CERA Sanitaryware Limited

Q3 FY22 Earnings Conference Call Transcript

January 25, 2022

Moderator: Ladies and gentlemen, good day and welcome to the Q3 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'll now hand the conference over to Mr. Mayank Vaswani of CDR India. Thank you, and over to you, sir.

Mayank Vaswani: Thank you, Steven. Good morning, everyone and thank you for joining us on the earnings conference call for CERA Sanitaryware Limited for Q3FY22. 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 shall 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 will now turn the call over to Mr. Ayush Bagla for his opening remarks.

Ayush Bagla: Good morning, everyone. The earnings for the third quarter of the FY2021-22 were adopted by the Board of Directors yesterday 24th January 2022. The earnings documents have been released to the stock exchanges. I'm delighted to share that the demand from both retail and projects in Q3 FY22 was robust, and we registered healthy growth across all markets and products. We witnessed continued strong demand as the trend towards home upgradation and home improvement persists. Accelerating real estate demand due to vectors like low mortgage rate, traction in residential unit sales, strong salary and hiring growth in the IT and ITES sectors, continued work from home have all combined to contribute an all-time high sales velocity. The improving volumes coupled with other Government initiatives we believe are key drivers for increasing demand for CERA's products during the quarter gone by.

We expect this trend of robust consumer demand to grow for the medium term. Primary and secondary sales of homes, home improvements and upgradation became a major theme with homeowners. The focus remains on monetizing this demand by; (i) maximizing throughput of technologically complex SKUs at our own manufacturing facility; (ii) broad basing the product portfolio and the vendor network in India; and (iii) using the pricing power of the brand to proactively lead the Sanitaryware and Faucetware markets.

We started 2022 with the third wave of COVID in India. At CERA, we have continued with necessary safety protocols at our Kadi factory to keep our operations running smoothly. At present, our factory continues to function normally and at a high utilization level. Capacity utilization for Q3 for Sanitaryware was at 103% and in January 2022 it continues to operate at similar levels. In Faucetware capacity utilization was at 99%, our dealerships and vendors are functioning well.

We have been consistent in our choices. We have relied on CERA's own manufacturing capabilities rather than opting for imports. This has been a route taken by a few Sanitaryware companies in India. The rise in single container costs from $600 per container to $6,000 in August 2021 and then $10,000 in September 2021 have disrupted imports. In January 2022, the freight rates are $7,000 per container, rendering it almost unviable to import Sanitaryware products from China. Since July-August 2021, we have seen many Sanitaryware players unable to book orders for any deliveries before 2022 in the expectation that freight rates will soften.

This has opened a huge opportunity for us. We have acquired new customers and have gained from this vacuum. The B2C front-end is contributing a higher share of revenue, leveraging off the power brand CERA, that has demonstrated pricing power and customer pull in retail markets. The B2B business is at a level that we are most comfortable with. Our core business of Sanitaryware and Faucetware offered tremendous growth, ability to innovate, opportunities to create newer niches and to expand sub-markets. Demand has been robust in both verticals. Sanitaryware contributed 53% of topline for the quarter and Faucetware 35%. Together Sanitaryware and Faucetware contributed 88% of topline during the quarter compared to 73% of topline contributed in Q3 last year. This composition has a direct bearing on the EBITDA margin which has achieved a higher range despite input cost inflation.

Relations with labor 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 product or result in cost reduction. This focus on ensuring optimum production as well as product availability may require us to carry higher inventory levels of both raw materials as well as finished products.

As we shared earlier, we are also rebuilding inventories across our network in order to be able to serve the demand which is reflected in the rise in inventory days. As a result, capital deployed in working capital may rise over the next few quarters. Given the adequate cash reserves of Rs. 523 crore on 30th September 2021, we are comfortable place to do so. Getting product to market and product availability is a high priority for the Company as markets remain strong.

In addition to complete availability of our manufacturing facilities, our entire network comprising touch points such as 8 CERA style studios, around 150 CERA style galleries and around 375 CERA style centers, as well as 4,000 dealers and over 11,000 retailers are fully operational.

The other development to touch upon is the overall inflationary environment. The quarter was marked by an increase in prices of raw materials as being witnessed across all industries. The Company took necessary price hikes to remain ahead of cost pressures. In sanitaryware, we undertook a price hike of 3% to 5% in August 2020, a rise of 5% to 7% in February 2021, 4% in August 2021, and 10% in November 2021. The compounded impact of all these price increases is 26%. In Faucetware, price hike was 8% to 10% in February 2021, another 10% in August '21 and 5.5% in December '21. The compounded impact of all these price increases is 27%. Despite the external environment witnessing an increase in prices of imports and raw materials, CERA has witnessed limited impact in Q3 FY22.

On the Sanitaryware side key items like China clay, Feldspar and Plaster of Paris which constitute more than 95% of Sanitarywares, raw material mix had a combined impact of less than 1%. In the Sanitaryware business within the glazing recipe which constitutes less than 1.5% of Sanitarywares' raw material mix, the key constituents have moved 5% during Q3.

Freight has been stable in Q3 due to availability of gas from isolated wells near our plant. The pricing of gas from GAIL continues to remain below market prices and will do so in the future. Price from GAIL has moved from Rs. 9.5 per cubic meter in September 2021 to Rs. 13.3 per cubic meter in October 2021. In Q3 GAIL had provided 44% of the gas requirements of the Sanitaryware business. Sabarmati (JV of BPCL and GSPC)'s pricing went from Rs. 45 per cubic meter in September '21 to Rs. 70 per cubic meter in November '21 supplying 56% of the gas needs of the plant for Q3. The impact of both the price rises per month is Rs. 1.85 crore and for the entire quarter was Rs. 2.6 crore. There have also been price increases in some of the ancillary cost items like packaging. Cost of corrugated boxes have gone up by 3%, further increasing expenses in the current quarter.

Our high reliance on renewable energy for two decades has significantly benefited us given that 90% of our energy requirement is met from wind and solar power sources. As a result, we have been able to keep significant parts of our cost basket stable. Sanitaryware vendors too have been provided a price hike as their cost of gas and labour has moved upwards. The rate and range of change effective October-November 2021 is at 8.5% to 9% for Sanitaryware vendors and 5% to 6% for Faucetware vendors. For faucetware we have witnessed no rise in prices of brass in Q3 which is an important raw material and ancillary items like cartridge, washers etc. have witnessed a price hike of 3%.

In that backdrop, we can go over the financials.

Revenues in Q3 FY22 was Rs. 387 crore versus Rs. 310 crore in Q3 FY21. EBITDA excluding other income was Rs. 61 crore in Q3 versus Rs. 40 crore in Q3 FY21. The gross margin has improved at 52.48% in Q3 FY22 against 41.88% in Q3 FY21. The EBITDA margin is higher by 300 basis points at 15.8% in Q3 FY22 versus 12.8% in FY21. PAT was at Rs. 42 crore in Q3 FY22 versus Rs. 29 crore in Q3 FY21, an increase of 45.31% Y-o-Y. EPS for Q3 was Rs. 32.5 versus Rs. 22.37 in Q3 FY2021.

For Q3 FY22, 53% of the topline was from Sanitaryware, 35% from Faucetware, Tiles represented 10% and Wellness 2%. On a Y-o-Y basis, Sanitaryware revenues registered an increase of 47.19%. Faucetware were revenues increased by 51.97%, Tiles decreased by 46.33% and Wellness decreased by 3.94%. The Sanitaryware and Faucetware verticals remained the bedrock of the business with contribution of 88% to our overall revenues.

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

Inventory days in Q3 FY22 were 66.57 days compared to 53.88 days in Q3 FY21. Receivable days in Q3 FY22 were 29.67 days versus 53.93 days. Payable days in Q3 were 35.70 days against 46.25 days in Q3 of FY21. Therefore, net working capital days in Q3 FY22 were 60.54 days versus 61.56 days in Q3 of FY21.

As on September 30th, our cash and cash equivalents were around Rs. 480 crore. As on 30th December, our cash and cash equivalents increased to Rs. 523 crore compared to Rs. 409 crore on 30th December 2020, an increase of 28%.

After a fairly low capex here in 2021 which we spent Rs. 9.84 crore against a capex budget of Rs. 21.82 crore, there's only a slight increase in the current year. For FY'21-'22 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. In the first three quarters, the amount spend has been Rs. 5.63 crore for Sanitaryware automation, Rs. 1.45 crore for Faucetware automation and Rs. 2.25 crore for logistics and IT.

We continue to evaluate opportunities for accretion to our manufacturing capability, including inorganic opportunities and possibly even a greenfield capacity increase in Sanitaryware. In Faucetware a brownfield capacity expansion is possible and as plans are made more concrete, it will be presented to the Board and also to the investment community.

To conclude, I would like to mention that overall, the internal and external factors today bode well for CERA's future growth. We remain very enthusiastic and optimistic about the market opportunity. The efforts of the last three, four years in new product development, productivity gains at the shop floor and deeper penetration of the brand provides a superb opportunity to scale up the business and enhance all matrices of profitability.

The various supporting macro factors driving real estate demand and various other Government initiatives specifically for our building materials industry have some of the many positive aspects which we believe would provide necessary tailwinds to our business performance in the remaining part of 2022 and over the next two years. Given our strong positioning in the industry for over four decades now, we at CERA continue to remain excited to make the most out of the positive evolving opportunities for our business.

I would now request the moderator to open up the line for Q&A. And thank you very much.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Hiral Desai from Anived Portfolio Managers Private Limited. Please go ahead.

Hiral Desai: Hi, Ayush. Congrats on the quarter. Just had couple of questions. So, one was in terms of the revenue growth. While the headline number at 25% looks strong, but we had an almost you know 20% kind of pricing impact and plus Q3 last year, I think, still had that lingering impact of the employee unrest. So, if I just look at that 20% price hike, then we're looking at a 4% to 5% of the volume growth which looks a bit underwhelming given that the base quarter at that employee unrest issue. So, just wanted your comments on that.

Ayush Bagla: You're right. If you compare the Q3 numbers with Q2 numbers, the Sanitaryware and Faucetware numbers are flat, but the price rise impact was for a very small portion of Q3.

Hiral Desai: No, Ayush I am talking about the Y-o-Y numbers. So, we have had a 25% topline growth. But if we look at last 12 months, we would have broadly taken between 15% to 20% kind of price hike, because we started the price hike I think somewhere in August of 2020. So, if I just net that off, then we are looking at 4% to 5% kind on volume growth which looks a bit underwhelming given that Q3 of the base quarter also had that employee unrest issue.

Ayush Bagla: Yes, we had access to our vendors and all outsourcing products during that quarter and we had quantified the loss sales in Q3 of 2021 at Rs. 65 crore across all businesses. So, if you add that to that number, there is still an increase and the price has impact on, in that quarter since that quarter, the bulk of it has been from August of 2021. So, till August there was very little price hike. Post August also though it was announced all the old orders which were already punched, and advances received, those had to be executed in the old pricing. So, now the real benefits you will see from let's say 15th of December of all that compounding impact of all the three, four price hikes. But every quarter is a record quarter for us. So, Q2 was a record, Q2 both in top line, EBITDA, PAT. Q3 is a record Q3 in topline, EBITDA, PAT. In compression of working capital, in compression of all parameters of cash utilization. And obviously, there is a lot of room to grow, the industry has performed so well. In sanitaryware, the demand is huge after many years that we are seeing supply constraints. So, the capacity utilization in our own plant is 103%. Now the only way Sanitaryware grows is by increasing number of vendors and uptake from the current and newer vendors. So, that process is on, that process definitely has a lag effect. In Faucetware, we are operating at 97%. So, again, any increase in Faucetware will require newer vendors and increased throughput from current vendors. That has a slightly lag effect. That process is also on.

Hiral Desai: Got it. And Ayush these new products which you developed over the last 18 to 24 months which now contribute about 20% of revenues, within that what would be mix of what you would be manufacturing in-house versus outsourcing it through the vendors?

Ayush Bagla: That of course, we can dive deep into that data, get more granular and of course, share that in our next investor power point which we'll put on our website and release to the exchanges. So, we can split that 20% sales in in-house and outsourcing. But it will be a reflection of the overall numbers. So, outsourcing this quarter for Sanitaryware was 59.24%, own manufacturing was 14.76%. So, even within that 20% new product development portfolio, you'll find a very similar number. In Faucetware, it was 55.51% and own manufacturing was 44.49%.

Hiral Desai: Got it. And lastly, assuming that the demand continues to remain fairly strong in the medium term, you have enough vendor supply available to be able to fulfill that demand. You would not end up with a situation where you are unable to fulfill the demand that is there in the marketplace.

Ayush Bagla: Vendor availabilities of many categories and our quality standards reduce the universe of vendors available to a Company like CERA by 80%-90%. So, especially in Sanitaryware, and to a lesser extent in Faucetware and of course, in tiles, the differentiation is so little, that even if you apply the highest quality parameters, your vendor ecosystem is still very large. But in Sanitaryware, the ecosystem for CERA is limited to maximum of 20-30 vendors.

Hiral Desai: Okay. But there will not be any shortfall in terms of supply?

Ayush Bagla: Those vendors continue to make low-end and less complicated SKUs and that has been our strategy from the beginning that complicated SKUs need to be made in our own factory. And you and I have been interacting for so many years now. We keep on stressing this point, development of capabilities has become very, very important. The factory has to be equipped to make very complicated SKUs and the throughput of those SKUs always need to rise. So, those efforts made over the last three, four years are all coming through now, which is why you're seeing the capacity utilization cross 100%. That was never the case earlier. And the list of SKUs being manufactured in the factory are purely the complicated ones which vendors cannot make, which is why you find in our peer group they are forced to import from China. And I mean, we can talk about China. Yesterday we were doing the math once again, a typical container from China costs between $18,000 to $22,000. If you add the freight of $7,000 to $10,000 on that, almost one-third of the landed cost of a container Sanitaryware is freight. So, it is just not possible to import from China, which is why you're seeing so much upheaval in the companies which don't have manufacturing capabilities.

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

Ritesh Shah: Hi, sir. Congratulations with a good set of numbers. Ayush, you indicated the vendor base cost inflation numbers. I think for Faucetware and sanitaryware you indicated 8.5% and 9%, and 6.5% to 7%. Did I hear those numbers right?

Ayush Bagla: In relation to the vendors?

Ritesh Shah: Yes, yes.

Ayush Bagla: Yes, within Sanitaryware an average of about 8.5%-9% and Faucetware a little less, because in Q3 brass was more or less stable and Faucetware the entire universe of own manufacturing and vendors is totally linked to brass price.

Ritesh Shah: Right. So, how should one look at the margin profile for our vendor base? Is this something that we adjust given supply is definitely very tight in the market, wherein CERA is benefiting out of it? So, how are we taking care of our vendor base given incremental capex growth we are still yet to finalize that?

Ayush Bagla: See vendor base and as they are very transparent about their costs, and we have their cost sheets. So, given that transparency whenever there is an increase in labour wages or gas, we bill that in, and then that is negotiated price. And you see some of these vendors they have benefited greatly from partnering with CERA. Their quality standards have been upgraded dramatically. So, they can go and offer their products to many in the peer group. So, for them, there are a lot of advantages, and we get some part of that advantage as well. Now, as far as our own capacity increase is concerned, in Sanitaryware, we have more or less maximized and optimized whatever there was to be done in the current facility. In Faucetware, we have acquired the land adjacent to our Faucetware facility and exact plans on what kind of plants and what level of automation, those are currently on the drawing board. Let them become little more concrete then we'll be able to present it to the Board and post the views to the investment community. In sanitaryware, of course, there are a lot of discussions and options being toyed with internally. One of them is, of course, brownfield, then one is greenfield in some other geography, one is a greenfield in the same state and a few acquisition opportunities have also come our way of acquiring vendors. So, all those cost benefit analysis is currently on. So, I would say it's a matter of time before the Company finalizes one or two options and then gets everybody's feedback on that.

Ritesh Shah: That's quite encouraging. Sir, my second question is one of the variables that we were looking at is tweaking the dealer discounts. I think, given the might that the brand has and given the demand supply situation is also much in favor and actually the Company is taking proactive efforts on the inventory side as well. So, is it a variable which is actually working in our favor? Have you seen some improvement over last couple of quarters and also how should one look at it going forward?

Ayush Bagla: Not just last few quarters, if you see our pricing with dealers that has been continuously changing in the company's favour for the last many years. So, the dealer margins are getting compressed, but their volumes are increasing, their value is increasing, they're getting opportunities to bundle sales between Sanitaryware and Faucetware. So, their overall take home is increasing, and the Company is, of course, increasing its landed cost to dealers and compressing the price between MRP and the dealer landed price.

Ritesh Shah: That's quite encouraging. And sir just one last question if I may squeeze. Do we look at a policy wherein the dealers actually cannot sell at lower than the MRP? I think few of the industry guys do that. Given the might the brand has can we look at a policy in that direction or is it something that we'll leave up to the dealer to determine his economics?

Ayush Bagla: See the dealer and retailer economics in this business has been very healthy and very chunky. And in many cases the retailer shares some of those margins with the end consumer and that is across all brands, whether it's an Indian brand or MNC brand or any one of the low-end/high-end. Till the industry combines to lower retailer margin. There will be unlikely scenario where the retailer will not be passing on some of his margins to the consumer.

Moderator: Thank you. The next question is from the line of Abhishek Basumallick from Intel Sense Capital. Please go ahead.

Abhishek Basumallick: Thank you. First of all, congrats on a great set of numbers. I just wanted to understand your plan for the Tiles business and how do you look at growing that side of the business.

Ayush Bagla: See the Tiles business has always been around a 15% business for us, 15% of sales. Now it has come down to about 10%-10.5% of sales and you're seeing the impact of that in the blended EBITDA margins. It's got a lower margin profile than Sanitaryware and Faucetware. And from the start, as a Company CERA was very clear that it won't invest in any capacity on its balance sheet, so it's 100% outsourcing business and that remains. So, there's a lot of flexibility on how to push the pedal and accelerate the top line or slam the brakes as and when required. So, we have a stake in two manufacturing JVs, one of which we are exiting and getting our capital back. The other one is also a smaller JV. So, we almost had Tile sales last year of close to Rs. 270 crore - Rs. 280 crore and both the JVs together contributed about Rs. 100 crore of that product, the rest Rs. 180 crore came purely from third-party vendors and that philosophy will not change. At 10% of top line in a growing top line, so if you see the run rate etc. Tiles is still going to be a sizable business but with a very expanded EBITDA margin. For example, the low-end soluble salt is now only 6%-7% of our tiles top line, and high-end, GVT, double charge, wall tiles etc. are now 93% of sales. So, those are the shifts being planned and already taken place in the tiles business. So, growing Tiles topline was not an objective, growing Tiles bottom line was the objective. And within the tiles business, we have done a lot of work in increasing payable days, reducing the receivable days. So, we have very close to the market leader on those parameters. Now, the only parameter where we want to get close to the market leader is on the EBITDA margin front.

Abhishek Basumallick: That's great. So, one last question on the sanitaryware side. Right now, you said you're operating at around 103% capacity utilization. And so, what that probably mean that, you will have to depend on your vendors for incremental growth. So, does it mean that most of your incremental growth will come from lower-end segment, because you're probably doing the manufacturing for the higher-end segment yourself and you're sort of flat out on that in terms of capacity?

Ayush Bagla: That is what would appear intuitively, but the best way to look at it is the list of SKUs made in the factory each year is a very dynamic list. So, SKUs which were considered complex today are given to vendors the next year to make and more complex SKUs are made in the factory. So, that list is a very dynamic list. And some vendors who have the ability to make a few wall hung WCs or rimless sinks etc. which were considered complicated SKUs, those products are also being considered to be made by them. So, that number of percentage from own manufacturing should stay in that 40%-42% region in value terms. The number of SKUs and number of products in volume from vendors will increase dramatically.

Abhishek Basumallick: And your margins in the sanitaryware segment will remain more or less where it is today?

Ayush Bagla: The margins in both Sanitaryware and Faucetware are little higher than the blended number that you are seeing. So, yes, they will remain, the only advantage you will get with increased sales and increasing top line is 20% of our overall costs which are fixed in nature will get spread over a higher base.

Moderator: Thank you. The next question is from the line of Akshay Chheda from Canara Robeco. Please go ahead.

Akshay Chedda: Yeah, so thank you for the opportunity. So, just I wanted the, I wanted your views on the guidance like how should we see the topline etc. going forward? So, because what I recollect that you were guiding for around 14% to 17% kind of a topline growth for the next 2-3 years, considering the demand that is there and even the price hike we have taken. So, just wanted to understand your guidance for the next 2-3 years on the topline and even on the gross margin side because that I see has become a little volatile. So, we were doing around 47%-48% in FY21 and then in FY22 now we are doing north of around 50%, so some guidance that side and even on the EBITDA margin because 14.5%-15% is what you were looking, I mean, you were guiding for but now in this quarter we have been a phenomenal good number of around 15.8%. So, should we look at 15.5% as the new base or how should we look at it? So, yeah, your comments on these three things. Thank you.

Ayush Bagla: See if we are adding Rs. 400 crore of top line this quarter, that's a good number to estimate for Q4 or slightly a little higher number because Q4 is the culmination of monthly, quarterly and annual targets for the trade. And going forward, we could easily, I mean, it's not a guidance, it's just a guesstimate at this level because company is still too small to give out a guidance but adding Rs. 250 crore, Rs. 300 crore of sales annually for the next two years is very possible and very real. So, that's the number that I would work with. And on the EBITDA front, anything above 14.5%-15% is a very good number very healthy number and it's a leadership number in the industry. So, those are the two numbers that I would just look at right now, but again we don't want to make anything forward looking because the Company should attain atleast Rs. 2,000 crore in sales before it can predict earnings and top line with a lot of accuracy.

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

Sujit Jain: Hi, Ayush. If I add back the Rs. 60 crore, Rs. 65 crore sale in the base quarter, then the growth Y-o-Y actually comes at 6%. What would be in your opinion industry growth in terms of volumes and versus our growth in volumes both in Q3 and in nine months?

Ayush Bagla: So, we've always looked at value growth rather than volume growth simply because the number of SKUs in Sanitaryware are 350 and 850 in Faucetware. So, looking at any kind of volume will not give you a good picture on either the market or the Company. On value terms, adding 15%-17% to topline or even close to 20% in topline is definitely possible and the industry so far was growing at 7%. This year we expect the industry to grow at between 9.5% and 11%. So, we want to grow at least 1.5 times the overall industry growth.

Sujit Jain: If I add back the sales of Rs. 65 crore in base quarter and for nine months basically and look at increase in sales for nine months in FY22 then that is 22% increase versus what you have reported, which is 32% and so ineffective you said is that industry has grown 11%, you have grown, even after adjusting the base nine months, you've grown at 21%. That is a correct understanding, right?

Ayush Bagla: Right.

Sujit Jain: In terms of capex, if one looks at the commentary of other players who are becoming very aggressive in sanitaryware, Kajaria has announced I think a Rs. 80 crore capex, Asian Paints has been very aggressive with ESS brand, we have been very conservative in terms of our capex. Would that not eventually limit your growth for you to be able to reach a size eventually of Rs. 2,000 crore from currently Rs. 1,200 crore, Rs. 1,300 crore?

Ayush Bagla: So, Sanitaryware, you see we already were given the largest plant in the country. We already started with the largest plant in the country. So, we had huge advantages there. We were never close to 100% capacity utilization, over the last three years we were sometime 91%, 92%, 93%. In a few quarters, we slipped below 90%. So, we had a lot of headroom. So, we have now come to the point where we are at 103%. Now, looking at a new capex for brownfield, greenfield or an acquisition or strategic alliances with vendors, those things make sense. The companies you are speaking about did not have a legacy large sanitaryware installed base of capacity. So, they were relying completely on vendors and their products were going only in projects in B2B which is a price dominated sector. Despite their strong brands, there was no acceptance by the end consumer. So, their B2C sales were very low, which is why you'll see in those cases that discounting factor, lot of tile companies have entered Sanitaryware, but that discounting factor to the trade is very, very high. And composition of sales is all B2B which is why they don't give that split. In our case, the situation is very reverse. 70%-72% has been a historic B2C number and this year is 68%, because there is a surge in demand in the B2B business. We are trying to limit that demand because we know the margin profile in B2B and B2C is completely different. Now is the time for the Company to look at an expansion. If we had done that earlier not utilize the strengths and the trained labor and the other historical advantages low gas etc. of the current facility, then our cost structure and opex would have gone completely out of whack.

Sujit Jain: B2C meaning through centers and galleries, is that the understanding, correct?

Ayush Bagla: And dealers.

Sujit Jain: Okay. And one last quick question is your management. You've had attrition in the very highest levels. How have you dealt with that in terms of filling up of the positions?

Ayush Bagla: Yeah, so I'll just go one by one. Mr. Atul Sanghvi, who was the Executive Director, his primary responsibility was manufacturing operations that has been taken over by Mr. Anupam Gupta, who's joined the Company immediately around September from Grasim Industries. He was looking after manufacturing facilities of their ceramic insulator business which is a more complicated ceramic technologies than sanitaryware. So, he's joined not only our Board, but he is Executive Director, Technical in charge of all manufacturing activity. Then the CFO Mr. Rajesh Shah is now with us. From HDFC bank, one year ago Mr. Mahesh Taparia joined us who's completed one year from HDFC Bank having spent 18 years in HDFC Bank. Then from HSIL Mr. V. Krishnamurthy joined us as Head of Marketing and Procurement, who was with HSIL for more than 25 years. And Mr. Parthiv Dave who was with CERA for about 12-13 years and then became CEO of a multinational Company has joined us back as Head of Sales. So, before that Mr. Rahul Jain joined us as Vice President Marketing and Head of New Product Development from Parry which is also owned by Roca of Spain. So, these were the management additions. And other than Mr. Sanghvi, most of the people who left had reached their retirement age. Mr. Sanghvi was six months away from the CERA retirement age.

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

Achal Lohade: Yeah, good morning. Thank you for the opportunity, Ayush. My first question was in terms of the demand. You said the demand was robust across the pocket, B2B, B2C. But if you can give any qualitative commentary in terms of Q-o-Q, if there is any material improvements in terms of demand or improvement or kind of moderations from demands in metro as well as non-metros?

Ayush Bagla: See, the best way to look at it is to look at some of the numbers in distribution of tier 1, 2, 3 sales. So, historically, our tier 1 sales have been around 27%, this year is 30%. Tier 2 has historically been 14%, this year is 15%, and tier 3 which is population centers below 10 lakhs has been 58% which is now 54%. That is the only material change. So, that will give you a slightly, direction on where the demand is headed. Though the urban centers in tier 1 cities were the ones most hit by COVID, the recovery in them has also been faster. So, that was a learning for us this year as compared to 2021. But we don't see any impact, there's so much talk in the media about interest rate changes and will home loans get more expensive etc. we are not seeing any impact in terms of off take or consumer behavior.

Achal Lohade: Understood. If you can just comment in terms of the margins, is it fair to say the highest margins will be in Faucet followed by sanitary and then the Tiles or it could be Sanitaryware, Faucet and Tiles in terms of the margin?

Ayush Bagla: Sanitaryware and Faucetware are very similar within 150 basis points of each other. I won't be able to share which one is higher because that will give the peer group a pricing picture of our products, but both are higher than the blended EBITDA margin.

Achal Lohade: Understood. And in a comment, you said that the vendors get the opportunity to sell the products to other companies. So, just wanted to check in terms of the vendors for our Sanitary and Faucet, percentage of them how many are exclusive to us or 100% of them are multi-brand or non-exclusive vendors for us?

Ayush Bagla: Almost 100% will be multi-brand, because the B and C category of the products that they make, in terms of quality, those don't reach the CERA standard of quality, and we don't want to stop them from monetizing those products.

Moderator: The next question is from the line of Alisha Mahawla from Envision Capital. Please go ahead.

Alisha Mahawla: Hi, sir. Good morning and thank you for taking my question. Sir, firstly, just wanted to help or know what is the break-up between in-house manufacturing and outsourcing in the sanitaryware and faucet segment currently?

Ayush Bagla: In Sanitaryware, own manufacturing is 40.76%, outsourcing is 59.24% and Faucetware own manufacturing is 44.49% and outsourcing is 55.51% and Tiles is 100% outsourcing.

Alisha Mahawal: Understood. And sir with respect to the capex that we're talking about, when are we expecting this to come on stream, the expanded capacity in Sanitaryware I think we are spending Rs. 6 crore to Rs. 7 crore?

Ayush Bagla: No, this is all debottlenecking activities in the current facility. So, this does not require any plant shutdown or any new build. So, it's not a new plant at a new location. This is all at a current, specific machinery at specific processes within the current facility.

Alisha Mahawla: So, by when do we expect debottlenecking activity to complete?

Ayush Bagla: These are all you know ongoing. So, they would take just the time it takes to put up a foundation maximum of 30 to 45 days in each case. So, these don't require any disruption during manufacturing.

Alisha Mahawla: Okay. So, maybe by end of the year we can have some of the debottleneck capacity coming on stream.

Ayush Bagla: And during the year as well, even during the year.

Alisha Mahawla: Okay, sure. Sir one more thing that I wanted to understand is if you look at the last two quarters we are at about a quarterly run rate of Rs. 400-odd crore and you have mentioning even to the earlier participant that that is sort of maybe how we can also end the year with. But if we'll see such strong demand and there is scope for outsourcing for us to do volume growth and full impact of the price hike that we took in November will also be coming, isn't there a scope to for better growth?

Ayush Bagla: There is scope to increase Tiles topline in anyways that a Company would like, but we are very careful because for us any Tiles topline increase requires a threshold

EBITDA margin number to be met which is why you're seeing the Tiles number reducing. Now, once the renewed Tiles profile of products etc. is reintroduced in the market, it will be at dramatically high EBITDA numbers. And Sanitaryware, yes, the market is very responsive, very open to new products and even current products. There is a constraint in terms of capacity and products and bulk of the vendor eco-space does not meet our quality standards. So, there is only one constraint in Sanitaryware. In Faucetware, the constraints are slightly less. The throughput in our own manufacturing facility is being increased and the vendor ecosystem is slightly larger than the Sanitaryware ecosystem. The quality standards we are able to upgrade in our vendor ecosystem. So, that is being maximized. You're seeing the change in Faucetware topline. It could end the year with almost a 50% increase over last year. So, you're seeing the monetization of exactly what we mentioned. In Faucetware, we able to do that and in Sanitaryware there's a lag effect. We'll also be able to do that in Sanitaryware with a slight lag effect.

Moderator: Thank you. The next question is from the line of Rahul Agarwal from Incred capital. Please go ahead.

Rahul Agarwal: Ayush, two questions. Firstly, in terms of sales breakdown, just one bookkeeping question which would help me with entry, middle, premium level product sales for 3Q and nine-months?

Ayush Bagla: Yes, that I can do. In Sanitaryware, in the quarter, 29% of our sales were entry level, 13% mid-level and 57% premium. In Faucetware, 30% of our sales were entry level, 47% mid-level and 23% premium. So, I can give you the blended number as well which is 30% entry, 28% mid and 43% premium.

Rahul Agarwal: 43% premium blended right?

Ayush Bagla: Blended, yeah, for the quarter.

Rahul Agarwal: Okay, got it. Possible for nine months?

Ayush Bagla: Yes. For nine months, Sanitaryware 32% is entry, 13% is mid, 56% is premium. Faucetware 30% entry, 40% mid and 30% premium and blended for nine months 31% entry, 24% mid and 45% premium.

Rahul Agarwal: Go it. And second question essentially was on the new hires. I still cannot see a ESOP scheme there. Any thoughts on how you want to have long term retention and incentivizing for better-than-expected performance?

Ayush Bagla: Bulk of the management personnel and talent in the Company has been retained for a minimum of 20-30 years. So, even someone who leaves be it closer to retirement where he might see some runway for another 5-7 years. So, Company has always retained people for very, very long durations. And that is the current trend. Our current head of sales left the Company became a CEO of an MNC Company where he had a stake and has re-joined the Company as head of sales. So, if you ask anyone in the Company and I'm sure you know a lot of people in the Company they will give the same feedback. Nobody leaves here before 20 years.

Rahul Agarwal: Got it. So, even for let's say a new hire, who is not from CERA earlier, still in terms of any ESOP scheme there is nothing as planned as of now. Is that correct?

Ayush Bagla: Yeah. Currently, there is no ESOP scheme and nothing on the drawing board either.

Rahul Agarwal: Got it. And any plans on the analyst meet with promoter family sharing their long-term thoughts of strategy for CERA this year?

Ayush Bagla: Can you repeat that please?

Rahul Agarwal: Any plans for an analyst meet with promoter family sharing their long-term thoughts or strategies?

Ayush Agarwal: We can plan as soon as there's a slight easing of COVID norms. We can definitely plan one.

Rahul Agarwal: Okay, perfect. So, if we would take that as a suggestion, it will really help us in terms of getting some interaction with them. Thank you so much and all the best.

Ayush Bagla: Yes, yes. We always like to do that and even factory visit we can plan arrange as soon as COVID norms ease.

Modertor: Thank you. The next question is from the line of Rajesh Ravi from HDFC Securities. Please go ahead.

Rajesh Ravi: Could you share the revenue breakup? I missed that if you shared earlier.

Ayush Bagla: Yes, of course. 53.28% of sales of the quarter was from Sanitaryware, 34.52% for the quarter was from Faucetware, 10.36% from Tiles and 1.84% from Wellness.

Rajesh Ravi: Okay. My second question pertains to this crisis of freight rate crisis which the industry is witnessing, while it is hitting imports from China and all. Would that seem also with the case for most of the Morbi players and other exporters from India? So, how is that helping domestic players like you who have a large competent of outsource to volumes?

Ayush Bagla: Our outsourced volumes are all from Indian vendors. Only 5% of our total sales have ever been from Chinese imports.

Rajesh Ravi: No, my question is like with most of the domestic producers would be facing export headwinds, is that helping you source their product at a competitive price?

Ayush Bagla: See, you'll have to divide that question into Sanitaryware, Faucetware and Tiles. In Sanitaryware very few of our vendor ecobase were into exports, very, very few. So, there has been no change. In Faucetware also very few of our vendor ecobase is into exports and the freight doesn't apply in Faucetware because it's a high value item which takes a very small space in the container. So, freight changes get diluted in case of Faucetware. And similarly, in Tiles export is item that takes up very little space. So, of course, the value of the Tiles in the container is much more than that

$20,000 to $22,000 that I mentioned earlier, which is the case in Sanitaryware. So, Sanitaryware both domestically and in container imports faces the brunt of changes in freight.

Rajesh Ravi: Okay. But tiles is less impacted from a freight perspective?

Ayush Bagla: That's right.

Rajesh Ravi: Okay. So, is it more because of the non-availability of containers that is hitting export market?

Ayush Bagla: See that you will have to ask the relevant exporters, because my interaction with freight agencies is limited to China import and getting feedback on pricing over there.

Rajesh Ravi: Okay. And sir what would be your margin any tentative in the tile segments?

Ayush Bagla: Our margins in Tiles is definitely lower than the blended number. And there is a lot of headroom to grow which is why we are making changes in the Tiles business and we'll be back with double-digit margins in the Tiles business and try and reach and then cross the same to Rs. 280 crore number that we had last year.

Rajesh Ravi: You are already making double-digit margin?

Ayush Bagla: We aspire to make double-digit margins very soon in tiles.

Moderator: Thank you. The next question is from the line of Amit Zade from Antique Stock Broking. Please go ahead.

Amit Zade: My question is on our peak potential on the revenue side considering the fact that we have taken price hikes and in sanitary, in own manufacturing, we're already at 100%. So, sir what could be the peak revenue potential per quarter in the existing vendor base plus own manufacturing? Is it closer to Rs. 500 crore or is it (inaudible), any color on that side, sir?

Ayush Bagla: That answer has too many moving parts in Tiles, Faucetware and Sanitaryware. So, if you look at the current base, increase in vendors can add Rs. 100 crore, Rs. 150 crore per quarter easily. And then once Tiles, again, comes back to its old revenue trajectory, then another Rs. 70 crore can be added per quarter.

Amit Zade: Per quarter.

Ayush Bagla: Yes.

Moderator: Thank you. Ladies and gentlemen, we take that as the last question. I would now like to hand the conference over to the management for their closing comments. Over to you, sir.

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 is strong positioning in the industry, improving macros would help it deliver steady and consistent growth going forward. 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 time to join the call and see you all next quarter.

Moderator: Thank you. Ladies and gentlemen, on behalf of CERA Sanitaryware Limited that concludes this conference. We thank you all for joining us and you may now disconnect your lines.
