



Cera Sanitaryware Limited

Q1 FY23 Earnings Conference Call Transcript

August 5, 2022

Moderator: Ladies and gentlemen, good day and welcome to the Q1 FY23 earnings conference call of CERA Sanitaryware Limited. As a reminder, all participant lines will be in listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “*” and “0” on your touch tone phone. Please note, that this conference is being recorded.

I now hand the conference over to Mr. Devrishi Singh of CDR India. Thank you, and over to you, Mr. Singh.

Devrishi Singh: Thank you. Good morning, everyone, and thank you for joining us on the earnings conference call for CERA Sanitaryware Limited for Q1 FY23 earnings, which were announced yesterday. We have with us today, the management team comprising Mr. Ayush Bagla, Executive Director and Mr. Rajesh B. Shah, CFO and COO of CERA Sanitaryware.

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

I would now turn the call over to Mr. Ayush Bagla for his opening remarks. Thank you, and over to you, sir.

Ayush Bagla: Good morning, everyone. The earnings for the first quarter for the period ended 30th June 2022 were adopted by the Board of Directors yesterday, 4th August 2022. The earnings documents have been released to the stock exchanges.

During the quarter gone by, we continued to witness strong demand for our products as the overall replacement demand remained quite positive, with consumers continuing to spend on home upgradation and improvement. The velocity of sales in residential apartments continues to see good momentum, with new project launches getting announced by many real estate players across most regions. We are well positioned to monetize current and ongoing demand. We are positive that this scenario will lead to sustained new demand generation for CERA's products.

At present, our manufacturing facility continues to function at high utilization levels. Capacity utilization for Q1FY23 for sanitaryware was at 109.53%, and we endeavor to operate the plant at similar levels all through FY23. In Faucetware, the capacity utilization was 102.65% during Q1FY23 and all efforts are on to maintain these capacity utilization levels.

As indicated in our previous earnings call, our average production at the Faucetware plant was 1.8 lakh pieces per month up to H1 of FY22, which in March 2022 increased to an average of 2.5 lakh pieces. Current production in July 2022 is 3 lakh pieces, an all-time high, almost 67% over the previous year's numbers. This development has set new volume benchmarks, enabling us to sweat our existing assets more extensively and also allow us to cater to the increasing demand over the next twelve months. The Faucetware expansion program commenced in July 2022, and current indications are that the program will be completed in Q1 FY24, and an enhanced capacity of another 1 lakh pieces, totaling 4 lakh pieces per month will be available for in-house manufacturing.

During the expansion phase, no disruption to current manufacturing is envisaged and a comprehensive risk mitigation model has been implemented envisaging various scenarios to ensure that the market need for Faucetware products are continuously met from the existing plant.

For fresh capacity for manufacturing in sanitaryware, the Company has carried out extensive surveys of water, gas and labor availability for a greenfield facility. A few land parcels have been shortlisted and the Company is currently conducting due diligence for those land parcels. Since capex will commence post land acquisition, the detailed plan of the phase wise capital expenditure will be made available in due course.

As on 30th June 2022, our cash and cash equivalents stood at Rs. 566 crore against Rs. 433 crore in June 2021, registering an increase of 30.72%. Positive cash flow for this quarter is Rs. 49 crore. In FY22, for the full year, positive cash flow was Rs. 164 crore, therefore, going forward, internal approvals will be deployed to fund the two capex programs, and we also have the flexibility to use some part of the accumulated cash and cash equivalent if required. I would like to reiterate that no debt raising, or equity dilution is planned or required for the entire capacity expansion.

Q1 FY23 also continued to witness a stable to slightly upward bias in prices of raw materials. To counter these cost pressures, the Company undertook necessary price hikes in the month of May 2022. In sanitaryware, a price hike of 3% and in Faucetware, a price hike of 5% was implemented in May 2022.

Despite the external environment witnessing an increase in prices of inputs and raw materials, CERA has not witnessed a material impact during Q1 FY23. On the Sanitaryware side, key items like China clay, Feldspar and Plaster of Paris, which constitute more than 95% of Sanitaryware's raw material mix had a combined impact of 2%. In the Sanitaryware business within the glazing recipe, which constitutes less than 2% of Sanitaryware's raw material mix, the key constituents of color and zinc have moved up 11% during Q1.

Due to availability of gas from isolated wells near our plant, the pricing of gas from GAIL continues to remain below market and will do so in the future. Price has increased at Rs. 25.69 per cubic meter in June 2022, which was Rs. 13.26 per cubic meter in March 2022. In Q1 FY23, GAIL provided 49% of the gas requirements of the Sanitaryware business. Sabarmati Gas, a JV of BPCL and GSPC's pricing went down from Rs. 75.01 per cubic meter in March '22 to Rs. 73.58 per cubic meter in June 2022, supplying 51% of the gas needs of the plant for Q1. Gas costs constitute 3.06% of CERA's topline.

There have also been price increases in some ancillary cost items like transportation cost at 2% to 3%. Cost of corrugated boxes have gone up by 6%. Our reliance on in-house renewable energy for over two decades has significantly benefited us, given that 65% of our electricity needs are met from in-house, wind and solar power sources. As a result, we have been able to keep significant parts of our cost basket stable.

There has been significant innovation in marketing and sales. A retail engagement and loyalty program was launched unlike any other in the building materials industry. In a span of three months, 11,500 plus retailers have adopted this platform. More than 5,000 plus, or 40% of those retailers are regular users of the app-based software. Various artificial intelligence tools and algorithms are used to curl out meaningful insights from this program.

The Company has rewarded retailers on a well thought out matrix of sales and profitability. The dealer, distributor is also fully on board with this program as the retailer service by the dealer receives an incentive, with no cost to the dealer. There is full transparency in margins and discounts that a dealer offers the retailer. The Company has access to valuable data, which is being monetized by mining, to cross sell and upsell. This is one unique step in CERA getting very close to the retailer, to the point of sale and to the ultimate consumer.

In that backdrop, we can go over the financials:

Revenues from operations in Q1FY23 were Rs. 396 crore versus Rs. 223 crore in Q1FY22, an increase of 77.6%. EBITDA, excluding other income was Rs. 62 crore in Q1FY23 versus Rs. 20 crore in Q1FY22, a growth of 210.6%. The EBITDA margin is higher by 660 basis points at 15.5% in Q1FY23 versus 8.9% in Q1FY22. Therefore,

margin expanded by 74%. PAT was Rs. 40 crore in Q1FY23 versus Rs. 13 crore in Q1FY22, an increase of 207% Y-o-Y. Earnings per share for Q1FY23 was Rs. 30.47 versus Rs. 9.93 in Q1FY22.

For Q1FY23, 54% of the topline was from Sanitaryware, 35% from Faucetware, Tiles represented 12% and Wellness, 1%. On a Y-o-Y basis, Sanitaryware revenues registered an increase of 89%. Faucetware revenues increased by 99%, Tiles increased by 9%, and Wellness increased by 49%. The Sanitaryware and Faucetware verticals remain the bedrock of the business with the contribution of 89% to CERA's overall revenues.

We continue to witness encouraging demand for newly launched products. During the last three years, the new product development program contributed close to 22% of revenues.

Inventory days in Q1FY23 was 72.76 days compared to 60.86 days in Q1FY22. Receivable days in Q1FY23 was 26.38 days versus 38.51 days. Payable days in Q1 FY23 were 38.94 days against 29.11 days in Q1 of FY22. Therefore, net working capital days in Q1FY23 was 60.20 days versus 70.37 days in Q1 of FY22.

After a fairly low capex last year, where against the capex budget of Rs. 17.19 crore for FY22, the total capex spent was Rs. 11.12 crore. In the current year, the capex budget other than the Faucetware and Sanitaryware expansion programs is Rs. 24.7 crore, of which Rs. 7.7 crore is for Sanitaryware automation, Rs. 6.4 crore is for Faucetware automation, Rs. 6.6 crore for land and building, and Rs. 4 crore for logistics and IT. During Q1, Rs. 0.26 crore was spent on Sanitaryware automation, Rs. 0.02 crore on Faucetware automation, Rs. 0.01 crore on land and building, and Rs. 0.03 crore on logistics and IT.

In conclusion, I would like to say that today, there are multiple industry tailwinds, which we believe would enable the Sanitaryware and Faucetware industry to maintain its steady and consistent growth. CERA's growth plan remains intact as it plans to expand its capacities and be at the forefront to capture this rising demand.

After taking a few years to break the Rs. 1,250 crore to Rs. 1,350 crore topline band, in FY22, CERA touched a topline of Rs. 1,446 crore. The impact on PAT and EBITDA margins was clearly visible. Going forward, CERA is set on a new topline trajectory, which is reflected in the Q1 numbers.

Every decision made at CERA is from the shareholders point of view, with ROCE, payback period, impact on EPS fully considered before being placed for deliberation before the Board of Directors. The positive macro factors in our industry coupled with the Company's strong balance sheet, distribution channels, R&D capabilities, comprehensive offerings, high brand salience, and others such

strong inherent strengths of this four-decade old Company would not only enable it to face any macro level uncertainties but also continue to support its growth and its leadership position going forward.

I would now request the moderator to open-up the line for Q&A. 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 Naysar Parikh from Native capital. Please go ahead.

Naysar Parikh: Two questions. One is, can you talk a bit about your market share in both, Sanitaryware and Faucetware and how that has been moving and how you see that going forward?

Ayush Bagla: We would like to but there is no third-party published data on market shares in both, Sanitaryware and Faucetware, but I can give you some rough estimates. CERA have been for the last four years, the largest player in sanitaryware in the country and our growth is, let's say, 25% higher than industry growth. And industry growth for the last four or five years has been in high single digits. So, if you take a mix of price and volume, you will find that we are growing in the teens. And going forward, that growth number will increase. In Faucetware, we are the second largest player. But let's say the market is growing by 9%, 10%, and we are growing, let's say at 40% but our share of incremental market share is 15%. So, we are growing at 1.5 times the growth in industry in Faucetware.

Naysar Parikh: Understood. Got it. And the second question was on, in terms of your pricing and margins, right, you mentioned the 3%, 5% price hike that you have taken. So going forward, for this fiscal, are there any other projected price hikes and with where the raw material prices are, what should we expect on the margin front going forward?

Ayush Bagla: See, the bulk of price hikes was also due to the ability of the market to bear these price hikes. So, last year we took 21% price hikes in Sanitaryware, 26% in Faucetware. On the back of that, a 3% and 5% makes Sanitaryware closer to 26%, 27%, and Faucetware closer to 31% in about 15 months. And you're seeing no dent on sales velocity. So, you can see how strong the markets are. How strong the brand promise and brand recall and brand salience is. So, our strategy towards price hikes is very simple. There is in most cases in Sanitaryware very little push from raw materials. Sometimes, there is a push on other costs like transport, gas, labor, and packaging. So, we take a very nimble and agile decision as and when the situation presents itself. And in the past, there have never been any price rollbacks. But you are seeing raw material prices cool off. So, we do expect margin expansion on that front. As far as the next price hike is concerned, earlier, we used to review pricing twice a year. But last year, we reviewed pricing three, four

times a year. So, we'll just be very nimble about it, as and when there are changes in the market.

Naysar Parikh: Got it. And this last question, what would be your mix between retail and projects?

Ayush Bagla: See, our B2C business is now 68% of sales. And this is a very important question because it takes 15 years to get there. So, I'll just give you another example based on the question you have asked. 13 years, 14 years ago when large sized companies entered sanitaryware and faucetware, there was a threat. But to bulk up, they immediately went the other way. They went the B2B way. And there is a lot of temptation to do that to bulk up your volumes. But the problem with that is when you enter a business and start negotiating your pricing, it dilutes the brand so much, you can never be a B2C player. Same thing is happening with newer entrants now. In the temptation to bulk up and show some immediate benefits, they are all going the B2B way.

Moderator: The next question is from the line of Saurabh Shroff from QRC Investment Advisors LLP. Please go ahead.

Saurabh Shroff: Congratulations on a very strong show. You mentioned something interesting on the trajectory of Faucetware, where we've gone from 1.8 lakh pieces a month to 3 lakh, and eventually 4 lakh. So, if you could sort of maybe help us understand better what has led to this massive expansion? What steps has the Company taken to be able to do this, with very minimal capex? And also, the second question, overall, is sort of we look at, let's say, economy, or luxury, and what is the sales mix across Faucetware and Sanitaryware and is there a shift and is there a benefit of sort of more premium products in the mix that has already happened, or we anticipate happening, which should also help margins going forward?

Ayush Bagla: So, in Faucetware, the Company was growing between 25% and 35%, annually, for the last four, five years. We are the second largest player and last year, we grew 37% to 40%, almost four times the growth in industry. And there was some addition of talent in Faucetware manufacturing facility. SOPs were changed. And some processes were changed, some automation projects which were completed last year, helped in this increase from 1.8 lakh to first, 2.5 lakh and now 3 lakh. So, with virtually close to zero capex, this was achieved. And you know, I mean, there was a lot of question and answer for the last seven, eight quarters, - why aren't we expanding Faucetware, when the Faucetware business is doing so well? And we kept saying that without really having to invest through money, there are other changes that can take place in the business which will make the business even more profitable and that is exactly what has happened. With minimal capex, we have achieved 3 lakh pieces per month and now with just expenditure of Rs. 69 crore in the brownfield expansion, we will go to 4 lakh a month. So, this is all I

think, outcome of managerial decision making, and trying to optimize and maximize every rupee spent both on opex and capex.

The second question was on upselling. So, I'll give you some data which will add color to your question and also give you some initiatives that the Company is taking. So, same quarter last year, entry level products were 14.5% of sale. And you know, we've done a full reclassification of what is entry, what is mid, what is premium based on all the price hikes. So, the base values have always been taken up dramatically. So, what was considered mid last year is now entry. What was considered luxury last year is now mid. So, from 40.5% of sales value, entry level in Sanitaryware, it's 46.7%. In the mid-category, last year, we had 49.9% which is 43.1%, and in the premium category we had 9.6%, which is 10.2%.

In Faucetware, entry level was 59.5% last year, which is down 51.7%. Mid-level was 22.8%, which is now 30.4%, and premium was 17.6%, which is now 17.9%. So, we are consistently taking the bar up on a blended basis for the overall Company. Last year entry level was 48.5%, which is now 48.8%. Mid-level was 38.5%, which is 37.8%. And premium was 13.0%, which is now 13.4%.

Saurabh Shroff: Okay. Got it. And initiatives that we are taking on the retailers, etc., as one would imagine that all of that and the data analytics that you spoke about, that should eventually help us drive getting more of a premium push as well over time?

Ayush Bagla: So far, this industry has been dealing only with dealers or distributors. And there was across the industry and also for CERA, there was very little engagement directly with retailers, and very little data collection of consumer behavior, or retailer. So, we also would rely on our sales team which is on the ground in all the States, that was one, and lots of feedback from the dealers. But we wanted to go one step beyond and now with AI tools and software-based apps available, we rolled out a fairly large program. Got onboard 11,500 dealers. We are getting consumer behavior, point of sale behavior, the interplay between dealer discounts and margins, retailer discounts and margins, all of that data. So cross selling is the obvious thing that we are having to do and we want to do but upselling is going to be a huge theme this year.

Moderator: The next question is from the line of Shrenik Jain from LIC Mutual Fund. Please go ahead.

Shrenik Jain: Sir, basically, I want to understand that over the longer term what is the view for the Company? Will we continue to be a bathware player, or we will also plan to get into other adjacent products like currently in the industry we are seeing like the Pipe players are getting into bathware and paints. The tiles player are getting into wood panels and different groups. So, what is our view on longer term basis? As we are making healthy cash flows, how do we plan to deploy it effectively?

Ayush Bagla: See, currently, you would have heard that we are expanding the Faucetware facility on a brownfield basis at a cost of Rs. 69 crore. And we have estimated that a greenfield facility for Sanitaryware will cost Rs. 129 crore. So, we see tremendous opportunities in Sanitaryware and Faucetware going forward, not only in the short-term, in the medium-term. And there are significant advantages in profitability being the largest player in Sanitaryware. And, of course, taking our market share in Faucetware up, I mean, it's 37% to 40% growth, no industry, even in building material they are seeing that kind of growth that CERA's Faucetware is seeing.

So, there are tremendous opportunities available. And currently there are no plans. And for other companies, of course, they are also profitable. They want to deploy their cash in newer businesses. But this is a temptation to start a new business and then become a B2B player. That is a very risky temptation. Because then you're always a marginal player, with marginal profitability and the return metrics on capital deployed, it might get lost in the overall balance sheet. But on a standalone basis, it is not more than single digit.

Shrenik Jain: Sure, sir. But over the longer term, if we plan to get into any other adjacencies, which are the products that we can get into, which uses similar channels as we are currently having?

Ayush Bagla: Currently, there are no plans. There is no discussion in front of the Board or even at a nascent stage. Currently, the discussion is, maximize the throughput in your current manufacturing facilities and put-up new capacities. See, there's another angle to this. Product lifecycle is reducing. The industry average for new product development is 10% to 11% of sales. CERA's is 22% of sales. That is like entering a new business. This incremental 11% of sales that CERA is getting is purely new business, which was not there. So, managing a shorter product life cycle is a full-time department and a full time understanding of the consumer, dealer, retailer all of that. So currently, there are no plans of entering any new businesses, not even at the nascent stages.

Shrenik Jain: Sure, sir. Got it. And sir, we talk on margin. So, over the next three, four years, our own capacities will improve and our topline will grow. I am sure operating leverage benefit will sweep in. So, where do we see our EBITDA margins in normal scenario, three years down the line?

Ayush Bagla: Steady state EBITDA margins for the last many years has been 14%. That went up dramatically in Q4, and also for the year last year. So now our steady state EBITDA has crossed, let's say, 15.5%, which was the number for last year. So going forward, you could see between 50 to 75 basis point increase annually. And I am saying this annually, because in 40 months, the company will definitely double its FY22 topline. So, you can calculate the absolute impact it will have on numbers.

- Moderator:** We'll move to the next question from the line of Pritesh Chheda from Lucky Investment. Please go ahead.
- Pritesh Chheda:** Sir, just a clarification. We exited Anjani Tiles in quarter four, right, so the number that we see and the margin that we see is now ex of Anjani Tiles? Is that correct? Because that portfolio for us was a lower margin.
- Ayush Bagla:** Yes, see, about six years ago, the Company took a decision, never to have any tiles manufacturing on its own balance sheet. So, it took stakes in two ventures, one was Anjani Tiles, and one was Milo, where our risk was restricted to our equity investment. So, once Anjani put up the plant, and it's become large enough, and is profitable and doing well, the Company decided to exit its investment at the optimum time, at the peak of the performance of the last four, five years. And that's what happened in August, September last year. So, when the agreement was signed, in that rules were followed. The turnover was consolidated in the first three quarters and in the fourth quarter, whatever amount was added, was deducted. So, you will see a note by the auditors in Q1, Rs. 5 crore has been deducted off from Q1FY22's turnover, so, as to give investors and shareholders a like-to-like comparison between Q1FY22 and Q1FY23.
- Pritesh Chheda:** So, now instead of consolidation, we will have a trade (inaudible), right?
- Ayush Bagla:** Now there is no consolidation with Anjani after last year, after Q3.
- Pritesh Chheda:** And what is the margin impacts on it?
- Ayush Bagla:** See, Anjani was making EBITDA of Rs. 5 crore, Rs. 6 crore for the year. And the topline CERA was consuming 70%, 80% of the product. So, it was getting added to topline of CERA on a consolidated basis and a standalone basis.
- Pritesh Chheda:** Okay. Sir, my another two questions, I missed your revenue target for FY23. And you were mentioning that with this capacity expansions that you have lined up, what is the revenue, you mentioned that the revenue will double, right, but over how many years?
- Ayush Bagla:** 40 months. 3.5 years.
- Pritesh Chheda:** 3.5 years it will double. And what is your revenue target for FY23?
- Ayush Bagla:** That you know, we've been careful about giving forward-looking numbers for the year. But those who have built the financial model, if you put the Q1 numbers, and you normally 22% of the annual topline is Q1, you will get the annual number.
- Pritesh Chheda:** Okay. And lastly sir, if you could tell me again, the Sanitaryware and Faucetware revenues for the quarter? Just the absolute revenues?

- Ayush Bagla:** Yes, I'll give you that, and I'll also give you one more data point that will help you about outsourcing. The absolute number in Sanitaryware was to Rs. 211.63 crore, which is 53.56% of sales. Out of which, outsourcing was 50.03%. Last year, the same outsourcing figure was 58.62%.
- Pritesh Chheda:** This time it is 53%?
- Ayush Bagla:** 50.03%. And it's a dramatic change because of the throughput increase. For the year was 58.62% last year for Q1 it was 55.21%. So, 10% change. In Faucetware, the absolute number for topline for Q1FY23 is Rs. 136.32 crore i.e 34.50% of sales. Outsourcing is 54.80%. Last year outsourcing was also 54.55%.
- Pritesh Chheda:** And lastly, sir. Can you give us the tiles revenue?
- Ayush Bagla:** Yes. Tiles revenue for the quarter is Rs. 40.48 crore, which is 10.25% of sales. And the same number last year was Rs. 37.2 crore, which was 16.73% of sales.
- Moderator:** The next question is from the line of Alisha Mahawla from Envision Capital. Please go ahead.
- Alisha Mahawla:** Just taking forward the earlier participant's question. So, for the current year for '23, our capacities are more than 100% utilized. So, any kind of volume growth will only be by increasing the share of outsourcing?
- Ayush Bagla:** Till fresh capacity comes on instream in Faucetware, which will be Q1 of FY24, there might be some increase in outsourcing. And similarly, in Sanitaryware. So, for the next two, two and a half years, there will be increase in outsourcing percentage, but that percentage doesn't tell you the entire story. There are a lot of SKUs which the Company was making, and they may decide to outsource because the Company wants to adopt the new development program and make those in-house, because those are too complicated for vendors to make. So, the Company might decide to free up certain capacity to make new products.
- Alisha Mahawla:** So, is this expected to have any negative impact on the margins as the share of outsourcing increases?
- Ayush Bagla:** In fact, outsourcing partners and vendors have a dramatically lower cost base than the Company, which is why they choose to make low-end products in large quantities. And for the Company to buy and sell, the margins are the same as own manufacturing.
- Alisha Mahawla:** Okay. And my second question is, couple of quarters ago, you'd highlighted that for most players in this industry were facing challenges because we were importing from China and other countries and hence, there was supply side

disruption. Can you just share with us the latest update on the competitive intensity in this industry now?

Ayush Bagla: Yes, please. I'll give you some background of what is happening in China. After the Chinese New Year, there are two clusters, the Cheng-Yu cluster and the Hinang cluster. In the Hinang cluster, which is a much larger cluster, due to frequent lockdowns, capacities are still between 60% and 70% operational. In the smaller cluster, the Chengdu cluster, there is more or less 90% availability. But again, the largest impediment to importing from China continues to be the container cost, which pre-COVID was USD600, currently it is USD6,400 in June. And one container of sanitaryware imports only contains USD18,000 worth of sanitaryware products. So, from a landed cost perspective, one-third of the landed cost is freight.

Moderator: Next question is from the line of Sudarshan Mall of Dhunseri Investment. Please go ahead.

Sudarshan Mall: I got your comments on the margin thing that we should expect the 50 basis points to 75 basis point improvement every year. But like last year, our exact margins were 19%. So, what should be the starting point for say, FY23? Should it be like I think in your TV interview, you mentioned something between 17% to 19%. Is that correct?

Ayush Bagla: See, margins have been very susceptible to increases in topline. When you saw a significant jump in topline in Q4 last year, you saw a significant jump in EBITDA margins. And that is the trend going forward. As you see slight changes in topline, you will see massive changes in EBITDA and PAT margins. And that happened not only for Q4 last year, it happened for the calendar year last year, the financial year, and for Q1 of this year. So, the steady state, which was 14% has already moved to 15.5%. And I'm talking about an increment of 50 basis points to 75 basis annually on a full year basis on 15% to 15.5%. And the driver of that is 80:20 mix between variable costs and fixed costs. So, fixed costs are increasing maybe at a nominal rate of inflation. And variable costs may increase, but they are completely linked to sales.

Sudarshan Mall: Sir, I understood the operating results. All I'm trying to understand, in a TV interview, I heard that margin guidance for FY23 stands between 17% to 19%. Is that a correct thing I heard?

Ayush Bagla: We will be careful about giving out any number for the full-year FY23.

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

Mithun Aswath: Hi, a couple of questions. One was on, kind of revenue growth we expect in the current year because (inaudible) last year was a low base. Just wanted to

understand how the market dynamics are faring? And do you see robust growth this year as well? And number two on your expansion plans, when do you think these will come on board? So, those were the two questions that I had.

Ayush Bagla:

See, over the last 30 months, which includes some part of pre-COVID, the industry was dealing with a shortage of products. So, in Sanitaryware, the industry size is very small, and that is why the four largest players command such a sizable market share. More than 60% plus combined market share is divided amongst four players and that has not changed for decades. And the size of the industry does not allow for external entrant to suddenly disrupt the industry. It does not allow it. It's not that big. That is one reason. So, dealing with shortage was something all four players were grappling with. Now, at least I can speak for CERA. CERA has come out of that problem over the last 12 to 15 months. There is no shortage of any Sanitaryware or Faucetware product, and that will remain for the foreseeable future. So, our ability to monetize all the opportunities coming from the market that is going to be important and that is available. There are very strong tailwinds, both, in the B2B and B2C business. We restrict our involvement in the B2B business because we don't want to change this ratio too fast. After so much efforts over the last 15 years, we somehow reached 68% of sales as B2C sales. We don't want to change that ratio. Second question was when will we get access to product from our expanded capacity. So, in Faucetware, we expect Q1FY24 to be the time where capacity expansion goes on stream. So, our 3-lakh current production will become 4-lakh. And in Sanitaryware, it will take a little more time because once the zero date is set, which will be set sometime in this calendar year, once land is acquired and permissions for water gas and a few other regulatory permissions are obtained, since from the zero date, it will be another 24 months to completion of the plant.

Mithun Aswath:

Right. And just one last one. On your raw material, not raw material, on your energy costs because of natural gas going up, have you taken any further price hikes in the last few months or are you planning anything? Just wanted to know?

Ayush Bagla:

Yes, in May of this year, which was part of the quarter, we took a price hike of 3% in Sanitaryware and 5% in Faucetware, but, unlike tiles companies, where some tiles companies have an impact of Rs. 200 crore or Rs. 300 crore in changes in gas cost, in CERA's case, the impact is always between Rs. 5 crore and Rs. 10 crore annually in a rising gas cost environment. So, gas is 3% of sales. It's very different metrics to be applied for CERA and other tiles companies.

Moderator:

The next question is from the line of Archana Gude from IDBI Capital. Please go ahead.

Archana Gude:

Ayush, congrats on very decent set of numbers. So, I have two questions. Firstly, on the competitive intensity, so, a very strong player in pipes has entered into bathware, and the two tile players have been very aggressive on increasing the

sales from this segment. So, is the demand at the retail end is strong enough to support the pricing and margins going forward? How we should look at the competitive intensity going forward? I know you had replied this earlier, but what should give us the assurance that we should not be too much worried about CERA's growth, like how we have delivered in the past?

Ayush Bagla: See, we welcome any new entrants. You know, the same topic was raised when the top two tiles' companies entered this business 12, 13 years ago. Then a very large paints Company, a giant, entered this business nine years ago. Again, the same question was asked, and the last mile between paints and sanitaryware is very different. And again, the last mile between tiles and sanitaryware is very different. And tiles is a predominantly B2B business. A B2B player entering a B2C segment is almost like a new business, which has to face all the challenges. You cannot just replicate the entire distribution model. Even the brand, the brand transferability is not that simple. So yes, you're seeing some tiles company, sorry, pipes companies are entering the business. If they come up with good designs, that will be good for the consumer. That's great. But globally, we have not heard of any success stories of companies who have replicated a behind-the-wall strategy to front-of-the-wall. We've not really heard of those success stories. And behind-the-wall strategy is selling to a plumber. Front-of-the-wall strategy is selling directly to the consumer based on aesthetics, design, and functionality. So, they are very different models.

Archana Gude: Sure. Ayush, I missed out on the number. What is the percent of tiles in total sales for Q1?

Ayush Bagla: It is 10.25%. Rs. 40.48 crore, which translates into 10.25%.

Archana Gude: And should we assume the same kind of run rate going ahead?

Ayush Bagla: See, tiles the what we've done is we've changed the complete product mix. So, now triple fired tile, then full body double charged. Now, even GVT, the way prices of GVT has been declining, it is no more a premium tile. So, I'll give you one example. Our Double Charge, which is now pretty much the most expensive tile that we are selling, share of Double Charge has moved from 16% to 22% of sales. Share of Soluble Salt, which is commoditized remains at 6% of sales. Share of wall tiles has moved from 26% to 30% of sales. Those are the initiatives. So without really going into a topline number, we are focusing totally on the bottom line number because this is a pure outsource model, a trading business.

Archana Gude: Sure, that's helpful. And lastly, Ayush, I guess many would like to know, what is the succession plan for CERA? Who would be taking over from Mr. Vikram Somany as and when he retires?

- Ayush Bagla:** I think the promoters have already made their intent clear with Deepshikha Khaitan is already Joint Managing Director. She has been on the Board for more than 10 years. She is running the business already for many years. So that is already an event that is behind us.
- Archana Gude:** So, Deepshikha will be the next, in the shoes of Mr. Vikram Somany?
- Ayush Bagla:** No. That I am not saying what will happen in the future. I'm saying succession plan can be analyzed from the intent and past actions.
- Archana Gude:** Right. But if the management can give a slightly more clear guidance to us, that will be really helpful.
- Ayush Bagla:** The promoter team is Ms. Deepshikha Khaitan and Mr. Vikram Somany, and they are running the business currently. And as Joint Managing Director, Ms. Khaitan is running every aspect of the business for the last many years.
- Moderator:** The next question is from the line of Deepak Lalwani from Unifi Capital. Please go ahead.
- Deepak Lalwani:** So, my question was on the volume growth. So, if we compare our topline with pre-COVID levels, our Sanitaryware has grown at 15%, Faucetware at 25% and our Tiles business has declined. So, in this number, if you could spell out the volume growth, which you have seen, that will be helpful.
- Ayush Bagla:** See, volume growth is important and without volume growth the business really can't grow, but there's a reason why we don't discuss SKU-wise growth simply because now, the number of SKUs, I'll just give you the number. Total SKUs in Sanitaryware are already 515. Intentionally, the Company might decide to lower the sales of some SKUs, and increase the sales of newer SKUs, because the profitability matrix is completely different. In Faucets, we are now 978 SKUs. So, if we only restrict our discussion to volumes, it will not give a good flavor on this new product development, because product lifecycle has come down dramatically. And those who know the marble industry and they can take up the best references, the marble industry where designs come in and out of fashion. So similar trends are now visible in Faucetware and Sanitaryware.
- Deepak Lalwani:** Okay, so if you could just give us a ballpark range that will be useful because it would help us ascertain the quality of growth and help us forecast better result.
- Ayush Bagla:** The best way to look at it is, let's say, the industry grows at 7% to 9% or 7% to 10% and CERA's Faucetware will grow at almost 50% to 75% higher than industry growth. Half of that growth will be volume; half will be value. And Sanitaryware will grow 25% above industry growth. Again, half of that will be pricing-led and half will be volume-led.

- Moderator:** The next question is from the line of Akash Shah from UTI Mutual Fund. Please go ahead.
- Akash Shah:** Congratulations on a good set of results. So, on a three-year CAGR basis from Q1FY20 to Q1FY23, what would be the price increase in Sanitaryware and Faucetware segments?
- Ayush Bagla:** See, over last year, Sanitaryware pricing went up by 21% and Faucetware by 26%. But last year was an extraordinary year. But normally, you will find that we have been a little ahead of the inflation curve. So, if you look at right from 2015 to up to COVID, we just would review our pricing twice a year, every March and October and we would stay ahead of the inflation curve. So, early teens you would say.
- Akash Shah:** Okay. So, around 10%, 11%, 12%?
- Ayush Bagla:** Yes. Yes.
- Akash Shah:** Yes. Sure. So, if we look at on a year-on-year basis, standalone gross margin numbers, so our gross margins actually reduced from 55.8% in Q1 FY22 to 53.7% in Q1 FY23. So, even though the product mix would have improved some bit and outsourcing portion would not have been not changed materially. So, still there was some pressure on gross margins. So, will you please help us reconcile or maybe understand why this was so?
- Ayush Bagla:** So, inward freight, gas and labor were the three variable costs that went up. So, in COGS you will find that the fixed costs which were 20% of costs more or less were stable. Amongst the 80% basket, there was slight increase. And if another price hike is to happen, it will come with a slight lag effect. Having taken so many price hikes in the last 15 months, we will wait to see because now, bulk of the raw materials including brass, and many other raw materials are now declining. Even gas from Sabarmati has declined by Rs. 2.5. So, in a declining RM environment, we'll wait to take any more price hikes, because there'll be a sufficient cushion. You are right 55.78% has become 53.7%, but that's the impact of slight changes in the variable cost, which is part of the COGS.
- Akash Shah:** Sure. And going forward, maybe the price hikes that we have taken would help us come back to normalize the gross margins?
- Ayush Bagla:** See, normalized was always between 48% and 52%. Because we saw 55% plus last year, that has become the new watermark. But if you go back to last eight, nine years, you will see between 48% to 52% was the normalized gross margin.
- Akash Shah:** And just last bit on rural demand. So how is the demand situation in Tier-3, Tier-2 towns, because predominantly, I mean, our large chunk of sales comes from these

towns. If you can just help us understand, I mean, are there new smaller projects coming up and is there a visibility over next three, four years that we will be able to drive Sanitaryware and Faucetware sales in these towns?

Ayush Bagla: See, Tier-3 and below are exactly where the meat of the market lies. So, I'll give you some data to add color to your question. Export is 1% of sales this quarter. Tier-1 sales, which are population centers about 25 lakh is 30% of sales. Tier-2 cities with population of between 10 lakh and 25 lakh is 13% of sales, and Tier-3 towns with population up to 10 lakh is 56% of sales. So, though our definition of Tier-3 is very high, but that's where the meat of the market is, and bulk of the efforts, whether it's opening new showrooms, new dealer engagement, appointing new dealers, creating infrastructure sales team, all is directed in Tier-3 markets. But at the same time, you saw a share of Tier-1 go from 27% last year to 30% this year. And that's again the outcome of new product development program and newer, higher-end SKU is being launched by the Company and being accepted by the marketplace.

Akash Shah: Sure. Sorry, so, are we seeing new projects coming up? Just this last thing.

Ayush Bagla: Yes, the new projects in Tier-3 towns are self-funded projects, and they don't have multiple stage approval processes like we have in Bombay and other cities. So, the lifecycle of those projects is six months, nine months, and they are not dependent on external Bank funding, construction finance etc. So, there is much lower risk, and we are not dealing with those projects directly. Our dealers are, as and when required. There is no negotiated pricing, there is no credit risk. So those are the pluses of those projects, and the velocity is very strong in those cities.

Moderator: This was the last question for today. I now hand the conference over to management for closing comments.

Ayush Bagla: Thank you. I would like to thank everyone for attending this call and for showing interest in CERA Sanitaryware Limited. CERA remains positive that its strong positioning in the industry, improving macros will 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 very much. So, on behalf of CERA Sanitaryware Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.

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