



Cera Sanitaryware Limited

Q4 and FY '20 Earnings Conference Call Transcript July 01, 2020

Moderator: Ladies and gentlemen, good day and welcome to the Cera Sanitaryware Limited Q4 and FY '20 earnings conference call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Mayank Vaswani from CDR India. Thank you and over to you, sir.

Mayank Vaswani: Thank you, Bikram. Good morning, everyone and thank you for joining us on the Q4 and FY '20 earnings conference call of Cera Sanitaryware limited. We have with us today from the management team Mr. Ayush Bagla – Executive Director, and Mr. Rajesh B. Shah – CFO and COO of the Company.

We will begin the call with brief opening remarks from the management following which, we will have the forum open for an interactive question and answer session. Before we begin, I would like to state that some of the statements made in today's conference call may be forward-looking in nature and a disclaimer in this regard is available in the results documents that have been shared with all of you earlier.

I will now hand over the floor to Mr. Ayush Bagla for his opening remarks.

Ayush Bagla: Good morning, everyone and thank you for taking time to join us all. The earnings for the fourth quarter and twelve months for the period ending 31/3/2020 were adopted by the Board of Directors yesterday, June 30th, 2020. The earning documents have been released to the stock exchange,

We began Q4 with the expectation of improving momentum in sales, positive traction for new products by consumers and segmentation implemented in recent quarters. Demand in Tier 3 centers and beyond was improving due to improving prospects for rural and semi-urban parts of the economy.

In Q4, the Company achieved an overall profitable quarter with positive cash flow despite the material development in the external environment. March is a crucial month for Cera each year, with the highest sales of any month. The disruption during the most crucial fortnight of the year has materially impacted revenues. The end of the year is a period of heightened activity as dealers rush to complete targets, promotions and schemes are implemented, and there is an enhanced traction of high-value products. The lost revenues have a high margin component, as fixed costs have already been incurred, impacting the quarter's profitability.

As we sensed the concerns around rise of the pandemic, we undertook swift action to ensure unhindered operations. While the plant discontinued operations following imposition of the lockdown on 25th March as per direction of Ministry of Health Affairs, Government of India, our teams rapidly set up facilities for employees to work from home, took steps to ensure data security and reached out to our trade partners and customers, while ensuring tracking of goods in transit. Once we received permissions to resume operations at the plant on 5th May, we executed the enhanced SOP.

Migrant labor was not an issue for Cera, as out of the total labor working in the plant, 60% live in and around the manufacturing facility for many years. In Mehsana district and Kadi town where the factory is situated, the COVID-19 impact was lesser than urban areas such as Ahmedabad.

Over the last seven years, manufacturing capabilities at own facilities have been significantly upgraded, with the introduction of fully automated pressure casting of sanitaryware products, an industry first, robotic anti-bacterial glazing of sanitaryware, automated grinding, polishing, threading and electroplating for faucetware. Some of these processes have assumed greater importance in view of COVID-19. As we have discussed with stakeholders at every opportunity, sanitaryware manufacturing is a complex process where training of labor and even standardization of automation takes a long time to develop.

Another delicate aspect is the ratio of in-house manufacturing and outsourcing, as neither full outsourcing nor fully in-house manufacturing has worked for any player striving to be competitive. At Cera we have been able to balance the products made in-house, and those that need to be outsourced along capabilities. We believe our facilities are best used for complex products such as wall-hung WCs, table top basins and one piece floor-standing WC's. In addition, our capacities are focused towards higher margin products. Our domestic outsourcing strategy is for lower technology products which do not require sophisticated robotics and can be produced competitively by our supply chain partners.

We have chosen to always develop in-house manufacturing capabilities and never had a need to rely on Chinese imports. This has set us apart from the rest of the industry where a high percentage of sales are from Chinese imports; and the industry has dependence for many complex products. The consumer is now in a position to call out those brands and ask for a 'Made in India' certification. We welcome this change in consumer behavior. We are in the process are working on an effective communicating stretch communication strategy on Cera's 'Make in India' and 'Aatma Nirbhar Bharat' strategy.

Next point, low CAPEX model. CAPEX over the last few years has never exceeded the band of Rs. 55 crore to Rs. 70 crore, even though annual cash flow was between Rs. 125 crore to be Rs. 145 crore each year. CAPEX was normally maintained within a band of 40% to 45% of cash flow. We believe an overall conservative approach to financial decisions, and emphasis on solidifying our balance sheet has placed us well to withstand volatility in the macroeconomic environment.

We continue to hold no long term debt and continue to be AA rated.

In terms of working capital we have sanctioned limits which are leveraged at various points during the year up to 25% of sanctioned amounts, which is about 11% of our combined inventories and receivables. As a result, we have never had to dip into our liquid reserves of Rs. 230 crore, which have increased every quarter till 31st March, 2020.

As a result of the low CAPEX and prudent financial management in the Company, the mark-to-market value of cash and cash equivalents has risen to Rs. 230 crore on 31st March, 2020. This is the highest level in the company's history. In each quarter through the years, and through the financial year 2019-2020, the liquidity balance continued to grow. Even after the Covid impact from mid-March 2020, there was no depletion or need to dip into these funds. In April 2020, during the lockdown, collections were sufficient to meet expenses and there was no need to use any portion of these funds.

Inventory strategy. We monitor the inventory very closely, and in a few cases have opted for just-in-time vendor arrangements, and at most geographies have localized warehousing, allowing us to keep ready availability of products at local markets.

Just-in-time inventory management and similar offer to project customers - We encourage our project linked customers to allow us to work with them to schedule smaller dispatches of products as and when their sites need them, rather than try to save costs on logistics via large deliveries, which take time to fit out and start the billing cycle earlier than required. This is a step towards faster and smaller billing cycles and receivable management as well.

A quick word on our cost lines:

Raw materials - Many of our raw materials are trending downwards in pricing. Savings have been made during financial year 2019-2020. Prices of claims are 5% lower than before, prices of zinc are 5% lower than before, zirconium pricing is 5% lower than before, brass is 2% lower in Q4 and 10% lower in FY19-20.

Vendor negotiations - We are in negotiations with vendors to assess scope for reduction in costs. So based on changing market dynamics, newer pricing and quality parameters are being built into contracts with vendors.

Fixed costs- Rents for warehouses, offices and Company owned customer touch-points have been negotiated, and fresh contracts are being signed during financial year 2021.

For Q4 FY20, revenue for the quarter stood at Rs. 293 crore, versus Rs. 413 crore in Q4 FY19, registering a 29% Y-o-Y decline. For Q4, 49% of the top-line was from sanitaryware, 27% from faucetware, tiles represented 21% and wellness 3%. On the Y-o-Y basis, sanitaryware revenues registered a decline of 30.7%, faucetware revenues declined 23.1%, tiles declined by 31% and wellness declined by 39%. EBITDA, excluding other income for Q4 FY20 was Rs. 42.40 crore, versus Rs. 63.79 crore in Q4 FY19. The EBITDA margin for Q4 FY20 stood at Rs. 14.5 crore, lower by 90 basis points. Profit after tax of Q4 FY20 was Rs. 38.47 crore against a

Y-o-Y number of Rs. 38.04 crore. PAT margin was higher by 113 basis points. EPS for Q4 was Rs. 29.58 versus Rs. 29.25 in financial year 2018-2019.

For FY19-20, revenue was Rs. 1,209 crore versus Rs. 1,344 crore, a decline of 10%. Sanitaryware revenues were 49%, faucetware 26%, tiles 22% and wellness 3%. On a 12-month comparison, sanitaryware revenues registered a decline of 16.8%, faucetware declined by 2.5%, tiles declined by 3.1%, and wellness by 2.7%. EBITDA, excluding other income for FY19-20 was Rs. 162.12 crore against Rs. 190.6 crore in FY18-19, a decline of 14.9%. EBITDA margins for FY19-20 is 13.4% against 14.2% in FY18-19, lower by 80 basis points. Profit after tax for FY19-20 was Rs. 115.94 crore against Rs. 115.05 crore in FY18-19. PAT margin was higher by 100 basis points. EPS for FY19-20 was Rs. 89.15 against Rs. 88.46 in FY18-19.

Inventory days in Q4 FY '20 was 62.01 days compared to 48.84 days in queue for FY '19. Receivable days in Q4 FY '20 was 56.78 days versus 68.57 days in Q4 FY '19. Payable days in Q4 were 44.36 days against 38 days in Q4 of FY '19. Therefore, net working capital days in Q4 FY '20 was 74.43 days versus 79.41 days in Q4 FY '19.

We have launched eight new SKUs in Q4 of FY19-20, and 765 new SKUs in FY 19-2020.

Touch free products and antibacterial glazing - We have a total of six touch-free faucets. We have developed a unique anti-bacterial glazing process called nanoglazing, which provides stain resistant water repellent surfaces.

We have enhanced our customer touch-points with 44 additional touch-points in Q4.

As the numbers indicate, we have built a resilient model where a large proportion of our costs are variable. The EBITDA margin and profitability have held up even in times of subdued demand.

Sanitaryware and faucetware businesses remain the core focus area for us and we are confident of the prospects on a sustained basis. The tile segment is growing according to business plan, with close to zero inventory days.

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

Moderator: Thank you very much, sir. We have a first question from the line of Archana Gude IDBI Capital. Please go ahead.

Archana Gude: Congrats on a decent quarter amidst these challenging times. I have two questions. Sir, how the quarter would have been looked in the absence of COVID-19? I know last March was really strong for us, but still some colour on that.

Ayush Bagla: Okay, see, the March month is very important for the Company because the trade partners rush to meet their monthly, quarterly and annual incentives. So the last 15

days of the month, which were lost in sales is the reason there is a 10% decline in sales, otherwise we would have been very close to, if not equal, to last year's numbers. And these are products which have much higher margin than the overall annual average. So that is the only difference. On the flip side, of course, our receivable days also decreased and receivable amount has also decreased, so total debtors instead of Rs. 297 crore were Rs. 220 crore, a decline of Rs. 77 crore.

Archana Gude: Okay. Sir, secondly, how is the demand from April onwards and is there any pricing pressure, particularly in the low and mid-price products?

Ayush Bagla: See, April was a month that was completely lost. And there were a lot of goods which were stuck in inter-state borders etc., at the end of March. So, all that got released in early parts of May, on 5th May we restarted the factory. So by the time that goods reached our localized depots and warehouses and even dealers, it was almost 10, 15 May. So sales have just started trickling in May. Dealers have started opening up in non-containment non-red zones. So we will see the impact more in the month of end May and June. And then we will be able to make a realistic assessment of how Q2 and Q3 of this current financial year will pan out. But rather than make any guesstimate about those numbers, we will wait for things to develop.

As far as pricing pressure is concerned, in any case, 70% of the new product launches are in affordable housing and we have bulk of our products addressing that segment. This is not to say they are only cheap products, because affordable housing projects which like to advertise the kind of products they are using, try to use Cera as one of the unique selling points in their projects. So they are also customers for high-end products.

And finally pricing, you see, as a Company we have negotiated pricing for our project customers, which is now 20% to 23% of our sales. But for our dealership customers, it's a fixed price. And dealers are free to sacrifice some of their margins with their customers, which is something that they do sometimes, sometimes they don't.

Archana Gude: Right. And sir, another question if I can squeeze in. Like last time we said the price hike will be taken from the 1st of April, I am sure now even that will get postponed. So when should we expect price hike for this year FY '21?

Ayush Bagla: The last price hike we took was between 3% and 5% across all products in May 2019. And the next price hike was scheduled from 1st April, 2020, which has now been postponed to August 2020 of between 3% and 5% across all products. Now, but we have to see this price hike in relation to the declining RM environment, the declining gas costs. See, as I mentioned, clay has declined by 5%, zinc, zirconium by 5%, brass by 10% during the year. And I will give you some flavor on the gas costs. For the year average we paid Rs. 22.58 per cubic meter, and our GAIL rate was Rs. 14.58, our Sabarmati rate was Rs. 34.15. In June, the rate has further declined. GAIL is Rs. 11.75 and Sabarmati has increased to Rs. 36.37. But the overall sentiment of gas consumers has been subdued, so our mix which was normally 50:50, in Q4 we consume 63% from GAIL and 37% from Sabarmati and for the year, we consumed 59% from GAIL and 41% from Sabarmati.

- Archana Gude:** Sure, sir. Sir, you spoke about maybe the increase in price hike by August. But let's say, hypothetically if the demand doesn't pick up, will you go ahead with this price hike or will you further postpone it to, let's say, Q3?
- Ayush Bagla:** See, it is an evolving situation. If raw material prices decline by another 10%, then that would be as good as a price hike for us.
- Archana Gude:** Correct. Yes, that was my question, like we already are saving in terms of raw materials, and considering the current scenario wherein demand looks muted, so we may postpone further is what my understanding was. Correct me if I am wrong, sir.
- Ayush Bagla:** It's an evolving situation. We will only know once Q2 pans out, we are still two, two and a half months away from August.
- Moderator:** Thank you. We have next question from the line of Sonali Salgaonkar from Jefferies India. Please go ahead.
- Sonali Salgaonkar:** Apologies, I joined the call a bit late so missed your initial comments. Sir, but my question is on the resumption activity. I mean, in terms of demand I understand that April was negligible, but how are the demand trends in May and June versus sales of last year? And also, what is the current capacity utilization that we are working at? And also the channel inventories, the status of that, I mean, have we managed to liquidate them or they are yet to be liquidated?
- Ayush Bagla:** See, when we resumed our factory on 5th May, we started with one shift operations, because we didn't have a migrant labor problem so we were just assessing the demand environment and the inventory at the localized depot and warehousing level. Now, other than the Tier-1 metros where the demand is still not back to where we would like it to be, markets in Tier-3 towns are getting back. So, the bulk of the liquidation of inventory at the depots is currently taking place and there was a lot of goods in transit when the lockdown happened. All that has reached its final destination and that will be liquidated. So we are still operating on one shift in the factory currently. And as and when there is a demand uptick, we will take that up.
- Sonali Salgaonkar:** Understand. Sir, so if we look at June, I mean, June sales very approximately were how much percentage of our June 2019 sales?
- Ayush Bagla:** That number is not currently out yet.
- Sonali Salgaonkar:** Understand. Sir, and currently the utilization of your capacities on an average would be?
- Ayush Bagla:** One shift only. So I can give you the Q4 capacity utilization numbers if that interests you. For Q4 FY '20, faucetware was utilized at 72%, sanitaryware was utilized at 73%, and for the 12 months faucetware was at 70% and sanitaryware was at 86%.
- Sonali Salgaonkar:** Okay. Sir, my second question is on the pricing action over the past two, three months. With the COVID disruption coming in, have you seen any rationalization of

competition from the unorganized, smaller players, especially in your tiles division? And secondly, has there been any pricing action to push demand?

Ayush Bagla:

See, the unorganized business, in tiles we will talk about first and then about sanitaryware for faucetware. As far as tiles is concerned, we keep on hearing about 800 or 900 plants in Morbi. But when we go for project or retail orders, we are competing with the top 10, 12 brands, because most of these 800, 900 plants are becoming vendors to these top 10, 12 brands. So the unorganized segment neither has the marketing infrastructure nor the capability of selling, marketing, localized warehousing and supplying credit to their customers, which the top 10, 12 brands have. Which is why despite whatever is happening in the tiles business in terms of overcapacity, Cera's tiles business has performed. We are close to zero inventory days, and we find ourselves competing with only the top players. Now, in this environment where our vendors are reducing prices that they charge us and the prices we charge our customers are more or less stable with a slight downward trend maybe, the market is going to shift. Only 60% of the morbi capacity has come back on-stream over the last two and a half months. So you will see a huge shakeout in the excess capacity of the vendor base. And we do not find ourselves competing with them. so our vendors do not reach our customers.

Now similarly in sanitaryware; our products have a 10 year warranty. We have a huge after sales team. We have a servicing team, we have a spare parts team, we have 24 hour call center, then customer touch points where the consumer can walk-in and register complaints or after-sales service requests. He has an app through which a consumer can reach the Company and in most cases between 24 to 48 hours is the lead time between someone reaching their home. So those are the benefits for the product which has a lifespan of 20 years and maybe a price difference of Rs. 500 to Rs. 1,500. So again, in sanitaryware, you will find that unorganized players have restricted them to maybe projects of Swach Bharat etc., but do not compete with the same consumers with a Company like Cera.

Sonali Salgaonkar:

Okay. Sir, and have you encountered any plants being shut down and Morbi over the past two, three months? Since you mentioned only 60% of capacity of the 800, 900 plants are back.

Ayush Bagla:

Yes. In any case, Morbi over the last one, one and a half years has had significant cash flow problems. And bulk of those plants, because of lack of scale or lack of product differentiation were not profitable. Add to that the migrant labor problem in Morbi is the reason less than 60% of the capacity has come back on-stream, and that too not at 75%. So even though capacity which has come back on stream is maybe one shift.

Sonali Salgaonkar:

Okay. Sir, and my last question is regarding the construction or real estate activity. We understand that it is not looking at a very good pace in the urban or the Tier-1 cities, but what about the Tier-2, Tier-3 cities, are you seeing any heightened activity over there? And in which segment, I mean, affordable or own construction?

Ayush Bagla:

We are seeing activity where there are large national EPC contractors involved. So, wherever there is a Shapoorji or L&T or those kind of contractors involved we are seeing resumption of activity. And we are also seeing some activity in small

projects, the G+3, G+4 projects in any case are very quick to start and finish. So, we are seeing resumption of activity there.

Moderator: Thank you. We have next question from the lineup Achal Lohade from JM Financial. Please go ahead.

Achal Lohade: I wanted to check first in terms of the gross margin improvement. How do we explain that, what has driven the gross margin improvement, especially when the price increase hasn't really been that significant?

Rajesh B. Shah: Yes, two specific items stand out. Let's say, in publicity we stopped our mass communication activities in the middle of the year, sensing that the year was slowing down. And then of course, the pandemic was fully in place in March. So there was about a Rs. 10 crore saving in publicity cost. Then there was a sales and marketing expenses which were clamped down and the trade partners also did not get themselves entitled to their full quarterly, monthly and annual targets, so there was a saving of Rs. 18 crore there. Freight and forwarding and logistics, there was a lot of saving on that because we did a lot of AI based freight saving cost, that was Rs. 6 crore. And finally at the EBITDA level, the IndAS 116 adjustment resulted in a Rs. 7 crore benefit.

Achal Lohade: And this is for the fourth quarter you are talking about or for the full year?

Rajesh B. Shah: For the full year.

Achal Lohade: And for the fourth quarter if you could?

Rajesh B. Shah: For the same number, publicity difference in fourth quarter is about Rs. 7 crore, in sales and marketing is about Rs. 8 crore. In freight is about Rs. 4.5 crore, and IndAS adjustment is about Rs. 1.6 crore.

Achal Lohade: Right. And what about the gross margin improvement? We saw a 280 bps improvement Y-o-Y, is it due to like the inventory evaluation or is it to do with the product mix or....

Ayush Bagla: You see, we started austerity measures in the middle of Q2 last year and the full benefits of that were available in Q3 and Q4. So on every front on fixed and variable costs we gained. Then the raw material prices were trending downwards across the board, and we took advantage of that. Now these are raw material suppliers who have been with the Company for more than 20 years. So they are quite happy to negotiate contracts with us on an ongoing basis.

Achal Lohade: And with respect to the distribution mix, would you be able to give some sense about what is the contribution we have in terms of the top 20 cities how much do they contribute to our total revenues or if any breakup in terms of metro Tier-1, Tier-2 kind of?

Ayush Bagla: Yes, of course. So, I will give for you for Q4 and also for the 12 months. Exports for the quarter and for the year were about 1.2% of top-line, Tier-1 sales were 31% of top-line, Tier-2 sales were 12% of top-line, and Tier-3 and below sales were 55% of

top-line. Then sales to top 100 dealers were 36% of top-line, and sales to top 500 dealers were 66% of top-line. Then if you want geographic spread, I have that as well. North was 30% of top-line, east was 10%, west was 17% and south was 42%, and export was 1%.

Achal Lohade: This is for the full year you are talking about?

Ayush Bagla: Yes.

Achal Lohade: And even the Tier-1, Tier-2 thing as well full year, right?

Ayush Bagla: Yes.

Achal Lohade: Okay, sounds good. In terms of the project, you had said 22%, 23% of revenues are from projects, that is directly for us or this includes the dealer sales?

Ayush Bagla: So that is direct billing. So we only count project sales where we are comfortable in direct billing.

Achal Lohade: Sir, at an aggregate level, I mean, I know it's tough to guess how much a dealer would be selling to project, or broadly would it be like 50:50 in terms of projects in retail or could it be even higher for project?

Ayush Bagla: See, we are extremely in a beneficial position if dealers sell to projects, because we don't have to take out credit calls, nor do we have to negotiate prices. So if a dealer can find his inroad into a project, that's the best case scenario for us because we haven't sacrificed margins, nor do we have to have a direct credit assessment of the customer.

Achal Lohade: Got it. This is helpful. And just last question if I may, with respect to commercial versus residential, would you have any sense as to how much would be the mix for us in terms of the commercial specifically, which is probably looking a little weak now going forward?

Ayush Bagla: Commercial is negligible. It always has been negligible. Because the amount of toilet material required on a per square feet basis in commercial, IT parks, etc., is very, very small.

Moderator: Thank you, sir. We have next question from the line of Manish Poddar from Nippon AIF. Please go ahead.

Manish Poddar: So first, would you be able to help, let's say, how is the sales performance, let's say, in January, February and March on a Y-o-Y basis?

Ayush Bagla: In January?

Manish Poddar: Yes, January, February and March?

Ayush Bagla: See, January and February were the good performing months, right from Q3 sales were picking up and more in the semi urban and Tier-3 towns. And right till the 10th

of March sales were well alright. But then post 10th of March it completely collapsed. And we ended up billing almost two months' worth of average annual billing in the last 10 days of March. And that's a phenomena that you can see from the last many years.

Manish Poddar: So, effectively what you are trying to say, in the last 10 days of the month in March, two months of billing happens. So roughly about Rs. 200 crore, Rs. 250 crore of sales happen in the last 10 days in Q4?

Ayush Bagla: Between Rs. 125 crore to Rs. 150 crore.

Manish Poddar: Okay. And you mentioned three, four variables which led to savings during the full year last year. So, in that you mentioned, I missed one of the variables, so marketing was Rs. 10 crore, trade payout was Rs. 18 crore, India is for Rs. 7 crore, and what was the fourth variable?

Ayush Bagla: Freight forwarding expenses of Rs. 6 crore.

Manish Poddar: So roughly about Rs. 40 crore, Rs. 41 crore savings you had in that?

Ayush Bagla: Right.

Manish Poddar: So Ayush, any idea now, let's say, after you have commenced the plan of this kind of saving measures which you were doing, so what is the quarterly run rate one should expect? You would be trying at the Rs. 110 crore run rate, plus/minus Rs. 10 crore in the last 8 or 10 quarters, so what should be the run rate going ahead?

Ayush Bagla: See, for top-line, the run rate for Q1 will be very small.

Manish Poddar: No, I am talking about the expenses.

Ayush Bagla: Yes, expenses, we have renegotiated a lot of contracts, whether its Company owned customer touchpoints, experience centers. Then we have tried to implement co-location for our depot. So if depots were within 100 kilometers of each other, we have tried to implement co-location, we have reduced the space of warehouses in most locations, so there will be a lot of fixed cost reduction as well. And variable costs, raw material pricing is undergoing a sea change right now. So those are, of course, ongoing discussion and evolving situation. We won't be able to put an estimate on that for the current financial year.

Manish Poddar: Okay. And just one final one from my side. Would you be able to share, let's say, for the full year how is the contribution from the four segments and the growth which you got for that for the full year? That's it from my side.

Ayush Bagla: Yes. For the full year, revenue was Rs. 1,209 crore versus Rs. 1,344 crore. Sanitary ware revenues were 49%, faucet ware 26%, tiles 22% and wellness 3%.

Moderator: Thank you. We have next question from line of Hiral Desai from Anived PMS. Please go ahead.

Hiral Desai: Ayush, I had a couple of questions. One was with respect to working capital, that you also alluded to in your opening remarks. If I look at the receivables at about Rs. 220 crore, the number is similar that we had in FY '17. So, when you are so tight on working capital, does that stifle your sales? How do you take a call between being tight on working capital and forgoing sales, especially in an environment where demand is extremely challenging?

Ayush Bagla: Those who have followed this Company for last five, seven years, would find a consistent financial conservatism, because we have learned from the horror stories that we hear in our industry about credit calls that went wrong. So when you are operating on 14% EBITDA margin and whatever 9%, 10% PAT margin, at that time to take large credit calls is an extremely risky decision and people have done it and nobody has succeeded. But even then, a lot of people in our peer group continue to do it, but we have never done it. So that is why you will see our delinquencies figure being extremely low and our working capital figures being very tight. Now if there is an argument to be made that by loosening your credit terms you will gain significantly in cost in revenues, that is something I have not really seeing the evidence of in this business. But pricing, design, those things play a larger role than only credit.

Hiral Desai: No, sir I don't mean that by loosening the credit norms you are going to have a massive gain in terms of revenues. But just at the margin, especially when the environment is very tight, so in the last couple of years the dealership and the return channel also itself has been under a lot of pressure. So, whether it makes sense to be slightly loose in terms of working capital and see if it drives incremental sales and market share?

Ayush Bagla: You see, if a AAA rated customers customer comes to us and asks for better credit terms, so obviously we will agree. But just doing that for the trade and the trade also taking on additional risk in poor credit quality customers, that is something we want to be careful of. If a project customer has been with us for 10, 15 years, and there are customers who have been with us for 40 years, if they ask for differential terms obviously we will agree.

Hiral Desai: Okay. And the other question I had was, do you guys internally track secondary sales in terms of sales from dealer to retailer and from retailer to the final consumer? The reason why I was asking this is, usually March is a big month for a lot of these businesses. And there will be fair amount of inventory which would have got stuck in the system, given that April, May was almost a washout. So outside of the inventory that we have, how much of inventory would there be in the system? Well, that will affect the growth that we have in H1.

Ayush Bagla: See at the trade level, as you have been hearing our commentary, last six quarters we have been saying that at the trade level there is financial mismanagement. And at the trade level a lot of costs have been piled on by people taking showrooms on rent, hiring three wheelers, four wheelers, hiring a lot of sales force, and also taking credit calls and expanding into unrelated businesses. So those problems have now come to a (inaudible). I think the trade will realize they should stick to their knitting, stick to the customer they have done businesses with in the past, etc. So yes, I am sure, in many cases the trade has taken cement dealership, pipe dealership, plywood dealership which has not worked out for them, and therefore they are

stuck. So we are very conscious of who we do business with, taking in new dealers etc. But yes, you are correct that there will be a massive shakeout in the trade.

Hiral Desai: So my question was, there is about Rs. 200 crore of inventory that we have. So apart from that, in the channel, what would be the amount of inventory? If you have any sense on that number.

Ayush Bagla: For the Company, we have a sense of the number, but for the industry we don't have a sense of that number.

Hiral Desai: So what would be the total number, including the channel inventory for Cera?

Ayush Bagla: The debtors are Rs. 220 crore.

Hiral Desai: No, so we have about Rs. 204 crore of inventory that we have on our balance sheet, outside of that there will be some inventory which is with dealers and retailers. So what would be the quantum of that?

Ayush Bagla: That is captured in the receivable of Rs. 220 crore. And some part of that is sold, some is unsold.

Hiral Desai: See, one of the things we are encouraging both our dealers and project customers, please do not try and save money by ordering 400 pieces which will just full truck because of just saving in the freight. We want to give you shorter billing cycles and smaller cycles of smaller amounts. So please take that as offer from us. Whatever differential extra cost and freight etc. is taking place, we will find a way of offsetting that.

Hiral Desai: Got it. And lastly, the mix that you gave in terms of Tier-1, Tier-2, Tier-3 for this year, would we have a similar number for last year for FY '19?

Ayush Bagla: Yes, I think I would have that number. For 12 months FY '19, that number one export- 1%; Tier-1- 28.8%; Tier-2- 12.98% which is 13%; and Tier-3 would be 57%.

Moderator: Thank you, sir. We have a next question from the line of Omkar Kulkarni from Sri Investments. Please go ahead.

Omkar Kulkarni: My question was regarding any cost cutting measures you have taken apart from the savings which you are getting from the lower raw material price?

Rajesh B. Shah: Yes. First thing is, we have done co-location of our disposal warehouses. So suppose in UP there were more than two warehouses, we are trying to combine them into one of the NCR warehouses. So those are the fixed cost reductions. Within the warehouses if we had taken 15,000 square feet, we are trying to manage with 9,000 square feet. That is our second saving. Similarly for all our offices, regional offices, and large format 10 Company owned experience centers, of which some of them are owned, some are rented, we are trying to renegotiate the rent. Then next in factory we are trying to implement, of course, there are wage agreements which are three and four years long, we are trying to implement additional incentives on a completely variable basis. So fixed cost reduction is

going to be ongoing exercise at least for the 12 to 18 month period that you are seeing going forward. And in any case, total fixed cost even last year was less than 20% of our overall cost. So, this Company is built on a high variable cost model, which is why we keep talking about that outsourcing percentage, 50% of our total product sold is outsourced. And no Company has succeeded with full outsourcing or full in-house manufacturing; we seem to have found a good balance currently.

Omkar Kulkarni: Okay. All the things which you have mentioned, do you have any number for that?

Rajesh B. Shah: A bulk of those savings will be for this financial year. So, in the Q1 call we will be able to give you a better estimate.

Omkar Kulkarni: Okay, all right. The second question is, I guess you mentioned you have now around Rs. 230 crore of cash in your hand, which is the highest So, how do you plan to utilize it, apart from the CAPEX?

Rajesh B. Shah: See, I will give you a sense of this year's CAPEX and also last year's CAPEX. Last year, in 2019-2020, the proposed CAPEX was Rs. 56 crore, and the split was, sanitaryware automation Rs. 20 crore, faucetware automation Rs. 9 crore, customer touch points Rs. 6 crore, staff colony completion Rs. 17 crore, logistics and IT Rs. 4 crore. And at the end of the year, I can tell you that out of these Rs. 56 crore, only Rs. 41.83 crore was finally spent. And that breakup is also available. Rs. 9.53 crore was in sanitaryware automation, Rs. 3.6 crore was spent in faucetware automation, Rs. 6.9 crore was spent in customer touch points, Rs. 15.5 crore was spent at the staff colony at the plant and Rs. 6.23 crore was spent in logistics and IT, totaling Rs. 41.83 crore.

Now for 2021, we proposed a total of Rs. 21.82 crore as the overall CAPEX budget. And the split is; sanitaryware automation, Rs. 5.85 crore; faucetware automation, Rs. 4.41 crore; customer touch points, Rs. 6.15 crore; staff colony at Kadi, we have bought one adjacent land next to our plant for Rs. 3.19 crore, and logistics and IT Rs. 2.2 crore. So this is half the budget of last year, which is the proposed budget for 2021.

Omkar Kulkarni: Okay, that's about it. I was asking more about how do you plan to utilize this apart from the CAPEX which we are doing, I mean, to plan to hold it or in terms of investments or like something else you have planned?

Ayush Bagla: See, currently this number has been growing. And currently, even though the yields are low and it overall depresses our ROCE, we have invested in Government bonds, tax free bonds, AAA instruments etc., and fixed deposits with SBI etc. Currently, there are no acquisition plans or any large CAPEX plans. So currently, we have found our investors telling us that your strategy of high liquidity has been validated given these troubling times. But we had never had to dip into this liquidity reserve even during April and May, and certainly not during March. So we continue to hold.

Omkar Kulkarni: Okay. Just one last question on the on-the-ground situation, what is the dealers' network telling you or the retailers telling you? Especially in the month of June, how is the demand situation?

- Ayush Bagla:** It is an emerging situation, as markets are opening up, as project sites opening up, demand is trickling in, but definitely much lower than what we expected. And we are also being a little cautious in supplying to people, to projects and to dealers. So it's both ways.
- Omkar Kulkarni:** Sir, just wanted to get to understand whether people are hoarding cash or they are not willing to spend on or such a discretionary items such as sanitaryware or wellness products?
- Ayush Bagla:** We will get to know the insight on consumer behavior not before end of Q2. Currently we can only gauge the trait behaviorally, we don't get any insight into the consumer behavior.
- Moderator:** Thank you, sir. We have next question from the line of Rajat Sethia from Riddhi Capital. Please go ahead.
- Rajat Sethia:** Sir, wanted to understand from the perspective that in the last 5, 10 years we have generated very good return on capital and return on equity. However, now our mix is changing. So, my question is, how will we sustain similar kind of return on capital, return on equity going in the next five to 10 years? And the concern that I have there is, like I mentioned tiles which has probably inferior economics. And second is, in sanitaryware, our market share has been stagnant in the last seven years. So how do we grow and increase our margins there?
- Ayush Bagla:** See, ROCE, again, there are two figures, one is with cash of Rs. 230 crore, one is without cash of Rs. 230 crore. If you look at ROC for even this year, 2019-2020, with the kind of sales we lost in mass, without cash it's Rs. 25.48 crore, because our cash reserves are generating 6%, 6.5% and bringing down the overall ROCE and ROE. As far as the business performance is concerned, of course, earlier the company six, seven years ago had maybe 100 SKUs, today the Company has so many SKUs, it introduces about 700 SKUs annually. And sanitaryware pricing, faucetware pricing for brands like ours are still very important. Tiles is a little more commoditized than sanitaryware and faucetware. But we are lucky we don't have heavy assets on our books of tiles, plants, etc. Our cost of purchase of tiles from third-party vendors is much lower than the cost of production of the largest tiles Company in the country. So going forward, on a zero inventory basis for tiles and better purchase costs, even tiles businesses will start doing healthy EBITDAs.
- Rajat Sethia:** So in tiles segment you expect to clock similar return on capital?
- Ayush Bagla:** Yes, return on capital even with a lower EBITDA percentage in tiles will be very good because of zero inventory. So even though there is an extended credit in tiles compared to receivable days in sanitary ware and faucet ware, we expect return on capital in tiles to improve dramatically.
- Rajat Sethia:** Sure. And sir, the other question was on, you mentioned that you also sell around 20% plus kind of sales comes from your direct sales to institution, is that what you mentioned? Is that correct?

- Ayush Bagla:** Yes, I can give you the latest numbers. For Q4 2019-2020, our project sales were 30% and retails was 70%. And for the full year, project was 28% and retail was 72%.
- Rajat Sethia:** So in this project sales of 28%, do we bill directly to the projects?
- Ayush Bagla:** That's right.
- Rajat Sethia:** So does it not create any sort of conflict with the dealers?
- Ayush Bagla:** No, these are, of course, large companies, large national developers who will not be speaking to any dealer for any product, whether it lifts, cement, pipes, plywood.
- Moderator:** Thank you. Ladies and gentlemen, that was the last question. I would now like to hand the conference over to the management for closing comments. Over to you, sir.
- Ayush Bagla:** Thank you. I know these are unprecedented times; most people are working from home and so I really want to thank you all for joining this call. Cera is optimistic that it's strong positioning in the industry and improving macros will help it deliver steady and consistent growth going forward. With this, I hope that I have been able to answer your questions satisfactorily. 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 the time to join the call and see you all next quarter. Thank you very much.
- Moderator:** Thank you very much, sir. Ladies and gentlemen, on behalf of Cera Sanitaryware Limited, that concludes this conference call. Thank you for joining with us and you may now disconnect your lines.
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