDA, if you look at 15% of the Company's average EBITDA over the 6-7 years, then the EBITDA loss we estimate was Rs. 10 crore. But the Company stood by whatever agreements were in place and there was no change in any commercial or any other non-cash terms of any kind. Going forward the commercials for the labor remain the same, three shift working is on, that currently is still not enough to cater to the demand, in January and a few days of February. Going forward with the newest interest rate regime, we feel that demand will dramatically be higher than supply going forward. So, all efforts will be made to somehow monitor this demand.

Mithun Aswath: I just wanted to understand, since it's your own production and you will not be outsourcing, would this be higher margin than your current business? And again, on the labor I understand that they have come back but I just wanted to understand what is their grievance for doing that and how would you stop that from happening in the future? I just want you to understand that.

Ayush Bagla: See before this the last disruption was in 2002. So it's happened after a period of 18 years. That's number one. The reason for the disruption was simple. The same union was also in the plant of Hitachi which is adjacent to our plant, where Hitachi had given a substantial increase in fixed wages after a disruption. So they expected that CERA would follow suit if a disruption would take place, that didn't happen. That was the only grievance. And as far as margins are concerned, margins for our own production even on high-end pieces etc. are almost similar to our outsourced pieces, which continued throughout this period of Q3. In most quarter if you follow the Company, 50% to 55% of sanitaryware is outsourced. This number became 77% because of the percentage of own production decreasing.

Moderator: Thank you, ladies and gentlemen, that was the last question for today. I would now like to hand the conference back to the management for 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 is strong positioning in the industry and improving macros would help it to deliver steady and consistent growth going forward. With this, I hope I have been able to answer your question satisfactorily. However, should you need any further clarification or would like to know more about the Company, please feel free to reach out to me or CDR India.



Before I close I would like to thank you all very much once again, for joining the call and see you all next quarter.

Moderator: Thank you. On behalf of Cera Sanitaryware Limited, we conclude to today's conference. Thank you all for joining. You may now disconnect your lines.
